Bulgaria: Letter of Intent

March 1, 2007

The following item is a Letter of Intent of the government of Bulgaria, which describes the policies that Bulgaria intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Bulgaria, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.
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/ Plamen Oresharski       /s/ Rumen Ovcharov       /s/ Ivan Iskrov
Minister of Finance         Minister of Economy and Energy   Governor
Republic of Bulgaria        Republic of Bulgaria                Bulgarian National Bank