SigmaBleyzer

Bulgaria
Macroeconomic Situation

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Summary

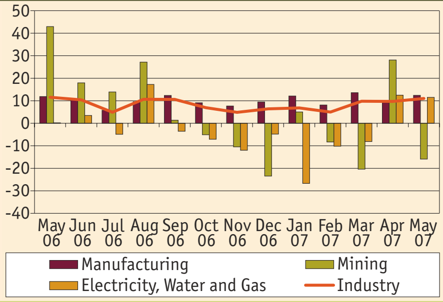
- GDP growth accelerated to 6.2% yoy in Q1 from 5.7% yoy in Q4 2006 driven by private consumption and investments, which grew 8.1% yoy and 35.9% yoy respectively.
- In May, industrial sales surged 11% yoy compared to 10.2% yoy in April outpacing growth of production in industry and mining.
- In May, the government's fiscal reserve increased to EUR 3.33 billion (Lev 6.51 billion) from EUR 3 billion (Lev 5.88 billion) a month earlier.
- Public debt increased by 0.79% to EUR 5.63 billion due mainly to the rise in domestic debt and exchange rate fluctuations.
- In January-June, consumer prices as measured by the CPI grew 2%, down from 2.4% during January-May.
- The current account deficit widened to EUR 2.59 billion (9.7% of GDP) in January-May. Net foreign direct investment covered 59.1% of the current account deficit and amounted to EUR 1.53 billion (5.7% of GDP).

Economic Growth

The National Statistical Institute (NSI) published preliminary data on economic growth for the first quarter 2007. GDP growth accelerated to 6.2% yoy in Q1 from 5.7% yoy in Q4 2006 (6.1% in 2006). Private consumption and investments are the primary drivers of economic growth. Private consumption increased 8.1% yoy and investments in fixed assets 35.9% yoy. In the real sector, industry and services expanded by 7.6% yoy and 8.1% yoy respectively. After two years of decline, agriculture posted an increase of 2.5% yoy. Exports continued to grow slower than imports, increasing to EUR 3.5 billion (Lev 6.91 billion) or 2.2% yoy compared to EUR 5.22 billion (Lev 10.21 billion) or 13.2% yoy in imports.

In Q1 2007, investment expressed by gross capital formation reached EUR 2.14 billion (Lev 4.19 billion) or 36.5% of GDP, while consumption amounted to EUR 5.32 billion (Lev 10.41 billion).

Index of Industrial Sales by Sector, % yoy



Source: National Statistical Institute

In May, industrial sales growth accelerated to 11% yoy compared to 10.2% yoy in April. Manufacturing and utilities posted growth of 12.4% and 11.5% respectively, while mining dropped 15.9% yoy. Industrial sales growth outpaced growth of production in industry and mining (industrial production increased 7.5% yoy.) The utilities sector posted a growth rate of 11.5% in sales and 17.3% in production. Manufacturing, food products, fabricated metals, mineral products, furniture and textiles are major contributors to the growth of industrial sales. In the mining sector, the sharp changes in sales and production are explained by fluctuations in external demand and world prices, while the utilities sector is highly dependent on weather-related energy demand.

In May, retail trade advanced by 4.7% mom, while wholesale trade edged up 2.5% mom. In January-May, retail and wholesale trade grew 9.7% yoy and 4.1% yoy respectively. The wide margin between retail and wholesale growth rates is a result of the structural changes of trade. Direct sales through large chains of supermarkets and department stores grew faster than retail sales in smaller stores. In January-May, sales of electrical household appliances and food posted the strongest growth rates of 13.2% yoy and 10% yoy respectively.

According to a survey by the NSI, the prospects for economic growth remain favorable. In June, the composite business sentiment indicator (CBSI) increased by 0.4% pps compared to May and remains just 0.7 pps below its 13 year high of 50.7%. The CBSI increased in industry, retail trade and service sectors. In industry, CBSI reached a long term high of 51.4% (since 1994) on managers' assessment of the present situation and business expectations. In construction, the composite indicator of business sentiment decreased by 4.3 pps due to the shifting of managers' expectations from 'better" towards preserving the "same" business situation in enterprises.

Fiscal Policy

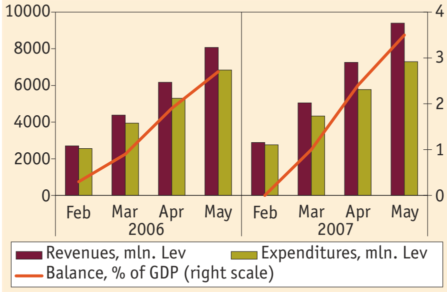
In May, the government's fiscal reserve increased to EUR 3.33 billion (Lev 6.51 billion) from EUR 3 billion (Lev 5.88 billion) a month earlier. The fiscal reserve is above the government target of 2% of projected full year GDP. The surplus in January-May accounts for 3.5% of our full-year GDP projection against 2.4% in April. As a result of the government's restrictive fiscal policy, the full year surplus is forecasted to reach 5% of GDP. The government fiscal reserve covers 59% of government and government guaranteed debt.

The consolidated budget achieved a surplus of EUR 944.4 million (Lev 1847.14 billion) in May, a sharp increase as compared to a surplus of EUR 649 million (Lev 1.27 million) in April. Revenue growth decelerated to 16.4% yoy down from 17.55% yoy growth in January-April. Consolidated fiscal revenues reached EUR 4.8 billion (Lev 9.4 billion). Tax and social insurance revenues performed better than expected. Tax revenue grew 17.2% yoy and reached EUR 3.89 billion (Lev 7.6 billion). According to the National Revenue Agency (NRA), in January-May, tax and social insurance revenue reached 47.2% of full year projections compared to 44% in January-May last year. The revenue growth was driven by individual and corporate tax collections. Despite a decrease in the tax rate, corporate profit tax revenues already amount to almost a full year projection. Non-tax revenue decelerated to 13.5% yoy to EUR 805.1 million (Lev 1.57 billion).

According to National Revenue Agency (NRA) chief Maria Murgina, strong budget performance creates good opportunities for further reduction of direct taxes and social insurance contributions. In the second half of the year, the overall burden of mandatory pension insurance contributions may be reduced by 3% of gross personal income. The parliament approved a 10% increase in pensions instead of the projected growth of 8.5%.

Consolidated budget expenditures amounted to EUR 3.73 billion (Lev 7.3 billion), an increase of 6.6% yoy. In January-May, social expenditures accounted for 40.3% of all budget allocations. The consolidated national budget allocated EUR 1.5 billion (Lev 2.94 billion) to social expenditures and EUR 0.4 billion (Lev 0.79 billion) to capital expenditures according to the national strategy of social sector and infrastructure development. Wages and salaries and maintenance allocations increased to EUR 0.58 billion (Lev 1.14 billion) and EUR 0.72 billion (Lev 1.41 billion), with growth rates of 10.1% yoy and 2.7% yoy respectively.

Consolidated Budget Flows

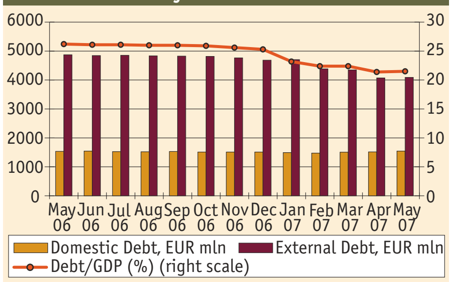


Source: Bulgarian Ministry of Finance

In May, government and government guaranteed debt increased by 0.79% to EUR 5.63 billion due mainly to the rise in domestic debt and exchange rate fluctuations. On an annual basis, government and government guaranteed debt is down 12.1%. The debt to GDP ratio grew to 21.5%, up 0.1% pps. External debt slightly increased to EUR 4.09 billion as compared to EUR 4.07 billion in April. The share of external debt in government and government guaranteed debt decreased to 72.6%. Domestic public debt increased to EUR 1.54 billion. In the debt interest structure, fixed interest rate debt increased to 69.3% and debt with floating interest rates dropped to 30.7%. Government external debt may increase slightly by the end of the year since the EIB and WB loans are expected to exceed regular debt payments.

Gross external debt decreased to EUR 20.38 billion (76.3% of GDP) at the end of May. In January-May, external debt surged by EUR 714.6 million (3.6%). Long-term liabilities accounted for 67.3% of total external debt. Gross external debt service amounted to EUR 2.37 billion by the end of May (8.9% of GDP). Private sector external debt decreased primarily due to a decrease of EUR 267 million in external liabilities of the banking sector.

Dynamics of Domestic and External Public and Publicly Guaranteed Debt



Source: Bulgarian Ministry of Finance

Monetary Sector

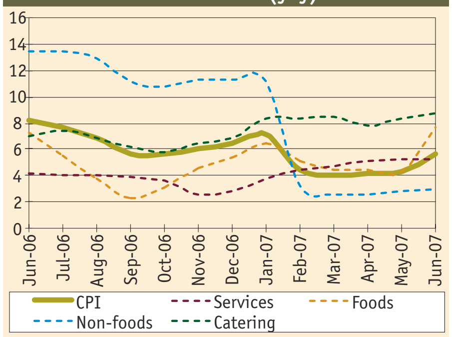
In June, consumer prices as measured by the CPI increased 5.6% yoy. Since the start of the year, the CPI has grown 2%, down from 2.4% in January — May. Year-end CPI is expected to decelerate to 3.7% in 2007 and 2.9% in 2009. The National Bank (NB) inflation target for 2007 is set at 4.4%. The country is expected to accommodate the ERM-2 currency mechanism this summer and meet the Maastricht price criterion in 2009. The Bulgarian Central Bank strategy is to maintain the present exchange rate peg of Lev 1.95583 for EUR 1 and adopt the EU single currency in the medium-term.

Consumer prices in catering and services predictably grew at a faster rate than in other sectors as a result of their adjustments to EU average levels. In June, prices in services and catering grew 5.3% yoy and 8.7% yoy, while prices in food and non-food sectors grew 7.7% yoy and 2.9% yoy. The relatively high growth rate of food prices on an annual basis is attributed to the sharper seasonal drop of food prices last year (a low statistical base). On a monthly basis, food prices dropped 1.3%, while prices in non-food, catering and services edged up 0.1%, 0.3% and 0.2% respectively.

The harmonized index of consumer prices (HICP), calculated on the basis of consumer weights and standardized product groups of EU countries, increased 5.3% yoy in June (4.5% in May). The difference between HICP and the national CPI is attributed to the larger weight of catering and services in the consumer basket of the EU.

In June, the monetary base and money supply grew by 5.8% mom and 4.2% mom respectively. Broad money (M3) reached EUR 18.07 billion (Lev 35.34 billion) and narrow money (M1) increased to EUR 9.1 billion (Lev 17.81 billion). On an annual basis, the growth of the money supply was 28.4%. The money supply multiplier was 3.49 versus 3.55 in May. The ratio of money supply to GDP increased to 67.6%. Deposits with a maturity of up to 2 years grew by EUR 197 million (Lev 386 million) to EUR 7.39 billion (Lev 14.46 billion), posting an annual growth rate of 24.09%. Deposits redeemable at notice of up to 3 months increased by EUR 43.6 million (Lev 85 million) to EUR 1.57 billion (Lev 3.07 billion), up 26.7% yoy.

Changes in CPI, PPI and CPI Major Components in 2006–2007 (yoy)



Source: Bulgarian National Statistical Institute

Overnight deposits grew by EUR 360 million (Lev 704 million) to EUR 5.84 billion (Lev 11.42 billion). On an annual basis, overnight deposits grew 43.8%. The share of deposits in foreign currencies increased to 46.5% of all deposits.

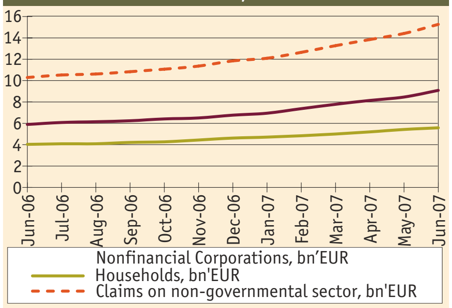
The Bulgarian National Bank increased its base interest rate to 3.84% p.a. in June and 4.01% p.a. in July.

In June, claims on the non-government sector grew by EUR 851 million (Lev 1.67 billion) and amounted to EUR 15.27 billion (Lev 29.86 billion), which is an increase of 47.9% yoy. Loans to non-financial corporations reached EUR 9.09 billion (Lev 17.8 billion), up 54% yoy. The monthly increase in loans to non-financial corporations is EUR 634 million (Lev 1.24 billion), which is 7.5% mom growth. The share of loans to non-financial corporations in foreign currencies reached 65.5%. Loans to households amounted to EUR 5.59 billion (Lev 10.93 billion), up 38.6% yoy. The monthly growth in household loans is EUR 152 million (Lev 298 million) or 2.8% mom.

As of September 1, the National Bank will increase the minimum reserve requirement (MRR) of banks from 8% to 12% to achieve a moderate bank credit growth and stable development of the banking system.

International Trade and Capital

Growth of Loans to Nonfinancial Corporations and Households, 2006–2007



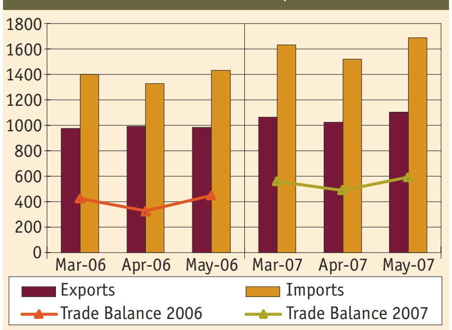
Source: Bulgarian National Bank

In May, the trade deficit expanded to EUR 590 billion (Lev 1.15 billion) as compared to EUR 487 million (Lev 954 million) in April according to customs reports for non-EU countries and incomplete INTRASTAT files for EU states. In January-May, the trade deficit reached EUR 2.67 billion (Lev 5.21 billion), a growth of 47% yoy. In May, the trade deficit increased to 10% of GDP.

Imports continue to grow faster than exports, posting 17.9% yoy growth in May. On a positive note, imports growth decelerated for the fifth month in a row from 25.2% yoy in January 2006 to 20.2% yoy in February, 18.7% yoy in March and 17.9% yoy in May. Despite lost opportunities in the energy sector and unfavorable price dynamics for non-ferrous metals, exports grew 11% yoy in May.

Bulgaria exported EUR 1.1 billion worth of goods in May, up EUR 71.8 million from April. Monthly imports surged by EUR 173.5 million to EUR 1.69 billion. The EU is the largest trading partner with respective shares of 60.4% and 62.7% in total imports and exports[1].

Balance of Trade in Goods, EUR million



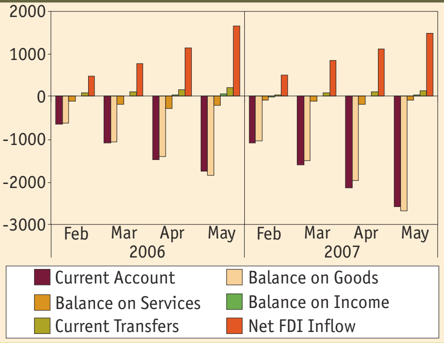
Source: Bulgarian National Statistical Institute

According to revised monthly data for 2007, the current account (CA) deficit widened to EUR 2.59 billion (9.7% of GDP) in January-May as compared to

[1] Preliminary data of the NSI.

EUR 1.75 billion for the same period in 2006. In May, the CA deficit amounted to EUR 456.8 million (EUR 531 million in April) due to a large trade deficit in goods and services. Net foreign direct investment (FDI) covered 59.1% of the current account deficit. In January-May, FDI amounted to EUR 1.53 billion (5.7% of GDP) compared to EUR 1.7 billion (6.8% of GDP) for the same period last year. Attracted equity capital reached EUR 1.09 billion as compared to EUR 663 million in the same period last year. The share of equity capital in FDI was 84%. The financial account posted a surplus of EUR 579 million in May and EUR 2.63 billion in January-May 2007.

Current Account Components and Net FDI Inflow, EUR million



Source: Bulgarian National Bank

The Bulgarian government forecasts continued growth in net FDI inflows to EUR 2.7 billion in 2007 (11.8% of GDP) due to a favorable investment climate, predictable macroeconomic environment and transparent legislation.

In June, the Bulgarian National Bank (BNB) reserve assets increased by EUR 570.5 million to EUR 9.6 billion. The reserve assets grew 21.5% yoy due to external debt financing and net FDI inflows.

Other Developments and Reforms Affecting the Investment Climate

The basic unemployment rate dropped to 7.42% as of the end of June. Strong economic growth and increasing seasonal demand improve employment opportunities. The jobless ratio could reach an all time low of about 7% in the summer months.

Due to closure of the nuclear plant in Kozloduy and upgrade works at three power plants in Maritsa East, the National Electricity Company estimated that the energy deficit may reach 760 MWh. The energy regulators proposed a 5.5% increase in the electric energy price as of July and approved preferential prices for purchase of electricity from small biomass-fired plants with production capacities of up to 5 MWh. Investments in power generation to cover estimated supply shortage will be a national priority for the present government.

Current projects in the energy sector:

Ten companies announced their interest in acquiring an equity stake of up to 49% in nuclear plant Belene including ATEL (Switzerland), CEZ (Czech Rep), Cumerio Med (Belgium's Cumerio Group), EdF (France), EGL (Switzerland), Electrabel (Belgium), Endesa (Spain), Enel (Italy), E.O.N (Germany) and RWE (Germany). The government will hold a 51% stake in the Belene nuclear plant, which will start operating in 2014 with two nuclear power blocks of 1,000 MWh each. AtomStroyExport (Russia), in a partnership with Areva (France) and Siemens (Germany), signed a preliminary contract for building ground infrastructure, supply, installation and commissioning of two power reactors. The contract is valued at EUR 4 billion.

Government-owned coal mine Maritsa East will launch a tender for building a power block with capacity of 600 MWh. In May, Maritsa East mines and RWE already signed an agreement to build a new power generator.

Hans-Gert Poetering, President of the European Parliament, welcomed 18 newly elected members from Bulgaria. Five members of the CEDB (Citizens for European Development of Bulgaria) party joined the centre-right bloc EPP-ED, five members of BSP (Bulgarian Socialist Party) entered the left-wing bloc PES, four representatives from MRF (Movement for Rights and Freedoms) and one from NMS — II (National Movement Simeon) entered the Liberals' group ALDE and three members of the ATTACK joined nationalist group Identity, Tradition, Sovereignty (ITS).

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