



**UNITED  
BULGARIAN  
BANK**

A Member of NBG Group

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



**Current account gap widened by 69.2% y/y to 18.9% of GDP in January-November. Net FDI inflows rose by 29.4% y/y in January-November to 92% of CA gap**

**Foreign trade deficit widened by 37.2% y/y to EUR 6.572bn (23% of GDP) in January-November**

**Gross external debt grew by 31.5% y/y to 91.1% of GDP as of end-October**

**GDP growth slowed to 4.5% y/y in Q3 as agriculture fell by 43% y/y**

**Consumer price inflation slowed marginally to 12.5% y/y in December. PPI inflation accelerated to 13.2% y/y in November**

**Industrial sales growth slowed down to 5.3% y/y in November**

**Retail sales rose by 2.1% y/y in November**

**Household monetary income and expenditure increased by 19.7% y/y and 28.6% y/y respectively in November**

**Unemployment rate reached 6.91% y/y in December**

**Consolidated budget surplus widened by 57.5% y/y to 7.2% of GDP in January-November.**

**Money supply grew by 30.5% y/y as of end-November. Credit to non-government sector surged by 62.1% y/y at end-November**

**Banks' net profit grew by 55.2% y/y to EUR 536 mn in January-November**

**Pension funds reported double-digit return rates for the past two years**

**In November bourse indices fell by 15% and the BSE lost nearly BGN 2.2 bn (8%) of its market capitalisation**

**I. EXTERNAL SECTOR**

**1. Balance of Payments**

**Current account gap widened by 69.2% y/y to 18.9% of GDP in January-November**

Current account (CA) gap widened by 69.2% y/y to EUR 5.291 bn in January-November according to Central bank preliminary data. In relative terms, the CA gap accounted for 18.9% of the projected full-year GDP in January-November relative to 12.5% a year ago. In November alone, the CA deficit expanded by 55.3% y/y to EUR 746.4 mn.

Merchandise foreign balance continued to be the main factor for the CA gap widening.

Service balance posted a surplus of EUR 2.175 bn in January-November, up by 9.5% y/y. Tourism revenues rose by 11.3% y/y. In November, the service balance was negative amounting to EUR 64mn relative to a negative balance of EUR 5.6 mn a year earlier as a result of the larger outflows on tourism and transport items.

Net income balance was negative amounting to EUR 93.7 mn in January-November relative to a positive balance of EUR 79 mn a year earlier. In November for a second month in a row the income balance marked a surplus of EUR 55.6 mn, up by 57.7% y/y.

Net current transfers decreased by 49.1% y/y to EUR 312 mn in January-November and by 16.2% y/y to EUR 50.4 mn in November.

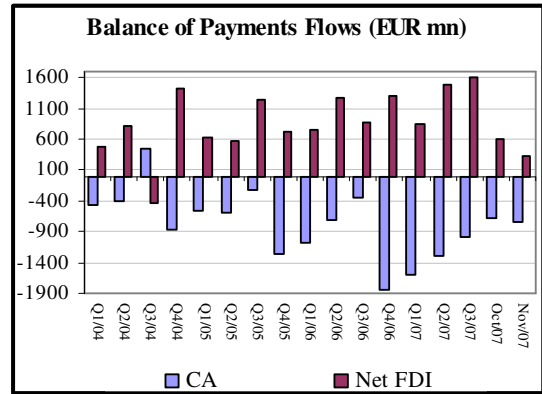
The overall balance of payments improved by 81.3% y/y to EUR 3.293 bn in January-November, on the back of strong debt and not-debt inflows in the financial account. The net increase in foreign reserves is however fully linked to debt inflows, as the non-debt financial inflows have moved below the CA gap.

The Ministry of Finance has recently revised upwards its estimate of the CA deficit to 21% of GDP for 2007 and expects further deterioration to 21.9% for 2008.

**Net FDI inflows rose by 29.4% y/y in January-November to 92% of CA gap**

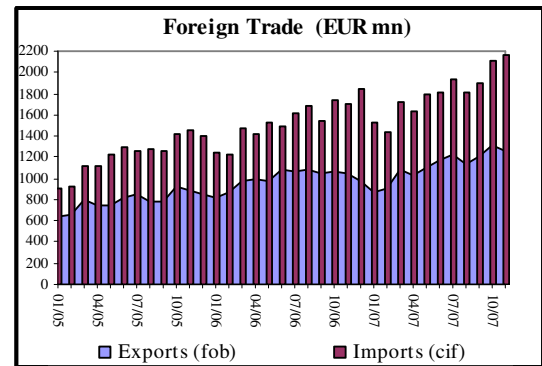
Net FDI inflows rose by 29.4% y/y to EUR 4.88bn in January-November covering 92% of the CA gap for the same period, according to Central bank preliminary data. The inflows however dropped by 3.3% y/y in November that could be a signal of adverse effects from the internal mortgage crisis

that could seriously weaken foreign investor interests in purchase of vocational real estates. Such deals constituted about 50% of the FDI inflows in the past 2-3 years. Reinvested earnings also contributed to the reduced FDI inflow in November.



**Foreign trade deficit widened by 37.2% y/y to EUR 6.572bn (23% of GDP) in January-November**

Foreign trade deficit widened by 38.2% y/y to EUR 788.5mn in November alone and 37.2% y/y to EUR 6.572 bn in January-November, according to Central bank preliminary data. Exports grew by 20.7% y/y in November as compared to 23.1% in October. Imports (cif) increased at a quicker pace of 27.3% y/y in November and the trade balance worsened to 23% of the projected full-year GDP in January-November as compared to 19% a year earlier.

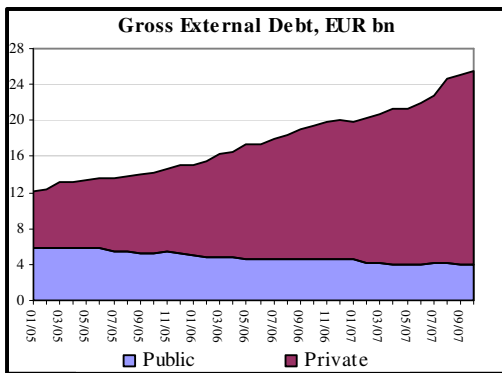


**2. External Debt**

**Gross external debt grew by 31.5% y/y to 91.1% of GDP as of end-October**

Gross external debt grew by 31.5% y/y to EUR 25.5 bn as of end-October accounting for 91.1% of the projected full-year GDP, according to Central bank preliminary data. Robust domestic demand continued to spur the accumulation of debt in the private sector, which reached a share of 84.4% in the total, up by 0.4pps as compared to the previous month and 8pps on an annual basis. The public liabilities decreased by 12.4% y/y and 0.7% m/m to EUR 4bn as of end-October. The share of short-term debt dropped marginally by 0.2pps in a month to 31.8% of the total external debt.

Internal financing within foreign-owned companies accounted for 35% of the total external debt. Banks' external debt rose by 46.3% y/y to EUR 4.6 bn (16.4% of GDP) as of end-October. The foreign liabilities of commercial firms (state-owned and private companies) grew by 31.7% y/y to EUR 8.916bn as of end-October.



**II. REAL SECTOR**

**1. Gross Domestic Product**

**GDP growth slowed to 4.5% y/y in Q3 as agriculture fell by 43% y/y**

The real economic growth slowed to 4.5% y/y in Q3 and 5.7% y/y in January-September versus 6.4% y/y in H1, according to NSI preliminary data. Nominal GDP stood at BGN 15.659bn (EUR 8.006 bn) in Q3 and BGN 40.133 bn (EUR 20.52 bn) in January-September.

The agricultural sector plunged 43% y/y due to unfavourable weather conditions and very weak

capacity of farmers for offsetting negative effects from droughts, floods, and other natural disasters. The country turned into a net importer of agricultural products for the first time in the last few years as a result of the weather shocks while price indicators surged to double-digit levels. The value added in the other two sectors, industry and services, grew at accelerated rates of 12.8% y/y and 11.1% y/y, respectively.

Real changes (% y/y)	2005	2006	Q1/07	Q2/07	Q3/07	Jan-Sep/07
Agriculture	-9,4	-1,9	2,5	-5,3	-4,3	-26,4
Industry	4,8	8,2	7,6	10,5	12,8	10,5
Services	8,2	6,1	8,1	9,5	11,1	9,7
<b>GDP</b>	<b>6,2</b>	<b>6,1</b>	<b>6,2</b>	<b>6,6</b>	<b>4,5</b>	<b>5,7</b>
Consumption	5,3	6,5	7,0	5,2	4,3	5,4
Investment (excl. inventories)	23,3	17,6	35,9	24,7	19,7	25,9
Export	8,5	9,0	2,2	5,7	6,2	4,9
Import	13,1	15,2	13,2	10,7	9,6	11,1

Source: National Statistics Institute

Both consumption and investment slowed down and lowered the pressure on domestic and import demand. Exports growth sped up to 6.2% y/y in Q3 in line with the industrial rebound and solid tourism performance but was still unable to offset the rapid deterioration in the CA balance. The economic growth is expected to recover in Q4 as the agricultural sector will have a smaller seasonal weight. However, the full-year growth is not likely to exceed 6% of GDP while the budget forecasts for 2008 are drafted under a growth projection of 6.4% for 2007.

**2. Inflation**

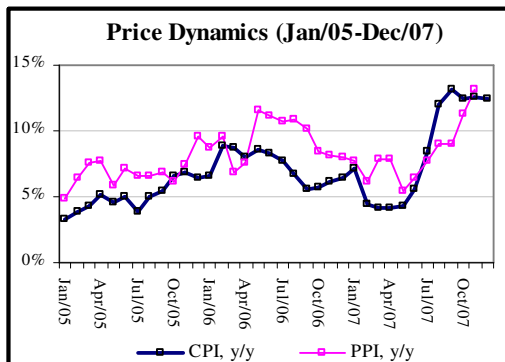
**Consumer price inflation slowed marginally to 12.5% y/y in December**

The consumer price index slowed marginally to 12.5% y/y in December from 12.6% y/y in November, according to NSI data. The deceleration resulted from the slowdown of the price indices of food items from 21.6% y/y in November to 20.8% y/y in December. The other price indices of services and catering items marginally moved up to 8.1% y/y and 20% y/y in December from 7.8% y/y and 19.6% y/y in November, respectively. On a monthly base, CPI also slowed down to 1.1% in December from 1.6% in November.

However, the index marked significant acceleration from 6.5% y/y at end-2006 to reach the highest end-year rate since the hyperinflation

period in 1996 and 1997. In annual average terms, the CPI dynamics indicates a much weaker pace of acceleration to 8.4% in 2007 from 7.3% in 2006 and is below the post-crisis peak of 10.3% reached in 2000. Roughly two-thirds of the consumer price inflation is generated by weather-related unfavourable factors in the agricultural sector and related food industries, helped by a huge budget expenditure boost in the last month of the year.

As regards the harmonised index of consumer prices (HICP) used as a main price gauge by ECB, the index accelerated slightly to 11.6% y/y in December from 11.4% y/y in November. The annual average HICP is estimated at 7.6% - - 0.8pps below the national index but more than two times above the line ceiling for the euro adoption price criterion. According to government projections, the annual average CPI inflation is expected to move down to 6.9% and the end-year CPI inflation to decelerate to 4.5%.

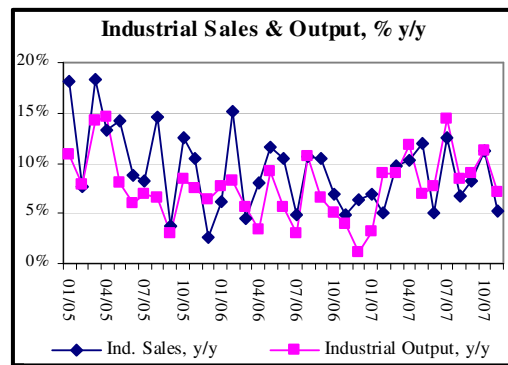


The producer price index covering industrial goods traded on the domestic market accelerated to 13.2% y/y in November versus 11.3% y/y in October, according to NSI. Prices of extraction and processing of metals dropped by 1.2% y/y and 2.2% y/y respectively and eased the pressure on the overall index. The prices in processing industry sped up by 15.4% y/y in November as compared to 11.3% y/y in October pushed by the hikes in several branches like production of electrical machines, precision and medical appliances and manufacturing of rubber and plastic products. Food producer prices remained on a disinflation mode for a fourth month in a row but still at a very high rate of 22.7% y/y following contraction of the value added in agriculture by almost 50% in Q3.

**3. Industrial Sales**

**Industrial sales growth slowed down to 5.3% y/y in November**

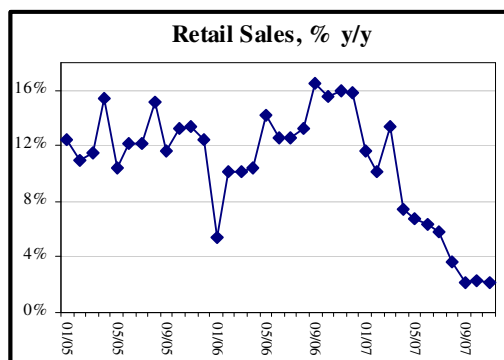
Industrial sales growth slowed down to 5.3% y/y in November as compared to revised 11.3% y/y a month earlier, according to NSI preliminary data. Industrial production also slowed down its growth rate from the revised 11.3% in October to 7.1% y/y in November. The faster increase of production reflects positive changes in inventories. Sales in manufacturing sector suffered even a steeper slowdown to 3.6% y/y in November from 10.1% in October as a result of the weak export performance. The mining industry dropped again by 19.6% y/y in November. Metals extraction and processing dropped by 33.6% y/y and 25.4% y/y in November. Food sales as well as rubber and plastics production reversed to negative rates while chemical products and automobiles manufacturing grew at much weaker pace than in previous months.



**4. Retail Sales**

**Retail sales rose by 2.1% y/y in November**

Retail sales growth slowed marginally to 2.1% y/y in November against 2.3% y/y in October, according to NSI data. Sales of food and home appliances remained almost flat on an annual basis. However, the record-high budget spending in December, including end-year bonus payments to pensioners and civil servants, have most likely pushed up retail sales to much higher growth rates in December. This will also have some impact on wholesales, which dropped by 1.7% y/y in November as compared to a growth of 1% in October.



## 5. Household Consumption

**Household monetary income and expenditure increased by 19.7% y/y and 28.6% y/y respectively in November**

Household monetary income increased by nominal 28.6% y/y in November, according to NSI data. The indicator accelerated from 16.7% y/y in October and outpaced that of the household monetary expenditure which slowed down to 19.7% /y in November from 22.6% a month earlier. The incomes from sale of property increased more than seven times that is quite indicative of ongoing activities for purchase of real estates by foreigners, on one hand, and aggregation of land through special-purpose funds registered on the local stock exchange. Consumption and incomes are expected to speed up in the last month of the year due to regular end-year bonuses and excessive fiscal transfers to various state-run undertakings in the last months of the year that will have indirect impact on aggregate domestic demand.

## 6. Unemployment

**Unemployment rate reached 6.91% y/y in December**

Unemployment rate fell by 2.21pps to 6.91% y/y in December from 9.12% y/y in December 2006, according to National Employment Agency. On a monthly basis, the unemployment rate edged up 0.29pps. The number of jobless decreased by 81 886 over the past year but increased by 10 635 people as compared to a previous month to 255 910 in December. The average annual unemployment rate dropped to 7.75% y/y from 9.61% in 2006.

## II. FISCAL SECTOR

**Consolidated budget surplus widened by 57.5% y/y to 7.2% of GDP in January-November**

The consolidated budget surplus widened by 57.5% y/y to BGN 3.959 bn (EUR 2.02 bn) in January-November, according to Finance Ministry data. In relative terms, the surplus accounted for 7.2% of the projected full-year GDP and 8.2% when the transfer to the EU budget is excluded. A part of the surplus was spent in December, so the consolidated budget will end the year at a smaller positive balance. Nevertheless, the full-year budget surplus would be about 4% of GDP the revised Finance ministry estimate for 3.3% of GDP. The fiscal revenues grew by 20.4% y/y in the reporting period exceeding the full-year projection by 1.5%. The fiscal expenditures rose by 10.9% y/y in January-November accounting for 84.4% of the annual plan.

Republican budget surplus increased by 39.3% y/y to BGN 3.363 bn (EUR 1.719 bn) in January-November. Republican budget revenues and grants accounted for BGN 14.7 bn, up by 20.5% y/y due to the increased direct tax revenues.

Tax revenues rose by 20.9% y/y in January-November. Direct taxes marked the biggest increase of 32.8% y/y and exceeded the full-year projection by 15.4%. Indirect tax revenues rose by 17% y/y.

Import duties, however, would most likely remain below the indicative level set in the budget as they are just 73.3% of the plan in January-November. China and Brazil accounted for half of all collected import duties during the period.

Republican budget expenditure (excl. the transfers) increased by 8.6% y/y in January-November.

According to Ministry of Finance, the main drivers for the good revenue performance have been the stable economic growth, the high investment activity, the cut in direct taxes, the fight with the tax and duty violations, the high import growth rate and the high oil prices.

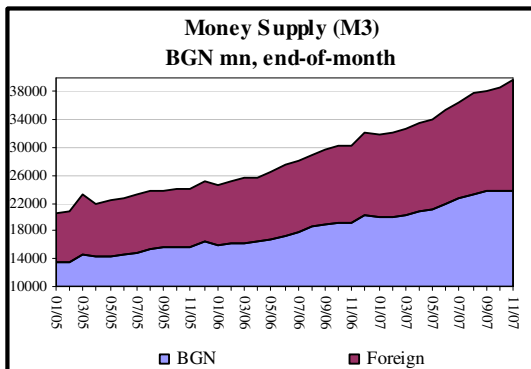
**IV. MONETARY SECTOR**

**1. Monetary Aggregates**

**Money supply grew by 30.5% y/y as of end-November**

Money supply (M3) growth rate accelerated from 28.5% y/y as of end-October to 30.5% as of end-November according to Central bank data. On a monthly base, money supply increased by 2.2% or by BGN 849.4 mn. The increase was due to the higher deposits with agreed maturity up to 2 years, which marked a 35.4% y/y growth as well as to the higher overnight deposits which rose by 33.8% y/y as of end-November.

The foreign reserves of the Central bank rose by 1.8% m/m to BGN 23.534 bn (EUR 12.033 bn) on the back of the increase in the government deposits with the Central bank. The government deposits reached BGN 8.518 bn (EUR 4.355 bn). The foreign reserve coverage of the money base rose considerably as compared to a previous month and reached 190% as a result of the increased foreign reserves and the drop in the money in circulation. The monetarization of the economy reached 72.2% of the projected full-year GDP.



**2. Domestic Credit**

**Credit to non-government sector surged by 62.1% y/y at end-November**

Domestic credit growth accelerated from 51.8% y/y as of end-October to 55% y/y as of end-November, according to Central Bank data. In relative terms, the domestic credit reached near

55% of the projected full-year GDP. Credit to non-government sector continued to grow reaching BGN 35.062 bn (EUR 17.9 bn), up by 62.1% y/y as of end-November. More than a half of the credit to the private sector was granted to the non-financial companies ( 61.2%), followed by households and NPISH with 37.7%. Credits to households and NPISH rose by 52% y/y as of end-November.

Domestic credit, % of GDP

	11/06	10/07	11/07
<b>Domestic credit</b>	<b>39,6%</b>	<b>53,0%</b>	<b>54,9%</b>
Claims on general government	-5,9%	-9,8%	-10,7%
Claims on non-government sector	45,4%	62,8%	65,5%
o/w Loans	44,1%	61,3%	63,9%
<b>Non-Financial Corporations</b>	<b>25,9%</b>	<b>37,4%</b>	<b>39,1%</b>
<b>Financial Corporations</b>	<b>0,5%</b>	<b>0,7%</b>	<b>0,7%</b>
<b>Households and NPISH</b>	<b>17,7%</b>	<b>23,2%</b>	<b>24,1%</b>
Consumer loans	8,0%	9,9%	10,3%
Loans for house purchase	6,5%	9,4%	9,6%
<b>Deposits</b>	<b>53,3%</b>	<b>65,0%</b>	<b>66,9%</b>
<b>Assets</b>	<b>81,5%</b>	<b>97,0%</b>	<b>100,2%</b>

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

The mortgage loans continued to decelerate their growth pace from 72% y/y as of end-October to 65.7% y/y as of end-November. On the contrary, consumer loan growth continued to accelerate to 44.8% y/y as of end-November from 41% y/y as of end-October.

**V. FINANCIAL SECTOR**

**1. Banking Sector**

**Banks' net profit grew by 55.2% y/y to EUR 536 mn in January-November**

The aggregated net profit of the commercial banks rose by 55.2% y/y to BGN 1.048 bn (EUR 536 mn) in January-November, according to Central bank data. The total value of assets increased by 37.4% y/y to BGN 54.9 bn (EUR 28.1 bn) at end-November and exceeded the nominal GDP estimate for 2007.

Gross loans to enterprises surged by 64% y/y to BGN 22.895 bn as of end-November.

Retail exposures rose by 58.6% y/y to BGN 12.449 bn. Mortgage loans increased by 69.1% y/y to BGN 5.544 bn. Consumer loans amounted to BGN 6.904 bn in January-November, up by 51% y/y.

The funds attracted by commercial banks as of end-November totalled BGN 48.132 bn (EUR 24.61bn) or 87.7% of the full-year GDP projection. Deposits of private sector (corporate deposits plus deposits of individuals and households) accelerated their growth rate from 37.7% y/y as of end-October to 40.3% y/y as of end-November. Their total amount stood at BGN 36.723 bn (EUR 18.776 bn). The private sector deposits accounted for near 67% of GDP.

The number of the banks active in the country dropped to 29 after the merger of the local subsidiaries of the Greek Eurobank EFG – DZI Bank and Post Bank, into Eurobank EFG Bulgaria, which became the country's fifth largest bank. The five largest players on the market account for 56.9% of total assets.

## 2. Pension Funds

### *Pension funds reported double-digit return rates for the past two years*

The eight pension insurance companies operating on the local market achieved double-digit return rates for all funds with voluntary savings and for most of the mandatory (second-pillar) instruments for the past two years. However, the average return rates posted by the pension funds as of end-December 2007 were lower compared to end-September: 12.06% for universal funds, 12.48% for professional funds and 12.84% for voluntary funds versus 12.88%, 13.75% and 14.34%, respectively. The return rates reported by Financial supervision commission (FSC) range from 10.17% to 20.4% for funds accumulated by voluntary savings, from 9.56% to 16.06% for universal funds and from 9.52% to 16.95% for professional funds covering high-risk labour categories.

The FSC set a minimum annualized yield of 7.24% on universal funds' assets for the past 24 months and – 7.49% on occupational ones. None of the funds has exceeded the return set cap.

All funds registered lower average return rates as compared to end-September due to the the downward correction on the local stock exchange in the last quarter of the year.

## 3. Stock Exchange

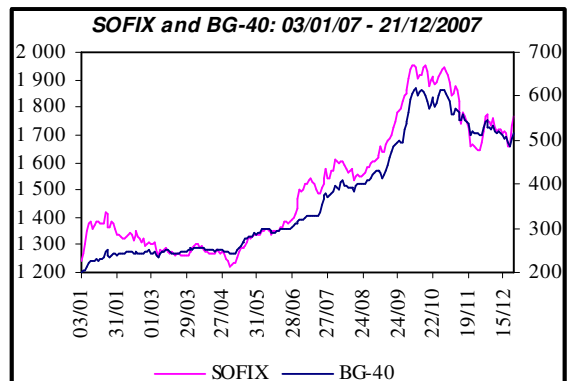
### *SOFIX lost more than 6% of its value since the beginning of December. BG 40 slipped by nearly 10% over the same period*

Public offerings of Zarneni Hrani Bulgaria and Billboard AD have been carried out on the BSE in December.

Bulgarian blue-chip industrial group Chimimport gained BGN 192 mn from the initial public offering (IPO) of 25% of its grain business Zarneni Hrani Bulgaria. The company offered to investors a total of 42 696 400 shares. The company's shares were traded at BGN 4.50 per piece or close to the low end of the guide price range of BGN 4.4 to BGN 5.6. Shares offered to local investors were 2.5 times oversubscribed and those offered to foreign investors were 1.5 times oversubscribed. Shares subscribed by local investors account for 15% of the company's share capital and those subscribed by foreign investors are equal to 10%. Zarneni Hrani Bulgaria was set up through the merger of Sofia-listed Slynchevi Luchi company and seven other grain companies majority-owned by Chimimport, in a move aimed at consolidating the group's grain business.

The public offering of Billboard AD was 13.91-fold oversubscribed. The submitted orders for the advertising and printing company's shares exceeded BGN 174.4 mn. The orders will be fulfilled at a price of BGN 7.30. More than 1 000 individuals and companies took part in the IPO. Billboard offered to investors 1.5 mn new shares with a par value of BGN 1 each. The shares were offered through a book-building method. The operation will increase the company's capital from BGN 6 mn to BGN 7.5 mn. The free float of the company will stand at 20% after the stock is registered for trade on BSE. Billboard specialises mainly in the wide format printing of advertising materials. The company will use the amount to finance its investment programme.

The blue-chip index SOFIX lost more than 6% of its value since the beginning of December. The broader BG 40 slipped by nearly 10% over the same period. The combined market capitalization of the companies listed on BSE gone down by BGN 500 mn to BGN 27.4 bn in the period December 1 to 18.



In December Sopharma and Corporate Commercial Bank (Corp CBank) were included in the calculation of the new CECE MID CAP (CECE MID) regional index of the Vienna Stock Exchange (VSE).

The new index includes 30 of the most actively traded stocks listed on the stock exchanges in Central, Eastern and Southeastern Europe. These are also the stocks with the highest market capitalisation.

When the stocks of Sopharma and Corporate Commercial Bank comply with certain criteria for market capitalisation and traded volume they will be transferred to VSE's universal CECE Extended index. Chimimport is the only Bulgarian stock included in the CECE Extended index so far. No more than six stocks from the same country may be included in the CECE MID index, according to VSE's regulations. The common weight of each stock exchange included in the index should be up to 40% and the weight of each individual participant is limited to at most 10%. The new index CECE MID comprises companies listed on the stock exchanges of Bucharest, Prague, Warsaw, Budapest, Belgrade, Sofia, Ljubljana and Zagreb.

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