August 2004
IMF Country Report No. 04/267

Bulgaria: Request for Stand-By Arrangement—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Bulgaria

In the context of the request for a Stand-By Arrangement with Bulgaria, the following documents have been released and are included in this package:

- the staff report for the request for Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on July 5, 2004, with the officials of Bulgaria on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 21, 2004. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of August 6, 2004 updating information on recent developments.

- a Press Release summarizing the views of the Executive Board as expressed during the August 6, 2004 Executive Board discussion of the staff report that completed the request.

- a statement by the Executive Director for Bulgaria.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Bulgaria*
Memorandum of Economic and Financial Policies of the authorities of Bulgaria*

*May also be included in Staff Report.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

BULGARIA

Request for Stand-By Arrangement

Prepared by the European Department
(In consultation with the Policy Development and Review Department)

Approved by Carlo Cottarelli and John Hicklin

July 21, 2004

- In a letter to the Managing Director dated July 21, 2004, and the accompanying Memorandum of Economic and Financial Policies (MEFP) (attached), the Bulgarian authorities request support in an amount equivalent to SDR 100 million (15.62 percent of quota) under a 25-month Stand-By Arrangement (SBA) for their economic program covering the period 2004-06. The authorities intend to treat this SBA as precautionary. Bulgaria's economic program is also supported by the World Bank through Programmatic Adjustment Loans, the EU, and other donors. Performance under the last SBA was good as most performance criteria and benchmarks were met and all purchases were made.

- On June 14, 2004, in concluding the 2004 Article IV consultation (IMF Country Report No. 04/176) and their discussion of the ex post assessment (EPA) of previous Fund-supported programs (IMF Country Report No. 04/176), Executive Directors commended Bulgaria for the progress made under the last SBA and endorsed the recommendation of the EPA to proceed with a successor SBA. They noted that, in order to lower external vulnerability, the authorities needed to resolutely follow their strategy to reduce excess demand, and to boost supply through the steadfast implementation of structural reforms.

- This report is based on discussions held in Sofia during March 25-April 13, 2004 and June 29-July 5 by Messrs. Flickenschild (head), Duenwald, Egoumé-Bossogo, Joshi (March/April only) (all EUR), and Pitt (PDR), assisted by Mr. Roaf (Resident Representative). The mission met with the Prime Minister, all key economic ministers, the governor of the Bulgarian National Bank (BNB), and representatives of parliament, the trade unions and the private sector, and coordinated its work closely with the World Bank staff.

- The quality and timeliness of statistical data is generally sufficient for program monitoring and surveillance purposes and progress has been made to observe transparency and international standards and codes. In December 2003, Bulgaria became a participant in the SDDS.

Contents Page

Main Websites for Bulgarian Data

Data in this report reflect statistical information received by July 7, 2004.
More recent data can be obtained from the following internet sources:
National Statistical Institute ..... http://www.nsi.bg
Bulgarian National Bank ..... http://www.bnb.bg
Ministry of Finance ..... http://www.minfin.bg

Information on Bulgarian economic statistics can be found at the Fund's Special Data Dissemination Standard website:
http://dsbb.imf.org/Applications/web/sddscountrycategorylist/?strcode=BGR

LIST OF ACRONYMS

ALMPs	Active Labor Market Policies
BCC	Bank Consolidation Company
BNB	Bulgarian National Bank
BTC	Bulgarian Telecommunications Company
CAS	Country Assistance Strategy
CBA	Currency Board Arrangement
CPI	Consumer Price Index
EFF	Extended Fund Facility
EPA	Ex Post Assessment
ERM2	Exchange Rate Mechanism 2
EU	European Union
FDI	Foreign Direct Investment
FRA	Fiscal Reserve Account
FSAP	Financial Sector Assessment Program
FSC	Financial Supervision Commission
GDP	Gross Domestic Product
GFS	Government Finance Statistics
GFSM	Government Finance Statistics Manual
GSM	Global System for Mobile Communications
IFS	International Financial Statistics
LOI	Letter of Intent
MEFP	Memorandum of Economic and Financial Policies
MOF	Ministry of Finance
NATO	North Atlantic Treaty Organization
NHIF	National Health Insurance Fund
NFA	National Framework Agreement
NRA	National Revenue Agency
NSI	National Statistical Institute
NSSI	National Social Security Institute
OECD	Organization for Economic Co-operation and Development
PAL	Programmatic Adjustment Loan
PEIR	Public Expenditure and Institutional Review
PPI	Producer Price Index
REER	Real Effective Exchange Rate
ROSC	Report on the Observance of Standards and Codes
SBA	Stand-By Arrangement
SDDS	Special Data Dissemination Standard
SDR	Special Drawing Rights
SOE	State-Owned Enterprises
TSA	Treasury Single Account
VAT	Value Added Tax

Executive Summary

- The authorities have requested a 25-month precautionary stand-by arrangement in an amount of SDR 100 million or 15.62 percent of quota.

- Macroeconomic developments remain broadly favorable, but point to a further increase in external vulnerability since the Article IV discussions. Driven by investment and exports, real GDP growth accelerated to 5.3 percent year on year in the first quarter. Twelve-month inflation accelerated to 6.8 percent in May, owing to a slower than expected decline in food prices and higher oil prices. The growth of bank claims on the nongovernment sector declined to below 50 percent year on year in June, but during January-April, the seasonally adjusted external current account deficit further deteriorated to close to10 percent of GDP. The general government's cumulative cash surplus through May increased to 1.9 percent of GDP, reflecting revenue overperformance of the same magnitude.

- In this context, the authorities agreed that a stronger policy response than outlined in the May 2004 Article IV staff report was needed. Consistent with the policies discussed then, their SBA-supported program seeks to reduce increased external vulnerability and to achieve sustainable high growth through (i) a tighter fiscal policy and measures to drain bank liquidity in order to reduce excess demand in the short run and (ii) structural reforms to boost output and export capacity in the medium term. The program's macroeconomic framework includes more ambitious fiscal targets. Based on more realistic revenue projections and expenditure allocations, the program targets, at a minimum, a balanced budget. Any additional revenue due to overheating will be saved, possibly resulting in a surplus of 0.9 percent of GDP in 2004. The 2005-06 budgets will reflect a broadly neutral fiscal stance, unless credit expansion slows as expected and the current account deficit does not give reason for concern. The program also targets a deceleration of credit growth to 33 percent by year end, reflecting bank liquidity-reducing measures.

- The program includes structural reforms to enhance the conduct of fiscal policy, improve the business climate, and complete privatizations. Improvements in tax administration and expenditure management would increase the efficiency and flexibility of fiscal policy. Privatizations and reforms in the business climate would attract higher levels of FDI, while boosting productivity and competitiveness.

- Risks to the program are not trivial. On the domestic front, complacency due to past achievements and political pressures in the run-up to mid-2005 elections may undermine the resolve to maintain flexibility in the conduct of fiscal policy and the drive for continued reforms. External risks arise from possible higher import prices (in particular oil) or a rise in interest rates. However, a wide consensus to maintain the currency board arrangement and to press ahead with structural reforms required for EU accession is likely to provide the discipline to maintain strong policies.

I. Recent Developments

1. **Recent macroeconomic developments point to a slightly stronger economic expansion than expected during the Article IV discussions, amid continued rapid credit growth and a high current account deficit; the general government budget had an unexpectedly large surplus during January-May** (Table 1).

- Driven by investment and exports, real GDP grew by 5.3 percent year on year in the first quarter. High-frequency data for April-May confirm continued strong growth. Reflecting higher oil prices and a smaller than expected decline in food prices, twelve-month inflation rose to 6.8 percent in May (Figure 1). The registered unemployment rate declined to 12.6 percent in May, while real wages were virtually unchanged year on year in January-March 2004.

- Growth in banking system claims on the nongovernment sector has been higher than expected, exceeding 50 percent year on year in the first five months of the year (Table 2 and Figure 2). However, preliminary data for June point to a modest slowdown to around 47 percent, as a substantial reduction in corporate credit growth more than offset higher growth in consumer credit. As a result, the seasonally adjusted annual rate of credit expansion has fallen to below 50 percent. However, after rising in May, interbank money market rates have declined more recently. Despite the rapid growth of bank credit, prudential indicators suggest that the banking system remains healthy (Table 3).

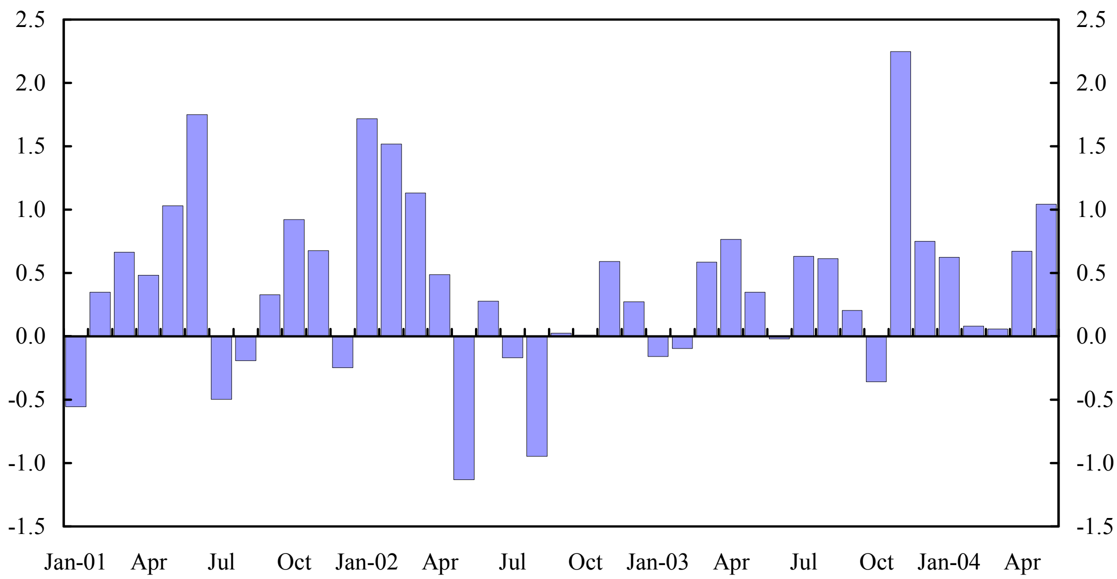
- The current account deficit has been broadly in line with expectations (Table 4). During January-April, the seasonally adjusted deficit was close to 10 percent, with a weaker than expected trade deficit (13.4 percent of GDP) offset by better net income and transfers balances (Figure 3). At €402 million in the first four months, net FDI inflows (mostly greenfield) were higher than expected, covering 55 percent of the current account deficit and contributing, together with strong capital inflows, to a gain in international reserves to €5.4 billion.

2. **The general government's cash surplus has continued to increase** (Tables 5 and 6). Through May, the surplus reached 1.9 percent of annual GDP. Reflecting an understatement of revenue projections underlying the budget, improved tax compliance, and stronger economic conditions, revenue overperformed by 1.9 percent of GDP, of which nontax revenue overperformance was about 0.6 percent of GDP. By contrast, expenditure was in line with the budget, with higher current expenditure offsetting a shortfall in capital expenditure.

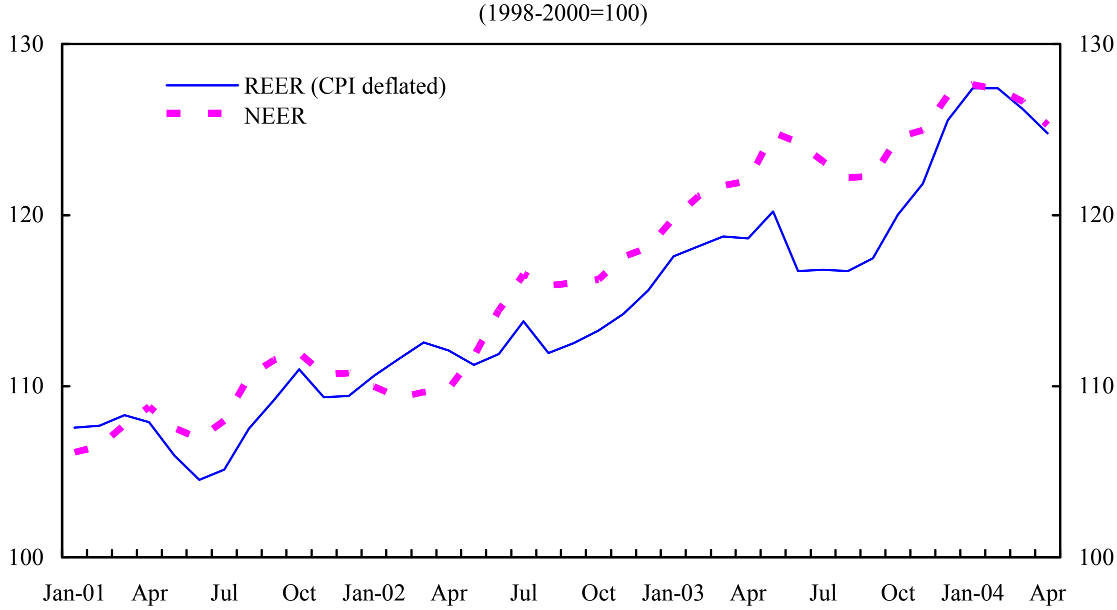
3. **Progress was made on structural reforms and EU accession, against a stable political background**. On June 11, the privatization of the Bulgarian Telecommunications Company (BTC) was completed. Household electricity and district heating prices were increased by 10 percent on average on July 1. Binding bids for the privatization of seven electricity distribution companies were received on July 9. Bulgaria closed the last EU

Figure 1. Bulgaria: Inflation and Effective Exchange Rates, 2001-04

CPI Inflation, 2001-04
(month-on-month change, seasonally adjusted)



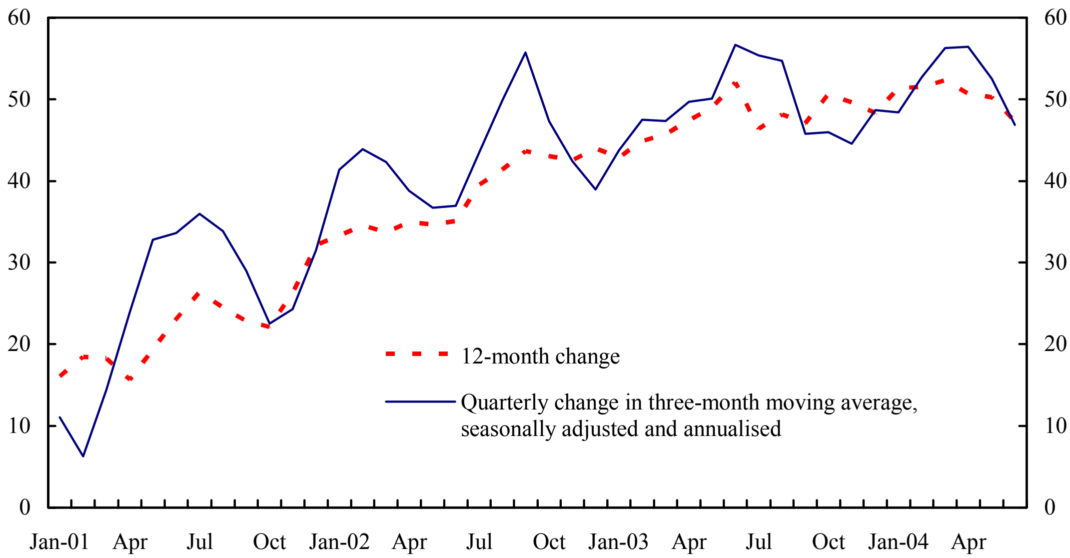
Real and Nominal Effective Exchange Rates, 2001-04
(1998-2000=100)



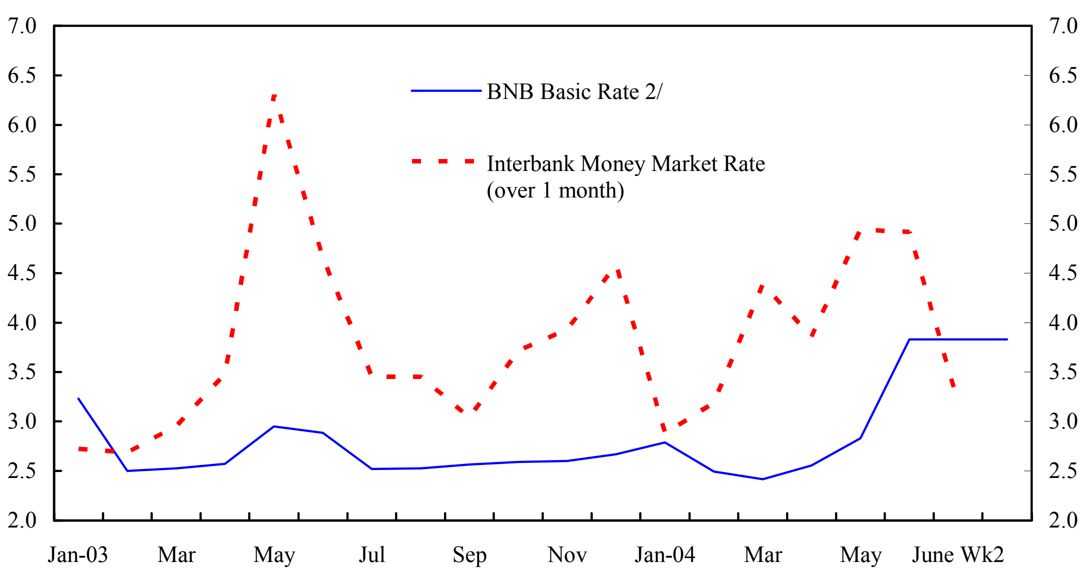
Source: Bulgarian authorities; and INS.

Figure 2. Bulgaria: Credit Growth and Interest Rates, 2001-04

Claims on Nongovernment Sector, 2001-04 1/



Interest Rates, 2003-04

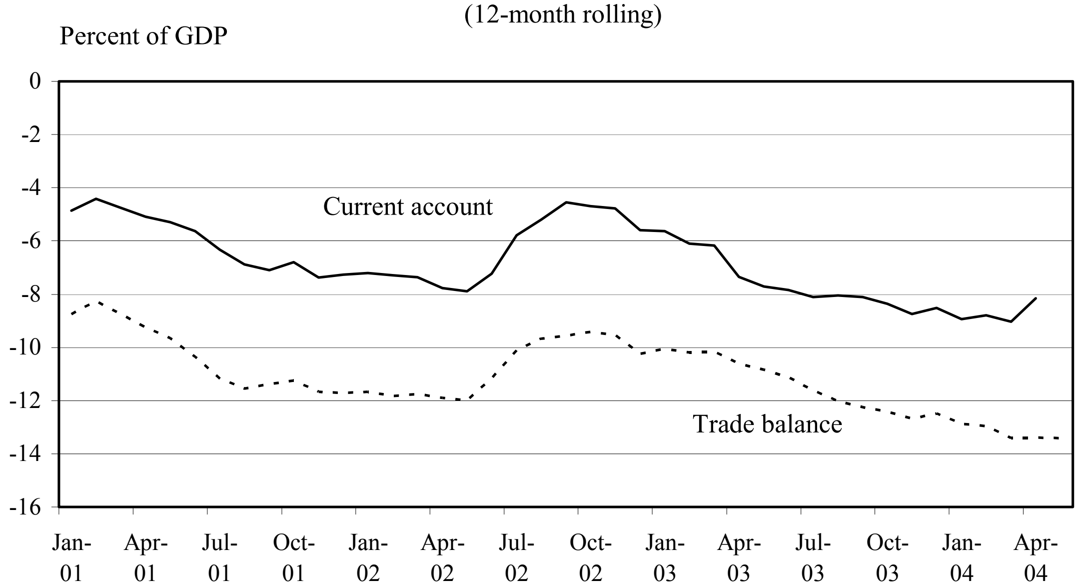


Sources: Bulgarian National Bank.

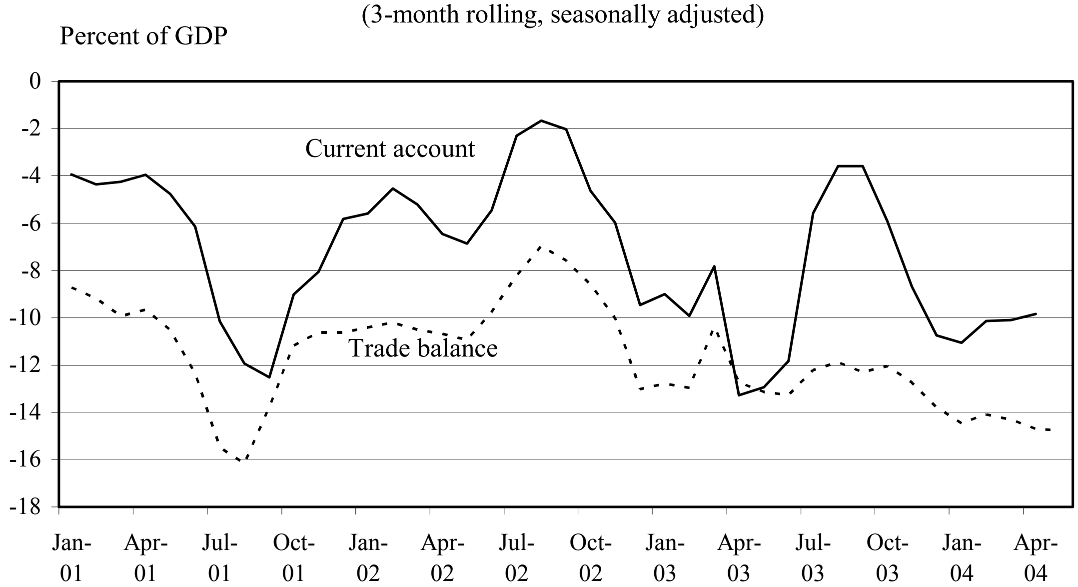
1/ Data for June 2004 are preliminary.
2/ Basic rate is determined on the basis of the average annual yield achieved at the primary market for three-month government securities.

Figure 3. Bulgaria: External Indicators, 2001-2004

Current Account and Trade Balance
(12-month rolling)



Current Account and Trade Balance
(3-month rolling, seasonally adjusted)



Sources: Bulgarian authorities and Fund staff estimates.

accession chapters on June 15 and obtained an additional €240 million (to be disbursed in 2007) in accession funds for border control and budgetary support. The government lost its parliamentary majority in March 2004 and its popularity remains low. Nevertheless, the political situation is relatively calm in spite of the approaching mid-2005 elections, possibly reflecting the intensification of preparations for EU accession, which no political party wants to derail.

II. The Authorities' Economic Program

A. Macroeconomic Framework and Objectives

4. **To strengthen the macroeconomic framework centered on the currency board arrangement (CBA), the authorities' program seeks to reduce external vulnerability in the context of high sustainable growth**. The key elements of the authorities' strategy were discussed during the Article IV consultation. They are based on the following considerations:

- The CBA, which the authorities continue to regard as the cornerstone of macroeconomic stability, provides a stable nominal anchor and the discipline to maintain tight fiscal and incomes policies. The envisaged exit strategy from the CBA is participation in the European Monetary Union, which could be achieved by 2009.

- The authorities and staff agree that the widening of the external current account deficit since mid-2002 reflects the excessive pace of domestic demand, sustained by the credit boom, as financial deepening proceeds, and not a serious erosion of competitiveness.[1] However, the appreciation of the REER over the past year occurred against a backdrop of an appreciating euro—and with it, the lev—which, together with a decline in productivity growth, limits the room for further real wage increases. Further, while the deficit has been financed to a large extent by FDI, some of it has reflected privatization receipts. At 8½ percent of GDP, the deficit in 2003 involves substantial external risks. The authorities intend to reduce it gradually to below 7 percent of GDP—a level that would allow the stability of the external debt ratio, even in the absence of privatization receipts. Moreover, continued excess demand could spill over into inflation and thus further erode competitiveness.

- Containing excess demand in the short run requires a tighter fiscal policy and measures to reduce bank liquidity. The program's macroeconomic policy framework is broadly consistent with the one discussed during the Article IV consultation, although the fiscal targets are somewhat more ambitious in light of the fiscal outcome of the first few months and the need to respond to a further expected weakening of the external outlook reflecting the unfavorable evolution of the terms of trade.

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[1] See Box 1 in the recent Article IV staff report (IMF Country Report No. 04/176).

- Concomitantly, an acceleration of structural reforms is needed to boost output and export capacity in the medium term.

In light of stronger evidence of overheating and prospects for a renewed worsening of the external current account during the remainder of the year, the authorities agreed that a stronger policy response than outlined in the May 2004 Article IV staff report was needed.

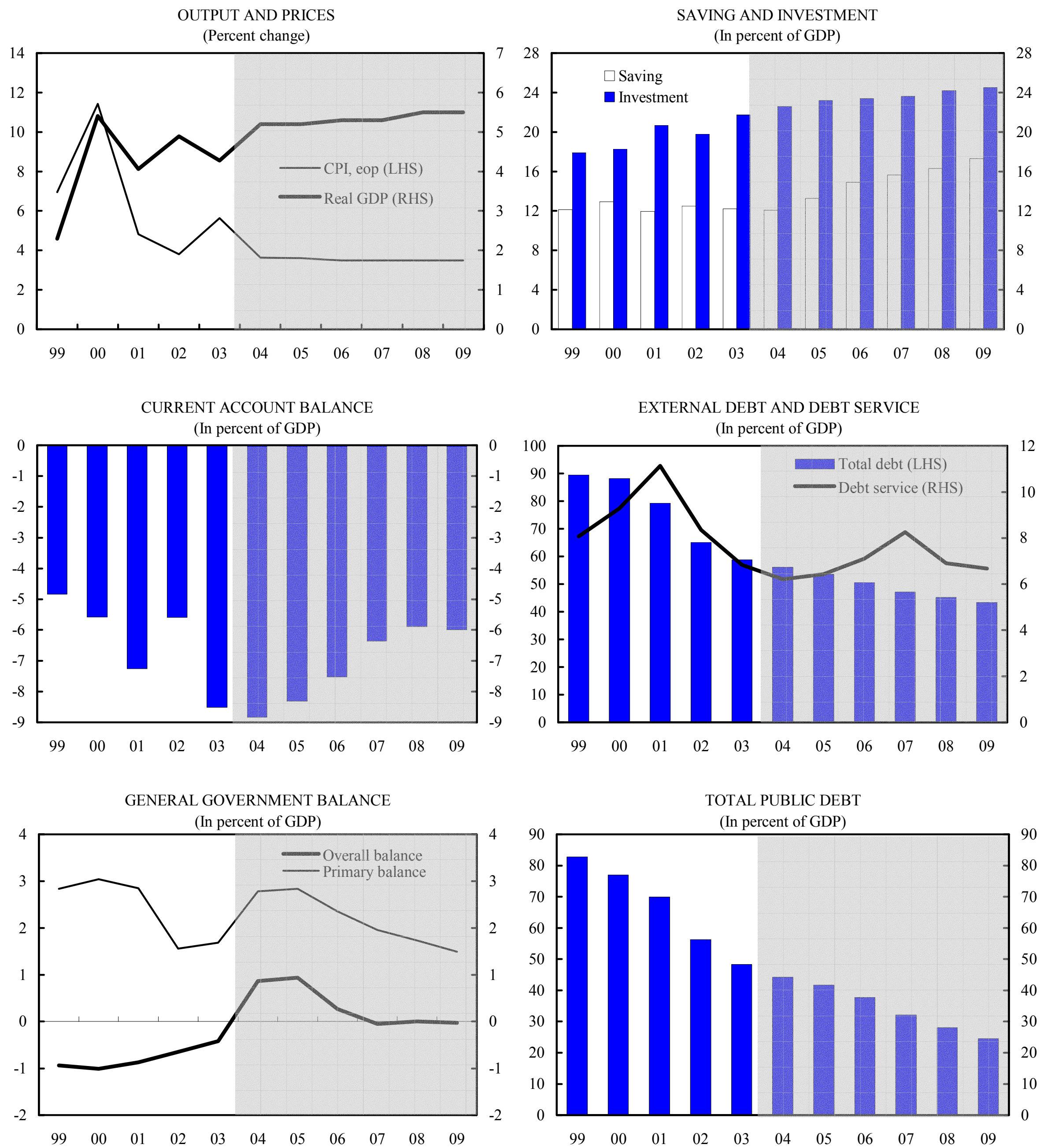
5. **Against this backdrop, the authorities' new macroeconomic framework, relative to the framework envisaged during the 2004 Article IV Board discussion, targets slightly stronger growth in 2004, a more gradual decline in the current account deficit and credit growth, and somewhat higher inflation** (Table 7 and Figure 4).

- Real GDP growth in 2004 is now projected to reach 5.2 percent. Slower domestic demand growth than in 2003—reflecting a tighter fiscal policy and a deceleration of credit growth—is expected to be more than offset by a less negative contribution from net exports. From the supply side, output growth should benefit from a recovery in agriculture, recent investment in capacity, and a good tourist season. Inflation is projected to average 6¼ percent this year, with a deceleration of the 12-month rate to 3½ percent forecast by year end, with the unwinding of one-off factors such as drought-related food price rises late last year as well as hikes in excise taxes and energy prices. Over the medium term, rising investment and higher productivity due to structural reforms are likely to boost the economy's growth rate of about 5½ percent. Average inflation should decelerate to 3½ percent, slightly higher than EU levels, but consistent with continued competitiveness, reflecting productivity catch up effects.

- Private sector credit growth is projected to decelerate to about 33 percent by year end, owing to measures taken to reduce bank liquidity, and to below 20 percent in the medium term as Bulgaria's financial system matures.

- Exacerbated by higher oil and other commodity price projections, which lead to high nominal growth of both imports and exports, the external current account deficit is projected to deteriorate to 8¾ percent of GDP this year. The deficit should decline gradually to around 6 percent of GDP by 2007 as domestic saving rises in line with per capita income, financial deepening, and public saving, the latter reflecting a shift from current to capital spending (Table 8). Over the program period and beyond, FDI is expected to cover more than 85 percent of the external current account deficit, owing to privatization receipts and increasing greenfield investment. This would help keep gross international reserves at over two times short-term external debt, while still allowing the external debt ratio—which is projected to fall to about 56 percent of GDP this year reflecting a debt buyback operation—to decline gradually.

Figure 4. Bulgaria: Baseline Medium-Term Projections, 1999-2009 1/



Sources: Bulgarian authorities; and Fund staff estimates and projections.

1/ 2003 onward: projections.

B. Fiscal Policy and Reforms

6. **The 2004 fiscal program targets a tighter and more transparent fiscal stance**. Owing to increased domestic demand pressures and attendant higher external vulnerability than envisaged at the time of the budget, the program targets at least a fiscal balance (performance criterion) compared to a deficit of 1¼ percent of GDP in the original budget and ½ percent of GDP during the Article IV discussions (text table). Any revenue overperformance in excess of the agreed overall expenditure level will be saved and current indications suggest that a surplus of 0.9 percent of GDP is achievable in 2004. Nominal expenditure ceilings (performance criteria) will help ensure that this outcome is reached. The program also seeks to enhance transparency by revising baseline revenue and expenditure to significantly higher and more realistic levels, thereby preempting now customary end-year surges in nonpriority spending.

Bulgaria: Fiscal stance in 2003-04 (In percent of GDP)

		2004			
				Program	
	2003	Budget	Art IV	Baseline	Likely Outcome
Revenue	37.9	35.4	35.4	37.5	38.4
Tax revenue	29.7	27.9	28.0	29.9	30.3
Nontax revenue	7.3	6.2	6.2	6.4	6.9
Grants	0.9	1.2	1.2	1.3	1.3
Expenditures	38.4	36.6	35.8	37.5	37.5
Overall balance	-0.4	-1.2	-0.4	0.0	0.9

Source: National authorities and Fund staff estimates.

7. **Altogether, staff now projects revenue to overperform the original budget projection by some 3 percent of GDP in 2004.** The original budget had assumed a reduction in total revenue by some 2½ percentage points of GDP relative to the 2003 outturn reflecting, on the one hand, what appear now to be overly cautious projections of the net effect of lower direct taxes and higher indirect taxes as well as of dividends from state-owned enterprises and, on the other hand, the authorities' desire to maintain a "hidden reserve" against unexpected fiscal shocks and macroeconomic vulnerabilities[2]. Staff estimates that 2.1 percent of GDP of the projected revenue overperformance would be due to the conservative budget projection and improvements in tax compliance, and 0.9 percent of GDP would result from the unexpected strength of domestic demand. Tax (particularly corporate income tax) and nontax revenue (notably dividends from state-owned enterprises) were understated in the budget by some 1.4 percent of GDP and 0.7 percent of GDP, respectively. The revenue overperformance due to the unexpected strength of domestic demand is expected to come mostly from VAT, reflecting the widening of the trade deficit relative to the projection made at the time of the budget. The authorities will not introduce any changes to their tax system during the remainder of 2004 (¶12).

[2] Additional spending is usually released only late in the year once the additional revenue has materialized.

8. **The upward revision of the original budget revenue projection allows an increase of expenditure by about 1 percent of GDP while still achieving fiscal balance.** Expenditure will be capped at the new level (¶ 11) and its increase will be devoted to priority areas. Expenditure cuts of 0.8 percent of GDP underlying the Article IV staff report were only partially reinstated. Instead, staff and authorities agreed that previously unbudgeted priority spending could take place and that allocations could be made to meet end-year discretionary but customary spending. In particular, relative to the original budget, spending for health care, road maintenance, and investment was raised by a total of 0.8 percent of GDP, while 0.5 percent of GDP was allocated for end-year wage and pension bonuses, which the authorities found impossible to avoid given expectations built from previous years[3].

9. **The authorities will proceed cautiously in implementing the revised budget**. Until the end of the third quarter, the authorities will continue to implement only 93 percent of central government discretionary expenditure and 90 percent of expenditure for local governments' state mandates (except those financed by municipalities' own tax revenue). This will provide flexibility—of somewhat less than 1 percent of GDP—in the execution of the budget, particularly as the central government lacks control over local government spending, which could exceed current projections if local governments were to spend—as is likely—the revenue overperformance that legally belongs to them.[4] Under the program, cash expenditure of the general government will be adjusted by changes in the stock of arrears (Annex II of Attachment).

10. **The 2005 budget will reflect a neutral fiscal stance and also be based on realistic revenue and expenditure projections**. Staff urged the authorities to make budget preparations on the basis of an unchanged fiscal balance relative to the projected 2004 outcome (i.e., a surplus of 0.9 percent of GDP), making sure that spending allocations reflect government priorities, notably outlays for investment, maintenance, and the social safety net, and are consistent with realistic revenue projections. In this regard, staff urged that planned cuts in direct taxes and increases in excises should be revenue neutral unless compensating expenditure cuts can be made (¶ 15).[5] The authorities concurred but stressed that it would be difficult to target a surplus in an election year.

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[3] In addition to end-year bonuses, the increase in the wage bill in 2004 reflects a wage increase of 8½ percent awarded on July 1 and higher employment for the judiciary, EU-related projects, and education.

[4] The constitution does not allow the central government to control how local governments spend their revenue.

[5] Nonetheless, the provisional projections assume a small decline in the revenue and expenditure ratios as reductions in the personal and corporate income tax rates may not fully be compensated by higher excise taxes and as profits from state-owned enterprises would be lower due to privatization.

11. **Although increasing public investment is a priority, two major projects do not appear solidly justified and would crowd out more worthwhile projects**. The authorities recently announced plans to build a nuclear power plant with private sector participation. However, the project—whose total cost could top €2.5 billion (12 percent of projected 2005 GDP)—could eventually result in government guarantees of similar amounts. Staff questioned the wisdom of devoting public resources to build new power generation capacity at a time when the government is proceeding with the privatization of existing plants. The authorities responded that the need to replace capacity that will be lost after the EU-mandated closure of two older nuclear units and the expected increase in electricity demand in line with the expansion of the Bulgarian economy justify the building of this plant. In the same vein, the staff reiterated that in preparing the 2005 budget, the scheme to build motorways—which was postponed from 2004—with likely state-guaranteed private sector financial participation should be carefully considered, as the World Bank has concluded that improvement of existing roads would be less costly and more appropriate to meet the existing and projected levels of road traffic.

12. **To strengthen medium-term fiscal viability, reforms in the pension and health systems will be advanced** (¶14). The authorities confirmed that they plan to implement measures that would remove discretion in the adjustment of pensions, thereby avoiding politically driven pension increases. Also, they committed to ensure that the National Social Security Institute (NSSI) will be represented in the commissions responsible for certifying eligibility for disability pensions and that the NSSI will be required to reconfirm certifications issued by these commissions. To limit the inflation in health care costs, hospital reimbursement on the basis of fee-for-service will be strictly enforced and the scope for co-payment broadened during 2005-06.

13. **The authorities reiterated their commitment to further improve tax administration, budget preparation, and expenditure management**. Staff and authorities viewed these reforms as essential to ensuring that the objectives of fiscal policy are achieved. A number of steps toward the introduction of the National Revenue Agency (NRA) by January 1, 2006 will be taken (¶16). The NRA will consolidate the collection of taxes and social security contributions, which would improve controls, risk assessment, audits and, ultimately, collection. At the same time, the existing Large Taxpayer Office and the VAT accounts system will be strengthened. On expenditure management, the incorporation of all autonomous budgetary entities into the Treasury Single Account will be completed. In the same vein, with a few exceptions, no new extrabudgetary funds or state-owned enterprises will be created during the program period. Finally, the Financial Management Information System, which will improve budget planning, execution, and accounting, will be extended to all second-level spending units in the Ministry of Finance and subsequently to other ministries. Also, budget preparation will be improved and program budgeting expanded to additional ministries.

C. Incomes and Labor Market Policies

14. **The program will include, as in the past, strong incomes policies and measures to improve further the functioning of the labor market**. As a demonstration of their commitment to a strong incomes policy, the authorities pointed to their announcement that the mid-year increase in the wage bill in the budget sphere in 2005 will be limited to projected average inflation. As in the past, the growth of the combined wage bill of the 58 closely monitored state-owned enterprises that have the largest losses and arrears, are monopolies, or receive subsidies will not exceed 4 percent in 2004 (¶17). Also, understandings were reached to remove the portability of the seniority bonus (so as to help older unemployed workers find jobs) and to facilitate work outside regular hours.

15. **The planned increase in the minimum wage is excessive**. Staff stressed that the increase in the minimum wage by 25 percent—recently announced by the senior coalition party—could erode competitiveness, add further to demand pressures, reduce job opportunities for low-skilled workers who constitute the bulk of the unemployed (particularly the long-term unemployed), and reverse the reduction of the informal sector. Thus, staff proposed limiting the increase to three annual increments of 10 percent each beginning in 2005. The authorities argued that repealing the increase would be politically very costly in the pre-electoral period. Nonetheless, they saw merit in staff's suggestions and agreed to reconsider their approach in time for discussions with the staff in September 2004. The adoption of a satisfactory minimum wage policy for 2005 and beyond will be a focus of the first review.

D. Financial Sector and Public Asset and Liability Management Policies

16. **The program aims to reduce bank credit growth to more sustainable levels to help reduce external vulnerability**. While both staff and authorities thought that increased financial intermediation was welcome from a structural perspective, and financial stability and prudential risks did not constitute a major concern at this stage, a deceleration of credit would be needed to reduce demand pressure and contain import growth.

17. **With monetary policy operations circumscribed by the CBA and an open capital account, the authorities' credit-reducing strategy—launched in mid-2003—has initially focused on intensifying supervisory activity**. The BNB has increased the frequency of on-site inspections, tightened provisioning requirements on classified loans, increased the information available to lenders by expanding the credit registry, and introduced stricter treatment of current profits for the calculation of own capital in line with EU banking directives (¶ 19).

18. **In view of the continued sharp rise in bank credit this year, however, the authorities have supplemented this strategy with liquidity draining operations**. In May-June 2004, they transferred government deposits at commercial banks to the BNB (amounting to 4¼ percent of base money). In addition, effective July 1, the BNB broadened the coverage of reserve requirements to include, at a rate of 4 percent, most liabilities previously excluded from the deposit base, and from October 1, the proportion of cash in vault that can be used for fulfilling reserve requirements will be lowered to 50 percent (¶ 20).

Moreover, the authorities intend to instruct the Deposit Insurance Fund to invest its cash balances and maturing repurchase agreements with banks in government debt, and to undertake bond sales in excess of those already planned to ensure credit growth slows to the targeted level.

19. **Since the effect of these measures is uncertain, the authorities stand ready to implement further measures if credit growth does not slow as projected**. In principle, the above measures could drain some 13½ percent of base money. However, staff and authorities recognized that their actual impact will to a large extent depend on the responsiveness of capital flows to tightened domestic monetary conditions. In this context, the authorities reiterated their view that banks were likely to raise capital abroad to replace reduced domestic liquidity, and noted that Bulgaria's recent credit upgrade to investment grade by a major rating agency would likely further facilitate access to foreign capital for local banks. In view of the many measures recently introduced, however, they planned to await further data on credit growth before implementing new measures. If, by September, credit growth continued to overshoot the projected path, the authorities would, in consultation with the staff:

- Introduce minimum liquidity requirements, requiring banks to maintain a minimum level of liquid assets relative to total assets.
- Further increase the reserve requirement rate on previously excluded liabilities.
- Further reduce the proportion of cash in vault that can be used for fulfilling reserve requirements.

The authorities would also consider increasing government domestic borrowing and raising the reserve requirement rate beyond the current 8 percent. Regarding staff's suggestions for further prudential measures targeting consumer credit, the BNB thought that the effects of the various measures already introduced needed to be assessed first, that prudential standards were at or exceeded international best practice, and that introducing further distortions into the credit market should be avoided.[6] Staff saw merit in the BNB's arguments, but urged it to further develop its plans in the coming months so that any new measures could be implemented without delay if necessary.

20. **The government's public debt management strategy continues to aim at reducing the external debt component, while continuing to lower the public debt-to-GDP ratio.** Within these overall objectives, the authorities are (i) reducing the floating rate and dollar components of the public debt, and (ii) establishing benchmarks for the domestic yield curve. Regarding the first objective, they have announced the buyback of outstanding

[6] For example, in response to staff suggestions that it target more explicitly consumer credit, the BNB countered that this would simply shift lending activity to nonbank financial institutions (such as leasing companies and large retailers) that are not under the BNB's supervision.

GDP-linked Brady discount bonds (¶ 21), which will reduce the gross public and external debt by 2.9 percent of GDP, while releasing collateral of 1.2 percent of GDP. Net issuance of domestic debt (about three quarters denominated in leva) of about 3 percent of GDP in the program period will help achieve the second objective.

E. Other Structural Reform Areas

21. **The program seeks to address impediments to a more enabling business climate, which is crucial to boosting investment and productivity**. The business climate continues to be viewed by potential investors as a negative factor. Reforms in this area will seek to simplify company registration and licensing regulations to reduce red tape; offer administrative support to investors through one-stop shops; improve dispute resolution procedures and enforcement of judicial decisions; and strengthen corporate governance (¶ 23). Action to combat corruption will be in line with the national anti-corruption strategy developed in 2001. In particular, the accountability of the judiciary will be strengthened; a code of ethics for civil servants will be developed in parallel with aggressive prosecution of corrupt civil servants; and asset forfeiture will be legislated to target organized crime (¶ 24).

22. **Building on the sale of BTC, the privatization of the remaining major state-owned enterprises will be accelerated in consultation with the World Bank**. Completing the remaining privatizations would reduce the size of the public sector and improve economic efficiency, while bolstering the FDI coverage of the external current account deficit (¶ 25). In this context, by year end the privatizations of the electricity distribution companies and the readily salable tobacco companies are expected to be completed. In parallel, plans for the privatization (over 2005-06) of the nonnuclear electricity generation plants are advancing.

III. Medium-term Sustainability and Capacity to Repay the Fund

23. **External vulnerabilities have increased, but remain manageable.** Following significant progress in the reduction of the external debt ratio, to below 60 percent of GDP at end-2003, further—albeit slower—progress is expected. In addition, the private sector's exposure to short-term external debt has increased, though almost two-thirds of this constitutes trade credits. However, public debt (entirely at medium and long maturities) still constitutes 70 percent of external debt. Further, balance sheet indicators suggest that while there are risks arising from private sector net short-term foreign currency liabilities, these are more than covered by ample official foreign currency reserves. Financial market confidence remains strong, as evidenced by the decline of the Bulgaria component of the EMBI global spread to around 130 basis points in early July.

24. **The balance of payments projections do not indicate external financing gaps over the program period** (Table 8). The external current account is projected to improve gradually after 2004, driven by gains in export market shares and a decline of import growth rates as the rate of domestic credit expansion abates. FDI, boosted by completion of the privatization program and the approach of EU accession, is expected to allow a continued gradual reduction of the external debt ratio while maintaining a high international reserves level.

25. **Risks to the program are not trivial and arise from both domestic and external factors.** On the domestic front, complacency due to past achievements and political pressures in the run-up to the elections may undermine the drive for continued reforms, including the privatization program, as well as the critical need to maintain fiscal flexibility in case private sector demand does not decelerate. In this respect, the behavior of bank credit remains highly uncertain. External risks arise from possible higher import prices (in particular oil) or a rise in interest rates. Staff calculations suggest that a one dollar increase in oil prices or a one percentage point rise in interest rates would lead to a deterioration of the current account of around 0.2 percent or around 0.1 percent of GDP, respectively, on a full-year basis. A Debt Sustainability Analysis (Tables 9-12) suggests that under a range of scenarios the external and public debt ratios would decline and, under the most adverse scenario, remain stable. However, a failure to carry out the envisaged privatization program or attract sufficient greenfield FDI would put the projected external financing at risk, requiring additional adjustment to ensure that debt levels continue to decline.

26. **Bulgaria has the capacity to make repurchases to the Fund on the expectations schedule** (Tables 13 and 14). Over the course of the proposed arrangement, total debt service to the Fund will be lower than in previous years, averaging 14 percent of total external debt service, or about 1¾ percent of exports of goods and nonfactor services. Debt service to the Fund will peak in 2006-07 at 2¼ percent of exports of goods and nonfactor services. The BNB's safeguards practices are broadly adequate. A follow-up assessment to the one completed in June 2002 is currently underway for the purposes of the requested SBA.

IV. Features of the Proposed Arrangement

27. **The program will continue to rely on structural conditionality to achieve its objectives**. The Ex Post Assessment concluded that structural conditionality played an important role in the success of previous Fund-supported programs. This program includes structural conditions in four areas that are considered macro-critical, particularly given the CBA: (i) reform in the areas of tax administration and expenditure management are crucial to achieving fiscal objectives, while reforms of the pension and health systems would safeguard medium-term fiscal viability; (ii) measures to reduce bank liquidity would help reduce demand pressure and external vulnerability; (iii) privatization would bolster the FDI coverage of the current account deficit; and (iv) an improved business climate would foster higher investment, increase productivity and facilitate the supply response, which would help mitigate the effect of excess demand.

28. **The arrangement is proposed to be for 25 months covering the period August 6, 2004–September 15, 2006 and will be treated as precautionary by the authorities** (Table 15). Implementation of the program will be monitored on the basis of prior actions, quantitative and structural performance criteria, and benchmarks, as specified in Annexes I-IV attached to the MEFP. Reviews will be semi-annual. The first will focus on the 2005 budget, minimum wage policy, and measures to complete the planned privatizations and improve the business climate. Quantitative performance criteria for end-March and end-June 2005 will be set at the time of the first review, and subsequent performance criteria will be specified at the time of the following reviews. There will be nine potential purchases during the arrangement period.

V. Staff Appraisal

29. **Despite a broadly satisfactory economic performance in recent years, the sharp deterioration of the external current account, fueled by a domestic credit boom, has increased Bulgaria's external vulnerability**. While a prudent macroeconomic framework in the context of the CBA and structural reforms have helped deliver solid economic growth, low inflation, and steadily declining public and external debt ratios, these achievements have been recently threatened by demand pressures that have sharply increased the reliance on foreign savings. To prevent a reversal of the favorable external debt dynamics without jeopardizing continued high rates of economic growth, this external imbalance needs to be addressed by a combination of measures to both restrain demand and enhance supply.

30. **The authorities' program represents an appropriate response to the twin challenges of reducing external vulnerability and achieving sustained high growth rates**. Given the constraints of the CBA, their efforts to restrain demand rely primarily on fiscal tightening and prudent public sector wage policies while trying to drain the excess liquidity that has fanned the credit boom. In parallel, the authorities aim at enhancing supply by reinvigorating structural reforms—including privatization—to bolster competitiveness and attract foreign investment.

31. **In light of continued rapid credit growth and the widening current account deficit, the authorities' further tightening of fiscal policy is particularly welcome**. The authorities have responded flexibly to fresh evidence of overheating by tightening their fiscal stance for the second time this year. A fiscal surplus is now in prospect for 2004, but to achieve it the authorities must strictly adhere to their revised expenditure plans. In firming up their fiscal program for 2005-06, the authorities should stick to their intention not to ease the fiscal stance unless credit expansion is slowing as expected and the external current account ceases to be of concern. Plans to reduce taxes and adjust wages need to be compatible with this overall objective and with the need to increase public investment spending.

32. **Steps to rein in credit growth may need to be intensified**. While the increased level of financial intermediation is welcome from a structural perspective, the sustained rapid pace of credit expansion raises both prudential and macroeconomic concerns. The BNB has responded decisively by strengthening prudential regulations and stepping up its supervisory activity, and the banking system appears to remain sound. The authorities have begun draining bank liquidity by shifting government deposits to the BNB and tightening reserve requirements. The success of these measures is uncertain because of the open capital account and the authorities should stand ready, in line with their program intentions, to resort to additional measures to encourage slower credit growth.

33. **Debt management policy supports the authorities' efforts to reduce external vulnerability.** The announced early redemption of the Brady discount bonds will reduce gross external debt, free collateral, and ease fiscal constraints. Future plans to prepay external obligations should ensure the maintenance of an adequate international reserve cover.

34. **Wage discipline and labor market reform will bolster competitiveness and enhance supply.** Strict limits, as imposed for 2004, on wage increases in public enterprises

with monopoly power or in a weak financial position send important signals for private sector wage bargaining. Increases in the minimum wage also need to be restrained to maintain competitiveness, contain demand pressures, and protect the employment of low-skilled workers. The authorities need to cooperate closely with the World Bank to facilitate entry to and exit from employment.

35. **The more resolute implementation of other structural reforms is required to lower external vulnerability through an expansion of supply and prepare the economy for the competitive pressures of EU membership**. The regained privatization momentum bodes well for the authorities' plans to complete privatization over the next two years, thereby strengthening the external position in 2005-06. The focus of the authorities' program on measures to improve the business climate to stimulate investment is appropriate. The structural measures envisaged need to be implemented promptly on a broad front in close collaboration with the World Bank.

36. **The authorities' program offers good prospects for reducing external vulnerability and fostering sustained high rates of economic growth and therefore deserves the Fund's support**. Bulgaria has no imminent or prospective balance of payments need. Therefore, the authorities intend to treat the arrangement as precautionary. However, important macroeconomic risks remain and a new Fund arrangement would exercise strong policy discipline and reassure creditors and investors in the run-up to EU accession. With EU accession expected in early 2007, the authorities view the requested 25-month stand-by arrangement as an appropriate exit from a successful long-term program engagement with the Fund. The staff supports the authorities' request.

Table 1. Bulgaria: Selected Economic Indicators, 2000-2004

	2000	2001	2002	2003	2004 Q1
Output, prices, and employment	(Annual percent change, unless otherwise stated)				
Real GDP	5.4	4.1	4.9	4.3	5.3
Real industrial sales	...	2.8	1.3	17.4	18.1
Consumer price index (average)	10.4	7.5	5.8	2.3	6.4
(end of period)	11.4	4.8	3.8	5.6	6.2
Unemployment rate (in percent)					
Registered unemployment	18.1	17.5	17.4	14.3	14.1
Labor force survey	16.9	19.8	17.8	13.7	...
Real public sector wages	2.4	6.3	2.5	3.9	...
Real private sector wages	7.8	4.1	-4.1	5.7	...
General government	(In percent of GDP)				
Revenue	38.7	37.6	36.5	37.9	9.0
Noninterest expenditure	35.7	34.7	34.9	36.2	7.5
Primary balance	3.0	2.8	1.6	1.7	1.5
Interest payments	4.0	3.7	2.2	2.1	0.9
Overall balance	-1.0	-0.9	-0.6	-0.4	0.6
Privatization receipts	1.3	2.9	0.9	1.1	0.3
External financing	-1.5	-0.3	1.5	0.0	-0.3
Domestic financing	1.2	-1.7	-1.7	-0.7	-0.5
Public debt (end of period) 1/	77.0	69.9	56.2	48.3	45.1
Domestic public debt (end of period) 1/	6.6	6.2	6.5	6.5	6.4
Money and credit 2/	(Annual percent change, unless otherwise stated)				
Broad money (end of period; millions of leva)	9,857	12,401	13,857	16,566	16,806
Broad money (M3)	30.8	25.8	11.7	19.6	23.0
Claims on nongovernment	17.0	32.1	44.0	48.3	52.3
FX deposits (euro millions) 3/	2,068	2,516	2,678	3,150	4,020
FX deposits (percent of M3) 3/	41.0	39.7	37.8	37.2	38.6
Broad money to FX reserves ratio	1.3	1.6	1.5	1.6	1.6
Interest rates (annualized)	(In percent)				
BNB basic rate	4.6	4.7	3.4	2.7	2.4
Time deposits (leva)	3.3	3.4	3.2	3.2	3.1
Balance of payments	(In millions of euro, unless otherwise stated)				
Current account balance	-761	-1,102	-924	-1,498	-518
(In percent of GDP)	-5.6	-7.3	-5.6	-8.5	-12.6
Trade balance	-1,280	-1,779	-1,692	-2,196	-509
Exports, fob	5,253	5,714	6,063	6,663	1,718
Imports, fob	-6,533	-7,493	-7,755	-8,859	-2,227
Gross official reserves (end of period)	3,719	4,063	4,575	5,309	5,366
(In months of prospective imports of GNFS)	4.7	5.0	4.9	4.8	4.7
External debt (end of period) 4/	12,038	12,049	10,769	10,330	10,950
(In percent of GDP)	88.2	79.4	65.1	58.7	56.3
Exchange rates					
Leva per euro	Currency board, peg to euro at lev 1.95583 per euro				
Leva per U.S. dollar (end of period)	2.102	2.219	1.885	1.611	1.615
(yoy percent change, + means depreciation)	8.0	5.6	-15.1	-14.5	-10.0
REER (end of period; CPI based)					
(yoy percent change, + means appreciation)	2.6	3.7	5.6	8.6	5.7

Sources: Bulgarian authorities; and Fund staff estimates.

1/ Domestic debt as reported by Ministry of Finance and external debt as reported by BNB.
2/ Starting in 2002, a new format was adopted for monetary data resulting in revisions to historical series.
3/ Includes foreign currency deposits in broad money and other longer-term liabilities (not included in broad money).
4/ Includes trade credits.

Table 2. Bulgaria: Monetary Survey, 1999-2004
(End-period; in millions of leva unless otherwise stated)

	1999	2000	2001	2002	2003	2004			
						Q1	Q2	Q3	Q4
						Act.	Proj.		
Broad Money 1/	**7,536**	**9,857**	**12,401**	**13,857**	**16,566**	**16,806**	**17,952**	**18,989**	**19,778**
Currency outside banks	1,962	2,374	3,081	3,335	3,874	3,723	3,699	4,000	4,304
Deposits	5,574	7,483	9,319	10,519	12,591	12,956	13,839	14,639	15,247
Lev	2,772	3,438	4,400	5,302	6,514	6,597	7,040	7,447	7,756
Foreign currency	2,802	4,044	4,919	5,218	6,077	6,359	6,799	7,192	7,490
Other	0	0	0	3	102	128	414	351	227
Other Longer-Term Liabilities (not incl. in broad money)	**2,303**	**2,684**	**2,888**	**3,402**	**3,982**	**4,340**	**4,328**	**4,394**	**4,633**
Deposits	0	0	15	94	202	260	415	512	747
Lev	0	0	12	74	118	126	211	261	380
Foreign currency	0	0	2	20	84	134	204	252	367
Other	2,303	2,684	2,874	3,309	3,780	4,080	3,913	3,882	3,886
o/w capital and reserves	2,303	2,684	2,867	3,293	3,726	3,962	3,888	3,857	3,861
Net Foreign Assets	**6,566**	**8,196**	**9,454**	**9,892**	**10,049**	**9,940**	**11,318**	**11,984**	**11,502**
BNB	3,996	4,661	5,485	6,982	8,545	8,532	10,187	10,809	10,446
DMB	2,570	3,535	3,969	2,910	1,504	1,408	1,131	1,175	1,056
Net Domestic Assets	**3,273**	**4,345**	**5,835**	**7,368**	**10,499**	**11,206**	**10,962**	**11,399**	**12,909**
Domestic credit	3,640	4,770	6,009	7,656	10,251	11,049	10,813	11,418	12,725
General government	766	1,408	1,566	1,259	764	658	-644	-329	110
Non-government	2,874	3,362	4,443	6,397	9,487	10,391	11,457	11,747	12,615
Other items, net	-1,042	-1,185	-1,052	-1,239	-935	-1,061	-942	-1,226	-1,041
Fixed assets	674	759	879	951	1,183	1,218	1,091	1,208	1,226
				(12-month percent change)					
Broad Money	13.4	30.8	25.8	11.7	19.6	23.0	25.3	24.6	19.4
Reserve Money	14.1	10.9	33.5	11.2	17.5	21.7	19.2	19.7	10.5
Claims on Nongovernment	21.4	17.0	32.1	44.0	48.3	52.3	47.6	38.5	33.0
Claims on nonfinancial corporations	24.3	16.2	27.1	42.3	37.1	...	...	...	...
Claims on households	9.7	18.5	51.0	48.3	80.7	...	...	...	...
Deposits 2/	13.7	34.2	24.6	12.9	19.7	23.9	27.6	27.9	21.1
Lev	15.7	24.1	28.0	20.5	22.9	29.6	29.3	28.2	19.1
Foreign currency	11.7	44.3	21.6	6.1	16.5	18.5	26.0	27.6	23.3
				(In percent of GDP)					
Broad Money	31.7	36.8	41.7	42.9	48.1	44.2	47.2	49.9	52.0
Claims on Nongovernment	12.1	12.6	15.0	19.8	27.6	27.3	30.1	30.9	33.2
Claims on nonfinancial corporations	9.8	10.1	11.6	15.2	19.6	...	...	...	...
Claims on households	2.2	2.3	3.1	4.3	7.3	...	...	...	...
Memorandum items:									
Reserve money	2,725	3,021	4,033	4,482	5,266	4,978	5,129	5,512	5,817
Currency outside banks	1,962	2,374	3,081	3,335	3,874	3,723	3,699	4,000	4,304
Banks' reserves	763	647	952	1,147	1,392	1,255	1,430	1,512	1,513
Money multiplier (M3/reserve money)	2.8	3.3	3.1	3.1	3.1	3.4	3.5	3.4	3.4
BNB foreign assets/Reserve money (in percent)	236	246	197	200	197	211	328	319	287
Foreign currency deposits (percent of broad money)	37.2	41.0	39.7	37.7	36.7	37.8	37.9	37.9	37.9
DMB NFA/Foreign currency deposits (in percent)	91.7	87.4	80.7	55.8	24.8	22.1	16.6	16.3	14.1
Claims on nongovernment/deposits (in percent)	51.6	44.9	47.7	60.8	75.4	80.2	82.8	80.2	82.7

Sources: Bulgarian National Bank; National Statistical Institute; and Fund staff estimates.

1/ In February 2004, monetary data were recast to further harmonize with ECB requirements. Among the changes is the creation of a new category outside the money supply called long-term liabilities (see category immediately below). This includes deposits and securities with a maturity over 2 years, deposits redeemable at notice over three months, and capital and reserves.

2/ Deposits included in M3.

Table 3. Bulgaria: Selected Vulnerability Indicators, 2000-2004

	2000	2001	2002	2003	2004 1/	
Key Economic and Market Indicators						
Real GDP growth (in percent)	5.4	4.1	4.9	4.3	5.2	
CPI inflation (period average, in percent) 2/	10.4	7.5	5.8	2.3	6.3	
Short-term (ST) interest rate (in percent)	4.6	4.7	3.4	2.7	2.8	May-04
EMBI + secondary market spread (bps; end of period)	772	433	291	177	135	Jul-04
Exchange rate NC/US$ (end of period)	2.1	2.2	1.9	1.6	1.6	May-04
External Sector						
Exchange rate regime	Currency board, peg to euro at lev 1.95583 per euro					
Current account balance (percent of GDP) 3/	-5.6	-7.3	-5.6	-8.5	-8.8	
Net FDI inflows (percent of GDP) 4/	8.1	5.9	5.8	7.0	7.2	
Export growth (Euro value, GNFS) 5/	40.6	6.3	5.5	10.7	18.9	
Real effective exchange rate (1995 = 100; end of period))	129.3	134.1	141.7	153.9	152.9	Apr-04
Gross international reserves (GIR) in Euro billion	3.7	4.1	4.6	5.3	5.9	
GIR in percent of ST debt at remaining maturity	238.6	293.8	258.1	269.2	271.1	
Total gross external debt in percent of GDP 6/	88.2	79.4	65.1	58.7	56.1	
o/w ST debt (original maturity in percent of GDP) 6/	11.4	9.1	10.7	11.2	11.1	
Private sector debt (in percent of GDP) 6/	14.9	14.9	17.0	18.0	18.3	
Total gross external debt in percent of exports of GNFS	158.0	148.8	126.1	109.3	101.3	
Gross external financing requirement (in Euro billion)	...	...	2.6	3.3	3.8	
Public Sector 7/						
Overall balance (percent of GDP) 6/	-1.0	-0.9	-0.6	-0.4	0.9	
Primary balance (percent of GDP) 6/	3.0	2.8	1.6	1.7	2.8	
Public sector gross debt (in percent of GDP) 6/	77.0	69.9	56.2	48.3	44.3	
o/w External debt from official creditors (in percent of total)	40.6	36.0	38.8	40.6	36.1	Apr-04
External debt from private creditors (in percent of total)	52.5	52.4	52.0	47.6	42.1	Apr-04
Domestic debt linked to foreign currency (in percent of total)	3.7	3.5	3.7	4.8	4.2	Feb-04
Domestic debt linked to ST interest rate or inflation (in percent of total	0.0	0.0	0.0	0.0	0.0	
Public sector net debt (in percent of GDP) 8/	72.8	65.7	45.4	36.8	32.2	May-04
Financial Sector 9/						
Capital adequacy ratio (in percent)	35.6	31.3	25.2	22.0	21.3	Mar-04
NPLs in percent of total loans 10/	17.3	13.1	8.6	7.3	7.0	Mar-04
Provisions in percent of NPLs 10/	65.8	61.6	65.0	53.0	52.9	Mar-04
Return on average assets (in percent)	3.1	2.9	2.1	2.4	2.5	Mar-04
FX deposits (in percent of total deposits)	54.0	52.7	49.3	48.2	49.8	May-04
FX deposits (in percent of gross international reserves)	55.6	61.9	58.5	59.3	61.9	Mar-04
FX loans (in percent of total loans)	35.4	35.5	41.3	42.8	44.6	May-04
Net open forex position (sum of on- and off- balance sheet exposure) (in perc	-5.2	-5.2	-4.2	-4.9	...	

Sources: Bulgarian authorities; and Fund staff estimates.

1/ Staff projections or actual data for period indicated in the next column.
2/ The latest figure is the 12-month rate of inflation as of the indicated period.
3/ 12-month current account in percent of 12-month GDP.
4/ 12-month net FDI inflows in percent of 12-month GDP.
5/ Year-on-year growth rate.
6/ 2004: In percent of projected annual GDP.
7/ General government.
8/ Public sector gross debt minus balance of the fiscal reserve account.
9/ Commercial banks.
10/ Total loans exclude interbank loans. Non-performing loans including watch, substandard, doubtful, and loss.
11/ Does not include off-balance sheet items.

Table 4. Bulgaria: Balance of Payments, 2000-2006

(In millions of euros)

	2001	2002	2003	2004				2004	2005	2006
				Q1	Q2	Q3	Q4			
				Act.	Est.	Projections		Projections		
CURRENT ACCOUNT	-1,102	-924	-1,498	-518	-550	175	-826	-1,719	-1,755	-1,728
Trade balance	-1,779	-1,692	-2,196	-509	-805	-476	-869	-2,659	-2,800	-2,855
Exports (f.o.b.)	5,714	6,063	6,663	1,718	1,913	2,206	2,043	7,881	8,589	9,190
y-o-y change (in percent)	8.8	6.1	9.9	5.2	18.5	26.0	22.8	18.3	9.0	7.0
Imports (f.o.b.)	-7,493	-7,755	-8,859	-2,227	-2,718	-2,683	-2,912	-10,540	-11,389	-12,046
y-o-y change (in percent)	14.7	3.5	14.2	15.7	20.1	21.6	18.1	19.0	8.1	5.8
Services, net	454	486	524	-34	153	559	-65	612	702	908
Of which: Exports of travel services	1,084	1,203	1,460	200	392	781	248	1,619	1,728	1,860
Income, net	-340	-285	-439	-150	-37	-120	-70	-376	-512	-703
Of which: Income to direct investors	-166	-242	-343	-39	-84	-83	-83	-290	-442	-553
Current transfers, net	562	567	613	175	139	212	178	704	856	923
CAPITAL AND FINANCIAL ACCOUNT	1,527	1,656	2,280	509	998	143	646	2,296	2,045	1,956
Capital transfers, net	0	0	0	0	0	0	0	0	0	0
Foreign direct investment, net 1/	893	951	1,235	327	549	237	449	1,562	1,604	1,366
Of which: Privatization receipts	21	144	323	0	230	0	210	440	523	200
Portfolio investment, net	94	-99	-192	-115	-10	-568	59	-634	-103	-34
Other investment, net	-232	979	703	224	350	474	139	1,186	544	623
General government	-341	-144	55	-29	56	373	56	456	273	161
Domestic banks	-92	437	550	69	140	-33	-25	151	-198	-77
Other private sector	201	686	98	184	154	133	108	579	469	540
Errors and omissions	772	-174	534	74	109	0	0	183	0	0
OVERALL BALANCE	426	732	781	-9	448	318	-180	577	290	229
FINANCING	-426	-732	-781	9	-448	-318	180	-577	-290	-229
Gross international reserves (increase: -) 2/	-318	-578	-817	-38	-437	-297	219	-553	-76	42
Use of Fund credit, net	-185	-155	35	46	-11	-21	-39	-24	-214	-271
Purchases	141	117	128	62	0	0	0	62	0	0
Repurchases 3/	-326	-271	-93	0	-11	-21	-39	-70	-214	-271
Exceptional financing	78	0	0	0	0	0	0	0	0	0
MEMORANDUM ITEMS										
Gross international reserves (stock, e.o.p.) 4/	4,063	4,575	5,309	5,366	5,803	6,100	5,881	5,862	5,938	5,896
In months of prospective GNFS imports	5.0	4.9	4.8	4.7	5.1	5.2	4.9	4.9	4.7	4.3
In percent of short-term debt	293.8	258.1	269.2	242.7	274.4	282.7	272.0	271.1	257.8	241.7
Excess international reserves (stock, e.o.p.) 5/	2,002	2,282	2,617	2,820	3,185	3,203	2,829	2,809	...	...
In percent of short-term debt	144.7	128.8	132.7	127.6	150.6	148.4	130.8	129.9	...	...
Current account + FDI	-209	27	-264	-191	0	412	-378	-158	-151	-361
(in percent of GDP)	-1.4	0.2	-1.5	-1.0	0.0	2.1	-1.9	-0.8	-0.7	-1.6
Current account (in percent of GDP)	-7.3	-5.6	-8.5	-12.6	-12.2	3.2	-15.3	-8.8	-8.3	-7.5
Merchandise trade account (in percent of GDP)	-11.7	-10.2	-12.5	-12.4	-17.9	-8.8	-16.1	-13.7	-13.3	-12.4
Merchandise exports (in percent of GDP)	37.6	36.7	37.9	41.7	42.5	40.7	37.8	40.5	40.7	40.0
Merchandise imports (in percent of GDP)	49.3	46.9	50.4	-54.1	-60.3	-49.5	-53.9	54.2	-53.9	-52.5
Export volume (year-on-year change)	11.8	9.7	16.3	5.9	8.3	14.6	18.4	11.8	11.4	10.9
Import volume (year-on-year change)	19.8	6.7	19.8	17.6	11.8	12.6	14.6	13.7	10.3	9.6
FDI (net) in percent of current account	81.0	102.9	82.4	63.0	99.9	-135.5	54.3	90.8	91.4	79.1
Gross external debt (stock, e.o.p.)	12,049	10,769	10,330	10,950	11,187	10,865	10,906	10,906	11,307	11,598
(In percent of annual GDP)	79.4	65.1	58.7	56.3	57.5	55.9	56.1	56.1	53.5	50.5
Public	9,792	7,961	7,156	7,303	7,684	7,291	7,325	7,325	7,491	7,557
Private	2,257	2,808	3,174	3,648	3,503	3,574	3,581	3,581	3,816	4,040
Short-term debt (in percent of total debt, e.o.p.)	11.5	16.5	19.1	20.2	18.9	19.9	19.8	19.8	20.4	21.0
GDP	15,184	16,533	17,594	4,119	4,506	5,421	5,406	19,452	21,119	22,950

Sources: Bulgarian authorities, and Fund staff estimates.

1/ All FDI is assumed non-debt creating.
2/ Excluding valuation changes.
3/ According to expectations schedule.
4/ Historical figures include valuation changes.
5/ Gross international reserves minus reserve money.

Table 5. Bulgaria: General Government, 2001-2006

(In millions of leva)

	2001	2002	2003	2004	Q1	Q2	Q3	Q4	2004		2005	2006
				Budget	Prel.		Prog.		Prog.	Proj.	Projections	
Total revenue and grants	11,164	11,799	13,052	13,450	3,419	3,749	3,445	3,662	14,275	14,605	15,399	16,533
Tax revenue	8,517	8,873	10,214	10,621	2,731	2,873	2,809	2,946	11,359	11,524	12,248	13,301
Profit taxes	1,150	976	1,032	937	344	286	204	197	1,031	1,088	1,096	1,192
Nonfinancial enterprises	812	871	899	815	306	257	174	165	902	953	962	1,046
Financial enterprises	339	105	133	122	39	28	30	31	129	134	134	146
Income taxes	1,063	1,052	1,140	1,109	275	315	301	336	1,228	1,204	1,258	1,391
VAT	2,454	2,688	3,101	3,336	869	907	903	984	3,663	3,666	3,989	4,333
Excise and fuel duties	1,107	1,314	1,544	1,747	357	450	484	474	1,765	1,829	1,967	2,128
Customs duties	195	188	231	204	66	66	60	70	262	285	315	336
Social insurance contributions	2,311	2,352	2,806	2,944	702	750	780	801	3,033	3,078	3,218	3,497
Pension and unemployment contributions 1/	1,822	1,839	2,192	2,309	539	588	621	638	2,387	2,395	2,513	2,732
Health Insurance Fund	489	513	614	636	163	163	158	163	646	683	704	765
Other taxes	236	303	359	344	116	98	77	85	377	374	405	424
Nontax revenues	2,284	2,625	2,527	2,364	602	795	523	517	2,437	2,637	2,605	2,633
BNB transfers	175	173	133	156	0	171	0	0	171	171	156	160
Other	2,109	2,452	2,394	2,208	602	624	523	517	2,266	2,466	2,449	2,473
Grants and donations	363	301	312	465	86	81	113	198	479	444	546	599
Total expenditure and net lending	11,423	12,009	13,197	13,901	3,205	3,264	3,742	4,064	14,275	14,275	15,013	16,413
Noninterest expenditure, net lending, contingency	10,317	11,296	12,473	13,113	2,846	3,189	3,521	3,991	13,546	13,546	14,227	15,476
Current noninterest expenditure	8,812	10,061	11,190	11,559	2,638	2,928	3,006	3,358	11,930	11,930	12,308	13,216
Compensation	1,196	1,379	1,552	1,632	361	406	435	551	1,752	1,752	1,811	1,900
Wages and salaries	1,159	1,338	1,506	1,589	351	391	430	535	1,707	1,707	1,768	1,856
Scholarships	37	41	45.4	43	10	14	5	16	46	46	43	43
Maintenance and operations	1,876	2,200	2,389	2,300	517	577	604	691	2,389	2,389	2,561	2,783
Defense and security	957	1,066	1,107	1,211	241	325	300	355	1,221	1,221	1,319	1,436
Subsidies	709	772	887	683	154	219	177	233	783	783	783	808
Social expenditures	4,074	4,634	5,106	5,566	1,341	1,361	1,441	1,474	5,617	5,617	5,834	6,289
Pension fund	2,586	2,944	3,161	3,376	821	843	881	921	3,466	3,466	3,612	3,905
Assistance and unemployment	858	1,007	1,004	1,167	265	234	276	327	1,102	1,102	1,135	1,167
Health Insurance Fund	404	498	720	770	194	218	218	153	784	784	812	898
Other social expenditures 2/	225	185	221	254	61	66	67	72	265	265	275	319
Capital expenditures	1,198	1,046	1,189	1,330	205	254	494	463	1,416	1,416	1,690	2,020
Contingency	245	189	95	224	2	7	21	170	200	200	228	240
Enterprise restructuring	18	0	0	168	0	0	0	10	10	10	168	170
Budget	188	143	48					136	136	136	0	0
Natural disaster	39	46	46	56	2	7	21	23	54	54	60	70
Primary balance	847	503	579	337	574	560	-76	-329	729	1,059	1,172	1,057
Interest	1,106	713	724	788	359	75	221	74	729	729	786	937
External	853	544	561	593	310	31	163	39	543	543	632	749
Domestic	253	169	163	195	49	45	59	35	187	187	154	188
Overall balance	-259	-210	-145	-451	215	485	-297	-403	0	330	386	120
Financing	259	210	145	451	-215	-485	297	403	0	-330	-386	-120
Privatization 4/	861	286	387	1,000	110	469	18	694	1,294	1,294	1,041	411
External (net)	-96	481	-2	338	-122	78	116	223	338	338	125	-846
Domestic (net)	-506	-558	-240	-887	-203	-1,032	163	-514	-1,631	-1,961	-1,552	314
Banking system	...	...	...	-402	-223	-1,063	184	-478	-1,706	-2,037	-1,672	164
Nonbank	...	...	...	137	14	34	34	34	197	197	120	150
Acquisition of assets	...	...	...	-622	6	-4	-55	-71	-122	-122	...	...
Memorandum item:												
Nominal GDP in millions of leva	29,709	32,324	34,410	38,046					38,046	38,046	41,305	44,886

Sources: Ministry of Finance; and Fund staff projections.

1/ Pension and unemployment contributions were combined in January 2002.

2/ Includes additional compulsory social security contributions (for the second pillar of the pension system) for public sector employees.

3/ Under the 2003 and 2004 budget, these transfers were envisaged to be made below the line for various purposes.

4/ Slight differences between privatization receipts in the balance of payments and the fiscal accounts are due to domestic privatization. In 2004, however, 500 million leva (1.3 percent of GDP) of previously completed bank privatizations will be transferred to the government upon the closure of the Bank Consolidation Company.

Table 6. Bulgaria: General Government, 2001-2006

(In percent of GDP)

	2001	2002	2003	2004	Q1	Q2	Q3	Q4	2004		2005	2006
				Budget	Prel.		Prog.		Prog.	Proj.	Projections	
Total revenue and grants	37.6	36.5	37.9	35.4	9.0	9.9	9.1	9.6	37.5	38.4	37.3	36.8
Tax revenue	28.7	27.4	29.7	27.9	7.2	7.6	7.4	7.7	29.9	30.3	29.7	29.6
Profit taxes	3.9	3.0	3.0	2.5	0.9	0.8	0.5	0.5	2.7	2.9	2.7	2.7
Nonfinancial enterprises	2.7	2.7	2.6	2.1	0.8	0.7	0.5	0.4	2.4	2.5	2.3	2.3
Financial enterprises	1.1	0.3	0.4	0.3	0.1	0.1	0.1	0.1	0.3	0.4	0.3	0.3
Income taxes	3.6	3.3	3.3	2.9	0.7	0.8	0.8	0.9	3.2	3.2	3.0	3.1
VAT	8.3	8.3	9.0	8.8	2.3	2.4	2.4	2.6	9.6	9.6	9.7	9.7
Excise and fuel duties	3.7	4.1	4.5	4.6	0.9	1.2	1.3	1.2	4.6	4.8	4.8	4.7
Customs duties	0.7	0.6	0.7	0.5	0.2	0.2	0.2	0.2	0.7	0.8	0.8	0.7
Social insurance contributions	7.8	7.3	8.2	7.7	1.8	2.0	2.0	2.1	8.0	8.1	7.8	7.8
Pension and unemployment contributions 1/	6.1	5.7	6.4	6.1	1.4	1.5	1.6	1.7	6.3	6.3	6.1	6.1
Health Insurance Fund	1.6	1.6	1.8	1.7	0.4	0.4	0.4	0.4	1.7	1.8	1.7	1.7
Other taxes	0.8	0.9	1.0	0.9	0.3	0.3	0.2	0.2	1.0	1.0	1.0	0.9
Nontax revenues	7.7	8.1	7.3	6.2	1.6	2.1	1.4	1.4	6.4	6.9	6.3	5.9
BNB transfers	0.6	0.5	0.4	0.4	0.0	0.4	0.0	0.0	0.4	0.4	0.4	0.4
Other	7.1	7.6	7.0	5.8	1.6	1.6	1.4	1.4	6.0	6.5	5.9	5.5
Grants and donations	1.2	0.9	0.9	1.2	0.2	0.2	0.3	0.5	1.3	1.2	1.3	1.3
Total expenditure and net lending	38.4	37.2	38.4	36.5	8.4	8.6	9.8	10.7	37.5	37.5	36.3	36.6
Noninterest expenditure, net lending, contingency	34.7	34.9	36.2	34.5	7.5	8.4	9.3	10.5	35.6	35.6	34.4	34.5
Current noninterest expenditure	29.7	31.1	32.5	30.4	6.9	7.7	7.9	8.8	31.4	31.4	29.8	29.4
Compensation	4.0	4.3	4.5	4.3	0.9	1.1	1.1	1.4	4.6	4.6	4.4	4.2
Wages and salaries	3.9	4.1	4.4	4.2	0.9	1.0	1.1	1.4	4.5	4.5	4.3	4.1
Scholarships	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Maintenance and operations	6.3	6.8	6.9	6.0	1.4	1.5	1.6	1.8	6.3	6.3	6.2	6.2
Defense and security	3.2	3.3	3.2	3.2	0.6	0.9	0.8	0.9	3.2	3.2	3.2	3.2
Subsidies	2.4	2.4	2.6	1.8	0.4	0.6	0.5	0.6	2.1	2.1	1.9	1.8
Social expenditures	13.7	14.3	14.8	14.6	3.5	3.6	3.8	3.9	14.8	14.8	14.1	14.0
Pension fund	8.7	9.1	9.2	8.9	2.2	2.2	2.3	2.4	9.1	9.1	8.7	8.7
Assistance and unemployment	2.9	3.1	2.9	3.1	0.7	0.6	0.7	0.9	2.9	2.9	2.7	2.6
Health Insurance Fund	1.4	1.5	2.1	2.0	0.5	0.6	0.6	0.4	2.1	2.1	2.0	2.0
Other social expenditures 2/	0.8	0.6	0.6	0.7	0.2	0.2	0.2	0.2	0.7	0.7	0.7	0.7
Transfers 3/	...	...	0.4	0.4	0.1	0.1	0.1	0.1	0.4	0.4	0.0	0.0
Capital expenditures	4.0	3.2	3.5	3.5	0.5	0.7	1.3	1.2	3.7	3.7	4.1	4.5
Contingency	0.8	0.6	0.3	0.6	0.0	0.0	0.1	0.4	0.5	0.5	0.6	0.5
Enterprise restructuring	0.1	0.0	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.4
Budget	0.6	0.4	0.1	0.0	0.0	0.0	0.0	0.4	0.4	0.4	0.0	0.0
Natural disaster	0.1	0.1	0.1	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.2
Primary balance	2.8	1.6	1.7	0.9	1.5	1.5	-0.2	-0.9	1.9	2.8	2.8	2.4
Interest	3.7	2.2	2.1	2.1	0.9	0.2	0.6	0.2	1.9	1.9	1.9	2.1
External	2.9	1.7	1.6	1.6	0.8	0.1	0.4	0.1	1.4	1.4	1.5	1.7
Domestic	0.9	0.5	0.5	0.5	0.1	0.1	0.2	0.1	0.5	0.5	0.4	0.4
Overall balance	-0.9	-0.6	-0.4	-1.2	0.6	1.3	-0.8	-1.1	0.0	0.9	0.9	0.3
Financing	0.9	0.6	0.4	1.2	-0.6	-1.3	0.8	1.1	0.0	-0.9	-0.9	-0.3
Privatization 4/	2.9	0.9	1.1	2.6	0.3	1.2	0.0	1.8	3.4	3.4	2.5	0.9
External (net)	-0.3	1.5	0.0	0.9	-0.3	0.2	0.3	0.6	0.9	0.9	0.3	-1.9
Domestic (net)	-1.7	-1.7	-0.7	-2.3	-0.5	-2.7	0.4	-1.4	-4.3	-5.2	-3.8	0.7
Banking system	...	...	...	-1.1	-0.6	-2.8	0.5	-1.3	-4.5	-5.4	-4.0	0.4
Nonbank	...	...	...	0.4	0.0	0.1	0.1	0.1	0.5	0.5	0.3	0.3
Acquisition of assets	...	...	...	-1.6	0.0	0.0	-0.1	-0.2	-0.3	-0.3	...	...
Memorandum item:												
Nominal GDP in millions of leva	29,709	32,324	34,410	38046	38,046	38,046	38,046	38,046	38,046	38,046	41,305	44,886

Sources: Ministry of Finance; and Fund staff projections.

1/ Pension and unemployment contributions were combined in January 2002.

2/ Includes additional compulsory social security contributions (for the second pillar of the pension system) for public sector employees.

3/ Under the 2003 and 2004 budget, these transfers were envisaged to be made below the line for various purposes.

4/ Slight differences between privatization receipts in the balance of payments and the fiscal accounts are due to domestic privatization. In 2004, however, 500 million leva (1.3 percent of GDP) of previously completed bank privatizations will be transferred to the government upon the closure of the Bank Consolidation Company.

Table 7. Bulgaria: Macroeconomic Framework, 2000-2009

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
					Projections					
GDP and prices (annual percent change)										
Real GDP	5.4	4.1	4.9	4.3	5.2	5.2	5.3	5.3	5.5	5.5
GDP deflator	6.7	6.7	3.8	2.1	5.1	3.2	3.2	3.2	3.2	3.2
CPI (end of period)	11.4	4.8	3.8	5.6	3.6	3.6	3.5	3.5	3.5	3.5
(period average)	10.4	7.5	5.8	2.3	6.3	3.6	3.5	3.5	3.5	3.5
Monetary aggregates (annual percent change)										
Broad money (nominal, end of period)	30.8	25.8	11.7	19.6	19.4	14.4	14.5	13.0	12.5	12.4
Claims on non-government (nominal, end of period)	17.0	32.1	44.0	48.3	33.0	25.4	22.5	18.9	15.4	15.3
Saving and investment (in percent of GDP)										
Foreign saving 1/	5.4	8.7	7.3	9.5	10.5	9.9	8.5	7.9	7.9	7.2
Gross national saving	12.7	13.4	14.2	13.2	13.8	14.9	15.9	17.2	18.3	18.5
Gross domestic saving 2/	12.9	12.0	12.5	12.2	12.1	13.3	14.9	15.7	16.3	17.3
Government	6.3	6.0	4.3	4.7	6.0	6.6	6.4	6.7	6.7	6.4
Non-government	6.7	5.9	8.2	7.6	6.1	6.7	8.5	9.0	9.6	10.9
Gross domestic investment	18.3	20.7	19.8	21.7	22.6	23.2	23.4	23.6	24.2	24.5
Government	4.2	4.0	3.2	3.5	3.7	4.1	4.5	5.2	5.5	5.4
Non-government	14.1	16.6	16.6	18.3	18.9	19.1	18.9	18.4	18.7	19.1
General government (in percent of GDP)										
Revenue	38.7	37.6	36.5	37.9	38.4	37.3	36.8	38.7	39.0	38.1
Non-interest expenditure	35.7	34.7	34.9	36.2	35.6	34.4	34.5	36.7	37.3	36.6
Primary balance	3.0	2.8	1.6	1.7	2.8	2.8	2.4	2.0	1.7	1.5
Interest payments	4.0	3.7	2.2	2.1	1.9	1.9	2.1	2.0	1.7	1.5
Overall balance 3/	-1.0	-0.9	-0.6	-0.4	0.9	0.9	0.3	0.0	0.0	0.0
Total public debt	77.0	69.9	56.2	48.3	44.3	41.7	37.7	32.2	28.1	24.5
Of which : External	70.5	63.7	49.7	41.8	37.1	34.0	29.8	24.1	20.2	16.8
Balance of payments (in millions of euros)										
Current account	-761	-1,102	-924	-1,498	-1,719	-1,755	-1,728	-1,586	-1,599	-1,774
Trade balance	-1,280	-1,779	-1,692	-2,196	-2,659	-2,800	-2,855	-3,029	-3,232	-3,363
Exports	5,253	5,714	6,063	6,663	7,881	8,589	9,190	10,056	11,162	12,373
Imports	6,533	7,493	7,755	8,859	10,540	11,389	12,046	13,084	14,394	15,736
Services, net	547	454	486	524	612	702	908	1,047	1,090	1,237
Receipts	2,366	2,385	2,479	2,791	3,359	3,670	3,988	4,357	4,731	5,159
Payments	1,819	1,930	1,993	2,267	2,748	2,968	3,080	3,310	3,641	3,922
Income, net	-345	-340	-285	-439	-376	-512	-703	-911	-1,075	-1,279
Memorandum items										
Gross official reserves (in millions of euros)	3,719	4,063	4,575	5,309	5,862	5,938	5,896	6,011	6,461	6,820
(in months of prospective imports of GNFS)	4.7	5.0	4.9	4.8	4.9	4.7	4.3	4.0	3.9	...
Current account balance (in percent of GDP)	-5.6	-7.3	-5.6	-8.5	-8.8	-8.3	-7.5	-6.4	-5.9	-6.0
External debt/GDP (in percent)	88.2	79.4	65.1	58.7	56.1	53.5	50.5	47.1	45.2	43.3
External debt/exports of GNFS (in percent)	158.0	148.8	126.1	109.3	97.0	92.2	88.0	81.6	77.3	73.0
External debt service/exports of GNFS (in percent)	16.6	20.8	16.4	12.5	14.8	11.0	12.5	14.6	12.6	12.4
Export growth (percent change)	40.7	8.8	6.1	9.9	18.3	9.0	7.0	9.4	11.0	10.8
Import growth (percent change)	37.8	14.7	3.5	14.2	19.0	8.1	5.8	8.6	10.0	9.3
Terms of trade (percent change)	-10.6	1.8	-0.6	-1.0	1.4	-0.2	-0.1	0.3	0.7	1.0
Nominal GDP (in millions of leva)	26,753	29,709	32,335	34,410	38,046	41,305	44,886	48,777	53,107	57,821
Nominal GDP (in millions of euros)	13,646	15,184	16,533	17,594	19,452	21,119	22,950	24,939	27,153	29,563

Sources: Bulgarian authorities; and Fund staff projections.

1/ Net imports of goods and nonfactor services.

2/ Gross domestic saving equals gross national saving less net factor income and transfers from abroad. The government contribution to gross domestic saving equals revenues less current expenditures, excluding external interest payments.

3/ From 2003 onwards, includes below-the-line transfers. In 2003, balance excluding below-the-line transfers was 0.0 percent of GDP.

Table 8. Bulgaria: Balance of Payments, 2000-2009
(In millions of euros)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
							Projections			
CURRENT ACCOUNT	-761	-1,102	-924	-1,498	-1,719	-1,755	-1,728	-1,586	-1,599	-1,774
Trade balance	-1,280	-1,779	-1,692	-2,196	-2,659	-2,800	-2,855	-3,029	-3,232	-3,363
Exports (f.o.b.)	5,253	5,714	6,063	6,663	7,881	8,589	9,190	10,056	11,162	12,373
y-o-y change (in percent)	40.7	8.8	6.1	9.9	18.3	9.0	7.0	9.4	11.0	10.8
Imports (f.o.b.)	-6,533	-7,493	-7,755	-8,859	-10,540	-11,389	-12,046	-13,084	-14,394	-15,736
y-o-y change (in percent)	37.8	14.7	3.5	14.2	19.0	8.1	5.8	8.6	10.0	9.3
Services, net	547	454	486	524	612	702	908	1,047	1,090	1,237
Of which: Exports of travel services	1,168	1,084	1,203	1,460	1,619	1,728	1,860	1,990	2,089	2,197
Income, net	-345	-340	-285	-439	-376	-512	-703	-911	-1,075	-1,279
Of which: Income to direct investors	-116	-166	-242	-343	-290	-442	-553	-690	-801	-911
Current transfers, net	316	562	567	613	704	856	923	1,307	1,618	1,631
CAPITAL AND FINANCIAL ACCOUNT	950	1,527	1,656	2,280	2,296	2,045	1,956	1,924	2,172	2,196
Capital transfers, net	25	0	0	0	0	0	0	0	0	0
Foreign direct investment, net 1/	1,100	893	951	1,235	1,562	1,604	1,366	1,468	1,465	1,558
Of which: Privatization receipts	396	21	144	323	440	523	200	200	0	0
Portfolio investment, net	-192	94	-99	-192	-634	-103	-34	-301	-37	-59
Other investment, net	-9	-232	979	703	1,186	544	623	756	744	697
General government	-235	-341	-144	55	456	273	161	158	126	120
Domestic banks	-389	-92	437	550	151	-198	-77	-45	-75	-53
Other private sector	614	201	686	98	579	469	540	643	693	629
Errors and omissions	26	772	-174	534	183	0	0	0	0	0
OVERALL BALANCE	188	426	732	781	577	290	229	338	573	422
FINANCING	-188	-426	-732	-781	-577	-290	-229	-338	-573	-422
Gross international reserves (increase: -) 2/	-492	-318	-578	-817	-553	-76	42	-115	-450	-359
Use of Fund credit, net	151	-185	-155	35	-24	-214	-271	-223	-123	-63
Purchases	294	141	117	128	62	0	0	0	0	0
Repurchases 3/	-143	-326	-271	-93	-70	-214	-271	-223	-123	-63
Exceptional financing	153	78	0	0	0	0	0	0	0	0
MEMORANDUM ITEMS										
Gross international reserves (stock, e.o.p.) 4/	3,719	4,063	4,575	5,309	5,862	5,938	5,896	6,011	6,461	6,820
In months of prospective GNFS imports	4.7	5.0	4.9	4.8	4.9	4.7	4.3	4.0	3.9	...
In percent of short-term debt	238.6	293.8	258.1	269.2	271.1	257.8	241.7	224.7	218.3	210.5
Excess international reserves (stock, e.o.p.) 5/	2,178	2,002	2,282	2,617	2,809	...	...	...	...	...
In percent of short-term debt	139.8	144.7	128.8	132.7	129.9	...	...	...	...	...
Current account + FDI	338	-209	27	-264	-158	-151	-361	-117	-134	-216
(in percent of GDP)	2.5	-1.4	0.2	-1.5	-0.8	-0.7	-1.6	-0.5	-0.5	-0.7
Current account (in percent of GDP)	-5.6	-7.3	-5.6	-8.5	-8.8	-8.3	-7.5	-6.4	-5.9	-6.0
Merchandise trade account (in percent of GDP)	-9.4	-11.7	-10.2	-12.5	-13.7	-13.3	-12.4	-12.1	-11.9	-11.4
Merchandise exports (in percent of GDP)	38.5	37.6	36.7	37.9	40.5	40.7	40.0	40.3	41.1	41.9
Merchandise imports (in percent of GDP)	-47.9	49.3	46.9	50.4	54.2	53.9	52.5	52.5	53.0	53.2
Export volume (year-on-year change)	16.8	11.8	9.7	16.3	11.8	11.4	10.9	10.6	10.4	10.3
Import volume (year-on-year change)	2.3	19.8	6.7	19.8	13.7	10.3	9.6	10.1	10.1	9.9
FDI (net) in percent of current account	144.4	81.0	102.9	82.4	90.8	91.4	79.1	92.6	91.6	87.8
Gross external debt (stock, e.o.p.)	12,038	12,049	10,769	10,330	10,906	11,307	11,598	11,758	12,285	12,801
(In percent of GDP)	88.2	79.4	65.1	58.7	56.1	53.5	50.5	47.1	45.2	43.3
Public	10,006	9,792	7,961	7,156	7,325	7,491	7,557	7,327	7,382	7,433
Private	2,032	2,257	2,808	3,174	3,581	3,816	4,040	4,431	4,903	5,367
GDP	13,646	15,184	16,533	17,594	19,452	21,119	22,950	24,939	27,153	29,563

Sources: Bulgarian authorities, and Fund staff estimates.

1/ All FDI is assumed non-debt creating.
2/ Excluding valuation changes.
3/ According to expectations schedule.
4/ Historical number include valuation changes.
5/ Gross international reserves minus reserve money.

Table 9. Bulgaria: External Debt Sustainability Framework, 1998-2009
(In percent of GDP, unless otherwise indicated)

	Actual							Prel.	Projections						
	1998	1999	2000	2001	2002			2003	2004	2005	2006	2007	2008	2009	
										I. Baseline Projections					**Debt-stabilizing non-interest current account 6/**
1 **External debt**	83.1	89.5	88.2	79.4	65.1			**58.7**	**56.1**	**53.5**	**50.5**	**47.1**	**45.2**	**43.3**	**-6.6**
2 Change in external debt	-17.3	6.3	-1.2	-8.9	-14.2			-6.4	-2.6	-2.5	-3.0	-3.4	-1.9	-1.9	
3 Identified external debt-creating flows (4+8+9)	-13.3	-7.8	-12.6	-7.0	-5.0			-1.2	-4.8	-3.7	-2.7	-3.6	-3.3	-3.0	
4 Current account deficit, excluding interest payments	-4.0	1.1	1.5	3.4	3.4			6.4	6.9	6.4	5.4	4.0	3.6	3.7	
5 Deficit in balance of goods and services	-0.2	5.8	5.4	8.7	7.3			9.5	10.5	9.9	8.5	7.9	7.9	7.2	
6 Exports	47.6	44.6	55.8	53.3	51.7			53.7	57.8	58.0	57.4	57.8	58.5	59.3	
7 Imports	47.4	50.4	61.2	62.1	59.0			63.2	68.3	68.0	65.9	65.7	66.4	66.5	
8 Net non-debt creating capital inflows (negative)	-5.8	-6.3	-8.3	-5.3	-4.2			-5.7	-8.0	-7.6	-6.0	-5.9	-5.4	-5.3	
9 Automatic debt dynamics 1/	-3.5	-2.5	-5.8	-5.1	-4.2			-1.8	-3.7	-2.6	-2.1	-1.7	-1.5	-1.3	
10 Contribution from nominal interest rate	4.2	3.7	4.1	3.9	2.2			2.1	1.9	1.9	2.2	2.3	2.3	2.4	
11 Contribution from real GDP growth	-3.7	-1.8	-4.3	-3.2	-3.6			-2.6	-2.8	-2.7	-2.6	-2.5	-2.4	-2.3	
12 Contribution from price and exchange rate changes 2/	-4.0	-4.5	-5.5	-5.7	-2.9			-1.3	-2.9	-1.7	-1.7	-1.6	-1.5	-1.4	
13 Residual, incl. change in gross foreign assets (2-3)	-4.0	14.1	11.3	-1.9	-9.2			-5.3	2.1	1.2	-0.3	0.2	1.4	1.0	
External debt-to-exports ratio (in percent)	174.5	200.4	158.0	148.8	126.1			109.3	97.0	92.2	88.0	81.6	77.3	73.0	
Gross external financing need (in billions of euros) 3/	1.8	2.5	2.7	3.8	3.3			4.1	5.0	4.9	5.2	5.6	5.6	6.2	
in percent of GDP	16.2	20.3	20.0	24.8	20.1			23.1	25.6	23.0	22.6	22.3	20.8	21.0	
Key Macroeconomic Assumptions						5-Year Historical Average	5-Year Standard Deviation								Projected Average
Real GDP growth (in percent)	4.0	2.3	5.4	4.1	4.9	4.1	1.2	4.3	5.2	5.2	5.3	5.3	5.5	5.5	5.2
Exchange rate appreciation (Euro value of local currency, change in percent)	-15.8	1.9	-0.1	0.2	0.0	-24.9	31.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GDP deflator in euros (change in percent)	4.2	5.7	6.6	6.9	3.8	5.4	1.4	2.1	5.1	3.2	3.2	3.2	3.2	3.2	3.3
Nominal external interest rate (in percent)	4.5	4.9	5.1	4.9	3.1	4.5	0.8	3.5	3.6	3.6	4.4	5.0	5.3	5.7	4.4
Growth of exports (Euro terms, in percent)	-23.7	1.3	40.6	6.3	5.5	6.0	22.9	10.7	18.9	9.1	7.5	9.4	10.3	10.3	10.9
Growth of imports Euro terms, in percent)	-8.9	15.0	36.4	12.8	3.4	11.8	16.7	14.1	19.4	8.0	5.4	8.4	10.0	9.0	10.6
Current account balance, excluding interest payments	4.0	-1.1	-1.5	-3.4	-3.4	-1.1	3.0	-6.4	-6.9	-6.4	-5.4	-4.0	-3.6	-3.7	-5.2
Net non-debt creating capital inflows	5.8	6.3	8.3	5.3	4.2	6.0	1.5	5.7	8.0	7.6	6.0	5.9	5.4	5.3	6.3
										II. Stress Tests for External Debt Ratio					**Debt-stabilizing non-interest current account 6/**
A. Alternative Scenario															
A1. Key variables are at their historical averages in 2004-09 4/								**58.7**	**53.1**	**46.8**	**39.4**	**32.7**	**27.7**	**22.4**	**-5.9**
A2. Country-specific Scenario -- Higher trade deficit and lower FDI 2004-2009 5/								**58.7**	**55.9**	**55.5**	**55.1**	**54.6**	**55.2**	**56.1**	**-5.5**
B. Bound Tests															
B1. Nominal interest rate is at historical average plus two standard deviations in 2004 and 2005								**58.7**	**57.4**	**56.2**	**53.1**	**49.6**	**47.6**	**45.6**	**-6.6**
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005								**58.7**	**57.7**	**56.5**	**53.0**	**49.1**	**46.9**	**44.6**	**-6.9**
B3. Change in euro GDP deflator is at historical average minus two standard deviations in 2004 and 2005								**58.7**	**57.3**	**54.8**	**51.5**	**48.0**	**45.9**	**43.8**	**-6.7**
B4. Non-interest current account is at historical average minus two standard deviations in 2004 and 2005								**58.7**	**56.2**	**54.3**	**51.3**	**47.9**	**45.9**	**44.0**	**-6.6**
B5. Combination of 2-5 using one standard deviation shocks								**58.7**	**55.8**	**52.2**	**49.2**	**45.8**	**43.9**	**42.0**	**-6.8**
B6. One time 30 percent nominal depreciation in 2004								**58.7**	**77.1**	**70.9**	**64.5**	**58.2**	**54.3**	**50.2**	**-9.0**

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in euro terms, g = real GDP growth rate, e = nominal appreciation (increase in euro value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

4/ The key variables include real GDP growth; nominal interest rate; euro deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

5/ Nominal export growth at 95 percent of baseline scenario, nominal import growth at 105 percent of baseline scenario, net FDI (excluding privatization) at 80 percent of baseline scenario, and no privatization of energy generation companies.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, euro deflator growth, and both non-interest current account and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 10. Bulgaria: External Debt Sustainability Framework--Gross External Financing Need, 1998-2009

	Actual					Prel.	Projections					
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
I. Baseline Projections												
Gross external financing need in billions of euros 1/	1.8	2.5	2.7	3.8	3.3	4.1	5.0	4.9	5.2	5.6	5.6	6.2
in percent of GDP	16.2	20.3	20.0	24.8	20.1	23.1	25.6	23.0	22.6	22.3	20.8	21.0
II. Stress Tests												
Gross external financing need in billions of euros 2/												
A. Alternative Scenario												
A1. Key variables are at their historical averages in 2004-08						4.1	3.9	3.6	3.6	3.7	3.4	3.4
B. Bound Tests												
B1. Nominal interest rate is at historical average plus two standard deviations in 2004 and 2005						4.1	5.3	5.3	5.4	5.8	5.9	6.5
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005						4.1	4.9	4.8	5.0	5.4	5.5	6.0
B3. Change in euro GDP deflator is at historical average minus two standard deviations in 2004 and 2005						4.1	4.9	4.8	5.1	5.5	5.6	6.1
B4. Non-interest current account is at historical average minus two standard deviations in 2004 and 2005						4.1	5.0	5.0	5.2	5.6	5.7	6.3
B5. Combination of 2-5 using one standard deviation shocks						4.1	4.5	4.3	4.9	5.2	5.3	5.8
B6. One time 30 percent nominal depreciation in 2004						4.1	4.5	4.3	4.5	4.7	4.7	5.0
Gross external financing need in percent of GDP 2/												
A. Alternative Scenario												
A1. Key variables are at their historical averages in 2004-08						23.1	20.0	16.8	15.6	14.5	12.3	10.9
A2. Country-specific Scenario -- Higher trade deficit and lower FDI 2004-2008 3/						23.1	25.7	23.5	24.9	27.1	28.5	31.4
B. Bound Tests												
B1. Nominal interest rate is at historical average plus two standard deviations in 2004 and 2005						23.1	27.1	24.9	23.4	23.2	21.7	21.9
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005						23.1	26.2	24.1	23.5	23.1	21.5	21.6
B3. Change in euro GDP deflator is at historical average minus two standard deviations in 2004 and 2005						23.1	26.1	23.5	23.0	22.6	21.1	21.3
B4. Non-interest current account is at historical average minus two standard deviations in 2004 and 2005						23.1	25.8	23.8	22.8	22.5	21.0	21.3
B5. Combination of 2-5 using one standard deviation shocks						23.1	24.1	21.5	22.4	21.9	20.4	20.7
B6. One time 30 percent nominal depreciation in 2004						23.1	33.3	29.0	27.9	27.1	24.6	24.3

1/ Defined as non-interest current account deficit, plus interest and amortization on medium- and long-term debt, plus short-term debt at end of previous period.

2/ Gross external financing under the stress-test scenarios is derived by assuming the same ratio of short-term to total debt as in the baseline scenario and the same average maturity on medium- and long term debt. Interest expenditures are derived by applying the respective interest rate to the previous period debt stock under each alternative scenario.

3/ Nominal export growth at 90 percent of baseline scenario, nominal import growth at 105 percent of baseline scenario, net FDI at 75 percent of baseline scenario. Debt accumulation to maintain stocks of reserves at the same level as in baseline scenario.

Table 11. Bulgaria: Public Debt Sustainability Framework, 1998-2009
(In percent of GDP, unless otherwise indicated)

	Actual							Prel.	Projections					
	1998	1999	2000	2001	2002	5-Year Historical Average	5-Year Standard Deviation	2003	2004	2005	2006	2007	2008	2009
											I. Baseline Projections			
Public sector debt 1/	79.4	82.8	77.0	69.9	56.2			**48.3**	**44.3**	**41.7**	**37.7**	**32.2**	**28.1**	**24.5**
o/w foreign-currency denominated	75.3	78.9	73.4	66.5	53.2			44.4	40.2	36.8	32.7	27.3	22.6	19.2
Change in public sector debt	-34.1	3.4	-5.8	-7.1	-13.7			-7.9	-4.0	-2.6	-3.9	-5.6	-4.1	-3.6
Identified debt-creating flows (4+7+12)	-11.8	2.3	-5.2	-5.5	-2.6			-2.1	-7.0	-5.2	-2.9	-2.3	-1.3	0.7
Primary deficit	-5.2	-2.8	-3.0	-2.8	-1.6			-1.7	-2.8	-2.8	-2.4	-2.0	-1.7	-1.5
Revenue and grants	35.4	38.5	38.7	37.6	36.5			37.9	38.4	37.3	36.8	38.7	39.0	38.1
Primary (noninterest) expenditure	30.2	35.7	35.7	34.7	34.9			36.2	35.6	34.4	34.5	36.7	37.3	36.6
Automatic debt dynamics 2/	-12.3	-0.7	-5.1	-3.9	-3.5			-1.3	-2.7	-1.6	-1.2	-1.0	-0.9	-0.8
Contribution from interest rate/growth differential 3/	-21.0	-0.8	-5.1	-3.9	-3.5			-1.3	-2.7	-1.6	-1.2	-1.0	-0.9	-0.8
Of which contribution from real interest rate	-17.5	0.9	-1.2	-1.1	-0.3			1.0	-0.4	0.5	0.8	0.8	0.7	0.6
Of which contribution from real GDP growth	-3.5	-1.7	-4.0	-2.8	-3.1			-2.3	-2.3	-2.1	-2.0	-1.8	-1.6	-1.4
Contribution from exchange rate depreciation 4/	8.8	0.1	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other identified debt-creating flows	5.6	5.9	3.0	1.3	2.5			0.9	-1.5	-0.7	0.7	0.6	1.4	3.0
Privatization receipts (negative)	-1.5	-2.1	-1.3	-2.9	-0.9			-1.1	-3.4	-2.5	-0.9	-0.8	0.0	0.0
Recognition of implicit or contingent liabilities	7.1	8.0	4.3	4.2	3.3			2.0	1.9	1.8	1.6	1.5	1.4	1.3
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	1.7
Residual, including asset changes (2-3)	-22.3	1.0	-0.6	-1.6	-11.1			-5.8	3.0	2.6	-1.1	-3.2	-2.8	-4.3
Public sector debt-to-revenue ratio 1/	224.5	215.0	198.9	186.1	154.1			127.4	115.4	111.8	102.5	83.1	72.0	64.3
Gross financing need 5/	8.5	7.6	7.0	6.1	4.8			4.1	3.7	1.5	2.5	3.7	2.6	2.4
in billions of euros	1.0	0.9	1.0	0.9	0.8			0.7	0.7	0.3	0.6	0.9	0.7	0.7
Key Macroeconomic and Fiscal Assumptions														
Real GDP growth (in percent)	4.0	2.3	5.4	4.1	4.9	4.1	1.2	4.3	5.2	5.2	5.3	5.3	5.5	5.5
Average nominal interest rate on public debt (in percent) 6/	4.8	5.0	5.5	5.4	3.4	4.8	0.8	4.0	4.4	4.7	5.4	5.8	5.9	5.9
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-18.9	1.3	-1.2	-1.3	-0.3	-4.1	8.3	1.9	-0.7	1.5	2.2	2.6	2.7	2.7
Nominal appreciation (increase in euro value of local currency, in percent)	-9.1	-0.1	0.0	0.0	0.0	-1.8	4.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Inflation rate (GDP deflator, in percent)	23.7	3.7	6.7	6.7	3.8	8.9	8.4	2.1	5.1	3.2	3.2	3.2	3.2	3.2
Growth of real primary spending (deflated by GDP deflator, in percent)	25.9	20.7	5.4	1.3	5.5	11.8	10.8	8.2	3.3	1.8	5.4	12.2	7.0	3.6
Primary deficit	-5.2	-2.8	-3.0	-2.8	-1.6	-3.1	1.3	-1.7	-2.8	-2.8	-2.4	-2.0	-1.7	-1.5
											II. Stress Tests for Public Debt Ratio			
A. Alternative Scenario														
A1. Key variables are at their historical averages in 2004-08 7/								**48.3**	**43.0**	**38.4**	**32.0**	**23.7**	**17.2**	**11.4**
B. Bound Tests														
B1. Real interest rate is at historical average plus two standard deviations in 2004 and 2005								**48.3**	**50.1**	**52.4**	**48.2**	**42.3**	**37.9**	**34.1**
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005								**48.3**	**47.1**	**48.4**	**46.5**	**43.1**	**41.1**	**39.6**
B3. Primary balance is at historical average minus two standard deviations in 2004 and 2005								**48.3**	**46.6**	**46.2**	**42.1**	**36.4**	**32.2**	**28.5**
B4. Combination of 2-4 using one standard deviation shocks								**48.3**	**48.5**	**49.2**	**45.0**	**39.1**	**34.8**	**31.0**
B5. One time 30 percent real depreciation in 2004 8/								**48.3**	**66.7**	**63.3**	**58.7**	**52.6**	**47.9**	**43.8**
B6. 10 percent of GDP increase in other debt-creating flows in 2004								**48.3**	**54.3**	**51.3**	**47.1**	**41.3**	**36.9**	**33.1**

1/ This represents gross public sector debt, and thus is different from general government debt figures shown elsewhere.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of euro).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
6/ Derived as nominal interest expenditure divided by previous period debt stock.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Real depreciation is defined as nominal depreciation (measured by percentage fall in euro value of local currency) minus domestic inflation (based on GDP deflator).
9/ Assumes that key variables (real GDP growth, real interest rate, and primary balance) remain at the level in percent of GDP/growth rate of the last projection year.

Table 12. Bulgaria: Public Debt Sustainability Framework--Gross Public Sector Financing Need, 1998-2009
(In percent of GDP, unless otherwise indicated)

	Actual					Prel.	Projections					
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
I. Baseline Projections												
Gross financing need 1/	8.5	7.6	7.0	6.1	4.8	4.1	3.7	1.5	2.5	3.7	2.6	2.4
in billions of euros	1.0	0.9	1.0	0.9	0.8	0.7	0.7	0.3	0.6	0.9	0.7	0.7
II. Stress Tests												
Gross financing need 2/												
A. Alternative Scenario												
A1. Key variables are at their historical averages in 2003-08						4.1	1.8	-1.2	-1.1	-0.6	-1.7	-2.1
B. Bound Tests												
B1. Real interest rate is at historical average plus two standard deviations in 2004 and 2005						4.1	10.1	7.4	3.7	5.4	4.0	3.9
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005						4.1	5.2	4.4	5.8	7.8	6.8	7.0
B3. Primary balance is at historical average minus two standard deviations in 2004 and 2005						4.1	6.2	4.2	3.0	4.4	3.2	3.0
B4. Combination of 2-4 using one standard deviation shocks						4.1	7.4	4.4	3.4	4.8	3.5	3.4
B5. One time 30 percent real depreciation in 2004						4.1	5.8	3.7	5.0	7.1	5.4	5.3
B6. 10 percent of GDP increase in other debt-creating flows in 2004						4.1	4.6	2.5	3.6	5.2	3.8	3.7
Gross financing need in billions of euros 2/												
A. Alternative Scenario												
A1. Key variables are at their historical averages in 2003-08						0.7	0.3	-0.2	-0.2	-0.2	-0.4	-0.6
B. Bound Tests												
B1. Real interest rate is at historical average plus two standard deviations in 2004 and 2005						0.7	2.0	1.6	0.9	1.3	1.1	1.1
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005						0.7	1.0	0.9	1.2	1.8	1.7	1.9
B3. Primary balance is at historical average minus two standard deviations in 2004 and 2005						0.7	1.2	0.9	0.7	1.1	0.9	0.9
B4. Combination of 2-4 using one standard deviation shocks						0.7	1.4	0.9	0.7	1.2	0.9	1.0
B5. One time 30 percent real depreciation in 2004						0.7	0.7	0.5	0.7	1.1	1.0	1.0
B6. 10 percent of GDP increase in other debt-creating flows in 2004						0.7	0.9	0.5	0.8	1.3	1.0	1.1

1/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
2/ Gross financing under the stress test scenarios is derived by assuming the same ratio of short-term to total debt as in the baseline scenario and the same average maturity on medium- and long term debt. Interest expenditures are derived by applying the respective interest rate to the previous period debt stock under each alternative scenario.

Table 13. Bulgaria: Capacity to Repay the Fund, 2003-2009 1/

	2003	2004	2005	2006	2007	2008	2009
Fund repurchases and charges							
In millions of SDRs	86.1	89.2	178.1	227.2	205.4	142.6	82.8
In millions of euros	106.4	107.2	213.8	272.8	246.6	170.9	99.1
In percent of exports of goods and NFS	1.1	1.0	1.7	2.1	1.7	1.1	0.6
In percent of total debt service	9.0	6.4	15.9	16.5	11.5	8.4	4.5
In percent of quota	13.4	13.9	27.8	35.5	32.1	22.3	12.9
In percent of gross international reserves	2.0	1.8	3.6	4.6	4.1	2.7	1.5
Fund credit outstanding							
In millions of SDRs	799.2	784.2	650.5	456.6	251.2	108.6	25.8
In millions of euros	988.3	942.7	780.9	548.4	301.5	130.2	30.9
In percent of exports of goods and NFS	10.5	8.4	6.4	4.2	2.1	0.8	0.2
In percent of quota	124.8	122.5	101.6	71.3	39.2	17.0	4.0
In percent of gross international reserves	18.6	16.1	13.2	9.3	5.0	2.0	0.5
Memorandum items:							
Exports of goods and NFS (in millions of euros)	9,453.1	11,240.6	12,258.5	13,178.2	14,412.9	15,892.5	17,531.2
Debt service (in millions of euros)	1,178.9	1,665.3	1,344.0	1,651.0	2,136.9	2,046.4	2,213.3
Quota (in millions of SDRs)	640.2	640.2	640.2	640.2	640.2	640.2	640.2
Quota (in millions of euros)	753.2	779.4	778.2	778.4	777.6	776.2	774.6
Gross international reserves (in millions of euros)	5,308.6	5,861.6	5,936.5	5,889.5	5,977.7	6,377.5	6,699.3
Euros per SDR (period avg)	1.24	1.20	1.20	1.20	1.20	1.20	1.20
Euros per SDR (eop)	1.18	1.22	1.22	1.22	1.21	1.21	1.21

Source: Fund staff calculations.

1/ Assumes that all purchases are made under the proposed arrangement, and that repurchases are made on the expectations schedule.

Table 14. Bulgaria: Financial Relations with the Fund, 2000-2009

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
					(In millions of SDR)					
Purchases										
SBA	0.0	0.0	84.0	104.0	52.0	0.0	0.0	0.0	0.0	0.0
EFF	156.9	104.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Obligations schedule										
Repurchases	250.2	580.3	437.1	72.2	74.7	110.4	169.4	199.6	159.9	85.0
Charges and interest	33.8	36.7	18.1	13.8	20.0	20.6	17.0	11.9	6.7	3.0
Fund credit outstanding	1,014.6	883.0	771.8	799.2	776.5	666.1	496.7	297.1	137.3	52.3
Expectations schedule										
Repurchases	250.2	580.3	437.1	72.2	89.2	178.1	225.8	186.0	102.4	52.3
Charges and interest	33.8	36.7	18.1	13.8	20.0	19.7	14.1	8.2	3.8	1.5
Fund credit outstanding	1,014.6	883.0	771.8	799.2	762.0	583.9	358.1	172.1	69.7	17.4
					(In percent of quota)					
Purchases										
SBA	0.0	0.0	13.1	16.2	8.1	0.0	0.0	0.0	0.0	0.0
EFF	24.5	16.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Obligations schedule										
Repurchases	39.1	90.6	68.3	11.3	11.7	17.2	26.5	31.2	25.0	13.3
Charges and interest	5.3	5.7	2.8	2.2	3.1	3.2	2.7	1.9	1.1	0.5
Fund credit outstanding	158.5	137.9	120.5	124.8	121.3	104.0	77.6	46.4	21.4	8.2
Expectations schedule										
Repurchases	39.1	90.6	68.3	11.3	13.9	27.8	35.3	29.1	16.0	8.2
Charges and interest	5.3	5.7	2.8	2.2	3.1	3.1	2.2	1.3	0.6	0.2
Fund credit outstanding	158.5	137.9	120.5	124.8	119.0	91.2	55.9	26.9	10.9	2.7

Source: Fund staff calculations.

Table 15. Bulgaria: Schedule of Purchases Under the Proposed Stand-By Arrangement

	Amount of Purchase 1/		
Date	In millions of SDRs	In percent of quota	Conditions
August 6, 2004	12.0	1.9	Board approval of Stand-By Arrangement
December 15, 2004	11.0	1.7	Observance of end-September 2004 performance criteria
March 15, 2005	11.0	1.7	Observance of end-December 2004 performance criteria and completion of first review
June 15, 2005	11.0	1.7	Observance of end-March 2005 performance criteria
September 15, 2005	11.0	1.7	Observance of end-June 2005 performance criteria and completion of second review
December 15, 2005	11.0	1.7	Observance of end-September 2005 performance criteria
March 15, 2006	11.0	1.7	Observance of end-December 2005 performance criteria and completion of third review
June 13, 2006 2/	11.0	1.7	Observance of end-March 2006 performance criteria
September 15, 2006	11.0	1.7	Observance of end-June 2006 performance criteria and completion of fourth review
Total	**100.0**	**15.6**	

Source: Fund staff calculations.

1/ Assuming maximum proposed access. The authorities plan to treat the arrangement as precautionary and do not intend to make any purchases.
2/ Board date for 2006 Article IV consultation.

Bulgaria: Fund Relations
As of May 31, 2004

I. **Membership Status**: Joined 09/25/1990; Article VIII as of 09/24/1998

II. **General Resources Account**:	SDR million	%Quota
Quota	640.20	100.00
Fund holdings of currency	1,427.48	222.97
Reserve position in Fund	32.78	5.12

III. **SDR Department**:	SDR million	%Allocation
Holdings	57.96	N/A

IV. **Outstanding Purchases and Loans**:	SDR million	%Quota
Stand-by	236.00	36.86
EFF	584.04	91.23

V. **Financial Arrangements**:

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
Stand-by	02/27/2002	03/15/2004	240.00	240.00
EFF	09/25/1998	09/24/2001	627.62	627.62
Stand-by	04/11/1997	06/10/1998	371.90	371.90

VI. **Projected Payments to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):[7]

	Forthcoming				
	2004	2005	2006	2007	2008
Principal	58.08	178.07	225.76	186.01	102.39
Charges/Interest	11.07	19.65	14.10	8.22	3.81
Total	69.16	197.72	239.85	194.23	106.20

[7] On expectation basis.

VII. **Safeguards Assessment**:

Under the Fund's safeguards assessment policy, the Bulgarian National Bank (BNB) was subject to an assessment with respect to the SBA arrangement which was approved on February 27, 2002. The assessment, which was completed on June 12, 2002, identified certain weaknesses and made appropriate recommendations, as reported in Country Report No. 02/174. The BNB has implemented most of the safeguards recommendations and committed to implementing the remaining ones. Currently, the BNB is subject to a subsequent assessment with respect to the expected, new arrangement. The necessary documentation has been provided by the authorities and the assessment is underway.

VIII. **Exchange Arrangement**:

An amendment to the Law on the Bulgarian National Bank (BNB) effectively established a currency board arrangement from July 1, 1997. The deutsche mark was chosen as the peg currency, which has since been replaced with the euro at the rate of lev 1.95583 per € 1 at par. The BNB is buying and selling euros in noncash transactions at the parity rate. In cash transactions it levies a commission of 0.5 percent on the selling side. Bulgaria has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement, and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

IX. **Article IV Consultation**:

The last Article IV consultation was concluded on June 14, 2004 (see IMF Country Report No. 04/176). Bulgaria is on a 12-month cycle. The Acting Chairman's summing-up of the discussion was circulated as SUR/04/60.

X. **FSAP Participation and ROSCs**:

Bulgaria participated in an FSAP held from October 29 to November 14, 2001. A focused FSAP update was conducted as part of the 2004 Article IV consultation mission. Table 16 provides information on the production of ROSCs.

XI. **Technical Assistance**

Table 17 provides information on IMF technical assistance activities in Bulgaria.

Table 16. Bulgaria: ROSCs

Standard/code assessed	Date of issuance	Document number
ROSC update – Data dissemination and fiscal transparency.	08/07/2002	IMF Country Report No. 02/172
ROSC – Monetary and financial policy transparency, banking supervision, securities regulation, insurance regulation, and payment systems	07/15/2002	IMF Country Report No. 02/188
ROSC update – Data dissemination, fiscal transparency, transparency of monetary and financial policies, banking supervision, deposit insurance, insurance supervision, securities market supervision	03/08/2001	www.imf.org
ROSC – Data dissemination, fiscal transparency, transparency of monetary policy, banking supervision, system of deposit insurance, insurance supervision, securities market supervision	03/17/2000	www.imf.org
Experimental ROSC – Data transparency, fiscal transparency, transparency of monetary policy, banking supervision, system of deposit insurance, insurance supervision, securities market supervision, insurance supervision, accounting and auditing practices	08/27/1999	www.imf.org

XII. **Resident Representatives**:

Mr. James Roaf took up the resident representative position on August 24, 2003.

Table 17. Bulgaria: Technical Assistance, 1999–2004

Dept.	Subject/Identified Need	Action	Timing	Counterpart
MAE	Accounting	Expert	Jun. & Aug./Sep.99	BNB
MAE	Transparency Report/Based Core Principles	Mission	Jul. 99	BNB
MAE	Deposit insurance	Mission	Oct. 99	BNB
MAE	Accounting	Expert	Feb. 00	BNB
MAE	Payment system/liquidity management/ bankruptcy legislation	Mission	May 00	BNB
MAE	Bankruptcy legislation	Expert	Jun. 00	BNB
MAE	Foreign exchange	Mission	Nov. 00	BNB
MAE	Accounting	Expert	Nov.-Dec. 00	BNB
MAE	Short-term advisor payment system	Expert	Jun. 01	BNB
MAE	Accounting and Internal Audit	Expert	Apr. 02	BNB
MAE	Foreign Exchange	Expert	Apr. 02	BNB
MAE	Review of TA needs resulting from FSAP	Mission	May 02	BNB
MAE	Accounting	Expert	Aug. 02	BNB
MAE	Accounting	Expert	Oct. 02	BNB
MAE	Accounting	Expert	Mar.-Apr. 03	BNB
MFD	Accounting	Expert	Oct. 03	BNB
FAD	Budget General	Expert	Jun. 99	MOF
FAD	Tax administration	Expert	Jul. 99	MOF
FAD	Public Expenditure Management	Mission	Sep. 99	MOF
FAD	Budget General	Expert	Oct. 99-Oct. 00	MOF
FAD	Tax Administration	Mission	Jan. 00-Feb. 00	MOF
FAD	Tax Administration Advisor	Expert	Apr.-Jun. 00	MOF
FAD	Tax Administration	Expert	Apr.-May 00	MOF
FAD	Tax Administration	Expert	May-Jun. 00	MOF
FAD	Tax Administration	Expert	Jun. 00	MOF
FAD	Tax Administration	Expert	Sep. 00-01	MOF
FAD	Expert Installation mission/Tax Administration	Expert	Oct. 00	MOF
FAD	Tax Administration-Follow-up Mission	Mission	Jan. 01	MOF
FAD	Public Expenditure Management	Mission	Jan.-Feb. 01	MOF
FAD	Mission for Workshop	Mission	Jun. 01	MOF
FAD	Tax Administration Follow-up Mission	Expert	Sep. 01	MOF
FAD	Customs administration	Mission	Oct. 01	MOF
FAD	Tax policy	Mission	Jan. 02	MOF
FAD	Budget General	Expert	Apr. 02-Mar. 03	MOF
FAD	TA Expert Installation Mission	Expert	Apr. 02	MOF
FAD	Tax Administration Follow-Uup Mission	Mission	Apr. 02	MOF
FAD	Tax Administration	Expert	Sep.-Oct. 02	MOF
FAD	Budget General: Inspection	Expert	Jan. 03	MOF
FAD	Tax Administration-Installation Visit	Expert	Mar.03	MOF
FAD	Tax Administration	Expert	Mar.-Apr. 03	MOF
FAD	Public Expenditure Management	Expert	Apr-Sep. 03	MOF
FAD	Tax Administration	Mission	Apr. 04-May. 04	MOF
STA	BOP statistics	Mission	Jun.-Jul. 99	BNB
STA	GDDS	Mission	Jul. 99	BNB
STA	National accounts	Mission	Nov. 99	NSI
STA	Price statistics	Mission	Jun. 00	NSI
STA	BOP statistics	Mission	Dec. 00	BNB
STA	Producer prices	Mission	Nov. 01	NSI
STA	Producer prices	Mission	Apr. 02	NSI
STA	Price statistics	Mission	May 02	NSI
STA	Producer prices	Mission	Jan 03	NSI
STA	Data ROSC	Mission	Jan.03	BNB/MOF/NSI
STA	SDDS	Mission	Sep. 03	BNB

Bulgaria: IMF-World Bank Relations

A. Partnership in Bulgaria's Development Strategy

1. The government's economic program has been underpinned by a conservative fiscal policy and significant progress with structural reforms. So far Bulgaria has made substantial progress towards long-term macroeconomic stability—an important step along the way to its ultimate goals of improving living standards and accession to the EU. The wide-ranging reforms in the government's agenda hinge on the continuing challenge of macroeconomic stability in the context of the Currency Board Arrangement (CBA), sustaining structural reforms and establishing a business environment conducive to growth, together with improved governance, a deeper financial system, and investment in human capital and physical infrastructure.

2. The IMF has been leading in supporting Bulgaria's medium-term program in maintaining macroeconomic stability. Building on the achievements of the three-year Extended Fund Facility (EFF) arrangement with Bulgaria, in February 2002 the IMF Board approved a two-year Stand-By Arrangement (SBA) with Bulgaria. The SBA, with a reduced scope and detail of structural conditionality compared to the EFF, focused on medium-term fiscal challenges and structural reforms with significant macroeconomic, typically fiscal, implications. Currently the IMF and the government are discussing a new 2-year precautionary program.

3. The World Bank has been leading the policy dialogue in structural and institutional reforms aiming at (i) promoting competitive private sector-led growth; (ii) strengthening market institutions and improving both corporate and public sector governance; and (iii) mitigating the social impact of restructuring and delivering social services more effectively. In May 2002 the Board of Directors discussed the Country Assistance Strategy (CAS) of the Bank which outlined the roadmap for the Bank's country support for the period 2002–04. In addition to the Bank's ongoing lending operations in areas such as health, child welfare, water, trade and transport, environment, land registration and cadastre, the CAS includes a three-year programmatic adjustment lending (PAL) program of up to three PALs of up to US$150 million each. In February 2003, the Board of Directors approved the first PAL operation—it aimed at advancing structural, regulatory, and institutional reforms in the real and financial sectors. In June 2004, the Board of Directors approved the second PAL, which aims at supporting improvements in public sector governance. The Bank continues to undertake substantive country diagnostics providing a solid base for policy dialogue and design and implementation of its lending operations in Bulgaria.

B. IMF-World Bank Collaboration in Specific Areas

4. In general, the Bank has the lead on the dialogue on the core structural aspects of the reforms while the Fund has the lead on the dialogue on the macroeconomic, typically fiscal, aspects of the reforms. There are a number of areas where the IMF leads and its analyses serve as inputs into World Bank policy formulation and advice, including policies to maintain macroeconomic stability, fiscal policies, income policies and external sector policies. There are other areas in which the Bank and the Fund share responsibility and are coordinating closely their policy advice to the Bulgarian authorities such as in the financial sector, public expenditure management and budgeting, and tax administration. In some areas, the Bank has taken the lead

but its analysis, country diagnostic work, and policy recommendations served as inputs into the Fund's policy advice on the fiscal front such as education, health care, pensions, social protection, energy, and railways. In areas such as private sector development, strengthening market institutions (including entry and exit policies, regulatory reform to enhance the business climate, judicial reform, labor market reform), and improving governance the Bank has the lead and there has been no conditionality under Fund programs. In addition to consultations early in the process of formulating and adjusting each institution's program with Bulgaria, the Bank and Fund staff teams interact extensively during the review of the progress achieved in the country and coordinate closely their policy advice to the Bulgarian authorities.

B.1. Areas where the IMF leads and its analyses serve as inputs into the World Bank policy formulation and advice.

5. To achieve the objectives of its economic program, the Bulgarian authorities are fully committed to maintain sound and flexible macroeconomic policies centered on a Currency Board Arrangement (CBA) and implement an ambitious reform agenda. In particular, the authorities have maintained a very tight fiscal policy since 1998 and, attaining a deficit of 0.4 percent of GDP in 2003. The aim is to have at least balanced budget in 2004 and a surplus of 0.9 percent of GDP in 2005, conduct fiscal policy flexibly in the face of shocks, and maintain a high level of fiscal reserve assets. Given the constraints of the CBA, the authorities see labor market policies as another key component of the broad policy strategy. A strict incomes policy for the state enterprise sector is enforced and measures aimed at facilitating the adjustment of labor markets are being implemented. The structural and institutional reforms, which constitute the third pillar of the policy strategy, are focused on creating a fully functioning market economy that is competitive and can flexibly adjust to shocks.

6. In the context of a 24-month Stand-By Arrangement that expired on March 15, 2004, the IMF took the lead in assisting Bulgaria in safeguarding macroeconomic stability and promoting structural reforms in areas that are macro-critical and fall within the Fund's core expertise. To safeguard the CBA and ensure that it can continue to serve as the macroeconomic policy anchor, the IMF set ceilings on the size of the overall deficit of the general government and quantitative floors on the balance of the fiscal reserve account. To prevent threats to the currency board and macroeconomic stability that could arise from a loss in competitiveness or excessive external financing requirements, Fund conditionality also included ceilings on the wage bill of those state enterprises that have the largest losses and arrears, are monopolies, and receive subsidies, and on the contracting and guaranteeing of public sector external debt. A new 2-year precautionary program is currently being discussed.

B.2. Areas of shared responsibility.

7. **Financial Sector.** In late 2001, staff of the two institutions carried out a joint IMF-World Bank *Financial Sector Assessment Program* (FSAP) for Bulgaria, providing a shared perspective on the development agenda of the country and on the prioritization and sequencing of reforms in the financial sector. Key findings of the FSAP are conditionalities on financial sector policies under both the SBA and the PAL program. The IMF has emphasized aspects related to the banking sector—mainly on policies under the mandate of BNB and supervisory agencies—while the World Bank is focusing on policies that affect market performance and development of the financial sector such as improving the legal and institutional framework for lending,

restructuring of the banking sector, strengthening creditor rights, corporate insolvency and governance, and non-banking financial sector issues. A focused update of the FSAP was undertaken by Fund staff in the context of the 2004 Article IV consultation mission in March–April 2004.

8. Since 1997, in the context of two Finance and Enterprise Adjustment Loans (FESALs), and now with the PAL program, the Bank has supported the government in sector restructuring of the financial sector. Privatization of commercial banks has been a major component of the FESALs, while the Fund provided support for the institution building efforts of the BNB and its Banking Supervision Department in particular. In the financial sector, the Bank has focused on banking, insurance, pension funds, and capital markets while the Fund has continued its focus on the BNB, banking supervision, and the payments system.

9. **Revenue Administration.** The IMF and the World Bank have been carrying out a joint effort since 1996 to assist Bulgaria in reforms aimed at the establishment of an efficient revenue collection agency. Diagnostics consistently pointed to revenue collection deficiencies including weak management, and problematic audit and enforcement of collection, which in turn facilitates low compliance. Supporting reform efforts, the World Bank implemented a project to modernize the Social Security Institute, including its revenue collection activities. The IMF provided a long-term advisor to the Ministry of Finance, and focused advisory services through consulting assignments. Joint World Bank-IMF efforts resulted in a proposal for "Implementing a Modern Revenue Collection Agency" in March 2000, which is now moving forward. The World Bank's Board approved on June 5, 2003 the Revenue Administration Reform Project (RARP, €31.9 million), developed with technical assistance of the IMF, to support the establishment of the national revenue agency (NRA), which seeks to maximize the level of voluntary taxpayer compliance, promote effectiveness and efficiency, establish a professional workforce and approach to collection, and help reduce the scope for corruption. The RARP became effective on August 7, 2003.

10. **Public Expenditure Management.** The Bank has taken the lead in the dialogue on the efficiency and effectiveness of public expenditures and has outlined policy directions in the context of the Public Expenditure and Institutional Review (PEIR)[8] which are being further supported by the PAL program. The PEIR has also been a useful input to the IMF program. The PEIR notes that notwithstanding progress to date, important challenges remain in: (i) improving management and accountability in the use of public resources; (ii) restructuring and rationalizing intersectoral public expenditure—particularly energy and railways, economic services, defense and security, and general services; (iii) reallocation of intrasectoral priorities—especially in health, education, and social protection; and (iv) higher investment requirements in many sectors—infrastructure and environment—some of which are priorities for EU accession, and some of which should involve the private sector. The PEIR notes that Bulgaria's main fiscal challenges include working towards an improved allocation of expenditures, while gradually reducing the overall level of expenditures over the medium term in tandem with Bulgaria's fiscal targets of easing the overall tax burden, especially payroll taxes.

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[8] The PEIR is entitled *Bulgaria: Public Expenditure Issues and Directions for Reform*, August 2002, The World Bank, (Report No. 23979-BUL)

11. The IMF has provided long-term technical assistance on budgeting and expenditure management. To ensure the fiscal discipline necessary to support the CBA, the government has already initiated a number of public expenditure management reforms. New budget procedures were introduced in early 2002 and were implemented for the 2003 budget. Despite this important progress, the PEIR notes that there is a need to continue and broaden the reform effort—capital expenditure proposals should be prepared under hard budget constraints and as an integral part of the medium-term budget frameworks; and the financial management at the local level should be strengthened. These reforms are also supported by the Bank through the PAL program.

B.3. Areas where the World Bank leads and its analyses serve as inputs into the IMF policy formulation and advice.

12. **Energy sector.** The Bank has played the lead role in assisting the government in the design of the reform program in the sector, and more importantly on its implementation. After the completion of the Energy Project at end-2000, the Bank has continued to support the developmental objectives of the sector to increase the energy efficiency. Under the PAL program, the government has strengthened the legal and regulatory framework and initiated steps to enable the private sector to assume an increasing share of commercial risks. Policy recommendations have been outlined in the Bank Energy and Environment Review completed in 2003, which aimed at also evaluating alternative strategies to balance the need for economic development and environmental protection. In June 2003 the Bank's Board approved two district heating projects to support the rehabilitation of the Sofia and the Pernik District Heating Companies. The Fund's and the Bank's teams have worked collaboratively in close consultations with the government on energy price increases, and the SBA included a performance criterion focusing on implementation of the schedule for bringing electricity prices to full cost recovery level, and two benchmarks—one on implementation of the new regulatory pricing regime, and the other on preparing a new Energy Act to harmonize Bulgaria's legislation with EU Directives. In addition, in the proposed SBA program, the Fund included a performance criterion on selection of winning bids for the sale of seven electricity distribution companies.

13. **Railways.** The Bank has been the government's main external partner in the transformation of the railway sector, particularly through the Railway Rehabilitation Project, which was completed in June 2002. This transformation is at present only half way achieved. Some essential measures have been implemented under the PAL program, especially the divestiture of all railway ancillary activities, securing a major reduction in staffing, and completing the institutional separation of the national company into two new infrastructure and rail services enterprises together with the opening of rail services to private operators. Key remaining steps include tariff reform, reduction of loss making services to only those that can be socially justified and supported by state contracts (public service obligations), further reduction of staff, and improved corporate governance. They were refined in the context of the recent PEIR and are being supported by the Bank through the PALs. Detailed assistance with the design of these reforms will be further provided through transport sector work in the near future.

14. **Bulgartabac.** Expanding the role of the private sector in the economy is also being supported by the PAL program—for example the privatization of the tobacco monopoly, Bulgartabac, which was also included as a structural benchmark in the proposed SBA of the Fund.

15. **Education.** The reform efforts in the education sector aim at improving expenditure management in view of the declining population, especially in school age, and at enhancing quality and access to education. The main priority in the education sector, including universities, is to reallocate expenditures from surplus capacity in teaching staff and underused facilities toward modernization and upgrading of curricula, textbooks, teaching materials, schools, and other quality-enhancing education inputs. The Bank has supported the government program in education through the Education Modernization Project loan (closed on March 31, 2004), the PALs, and the analytical work done for the Poverty Assessment, the PEIR, and the Inter-governmental Finance study[9]. Under PAL-2 the government has developed a concept for an education reform strategy and action plan, the implementation of which would be supported though PAL-3.

16. **Health care.** Key reform priorities in the health sector include addressing the concurrent problems of surplus capacity issues in health facilities, the serious deterioration in the quality of facilities and health services, and the inadequate modernization of equipment. At the same time, the government needs to ensure the financial integrity of the NHIF, which is the central point of the reforms in the sector. For a long time the Bank has been supporting the restructuring of the health sector through the Health Sector Restructuring Project which was closed at end-2001. The follow-up Health Sector Reform project approved in late 2000 is under implementation and focuses on the administrative and information systems of the NHIF, and supports the ambulatory care sector and the hospital sector.

17. **Social protection programs.** Social protection programs—pensions, labor market programs, social assistance, and short-term and family benefits—have a wide coverage among the population. On pensions, one reform priority is to improve compliance with, and coverage of, the public pillar, and define a clear rule for indexing pensions. During FY04, the preparation of a policy-oriented note will support the pension policy dialogue. On labor market programs, there is a need to monitor these closely to improve their effectiveness and long-term impact in stimulating labor demand. Subject to progress in key reforms, consideration should be given to reduce the tax burden related to labor market policies in order to curtail labor costs.[10] Some social assistance and benefit programs have become more pro-poor since the mid-1990s and are playing a major role in alleviating poverty. However, given the plethora of these programs, and the complexity of program design in many cases, a constant challenge of the social protection system as a whole is to examine opportunities for consolidation and engage in systematic monitoring of the programs, their costs and effectiveness.

18. The Bank has been the main partner of the government in its efforts to address poverty reduction and meet its social development objectives. The main findings of the Poverty Assessment and the PEIR contribute significantly to the enhanced policy dialogue with the government on its policy options to improve living standards in the country, and increase the

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[9] *Issues in Intergovernmental Relations*, the World Bank, January 27, 2004, Report No. 25821-BUL.

[10] However, such fiscal adjustment requires lowering public expenditures to GDP before implementing tax reductions.

effectiveness and adequacy of its social protection programs. The Bank is assisting these important reforms in the social protection system through providing grants amounting to US$2.2 million. The latter focus on poverty monitoring and evaluation, integration of ethnic minorities, child development and building social capital in disadvantaged communities. A Bank-financed Child Welfare Reform project helps address the needs of children in public care, while a Bank-financed Social Investment and Employment Promotion (SIEP), which supports community and employment creation and strengthening of ALMPs, was approved in 2002. The IMF has been also monitoring the sustainability of the pension system and the advancing of the labor market reforms in terms of their relevance for the Fund's program objectives.

B.4. Areas where the World Bank leads and there is no direct IMF involvement.

19. **Private Sector Development.** Bulgaria has completed the divestiture of about 95 percent (based on value of assets) of its non-infrastructure state-owned enterprises (SOEs) since 1995. To encourage the entry of new firms and the expansion of existing ones, the business climate will have to be improved focusing on reducing barriers to entry, reducing compliance cost of the regulatory regime, developing a competitive environment, eliminating the constraints to bank lending, and establishing an efficient exit mechanism for non-viable enterprises. Under the PAL program, major changes in the basic legislation have been initiated - notably the Commercial Code, the Civil Procedure Code, and the passage of legislation on how the State will regulate economic activity to ensure stability and predictability of regulatory regimes

20. **In the context of the two Finance and Enterprise Adjustment Loans (FESALs) and the PAL program, the Bank has supported the government in sector restructuring of the non-infrastructure enterprise sector.** Privatization of SOEs has been a major component of the FESALs. Under PAL-1 and PAL-2, and currently under PAL-3, the Bank has led the dialogue on reforms covering the regulatory regimes, the insolvency process, and competition.

21. **Public sector governance.** The government is pursuing a broad program to improve public sector governance including strengthening the capacity of the public administration, improving service delivery, reducing corruption, and reforming the judiciary. The support of this program has been the main focus of PAL-2. The policy, legal and institutional framework has been developed and put in pace to strengthen merit and depolitization. Performance standards for service delivery have been developed and one-stop shop principles have been introduced in five central administrations and six regional administrations, the system of performance appraisal and professional development within the state administration has been enhanced. Concrete steps have been undertaken to increase accountability and transparency – the conflict of interest and asset declaration regime has been strengthened; a monitoring system to track progress in meeting the anti-corruption objectives has been designed; key ministries and agencies have prepared detailed and practical anticorruption action plans.

C. The World Bank Group Strategy and Lending Operations

The Country Assistance Strategy (CAS) for Bulgaria[1] discussed by the Bank's Board on May 9, 2002, focuses on three main themes: (i) promotion of competitive private sector led growth, (ii) strengthening public administration reforms and anti-corruption initiatives, and (iii) mitigating the social impact of restructuring and delivering social services more effectively.

Programmatic Adjustment Lending. Up to three Programmatic Adjustment Loans (PALs), the first two, PAL-1 and PAL-2, approved by the Board in February 2003 and June 2004 respectively, [2] support the government's reforms aiming at: (a) completion of privatization and restructuring in energy and infrastructure; (b) improving the environment for private sector led growth; (c) deepening the financial sector; (d) reducing poverty and improving human capital, and better delivery of social services; and (e) support public administration reform and anti-corruption programs.

Bank Assistance Program in Bulgaria to date comprises 34 operations for a total original commitment of US$1,970.9 million equivalent. This includes eleven adjustment loans (US$1,200.8 million), 19 investment projects (US$750.7 million), and two Bank-managed Global Environmental Fund (GEF) grants and one Bank-managed Prototype Carbon Fund (PCF) operation—Wood Residue to Energy. Of these 33 operations, 24 have been completed, of which two have been restructured and partially cancelled during implementation, and nine operations are currently under implementation.

IFC's Activities in Bulgaria comprise 17 projects (totaling US$213 million) in the support of financial sector development, infrastructure and restructuring of post-privatized companies. Of those, 15 projects were approved from 1999 on. In the financial sector, IFC has supported two specialized SME banks and established Bulgaria's first micro lending bank. In addition, IFC has invested in a leasing company and in a venture capital fund which targets the SME sector.

Economic and Sector Work. The country diagnostic work recently completed includes Bulgaria: Country Financial Accountability Assessment (2004) and Bulgaria: Inter-governmental Finances (2004). Other country diagnostic work being completed includes a study on environmental sequencing, an infrastructure and energy study, a national energy efficiency study, and an expenditure needs for roads study. Going forward, the Bank plans additional country diagnostic work including a CEM (Country Economic Memorandum) that focuses on policies for growth and EU integration.

Table 16. Bulgaria: World Bank Operations[3] (net of cancellations)

	Operation	US $ million	Board Date
1.	Trade and Transport Facilitation in Southeast Europe	7.4	2000
2.	Health Sector Reform	63.3	2000
3.	Child Welfare Reform	8.0	2001
4.	Registration and Cadastre	30.0	2001
5.	Wetlands Restoration and Pollution Reduction (GEF Grant)	7.5	2002
6.	Social Investment and Employment Promotion	50.0	2002
7.	Programmatic Adjustment Loan (PAL 1)	150.0	2003
8.	Revenue Administration Reform Project	34.2	2003
9.	District Heating Project	34.2	2003
10.	Wood Residue to Energy	2.0	2003
11.	Programmatic Adjustment Loan (PAL 2)	150.0	2004

[1] *Memorandum of the President of the International Bank for Reconstruction and Development and the International Finance Corporation to the Executive Directors on a Country Assistance Strategy of the World Bank Group for Bulgaria*, May 31, 2002.
[2] *Program Document for a Proposed Programmatic Adjustment Loan to the Republic of Bulgaria*, The World Bank, January 23, 2003. *Program Document for a Proposed Second Programmatic Adjustment Loan in the Amount of Euro 123.7 million to the Republic of Bulgaria, May 4, 2004.* PAL 2 is structured as a two tranche operation. The first tranche of €103.7 million is disbursed immediately after loan effectiveness. The second tranche of €20 million is linked to progress on Bulgartabak privatization and restructuring/liquidations.
[3] *Education Modernization project closed on March 31, 2004.*

Questions may be referred to Ms. R. Quintanilla (202-473-7673), Ms. Myla Taylor Williams (202-437-6997), or Ms. Stella Ilieva (359-2-9697-251).

Bulgaria: Statistical Issues

1. Bulgaria compiles and submits data to the Fund of sufficient quality and in a regular timely manner to adequately permit program monitoring and surveillance (Table 18). Despite a comprehensive economic database, problems remain in national accounts and price statistics, particularly in the coverage of the emerging private sector, as well as in the balance of payments statistics, where frequent and substantial revisions have hampered economic analysis. In addition, work remains to be done in fully reconciling high frequency data on economic activity with quarterly and annual national accounts data. Annual international investment position statistics are compiled and reported to STA for publication.

2. On December 1, 2003, Bulgaria subscribed to the International Monetary Fund's Special Data Dissemination Standard (SDDS), marking a major step forward in the development of the country's statistical system.

Real sector

3. The National Statistical Institute (NSI), with technical assistance from the OECD, has established a system to compile national accounts according to the recommendations of the European System of Accounts, 1995. GDP statistics by activity and expenditure categories are compiled and reconciled within an annual supply and use framework. Government output and final consumption are estimated on a cash rather than an accrual basis. In addition, Bulgaria publishes national accounts including current and capital accounts for the five main domestic sectors (general government, financial corporations, nonfinancial corporations, nonprofit institutions serving households, and households). As for most countries, the financial account and the balance sheets are missing.

4. A monthly industrial production index is compiled. An IMF STA national accounts statistics mission found problems with the quality of inventories data and the deflation method used to construct the industrial production index, and the mission made recommendations for their resolution.

5. The NSI has also compiled estimates of quarterly GDP by expenditure categories for the period beginning with first quarter of 1994 through the third quarter of 2002, based on significantly improved quarterly surveys. Problems remain in the methods for the deflation of some components of the national accounts, such as household consumption, capital formation, and external trade, and in the coverage of private sector activities. However, significant progress has been made in the development of export and import deflators.

6. The producer price index (PPI) is being revised. Detailed product specifications and transaction prices are being introduced gradually during the rotation of samples by branch classes. The NSI is in the process of expanding the collection of transaction prices throughout the industrial sector with 83 percent of domestic industry sales now covered. The new work program calls for completing the PPI revision process by June 2004. Publication of the rebased PPI began in March 2003, with the weights and reference period updated to 2000 and linked at December 2002 to form a continuous monthly series for the period January 2000 to January 2003.

7. The consumer price index (CPI) provides a reasonable measure of inflation and price developments in Bulgaria. The recommendations provided by STA missions have been broadly implemented. The NSI has completed the exercise to link annual Laspeyres price indices together, producing a time series that begins in 1995. This series also follows the new classifications and index methods recommended by Eurostat and STA, and has been published as the official CPI. The coverage of the index was extended, although it still does not include owner-occupied housing. A new method for imputing missing observations of new products is being applied, but quality adjustment procedures are only applied in a few particular cases (e.g., the heating component).

8. The flow of customs data has improved significantly since the April-May 1998 STA mission and a new system for processing customs records is near completion. The development of export and import unit value indices is progressing smoothly and additional support is expected from Eurostat in this area. The current indices can be used effectively as deflators for the import and export components of the national accounts. The Import and Export Division meets monthly with the Bulgarian National Bank to review data issues and ensure consistency between the NSI export and import data and the balance of payments data.

9. The lack of comprehensive labor statistics hampers the assessment of developments in employment and wages, especially in the private sector. Annual data are collected by the NSI, using a census of all establishments. The NSI also obtains current estimates from a monthly survey of establishments using all public employers and a sample of private employers (excluding establishments with less than 5 employees, and including about 10,000 private employers out of approximately 69,000 qualifying establishments). The main shortcomings of these data include: (i) the under-reporting of private sector wages; (ii) the reporting of only average gross earnings, not wages for time worked and wages by occupation; and (iii) the lack of coverage of the self-employed and employment in small firms. Plans for improvement include using National Social Security Institute (NSSI) data to estimate wages by occupation and age and the number of self-employed and employment in small firms. The household budget survey could provide an alternative source of data for private sector wages. Regarding employment, the NSI household labor force survey is an alternative source of data, but improvements are needed to make it more consistent with the establishment survey, especially regarding agricultural employment. The survey also needs to be conducted on a consistent schedule, semi-annually or quarterly. It has been conducted twice a year since 1993 (three times a year since 1999), but at irregular intervals. From 2001 onward, the NSI intended to conduct the survey on a quarterly basis. Also, Eurostat has been providing support since mid-2000 in the context of a pilot project ending in mid-2001 to improve the labor force survey's compliance with Eurostat recommendations.

10. A Population Census was conducted in early 2001 and is a source for redesign of the household surveys conducted by the NSI, particularly the household budget survey and the labor force survey.

Government finance

11. A combined STA/FAD mission in September 1999 reviewed progress under the budget execution reform program, assisted the MoF with the development of a new chart of accounts for the government sector, and provided advice on the implementation of accrual accounting for government, budgetary, and the statistical system. The mission also examined possible actions to improve fiscal transparency in line with the Experimental Report on the Implementation of Standards and Codes prepared in August 1999; key recommendations are to improve the fiscal data to meet fiscal reporting requirements for EU accession, in particular, implementing the new chart of accounts and the Financial Information Management System; disseminate information on arrears of central and local governments, local government debt, and details of financing; compile and disseminate discrete monthly and quarterly data; and update the MOF website monthly. Consolidated data on central government operations are routinely reported for publication in the *GFS Yearbook* and in *IFS*. For the *GFS Yearbook 2003*, 2002 data for the general government sector and its subsectors were reported on an accrual basis in accordance with *GFSM 2001*. The Ministry of Finance prepares data on the execution of the consolidated government on a monthly basis. These data do not conform to *GFS* standards and, while not published in a bulletin format, they are posted on the Ministry of Finance's website.

Money and banking statistics

12. Statistical methods conform with the key classification and valuation principles in the IMF's *Monetary and Financial Statistics Manual, 2000*. To address remaining deviations, the authorities reported that starting in January 2003, positions on financial derivatives, which at present are small, would be included in the balance sheets. Further, the consistency in the coverage of the BNB's claim on banks (which included claims on liquidated banks) and the banks' liabilities to the BNB had improved in January 2003 after the BNB had written off most of the claims on the liquidated banks. With respect to its near-term statistical program, the BNB is progressively harmonizing its data collection and compilation methods in line with the European Central Bank's framework for monetary statistics. In particular, a significant number of enhancements in sectoral and instrument detail and classification were made in the data for 1995 and onward. These were reflected in the revised monetary statistics published in the August 2002 and November 2003 issues of *IFS*.

Balance of payments

13. Bulgaria reports monthly balance of payments data on a regular and timely basis, but data are subject to frequent and substantial revisions. An IMF technical assistance mission in December 2000 made a number of recommendations to strengthen the balance of payments and external debt compilation systems, which included the development of a closed-type of international transactions reporting system, the development of estimates of "shuttle trade" with countries bordering Bulgaria, strengthening the methodology for travel transactions, and compiling data on trade credit liabilities. The treatment of the license to operate a mobile telephone service has been clarified and agreed with the BNB. The GSM license purchase

has been recorded under foreign direct investment, in Bulgaria's equity capital component in the first quarter of 2001. As there is no repayment obligation, the transaction does not change the country's external debt position. Balance of payments transactions related to the mobile phone license are no longer recorded for the subsequent periods. In 2003, the ROSC mission identified the following problems in the balance of payments statistics: i) residents' foreign currency accounts with resident banks are incorrectly included; ii) merchandise trade data are prone to errors and are not timely; and iii) most data are collected on a cash basis.

Table 18. Bulgaria: Core Statistical Indicators as of July 7, 2004

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govt. Balance	GDP	External Public Debt/ Debt Service
Date of Latest Observation	June 30 2004	May 2004	May 2004	May 2004	May 2004	June 2004	May 2004	April 2004	April 2004	May 2004	Q1 2004 (qtrly) 2001-03 (annual)	April 2004
Date Received	June 30 2004	June 30 2004	June 30 2004	June 30 2004	June 30 2004	June 30 2004	June 14 2004	June 30 2004	June 30 2004	June 24 2004	June 28 2004	June 30 2004
Frequency of Data	Daily	Daily	Weekly and Monthly	Weekly and Monthly	Weekly and Monthly	Weekly and Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly Annually	Monthly
Frequency of Reporting	Daily	Weekly	Weekly and Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly Annually	Monthly
Source of Update	BNB	BNB	BNB	BNB	BNB	BNB	NSI	NSI	BNB	MoF	NSI	MoF and BNB
Mode of Reporting	Email from BNB	Email from BNB	Email from BNB	Email from BNB	Email from BNB	BNB website	Email from NSI	NSI website	Email from BNB	Email/fax from RR	Email from NSI	Email from BNB
Confidentiality	No	Yes	Yes	Yes	No	No	No	No	No	No	No	No
Frequency of Publication	Daily	Daily	Weekly	Daily	Weekly and Monthly	Weekly	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly

Bulgaria: Tentative Work Program

1. UFR/Article IV missions, discussions, and Board meetings

a.	Board discussion of the use of Fund resources	August 6, 2004
b.	Staff visit on the 2005 budget	September 2004
c.	Use of fund resources—First review	November-December 2004
d.	Board discussion of the use of Fund resources—First review	February 2005

2. Technical assistance

a.	MFD: Accounting and internal audit	October 2004

3. World Bank—Policy-based lending (PAL3)

a.	Pre-appraisal mission	September 2004
b.	Appraisal mission	December 2004
c.	Board Discussion	March 2005

Sofia, Bulgaria
July 21, 2004

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Rato:

1. The Bulgarian authorities have prepared an economic and financial program for 2004-06 that aims at maintaining macroeconomic stability and strengthening the foundations for sustained high rates of economic growth in the runup to membership in the European Union, which we expect to obtain at the start of 2007. To achieve these objectives in light of risks posed by the external position, the program relies on fiscal adjustment, a tight incomes policy in the public sector, measures to reduce bank liquidity, and structural reform (including further privatization) in the context of the currency board arrangement. In support of our program, we herewith request a stand-by arrangement from the International Monetary Fund in an amount of SDR 100 million (15.62 percent of quota) to be made available over a 25-month period ending in September 2006.

2. The implementation of our program, which is described in the attached Memorandum of Economic and Financial Policies (MEFP), will be monitored through quantitative performance criteria and indicative targets in the fiscal and external sectors. In this regard, the MEFP proposes indicative targets for end-June 2004 and performance criteria for end-September 2004 and end-December 2004. Program implementation for the remainder of 2004 will also be monitored through 5 structural performance criteria and 10 structural benchmarks, all of which are listed in Annex I of the MEFP. The quantitative performance criteria are described in greater detail in Annexes II-IV.

3. The Government believes that the policies set forth in the MEFP are adequate to attain the objectives of its program, but it will take any further measures that may become appropriate for this purpose. Bulgaria will consult with the Fund on the adoption of these measures, and in advance of any revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. We will provide the Fund with such information as it requests on policy implementation and achievement of program objectives. In any event, there will be four reviews during the period of the requested arrangement, scheduled to take place by March 15, 2005, September 15, 2005,

March 15, 2006, and September 15, 2006 in order to assess progress in implementing the program and reach understandings on any additional measures that may be needed to achieve its objectives. In addition, (i) the first review will focus on the economic program for 2005 and set the performance criteria and structural benchmarks for the first half of 2005, (ii) the second review will set the performance criteria and structural benchmarks for the second half of 2005, and (iii) the third review will focus on the economic program for 2006 and set the performance criteria and structural benchmarks for the first half of 2006.

4. In view of Bulgaria's comfortable international reserves position and easy access to international capital markets, we intend to treat the requested arrangement as precautionary (i.e., we do not intend to make the purchases under the requested arrangement that will become available upon its approval and after observance of its performance criteria and completion of its reviews). We reaffirm our intention to make all outstanding repurchases to the Fund on the expectations schedule.

Sincerely yours,

/s/	/s/	/s/
Lydia Shouleva Deputy Prime Minister and Minister of Economy Republic of Bulgaria	Milen Veltchev Minister of Finance Republic of Bulgaria	Ivan Iskrov Governor Bulgarian National Bank

Attachment: Memorandum of Economic and Financial Policies

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

I. RECENT ECONOMIC DEVELOPMENTS AND POLICY IMPLEMENTATION

1. **Economic developments in 2003 were broadly satisfactory**. Led by private domestic demand and exports, real GDP grew by 4.3 percent, with an accelerating trend in the fourth quarter. A decline of agricultural output due to a severe drought was more than offset by large output gains in industry (especially manufacturing) and services (especially communications and tourism). In the context of this economic expansion, the unemployment rate dropped by more than 6 percentage points to 13½ percent, reflecting in equal measure active labor market policies and private sector job creation. Consumer price inflation declined to 2¼ percent on average, but its twelve-month rate rose to 5½ percent at end-2003 mainly due to rising food prices in the wake of the drought.

2. **Economic activity has remained strong in early 2004, but inflation has so far failed to decline.** Driven by investment and exports, real GDP growth accelerated to 5¼ percent year on year in the first quarter, and the growth momentum appears to have continued in the second quarter. Reflecting higher oil prices and a less rapid than expected decline in food prices, twelve-month consumer price inflation rose to 6¾ percent in May. Mainly for seasonal reasons, the registered unemployment rate declined to 12½ percent in May, while real wages were nearly unchanged year on year in the first quarter.

3. **The economic expansion has been accompanied by the emergence of macroeconomic imbalances which we have begun to address by policy adjustments.** A credit boom has contributed to a surge in domestic demand that has led to a deterioration of the external current account deficit, which widened to 8½ percent of GDP in 2003. As more than 80 percent of the 2003 current account deficit was covered by foreign direct investment, the external debt ratio still declined to 58¾ percent of GDP and international reserves remained close to 5 months of imports at end-2003. The rate of growth of banking system claims on the nongovernment sector accelerated again to more than 50 percent year on year in the first months of 2004. In response to these developments, the Bulgarian National Bank (BNB) took measures to strengthen its supervision and reduce banking system liquidity, and the government tightened fiscal policy by saving one half of its revenue overperformance in 2003, posting a deficit of ½ percent of GDP (with capital transfers treated as expenditure). The most recent data for the twelve-month rates of the current account and nongovernment claims show reductions to 8¼ percent of GDP in April and some 47 percent in June, respectively. Reflecting rapid growth in revenue, the general government recorded a cash surplus of almost 2 percent of annual GDP in the first five months of 2004.

II. THE ECONOMIC PROGRAM FOR 2004–06

4. **Our economic program for 2004–06 aims at reducing external and financial sector vulnerabilities to maintain macroeconomic stability and achieve sustainable high**

rates of growth in the runup to EU membership in early 2007. The program relies on fiscal adjustment, tight incomes policies in the public sector, strengthened banking supervision, measures to reduce bank liquidity, and structural reforms (including privatization) in the context of the currency board arrangement. The latter has served us well as a disciplining device and will be maintained until the adoption of the euro later this decade. The development of unit labor costs in manufacturing and the rising share of our exports in the EU suggest that competitiveness remains broadly adequate, and the policies under our economic program are designed to bolster it.

5. **We expect to achieve real GDP growth of some 5¼ percent a year during 2004-06.** Our program contains the measures necessary to raise productivity, employment, and investment. Domestic saving is expected to catch up with levels observed in other EU accession countries in response to higher per capita income, rising enterprise profits, fiscal consolidation, financial deepening, and other structural reforms, including measures to improve governance and the business climate. But, with the investment-to-GDP ratio also rising, reliance on external saving is forecast to decline only modestly to 7½ percent of GDP in 2006. Together with expected high foreign investment (boosted by privatization inflows), this would help reduce the external debt ratio to 50½ percent of GDP at end-2006. After a temporary increase in 2004, average consumer price inflation is projected to abate to 3½ percent in 2005–06, reflecting tight fiscal and incomes policies and structural reform.

6. **With monetary policy constrained by the currency board arrangement and an open capital account, macroeconomic policy will rely heavily on fiscal policy.** Our program aims at achieving at least general government balance in 2004, withdrawing the fiscal stimulus that was originally planned in 2004. The fiscal stance will be eased in 2005-06 only if credit expansion declines as envisaged in our program and the external current account deficit ceases to give grounds for concern. While NATO and EU related spending and unfavorable demographics make it difficult to reduce further the size of government in the economy, we intend to (i) use EU accession related increases in excise taxes to reduce direct taxes and (ii) improve the quality of expenditure by reducing subsidies and targeting social spending, thereby creating room for priority spending on investment, operations, and maintenance. An unchanged fiscal stance, the realization of privatization receipts and the sparing use of government guarantees will allow the public debt ratio to fall to 37¾ percent of GDP by end-2006.

7. **We have begun to implement a step-by-step strategy to reduce bank liquidity, to levels that will still allow banks to maintain an adequate level of lending.** Within the limits imposed by an open capital account, we have started to reduce bank liquidity by transferring government deposits with commercial banks to the BNB and tightening reserve requirements, and will monitor closely the effects of these measures on the pace of credit expansion. We stand ready to resort to additional measures, including minimum liquidity requirements and increased government domestic borrowing if needed to achieve our objectives, but we do not envisage the need for restricting capital inflows to make our strategy effective. We have tightened prudential requirements in the banking sector and will

intensify our supervisory activity as well as strengthen nonbank supervision during the program period to reduce financial sector vulnerability.

8. **To elicit the requisite supply response and reduce vulnerabilities, our program relies heavily on structural reforms**. We intend to essentially complete privatization during 2004–06. Apart from the privatization deals already in progress, this requires preparing for the sale of electricity generation and several transportation companies. Measures will be taken to make the labor market more flexible by facilitating entry to and exit from employment and to cut red tape, reduce corruption, and strengthen the enforcement of property rights. As part of our fiscal adjustment program, we will take measures to improve revenue collection and expenditure management and strengthen the pension and health care systems.

9. **Fiscal policy needs to remain tight and flexible during 2004–06 to address possible exogenous shocks and program slippages, achieve the targeted improvement in the external current account, and deal with the fiscal impact of EU membership in 2007.** EU contributions and cofinancing requirements of EU financed projects are expected to burden the budget by some 2 percent of GDP in 2007 and by some 1½ percent of GDP thereafter. We do not consider it prudent to enter ERM2 with a deficit of this size and therefore will take the appropriate measures to ensure fiscal balance in 2007 and beyond. This objective will be facilitated by the exceptional budgetary support (to be disbursed in 2007) we obtained from the EU at the conclusion of our negotiations of the accession chapters in June 2004.

III. THE PROGRAM FOR THE REMAINDER OF 2004

10. **Our objectives for 2004 are an acceleration of economic growth to just over 5 percent, a reduction of consumer price inflation to 3½ percent at yearend, and to contain the external current account deficit to 8¾ percent of GDP.** The acceleration of growth is expected to result from a reduction in the negative external sector contribution, which more than offsets a modest slowdown in the growth of domestic demand. From the supply side, output growth should benefit from a recovery in agriculture, recent investment in capacity, and a good tourist season. While average inflation will be high at 6¼ percent, its twelve-month rate should—despite corrective price increases for electricity and heating—fall rapidly with the arrival of the new harvest. Despite the expected slowdown of credit expansion to 30-35 percent year on year by end 2004 and of domestic demand, the external current account is expected to worsen slightly with respect to 2003 due to recent increases in oil and other commodity prices. With the expected inflow of foreign direct investment and the pending prepayment of external debt, and in spite of a further buildup of gross international reserves, the gross external debt ratio is projected to fall to 56 percent of GDP.

A. Fiscal Policy and Reform

11. **We have decided to tighten fiscal policy and aim at overall general government balance (redefined to treat capital transfers as expenditure) on an adjusted accrual basis in 2004** (performance criterion). In view of the further current account deterioration and a weakening private sector saving performance, we have come to the conclusion that the expansionary fiscal stance of the 2004 budget is no longer appropriate. We have therefore decided to achieve, as a minimum, fiscal balance in 2004. In addition, we have also decided to limit general government expenditure (performance criterion), so as to ensure that any revenue overperformance resulting from the more buoyant demand situation than envisaged at the time of budget preparation will be saved. Beyond these commitments, fiscal policy needs to remain flexible and we will consider additional measures to tighten fiscal policy further in consultation with the Fund staff if the current account deficit does not develop as envisaged. To convert our fiscal cash data to an accrual concept, we have begun monitoring the stock of general government arrears on a quarterly basis, and will treat the net accumulation of arrears as expenditure. All central government arrears will be eliminated by end-September 2004 (performance criterion).

12. **In the interest of greater transparency, our program for 2004 is based on more realistic revenue projections.** This has resulted in an upward revision of revenue by some 2 percent of GDP as revenue losses associated with lower personal and corporate income tax rates are more than offset by improved tax administration, increased excise taxes, and the more realistic reflection of the macroeconomic assumptions made at the time of budget preparation. All revenue categories have experienced upward revisions, most notably, however, value added, personal income and corporate income taxes. Our revised projections were also boosted by higher profits, both realized and still expected, from the BNB and the recently privatized telecommunications company and other nontax revenue. Following the shift to greater reliance on indirect taxes at the start of the year, we will keep our tax system unchanged during the remainder of 2004.

13. **In line with the need to increase the program's transparency, and consistently with the goal of achieving at least fiscal balance in 2004, we have raised our budget expenditure by around 1 percent of GDP.** This, and a more realistic estimate of interest expenditure, has allowed us to make room for previously unbudgeted priority expenditure for healthcare and road maintenance and to meet late-year expenditure pressures such as wage and pension bonuses. Despite these revisions, the expenditure-to-GDP ratio remains almost 1 percentage point of GDP lower than in 2003. Nevertheless, capital expenditure has been raised somewhat in relation to 2003. As we are determined not to allow expenditure to exceed its revised level in 2004, we will continue to cap all discretionary central government spending at 93 percent, and budget transfers to local governments (except taxes) related to state mandates at 90 percent, of its revised budgeted level until the fourth quarter. These limits have been incorporated in the controls of the Treasury Single Account (TSA). The amount of spending deferred in this manner during the first three quarters is estimated at somewhat less than 1 percent of GDP and will be available for spending in the fourth quarter up to the overall expenditure ceiling. Plans to transfer funds to a new road construction

enterprise have been postponed in view of the macroeconomic situation and the need to clearly determine the scheme for building motorways.

14. **We will take measures to strengthen the sustainability of the pension and public health insurance systems**. To remove discretion, the formula (the annual increases in the average consumer price index and the average insurable income, with weights of 75 percent and 25 percent, respectively) determining the annual adjustment of pensions will be enshrined in the social security code by end-2004 (benchmark). To contain spending on disability pensions the National Social Security Institute (NSSI) will (i) appoint representatives to the regional and national medical expert commissions, and (ii) be given authority from January 1, 2005 to have its own medical experts verify and re-certify any disability certification issued before January 1, 2005 and be required to reconfirm all the commissions' certifications of eligibility for disability pensions issued from January 1, 2005 by end-December 2004 (performance criterion). In addition, the government will pass a decree by end-September 2004 limiting retroactive payments to newly certified individuals eligible for disability pensions to the six months before issuance of the certificate of disability. For 2005, the government will review NSSI benefit expenditures to ensure that the NSSI deficit does not lead to an increase in the transfer from the central government by more than the projected average CPI inflation. Despite the failure to sign a national framework agreement (NFA) for 2004, the National Health Insurance Fund (NHIF) and the Ministry of Health will reimburse hospital financing exclusively on a fee-for-service basis (clinical paths and price per diagnosis). Discussions for the 2005 NFA will be conducted within the terms of the budget procedure for that year, and we intend to broaden the scope for patient co-payments for medicines and other health services.

15. **The prevailing excess demand pressure requires continued fiscal prudence.** We will set the 2005 budget targets at the same level as projected for 2004. However, we may ease the fiscal stance somewhat, if, at the time of the budget preparation (i.e., in September 2004 for the 2005 budget), private sector credit growth does decelerate as projected and current account trends do not give reason for concern. The detailed policies of the 2005 budget are still being developed. We are examining the feasibility of further lowering the corporate income tax rate from 19½ percent to 15 percent and the personal income tax by reducing its rates and introducing child tax credits. The associated revenue shortfall would be largely offset by raising excise taxes selectively toward minimum EU levels and by the expected further improvement in tax collection. On the expenditure side, better targeted social spending and outlays related to EU accession and for improving infrastructure remain priorities. Following a 8.5 percent wage increase in mid-2004 and employment increases related to judicial and education reform and EU accession, the mid-year increase in the wage bill in the budget sphere will not exceed the projected average CPI inflation for 2005. Subsidies will be further reduced, particularly with the elimination of those to the district heating companies. An agreement on public service obligations of the railways is expected to be signed by end-September 2004. In pursuing plans to construct a new nuclear power plant, we will be guided by the need to enhance the efficiency of public expenditures and maintain fiscal space for priority public investment, and we will minimize (i) recourse to public

expenditure and guarantees, and (ii) interference with our plans to privatize existing electricity generation companies.

16. **A number of structural reforms will additionally strengthen fiscal performance.**

- To boost revenue collection, the National Revenue Agency (NRA), which will combine the collection of taxes and social contributions, will become operational on January 1, 2006. In preparation, legislation has been sent to parliament to use the Bulstat number for all tax and social contribution payments (prior action), with approval expected by end-December 2004 (performance criterion), and the information technology for the NRA will be acquired by end-September 2004 (benchmark). The procedural code for the NRA, which integrates, aligns and improves all liable persons' registration and services procedures, the assessment of taxes and social security contributions due, as well as collection of public receivables, has been submitted to parliament (prior action) and will be passed by November 15, 2004 (benchmark). To improve the functioning of the NRA, we will also amend the value added, personal income, and corporate income tax laws in time for the NRA's startup on January 1, 2006. Revenue collection is expected to be strengthened further by the establishment of a National Agency for Financial Investigation in the Ministry of Finance to combat tax evasion and fraud. In the customs area, we intend to restructure intelligence and investigation functions and will study the feasibility of a national control room for troubleshooting and fraud prevention.

- A recent review of the VAT accounts concluded that they have played a positive role in improving VAT collections, but we intend to accelerate procedures for enterprises to gain access to the cash flow frozen in these accounts. The large taxpayers office will be further strengthened with the introduction of online services.

- To strengthen treasury operations, we will incorporate in the TSA the lev-denominated accounts of autonomous budgetary entities currently outside the TSA by end-December 2004 (performance criterion). In the interest of fiscal transparency, we will not create any new extrabudgetary funds or state-owned enterprises during the program period with the possible exception of companies set up for forestry and ports management and two funds to protect the environment and cover unexpected future pension gaps (structural benchmark). Five modules (financial accounting, cash management, budget management, asset management, and material management) of the Financial Management Information System will start operating in the Ministry of Finance by end-December 2004 (benchmark) and will be expanded to all ministries by mid-2006.

- We have started preparing the 2005 budget to ensure its smooth passage by the end of 2004. Each ministry has been asked to identify 7 percent of its spending as "lower priority." These more rational contingencies will replace the within-year across-the-board caps on discretionary spending used until now to ensure expenditure flexibility.

Program budgeting is being introduced in three additional ministries in 2004 and will be expanded to four more ministries in 2005, with a view to preparing the central government budget on a program basis by 2007. To improve budget execution, we intend to adopt accrual accounting with the 2006 budget report and are requesting technical assistance from the Fund to prepare for the change.

- To more clearly delineate the responsibilities of the central and local governments, local finances will be strengthened with the development of expenditure standards for municipal mandates, the establishment of a monitoring system for local government spending, and improvements in the implementation capacity of the municipalities through training. At the same time, the equalization subsidy will be better targeted and a municipal debt law will be passed by end-2004.

B. Incomes and Labor Market Policies

17. **Wage restraint is important to maintain competitiveness**. To provide guidance to private sector wage bargaining, we are pursuing a restrained wage policy in the public sector. Along with the restraint on the government wage bill discussed above, the increase in the aggregate wage bill of the 58 largest public enterprises that are monopolies, received government subsidies, or made losses in the third quarter of 2003 will be limited to 4 percent in 2004 (performance criterion). In collaboration with the World Bank, we intend to amend our labor regulations with a view to making entry to and exit from work more flexible. As a minimum, we will (i) eliminate the portability of the seniority bonus to improve the re-employability of older workers and (ii) facilitate work outside regular hours. A decree satisfying the first requirement will be issued by end-December 2004 and a draft law satisfying the second requirement will be sent to parliament by end-December 2004 (benchmark). We are currently considering our minimum wage policy for 2005 and beyond with a view to finding a solution that strikes an appropriate balance between social considerations and the need to preserve competitiveness and promote employment in the formal economy. We will consult on our proposals with the Fund staff in September and the adoption of a satisfactory minimum wage policy will be a focus of the first program review.

C. Financial Sector and Public Asset and Liability Management Policy

18. **While we view the expansion of bank credit as an overdue catchup process that will eventually run its course, we are concerned that its rapid pace increases external vulnerability.** To mitigate this risk, we have taken and will take a number of measures to strengthen bank supervision and drain liquidity as appropriate.

19. **Under a stepwise strategy adopted in mid-2003, the BNB has already considerably intensified its supervisory activity**. On-site inspections and targeted reviews of aggressive lenders are conducted more frequently. From April 1, 2004, provisioning requirements on distressed loans were tightened by reclassifying loans as nonperforming with a 100 percent provisioning requirement after 90 days instead of 120 days previously, and by raising the requirement for loans overdue by 61–90 days from 30 percent to

50 percent. In June 2004, banks were required to treat their current profits for the calculation of own capital more restrictively in line with EU banking directives. From July 1, 2004 the BGN 10,000 minimum for loans to be reported to the BNB's credit register was eliminated, thus providing banks important information for their retail lending decisions. As also indicated by macroprudential soundness indicators, we consider the banking system financially sound but, if needed, are prepared to step up our supervision and adopt additional prudential regulations to ensure that banks' balance sheets remain of high quality.

20. **In an effort to restrain credit growth, however, we recognize the need to adopt additional measures to reduce banks' liquidity.**

- The government has returned its deposits from the Fiscal Reserve Account (FRA) that were placed with commercial banks, and transferred all but a small technically required amount of the deposits of the Bank Consolidation Company (BCC), to the BNB. The lev-denominated suspense accounts of the customs office will be transferred to the BNB by end-October 2004 (benchmark).

- The BNB has expanded the coverage of reserve requirements to include all liabilities previously excluded from the deposit base (except subordinated debt, debt-capital hybrid instruments, and repo agreements among banks) in the calculation of reserve requirements from July 1, 2004. The reserve requirement rate for these liabilities has been set at 4 percent.

- Furthermore, the BNB has decided to reduce the proportion of cash in vault that can be used for fulfilling reserve requirements to 50 percent from October 1, 2004 (performance criterion).

- The government is prepared to undertake bond sales in excess of those already planned in the second half of 2004 to drain liquidity.

- The Deposit Insurance Fund will invest by end-September 2004 its cash balances and maturing repo agreements with banks in newly issued government obligations and place any future liquid assets with the BNB.

- We will closely monitor the success of these measures in slowing credit expansion and are prepared, in consultation with the Fund staff, to (i) introduce minimum liquidity requirements, (ii) increase the reserve requirements on previously excluded liabilities, and (iii) reduce further the proportion of cash in vault that can be used for fulfilling reserve requirements. We also would consider further increasing government borrowing in the domestic market and raising reserve requirement rates, if needed to help reduce credit growth.

21. **The government has announced the early redemption of its outstanding Brady discount bonds at the next call date on July 28, 2004**. This transaction will reduce the external and public debt ratios by 2.9 percent of GDP and release some 1.2 percent of GDP

in collateral, thus reducing net international reserves by only 1.7 percent of GDP as a result of this transaction. We may buy back or prepay some of our other external obligations, subject to maintaining an adequate level of international reserves. To strengthen external sustainability, the government has established ceilings on the contracting and guaranteeing of external public debt (performance criteria). The government's ongoing strategy of shifting from external to domestic borrowing will also help absorb bank liquidity, provide assets to the private pension funds, and develop the domestic capital market.

22. **We will strengthen the supervisory and regulatory framework of the nonbank financial sector.** The creation of the Financial Supervision Commission (FSC) has been an important step forward, but more effort is needed to strengthen its supervisory capacity, regulatory framework, and enforcement powers, with a particular focus on the insurance sector. By end-2004, we intend to:

- Give the FSC adequate enforcement powers to identify the ownership structure of its supervised entities and implement effectively the law of public offerings of securities;
- Streamline existing regulations into a single insurance law, revise the fiscal regime of insurance companies, and eliminate remaining differential tax treatment and other regulatory gaps between life insurance products and voluntary pension funds; and
- Regulate leasing activities to allow proper monitoring of developments in this area, as relevant to the analysis of credit growth and the indebtedness of the private sector.

D. Other Structural Reforms

23. **We realize that an improved business climate is essential in order to stimulate investment and generate a supply response to sustain higher rates of growth.** To that end, we are in the process of reforming company registration regulations, dispute resolution procedures, judgment enforcement, collateral law, and corporate governance. Specifically,

- We intend to submit to parliament by end-2004 amendments to the companies law, the civil procedure code, and any other legal instruments necessary to transfer business registration to a nonjudicial administrative body and establish a unified national electronic register with limited judicial oversight and simplified administrative procedures (benchmark). We expect to have this law approved by parliament and make the new centralized register operational in 2005.
- A draft law on mediation as an alternative dispute resolution mechanism to relieve the caseload of the courts is in parliament and is expected to be approved by end-September 2004.
- We will prepare a draft law creating a private system of bailiffs to strengthen creditors' rights in the enforcement of court judgments by end-September 2004, with a view to implementing the new system in 2005.

- Collateral law and corporate governance reform will take longer to develop and implement, but we are setting up working groups to examine options for reform and will report on progress in these areas during reviews of our program.

As part of our efforts to improve the quality of administrative services, we will extend one-stop shops, which are already functioning in the majority of public administrations, to all such administrations at the central, regional, and municipal levels by end-2004. We intend to provide concrete plans to unify these one-stop shops across administrations for discussion during the first program review. To further improve incentives for entrepreneurial activities, we have already submitted to parliament laws on investment promotion and on small and medium enterprises development. These laws, which simplify investment procedures as well as provide nonfinancial assistance to potential investors, are expected to be passed by end-September 2004.

24. **While surveys have shown a decline in recent years, and relevant indicators place us favorably among other countries in the region, we are determined to further reduce the incidence of corruption and improve governance.** We are fully committed to the national strategy to counteract corruption outlined in 2001, and intend to improve coordination among ministries and other administrative bodies to reach our goals. We will implement commitments made in closing the judiciary chapter of the EU accession negotiations and further improve accountability of the judiciary. We expect to have a comprehensive code of ethics for public servants approved by the Council of Ministers for application by end-September 2004. In addition, we intend to continue actively prosecuting civil servants engaged in corrupt activities. We had to increase the threshold level for competitive tendering in the public procurement law due to EU requirements, but as the threshold remains high relative to Bulgaria's per capita income, we plan to introduce simple and transparent procedures to tackle petty corruption in low-value procurements by end-2004. To combat corruption related to organized crime, we submitted to parliament a law on asset forfeiture in March 2004, which we expect to be approved by end-2004.

25. **Further reforms in the railway and energy sectors, and completion of privatizations remain critical to our medium-term fiscal and external financing strategies and to remove impediments to sustained higher growth.** We are working with the World Bank to make the railway sector sustainable, including through cuts of redundant staff and tariff increases. Household electricity and district heating prices have been increased by 10 percent on average, with effect from July 1, 2004. With these adjustments, cost recovery for these utilities has been achieved and the need for subsidies has been reduced. With the adoption of the energy law, we are now addressing restructuring and privatization of the electricity and district heating companies. The heightened external vulnerability during the program period has added to the need to accelerate privatization. A new privatization law, which is currently under discussion in the Council of Ministers, will involve line ministries under tight deadlines in the preparation of privatization deals, with the aim of attracting strategic investors. Specifically:

- We have completed the sale of 65 percent of the telecommunications company (BTC). The remaining share is expected to be sold on the stock exchange.

- We intend to sell at least 5 tobacco companies, representing at least 50 percent of the assets of the Bulgartabac holding company identified as salable by the privatization advisor, by end-2004 (benchmark) and privatize or liquidate the remaining companies in 2005.

- The selection of the winning bids for the seven electricity distribution companies will be made by end-September (performance criterion) and any outstanding issues with the successful bidders will be resolved by end-December 2004.

- To establish a privatization pipeline for 2005–06, we will prepare for discussion during the first program review mission privatization plans consistent with our program's external financing requirement for the nonnuclear electricity generation companies, the airline, the remainder of the river shipping company, and the maritime shipping company (benchmark). In preparing this plan, we will consult with the World Bank. The first program review will focus on the agreement of such a privatization plan. Facilities in the ports and airports will be offered for private concessions on the basis of recently adopted ports and airports laws.

Bulgaria: Conditionality Under the Stand-By Arrangement in 2004

Prior Actions

1. Submission to parliament of legislation to use the Bulstat number as the single identification for all tax and social contribution payments

2. Submission to parliament of the NRA procedural code (described in paragraph 16, first bullet)

Quantitative Performance Criteria

1. Floor on the overall fiscal surplus of the general government (Annex II)

2. Ceiling on general government expenditure (Annex II)

3. Ceiling on central government arrears (Annex II)

4. Ceiling on the wage bill of the 58 largest SOEs in financial distress or monopoly situation (Annex III)

5. Ceiling on the contracting or guaranteeing of nonconcessional external public debt (short term, 1-5 years, longer) (Annex IV)

Structural Performance Criteria

1. Selection of winning bids for the sale of seven electricity distribution companies (September 30, 2004)

2. Reduction of the proportion of cash in vault usable for fulfilling reserve requirements to 50 percent (October 1, 2004)

3. Approval of a law giving the NSSI authority from January 1, 2005 to have its own medical experts verify and recertify any disability certification issued before January 1, 2005; and requiring the NSSI to have its own medical experts recertify all disability certifications issued from this date (December 31, 2004)

4. Incorporation into the Treasury Single Account (TSA) of the lev-denominated accounts of all autonomous budgetary entities currently outside the TSA (i.e., all entities of the judicial system, the teachers' pension fund, and all state universities) (December 31, 2004)

5. Approval by parliament of legislation to use the Bulstat number as the single identification for all tax and social security payments (December 31, 2004)

Bulgaria: Conditionality Under the Stand-By Arrangement in 2004 (Concluded)

Other Performance Criteria

1. No imposition of new or intensification of existing restrictions on the making of payments and transfers for current international transactions, nor introduction or modification of multiple currency practices, nor conclusion of any bilateral payments arrangements that are inconsistent with Article VIII of the IMF Articles of Agreement, nor imposition or intensification of any import restrictions for balance of payments purposes, nor accumulation of any external payments arrears (continuous)

Structural Benchmarks

1. No new extrabudgetary funds or state-owned enterprises (with the possible exception of the companies set up for forestry and ports management and two funds to protect the environment and cover possible future pension gaps) to be created during the program period (continuous)

2. Acquisition of an information technology system for the National Revenue Agency (September 30, 2004)

3. Transfer of the lev-denominated suspense accounts of the customs office to the BNB (October 31, 2004)

4. Parliamentary approval of the NRA procedural code (described in paragraph 16, first bullet) (November 15, 2004)

5. Preparation of a privatization plan that ensures revenues consistent with the 2005-06 balance of payments projections (November 15, 2004)

6. Adoption of a law to base the annual adjustment of pensions on 75 percent of the increase in the average consumer price index in the previous year and 25 percent of the increase in the average insurable income in the previous year (December 31, 2004)

7. Full operationalization of the five modules of the Financial Management Information System in the Ministry of Finance (December 31, 2004)

8. Adoption of a decree that eliminates the portability of the seniority bonus and submission to parliament of an amendment to the labor code that facilitates work outside regular hours (December 31, 2004).

9. Sale of at least 5 tobacco companies representing at least 50 percent of the assets of the entities of the Bulgartabac holding identified as salable in the Phase I preparation phase (measured either as 50 percent of the market value as estimated as at the end of the financial advisor's Phase I valuation work, or as 50 percent of net assets of the entities to be privatized, or as 50 percent of sales in 2003 of the entities to be privatized) (December 31, 2004)

10. Submission to parliament of amendments to the companies law, the civil procedure code, and any other legal instruments necessary to transfer business registration to a nonjudicial administrative body and establish a unified national electronic register with limited judicial oversight and simplified administrative procedures (December 31, 2004)

Performance Criteria and Indicative Limits on the General Government Deficit, General Government Expenditure, and Central Government Arrears

	Arrears Ceiling	Expenditure Ceiling	Fiscal Surplus Floor
	(In millions of leva)		
Cumulative change from January 1, 2004			
June 30, 2004	-9.8 1/	6,469 1/	699 1/
September 30, 2004	-54.8	10,211	403
December 31, 2004	-54.8	14,275	0

1/ Indicative limit.

All quarterly limits in this Annex are cumulative.

The general government accounts are defined to comprise the consolidated budget (including the republican budget, the budgets of ministries and local governments, and the social security funds NSSI and NHIF) as well as all extrabudgetary funds and accounts at the central and local government levels. The central government is defined as the general government minus the sum of the local government budgets and the extrabudgetary funds and accounts at the local government level.

For program monitoring purposes, the arrears of the central government are all overdue obligations on the payment for central and general government expenditure. The stock of central government arrears as of December 31, 2003 amounted to BGN 54.8 million.

For program monitoring purposes, the cumulative general government cash expenditure will be increased/decreased, and the surplus decreased/increased, at the end of each quarter by the cumulative increase/decrease in general government arrears (excluding the increase/decrease of arrears on the amortization of principal) until the end of the quarter concerned.

For program monitoring purposes, the fiscal balance (surplus/deficit) will be defined as the difference between general government revenue (taxes, nontaxes, and grants) and general government expenditure, including net capital transfers (net acquisition of shares and net lending). The cash expenditure data will be adjusted by the cumulative variation of the stock of general government arrears, as described in the preceding paragraph.

Reporting on the fiscal balance will be cross checked from the financing side as the sum of net credit from the domestic banking system to the general government, general government deposits and accounts abroad, net domestic nonbank credit to the general government, privatization receipts of the budget, receipts from external loans for project implementation and direct budgetary support minus amortization due, net disbursement/repayment of loans whose final payee is an entity outside the general government consolidation (onlending operations), and the net increase/decrease of general government arrears, including those on the amortization of principal. For calculating the performance against this ceiling, all privatization receipts, including dividends of the Bank Consolidation Company (BCC) distributed to the general government and taxes and other proceeds from the BCC related to bank privatization, and any revenues from release of Brady bond collateral, are treated as financing items. External flows will be converted into leva at the BNB daily exchange rate. Valuation changes in deposits and accounts that are denominated in foreign currencies will be recorded daily and reported by the BNB and the Ministry of Finance at the end of each quarter, and such changes will be netted out.

All data in this Annex will be reported quarterly by the Ministry of Finance (and by the BNB for some of the financing items in the preceding paragraph) within 60 days of the end of each calendar quarter.

Performance Criteria and Indicative Limit on the Wage Bill of 58 State-Owned Enterprises (SOEs)

	Wage Bill of 58 SOEs
	(In millions of leva)
July 1, 2003–September 30, 2003 (actual)	151.3
Cumulative change from January 1, 2004	
June 30, 2004	314.7 1/
September 30, 2004	472.1
December 31, 2004	629.4

1/ Indicative limit.

The ceiling on the aggregate wage bill of the 58 state-owned enterprises closely monitored for their large losses or arrears, for receiving subsidies, or for being monopolies, is 4 percent above the level of their aggregate wage bill in the third quarter of 2003. The wage bill is defined to include wages and payroll taxes paid by the employer but does not include additional compensation under Article 12 of the 2004 Incomes Ordinance.

Those enterprises that have been privatized or ceased operations will be excluded from the list for the respective test dates. Those enterprises that register profits in each of the first two quarters of 2004 will also exit the list in the second half of 2004 unless they are monopolies, have arrears, or receive state subsidies. If an enterprise is excluded from the list, the wage bill ceiling for each subsequent quarter will be adjusted down by the amount of that enterprise's wage bill in the third quarter of 2003 plus 4 percent times the number of quarters it has been excluded from the list. The 58 enterprises monitored (enterprises number 1 to 16 are considered monopolies):

1. Railway Infrastructure Company
2. BDZ EAD
3. Bulgargas EAD
4. BTC EAD
5. National Electric Company
6. TPP Varna EAD
7. EDC –Varna EAD
8. EDC –G. Oriahovitsa EAD
9. NPP Kozlodui EAD
10. TPP Bobov D
11. EDC -Pleven EAD
12. EDC -Plovdiv EAD
13. EDC-Sofia City EAD
14. EDC -Sofia District EAD
15. EDC -Stara Zagora
16. TPP Maritza Iztok 2 EAD
17. City Transport Plovdiv EOOD
18. Ruse Municipal Autotransport EOOD
19. Bulgarian Maritime Shipping Company-EAD
20. Electricity Transport-Sofia EAD
21. Autotransport-Sofia EAD
22. Burgasbus EOOD
23. DHC-Burgas EAD
24. DHC-Varna EAD
25. DHC-Pernik EAD
26. DHC-Pleven EAD
27. DHC-Plovdiv EAD
28. Bulgartabac Vidin AD
29. DHC-Sliven EAD
30. DHC-Sofia EAD
31. DHC-Shumen EAD
32. Pirin Mines EAD
33. Port Burgas EAD
34. Bobov Dol Mines
35. Vazov Machinery Work
36. Bulgartabac-Plovdiv AD
37. Bulgartabac-Asenovgrad s
38. Dunarit AD
39 Bulgarian Rivershipping EAD
40. Bulgartabac Haskovo AD
41. Bulgartabac Shumen AD
42. Bulgartabac Dupnitsa AD
43. Sluntse EAD-Smolian
44. Mina Zdravec EAD
45. AD Balkankar - Dunav
46. Terem EAD
47. V & K EOOD - Dobrich
48. PE-Constructing & Rebuilding
49. EOOD Central Base - Pernik
50. EOOD Vointech
51. Intendantsko Service EAD
52. Bulgartabac-Gotce Delchev AD
53. Bulgartabac-Kurdjali AD
54. Balkan Car 6th September EAD
55. Balkan Mine – 2000 EAD
56. Brikell EAD
57. Open Coal Mine EAD
58. Transport Constructing & Rebuilding

Performance Criteria and Indicative Targets on the Ceilings on Contracting or Guaranteeing Public Sector External Debt 1/2/
(In millions of euros)

	One year and under 3/	Over 1 year 4/	1-5 years 4/
Cumulative change from December 31, 2003			
June 30, 2004	0 5/	150 5/	0 5/
September 30, 2004	0	390	0
December 31, 2004	0	390	0

1/ The public sector comprises the central government, the local government, the social security fund and all other extrabudgetary funds and the Bulgarian National Bank.

2/ The term "debt" has the meaning set forth in point No. 9 of the IMF Guidelines on Performance Criteria with Respect to Foreign debt adopted on August 24, 2000 (Executive Board Decision No. 12274-(00/85)). Excluded from this performance criterion are (i) normal import-related financing credits; and (ii) outstanding balances under bilateral payments arrangements. Debt and commitments falling within the ceilings shall be valued in euros at the program exchange rates of 1.25 US$/€ and 135 ¥/€.

3/ The ceilings apply to debt with original maturities of up to and including one year. The actual stock of short-term debt outstanding (according to this definition) as of December 31, 2003 was zero.

4/ The ceilings apply not only to "debt," but also to commitments contracted or guaranteed for which value has not been received.

5/ Indicative limits.

Statement by the IMF Staff Representative
August 6, 2004

This statement provides information that has become available since the issuance of the staff report. This information does not change the staff's appraisal in that report.

- The two prior actions for Board consideration of the stand-by request have been completed. The draft NRA procedural code was submitted to parliament on July 26, while the draft Bulstat Register Act was submitted to parliament on July 28. Moreover, incomplete data suggest that the indicative fiscal targets for end-June 2004 have been met.

- High-frequency economic data point to continued robust growth, but inflation has risen further. Industrial output and sales volume surged by 20.4 percent and 18.8 percent, respectively, year on year in May, while the unemployment rate declined further to 12.2 percent in June. However, twelve-month inflation rose further to 7.3 percent in June, in part reflecting the relatively sharper year-ago monthly drop in the price of food—which accounts for 37 percent of the CPI.

- External developments present a mixed picture, but are broadly in line with projections. The twelve-month external current account deficit narrowed to 8.1 percent of GDP in May, with a somewhat wider than expected trade deficit (13.6 percent of GDP) offset by better net income and transfers balances. Net FDI inflows totaled €421 million in January-May, covering nearly 46 percent of the current account deficit and contributing, together with other capital inflows, to a gain in international reserves to €5.7 billion. With the receipt of the proceeds from the BTC privatization in June, FDI coverage of the current account deficit should jump significantly.

- Financial market confidence in Bulgaria remains strong. On August 4, Fitch Ratings became the second major international rating agency to raise Bulgaria's credit rating to investment grade this year. Meanwhile, spreads on Bulgarian sovereign debt—as measured by the Bulgaria component of the EMBI—have narrowed further, reaching 123 basis points on August 4, 2004.

- Preliminary data for July point to a renewed pick-up in the growth of bank credit to the nongovernment sector to nearly 53 percent year on year, suggesting that the decline in June partly reflected a high base in June 2003. Nevertheless, the staff continues to expect a slowdown in credit growth during the remainder of the year, as the full effect of the measures already implemented begins to be felt.

- Fiscal performance has remained strong. In the first half of 2004, the general government balance recorded a cash surplus of 2.1 percent of GDP, against a programmed indicative target of 1.8 percent of GDP. The overperformance reflected largely higher revenues.

- The government has selected the winning bidders for the sale of 67 percent stakes in seven electricity distribution companies. Proceeds from the sale, which should be finalized by end-October, are expected to total nearly €700 million, or some €300 million (1½ percent of GDP) more than assumed in the program. Meanwhile, Bulgartabac has invited bids for the privatization of four cigarette companies, grouped into two packages. Several foreign companies have expressed interest.

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves Stand-By Arrangement for Bulgaria

The Executive Board of the International Monetary Fund (IMF) today approved a 25-month Stand-By Arrangement for Bulgaria in an amount equivalent to SDR 100 million (about US$146 million) to support the government's economic program for 2004-06. The authorities intend to treat the arrangement as precautionary.

Following the IMF Executive Board discussion on Bulgaria, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, said:

"Bulgaria's economic performance continues to be broadly satisfactory, with robust economic growth, favorable debt dynamics, and strong financial market confidence. To address the vulnerability arising from the deterioration of the external current account and sustain high rates of economic growth, the authorities have devised an appropriate combination of measures to restrain demand and enhance supply.

"With the currency board arrangement remaining a central pillar of the policy framework, the authorities' efforts to restrain demand primarily rely on fiscal tightening and prudent public sector wage policies, supported by measures to drain excess liquidity from the banking system. To enhance supply, the authorities are reinvigorating structural reforms, including privatization.

"The minimum fiscal objective for 2004 is to achieve overall balance in the fiscal accounts. Nonetheless, if the authorities adhere to their commitment not to exceed the expenditure levels under their program, and revenue overperformance continues, there is a possibility that a fiscal surplus may be achieved. The authorities should not ease their fiscal stance in 2005 unless credit expansion is slowing and the external current account deficit ceases to be of concern.

"A critical component of the strategy is wage restraint. Prudent limits on the increases in wages of public enterprises with monopoly position or in financial difficulty, and in the economy-wide minimum wage will be needed to help maintain competitiveness, contain demand pressures, and protect the employment of low-skilled workers.

"The authorities have appropriately taken a number of measures to strengthen prudential supervision and drain bank liquidity in the face of substantial credit growth. Given the constraints on monetary policy of the currency board arrangement and an open capital account, they stand ready to take additional measures as needed, in line with the program.

"Improving the overall business climate will stimulate investment and enhance the economy's competitiveness in preparation for EU membership. To this end, the authorities need to persevere in undertaking structural reforms to product and labor markets and completing rapidly their privatization program, which by generating additional foreign direct investment flows will strengthen the external position and bolster competitiveness," Mr. Kato said.

ANNEX

Recent Economic Developments

Macroeconomic developments have been generally favorable. Real GDP grew by 4¼ percent in 2003, as strong domestic demand was partly offset by a deterioration in net exports. Driven by investments and exports, real GDP grew by 5.3 percent year on year in the first quarter of 2004, with high-frequency indicators suggesting robust growth in the second quarter as well. While consumer price inflation averaged 2¼ percent in 2003, a drought-related jump in food prices raised 12-month CPI inflation to 5½ percent at end-2003. Reflecting higher oil prices and a smaller-than-expected decline in food prices, twelve-month inflation rose to 7.3 percent in June 2004. Unemployment has declined considerably, to 12.2 percent in June, while growth in real wages has been subdued.

Growth in banking system claims on the nongovernment sector has been higher than expected. Claims on the nongovernment sector rose by nearly 50 percent in 2003, with year on year growth in 2004 remaining around that level so far. However, prudential indicators remain strong.

The external current account has been broadly in line with projections. The current account deficit widened to 8½ percent of GDP in 2003, with a deterioration of the trade balance accounting for 90 percent of this widening. The deficit narrowed slightly in the twelve months to June 2004, with a weaker trade deficit offset by better income and transfers balances. Strong foreign direct investment and other capital inflows have led to a surplus in the balance of payments, increasing international reserves to US$6.9 billion in mid-2004. Competitiveness remains broadly adequate but warrants close monitoring.

Fiscal performance has remained strong. The government saved half of the revenue overperformance and balanced the budget in 2003. In 2004, the general government's cash surplus has continued to increase, reaching 2.1 percent of annual GDP by June. The overperformance largely reflects increased tax revenue, while expenditure has been in line with the budget.

Progress has also been made on structural reforms. The privatization of the Bulgarian Telecommunications Company was completed and the binding bids for the privatization of seven electricity distribution companies were received in July 2004. To allow cost recovery, household electricity and district heating prices were increased by 10 percent on average on July 1.

Program Summary

To strengthen the macroeconomic framework centered on the currency board arrangement (CBA), the authorities' program seeks to reduce external vulnerability in the context of high growth. The authorities continue to regard the CBA as the cornerstone of macroeconomic stability, providing a stable nominal anchor and the discipline to maintain tight fiscal and incomes policies. The authorities are complementing these policies with an acceleration of structural reforms, including completion of the privatization process and measures to improve the business climate as well as labor market flexibility.

The authorities and staff agree that the widening of the external current account deficit since mid-2002 reflects the excessive pace of domestic demand, fueled by the credit boom, as financial deepening proceeds, and not a serious erosion of competitiveness. Given the constraints imposed by the CBA, the authorities' plan addresses these developments by targeting a tighter and more transparent fiscal stance for 2004. The program targets at least a fiscal balance for the year, with any revenue overperformance to be saved. Nominal expenditure ceilings will help ensure that this outcome is reached. The authorities plan to proceed cautiously in implementing the budget, providing flexibility in its implementation. The 2005 budget will reflect a neutral fiscal stance and be based on realistic revenue and expenditure projections. Under the program, the authorities also plan to strengthen the pension and health care systems, and to improve tax administration, budget preparation, and expenditure management.

The program intends to slow down bank credit growth to help reduce external vulnerability. Given the policy tools available under a CBA and an open capital account, the authorities have intensified their already strong supervisory activities. In view of the continued rise in bank credit this year, however, the authorities have also implemented various measures to drain liquidity, including transferring government deposits at commercial banks to the central bank, broadening the coverage of reserve requirements, and from October 1, lowering the proportion of cash in vault that can be used to fulfill reserve requirements. In addition to intending to undertake bond sales in excess of those already planned to slow credit growth, the authorities stand ready to take further measures if the expected slowdown does not materialize.

The authorities' structural reform agenda seeks to improve the business climate, which is crucial to boosting investment and productivity. The authorities plan to complete the remaining privatizations, reducing the size of the public sector and improving economic efficiency. A strong incomes policy is envisaged for selected state-owned enterprises to improve their financial situation. Further reforms are envisaged in the Labor Code to improve the functioning of the labor market. The authorities plan to simplify company registration and licensing procedures, expand one-stop shops, and intensify their efforts to combat corruption. They are also pursuing a more active debt management strategy, with the aims of reducing the public debt-to-GDP ratio and reducing the external component of the debt.

Bulgaria joined the IMF on September 25, 1990. Its quota is SDR 640.2 million (about US$934 million), and its outstanding use of IMF resources currently totals SDR 811.32 million (about US$1.2 billion).

Bulgaria: Selected Economic Indicators

	2000	2001	2002	2003	2004Q1
Output, prices, and employment	(Annual percent change, unless otherwise stated)				
Real GDP	5.4	4.1	4.9	4.3	5.3
Real industrial sales	...	2.8	1.3	17.4	18.1
Consumer price index (average)	10.4	7.5	5.8	2.3	6.4
(End of period)	11.4	4.8	3.8	5.6	6.2
Unemployment rate (in percent)					
Registered unemployment	18.1	17.5	17.4	14.3	14.1
Labor force survey	16.9	19.8	17.8	13.7	...
Real public sector wages	2.4	6.3	2.5	3.9	...
Real private sector wages	7.8	4.1	-4.1	5.7	...
General government	(In percent of GDP)				
Revenue	38.7	37.6	36.5	37.9	9.0
Noninterest expenditure	35.7	34.7	34.9	36.2	7.5
Primary balance	3.0	2.8	1.6	1.7	1.5
Interest payments	4.0	3.7	2.2	2.1	0.9
Overall balance	-1.0	-0.9	-0.6	-0.4	0.6
Privatization receipts	1.3	2.9	0.9	1.1	0.3
External financing	1.5	-0.3	1.5	0.0	-0.3
Domestic financing	1.2	-1.7	-1.7	-0.7	-0.5
Public debt (end of period)[1]	77.0	69.9	56.2	48.3	45.1
Domestic public debt (end of period)[1]	6.6	6.2	6.5	6.5	6.4
Money and credit[2]	(Annual percent change, unless otherwise stated)				
Broad money (end of period, millions of leva)	9,857	12,401	13,857	16,566	16,806
Broad money (M3)	30.8	25.8	11.7	19.6	23.0
Claims on nongovernment	17.0	32.1	44.0	48.3	52.3
Foreign exchange deposits (euro million)[3]	2,068	2,516	2,678	3,150	4,020
Foreign exchange deposits (percent of M3)[3]	41.0	39.7	37.8	37.2	38.6
Broad money to foreign exchange reserves ratio	1.3	1.6	1.5	1.6	1.6
Interest rates (annualized)	(In percent)				
BNB basic rate[4]	4.6	4.7	3.4	2.7	2.4
Time deposits (leva)	3.3	3.4	3.2	3.2	3.1
Balance of payments	(In millions of euro, unless otherwise stated)				
Current account balance	-761	-1,102	-924	-1,498	-518
(In percent of GDP)	-5.6	-7.3	-5.6	-8.5	-12.6
Trade balance	-1,280	-1,779	-1,692	-2,196	-509
Exports, f.o.b.	5,253	5,714	6,063	6,663	1,718
Imports, f.o.b.	-6,533	-7,493	-7,755	-8,859	-2,227
Gross official reserves (end of period)	3,719	4,063	4,575	5,309	5,366
(in months of prospective imports of GNFS)	4.7	5.0	4.9	4.8	4.7
External debt (end of period)[5]	12,038	12,049	10,769	10,330	10,950
(In percent of GDP)	88.2	79.4	65.1	58.7	56.3
Exchange rates					
Leva per euro	Currency Board, peg to euro at lev 1.95583 per euro				
Leva per U.S. dollar (end of period)	2,102	2,219	1,885	1,611	1,615
(year-on-year percent change, + means depreciation)	8.0	5.6	-15.1	-14.5	-10.0
REER (end of period; CPI based)					
(year-on-year percent change, + means appreciation)	2.6	3.7	5.6	8.6	5.7

Sources: Bulgarian authorities; and IMF Staff estimates.
[1]Domestic debt as reported by Ministry of Finance and external debt as reported by BNB.
[2]Starting in 2002, a new format was adopted for monetary data resulting in revisions to historical series.
[3]Includes foreign currency deposits in broad money and other longer-term liabilities (not included in broad money)
[4]Average annual yield achieved at the primary market for three-month government securities.
[5]Includes trade credits.

Statement by Jeroen Kremers, Executive Director for Bulgaria and Victor Ivanov Yotzov, Advisor to Executive Director Executive Board Meeting August 6, 2004

The Bulgarian authorities wish to thank the Fund for the continued support that helped the country to stabilize and reform its economy and to make progress in the run up to EU accession. They appreciated the recent ex-post assessment (EPA) and Article IV Consultation, which scrutinized past developments, but also gave a view of the policy challenges ahead. The authorities were encouraged by the main message from the EPA report, that most of the possible drawbacks identified in the case of longer-term program engagement - weaker incentives to take decisive action, loss of credibility of the Fund in supporting weak programs, poor ownership, and weakening of the surveillance function of the Fund - do not apply to Bulgaria.

The last SBA ended in March 2004 and upon its expiration the Bulgarian authorities expressed their interest in a successor arrangement. By seeking a new program, the authorities want to address the remaining macroeconomic and structural problems. To achieve its objectives, the program focuses on fiscal adjustment, measures to reduce liquidity in the banking system and further progress in structural reforms. The program will continue to rely on structural conditionality following the EPA's conclusion that this type of conditionality played an important positive role in the success of previous Fund-supported programs. In accordance with the main findings and suggestions from the last Article IV Consultation and EPA report, the successor SBA has been designed as a low access, precautionary arrangement, that will also serve as an explicit exit from Fund program engagement. The Bulgarian authorities consider such a precautionary program as an adequate exit vehicle, offering a framework that is familiar both internally and externally.

Policy framework and recent developments

Macroeconomic and political stability has been underpinned by the currency board arrangement (CBA) and related strong fiscal discipline. The authorities are firmly committed to continuing this policy approach, which proved to suit well the country's needs. There is broad agreement among all the political parties in the Parliament on the main direction of economic development – i.e. keeping the CBA until joining the European Monetary Union.

A number of positive developments occurred since the last Board meeting on Bulgaria took place less than two months ago. On June 15, 2004 Bulgaria closed all the negotiating chapters of the *acquis communautaire,* thus formally ending the negotiating process for its EU accession. The expectations are that later this year, the European Commission will deliver a positive monitoring report, which will allow the country to sign the treaty next spring and to join the union in 2007, as planned.

On the economic front, just weeks after the sale of the telecommunication company, the Privatization Agency announced the results of the bids for seven local power distribution companies. On July 1, the government officially launched the privatization procedure for the tobacco company BULGARTABAC. The latest privatization deals prove growing investor interest in the country and indicate that FDI in 2004 and 2005 could exceed the projected external current account deficits. These series of favorable economic developments could be extended by the early retirement of discounted Brady bonds that took place on July 28, lowering further the external public debt. As business sentiments have improved, S&P recently raised its long-term credit rating moving the country into the investment-grade. It is widely expected that other major credit-rating agencies will undertake similar steps soon.

Economic activity

Preliminary data for the first quarter of 2004 show an impressive performance. Real GDP grew by 5.3 percent compared to the same period of the previous year, which was more than expected. Overall consumption spending contributed the most, as anticipated, while fixed capital formation, which rose by over 20 percent, performed unexpectedly strongly. Exports also rose fairly well, but imports increased even faster, reflecting robust demand for both consumption and investment goods. According to the recent statistics on industrial production and sales, the growth momentum has continued in the second quarter of the year. Despite higher oil prices and a smaller than expected decline in food prices, a targeted end year inflation of 3.6 percent is likely to be observed as the accumulated inflation until end June is just 0.2 percent.

The economic expansion has led to some issues that need to be addressed. During the last mission the authorities and staff had candid discussions on the risk of overheating and how it should be reflected in the program. Continued rapid credit growth, the size of the current account deficit and the overall excess domestic demand are considered evidence for possible overheating. Although there are no threats to financial stability, owing to the existing strong supervisory practices, a common understanding was reached that the current situation should not be left unchecked. The authorities are fully cognizant of the challenges of possible overheating and are prepared to take necessary steps to solidify economic performance and prevent the external imbalance from exacerbation.

External sector

Generally favorable macroeconomic developments in the last couple of years have been accompanied by external imbalances that threaten to increase the country's vulnerability, if not properly and timely addressed. Exacerbated by higher oil and other key commodity prices, the external current account deficit is currently estimated at about 9 percent of GDP. The strong rise in imports (both consumption and investment) is related to growing domestic demand and rapid credit growth of the private sector. To a smaller extent, though far from negligible, FDI inflows also contribute to high import growth. Competitiveness, however, does not appear to have been a significant factor in recent foreign trade developments. The appreciation of the Euro is likely to have only a moderate direct impact on external competitiveness (as most of the exports go to EU markets) and a mixed effect on the economy as a whole.

Financing the current account deficit does not seem to pose problems. Net inflows of FDI reached a record high level while the overall balance of payments has been in surplus every year since 1999. Over the program period and beyond, FDI is expected to cover about 90 percent of the current account deficit, owing to privatization receipts and rapidly increasing greenfield investment. This would help keep the official foreign reserves at an appropriate level, which is crucial for the economy given the specifics of the CBA.

Experiencing significant trade deficits during transition and structural reforms is not unusual. Broadly similar developments have been observed in a number of other transition countries. This, however, does not comfort the authorities and they stand ready to take appropriate measures, including further fiscal tightening, should the external conditions require it.

Fiscal policy

At the time of the last Board discussion, many Directors expressed their preference for a more ambitious fiscal adjustment, especially in 2004, to dampen domestic demand. The authorities have taken the advice. Amid strong domestic demand, increased bank lending and a widening trade deficit they have decided to tighten fiscal policy substantially. The initial fiscal stance for the 2004 budget envisaged a deficit of 1.2 percent of GDP – a fiscal expansion with respect to the 2003 outcome of a 0.4 percent deficit. However, in view of the external position and the weakening private sector saving performance, the authorities have come to the conclusion that expansionary fiscal policy in 2004 is no longer appropriate, and at least an overall general government balance will be pursued. This was a difficult political decision given the upcoming parliamentary elections to be held in mid 2005. By undertaking such a step, the authorities demonstrate their strong commitment to prudent macroeconomic policy.

Reflecting improved tax compliance and stronger economic conditions, revenue collection overperformed significantly in the first half of 2004, while expenditure was in line with the budget. This resulted in a cash surplus of about 2 percent of annual GDP. In the interest of greater transparency, all revenue categories were revised upward to mirror macroeconomic assumptions more realistically. Subsequently, and consistently with the goal to achieve fiscal balance, budget expenditure was also raised to make room for some unbudgeted priority expenditure for healthcare and road maintenance.

As the strong domestic demand requires continued fiscal prudence, the 2005 budget too will reflect a neutral fiscal stance. In accordance with its policy program the government is examining the feasibility of further lowering corporate and personal income tax rates. This revenue shortfall is expected to be largely offset by raising excise taxes toward minimum EU levels and a further improvement in tax collection. On the expenditure side, better targeted social spending and outlays related to EU accession and infrastructure remain priorities.

Credit growth

Continued rapid credit growth has been observed over the last three years. In many respects the increased financial intermediation is a welcome development that represents an overdue catching-up and supports real convergence. The recent pace of credit growth at about 50 percent year-on-year, however, may have led to an increase of macroeconomic vulnerabilities and is seen as one of the key factors behind the widening trade deficit.

Data for June suggest a modest slowdown, as a substantial reduction in corporate credits more than offset higher growth in consumer credit. Nonetheless, in response to the overall substantial increase of domestic credit, the Bulgarian National Bank (BNB) has been closely monitoring the process and is taking measures to further strengthen supervisory activities and reduce banking system liquidity. Most recent steps comprise expanding the coverage of reserve requirements to include virtually all liabilities previously excluded and reducing the proportion of cash in vault that can be used for fulfilling reserve requirements. The BNB is contemplating the introduction of minimum liquidity requirements if no clear signs of decline of credit growth appear by fall of this year.

After returning its deposits that were placed with commercial banks to the central bank, the government also transferred to the BNB almost the full amount of the deposits of the Bank Consolidation Company. The same actions are to be taken soon with regard to the lev-denominated suspense account of the customs office. In addition the Deposit Insurance Fund will invest its cash balances and maturing bank repos in newly issued government bonds and place any future liquid assets with the BNB. Also, the government is ready to start bond sales in excess of those already planned if the above measures prove to be insufficient to drain liquidity.

Structural reforms

The authorities realize that reducing excess demand would not be enough to lower external vulnerability. As a decisive boost of supply will also be needed as a policy response, the authorities have committed to a number of structural reforms aimed to strengthen program implementation. In this regard, an improved business climate is seen as essential to stimulate investment and growth. Steps are being taken to ease company registration and dispute resolution procedures, and to simplify investment procedures. In the same vein are the efforts to improve the quality of administrative services.

To further enhance revenue collection, a National Revenue Agency combining collection of taxes and social contributions will be established and become operational at the beginning of 2006. The existing large taxpayer offices will be further strengthened with the introduction of online services. Treasury operations will be strengthened by including in the Treasury Single Account system some accounts previously staying outside the system. Further reforms in the energy and railway sectors are being contemplated, while pending privatization will be completed on time and a new pipeline for 2005/06 will be created.

In conclusion, the authorities look forward to continue working closely with the staff to secure the successful implementation of the program, that is intended to be the last program-based relation with the Fund. While believing that the policies set forth in the MEFP are adequate, they commit to take any further measures that may become appropriate to achieve the program objectives in full.