



UNITED BULGARIAN BANK

A Member of NBG Group

BULGARIA: ECONOMIC & MARKET ANALYSES January, 2008



Current account gap widened by 57% y/y to 21.6% of GDP in 2007. Net FDI inflows covered 88.9% of CA gap in 2007

Foreign trade gap widened to 26% of GDP in 2007

Gross external debt grew by 32.7% y/y to 93.6% of GDP as of end-November

Consumer price inflation remained high at 12.5% y/y in January. PPI inflation slowed down to 11.3% y/y in December

Industrial growth slowed down again in December due to weak manufacturing sales

Retail sales rose by 5.2% y/y in December

Household monetary expenditure grew by 25.9% y/y in December

Average monthly wage rose by 22.9% y/y to BGN 451 (EUR 230.6) in Q4

Unemployment rate fell by 2.3pps y/y to 7.38% as of end-January

Consolidated budget surplus widened by 20.3% y/y to 3.8% of GDP in 2007

Money supply grew by 31.2% y/y to 76.7% of GDP in 2007. Credit growth to non-government sector accelerated to 63.7% y/y as of end-December

Banks' net profit grew by 41.6% y/y to EUR 584.7 mn in 2007

Net assets of pension funds surged by 52.8% to EUR 1.2 bn in 2007

BG stock market indexes slumped on the back of global stock market decline

Average housing prices accelerated to 34.6% y/y in Q4 and 28.9% y/y in 2007

I. EXTERNAL SECTOR

1. Balance of Payments

Current account gap widened by 57% y/y to 21.6% of GDP in 2007

Current account (CA) gap widened by 57% y/y to EUR 6.175 bn in 2007, according to Central bank preliminary data. In relative terms, the CA gap accounted for 21.6% of the projected full-year GDP relative to 15.7% in 2006. In December alone, the pace of deterioration narrowed to 12.1% as compared to revised 50.9% y/a month earlier.

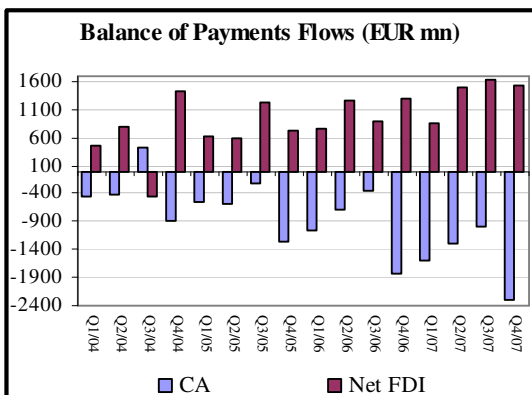
All sub-groups contributed to the widening of the deficit during the month. Services were the only item that counterbalanced the worsening of the country's position with the foreign countries during the year. The surplus on the service balance increased by 4.3% y/y to EUR 1.0 bn in 2007. Tourism revenues rose by 10.8% y/y to EUR 2.285 bn in 2007 staying as a major component in the service balance.

Net income balance was negative amounting to EUR 120.8 mn in 2007 as compared to a negative balance of EUR 5.8 mn year earlier.

Net current transfers decreased by 47% y/y to EUR 350.8 mn in 2007.

The overall balance of payments improved by 77.2% y/y to EUR 3.2 bn in 2007, on the back of strong debt and not-debt inflows in the financial account.

The government expects the CA gap at 21.9% this year but terms of trade indicators as well as external demand sentiments do not provide convincing arguments that the trend of external balance deterioration will be reversed. However, we expect positive effects on the side of agricultural and food supplies in the summer months compared to unfavourable base from last year.



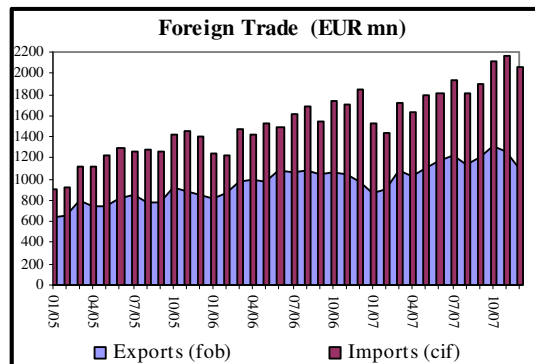
Net FDI inflows covered 88.9% of CA gap in 2007

Net FDI inflows rose by 29.9% y/y to EUR 5.5bn in 2007 covering 88.9% of the CA gap and 19.6% of GDP, according to Central bank preliminary data. FDI inflows advanced by 11.4% y/y to EUR 556 mn in December and 30.3% to EUR 5.687 bn for the whole year. However, the net FDI coverage of the CA gap deteriorated from 107.4% in 2006. The surplus in the financial and capital account improved significantly to EUR 9.72 bn last year (EUR 5.4 bn in 2006) helped by huge debt financing to the private sector.

Foreign trade gap widened to 26% of GDP in 2007

The foreign trade deficit increased by 8.9% y/y to EUR 841.6 mn in December and 33.4% y/y to EUR 7.4bn in 2007, according to Central bank preliminary data. The deficit in December is well below the expectations based on earlier reported data of industrial growth slowdown coupled with accelerating retail sales. It seems however that the monthly indicators for December are seriously affected by the long holiday period that could also result into significant deviations from the trend lines in January as well. The foreign trade gap reached 26% of the projected full-year GDP as compared to 22.2% of GDP in 2006. Merchandise exports (fob) grew by 11.7% y/y last year but imports (cif) increased at a much quicker pace of 18.4% y/y. In December alone, export growth (13.5% y/y) outpaced that of imports (11.7% y/y).

The trade gap with EU countries followed a trend of steeper expansion throughout the whole year accounting for 54.3% of the total gap as compared to 46.6% in 2006. The deficit generated with Russia and Ukraine accounted for 46% of the whole trade deficit as compared to 60.8% in 2006.



2. External Debt

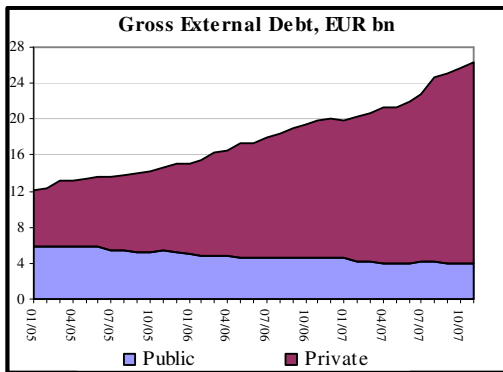
Gross external debt grew by 32.7% y/y to 93.6% of GDP as of end-November

Gross external debt grew by 32.7% y/y to EUR 26.25 bn as of end-November, according to Central bank preliminary data. The external liabilities of the country reached 93.6% of the full-year GDP projection.

Public debt decreased by 12.2% y/y and 0.2% m/m to EUR 3.99 bn as of end-November. The share of short-term debt rose by 2.9 pps y/y to 32.7% of the total external debt. The liabilities of the private sector surged by 46% y/y accounting for 84.8% of the total at end-November as compared to 77% a year earlier.

Internal financing within foreign-owned companies accounted for 34.3% of the total external debt. Banks' external debt rose by 56.1% y/y to EUR 5.1 bn (18.1% of GDP) as of end-November. The foreign liabilities of commercial firms (state-owned and private companies) grew by 30.4% y/y to EUR 9.1 bn as of end-November.

Accumulation of foreign debt was an important factor for the CA gap financing in November in view of the lower FDI inflows.



II. REAL SECTOR

1. Inflation

Consumer price inflation remained high at 12.5% y/y in January

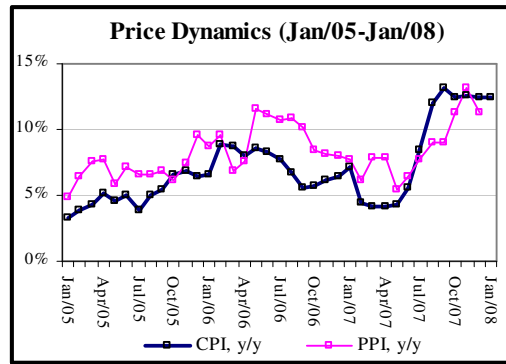
The index of consumer prices increased by 12.5% y/y in January, according to NSI preliminary data based on newly adjusted weights in the consumer basket. The year-on-year inflation rate stayed unchanged from the previous month but much

higher than the government full-year projections set at an annual-average of 6.9%.

As regards the harmonised index of consumer prices (HICP) used as a main price gauge by ECB, the index remained flat from the previous month at 11.7% y/y in January.

Consumer prices indices for January are preliminary as they are calculated on the basis of the data for the household budgets for the period January-November 2007. The revised data on the consumer price indices calculated on the basis of the full-year data will be published with the next inflation release. However, this will have very small impact on the preliminary released data for January, as the changes in the consumer basket weights are insignificant.

The NSI has revised the consumer basket for 2008. A total of 24 commodities have been removed and 48 new goods have been added, including third party motor liability insurance, import tobacco goods and the current tariffs of mobile operators. The consumer basket is updated in order to decrease the influence of the food stuffs, which hold traditionally the biggest share in the basket and whose prices affect most sensibly the normal living of the people and then the inflation.

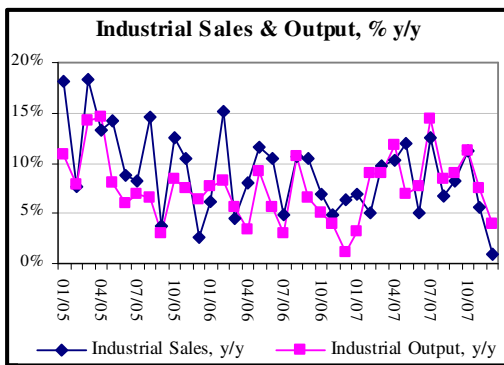


The producer price index covering industrial goods traded on the domestic market slowed down to 11.3% y/y in December from 13.2% y/y in November, according to NSI. Prices of metals extraction and processing and coals mining were among the major contributors for the weaker price hike. Food producer prices were the main generator of inflation in the summer months of the year although the index slowed to 21.7% y/y in December from 22.7% y/y in the previous month.

2. Industrial Sales

Industrial growth slowed down again in December due to weak manufacturing sales

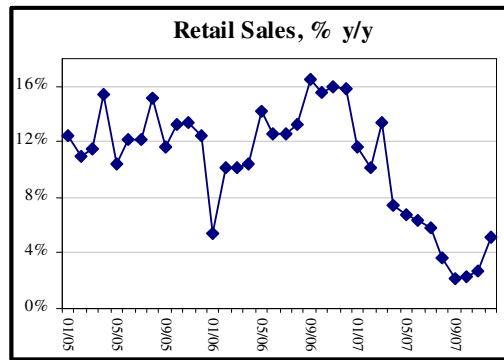
Industrial sales growth slowed down to real 1% y/y in December as compared to the revised 5.6% y/y in November and 11.3% y/y in October, according to NSI data. The figures add concerns about further weakening of the GDP growth in Q4 after a slowdown to 4.5% y/y in Q3 from 6.4% y/y in H1. While the setbacks in Q3 were fully driven by agricultural supplies, the last two months of the year unveil significant deterioration in the more important industrial sector, especially in the export-oriented manufacturing sales where a drop by 2.3% y/y is recorded in December. Electricity supplies as a main component of the utilities sector retained a strong pace of expansion in December influenced by weather-related demand hikes. The index of industrial production, comprising sales and changes in inventory, grew by 4% y/y in December slowing from 7.4% y/y in November.



3. Retail Sales

Retail sales rose by 5.2% y/y in December

The growth of retail sales improved to 5.2% y/y in December from the revised 2.7% y/y in November, according to NSI preliminary data. The rebound has been apparently driven by huge end-year fiscal boosts that have reduced the full-year budget surplus to 3.8% of GDP from 7.2% in January-November. The combination of slowing industrial sale growth and accelerated retail sales unveils that imports have financed the bigger part of consumption hikes linked to expansionary budget policies in December. Wholesales dropped by 0.7% y/y during the month and marked a marginal improvement of 1.4% for the whole year.



4. Household Consumption

Household monetary expenditure grew by 25.9% y/y in December

The growth of household monetary expenditure accelerated to nominal 25.9% y/y in December as compared to nominal 19.7% y/y in November respectively, according to the household surveys of the NSI. The indicator was influenced by seasonal effects during the last month of the year and must have been affected by wage and pension end-year bonuses. Household monetary income also increased by nominal 31.6% in December as compared to 28.6% y/y in November.

5. Average Monthly Wage

Average monthly wage rose by 22.9% y/y to BGN 451 (EUR 230.6) in Q4

The average gross wage rose by nominal 22.9% y/y to BGN 451 (EUR 230.6) in Q4 as compared to nominal 19.8% y/y in Q3, according to NSI preliminary data. Private wages increased at a slightly faster rate than those in the public sector (23.8% y/y against 22.5% y/y respectively). Data, however, do not include bonus pays, which are supposed to have a bigger weight in the private sector in addition to various creative ways of income transfers designed to lower tax deductions. Average wages increase accelerated to 23.7% y/y in Q4 (BGN 480, 6.4% above Q4 wages without bonuses) when end-year bonus payments added. Incomes in manufacturing, transport, hotels and restaurants, trade, construction and other activities servicing society marked faster than the average rate of increase. Wages in the government sector increased by an average of 19% y/y in Q4 as planned in the state budget.

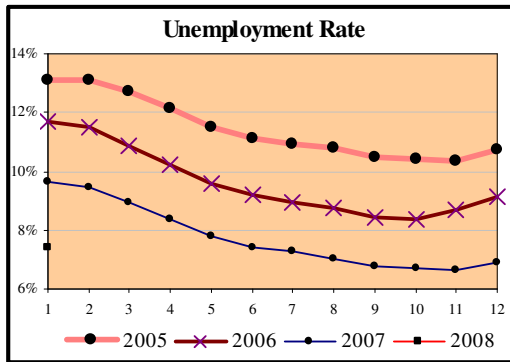
The European Commission criticised the country for excessive growth of public wages, however,

which in the opinion of the Commission have outpaced productivity gains last year and have served as a major inflation factor.

6. Unemployment

Unemployment rate fell by 2.3pps y/y to 7.38% as of end-January

Unemployment rate fell by 2.3pps y/y to 7.38% in January, according to National Employment Agency. On a monthly basis, the unemployment rate increased seasonably by 0.47pps. The number of unemployed increased by 6.8% m/m but dropped by 23.7% y/y to 273,280 people respectively. The rate of unemployment is likely to fall below 5% in the summer months if its annual improvement remains at its current level and pose serious pressure on wages due to labour supply shortages especially in sectors like construction and tourism.



II. FISCAL SECTOR

Consolidated budget surplus widened by 20.3% y/y to 3.8% of GDP in 2007

The consolidated budget surplus widened by 20.3% y/y to BGN 2.11 bn (EUR 1.08 bn) in 2007, according to Finance Ministry data. In relative terms, the surplus accounted for 3.8% of the projected full-year GDP as compared to 3.5% a year earlier.

The surplus remained significantly above the base-line target of 2% set in the budget programme. The figures unveil record-high expenditures in the last month of the year that has reduced the surplus from 7.2% of GDP in January-November. Although a great share of the extraordinary end-year transfers are reported as being allocated to investment projects, they will still have indirect effects on aggregate demand through income redistribution mechanisms and

will keep strong inflationary pressures on the demand side of the economy.

The fiscal revenues grew by 20.1% y/y to BGN 24.1 bn (EUR 12.3 bn) in 2007. They exceeded the full-year projection by 12.6% and reached a record high share of 43.9% in relation to GDP from 40.8% in the previous year. The fiscal expenditures rose by 16.9% y/y in 2007 to BGN 21.35 bn (EUR 10.92 bn) or 4.9% above the government plan.

Republican budget surplus dropped by 37.7% y/y to BGN 1.813 bn (EUR 927 mn) in 2007. Republican budget revenues and grants increased by 19.7% y/y to BGN 16.2 bn, and exceeded by 11.3% the government plan.

Tax revenues rose by 19.5% y/y to BGN 13.9 bn in 2007 due mainly to the improved profit tax and inflation-related hikes in indirect taxes. Despite the weak performance in the beginning of 2007, VAT revenues outperformed the government full-year target by 4.7% to reach BGN 6.6 bn.

Direct taxes totalled BGN 3.8 bn in 2007 exceeding the full-year target by 27%.

Import duties remained below the indicative level set in the budget as they constituted just 80.4% of the government plan.

Republican budget expenditure (excl. the transfers) increased by 23.3% y/y to BGN 8.614 bn (EUR 4.4 bn) in 2007.

IV. MONETARY SECTOR

1. Monetary Aggregates

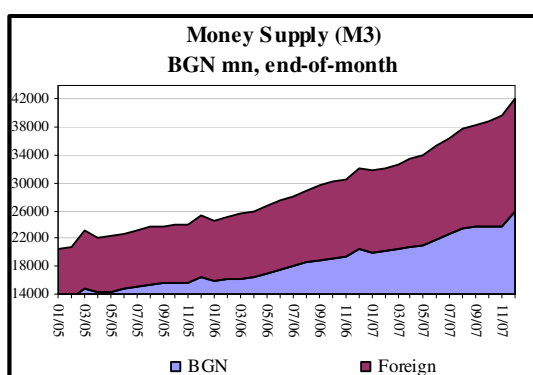
Money supply grew by 31.2% y/y to 76.7% of GDP in 2007

Money supply (M3) growth rate accelerated from near 27% y/y as of end-2006 to 31.2% as of end-2007 according to Central bank data. The indicator rose sharply by 6.2% in the last month of the year pushed by robust consumption and additional budget spending. The Central bank expected that credit growth would moderate to some 45-50% by year-end after it raised the reserve requirements by 4pps to 12% as of September 1.

The increase was mainly due to the higher deposits with agreed maturity up to 2 years, which marked a 35.3% y/y growth as well as to the higher overnight deposits which rose by 35% y/y as of end-2007. So, at the end of the year the

money indicator M3 reached BGN 42.06 bn (EUR 21.5 bn), as the quasi-money constituted 50.7% of M3.

During the last month of the year the consumption rose significantly, which contributed to the increase in the imports and therefore to the widening of the CA gap and the dynamic of the foreign reserves. The government decision to spend a part of the fiscal reserve had additional impact. Tthe foreign reserves dropped by 0.8% m/m as of end-December to BGN 23.35 bn (EUR 11.9 bn). on the back of the decrease in government deposits with the Central bank. The foreign reserve coverage of the money base fell considerably to 164.5% agianst 190.1% in November. A year earlier this indicator was 166.6%.



2. Domestic Credit

Credit growth to non-government sector accelerated to 63.7% y/y as of end-December

Domestic credit growth accelerated from 55% y/y as of end-November to 58.8% y/y as of end-December, according to Central Bank data. The stock of domestic credit reached BGN 33.5 bn (EUR 17.1 bn) or 61% of the projected full-year GDP against 43% a year earlier.

Claims on non-government sector sped up their growth rate to 62.5% y/y as of end-December against 61.3% y/y as of end-November.

Credits denominated in foreign currency grew at a much faster pace of 79.6% y/y (74.5% y/y a month earlier) as compared to those in local currency: the increase of the latter slowed down to 48.3% y/y as of end-December (50.3% y/y as of end-November). The share of foreign-currency loans reached 50% of total, up by 5pps on an annual basis.

Credit growth to non-government sector accelerated from 62.1% y/y as of end-November to 63.7% y/y as of end-December.

Credits to non-financial companies rose by 71.5% to BGN 22.7 bn (EUR 11.6 bn) as of end-2007. Credits to households and NPISH totalled BGN 13.8 bn (EUR 7.04 bn), up by 52.2% y/y as of end-2007.

The mortgage loans growth decelerated from 65.7% y/y as of end-November to 64% y/y as of end-December. Consumer loans growth continued to accelerate from 44.8% y/y as of end-November to 46.3% y/y as of end-December. Consumer loans constituted 42.2% of all credits to households and NPISH.

Domestic credit, % of GDP

	12/06	11/07	12/07
Domestic credit	43,0%	54,9%	61,0%
Claims on general government	-4,4%	-10,7%	-7,8%
Claims on non-government sector	47,4%	65,5%	68,9%
o/w Loans	45,9%	63,9%	67,3%
Non-Financial Corporations	27,0%	39,1%	41,4%
Financial Corporations	0,5%	0,7%	0,8%
Households and NPISH	18,4%	24,1%	25,1%
Consumer loans	8,1%	10,3%	10,6%
Loans for house purchase	7,0%	9,6%	10,2%
Deposits	56,1%	66,9%	71,3%
Assets	86,0%	100,2%	107,7%

Source: BNB's Monetary survey and Balance sheet of the banking system

V. FINANCIAL SECTOR

1. Banking Sector

Banks' net profit grew by 41.6% y/y to EUR 584.7 mn in 2007

The aggregated net profit of the commercial banks rose by 41.6% y/y to BGN 1.144 bn (EUR 584.7mn) in 2007, according to Central bank data. The total value of assets increased by 40% y/y to BGN 59.1 bn (EUR 30.2 bn as of end-December and exceeded the full-year GDP estimate by 7.7 percentage points. The five largest lenders in the country held 56.5% of total assets. The gross credits accounted for some 76% of banks' assets.

Gross loans to enterprises surged by 67.5% y/y to BGN 24.3 bn as of end-December.

Retail exposures rose by 58.8% y/y to BGN 12.9 bn. Mortgage loans increased by 67.4% y/y to BGN 5.9 bn. Consumer loans amounted to BGN

7.1 bn as of end-December, up by 52.2% y/y. Consumer loans hold 54.6% of total household credits.

The funds attracted by commercial banks increased by 57.3% y/y to BGN 52.2 bn (EUR 26.7 bn) as of end-December. Deposits of private sector (corporate deposits plus deposits of individuals and households) accelerated their growth rate from 40.3% y/y as of end-November to 42% y/y as of end-December. The private sector deposits amounted to BGN 39.1 bn (EUR 20 bn) or 71.3% of the projected full-year GDP.

Although the share of non-serviced credits increases as compared to a year earlier, the indicators for banks' stability remain at a good level. The Central bank reported also good liquidity and sufficient capital adequacy of 13.8% at the end of the year.

2. Pension Funds

Net assets of pension funds surged by 52.8% to EUR 1.2 bn in 2007

The net assets of the nine private pension funds in the country increased by 52.8% y/y to BGN 2.32 bn (EUR 1.2 bn) last year or 4.2% of the full-year GDP estimate, according to Financial supervision commission data. The number of insured persons rose by 7.5% to 3.4 mn. The weighted average annual return rates for universal, professional and voluntary funds improved to 15.4%, 15.6% and 16.6% last year as compared to 7.4%, 8.5%, and 6.8% in 2006, respectively.

The share of the corporate stocks in the investment portfolios of the funds expanded to 29.9% last year as compared to 20.6% in 2006 but decreased by 3.9pps on a quarterly basis due to downward corrections in the prices of equities traded on the stock exchange. The savings invested abroad accounted for 18.7% of the total at the end of last year as compared to 8.5% at end-2006.

The parliament approved last month changes to the regulation allowing broader opportunities for investments of pension funds adding Croatia and Macedonia to the list.

Investment portfolio (in %)

Instruments	Voluntary		Occupational		Universal		Total	
	12/06	12/07	12/06	12/07	12/06	12/07	12/06	12/07
1.State securities	21,58	9,94	33,11	18,41	32,26	18,48	28,92	16,03
2.Securities traded on reg. market	34,45	41,22	32,03	44,39	32,33	41,55	32,96	41,96
2.1.Shares	21,74	32,11	21,17	31,07	19,54	28,25	20,61	29,86
2.2.Corporate bonds	12,71	9,11	10,86	13,32	12,79	13,29	12,35	12,10
3.Minicipal bonds	0,32	0,19	0,58	0,29	0,38	0,14	0,40	0,18
4.Bank deposits	22,91	17,30	20,96	14,70	21,51	16,24	21,86	16,26
5.Mortgage bonds	7,05	4,00	5,01	3,63	4,72	2,92	5,55	3,36
6. Derivatives	0	0	0	0	0	0	0	0
7.Commercial real estate	3,55	6,47	1,23	2,58	0,80	2,20	1,80	3,49
8.Foreign investments	10,14	20,88	7,08	15,99	8,00	18,47	8,51	18,71
Total	100	100	100	100	100	100	100	100

Source: Financial Supervision Commission

3. Stock Exchange

BG stock market indexes slumped on the back of global stock market decline

The first month of the year started with the IPOs of meat producer Mekom and bottle cap maker Herti but due to the recent sharp fall and volatility of the stock market the public offerings of the both companies failed to lure investors.

Mekom was the first company to hold an IPO this year after some 20 successful listings on the BSE in 2007. Some 60 Bulgarian companies announced plans going public this year.

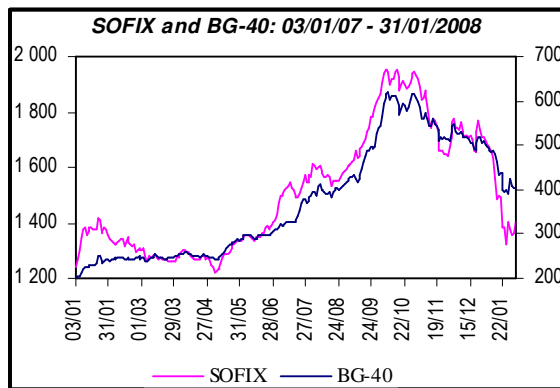
Bulgarian meat processor Mekom extended the subscription period for its initial public offering (IPO) by March 7 due to the slump of the domestic capital market prompted by global stock exchange falls. According to the company's prospectus, it would consider the IPO successful if minimum 10 mn shares are subscribed for.

Mekom is offering to the public 10 682 800 shares with a face value of BGN 1.0 at a minimum price of BGN 2.20. The price will be determined through the method of book-building and all shares will be

allocated proportionally to the orders. If the IPO is successful the company's capital will increase from BGN 53.414 mn to BGN 64.09 mn. The company hoped to raise some BGN 23.5 mn (EUR 12 mn) for capacity expansion and investments abroad, building additional swine farms and taking over companies from the western Balkan region.

The public offering of Herti was successful despite the fact that the issue was not fully subscribed. According to the company's prospectus, it would consider the IPO successful if at least one share is subscribed for. Herti planned to increase its capital by 25% to BGN 15 mn by selling BGN 3.0 mn shares at a minimum price of BGN 3.10. The subscribed shares amounted to 13 797, which was 0.46% of the offered shares. The orders were fulfilled at the minimum price.

Herti is the largest Bulgarian manufacturer of aluminium caps for spirits bottles and plastic caps for water bottles, with a capacity of one billion caps per year. The company sells 80% of its output mainly to the rest of the EU, Turkey, Russia and other ex-Soviet republics.



Fears of U.S. recession caused sharp falls on global capital markets, which in turn sparked panic selling on the Bulgarian stock exchange in January. Since the beginning of the year the blue-chip SOFIX index lost 23% to reach 1321.03 points, a level equal to the lowest level since May 2007. At the same time, the broader BG40 plunged 24% to 392.09 points on January, 25. So, it plummeted to the lowest level since August last year. The weak trade on the stock exchange was due to the strong fear of losses in the conditions of an unstable market. The lack of free financial resources on the Bulgarian capital market was one of the reasons for the slump registered by the stock indexes. The lack of fresh funding may be put down to the fact that resources were withdrawn by

foreign investors, as well as to the more frequent redemption of shares by mutual funds. Investors' fear, however, continues to be the major driving force behind the trade on BSE. Even good financial reports did not have a positive impact on the bourse.

VI. REAL ESTATE

Average housing prices accelerated to 34.6% y/y in Q4 and 28.9% y/y in 2007

Average housing prices accelerated to 34.6% y/y in Q4 from and 30.6% in Q3 reaching BGN/m² 1216.85 (EUR/m² 622.2) according to NSI data. The figures cover prices in district centres and some of the smaller settlements in the district of Sofia. The year-average prices grew by 28.9% y/y. The highest average annual price is reported for the capital city Sofia at BGN/m² 1,813.2, followed by Varna and Burgas with margins of 2.9% and 25.7%.

The steepest growth rate was recorded in the north-eastern city of Turgoviste (44.3%), followed by the Danube city of Rousse (40.9%) and Pernik (40%). The increase in the housing prices of old apartments was due to the stronger demand for and the limited supply of newly-built apartments.

According to forecast of the one of the major real estate agencies in the country home prices will rise by 10% to 15% in 2008 after a surge by 18.6% to a country-wide average of EUR/m² 737 last year.

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