

THE ECONOMY OF BULGARIA - April 2010

SUMMARY REPORT of the Center for Economic Development

Full text of the report can be found at www.ced.bg, www.econ.bg and www.manager.bg

MACROECONOMIC DYNAMICS. The Bulgarian economy has registered a decline for the first half of 2010 as well. The expectations for the first quarter are for a decline of 3% on an annual basis. The slowing down, compared to the size in the last quarter of the previous year (5.9%) will be due to the more active export growth and to the smaller decrease in industrial production. Small growth is expected not earlier than the third and fourth quarters of 2010. Bulgaria will emerge from the cyclical crisis this year, but there is the question about the scale of structural problems in the economy and overcoming them.

The decline of the Bulgarian economy on an annual basis is was intensified during the whole previous year. For the last quarter of 2009 it reached 5.9 percent (5% for the year). The declining trend in Bulgaria continued longer compared to the major world economies, which starting from the middle of last year register a slowing down decline on an annual basis. There are two basic factors to deal with the crisis. The external independent of us factors – the activation in the economies of our key partners and domestic – and the anti-crisis response by all economic agents. The improvement of the external environment continues, but it is weak and hesitant. In the conditions of the slight improvement in the external environment, the continuing slow down of the Bulgarian economy may be associated with delayed or weak domestic anti-crisis events.

On the production side of GDP the deepening of the overall economic drop in the last quarter of 2009, and the decline in the third quarter, is due to the *services sector*. Only in the third quarter of last year the value added in the sector fell below its level from last year (5.1% drop), the decline continued during the last quarter, but was smaller (3.9%). Slowing the decline in services sector is due to the slowing the decline in "transport, storage and communication" and "trade, " which is an encouraging sign. In the 2009 drop the largest negative contribution comes from *industry*. After the slower decline in the third quarter, the decline in the fourth quarter deepened again (from 6% to 7.5%). This is due to the deeper decline in the value added in construction (from 8.7% to 9.7%) and industry (from 4.8% to 6.5%). However, there is a hopeful rising trend in the industrial export sales since November on an annual basis, while they demonstrate a slower decline on the domestic market. The grate ranges in the dynamics of the *agricultural sector* reflect, in addition to the impact on the basis since 2007, a hesitant adaptation in the conditions of crisis.

Investments in the fourth quarter decreased by 35%, had the most significant adverse effect on the deepening of the slowdown of **the final use of GDP**. The decrease in investments stood near that of the third quarter (36.5%), after 16.3 percent in the second and 14% in the first quarters. The slight delay in the decline in *household consumption* in the third quarter was followed by a deepening decline in the fourth quarter to 8%. The contraction in government spending led to a significant decrease in government consumption (individual spending decreased by 14%, with a collective 22.6 percent compared to last year). Foreign trade continues to have a positive effect on overall economic developments. The exports of goods and services has increased on an annual basis, though by only 0.8 %, after the slowing decline in the previous two quarters, due to the actual increase in exports by 2.8%. However, slowing the decline in imports of goods and services in the fourth quarter is more significant than the delay for the third and, despite growth in exports, it led again to negative *foreign trade balance in goods and services* (after the positive balance in the third quarter). There is a noticeable less decline in the imports of services, which is due mainly to the reorientation of Bulgarian tourists to tourism in Bulgaria rather than travel abroad.

The monthly data on *industry* from October onwards highlights slowing the decline in production and growth in export sales on an annual basis. Compared to the greatest decline in production in May 2009 (24%), in January 2010 the decline was only 1.2%, but in February it deepened again, significantly to 9.1 percent. The dynamics of the industry depends mainly on the dynamics of manufacturing in which - after the double-digit declines throughout 2009 - for January the decline in production was only 1.6 percent on an annual basis, but for February it rose to 13.7 percent, probably due to the difficulties on Bulgaria's southern border. The mining industry demonstrates a rise on an

annual basis since October, and this is due to the extraction of metal ores. Among the five groups, which comprise the industrial production by product type, February finally marked a growth in investment products, after a significant contraction in declines in the previous two months, which brings hope that the growth will continue. Among energy products, consumer durables and intermediate products began to grow in January, which, however, again turned in decline for February. In non-durable consumer products the smaller decline that started in November, continues. **For the first quarter of 2010 the decline in value added in industry is expected to contract on an annual basis.** At the relatively stabilized rate of the business climate indicator and the increased confidence in industry indicators (as of March), it should be noted that among the cyclical indicators with a quarterly frequency (latest data as of January) the only indicator that improved is that of the production assurance with orders (measured in number of months) - from 4.1 up to 4.6 months.

Construction shows a slowing down in monthly production declines on an annual basis compared to their deepening especially at the end of last year. **Expectations for the first of 2010 are that the decrease in value added in this sector will also be more moderate than that for the last quarter of 2009.** These expectations come from the higher levels of performance and business climate confidence in construction in the first quarter of 2010 compared to the last months of the previous year. Short-term data on **trade** from the beginning of the year **do not give reason to expect a delay in the decrease in value added compared with the previous quarter.** The **service sector** (excluding trade) is the only one demonstrating an improved business climate indicator in March. **A decline in the value-added of services is expected in the first quarter of 2010, but more moderate than the decline in the last quarter of 2009.** The latest (in January) **consumer survey does not give reason to hope for a slower decline in final consumption of households in the first quarter of 2010.**

The main arguments in support of a slight decline in GDP for the first quarter come from the expectations for a slower decline in value added in industry and the continuing growth in exports.

The **current account deficit** for 2009 fell double - from 24 percent of GDP in 2008 to 9.4%. In the first two months of 2010 the trend of narrowing of the deficit remains – several times from the current account deficit less than a year ago. Now it amounts to Euro 155.3 million (0.5% of GDP) compared to the deficit of Euro 864.9 million (2.6% of GDP) for January-February 2009). Reducing the current account deficit continues to be driven mainly by shrinking the deficit in **trade balance**. The new feature in the formation of external balance of goods is that since November it has already seen export growth. Second is the effect of reducing the deficit on **income**. The positive balance in **services** has improved - it now amounts to 41.9 million from 13.3 million euros for January-February 2009, due to improved **balance of travel** (from euro 12.7 million to 57.5 million) and **transport services** (from 21.9 million to 33.5 million). The results from **net current transfers** are also positive. Given the recovery of our main partners and the expected start of recovery process in the country, it is seen that the contraction in the current account deficit will continue this year, albeit more gradual than that in 2009 and this will be due mainly to more favorable dynamics of export-related imports and their growth.

The most characteristic feature of **foreign trade** in the first two months of 2010 is the shrunk by half trade balance deficit as compared to a year ago. The registered deficit (FOB / CIF) of euro 426.9 million represents 1.2 percent of estimated GDP, while in January-February 2009 it was 824.4 million or 2.4 percent of GDP. This is mainly due to the continuing decline in imports (by 8.7 per cent) and less so to the growth of exports. The weak economic activity and lack of investments decreased imports (CIF) to 2,318.4 million euros, while exports (FOB) increased by 10.4 percent on an annual basis and reached 1891.5 million.

The changes in the commodity structure of trade result from the recovery which started in the European economy and the still ongoing recession and slow economic activity in the country. For example, only in January the exports of investment goods showed an increase of 50 percent annually, while imports of such goods declined by 25 percent. Changes are also seen in **geographical structure** of trade. If the 2009 trade integration with the EU continued and share of exports to EU countries reached 64 per cent and in imports exceeds 60 per cent, while since early 2010 a diversification of markets is observed – the exports to third countries increased by almost 40 per cent annually for the first two months, while exports to the EU remains at the level of 2009. Thus the share of EU exports fell to 61.4 per cent. In imports, however, EU countries retain their advantage and although the value

of imported goods from European markets decreased by 6 per cent the decline in imports from third countries is 13 per cent. Thus the share of EU import increases from last year to 61.2 per cent.

The expected increase in world trade by 10 per cent in 2010 (after a drop of 12 per cent in 2009) will also affect the Bulgarian foreign trade. The reviving of the major economies is already leading to increased prices of raw materials - oil, copper and other nonferrous metals. Some export businesses in Bulgaria have found new customers and established themselves on new markets. Nevertheless the recovery of exports to the pre-crash levels and the recovery in growth rates will take at least several years.

The reported 28 million euro **FDI** for first two months of 2010 are not a surprise with the conditions on global financial markets but are not indicative of the intentions of investors or the potential of the country. Bulgaria is still seen by many foreign investors as an attractive investment destination with a favorable business climate. As key factors to attract investor interest are the EU membership and the possibility of obtaining EU funds, the political stability, low taxes and cheap and well trained workforce. Even conservative estimates of the IMF are for an influx of euro over 2 billion of foreign investment by the end of the year. As market niches with good potential for attracting FDI not only in terms of domestic market but also to the region as a whole are seen areas as renewable energy, food processing, retailing, logistics, outsourcing center services, ICT, finance, accounting, etc.

For three months this year **inflation** was 1.4 percent, at only 0.6% accumulated inflation for the whole 2009 (*national CPI index*, which reflects the prices of consumption of Bulgarian households). In the harmonised index of consumption prices (HICP, which includes both Bulgarian and foreign customers in the country) the accumulated inflation in March was 1.3% (1.6% in 2009) - low values comparable to those in the Eurozone. Consumer prices in the small basket (ITSMK) again change with the greatest magnitude – with 1.6% since early 2010, at accumulated deflation of 2.7% for the whole previous year. In the noticeable monthly increase of the three indices in January and February 2010 the most significant influence has come from rising food prices. Price increases in the group "Alcoholic beverages and tobacco products" came relatively smoothly. It is expected that the effect from the introduced excise duties on tobacco will occur mostly in April.

Till the end of 2010, consumer prices will grow relatively slowly mainly due to the lack of serious pressure from the international prices. With the recovery of the world leading economies, however, they will be rising and this will gradually reflect on domestic producer prices in the country. In household income and domestic consumption we expect impact in the opposite direction. Key pro-inflation factors this year will be the changes in fuel prices in international markets and changes in administered prices in the country. Higher rates of inflation are expected than in 2009 most likely in the second half of the year but no more than about 2.5-3% annual inflation at the end of the year.

The situation would be radically different in case if higher rate of VAT. At an increase of 3% this will lead to additional rising of inflation and at the end of the year it may be over 4-5%. This will contract domestic consumption and will delay the coming out of the recession.

There is an accelerated growth in quarterly **unemployment** (Labour Force Survey) - in the last quarter of last year the overall rate reached 7.9 percent (6.7 percent in the third quarter and 5% a year ago). There is an increase in the total number of discouraged people - they are nearly 71 thousand more (after growing by 42 thousand in the third quarter). For the second quarter of 2010 the trend for reduction of staff continues - according to the monthly business surveys of NSI. In March for industry and retails they are even worse, while in construction they are more moderate compared to previous months, only services demonstrate weak expectations for employment growth over the next three months.

The increase in overall unemployment in the country is below the levels in the EU 27, but is growing steep. Particularly worrying is the rapid growth in youth unemployment, which already exceeds the average for EU 27. *Registered monthly unemployment* since February has risen to beyond 10%. The rate for March was 10.14% (at 6.88 percent a year ago). It is expected to grow until early summer to about 11%, and with the slowdown of the decline and the increase of seasonal employment the level of employment is expected to stabilize. However, the unemployment rate will remain at higher levels compared to pre-crisis and possibly will slightly increase in the autumn, mainly due to restructuring of

employment.

ENTERPRISE POLICY. In order *to improve the business environment and encourage entrepreneurship* in government anti-crisis program, announced in late March, *several measures are foreseen*: adoption of a timetable for the accelerated development of e-government, transfer of government services to private contractors, establishing a timetable for complete payment by the end of the first half of 2010 from the state and state enterprises of the amounts due on completed contracts, the legal term recovery of VAT to businesses; accelerated repayment of amounts which are due to beneficiaries of EU funds, acceleration in the existing or in the startup of new schemes for the operational programs to maximize the absorption of EU funds, increasing advance payments to 40%, creation of public records of funds owed under public contracts, in VAT, excise and European projects, simplified and shorter insolvency procedures. There are also measures to provide additional financial resources for the real sector, namely increasing the debt capital of Bulgarian Development Bank, not less than 60% of financial resources are targeted to SMEs. Most of the measures are reasonable, but it should be noted that some of them have desirable character, are insufficiently specified and do not have deadlines for implementation.

The promotion of investment activity is an opportunity to emerge quickly from the crisis. In this respect is the proposal laid out in the package of anti-crisis measures for amendments to the Rules for Implementing the Law on Investment Promotion. The idea is to significantly reduce the current thresholds for a certificate for investment class A and B, when it comes to high-tech activities and investments in municipalities with higher than national average unemployment. In addition, attention is paid to investment in research, information technology, education, health and culture, for which the lowest threshold is envisaged. Rapid introduction of these amendments will encourage the inflow of foreign direct investment and encourage investment activity in the country.

Corruption continues to be one of the serious problems which create difficulties for the business. Over the past several months active steps were observed from the law enforcement and prosecution, who have undertaken a number of activities against organized crime and corruption. Notwithstanding the efforts and measures at all levels, the spread of corruption remains very high. Along with the demonstration of political will, which must be consistent and systematic and in cooperation with other authorities, the need for further urgent reform of the judiciary is increasingly necessary. The Parliament has to cope with hard work ahead to improve a number of laws, with an anti-corruption focus.

With regard to the *privatization process* it should be noted that 2009 was virtually zero privatization year. The investment community receives new signals about sale of minority shares of electricity companies in the country and parts of the energy holding the stock exchange but no specific measures follow.

The government has proposed a public discussion "Strategy for development of transport infrastructure of Bulgaria through mechanisms of concession." The document presents the government medium term intentions to attract private investment in construction and operation of transport infrastructure sites - ports, airports and railway stations. The justification of the Strategy points to the need of modernization in existing transport infrastructure and for integration and interconnection between networks of different types of transport. The opportunities for attracting investment in the transport sector will provide on the one hand for the construction and maintaining of a modern transport system, for the public interest and the business, while on the other hand will reduce government budget spending in the economic crisis.

PUBLIC FINANCE. The monthly deficits in government budget, which reappeared in December 2009, continue through the first two months of 2010, but with a significantly higher volume. The accumulated *consolidated deficit* as of February is near 1.4 billion, of which 382 million is the excess of expenditure over revenue of European funds. The large deficit is due to the failure on the revenue side and a significant increase in costs. The main revenue sources - VAT and excise duties - decrease by 45.69% and 13.84% for the first two months of 2010 compared to the same period of the previous year. Only tax revenues from income tax are increasing - by 1.85 percent for the first two months. Given that the increased unemployment rate in comparison to 2009 and the severe economic

situation, which limit wage growth, the better results speak of personal income leaving the grey economy.

In the main expenditure groups on a consolidated basis - salaries, current dependency, capital, social costs and scholarships - the growth is between 8 and 34 per cent annually. In the four expenditure groups there is a very strong increase on an annual basis in January and significantly lower in February, but it is too early to speak of a trend.

The *gross government debt* is reduced as a percentage of GDP and in February is at 13.8 percent, compared to 14.2 percent in December 2009, the decrease is due to the lower domestic debt, which declined from 4.5 percent in December to 4.1% in February while the foreign government debt remains at 9.7 percent. The government and government guaranteed foreign debt remains slightly above its average value over the past nine months, but in February it decreases by 0.1 percentage points compared to December, to a level of 12.2 percent of GDP.

In the remaining months of 2010, domestic demand is expected to shrink further from 2009, which will have a negative effect on the main income sources for the budget - VAT and excise duties. This will be offset by the measure of linking costs to revenue in the budget and will not result in further monthly deficits. On the other hand, if revenues are significantly below the planned expenditure, this would mean further delays of state obligations.

The foreseeable result of the government tax policy is 1.8 percent growth in revenues from personal income tax - the only duty with growth in earnings. Besides, revenues from health insurance increase by 15.4 percent for the first two months of 2010. Against this background is an inexplicable decline for the same period in revenues from social security contributions by 13%, far exceeding the decrease of contribution from the beginning of 2010 by 2 percentage points.

The government has taken measures, to be voted by parliament, for amendments in tax laws that will have a positive effect on revenue budget, but it is difficult to predict to what extent. Changes in the taxation of insurance companies comply with Directive 2009/138/ES, but in the short term would have a negative effect on the financial position of companies. Increasing the rate of advance payments of the companies will have a positive effect on earnings, but will further complicate the situation of companies that receive delayed VAT or late payment of state debts. The effect of changes in the Local Taxes and fees will be felt in 2011 when most of the duties will be already paid. It should also be borne in mind that the final effect will probably be lower than the expected resulting from various tax avoidance practices.

Maintaining a balanced budget should be a main priority of the government. Expenditure contraction should be the main instrument for this. If it necessary the government budget should be corrected in mid year to come with a smaller but balanced budget. In the conditions of fiscal and debt crises in a number of EU countries this would position Bulgaria favourably as an attractive place for investments and would open for us the door to the Euro zone.

SOCIAL AND HEALTH POLICY. The Anti-crisis Program of the Government outlined the most important amendments in the social legislation this year. Most of the measures in social and health insurance are intended to achieve immediate fiscal impact and restriction of public spending on certain benefits. The intended reduction in social security burdens on businesses and the workforce was cancelled in 2010 and 2011. It also provides measures to stabilize income and promote domestic consumption of households, but they are of long-term nature. Their implementation requires a longer period to prepare an adequate legal framework. The policy of the labor market is evolving to maintain employment in industries experiencing difficulties in production and marketing. Conditions will be regulated for introducing flexible working hours and special leave for economic reasons. The ranged of subsidized employment and inefficient tools for setting up of unemployed persons on the labour market are diminished significantly. The healthcare reform is in a standstill.

ENVIRONMENTAL POLICY. In the first months of 2010 worrying trends have emerged in the absorption of EU funds intended for environmental infrastructure projects. The opinion of the Commission is that 2010 is crucial for successful implementation of ISPA and Environment Programs and positive result can only be achieved if the central government's efforts are supported by competent and responsible actions of municipalities. Although the actions of municipal and regional

structures in the absorption of EU funds are still not in the focus of public interest, the present practice shows that the quality of application and project management are both crucial for either a successful implementation or for a failure.

The vote in Parliament on Amendments to the Law on Environmental Protection launched the preparation of a National Green Investment Scheme. The Government concept of green investment includes active sale of reduced greenhouse emissions under Art. 17 of the Kyoto Protocol and active steps by the companies in connection with final adoption of the Second National Allocation Plan for emissions allowances, which in turn will make the Bulgarian enterprises equal participants on the European stock exchanges in trading carbon allowances. Despite the unfavourable situation for free market values of emissions preliminary expectations of MEW for a revenue of 400 million to the National Trust EcoFund may quite possibly be achieved. The funds will be used for subsequent financing of environmental projects in energy efficiency, transport, waste management and others. The long-term effect of the program is to encourage businesses to participate in the so called green economy and create conditions for higher employment and the creation of green jobs. Such an approach in the development of national economies is promoted by the priorities of the European Commission formulated in the Development Strategy 2020 of the community.

FINANCIAL SYSTEM. Foreign exchange reserves in Bulgaria during the first two months of 2010 followed the trend from January and February 2009. While in the beginning of 2009 the decrease in foreign currency reserves was due to regulatory changes, at the beginning of this year it is due to government budget deficits in January and February, which are financed mainly from the fiscal reserve. The accumulated excess of revenues over government expenditures for the first two months was BGN 1.39 billion and just a little over the decrease of funds from the state deposit at the BNB. If the monetary basis remains at current levels, which is very likely, the change in foreign currency reserves will mostly depend on the movements in the State National Bank account. Even if they fall further this year, not later than December they will return at least to the level of February 2009 because the government is obliged to maintain a minimum amount of fiscal reserves of 6.3 billion, which was achieved in that month.

Banking system. In early 2010 the levels of key financial indicators of the banking system remain without significant changes, and total assets reached BGN 71.1 billion in February. Liquid assets also show growth, and their ratio to the amount of liabilities is improved up to 22.97%. Despite the unfavourable economic situation and the growth of overdue debts which in February are 12.2 per cent of all claims the banking system demonstrates good risk management and system stability. Good management of the banks is also evident in the high returns on bank capital - 9.29% as of December 2009.

The dynamics of foreign bank debt demonstrates confidence by the international institutions that the difficulties in Bulgaria are coming to an end and this is a sign of their long-lasting interest in the local market. However, starting in 2009 and still continuing reduction of external indebtedness of the vaults and full compensation with funds from domestic institutions will further help to be more independent of negative external shocks.

Leasing. In the last quarter of 2009, the leasing market has not only continued but also accelerated its decline to 14.55 percent on an annual basis at a decrease of 1.6 percent in the third quarter of 2009. The main reason for this surprisingly large annual decline in GDP in the fourth quarter of 2009. The situation was further aggravated by tight public spending and the slowdown of VAT at the end of 2009, which allowed non-financial corporations, which represent 90% of the amount of leasing companies with limited financial resources.

These factors limit the ability to grant new loans and increased non-performing receivables, already 15.8% of all claims. All this makes leasing companies to be more conservative, but still difficulties in the sector are not quite evident. Although the outflow of investments from the sector short term growth in financing is noticeable which is evident of the care and desire to keep foreign investments in the country and in the sector. Prospects for the leasing market in the first and second quarter of 2010 seem rather negative. Positive impact can be expected from the private sector, where some positive signs already seen - notably in exports and industry. Both sectors rely heavily on trucks and machinery and equipment, representing 50% of the total lease receivables in December 2009.

Insurance. For the first time in 6 years the gross premiums of general and life insurance is shrinking – by 6.2 % in 2009 according to preliminary data of the Financial Supervision Commission. A recovery of the premium income in the first quarter of 2009 is very unlikely. Total insurance companies reported negative results from core business of nearly 10.99 million in 2009 while a year earlier they had a loss of 4.69 million. Still, their financial results improve to BGN 24.51 mln. while in 2008 they reported a financial loss of 2.36 million. Despite the challenging year for the Bulgarian economy and the losses from operating activities, insurance companies significantly improved their final gains which is indicative of their flexible management.

A coming vote in parliament for a change in tax legislation will replace the payment of income tax of 10% on the profits of insurers duty, gross premiums earned, less the gross amount of ceded reinsurance and insurance premiums returned. Changes in tax legislation at this stage may have an additional negative effect on companies at a time when they are to begin economic recovery.

Capital Market. The most characteristic features in the first quarter of 2010 on the capital market in the country was the continuing decline in liquidity and outflow of investors. Poor liquidity has led to poor daily fluctuations of the indices, as their movements are usually conditional of a few companies, while others remained unchanged. The main stock index for the period fell by 1.36 per cent, as in most of the time its daily fluctuations were minimal. However, in early February there was a rise to 444 points or just over 4 per cent as of end last year, but it was followed by a prolonged decline, which destroyed what was accumulated. Second Exchange index, BG40 moved similarly, and throughout three-month period ranged between 115 and 120 points with no clear trend.

Such movements for a consecutive quarter were not in line with other markets of Central and Eastern Europe, which in turn saw moderate growth rates. In this regard, the existing until recently relatively significant correlation of the domestic market with international markets, almost disappeared, which can be attributed mainly to the weak investment activity and lack of interest on part of institutional investors on the domestic market. Of course, not all markets in the region saw increases, and once again the Greek market saw great losses as a result of the deepening budget crisis during the quarter and the lack of a clear source of funding for the deficit. Such events inevitably have an impact on the local market, if only indirectly in the form of worsened perspectives or expectations of the participants. In addition, concerns that Bulgaria could repeat the Greek scenario in the local version due to the large budget deficit in the first two months, were also among the factors which have injected new pessimism among investors.

Although the index remained relatively stable during the quarter, as noted, liquidity continued to decline as turnover dropped to about 100 million as compared to 185 million leva in the previous quarter, and it should be noted that a quarter of it was due to the trading of bonds. In late 2006 and early 2007, just to compare, for a three month period the turnover reached BGN 1 bln. Although the market capitalization of exchange rates stay at the range of 4 years ago, the daily turnovers are at levels of 8 years ago. The very market capitalization decreased slightly to BGN 11.142 billion or 16.78 percent of the forecast gross domestic product.

ENERGY. The Draft Energy Strategy of Bulgaria to 2020 is ready to be presented for a public discussion as soon as possible, following the completion of its environmental assessment. It is expected that this important document will be adopted in the present session of the Parliament, i.e. by the end of the summer. Priorities set out in the energy strategy are: improving energy security, reduce emissions of harmful gases, increasing to 16% the share of renewables in final consumption, improve energy efficiency by 50 percent, creation of a competitive and open energy market. Large scale energy projects will be set out in the strategy, but will not be considered in detail. It is envisaged to maintain and increase the share of nuclear energy, which is currently 33 per cent of the energy mix.

The position of the Government for a possible future construction of the biggest energy project in Bulgaria Belene with a probable value of over 10 billion euro, is related to meeting the key requirement for a strategic European investor. Besides, for the construction of a second nuclear power plant no state, corporate guarantees will be granted, or additional state funds spent. This in fact means stopping of the project.

In early March the European Commission has allocated funds for construction of gas connections between Bulgaria, Romania and Greece. For linking the gas systems Bulgaria and Greece received 45

million euros. For the same purpose Bulgaria and Romania are granted 8.929 million.

In early April the government announced its intention to dissolve BEH by June. The reasons for this are that Holding does not fulfill the tasks for which it was created, including: to increase investment in the sector to make companies in the energy sector market-oriented, to start their privatization, etc. The model of management in the Energy after dissolution of BEH is not yet clear.

The Parliament debated a draft law amending the Law on Energy. Some of the major proposals for change are: the composition of the regulator of 13 down to 7 members, including chairman and six members as they will be entitled to a maximum of two consecutive terms; texts are suggested concerning issues in the field of electricity, in particular - the obligation to purchase and the pricing for the combined production of electricity and heat, until the end of 2011, extending the term to purchase electricity generated from existing thermal power cogeneration achieved without high efficiency indicators.

TRANSPORT. According to preliminary NSI data in the fourth quarter of 2009, the **goods transported by road transport** decreased by 17.6% from the third quarter. This is primarily due to the reduced volume of both domestic and international shipments by road. **Water transport** data show that in the period October - December 2009 the *volume of cargo transported* by vessels is 1.7% more than that in the third quarter. **Goods carried by rail** in December 2009 were 1.8% less compared to November last year, resulting from the reduction in international transport. **In 2009, the Bulgarian airline companies have shipped 15% less passengers than in 2008.**

On April 23 a contract was concluded with the Bulgarian Unification "Highway Trace" and in early May, construction began on Lot 2, Stara Zagora - Nova Zagora from Trakia Motorway. The government decided to start the completion of Trakia Motorway with government funding since European authorities have not yet received and approved the project application form. In late February and early April, the procedures were initiated for selecting the contractor for Lot 3 "Nova Zagora - Yambol and Lot 4 Yambol - Karnobat. Expectations are that by the end of the summer work on these two sections will start. In early April the Council of Ministers adopted the **Strategy for the development of transport system of the Republic of Bulgaria for the period 2020.** The implementation of the strategy should ensure that in 2020 Bulgaria will have modern, safe and secure transport system that meets the needs for transport quality and safety. A **Strategy for the implementation of technical specifications for interoperability of the Bulgarian with the European rail system** will be completed by the end of 2010. The contract for this work was signed in late March between MTITS consortium SHGV (group of companies "plan Shusler" "Range Management Plc and Bull Vector Ltd).

CONSTRUCTION AND REAL ESTATE. In March 2010 the National Statistics Institute (NSI), *the composite business climate indicator* in construction again registered a decline of 0.4 points on a monthly basis, because of the reduced assessments of construction entrepreneurs on the economic situation of enterprises. Bulgaria recovers foreign investment interests, due to better opportunities for returns compared to other Central and East European countries. The *residential market* in the first three months of the year is smaller, but with stable prices. Buyers are back, increasing the number of transactions, but this applies only to properties at attractive prices. A second cycle of decline in housing in Sofia is expected, especially for houses with a poor location, poor environments, or panel repairs. The most heavily affected by the economic crisis is the segment of *winter vacation property*. Interest to them in season 2009/2010 was three times lower than in the previous. It is worrying that if construction sites which have been launched are not completed, they will become "monuments" and will lead numerous entrepreneurs to failures. *Shopping centers* remain the fastest growing segment. In 2010, the construction of some 446 thousand square meters of new leasing space in malls will be completed, which exceeds almost twice the existing. In early 2010, rents in main shopping streets in Sofia, Varna, Bourgas and Plovdiv have seen no significant change in prices compared to last quarter of 2009. The capital is reporting a slight increase in free space. The year 2009 was a record with the completion of over 188 thousand sq. m. of *offices* in Sofia, the volumes of supply will remain high in the next 12 to 24 months. The reason is the accumulated momentum of longer periods for the construction of buildings. Supply in the logistics and industrial segments registers a slight increase due to the continued decline in economic activity. This market continues to be the least affected since it remains underdeveloped compared to other segments.

TOURISM. In 2009, the number of foreign tourists in Bulgaria was 5.738 million, which represents a small decrease of 0.7 percent on an annual basis to 2008. According to BNB data in 2009 international tourism revenues amount to 2.559 billion euro, or 0.9 percent more than in 2008. This amount includes the revenues from Bulgarian tourists resting in our resorts and taking trips to them, are estimated around EUR 500 million. Data on revenues from foreign tourists give reasons and most experts note that in the picture of the financial and economic crisis, tourism is one of the sectors that are relatively stable in this difficult situation. The crisis affects mainly construction of new tourist sites, which decreased significantly compared to 2008. The crisis influences the travel of Bulgarian citizens abroad, they remained in Bulgaria, which is favourable to domestic tourism. Costs of Bulgarian citizens travelling abroad in 2009 fell to 1.314 billion euro, which is 18.7 percent less than in 2008. In 2009, alternative tourism developed actively - the revenues from eco, adventure and rural tourism are between 13 and 15 million euro.

In all likelihood, 2010 will be harder on the tourism than in the past year, mainly due to strong competition on the regional market and the economic crisis, but we do not expect decrease in revenues from tourism compared to 2009. Prospects for tourism development include the development and adoption of a new law limiting the overbuilding in national resorts. It is expected that the new Tourism Law will concern the regulations of tourist supply, functions and tasks of travel agencies and offices, the requirements for national representation of associations and the creation of national tourist organization to deal with marketing and advertising of the Bulgarian product . The main emphasis this year will be placed on developing a strategy for eco and rural tourism and the promotion of quality standards in balneological and spa tourism.

Bearing in mind the strategic importance of the tourism sector for Bulgaria and the significant problems of regulation and support from the state, the need for a separate ministry of tourism is becoming very obvious.

AGRICULTURE. Although agriculture is the sector least affected by the crisis in national economy, more expensive credit resources, the unpredictability of weather conditions, slow to consolidation, the continuing erosion of the old irrigation systems and lack of new irrigation facilities and uncertainty in the purchase of agricultural production continue to still make agriculture a very risky industry. In the fourth quarter of 2009 the *share of agriculture* in GDP declined to 3 per cent.

In a crisis, additional support schemes for agriculture are sought, and although this is the most subsidized industry in Europe, including Bulgaria, investing in it remains extremely low. Farmers and administration are learning to meet European requirements. The possibility for mistakes and to suffer sanctions made many producers to give up the idea of support. In practice it appears that the allocation of new funds, the supply of new schemes, the opening of new measures of the Program for Rural Development does not work for the majority of farmers and their activity is gradually marginalized. The increase in insurance this year also led many farmers to decide not to register. The requirements of the EU directives on the organization and provision of grants to beneficiaries and the control on expenditure is constantly tightened while the expected payments of subsidies is delayed. As a result of all this, no matter that it is declared a priority sector by almost all governments, its development remains unsatisfactory, solving the problems is postponed, and investments are episodic without a clear vision and overall strategy

REGIONAL POLICY AND EUROPEAN FUNDS. At the end of March 2010 EU leaders endorsed the proposed strategy by the European Commission "Europe 2020" for the economic development of the Union over the next 10 years. The document set out the key priorities of the EU concentrated in the following areas: value through knowledge-based growth, more opportunities for people in open societies, acquiring new skills, encouraging creativity and innovation, development of competitive environmental economy. Each country should formulate its development goals by 2020, for Bulgaria it is particularly important to determine by consensus its medium-term strategic priorities.

At the end of March 2010 the European Commission presented the Report on Bulgaria's progress under the Cooperation and Verification. The report acknowledges that in the recent months the country has taken important initiatives, which demonstrate commitment to reforms. However the report indicates poor results in terms of the judiciary and its ability to investigate and convict for corruption and organized crime at high levels.

In early 2010 the government continued efforts to *accelerate the absorption of EU funds*. In early 2010 the European Commission gave a positive assessment of compliance of all operational programs, which effectively unfreeze EU funds for Bulgaria. Now the country may use the full financial resources of seven operational programs (without positive assessments you can use only 20% of the money as advance payments). As of early 2010 in seven operational programs are paid nearly 208 million euros, which represents only 2.6% of the funds provided for three years.

Efforts are put together to optimize the utilization of EU funds: in March a Minister for management of EU funds was appointed, and a permanent working group was set up, which controls the disbursement of EU funds. General guidelines for avoiding conflicts of interest were created and guidelines for interpretation of the term "conflict of interests." Despite the efforts, Bulgaria continues to be lagging behind all EU member states in terms of absorption of EU funds. Bulgaria is lagging with project implementation too. It is necessary to make use of resources more efficient, more transparent and cost-effective. This means working in partnership – economic and social partners should work together and inform the public of successes or problems. There has been some progress in building a working mechanism for cooperation between local government authorities and program governing bodies. There remain difficulties in developing partnership with business, because it is more difficult to formulate common positions.

In 2010 Bulgaria will surely come out of the cyclical economic crisis triggered by the global downturn in 2008-2009. Nevertheless, it is equally certain that the renewed growth will be weak. This is due to structural causes in our economy that do not allow high growth under the favorable global conditions. First, the exhausted opportunities for strong growth in the real estate market and construction as a result of the global collapse of the real estate market and domestic factors. Secondly, there are purely Bulgarian problems with the structure of the economy that must be addressed and solved. This is the insufficient development of modern industrial production, particularly manufacturing, which do not show growth potential. Foreign investments have rarely been attracted to the sector.

In general, the country must solve in a short time the following issues, in order to be a competitive and dynamic economy:

- **attracting foreign investment to domestic industry;**
- **further improving the business environment;**
- **infrastructure development, education and health;**
- **aggressive innovation policy in all sectors, using the capacities of Bulgarian science;**
- **a more active government support and regulation for tourism development;**
- **a clear energy policy;**
- **measures to promote large scale agriculture on the one hand and a modern average farm agriculture, especially in livestock farming on the other hand.**