



**UNITED
BULGARIAN
BANK**

A Member of NBG Group

**BULGARIA:
ECONOMIC & MARKET ANALYSES
February, 2008**



Current account gap widened by 13.4% y/y to 2.3% of GDP in January. Net FDI inflows surged by 64% y/y to EUR 223 mn in January

Foreign tourist visits increased by 3% y/y in 2007

Foreign trade gap widened by 2.2% y/y to 1.9% of GDP in January

Gross external debt grew by 34.5% y/y to 94.6% of GDP as of end-December

GDP growth rose by 6.2% y/y in 2007, slowing marginally from 6.3% y/y in 2006

Consumer price inflation accelerated again to 13.2% y/y in February. PPI inflation accelerated to 13% y/y in January

Industrial sales growth rebounded to 11.5% y/y in January

Retail sales rose by 11.5% y/y in January

Household monetary expenditure grew by 20.4% y/y in January

Unemployment rate fell by 2.2pps y/y to 7.26% as of end-February

Consolidated budget surplus stood at 0.7% of the projected full-year GDP in January

Money supply grew by 30.9% y/y to 67.4% of GDP as of end-January. Credits to non-government sector rose by 63.2% y/y as of end-January

Banks' net profit grew by 14.7% y/y to EUR 56.9 mn in January

In February total turnover of the BSE- Sofia dropped by 50.7% m/m

I. EXTERNAL SECTOR

1. Balance of Payments

Current account gap widened by 13.4% y/y to 2.3% of GDP in January

Current account (CA) gap widened by 13.4% y/y to EUR 725.6 mn in January or 2.3% of the projected full-year GDP, according to Central bank preliminary data. The pace of deterioration was faster as compared to the revised rate of 3.6% y/y a month earlier.

Tourism revenues increased by 18.1% y/y but were not able to offset the widening gap in the service account in January. The deficit on the service balance rose by 165% y/y to EUR 114.3 mn.

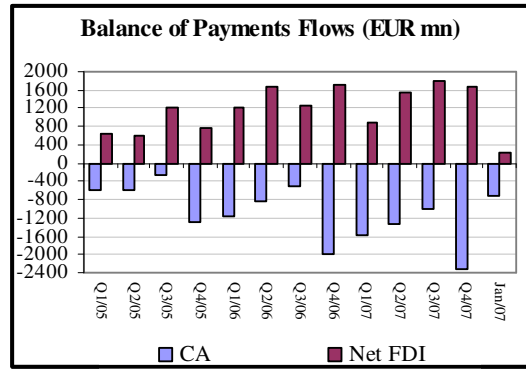
Net income balance was positive amounting to EUR 8.2 mn in January as compared to a negative balance of EUR 46.9 mn year earlier.

Net current transfers item was negative amounting to EUR 20.7 mn in January, against a positive item of EUR 36.2 mn in January 2007.

The overall balance of payments posted a deficit of EUR 330.9 mn as compared to EUR 374 mn a year earlier despite the steep rise in the net inflow of foreign direct investments.

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.

The Central bank revised the earlier reported data for 2005-2007 showing even more alarming CA deficits for the period, especially for 2006 when reinvested earnings in foreign owned companies had dramatic symmetric impacts on CA outflows and FDI inflows. The figures for 2007 will undergo further dramatic changes in this direction. As a result of the revision, the CA deficit in 2006 was moved upwards to 17.9% of GDP from 15.7%. The change for 2007 is smaller, from 21.6% to 22.2%, but still has not taken into account all reinvested earnings that could bring up the CA gap to about 25% of GDP. Moreover, the latest figures for 2007 unveil a large outflow of EUR 1.1 bn (3.8% of GDP) booked in *Errors and omissions* that could be also transferred to the CA balance.



Net FDI inflows surged by 64% y/y to EUR 223 mn in January

Net FDI inflows rose by 64% y/y to EUR 222.7 mn in January covering 30.7% of the CA gap during the month, according to Central bank preliminary data. Along with January data, the Central bank revised earlier released FDI figures for 2006 and 2007 by 37.8% (EUR 1.6 bn) and 7.6% (EUR 419 mn), respectively. Thus net FDI inflows accounted for 21.1% and 23.2% of GDP in 2006 and 2007 respectively as compared to 16.8% and 19.6% before the revisions. The newly released data improves significantly the coverage of the CA gap by net FDI inflows last year (95%). All changes were done on the account of the item *Errors and omissions* which turned negative in 2006 amounting to EUR 746.7 mn as compared to positive value and almost tripled in 2007 to as a result of the revisions.

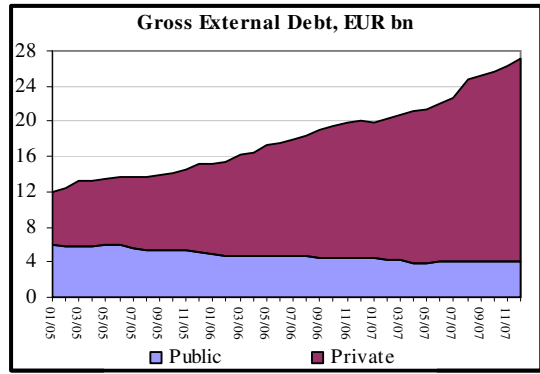
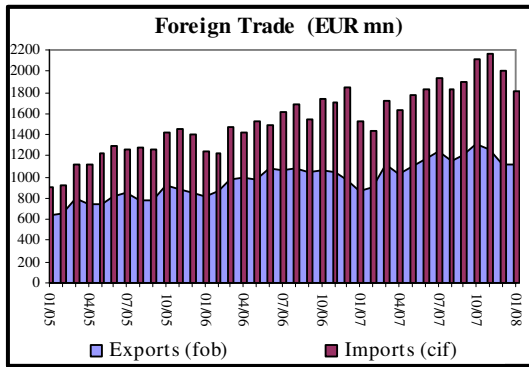
Foreign tourist visits increased by 3% y/y in 2007

The visits of foreigners to the country increased by 3% to 7.7mn in 2007, according to NSI data. The number of tourists from Hungary, Spain, Portugal, Poland, Romania, Greece, France and Italy rose by more than 30%. At the same time, visitors from Serbia and Macedonia dropped by almost 70% due to introduction of visas after the country entered the EU. The number of visits of Bulgarian citizens abroad increased by 8% y/y to 4.5 mn last year.

Foreign trade gap widened by 2.2% y/y to 1.9% of GDP in January

The foreign trade deficit increased by 2.2% y/y to EUR 599 mn in January or 1.9% of the projected full-year GDP, according to Central bank preliminary data. Merchandise exports (fob) grew by 28.1% y/y during the month outpacing imports (cif), which rose by 18% y/y. Russia and Ukraine

accounted for 72.5% of the trade gap in January while EU countries for only 29.8%. Mineral fuels generated about 50% of the trade deficit.



2. External Debt

Gross external debt grew by 34.5% y/y to 94.6% of GDP as of end-December

Gross external debt grew by 34.5% y/y to EUR 27.04 bn as of end-December, according to Central bank preliminary data. The debt stock reached 94.6% of the full-year GDP projection as compared to 80.1% a year earlier.

Public debt decreased by 10.1% y/y to EUR 4.0 bn as of end-December. The liabilities of the private sector surged by 47.3% y/y accounting for 85% of the total as of end-December and 82% of the projected full-year GDP. Debt servicing accounted for 18.7% of GDP and 29.9% of exports during the period against 17.1% and 27% in 2006. The share of short-term debt rose by 4.1 pps y/y to 34.4% of the total external debt.

Internal financing within foreign-owned companies accounted for 33.6% of the total external debt. Banks' external debt rose by 68% y/y to EUR 5.6 bn (20.1% of GDP) as of end-December. The foreign liabilities of commercial firms (state-owned and private companies) grew by 28.9% y/y to EUR 9.3 bn as of end-December.

The rapid increase in the country indebtedness is driven by investment demand mainly and the large presence of foreign investors which helps for increased inter-company transfers. In addition, a big share of the external debt is directly or indirectly linked to investments in real estates by non-residents and follow-up expenses for furnishing and related activities.

II. REAL SECTOR

1. Gross Domestic product (GDP)

GDP growth rose by 6.2% y/y in 2007, slowing marginally from 6.3% y/y in 2006

Real GDP growth rose by 6.2% y/y in 2007, slowing its rate from the revised 6.3% y/y in 2006, according to NSI preliminary data. The full-year growth is also below the government projection of 6.4%. In nominal terms, GDP amounted to BGN 56 519.8 mn (EUR 28.9 bn). GDP per capita stood at BGN 7341/EUR 3 753 in 2007. In Q4 GDP growth accelerated to 6.9% y/y from revised 4.9% y/y in Q3 reaching BGN 16.346 bn (EUR 8.358 bn).

The slowdown in the economic growth was mainly due to the poor agricultural harvest last year. Agricultural sector plunged by near 30% y/y as its share of the total value added decreased to 6.2% last year from 8.5% in 2006. The role of the farming sector is declining not only on the back of unfavourable weather conditions last year but also reflects a long-term structural trend for reallocation of resources. The agricultural share in the gross value added statistics was 26.2% in 1996 and 13.9% in 2000 for instance. The value added realized by the industrial sector rose by 14% y/y. As a relative share the industrial sector constituted 32.3% of the gross value added. The manufacturing industry grew by 15.4% y/y, the construction – by 16.9% and the production of energy – by 17.2% y/y. The services generated 61.5% of the gross value added increasing by 7.5% y/y in 2007. Financial intermediation and hotels and restaurants recorded significant growth rates of 34% y/y and 11.8% y/y, respectively.

Real changes (%, y/y)	2005	2006	Q1/07	Q2/07	Q3/07	Q4/07	2007
Agriculture	-9,4	-1,0	0,3	-6,9	-44,1	-36,4	-29,7
Industry	4,8	7,8	10,1	12,7	14,3	18,2	14
Services	8,2	7,1	3,6	7,9	8,9	8,6	7,5
GDP	6,2	6,3	5,5	7,3	4,9	6,9	6,2
Consumption	5,3	7,3	6,0	5	4,2	4,5	4,9
Investment (excl. inventories)	23,3	14,7	35,9	24,7	19,7	14	21,7
Export	8,5	8,7	3,7	5,3	5,4	6,0	5,2
Import	13,1	14,0	14,7	11,1	9,3	5,7	9,9

Source: National Statistics Institute

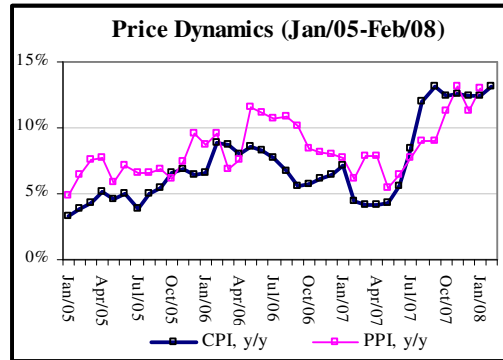
On the demand side of the economy, the GDP breakdown unveils that investments were the main growth driver while exports and domestic consumption grew at lower rates than in the previous years. The slowdown in the export performance provides rather unfavourable signals for the country's external balance, as the CA gap reached 22.2% of GDP last year. The government expects a GDP growth of 6.4% this year, which is not unrealistic in view of the expected rebounds from the low agricultural base last year, but the forecast is threatened by external risks stemming from the financial crisis in the US and related slowdown effects to the global and European economy.

2. Inflation

Consumer price inflation accelerated again to 13.2% y/y in February

Consumer price inflation accelerated to 13.2% y/y in February from 12.5% y/y in January, according to NSI data. The monthly inflation is reported at 1.1% as compared to the revised 1.4% in January. The harmonised index of consumer prices (HICP) used as a main price gauge by ECB, also accelerated to 12.2% y/y in February from the revised 11.7% y/y in the previous month. Food prices accounted for more than 60% of the total inflation in the first two months and would most probably impact the overall price changes during the whole year along with the new rebounds on the energy markets. On the demand side, wage hikes driven by labour shortages in some branches will continue to create inflation risks. The government expects steep disinflation moves in the summer months over positive food supply effects. The budget projections are thus derived under a year-average consumer price inflation of 6.9%. This is still a feasible assumption but only in the case of radical improvements in agricultural and food supplies. Inflation however

remains a very serious threat to the economic balance, as it worsens the country's competitiveness through the mechanisms of real exchange rate appreciation and more importantly it delays the country's plans for quick adoption of the euro that adds mostly speculative pressures on the central bank's capacity to maintain the fixed exchange rate regime.

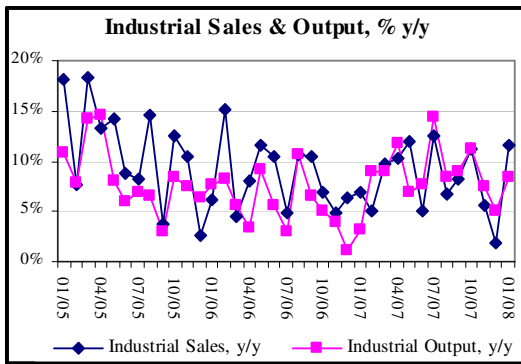


The producer price index covering industrial goods traded on the domestic market accelerated to 13% y/y in January from 11.3% y/y in December, according to NSI. The price growth in mining industries was among the main components that pushed up the overall index. Food prices sped up again after two consecutive months of deceleration and would adversely affect the consumer price index in February. The latest rebound in oil and fuel prices is also pushing up industrial and consumer prices.

3. Industrial Sales

Industrial sales growth rebounded to 11.5% y/y in January

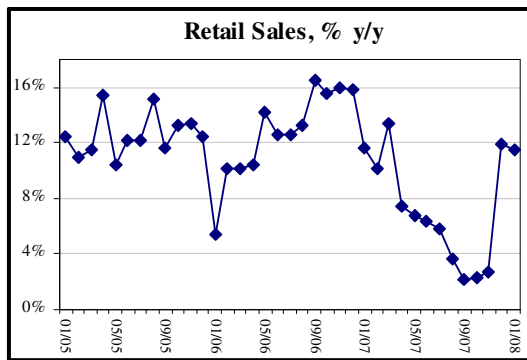
Industrial sales growth accelerated to 11.5% y/y in January from the revised 1.8% y/y in December, according to NSI preliminary data. The breakdown by exports and domestic sales provides positive signals that the overall industrial growth is driven by export-oriented companies since the middle of last year. This is also confirmed by the steep recovery in the manufacturing sector to a sales growth of 11.9% y/y in January from a one-off drop by 0.9% y/y in December. The index of industrial production, comprising sales and changes in inventory, grew by 8.5% y/y in January speeding up from the revised 5% y/y in December.



4. Retail Sales

Retail sales rose by 11.5% y/y in January

Retail sales rose by 11.5% in January indicating strong domestic consumption supported by lagged effects from wage bonuses paid at the end of last year and record-high fiscal expenditure boosts, according to NSI preliminary data. The growth pace decelerated marginally from 11.9% y/y in December after significant upward revisions from previously reported 5.2% y/y. Sales of clothes, household goods and appliances and pharmaceutical products posted the steepest hikes. Wholesales grew by 1.1% y/y during the month.



5. Household Consumption

Household monetary expenditure grew by 20.4% y/y in January

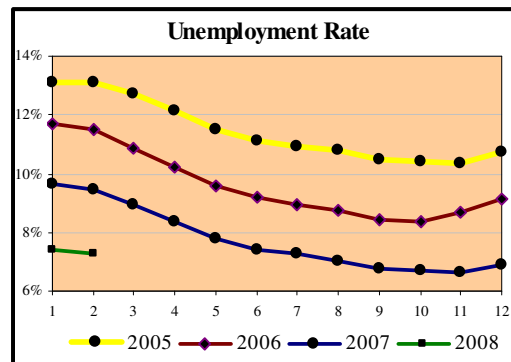
The growth of household monetary expenditure slowed down to nominal 20.4% y/y from 25.9% y/y in December, according to the household surveys of the NSI. The indicator was influenced by seasonal factors as end-year bonuses usually shape acceleration of the growth rates in December. The increase in household monetary income also decelerated to nominal 22.4% y/y in

January from 31.6% in December. Wages and salaries remain the largest source of monetary household income with share of 55.4% in the structure of household income, followed by pensions with 26.8% and entrepreneurship with 5.9%. At the same time, the incomes from pensions and entrepreneurship increased by 25% y/y and 39% y/y, respectively in January. The incomes from property rose three-fold to average BGN 10.81 per household. The incomes of the households from savings dropped by 41.3% y/y.

6. Unemployment

Unemployment rate fell by 2.2pps y/y to 7.26% as of end-February

Unemployment rate fell by 2.2pps y/y and 0.12pps m/m to 7.26% in February, according to National Employment Agency. The number of unemployed dropped by 23.5% y/y to 268,756 people.



II. FISCAL SECTOR

Consolidated budget surplus stood at 0.7% of the projected full-year GDP in January

The consolidated budget surplus widened more than 4 times y/y to BGN 440.4 mn (EUR 225.2 mn) in January and accounted for 0.7% of the projected full-year GDP, according to data of the Finance Ministry.

The fiscal revenues surged by 39.4% y/y to BGN 2.08 bn (EUR 1.06 bn) in January over a strong rebound in the VAT collection rates caused by one-off effects in the base period. As recalled, the country's entry in the EU on Jan 1, 2007, has changed the system of VAT payments on shipments from member countries delaying all related charges by nearly two months in comparison with previous periods. As a result, the VAT and excise tax base from the first two months of last year is exceptionally low. The fiscal revenue report for February this year will also

contain big one-off hikes while the monthly flows in the following months will return to normal year-on-year rates.

The fiscal expenditures (excluding the installment for the EU budget) increased by 5% y/y to BGN 1.57 bn (EUR 0.8 bn) in January.

Republican budget surplus rose almost twice y/y to BGN 378.1 mn (EUR 178 mn) in January. Republican budget revenues and grants increased by 55.5% y/y to BGN 1.63 bn.

Revenues from direct taxes dropped by 10.9% y/y in January due to lower payments by free-lancers.

Personal income taxes paid under labour contracts decreased by 22.2% y/y in January, which is the first month when the new flat tax rate of 10% is applied in comparison to the progressive tax scale ranging from 0% to 24% last year. The slowdown in the revenues is likely to be compensated in February as this year the term for a 5% discount from the amount of the annual tax for extra-payment was extended up to February, 10.

The excise revenues increased by 59.3% y/y due to the higher than the last year tax rates on several kinds of fuels, coals, coke, electricity and cigarettes.

IV. MONETARY SECTOR

1. Monetary Aggregates

Money supply grew by 30.9% y/y to 67.4% of GDP as of end-January

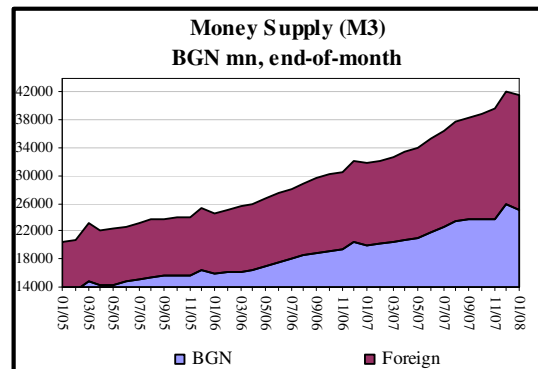
Money supply (M3) growth rate decelerated to 30.9% y/y as of end-January from 31.2% y/y as of end-2007 due to seasonal factors, according to Central bank data.

Deposits with agreed maturity up to 2 years rose by 39.4% y/y. For the first time since almost an year and a half the annual growth of overnight deposits was below 30% - as of end-January they increased by 28.6% y/y. The lower growth pace resulted from the slowdown in the overnight deposits in leva of non-financial enterprises.

The monetarization of the economy reached 67.4% of the projected full-year GDP as of end-January.

The foreign reserves rose by 36.2% y/y to EUR 11.68 bn as of end-January but dropped by 2.2%

on a monthly basis. Deposits of the commercial banks with the Central Bank decreased by 7.1% on December but this slowdown was fully compensated by the increase in the government deposits with the Central Bank.



2. Domestic Credit

Credits to non-government sector rose by 63.2% y/y as of end-January

Domestic credit growth decelerated marginally to 57.8% y/y as of end-January from 58.8% y/y as of end-December, according to Central Bank data. The stock of domestic credit reached BGN 34.01 bn (EUR 17.4 bn) or 55.1% of the projected full-year GDP.

Claims on non-government sector decelerated their growth rate to 61.8% y/y as of end-January from 62.5% y/y as of end-December. Notwithstanding, for the first time since the start of 2007 the monthly increase was below BGN 1 bn, e.g., on a monthly basis the claims rose by BGN 631mn.

A slowdown was registered in lending to both households and corporations. Credits to non-government sector rose by 63.2% y/y as of end-January as compared to 63.7% y/y as of end-December.

Credits to non-financial companies rose by 69.9% y/y to BGN 23.1 bn (EUR 11.8 bn) against 71.5% y/y as of end-December. Credits to households and NPISH grew by 52.6% as of end-January as compared to 52.2% y/y as of end-December.

The mortgage loans growth decelerated from 64% y/y as of end-December to 61.8% y/y as of end-January. Consumer loans growth continued to accelerate from 46.3% y/y as of end-December to 49.1% y/y as of end-January.

According to expectations, the annual growth of credits to the private sector will decelerate in the forthcoming months due to the hike in the interest rates, on one hand, and on the other hand, to the higher base.

Domestic credit, % of GDP

	01/07	12/07	01/08
Domestic credit	39,3%	61,0%	55,1%
Claims on general government	-4,0%	-7,8%	-7,1%
Claims on non-government sector	43,3%	68,9%	62,2%
o/w Loans	42,0%	67,3%	60,9%
Non-Financial Corporations	24,8%	41,4%	37,4%
Financial Corporations	0,4%	0,8%	0,7%
Households and NPISH	16,8%	25,1%	22,8%
Consumer loans	7,3%	10,6%	9,7%
Loans for house purchase	6,5%	10,2%	9,3%
Deposits of NFIs and other clients	53,2%	71,3%	62,1%
Assets	75,2%	107,7%	92,4%

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

V. FINANCIAL SECTOR

1. Banking Sector

Banks' net profit grew by 14.7% y/y to EUR 56.9 mn in January

The aggregated net profit of the 29 commercial banks rose by 14.7% y/y to BGN 111.29 mn (EUR 56.9 mn) in January, according to Central bank data.

The total value of assets increased by 38.2% y/y to BGN 57.01 bn (EUR 29.15 bn) as of end-January but dropped by 3.6% on December last year due to seasonal factors. Assets accounted for 92.4% of the full-year GDP. The monthly reduction resulted from changes in the assets of the five largest players, which share dropped to 55.9%, down from 56.5% at the end of the last year.

The growth of the credit stock slowed to 43.7% y/y as of end-January as compared to 67.5% last year to reach a share of 77% of all banks' assets. The gross loans to enterprises amounted to BGN 24.613 bn (EUR 12.6 bn) at end-January, up by 1.3% m/m.

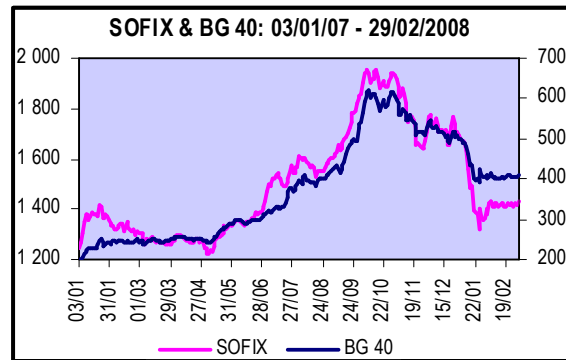
Retail exposures rose by 2.8% m/m to BGN 13.3 bn (EUR 6.8 bn). Consumer loans increased by 2.9% m/m and mortgage loans – by 2.6% m/m at end-January.

The stock of all deposits rose by 38.5% y/y to BGN 49.965 bn (EUR 25.547 bn) at end-January and still covers more than fully all loans. The private sector deposits amounted to BGN 37.9 bn (EUR 19.4 bn) or 61.5% of the projected full-year GDP.

2. Stock Exchange

In February total turnover of the BSE- Sofia dropped by 50.7% m/m

External pressure is dragging down the indexes of the Bulgarian Stock Exchange (BSE), despite the good annual reports of public companies. Since the beginning of the year the blue-chip SOFIX index has declined by 18.8% to 1,409.92 on February 26. Many professional investors believe that that is due to the insecurity on foreign financial markets, which discourages big players from returning to the developing markets. . The total turnover dropped by 50.7% m/m to BGN 209.05 mn (EUR 106.9 mn) as a result of the smaller number of traded deals. Despite the precaution of the investors the total market capitalisation of the bourse rose by 5.4 m/m to reach BGN 25.516 bn (EUR 13 bn) at the end of February.



In February the fifth most liquid companies on BSE were Enemona, Chimimport, Eurohold Bulgaria, Monbat and Holding Roads.

On March 13, new changes concerning the list of companies included in SOFIX and BG 40 came into force. BSE dropped from the SOFIX the country's largest fuel retailer Petrol and added Corporate Commercial Bank and First Investment Bank, Bulgaria's second-largest lead and zinc smelter OTZK and construction firm Holding Roads. After the revision the index portfolio already includes the 19 most liquid stocks on the local market. The BSE also dropped from the BG40 index six companies - aluminium producer Alcomet, oil and gas prospecting company Prouchvane I Dobiv Na Neft I Gaz, holding

company Favorit Hold, chemical company Polimeri, cable maker EMKA and textile firm Decotex, and replaced them with construction company Moststroy, Corporate Commercial Bank, water bottling company Devin, cosmetics producer Aroma, batteries manufacturer Elhim Iskra and brewery Lomsko Pivo.

BSE also added one more component to its BG-REIT index which tracks the performance of the real estate investment trusts, replacing Prime Property with Agro Finance and Exclusive Property.

The latest revision of the SOFIX index was in September. The BSE last updated the BG 40 index in November.

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