

**Bulgaria: 2006 Article IV Consultation, Third Review Under the Stand-By Arrangement, and Request for Rephasing, Waiver of Applicability and Nonobservance of Performance Criteria and Extension of the Arrangement—Staff Report; Staff Statement; and Public Information Notice and Press Release on the Executive Board Discussion**

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2006 Article IV consultation with Bulgaria, the third review under the Stand-By Arrangement, and request for rephasing, waiver of applicability and nonobservance of performance criteria and extension of the arrangement, the following documents have been released and are included in this package:

- the staff report for the combined 2006 Article IV Consultation, Third Review Under the Stand-By Arrangement, and Request for Rephasing, Waiver of Applicability and Nonobservance of Performance Criteria and Extension of the Arrangement, prepared by a staff team of the IMF, following discussions that ended on May 17, 2006, 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 18, 2006. 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 2, 2006 updating information on recent economic developments.
- a Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its August 2, 2006, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

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

Letter of Intent sent to the IMF by the authorities of Bulgaria\*  
Selected Issues Paper and Statistical Appendix  
Third Supplementary Memorandum of Economic and Financial Policies by  
the authorities of Bulgaria\*  
\*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

BULGARIA

**Staff Report for the 2006 Article IV Consultation,  
Third Review Under the Stand-By Arrangement, and  
Request for Rephasing, Waiver of Applicability and Nonobservance of  
Performance Criteria and Extension of the Arrangement**

Prepared by Staff Representatives for the 2006 Consultation with Bulgaria

Approved by Ajai Chopra and Matthew Fisher

July 18, 2006

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## EXECUTIVE SUMMARY

**Bulgaria has experienced good growth in recent years, but large external imbalances pose new challenges:**

- Private sector confidence has increased with impending EU accession, contributing to rapid growth of private domestic demand and rising current account deficits.
- Fiscal policy has been tightened but external imbalances have continued to grow.
- Bank lending to the non-government sector has slowed, but non-bank financial intermediation and foreign debt are growing rapidly.
- The pace of structural reform has decelerated, constraining potential output growth.

**Discussions focused on how to limit rising underlying vulnerabilities while taking advantage of the opportunities offered by EU accession.**

**Outlook:** Staff and authorities agreed that growth is likely to pick up in 2006 and the medium term. Different assessments of the Balassa-Samuelsen effect over the medium term led staff to project a slightly higher inflation rate than the authorities. Both staff and authorities expect a widening current account deficit in 2006 and a gradual narrowing over the medium term as exports pick up.

**Euro adoption:** Staff and authorities agreed that euro adoption could reduce external vulnerabilities. Success within EMU will require increasing the economy's flexibility through deeper structural reforms.

**Fiscal policy:** Staff and authorities agreed that persistent vulnerabilities over the medium term would mean there would be scope for only a gradual loosening of the fiscal stance from the projected 2006 surplus of 3.2 percent GDP. Increased financial flows from the EU will add to demand pressures, but also to supply capacity over time. Staff and authorities agreed that, after taking these flows fully into account, the 2007 budget should aim at a surplus of about 2 percent of GDP.

**Financial sector policy:** Staff and authorities agreed that the demand restraining impact of the credit measures was waning rapidly while the distortionary costs were rising. It was agreed that the BNB will phase out the measures with minimum disruption to the banking system while maintaining a tight prudential framework.

**Structural policies:** Staff and authorities agreed that structural reforms need to be revitalized to raise medium term growth prospects and reduce external vulnerabilities. Although legislative frameworks have been strengthened, implementation remains weak and stronger reform effort is required in the areas of business environment, public infrastructure, the labor market and the health and education sectors. A more forceful fight against high level corruption is urgently needed.

## I. INTRODUCTION

1. **A staff team<sup>1</sup> visited Sofia during May 4-17, 2006 to conduct the 2006 Article IV consultation and the Third Review under the Stand-By Arrangement (SBA).** The 25-month precautionary arrangement in the amount of SDR 100 million (15.62 percent of quota) was approved on August 6, 2004. The second review was completed on April 3, 2006 (IMF Country Report No. 06/131). Discussions focused on policies to end-2006 following the authorities' decision to request extension of the SBA to end-March 2007 (LOI, ¶4).

2. **The three-party government formed after parliamentary elections in June 2005 remains coalesced around achieving EU accession in 2007.** The European Commission (EC) has announced that its recommendation on the timing of accession will be delayed until September 2006 and will be contingent on progress in areas such as combating organized crime, corruption and money laundering, and strengthened financial controls over EU project funds. Presidential elections follow soon after in November.

3. **This Article IV consultation takes place against a backdrop of broadly favorable economic performance but greater underlying vulnerabilities.** The benign international economic environment of recent years and confidence in Bulgaria's transition prospects have buoyed investment and growth. At the same time, the external current account deficit has widened and external debt has increased. Managing risks remains the central challenge facing the authorities and is a principal aim of the program under the SBA.

## II. BACKGROUND TO THE DISCUSSIONS

### A. Recent Economic Developments

4. **GDP growth has been strong.** GDP grew by 5½ percent in 2005, up from an average of 4.8 percent during 2001-04 (Text Table 1). The contribution of domestic demand to growth jumped sharply in 2005 (Table 2); both consumption and investment grew strongly while net exports fell, a pattern that was sustained during the first quarter of 2006. The buoyancy of domestic demand can be traced to rapid growth of credit to businesses and households. With the general government budget surplus rising in 2004-2005, and prospectively again in 2006, fiscal policy has been providing partially offsetting negative impulses.

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<sup>1</sup> Messrs. Roaf (acting head), Duenwald, Herderschee, Luengnaruemitchai (all EUR), Mukhopadhyay (PDR), and Ms. Ong (MFD). Mr. Chopra (EUR) participated in the Article IV discussions during May 8-11. The mission met with the Prime Minister, key economic ministers, the Governor of the Bulgarian National Bank (BNB), parliamentarians, and representatives of trade unions and the private sector, and coordinated its work with World Bank staff. Documentation relating to this consultation and review was prepared under the direction of Robert Hagemann, Mission Chief for Bulgaria.

Text Table 1. Macroeconomic Developments, 2001–06  
(in percent of GDP unless otherwise noted)

	2001	2002	2003	2004	2005	2006 (proj.)
Real GDP	4.1	4.9	4.5	5.7	5.5	5.6
Contribution to growth:						
Domestic demand	7.5	4.1	9.3	7.7	11.3	7.0
Net exports	-3.5	0.8	-4.9	-1.9	-5.7	-1.4
CPI (% change, end-of-period)	4.8	3.8	5.6	4.0	6.5	6.2
Unemployment rate (ILO)	17.5	17.8	13.7	12.0	10.1	...
General government budget balance	-0.9	-0.8	-0.4	1.8	2.3	3.2
Gross external debt	78.6	65.1	60.2	64.7	67.7	69.0
Current account deficit	-7.3	-2.4	-5.5	-5.8	-11.8	-12.4
Reserve cover (in months of imports)	5.0	4.9	4.9	5.0	4.6	4.3

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

5. **There has been a steady increase in inflation over the last year, although core inflation has fallen recently** (Figure 1). Rising inflation reflected both temporary and more durable factors. Oil price hikes and flood-related shortages in 2005 raised CPI inflation to 6.5 percent by end-2005. Inflation has increased sharply during the first five months of 2006, due largely to excise tax increases, reaching 8.5 percent in May. Core inflation closely tracked the overall CPI during the first half of 2005, but has declined since.

6. **Wage growth has remained moderate.** Incomes policies have generally helped to moderate economy-wide wage demands, contributing to a fall in unemployment, which reached a low of 9.7 percent (ILO definition) in the first quarter of 2006. Wages in the manufacturing sector have remained in line with productivity growth.

7. **Credit growth has slowed considerably, constrained by ceilings imposed by the BNB** (Table 3). Bank credit growth decelerated to 32 percent in 2005 from nearly 50 percent in 2004.<sup>2</sup> However, the high cost of the penalty deposits imposed under the credit ceilings has increased banks' incentives for circumvention, notably by transferring existing credits abroad and through intermediation via non-bank financial institutions. Nevertheless, banks remain profitable and capital adequacy ratios are high (Table 4). Although non-standard loans (overdue by 30 days) increased during 2005, NPLs (overdue by 90 days) remain stable at around 2.3 percent of total loans.

<sup>2</sup> Following the introduction of the credit measures, new bank deposits exceeded bank lending in 2005 and commercial banks' net foreign assets increased, a reversal from the developments during 2004.



8. **The current account deficit, which doubled in 2005 to 11.8 percent of GDP, deteriorated further to 14.6 percent of GDP during the first four months of 2006** (Table 5). Both buoyant domestic demand and supply shocks have contributed to the deterioration, while competitiveness indicators are satisfactory.

- Real import growth has remained high despite a sharp increase in import prices. The growth of goods imports has been dominated by capital goods, propelled by strong investment growth, both domestic-sourced and FDI.
- Higher oil prices have pushed up nominal imports.
- One-off factors, including adverse effects of summer floods last year and a temporary shutdown of a major steel producer for plant expansion, explain much of the weakened export outcome.
- Although the ULC-based REER appreciated slightly during 2005, most competitiveness indicators are satisfactory (Box 1). Moreover, when viewed in a wider CEEC context, the drop in export growth in 2005 appears to have had a regional dimension.<sup>3</sup>

9. **The current account deficit continues to be substantially financed by FDI flows.** During the first quarter of 2006, net FDI inflows covered 70 percent of the deficit.<sup>4</sup> With early repayments to the IMF and the World Bank, gross reserves declined modestly since end-2005, but remained at 140 percent of short-term debt at original maturity. External debt, however, rose to nearly 69.5 percent of GDP by the end of the first quarter of 2006, up by about 9¼ percentage points from end-2003.

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<sup>3</sup> See IMF Country Report on Romania, No. 06/168, May 2006, Box 3.

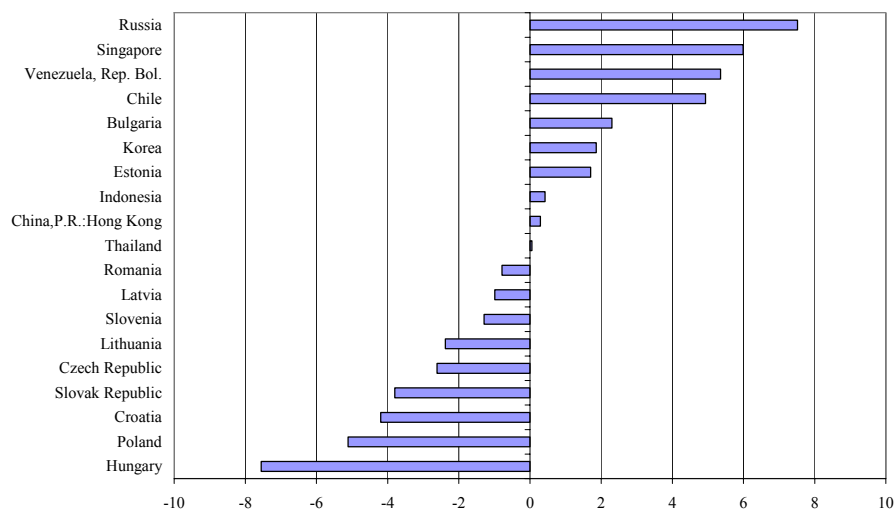
<sup>4</sup> With privatization receipts falling steadily in recent years, greenfield investments as a share of overall FDI flows have been increasing.

## B. Policy Developments

### 10. Fiscal policy has been cautious for several years, and is being tightened further in 2006 (Table 6).

Following budget surpluses of 1.8 and 2.3 percent of GDP in 2004 and 2005, a surplus of 3 percent of GDP is planned for 2006. Recent data suggest that the surplus target may be exceeded, due largely to buoyant tax revenues. Bulgaria's fiscal position in recent years compares favorably with other emerging markets (Text Figure 1).

Text Figure 1. Fiscal Balance of Selected Emerging Markets and other Economies, 2005 1/  
(In percent of GDP)



Source: WEO  
Note: 1/ General government balance. Central government balance for Korea.

11. **The BNB introduced successively tighter credit limits and enhanced prudential measures.** The authorities temporarily raised penalties for breach of the credit ceilings and introduced prudential requirements for household loans, including mortgages.<sup>5</sup> With non-bank intermediation gaining importance, the authorities have also taken steps to monitor leasing activities and are seeking ways to improve supervision of insurance companies and pension funds.

12. **The structural reform momentum has weakened.** There have been frequent delays in implementing reforms in key areas such as improving the business climate, privatization, governance and, until recently, improving labor market flexibility. As a result, Bulgaria performs relatively poorly on the basis of a number of structural indicators (Table 8).

## III. REPORT ON THE DISCUSSIONS

13. **The discussions centered on policies to contain macroeconomic imbalances and achieve sustainable high growth.** With persistently strong domestic demand pressures contributing to the continued widening of the external current account deficit and a rising gross external debt burden, there was broad agreement that restrictive macroeconomic policies—in particular, fiscal policy—would continue to be required in the foreseeable

<sup>5</sup> IMF Country Report on Bulgaria, No. 6/131, April 2006, pp. 77-78.

future. At the same time, there was recognition that in order to set the stage for more rapid convergence to EU living standards, the structural reform effort needed to be reinvigorated. Accordingly, the discussions covered the following key questions:

- What is the appropriate short-term macro policy stance in light of underlying macroeconomic and financial sector vulnerabilities?
- Beyond the short term, how should macroeconomic policies be adapted to the new environment after EU accession? In particular, given that external vulnerabilities will diminish only gradually and that EU financial flows will tend to impart positive fiscal stimulus and demand pressures, what should be the stance of fiscal policy over the medium term?
- What are the key elements of a structural reform agenda that can help ensure competitiveness within the EU and place Bulgaria on a higher sustainable growth path?

14. **The authorities reiterated their intention to join ERM2 shortly after EU accession and to maintain the CBA at an unchanged peg until euro adoption in 2009-10** (Third Supplementary Memorandum of Economic and Financial Policies, ¶2). Staff supported these goals, noting that euro adoption is likely to reduce external vulnerabilities and accelerate integration with the EU. However, staff cautioned that macroeconomic and structural policies needed to be supportive of this framework since a more flexible economy would be better able to handle shocks both before and after euro adoption.

#### **A. Macroeconomic Framework**

15. **The authorities and staff concurred that the 2006 macroeconomic outlook is broadly favorable, albeit still marked by large external imbalances:**

- Real GDP growth is projected at 5.6 percent, slightly higher than in 2005. Domestic demand growth should remain strong, though slower than last year. A less negative contribution of net exports than in 2005 is expected as real export growth recovers, including initially from last year's one-off effects.
- Consumer price inflation is expected to moderate during the second half of the year and reach 6.2 percent at year-end, as temporary factors driving recent price increases unwind.
- After widening further in the first four months of 2006, the 12-month current account deficit is expected to narrow to 12.4 percent of GDP for the full year, reflecting the projected export recovery. With about three-quarters of the deficit covered by FDI, the gross external debt ratio is expected to rise to nearly 70 percent of GDP.

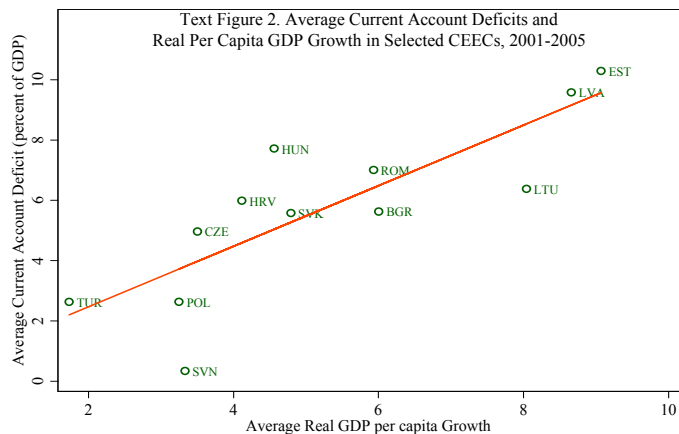
16. **There was also agreement on medium-term economic prospects—which assume that Bulgaria joins the EU on January 1, 2007—although inflation projections caused some debate** (Table 9). Staff noted that an acceleration of structural reforms—in the context of reduced macroeconomic imbalances—would be required to enjoy the full benefits of economic integration with the EU. Under suitable policies, growth could then rise to about 6 percent over the medium term, with an increase in the capital contribution and TFP growth (Text Table 2 and Box 3).<sup>6</sup> Medium-term inflation could be around 1½ percentage points above rates prevailing in the

	Labor Contribution	Capital Contribution	TFP Growth	Real GDP Growth
2001–2005	0.7	1.3	2.9	5.0
2006–2011	0.1	2.4	3.4	5.9

Source: Fund staff estimates and projections.

eurozone, reflecting Balassa-Samuelson effects and administered price increases, which would likely exceed the currently expected Maastricht inflation criterion on average. The BNB argued that Balassa-Samuelson effects would be minimal and therefore projected inflation below 3 percent.

17. **Staff noted that Bulgaria’s economic transition is likely to continue to be marked by large current account deficits and only gradual reductions in external debt.** As in other transition countries, growth has been accompanied by high current account deficits (Text Figure 2). The deficits mainly reflect consumption smoothing and catch-up effects and are not necessarily symptomatic of competitiveness problems. Indeed, staff analysis suggests that Bulgaria’s current account deficit is not substantially higher than what would be predicted by an income convergence model.<sup>7</sup> Over the medium term, the current account deficit is projected to decline gradually, as private savings rise in line with higher income.<sup>8</sup> Sustained FDI inflows



<sup>6</sup> The large drop in labor’s contribution during 2006–11 mostly reflects the projected 0.7 percent per year population decline during this period.

<sup>7</sup> Chapter 1 of Selected Issues assesses the current account deficit using several other methods as well.

<sup>8</sup> Some advanced transition economies have experienced rising savings rates while others have not, suggesting that this expectation in the case of Bulgaria is feasible but optimistic.

are expected to cover three-quarters of the current account deficit on average, and gross external debt would decline to about 61 percent of GDP by 2011.

18. **While near-term crisis risks are low, slow progress in structural reform poses a medium-term risk.** The authorities underscored that strong liquidity buffers and other macro-prudential indicators provided some near-term comfort (Box 4). Although private sector external debt has increased

rapidly, most of the rise is FDI-related and long term borrowing (Text Table 3). Moreover, short-term debt is fully covered by liquid assets held abroad (financial sector) or largely accounted for by trade credits (non-financial sector). Although private sector external debt has increased rapidly, most of the rise is FDI-

Text Table 3: Structure of Private Sector External Debt, 2003-06

	2003	2004	2005	2006 1/
	(In percent of GDP; unless otherwise noted)			
Total	20.3	31.4	43.7	47.9
Financial sector	4.5	8.6	11.8	13.4
<i>of which</i> : Short term	3.4	5.8	7.9	10.2
Nonfinancial sector	15.9	22.7	32.0	34.5
FDI related 2/	7.7	10.4	17.2	17.9
Other	8.2	12.3	14.8	16.6
Short term	5.2	6.6	8.7	10.1
<i>of which</i> : Trade credits	3.7	4.1	4.7	4.6
Long term	3.0	5.7	6.1	6.5
Memorandum items:				
Banks' cash and deposits abroad (in percent of banks' short-term debt)	177.6	142.3	119.2	95.7
Banks' claims on domestic nonfinancial corporations 3/	19.3	24.1	27.1	27.3

1/ End-March.

2/ Half of the increase since 2003 corresponds to the purchase of a local mobile telecom operator.

3/ Claims in domestic and foreign currency.

related (i.e., financing from foreign companies to local subsidiaries, largely to import investment goods) and long-term borrowing. However, staff noted there were reasons for concern as large imbalances increased risks and implied significant adjustments to ensure sustainability. Furthermore, the ongoing credit boom increases financial sector vulnerabilities. The baseline scenario assumes EU accession on January 1, 2007, sustained large capital inflows, and an adequate margin of competitiveness.<sup>9</sup> However, a less benign scenario, involving for example a sudden “flight to quality” and a redirection of capital flows away from Bulgaria, would require a substantial macroeconomic correction. The authorities agreed that absent prudent macro policies, more forceful implementation of structural reform, and vigilant supervision of the financial sector, economic performance could deteriorate and the current account deficit and gross debt levels would not decline as envisaged (Table 15 and 15a). In short, the economy’s underlying vulnerabilities would not abate, and the likelihood of a low growth/high debt scenario and of unpleasant adjustments to domestic absorption would rise.<sup>10</sup>

<sup>9</sup> Bulgaria’s Accession Treaty assures EU membership no later than January 1, 2008.

<sup>10</sup> Chapter 1 of Selected Issues.

## B. Fiscal Policy

19. **In light of the persistently large external imbalances, authorities and staff concurred that there was no scope to relax the ambitious surplus target for this year.**

There was also concurrence that further tightening of fiscal policy would come from the adjustor embedded in the program rather than from discretionary policy action. In this regard, preliminary information for January to April suggests strong collections and some revenue overperformance for the year as a whole. If realized, the projected revenue overperformance relative to target—0.4 percent of GDP—would imply an upward revision to the surplus target of 0.2 percent of GDP under the adjustor, to 3.2 percent of GDP (¶4), providing some offset to strong private demand.

20. **With broad agreement on the near-term stance of fiscal policy, discussions focused on policies in 2007 and beyond.** Staff stressed the competing objectives and challenges for fiscal policy in coming years:

- Avoiding a large relaxation in the fiscal stance given persistently strong domestic demand pressures and large external vulnerabilities.
- Making maximum use of the available EU post-accession grants, within an overall prudent expenditure envelope, while taking into account significant fiscal costs associated with accession.
- Increasing the transparency of budget preparation and execution.

21. **Staff noted that EU accession would complicate fiscal management in 2007 and beyond** (Box 5). While the availability of sizeable post-accession grants from the EU would be a one-time opportunity to help lay the foundations for more rapid integration and convergence with the EU, the fiscal impact of accession needed to be carefully managed lest it result in an excessive fiscal expansion.<sup>11</sup> Also, with the diminished role of the credit restraints (see below), the role of fiscal policy as a short-run demand management tool would become more critical. The authorities broadly agreed with this assessment, but underlined the uncertainties behind some of the estimates of accession-related financial flows to Bulgaria (¶5) as well as uncertainty about the country's absorptive capacity.

22. **Taking these considerations into account, the authorities and staff agreed that a fiscal surplus of around 2 percent of GDP in 2007 would be appropriate.** The authorities

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<sup>11</sup> Disbursement of accession-related EU funds will be conditional on Bulgaria's ability to assure the EC that adequate institutional capacity is in place to minimize fiduciary risk.

noted that this echoed advice from the EC. Based on the authorities' initial estimate of the cost of accession, amounting to about 2½ percent of GDP (Box 5), expenditure savings/substitution of about 0.6 percent of GDP would be needed to reach the 2 percent surplus target.

23. **In light of the near-term challenges, staff argued that the government's proposal to cut direct taxes needed to await clear evidence that they could be afforded.** The proposals were to: (i) reduce the corporate income tax rate from 15 percent to 12 percent; and (ii) eliminate the middle tax bracket in the personal income tax and increase the nontaxable income threshold. The total cost of these measures is estimated at about 0.6 percent of projected 2007 GDP. The authorities agreed to reconsider these proposals in the autumn (¶5), but stressed their intention to maintain a tax system with low rates and few exemptions in the context of a continued shift away from direct taxation. They agreed with staff that future tax cuts should give priority to reducing the payroll tax rate, which remains high relative to other tax rates even after this year's welcome reduction. Staff pointed out that further improvements in tax administration are necessary, particularly to ensure that tax and social security contributions become fully integrated within the NRA as early as possible.

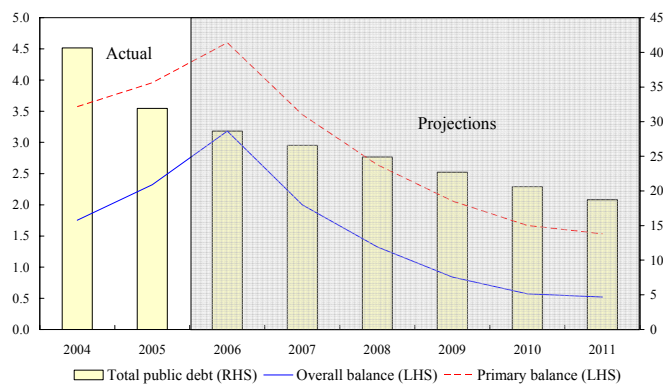
24. **Staff argued that Bulgaria needed to move toward standards of fiscal transparency consistent with its prospective status as an EU member state.** Recalling the conclusions of the 2005 fiscal ROSC, staff pressed the authorities to present the 2007 budget with realistic fiscal projections. The practice of providing parliament with underestimated revenue and the ability under current budget laws to spend a significant part of the eventual revenue overperformance undermined parliamentary scrutiny of government activities. The authorities concurred, and are planning on a 2007 budget with a realistic revenue projection (¶9). They also committed to provide more information with their budget submission, and to strengthen public procurement procedures.

25. **Although medium-term public debt sustainability is not at issue, the public sector needs to continue to provide an offset to private sector savings-investment imbalances.** As such imbalances are

projected to diminish only gradually, and in view of possible inflationary impulses from EU accession and the need to maintain fiscal flexibility in the event of cyclical downturns, staff recommended fiscal surpluses (albeit declining) through the medium term. If the surplus stabilizes at around ½ percent of GDP in the medium term, it would be consistent with a reduction in public debt to under 19 percent of

GDP in 2011 (from 32 percent of GDP at end-2005). Absent monetary policy either under

Text Figure 3: Bulgaria: Fiscal Indicators  
(In percent of GDP)



the CBA or following prospective EMU participation, this cautious medium-term stance would secure room for fiscal maneuver during cyclical downturns. Staff also stressed that substantial expenditure substitution would be necessary in order to make room for EU project grants without undue fiscal relaxation. Looking beyond the initial post-accession years, however, Bulgaria should anticipate spending needs in priority areas such as infrastructure and education, warranting a build-up of public finance capacity in the interim. The authorities broadly concurred with these recommendations, noting that this fiscal restraint was consistent with the 40 percent of GDP ceiling on general government expenditure set in the post-election coalition agreement.

26. **Staff underlined the need for further fiscal reforms to solidify the foundation for public finances.** The authorities noted their commitment to reduce fraud and abuse, noting that the law on duty-free trade—which specifies limits on individual purchases of goods and fuels and strengthened controls—is expected to be passed by parliament by August 31, 2006 (¶8). Staff also emphasized the need for improvements in expenditure management, in part to ensure a high degree of absorption of EU funds within a prudent overall expenditure envelope. The authorities pointed to the deployment of the Financial Management Information System in the Ministry of Finance, which is designed to help manage expenditure, and noted that program budgeting was being introduced in additional ministries (¶9). Furthermore, local government debt operations would be more closely monitored through the establishment of a municipal debt register (¶18).

27. **Reform of public services is a priority.** Absent wide ranging and fundamental reform, the health and education sectors would continue to provide poor value for money, while putting rising pressure on public expenditure. In the health sector, staff stressed that near-term plans to tighten financial controls and increase the transparency of hospital financing would need to be bolstered by extensive restructuring and consolidation of the hospital sector. In the education sector, the authorities noted that a reform strategy—setting out broad objectives in terms of improving outcomes and rationalizing school and staff numbers in the context of a falling student population—had been submitted to parliament (¶6). Staff encouraged the authorities to make headway in these difficult areas—with the assistance of the World Bank—following years of disappointing progress.

### C. Financial Sector Policies

28. **There was agreement that the bank credit growth limits were rapidly losing effectiveness and should be phased out.** The authorities noted that banks had generally observed the limits and that bank lending growth to the non-government sector had declined as projected since their introduction in March 2005. However, there was mounting evidence that the impact on financial flows and demand was fading as both business and households were increasingly finding alternative means of obtaining credit. Staff also agreed with the BNB that the measures were distorting credit allocation decisions and reducing the central bank's ability to reliably monitor changes to credit quality.

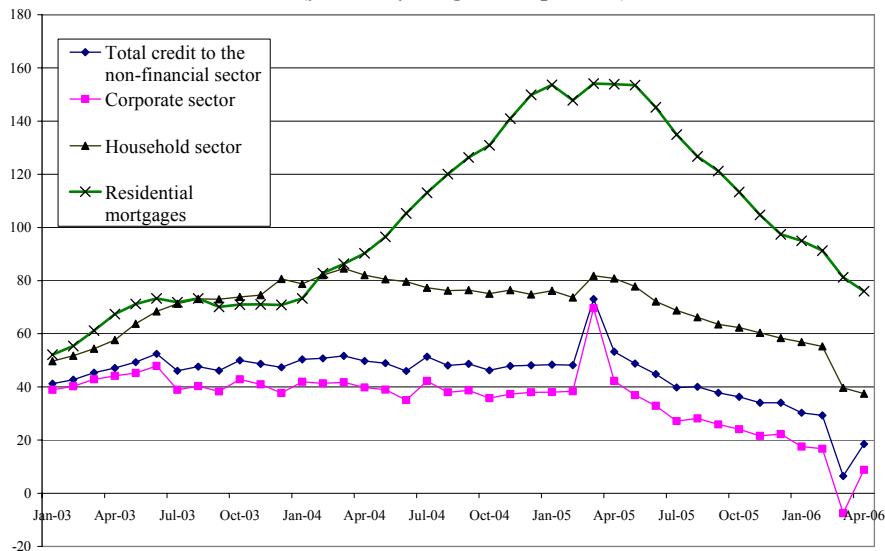


29. **The authorities plan to phase out the measures in a manner that minimizes disruption to the financial system.** The BNB said it was not committed to a particular time schedule but noted its intention to

gradually remove the limits in consultation with staff (¶12). They considered the current environment of rising international interest rates to be conducive to such a move. As a first step, the penalty rate on lending in excess of the limits would be reduced

from 400 to 200 percent from August 4, 2006. The BNB also announced that it was broadening requirements on banks for reporting to the credit registry to include third party loans that they manage.

Text Figure 4. Bulgaria: Growth of Bank Credit  
(year-on-year growth, percent)



30. **Staff stressed that the existing tight prudential framework for banks should be maintained.** Although the banking system is well capitalized and profitable, its health had been supported by propitious operating conditions, including robust economic growth and high global liquidity. There was agreement that although the NPL ratio remained broadly stable, the lagging nature of the indicator could possibly mask a latent deterioration of the quality of loan portfolios. Moreover, discussions with market participants suggest that the creditworthiness of new borrowers may be falling. However, the BNB's stress tests—which staff views as appropriately conservative—suggest that the banking system is well-positioned to absorb a significant adverse shock. The authorities also noted that they are carefully monitoring developments in classified loans, taking note of staff's research showing that Bulgarian-owned banks in particular exhibited greater solvency risk.<sup>12</sup> They also intend to implement a conservative version of Basel II from January 1, 2007 (¶13) but cautioned that overly stringent prudential regulations would likely promote regulatory arbitrage, especially with the opening of the domestic banking sector to foreign bank branches under the EU's Single Passport directive following accession.

<sup>12</sup> Chapter 4 of Selected Issues.

31. **The authorities acknowledged the need to improve the supervision of the rapidly growing non-bank financial sector (¶15).** They agreed with staff that, while the systemic risk posed by this sector is small, the increased shifting of credit risk from the banks to their non-bank financial counterparts, along with associated reputation risk, is an area of potential concern. To address this risk, the authorities have submitted to parliament a law on supervision of financial conglomerates, and the social insurance code was amended in February 2006. On the issue of insurance sector supervision, an MFD TA mission overlapped with the Article IV consultation and made a number of recommendations to strengthen prudential and market conduct regulation in the sector (¶16).

#### **D. Incomes and Labor Market Policies**

32. **Staff stressed that a prudent incomes policy and efforts to increase labor market flexibility would be critical to maintain the competitiveness and agility of the economy.** In view of proposals from trade unions and some in the government for significant increases in public sector pay and the minimum wage, staff cautioned that more modest increases this year and next would send appropriate signals to businesses and workers to avoid excessive pay rises. Staff also pointed out that higher wages in the public sector could be better afforded if excess labor were cut. With respect to private sector wage determination, staff stressed that wages should be set in the market according to productivity improvements and other factors at the firm level. The authorities concurred with staff's observations on labor market flexibility, and intend to increase working time flexibility and eliminate the portability of the seniority bonus when changing jobs (¶11). Staff also stressed that Bulgaria's adverse demographics highlight the need to increase labor market participation, and encouraged the authorities to review social assistance programs, including for sick leave, to ensure that disincentives to participation are minimized.

#### **E. Other Structural Reforms**

33. **Staff emphasized that a revitalization of structural reforms was needed to improve medium-term growth prospects and help address external vulnerabilities.** Although a number of fundamental reforms were undertaken in the years following the creation of the CBA, the momentum has slowed in recent years. With external vulnerabilities remaining significant even in a benign scenario, and with macroeconomic policies having reached their limit in terms of efficacy and feasibility, staff emphasized that the policy burden would increasingly shift to the structural side to elicit a supply response from the economy. Absent a more forceful approach to structural reform implementation, staff warned that convergence to EU living standards would be even more prolonged and that Bulgaria would not be sufficiently agile to benefit fully from EMU. The authorities acknowledged that differences within the coalition government had delayed the formulation of clear strategies for structural reform. However, they agreed on the importance of removing remaining impediments to investment and growth, including the following priority areas put forward by staff:

- Further efforts to improve the business climate, including: completing reforms to transform business registration from a judicial to an administrative procedure (¶19), further lifting the regulatory burden on businesses (¶21), strengthening the quality of public services, and improving public infrastructure.
- Re-establish momentum in the areas of privatization and concession agreements, which have tended to get mired in court proceedings or delayed for other reasons (¶20).
- The decline in corruption seen earlier has slowed down, and implementation of the government's anti-corruption strategy (¶22) has fallen short of its objectives. Here, determined implementation of the anti-corruption agenda agreed in response to the latest European Commission monitoring report, along with improvements in public procurement procedures, will be important.

## **F. Program Issues**

34. **Discussions on the third review focused on measures in the remainder of 2006 to reduce external vulnerabilities and get the structural program back on track.** Staff and authorities concurred that the further widening of the external current account deficit meant there was no scope for a fiscal loosening this year. Understandings were also reached on a revised timeline for structural actions.

35. **Quantitative PCs remain on track** (Table 11), **but there have been numerous slippages in structural conditionality** (Table 12). The three measures set as structural PCs for end-April and end-June are expected to be implemented partially or with delay, and waivers are sought for the following items below (LOI, ¶2):

- Approval of the new VAT law by parliament is a Prior Action, following a delay from the April 30, 2006 deadline set in the second review due to extended consultations with the business community.
- Because of the need to develop new software for electronic registration, the start-up of the new business register is now proposed as an October 1, 2006 structural PC, a three month delay from the June 30, 2006 deadline set in the second review.
- The selection of the winning bidder for the Varna electricity generation company was implemented on schedule. Lacking an acceptable bid for the Rousse plant, the tender for its sale has been re-issued, and the selection of the winning bidder is proposed as an October 31, 2006 structural PC.

36. **Relative to the second review, there are a number of other proposed changes to program conditionality outlined in Table 13.** In recent weeks, the authorities have stepped up efforts in the structural area, including progress toward passage of a new duty-free trade

law, amendment of the labor code increasing work-time flexibility, submission to parliament of laws on credit institutions and financial conglomerates, and amendment of the law on investment promotion to speed up administrative processes.

37. **The authorities have requested an extension of the SBA until March 2007 (LOI, ¶4), noting that a short extension of the arrangement would help mobilize political support for prudent policies through end-year.** Staff supports this request. In light of the proposed extension, preliminary agreement was reached on the outline of the budget for 2007. While specific discussions of the parameters of the 2007 budget will await the fourth review mission, staff and authorities concurred that understandings on the budget will be an important element of that review. The authorities have also requested a waiver of applicability for the end-June performance criteria on the general government balance, central government arrears and the wage bill of 58 state-owned enterprises. Data to verify performance against these targets will not be available by the August 2 Board date, but information received thus far suggest that these are likely to be met.

#### G. Other Issues

38. **The authorities and staff also discussed the following issues:**

- The legislative framework for AML/CFT is largely in place. The authorities stressed their commitment to strengthening enforcement (¶17). Bulgaria's AML/CFT system is to be evaluated by MONEYVAL later in 2006.
- The BNB has an infrastructure disruption plan that would be invoked in the event of an outbreak of **avian flu** in the population. Commercial banks for the most part have developed business continuity plans.
- **Data provision and quality** remain sufficient for program monitoring and surveillance. The authorities are nevertheless committed to further improve the quality of statistics.
- **Bulgaria's trade regime will be further liberalized when the country joins the EU.** The current simple average MFN tariff of 11.8 percent will be halved upon EU accession. Trade in services, notably financial services, will be further liberalized under the EU single passport regime.

#### IV. STAFF APPRAISAL

39. **Bulgaria's successful transition from crisis a decade ago to steady growth has helped the country reach the doorstep of EU accession.** The confidence inspired by Bulgaria's economic performance and expectations of convergence to European living standards has spurred consumption as well as investment flows from abroad. This has contributed to strong growth, buoyed by rapid investment growth, and falling unemployment.

Wage increases have remained broadly in line with productivity growth and have helped to maintain competitiveness. Capitalizing further on accession will require maintaining sound macroeconomic policies and an acceleration of structural reforms to enhance the performance and agility of the economy.

40. **Growth has been accompanied, however, by a worrying increase in Bulgaria's external vulnerability.** Buoyant domestic demand, fueled in part by rapid bank credit growth, has contributed to the recent increase in inflation and has boosted imports. The consequent widening of the current account deficit has been rapid and substantial. Although competitiveness appears to be satisfactory and the export outlook is reassuring, the already high and rising external debt level makes Bulgaria vulnerable to external shocks, including the risks inherent in a less benign global economic and financing environment.

41. **The authorities' plan to retain the currency board at the present parity through to euro adoption is appropriate.** Staff considers the exchange rate broadly in line with fundamentals, but it will be crucial that the policy framework is conducive to maintaining going forward and euro adoption is likely to reduce external vulnerabilities and also accelerate the process of integration with the EU. As the lev is already pegged rigidly to the euro, Bulgaria only stands to gain by joining EMU at the earliest feasible date.

42. **The progressive tightening of fiscal policy has provided a strong signal of the government's commitment to contain macroeconomic imbalances.** Substantial fiscal surpluses have helped to offset strong private sector demand, and with the current account deficit projected to remain high over the near term, the government's commitment to a fiscal surplus of at least 3 percent of GDP in 2006 is appropriate. With revenue performance presently expected to exceed earlier projections, application of the fiscal adjustor agreed under the program will yield a slightly higher surplus.

43. **With external vulnerabilities likely to unwind slowly in coming years, there is only limited room to relax fiscal policy.** For 2007, the budget should aim to achieve a surplus of at least 2 percent of GDP. As financial flows associated with EU accession will add to demand pressures, achieving this budget objective will require the identification of offsetting expenditure savings and substitution. In addition, although the EU-financed projects can also add greatly to Bulgaria's productive capacity, they will raise potential output growth only if they are planned carefully and managed properly. This requires urgent improvements to administrative capacity.

44. **Bulgaria needs to improve standards of fiscal transparency.** Purposefully under-budgeting revenue or over-stating spending plans distorts budgetary decisions and undermines parliamentary scrutiny of government activities. Such non-transparent practices undermine the government's credibility and provide confusing signals about fiscal policy, with potential adverse consequences for investor sentiment. There is also urgent need to improve public procurement and expenditure management—including internal controls,

accounting, auditing and budget execution reporting—especially in light of the prospective EU project grants.

45. **The government has wisely opted to delay decisions on further tax cuts.** Tax policy and administration should focus on reducing distortions and incentives to operate in the grey economy. Despite the significant reduction of social security contribution rates in 2006, taxes on labor remain high, promoting the underground economy. Thus, to the extent that further tax cuts can be afforded, they should be directed towards payroll taxes. There is still much scope for improvements in tax administration, particularly by ensuring that tax and social security collections are fully integrated within the National Revenue Agency as early as possible.

46. **Risks to the banking sector in an environment of rapid credit growth need to be monitored closely.** Although the banking system is well capitalized and profitable, supervisors need to scrutinize developments in non-performing loans and ensure the adequacy of banks' risk management frameworks. The credit limits introduced by the BNB helped reduce excessive growth in bank lending, but their effectiveness has diminished as banks found means of circumvention. The BNB's plan to phase out the administrative credit measures while maintaining the existing tight prudential framework is therefore appropriate.

47. **The insurance and pension sectors are growing rapidly and require close supervision.** Although the systemic risk posed by the non-bank financial sector remains small at this stage, reputation risks to the wider financial sector may exist.

48. **A revitalization of structural reforms is needed to improve medium-term growth prospects and help address external vulnerabilities.** A more flexible and dynamic economy will yield stronger growth, increase resilience to shocks, and help export performance by sustaining competitiveness. It will also improve prospects for success within the monetary union. However, following a period of profound economic restructuring following adoption of the CBA, the reform momentum has slowed over time. Although the legislative framework has been strengthened in a number of areas, implementation on the ground remains the weak link. Particular areas requiring attention include:

- Efforts to improve the business environment and encourage foreign and domestic investment need to be accelerated. The judicial system does not yet deliver the needed standards of legal certainty, the burden of regulation remains onerous, and public administration remains slow and unresponsive to the needs of businesses.
- Privatization and concession arrangements need to be sped up.
- Public infrastructure needs to be modernized and renovated.
- Labor market participation needs to be increased to counter Bulgaria's adverse demographic prospects. This will require a review of social assistance programs,

including sick leave, to ensure that disincentives to labor market participation are minimized. Release of excess staff from the public sector would also contribute to improved labor supply to the private sector. The government needs to work with its social partners to ensure implementation of its initiatives to improve labor market flexibility.

- In the critical social sectors of health and education, more vigorous reform efforts are needed. The education system needs to be rationalized in light of demographics and skills demands of the economy. Health care financing needs urgent reform to reduce the burden on public finances.

49. **Corruption remains a serious problem.** The declining trend in corruption reported since the late 1990s appears to have come to an end, and implementation of the government's anti-corruption strategy has fallen short of its objectives. Improvements to public procurement procedures would help in this regard, as will legislative initiatives such as the expected new duty-free trade law. But results in the fight against corruption will depend ultimately on the political will of the government, parliament and other institutions.

50. **Failure to maintain firm fiscal policy and re-invigorate the structural reform agenda would make Bulgaria increasingly vulnerable to shocks.** Large and persistent external imbalances, together with rapid credit growth and rising inflation, give rise to sizeable risks. To avoid a scenario of deteriorating competitiveness, low growth and high debt, and the consequent disorderly adjustment of domestic absorption, it will be imperative for the authorities to be resolute in implementing policies that contain these underlying risks and increase the flexibility of the economy.

51. Staff recommends completion of the Third Review under the SBA, and supports the authorities' requests for waivers of non-observance and of applicability of performance criteria, and for an extension of the arrangement to March 31, 2007. It further proposes that, consistent with provisions of decision 12794-(02/76) Bulgaria revert to a 12-month Article IV consultation cycle upon expiration of the SBA.

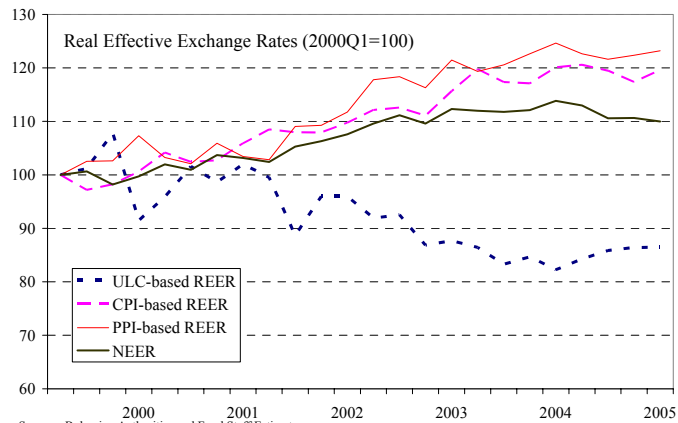
### Box 1. International Competitiveness

**The rapid widening in the external current account deficit in 2005 has raised concerns about Bulgaria's international competitiveness.** As with any transition economy, however, it is difficult to disentangle the structural and cyclical effects: a larger current account deficit may reflect consumption smoothing and catch-up effects, rather than a loss of competitiveness. Similarly, an appreciation of the real effective exchange rate (REER) may reflect underlying changes in the equilibrium exchange rate.

**An analysis of standard indicators suggests that there has not been a significant loss in external competitiveness.**

- **REER indicators:** CPI- and PPI-based REERs show a trend appreciation since 2000, which is to be

expected in a transition economy, given the impact of price liberalization and adjustments of administered prices. Furthermore, the appreciation of the CPI-based REER might reflect the effects of differential productivity gains across tradable and nontradable sectors (Balassa-Samuelson effect), rather than changes in external competitiveness. The CPI-based REER was relatively steady in 2004-05, in contrast to significant appreciations in

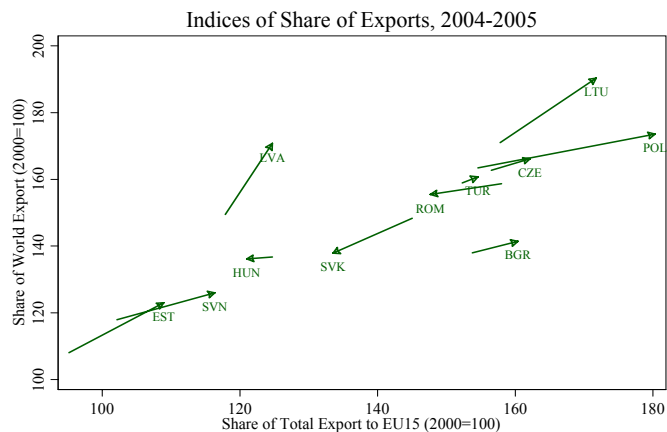


Sources: Bulgarian Authorities and Fund Staff Estimates.  
Note: CPI-based REER uses IMF's INS weights. PPI- and ULC-based REERs use bilateral trading values of top 70% Bulgaria's trading partners as the weights

Romania and the NMS8 (see Figure 3, panel 1). The ULC-based REER (manufacturing sector) has shown a trend depreciation, although it appreciated modestly in 2005. However, wage levels in Bulgaria remain far below other transition countries, and this differential did not change appreciably in 2005 (Figure 3, panel 2). In addition, the divergent trends in the price- and cost-based REERs suggest strong growth in corporate profitability.

- **Export performance:** The growth in exports of goods and services declined in 2005, due in part to an adverse exogenous shock (floods). Slower domestic demand growth in the EU-15 (following an exceptional year in 2004) also played a role. Bulgaria's export shares in the EU-15 have continued to increase, in contrast to some other countries in the region.

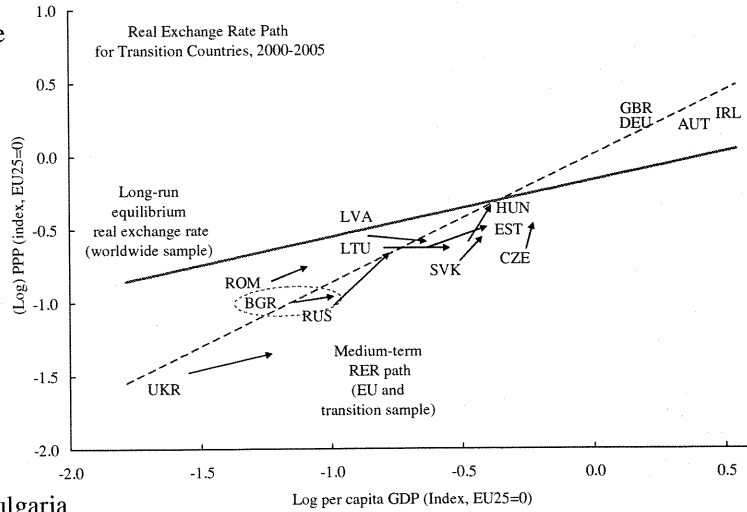
Finally, a sectoral breakdown of the contribution to this growth suggests a modest move towards higher value added exports, with the contribution of services rising and that of textiles falling (Figure 3, panel 3).





### Box 1. International Competitiveness (concluded)

- Exchange rate (mis)alignment:** Whether the appreciation of Bulgaria's price-based REER is a problem or not depends on whether the exchange rate is moving towards or away from its equilibrium. One approach to making this assessment is to use the gap between the actual and implicit PPP exchange rates as a measure of misalignment (*see IMF Country Report No. 06/169*). Compared to a world-wide benchmark, the exchange rates of Bulgaria and other transition economies appear undervalued; indeed Bulgaria's exchange rate is undervalued relative to the EU transition group. Bulgaria's REER has also moved along the benchmark paths during 2000–05.



**Box 2. Implementation of Past IMF Policy Recommendations**

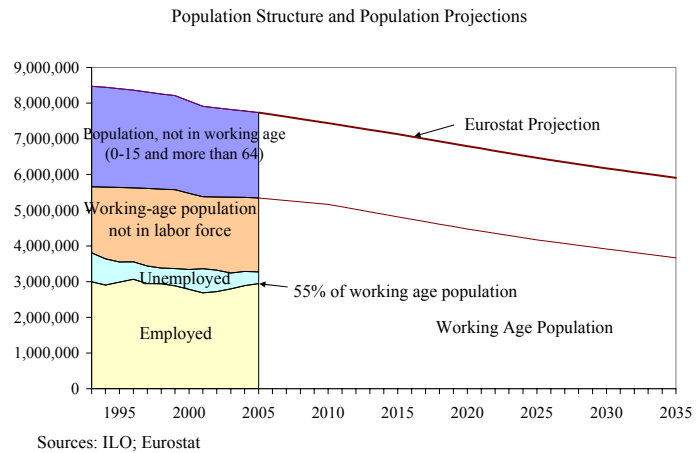
**Fiscal policy:** Bulgaria has maintained a very cautious stance of fiscal policy in support of the CBA, in line with staff recommendations. Sustained and increasing primary surpluses have allowed continued reductions of gross external public debt. Fiscal transparency is improving, but further steps are necessary in this area in line with ROSC recommendations.

**Financial sector issues:** There has been good collaboration on measures to reduce bank credit growth, and the authorities have been receptive to Fund advice on strengthening financial sector soundness. Implementation of the 2002 FSAP banking sector recommendations has been strong; further progress is needed in the non-banking sector. The authorities have expressed an interest in a follow-up during the latter part of 2007.

**Structural reforms:** After several years of vigorous efforts following the 1996-97 crisis, the structural reform momentum slowed. There has been agreement on the reform agenda, including staff recommendations in areas such as privatization, tax administration, business registration and dispute resolution and enforcement, but implementation has been slow.

### Box 3. Convergence Prospects

**One of the major challenges to Bulgaria's medium- and longer-term growth prospects is its declining and aging population.** Bulgaria's population has been declining for more than a decade and is projected to decline by another 24 percent by 2035 and the working-age population by 31 percent, overwhelmingly due to a negative rate of natural increase. Failing an improvement in labor force participation (presently 61 percent of working age population), employment will soon fall, and the labor contribution to growth will shrink. In order to sustain higher economic growth and achieve faster catch-up, Bulgaria needs to raise its labor force participation rate and increase overall productivity through further structural reforms.



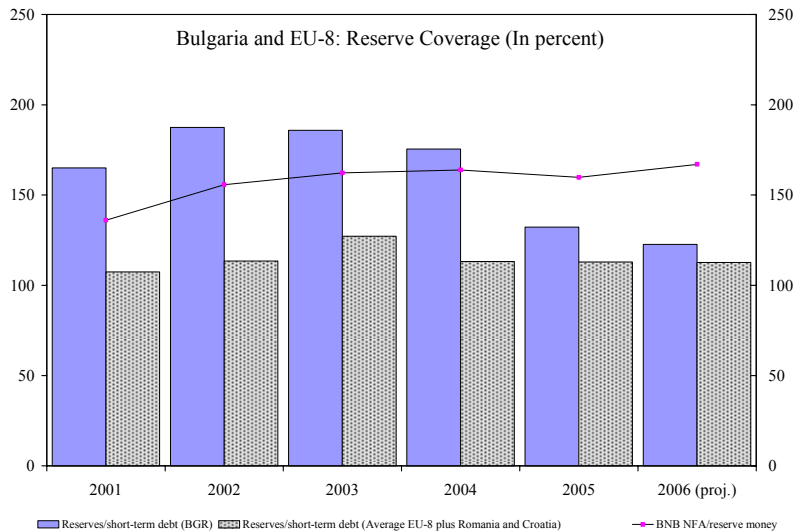
**Given the large initial income gap, it will take Bulgaria several decades to converge to the living standards of the more advanced members of the EU, even with optimistic assumptions regarding economic growth.** At market exchange rates, Bulgaria's GDP per capita is only about one tenth of the average of EU15 and less than half of the average of the new member states. Adjusted for purchasing power parity, Bulgaria's GDP per capita is a little more than  $\frac{1}{4}$  of the EU15 average. Even with optimistic assumptions, it would take Bulgaria more than 20 years to reach the *current* level of average per capita income of EU15. Assuming absolute convergence and allowing EU15 to converge to its steady state, it is estimated that it will take Bulgaria more than 40 years to reach  $\frac{3}{4}$  of the average income level of the EU15.

**Box 4. Assessing Near-Term Risks**

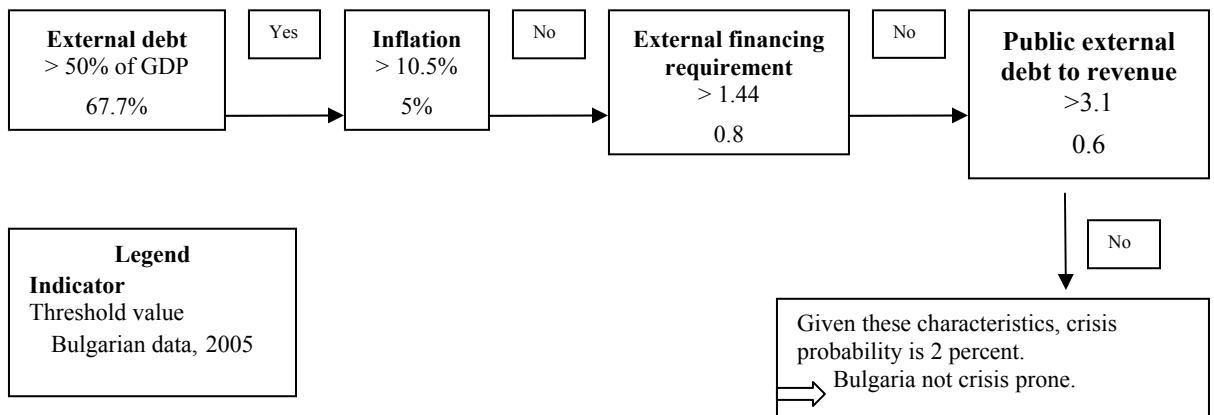
**While underlying medium-term vulnerabilities are significant, risks of a near-term crisis appear low.**

Bulgaria continues to enjoy strong liquidity buffers, and the focus on only a few indicators—such as the external current account deficit—in isolation, rather than on a broader set of macro-prudential indicators, may be misleading.

- The liquidity buffers—the high level of gross international reserves relative to the usual metrics such as short-term external debt, and, for a currency board, the central bank’s monetary liabilities—are ample and macroeconomic policy has been prudent, striking an appropriate balance between risk management and growth.



- One recent approach to crisis prediction uses an empirical decision tree, which allows individual vulnerabilities to interact with others so as to identify different types of risks (see IMF WP/05/42). An analysis of a set of macro-prudential indicators and associated thresholds that have been shown to be statistically significant in predicting sovereign debt defaults and recourse to large-scale IMF assistance suggests that Bulgaria is not at present crisis prone. The tree begins with the external debt-to-GDP ratio (threshold of 50 percent), and then splits in a binary fashion, depending on actual data compared to certain threshold values, until a country is identified as either safe or crisis prone (see below for Bulgaria).
- With relatively low public external debt levels, a sovereign debt crisis may not be the most likely crisis scenario in Bulgaria. However, in the event of problems in the financial sector, there could be important spillover effects. Specifically, in the case of a banking crisis, although the BNB’s stress tests indicate that banks are well-placed to absorb high levels of stress,<sup>1</sup> liquidity and solvency risks for the sovereign could materialize rather quickly.



<sup>1</sup> Chapter 5 of Selected Issues assess the BNB’s stress-testing.

### Box 5. Fiscal Impact of EU Accession 1/

**Upon EU accession, Bulgaria will begin to benefit from substantial EU transfers.** These transfers—which come in addition to those Bulgaria has already been receiving through the pre-accession financial instruments PHARE, ISPA, and SAPARD—offer a unique opportunity to hasten economic, social, and institutional integration with the EU. Annual post-accession transfers to Bulgaria's budget are estimated to average around 2 percent of GDP during 2007-09, although the precise amount will ultimately depend on Bulgaria's ability to identify projects and demonstrate capacity to use these funds effectively.

**However, other fiscal effects of accession will complicate fiscal management.** Revenue is boosted by the EU transfers, but so is expenditure. Indeed, costs related to accession—which include the contribution to the EU budget (net of some compensatory payments designed to prevent a negative cash flow for Bulgaria), revenue losses arising from the elimination of customs borders with the EU, and cofinancing requirements—are estimated to total 2½ percent of GDP in 2007. On top of this comes the grant-financed project spending.

**In order to prevent an excessive loosening in the fiscal stance, expenditure savings/substitution will be necessary.** In 2007, EU post-accession net transfers to the budget are negligibly small. 2/ Other factors as listed in the table below are estimated to produce a negative impact on the budget of 2.6 percent of GDP. Absent offsetting expenditure savings, this would produce a 1.4 percent of GDP surplus in 2007, which, given the continued increase in external vulnerabilities, would be excessively expansionary relative to the targeted surplus of 3.2 percent of GDP in 2006. However, with expenditure savings or substitution of 0.6 percent of GDP a surplus of 2 percent of GDP is attainable.

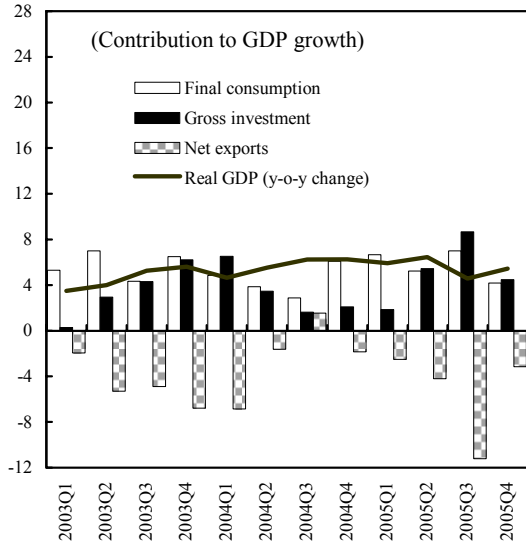
Bulgaria: Net Budgetary Impact of EU Accession, 2007-09 1/ (In percent of GDP)			
	2007	2008	2009
Net transfers to National Budget	0.0	1.0	1.9
Receipts from EU budget (+)	1.3	2.2	3.1
Contributions to EU budget (-)	1.2	1.3	1.2
Other factors	-2.6	-3.6	-4.4
Project spending (EU financed)	-1.1	-1.8	-2.8
Cofinancing	-0.3	-0.5	-0.6
Indirect revenue impact	-1.2	-1.3	-1.1
Net impact on budget	-2.6	-2.6	-2.5
Expenditure savings	0.6	0.9	0.7
Total net impact on budget	-2.0	-1.7	-1.8
Change in budget balance (- = expansionary)	-1.2	-0.7	-0.5
1/ Includes only post-accession effects. Sources: Ministry of Finance; and IMF staff calculations.			

1/ Chapter 3 of Selected Issues.

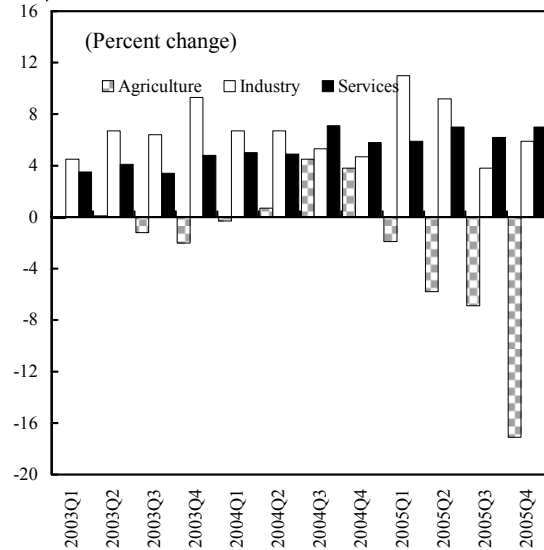
2/ In addition to the EU flows into the budget, Bulgaria will receive substantial agricultural subsidies under the CAP beginning in 2008, mostly in the form of direct payments to farmers.

Figure 1. Bulgaria: Real Sector Developments, 2003–06  
(In percent, unless otherwise noted)

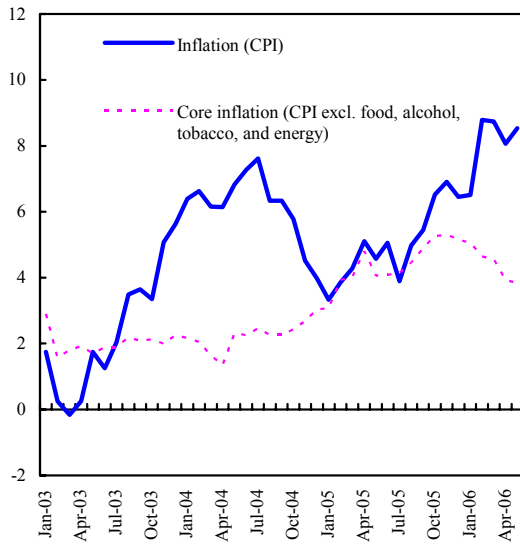
*Growth of domestic demand has been vigorous, but the external sector has been a drag ...*



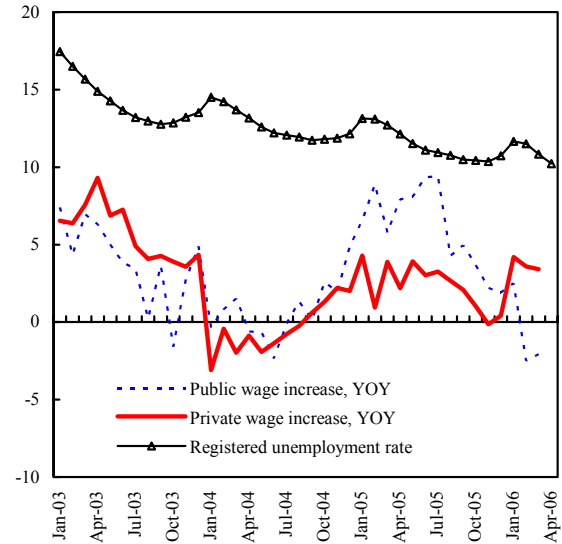
*... industry and services expanded rapidly, but agriculture contracted sharply mainly due to floods.*



*Headline and, until recently core inflation, have been increasing ...*



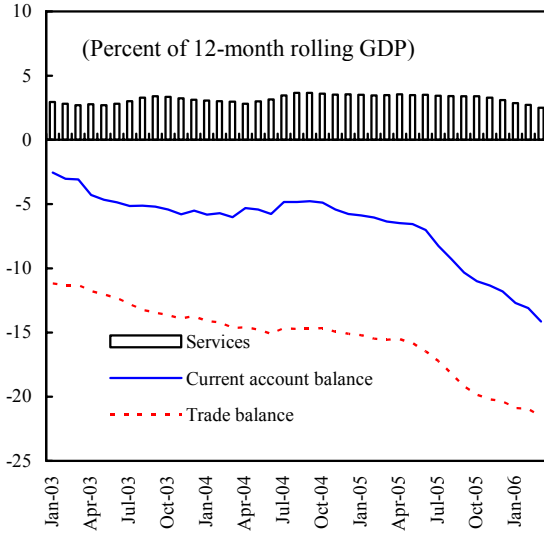
*... but real wage increases have remained modest and unemployment has continued to fall.*



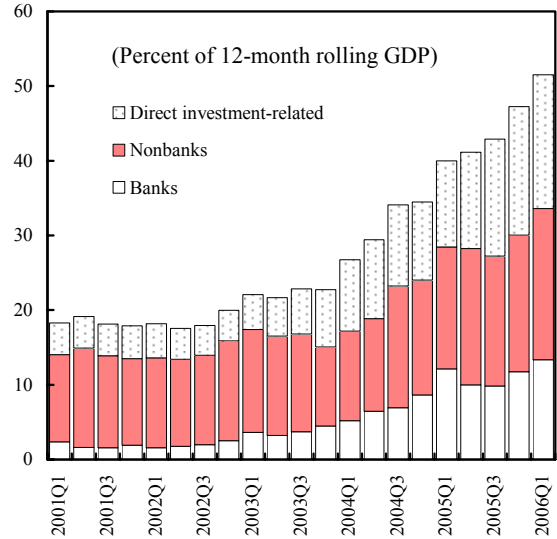
Sources: Bulgarian authorities; and Fund staff estimates.

Figure 2. Bulgaria: Balance of Payments Developments

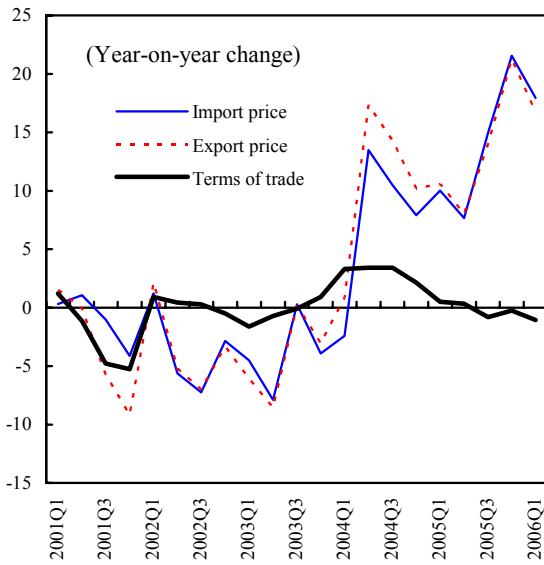
*The current account has been deteriorating sharply ...*



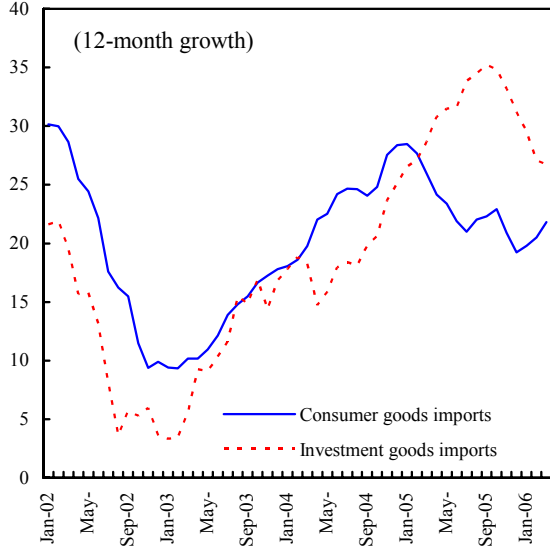
*... and foreign private debt has been increasing, mainly due to rising bank and FDI-related intercompany loans.*



*Export and import prices have risen rapidly, and the terms of trade have fallen modestly.*



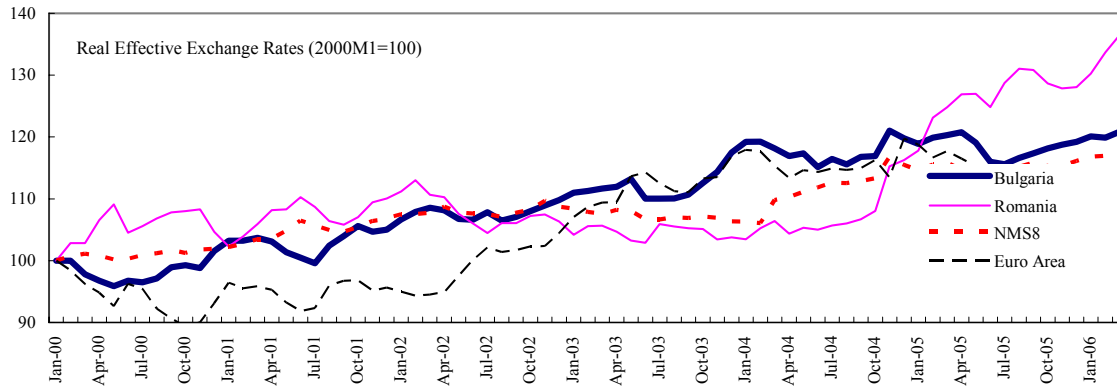
*The growth rate of investment goods imports moderated recently, while consumption goods import growth stabilized.*



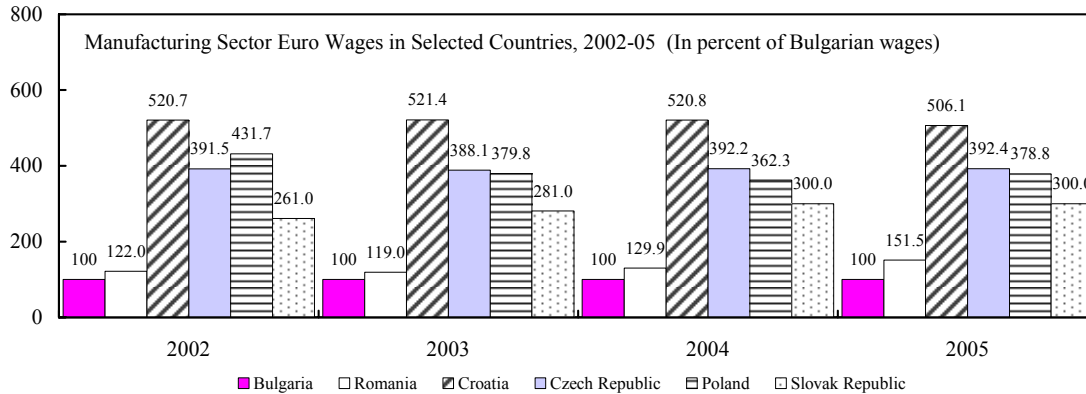
Sources: Bulgarian authorities; and Fund staff estimates.

Figure 3. Bulgaria: Competitiveness

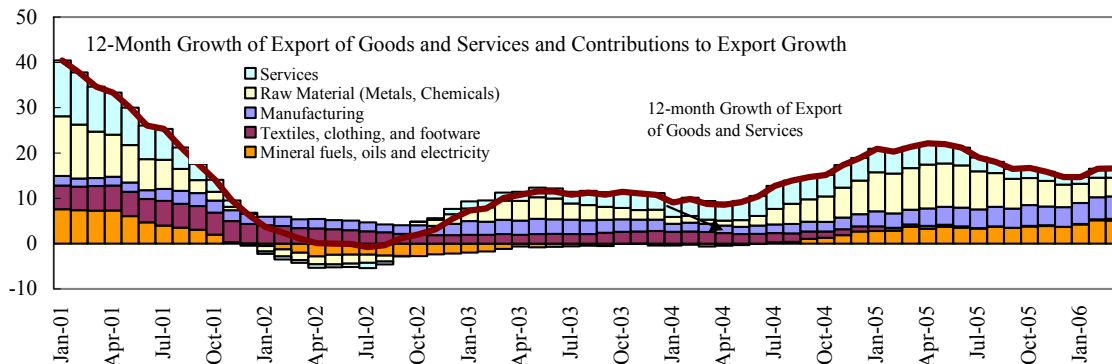
*Bulgaria's real effective exchange rate has remained relatively stable since 2004, while the exchange rate of competing countries appreciated.*



*But Bulgaria's wages remain low ...*



*and export growth remains healthy.*

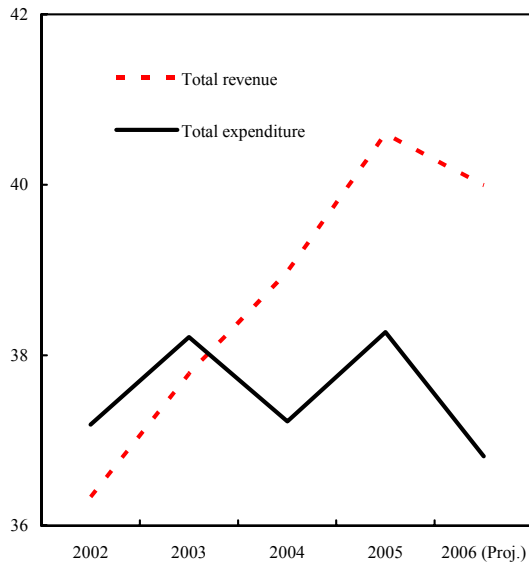


Sources: Bulgarian authorities; and Fund staff estimates.

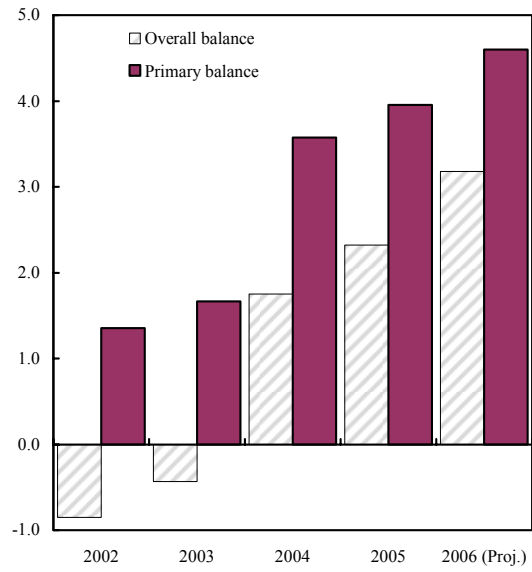


Figure 4. Bulgaria: Fiscal Sector Developments  
(In percent of GDP)

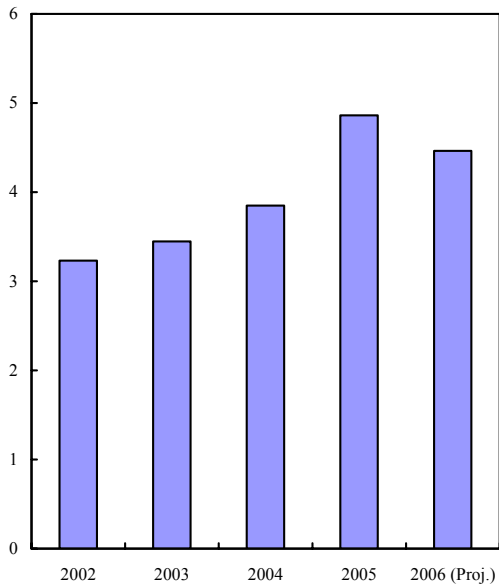
*Revenues are buoyant and expenditures are being contained ...*



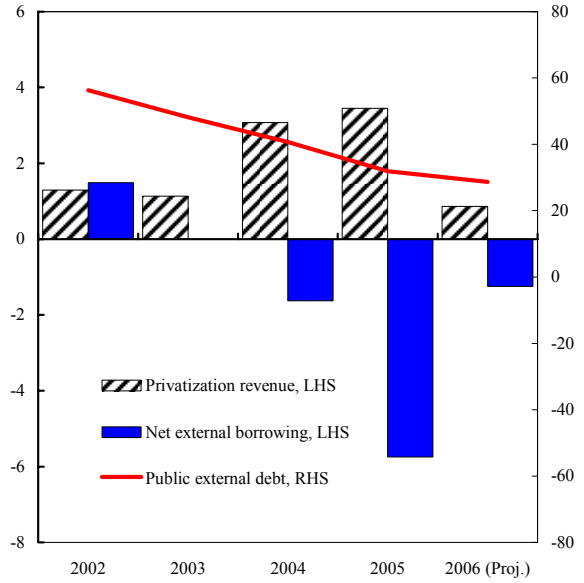
*... resulting in increasing surpluses.*



*Public capital expenditure has increased...*



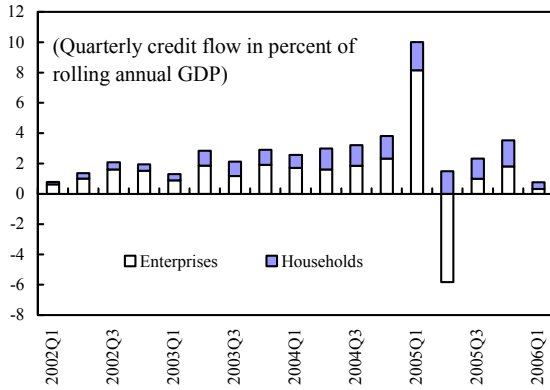
*... while budget surpluses and privatization have enabled reductions in the public external stock of debt.*



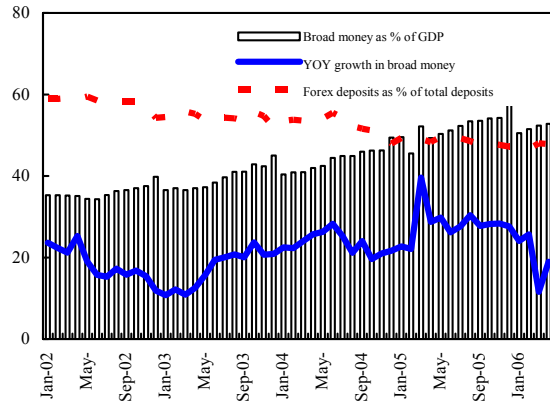
Sources: Bulgarian authorities; and Fund staff estimates.

Figure 5. Bulgaria: Financial Sector Indicators

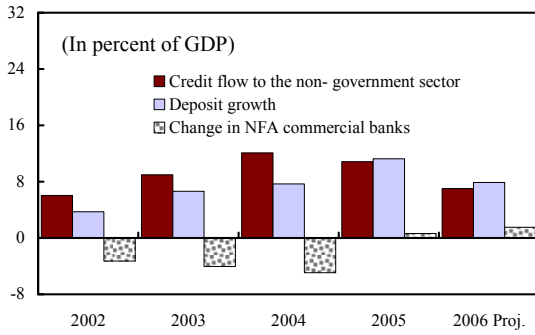
*The timing of the credit measures contributed to a spike in enterprise credit ...*



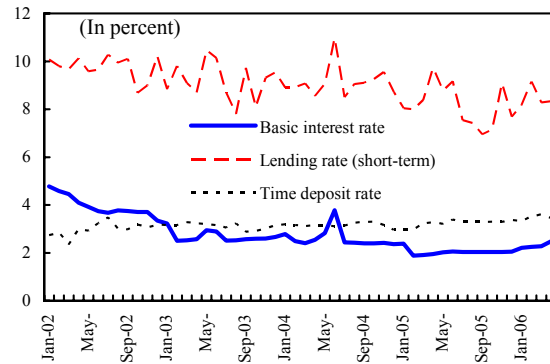
*... and a concomitant temporary surge in M3 growth.*



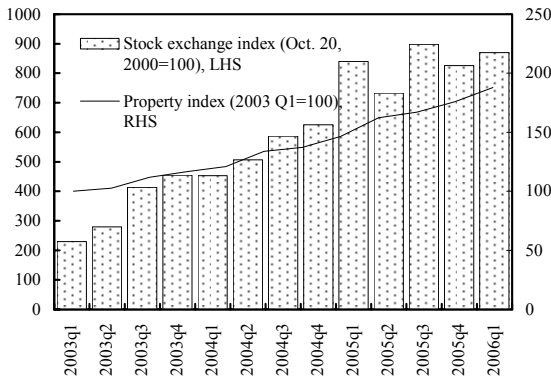
*Credit growth slowed in 2005 and is projected to slow further in 2006, while banks rebuild their NFA.*



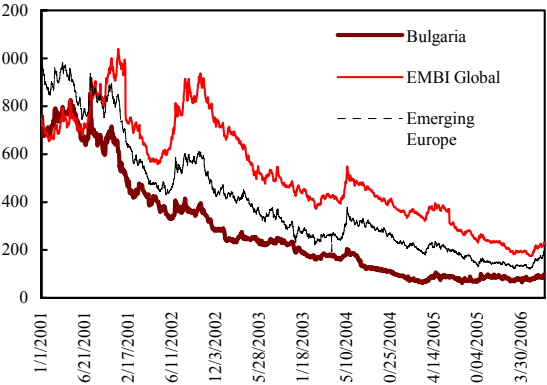
*Interest rates are broadly stable.*



*The stock market index stabilized but real estate prices continued their upward trend ...*

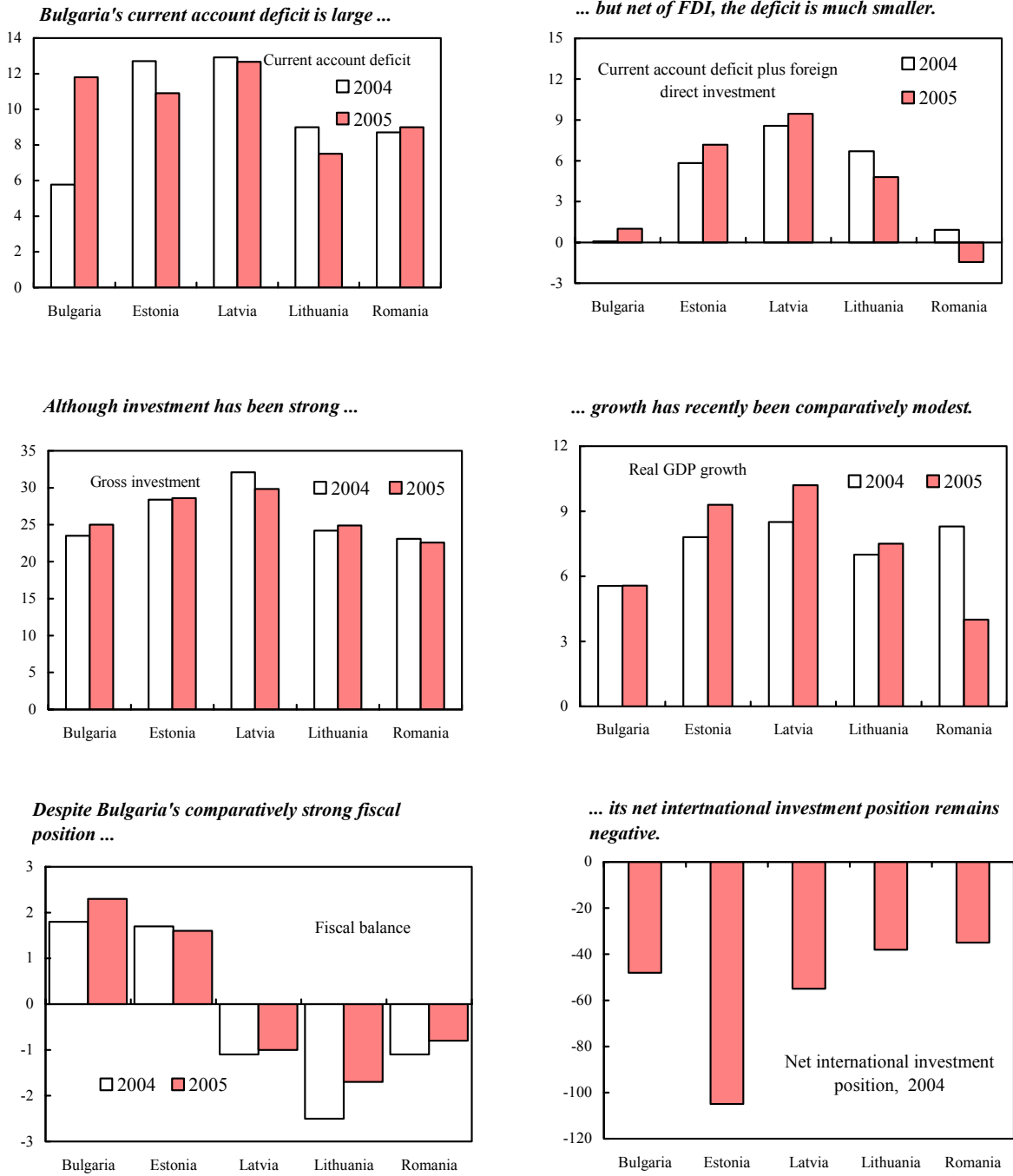


*... and stable and low sovereign bond spreads indicate continued investor confidence.*



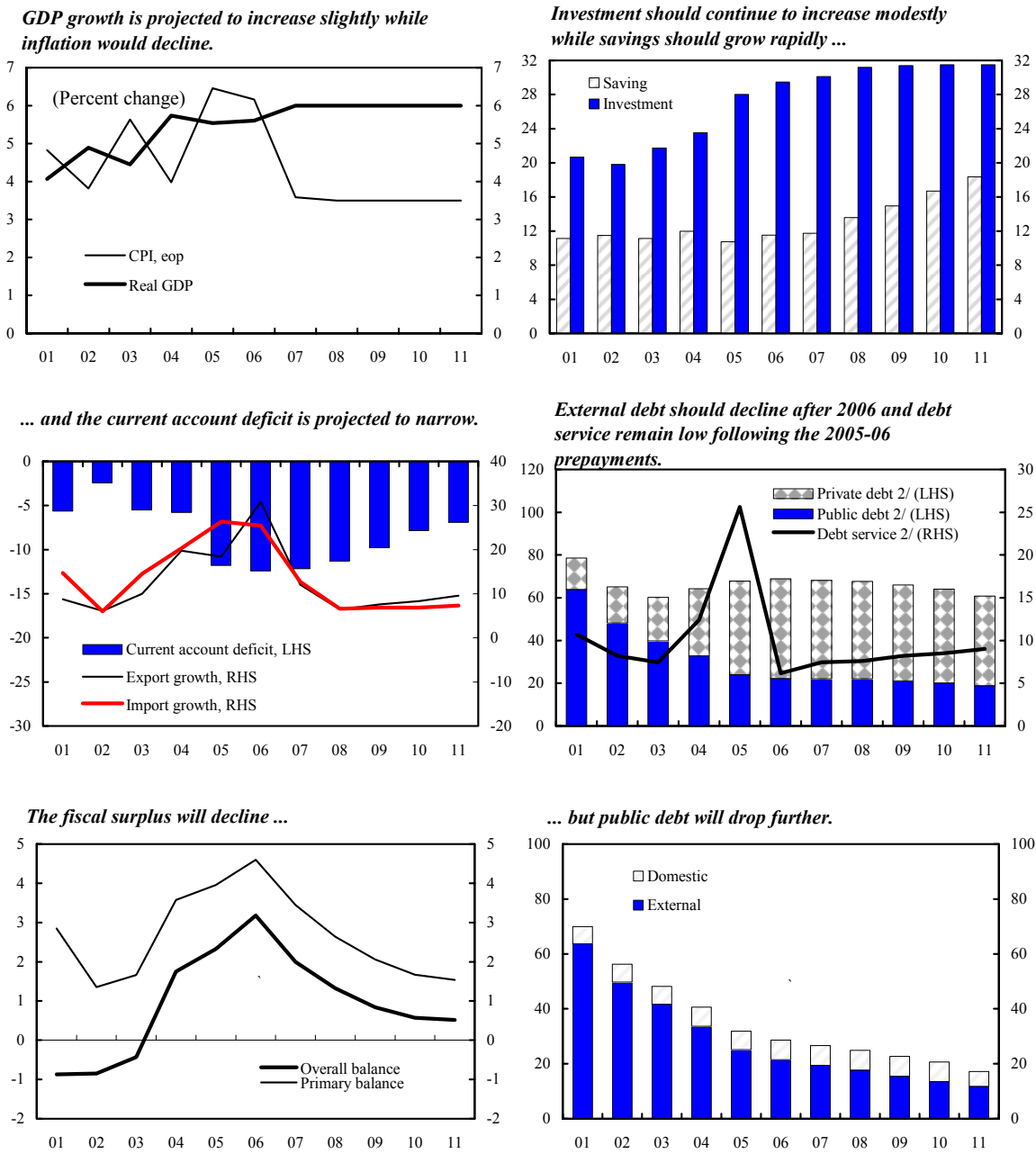
Sources: Bulgarian authorities; and Fund staff estimates.

Figure 6. Bulgaria and Comparator Countries, Selected Macroeconomic Indicators, 2004 and 2005 (in percent of GDP, unless otherwise indicated)



Sources: WEO and country authorities, various years.

Figure 7. Bulgaria: Baseline Medium-Term Projections, 2001–2011 1/  
(In percent of GDP, unless otherwise indicated)

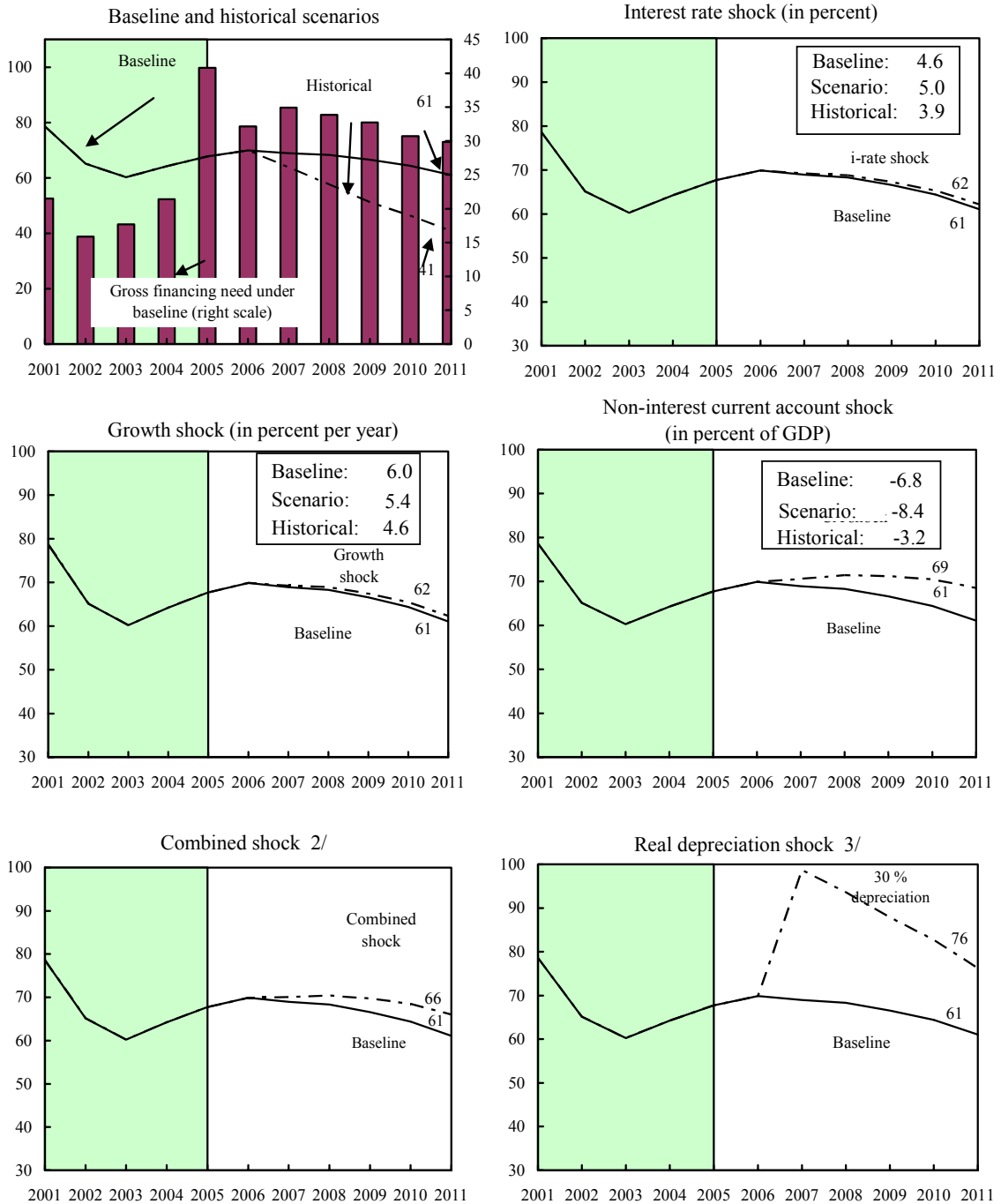


Sources: Bulgarian authorities; and Fund staff estimates and projections.

1/ 2006 onward; projections.

2/ Projections include assumptions on disbursements related to debt not already contracted.

Figure 8. Bulgaria: External Debt Sustainability: Bound Tests 1/  
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates; see Table 15.

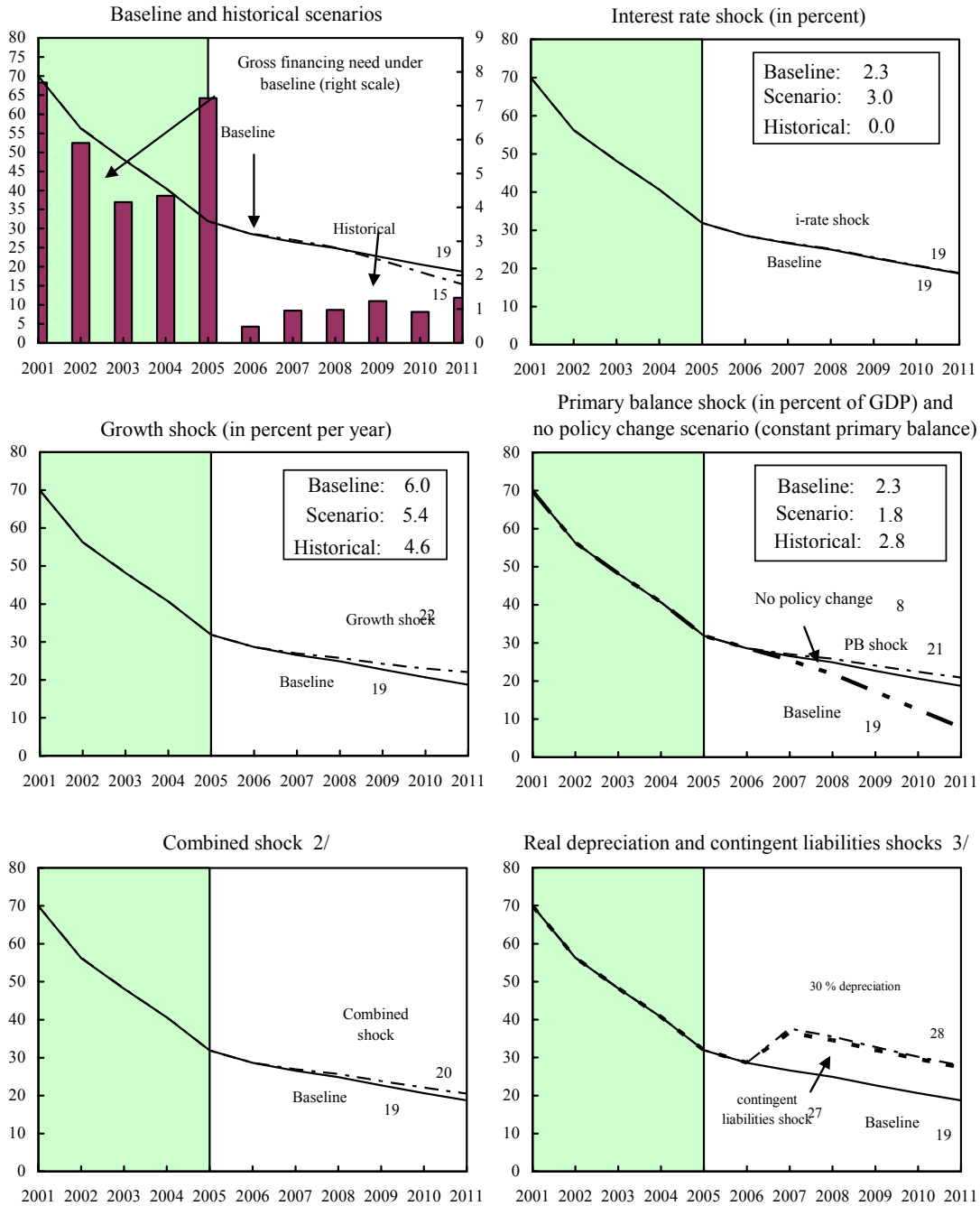
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks.

Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2006.

Figure 9. Bulgaria: Public Debt Sustainability: Bound Tests 1/  
(Public debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates; see Table 16.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks.

Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2006, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 1. Bulgaria: Selected Economic Indicators, 2002-06

	2002	2003	2004	2005	2006 Proj.
<b>Output, prices, and employment</b>					
	(Annual percent change, unless otherwise stated)				
Real GDP	4.9	4.5	5.7	5.5	5.6
Real industrial sales	1.3	16.1	19.8	6.3	...
Consumer price index (average)	5.8	2.3	6.1	5.0	7.4
(end of period)	3.8	5.6	4.0	6.5	6.2
Unemployment rate (in percent)					
Registered unemployment (average)	17.4	14.3	12.7	11.5	...
Labor force survey (average)	17.8	13.7	12.0	10.1	...
Real public sector wages (average)	2.5	3.9	0.8	6.0	...
Real private sector wages (average)	-4.1	5.7	-0.4	2.3	...
<b>General government</b>					
	(In percent of GDP)				
Total expenditure	37.2	38.2	37.2	38.3	36.8
Noninterest expenditure	35.0	36.1	35.4	36.6	35.4
Interest payments	2.2	2.1	1.8	1.6	1.4
Revenue	36.3	37.8	39.0	40.6	40.0
Primary balance	1.4	1.7	3.6	4.0	4.6
Overall balance	-0.8	-0.4	1.8	2.3	3.2
Privatization receipts	1.3	1.1	3.1	3.4	0.9
External financing	1.5	0.0	-1.6	-5.7	-1.2
Domestic financing	-1.9	-0.7	-3.2	0.0	-2.8
Public debt (end of period)	56.3	48.2	40.7	31.9	28.6
Domestic public debt (end of period)	6.6	6.5	7.0	6.8	7.1
<b>Money and credit 1/</b>					
	(Annual percent change, unless otherwise stated)				
Broad money (end of period; millions of leva)	12,867	15,588	18,926	24,160	28,388
Broad money (M3)	11.9	21.1	21.4	27.7	17.5
Claims on nongovernment	44.0	48.3	48.7	32.3	17.5
FX deposits (euro millions) 2/	2,659	3,110	3,470	4,727	5,676
FX deposits (percent of M3) 2/	40.4	39.0	35.9	38.3	39.1
Broad money to FX reserves ratio	1.4	1.5	1.4	1.7	1.7
<b>Interest rates (annualized)</b>					
	(In percent)				
BNB basic rate	3.4	2.7	2.4	2.1	...
Time deposits (leva)	3.2	3.2	3.0	3.4	...
<b>Balance of payments</b>					
	(In millions of euros, unless otherwise stated)				
Current account balance	-402	-973	-1,132	-2,531	-2,956
(In percent of GDP)	-2.4	-5.5	-5.8	-11.8	-12.4
Trade balance	-1,878	-2,426	-2,954	-4,369	-4,973
Exports, fob	6,063	6,668	7,985	9,454	12,367
Imports, fob	-7,941	-9,094	-10,938	-13,823	-17,340
Net FDI	951	1,827	1,550	2,210	2,246
(In percent of current account deficit)	236.5	187.8	137.0	87.3	76.0
Gross official reserves (end of period)	4,575	5,405	6,854	7,370	8,473
(In months of prospective imports of GNFS)	4.9	4.8	5.0	4.3	4.3
External debt (end of period) 3/	10,769	10,641	12,572	14,530	16,659
(In percent of GDP)	65.1	60.2	64.2	67.7	69.9
<b>Exchange rates</b>					
Leva per euro	Currency board, peg to euro at lev 1.95583 per euro				
Leva per U.S. dollar (end of period)	1.885	1.591	1.459	1.658	...
(yoy percent change, + means depreciation)	-14.0	-15.6	-8.3	13.7	...
REER (end of period; CPI based)					
(yoy percent change, + means appreciation)	4.6	7.0	2.0	-0.5	...
<b>Social Indicators</b> (reference year in parentheses)					
<b>Per capita GNI</b> (Atlas method, 2004); US \$2740; <b>Population</b> (2004): 7.8 million; <b>Urban population</b> (2004): 70.15 percent;					
<b>Poverty rate</b> (2001): 12.8%; <b>Life expectancy at birth</b> (2003): 72.1 years; <b>Infant mortality</b> per 1,000 live births (2003): 12.3					
<b>Child malnutrition</b> (percent of children under 5): n/a; <b>Income distribution</b> (Gini index, 2001): 31.9;					
<b>Gross primary enrollment</b> (percent of school-age group, 2002): 100 (male), 99.2 (female)					

Sources: Bulgarian authorities, Fund staff estimates, and World Development Indicators database.

1/ Starting in 2002, a new format was adopted for monetary data resulting in revisions to historical series.

2/ Includes only foreign currency deposits in M3.

3/ Includes trade credits.

Table 2. Bulgaria: Real GDP by Expenditure, 2001-2006

	2001	2002	2003	2004	2005	2006 proj.
	(Percentage change)					
<b>Real GDP</b>	<b>4.1</b>	<b>4.9</b>	<b>4.5</b>	<b>5.7</b>	<b>5.5</b>	<b>5.6</b>
<b>Domestic demand 1/</b>	<b>7.1</b>	<b>3.8</b>	<b>8.9</b>	<b>7.1</b>	<b>10.5</b>	<b>6.1</b>
Private demand	8.8	4.4	8.9	7.4	10.9	7.6
Public demand	0.8	1.4	8.7	6.3	9.1	0.0
<b>Final consumption</b>	<b>4.4</b>	<b>3.6</b>	<b>6.6</b>	<b>5.1</b>	<b>6.8</b>	<b>4.6</b>
Private consumption	5.2	3.5	6.4	5.5	7.6	5.5
Public consumption	1.4	4.1	7.5	3.9	3.8	1.0
<b>Gross Investment</b>	<b>20.1</b>	<b>4.4</b>	<b>18.2</b>	<b>14.7</b>	<b>23.3</b>	<b>10.7</b>
Gross fixed capital formation	23.3	8.5	13.9	13.5	19.0	13.0
Changes in inventories	0.4	-25.8	69.2	24.6	57.0	-1.9
<b>Net exports</b>	<b>64.6</b>	<b>-10.6</b>	<b>74.0</b>	<b>20.5</b>	<b>-55.9</b>	<b>-8.6</b>
Exports of goods and services	10.0	7.0	8.0	13.0	7.2	12.8
Imports of goods and services	14.8	4.9	15.3	14.1	14.6	11.9
	(Contribution to real GDP growth) 2/					
<b>Domestic demand</b>	<b>7.5</b>	<b>4.1</b>	<b>9.3</b>	<b>7.7</b>	<b>11.3</b>	<b>7.0</b>
Private demand	7.3	3.8	7.5	6.3	9.4	7.0
Public demand	0.2	0.3	1.8	1.4	1.9	0.0
<b>Final consumption</b>	<b>3.8</b>	<b>3.2</b>	<b>5.7</b>	<b>4.5</b>	<b>5.9</b>	<b>4.0</b>
Private consumption	3.6	2.5	4.4	3.8	5.2	3.9
Public consumption	0.2	0.7	1.4	0.7	0.7	0.2
<b>Gross capital formation</b>	<b>3.7</b>	<b>0.9</b>	<b>3.6</b>	<b>3.2</b>	<b>5.5</b>	<b>3.0</b>
Gross fixed capital formation	3.7	1.5	2.5	2.6	4.0	3.1
Changes in inventories	0.0	-0.6	1.1	0.6	1.5	-0.1
<b>Net exports</b>	<b>-3.5</b>	<b>0.8</b>	<b>-4.9</b>	<b>-1.9</b>	<b>-5.7</b>	<b>-1.4</b>
Exports of goods and services	5.6	3.9	4.3	6.9	4.2	7.8
Imports of goods and services	-9.0	-3.1	-9.1	-8.9	-9.9	-9.2
	(Percentage change in implicit deflators)					
<b>GDP</b>	<b>6.7</b>	<b>3.8</b>	<b>2.3</b>	<b>4.8</b>	<b>3.8</b>	<b>5.2</b>
<b>Final consumption</b>	<b>6.2</b>	<b>4.9</b>	<b>1.3</b>	<b>4.3</b>	<b>4.8</b>	<b>5.1</b>
<b>Gross capital formation</b>	<b>4.5</b>	<b>-0.1</b>	<b>-0.8</b>	<b>4.1</b>	<b>6.2</b>	<b>5.6</b>
<b>Net exports</b>						
Exports of goods and services	0.7	-2.8	-0.3	6.2	7.2	12.1
Imports of goods and services	0.1	-1.8	-2.2	5.1	8.5	10.7
<b>Memorandum items</b>						
Share of domestic demand in nominal GDP	107.6	106.6	109.5	110.2	116.6	117.1
Share of domestic private demand in nominal GDP	86.3	85.3	87.1	87.8	93.2	97.3
Share of domestic public demand in nominal GDP	21.3	21.3	22.4	22.5	23.4	22.6
Share of net exports in nominal GDP	-7.6	-6.6	-9.5	-10.2	-16.6	-17.0
Nominal GDP (in millions of leva)	29,709	32,335	34,547	38,275	41,948	46,620

Sources: National Statistical Institute for actuals; Agency for Economic Forecasting and Analysis, Bulgarian National Bank, and staff estimates.

1/ Private and public sector decomposition based on staff calculations and not officially reported by the NSI.

2/ Sum of contributions to real GDP growth may not add up to total growth due to statistical discrepancy in the official data.



Table 3: Bulgaria, Monetary Survey, 2004-2011  
(End-period; in millions of leva, unless otherwise stated)

	2004	2005	2006				2007	2008	2009	2010	2011
			Q1	Q2	Q3	Q4					
			Act.	Proj.	Proj.	Proj.					
	Act.	Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	
Broad money	18,926	24,160	24,422	25,622	26,826	28,388	32,737	37,300	41,298	45,637	50,367
Currency outside banks	4,628	5,396	5,113	5,464	5,855	6,070	6,814	7,531	8,288	9,127	10,024
Reserve money	7,058	8,351	8,347	9,193	9,211	9,560	10,242	10,954	11,705	12,486	13,272
Deposits 1/	14,298	18,764	19,310	20,158	20,971	22,319	25,923	29,769	33,010	36,509	40,343
Lev	7,512	10,052	10,038	10,684	11,115	11,829	13,739	15,778	17,496	19,350	21,382
Foreign currency	6,786	8,712	9,272	9,474	9,856	10,490	12,184	13,992	15,515	17,159	18,961
Other longer-term liabilities (not incl. in broad money)	4,767	6,216	6,679	6,843	7,010	7,182	7,541	7,918	8,314	8,730	9,166
Deposits 1/	571	827	906	943	980	1,020	1,193	1,395	1,632	1,910	2,234
Lev	225	294	302	349	363	377	441	516	604	707	827
Foreign currency	346	533	604	594	618	642	751	879	1,028	1,203	1,407
Capital and reserves	4,196	5,389	5,773	5,900	6,030	6,162	6,723	7,334	8,001	8,729	9,523
Net foreign assets	11,194	13,221	13,380	14,378	15,196	16,649	18,224	19,183	19,690	20,489	21,366
BNB	11,571	13,343	13,047	14,111	14,737	16,058	17,696	19,386	20,277	20,997	21,855
Commercial banks	-377	-122	333	266	459	591	528	-202	-587	-509	-489
Net domestic assets	12,499	17,155	17,722	18,087	18,641	18,921	22,054	26,035	29,922	33,877	38,167
Domestic credit	12,289	17,200	17,786	18,144	18,690	18,962	22,061	26,005	29,851	33,761	38,001
General government 1/	-1,808	-1,462	-1,204	-1,727	-2,093	-2,967	-4,243	-5,087	-5,053	-4,975	-4,975
Non-government	14,097	18,663	18,990	19,872	20,783	21,929	26,304	31,091	34,904	38,736	42,976
Claims on non-financial corporations	9,293	11,439	11,516	...	...	...	...	...	...	...	...
Claims on households	4,374	6,928	7,116	...	...	...	...	...	...	...	...
Other items, net	-1,127	-1,620	-1,697	-1,714	-1,731	-1,748	-1,819	-1,893	-1,970	-2,050	-2,133
Fixed assets	1,337	1,575	1,633	1,657	1,682	1,707	1,812	1,923	2,041	2,166	2,299
			(12-month percentage change)								
Broad money	22	28	12	19	19	18	15	14	11	11	10
Currency outside banks	19	17	14	13	12	12	12	11	10	10	10
Reserve money	34	18	25	26	18	14	7	7	7	7	6
Claims on non-government	49	32	6	22	21	18	20	18	12	11	11
Claims on non-financial corporations	38	23	-6	...	...	...	...	...	...	...	...
Claims on households	75	58	40	...	...	...	...	...	...	...	...
Deposits	22	31	11	21	21	19	16	15	11	11	10
Lev	34	34	13	25	22	18	16	15	11	11	10
Foreign currency	12	28	9	18	21	20	16	15	11	11	10
			(quarterly growth rates)								
Claims on non-government	10.4	7.3	1.8	4.6	4.6	5.5	4.7	4.3	2.9	2.6	2.6
Claims on non-financial corporations	8.4	5.3	0.7	...	...	...	...	...	...	...	...
Claims on households	15.0	12.2	2.7	...	...	...	...	...	...	...	...
			(share of GDP)								
Broad Money	49.4	57.6	57.2	58.6	59.3	60.9	64.1	67.1	68.3	69.1	69.8
Claims on Nongovernment	36.8	44.5	44.5	45.5	46.0	47.0	51.5	55.9	57.7	58.6	59.5
Claims on non-financial corporations	24.3	27.3	27.0	...	...	...	...	...	...	...	...
Claims on households	11.4	16.5	16.7	...	...	...	...	...	...	...	...
<i>Memorandum items:</i>											
Reserve money (leva, million)	7058	8,351	8,347	9,193	9,211	9,105	9,795	10,508	11,259	12,048	12,848
Banks' reserves (including cash in bank vault, Leva, million)	2431	2,956	3,234	3,729	3,355	3,035	2,981	2,977	2,971	2,921	2,824
Money multiplier (M3/reserve money)	2.7	2.9	2.9	2.8	2.9	3.1	3.3	3.5	3.7	3.8	3.9
BNB net foreign assets/Reserve money (in percent)	164	159.8	156.3	153.5	160.0	168.0	172.8	177.0	173.2	168.2	164.7
Foreign currency deposits (percent of broad money)	36	36.1	38.0	37.0	36.7	37.0	37.2	37.5	37.6	37.6	37.6
Commercial banks NFA/foreign currency deposits (in percent)	-5	-1.3	3.4	2.6	4.4	5.3	4.1	-1.4	-3.5	-2.8	-2.4
Claims on nongovernment/deposits (in percent)	95	95.3	93.9	94.2	94.7	94.0	97.0	99.8	100.8	100.8	100.9
Velocity M3	2.0	1.7	1.7	1.7	1.7	1.6	1.6	1.5	1.5	1.4	1.4

Source: BNB, National Statistics Institute, and IMF staff estimates.

1./ Net deposits by the Public Investment Projects Company (PIP), local governments and social security funds are excluded from deposits and included in net lending to the general government.

Table 4. Bulgaria: Selected Vulnerability Indicators, 2002-2006

	2002	2003	2004	2005	2006 1/	
<b>Key Economic and Market Indicators</b>						
Real GDP growth (in percent)	4.9	4.5	5.7	5.5	5.6	Proj.
CPI inflation (period average, in percent)	5.8	2.3	6.1	5.0	7.4	Proj.
Short-term (ST) interest rate (in percent)	3.4	2.7	2.4	2.1	2.5	Apr-06
EMBI + secondary market spread (bps; end of period)	291	177	77	90	93	28-Jun-06
Exchange rate NC/US\$ (end of period)	1.9	1.6	1.4	1.7	1.6	Apr-06
<b>External Sector</b>						
Exchange rate regime	Currency board, peg to euro at lev 1.95583 per euro					
Current account balance (percent of GDP)	-2.4	-5.5	-5.8	-11.8	-12.4	Proj.
Net FDI inflows (percent of GDP)	5.8	10.3	7.9	10.3	9.4	Proj.
Export growth (yoy, Euro value, GNFS)	5.5	10.7	20.0	15.7	20.9	Proj.
Real effective exchange rate (1995 = 100; end of period)	111.7	119.5	121.9	121.3	122.0	Feb-06
Gross international reserves (GIR) in Euro billion	4.6	5.4	6.9	7.4	8.5	Proj.
GIR in percent of ST debt at remaining maturity	212.5	177.0	110.2	156.4	142.5	Proj.
GIR in percent of ST debt at RM and banks' FX deposits.	93.8	77.7	61.7	71.4	63.9	Proj.
Net international reserves (NIR) in Euro billion	3.6	4.5	6.0	6.8	8.2	Proj.
Total gross external debt in percent of GDP 3/	65.1	60.2	64.2	67.7	69.9	Proj.
o/w ST external debt (original maturity, in percent of total ED)	14.1	14.3	19.3	24.5	29.2	Proj.
ED of domestic private sector (in percent of total ED)	26.1	33.8	48.9	64.6	68.4	Proj.
ED to foreign official sector (in percent of total ED)	30.4	29.3	26.5	22.6	19.8	Proj.
Total gross external debt in percent of exports of GNFS	126.4	113.2	111.8	112.7	102.5	Proj.
Gross external financing requirement (in Euro billion) 2/	1.4	1.9	3.2	7.6	4.3	Proj.
<b>Public Sector 3/</b>						
Overall balance (percent of GDP)	-0.8	-0.4	1.8	2.3	3.2	Proj.
Primary balance (percent of GDP)	1.4	1.7	3.6	4.0	4.6	Proj.
Debt-stabilizing primary balance (percent of GDP) 4/	...	...	...	...	1.0	Proj.
Gross public sector financing requirement (in percent of GDP) 5/	5.9	4.2	4.3	7.2	0.5	Proj.
Public sector gross debt (in percent of GDP) 6/	56.3	48.2	40.7	31.9	28.6	Proj.
o/w Exposed to rollover risk (in percent of total PSGD) 6/	8.4	8.0	12.9	30.5	13.3	Proj.
Exposed to exchange rate risk (in percent of total PSGD) 7/	91.7	91.0	88.2	85.3	79.9	Proj.
Exposed to interest rate risk (in percent of total PSGD) 8/	59.0	56.7	51.7	39.5	32.6	Proj.
o/w External debt from official creditors (in percent of total)	29.7	31.3	34.1	36.0	29.2	Proj.
External debt from private creditors (in percent of total)	25.8	22.2	14.6	0.0	0.0	Proj.
Domestic debt linked to foreign currency (in percent of total)	3.4	3.1	3.0	3.4	3.2	Proj.
Public sector net debt (in percent of GDP) 9/	45.5	36.6	27.5	21.4	...	Dec-05
<b>Financial Sector 10/</b>						
Capital adequacy ratio (in percent)	25.2	22.0	16.1	15.2	16.0	March-06
Non-standard loans in percent of total loans (excl. financial institutions) 11/	6.5	7.3	7.1	7.7	7.5	March-06
o/w Non-performing loans (due over 90 days)	2.6	3.2	2.0	2.2	2.3	March-06
Provisions in percent of non-standard loans	59.6	50.0	48.5	45.3	45.3	March-06
Return on average assets (in percent)	2.1	2.4	2.1	2.1	2.6	March-06
Return on equity (in percent)	14.9	22.7	20.6	22.1	25.8	March-06
FX deposits (in percent of total deposits)	54.3	52.1	48.0	47.2	48.7	Apr-06
FX loans (in percent of total loans)	41.3	42.8	47.5	47.3	46.3	Apr-06
Net open forex position (in percent of capital) 12/	-4.2	-4.9	-5.9	-5.6	...	Jun-05
Government debt held by FS (percent of total FS assets)	22.5	18.9	15.6	12.2	10.7	Apr-06
Credit to private sector (percent change)	44.0	48.3	48.7	32.3	18.7	Apr-06
Memo item:						
Nominal GDP in billions of euros	16.5	17.7	19.6	21.4	23.8	Proj.
Nominal GDP in billions of U.S. dollars	15.7	20.0	24.4	26.6	28.5	Proj.

Sources: Bulgarian authorities; and Fund staff estimates.

1/ For 2005, staff estimates or latest available observations as indicated in the last column. For 2006, staff projection.

2/ Current account deficit plus amortization of external debt.

3/ Public sector covers central government, autonomous budgets, social security funds, municipal budgets, and extra budgetary funds.

4/ Based on averages for the last five years for the relevant variables (i.e., growth, interest rates).

5/ Overall balance plus debt amortization.

6/ Amortization on domestic and external debt (excluding external debt to official creditors) in 2005 divided by 2004 total debt stock.

7/ Debt in foreign currency or linked to the exchange rate, domestic and external. Does not exclude external debt on concessional terms.

8/ Total debt at variable interest rate (domestic and external)

9/ Public sector gross debt minus balance of the fiscal reserve account.

10/ Financial sector covers banking sector only excluding insurance, pension funds and capital market institutions.

11/ Loans overdue by more than 30 days.

12/ Does not include off-balance sheet items.

Table 5. Bulgaria: Balance of Payments, 2004-2006  
(In millions of euros)

Friday, June 02, 2006 3:44 PM	2003	2004	2005				2005	2006				2006
			Q1 Act.	Q2 Act.	Q3 Act.	Q4 Act.		Q1 Act.	Q2 Proj.	Q3 Proj.	Q4 Proj.	
<b>CURRENT ACCOUNT</b>	-973	-1,132	-550	-566	-230	-1,185	-2,531	-1,054	-757	10	-1,157	-2,956
Trade balance	-2,426	-2,954	-705	-1,115	-1,174	-1,376	-4,369	-1,038	-1,324	-1,159	-1,454	-4,973
Exports (f.o.b.)	6,668	7,985	2,081	2,305	2,415	2,654	9,454	2,667	3,011	3,266	3,423	12,367
y-o-y change (in percent)	10.0	19.7	21.1	21.5	10.6	21.4	18.4	28.2	30.6	35.2	29.0	30.8
Imports (f.o.b.)	-9,094	-10,938	-2,785	-3,420	-3,588	-4,030	-13,823	-3,705	-4,335	-4,425	-4,877	-17,340
y-o-y change (in percent)	14.5	20.3	22.4	24.4	32.6	25.6	26.4	33.0	26.8	23.3	21.0	25.4
Services, net	553	692	-77	220	658	-134	667	-200	227	772	-103	696
<i>Of which: Exports of travel services</i>	1,500	1,789	221	499	978	233	1,932	226	546	1,039	274	2,085
Income, net	288	238	60	90	47	50	247	40	58	98	66	261
<i>Of which: Income to direct investors</i>	-493	-609	-66	-110	-168	-189	-533	-73	-164	-164	-190	-592
Current transfers, net	613	891	172	239	239	275	925	145	282	300	334	1,060
<b>CAPITAL AND FINANCIAL ACCOUNT</b>	1,754	2,669	436	1,268	85	1,425	3,215	836	1,304	310	1,833	4,283
Capital transfers, net	0	0	0	-1	0	0	-1	0	0	0	0	0
Foreign direct investment, net 1/ 2/	1,827	1,550	931	365	454	460	2,210	740	444	444	618	2,246
<i>Of which: Privatization receipts 3/</i>	312	243	554	0	139	0	693	0	0	0	205	205
Portfolio investment, net	-191	-564	-725	267	-378	80	-757	90	11	11	11	125
Other investment, net	840	2,047	816	89	-304	597	1,199	-261	849	-146	1,204	1,646
General government	60	102	-28	23	-71	131	55	-216	93	70	145	94
Domestic banks	562	1,029	117	-320	-162	176	-189	-26	-176	-98	-68	-368
Other private sector	219	915	728	386	-70	290	1,333	-19	931	-118	1,126	1,920
Errors and omissions	-722	-364	-587	548	314	288	564	266	0	0	0	266
<b>OVERALL BALANCE</b>	781	1,538	-114	702	-145	240	684	-218	547	320	676	1,327
<b>FINANCING</b>	-781	-1,538	114	-702	145	-240	-684	218	-547	-320	-676	-1,327
Gross international reserves (increase: -)	-817	-1,493	147	-650	196	-17	-324	412	-514	-292	-650	-1,047
Use of Fund credit, net	35	-44	-32	-52	-52	-223	-359	-193	-33	-28	-25	-279
Purchases	128	62	0	0	0	0	0	0	0	0	0	0
Repurchases 4/	-101	-106	-32	-52	-52	-223	-359	-193	-33	-28	-25	-279
Exceptional financing	0	0	0	0	0	0	0	0	0	0	0	0
<b>MEMORANDUM ITEMS</b>												
Gross international reserves (stock, e.o.p.) 5/	5,405	6,854	6,748	7,453	7,299	7,370	7,370	7,016	7,531	7,823	8,473	8,473
In months of prospective GNFS imports	4.8	5.0	4.6	4.8	4.5	4.3	4.3	3.6	3.8	4.0	4.3	4.3
In percent of short-term debt (original maturity)	354.5	282.4	189.3	209.1	204.8	206.8	206.8	140.0	150.6	156.6	170.7	170.3
Excess international reserves (stock, e.o.p.) 6/	2,712	3,245	3,342	3,728	3,292	3,100	3,100	2,693	3,078	3,237	3,642	3,622
In percent of short-term debt	177.9	133.7	100.7	123.7	107.8	87.0	87.0	60.7	73.2	72.2	75.0	74.6
Current account + FDI	854	418	381	-201	224	-725	-321	-314	-313	455	-540	-710
(in percent of GDP)	4.8	2.1	1.8	-0.9	1.0	-3.4	-1.5	-6.5	-5.6	6.7	-8.1	-3.0
Current account (in percent of GDP)	-5.5	-5.8	-12.3	-11.3	-3.8	-20.0	-11.8	-21.7	-13.7	0.2	-17.4	-12.4
Merchandise trade account (in percent of GDP)	-13.7	-15.1	-15.7	-22.2	-19.5	-23.2	-20.4	-21.4	-23.9	-17.1	-21.8	-20.9
Merchandise exports (in percent of GDP)	37.8	40.8	46.5	45.9	40.2	44.7	44.1	54.9	54.3	48.2	51.4	51.9
Merchandise imports (in percent of GDP)	-51.5	-55.9	-62.2	-68.1	-59.7	-67.8	-64.5	-76.3	-78.2	-65.3	-73.2	-72.7
Export volume (year-on-year change)	15.2	8.8	9.5	12.5	-3.0	0.1	4.4	9.9	9.3	18.1	18.6	13.3
Import volume (year-on-year change)	19.6	12.3	11.3	15.5	15.4	3.3	11.4	12.8	8.6	12.1	14.1	11.7
FDI (net) in percent of current account	187.8	137.0	169.2	64.5	197.2	38.8	87.3	...	...	...	...	76.0
Gross external debt (stock, e.o.p.) 7/	10,641	12,572	13,120	13,589	13,550	14,530	14,530	15,176	15,285	15,638	16,659	16,659
(In percent of 12-month GDP)	60.2	64.2	65.8	66.6	64.8	67.7	67.7	69.5	68.4	67.7	69.9	69.9
Public	7,048	6,428	5,779	5,889	5,299	5,148	5,148	4,722	4,915	5,026	5,267	5,267
Private	3,593	6,144	7,342	7,700	8,251	9,383	9,383	10,454	10,370	10,612	11,392	11,392
Short-term debt (in percent of total debt, e.o.p.)	14.3	19.3	25.3	22.2	22.5	24.5	24.5	29.2	27.5	28.7	29.2	29.2
Net external debt (in percent of annual GDP) 8/	20.9	17.5	19.0	17.9	19.1	22.2	22.2	24.9	23.3	21.3	23.4	23.4
GDP	17,663	19,570	4,476	5,022	6,010	5,939	21,448	4,857	5,543	6,772	6,664	23,836

Sources: Bulgarian authorities, and Fund staff estimates.

1/ All FDI are assumed to be non-debt creating in the projections.

2/ The figures for 2004 and 2005 are influenced by a complex debt financed merger and acquisition transaction of a local mobile telephone company that led to a sharp increase in its equity value, and a transfer of the realized capital gains out of the country by the original owners. This resulted in a net FDI outflow of 650 million euros and an increase in gross external debt by 590 million euros in 2004.

3/ Privatization receipts for the electricity distribution companies are included in 2005. These are included in the receipts for 2004 in the balance of payments presentation of the BNB. The present treatment aligns them with its receipt in the fiscal accounts.

4/ According to expectations schedule.

5/ Historical numbers include valuation changes. From 2006-10 includes reserves posted as a guarantee for defense related purchases. Reserve coverage ratios are calculated net of impaired reserves.

6/ Gross international reserves minus reserve money. For 2006-08, reserves posted as a guarantee for defense related purchases are excluded.

7/ Projections include assumptions on disbursements related to debt not already contracted.

8/ External debt minus gross foreign assets of the banking system.

Table 6. Bulgaria: General Government Operations, 2001-2007  
(In millions of leva)

	2001	2002	2003	2004 1/	2005	2006		2007
						Program	Proj.	Proj.
<b>Total revenue and grants</b>	11,124	11,750	13,053	14,918	17,030	18,454	18,645	20,254
Tax revenue	8,518	8,882	10,215	11,869	13,579	14,676	14,885	15,914
Profit taxes	1,150	976	1,032	973	1,028	1,094	1,173	1,299
Nonfinancial enterprises	812	871	899	853	901	962	1,031	1,142
Financial enterprises	339	104	133	119	127	132	141	157
Income taxes	1,063	1,052	1,140	1,248	1,249	1,131	1,139	1,242
VAT	2,454	2,688	3,101	3,891	4,798	5,538	5,581	5,831
Excise and fuel duties	1,107	1,314	1,544	1,885	2,188	2,751	2,751	2,976
Customs duties	195	188	231	292	372	443	468	340
Social insurance contributions	2,312	2,361	2,808	3,171	3,505	3,247	3,300	3,689
Pension and unemployment contributions 2/	1,823	1,848	2,194	2,456	2,696	2,355	2,400	2,683
Health Insurance Fund	489	513	614	715	809	892	900	1,006
Other taxes	236	303	359	409	440	472	472	538
Nontax revenues	2,243	2,566	2,527	2,595	2,935	3,090	3,067	3,201
BNB transfers	175	173	133	171	149	150	150	170
Other	2,069	2,393	2,394	2,424	2,786	2,940	2,917	3,031
Grants and donations	363	302	311	455	516	688	693	1,139
<b>Total expenditure and net lending 3/</b>	11,384	12,025	13,202	14,248	16,055	17,067	17,162	19,233
Noninterest expenditure, net lending, contingency	10,278	11,312	12,478	13,551	15,370	16,405	16,501	18,492
Current noninterest expenditure	8,893	10,077	11,199	11,943	12,883	13,991	14,087	15,030
Compensation	1,748	2,015	2,205	2,381	2,505	2,785	2,785	2,950
Wages and salaries	1,711	1,974	2,159	2,335	2,459	2,739	2,739	2,902
Scholarships	37	41	45	46	46	46	46	48
Maintenance and operations	2,282	2,570	2,849	3,178	3,475	3,573	3,668	3,960
Subsidies	709	773	888	869	870	592	592	579
Social expenditures	4,074	4,653	5,109	5,445	5,987	6,941	6,941	7,506
Pension fund	2,586	2,944	3,161	3,457	3,715	4,073	4,073	4,286
Assistance and unemployment	858	1,007	1,004	941	1,032	1,340	1,341	1,420
Health Insurance Fund	404	498	720	778	947	1,220	1,219	1,357
Other social expenditures 4/	226	204	224	269	293	308	308	443
Transfers 5/	79	66	150	71	46	100	100	35
Capital expenditures	1,158	1,045	1,191	1,473	2,039	2,081	2,081	2,508
Contingency	227	189	88	219	439	333	333	320
Enterprise restructuring	0	0	0	0	4	20	20	45
Budget	188	143	42	168	317	193	193	197
Natural disaster	39	46	46	51	118	120	120	78
EU budget contribution	...	...	...	...	...	...	...	634
Primary balance	847	438	575	1,368	1,660	2,049	2,144	1,762
Interest	1,106	713	724	697	686	662	662	741
External	853	544	561	517	494	445	445	543
Domestic	253	169	163	181	192	217	217	198
<b>Overall balance</b>	-259	-275	-149	670	974	1,387	1,482	1,021
Financing	259	275	149	-670	-974	-1,387	-1,482	-1,021
Privatization 6/	861	417	391	1,180	1,447	293	401	435
External (net)	-96	481	-2	-622	-2,411	-332	-581	-146
Domestic (net)	-506	-623	-240	-1,228	-11	-1,348	-1,302	-1,311
Memorandum item:								
Nominal GDP in millions of leva	29,709	32,335	34,547	38,275	41,948	46,221	46,620	51,102

Sources: Ministry of Finance; and Fund staff projections.

1/ In late 2004, a state enterprise for infrastructure projects ("PIP") was created, capitalized with BGN 340 million to execute spending in 2005. PIP is consolidated with the general government.

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

3/ From 2004, total expenditure is adjusted for variation of arrears (net). Net variation in arrears amounted to BGN -84.7 million and BGN 8.2 million in 2004 and 2005, respectively.

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

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

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

Table 7. Bulgaria: General Government Operations, 2001-2007  
(In percent of GDP)

	2001	2002	2003	2004 1/	2005	2006		2007
						Program	Proj.	Proj.
<b>Total revenue and grants</b>	37.4	36.3	37.8	39.0	40.6	39.9	40.0	39.6
Tax revenue	28.7	27.5	29.6	31.0	32.4	31.8	31.9	31.1
Profit taxes	3.9	3.0	3.0	2.5	2.5	2.4	2.5	2.5
Nonfinancial enterprises	2.7	2.7	2.6	2.2	2.1	2.1	2.2	2.2
Financial enterprises	1.1	0.3	0.4	0.3	0.3	0.3	0.3	0.3
Income taxes	3.6	3.3	3.3	3.3	3.0	2.4	2.4	2.4
VAT	8.3	8.3	9.0	10.2	11.4	12.0	12.0	11.4
Excise and fuel duties	3.7	4.1	4.5	4.9	5.2	6.0	5.9	5.8
Customs duties	0.7	0.6	0.7	0.8	0.9	1.0	1.0	0.7
Social insurance contributions	7.8	7.3	8.1	8.3	8.4	7.0	7.1	7.2
Pension and unemployment contributions 2/	6.1	5.7	6.4	6.4	6.4	5.1	5.1	5.3
Health Insurance Fund	1.6	1.6	1.8	1.9	1.9	1.9	1.9	2.0
Other taxes	0.8	0.9	1.0	1.1	1.0	1.0	1.0	1.1
Nontax revenues	7.6	7.9	7.3	6.8	7.0	6.7	6.6	6.3
BNB transfers	0.6	0.5	0.4	0.4	0.4	0.3	0.3	0.3
Other	7.0	7.4	6.9	6.3	6.6	6.4	6.3	5.9
Grants and donations	1.2	0.9	0.9	1.2	1.2	1.5	1.5	2.2
<b>Total expenditure and net lending 3/</b>	38.3	37.2	38.2	37.2	38.3	36.9	36.8	37.6
Noninterest expenditure, net lending, contingency	34.6	35.0	36.1	35.4	36.6	35.5	35.4	36.2
Current noninterest expenditure	29.9	31.2	32.4	31.2	30.7	30.3	30.2	29.4
Compensation	5.9	6.2	6.4	6.2	6.0	6.0	6.0	5.8
Wages and salaries	5.8	6.1	6.2	6.1	5.9	5.9	5.9	5.7
Scholarships	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Maintenance and operations	7.7	7.9	8.2	8.3	8.3	7.7	7.9	7.8
Subsidies	2.4	2.4	2.6	2.3	2.1	1.3	1.3	1.1
Social expenditures	13.7	14.4	14.8	14.2	14.3	15.0	14.9	14.7
Pension fund	8.7	9.1	9.2	9.0	8.9	8.8	8.7	8.4
Assistance and unemployment	2.9	3.1	2.9	2.5	2.5	2.9	2.9	2.8
Health Insurance Fund	1.4	1.5	2.1	2.0	2.3	2.6	2.6	2.7
Other social expenditures 4/	0.8	0.6	0.6	0.7	0.7	0.7	0.7	0.9
Transfers 5/	...	...	0.4	0.2	0.1	0.2	0.2	0.1
Capital expenditures	3.9	3.2	3.4	3.8	4.9	4.5	4.5	4.9
Contingency	0.8	0.6	0.3	0.6	1.0	0.7	0.7	0.6
Enterprise restructuring	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Budget	0.6	0.4	0.1	0.4	0.8	0.4	0.4	0.4
Natural disaster	0.1	0.1	0.1	0.1	0.3	0.3	0.3	0.2
EU budget contribution	...	...	...	...	...	...	...	1.2
Primary balance	2.8	1.4	1.7	3.6	4.0	4.4	4.6	3.4
Interest	3.7	2.2	2.1	1.8	1.6	1.4	1.4	1.4
External	2.9	1.7	1.6	1.4	1.2	1.0	1.0	1.1
Domestic	0.9	0.5	0.5	0.5	0.5	0.5	0.5	0.4
<b>Overall balance</b>	-0.9	-0.8	-0.4	1.8	2.3	3.0	3.2	2.0
Financing	0.9	0.8	0.4	-1.8	-2.3	-3.0	-3.2	-2.0
Privatization 6/	2.9	1.3	1.1	3.1	3.4	0.6	0.9	0.9
External (net)	-0.3	1.5	0.0	-1.6	-5.7	-0.7	-1.2	-0.3
Domestic (net)	-1.7	-1.9	-0.7	-3.2	0.0	-2.9	-2.8	-2.6
Public debt	69.9	56.3	48.2	40.7	31.9	...	28.6	26.6
External	63.7	49.7	41.6	33.6	25.1	...	21.5	19.4
Domestic	6.3	6.6	6.5	7.0	6.8	...	7.1	7.2
Memorandum item:								
Nominal GDP in millions of leva	29,709	32,335	34,547	38,275	41,948	46,221	46,620	51,102

Sources: Ministry of Finance; and Fund staff projections.

1/ In late 2004, a state enterprise for infrastructure projects ("PIP") was created, capitalized with BGN 340 million to execute spending in 2005. PIP is consolidated with the general government.

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

3/ From 2004, total expenditure is adjusted for variation of arrears (net). Net variation in arrears amounted to BGN -84.7 million and BGN 8.2 million in 2004 and 2005, respectively.

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

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

6/ Slight differences between privatization receipts in the balance of payments and the fiscal accounts are due to domestic privatization.

In 2004, however, about BGN 500 million (1.3 percent of GDP) of previously completed bank privatizations was transferred to the government upon the closure of the Bank Consolidation Company.

Table 8. Bulgaria: Rankings of Selected Competitiveness and Structural Indicators 1/

	Overall Ranking	Emerging Markets 2/	Emerging Europe 3/	Acceding and Candidate Countries 4/
2005 World Economic Forum				
Growth Competitiveness Index	58	24	9	1
Business Competitiveness Index	78	34	12	4
Company Operation and Strategy	82	36	12	4
Quality of the national business environment	71	31	12	4
2006 Heritage Foundation "Economic Freedom"	64	20	10	3
2005 Transparency International Corruption Perception Index	55	17	8	1
2004 EBRD Transition Index	n.a.	n.a.	9	2
Large-scale privatization	n.a.	n.a.	1	1
Small-scale privatization	n.a.	n.a.	10	3
Enterprise Restructuring	n.a.	n.a.	10	2
Price Liberalization	n.a.	n.a.	1	1
Trade and Foreign Exchange System	n.a.	n.a.	1	1
Competition Policy	n.a.	n.a.	9	1
Banking Reform and Interest Rate Liberalization	n.a.	n.a.	4	2
Securities Markets and Nonbank Financial Institutions	n.a.	n.a.	10	2
Infrastructure	n.a.	n.a.	6	2
2006 IBRD Doing Business Survey	52	18	8	1
Starting a Business	69	23	10	3
Dealing with Licenses	107	28	8	3
Hiring and Firing	77	19	5	1
Registering Property	56	18	6	2
Getting Credit	44	14	6	1
Protecting Investors	49	19	6	3
Paying Taxes	65	17	7	3
Trading Across Borders	39	15	6	1
Enforcing Contracts	74	23	9	4
Closing a Business	55	21	7	1
2004 World Bank's Governance Indicator				
Voice and accountability	55	13	9	1
Political Stability	75	17	11	3
Government effectiveness	77	26	11	3
Regulatory Quality	50	15	9	1
Rule of Law	71	19	10	2
Control of Corruption	73	20	10	2
2005 International country risk guide	69	26	11	3
Law and order	52	15	7	3
Corruption	69	24	10	4
Quality of bureaucracy	52	21	10	2
Investment profile	22	5	3	1

1/ The ranking is equal to 1+ the number of countries with better rankings.

2/ MSCI countries, including Argentina, Brazil, Bulgaria, Chile, China, Colombia, Croatia, Czech Republic, Egypt, Estonia, Hong Kong SAR, Hungary, India, Indonesia, Israel, Jordan, South Korea, Latvia, Lebanon, Lithuania, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Romania, Russia, Singapore, Slovakia, Slovenia, South Africa, Sri Lanka, Taiwan POC, Thailand, Turkey, Venezuela

3/ Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia, and Turkey

4/ Bulgaria, Croatia, Macedonia, Romania, Turkey

Table 9. Bulgaria: Macroeconomic Framework, 2002-2011

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
					Projections					
<b>GDP and prices (annual percent change)</b>										
Real GDP	4.9	4.5	5.7	5.5	5.6	6.0	6.0	6.0	6.0	6.0
GDP deflator	3.8	2.3	4.8	3.8	5.2	3.4	2.8	2.9	3.0	3.0
CPI (end of period) 1/ (period average)	3.8	5.6	4.0	6.5	6.2	3.6	3.5	3.5	3.5	3.5
	5.8	2.3	6.1	5.0	7.4	3.8	3.5	3.5	3.5	3.5
<b>Monetary aggregates (annual percent change)</b>										
Broad money (nominal, end of period)	11.9	20.9	21.6	27.7	17.5	15.3	13.9	10.7	10.5	10.4
Claims on non-government (nominal, end of period)	44.0	48.3	48.7	32.3	17.5	20.0	18.2	12.3	11.0	10.9
<b>Saving and investment (in percent of GDP)</b>										
Foreign saving 2/	8.3	10.6	11.6	17.3	17.9	18.4	17.6	16.4	14.8	13.1
Gross national saving	17.4	16.2	17.7	16.2	17.1	17.9	19.9	21.6	23.7	24.6
Gross domestic saving 3/	11.5	11.1	12.0	10.7	11.5	11.7	13.6	15.0	16.7	18.4
Government	4.1	4.6	7.0	8.4	8.6	8.0	7.9	8.2	8.6	8.0
Non-government	7.4	6.5	5.0	2.4	2.9	3.8	5.6	6.8	8.1	10.3
Gross domestic investment	19.8	21.7	23.5	28.0	29.5	30.1	31.2	31.4	31.5	31.5
Government	3.2	3.4	3.8	4.9	4.5	4.9	5.6	6.4	7.2	6.8
Non-government	16.6	18.3	19.7	23.1	25.0	25.2	25.6	25.0	24.3	24.7
<b>General government (in percent of GDP)</b>										
Revenue	36.3	37.8	39.0	40.6	40.0	39.6	40.1	40.6	40.6	40.0
Non-interest expenditure	35.0	36.1	35.4	36.6	35.4	36.2	37.4	38.6	39.0	38.5
Primary balance	1.4	1.7	3.6	4.0	4.6	3.4	2.6	2.1	1.7	1.5
Interest payments	2.2	2.1	1.8	1.6	1.4	1.4	1.3	1.2	1.1	1.0
Overall balance 4/	-0.8	-0.4	1.8	2.3	3.2	2.0	1.3	0.8	0.6	0.5
Total public debt	56.3	48.2	40.7	31.9	28.6	26.6	24.9	22.7	20.6	18.7
Of which : External	49.7	41.6	33.6	25.1	21.5	19.4	17.7	15.5	13.5	11.8
<b>Balance of payments (in percent of GDP)</b>										
Current account	-2.4	-5.5	-5.8	-11.8	-12.4	-12.2	-11.3	-9.8	-7.8	-6.9
Trade balance	-11.4	-13.7	-15.1	-20.4	-20.9	-21.7	-21.4	-20.7	-19.6	-18.2
Exports	36.7	37.8	40.8	44.1	51.9	53.0	51.9	51.3	50.9	51.0
Imports	48.0	51.5	55.9	64.5	72.7	74.8	73.3	72.0	70.5	69.2
Services, net	3.1	3.1	3.5	3.1	2.9	3.4	3.8	4.3	4.8	5.1
Receipts	14.8	15.4	16.7	16.1	16.3	16.5	16.6	16.6	16.8	16.8
Payments	11.8	12.3	13.1	13.0	13.4	13.1	12.8	12.4	12.0	11.7
Income, net	2.4	1.6	1.2	1.2	1.1	0.9	0.2	-0.3	-0.7	-1.0
<b>Memorandum items</b>										
Gross official reserves (in millions of euros)	4,575	5,405	6,854	7,370	8,473	9,226	9,996	10,389	10,736	10,561
(in months of prospective imports of GNFS)	4.9	4.8	5.0	4.3	4.3	4.4	4.5	4.4	4.3	...
External debt/GDP (in percent)	65.1	60.2	64.7	67.7	69.9	69.0	68.3	66.6	64.4	61.1
External debt/exports of GNFS (in percent)	126.4	113.2	111.8	112.7	102.5	99.2	99.7	98.0	95.3	90.1
External debt service/exports of GNFS (in percent)	15.9	14.0	21.6	42.6	10.6	10.3	10.5	11.5	11.9	12.5
Export volume (year-on-year change)	9.9	15.2	8.8	4.4	13.3	12.9	11.9	11.2	11.3	10.0
Import volume (year-on-year change)	10.1	19.6	12.3	11.4	11.7	12.0	10.6	9.7	9.5	8.0
Terms of trade (percent change)	0.2	-0.3	2.7	-0.1	2.8	-1.3	-1.4	-0.8	-0.2	0.2
Nominal GDP (in millions of leva)	32,335	34,547	38,275	41,948	46,620	51,102	55,577	60,502	66,082	72,176
Nominal GDP (in millions of euros)	16,533	17,663	19,570	21,448	23,836	26,128	28,416	30,934	33,787	36,903

Sources: Bulgarian authorities; and Fund staff projections.

1/ Projections are based on the current consumer price index (CPI), which may be different from the EU's Harmonized Index of Consumer Prices (HICP)

2/ Net imports of goods and nonfactor services.

3/ 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.

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

Table 10. Bulgaria: Balance of Payments, 2002-2011  
(In millions of euros)

Friday, June 02, 2006 3:49 PM	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
	Projections									
<b>CURRENT ACCOUNT</b>	-402	-973	-1,132	-2,531	-2,956	-3,178	-3,212	-3,033	-2,650	-2,551
Trade balance	-1,878	-2,426	-2,954	-4,369	-4,973	-5,680	-6,085	-6,405	-6,622	-6,719
Exports (f.o.b.)	6,063	6,668	7,985	9,454	12,367	13,858	14,748	15,864	17,181	18,828
y-o-y change (in percent)	6.1	10.0	19.7	18.4	30.8	12.1	6.4	7.6	8.3	9.6
Imports (f.o.b.)	-7,941	-9,094	-10,938	-13,823	-17,340	-19,539	-20,833	-22,269	-23,803	-25,547
y-o-y change (in percent)	6.0	14.5	20.3	26.4	25.4	12.7	6.6	6.9	6.9	7.3
Services, net	506	553	692	667	696	884	1,077	1,318	1,619	1,871
Exports of NFS	2,455	2,729	3,262	3,444	3,886	4,310	4,723	5,149	5,661	6,187
Imports of NFS	-1,949	-2,176	-2,569	-2,778	-3,190	-3,426	-3,647	-3,831	-4,042	-4,316
<i>Of which: Exports of travel services</i>	1,242	1,500	1,789	1,932	2,085	2,267	2,469	2,699	3,013	3,291
Income, net	405	288	238	247	261	232	66	-95	-222	-369
<i>Of which: Income to direct investors</i>	-237	-493	-609	-533	-592	-692	-848	-982	-1,084	-1,288
Current transfers, net	566	613	891	925	1,060	1,386	1,730	2,149	2,575	2,666
<b>CAPITAL AND FINANCIAL ACCOUNT</b>	1,134	1,754	2,669	3,215	4,283	4,026	4,076	3,489	3,018	2,376
Capital transfers, net	0	0	0	-1	0	0	0	0	0	0
Foreign direct investment, net 1/ 2/	951	1,827	1,550	2,210	2,246	2,288	2,219	2,114	2,148	2,202
<i>Of which: Privatization receipts 3/</i>	144	312	243	693	205	223	150	0	0	0
Portfolio investment, net	-99	-191	-564	-757	125	-186	76	76	76	76
Other investment, net	1,006	840	2,047	1,199	1,646	1,924	1,781	1,299	794	98
General government	-129	60	102	55	94	486	379	194	174	125
Domestic banks	443	562	1,029	-189	-368	32	373	197	-40	-10
Other private sector	691	219	915	1,333	1,920	1,405	1,028	908	661	-17
Errors and omissions	-723	-722	-364	564	266	0	0	0	0	0
<b>OVERALL BALANCE</b>	732	781	1,538	684	1,327	848	864	456	368	-175
<b>FINANCING</b>	-732	-781	-1,538	-684	-1,327	-848	-864	-456	-368	175
Gross international reserves (increase: -)	-578	-817	-1,493	-324	-1,047	-753	-769	-393	-347	175
Use of Fund credit, net	-155	35	-44	-359	-279	-95	-95	-63	-21	0
Purchases	117	128	62	0	0	0	0	0	0	0
Repurchases 4/	-270	-101	-106	-359	-279	-95	-95	-63	-21	0
Exceptional financing	0	0	0	0	0	0	0	0	0	0
<b>MEMORANDUM ITEMS</b>										
Gross international reserves (stock, e.o.p.) 5/	4,575	5,405	6,854	7,370	8,473	9,226	9,996	10,389	10,736	10,561
In months of prospective GNFS imports	4.9	4.8	5.0	4.3	4.3	4.4	4.5	4.4	4.3	...
In percent of short-term debt (original maturity)	301.9	354.5	282.4	206.8	170.3	168.3	165.3	156.8	149.5	138.1
Current account + FDI	549	854	418	-321	-710	-890	-993	-919	-502	-349
(in percent of GDP)	3.3	4.8	2.1	-1.5	-3.0	-3.4	-3.5	-3.0	-1.5	-0.9
Current account (in percent of GDP) 6/	-2.4	-5.5	-5.8	-11.8	-12.4	-12.2	-11.3	-9.8	-7.8	-6.9
Merchandise trade account (in percent of GDP)	-11.4	-13.7	-15.1	-20.4	-20.9	-21.7	-21.4	-20.7	-19.6	-18.2
Merchandise exports (in percent of GDP)	36.7	37.8	40.8	44.1	51.9	53.0	51.9	51.3	50.9	51.0
Merchandise imports (in percent of GDP)	-48.0	-51.5	-55.9	-64.5	-72.7	-74.8	-73.3	-72.0	-70.5	-69.2
Export volume (year-on-year change)	9.9	15.2	8.8	4.4	13.3	12.9	11.9	11.2	11.3	10.0
Import volume (year-on-year change)	10.1	19.6	12.3	11.4	11.7	12.0	10.6	9.7	9.5	8.0
FDI (net) in percent of current account	236.5	187.8	137.0	87.3	76.0	72.0	69.1	69.7	81.1	86.3
Gross external debt (stock, e.o.p.) 7/	10,769	10,641	12,572	14,530	16,659	18,016	19,409	20,593	21,760	22,537
(In percent of GDP)	65.1	60.2	64.2	67.7	69.9	69.0	68.3	66.6	64.4	61.1
Public	7,961	7,048	6,428	5,148	5,267	5,739	6,254	6,506	6,745	6,932
Private	2,808	3,593	6,144	9,383	11,392	12,277	13,155	14,088	15,014	15,605
Short-term debt (in percent of total debt, e.o.p.)	14.1	14.3	19.3	24.5	29.2	29.9	30.8	31.9	32.9	33.9
Net external debt (in percent of annual GDP) 8/	25.7	20.9	17.5	22.2	23.4	24.2	25.1	25.5	24.3	22.8
GDP	16,533	17,663	19,570	21,448	23,836	26,128	28,416	30,934	33,787	36,903

Sources: Bulgarian authorities, and Fund staff estimates.

1/ All FDI are assumed to be non-debt creating in the projections.

2/ The figures for 2004 and 2005 are influenced by a complex debt financed merger and acquisition transaction of a local mobile telephone company that led to a sharp increase in its equity value, and a transfer of the realized capital gains out of the country by the original owners. This resulted in a net FDI outflow of 650 million euros and an increase in gross external debt by 590 million euros in 2004.

3/ Privatization receipts for the electricity distribution companies are included in 2005. These are included in the receipts for 2004 in the balance of payments presentation of the BNB. The present treatment aligns them with its receipt in the fiscal accounts.

4/ According to expectations schedule.

5/ Historical numbers include valuation changes. From 2006-10 includes reserves posted as a guarantee for defense related purchases. Reserve coverage ratios are calculated net of impaired reserves.

6/ Current account adjustment is facilitated by average net EU transfers over 2008-11 that are 1.8 percentage points of GDP higher than the 2006 level.

7/ Projections include assumptions on disbursements related to debt not already contracted.

8/ External debt minus gross foreign assets of the banking system.



Table 11. Bulgaria: Quantitative Performance Criteria and Indicative Targets Under the Stand-By Arrangement 1/  
(In millions of leva, unless otherwise indicated)

	2005				2006			
	March 31 2/	June 30	September 30	December 31 2/	March 31	June 30	September 30	December 31
<b>I. Floor on the overall fiscal surplus of the general government</b>								
Original Target	198	383	605	417	256	786	1,099	1,387
Adjusted Target 3/	277	556	914	943	256			
Actual 4/	486	1,081	1,378	974	398			
Margin (actual less adjusted target)	209	525	464	31	142			
<b>II. Ceiling on central government arrears 4/</b>								
Target	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Actual	5.7	4.5	4.2	4.8	4.7			
Margin	-0.7	0.5	0.8	0.2	0.3			
<b>III. Ceiling on the wage bill of the selected SOEs 4/</b>								
Target 5/	92.7	184.3	275.4	366.1	89.2	178.4	267.7	356.9
Actual	84.4	168.6	253.5	340.1	83.7			
Margin	8.3	15.7	21.9	26.0	5.5			
<b>IV. Ceiling on the contracting or guaranteeing of nonconcessional external public debt 6/</b>								
<b>(i) 1 year and less than 3 years</b>								
Target	0	0	0	0	0	0	0	0
Actual	0	0	0	0	0	0	0	0
Margin	0	0	0	0	0	0	0	0
<b>(ii) Over 1 year</b>								
Target	38.0	229.8	229.8	229.8	293.0	0	74.6	203.3
Actual	0	0	0	154.1	0.0	0	0	0
Margin	38.0	229.8	229.8	75.7	293	0	0	0
<b>(iii) 1-5 years</b>								
Target	0	0	0	0	0	0	0	0
Actual	0	0	0	0	0	0	0	0
Margin	0	0	0	0	0	0	0	0

1/ Definitions of the performance criteria are included in the Annexes to the Supplementary Memorandum of Economic and Financial Policies.

2/ Indicative limit or target.

3/ In 2005, the targets were raised by 69 percent of the cumulative tax revenue (excluding personal income tax) overperformance. In 2006, the targets will be raised by 50 percent of the cumulative total revenue (and grant) overperformance.

4/ Cumulative change from January 1, 2005 for 2005 performance criteria and from January 1, 2006 for 2006 performance criteria. For central government arrears, targets are stocks.

5/ Targets for 2005 have changed compared to IMF Country Report No. 05/169 due to staff layoffs in Terem EAD in Q1 and closures of Balkancar Zaria, Elektrostomana, Dunarid AD, and Balkan Car 6th September in Q2 2005.

6/ In millions of euro. Cumulative change from December 31, 2004 for 2005 performance criteria and December 31, 2005 for 2006 performance criteria.

Table 12. Bulgaria: Observance of Structural Conditionality Under the Stand-By Arrangement in 2006 1/

Conditionality Met	Type and date due 2/	Notes	Current Status 2/
1. Approval by parliament of legislation transferring business registration to the Registration Agency under the Ministry of Justice and establishing a unified national electronic register with limited judicial oversight and simplified administrative procedures.	PA	The prior action was met on March 24, 2006. The President vetoed the law and sent it back to Parliament. The Parliament voted to overrule the veto. The law was again passed on April 20, 2006 and enacted April 25, 2006.	
2. 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.	PC, continuous	Met	
3. No reduction of tax rates and bases (except for those described in ¶6 of the SSMEFP).	PC, continuous	Met	
4. The monthly minimum wage not to exceed BGN160	PC, continuous	Met	
5. No new extrabudgetary funds or state-owned enterprises to be created.	SB, continuous	Decision to transform the Road Executive Agency into an extrabudgetary fund has been made. The agency will be established in January 2007.	
6. Submission to parliament of legislation to increase work time flexibility, as agreed with the social partners.	SB, June 30, 2006	The amendment to the Labor Code to increase the limit on working hours from 40 to 48 hours per week, increase working time calculation period from 4 to 6 months was approved by parliament on May 31, 2006.	
<b>Conditionality Not Met (Implemented Partially, or with Delay)</b>	<b>Previous Status 2/</b>	<b>Notes</b>	<b>Current Status 2/</b>
1. Agreement with social partners to increase work time flexibility by raising the legal limits on maximum working hours, lengthening calculation periods, and expanding the reasons for work outside regular hours.	SB, March 31, 2006	Draft amendments to the Labor Code envisaging raising the maximum working hours under labor contracts from 40 to 48 hours per week were adopted by the National Tripartite Council on March 16, 2006. The draft did not include the lengthening of the working time calculation period, which was later introduced in parliament and agreed by social partners on May 18, 2006.	
2. Submission to parliament of an education reform strategy envisaging an initial employment cut of at least 5,500.	SB, March 31, 2006	The strategy was submitted to parliament on March 27, 2006, however, with no explicit mention of the envisaged 5,500 job cuts.	Implementation of employment cuts of at least 5,500 positions in the education sector is SB for September 5, 2006.
3. Approval by parliament of the new VAT law.	SPC, April 30, 2006	The draft law was approved by CoM on March 30, 2006. It was submitted to Parliament on April 12, 2006. On April 27, 2006, the draft was passed in second reading by the budget commission.	Prior action.
4. Selection of the winning bidders for the Rousse and Varna electricity generation companies.	SPC, June 30, 2006	The privatization of the Varna electricity generating company was completed on April 24, 2006. The privatization of Rousse power plant was blocked by the decision of Commission for Protection of Competition. In February 2006, the Privatization Agency cancelled the procedure as the bid from the second bidder was unsatisfactory. A new tender is expected to be issued by July 25, 2006.	Selection of winning bid for Rousse electricity generation company is SPC for October 31, 2006.

Table 12. Bulgaria: Observance of Structural Conditionality Under the Stand-By Arrangement in 2006 (concluded) 1/

Conditionality Not Met (Implemented Partially, or with Delay)	Notes	Previous Status 2/	Current Status 2/
5. Reduction of central administration employment by 4,500 positions.	As of July 10, 2006, the total number of employees in the state administration has been reduced by 3,909 positions.	SB, June 30, 2006	
6. Approval by parliament of a law on duty free trade specifying limits on individual purchases of goods and fuels and strengthened controls.	The draft law was submitted to parliament on June 8, 2006, and is expected to be passed by parliament on July 31, 2006.	SB, June 30, 2006	
<b>Conditionality Not Met</b>			
1. Agreement with social partners on a solution repealing the obligatory character of the portability of seniority bonuses in the case of unemployment, change of employer, or job position.	Not met. Discussions with trade unions and employers are still ongoing.	SB, March 31, 2006	SB, December 31, 2006
2. Adoption of a decree repealing the obligatory character of the portability of seniority bonuses in the case of unemployment, change of employer, or job position.		SB, June 30, 2006	Agreement with social partners on the issue is SB for December 31, 2006.
3. Start-up of operations of the new business register, at least for all new business registrations.	The President vetoed the law that was passed as prior action. The veto was later overruled by parliament. The law will enter into force on October 1, 2006.	SPC, June 30, 2006	Start-up of operations of the new business register is SPC for October 1, 2006.
<b>Conditionality Not Yet Due</b>			
1. Approval by parliament of new CIT and PIT laws.		SB, July 31, 2006	SB, July 31, 2006
2. Approval by parliament of a law on consolidated supervision of financial conglomerates.		SB, September 5, 2006	The draft law was submitted to parliament on April 27, 2006, and was passed on the first reading on June 8, 2006.
3. Implementation of an employment cut of at least 5,500 positions in the education sector.		SB, September 5, 2006	SB, September 30, 2006

1/ Details of the performance criteria and benchmarks are included in the Annexes to the Second Supplementary Memorandum of Economic and Financial Policies, IMF Country Report No. 06/131.

2/ SPC denotes structural performance criterion, SB denotes structural benchmark, and PA denotes prior action.

Table 13. Changes to Structural Conditionality Since Second Review (IMF Country Report No. 06/131)

Measure	Date	Type	¶ in TSMEFP
Selection of winning bid for Rousee district heating company	31-Oct-06	revised structural PC	¶120
Start up of operations of a register covering all municipal borrowing	31-Dec-06	new structural PC	¶118
An exception to the continuous structural benchmark proscribing the creation of extrabudgetary funds or state-owned enterprises was necessitated by the EU-mandated establishment of a state executive agency to disburse EU funds for building roads	from January 2007	revised structural benchmark	¶9
Approval by parliament of an amendment to the Health Insurance Law	31-Jul-06	new structural benchmark	¶6
Employment cut of at least 5,500 positions in the education sector.	30-Sep-06	revised structural benchmark	¶6
Approval by parliament of a new law on credit institutions	30-Sep-06	new structural benchmark	¶13
Approval by the Council of Ministers of the system of school financing based on the unified per student standards	31-Oct-06	new structural benchmark	¶6
The deadline for an agreement on the portability of seniority bonuses	31-Dec-06	revised structural benchmark	¶11
Initiate the legal procedure to close the Public Investment Projects company	31-Dec-06	new structural benchmark	¶9
New integrated tax and social security software system for the NRA to be fully operational	31-Dec-06	new structural benchmark	¶8

Table 14. Bulgaria: Schedule of Purchases Under the Current Stand-By Arrangement

Date	Amount of Purchase 1/		Conditions
	In millions of SDRs	In percent of quota	
August 6, 2004	12.00	1.87	Board approval of Stand-By Arrangement
December 15, 2004	11.00	1.72	Observance of end-September 2004 performance criteria
March 15, 2005	11.00	1.72	Observance of end-December 2004 performance criteria and completion of first review
September 15, 2005	22.00	3.44	Observance of end-June 2005 performance criteria
December 15, 2005	22.00	3.44	Observance of end-September 2005 performance criteria and completion of second review
June 13, 2006	11.00	1.72	Observance of end-March 2006 performance criteria and completion of third review
September 15, 2006	3.67	0.57	Observance of end-June 2006 performance criteria
December 15, 2006	3.67	0.57	Observance of end-September 2006 performance criteria and completion of fourth review
March 15, 2007	3.66	0.57	Observance of end-December 2006 performance criteria
<b>Total</b>	<b>100.00</b>	<b>15.62</b>	

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.

Table 15: Bulgaria: External Debt Sustainability Framework, 2001-2011  
(In percent of GDP, unless otherwise indicated)

	Actual							Projections					Debt-stabilizing non-interest current account 6/ -8.3
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011		
<b>1 Baseline: External debt</b>	78.6	65.1	60.2	64.2	67.7	69.9	69.0	68.3	66.6	64.4	61.1		
2 Change in external debt	-8.5	-13.5	-4.9	4.0	3.5	2.1	-0.9	-0.6	-1.7	-2.2	-3.3		
3 Identified external debt-creating flows (4+8+9)	-8.4	-8.3	-7.7	-8.0	-4.1	-0.4	-0.4	-0.3	-0.8	-2.2	-2.6		
4 Current account deficit, excluding interest payments	1.9	0.1	3.4	4.0	9.9	10.4	9.7	8.6	6.9	4.8	3.9		
5 Deficit in balance of goods and services	9.5	8.3	10.6	11.6	17.3	17.9	18.4	17.6	16.4	14.8	13.1		
6 Exports	53.6	51.5	53.2	57.5	60.1	68.2	69.5	68.5	67.9	67.6	67.8		
7 Imports	63.2	59.8	63.8	69.0	77.4	86.1	87.9	86.1	84.4	82.4	80.9		
8 Net non-debt creating capital inflows (negative)	-5.2	-4.3	-9.1	-7.9	-10.3	-9.4	-8.8	-7.8	-6.8	-6.4	-6.0		
9 Automatic debt dynamics 1/	-5.1	-4.1	-2.1	-4.1	-3.7	-1.5	-1.3	-1.1	-0.9	-0.6	-0.5		
10 Contribution from nominal interest rate	3.7	2.3	2.1	1.8	1.9	2.0	2.5	2.7	2.9	3.0	3.0		
11 Contribution from real GDP growth	-3.2	-3.5	-2.7	-3.1	-3.2	-3.4	-3.8	-3.8	-3.8	-3.7	-3.5		
12 Contribution from price and exchange rate changes 2/	-5.6	-2.9	-1.5	-2.8	-2.4	...	...	...	...	...	...		
13 Residual, incl. change in gross foreign assets (2-3) 3/	0.0	-5.2	2.8	12.0	7.6	2.6	-0.5	-0.3	-0.9	0.0	-0.7		
External debt-to-exports ratio (in percent)	146.6	126.4	113.2	111.8	112.7	102.5	99.2	99.7	98.0	95.3	90.1		
<b>Gross external financing need (in billions of Euros) 4/</b>	3.3	2.6	3.1	4.2	8.8	7.7	9.1	9.6	10.1	10.4	11.0		
in percent of GDP	21.5	15.9	17.7	21.4	40.8	32.2	34.9	33.8	32.7	30.7	29.9		
<b>Scenario with key variables at their historical averages 5/</b>						<b>69.9</b>	<b>63.8</b>	<b>57.6</b>	<b>51.2</b>	<b>46.3</b>	<b>40.8</b>	<b>-9.5</b>	
<b>Key Macroeconomic Assumptions Underlying Baseline</b>													
Real GDP growth (in percent)	4.1	4.9	4.5	5.7	5.5	5.6	6.0	6.0	6.0	6.0	6.0		
GDP deflator in Euros (change in percent)	6.9	3.8	2.3	4.8	3.8	5.2	3.4	2.8	2.9	3.0	3.0		
Nominal external interest rate (in percent)	4.8	3.2	3.4	3.3	3.3	3.2	3.9	4.3	4.6	5.0	5.1		
Growth of exports (Euro terms, in percent)	6.9	4.6	10.3	19.7	14.7	26.0	11.8	7.2	7.9	8.7	9.5		
Growth of imports (Euro terms, in percent)	14.8	3.1	13.9	19.9	22.9	23.7	11.9	6.6	6.6	6.7	7.2		
Current account balance, excluding interest payments	-1.9	-0.1	-3.4	-4.0	-9.9	-10.4	-9.7	-8.6	-6.9	-4.8	-3.9		
Net non-debt creating capital inflows	5.2	4.3	9.1	7.9	10.3	9.4	8.8	7.8	6.8	6.4	6.0		

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

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

3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

Table 15a. Bulgaria: External Debt Sustainability Framework: Alternative Scenario 1/  
(In percent of GDP, unless otherwise indicated)

	Actual										Projections					Debt-stabilizing non-interest current account 7/ -8,9
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011					
<b>1 Baseline: External debt</b>	78.6	65.1	60.2	64.2	67.7	69.9	69.2	69.6	69.5	69.5	68.9					
2 Change in external debt	-8.5	-13.5	-4.9	4.0	3.5	2.1	-0.7	0.4	-0.1	0.0	-0.6					
3 Identified external debt-creating flows (4+8+9)	-8.4	-8.3	-7.7	-8.0	-4.1	-0.4	-0.2	0.7	0.9	0.1	0.3					
4 Current account deficit, excluding interest payments	1.9	0.1	3.4	4.0	9.9	10.4	10.4	10.0	9.0	7.4	7.1					
5 Deficit in balance of goods and services	9.5	8.3	10.6	11.6	17.3	17.9	19.1	19.0	18.4	17.4	16.2					
6 Exports	53.6	51.5	53.2	57.5	60.1	68.2	69.2	67.8	66.9	66.3	66.2					
7 Imports	63.2	59.8	63.8	69.0	77.4	86.1	88.2	86.8	85.4	83.7	82.5					
8 Net non-debt creating capital inflows (negative)	-5.2	-4.3	-9.1	-7.9	-10.3	-9.4	-9.2	-8.2	-7.2	-6.7	-6.3					
9 Automatic debt dynamics 2/	-5.1	-4.1	-2.1	-4.1	-3.7	-1.5	-1.3	-1.1	-0.9	-0.6	-0.5					
10 Contribution from nominal interest rate	3.7	2.3	2.1	1.8	1.9	2.0	2.5	2.7	2.9	3.2	3.3					
11 Contribution from real GDP growth	-3.2	-3.5	-2.7	-3.1	-3.2	-3.4	-3.8	-3.8	-3.8	-3.8	-3.8					
12 Contribution from price and exchange rate changes 3/	-5.6	-2.9	-1.5	-2.8	-2.4	...	...	...	...	...	...					
13 Residual, incl. change in gross foreign assets (2-3) 4/	0.0	-5.2	2.8	12.0	7.6	2.6	-0.5	-0.3	-1.0	-0.1	-0.9					
External debt-to-exports ratio (in percent)	146.6	126.4	113.2	111.8	112.7	102.5	100.1	102.6	103.8	104.8	104.0					
<b>Gross external financing need (in billions of Euros) 5/</b> in percent of GDP	3.3	2.6	3.1	4.2	8.8	7.7	9.3	10.1	11.0	11.9	13.4					
21.5	15.9	17.7	21.4	40.8	32.2	35.6	35.4	35.6	35.1	36.2						
<b>Scenario with key variables at their historical averages 6/</b>						<b>69.9</b>	<b>63.8</b>	<b>57.6</b>	<b>51.2</b>	<b>46.3</b>	<b>40.8</b>				<b>-9.5</b>	
<b>Key Macroeconomic Assumptions Underlying Baseline</b>																
Real GDP growth (in percent)	4.1	4.9	4.5	5.7	5.5	5.6	6.0	6.0	6.0	6.0	6.0					
GDP deflator in Euros (change in percent)	6.9	3.8	2.3	4.8	3.8	5.2	3.4	2.8	2.9	3.0	3.0					
Nominal external interest rate (in percent)	4.8	3.2	3.4	3.3	3.3	3.2	3.9	4.3	4.6	5.0	5.2					
Growth of exports (Euro terms, in percent)	6.9	4.6	10.3	19.7	14.7	26.0	11.2	6.6	7.4	8.2	9.1					
Growth of imports (Euro terms, in percent)	14.8	3.1	13.9	19.9	22.9	23.7	12.3	7.0	7.0	7.1	7.6					
Current account balance, excluding interest payments	-1.9	-0.1	-3.4	-4.0	-9.9	-10.4	-10.4	-10.0	-9.0	-7.4	-7.1					
Net non-debt creating capital inflows	5.2	4.3	9.1	7.9	10.3	9.4	9.2	8.2	7.2	6.7	6.3					

1/ The assumptions for this alternative scenario include (1) real export growth of non-energy commodities are 5 percent lower; (2) real import growth of non-energy commodities are 2 percent higher; and (3) FDI is 5 percent lower.

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

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

4/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

Table 16. Bulgaria: Public Sector Debt Sustainability Framework, 2001-2011  
(In percent of GDP, unless otherwise indicated)

	Actual										Projections						Debt-stabilizing primary balance 9/
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011						
<b>1 Baseline: Public sector debt 1/</b> o/w foreign-currency denominated	69.9	56.3	48.2	40.7	31.9	28.6	26.6	24.9	22.7	20.6	18.7	18.7	11.5	1.0			
2 Change in public sector debt	-7.2	-13.7	-8.1	-7.5	-8.7	-3.3	-2.1	-1.7	-2.2	-2.1	-1.9	-1.9	-1.9				
3 Identified debt-creating flows (4+7+12)	-5.9	-2.5	-2.1	-7.3	-6.9	-4.5	-2.5	-1.2	-0.5	-0.5	-0.6	-0.6	-0.6				
4 Primary deficit	-2.8	-1.4	-1.7	-3.6	-4.0	-4.6	-3.4	-2.6	-2.1	-1.7	-1.5	-1.5	-1.5				
5 Revenue and grants	37.4	36.3	37.8	39.0	40.6	40.0	39.6	40.1	40.6	40.6	40.0	38.5	38.5				
6 Primary (noninterest) expenditure	34.6	35.0	36.1	35.4	36.6	35.4	36.2	37.4	38.6	39.0	38.5	38.5	38.5				
7 Automatic debt dynamics 2/	-4.0	-3.5	-1.5	-2.9	-1.9	-1.8	-1.1	-0.9	-0.9	-0.8	-0.7	-0.7	-0.7				
8 Contribution from interest rate/growth differential 3/	-4.0	-3.5	-1.5	-2.9	-1.9	-1.8	-1.1	-0.9	-0.9	-0.8	-0.7	-0.7	-0.7				
9 Of which contribution from real interest rate	-1.1	-0.3	0.8	-0.4	0.1	-0.2	0.5	0.6	0.5	0.4	0.4	0.4	0.4				
10 Of which contribution from real GDP growth	-2.8	-3.1	-2.3	-2.5	-2.1	-1.6	-1.6	-1.5	-1.4	-1.2	-1.1	-1.1	-1.1				
11 Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	...	...				
12 Other identified debt-creating flows	0.9	2.3	1.1	-0.8	-1.0	1.9	2.1	2.3	2.4	2.0	1.7	1.7	1.7				
13 Privatization receipts (negative)	-2.9	-0.9	-1.1	-3.1	-3.4	-0.9	-0.9	-0.5	0.0	0.0	0.0	0.0	0.0				
14 Recognition of implicit or contingent liabilities	3.8	3.2	2.2	2.3	2.4	2.7	2.9	2.8	2.4	2.0	1.7	1.7	1.7				
15 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	0.0	0.0				
16 Residual, including asset changes (2-3) 5/	-1.3	-11.2	-6.0	-0.3	-1.9	1.2	0.4	-0.5	-1.7	-1.6	-1.3	-1.3	-1.3				
Public sector debt-to-revenue ratio 1/	186.8	154.8	127.5	104.3	78.6	71.6	67.0	62.2	55.9	50.8	46.8	46.8	46.8				
<b>Gross financing need 6/</b> in billions of euros	7.7	5.9	4.2	4.3	7.2	0.5	1.0	1.0	1.2	0.9	1.3	1.3	1.3				
	1.2	1.0	0.7	0.8	1.5	0.1	0.2	0.3	0.4	0.3	0.5	0.5	0.5				
<b>Scenario with key variables at their historical averages 7/</b> <b>Scenario with no policy change (constant primary balance) in 2006-11</b>						28.6	27.1	25.0	21.9	18.6	15.4	15.4	15.4	1.1			
						28.6	25.4	21.8	17.2	12.4	7.8	7.8	7.8	1.4			
<b>Key Macroeconomic and Fiscal Assumptions Underlying Baseline</b>																	
Real GDP growth (in percent)	4.1	4.9	4.5	5.7	5.5	5.6	6.0	6.0	6.0	6.0	6.0	6.0	6.0				
Average nominal interest rate on public debt (in percent) 8/	5.4	3.4	4.0	4.2	4.4	4.9	5.6	5.6	5.7	5.8	6.1	6.1	6.1				
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-1.4	-0.3	1.7	-0.6	0.6	-0.3	2.2	2.8	2.8	2.8	3.1	3.1	3.1				
Nominal appreciation (increase in euro value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	...	...				
Inflation rate (GDP deflator, in percent)	6.7	3.8	2.3	4.8	3.8	5.2	3.4	2.8	2.9	3.0	3.0	3.0	3.0				
Growth of real primary spending (deflated by GDP deflator, in percent)	0.9	6.1	7.8	3.6	9.2	2.0	8.4	9.4	9.0	7.1	4.7	4.7	4.7				
Primary deficit	-2.8	-1.4	-1.7	-3.6	-4.0	-4.6	-3.4	-2.6	-2.1	-1.7	-1.5	-1.5	-1.5				

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as  $[(r - \pi(1+g) - g + \alpha\pi(1+r))/(1+g+\pi+gr)]$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $\alpha$  = share of foreign-currency denominated debt; and  $\varepsilon$  = 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  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as  $\alpha\pi(1+r)$ .

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include seven year averages of real GDP growth, real interest rate, and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.



Table 17. Bulgaria: Capacity to Repay the Fund, 2003-2011 1/

	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Fund repurchases and charges</b>									
In millions of SDRs 2/	94.8	110.5	325.4	242.4	102.5	88.8	70.9	70.7	39.4
In millions of euros	117.5	131.4	389.5	283.3	123.6	107.1	85.5	85.2	47.4
In percent of exports of goods and NFS	1.3	1.2	3.0	1.7	0.7	0.5	0.4	0.4	0.2
In percent of total debt service	8.9	5.4	7.1	16.5	6.6	5.2	3.5	3.1	1.5
In percent of quota	14.8	17.3	50.8	37.9	16.0	13.9	11.1	11.0	6.1
In percent of gross international reserves	2.2	1.9	5.3	3.3	1.3	1.1	0.8	0.8	0.4
<b>Fund credit outstanding</b>									
In millions of SDRs	799.2	762.0	461.8	332.7	248.2	169.7	105.9	38.9	0.5
In millions of euros	954.1	875.4	557.5	386.0	299.2	204.6	127.6	46.9	0.6
In percent of exports of goods and NFS	10.2	7.8	4.3	2.4	1.6	1.1	0.6	0.2	0.0
In percent of quota	124.8	119.0	72.1	52.0	38.8	26.5	16.5	6.1	0.1
In percent of gross international reserves	17.7	12.8	7.6	4.6	3.2	2.0	1.2	0.4	0.0
<b>Memorandum items:</b>									
Exports of goods and NFS (in millions of euros)	9,396.7	11,246.6	12,898.4	16,252.3	18,168.6	19,471.5	21,012.8	22,842.5	25,014.8
Debt service (in millions of euros)	1,315.4	2,428.6	5,497.1	1,715.6	1,862.3	2,053.0	2,412.3	2,721.0	3,134.5
Quota (in millions of SDRs)	640.2	640.2	640.2	640.2	640.2	640.2	640.2	640.2	640.2
Quota (in millions of euros)	764.3	735.5	772.8	742.7	771.9	771.8	771.9	771.8	771.5
Gross international reserves (in millions of euros)	5,405.0	6,854.2	7,370.3	8,473.4	9,226.4	9,995.7	10,388.5	10,735.8	10,560.9
Euros per SDR (period avg)	1.24	1.19	1.19	1.17	1.21	1.21	1.21	1.21	1.21
Euros per SDR (eop)	1.19	1.15	1.21	1.16	1.21	1.21	1.21	1.21	1.21

Source: Fund staff calculations.

1/ Assumes purchases are made under the current precautionary arrangement.

2/ Projections are based on actual repurchases through end-February and obligations basis thereafter.

Table 18. Bulgaria: Financial Relations with the Fund, 2000-2010

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
	(In millions of SDRs)										
Purchases											
SBA	0.0	0.0	84.0	104.0	52.0	0.0	0.0	0.0	0.0	0.0	0.0
EFF	209.2	104.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Obligations schedule 1/											
Repurchases	105.3	236.2	195.2	76.6	89.2	300.1	225.4	88.2	78.5	52.3	17.4
Charges and interest	33.8	36.7	18.1	18.2	21.3	25.3	16.1	10.1	6.0	2.5	0.5
Fund credit outstanding	1,014.6	883.0	771.8	799.2	762.0	461.8	236.4	148.2	69.7	17.4	0.0
Expectations schedule											
Repurchases	105.3	236.2	195.2	76.6	89.2	300.1	235.2	78.4	78.5	52.3	17.4
Charges and interest	33.8	36.7	18.1	18.2	21.3	25.3	15.9	9.7	6.0	2.5	0.5
Fund credit outstanding	1,014.6	883.0	771.8	799.2	762.0	461.8	226.6	148.2	69.7	17.4	0.0

Source: Fund staff calculations.

1/ Based on actual repurchases through end-March and obligations basis thereafter.

**APPENDIX I: BULGARIA: FUND RELATIONS**

As of June 30, 2006

I. <b>Membership Status:</b> Joined 09/25/1990; Accepted Article VIII 09/24/1998						
II. <b>General Resources Account:</b>						
			<u>SDR million</u>	<u>%Quota</u>		
Quota			640.20	100.00		
Fund holdings of currency			879.51	137.38		
Reserve position in Fund			33.07	5.17		
III. <b>SDR Department:</b>						
			<u>SDR million</u>	<u>%Allocation</u>		
Holdings			0.67	N/A		
IV. <b>Outstanding Purchases and Loans:</b>						
			<u>SDR million</u>	<u>%Quota</u>		
Stand-by Arrangements			265.86	41.53		
Extended Arrangements			6.50	1.02		
V. <b>Financial Arrangements:</b>						
	<u>Type</u>	<u>Approval date</u>	<u>Expiration date</u>	<u>Amount approved (SDR million)</u>	<u>Amount drawn (SDR million)</u>	
	Stand-by	08/06/2004	09/05/2006	100.00	0.00	
	Stand-by	02/27/2002	03/15/2004	240.00	240.00	
	EFF	09/25/1998	09/24/2001	627.62	627.62	
VI. <b>Projected Payments to Fund</b> (SDR million; based on existing use of resources and present holdings of SDRs): <sup>13</sup>						
		<u>Forthcoming</u>				
		<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
	Principal	45.72	78.45	78.45	52.30	17.43
	Charges/Interest	6.74	10.30	6.36	2.70	0.54
	<b>Total</b>	52.47	88.75	84.81	55.00	17.98

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<sup>13</sup> 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 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 IMF Country Report No. 02/174. An updated assessment, which was conducted with respect to the current SBA and completed on November 23, 2004, found that the BNB's financial statements had been improved and earlier audit qualifications eliminated, the scope of the internal audit function had been widened and a risk-based audit methodology had been introduced. No major vulnerabilities in the safeguards framework were identified. The mission's recommendations to further solidify Bulgaria's safeguards are being implemented.

**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 at par as the peg currency, which has since been replaced with the euro at the rate of lev 1.95583 per € 1. 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 24-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 follow-up to the FSAP update was conducted as part of the 2004 Article IV consultation mission. Table 1 provides information on the production of ROSCs.

**XI. Technical Assistance**

Table 2 provides information on IMF technical assistance activities since 1999.

Table 1. Bulgaria: ROSCs

Standard/code assessed	Date of issuance	Document number
ROSC – Fiscal transparency module	08/05/2005	IMF Country Report No. 05/300
ROSC – Detailed assessments using the data quality assessment framework	12/12/2003	IMF Country Report No. 03/393
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 Representative:

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

Table 2. Bulgaria: Technical Assistance, 1999–2006

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
MFD	Accounting	Expert	Oct. 04	BNB
MFD	Policies and tools to manage rapid credit growth	Mission	Dec. 04	BNB
MFD	Financial Accounting and Information Systems	Mission	Apr. 05	BNB
MFD	Accounting and internal audit	Expert	Oct. 05	BNB
MFD	Financial Management Systems Implementation	Expert	Jan.-Feb. 06	BNB
MFD	Insurance supervision	Expert	May. 06	FSC
MFD	Inflation forecast	Expert	Jun. 06	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-Up 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
FAD	Accrual Accounting and Budget Execution Reforms	Mission	Sep. 05	MOF
FAD	Program Budgeting	Expert 1/	Sep. 05	MOF
LEG	Tax legislation	Mission	May. 06	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
STA	Producer prices	Mission	Sep. 04	NSI

1/ Mission by FAD's Regional TA Advisor based in Slovenia.

## **APPENDIX II. 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 successful EU integration hinges 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 and a follow-up two-year Stand-By Arrangement (SBA). The IMF Board approved, in August 2004, a 25-month precautionary SBA (ending September 2006) in an amount of SDR100 million.
3. The World Bank has been leading the policy dialogue in structural and institutional reforms aimed 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. On June 13, 2006 the Board of Directors discussed the Country Partnership Strategy (CPS) of the Bank which outlined the roadmap for the Bank's country support for the period 07-09. In addition to the Bank's ongoing lending operations in areas such as health, child welfare, water, trade and transport, environment, the CPS includes a three-year development policy lending (DPL) program of three DPLs of up to US\$150 million each, as well as investment lending in road and municipal infrastructure, trade and transport facilitation for South East Europe, social inclusion, regional development. 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. 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 their 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 tight fiscal policy since 1998, attaining a surplus of 2.4 percent of GDP in 2005. The aim is to have three percent surplus 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 a competitor market economy that is competitive and can flexibly adjust to shocks.

6. In the context of a 25-month Stand-By Arrangement that was approved in August 2004, the IMF continued to 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 a floor on the size of the overall surplus of the general government and a ceiling on central government arrears. 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.

### **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 have been 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 has focused 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 follow-up to 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 with the PAL program, the Bank has supported the government in sector restructuring of the financial sector. Privatization of commercial banks was 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 focused on banking, insurance, pension funds, and capital markets while the Fund 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 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.

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)<sup>14</sup> of 2002, and the recently completed Public Finance Policy Review.

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 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, 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.

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<sup>14</sup> The PEIR is entitled *Bulgaria: Public Expenditure Issues and Directions for Reform*, August 2002, The World Bank, (Report No. 23979-BUL)

### **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 in its implementation. Under the PAL program, the government strengthened the legal and regulatory framework, removed major price distortions and initiated steps to enable the private sector to assume an increasing share of commercial risks. 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, and the previous 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 and the Energy Efficiency GEF Project.

13. **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, the Inter-governmental Finance study<sup>15</sup>, and the Public Finance Policy Review. Under PAL-2 the government developed a concept for an education reform strategy and action plan, the implementation of which was supported through PAL-3.

14. **Health care.** Key reform priorities in the health sector include addressing the concurrent problems of surplus capacity issues in health facilities and hospitals, 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. The Bank supported 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. The reform agenda was also supported through the PALs, with PAL-3 focusing on the implementation of the action plan for the hospital restructuring.

15. **Social protection programs.** Social protection programs—pensions, labor market programs, social assistance, and short-term and family benefits—have a wide coverage

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<sup>15</sup> *Issues in Intergovernmental Relations*, the World Bank, January 27, 2004, Report No. 25821-BUL.

among the population. On pensions, one reform priority is to improve compliance with, and coverage of, the public pillar. Ensuring successful implementation of the pension reform was supported through the PALs. 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.<sup>16</sup> 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 consolidate the system driven by improving targeting of vulnerable groups, and engage in systematic monitoring of the programs, their costs and effectiveness to ensure fiscal sustainability.

16. 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 contributes significantly to the enhanced policy dialogue with the government on its policy options to improve living standards in the country, and increase the 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.**

17. **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 continue to improve focusing on reducing barriers to entry, reducing compliance cost of the regulatory regime, developing a competitive environment, and establishing an efficient exit mechanism for non-viable enterprises. Under the PAL program, major changes in the basic legislation were initiated - notably the Commercial Code, the Civil Procedure Code, and the Labor Code, and the passage of legislation on how the State will regulate economic activity to ensure stability and predictability of regulatory regimes.

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<sup>16</sup> However, such fiscal adjustment requires increasing efficiency in public expenditures, and lowering public expenditures to GDP before implementing tax reductions.

**18. In the context of the PAL program, the Bank supported the government in sector restructuring of the non-infrastructure enterprise sector.** Privatization of SOEs was a major component of the FESALs. Under the PALs, the Bank led the dialogue on reforms covering the regulatory regimes, the insolvency process, and competition.

**19. 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 was the main focus of PAL-2. The policy, legal and institutional framework was developed and put in place to strengthen merit and depolitization. Performance standards for service delivery were developed and one-stop shop principles were introduced in five central administrations and six regional administrations. The system of performance appraisal and professional development within the state administration were enhanced. Concrete steps were undertaken to increase accountability and transparency – the conflict of interest and asset declaration regime was strengthened; a monitoring system to track progress in meeting the anti-corruption objectives was designed; key ministries and agencies prepared detailed and practical anticorruption action plans.

### *C. The World Bank Group Strategy and Lending Operations*

**20. The Country Partnership Strategy (CPS) for Bulgaria<sup>17</sup>,** discussed by the Bank's Board on June 13, 2006, focused on three main themes: (i) productivity and employment, (ii) fiscal sustainability and absorption of EU funds, and (iii) social inclusion.

**21. The World Bank's assistance program in Bulgaria to date comprises 38 operations for a total original commitment of US\$2,137 million equivalent.** This includes 12 adjustment loans (US\$1,225.8 million), 19 investment projects (US\$750.7 million), one debt reduction loan (US\$125.0 million), four Bank-managed Global Environmental Fund (GEF) grants, and two Bank-managed Prototype Carbon Fund (PCF) operations. Of these 38 operations, 27 have been completed, of which eleven have been partially cancelled during implementation, and 11 operations are currently under implementation (see Table 1 below).

**22. IFC, as of May 2006, has 16 projects in its portfolio with total commitments of US\$261 million for its own account and an additional US\$78 million syndicated from partner banks.** IFC's activities comprise the support of financial sector development, manufacturing, gas production, retail, tourism and restructuring of post-privatized companies. In the financial sector, IFC has supported two specialized SME banks, Bulgarian American Credit Bank and Unionbank, established Bulgaria's first micro lending bank, and has invested in a leasing company and in a venture capital fund that also target the SME sector. IFC has invested in a number of key manufacturing projects, such as Devnya Cement (modernization of a cement production plant), EPIQ Electronic Assembly (modernization and expansion of an electronic assembly facility), Kronospan I & II (wood panel and board production), and Sofia Med (revamping of a copper processing facility). IFC committed

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<sup>17</sup> 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, 2006.

US\$48 million to support a project in retail sector (Schwarz Group) and extended a credit line to a local bank for on-lending to SMEs. As a good example of South-South investments, IFC has committed about US\$90 million to support post-privatization restructuring of a steel mill (Stomana) and two glass processing plants (Droujba and Trakya).

23. **Economic and Sector Work.** The country diagnostic work recently completed includes: Country Procurement Assessment Report, Issues in Inter-governmental Relations, and the National Energy Efficiency Study. Other country diagnostic work being completed includes an infrastructure and energy study, and a roads study, and a Country Economic Memorandum focused on policy reforms for growth and successful EU integration. Also, a Public Finance and Policy Review, which examines the options for programming of EU Structural Funds in a fiscally responsible manner, has recently been finalized.

**Table 1. Bulgaria: Active World Bank Operations (Net of cancellations)**

Operation	US \$ million	Board Date
1. Health Sector Reform	63.3	2000
2. Child Welfare Reform	8.0	2001
3. Registration and Cadastre	24.2	2001
4. Wetlands Restoration and Pollution Reduction (GEF Grant)	7.5	2002
5. Social Investment and Employment Promotion	50.0	2002
6. Revenue Administration Reform Project	34.2	2003
7. District Heating Project	34.2	2003
8. Wood Residue to Energy (PCF)	1.6	2003
9. District Heating (PCF)	5.0	2004
10. Energy Efficiency Fund (GEF)	10.0	2005
11. Pomoriisko Lake (GEF)	0.9	2005

Questions may be referred to Ms. Myla Taylor Williams (202-473-6997), Ms. Satu Kähkönen (202-473-2170), or Ms. Stella Ilieva (202-473-1744).

### APPENDIX III. BULGARIA: STATISTICAL ISSUES

1. Bulgaria compiles and submits data to the Fund of sufficient quality and in a timely manner to adequately permit program monitoring and surveillance. 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. In January 2003, an STA mission visited Bulgaria to produce a data module of the Report on the Observance of Standards and Codes (ROSC). The report provided a summary of Bulgaria's data dissemination practices against the Fund's Special Data Dissemination Standard, even though Bulgaria, at that time, was a participant in has worked with the General Data Dissemination System (GDDS).
3. The ROSC mission concluded that the Bulgarian national accounts, CPI, PPI, government finance statistics (GFS), and monetary statistics generally follow internationally accepted guidelines on definitions, scope, classification, sectorization, and valuation. Certain improvements to scope (national accounts, CPI, and GFS), classification (monetary) and the basis of recording (national accounts, GFS, and monetary) could be made. More substantial improvements should be made to the balance of payments statistics. In regard to accuracy and reliability, the mission noted that source data and statistical techniques are generally sound for national accounts, and monetary statistics. Improvements could be made to certain aspects of the price indices and GFS. In the case of balance of payments, significant improvements are required.
4. In late 2003, Bulgaria moved from participation in the GDDS to SDDS subscription, marking a major step forward in the development of the country's statistical system.

#### **Real sector**

5. 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 data 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.
6. The NSI has compiled estimates of quarterly GDP by the production and expenditure approaches in current and constant prices since 1994. The preliminary data are disseminated 80 days after the end of the reference quarter with final figures disseminated after approximately 5 quarters. Problems remain in the coverage of private sector activities as well

as on the constant price estimates of capital formation and external trade. However, significant progress has been made in the development of export and import deflators. The estimates at constant prices use chain-linked indices, which follow international standards (*SNA 1993*).

7. A continuing producer price index (PPI) project covering the period June 2000 to January 2004 was established by a price statistics mission that visited the NSI in June 2000. The project included three supporting IMF technical assistance missions. The main objectives of the project were to convert from using average prices (unit values) for product categories to samples of transaction prices for fully specified products, and to update the index aggregation weights from 1995 to 2000. Despite some minor slippage in timing due to unforeseen complexities, the project, which related to the domestic market, has now been completed. The major achievements include the completion of the progressive conversion to transaction pricing, rebasing the index to the year 2000, recommencement of publication (accompanied by notification in the Advance Release Calendar and Catalog of Publications and the release of up-to-date metadata), and improvement in the timeliness of release to conform to the SDDS standard. A revision of the producer price index (PPI) for domestic sales was completed in June 2004. The NSI has expanded the collection of transaction prices throughout the industrial sector of the domestic economy. 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. The index is to be rebased every 5 years. Timeliness of release is now within one month. Also, progress is being made on the development of a PPI for export sales.

8. 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-type 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 excludes some important sectors, mainly owner-occupied housing and health and life insurance. Since 2004 financial services are included. The geographical coverage of the index is restricted to 27 urban areas which account for an estimated 65 percent of sales. 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).

9. The lack of comprehensive labor statistics has hampered the assessment of developments in employment and wages, especially in the private sector, though there have been some recent improvements. Annual data are collected by the NSI, using a census of all establishments. The NSI also obtains current monthly estimates from a quarterly survey of establishments using all public enterprises and a sample of private employers that includes, since 2002, establishments with less than 5 employees. For 2003, it includes 14,000 private employers out of approximately 113,000 qualifying private enterprises. 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. However, the National Social Security Institute (NSSI) administrative data are used 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 is conducted four times a year at regular intervals.

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

### **Government finance**

12. In recent years, following the recommendations of a combined STA/FAD mission and within the framework of fiscal reporting requirements for EU accession, the authorities have made great progress on the implementation of accrual accounting for government, budgetary and statistical systems. Consolidated data on central government operations are routinely reported for publication in the *GFS Yearbook* and in *IFS*. For the *GFS Yearbook 20045*, 20034 data for the general government sector and its subsectors were reported on a cash basis. The Ministry of Finance prepares data on the execution of the consolidated government budget 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. The authorities have made progress in presenting data on a disaggregated basis, including expenditure by functional classification. In addition, a full economic classification of expenditure is now available, and the authorities have provided such data on an annual basis back to 1998.



## Money and banking statistics

13. Statistical methods conform with the key classification and valuation principles of the IMF's *Monetary and Financial Statistics Manual, 2000*. Consistency in the coverage of the Bulgarian National Bank's (BNB) claims on banks (which included claims on liquidated banks) and the banks' liabilities to the BNB improved in January 2003 after the BNB wrote 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 have progressively been made in the data for 1995 and onward. These were reflected in the revised monetary statistics published in the August 2002, November 2003, and October 2004 issues of *IFS*. The latter revision in *IFS* is a consequence of the BNB's statistical work in early 2004, which allowed to recast monetary data to further harmonize with ECB requirements. Among the changes in the national presentation was the creation in February 2004 of a new long-term liabilities category outside the money supply that includes deposits and securities with a maturity over 2 years, deposits redeemable at notice over three months, and capital and reserves. For program purposes, deposits of the newly created public investment company, municipalities and social security funds are considered part of the consolidated general government. These deposits are excluded from M3 and included in net lending to the consolidated general government.

## Balance of payments

14. Bulgaria reports monthly balance of payments data on a regular and timely basis, but data on reinvested earnings by foreign-owned companies are subject to large revisions due to incomplete responses on surveys used for preliminary estimates. 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. As a result the GSM license purchase has been recorded under foreign direct investment (equity capital) in the first quarter of 2001. As there is no repayment obligation, the transaction did 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.

15. 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. More recently, large revisions to the data on reinvested earnings for 2003 have revealed that the sample used to obtain the preliminary data for this series is inadequate, in part because of the omission of the largest firms.

**Table 1. Bulgaria: Common Indicators Required for Surveillance**  
As of June 22, 2006

	Date of latest observation	Date received	Frequency of data <sup>6</sup>	Frequency of reporting <sup>6</sup>	Frequency of publication <sup>6</sup>	Memo Items:	
						Data Quality – Methodological soundness <sup>7</sup>	Data Quality Accuracy and reliability <sup>8</sup>
Exchange Rates	May, 2006	6/5/2006	D/M	D/M	D/M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	Mar 2006	5/17/2006	M	W	D		
Reserve/Base Money	Apr 2006	5/31/2006	W/M	M	D	O, O, LO, LO	O, O, O, O, O
Broad Money	Apr 2006	5/31/2006	W/M	M	W/M		
Central Bank Balance Sheet	Apr 2006	5/31/2006	W/M	W/M	W		
Consolidated Balance Sheet of the Banking System	Apr 2006	5/31/2006					
Interest Rates <sup>2</sup>	Apr 2006	5/31/2006	W	M	W		
Consumer Price Index	May 2006	6/15/2006	M	M	M	O, LO, O, O	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	2005	2/28/2006	A	A	A	O, LO, O, LO	LO, O, O, O, NO
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	Mar 2006	5/17/2006	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	Q4 2005	3/2006	Q	Q	Q		
External Current Account Balance	Mar 2006	5/30/2006	M	M	M	LNO, LO, O, LO	LNO, LNO, LNO, LO, LO
Exports and Imports of Goods and Services	Mar 2006	5/17/2006	M	M	M		
GDP/GNP	2005 Q4 (Quarterly); 2005 (Annual)	4/3/2006	Q/A	Q/A	Q	O, LO, O, LO	O, O, O, O, O
Gross External Debt	Mar 2006	5/30/2006	M	M	M		

<sup>1</sup> Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

<sup>2</sup> Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

<sup>3</sup> Foreign, domestic bank, and domestic nonbank financing.

<sup>4</sup> The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and local governments.

<sup>5</sup> Including currency and maturity composition.

<sup>6</sup> Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

<sup>7</sup> Reflects the assessment provided in the data ROSC published in December 2003, which is based on the findings of the mission that took place during January 15-30, 2003 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

<sup>8</sup> Same as footnote 7, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

Sofia, Bulgaria, July 17, 2006

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

Dear Mr. de Rato:

1. The attached Third Supplementary Memorandum of Economic and Financial Policies (TSMEFP) describes the performance under the economic program that is supported by the Stand-By Arrangement (SBA) approved by the International Monetary Fund on August 6, 2004 and the policies that the government and the Bulgarian National Bank (BNB) intend to pursue in the remainder of 2006 as part of the 2004-06 economic and financial program outlined in the Memorandum of Economic and Financial Policies attached to the letter of July 21, 2004 and amended by the supplementary memoranda attached to the letters of April 26, 2005 and March 14, 2006. Our core objectives, supported by the policies described in the TSMEFP, remain the maintenance of macroeconomic stability and sustained high rates of economic growth in the run-up to EU membership in 2007.

2. As described in the TSMEFP, economic developments in the early months of 2006 show a continuation of excess demand trends, with a further deterioration in the current account projected for 2006. All quantitative performance criteria for March 31, 2006 were met. However, the three structural performance criteria for April 30 and June 30, 2006 were missed, and we request waivers for their nonobservance.

- Owing to extended consultations with the business community, it was not possible to complete the parliamentary passage of the new VAT law by April 30, 2006. It has been passed in second reading by the budget commission and its approval by parliament is a prior action for the completion of the third review (TSMEFP, Annex I).
- Delays in parliamentary passage of the law transforming business registration from a judicial to an administrative procedure, and the need to identify and prepare software, meant that it was not feasible for the new business register to start operations by June 30, 2006. We now expect the register to start operations on the date specified in the legislation, of October 1, 2006 (performance criterion).
- The Varna thermal power plant was sold by June 30, 2006. However, it has not yet been possible to complete the sale of the Rousse district heating company, due to

delays in the tender process. We now intend to select winning bids for the Rousse plants by October 31, 2006 (performance criterion).

3. In addition, six of the eight structural benchmarks applying through end-June, 2006 were missed. Of these, one was missed by a small margin, one implemented with delay, and one is on track to be completed shortly. Remedial actions and rephrasing of conditionality have been proposed for the remaining three.

4. We request an extension of the arrangement through to end-March 2007 and a rephrasing of our remaining access of SDR 11 million. We understand that our compliance with the program will be monitored through a fourth review, quantitative and structural performance criteria and structural benchmarks through December 31, 2006, as well as a continuous performance criterion and benchmark through the end of the arrangement. Reaching an understanding on the 2007 budget will be a key element for completion of the fourth review.

5. The TSMEFP proposes quantitative performance criteria for September 30 and December 31, 2006, as described in its Annexes II – IV. In addition, program implementation is proposed to be monitored by the three structural performance criteria, the three continuous performance criteria and the nine structural benchmarks listed in Annex I of the TSMEFP.

6. We believe that the policies set forth in the TSMEFP are adequate to attain the objectives of our program, but we 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 TSMEFP, in accordance with the Fund's policies on such consultations. We will provide the Fund with such information as it requests on policy implementation and achievement of program objectives.

7. We would like to reaffirm our intention not to make the purchases under the SBA that will become available upon observance of its performance criteria and completion of its reviews and to make all outstanding repurchases to the Fund on the expectations schedule.

Sincerely yours,

/s/

/s/

/s/

Plamen Oresharski  
Minister of Finance  
Republic of Bulgaria

Rumen Ovcharov  
Minister of Economy and Energy  
Republic of Bulgaria

Emilia Milanova  
Deputy Governor  
Bulgarian National Bank

Attachment: Third Supplementary Memorandum of Economic and Financial Policies

## Third Supplementary Memorandum of Economic and Financial Policies

### I. Recent Economic Developments

1. **Recent economic developments point to upward revisions to forecasts of growth, inflation and the current account deficit.** Economic growth is now projected at 5.6 percent for the year, a little higher than the 5.5 percent projected under the program, because of stronger domestic demand. Demand continues to be fueled by strong corporate and household borrowing. At 8.1 percent in April, inflation was somewhat higher than projected, mainly because of higher fuel prices and a larger-than-anticipated impact of the increase in tobacco and alcohol excise duties at the start of the year. Inflation is now expected to moderate to 6.2 percent by the end of the year, compared to 5.7 percent under the program. The current account deficit was considerably larger than projected in the first three months of 2006. This was partly due to temporary factors that should unwind later in the year. Nevertheless the stronger than expected demand suggests that the current account will now show a slight deterioration in 2006 compared to 2005, at about 12.4 percent of GDP, compared to 10.2 percent of GDP previously projected. We do not see competitiveness as being a significant factor in this deterioration. Foreign direct investment is on track to come in close to the program level in 2006, at 9.2 percent of GDP. Gross external debt reached 69.5 percent of GDP at end-March, and is expected to end the year at nearly 70 percent of GDP, close to the programmed level.

### II. Economic Policies and Objectives for the Remainder of 2006

2. **Our economic program aims at maintaining a stable policy framework within which to prepare for EU accession on January 1, 2007 and subsequent entry into the eurozone.** Maintenance of the currency board at an unchanged exchange rate until euro adoption in 2009-10 remains the cornerstone of our economic policy. Strong private sector demand in anticipation of EU accession and convergence is likely to lead to continued high current account deficits and external debt levels through the medium term. The priorities of reducing these external vulnerabilities and lowering inflation in order to meet the conditions for euro adoption will require a continued commitment to very prudent economic policies in coming years. Our program for the remainder of 2006 therefore remains focused on fiscal restraint, incomes policies, tight financial sector supervision, and structural reforms to strengthen competitiveness. The limited capacity and availability of fiscal and monetary policy to manage the very rapid private sector demand growth highlights the importance of the structural agenda in particular, in order for Bulgaria to grow strongly and function effectively under the currency board arrangement and, eventually, within EMU.

## A. Fiscal Policy

3. **Given the further deterioration of the external current account now projected for 2006, we do not see any scope to relax our ambitious fiscal surplus target for this year.** As described in the Second Supplementary Memorandum of Economic and Financial Policies (SSMEFP) attached to our letter of March 14, 2006, and set out in Annex II of this Memorandum, we will achieve a significant increase in the budget surplus from 2.3 percent of GDP in 2005 to at least 3 percent of GDP in 2006 (performance criterion). Should revenues exceed the quarterly targets set out in Annex II, we will save 50 percent of any such cumulative quarterly overperformance, and the performance criterion on the fiscal surplus will accordingly be raised above 3 percent of GDP. In pursuing these objectives we will seek to avoid the accumulation of new central government arrears (performance criterion) and urge municipalities to eliminate their arrears (which amounted to 0.1 percent of GDP at end-March, 2006). We do not envisage making any adjustments to tax rates applying in the remainder of 2006, and we remain committed to permanently withholding 7 percent of discretionary expenditure if necessary to meet our fiscal targets, as set out in the SSMEFP and regardless of the level of the current account deficit.

4. **Fiscal policy implementation in the first three months of 2006 has been consistent with our commitments under the program.** The fiscal surplus in the first quarter is estimated at BGN 398 million, comfortably exceeding the program target of BGN 256 million. Revenues came in slightly below target, partly because of a number of temporary factors which we expect to be made good in the remainder of the year. The revenue shortfall in the first quarter was more than made up by a slow pace of expenditures, especially on wages and salaries, social assistance, and capital spending. For the year as a whole we expect a small overperformance of revenues, which, if realized, would imply an increase in the fiscal surplus target from 3 to 3.2 percent of GDP.

5. **Given the stubbornly high current account deficit, our preliminary plans envisage passage of a budget for 2007 targeting a fiscal surplus of about 2 percent of GDP.** At present considerable uncertainties remain regarding the fiscal impact of EU-related flows and revenue losses arising from accession, as well as about prospective underlying revenue performance. We will therefore refrain from committing to tax cuts for next year until the full parameters of the 2007 budget are clarified in the fall of 2006. Reaching an understanding on the 2007 budget will be a key element for completion of the fourth review under the SBA.

6. **We have strengthened our program for public sector reforms, including reductions in staff numbers.** Fiscal costs associated with EU accession reinforce the need to restructure existing budgetary spending programs, in order to achieve fiscal savings and more efficient delivery of public services.

- We have cut 3,909 existing positions in the state administration, with a further 1,381 positions identified for closure by the end of 2006.
- We have submitted an education reform strategy to parliament which sets out our broad objectives in terms of improving the quality of teaching, and rationalizing school and staff numbers against the backdrop of sharply falling pupil numbers. In pursuit of these objectives we have identified 5,500 staff cuts that will be implemented by September 30, 2006 (structural benchmark). The 2006 budget incorporates a contingency of BGN 9m to help meet transitional costs associated with school closures and redundancies. We have further decided to move to a decentralized system of school financing based on unified per student standards for financing municipalities, which will provide appropriate incentives to municipalities to implement school consolidation and staff cuts, compared to the present input-based system of school financing. We will develop the new unified standards with the assistance of the World Bank, with Council of Ministers approval expected by October 31, 2006 (structural benchmark). We are developing a strategy for reform of tertiary education, including review of financing mechanisms, which we will submit to parliament by December 31, 2006.
- The move to financing of nearly all hospital care through the National Health Insurance Fund (NHIF) from January 1, 2006 has improved incentives for better financial management in the hospital sector, and there has been no net accumulation of hospital arrears in the first quarter of the year. We are committed not to undermine these incentives by bailing out hospitals that run arrears. However, reimbursements by the NHIF have been running ahead of plan, which could lead to a budget shortfall for the year of around BGN 50 million, requiring offsetting savings elsewhere in the budget sector. In order to improve financial discipline from 2007 on we have drafted amendments to the health insurance law that will: (i) include in the law control procedures and sanctions for misreporting in reimbursement claims by hospitals and other health care providers to the NHIF, at a sufficiently high level to discourage such abuses; (ii) regulate that price and volume ceilings for the clinical paths are part of the annual budget law of the NHIF; and (iii) require hospitals to provide the NHIF with full financial reporting, subject to audit, and give the NHIF powers to withhold finance in case of inadequate reporting or unsatisfactory financial results. We will submit these amendments to parliament by July 31, 2006, with a view to passage by August 31, 2006 (structural benchmark). Nevertheless it remains the case that an improved financial situation in the health sector and more effective delivery of health services will depend on an extensive restructuring and consolidation of the hospital sector. To this end we will engage consultants by September 30, 2006, with the assistance of the World Bank, to develop a National Hospital Masterplan.

7. **Any changes to pension levels in the remainder of 2006 will be limited to the lower pension brackets, and fit within the overall NSSI budget plan.** Our plans for 2007 are based on pension indexation according to a 50 percent/50 percent ratio between CPI and insured income growth from June 1, 2007, increasing the employees' share of social security contributions from 35 percent to 40 percent, and raising the contribution to the second pillar of the pension system from 4 to 5 percent.

8. **We are pursuing our program of revenue administration reform.** The start-up of the National Revenue Agency (NRA) in January 2006 did not lead to any discernible initial loss in revenues, and we are confident that over time the NRA will contribute to revenue gains. Unfortunately there has been further delay in the delivery of the new software to integrate tax and social security collections. We now expect the new integrated collection software system to be fully operational by December 31, 2006 (structural benchmark). The new law on duty free trade, specifying limits on individual purchases of goods and fuels and strengthened controls, is expected to be passed by the parliament by August 31, 2006. The new VAT law is intended to be passed by the parliament by July 25, 2006 (prior action). We intend the PIT and CIT laws to be passed by July 31, 2006 (structural benchmark).

9. **We are planning a number of other reforms in the fiscal area:**

- **Fiscal transparency.** We intend to present parliament with realistic fiscal projections in the 2007 budget, and plan to achieve our fiscal target without resort to within-year caps on discretionary expenditures. Along with the budget submission we plan to provide more information, including full medium-term fiscal forecasts, an expanded analysis of fiscal risks, details of concessions, central government contingent liabilities, and government financial asset holdings. We recognize the importance of improved public procurement procedures, especially in view of increased project funding from the EU. A new public procurement law has been adopted. It remains our intention to avoid the creation of new extrabudgetary funds or state-owned enterprises (continuous structural benchmark). However, the CoM has approved the transformation of the existing Road Agency into an extrabudgetary fund structure from January 2007, in order to meet EU requirements. The Road Agency will continue to be fully consolidated in general government accounts, and subject to the same accounting and auditing standards as the rest of the budget sector. The legal process for closure of the Public Investment Projects company (PIP) will be initiated by December 31, 2006 (structural benchmark).
- **Expenditure management.** While our budget management system meets EU requirements, we nevertheless intend to further strengthen public expenditure management. With the reporting for the second half of 2006 we will have implemented the Financial Management Information System as the sole expenditure



accounting system in the Ministry of Finance. We intend to identify improved expenditure control mechanisms for other ministries by the end of 2006.

- **Program budgeting.** We are continuing to introduce program and performance-oriented budgeting. We intend to expand pilot program budgeting by six further ministries in the 2007 budget, bringing the total to 16 ministries and one agency, and five ministries will also report their 2006 budgets on a program basis.

## **B. Incomes and Labor Market Policies**

10. **The persistent excess demand situation underscores the importance of public sector wage restraint and labor market reforms to help maintain competitiveness and flexibility of the economy.** Budget sector wages will be increased by 6 percent on average in July 2006. Larger wage increases needed to attract and retain staff working on EU project administration will be met within the overall budgeted wage bill. In 2007, we intend public sector wages to rise only modestly in real terms. In the first quarter of 2006 we observed the quarterly limit on the increase of the aggregate wage bill of the 58 largest public enterprises that are monopolies, received government subsidies, made losses, or had arrears in the third quarter of 2005. Observance of these limits will continue to be monitored on a cumulative quarterly basis (performance criterion). We continue to plan for an increase in the minimum wage in 2007 to BGN 170, from BGN 160 in 2006.

11. **Labor market reforms are aimed at improving flexibility and labor force participation.** Our key policy initiatives in this area are:

- The parliament has passed legal amendments to increase working time flexibility by extending the maximum working week from 40 to 48 hours and by lengthening calculation periods for overtime work from four to six months.
- We have been unable to agree with our social partners on the removal of the obligatory character of the portability of seniority bonuses in case of unemployment, change of employer or job position. We are continuing the discussions with our social partners on this issue, and hope to reach agreement by the end of 2006 (structural benchmark). Any reduction in seniority pay for existing workers resulting from our discussions would be expected to be added back in to the basic wage, so that no existing employee would suffer a pay cut from the change.

## **C. Financial Sector and Public Asset and Liability Management**

12. **The bank credit ceilings adopted by the BNB in 2005 will be phased out gradually.** Total credit growth in the first quarter of 2006 was in line with the ceilings set by the BNB, and the individual banks that exceeded the limits were subjected to significant

penalty deposits at the BNB. However, as expected, banks are increasingly able to circumvent the limits. Methods have included passing loans to foreign banks' head offices, and packaging loans in off-balance sheet special purpose vehicles, in order to remove loans from bank balance sheets to free up space for new lending within the ceilings. At the same time, credit from the nonbank financial sector continues to grow strongly. Thus the effectiveness of the bank credit ceilings in reducing financial flows to the private sector is much diminished at this stage. The lifting of the credit ceilings will be phased so as to minimize disruption to the financial sector. Our plans in this regard will be discussed with IMF staff.

13. **The existing tight bank prudential and supervisory framework will be maintained.** To allow the implementation of Basel II as of January 2007, we have submitted to parliament a new law on Credit Institutions for approval by September 30, 2006 (structural benchmark), and the BNB will issue the relevant regulations by the end of 2006 at the latest. The BNB will apply the EU Capital Requirement Directive in a conservative way.

14. **Transparency in lending has been improved.** The new law on consumer credit requires disclosure in advertising of effective annual percentage rates on consumer and household mortgage loans between BGN 400 and BGN 40,000.

15. **Supervision of the rapidly growing non-bank financial sector is being modernized.** The pension law was amended to remove the minimum share that voluntary pension funds were required to hold in government securities, with only a modest impact on these funds' asset allocation. The law on supplementary supervision of financial conglomerates has been submitted to parliament and is expected to be approved by September 5, 2006 (structural benchmark). The Financial Supervision Commission (FSC) has received technical assistance from the IMF to support the implementation of the insurance law adopted in December 2005.

16. **We will continue to strengthen prudential and market conduct regulation, and supervision, of the insurance sector.** By end July, the FSC will develop (a) an internal procedure for enforcement and (b) a strategy to tighten supervision of underwriting practices of non-life insurance companies. During the second half of 2006, the FSC will re-license compulsory motor third party liability (MTPL) insurance companies. The FSC will also conduct an in-depth review of the adequacy of premiums and of the other guarantees for the solvency of the insurance companies offering MTPL insurance. By the end of 2006, we will submit to the Council of Ministers a draft amendment to the Insurance Code that will a) tighten corporate governance practices of insurance companies by requiring separation of powers between the board and the management and by requiring independent directors, and b) require audit of the statutory annual returns of insurance companies. By year end, the FSC will issue a regulation to exclude investments in related and affiliated companies from calculations of own funds for meeting statutory solvency requirements.

17. **We will improve the follow-up to money laundering-related disclosures of the Financial Intelligence Agency.** Referrals to the police made by the Agency are rising rapidly but have not led to any convictions by the courts. To improve the follow-up to these disclosures a special unit within the police has been established. This unit is organized in a similar manner to the unit that was created in the prosecutor's office in March 2006.

18. **Public asset and liability management will continue to aim at reducing gross debt while maintaining adequate reserve cover.** The ceilings on the contracting and guaranteeing of external public debt in 2006 remain as in the original program (performance criteria). We have no immediate plans for additional external debt prepayments, but such prepayments could be considered, subject to the maintenance of freely available international reserves. In order to better monitor municipal borrowing we are developing a register for such loans, to be made operational by December 31, 2006 (structural performance criterion).

#### **D. Other Structural Reforms**

19. **We are proceeding with the reform of business registration.** The law transforming business registration from a judicial to an administrative procedure under the Registration Agency was passed on March 24 and enacted on April 25, 2006. We intend to make the new registry operational by October 1 (structural performance criterion).

20. **We are committed to further privatization of state assets.** The privatization of Varna electricity generation company has recently been completed. We will issue tenders for the eastern and western plants of the Rousse district heating company by August 15, 2006, with a view to selecting the winning bids for both by October 31, 2006 (structural performance criterion). We will proceed expeditiously to privatize the Bobov Dol power plant once the court case concerning its sale is resolved. All but one of the remaining district heating companies are expected to be privatized by December 31, 2006. We intend to privatize units of Bulgartabac Holding during the second half of 2006. We have selected the winning bid for the river shipping company in Rousse. The transaction has been approved by the Privatization Agency and the Council of Ministers. The privatization strategy for the maritime shipping company will be submitted to parliament by July 31, 2006, with approval expected by August 31. The privatization strategy for the airline company has been approved, and the tender has been issued. The concession agreement for the Varna and Bourgas airports has been awarded, and provided there are no further court appeals we hope that construction work will commence later in 2006. Concessions for four major ports are being prepared.

21. **Based on an assessment by business organizations, we plan to establish a body to evaluate the regulatory environment.** This will monitor the implementation of existing regimes, and scrutinize new regulatory proposals. We have prepared draft amendments to the

law on investment promotion intended to speed up administrative processes, and plan to submit them to parliament by August 31, 2006, following further consultation within government.

22. **We are continuing to implement our anti-corruption program.** We have prepared the anti-corruption strategy for 2006-08 and implementation program for 2006. In the first three months of 2006, we set our priority towards prevention and counteraction of high-level corruption, corruption in the education and healthcare systems, as well as in the administration of the tax revenues. We plan to develop an amendment to the Law on the Political Parties to introduce transparency in party financing (including publicity of the source of financing) by end 2006. The National Audit Office is due to publish an audit report on the political parties by September 30, 2006. We have prepared a program for transparency in the activity of the state administration and high-level officials.

## **Annex I. Bulgaria: Conditionality Under the Stand-By Arrangement in 2006**

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### ***Prior Action***

1. Approval by parliament of the new VAT law.

### ***Quantitative Performance Criteria***

1. Floor on the overall surplus of the general government (Annex II).
2. Ceiling on central government arrears (Annex II).
3. Ceiling on the wage bill of the 58 largest SOEs in financial distress or monopoly situation (Annex III).
4. 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 western and eastern plants of Rousse district heating company (October 31, 2006).
2. Acceptance of new company registrations by the new business register established by legislation enacted on April 25, 2006 (October 1, 2006).
3. Establishment of a register which covers all municipal borrowing and is ready to receive data (December 31, 2006).

### ***Continuous 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.
  2. No reduction of tax rates and bases applying in 2006.
  3. The monthly minimum wage not to exceed BGN160 during 2006.
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## Bulgaria: Conditionality Under the Stand-By Arrangement in 2006 (concluded)

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### *Structural Benchmarks*

1. No new extrabudgetary funds or state-owned enterprises to be created except for the state executive agency to disburse EU funds for building roads.
2. Approval by parliament of new CIT and PIT laws (July 31, 2006).
3. Approval by parliament of an amendment to the Health Insurance Law as detailed in paragraph 6, bullet 3 of TSMEFP (August 31, 2006).
4. Approval by parliament of a law on supplementary supervision of financial conglomerates (September 5, 2006).
5. Implementation of employment cuts of at least 5,500 positions in the education sector (September 30, 2006).
6. Approval by parliament of a new law on credit institutions, to allow implementation of Basel II (September 30, 2006).
7. Approval by the Council of Ministers of the system of school financing based on the unified per student standards (October 31, 2006).
8. Agreement with social partners on a solution repealing the obligatory character of the portability of seniority bonuses in the case of unemployment, change of employer, or job position. (December 31, 2006).
9. Initiate the legal procedure for the closure of the Public Investment Projects company (PIP) (December 31, 2006).
10. New integrated tax and social security software system for the NRA to be fully operational (December 31, 2006)

**Annex II. Performance Criteria on the General Government Balance and Central Government Arrears and Indicative Revenue Targets for the General Government**

	Fiscal Surplus Floor	Arrears Ceiling 1/	Overall Revenue Target 2/
	(In millions of leva)		
Cumulative change from January 1, 2006			
March 31, 2006	256	5	4,251
June 30, 2006	786	5	9,051
September 30, 2006	1,099	5	13,554
December 31, 2006	1,387	5	18,454

1/ Arrears ceiling is on the stock of central government arrears.

2/ Indicative target on general government revenue (including grants).

Quarterly limits in this Annex are cumulative with the exception of central government arrears.

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 public investment projects (PIP) enterprise, and the environment enterprise. 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 (general) government are all overdue obligations on the payment for central (general) government expenditure excluding items in dispute. The stock of central government arrears as of December 31, 2005 amounted to BGN 4.8 million.

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) and adjusted for the net change of the stock of general government arrears. In contrast with the national practice, in the program definition the government's social security contributions for its own workers (except those to the second pension pillar) are excluded from both revenue and expenditure. In 2006, the quarterly fiscal balance targets will be raised by 50 percent of the excess of actual over targeted cumulative general government revenue (including grants). If general government revenue (including grants) exceeds the program's

target of BGN 18,454 million, 50 percent of any such cumulative quarterly revenue overperformance will be saved and the fiscal surplus floor raised accordingly.

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 central and municipal government budgets, 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 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.



**Annex III. Performance Criteria on the Wage Bill of 58 State-Owned Enterprises (SOEs)**

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	Wage Bill of 58 SOEs
	(In millions of leva)
Cumulative from January, 1 2006	
March 31, 2006	89.2
June 30, 2006	178.4
September 30, 2006	267.7
December 31, 2006	356.9

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The quarterly 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 5 percent above the level of the aggregate wage bill in the third quarter of 2005 and is accumulated by the same amount for each subsequent quarter. 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 2006 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 2006 will also exit the list in the second half of 2006 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 2005 plus 5 percent times the number of quarters it has been excluded from the list. The 58 enterprises monitored are in the table below (enterprises numbers 1 to 4 are considered monopolies).

## List of 58 Monitored State-Owned Enterprises

- |   |   |
|---|---|
| 1 State Railways                              | 30 Burgas Sea Port  |
| 2 Railway Infrastructure                      | 31 Terem Khan Krum  |
| 3 BulgarGas                                   | 32 Terem Georgi Benkovsky   |
| 4 The National Electricity Company            | 33 Terem Ovech  |
| 5 Kozloduy Nuclear Powerstation               | 34 Terem Letetz   |
| 6 Varna Power Station                         | 35 Terem Ivaylo   |
| 7 Bobov Dol Power Station                     | 36 Khaskovo BT  |
| 8 Bobov Dol Coal Mine                         | 37 Gotze Delchev BT   |
| 9 Pirin Coal Mine                             | 38 Shumen BT  |
| 10 Russe Urban Heating Company                | 39 Kardjali Bulgartabak   |
| 11 Shumen Urban Heating Company               | 40 Yambol BT  |
| 12 Plovdiv Urban Heating Company              | 41 Sandansky BT   |
| 13 Sofia Urban Heating Company                | 42 Assenovgrad BT   |
| 14 Varna Urban Heating Company                | 43 Stroitelstvo and Vazstanovjavane<br>(Construction and Refurbishing) Public Company |
| 15 Sliven Urban Heating Company               | 44 Transport Construction and Repair Public Company                                   |
| 16 Pernik Urban Heating Company               | 45 Public Works   |
| 17 Sofia Urban Transport Company              | 46 Military Supplies Company  |
| 18 Plovdiv Urban Transport Company            | 47 Spatial and Urban Public Works   |
| 19 Varna Urban Transport Company              | 48 Copper Well  |
| 20 Sofia Electric Urban Transport Company     | 49 BalkanCar Sredetz  |
| 21 Pernik Trolley Bus Urban Transport Company | 50 BalkanCar Dunav  |
| 22 Pleven Urban Bus Transport                 | 51 BalkanCar Erma   |
| 23 Diana Bus Company                          | 52 Dupnitsa Supply Water and Wastewater Services                                      |
| 24 Passanger Transport                        | 53 Supply Water and Wastewater Services   |
| 25 Aytos Bus Transport                        | 54 Supply Water Engineering   |
| 26 Bus Transport                              | 55 Vazov Mechanical Engineering Plants  |
| 27 Beltrans                                   | 56 Rudozem GORUBSO  |
| 28 Russe Urban Bus Transport                  | 57 Land Geodetic Metrology  |
| 29 Roshen Express                             | 58 Rope Ways  |

**Annex IV. Performance Criteria and Indicative Targets on the Ceilings on Contracting  
or Guaranteeing of 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, 2005			
June 30, 2006	0	0	0
September 30, 2006	0	74.6	0
December 31, 2006	0	203.3	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 1.21 US\$/€.

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, 2004 was zero.

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



**Statement by the IMF Staff Representatives**  
**August 2, 2006**

1. This statement provides information on data releases that have become available since the issuance of the staff report on July 19, and on the outstanding prior action. The new information does not change the thrust of the staff appraisal.
2. **On balance, the new data suggest that economic developments are in broad conformity with the staff report.** Year-on-year GDP growth in the first quarter of 2006 reached 5.6 percent per annum, up marginally from 5.5 percent in 2005. News on inflation in June was mixed—headline inflation (year-on-year) fell to 8.2 percent from 8.5 percent in May due largely to lower food prices, but core inflation (excluding food, alcohol, tobacco and energy) turned up slightly to 4.1 percent.
3. **The 12-month current account deficit reached 14.7 percent of GDP at end-May, essentially unchanged from its end-April level.** The broad-based growth of merchandise exports was especially strong during May, exceeding import growth by a large margin for the second consecutive month. FDI inflows remained strong, covering about two-thirds of the current account deficit during January-May. At the same time, large positive errors and omissions, amounting to some 3.2 percent of annual GDP during the period, also help to moderate concerns about the size of the current account deficit insofar as they do not reflect additional debt flows.
4. **Fiscal developments continue to be favorable.** The general government surplus reached 2.6 percent of GDP in the year to May (on a cash basis). Assuming that the ceiling on arrears was observed, the data suggest that the second quarter fiscal target under the program was probably comfortably met.
5. **The prior action has been implemented.** On 20 July 2006, Parliament adopted the VAT law on its second reading.





INTERNATIONAL MONETARY FUND

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EXTERNAL  
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Public Information Notice (PIN) No. 06/87  
FOR IMMEDIATE RELEASE  
August 4, 2006

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Executive Board Concludes 2006 Article IV Consultation with Bulgaria**

On August 2, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bulgaria and completed the Third Review under the Stand-By Arrangement.<sup>1</sup>

### **Background**

Bulgaria's successful transition from crisis a decade ago to steady growth has helped the country reach the doorstep of the European Union accession. A policy strategy anchored by the currency board arrangement and supported by prudent fiscal policy, strict incomes policy for state-owned enterprises, tight supervision of the banking sector, and structural reforms has resulted in average real GDP growth of 5½ percent since the last Article IV consultation in 2004. The unemployment rate has continued to drop and wage pressures remain contained. Inflation has been trending up since early 2005, but should begin to taper off during the second half of 2006. In response to rapidly rising current account deficits, fiscal policy have been prudent during the past few years, and the growth of bank lending to the nongovernment sector was brought down from almost 50 percent during 2003-04 to 32 percent in 2005.

Despite generally favorable macroeconomic developments, Bulgaria's vulnerability has increased with the sharp widening of the current account deficit. The current account deficit deteriorated from under 6 percent of GDP in 2003 and 2004 to around 12 percent of GDP in

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

2005, rising further to 14.6 percent by April 2006. Although one-off factors and rising oil prices have contributed, much of the increase of the deficit can be traced to the buoyancy of domestic demand, notably investment but also consumption. Competitiveness indicators remain favorable. Foreign direct investment financed more than two thirds of the current account deficit and contributed to a rising investment to GDP ratio. Gross reserves at 140 percent of short-term debt, low public debt, and a well-capitalized banking sector suggest low risk exposure. Still, with the growth of private debt out-pacing the decline in public debt, Bulgaria's external debt has increased substantially since 2003, increasing the country's vulnerability to shocks. Close monitoring is warranted as liquidity and solvency risk could change quickly.

The structural reform momentum has weakened, adversely affecting Bulgaria's growth potential. An impressive privatization program made substantial progress but recent transactions have been mired in the courts. Reform of the education sector, critical to Bulgaria's future competitiveness, has been stalled. Health sector reforms have been equally inert, yet are crucial to releasing scarce public resources for higher priority spending. The business climate and governance indicators have ceased to improve, and greater labor market flexibility is needed notably in view of the projected decline of Bulgaria's population of labor force age.

For 2006, given the large and growing current account deficit, the authorities target of at least 3 percent of GDP in 2006 and around 2 percent in 2007 after taking account of EU accession effects. Fiscal policy is the main short-term macroeconomic policy instrument as credit controls have largely lost their effectiveness. In order to enhance Bulgaria's medium term supply potential, the authorities are implementing measures to improve governance and the business climate.

### **Executive Board Assessment**

Executive Directors commended the Bulgarian authorities for implementing sound economic policies in recent years that have resulted in robust growth and falling unemployment. These achievements have enhanced confidence in the economy and prepared the ground for accession to the European Union. Directors noted, however, that external imbalances have increased, credit growth is rapid, and inflation has risen, giving rise to sizeable risks. They stressed that policies need to aim to contain the underlying vulnerabilities and increase the resilience of the economy.

Directors noted that buoyant domestic demand has contributed to a sharp widening of the external current account deficit and higher inflation. Although competitiveness appears to be satisfactory, the high and rising ratio of gross external debt to GDP is of concern, despite the sharp reduction in public external debt. Directors therefore called for maintaining cautious macroeconomic policies to moderate the growth of domestic demand and reduce debt, for prudent incomes policies to help safeguard competitiveness, and for a revitalized structural reform effort to boost output and export potential. Directors supported the authorities' strategy of retaining the currency board at the present parity through to euro adoption. Directors saw fiscal policy as the key macroeconomic policy tool, and commended the authorities for the progressive fiscal tightening in recent years. In view of the further deterioration of the current account balance, Directors welcomed the government's commitment to a fiscal surplus of 3 percent of GDP in 2006. They noted that, with revenue performance



expected to exceed earlier projections, and with the authorities' commitment to save half of this overperformance, achieving a larger surplus is appropriate and feasible.

As the current account deficit is projected to decline only slowly, Directors welcomed the authorities' commitment to caution in relaxing the fiscal stance over the medium term. Directors endorsed the fiscal surplus target of 2 percent of GDP for 2007, seeing the slight reduction in the surplus from that of 2006 as balancing appropriately the need to absorb EU accession-related financial flows with the need to contain domestic demand. Directors stressed that for EU-financed projects to boost Bulgaria's productive potential, stronger administrative capacity is needed to ensure both high quality projects and effective use of the inflows. Directors called for improvements in public procurement and expenditure management and, more broadly, for greater fiscal transparency, notably by providing parliament with realistic revenue and expenditure projections at the time of budget submission.

Directors concurred with the authorities' plans to maintain low tax rates and to limit exemptions in the context of a continued shift away from direct taxation. In light of macroeconomic developments, however, they welcomed the authorities' intention to postpone further tax cuts until there is clear evidence of their affordability. They also agreed that future rate cuts should give priority to reducing the payroll tax, which remains relatively high even after the welcome reduction in 2006.

Directors supported the authorities' intention to phase out the bank credit growth limits, noting that their effectiveness has faded over time due to increasing circumvention and the expanding availability of nonbank credit. While financial soundness indicators are satisfactory and stress tests indicate that the banking system is resilient to a significant adverse shock, supervisors need to scrutinize nonperforming loans closely and ensure the adequacy of banks' risk management frameworks. Directors underlined the importance of supervising closely the growing non-bank financial sector.

Directors underscored the urgency of enhancing the flexibility of the economy to enable it to handle better external shocks. They encouraged the authorities to revitalize the structural reform effort to reduce vulnerabilities, help sustain competitiveness, and boost growth potential, thereby accelerating the convergence of Bulgarian living standards to those of Western Europe. Efforts to increase labor market flexibility and minimize disincentives to labor market participation will be critical, especially in light of demographic prospects. Directors stressed the need to improve the business climate to sustain foreign direct investment, including by strengthening the judicial system, reducing red tape, and combating corruption forcefully. Directors welcomed the authorities' intention to privatize several remaining state assets—including in the energy sector—and to reform the health and education sectors.

**Public Information Notices (PINs)** form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

**Bulgaria: Selected Economic Indicators**

	2002	2003	2004	2005	2006 <sup>1</sup>
<b>Real economy</b>	Percent change				
Real GDP	4.9	4.5	5.7	5.5	5.6
Consumer price index (end of period)	3.8	5.6	4.0	6.5	6.2
Registered Unemployment	17.4	14.3	12.7	11.5	...
<b>Public finance</b>	(In percent of GDP)				
General government balance	-0.8	-0.4	1.8	2.3	3.2
Public debt (end of period)	56.3	48.2	40.7	31.9	28.6
<b>Money and credit</b>	(Annual Percent change)				
Broad money (nominal, end of period)	11.9	20.9	21.6	27.7	17.5
Credit to nongovernment sector (nominal, end of period)	44.0	48.3	48.7	32.3	17.5
<b>Interest rates</b> (annualized)	(In percent annualized)				
BNB basic rate	3.4	2.7	2.4	2.1	...
Time deposit (leva)	3.2	3.2	3.0	3.4	...
<b>Balance of payments</b>	(In millions of euro)				
Gross official reserves (end of period)	4,575	5,405	6,854	7,370	8,473
(In months of prospective imports of GNFS)	4.9	4.8	5.0	4.3	4.3
Current account (percent of GDP)	-2.4	-5.5	-5.8	-11.8	-12.4
Trade balance (percent of GDP)	-11.4	-13.7	-15.1	-20.4	-20.9
<b>Exchange rates</b>	Currency Board since July 1997 <sup>2</sup>				
Exchange rate regime	Currency Board since July 1997 <sup>2</sup>				
Leva per dollar (end of period)	1.885	1.591	1.459	1.658	...
Nominal effective exchange rate (2000=100) <sup>3</sup>	105.5	110.8	113.0	111.8	...
Real effective exchange rate (2000=100) <sup>3,4</sup>	109.6	114.0	119.8	120.5	...

Sources: Bulgarian authorities; and IMF staff estimates.

<sup>1</sup>Projection.

<sup>2</sup>The Currency Board arrangement fixed the exchange rate at 1,000 leva = 1 DM through end-1998 and 1,955.83 leva = 1. Euro since January 1, 1999. On July 5, 1999, the lev was redenominated by removing three zeroes.

<sup>3</sup>Annual average level.

<sup>4</sup>CPI-based.



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FOR IMMEDIATE RELEASE  
August 3, 2006

International Monetary Fund  
Washington, D.C. 20431 USA

### **IMF Executive Board Completes Third Review Under Stand-By Arrangement for Bulgaria**

The Executive Board of the International Monetary Fund (IMF) has completed the third review of Bulgaria's economic performance under the 25-month Stand-By Arrangement with Bulgaria. The authorities continue to treat the arrangement as precautionary.

In completing the review, the Board approved the authorities' request for a waiver for the non-observance of the end-April 2006 structural performance criteria on the approval by Parliament of the new law on the value added tax, the end-June 2006 structural performance criterion on the start-up operations of the new business register, and the end-June structural performance criterion on the selection of the winning bidders for the Rousse and Varna electricity generation companies. The Board approved the authorities' request to rephrase and extend the Arrangement until March 31, 2007.

The 25-month Stand-By Arrangement was approved on August 6, 2004 ([see Press Release No.04/175](#)) for an amount equivalent to SDR 100 million (about US\$148.4 million).

Following the Executive Board discussion, on August 2, 2006, Ms. Anne O. Krueger, First Deputy Managing Director and Acting Chair, said:

“The Bulgarian economy has continued to benefit from confidence inspired by sustained sound macroeconomic policies and optimism surrounding impending EU accession. Spurred by consumption and strong investment, steady growth continues to be accompanied by falling unemployment. However, strong private domestic demand, buoyed by rapid credit growth, has contributed to rising inflation and a substantial deterioration of the current account deficit. Despite the halving of public external debt in recent years to a comparatively low level, Bulgaria’s overall external debt is high and climbing, raising the country’s vulnerability to external shocks. The authorities’ economic and structural reform program under the stand-by arrangement is therefore appropriately aimed at containing the underlying risks.

“Fiscal policy remains the key macroeconomic policy lever under the currency board arrangement. In this regard, the budget surplus in 2006, now expected to exceed 3 percent of GDP, is helping to compensate partly for excess private domestic demand. With the current account deficit expected to remain high over the near term, however, there is little room for a

relaxation of fiscal policy. Taking into account the negative budgetary impact of financial flows upon EU accession and the ensuing additional demand pressures, the budget in 2007 should aim to achieve a surplus of 2 percent of GDP. In reaching this minimum target, however, the authorities will need to compensate accession-related spending increases by offsetting cuts in existing programs and projects. Postponing further tax cuts until they are more affordable is also important.

“Credit growth has slowed, although the effectiveness of the credit limits introduced by the central bank has been declining. The program anticipates their gradual phase-out during the remainder of 2006. Although the banking system remains profitable and well capitalized, risks need to be monitored with vigilance following several years of rapid credit growth. Supervisors need to follow monetary and credit developments and ensure the adequacy of banks’ risk management frameworks.

“A revitalization of the structural reform effort is needed, and in this vein, the program focuses rightly on speeding up and deepening structural reforms to safeguard competitiveness and boost Bulgaria’s growth potential. Particular emphasis is being placed on increasing labor market flexibility to raise labor force participation and employment, improving the business climate to sustain investment, including through reforms of the judiciary and reductions of red tape, and a forceful anti-corruption effort. Privatization of additional state assets will be accelerated.

“Bulgaria’s transition from crisis a decade ago to steady growth has helped the country reach the doorstep of EU accession. To reap the full economic benefits of membership, further structural reforms will be particularly crucial, because they hold the promise of making the economy more flexible and dynamic, yielding stronger growth and better export performance. They are also needed for Bulgaria to realize its ambitions for faster convergence of living standards toward EU levels, and to have the agility to function successfully upon eventual membership of the monetary union,” Ms. Krueger said.