

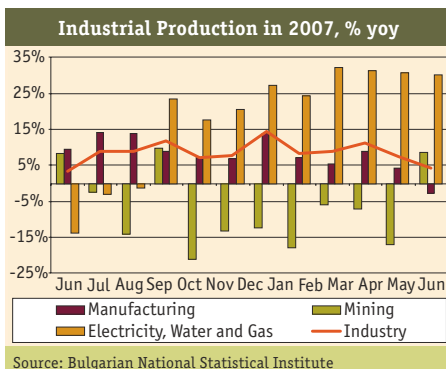
Macroeconomic Situation

Summary

- In 2007, Bulgaria's economic performance was one of the best in the region, posting a rate of growth of around 5.8% year-over-year (yoy), which was supported by the rapid expansion in domestic consumption.
- Positive economic development was supported by prudent fiscal policy, which helped to maintain a solid fiscal budget surplus at 3.8% of full year GDP.
- Thoughtful debt management helped decrease the amount of public and publicly guaranteed debt to €5.13 billion, which represents 16.3% of projected full year GDP, compared with around 18.5% at the end of 2006.
- High growth of the consumer price index (CPI) at around 10% is significantly higher than initial government forecasts, driven by the increase in prices for food products and energy resources. High inflationary pressure was backed by growth in consumption supported by significant growth in credit, which surged during 2007 by almost 59%.
- The current account (CA) deficit still remains the main risk factor for the Bulgarian economy, reaching 21.6% of the country's annual GDP. Although the amount of FDI inflows was on upward trend throughout the year, it was sufficient to cover only 89% of the existing CA gap.
- The Bulgarian Investment Agency forecasts a 5% increase in the level of FDI inflows for 2008 to around € 6 billion.

Economic Growth

In 2007, the Bulgarian economy demonstrated solid economic growth. According to official statistics, GDP grew by 6.2% yoy in Q1, 6.6% yoy in Q2, and 4.5% yoy in Q3. Since the preliminary data for Q4 is also optimistic, there is a high chance that the final annual rate of growth for 2007 is going to be around 5.8% yoy. The actual rate of economic growth is slightly lower than the initially forecasted level of 6.4% yoy but still very solid and one of the highest in the EU. The main driver of growth in 2007 was rapidly expanding domestic consumption, which posted an annual increase of around 17% yoy.



On the supply side, growth in the real sector in 2007 was supported by the very strong performance of

both industrial and service sectors. During the first three quarters of the year, these two sectors gained 10.5% yoy and 9.7% yoy respectively and it is very likely that the year end performance will not be lower than 10% yoy. In 2007, industry advanced on the back of booming sales in the mining sector, which expanded by an impressive 36.2% yoy. In addition, manufacturing continued on a robust uptrend, posting 5% yoy growth in November. Above all, gains in manufacturing were largely supported by booming domestic consumption. In January-November 2007, the chemical industry and machine building emerged as leaders of Bulgarian manufacturing in terms of growth rates.

The utilities sector continued to exact a toll on the overall expansion of industry as output in this sector dropped for the third consecutive month. During November 2007, production of utilities declined by 15.4% yoy. Relatively mild weather conditions and the widespread introduction of energy saving technologies were the main forces behind weaker domestic demand for energy resources, which pushed down the supply of utilities.

On top of that, the performance of Bulgaria's real sector was visibly affected by a sharp contraction of agriculture. In January-November, agricultural output shrank by 26.4% yoy due to surprisingly unfavorable weather conditions, which brought about significant crop damages and yield losses. The deepest decline was registered for yields of sunflowers, tomatoes and raw tobacco, which plunged by 54.5% yoy, 44.9% yoy and 10.6% yoy respectively. As a result, Bulgaria turned into a net importer of agricultural products.

Fiscal Policy

In 2007, the Bulgarian Ministry of Finance demonstrated prudent fiscal policy by holding a solid fiscal budget surplus, which reached around 3.8% of GDP. The most significant decrease in the size of the fiscal surplus was observed in December of last year, when Bulgaria made a payment of around half of the initially accumulated surplus to EU funds. The main driving force for the significant budget surplus in 2007 was a rebound in the growth rate of revenues, which substantially exceeded the growth of budget expenditures.

In 2007, budget revenues surged at a rate of 20.2% yoy, while expenditures grew at a lower rate of 16.9% yoy. The main sources of growth on the revenue side are the strongly developing economy, which grew in 2007 by almost 6% yoy, and improved tax administration and tax collection.

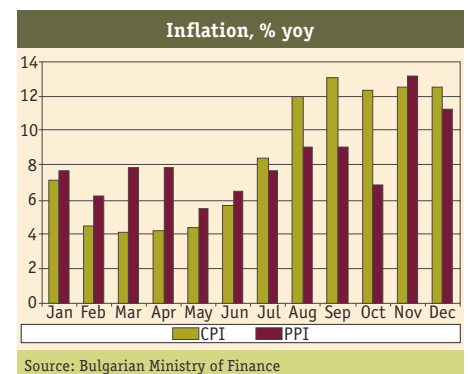
Throughout the year, Bulgaria demonstrated effective debt management. The Ministry of Finance declared that the same strategy would continue in 2008 as well. In January, the total amount of public and publicly guaranteed debt was decreased by 17.2% yoy and reached €5.13 billion. The current

stock of debt translates into 16.3% of projected full year GDP, compared to around 18.5% at the end of 2006. Besides significant repayments made in 2007, the decrease in the debt stock is also due to the efficient currency restructuring of debt.

In contrast to the tendency observed with public and publicly guaranteed debt, the total stock of foreign debt was on an upward trend reaching €27 billion at the end of 2007. This number can be translated into 80.5% of full year GDP. The main driving force for such an increase was investment demand factors. On the negative side, the share of short-term borrowings in the total amount of foreign debt was constantly increasing. It started from 29.3% at the end of 2006 and reached 33.6% at the end of 2007. Such a significant share of short-term loans makes the Bulgarian economy more vulnerable to possible external shocks and the existing turbulence on the global financial market.

Monetary Sector

In the last quarter of 2007, the consumer price index (CPI) continued to accelerate. The CPI surged by 1.1% month-over-month (mom) in the last month of the year, driven by increasing food and energy prices. Prices of foods and transportation tariffs posted the highest gains within the consumer basket, surging by 21.1% yoy and 15% yoy respectively. Still, in December, inflation in Bulgaria marginally decelerated to 12.5% yoy down from 12.6% yoy a month before, as inflationary pressures slightly eased in the last month of the year. Foods, which account for over one third of the consumer-price basket, became more expensive by 1.6% mom compared to a 2.4% mom increase in the previous month. The rate of growth in transportation tariffs, including gasoline prices, which account for around 15% of the consumer basket, decelerated to 1.3% mom down from 3.7% mom posted in the previous month.

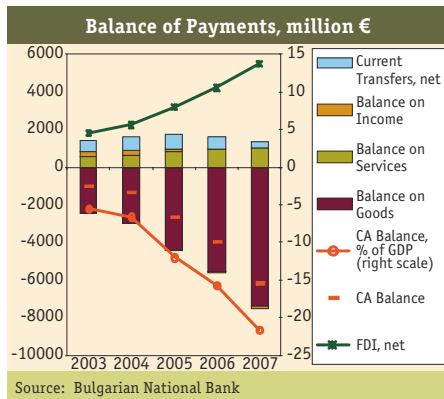


Contrary to the CPI, growth of the Producer Price Index (PPI) decelerated in December to 11.3% yoy from 13.2% yoy in the previous month. Within the PPI, mining, manufacturing and utility sectors showed the most significant deceleration by 2.6% yoy, 13.1% yoy and 9.4% yoy respectively versus 4.5% yoy, 15.3% yoy and 10.3% posted in the previous month.

In 2007, Bulgaria demonstrated a significant increase in credit, which grew by 58.8% yoy. Although the Bulgarian National Bank (BNB) undertook efforts to curb the growth in credit, during the period, credit to the non-government sector continued to demonstrate significant growth and surged by 62.5% yoy. Fast growth in credit is under control of the National Bank. However, in order to provide tight monetary policy and downsize inflation, more restrictive measures are required.

International Trade and Capital

In 2007, the Bulgarian trade deficit in goods and services continued to post further deterioration reaching €7.3 billion, which translates into a 34.2% yoy rate of growth. At the end of the year, the foreign trade gap reached 26.2% of annual GDP compared with 21.8% at the end of 2006.



During the year, imports grew at a significantly faster pace than exports, surging by 19% yoy versus 12.1% yoy growth in exports. The rapid increase in imports was mainly due to a significant increase in energy prices and increasing domestic consumption, including growth in household incomes and credit growth.

A high CA deficit remains the most significant risk factor for the Bulgarian economy. The main source of widening in the CA gap is significant growth in the trade deficit. In 2007, its size reached €6.2 billion, which can be translated into a rate of growth of around 57% yoy. The existing CA deficit accounted for 21.6% of the country's annual GDP. In order to ensure a stable financial situation, the existing CA gap should be one of the main areas of concern for Bulgarian authorities.

On the negative side, the total amount of FDI inflows in 2007 was not sufficient to cover the existing CA gap. Although the received annual amount of FDI is significantly higher than in the previous year (i.e., the annual rate of growth exceeded 30.3% yoy) it is not enough to cover the existing gap. In 2007, €5.5 billion of FDI was able to cover only 88.9% of the gap compared with the previous year when FDI coverage of the CA gap was around 107%.

Despite insufficient coverage of the CA deficit through FDI inflow, there was significant accumulation in the financial and capital account surplus, which helped to keep the overall balance in surplus of €3.2 billion. Although lately the CA gap is partially covered through short term borrowings, which imposes some risks on financial stability, prudent fiscal policy with a significant budget surplus helps contain the rapid expansion of the CA gap and ensure financial stability in the country.

Other Developments and Reforms Affecting the Investment Climate

The Bulgarian Investment Agency forecasts the level of FDI inflows in 2008 at €6 billion, which is more than 5% higher than the previous year. The Agency also expects that around half of the funds will be allocated to real estate projects. The second

largest field of FDI allocation is going to be the construction sector, which absorbed around one third of FDI inflows last year. It is also expected that around 10% will be allocated to manufacturing.

A report released by Moody's stated that Bulgaria's economic performance in 2008 should remain robust and that prudent fiscal policy would be appropriate for offsetting external risks despite monetary constraints imposed by the currency board. The sovereign government bond rating was updated to Baa3 with a positive outlook, which is mainly due to positive developments in reduction of the public debt in 2007. Moody's pointed to the high CA deficit and quick debt accumulation in the private sector as the main risk factors affecting the Bulgarian economy in 2008. They also indicated that the global financial turmoil might have an indirect impact on Bulgaria through reduced financial inflows. Moody's believes that Bulgaria may enter the EU's exchange rate mechanism ERM II this year. However, due to high inflation, it is unlikely that the country can join the EMU within the next several years.

Fitch affirmed ratings at BBB and BBB+ for long-term foreign and local currency instruments, respectively. Fitch confirmed that the main sources of risk for the Bulgarian economy in 2008 remains the CA gap and slowdown in EU growth, which can weaken the country's exports.