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RECORD FOREIGN TRADE DEFICIT OF BULGARIA IN 2004

The foreign trade turnover of Bulgaria grew from 31.8 bn Leva in 2003 to 38.4 bn Leva in 2004. This represented a 20.4 % increase on a year to year basis. 2004 was the second year in raw when such record breaking rate of increase was achieved. Exports in 2004 totalled 15.6 bn Leva, which was more by 19.9 % than in 2003. The value of imports in 2004 made up 22.7 bn Leva, which represented an increase of 20.9 % compared to the value of imports in 2003.

Due to the slightly higher growth rate of imports than that of the exports during 2004 the balance of trade deteriorated by about 23.2 %. A year earlier, the balance of trade deficit increased by 25.8 %. In December alone, the foreign trade deficit was about 700 million Leva, which was a record sum for one month. The fourth quarter of 2004 generated 35.2% of the annual foreign trade deficit. Imports not only continued to grow faster than exports but its growth rate speeded up substantially (Table 1).

Thus, the value of trade deficit reached 7.1 bn Leva (or 5.3 bn Leva on FOB basis) in 2004. This amount was a negative record level since the mid-1990s. If the foreign trade data and ratios are calculated in USD the results are even worth because of the adverse effects of the depreciation of the USD vis-à-vis the euro, to which the Leva is pegged (Table 2).

The member states of the European Union were the most important trade partners of Bulgaria. The foreign trade turnover with these countries accounted to about 21.4 bn Leva, which was about 55.8 % of the total trade turnover of Bulgaria. The largest trade partner within the EU was Italy, followed by Germany, Greece, Belgium and France. These five countries represented about 40 % of the total value of turnover. It means that the geographical structure of the exports was very much concentrated on these EU countries.

From the non-European countries, the most important trade partner was the USA, but for the first time in several years, the USA was not among the top ten importers. Foreign trade turnover with the Commonwealth of Independent States increased both in 2003 and 2004. Imports from China increased by 51.9 % within one year and its worth reached 738.8 mn Leva (Table 3).

In 2004, the current account balance deficit was mainly covered by the substantially increased FDI inflows, which totalled about USD 2.5 bn and not by foreign loans, which would have increased the external debt of Bulgaria considerably. The foreign trade deficit was resulted in exclusively by the increasing expenditures of the private sector because the government budget had surplus in 2004. (See: Record budget revenues in Bulgaria in 2004 – an estimated surplus of the budget again, SEE Monitor 2005/3, p. 6-7.) The consumption and investment expenditures of the Bulgarian private sector increased substantially and to different extent.

Looking at the commodity structure of imports there are some worrying and some positive trends. The imports from the EU consisted of mostly yarns, textile and leather that were processed in Bulgarian firms and then the ready-made clothes and shoes were exported. The most important export destination of the Bulgarian goods and services were mainly Italy, Germany, Greece and Turkey. About 37 % of total imports came from Russia, Germany and Italy. During the last year, the value of clothes imported from China increased substantially. It contributed to the record-breaking value of total imports from China.

Crude oil, copper ores, natural gas and second-hand cars were the dominating items in the Bulgarian import. These goods account for 20 % of the total import. Within a year, the import of second-hand vehicles grew by 47 %. The most important products in the export were unrefined copper and electric power (Table 3).

The negative signs in the commodity structure of foreign trade were that the imports contained proportionally too much consumption goods and second-hand vehicles within the machinery and transport equipment. The annual rate of increase of the import of these products exceeded the average increase of the total imports. It would have been more useful for the overall development of the Bulgarian economy if the share and annual increase of the values of imported capital goods (producing equipment and machinery) had increased more substantially.

TABLE 1 EXPORTS AND IMPORTS OF BULGARIA IN 2004*

MONTHS	EXPORT-FOB		IMPORT-CIF		IMPORT-FOB		TRADE BALANCE FOB/FOB	
	mn. levs	mn. USD	mn. levs	mn. USD	mn. Levs	mn. USD	mn. levs	mn. USD
January-March	3 362.4	2 169.3	4 718.4	3 044.4	4 356.8	2 811.1	-994.4	-641.8
April-June	3 713.8	2 279.7	5 705.7	3 501.9	5 262.5	3 229.9	-1 548.7	-950.2
July-September	4 280.3	2 677.1	5 622.1	3 517.1	5 179.7	3 240.3	-899.4	-563.2
October-December	4 278.1	2 761.9	6 675.5	4 314.3	6 151.5	3 975.8	-1 873.4	-1 213.9
January –December	15 634.6	9 888.0	22 721.7	14 377.7	20 950.5	13 257.1	-5 315.9	-3 369.1

**Data are preliminary*

TABLE 2 EXPORT AND IMPORT VOLUMES BY YEAR (IN MN LEVA AND MN USD)

Leva million	1998	1999	2000	2001	2002	2003	2004
Total turnover	16,107.7	17,484.4	24,130.9	27,072.7	28,326.8	31,838.5	38,356.3
Exports (FOB)	7,381.4	7,356.6	10,274.1	11,176.1	11,875.9	13,041.9	15,634.6
Imports (CIF)	8,726.3	10,127.7	13,856.8	15,896.6	16,450.9	18,796.6	22,721.7
Imports (FOB)	8,052.1	9,341.8	12,777.4	14,654.2	15,166.9	17,343.9	20,950.5
BALANCE (FOB/CIF)	-1,344.9	-2,771.1	-3,582.7	-4,720.5	-4,575.0	-5,754.7	-7,087.1
BALANCE (FOB/FOB)	-670.7	-1,985.2	-2,503.3	-3,478.1	-3,309.0	-4,302.0	-5,315.9
USD million	1998	1999	2000	2001	2002	2003	2004
Total turnover	9,150	9,521	11,332	12,374	13,595.5	18,198.4	24,265.7
Exports (FOB)	4,193	4,006	4,825	5,113	5,692.1	7,444.8	9,888.0
Imports (CIF)	4,957	5,515	6,507	7,261	7,903.4	10,753.6	14,377.7
Imports (FOB)	4,574	5,087	6,000	6,693	7,286.6	9,922.8	13,257.1
BALANCE (FOB/FOB)	-381	-1,081	-1,175	-1,580	-1,594.5	-2,478.0	-3,369.1

Source: BNB, NSI

TABLE 3 EXPORTS AND IMPORTS BY COUNTRIES AND BY COMMODITY GROUPS IN 2003 AND 2004* (MN LEVA)

	Export-FOB			Import-CIF		
	2003	2004	2004/2003 %	2003	2004	2004/2003 %
Countries	**Geographical structure of exports and imports**					
TOTAL	13 041.9	15 634.6	119.9	18 796.6	22 721.7	120.9
Central and Eastern European countries	1 654.2	2 170.2	131.2	1 676.4	2 227.3	132.9
CIS	463.8	528.0	113.8	3 478.8	4 207.6	120.9
Of which: Russian Fed.	182.2	197.2	108.2	2 363.0	2 874.7	121.7
Other OECD	2 327.1	2 964.9	127.4	3 335.6	3 998.1	119.9
Turkey	1 193.4	1 562.0	130.9	1 151.1	1 369.2	118.9
USA	582.7	698.7	119.9	480.6	512.9	106.7
EU **	7 843.6	9 115.9	116.2	10 403.4	12 291.4	118.1
Belgium	791.6	932.7	117.8	258.2	328.0	127.0
France	661.4	704.4	106.5	1 059.7	1 207.0	113.9
Germany	1 404.7	1 597.2	113.7	2 681.9	3 312.5	123.5
Greece	1 352.3	1 554.7	115.0	1 250.2	1 305.6	104.4
Italy	1 829.1	2 041.6	111.6	1 922.0	2 232.7	116.2
EFTA	105.2	122.7	116.6	233.9	294.2	125.8
Other countries	1 484.5	1 831.0	123.3	1 895.9	2 499.5	131.8
Of which: China	106.6	57.3	53.8	486.3	738.8	151.9
by SITC	**Commodity structures of exports and imports**					
TOTAL	13 041.9	15 634.6	119.9	18 796.6	22 721.7	120.9
Food and live animals	868.6	1 058.3	121.8	824.1	1 009.6	122.5
Beverages and tobacco	273.2	367.8	134.6	79.9	113.6	142.2
Crude materials, inedible (except fuel)	817.3	961.5	117.6	1 041.7	1 361.4	130.7
Mineral fuel, lubricants and related materials	1 088.5	1 601.2	147.1	3 285.5	3 793.8	115.5
Animals and vegetable oils, fats and waxes	23.7	46.6	196.6	77.3	77.8	100.6
Chemical and related products	1 180.0	1 204.3	102.1	1 875.7	2 358.1	125.7
Manufactured goods classified chiefly by material	3 214.3	4 311.8	134.1	3 951.5	4 911.4	124.3
Machinery and transport equipm.	1 701.4	1 932.6	113.6	5 390.2	6 734.1	124.9
Misc. manufactured articles	3 749.1	4 015.0	107.1	1 896.7	2 063.8	108.8
Commodities and transactions	125.8	135.5	107.7	374.0	298.1	79.7

** Data are preliminary*

*** EU have the structure of 1 of May 2004 and includes 25 countries*

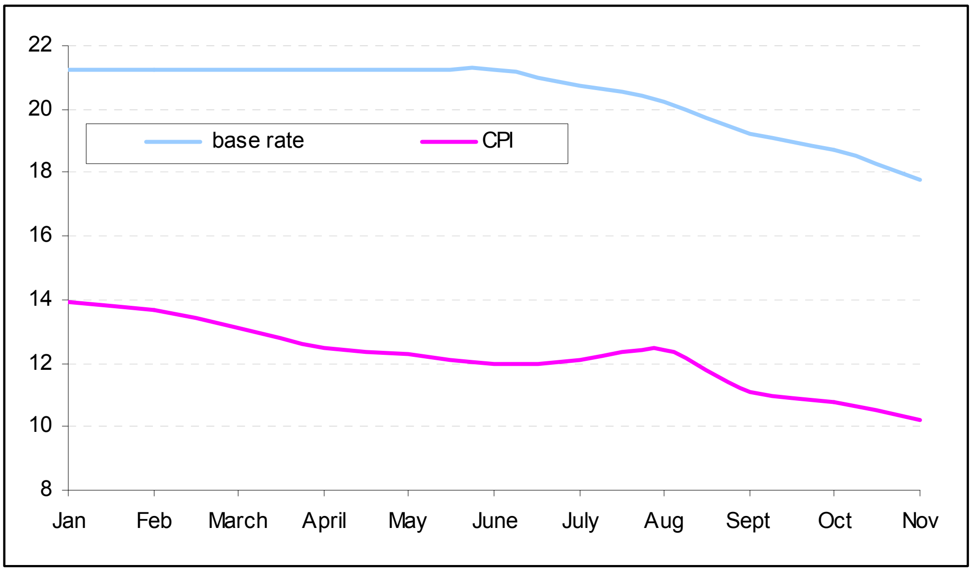
MACROECONOMIC TARGETS IN ROMANIA FOR 2005

JOINTLY AGREED MACROECONOMIC TARGETS WITH THE IMF FOR 2005, AND ONGOING PROBLEMS WITH THE APPRECIATION PRESSURE ON THE CURRENCY IN ROMANIA.

IMF finished its latest mission to Romania, and really ambitious macroeconomic goals were set for the year 2005. The Fund and the government agreed on a 6.5-6.8% current account deficit ratio to the GDP for this year. In order to curb the worsening trend of the external balance and help disinflation, a significant fiscal adjustment was approved, consolidated general government deficit is expected to be reduced to 0.4-0.5% of the GDP, following last year's 1.2%. The growth rate of the economy is projected to be 5.5% in 2005 after the robust 8.0% in 2004. The main goal of the monetary policy, pursued by the National Bank of Romania (NBR) will be to bring the year-on-year CPI to 7% by the end of the year. The year 2005 will be certainly a challenging one for the country, because of the capital account liberalisation scheduled for spring. The high base rate, which is necessary for the disinflation, is likely to attract a huge amount of speculative capital to the country, which might destabilize the financial system and put a serious appreciation pressure on the local currency.

NBR cut its key interest rate by 75bp to 15.75% on February 13. The Central Bank needs to reduce the base rate quickly because the double digit rates provide significant spread, and thus attract serious capital inflows to the country. The situation will get more problematic later on this year, since Romania has to free up the capital flows as a part of its convergence process before joining the European Union in 2007. Following the rate cut decision the bank said that its prudent monetary policy would focus on achieving three long term goals: sustainable, long term economic growth, keeping the current account within reasonable limits, and curbing annual inflation to a level of 2-3%.

CHART 1. CPI AND BASE RATE IN ROMANIA IN 2004



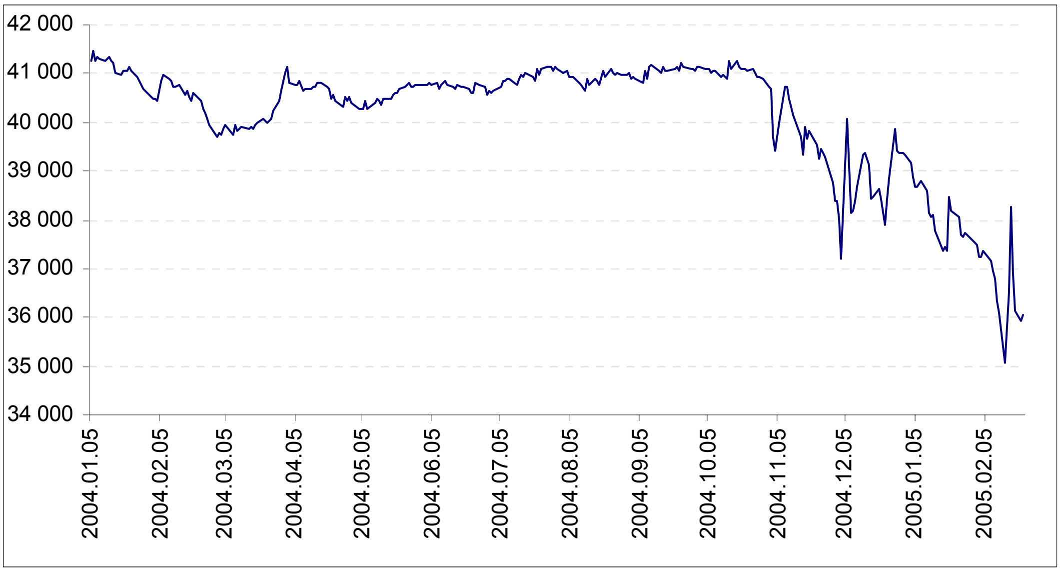
In the statement, released after the rate slash NBR reiterated the 7% inflation target for 2005. The Central Bank said that the ongoing disinflation allowed room for the monetary easing. CPI dropped to 8.9% in January 2005 compared to the 9.3% of December last year. Despite the slow down of the y-o-y rate, inflation quickened to 0.8% in January after the 0.6% in December, mainly due to the sharp rise of the energy prices. According to the National Statistics Board, electricity prices rose by 4.4%, while gas prices increased by 5% in January. The high energy prices coupled with a 0.5% rise of the fuel resulted in a 1.3% increase of the non-food prices. The data showed that the decline of the services prices reversed, and prices edged up by 0.6% in January, following the 0.4% decline in December last year.

Concerning the general macroeconomic trends NBR claimed that the 28% y-o-y rise of the broad money in real terms was favourable, because it pointed to a significant remonetization of the economy, that can be attributed to the rise of the ROL-denominated savings. NBR pointed out, however, to the risks of the rapid credit expansion. In 2004 non-government credit increased by 26% in real terms, while foreign exchange credit in euro terms shot up by 57%, which might pose prudential risks on the commercial banks. It is for these reasons the NBR decided to impose on the commercial banks a 30% minimum reserve requirement for the debt with maturities of more than two years.

The rapid credit expansion contributes to Romania's main macroeconomic challenge, which stems from the simple fact that the current output fails to accommodate the significant increase of the domestic demand. Current account deficit reached 4.4 bln euros in 2004, 7.7% of the GDP according to the revised methodology. The widening of the gap was mainly due to the increasing trade deficit, the shortfall reached 5.3 bln euros following the 3.95 bln euros in 2003. The government and the NBR plans to reduce the C/A gap to 6.9%, that is supported by the significant fiscal adjustment. Government plans to cut the general government deficit to be 0.4-0.5% of the GDP in 2005 after the 1.2% in 2004, however the ambitious target requires serious efforts because of the recently approved tax rate cuts. Despite the high C/A figures Central Bank Governor Mugur Isarescu said no major adjustment was needed, because 98.4% of the gap was financed by FDI inflows. Besides the favourable financing structure the NBR reserves rose significantly as well, reaching 5 months of imports.

Concerning the C/A deficit developments and the disinflation process, the strong capital inflows and the rapid appreciation of the leu certainly pose some risks. The strong currency causes huge losses for the exporters and might force the Central Bank to cut rates faster than domestic conditions would allow. It is for these reasons that Romanian Central Bank directly intervened on the FX market to curb the firming of the local currency.

EUR/ROL EXCHANGE RATE SINCE 2004



NBR entered the FX market on February 15, when the EUR/ROL was quoted at 34,800/900, and pushed the cross back to 36,300/700, later on the day the Central Bank entered trading again, and EUR/ROL closed the day 36,800/37,100. The bank intervened on the next day again, and the cross temporarily got above 38,000. According to the dealers, the intervention was likely since the currency had firmed sharply recently. The Central Bank Governor Mugur Isarescu announced on February 17 that the bank bought more than 520 million euros in the past few days in order to rein in the strengthening of the local currency. Mr. Isarscu said that 220 million was bought directly on the FX market while 300 million was bought indirectly from banks. The Central Bank governor added that the bank would continue to do so in the future, but it would mainly focus on keeping the foreign exchange reserves at an optimal level to cover five months of imports.

The Central Bank Governor claimed that NBR did not have any specific exchange rate target, their main goal was price stability. (Central Bank used to have a pre-announced real exchange rate target against a euro/dollar basket with 75/25 weights, but the bank shifted to a more flexible exchange rate regime in November last year.) The main reason for giving up an exchange rate target and intervene less frequently was to induce higher volatility for the leu, and discourage the speculative inflows. Isarescu pointed out this time again that such sharp swings in the exchange rate in such short time should make the speculative investors more cautious, because high local interest rates might be offset by exchange rate losses. „Such investors will know the exchange rate when they enter the market, but no one would be able to predict the exchange rate when they exit". According to the Central Bank Governor, speculative capital was significant on the market at the time of the intervention, only 20% of the more than 500 million euros bought by the NBR, came from exporters. Mr. Isarescu said however, that he saw no major threat from potential future speculative capital, because the market simply can not absorb the huge amounts. The Central Bank Governor put it the following way. „They may want to come in with a long train but we have quite a short platform for it."

MONTENEGRO: BUDGET IN 2005

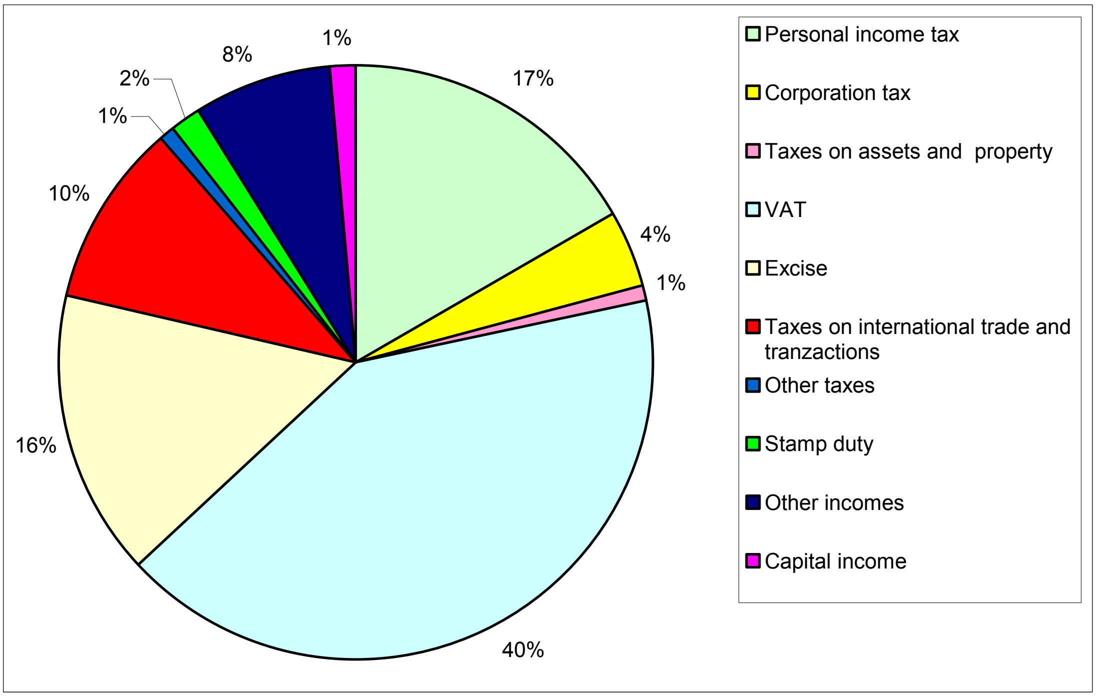
The budget of Montenegro for 2005 is compatible with the Agenda of economic reforms in Montenegro, the main goal is to keep the economic stability. The gross amount of the budget is planned to be EUR 492 million, the net expenditure is expected to be EUR 462 million, and the planned deficit is EUR 34 million. This is the first time when gross and net amounts have been presented and the gross amount contains EUR 29 million loans.

The deficit counted with current methods will be EUR 34 million, 2,17% of the GDP. It will be financed by domestic and foreign loans in amount of EUR 24,6 million, with income from privatization around EUR 6 million, foreign source is expected to be EUR 14,5 million, from which EUR 3,6 million is donation. According to IMF's methods, which will be applied from this year, the budget deficit will be EUR 26 million, only 1,6% of GDP. This means that instalment of old foreign exchange deposits is treated as debt redemption. With the low level of budget deficit and inflation Montenegro is slowly converging to some EU macroeconomic indicators.

The planned budget expenditures is expected to be 29,9% of GDP, which is lower than 30,45% in 2004 and 32,83% in 2003. The budget is in consistence with the valued economic growth and economic policy for 2005. It also follows the main point of the Agenda of economic reforms in Serbia, which was accepted in 2003 as a four-year plan for economic reforms.

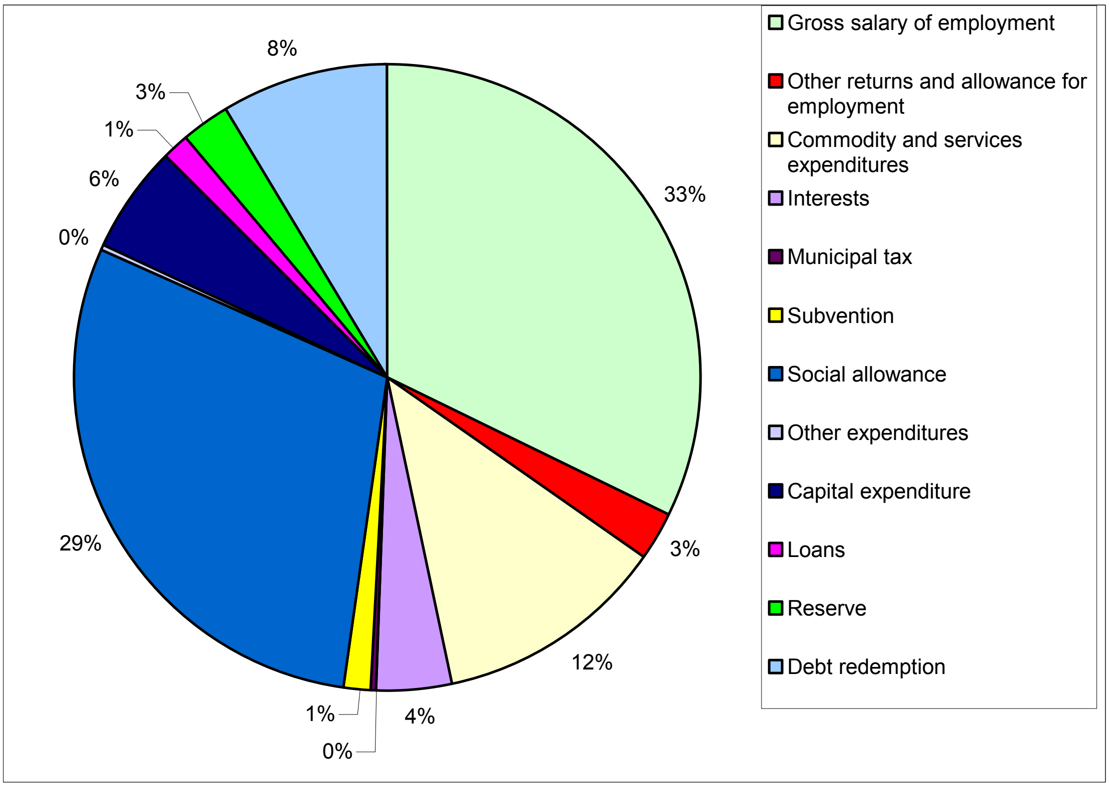
The budget revenue will be EUR 428,52 million from taxes (from VAT EUR 177,1 million) duties, stamp duty, excises and other taxes. The amount of budget expenditures will be EUR 349,2 million, and the transfers to pension fund, to social security fund and other transfers will be EUR 79,32 million. The interest payment will be 3,97% (from EUR 19,5 million: IBRD - EUR 13,6 million, EIB - EUR 1,8 million, Paris Club - EUR 3,5 million) of the budget expenditures in 2005.

CHART 3. PLANNED BUDGET REVENUES IN 2005



Source: Ministry of Finance Montenegro

CHART 4. PLANNED EXPENDITURES FOR 2005



Source: Ministry of Finance Montenegro

The expenditure of pension fund will be EUR 10 million higher this year (EUR 66 million). The reason for this increase is that starting from this year the government want to relieve the economy, to cut back taxes and contribution, and due to rationalization of government structure more retirements are expected.

The structural reform of pension fund and health fund is planned this year with the help of World Bank. The tax rates for social-security for employees are 20% and 17,8% for employers, which is similar to other countries in the region. The tax rate of value added tax is 17% on all products and services, except for bread, milk and export with 0%. It is often criticised that only one tax rate exists, another lower tax rate would be relevant, especially for services in tourism, where a lot of investments are needed. The lower tax rate is also needed to stimulate the domestic production. The delay of VAT refund still has an effect on the liquidity of enterprises (VAT was introduced in April 2003).

The tax rate on income was 15% up to EUR 100 000, over that it was 20%, but government starting with 1th of January 2005 had reduced the tax rate to 9% to make the country more attractive for investors. It makes Montenegro in this respect the most competitive in the region. The rate of duty is between 0-30%. The problem in the duty system is inconsistency because of permanent changes due to the need of harmonization with Serbia.

Some estimations show that households in Montenegro spent EUR 50 more than their income. The Ministry of Finance is planning to make an analysis in 1Q 2005, to value the level of gray economy, currently it is estimated around 30% of the GDP. With the reduction of the grey economy reserves could be produced to help pulling the economy round.

Budget and Inflation in 2004

The inflation was 4,3% in 2004, which is lower than it was expected (4,5%), the main cause of inflation is the increase of prices in telecommunication and insurance. To reduce the inflation in 2005 it is required to break a monopoly in these sectors. The growth of GDP was expected to be 2,7 % in 2004.

The budget revenues were EUR 436,9 million, EUR 12,3 million lower in 2004 than it was planned. The primary revenues were lower by EUR 28 million (EUR 372 million), however, it was larger than the year before and from VAT the revenues were EUR 9 million higher than it was planned. Government indebted more than 40% it was planned, to EUR 51 million, but the foreign transfers were also higher by 7%. From loans EUR 51,9 million was paid, which is 7 times higher than it was planned.

Albania – EU Accession in 2014?

This year Albania is intent on signing the Association Agreement with the EU and it wants to be an EU full member state in 2014. The Prime Minister of the country (Fatos Nano) thinks that if they manage to do the first official step towards the EU-membership in 2005, 2014 (the year when Europe celebrates the 25th anniversary of the demolition of the Wall in Berlin) will be an excellent date for the accession.

The commissionaire of the enlargement of the EU (Olli Rehn) emphasizes that the pre-arrangements are not completed; the outcome of the negotiations depends on the elections in the first quarter of the year 2005, and the advancement of the reforms. He is concerned about the political atmosphere of the country which accepts the reforms with averseness, and it sets back the process of the accession.

About Albanian economy

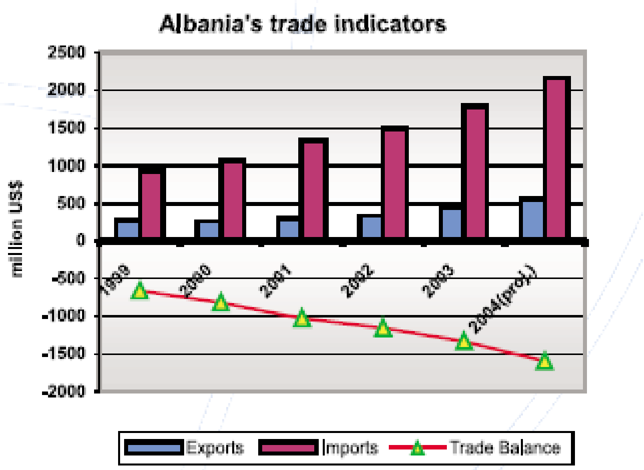
Albania is one of the poorest European countries; the half of the wage-earners works in the agriculture, and every fifth of them works abroad. The unemployment rate is high: in the second quarter in 2004 it was 14,8%, although it means a decline compared to the rate of the previous year. The corruption and the organized delinquency are great problems as well.

Table 4. The main economic indicators from 2000 to 2002 in Albania:

Description	2000	2001	2002
GDP at current prices (million Leks)	530 906	588 663	630 000
Annual real growth of GDP (%)	7,3	7,2	3,4
GDP per capita (Leks)	164 250	191 410	203 370
Export (million Leks)	37 037	44 096	47 490
Import (million Leks)	157 109	190 155	210 368

Source: Institute of Statistics – Albania

As the table shows the export of the country is weaker than the import, which is financed from grants and the foreign wage of the Albanian workers. However, in the first half of 2004, exports increased by 32% (in dollar terms) compared to the first half of 2003, while imports increased by 15% (in dollar terms), the trade deficit widened by USD 61 million and the export to import coverage ratio increased to 28% (from 25%).



Soruce: Albania Quarterly – World Bank Country Office Newsletter

After all, Albanian economy showed a dynamic growth in the last few years, and expectedly it will be maintained in 2005 and 2006 as well. The growth rate of the Gross Domestic Product was 6% in 2004, which has been largely led by high levels of growth in consumption and gross fixed capital formation in recent years. The main drivers of growth during the first nine months of the previous year have been in the services sector, mainly in transport and telecommunications.

The Bank of Albania (BoA) succeeded to maintain the inflation rate within the targeted 2-4% range: the CPI stood at 2,9% in the last year.

The current account deficit increased to 6,8% in 2004, and likely it will stand at 7,1 percent in 2005. Whereas the country can expect considerable FDI-inflow this year due to the possible privatisation processes.

Albania has to stay on a growth-field and be a stronger economy to start on the way to the European Union. And maybe the target they set could help the country to enhance the economy and slowly make its way to be up to the EU member states. But certainly it needs time and a lot of assistance especially from the EU.

Relations with the European Union

South East Europe (SEE)

The EU has been the largest assistance donor to the Western Balkans for years. Its fundamental objective for South East Europe is to create an environment where a military conflict is unimaginable. The basis for the EU's approach to SEE is the *Stabilisation and Association Process (SAP)* with the aim of enhancing and supporting the domestic reform processes in these countries. This agreement is based on aid, trade preferences, dialogue, technical advice and ultimately, contractual relations and could help the countries to become fully integrated into the EU structures. Albania, Bosnia and Herzegovina, Croatia, Serbia and Montenegro, and Macedonia all profit from the generous trade preferences from the end of 2000 as well. Since then they have been able to trade with their products duty-free and unlimited to the markets of the EU members. Because these five countries need a stable macroeconomic environment to achieve institution reforms and attract FDI, the EU supports the balance of payments, the budgetary and loans major infrastructure projects through the European Investment Bank. The EU experts think it is also essential to create a common European education area, because the new methods of education can help to bring peace and economic development to the south-eastern European countries and provide a humanitarian assistance to the vulnerable region.

Albania

Albania's diplomatic relations with the European Union were established in 1991. May 11, 1992 passed the most important episode in the relations with the signing of the *Trade and Cooperation Agreement.* It creates the most important contractual documents that Albania has signed in the past decade, which finally attached the country to the EU. This agreement allowed Albania to benefit from the PHARE program funds, within framework in the period of 1992-2000 approximately € 700 000 000 were delivered to the country.

The next milestone in the relation between Albania and the EU was the year 1999 with the signing of the *Stabilization and Association Process.* This process aims at generating closer relations between the European Union and the countries of the region including Albania

Albania, as every potential candidate country, has to meet the criteria established by the Copenhagen European Council in 1993. These criteria means political and economic requirements, as well. On the one hand, the countries have to guarantee democracy, rule of law, respect of human rights and minorities and on the other hand they have to develop a market economy, which has the ability to cope with competitive pressures in the EU. Finally the candidates need to be able to meet the obligations of the acquis communautaire.

In accordance with these requirements the overall objectives of the assistance from the EU to Albania are:

- To bring Albania closer to EU standards and principles and to prepare the country for gradual integration into EU structures in the framework of the SAP,
- to help Albanian authorities in consolidating democracy and implementing the rule of law,
- to assist the government of Albania in the efforts to achieve a comprehensive administrative and institutional reform,
- to facilitate the process of economic and social transformation towards an efficient market economy.

From 1991 to 2004 the European Union lent 1273,1 million Euro to Albania in all. The main allocations were done under PHARE and from 2001 onwards under CARDS programme.

Further progress depends on Albania's ability to realise serious challenges and reforms, for example to enhance its fights against the corruption and organised crime or to strengthen its judicial system and public administration. But it is certain that they have made the first step on the right way to the European Union with the decision to be a candidate in 2014.