



**UNITED
BULGARIAN
BANK**

A Member of NBG Group

**BULGARIA:
ECONOMIC & MARKET ANALYSES
July, 2007**



Current account gap widened by 54.1% y/y to EUR 2.836bn (10.6% of GDP) in January-June. FDI in Bulgaria increased to EUR 2.113bn (7.9% of GDP) in the reported period

Foreign trade deficit worsened by 45.2% y/y to EUR 3.201bn (12% of GDP) in H1

Gross external debt reached EUR 20.384bn (76.3% of GDP) in May

2.2% inflation in July (8.4% y/y)

Industrial sales and output grew by 7.8 % y/y and 13.3% y/y respectively in June

Retail and wholesales growth decelerated to 6.5% y/y and 1.5% y/y respectively in June

Household monetary income and expenditure increased by 23% y/y and 25% y/y respectively in June

Average monthly wage rose by 17.7% y/y to BGN 406 (EUR 208) in Q2

Unemployment dropped to 7.25% as of end-July

General budget surplus widened by 53.6% y/y to BGN 2.61bn (4% of GDP) in H1

Money supply growth accelerated to 28.4% y/y at the end of June. Domestic credit growth accelerated from 33.9% y/y as of end-May to 35.3% as of end-June

Loans extended to corporate clients and households increased by 47.1% y/y in Q2

End-June pension funds assets up 46.7% y/y

New records on the BSE in July

I. EXTERNAL SECTOR

1. Balance of Payments

Current account gap widened by 54.1% y/y to EUR 2.836bn (10.6% of GDP) in H1

According to Central Bank preliminary data, the current account gap widened by 184% y/y to EUR 247.9mn in June only and by 54.1% y/y to EUR 2.836bn in H1. In relative terms the CA deficit represented 10.6% of the GDP, compared to 7.3% a year earlier.

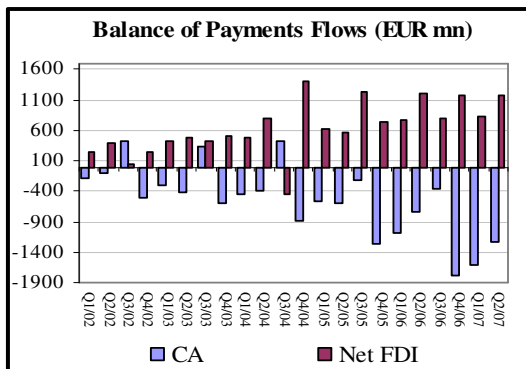
The trade balance continued to be the main reason for the CA deterioration.

The services balance improved to EUR 204.9mn in H1 (from EUR 32.5mn a year earlier), thanks to the 16% y/y hike in receipts from tourism. At the same time, the net transfers dropped by 33.5% y/y to EUR 180.6mn.

However, the overall balance of payments continued to improve (to EUR 896mn in H1; up 30% y/y), on the back of strong financial inflows.

BNB warns that the CA data may undergo serious revisions due to the problems met with the foreign trade data collection after Bulgaria's EU entry.

Finance minister estimated that the CA deficit is likely to reach 18% of GDP this year, against initial expectations in the range of 15-16%.



FDI in Bulgaria increased to EUR 2.113bn (7.9% of GDP) in H1

FDI inflows increased to EUR 2.113bn (7.9% of GDP) in January-June, compared to EUR 2.016bn (8% of GDP) a year earlier. Thus they covered only 74.5% of current account deficit, versus 109.6% in the same period last year.

The attracted equity capital for January-June amounted to EUR 1.412bn (66.8% of total FDI), including EUR 1.4mn from privatisation deals. The reinvested earnings for the reported period are estimated to EUR 146mn.

By country, the largest investments in Bulgaria for the period concerned came from UK (15.9%), Austria (13.2%) and Luxembourg (11.8%).

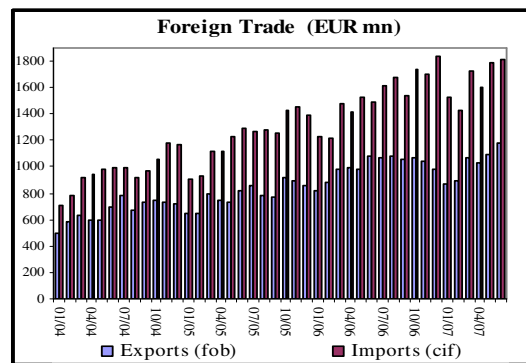
By branch, the largest investments for January – June 2007 were in real estate, renting and business activities (EUR 729.3mn), financial intermediation (EUR 439.3mn) and construction (EUR 296.6mn).

At the same time the foreign investments abroad was EUR 91.7mn versus EUR 29.7mn a year earlier.

Foreign trade deficit widened by 45.2% y/y to EUR 3.201bn (12% of GDP) in H1

According to Central bank preliminary data, the foreign trade deficit widened by 49.5% y/y to EUR 534.6mn in June only and 45.2% y/y to EUR 3.201bn in H1. In relative terms it accounted for 12% of GDP compared to 8.8% a year earlier.

Imports grew much faster than exports in January-June: 18% y/y versus 7.6% y/y, reaching EUR 9.344bn and EUR 6.142bn respectively. The data may undergo serious revisions in the favour of the trade balance with EU.



2. External Debt

Gross external debt reached EUR 20.384bn (76.3% of GDP) in May

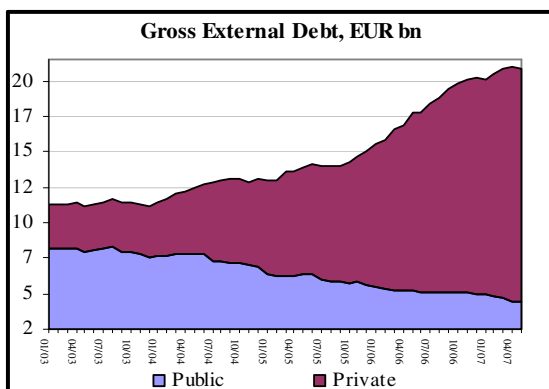
The gross external debt increased by 17.9% y/y to EUR 20.384bn as of the end of May, accounting for 76.3% of projected full-year GDP (68.9% a year earlier). On monthly base, the debt decreased marginally by 0.7% (EUR 143mn), due

to withdrawal of bank reserves from central bank and symmetric transfers to foreign parent companies.

The short term liabilities represented 32.7% (EUR 6.656bn) of the total external debt, compared to 29.5% a year earlier. The servicing of the total debt as a percentage to GDP has expanded by 2 pps y/y to 8.6%.

The public external debt reduced by 16.2% y/y to 3.910bn (14.6% of GDP) in May, taking into account the monthly increase of BGN 1.7mn.

Amounted EUR 16.475bn at the end of May, private external debt represented 80.8% of the total, which shows an increase of 7.8% as compared to the structure one year ago. External debt of the banks decreased in May (EUR 267.7mn; 7.2%), while the foreign liabilities of commercial firms and the intra-company liabilities increased (by EUR 93.8mn and EUR 29.3mn respectively). On annual base, the liabilities in the private sector to external lenders continue to rise at a very quick pace: 30.5% as of end-May.



II. REAL SECTOR

1. Inflation

2.2% inflation in July

According to NSI, consumer prices rose by 2.2% m/m in July. Inflation from the beginning of the year accelerated to 4.3%, while the year-on-year June inflation quickened to 8.4%.

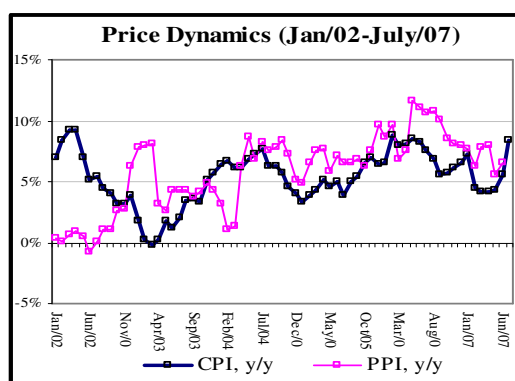
In July food prices rose by 3.9% m/m, pushed up by the double-digit increase in the price of some vegetables and eggs (10%). Damages caused by summer droughts in the farming sector push up prices of agricultural crops and related food products: flour (4.8%), bread (9.9%) and pasta (2.2%) etc.

Catering and services also went up respectively by 1.3% and 2.7% m/m.

The prices of non-foods kept their level as of the previous month. Prices of electricity (7.8%) and some fuels (1.3-1.9%) increased, while petrol prices decreased (1.3-1.6% depending of the type).

The EU-harmonized monthly consumer price index (HICP) reached 1.7% in July and the annual one - 6.8%.

The government expects inflation to slow down to 3.4% this year, while the IMF has projected an end-year inflation of under 4.5%.



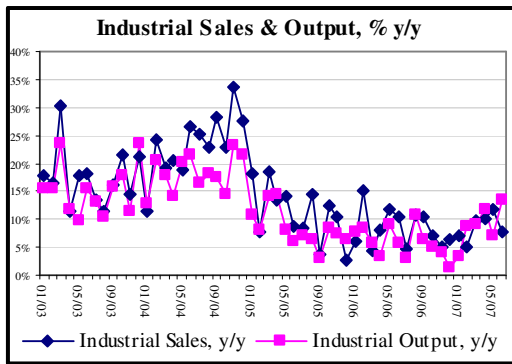
According to NSI data, producer prices inflation (PPI) on the domestic market accelerated to 6.5% y/y in June from 5.5% y/y in May, due to the upward correction in mining industries after a one-off drop in May. That affects the prices of metal processing and other manufacturing branches, relying on metal inputs.

2. Industrial Sales

Industrial sales and output grew by 7.8 % y/y and 13.3% y/y respectively in June

Industrial sales grew by real 7.8% y/y in June slowing from revised 11.9% y/y in May. The sales in metal ore mining plunged 47.1% y/y in June, bringing down the whole extraction industry (by 23.9%) and the metal processing branches. The manufacturing sector slowed to its weakest growth rate over a period of 12 months: 5.2% y/y. For third month in a row, energies utilities reported a double digit y/y growth – 49.6% in June, despite the closure of two of power units in Kozloduy.

On the other hand, industrial production improved to a growth rate of 13.3% y/y in June, as compared to 7% in May.



3. Retail Sales

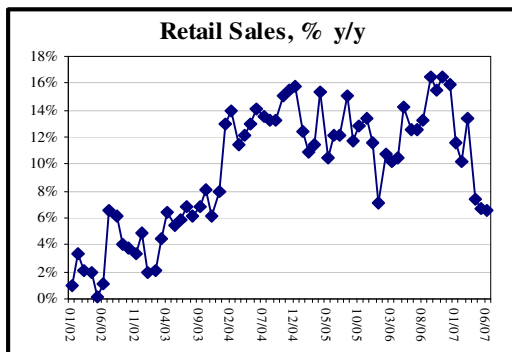
Retail sales rise 9.1% y/y in H1

According to NSI data, the retail sales growth slowed for a seventh consecutive month to real 6.5% in June (6.7% y/y in May).

The wholesale trade also decelerated in June - to 1.5% y/y from 2.4% y/y in May.

On monthly base the retail and wholesales receipts marked an increase of 3.8% and 4.4% respectively.

The period average increase in retail and wholesale trade was reported at real 9.1% and 3.4% y/y respectively in H1.



4. Household Consumption

Household monetary income and expenditure increased by 23% y/y and 25% y/y respectively in June

In June the growth of household monetary expenditure overpaced the income one: 25% y/y versus 23% and reached respectively BGN 562.61 and BGN 585.27.

Income from property and property sale, entrepreneurship and other earnings were with increased weight in the household income structure, principally to the detriment of pensions and wages.

At the same time the payments for clothing and footwear; furnishing and maintenance of the house; and taxes are moving up on the expenditure side of the households' budgets in detriment of the other items.

5. Average monthly wage

Average monthly wage rose by 17.7% y/y to BGN 406 (EUR 208) in Q2

According to NSI preliminary data, the average wage in Q2 stood at BGN 406 (EUR 208), up by 5.7% q/q and 17.7% y/y. Average wage in the private sector grew faster than in the public one (21.3% y/y versus 14.4% y/y), reaching respectively BGN 375 and BGN 484. The highest wages were in the financial intermediation - in the public BGN 1043 (EUR 533) as well in the private sector BGN 942 (EUR 482), and the lowest - in other activities BGN 298 (EUR 152) and in the private farming - BGN 276 (EUR 141), hotels and restaurants - BGN 277 (EUR 142). The most important salary growth in public and private sectors was recorded respectively in mining (40.7%) and other activities (42.9%).

6. Unemployment

Unemployment dropped to 7.25% as of end-July

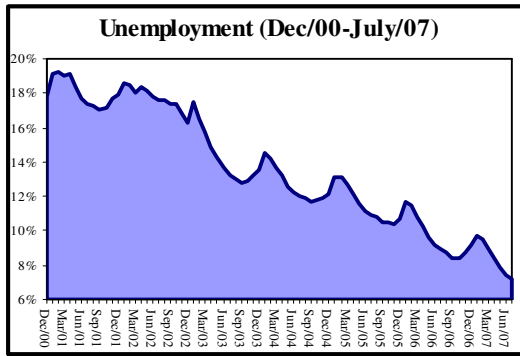
At 7.25% the July unemployment level in Bulgaria was down 1.71% from a year earlier and - 0.17% from June. Thus it is drawing closer to the EU average levels in June: 6.9%.

The drop in unemployment is due to the increased number of job openings during the summer time in the agriculture, construction and tourism sectors.

All regions except Kurdjali and Yambol reported lower unemployment rates than June.

The number of jobless people forming the main groups under observation dropped, with 20.1% of the jobless total aged under 29 and 36.4% aged over 50. The long-term unemployed were 58.8%.

In July a total of 11 465 jobs opened up (down from 15 900 in June) and 13 746 people started work (down from 17 037 in June).



III. FISCAL SECTOR

General budget surplus widened by 53.6% y/y to BGN 2.61bn (4% of GDP) in H1

A surplus of BGN 1.92bn was booked in the republican budget in H1, up 32.2% y/y.

Revenues in the republican budget grew by 21.3% y/y in June due to the 19.7% y/y rise in indirect taxes and 26.9% y/y - in direct taxes. VAT receipts registered a 28.7% y/y increase in June, the internal transactions being twofold. The revenues of excise taxes also grew - by 14.6% y/y, as a result both of their hike and more goods, subject to taxation. On the contrary, the duties revenues were reduced by 55% y/y in June, due to the adopted EU common customs tariff with third countries. The revenues from profit and income taxes grew respectively by 20.7% and 52.1% y/y, due to higher firm profit and lower unemployment.

Budgetary expenses increased by 17.7% y/y, all items of the expenditure side being above their level in June 2006. The contribution to the EU budget was BGN 19.9mn in June.

Concerning the consolidated budget, the revenues grew much faster than the expenses in H1: 17.4% y/y versus 7.9% y/y, reaching respectively BGN 11.3n and BGN 8.8bn. That resulted into a surplus of BGN 2.16bn, up 53.5% y/y.

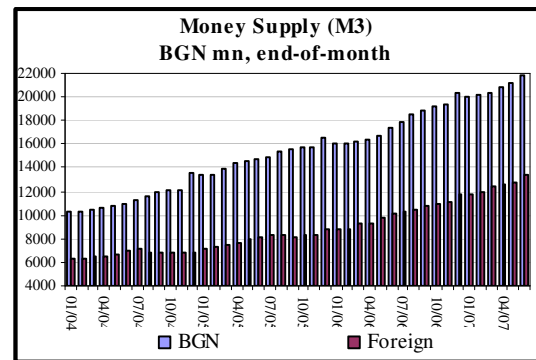
The three parties in Bulgaria's coalition Cabinet agreed on July 30 to introduce a 10% flat tax on individual incomes from 2008. The current three-bracket tax rate system will be abolished. The cabinet also intends to raise all pensions by 10% and to cut social insurance contributions by 3pps to 20% as of October. The pensions were already raised by an average of 10% as of July.

IV. MONETARY SECTOR

1. Monetary Aggregates

Money supply growth accelerated to 28.4% y/y at the end of June

According to Central Bank data, money supply (M3) growth accelerated to 28.4% y/y as of end-June from 27.7% y/y as of end-May. The fastest growing components were the overnight deposits in BGN (41.3%) and in foreign currency (48.8%). On monthly base, M3 increased by BGN 1.424bn (4.2%) to BGN 35.349bn. The share of foreign currency in M3 moved up to 38.1%.



2. Domestic Credit

Domestic credit growth accelerated from 33.9% y/y as of end-May to 35.3% as of end-June

Domestic credit growth accelerated from 33.9% y/y as at end-May to 35.3% as at end-June, according to Central Bank data. The stock of domestic credit reached BGN 26.039bn (EUR 13.313bn). Claims on government sector passed from - BGN 3.262bn as at end of May to - BGN 3.825bn a month later. **Credit** to the non-government sector increased to BGN 29.030bn in June, its annual growth rate being 47.9% y/y compared to 45.5% y/y in May. It included BGN 17.790bn credits to non-financial corporations and BGN 10.927bn loans to households and NPISH. The former grew at accelerated rates in June: 53.8% compared to 49.1% y/y in May, while the latter slackened the pace from 40.1% to 38.6% y/y.

The most important y/y increase in June was recorded by the mortgage credits: 74.6% compared to 77% in May, the annual growth rate of consumer and other loans being 17.1% and 15.9% respectively, versus 16.2% and 30.1% in May. On monthly base, the former increased by

BGN 195.7mn (4.6%) to BGN 4.412bn and represented 44.4% of all credits (except overdraft), compared to 34.9% a year earlier. The consumer loans grew by BGN 143.6mn (3.2%) to BGN 4.618bn in June, but their relative share shrunk from 54.4% to 46.5% in a year.

Domestic credit, % of GDP

	06/06	05/07	06/07
Domestic credit	39,2%	47,7%	49,8%
Claims on general government	-2,0%	-6,2%	-7,3%
Claims on non-government sector	41,2%	53,9%	57,1%
o/w Loans	40,0%	52,5%	55,5%
Non-Financial Corporations	23,6%	31,7%	34,0%
Financial Corporations	0,4%	0,5%	0,6%
Households and NPISH	16,1%	20,3%	20,9%
Consumer loans	8,0%	8,6%	8,8%
Loans for house purchase	5,1%	8,1%	8,4%

Source: BNB's Monetary survey

V. FINANCIAL SECTOR

From 1 January 2007, the BNB introduced a new consolidated financial reporting framework, applicable to the EU credit institutions. The credit portfolio includes both banks and non-banks.

Loans extended to corporate clients and households increased by 47.1% y/y in Q2

At the end of June the total assets of the banking system reached BGN 47.216bn (90.3% of GDP), marking an increase by BGN 2.327bn (5.2%) for a month, and by BGN 11.229bn (31.2%) for a year. The intensified activities in the month have impacted the quarterly dynamics, thus resulting in a 6.1% growth in the period April – June.

The merger of three banks of the UniCredit Group in Bulgaria resulted in an enhanced concentration, and the five largest banks account for 56.5% of the assets in the banking system as of end-June.

The quick growth of bank lending after the AMRR revocation has a significant impact on the amount of *loans and receivables (including financial leases)* and their weight comes near to 77% of the assets in the system. The BGN 3.128bn increase of *loans and advances* in the second quarter is financed by the released cash and increased *deposits*, and *subordinated liabilities and capital*. In this period, gross loans and advances to corporations and retail exposures mark a significant growth (14.9%), as the annual growth rate is 47.1%.

Financial liabilities designated as at fair value, being the chief source of financing for the banking

business, increased by BGN 2.316bn in the quarter, which makes 74% of credit and advances growth. In spite of contracting *deposits of credit institutions*, the aggregate reports increase at a rate near to growth rate of assets. *Deposits of institutions other than credit institutions* increase by 8% amounting to BGN 32.249bn. Funds attracted from individuals and households, being part of this category, increase by 5.5%, and as of end-June account for approximately 39% of the total attracted resources in the banking system.

In the first six months of 2007, the banking sector reports a profit of BGN 490bn., i.e. by BGN 148bn (43.4%) higher than in the same period of the previous year.

The BNB approved an increase in the required reserves of the commercial banks held at the central bank by 4pps to 12% of deposits, effective as of September 1. The new measure results from the robust credit growth which raises the overall credit risk of the banking system in the conditions of falling interest rates due to the vigorous competition.

End-June pension funds assets up 46.7% y/y

The net assets of the private pension funds, operating in Bulgaria, rose by 46.7% on the year to BGN 1.852bn at the end of June (or 3.4% of projected GDP).

About 30% of the pension savings are held in voluntary funds, 19% - in professional and 51% - in universal funds.

The number of pension fund holders totalled 3.3mn at end-June, up 6.95% y/y. 76.6% are insured in universal pension funds, 17.4% - in voluntary and 6% - in occupational funds.

Substantial changes were observed in their investment portfolio in Q2, compared with the year-ago period. The relative share of government securities in the portfolios of mandatory and occupational funds decreased by nearly 20% and by nearly 25% as concerns voluntary funds. At the same time, nearly 30% of the investment portfolio is held in equities (27% for universal, 29% for professional and 31 for voluntary funds). Investments in foreign securities also increased.

New records on the BSE in July

For third month in row, the capital market followed an upward trend.

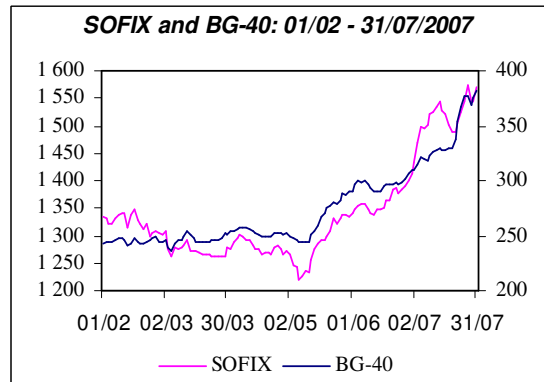
Two IPOs were completed in July. Specialized Business Systems (SBS) successfully raised BGN 2.29mn in an IPO which was 5 times oversubscribed. The other IPO was that of mineral water distributor – Devin AD. The issue attracted orders for BGN 235mn through a book-building and was 11 times oversubscribed.

The non-consolidated half year reports published at the end of July were positive as whole.

The SOFIX hit a new all time high of 1569.7points in July, gaining 11.2% m/m and 68.8% y/y. BG-40 made even better, adding 23% on a month and -116.2% in a year to 381.18 points. The market capitalization of Sofia Stock Exchange increased by 9.2% to the record BGN 22.7bn (43% of GDP) in July.

August is expected to be relatively calm as the accent of the month will be the publication of consolidated half-year reports.

As from September 3, the BSE-Sofia starts calculating two new indices: BG-REIT and BG Total Return 30. BG-REIT will be constituted of shares in special-purpose investment companies securitizing land and other real estate and will be based on the market capitalization adjusted for free float. The second index - BG Total Return 30 - will be based on the price fluctuations of the constituent issues (the top 30 companies ranked according to 4 equal weighted criteria: market capitalization, free float, number of transactions and value traded over the past year) and each will be awarded an equal weight factor. The idea is to show the total return of the shares, including the dividends distributed.



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