Republic of Bulgaria

EUR 1,493,000,000

2.950 per cent. Notes due 2024

Issue price: 99.085 per cent.

The issue price of the EUR 1,493,000,000 2.950 per cent. Notes due 2024 (the "**Notes**") of the Republic of Bulgaria (the "**Issuer**", the "**Republic**" or "**Bulgaria**") is 99.085 per cent. of their principal amount.

The Notes will bear interest from and including 3 July 2014 at the rate of 2.950 per cent. per annum payable annually in arrear on 3 September in each year commencing on 3 September 2015. See "*Terms and Conditions of the Notes – Interest*". Payments under the Notes will be made free and clear of, and without withholding or deduction for, any taxes imposed by the Republic, to the extent described under "*Terms and Conditions of the Notes— Taxation*" and "*Taxation—Republic of Bulgaria*". Unless previously redeemed, or purchased and cancelled, the Notes will be redeemed at their principal amount together with accrued interest on 3 September 2024 and are not redeemable prior to that date. See "*Terms and Conditions of the Notes—Redemption, Purchase and Cancellation*".

Application has been made to list the Notes on the Official List of the Luxembourg Stock Exchange (the "**Official List**") and to admit the Notes to trading on the Luxembourg Stock Exchange's regulated market (the "**Market**"), pursuant to the rules and regulations of the Luxembourg Stock Exchange.

SEE "*RISK FACTORS*" STARTING ON PAGE 3 FOR A DISCUSSION OF CERTAIN FACTORS TO BE CONSIDERED IN CONNECTION WITH AN INVESTMENT IN THE NOTES.

THE NOTES HAVE NOT BEEN, AND WILL NOT BE, REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"). THE NOTES ARE BEING OFFERED AND SOLD IN OFFSHORE TRANSACTIONS OUTSIDE THE UNITED STATES BY THE JOINT LEAD MANAGERS (AS DEFINED IN "SUBSCRIPTION AND SALE") IN ACCORDANCE WITH REGULATION S ("REGULATION S") UNDER THE SECURITIES ACT, AND MAY NOT BE OFFERED, SOLD OR DELIVERED WITHIN THE UNITED STATES EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT.

The Notes will be issued in registered form in denominations of EUR 100,000 and integral multiples of EUR 1,000 in excess thereof. The Notes will be represented by a global registered note certificate (the "**Global Note Certificate**") registered in the name of the nominee for, and deposited with, the common safekeeper for Euroclear Bank SA/NV ("**Euroclear**") and Clearstream Banking, *societe´ anonyme* ("**Clearstream, Luxembourg**"). Individual note certificates ("**Note Certificates**") evidencing holdings of Notes will only be available in certain limited circumstances. See "*Summary of Provisions relating to the Notes while in Global Form—Exchange for Note Certificates*".

Joint Lead Managers

CITIGROUP **HSBC** **J.P. MORGAN**

Offering Circular dated 30 June 2014

The Issuer, having made all reasonable enquiries, confirms that this Offering Circular contains all information with respect to the Issuer and the Notes which is material in the context of the issue and offering of the Notes, that the information contained in this Offering Circular is true and accurate in every material respect and is not misleading, that the opinions and intentions expressed in this Offering Circular are honestly held and that there are no other facts the omission of which makes misleading any statement herein, whether of fact or opinion. The Issuer accepts responsibility for the information contained in this Offering Circular accordingly.

This Offering Circular neither constitutes a prospectus pursuant to Part II of the Luxembourg law on Prospectus for securities (*loi relative aux prospectus pour valeurs mobilieres*) dated 10 July 2005 (the "**Luxembourg Prospectus Law**") which implements Directive 2003/71/EC, as amended (the "**Prospectus Directive**") nor a simplified prospectus pursuant to Part III of the Luxembourg Prospectus Law. Accordingly, this Offering Circular does not purport to meet the format and the disclosure requirements of the Prospectus Directive and Commission Regulation (EC) No. 809/2004 implementing the Prospectus Directive, and it has not been, and will not be, submitted for approval to any competent authority within the meaning of the Prospectus Directive and in particular the Supervisory Commission of the Financial Sector (*Commission de Surveillance du Secteur Financier* (the "**CSSF**"), in its capacity as competent authority under the Luxembourg Prospectus Law. The Notes issued pursuant to this Offering Circular will therefore not qualify for the benefit of the single European passport pursuant to the Prospectus Directive.

No person has been authorised in connection with the offering of the Notes to give any information or make any representation regarding the Issuer or the Notes other than as contained in this Offering Circular. Any such representation or information should not be relied upon as having been authorised by the Issuer or any agency thereof or the Joint Lead Managers (as defined under "**Subscription and Sale**"). Neither the delivery of this Offering Circular nor any sales made in connection with the issue of the Notes shall, under any circumstances, constitute a representation that there has been no change in the affairs of the Issuer since the date hereof.

To the fullest extent permitted by law, the Joint Lead Managers do not accept any responsibility for the contents of this Offering Circular or for any other statement, made or purported to be made by the Joint Lead Managers in connection with the Issuer or the issue and offering of the Notes. The Joint Lead Managers accordingly disclaim all and any liability whether arising in tort or contract or otherwise which any of them might otherwise have in respect of this Offering Circular or any such statement. Each person receiving this Offering Circular acknowledges that such person has not relied on any Joint Lead Manager or any person affiliated with any Joint Lead Manager in connection with its investigation of the accuracy of such information or its investment decision. Each person contemplating making an investment in the Notes must make its own investigation and analysis of the creditworthiness of the Issuer and its own determination of the suitability of any such investment, with particular reference to its own investment objectives and experience and any other factors which may be relevant to it in connection with such investment.

This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Issuer or any agency thereof or any Joint Lead Manager to subscribe or purchase, any of the Notes. The distribution of this Offering Circular and the offering of the Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Joint Lead Managers to inform themselves about and to observe any such restrictions. For a description of certain further restrictions on offers and sales of Notes and distribution of this Offering Circular, see "*Subscription and Sale*".

In this Offering Circular, all references to "**BGN**", "**Lev**" and "**Leva**" are to the lawful currency for the time being of the Issuer, all references to "**U.S. Dollars**", "**U.S.$**" and "**USD**" are to the lawful currency for the time being of the United States of America, all references to "**€**", "**EUR**" and "**Euro**" are to the currency introduced on 1 January 1999 at the start of the third stage of European Economic and Monetary Union pursuant to the Treaty establishing the European Community, as amended. Bulgaria maintains a currency board arrangement pursuant to which the exchange rate for the Lev has

been fixed to the Deutsche Mark since 1 July 1997 and subsequently to the Euro since 1 January 1999 see "*Monetary and Financial System*". Since 1 January 1999, the exchange rate of the Lev against the Euro has been fixed at €1.00 = BGN 1.95583.

Unless otherwise stated, all annual information, including budgetary information, is based on calendar years. Figures included in this Offering Circular have been subject to rounding adjustments; accordingly, figures shown for the same item of information may vary, and figures which are totals may not be the arithmetical aggregate of their components.

Statistical data appearing in this Offering Circular has been extracted or compiled from the records, statistics and other official public sources of information in Bulgaria, and has not been independently verified or checked by the Joint Lead Managers. Similar statistics may be obtainable from other sources, although the underlying assumptions and methodology, and consequently the resulting data, may vary from source to source. While there have been significant steps taken to improve the accuracy of the statistics, it is inevitable in the context of a transition economy that there is a degree of uncertainty as to the accuracy or reliability of the statistics when compared with those produced by countries that have for many years been preparing market economy statistics. In addition, the statistics may not be calculated on the basis that is fully in accordance with international standards, and the statistics have in the past been and may in the future be subject to significant revision. Certain statistical data appearing in this Offering Circular may not have been restated to reflect inflation. Investors should be aware that distortions caused by inflation are present in such statistics and that period-to-period comparisons may not be meaningful.

Bulgaria is a sovereign state. Consequently, it may be difficult for investors to obtain judgments of courts in countries outside Bulgaria against Bulgaria. Enforcement of such judgments in Bulgaria may be refused in certain circumstances in the absence of an applicable treaty facilitating such enforcement. See "*Risk Factors—Risks Relating to the Notes—Enforcement of Liabilities; Waiver of Immunity*".

In connection with the issue of the Notes, HSBC Bank plc (the "**Stabilising Manager**") or any person acting on behalf of the Stabilising Manager may over-allot Notes or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager (or any persons acting on behalf of the Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the Notes and 60 days after the date of the allotment of the Notes. Any stabilisation action or over-allotment must be conducted by the Stabilising Manager (or persons acting on behalf of the Stabilising Manager) in accordance with all applicable laws and rules.

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FORWARD-LOOKING STATEMENTS

This Offering Circular includes forward-looking statements. All statements other than statements of historical fact included in this Offering Circular regarding, among other things, Bulgaria's economy, fiscal condition, politics, debt or prospects may constitute forward-looking statements. In addition, forward-looking statements generally can be identified by the use of forward-looking terminology such as "may", "will", "expect", "project", "predict", "aim", "intend", "estimate", "anticipate", "believe", "continue", "could", "should", "would" or similar expressions or the negative thereof or other variations thereof or comparable terminology or discussions of strategy, plans or intentions, involve a number of risks and uncertainties. Although the Issuer believes that expectations reflected in its forward-looking statements are reasonable as at the date of this Offering Circular, there can be no assurance that such expectations will prove to have been correct. The Issuer undertakes no obligation to update the forward-looking statements contained in this Offering Circular or any other forward-looking statement it may make. Forward-looking statements involve inherent risks and uncertainties.

For the Issuer, in addition to the factors described in this Offering Circular, including, but not limited to, those discussed under "Risk Factors", the following factors, among others, could cause future conditions to differ materially from those expressed in any forward-looking statements made herein:

- External factors, such as:
  - the impact of the international economic environment on the Bulgarian economy, including liquidity in the international financial markets and volatility in international equity, debt and foreign exchange markets;
  - interest rates in financial markets outside Bulgaria;
  - the impact of any changes in the credit rating of Bulgaria;
  - the impact of regional political conditions;
  - the impact of changes in the international prices of commodities; and
  - economic conditions in Bulgaria's major export markets.
- Internal factors, such as:
  - general economic and business conditions in Bulgaria;
  - foreign currency reserves;
  - the level of domestic debt;
  - the level of unemployment;
  - domestic inflation;
  - the ability of Bulgaria to effect key economic reforms;
  - the level of foreign direct and portfolio investment; and
  - the level of Bulgarian domestic interest rates.

EXCHANGE RATES

On 1 July 1997 the Lev was fixed to the German Mark ("**DEM**") at a rate of 1 BGN for 1 DEM. Since 1 January 1999, with the introduction of the Euro for electronic payments, the Lev has been fixed to the Euro at a rate of BGN 1.95583 to €1.00.

The following table sets out both the Lev to U.S. Dollar exchange rate and the U.S. Dollar to Euro exchange rate for the last day of the periods indicated; also set out below are the average exchange rates for the same periods:

	2009	**2010**	**2011**	**2012**	**2013**
			(BGN per U.S.$)[1]		
Year or period end	1.36409	1.47276	1.51158	1.48360	1.41902
Average for year or period	1.40670	1.47738	1.40645	1.52205	1.47356
			(U.S.$ per €)[2]		
Year or period end	1.4406	1.3362	1.2939	1.3194	1.3791
Average for year or period	1.3948	1.3257	1.3920	1.2848	1.3281

(1) *Source*: Bulgarian National Bank
(2) *Source*: European Central Bank

RISK FACTORS

Investment in the Notes involves risks. Prospective investors should carefully consider the following risk factors, together with the other information set out in this Offering Circular, before making a decision to invest in the Notes and should understand that the risks set forth below could, individually or in the aggregate, have a material adverse effect on Bulgaria's capacity to repay principal and make payments of interest on the Notes or otherwise fulfil its obligations under the Notes. Most of these factors are contingencies which may or may not occur and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring. Additional risks and uncertainties not currently known to the Issuer or that the Issuer currently deems to be immaterial may also materially affect Bulgaria's economy and its ability to fulfil its obligations under the Notes. In any such case, investors may lose all or part of their investment in the Notes. Words and expressions defined in "**Terms and Conditions of the Notes**" or elsewhere in this Offering Circular have the same meanings in this section.

Risk Factors Relating to Bulgaria

Bulgaria's economy remains vulnerable to external shocks, including the recent global economic crisis and those that may be caused by future significant economic difficulties among its major trading partners or by more general "contagion" effects, which could have a material adverse effect on Bulgaria's economic growth.

As a small open economy Bulgaria faces the risk of external shocks. The global financial crisis which started in 2007 had a material negative effect on the Bulgarian economy. In 2009, Bulgaria's gross domestic product ("**GDP**") fell by 5.5 per cent. The economy briefly recovered with economic growth reaching 0.4 per cent. in 2010 and 1.8 per cent. in 2011; however, the recession across the European Union (the "**EU**") during the course of 2012 caused the demand for Bulgarian exports to fall, and the country's economic growth slowed to 0.6 per cent. In 2013, as a consequence of rising exports, economic growth in Bulgaria rose to 0.9 per cent. despite the decline in domestic demand which remains relatively weak.

According to the European Commission (the "**Commission**"), the risks for the short-term economic development of Bulgaria are balanced. Domestic demand in Bulgaria remains relatively weak and slow to recover; however, this may be compensated by higher net exports in the coming years. The Commission projects real GDP growth of 1.7 per cent. in 2014 and 2 per cent. in 2015. Economic recovery within the EU is expected to be steady across 2014 and 2015; however, lower than expected economic growth in Bulgaria's major export partners (Germany, Italy, Turkey, Romania and Greece) could have an adverse effect on the Bulgarian economy, resulting in lower economic growth than originally projected. Although the Bulgarian government (the "**Government**") has announced its intention to pursue a series of structural economic and fiscal reforms, and has commenced the implementation of some of these initiatives, no assurance can be given that such initiatives will be adequately funded, will achieve or maintain the necessary long term political support, will be fully implemented or prove successful in achieving their objectives.

In addition, the recent hostilities between Russia and Ukraine have prompted condemnation by members of the international community and have been strongly opposed by the EU and the United States. The potential repercussions surrounding the situation in Ukraine are unknown. The emergence of new or escalated tensions between Russia and Ukraine, or the imposition of further economic or other sanctions in response to such tensions, which may include targeted sanctions against certain industries, could negatively affect other economies in the region and the Eurozone in general. As the Eurozone is Bulgaria's major trading partner, and Ukraine was among the main trading partners of Bulgaria outside the EU in 2013 (after Turkey, Russia and China), any contingent and ongoing escalation of the current tension in Ukraine may in turn have a material adverse effect on economies in the Eurozone, and as a result would adversely impact the Bulgarian economy.

Large-scale economic sanctions by the EU against Russia over its actions in Ukraine may have a material adverse effect on Bulgaria's ability to meet its energy consumption needs

As a result of the ongoing tension between Russian and Ukraine, the EU and the United States have each authorised and imposed sanctions, including the implementation of visa bans and the blocking of property and interests in property that are in the United States or that come within the possession or control of any United States person (including any foreign branch), of individuals and entities who the United States government considers to have misappropriated funds and threatened or undermined the peace, security, stability and sovereignty or territorial integrity of Ukraine. No assurance can be given that other jurisdictions or bodies (including individual member states of the EU) will not impose sanctions as a result of the escalating situation in Ukraine. Any additional large-scale economic sanctions imposed on Russia by the EU, as a consequence of Russia's actions in Ukraine, may have a material adverse impact on Bulgaria's ability to continue meeting its energy consumption needs. In the event that Russia were to impose restrictions on oil and gas exports to EU Member States in response to potential EU sanctions, Bulgaria would most likely be affected, owing to its high dependence on oil and gas exports from Russia, See "—*Bulgaria is highly dependent on imported oil and natural gas and thus exposed to fluctuations in international prices*". This in turn could potentially have a negative impact on the Bulgarian economy.

Early parliamentary elections to be held in the period between 28 September 2014 and 12 October 2014

In view of the results of the elections for the EU Parliament, on 17 June 2014, the President of Bulgaria, President Plevneliev held consultations with the political parties represented in the current Bulgarian Parliament. After the Consultative Council on National Security, the President made a statement, that all parties agreed to, that early parliamentary elections should be held in the period between 28 September 2014 and 12 October 2014. This unanimous decision between the major political parties was taken in order to calm down the political environment and to create favourable conditions for establishing a reformist majority in the next Parliament. All the major parties agreed not to deviate from the fiscal discipline currently implemented. However, there is a risk that following the results of the forthcoming new general elections, a new party or coalition of parties may be voted in and implement different political, economic and fiscal policies to that of the current government, or that no sufficient or stable political majority is elected to parliament and as a result there be difficulties in voting in government. This in turn could hinder implementing potential reforms in the run up to, and potentially following, the elections and therefore have a negative impact on the Bulgarian economy.

Bulgaria is highly dependent on imported oil and natural gas and thus exposed to fluctuations in international prices.

Bulgaria is reliant on a limited variety of energy resources and any delay or failure by Bulgaria to successfully secure access to such energy resources at favourable prices could have a material adverse effect on the Bulgarian economy. Bulgaria's energy and petrochemical industry, for example, obtains most of its input from abroad, principally in the form of oil and gas from Russia. During 2012 and 2013, Bulgaria received about 85 per cent. of its natural gas from Gazprom, a global energy company based in Russia. Equally, Bulgaria's only operational oil refinery, Neftochim, which produces more than 75 per cent. of the country's refined petroleum, is fully owned by Lukoil. Russia is also the only supplier of the Bulgarian Kozloduy nuclear power plant. In addition, Bulgaria is a transit country for Russian natural gas to Turkey, Greece and the Former Yugoslav Republic of Macedonia. The continued impact of the current events in Ukraine and any continuing or escalating military action, public protests, unrest, political instability or possible sanctions, could jeopardise the supply of Russian gas through Ukraine to Bulgaria, as well as to other neighbouring countries, which in turn could have a material adverse impact on the Bulgarian economy as it will be required to seek alternative means to import gas.

Furthermore, consumer prices in Bulgaria largely follow the direction of international food and energy price dynamics. A sharp increase in the price of crude oil will cause inflation both at home and abroad, resulting in higher energy prices and secondary effects on other items included in the

Harmonised Index of Consumer Prices ("**HICP**"). Given the low inflation projection, this could in turn suppress, to some extent, domestic demand and have a material adverse effect on GDP growth.

Lower FDI inflows and EU Fund absorption may negatively affect private and public investment and thus undermine Bulgaria's economic growth

Foreign indirect investment ("**FDI**") in export-oriented sectors such as the processing industries, real estate and construction grew considerably in the run-up to the global financial crisis; however, since the crisis FDI inflows have weakened, reflecting deterioration in the global investment sentiment. FDI inflow, currently amounting to approximately 2-3 per cent. of GDP, is predominantly targeted towards the manufacturing, trade, mining and quarrying sectors. Reduced flow of investment into the Bulgarian economy could lead to lower potential growth in the medium term which may result in an indirect negative effect on budget balance.

In order to incentivise the flow of investments into the Bulgaria economy, the Government is currently introducing measures for improving the business environment and reducing costs for businesses. Several measures aim at reducing excessive bureaucracy comprising the implementation of a new package of measures for reducing the regulatory burden at national and municipal level, amendments to the legislation on state fees, a large-scale administrative reform for introducing complex administrative services and the introduction of preliminary impact assessment to ensure continuity and predictability of legislation by limiting frequent changes to laws and preventing inconsistencies in statutory regulations. Other measures intended to improve the business environment in Bulgaria include increasing the provision of e-administrative services by approximately 60 per cent., improving the quality of the judicial system and developing insolvency framework.

Absorption of EU funds has improved in recent years in Bulgaria and has been used as an instrument for increasing public investments by the Government. Public investments contributed positively to GDP growth in 2012 and 2013 and are expected to support economic growth in 2014. However, lower than expected absorption of EU funds in recent years would require the allocation of additional national funds in order to keep the level of Government investments to existing projects, which may result in an adverse effect on other components of Government budget and have a negative impact on economic growth in Bulgaria.

Risks affecting the financial stability of public pensions and public healthcare

One of the challenges facing the Government in the current economic climate is securing public spending in the fields of social security and healthcare. The Government has already adopted fiscal measures to reduce costs and increase revenue streams for the medium and the long term to fund such services; however, with an ageing demographic, it is anticipated that maintaining such welfare services in Bulgaria may become more and more burdensome on public resources, and so pose a serious risk to the sustainability of public pensions and health care services in the country.

This pressure placed on the sustainability of the public finances therefore necessitates the adoption of a conservative fiscal policy not only with respect to budget balance, but also with regard to pension reforms and public healthcare expenditures. If the Government cannot successfully implement such policies, it could have an adverse effect on the funds available to fund social security and healthcare in Bulgaria in the future.

Changes in Bulgaria's relationships with Western governments and institutions may have a negative impact on the country's economy

The relationships that Bulgaria maintains with Western governments and institutions vary and any change in these relationships could have a negative impact on the economy of Bulgaria. The EU has expressed concerns about deficiencies in Bulgaria's judiciary, and over the Government's contravention of specific commitments, such as those on water and waste management, and tenders within the communications sector. The latest report by the Commission, published in January 2014, showed that Bulgaria has made some progress in the areas of judicial reform, tackling corruption, and

furthering the fight against organised crime; however, additional improvements still need to be made. Corruption is perceived as a major problem and continues to pose a significant challenge for the Bulgarian authorities. Equally, concerns remain about the lack of convictions in organised crime cases and there has also been criticism of the judiciary. In addition, Bulgaria has had problems utilising allocated EU funds in the past, resulting in the risk that any part of the resources allocated to the operational programmes, co-financed by the European Structural and Cohesion funds, that has not been utilised by 31 December of the third financial year following the year of budget commitment, would be subject to the option of decommitment by the EU. In order to improve the chances of more EU funds being received, the Government has introduced new mechanisms to achieve better utilisation rates of EU funds, which are being supervised by both the Cabinet and the Prosecutor's Office and resulted in improved utilisation rates in the second half of 2013. Furthermore, a Cabinet position has also been created to specifically deal with the administration of EU funds. Any deterioration of Bulgaria's relationship with the EU could result in the reduction of EU funds which, in turn, could have an adverse effect on the Bulgarian economy.

Bulgaria suffers from high levels of unemployment

Despite recent improving macroeconomic performance, unemployment remains high in Bulgaria, with 13 per cent. unemployment rate recorded at the end of 2013. Since the end of the 2009 recession, the labour market recovery has been limited. The number of unemployed persons increased from 238 thousand in 2009 to 436.3 thousand in 2013, according to the EU Labour Force Survey ("**LFS**"). Although the global financial crisis has affected many members of the Bulgarian workforce, job losses were more widespread amongst male, the youth, and those in low-skilled positions. The unemployment rate amongst the young (15-24 year old) has increased by over 15 percentage points ("**pps**") during the last five years and reached 28.4 per cent. in 2013.

As part of its measures to improve and strengthen the Bulgarian labour force, the Government has implemented the national employment strategy, which combines measures for improving business environment and providing support for SMEs, including means to activate and improve the inclusion rates of unemployed individuals. Active labour market policies are currently targeted at the most vulnerable groups, such as young unemployed individuals aged up to 29 years, unemployed individuals aged over 50 years, individuals with low qualifications or qualifications for which there is limited demand as well as discouraged or inactive individuals. The development of inter-institutional cooperation and social partnership and further improvement of public employment services is expected to support the effectiveness of the employment policy measures.

Although the Government is planning to continue the process of implementing the national employment strategy, as well as other reforms in the education and labour markets, if high levels of unemployment are not addressed they could become a source of political and social instability in Bulgaria and may lead to a negative effect on the Bulgarian economy in general.

There are risks relating to the Bulgarian banking sector

As at 31 December 2013, 69.8 per cent. of the total assets of the banking system in Bulgaria were foreign owned, and 30.2 per cent. of banks were domestically owned according to supervisory data reported by the Bulgarian National Bank (the "**BNB**"). Out of 69.8 per cent. of foreign owned banks, EU banks had a share of 67.7 per cent., of which 62.2 per cent. were subsidiaries of EU banks and 5.5 per cent. were branches (See "*Monetary and Financial System – Banking System*"). The Bulgarian banking system is exposed to the banking systems of other countries, including Italy, Greece, Austria and France. Foreign banks may rebalance their global loan portfolio in a manner adversely affecting Bulgaria as a result of events related or unrelated to Bulgaria, including as a result of the ongoing economic turbulence in the Eurozone and sovereign debt markets. In addition, foreign banks may decrease funding to their subsidiaries operating in Bulgaria due to actual or perceived deterioration in asset quality, particularly in the event of a weaker than expected economic performance and a rise in non-performing loans.

In addition, following the 2008-2009 global economic crisis, the level of non-performing loans ("**NPLs**") in the Bulgarian banking system began to increase. As of the end of 2013, NPL share amounted to 10.1 per cent. of total net loans (excluding those to credit institutions) and 6.4 per cent. of total assets, compared to 10.6 per cent. in 2012, 9.6 per cent. in 2011 and 8.0 per cent. in 2010. Although NPLs in Bulgaria began to stabilise in 2013, and NPLs are well provisioned for, any new slowdown of economic growth in the Eurozone or the EU as a whole will put pressure on Bulgarian exports, due to a reduction in demand for Bulgarian goods. This may lead to a deterioration of the liquidity position of exporters, which in turn may lead to an increase in companies being unable to make timely payments or repay their debts and a resulting deterioration of the banks' credit portfolio quality and lower bank profitability. The deterioration in banks' portfolios could make them more susceptible to aggregate shocks, such as increases in their own cost of borrowing.

Risks relating to the Notes

Notes May Not be a Suitable Investment for All Investors

Each potential investor in the Notes must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

- have sufficient knowledge and experience to make a meaningful evaluation of the Notes, the merits and risks of investing in the Notes and the information contained or incorporated by reference in this Offering Circular or any applicable supplement;
- have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Notes and the impact such investment will have on its overall investment portfolio;
- have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes;
- understand thoroughly the terms of the Notes; and
- be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate, legal and other factors that may affect its investment and its ability to bear the applicable risks.

A potential investor should not invest in the Notes unless it has the expertise (either alone or with the help of a financial adviser) to evaluate how the Notes will perform under changing conditions, the resulting effects on the value of such Notes and the impact this investment will have on the potential investor's overall investment portfolio.

Modification and Waivers

The Terms and Conditions of the Notes contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority. For example, under these provisions, certain key terms of the Notes may be amended, including the maturity date, interest rate and other payment terms, with the consent of the holders of 75 per cent. of the aggregate nominal amount of the outstanding Notes.

The Terms and Conditions of the Notes also provide that the Notes and such Conditions may, subject to the prior written approval of the Issuer, be amended without the consent of the Noteholders to correct a manifest error. In addition, the parties to the Fiscal Agency Agreement (as defined in "**General Information**") may agree to modify any provision thereof, but the Issuer shall not agree, without the consent of the Noteholders, to any such modification unless it is of a formal, minor or technical nature, it is made to correct a manifest error or it is, in the opinion of such parties, not materially prejudicial to the interests of the Noteholders.

Minimum Denomination

As the Notes have a minimum denomination consisting of EUR 100,000 plus higher integral multiples of EUR 1,000, it is possible that the Notes may be traded in amounts in excess of EUR 100,000 (or its equivalent) that are not integral multiples of EUR 100,000 (or its equivalent). In such case a Noteholder who, as a result of trading such amounts, holds a principal amount of less than the minimum denomination may not receive a Note Certificate in respect of such holding (should Note Certificates be printed) and would need to purchase a principal amount of Notes such that its holding amounts to the minimum denomination.

The EU Savings Directive may result in certain holders not receiving the full amount of interest

Under EC Council Directive 2003/48/EC (the "**EU Savings Directive**") on the taxation of savings income, each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income (within the meaning of the EU Savings Directive) paid by a paying agent (within the meaning of the EU Savings Directive) within its jurisdiction to, or collected by such a paying agent for, an individual resident or certain limited types of entity established in that other Member State. However, for a transitional period, Austria and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at rates which have risen over time to 35 per cent., unless in the case of Luxembourg the beneficial owner of the interest payments opts for information exchange. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.

In a press release of 10 April 2013, the Luxembourg Ministry of Finance announced that the Luxembourg government had decided to introduce with effect from 1 January 2015, the automatic exchange of information system under the EU Savings Directive for all interest payments made by Luxembourg financial operators to individuals resident in another Member State. This will replace the 35 per cent. withholding tax.

A number of non-EU countries and certain dependent or associated territories of certain Member States, have adopted similar measures (either provision of information or transitional withholding) in relation to payments made by a paying agent within their jurisdiction to, or collected by such a paying agent for, an individual resident in a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident or certain limited types of entity established in one of those territories.

The European Commission has proposed certain amendments to the EU Savings Directive, which may, if implemented, amend or broaden the scope of the requirements described above. Investors who are in any doubt as to their position should consult their professional advisers.

If an amount of, or in respect of, tax were to be withheld from a payment of principal or interest under a Note, pursuant to the EU Savings Directive, any other European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. See Condition 8 (*Taxation*) of the "**Terms and Conditions of the Notes**". However, the Issuer is required, as provided in Condition 12 (*Agents*) of the "**Terms and Conditions of the Notes**", to maintain a Paying Agent in a Member State that does not impose an obligation to withhold or deduct tax pursuant to the EU Savings Directive or any law implementing or complying with, or introduced in order to conform to, the EU Savings Directive or any such other Directive.

Change in Law

The "**Terms and Conditions of the Notes**" are based on English law in effect as at the date of this Offering Circular. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of this Offering Circular and any such change could materially and adversely impact the value of any Notes affected by it.

The Terms and Conditions of the Notes restrict the ability of an individual holder to declare a default and permit a majority of holders to rescind a declaration of default.

The Terms and Conditions of the Notes contain a provision which, if an Event of Default occurs, allows the holders of at least 25 per cent. in aggregate nominal amount of the outstanding Notes to declare all the Notes to be immediately due and payable by providing notice in writing to the Issuer, whereupon the Notes shall become immediately due and payable, at their principal amount with accrued interest, without further action or formality.

The Terms and Conditions of the Notes also contain a provision permitting the holders of at least 50 per cent. in aggregate nominal amount of the outstanding Notes to notify the Issuer to the effect that the Event of Default or Events of Default giving rise to any above mentioned declaration is or are cured following any such declaration and that such holders wish the relevant declaration to be withdrawn. The Issuer shall give notice thereof to the Noteholders, whereupon the relevant declaration shall be withdrawn and shall have no further effect.

The Secondary Market Generally

The Notes may have no established trading market when issued, and one may never develop. If a market does develop, it may not be liquid. Therefore, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments where a developed secondary market exists.

Legal Investment Considerations May Restrict Certain Investments

The investment activities of certain investors are subject to investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (1) the Notes are legal investments for it, (2) the Notes can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of any Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of the Notes under any applicable risk based capital or similar rules.

Exchange rate risks and exchange controls

The Issuer will pay principal and interest on the Notes in Euro. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the "**Investor's Currency**") other than Euro. These include the risk that exchange rates may significantly change (including changes due to devaluation of Euro or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to Euro would decrease (1) the Investor's Currency equivalent yield on the Notes, (2) the Investor's Currency equivalent value of the principal payable on the Notes and (3) the Investor's Currency equivalent market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate or the ability of the Issuer to make payments in respect of the Notes. As a result, investors may receive less interest or principal than expected, or no interest or principal.

Interest rate risks

Investment in the Notes involves the risk that subsequent changes in market interest rates may adversely affect the value of the Notes.

Credit Ratings May Not Reflect All Risks

In general, European regulated investors are restricted under Regulation (EC) No. 1060/2009 (the "**CRA Regulation**") from using credit ratings for regulatory purposes, unless such ratings are issued by a credit rating agency established in the EU and registered under the CRA Regulation (and such registration has not been withdrawn or suspended), subject to transitional provisions that apply in certain circumstances whilst the registration application is pending. Such general restriction will also apply in the case of credit ratings issued by non-EU credit rating agencies, unless the relevant credit ratings are endorsed by an EU-registered credit rating agency or the relevant non-EU rating agency is certified in accordance with the CRA Regulation (and such endorsement action or certification, as the case may be, has not been withdrawn or suspended).

The Issuer has been assigned sovereign credit ratings of Baa2 by Moody's Investors Service Ltd. ("**Moody's**") on 22 July 2011, as last reaffirmed on 28 May 2012, BBB- by Standard & Poor's Credit Market Services Europe Limited ("**Standard & Poor's**") on 13 June 2014 (a change from the BBB rating assigned by Standard & Poor's on 30 October 2008 and last reaffirmed on 13 December 2013) and BBB- by Fitch Ratings Inc. ("**Fitch**") on 10 November 2008, as last reaffirmed on 10 January 2014. Each of Moody's, Standard & Poor's and Fitch is established in the EU and registered under the CRA Regulation. A credit rating is not a recommendation to buy, sell or hold the Notes. Credit ratings are subject to revision or withdrawal at any time by the assigning rating agency. The Issuer cannot be certain that a credit rating will remain for any given period of time or that a credit rating will not be downgraded or withdrawn entirely by the relevant rating agency if, in its judgment, circumstances in the future so warrant. The Issuer has no obligation to inform Noteholders of any such revision, downgrade or withdrawal. A suspension, downgrade or withdrawal at any time of the credit rating assigned to the Issuer may adversely affect the market price of the Notes.

Enforcement of Liabilities

Bulgaria is a sovereign state. Consequently, it may be difficult for investors to obtain judgments of courts in countries outside Bulgaria against the Republic. In the absence of any applicable international treaty, recognition and enforcement of judgments of courts outside the European Union in Bulgaria may be refused on the grounds provided in Bulgaria's Private International Law Code. Such non-enforcement grounds are similar to, yet are slightly broader than, the grounds under Council Regulation (EC) No. 44/2001 of 22 December 2000 on the jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (the "**Council Regulation (EC) No. 44/2001**").

As at the date of this Offering Circular, a judgment obtained in an English court should be enforceable in Bulgaria on the basis that Council Regulation (EC) No. 44/2001 is directly applicable in Bulgaria, *provided, however, that* the conditions of enforcement set out therein are met.

After a final court judgment, whether of an English court or of any other court of competent jurisdiction, is recognised in Bulgaria it has the validity of a Bulgarian judgment and will be subject to enforcement against the Republic in accordance with the provisions of Bulgaria's Civil Procedure Code. It is notable, that enforcement against the Republic will be carried out in accordance with procedures which differ from the enforcement procedures applicable to other defendants (for example, the attachment of or forcible liquidation of assets of the Republic located in Bulgaria is not possible).

TERMS AND CONDITIONS OF THE NOTES

The following is the text of the Terms and Conditions of the Notes which, subject to completion and amendment will be endorsed on each Note Certificate (*if issued*):

The EUR 1,493,000,000 2.950 per cent. Notes due 2024 (the "**Notes**", which expression includes any further notes issued pursuant to Condition 14 (*Further Issues*) and forming a single series therewith) of the Republic of Bulgaria (the "**Issuer**") were authorised by the 2014 State Budget Act of the Republic of Bulgaria, the resolutions of the Council of Ministers dated 19 March 2014 and dated 30 May 2014 and by the law on ratification of the Fiscal Agency Agreement (as defined below), the Subscription Agreement (as defined in "**Subscription and Sale**") and the Deed of Covenant (as defined below) adopted by parliament on 6 June 2014, sealed by the President on 11 June 2014 and published by the State Gazette Issue No. 49/2014 on 13 June 2014 and in force as of 17 June 2014 (the "**Law on Ratification**"). A fiscal agency agreement dated 21 May 2014, as amended or supplemented from time to time (the "**Fiscal Agency Agreement**") has been entered into, between the Issuer and The Bank of New York Mellon as fiscal agent and the other agents named in it. The Notes have the benefit of a Deed of Covenant dated 21 May 2014 (the "**Deed of Covenant**") executed by the Issuer relating to the Notes. The fiscal agent, the registrar, and any transfer agent for the time being are referred to below respectively as the "**Fiscal Agent**", the "**Registrar**" and the "**Transfer Agents**". "**Paying Agents**" means the Fiscal Agent and the paying agents named in the Fiscal Agency Agreement, which expression includes any other paying agent or paying agents appointed from time to time with respect to the Notes. "**Agents**" means the Fiscal Agent, the Paying Agents, the Registrar, the Transfer Agents and any other agent or agents appointed from time to time with respect to the Notes. Certain provisions of these Conditions are summaries of the Fiscal Agency Agreement and are subject to its detailed provisions. The Fiscal Agency Agreement includes the form of the Notes. Copies of the Fiscal Agency Agreement and the Deed of Covenant are available for inspection by Noteholders (as defined below) during normal business hours at the Specified Offices (as defined in the Fiscal Agency Agreement) of each of the Paying Agents, the Registrar and any Transfer Agents, the initial Specified Offices of which are set out below. The holders of the Notes are bound by, and are deemed to have notice of all the provisions of the Fiscal Agency Agreement applicable to them.

All capitalised terms that are not defined in these terms and conditions (the "**Conditions**") will have the meanings given to them in the Fiscal Agency Agreement, the absence of any such meaning indicating that such term is not applicable to the Notes. References to "**Conditions**" are, unless the context otherwise requires, to the numbered paragraphs of these terms and conditions.

1. Form, Denomination and Title

The Notes are serially numbered and in registered form in denominations of EUR 100,000 and integral multiples of EUR 1,000 in excess thereof (each such denomination an "**Authorised Holding**").

The Notes are intended to be issued under the new safekeeping structure and are represented by registered certificates ("**Note Certificates**") and, save as provided in Condition 2(a) (*Transfer*), each Note Certificate shall represent the entire holding of Notes by the same holder.

Title to the Notes shall pass by registration in the register that the Issuer shall procure to be kept by the Registrar at its Specified Office in accordance with the provisions of the Fiscal Agency Agreement (the "**Register**"). The holder (as defined below) of any Note shall (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any other interest therein, any writing thereon or any notice of any previous loss or theft thereof) and no person shall be liable for so treating the holder. No person shall have any right to enforce any term or condition of the Notes under the Contracts (Rights of Third Parties) Act 1999.

In these Conditions:

"**Noteholder**" and "**holder**" means the person in whose name a Note is registered in the Register (or, in the case of joint holders, the first name thereof); and

"**person**" means any individual, company, corporation, firm, partnership, joint venture, association, organisation, state or agency of a state or other entity, whether or not having separate legal personality.

2. Transfer of Notes

(a) Transfer

One or more Notes may, subject to the terms of the Fiscal Agency Agreement and to Condition 2(c) (*Transfer or Exercise Free of Charge*) and 2(d) (*Closed Periods*), be transferred in whole or in part in an Authorised Holding upon the surrender (at the Specified Office of the Registrar or any Transfer Agent) of the Note Certificate(s) representing such Notes to be transferred, together with the form of transfer endorsed on such Note Certificate(s) (or another form of transfer substantially in the same form and containing the same representations and certifications (if any), unless otherwise agreed by the Issuer), duly completed and executed and any other evidence as the Registrar or Transfer Agent may reasonably require. In the case of a transfer of part only of a holding of Notes represented by one Note Certificate, a new Note Certificate shall be issued to the transferee in respect of the part transferred and a further new Note Certificate in respect of the balance of the holding not transferred shall be issued to the transferor. In the case of a transfer of Notes to a person who is already a holder, a new Note Certificate representing the enlarged holding shall only be issued against surrender of the Note Certificate representing the existing holding. All transfers of Notes and entries on the Register will be made in accordance with the detailed regulations concerning transfers of Notes scheduled to the Fiscal Agency Agreement. The regulations may be changed by the Issuer, with the prior written approval of the Registrar and the Fiscal Agent (such approval not to be unreasonably withheld or delayed). A copy of the current regulations will be made available by the Registrar to any Noteholder upon request. A Note may be registered only in the name of, and transferred only to, a named person or persons. No transfer of a Note will be valid unless and until entered on the Register.

(b) Delivery of New Note Certificates

Each new Note Certificate to be issued pursuant to Condition 2(a) (*Transfer*) shall be available for delivery within five business days of receipt of a duly completed form of transfer and surrender of the existing Note Certificate(s). Delivery of the new Note Certificate(s) shall be made at the Specified Office of the Transfer Agent or of the Registrar (as the case may be) to whom delivery or surrender of such form of transfer or Note Certificate shall have been made or, at the option of the holder making such delivery or surrender as aforesaid and as specified in the relevant form of transfer or otherwise in writing, be mailed by uninsured post at the risk and at the expense of the holder entitled to the new Note Certificate to such address as may be so specified, unless such holder requests otherwise and pays in advance to the relevant Transfer Agent or the Registrar (as the case may be) the costs of such other method of delivery and/or such insurance as it may specify. In this Condition 2(b), "**business day**" means a day, other than a Saturday or Sunday, on which banks are open for general business (including dealing in foreign exchange and foreign currency deposits) in both London and the place of the Specified Office of the relevant Transfer Agent or the Registrar (as the case may be).

(c) Transfer or Exercise Free of Charge

Note Certificates, on transfer, exercise of an option or partial redemption, shall be issued and registered without charge by or on behalf of the Issuer, the Registrar or any Transfer Agent, but subject to (i) the payment by the person making the application for transfer of any tax, duties or other governmental charges that may be imposed in relation to it (or the giving of such indemnity as the Registrar or the relevant Transfer Agent may require), (ii) the Registrar being satisfied with the documents of title and/or identity of the person making the application, and (iii) such reasonable regulations as the Issuer may from time to time agree with the Registrar.

(d) **Closed Periods**

No Noteholder may require the transfer of a Note to be registered during the period of 15 days immediately prior to the due date for any payment of principal or interest in respect of the Notes.

(e) **Authorised Holdings**

No Note may be transferred unless the principal amount of Notes transferred and (where not all of the Notes held by a holder are being transferred) the principal amount of the balance of the Notes not transferred are Authorised Holdings.

3. Status

The Notes constitute direct, general, unconditional and (subject to Condition 4 (*Negative Pledge*)), unsecured and unsubordinated obligations of the Issuer and the full faith and credit of the Issuer is pledged for the due and punctual payment of principal of, and interest on, the Notes and for the performance of all other obligations of the Issuer pursuant to the Notes. The Notes shall at all times rank *pari passu* without any preference among themselves and at least *pari passu* in right of payment with all other present and future unsecured and unsubordinated obligations of the Issuer, save for such obligations as may be preferred by provisions of law that are of mandatory application.

4. Negative Pledge

So long as any of the Notes remain outstanding (as defined in the Fiscal Agency Agreement), the Issuer will not grant or permit to be outstanding, and will procure that there is not granted or permitted to be outstanding, any mortgage, charge, lien, pledge or other security interest over any of its present or future assets or revenues or any part thereof, to secure any Public External Indebtedness or any Guarantee thereof unless the Issuer shall, in the case of the granting of the security, before or at the same time, and in any other case, promptly, procure that all amounts payable in respect of the Notes are secured equally and rateably, or such other security or other arrangement is provided as shall be approved by an Extraordinary Resolution (as defined in the Fiscal Agency Agreement) of the Noteholders.

In these Conditions:

"**Guarantee**" means any guarantee of or indemnity in respect of indebtedness or other like obligation; and

"**Public External Indebtedness**" means any present or future indebtedness (a) in the form of, or represented by, notes, bonds or other similar instruments which are for the time being, or are capable of being, quoted, listed or ordinarily dealt in on any stock exchange, over the counter or other securities market and (b) which is not (i) denominated in Bulgarian lev, (ii) admitted to trading on a market of the Bulgarian Stock Exchange, (iii) registered with the Central Depositary AD of the Republic of Bulgaria, (iv) expressed to be governed by the laws of the Issuer, or (v) placed or sold in the Republic of Bulgaria. For the purposes of this Condition, an issue is "placed or sold in the Republic of Bulgaria" if more than 50 per cent. of its aggregate nominal amount is initially placed in the Republic of Bulgaria.

5. Interest

Each Note bears interest from 3 July 2014 (the "**Issue Date**") at the rate of 2.950 per cent. per annum (the "**Rate of Interest**"), payable in arrear on 3 September in each year (each, an "**Interest Payment Date**"), subject as provided in Condition 7 (*Payments*).

Each Note will cease to bear interest from the due date for redemption unless, upon due presentation of the corresponding Note Certificate, payment of principal is improperly withheld or refused, in which case it will continue to bear interest at such rate (both before and after judgment) until whichever is the earlier of (a) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (b) the day which is seven days after notice has been given to the Noteholders that the Fiscal Agent has received all sums due in respect of the Notes up to such seventh day (except, in the case of payment to the Fiscal Agent, to the extent that there is any subsequent default in payment in accordance with these Conditions).

The amount of interest payable on each Interest Payment Date shall be EUR 2,950 in respect of each Note of EUR 100,000 denomination and EUR 29.50 in respect of each integral amount of EUR 1,000 denomination thereafter. If interest is required to be paid in respect of a Note on any other date, it shall be calculated by applying the Rate of Interest to the EUR Calculation Amount, multiplying the product by the EUR Day Count Fraction and rounding the resulting figure to the nearest cent (half a cent being rounded upwards) and multiplying such rounded figure by a fraction equal to the denomination of such Note divided by the EUR Calculation Amount, where:

"**EUR Calculation Amount**" means EUR 1,000;

"**EUR Day Count Fraction**" means, in respect of any period, the number of days in such period, from (and including) the first day to (but excluding) the last day, divided by the number of days in the Regular Period in which such period falls; and

"**Regular Period**" means each period from (and including) the Issue Date or any Interest Payment Date to (but excluding) the next Interest Payment Date.

6. Redemption, Purchase and Cancellation

(a) Final Redemption

Unless previously purchased and cancelled, the Notes will be redeemed at their principal amount on 3 September 2024 subject as provided in Condition 7 (*Payments*).

(b) Purchase

The Issuer and its Agencies may at any time purchase Notes in the open market or otherwise at any price. Any Notes so purchased, while held by or on behalf of the Republic or any Agency, shall not entitle the holder to vote at any meeting of Noteholders and shall not be deemed to be outstanding for the purposes of calculating quorums at meetings of Noteholders.

All Note Certificates representing Notes so purchased may be held or resold or surrendered to the Registrar for cancellation.

(c) Cancellation

Any Note Certificate so surrendered for cancellation pursuant to Condition 6(b) (*Purchase*) may not be reissued or resold and upon such cancellation the obligations of the Issuer in respect of any such Note shall be discharged.

"**Agency**" means any political sub-division, regional government, ministry, department, central or local authority or statutory corporation of the Republic of Bulgaria or the Government (whether or not such statutory corporation is autonomous) and any corporation or other entity (but not any commercial corporation or other commercial entity) which is directly or indirectly controlled (whether by reason of whole or partial ownership, control over voting or other relevant decision making power to direct management, the composition of management or otherwise) by the Republic of Bulgaria or the Government or one or more Agencies;

7. Payments

(a) Principal

Payments of principal shall be made by euro cheque drawn on, or, upon application by a Noteholder to the Specified Office of the Fiscal Agent not later than the fifteenth day before the due date for any such payment, by transfer to a euro account (or other account to which euro may be credited or transferred) maintained by the payee with, a bank in a city in which banks have access to the TARGET System and (in the case of redemption) upon surrender (or, in the case of part payment only, endorsement) of the relevant Note Certificates at the Specified Office of any Paying Agent.

(b) Interest

Payments of interest shall be made by euro cheque drawn on, or upon application by a Noteholder to the Specified Office of the Fiscal Agent not later than the fifteenth day before the due date for any such payment, by transfer to a euro account (or other account to which euro may be credited or transferred) maintained by the payee with, a bank in a city in which banks have access to the TARGET System and (in the case of interest payable on redemption) upon the due date for payment.

(c) Interpretation

In these Conditions:

"**TARGET2**" means the Trans-European Automated Real-Time Gross Settlement Express Transfer payment system which utilises a single shared platform and which was launched on 19 November 2007;

"**TARGET Settlement Day**" means any day on which TARGET2 is open for the settlement of payments in euro; and

"**TARGET System**" means the TARGET2 system.

(d) Payments on business days

Where payment is to be made by transfer to a euro account (or other account to which euro may be credited or transferred), payment instructions (for value the due date, or, if the due date is not a business day, for value the next succeeding business day) will be initiated and, where payment is to be made by cheque, the cheque will be mailed (i) (in the case of payments of principal and interest payable on redemption) on the later of the due date for payment and the day on which the relevant Note Certificate is surrendered (or, in the case of part payment only, endorsed) at the Specified Office of a Paying Agent and (ii) (in the case of payments of interest payable other than on redemption) on the due date for payment. A Noteholder shall not be entitled to any interest or other payment in respect of any delay in payment resulting from (A) the due date for a payment not being a business day or (B) a cheque mailed in accordance with this Condition 7 arriving after the due date for payment or being lost in the mail. In this Condition 7(e), "**business day**" means:

(i) in the case of payment by transfer to a euro account (or other account to which euro may be credited or transferred) as referred to above, any day which is a TARGET Settlement Day; and

(ii) in the case of surrender (or, in the case of part payment only, endorsement) of a Note Certificate, any day on which banks are open for general business (including dealings in foreign exchange and foreign currencies) in the place in which the Note Certificate is surrendered (or, as the case may be, endorsed).

(e) **Payments subject to fiscal laws**

All payments in respect of the Notes are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment, but without prejudice to the provisions of Condition 8 (Taxation). No commissions or expenses shall be charged to the Noteholders in respect of such payments.

(f) **Partial payments**

If a Paying Agent makes a partial payment in respect of any Note Certificate, the Issuer shall procure that the amount and date of such payment are noted on the Register and, in the case of partial payment upon presentation of a Note Certificate, that a statement indicating the amount and the date of such payment is endorsed on the relevant Note Certificate.

(g) **Record date**

Each payment in respect of a Note will be made to the person shown as the holder in the Register at the close of business in the place of the Registrar's Specified Office on the fifteenth day before the due date for such payment (the "**Record Date**"). Where payment in respect of a Note is to be made by cheque, the cheque will be mailed to the address shown as the address of the holder in the Register at the close of business on the relevant Record Date.

8. Taxation

All payments of principal and interest in respect of the Notes by the Issuer shall be made free and clear of and, without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of the Republic of Bulgaria or any political subdivision of, or any authority therein or thereof having power to tax, unless the withholding or deduction of such taxes, duties, amendments or governmental charges is required by law. In that event, the Issuer will pay such additional amounts as will result in receipt by the Noteholders after such withholding or deduction of such amounts as would have been received by them had no such withholding or deduction been required, except that no additional amounts shall be payable in relation to any payment in respect of any Note:

(a) where (in the case of a payment of principal or interest on redemption) the relevant Note Certificate is surrendered for payment by or on behalf of a holder which is liable to such taxes, duties, assessments or governmental charges in respect of such Note by reason of its having some connection with the Republic of Bulgaria other than the mere holding of the Note; or

(b) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law

implementing or complying with, or introduced in order to conform to, such Directive; or

(c) where (in the case of a payment of principal or interest on redemption) the relevant Note Certificate is surrendered for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by surrendering the relevant Note Certificate to another Paying Agent in a member state of the European Union; or

(d) more than 30 days after the Relevant Date except to the extent that the holder of such Note would have been entitled to such additional amounts on surrendering such Note Certificate representing such Note for payment on the last day of such period of 30 days.

In these Conditions, "**Relevant Date**" means whichever is the later of (1) the date on which the payment in question first becomes due and (2) if the full amount payable has not been received in a city in which banks have access to the TARGET System by the Fiscal Agent on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Noteholders.

Any reference in these Conditions to principal or interest shall be deemed to include any additional amounts in respect of principal or interest (as the case may be) which may be payable under this Condition 8.

9. Events of Default

If any of the following events (each an "**Event of Default**") occurs and is continuing:

(a) **Non-payment**

Any default is made in the payment of any interest due in respect of the Notes or any of them when due and the default continues for a period of 15 days; or

(b) **Breach of Other Obligations**

The Issuer fails to perform or observe any of its other obligations under these Conditions and (except in any case where the failure is incapable of remedy when no continuation or notice as is hereinafter mentioned will be required) the failure continues for the period of 30 days after written notice thereof, addressed to the Issuer by any Noteholder, has been delivered to the Issuer or to the Fiscal Agent requiring the same to be remedied; or

(c) **Cross-default**

(i) the holders of any Public External Indebtedness of the Issuer accelerate such Public External Indebtedness or declare such Public External Indebtedness to be due and payable, or required to be prepaid (other than by a regularly scheduled required payment), prior to the stated maturity thereof; or

(ii) the Issuer fails to pay in full any principal of, or interest on, any Public External Indebtedness when due (after expiration of any applicable grace period) or any Guarantee thereof given by the Issuer shall not be honoured when due and called upon (after the expiration of any applicable grace period);

provided that the aggregate amount of the relevant Public External Indebtedness or Guarantee in respect of which one or more of the events mentioned above in this paragraph (c) shall have occurred equals or exceeds EUR 100,000,000 or its equivalent in any other currency or currencies; or

(d) **Unenforceability**

For any reason whatsoever, any of the Issuer's obligations under the Notes are declared by a court of competent jurisdiction pursuant to a final non-appealable decision to be no longer binding or no longer enforceable against the Issuer or as a result of a judgment or any other act of the Constitutional Court of the Republic of Bulgaria or for any other reason whatsoever any such obligation ceases to be in full force and effect; or

(e) **Validity**

The Republic of Bulgaria, or any of its political sub-divisions, authorised Agencies or officials (on its behalf) repudiates or contests the validity of the Notes;

then the holders of at least 25 per cent. in aggregate nominal amount of the outstanding Notes may, by notice in writing to the Issuer (with a copy to the Fiscal Agent), declare all the Notes to be immediately due and payable, whereupon they shall become immediately due and payable at their principal amount together with any accrued interest without further action or formality. Notice of any such declaration shall promptly be given to all other Noteholders by the Issuer.

If the Issuer receives notice in writing from holders of at least 50 per cent. in aggregate nominal amount of the outstanding Notes to the effect that the Event of Default or Events of Default giving rise to any above mentioned declaration of acceleration is or are cured following any such declaration and that such holders wish the relevant declaration to be withdrawn, the Issuer shall give notice thereof to the Noteholders (with a copy to the Fiscal Agent), whereupon the relevant declaration shall be withdrawn and shall have no further effect, but without prejudice to any rights or obligations which may have arisen before the Issuer gives such notice (whether pursuant to these Conditions or otherwise). No such withdrawal shall affect any other or any subsequent Event of Default or any right of any Noteholder in relation thereto.

10. Prescription

Claims against the Issuer for payment in respect of the Notes shall become void unless made within a period of ten years, in the case of principal, and five years, in the case of interest, of the appropriate Relevant Date (as defined in Condition 8 (*Taxation*)).

11. Replacement of Note Certificates

If any Note Certificate is lost, stolen, mutilated, defaced or destroyed it may be replaced at the Specified Office of the Registrar or such other Transfer Agent as may from time to time be designated by the Issuer for that purpose and notice of whose designation is given to Noteholders, subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer may reasonably require. Mutilated or defaced Notes Certificates must be surrendered before replacements will be issued.

12. Agents

In acting under the Fiscal Agency Agreement and in connection with the Notes, the Agents act solely as agents of the Issuer and do not assume any obligations towards or relationship of agency or trust for or with any of the Noteholders.

The initial Agents and their initial Specified Offices are listed below. The Issuer reserves the right at any time to vary or terminate the appointment of any Agent and to appoint a successor

registrar, principal paying agent and additional or successor paying agents and transfer agents; *provided, however, that* the Issuer shall at all times maintain (a) a fiscal agent and a registrar and (b) a paying agent in an EU member state that will not be obliged to withhold or deduct tax pursuant to any law implementing European Council Directive 2003/48/EC.

Notice of any change in any of the Agents or in their Specified Offices shall promptly be given to the Noteholders in accordance with Condition 15 (*Notices*).

13. Meetings of Noteholders; Written Resolutions

(a) Convening Meetings of Noteholders

The Fiscal Agency Agreement contains provisions for convening meetings of Noteholders to consider matters relating to the Notes, including the modification of any provision of these Conditions or the provisions of the Fiscal Agency Agreement. Such a meeting may be convened by the Issuer or the Fiscal Agent and shall be convened by the Issuer or the Fiscal Agent at any time upon the request in writing of holders of at least 10 per cent. of the aggregate nominal amount of the outstanding Notes.

(b) Quorum

The quorum at any meeting of Noteholders convened to vote on an Extraordinary Resolution will be:

(i) two or more persons present and holding or representing at least 50 per cent. of the aggregate nominal amount of the outstanding Notes; or

(ii) where a meeting is adjourned and rescheduled owing to a lack of quorum, at any rescheduled meeting of Noteholders, one or more persons present and holding or representing at least 25 per cent. of the aggregate nominal amount of the outstanding Notes,

provided, however, that any proposals relating to a Reserved Matter may only be approved by an Extraordinary Resolution passed at a meeting of Noteholders at which two or more persons present and holding or representing at least 75 per cent. of the aggregate nominal amount of the outstanding Notes form a quorum.

(c) Reserved Matters

In these Conditions, "**Reserved Matter**" means, any proposal:

(i) to change the date, or the method of determining the date, for payment of principal, interest or any other amount in respect of the Notes, to reduce or cancel the amount of principal, interest or any other amount payable on any date in respect of the Notes or to change the method of calculating the amount of principal, interest or any other amount payable in respect of the Notes on any date;

(ii) to change the currency in which any amount due in respect of the Notes is payable or the place in which any payment is to be made;

(iii) to change the quorum required at any meeting of Noteholders or the majority required to pass an Extraordinary Resolution, Written Resolution or any other resolution of Noteholders or the number or percentage of votes required to be cast, or the number or percentage of Notes required to be held, in connection with the taking of any decision or action by or on behalf of the Noteholders or any of them;

(iv) to change this definition, the definition of "**Extraordinary Resolution**", the definition of "**outstanding**" or the definition of "**Written Resolution**";

(v) to change or waive the provisions of the Notes set out in Condition 3 (*Status*);

(vi) to change any provision of the Notes describing circumstances in which Notes may be declared due and payable prior to their scheduled maturity date, set out in Condition 9 (*Events of Default*);

(vii) to change the law governing the Notes, the courts to the jurisdiction of which the Issuer has submitted in the Notes, the Issuer's obligation to maintain an agent for service of process in England or the Issuer's waiver of immunity, in respect of actions or proceedings brought by any Noteholder, set out in Condition 17 (*Governing Law and Jurisdiction*); or

(viii) to modify any provision of these Conditions in connection with any exchange or substitution of the Notes for, or the conversion of the Notes into, any other obligations or securities of the Issuer or any other person, which would result in the Conditions as so modified being less favourable to the holders of Notes are subject to the Conditions as so modified than:

(A) the provisions of the other obligations or securities of the Issuer or any other person resulting from the relevant exchange or substitution or conversion; or

(B) if more than one series of other obligations or securities results from the relevant exchange or substitution or conversion, the provisions of the resulting series having the largest aggregate nominal amount.

(d) **Modifications**

Any modification of any provision of these Conditions may be made if approved by an Extraordinary Resolution or a Written Resolution. In these Conditions, "**Extraordinary Resolution**" means a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement by a majority of at least:

(i) in the case of a Reserved Matter, 75 per cent. of the aggregate nominal amount of the outstanding Notes; or

(ii) in the case of a matter other than a Reserved Matter, 50 per cent. of the aggregate nominal amount of the outstanding Notes which are represented at that meeting.

Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders, whether present or not and whether they voted in favour or not.

(e) **Written resolutions**

In addition, the Fiscal Agency Agreement contains provisions relating to Written Resolutions. A "**Written Resolution**" is a resolution in writing signed by or on behalf of the holders of at least 75 per cent. of the aggregate nominal amount of the outstanding Notes, in the case of a Reserved Matter, or 50 per cent. of the aggregate nominal amount of the outstanding Notes, in the case of a matter other than a Reserved Matter. Any Written Resolution may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders. Any Written Resolution shall be binding on all of the Noteholders, whether or not signed by them.

(f) **Manifest error, etc.**

The Notes, these Conditions and the provisions of the Fiscal Agency Agreement may be amended without the consent of the Noteholders to correct a manifest error. In addition, the parties to the Fiscal Agency Agreement may agree to modify any provision thereof, but the Issuer shall not agree, without the consent of the Noteholders, to any such modification unless it is of a formal, minor or technical nature or it is not materially prejudicial to the interests of the Noteholders.

(g) **Outstanding Notes**

For the purposes of (i) ascertaining the right to attend and vote at any meeting of Noteholders, (ii) this Condition 13 and Schedule 3 to the Fiscal Agency Agreement and (iii) Condition 9 (*Events of Default*), those Notes (if any) which are for the time being held by or on behalf of the Issuer or by any person owned or controlled directly or indirectly by the Issuer, or by any Agency, shall (unless and until ceasing to be so held) be disregarded and be deemed not to remain outstanding. "**Control**" means the power, directly or indirectly, through the ownership of voting securities or other ownership interests or otherwise, to direct the management of or elect or appoint a majority of the board of directors or other persons performing similar functions in lieu of, or in addition to, the board of directors of a corporation, trust, financial institution or other entity.

In advance of any meeting of Noteholders or Written Resolution the Issuer shall provide to the Fiscal Agent a certificate of the Issuer setting out the total number of Notes which are held in circumstances where the Issuer has at the date of such certificate the power to direct the casting of votes in respect of such Notes. The Fiscal Agent shall make any such certificate available for inspection during normal business hours at its Specified Office and, upon reasonable request, will allow copies of such certificate to be taken.

(h) **Noteholders' Committee**

(i) The Noteholders may, by a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement by a majority of at least 50 per cent. in aggregate nominal amount of the Notes then outstanding, or by notice in writing to the Issuer (with a copy to the Fiscal Agent) signed by or on behalf of the holders of at least 50 per cent. in aggregate nominal amount of the Notes then outstanding, appoint any person or persons as a committee to represent the interests of the Noteholders if any of the following events has occurred:

(A) an Event of Default;

(B) any event or circumstance which could, with the giving of notice, lapse of time, the issuing of a certificate and/or fulfilment of any other requirement provided for in Condition 9 (*Events of Default*), become an Event of Default; or

(C) any public announcement by the Issuer, to the effect that the Issuer is seeking or intends to seek a restructuring of the Notes (whether by amendment, exchange offer or otherwise),

provided, however, that no such appointment shall be effective if the holders of more than 25 per cent. of the aggregate nominal amount of the outstanding Notes have either (i) objected to such appointment by notice in writing to the Issuer (with a copy to the Fiscal Agent) during a specified period following notice of the appointment being given (if such notice of appointment is made

by notice in writing to the Issuer) where such specified period shall be either 30 days or such other longer or shorter period as the committee may, acting in good faith, determine to be appropriate in the circumstances, or (ii) voted against such resolution at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement. Such committee shall, if appointed by notice in writing to the Issuer, give notice of its appointment to all Noteholders in accordance with Condition 15 (*Notices*) as soon as practicable after the notice is delivered to the Issuer.

(ii) Such committee in its discretion may, among other things, (i) engage legal advisers and financial advisers to assist it in representing the interests of the Noteholders, (ii) adopt such rules as it considers appropriate regarding its proceedings and (iii) enter into discussions with the Issuer and/or other creditors of the Issuer. The Issuer shall pay any fees and expenses which are reasonably incurred by any such committee (including, without limitation, the costs of giving notices to Noteholders, fees and expenses of the committee's legal advisers and financial advisers, if any) within 30 days of the delivery to the Issuer of a reasonably detailed invoice and supporting documentation.

14. Further Issues

The Issuer shall be at liberty from time to time, without the consent of the Noteholders, to create and issue further notes ranking equally in all respects (or in all respects save for the date for and amount of the first payment of interest thereon) so that the same shall be consolidated and form a single series with the Notes.

15. Notices

Notices to Noteholders will be valid if published in a leading newspaper having general circulation in Luxembourg (which is expected to be the Luxembourg Wort) and/or the Luxembourg Stock Exchange's website, www.bourse.lu or, if such publication is not practicable, in a leading English language daily newspaper having general circulation in Europe. Any such notice shall be deemed to have been given on the date of first publication. The Issuer shall also ensure that notices are duly published in a manner which complies with the rules of any stock exchange or other relevant authority on which the Notes are for the time being listed or by which they have been admitted to trading.

16. Currency Indemnity

If any sum due from the Issuer in respect of the Notes or any order or judgment given or made in relation thereto has to be converted from the currency (the "**first currency**") in which the same is payable under these Conditions or such order or judgment into another currency (the "**second currency**") for the purpose of (a) making or filing a claim or proof against the Issuer, (b) obtaining an order or judgment in any court or other tribunal or (c) enforcing any order or judgment given or made in relation to the Notes, the Issuer shall indemnify each Noteholder, on the written demand of such Noteholder addressed to the Issuer and delivered to the Issuer or to the Specified Office of the Fiscal Agent, against any loss suffered as a result of any discrepancy between (i) the rate of exchange used for such purpose to convert the sum in question from the first currency into the second currency and (ii) the rate or rates of exchange at which such Noteholder may in the ordinary course of business purchase the first currency with the second currency upon receipt of a sum paid to it in satisfaction, in whole or in part, of any such order, judgment, claim or proof.

This indemnity constitutes a separate and independent obligation of the Issuer and shall give rise to a separate and independent cause of action.

17. Governing Law and Jurisdiction

(a) The Notes and any non-contractual obligations arising out of or in connection with the Notes are governed by English law.

(b) The Issuer irrevocably agrees for the benefit of the Noteholders that the courts of England are to have jurisdiction to settle any disputes which may arise out of or in connection with the Notes (including a dispute relating to any non-contractual obligation arising out of or in connection with the Notes) and that accordingly any suit, action or proceedings arising out of or in connection therewith (together referred to as "**Proceedings**") may be brought in the courts of England.

(c) The Issuer irrevocably and unconditionally waives and agrees not to raise any objection which it may have now or subsequently to the laying of the venue of any Proceedings in the courts of England and any claim that any Proceedings have been brought against the Issuer in an inconvenient forum and further irrevocably and unconditionally agrees that a judgment in any Proceedings brought in the courts of England shall be conclusive and binding upon the Issuer and may be enforced in the courts of any other jurisdiction. Nothing in this Condition shall limit any right to take Proceedings against the Issuer in any other court of competent jurisdiction, nor shall the taking of Proceedings in one or more jurisdictions against the Issuer preclude the taking of Proceedings in any other jurisdiction, whether concurrently or not.

(d) The Issuer hereby irrevocably and unconditionally appoints Law Debenture Corporate Services Limited at its registered office for the time being in England for the time being as its agent for service of process in England in respect of any Proceedings.

(e) The Issuer hereby irrevocably waives any right to claim sovereign or other immunity from jurisdiction or execution and any similar defence, and irrevocably consents (to the fullest extent permitted by Bulgarian law, as may be amended from time to time, or any other applicable law, as may be amended from time to time), to the giving of any relief, the imposition of any security measure (except pre-judgment attachments or injunctions) or the issue of any process, including, without limitation, the making, enforcement or execution against any assets, revenue or property of the Issuer whatsoever (irrespective of its use or intended use) of any order, ruling, award or judgment made or given in connection with any Proceedings *provided, however, that* immunity is not waived with respect to (i) present or future "**premises of the mission**" as defined in the Vienna Convention on Diplomatic Relations signed in 1961, (ii) "**consular premises**" as defined in the Vienna Convention on Consular Relations signed in 1963, or (iii) military property or military assets or property or assets of the Republic of Bulgaria related thereto.

(f) If any Condition is or becomes invalid, illegal or unenforceable in any respect under any law of any relevant jurisdiction (including under the laws of England or the Republic of Bulgaria), the validity, legality and enforceability of the remaining Conditions shall not be affected or impaired in any way nor shall it affect or impair the validity or enforceability of such Condition in any other jurisdiction. If the choice of English law as the governing law regarding any non-contractual obligations arising out of or in connection with the Notes is declared null and void by a court of competent jurisdiction pursuant to a final non-appealable decision and as a result Noteholders are not able to validly exercise their rights under the rules of unjust enrichment of English law, Noteholders shall be entitled to file claims against the Issuer in compliance with the unjust enrichment rules of Bulgarian law, where applicable.

There will appear at the foot of the Conditions endorsed on each Note Certificate the names and Specified Offices of the Paying Agents, the Registrar and any Transfer Agents as set out at the end of this Offering Circular.

SUMMARY OF PROVISIONS RELATING TO THE NOTES WHILE IN GLOBAL FORM

Global Note Certificate

The Notes will be represented by a Global Note Certificate that will be registered in the name of a nominee for, and deposited with, the common safekeeper for Euroclear and Clearstream, Luxembourg.

The Notes are intended to be held in a manner which would allow Eurosystem eligibility – that is, in a manner which would allow the Notes to be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon satisfaction of the Eurosystem eligibility criteria.

Interests in the Global Note Certificate may be held only though Euroclear or Clearstream, Luxembourg at any time. See "*Book Entry Procedures*".

Except in the limited circumstances described below, owners of interests in the Global Note Certificate will not be entitled to receive physical delivery of Note Certificates. The Notes are not issuable in bearer form.

Exchange for Note Certificates

The Global Note Certificate will become exchangeable in whole, but not in part, for Note Certificates if (a) Euroclear or Clearstream, Luxembourg is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention permanently to cease business or does in fact do so, or (b) any of the circumstances described in Condition 9 (*Events of Default*) of the "**Terms and Conditions of the Notes**" occurs.

Whenever the Global Note Certificate is to be exchanged for Note Certificates, such Note Certificates will be issued in an aggregate nominal amount equal to the principal amount of the Global Note Certificate within five business days of the delivery, by or on behalf of the registered Holder of the Global Note Certificate, Euroclear and/or Clearstream, Luxembourg, to the Registrar of such information as is required to complete and deliver such Note Certificates (including, without limitation, the names and addresses of the persons in whose names the Note Certificates are to be registered and the principal amount of each such person's holding) against the surrender of the Global Note Certificate at the Specified Office of the Registrar. Such exchange will be effected in accordance with the provisions of the Fiscal Agency Agreement and the regulations concerning the transfer and registration of Notes scheduled thereto and, in particular, shall be effected without charge to any Holder, but against such indemnity as the Registrar may require in respect of any tax or other duty of whatsoever nature which may be levied or imposed in connection with such exchange.

Amendment to the Terms and Conditions of the Notes

In addition, the Global Note Certificate will contain provisions which modify the "**Terms and Conditions of the Notes**" as they apply to the Notes evidenced by the Global Note Certificate. The following is a summary of certain of those provisions:

Payments: Payments of principal and interest in respect of the Notes evidenced by the Global Note Certificate will be made against presentation for endorsement by the Fiscal Agent and, if no further payment falls to be made in respect of the relevant Notes, surrender of the Global Note Certificate to or to the order of the Fiscal Agent or such other Agent as shall have been notified to the relevant Noteholders for such purpose. A record of each payment so made will be endorsed in the appropriate schedule to the Global Note Certificate, which endorsement will be *prima facie* evidence that such payment has been made in respect of the relevant Notes.

Payments on business days: In the case of all payments made in respect of the Global Note Certificate, "**business day**" means any day on which the TARGET System is open.

Payment Record Date: Each payment in respect of the Global Note Certificate will be made to the person shown as the Holder in the Register at the close of business (in the relevant clearing system) on the Clearing System Business Day before the due date for such payment (the "**Record Date**") where "**Clearing System Business Day**" means Monday to Friday inclusive except 25 December and 1 January.

Notices

Notwithstanding Condition 15 (*Notices*) of the "*Terms and Conditions of the Notes*", so long as the Global Note Certificate is held on behalf of Euroclear, Clearstream, Luxembourg or any other clearing system (an "**Alternative Clearing System**"), notices to Noteholders represented by the Global Note Certificate may be given by delivery of the relevant notice to Euroclear, Clearstream, Luxembourg or (as the case may be) such Alternative Clearing System. For so long as the Notes are admitted to trading on the Luxembourg Stock Exchange and it is a requirement of such exchange or of applicable law or regulations, a notice will be valid if published in a leading newspaper having general circulation in Luxembourg (which is expected to be Luxemburger Wort) or published on the website of the Luxembourg Stock Exchange (www.bourse.lu).

Prescription

Claims against the Issuer for payment in respect of the Notes while the Notes are represented by a Global Note Certificate shall become void unless it is presented for payment within ten years (in the case of principal) or five years (in the case of interest) of the appropriate Relevant Date (as defined in Condition 8 (*Taxation*) of the "*Terms and Conditions of the Notes*"), in respect of them.

Meetings

For the purposes of any meeting of Noteholders, the holder of the Notes represented by the Global Note Certificate shall (unless the Global Note Certificate represents only one Note) be treated as two persons for the purposes of any quorum requirements of, a meeting of Noteholders and as being entitled to one vote in respect of each integral currency unit of the currency of the Notes.

Events of Default

If principal in respect of any Note is not paid when due, the Holder of a Note represented by the Global Note Certificate may elect for direct enforcement rights against the Issuer under the terms of a Deed of Covenant executed as a deed by the Issuer on 21 May 2014 to come into effect in respect of a principal amount of Notes up to the aggregate nominal amount in respect of which such failure to pay has occurred in favour of the persons entitled to such payment as accountholders with a clearing system. Following any such acquisition of direct rights, the Global Note Certificate and the corresponding entry in the register kept by the Registrar will become void as to the specified portion. However, no such election may be made in respect of Notes represented by the Global Note Certificate unless the transfer of the whole or a part of the holding of Notes represented by the Global Note Certificate shall have been improperly withheld or refused.

Book Entry Procedures

Custodial and depositary links are to be established between Euroclear and Clearstream, Luxembourg to facilitate the initial issue of the Notes and cross market transfers of the Notes associated with secondary market trading. See "—*Settlement and Transfer of Notes*" below.

Investors may hold their interests in the Global Note Certificate directly through Euroclear or Clearstream, Luxembourg if they are accountholders ("**Direct Participants**") or indirectly ("**Indirect Participants**", and together with Direct Participants, "**Participants**") through organisations which are accountholders therein.

Euroclear and Clearstream, Luxembourg

Euroclear and Clearstream, Luxembourg each hold securities for their customers and facilitate the clearance and settlement of securities transactions through electronic book entry transfer between their respective accountholders. Indirect access to Euroclear and Clearstream, Luxembourg is available to other institutions which clear through or maintain a custodial relationship with an accountholder of either system. Euroclear and Clearstream, Luxembourg provide various services including safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg also deal with domestic securities markets in several countries through established depository and custodial relationships. Euroclear and Clearstream, Luxembourg have established an electronic bridge between their two systems across which their respective customers may settle trades with each other. Their customers are worldwide financial institutions including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations.

Relationship of Participants with Clearing Systems

Each of the persons shown in the records of Euroclear and Clearstream, Luxembourg as the holder of a Note evidenced by a Global Note Certificate must look solely to Euroclear or Clearstream, Luxembourg (as the case may be) for his share of each payment made by the Issuer to the holder of a Global Note Certificate and in relation to all other rights arising under a Global Note Certificate, subject to and in accordance with the respective rules and procedures of Euroclear or Clearstream, Luxembourg (as the case may be). The Issuer expects that, upon receipt of any payment in respect of Notes evidenced by a Global Note Certificate the common safekeeper by whom such Note is held, or nominee in whose name it is registered, will immediately credit the relevant Participants' or accountholders' accounts in the relevant clearing system with payments in amounts proportionate to their respective interests in the principal amount of the Global Note Certificate as shown on the records of the relevant clearing system or its nominee. The Issuer also expects that payments by Direct Participants in any clearing system to owners of interests in a Global Note Certificate held through such Direct Participants in any clearing system will be governed by standing instructions and customary practices. Save as aforesaid, such persons shall have no claim directly against the Issuer in respect of payments due on the Notes for so long as the Notes are evidenced by a Global Note Certificate and the obligations of the Issuer will be discharged by payment to the registered holder, as the case may be, of a Global Note Certificate in respect of each amount so paid. None of the Issuer, the Fiscal Agent or any other Agent (as named in the Fiscal Agency Agreement), will have any responsibility or liability for any aspect of the records relating to or payments made on account of ownership interests in a Global Note Certificate or for maintaining, supervising or reviewing any records relating to such ownership interests.

Settlement and Transfer of Notes

Subject to the rules and procedures of each applicable clearing system, purchases of Notes held within a clearing system must be made by or through Direct Participants, which will receive a credit for such Notes on the clearing system's records. The ownership interest of each actual purchaser of each such Note (the "**Beneficial Owner**") will in turn be recorded on the Direct and Indirect Participants' records.

Beneficial Owners will not receive written confirmation from any clearing system of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which such Beneficial Owner entered into the transaction.

Transfers of ownership interests in Notes held within the clearing system will be affected by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in such Notes, unless and until interests in a Global Note Certificate held within a clearing system are exchanged for Note Certificates.

No clearing system has knowledge of the actual Beneficial Owners of the Notes held within such clearing system and their records will reflect only the identity of the Direct Participants to whose accounts such Notes are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers. Conveyance of notices and other communications by the clearing systems to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

The laws of some jurisdictions may require that certain persons take physical delivery in definitive form of securities. Consequently, the ability to transfer interests in a Global Note Certificate to such persons may be limited.

Trading between Euroclear and/or Clearstream, Luxembourg Participants

Secondary market sales of book entry interests in the Notes held through Euroclear or Clearstream, Luxembourg to purchasers of book entry interests in the Notes held through Euroclear or Clearstream, Luxembourg will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream, Luxembourg and will be settled using the procedures applicable to conventional eurobonds.

USE OF PROCEEDS

The net proceeds of the issue of the Notes, expected to amount to approximately EUR 1,478,816,500 after deduction of expenses incurred in connection with the issue of the Notes, will be used by the Issuer to repay existing state debt and to increase the fiscal reserves of the Government.

THE REPUBLIC OF BULGARIA

Geography and Population

Bulgaria is located in Southeastern Europe in the eastern part of the Balkan peninsula and covers an area of approximately 110,994 square kilometres. It is bordered by Romania to the north, Serbia and the former Yugoslav Republic of Macedonia to the west, Greece and Turkey to the south and the Black Sea to the east. According to the Republic of Bulgaria National Statistical Institute, as of 31 December 2013, Bulgaria had a population of 7.2 million, or 1.4 per cent. of the EU population.

The capital of Bulgaria is Sofia which is situated in the western part of the country, at the foot of the Vitosha mountain massif. Sofia has a population of approximately 1.2 million as of 31 December 2013. The population density of Bulgaria is approximately 66 persons per square kilometre.

History

The name "**Bulgaria**" is derived from the Bulgars, a people who migrated from Central Asia and united with the Slavic tribes to found the First Bulgarian Kingdom in 681 AD. The Bulgars were eventually absorbed into the larger Slavic population; a process that was facilitated by the adoption of Orthodox Christianity by Prince Boris I in 865 AD. In the late-ninth and early-tenth centuries, during the reigns of Prince Boris I and Tsar Simeon the Great, Bulgaria reached its cultural, economic and political high-point so much so that Bulgaria became the strongest power in Southeastern Europe. During this period, Old Church Slavonic - the first written Slavic language - and the Cyrillic alphabet were adopted in Bulgaria's theological schools; these would provide the basis for the modern Bulgarian language. Thereafter, Bulgaria underwent a period of political turmoil before eventually being absorbed into the Byzantine Empire. The Bulgarians revolted against Byzantine rule in 1185 and established a second kingdom which, during the reign of Tsar Ivan Asen II (1218-1241), became a dominant political power on the Balkan Peninsula and across Southeastern Europe.

By the end of the fourteenth century, the Ottoman Empire had gained control of Bulgaria. During the next centuries the political and cultural existence of Bulgaria was dominated by the Ottoman Turks, although many of Bulgaria's national customs and values were preserved. Numerous uprisings over the centuries were suppressed by the Ottomans; however, in the latter part of the nineteenth century, they provided the pretext for Russian intervention and the creation of the modern Bulgarian state. In 1877, Russia declared war on the Ottoman Empire. The war ended with the preliminary peace treaty of San Stefano of 1878; however, this was replaced soon after by the Treaty of Berlin of 1878. The Treaty of Berlin saw the creation of the semi-independent state of the Principality of Bulgaria (what is now present-day Northern Bulgaria and the Sofia region) and the autonomous Ottoman province of Eastern Rumelia (forming a significant part of present-day Southern Bulgaria). In 1885, the population of Eastern Rumelia rose up against Ottoman rule and united with the Principality of Bulgaria to create a unitary Bulgarian state under the rule of Prince Alexander I. In 1908, the recently-unified country became fully independent from the Ottoman Empire under the name of the Kingdom of Bulgaria. Bulgaria at this point was still a largely agrarian society but, in the period leading up until World War II, it underwent significant economic development.

Bulgaria took part in the Balkan Wars of 1912-1913 and allied itself with Germany during World War I. The country also allied itself with the Axis Powers for the greater part of World War II. In 1944, however, Bulgaria joined the Allied powers and fought with them until the end of the war. At the end of the war, Bulgaria's pre-war boundaries were reconfirmed.

During the post-war period, Bulgaria fell under the influence of the former Soviet Union and, within a short space of time, a communist regime secured itself in power. In November 1989, however, as elsewhere in Central and Eastern Europe, the communist system in Bulgaria collapsed.

Recent History

1989 to 1997

From 1989 until early 1997, the political environment in Bulgaria was characterised by the continued influence of the former communist party (now called the Bulgarian Socialist Party) along with repeated changes in Government and a relative lack of political cohesion, particularly when compared to the other former Eastern-bloc countries. Prior to 1990, Bulgaria's economy was oriented toward the COMECON countries, which included the former Soviet Union, Poland, Hungary, Bulgaria, the German Democratic Republic, the former Czechoslovakia, Romania, Cuba, Vietnam and Mongolia. The collapse of the COMECON regime in 1991 had a negative impact on Bulgaria's GDP. By 1997, the cumulative fall in real GDP as compared to 1989 was 33.5 per cent.

In mid-1996 through to the first quarter of 1997, a severe banking crisis reached its peak in Bulgaria. with the value of deposits in the banking system falling from the equivalent of USD 7.4 billion at the end of 1995 to USD 1.8 billion in March 1997. The crisis witnessed the closure of many banks in Bulgaria and the depreciation of Bulgaria's currency, the Lev. Beset by the financial crisis, the Bulgarian Socialist Party resigned from Government at the end of 1996.

1997 to 2013

During the period from 1997 through to 2013, Bulgaria was governed by four different administrations: the UDF Government (May 1997–July 2001); the coalition between the Simeon II National Movement and the Movement for Rights and Freedoms Government (July 2001-August 2005); the coalition between the Simeon II National Movement, the Movement for Rights and Freedoms and the Bulgarian Socialist Party Government (August 2005–July 2009); the Citizens for European Development of Bulgaria Party (the "**GERB**") Government (July 2009 – March 2013).

Bulgaria also underwent its transition into a market economy during this period. Characteristic features of the economy at this time were: the privatisation of large state-owned companies; the establishment of a Currency Board; the adoption of a conservative fiscal policy; the harmonisation of Bulgarian legislation with EU regulations; and the attracting of foreign investment. By the end of 2012, 66.31 per cent. of all former state-owned entities from the communist era had been privatised and over 86 per cent. of the economy had shifted into the hands of the private sector. In 2004, Bulgaria became a member of NATO and in 2007 it joined the EU.

2013 to present

The GERB Government resigned on 20 February 2013 following weeks of escalating protests. The initial cause of these protests was the spiking of electricity prices; however, as the protests continued the list of grievances grew as people expressed their frustration about the rising cost of living and alleged corruption within Government. On 13 March 2013, diplomat Marin Raykov formed a caretaker government, which was swiftly followed by the parliamentary elections for the 42nd National Assembly on 12 May 2013.

Following the parliamentary elections of 12 May 2013, which were held earlier than initially expected due to the resignation of the Borisov cabinet, Plamen Oresharski, a non-partisan politician and former finance minister, was given a mandate to form a new government by President Rosen Plevneliev. On 29 May 2013, members of the National Assembly ("**MPs**") elected Plamen Oresharski into office as Prime Minister of the Republic of Bulgaria by 119 votes to 98. The Government received much of its support from members of the Socialist Party and the Movement for Rights and Freedoms. The Government immediately commenced implementing important changes, which were vital not only for the improvement of Bulgarian society but for general stability. The Government is focused on achieving three main goals: firstly, the improvement of social welfare and the reduction of youth unemployment; secondly, improving Bulgaria's competitiveness as a place for doing business by

removing unnecessary administrative burdens; and thirdly, overseeing the continued democratisation of government.

As a consequence of the measures adopted by the Oresharski administration, there have been positive changes in Bulgaria's macroeconomic development. The fiscal targets for the budget deficit, the fiscal reserves and the public debt for 2013 were achieved. Further, the budget deficit for the 2013 consolidated fiscal programme is expected to account for approximately 1.5 per cent. of the country's projected GDP. The lower deficit resulted in higher reserves, providing a buffer for minimising liquidity risks in the context of forthcoming debt payments during the course of 2014. In addition, during the short period during which Government has been in office, social policies have been implemented and reinforced, payments by the state to the private sector accelerated and the centralised administrative burden on businesses reduced. The institutional culture of transparency and good governance has been improving further, as legal framework reforms have been initiated, aimed to allow for a more efficient competition, less administrative burdens, clear and simplified rules and improved budgetary revenue collection. The Government has undertaken actions to facilitate access to financing with focus on small and medium sized enterprises through better utilisation and allocation of EU funds.

This positive trend also helped to calm the civil unrest and political protests that commenced only a month after the new Government has assumed office, and was the outcome of prolonged discontent of the Bulgarian society with the political regime as a whole. The protests wave calmed down over time mainly due to the new policies implemented by the Government to reduce the social imbalances and to enhance transparency in its relations with citizens and businesses.

Political System

Legislature

Bulgaria is a parliamentary republic. The legislative power of Bulgaria is vested with the National Assembly which is a unicameral parliament. The National Assembly consists of 240 members who are elected for a period of four years by proportional representation. On 5 March 2014, a new Electoral Code took effect.

To qualify for a seat in the National Assembly, a party or coalition must achieve at least 4 per cent. of the national vote. Any Bulgarian citizen who: (1) does not hold citizenship from another country; (2) is above the age of 21; (3) is not under a judicial interdiction; and (4) is not serving a prison sentence is eligible for election to the National Assembly. Early parliamentary elections may be held if no agreement on the formation of a government can be reached; or if the government loses a vote of confidence, or a non-confidence vote succeeds or the government resigns, and no successor earning the support of the existing National Assembly can be found.

The National Assembly has many roles: it passes, amends, supplements, and repeals laws; adopts the State Budget and the budget implementation report; establishes the types of taxes and the rate of state taxes in Bulgaria; passes resolutions on the holding of a national referendum; schedules the presidential elections; elects and removes the Prime Minister and, on his recommendation, the members of the Council of Ministers; elects the governor and the three deputy governors of the BNB; effects changes in government on a motion from the Prime Minister; takes part in the constitution of other key agencies and other bodies of the state (Constitutional Court, Supreme Judicial Council, Financial Supervision Commission ("**FSC**") among others); approves state loan agreements and ratifies international treaties (where applicable); and has certain other rights and powers incorporated into the Constitution of Bulgaria. The National Assembly also exercises parliamentary control over the executive branch of government. Certain issues, like adopting a new Constitution and deciding on any changes to the territory of the Republic, are beyond the powers of an ordinary National Assembly and are reserved for a 400 member Grand National Assembly.

Elections for the 42nd National Assembly were held on 12 May 2013 on a proportional representation basis with ballot lists of political parties and coalitions registered in 31 multi-mandate constituencies. In all, 45 parties and coalitions took part in the elections.

Four political parties passed the 4 per cent. electoral threshold for participation in the National Assembly. The GERB Party achieved the highest number of votes (30.54 per cent.) followed by the Coalition for Bulgaria Party (26.61 per cent.), the Movement for Rights and Freedoms Party (11.31 per cent.) and the "Ataka" Party (7.3 per cent.).

	Mandates
Parties and Coalitions	
GERB Party	94
Coalition for Bulgaria Party	83
Movement for Rights and Freedoms Party (DPS in Bulgarian)	36
"Ataka" Party	23
Independent MPs	4
Total	**240**

Source: Central Elections Commission

In view of the results of the elections for EU Parliament, on 17 June 2014, the President held consultations with the political parties represented in the current Bulgarian Parliament. After the meeting, the President made a statement that all parties agreed that new general elections should be held in the period 28th September 2014 – 12th October 2014. This unanimous decision between the major political parties was taken in order to calm down the political environment and to create favourable conditions for establishing a reformist majority in the next Parliament. It is also agreed not to deviate from the implemented fiscal discipline.

President

The President of Bulgaria (the "**President**") is the Head of State, elected under a system of majority representation by direct popular vote for a term of five years and for a maximum of two five-year terms. To be eligible for the position of President, a candidate must be a natural-born Bulgarian citizen over 40 years of age, have resided in the country for the five years preceding the election and be eligible for election to the National Assembly. The President is elected with a majority of the valid votes, *provided that* a majority of all eligible voters took part in the election. If none of the candidates for President receives the required majority in the first round, a second round vote is held within seven days between the two leading candidates. The candidate who wins the majority of the vote is declared a winner.

The current President is Mr. Rosen Plevneliev. He was elected with 52.58 per cent. of the votes in the last presidential election held on 23 October 2011, with a runoff held on 30 October 2011. The inauguration of Mr. Plevneliev as President took place on 20 January 2012. Pursuant to the Constitution of Bulgaria the next presidential election shall be held not earlier than three months and not later than two months before the expiry in January 2017 of the term of office of the incumbent President.

The President symbolises the unity of the nation and represents Bulgaria in its foreign affairs. The President is also the commander-in-chief of the armed forces and the Chairman of the Consultative National Security Council. The President instructs the prime ministerial candidate, who is nominated by the party holding the highest number of seats in the National Assembly, to form a government. If such nominee does not succeed in forming a cabinet, the President assigns the mandate to a nominee from the second largest party in the National Assembly and if such nominee is also unsuccessful, the President assigns the mandate to one of the other parties. If the third attempt to form a government fails, the President appoints a caretaker government, dissolves the National Assembly and schedules new elections. The President also has the power of a delaying veto over legislation. If the Parliament votes for a second time on a bill that the President has vetoed, the President must sign it. The President schedules the elections for a National Assembly and for the bodies of local self-government

and sets the date for national referendums pursuant to a resolution of the National Assembly. His powers also include awarding orders and medals, the naming of towns, villages and geographical places, granting asylum and citizenship and exercising the right to pardon. A Vice-President assists the President.

Government

The executive power of Bulgaria is vested in the Council of Ministers. The Council of Ministers consists of the Prime Minister, Deputy Prime Ministers and ministers.

The Council of Ministers directs and implements the state's domestic and foreign policy in accordance with the Constitution and the laws of Bulgaria. It ensures public order and national security and exercises overall guidance over state administration and the armed forces. The Council of Ministers informs the National Assembly on issues concerning the obligations of Bulgaria resulting from its membership in the EU. The Council of Ministers manages the implementation of the State Budget, organises the management of the state's assets and concludes, confirms or denounces international treaties when authorised to do so by law. As the supreme executive body, the Council of Ministers adopts and promulgates certain acts of delegated legislation, including decrees, resolutions and orders. The Council of Ministers is also entitled to initiate the adoption of laws by drafting, deliberating and forwarding bills to the National Assembly.

The President assigns a mandate for the formation of a new government. See "*Republic of Bulgaria – Political System – President*". Once the prime ministerial candidate forms a government, the Prime Minister and the Government are formally elected by the National Assembly.

The Prime Minister takes charge of, coordinates and bears responsibility for, the overall policy of the Government. He appoints and removes deputy ministers and may suggest changes in the cabinet to the National Assembly. The Prime Minister or the minister concerned countersigns the President's decrees with certain exceptions, such as decrees vetoing legislative Acts of Parliament, decrees for dissolving the Parliament and for the appointment of a caretaker government. Ministers implement state policy in their respective fields.

The powers of the Council of Ministers shall terminate if: the National Assembly passes a vote of no confidence with regard to the Prime Minister or the Council of Ministers; if the Prime Minister loses a vote of confidence; if the National Assembly accepts the resignation of the Prime Minister or the Council of Ministers; or if the Prime Minister dies. Once a newly elected National Assembly is formed, the Prime Minister and the Council of Ministers are to submit their collective resignation. However, the Council of Ministers shall continue performing its functions until the election of a new Council of Ministers.

Judicial Branch

The judicial branch of the government is independent from the legislative and executive branches of the state. The civil and criminal justice system has three levels: trial courts, appellate courts and the Supreme Cassation Court. In civil cases, an appeal to an appellate court is as of right, while an appeal to the Supreme Cassation Court is by leave. In criminal cases, appeals to both appellate courts and the Supreme Cassation Court are as of right. In 2011, a specialised criminal court was established. It has jurisdiction over organised crime. Its judgments are subject to appeal to the Specialised Criminal Court of Appeals and the Supreme Cassation Court.

The administrative justice system has two levels: specialised administrative courts and the Supreme Administrative Court. In some cases the Supreme Administrative Court acts both as a first-instance court and a cassation court.

The martial justice has three levels – courts martial, the Martial Court of Appeals, and the Supreme Cassation Court.

The Supreme Judicial Council administratively manages the judicial branch. It is a part of the judicial branch, and is independent from the executive and legislative branches. It consists of the Chairpersons of the Supreme Cassation Court and the Supreme Administrative Court, the Chief Prosecutor and 22 other lawyers of high professional and moral integrity with at least 15 years of professional experience. They are appointed by the National Assembly and by the judiciary itself, and have a term of 5 years. The Supreme Judicial Council appoints, promotes, demotes, transfers and discharges all judges from office. It also approves the budget of the judicial branch.

The Judicial Inspectorate is administratively attached to the Supreme Judicial Council. It consists of 11 members elected by the National Assembly. Its task is to check the activity of the judicial system bodies without interfering with the independence of the judges. The inspectors are independent in their work.

Judges may acquire permanent tenure after five years in office, a performance appraisal and the requisite decision by the Supreme Judicial Council. After that, they may only be discharged from office in the following circumstances:

- reaching the age of 65;
- resignation;
- the entry into force of a sentence for deprivation of liberty for an intentional crime;
- *de facto* inability to perform their duties for more than one year;
- serious or systematic failure to discharge their official duties; or
- behaviour that undermines the prestige of the judicial branch.

In addition, judges have criminal and civil immunity for acts performed in discharge of their official duty, unless the act constitutes an intentional crime.

The Constitutional Court is separate from the civil, criminal and administrative justice system. It is responsible for the following:

- rendering binding interpretations of the Constitution;
- reviewing the constitutionality of legislative acts of Parliament (including ratification laws) and of acts of the President. If a legislative act of the Parliament is declared unconstitutional by the Constitutional Court, it no longer applies;
- settling competence disputes between the Parliament, the President and the Council of Ministers;
- reviewing the constitutionality of international treaties entered into by Bulgaria before their ratification;
- adjudicating the constitutionality of political parties, the lawfulness of the election of the President and the Vice President, and of a member of the National Assembly; and
- having jurisdiction in impeachment cases against the President and the Vice President.

As is the case with other constitutional democracies, Acts of the Parliament are occasionally subject to challenge in the Constitutional Court. The Constitutional Court is composed of 12 judges appointed in equal quotas by the National Assembly, the President, and the judges of the Supreme Cassation and Administrative Courts. Each judge is appointed for a single term of 9 years.

The European Commission established a mechanism for cooperation and verification of the Bulgarian legal system pursuant to Article 4(3) of the Treaty of Accession of Bulgaria to the EU by a decision

dated 13 December 2006. This mechanism aims to ensure that the Bulgarian legal system meets the standards of the EU and requires Bulgaria to address specific benchmarks in the areas of judicial reform and the fight against corruption and organised crime. This decision also empowers the European Commission to take appropriate measures in the case of imminent risk to the implementation and application of, *inter alia*, mutual recognition in civil law matters, including the suspension of the obligation of Member States to recognise and execute Bulgarian judgments and judicial decisions.

This mechanism is an ongoing process and involves the publication of progress reports by Bulgaria and the European Commission. Despite the criticism of the European Commission in certain reports, no measures have been imposed. See "*Risk Factors – Changes in Bulgaria's relationships with western governments and institutions may have a negative impact on the economy of Bulgaria*".

Since Bulgaria's accession to the EU, judgments originating in another Member State are recognised and enforced in Bulgaria pursuant to a simplified procedure established by, among others:

- Council Regulation (EC) No. 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (to be replaced with effect as from 10 January 2015 by Regulation (EU) No.1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters);
- Regulation (EC) No. 805/2004 of the European Parliament and of the Council of 21 April 2004 creating a European Enforcement Order for uncontested claims; and
- Regulation (EC) No. 861/2007 of the European Parliament and of the Council of 11 July 2007 establishing a European small claims procedure.

Regional Government Structure

The Constitution of Bulgaria sets out the principles for administrative division and local self-governance within the country:

- The territory of Bulgaria is divided into municipalities and regions;
- Municipalities are the main administrative and territorial units that are responsible for local governance;
- Municipalities are independent legal entities with property rights and their own budgets;
- Citizens can participate in the municipal government indirectly through local elections and directly through referendums and general meetings; and
- Sofia is the capital of Bulgaria.

The administrative structure of Bulgaria and the public relationships connected with local self-governance and local administration within the country are further governed by the Territorial Administration of Bulgaria Act and the Local Self Government and Local Administration Act, as well as a number of Acts of Parliament regulating self-governance of municipalities.

Since 1998 Bulgaria has been divided into 28 regions. Regional boundaries, administrative centres and changes thereto are determined by Presidential decrees, subsequent to a proposal by the Council of Ministers. Regions are named after their administrative centres. Each region is governed by a Regional Governor, who is a representative of the executive branch and is appointed and dismissed by a resolution of the Council of Ministers.

The regions of Bulgaria are currently sub-divided into 264 municipalities. Municipalities are established by a resolution of the Council of Ministers, which is confirmed by a presidential decree.

Municipalities are the main administrative territorial units through which local self-government is exercised. Each municipality is governed by a Mayor and a Municipal Council.

Municipalities are in turn divided into mayoralties. Mayoralties are settlements with a population exceeding 100 inhabitants. Cities with a population of more than 300,000 people (i.e. Sofia, Plovdiv and Varna) are sub-divided into districts. Mayors are also elected in mayoralties, as well as in the districts of Sofia, Plovdiv and Varna.

The Local Self Government and Local Administration Act empowers Bulgarian citizens to resolve issues of local importance directly by means of a referendum or a general assembly of the local community or indirectly through their elective bodies, in the fields of:

- municipal properties, municipal enterprises, municipal finance, taxes and fees, and municipal administration;
- planning and development of the territory of the municipality and settlements therein;
- education, health, culture, public works and utilities;
- social welfare services;
- protection of the environment and the reasonable use of natural resources;
- maintenance and conservation of cultural, historical and architectural monuments; and
- development of sports, recreation and tourism.

The population in each municipality elects its Municipal Council, as well as the Mayors of the municipalities, mayoralties and districts of Sofia, Plovdiv and Varna. The elections are carried out in compliance with the provisions of the Electoral Code of the Republic of Bulgaria, promulgated in 2014.

A Municipal Council is responsible for formulating and implementing the policy of the municipality's growth and development in connection with the activities described above and is empowered, among other things, to:

- set the internal structure and bodies of the local administration and appoint the Chairman of the Municipal Council;
- adopt and amend the budget of the municipality, as well as exercise control over its implementation and approve the relevant report;
- determine the rate of local taxes and fees within the limits established by the Parliament;
- make decisions on the acquisition, management, and disposal of municipal property;
- decide on bank loans, and other municipal debt, issuance of municipal securities and guarantees;
- enact decisions concerning the territorial development plans, as well as adopt municipal development strategies, projections, programmes and plans which also reflect European policies for development of local communities; and
- resolve other issues of local importance that do not fall within the exclusive competence of other bodies.

The acts of a Municipal Council are subject to control by the relevant Regional Governor and can be appealed against before the competent administrative court. The Mayor of the Municipality is entitled to call for further discussion on acts which do not comply with the law of the Republic or that go

against the best interests of the municipality; the Mayor of the Municipality can also appeal acts of the Municipal Council before the relevant administrative court.

Mayors of municipalities, mayoralties and districts are officers of the local executive authorities and manage the implementation of executive activities of municipalities. The acts of a Mayor are subject to control by the respective Regional Governor and the Municipal Council, and can be appealed before the competent administrative court. The last elections for self-government bodies were held on 23 October 2011.

Legal Proceedings

Dispute between Atomstroiexport (Russia) and the National Electricity Company ("NEK")

An arbitration case under the Arbitration Rules of the Arbitration Court to the International Chamber of Commerce, Paris.

The case relates to termination of an alleged agreement between NEK and Atomstroiexport for construction of a nuclear plant. The claim is for EUR 1 billion.

The case is against NEK, which is a separate legal entity from the state. Nevertheless, the case may have possible ramifications for the state. As NEK is a state owned company that is important for the national economy, in case the award is too substantial for NEK to bear, the state might cover its obligation under the arbitral award, not out of legal obligation, but as a matter of economic necessity.

Disputes with electricity companies

EVN AG has started an international arbitration case against Bulgaria before the International Center for Settlement of Investment Disputes, Washington, D.C. It contends that the actions of the State Commission for Energy and Water Regulation (the sector Regulator) in regard to setting the electricity price are contrary to the standards for treatment of an investor and an investment established in the Austria-Bulgaria BIT and the Energy Charter Treaty, and that they have caused damage to both its electricity grid company and its electricity supply company in the amount of EUR 511 million.

Energo-Pro a.s. notified Bulgaria that it intends to file a claim similar to the one of EVN but has not commenced an arbitration yet.

At present, there are no international arbitration cases in which damages are claimed in relation to licence revocation procedures for the electricity supply companies.

International Relations

Bulgaria is a member of a large number of international organisations which include: the United Nations; the Organisation for Security and Cooperation in Europe; the Council of Europe; the WTO; the International Labour Organisation; the Central European Initiative; the Organisation of the Black Sea Economic Cooperation ("**BSEC**"); the International Monetary Fund; the World Bank; the European Investment Bank; the Council of Europe Development Bank; the European Bank for Reconstruction and Development ("**EBRD**"); and the Black Sea Trade and Development Bank ("**BSTDB**"). Although Bulgaria is not currently a member of the Organisation for Economic Co-Operation and Development ("**OECD**"), it has already implemented a number of OECD measures such as the OECD Anti-Bribery Convention.

European Union

Bulgaria became a full member of the EU on 1 January 2007. Bulgaria submitted its application for EU membership in December 1995. Following the Helsinki European Council's decision in December 1999, the accession negotiations between Bulgaria and the EU lasted for four years, having been started in 2000 and concluded by the European Council of 17 December 2004. The European Parliament gave its support to Bulgaria's EU membership on 13 April 2005. The Accession Treaty of

Bulgaria to the EU was signed on 25 April 2005. Bulgaria is a Member State with derogation as it has not yet joined the Euro area.

Between 22-25 of May 2014, the eighth European elections were held, with 28 member states voting. For the first time, European political parties presented official candidates for the top post of the European Commission, the EU's executive body in charge of formulating and enforcing the EU policies that have to be approved by the Parliament and the national governments. Provisional results published on 28 May 2014 showed European People's Party ("**EPP**") winning 214 seats in the new Parliament, ahead of Progressive Alliance of Socialists and Democrats in the European Parliament ("**S&D**") (191 seats), Alliance of Liberals and Democrats for Europe ("**ALDE**") (64 seats) and the Greens/European Free Alliance (52 seats). European Conservatives and Reformists ("**ECR**") is projected to win 46 seats, European United Left/Nordic Green Left ("**GUE/NGL**") - 45 seats and Europe of freedom and democracy Group ("**EFD**") - 38 seats. The number of MEPs coming from parties/lists that were among those non-attached in the outgoing Parliament is 41, while another 60 seats were won by new parties/candidates still not aligned to any of the existing groups.

Bulgaria currently holds 17 seats in the European Parliament. After the recent European Parliamentary elections of 2014, the GERB Party (EPP member) holds six seats, the Movement for Rights and Freedoms Party (ALDE member) and the Coalition for Bulgaria Party (S&D member) each hold four seats, the Bulgaria Without Censorship Coalition Party holds two seats and the Reformers Bloc Coalition Party (EPP member) holds one seat.

Economic Relations with the EU

As full membership of the European Economic and Monetary Union and the adoption of the single currency are both required by the Accession Treaty and have been set as objectives by the Government. Bulgaria remains in a continuing dialogue with the EU on such matters. The Treaty on the Functioning of the European Union requires the Commission and the European Central Bank ("**ECB**") to report to the Council at least once every two years on the progress made by the Member States in fulfilling their obligations regarding the conditions of Euro area membership. In the 2012 Convergence Report, the Commission stated that Bulgaria fulfilled the price stability criterion, the interest rate criterion and would meet the fiscal criterion. Bulgaria did not fulfil the exchange rate criterion since the Bulgarian Lev is not participating in ERM II. The Commission noted however that during the two-year assessment period the Bulgarian Lev remained fully stable relative to the euro, in line with the operation of the currency board arrangement. Full legal compatibility has not yet been achieved, in particular the Law on the Bulgarian National Bank and the Conflict of Interest Prevention and Ascertainment Act.

As a non-Euro area Member State, Bulgaria did not contribute to the capital of the European Financial Stability Facility, a mechanism established in 2010 between the Euro area countries with the objective of providing temporary financial assistance to Euro area Member States. Bulgaria did not participate in any European Financial Stability Facility support activities through bilateral loans. Bulgaria is not involved in the activities of the European Financial Stabilisation Mechanism since the European Commission borrows the funds in financial markets under an implicit EU budget guarantee.

A new permanent crisis resolution mechanism for the countries of the Euro area – the European Stability Mechanism – has been operational since October 2012, assuming the functions of the European Financial Stability Facility. As a non-Euro area Member State, Bulgaria does not contribute to the European Stability Mechanism.

As an EU Member State, Bulgaria is subject to multilateral surveillance by the European Council. Bulgaria is obliged to prepare an annual Convergence Programme covering fiscal policy, Bulgaria's main assumptions underlying its economic outlook and an assessment of economic policy measures and their budgetary impact. Bulgaria also sends annual updates of the National Reform Programme which is another element of European Semester surveillance. This information must cover the current and previous year and include forecasts for at least the next three years. In December 2011, the European Parliament and the Council adopted a package of six new legislative acts (the so called

"**six-pack**"), which aim to strengthen economic governance in the EU. Part of the six-pack is the Macroeconomic Imbalance Procedure to detect and correct risky economic developments in Member States. In the third annual Alert Mechanism Report, adopted on 13 November 2013, the European Commission identified 16 EU Member States, including Bulgaria, whose macroeconomic situation needs to be analysed in more depth. In the subsequent in-depth review, published on 5 March 2014, the Commission stated that Bulgaria is experiencing some imbalances, but they are not excessive. It acknowledged that positive developments were observed regarding the external position and corporate deleveraging and advised that further attention should be paid to the labour market adjustment process.

On 2 March 2012 Bulgaria signed the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union ("**TSCG**") aimed at strengthening fiscal discipline and introducing stricter surveillance, in particular by establishing a "balanced budget rule". Following the ratification of the treaty by the National Parliament in November 2013, Bulgaria has been obliged to apply Part III "Fiscal Compact" of the Treaty (effective from 1 January 2014). Bulgaria has already transposed all the fiscal rules envisaged in the six-pack, and further elaborated in the TSCG, into Bulgarian law.

The EU provided funds to Bulgaria through the pre-accession instruments PHARE, Cohesion Fund (Regulation 1164/94)/ISPA and SAPARD. These instruments focused on improving the administrative capacity of Bulgaria's institutions, accelerating the development of the country's infrastructure, ensuring stable growth within the farming industry and promoting the economic and social development of rural areas. By way of these instruments Bulgaria received more than EUR 1.9 billion in funding.

Within Article 32 of the 2005 Accession Act, the Schengen Facility was created as a temporary instrument to help beneficiary Member States to finance actions at the new external borders of the EU, for the implementation of Schengen acquis and external border control between the date of accession and the end of 2010. The funds allocated to Bulgaria through Schengen Facility Instrument were fully utilised.

The EU structural assistance for the period 2007 to 2013 is rendered by the European Social Fund, the European Regional Development Fund and the Cohesion Fund. It is provided under Operational Programmes ("**Ops**") elaborated by EU Member States and approved by the European Commission. They are designed to improve working and living conditions in EU Member States in different economic sectors, including transport and environment protection infrastructure, investments in business, sustainable development, information society, energy efficiency, direct and indirect assistance to research and development and enhancement of public administration capacity. The strategic priorities in EU funds absorption in Bulgaria are set out in the National Strategic Reference Framework 2007 – 2013. Within this framework the following seven Ops are implemented: "Transport"; "Regional Development"; "Environment"; "Development of the Competitiveness of the Bulgarian Economy"; "Human Resources Development"; "Administrative Capacity" and "Technical Assistance".

Since its accession into the EU through 31 January 2014, Bulgaria has received EUR 3.3 billion in funds by way of the EU Structural and Cohesion Funds ("**SCF**").

For the period 2014-2020, the EU assistance allocated to Bulgaria under SCF is EUR 8.1 billion. It will be distributed between the following Ops: transport and transport infrastructure; environment; regions in growth; innovations and competitiveness; human resources development; science and education for intelligent growth; and good governance. The experience gained from the previous EU assistance period will assist the Government in ensuring that the new Ops will start to be implemented without delay; thus ensuring that the country's strategic priorities for the new period are met.

The following table sets out the current status of the Ops co-financed by the SCF as of 31 January 2014:

		Contracted		Payments	
	Programme Budget Total	Total as of 31.01.2014	Implementation (%)	Total as of 31.01.2014	Implementation (%)
		(EUR millions, except percentages)			
Ops					
"Transport"	2,003.48	2,003.48	100.00%	1,132.07	56.51%
"Environment"	1,800.75	1,800.75	100.00%	852.21	47.33%
"Regional Development"	1,601.27	1,542.34	96.32%	935.76	58.44%
"Competitiveness"	1,162.22	1,162.22	100.00%	689.85	59.36%
"Human Resources"	1,213.87	1,186.64	97.76%	768.65	63.32%
"Administrative Capacity"	180.79	173.63	96.04%	103.80	57.42%
"Technical assistance"	56.82	53.16	93.55%	33.03	58.13%
Total SCF:	**8,019.20**	**7,922.22**	**98.79%**	**4,515.36**	**56.31%**

Source: Ministry of Finance

The Bulgarian contribution to the EU budget was EUR 2,686.27 million for the period from 1 January 2007 to 31 December 2013. The following table sets out the resources paid by Bulgaria to the EU Budget for the period 2007 to 2013:

	2007	2008	2009	2010	2011	2012	2013	Total 2007-2013
				(EUR millions)				
Traditional Own Resources	60.78	86.30	52.88	42.43	49.17	45.94	54.79	392.29
Customs Duties	60.78	85.90	52.48	42.03	48.77	45.38	54.39	389.73
Sugar Levies		0.40	0.40	0.40	0.40	0.56	0.40	2.56
Total "National Contribution"	243.54	281.90	328.63	300.01	349.21	367.86	422.83	2,293.98
VAT based resources	46.23	52.55	50.96	45.99	51.20	52.84	59.97	359.74
GNI based resource	176.54	200.71	250.19	237.08	277.24	292.13	336.04	1,769.94
UK rebate	20.76	28.64	25.07	14.71	18.35	20.18	24.02	151.73
Gross reduction in favour of the Netherlands and Sweden	-	-	2.42	2.23	2.42	2.71	2.80	12.57
Total Own Resources and "National Contribution"	**304.32**	**368.20**	**381.51**	**342.44**	**398.38**	**413.80**	**477.61**	**2,686.27**

Source: Ministry of Finance

North Atlantic Treaty Organisation

Bulgaria became a member of NATO on 29 March 2004. Since then the country has been an active member of the Alliance. Bulgaria contributes to NATO missions through crisis response and the development of the alliance's military capabilities. The Bulgarian armed forces are currently contributing 420 troops to the NATO-led International Security Assistance Force in Afghanistan which will be withdrawn in phases by the end of 2014. Bulgaria maintains its commitment to the security of Kosovo through its participation in KFOR with 10 military personnel. The country regularly participates in NATO Training Missions, such as in Iraq, where it contributed to the training of Iraqi security forces.

Bulgaria's defence expenditure, directly connected to its participation in NATO-led missions and operations for the years 2009 – 2013, is shown below:

	2009	2010	2011	2012	2013	Total 2009 2013
			(EUR millions)			
Total expenditure	36.42	25.46	27.65	28.63	21.24	139.40

Bulgaria highly values the role of NATO as an important international forum for dialogue and consultation. The country is an active participant in many initiatives and programmes of the Alliance, such as the NATO-Russia Council, NATO-Ukraine Commission, NATO-Georgia Council, NATO's Mediterranean Dialogue and Istanbul Cooperation Initiative.

Black Sea Economic Cooperation

Bulgaria was one of eleven countries to sign the Summit Declaration and the Bosporus Statement in Istanbul on 25 June 1992 giving rise to the BSEC. The BSEC is a multilateral political and economic initiative which aims to foster interaction and harmony among Member States and ensure peace, stability and prosperity by encouraging good relations with neighbouring countries in the Black Sea region.

Many countries, including seven EU Member States, the United States, Egypt and Tunisia have observer status, while the European Commission and the Energy Charter are among the BSEC's partner organisations.

Organisation for Security and Cooperation in Europe

Bulgaria has been a participating state since 1975. In 2004 Bulgaria took over the OSCE chairmanship for one year after receiving unanimous approval in the 10th Meeting of the Ministerial Council in Porto, Portugal in 2003.

Double Taxation Agreements

To date, Bulgaria has concluded bilateral agreements on the avoidance of double taxation with 68 countries, including Austria, Belgium, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Russia, Spain, the United Kingdom and the United States.

Foreign Investment Treaties

Bulgaria has entered into 70 bilateral investment treaties ("**BITs**") with countries including Austria, China, France, Germany, Russia, the United States and the United Kingdom. BITs have been signed with all European countries except the Republic of Ireland, Norway, Estonia, Montenegro, Andorra, Bosnia and Herzegovina, Liechtenstein and Monaco. In North and South America, BITs have only been concluded with the United States, Cuba and Argentina. In Africa, BITs have been concluded with Algeria, Egypt, Morocco and Tunisia. In Asia, BITs have been concluded with China, Vietnam, Indonesia, Singapore, Thailand, India, Mongolia, South Korea, Iran, Armenia, Kazakhstan, Qatar, Bahrain, Kuwait, Israel, Jordan, Lebanon, Syria and Yemen.

THE ECONOMY

Background

Since the introduction of the Currency Board in July 1997, Bulgaria has achieved sustainable economic growth resulting from macroeconomic stability and structural reforms. The annual growth for the period from 2000 to 2008 was 5.8 per cent. on average. The high rates of investment in fixed capital were among the main factors for the accelerated economic growth before the crisis. Household consumption was also strong due to extensive financial flows into the Bulgarian economy.

Since Bulgaria's accession to the EU in 2007, reforms have been made for the improvement of the business environment. The country's macroeconomic stability, consistent economic and prudent fiscal policies, improvement of institutional environment and continuous cuts in taxes and social insurance contributions have been at the core of Bulgaria's strong economic performance, increased investment activity, higher employment and real income growth.

Currently, the Government is committed to completing key structural reforms, which have a growth enhancing impact in the medium and long-term. Efforts are directed towards strongly improving the competitiveness of the economy, increasing employment and improving the sustainability of public finances.

Recent Economic Developments and Trends

In 2009 and 2010, the Bulgarian economy faced many challenges due to the global financial and economic crisis. After a decline in GDP of 5.5 per cent. in 2009, the economic recovery began during 2010 and annual growth was 0.4 per cent., mainly due to an increase in exports. The weakening of domestic demand led to a quick adjustment in the current account balance and low core inflation in the period 2009 to 2011. Growth for 2011 was 1.8 per cent., and inflation was 3.4 per cent. using HICP methodology. The recovery in domestic demand started in 2012 with growth in investment and a continued increase in consumption. Nevertheless, due to a decrease in exports, triggered by the recession across the EU, GDP growth decelerated to 0.6 per cent. in 2012. In 2013, exports recovered and were again the main driver of growth.

The recent economic crisis provided an opportunity to restructure the Bulgarian economy and optimise labour costs. The process of optimisation led to the improved competitiveness of the economy and a significant increase in rates of real exports, which was the primary driver of growth. The composition of Bulgaria's exports to EU markets also improved with the rising share of capital-intensive and skilled-labour products, although such share is still considered low compared to other EU countries. In 2010 and 2011 and then again in 2013, Bulgaria's exports increased significantly, surpassing their pre-crisis levels and reaching an all-time high.

The rapid contraction of the current account deficit over the course of 2009-2012 and the surplus recorded in 2013 are indicative of the versatility of the economy and its ability to perform even in times of economic difficulty.

In 2009, the budget deficit of Bulgaria reached 4.3 per cent. of GDP (on an accrual basis). In response, the Government tightened its fiscal policy to restore macroeconomic stability. Accordingly, the budget deficit fell over the course of the 2010-2012 period from 3.1 per cent. of GDP in 2010 through 2.0 per cent. of GDP in 2011 and 0.8 per cent. in 2012. *See Public Finance – Fiscal Policy*. On 30 May 2012, the Commission supported a Council decision to abrogate the Excessive Deficit Procedure (the "**EDP**") for Bulgaria. In 2013, the budget deficit was 1.5 per cent. of GDP.

The following table sets out certain macroeconomic data regarding the Bulgarian economy for the period 2009 to 2013:

	2009	2010	2011	2012	2013
		(EUR billions, except for percentages)			
Economic Data					
Nominal GDP	**34,932**	**36,052**	**38,504**	**39,926**	**39,940**
Real GDP (growth in %)	(5.5)	0.4	1.8	0.6	0.9
Real exports (growth in %)	(11.2)	14.7	12.3	(0.4)	8.9
Real imports (growth in %)	(21.0)	2.4	8.8	3.3	5.7
Unemployment (%)	6.8	10.2	11.3	12.3	12.9
Consumer prices (average growth in %)	2.5	3.0	3.4	2.4	0.4
Producer prices (growth in %)	(4.3)	7.2	8.6	5.3	(1.3)
General government surplus (deficit)	**(1.5)**	**(1.1)**	**(0.8)**	**(0.3)**	**(0.6)**
as a % of GDP	(4.3)	(3.1)	(2.0)	(0.8)	**(1.5)**
Total revenues	**13.0**	**12.4**	**12.9**	**14.3**	**14.7**
as a % of GDP	37.1	34.3	33.6	35.7	**36.8**
Total expenditures	**14.5**	**13.5**	**13.7**	**14.6**	**15.3**
as a % of GDP	41.4	37.4	35.6	36.5	38.3

Source: Eurostat. NSI. Ministry of Finance

The following table sets out certain data relating to the balance of payments for the period 2009 to 2013:

	2009	2010	2011	2012	2013
		(EUR millions, except for percentages)			
Balance of Payments Data					
Current account surplus (deficit)	(3,116.2)	(533.1)	33.2	(333.9)	751.3
as a % of GDP	(8.9)	(1.5)	0.1	(0.8)	1.9
Export of goods (f.o.b)	11,699.2	15,561.2	20,264.3	20,770.2	22,228.2
Import of goods (f.o.b)	15,873.1	18,324.8	22,420.4	24,230.4	24,581.5
Change in BNB's foreign exchange reserves	649.8	383.9	(158.7)	(2,161.0)	599.2

Source: BNB.

Gross Domestic Product

The effects of the global financial crisis were first felt in Bulgaria at the end of 2008 when exports of goods and services started to decrease. This negative trend continued into 2009 when GDP fell by 5.5 per cent. in real terms due to the low demand for Bulgarian goods abroad. Domestic demand, which drove economic growth in the years preceding the global financial crisis, also fell by 7.6 per cent. The decline was largely driven by a drop in consumer confidence and a rise in unemployment. In 2009, investment also shrank owing to the deterioration in the business climate.

The contraction in the economy continued into the first quarter of 2010 but growth resumed in the second quarter of 2010 and overall growth for the year was 0.4 per cent. The economic recovery started with an increase in exports and a stalling of the decline in domestic demand for goods and services.

Bulgarian real GDP growth reached 1.8 per cent. in 2011; this was mainly driven by external demand (as was the case in 2010). Domestic demand made no contribution to the growth of the economy at this stage.

As a result of the debt crisis deepening in some Euro area countries, the European economy shrank by 0.4 per cent. in 2012. Reduced economic activity across the EU resulted in a weakening of economic growth in Bulgaria, most visibly by a decline in net exports. However, by the end of 2012, domestic demand had begun to recover and investments started to rise after four years of decline.

In 2013, Bulgarian exports returned to a positive trend, growing at a rate of 8.9 per cent., reaching the highest levels since 1995 in constant prices. Imports of goods and services also strengthened compared to the previous year, reaching a growth rate of 5.7 per cent. This was driven largely by export-oriented economic activity. The negative contribution of domestic demand amounted to 1.1 percentage points. Gross fixed capital formation declined by 0.3 per cent. in 2013 and final consumption shrank by 1.4 per cent. during the same period. Household expenditure made the largest negative contribution to GDP growth (1.5 percentage points) with high unemployment and a lack of consumer confidence restraining consumer spending. On the supply side, gross value added ("**GVA**"), which is a measure of the total value of final products and services produced in an area, industry or sector of an economy, increased by 1.1 per cent. with the main contribution coming from the services industry.

In the first quarter of 2014, domestic demand returned to growth due to improvement in consumer confidence and business sentiments. According to seasonally adjusted data, final consumption was up by 3 per cent. compared to the corresponding period of 2013 and gross fixed capital formation ("**GFCF**") increased by 3.4 per cent. Strong domestic demand led to an increase in imports by 6.3 per cent., while exports expanded by 1.5 per cent. As a result, GDP growth in the first quarter of 2014 reached 1.2 per cent.

The following table sets out the components of real GDP in the period 2009 to 2013:

	Actual				
	2009	**2010**	**2011**	**2012**	**2013**
	(EUR billions, using constant prices[(1)], except for percentages)				
Total consumption expenditure	22,291	22,397	22,736	23,394	23,072
of which:					
Private	18,216	18,237	18,509	19,201	18,760
Government	4,092	4,170	4,236	4,216	4,323
Gross fixed capital formation	7,607	6,217	5,811	6,041	6,022
Export of goods and services	13,786	15,817	17,759	17,685	19,264
less:					
Import of goods and services	17,248	17,663	19,217	19,852	20,975
Real GDP	**26,466**	**26,570**	**27,059**	**27,217**	**27,452**
Percentage change (%)	(5.5)	0.4	1.8	0.6	0.9

(1) Constant prices are chain linked with 2005 as the reference year. Includes structural changes in the economy which have occurred within the period under observation, however the sum of component data does not necessarily equal the value acquired in calculation of the aggregate. Therefore data for total real GDP presented in the above table may not be equal to the sum of the components presented in the table.

Source: Eurostat

The following table sets out nominal GDP and the annual percentage shares of nominal GDP by sector in the period 2009 to 2013:

	2009		**2010**		**2011**		**2012**		**2013**	
	(EUR billions, except for percentages)									
Industry (except construction)	6,638	19.0	6,923	19.2	8,022	20.8	8,566	21.5	8,640	21.6
Construction	2,767	7.9	2,220	6.2	2,157	5.6	2,106	5.3	1,919	4.8
Agriculture; fishing	1,453	4.2	1,522	4.2	1,799	4.7	1,865	4.7	1,696	4.2
Services	19,153	54.8	20,380	56.5	21,345	55.4	21,760	54.5	22,042	55.2
Taxes less subsidies on products	4,922	14.1	5,008	13.9	5,182	13.5	5,631	14.1	5,643	14.1
Nominal GDP	**34,933**	**100.0**	**36,052**	**100.0**	**38,505**	**100.0**	**39,927**	**100.0**	**39,940**	**100.0**
Nominal GVA	30,011	85.9	31,044	86.1	33,323	86.5	34,296	85.9	34,297	85.9

Source: Eurostat

The following table sets out real annual growth of GDP by sector in the period 2009 to 2013:

	Actual				
	2009	**2010**	**2011**	**2012**	**2013**
	(real growth, % change on previous year)				
Industry (except construction)	(8.0)	(1.5)	8.4	2.5	(0.1)
Construction	(0.3)	(17.9)	(2.2)	(1.8)	(1.0)
Agriculture; fishing	(9.5)	(6.2)	(1.1)	(7.2)	3.4
Services	(1.3)	4.4	0.7	0.0	1.5
GVA	(3.3)	0.5	2.1	0.1	1.1
Taxes less subsidies on products	(16.5)	(0.5)	0.2	3.9	(0.4)
Real GDP	**(5.5)**	**0.4**	**1.8**	**0.6**	**0.9**

Source: Eurostat. Ministry of Finance

Principal Sectors of the Economy

Services

The service industry is the biggest sector of the Bulgarian economy and for the period 2009-2013 it represented on average 55.3 per cent. of nominal GDP. In 2009, as a result of low domestic demand in the country, GVA in services fell by 1.3 per cent. compared to 2008. The service industry was the main contributor to the increase in GDP which occurred in 2010 and reported real growth of 4.4 per cent. In 2012, there was no change in the GVA of the service sector with telecommunications and media, finance and insurance activities, professional services, scientific, and administrative fields of the industry providing a negative contribution. In 2013, the growth rate in services accelerated to 1.5 per cent. mainly due to accelerated growth in: public administration and defence; compulsory social security; education; human health and social work activities; and finance and insurance activities. Conversely, weak domestic demand led to a decline in the trade, transportation and hotel industry.

Industry

In 2013, the industrial sector (which includes mining and quarrying; manufacturing; electricity, gas, steam and air conditioning; water supply; and sewerage, waste management and remediation activities) accounted for 21.6 per cent. of nominal GDP as compared to 19.0 per cent. in 2009. At the same time, the construction industry's share of total nominal GDP fell from 7.9 per cent. in 2009 to 4.8 per cent. in 2013.

Industry (excluding construction)

Manufacturing was the first sector of the Bulgarian economy to be adversely affected by the global financial crisis with the sector starting to register a decline in real growth during the last quarter of 2008. This negative trend in manufacturing was largely due to a sharp decline in industrial sales to overseas markets. In 2010, manufacturing started to recover and, after two years of decline, the industry (excluding construction) registered real growth of 8.4 per cent. in 2011. Weak external demand in 2012, however, caused real growth to slow again to 2.5 per cent. According to the National Statistical Institute, in 2013, the industrial sector's GVA decreased slightly by 0.1 per cent. as a result of the weakness of the domestic market. According to the Ministry of Finance, GVA in manufacturing, however, is expected to increase in the medium term as a result of the renewed recovery of the European economy and the higher external demand for Bulgarian goods. GVA in manufacturing already started increasing at the end of 2013 (not seasonally adjusted data).

Construction

In the pre-crisis period, FDI in Bulgaria was mainly directed at the construction and real estate industries because of the strong demand from both foreign and domestic consumers for property. An increase in real household income, credit facilities and real estate prices following Bulgaria's accession to the EU precipitated a boom in the construction industry. However, during the third quarter of 2009, GVA in the construction industry started to fall as a consequence of the knock-on

effect of the global financial crisis; although the early signs of decline in the construction sector were already apparent at the end of 2007 when the total number of building permits being issued began to fall. This negative trend in the construction industry resulted in the cumulative decline of average annual house prices to the level of 36.5 per cent. over the course of the 2009-2013 period. By 2013, the decline in the construction sector had slowed to just 1.0 per cent. compared to the 17.9 per cent. drop witnessed in 2010. In 2012, the favourable conditions enjoyed by the civil engineering industry had helped to limit the overall decline in the construction sector; however, in 2013 both building and civil engineering contributed to the overall decline. Civil engineering is expected to recover in the medium term due to the planned construction of roads and environmental and utility projects, supported through the use of EU funds.

Agriculture

The GVA in the agricultural sector declined over 2009-2012 but experienced growth of 3.4 per cent. during 2013. The cultivation of cereals and industrial crops has increased in recent years which continue to constitute a large share of the agricultural products exported by the country. The effectiveness of the sector has been improved as the sector showed high levels of consolidation during that period. According to the 2010 census, the number of farms has decreased by 44 per cent. in Bulgaria compared to the number reported back in the 2003 census. At the same time, however, farmland being utilised has increased by 25 per cent. with the average utilised space by individual farm rising from 4.4 hectares in 2003 to 10.1 hectares in 2010. Moreover, investment in agriculture has been growing, particularly by way of investment in general machinery and farming equipment.

Energy Market

In 2011 the Commission recommended the further liberalisation of the electricity and gas markets in Bulgaria. In response, the country has taken a variety of measures to ensure its long-term energy security including the implementation of the Energy from Renewable Sources Act of 2011 (as amended) and the Third Energy Liberalisation Package (under which legislation amending the Law on Energy was drafted and passed in 2012). The key amendments regulate the independence of energy generation and supply from transmission and distribution. These amendments also, among other things, strengthen the powers of the national energy regulator, facilitate cross-border trade in energy, promote cross-border co-operation and investment, increase market transparency with regard to network operation and supply, and serve to better protect consumers' rights. The amendments to the Law on Energy from 5 July 2013 also provide for the introduction of market principles with the further liberalisation of the way in which energy is purchased. Network charges for electricity for export have been reduced too with such exports being exempted from the payment of subsidies for renewable and non-renewable energy as well as other miscellaneous costs. The introduction of a fully functioning balancing market for electricity is underway and is expected to be completed by June 2014. The Government's target date for having a fully liberalised electricity market is 2015.

In respect of renewable energy, Bulgaria has already achieved its 2020 target of 16 per cent. share of energy generated from renewable sources in the gross final energy consumption, as set in the Energy from Renewable Sources Act that transposes Directive 2009/28/EC. According to the currently effective Energy from Renewable Sources Act, purchasing of electricity from renewable sources on the base of long term contracts and feed-in tariffs shall not be applied to energy facilities that apply for connection to the electricity grids after 27 December 2013 (the date of reporting that the overall national RES target is achieved). The exception is applied for energy facilities that fall within the scope of art. 24, para 1 of the Energy from Renewable Sources Act. In addition, after 27 December 2013, the connection to the electricity grids of energy facilities for production of electricity from renewable sources that will not benefit from the abovementioned incentives for purchasing the produced electricity, will not be restricted within the approved electricity capacities by the State Commission for Energy and Water Regulation, that can be provided for connection to the electricity transmission and distribution grid to projects for production of electricity from renewable sources by region of connection and by voltage level. The connection to the electricity grids will be conducted

according to the terms and condition of a special ordinance No. 6 under art. 116, para 7 of the Energy from Renewable Sources Act.

Equally, Bulgaria is implementing measures to diversify its sources of natural gas by building interconnections with neighbouring countries. In the short term, plans for the construction of gas interconnections between Bulgaria and Romania, Bulgaria and Serbia, Bulgaria and Greece, and Bulgaria and Turkey have already been drawn up. The construction of the Ruse – Giurgiu gas interconnection will connect the national gas transmission networks of Bulgaria and Romania. The total value of the project is EUR 23.8 million with construction having started in August 2012; the intention is that the project will be finalised in the summer of 2014 and operational by the autumn of 2014. A feasibility study into the construction of the Bulgaria – Serbia gas interconnection was carried out in 2012. The project "*Construction of gas interconnection Bulgaria – Serbia*", co-financed by the European Fund for Regional Development, is now underway with the interconnector expected to be operational by the end of 2017. The planned route for the gas interconnector between Bulgaria and Greece currently runs from Stara Zagora to Komotini. The project is being implemented by the joint investment company ICGB AD whose shareholders include the Bulgarian Energy Holding EAD (50 per cent.) and IGI Poseidon S.A. The pipelines are expected to be commissioned in 2016. Bulgaria will also participate in the construction of a floating liquefied natural gas ("**LNG**") terminal in the Aegean Sea Greek coast with the aim of securing constant access to natural gas. The construction of the facility is expected to result in the establishment of the necessary gas infrastructure allowing Bulgaria to receive liquefied natural gas from Greece with the option of transporting it to Romania and Serbia. The agreement with Greece is expected to be signed by the end of 2014. Bulgaria also expects to sign an agreement with Qatar for the supply of liquefied natural gas in 2017. In January 2014, a Memorandum of Understanding for the implementation of the gas interconnection between Bulgaria and Turkey has also been agreed by the joint-working group which was set up after the meeting of the ministers responsible for energy policy in both Bulgaria and Turkey. The Memorandum was signed by the two ministers in March 2014. The interconnector project with Turkey will include a 77 kilometer long gas pipeline and is expected to carry up to 3 billion cubic meters of Caspian natural gas a year, initially.

Bulgaria also supports the "**Southern Gas Corridor**" pipeline to the EU and the "**South Stream**" pipeline. The offshore gas pipeline section of the South Stream pipeline will run from the black sea near Russia through the exclusive economic zone of Turkey in the Black Sea to the Bulgarian coast near Varna. The offshore section is planned to be approximately 900 kilometers long. The onshore part of the pipeline will then extend across Europe, through Bulgaria, Serbia, Hungary and Slovenia with the end point in Tarvisio (Italy). Recently, OMV and Gazprom signed an agreement for gas deliveries to Baumgarten hub in Austria. At the end of 2013, the construction of the Bulgarian section of the South Stream gas pipeline commenced. The pipeline will allow the supply of gas directly from Russia to Bulgaria and from Russia to the EU, bypassing transit countries. The South Stream pipeline is expected to accelerate the economic development of Bulgaria, attracting EUR 4.0 billion of direct investments to the country and creating over 5,000 jobs. According to the current construction schedule, Bulgarian consumers are expected to receive the first supply pf gas via the South Stream pipeline in December 2015.

A risk to the implementation of the "South Stream" project may arise following possible EU sanctions against Russia. In a press release dated 8 June 2014, Prime Minister Oresharski stated that the South Stream project will go forward only after any alleged non-compliance with EU law will be resolved and agreement would be reached regarding the project's further implementation, and further noted that work on South Stream had been put on hold until the procedure is agreed with the Commission. See "*Risk Factors - Large-scale economic sanctions by the EU against Russia over its actions in Ukraine may have a material adverse effect on Bulgaria's ability to meet its energy consumption needs*".

Other possible projects to reduce Bulgaria's energy dependency on Russian gas include the expansion of the country's existing gas storage "**Chiren**" from the current capacity of 550 million cubic meters to 1 billion cubic meters of natural gas by 2017, and the construction of new gas storage facilities.

There are also plans to conduct further geological surveys to promote new onshore and offshore oil and gas fields. Bulgaria is also in the process of extending the life of units 5 and 6 of the Kozloduy nuclear power plant. According to the current estimates of the Kozloduy nuclear power plant management, a licence for another 10 years of exploitation of unit 5 will be received by 2017 and a similar licence for unit 6 is expected to be received by 2021. In addition, negotiations with US Westinghouse with respect to the construction of unit 7 of the power plant are ongoing and the contract for the first stage of the project is expected to be signed by the end of the year.

Despite such measures, Bulgaria is still largely reliant on Russia for its energy supply and any delay or failure by Bulgaria to successfully secure access to further sources at favourable prices could have a material adverse effect on the Bulgarian economy. See *Risk Factors – Bulgaria is dependent on the import of fuels and fluctuations in international prices*.

Procedures for revocation of the licences of electricity supply companies

The operation of low and medium voltage grids and the supply of electricity in Bulgaria is carried out by Bulgarian subsidiaries of EVN AG, Energo-Pro a.s. and CEZ a.s., notably the electricity grid companies (EVN Bulgaria Electrorazpredelenie EAD, Energo-Pro Mrezhi AD and CEZ Razpredenie Bulgaria AD) own and operate the low and medium voltage electricity grids in different regions of Bulgaria, whereas the electricity supply companies (EVN Bulgaria Electrosnabdiavane EAD, Energo-Pro Prodazhbi AD and Cez Electro Bulgaria AD) sell electricity to end consumers in the same regions. Each company has a separate licence for, respectively, distribution of electricity or sale of electricity.

There are pending procedures before the State Commission for Energy and Water Regulation (the "**Regulator**") for revocation of the licences of all three electricity supply companies. The Regulator considers that the three companies failed to observe the regulatory regime as stated in the law and in the decisions of the Regulator. The electricity supply companies dispute this view of the Regulator.

At present, there are no procedures for revocation of the licences of the electricity grid companies and the licence revocation procedures of the electricity supply companies are still pending.

A possible decision of the Regulator to revoke a licence could be appealed to the Bulgarian Supreme Administrative Court.

If the licence of an electricity supply company is revoked, it will no longer have a right to sell electricity in Bulgaria. The respective foreign company will retain ownership over the electricity supply company. However, the Regulator may appoint a temporary manager of the company in order to ensure continuous supply of electricity to end consumers while a new licence to a new electricity supplier for the respective region is granted.

Labour Market

The robust economic growth and investment activity during the years preceding the global financial crisis resulted in strong employment growth of approximately 3 per cent. per annum. Labour force participation increased, while unemployment reached its lowest levels on record during the second half of 2008 when it fell to approximately 5 per cent. However, these positive trends changed during 2009., creating a ten-year peak in unemployment of almost 13 per cent. in 2013. Only recently has participation rate started to increase again, and, according to the Spring 2014 European Economic Forecast, unemployment rate is expected to decrease from 13 per cent. in 2013 to 12.8 per cent. in 2014 and 12.5 per cent. in 2015. See "*Risk Factors –Bulgaria suffers from high levels of unemployment*".

The table below sets out the primary indicators and developments in the labour market for the period 2009 to 2013:

	2009	2010	2011	2012	2013
Employment (SNA[1]. thousands)	3,749.3	3,603.9	3,524.6	3,436.4	3,421.6
Employment (SNA[1]. %. year on year)	(1.7)	(3.9)	(2.2)	(2.5)	(0.4)
Unemployment (thousands. LFS[2])	238.0	348.0	376.2	410.3	436.3
Unemployment (%. LFS[2])	6.8	10.2	11.3	12.3	12.9
Unemployment (thousands. Employment agency)	281.0	350.9	332.6	364.5	371.4
Unemployment (%. Employment agency)*	7.6	9.5	10.1	11.1	11.3
Participation rate (15–64. %)	67.2	66.5	65.9	67.1	68.4

(1) System of National Accounts
(2) EU Labour Force Survey
* 2011 registered unemployment rate was recalculated using the 2011 Census working age population.
Source: NSI. Employment agency

The fall in external demand since the second half of 2008 and the contraction of capital inflows has pushed local employers to cut expenditure, including labour costs. Following a delayed reaction, partly sustained by the introduction of short-time working schemes, employment started to fall in mid-2009 and have continued on this downward trend for the last five years. The total employment loss for the 2009-2013 period totalled 393,070 which corresponded to a rate of decrease of 10.3 per cent.

Among those industries with the highest fall in employment was manufacturing (industry, excluding construction) (a drop of 171,445 personnel since 2008); a trend which could not be reversed by the revival in foreign demand for Bulgarian manufactured goods during 2010 and 2011. Employment levels were also severely affected in the construction industry with up to 118,357 jobs lost. Weak domestic demand was the major driver in the decline of employment within the service sector. Areas which were particularly affected were trade, transport, catering, and leisure.

The tightening of fiscal policy and expenditure consolidation also contributed to the overall decline in employment with many people losing their jobs in the public administration sector; however, the number of public sector employees being laid-off has stabilised during 2012 and 2013 with the overall loss in the number of public administration personnel averaging 12.3 per cent. for the 2008-2013 period.

The table below sets out the number of employees in the public sector (total numbers and those in the largest budgetary sectors):

	2009	2010	2011	2012	2013[1]
			(thousands)		
Public employment, total	603.2	565.8	562.6	558.4	560.6
Public administration; compulsory social security [2]	129.4	117.0	114.1	114.3	113.5
Education	158.5	156.2	155.8	154.9	154.7
Healthcare and social securities	106.7	104.7	105.9	105.2	104.4

(1) Preliminary figures.
(2) Excluding military personnel and police officers.
Source: NSI

According to the EU Labour Force Survey ("**LFS**"), the unemployment rate in Bulgaria began to increase as of 2009, reaching a rate of 12.9 per cent. during 2013. Although the global financial crisis has affected many participants in the Bulgarian labour market, job losses were more widespread amongst male, the youth, and those in low-skilled positions.

The adverse effect was more pronounced among male, given that most of the job losses were concentrated in sectors with majority of male positions (e.g. manufacturing and construction). Unemployment among male rose to 13.9 per cent. in 2013 (up from 5.5 per cent. in 2008).

In addition, another challenge to the labour market is the high rate of youth unemployment. The unemployment rate amongst the young (15-24 year olds) has increased by over 15 pps during the last five years and reached 28.4 per cent. in 2013. This strong increase in the number of young people being unemployed stems from the fact that they are among the least experienced in the labour market.

Low-skilled labour was also adversely affected during the same period due to the reallocation of jobs towards more productive employment. The share of those unemployed with only primary and lower secondary education amounted to 29.9 per cent. in 2013, doubling from 2008. The layoffs of low qualified workers along with the economic restructuring were the main factors behind structural unemployment. Long-term unemployment (unemployment spells of over 12 months) increased to 7.4 per cent. in 2013 from 2.9 per cent. in 2008.

The number of those registered as unemployed fell in 2011, decreasing by 5.2 per cent. year-on-year mainly as a result of active labour market programmes implemented by the Government. These programmes have been designed to support the most vulnerable members of the workforce such as the young, the elderly, the low-skilled, the disabled and various other marginalised groups by way of subsidised employment and training. Such programmes for subsidised employment have usually been activated at the beginning and end of each year to counteract the seasonal shifts in private sector activity.

Both the LFS and the Bulgarian Employment Agency reported a rise in the unemployment rate year-on-year in 2012 and 2013. For the purpose of fighting poverty and unemployment, the caretaker government approved an additional BGN 41 million investment in the labour market in 2013, of which BGN 30.6 million were allocated to active labour market programmes.

Hiring capacity in the period 2009-2013 remained low which prevented inactive individuals from re-entering the labour market and delayed those who had recently been laid-off from being hired again. In 2011, labour force participation amongst persons aged 15 to 64 stood at 65.9 per cent. having fallen from 67.8 per cent. back in 2008. Since 2012, the labour force has started to stabilise and improve due to increasing number of people who were actively seeking employment. Thus, the participation rate of population aged 15 to 64 during 2013 rose to 68.4 per cent. not only on account of the shrinking population but also due to more activity amongst the workforce.

After having stabilised in 2013, employment figures further increased in the beginning of 2014 by 0.3 per cent. (SNA) year-on-year. Unemployment rate (LFS) in the first quarter of 2014 remained at its level of the last quarter of 2013 of 13 per cent. and decreased by 0.8 pps. compared to the earlier year, when a 10-year peak was recorded. Contrary to 2013, when the increased labour force participation was a factor for keeping a high level of unemployment, since the beginning of 2014 the higher participation and motivation for job finding has translated into unemployment decrease, reflecting the enhanced opportunities for employment creation.

Wages

During 2009-2012 the rate at which wages grew began to slow, increasing by a nominal 7.7 per cent. on average while real wages, deflated by the HICP, grew by 4.7 per cent. These figures were largely influenced by public sector wages which exhibited lower growth rates for the same period, owing to the Government's adoption of a conservative fiscal policy. A downward trend in wages has been experienced in almost all sectors of the Bulgarian economy with leading contributions coming from construction, real estate, transport, the financial services, and energy.

In 2013, average wage growth accelerated to 10.5 and 10.0 per cent. in nominal and real terms, respectively. The leading upward contribution came from the private sector, having increased by 12.0 per cent. in 2013 from 7.4 per cent. for the 2010-2012 period. Nominal wage growth in the public sector stood at 6.1 per cent. in 2013, up from 3.5 per cent. for the 2010-2012 period. As part of its plans to stimulate the labour market and reduce poverty, the Government plans to increase the minimum wage from BGN 340 (gross/per month, based on 40 hour week) to BGN 450 by 2017.

The following table sets out nominal and real annual wage growth in the public and private sectors for the period 2009-2013:

	Actual				
	2009	**2010**	**2011**	**2012**	**2013**
Average monthly wage (EUR)					
Total economy	311.4	331.4	350.7	373.8	412.9
Public sector	364.8	382.7	389.1	404.6	429.2
Private Sector	293.4	313.8	337.7	363.4	407.1
Nominal wage growth *(average % change year-on-year)*					
Total economy	11.8	6.4	5.8	6.6	10.5
Public sector	9.6	4.9	1.7	4.0	6.1
Private Sector	12.6	7.0	7.6	7.6	12.0
Real wage growth *(average % change year-on-year)*					
Total economy	9.1	3.3	2.4	4.1	10.0
Public sector	7.0	1.8	(1.7)	1.5	5.7
Private sector	9.9	3.8	4.1	5.1	11.6

Source: NSI. Ministry of Finance

As a result of the drop in economic activity, falling sales revenues and pressure on finance resources available since 2009, employers have been compelled to make certain labour cost adjustments. These have manifested themselves through the redistribution of working time, a reduction in the workforce, and limits on wage growth. Over the period between 2010 and 2013, labour productivity in Bulgaria grew, on average, at a stable rate of 3.3 per cent. with the largest growth in productivity coming from the industrial sector excluding construction (9.4 per cent.); the productivity of the service sector meanwhile grew by 6.6 per cent. Whilst productivity has been increasing over the period, average wage growth has also been increasing, contributing to a rise in real unit labour costs ("**RULC**"). RULC growth reached 6.1 per cent. in 2013; however, manufacturing, which is directly exposed to external competition and is a driver of economic growth in the country, has succeeded in maintaining cost competitiveness. Overall, the current wage developments have not undermined the competitiveness of Bulgarian businesses.

The following table sets out real labour productivity and RULC growth in the period 2009-2013:

	Actual				
	2009	**2010**	**2011**	**2012**	**2013**
	(average % change year on year)				
Real labour productivity growth	(3.8)	4.4	4.1	3.2	1.3
RULC growth	7.7	2.4	(2.2)	1.3	6.1

Source: NSI, Ministry of Finance

Inflation

Economic growth during 2007-2008 was strong however accompanied by an accumulation of certain macroeconomic pressures, such as a high current account deficit, a high inflation rate, a significant rise in house prices and increasing RULC. In the second half of 2008, as a result of the global financial crisis, international prices started to fall, which affected domestic prices as well. As a result, annual inflation decelerated at the end of 2008, followed by a clear disinflation trend during 2009. The subsequent easing of domestic demand pressures, due to weakened economic activity in the aftermath of the economic crisis, resulted in a protracted period of low inflation in the country.

The following table sets out the rate of inflation for the period 2009 to 2013:

	2009	2010	2011	2012	2013
		(average % change year on year)			
All items HICP	**2.5**	**3.0**	**3.4**	**2.4**	**0.4**
Food and non-alcoholic Beverages	(0.9)	(0.5)	6.5	3.2	2.5
Alcoholic beverages, tobacco	17.9	23.9	5.2	0.3	1.2
Non energy industrial goods	2.9	0.3	(0.4)	(0.8)	(1.5)
Energy	(5.7)	9.2	8.9	8.0	(1.7)
Services	5.8	1.5	1.9	2.4	1.1
Core inflation[(1)]	4.7	1.0	0.9	1.1	0.0

(1) Overall index excluding energy, food, alcohol and tobacco.
Source: Eurostat

During 2009-2012, consumer price dynamics in Bulgaria were largely driven by external factors, particularly by changes in energy and food prices on the international markets. Core inflation has been following a pronounced downward trend since late 2008, and since the beginning of 2010 it has moved below the headline rate with the contraction of domestic demand leading to historically low levels of inflation for services and non-energy industrial goods. The harmonisation of indirect taxes has continued in line with EU requirements with excise duty hikes on tobacco adding 0.7 and 1.3 pps to the annual average HICP inflation in 2009 and 2010, respectively. Increases in administered prices had a substantial impact on the overall inflation in 2009 and 2012, contributing 0.95 and 0.88 pps, respectively.

Headline inflation slowed significantly in 2013, largely due to adjustments in administrative prices and the downward trend in international prices of food and energy. Core inflation decreased, reaching (0.7) per cent. in December (compared to the corresponding month of the previous year), largely on the back of weak domestic demand and lower import prices. Total HICP remained negative at 0.9 per cent. at the end of 2013, while the annual average inflation rate stood at 0.4 per cent. Consequently, Bulgaria ranked among the top EU countries in terms of the lowest inflation rates.

The deflation rate widened somewhat in the first two months of 2014 but decelerated to (1.3) per cent. as of April, due to the declining negative contribution of unprocessed food and fuels. Consumer price increases are expected to return to positive territory in the second half of the year and slightly accelerate towards the end of 2014. The main risks to current inflation expectations are fluctuations in international prices and the pace of economic growth in Bulgaria.

PUBLIC FINANCE

Under the European System of Accounts 1995 ("**ESA 95**"), the public finance system in Bulgaria comprises the central government subsector, the local government subsector, and social security funds, which together comprise the "**general government**". The rules defining the general government are harmonised internationally and are updated regularly. The fiscal year applicable to the general government is the calendar year.

The National Statistical Institute of Bulgaria (the "**NSI**") is responsible for compiling both the public finance data reported to the European Commission under the ESA transmission programme and the fiscal notification tables reported twice a year to Eurostat in accordance with the Council Regulation No. 479/2009 of 25 May 2009 (on the application of the Protocol on the Excessive Deficit Procedure annexed to the Treaty Establishing the European Community, as amended, and the Statements contained in the Council minutes of 22 November 1993).

With the entering into force of the Organic Budget Law (the "**OBL**") in 1996, the OBL became the prime instrument for managing the budgetary process and for regulating the relationship between the state and municipal budgets; however, the OBL has recently been superseded by the passing of the new Public Finance Act (the "**PFA**").

As part of the wide-ranging reforms which were conducted to address the weaknesses in the budgetary process in Bulgaria, the PFA was adopted in 2013 and came into effect on 1 January 2014. It transposed Directive 2011/85/EU of the Council of 8 November 2011 concerning the new budgetary framework requirements for EU member countries; however, the PFA was also a product of the recommendations given by the National Audit Office.

In addition to the adoption of the PFA into Bulgarian law, the EU regulation of Chapter III ("**Fiscal Compact**") of the Treaty on the stability, co-ordination and governance within the Economic and Monetary Union signed on 2 March 2012 in Brussels, was also adopted into law by the Republic of Bulgaria.

The PFA has been designed to bring various elements of EU and Bulgarian law under one law. It serves to consolidate all aspects of budgetary management both on a national and a municipal level so as to best use public funds. As a consequence of the consolidation of budgetary management under the PFA, the Organic Budget Law and the Municipal Budgets Act were repealed and a number of other acts were amended to reflect necessary adjustments. The PFA applies strict fiscal rules and has created a permanent regulation for the reporting and forecasting of current and future budgets on a multi-annual basis.

Included in the PFA are the fiscal rules, the regulations which co-ordinate the structures of current and future budgets, budgetary relations between national and municipal government, and the use of and contribution to EU funds. The PFA sets out in detail the functions, responsibilities and the timelines for assembling, adopting and executing state budgets as well as the reporting requirements for consolidated fiscal programmes ("**CFP**") and annual reports. The regime for EU funds and other external funds is also regulated under the PFA.

The PFA also contains a summary of the country's fiscal rules for, among other things, the structural deficit, the consolidated fiscal programme (calculated on a cash basis), and the costs of government and public administration. These rules also set out the restrictions on fiscal policy in the long-term, including the imposition of restrictions on basic budgetary aggregations. The rules also comply with internationally-adopted definitions and criteria as well as with the requirements of the Stability and Growth Pact.

Another purpose of the PFA has been to strengthen the interaction between the legislative, executive, and judicial arms of the state when it comes to the adoption of a prudent fiscal policy. The PFA has also been designed to ensure compliance with EU and Maastricht criteria with respect to budget deficits and consolidated debt.

To ensure the sustainability of public finances along with budgetary discipline by successive governments, the PFA also includes a series of rules for all the bodies and funds which are not part of the regular budget; these bodies are subject to evaluation and review in strategic and annual budget documents.

The PFA rules restrict the ability of social insurance funds to incur debt and issue guarantees. Similar restrictions have also been set for the budgetary organisations whose budgets are not part of the State Budget but are included in the consolidated fiscal programme. The PFA also foresees that budgetary expenditure will increasingly be classified through economic and financial indicators as well as being moulded by future EU regulations. The budget procedure has also been synchronised to strengthen the co-ordination of the country's economic policies.

According to the PFA, all spending units and other legal entities which receive budgetary funds as well as those legal entities controlled by the state and/or the municipalities must participate in the budget procedures set out in the PFA. Additionally, they must also adhere to those recommendations made by the Commission for the purposes of ensuring that the country's finance remains balanced.

In order to increase transparency with regard to budgetary procedures, provision has also been made under the PFA to widen access to budgetary information as well as improving the quality and scope of existing information.

The procedure governing the municipal budget is, to a large extent, still within the scope of the repealed Municipality Budget Act. The criteria by which municipal budgets are assembled and adopted remain the same. Moreover, the rights of the Council of Ministers, the Minister of Finance and the first-level spending units for the State Budget are also set out in the PFA.

The procedure for the promulgation of budgetary reports in the National Assembly has also been set out in the PFA, with the Minister of Finance being mandated to present the annual report on the State Budget to the assembly. Equally, each minister is responsible for presenting his/her department's annual report and for implementing their department's budgetary policies. In the case of the municipal budget, the scope of the information required in the annual report is much broader.

The PFA also regulates, among others, the EU funds account regime, the regime of the foreign fund accounts, and any centralised payment schemes.

The new legislative framework for public finance entered into force on 1 January 2014. The final adoption of the Fiscal Council and Corrective Mechanisms Act, for the purposes of creating an independent body to monitor the budgetary framework (pursuant to Article 6 of Directive 2011/85/EU of the Council of 8 November 2011), is on-going.

Fiscal Policy

The prudent fiscal policy adopted by all levels of Government after the introduction of the currency board arrangement in 1997 has been supported by the implemented reforms in the area of budgeting and public finance management.

In the first two years after its accession to the EU, Bulgaria's fiscal policy was based on promoting sustainable economic growth while maintaining the stability of its public finances. The main priorities were the implementation of measures to encourage investment and the reduction of tax rates and social security contributions. One of the main challenges faced by the Government was counteracting the increasing trade deficit and the deficit of the current account by targeting sizable surpluses in the budget and accumulating a buffer in the Fiscal Reserve Account.

The global financial crisis reversed those favourable economic and financial conditions which had prevailed in Bulgaria up until 2008. Bulgaria was well-prepared for the crisis, however, owing to its strong budgetary position, budget surpluses, and hitherto falling public debt. In 2008, the general government surplus reached 1.7 per cent. of GDP; however, this positive trend has subsequently been undermined by the global financial crisis; since 2009 the Government has continued to run a deficit.

During 2010 and 2011, Bulgaria took stringent measures to bring down its deficit to 3.1 per cent. and 2.0 per cent. of GDP respectively. To improve fiscal efficiency and reduce public expenditures the Government implemented a series of measures such as improving the process of tax collection, freezing public sector spending on wages, increasing departmental efficiency through various cost-cutting exercises and improving the rules and procedures for public finance management.

This fiscal consolidation continued in 2012 with the general government budget balance improving from 2.0 per cent. of GDP in 2011 to 0.8 per cent. of GDP in 2012. This improvement was achieved by reducing fiscal expenditures, bolstering fiscal control mechanisms and enhancing tax collection initiatives. Since 2011, the Republic's budget has corresponded fully with the EU Council's recommendations and in June 2012 the Council removed the EDP for the country. Bulgaria is currently one of the EU Member States which are not subject to the EDP.

After several years of strong fiscal consolidation, the fiscal policy focus was shifted towards policies supporting growth, social protection, the improvement of the business climate and sustainable fiscal management. The fiscal deficit of Bulgaria grew from 0.8 per cent. of GDP in 2012 to 1.5 per cent. of GDP in 2013, well below the 3 per cent. of GDP reference value set in the Stability and Growth Pact.

The current budget is mainly concerned with securing tangible results, supporting a policy of enhanced efficiency and effectiveness of budgetary expenditure, and retaining fiscal discipline. In spite of the deficits registered over the last three years, Bulgaria has achieved notable fiscal consolidation and strengthen its position among the EU Member States with a sustainable budget position. At present, the Government plans to gradually reduce the budget deficit from 1.8 per cent. of GDP in 2014 to 1.5 per cent. in 2015 and 1.1 per cent. in 2016. It is anticipated that this level of reduction will prove conducive to medium- and long-term economic growth in Bulgaria. Bulgaria continues to consider the convergence of its economy with the average levels of economic development across the EU as a key priority, particularly by making the most of EU development funds.

Tax Policy

Bulgaria's tax strategy after 2007 has been characterised by continuity and predictability. The main focus has been to support macro-economic stability in both the medium and the long-term and to provide the necessary financial resources to meet budgetary requirements, promote economic growth, attract foreign investment and increase long-term fiscal stability.

Fiscal policy in recent years has helped to mitigate the negative impact of the global financial crisis on the Bulgarian economy, improve the business environment, stimulate investment activity, promote employment and reduce the grey economy.

The main priorities for tax policy are:

- reducing the administrative burden and costs for businesses and individuals;
- increasing budget revenues;
- ensuring a stable tax environment (i.e. one in which tax rates remain stable and low to encourage investment, growth and jobs); and
- increasing tax rates for certain excise goods according to EU tax legislation (tax rates in terms of direct taxation remain unchanged at 10 per cent. for corporations (one of the lowest in the EU) and 10 per cent. for individuals which is the lowest in the EU).

The development of Bulgarian tax policy since 2007 has been in line with EU law requirements and those international treaties to which Bulgaria is a party.

Improving Tax Collection and Ensuring the Fiscal Reserve Level

The Government has taken legislative and administrative measures in order to implement policies aimed at enhancing the effectiveness and efficiency of the revenue agencies and increasing budget revenue through effective measures for prevention and addressing tax fraud and smuggling of excisable goods, as well as implementing specific recommendation 1 of the European Commission. Some of these measures include:

- Following the amendments to the Law on Value Added Tax, as of 1 January 2014, a reverse charge mechanism for VAT is applied to supplies of cereals and industrial crops. This mechanism aims at limiting abuse in the trade in cereals and will be applied by the end of 2018.

- The National Revenue Agency ("**NRA**") has been exercising effective fiscal control on goods with high fiscal risk and developed a comprehensive strategy for introducing fiscal controls of the movement of goods with high fiscal risk. This policy became effective at the beginning of 2014 with amendments to the Tax and Social Insurance Procedure Code. Measures were taken to enhance the administrative capacity of the control authorities by setting up the specialised "Fiscal Control" directorate at the Central Division of the NRA and strategic placement of permanent fiscal control teams at specially designated fiscal control points and at locations where risk goods are unloaded.

- In 2013, an analysis of the collection of Government receivables was carried out and a new organisation in charge of the process of collection of Government receivables was introduced. One of its objectives was to streamline the process of investigating and selecting the debtor's assets and an improvement is planned to the process of electronic exchange of documents and data with public creditors and with institutions keeping information about the property and assets of liable individuals. The development of comprehensive specialised software, covering all activities related to collection of public receivables, is underway, and expected to be launched in 2015.

- Every year targeted campaigns are held to collect overdue public receivables. Seventeen information telephone campaigns are planned for 2014.

- Legal framework for rescheduling and deferring tax liabilities and mandatory social security contributions at alleviated conditions for a longer period and in a greater amount was created. The goal of this framework is to provide liable individuals facing temporary financial difficulties with the opportunity to service their overdue liabilities for tax and social security contributions.

- Measures are taken in order to strengthen the capacity of the revenue authorities to curtail "shadow" practices and their negative effect on tax collection. Using the Risk Information Exchange System ("**RIES**") of the Customs Agency, the Customs Agency is developing rules for collecting information intelligence and providing data for risk analysis. In addition, the Customs Agency and the NRA are joining efforts to exchange information with regard to intra-community supplies and acquisitions, and conducting joint analysis for identification of objects of unregulated production, storage and sale of motor fuels and targeted inspections of suspected individuals.

- A programme was developed including planned measures for compliance with tax legislation and reducing the risk levels in 2014. The result will be assessed in 2015.

- Road and railway controls have been improved and strengthened with regard to the illegal transportation and shipment of tobacco products, including through mobile control and surveillance groups.

- The Customs Agency has made an analysis of and has taken specific measures to improve the Bulgarian Excise Centralised Information System ("**BECIS**"). The BECIS was launched on 1 April 2013, in order to enhance control, increase collection of excise duties and VAT and guarantee equal treatment of economic operators. It is expected to ensure automation of the process of submission and processing of excise documents, exchange of information and control of the overall chain of sale of excisable goods.
- Some activities have been carried out with regard to the refinement and upgrading of the Bulgarian Integrated Customs Information System ("**BICIS**"). The existing risk analysis module has been upgraded by creating a centralised version of this module and upgrading its functionality.
- A joint analytical and information centre is being set up for exchanging information and performing analytical activities and interaction among the National Revenue Agency, the Customs Agency, the General National Police Directorate, the General Border Police Directorate and the National Security Agency. A System for Exchange of Risky Information is to be introduced which is an instrument for collection, storage and exchange of information for the purposes of risk analysis, facilitation of control activities and documentation of the results from the control actions taken.

Revenues

The principal source of revenue in the State Budget is taxation, particularly VAT, excise duties, corporate profit tax and personal income tax. A number of significant tax reforms have been introduced which aim to shift the taxation burden from direct to indirect taxes to achieve more progressive taxation and the tax base to be broadened by removing exemptions and reducing activities in the grey economy.

Corporate income tax

For the period 2005 to 2007, the corporate income tax rate decreased from 19.5 per cent. to 10 per cent. and tax on dividends from 15 per cent. to 7 per cent. (in 2008 it reached 5 per cent.) which was a tax incentive for business. These tax rates are among the lowest in the EU, which in turn reflected very positively on investment and increased profits for companies. The fiscal effect of these steps was more evident in 2007 when revenues from corporate income tax rose significantly in spite of the reduced rates. Current tax rates remain unchanged. This played an important role in the increase of budget revenues from corporate income tax due to the promotion of foreign and local investments and the reduction of the informal sector.

The following table sets out corporate income tax revenues as a percentage of GDP in the period 2009 to 2013:

	Actual				
	2009	**2010**	**2011**	**2012**	**2013**
	(EUR millions, except for percentages)				
Total Revenue	901	692	765	756	794
Tax Rate	10%	10%	10%	10%	10%
Total Revenue *as % of* **GDP**	2.6%	1.9%	2.0%	1.9%	2.0%

Source: Ministry of Finance

Despite the significant decrease in the tax rate in 2007, the revenues from corporate income reached EUR 1,139 million in 2008. Revenues fell during the economic crisis and in 2010 they were EUR 692 million. After the beginning of the economic recovery in 2010 and 2011, revenues from corporate income taxes increased from EUR 692 million in 2010 to EUR 794 million in 2013, an increase of 14.7 per cent.

Personal income tax

In 2008, significant changes to personal taxtion were made by which a flat tax rate of 10 per cent. was introduced and the requirement for a non-taxable minimum was abolished.

There were no significant legislative amendments between 2008 and 2013. Revenues for this period rose gradually (except for 2010 compared to 2011) from EUR 1,008 million in 2008 to EUR 1,201 million in 2013. However, at the same time the unemployment rate doubled from 5.6 per cent. in 2008 to 12.9 per cent. in 2013.

The following table sets out revenue from personal income tax as a percentage of GDP for the period 2009 to 2013:

	Actual				
	2009	**2010**	**2011**	**2012**	**2013**
	(EUR millions, except for percentages)				
Total Revenue from personal income tax	1,049	1,039	1,114	1,175	1,201
Tax rate	10%	10%	10%	10%	10%
Total Revenue from personal income tax *as a % of* **GDP**	3.00%	2.88%	2.90%	2.94%	3.0%

Source: Ministry of Finance

Excise duties

In order to implement EU requirements, excise duties on some products are increasing gradually during the years, but others remain steady.

The following table sets out excise duties for the period 2009 to 2013:

	Actual				
	2009	**2010**	**2011**	**2012**	**2013**
	(EUR millions)				
Excise duties					
Tobacco products	904.0	777.4	866.0	921.8	922.4
Fuels	948.5	911.4	956.8	991.7	996.9
Alcoholic beverages and beer	88.0	115.4	134.2	137.0	135.0
Other stock	25.2	20.0	16.6	19.1	19.4
Revenues	**1,965.7**	**1,824.2**	**1,973.6**	**2,069.6**	**2,073.7**

Source: Ministry of Finance

Revenues from excise duties are stable despite the impact of the economic crisis. This is due to the legislative measures undertaken against the evasion of excise duties and improvements in customs administration.

VAT

VAT levied on the supply of goods and services and other activities in Bulgaria complies with the rules of Council Directive 2006/112/ES on the common system of value added tax. The following VAT rates apply from 1 January 2014: a standard rate of 20.0 per cent., a reduced rate of 9.0 per cent. applicable to accommodation provided at hotels and similar establishments, including the provision of vacation accommodation and letting out of places for camping sites or caravan sites and a reduced rate of 0 per cent. for export and selected services such as international transport.

Furthermore, the VAT system provides for exemptions (without the right to deduct the input tax) for certain services, such as educational, healthcare and welfare and financial services (with exceptions).

With the entry into force of the changes in VAT Act in 2007, a more liberal regime in respect of payment of tax liabilities was introduced, for example, reduced customs control and introduction of new rules for the administration of VAT. This created a favourable business environment by reducing tax and customs administrative formalities for persons to a minimum.

The following table sets out the revenues from VAT as a percentage of GDP for the period 2009 to 2013:

	Actual				
	2009	2010	2011	2012	2013
	(EUR millions, except percentages)				
Total Revenue	**3,288.9**	**3,204.4**	**3,380.5**	**3,656.7**	**3,766.4**
Tax rate	20%	20%	20%	20%	20%
Total Revenue *as a % of* **GDP**	9.42%	8.89%	8.78%	9.16%	9.43%

Source: Ministry of Finance

During the economic crisis in 2009 and 2010, the ratio of VAT revenues to GDP decreased, but in 2011 VAT revenues reversed this negative trend after several measures to improve the collection of VAT were undertaken and the rate continued to increase over 2012-2013. These measures included: an increase in the number of on-site inspections, improvement of performance of mobile units, more frequent and more thorough audits, the introduction of more rigorous accounting rules and judicial prosecution of unlawful practices inflicting losses on the budget, the implementation of on-line connections between the cash registers of traders and the National Revenue Agency ("**NRA**"), remote connection of fiscal devices with the NRA and automatic exchange of information between the NRA and the Customs Agency.

Fiscal decentralisation

Legislative amendments in the municipality laws in 2006 gave municipalities the power to determine and collect the following local taxes: real estate, inheritance, donation, vehicle, lump-sum, and tourist tax as well as tax on acquisition of property.

Municipalities also have the power to collect local fees in a number of local matters such as disposal of waste, administrative services etc.

Since 2008, property tax amounts have been determined by the municipal councils within limits set by the law.

Fiscal goals

Bulgaria's tax policy is oriented towards the maintenance of economic stability during crisis, promotion of business investments and employment. Some of these goals may be reached through the implementation of the following measures: tax reliefs for business and achievement of the minimum excise tax rates of the EU; simplification of the tax system and preciseness of the tax laws in order to eliminate the inconsistencies and imperfections in the practice of taxation and to obtain transparency and understanding for taxpayers; retention of direct taxes' rates in combination with lower social insurance burden on employers in support of economic growth and employment; and retention of a higher share of indirect taxes as compared to the direct taxes.

General Government

The table below sets out the revenues, expenditure and net lending/borrowing for the general government of Bulgaria and the second table represents the net lending/net borrowing by sub-sector for the years 2009 to 2013 (under ESA 95 methodology):

ESA 95 code	General government	2009	2010	2011	2012	2013
				(EUR millions)		
OTR	Total Revenue	12,963.9	12,368.4	12,940.3	14,264.3	14,696.1
OTE	Total Expenditures	14,477.7	13,492.2	13,702.9	14,573.2	15,293.3
B9	**Net lending (+) Net borrowing (-)**	**(1,513.7)**	**(1,123.8)**	**(762.6)**	**(308.9)**	**(597.2)**
				(% of GDP)		
OTR	Total Revenue	37.1	34.3	33.6	35.7	36.8
OTE	Total Expenditures	41.4	37.4	35.6	36.5	38.3
B9	**Net lending (+) Net borrowing (-)**	**(4.3)**	**(3.1)**	**(2.0)**	**(0.8)**	**(1.5)**

Source: Ministry of Finance

ESA 95 code	B.9 Net lending (+) Net borrowing (-)	2009	2010	2011	2012	2013
				(EUR millions)		
S.1311	Central government	(1,327.1)	(707.9)	(848.0)	(447.1)	(727.9)
S.1313	Local government	(313.6)	(4.5)	(9.8)	103.9	172.1
S.1314	Social security funds	127.0	(411.4)	95.1	34.2	(41.3)
S.13	**General government**	**(1,513.7)**	**(1,123.8)**	**(762.6)**	**(308.9)**	**(597.2)**
				(% of GDP)		
S.1311	Central government	(3.8)	(2.0)	(2.2)	(1.1)	(1.8)
S.1313	Local government	(0.9)	0.0	0.0	0.3	0.4
S.1314	Social security funds	0.4	(1.1)	0.2	0.1	(0.1)
S.13	**General government**	**(4.3)**	**(3.1)**	**(2.0)**	**(0.8)**	**(1.5)**

Source: Ministry of Finance

Bulgaria's fiscal position is strong compared to other EU countries. The public debt to GDP ratio of 18.9 per cent. at the end of 2013 was the second lowest in the EU, after Estonia. Successive governments have shown a strong commitment to fiscal prudence, resulting in a significant decline in the public debt to GDP ratio from over 100 per cent. in 1997. Prudent fiscal policy has been based on targeting the fiscal stance on surpluses during expansionary economic periods and accumulating a buffer in the Fiscal Reserve Account against potential shocks and strong fiscal consolidation after entering the global crisis and economic recession. Prudent fiscal policy is extremely important for the sustainability of the currency board arrangement and long-term fiscal sustainability.

The sizeable fiscal and financial buffers accumulated in the high-growth pre-crisis years following the EU accession, provided important cushions to support the economy through the downturn. The economy entered into recession in 2009 and the fiscal stance deteriorated to a deficit of 4.3 per cent. of GDP for 2009 due to a sharp slowdown in Government revenues. For the period 2010-2013 the general government deficit registered a considerable improvement to 1.5 per cent. of GDP driven by the decisive actions for fiscal consolidation, mainly on the expenditure side through tightening the medium-term expenditure ceilings for the ministries, agencies, and some autonomous budgets. After achieving successive fiscal consolidation, current fiscal policy remains focused on supporting growth, providing social welfare protection, and improving the business climate. The sizeable increase in the absorption of the funds under the EU programmes is expected to contribute to positive long-term growth. The need to increase social security payments after a three-year-long freeze was well-balanced and mindful of the need to keep the deficit down.

Consolidated Fiscal Programme - Cash Basis

Although ESA 95 is the prime methodology used for the general government budget, the National Assembly approves the Annual Budget Law compiled under the national budget methodology, which

is on a cash basis. The approved deficit on a cash basis however, is fully consistent with the general government deficit target set in the Convergence Programme (ESA 95).

The following table sets out the sub-category of revenues and expenditures under the CFP in the period 2009 to 2013 (on a cash basis):

	2009	2010	2011	2012	2013
			(EUR millions)		
Consolidated Fiscal Programme					
Total revenues	**12,803.2**	**12,236.6**	**12,975.6**	**14,044.9**	**14,815.9**
Tax revenues	**10,313.7**	**9,721.9**	**10,529.7**	**11,007.6**	**11,437.8**
Direct taxes	**1,949.8**	**1,730.5**	**1,879.2**	**1,930.5**	**1,994.8**
Profit tax	901.1	691.9	764.9	755.7	794.0
Income tax	1,048.7	1,038.5	1,114.4	1,174.8	1,200.8
Social insurance contributions	2,696.1	2,541.0	2,817.0	2,861.2	3,098.5
Indirect taxes	**5,316.7**	**5,089.4**	**5,432.3**	**5,799.5**	**5,926.3**
VAT	3,288.9	3,204.3	3,380.5	3,656.7	3,766.4
Excise duties	1,965.6	1,824.2	1,973.6	2,069.6	2,073.7
Insurance premium tax			11.0	13.0	11.4
Customs duties	62.2	60.9	67.1	60.2	74.7
Others	**350.6**	**360.4**	**400.4**	**415.9**	**417.6**
Sugar Levy	**0.5**	**0.5**	**0.7**	**0.5**	**0.5**
Non tax revenues	**1,811.4**	**1,695.1**	**1,697.8**	**1,826.8**	**2,019.9**
Grants	**678.1**	**819.6**	**748.1**	**1,210.5**	**1,358.2**
Total Expenditure with the EU contribution	**13,123.3**	**13,679.8**	**13,736.7**	**14,228.4**	**15,557.4**
Total Expenditure	**12,741.8**	**13,337.4**	**13,338.3**	**13,814.6**	**15,079.8**
Total noninterest expenditure	**12,475.5**	**13,089.0**	**13,058.6**	**13,521.8**	**14,727.6**
Current noninterest expenditures	**10,611.7**	**11,214.1**	**11,486.2**	**11,639.7**	**12,628.0**
Compensation	2,097.9	2,120.1	2,123.1	2,167.4	2,331.4
Wages and salaries	2,058.7	2,078.2	2,080.6	2,116.8	2,277.1
Scholarships	39.2	41.9	42.5	50.6	54.3
Social security contributions	538.5	502.5	537.5	545.8	700.0
Maintenance and operating	2,208.5	2,271.0	2,277.2	2,291.4	2,401.6
Subsidies	649.5	759.3	815.5	630.5	731.9
Social expenditures	5,117.3	5,561.2	5,732.8	6,004.5	6,463.1
Pensions	3,319.6	3,576.8	3,634.2	3,698.8	3,968.8
Social assistance	948.5	991.5	980.6	1,057.1	1,124.7
Health Insurance fund	849.3	993.0	1,118.1	1,248.6	1,369.7
Capital expenditures	**1,863.8**	**1,874.8**	**1,572.4**	**1,882.1**	**2,099.6**
Interest	**266.3**	**248.4**	**279.7**	**292.8**	**352.2**
External	186.0	171.9	178.9	191.2	247.6
Domestic	80.3	76.6	100.8	101.6	104.5
Contribution to the EU budget	**381.5**	**342.4**	**398.4**	**413.8**	**477.6**
Primary balance	**(53.8)**	**(1,194.8)**	**(481.4)**	**109.3**	**(389.3)**
Deficit/Surplus (-/+)	**(320.1)**	**(1,443.3)**	**(761.1)**	**(183.5)**	**(741.5)**

Source: Ministry of Finance

The sizeable fiscal buffers accumulated in the growth years provided important protection for the economy during the recent crisis. The Bulgarian economy entered recession in 2009 with the fiscal stance of the Government shifting towards addressing the deficit. During the next few years, the Government focused on a fiscal consolidation programme to reduce expenditures and control public finance. As a result of such fiscal prudence, the budget deficit shrank to 1.5 per cent. of GDP in 2013. The composition of spending has also improved through an increase in the share of investment spending as a consequence of the accelerated absorption of the funds under the EU programmes along with increases in social protection spending. On the revenue side, the main tax rates have remained unchanged. This has provided both a stable and predictable environment for businesses and investors, conducive to the recovery of domestic demand and economic growth. The Government is determined to preserve low tax rates to encourage private investment both within the country and from abroad.

As mentioned previously, Bulgaria exercised prudence in the pre-crisis high growth years, running fiscal surpluses and creating a large fiscal reserve. The fiscal reserve has been enshrined in the annual budget law for 2014, with a legal minimum of EUR 2.3 billion.

The following table sets out the fiscal reserve account for the period 2009 to 2013:

	2009	2010	2011	2012	2013
Fiscal reserve account					
EUR millions	3,923.1	3,073.8	2,555.8	3,109.2	2,393.1
% of GDP	11.2	8.5	6.6	7.8	6.0

Source: Ministry of Finance

Approved Annual Budget Law for 2014

The annual budget law for 2014 was approved by the National Assembly on 9 December 2013 and came into effect on 1 January 2014.

The 2014 Budget is focused on achieving a stable and predictable investment environment and on increasing the overall competitiveness of the Bulgarian economy.

The 2014 Budget aims to improve tax collection and restructure public expenditures.

In the fiscal strategy for the 2014 Budget, a negative budget balance is set as 1.8 per cent. of GDP. This percentage, in nominal terms, represents a deficit of EUR 752.8 million. The deficit is a result of additional Government spending on measures to promote economic growth both in the cities and in the localities as well as being a consequence of increased spending on education, healthcare and social security. The Government believes that such spending is essential to ensure that Bulgaria is well protected against any further fluctuations in the global economy.

	CFP		of which			
	Annual Budget Law		National budget		EU funds*	
	2013	2014	2013	2014	2013	2014
			(EUR millions)			
Total revenues	**15,535.5**	**15,868.1**	**13,668.3**	**14,267.0**	**1,867.2**	**1,601.1**
(% of GDP)	38.0	38.0	33.4	34.2	4.6	3.8
Tax revenues	11.683.6	12,439.1	11,683.6	12,439.1	0.0	0.0
Non tax revenues	1.939.8	1,774.8	1,939.6	1,774.7	1.6	0.3
Grants	1.912.1	1,654.2	45.0	53.3	559.1	1,003.9
Total expenditure	**16,350.2**	**16,620.9**	**14,314.4**	**14,908.4**	**2,490.0**	**2,198.1**
(% of GDP)	40.0%	39.8%	35.0%	35.7%	6.1%	5.3%
BG contribution to the EU budget	464.4	462.6	464.4	462.6		
(% of GDP)	1.1	1.1	1.1	1.1		
Transfers for national co financing			(454.2)	(485.6)	454.2	485.6
(% of GDP)			(1.1)	(1.1)	1.1%	1.2%
Budget balance	**(814.7)**	**(752.8)**	**(646.2)**	**(641.3)**	**(168.5)**	**(111.5)**
(% of GDP)	**(2.0)**	**(1.8)**	**(1.6)**	**(1.5)**	**(0.4)**	**(0.3)**

* The total expenditure on EU funds includes EU financing and national co financing.
Source: Ministry of Finance

Privatisation

The privatisation process in Bulgaria started in 1992. Most of the major sectors of the economy have been privatised and the resources of state-owned companies available for privatisation are considerably limited.

Until 31 December 2009, the proceeds from privatisation were distributed according to the Privatisation and Post Privatisation Control Act, respectively 10 per cent. to the Privatisation and Post-Privatisation Control Expenditures Fund and the remaining 90 per cent. were channelled to the central budget (from 2008 allocated to the benefit of the State Fund for Guaranteeing the Stability of the State Pension System (the "**Silver Fund**")). Since 1 January 2010 the proceeds from privatisation are allocated entirely to the Silver Fund.

As of 31 December 2012, the total amount (in terms of value) of privatised assets amounted to 66.31 per cent. of all state assets. Shares in 5,262 state enterprises have been sold, including 2,939

enterprises and 2,323 separate parts of companies. 4,240 sales of minority stakes have also been completed. The total financial effect of privatisation transactions amounted to US$12,539 million, including US$ 6,490 million in payments, US$1,192 million in assumed liabilities and US$4,857 million in investment commitments.

The largest number of privatised enterprises are found in the fields of industry (1,646), trade (1,177), agriculture (621), construction (536) and tourism (524).

A total of 174 privatisation transactions that have taken place in Bulgaria since the beginning of privatisation process were made involving foreign investors, which has contributed substantially to the financial results provided above. As a result of its privatisation programme, Bulgaria has attracted large investors from the Czech Republic, Russia, Austria, Germany, Belgium, Greece and other countries.

Some of the largest enterprises in Bulgaria have already been privatised such as: the former state-owned banks (with the exception of the Bulgarian Development Bank which has remained state-owned); the Bulgarian Telecommunications Company EAD; Kremikovtzi EAD; TPP Bobov Dol EAD; Neftochim EAD; Bulgarian Maritime Fleet (Navibulgar) EAD; Sodi Devnya EAD; SOMAT EAD; Arsenal EAD; Asarel Medet EAD; Bulgartabac Holding AD; energy distributing companies; and many others.

Privatisation in the period 2009 to 2013

The following table summarises the results of the privatisation process in the period 2009-2013:

Report Year	**Revenue** *(EUR millions)*	**Primary Divestitures**
2009	23.3	TPP Bobov Dol-partial payment ("**p.p**") EDC Plovdiv and Stara Zagora - p.p. Hotel Vitosha and Riga Hotels - p.p.
2010	13.4	KCM EAD-p.p. EDC Sofia Region - p.p. EDC Pleven EAD - p.p. TPP Bobov Dol - p.p. TPP Varna EAD - p.p. Bulgarian Maritime Fleet EAD - p.p.
2011	164.8	Bulgartabac Holding AD Arsenal AD Industrial Construction Holding EAD EVN EDC companies - minority stakes
2012	138.9	Technoexportstroy EAD MDK Pirdop – p.p. IPK Rodina Energo-Pro EDC – minority stakes CEZ EDC – minority stakes
2013	9.1	IPK Rodina – p.p.

Source: Ministry of Finance

2014 Forecast

Forecasted cash receipts from privatisation in the central budget for 2014 amount to EUR 66.98 million according to the CFP for 2014.

The majority of estimated receipts from privatisation during the year are expected from the privatisation of the following holdings of the state: the Bulgarian Stock Exchange – Sofia AD; the Central Depository AD; NITI EAD (development and manufacture of products for military use); and the 30% minority stake in Bulgarian Maritime Fleet AD.

Pension System

The pension system in Bulgaria has undergone substantial structural reform since the late 1990s. The traditional pay-as-you-go system was transformed into a three-pillar system through the introduction of compulsory and voluntary fully funded pensions. The current Bulgarian pension system came into force with the Mandatory Social Insurance Code on 1 January 2000 (renamed the Social Security Code in 2003). It is based on the principle of security through diversity and includes the following:

Mandatory pension insurance (Pillar I)

The public system of mandatory pension insurance of the pay-as-you-go type (Pillar I) ensures linkage of the pensions amounts with contribution periods and earnings. New, more restrictive eligibility criteria on the basis of length of service and old age were introduced in 2000. Promoting the principle of mandatory participation and universality, the first pillar covers all economically active persons. There is differentiation among the categories of insured persons, depending on the number and types of included social insurance risks. These include: mandatory social security for all social risks, compulsory social security for disability, old age, death, accidents at work and occupational disease, and compulsory social security for disability due to general disease, old age and death.

The first pillar is financed through contributions from employers and employees, as well as through transfers from the State Budget for covering all non-contributory pension benefits and some non-contributory periods, which are regarded as insurance periods. Since 2009, the state has become a "**third insurer**" and pays contributions equal to 12 per cent. of the total insurance income.

The first pillar is administrated by the National Social Security Institute, which is responsible for entitlement to and payment of pensions and other social insurance benefits in the event of temporary incapacity to work, maternity and unemployment. The pension policy is formulated and implemented by the Ministry of Labour and Social Policy.

Inflows to the first pillar are allocated into separate and financially independent public social insurance funds being: the Pensions Fund, the Accidents at Work and Occupational Disease Fund, the General Disease and Maternity Fund and the Unemployment Fund. The fifth fund for pensions not related to labour activities is financed through transfers from the central budget. The deficit of the Pensions Fund is covered by subsidy from the government budget on an annual basis.

In 2012, the rate of social insurance contributions to annual social insurance income for the third labour category (labour without risk for which employer pays no financial contribution in Professional Pension Funds ("**PPFs**")), is as follows: 17.8 per cent. for the Pension Fund (for persons born after 1 January 1960, 5 per cent. of this 17.8 per cent. are transferred to Pillar II); between 0.4 per cent. and 1.1 per cent. for the Accidents at Work and Occupational Disease Fund (differentiated by type and degree of risks for main groups of economic activities; these contributions are only at the employers expense); 3.5 per cent. for the General Disease and Maternity Fund and 1 per cent. for the Unemployment Fund.

Supplementary mandatory pension schemes (Pillar II)

The supplementary mandatory pension schemes are capital-based schemes with defined social security contributions, accumulated and capitalised in individual pension accounts. They do not replace the first pillar pensions and allow for receiving more than one pension, thus increasing the replacement rate without any increase of the social insurance burden.

The scope of the second pillar is narrower than that of the first pillar and it covers only old-age and death risks. It is also more limited because it covers two categories of persons. First, it covers any person subject to mandatory social insurance in a universal pension fund; these are all persons insured under the first pillar and born after 31 December 1959. Second, all persons subject to mandatory social insurance in a professional pension fund (all persons working under the conditions of labour "at risk" requiring employers to make additional payments into professional pension fund in order to

acquire the right to a time-limited pension for early retirement, which precedes the pension based on the length of service and age, without any cumulative effect on the two pensions).

The supplementary mandatory pension schemes are based on monthly contributions to a universal and/or professional pension fund in amounts set out in the Social Security Code. Currently, the contribution to a universal pension fund is 5 per cent. (paid in the same ratio as the other part of the social insurance contributions), which is transferred from the first pillar Pension Fund contributions. The contribution to a professional pension fund has been 7 per cent. for the second labour category (labour "at risk" for which the employer pays additional contributions into PPFs each month) and 12 per cent. for the first labour category, at the sole expense of the employer.

As at 31 December 2013, the second pillar of the pension system had approximately 3.6 million participants. Total assets of this pillar comprise EUR 3.1 billion. In the period between 1 January 2007 and 31 December 2013, the number of insured persons increased by around 26 per cent., and the assets of the second pension pillar rose from EUR 0.51 billion to EUR 3.1 billion.

Supplementary voluntary pension schemes (Pillar III)

The supplementary voluntary pension schemes are also capital-based. They involve voluntary contributions at the expense of insured persons, insurer or at the expense of insured persons and the insurer in order to provide life or term pension for old age or disability, as well as survivor pensions. They are organised and administered by shareholding companies with pension licenses.

As of 1 January 2007, occupational pension schemes were introduced into this pillar. The contributions paid by employers (up to EUR 30.68 per month) and insured persons (up to 10 per cent. of the taxable income) are tax exempt, while the benefits to be paid may differ between a life-long, time-limited or lump sum pension.

Recent pension reforms

Important pension reforms were adopted in 2011 which include the gradual increase of the statutory retirement age to 63 years for women (effective 2021) and 65 years for men (effective 2018) (37 years of service for women and 40 years of service for men by 2021). The present Government introduced a "zero" year for 2014. Throughout 2014 it is anticipated that the 2013 retirement conditions will be retained but only for the third category of labour, namely:

- 60 years and 8 months and 34 years and 8 months of contributory service for women; and
- 63 years and 8 months and 37 years and 8 months of contributory service for men.

For the first and second categories of labour, the increase of 4 months continues in compliance with the existing provisions of the Social Insurance Code.

A new mechanism linking the statutory retirement age to average life expectancy after retirement will be discussed during 2014. This mechanism is not expected to be applied before a sufficiently high retirement age is reached so as to comply with the existing parameters of the reforms.

Other recent pension reforms include: raising the social security contributions to the Pensions Fund by 1.8 percentage points as of 1 January 2011 and the introduction of Swiss Golden rule indexation as of 1 July 2014 (indexation of pensions with percentages equal to 50 per cent. of the growth rate of the average insurable income plus 50 per cent. of the growth rate of the consumer price inflation). Moreover until 31 December 2018, the maximum pension levels will be fixed at 35 per cent. of maximum insurance income. Likewise, as of 1 January 2015 early retirement pensions of first and second labour category workers will be covered only by second pillar professional pension funds; as of 1 January 2017 the contribution rate for universal pension funds will be increased from 5 per cent. to 7 per cent. and as of 2017 the accrual rate for the new pensions will be increased from 1.1 to 1.2 per cent.

Health Insurance

Bulgaria has a mixed system of health care financing. Health care is financed in a large part as a compulsory social health insurance system funded from wage-related contributions of employed individuals and from general tax revenue which covers the contributions of the non-working population (children, pensioners, unemployed, people taking care of disabled members of the family, people with right to social welfare etc.). Another important source of revenues are the subsidies allocated by the Ministry of Health.

Mandatory health insurance is income based and amounts to 8 per cent. (increasing insurance contributions from 6 per cent. to 8 per cent. in 2010) of the payroll paid in 40/60 parts between the employee and the employer. The contributions are collected by the regional branches of the NRA which pools them and allocates to the accumulation account of the National Health Insurance Fund (the "**NHIF**"), which in turn distributes the funds to the Regional NHIFs. The NHIF was established in 1999 and is regulated by the Law on Health Insurance of Bulgaria. It guarantees healthcare services to eligible persons and reimburses the costs related to such services, including medicines and medical aid equipment. In order to be covered, a person either has to personally make contributions or have contributions made on his/her behalf.

With respect to employed persons, the employer deducts insurance contributions from the monthly payroll and transfers these amounts to NHIF accounts. In the case of children, pensioners, students, soldiers, unemployed and other dependent categories the insurance contributions are transferred from the budgets of relevant institutions. The self-employed persons pay into NHIF accounts directly.

Health care expenditure in Bulgaria is below the average amount spent in the EU. According to the World Health Organisation database in 2011, total spending amounted to 7.3 per cent. of GDP, compared to the EU average of 9.6 per cent. Public spending as a percentage of GDP was 4 per cent. in 2011, well below the EU average of 7.3 per cent. In 2012 and 2013, public expenditure on healthcare represented 4.3 per cent. of GDP and 4.53 per cent. of GDP, respectively.

MONETARY AND FINANCIAL SYSTEM

Bulgarian National Bank

The BNB is the central bank of Bulgaria. It was established on 25 January 1879.

Primary Objective, Tasks, and Reporting

The primary objective and the tasks of the BNB are stipulated in the Law of the BNB (the "**LBNB**"), adopted by the 38th National Assembly on 5 June 1997. The BNB is independent from the state and is accountable to the National Assembly. The BNB's independence from the state is guaranteed by the LBNB, the Treaty on the functioning of the European Union and by the Statute of the European System of Central Banks ("**ESCB**") and the ECB. Since 1 January 2007, the BNB has been a fully-fledged member of the ESCB and participates in the decision-making process in the area of banking and finance in the European Union. The BNB Governor is a member of the General Council of the European Central Bank and a member of the General Board of the European Systemic Risk Board. The primary objective of the BNB is to maintain price stability through ensuring the stability of the national currency and implementing monetary policy as provided for by the LBNB. The BNB acts in accordance with the principle of the open market economy with free competition, targeting an efficient allocation of resources.

The tasks and responsibilities of the BNB also include:

- maintaining full foreign exchange cover of the total amount of monetary liabilities of the BNB, by taking actions needed for the efficient management of the BNB's gross international reserves;
- investing the gross international reserves in accordance with the principles and practices of prudent investment, with investments in securities being limited to liquid debt instruments satisfying the provisions of the LBNB;
- regulating and supervising credit institutions' activities in the country for the purpose of ensuring the stability of the banking system and protecting depositors' interests;
- contributing to the establishment and functioning of efficient payment systems and overseeing them;
- regulating and supervising the activities of payment system operators, payment institutions and electronic money institutions in Bulgaria;
- issuing banknotes and mint coins in Bulgaria (an exclusive right of the BNB);
- acting as the fiscal agent and depositary of the state by virtue of concluded contracts at market conditions and prices of services;
- compiling balance of payments, monetary and interest rate statistics as well as the quarterly financial accounts statistics of Bulgaria.

According to the LBNB, the BNB cannot extend credits or guarantees to the Government and governmental institutions, municipalities and municipal institutions, organisations and enterprises. The BNB cannot provide credit to banks except in the case of a liquidity risk threatening to affect the stability of the banking system and only in accordance with the requirements set out in the LBNB.

The BNB keeps accounts and records in compliance with the Accountancy Act and in accordance with IFRS. The expenditure of the BNB is in accordance with the annual budget approved by the Governing Council of the BNB and published in Darjaven Vestnik ("**State Gazette**"). The reports on the budget expenditures of the BNB are examined by the National Audit Office, which prepares a special report on the results of the examination; the reports are also submitted to the National Assembly along with the annual report.

The BNB publishes the balance sheet of the Issue Department on a weekly basis, showing the position of its assets and liabilities, inclusive of the gross international reserves and the total amount of the BNB's monetary liabilities. The BNB publishes the position of its assets and liabilities in the State Gazette at the end of each month, presenting separate balance sheets of the Issue and Banking Departments, an annual financial statement and the profit and loss account of the BNB.

The consolidated financial statements of the BNB are certified by an independent international auditor and published together with the auditor's report in accordance with the requirements of IFRS. The BNB prepares annual and semi-annual reports which review and assess the BNB's activities. These reports are submitted to the Parliament and are made public.

Governance

The management of the BNB is carried out by the Governing Council, the Governor and the three Deputy Governors. The Governing Council consists of seven members: the Governor of the Bank, the three Deputy Governors, and three non-executive members. The Governor of the BNB is elected by the National Assembly. The National Assembly elects the Deputy Governors - heads of the main departments, defined by the LBNB - upon a proposal by the Governor. The non-executive members of the Governing Council are appointed by the President of the Republic. The term of office of the members of the Governing Council is six years. The replacement of the Governing Council follows a staggered schedule with a mandate expiring every year.

Structure of the BNB

The LBNB establishes three main departments at the BNB - an Issue Department, a Banking Department and a Banking Supervision Department. Each department is headed by a Deputy Governor elected by the National Assembly.

The main function of the Issue Department is to maintain full foreign exchange cover of the total amount of monetary liabilities of the BNB, by taking actions needed for the efficient management of the BNB's gross international reserves.

The head of the Banking Department is responsible for the supervision over payment system operators, payment institutions and electronic money institutions, in accordance with applicable rules and regulations. This Deputy Governor is also responsible for enforcement measures and sanctions as provided for by law.

Supervision over the banking system is exercised by the Deputy Governor heading the Banking Supervision Department, in accordance with the rules provided for by law and the regulations for its enactment.

The BNB concentrates the powers and responsibilities on monetary policy and bank supervision, which equips the BNB with macro-prudential tools in addition to the standard micro-prudential tools. The general strategy followed by the BNB is to address the relevant policy issues and other systemic risk issues via calibrated counter-cyclical changes in both macro- and micro-prudential policy tools.

Currency Board Arrangements

The primary objective of the BNB to maintain price stability through ensuring the stability of the national currency has been achieved since July 1997 within the framework of the currency board arrangements, provided for by the LBNB.

Legal Framework

The functioning of the currency board arrangements in Bulgaria is based on three major principles laid down in the LBNB, namely:

- a fixed exchange rate of the Lev to the Euro which is BGN 1.95583 per EUR 1;

- the total amount of BNB monetary liabilities is fully covered by high quality foreign reserves. The aggregate amount of the monetary liabilities of the BNB consists of: all banknotes and coins in circulation issued by the BNB; any balances on accounts held by other parties with the BNB, with the exception of the accounts held by the International Monetary Fund. The gross international reserves of the BNB shall be equal to the market value of the following assets of the Bank: (a) banknotes and coins held in freely convertible foreign banknotes and coins held in freely convertible foreign currency; (b) funds in freely convertible foreign currency held by the BNB on accounts with foreign central banks or with other foreign financial institutions, whereof obligations are assigned one of the two highest ratings by two internationally recognised credit rating agencies; (c) the Special Drawing Rights ("**SDRs**") of the International Monetary Fund held by the BNB; (d) debt instruments held by the BNB and issued by foreign countries, central banks, other foreign financial institutions or international financial organisations, whereof obligations are assigned one of the two highest ratings by two internationally recognised credit rating agencies, and which are payable in freely convertible foreign currency with the exception of debt instruments given or received as collateral; (e) the balance on accounts receivable and accounts payable on forward or repurchase agreements of the BNB, concluded with or guaranteed by foreign central banks, public international financial organisations or other foreign financial institutions, whose obligations are assigned one of the two highest ratings by two internationally recognised credit agencies, as well as futures and options of the BNB, binding foreign persons and payable in freely convertible foreign currency; (f) the monetary gold held by the BNB as a component of foreign reserves; and

- the reserve currency is treated on equal terms with the national currency and the BNB has the obligation to unconditionally and irrevocably sell and purchase levs against Euro at the exchange rate fixed by the LBNB. Hence, the BNB does not intervene on the foreign exchange market but the BNB exchanges on demand domestic currency against the anchor currency and vice versa at the fixed rate. The national currency is issued solely against providing reserve currency at the fixed exchange rate without a spread.

In addition to the above principles:

- The BNB cannot extend loans and guarantees in any form whatsoever, including through purchase of debt instruments, to the central government, municipalities, as well as to other government and municipal institutions, organisations and enterprises.

- The BNB may not provide loans to banks except in the case of a liquidity risk threatening to affect the stability of the banking system. The terms and procedure for extending such loans, and the criteria for identifying the existence of liquidity risks are set by an ordinance of the BNB. The total loan amounts extended shall not be greater than the amount of the excess of the Lev equivalent of the gross international reserves over the total amount of BNB monetary liabilities. This provision has never been used since the introduction of the currency board arrangements in Bulgaria.

- The BNB combines typical monetary policy functions (money issuance, regulation over the minimum reserve requirements, oversight of the payment systems) with banking supervision (both regulatory and supervisory powers), and fiscal agency functions. The BNB has both a macro- and micro-prudential mandate.

- The BNB invests its gross international reserves in accordance with the principles and practices of prudent investment.

Operational Framework

The Currency Board arrangements framework contributes towards maintaining overall macroeconomic and financial stability and the implementation of strict fiscal policies. Bulgaria

weathered the global financial crisis relatively well which indicates the strength of the country's policy framework and policy implementation.

The legal framework of the Currency Board guarantees an automatic mechanism of balancing national currency demand and supply at the fixed exchange rate determined by the law. Under the currency board, it is impossible that the issue of national currency exceeds the level of the gross international foreign exchange reserves, which could, otherwise, lead to erosion of the fixed exchange rate (a key difference between a currency board regime and one of a standard fixed exchange rate). The change in the level of BNB gross international reserves reflects the net result of the change in the demand for national currency by economic agents, the Government and banks, as well as changes in the market value of gold (as part of international reserves) and the financial assets in which these reserves are invested (see table below).

Under the conditions of the fixed exchange rate against the Euro and a free movement of capital, the BNB exercises no control over the interest rates and therefore, monetary conditions in Bulgaria follow to a great extent those in the Euro area. Thus, the currency board largely reproduces the monetary conditions in which the Euro area economy is functioning. With the outbreak of the global financial crisis resource availability declined worldwide. The competition for local resources intensified, interest rates on deposits in Bulgaria were decoupled from that of the Euro area and domestic deposit rates increased. Rising funding costs and tightened credit conditions were reflected in the upward movement of interest rates for loans over the course of 2008-2009. Driven by high global liquidity, the downward interest-rate cycle and domestic factors such as the confidence in the banking system, the robust savings rate improved liquidity and capital adequacy ratio ("**CAR**"), average interest rates in loans started to fall at the end of 2009. The BNB's latest forecast envisages a continuation of this moderate downward movement of interest rates on loans over 2014-2016, based on the expected high savings rate of households and, with that, the steady increase in locally-held deposits.

The main policy instrument used by the BNB to influence domestic monetary conditions is the regulation of minimum reserve requirements which banks maintain with the central bank. As the minimum reserve requirements held at the BNB are not remunerated, their rate implicitly affects the overall cost of funding of banks and thus influences the banks' policies in setting their lending rates. For example, the reduction of the minimum reserve requirements rate since early 2009 has boosted liquidity in the banking system and contributed to falling interest rates in the interbank money market. It is also possible for the BNB to indirectly influence the monetary conditions in Bulgaria by applying macro-prudential and micro-prudential tools as well as administrative measures. Nonetheless, the objective of those measures is mainly financial stability rather than affecting monetary conditions.

In the years preceding the global financial crisis the steady increase of bank deposits at the BNB reflected both BNB policy and the increase of financial intermediation in the economy. From 2004 to 2007 BNB introduced a number of measures aimed at curbing the rapid credit expansion which took place during that period and at building counter-cyclical buffers in banks. One of the macro-prudential tools implemented in this period was the increase to the banks' short-term liquidity requirements which entailed broadening the deposit base for the calculation of minimum reserve requirements and increasing the rate from 8 to 12 per cent. In late 2008 and early 2009 the reduction of the minimum reserve requirements rate provided liquidity to banks at the time of a contraction in global liquidity. Changes to the banks' reserves at the BNB also affect the level of international reserves. In the period running from 2009 to 2013 the changes to the banks' reserves reflected not only the heightened savings rate of domestic economic agents and the increasing confidence in the banking system, but also subdued credit demand and the banks' policy of managing their assets. Banks managed their liquidity by reducing their foreign liabilities, investing in foreign assets, purchasing Government securities and holding excess reserves at the BNB. These developments have resulted in a positive balance of net foreign assets of banks since August 2013. In 2012 and 2013, banks also maintained sizable funds on their settlement accounts in the TARGET2-BNB[1] payment system as part of their

[1] Trans-European Automated Real-time Gross settlement Express Transfer system for settlements in euro. TARGET2-BNB is the TARGET2 national system component which is run by the BNB. As of 1 February 2010 the Bulgarian National Bank

overall deposits at the BNB. Recently banks reduced their balances in TARGET2-BNB as improvements in the international money markets took place and new investment opportunities emerged.

The level of gross international reserves shifted upwards in 2009 by SDR 610.9 million; this represented Bulgaria's quota-based SDR allocation by the IMF. The SDR allocation formed part of BNB's gross international reserves and was duly included in the Banking Department Deposit item within the Issue Department balance sheet. The BNB Governing Council resolved to keep the SDRs in the BNB's IMF account for the long term. This not only protects them from risks (interest, currency, credit, etc.) but also ensures that their market value in the original currency is maintained, and that the international reserve currency structure is diversified.

Fiscal policy may also affect the level of gross international reserves, reflecting the changes in the Government deposits at the BNB's balance sheet. During the years of high economic growth, the Government was running fiscal surpluses and accumulating fiscal reserves which were largely deposited at the BNB. The adverse cyclical conditions in 2009 led to a sharp decline in government revenues, which in turn resulted in a budget deficit of 4.3 per cent. of GDP. In this period Bulgaria took advantage of the readily available fiscal buffers generated during the pre-crisis years, which allowed policymakers to minimise the negative effects of the financial market tensions on the Government budget. This caused a decrease in Government deposits at the BNB in the period of 2009-2011. Despite this decrease, year-end international reserves did not fall over the period due to positive changes in the other components of the Issue Department balance sheet. During the course of 2012-2013, the fluctuations in the amount of Government deposits held at the BNB were influenced by the country's Eurobond issue in July 2012 ("**EUR 950m Eurobond**"); the EUR 950m Eurobond was aimed at pre-financing the outstanding government bonds which were due to mature at the beginning of 2013.

The BNB's gross international reserves reached EUR 14.4 billion (36.1 per cent. of GDP) at year-end 2013, decreasing by 7.2 per cent. on year-end 2012. This drop in international reserves over the period was mainly a consequence of the decrease in Government deposits (reflecting the Government's repayment of maturing bonds as well as financing of budget deficit) and the significant fall in the price of gold. At the end of December 2013, the gross international reserves covered slightly over 6 months of imports of goods and non-factor services, while their ratio to short-term external debt amounted to 148 per cent.

The following table sets out international reserves for the period 2009-2013:

	As of 31 December				
	2009	**2010**	**2011**	**2012**	**2013**
			(EUR millions)		
International reserves	**12,918.9**	**12,976.7**	**13,348.7**	**15,552.5**	**14,425.9**
International reserves growth, year on year (%)	1.6	0.4	2.9	16.5	(7.2)
Coverage of monetary base. (%)	195.2	179.8	175.1	174.9	162.9
Coverage of short term ext. debt. (%)	106.5	115.9	132.0	149.2	148.0
Coverage of imports. months. annually	8.0	7.3	6.3	6.8	6.1

Source: BNB.

and the national banking community joined TARGET2. Balances of Bulgarian banks in TARGET2-BNB system are recorded as BNB's liabilities to banks.

The following table sets out the total assets and liabilities of the BNB's Issue Department for the period 2009-2013:

	2009	2010	2011	2012	2013
			(% of GDP)		
Cash and foreign currency denominated deposits	6.1	8.1	8.9	12.0	8.1
Monetary gold and other monetary gold instruments	2.8	3.8	4.1	4.1	2.8
Investments in securities	28.1	24.1	21.7	22.9	25.2
Total Assets	**37.0**	**36.0**	**34.7**	**39.0**	**36.1**
Notes and coins in circulation	11.8	11.8	11.6	12.2	13.1
Liabilities to banks	7.2	8.2	8.2	10.0	9.0
Liabilities to Government and to government budget institutions	10.5	7.7	5.8	7.4	5.7
Liabilities to other depositors	0.6	0.7	1.3	1.6	2.0
Banking Department deposit	7.0	7.6	7.7	7.7	6.3
Total Liabilities	**37.0**	**36.0**	**34.7**	**39.0**	**36.1**

Source: BNB, NSI.

The BNB's latest forecast envisages moderate growth of gross international reserves over the period 2014–2016 (assuming no changes in the price of gold, SDR exchange rate and banks' balances in TARGET2-BNB). The forecasts of the BNB are also in line with the expectations that Bulgaria will experience a gradual strengthening of economic activity and a relatively high savings rate over the 2014-2016 period.

The following tables set out monetary and credit developments for the period 2009-2013 (as at 31 December):

	2009	2010	2011	2012	2013
		(EUR millions, end of period)			
Broad money	24,384	25, 943	29,104	31,558	34,377
Ml	9,267	9,401	10,751	11,767	13,825
Quasi money	15,087	16,505	18,292	19,733	20,515
Claims on non-government sector	26,375	26,731	27,743	28,507	28,587
Non-financial corporations	16,013	16,406	17,413	18,226	18,281
Financial corporations	573	617	665	710	752
Households and NPISHs*	9,789	9,708	9,665	9,570	9,554
Net foreign assets of other MFIs**	(4,686)	(3,511)	(1,792)	(1,864)	794
Foreign assets	4,097	4,076	4,638	5,128	6,961
Foreign liabilities	8,783	7,587	6,431	6,992	6,167

* Non-profit institutions serving households (NPISHs).
** Monetary financial institutions (MFIs).
Source: BNB Monetary Survey and Analytical Reporting of Other MFIs.

	2009	2010	2011	2012	2013
		(annual growth, end of period, %)			
Broad money	4.2	6.4	12.2	8.4	8.9
Ml	(8.8)	1.4	14.4	9.5	17.5
Quasi money	14.3	9.4	10.8	7.9	4.0
Claims on non-government sector	3.8	1.3	3.8	2.8	0.3
Non-financial corporations	2.2	2.5	6.1	4.7	0.3
Financial corporations	16.8	7.6	7.9	6.8	5.8
Households and NPISHs	5.8	(0.8)	(0.4)	(1.0)	(0.2)
Net foreign assets of other MFIs					
Foreign assets	4.8	(0.5)	13.8	10.6	35.7
Foreign liabilities	(7.1)	(13.6)	(15.2)	8.7	(11.8)

Source: BNB Monetary Survey and Analytical Reporting of Other MFIs.

	2009	2010	2011	2012	2013
			(% of GDP)		
Broad money	69.8	72.0	75.6	79.0	86.1
Ml	26.5	26.1	27.9	29.5	34.6
Quasi money	43.2	45.8	47.5	49.4	51.4
Claims on non-government sector	75.5	74.1	72.1	71.4	71.6
Non-financial corporations	45.8	45.5	45.2	45.7	45.8
Financial corporations	1.6	1.7	1.7	1.8	1.9
Households and NPISHs	28.0	26.9	25.1	24.0	23.9
Net foreign assets of other MFIs	(13.4)	(9.7)	(4.7)	(4.7)	2.0
Foreign assets	11.7	11.3	12.0	12.8	17.4
Foreign liabilities	25.1	21.0	16.7	17.5	15.4

Source: NSI, BNB Monetary Survey and Analytical Reporting of Other MFIs.

The following table sets out annual average interest rates for the period 2009-2013:

	2009	2010	2011	2012	2013
			(period average, %)		
LEONIA	2.01	0.18	0.20	0.10	0.02
SOFIBOR1M	4.51	2.41	2.08	1.15	0.52
SOFIBOR3M	5.72	4.12	3.76	2.25	1.14
Interest rate on time deposits*	6.01	4.91	4.40	4.01	3.33
Lending interest rate (NFC)**	8.80	8.52	8.76	8.34	8.01
Long term interest rate***	7.21	6.01	5.36	4.50	3.47

Notes:

* Interest rate of new business on time deposits, weighted average across non-financial corporations and households and NPISH sectors, currencies and maturities.

** Interest rate of new business on loans to non-financial corporations (NFC), weighted average across currencies and maturities.

*** Long term interest Rate for Convergence Assessment Purposes

Source: BNB

The adoption of the single currency by Bulgaria is required under the country's accession treaty to the EU. Bulgaria will retain a "derogation" with respect to participation in the single currency until it fulfils all the criteria for joining the Euro; once fulfilled, the existing derogation will be abrogated and Bulgaria will join the Euro area.

Joining the single currency remains a primary objective for Bulgaria, as well as a matter of consensus and policy continuity for the Bulgarian authorities. The Government has reiterated its commitment to maintaining the Currency Board regime and the existing fixed Euro/Lev exchange rate until the Euro is adopted. Consequently, joining the Euro area remains the only exit strategy from the Currency Board regime.

At present the Bulgarian authorities have not set a target date for adopting the Euro. Nor have they announced a time frame for taking a decision on setting a target date for adopting the Euro.

The primary objective of the BNB, as stipulated under Article 2, paragraph 1 of the LBNB, is to maintain price stability by ensuring the stability of the national currency. This objective has continued to be achieved through the operation of the Currency Board arrangements since 1997. The Bulgarian authorities, including the central bank and the political parties, are committed to maintaining the Currency Board arrangement and the fixed exchange rate until the state becomes a member of the Euro area.

The Banking System

The main risks for the banking system are connected mainly with strengthening the effective management of the residual credit risk, estimated on the basis of net NPL exposures. As of the end of 2013, their share amounted to 10.1 per cent. of total net loans (excluding those to credit institutions) and 6.4 per cent. of total assets. BNB requires institutions to undertake active measures to cover the maximum possible scope of instruments (e.g. impairment provisioning, writing off and selling of portfolios) to address the pressure of net NPLs on banks' balance sheets.

The level of NPLs remains high compared to the pre-crisis levels, but has begun to stabilise in the last 12 months. In practice, no new loans extended in recent years have turned into NPLs. This, in combination with the existing high level of coverage of NPLs and additional capital buffers (the amount of capital buffers equals the balance sheet amount of NPLs), allows banks to start implementing more active measures for further reducing the level of NPLs. At the same time, banks have both the sufficient capital and the incentives (to generate revenue and thus to improve the overall quality of their loan portfolio) to lend.

Despite their foreign ownership, the vast majority of banks operate in Bulgaria as subsidiaries, i.e. they are licensed, regulated and supervised more conservatively than the Basel II requirements. Since the introduction of the Currency Board, the BNB has been imposing higher standards than the EU average capital and liquidity requirements, which allowed banks to accumulate and sustain adequate capital and liquidity buffers following the 2008 global economic crisis.

Throughout 2013, credit activity remained weak. In December 2013, loans (excluding those to credit institutions) amounted to EUR 29.9 billion, which marked a 1.1 per cent. increase on an annual basis (based on aggregated balance sheet information submitted by credit institutions to the BNB Banking Supervision Department). The growth of corporate loans significantly declined when compared to previous years, but still remained positive at 0.4 per cent. Retail exposures reversed their negative trend and also showed a modest growth of 0.5 per cent., primarily due to consumer loans, which increased for the first time since 2009.

Structure and Development of the Bulgarian Banking System

The financial sector is dominated by the banking system – the share of banks' assets is approximately 80.9 per cent. of the assets in the financial sector. At the end of 2013, there were thirty credit institutions in Bulgaria - twenty four banks (of which nine were domestically-owned banks) and six foreign bank branches. As of 31 December 2013, the total assets of the banking sector in Bulgaria amounted to EUR 43.8 billion, an increase of 4.1 per cent. as compared to 31 December 2012 (based on aggregated balance sheet information submitted by credit institutions to the BNB Banking Supervision Department).

A total of 230 credit institutions licensed in EEA countries have filed a Notification in Bulgaria from the relevant competent authority to carry out activities on a cross-border basis. These activities are subject to mutual recognition according to the rules of the European Banking Directives – the so-called Single European Passport or Passport Notifications.

The process of consolidation of the banking sector is on-going. After the EUR 950m Eurobond, First Investment Bank ("**FIB**") received permission from the BNB to buy all the shares of Unionbank, a local subsidiary of MKB of Bayern LB Group. Furthermore, in the first quarter of 2014, the BNB gave Unionbank permission for its merger into FIB; the merger was completed in early March 2014 as a result of which the acquired credit institution, Unionbank, was wound up without liquidation. Another consolidation that is expected to be finalised in 2014 will be that of the domestically owned Corporate Commercial Bank and Credit Agricole's Bulgarian subsidiary (with the relevant purchase agreement already signed, and BNB's approval for acquisition and concentration clearance approval, already received).

The sustained high household savings rate continues to boost attracted funds growth in the banking system, which coupled with comparatively low demand for loans ensured sufficient liquidity in the banking sector. In 2013, a substantial part of the liquidity was channelled to invest in foreign assets and to reduce banks' foreign liabilities. Banks kept part of their liquidity in the form of Government securities and as excess reserves with the BNB.

In 2013, annual growth of credit to the non-government sector slowed due to lower lending to non-financial corporations, while banks' claims on households reported a small decline. Low demand for loans in the context of still weak economic activity and the sustained high household savings rate were the key factors determining the trends in lending. As a result banks are expected to continue to

operate under conditions of high liquidity whilst demand for credit remains low. Given the expected gradual recovery of economic activity, growth rates of loans to the non-government sector are expected to increase over time.

The following table sets forth the aggregate assets, liabilities, balance capital and profits of the banking system as at the dates indicated:

(end of period, EUR millions)	**2009**	**2010**	**2011**	**2012**	**2013** (1)
Cash	3,268.1	3,747.8	3,891.5	4,832.6	4,546.0
Securities	2,277.0	2,776.1	3,032.4	4,876.9	5,341.7
Loans and advances to credit institutions	3,785.5	3,914.2	4,247.9	3,520.1	4,921.4
Corporate loans	16,220.4	16,469.8	17,230.5	17,943.9	17,853.8
Residential Mortgage Loans	4,439.8	4,548.5	4,509.4	4,506.8	4,436.2
Consumer Loans	4,541.8	4,280.7	4,104.7	4,127.9	4,195.7
Total Assets	**36,214.6**	**37,688.4**	**39,219.9**	**42,122.2**	**43,841.6**
Attracted funds from credit institutions	7,761.0	6,943.7	5,122.5	5,482.5	4,662.1
Attracted funds from non-credit institutions	9,555.4	9,836.2	11,025.0	11,283.0	12,077.3
Deposits (households)	12,699.2	14,335.1	16,311.0	18,340.1	20,067.4
Subordinated Debt	873.6	900.1	923.4	775.4	608.7
Debt/Equity (Hybrid) Instruments	210.8	200.7	223.7	265.7	360.1
Total Liabilities	**31,393.7**	**32,567.7**	**33,935.2**	**36,595.0**	**38,133.3**
Issued Capital	1,699.2	1,766.5	1,913.4	1,964.4	1,992.2
Reserves	2,737.1	3,047.6	3,128.9	3,294.2	3,417.0
Profit	384.5	306.6	242.3	268.5	299.0
Total Equity	**4,820.8**	**5,120.7**	**5,284.6**	**5,527.1**	**5,708.3**

(1) Unaudited results
Source: BNB, Banking Supervision

Banking system indicators

	2009	**2010**	**2011**	**2012**	**2013**(1)
			(end of period, %)		
Return on assets (ROA)	1.1	0.8	0.6	0.7	0.6
Return on equity (ROE)	9.0	6.6	4.9	5.3	4.9
Capital adequacy	17.0	17.5	17.6	16.6	17.0
Tier I	14.0	15.2	15.7	15.1	16.0
Profit (EUR mln.)	384	307	242	268	299
NPL (more than 90 days overdue)	6.4	11.9	15.0	16.6	16.9
Net NPL (more than 90 days overdue) to Total Net Loans (excluding those to credit institutions).	4.1	8.0	9.6	10.6	10.1
Net NPL (more than 90 days overdue) to Total Assets	2.9	5.5	6.5	6.8	6.4
Liquidity	21.9	24.4	25.5	26.0	27.0
Credit growth (private sector)	4.5	2.7	4.1	3.2	1.1
Loans/Total Deposits	120.5	113.9	104.8	99.8	93.0
Loans/Residents Deposits	125.5	118.8	109.8	105.7	98.1
Primary capital leverage (units of assets in proportion of one unit of Tier 1 capital)	9.2	9.6	9.3	9.9	9.7
Leverage (units of assets in proportion of one unit of balance sheet capital)	7.5	7.4	7.4	7.6	7.7

(1) Unaudited results
Source: BNB, Banking Supervision

All Bulgarian banks are expected to comply with the liquidity and capital requirements set by the BNB. The banking system displayed a high level of capitalisation reflecting the strong regulatory policies of the BNB. The system-wide capital adequacy ratio ("**CAR**") is well above the BNB regulatory minimum of 12 per cent. and the EU minimum of 8 per cent., according to Basel II standards. The CAR across the sector as of 31 December 2013 was 17.0 per cent. Moreover, Bulgarian banks' capital is made up almost exclusively of Tier 1 capital. The Tier 1 capital ratio across the Bulgarian banking sector is 16.0 per cent.

The increased savings rate in the economy, combined with the low demand for new loans, markedly improved the liquidity position of the banking system. The accumulating excess resources allowed banks to start repaying foreign liabilities, which in the case of subsidiary institutions led to a gradual substitution of parent funding with local deposits and a significant reduction in their dependence on group financing. As a result, no deleveraging pressures were observed and the sector maintained solid levels of liquid assets (27.0 per cent. as of 31 December 2013). In 2013, local deposits formed the primary source of funding for banks operating in Bulgaria, with the dominant part coming from individuals and households, which throughout the year increased by 9.4 per cent.

The confidence in the banking system is high and is manifested in an increase in the main attracted funds over recent years, which provides a source for sustainable organic growth. At the same time no pressure by the parent banks for liquidity withdrawal was observed. Foreign banks maintained their presence in the Bulgarian banking market and there is no evidence of a process of deleveraging. Assets of all banks increased by EUR 1.7 billion or 4.1 per cent. from 31 December 2012 to EUR 43.8 billion at the end of 2013. Loans to customers increased annually by EUR 331 million or 1.1 per cent. to EUR 29.9 billion as of 31 December 2013.

In contrast to many other countries, credit did not contract during the crisis. Credit growth remained positive, albeit weak, in the period 2009 - 2013. The sluggishness of credit given to the private sector is due to a combination of supply and demand factors: on the supply side banks have tightened their lending standards; on the demand side, economic uncertainty faced both by households and corporations dampened demand. The lower rate of growth of the loan portfolio compared to the pre-crisis situation was due not only to a decrease in bank lending volumes but also to increased provisions. Asset quality weakened in 2013 on the back of depressed growth and rising unemployment. The share of net non-performing loans (over 90 days) in total net loans (excluding those to credit institutions) was 10.1 per cent. at the end of 2013. Asset quality deteriorated across all categories of loans with a higher share for non-financial corporations compared to consumer and mortgage loans. The worsening of the credit portfolios was accompanied by a high coverage of non-performing loans with provisions and the existence of an excess capital surplus. The provisioning ratio remains high at 73.2 per cent. The amount of accumulated capital surplus (the excess of capital over the regulatory minimum) is EUR 1.4 billion as of 31 December 2013. This additional buffer represents 3.4 per cent. of GDP as at the end of 2013.

Presently, the banking sector, as well as credit institutions, are well capitalised and liquid. Risks are adequately provisioned for and covered by the accumulated capital buffers, which ensure the resilience of the system. Despite the weak economic recovery, the sector remains profitable. In the course of 2013, the number of credit institutions that registered negative results decreased to seven and the total unaudited profit of the banking sector amounted to EUR 299 million, which contributed to the preservation of capital in the system. Regardless of the negative financial results of some banks, they continue to keep their capital and liquidity buffers adequate to the risks in their profiles. As a result, there is no indication that any licenses would need to be revoked.

Retail deposits have experienced strong and steady annual growth which, since 2009, averaged close to 9.5 per cent. (based on aggregated balance sheet information submitted by credit institutions to the BNB Banking Supervision Department). The trend is significantly more pronounced for domestic credit institutions, for which local deposits are the primary source of funding. As at the end of 2013, their assets amounted to EUR 12.5 billion, which marks a 12.1 per cent. increase when compared to the end of 2012. Foreign credit institutions maintained a dominant presence in the Bulgarian banking sector. However, their market share is decreasing due to the greater tendency of domestic banks to lend. The steady deposit growth also allowed subsidiaries to reduce their reliance on parent funding, which prevented deleveraging pressures and provided for a more sustainable growth of their balance sheets.

External financing is primarily comprised of inter-company lending. The strong savings growth in recent years has consistently outpaced the demand for new credit, which reduced the need for both external financing and subordinated liabilities. As a result, foreign subsidiaries managed to substitute

their reliance on parent funding with local deposits. Accordingly, significant upswings in external funding demand are not envisaged. Foreign banks, especially from European banking groups, have significant presence in the local market via their subsidiaries. In December 2013, the share of EU banking groups in the system's total assets was 67.7 per cent., of which 62.2 per cent. corresponded to EU subsidiaries and 5.5 per cent. to branches of banks licensed in the EU.

The banking sector has not experienced any need for government support since the establishment of the Currency Board arrangement in 1997. Following the pro-active supervisory approach applied by the BNB, the sector has accumulated significant buffers against both external and internal shocks, and set aside adequate provisions for available risks. As of the end of December 2013, Tier I capital adequacy amounted to 16.0 per cent., which formed a capital surplus over the required minimum of EUR 1.4 billion (3.4 per cent. of GDP). After the introduction of the new framework, in line with EU-wide regulatory reform, which came into force on 1 January 2014 (Directive 2013/36/EU and Regulation (EU) 575/2013), capital adequacy is estimated to strengthen further and the surplus to increase. The risk absorption capacity of banks will also be enhanced via the planned introduction of a systematic risk buffer and capital conservational buffer. In addition, the Law on Bank Deposit Guarantee allows the Bulgarian Deposit Insurance Fund to acquire shares in banks under specific conditions (Article 118 (1) of the Law on Credit Institutions). Furthermore, the recently amended Law on Credit Institutions also provides for full compliance with the state aid rules of the EU.

On 20 June 2014, the BNB Governing Council decided to place Corporate Commercial Bank AD and its subsidiary, the former Credit Agricole Bulgaria EAD (the "**CCB group**"), under conservatorship due to insufficient liquidity. The Government and the BNB announced that they intend to secure the needed liquidity and capital increase to support the CCB group to fully cover its obligations to its customers and that all necessary actions under the conservatorship imposed are planned to be taken by 20 July 2014, so that Corporate Commercial Bank and its subsidiary will commence business as normal again on 21 July 2014.

The Deposit Insurance Fund guarantees the full payment of funds held in depositors' accounts with a bank regardless of the number and size of the deposits up to EUR 100,000 (BGN 196,000). As of December 2013, 70.2 per cent. of the deposits fell within this limit. The accumulated funds correspond to EUR 0.9 bn. (2.4 per cent. of GDP) and cover 4.6 per cent. of the eligible deposits (based on the information submitted by credit institutions to the BNB Banking Supervision Department). The Fund is financed via advance installments and if necessary additional ad hoc payments could be imposed.

In the last five years the mortgage growth has experienced a slowdown, as annual rates declined from 8.4 per cent. in 2009 to 0.8 per cent. in 2012. In 2013, mortgage loans contracted by 0.6 per cent. New non-performing loans in the segment slightly increased and reached 17.1 per cent. Nevertheless, overall provisioning improved and accounted to 41.6 per cent. of gross value. While not having an explicit loan-to-value cap, credit institutions are allowed to apply lower risk weights exposures secured by real estate property if they meet a number of conservative criteria among which are a loan-to-value requirement of up to 70 per cent. and at least an annual revaluation of available collateral according to market prices. Banks have been traditionally prudent in their mortgage lending and the implicit LTV requirement has proved to be binding, which is reflected in the aggregated level of the ratio for the system as of end 2013 – 63.1 per cent. (based on aggregated balance sheet information submitted by credit institutions to the BNB Banking Supervision Department). As a result, exposures are well collateralised and risks associated with NPLs are adequately provisioned for. BNB has a regular reporting procedure put in place, which allows it to quarterly monitor the developments in the level of collateralisation of mortgage loans (LTV reporting).

The pace of growth in Non-performing loans has decreased in recent years. In 2013, the upward trend reversed and their level slightly declined. As of December 2013, the net NPLs formed 10.1 per cent. of net total loans (excluding those to credit institutions). The level of provisions remains adequate and exposures are well collateralised. On a system level, the eligible collateral on corporate exposures is 28.6 per cent. of their value, while all available collateral covers the underlying positions close to

three times. In addition, according to the supervisory regulation enforced until the end of 2013, banks were required to allocate additional provisions for credit risks that are deductible from capital. After the introduction of CRD IV and CRR they will be integrated into the banks' own funds. The BNB requires this already created additional capital buffer to be directly linked with the banks' NPLs.

While addressing the risks posed by adversely classified exposures, banks used both practices of renegotiation and restructuring (the renegotiation allows for the amendment/alleviation of credit terms without actual reduction in the exposure, while the restructuring involves effective forfeiting of part of the claim a bank holds against a distressed debtor). Both practices were actively employed after 2008. Since 2011, the share of renegotiated and restructured loans has remained relatively stable and as of 31 December 2013 they amounted to 25.2 per cent. and 10.2 per cent. respectively. The special reporting, introduced by BNB supports the timely identification, assessment and control of the risks associated with NPL and forbearance.

Money Laundering and Terrorist Financing Regulations

The money laundering and terrorist financing prevention framework of Bulgaria is based on Law on the Measures against Money Laundering and the Law on Measures against Financing of Terrorism, which is fully compliant with EC 2005/60 Directive. The preventive measures against money laundering, terrorist financing, and financial fraud are of key importance for the financial sector. The BNB makes sure that banks and financial institutions have adequate and effective policies and procedures, including stringent 'know your customer' rules which prevent banks and financial institutions from being used intentionally or unintentionally for criminal activities. The current money laundering and terrorist financing prevention framework facilitates cross-border co-operation between Bulgaria and the other members of the EU. In addition to the Law on Measures against Money Laundering, the Governing Council has issued various related letters on money laundering and terrorist financing prevention guidelines.

Regulatory Developments

The transposition of the provisions of Directive 2013/36/EU into Bulgarian law and the application of Regulation (EU) No. 575/2013 has heralded a thorough revision of the way in which the bank supervisory legal framework operates. The revisions have, for example, brought significant amendments to the Law on Credit Institutions (adopted by the Bulgarian Parliament on 11 March 2014). From 1 January 2014, with the application of Regulation (EU) No. 575/2013, the following statutory instruments concerning banks and credit institutions cease to have effect: Ordinance No. 7 for Large Exposures of Banks; Ordinance No. 9 on the evaluation and classification of risk exposures within banks and the allocation of specific provisions for credit risk; Ordinance No. 8 on the Capital Adequacy of Credit Institutions; Ordinance No. 12 on the Supervision of Banks on a Consolidated Basis; and Ordinance No. 17 on Establishing the Amount of Investment of Banks under Art. 47 of the Law on Credit Institutions. New regulations on risk management, capital buffers and on transitional treatment and discretions under Regulation (EU) No 575/2013 have been adopted: new Ordinance No. 7 on the organisation and management of risks in banks; and new Ordinance No. 8 on banks' capital buffers. In addition, Ordinance No. 2 on the licences, approvals and permissions granted by the Bulgarian National Bank according to the Law on Credit Institutions; Ordinance No. 4 on the Requirements for Remuneration in Banks; Ordinance No. 11 on Bank Liquidity Management and Supervision; and Ordinance No. 20 regulating the issuance of approvals for members of bank Boards have been amended accordingly.

In accordance with Directive 2013/36/EU, the BNB has decided to introduce a capital conservation buffer of 2.5 per cent. and a systemic risk buffer on all credit institutions equal to 3 per cent. of their total risk exposure; this will complement the minimum Common Equity Tier 1 requirements that are in force as of 1 January 2014 following the application of Regulation (EU) No 575/2013. Equally, an additional capital buffer on Other Systemically Important Institutions ("**OSII**") equal to 2 per cent. of their total risk exposure will be imposed. The introduction of these buffers in advance of the designated transition periods stipulated in CRD IV will ensure the continuation of a conservative

approach in terms of capital requirements; it will also assist in preserving high capitalisation and the resilience of the banking sector. Moreover, the potential introduction of counter-cyclical capital buffers ("**CCB**") in advance of the indicated transitional arrangements has also been considered (once the ESRB guidance on its implementation has been finalised and published in the course of 2014).

The impact of the new framework on the capital positions of the banks has been estimated via simulations. Banks were asked to apply CRD IV rules using end of 2013 data in order to calculate the capital, risk-weighted assets, and relevant capital ratios. The aggregated figures for the entire banking sector illustrate an increase of total CAR from 16.9 per cent. to 21.5 per cent. and an increase for the Tier 1 ratio from 16.0 per cent. to 18.9 per cent.

The introduction of the CRD IV is not expected to have a significant impact on the liquidity of the banking sector which, at present, remains solid. The BNB has issued a regulatory recommendation to credit institutions to maintain, on an-ongoing basis, an above 20 per cent. ratio of liquid assets to core deposits; this is currently respected by all the banks.

Non-Bank Financial Institutions

The non-banking financial sector in Bulgaria has proved to be stable, accounting for 23.7 per cent. of the country's GDP at the end of 2013. Its role in the financial sector has increased to 15.3 per cent. of the total assets of financial sector. Although the performance of the non-banking financial sector is still below pre-2008 levels, it has exhibited signs of recovery which is significant given the weakness of the Bulgarian economy in the wake of the global financial crisis. Apart from the macroeconomic constraints, the development of the non-banking financial sector is generally in line with current levels of performance in other parts of the EU.

Financial Supervision Commission ("FSC")

The FSC is a specialised body for regulation and integrated supervision over different segments of the non-banking financial sector – capital markets, insurance markets (including voluntary health insurance) and supplementary pension insurance market. The main objectives of the FSC are to provide for the integrity, transparency and credibility of the financial markets and the protection of the interests of investors, insurance policy holders and pension scheme members.

When performing its functions and exercising its powers, the FSC lays down clear priorities and guidelines for market development in compliance with internationally recognised principles and standards for regulation and supervision. The institution follows a consistent policy aimed at the establishment of optimal conditions for the realisation of the economic potential of the non-banking financial intermediation. The consumer protection and enhancement of the public confidence in the use of financial products and services is one of the strategic objectives of the FSC.

Similar to the BNB, the FSC enjoys organisational and functional independence from other state bodies and therefore, such bodies may not instruct the FSC as to the conduct of its activities and the exercise of its powers. The Chairperson and the other four members of the FSC are elected by the National Assembly and may not be removed prior to the end of their term unless in accordance with the grounds set out in the Law on the FSC.

The FSC is the authority which issues licenses which are a prerequisite for carrying out certain types of activities, explicitly provided in the laws regulating the activities of the participants in the financial markets. As a competent authority in relation to the non-banking financial sector, the FSC has all necessary tools and powers to enforce the legislation.

As a result of the global financial crisis, the European System of Financial Supervision ("**ESFS**"), which is the EU supervisory framework for the banking, securities, insurance, and occupational pensions sectors, came into operation on 1 January 2011. This system functions on the basis of a single set of harmonised rules which are compulsory for the supervisory authorities of all EU Member States. The FSC is also an important part of this system as it is responsible for the supervision of the capital markets, insurance, and supplementary social security sectors.

Capital Markets

Following the global financial crisis in 2008, the negative effects of foreign capital outflows impacted the recovery of the capital markets in Bulgaria until the end of 2010. Since 2011, however, the Bulgarian capital markets started a positive trend, as the market capitalisation increased by 15.6 per cent. The low market liquidity influenced the performance of the capital markets in 2012, and again in 2013 when capitalisation increased by 1.4 per cent. During 2013, all market indices had been increasing on an annual basis – SOFIX (42.3 per cent.), BG40 (27.0 per cent.), BGTR30 (35.4 per cent.) and BGREIT (11.4 per cent.).

The positive performance of the Bulgarian Stock Exchange – Sofia in 2013 is also reflected in the growth of the assets of the investment intermediaries which increased by 3.5 per cent. on an annual basis (calculated for the non-bank investment intermediaries only). There are currently 75 investment intermediaries in Bulgaria of which 28 are banks. There are also 30 Management companies ("**MCs**") which manage 110 Collective Investment schemes ("**CIS**"), of which one is an open-ended investment company and 109 are contractual funds. The assets of the CISs have been growing in spite of the difficulties in the economic climate in recent years. After the slight slowdown of their performance in 2011, the assets of the CISs have bounced back and returned to a positive trend, growing by 10.6 per cent. in 2012 and by another 47.7 per cent. in 2013. Furthermore, after two years of moderate decline of up to 3 per cent. per annum, reflecting the changes in real estate prices, the assets of the Special Purpose Investment Companies ("**SPIC**") increased by 12.4 per cent. in 2011 though slightly declining by 0.6 per cent. in 2012. There are presently 66 SPICs which are supervised by the FSC, 8 of which are involved in securitisations (receivables). Among the remaining 58 SPICs, which are involved in real estate securitisations, 6 are specialised in agrarian land. In 2013, the assets of the SPICs showed a decline of 12.1 per cent. year-on-year, reflecting a decrease in the number of such entities and the respective decrease in the asset value of agrarian land being securitised.

Insurance Market

As a result of the negative effects of the global financial and economic crisis and the depressed economic activity at home, the insurance market in Bulgaria recorded a decrease in its gross premium income of 6.3 per cent. in 2009. Since then the negative growth rate of the premiums has been declining, reflecting gradual recovery of its segments (particularly in the field of non-life insurance which represents 83 per cent. of the gross premium of the entire insurance market). Throughout the long-recovery period, the funds of insurance companies, reduced by intangible assets, were maintained well above the solvency margin. In 2013, all segments of the insurance market recorded an increase in gross premium income.

In 2013, the insurance market was characterised by a structural change. All voluntary health insurance companies were obliged to acquire a licence to provide certain insurance products, in order to align them with the insurance regulation of the European Union. As a result of this change, the number of non-life insurance companies increased from 17 at the end of 2012 to 29 at the end of 2013. For the first time since the crisis, the gross premium of non-life insurance companies (BGN 1.7 billion) recorded an increase of 6.5 per cent. in 2013 (or 4.1 per cent. excluding the impact of the structural change).

Life insurance (comprising 14 entities) has stabilised in the last two years, providing an alternative for long-term savings investment. The gross premium income of this segment increased by 6.9 per cent. year-on-year in 2012 and by another 14 per cent. in 2013. The growth in 2013 was partly due to the tax introduced on income on time deposits, and due to the structural change in the insurance market as life insurance companies received licenses to offer insurance products replacing the packages provided by the voluntary health insurance funds. The structural change resulted in an increase in market competition for both segments (non-life and life insurance) which is expected to have a positive effect and has the potential to develop further in the medium term.

Pension Funds

The assets of the 9 Pension Insurance Companies ("**PICs**") in Bulgaria have been slowly growing since 2009, reflecting the increase in the number of insured people and the growth in earned investment income. The net assets of the 29 Supplementary Pension Insurance Funds ("**SPIFs**") have recorded an annual average increase of 24.5 per cent. in the last 5 years, reaching BGN 6.8 billion in 2013. The continuous accumulation of assets is a result of the contribution made by the Supplementary Mandatory Pension Insurance (EU - Second Pillar) provisions and prudent investment decisions. The global financial crisis caused a negative rate of return for the SPIFs in 2008, which was compensated for in the following two years. The modified, weighted rate of return (on a biannual basis) for SPIFs remains positive, reflecting the development of the capital markets and the diversification of their portfolios.

	31 Dec 2010 - 31 Dec 2012	31 Dec 2011 - 31 Dec 2013
SPIFs		
Universal Pension Funds Second Pillar (%)	3.40	6.22
Professional Pension Funds Second Pillar (%)	3.45	6.27
Voluntary Pension Funds Third Pillar (%)	4.06	7.22

Apart from its social function, the net assets of the SPIFs are the second-most important contributor to the non-banking financial sector in Bulgaria in terms of financial intermediation functions, representing 6.8 per cent. of GDP.

The following table sets out the performance of the non-banking financial sector in Bulgaria for the period between 2009 and 2013:

	2009	2010	2011	2012	2013
			(% of GDP)		
Capital market capitalisation	17.3	15.3	16.5	12.6	12.8
Insurance and voluntary health insurance premiums	2.5	2.4	2.2	2.1	2.2
Net assets of the Supplementary Pension Insurance Funds(SPIFs)	4.6	5.7	6.1	7.3	8.7
Non-banking financial sector (total)	**24.4**	**23.3**	**24.8**	**22.1**	**23.7**
Assets of the non-banking sectors			*(EUR millions)*		
Capital market capitalisation	6,031	5,498	6,358	5,025	5,093
Assets of Investment Intermediaries (Ils)	2,301	1,969	2,383	2,329	2,412
Assets of Collective Investment Schemes (CISs)	194	245	243	268	396
Assets of Special Purpose Investment Companies (SPICs)	808	785	882	924	771
Insurance and voluntary health insurance premiums	879	851	844	841	881
Net assets of the Supplementary Pension Insurance Funds(SPIFs)	1,614	2,039	2,351	2,905	3,481
Annual rate of change		*(%)*			
Capital market capitalisation	(5.3)	(8.8)	15.6	(21.0)	1.4
Assets of Investment Intermediaries (Ils)	(18.6)	(14.4)	21.0	(2.2)	3.5
Assets of Collective Investment Schemes (CISs)	15.6	26.3	(1.0)	10.6	47.4
Assets of Special Purpose Investment Companies (SPICs)	(2.5)	(2.8)	12.4	4.7	(12.1)
Insurance and voluntary health insurance premiums	(6.3)	(3.2)	(0.9)	(0.3)	4.8
Net assets of the Supplementary Pension Insurance Funds (SPIFs)	37.3	26.3	15.3	23.6	19.8
Relative structure of financial intermediation			*(shares. %)*		
Assets of Investment Intermediaries (Ils)	5.5	4.5	5.2	4.7	4.7
Assets of Collective Investment Schemes (CISs)	0.5	0.6	0.5	0.5	0.8
Assets of Special Purpose Investment Companies (SPICs)	1.9	1.8	1.9	1.9	1.5
Insurance and voluntary health insurance premiums	2.1	2.0	1.8	1.7	1.7
Net assets of the SPIFs	3.8	4.7	5.1	5.9	6.7
Non-banking financial sector (total)	**13.8**	**13.5**	**14.6**	**14.7**	**15.3**

Source: Bulgarian FSC

Bulgarian Stock Exchange-Sofia ("BSE-Sofia")

In July 1991, the first Bulgarian stock exchange was established with the introduction of the Commercial Law in Bulgaria. At that time no specific legal framework existed and the exchange operated on the grounds of the general regulatory framework applicable to all privately held companies.

In July 1995, the first Securities, Stock Exchanges and Investment Companies Act was adopted. The Bulgarian capital markets operate within the framework of the following main legal provisions: Public Offering of Securities Act of December 1999, Markets in Financial Instruments Act of June 2007, Act on the Activities of Collective Investment Schemes and other Undertakings for Collective Investment of October 2011, Commerce Act of June 1991, Measures Against Market Abuse With Financial Instruments Act of October 2006, Special Investment Purpose Companies Act of May 2003, Privatisation and Post-privatisation Control Act of March 2002, Financial Supervision Commission Act of January 2003 and Ordinances of the Financial Supervision Commission. The current regulatory framework is harmonised with EU regulations in the financial markets area. Access to the market is on a non-discriminatory basis and foreign investors may trade on the BSE-Sofia under the same terms as all domestic investors.

Between 2004 and 2007, the BSE-Sofia was growing dynamically in terms of both liquidity and market performance and quickly turned into a venue of choice for capital raising purposes. However, the indices and the overall liquidity of the exchange sharply declined as a result of the financial and economic crisis. In order to revive the market, the Government announced an ambitious privatisation program for the state's share in strategic companies through the stock exchange. As a result of this, the Government successfully sold its minority stake in the three energy distributors in the country between December 2011 and November 2012.

On 15 December 2010, BSE-Sofia went public and its shares were admitted to trading on the BSE-Sofia from 6 January 2011. Currently, the Bulgarian Ministry of Finance holds a majority stake of 50.05 per cent. in the BSE-Sofia's capital, with the remaining shares being held by brokerage firms and banks, other legal and natural persons and institutional investors. As a result of a strategic decision of the Government in the first half of March 2012, the Ministry of Finance empowered the Privatisation Agency to initiate the privatisation procedure of its stake both in the exchange and in the Central Securities Depository where it also holds a controlling share. Both stakes are to be privatised in 2014 and the potential candidates must meet certain requirements in order to be able to guarantee long term market and business development. Legal status analyses, privatisation appraisals and information memorandums for both companies were prepared at the beginning of 2014 by an external advisor appointed by Privatisation Agency. The privatisation is planned to be realised by the end of the third quarter of 2014.

Since 16 June 2008, BSE-Sofia uses the Xetra trading platform of Deutsche Boerse. On-exchange trading is carried out on a continuous trading basis with opening and closing auctions. Since 1 March 2012, BSE-Sofia operates the Main Market BSE and the Alternative Market BSE. The following financial instruments are traded on BSE-Sofia: stocks (common and preferred), corporate and municipal bonds, UCITS, compensatory instruments, subscription rights and warrants. The number of issues admitted to trading on BSE-Sofia amounted to 481 at the end of March 2014 which constituted a decrease of 13 issues as compared to the end of March 2013.

SOFIX, BSE-Sofia's main index, was launched on 20 October 2000. The index was one of the top performing indices in Europe for 2013 increasing by 42.28 per cent. on an annual basis. SOFIX continued its strong performance in the first quarter of 2014, adding more than 22 per cent. The overall market capitalisation of BSE-Sofia stood at EUR 5.711 billion at the end of March 2014, with an increase of 11.89 per cent. year-on-year. The total turnover increased by 76 per cent. in 2013 reaching EUR 778 million. In addition, BSE-Sofia maintains three other indices, one of which, BG REIT, is a sector index tracking the performance of seven listed REITs.

Since September 2011, BSE-Sofia has been acting as a calculation agent of the National Corporate Governance Commission, with respect to the first Bulgarian index, tracking 7 selected companies that implemented the best corporate governance practices in their business operations. As of 31 December 2013, 64 stock exchange members (42 investment firms and 22 banks) were admitted to trading.

The settlement cycle is T+2 and settlement is conducted on a mandatory delivery-versus-payment basis for all on-exchange trades via the computerised book-entry system of Bulgaria's Central Securities Depository. The depository recently started an ambitious technological and regulatory overhaul. The primary purpose of this is to turn the institution into a fully functional clearing and settlement organisation that effectively supports the entire financial market.

BALANCE OF PAYMENTS AND FOREIGN TRADE

The following table sets out Bulgaria's balance of payments in millions of EUR for the period 2009-2013 (as at 31 December):

	2009	2010	2011	2012	2013
			(EUR million)		
Balance of Payments Data					
Current account	**(3,116.2)**	**(533.1)**	**33.2**	**(333.9)**	**751.3**
Goods, credit (f.o.b.)	11,699.2	15,561.2	20,264.3	20,770.2	22,228.2
Goods, debit (f.o.b.)	(15,873.1)	(18,324.8)	(22,420.4)	(24,230.4)	(24,581.5)
Trade Balance	(4,173.9)	(2,763.7)	(2,156.1)	(3,460.3)	(2,353.3)
Services, credit	4,916.3	5,011.5	5,354.0	5,794.0	5,769.2
Transportation	1,007.6	986.5	1,112.2	1,109.9	1,153.8
Travel	2,681.2	2,747.1	2,852.4	2,916.6	3,058.4
Other services	1,227.5	1,277.9	1,389.4	1,767.5	1,557.0
Services, debit	(3,616.5)	(3,143.7)	(3,038.5)	(3,413.9)	(3,661.1)
Transportation	(801.5)	(699.0)	(829.5)	(989.1)	(1,048.1)
Travel	(1,258.7)	(931.2)	(958.7)	(1,015.7)	(1,150.4)
Other services	(1,556.2)	(1,513.4)	(1,250.2)	(1,409.0)	(1,462.6)
Services, net	1,299.9	1,867.8	2,315.5	2,380.1	2,108.1
Goods and services, net	(2,874.0)	(895.9)	159.4	(1,080.2)	(245.2)
Income, credit	804.3	617.6	616.5	715.1	860.8
Compensation of employees	425.7	290.1	291.8	327.7	406.8
Investment income	378.6	327.5	324.7	387.4	454.0
Direct investment	4.8	14.5	(14.6)	24.4	18.9
Portfolio investment	294.4	256.5	256.8	281.9	346.8
Other investment	79.4	56.6	82.5	81.1	88.3
Income, debit	(2,002.5)	(1,751.8)	(2,427.3)	(2,043.4)	(2,246.2)
Compensation of employees	(63.8)	(11.9)	(12.4)	(16.1)	(11.2)
Investment income	(1,938.7)	(1,739.9)	(2,414.9)	(2,027.3)	(2,234.9)
Direct investment	(1,311.8)	(1,208.3)	(1,803.9)	(1,463.8)	(1,714.1)
Portfolio investment	(73.4)	(80.6)	(76.5)	(61.7)	(82.5)
Other investment	(553.6)	(451.0)	(534.5)	(501.8)	(438.3)
Income, net	(1,198.3)	(1,134.2)	(1,810.8)	(1,328.2)	(1,385.4)
Current transfers, net	956.1	1,496.9	1,684.6	2,074.5	2,381.9
Current transfers, credit	1,562.7	2,047.5	2,238.0	2,719.8	3,103.3
Current transfers, debit	(606.6)	(550.6)	(553.3)	(645.3)	(721.4)
Capital account	**477.1**	**290.9**	**503.6**	**541.0**	**466.4**
Capital transfers, net	478.7	256.3	471.2	518.3	533.2
Financial account	**1,163.4**	**(673.1)**	**(885.8)**	**1,466.2**	**(1,465.6)**
Direct investment, net	2,505.3	977.3	1,212.7	802.0	957.3
Abroad	68.3	(173.9)	(117.5)	(268.3)	(135.1)
In Bulgaria	2,436.9	1,151.2	1,330.2	1,070.3	1,092.4
Mergers and acquisitions	0.0	0.0	0.0	0.0	0.0
Portfolio investment, net	(619.1)	(635.4)	(357.4)	(898.4)	(128.2)
Assets	(623.5)	(547.9)	(47.5)	(1,461.5)	(642.3)
Liabilities	4.4	(87.5)	(309.9)	563.1	514.1
Financial derivatives, net	(18.3)	(24.7)	(65.3)	(33.3)	(119.4)
Other investment, net	(704.5)	(990.3)	(1,675.8)	1,595.9	(2,175.4)
Assets	(632.3)	(26.2)	(708.3)	673.4	(1,659.9)
Liabilities	(72.2)	(964.1)	(967.5)	922.5	(515.5)
Net errors and omissions	**825.9**	**531.4**	**507.6**	**487.7**	**(351.3)**
OVERALL BALANCE	**(649.8)**	**(383.9)**	**158.7**	**2,161.0**	**(599.2)**
Reserves and related items	649.8	383.9	(158.7)	(2,161.0)	599.2
Official reserve assets	649.8	383.9	(158.7)	(2,161.0)	599.2
Use of fund credits and loans, net	0.0	0.0	0.0	0.0	0.0
Exceptional financing transactions	0.0	0.0	0.0	0.0	0.0

Source: Bulgarian National Bank.

The following table sets out the balance of payments for Bulgaria as a percentage of GDP for the period 2009-2013 (as at 31 December):

	2009	2010	2011	2012	2013
			(% of GDP)		
Balance of Payments Data					
Current account	**(8.9%)**	**(1.5%)**	**0.1%**	**(0.8%)**	**1.9%**
Trade Balance	(11.9%)	(7.7%)	(5.6%)	(8.7%)	(5.9%)
Services, net	3.7%	5.2%	6.0%	6.0%	5.3%
Income, net	(3.4%)	(3.1%)	(4.7%)	(3.3%)	(3.5%)
Current transfers, net	2.7%	4.2%	4.4%	5.2%	6.0%
Capital account	**1.4%**	**0.8%**	**1.3%**	**1.4%**	**1.2%**
Financial account	**3.3%**	**(1.9%)**	**(2.3%)**	**3.7%**	**(3.7%)**
Direct investment, net	7.2%	2.7%	3.1%	2.0%	2.4%
Portfolio investment, net	(1.8%)	(1.8%)	(0.9%)	(2.3%)	(0.3%)
Financial derivatives, net	(0.1%)	(0.1%)	(0.2%)	(0.1%)	(0.3%)
Other investment, net	(2.0%)	(2.7%)	(4.4%)	4.0%	(5.4%)
Net errors and omissions	**2.4%**	**1.5%**	**1.3%**	**1.2%**	**(0.9%)**
OVERALL BALANCE	**(1.9%)**	**(1.1%)**	**0.4%**	**5.4%**	**(1.5%)**

Source: Bulgarian National Bank.

Current Account

Before the global financial crisis, Bulgaria's current account balance was driven by a rapidly expanding trade deficit. Foreign trade dynamics were largely shaped by a boost in investment activity, strong local consumption fostered by real income growth, global price changes and increased bank lending. In addition, Bulgaria's full membership in the EU led to the removal of trade barriers and market expansion and attracted significant FDI from mainly Euro area countries. Merchandise exports and imports increased in 2007 and 2008 before falling significantly in 2009. After 2009 the economy went through a phase of orderly adjustment with decreasing levels of FDI and a shrinking deficit on the current account. Exports started to recover in early 2010 with growth continuing throughout 2011. This increase in exports was underpinned by the gradual recovery of Bulgaria's major trading partners. Furthermore, the growth rates of exports for 2010, 2011 and 2013 were higher than the EU average, thus confirming the strong competitive position of the Bulgarian economy. The share of Bulgarian exports in intra-EU imports and world imports continued to increase during the global crisis as well. At the same time the growth rate of exports outstripped that of imports. The rebound in imports started in March 2010; this was driven by the demand for raw materials amongst the country's export-oriented manufacturers. After expanding over the course of 2007-2008, the trade deficit pursued a downward trend for the period 2009-2013. An exception to this trend was in 2012 when adverse weather conditions negatively affected export levels and contributed to the widening of the trade deficit. As a percentage of nominal GDP, Bulgaria's trade deficit was 11.9 per cent. in 2009, 7.7 per cent. in 2010, 5.6 per cent. in 2011, 8.7 per cent. in 2012 and 5.9 per cent. in 2013.

The services sector balance has been positive since 2007; and increased in nominal terms in each year except for 2009 and 2013. In 2009, both exports and imports of Bulgaria's services contracted, but the sector weathered the crisis. Revenues from tourism accounted for around 50 per cent. of the total revenue from services, making the strongest contribution to the positive balance in the period surveyed. After a drop in 2009, the number of holiday-makers visiting Bulgaria increased, bringing in an annual year-on-year increase in receipts.

The income balance was negative in the 2007-2013 period. The deficit was due to repayment of investment income mostly related to the FDI inflows in the country. The positive contribution of net transfers to the current account balance has increased since 2007. At the beginning of the period, budget transfers to other countries increased significantly, with approximately 60 per cent. accounting for Bulgaria's regular contribution to the EU budget. As Bulgaria improved its EU funds transfer management, EU transfers showed a steady annual increase in 2010-2013.

Positive trade dynamics, improving services and net transfer balances have resulted in a sharp adjustment to Bulgaria's current account in the last couple of years. The current account deficit shrank to 1.5 per cent. in 2010 and turned into a surplus in 2011 and 2013. The balance will remain dependent on trade dynamics. With the recovery of domestic demand it can be expected that imports will increase and that the trade balance will deteriorate. The Ministry of Finance expects the current account surplus to decline in 2014 and 2015 and the balance to be slightly negative in the medium term.

Downside risks for the current account include the possibility of a faster recovery in domestic demand than first anticipated as well as the risk of higher crude oil prices. At the same time, if exports outperform expectations or higher international prices of metals and foods result in a lower trade deficit, a better current account balance may materialise. Equally, net foreign direct investment is projected to stabilise as a ratio to nominal GDP at levels around 3 per cent. for the 2014-2016 period.

Imports and Exports of Goods by Region

The following table sets out the percentage shares of exports and imports of goods by region for Bulgaria for the period 2009-2013 (as at 31 December):

	Exports (%)				
	2009	**2010**	**2011**	**2012**	**2013**
EU [(1)]	**65.53**	**61.38**	**62.62**	**58.92**	**60.09**
Euro area [(5)]	**49.64**	**44.66**	**45.29**	**43.22**	**44.42**
of which:					
Germany	11.29	10.66	11.62	10.24	12.35
Italy	9.34	9.71	8.69	8.49	8.66
Greece	9.55	7.95	7.02	7.20	6.95
France	4.48	4.04	4.22	4.00	4.32
Belgium	5.67	3.77	4.93	3.69	2.90
EU Member States not members of the Euro Area [(5)]	**15.89**	**16.72**	**17.33**	**15.70**	**15.67**
of which:					
Romania	8.63	9.11	9.54	8.06	7.74
Balkan countries [(2)]	**13.80**	**15.05**	**13.94**	**14.11**	**12.99**
of which:					
Turkey	7.24	8.46	8.55	9.43	9.01
Serbia	3.18	3.53	2.36	2.13	1.68
Macedonia	2.04	2.14	2.28	1.89	1.58
Other European countries [(3)]	**5.42**	**7.60**	**8.40**	**8.81**	**7.65**
of which:					
Russia	2.50	2.84	2.68	2.71	2.58
Ukraine	0.86	1.27	1.43	1.18	1.93
Gibraltar	0.65	2.19	3.08	3.53	1.81
Asia	**7.78**	**8.62**	**7.68**	**10.30**	**11.55**
of which:					
China	0.82	1.20	1.45	2.86	2.91
Singapore	1.88	1.20	0.19	0.23	1.50
America	**2.27**	**2.09**	**2.32**	**2.78**	**2.08**
of which:					
USA	1.56	1.36	1.31	1.79	1.37
Other countries	**5.20**	**5.26**	**5.04**	**5.08**	**5.64**

	Imports (%)				
	2009	**2010**	**2011**	**2012**	**2013**
EU[1]	**53.5**	**51.3**	**48.6**	**47.7**	**48.7**
Euro Area[5]	**38.8**	**36.3**	**34.3**	**33.5**	**34.1**
of which:					
Germany	11.1	10.4	9.7	9.7	10.0
Italy	7.9	7.6	7.2	6.6	7.3
Greece	5.5	5.4	5.0	5.3	4.9
France	3.9	3.4	3.3	3.0	3.0
EU Member States not members of the Euro Area[5]	**14.7**	**15.0**	**14.3**	**14.2**	**14.6**
of which:					
Romania	4.7	5.9	5.8	5.5	5.3
Poland	2.3	2.3	2.0	2.3	2.9
Other European countries[3]	**19.0**	**20.8**	**20.9**	**24.1**	**21.3**
of which:					
Russia	15.5	17.1	16.6	20.3	18.1
Ukraine	2.1	2.4	3.0	2.2	2.0
Asia	**13.1**	**13.4**	**15.4**	**13.9**	**14.0**
of which:					
China	5.4	5.4	6.0	6.5	5.9
Balkan countries[2]	**7.6**	**8.1**	**6.9**	**6.8**	**7.7**
of which:					
Turkey	5.5	5.5	4.6	4.7	5.4
America	**5.8**	**5.4**	**7.2**	**6.5**	**6.3**
of which:					
USA	1.9	1.5	1.6	1.5	1.7
Chile	1.5	0.9	1.3	1.0	1.6
Other countries	**1.0**	**1.0**	**1.0**	**1.0**	**2.0**

1. EU-28 including Croatia.
2. Includes Turkey, Serbia, the former Yugoslav Republic of Macedonia, Albania, Montenegro, Kosovo, and Bosnia and Herzegovina. The data for Serbia until April 2008 includes the data for Kosovo.
3. Includes Russia, Switzerland, Ukraine, Gibraltar (GB), Moldova, Belarus, Norway, Liechtenstein, Iceland, San Marino, Andorra, Faroe Islands and the Vatican.
4. By country of origin.
5. Changing composition.

For 2009 – 2012, final data provided by the NSI. For the 2013 preliminary data, data provided by the NSI, including Intrastat system data as of 25 February 14 and customs declarations data as of 24 February 14.
Source: BNB.

Trade balance by region

EU Member States constitute Bulgaria's main trading partners. Exports to the Euro area and non-Euro area EU countries accounted for 44.4 per cent. and 15.7 per cent. respectively of total exports in 2013. compared to 49.6 per cent. and 15.9 per cent. respectively in 2009. In 2012 the share of exports to the Euro area fell as the members of the single currency union went back into recession. Bulgarian exporters managed to respond quickly, however, by re-directing their exports to other countries. The highest increase in Bulgarian exports in 2013 was to Germany, Italy, France, and the Netherlands. Germany continues to be Bulgaria's major export market followed by Turkey, Italy and Romania. On the import side, Russia remains Bulgaria's main trading partner followed by Germany and Italy. A significant amount of Bulgaria's imports from Russia derive from its importation of crude oil from Lukoil Oil Refinery, which is Russian owned. In 2013, the highest import increases were from Italy and Poland. Among non-EU countries, most trade relations are with countries from the Balkan region, although their relative share in total exports is decreasing.

Composition of trade

The following table sets out the composition of trade for the period 2009-2013 (as at 31 December). (figures are presented in percentages except for the total imports (cif) and exports (fob) which are in EUR millions):

	Exports				
	2009	**2010**	**2011**	**2012**	**2013**
			(%)		
Consumer goods (%)	**28.12**	**25.39**	**22.24**	**23.22**	**23.44**
Food (%)	5.73	5.39	4.45	4.76	4.90
Tobacco (%)	0.57	0.81	0.76	1.04	0.97
Beverages (%)	0.62	0.48	0.44	0.48	0.46
Clothing and footwear (%)	10.12	8.73	7.53	7.01	6.98
Medicines and cosmetics (%)	3.33	3.43	3.14	3.37	3.61
Furniture and household appliances (%)	4.79	3.68	3.23	3.60	3.49
Others (%)	2.96	2.85	2.68	2.94	3.04
Raw materials (%)	**42.68**	**43.85**	**46.40**	**43.17**	**43.41**
Iron and steel (%)	3.74	4.23	4.44	3.47	2.78
Other metals (%)	10.42	11.47	12.27	11.03	10.85
Chemicals (%)	1.86	1.64	1.61	1.66	1.40
Plastics and rubber (%)	2.43	2.40	2.49	2.65	2.96
Fertilisers (%)	0.37	0.84	0.99	0.98	0.77
Textiles (%)	3.24	2.07	1.96	1.79	1.80
Raw materials for the food industry (%)	7.87	8.41	9.06	8.34	10.24
Wood products, paper and paperboard (%)	1.57	2.07	1.91	1.94	1.98
Cement (%)	0.08	0.07	0.07	0.13	0.10
Raw tobacco (%)	1.77	0.94	0.81	0.64	0.76
Others (%)	9.34	9.71	10.80	10.53	9.79
Investment goods (%)	**16.23**	**17.14**	**17.43**	**16.82**	**17.81**
Machines and equipment (%)	4.63	4.50	4.70	4.82	5.13
Electrical machines (%)	2.34	2.20	2.72	2.18	2.47
Vehicles (%)	1.71	2.00	1.93	1.79	1.85
Spare parts and equipment (%)	3.17	3.73	3.78	4.14	4.74
Others (%)	4.38	4.71	4.31	3.88	3.63
Mineral fuels, oils and electricity	**12.93**	**13.58**	**13.89**	**16.76**	**15.23**
Petroleum products (%)	10.18	10.67	10.98	14.10	13.06
Others (%)	2.76	2.91	2.91	2.66	2.16
Other Exports (%)	**0.04**	**0.04**	**0.04**	**0.04**	**0.11**
TOTAL EXPORTS /FOB (*EUR millions*)	**11,699.20**	**15,561.17**	**20,264.32**	**20,770.18**	**22,228.18**

Source: BNB.

For 2009-2012, the final data was provided by the NSI. For 2013, preliminary data was provided by the NSI, including Intrastat system data as of 25 February 2014 and customs declarations data as of 24 February 2014.

	Imports				
	2009	2010	2011	2012	2013
			(%)		
Consumer goods (%)	**20.7**	**20.0**	**18.1**	**17.3**	**18.5**
Food, drinks and tobacco (%)	6.6	6.1	5.9	5.9	6.0
Furniture and household appliances (%)	4.2	3.5	2.7	2.5	2.7
Medicines and cosmetics (%)	4.4	4.2	3.9	3.7	4.0
Clothing and footwear (%)	1.7	2.4	2.0	1.9	2.0
Automobiles (%)	1.0	0.9	1.0	0.9	1.1
Others (%)	2.9	2.9	2.5	2.4	2.6
Raw materials (%)	**34.2**	**35.7**	**37.5**	**34.4**	**35.4**
Ores (%)	4.3	5.2	6.4	5.4	6.3
Iron and steel (%)	3.0	3.3	4.1	3.2	3.2
Other metals (%)	1.8	2.7	2.9	2.8	2.8
Textiles (%)	5.5	4.8	4.7	4.2	4.3
Wood products, paper and paperboard (%)	2.1	2.0	1.8	1.8	1.7
Chemicals (%)	1.7	2.1	2.0	2.0	2.0
Plastics and rubber (%)	4.7	5.0	4.8	4.7	5.0
Raw materials for the food industry (%)	2.4	2.5	2.4	2.2	2.3
Raw skins (%)	0.4	0.4	0.4	0.4	0.3
Raw tobacco (%)	0.5	0.5	0.4	0.5	0.5
Others (%)	7.8	7.2	7.6	7.2	6.9
Investment goods (%)	**24.9**	**21.8**	**21.3**	**22.9**	**22.3**
Machines and equipment (%)	8.9	7.0	6.7	6.7	8.0
Electrical machines (%)	4.3	4.0	3.3	3.2	3.1
Vehicles (%)	3.3	3.0	3.7	4.0	4.0
Spare parts and equipment (%)	3.3	3.9	4.6	5.5	3.7
Others (%)	5.2	3.9	3.0	3.4	3.5
Mineral fuels, oils and electricity (%)	**19.9**	**22.2**	**22.9**	**25.2**	**23.4**
Fuels (%)	16.9	17.7	17.9	20.4	18.0
Crude oil and Natural gas (%)	15.3	16.2	16.4	18.8	16.8
Coal (%)	1.4	1.3	1.3	0.9	0.5
Others (%)	0.2	0.2	0.2	0.6	0.6
Others (%)	3.0	4.5	5.1	4.9	5.4
Oils (%)	3.0	4.5	5.1	4.9	5.4
Electricity (%)	0.0	0.0	0.0	0.0	0.0
Other Imports (%)	**0.2**	**0.3**	**0.2**	**0.2**	**0.4**
TOTAL IMPORTS /CIF (*EUR millions*)	**16,875.4**	**19,244.8**	**23,406.2**	**25,459.1**	**25,844.9**

Source: BNB.

For 2009-2012, the final data was provided by the NSI. For 2013, preliminary data was provided by the NSI, including Intrastat system data as of 25 February 2014 and customs declarations data as of 24 February 2014.

Imports into Bulgaria are diverse with raw materials and fuels making up the largest share. The swift rise of the construction industry and the up- and downstream industries during the pre-crisis period saw the growth in the importation of iron products, non-alloy steel, metal construction, and spare parts. The pre-crisis period was also characterised by increased imports of high-value goods. This was due to the country's integration into the EU common market, which called for the implementation of rigid standards of manufacturing and sizable investment amounts. In addition, significant FDI inflows into the local economy gave further impetus to the importation of investment goods. With the global financial crisis and subdued economic activity, however, the share of investment goods declined. The negative growth of imports of investment goods decelerated gradually in 2010 and increased in 2011 and 2012. The main contribution to the import increases in 2013 on an annual basis was the renewed demand for machinery and equipment, and ores and oils. Commensurately, imports of spare parts and crude oil fell.

There has been a shift in focus to the export of higher value added items. Prior to the global financial crisis, base metals (including copper, iron and steel) and their products, and mineral fuels and oils were important components of Bulgaria's exports. Among the main contributors to growth were also textiles, clothing and footwear. With Bulgaria's accession to the EU and increased competition,

however, their relative share of total exports declined. Meanwhile the weight of investment goods such as machines (including electric machines, machines for general use, energy production machines, automobiles, bicycles and other vehicles) has increased annually, reaching 17.8 per cent. of total exports in 2013 as compared with 16.2 per cent. in 2009. Over the same period, the share of raw materials and base metals being exported has increased from 42.7 per cent. in 2009 to 43.4 per cent. in 2013.

Foreign Direct Investment

The years before the global economic and financial crisis were marked by high economic growth and an accelerated real convergence of the Bulgarian economy following the country's accession to the EU in 2007. In those conditions, the expectations for relatively high returns on investment and high growth encouraged financial inflows, primarily in the form of FDI. Since 2005, FDI in export-oriented sectors such as the processing industries increased considerably, while FDI in real estate and construction peaked dramatically in the run-up prior to the global financial crisis. The decline in FDI flows in those sectors following the 2008 global financial crisis contributed to the substantial drop in real estate prices. In 2010, FDI inflows in manufacturing were the largest in Bulgaria and were principally aimed at upgrading and expanding existing production units. The low overall FDI level in 2010-2013 reflected lower capital inflows due to investor risk aversion on the one hand, and net repayment of intercompany loans as a result of the lower investment demand on the local market on the other. According to preliminary data, the inflow of foreign direct investment in Bulgaria for 2013 amounted to EUR 1,092.4 million (2.7 per cent. of GDP). compared to an inflow of EUR 1,070.3 million (2.7 per cent. of GDP) for 2012. For the period 2014-2016, BNB projects net foreign direct investment to stabilise at about 3-3.5 per cent. of nominal GDP.

The fluctuations of net portfolio investments in the period after the global financial crisis have been influenced mainly by one-off transactions. The net portfolio investment in 2013 was mainly driven by the repayment of government debt in January and the issuance of corporate bonds in the amount EUR 900 million in November.

The following tables include data for the end of year stock of FDI in Bulgaria (grouped by country of origin of investment and annual flows by economic activity):

	Total FDI stock by country of origin				
	2009	2010	2011	2012	2013
			(*EUR millions*)		
EU[1]	**29,168.4**	**30,015.9**	**30,189.8**	**29,916.0**	**30,644.7**
Euro area	**23,638.4**	**24,635.5**	**25,324.0**	**25,125.6**	**26,140.6**
of which:					
The Netherlands	5,772.0	7,326.2	7,230.6	7,138.1	7,683.1
Austria	6,442.5	5,529.5	5,822.9	5,526.4	5,435.1
Greece	3,032.4	2,873.8	2,857.6	2,759.7	2,777.5
Cyprus	1,829.5	1,957.6	2,118.6	2,045.3	2,011.1
Germany	2,007.4	1,986.0	1,842.0	1,756.1	1,898.2
Luxembourg	607.3	951.3	1,284.0	1,363.7	1,574.1
France	756.4	767.2	848.4	966.0	993.9
Spain	908.9	880.1	877.2	941.8	955.3
Italy	515.6	621.1	724.0	780.8	762.2
Ireland	778.9	775.8	738.1	685.8	686.6
EU Member States not members of the Euro Area	**5,530.0**	**5,380.4**	**4,865.8**	**4,790.4**	**4,504.1**
of which:					
UK	2,897.3	2,665.2	2,334.9	2,183.7	2,059.7
Hungary	1,048.1	1,118.5	1,020.6	1,055.5	977.4
Non-EU	**5,001.6**	**5,331.4**	**6,429.1**	**7,403.8**	**7,512.5**
of which:					
Russia	1,005.1	1,174.9	1,424.1	1,737.6	1,818.6
Switzerland	658.5	764.6	980.4	1,171.9	1,120.7
USA	923.2	934.3	957.3	1000.7	1017.0
British Virgin Islands	623.5	667.4	894.6	846.9	796.7
TOTAL	**34,170.0**	**35,347.3**	**36,619.0**	**37,319.8**	**38,157.2**

(1) EU-27 up to 2012. EU-28 from 2013 including Croatia.

	Annual FDI flow by economic activity				
	2009	2010	2011	2012	2013
			(*EUR millions*)		
Total	**2,436.9**	**1,151.2**	**1,330.2**	**1,070.3**	**1,092.4**
Agriculture, hunting and forestry	23.5	0.0	13.5	5.5	(8.6)
Construction	278.1	110.2	(90.5)	227.9	19.1
Education	0.3	0.7	0.9	0.8	0.0
Electricity, gas and water supply	307.3	324.6	450.7	737.3	64.7
Financial intermediation	681.2	202.8	257.2	(161.1)	(64.3)
Fishing	1.1	0.1	5.6	2.2	0.1
Health and social work	0.8	(10.6)	(3.6)	9.2	0.4
Hotels and restaurants	57.7	51.7	141.2	62.3	(9.9)
Manufacturing	(219.8)	541.8	283.5	504.9	188.5
Mining and quarrying	45.6	35.7	150.4	231.7	110.8
Not allocated	83.1	88.7	(8.9)	16.6	159.5
Other community, social and personal service activities	(23.0)	(45.9)	140.8	0.5	48.2
Real estate, renting and business activities	527.6	(16.0)	(251.8)	(458.6)	(44.1)
Transport, storage and communication	271.4	57.9	203.1	(364.3)	412.2
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	402.1	(190.5)	38.1	255.5	215.9

Source: BNB.

Gross external debt

The following table sets out the end of year stock of gross external debt ("**GED**") of Bulgaria by institutional sectors for the period 2009-2013:

	GED as at 31 December									
	2009		**2010**		**2011**		**2012**[2]		**2013**[3]	
	EUR mln	*% GDP*	*EUR mln*	*% GDP*	*EUR mln*	*% GDP*	*EUR mln*	*% GDP*	*EUR mln*	*% GDP*
GED	**37,816.4**	**108.3**	**37,026.3**	**102.7**	**36,294.9**	**94.3**	**37,780.2**	**94.6**	**37,338.9**	**93.5**
General Government Debt[1]	2,827.9	8.1	2,873.0	8.0	2,788.4	7.2	3,471.7	8.7	3,331.7	8.3
Short term	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long term	2,827.9	8.1	2,873.0	8.0	2,788.4	7.2	3,471.7	8.7	3,331.7	8.3
Banks	8,378.8	24.0	6,861.8	19.0	5,648.7	14.7	6,454.5	16.2	5,757.5	14.4
Short term	6,218.4	17.8	5,227.7	14.5	4,065.4	10.6	4,813.1	12.1	4,305.9	10.8
Long term	2,160.4	6.2	1,634.1	4.5	1,583.3	4.1	1,641.4	4.1	1,451.6	3.6
Other Sectors Debt[(2)]	12,048.4	34.5	12,350.5	34.3	12,331.4	32.0	12,102.4	30.3	12,376.5	31.0
Short term	5,910.0	16.9	5,970.2	16.6	6,048.7	15.7	5,607.8	14.0	5,439.6	13.6
Long term	6,138.4	17.6	6,380.3	17.7	6,282.7	16.3	6,494.6	16.3	6,936.9	17.4
Direct investment: intercompany lending	14,561.3	41.7	14,940.9	41.4	15,526.4	40.3	15,751.6	39.5	15,873.2	39.7
Memo items:										
Long term debt	25,688.0	73.5	25,828.3	71.6	26,180.8	68.0	27,359.2	68.5	27,593.3	69.1
Short term debt	12,128.5	34.7	11,197.9	31.1	10,114.1	26.3	10,420.9	26.1	9,745.5	24.4

Notes:

(1) General Government Debt includes central government debt, local government debt, debt of social security funds and debt of all non-market, non-profit institutions that are controlled and mainly financed by government units.

(2) Other Sectors Debt includes debt of private and state-owned non-bank enterprises and debt of households.

(3) Data is as of 25 March 2014.

Source: BNB.

Bulgaria's GED is mostly private debt as the expansion of the economy prior to the crisis attracted substantial capital inflows in the form of direct investment (intercompany lending) and support from parent banks to local subsidiaries. With the contraction in economic activity in 2009, the need for external financing decreased. The moderate recovery that followed was accompanied by subdued domestic demand and growth in domestic savings. As a result, the liquidity position of the banking sector improved and banks reduced their external indebtedness mainly through repayment of short-term loans.

The total external debt of the banking sector shrank from 24.0 per cent. of GDP at the end of 2009 to 14.4 per cent. of GDP at the end of 2013. Intercompany lending and Other Sectors Debt increased slightly after the global financial crisis towards 2013 in line with the significantly lower capital inflows in the country. General government external debt increased in the period 2009 to 2013 but Bulgaria retained its low external public debt levels at 8.3 per cent. of nominal GDP as of the end of 2013. After increasing to 108.3 per cent. of GDP at end of 2009, the overall external debt stock shrank to 93.5 per cent. of GDP at the end of 2013. Average maturities of GED have also increased with the share of short-term GED being 26.1 per cent. of total GED and the share of long-term GED being 73.9 per cent. of total GED as of the end of 2013. The currency structure remained favourable with 89.4 per cent. of total debt being euro-denominated.

INDEBTEDNESS

Management of State Debt

The Government Debt Act was adopted in 2002 to unify existing regulatory arrangements and ensure clarity with regard to procedures and the authority to issue debt.

For the purpose of transposing the main requirements of Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States and on establishing the framework for implementation of the respective regulations, the PFA was enacted in 2013 and became effective on 1 January 2014. The PFA regulates the development and management of public finance, so that the mid-term budget framework may be relied upon as an instrument for mid-term forecasting and planning. The PFA applies strict fiscal rules to be observed by central and local governments as well as the general government. The PFA sets the development of reliable practices of projecting and monitoring of the subsectors of the general government. The legislation summarises the national fiscal rules for the balance of the general government and for the budget of the consolidated fiscal programme (calculated on the cash-based principle); it also sets out the maximum limit of expenditure under the consolidated fiscal programme and the nominal value of consolidated debt for the general government.

The provisions of the Government Debt Act and the PFA include the following:

- a comprehensive definition of different types of debt;
- an outline of debt-related powers;
- restrictions as to debt growth;
- an obligation to announce a medium-term debt management strategy and publish an annual report on its implementation;
- regulation of the powers and procedures for the project proposals financed by government loans and for issuing government guarantees; and
- regulation of the fiscal agency of the BNB.

A new definition of the consolidated debt of the general government was introduced in accordance with the requirements of Council Regulation (EC) No 479/2009 of 25 May 2009. This regulation addresses the application of the Protocol on the EDP. Besides the debt undertaken in accordance with the Government Debt Act, the scope of government debt also includes other forms of debt, including, in some instances, funds received from the EU. The PFA also calls for adherence to the Maastricht criterion on the ratio of general government debt against GDP (which may not exceed 60 per cent. at the end of each year), and it also provides for specific measures which limit the possibilities of exceeding this benchmark.

The conservative approach to defining the value of the consolidated debt of the general government is also applied in setting a debt threshold of 40 per cent. of GDP; the implementation of which, in terms of the mid-term budget target, must not exceed 0.5 per cent. of GDP on a year-on-year basis.

The Council of Ministers is the body which approves debt on behalf and at the expense of the state and issues government guarantees in accordance with the requirements of the Constitution. The authority to issue government securities ("**GS**") and to negotiate and sign government loan agreements and government guarantee agreements within the ambit of the State Budget Law is delegated to the Minister of Finance. The Ministry of Finance manages and monitors debt and provides official information on debt performance.

The BNB is the agent for state debt. The BNB is responsible for maintaining systems for registering and servicing state debt, organising and holding auctions of GS, registration of transactions with GS

in the secondary market and other mutually agreed activities. See "*Monetary and Financial System - The BNB*".

Government policy regarding the primary market of GS contributes to the efficiency and transparency of both the primary and secondary market of GS, and ensures the provision of accurate information in relation to such GS. Some decisions that are particularly relevant to primary market development include the choice of auction system and the establishment of a system of primary dealers.

The Government Securities Auction System

The Government Securities Auction System (the "**GSAS**") was initially developed by the BNB in 1991 as part of the Electronic System for Registration and Trade in Government Securities ("**ESROT**"). The system has been developed and updated on multiple occasions.

In 2004, the BNB introduced a new auction system. It was developed as an independent system ensuring a fully automated direct execution of auction bids in line with the provisions of Ordinance No. 5 of Ministry of Finance and BNB on the Procedure and Terms for Acquisition, Registration, Redemption and Trade in Government Securities ("**Ordinance No.5**"). The replaceable technical devices used by GSAS for communication with GS auction participants (SWIFT and WEB-based interface in applying universal electronic signature) comply with international procedures and standards and enable the smooth integration of new users regardless of their location at minimum costs.

The updated system considerably reduces the auction time and the time for communicating auction results to bidders. This is an open auction system and can be updated to keep up with the GS market developments and regulatory amendments.

GSAS functionality meets issuers' requirements for technical support of debt management operations by allowing auctions of different types to be held simultaneously. The interest rate conventions set up in the system are aligned with those of EU Member States.

Auctions are conducted pursuant to Chapter Two and Chapter Six (dealing with repurchases) of Ordinance No. 5. Participation in these auctions is performed by competitive bids. By decision of the Minister of Finance, some of the GS selling auctions also allow non-competitive bids. Bidders may change their bids in an auction until closing bid time, after which the bid becomes irrevocable. The last quotation of each relevant bidder is considered to be their final bid.

The Minister of Finance approves which bids are acceptable. Based on that approval, an auction is closed and the auction data are directly transferred to ESROT through a dedicated interface. The competitive bids are paid up at the price quoted in the bid and this is a rule followed in the so-called multiple-price auction. Non-competitive bids are paid up at the weighted average price of approved competitive bids.

The System of Primary Dealers

The System of Primary Dealers was established in Bulgaria in 1996 in line with the practice in other European countries with developed financial markets. The requirements GS primary dealer applicants should comply with are set out in Chapter Two of Ordinance No. 15 of Ministry of Finance and BNB on the Control over Transactions in Government Securities ("**Ordinance No. 15**"), which stipulates the selection procedure. The list of the primary dealers of GS is approved by the Minister of Finance. The investment intermediaries and banks which are included in the list sign a contract for primary dealership in GS with the Ministry of Finance. This contract defines the contractual obligations of the parties. The system of primary dealers ensures non-discriminatory access to the GS market and is strictly abided to by the Ministry of Finance and the BNB.

The primary dealers of GS for the period 1 January 2014 to 31 December 2014 include Allianz Bank Bulgaria AD, DSK Bank EAD, Corporate Commercial Bank AD, United Bulgarian Bank AD, Municipal Bank AD, FIB, Raiffeisen Bank (Bulgaria) EAD, Cibank EAD, Citibank Europe PLC. –

Bulgaria Branch, Société Générale Expressbank AD, Unicredit Bulbank AD, Central Cooperative Bank AD and Eurobank EFG Bulgaria AD

In addition to the above, the Ministry of Finance maintains an active dialogue with participants in the government debt market.

Secondary market of GS

In accordance with the Law on the Government Debt and the Government Debt Agency Agreement between the Ministry of Finance and BNB, the latter develops and organises a GS settlement system ("**Settlement System**") with members, who can be primary dealers, sub-depositories of GS or other persons determined pursuant to Article 3 of Ordinance No. 5 under common rules ensuring the fulfilment of obligations by the system participants based on an agreement. The Settlement System comprises of the ESROT and a System of Government Securities Settlement Accounts ("**GSSA**") connected through a direct interface for automated data exchange. The ESROT participants are also participants in GSSA.

The Settlement System functions in compliance with the recommendations for the GS settlement systems developed by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organisation of Securities Commissions, the recommendations of the Committee of European Securities Regulators/ESCB, and the ECB standards of using securities settlement systems in the EU for the credit operations of the ESCB. The settlement of GS is accomplished through the Real Time Gross Settlement System of the BNB in central bank money. Settlement cycle is T+0 and the settlement model is delivery versus payment. By the end of 2013 the Settlement System had become an auxiliary system (TARGET2-BNB), which thereby ensures real time transaction-by-transaction processing (DVP - Model 1 settlement), irrespective of the government debt instrument's currency denomination.

The BNB operates the Central Securities Depository ("**CSD**") for GS. Participants in ESROT are primary dealers of GS; GS sub-depositories; investment intermediaries other than GS primary dealers, whose license covers investment services under the Law on the Markets in Financial Instruments, including those from other Member States, banks other than primary dealers or sub-depositories of GS and other CSDs. The system is designed as a two tier model. In the first level of holding, the CSD maintains the accounts of the GS sub-depositories in the system and the second level comprises GS sub-depositories who maintain the accounts of their clients.

On 2 December 2013 a direct link between the Government Securities Depository of the BNB and the Luxembourg-based International Central Securities Depository ("**ICSD**") was established, thus allowing the direct participants in the Settlement System to effect cross-border transfers of government debt instruments issued in the domestic market (irrespective of their currency denomination). This is expected to ensure better protection of domestic and foreign investments in Bulgarian government debt instruments, and facilitate the Settlement System's successful integration into European market infrastructure.

Key responsibilities of the Ministry of Finance in relation to the debt issue policy

The Ministry of Finance is responsible for measures regarding domestic and external government debt management and planning, organising and controlling activities related to implementation of the issue policy in the domestic market.

As part of the debt issue policy, the Ministry of Finance carries out activities related to the announcement of any forthcoming auctions for GS issuance on the basis of Ordinance No. 5.

The Ministry of Finance is also responsible for scheduling the monthly and annual calendars for domestic GS issues, including monitoring and analysing domestic debt instruments market developments, especially the quotations of the respective issues on the secondary market.

The BNB and the Ministry of Finance are together responsible for transparency of the government debt market by providing public disclosure (on the website of the Ministry of Finance and the BNB) of:

- debt management strategy;
- monthly issue calendars;
- monthly bulletins with extensive government debt statistics and analysis;
- annual review of government debt;
- legal acts;
- detailed information about the status and tendencies of government debt (including forthcoming issues and the level of state guarantees; and
- the official information on consolidated general government debt shall be disclosed by the Ministry of Finance in the month following the month of publication of that data by the European Commission (Eurostat).

In 2003, the State Budget Law introduced for the first time annual limits on the maximum volume of new government and government guaranteed debt that may be assumed as well as the maximum amount of outstanding government debt as of the end of the year.

The local government debt, debt of social security funds, the BNB, and other local entities shall not be government debt and shall not entail any obligations for the state except where a government guarantee was issued.

In accordance with the PFA, the nominal amount of consolidated general government debt at the end of every year may not exceed 60 per cent. of the gross domestic product. If the debt exceeds 60 per cent. of GDP, the medium-term budgetary forecast and the State Budget Act shall set out measures aimed at reducing that debt by at least 5 per cent. of the excess ascertained per annum until reaching the ratio of 60 per cent. The consolidated general government debt at the end of every year, as a proportion of GDP, may not exceed the ratio of the preceding year if that ratio is higher than 60 per cent. In the event that consolidated general government debt exceeds 60 per cent. of GDP, State Budget legislation for the relevant year may set out additional constraints on the municipalities and social security funds accruing further debt.

The Minister of Finance develops a three year government debt management strategy (the "**Strategy**"), which is approved by the Council of Ministers. The Strategy is updated annually and this update will be approved by the Council of Ministers together with the medium-term budgetary forecast. This allows for the timely and adequate redefinition of part of the objectives and measures in accordance with economic development, market indicators and results achieved in the course of the implementation of the Strategy.

The Strategy is a fundamental document aimed at summarising the main priorities of the Government in the area of medium term government debt management and defining the tools used for its implementation. Its main purpose is to assess and limit as much as possible the various risks generated by the debt structure and profile. The main objective of the Strategy is to ensure smooth financing of the budget and refinancing of the debt at an optimal cost and degree of risk.

In 2003, by decree of the Council of Ministers, an Ordinance was adopted for the purposes of setting out the requirements for Investment Projects financed by Government loans. According to the Government Debt Act, the Minister of Finance shall sign on behalf of the Government any loan agreements agreed to by the Council of Ministers pursuant to the procedure set out in the International Treaties of the Republic of Bulgaria Act. The Council of Ministers may also assign or co-join this authority to other government authorities so that they may also participate in the negotiations for

government loans. Government guarantees are issued by the Council of Ministers in line with the requirements of the Constitution and the ratification procedures contained therein. The negotiation and signing of guarantee agreements and letters of guarantee is delegated to the Minister of Finance. Projects financed by loans with a government guarantee are selected by the Council of Ministers. A list of such projects constitutes a part of the State Budget Law for the respective year.

Methodology

Bulgaria uses its national methodology for reporting purposes with international financial institutions ("**IFI**") and for comparison with other countries. The state debt under national methodology is only the debt incurred directly by the state under the provisions stipulated in the State Debt Act. Local authorities and Social Security Funds issue debt under special regulations, namely the Municipal Debt Act and Social Insurance Code, which impose specific terms and conditions when undertaking debt. However, the debt figures for all are included within the reporting provisions found stipulated in the PFA, Eurostat and the EDP.

The national methodology, in accordance with the PFA, also provides full coverage of the financial instruments used in preparing the debt statistic figures for the country. Further to this, it also sets out the statistics under Eurostat methodology requirements, as defined in Council Regulation (EC) No. 479/2009 and its amendment, Regulation (EC) No. 679/2011.

As a member of the EU, Bulgaria reports on the consolidated debt of the general government to Eurostat, the statistical body of the Commission (in compliance with the ESA 95 methodology for comparisons with other countries in EU – 28). The general government in the Republic of Bulgaria consists of Central Government, Local Government and the Social Security Funds subsector. See "*Public Finance*" for more information on ESA 95 methodology. It is anticipated that the introduction of ESA 2010 through Council Regulation (EC) No. 549/2013, effective from September 2014, will not have a significant impact on the reporting requirements for the consolidated debt of the general government.

Eurostat's methodology differs from the national methodology for state debt as the former requires the inclusion of debt incurred under financial leasing contracts, cessions, factoring without recourse provisions, and those financial obligations of the state which are not connected with real financial instruments or the debt of non-financial public entities.

The following table sets out general government debt and its subsectors as reported under Eurostat's requirements for the period 2009-2013 (as at 31 December):

	As at 31 December				
	2009	**2010**	**2011**	**2012**	**2013** [(2)]
			(EUR millions)		
General Government Debt	5,108.61	5,856.01	6,284.12	7,356.49	7,532.81
General Government Debt as % of GDP	14.62	16.24	16.32	18.43	18.86
Central Government Debt	4,944.13	5,634.30	6,052.34	7,172.01	7,416.18
Central Government Debt as % of GDP	14.15	15.63	15.72	17.96	18.57
Local Government Debt	332.65	429.94	481.37	502.48	476.93
Local Government Debt as % of GDP	0.95	1.19	1.25	1.26	1.19
Social Security Funds Debt	11.24	9.85	8.34	6.69	4.93
Social Security Funds Debt as % of GDP	0.03	0.03	0.02	0.02	0.01
Nominal GDP	34,932.3	36,051.8	38,504.3	39,926.4	39,939.7

(1) General Government Debt under Eurostat methodology is not equal to the arithmetical sum of the three sub-sector debts due to consolidation between the sub-sectors.
(2) Preliminary data as of 31 December 2013 (prepared for April Notification Tables for Eurostat).
Source: Ministry of Finance

With respect to the Eurostat requirements and ESA 95 methodology, Bulgaria's ratio of general government debt to GDP was ranked second lowest in the EU, standing at 18.86 per cent. as at the end of December 2013 (see table above).

State debt under Bulgaria's national methodology comprises only debt incurred directly by the state under the provisions stipulated in the State Debt Act. State debt differs from the definition of General Government Debt and Central Government Debt which are defined in accordance with the Eurostat methodology.

The classification of Bulgaria's external and internal debt depends on the governing law of the debt issued. All issuances under Bulgarian law are classified as internal debt and all debt issuance under foreign law, including debt incurred abroad in the form of loans (such as from IFIs or bilateral credit agreements), are classified as external debt.

State Debt

State debt under Bulgaria's national methodology comprises only debt incurred directly by the state under the provisions stipulated in the State Debt Act. State debt discussed in this section differs from the definition of General Government Debt and Central Government Debt which are defined in accordance with Eurostat methodology. See "*Indebtedness - Methodology*".

According to the Ministry of Finance, the nominal amount of state debt at the end of 2013 was EUR 7,218.7 million, of which EUR 4,002.8 million was external debt and EUR 3,215.8 million domestic debt (see table below). In nominal terms the state debt increased by EUR 227.5 million compared to the level registered at the end of 2012. At the end of 2013, the relative share of domestic state debt was 44.6 per cent., and of external state debt was 55.4 per cent. The state debt to GDP ratio at the end of 2013 was 18.1 per cent., which represented a 0.6 per cent. increase compared to the level reported at the end of 2012. This was due mainly to the increase in the nominal amount of domestic debt.

At the end of 2013, the state debt structure (currency, interest rate, type of instruments and maturity) was well balanced. The debt amortisation profile is relatively well distributed, with the exception of 2015 and 2017, when both outstanding international bonds become due. The share of state debt denominated in EUR and BGN at the end of 2013 was 87.1 per cent. (31.7 per cent. in BGN and 55.4 per cent. in EUR, respectively). Fixed rate state debt was 87.0 per cent. and floating rate state debt was 13.0 per cent. of the total. At the end of 2013 the residual maturity of the state debt is 6 years, 9 months and 19 days.

Of the outstanding state debts at the end of 2013, 45 per cent. were GS issued on the domestic market, 24 per cent. are bonds issued in the international capital markets and 31 per cent. are external loans from IFIs and bilateral loans. Moreover, 40 per cent. of these external loans are in the form of government investment loans intended for the implementation of investment projects which are a priority for Bulgaria's economy.

The domestic market noted the following positive trends:

- During the last several years, the yield on domestic debt has been decreasing. The average weighted annual yield on government bonds in 2013 was 1.75 per cent., compared with 3.54 per cent. in 2012, 4.21 per cent. in 2011 and 5.06 per cent. in 2010.
- During 2013, the Ministry of Finance auctioned GS with a total volume of EUR 1,190.9 million (of which EUR 628.5 million were government bonds and EUR 562.4 million were treasury bills), while actual demand for government bonds amounted to EUR 1,633.7 million and the demand for treasury bills amounted to EUR 1,132.6 million. Thus, the oversubscription was about 2.6 times for government bonds and 2.01 times for treasury bills.
- In the first quarter of 2014, the Ministry of Finance successfully conducted 8 auctions for the sale of GS in the main maturity segments – 3, 6 and 9 month treasury bills and 2.5, 5 and 10.5 year in BGN and 7 year in EUR, with a total approved quantity of BGN 1,448.9 million (EUR 740.8 million).

- On 12 February 2014, the ECB published data for the harmonised long-term interest rate for convergence purposes. The indicator for Bulgaria as of February 2014 was 3.58 per cent.

- The yield on the primary market for seven year GS (denominated in EUR) from the auction held on 10 February 2014 was 2.97 per cent.

- The recorded yield on the auction for sale of 10.5-year GS conducted on 10 March 2014 was 3.55 per cent. and the cover ratio was 3.60.

- The recorded yield on the auction for sale of 2.5-year GS conducted on 24 March 2014 was 1.07 per cent. and the cover ratio was 4.73.

The following table sets out state debt (excluding state guaranteed debt) in accordance with the Ministry of Finance methodology in the period 2009 to 2013:

	As at 31 December				
	2009	**2010**	**2011**	**2012**	**2013**
			(EUR millions)		
Domestic State debt	1,538.71	2,011.50	2,458.28	2,546.73	3,215.85
as a % of nominal GDP	4.4	5.6	6.4	6.4	8.1
External State debt	3,289.77	3,373.49	3,487.60	4,444.45	4,002.83
as a % of nominal GDP	9.4	9.4	9.0	11.1	10.0
Total	**4,828.48**	**5,384.99**	**5,945.88**	**6,991.18**	**7,218.67**
as a % of nominal GDP	13.8	14.9	15.4	17.9	18.1
Nominal GDP	34,932.28	36,051.83	38,504.33	39,926.41	39,939.57

Source: Ministry of Finance

At the end of 2013, state guaranteed debt ("**SGD**") amounted to EUR 397 million and the majority of this was composed of external SGD. The ratio of SGD to state and state guaranteed debt (total debt) was 5.2 per cent. (see table below).

Compared to the end of 2012, SGD fell by EUR 120 million in nominal terms by 31 December 2013. The ratio of SGD to GDP at the end of 2013 was 1.0 per cent. which represents a decrease of 0.3 per cent. compared to the end of 2012.

The relatively low values of these indicators are a prerequisite for low vulnerability of the debt portfolio to shocks driven by contingent liabilities. At the end of 2013, there were 14 government guaranteed loans, which were mainly divided between the transport (22.6 per cent.) and energy (64.5 per cent.) sectors.

The following table sets out SGD in accordance with the Ministry of Finance methodology in the period 2009-2013:

	As at 31 December				
	2009	**2010**	**2011**	**2012**	**2013**
SGD, *EUR millions*	612	637	612	516	397
% of total debt	11.25	10.58	9.33	6.87	5.2
% of GDP	1.75	1.77	1.59	1.30	1.0
SGD in BGN - % of SGD	0	0.22	1.00	2.32	4.61
SGD in USD - % of SGD	6.47	4.25	3.00	2.67	2.27
SGD in EUR - % of SGD	46.82	41.84	39.80	42.00	45.09
Debt in other currencies — % of SGD	46.72	53.70	56.22	53.01	48.04
Debt with fixed interest rate - % of SGD	54.14	60.63	63.22	60.29	61.30
Debt with variable interest rate - % of SGD	45.88	39.38	36.80	39.71	38.70
Average interest rate % of SGD	2.21	2.22	2.5	1.94	1.8
Remainder of SGD in years	11.01	10.68	10.13	9.17	8.24

Source: Ministry of Finance

State Debt Service

The following table sets out state debt service in accordance with the Ministry of Finance methodology for the period 2009 to 2013:

	Actual				
	2009	2010	2011	2012	2013
			(EUR millions)		
Domestic State Debt					
1 Interest of domestic State bonds	71.2	65.2	86.6	81.0	92.7
2 Cost of cash management	0.2	0.2	0.2	0.2	0.3
3 Interest of domestic loans	0.0	0.0	0.0	3.0	0.0
4 Fees	0.0	0.0	0.0	0.0	0.0
Total Domestic State Debt	**71.4**	**65.5**	**86.8**	**84.2**	**93.0**
Foreign State Debt					
1 Interest of foreign state bonds	127.4	127.6	126.5	133.3	197.7
2 Interest of domestic bonds - non residents	0.9	0.9	0.8	0.6	0.8
3 Cost of foreign cash management	0.6	0.2	0.3	0.7	0.8
4 Interest of foreign loans	55.8	38.9	45.2	50.4	42.3
5 Fees	1.0	1.0	1.0	1.1	0.9
Total Foreign State Debt	**185.8**	**168.6**	**173.8**	**186.0**	**242.6**
Total State Debt	**257.2**	**234.1**	**260.5**	**270.2**	**335.6**

Source: Ministry of Finance

Relationship with Supranational Financial Institutions

International Monetary Fund ("IMF")

Bulgaria joined the IMF in 1990. At present Bulgaria has no active agreement with the Fund and all its obligations to the IMF are fully settled. The IMF holds regular Article IV consultations with the country on a 12-month cycle and makes unscheduled staff visits. The last IMF visit was a regular Article IV mission conducted over 6-14 November 2013. Currently Bulgaria's quota share in the Fund is 0.27 per cent. of the total IMF quota.

World Bank

Since Bulgaria joined the World Bank in 1990, the World Bank, through the International Bank for Reconstruction and Development ("**IBRD**"), has provided significant financial support for structural reforms and development in the infrastructure, social, health, environment, telecommunications and energy sectors. As at 28 February 2014, the World Bank had authorised approximately USD 3.0 billion in loans to Bulgaria, of which only approximately USD 0.1 billion were undisbursed. These amounts apply to both government loans and loans guaranteed by Bulgaria. IBRD's total debt exposure to Bulgaria as at 28 February 2014 amounted to approximately USD 1.2 billion.

European Investment Bank ("EIB")

Bulgaria signed its first framework agreement with the EIB in 1991 and became a full member of the EIB upon its accession to the EU in January 2007.

The main areas of the EIB operations in Bulgaria are transport, energy and telecommunications. The EIB also provides loans to private enterprises, municipalities and financial intermediaries to support SMEs. In 2007, Bulgaria and the EIB signed a Credit Agreement for a structural programme loan. Bulgaria EU Funds Co-financing 2007-2013 for up to EUR 700 million and providing for national co-financing of projects under the Transport, Environment and Regional Development EU Structural and Cohesion Funds Ops. As at 31 December 2013, the EIB had committed EUR 3.6 billion to Bulgarian borrowers, of which EUR 2.5 billion had already been disbursed.

Council of Europe Development Bank ("CEB")

Bulgaria has been a member of CEB since May 1994. Since the beginning of its operations in Bulgaria, CEB has committed around EUR 280 million in socially oriented projects for increasing employment in SMEs, environmental protection, health and public infrastructure.

European Bank for Reconstruction and Development ("EBRD")

Bulgaria is a founding member of the EBRD. As of 31 December 2013 the EBRD has committed over EUR 2.837 billion to corporates, financial institutions, infrastructure projects, and the energy sector, of which EUR 0.351 billion was granted to the public sector and EUR 2.486 billion to the private sector.

Black Sea Trade and Development Bank ("BSTDB")

Bulgaria is a founding member of the BSTDB. As of 31 December 2013 the BSTDB has approved funding for 26 projects in Bulgaria totalling EUR 220.6 million for SMEs, the financial sector, telecommunications, transport, and renewable energy projects.

TAXATION

The following is a general description of the material Bulgarian and EU tax considerations relating to the acquisition, ownership, disposition and retirement of the Notes. It does not purport to be a complete analysis of all tax considerations relating to the Notes. This summary does not take into account or discuss the tax laws of any country other than the Republic of Bulgaria nor does it take into account specific double taxation treaties, the individual circumstances, financial situation or investment objectives of an investor in the Notes.

Prospective purchasers of Notes should consult their own tax advisers as to which countries' tax laws could be relevant to acquiring, holding and disposing of Notes and receiving payments of interest, principal and/ or other amounts under the Notes and the consequences of such actions under the tax laws of those countries. This summary is based upon tax laws of the Republic of Bulgaria as in effect on the date of this Offering Circular and is subject to any change in law that may take effect after such date, including changes which could have a retroactive effect.

Republic of Bulgaria

Individuals

Payment of principal on the Notes to individuals is not subject to taxation in Bulgaria.

Interest payments on the Notes received by an individual who is a Bulgarian tax resident, or who is a non-Bulgarian tax resident established for tax purposes in a Member State of the EU or the European Economic Area, or who is a non-Bulgarian tax resident acting through a fixed base in Bulgaria, is exempt from taxation in Bulgaria.

Interest on the Notes received by an individual who is a non-Bulgarian tax resident and is established for tax purposes outside of a Member State of the EU or of the European Economic Area is subject to a one-time withholding tax in Bulgaria at the rate of 10 per cent.

Capital gains realised from the sale or exchange of Notes realised by an individual who is a Bulgarian tax resident, or who is a non-Bulgarian tax resident acting through a fixed base in Bulgaria is included in his or her annual taxable income and is subject to personal income tax in Bulgaria at the rate of 10 per cent.

Capital gains realised from the sale or exchange of Notes by an individual who is a non-Bulgarian tax resident, irrespective of the place where the individual is established for tax purposes, is subject to a one-time tax in Bulgaria at the rate of 10 per cent. The tax is to be reported in a tax return and paid by such individual investor before the end of the month following the quarter in which the capital gains are actually received.

An individual who is a Bulgarian tax resident and in regards to the Notes is acting as sole proprietor within the meaning of the Bulgarian Commerce Act, whether registered or not, is subject to taxation as a legal entity but the tax rate is 15 per cent.

Legal entities

Payment of principal on the Notes to a legal entity is not subject to taxation in Bulgaria.

Interest on the Notes and capital gains realised from the sale or exchange of Notes received by a legal entity which is a Bulgarian tax resident or which is a non-Bulgarian tax resident acting through a permanent establishment in Bulgaria is included in the corporate income taxable base of the recipient and is subject to corporate income tax in Bulgaria at the rate of 10 per cent.

Interest on the Notes and capital gains realised from the sale or exchange of Notes received by a legal entity which is a non-Bulgarian tax resident, are subject to a one-time withholding tax in Bulgaria at the rate of 10 per cent. Although the law names this tax on capital gains a "withholding" tax, it is paid by the recipient of the income. The tax on capital gains is to be reported in a tax return and paid by

such non-resident legal entity before the end of the month following the quarter in which the capital gains are actually received.

Gross-up

Notwithstanding the above, in accordance with the Terms and Conditions of the Notes, if withholding tax is or becomes payable in Bulgaria, subject to certain exceptions set forth in Condition 8 (*Taxation*) of the "*Terms and Conditions of the Notes*", Bulgaria shall pay such additional amounts as will result in the receipt by the holders of the Notes of such amounts as would have been received by them had no such withholding or deduction been required under Bulgarian law.

Bilateral Treaties for Avoidance of Double Taxation

As at the date of this Offering Circular, Bulgaria is a party to 68 bilateral treaties on the avoidance of double taxation. In cases where Bulgarian law imposes tax on interest received or capital gains realised in relation to the Notes (see above herein *Individuals* and *Legal Entities*), these treaties may provide different forms of tax relief.

Prospective purchases of Notes should consult their own tax advisers with regards to the applicability and effect of such treaties, and to treaty clearance procedures.

Other taxation

No Bulgarian stamp duty, registration, transfer or similar tax is payable in connection with the acquisition, ownership, sale or disposition of the Notes by Bulgarian or non-Bulgarian holders of Notes.

EU Savings Directive

Under EC Council Directive 2003/48/EC (the "**EU Savings Directive**") on the taxation of savings income, each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income (within the meaning of the EU Savings Directive) paid by a paying agent (within the meaning of the EU Savings Directive) within its jurisdiction to, or collected by such a paying agent for, an individual resident or certain limited types of entity established in that other Member State. However, for a transitional period, Austria and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at rates which have risen over time to 35 per cent., unless in the case of Luxembourg the beneficial owner of the interest payments opts for information exchange. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments. A number of other countries and territories have adopted similar measures to the EU Savings Directive. On 10 April 2013, the Luxembourg Ministry of Finance announced that Luxembourg's transitional period will end with effect from 1 January 2015, in favour of automatic information exchange under the EU Savings Directive.

The European Commission has proposed certain amendments to the EU Savings Directive, which may, if implemented, amend or broaden the scope of the requirements described above.

If an amount of, or in respect of, tax were to be withheld from a payment of principal or interest under a Note, pursuant to the EU Savings Directive, any other European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. See Condition 8 (*Taxation*) of the "*Terms and Conditions of the Notes*". However, the Issuer is required, as provided in Condition 12 (*Agents*) of the "*Terms and Conditions of the Notes*", to maintain a Paying Agent in a Member State that does not impose an obligation to withhold or deduct tax pursuant to the EU Savings Directive or any law implementing or complying with, or introduced in order to conform to, the EU Savings Directive or any such other Directive.

Investors who are in any doubt as to their position should consult their professional advisers.

SUBSCRIPTION AND SALE

Subscription Agreement

Citigroup Global Markets Limited, HSBC Bank plc and J.P. Morgan Securities plc (together, the "**Joint Lead Managers**") have, in a subscription agreement (the "**Subscription Agreement**") dated 21 May 2014, agreed jointly and severally to subscribe and pay for the Notes at their issue price of 99.085 per cent. of their principal amount less a combined management and underwriting commission. Each Joint Lead Manager is entitled in certain circumstances to be released and discharged from its obligations under the Subscription Agreement prior to the issue of the Notes. The Issuer has agreed to indemnify the Joint Lead Managers against certain liabilities in connection with the issue of the Notes.

Selling Restrictions

United Kingdom

Each Joint Lead Manager has severally represented, warranted and undertaken that:

(a) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000, as amended (the "**FSMA**")) received by it in connection with the issue or sale of the Notes in circumstances in which section 21(1) of the FSMA does not apply to the Issuer; and

(b) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

United States of America

The Notes have not been, and will not be, registered under the Securities Act and, subject to certain exceptions, Notes may not be offered, sold or delivered within the United States or its possessions. Each Joint Lead Manager has agreed that it will not offer, sell or deliver any Notes within the United States or its possessions.

In addition, until 40 days after the commencement of the offering, an offer or sale of Notes within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act.

Bulgaria

Each Joint Lead Manager has severally represented and agreed that:

(a) the Notes have not been and will not be registered for a public offer and/or admitted to trading in a regulated market in Bulgaria; and

(b) neither it nor any of its affiliates, nor any persons acting on its or its affiliates behalf, have publicly offered or sold, or will publicly offer or sell, any Note within Bulgaria, other than in accordance with the laws of Bulgaria.

General

Each Joint Lead Manager has severally represented, warranted and agreed that it has, to the best of its knowledge and belief, complied and will comply in all material respects with all applicable laws and regulations in each country or jurisdiction in which it purchases, offers, sells or delivers Notes or possesses, distributes or publishes this Offering Circular or any other offering material relating to the Notes. Persons into whose hands this Offering Circular comes are required by the Issuer and the Joint Lead Managers to comply with all applicable laws and regulations in each country or jurisdiction in

which they purchase, offer, sell or deliver Notes or possess, distribute or publish this Offering Circular or any other offering material relating to the Notes, in all cases at their own expense.

GENERAL INFORMATION

Authorisation

1. Bulgaria has obtained all necessary consents, approvals and authorisations in Bulgaria in connection with the issue and performance of the Notes. The creation and issue of the Notes was authorised by the 2014 State Budget Act of the Republic of Bulgaria, the resolutions of the Council of Ministers dated 19 March 2014 and 30 May 2014, and by the law on ratification of the Fiscal Agency Agreement, the Subscription Agreement and the Deed of Covenant, adopted by the parliament on 6 June 2014, sealed by the President on 11 June 2014 and published by the State Gazette Issue No. 49/2014 on 13 June 2014, in force as of 17 June 2014 (the "**Law on Ratification**").

Listing and admission to trading

2. Application has been made for the Notes to be admitted to listing on the official list and trading on the Luxembourg Stock Exchange's regulated market.

3. The total expenses related to the admission to trading of the Notes are expected to be approximately EUR 5,500.

Legal and Arbitration Proceedings

4. Bulgaria is, from time to time, involved in a number of legal and arbitration proceedings. Save as disclosed in this Offering Circular, Bulgaria is not involved in any legal or arbitration proceedings (including any such proceedings which are pending or threatened of which Bulgaria is aware) which may have, or have had during the 12 months preceding the date of this document, a significant effect on the financial position of Bulgaria.

No Significant Change

5. There has been no significant change in the tax and budgetary systems, gross public debt, foreign trade and balance of payments, foreign exchange reserves, financial position and resources and income and expenditure figures of Bulgaria since 31 December 2013.

Documents on Display

6. For so long as any of the Notes are admitted to listing on the official list and trading on the Luxembourg Stock Exchange's regulated market, copies of the following documents (together with English translations thereof) may be inspected during normal business hours at the specified address of the Fiscal Agent and the Listing Agent in Luxembourg:

   (a) this Offering Circular and any supplements thereto;

   (b) the Fiscal Agency Agreement, together with the supplement thereto; and

   (c) the Deed of Covenant.

   A copy of this Offering Circular is available on the Luxembourg Stock Exchange's website at www.bourse.lu.

Yield

7. The projected yield of the Notes will be 3.055 per cent. Such projection has been calculated on the basis of the offering price as at the date of this Offering Circular and is not an indication of actual future return for investors.

ISIN and Common Code

8. The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The ISIN is XS1083844503 and the common code is 108384450.

9. The address of Euroclear is 1 Boulevard du Roi Albert II, B-1210 Brussels, Belgium and the address of Clearstream, Luxembourg is 42 Avenue JI Kennedy L-1855 Luxembourg.

ISSUER

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