

Pest Analysis

RATIONALE: The following section aims at providing the Company's management and designated employees with detailed, up-to-date information and analysis of the current political, economic, social and technological climate in Bulgaria that we believe are relevant to a prospective investor in the real estate segment.

Political Factors

Bulgaria's transition to a democracy and a free-market economy after the collapse of the communist regime was difficult and prolonged. Throughout the early 1990s, the country was struggling to tackle political instability and to boost low living standards. The former communists left a burdensome heritage. Although the end of the decade was more stable, there was little tangible progress in political and economic reforms. However, under the government of Bulgaria's former king, Simeon II, who was prime minister between 2001 and 2005, market reforms designed to meet the EU economic targets were implemented as a result of which the country achieved stable growth, fall of unemployment, and significant increase in earnings and living standards. Nowadays, the political climate in Bulgaria is stable. In the past decade, Bulgaria has seen rapid economic development, the establishment of long-standing political and economic relationship with Western Europe and the US, and wide support by international organizations such as the IMF, World Bank, NATO, and the EU.

Political System and Ruling Party

Ever since the collapse of the Soviet Union and the establishment of a democratic system in the country in 1991, Bulgaria has been a Parliamentary Republic ruled by a self-governing, publicly elected government, functioning within a unitary republican constitution. The Prime Minister of the nation is the leader of the executive branch of the administration. The National Assembly is composed of 240 deputies elected by a national vote for a term of 4 years. In order for a political organization (party or coalition) to enter the parliament, it must receive at least 4% of the popular vote. In 2009, a modification of the parliamentary election system was passed under which only 209 of the members of the assembly are elected by proportionate vote, where citizens choose from nominated parties or coalitions, whereas the remaining 31 are elected by majority vote, where citizens make their vote from a list of individual candidates instead of their pertaining political organizations.¹ The political system in the country is established in a manner that provides the majority of power in the hands of the Parliament given that it is the one responsible for enacting or amending laws, organizing and distributing the budget, ratifying international agreements and treaties, scheduling presidential elections, selecting or dismissing the Prime Minister and other leaders of specific ministries, as well as declaring war.²

Bulgaria's most recent parliamentary elections took place on July 5th, 2009. The decisive winner of the vote was the recently formed centre-right party Citizens for European Development of Bulgaria (GERB), led by the mayor of the capital city of Sofia . Boyko Borissov. The percentage spread of the vote was as follows: 39.71% for GERB, 17.7% for the Bulgarian Socialist Party (BSP), 11.3% for Movements for Rights and Freedoms (MRF), 9% for Ataka, 7.7% for the Blue Coalition, and 4.13% for the Law, Order and Justice Party (LOJ). The winner accumulated more votes than the combined percentage collected by the members of the previously ruling three-sided, centre-left coalition (which consisted of the BSP, under the leadership of the ex-Prime Minister Sergey Stanishev, the Simeon II National Movement (SNM), and the predominately ethnic Turkish MRF). As a result, the Stanishev three-sided coalition was removed from power and a minority government formed solely by GERB took office soon after the elections, taking 116 of the 240 seats of the National Assembly. Despite the lack of majority, the leader of GERB refused to enter into a coalition with his preferred partners of the

¹ <http://www.fc.gov.uk/en/about-the-fco/country-profiles/europe/bulgaria/?profile=politics&pg=7>

² http://en.wikipedia.org/wiki/Bulgaria#cite_note-7

Blue Coalition and the LOJ Party. Nevertheless, their declared political support for GERB in the coming 4-year term secured the stability of the government.³

Bulgaria's President is elected by popular vote for a five-year term. He serves as the country's head of state and commander-in-chief of the armed forces and also chairs the Consultative Council for National Security.⁴ Nevertheless, his political role in the government is largely limited to a ceremonial function since the legislative power is exercised solely by the parliament and the Prime Minister. The President cannot initiate legislation other than amendments to the constitutions although he is allowed to veto a law and return it for further debate, which however can be superseded by the Parliament by a majority vote of all members of the assembly.⁵

The President of Bulgaria since January 2002 has been Georgi Parvanov. He won re-election in October 2006 and commenced his second term in the position in the beginning of 2007, beating the nationalist Volen Siderov. The next Presidential elections in Bulgaria will be held in 2011.

Foreign Policy

In recent years, Bulgaria has established and maintained longstanding political and economic foreign relationship with Western Europe and the rest of the industrialized world, which has received widespread public support. The country takes active participation in several multilateral organizations. It joined NATO in March 2004 and the European Union (EU) Accession Treaty in April 2005. It became a full-member of the EU on January 1st, 2007, along with Romania, which among other privileges gave the country the right to elect and provide 17 of the members of the European Parliament (EP).⁶ Bulgaria has also received wide support by international organizations such as the International Monetary Fund (IMF) and the World Bank.

The nation is also a member of the United Nations since 1955 and is a founding associate of the Organization for Security and Co-operation in Europe (OSCE) in 1995. It is a Consultative Party to the Atlantic Treaty, as a result of which, it participates in the administration of the territories located south of the 60-degree latitude.⁷ Furthermore, Bulgaria has been a member of the Council of Europe since May 1992 (in the second half of 1994 it became the first former communist republic to hold the Presidency of the organization)⁸ and of the World Trade Organization (WTO) since December 1996.⁹ The country is also a member of the Australia Group and several other similar international groups and organizations such as the Wassenaar Agreement, the Zangger Committee, the Nuclear Suppliers Group and the Missile Technology Control Regime.¹⁰

Bulgaria and the EU

The EU officials set tough entry requirements for Bulgaria, reflecting their concerns about the economic and political reforms still to be implemented in the country, as well as the growing corruption and organized crime. Even though a number of market reforms were introduced that significantly improved its economic performance, anti-corruption measures in Bulgaria have still been evaluated as inadequate. In the last months of 2008, Bulgaria experienced severe problems in its cooperation with the EU in the field of the EU funded pre-accession projects. In July 2008 the EC suspended Bulgarian financing under the PHARE, SAPARD and ISPA pre-accession programs. Additionally, it withdrew the accreditation of two government agencies charged with managing funds

³ http://www.dfat.gov.au/geo/bulgaria/bulgaria_cob.html; http://en.wikipedia.org/wiki/Bulgarian_parliamentary_election,_2009

⁴ http://en.wikipedia.org/wiki/Bulgaria#cite_note-7

⁵ <http://www.fco.gov.uk/en/about-the-fco/country-profiles/europe/bulgaria/?profile=politics&pg=7;>

http://en.wikipedia.org/wiki/Bulgaria#cite_note-7

⁶ http://www.dfat.gov.au/geo/bulgaria/bulgaria_cob.html

⁷ http://en.wikipedia.org/wiki/Bulgaria#cite_note-7

⁸ http://www.coe.int/T/E/com/about_coe/member_states/e_bu.asp

⁹ http://www.wto.org/english/thewto_e/countries_e/bulgaria_e.htm

¹⁰ http://www.dfat.gov.au/geo/bulgaria/bulgaria_cob.html

under the PHARE pre-accession program. EUR 500 million designated for Bulgaria under the three programs was frozen following investigations by the European Anti-Fraud Office, which indicated that funds have been misused. The decision was taken due to concerns about the growing corruption and organized crime in the country. According to the report, strongest corruption was evident in the judicial and health-care systems as well as the political parties. EC is said to be willing to release the financial support on the programs once the government takes the necessary measures for improving the management, implementation and control of the funds. In order to address the concern of the EC, as well as the rising tension in the parliamentary opposition, the previous Bulgarian government significantly tightened its policies but did not manage to achieve significant reduction in the levels of corruption and fraud in the country, which is considered a major reason for their defeat in the last parliamentary elections held in July 2009.

In July 2009, the EC published its third full report on Bulgaria's advancement on the remaining unresolved issues in the Justice and Home Affairs (JHA) of the country. The report was critical of the outgoing Bulgarian government's failure to make significant steps forward in the fight against corruption and organized crime, highlighting ongoing concerns with the efficiency of the pre-trial phase, and the administrative capacity of the police and judiciary. Nevertheless, the new government of GERB has received wide support among EU officials and there is much hope that it will succeed in the fight against corruption in the country. In order to have a chance to show some progress on the issues raised by the EU, during his first official visit to Brussels in early September 2009, the newly elected Prime Minister Boyko Borissov made a special appeal to the EC to give some faith to the new government and allow Bulgaria to improve its image. As a result, the officials agreed to release some EUR 140 million originally allocated for agriculture and rural development but frozen over corruption fears in 2007/2008.¹¹ More positive advancements in the EU-Bulgaria relationship are expected to come in the near future as the funds allotted to the country are successfully used in approved projects.

Another problematic area has been the Kozloduy nuclear power plant, which supplies about half of Bulgaria's electricity and brings millions of euro from electricity exports. Under pressure from the EU, two of the oldest reactors were already shut down at the end of 2002 in response to some of the pre-acquisition demands. Despite insistence from the Bulgarian government that extensive safety improvements had been introduced in recent years, Brussels has requested that two of the remaining four reactors are also closed.¹²

The EU has also praised the country for the progress it has achieved. Many projects under the supervision of the union have been approved and are expected to considerably improve the economic and political stability in Bulgaria. First installed at BCP Lesovo (at the border with Turkey) in 2006, the Single Fiche (also known as a circulation sheet), a pioneering system for improving the border quality of service and security, has demonstrated a number of benefits including faster processing, strong anti-corruption deterrent and larger revenues to the national / EU budget. In a recent report on the progress achieved by Bulgaria in the context of the Cooperation and Verification Mechanism, the EC praised the Single Fiche system as a good practice and a strong anti-corruption measure.¹³

Visa Free

One of the main advantages for the Bulgarian economy as a result of the accession of the country to the EU is the free movement of people and capital. The opening of the borders facilitates the business environment in the country and is a key factor for increasing the FDI. Bulgaria has signed a declaration for its accession to the Schengen common border control and visa space. Under the Schengen Treaty, moving from one country to another within the Schengen area is done without border controls since the Schengen visa allows members to visit all associate states in the area and

¹¹ <http://www.euranet.eu/eng/Today/News/English-News/Bulgarian-PM-fights-to-unfreeze-EU-funds>

¹² http://news.bbc.co.uk/2/hi/europe/country_profiles/1059735.stm

¹³ <http://www.epractice.eu/en/news/284488>

to cross borders without any formalities. It is important to add that the Schengen area and the European Union are two different zones that in some cases include different countries. According to the statement, the country is expected to become full-right member of the Schengen system by March 2011.¹⁴ Currently, the Schengen treaty consists of all EU member states excluding Bulgaria, Romania, and Cyprus, and including the non-EU nation of Norway.¹⁵

Economic Factors

The Bulgarian economy went through some particularly difficult times during the transition years of the 1990s, when its traditionally strong agricultural sector was hampered by slow reform of the centralized communist system and its main export markets in the Council for Mutual Economic Assistance (Comecon) . an economic organization of communist states equivalent but less geographically inclusive than the European Economic Community (EEC)¹⁶ that is considered as the economic counterpart to the Warsaw Pact, were disintegrated. The industries developed by the communist nations were found unsuited for the global competition they came upon in the period of a transition to a market economy. Those factors caused a sharp drop in the agricultural and industrial productivity of Bulgaria and led to a major national economic and financial crisis in the 1996-98, when the country experienced severe contraction of GDP and triple-digit inflation. Over the past decade, the nation's economic situation has improved significantly. The monetary and fiscal stability in the country has been steadily recovered with the assistance of the IMF and the adoption of a broad reform program, including key trade and price liberalization, establishment of a currency board with the Bulgarian Lev tied to the Euro, restructuring all major economic sectors, reforming the social segment of the economy, and privatizing state-owned enterprises and allowing for increasingly more competition in all economic sectors.¹⁷ As a result, Bulgaria achieved macro-economic stability, low basic interest rate, a sharp drop in unemployment, and fairly low levels of inflation.¹⁸

Nowadays, Bulgaria has a highly industrialized, free market economy, with a large, fairly advanced private sector and a number of important state-owned enterprises. The country is classified as an upper-middle-income economy by World Bank statistics.¹⁹

Gross Domestic Product (GDP) and Economic Growth

The Bulgarian economy has been developing at a rapid pace since the early 2000s, driven by strong investment and consumption. The country's real economic growth rate had been sustained at levels between 5% and 6% for the past several years, which was more than double the EU average of 2.8%. Nevertheless, the nation continues to be ranked as the lowest income member of the EU. As revealed by Eurostat (the statistical office of the European Communities) data published in a news release in June 2009, the GDP per capita in Bulgaria expressed in Purchasing Power Standards (PPS) stood at 40% of the EU-27 average based on latest GDP data as of the end of 2008 and most recent PPPs available.²⁰

In 2008, Bulgaria's GDP totaled BGN 66.4 billion (EUR 34 billion), which marked a real growth of 5.8% year-on-year basis as compared with 2007.²¹ The country's leading economic sectors of services and industry (contributing with respectively 60% and 30% to GDP) were major drivers of

¹⁴ <http://www.mvr.bg/en/Schengen/accession.htm>

¹⁵ <http://www.axa-schengen.com/en/schengen-countries>

¹⁶ <http://en.wikipedia.org/wiki/Comecon>

¹⁷ <http://cweb2.loc.gov/frd/cs/profiles/Bulgaria.pdf>

¹⁸ http://www.dfat.gov.au/geo/bulgaria/bulgaria_cob.html

¹⁹ http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0..contentMDK:20421402~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html#Europe_and_Central_Asia

²⁰ http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-25062009-BP/EN/2-25062009-BP-EN.PDF

²¹ <http://www.emergingeuropemonitor.com/file/75952/macroeconomic-forecast-bulgaria.html>

economic expansion by growing with 7% and 8.1% respectively.²² However, the nation is increasingly more affected by the global financial crisis as all reputable statistical agencies have estimated overall negative economic growth for 2009 and possibly for 2010. The imbalances generated in the last few years of rapid economic expansion, along with the impact of the global financial crisis, are expected to cause a sharp slowdown in the next couple of years. As released by the National Statistical Institute (NSI), in the first quarter of 2009, Bulgaria's GDP contracted by 3.5% on an annual basis, which was the first tangible indication of the severe effects of the global crisis on the nation's economy, which had so far been measured only in terms of falling Foreign Direct Investment (FDI), industrial output, and trade.²³ Furthermore, this was the first drop in GDP in the country since the financial and economic slump in 1996-98 and was much sharper than initially forecasted by macroeconomists. For the second quarter of 2009, the NSI announced that Bulgaria's GDP had shrunk by 4.8% compared to the same period in 2008. As of the end of August 2009, the country's GDP was estimated at about EUR 8,090 (BGN 15,825) billion in current prices. The gross added value generated by the national economy's sectors was at the level of EUR 6,700 (BGN 13,105) billion in current prices, which, when compared to the same period of 2008, is down by 3.4%.²⁴ The reduction in economic growth is expected to have a sharp effect on the Bulgaria's standard of living, which continues to be ranked lower than in other Central European countries.²⁵

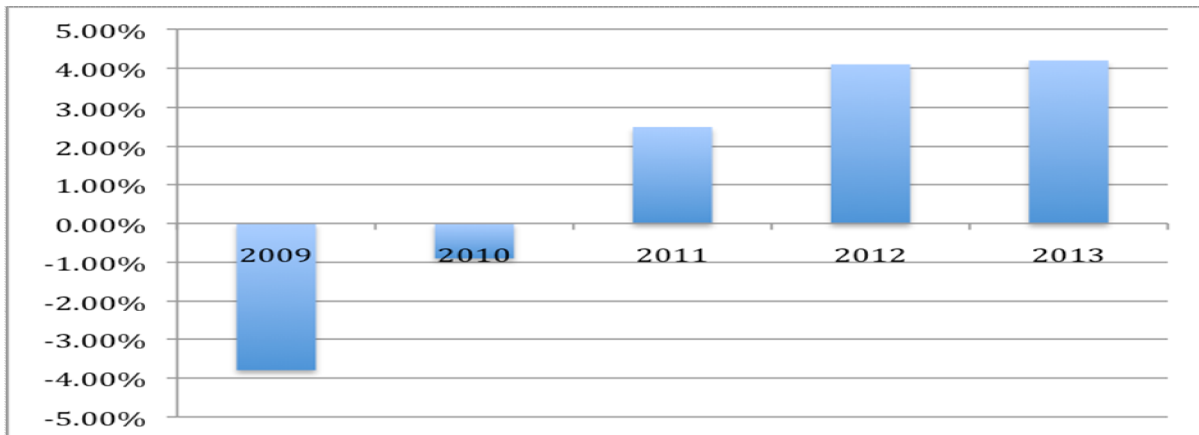


Chart 1. Real GDP Growth for the period 2009-2013 (including estimates)

The slowdown in economic activity is mainly attributable to the sharp decrease in bank lending as well as demand for Bulgarian exports as foreign markets have sharply contracted. The foreign banks that hold the largest share of the Bulgarian banking system severely reduced the credit lines to their Bulgarian counterparts and tightened the credit conditions, which made it largely impossible for the majority of the clients to serve new credits.²⁶ Furthermore, the NSI argues that the reduction in GDP growth in the second quarter of 2009 is accredited mainly to the decrease of nearly 10% in the added value of the industrial sector compared to the same period in 2008.²⁷ The GDP growth forecasts provided by several statistical sources have deteriorated sharply over the past quarter and have an average level of about 4% decline in 2009 with standard deviation of 1.5.²⁸ The latest forecast as of June 2009 provided by the Economist Intelligence Unit (EIU), a foremost provider of country economic and business data and analysis, suggests that real GDP will contract with 3.8% in 2009 and 0.9% in 2010, which will be followed by an average growth of 3.6% in the period 2011-2013 (refer

²² <http://www.nsi.bg>

²³ http://www.novinite.com/view_news.php?id=104543

²⁴ http://www.amcham.bg/news/todays_news/economy/09-08_18/Bulgaria_GDP_down_by_4_8_during_2nd_2009_Quarter.aspx

²⁵ http://www.dfat.gov.au/geo/bulgaria/bulgaria_cob.html

²⁶ http://forton.bg/en/wp-content/FORTON_Q2_2009_Economic_report.pdf

²⁷ http://www.amcham.bg/news/todays_news/economy/09-08_18/Bulgaria_GDP_down_by_4_8_during_2nd_2009_Quarter.aspx

²⁸ http://forton.bg/en/wp-content/FORTON_Q2_2009_Economic_report.pdf

to Chart 1 above).²⁹ The forecast for the period 2009-2010 is largely supported by statistical data released by the IMF (an economic contraction of -3.5% in 2009 and -1% in 2010), the European Bank for Reconstruction and Development (EBRD) (an economic contraction of -3% for 2009 and -1% in 2010), and Raiffeisen Bank (an economic contraction of -3.5% in 2009 and growth of 1% in 2010).

Balance of Payments

The continuously growing current-account deficit and the consequent need to attract external finance have been major concerns to policymakers in the past years due to the rising challenges to the macroeconomic stability of the country. In 2008, Bulgaria's current and capital account deficit was reported at the record high level of 23.5% of GDP (BGN 15.6 billion or EUR 7.98 billion), against a deficit of 20.6% of GDP (BGN 12.9 billion or EUR 6.5 billion) for the same period in 2007. For 2008, the current account deficit was 24.3% of GDP (BGN 16 billion or EUR 8.25 billion), against a deficit of 21.8% of GDP (BGN 12.3 billion or EUR 6.3 billion) for the same period in 2007.³⁰

However, due to the decreasing domestic demand as compared to the period 2006-08 resulting from the global economic slowdown, the growth in imports has been restrained, leading to a rapidly shrinking current account deficit in the country. During the period January-May 2009, the current account deficit was estimated to be with 44.7% lower than the same for the equivalent period in 2008. The current account deficit amounted to EUR 1.97 billion (or about 5.8% of total GDP) for the first six months in 2009 compared to EUR 3.57 billion (or about 10.5% of GDP) for the same period in 2008.³¹ The EIU has forecasted total a decline of the deficit of 13.5% of GDP (or EUR 4.5 billion) for 2009 and a further decline of 8% on average during the rest of the forecast period concluding in 2013 (see Chart 2 below).

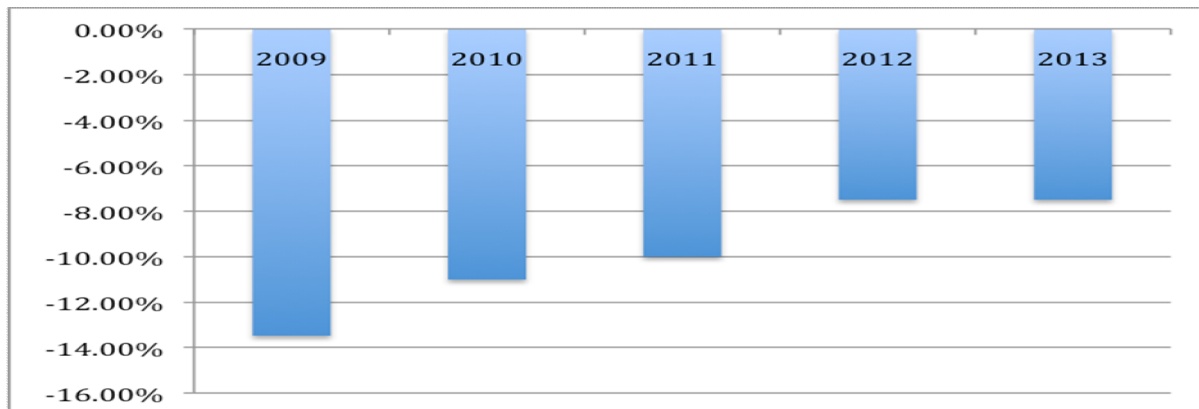


Chart 2. Current Account Balance for the period 2009-2013 (estimates)³²

The major factor for the sharp decline in the current account deficit has been the ongoing economic slowdown as a result of which, the trade balance of the country decreased by EUR 1.29 billion for the first half of 2009. Imports totaled EUR 6.455 billion in the first six months of the year compared to EUR 9.690 billion during the same period in 2008. Similarly, exports amounted to EUR 4.394 billion in 2009 against EUR 6.342 billion for the first half of 2008. Therefore, the total trade deficit for the first six months of the year was EUR 2.061 billion (or about 6.1% of GDP) against 3.348 billion (or about 9.8% of GDP) for the same period the previous year. The services balance was estimated at EUR 16.9 million against EUR -245.5 million for the same period in 2008.³³

²⁹ <http://store.eiu.com/product/1930000193BG/wf-ssb-articles.html>

³⁰ http://reports.aiidatapro.com/BBC/Balance_of_Payments_Dec_2008.pdf

³¹ http://forton.bg/en/wp-content/FORTON_Q2_2009_Economic_report.pdf

³² <http://store.eiu.com/product/1930000193BG/wf-ssb-articles.html>

³³ http://forton.bg/en/wp-content/FORTON_Q2_2009_Economic_report.pdf

In mid-September 2009, the Bulgarian National Bank (BNB) announced that for the first time in five years, the Bulgarian economy reported a current account surplus as a result of the sharp reduction in consumer spending in the country due to the deepening economic recession forcing households to limit consumption and raise saving. As of July 2009, the current account surplus was EUR 102 million compared with the EUR 439 million current account deficit in the same month of 2008.³⁴ The surplus was further enhanced by a fall in the trade deficit by EUR 328.3 million as well as by a EUR 113.1 million increase in currency inflows from tourist activities. Furthermore, a EUR 95.8 million decline in income deficit also added to the overall current account surplus. Therefore, as a result of the global financial crisis reaching the Bulgarian economy, the current account deficit of the country, which in 2008 was the only one from the EU-27 to finish the year 2008 in negative levels, no longer seems the most overwhelming challenge for the economic stability as the gap almost halved between January and July 2009, reaching EUR 2.8 billion compared to about EUR 5 billion for the same period in 2008.³⁵

Foreign Economic Relations

After the collapse of the Soviet Union, Bulgaria gradually moved away from dependence on the Comecon markets, increasing its exports to Western Europe. In 1996 the country joined the WTO and in 1999 the Central European Free-Trade Agreement (CEFTA), members of which are also Croatia, the Czech Republic, Hungary, Poland, Romania, Slovakia, Slovenia, and Macedonia (since 2006).³⁶ This allowed for the nation to establish import foreign economic relations with the above countries, co-operation with which has now been transferred to the wider sphere of the EU, which is now the largest trading partner of Bulgaria, contributing with roughly 60% of the country's total trade. As revealed by the NSI, in 2008 Bulgaria exported a total of EUR 9.2 (BGN 18) billion to its EU partner countries, out of a total export value of EUR 15.2 (BGN 29.8) billion. Compared to 2007, Bulgarian exports to other EU countries grew by 11.8%, while imports also increased by 12.1%.³⁷ Nevertheless, the global economic turbulences have caused severe reductions in the export / import trade of the country as preliminary data for 2009 discloses. As preliminary data released by the NSI in early September suggests, total exports for the first seven months of 2009 amounted to EUR 6,437 (or BGN 12,590) million, of which EUR 4,212 (or BGN 8,238) million resulted from trade solely with the EU, whereas the remaining EUR 2,224 (BGN 4,350) million came from non-EU export trade. On the other hand, total imports for the same period of 2009 amounted to EUR 9,255 (or BGN 18,099) million, of which EUR 5,497 or (BGN 10,970) million resulted from the trade solely with the EU, and the remaining EUR 3,572 (or BGN 7,128) million came from non-EU import trade.³⁸ This marked a total trade deficit of EUR 2,760 (or BGN 5,510) million, which is a strong indication for the declining economic activity of the country due to the global financial instability.

Within the EU, Greece ranks first as a destination for Bulgarian products, followed by Germany and Italy. As latest data announced by the NSI suggests, in 2008 these three countries accounted for 46% of Bulgaria's total exports to the EU. They were also the country's main import partners, accounting for 44% of the total imports for the same period. Other important export partners of Bulgaria are Belgium, France, and the US (outside the EU). Romania is also a large import partner of Bulgaria. On the import side, the economy also has stable relationships with France and Austria. The country's trade deficit with the EU reached BGN 10 billion in 2008. Bulgaria's main EU export products include metals (iron and steel) and other raw products (32%), clothes, furniture, and footwear (23%), machinery and equipment (17%), and fuels (11%). On the other hand, a large percentage of the imports are accounted for by raw materials such as cloth, metal ore, and petroleum, which are processed and re-exported.

³⁴ http://sofiaecho.com/2009/09/17/785954_bulgaria-produces-current-account-surplus-for-the-first-time-in-five-years

³⁵ <http://news.dnevnik.bg/?y=2009&m=9&d=17>

³⁶ http://en.wikipedia.org/wiki/Economy_of_Bulgaria#cite_note-cp12-25

³⁷ http://www.novinite.com/view_news.php?id=101867

³⁸ http://www.nsi.bg/ZActual_e/ImpExp0709.htm

However, as a result of the ongoing global financial crisis that has hit the Bulgarian economy in the past several months and in parallel with forecasts for increasing unemployment in the economy, which is set to reach 10% by the end of the year, exports and imports have been decreasing in across all types, with the exception of cosmetics. As revealed by a report by the Bulgarian Industrial Association, in the first half of 2009, production, sales and exports declined in nearly all sectors. The wood-processing industry has suffered major losses, registering a decrease of 44.6% in sales and 21.3% in exports. Furthermore, according to the same report, fuel exports decreased by 32.6% for the same period of 2009. Nevertheless, cosmetics exports from the country increased by 6% during the first half of the year compared with the same time in 2008. Industry Watch, Sofia-based think-tank, argued that Bulgaria's export structure has been changing fundamentally, with the share of some consumer goods such as cosmetics increasing at the expense of raw materials.³⁹ The country's electrical energy exports have also dropped by 28.4% in the first half of 2009 or from 2.16 million MWh in the middle of 2008 to 1.5 million MWh in July 2009.⁴⁰ Finally, one of Bulgaria's rapidly growing export sectors – the wine industry, declared a 70% fall in exports in the beginning of September 2009 as a result of the economic crisis. The National Vine and Wine Chamber (NVWC) announced that despite the growing favorable publicity of the Bulgarian wine quality in recent newspaper articles in the UK, France, and US, the export of bottled and dry wines declined by 21% and 30% respectively. In 2008, Bulgaria exported 873 hectoliters of wine, of which 63% went to Russia and 19% to Poland.⁴¹

Leading trade partners outside the EU are Russia, Turkey, and increasingly Japan. Russia is the major gas importer to Bulgaria, which for years has caused large trade deficits between the two countries. However, the last two years have seen an 80% increase in the Bulgarian exports to the country, which has significantly improved the trade balance. Overall, Bulgaria has a strong position in the Commonwealth of Independent States (CIS), which is expected to be developed further in the future. Another key trading partner of Bulgaria is Turkey, commerce with which is expected to improve Bulgaria's balance as a result of the reduction of tariffs and other impediments to trade (by not being a member of the EU, Turkey is not part of the Single market and has higher tariffs and taxes on Bulgarian imports). Also, in 2008, Bulgaria's imports from Japan rose by 231%, mostly due to the increased purchases of Japanese cars and air-conditioning systems by the Bulgarian customers. This development is due to decelerate considerably in 2009 due to the global economic slowdown.

Foreign Direct Investment (FDI)

FDI has been the driving force for economic expansion in Bulgaria during the past decade. Since the beginning of the 2000s, FDI has been growing steadily, reaching BGN 12.7 billion (EUR 6.51 billion) in 2007. Investments have been stimulated by a favorable fiscal policy, flat corporate tax rate of 10% (lowest level in the EU) and 0% for regions with high unemployment (refer to Map 1 below), and low operational costs. Another investment incentive measures have also been the right of acquisition of land and property through a Bulgarian registered company with up to 100% foreign ownership, the VAT exemption on equipment imports for investment projects over EUR 5 million, and the treaties for double taxation avoidance with 61 countries.⁴² Nevertheless, foreign capital inflows have shown significant imbalances, with 60% of FDI going to real estate, tourism and commerce, and only 30% dedicated to production. In 2008 FDI in Bulgaria experienced a significant decline as a result of the global economic crises, which has caused an unfavorable investment environment. According to data released by the BNB, FDI in Bulgaria for the period of 2008 was BGN 10.6 billion (EUR 5.43 billion), or 16% of GDP against BGN 12.73 billion (EUR 6.51 billion), or 22.6% of GDP, for the same period in 2007.⁴³

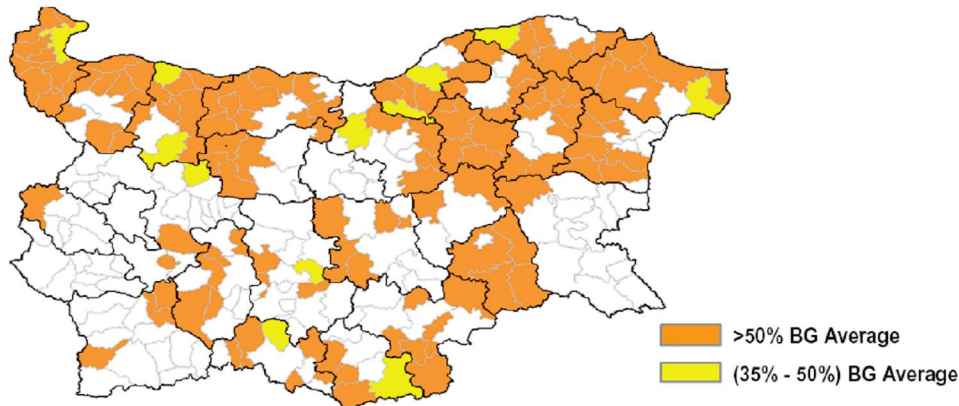
³⁹ http://sofiaecho.com/2009/08/25/774311_economic-crisis-reshapes-bulgarias-exports-structure

⁴⁰ http://www.novinite.com/view_news.php?id=106812

⁴¹ http://www.novinite.com/view_news.php?id=107379

⁴² http://forton.bg/en/wp-content/FORTON_Q2_2009_Economic_report.pdf

⁴³ http://reports.aiidatapro.com/BBC/Balance_of_Payments_Dec_2008.pdf



Map 1. Regions with High Unemployment (marked in red and yellow)

This negative development has continued in 2009, with FDI levels declining substantially during the first half of 2009 as compared with the same period of 2008. The BNB announced that the foreign capital inflows the country attracted in January-July 2009 was EUR 1,881.4 million (or 5.6% of GDP) compared to EUR 3,954.1 million (or 11.6% of GDP) in the same period of 2008.⁴⁴ So far, during 2009 only in June a positive balance of payments of EUR 146 million was registered mainly due to the large state loan the country received from the World Bank. Overall, Bulgaria's balance of payments for the first six months of 2009 declined to the negative amount of EUR 888 million against the positive balance of payments of EUR 1,271 billion during the same period in 2008.⁴⁵ The attracted Equity Capital for the first seven months of 2009 amounted to EUR 1,453.1 million, which was 77.2% of the foreign direct investment. It decreased by EUR 603.6 million compared to that attracted in the same period of 2008 (EUR 2,056.8 million, 52% of total foreign direct investment). The receipts from real estate investments of non-residents amounted to EUR 352.3 million compared to EUR 863.9 million for January . July 2008.⁴⁶

The decline in FDI as well as in domestic demand has already had an impact on the economic growth of the country, which has contracted with 3.5% for the first quarter of 2009. The direct investment covered 76.8% of the current account deficit in 2009 against 65.6% for the same period in 2008 and 103.4% for the same period in 2007, when the economy was rapidly growing.⁴⁷ Nevertheless, taking into account the negative impact of the global recession, Bulgaria still manages to attract very high levels of FDI. Furthermore, the structure of FDI in the country has significantly improved; the manufacturing sector has attracted BGN 1.4 billion (EUR 720 million) in 2008, compared to just BGN 312 million (EUR 160 million) for the same period last year. It should be noted that the figures above are preliminary and are usually revised significantly upwards. The increased FDI in manufacturing is expected to accelerate labor productivity growth and ultimately total factor productivity growth. Expectations are for a revival in the levels of FDI in the country from 2010 onwards, when the economic environment is projected to start recovering from the global economic turndown.

In a recent report on the economic circumstances in Bulgaria, Forton International has concluded that since October 2008, the overall business climate in the country has deteriorated severely. Only in July 2009, the total business climate declined by 1.2% compared to June the same year. The total business climate in the industry was reduced by 4.3% against the previous month; in the real estate sector individually it declined by 1.5%, while in the construction branch investment prospects increased by 2.4%. Investments in the real estate sector have experienced the most significant decrease in FDI . from EUR 409 million in Q1 of 2008 to EUR 103 million in Q1 of 2009, which

⁴⁴ [http://bnbank.org/bnb/home.nsf/vPages/S_FDI_Dev_euro/\\$FILE/200907_S_FDI_Box-en.pdf](http://bnbank.org/bnb/home.nsf/vPages/S_FDI_Dev_euro/$FILE/200907_S_FDI_Box-en.pdf)

⁴⁵ http://www.novinite.com/view_news.php?id=106779

⁴⁶ [http://bnbank.org/bnb/home.nsf/vPages/S_FDI_Dev_euro/\\$FILE/200907_S_FDI_Box-en.pdf](http://bnbank.org/bnb/home.nsf/vPages/S_FDI_Dev_euro/$FILE/200907_S_FDI_Box-en.pdf)

⁴⁷ http://sofiaecho.com/2009/09/17/785954_bulgaria-produces-current-account-surplus-for-the-first-time-in-five-years

marked a decrease of about 75%. The construction sector also revealed a significant decrease for the first quarter of 2009 as compared with 2008 . from EUR 102 million to EUR 74 million.⁴⁸ This trend is expected to continue during the rest of 2009 and beginning of 2010, but reverse onwards as the economy is forecasted to start reviving.

Currency Board

Since 1997 Bulgaria has been operating under a currency board arrangement implemented by the BNB. The exchange rate of the Bulgarian Lev was fixed to the Euro by law at the level of 1.95583. The arrangement is considered as one of the most radical and positive reforms implemented in Bulgaria, which is set to prepare the country for eventually entering the European Monetary Union (EMU) and adopting the Euro by protecting its currency risk and curbing high levels of inflation. Consequently, there has been a strong political commitment in its maintenance until the likely acceptance of Bulgaria in the Euro zone in 2014. The Bulgarian Lev is likely to join the EU exchange rate mechanism (ERM II) sometime between 2011-13. A currency in ERM II is allowed to float within a range of -15% to +15% with respect to a central rate against the euro. The adoption of the ERM II is considered as the pre-ultimate stage in joining the EMU for a member of the EU. Even though Bulgaria was expected to enter the ERM II in 2008, high levels of inflation . 12.5% at year-end and 8.4% average for 2007 and upward revision of inflation expectations for 2008 did not allow it. Although inflation is not a formal criterion for ERM II entry, EC and ECB parties are unwilling to let Bulgaria enter before the country has clear prospects of reducing inflation to a level closed to the Maastricht criterion (lowest three of EU of 1.5%). Current levels of inflation as of the first seven-eight months of 2009 have lowered significantly due to the economic crisis in the country but are expected to revise upwards in during 2010 as the country's economy is forecasted to start reviving. Furthermore, currency reserves, which are aimed at supporting the currency board mechanisms, have shrank by EUR 180.3 million in July 2009 and by a total amount of EUR 1.07 billion for the first seven months of the year, which could potentially create grounds for financial instability in the economy in the next few months and may postpone the country's entry in the ERM II.⁴⁹

Interest Rates

The BNB has been lowering monthly the country's base interest rate since its record high level of 5.77% in December 2008. In January 2009 it was lowered to 5.17% (a decrease by 0.60 percentage points). This downward trend followed in the next two months . in February the base rate was decreased by another 1.25 percentage points to 3.92% and in March, the BNB announced another reduction of 0.43 percentage points, bringing the rate to its lowest level since January 2007. Thus, Bulgaria's base interest rate has been lowered with 1.68 percentage points since the beginning of the year.

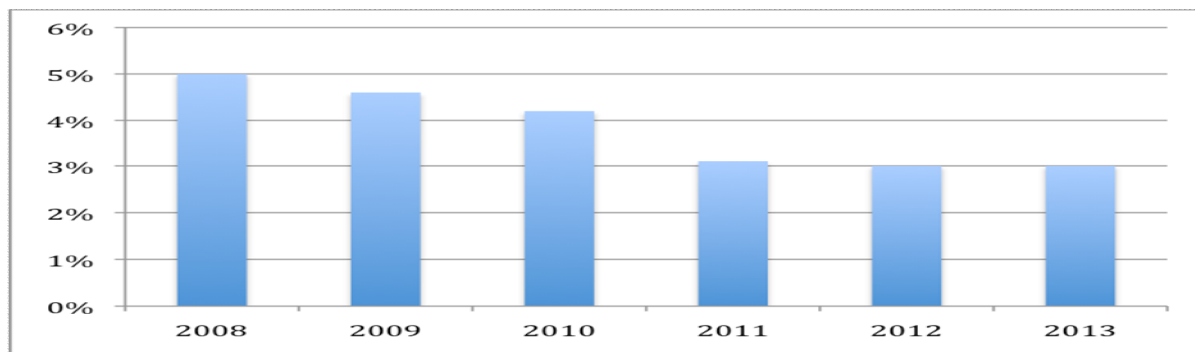


Chart 3. Average Short-term Interest Rates for the period 2008-2013 (including estimates)⁵⁰

⁴⁸ http://forton.bg/en/wp-content/FORTON_Q2_2009_Economic_report.pdf

⁴⁹ http://sofiaecho.com/2009/09/17/785954_bulgaria-produces-current-account-surplus-for-the-first-time-in-five-years

⁵⁰ <http://store.eiu.com/product/1930000193BG/wf-ssb-articles.html>

In September 2009, the BNB announced the lowest basic interest rate of 1.57% since the index was first started being recorded in 1991. This was down by 0.14 percentage points compared to the previous month.⁵¹ This trend has continued since the beginning of the year and is expected to do so in the following months since the global economic crisis is still unfolding, causing very low levels of domestic demand. By taking this step, the government is hoping to encourage banks to lower their rates on loans and deposits and thus, to boost consumption in the economy. Furthermore, the EIU forecasts a stable decline in the short-term central interest rate for the rest of the forecast period, reaching about 3% in 2012-13 (refer to Chart 3 above). However, these reductions have not been matched by interest rates for borrowers yet.

Over the third quarter of 2009, several Bulgarian banks started bringing down their loan rates, as the first signs that the global credit crunch, which to a large extent froze Bulgaria's economic activity, was easing up were evident. DSK Bank was the first to decrease interest rates on loans and take some burden off the borrowers in June 2009, when it reduced its housing and mortgage loans with 0.5 percentage points. In August, Raiffeisenbank cut by 50% the rate on its Lev-denominated unsecured consumer loans, following a 0.55% cut of all dollar-denominated household loans in July. Several other leading lenders followed decreasing their rates. In August 2009, MKB Unionbank took 1% off its mortgage rates, which dropped to 7.95% for Euro-denominated and 9.05% for local currency loans. Postbank, one of the market's top five lenders, also lowered its interest rate on new housing mortgages. The bank will provide local-currency (BGN) financing with a 10.95% rate and euro-denominated loans for a monthly rate of 8.7%. It is expected that most other lenders will follow decreasing their rates.⁵² Market insiders argue that banks will start relaxing their funding conditions but are still waiting to see the way the economy will develop in the next few months and whether the financial sector will remain stable before the global economic crisis is overcome.

After first lowering interest rates on household mortgages in the beginning of September, the Bulgarian banking sector has showed the first indications that the business will get some support as well. In mid-September 2009, Raiffeisenbank offers its secured loans for small and medium enterprises at 10.8% interest rate for local-currency loans and at 9.2% for Euro-denominated loans. This is against a market average of 10.44% and 9.26% respectively for July 2009 and 10.32% and 9.10% respectively for July 2008. Three other lenders, including Postbank, CIBank, and UniCredit Bulbank also provided promotional terms for business loans at lower rates as well as other special offers on their mortgages targeting individuals. According to analysts, the change in strategy was induced by a fierce deposit war that drained banks' resources and, on the other hand, excess liquidity accumulated by lenders that stockpiled cash while being too anxious to lend.⁵³ Loan interest rates are expected to further decrease with about 1 percentage point by the end of the year, before lending volumes could start gaining some load.

In an attempt to attract more financial resources, banks also significantly raised their interest rates on deposits and increased the spread between interest rates on deposits in Euros and Levs. According to central BNB statistics, the return gained by newly opened Lev- and Euro-denominated deposits has decreased by 40.5% in the period January-July 2009. While racing to attract depositors by offering better deposit terms in order to satisfy their liquidity needs, the average percentage rate (APR) of consumer and housing loans denominated in BGN rose as much as 24.2% by July 2009, whereas for Euro-denominated home loans it reached 11.4%. Thus, APR on local-currency loans rose by 15.3% in the 12 months to July, while for the Euro-denominated ones, it had gone up by 7.5%. Consumer loans' APR rose by 24% for both Euro and BGN-denominated loans. Rates on local currency-denominated term deposits surged by 37.8%, while Euro-denominated financial instruments produced 43.1% higher returns. Nevertheless, local lenders on the Bulgarian banking sector seem to have become unable to manage this record high deposit rates and have been decreasing the same

⁵¹ http://www.novinite.com/view_news.php?id=107344

⁵² http://sofiaecho.com/2009/09/03/778571_bulgarian-banks-break-into-september-2009-with-cuts-to-loan-rates

⁵³ http://sofiaecho.com/2009/09/17/785950_bulgarian-banks-reduce-corporate-loan-interest-rates

during the past three months. Thus, as at the end of July, the average effective annual interest rate was 7.99% on BGN term deposits and 6.34% on Euro-denominated ones.⁵⁴

According to the executive director of Raiffeisenbank Bulgaria . Momchil Andreev, lending and deposit rates in the sector are expected to go down slightly during the final quarter of 2009 but would not reach their low levels before the bankruptcy of Lehman Brothers. He argued that local lending financial institutions have already been able to cut some rates as a result of the decline in the country premium for Bulgaria, which is estimated through credit default swaps on the state debt. Nevertheless, the country's banking sectors also has an excessive amount of capital invested in the money markets at much lower interest rates rather than in the more profitable private sector loans. The BNB announced a fairly small decline in consumer loans in July 2009 to an average rate of 14.15%. On the other hand, average mortgage rates were reduced in February and May but have increased by 78 basis points since the beginning of the year.⁵⁵

Banking, Credit Market and Risk

The record growth in GDP during the past several years, partly thanks to the 10% flat tax rate for corporate and personal incomes introduced in 2007 and 2008 respectively, in combination with the stable FDI flows, have resulted in a rapidly growing credit market. The stable increase in earnings and the low unemployment levels have resulted in a significant increase in the credits granted to households and companies in 2007 and beginning of 2008. However, the global financial crisis has impacted negatively the Bulgarian credit market, which, according to the BNB, has lost half of its last year's growth, with household loans contributing 28.3% and corporate loans adding only 32% year-on-year basis. The slowdown in economic activity is mainly attributable to the sharp decrease in lending as well as decrease of demand for Bulgarian exports. The foreign banks that own the larger share of the Bulgarian banking system sharply reduced the credit lines to their Bulgarian counterparts and tightened credit conditions. Analysts conclude that banks and customers are being increasingly more cautious in the times of turbulence. The respective figures were 52.6% and 69.9% for the same month in 2008, when they reached their highest growth. Since then, both household and credit loans have started dropping dramatically, reaching 48.9% and 55.5% respectively in the middle of 2008. At the end of 2008, the household segment grew with 31.4%, whereas the business loans rose with 33.1%. The credit market is expected to rise in the range of 10% to 15% this year. Interest on mortgage loans is continuously decreasing against a background of sliding real estate prices. Moreover, people are choosing not to take on new debt because of fears unstable jobs and incomes. In January, banks' combined corporate loan portfolio expanded by BGN 33 million, which shows a growth rate of only 0.1%. Expectations for the coming months are for an even slower growth. However, in light of the credit market circumstances in the EU-27 overall, where net cash flows have decreased sharply and bank financing has contracted with 0.4% down to EUR 47 billion, Bulgaria still exhibits strong financing and general stability.

The country's financial market appears to be safe due to the high quality and modest size of its banking sector. Bulgaria's credit rating has remained stable in the first months of 2009 unlike many of its Central and Eastern European neighbors that have experienced a rating downgrade. In February Standard and Poor's (S&P) long-term sovereign foreign currency rating for the country was BBB+ and this has not changed ever since. Even though its current account balance is still large and negative, Bulgaria's currency is considered stable as strong finances back the currency peg.⁵⁶ Furthermore, Moody's kept its credit rating for the country at Baa3, with a stable outlook.⁵⁷ The country's bonds have therefore retained investment grade even though classed as one level above junk bonds. In April 2009, Coface, the international credit risk management company, announced that it revised Bulgaria's credit rating from A4 to B due to the increased business risk in the country, which has put Bulgaria among one of 47 economies with reduced credit rating due to the impact of the worldwide

⁵⁴ http://sofiaecho.com/2009/09/04/779270_bulgaria-deposit-rates-increase-by-40-per-cent-loan-costs-up-11-20-per-cent

⁵⁵ http://sofiaecho.com/2009/09/10/782159_bulgaria-bank-rates-could-go-down-in-q4-2009

⁵⁶ http://www.economist.com/world/europe/displaystory.cfm?story_id=13184594

⁵⁷ www.moody.com

financial turmoil. The company argued that Bulgaria is expectedly among the countries with increased vulnerability to external economic shocks and local currency instability. Analyses of Coface showed that the construction and agricultural sectors have been impacted worst by the crisis.⁵⁸

The global ratings house reported that the Bulgarian economy is expected to experience difficult economic times in 2009 due to a slowdown in exports to Western and Central Europe and a decline in inflows of foreign funds. At the same time, the country is in a strong position to cope with the challenges ahead due to its strong financial discipline, tight fiscal policy, and low debt in recent years.⁵⁹

Taxes⁶⁰

- **Value Added Tax (VAT)**

- VAT in Bulgaria is 20%. There is a reduced rate of 7%;
- VAT is payable on assets and services as well as on imports into the country;
- Exports from Bulgaria are exempt from VAT;
- Income from financial services such as insurance and banking are exempt from VAT. Legal advice is also exempt from VAT subject to the terms specified in law;
- Every business with a turnover larger than BGN 50,000 during the last 12 months must register with the VAT authorities;
- Imports for investment projects of over EUR 5 million are exempt from VAT;
- There are treaties for avoidance of double taxation with 61 countries;

- **Income and Corporate Taxes**

- In 2009, income of any individual in the country is subject to a flat income tax rate of 10%;
- Exemptions from the income tax rate are granted to taxpayers with specific types of income;
- An individual in Bulgaria is liable for tax on his income as an employee and as a self-employed person. If a permanent resident of the country, tax on the individual will be calculated both on his income earned in Bulgaria and overseas;
- A foreign resident who is employed in Bulgaria pays tax only on his income in Bulgaria;
- In 2009, the standard corporate tax in Bulgaria is 10%;
- A special tax rate is applicable for companies dealing with insurance as well as companies engaged in games of chance and gambling;

- **Property Tax**

- The rate of tax on real estate that is not used for residential purposes is 0.15%;
- The tax rate on residential buildings is determined according to the provisions specified in the local tax laws;

- **Transfer Tax**

⁵⁸ http://www.novinite.com/view_news.php?id=102775

⁵⁹ http://econ.bg/en/news/article158610/moody_s_leaves_romania_bulgaria_ratings_at_investment_grade

⁶⁰ <http://www.investbg.government.bg/?sid=18&ssid=45&c=77>

- The transfer tax rates are 2%-4%. Tax is levied on transfer of real estate and vehicles.

Inflation

A major concern for the Bulgarian economy has become the continuously rising inflation, which reached 12.3% in 2008.⁶¹ The country had the second highest inflation rate in the EU after Latvia, which reached an inflation of 14.1% for the same period, Eurostat reported. This growth has been driven mainly by the large food and energy price hikes, but has also reflected a tighter labor market and an accelerating nominal wage growth.⁶² Furthermore, there has been a 2% price increase in the housing sector (including rents, repairs, and maintenance), as well as in prices of water, electric power, gas and other fuels.

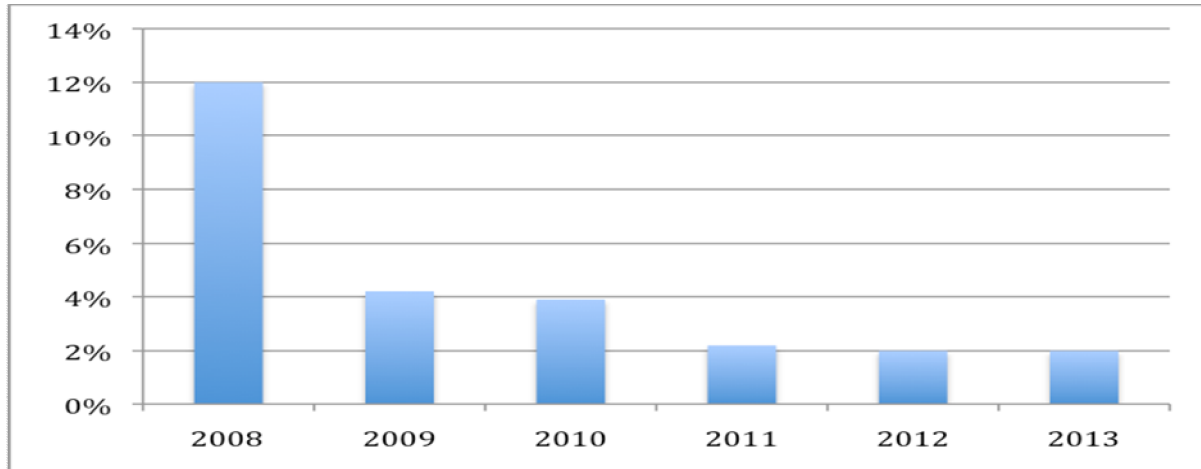


Chart 4. Consumer Price Inflation Rate for the period 2008-2013 (including estimates)

However, inflationary pressures are beginning to abate from the high levels. Weaker fuel and food prices, as well as slower growth in domestic demand, will bring down inflation in 2009-10. Inflation is forecast to continue to fall gradually in the second half of the forecast period (2008-2013), reaching levels of about 2% in 2012-13 (see Chart 5 above).⁶³ Forton International announced that the annual change of the consumer price index in 2008 was 7.8%, which has been bound to decrease significantly as a result of the economic slowdown. As expected, the inflation rate has decelerated considerably during 2009 and even deflation rates have occurred due to the global financial crisis. The inflation rate for the period January-July 2009 was 0.6%, while June and July recorder deflation of about 0.4% each.⁶⁴ According to Emerging Europe Monitor, with the forecast of further economic slowdown by the end of the year along with the fixed exchange rate regime, which prevents a depreciation of the Bulgarian currency from occurring, the disinflation process will continue during the rest of the year. However, the experts also project a devaluation of the Lev to the Euro by the end of quarter 4 of 2009, which, if true, will lead to a resurgence of the inflationary pressures, with consumer price growth at the level of 4.5% at the end of the year.⁶⁵

Employment

During the past several years, Bulgaria had maintained one of the highest employment levels in the EU, reaching about 64% in 2008. However, as a result of the raging global financial crisis, as well as the expiration of the labor contracts of many temporarily employed Bulgarians, the unemployment

⁶¹ <http://www.economist.com/countries/bulgaria/profile.cfm?folder=Profile-Economic%20Data>

⁶² <http://www.imf.org/external/np/sec/pr/2008/pr0879.htm>

⁶³ <http://store.eiu.com/product/1930000193BG/wf-ssb-articles.html>

⁶⁴ http://forton.bg/en/wp-content/FORTON_Q2_2009_Economic_report.pdf

⁶⁵ <http://www.emergingeuropemonitor.com/file/75952/macroeconomic-forecast-bulgaria.html>

rate in the country has started soaring since the beginning of the year. According to statistics released by the NSI in August 2009, unemployment in Bulgaria was 6.3% in the second quarter of 2009, which revealed a continuously worsening picture since the beginning the year. A total of 222,600 people were unemployed as of the end of Q2 2009, a decrease of 0.5% below the figure for the same period in 2008. The Institute argued that in urbanized areas, unemployment averaged 5.5%, whereas in the villages, it was 9%. The proportion of those employed in the private sector was 72.7%. These unemployment figures cover citizens of working age between 15 and 64 years.⁶⁶ Other statistical sources such as Emportal reveal worse unemployment figures of 7.88% for August 2009.⁶⁷ According the Industry Watch, more than 60% of the recently lost jobs were in the manufacturing industry. Furthermore, nearly all layoffs have been in the private sectors. The NSI released that as of August 2009, 72,000 workers had lost their jobs in the second quarter of the year, while the layoff have soared by a fifth compared to the past 12 months. The Finance Ministry's medium-term fiscal framework for 2010 to 2013 revealed that in 2009 unemployment in Bulgaria is expected to reach 9.5%, growing further in 2010 to reach 11.4%. A sharp economic contraction and decreasing inflation levels accompany the rising unemployment levels.⁶⁸

Average Earnings and Key Income Trends

The most visible effect of the growing Bulgarian economy has been the stable increase in average wages. The average earnings in the fourth quarter of 2008 amounted to BGN 548 (EUR 280), according to data revealed by the NSI. Compared to the same period of 2007, wages had increased by 22.5% or BGN 96 (EUR 49). The private sector offered the highest remuneration levels, reaching BGN 646 (EUR 330). The average growth rate of earnings as per quarter of the year has been at the level of 4.5-5%. In 2008 solely, average wages had grown from BGN 469 (EUR 240) to BGN 548 (EUR 280). The highest increase in wages was observed in the field of education and healthcare, reaching growth of 38% and 30.3% respectively. The lowest growth in the average income is observed in the extractive industries (10.6%) and in the trade and repair of vehicles, personal and household goods services (10.8%). Also, as a result of the current economic crisis, remuneration in the real estate and business services, as well as agriculture and fishery, has decreased. At the same time, household expenses have increased by only 4.5% to an average of BGN 332 per person in the last month of 2008 compared to the same period in 2007. Expenses have increased the most in the health care and transportation sectors . with 20% and 11% respectively.⁶⁹

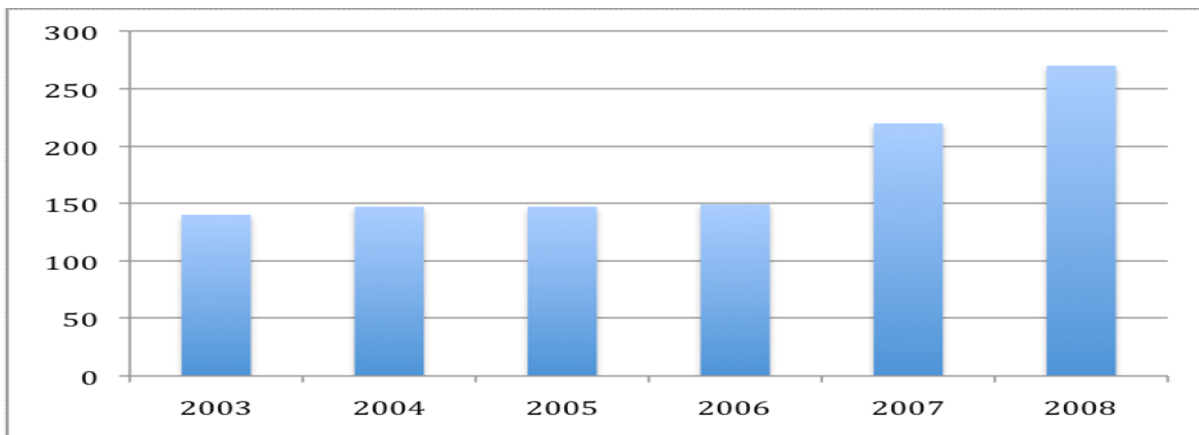


Chart 5. Average Wages for the period 2003 to 2008

⁶⁶ http://sofiaecho.com/2009/08/21/772900_unemployment-in-bulgaria-is-63-per-cent-national-statistics-institute

⁶⁷ <http://www.emportal.rs/en/news/region/99249.html>

⁶⁸ http://sofiaecho.com/2009/08/25/774311_economic-crisis-reshapes-bulgarias-exports-structure

⁶⁹ http://www.nsi.bg/Labour_e/Labour_e.htm

Despite the economic crisis in the country, the average wage in Bulgaria increased by 15.3% in quarter 2 of 2009, according to data released by the NSI. The rise in the public sector was of 16.9%, while the surge in the private sector remuneration was of 14.3%. In the first 3 months of 2009, wages surged by 4.4% to BGN 588 (EUR 295). As argued by the Institute, the largest increase in the average salaries was observed in the cultural, sports and entertainment sector, reaching 26.8%, followed by the construction branch with 26.2%. On the other hand, the lowest increase of 3.8% was observed in the scientific and research sector as well as the manufacturing one with 2.8%. The highest remuneration in the country is traditionally maintained in the financial sphere with BGN 1,355 (EUR 679) per month, as well as the electric supply and heating sector with BGN 1,321 (EUR 661) and the media sector with BGN 934 (EUR 468).⁷⁰

According to a survey done by the global real estate services firm Jones Lang LaSalle, Bulgaria continues to offer one of the best locations for Western European business looking to outsource their activities during the challenging times of global financial crisis. The country's main advantages are the lowest real estate and labor costs within the EU, along with its stable political and economic systems and its membership in the EU.⁷¹

	2008	2009	2010	2011	2012	2013
Real GDP growth (%)	6.0	-3.8	0.9	3.7	4.7	4.8
Consumer price inflation (av.; %)	12.3	4.8	4.1	3.0	2.5	2.5
Budget balance (% of GDP)	3.0	-0.3	0.3	1.0	1.4	1.4
Current-account balance (% of GDP)	-24.4	-13.5	-10.1	-8.4	-7.4	-6.8
Short-term central interest rate (av.; %)	5.2	4.8	4.4	3.3	3.2	3.2
Exchange rate Lev: Euro (av.)	1.96	1.96	1.96	1.96	1.96	1.96

Table 1. Key Macroeconomic Indicators (2008 and forecast for the period 2009-2013)

Social Factors

Welfare

According to the NSI, the number of Bulgarians living in poverty has decreased by 60% between 1999 and 2008, as a result of the effects of the growing economy and improving social politics. The poverty rate, still substantially higher than in the other EU countries, is largest in the rural and northern areas of the country. In 2000, Bulgaria started applying a large-scale reform of its pensions and social services systems, which until that time had been state-run and state-subsidized. The reform established a comprehensive pension insurance system in which participation is obligatory for all employers and employed and self-employed individuals. The system provides funds for regular retirement, worker disability, temporary incapacity, unemployment, pregnancy, and others. The establishment of this system has contributed to a large extent to the increase of the minimum wage and worker pension, which has resulted in the great reduction of poverty.

Growth in Private Savings, Credits, Investments

According to Industry Watch, a reputable local analyst, private savings have increased with 29.9% during 2008 and have continued surging throughout 2009 as a result of the economic crisis, which

⁷⁰ http://sofiaecho.com/2009/08/11/768717_wages-in-bulgaria-increase-by-15-per-cent-in-q2-of-2009

⁷¹ http://sofiaecho.com/2009/04/06/700841_low-wages-still-give-bulgaria-outsourcing-edge-real-estate-consultancy-says

has threatened the financial security of many citizens. As expected, households prefer saving in this difficult time and thus, have cut largely on their consumption. Families are being conservative in their decisions of wealth allocation. Approximately 50% of them still prefer to keep savings in bank deposits and about 25% prefer cash. The deposits between EUR 500 and EUR 1,250 prevail. A positive trend is the increase in the number of deposits of over EUR 25,000, which is significant for the development of the economy.⁷² The analysts expect that in the future, with the increase in wealth, households would turn to riskier and more profitable investments. A major problem in the financial market is the fact that investments significantly outweigh savings.⁷³

Demographics

In the context of demographics, some significant problems are evident in the country. The population has been increasingly declining for the last 18 years and currently totals 7,640,240 people after a peak of about 9 million in 1988. The decline in population is attributed to the negative population growth rate of -0.86%, which is expected to continue for at least the next 3-5 years, as well as the constant emigration. In the post communist era, migration into and out of the country increased significantly and was further accelerated by the integration of Bulgaria with the European community. According to Eurostat data, during the last few years, 2.4% of the workforce has left the country, placing Bulgaria among the countries with the highest emigration rate in the EU. The trend shows that the population will continue to decline with approximately 40,000 people per year.⁷⁴ In the worst case-scenario, by 2060 the population of Bulgaria could have dropped to as low as 5.166 million people, NSI estimates showed.

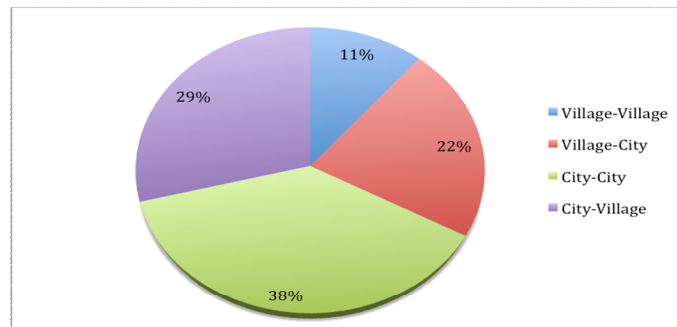


Chart 6. Internal Migration Flows (in %)

Another major demographic tendency has been the long trend of urbanization that began after World War II. Currently, about 70% of the population is urban, 40% of which is concentrated in the 8 largest cities in the country. However, Sofia (unofficially with about 2 million inhabitants) is the only city with more than 350,000 inhabitants. This process is due to the big discrepancies between the living standards and working conditions in the cities and villages. It has been observed in many other developing economies in the past. However, the analysis of NSI shows that since 2007, this trend has started to reverse.⁷⁵ An additional important has been the aging of the population. In 2008 some 13.9% of the population was 14 years of age or younger, and 17.3% was 65 years of age or older. For the same period, the birth rate in the country was 9.7 per 1,000 inhabitants, and the death rate was 14.3 per 1,000 inhabitants. The birthrate is also expected to decrease in the next 15 years as the childbearing age cohorts will decrease during that period. This trend is expected to lead to a future decrease in the workforce. In 2008, the average age of the population was 41.5 years and the average lifespan - 72.7 years (69.2 years for men, 76.3 years for women).⁷⁶

⁷² <http://www.fincity.bg/show.php?storid=542>

⁷³ <http://www.novinar.net/?act=news&act1=det&stat=center&mater=MiyZMTs4MQ==&sql=MiyZMTs0Mw>

⁷⁴ <http://evropa.dnevnik.bg/show/?storid=487504>

⁷⁵ <http://www.nsi.bg/ZActual/Population07.htm>

⁷⁶ <http://www.nsi.bg/Census/DomSemTable.htm>

Ethnic Groups

According to data provided by the NSI, the major groups in Bulgaria's population are Bulgarians, 83.9%; Turks, 9.4%, and Roma, 4.7%. However, by 2008 the actual Roma population was estimated at more than 7%. The Turkish population is concentrated in the southeastern and northeastern parts of the country. Other ethnic groups present include Armenians, Macedonians, and Tatars. Since the campaign of the Zhivkov regime to assimilate the Turkish population in the 1980s, the only ethnic issue of consequence is that of the Roma, who complain of discrimination and still suffer from very low standards of living.⁷⁷

Languages

Bulgaria's official language is Bulgarian, which is the first language of 84.55% of the population according to the last published census data. Other spoken languages are roughly in proportion to the populations of the corresponding ethnic groups present: Turkish (9.6%), Roma (4.7%), Armenian, Caucasian, Macedonian, and Tatar. As in the case of ethnic groups, the proportion of Roma speakers in the population is believed to be substantially higher than the census figure.

Education and Literacy

In 2008 Bulgaria's literacy rate as estimated at 98.6%, with approximately the same rate for both sexes. The country has traditionally had high educational standards. In 2007, enrollment in the primary grades was more than 99% of eligible students, and enrollment in the lower secondary grades was 84% of eligible students. Because of Bulgaria's low birth rate, total primary and secondary school enrollment has decreased in the post communist era, causing reductions in teaching staff and facilities. In 2008 a national teachers' strike protested budget cuts in education and resulted in salary increases. At the same time, the number of private schools has increased rapidly during the last decade. In 2007, the country had 100 private schools and about 10,000 students studying there. Bulgaria's higher education system was fully reorganized in the mid-1990s. In 2007 some 43 institutions of higher education were in operation, and 220,000 students were enrolled.⁷⁸ The three of the most prominent universities in the country are the technical universities of Sofia, Varna, and Ruse. With more than 3,500 graduating professionals every year, these universities prove the market with specialists in the fields of electrical and electronic engineering, telecommunications, computer systems and control, etc.

Cultural Perceptions

Bulgaria is among the countries with the highest ownership rate in the EU. According to official statistics, approximately 91% of the people own their place of residence.⁷⁹ This fact could be explained with deeply rooted psychological factors. People's perceptions that property is among the most secure investments and will always remain profitable are predominant. In the context of the membership in the EU, Bulgarians have many opportunities for investment and development. Thus, currently, many programs are aimed at stimulating the entrepreneurial spirit among students and businessmen.

Technological Factors

Online Property Selection and Purchase

The Bulgarian real estate market has quickly adapted to the trends and the growing popularity of Internet in the society. Since 2008, real estate pages have been some of the most often visited web sites in the local Internet space. The largest ones . www.imot.bg and www.imoti.net administer more than 30,000 visitors per day, which accounts for more than 5,000 viewers per offer, weekly. The two web sites had managed to increase their earnings by more than 30% before the crisis hit the market,

⁷⁷ <http://cweb2.loc.gov/frd/cs/profiles/Bulgaria.pdf>

⁷⁸ <http://cweb2.loc.gov/frd/cs/profiles/Bulgaria.pdf>

⁷⁹ http://bulgaria.thebulgarianpost.com/story-read_bulgarian_real_estate_market_expects_growth_in_2006-8.php

which was a clear indication for the increased consumer demand. According to Mr. Strahil Ivanov, general manager of Yavlena Properties, one of the largest local real estate companies, an increasing number of potential customers are doing preliminary selection of properties online. This trend makes real estate firms invest in increased Internet presence. Even though the segment of real estate web sites is quite consolidated at the moment . around 80% of the deals are administered by 3-4 major websites . it has undoubtedly contributed to the diminishing of consumer risk, shortened the time for selection and purchase of property and led to fair pricing.⁸⁰

The Use of Modern Engineering Techniques and High-Quality Materials

Bulgaria's architectural landscape has drastically changed its shape for the last several years. Grey blocks are now being obsolete; modern architecture is gradually shifting the look of urban centers. The modern design and engineering approach and the use of high quality materials and machines have shortened the construction process and at the same time increased the efficiency of the buildings. According to architect Mityo Videlov, chair of the Building of the Year competition, this trend is to remain positive in the long run.⁸¹ As of 2008, there appear the first real estate projects completed with the idea to create not only a highly technological, but also an eco-friendly environment. A notable example, according to Mr. Sergey Koinov, general manager of Forton International, is the Sofia Airport Center.⁸² Despite the growing fears that modern techniques will further increase the supply of properties in the local market, experts such as Mr. Sergey Koinov, and Mr. Valeri Leviev, general manager of Elta Consult, both argue that until 2010, no oversupply is expected.^{83 84} This trend of modernization and creation of green+environment is expected to continue in the future since the real estate market of Bulgaria has seen quickly growing supply of properties during the past several years, which has made clients much more demanding for quality buildings and eco-friendly surroundings. Even though many projects have been frozen or suspended due to the ongoing economic crisis in the country, industry experts believe that after the expected revival of the Bulgarian economy during 2010, property investments with even higher quality architectural planning will be present on the market.

⁸⁰ <http://www.capital.bg/show.php?storyid=467333>

⁸¹ <http://www.indeximoti.bg/show.php?storyid=445714>

⁸² <http://knigi.dnevnik.bg/show/?storyid=482559>

⁸³ <http://knigi.dnevnik.bg/show/?storyid=482559>

⁸⁴ <http://www.indeximoti.bg/show.php?storyid=397014>