

Macroeconomic Situation

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Summary

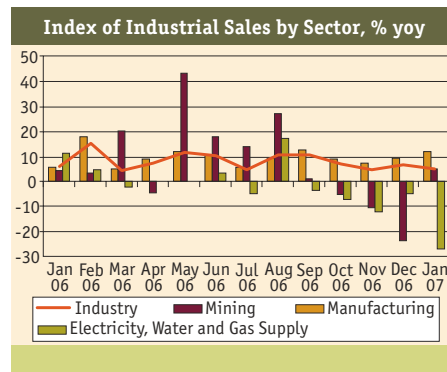
- In 2006, Bulgaria's economic growth reached 6.1% year-over-year (yoy) driven by strong consumption and investment. Positive developments continued in January, when industrial sales grew by 5.4% yoy.
- In January-February, the consolidated budget deficit reached EUR 54 million.
- As of the end of February, the Bulgarian fiscal reserve fell to EUR 2.6 billion due to public debt repayments but remains EUR 0.76 billion above the 2007 reserve threshold target of EUR 1.84 billion.
- The consumer price inflation (CPI) decelerated to 4.5% yoy in February down from 7.1% yoy in January. Since the beginning of the year, CPI grew by 1.9%, a notable deceleration as compared to the 3.8% increase over January-February last year.
- The current account (CA) deficit remains a significant risk factor, reaching EUR 0.9 billion at the end of February.
- In February, the unemployment rate decreased by 0.2% month-over-month (mom) to 9.48%.
- Moody's improved the country's outlook to positive.

Economic Growth

According to preliminary data from the National Statistical Institute (NSI), GDP grew by 6.1% in 2006 driven by strong consumption and investment activities. GDP growth in 2007 is forecasted at 5.8% yoy and is expected to accelerate to 6.45% yoy in 2009. In the Bulgarian National Convergence Programme, recently approved by the Finance Ministers of the EU, the country's potential GDP growth is estimated in compliance with the EU recommended approach. The high growth rates of investment in the economy and total factor productivity (TFP) are two major drivers of economic growth.

In January, industry demonstrated only marginal growth of 1.3% yoy primarily due to the closure of two nuclear power blocks, while industrial sales grew by 5.4% yoy according to preliminary data of the NSI. The production of electricity and utilities plunged by 21.7% yoy. Manufacturing demonstrated strong growth of 9.3% yoy and manufacturers' sales increased 12.1% yoy. The best performing industries were non-metallic mineral products, medical and optical instruments, furniture, and basic metals with annual production growth rates of 70%, 45%, 36%, and 24% respectively. Other industries also showed double digit growth in production: rubber and plastic products — 19% yoy, food and beverages — 16% yoy, apparel — 20% yoy and electrical machinery — 14% yoy. The output of publishing, printing and reproduction of recorded media decreased 12% yoy, but manufacturers' sales in the industry remained flat. Production and sales of radio, television and communication equipment dropped 65% and 60% respectively. The mining industry recovered to 9% yoy in production and 5% yoy growth in sales. January manufacturing sales grew

faster in most sectors except for paper, wood, chemical and tobacco products.



Retail trade expanded by 11.8% yoy in January, driven by strong demand for household appliances, clothing and other non-food products and services. January's retail trade decelerated 3.5 percentage points (pps) as compared to December's 2006 growth. Wholesale trade increased 2.9% yoy during the same period.

The prospects for GDP and industry growth are positive. An NSI survey of the business climate showed that the economic situation remained favorable in March. The total business climate indicator maintained its long-term maximum of 50.7% since 1994. The service sector index was 1.2 pps higher than in February, the retail sector index decreased 1 pps, while industry remained unchanged.

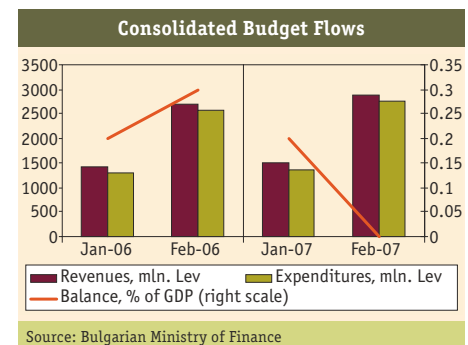
Fiscal Policy

The fiscal objective for 2007 is to achieve a consolidated budget surplus at 2% of GDP. This objective is aimed at curbing growth of domestic demand and to restrict the current account deficit. Although the legislative minimum fiscal reserve is set at EUR 1.3 billion, this year's budget established a fiscal reserve threshold of EUR 1.84 billion (Lev 3.6 billion). In February 2007, the fiscal reserve fell to EUR 2.6 billion (Lev 5.1 billion) from EUR 3.02 billion (Lev 5.9 billion) in January due to debt repayments.

Although the consolidated budget posted a deficit of Lev 160.8 million in February (EUR 82 million) on a cash basis as compared with a Lev 53.8 million (EUR 27.5 million) surplus in January, the deficit was less than expected. After joining the EU, Bulgaria started collecting import VAT tax at the point of sale, decreased customs duties by 55%, reduced the corporate income tax from 15% to 10% and made contributions of Lev 37.3 million (EUR 19.1 million) and Lev 109.3 million (EUR 55.9 million) in January and February respectively to the EU budget. The relatively low weight of customs duties and delays in VAT payments proved to have a milder effect on fiscal receipts. Stronger performance of income-related taxes and insurance contributions helped to offset the expected decrease in revenue from customs duties.

In February, budget revenue growth accelerated to 6.76% yoy up from 5.76% yoy in January, which can be translated into 5.5% of the period's GDP growth. In January-February, revenue collections amounted to Lev 2.89 billion (EUR 1.5 billion), which is an increase of Lev 183 million (EUR 93.6 million) against the same period last year. Tax revenues grew 1.9% yoy, which is 0.8 pps higher than the growth rate in January. The February budget showed sharp increases in non-tax revenues (23% yoy) and grants (133.7% yoy).

In January-February, the government moderately increased consolidated expenditures to Lev 2.76 billion (EUR 1.41 billion) as compared to Lev 2.56 billion (EUR 1.31 billion) during the same period last year. The increase of Lev 202 million (EUR 103 million) represents 7.9% yoy nominal growth, which is 5.3 pps higher than in January. According to the national strategy, social sector and infrastructure development have priority in budget spending. The infrastructure development is to be financed through private-public partnerships' funds under the National Strategy for Integrated Development of the Infrastructure (2006–2015). In January-February, the government allocated Lev 165.8 million (EUR 84.8 million) in capital expenditures, up Lev 104 million (EUR 52 million) from January's level. On an annual basis, the February growth of capital expenditures was 20.3% (13.6% in January). Social expenditures amounted to Lev 1.14 billion (EUR 0.59 billion), up by 6.4% yoy. The share of social expenditures in the consolidated budget remained unchanged at 40%. The fastest growing components of social expenditures were wages and salaries (up 9.4% yoy) and social and health insurance contributions (up 8.24% yoy).



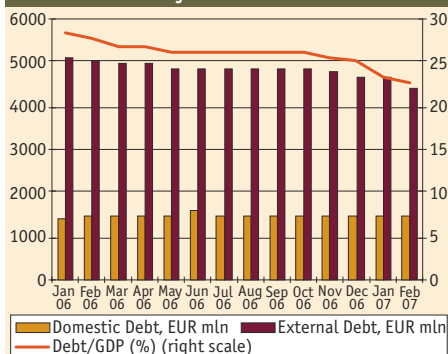
Source: Bulgarian Ministry of Finance

According to the Debt Management Strategy, the government continues strict debt level monitoring and reduction of public debt and service costs. The stock of public and publicly guaranteed debt dropped 5% mom to EUR 5.86 billion in February due to payments of EUR 320 million of external and Lev 111.8 million (EUR 57.2 million) of domestic debt. The debt to GDP ratio fell to 22.4%, down by 1.3 pps from January's level. Domestic and external debt to GDP stood at 5.6% and 16.8% respectively. The government accumulated fiscal reserve covers 44% of public and government guaranteed debt. External debt amounted to EUR 4.39 billion, including

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EUR 3.84 billion in government debt and EUR 0.55 billion in government guaranteed debt. Domestic and external debt shares in the public debt structure were 25.2% and 74.9%. Euro denominated debt changed slightly to 50.9% and debt in US dollars reached 21.9%, while Bulgarian Lev debt was 18.3% and 8.9% in other currencies. In the debt interest structure, fixed interest rate debt was 66.2% and debt with floating interest rates was 33.8%. In the structure of external debt, the share of Eurobonds was 30.7%, government securities 25.1%, obligations to the World Bank 13.4%, government investment loans and guaranteed debt 19.3%.

Dynamics of Domestic and External Public and Publicly Guaranteed Debt



Source: Bulgarian Ministry of Finance

Gross external debt decreased by EUR 376.8 million to EUR 19.3 billion (72.2% of GDP) as of the end of January. Long-term liabilities accounted for 70.9% of total external debt. Gross external debt service was EUR 684.2 million (2.6% of GDP). External borrowing is expected to increase after the national bank abolished credit restrictions on January 1, 2007.

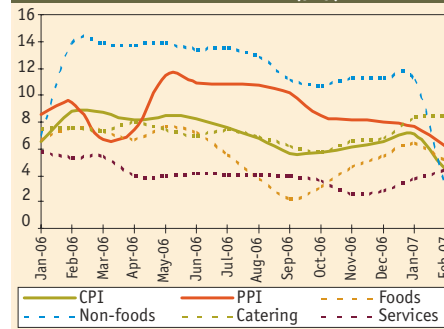
Monetary Sector

The NSI revised the consumer price index (CPI) to 7.1% yoy in January. Preliminary data shows a deceleration of consumer price inflation to 4.5% yoy in February. The CPI has grown by 1.9% since the beginning of the year, a notable deceleration as compared to a 3.8% increase over January-February last year. February inflation was mostly driven by the food and catering sector due to seasonal fluctuations in the supply of vegetables. Prices in the food and catering sectors grew 5.1% yoy and 8.4% yoy respectively. In February, prices in the services sector grew 4.4% yoy, which is 0.7 pps higher than the 3.7% yoy increase in January. The acceleration of the prices of services is expected as a result of their adjustment to EU average levels. Non-food prices dropped 0.1% mom and increased 3.2% yoy.

The harmonized index of consumer prices (HICP), calculated on the basis of consumer weights and standardized product groups of EU countries, increased 4.6% yoy in February, down from 6.8% yoy in January.

The National Bank inflation target for 2007 is set at 4.4%. The decrease in average customs tariffs, liberalized access of the 3rd countries' importers of agricultural products to the Bulgarian market and increased competition will continue to exert downward pressure on consumer prices.

Changes in CPI and its Major Components in 2006-2007, % (yoy)



Source: Bulgarian National Statistical Institute

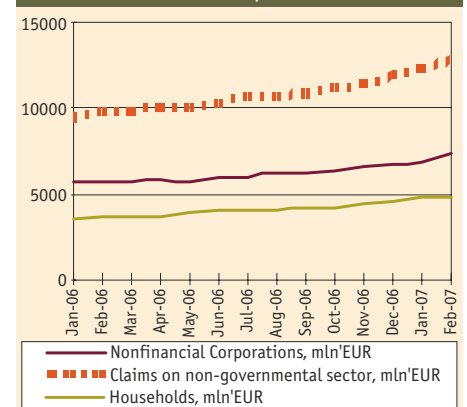
The growth of producers' prices on the domestic market continued to decelerate from 8% yoy in December 2006 to 7.7% yoy in January 2007 and a preliminary 6.2% yoy in February. The PPI rose 0.1% mom as compared to disinflation of 0.8% mom in January. Prices dropped 3% mom in the mining sector, increased 0.1% mom in manufacturing and 1.1% in utilities. In annual terms, producer price growth slowed down in the mining and manufacturing sectors to 14.9% yoy and 4.1% yoy respectively as compared to a 21.7% yoy and 5.7% yoy hike in January.

In February, the monetary base and money supply increased by 5.7% mom and 1% mom as opposed to the decline by 7.82% mom and 0.8% mom in January. Broad money (M3) reached Lev 32.1 billion (EUR 16.4 billion) and narrow money (M1) increased to Lev 16 billion (EUR 8.2 billion) at 32.7% yoy (34.8% yoy in January). The annual growth in money supply slightly slowed down to 27.8% yoy as compared to 29% yoy in January. As a result, the monetary multiplier in February was 3.14 versus 3.29 in the previous month. The ratio of broad money to GDP slightly increased to 61.4% in February. Deposits with a maturity of up to 2 years grew by Lev 214.3 million (EUR 109.6 million) in contrast to Lev 129.8 million (EUR 66.4 million) in January, becoming the second fastest growing component of the money supply. The growth rate of deposits with maturities of up to 2 years was 1.6% mom and 23.1% yoy (24.1% yoy in January). The deposits redeemable at notice of up to 3 months increased 2.7% mom and 23.9% yoy (21.3% yoy in January) while overnight deposits grew 0.7% mom and 45% yoy (50% yoy in January). February deposits in foreign currency constituted 46% of all deposits.

In March, the Bulgarian National Bank decreased the base interest rate to 3.52% p.a. as compared to 3.53% p.a. in February 2006.

In February, claims on the non-governmental sector grew Lev 1.1 billion (EUR 0.57 billion) and amounted to Lev 24.83 billion (EUR 12.69 billion), which is an increase of 31.1% yoy (27.3% yoy in January). The share of claims in foreign currency is 47%. The growth of loans to non-financial corporations accelerated to 29.6% yoy (27.3% yoy in January) and amounted to Lev 14.4 billion (EUR 7.4 billion) as a result of abolished credit restrictions by the Bulgarian National Bank. Loans to households posted growth of 32.4% yoy (31.8% yoy in January) and amounted to Lev 9.5 billion (EUR 4.8 billion).

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

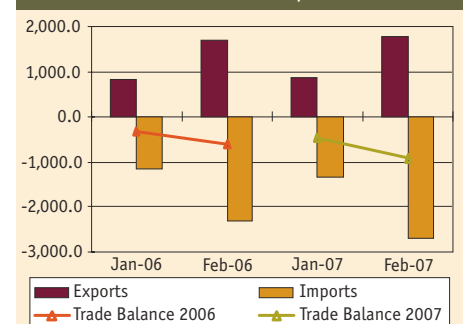


Source: Bulgarian National Bank

International Trade and Capital

In January-February, the trade in goods and services posted a deficit of EUR 1.03 billion, which is an increase of 39.5% yoy. In February, the monthly deficit decreased by EUR 23 million to EUR 0.5 billion. The balance of goods posted a 61.8% yoy deficit growth due to (i) strong increase in consumption, (ii) declined exports in the energy sector and (iii) liberalization of foreign trade.

Balance of Trade in Goods, EUR million



Source: Bulgarian National Bank, The Bleyzer Foundation

Bulgarian exports expanded 3.9% mom and 2.6% yoy in February. In nominal terms, Bulgaria exported EUR 0.89 billion worth of goods. In Janu-

Headquarters

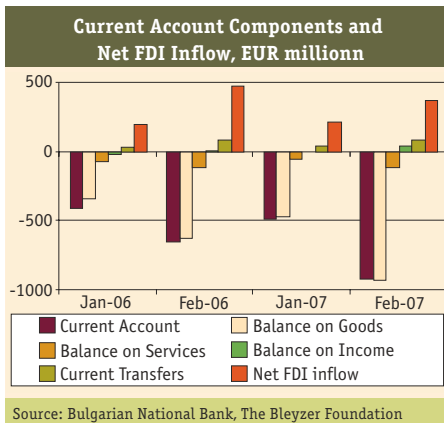
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ary-February, data shows growth of 4.1% yoy (EUR 1.77 billion). The EU is the single largest importer of Bulgarian merchandise goods and services with a 66.5% share in total exports. In February, Bulgarian imports reached EUR 1.43 billion (1.1% mom growth). Imports surged 24.3% yoy in February and 23.3% yoy in January — February (EUR 2.84 billion). Last year, the cumulative growth in imports was 25.2% yoy decelerating from January's 31.2% yoy to 14.8% yoy in December. This trend is likely to continue in 2007.



The current account deficit widened 29.2% yoy to EUR 0.92 billion as of the end of February. The CA deficit remains the most significant risk factor for the Bulgarian economy. The trade balance of goods and services was the only reason for the CA deficit widening since other components of the CA posted

surpluses. The surplus of the financial account (EUR 0.59 billion) covered 65% of the current account deficit. Net FDI inflow slowed to 22.7% yoy and amounted to EUR 0.37 billion. As a result, the National Bank reserve assets decreased EUR 0.37 billion in January and EUR 0.06 billion in February. 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.

International Programs

On March 23rd, Bulgaria signed the Development Policy (DPL-1) and Trade and Transport Facilitation (TTF 2) loan agreements with the World Bank. The DPL-1 loan of EUR 114 million will be used to support the balance of payments during the first months of Bulgaria's membership in the EU. The TTF-2 loan of EUR 54.6 million is an investment loan targeted at strengthening the regional trade and transport network.

Other Developments and Reforms Affecting the Investment Climate

The unemployment rate decreased to 9.48% at the end of February, down 0.2% mom compared with 10.5% in 2006. Unemployment is expected to drop further as a result of a seasonal demand increase in tourist, agricultural, and construction sectors.

On March 1st, the Bulgarian Council of Ministers adopted the National Reform Program 2007–2009. The programme is a strategic policy document in the framework of the Lisbon strategy for growth and jobs aimed at development of the Bulgarian infrastructure, enhancement of the administrative capacity, improvement of the business environment and the quality of human capital, and creation of jobs. According to the Program, Bulgaria is to achieve GDP growth at a rate of 6% per year and an employment level of 61% by 2009 and also narrow the income gap with other EU member countries.

On March 7th, the finance ministers of the EU approved the Convergence Programme of Bulgaria. The Convergence Program is part of the monitoring and control process over member states. The implementation of the Programme is aimed at achieving criteria for membership in the EU's Monetary Union. Bulgaria was given recommendations to continue pursuing the current fiscal policy and improve the efficiency of state expenditures in the health care and other sectors.

On February 23rd, Moody's raised the outlook on Bulgaria's Baa3 long-term foreign and local currency bond ratings from stable to positive. The outlook on the A1 foreign currency bond ceiling, Baa3 foreign currency deposit ceiling and Baa1 local currency deposit ceiling was raised to positive. The agency outlook is based on the country's strong economic growth, prudent fiscal policy, and expected imminent membership in ERM2.