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IMMEDIATE ATTENTION

EBS/92/211

CONFIDENTIAL

December 16, 1992

To: Members of the Executive Board

From: The Secretary

Subject: Bulgaria - Second Review of Financing of the Program

It is not proposed to bring the attached memorandum to the agenda of the Executive Board for discussion unless an Executive Director so requests by the close of business on Monday, December 21, 1992. In the absence of such a request, the draft decision that appears on page 3 will be deemed approved by the Executive Board and it will be so recorded in the minutes of the next meeting thereafter.

Mr. Singh (ext. 36222) or Ms. Sahay (ext. 37181) is available to answer technical or factual questions relating to this paper.

Att: (1)

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CONFIDENTIAL

INTERNATIONAL MONETARY FUND

BULGARIA

Second Review of Financing of the Program

Prepared by the European Department

(In consultation with other Departments)

Approved by Michael C. Deppler and Jack Boorman

December 16, 1992

The fourth purchase (SDR 31 million) under the 12-month stand-by arrangement (SBA) approved on April 17, 1992 is contingent upon observance of end-September performance criteria and completion of the second review of the financing of the program. Economic developments and policies during the first half-year were reviewed in the context of the program review and the first financing assurances review, which were completed on August 7, 1992. At that time, the staff had assessed that Bulgaria's commitment to the policies underlying the program remained strong, and that progress continued to be made on a number of fronts as envisaged.

Developments in the third quarter were moderately encouraging; the decline in economic activity slowed and inflation subsided: the monthly inflation rate averaged slightly over 3 percent during July-September, compared with about 6 percent monthly during the first half-year. Although fiscal revenue shortfalls continued, the authorities were able to keep expenditures under a tight rein, and other financial policies within the parameters of the program. The lev remained relatively stable, as it had been since the start of the year (at about leva 22-23 per U.S. dollar), despite substantial purchases of foreign exchange by the National Bank. The external performance continued to be better than originally projected, broadly offsetting delays in the commitment and disbursement of requested external financing. The trade account is now expected to be in small surplus for 1992 as a whole, rather than in deficit as projected under the program, and gross official foreign exchange reserves reached almost US$1 billion at end-September (well above the program objective). All end-September performance criteria were observed (Table 1).

However, developments since the third quarter have underscored the continued fragility of the reform process. October and November inflation--in the 4-5 percent range--was higher than projected, and the lev also came under some pressure in the wake of the resignation of the Government on October 28. Budgetary policies showed additional strain as revenue shortfalls and expenditure pressures appeared to grow.

To mitigate the effects of political uncertainty on confidence, the principal political parties have reiterated their commitment to the present program with the Fund, and have given assurances of continuity of economic policies (Attachment). In addition, the Bulgarian National Bank has moved to tighten liquidity conditions to forestall speculative pressures, which has contributed to the restoration of relative stability in the foreign exchange market in recent weeks. Additional measures by the caretaker government are also under consideration.

As regards the external financing of the program, Bulgaria has made substantial further progress in its negotiations with commercial creditors. In September, Bulgaria started partial interest payments to banks at the rate of about US$10 million per month, meeting a long-standing concern of its creditors and improving the climate for the negotiations. Bulgarian representatives have met representatives of the commercial banks' Advisory Committee (AC) several times during the last two months, most recently on December 11, and have agreed on the principles of an eventual commercial debt and debt service reduction (DDSR) operation. It envisages a one-time comprehensive DDSR, covering long-term and short-term debt (and part of the interest arrears) and including debt buybacks. Both sides agreed to work together toward a quick reconciliation of the debt database, and have set March 31, 1993 as a target date for completion of the negotiations. Detailed proposals (reflecting revisions to previous proposals) have been exchanged. The staff has been informed that the AC is satisfied with the pace of the negotiations thus far, and hopeful that, provided progress continues to be made, a market-based agreement can be reached by the target date.

Concerning official financing, Bulgaria concluded a rescheduling agreement with Paris Club creditors on December 14, 1992, covering part of debt service obligations falling due during the period of the current stand-by arrangement. Cash flow relief obtained from Paris Club creditors is in line with the assumption underlying the program. A staff paper providing details on the rescheduling agreement will be made available to Directors shortly.

Some limited progress has also been made with the G-24 with respect to the 1991 and 1992 financing packages. The European Community has disbursed its share of the 1991 financial package, and agreements have been signed with four non-EC G-24 countries. Discussions are also underway regarding the contributions of other countries and, on this basis, the committed amounts are expected to be disbursed in 1993. As regards the 1992 financial package requested from the G-24 (US$240 million), the Council of the European Communities has taken a decision to cover--in two tranches--slightly over half of the request (equivalent to ECU 110 million). We have been informed that release of the first tranche (expected in the first quarter of 1993) is subject to Bulgaria taking the necessary steps to allow the disbursements of the amounts committed by non-EC G-24 countries in 1991; reaching a satisfactory settlement on official debt with its EC Paris Club creditors; and agreeing in principle with its commercial creditors on a set of guidelines for a future debt reduction operation. Release of the second tranche, in turn, is subject to decisive progress towards a comprehensive medium-term debt restructuring agreement with Bulgaria's commercial creditors. Progress in mobilizing non-EC G-24 financing in respect of Bulgaria's 1992 request is expected to be made following the recent agreement reached with the Paris Club. The staff continues to attach great importance to the early commitment and disbursement of the requested assistance by the G-24, particularly in view of the substantial balance of payments need projected for the near term, partly resulting from the costs of the expected commercial debt reduction operation. As for the second tranche of the World Bank's 1991 Structural Adjustment Loan, it has not yet been made effective. Bank staff expect that effectiveness would be forthcoming once the remaining outstanding condition--the adoption of appropriate banking prudential regulations--is met, possibly in the coming weeks.

Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. Bulgaria has consulted with the Fund in accordance with paragraph 4 (c) of the stand-by arrangement for Bulgaria (EBS/92/55, Supp. 2 (5/4/92)) and the second paragraph of the letter of the Minister of Finance and the Governor of the National Bank of Bulgaria dated March 11, 1992.

2. The Fund decides that the second review contemplated in paragraph 4 (c) of the stand-by arrangement for Bulgaria is completed.

Table 1. Bulgaria: Compliance with Performance Criteria
Under the Stand-By Arrangement, and Performance Criteria for December 1992 1/

	May		June		September		December
	Program	Actual	Program	Actual	Program	Prelim.	Program
Net domestic assets of the banking system (in millions of leva) 2/	122,000	118,972	126,600	120,867	143,500	128,124	156,050
Change in net bank credit to general government (in millions of leva) 2/ 3/	7,800	-117 4/	10,000	1,070 4/	13,200	10,659 4/5/	11,700
Change in net foreign assets of the National Bank (in millions of U.S. dollars) 3/ 6/	-115	122	-195	177	-125	438	-215
Contracting or guaranteeing of 1-12 year external debt (in millions of U.S. dollars) 2/ 3/	1,000	263	1,200	263	1,300	263	1,500
Guaranteed debt of up to one year (in millions of U.S. dollars) 2/	2,600	2,500	2,650	2,500	2,800	2,500	2,950

Source: Program projections; and data provided by the Bulgarian authorities.

1/ EBS/92/188, 7/10/92.
2/ Ceiling.
3/ Cumulative flow from December 1991.
4/ Adjusted for the sale of leva 120 million of government bonds to banks to replace noncollectible enterprise loans during January-May 1992.
5/ Including leva 2,605 million of interest arrears by the budget to the Central Bank accumulated during the third quarter.
6/ Floor.

BULGARIAN
NATIONAL
BANK

December 4, 1992

Dear Mr. Camdessus:

As you are undoubtedly aware, a new Government is to be formed in Bulgaria. The Government led by Prime Minister Philip Dimitrov resigned on October 28, 1992, and remains in a caretaker capacity. The procedures specified in the Constitution for the formation of a new Government are currently being followed.

In this interim period, I have taken the initiative as the Bulgarian Governor for the Fund to consult with all three political parties represented in Parliament. All three have confirmed their ongoing commitment to Bulgaria's economic and financial program currently being supported by a stand-by arrangement with the Fund. We can be confident, therefore, of the commitment of the future Government to the economic strategy currently followed. Needless to say, the Bulgarian National Bank also remains fully committed to this strategy. The Bulgarian authorities intend to continue to implement the domestic financial policies envisaged in the program, and we are the near future our relations with our external creditors.

We look forward to your continuing support and assistance.

With highest regards,

Professor T.Vulchev
Governor
Bulgarian National Bank

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.