GOVERNMENT DEBT REVIEW • 2003

Republic of Bulgaria
Ministry of Finance

Government Debt Review • 2003

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Abbreviations

GDP	Gross Domestic Product
BNB	The Bulgarian National Bank
G24	The Intergovernmental Group of Twenty-Four
EBRD	The European Bank for Reconstruction and Development
EIB	The European Investment Bank
EU	The European Union
LSPDACB	Law on State Protection of Deposits and Accounts with Commercial Banks in Respect Whereof the BNB Has Petitioned the Institution of Bankruptcy Proceedings
ZUNK	Law on Settlement of Nonperforming Credits Negotiated prior to 31 December 1990
LIBOR	The London Interbank Interest Rate
IMF	The International Monetary Fund
MF	The Ministry of Finance
NSI	The National Statistics Institute
WB	The World Bank
SDR	Special Drawing Rights
USD	The United States' dollar
DISCs	Discount Bonds
FLIRBs	Front Loaded Interest Reduction Bonds
IABs	Interest Arrears Bonds
JBIC (JEXIM)	The Japan Bank for International Cooperation (formerly the Japan Export-Import Bank)

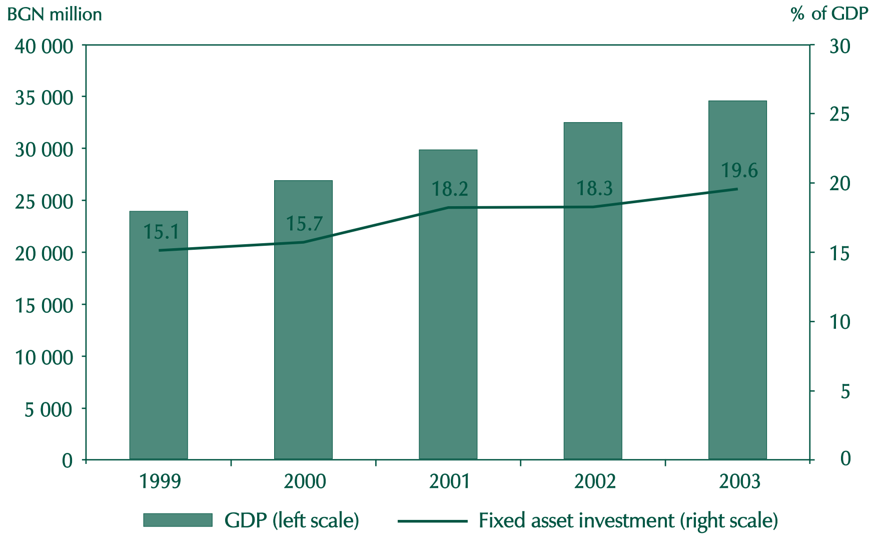
Contents

I. Bulgarian Economic Performance in 2003

The favourable movement of major macroeconomic indicators in recent years and prudent fiscal policy were the major contributors to economic stability and to protecting the Bulgarian economy from detrimental external influences. Though lower than government forecasts, real GDP grew by 4.3 per cent in 2003, accompanied by increased domestic demand and capital investment. A poor harvest and the slower growth of services were among the main reasons for growth being 0.6 percentage points lower than in 2002. Despite strong growth in goods and services exports, net exports contributed insignificantly to GDP growth during the year due to matching import growth.

Bulgaria maintained relatively high and stable real GDP growth, yet in 2003 it still lagged behind Central Europe and euro area averages. Yet, as distinct from 2002, significant growth marked the Baltic nations, with 7.4 per cent in Latvia and 6.6 per cent in Lithuania.

GDP Share of Fixed Asset Investment



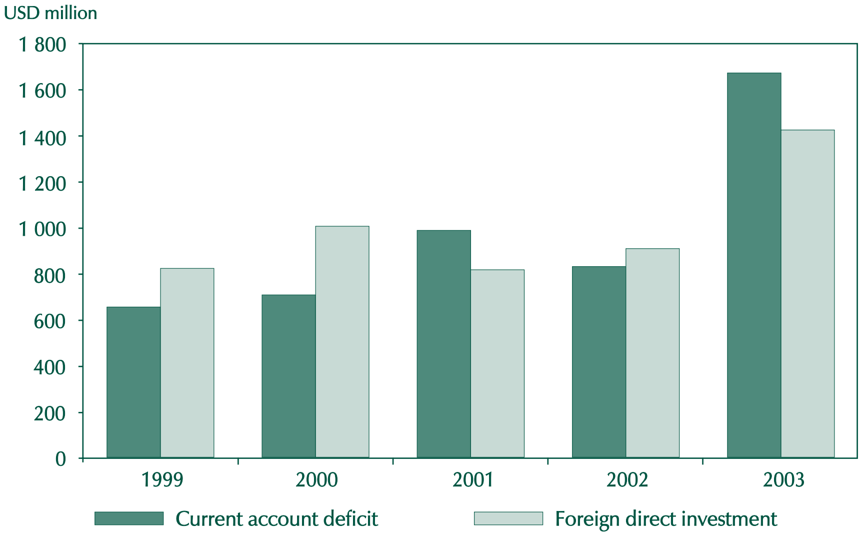
Source MF.

Bulgarian industry developed exceptionally dynamically compared with Central and East European averages. This welcome result owed most to rising exports of industrial goods. Expectations of EU growth and the exceptionally clement business climate promise further industrial growth.

Unemployment fell significantly. Social sphere reform and government employment programs over the last three years enabled Bulgaria to cut joblesness to a level comparable with those of EU First Wave accession states. Over 2003 unemployment fell 2.8 percentage points to 13.5 per cent at the close of the year. The gradual expansion of private sector job opportunities contributed to this.

The boost in private consumption resulting from a significant credit expansion, along with the rapid development of financial intermediation, contributed directly to an undesirable growth in the current account deficit at rates exceeding those of prior periods. A 14.8 per cent growth in imports, mainly raw materials for export oriented manufacturing, far outstripped the 8 per cent export volume growth during the year. The growth in investment goods imports (equipment and machinery) by some 17 per cent in 2003 was also a meanigful sign of a business reactivation and a broadening of production capacity. Amid lower than expected growth in leading industrial economies, Bulgarian exports grew for a successive year. Some 67 per cent of the nation's 2003 exports were destined for European markets (the 25 EU member states and Romania), with the overall volume of output sold in the European Union growing by 11.6 per cent.

Foreign Direct Investment



Source MF.

The year saw a record increase in foreign direct investment into Bulgaria. Final data put its size for the year at USD1.4b, with USD3.1b invested over the last three years. The volume of foreign direct investment largely offset (to the tune of 83.3 per cent) 2003's large current account deficit.

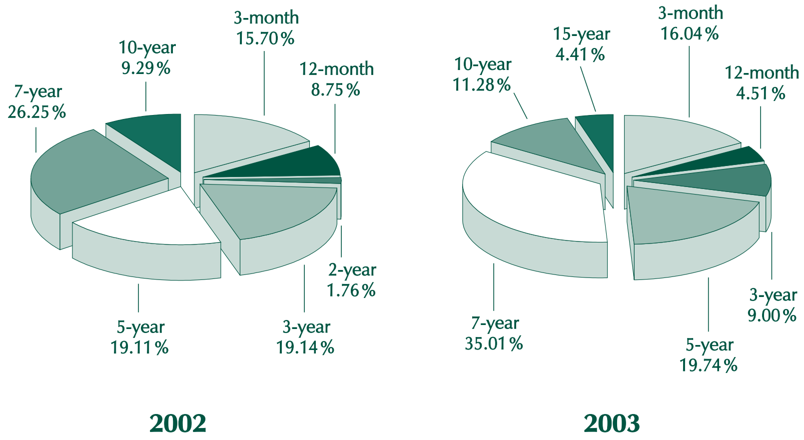
Rises in Bulgaria's foreign and domestic credit ratings reflected the fall in government debt and the aforementioned macroeconomic improvements. In 2003 leading international ratings agencies Moody's, Standard & Poor's, and Fitch, announced credit rating increases in both local and foreign exchange. In mid-year, one of Asia's largest ratings bodies, the Japan Credit Rating Agency, assigned a BBB- rating to Bulgaria's foreign obligations.

In 2003, Bulgaria continued developing and improving its economic competitiveness. If the current state of economic parameters were maintained in coming years, it would secure a sound investment outlook and improved living standards.

II. Domestic Debt

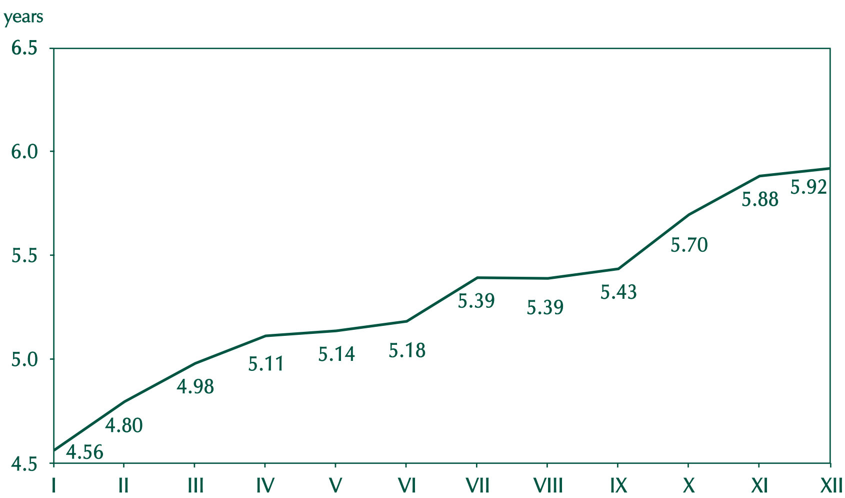
A stable macro environment and relatively fast-growing pension fund and banking and insurance assets were the major factors governing domestic debt management policy in 2003. At the year's outset, the Cabinet adopted a Government Debt Management Strategy setting government priorities for the medium term. The Strategy puts a strong emphasis on the need to develop the domestic government securities market to benefit from conditions favouring an increase of domestic at the expense of external debt. This is set to happen gradually, by reference to the balance of payments and the state of the financial system, and of the need for Budget finance.

The year saw relatively high banking liquidity and still relatively low rates of credit growth. This made government securities attractive, with the risk premium on them falling through the year. Investment in long-term instruments, which assumed ever larger proportions, and optimistic economic forecasts shifted demand to the steeper end of the curve.



Maturity Structure of Newly Issued Government Securities

Source MF.

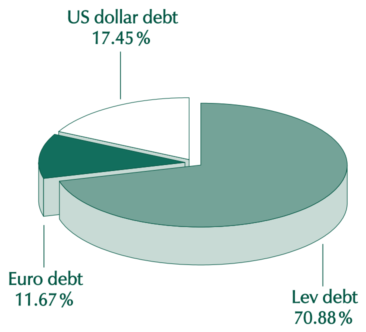


Average-weighted Maturity of Government Securities Issued for Budget Deficit Financing at the Close of Each Month

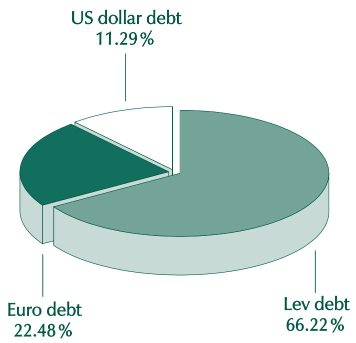
Source MF.

As set out in the Strategy, domestic debt continued growing, rising by 6.2 per cent in 2003. Positive net issues came to BGN194m. Because of changes in demand, and hence issuing, growth was greatest in seven-year bonds in circulation (BGN310.4m), followed by five- and ten-year bonds (BGN109.6m and BGN100m). For the first time, a 15-year issue was offered, denominated in euro.

Currency Structure of Domestic Government Debt



31 December 2002

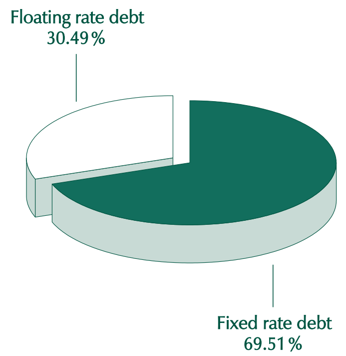


31 December 2003

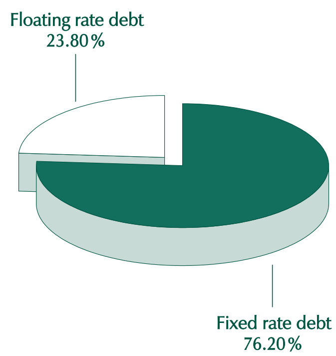
Source MF.

Debt structure showed a number of other positive changes conforming to Strategy objectives. The lev and euro shares of debt grew by 6 per cent to 88.7 per cent. This was attained by issuing only in levs and euro on the home market, cutting the dollar debt through regular amortization payments, employing it in privatization, in repaying debt to the state, and by regular swaps of bonds issued for structural reform from dollars to euro. The share of fixed interest coupons in the interest structure of debt grew from 69.5 per cent at the close of 2002 to 76.2 per cent a year on. The average original maturity of government securities issued on an auctional principle grew to five years nine months: some 18 months longer than in the prior year.

Interest Structure of Outstanding Government Securities



31 December 2002



31 December 2003

Source MF.

1. Issuing Policy

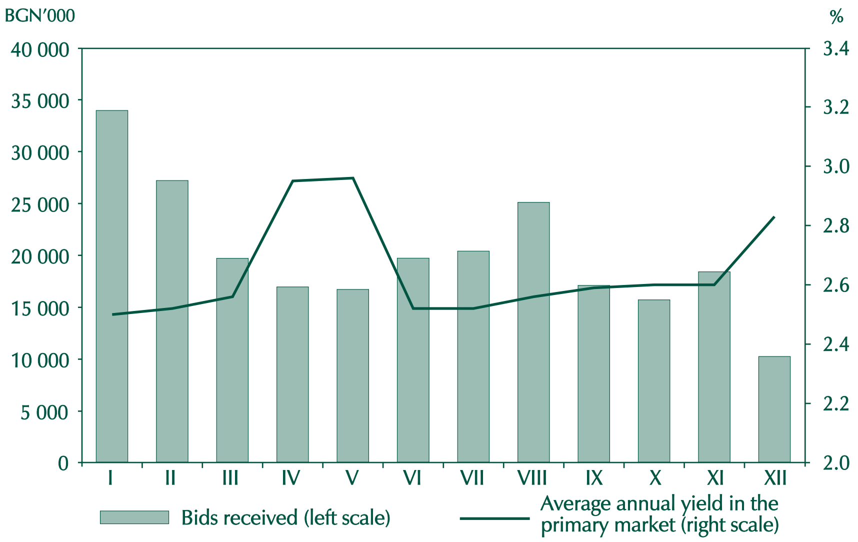
Government securities to an overall nominal value of BGN886.5m were issued on the domestic market in 2003. Of this, BGN856.6m was issued at auctions, with the balance sold directly to individual investors.

Treasury Bill Issues

Short-term government bills issued over the year came to BGN182.2m. They comprised treasury bills with three- and 12-month maturities. The average annual yield attained at auctions for three-month bills continued serving as the base for determining the base interest rate.

The frequency of three-month bill issues changed to monthly. The volume offered remained unchanged on the prior year at BGN12m. The January auction brought the lowest yield at 2.5 per cent, with the May auction bringing the highest at 2.96 per cent. The value of three-month bills offered in 2003 came to BGN144m with bids received coming to BGN240.2m. Demand was not significantly greater than supply, with an average bid-to-cover ratio of 1.66, and three-month bill yield largely reflected banking system liquidity.

Issues of Three-month Government Securities



Source MF.

There were only two issues of one-year securities in the year: in January and April, to an overall nominal value of BGN40m. No government securities with one-year maturity were offered in the year's second half due to the relatively high yield demanded by the market (4.27 to 4.36), and in line with the Strategy objective of smoothly lengthening domestic debt durations.

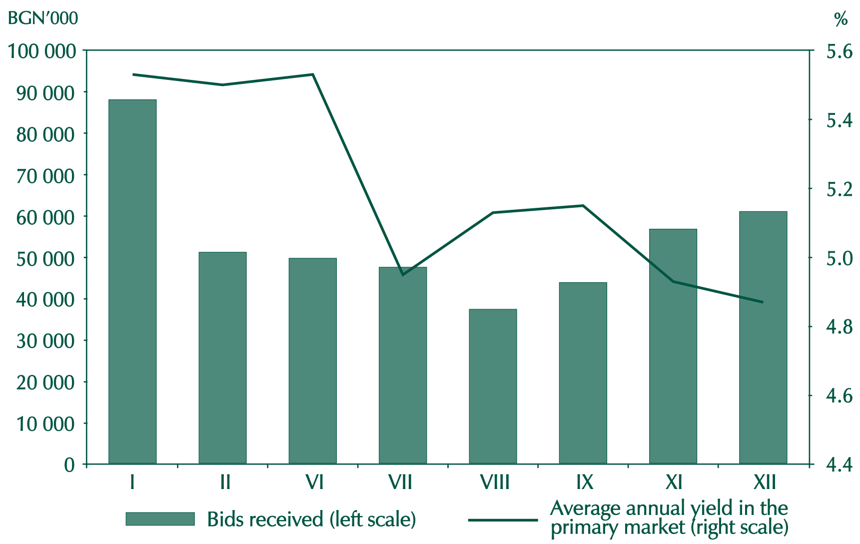
Treasury Bond Issues

Tap treasury bonds to an overall volume of BGN704.3m were issued in 2003. This represents almost 80 per cent of the sold amount. Of them, seven-year instruments had the largest share, followed by five- and ten-year securities.

Three-year bonds were offered at two auctions, in January and April. The offered amount was BGN65m, of which BGN50m was sold due to weak interest at the second opening. The auctions for three-year securities scheduled for the second half of the year were cancelled and replaced by auctions of longer maturity bonds. Yields from the two auctions reached respectively 4.93 and 5.13 per cent.

Two five-year bond issues were offered at eight auctions. Overall nominal value was BGN175m. Interest in these securities held relatively steady through the year, except in January and December, when very high banking liquidity hit demand. Bids received came to BGN433.4m, or a 2.48 bid-to-cover ratio. Five-year paper yields hovered at around 5.53 per cent in the year's first half, following demand movements and the downward trend throughout the curve in the second half.

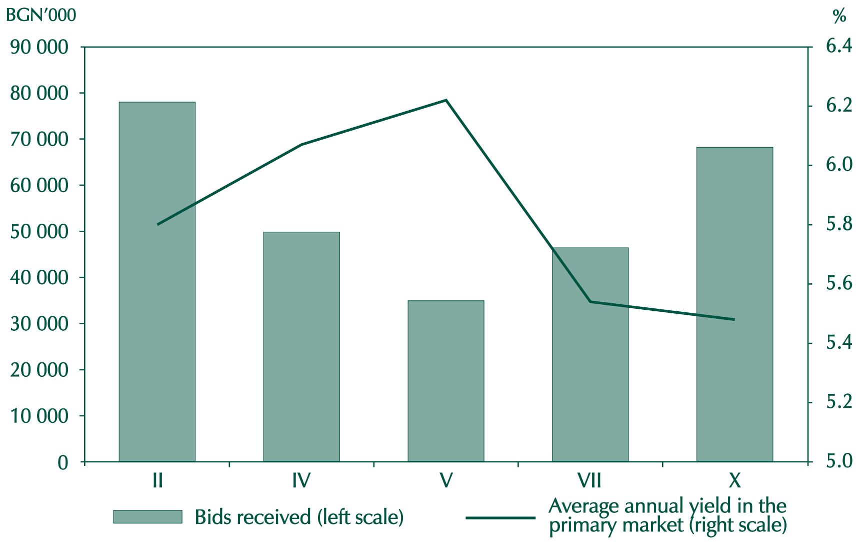
Five-year Bond Issues



Source MF.

The year saw the launch into circulation of two seven-year bond issues: one each in levs and euro. The lev bonds came to an overall volume of BGN105m and were offered at five auctions. In the first half of the year interest in the offers slowly declined (despite a lowest bid-to-cover ratio of 1.74) and the February yield of 5.8 per cent grew to 6.22 per cent in May. As early as July, however, it reversed to reach 5.48 per cent at the year's final auction. A two phase auction of euro-denominated 87-month paper also hit yield and demand for seven-year lev bonds. Great interest caused the latter issue's overall volume to be boosted to EUR105m, EUR30m more than the initial offering. Yield on these securities at the first opening in February reached 5.58 per cent or 20 basis points below seven-year lev bond yields. At the second opening a month later, yield grew by eight basis points.

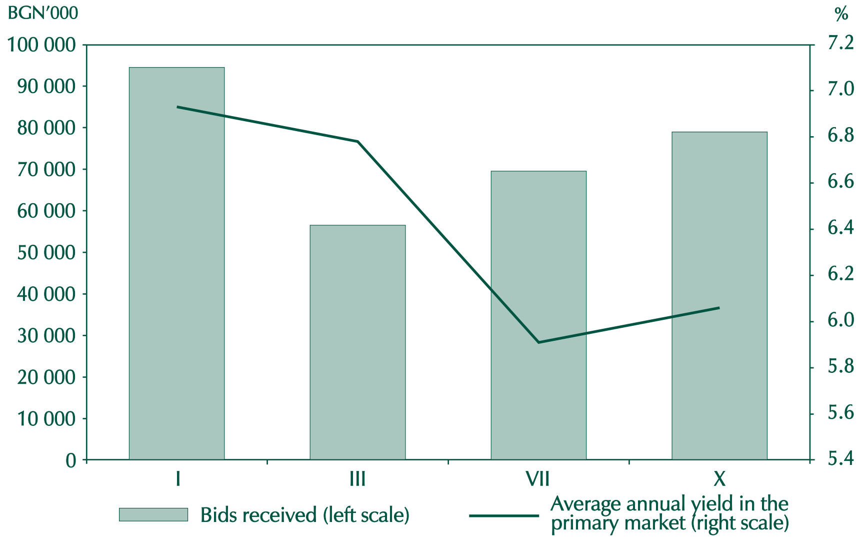
Seven-year Bond Issues



Source MF.

Two issues offered at four auctions represented ten-year paper. Interest was consistently high, with yield very closely following seven-year bonds. The overall volume of sold ten-year securities came to BGN100m, an average bid-to-cover ratio of 2.99.

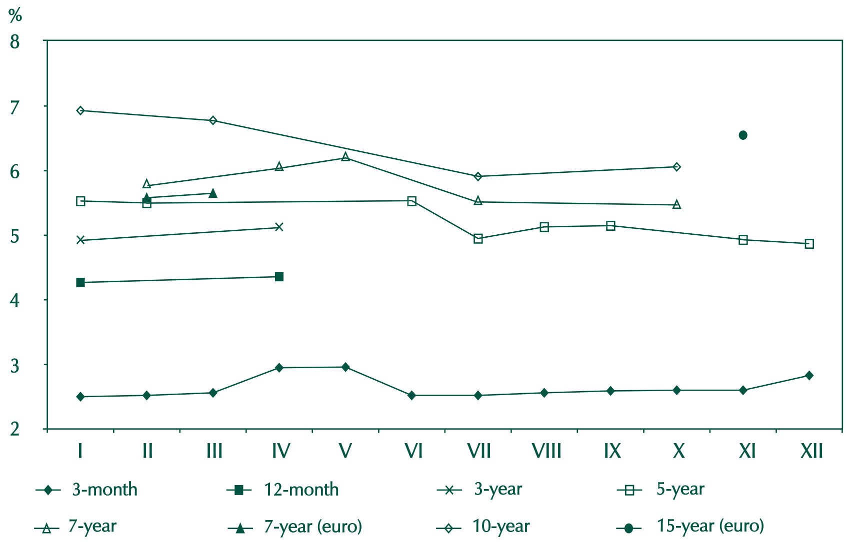
Ten-year Bond Issues



Source MF.

November saw the first auction of 15-year euro bonds. The very small offered amount of EUR20m mainly aimed to explore likely demand and yield levels. A 3.68 bid-to-cover ratio was attained, with interest shown by traditional buyers like commercial banks, as well as pension funds, insurance companies and foreign investors. Approved bids attained an average yield of 6.55 per cent.

Primary Market Yield Attainment



Source MF.

Table 1

Government Securities Issues in 2003

No.	Auction date	Issue date	Issue number	Maturity	Maturity date	Interest rate	Offered amount (BGN/EUR)	Bids received (BGN/EUR)	Bids approved at nominal value (BGN/EUR)	Bids approved at sell price (BGN/EUR)	Average price attained per 100 units nominal value	Minimum approved price per 100 units nominal value	Average annual yield (%)	Maximum approved yield (%)
1	6.I.2003	8.I.2003	BG 20 400 03 217	10 years	8.I.2013	7.5	30 000 000	94 289 800	30 000 000	30 000 000.00	104.08	103.67	6.93	6.98
2	13.I.2003	15.I.2003	BG 20 300 03 110	5 years	15.I.2008	5.6	30 000 000	87 720 000	30 000 000	30 000 000.00	100.42	99.97	5.53	5.63
3	14.I.2003	16.I.2003	BG 30 100 03 005	1 year	16.I.2004	0.0	20 000 000	77 550 000	20 000 000	19 170 840.01	95.85	95.75	4.27	4.38
4	20.I.2003	22.I.2003	BG 20 301 03 118	3 years	22.I.2006	5.5	25 000 000	62 650 000	25 000 000	25 000 000.00	101.57	101.24	4.93	5.05
5	27.I.2003	29.I.2003	BG 30 101 03 003	3 months	29.IV.2003	0.0	12 000 000	33 870 000	12 000 000	11 925 475.99	99.38	99.33	2.50	2.70
6	3.II.2003	5.II.2003	BG 20 401 03 215	7 years	5.II.2010	5.9	20 000 000	77 850 000	20 000 000	20 000 000.00	100.42	100.07	5.80	5.86
7	10.II.2003	15.I.2003	BG 20 300 03 110	5 years	15.I.2008	6.6	25 000 000	50 900 000	25 000 000	25 000 000.00	100.55	100.17	5.50	5.59
8	18.II.2003	24.II.2003	BG 20 402 03 213	7 years	24.V.2010	5.8	97 791 500	273 796 642	97 791 500	97 791 500.00	100.99	100.60	5.58	5.64
9	24.II.2003	26.II.2003	BG 30 102 03 001	3 months	26.V.2003	0.0	12 000 000	27 120 000	12 000 000	11 926 099.99	99.38	99.37	2.52	2.56
10	10.III.2003	24.II.2003	BG 20 402 03 213	7 years	24.V.2010	5.8	48 895 750	149 572 099	107 570 650	107 570 650.00	100.55	100.10	5.65	5.73
11	24.III.2003	26.III.2003	BG 30 103 03 009	3 months	26.VI.2003	0.0	12 000 000	19 620 000	12 000 000	11 922 109.00	99.35	99.32	2.56	2.68
12	31.III.2003	8.I.2003	BG 20 400 03 217	10 years	8.I.2013	7.5	20 000 000	56 355 000	20 000 000	20 000 000.00	105.18	104.76	6.78	6.84
13	7.IV.2003	9.IV.2003	BG 30 104 03 007	1 year	9.IV.2004	0.0	20 000 000	51 600 000	20 000 000	19 152 355.01	95.76	95.68	4.36	4.44
14	14.IV.2003	5.II.2003	BG 20 401 03 215	7 years	5.II.2010	5.9	20 000 000	49 650 000	20 000 000	19 779 125.01	98.90	98.48	6.07	6.15
15	21.IV.2003	22.I.2003	BG 20 301 03 118	3 years	22.I.2006	5.5	40 000 000	42 850 000	25 000 000	25 000 000.00	101.01	100.44	5.13	5.34
16	29.IV.2003	30.IV.2003	BG 30 105 03 004	3 months	30.VII.2003	0.0	12 000 000	16 860 000	12 000 000	11 911 731.25	99.26	99.12	2.95	3.51
17	7.V.2003	5.II.2003	BG 20 401 03 215	7 years	5.II.2010	5.9	20 000 000	34 800 000	20 000 000	19 612 370.00	98.06	97.43	6.22	6.34
18	26.V.2003	28.V.2003	BG 30 106 03 002	3 months	28.VIII.2003	0.0	12 000 000	16 620 000	12 000 000	11 909 868.00	99.25	99.12	2.96	3.47
19	2.VI.2003	15.I.2003	BG 20 300 03 110	5 years	15.I.2008	5.6	20 000 000	49 450 000	20 000 000	20 000 000.00	100.40	100.21	5.53	5.58
20	23.VI.2003	25.VI.2003	BG 30 107 03 000	3 months	25.IX.2003	0.0	12 000 000	19 630 000	12 000 000	11 923 699.00	99.36	99.29	2.52	2.80

(continued)

(continued)

No.	Auction date	Issue date	Issue number	Maturity	Maturity date	Interest rate	Offered amount (BGN/EUR)	Bids received (BGN/EUR)	Bids approved at nominal value (BGN/EUR)	Bids approved at sell price (BGN/EUR)	Average price attained per 100 units nominal value	Minimum approved price per 100 units nominal value	Average annual yield (%)	Maximum approved yield (%)
21	30.VI.2003	2.VII.2003	BG 20 403 03 211	10 years	2.VII.2013	5.8	20 000 000	69 350 000	20 000 000	19 763 860.01	98.82	98.20	5.91	5.99
22	7.VII.2003	9.VII.2003	BG 20 302 03 116	5 years	9.VII.2008	4.8	25 000 000	47 300 000	25 000 000	24 780 405.00	99.12	98.62	4.95	5.07
23	21.VII.2003	5.II.2003	BG 20 401 03 215	7 years	5.II.2010	5.9	15 000 000	46 260 000	15 000 000	15 000 000.00	101.92	101.59	5.54	5.60
24	28.VII.2003	30.VII.2003	BG 30 108 03 008	3 months	30.X.2003	0.0	12 000 000	20 320 000	12 000 000	11 923 008.00	99.36	99.32	2.52	2.68
25	4.VIII.2003	9.VII.2003	BG 20 302 03 116	5 years	9.VII.2008	4.8	15 000 000	37 150 000	15 000 000	14 749 215.02	98.33	97.97	5.13	5.22
26	25.VIII.2003	27.VIII.2003	BG 30 109 03 006	3 months	27.XI.2003	0.0	12 000 000	25 010 000	12 000 000	11 922 584.01	99.35	99.32	2.56	2.68
27	8.IX.2003	9.VII.2003	BG 20 302 03 116	5 years	9.VII.2008	4.8	20 000 000	43 600 000	20 000 000	19 649 305.00	98.25	97.97	5.15	5.22
28	23.IX.2003	24.IX.2003	BG 30 110 03 004	3 months	24.XII.2003	0.0	12 000 000	17 020 000	12 000 000	11 922 213.00	99.35	99.30	2.59	2.79
29	29.IX.2003	2.VII.2003	BG 20 403 03 211	10 years	2.VII.2013	5.8	30 000 000	78 753 000	30 000 000	29 314 095.01	97.71	97.30	6.06	6.11
30	20.X.2003	5.II.2003	BG 20 401 03 215	7 years	5.II.2010	5.9	30 000 000	68 030 000	30 000 000	30 000 000.00	102.27	101.77	5.48	5.57
31	27.X.2003	29.X.2003	BG 30 111 03 002	3 months	29.I.2004	0.0	12 000 000	15 620 000	12 000 000	11 920 670.00	99.34	99.28	2.60	2.84
32	3.XI.2003	12.XI.2003	BG 20 404 03 219	15 years	11.X.2018	6.0	39 116 600	144 004 900	39 116 600	37 087 944.26	94.81	93.90	6.55	6.65
33	10.XI.2003	9.VII.2003	BG 20 302 03 116	5 years	9.VII.2008	4.8	20 000 000	56 500 000	20 000 000	19 843 378.00	99.22	99.05	4.93	4.97
34	24.XI.2003	26.XI.2003	BG 30 112 03 000	3 months	26.II.2004	0.0	12 000 000	18 330 000	12 000 000	11 920 963.01	99.34	99.30	2.60	2.76
35	1.XII.2003	9.VII.2003	BG 20 302 03 116	5 years	9.VII.2008	4.8	20 000 000	60 750 000	20 000 000	19 895 570.00	99.48	99.21	4.87	4.93
36	22.XII.2003	23.XII.2003	BG 30 113 03 008	3 months	23.III.2004	0.0	12 000 000	10 170 000	10 170 000	10 097 354.00	99.29	99.00	2.83	4.00
Total for 2003							814 803 850	2 050 921 441	856 648 750	849 386 387.58				

Source MF.

Government Securities Targeted to Individual Investors

In 2003, the Ministry of Finance continued issuing bonds targeted to individual investors. An overall nominal value of BGN29.8m of issues sold during 2003: 3.41 per cent of the volume of government bonds launched during the year. This was BGN13.8m more than similar issues in the prior year. All issues had three-year maturities and stepped interest coupons. Average-weighted yield for the period was 6.46 per cent or 1.43 per cent more than yield formed at regular government bond auctions with an identical maturity. As before, the issues sell *via* the BNB and primary dealers who have contracted to sell them.

2. Debt Service

Domestic debt repayments in 2003 came to BGN803.6m. Of this, BGN684.9m was principal and BGN118.6m was interest. Repayments exceeded the 2002 total by BGN125.3m due to there being more maturity dates in 2003, and to reverse repurchases of government securities. Interest expenses on domestic debt came to 0.8 per cent of the Consolidated State Budget, and to 0.3 per cent of GDP.

To optimize domestic debt service costs and improve secondary market liquidity in April and May, illiquid five-year issues with interest coupons significantly in excess of market yield were reverse repurchased. Holders of government bonds to an overall nominal value of BGN160m were given the chance to sell or swap their paper. Paper offered in return was for three years, issued to the regular schedule. These operations resulted in reverse repurchases of bonds to a nominal value of BGN55.1m and swaps to the value of BGN5.3m. Interest in reverse repurchase auctions was low, mainly due to great demand for longer-term paper.

Government Securites Issued for Structural Reform

Debt on government securities issued subsequent to structural reform in the real sector and banking fell by BGN110.4m in 2003.

Repayments for the period came to BGN37.2m. Cancelled bonds used in privatization deals had a nominal value of USD 208,000. Subsequent to repayments of debt to the state, ZUNK bonds cancelled USD2.5m and EUR 300,000 of debt.

Regular subscriptions for replacement of dollar-denominated ZUNK bonds with euro-denominated ones continued in 2003. A total of USD17.2m of dollar ZUNK bonds was exchanged for ones worth EUR15.4m.

Interest expenses on government structural reform securities came to BGN15m.

Table 2

Domestic Debt Dynamics*

Debt Structure	Debt by 31 Dec 2002, BGN million	Rise, BGN million	Fall, BGN million	Debt by 31 Dec 2003 BGN million	Nominal rise/fall BGN million	%
I. Government Debt	**2 124.13**	**916.61**	**726.03**	**2 256.70**	**132.57**	**6.24**
1. Budget Deficit Financing						
Government Securities	1 476.53	886.45	643.48	1 719.50	242.97	16.46
3-month	36.00	142.17	144.00	34.17	-1.83	-5.08
1-year	80.00	40.00	80.00	40.00	-40.00	-50.00
2-year	227.67	0.00	213.61	14.06	-213.61	-93.82
3-year	315.00	79.80	140.48	254.32	-60.68	-19.26
5-year	462.94	175.00	65.40	572.54	109.60	23.68
7-year	270.00	310.36	0.00	580.36	310.36	114.95
10-year	84.92	100.00	0.00	184.92	0.00	0.00
15-year	0.00	39.12	0.00	39.12	0.00	0.00
2. Structural Reform						
Government Securities	629.16	30.16	72.39	528.92	-100.24	-15.93
19-year	2.48	0.00	0.28	2.20	-0.28	-11.11
20-year	248.01	30.16	15.24	262.93	14.92	6.02
24-year	1.91	0.00	0.13	1.78	-0.13	-6.67
25-year	376.77	0.00	56.75	262.01	-114.76	-30.46
3. Deposit Insurance						
Government Securities	18.44	0.00	10.16	8.28	-10.16	-55.09
7-year	18.44	0.00	10.16	8.28	-10.16	-55.09
II. Domestic Government Guarantees	**1.88**	**0.00**	**1.88**	**0.00**	**-1.88**	**-100.00**
Overall Domestic Debt	**2 126.01**	**916.61**	**727.91**	**2 256.70**	**130.69**	**6.15**

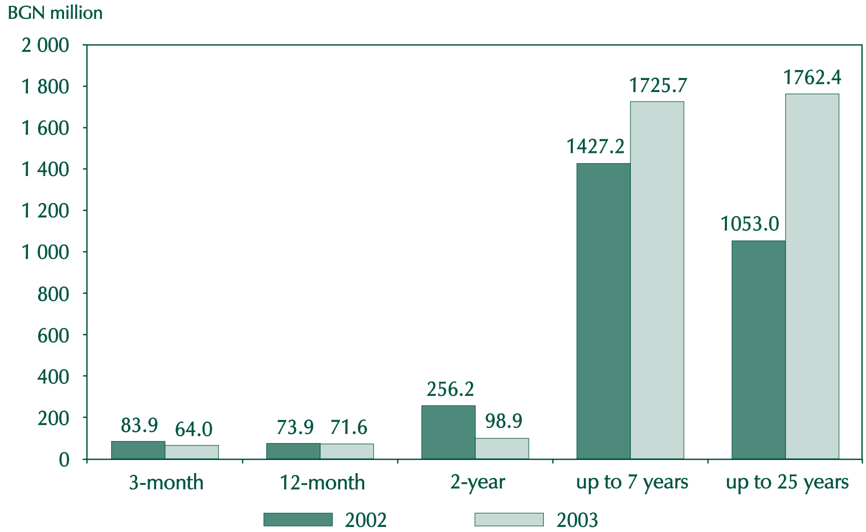
* All data at nominal values.

III. The Secondary Government Securities Market in 2003

In 2003 the secondary market in government debt instruments showed marked interest in long-term bonds and relatively weak interest in short- and medium-term bonds. Compared with the past few years, trading grew mainly on the back of new euro-denominated issues.

Over the year the secondary market saw 9158 transactions to a nominal value of BGN 10,273.1 million. The lion's share of deals was with, or on account of, customers (55.6 per cent), followed by repo agreements (22.9 per cent) and outright transactions (21.5 per cent).

Maturities of Government Securities Traded on the Interbank Market

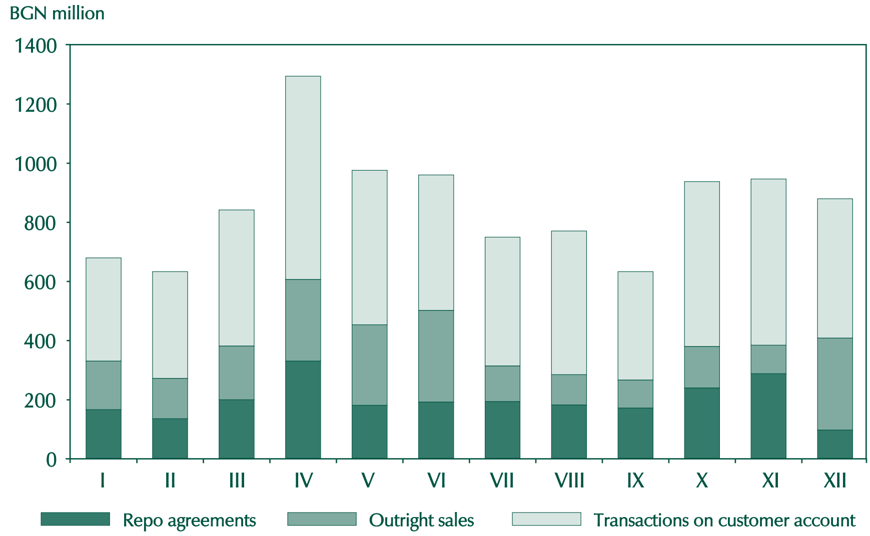


Notes: 1. Only current day repo agreements are included.

2. Forex denominated government securities are at lev equivalence using BNB forex rates valid on the final business day of each period.

Source BNB.

Traded Government Securities Volume by Deal Type in 2003



Notes: 1. Including approved bids at government securities auctions on behalf of non-primary dealers, companies, and individuals.

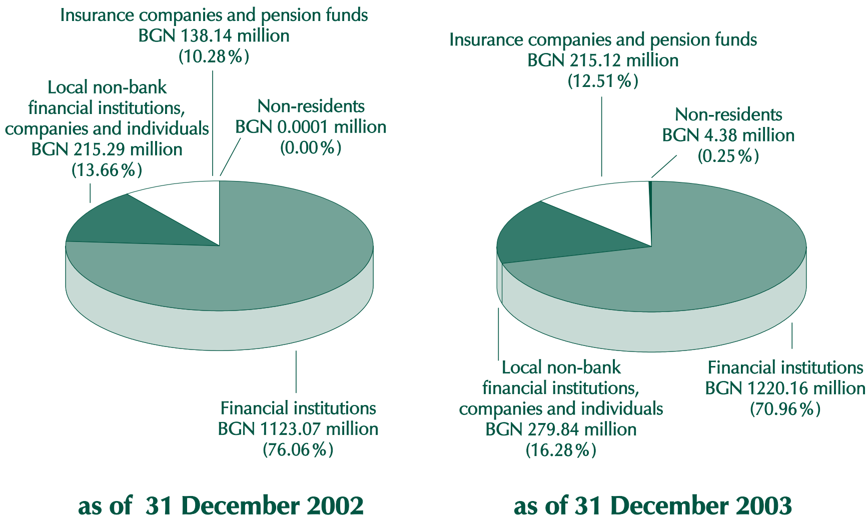
2. Repo volumes include reverse repo agreements and current day transactions.

3. Forex denominated government securities are at lev equivalence using BNB forex rates valid for day of each transaction.

Source BNB.

Uneven volumes were traded month by month, with livelier trading on new issue days and days when banks adjusted minimum required reserves with the BNB. In structure terms, the interbank government securities market in 2003 saw mainly long-term bonds being traded. The last few years' trend of a fall in the trading of short- and medium-term government securities continued, with respective falls of 14.1 per cent and 61.4 per cent on 2002. Trading in long-term bonds increased by 40.6 per cent. Long-term bond trading comprised 93.7 per cent of the overall traded volume, while short- and medium-term instruments accounted for 3.6 per cent and 2.7 per cent respectively. As a whole, interbank market activity grew by 28.62 per cent in 2003 on the prior year. This was largely due to the very great interest enjoyed by euro-denominated issues launched into circulation.

Holders of Budget Deficit Financing Government Securities



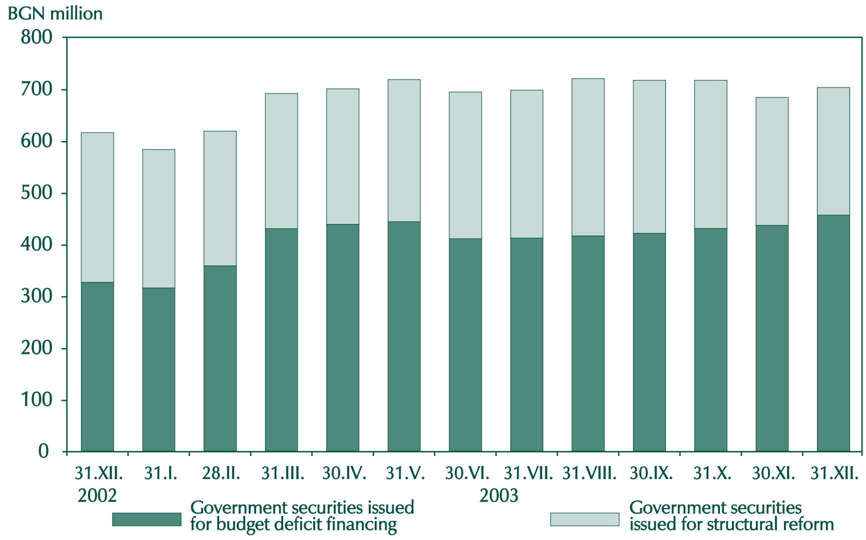
Notes: 1. Including government securities blocked by holders.

2. Including issues targeted to individual investors.

3. Forex denominated bonds are at lev equivalence using BNB forex rates valid on 31 December 2002 and 2003.

Source BNB.

The profile of government securities holders remained relatively stable through the year, with slight monthly fluctuations. Budget deficit financing government securities were held mostly by commercial banks (70.9 per cent), followed by local non-bank financial institutions, companies and individuals (16.3 per cent), insurance companies and pension funds (12.5 per cent).

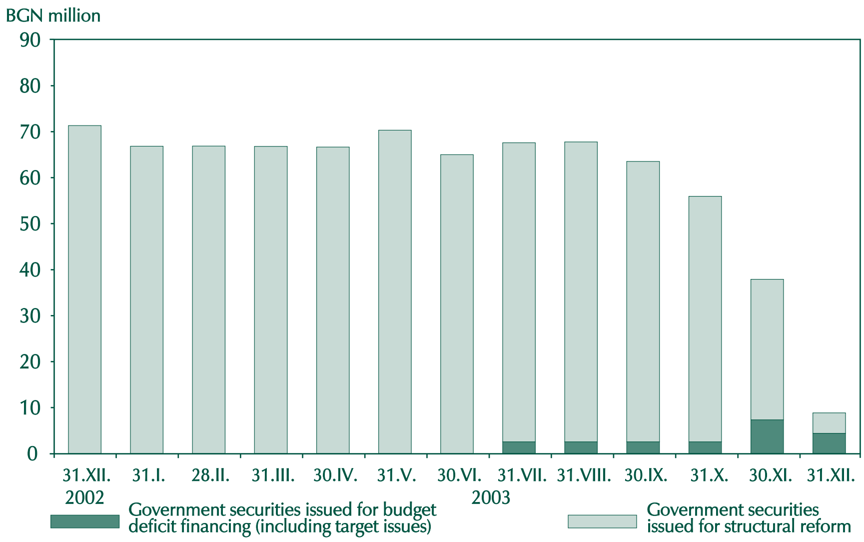


Government Securities Investment by Non-bank Financial Institutions, Companies and Individuals

Note: Forex denominated securities are at lev equivalence using BNB forex rates valid on the final business day of each period.

Source BNB.

Commercial banks again held most structural reform securities (53 per cent), followed by insurance companies and pension funds (30.6 per cent), local non-bank financial institutions, companies and individuals (15.5 per cent). Foreign investors still hold the negligible share of 1.2 per cent of government securities.



Government Securities in Foreign Investors' Portfolios

Note: Forex denominated securities at lev equivalence using BNB forex rates valid on the closing business day of each period.

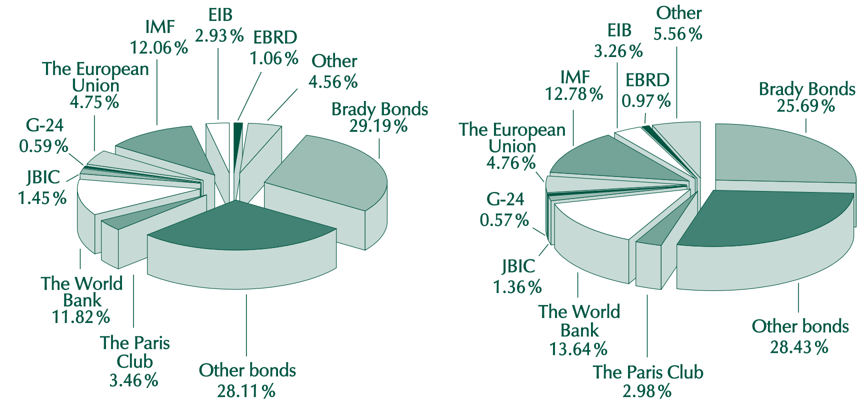
Source BNB.

IV. External Debt

At the close of 2003 nominal government and government guaranteed external debt came to EUR7356m, or EUR860.4m less than a year earlier. This was 41.8 per cent of GDP, against 49.7 per cent at the close of 2002: a drop due to the almost 18 per cent fall in the dollar euro rate.

Debt structure by creditor showed no significant change. Only Brady Bonds fell 2.4 percentage points to 25.7 per cent because of forex rate fluctuations and regular debt repayments. The year's positive net financing by the IMF resulted in a slight rise in relevant indebtedness. World Bank and EIB obligations grew with the development of various public projects financed by the two banks, and with the closure of the World Bank PAL 1 loan program.

External Debt by Creditor

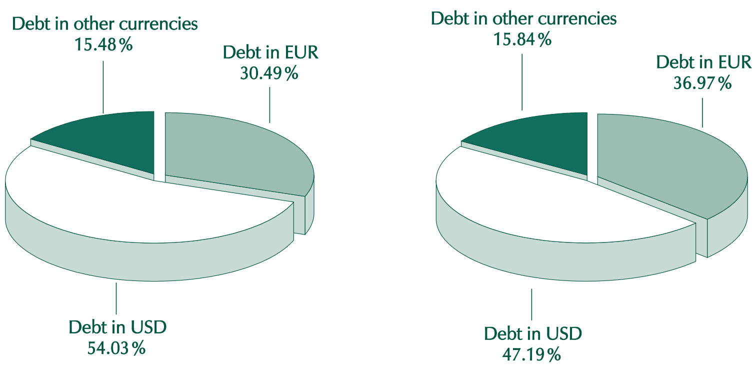


31 December 2002 **31 December 2003**

Source MF.

The euro share of debt continued growing in 2003 at the expense of the US dollar. Compared with the close of 2002, euro debt grew 6.5 percentage points to 37 per cent. This was at the cost of dollar debt which fell from 54 per cent to 47.2 per cent. The improved forex structure cut foreign exchange risk (especially from the significant dollar fall against the euro) and reflected in regular repayments of dollar debt, in the policy of borrowing mainly in euro, and in the currency swap of a dollar loan from the World Bank.

Currency Structure of External Government and Government Guaranteed Debt

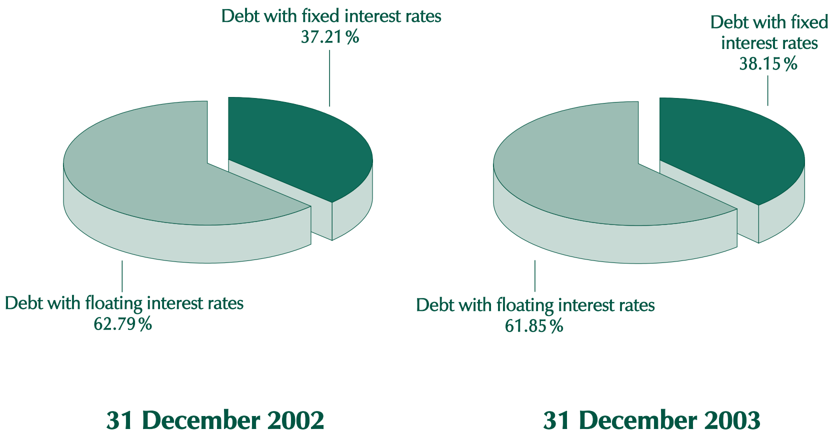


31 December 2002 **31 December 2003**

Source MF.

The fixed and floating interest ratio also changed somewhat, with the fixed coupon share growing slightly from 37.2 per cent to 38.2 per cent. This change is also due to the dollar depreciation and the subsequent fall in dollar debt which is mainly with floating interest.

Interest Structure of External Government and Government Guaranteed Debt



Source MF.

1. External Financing

New external financing for 2003 came to EUR437.4m, mainly from official creditors (the IMF and the World Bank). Most monies (EUR151.2m) came from the World Bank's Programmatic Adjustment Loan (PAL1). This is the first of three structural loans scheduled in a three-year World Bank Support Strategy. The IMF remitted EUR131.2m into the Central Budget under the two-year stand by agreement. Finance for investment projects contracted earlier continued being drawn through the year under government and government guaranteed loans. Government investment loan finance in 2003 came to EUR86m, with EUR69.6m of government guaranteed loan finance.

Net external financing for the year came to EUR45m, of which EUR26m was for projects with approved government guarantees. The largest positive balance of EUR112.8m was on World Bank loans, followed by the IMF with EUR55.5m. Paris Club, G24 and European Union financing was negative during 2003. On the other hand, net external finance for government investment loans was positive to the tune of EUR52.9m.

Table 3

New Foreign Financing and Foreign Debt Repayments in 2003

(EUR million)

Structure	Loans or tranches	Repayments, incl.		
		Principal	Interest	Total
Government Debt	**368.9**	**348.8**	**313.1**	**661.9**
I. Bonds	-	91.4	222.3	313.7
1. Brady Bonds	-	91.4	55.0	146.5
2. Other bonds	-	-	167.3	167.3
II. Loans	368.9	257.3	90.8	348.2
1. Paris Club	-	62.2	10.2	72.4
2. World Bank	151.2	38.4	26.8	65.2
2.1. World Bank	151.2	28.8	23.9	52.6
2.2. JBIC (JEXIM)	-	9.7	2.9	12.6
3. G24	-	3.1	1.2	4.3
4. European Union	-	40.0	10.4	50.4
5. IMF	131.2	75.7	21.6	97.3
6. Others	-	-	1.9	1.9
7. Government Investment Loans	86.0	33.1	16.7	49.8
7.1. World Bank	17.0	1.8	2.3	4.1
7.2. EIB	47.9	22.8	11.3	34.0
7.3. EBRD	0.0	8.5	1.8	10.4
7.4. Others	21.0	-	1.3	1.3
8. Called Government Guarantees	0.5	4.9	2.0	6.9
8.1. World Bank*	0.5	3.7	1.6	5.3
8.2. EIB	-	0.4	0.2	0.6
8.3. Others	-	0.8	0.3	1.0
Government Guaranteed Debt	**69.6**	**43.6**	**16.3**	**59.9**
1. World Bank	0.5	10.0	6.1	16.0
2. EIB	2.0	5.9	2.6	8.5
3. EBRD	9.3	6.4	1.2	7.6
4. Others	57.7	21.3	6.4	27.7
OVERALL	**438.5**	**392.4**	**329.4**	**721.8**

* The sum of EUR0.5m is negative and represents reinstated monies under the World Bank Water Companies' Restructuring and Modernization Loan in connection with the conclusion of the loan grace period.

Note: The lev equivalent of new external financing and repayments is at the BNB central rate at 4pm on the day of remittance.

2. Debt Service

Debt repayments of EUR721.8m were made in 2003, of which EUR392.4m principal and EURE329.4m interest. Dollar repayments led at a euro equivalent of USD342m, followed by euro repayments of EUR217m, and repayments of SDR116.8m in euro equivalent.

Brady Bond repayments led with EUR91.4m, followed by IMF amortization repayments of EUR75.7m, repayments of EUR62.2m to Paris Club official creditors, of EUR40m to the European Union, and of EUR38.4m to the World Bank. Called government guarantees resulted in payments of EUR4.9m from the State Budget.

Due to the relatively high share of dollar debt and floating interest coupons, interest repayments in 2003 greatly benefited from the low dollar euro rate and from exceptionally low international interest rates. Interest expenses on external financing came to EUR329.4m or 4.6 per cent of the Budget and 1.9 per cent of GDP. Sums related to bond loans led at EUR222.3m. Government investment loan interest came to EUR16.7m, and government guaranteed loan interest totaled EUR16.3m.

Table 4

External Debt

(EUR million)

Structure	by 31 Dec 2002	by 31 Dec 2003
Government Debt	**7 685.9**	**6 961.1**
I. Bonds	4 708.6	3 981.6
1. Brady Bonds	2 398.7	1 890.1
2. Other bonds	2 310.0	2 091.4
II. Loans	2 977.3	2 979.5
1. Paris Club	284.5	218.9
2. World Bank	836.1	870.0
3. G24	48.9	42.0
4. European Union	390.0	350.0
5. IMF	990.9	940.2
6. Others	129.2	125.2
7. Government Investment Loans	236.7	383.0
7.1. World Bank	69.0	83.1
7.2. EIB	122.5	193.5
7.3. EBRD	26.2	31.8
7.4. Others	19.0	74.6
8. Called Government Guarantees	61.0	50.2
8.1. World Bank	48.5	41.0
8.2. EIB	2.6	1.8
8.3. Others	9.9	7.4
Government Guaranteed Debt	**530.5**	**394.9**
1. World Bank	137.1	109.2
2. EIB	115.8	44.5
3. EBRD	60.7	39.5
4. Others	216.8	201.7
OVERALL	**8 216.4**	**7 356.0**

Note: At nominal values. Euro conversion at BNB central rates for the closing business day of each period.

V. Government Debt Management in 2003

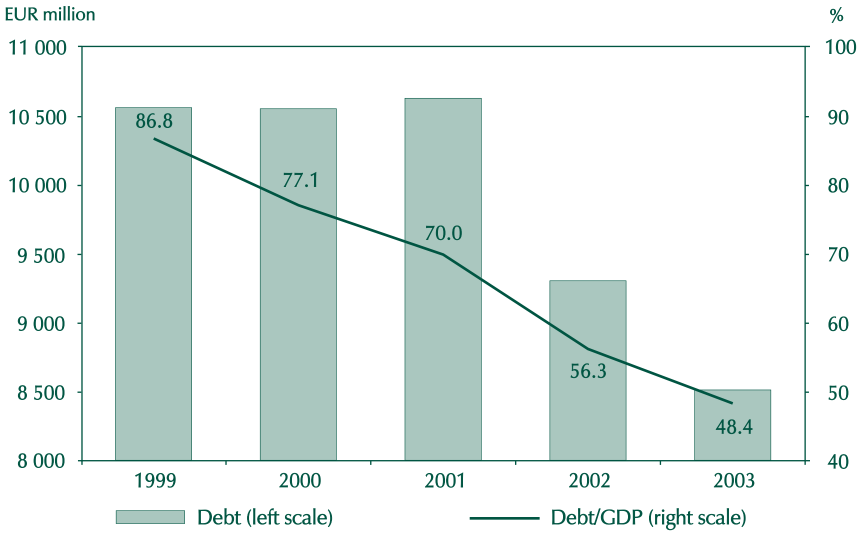
In March 2003 the Cabinet adopted a Government Debt Management Strategy which set out medium-term tasks and priorities in debt management. The paper was needed because of the large debt amount, the high cost of servicing and refinancing it, and its significance for the State Budget, balance of payments, banking system, and the money market. Debt management is exceptionally important for maintaining macroeconomic stability and confidence in the currency board, and a framework was needed for the various measures it entails. Transparency in the conduct of this policy is also most important for securing steady and economical Budget finance. The setting of debt management objectives renders Ministry of Finance actions more effective and facilitates public oversight of them.

The Strategy states that the greatest risks debt poses to the Budget and hence the economy are those of refinancing, of the sheer amount of debt, of the market, and of assuming conditional obligations. An analysis then leads to the setting of major debt management objectives, and of measures for their attainment.

The primary objective of debt management policy is defined as 'ensuring unconstrained Budget financing and debt refinancing at the lowest attainable cost in the medium and long terms, while maintaining optimum risk levels.' This traditional formulation of government debt management objectives is accompanied by objectives and measures which take into account debt structure and national macroeconomic indicators.

Maintaining a stable nominal extent of debt with a steadily declining GDP ratio is of primary significance to government finance. In 2003 the Debt/GDP ratio fell to 48.4 per cent from 56.3 per cent at the close of the prior year. This significant fall resulted from GDP growth and favourable falls of the dollar euro rate.

Dynamics of Government and Government Guaranteed Debt between 1999 and 2003

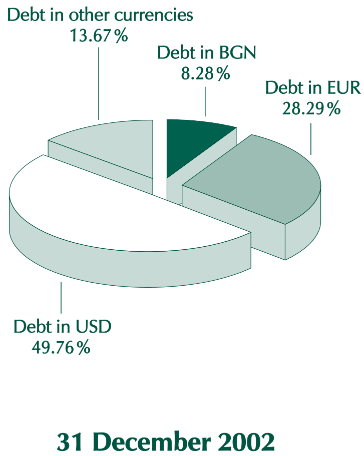


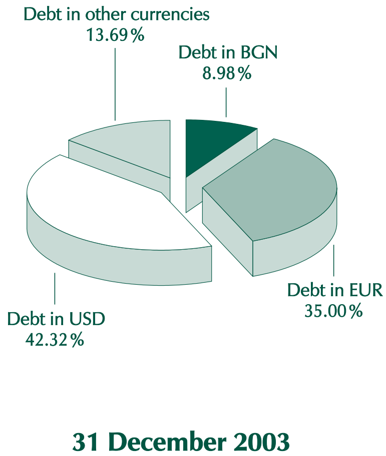
Source MF.

The large fiscal reserve and zero budget deficit enabled new lending to be limited to project finance and to IMF and World Bank loans contracted earlier. Net issues were positive mainly due to domestic market sales of government securities.

Cutting the risks to the Budget posed by government debt is the second major priority. Though significantly improved over recent years, debt currency and interest structure still entail serious market risks. Over the past year, this led to new external financing being denominated solely in euro (excluding IMF tranches), and domestic financing being drawn solely in levs and euro. It also led to a currency swap on a World Bank loan with a nominal value of USD95.8m. In view of regular dollar-denominated debt amortizations, debt forex structure changed significantly. Euro debt rose by 6.7 percentage points to 35 per cent, forming alongside lev-denominated debt a debt component of 44 per cent free of forex rate risk by the close of 2002.

Currency Structure of Government and Government Guaranteed Debt

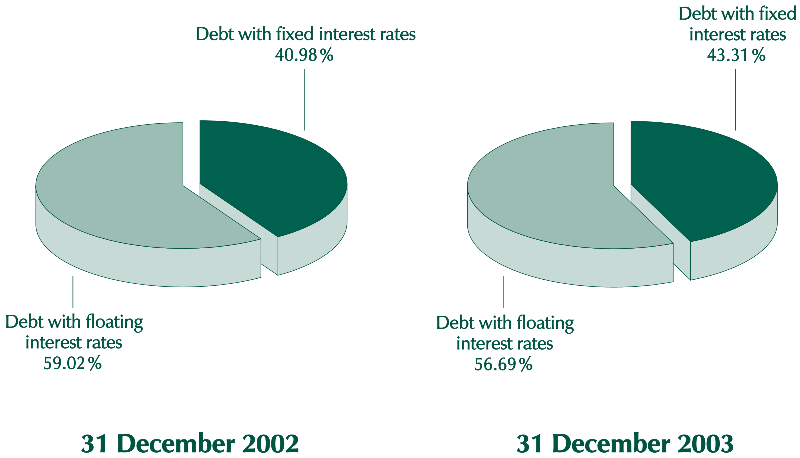




Source MF.

Interest structure also improved. Fixed interest debt rose by 2.3 per cent to 43.3 per cent, vindicating the objective of seeking parity between fixed and floating interest. In view of the significant share of international financial institution (IMF and WB) financing, interest structure rollover will take much longer. The fixed interest component grows largely at the expense of government securities issues. It is worth noting that the dollar rate change helped in 2003 since a large share of dollar-denominated debt carries floating interest coupons.

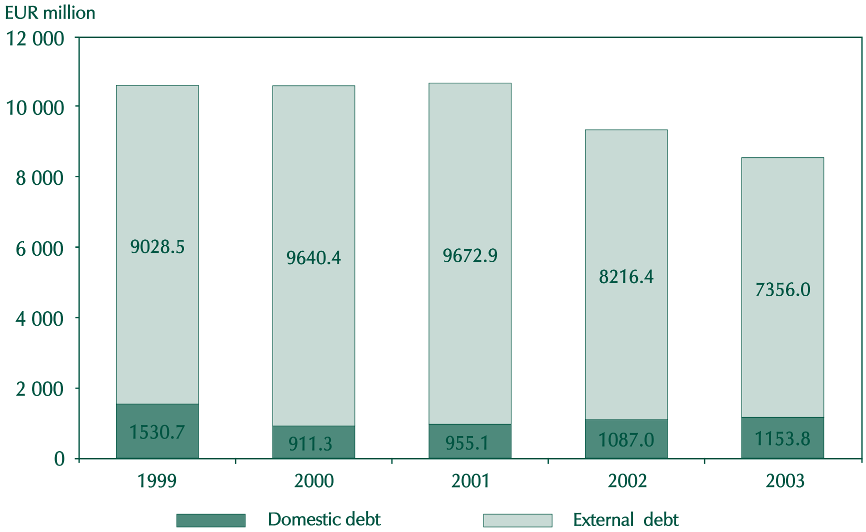
Interest Structure of Government and Government Guaranteed Debt



Source MF.

Raising the relative share of domestic debt is another long-term Strategy objective. High banking liquidity and the growth of pension fund and insurance company assets enabled measures in this sense in 2003. Net positive issues of almost BGN200m were sold despite the lack of any need for domestic financing. Government securities yields, however, followed a downward trend through the year, due partly to exceptionally high demand for government securities, and partly to falling international interest rates. The requirements for a share of government securities in institutional investors' portfolios, and for guaranteeing Budget funds deposited in banks with government securities boosted the home market. As a result, the share of domestic debt grew 1.9 percentage points to 13.6 per cent of overall government and government guaranteed debt.

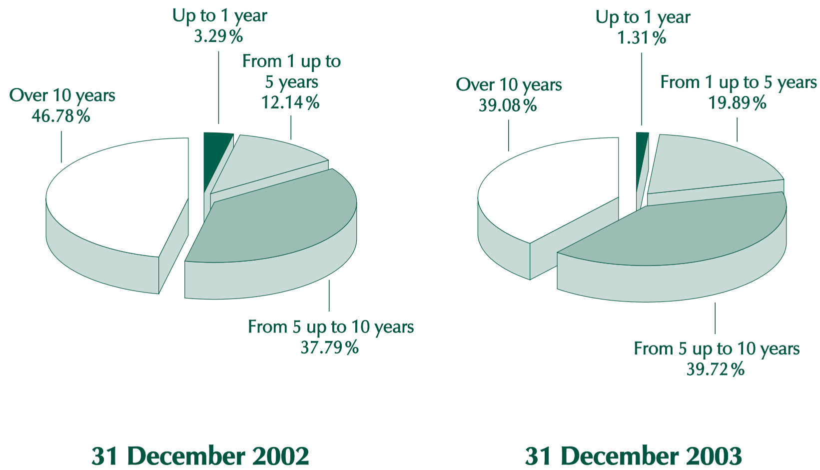
Dynamics of Domestic and External Debt between 1999 and 2003



Source MF.

The average debt duration and maintaining an even repayment profile are also among major debt management policy objectives. After its mid-Nineties restructuring, external debt has an average residual maturity. In this sense, efforts at lengthening debt terms mainly address government securities issued on the domestic market.

Residual Term of Government and Government Guaranteed Debt



Source MF.

Several factors influenced the change of various terms in the overall portfolio. First, debt growth during the year was due to government securities issues on the home market. The net positive issue sold was mainly in the seven- and five-year segments. Compared with the prior year, five- to ten-year paper volumes grew significantly. A 15-year issue was also opened for the first time. At the same time, debt with over ten-year terms fell considerably after repayments, and due to forex rate changes (the lion's share of debt with a term of over ten years is denominated in US dollars). A large proportion of debt fell below the five-year timeline owing to pending maturity dates.

The marketing of long-term issues in 2002 and 2003 gives prospects of a slow lengthening of debt maturity over coming years, but only subject to further improvements in national credit rating and attendant cuts in credit risk premiums. With this in mind, this type of bond calls for cautious use.

Debt service remained at very low levels over the past year. Interest expenditure represented 5.4 per cent of the overall Budget (against 5.6 per cent in the prior year), largely due to low international interest rates and the low dollar euro rate. Given the gradual change of debt currency and interest structures, market fluctuations should affect interest expenditure to an ever reducing extent over coming years.

The Strategy objectives and their implementation over the past year show that the focus of government debt management is shifting from the sheer size of debt to a restructuring in anticipation of European Union accession. Investor base is shifting from official creditors to market instruments, and risks to the Budget are lessening with debt restructuring. Low budget deficits foreseen for coming years, combined with the large fiscal reserve, offer the opportunity for these objectives to be attained without any pressure from the extent of debt and financing cost. Measures set out in the Strategy should change solely with reference to market conditions, with reference to clearly set targets.

Table 5

Dynamics of Government and Government Guaranteed Debt between 1999 and 2003*

(EUR million)

Structure	1999	2000	2001	2002	2003
Domestic Debt	**1 530.7**	**911.3**	**955.1**	**1 087.0**	**1 153.8**
I. Government	1 060.3	906.2	951.7	1 086.1	1 153.8
Budget Deficit Financing Government Securities	450.9	491.4	554.6	754.9	879.2
Structural Reform Government Securities	495.5	389.9	382.4	321.7	270.4
Government Securities issued under LSPDACB	113.9	24.9	14.6	9.4	4.2
II. Domestic Government Guarantees	470.4	5.1	3.4	1.0	-
External debt	**9 028.9**	**9 640.4**	**9 672.9**	**8 216.4**	**7 356.0**
I. Government	8 587.4	9 159.5	9 096.6	7 685.9	6 961.1
Brady Bonds	4 954.6	5 347.7	5 400.0	2 398.7	1 890.1
Other Bonds	-	-	250.0	2 310.0	2 091.4
Paris Club	811.1	645.3	433.5	284.5	218.9
World Bank	820.5	889.6	941.1	836.1	870.0
G24	71.2	60.8	53.8	48.9	42.0
European Union	400.0	460.0	390.0	390.0	350.0
IMF	1 126.5	1 309.4	1 183.4	990.9	940.2
Others	147.7	136.6	136.6	129.2	125.2
Government Investment Loans	207.8	251.0	240.3	236.7	383.0
Called Government Guarantees	48.1	59.2	67.8	61.0	50.2
II. Government Guaranteed debt	441.4	480.8	576.3	530.5	394.9
GDP (BGN million)	**23 790.4**	**26 752.8**	**29 709.2**	**32 335.1**	**34 410.2**
GDP (EUR million)	12 163.9	13 678.5	15 190.1	16 532.7	17 593.7
Total Debt/GDP (%)	**86.8**	**77.1**	**70.0**	**56.3**	**48.4**

* Nominal figures.

Note: GDP data from the National Statistics Institute.

Table 6

Consolidated Government Debt

(EUR million)

Structure	by 31 Dec 2002	by 31 Dec 2003
Consolidated Government Debt	**8793.9**	**8147.0**
1. Central Government Debt	8771.9	8114.9
2. Social Security Funds Debt	0.0	0.0
3. Municipal Debt	22.0	32.0
Consolidated Government Debt/GDP (%)	**53.2**	**46.3**

Notes: 1. Central government debt shown at nominal value excluding government guaranteed loans.

2. 2003 GDP is set at BGN34,410.2 million and 2002 GDP is set at BGN32,335.1 million.

3. Euro recalculations are at BNB central lev rates for the closing business day of each period.

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