March 2007
IMF Country Report No. 07/127

Bulgaria: Fourth Review Under the Stand-By Arrangement and Request for Waiver of Nonobservance of Performance Criteria—Staff Report; Staff Statement Press Release on the Executive Board Discussion; and Statement by the Executive Director for Bulgaria

In the context of the fourth review under the Stand-By Arrangement and request for a waiver of nonobservance of performance criteria, the following documents have been released and are included in this package:

- the staff report for the Fourth Review Under the Stand-By Arrangement and Request for Waiver of Nonobservance of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on December 20, 2007, 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 March 1, 2007. 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 March 16, 2007 updating information on recent developments;

- a Press Release summarizing the views of the Executive Board as expressed during its March 16, 2007 discussion of the staff report that completed the request and review; and

- a statement by the Executive Director for Bulgaria.

The document listed below has been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Bulgaria*

*Also be 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
Washington, D.C.

INTERNATIONAL MONETARY FUND

BULGARIA

Fourth Review Under the Stand-By Arrangement and Request for Waiver of Nonobservance of Performance Criteria

Approved by Juha Kähkönen and Matthew Fisher

March 1, 2007

EXECUTIVE SUMMARY

Background. A 25-month precautionary arrangement of SDR 100 million (15.62 percent of quota) was approved on August 6, 2004 and extended to end-March 2007 during August 2006. Under the program, Bulgaria has achieved robust growth, falling unemployment, moderate inflation, and sustained competitiveness. However, strong FDI inflows attracted by positive prospects have contributed to a widening current account deficit, to 15.9 percent of GDP in 2006, while gross external debt is expected to reach 81 percent of GDP. Bulgaria's vulnerability to external shocks has increased in tandem.

Program performance. Performance in 2006 was broadly satisfactory, although structural reform implementation was weaker than expected. Notably, the government postponed until mid-2007 the launching of the electronic business registry, a key business climate measure.

The discussions focused on fiscal policies for 2007 and structural reforms to help maintain competitiveness.

2007 outlook. Growth should remain around 6 percent driven by buoyant domestic demand, accompanied by falling inflation. The external deficit and gross debt relative to GDP should stabilize around their 2006 levels—owing to strong export growth and terms of trade improvement—and gradually decline thereafter as import growth slows in line with more tempered FDI inflows and investment growth.

Fiscal policy. Following rising fiscal surpluses in recent years, the targeted 2007 surplus of 2.3 percent of GDP implies a relaxation vis-à-vis the estimated 2006 outcome. However, the authorities committed to tighten the fiscal stance should external risks increase further. While staff regretted the budget's lack of transparency, the authorities stressed the need to enhance transparency in stages, with the 2007 budget representing the first step.

Financial sector policies. The financial system remains well capitalized and profitable with modest non-performing loans. The authorities and staff agreed that the credit restraints should lapse and that Basel II should be implemented cautiously. The authorities were confident in their ability to ensure banking sector soundness in the presence of rapid bank lending through continued tight prudential oversight. Moreover, stringent stress tests are presently comforting.

Structural policies. Authorities and staff concurred that continued structural reform to increase the flexibility of the economy and maintain its competitiveness was critical. Staff emphasized the need to improve the business climate while maintaining prudent incomes policies. With regard to the latter, staff viewed the planned increases in public sector wages and the minimum wage as excessive, while the authorities downplayed the associated macroeconomic risks.

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I. INTRODUCTION[1]

1. **As it exits its program relationship with the Fund, Bulgaria is on solid footing to tackle the challenges and reap the benefits of membership in the European Union (EU).** Indeed, steady growth, job creation, moderate inflation and the country's attractiveness to foreign investors are ample proof to Bulgarians of the benefits of prudent macroeconomic policies and sustained structural reforms.

2. **At the same time, underlying vulnerabilities have risen and need to be addressed.** The widened current account deficit, while partly reflecting foreign investors' optimism, has also increased Bulgaria's vulnerability to economic shocks. In response, commitments in the authorities' Letter of Intent (LOI) aim at containing risks.

II. PERFORMANCE UNDER THE PROGRAM

A. Economic Developments

3. **Macroeconomic performance in 2006 was good.** GDP growth (6.2 percent) exceeded program projections due to more buoyant domestic demand that more than offset a greater negative drag from net exports. Partial signs of overheating have accompanied the stronger growth; bank credit growth is again rising, the current account deficit continues to widen, and consumer price index inflation has decelerated more slowly than hoped. At the same time, real estate price growth slowed substantially. Moreover, although real wage growth has been high, competitiveness indicators remain good.

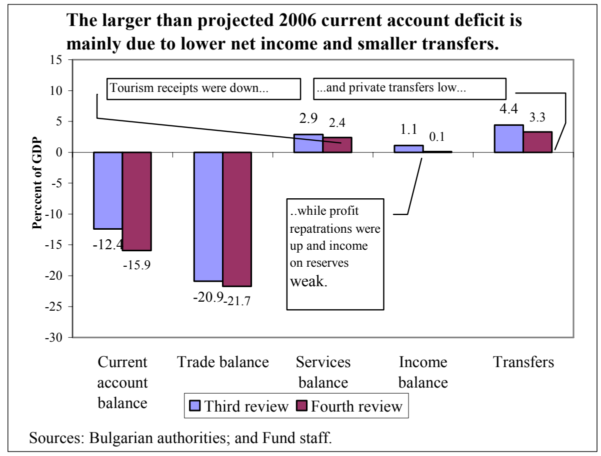
Bulgaria: Macroeconomic indicators

	2003	2004	2005	2006	
				Prog.	Est.
Real GDP (percent change)	4.5	5.7	5.5	5.6	6.2
Contributions to growth					
Domestic demand	9.3	7.7	11.3	7.0	10.8
Net exports	-4.9	-1.9	-5.7	-1.4	-4.6
CPI (percent change, end-of-period)	5.6	4.0	6.5	6.2	6.5
General government budget balance (percent of GDP)	-0.4	1.8	2.3	3.2	3.6
Gross external debt (percent of GDP)	60.2	64.2	70.5	69.9	81.2
Current account deficit (percent of GDP)	5.5	5.8	11.3	12.4	15.9
Reserve cover (in months of imports)	4.8	5.0	4.2	4.3	4.6

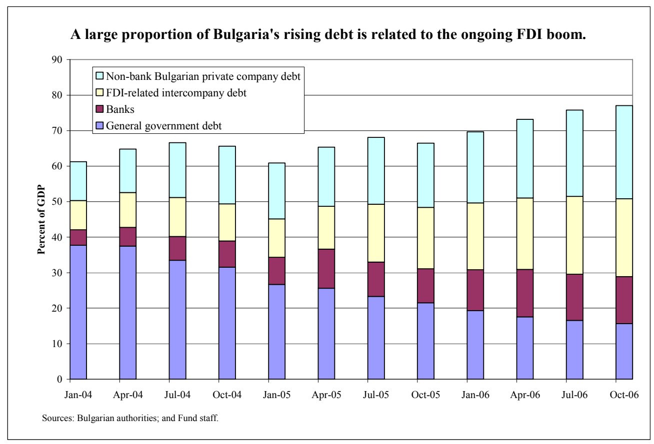
Source: Bulgarian authorities and Fund staff estimates.

[1] Mission details are in Appendix I on Fund Relations.

4. **The wider current account deficit reflects mostly a deterioration of the non-trade balances.** Following a near doubling in 2005, the deficit is estimated to have reached 15.9 percent of GDP in 2006, 3.5 percentage points higher than projected. About a quarter of the widened deficit was due to higher imports, notably of raw materials and consumer goods, and a delayed restoration of copper and steel export capacity due to slower restructuring than expected. The balance of the overshoot can be traced to declines in other accounts due partly to one-off factors (e.g. a temporary drop in tourism, exceptionally large profit outflows, and weaker private transfers).



5. **However, foreing direct investment (FDI) remains buoyant.** Unexpectedly large net FDI inflows during the second half of 2006 resulted in over 100 percent cover of the external deficit. Moreover, gross reserves rose to 133.3 percent of short-term obligations by remaining maturity. Still, albeit in part due to rising FDI-related inter-company borrowing, external debt is expected to reach 81 percent of GDP.



B. Program Performance in 2006

6. **Fiscal performance has been good.** Except for a small and subsequently reversed breach of the end-June 2006 ceiling on central government spending arrears, the authorities observed all quantitative performance criteria (PC). Thanks to buoyant tax bases, improvements in tax compliance, and spending restraint, the overall surplus reached an estimated 3.6 percent of GDP, and gross public debt fell to around 25½ percent of GDP.

7. **Progress on structural reform was broadly satisfactory, although somewhat weaker than hoped**. All structural benchmarks were met, but 3 of 9 only partially or with delay. The selection of a bidder for the sale of the Ruse heating plant (an end-October structural PC) was completed, but only in December. The launching of the electronic business registry (an October 1 structural PC) was postponed until July 1, 2007 due to insurmountable delays in initiating an implementation plan. To make up for the lost time, however, the authorities are executing a specific action plan (e.g., securing information technology and office space, hiring staff, etc.) to ensure success.

C. Outlook and Risks

8. **Bulgaria's economic outlook remains favorable.** The outlook is based on an agreed 2007 budget surplus target of 2.3 percent of GDP, and assumes a pick-up in bank credit growth following the lapse of administrative credit controls at end-2006. Domestic demand should therefore remain buoyant in 2007 owing to higher private and public consumption, partly muted by slightly slower investment growth, as experienced by several other new member states. Inflation should continue to decline thanks to falling oil prices, the ongoing favorable base effects of last year's hiked excise taxes, and moderation of core inflation. The current account deficit should remain broadly unchanged from its 2006 outturn.

Revisions to the 2007 Macroeconomic Framework

	3rd review	4th Review
GDP growth (% change)	6.0	6.0
Contribution to real GDP growth (%)		
Domestic demand	8.0	10.6
Net exports	-2.0	-4.7
Inflation (EOP)	3.6	4.2
(Average)	3.8	4.9
CA Deficit (% of GDP)	12.2	15.8

Source: Fund staff projections.

9. **There are substantial downside risks to the outlook, however.** First, with output growth remaining close to or above potential, the planned fiscal relaxation adds to demand and price pressures, increasing the risk of overheating. Second, a deterioration of the terms-of-trade or further delays of ongoing restructuring by the large steel and copper exporters could further widen the external deficit. Finally, a sudden reversal of capital flows to Bulgaria, including as part of a more generalized deterioration of the presently benign international environment, could force a disorderly adjustment of the external account.

III. Policy Discussions

10. **Discussions centered on the appropriate fiscal stance in 2007, and structural reforms to sustain competitiveness.** Economic circumstances clearly warrant a policy bias in favor of prudence, especially given Bulgaria's aspirations for early participation in ERM-II. Absent monetary policy under the currency board arrangement, and given the even greater degree of financial integration following accession, the burden falls on fiscal policy to help manage the risks accompanying macro imbalances. At the same time, however, the fixed exchange rate requires sustained structural reforms to enhance the flexibility of the economy.

A. Fiscal Policy

11. **The two key fiscal questions surrounding the discussions were:**

- What is an appropriate fiscal balance in present circumstances?
- What would constitute a transparent budget?

An appropriate budget target

12. **Given underlying vulnerabilities, staff considered that fiscal policy should avoid adding to already buoyant private demand.** The agreed 2.3 percent of GDP surplus target for 2007 comprises a budgeted surplus of 2 percent of GDP and additional savings of 0.3 percent of GDP via further cuts in spending (preferably in non-interest current outlays), to which the government commits in the LOI (¶3). The fiscal impulse is lower than otherwise implied because part of the decline of the surplus from the 2006 outturn is attributable to Bulgaria's 1.2 percent of GDP contribution to the EU, which has little direct domestic impact. To reach the budgeted target, staff pressed for substitution of EU-financed project spending and postponement of any tax reductions. Tax cuts and spending increases already decided by coalition partners, staff reluctantly agreed to the government's proposal to reach the budget's 2 percent of GDP target largely via sequestration and other measures (Box).

2007 Fiscal Policies: Budget and Letter of Intent Commitments

Targets (percent of GDP):

	2006	2007
Revenue:	40.2	39.0
Expenditure:	36.5	36.7
Overall balance:	3.6	2.3
Primary balance:	5.0	3.7

Main policy measures *(gross impact, where available, in % of GDP)*:

Revenue:
- Cut in corporate tax rate from 15 to 10 percent *(0.5)*
- 11 percent increase in non-taxable threshold of PIT *(0.2)*
- Advancement of fuel excise duty from 2008 *(0.3)*
- Introduction of ecology tax; upward adjustment of property values *(0.1)*

Expenditure:
- Budgeted sequestration of 10 percent of discretionary spending *(1.0)*
- 10 percent increase of public sector wages from July 1
- 8½ percent pension increase from July 1
- Additional unspecified spending cuts *(0.3)*

13. **The authorities and staff also saw the need for contingency measures should conditions warrant.** The budget requires saving 75 percent of revenue over-performance should the external deficit widen by more than 20 percent relative to the 2006 outturn. The authorities committed further in the LOI to save at least 90 percent of general government tax revenue over-performance exceeding amounts needed to ensure a full-year surplus of 2.3 percent of GDP (LOI, ¶4). To guard against insufficient revenue over-performance, the government agreed to cut non-interest spending or, if necessary, increase sequestration (LOI, ¶4).

Budgetary presentation

14. **Staff expressed concern that the authorities had stepped back from their commitment to improve budgetary transparency.** The budget is insufficiently transparent in at least two respects. First, it contains multiple surplus targets; an effective 2 percent of GDP budgeted surplus (see above) supersedes a "headline" surplus of 0.8 percent of GDP that is operationally meaningless. Second, release of sequestered funds depends on poorly conceived and confusing triggers: (i) the current account deficit does not deteriorate from its 2006 outturn, and (ii) the budget is on-track to yield a 2 percent of GDP surplus. Greater credibility was given to the 2 percent target with the government's agreement to include in

the budget the requirement that both triggers be assessed using final third quarter balance of payments and fiscal data, increasing the reliability of full-year projections for the current account and budget balances.

15. **The authorities emphasized that enhancing budgetary transparency would have to proceed in stages.** They argued that, as a first step and in contrast to previous years' targeted balances, the 2007 budget at least aims at a small 'headline' surplus and is based on relatively realistic revenue projections. The authorities viewed the 0.8 percent of GDP target as a balancing of the need to sensitize legislators to the importance of spelling out policy intentions and containing the appetite for increased spending that would arise from a higher 'headline' target. Staff agreed with the authorities that, although confusing in its multiple targets, the budget's language was clear enough for observers to ascertain the government's policy intentions.

B. Financial Sector

16. **The authorities and staff agreed that temporary credit restraints introduced since early 2005 should lapse.** Staff noted that banks had increasingly circumvented the restraints by selling part of their portfolio to non-bank or non-resident financial intermediaries. Removal of the restraints coincides with a tightening credit cycle in Europe, the introduction of Basel II and further liberalization of trade in financial services in the context of EU accession. In this environment, the authorities proposed to enforce adequate bank capitalization by requiring banks to follow a standardized risk-weighting approach when implementing Basel II, foregoing the bank-specific risk weighting (given insufficient historical data) that would have allowed banks to reduce their primary capital. Further, loan-quality standards are enforced and loan provisions are almost 3 percent of total loans. Staff agreed that financial sector vulnerabilities remain contained as banks are well capitalized and profitable, and only 2.2 percent of loans are overdue by more than 90 days. Moreover, stringent stress testing by the Bulgaria National Bank is reassuring. The risks of a possible pick-up in bank credit growth are likely to be at least partially shifted to non-bank financial institutions. In this context, the Financial Supervision Commission, which has benefited from Fund technical assistance, is modernizing supervision of the rapidly growing non-bank financial sector. Staff encouraged the authorities to continue such efforts while facilitating the development of financial markets to ensure improved pricing and allocation of risks.

C. Incomes and Labor Market Policies

17. The authorities considered that incomes and labor market policies had been broadly consistent with the program's policy commitments. In particular, state-owned enterprises kept wage bills under agreed ceilings, and social partners reached agreement on eliminating the full portability of seniority bonuses. Staff expressed concern about some lapses, however. Although public sector wage and pension increases in 2006 were held to agreed levels, staff viewed the planned 10 percent public sector wage increase from July 1, 2007 excessive given the inflation outlook. Moreover, staff viewed the large increase as an inappropriate signal to

the private sector. Similarly, the monthly minimum wage boost to 180 leva on January 1, 2007 (versus 170 leva under the program) is ill timed. The authorities, however, justified the larger increase as reflecting the higher-than-programmed inflation and as ensuring consistency with the increase of the minimum insurable income threshold. They stressed further that it would have neither inflationary nor budgetary impacts.

D. Other Structural Reforms

18. **The authorities recognized that implementation of structural reforms had been somewhat weaker than expected under the program and the need for stronger efforts in the future.** They agreed the delayed start-up of the business registry was regrettable, and the Prime Minister committed to redoubling efforts to meet the government's new deadline. By contrast, staff recognized the positive developments toward streamlining public administration, beginning to rationalize the education and health sectors, the furthering of privatization, notably in the energy sector, and improving in revenue administration. Acknowledging the importance of structural reforms to healthy public finances and securing the agility needed for eventual Euro adoption, the authorities confirmed the government's intention to persevere with reform.

IV. Staff Appraisal

19. **Bulgaria has made significant progress under the precautionary Stand-By-arrangement (SBA), helping to establish an enabling environment for a successful EU membership.** Sustained economic growth has raised real per capita income by a fifth during 2004-06. Additional privatizations reduced further the role of the state, and administrative reforms and modernization have improved the effectiveness of public institutions. The financial system, while still shallow, is maturing and has thus far managed well the rapid growth of intermediation, aided by prudential vigilance. Broad-based support for the macroeconomic framework has improved the dialogue among the social partners, in turn facilitating structural reform.

20. **However, the program period also witnessed a substantial rise in underlying risk exposure**. The widened current account deficit has been accompanied by a large increase in gross external debt. While partly reflecting capital inflows that facilitate income convergence, these developments also increase Bulgaria's vulnerability to external shocks.

21. **In contrast to previous years, the planned fiscal stance is potentially weaker than warranted**. Rising public savings have partially offset widening private sector saving-investment imbalances and helped build a buffer to manage possible shocks. The government's readiness to invoke contingency measures is reassuring. However, the macro-framework incorporates data received in recent weeks, and points to somewhat greater risks of overheating. The authorities' commitment to strive to overshoot the 2.3 percent of GDP surplus target is therefore welcome. The authorities would be well-advised to save all revenue over-performance even in the absence of a large widening of the external deficit.

Indeed, release of sequestered spending in the event revenue is insufficient to assure a 2.3 percent of GDP surplus risks adding excessively to already buoyant private demand.

22. **Budgetary presentation must be made more transparent.** Although the revenue projections for the 2007 budget are more realistic than in previous ones, it is regrettable that the government has stepped back from its commitment to avoid spending sequestrations. While politically expedient, sequestration is a blunt instrument that undermines expenditure prioritization and, therefore, the effectiveness of public finances. In addition, multiple budget targets cause confusion. As Bulgaria takes on the responsibilities incumbent upon EU members, full budgetary transparency will be essential to avoid sending confusing signals about fiscal policy.

23. **Allowing the credit restraining measures to lapse at the end of 2006 is appropriate.** The effectiveness of the measures had been exhausted, and their retention would serve mostly to invite creative circumvention and complicate overall prudential oversight. The authorities' decision to implement Basel II cautiously is indeed advisable. With financial market integration progressing rapidly, supervisory authorities need to continue to enforce capitalization and loan quality standards vigorously.

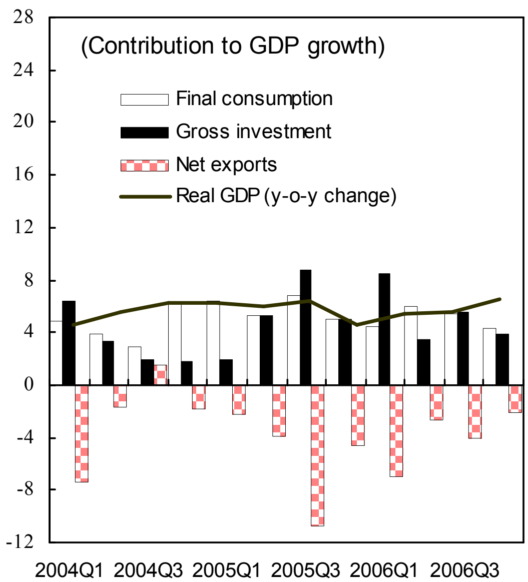
24. **Strong policies will be needed to succeed in the EU.** Beyond prudent fiscal policy and ensuring a strong financial sector resistant to shocks, the government and its social partners must remain committed to structural reform to increase the flexibility of the economy. Priority areas include improving the business climate through reduced corruption, streamlining licensing, and reducing minimum company capital requirements; additional rationalizing of the education system and adapting it to provide the skills demanded by the market; persevering with health sector reforms; and further reducing disincentives to the demand for, and supply of, labor. The successful implementation of these reforms is key to achieving the medium-term macro economic objectives set out in the authorities' *Convergence Programme*.[2]

25. Staff recommends completion of the Fourth Review under the SBA, and supports the authorities' request for waivers of non-observance of performance criteria.

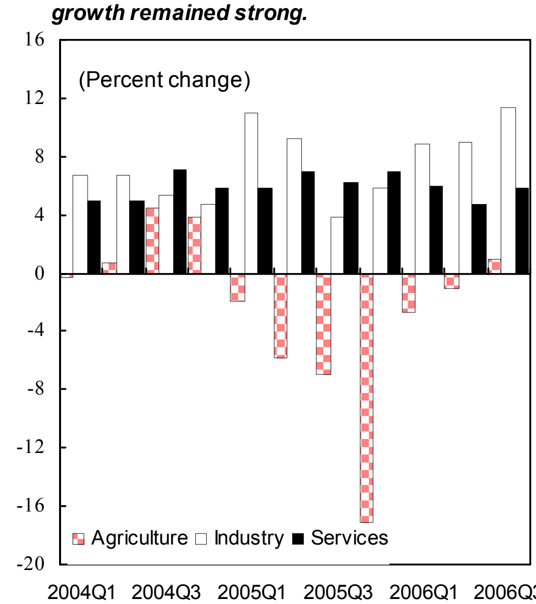
[2] http://ec.europa.eu/economy_finance/about/activities/sgp/country/doctype/scplist_en.htm.

Figure 1. Bulgaria: Real Sector Developments, 2004–06
(In percent, unless otherwise noted)

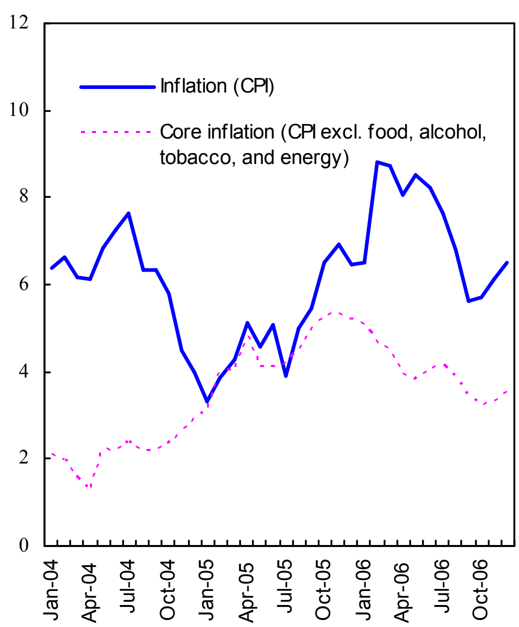
Growth of domestic demand has been vigorous, but the external sector has been a drag.



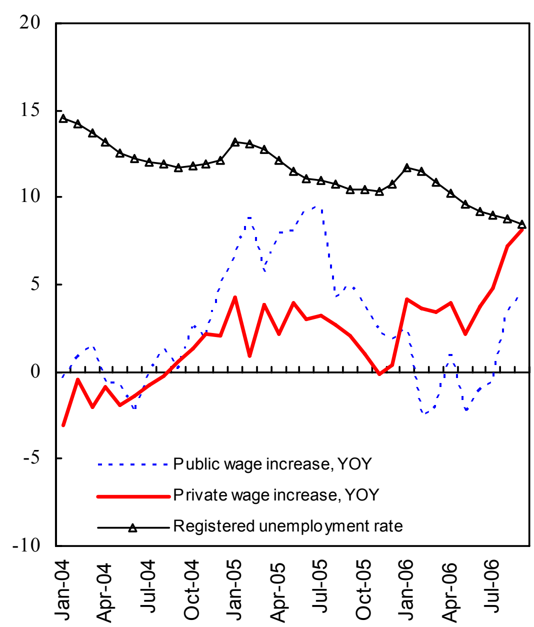
Industrial and agricultural growth recovered from the 2005 floods while service sector growth remained strong.



Core inflation has declined recently, but headline inflation picked up again.



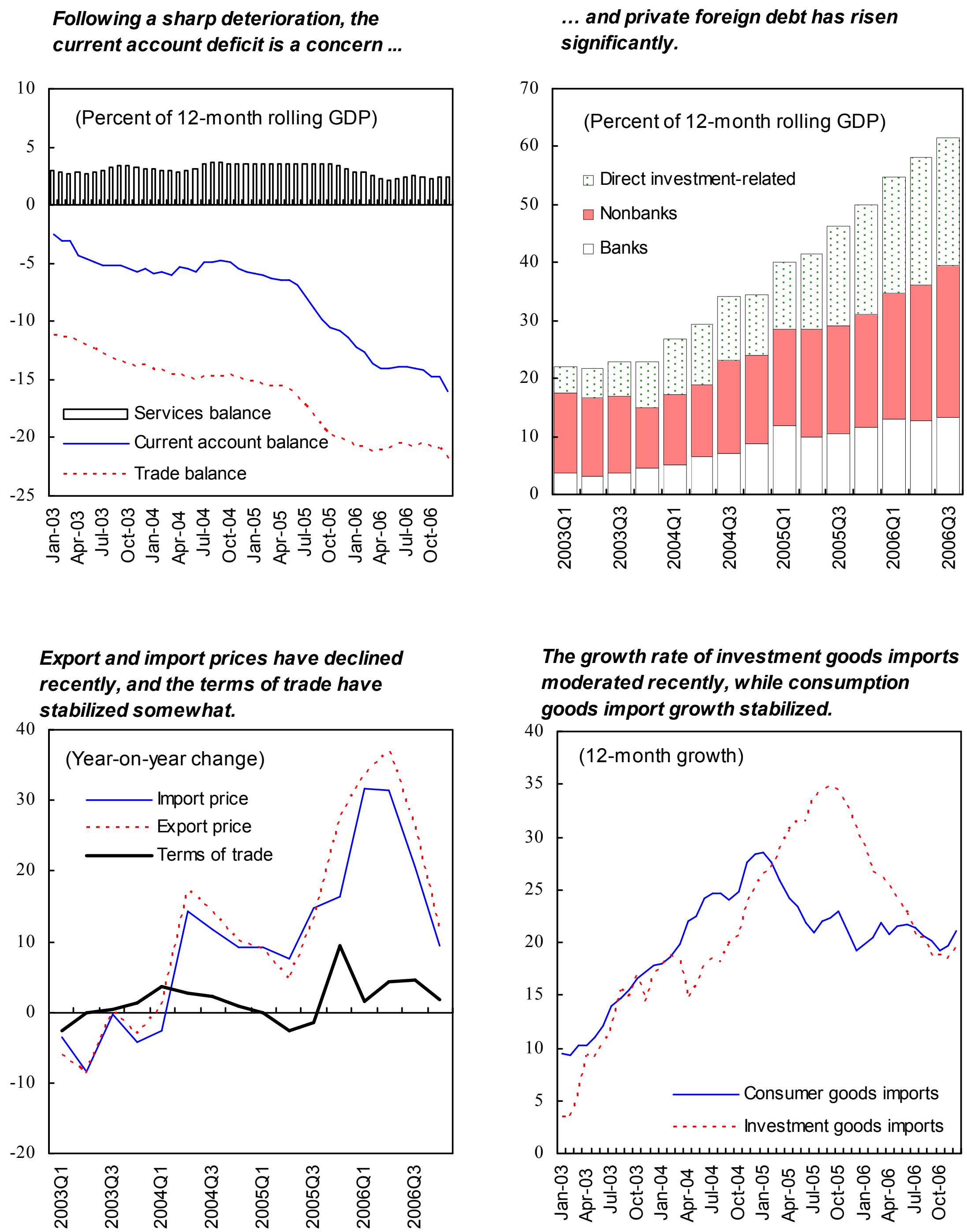
Real wage growth appears to have picked up while unemployment has continued to fall. 1/



Sources: Bulgarian authorities and Fund staff estimates.

1/ The reduction in the social security contribution rate in January 2006 may have increased reported private sector wages.

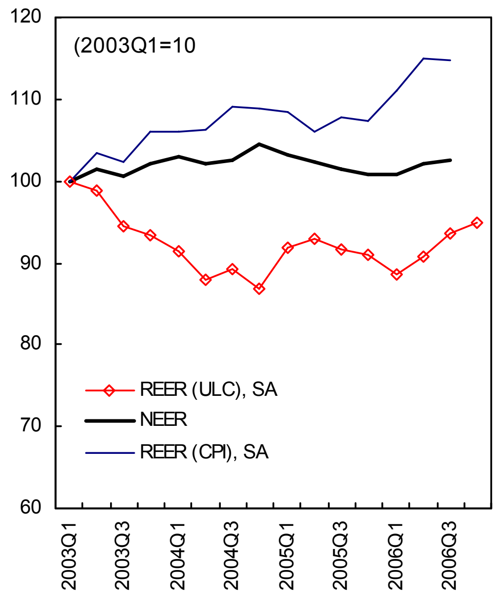
Figure 2. Bulgaria: Balance of Payments Developments



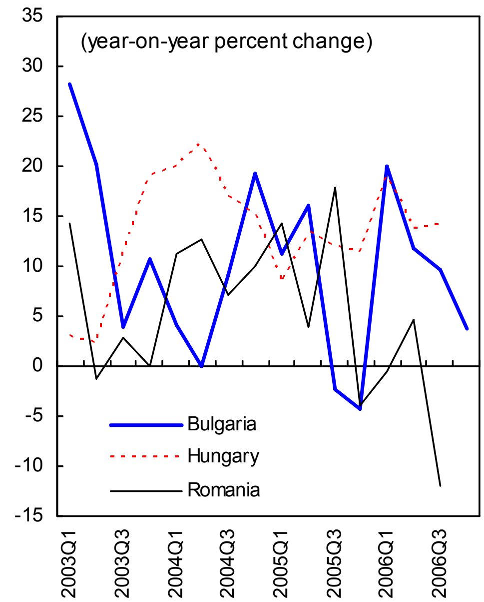
Sources: Bulgarian authorities and Fund staff estimates.

Figure 3. Bulgaria: Competitiveness

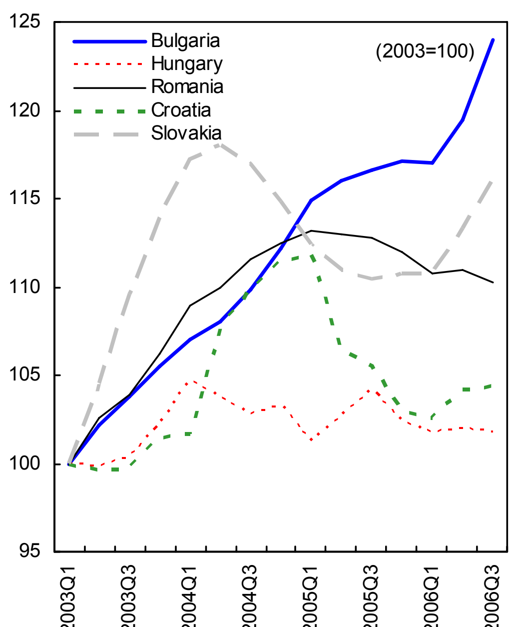
Relative unit labor costs remain broadly stable.



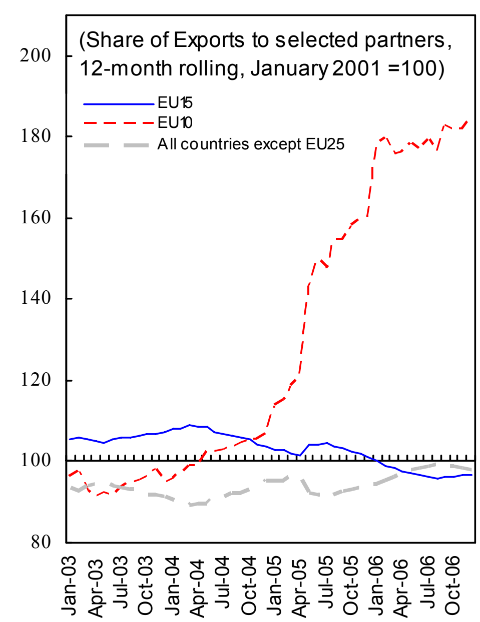
Export volumes are volatile but, on average, robust ...



... and Bulgaria's share in EU imports has continued to rise ...

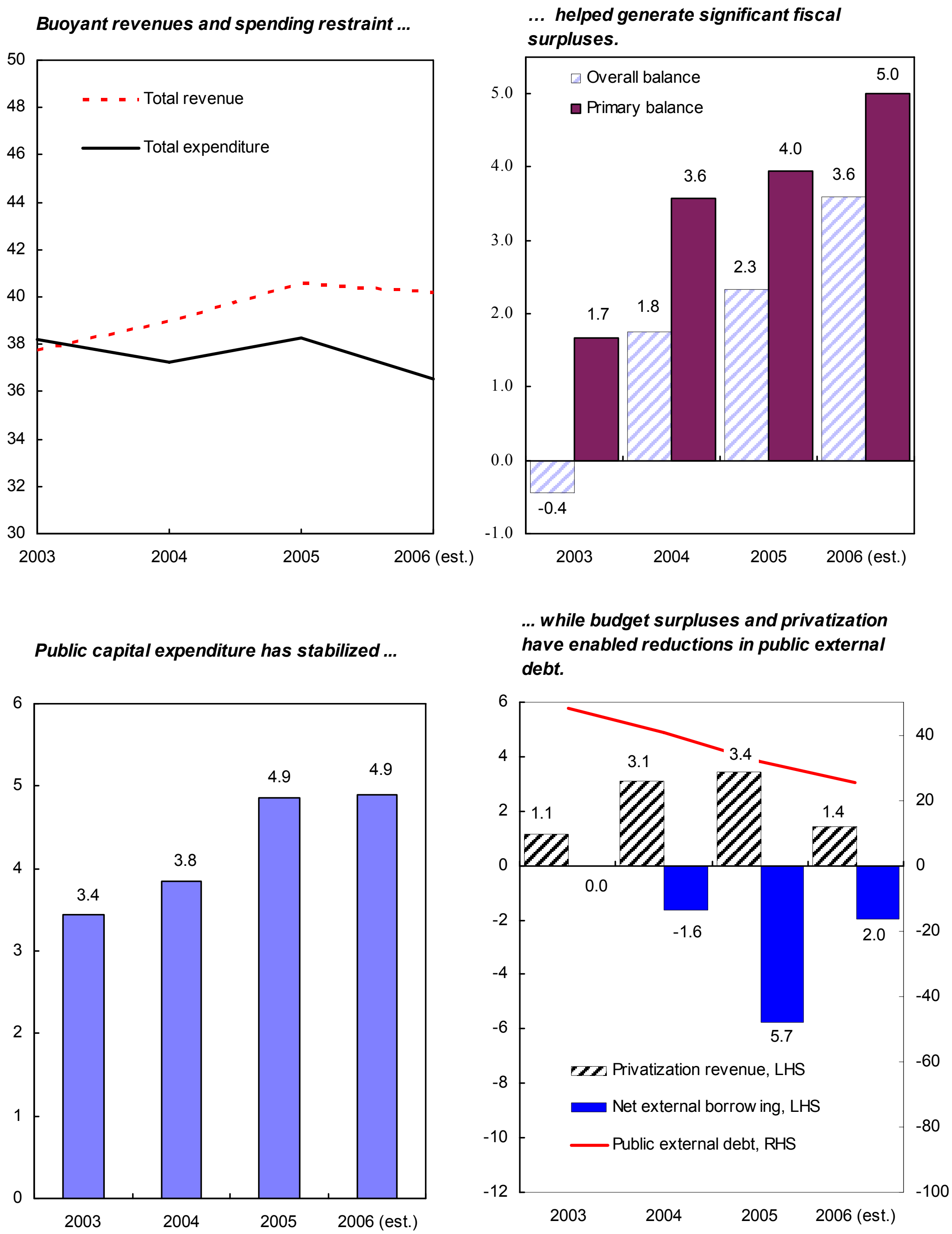


... and the share of exports to the new member states stabilized following a rapid increase.



Sources: Bulgarian authorities and Fund staff estimates.

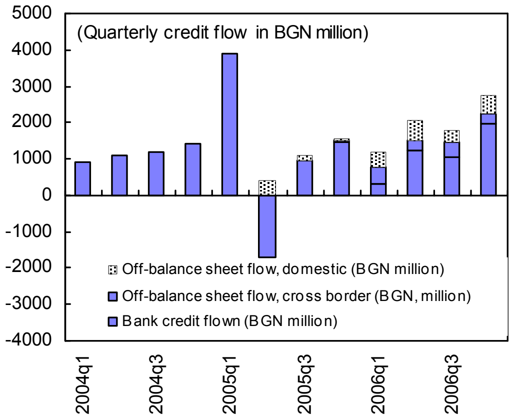
Figure 4. Bulgaria: Fiscal Sector Developments
(In percent of GDP)



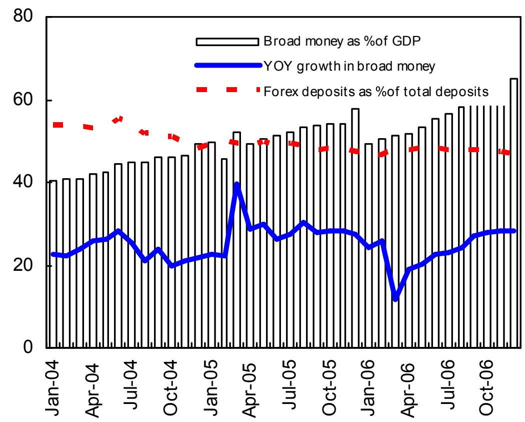
Sources: Bulgarian authorities and Fund staff estimates.

Figure 5. Bulgaria: Financial Sector Indicators

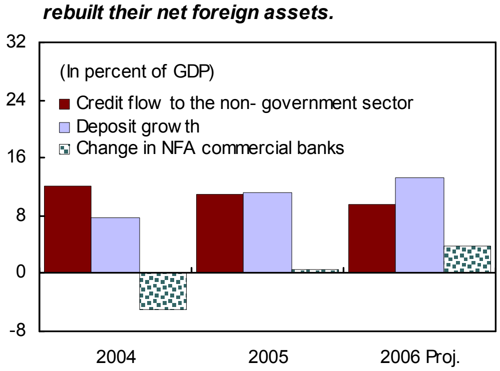
Overall credit growth has picked up again ...



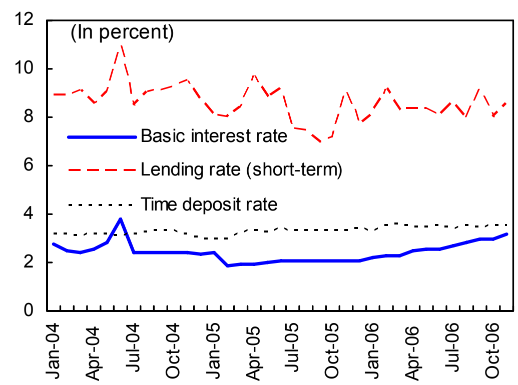
... while money growth has remained robust.



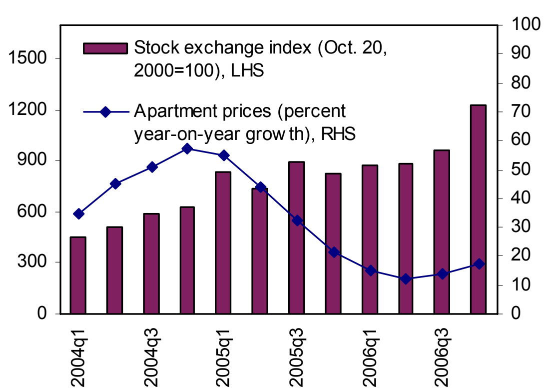
Bank credit growth (excluding off-balance sheet items) slowed further in 2006 and banks rebuilt their net foreign assets.



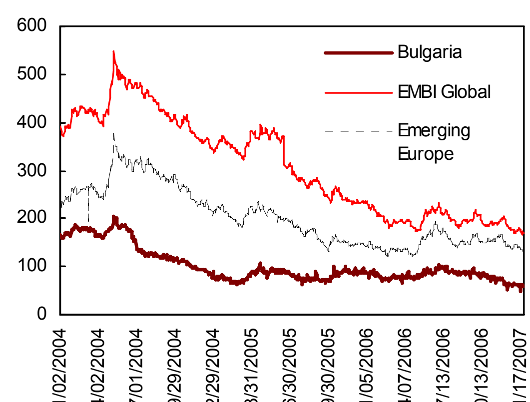
Basic interest rates have followed rising Euro rates, while lending rates have remained stable.



The stock market index has begun to rise, but real estate price growth has moderated.

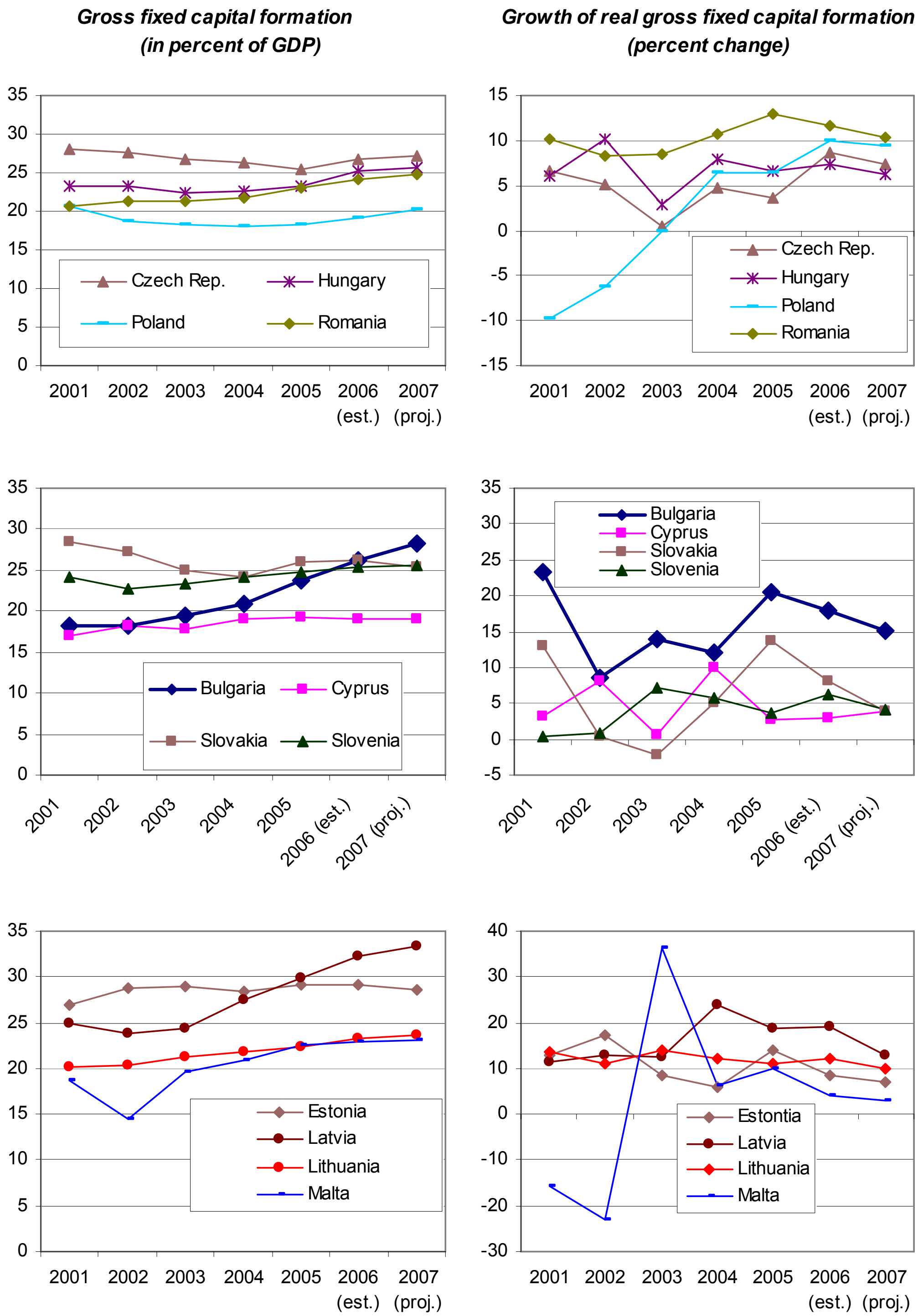


Sustained low sovereign bond spreads indicate continued investor confidence.



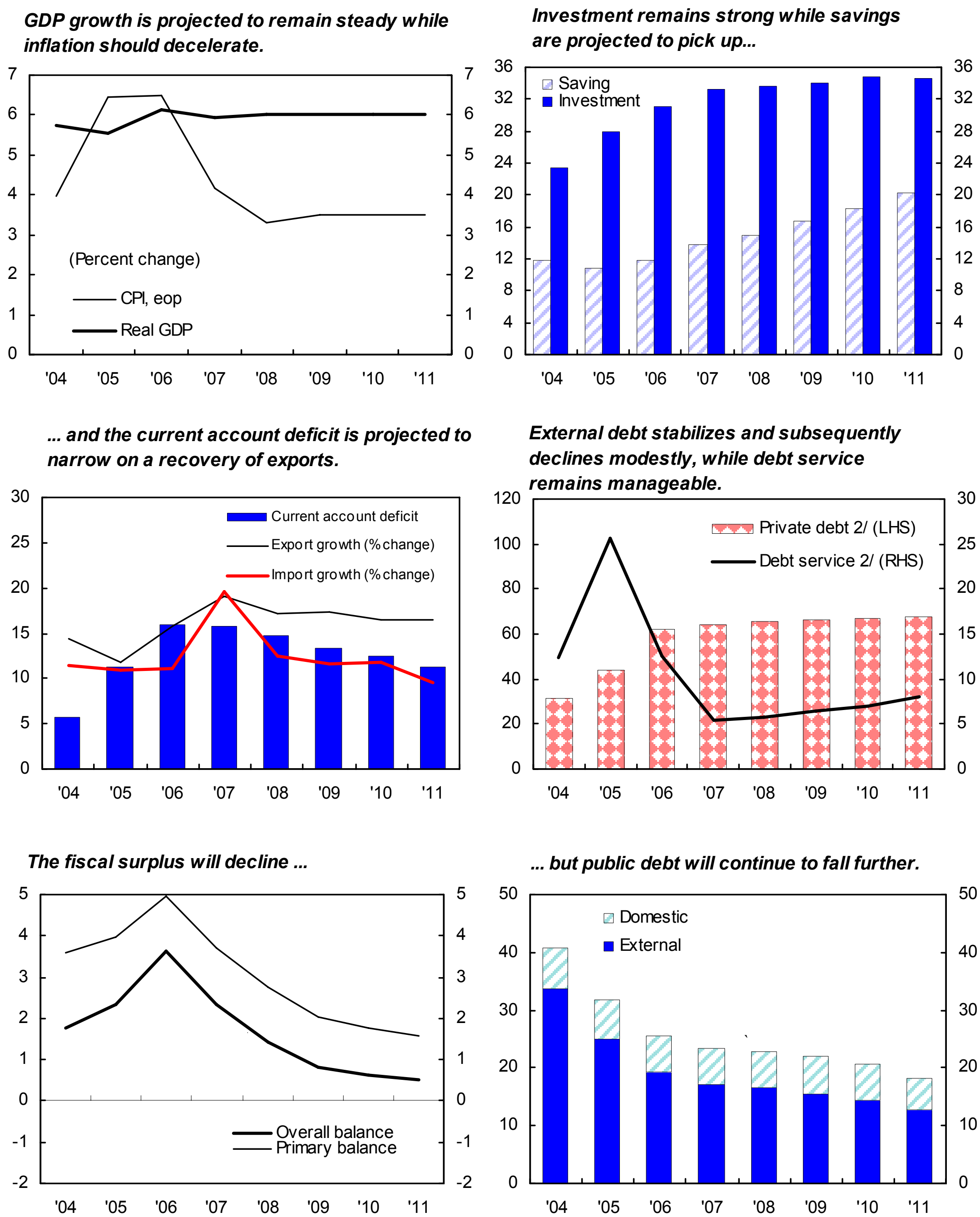
Sources: Bulgarian authorities; and Fund staff estimates.

Figure 6. Selected Countries: Gross Fixed Capital Formation, 2001–07



Sources: WEO data, Bulgarian authorities and staff estimates.

Figure 7. Bulgaria: Baseline Medium-Term Projections, 2004–2011 1/
(In percent of GDP, unless otherwise indicated)



Sources: Bulgarian authorities and Fund staff estimates, and projections.
1/ Projections from 2007.
2/ Projections include assumptions on disbursements related to debt not already contracted.

Table 1. Bulgaria: Selected Economic and Social Indicators, 2003-07

	2003	2004	2005	2006 3rd review projection	2006 Estimate	2007 Proj.
Output, prices, and employment	(Annual percentage change, unless otherwise stated)					
Real GDP	4.5	5.7	5.5	5.6	6.2	6.0
Real industrial sales	16.1	19.8	6.3	...	...	...
Consumer price index (average)	2.3	6.1	5.0	7.4	7.3	4.9
(end of period)	5.6	4.0	6.5	6.2	6.5	4.2
Unemployment rate (in percent)						
Registered unemployment (average)	14.3	12.7	11.5	...	...	...
Labor force survey (average)	13.7	12.0	10.1	...	...	...
Real public sector wages (average)	3.9	0.8	6.0	...	...	...
Real private sector wages (average)	5.7	-0.4	2.3	...	...	...
General government	(In percent of GDP)					
Revenue	37.8	39.0	40.6	40.0	40.2	39.0
Noninterest expenditure	36.1	35.4	36.6	35.4	35.2	35.3
Primary balance	1.7	3.6	4.0	4.6	5.0	3.7
Interest payments	2.1	1.8	1.6	1.4	1.3	1.4
Overall balance	-0.4	1.8	2.3	3.2	3.6	2.3
Privatization receipts	1.1	3.1	3.4	0.9	1.4	0.5
External financing	0.0	-1.6	-5.7	-1.2	-2.0	-0.5
Domestic financing	-0.7	-3.2	0.0	-2.8	-3.1	-2.3
Public debt (end of period)	48.2	40.7	31.9	31.9	25.4	23.4
Domestic public debt (end of period)	6.5	7.0	6.8	7.1	6.2	6.2
Money and credit	(Annual percentage change, unless otherwise stated)					
Broad money (end of period; in millions of leva)	15,588	18,926	24,160	28,388	30,995	37,624
Broad money (M3)	20.9	21.6	27.7	17.5	28.3	21.4
Claims on nongovernment	48.3	48.7	32.4	17.5	24.6	28.0
FX deposits (in millions of euro) 1/	3,110	3,470	4,454	5,676	5,955	7,375
FX deposits (percent of M3) 1/	39.0	35.9	36.1	39.1	37.6	38.3
Broad money to FX reserves ratio	1.5	1.7	1.8	1.7	1.7	1.9
Interest rates (annualized)	(In percent)					
BNB basic rate	2.7	2.4	2.1	...	3.3	...
Time deposits (leva)	3.2	3.0	3.4	...	3.5	...
Balance of payments	(In percent of GDP)					
Current account balance	-5.5	-5.8	-11.3	-12.4	-15.9	-15.8
Trade balance	-13.7	-15.1	-20.2	-20.9	-21.7	-21.9
Merchandise exports, fob	37.8	40.8	44.1	51.9	49.2	49.4
Merchandise imports, fob	51.5	55.9	-64.4	72.7	70.8	71.3
Foreign direct investment, net	10.3	7.9	14.4	9.4	16.9	12.2
(in percent of current account deficit)	187.8	137.0	127.3	76.0	106.5	77.1
Gross official reserves (end of period; in millions of euro)	5,405	6,854	7,370	8,473	8,926	9,302
(In months of prospective imports of GNFS)	4.8	5.0	4.2	4.3	4.6	4.4
External debt (end of period) 2/	10,641	12,572	15,111	16,660	19,789	21,965
(In percent of GDP) 3/	60.2	64.2	70.5	69.9	81.2	81.0
Exchange rates						
Leva per euro	Currency board peg to Euro at Lev 1.956 per Euro					
Leva per U.S. dollar (end of period)	1.591	1.459	1.650	...	1.481	...
(yoy percent change, + means depreciation)	-15.6	-8.3	13.1	...	-10.2	...
REER (end of period; CPI based)						
(yoy percent change, + means appreciation)	7.0	2.0	-0.5	...	...	...

Social Indicators (reference year in parentheses)
Per capita GNI (Atlas method, 2005)**:** US $3450;
Poverty rate (2001): 12.8%; **Life expectancy at birth** (2004)**:** 72.4 years; **Infant mortality** per 1,000 live births (2004): 12.3
Child malnutrition (percent of children under 5): n/a; **Income distribution** (Gini index, 2003): 29.2;
Gross primary enrollment (percent of school-age group, 2002): 100 (male), 99.2 (female)

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

1/ Includes only foreign currency deposits in M3.
2/ Includes trade credits.
3/ The 2006 program figure is lower than the 2005 outcome because of a later revision to the series.

Table 2. Bulgaria: Real GDP by Expenditure Category, 2003–07

	2003	2004	2005	2006		2007
				3rd review projection	Est.	Proj.
			(Real growth rate in percent)			
GDP	**4.5**	**5.7**	**5.5**	**5.6**	**6.2**	**6.0**
Domestic demand 1/	**8.8**	**7.0**	**10.3**	**6.1**	**9.3**	**8.9**
Private demand	8.8	7.2	10.8	7.6	10.9	9.8
Public demand	8.7	6.1	8.4	0.0	2.8	5.1
Final consumption	**6.6**	**5.1**	**6.8**	**4.6**	**6.2**	**7.1**
Private consumption	6.4	5.5	7.6	5.5	7.5	8.0
Public consumption	7.6	3.8	3.8	1.0	1.5	3.7
Gross investment	**18.2**	**14.7**	**23.3**	**10.7**	**19.0**	**14.1**
Gross fixed capital formation	13.9	13.5	19.0	13.0	17.9	15.1
Change in inventories	69.2	24.6	57.0	-1.9	24.9	8.0
Net exports	**-74.0**	**-20.5**	**-55.9**	**-8.6**	**-28.7**	**-24.4**
Exports of goods and services	8.0	13.0	7.2	12.8	9.3	15.2
Imports of goods and services	15.3	14.1	14.6	11.9	13.3	17.3
			(Contribution to real GDP growth)			
Domestic demand 1/	**9.3**	**7.7**	**11.3**	**7.0**	**10.8**	**10.6**
Private demand	7.5	6.3	9.5	7.0	10.2	9.5
Public demand	1.8	1.4	1.9	0.0	0.6	1.1
Final consumption	**5.7**	**4.5**	**5.9**	**4.0**	**5.5**	**6.3**
Private consumption	4.4	3.7	5.2	3.9	5.2	5.6
Public consumption	1.4	0.7	0.7	0.2	0.3	0.7
Gross investment	**3.6**	**3.2**	**5.5**	**3.0**	**5.3**	**4.4**
Gross fixed capital formation	2.5	2.6	4.0	3.1	4.3	4.0
Change in inventories	1.1	0.6	1.5	-0.1	1.1	0.4
Net exports	**-4.9**	**-1.9**	**-5.7**	**-1.4**	**-4.6**	**-4.7**
Exports of goods and services	4.3	6.9	4.2	7.8	5.7	9.9
Imports of goods and services	-9.1	-8.9	-9.9	-9.2	-10.3	-14.6
			(Percentage change in implicit deflators)			
GDP	**2.3**	**4.8**	**3.8**	**5.2**	**7.1**	**5.0**
Final consumption	**1.3**	**4.3**	**4.8**	**5.1**	**6.3**	**3.5**
Gross investment	**-0.8**	**4.1**	**6.2**	**5.6**	**6.4**	**4.0**
Net exports						
Exports of goods and services	-0.3	6.2	7.2	12.1	11.8	-3.3
Imports of goods and services	-2.2	5.1	8.5	10.7	9.5	-3.4
Memorandum items						
Share of domestic demand in nominal GDP	109.5	110.2	116.6	117.1	119.2	120.9
Share of net exports in nominal GDP	-9.5	-10.2	-16.6	-17.0	-19.2	-20.9
Nominal GDP (in millions of leva)	34,547	38,275	41,948	46,620	47,676	53,050

Sources: Bulgarian authorities, Fund staff estimates.

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

Table 3. Bulgaria, Monetary Survey, 2004–07
(End-period; in millions of leva, unless otherwise stated)

	2004	2005	2006				2007
			Q1	Q2	Q3	Q4	Proj.
Broad money	18,926	24,160	24,422	26,357	28,530	30,995	37,624
Currency outside banks	4,628	5,396	5,113	5,503	5,917	6,231	6,935
Reserve money	7,058	8,351	8,347	9,339	9,544	10,482	11,231
Deposits	14,298	18,764	19,310	20,854	22,613	24,764	30,690
Lev	7,512	10,052	10,038	10,778	11,816	13,118	16,265
Foreign currency	6,786	8,712	9,272	10,076	10,797	11,646	14,424
Other longer-term liabilities (not incl. in broad money)	4,767	6,216	6,679	6,663	7,036	7,596	8,375
Deposits	571	827	906	974	1,050	1,125	1,316
Lev	225	294	302	313	340	385	434
Foreign currency	346	533	604	661	711	740	882
Capital and reserves	4,196	5,389	5,773	5,689	5,985	6,471	7,059
Net foreign assets	11,181	13,221	13,380	15,135	17,778	18,634	19,974
BNB	11,571	13,343	13,047	14,806	15,977	16,976	17,861
Commercial banks	-390	-122	333	329	1,800	1,658	2,113
Net domestic assets	12,512	17,155	17,721	17,885	17,788	19,957	26,026
Domestic credit	12,302	17,200	17,786	18,062	18,121	20,024	26,058
General government	-1,808	-1,462	-1,204	-2,146	-3,153	-3,232	-3,710
Non-government	14,110	18,663	18,990	20,207	21,274	23,256	29,768
Claims on non-financial corporations	9,306	11,439	11,516	11,950	12,607	13,712	...
Claims on households	4,374	6,928	7,116	7,884	8,251	9,045	...
Other items, net	-1,127	-1,620	-1,697	-1,832	-2,049	-1,868	-1,944
Fixed assets	1,337	1,575	1,633	1,656	1,716	1,801	1,912
			(12-month percentage change)				
Broad money	22	28	12	23	27	28	21
Currency outside banks	19	17	14	14	14	15	11
Reserve money	34	18	25	28	22	26	7
Claims on non-government	49	32	6	24	24	25	28
Claims on non-financial corporations	38	23	-6	16	18	20	...
Claims on households	75	58	40	39	33	31	...
Deposits	22	31	11	25	31	32	24
Lev	34	34	13	26	29	30	24
Foreign currency	12	28	9	25	33	34	24
			(quarterly growth rates)				
Claims on non-government	11.5	8.5	1.8	6.4	5.3	9.3	6.4
Claims on non-financial corporations	9.8	7.4	0.7	3.8	5.5	8.8	...
Claims on households	14.9	11.3	2.7	10.8	4.7	9.6	...
			(share of GDP)				
Broad Money	49.4	57.6	56.8	59.0	61.3	65.0	70.9
Claims on Nongovernment	36.9	44.5	44.2	45.2	45.7	48.8	56.1
Claims on non-financial corporations	24.3	27.3	27.6	27.6	28.0	28.8	...
Claims on households	11.4	16.5	16.5	17.6	17.7	19.0	...
Memorandum items:							
Reserve money (leva, million)	7058	8,351	8,347	9,339	9,544	10,482	11,231
Banks' reserves (including cash in bank vault, Leva, million)	2431	2,956	3,234	3,836	3,628	4,251	4,297
Money multiplier (M3/reserve money)	2.7	2.9	2.9	2.8	3.0	3.0	3.3
BNB net foreign assets/Reserve money (in percent)	163.9	159.8	156.3	158.5	167.4	162.0	159.0
Foreign currency deposits (percent of broad money)	35.9	36.1	38.0	38.2	37.8	37.6	38.3
Commecial banks NFA/foreign currency deposits (in percent)	-5.5	-1.3	3.4	3.1	15.6	13.4	13.8
Claims on nongovernment/deposits (in percent)	94.9	95.3	93.9	92.6	89.9	89.8	93.0
Velocity M3	2.0	1.7	1.8	1.7	1.6	1.6	1.4

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

Table 4. Bulgaria: Selected Vulnerability Indicators, 2002–06

	2002	2003	2004	2005	2006 1/	
Key Economic and Market Indicators						
Real GDP growth (in percent)	4.9	4.5	5.7	5.5	6.2	Est.
CPI inflation (period average, in percent)	5.8	2.3	6.1	5.0	7.3	Dec-06
Short-term (ST) interest rate (in percent)	3.4	2.7	2.4	2.1	3.3	Dec-06
EMBI + secondary market spread (bps; end of period)	291	177	77	90	61	Dec-06
Exchange rate NC/US$ (end of period)	1.9	1.6	1.4	1.7	1.5	Dec-06
External Sector						
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	-11.3	-15.9	Dec-06
Net FDI inflows (percent of GDP)	5.8	10.3	7.9	14.4	16.9	Dec-06
Export growth (yoy, Euro value, GNFS)	4.6	10.3	19.7	15.1	22.6	Dec-06
Real effective exchange rate (1995 = 100; end of period))	111.8	119.5	121.9	121.3	125.3	Jun-06
Gross international reserves (GIR) in Euro billion	4.6	5.4	6.9	7.4	8.9	Est.
GIR in percent of ST debt at remaining maturity	212.5	177.0	110.0	128.7	133.3	Est.
GIR in percent of ST debt at RM and banks' FX deposits 2/	93.4	101.4	102.3	67.3	74.1	Est.
Net international reserves (NIR) in Euro billion	3.6	4.5	6.0	6.2	8.7	Est.
Total gross external debt in percent of GDP	65.1	60.2	64.2	70.5	81.2	Est.
o/w ST external debt (original maturity, in percent of total ED)	14.1	14.3	19.3	25.4	29.3	Est.
ED of domestic private sector (in percent of total ED)	26.1	33.8	48.9	65.8	76.3	Est.
ED to foreign official sector (in percent of total ED)	30.4	29.3	26.5	22.6	19.8	Est.
Total gross external debt in percent of exports of GNFS	126.4	113.2	111.8	116.7	124.6	Est.
Gross external financing requirement (in Euro billion) 3/	1.4	1.9	3.2	7.5	6.5	Est.
Public Sector 4/						
Overall balance (percent of GDP)	-0.8	-0.4	1.8	2.3	3.6	Est.
Primary balance (percent of GDP)	1.4	1.7	3.6	4.0	5.0	Est.
Debt-stabilizing primary balance (percent of GDP) 5/	...	...	...	...	0.8	Est.
Gross public sector financing requirement (in percent of GDP) 6/	10.6	6.1	4.2	8.0	0.1	Est.
Public sector gross debt (in percent of GDP)	56.3	48.2	40.7	31.9	25.4	Est.
o/w Exposed to rollover risk (in percent of total PSGD) 7/	8.4	8.0	12.9	30.5	13.3	Est.
Exposed to exchange rate risk (in percent of total PSGD) 8/	91.7	91.0	88.2	85.3	25.4	Est.
Exposed to interest rate risk (in percent of total PSGD) 9/	59.0	56.7	51.7	39.5	13.3	Est.
o/w External debt from official creditors (in percent of total)	29.7	31.3	34.1	36.0	82.3	Est.
External debt from private creditors (in percent of total)	25.8	22.2	14.6	0.0	33.8	Est.
Domestic debt linked to foreign currency (in percent of total)	3.4	3.1	3.0	3.4	29.5	Est.
Public sector net debt (in percent of GDP) 10/	45.5	36.6	27.5	21.4	3.3	Nov-07
Financial Sector 11/						
Capital adequacy ratio (in percent)	25.2	22.0	16.1	15.2	14.5	Dec-06
Non-standard loans in percent of total loans 12/	6.5	7.3	7.1	7.7	5.8	Dec-06
o/w Non-performing loans (due over 90 days)	2.6	3.2	2.0	2.2	2.2	Dec-06
Return on average assets (in percent)	2.1	2.4	2.1	2.1	2.2	Dec-06
Return on equity (in percent)	14.9	22.7	20.6	22.1	24.4	Dec-06
FX deposits (in percent of total nongovernment deposits)	54.3	52.1	48.0	47.2	47.8	Dec-06
FX loans (in percent of total nongovernment loans)	41.3	42.8	47.5	47.3	45.3	Dec-06
Government debt held by FS (percent of total FS assets)	22.5	18.9	15.6	12.2	8.6	Dec-06
Credit to private sector (percent change)	44.0	48.3	48.7	32.4	24.6	Dec-06
Memo items:						
Nominal GDP in billions of euros	16.5	17.7	19.6	21.4	24.4	Est.
Nominal GDP in billions of U.S. dollars	15.7	20.0	24.4	26.6	30.5	Est.

Sources: Bulgarian authorities; and Fund staff estimates.

1/ For 2006, staff estimates or latest available observations as indicated in the last column.
2/ Forex deposits by residents only, deposits by non-residents are included in foreign debt.
3/ Current account deficit plus amortization of external debt.
4/ Public sector covers central government, autonomous budgets, social security funds, municipal budgets, and extra budgetary funds.
5/ Based on averages for the last five years for the relevant variables (i.e., growth, interest rates).
6/ Overall balance plus debt amortization.
7/ Amorization on domestic and external debt (excluding external debt to official creditors) in 2005 divided by 2004 total debt stock.
8/ Debt in foreign currency or linked to the exchange rate, domestic and external. Does not exclude external debt on concessional terms.
9/ Total debt at variable interest rate (domestic and external).
10/ Public sector gross debt minus balance of the fiscal reserve account.
11/ Financial sector covers banking sector only excluding insurance, pension funds and capital market institutions.
12/ Loans overdue by more than 30 days.

Table 5. Bulgaria: Balance of Payments, 2003–07
(In millions of euros)

	2003	2004	2005	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2006	2007 Proj.
CURRENT ACCOUNT	-973	-1,132	-2,427	-1,113	-721	-304	-1,741	-3,878	-4,276
Trade balance	-2,426	-2,954	-4,343	-1,035	-1,127	-1,293	-1,829	-5,285	-5,935
Exports (f.o.b.)	6,668	7,985	9,466	2,672	3,038	3,189	3,083	11,983	13,397
y-o-y change (in percent)	10.0	19.7	18.6	28.4	31.8	32.1	15.6	26.6	11.8
Imports (f.o.b.)	-9,094	-10,938	-13,809	-3,708	-4,166	-4,483	-4,912	-17,268	-19,332
y-o-y change (in percent)	14.5	20.3	26.2	33.1	21.8	25.5	21.8	25.0	12.0
Services, net	553	692	678	-199	182	736	-140	580	646
Of which: Exports of travel services	*1,500*	*1,789*	*1,955*	*226*	*522*	*1,050*	*264*	*2,062*	*2,300*
Income, net	288	238	246	-12	36	-21	13	16	78
Of which: Income to direct investors	*-493*	*-609*	*-536*	*-117*	*-169*	*-239*	*-239*	*-763*	*-954*
Current transfers, net	613	891	993	133	188	274	215	811	935
CAPITAL AND FINANCIAL ACCOUNT	1,754	2,669	3,110	895	1,628	581	2,295	5,420	4,741
Capital transfers, net	0	0	-1	4	0	0	0	0	0
Foreign direct investment, net 1/ 2/	1,827	1,550	3,093	746	1,211	793	1,383	4,132	3,299
Of which: Privatization receipts 3/	*312*	*243*	*693*	*0*	*0*	*0*	*205*	*205*	*140*
Portfolio investment, net	-191	-564	-1,358	68	-76	2	11	6	-247
Other investment, net	840	2,047	992	-4	688	-146	37	600	1,689
General government	60	102	-97	-215	-13	-7	-69	-304	86
Domestic banks	562	1,029	-198	0	50	-970	-69	-990	-232
Other private sector	219	915	1,287	210	651	832	176	1,894	1,836
Errors and omissions	-722	-364	383	82	-195	-68	863	683	0
OVERALL BALANCE	781	1,538	684	-218	908	596	500	1,786	465
FINANCING	-781	-1,538	-684	219	-908	-596	-500	-1,785	-465
Gross international reserves (increase: -)	-817	-1,493	-324	412	-875	-568	-475	-1,506	-375
Use of Fund credit, net	35	-44	-359	-193	-33	-28	-25	-279	-90
Purchases	128	62	0	0	0	0	0	0	0
Repurchases 4/	-101	-106	-359	-193	-33	-28	-25	-279	-90
Exceptional financing	0	0	0	0	0	0	0	0	0
MEMORANDUM ITEMS									
Gross international reserves (stock, e.o.p.) 5/	5,405	6,854	7,370	7,016	7,875	8,447	8,926	8,926	9,302
In months of prospective GNFS imports	4.8	5.0	4.3	3.6	4.0	4.3	4.6	4.6	4.4
In percent of short-term debt (original maturity)	354.5	282.4	191.7	117.3	132.1	142.0	150.9	150.6	137.1
Excess international reserves (stock, e.o.p.) 6/	2,712	3,245	3,100	2,533	2,884	3,351	3,387	3,367	3,399
In percent of short-term debt	177.9	133.7	81	56	59	64	58	58	51
Current account + FDI	854	418	667	-368	490	488	-358	253	-977
(in percent of GDP)	4.8	2.1	3.1	-7.3	8.3	7.0	-5.5	1.0	-3.6
Current account (in percent of GDP)	-5.5	-5.8	-11.3	-22.2	-12.3	-4.4	-26.7	-15.9	-15.8
Merchandise trade account (in percent of GDP)	-13.7	-15.1	-20.2	-20.6	-19.2	-18.6	-28.1	-21.7	-21.9
Merchandise exports (in percent of GDP)	37.8	40.8	44.1	53.3	51.7	45.8	47.4	49.2	49.4
Merchandise imports (in percent of GDP)	-51.5	-55.9	-64.4	-73.9	-70.9	-64.4	-75.5	-70.8	-71.3
Export volume (year-on-year change)	15.2	8.8	5.3	20.0	11.9	9.6	3.7	11.4	18.1
Import volume (year-on-year change)	19.6	11.5	14.1	16.5	6.0	8.2	9.1	11.1	19.5
FDI (net) in percent of current account	187.8	137.0	127.5	67.0	168.0	260.5	79.5	106.5	77.1
Gross external debt (stock, e.o.p.) 7/	10,641	12,572	15,111	16,025	16,970	18,084	19,789	19,789	21,965
(In percent of annual GDP)	60.2	64.2	70.5	72.9	74.3	76.0	81.2	81.2	81.0
Public	7,048	6,428	5,173	4,738	4,604	4,582	4,685	4,685	4,585
Private	3,593	6,144	9,938	11,287	12,366	13,502	15,104	15,104	17,381
Short-term debt (in percent of total debt, e.o.p.)	14.3	19.3	25.4	28.3	28.7	28.7	29.3	29.3	30.3
Net external debt (in percent of annual GDP) 8/	20.9	17.5	23.2	24.0	24.7	23.0	27.2	27.2	30.5
GDP	17,663	19,570	21,448	5,019	5,875	6,959	6,523	24,376	27,124

Sources: Bulgarian authorities, and Fund staff estimates.

1/ 10%-20% of FDI inflows are assumed to be 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, 2003–07
(In millions of leva)

	2003	2004 1/	2005	2006		2007	
				Program	Est.	Budget	Proj.
Total revenue and grants	13,053	14,918	17,030	18,454	19,152	20,411	20,708
Tax revenue	10,215	11,869	13,579	14,676	15,507	16,583	16,732
Profit taxes	1,032	973	1,028	1,094	1,334	1,411	1,286
Nonfinancial enterprises	899	853	901	962	1,183	1,255	1,142
Financial enterprises	133	119	127	132	151	156	143
Income taxes	1,140	1,248	1,249	1,131	1,325	1,446	1,468
VAT	3,101	3,891	4,798	5,538	5,823	6,301	6,204
Excise and fuel duties	1,544	1,885	2,188	2,751	2,495	3,173	2,972
Customs duties	231	292	372	443	450	240	318
Social insurance contributions	2,808	3,171	3,505	3,247	3,499	3,601	3,847
Pension and unemployment contributions	2,194	2,456	2,696	2,355	2,603	2,607	2,843
Health Insurance Fund	614	715	809	892	895	993	1,004
Other taxes	359	409	440	472	581	412	637
Nontax revenues	2,527	2,595	2,935	3,090	3,010	2,740	2,889
BNB transfers	133	171	149	150	150	170	170
Other	2,394	2,424	2,786	2,940	2,859	2,570	2,719
Grants and donations	311	455	516	688	635	1,088	1,088
Total expenditure and net lending 2/	13,202	14,248	16,055	17,067	17,422	20,060	19,465
Noninterest expenditure, net lending, contingency	12,478	13,551	15,370	16,405	16,780	19,330	18,734
Current noninterest expenditure	11,199	11,943	12,883	13,991	14,114	15,592	15,122
Compensation	2,205	2,381	2,505	2,785	2,758	3,160	3,085
Wages and salaries	2,159	2,335	2,459	2,739	2,712	3,109	3,034
Scholarships	45	46	46	46	46	51	51
Maintenance and operations	2,849	3,178	3,475	3,573	3,739	4,035	3,765
Subsidies	888	869	870	592	674	937	812
Social expenditures	5,109	5,445	5,987	6,941	6,879	7,425	7,425
Pension fund	3,161	3,457	3,715	4,073	4,188	4,390	4,390
Assistance and unemployment	1,004	941	1,032	1,340	1,168	1,393	1,393
Health Insurance Fund	720	778	947	1,220	1,189	1,314	1,314
Other social expenditures 3/	224	269	293	308	334	328	328
Transfers 4/	150	71	46	100	64	35	35
Capital expenditures	1,191	1,473	2,039	2,081	2,333	2,797	2,671
Contingency	88	219	439	333	333	307	307
Enterprise restructuring	0	0	4	20	20	50	50
Budget	42	168	317	193	193	186	186
Natural disaster	46	51	118	120	120	70	70
EU budget contribution	…	…	…	…	…	634	634
Primary balance	575	1,368	1,660	2,049	2,372	1,081	1,974
Interest	724	697	686	662	643	730	730
External	561	517	494	445	450	532	532
Domestic	163	181	192	217	193	198	198
Overall balance	-149	670	974	1,387	1,730	351	1,243
Financing	149	-670	-974	-1,387	-1,730	-351	-1,243
Privatization 5/	391	1,180	1,447	293	684	274	274
External (net)	-2	-622	-2,411	-332	-934	-278	-278
Domestic (net)	-240	-1,228	-11	-1,348	-1,480	-347	-1,239
Memorandum item:							
Nominal GDP in millions of leva	34,547	38,275	41,948	46,221	47,676	51,141	53,050

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/ 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.

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

4/ As in previous budgets, the 2007 budget treats these transfers as below the line, while IMF staff treats them as above the line. For comparability, the budget column adopts staff's treatment of such transfers.

5/ 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, 2003-07
(In percent of GDP)

	2003	2004 1/	2005	2006 Program	2006 Est.	2007 Budget	2007 Proj.
Total revenue and grants	37.8	39.0	40.6	39.9	40.2	39.9	39.0
Tax revenue	29.6	31.0	32.4	31.8	32.5	32.4	31.5
Profit taxes	3.0	2.5	2.5	2.4	2.8	2.8	2.4
Nonfinancial enterprises	2.6	2.2	2.1	2.1	2.5	2.5	2.2
Financial enterprises	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Income taxes	3.3	3.3	3.0	2.4	2.8	2.8	2.8
VAT	9.0	10.2	11.4	12.0	12.2	12.3	11.7
Excise and fuel duties	4.5	4.9	5.2	6.0	5.2	6.2	5.6
Customs duties	0.7	0.8	0.9	1.0	0.9	0.5	0.6
Social insurance contributions	8.1	8.3	8.4	7.0	7.3	7.0	7.3
Pension and unemployment contributions	6.4	6.4	6.4	5.1	5.5	5.1	5.4
Health Insurance Fund	1.8	1.9	1.9	1.9	1.9	1.9	1.9
Other taxes	1.0	1.1	1.0	1.0	1.2	0.8	1.2
Nontax revenues	7.3	6.8	7.0	6.7	6.3	5.4	5.4
BNB transfers	0.4	0.4	0.4	0.3	0.3	0.3	0.3
Other	6.9	6.3	6.6	6.4	6.0	5.0	5.1
Grants and donations	0.9	1.2	1.2	1.5	1.3	2.1	2.1
Total expenditure and net lending 2/	38.2	37.2	38.3	36.9	36.5	39.2	36.7
Noninterest expenditure, net lending, contingency	36.1	35.4	36.6	35.5	35.2	37.8	35.3
Current noninterest expenditure	32.4	31.2	30.7	30.3	29.6	30.5	28.5
Compensation	6.4	6.2	6.0	6.0	5.8	6.2	5.8
Wages and salaries	6.2	6.1	5.9	5.9	5.7	6.1	5.7
Scholarships	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Maintenance and operations	8.2	8.3	8.3	7.7	7.8	7.9	7.1
Subsidies	2.6	2.3	2.1	1.3	1.4	1.8	1.5
Social expenditures	14.8	14.2	14.3	15.0	14.4	14.5	14.0
Pension fund	9.2	9.0	8.9	8.8	8.8	8.6	8.3
Assistance and unemployment	2.9	2.5	2.5	2.9	2.4	2.7	2.6
Health Insurance Fund	2.1	2.0	2.3	2.6	2.5	2.6	2.5
Other social expenditures 3/	0.6	0.7	0.7	0.7	0.7	0.6	0.6
Transfers 4/	0.4	0.2	0.1	0.2	0.1	0.1	0.1
Capital expenditures	3.4	3.8	4.9	4.5	4.9	5.5	5.0
Contingency	0.3	0.6	1.0	0.7	0.7	0.6	0.6
Enterprise restructuring	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Budget	0.1	0.4	0.8	0.4	0.4	0.4	0.4
Natural disaster	0.1	0.1	0.3	0.3	0.3	0.1	0.1
EU budget contribution	…	…	…	…	…	1.2	1.2
Primary balance	1.7	3.6	4.0	4.4	5.0	2.1	3.7
Interest	2.1	1.8	1.6	1.4	1.3	1.4	1.4
External	1.6	1.4	1.2	1.0	0.9	1.0	1.0
Domestic	0.5	0.5	0.5	0.5	0.4	0.4	0.4
Overall balance	-0.4	1.8	2.3	3.0	3.6	0.7	2.3
Financing	0.4	-1.8	-2.3	-3.0	-3.6	-0.7	-2.3
Privatization 5/	1.1	3.1	3.4	0.6	1.4	0.5	0.5
External (net)	0.0	-1.6	-5.7	-0.7	-2.0	-0.5	-0.5
Domestic (net)	-0.7	-3.2	0.0	-2.9	-3.1	-0.7	-2.3
Public debt	48.2	40.7	31.9	…	25.4	…	23.4
External	41.6	33.6	25.1	…	19.2	…	17.2
Domestic	6.5	7.0	6.8	…	6.2	…	6.2
Memorandum item:							
Nominal GDP in millions of leva	34,547	38,275	41,948	46,221	47,676	51,141	53,050

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/ 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.

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

4/ As in previous budgets, the 2007 budget treats these transfers as below the line, while IMF staff treats them as above the line. For comparability, the budget column adopts staff's treatment of such transfers.

5/ 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: Macroeconomic Framework, 2003-2011

	2003	2004	2005	2006	2007	2008	2009	2010	2011
				Est.			Projections		
GDP and prices (annual percent change)									
Real GDP	4.5	5.7	5.5	6.2	6.0	6.0	6.0	6.0	6.0
GDP deflator	2.3	4.8	3.8	7.1	5.0	2.9	2.8	2.8	2.8
CPI (end of period)	5.6	4.0	6.5	6.5	4.2	3.3	3.5	3.5	3.5
(period average)	2.3	6.1	5.0	7.3	4.9	3.5	3.4	3.5	3.5
Monetary aggregates (annual percent change)									
Broad money (nominal, end of period)	20.9	21.6	27.7	28.3	21.4	14.8	13.2	12.5	12.1
Claims on non-government (nominal, end of period)	48.3	48.7	32.4	24.6	28.0	23.0	20.0	17.5	16.0
Saving and investment (in percent of GDP)									
Foreign saving 1/	10.6	11.6	17.1	19.3	19.5	18.6	17.3	16.4	14.3
Gross national saving	16.2	17.7	16.7	15.3	17.5	18.9	20.6	22.1	23.0
Gross domestic saving 2/	11.1	11.9	10.9	11.9	13.7	15.0	16.8	18.4	20.2
Government	4.6	7.0	8.4	9.5	8.4	8.1	8.1	8.8	8.3
Non-government	6.5	4.9	2.5	2.4	5.4	6.9	8.7	9.6	11.9
Gross domestic investment	21.7	23.5	28.0	31.2	33.2	33.7	34.1	34.7	34.6
Government	3.4	3.8	4.9	4.9	5.0	5.7	6.3	7.3	7.0
Non-government	18.3	19.6	23.1	26.3	28.2	28.0	27.8	27.5	27.5
General government (in percent of GDP)									
Revenue	37.8	39.0	40.6	40.2	39.0	39.6	40.0	40.2	39.7
Non-interest expenditure	36.1	35.4	36.6	35.2	35.3	36.9	38.0	38.5	38.1
Primary balance	1.7	3.6	4.0	5.0	3.7	2.8	2.0	1.8	1.6
Interest payments	2.1	1.8	1.6	1.3	1.4	1.3	1.2	1.1	1.1
Overall balance	-0.4	1.8	2.3	3.6	2.3	1.4	0.8	0.6	0.5
Total public debt	48.2	40.7	31.9	25.4	23.4	22.8	22.0	20.7	19.3
Of which : External	41.6	33.6	25.1	19.2	17.2	16.5	15.5	14.3	12.8
Balance of payments (in percent of GDP)									
Current account	-5.5	-5.8	-11.3	-15.9	-15.8	-14.7	-13.5	-12.6	-11.5
Trade balance	-13.7	-15.1	-20.2	-21.7	-21.9	-21.5	-20.3	-20.0	-18.2
Exports	37.8	40.8	44.1	49.2	49.4	50.2	51.5	52.4	53.8
Imports	51.5	55.9	64.4	70.8	71.3	71.7	71.8	72.5	72.1
Services, net	3.1	3.5	3.2	2.4	2.4	2.9	3.0	3.7	3.9
Receipts	15.4	16.7	16.2	16.0	15.7	15.6	15.4	15.7	15.6
Payments	12.3	13.1	13.1	13.6	13.4	12.7	12.4	12.1	11.7
Income, net	1.6	1.2	1.1	0.1	0.3	-0.2	-0.8	-1.3	-1.7
Transfers, net	3.5	4.6	4.6	3.3	3.4	4.0	4.6	5.0	4.5
Memorandum items									
Gross official reserves (in millions of euros)	5,405	6,854	7,370	8,926	9,302	10,198	10,641	10,927	11,070
(in months of prospective imports of GNFS)	4.8	5.0	4.2	4.6	4.4	4.5	4.3	4.1	...
External debt/GDP (in percent)	60.2	64.2	70.5	81.2	81.0	82.0	81.6	81.0	80.2
External debt/exports of GNFS (in percent)	113.2	111.8	116.7	124.6	124.3	124.6	121.9	118.8	115.5
External debt service/exports of GNFS (in percent)	14.0	21.6	42.4	19.3	8.3	8.8	9.7	10.2	11.6
Export volume (year-on-year change)	15.2	8.8	5.3	11.4	18.1	14.4	14.5	13.0	13.1
Import volume (year-on-year change)	19.6	12.3	12.0	11.1	19.5	12.4	11.6	11.8	9.5
Terms of trade (percent change)	-0.3	2.7	-0.1	3.6	1.1	-0.7	-0.3	-0.2	-0.1
Nominal GDP (in millions of leva)	34,547	38,275	41,948	47,676	53,050	57,864	63,053	68,708	74,869
Nominal GDP (in millions of euros)	17,663	19,570	21,448	24,376	27,124	29,585	32,239	35,130	38,280

Sources: Bulgarian authorities; and Fund staff projections.

1/ Net imports of goods and nonfactor services.

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

Table 9. Bulgaria: Balance of Payments, 2003-2011
(In millions of euros)

	2003	2004	2005	2006	2007	2008	2009	2010	2011
					Projections				
CURRENT ACCOUNT	-973	-1,132	-2,427	-3,878	-4,276	-4,360	-4,347	-4,426	-4,414
Trade balance	-2,426	-2,954	-4,343	-5,285	-5,935	-6,358	-6,553	-7,029	-6,973
Exports (f.o.b.)	6,668	7,985	9,466	11,983	13,397	14,864	16,600	18,425	20,611
y-o-y change (in percent)	10.0	19.7	18.6	26.6	11.8	11.0	11.7	11.0	11.9
Imports (f.o.b.)	-9,094	-10,938	-13,809	-17,268	-19,332	-21,222	-23,153	-25,454	-27,584
y-o-y change (in percent)	14.5	20.3	26.2	25.0	12.0	9.8	9.1	9.9	8.4
Services, net	553	692	678	580	646	850	980	1,283	1,492
Exports of NFS	2,729	3,262	3,483	3,897	4,268	4,607	4,969	5,531	5,973
Imports of NFS	-2,176	-2,569	-2,805	-3,317	-3,622	-3,757	-3,989	-4,249	-4,482
Of which: Exports of travel services	1,500	1,789	1,955	2,062	2,300	2,515	2,740	3,162	3,445
Income, net	288	238	246	16	78	-49	-245	-444	-637
Of which: Income to direct investors	-493	-609	-536	-763	-954	-1,049	-1,257	-1,451	-1,634
Current transfers, net	613	891	993	811	935	1,197	1,471	1,763	1,704
CAPITAL AND FINANCIAL ACCOUNT	1,754	2,669	3,110	5,420	4,741	5,346	4,849	4,733	4,557
Capital transfers, net	0	0	-1	0	0	0	0	0	0
Foreign direct investment, net 1/ 2/	1,827	1,550	3,093	4,132	3,299	3,272	3,042	2,810	2,575
Of which: Privatization receipts 3/	312	243	693	205	140	100	0	0	0
Portfolio investment, net	-191	-564	-1,358	6	-247	0	0	0	0
Other investment, net	840	2,047	1,108	600	1,689	2,074	1,807	1,923	1,982
General government	60	102	19	-304	86	282	231	86	-64
Domestic banks	562	1,029	-198	-990	-232	534	566	483	414
Other private sector	219	915	1,287	1,894	1,836	1,258	1,011	1,354	1,632
Errors and omissions	-722	-364	267	683	0	0	0	0	0
OVERALL BALANCE	781	1,538	684	1,786	465	986	502	306	143
FINANCING	-781	-1,538	-684	-1,785	-465	-986	-502	-306	-143
Gross international reserves (increase: -)	-817	-1,493	-324	-1,506	-375	-897	-443	-287	-143
Use of Fund credit, net	35	-44	-359	-279	-90	-90	-60	-20	0
Purchases	128	62	0	0	0	0	0	0	0
Repurchases 4/	-101	-106	-359	-279	-90	-90	-60	-20	0
Exceptional financing	0	0	0	0	0	0	0	0	0
MEMORANDUM ITEMS									
Gross international reserves (stock, e.o.p.) 5/	5,405	6,854	7,370	8,926	9,302	10,198	10,641	10,927	11,070
In months of prospective GNFS imports	4.8	5.0	4.3	4.6	4.4	4.5	4.3	4.1	...
In percent of short-term debt (original maturity)	354.5	282.4	191.7	150.6	137.1	129.7	120.3	110.8	101.0
Current account + FDI	854	418	667	253	-977	-1,088	-1,305	-1,616	-1,839
(in percent of GDP)	4.8	2.1	3.1	1.0	-3.6	-3.7	-4.0	-4.6	-4.8
Current account (in percent of GDP)	-5.5	-5.8	-11.3	-15.9	-15.8	-14.7	-13.5	-12.6	-11.5
Merchandise trade account (in percent of GDP)	-13.7	-15.1	-20.2	-21.7	-21.9	-21.5	-20.3	-20.0	-18.2
Merchandise exports (in percent of GDP)	37.8	40.8	44.1	49.2	49.4	50.2	51.5	52.4	53.8
Merchandise imports (in percent of GDP)	-51.5	-55.9	-64.4	-70.8	-71.3	-71.7	-71.8	-72.5	-72.1
Export volume (year-on-year change)	15.2	8.8	3.5	11.4	18.1	14.4	14.5	13.0	13.1
Import volume (year-on-year change)	19.6	11.5	10.9	11.1	19.5	12.4	11.6	11.8	9.5
FDI (net) in percent of current account	187.8	137.0	127.5	106.5	77.1	75.0	70.0	63.5	58.3
Gross external debt (stock, e.o.p.) 6/	10,641	12,572	15,111	19,789	21,965	24,261	26,298	28,471	30,704
(In percent of GDP)	60.2	64.2	70.5	81.2	81.0	82.0	81.6	81.0	80.2
Public	7,048	6,428	5,173	4,685	4,585	4,783	4,901	4,905	4,779
Private	3,593	6,144	9,938	15,104	17,381	19,478	21,397	23,566	25,924
Short-term debt (in percent of total debt, e.o.p.)	14.3	19.3	25.4	29.3	30.3	32.0	33.4	34.5	35.7
Net external debt (in percent of annual GDP) 7/	20.9	17.5	23.2	27.2	30.5	32.7	35.0	37.5	39.8
GDP	17,663	19,570	21,448	24,376	27,124	29,585	32,239	35,130	38,280

Sources: Bulgarian authorities, and Fund staff estimates.

1/ 10%-20% of FDI inflows are assumed to be 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 r of impaired reserves.

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

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

Table 10. 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
I. Floor on the overall fiscal surplus of the general government								
Original Target	198	383	605	417	256	786	1,099	1,387
Adjusted Target 3/	277	556	914	943	256	858	1,282	…
Actual 4/	486	1,081	1,378	974	398	1,359	2,045	…
Margin (actual less adjusted target)	209	525	464	31	142	501	763	…
II. Ceiling on central government arrears 4/								
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	7.3	4.6	…
Margin	-0.7	0.5	0.8	0.2	0.3	-2.3	0.4	…
III. Ceiling on the wage bill of the selected SOEs 4/								
Target	95.0	189.9	284.9	379.9	89.2	178.4	267.7	356.9
Adjusted Target 5/	92.7	184.3	275.4	366.1	89.2	176.5	253.7	…
Actual	84.4	168.6	253.5	340.1	83.7	166.8	240.6	…
Margin	8.3	15.7	21.9	26.0	5.5	11.6	13.1	…
IV. Ceiling on the contracting or guaranteeing of nonconcessional external public debt 6/								
(i) 1 year and less than 3 years								
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
(ii) Over 1 year								
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
Margin	38.0	229.8	229.8	75.7	293.0	0	74.6	203.3
(iii) 1-5 years								
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 target is 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/ SOEs that have been privatized or ceased operations will be excluded from the list for the respective test dates.
6/ In millions of euro. Cumulative change from December 31, 2004 for 2005 performance criteria and December 31, 2005 for 2006 performance criteria.

Table 11. Bulgaria: Observance in 2006 of Structural Conditionality Under the Stand-By Arrangement 1/

	Type and date due 2/	Notes
Conditionality Met		
1. Promulgation of operational regulations for the new electronic business registry.	PA	The operational regulations have been approved by the Minister of Justice and are expected to be published on the web site of the Registry Agency.
2. Signing of all critical IT contracts for the new electronic business registry.	PA	Three were signed and the fourth one regarding System Integrator is expected to be signed by March 8, 2007.
3. Approval by parliament of a law on supplementary supervision of financial conglomerates.	SB, September 5, 2006	The law was approved on July 7, 2006.
4. Approval by parliament of a new law on credit institutions, to allow implementation of Basel II.	SB, September 30, 2006	The law was approved on July 13, 2006.
5. Implementation of employment cuts of at least 5,500 positions in the education sector.	SB, September 30, 2006	Slightly more than 5500 positions had been cut by September 30, 2006.
6. Approval by the Council of Ministers of the system of school financing based on the unified per student standards.	SB, October 31, 2006	The system of school financing was approved by the CoM together with the approval of the 2007 draft state budget law on October 30, 2006.
7. Establishment of a register which covers all municipal borrowing and is ready to receive data.	SPC, December 31, 2006	The Municipal Debt Register has been established for all 264 municipalities which have been registered and authorized in the system.
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.	SB, December 31, 2006	An agreement was reached in September 2006. On 11 January, 2007 the CoM formalized the agreement by adopting a regulation on the structure and organization of the working salary that becomes effective July 1, 2007. The regulation provides for the removal of the automatic portability of seniority bonuses and allows different firms to set their own specific seniority bonuses based on limits set by collective labor agreements.
9. Initiate the legal procedure for the closure of the Public Investment Projects company (PIP).	SB, December 31, 2006	In December 2006, the Minister of Finance signed a protocol for the closure of PIP by way of liquidation. The CoM announced the liquidation procedure on December 29, 2006. The process is expected to be finalized within seven months.
Conditionality Not Met (Implemented Partially, or with Delay)		
1. Approval by parliament of new CIT and PIT laws.	SB, July 31, 2006	The new PIT law was approved by parliament on November 9, 2006 and the new CIT law - on December 14, 2006.
2. Approval by parliament of an amendment to the Health Insurance Law as detailed in paragraph 6, bullet 3 of TSMEFP.	SB, August 31, 2006	Of the three amendments to the Health Insurance Law two were approved by the parliament together with the 2007 NHIF budget law on 14 December, 2006. The third one was only partially implemented insofar as only control procedures, rather than sanctions, were included in the law.
3. Selection of winning bids for the western and eastern plants of Ruse district heating company.	SPC, October 31, 2006	Thermo-Electric Power Plant (TPP) "Ruse - West" was sold on September 15, 2006. The winning bidder for the Ruse District Heating Company was selected on December 7, 2006.
4. New integrated tax and social security software system for the NRA to be fully operational.	SB, December 31, 2006	The critical functionality of the software system was introduced in December 2006. Eight modules became operational from the beginning of 2007. The remaining five non-core functional modules are expected to become operational during 2007.
Conditionality Not Met		
1. Acceptance of new company registrations by the new business register established by legislation enacted on April 25, 2006.	SPC, October 1, 2006	The start-up of the business registry was delayed by parliament until July 1, 2007.

1/ Details of the performance criteria and benchmarks are included in the Annexes to the Third Supplementary Memorandum of Economic and Financial Policies, IMF Country Report No. 06/298.
2/ SPC denotes structural performance criterion, SB denotes structural benchmark, and PA denotes prior action.

Table 12. 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 16, 2007	3.66	0.57	Observance of end-December 2006 performance criteria
Total	**100.00**	**15.62**	

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 13. Bulgaria: Capacity to Repay the Fund, 2003-2010 1/

	2003	2004	2005	2006	2007	2008	2009	2010
Fund repurchases and charges								
In millions of SDRs 2/	94.8	110.5	325.4	251.7	93.6	90.9	97.9	70.7
In millions of euros	117.5	131.4	389.5	295.7	108.8	105.4	113.3	81.7
In percent of exports of goods and NFS	1.2	1.2	3.0	1.9	0.6	0.5	0.5	0.3
In percent of total debt service	8.9	5.4	7.2	11.7	9.7	8.0	6.7	4.1
In percent of quota	14.8	17.3	50.8	39.3	14.6	14.2	15.3	11.1
In percent of gross international reserves	2.2	1.9	5.3	3.3	1.2	1.0	1.1	0.7
Fund credit outstanding								
In millions of SDRs	799.2	762.0	461.8	226.6	248.2	169.7	79.9	12.5
In millions of euros	954.1	875.4	557.5	266.2	288.4	196.8	92.5	14.4
In percent of exports of goods and NFS	10.1	7.7	4.3	1.7	1.6	1.0	0.4	0.1
In percent of quota	124.8	119.0	72.1	35.4	38.8	26.5	12.5	2.0
In percent of gross international reserves	17.7	12.8	7.6	3.0	3.1	1.9	0.9	0.1
Memorandum items:								
Exports of goods and NFS (in millions of euros)	9,458.7	11,346.7	12,949.2	15,879.8	17,664.5	19,471.0	21,569.3	23,956.2
Debt service (in millions of euros)	1,315.4	2,428.5	5,397.3	2,520.6	1,123.7	1,315.4	1,699.3	1,969.3
Quota (in millions of SDRs)	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	772.9	751.9	743.8	742.4	741.2	739.5
Gross international reserves (in millions of euros)	5,405.0	6,854.2	7,370.3	8,926.4	9,301.6	10,198.2	10,640.7	10,927.4
Euros per SDR (period avg)	1.24	1.19	1.19	1.17	1.16	1.16	1.16	1.16
Euros per SDR (eop)	1.19	1.15	1.21	1.16	1.16	1.16	1.16	1.15

Source: Fund staff calculations.

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

2/ Projections are based on actual repurchases through end-December 2006 and expectations basis thereafter.

Table 14. Bulgaria: Financial Relations with the Fund, 2000-2010 1/

	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 2/											
Repurchases	105.3	236.2	195.2	76.6	89.2	300.1	235.2	78.4	78.4	52.3	17.4
Charges and interest	33.8	36.7	18.1	18.2	21.3	25.3	16.5	11.2	6.9	2.9	0.6
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
Expectations schedule 2/											
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	16.5	11.8	6.9	2.9	0.6
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-December 2006 and obligations basis thereafter.

2/ Assumes purchases are not made under the current precautionary arrangement.

Table 15. Bulgaria: External Debt Sustainability Framework, 2002-2012
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	65.1	60.2	64.2	70.5	81.2	**81.0**	**82.0**	**81.6**	**81.0**	**80.2**	**81.2**	**-9.6**
Change in external debt	-13.4	-4.9	4.0	6.2	10.7	-0.2	1.0	-0.4	-0.5	-0.8	1.0	
Identified external debt-creating flows (4+8+9)	-11.3	-16.4	-8.7	3.4	-0.4	2.0	0.4	0.5	1.1	1.2	2.5	
Current account deficit, excluding interest payments	0.1	3.2	3.7	9.9	13.4	13.9	12.7	11.3	10.3	9.2	9.2	
Deficit in balance of goods and services	-103.3	-107.6	-117.3	-144.8	-142.2	-149.6	-150.0	-150.7	-152.2	-152.6	-154.5	
Exports	47.8	48.9	53.3	63.4	61.9	65.0	65.7	66.7	67.9	69.2	70.4	
Imports	-55.5	-58.7	-64.0	-81.4	-80.3	-84.5	-84.3	-84.0	-84.2	-83.4	-84.1	
Net non-debt creating capital inflows (negative)	-3.7	-7.2	-3.3	-2.6	-6.8	-9.5	-9.9	-8.4	-7.0	-5.9	-4.7	
Automatic debt dynamics 1/	-7.8	-12.3	-9.1	-4.0	-7.1	-2.4	-2.4	-2.4	-2.2	-2.1	-2.0	
Contribution from nominal interest rate	2.3	1.9	1.7	1.7	1.9	1.7	2.0	2.1	2.2	2.3	2.4	
Contribution from real GDP growth	-3.3	-2.3	-2.8	-3.2	-3.7	-4.1	-4.4	-4.5	-4.5	-4.4	-4.4	
Contribution from price and exchange rate changes 2/	-6.8	-12.0	-8.0	-2.5	-5.3	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-2.1	11.5	12.7	2.9	11.1	-2.2	0.7	-0.9	-1.6	-2.0	-1.6	
External debt-to-exports ratio (in percent)	136.3	123.1	120.5	111.1	131.1	124.5	124.8	122.2	119.3	116.0	115.3	
Gross external financing need (in billions of US dollars) 4/	2.4	3.3	5.0	10.8	12.0	14.1	15.6	17.2	18.8	20.7	23.4	
in percent of GDP	14.3	15.0	19.2	42.4	37.3	37.5	38.0	38.3	38.2	38.2	39.3	
Scenario with key variables at their historical averages 5/						**81.0**	**75.5**	**68.9**	**62.3**	**55.9**	**50.4**	**-8.5**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.9	4.5	5.7	5.5	6.0	6.0	6.0	6.0	6.0	6.0	6.0	
GDP deflator in US dollars (change in percent)	9.4	22.5	15.2	4.0	8.1	10.1	3.3	3.2	3.4	3.7	3.7	
Nominal external interest rate (in percent)	3.4	3.8	3.4	3.0	3.0	2.5	2.7	2.9	3.0	3.2	3.3	
Growth of exports (US dollar terms, in percent)	10.3	32.1	31.6	15.4	23.6	16.6	10.6	11.2	11.7	11.9	12.0	
Growth of imports (US dollar terms, in percent)	8.7	36.4	31.8	23.2	24.9	16.9	9.2	9.1	10.1	8.9	10.8	
Current account balance, excluding interest payments	-0.1	-3.2	-3.7	-9.9	-13.4	-13.9	-12.7	-11.3	-10.3	-9.2	-9.2	
Net non-debt creating capital inflows	3.7	7.2	3.3	2.6	6.8	9.5	9.9	8.4	7.0	5.9	4.7	

1/ Derived as [r - g - ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar
rms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as [-ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock. ρ increases with an appreciating domestic
ırrency (e > 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 real GDP growth; nominal interest rate; dollar 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, dollar deflator growth, and non-debt inflows in percent of
DP) 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						
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	69.9	56.3	48.2	40.7	31.9	**25.4**	**23.4**	**22.8**	**22.0**	**20.7**	**19.3**	**0.8**
o/w foreign-currency denominated	66.1	51.6	43.9	35.8	27.2	20.9	18.7	17.8	16.7	15.0	13.4	
Change in public sector debt	-7.2	-13.7	-8.1	-7.5	-8.7	-6.5	-2.0	-0.7	-0.7	-1.4	-1.4	
Identified debt-creating flows (4+7+12)	-5.5	-10.7	-10.7	-10.7	-2.4	-6.6	-2.8	-1.3	-0.5	-0.6	-0.7	
Primary deficit	-2.8	-1.4	-1.7	-3.6	-4.0	-5.0	-3.7	-2.8	-2.0	-1.8	-1.6	
Revenue and grants	37.6	36.4	37.8	39.0	40.6	40.2	39.0	39.6	40.0	40.2	39.7	
Primary (noninterest) expenditure	34.7	35.0	36.1	35.4	36.6	35.2	35.3	36.9	38.0	38.5	38.1	
Automatic debt dynamics 2/	-3.6	-11.2	-10.1	-6.3	2.5	-2.5	-1.2	-0.6	-0.7	-0.7	-0.6	
Contribution from interest rate/growth differential 3/	-4.0	-3.5	-1.5	-2.9	-1.9	-2.5	-1.2	-0.6	-0.7	-0.7	-0.6	
Of which contribution from real interest rate	-1.1	-0.3	0.8	-0.4	0.1	-0.8	0.2	0.7	0.6	0.5	0.5	
Of which contribution from real GDP growth	-2.8	-3.1	-2.3	-2.5	-2.1	-1.7	-1.4	-1.3	-1.3	-1.2	-1.1	
Contribution from exchange rate depreciation 4/	0.4	-7.8	-8.6	-3.4	4.5	...	...	...	...	...	...	
Other identified debt-creating flows	0.9	1.9	1.1	-0.8	-1.0	0.8	2.2	2.1	2.2	1.8	1.5	
Privatization receipts (negative)	-2.9	-1.3	-1.1	-3.1	-3.4	-1.4	-0.5	-0.3	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	3.8	3.2	2.2	2.3	2.4	2.3	2.7	2.5	2.2	1.8	1.5	
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	
Residual, including asset changes (2-3) 5/	-1.7	-3.0	2.6	3.2	-6.3	0.1	0.8	0.6	-0.2	-0.8	-0.7	
Public sector debt-to-revenue ratio 1/	186.1	154.5	127.5	104.3	78.6	63.3	60.1	57.5	55.1	51.4	48.6	
Gross financing need 6/	7.7	5.9	4.1	4.3	7.2	-0.1	0.4	0.4	0.8	1.0	0.8	
in billions of U.S. dollars	1.0	0.9	0.8	1.1	1.9	0.0	0.2	0.1	0.4	0.5	0.4	
Scenario with key variables at their historical averages 7/						**25.4**	**23.4**	**21.4**	**18.7**	**15.2**	**11.6**	**1.2**
Scenario with no policy change (constant primary balance) in 2006-2011						**25.4**	**22.2**	**19.3**	**15.8**	**11.4**	**7.0**	**1.3**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.1	4.9	4.5	5.7	5.5	6.2	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	4.8	6.0	6.1	5.8	5.6	5.6	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-1.4	-0.3	1.7	-0.6	0.6	-2.3	1.0	3.2	3.0	2.8	2.8	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-0.6	14.1	20.7	9.1	-11.6	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	6.7	3.8	2.3	4.8	3.8	7.1	5.0	2.9	2.8	2.8	2.8	
Growth of real primary spending (deflated by GDP deflator, in percent)	1.3	5.7	7.7	3.7	9.2	2.0	6.3	10.7	9.1	7.4	5.0	
Primary deficit	-2.8	-1.4	-1.7	-3.6	-4.0	-5.0	-3.7	-2.8	-2.0	-1.8	-1.6	

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 $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
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 $\alpha\varepsilon(1+r)$.
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 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.

APPENDIX I: BULGARIA: FUND RELATIONS

As of January 31, 2007

Mission: Sofia, December 13-19, 2006. A press conference was held at the conclusion of the mission.

Staff team: Messrs. Hagemann (Head), Duenwald, Herderschee and Klemm (EUR), and Ms. Rahman (PDR). The mission was assisted by Mr. Fernandez-Ansola (Senior Regional Resident Representative) and Mr. Kostov (Economist, IMF Office in Sofia).

Country Interlocutors: the Prime Minister; the Deputy Prime Minister and Minister of Education; the Minister of Finance, the Governor of the Bulgarian National Bank; the Minister of Economy and Energy; the Minister of Labor and Social Affairs; the Minister of Health; the Deputy Minister of Justice; the National Revenue Agency; the Chairman of the Parliamentary Budget and Finance Committee; the Financial Supervision Commission; representatives of the Bulgarian Bankers Association; and trade union representatives.

Fund Relations: The 2006 Article IV Consultation was concluded on August 2, 2006, at which time the Third Review under the Stand-By Arrangement was completed, and a six-month extension of the arrangement (to end-March 2007) was approved. Bulgaria has accepted the obligations under Article VIII.

Statistics: Bulgaria subscribes to the Fund's Special Data Dissemination Standard, and comprehensive data are available on a timely basis.

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

II.	**General Resources Account:**	SDR million	Percent Quota
	Quota	640.20	100.00
	Fund holdings of currency	833.70	130.23
	Reserve position in Fund	33.14	5.18

III.	**SDR Department:**	SDR million	Percent Allocation
	Holdings	4.11	N/A

IV. **Outstanding Purchases and Loans:**

	SDR million	Percent Quota
Stand-by Arrangements	0	0
Extended Arrangements	226.63	35.40

V. **Financial Arrangements:**

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
Stand-by	08/06/2004	03/31/2007	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. **Projected Payments to Fund:** (SDR million; based on existing use of resources and present holdings of SDRs):[1]

	Forthcoming				
	2007	2008	2009	2010	2011
Principal	78.45	78.45	52.30	17.43	
Charges/Interest	11.05	6.86	2.91	0.58	
Total	89.50	85.31	55.21	18.02	

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, 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.

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[1] On expectation basis.

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 August 2, 2006 (see IMF Country Report No. 06/298). The Acting Chairman's summing-up of the discussion was circulated as SUR/06/84. Bulgaria is on a 12-month cycle.

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.

XII. **Resident Representative:**

Mr. Juan Jose Fernandez-Ansola is the Senior Regional Resident Representative, based in Bucharest. He took up the position on September 4, 2006.

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.	8/7/2002	IMF Country Report No. 02/172
ROSC – Monetary and financial policy transparency, banking supervision, securities regulation, insurance regulation, and payment systems	7/15/2002	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	3/8/2001	www.imf.org
ROSC – Data dissemination, fiscal transparency, transparency of monetary policy, banking supervision, system of deposit insurance, insurance supervision, securities market supervision	3/17/2000	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	8/27/1999	www.imf.org

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
MFD/LEG	Secuities settlement system/legislation	Mission	Oct.-Nov.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-Uup Mission	Mission	Apr. 02	MOF
FAD	Tax Administration	Expert	Sep.–Oct. 02	MOF
FAD	Budget General: Inspection	Expert	Jan. 03	MOF
FAD	Tax Administration-Installation Visit	Expert	Mar.03	MOF
FAD	Tax Administration	Expert	Mar.–Apr. 03	MOF
FAD	Public Expenditure Management	Expert	Apr–Sep. 03	MOF
FAD	Tax Administration	Mission	Apr. 04–May. 04	MOF
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 to enhance productivity.

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. In August 2006 the program was extended by six months to March 2007.

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 FY07-09. In addition to the Bank's ongoing lending operations in areas such as health, child welfare, water, trade and transport, and environment, the CPS includes a three-year program of three development policy loans (DPLs) of up to US$150 million each that will support institutional reforms in the social sectors and build on the three-year Programmatic Adjustment Loan (PAL) program successfully completed in 2005. In addition, the CPS program includes a pipeline of investment lending in road and municipal infrastructure, trade and transport facilitation for South East Europe, social inclusion, and 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 and 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 estimated at 3.5 percent of GDP in 2006. The aim is to sustain the surplus in 2007, conduct fiscal policy flexibly in the face of shocks, and maintain a high level of fiscal reserve assets. Given the constraints of the CBA, labor market policies are another key component of the Government's economic 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 market economy that is competitive and can flexibly adjust to shocks.

6. In the context of a Stand-By Arrangement that expires in March 2007, the IMF continues to lead in assisting Bulgaria to safeguard macroeconomic stability and promote sustainable high growth through 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 used as 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 the PAL program, the Bank has supported the government in 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 supported 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 led to the Revenue Administration Reform Project (€31.9 million), approved by the Bank's Board in 2000, under which the new National Revenue Agency became operational on January 1, 2006. Tax administration has dramatically improved, with revenue increasing by 4.5 percentage points of GDP and VAT and corporate income tax compliance increasing by 9.8 and 4.5 percentage points, respectively, during 2002-2005. The project also aims to 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[1] of 2002, and the Public Finance Policy Review[2] of 2006.

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 further broaden the reform effort by preparing capital expenditure proposals under hard budget constraints and as an integral part of the medium-term budget frameworks; and strengthening the financial management at the local level.

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 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, the PALs, and the analytical work done for the Poverty Assessment, the PEIR, the Inter-governmental Finance study[3], and the Public Finance Policy Review. Under PAL-2 the

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

[2] *Bulgaria: Public Finance Policy Review – Leveraging EU Funds for Productivity and Growth*, February 2006, The World Bank (Report No. 33992-BG)

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

government developed a concept for an education reform strategy and action plan, the implementation of which was supported through PAL-3. The first DPL, which is scheduled for approval by the Bank's Board in March 2007, will support significant deepening of education reforms, in particular strengthening of the institutional capacity of the Ministry of Education and Sciences to assess the impact of curricular and other reforms on the quality of education, and governance and financing reform of the municipal school network involving the introduction of a per capita funding formula and progressive devolution of responsibilities to local and school levels.

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 National Health Insurance Fund (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 2000 is under implementation and focuses on the administrative and information systems of the NHIF, and supports the ambulatory care and hospital sectors. Building on the PAL agenda, which included hospital restructuring, the planned first DPL will support stabilization measures to control public spending on health and the introduction of changes in the pharmaceutical sector aimed at increasing efficiency in the commercialization of new drugs, increasing access to basic drugs to underserved groups of the population, and restoring financial balance to the NHIF.

15. **Social protection programs.** Social protection programs—pensions, labor market programs, social assistance, and short-term and family benefits—have a wide coverage among the population. The IMF has been 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. The Bank's planned first DPL will support an employment promotion program, which includes interventions to alter incentives both on the labor supply and the labor demand sides. These interventions include: (i) amendments to the Labor Code to increase flexibility of working time and fixed-term and part-time contracts; (ii) amendments to the Social Insurance Code to lower the contribution rate for pension insurance by 6 percentage points from 29 to 23 percent; and (iii) amendments to the Employment Promotion Act to introduce a monthly bonus for unemployed recipients of social assistance who find employment at their own initiative. To create additional incentives for job searching and lower reliance of able-bodied individuals on social welfare programs, the government will change eligibility criteria of some social assistance programs. The DPL series will support the impact evaluation of these changes and further reforms based on the results of the evaluation.

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 2002

Poverty Assessment contributed 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 assisted several of these important reforms with grants amounting to US$2.2 million, focusing on poverty monitoring and evaluation, integration of ethnic minorities, child development and building social capital in disadvantaged communities. A Bank-financed Social Investment and Employment Promotion (SIEP), which supports community and employment creation and strengthening of active labor market policies, was approved in 2002. The Bank has now embarked on a multi-year poverty monitoring program aimed at assessing the impact of government policies and economic growth on the poor. This work will also provide a feedback loop so that policy adjustments can be made as appropriate to take account of findings. In addition, the Bank and government are preparing a Social Inclusion Loan aimed at making early childhood education available to low-income families, including and in particular, ethnic minorities, to address longer term constraints to social inclusion. This loan, as well as planned additional financing under SIEP, are aimed at facilitating the government's absorption of grants from the European Social Fund.

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.

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 and PALs, and 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; and 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,**[4] 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 IBRD operations with a total original commitment of US$2,137 million equivalent**, consisting of 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, 29 have been completed, of which eleven have been partially cancelled during implementation, and 9 operations are currently under implementation (see Table 1 below).

Table 1. Bulgaria—Active World Bank Operations (Net of Cancellations)

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

4 "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 Bulgari*a*", May 31, 2006.

22. **Economic and sector work.** The country diagnostic work recently completed by the Bank includes a Country Economic Memorandum addressing policy reforms for growth and successful EU integration, and a Public Finance Review focused on leveraging EU structural funds for productivity and growth. Various pieces of country diagnostic work now under way include a Second Public Finance Review focusing on competitiveness, a regional development study, poverty monitoring, a regulatory impact assessment, an investment climate assessment, and a justice sector expenditure review.

23. **IFC, as of January 2007, has 13 projects in its portfolio with total commitments of US$237 million for its own account and an additional US$69 syndicated from partner banks.** In the financial sector, IFC has supported two specialized SME banks, established Bulgaria's first micro lending bank, and has invested in a venture capital fund that also targets the SME sector. IFC has invested in a number of key manufacturing projects to support a cement plant modernization, the expansion and modernization of an electronic assembly facility, the rehabilitation and capacity increase of a wood panel production facility, revamping of a copper processing facility, and a project in retail sector to establish discount stores, hypermarkets and distribution centers in the country. As a good example of South-South investments, IFC has committed about US$90 million to support post-privatization restructuring of a steel mill and two glass processing plants.

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 has worked with the General Data Dissemination System (GDDS). 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

3. The National Statistical Institute (NSI), with technical assistance from the OECD, has established a system to compile national accounts according to the recommendations of the *System of National Accounts 1993* (*SNA 1993*) and 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.

4. 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*).

5. 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.

6. The consumer price index (CPI) provides a reasonable measure of inflation and price developments in Bulgaria. The recommendations provided by STA missions have been broadly implemented. The NSI has completed the exercise to link annual Laspeyres price indices together, producing a time series that begins in 1995. This series also follows the new classifications and index methods recommended by Eurostat and STA, and has been published as the official CPI. The coverage of the index was extended, although it still 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).

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

8. 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 excludes 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.

9. 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

10. 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 2006*, 2005 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

11. 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 earl 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

12. Bulgaria reports monthly balance of payments data on a regular and timely basis, but data are subject to large and frequent revisions, often going several years back. Particularly, data on reinvested earnings by foreign-owned companies are subject to large revisions due to incomplete responses on surveys used for preliminary estimates including, in part, the omission of the largest firms. The most recent revisions relate to the 2004 data on reinvested earnings. 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. The authorities are taking measures to address these problems.

Table 1. Bulgaria: Common Indicators Required for Surveillance

As of February 15, 2007

	Date of latest observation	Date received	Frequency of data[6]	Frequency of reporting[6]	Frequency of publication[6]	Memo Items:	
						Data Quality – Methodological soundness[7]	Data Quality Accuracy and reliability[8]
Exchange Rates	Jan 2006	2/2/2007	D and M	D and M	D and M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Dec 2006	1/31/2007	M	W	D		
Reserve/Base Money	Dec 2006	1/31/2007	W/M	M	D and M	O, O, LO, LO	O, O, O, O, O
Broad Money	Dec 2006	1/31/2007	W/M	M	W/M		
Central Bank Balance Sheet	Dec 2006	1/31/2007	W/M	W/M	W and M		
Consolidated Balance Sheet of the Banking System	Dec 2006	1/31/2007	M	M	M		
Interest Rates[2]	Dec 2006	1/18/2007	W and M	W and M	W and M		
Consumer Price Index	Jan 2007	2/12/2007	M	M	M	O, LO, O, O	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2006	1/31/2007	A	A	A	O, LO, O, LO	LO, O, O, O, NO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Dec 2006	1/31/2007	M	M	M		
Stocks of General Government and General Government-Guaranteed Debt[5]	Dec 2006	1/29/2007	M	M	M		
External Current Account Balance	Dec 2006	2/13/2007	M	M	M	LNO, LO, O, LO	LNO, LNO, LNO, LO, LO
Exports and Imports of Goods and Services	Dec 2006	2/13/2007	M	M	M		
GDP	2006 Q3 (Quarterly); 2005 (Annual)	12/12/2006	Q/A	Q/A	Q	O, LO, O, LO	O, O, O, O, O
Gross External Debt	Nov 2006	1/31/2007	M	M	M		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] On a gross cash basis. The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and local governments.
[5] Including currency and maturity composition.
[6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).
[7] 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).
[8] 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, March 1, 2007

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431
USA

Dear Mr. de Rato,

1. The program supported by the precautionary Stand-by Arrangement (SBA) has produced tangible results: strong and steady economic growth accompanied by moderate inflation, falling unemployment and sustained external competitiveness. These achievements, aided by a favorable international environment, can be traced to the fiscal and incomes policies that have been anchored in the currency board arrangement, and to the structural reforms that have helped to modernize the economy and enhance its flexibility. Bulgaria is in turn better prepared to benefit from its accession to the European Union on January 1, 2007. At the same time, our policy framework and macroeconomic stability have faced significant challenges with the onset of rapid bank credit growth and large external imbalances.

2. Performance under the program has been good, with a few exceptions. Although the ceiling on central government arrears at end-June, for which a waiver of applicability had been granted, was breached by a small margin, all quantitative performance criteria for end-September and end-December were met. The structural reform agenda experienced delays or weakened implementation in some cases, but we do not believe these are of significant macroeconomic consequence. We request a waiver for non-observance of two structural performance criteria:

- The October 31, 2006 selection of the winning bid for the purchase of the Ruse District Heating plant. The winning bidder was selected on December 7, 2006.

- The start-up of operations of the new electronic business registry, which is now set for July 1, 2007. A detailed action plan to ensure implementation is being executed, however, and promulgation of operational regulations for the registry and the signing of all critical IT contracts are prior actions for completion of the fourth review.

3. Fiscal policy remains key to maintaining macroeconomic stability and reducing vulnerabilities. Indeed, although rooted in a largely investment-driven private sector saving-investment imbalance, the rapid widening of the current account deficit warrants a cautious stance. At the same time, the net official financial flows to Bulgaria are large and, if fully accommodated, would result in a significant fiscal impulse in 2007. The approved 2007 budget aims to achieve a surplus of 2 percent of GDP compared to about 3½ percent of GDP

in 2006. In view of the recent further widening of the current account deficit, the government also commits to achieving additional net savings of at least BGN 150 million (0.3 percent of GDP), preferably via cuts in non-interest current spending.

4. The government aims to overshoot the 2.3 percent target as economic conditions permit. In any event, the government stands ready to invoke contingency measures should unambiguous signs of over-heating become evident. In the event the current account deficit during the first half of 2007 deteriorates significantly relative to the end-2006 outcome, the government will save at least 90 percent of general government tax revenue collections exceeding amounts needed to ensure a full-year general government budget surplus of 2.3 percent of GDP. In the absence of revenue over-performance, the government will identify specific cuts in non-interest spending or, barring the latter, increase the rate of sequestration of discretionary spending.

5. In completing the final review under the SBA, we reaffirm Bulgaria's commitment to the sound macroeconomic policies and sustained structural reforms needed to support the currency board arrangement. Against the backdrop of sustained high current account deficits and rising private external debt, we recognize the need to maintain a cautious stance of fiscal policy over the medium term. To guard against risks to the financial system of rapid credit growth that might accompany EU accession, we plan to continue to strengthen our bank and non-bank supervisory capacity.

6. In requesting completion of the fourth and final review under the SBA, we confirm that we do not intend to seek a successor arrangement. We reaffirm our intention not to make the purchases under the SBA that will become available upon completion of the fourth review. In addition, we are giving consideration to making a further early repayment to the IMF during 2007.

7. Finally, we wish to thank the Fund for its support in helping to restore financial stability and sustained growth in Bulgaria following the serious crisis of the mid-1990s. We look forward to future Fund advice through the Article IV consultation process and technical assistance.

Sincerely,

/s/	/s/	/s/
Plamen Oresharski	Rumen Ovcharov	Ivan Iskrov
Minister of Finance	Minister of Economy and Energy	Governor
Republic of Bulgaria	Republic of Bulgaria	Bulgarian National Bank

Statement by the IMF Saff Representative
March 16, 2007

1. This statement provides information on new data that have become available since the issuance of the staff report on March 2, and confirms observance of quantitative performance criteria and the outstanding prior actions. The new information does not change the thrust of the staff appraisal.

2. **Quantitative performance criteria for end-December 2006 and the outstanding prior actions have been met.** The budget surplus for 2006 amounted to BGN 1,733 million, respecting the adjusted target. Central government arrears were held below the program's ceiling, as was the aggregate wage bill of selected SOEs. The prior actions pertaining to the electronic business registry were met with promulgation of the operational regulations following publication of the regulations in the State Gazette on March 6 and the signing of the last critical IT contract on March 8.

3. **Newly released data on external debt for 2006 paint a slightly better picture than in the staff report.** Final data put the stock of gross external debt at 78.2 percent of GDP compared to 81.2 percent reported in the staff report, reflecting lower levels of both public and private debt. In turn, the outlook for external debt has improved, and staff now projects external debt to remain below 80 percent of GDP over the medium term.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 07/54
FOR IMMEDIATE RELEASE
March 16, 2007

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fourth Review Under Stand-By Arrangement for Bulgaria

The Executive Board of the International Monetary Fund (IMF) has completed the fourth and final review of Bulgaria's economic performance under the Stand-By Arrangement for Bulgaria for the period from August 6, 2004 to March 31, 2007. The authorities continue to treat the arrangement as precautionary.

In completing the review, the Board approved the authorities' request for waivers for the non-observance of the October 1, 2006 structural performance criterion on the acceptance of new company registrations by the new business register and the October 31, 2006 structural performance criterion on the selection of winning bids for the western and eastern plants of Ruse district heating company. The 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, Mr. John Lipsky, First Deputy Managing Director and Acting Chair, said:

"Bulgaria is reaping the benefits of sustained sound macroeconomic policies and structural reform efforts with solid real per capita income growth, falling unemployment, and broadly moderate inflation. However, success has been accompanied by mounting underlying vulnerabilities, in particular a high current account deficit and external debt. Prudent fiscal and financial policies and continued structural reform to maintain competitiveness therefore remain necessary to guard against risks.

"The authorities have maintained a firm fiscal stance that remains the central policy pillar supporting the currency board arrangement. This is reflected in the record budget surplus in 2006, which resulted from strong spending restraint and dedicated revenue collection efforts. With the current account deficit projected to remain broadly unchanged, prudence should be the hallmark of economic policies going forward. Accordingly, notwithstanding the planned sizeable increase in real public spending in 2007 in the context of buoyant private demand, the authorities remain firmly committed to tightening the fiscal stance, should external risks warrant.

“Maintaining the soundness of the financial sector has appropriately been a key preoccupation of the supervisory authorities. The authorities are committed to continued prudential vigilance and close cooperation with foreign bank supervisory agencies to ensure a strong financial sector that is resistant to adverse shocks.

“Furthering structural reform has been a challenge, reflected in some delays in the implementation of a few measures. Maintaining the reform momentum will require strong political will, and the government’s commitment to continued structural reform will become evident on the start-up of operations of the electronic business registry. Continued reforms are needed in many areas, including to improve the business climate, further rationalize the education and health care sectors, and lower disincentives to the demand for, and supply of, labor.

“Succeeding in the European Union will require strong policies. Given Bulgaria’s aspirations for euro adoption and the country's commitment to the currency board arrangement, a high premium must be placed on sustained fiscal prudence, vigilant financial sector oversight, and sustained structural reform,” Mr. Lipsky said.

Statement by Jeroen Kremers, Executive Director for Bulgaria and Victor Yotzov, Advisor to Executive Director March 16, 2007

General remarks

The Bulgarian authorities wish to express their gratitude to the Fund for its surveillance and assistance. Over the last ten years, Bulgaria has implemented a comprehensive reform agenda and successfully completed several Fund-supported programs that helped the country to stabilize and make progress in the run-up to the EU accession. Prudent macroeconomic policy and well targeted structural reforms eventually paid off and as of January 2007, Bulgaria is a full-fledged member of the EU. This final review marks the end of program-based relationship with the Fund, and provides a good opportunity for some broader reflections.

Comprehensive economic reforms started soon after the political changes of late 1980's. The initial conditions on the way toward a market-oriented economy were extremely unfavorable. At this early stage of transition, the Fund supported the country by providing financial resources, as well as technical assistance and expertise. However, as happened with other transition countries, instead of allowing front-loaded structural conditionality, the emphasis was mostly on the macro-based conditionality, which proved to be a less effective approach. At the same time, insufficient ownership and hesitant support for reform, coupled with a fragile political situation, were perhaps even stronger barriers to success than the programs design itself. Thus, it is fair to conclude that the major shortcoming during the Fund's early engagement in Bulgaria was its willingness to support programs that had mixed ownership with respect to a number of key structural reforms.

Things changed dramatically after the implementation of the currency board arrangement (CBA) in mid 1997. While pre-1997 programs failed primarily because there was no pro-reform consensus and the programs were not implemented in their entirety, all the latter programs were successful. Their success reflected the improved ownership, which came as a result of political stabilization. The Fund responded properly by modifying the design of the programs making them more focused, while the conditionality was made much more detailed and front-loaded. These developments, coupled with broad support gained both domestically and internationally, helped securing the accomplishment of the programs, thus changing the image of the country from a failure to a success story.

Performance under the program

Following the conclusions from the ex-post assessment report on longer-term program engagement, the authorities opted in August 2004 for another SBA, designed as a low-access, precautionary arrangement, that would also serve as an explicit exit from Fund program engagement. The program was focused on fiscal adjustment, measures to moderate rapid credit growth, improving the business climate, and making further progress in structural reform. Against the backdrop of worsening external environment, some of the economic problems turned out to be more stubborn than initially envisaged, which warranted the extension of the program by six months at the time of the third review.

The overall performance under the program has been strong and the main program objectives were completed. Sustained economic growth has resulted in significantly higher real per capita growth over the program period, while inflation remained moderate, and unemployment rates declined to single digits for the first time in 15 years. Fiscal stance has strengthened remarkably and the country is now running one of the biggest fiscal surpluses in all of Europe. For a country not endowed with vast natural resources, this is a huge achievement. Financial sector has further matured and rapid credit growth was well managed. External sector imbalance, however, has risen along with a sizable increase in private external debt.

The fourth review is not an exception from what has been already observed during the previous reviews. Quantitative performance criteria were met, but a few structural criteria and benchmarks were delayed or partially met. With regard to the selection of the winning bid for the purchase of a district heating plant, and launching of the business registry, there were some technical reasons, and even circumstances where delays were in fact outside of direct government control. Remedial actions and a realistic timetable have been agreed with the mission and, accordingly, the authorities request a waiver. In any case, the authorities are determined to attain all program objectives and stand ready to take further measures to successfully conclude everything they have committed to under the program.

Fiscal policy

Fiscal policy remains key to maintaining macroeconomic stability and reducing vulnerabilities. Over the last several years, fiscal stance has strengthened remarkably and 2006 ended with a record-high surplus of 3.7 percent of GDP. By achieving this result the authorities have reaffirmed their strong commitment to sound macroeconomic policies, acknowledging the paramount importance of a prudent fiscal stance in the context of the currency board arrangement.

Given the prudent short-term fiscal stance, the authorities and staff are engaged in a dialogue over the policies to be followed after Bulgaria has joined the EU. The issue of the fiscal impact of accession, and hence the policies it entails, remains the most challenging one, as two competing objectives are present. From one hand, maximization of EU funds' utilization must be given priority, as it provides the country with a unique opportunity to speed up convergence and substantially increase living standards in a relatively short period of time. On the other hand, the authorities do acknowledge the need of fiscal surpluses in order to try to somewhat offset sustained private sector saving-investment imbalances.

In view of the external vulnerabilities and continued strong domestic demand, a broad agreement was reached on the need to avoid large fiscal relaxation in the years to come. Therefore, for 2007 the authorities intend to overshoot the approved surplus of 2 percent of GDP and to pursue at least 2.3 percent by achieving additional net savings. Even though the 2007 fiscal target may look lower than what was achieved in 2006, from an economic point of view it does not correspond to fiscal relaxation in 2007 as it also includes a 1.2 percent of GDP as the country's first contribution to the EU budget. By definition, these funds have no effect on domestic demand. In addition, the government stands ready to invoke other contingency measures should unambiguous signs of over-heating become evident.

The authorities would like once again to invite staff to take an active position and invest more in looking not only at the macro-side of the catch-up process (and all related issues), but also by digging deeper and helping to identify underlying micro-vulnerabilities, as well as possible policy action directly addressing such vulnerabilities. In particular, this applies to the degree to which external imbalances, emanating from private saving-investment imbalance, could/should be counterbalanced by moving and keeping the public finances in large imbalance as well.

External sector

It has long been observed that rapid catch-up economic growth is often associated with high investment, exceeding private saving. Like in other countries in the region and worldwide, the same developments are observed in Bulgaria over the last couple of years. Despite continued increase in public saving, the private sector's saving/investment balance has translated into a sizable current account deficit. Exacerbated by higher oil and other key commodity prices, in 2006 the external current account deficit reached almost 16 percent of GDP. The strong rise in imports relates to growing domestic demand while even stronger FDI inflows (on average for the last nine years, FDIs exceed current account deficits by 35 percent) contribute the most to high import growth. The capital inflows in last years were quite broad-based, going into investment in many sectors of the economy and increasingly into green-field investment.

Despite high current account deficits, competitiveness does not appear to have been a factor in recent foreign trade developments as evidenced by the stable NEER and the real depreciation when using unit-labor costs. Official reserves have grown in line with the higher imports and the reserve coverage remained broadly stable over the last couple of years.

This notwithstanding, the authorities have proved sensitive to external vulnerabilities. They have applied extremely prudent fiscal policies, and taken timely measures to restrain credit growth. But when assessing the external imbalance, full account must be taken of its context. Bulgaria's catching-up shows the usual combination of a current account deficit financed by massive capital inflows. In itself this is precisely desirable, and policy is carefully attuned to keeping the catching-up process stable and to identifying and controlling its potential vulnerabilities.

Financial sector

Thanks to the consistent measures taken by the central bank, rapid bank credit growth has slowed. Nevertheless, the main idea of reducing financial flows to the private sector was only partly met as the open capital account allows the corporate sector to access bank credit abroad, while credit from the non-blank financial institutions has continued to grow. Thus, the effectiveness of the bank credit ceilings has much diminished, and, what is worse, started to disrupt the financial sector. Accordingly, the authorities and staff agreed some time ago that temporary credit restraints introduced since early 2005 should be removed, which in fact took place as of the beginning of 2007.

The removal of the restraints coincides with a tightening credit cycle in Europe, the introduction of Basel II, and further liberalization of trade in financial services. There still is a risk of a possible pick-up in bank credit growth although it looks moderate as the pressure may be shifted to non-bank financial institutions. In any case, banks' portfolio is quite strong and only about 2 percent of loans are reported as overdue. Financial sector vulnerabilities remain contained as banks are well capitalized and profitable. Non-bank financial institutions are well supervised too, as the Financial Supervision Commission has benefited from Fund's technical assistance and substantially modernized its activity. The authorities look forward for the FSAP update, scheduled for early 2008.

With regard to the ERM II, the authorities maintain their long stated position that they will seek joining it at the earliest possible date. They have already started talks in this direction and it is widely expected to happen by mid-2007. The authorities' plan is to uphold the currency board arrangement at the existing exchange rate until Bulgaria joins the EMU. Moreover, the Bulgarian government and the central bank have committed to unilaterally maintain a zero deviation of the exchange rate during the stay in the ERM II.

In conclusion, the Bulgarian authorities are committed to achieving high and sustainable economic growth while maintaining a stable and predictable macroeconomic environment. With a view to the fulfillment of this objective, the topmost priority of the government will be the maintenance of sustainability of public finances and a level of government and government-guaranteed debt, which allows for a stable compliance with the Maastricht criteria. In the years to come, the government intends to keep running budget surpluses to help curb domestic demand as well as to moderate the external account imbalance.