

2012

RECENT ECONOMIC DEVELOPMENTS, BULGARIA

SELECTED ISSUES, JANUARY 2012

- ▶ Macroeconomic environment and policies in brief
- ▶ Recent Economic Developments
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- ▶ Recent Developments and Government Debt Review



REPUBLIC OF BULGARIA
Ministry of Finance

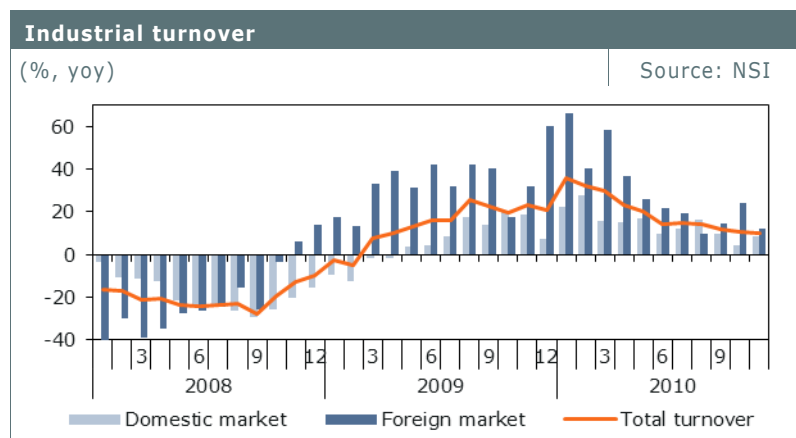


MACROECONOMIC ENVIRONMENT AND POLICIES IN BRIEF

- ▶ According to the flash estimate, Bulgarian economy grew 1.6% in 2011, reporting a real GDP growth of 1.5% yoy in Q4 2011. Thus, **Bulgaria ranked 3rd in terms of qoq growth and 7th among fastest growing EU Member States on an yoy basis**. Export expanded by 10% yoy in the fourth quarter, thus being the main growth engine. The investment activity in the country worsened, while final consumption growth stood at 1.4% yoy. On the supply side, GVA expanded by 1.6% in Q4 11, up 1.7% for the whole 2011.
- ▶ **Short-term business statistics** posted a downward adjustment, as slowing global activity and strong European headwinds continued to weigh on industrial turnover and foreign market sales in particular. Growth in industrial production decelerated, while the annual decrease in retail sales and construction output remained almost unchanged from the previous month. Business climate indicator also fell in January, almost entirely due to the worsening expectations in retail trade. The business conjuncture in industry remained flat, while export prospects were more reserved due to deteriorating external environment.
- ▶ **The unemployment rate** continued its mom pace of change to 10.4% as of end-December. Inflation stepped up by 0.3% mom, largely reflecting seasonally higher prices of travel services before Christmas and New Year's Eve and the beginning of the winter holiday season. The annual average inflation in 2011 stood at 3.4%, while the **HICP decelerated further to 2% yoy at the end of 2011**. The latter remained below EU and euro area averages, thus **Bulgaria ranked third among Member States with the lowest rates of inflation**.
- ▶ **Current account balance** was negative by EUR 126.5 mln in November, thus the surplus accumulated since the beginning of the year stood at EUR 1.2 bn (3% of GDP). During the month, exports growth outpaced the change in imports, resulting in a **50% yoy decrease in trade deficit**. Services balance also improved. **Financial account was almost balanced** at a EUR 10.2 mln deficit. Net FDI amounted to EUR 47 mln, as the investment flows to the country were two times higher than Bulgarian investments abroad. After six months on positive territory, November balance of payments came in negative at EUR 64.6 mln.
- ▶ At the end of the year **consolidated budget deficit** amounted to BGN 1 582.2 mln (2.1% of GDP) on a cash basis compared to the BGN 2 783.4 mln deficit (3.9% of GDP) a year earlier. Thus, **Bulgaria overshot by 0.4 pps its budget balance target** of -2.5% embedded in the State budget Law. Deficit improvement came on the back of strict fiscal consolidation measures, so that general government revenue recorded higher annual growth than total expenditure.
- ▶ **Bulgarian long-term GS yield remained stable** in an environment of escalating debt markets insecurity in Europe and on the background of increasing financing prices for a number of EU Member States. Taking into account the **positive developments on domestic debt market**, MF will continue to provide the necessary financing of the budget at the optimum price for the issuer. Reducing the cost of state funding allows for the optimization of the debt servicing cost, which is a condition for maintaining a low tax burden in Bulgaria in the long-run.

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Industrial turnover slowed further its annual growth to 9.9% in November. In contrast to previous month developments, this time it was due to decelerating foreign market sales (12.3% yoy). Domestic turnover accelerated to 8.5% yoy with the largest contribution coming from the energy products.

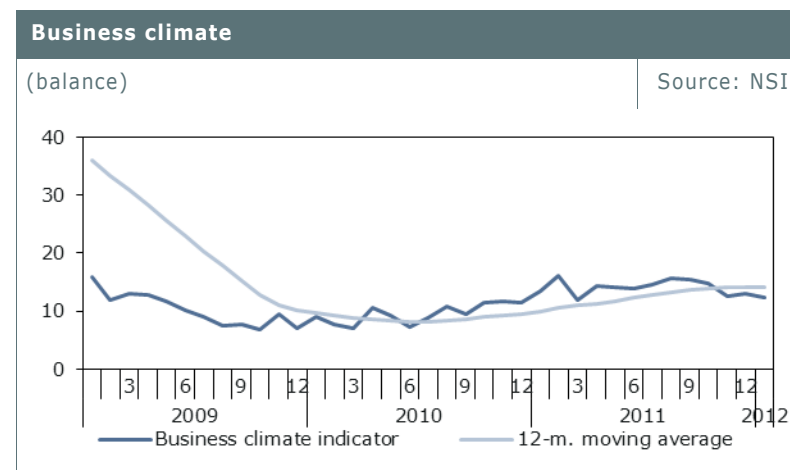


Growth in industrial **production** also decelerated to a meager 0.6% yoy. Both mining and quarrying and manufacturing contributed negatively for industrial output developments, indicating for a possible negative trend in the near future. Mining of metal ores posted the largest monthly change from a 16.4% yoy growth in October to a 41.6% yoy decline in November. Manufacturing sectors with the highest share in industrial production posted diverging results. Manufacture of basic metals had the highest positive contribution, while manufacturing of food products had a negative effect on growth.

Retail sales slump stood almost unchanged at 5.3% yoy. Almost all product groups contracted with the largest decline in

consumer durable products. For a second month in a row, retail sales of medical and orthopedic goods, cosmetic and toilet articles were the only ones that registered a positive growth, accelerating to 8.2% yoy.

Construction production decline came in at 10.7% yoy, after 10.2% in October, as both civil engineering and building construction deepened slightly their annual decrease to 18.4 and 4.8% yoy respectively.

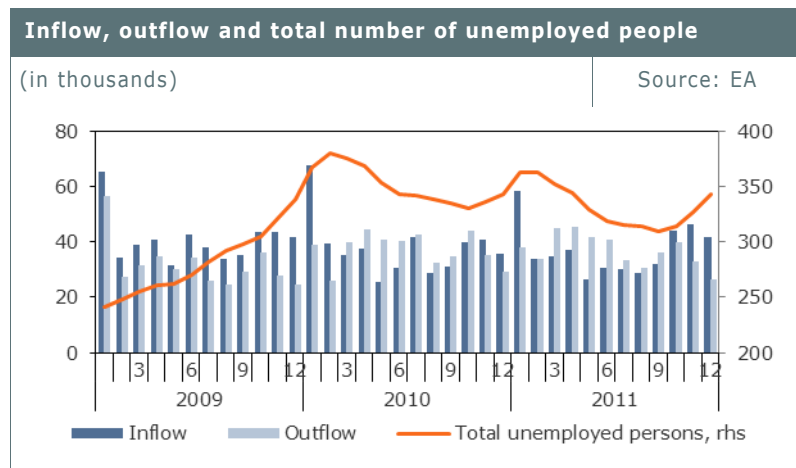


January business climate indicator fell by 0.7 pps compared to December 2011 almost entirely due to the worsening expectations in retail trade. The business conjuncture in industry remained unchanged, while expectations about the export were more reserved due to deteriorating external environment. Meanwhile, optimism prevailed in services and construction. Positive prospects for present and future demand for services, as well as expected increase in new orders in

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construction, largely accounted for the improvement in respondents' expectations about the economic situation in the country.

Seasonal activities fall and narrowed mom scope of the subsidized employment programs stayed behind the **UR** increase to 10.4% as of end-December. Jobless pool numbered 342.4 K, however remaining at 2010 end-of-period level. Both the unemployment inflow and outflow decreased over the previous month. People who found jobs in December (9 K) were 38.4% lower mom due to decreased demand of labour on the primary labour market, as well as the smaller number of persons who started working under the ALMM.

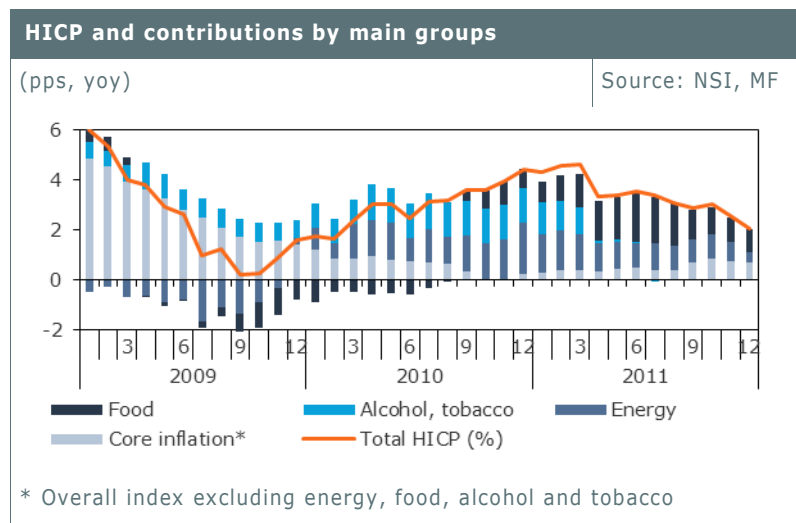


Inflation stepped up by 0.3% mom in December, largely reflecting seasonally higher **prices of travel services** before Christmas and New Year's Eve and the beginning of the winter

holiday season. Prices of package holidays and resort hotel accommodation rose by 13 and 16.2% mom respectively, contributing together by 0.31 pps to the monthly headline rate. Low-cost and foreign airlines fares also increased, adding another 0.13 pps. **Food prices** grew marginally by 0.2% on average. Divergent price movements in fresh fruits (down 7% mom), and vegetables (up 4.5% mom) again offset each other's impact, while eggs, soft drinks and meat prices, up by 7.3%, 2% and 0.2% respectively, had an upward bearing to the total HICP change over the previous month. **Fuel prices** fell 2% from November, thus having the largest downward impact (-0.13 pps), as both international and domestic oil producer prices eased. Non-energy industrial goods registered a marginal downward correction, down 0.2%, while prices of **consumer durables** continued decreasing. Administered prices contributed modestly in December, after the 3.7% increase in **railway fares**, which added 0.01 pps to the overall monthly inflation.

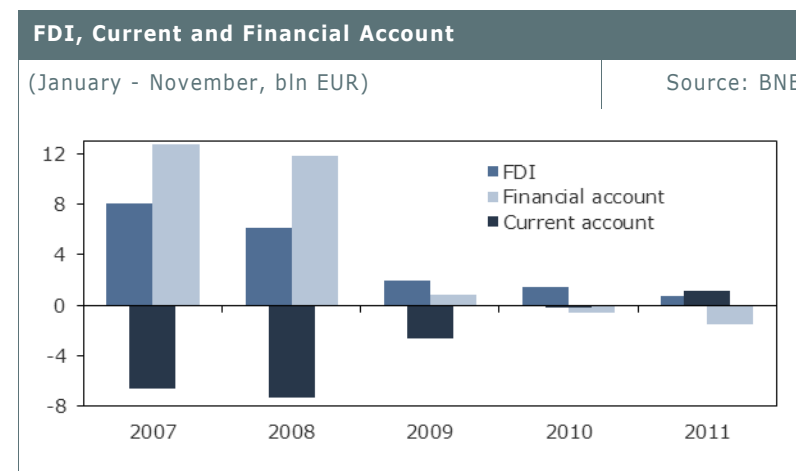
Considered on a year earlier, the **HICP decelerated further to 2% yoy at the end of 2011**. The latter remained below EU and euro area averages, thus **Bulgaria ranked third among Member States with the lowest rates of inflation**. Energy and automotive fuel prices in particular had the largest contribution to the reported slowdown, due to a considerable base effect. The **annual average inflation in 2011** came slightly higher than its 2010 value and stood at 3.4%. Higher inflation rates registered at end-2010 and early-2011 largely accounted for its dynamics, as mounting international commodity prices led to acceleration in domestic food and energy prices.

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Current account balance was negative by EUR 126.5 mln in November, thus the surplus accumulated since the beginning of the year stood at EUR 1.2 bn (3% of GDP). During the month, exports growth outpaced the change in imports (19.1% vs. 5.7% yoy respectively), resulting in a 50% yoy **decrease in trade deficit**, which came in at EUR 282.8 mln. **Services balance also improved** on a year earlier and stood at EUR 85.5 mln. Better performance was largely on account of higher travel services receipts and lower expenditures on other services (incl. construction and other business services). Income was the only article with negative contribution to the CA developments. Higher interest payments on FDI pushed the **income deficit** to EUR 74 mln in November, up 42% yoy. Net current transfers reached EUR 144.8 mln, as credit to public sector almost tripled on a year earlier. In cumulated terms,

trade deficit equaled 3.7% of GDP in January-November, services surplus reached 6% of GDP, while the income deficit (3.5%) was covered by current transfers' inflows (4.1%). Capital account balance amounted to EUR 240.5 mln. The external balance of Bulgaria (calculated as the sum of current and capital account balance) reached 3.6% of GDP, being 0.1% for the first eleven months of 2010.



Financial account was almost balanced at a EUR 10.2 mln deficit in November. Regarding **other investments** dynamics, which mostly result from banking sector activities, foreign loans repayment and withdrawal of deposits of foreign residents were offset by a decrease in assets abroad. Thus the net value over the month came in negative at EUR 48 mln compared with the EUR 245.3 mln deficit in 2010. **Net FDI** amounted to EUR 47 mln in November, as the EUR 77.4 mln investment flows to the country were two times higher than

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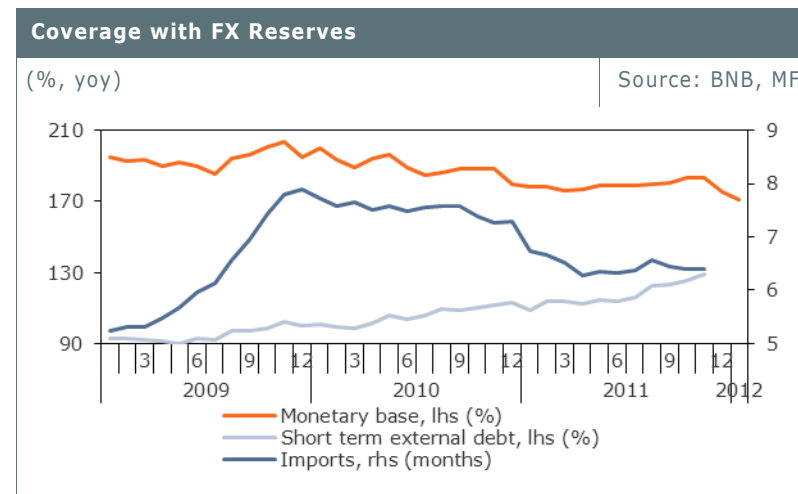
Bulgarian investments abroad. FDI kept decreasing compared to a year earlier. In January-November Bulgarian firms received EUR 740.3 mln in foreign investment.

After six months on positive territory, **November balance of payments** came in negative at EUR 64.6 mln. Thus Jan-Nov balance was also negative at EUR 56.1 mln, though being smaller than the EUR 662.8 mln deficit accumulated in the first eleven months of 2010.

Gross external debt (GED) stood at EUR 35.5 bn (91.3% of GDP) at end-November, down by 10.4 pps yoy and 0.6 pps mom. External debt stock of the banking system contracted further on a year earlier, as its rate of change accelerated to 14.9% yoy. At the end of the month banking sector foreign debt stood at 16.2% of GED (being 18.5% a year earlier). Other sectors foreign debt rose by 1.9% yoy, as the stock of short-term loans went up by 3.6%. Meanwhile, local subsidiaries continued repaying loans granted before the crisis by their parent companies, so that intercompany debt decreased to EUR 14.7 bn, being EUR 14.9 bn twelve months earlier. Maturity structure improved, as the long- and short-term debt stood at 71.3 and 28.7% respectively.

International reserves dropped by 2.8% mom in January, reaching EUR 13 bn, but their annual growth rate accelerated to 6.2% due to a sharper drop a year earlier. Seasonal decrease in notes in circulation and claims to the government largely accounted for the reported change, as the former reflected the usually lower demand for cash in the beginning of the year, while the latter derived from the budget expenditures traditionally exceeding the revenues. Monetary

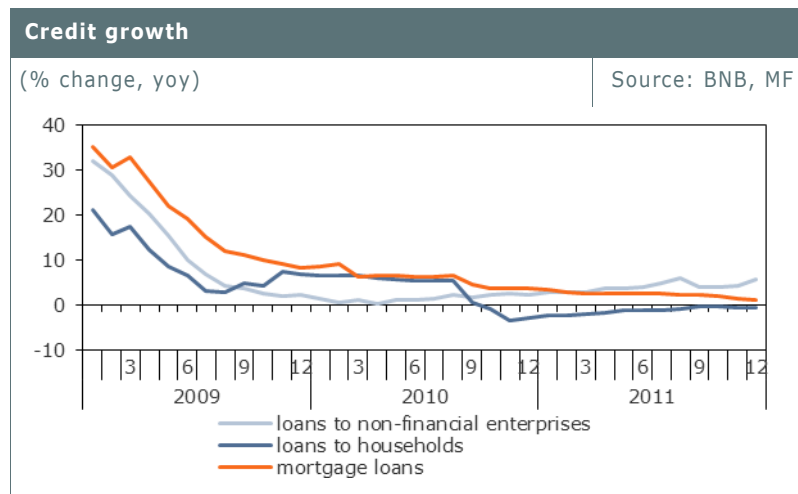
base coverage declined to 171.2% at the end of January, being 175.1% a month earlier. At the end of November the international reserves were enough to cover for 6.4 months of imports or 129.3% of the short-term external debt.



Money supply accelerated its annual growth in December to 12.2% from 7.8% a month earlier. The faster M3 growth was almost fully due to the 14.4% yoy increase in liquid monetary aggregate M1. Quasi-money also had a positive contribution, as the rate of increase in agreed maturity deposits picked up from 8.5% to 9.4%, while growth in deposits redeemable at notice up to 3 months speeded up to 20.8%. Broad money increased by 3.7% mom, reflecting the traditionally high demand for money in the end of the year. Most of the money supply growth could be attributed to the increase in currency outside MFI and overnight deposits, up by 6.5 and 5.1% respectively.

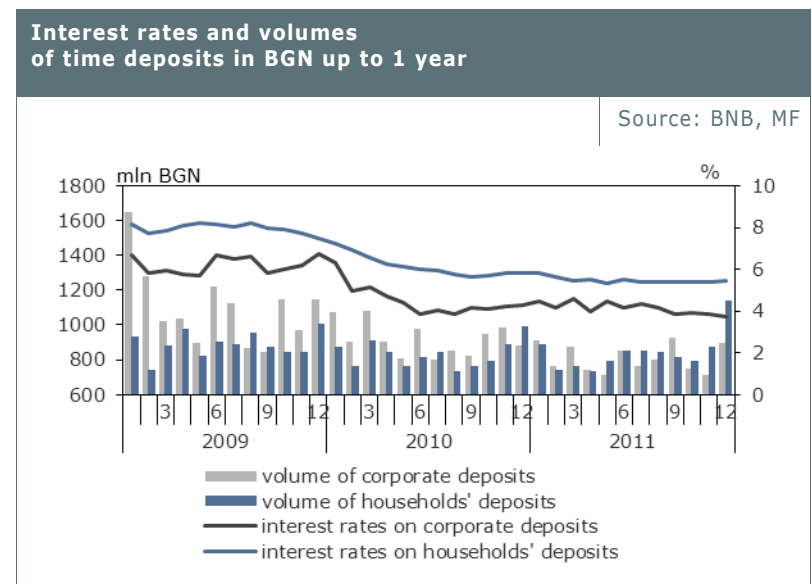
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After the slowdown to 8.2% yoy in November, total deposits growth picked up again and reached 13.2% at the end of 2011. In December alone deposits increased by BGN 1.5 bn (up 3.2%), with all institutional sectors deposits contributing positively.



Private sector credit growth reached 3.3% yoy as of end-December, being 2.3% in the previous month. It was defined by the 5.7% growth in corporate loans. Households' credit had almost neutral contribution, as consumer credits decreased by 0.7% and housing credits increased by 1.1%. Bad and restructured loans growth continued slowing down and reached 26.7% yoy. For the first time since December 2007 they had a negative monthly change in nominal terms, thus their share in total corporate and households' credit declined to 17.3%, down 0.2 pps.

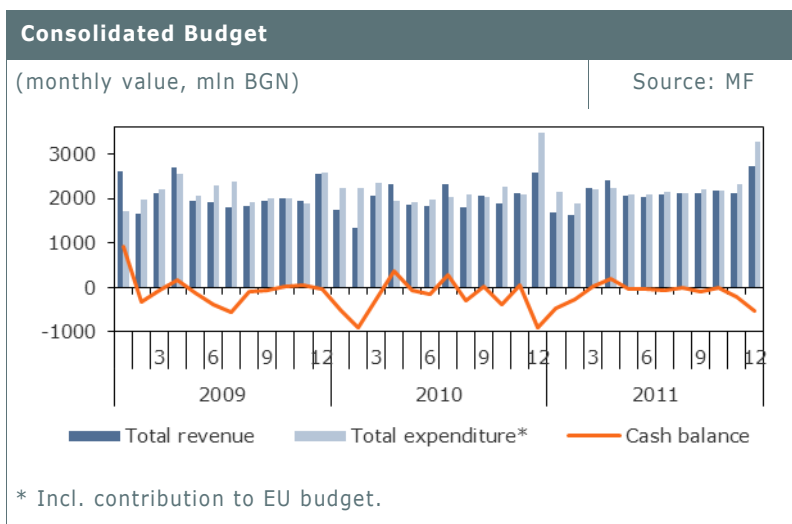
Weighted average **interest rate** on corporate credits declined by 0.9 pps in December, which was accompanied by a 25% increase in volumes over the previous month. The average rate on consumer credits increased marginally by 20 bps, while newly lent volumes declined 5% over the previous month. Mortgages posted a 36% increase in volume despite the 0.2 pps higher interest rate. Deposit interest rates were slightly above their level in the previous month and those on euro denominated deposits in particular. Total volume of newly attracted deposits increased by 17.2% mom.



At the end of the year **consolidated budget deficit** amounted to BGN 1 582.2 mln (2.1% of GDP) on a cash basis compared to the BGN 2 783.4 mln deficit (3.9% of GDP) a year

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earlier. Thus, Bulgaria overshoot by 0.4 pps its budget balance target of -2.5% embedded in the State budget Law. Deficit improvement came on the back of strict fiscal consolidation measures, so that general government revenue recorded higher annual growth than total expenditure.



Total year-end revenue accounted for BGN 25 378 mln (96.8% of the annual revenue projection), up 6% in nominal terms compared to 2010. Tax revenue increased by 8.3%, mainly due to the 6.7% growth in indirect taxes receipts. Revenues from VAT, excises and custom duties rose by 5.5, 8.2 and 10.2% yoy respectively. Direct tax receipts grew 8.6% compared to Jan-Dec 2010, while social and health insurance

contributions stepped up by 10.7%¹. Non-tax receipts amounted to BGN 3 325 mln, thus being 0.1% higher than their 2010 level, while those from grants went down by 8.8%.

Total expenditure, including Bulgarian contribution to the EU budget, amounted to BGN 26 960.2 mln, up 0.9% compared to 2010. It came to 35.4% of the 2011 GDP forecast and 95.7% of the annual plan. All expenditure subgroups contributed to the slight annual increase, except for capital costs, which had a negative contribution.

Fiscal reserve stood at BGN 5 bn in 2011, above the BGN 4.5 bn target embedded in the State Budget Law.

General government debt, including government guaranteed debt, accounted for 16.8% of GDP at end-December, up 0.1 pps yoy. Domestic debt came to 6.3% of GDP, while external and government guaranteed debt amounted to 9 and 1.6% of GDP respectively.

¹ Social security contribution has been increased by 1.8 pps since the beginning of 2011.

KEY ECONOMIC INDICATORS

		2008	2009	2010	2011	Q4	Q1	Q2	Q3	Q4	VII	VIII	IX	X	XI	XII
						2010	2011		2011							
GDP*																
Gross Domestic Product*	%, yoy	6.1	-5.5	0.2		3.7	3.3	2.0	1.6							
Consumption	%, yoy	2.5	-7.3	-1.1		0.5	1.2	1.4	1.6							
Gross fixed capital formation	%, yoy	16.3	-24.9	-14.0		-0.9	1.6	8.4	-2.8							
Export	%, yoy	3.0	-11.2	16.2		15.2	21.6	12.2	2.0							
Import	%, yoy	4.2	-21.0	4.5		10.7	10.0	7.5	8.1							
Agriculture	%, yoy	29.6	-6.1	3.9		-1.5	-1.4	-2.5	-2.3							
Industry	%, yoy	4.4	-7.8	1.9		10.5	5.4	5.9	2.2							
Services	%, yoy	5.0	-0.8	-0.9		0.6	0.1	0.1	3.2							
Adjustments	%, yoy	5.7	-16.5	-0.2		5.2	7.9	5.3	2.6							
Short term business statistics																
Industrial production	%, yoy	0.7	-18.3	2.0		5.2	10.6	6.3	3.1		5.1	2.6	1.5	2.5	0.6	
Industrial turnover	%, yoy	13.7	-20.2	14.1		21.1	32.6	19.1	13.5		15.0	14.1	11.7	10.8	9.9	
Retail trade turnover	%, yoy	8.9	-8.9	-5.6		-4.3	0.4	0.4	-2.9		-3.0	-2.7	-3.0	-5.2	-5.3	
Construction output	%, yoy	12.7	-14.5	-18.0		-8.5	-14.8	-14.4	-11.0		-14.2	-8.1	-10.8	-10.2	-10.7	
Total business climate	balance	38.0	10.2	9.6		11.5	13.8	14.1	15.2		14.5	15.6	15.5	14.8	12.7	13.0
Industrial confidence	balance	39.9	12.3	13.4		15.0	21.6	22.8	24.1		22.7	24.7	24.9	23.1	18.9	21.0
Retail trade confidence	balance	41.3	13.5	10.1		13.0	13.0	10.7	20.2		13.1	23.9	23.6	23.9	26.4	26.2
Construction confidence	balance	40.3	8.5	5.1		2.9	4.7	4.4	3.9		8.2	2.5	1.1	1.4	-1.1	-6.1
Services confidence	balance	28.7	5.1	5.6		11.8	8.1	10.1	3.8		5.7	2.5	3.1	2.4	0.1	2.9
Labour market																
Participation rate (15+)	level	53.8	53.0	52.0		52.1	50.8	51.0	51.9							
Employment rate (15+)	level	50.8	49.4	46.7		46.3	44.7	45.3	46.6							
Employment (LFS)	%, yoy	3.3	-3.2	-6.2		-4.7	-4.0	-4.5	-2.8							
Unemployment rate (LFS)	level	5.6	6.8	10.2		11.2	12.0	11.2	10.2							
Unemployment rate (Employment agency)	level	6.3	7.6	9.5		9.1	10.9	10.1	9.5		9.6	9.6	9.4	9.6	10.0	10.4
Nominal wage	%, yoy	26.5	11.8	6.3		10.4	8.5	9.3	8.6		8.4	8.5	8.5			
Real wage**	%, yoy	13.0	9.1	3.2		6.1	3.8	5.7	5.3		4.9	5.2	5.4			
Labour productivity (GDP per employed)	%, yoy	3.5	-2.9	6.4		7.8	5.2	6.0	5.7							

KEY ECONOMIC INDICATORS

		2008	2009	2010	2011	Q4	Q1	Q2	Q3	Q4	VII	VIII	IX	X	XI	XII
						2010	2011				2011					
Real ULC	%, yoy	3.7	8.1	-2.2		-6.7	-7.0	-3.4	1.3							
Prices																
Harmonized index of consumer prices	%, yoy	11.9	2.5	3.0	3.4	4.0	4.5	3.4	3.1	2.5	3.4	3.1	2.9	3.0	2.6	2.0
Domestic producer prices	%, yoy	13.3	-4.3	7.2	8.6	11.1	11.9	10.3	7.2	5.5	8.4	6.6	6.6	6.5	5.9	4.1
Consolidated fiscal program (cummulative)																
Revenue and grants	mln BGN	27313	25041	23933		23933	5530	12042	18354		14119	16242	18354	20519	22639	25378
Total expenses	mln BGN	25323	25667	26755		26755	6272	12692	19180		14839	16973	19180	21361	23688	26960
Contribution to EU budget	mln BGN	720	746	670		670	250	367	528		422	466	528	588	676	779
Cash deficit(-) / surplus(+)	mln BGN	1990	-626	-2823		-2823	-742	-651	-826		-721	-731	-826	-842	-1049	-1582
	% GDP	2.9	-0.9	-4.0		-4.0	-1.0	-0.9	-1.1		-0.9	-1.0	-1.1	-1.1	-1.4	-2.1
Government and government guaranteed debt	mln BGN	10710	10641	11778		11778	11447	11573	11944		11708	11764	11946	11946	12166	12826
	% GDP	15.5	15.6	16.7		16.7	15.1	15.3	15.7		15.4	15.4	15.7	15.7	16.0	16.8
Fiscal reserve	mln BGN	8382	7673	6012		6012	4699	5154	5071		4881	4993	5071	5342	5318	4999
	%, yoy	12.5	-8.5	-21.6		-21.6	-26.1	-14.5	-24.4		-22.8	-19.0	-24.4	-16.5	-16.8	-16.9
Financial sector																
BNB International reserves	mln EUR	12713	12919	12977	13349	12977	12209	12340	13051	13349	12500	13079	13051	13176	13198	13349
Monetary base coverage	%	175.3	195.2	179.8	175.1	179.8	176.3	179.2	180.7	175.1	178.9	179.7	180.7	183.3	183.3	175.1
Coverage of import with FX reserves	months	5.4	8.0	7.3		7.3	6.5	6.4	6.5		6.4	6.6	6.5	6.4	6.4	
Coverage of short-term external debt	%	96.5	100.2	112.8		112.8	112.4	113.6	121.5		115.7	122.8	123.1	125.6	129.3	
Money M1 (Narrow money)	%, yoy	-4.1	-8.8	0.8	14.4	0.8	4.9	3.7	5.5	14.4	5.2	6.8	5.5	6.3	4.4	14.4
Money M3 (Broad money)	%, yoy	8.8	4.2	6.2	12.2	6.2	7.4	8.0	10.3	12.2	9.4	9.4	10.3	9.6	7.8	12.2
Deposits	%, yoy	8.8	7.6	6.6	13.2	6.6	8.2	8.8	11.3	13.2	10.3	10.4	11.3	10.5	8.2	13.2
Credit to private sector	%, yoy	32.9	3.8	1.1	3.3	1.1	1.6	2.1	2.2	3.3	2.5	3.3	2.2	2.3	2.3	3.3
Credit to non-financial enterprises	%, yoy	33.1	2.3	2.4	5.7	2.4	3.0	4.1	4.1	5.7	4.8	6.1	4.1	4.1	4.2	5.7
Credit to households	%, yoy	31.4	5.8	-0.8	-0.4	-0.8	-0.7	-0.6	-0.2	-0.4	-0.5	-0.4	-0.2	-0.1	-0.2	-0.4
Interest rate on short-term loans	%	10.9	10.5	8.5	7.2	8.0	6.4	7.3	7.3	7.7	7.6	7.9	7.3	7.0	7.4	8.6
Interest rate on time deposits	%	5.6	7.0	5.4	4.8	5.1	5.1	4.9	4.7	4.8	5.0	4.8	4.7	4.8	4.8	4.7
Exchange rate BGN/USD	eop	1.39	1.36	1.47	1.51	1.47	1.38	1.35	1.45	1.51	1.37	1.35	1.45	1.40	1.46	1.51
	per. av.	1.34	1.41	1.48	1.41	1.44	1.43	1.36	1.38	1.45	1.37	1.36	1.42	1.43	1.44	1.48

KEY ECONOMIC INDICATORS

		2008	2009	2010	2011	Q4	Q1	Q2	Q3	Q4	VII	VIII	IX	X	XI	XII
						2010	2011				2011					
Gross External Debt (GED)																
Gross external debt	% GDP	104.9	108.0	101.8		101.8	93.2	93.8	93.1		93.7	93.2	93.1	91.9	91.3	
Short term external debt	% GED	35.4	32.7	31.4		31.4	30.0	29.7	29.2		29.6	29.3	29.2	29.3	28.7	
Intercompany lending	% GED	36.4	38.5	40.2		40.2	40.0	40.2	40.8		40.5	40.7	40.8	41.1	41.4	
Balance of payments																
Current account	mIn EUR	-8182	-3116	-476		-871	147	80	1170		610	460	101	-119	-127	
Current account, % GDP moving average		-23.1	-8.9	-1.3		-1.3	0.7	1.8	1.4		1.9	1.8	1.4	1.4	2.2	
Trade balance	mIn EUR	-8598	-4174	-2764		-1040	-11	-636	-237		38	-89	-186	-275	-283	
Trade balance, % GDP moving average		-24.3	-11.9	-7.7		-7.7	-5.8	-5.0	-5.0		-4.6	-4.8	-4.9	-5.1	-4.7	
Export, f.o.b.	mIn EUR	15204	11699	15561		4313	4777	4863	5314		1845	1757	1713	1806	1735	
	%, yoy	12.5	-23.1	33.0		32.8	57.5	28.0	20.3		20.7	20.9	19.4	23.6	19.1	
Import, f.o.b.	mIn EUR	23802	15873	18325		-5352	-4788	-5499	-5551		-1807	-1846	-1898	-2081	-2017	
	%, yoy	-214.7	-33.3	15.4		28.9	30.2	17.6	20.2		13.3	25.8	22.1	24.4	5.7	
Capital account	mIn EUR	277	477	291		140	16	47	126		42	32	52	0	52	
Financial account	mIn EUR	11463	1163	-174		358	-743	-202	-697		-180	-162	-106	-53	-74	
Net Foreign Direct Investments	mIn EUR	6206	2505	1585		693	-120	192	363		90	93	180	127	47	
Net Portfolio Investments	mIn EUR	-731	-619	-661		-150	-189	-16	-234		-12	52	-274	160	-2	
Other Investments - net	mIn EUR	6032	-704	-1074		-185	-424	-372	-798		-686	-162	50	-80	-48	
Change in BNB reserve assets	mIn EUR	-674	650	384		-65	665	-92	-470		-38	-411	-21	-111	65	

* Reference year 2005, seasonally and working day adjusted data.

**HICP deflated.

RECENT DEVELOPMENTS AND GOVERNMENT DEBT REVIEW

MF issued a new 10y&6m GS markets

On January 9, the Ministry of Finance (MF) held its first GS sale auction in 2012 - issuing bonds with original maturity of 10.5 years. It is a priority bond, as in 2012 it will be used by the ECB as a basis for calculating the harmonized long term interest rate to assess the extent of convergence - among Maastricht criteria.

Bulgarian long term sovereign yield has remained stable amid high volatility on European debt markets

Bulgarian long term GS yield remained stable in an environment of escalating debt markets insecurity in Europe and on the background of increasing financing prices for a number of EU Member States. The average weighted yield achieved at the auction was 5.35%, which is a decrease compared to the first auction in 2011 for bonds with the same maturity - 5.49%. GS offered for sale amounted to BGN 50 mln, while the submitted bids from primary dealers reached BGN 136.3 mln, thus the coverage being 2.73. There was an increased interest in the long-term maturity segment by a broad range of investors, including banks and other institutional investors. Pension Funds acquired the greatest share of GS at the auction (49%), followed by banks (35%), insurance companies (10%), and other inventors (6%).

This auction confirmed Bulgaria's status of a budgetary disciplined country and a low risk issuer of sovereign debt. The sustainable positive trend in government debt management allows an optimum price financing which leads to lower government debt service costs. In the long run these trends are also a precondition for maintaining the low tax burden in the country.

MF issued a new long-term benchmark bond denominated in Euro

On January 16, MF issued a new 7-year EUR-denominated government bond. The nominal value of the proposed and approved volume of the auction was EUR 35 mln. The issue is planned to be tapped throughout 2012 which will increase its liquidity on the secondary market. This bond is a new benchmark instrument in the long-term segment of the debt curve and diversifies the maturities proposed in EUR in the 2012 issuing calendar. This new instrument will further encourage market participants' interest in investing in Bulgarian government debt after MF successfully launched a new issue of 10.5-year GS on the market.

Auction demand exceeded supply by almost three and a half times, with primary dealers' offers being almost EUR 120 mln. The bid-to-cover ratio of 3.42 is one of the highest since March 2011, showing a high investor interest. In addition to the traditional active presence of banks, which acquired around 36% of the nominal value approved, pension funds and insurance companies also took active participation, acquiring 48% and 13% respectively of the securities offered.

RECENT DEVELOPMENTS AND GOVERNMENT DEBT REVIEW

The average weighted annual auction yield of 4.45% is indicative of the investors trust in Bulgarian sovereign debt and of their individual approach when evaluating the risk premium of our government debt. This is taking place at the background of the downgraded ratings of a number of EU Member States.

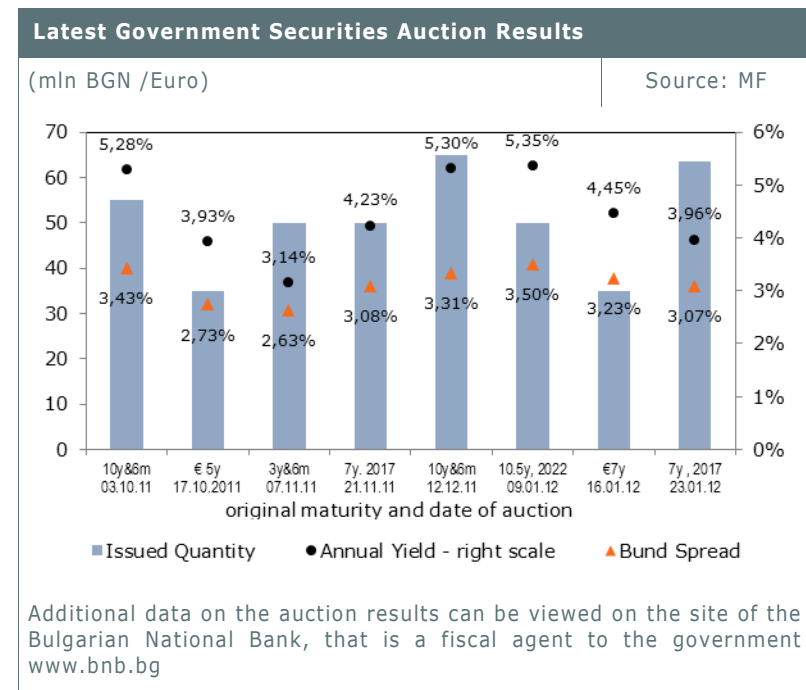
The spread to German federal bonds decreased to 323 bps, being 350 bps at the previous auction. The registered yield was to a great extent below yields of similar bonds of the states currently experiencing financial difficulties like Hungary (10.04%), as well as compared to states reporting high economic growth like Turkey (5.74%) and Poland (5.05%) and euro area members not being financially supported like Slovenia (6.33%) and Slovakia (4.89%).

High oversubscription of the auction, which was almost 3.5 times, is indicative of the successful outcome of government issuance policy on the domestic market. Bulgaria strengthened its status as one of the most stable issuers of debt in the region as the long-term interest rate reached its lowest value since November 2008 in such extremely precarious international economic and financial environment.

Record low yield in the medium-term government debt segment

On January 23, MF reopened the 7-year GS issue from 2010 with residual maturity of 5 years as of the reopening date. The total volume of submitted bids reached almost BGN 147 mln with an offered amount of BGN 50 mln. The bid-to-cover ratio of 2.94 is the highest one registered for this bond since October 2010. In

response to the extremely high interest of institutional investors in the auction, Ministry of Finance decided to approve all uncompetitive bids amounting to BGN 38.52 mln. As a result, the total amount of GS approved at the auction reached BGN 63.52 mln. Investor base allocation of the approved amount was as follows: banks - 33%, insurance companies - 31%, pension funds - 14%, etc.



After this auction, the volume of the issue in circulation reached BGN 363.8 mln, which consolidated its benchmark bond status and further encouraged its liquidity on the secondary market.

RECENT DEVELOPMENTS AND GOVERNMENT DEBT REVIEW

Thus, a new yield drop in the medium-term government debt segment has been registered after the successful offering of the two new long-term benchmark bonds of the Bulgarian government with maturity of 10.5 and 7 years respectively.

After the reported decreases in yield at the GS sale auctions of euro area countries, the average weighted annual yield of 3.96% registered on the auction is the lowest one so far for this issue. For comparative reasons, it was 4.23% in November 2011, while the reported average weighted annual yield of 5-year euro-denominated GS issued in 2011 was 4.03%. The registered yield at the auction is also below the current yield for Eurobonds with similar residual maturity of euro area countries with sustainable public finance like Slovakia (4.64%) and Slovenia (5.90%), and almost the same as the yield on newly issued 5-year Eurobonds of Poland (3.92%) and significantly below the level for the rapidly developing Turkish economy (5.35%).

Considering the positive development of the domestic debt market, MF will continue to provide the necessary financing of the budget at the optimum price for the issuer. Reducing the cost of state funding allows for the optimization of the debt servicing cost, which is a condition for maintaining a low tax burden in Bulgaria in the long term.

Stable nominal extent of government debt

At end-December government debt totaled EUR 5 945.9 mln in nominal terms, including EUR 2 458.3 mln domestic debt and EUR 3 487.6 mln external debt. Government debt posted an increase by EUR 331.8 mln in nominal terms over the end of the previous month, mainly due to the increase in internal debt. Government debt/GDP ratio stood at 15.3%.

Structure	Government Debt Amount (mln EUR)						
	31.12.2010	31.3.2011	30.6.2011	30.9.2011	31.10.2011	30.11.2011	31.12.2011
Domestic government debt	2011.5	1941.5	2059.8	2156.4	2217.2	2269.5	2458.3
External government debt	3373.5	3319.5	3272.1	3343.7	3299.6	3344.5	3487.6
Government Debt, total	5385.0	5261.0	5331.9	5500.1	5516.8	5614.1	5945.9
Government Debt /GDP (%)	14.9	13.5	13.7	14.1	14.2	14.4	15.3

RECENT DEVELOPMENTS AND GOVERNMENT DEBT REVIEW

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

The currency structure of the government debt by end-December registered a positive change, as BGN-denominated debt posted an increase over the previous month to 28.6%. A decrease was reported in debt in EUR, in USD and in other currencies, standing at 53.3%, 15.6% and 2.5% respectively.

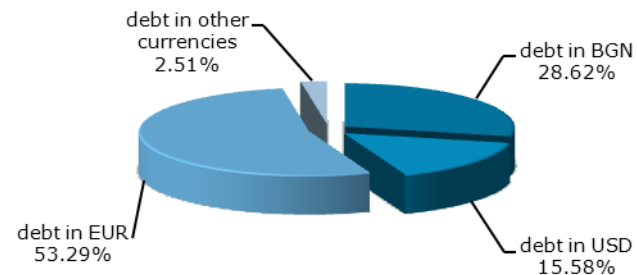
Government debt interest rate structure provides predictability of the resources required for its servicing

By end-December debt interest rate structure also underwent some changes: the share of debt with fixed interest rates reached 82.4%, as a result of the new internal financing during the month mainly with fixed interest rates debt. Debt with floating interest rates stood at 17.6%.

Government Debt Currency Structure

(as of 31 December)

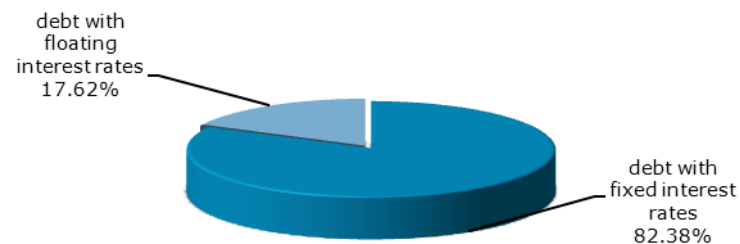
Source: MF



Government Debt Interest Rate Structure

(as of 31 December)

Source: MF



RECENT DEVELOPMENTS AND GOVERNMENT DEBT REVIEW

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

Debt structure by types of instruments and creditors in December showed no significant change. Liabilities related to domestic government debt had the largest relative share - 41.3%, followed by global bonds - 27.9%, government investment loans - 14.9%, commitments to the World Bank - 12%, obligations to Paris Club - 1.5%, the European Union - 2.3% and the enabled state guarantees - 0.1%.

Comprehensive information on Bulgarian Government Debt, including monthly bulletins and annual reviews, could be found at 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 Financial Markets Directorate, Ministry of Finance: email: M.Boikova@minfin.bg, tel. +359 2 9859 2450.

Government Debt Structure by Creditor

(as of 31 December)

Source: MF

