Monday, April 12, 2010

Country Focus – Bulgaria

Bulgarian government puts off ERM II application

Last Friday, the Bulgarian government announced in a press conference held by Finance Minister Djankov that it will not apply for ERM II entry during 2010. The decision was triggered by the discovery of additional annexes in procurement contracts, which led to a significant (voluntary) revision of past fiscal data. The government discovered unaccounted annexes to 150 procurement contracts that were signed by the previous Socialist-led government in late 2008 and in 2009 (ahead of the parliamentary elections).

According to the Prime Minister Borisov, prior government officials never disclosed those annexes, submitting misleading information to the incoming government. The annexes were revealed only after Prime Minister Borisov ordered an investigation. As a result, when the budget for 2010 was drafted in autumn 2009, those annexes were not included. According to preliminary estimates, the total value of the contracts amounted to around 2.2 billion Leva (€1.1 billion).

The above developments will likely have significant fiscal and policy implications for Bulgaria, as the government has already revised (voluntarily) the fiscal data of the last two years. Specifically, the budget surplus of 1.8% of GDP reported in 2008 will be revised to a surplus of just 0.2-0.3% of GDP. Furthermore, the government´s estimate for the 2009 budget deficit (in ESA95 terms) will be raised from 1.9% of GDP to 3.7% of GDP in 2009. The revised figure for 2009 stands above the 3%-of-GDP deficit threshold of the Maastricht criterion, but still remains well below the corresponding average deficit in EU-27 (6.9% of GDP, according to the EU Autumn forecasts). The 2009 public debt ratio stood at 16.1% of GDP before the revision, being the lowest in EU-27.

In our view, the news may temporary exert a negative effect on domestic financial markets. Yet, there is no imminent threat to the stability of the currency board, especially in view of the current significant pool of international reserves (€12.2 bn or 36.3% of GDP in late March) and the strong political commitment to it. On the other hand, maintaining a sound fiscal position is very crucial to maintain public confidence in the currency board. This necessitates a harder effort to contain the budget deficit below 3% in 2010 so as to

Research Team:
Gikas Hardouvelis, *Chief Economist and Director of Research*
Platon Monokroussos, *Head of Financial Markets Research*
Tassos Anastasatos, *Senior Economist*
Ioannis Gkionis, *Research Economist*
Stella Kanellopoulou, *Research Economist*
Galatia Phoka, *Emerging Markets Analyst*
Theodoros Rapanos, *Junior Economist Analyst*

Sales Team:
Fokion Karavias, *Treasurer*
Nikos Laios, *Head of Sales*
Yiannis Seimenis, Ioannis Maggel, *Corporate Sales*
Stogioglou Achilleas, *Private Banking Sales*
Petropoulos Theodore, *Institutional Sales*
Karanastasis Kostas, *Retail Sales*

EFG Eurobank Ergasias, 8 Othonos Str,GR 105 57, Athens,Tel:(30210) 3718 906, 3718 999, Fax:(30210) 3337 190, Reuters Page: EMBA,Internet Address: http://www.eurobank.gr

avoid the excessive deficit procedure (EDP). In any case, the upward revision under the current circumstances represents a blow to Bulgaria's solid fiscal record and the credibility of its fiscal data reporting.

In addition, the Bulgarian government´s decision to postpone its ERM-II entry application may entail significant implications for other Euro-entry aspirants. The first implication is that the Eurozone-enlargement fatigue may increase further in the period ahead, so that Euro-adoption plans may fall significantly behind for other candidates as well.

Last but not least, we anticipate that EU Commission will increase the level of scrutiny in all economies of New Europe given the experience with Greek fiscal statistics. On the positive side, pressure with structural reforms will now intensify. The last EU interim report on Bulgaria contained a relatively positive, though still cautious, assessment with respect to the recent progress on judicial and administrative reforms. The latest developments may indeed increase the pressure on the government to show more tangible results in its structural reforms drive.

Ioannis Gkionis, Research Economist
igkionis@eurobank.gr