Macroeconomic environment and policies in brief

The Government approved the draft State Budget of the Republic of Bulgaria Act for 2012 at a special meeting on October 31, 2011, as well as some minor amendments to the tax laws for next year in relation to some EU requirements. The Deputy Prime Minister and Minister of Finance Simeon Djankov labelled the 2012 draft budget to be submitted in Parliament for consideration as "*a conservative one within the framework of what is going on in national and EU economy*".

- Minimum fiscal reserve amount will be retained at its level of BGN 4.5 bn in 2011, which will ensure a sufficient level of Government's flexibility within the framework of the issuing policy for the following year. The draft budget projects a real growth of 2.9%, a harmonized end-of-period inflation of 2.8%, with FDI being foreseen to reach 2.8% of the projected GDP.

- The 2012 fiscal objective has been revised in the draft budget by setting a Consolidated Fiscal Programme deficit of 1.3% of GDP without altering the commitment for long-term sustainability and feasibility of tax insurance policy. The fiscal stance planned for 2012 is envisaged to be attained at an amount of CFP revenue of 35.2% of GDP and an amount of CFP expenditure of 36.5% of GDP.

- The 2012 draft budget actually envisages more funds for the Ministry of Health budget, aimed to improve working conditions and emergency centres payments. Funds envisaged for the Ministry of Culture are by BGN 15 mln higher, while the expenditure ceiling of the Ministry of Education, Youth and Science is increased by BGN 50 mln.

- An increase in the minimum wage from BGN 270 to BGN 290 is also envisaged as from April 1, 2012. Opportunities will be sought next year to increase the lowest pensions.

- The low levels of taxation will be preserved in 2012, while tax burden will be shifted from direct to indirect taxes by an increase in excise duty rates on some energy products in view of reaching minimum EU taxation levels in accordance with agreed transition periods. The introduction of an excise duty rate of BGN 0.85 per GJ on natural gas used as motor fuel, BGN 0.10 per GJ on natural gas used for heating and a zero tax rate on natural gas for household needs is envisaged. The purpose is a gradual transition to the natural gas taxation levels required by EU legislation at the end of 2013.

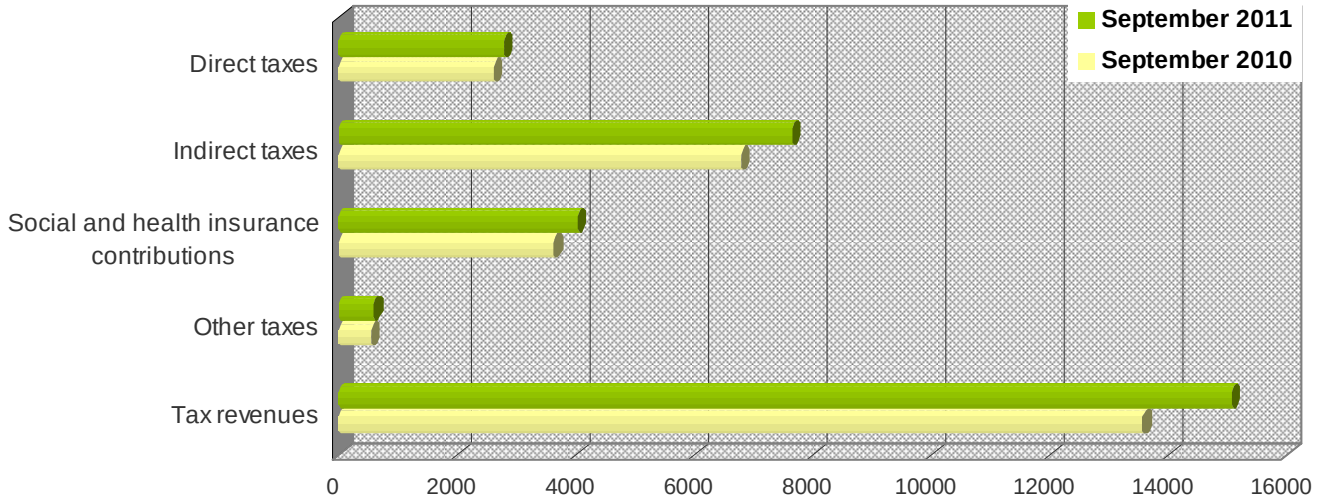
Focus: Budget balance in Q3 2011

Cash basis deficit improves in nominal terms by almost BGN 692 mln yoy for the three quarters of 2011

Consolidated budget deficit amounted to BGN 826 mln (1.1% of GDP) on cash basis at the end of September 2011, which is still well below the 2011 annual deficit target, thus budget balance improved by 1.1 pps of GDP (down BGN 691.9 mln) compared to the same period of 2010 there.

Total revenues and grants accumulated on the consolidated budget in Jan-Sept stood at BGN 18 353.6 mln, amounting to 70% of those planned in the 2011 State Budget Law, up by 5.7% yoy in nominal terms. Tax revenues for the first nine months, including social security contributions, accounted for 72.9% of the 2011 annual forecast, improving from 70.6% for the same period of 2010. Indirect taxes largely accounted for total revenue yoy increase. They stood at BGN 7 666.2 mln at end-September, equal to 73.7% of the planned for the year, up 12.7% in nominal terms (BGN 865.1 mln) compared to the first nine months of 2010.

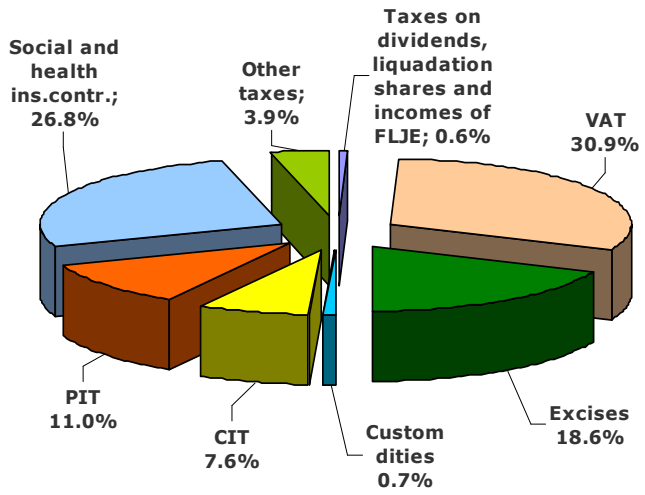
Total tax revenues (mln BGN) **on the consolidated budget as of September 2010 and September 2011**



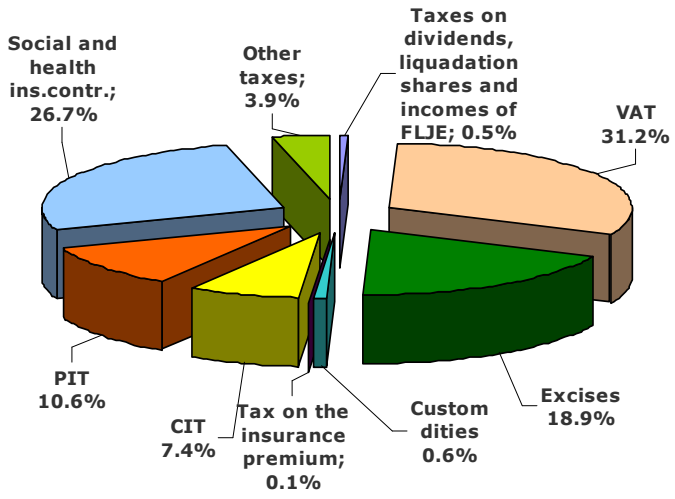
Source: MoF

VAT revenues accounted for BGN 4 702.5 mln at end-September, or 72.6% of those planned in the 2011 State Budget Law. Excise duty revenues totaled BGN 2 853.4 mln, with performance according to the estimates being 75.1%. Customs duty revenues reached BGN 95.1 mln, or 95.1% of those planned for the year. All these tax revenue components grew compared to Jan-Sept 2010, as follows: VAT – up by 12.2%, excises – up by 13.3%, custom duties – up by 2.5%. Direct taxes amounted to 73.6% of those planned for the year, while revenues from social security and health insurance contributions came to 70.2%.

Tax revenues structure, September 2010



Tax revenues structure, September 2011



Source: MoF

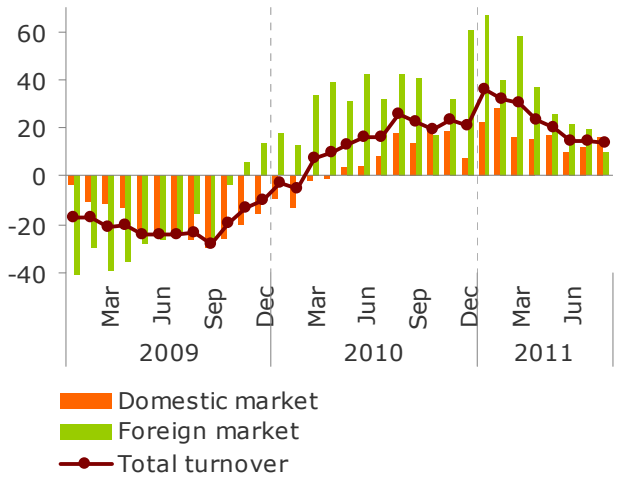
Total expenditures, including the contribution to the EU budget, as of 30 September amounted to BGN 19 179.5 mln, or 68.1% of the planned for the year. The share of total spending for the Jan–Sept 2010 in total 2010 expenditures was higher (70.6%). Non-interest current expenditures amounted to BGN 16 294.2 mln or 72.5% of those planned for the year, while capital expenditures (including net increment of state reserve) accounted for BGN 1 867.5 mln.

Fiscal reserve amounted to BGN 5.1 bn as of 30 September 2011.

Recent Economic Developments

- **Industrial turnover** annual growth rate stood at 13.9% yoy in August. Foreign market turnover decelerated further and reached 9.6% yoy, thus its slowdown has been compensated by the speeded increase in domestic turnover, up 16.4% yoy. Manufacture of basic metals and production of precious and non-ferrous metals in particular, largely accounted for the foreign market sales increase. According to the production purpose, products for intermediate consumption had again the largest share.
- **Industrial production** grew by 2.5% in real terms, showing some short-term fluctuations in the recent months. According to the production purpose, products for intermediate consumption had the largest positive contribution.

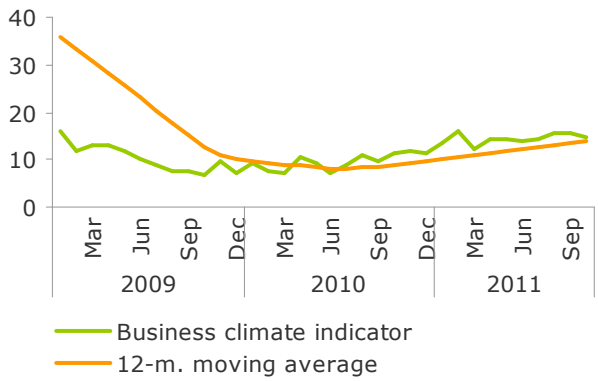
Industrial turnover
(%, yoy)



Source: NSI

- **Retail sales** slump narrowed marginally to 2.7% yoy, led by the decrease in major components such as retail sales of audio and video equipment, down 8.8% yoy.
- **Construction production index** decrease also contracted to 8.2% yoy, being 14.4% in July. Both building construction and civil engineering slowed their negative growth rates to 4.3% and 13.6% respectively.

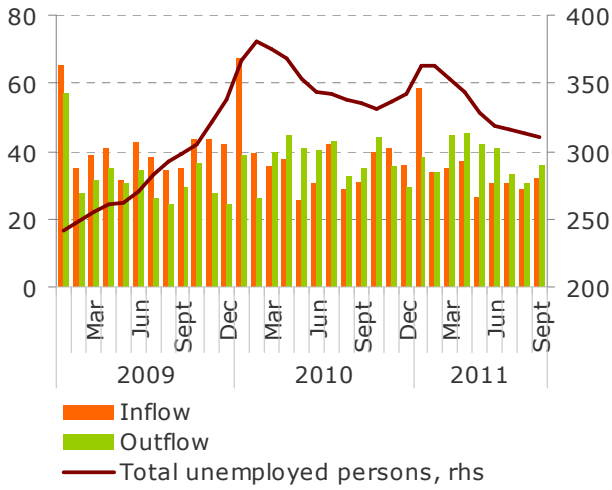
Business climate
(balance)



Source: NSI

- October **business climate** in the country slightly declined, down by 0.7 points, as deterioration in industry and services largely accounted for its dynamics, compensating the observed expectations improvement in the retail sector. Demand in services also fell, besides similar developments were valid for construction activity expectations over the next months as well.

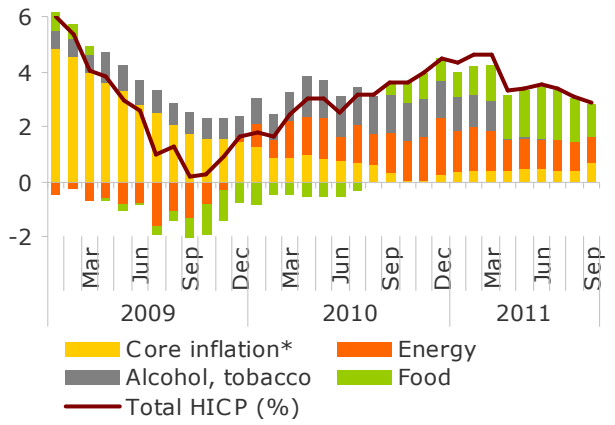
Inflow, outflow and total number of unemployed people (in thousands)



Source: EA

- Jobless number decreased to 310K in September, down by 1.2% mom, thus the **unemployment rate** declined by 0.2 pps, reaching 9.4%. Seasonal activities fall, in tourism sector in particular, strongly influenced the unemployment inflow increase by 11% to 32.1K. The outflow of unemployed people went up almost fully due to the higher number of persons settled on job – 17.9K in September. The larger job occupation on the primary labour market was highly determined by the start of the new school year. However, the activity of labour market programs and measures also increased, contributing to the overall outflow increase.

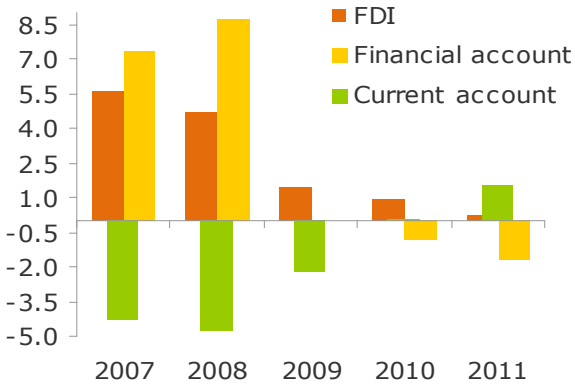
HICP and contributions by main groups
(pps, yoy)



Source: NSI, MF

- September **inflation rate** remained practically unchanged over the month, after stepping down by 0.1% mom in August. Thus annual HICP index decelerated further to 2.9%. Weaker-than-expected increase in food prices owing to the lower fruits and vegetables prices, as well as the downward seasonal correction in recreation and travel services were largely offset by the increase in administratively set prices of medical, dental and hospital services. The latter was the result from the minimum wage increase as of September 2011. The annual rate of increase in consumer prices kept decelerating on the back of slowing food and energy price inflation amid easing agricultural and energy commodity prices. Core inflation (services and non-energy industrial goods) picked up to 1.2% yoy mostly due to higher prices of healthcare and education services.

FDI, Current and Financial Account
(January - August, billion euro)



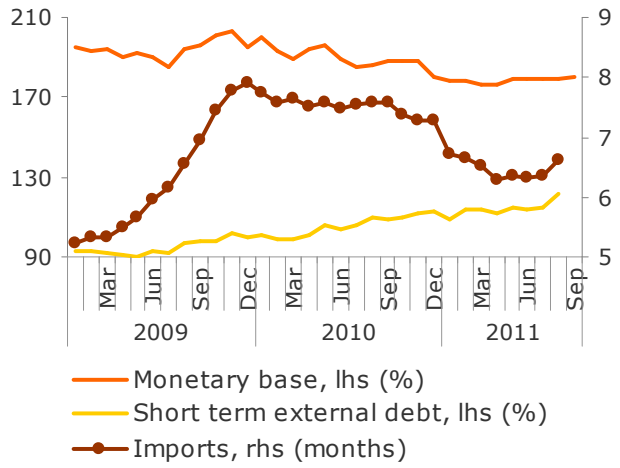
Source: BNB

- **Current account surplus** stood at EUR 705.7 mln in August. Thus, the accumulated surplus for the first eight months of 2011 amounted to EUR 1.56 bn (4% of GDP) and reached another record high, its dynamics mainly resulting from positive developments in trade balance. Export of goods slowed its rate of growth down to 15% yoy in August alone, while being up 34% yoy in January-August. For the same period Bulgarian companies exported goods worth EUR 13.2 bn. According to the latest commodity breakdown, export structure as of July remained practically unchanged, as raw materials kept their largest share, followed by consumer and investment goods. August imports stabilized their growth rate at 12.6% yoy, being 12.7% in July. For the first eight months of the year imported goods in Bulgaria amounted to EUR

13.7 bn, up 20.2% compared to the same period of 2010.

- **Services sector surplus** increased by 2% yoy to EUR 602.9 mln in August alone amid the ongoing summer holiday season. Bulgarians continued spending less on other foreign services (including telecommunications, construction, insurance and financial services), while expenditures on travel and transport services remained relatively constant. As a result, "Services" surplus reached EUR 1.84 bn in January-July. Meanwhile, **"income" deficit** widened to EUR 957.6 mln, up 13.4% yoy for the first eight months. In August alone, however, "income" deficit came 3 times lower compared to August 2010. Net current transfers increased by 19% to EUR 1.26 bn in January-August over the corresponding period a year earlier mainly due to better EU funds absorption, thus also having positive contribution to the current account.
- **Financial account balance came to positive territory in August**, since its surplus stood at EUR 22.2 mln. Thus, the accumulated deficit from the beginning of the year narrowed to EUR 1.68 bn. Foreign investment in the country remained low, as FDI stood at EUR 36.7 mln in August, while those accumulated for the first eight months amounted to EUR 225.6 mln. Net other investments reported a negative balance at EUR 124.4 mln, as the process of foreign liabilities repayment from local banks has been slowing down. Still, the accumulated deficit for the first eight months of the year stood rather high at EUR 1.7 bn.
- The **overall balance of payments** was positive at EUR 411.2 mln, since both current and financial account reported surplus in August. Thus the accumulated deficit shrank to EUR 123.8 mln, compared to the EUR 790 mln deficit for the same period of 2010.
- **Gross external debt** (GED) declined to 92% of GDP (EUR 36 bn) at end-August, down by 9.8 pps yoy and 0.5 pps mom. External debt stock of the banking system contracted further, though this dynamics eased lately. At the end of the month banking sector foreign debt stood at 17.4% of GED (being 18.2% a year earlier). Other sectors foreign debt rose by 2% yoy, as firms borrowed more short-term loans. Meanwhile, intercompany loans decreased to EUR 14.6 bn, being EUR 15 bn 12 months earlier. Maturity structure remained practically unchanged as the long- and short-term debt remained at 70 and 30% respectively.

Coverage with FX Reserves

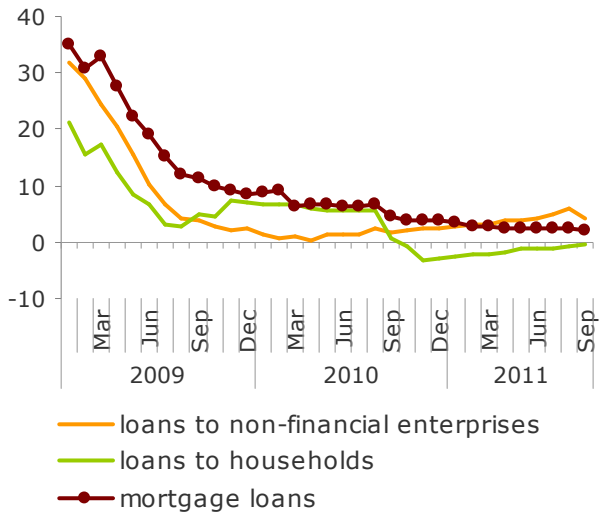


Source: BNB, MoF

- **International reserves** had a nearly 1% mom increase in October, reaching a total of BGN 13.2 bn, thus their annual growth rate accelerated to 5.2% from 2.3% a month earlier. Government deposit increase by 6% (up by BGN 141.3 mln) largely accounted for reserves' dynamics, while the other reserves' sources change was marginal. Monetary base coverage improved as of end-October, up 2.6 pps over the month, and reached 183.3%. At the end

of August Bulgarian National Bank's reserves were enough to cover 6.6 months of imports of goods and services and 122% of the short- term external debt.

Credit growth
(% change, yoy)

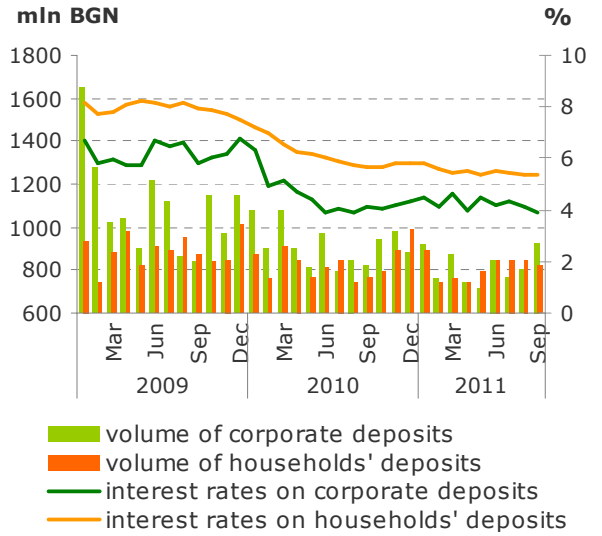


Source: BNB, MoF

- **Money supply** accelerated its pace of increase to 10.3% yoy as of end-September, as the faster broad money growth was driven by the increase in quasi-money. Considered by main components, deposits with agreed maturity up to 2 years and deposits redeemable at notice up to 3 months went up by 12.6 and 16.8% yoy respectively, up from 10.2 and 15.5% respectively in August. Liquid monetary aggregate M1 slowed down from 6.8% to reach 5.5% at the end of September. Money supply grew by 0.5% mom (up BGN 251.3 mln) mainly driven by deposits with agreed maturity up to 2 years, which came 1.5% higher or BGN 444.7 mln up over the previous month. Lower demand for liquidity after the end of the summer season resulted in a BGN 253.2 mln decrease in M1, down 1.2% mom. Total deposits accelerated further to 11.3% at the end of September, thus stepping up by 0.5% over the month (up by BGN 216.6 mln).

- **Credit to the private sector** annual growth decelerated to 2.2%, due to the corporate credit slowdown by almost 2 pps to 4.1% yoy. At the same time households' credits continued their previous months' dynamics. Consumer credits managed to limit their decrease down to 0.4% yoy. Mortgages registered a marginal change, as their annual growth rate slowed to 2.2%.

Interest rates (%) **and volumes** (mln BGN) **of time deposits in BGN up to 1 year**



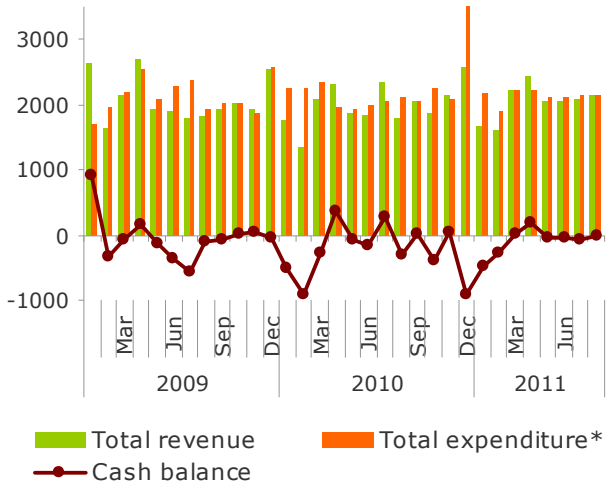
Source: BNB, MoF

- **Interest rates** on short-term BGN denominated loans, as well as those on long-term credits decreased in September, while those on short-term credits in foreign currency slightly increased. Volume of newly lent corporate credits was significantly lower compared to the previous month, whereas consumer credits and mortgages showed practically no change. Interest rates on deposits in local currency dropped. At the same time EUR and USD deposits' rates slightly increased. There was an increase in volumes of the newly attracted deposits in all currencies, especially in US dollars. While it is

possible that USD deposits are used to mitigate some exchange rate risk, this could also be a sign of growing trade relations with non-EU countries.

- **General government deficit** amounted to BGN 826 mln (1.1% of GDP) on cash basis at the end of September, decreasing by BGN 691.9 mln in nominal terms (down by approximately 1.1 pps) compared to the same period a year earlier.

Consolidated Budget
(monthly value, mln BGN)



** incl. contribution to EU budget*

Source: MoF

- **Total revenue for the first nine months** of the year accounted for 70% of the 2011 annual forecast, up 5.7% yoy in nominal terms. Tax revenues registered an 11.1% yoy increase with the largest positive contribution coming from indirect taxes (up 12.7%). VAT receipts collected in January-September came 12.2% higher compared to the corresponding period of 2010. Excises rose as well, up by 13.3%. Increases in direct taxes (up 7% yoy) and total social and health insurance contributions[1] (up 11%) also contributed positively to the total revenue dynamics. Both non-tax revenue and grants collected during the first nine months of 2011 decreased in yoy terms.
- **Total expenditure** accounted for 68.1% of the 2011 annual forecast. Compared to the same period of 2010 total expenditure grew by 1.6% in nominal terms, mainly driven by the increase in social payments. Expenditure on maintenance, social and health insurance contributions and interest were also up. Though, a reduction has been registered in capital expenditures, wages and salaries and subsidies payments.
- **Fiscal reserve** totaled approximately BGN 5.1 bn at end-September.
- **General government debt** (including government guaranteed debt) accounted for 15.4% of GDP at the end of August. Government external debt came to 8.4% of GDP, domestic debt - 5.4%, while guaranteed debt amounted to 1.5% of GDP.

[1] The administratively determined rate of social contributions has been raised by 1.8 pps since January 2011.

Key Economic Indicators

		2008	2009	2010	Q4 '10	Q1 '11	Q2 '11	Q3 '11	IV '11	V '11	VI '11	VII '11	VIII '11	IX '11
GDP*														
Gross Domestic Product*	%, yoy	6.1	-5.5	0.2	3.7	3.3	2.0							
Consumption	%, yoy	2.5	-7.3	-1.1	0.5	1.2	1.4							
Gross fixed capital formation	%, yoy	16.3	-24.9	-14.0	-0.9	1.6	8.4							
Export	%, yoy	3.0	-11.2	16.2	15.2	21.6	12.2							
Import	%, yoy	4.2	-21.0	4.5	10.7	10.0	7.5							
Agriculture	%, yoy	29.6	-6.1	3.9	-1.5	-1.4	-2.5							
Idustry	%, yoy	4.4	-7.8	1.9	10.5	5.4	5.9							
Services	%, yoy	5.0	-0.8	-0.9	0.6	0.1	0.1							
Adjustments	%, yoy	5.7	-16.5	-0.2	5.2	7.9	5.3							
Short term business statistics														
Industrial production	%, yoy	0.7	-18.3	2.0	5.2	10.6	6.0		8.8	9.1	1.6	5.1	2.5	
Industrial turnover	%, yoy	13.7	-20.2	14.1	21.1	32.6	19.1		23.1	20.2	14.5	15.0	13.9	
Retail trade turnover	%, yoy	8.9	-8.9	-5.6	-4.3	0.4	0.4		0.5	1.8	-0.9	-3.0	-2.7	
Construction output	%, yoy	12.7	-14.5	-18.0	-8.5	-14.8	-14.4		-22.1	-16.9	-3.7	-14.2	-8.2	
Total business climate	balance	38.0	10.2	9.6	11.5	13.8	14.1	15.2	14.4	14.2	13.8	14.5	15.6	15.5
Industrial confidence	balance	39.9	12.3	13.4	15.0	21.6	22.8	24.1	24.5	22.1	21.6	22.7	24.7	24.9
Retail trade confidence	balance	41.3	13.5	10.1	13.0	13.0	10.7	20.2	11.2	11.2	9.5	13.1	23.9	23.6
Construction confidence	balance	40.3	8.5	5.1	2.9	4.7	4.4	3.9	2.0	5.7	5.6	8.2	2.5	1.1
Services confidence	balance	28.7	5.1	5.6	11.8	8.1	10.1	3.8	9.7	9.8	10.7	5.7	2.5	3.1
Labour market														
Participation rate (15+)	level	53.8	53.0	52.0	52.1	50.8	51.0							
Employment rate (15+)	level	50.8	49.4	46.7	46.3	44.7	45.3							
Employment (LFS)	%, yoy	3.3	-3.2	-6.2	-4.7	-4.0	-4.5							
Unemployment rate (LFS)	level	5.6	6.8	10.2	11.2	12.0	11.2							
Unemployment rate (EA**)	level	6.3	7.6	9.5	9.1	10.9	10.1	9.5	10.5	10.0	9.7	9.6	9.6	9.4
Nominal wage	%, yoy	26.5	11.8	6.3	10.4	8.5	9.3		10.4	9.1	8.5			
Real wage***	%, yoy	13.0	9.1	3.2	6.1	3.8	5.7		6.9	5.5	4.8			
Labour productivity (GDP per employed)	%, yoy	3.5	-2.9	6.4	7.8	5.2	6.0							
Real ULC	%, yoy	3.7	8.1	-2.2	-6.7	-7.0	-3.4							
Prices														
Harmonized index of consumer prices	%, yoy	11.9	2.5	3.0	4.0	4.5	3.4	3.1	3.3	3.4	3.5	3.4	3.1	2.9
Domestic producer prices	%, yoy	13.3	-4.3	7.2	11.1	11.9	10.3	7.2	10.7	10.0	10.1	8.4	6.6	6.6
Consolidated fiscal program (cummulative)														
Revenue and grants	mln BGN	27313	25041	23933	23933	5530	12042	18354	7950	9997	12042	14119	16242	18354
Total expenses	mln BGN	25323	25667	26755	26755	6272	12692	19180	8502	10595	12692	14839	16973	19180
Contribution to EU budget	mln BGN	720	746	670	670	250	367	528	286	330	367	422	466	528
Cash deficit(-) / surplus(+)	mln BGN	1990	-626	-2823	-2823	-742	-651	-826	-552	-598	-651	-721	-731	-826
	% GDP	2.9	-0.9	-4.0	-4.0	-1.0	-0.9	-1.1	-0.7	-0.8	-0.9	-1.0	-1.0	-1.1
Government and gov. guaranteed debt	mln BGN	10710	10641	11778	11778	11447	11573		11406	11532	11573	11708	11763	
	% GDP	15.5	15.6	16.7	16.7	15.1	15.3		15.1	15.3	15.3	15.5	15.6	
Fiscal reserve	mln BGN	8382	7673	6012	6012	4699	5154	5071	4683	4986	5154	4881	4993	5071
	%, yoy	12.5	-8.5	-21.6	-21.6	-26.1	-14.5	-24.4	-29.8	-24.3	-14.5	-22.8	-19.0	-24.4
Financial sector														

		2008	2009	2010	Q4 '10	Q1 '11	Q2 '11	Q3 '11	IV '11	V '11	VI '11	VII '11	VIII '11	IX '11
BNB International reserves	mln EUR	12713	12919	12977	12977	12209	12340	13051	11965	12245	12340	12500	13079	13051
Monetary base coverage	%	175.3	195.2	179.8	179.8	176.3	179.2	180.7	176.7	179.3	179.2	178.9	179.7	180.7
Coverage of import with FX reserves	months	5.4	8.0	7.3	7.3	6.5	6.4		6.3	6.3	6.3	6.4	6.6	
Coverage of short-term external debt	%	96.5	100.2	112.8	112.8	112.4	113.6		112.1	114.7	113.6	115.1	122.0	
Money M1 (Narrow money)	%, yoy	-4.1	-8.8	0.8	0.8	4.9	3.7	5.5	4.5	3.5	3.7	5.2	6.8	5.5
Money M3 (Broad money)	%, yoy	8.8	4.2	6.2	6.2	7.4	8.0	10.3	7.6	7.9	8.0	9.4	9.4	10.3
Deposits	%, yoy	8.8	7.6	6.6	6.6	8.2	8.8	11.3	8.3	8.6	8.8	10.3	10.4	11.3
Credit to private sector	%, yoy	32.9	3.8	1.1	1.1	1.6	2.1	2.2	2.1	2.2	2.1	2.5	3.3	2.2
Credit to non-financial enterprises	%, yoy	33.1	2.3	2.4	2.4	3.0	4.1	4.1	3.8	3.7	4.1	4.8	6.1	4.1
Credit to households	%, yoy	31.4	5.8	-0.8	-0.8	-0.7	-0.6	-0.2	-0.7	-0.6	-0.6	-0.5	-0.4	-0.2
Interest rate on short-term loans	%	10.9	10.5	8.5	8.0	6.4	7.3	7.3	6.2	8.3	7.3	7.6	7.9	7.3
Interest rate on time deposits	%	5.6	7.0	5.4	5.1	5.1	4.9	4.7	4.8	5.0	4.9	5.0	4.8	4.7
Exchange rate BGN/USD	eop	1.39	1.36	1.47	1.47	1.38	1.35	1.45	1.32	1.36	1.35	1.37	1.35	1.45
	per. av.	1.34	1.41	1.48	1.44	1.43	1.36	1.42	1.35	1.36	1.36	1.37	1.36	1.42
Gross External Debt														
Gross external debt	% GDP	104.9	108.0	101.8	101.8	93.9	94.0		92.1	92.6	92.7	92.5	92.0	
Short term external debt	% GED	35.4	32.7	31.4	31.4	29.9	29.9		29.6	29.4	29.9	30.0	29.8	
Intercompany lending	% GED	36.4	38.5	40.2	40.2	40.4	40.0		40.4	40.3	40.0	40.4	40.6	
Balance of payments														
Current account	mln EUR	-8162	-3118	-356	-871	147	97		-79	127	50	614	706	
Current account, % GDP moving average		-23.4	-8.7	-1.0	-1.3	0.7	1.8		1.0	1.6	1.8	2.0	2.5	
Trade balance	mln EUR	-8597	-4174	-2412	-1040	-11	-630		-202	-219	-208	43	19	
Trade balance, % GDP moving average		-24.6	-11.6	-6.7	-7.7	-5.8	-5.0		-5.1	-4.8	-4.9	-4.6	-4.5	
Export, f.o.b.	mln EUR	15204	11699	15588	4313	4777	4862		1606	1660	1596	1841	1672	
	%, yoy	12.5	-23.1	33.2	32.8	57.5	28.0		36.7	37.0	12.9	20.5	15.1	
Import, f.o.b.	mln EUR	-23801	-15873	-18001	-5352	-4788	-5492		-1808	-1879	-1804	-1799	-1653	
	%, yoy	14.7	-33.3	13.4	28.9	30.2	17.4		18.7	20.0	13.7	12.8	12.6	
Capital account	mln EUR	277	477	291	140	16	45		2	-1	45	40	30	
Financial account	mln EUR	11473	1190	-1	358	-743	-273		-57	-80	-302	-149	-43	
Net Foreign Direct Investments	mln EUR	6212	2498	1459	693	-120	176		109	54	12	66	36	
Net Portfolio Investments	mln EUR	-731	-570	-661	-150	-189	-18		170	-148	-40	-13	118	
Other Investments - net	mln EUR	5980	-719	-774	-185	-424	-424		-469	44	1	-729	-124	
Change in BNB reserve assets****	mln EUR	-674	650	384	-65	665	-92		258	-220	-131	-38	-411	

** Reference year 2005, seasonally and working day adjusted data.*
*** Employment agency.*
**** HICP deflated.*
***** (-) - increase; (+) - decrease in BNB International Reserves.*

Recent Developments and Government Debt Review

Increasing investor demand for Bulgarian Sovereign Debt

The Ministry of Finance tapped successfully the benchmark issue of 10.5 year GS with a weighted average annual yield of 5.28% at the auction held on October 3, 2011. This is the lowest yield recorded throughout the six auctions conducted so far for this issue since its launch in circulation on January 17, 2011 with a peak yield of 5.49%. Thus, the positive trend of yield reduction with long-term bonds was preserved after the medium-term GS yield decrease. Investor demand exceeded supply and the issue was oversubscribed with a coverage ratio of 1.91. The nominal value of primary dealers bids submitted totaled almost BGN 106 mln, with a tendered volume of BGN 55 mln.

After this successful auction the volume of this priority issue totaled BGN 257.9 mln, thus its parameters emphasizing its status of a benchmark bond, enhancing its liquidity on the secondary market as well. The yield of this issue serves as a basis for the harmonized long-term interest rate calculation, which is among Maastricht convergence criteria. The yield recorded on the auction came lower than the latest harmonized long-term interest rate for Bulgaria as of September, published by the ECB, i.e. 5.3%. Just for comparison, this indicator for other Eastern European countries is as follows: Poland - 5.74%, Hungary - 7.64%, Romania - 7.43%, Latvia - 5.6%.

As expected, there has been a great interest from banks and other institutional investors in this long-term maturity segment. Allocation of the approved volume of GS by type of investor showed that banks had the largest share of GS acquired at the auction (50%), followed by pension funds (44%) and insurance companies (5%).

In the highly volatile market environment and ongoing sovereign debt crisis in Europe, Bulgaria maintained its fiscal consolidation and managed to reduce the cost of market oriented financing. The lower yield of domestic government debt keeps interest rate expenditures in check and thus influences favorably the economic activity. Retaining budget financing costs increase allows for preserving low tax burden and reducing government debt servicing costs in the medium and long run.

Investor confidence has been highly esteemed, thus MoF will continue to pursue its policy of spurring on domestic GS market development driven by its priority importance.

Yields on Bulgarian Government Debt at sustainable low levels

The auction for the sale of 5-year EUR-denominated GS held on October 17, reaffirmed Bulgaria's stable and predictable status as a government debt issuer. After the yield reduction observed in all maturity segments of the debt curve as of August 2011, this auction reaffirmed the declining trend of yield on GS placed on the domestic market. The average weighted yield of the approved volume of securities - for EUR 35 mln, was 3.93%. When the issue was launched in March 2011, its registered yield was 4.16%. During

the next two issue reopenings in May and July, the yield reached 4.1 and 4.16%, respectively.

The spread as compared to the German federal securities with similar maturity has dropped to the lowest level on a primary market – down to 2.73 pps, since the beginning of the debt crisis. The difference in the yield between Bulgarian and German benchmark securities is below the indicator measuring a country's default risk (5Y CDS), which is an indicator for the absence of a risk add-on in investors medium-term assessments.

The average weighted annual yield during the action was also below the current yield on the EUR-denominated Eurobonds with similar residual maturity of Hungary (6.65%), Turkey (4.67%) and Lithuania (4.4%), as well as below the yield on the benchmark debt issues with similar characteristics of Italy (5.37%) and Spain (4.52%).

All groups of government debt investors took part in the auction, the total volume of bids being EUR 72.4 mln. The coverage ratio achieved was 2.07, thus being the highest one at the last three auctions for placement of the 5-year EUR-denominated GS issue.

The sustainable trend of a stabilizing yield on the GS market, as well as Bulgaria's independent external assessment by the Institute on International Finance, based in Washington, showed a low level of vulnerability to imported external risks, confirming Bulgaria's overall position as one of the most stable EU countries in fiscal terms.

Ministry of Finance successfully conducted the first switch auction for domestic GS

MoF continued the series of active government debt management operations since the beginning of the year with the switch auction (buying-back of GS without a specific term and their replacement with GS from another issue) held for the first time on October 24. Its objective was smoothing repayment profile of government debt payments at the beginning of 2012.

Subject to the buy-back (the source bond) was an issue with original maturity of 5 years and residual maturity as of the date of the transaction of 3 months (the maturity date being 24.01.2012); the settlement bond was a seven-year one issued on 17.02.2010 (the maturity date being 17.02.2017) with residual maturity as of the date of the transaction of 5 years and 4 months. The nominal value of orders requested and approved, respectively, was around BGN 25.2 mln and after this auction the issue's volume exceeded BGN 250 mln. The buy-back prices offered at the auction were lower than the market quotations for that issue, the average weighted price per BGN 100 nominal value under issue 300/2007 being BGN 100.57, with 1.69% yield.

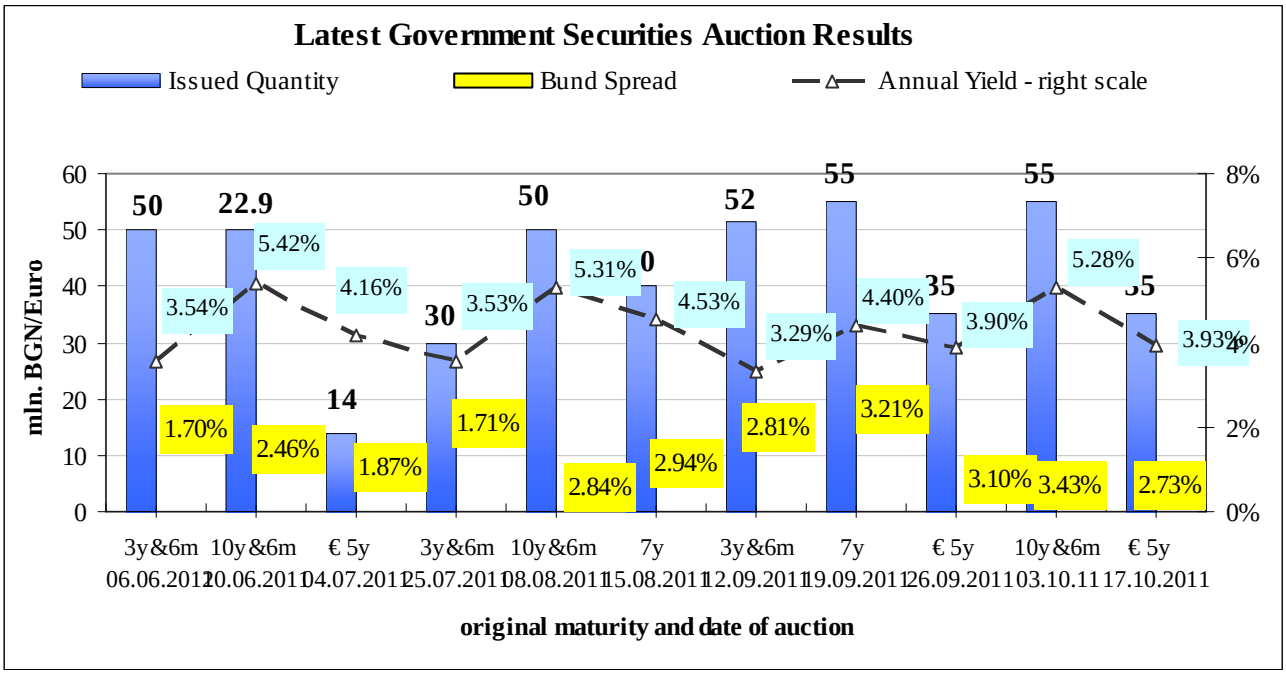
The price at which market participants acquired issue 401/2010 was fixed in advance at BGN 100.75 per BGN 100 nominal value, with 4.39% yield. The spread realized under the seven-year issue used for the replacement, as

compared to the German federal bonds with similar residual maturity, registered a decrease compared to the previous reopenings of this bond issue, being among the lowest spreads in this maturity segment registered so far.

Participants in the first Bulgarian auction for GS replacement without any cash flow movement were primary dealers with traditionally strong presence on the domestic debt market. Ministry of Finance rendered an account of market participants' interest in such transactions for investment portfolios' management, intending to continue offering new methods and instruments in the area of domestic debt management.

The transaction of buy-back through replacement had a positive effect on budget expenditure in 2011. Its results are an indicator of the higher interest of Bulgarian government debt holders in these new techniques and instruments offered on Bulgarian GS market and encourage seeking of new options and appropriate investment alternatives on the domestic market.

Ministry of Finance decision to conduct that transaction complied with its objectives to obtain a smooth profile of debt repayments and to reduce the risk of refinancing the sovereign portfolio of liabilities without increasing the amount of the government debt.



Additional data on the auction results can be viewed on the site of the Bulgarian National Bank, that is a fiscal agent to the government www.bnb.bg

Stable nominal extent of government debt is of primary significance to

By end-September 2011 government debt totalled EUR 5500.1 mln in nominal terms, including domestic debt of EUR 2156.4 mln and external debt of EUR 3343.7 mln.

In nominal terms, government debt posted an increase of some EUR 85.1 mln over the previous month, due mainly to domestic debt increase,

government finance

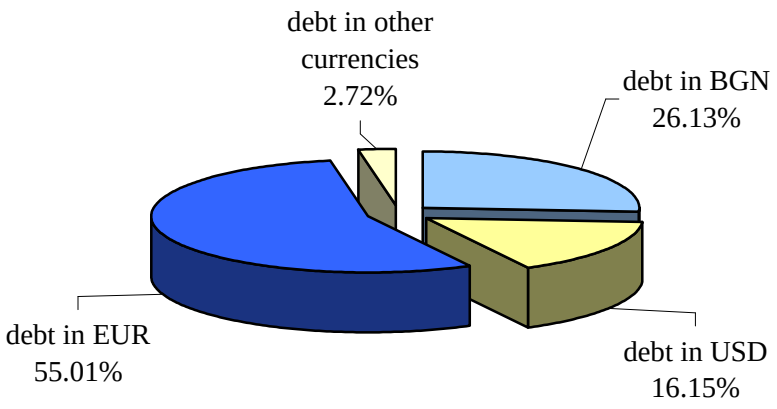
reflecting new domestic financing through GS issues and valuation adjustments. Government debt to GDP ratio was 14.2%.

Government Debt Amount (million EUR)						
Structure	**31.12.2010**	**31.03.2011**	**30.06.2011**	**31.07.2011**	**31.08.2011**	**30.09.2011**
Domestic government debt	**2 011.5**	**1 941.5**	**2 059.8**	**2 077.0**	**2 122.3**	**2 156.4**
External government debt	**3 373.5**	**3 319.5**	**3 272.1**	**3 307.9**	**3 292.7**	**3 343.7**
Government Debt, total	**5 385.0**	**5 261.0**	**5 331.9**	**5 385.0**	**5 415.0**	**5 500.1**
Government Debt /GDP (%)	**14.9**	**13.6**	**13.8**	**13.9**	**14.0**	**14.2**

Government debt currency structure does not generate risks associated with its servicing

Debt currency structure showed only marginal changes in September due to payments. Previous month tendency towards an increase in EUR and BGN denominated debt at the expense of debt in US Dollars and other currencies reversed, thus the latter rose slightly. Debt in EUR reached 55%, in BGN - 26.1%, in USD - 16.2% and in other currencies - 2.7%.

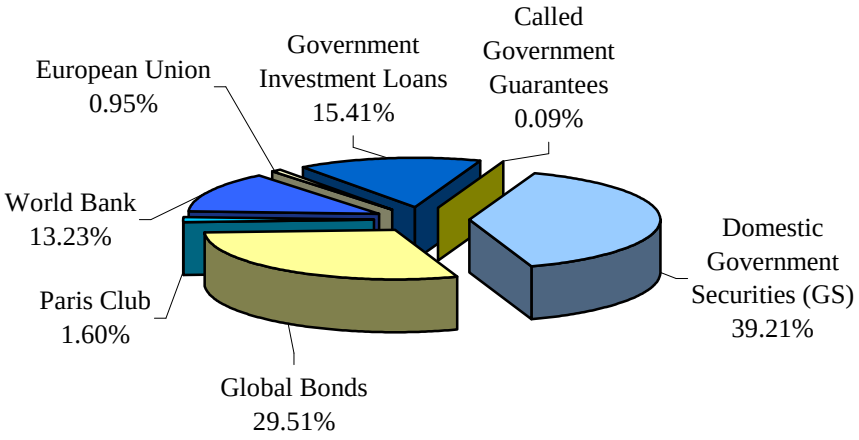
Government Debt Currency Structure as of 30 September



Government debt portfolio structure is another key indicator for successful debt management policy

Debt structure by types of instruments and creditors in September showed no significant change. Liabilities related to GS issued on the domestic market had the largest relative share at 39.2%, followed by global bonds - 29.5%, government investment loans - 15.4%, obligations to the World Bank - 13.2%, obligations to the Paris club - 1.6%, European Union - 1% and called government guarantees - 0.1%.

Government Debt Structure by Creditor as of 30 September



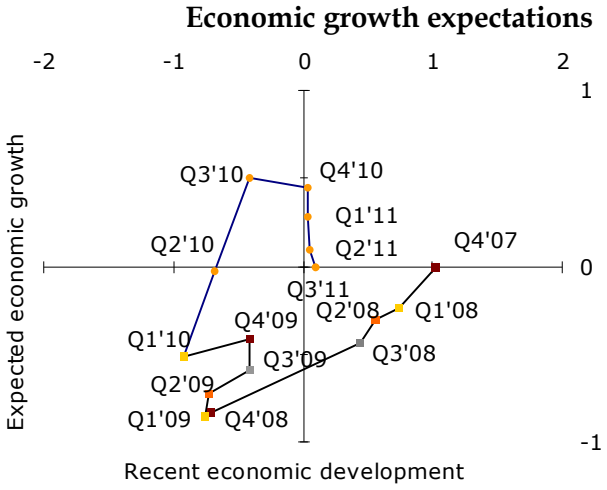
Comprehensive information on Bulgarian Government Debt, including monthly bulletins and annual reviews, could be found the website of Bulgarian Ministry of Finance.
http://www.minfin.bg/en/statistics/?cat=2&from=0&fyear=0&to=0&tyear=0&dq=&pokaz=0

For any further questions or comments, please contact Mrs. Milena Boikova, Director of Government Debt and Financ Markets Directorate, Ministry of Finance: email: M.Boikova@minfin.bg , tel. +359 2 9859 2450.

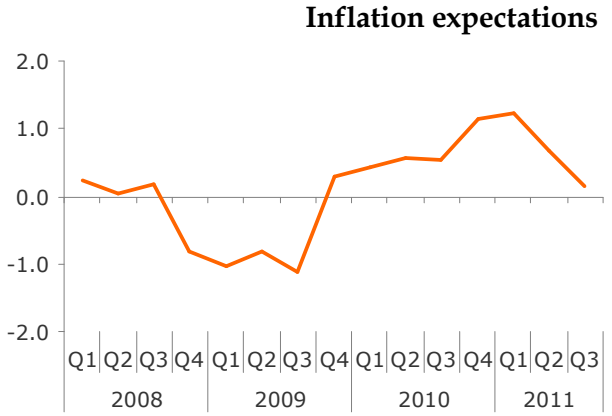
Financial Sector: Estimates and Expectations, #4/2011

Resume of the Main Findings

- Financial intermediaries are optimistic about the recovery of financial services demand to pre-crisis levels in medium term.
- Recent economic development assessment improves, but the Q3 economic growth expectations drop slightly towards preserving the current pace.



- Inflation rate expectations through December are declining.



- Deposits and credits interest rates levels will stay unchanged in the last quarter of 2011.
- US dollar will continue to appreciate slightly until the end of the year.