

Government Debt Review · 2007



Republic of Bulgaria
Ministry of Finance

Government Debt Review • 2007

Sofia, 2008

Abbreviations

AEAF	The Agency for Economic Analysis and Forecasting
BIR	Base Interest Rate
BNB	Bulgarian National Bank
CPI	The Consumer Price Index
DISC	Discount Bonds
EBRD	European Bank for Reconstruction and Development
FDI	Foreign Direct Investments
EIB	European Investment Bank
EU	European Union
EMBI	Emerging Markets Bond Index
FLIRB	Front Loaded Interest Reduction Bonds
FOB	Free on Board
G-24	The Group of the 24 Most Industrialised Nations
GDP	Gross Domestic Product
GS	Government Securities
IMF	International Monetary Fund
JBIC (JEXIM)	Japan Bank for International Cooperation (former Japan Export-Import Bank)
LIBOR	London Interbank Base Offered Rate
LEONIA	Lev OverNight Index Average
LFS	Labour Force Survey
LSPDACB	Law on State Protection of Deposits and Accounts with Commercial Banks in Respect whereof the BNB Has Petitioned the Institution of Bankruptcy Proceedings
MF	Ministry of Finance
NSI	National Statistics Institute
SDR	Special Drawing Rights
SOFIBOR	Sofia Interbank Offered Rate
USD	US dollar
WB	The World Bank
ZUNK	The Bulgarian Abbreviation of the Law on Settlement of Non-performing Credits Negotiated prior to 31 December 1990

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Macroeconomic Analysis of Bulgaria in 2007

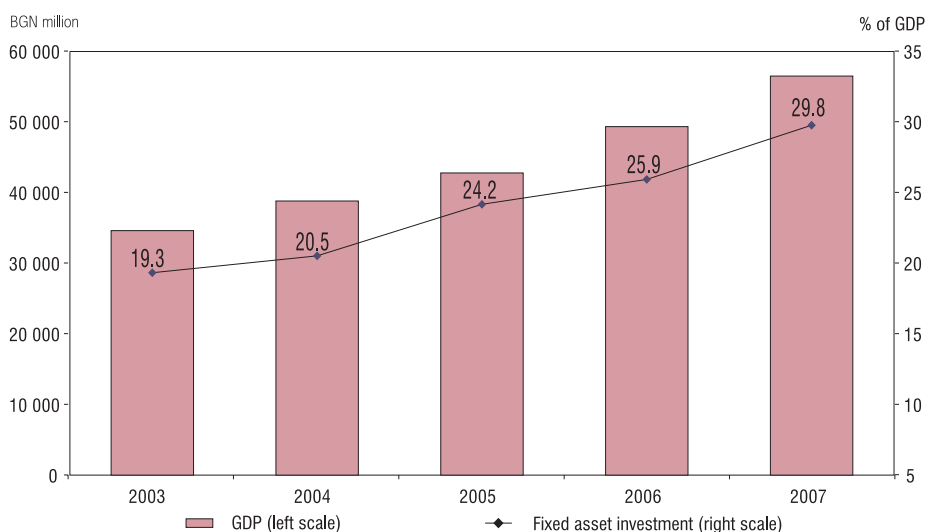
Notwithstanding the continued global economic recession, due to which the US and the European economies have shown a significant decline in 2007, the Bulgarian economy continued its upward trend of relatively high growth rates. Even though at levels lower than the expected ones, economic growth was sustained in Bulgaria, mainly due to the consistent economic policy pursued by the Bulgarian government in line with the clearly defined foreign political objectives relating to the country's accession to the European structures.

Gross Domestic Product

In 2007 the GDP came to BGN 56.5 billion, while the actual growth of this indicator was slightly slowed down to 6.2% (against 6.3% in 2006). The service sector was the biggest contributor to the economic growth. The actual increase of the value added in the sector came to 7.5% during the year, and its relative share rose by almost one percentage point, to reach 61.5%. Financial intermediation services were the most dynamically developing sector, with an actual value added growth of -34.3%, due to both further deepening of financial intermediation and the development of the insurance market, the pension funds, etc. Trade, transport and communications also made an appreciable contribution of their own.

The domestic demand showed a certain slowing down to 9.3% in 2007 against 10.2% in 2006, but still retained its role of a main driver of GDP growth. Investment in fixed assets was the main contributor to this, showing rise by 21.7% in real terms in 2007.

GDP Share of Fixed Asset Investment



Source: NSI

The service sector, which accounts for 61.5% of value added produced in the economy in the last year, again attracted the biggest share (59%) of the total investment. The real estate transactions, the real estate leasing activities and the business services made the greatest contribution to the sector's growth, which made up over one quarter of the nominal increase of total investment during the year. The share of investment in the industry rose to 38.7%, from 37.5% one year earlier. In spite of their slower growth rate, investments in construction still marked a growth of over 50% per year.

The final consumption was markedly decreased in the last year to 4.9% in real terms as compared to 7.3% in 2006, mainly on account of private consumption, the growth of which came to 5.3% against 9.5% in 2006. This indicator was probably mostly influenced by the price factor, given the increase in the marginal consumption trend. The recorded smaller consumer activeness, combined with the restructuring of the industries' sales towards increasing the share of domestic market sales during the year, has resulted in improving the negative impact of net exports on economic growth by one half percentage points in 2007 vs. 2006. The main contributor for this was the recorded significant drop of imports, which fell from 14.7% in the first quarter, to 5.7% in the fourth quarter of the last year. The increase in the volume of exports from 3.7% in January- March, to 6% in October-December also had an impact.

Inflation

In 2007 inflation has exceeded the values, registered in the recent years. The yearend inflation, measured by the CPI, reached 11.6%, and the average annual value stood at 7.6% while, unlike previous years, inflation was largely fuelled by the rise in the market-based prices of goods and services, not by the administrative prices.

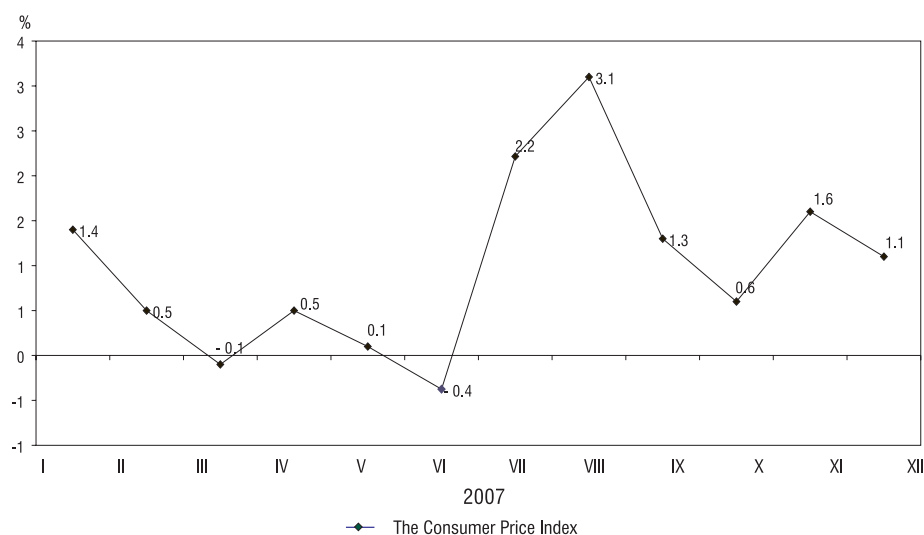
The main factors that influence the changes in the market-based prices may be classified most generally into two groups:

- Changes in international prices exerting influence on the dynamics of inflation in Bulgaria - crude oil and fuels, major agricultural products and products of the food industries;
- Bulgaria's accession to EU and the process of convergence of prices and incomes in Bulgaria with the average EU levels.

Inflation growth of the market-based prices is mostly due to food prices, largely influenced by the drought and the rise in the international prices of food and energy resources¹. The annual increase of food prices was 21.1%, and it was recorded mainly during the summer season.

¹ Data of the World Bank show that in 2007 the international prices of a number of goods (crude oil, natural gas, wheat and cereals, fats and oils) have reached their historic maximums. This comparison is based on international prices calculated in EUR (leva).

The Consumer Price Index change (monthly)



Source: AEF

The prices of energy goods and services have risen by an average of 12% by the end of the period under review, the main contributor for this being the international price of crude oil. The beginning of July saw the entry into effect of higher prices of electricity for domestic and industrial users. With the remaining prices, regulated administratively, the average increase in the end of 2007 was 6.3%, with which the overall contribution of regulated prices to inflation growth was 1.1 percentage points.

The rising of prices of non-energy and non-food goods and services was also accelerated in 2007, due to the increased efficient demand from the households, financed by both higher real incomes and broader access to credit.

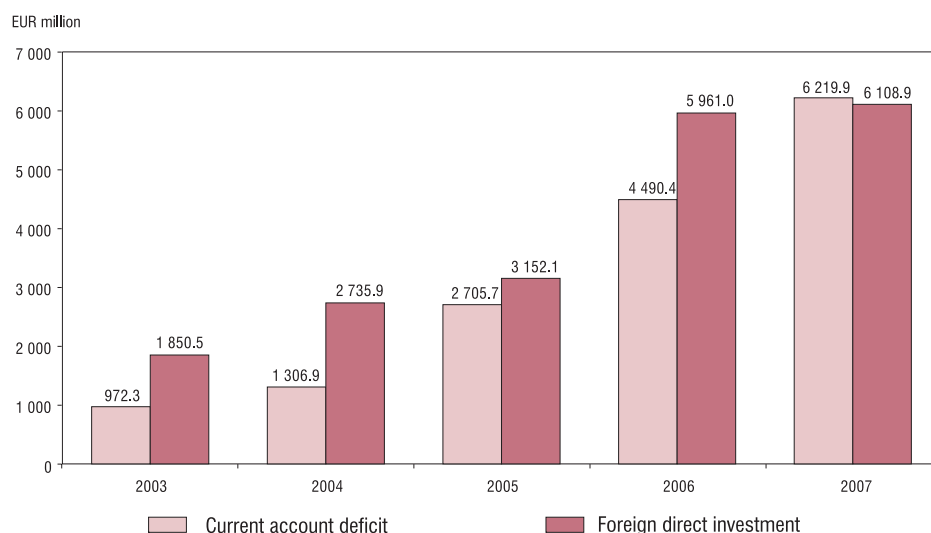
Bulgaria is the EU state with the lowest per capita income and accordingly - the lowest price level². Labour productivity growth in Bulgaria, which outpaces the average rate of labour productivity growth in EU, creates prerequisites for a parallel real adjustment of the income levels in the country, hence - of the price level, i.e. - for a higher inflation rate in Bulgaria than the EU average.

Among the factors constraining the growth of domestic prices, were the Government consumption and the formation of salaries in the budget-funded sector.

²Data of Eurostat for 2006 show a level of per capita GDP, according to the efficient demand standards, of 37.1 of the one of EU 27=100, and the levels of prices and productivity per employed person respectively 37.6 and 35.3.

Balance of Payments

The current account deficit reached EUR 6219.9 million in 2007, which is an increase of EUR 1729.5 million vs. the previous year. The negative development of this indicator was mainly due to the increased negative trade balance. What underlay the high negative balance on the current account was the fast growth of investment, which outpaced the growth of savings. This is a process typical of dynamically developing economies. The increased domestic demand, the credit activeness and relatively high return on investments were the factors accompanying the growing imbalance between investments and savings.



Current Account Deficit and Foreign Direct Investment

Sources: BNB and AEF

The financial account was positive and fully covered the current account deficit. Foreign direct investments reached EUR 6.1 billion for the year, the main factors for this being the high return on investments, the good investment climate, the dynamically developing economy and the political and economic stability.

Labour Market and Incomes

The trends observed in labour market development in the previous years continued in 2007 as well. The number of employed rose, while unemployment followed a stable trend of decrease, reaching values below 7% in the second half of the year. The creation of new jobs in the private sector of the economy and the increased level of involvement of the population in the labour force form the basis of the recorded employment growth by 4.6%³ on annual basis. Due to the mounting demand for labour at the primary labour market, the number of unemployed dropped to 240.2 thousand persons, reaching an average value for the year of 6.9% of the employable population.

Incomes from labour continued growing in 2007, both in nominal and in real terms, as a result of the sustainable economic growth and macroeconomic stability. Preliminary data of the National Statistics Institute⁴ show a nominal growth of the average labour salary by 19.7% and a real growth by 10.4% as compared to 2006, mainly due to the growth observed in the private sector. Incomes there rose by 21.6% nominally and by 12.1% in real terms.

The growth rate of labour productivity⁵ in the Bulgarian economy was also sped up in 2007 as compared to the previous year. The actual change in the indicator on annual basis stands at 3.3%, the biggest contributor for this being the industry.

Financial Sector

The foreign currency reserve of BNB increased by 33.7% on annual basis (i.e. by BGN 5.887 billion), to reach almost BGN 23.346 billion. The bank reserves made the highest contribution to this, since, as a result of the increased rate of minimum -required reserves they grew by 60.9% on annual basis. The increase of the Government's deposit due to the good budget performance also contributed to the increase of the foreign currency reserve. The 2007 yearend coverage of reserve money by the foreign currency reserve was 164.5% (with year average of 178.5%), which is 2 percentage points down from 2006 yearend level.

³ According to data of Workforce Monitoring (WM).

⁴ Annual monitoring of labour salaries and other labour costs.

⁵ Labour productivity is calculated as a ratio between GDP in fixed prices and the number of employed persons from the System of the National chart of accounts.

The banks' assets grew by 40% on annual basis, to reach BGN 59.1 billion at the end of 2007. The capital measurement framework and capital requirements of Basel II, introduced in 2007, compelled the banks to ensure additional capital coverage for the different types of risk, including the operational risk. As a result, the system's own resources increased by 52% in 2007 (28.9% in 2006). The overall capital adequacy of the banking system was 13.83% at the end of 2007 (against 14.5% at the end of 2006). The net profit in the banking system in 2007 marked an increase by 41.6% to BGN 1143.6 million, which is the highest value ever scored for the last ten years.

The administrative restrictions on lending activities of the banks were eliminated as of the beginning of 2007. This in turn resulted in a fast growth of lending to the private sector, which recorded not only high growth rates on annual basis, but growth of volumes as well. Even though the indicators for the credit portfolios have remained good, the fast growth of lending results in accumulation of credit risks in the system. In response to the increased liquidity of the credit markets BNB raised the minimum -required reserves for the banks from 8 to 12%, as of September 2007. However, the measures taken by BNB till the end of the year did not result in a sizeable slowing down of the credit expansion (the credit portfolios retained their good quality), but -reflected in the increase of interest rate levels both on the inter-bank market and on the deposits and credits for the private sector. The dynamics of the nominal interest rates was influenced by the inflation growth in the country, as well as by the instability on the international financial markets.

The international financial markets have started revealing strong instability since the middle of 2007, caused by the collapse of the mortgage bonds market in USA. This influenced the confidence in and the overall liquidity of the global markets and resulted in an increase of the interest rates. To date no significant adverse effects of the international crisis have been observed in the country. The banking system is still well capitalized and the credit portfolios are of good quality. A factor inter alia accounting for this is the minimum share of derivatives in the assets of the banking system and the fact that major Bulgarian banks are owned by banks, which have not declared losses as a result of the crisis. At the same time the credit price of the mother banks may be expected to rise, which in turn will affect the interest rates on deposits and credits.

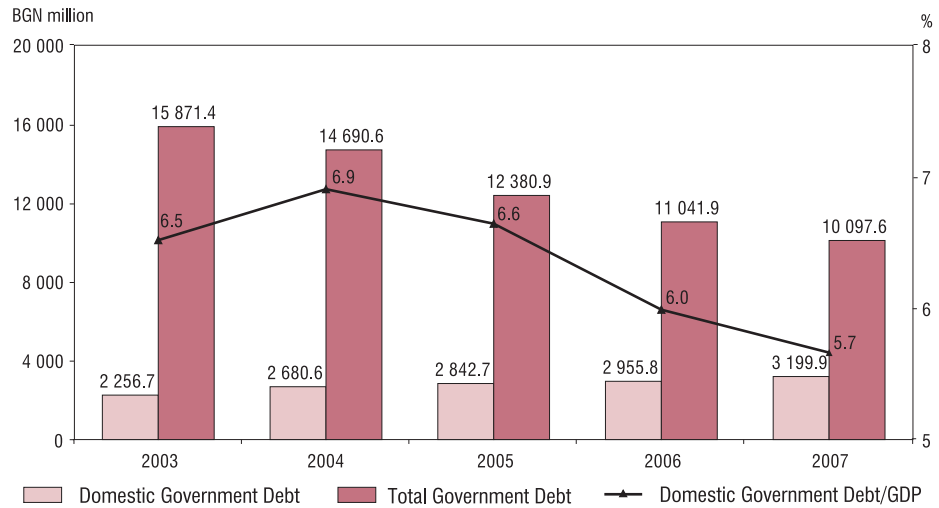
Domestic Government Debt

The past year saw a relatively favourable market environment for issuing of new Government securities. In line with the Government Debt Management Strategy, the development of the domestic market for GS has been the priority in the management of domestic debt in the last two years, aimed at increasing the share of domestic debt, while accounting for the parameters of the specific macroeconomic situation and the budget financing needs. Demand for government securities continued to exceed the amounts offered, as evident from the bid-to-cover ratios achieved. The following weighted average bid-to-cover ratios were achieved by type of issues - 3-month treasury bills, 3-year, 5-year and 10-year GS: 2.56, 2.73, 2.74, 2.86.

The offering of long-term GS in larger volumes resulted in extending the average original maturity of auctioned GS to 7 years and 4 months, which is 2 months longer than the one achieved during the previous year.

At 2007 yearend the nominal value of domestic government debt was BGN 3 199.9 million, which is 5.7% of GDP. This includes BGN 2 838.3 million debt on government securities issued on market principle and BGN 361.6 million debt on GS issued in the context of the structural reform. Expressed in percent, market-based government securities account for 88.7% of the total domestic government debt, and GS issued as part of the structural reform are 11.3%. Compared to 2006 domestic government debt saw an increase of BGN 244.1 million in nominal terms, which is due to the positive net financing achieved. Accordingly, compared to the total debt amount in the end of 2006, domestic debt has increased its share by approximately 5 percentage points.

Domestic Government Debt/GDP



Source: MF

Net domestic financing during the reporting year was positive and came to BGN 262.4 million. Accordingly, gross domestic financing was BGN 640.0 million, resulting from one issue in each of the main maturity segments, namely: 10-year government bonds in the amount of BGN 250.0 million, 5-year government bonds in the amount of BGN 180.0 million, 3-year government bonds in the amount of BGN 150.0 million. The short-term segment offered 4 issues of 3-month government bonds in the total amount of BGN 60.0 million.

Domestic Government Debt Dynamics

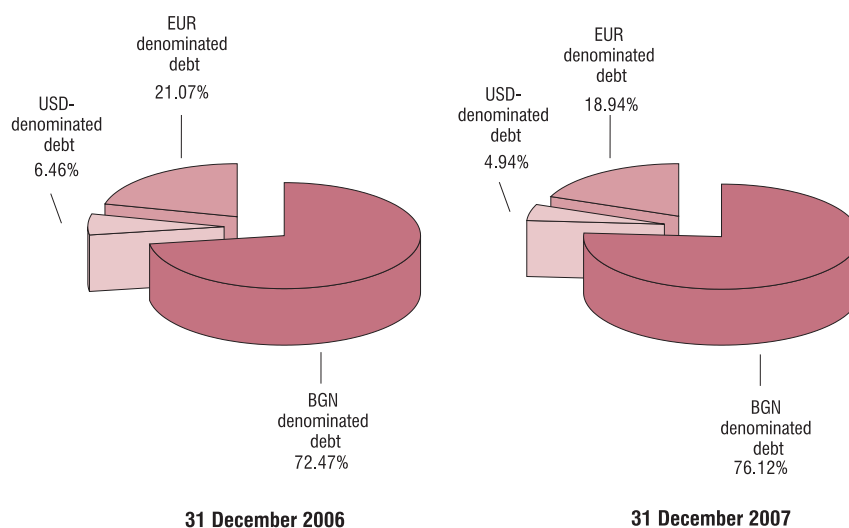
Debt Structure	Debt by 31 Dec. 2006 BGN million	Rise, BGN million	Fall, BGN million	Debt by 31 Dec. 2007 BGN million	Nominal rise/fall	%
Domestic Government Debt	2 955.81	640.00	377.63	3 199.91	244.10	8.26
1. Government securities issued	2 544.01	640.00	345.74	2 838.28	294.26	11.57
3-month	-	60.00	60.00	-	-	-
3-year	389.06	150.00	110.86	428.19	39.14	10.06
5-year	714.09	180.00	174.87	719.22	5.13	0.72
7-year	660.36	-	-	660.36	-	-
10-year	584.92	250.00	-	834.92	250.00	42.74
15-year	195.58	-	-	195.58	-	-
2. Structuural reform government securities	411.80	-	31.89	361.64	-50.16	-12.18
19-year	1.38	-	0.26	1.10	-0.28	-20.00
20-year	212.38	-	16.34	196.05	-16.34	-7.69
24-year	1.40	-	0.13	1.27	-0.13	-9.09
25-year	196.64	-	15.16	163.22	-33.42	-17.00

Note: All data at nominal values.

Source: MF

In line with the objectives laid down in the Government Debt Management Strategy, the currency structure of domestic government debt has undergone positive changes. The share of BGN-denominated debt has grown by 3.4 percentage points and reached 76.1% as a result of the offering on the domestic market of issues fully denominated in Bulgarian lev. This, together with the regular amortization payments on the euro and dollar bonds, has led to their shares reaching respectively 18.9% and 5.0%.

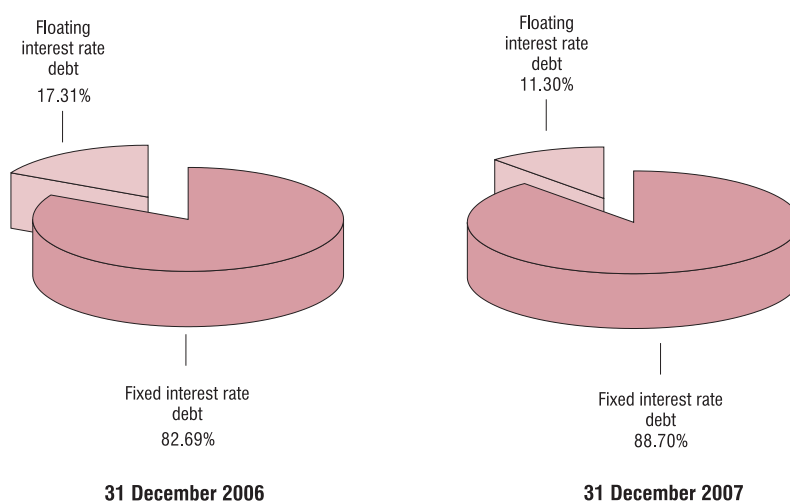
Currency Structure of Domestic Government Debt



Source: MF

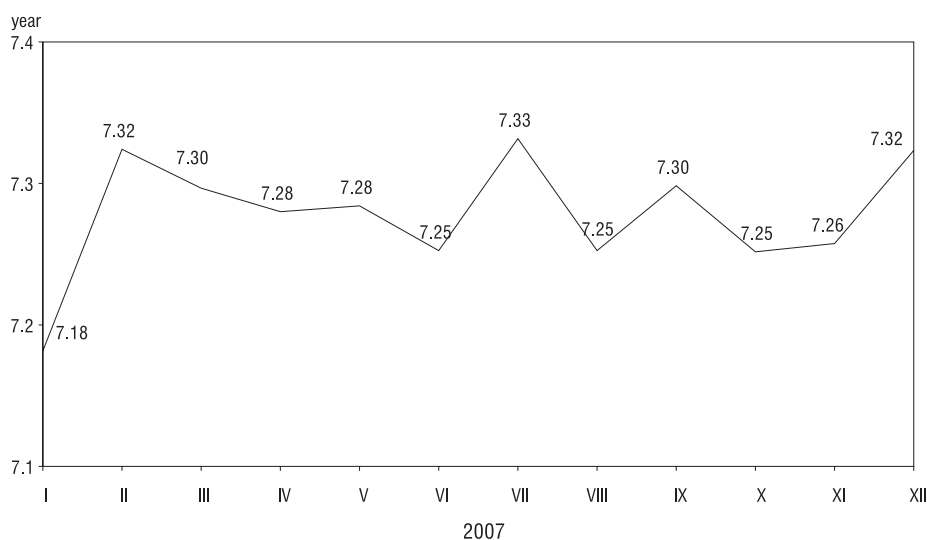
The interest structure continued to evolve in terms of increasing the debts with fixed interest coupons, which reached 88.7% against 82.7% at 2006 yearend. This is a result both from the new borrowing, which took place only at fixed rates and from the regular amortization payments on floating rate debts.

Interest Rate Structure of Domestic Government Debt



Source: MF

The reporting period also saw positive adjustments in the original maturity of government securities issued on auction. From an average original maturity of 7 years and 2 months as reported at 2006 yearend, in the end of 2007 this figure was already 7 years and 4 months.



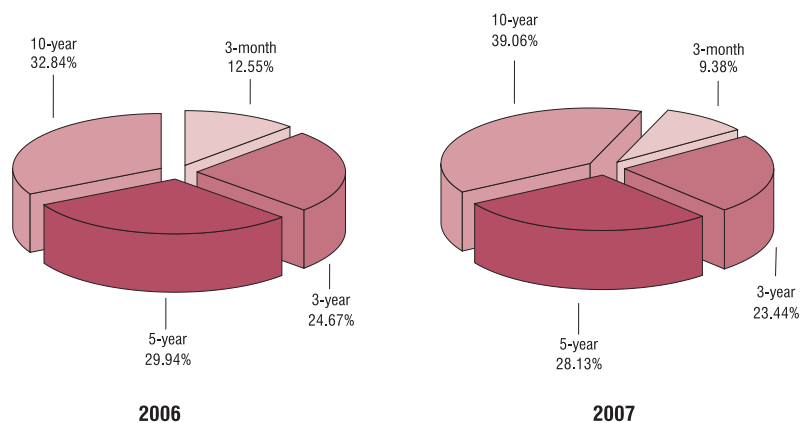
Average Original Maturity of Government Securities issued by auction end of the Month

Source: MF

Domestic Financing

Government securities in the total amount of BGN 640.0 million in nominal terms were issued in the domestic market during 2007. The tendency of offering GS on the basis of an issue calendar, pre-announced on monthly basis in the main maturity segments - 3- months, 3, 5, and 10 years - continued during the reporting year. Short-term securities were 9.4%, mid-term 51.6% and long-term 39.1% of the total amount of GS issued in 2007.

Maturity Structure of Government Bond and Bills issued per year

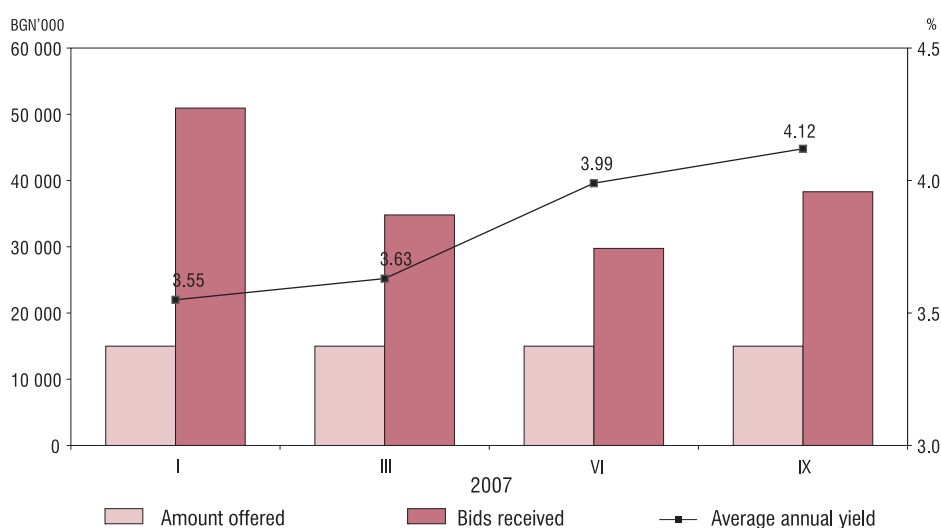


Source: MF

Issues of Treasury Bills

All government bills issued during the year were with 3-month maturity and totalled to BGN 60.0 million on nominal value basis. The periodicity of auctions for 3-month treasury bills was reduced in 2007 and four auctions for this type of bills were held. The lowest mean annual yield of 3.55% was achieved at the January auction and the highest one of 4.12% - at the auction held in September. All the orders placed for the amount put on the market came to BGN 153.8 million, meaning that the weighted average bid-to-cover ratio of the 3-month treasury bills sold was 2.56.

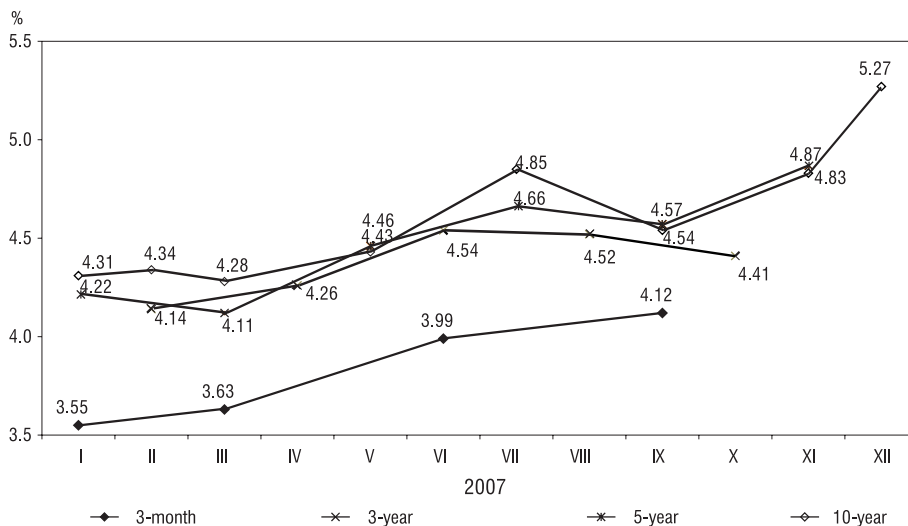
Three-month Treasury Bill Issues



Source: MF

Issues of Treasury Bonds

The nominal value of treasury bonds issued during the year stands at BGN 580.0 million. In terms of maturity structure, the treasury bonds offered were 3-, 5- and 10-year government bonds denominated in national currency. The prevailing offering of mid- and long-term bonds on one hand, and the demand for treasury bonds on the other hand, resulted in orders placed exceeding by far the amounts available for sale. The lowest bid-to-cover ratio was 1.45, recorded at the November auction for 5-year bonds and the highest bid-to-cover ratio of 4.02 was registered at the auction in February for 10-year bonds. In spite of the good bid-to-cover ratios achieved at all auctions during the year, the yield of all offered issues realized at the primary market showed a gradual increase. The main reason for this being the observed turbulences at the international financial markets and the global rise in the interest rate levels, which reflected in the increase of the interest levels at the local market as well. The bonds with 10-year maturity held the biggest share – 39.1% of the new treasury bonds issued in 2007, followed by the 5-year – 28.1% and 3-year bonds – 23.4%.

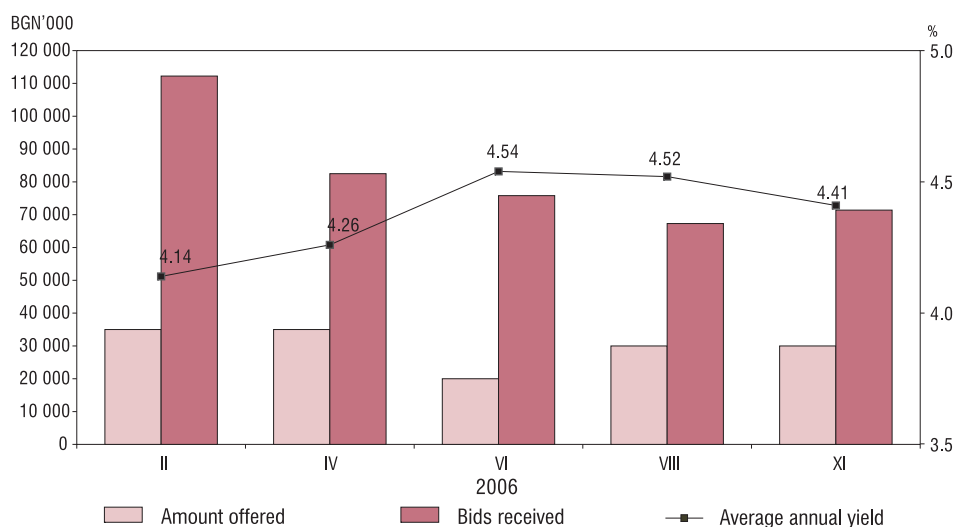


Yield of Primary Market Government Securities

Source: MF

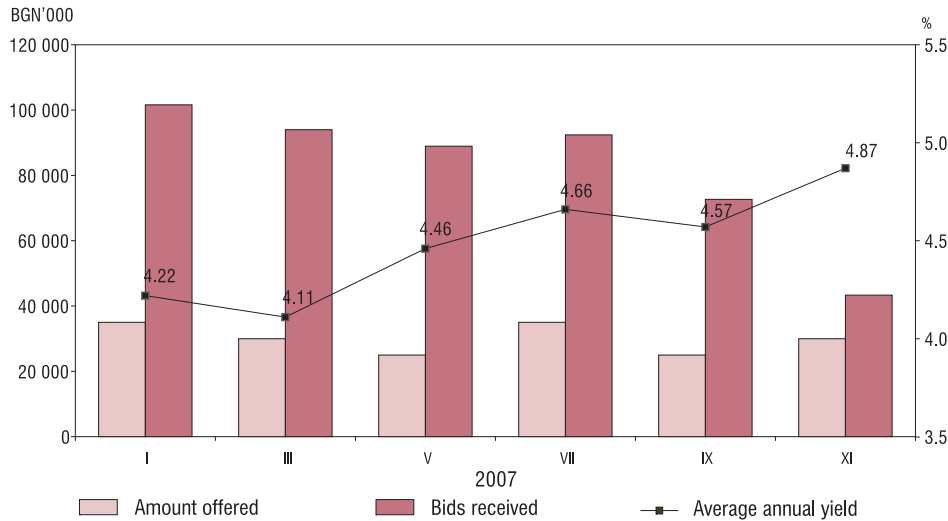
For 2007, five auctions were held to sell one issue of three-year bonds. The total amount offered during the year was BGN 150.0 million, and the subscribed amount BGN 409.3 million in nominal terms. The weighted average bid-to-cover ratio at the auctions carried out during the year marked a rise from 1.67 in 2006 to 2.73 in 2007. The average annual yield achieved at these auctions varied between 4.14% and 4.54%.

Auctions of Three-year Bond Issue



Source: MF

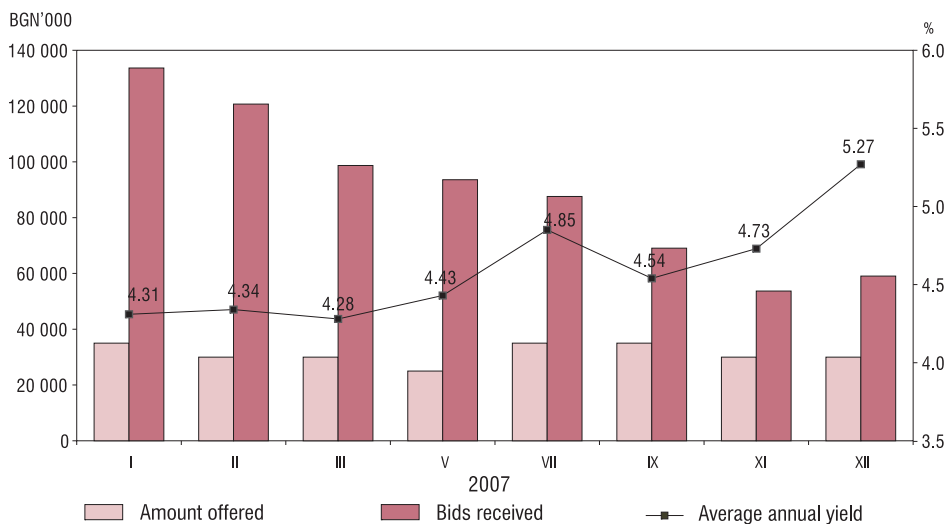
Five-year government securities were represented by one issue with a total nominal value of BGN 180.0 million, placed at six auctions. Demand for securities of five-year maturity was relatively high throughout the year - orders in the total amount of BGN 492.9 million were placed, resulting in weighted average bid-to-cover ratio for the six auctions of 2.74. Yield at the primary market for five-year government securities varied within the bracket of 4.11% to 4.87%.



Auctions of Five-year Bond Issue

Source: MF

One issue of ten-year bonds to a nominal value of BGN 250.0 million was launched during the year, placed at eight auctions. As a continuing tradition, the ten-year issue was the one most demanded by the market, with orders totalling to BGN 716.0 million and the average bid-to-cover ratio reaching 2.86. The first half of the year saw the greatest interest in this issue - as evidenced by the 4.02 bid-to-cover ratio at the second auction in February, which is the highest bid-to-cover ratio achieved at all auctions during the year. The yield in the primary market for the 10-year GS issue varied between 4.28% and 5.27%.



Auctions of Ten-year Bond Issue

Source: MF

Government Securities Issues in 2007

Auction date	Issue date	Issue number	Currency	Maturity (months)	Maturity date	Interest rate	Amount offered	Bids received	Bids approved at nominal value	Bids approved at sell price	Average price attained per 100 units nominal value	Minimum approved price per 100 units nominal value	Average annual yield (%)*	Maximum approved yield (%)
08.01.2007	10.01.2007	BG2040007218	BGN	120	10.01.2017	4.25	35 000 000.00	133 640 000.00	35 000 000.00	34 942 019.27	99.94	99.52	4.31	4.36
15.01.2007	17.01.2007	BG3010007006	BGN	3	17.04.2007	0.00	15 000 000.00	50 937 500.00	15 000 000.00	14 868 141.27	99.12	99.10	3.55	3.63
22.01.2007	24.01.2007	BG2030007111	BGN	60	24.01.2012	4.00	35 000 000.00	101 600 000.00	35 000 000.00	34 725 745.00	99.22	99.02	4.22	4.26
05.02.2007	07.02.2007	BG2030107119	BGN	36	07.02.2010	3.80	35 000 000.00	112 250 000.00	35 000 000.00	34 706 373.76	99.16	99.02	4.14	4.19
19.02.2007	21.02.2007	BG2040007218	BGN	120	10.01.2017	4.25	30 000 000.00	120 700 000.00	30 000 000.00	29 916 500.00	99.72	99.44	4.34	4.37
05.03.2007	07.03.2007	BG2030007111	BGN	60	24.01.2012	4.00	30 000 000.00	94 000 000.00	30 000 000.00	29 913 310.00	99.71	99.60	4.11	4.13
12.03.2007	14.03.2007	BG2040007218	BGN	120	10.01.2017	4.25	30 000 000.00	98 700 000.00	30 000 000.00	29 999 850.00	100.18	99.96	4.28	4.31
26.03.2007	28.03.2007	BG3010107004	BGN	3	28.06.2007	0.00	15 000 000.00	34 800 000.00	15 000 000.00	14 862 662.50	99.08	99.06	3.63	3.71
16.04.2007	18.04.2007	BG2030107119	BGN	36	07.02.2010	3.80	35 000 000.00	82 500 000.00	35 000 000.00	34 618 935.01	98.91	98.66	4.26	4.36
07.05.2007	09.05.2007	BG2040007218	BGN	120	10.01.2017	4.25	25 000 000.00	93 600 000.00	25 000 000.00	24 762 005.00	99.05	98.51	4.43	4.50
21.05.2007	23.05.2007	BG2030007111	BGN	60	24.01.2012	4.00	25 000 000.00	88 950 000.00	25 000 000.00	24 573 140.00	98.29	98.15	4.46	4.49
04.06.2007	06.06.2007	BG2030107119	BGN	36	07.02.2010	3.80	20 000 000.00	75 800 000.00	20 000 000.00	19 653 995.00	98.27	98.15	4.54	4.59
18.06.2007	20.06.2007	BG3010207002	BGN	3	20.09.2007	0.00	15 000 000.00	29 750 000.00	15 000 000.00	14 847 876.25	98.99	98.98	3.99	4.03
09.07.2007	11.07.2007	BG2040007218	BGN	120	10.01.2017	4.25	35 000 000.00	87 600 000.00	35 000 000.00	33 582 195.00	95.95	95.40	4.85	4.93
23.07.2007	25.07.2007	BG2030007111	BGN	60	24.01.2012	4.00	35 000 000.00	92 402 198.00	35 000 000.00	34 142 345.01	97.55	97.19	4.66	4.75
06.08.2007	08.08.2007	BG2030107119	BGN	36	07.02.2010	3.80	30 000 000.00	67 300 000.00	30 000 000.00	29 525 880.00	98.42	98.18	4.52	4.63
10.09.2007	12.09.2007	BG3010307000	BGN	3	12.12.2007	0.00	15 000 000.00	38 299 500.00	15 000 000.00	14 845 583.70	98.97	98.94	4.12	4.24
17.09.2007	19.09.2007	BG2040007218	BGN	120	10.01.2017	4.25	35 000 000.00	69 050 000.00	35 000 000.00	34 394 555.00	98.27	97.16	4.54	4.69
24.09.2007	26.09.2007	BG2030007111	BGN	60	24.01.2012	4.00	25 000 000.00	72 650 000.00	25 000 000.00	24 489 605.00	97.96	97.82	4.57	4.61
22.10.2007	24.10.2007	BG2030107119	BGN	36	07.02.2010	3.80	30 000 000.00	71 400 000.00	30 000 000.00	29 634 515.00	98.78	98.48	4.41	4.55
12.11.2007	14.11.2007	BG2040007218	BGN	120	10.01.2017	4.25	30 000 000.00	53 700 000.00	30 000 000.00	28 865 980.00	96.22	94.05	4.83	5.14
26.11.2007	28.11.2007	BG2030007111	BGN	60	24.01.2012	4.00	30 000 000.00	43 350 000.00	30 000 000.00	29 090 110.00	96.97	96.00	4.87	5.14
03.12.2007	05.12.2007	BG2040007218	BGN	120	10.01.2017	4.25	30 000 000.00	59 050 000.00	30 000 000.00	27 971 780.00	93.24	92.51	5.27	5.38
								640 000 000.00	1 772 029 198.00	640 000 000.00	628 933 101.77			

*Government securities yield has been calculated according to ISMA-International Yield.

Source: MF

Domestic Debt Service

All payments made in 2007 came to BGN 520 million, of which BGN 376.3 million in amortization payments and BGN 143.7 million in interest payments. Within the interest payments, BGN 127.3 million were interests and discounts on treasury bills/bonds and BGN 16.4 million were interest payments on GS issued in support of structural reform.

Government Securities Issued for Structural Reform

The nominal value of GS issued for structural reform came to BGN 361.6 million at 2007 yearend. The reduction of the debt by BGN 50.2 million compared to the previous year was the result of regular amortization payments and foreign exchange rate fluctuations.

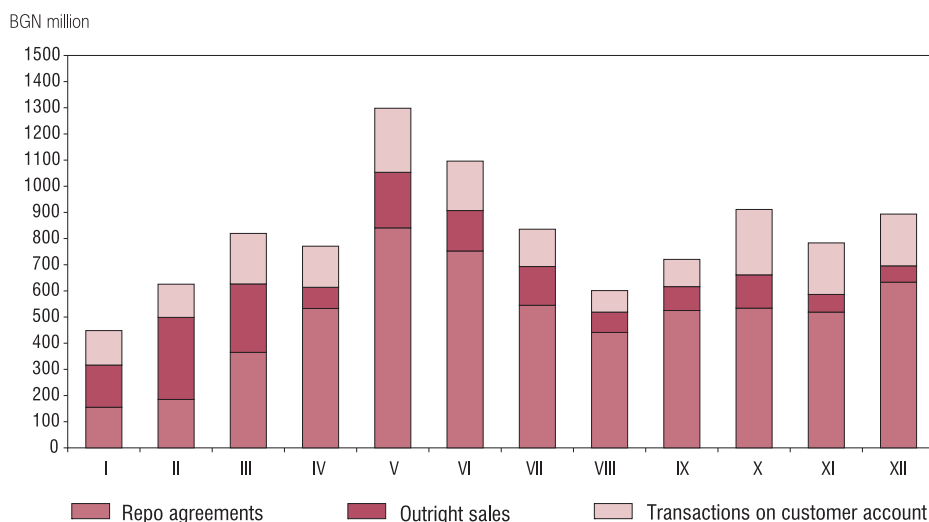
Principal repayments during the year amounted to BGN 31.9 million.

Interest payments on GS issued in support of structural reform came to BGN 16.4 million at 2007 yearend.

2007 GS Secondary Market Overview

2007 witnessed a dynamic secondary market for government bonds and bills with a pronounced demand for medium- and long-term bonds. The primary dealers used the GS as a risk-free and profitable investment and also as a means to cover their current liquidity needs.

In 2007 the secondary market registered 6,919 deals with a total nominal value of BGN 19,825.6 million. The greatest portion of these (50.5 %) were GS block/unblock transactions, followed by repo transactions (30.4 %), transactions with, or on account of, customers (10.2 %), final buys/sales (8.9 %). 2007 saw 1,783 repos, 600 final buys/sales and 1,771 transactions with, or on account of, customers. There were 2,765 GS block/unblock transactions, of which 2,728 were made to secure government money held by banks and 37 related to raising pledges on government securities. No privatisation deals with GS were registered during the year.



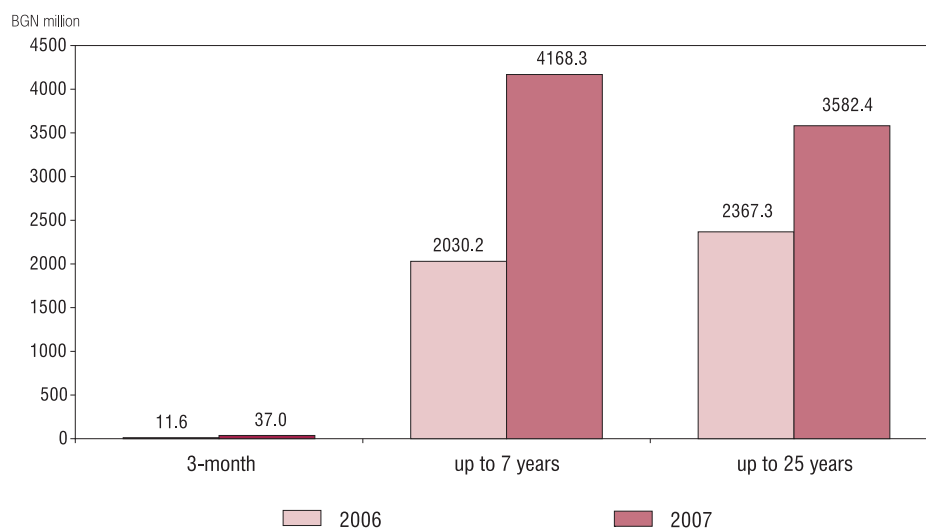
Volume of Transactions in Tradeable Government Securities

Notes: 1. Repo agreements include reverse repo agreements and those concluded during the current day.
2. Transactions in government securities denominated in foreign currency are in BGN at BNB exchange rates of the respective currency on the day of transaction.

Source: BNB

Maturity Structure of Government Securities Transactions on the Interbank Market

Notes: Transactions in government securities denominated in foreign currency are in BGN at BNB exchange rate quoted for the last business day of corresponding period.



Source: BNB

In 2007 GS with a nominal value total of BGN 9,813.6 million were traded on the secondary market and 4,154 deals were registered related to trade in GS. Again, the traded volumes followed an uneven distribution pattern over the year. As in previous years, the liveliest trade occurred during days for acquisition of new GS issues and at times when the budget-funded organisations were actively switching their positions at the banks.

The secondary GS market experienced negative impacts from a lasting tendency, which was observed throughout the year, namely that more and more government securities were blocked to secure government money held by banks - the average daily amount of these blocked securities in 2006 was BGN 1,132.63 million by nominal value and in 2007 it grew to BGN 1,447.70 million by nominal value¹. In 2007 the medium-term government securities were the most widely traded in the secondary market - they accounted for 53.5% of all trade in that market, long-term bonds also performed well and accounted for 46.0%, while treasury bills scored a marginal 0.5%².

¹ The BGN equivalent of the GS issues, denominated in foreign currency, is calculated using the BNB exchange rate for the relevant currency valid for 31.12. of the respective year.

² Data include final buys/sales and repos with or without any transactions thereunder.

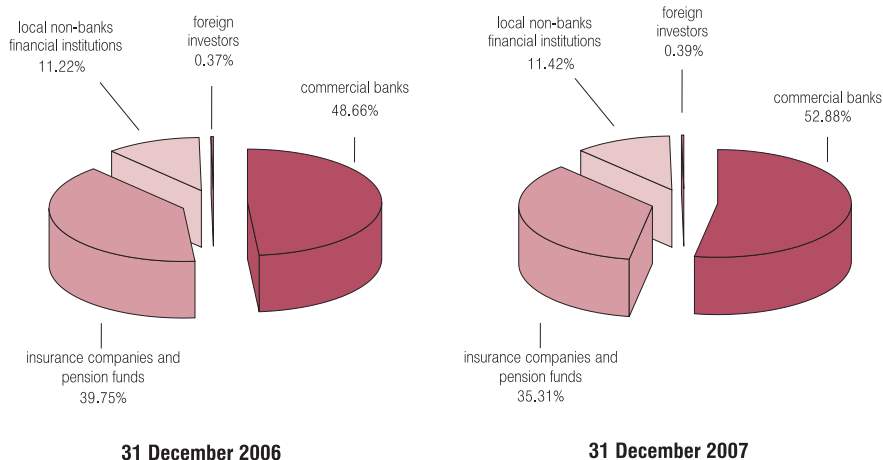


Holders of Government Securities

- Notes:**
1. Including frozen government securities.
 2. Including target issues earmarked for individuals investors.
 3. Preliminary data of the BNB and government securities primary dealers.
 4. The lev equivalent of government securities denominated in foreign currency is based on BNB exchange rate of foreign currencies against the Bulgarian lev quoted on 31 December 2007.

Source: BNB

The structure of GS holders remained relatively stable in 2007 as well. Banks again took the largest segment of GS issued to finance the budget (68.1%), followed by insurance companies and pension funds (17.8%), local non-banking financial institutions, companies and individuals (12.7%) and foreign investors (0.6%). Banks again accounted for the greatest share of government securities issued in support of structural reform (52.9%), followed by insurance companies and pension funds (35.3%), local non-banking financial institutions, companies and individuals (11.4%) and foreign investors (0.4%).



Holders of Structural Reform Government Securities

- Notes:**
1. Including frozen government securities.
 2. The lev equivalent is based on BNB exchange rate quoted for 31 December of the respective year.
 3. Preliminary data of the BNB and government securities primary dealers.

Source: BNB

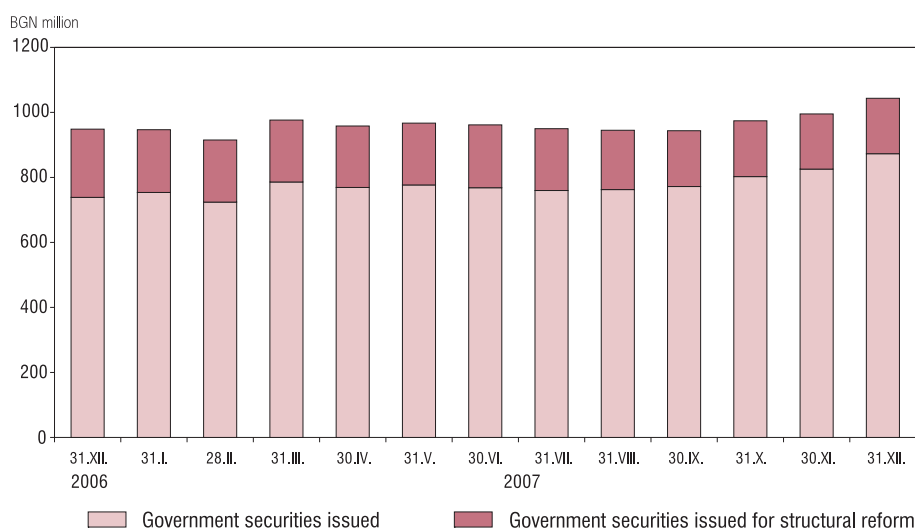
2007 GS Secondary Market Overview

At 2007 yearend, investments of non-banking financial institutions, companies and individuals in government securities issued to finance the budget recorded a net growth of 18.2%, while these investments in bonds issued for structural reform were down 18.7% net vs. 2006 yearend levels.

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

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

Source: BNB



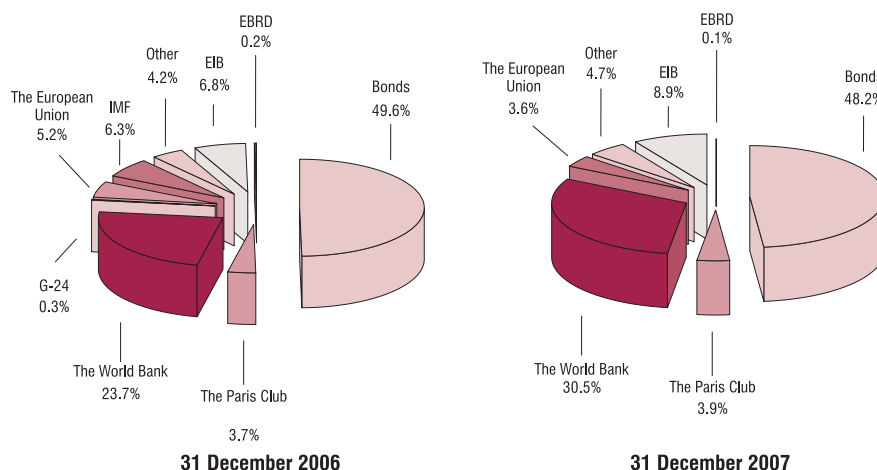
External Government Debt

At the end of 2007 the external government debt amounted to EUR 3,526.7 million in nominal terms - a nominal reduction of EUR 607.6 million from the 2006 level. The main reasons for the reduction of the external government debt and for preservation of the positive tendency of recent years in respect of the external debt level are due to the GDP growth, the regular debt repayments during the year and the premature debt extinction operations. The above factors underlie also the reduction of the external government debt/GDP ratio by 4.2%.



The policy pursued in the area of new borrowing, the premature extinction of external government debt and the regular payments made during the year have also a leading role for the changes of the debt structure in terms of lenders. The government debt to the IMF was repaid in full. The maturity of the Eurobonds issue of nominal value EUR 250 million has resulted in reduction of the weight of the Bonds in the overall amount of external government debt by 1.4 percentage points and reduction of the debt to the European Union by 1.6 percentage points, thus increasing the weight of the debt to the World Bank (WB) and the European Investment Bank (EIB), which are other major lenders of the Republic of Bulgaria. 2007 yearend figures demonstrate that the largest external government debt share goes to bonds issued at international capital markets - 48.2%, followed by the debt to the WB - 30.5%. Debt to miscellaneous lenders takes less than 10.0% of the overall debt structure.

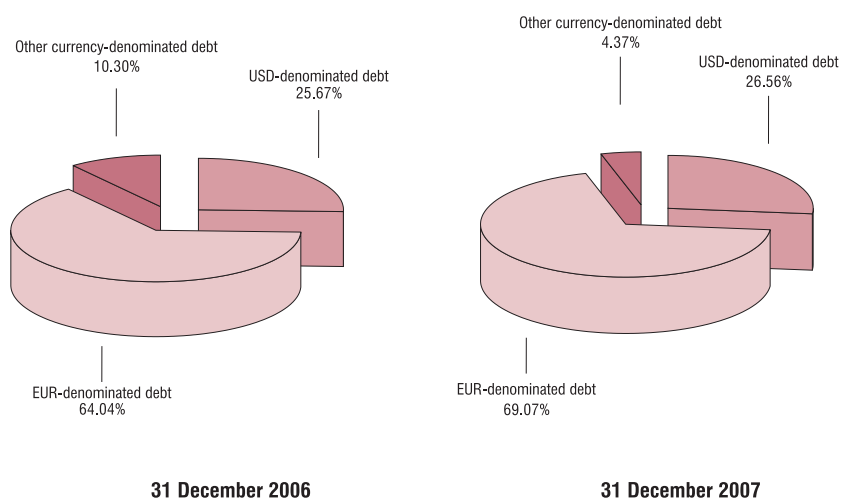
External Government Debt Creditor



Source: MF

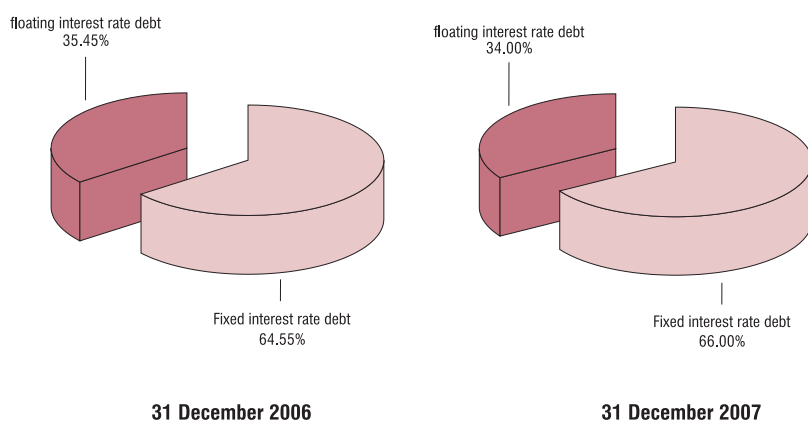
In 2007 the tendency of recent years towards increasing Euro debt on the account of debt in US Dollars and other currencies continued in respect of the currency structure. Against end of 2006 data, the Euro debt share rose by 5.0 percentage points, reaching 69.1%. This is due to reduction of other currency debts from 10.3% to 4.4%. In 2007 two premature external government debt extinction operations took place - repayment of the loan to the Confederation of Switzerland to the amount of EUR 14.3 million and the payment in full of the IMF debt. During the reported period, the Special Drawing Rights by-backs (down payments) totalled EUR 254.8 million, including the payment in full of the IMF debt in April to the amount of EUR 230.0 million. The payments to all other external creditors were made in accordance with the provided for in the contracts payment schedules.

Currency Structure of External Government Debt



Source: MF

Borrowing policy in 2007 was centred around procurement of financial resources at fixed interest rates with a view to reducing the impact of floating interest rates on external government debt service costs. At the end of the year the debt at fixed coupons was 66.0% vs. 34% debt at floating rates. To a large extent the change was also due to the advance repayment of the debt to the IMF and the one to the Government of the Confederation of Switzerland, which were both at floating rates.



Interest Rate Structure of External Government and Government Guaranteed Debt

Source: MF

External Financing

The new external financing in 2007 amounted to EUR 227.5 million. The main part of the receipts comes from official international lenders such as the WB and the EIB. Most of the disbursements made during the year came in the framework of already agreed government investment loans, financing infrastructure projects and social programmes. In 2007 the receipts from government loans amounted to EUR 114.0 million and from government investment loans were in the total amount of EUR 113.5 million.

Net external financing for the year is negative and comes to EUR 483.2 million. This is mainly due to premature repayments of government external debt totalling EUR 244.3 million, as well as to the payments under bonds issued at international capital markets because of the maturity of an issue with nominal value of EUR 250 million. In April 2007 all tranches of the IMF loan totalling EUR 230.0 million were prepaid. The debt to the Government of the Confederation of Switzerland was fully liquidated in October. Positive financing has been achieved with the government investment loans (GIL) - EUR 113.5 million. At the end of 2007 the nominal debt under GIL was EUR 637.4 million; including EUR 441.3 GIL administered under the budgets of ministries and EUR 196.1 million GIL with a company as an end beneficiary. The weight of GIL debt is 18.1% of the external government debt and continues to grow. For 2007 the growth was 7.7%. The upward trend will be maintained due to absorption of funds under launched projects and as a result of contracting new external loans to finance investment projects and social programmes.

New External Financing and External Government Debt Repayments in 2007

(EUR million)

Structure	Loans or tranches	Repayments, incl.		
		Principal	Interest	Total
External Government debt	227.5	710.7	242.8	953.4
I. Bonds	–	247.1	162.0	409.2
1. Bonds	–	247.1	162.0	409.2
II. Loans	227.5	463.5	80.7	544.3
1. Paris Club	–	12.6	5.0	17.6
2. World Bank	114.0	26.3	33.1	59.3
2.1. World Bank	114.0	22.0	31.8	53.8
2.2. JBIC /JEXIM/	–	4.3	1.3	5.5
3. G–24	–	14.3	0.6	14.9
4. European Union	–	87.5	7.6	95.1
5. IMF	–	254.8	6.6	261.4
6. Other	–	12.6	1.9	14.5
7. Government investment loans	113.5	51.9	25.0	76.9
7.1. World Bank	29.5	11.7	7.3	19.0
7.2. EIB	68.0	30.5	13.6	44.1
7.3. EBRD	–	5.5	0.4	6.0
7.4. Other	16.0	4.2	3.7	7.9
8. Called government guarantees	–	3.6	0.9	4.5
8.1. World Bank	–	3.6	0.9	4.5

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

Source: MF

External Government Debt Service

The decreasing absolute value of the external government debt, combined with the accomplished interest rate and currency structure - with prevalence of Euro denominations and fixed coupon rates - have mitigated the market risks and have also reduced the costs for attending to the outstanding debt.

In 2007 the amount of interest payments was influenced by the dropping US Dollar exchange rate and by the lower 6-month LIBOR levels for the US Dollar. That affected seriously the interest payments made during the year owing to the limited share of floating coupon debts. Interest payments during the year were EUR 242.8 million, or 10.7% less than those made in 2006. The overall reduction is due, inter alia, to the negative net external financing obtained as a direct result of premature debt repayments and regular extinction of outstanding debts. Most interest payments in 2007 went to bonds issued at international capital markets - EUR 162.0 million. Important interest payments were also made on loans from international organisations and institutions - EUR 47.3 million (this includes payments to the World Bank, Japan Bank for International Cooperation (JBIC), the European Union and the International Monetary Fund (IMF), followed by interest on government investment loans - EUR 25.0 million, loans from other states - EUR 5.6 million (including what is known as 'the Paris Club', G-24, etc.).

External Government Debt

(EUR million)

Structure	by 31 December 2006	by 31 December 2007
External Government debt	4 134.3	3 526.7
I. Bonds	2 050.2	1 700.3
1. Bonds	2 050.2	1 700.3
II. Loans	2 084.1	1 826.5
1. Paris Club	151.1	138.5
2. World Bank	787.0	870.5
3. G-24	14.3	-
4. European Union	215.0	127.5
5. IMF	258.9	-
6. Other	44.2	31.6
7. Government investment loans	588.6	637.4
7.1. World Bank	168.2	185.7
7.2. EIB	282.8	314.5
7.3. EBRD	8.1	2.2
7.4. Other	129.6	135.0
8. Called government guarantees	25.0	21.0
8.1. World Bank	25.0	21.0

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

Source: MF

Government Debt

The economic and fiscal policy implemented over recent years is focused on the growth potential and ensuring sound budgetary positions. The main priorities of the fiscal policy are maintenance of macroeconomic stability in a Currency Board Arrangement environment and in the light of Bulgaria's EU membership; fostering sustainable economic development; and implementation of priority policies in the public sector subject to the best use of the available budget resources.

The government debt management policy implemented in this environment has taken full account of the provided for in the Government Debt Management Strategy for the Period 2006 - 2008 objectives and the instruments envisaged for their realisation. This on its turn leads to subsequent positive adjustments both of the absolute debt and its weight vs. GDP and of all the other monitored and analysed debt indicators.

The improvements achieved in the government debt area during the past year should be considered in the context of the stringent fiscal policy implemented, based on a balanced budget or surplus, as well as on the macroeconomic stability maintained in a Currency Board Arrangement environment. In 2007 the budget surplus was 3.5 % of GDP, which was attained mainly through revenue over performance and by cutting costs through triggering the caps embedded in the budget and saving a large portion of the surplus revenue. The stable fiscal reserve levels made it possible to repay ahead of time government debt to international creditors in 2007.

At the end of 2007 the nominal government debt amounted to EUR 5,162.8 million, of which EUR 3,526.7 million external and EUR 1,636.1 million domestic. The debt reduction in absolute terms compared to 2006 was EUR 482.8 million, due both to the regular debt repayments and the premature debt extinction operations during the year. The government debt to GDP ratio at the end of 2007 was 17.9 %, which is a reduction of 4.5 percentage points compared to 2006 due mainly to the stable economic growth and the prudent fiscal policy.

Dynamics of Government Debt between 1999–2007¹

	(EUR million)									
Structure	1999	2000	2001	2002	2003	2004	2005	2006	2007	
Domestic government debt	1 060.3	906.2	951.7	1 086.1	1 153.8	1 370.6	1 453.5	1 511.3	1 636.1	
Budget deficit financing										
government securities	450.9	491.4	554.6	754.9	879.2	1 130.5	1 214.3	1 300.7	1 451.2	
Structural reform government securities	495.5	389.9	382.4	321.7	270.4	240.0	239.1	210.5	184.9	
Government securities issued under LSPDACB of 1996	113.9	24.9	14.6	9.4	4.2	-	-	-		
External government debt	8 587.1	9 159.5	9 096.6	7 685.9	6 961.1	6 140.6	4 876.8	4 134.3	3 526.7	
Brady bonds	4 954.6	5 347.7	5 400.0	2 398.7	1 890.1	1 164.1	-	-	-	
Bonds	-	-	250.0	2 310.0	2 091.4	2 018.3	2 162.5	2 050.2	1 700.3	
Paris Club	811.1	645.3	433.5	284.5	218.9	176.3	163.7	151.1	138.5	
World Bank	820.5	889.6	941.1	836.1	870.0	930.6	1 020.0	787.0	870.5	
G-24	70.9	60.8	53.8	48.9	42.0	34.6	36.9	14.3	-	
European Union	400.0	460.0	390.0	390.0	350.0	350.0	287.5	215.0	127.5	
IMF	1 126.5	1 309.4	1 183.4	990.9	940.2	868.7	559.5	258.9	-	
Other	147.7	136.6	136.6	129.2	125.2	125.2	62.3	44.2	31.6	
Government investment loans	207.8	251.0	240.3	236.7	383.0	428.8	549.2	588.6	637.4	
Called government guarantees	48.1	59.2	67.8	61.0	50.2	43.9	35.2	25.0	21.0	
Total government debt	9 647.4	10 065.7	10 048.3	8 771.9	8 114.9	7 511.2	6 330.2	5 645.6	5 162.8	
GDP (BGN million)	23 790.4	26 752.8	29 709.2	32 401.6	34 627.5	38 822.6	42 797.4	49 090.6	56 519.8	
GDP (EUR million)	12 163.9	13 678.5	15 190.1	16 566.7	17 704.8	19 849.7	21 882.0	25 099.6	28 898.1	
Total government debt/GDP	79.3%	73.6%	66.2%	52.9%	45.8%	37.8%	28.9%	22.5%	17.9%	

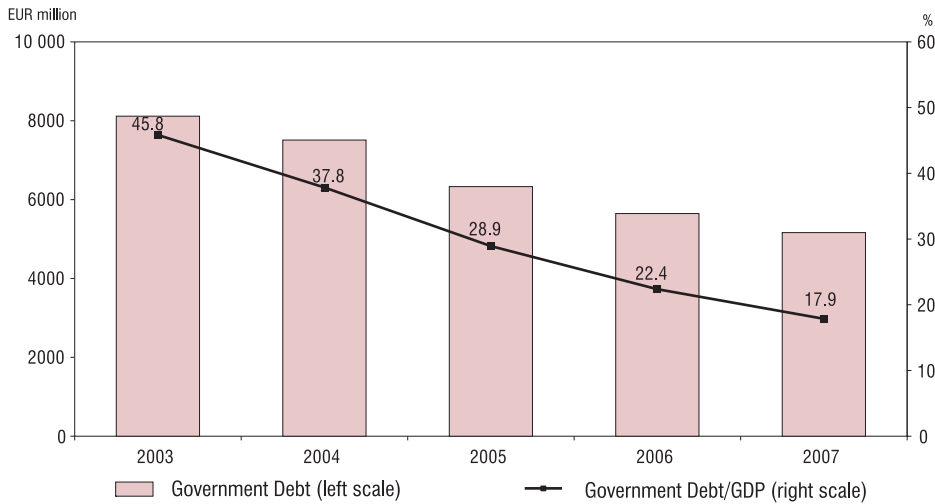
Notes: 1. Nominal figures.

2. Euro conversion at BNB central rates for the closing business day of each period.

3. GDP data from the National Statistics Institute.

Sources: MF and NSI

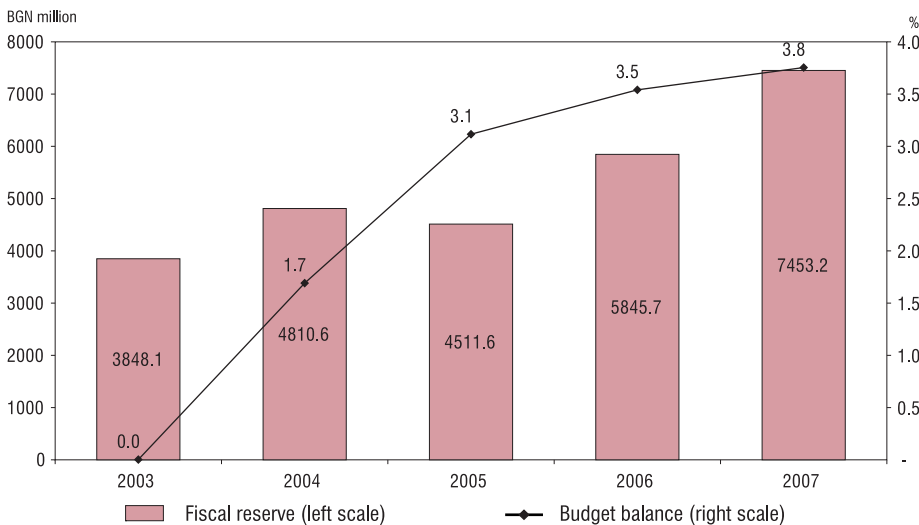
Dynamics of Government Debt



Sources: MF and NSI

The large fiscal reserve (BGN 7.5 billion translated at projected exchange rates as at 31.12.2007) and the reported budget surplus of 3.5% of GDP made it possible to repay in 2007 ahead of time BGN 0.5 billion in total government debt to international creditors. The net issue was positive mainly due to the GS issued on the local market.

Budget Balance and Fiscal Reserve

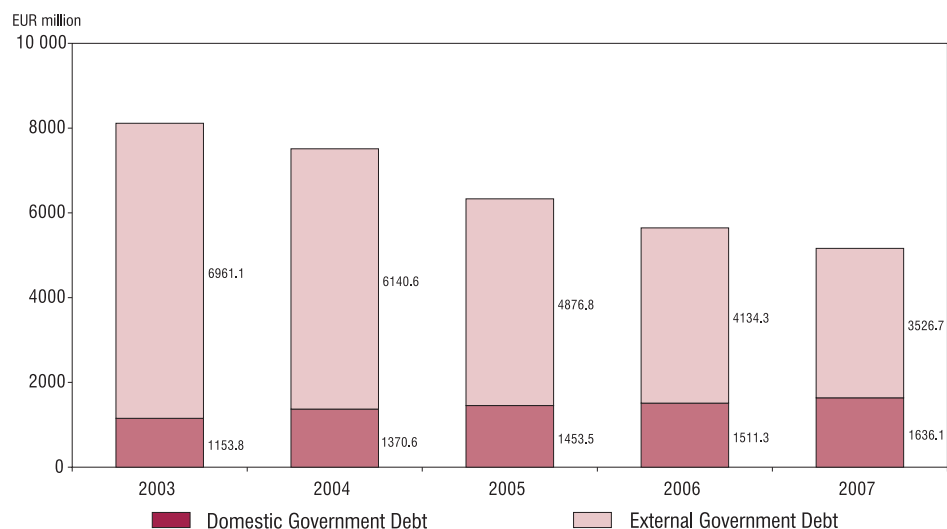


Sources: MF

During the past year the domestic government debt has increased by around EUR 124.8 million, due to the positive net financing by GS issued on the local market. Compared to the overall government debt the share of domestic government debt has increased by almost 5 percentage points for the period December 2006 - December 2007. As a percentage of GDP domestic government debt has reached 5.7%. The serious drop is due first and foremost to the GDP growth.

In 2007 the external government debt dropped by EUR 607.6 million as a result of the regular amortization, the exchange rate fluctuation and mainly the advance repayment of the debt of the Republic of Bulgaria to foreign lenders such as the International Monetary Fund (IMF) and the Confederation of Switzerland.

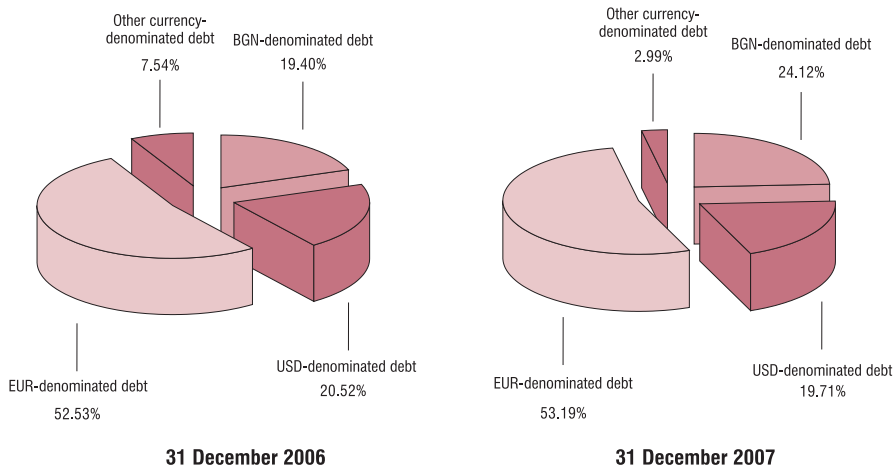
Dynamics of Domestic Government and External Government Debt 2003–2007



Source: MF

Continuation of the tendency to increase the share of Euro and BGN debt instruments and to reduce those denominated in US Dollars and other currencies is observed in respect of the government debt currency structure. Compared to 2006 yearend data Euro debt has risen from 52.5% to 53.2% and the BGN debt - from 19.4% to 24.1%, while US Dollar debt has dropped by 0.4 percentage points to 19.7% and other currency debt has dropped by 4.6 percentage points reaching 3.0%. The reported change resulted from the positive net domestic financing in BGN, the regular repayments of US Dollar debt and the premature debt extinction operations of mainly SDR and other currency denominated debt.

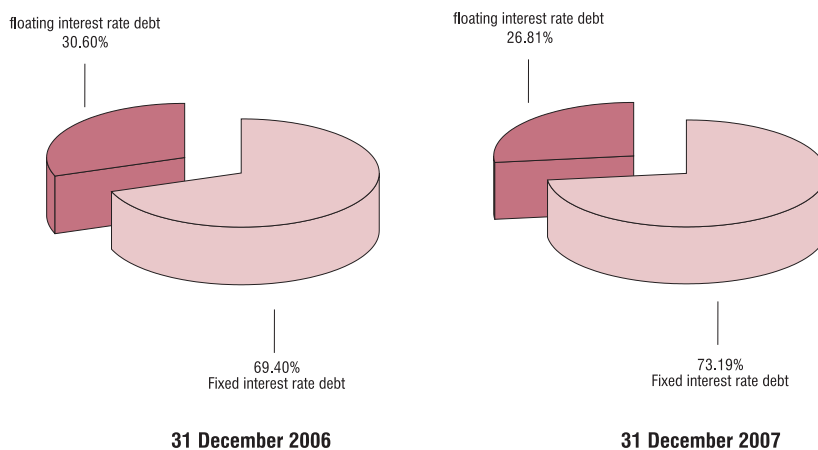
Currency Structure of Government Debt



Source: MF

In 2007 debt at fixed interest rates increased by 3.8%, reaching at the end of the period 73.2% of the overall government debt. The change is due to the GS at fixed interest coupons issued on the local market, sticking in general to borrowing at fixed interest rates and repayments during the year of domestic and external debt at floating interest rates. This has mitigated the impact of floating interest rates to 26.8%, and contributed to better predictability of the budget resources required for government debt service.

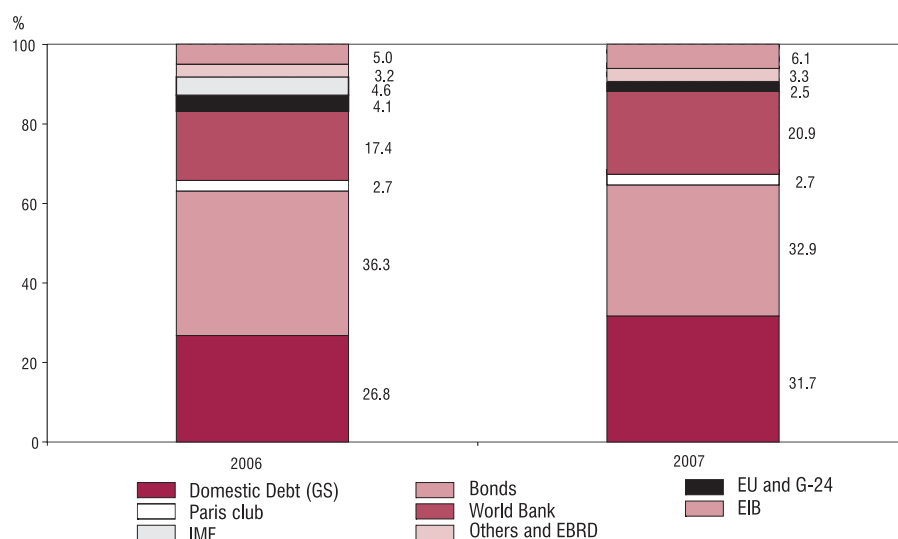
Interest Rate Structure of Government Debt



Source: MF

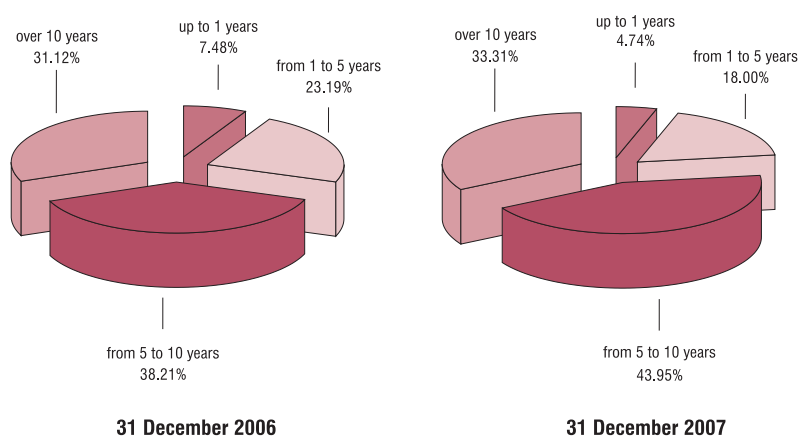
At the end of 2007 liabilities to foreign lenders in relative terms had the greatest share in the debt structure per creditor type; they represented 68.3% of the overall debt. Although a strong figure, these liabilities follow a downward tendency dropping by 4.9% in the period December 2006 – December 2007. This downslide results mainly from the negative net external financing and, respectively, the net positive domestic financing, but has also been impacted by the US Dollar devaluation. Bonds have the greatest share (including Global and Eurobonds) – 32.9%, followed by the World Bank (WB) – 20.9% and European Investment Bank (EIB) – 6.1%. The share of GS issued on the local market is 31.7%.

Debt Structure Per Creditors



Source: MF

There are several major factors influencing the debt maturity structure dynamics. The changes in the residual maturity of the debt are dependent on the repayments of external government debt long-term credits, increasing the volume of GS with residual maturity of 5 and 10 years issued on the local market and shifting between maturity groups of large in volume liabilities due to approaching maturity dates. Compared to previous year the volumes of bonds with maturity over 10 years increased considerably – 33.3%, as well as those with maturity from 5 to 10 years – 44.0%. Debt with maturity less than 5 years accounts for 22.7%.

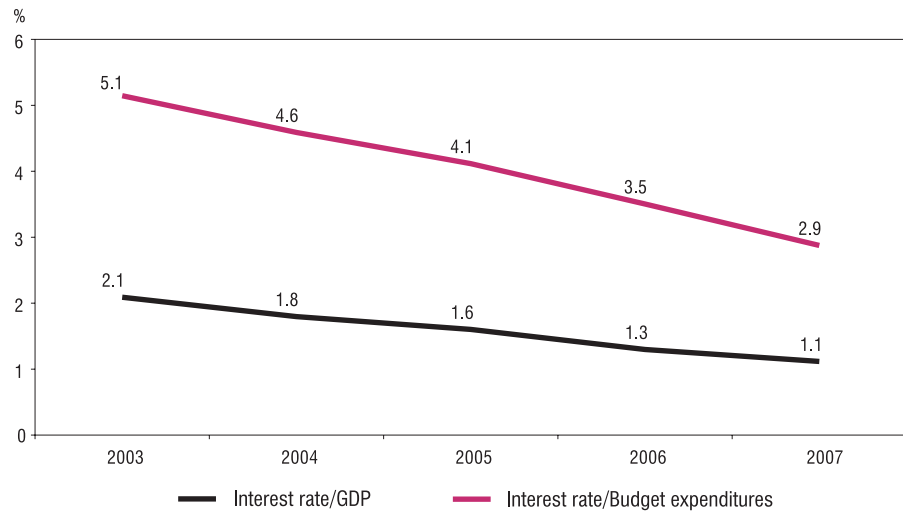


Residual Maturity of the Government Debt

Source: MF

The government debt payments during the year amount to EUR 1,219.3 million or an increase of EUR 23.7 million compared to the previous year, including principal – EUR 903.1 million and interest – EUR 316.2 million. In 2007 too the debt service costs in absolute and relative terms remained at approximately the same level. Debt service costs/GDP ratio is 1.1% – a reduction of 0.2% compared to the last yearend figure. For the same period interest rate expenses were 2.9% of the overall budget expenditures – a reduction of 0.6% compared to 2006. To a large extent this is due to debt reduction and GDP growth, and the US Dollar devaluation.

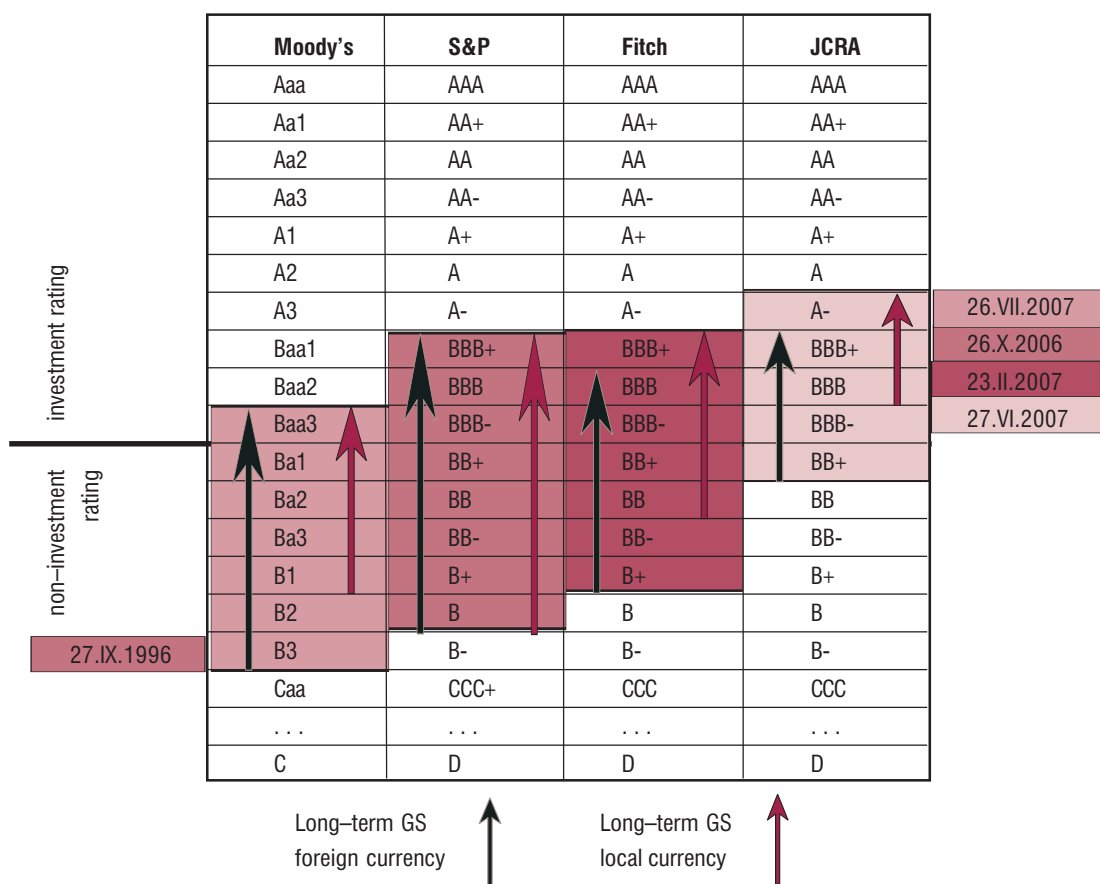
Interest Rate Expenses



Sources: MF and NSI

The debt reduction, the progress in a number of macroeconomic indicators, compensating the deterioration of others (current account deficit, credit growth, etc.), as well as the prudent fiscal policy contributed to the affirmation of Bulgaria's credit rating by the four credit rating agencies – Moody's, Standard & Poor's, Japan Credit Rating Agency and Fitch.

Credit Ratings Range for Bulgaria 2006–2007



Source: MF

At the end of 2007 the consolidated government debt amounted to EUR 5,338.8 million, compared to 2006 yearend - EUR 5,764.7 million. Within the consolidated government debt central government debt saw a reduction of EUR 425.9 million, while local government debt increased from EUR 119.1 million to EUR 175.9 million during the period under consideration. Due to higher GDP the consolidated government debt/GDP ratio has dropped from 22.8% in 2006 to 18.5% at the end of 2007.

Consolidated Government Debt

Structure	(EUR million)		
	by 31 December 2005	by 31 December 2006	by 31 December 2007
Consolidated Government Debt	6 422.9	5 764.7	5 338.8
1. Central government debt	6 330.2	5 645.6	5 162.8
2. Social security funds debt	0.0	0.0	0.0
3. Municipal debt	92.6	119.1	175.9
Consolidated government debt/GDP(%)	29.4	22.8	18.5

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

2. 2007 GDP is set at BGN – 56 519.8 million and 2006 GDP is set at BGN – 49 361.0 million and 2005 GDP is set at BGN – 42 797.4 million.

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

Source: MF

Government Guaranteed Debt

At the end of 2007 the government guaranteed debt amounted to EUR 547.0 million in nominal terms - a nominal reduction of approximately EUR 4.2 million from the 2006 yearend level. The government guaranteed debt/GDP ratio reached 1.9% compared to 2.2% at the end of 2006, the reduction being due mainly to the higher GDP.

Government Guaranteed Debt

Structure	(million EUR)	
	as of 31.12.2006	as of 31.12.2007
Government guaranteed debt	551.2	547.0
I. Domestic government guaranteed debt	-	-
II. External government guaranteed debt	551.2	547.0
1. World Bank	91.6	82.3
2. European Investment Bank	7.0	5.9
3. EBRD	49.0	42.4
4. Other	403.6	416.4
Government guaranteed debt/GDP (%)	2.2	1.9

Notes: 1. Debt at nominal value.

2. Euro conversion at BNB central rates for the closing business day of each period.

No substantial changes are noticed in the government guaranteed debt creditor structure. Only the group "Others" has increased its share reaching from 73.2% to 76.1%. The positive net financing in the group "Others" (including the Japanese Bank for International Cooperation, Euroatom, the Council of Europe Development Bank, etc.) resulted during the year in increasing the debt share under this item. During the year the new external financing under the government guaranteed debt was EUR 51.9 million. The government guaranteed debt payments amounted to EUR 61.7 million, of which EUR 37.8 million - principal and EUR 24.0 million - interest.

Government Guaranteed Debt

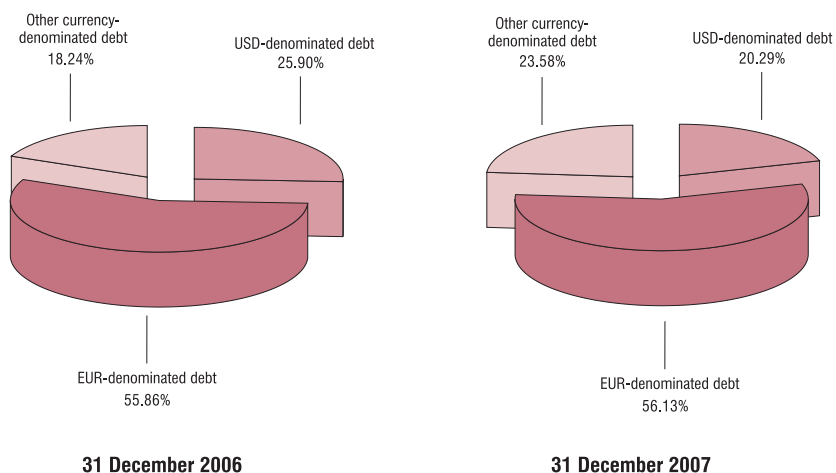
New External Financing and Government Guaranteed Debt Payments in 2007

(million EUR)

Structure	Received loans	Payments, incl.	
		Installments	Interest
I. Domestic government guaranteed debt	-	-	-
II. External government guaranteed debt	51.9	37.8	24.0
1. World Bank	4.9	10.2	4.2
2. European Investment Bank	-	1.1	0.3
3. EBRD	5.2	10.5	2.4
4. Other	41.8	16.0	17.1
Government guaranteed debt	51.9	37.8	24.0

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

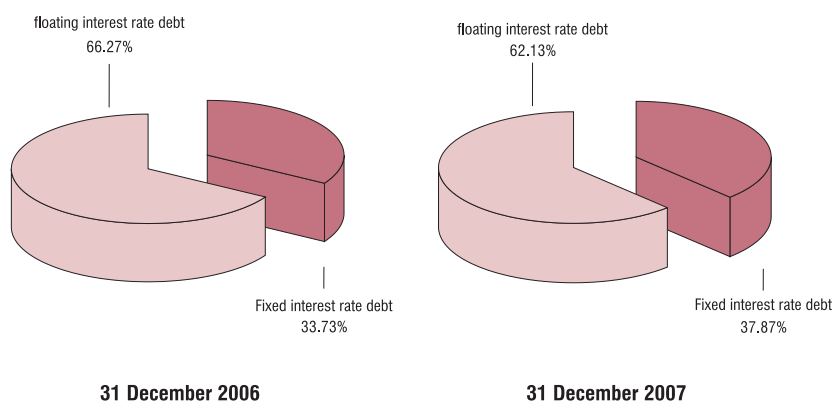
In 2007 the currency composition of the government guaranteed debt maintained the tendency of increasing Euro debt on the account of debt in US Dollars. Compared to 2006 yearend the Euro debt has increased by 0.3 percentage points to 56.1%. This is due to reduction of US Dollars debts from 25.9% to 20.3%. The share of other currency debts has also increased. Due to disbursements under Japanese Yen loans it has reached 23.6%.



Currency Structure of Government Guaranteed Debt

Source: MF

At the end of 2007 the interest rate structure of the government guaranteed debt also experienced positive changes. The debt at fixed and floating interest rates ratio has changed during the year, the share of debt at fixed coupons increasing from 33.7% to 37.9%. The change is due to the reduction of the US Dollars debt, which is mainly at floating interest rates.



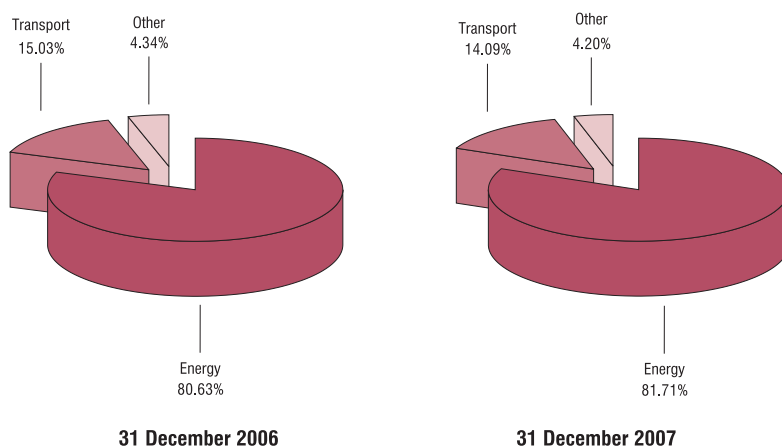
Interest Rate Structure of Government Guaranteed Debt

Source: MF

Government Guaranteed Debt

Energy has the greatest weight in the government guaranteed debt structure by sector – 81.7%, followed by Transport – 14.1% and others – 4.2%.

Government Guaranteed Debt by Sector



Source: MF

