

2012

RECENT ECONOMIC DEVELOPMENTS, BULGARIA

SELECTED ISSUES, MARCH 2012

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- ▶ Recent Developments and Government Debt Review



REPUBLIC OF BULGARIA
Ministry of Finance



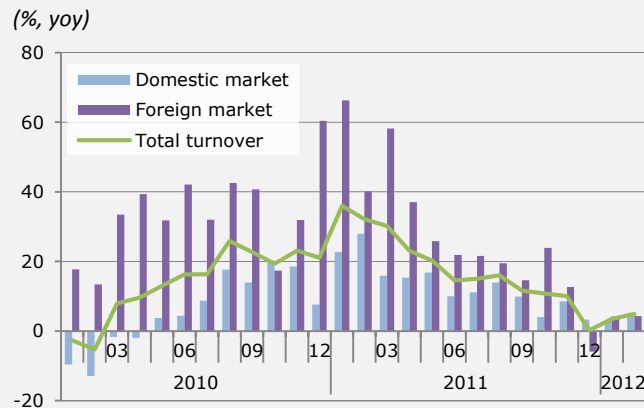
— MACROECONOMIC ENVIRONMENT AND POLICIES IN BRIEF

- According to first 2012 notification, approved by the Eurostat with no reservations, **General Government deficit** in 2011 amounted to BGN 1 576 mln or 2.1 % of GDP (ESA95). The fiscal consolidation continued in 2011, thus Bulgaria overshot the 2.5% deficit target on the back of the strict measures with regard to expenditure, improved control mechanisms and gradual revenue improvement. **Bulgaria ranked second among EU member states with the lowest ratios of government debt to GDP**, which stood at 16.3% at the end of 2011.
- Amid sustained concerns about European economies, Bulgarian **short-term business statistics** showed some positive signs. Industrial turnover increased in February, as both foreign and domestic market sales contributed for the registered growth; construction production index moved to positive territory for the first time since November 2010; business climate indicator also improved over the previous month, as optimistic prospects prevailed in all sectors.
- March **unemployment rate** remained unchanged over the previous month at 11.5%, being positively influenced by the gradual recovery in seasonal activities and the limited growth in the number of jobless people.
- Inflation increased marginally in March, up 0.1% over the previous month. The annual HICP continued slowing down to 1.7%, thus **Bulgaria placed 3rd among EU Member States with the lowest inflation rates**.
- **Trade balance** worsened compared to a year earlier, largely on account of the registered decrease of exports, down by 10.2% yoy. Meanwhile, imports remained practically unchanged. As a result, the trade deficit went up to EUR 176.4 mln, being only EUR 18.7 mln in January 2011.
- Repayment of liabilities to nonresidents, which accounted for the **gross external debt** dynamics in 2011, persisted in the current year as well. Thus external indebtedness edged down by 0.5% mom in January. Gross external debt amounted to EUR 35.2 bn (87.5% of GDP), down by 8.6 pps yoy and 4.4 pps mom.
- **International reserves** reached EUR 13.2 bn at the end of March, up 8% yoy. Monetary base coverage improved compared to a month earlier and stood at 176.3%. As of end-January international reserves covered 130.8% of the short-term external debt and 6.2 months of imports.
- At end-February, **consolidated budget deficit** stood at BGN 565 mln (0.7% of GDP) on a cash basis, down by 0.3 pps compared to a year earlier, as the annual growth in general government revenue remained higher than the increase in total expenditure.
- Amid continuing headwinds on EU debt markets, the positive outcome achieved on **Bulgarian government debt market** was supported by the fiscal policy pursued by the Government. The outcome of the four auctions held in March was in line with the steady stabilization of Bulgarian long-term debt dynamics and decreasing yield on the secondary market. ▼

— RECENT ECONOMIC DEVELOPMENTS

In February **industrial turnover** increased by 4.9% yoy, as both foreign and domestic turnover contributed for the registered growth. Foreign market sales rose by 4.3% over a year earlier with the main contribution coming from mining of metal ores, manufacture of food products and recycling of materials. For a second month in a row, extreme winter conditions in combination with an accident in one of the thermal power plants led to suspension of electricity exports for almost a week. At the same time, domestic turnover accelerated its growth to 5.2% yoy. Electricity, gas, steam and air conditioning supply had the major contribution for the registered growth.

Industrial turnover



Source: NSI

Industrial production slump widened to 4% yoy. Apart from lower external demand, some one-time factors, such as floods at the beginning of the month, also contributed for the slower in-

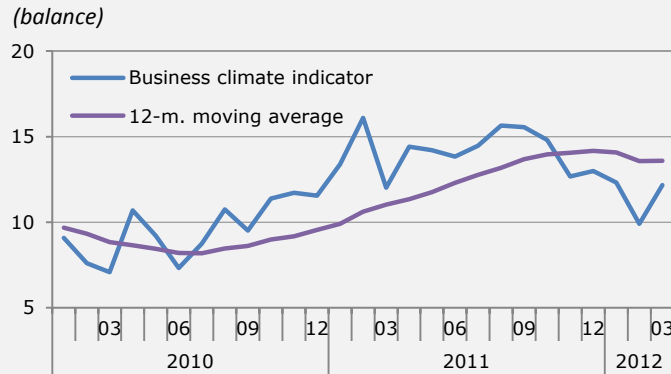
dustrial activity. According to the production purpose, investment goods had the largest positive contribution during the month. At the same time, a newly built car factory near the town of Lovech became operational in February.

Medical and orthopedic goods accelerated their growth to 11.2% yoy despite the 5.6% decline in **retail sales**. Household consumption contributed for the decline in retail sales of textile, clothing, footwear and leather goods, and retail sales of audio and video equipment, down by 25.6 and 19.4% respectively.

Construction production index increased temporary in January by 2.3% yoy for the first time since November 2010, entirely due to the positive development of civil engineering. The latter increased by 8.5%, while building construction kept declining by 2.1%. In February construction production index registered an 8.5% decline. Building construction output decreased by 13.1% and civil engineering was down by 2%. The regular revision of historical data at the beginning of the year concerned mainly the development in civil engineering during 2010, shifting the trend from negative to positive territory. According to revised data, civil engineering grew throughout 2010 in comparison to the registered decline in the first three quarters before the revision.

Business climate in the country improved for the first time since the beginning of the year. The indicator increased by 2.3 pps due to the optimistic prospects about future business situation in all sectors. However, the current business juncture in most of the sectors was assessed as difficult because of the weak demand. There was also a decrease in retail sales and industrial orders.

Business climate



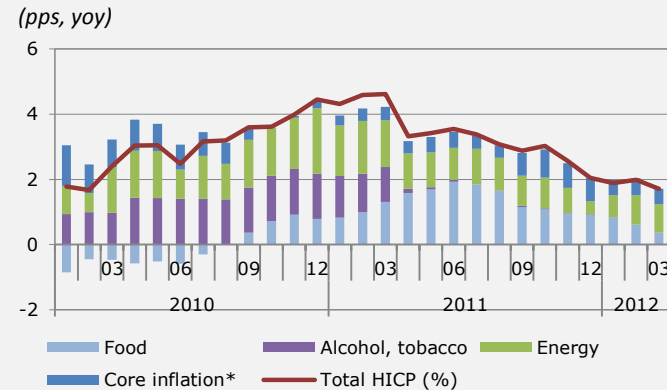
Source: NSI

March **jobless rate** remained at its February level, being 11.5%. The limited growth in the number of unemployed people was primarily related to the increased outflow of unemployed, the latter being positively influenced by the gradual recovery in seasonal activities. The primary sector labour demand picked up in agriculture, tourism, construction, trade, transport, etc., thus supporting the almost doubled number of persons who started working there – 12.5K in March. Meanwhile, programs and measures for subsidized employment were also activated from a month earlier, giving a positive contribution to the increased overall number of persons who found jobs in March (19.2K).

Inflation increased marginally in March, up 0.1% over the previous month. **The annual HICP continued slowing down to 1.7%, thus Bulgaria ranked 3rd among EU Member States with the lowest inflation rates.** Automotive fuel prices had again the largest positive contribution to the monthly headline rate (+0.13 pps), as mounting oil prices on international markets put

an upward pressure on domestic prices. However, their increase slowed somewhat to 1.5% mom after a 4% gain in February. Food prices increased by 0.3% and added another 0.08 pps. As a result of the extremely difficult supply situation of eggs in the whole EU, following the new welfare of laying hens legislation effective since January 2012, egg prices continued increasing rapidly, up 24.4% in March alone (+0.05 pps). Prices of clothing and footwear decreased by a further 1.2% mom and largely accounted for the 0.8% decline in prices of non-energy industrial goods over the month. Weak domestic demand also kept prices of consumer durables on the downward trend. Prices of alcohol and tobacco, as well as those of market services remained practically unchanged over January. Administered prices of water supply and refuse collection rose, up by 0.9 and 4.2% mom respectively, thus adding 0.03 pps to total HICP increase during the month.

HICP and contributions by main components



* Overall index excluding energy, food, alcohol and tobacco.

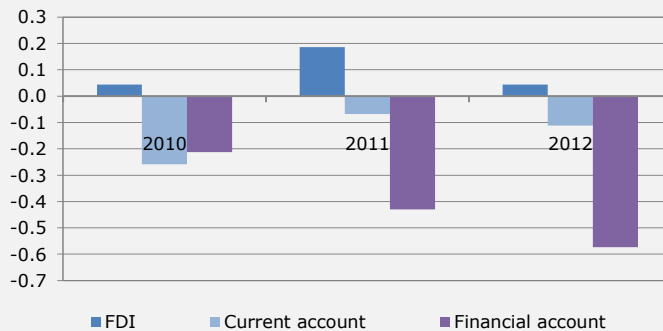
Source: NSI, MF

Current account balance was negative by EUR 112 mln in January, while services balance came positive at EUR 50.6 mln (being EUR 24.4 mln twelve months earlier). Current transfers reached EUR 65.8 mln and had a positive contribution to the CA balance.

Trade deficit widened compared to a year earlier, largely on account of the registered decrease of exports, down 10.2% yoy. In the meantime, imports remained practically unchanged. As a result, the trade deficit went up to EUR 176.4 mln, being only EUR 18.7 mln in January 2011. The “Income” balance was negative by EUR 52 mln, though the deficit decreased by 55.3% yoy, mainly due to the lower investment income paid to non-residents.

FDI, Current and Financial Account

(January, billion euro)



Source: BNB

Financial account came in at EUR 573 mln deficit, up by 33.5% yoy. “Other investments” balance was negative at EUR 649.9 mln, compared to EUR 467.3 mln deficit in January 2011.

Its dynamics was largely shaped by banking activity, as Bulgarian banks increased their foreign deposits by EUR 502.4 mln. Foreign direct investments stood at EUR 44.2 mln.

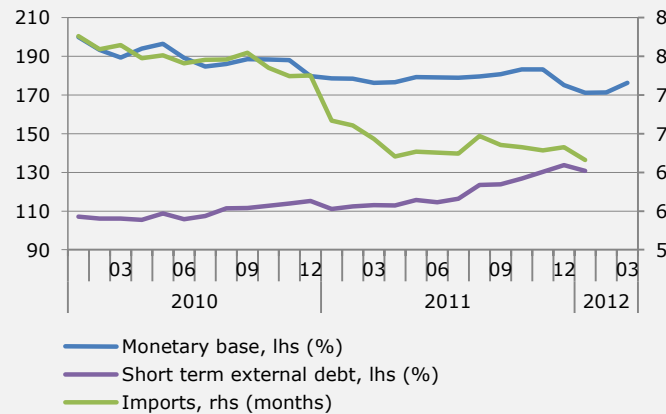
The January **balance of payments** reported less negative at EUR 489.7 mln compared to EUR 628.3 mln deficit a year earlier.

Repayment of liabilities to nonresidents, which accounted for the **gross external debt** (GED) dynamics in 2011, persisted in the current year as well. Thus the external indebtedness edged down by 0.5% mom in January. Gross external debt amounted to EUR 35.2 bn (87.5% of GDP), down by 8.6 pps yoy and 4.4 pps mom, with all sectors contributing to the decrease. The most substantial decline was recorded in the banking system, as deleveraging led to 20.1% yoy contraction in its short-term external debt stock. At end-January, banking sector foreign debt stood at 15.8% of GED, being 18% a year earlier. Foreign debt of other companies narrowed by 2.9% yoy as the stock of short and long-term loans decreased, down by 1.2 and 3.7% respectively. Meanwhile, local subsidiaries continued repaying loans granted before the crisis by their parent companies, so that intercompany loans narrowed to EUR 14.8 bn, being EUR 15.1 bn twelve months earlier. The ongoing deleveraging resulted in a further improvement in the short-to-long-term debt ratio, with short-term debt being 28.2%, while long-term debt standing at 71.8%.

The annual growth of **international reserves** picked up to 8% from 3.7% in February and reached EUR 13.2 bn at the end of March. The positive change was mainly due to the increase in Bank Department deposit, with a large contribution from notes in circulation and bank reserves. International reserves grew by 3.1% in March alone, led by a 24% increase in liabilities to the government and a 15.3% increase in those to other depositors.

Monetary base coverage improved compared to a month earlier and stood at 176.3%. As of end-January international reserves covered 130.8% of the short-term external debt and 6.2 months of imports.

Coverage with FX Reserves



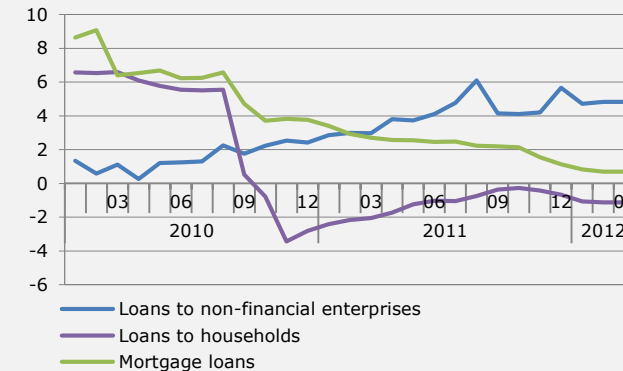
Source: BNB

All broad money components contributed for the **money supply** growth of 11.7% yoy at end-February, after the 12.7% increase a month earlier. Liquid monetary aggregate M1 had its rate of increase to 18% yoy coming from 18.9% in the previous month. Deposits with agreed maturity and deposits redeemable at notice also expanded at a lower pace (6.5 and 18.5% respectively) compared to the end of January. Money supply remained almost unchanged over the month as the 0.9% increase of the liquid aggregate M1 was offset by a 0.5% decrease of quasi-money. Total deposits kept growing at a relatively high rate, up 12.1%

yoy as of end-February, despite the relative slowdown from the 13.4% a month earlier.

Credit growth

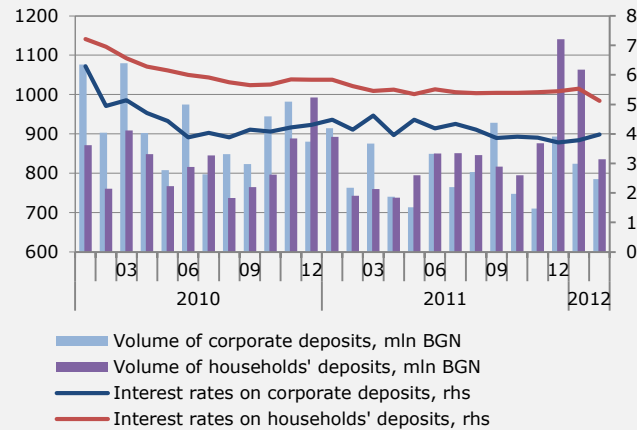
(% change, yoy)



Source: BNB

Credit to the private sector rose by 2.4% yoy at end-February (its growth rate being 2.5% at the end of the previous month). Corporate credits showed a marginal improvement, going from 4.7% yoy a month ago to 4.8%, while the annual decline in households' loans increased slightly to 1%. Consumer credits kept decreasing by 1.1%, while mortgages growth continued slowing down to 0.7%. The share of bad and restructured loans in total corporate and households credits remained broadly unchanged at 17.9%.

Interest rates and volumes of time deposits in BGN up to 1 year



Source: BNB, MF

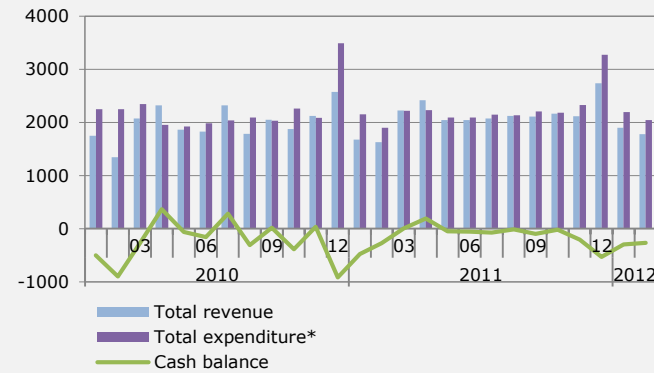
After going up in January, weighted average **interest rates on credits went down again** in February. The rate on corporate credits decreased the most, by 0.5 pps. The price of consumer credits was by 0.3 pps lower, while the rate on mortgages decreased only marginally by 0.1 pp. Despite the slightly improved conditions, the volumes of new business corporate and mortgage loans were below their level from the previous month, down by 12 and 7.6% respectively. At the same time, new consumer loans lent in February increased by 17.4% over January. Weighted average **interest rates on deposits** in local currency went down by 0.2 pps, while those in Euro and USD were up by 0.1 and 0.2 pps respectively. Total volume of new deposits decreased by 17.3% mom.

At end-February, **consolidated budget deficit** stood at BGN 565 mln (0.7% of GDP) on a cash basis, down by 0.3 pps com-

pared to the deficit-to-GDP ratio a year earlier. In the first two months of 2012 the yoy growth of general government revenue remained higher than the increase of general government expenditure, so that the deficit came by BGN 185.5 mln lower compared to the same period of 2011.

Consolidated Budget

(monthly value, mln BGN)



* Incl. contribution to EU budget

Source: MF

Total revenue and grants accounted for BGN 3 681.1 mln, up 11.5% in nominal terms compared to a year earlier. Tax revenue increased by 13.5% yoy, which was mainly due to the **significant rise in VAT receipts** (up 30.4%). **Excise duties** also had a positive contribution to the overall revenue growth, **up by 6.8%**, while custom duties decreased by 12.8%. Revenue from direct taxes and social and health insurance contributions came higher, up by 3.8 and 7.3% yoy respectively. Non-tax revenues increased by 10.6% yoy, while grants declined.

General government expenditure, including Bulgarian contribution to EU budget, stood at BGN 4 246.1 mln, up 4.8% yoy. The latter was mainly due to the yoy increase in payments of subsidies (90.9%) and capital expenditures (29.6%), while social spending and scholarships fell by 2.6%, reducing thus the growth of total expenditure.

Fiscal reserve stood at BGN 3.8 bn at end-February.

General government debt, including government guaranteed debt, rose by 11.9% yoy and accounted for 16.3% of GDP, of which: domestic debt – 6.3% of GDP, external debt – 8.6% of GDP and government guaranteed debt – 1.4% of GDP. ▼

— KEY ECONOMIC INDICATORS

		2008	2009	2010	2011	Q1'11	Q2'11	Q3'11	Q4'11	IX'11	X'11	XI'11	XII'11	I'12	II'12
— GDP¹															
Gross Domestic Product ¹	% , yoy	6.1	-5.5	0.4	1.7	3.2	2.2	1.6	1.6						
Consumption	% , yoy	2.5	-7.3	0.5	-0.3	0.6	0.4	0.9	0.5						
Gross fixed capital formation	% , yoy	21.9	-17.6	-18.3	-9.7	-5.5	-6.9	-7.4	-9.7						
Export	% , yoy	3.0	-11.2	14.7	12.8	21.5	13.2	5.4	12.6						
Import	% , yoy	4.2	-21.0	2.4	8.5	13.6	8.1	9.0	4.5						
Agriculture	% , yoy	32.4	-9.5	-6.2	-1.1	-0.8	-3.2	-1.8	1.0						
Industry	% , yoy	6.0	-5.7	-6.3	6.6	9.1	6.7	6.0	2.4						
Services	% , yoy	4.1	-1.3	4.4	-0.1	-2.6	3.0	-1.2	1.4						
Adjustments	% , yoy	5.7	-16.5	-0.5	0.8	6.1	-2.6	3.1	0.1						
— SHORT TERM BUSINESS STATISTICS															
Industrial production	% , yoy	0.7	-18.3	2.0	5.8	12.0	7.1	3.9	1.3	2.3	3.3	2.0	-1.2	-1.1	-4.0
Industrial turnover	% , yoy	13.7	-20.2	14.1	17.2	32.6	19.1	14.2	6.8	11.6	10.8	10.0	0.2	3.5	4.9
Retail trade turnover	% , yoy	8.9	-7.7	-8.4	-1.9		0.2	-3.0	-4.3	-3.3	-5.1	-5.6	-2.4	-2.4	-5.6
Construction output	% , yoy	12.2	-14.3	-14.5	-12.9	-15.1	-16.2	-11.3	-9.2	-11.1	-10.5	-10.9	-5.6	2.3	-8.5
Total business climate	balance	38.0	10.2	9.6	14.2	13.8	14.1	15.2	13.5	15.5	14.8	12.7	13.0	12.3	9.9
Industrial confidence	balance	39.9	12.3	13.4	22.4	21.6	22.8	24.1	21.0	24.9	23.1	18.9	21.0	21.4	21.3
Retail trade confidence	balance	41.3	13.5	10.1	17.3	13.0	10.7	20.2	25.5	23.6	23.9	26.4	26.2	11.0	9.1
Construction confidence	balance	40.3	8.5	5.1	2.8	4.7	4.4	3.9	-1.9	1.1	1.4	-1.1	-6.1	-2.4	-4.7
Services confidence	balance	28.7	5.1	5.6	5.9	8.1	10.1	3.8	1.8	3.1	2.4	0.1	2.9	10.2	2.6
— LABOUR MARKET															
Participation rate (15+)	level	53.8	53.0	52.0	51.3	50.8	51.0	51.9	51.5						
Employment rate (15+)	level	50.8	49.4	46.7	45.6	44.7	45.3	46.6	45.7						
Employment (LFS)	% , yoy	3.3	-3.2	-6.2	-3.4	-4.0	-4.5	-2.8	-2.3						
Unemployment rate (LFS)	level	5.6	6.8	10.2	11.2	12.0	11.2	10.2	11.4						
Unemployment rate (Employment agency)	level	6.3	7.6	9.5	10.1	10.9	10.1	9.5	10.0	9.4	9.6	10.0	10.4	11.1	11.5
Nominal wage	% , yoy	26.5	11.8	6.4	9.1	8.5	9.3	8.6	8.7	8.5	8.6	8.5	8.8		

		2008	2009	2010	2011	Q1'11	Q2'11	Q3'11	Q4'11	IX'11	X'11	XI'11	XII'11	I'12	II'12
Real wage ²	% , yoy	13.0	9.1	3.3	5.6	3.8	5.7	5.3	5.9	5.4	5.4	5.8	6.6		
Labour productivity (GDP per employed)	% , yoy	3.5	-3.0	5.3	6.2	7.4	7.5	7.3	2.6						
Real ULC (GDP)	% , yoy	3.7	8.1	2.7	-3.7	-13.6	-7.5	-2.7	8.1						
— PRICES															
National index of consumer prices (CPI)	% , yoy	12.3	2.8	2.4	4.2	5.1	4.8	3.9	3.1	3.3	3.5	3.1	2.8	2.3	2.0
Harmonized index of consumer prices (HICP)	% , yoy	12.0	2.5	3.0	3.4	4.5	3.4	3.1	2.5	2.9	3.0	2.6	2.0	1.9	2.0
Domestic producer prices	% , yoy	13.3	-4.3	7.2	8.6	11.9	10.3	7.2	5.5	6.6	6.5	5.9	4.1	5.3	4.6
— CONSOLIDATED FISCAL PROGRAM (CUMMULATIVE)															
Revenue and grants	mIn BGN	27313	25041	23933		5530	12042	18354		18354	20519	22639	25378	1900	3681
Total expenses	mIn BGN	25323	25667	26755		6272	12692	19180		19180	21361	23688	26960	2198	4246
Contribution to EU budget	mIn BGN	720	746	670		250	367	528		528	588	676	779	62	242
Cash deficit (-) / surplus (+)	mIn BGN	1990	-626	-2823		-742	-651	-826		-826	-842	-1049	-1582	-298	-565
	% of GDP	2.9	-0.9	-4.0		-1.0	-0.9	-1.1		-1.1	-1.1	-1.4	-2.1	-0.4	-0.8
Government and government guaranteed debt	mIn BGN	10710	10641	11778		11447	11573	11944		11946	11946	12166	12826	12715	12819
	% of GDP	15.5	15.6	16.7		15.1	15.3	15.7		15.9	15.9	16.2	17.0	16.2	16.3
Fiscal reserve	mIn BGN	8382	7673	6012		4699	5154	5071		5071	5342	5318	4999	4028	3802
	% , yoy	12.5	-8.5	-21.6		-26.1	-14.5	-24.4		-24.4	-16.5	-16.8	-16.9	-25.6	-25.0
— FINANCIAL SECTOR															
BNB International reserves	mIn EUR	12713	12919	12977	13349	12209	12340	13051	13349	13051	13176	13198	13349	12981	12789
Monetary base coverage	%	175.3	195.2	179.8	175.1	176.3	179.2	180.7	175.1	180.7	183.3	183.3	175.1	171.2	171.4
Coverage of import with FX reserves	months	5.4	8.0	7.3	6.3	6.4	6.3	6.4	6.3	6.4	6.3	6.3	6.3	6.2	
Coverage of short-term external debt	%	96.5	100.2	115.3	133.8	113.0	114.6	123.9	133.8	123.9	126.8	130.3	133.8	130.8	
Money M1 (Narrow money)	% , yoy	-4.1	-8.8	0.8	14.4	4.9	3.7	5.5	14.4	5.5	6.3	4.4	14.4	18.9	18.0
Money M3 (Broad money)	% , yoy	8.8	4.2	6.2	12.2	7.4	8.0	10.3	12.2	10.3	9.6	7.8	12.2	12.7	11.7
Deposits	% , yoy	8.8	7.6	6.6	13.2	8.2	8.8	11.3	13.2	11.3	10.5	8.2	13.2	13.4	12.1
Credit to private sector	% , yoy	32.9	3.8	1.1	3.3	1.6	2.1	2.2	3.3	2.2	2.3	2.3	3.3	2.5	2.4
Credit to non-financial enterprises	% , yoy	33.1	2.3	2.4	5.7	3.0	4.1	4.1	5.7	4.1	4.1	4.2	5.7	4.7	4.8
Credit to households	% , yoy	31.4	5.8	-0.8	-0.4	-0.7	-0.6	-0.2	-0.4	-0.2	-0.1	-0.2	-0.4	-0.8	-1.0
Interest rate on short-term loans	%	10.9	10.5	8.5	7.2	6.4	7.3	7.3	7.7	7.3	7.0	7.4	8.6	8.1	8.8
Interest rate on time deposits	%	5.6	7.0	5.4	4.8	5.1	4.9	4.7	4.8	4.7	4.8	4.8	4.7	4.8	4.6

		2008	2009	2010	2011	Q1'11	Q2'11	Q3'11	Q4'11	IX'11	X'11	XI'11	XII'11	I'12	II'12
Exchange rate BGN/USD	eop	1.39	1.36	1.47	1.51	1.38	1.35	1.45	1.51	1.45	1.40	1.46	1.51	1.48	1.45
	per. av.	1.34	1.41	1.48	1.41	1.43	1.36	1.38	1.45	1.42	1.43	1.44	1.48	1.52	1.48
— GROSS EXTERNAL DEBT (GED)															
Gross external debt	% of GDP	104.9	108.3	102.8	91.9	94.8	94.6	94.0	91.9	94.0	93.3	92.8	91.9	87.5	
Short term external debt	% of GED	35.4	32.1	30.4	28.2	29.6	29.6	29.1	28.2	29.1	28.9	28.4	28.2	28.2	
Intercompany lending	% of GED	36.4	38.5	40.3	41.8	40.2	40.3	40.8	41.8	40.8	41.4	41.8	41.8	42.0	
— BALANCE OF PAYMENTS															
Current account	mIn EUR	-8182	-3116	-376	361	-88	9	1155	-715	118	-81	-305	-329	-112	
<i>Current account (moving average)</i>	% of GDP	-23.1	-8.9	-1.0	0.9	0.1	1.0	0.6	0.9	0.6	0.6	0.9	0.9	0.8	
Trade balance	mIn EUR	-8598	-4174	-2764	-1975	-202	-697	-220	-856	-166	-168	-365	-323	-176	
<i>Trade balance (moving average)</i>	% of GDP	-24.3	-11.9	-7.7	-5.1	-6.3	-5.7	-5.6	-5.1	-5.6	-5.5	-5.3	-5.1	-5.3	
Export, f.o.b.	mIn EUR	15204	11699	15561	20227	4784	4866	5416	5162	1790	1822	1755	1585	1431	
	%, yoy	12.5	-23.1	33.0	30.0	57.7	28.1	22.6	19.7	24.8	24.7	20.5	13.6	-10.2	
Import, f.o.b.	mIn EUR	23802	15873	18325	22201	-4985	-5563	-5635	-6018	-1956	-1990	-2120	-1908	-1608	
	%, yoy	-214.7	-33.3	15.4	21.2	35.5	18.9	22.0	12.4	25.8	18.9	11.0	7.8	-0.3	
Capital account	mIn EUR	277	477	291	494	16	47	126	306	52	3	52	250	0	
Financial account	mIn EUR	11463	1163	-699	-1194	-723	-351	-707	588	-108	-89	-115	-155	-52	
Net Foreign Direct Investments	mIn EUR	6206	2505	1035	1205	-86	85	302	904	156	348	167	388	37	
Net Portfolio Investments	mIn EUR	-731	-619	-661	-357	-181	-9	-234	67	-274	146	57	-136	40	
Other Investments – net	mIn EUR	6032	-704	-1048	-1976	-445	-420	-747	-364	60	-100	-33	-230	-650	
Change in BNB reserve assets	mIn EUR	-674	650	384	-159	665	-92	-470	-261	-21	-111	65	-215	490	

Notes:

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

2. HICP deflated.

— RECENT DEVELOPMENTS AND GOVERNMENT DEBT REVIEW

The trend for advantageous financing of the state in the domestic capital market continued

Ministry of Finance (MF) achieved a record breaking yield drop at the auction for the sale of 7Y GS denominated in euro held on March 5. The weighted average annual yield of the approved EUR 30 mln GS stood at 4.21%, the lowest one for 7Y Bulgarian government bonds. The yield on the total amount of securities (EUR 100.4 mln) was 4.32%, which is below the average approved yield at the time of their issuance in January 2012 (4.45%).

The yield of the auction is considerably lower than that of the Eurobonds with similar residual maturity of a number of EU Member States and other countries in the region, including Hungary (8.15%), Croatia (7.13%), Turkey (5.09%), Slovenia (4.86%), and Spain (4.27%) and is close to those in Slovakia (4.11%) and Poland (3.80%). The spread to German government bonds with similar residual maturity also decreased compared to the previous auction for this issue.

Market participants showed great interest in the auction, as demand exceeded almost three and a half times the volume of GS offered for sale, thus the coverage coefficient reached 3.35. Pension funds acquired 55% of the nominal approved, followed by banks with 25% and insurance companies with 19%.

The successful fiscal policy of Bulgarian government strengthened the investor confidence, thus yields in all segments of the

debt curve followed a clear downward trend since August 2011. The auction held on March 5 yet again supported the positive price developments of state financing on domestic capital market. When implementing its issuance policy, MF will continue to take account of the increased investor interest in Government debt instruments.

On March 12, MF reopened for the second time this year the priority issue with an original maturity of 10.5 years. It will be used by the ECB during 2012 in calculating the harmonized long-term interest rate, which is among Maastricht criteria for convergence. The weighted average annual yield of the approved GS amount of BGN 55 mln was 4.95%, which was a record breaking yield drop since March 2008 in this maturity segment. For comparison, the yield of the total securities amount of BGN 159.6 mln was 5.03%, which is significantly lower than the average approved yield of 5.35% for the issue in January 2012 and the value of the long-term interest rate published by ECB for February 2012 – 5.31%. The positive downward trend of the spreads to German Bunds across all maturity segments continued, reaching 316 bps.

Orders from primary dealers reached BGN 159.6 mln with BGN 55 mln offered for sale, which was indicative of the great demand of market participants for sovereign bonds offered at the domestic market. The coverage coefficient reached 2.90, the highest rate on 10Y bonds since April 2011. Market participants showed great interest in the auction. Pension funds acquired 43% of the nominal approved, followed by banks with 37% and insurance companies with 12%.

The yield on 10-years benchmark bond moved below 5%

The outcome of the auction held on March 13 was in line with the steady stabilization of Bulgarian long-term debt dynamics and decreasing yield on the secondary market. According to February data on harmonized long-term interest rate, published by the ECB, the value of this indicator on 10Y government bonds for Bulgaria was 5.31%. According to ECB data, ten EU Member States have a reading higher than that of the Bulgarian long-term interest rate, six of them being members of the euro area. The yield achieved at the auction (4.95%) is an important prerequisite for further reducing the value of this indicator.

The stabilization of long-term debt dynamics of Bulgaria is important factor for financial stability. Lower cost of public debt servicing allows maintaining low taxation in the country.

5Y government bond yield twofold lower compared to June 2009

At the auction held on March 19, MF offered for a second time this year the 10Y GS of 2007. The yield of 3.71% reported in the first reopening of the securities on 20 February 2012 had been the lowest one in the 5Y BGN maturity segment since 2005. The outcome of this auction improved this seven-year record, with the average weighted yield reaching 3.48%, which is significantly lower than the yield of the same issue in the previous month. The spread vs. German federal bonds of similar residual maturity is 242 bps, down by 38 bps.

Auction demand exceeded two times the amount offered for sale, with banks securing their leading position in this maturity segment by acquiring 68% of the approved securities volume of BGN 50 mln. The issue in circulation after this auction totaled BGN 350 mln, which is a prerequisite for promoting its liquidity and turning it into a benchmark on the domestic debt market.

The trend ongoing since the start of 2011 of lowering the GS yield has been observed most clearly in the medium-term maturity segment, with 58% of the securities issued since 2012 falling in this category. For comparison, the yield on the primary market of 5Y GS reached 6.87% in June 2009, or almost two times higher than that of the auction. The yield of the BGN-denominated bond is below the current one of the 5Y Eurobonds of a number of European countries: including Hungary (8.15%), Turkey (4.37%), Slovenia (4.00%), Italy (3.85%), and Spain (3.71%) and is getting close to those in Slovakia (3.36%) and Poland (2.94%).

Amid continuing headwinds on EU debt markets, the positive outcome achieved on Bulgarian government debt market was supported by the fiscal policy pursued by the Government, placing Bulgaria among a few countries with sustainable finances. Outlining Bulgaria as an austerity country provides for market-oriented financing and contributes to the development of an effective and liquid market of Bulgarian GS

On March 26, MF reopened the 2Y GS for a second time since the beginning of the year, which have the shortest term maturity among those issued in 2012. The MF offered for sale GS with nominal value of BGN 35 mln, while the orders amounted to BGN 92.6 mln, thus the registered coverage coefficient was 2.65. By comparison, at the previous auction, held on February 6, orders admitted accounted for BGN 84.75 mln and the SG amount offered was BGN 20 mln.

Historically low yield of 2.11% for Bulgarian interest bearing government bonds

The result reaffirmed the obvious downward yield trend since the beginning of the year. The weighted average annual yield of all

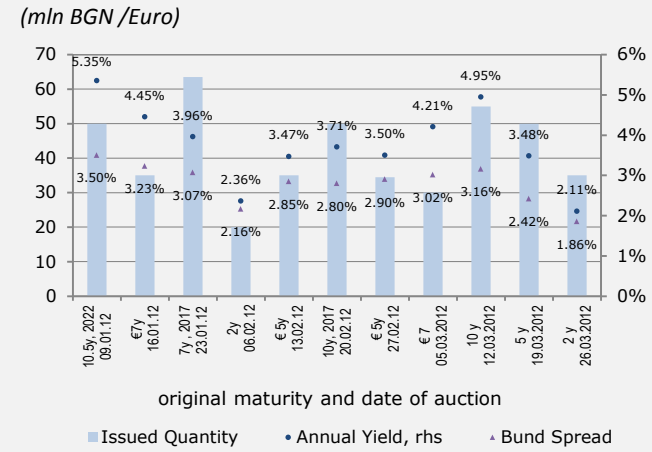
orders was 2.23%, while that of the auction held on February 6 was 2.51%. The 0.28% decline has been achieved on the back of the increased volume of GS offered for sale. The approved weighted average annual yield was 2.11%, after being 2.36% on the previous auction. The yield of the issue is historically the lowest one for Bulgarian interest bearing government bonds. It is comparable with the yield on Eurobonds with similar residual maturity and significantly lower than the yield of local currency denominated bonds of Turkey (9.41%), Romania (5.99%), Poland (4.54%). Another very positive indication is the narrowing of the spread to the German Government Bonds to 186 bps, while being 216 bps on the previous auction.

All GS primary dealers took part in the auction. In addition to the traditionally high interest of banks in the short-end of the debt curve, pension and investment funds were also interested. The investor base for the amount approved was as following: banks – 70%, investment and guarantee funds – 19% and pension funds – 11%.

This was the fourth consecutive auction in March 2012 with a record breaking drop in the yield. The MF offered this month GS issues covering the whole spectrum of the debt curve – 2, 5, 7 and 10.5Y, denominated in both BGN and EUR. The whole maturity spectrum coverage by offering GS of diverse characteristics helped to build a high liquidity benchmark curve of Bulgarian Government Bonds.

The results demonstrated increased investor confidence and interest in the GS auctions, evidencing clearly the security of investing in Bulgarian sovereign bonds. The issuer's policy is focused on offering GS in all maturity segments in order to answer as much as possible the expectations stated by investors and to provide a possibility for investor base diversification.

Latest Government Securities Auction Results



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
Source: MF

The nominal amount of government debt at end-February stood at EUR 5972.4 mln, including domestic government debt of EUR 2516.7 mln and external government debt of EUR 3455.7 mln. Debt has been steadily increasing in nominal terms, up by approximately EUR 79.9 mln compared to its level at the end of the previous month. It was due mostly to the internal financing of debt. At the end of February the government debt-to-GDP ratio was 14.9%.

Stable nominal amount of government debt is of primary significance for government finance

Table: Government Debt Amount, mln EUR

Structure	31.12. 2010	31.12. 2011	31.01. 2012	29.02. 2012
Domestic government debt	2 011.5	2 458.3	2 412.5	2 516.7
External government debt	3 373.5	3 487.6	3 480.1	3 455.7
Government Debt, total	5 385.0	5 945.9	5 892.6	5 972.4
Government Debt /GDP, %	4.9	15.3	14.3	14.9

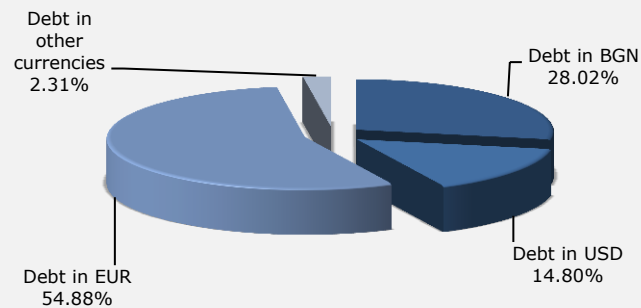
Government debt currency structure does not generate risks associated with its servicing

Debt currency structure underwent a positive change in February towards an increased share of debt instruments denominated in EUR and BGN. EUR denominated debt reached 54.9% (54.4% at the end of January), while debt in BGN stood at 28% (27.8% at the end of January). The share

of debt denominated in US dollars and other currencies decreased, reaching 14.8 and 2.3% respectively.

Government Debt Currency Structure

(as of 29 February)



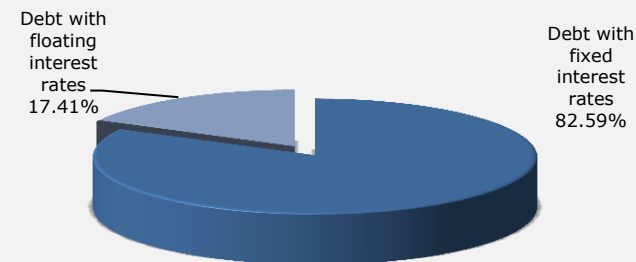
Source: MF

The share of debt with fixed interest recorded a slight increase compared to January and reached 82.6%. Debt with floating interest rates reduced by 17.4%, as a result of the loan policy for financing mainly at fixed interest rates during the period.

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

Government Debt Interest Rate Structure

(as of 29 February)



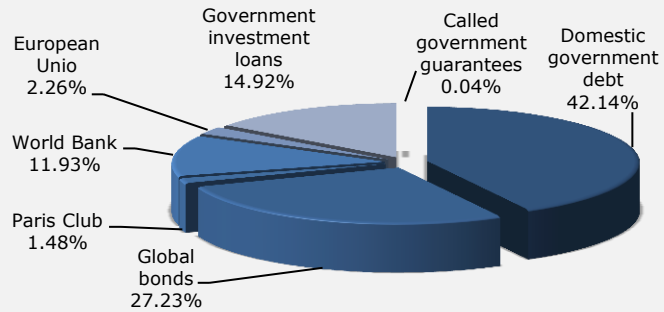
Source: MF

Debt structure by types of instruments and creditors remained stable in February as well and showed no significant change. Liabilities related to domestic government debt had the highest relative share at 42.1%, followed by global bonds at 27.2%, government investment loans at 14.9%, commitments to the World Bank at 11.9%, obligations to Paris Club at 1.5%, the European Union at 2.3% and the enabled state guarantees at 0.04%.

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

Government Debt Structure by Creditor

(as of 29 February)



Source: MF

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&ear=0&dq=&pokaz=0>

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