

Bulgaria: The Balkans' "Other" GDP-Linked External Debt
April 2004

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The best-known GDP-linked debt in Southeastern Europe belongs to Bosnia & Herzegovina, but a somewhat-similar feature of a Bulgarian Brady bond is attracting increasing, albeit still modest, attention. In contrast with most other value recovery rights (using a loose definition of VRRs), those associated with Bulgaria's Discount bonds are defined as Additional Interest Payments (AIP), and are not warrants, detachable or otherwise, though they are intrinsically equivalent. Ironically, Bulgaria's AIPs are arguably as vague as the Bosnia B warrants are complicated.

The basic obligation of the AIP clause is a supplemental disbursement, defined in Condition 5 of the Discount Bond documentation as an interest payment, for each year (not including the year in which the threshold is reached) in which 1) Bulgaria's Gross Domestic Product surpasses 125% of its 1993 level,¹ and 2) there is a year-to-year increase in GDP. For these years, the semi-annual interest supplement is defined as one-half of that year's GDP growth, with the outlays themselves scheduled to occur as soon as practically possible and coincide with regular interest payment dates. Given normal data collection and Calculation Agent technical lags and delays, the earliest that the supplemental payments can occur is seven months after the end of the calendar year of record, reflecting the January-and-July coupon schedule, but it can be as much as four years.

Figure 1. National Income Aggregates Published by the World Bank (units in billions)

	GDP (Constant 1995 US\$)	GDP (Constant Local Units)	GDP (Current US\$)	GNI (Current US\$)
1993	12.51	26.84	10.83	10.59
2001	13.07	27.80	13.55	13.24
2002	13.63	29.20	15.61	14.12
<i>Increase Relative to 1993</i>				
2001	4.46%	3.58%	25.10%	25.01%
2002	8.95	8.79	44.07	33.28

GNI: Gross National Income.
Source: World Bank.

The ambiguity arises because "Gross Domestic Product" itself is not well defined. According to the documentation, Gross Domestic Product is the figure associated with publication of "the World Tables of the World Bank," an out-of-print periodical

¹ This was a generous contribution to the debt restructuring by Bulgarian debt negotiators, given the steep contraction between 1990 and 1993, for a deal that closed in summer 1994, unless officials guessed that if the country was in a good-enough position to afford the AIPs, it would also be in a position to redeem early a significant proportion.

which has been superceded in large part by the World Development Indicators (WDI). Because the World Bank's data dissemination process has moved online, annual data updates can be produced at any time, whereas WDI (and its predecessor World Tables) are typically published in April. In any event, the most recent public World Bank GDP estimate is for year-end 2002.

An additional complication is the variety of national income aggregates published, with differing units of account (see Figure 1) and therefore differing time trends. The indicator upon which the AIP should be based is thus open to interpretation. In our view, though, "GDP reported in current US\$" is easily the most conspicuously published of national accounts indicators, by the World Bank, and therefore the trigger point was technically reached with the release of the 2001 estimate.²

We should not over-dramatize the implications for Bulgarian finances, however, because it is only the increase in GDP which is relevant, rather than the amount by which GDP exceeds the 1993 level. Nonetheless, the payments are more severe than would be suggested by initial reasoning. First, the spirit of the agreement entails for GDP to be calculated in current US dollars. Second, the weakening of the dollar since 2001³ implies a much higher liability than if one follows normal market convention, which is to reference the high-profile real GDP increase provided by the national statistical agency. We conclude that an Additional Interest Payment of 7.6% is due, based on the 2002 GDP data, which implies a supplemental outlay of \$51.6 million. The payment would be higher if not for the 63% cancellation of the Discount bond stock, as repurchased and exchanged bonds should not be eligible for back payments.

AIPs based on the 2003 data are scheduled to accelerate, as Figure 2 outlines. However, we do not believe this is worrisome to the Bulgarian Finance Ministry, because the dollar amount is containable and Discount bonds will be callable at par before any of the new AIP needs to be paid. In fact, the call feature is one reason why the Bulgaria Discounts returned only 6.2% last year (or 9.8% on an accrual basis if bondholders successfully file or otherwise lobby for the supplemental "2002" AIP), compared with 28.8% for the EMBI Global.

Figure 2. GDP Growth and Discount Bond Coupons (actual and implied AIP)

	Real GDP Growth (%)	GDP Growth in Current US\$	Additional Interest Payment ^a	Statutory Coupons
2001 ^b	4.1%	7.5%	3.7%	5.43%
2002	4.8	15.2	7.6	2.75
2003E	4.8	21.7	10.9	2.06
2004F	5.2	-5.3	--	2.11(E)

^a Payable semi-annually in arrears no less than 30 days after the World Bank publicly determines a given calendar year's Gross Domestic Product; therefore, in most instances 7 and 13 months, or 13 and 19 months, after the end of the calendar year, respectively.

^b This line is shown for illustrative purposes only. The borrower is not required to assume any additional liability until at least the calendar year *following* the achievement of the 125% threshold. Source: Bloomberg, Exotix estimates.

² The World Bank national income estimates differ from those published by other national and multilateral data dissemination agencies, because of its particular exchange rate adjustments.

³ Bulgaria's economy was heavily dollarized in 1994, when the Brady bond negotiations took place, but has since become almost fully euroized.

The Discount bonds may be attractive to investors most intrigued by the prospect of an uncorrelated emerging market asset possibly paying a GDP-linked bonus (the Bulgarian government may contest investor assertions of past-due AIPs), if they also believe financial officials will choose not to call a significant portion of the bond. We expect, for example, a holding period return of only 12.4% over the next 18 months. We should also counsel that Condition 5 does not provide much comfort to investors, as regards legal or other recourse, if the Issuer, Calculation Agent, or Paying Agent procrastinate.

As Figure 1 outlines, if the World Bank determines or an international arbiter rules that the appropriate GDP is the constant 1995 US dollar or constant local terms indicator, then there is no effective or contingent liability. However, we don't believe the borrower has a strong case for arguing that these are the relevant Gross Domestic Product comparators.

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