



Q2 | 2010

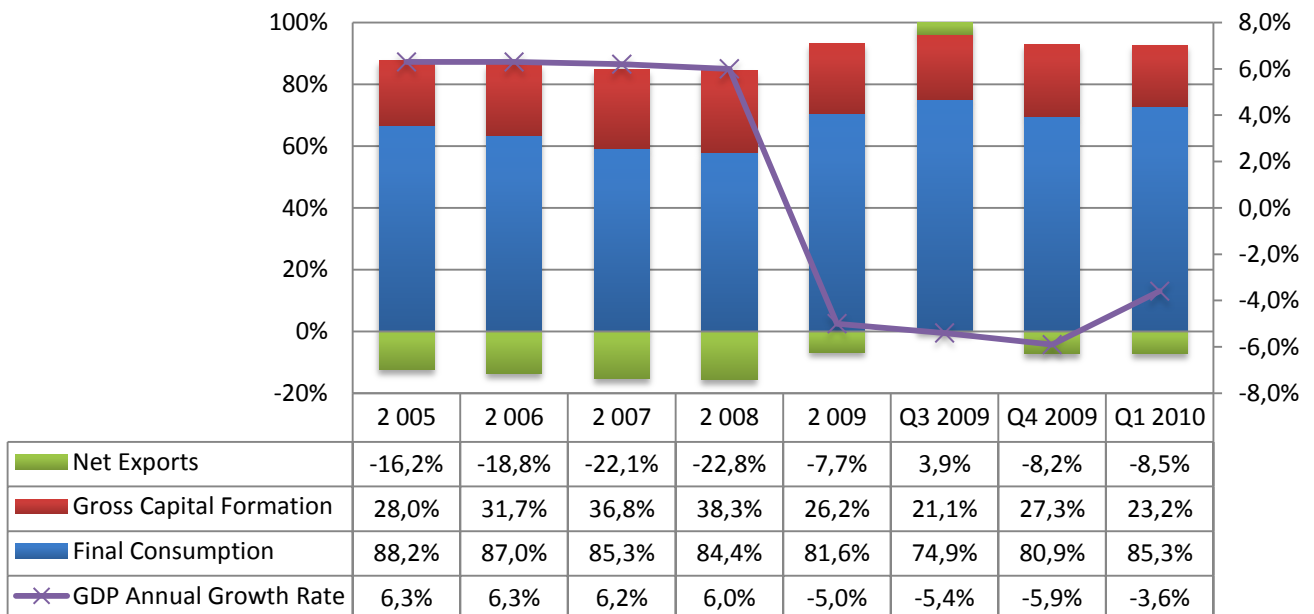
Bulgarian Economy Overview



Bulgarian Economy Overview – Q2 2010

- ❖ The first quarter of 2010 recorded a more modest decline of GDP (-3.6%) compared to the decline of 5.9% in the last quarter of 2009. The sharp contraction in capital inflows reduced domestic demand and at the same time the recession in Bulgaria's major trading partners diminished exports. Still, the first signs of recovery are already here. It is evident that the Bulgarian economy is heavily dominated by consumption and net exports used to have more than 20% negative contribution to GDP. However, net exports fell to more sustainable level as the country was affected by the global crisis.

GDP Growth Rate & Components



Source: Bulgarian National Bank

- ❖ The weaker GDP decline is almost entirely due to the significant improvement in exports. However, domestic demand remains subdued and is not projected to start recovering soon. The IMF sticks to its forecast of 0.2% GDP growth in 2010, while UniCredit predicts decline of 1% for this year. As can be seen from the graph below, Bulgaria continues to experience one of the steepest GDP declines in Central & Eastern Europe mainly explained by the huge external imbalances that are undergoing major correction.

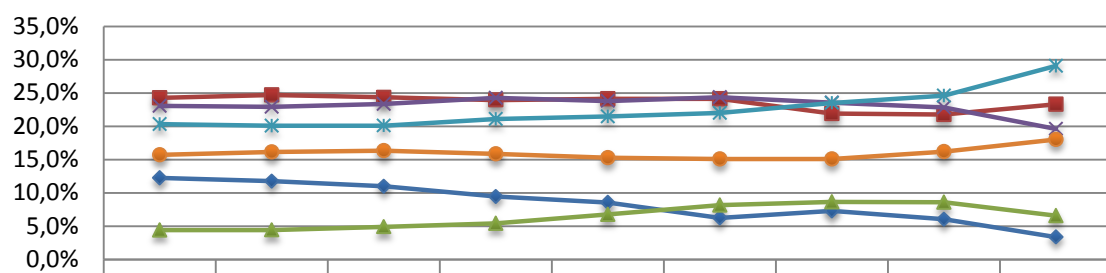
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GDP Annual Growth Rate		
Country	2009	Q1 2010
Bulgaria	-5,0%	-3.6%
Czech Republic	-4,8%	1.1%
Estonia	-14,1%	-2.0%
Greece	-2,0%	-2.5%
Cyprus	-1,7%	-1.7%
Latvia	-18,0%	-5.1%
Lithuania	-15,0%	-2.6%
Hungary	-6,3%	-0.9%
Poland	1,7%	2.8%
Romania	-7,1%	-3.2%
Slovenia	-7,8%	-0.8%
Slovakia	-4,7%	4.5%

- ❖ The positive side of the otherwise deteriorating economic conditions is the decrease of external imbalances. Bulgaria has to change its growth pattern if it is to resume its economic development on a sustainable basis. The economy has to shift its focus from domestic demand to higher value-added export industries. It is clear which industries are already shrinking but unfortunately it is not that obvious which sectors will become the new engines of growth.
- ❖ We observe relatively stable distribution across the major sectors in the Bulgarian economy. Agriculture is the major exception which more than halved since 2002. The industrial sector remained almost entirely flat in terms of proportion to the total economy. Financial and real estate services experienced significant increase from 20.3% in 2002 to 29.1% in Q1 2010.

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Gross Value Added Distribution



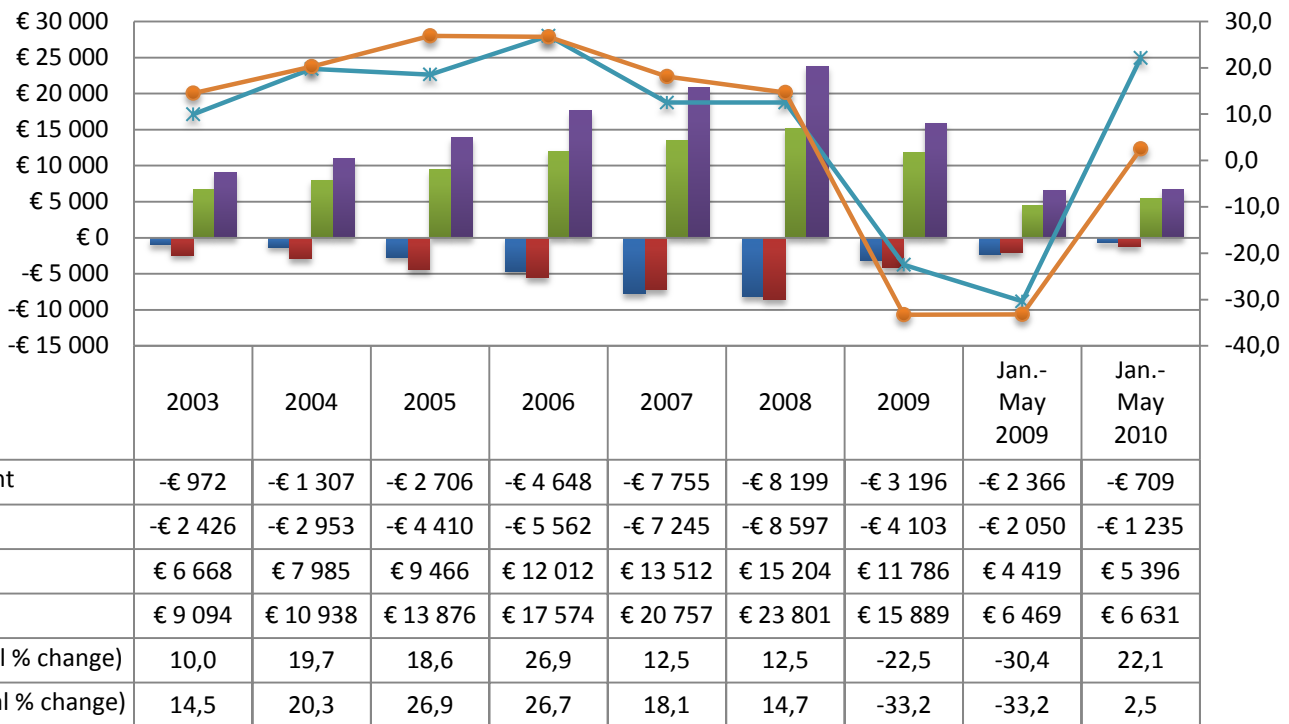
	2002	2003	2004	2005	2006	2007	2008	2009	Q1 2010
◆ Agriculture	12,2%	11,7%	11,0%	9,4%	8,5%	6,2%	7,3%	6,0%	3,4%
■ Industry	24,3%	24,7%	24,3%	24,0%	24,1%	24,1%	21,9%	21,8%	23,3%
▲ Construction	4,4%	4,4%	4,9%	5,4%	6,8%	8,2%	8,6%	8,6%	6,6%
✕ Trade, hotels, restaurants, transport & communication	23,1%	22,9%	23,4%	24,3%	23,8%	24,4%	23,5%	22,8%	19,6%
* Financial & Real Estate Services	20,3%	20,1%	20,1%	21,1%	21,5%	22,0%	23,5%	24,6%	29,1%
● Other Services	15,7%	16,1%	16,3%	15,8%	15,3%	15,1%	15,1%	16,2%	18,0%

Source: Bulgarian National Bank

- ❖ In the period January – May 2010, the current account deficit was 70% lower than the deficit in the same period in 2009. It amounted to € 709 million (2% of GDP) compared to € 2.37 billion (7% of GDP) for the period January – May in 2009. The decrease in trade balance (by € 815million) was the main factor behind the decline in the current account. **Exports increased sharply by 22.1%, while imports increased modestly by 2.5% on an annual basis.** Thus, the trade deficit was € 1.24 billion (3.5% of GDP) for the reporting period against € 2.05 billion (6.1% of GDP) for the same period last year.

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External Sector Indicators

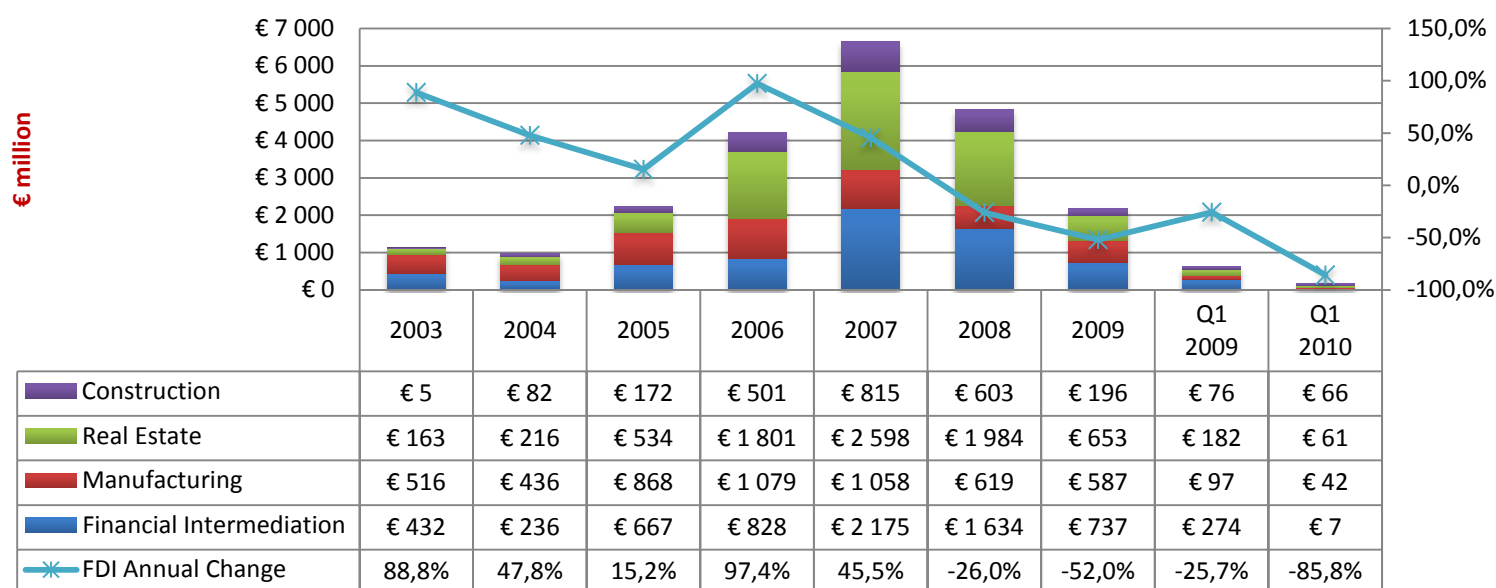


Source: Bulgarian National Bank

- ❖ FDI for the first five months of the year amounted to just € 253 million, which is 80% lower than a year ago. These figures are preliminary and usually revised significantly upward. The decrease for Q1 2010 against Q1 2009 is almost 86% and continues the negative trend since 2008 as Bulgaria was affected by the economic crisis. Investments in real estate and construction fell precipitously as these sectors were some of the most overheated in the economy. FDI fell by 67% in both real estate and construction.

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FDI by Sectors

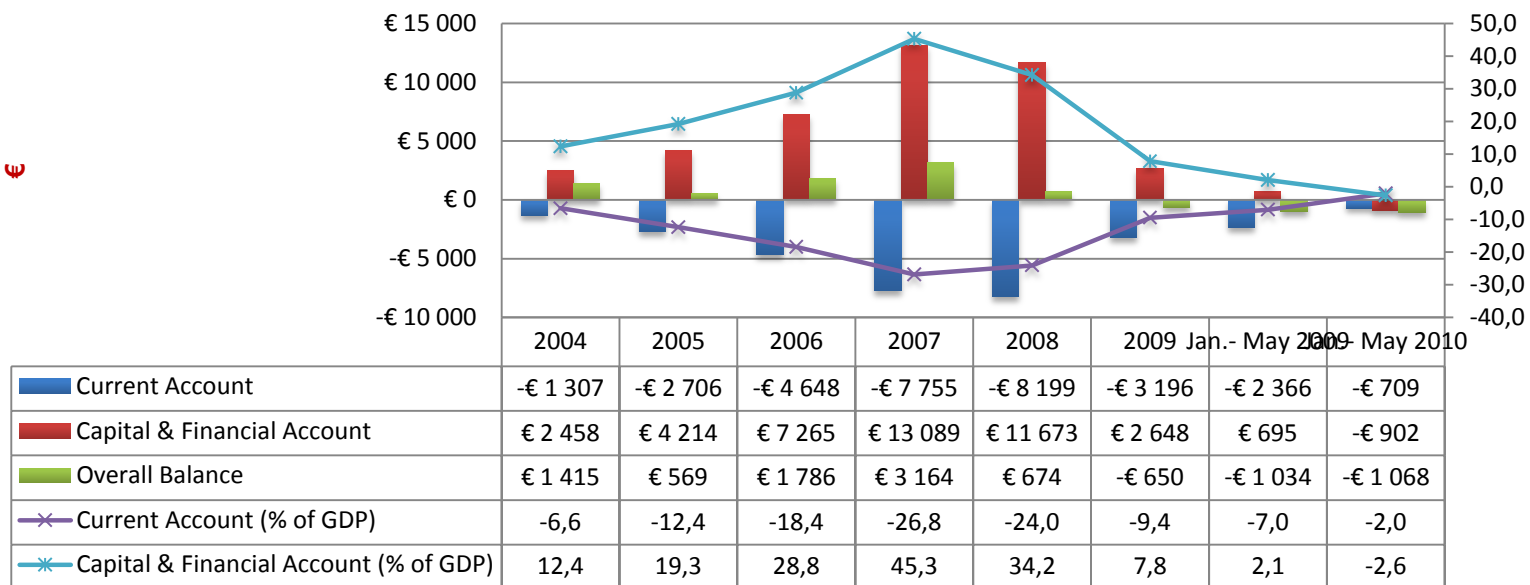


Source: Bulgarian National Bank

- ❖ Bulgaria's balance of payments has experienced a significant deterioration since Q4 2008 in terms of the overall balance. However, the current account deficit decreased significantly mainly due to the larger decrease of imports than the decline in exports. It declined from the worrying 24% of GDP in 2008 to a more sensible level of 9.4% of GDP in 2009. The often stated ratio of FDI over current account balance may lead to the wrong conclusion that FDI must cover the current account if the balance of payments is to be positive. In fact, FDI is just part of the financial account. The balance of payments identity is: **Current Account = Capital Account + Financial Account + Net Errors and Omissions**. If the absolute value of the surplus on any side of the equation is larger than the absolute value of the deficit on the other, the central bank accumulates foreign exchange reserves. As of May 2010, the capital and financial accounts deficit amounted to € 902 million against surplus of € 695 million in January - May 2009. **The major reason behind the stark decrease of the financial account is the fall in the net foreign liabilities of the banking system as well as the lower foreign direct investments.** Up to May 2010, the overall balance of payments is -€ 1.07 billion against negative balance of € 1.03 billion in May 2009. Thus, Bulgaria's foreign exchange reserves declined by the same amount.

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Balance of Payments

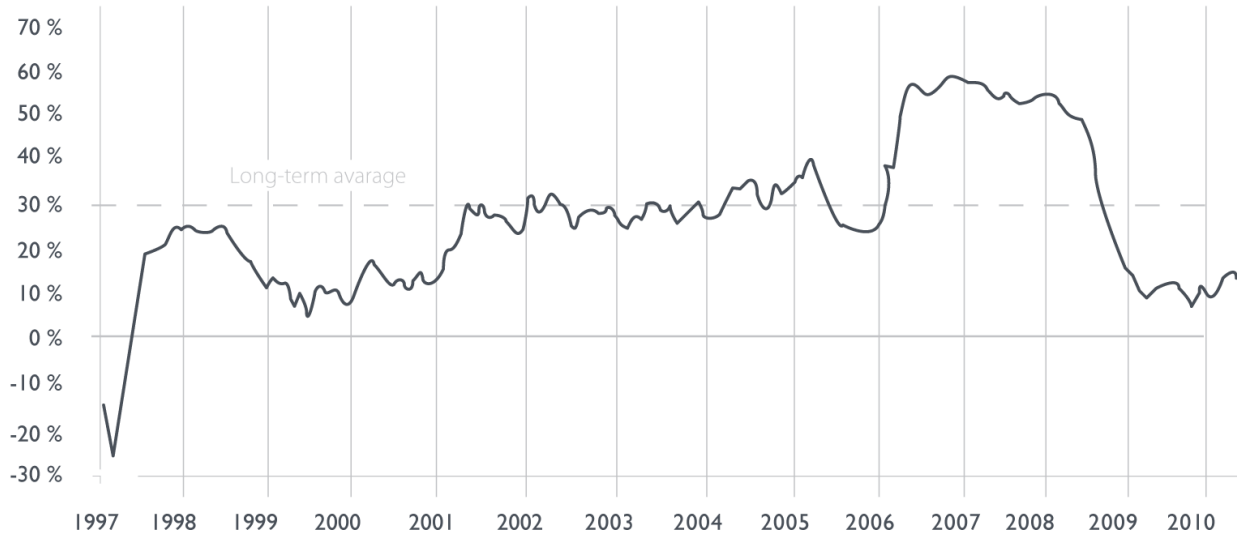


Source: Bulgarian National Bank

- ❖ Bulgaria has a favorable fiscal policy including flat corporate tax rate of 10% (equal to the lowest level in Europe) and it is 0% for regions with high unemployment. Among the investment promotion measures are also the VAT exemptions on equipment imports for investment projects over EUR 5 million, the right of acquisition of land and property through a Bulgarian registered company with up to 100% foreign ownership, as well as treaties for avoidance of double taxation with 61 countries.
- ❖ Since October 2008, the overall business climate has been generally deteriorating. The total business climate in June 2010 decreased by 1.2% in comparison to the business climate in the previous month. It deteriorated in all sectors with the exception of the retail sector. The decline in the industrial sector is 2.4% due to managers' lower expectations over the next three months. The business climate in construction decreased by 3.6%, while the service sector registered decline of just 0.4%. The only sector that registered improvement in sentiment was the retail sector with increase of 2.5%, but it comes following a drop of 5.3% in May 2010.

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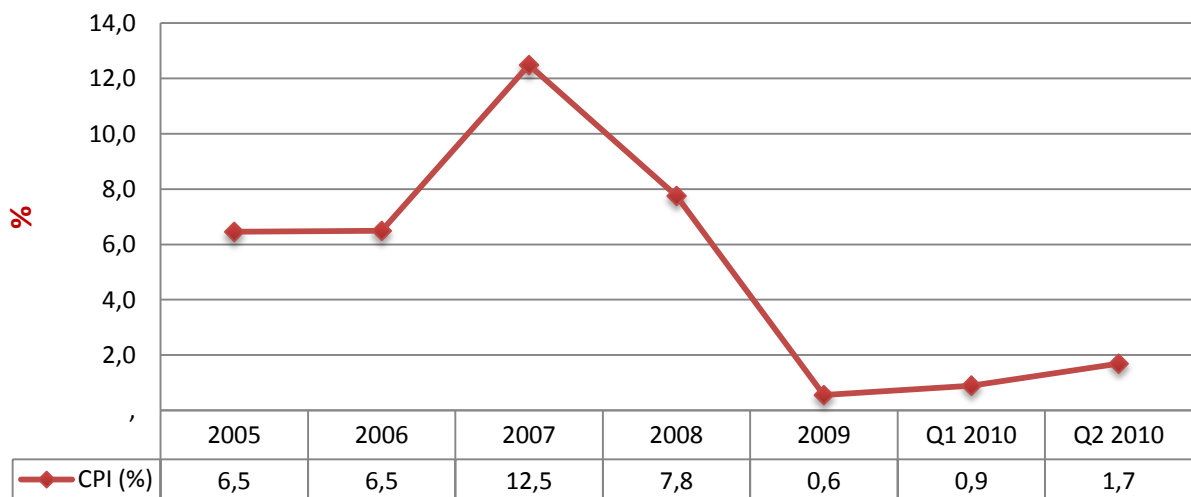
Business Climate - Total



Source: National Statistical Institute

- ❖ After years of high inflation due to the booming economy and credit expansion, inflation precipitously fell to just 0.6% in 2009 as a direct result of the sharp contraction of economic activity. The accumulated inflation for the first six months of 2010 was 1.7%.

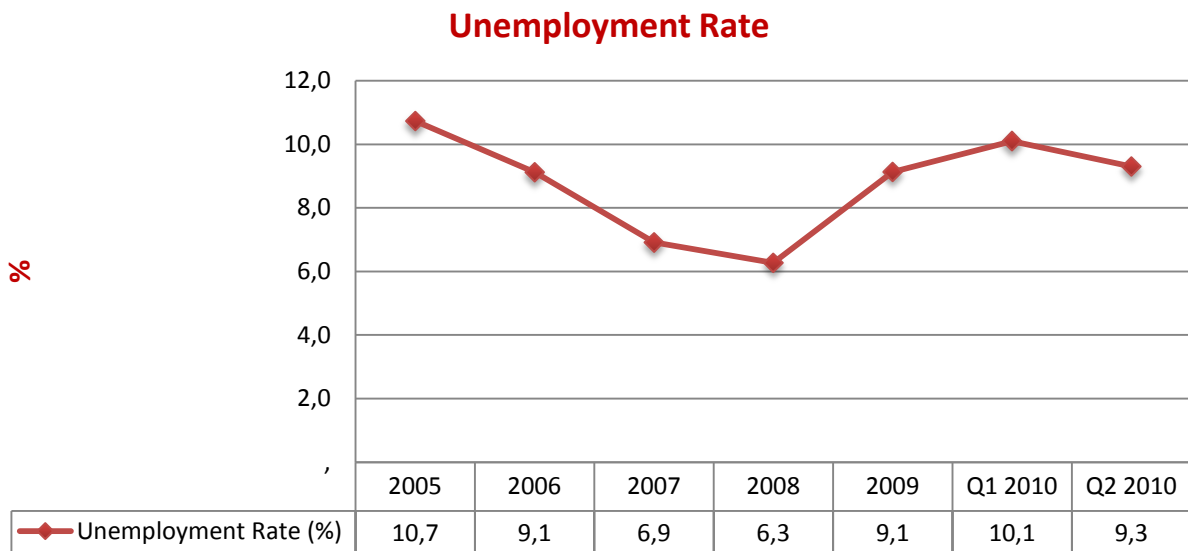
Annual Inflation



Source: National Statistical Institute

Bulgarian Economy Overview – Q2 2010

- ❖ The unemployment rate rose sharply in 2009 and reached the level of unemployment in 2006 of 9.1%. It continued to increase rapidly in 2010 and reached 10.1% in Q1 2010. However, it fell to 9.5% in May 2010. As of May 2010, the unemployment rate is 10% in the Eurozone and 9.6% in the EU.

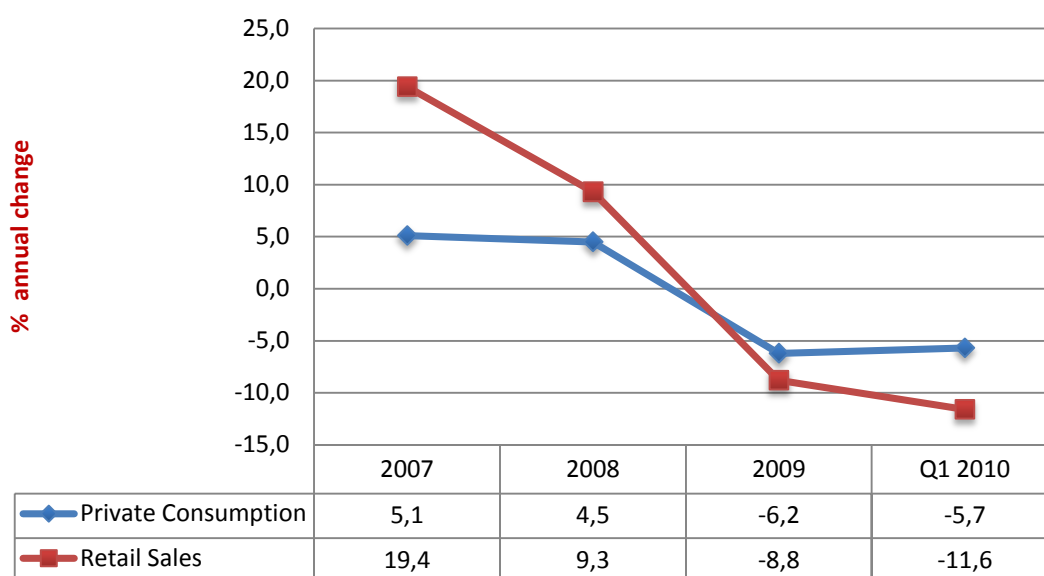


Source: National Statistical Institute

- ❖ The employment rate is equally important but often overlooked indicator. It is the ratio of employed people over the working – age population. As of Q1 2010, the employment rate (ages 15 – 64) in Bulgaria is 58.8% against 62.6% in Q1 2009.
- ❖ Both retail sales and private consumption continued to fall by 11.6%% and 5.7% respectively in Q1 2010. Restricted credit conditions, high unemployment job uncertainty as well as general consumer cautiousness all contribute to the subdued demand.

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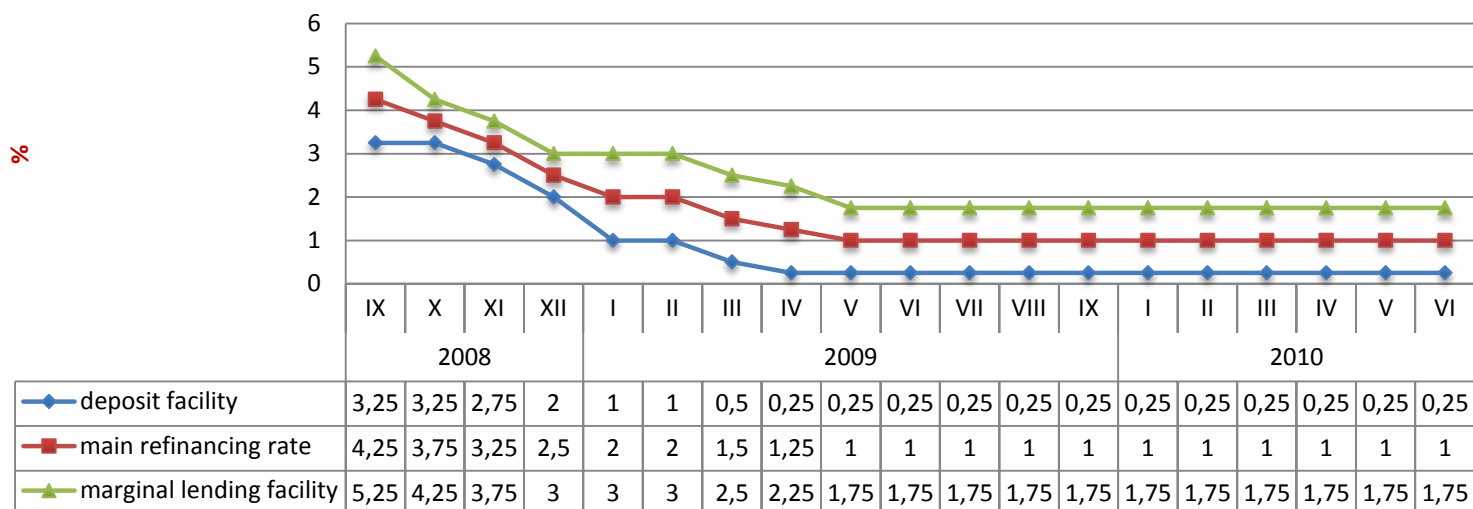
Private Consumption & Retail Sales



Source: National Statistical Institute

- ❖ There has been no change in the three main ECB interest rates since May 2009. The unprecedented low interest rates are staying flat due to fears of premature withdrawal of support measures considering the fragility of the recovery process.

ECB Interest Rates

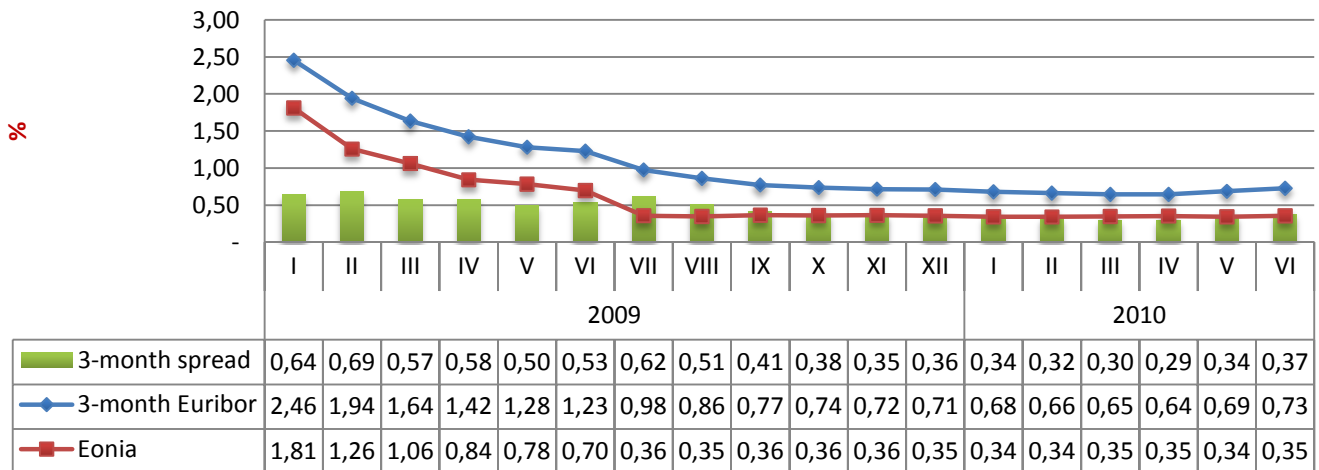


Source: European Central Bank

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- ❖ The overnight interbank rate in the euro-zone (Eonia) decreased in line with the main refinancing rate from their peak levels in 2008. The spread between Eonia and Euribor is an indication of perceived risk. The 3-month spread declined to 29 basis points in April 2010 but increased to 37 basis points in June due heightened uncertainty over sovereign debt problems in some European countries.

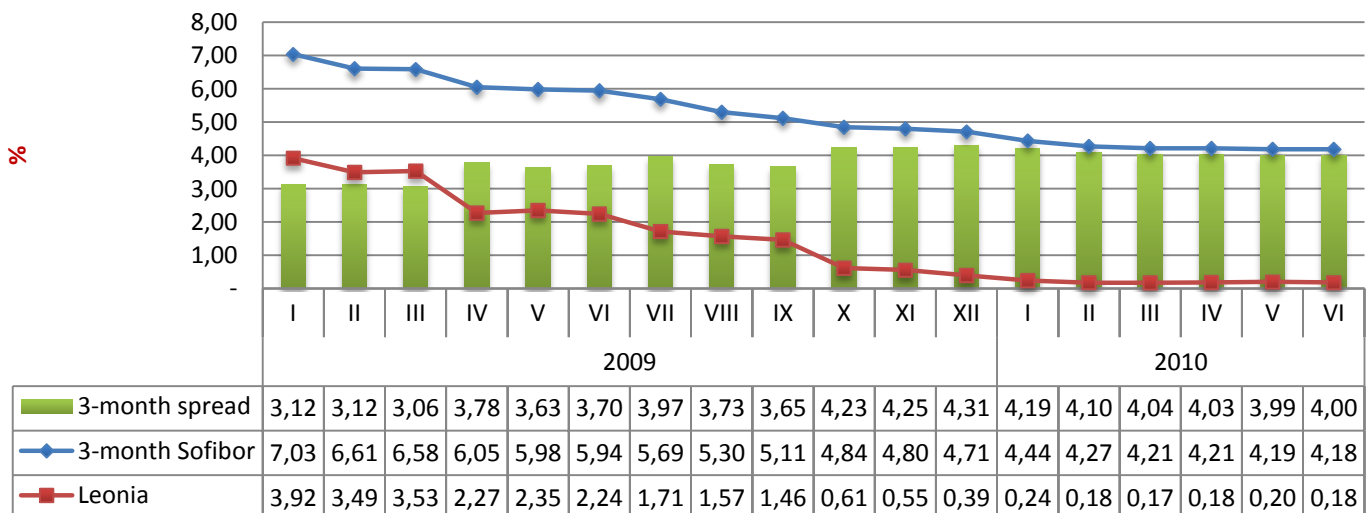
Euro-zone Liquidity Risk Premium



Source: Bulgarian National Bank

- ❖ Neither Leonia nor Sofibor moved in line with their European counterparts due to both external and domestic factors. The 3-month spread remains high hovering around 4%.

Bulgarian Liquidity Risk Premium

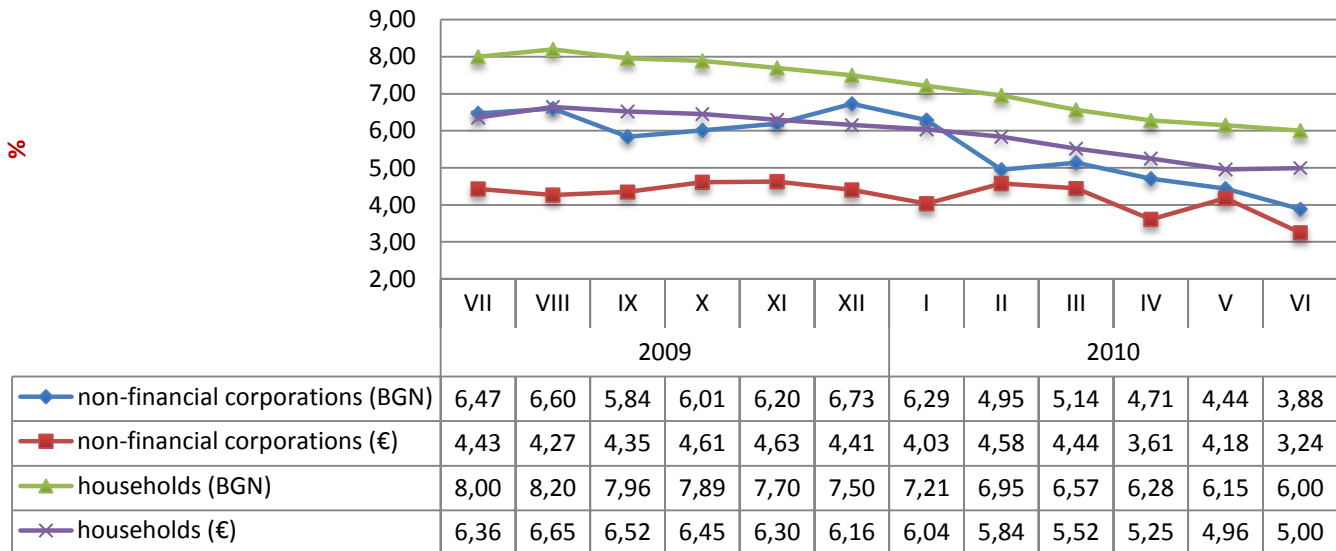


Source: Bulgarian National Bank

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- ❖ Interest rates on time deposits continued to decline as the quest for attracting domestic resources subdued and lending demand remains low. Deposit interest rates for non-financial corporations witnessed the steepest decline from 6.29% in January to 3.88% in June 2010.

Interest Rates on Time Deposits (over 1 day - 1 year)

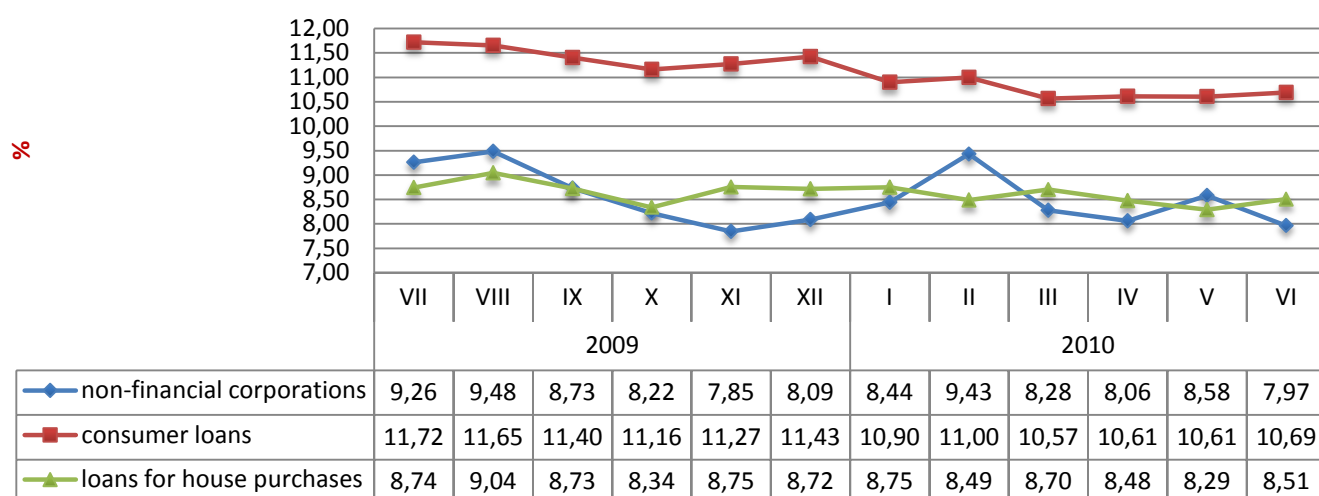


Source: Bulgarian National Bank

- ❖ The higher interbank rates increased the interest rates for non-financial corporations and home purchases as the crisis initially unfolded. However, the subsequent reduction in interbank rates did not translate into lower lending interest rates. There must be a significant decline in deposit rates before banks can afford to lower lending rates. The average interest rates remain relatively flat since the beginning of the year and there is no distinctive pattern.

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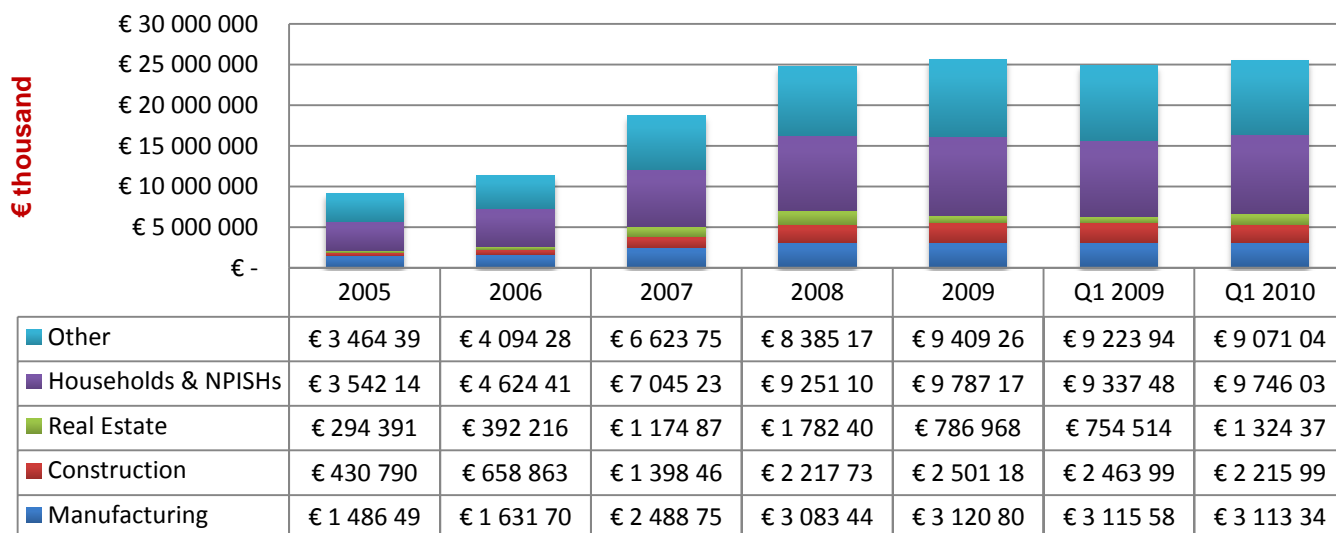
Average Interest Rates on Loans in Euros



Source: Bulgarian National Bank

- ❖ Lending growth contracted sharply in 2009 to just 3.6% from 32% in 2008 and 64% in 2007. It grew by only 2.3% in Q1 2010 on an annual basis but decreased by 0.5% on a quarterly basis underscoring the weak lending activity.

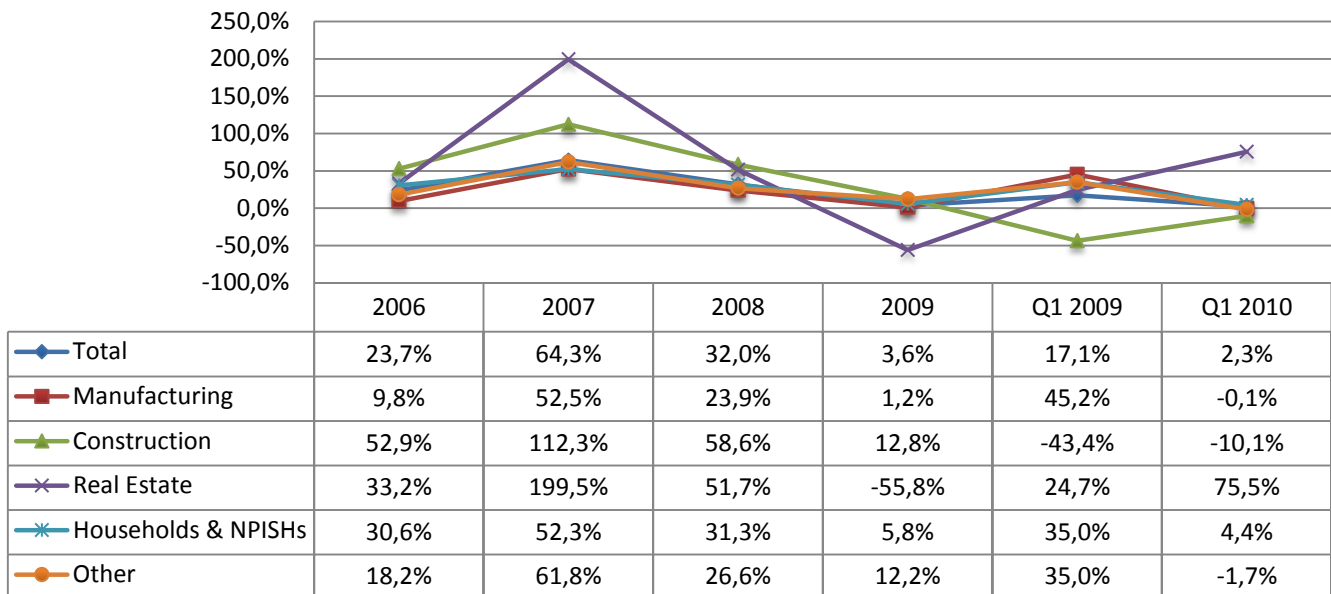
Lending by Sectors



Source: Bulgarian National Bank

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Annual Lending Growth

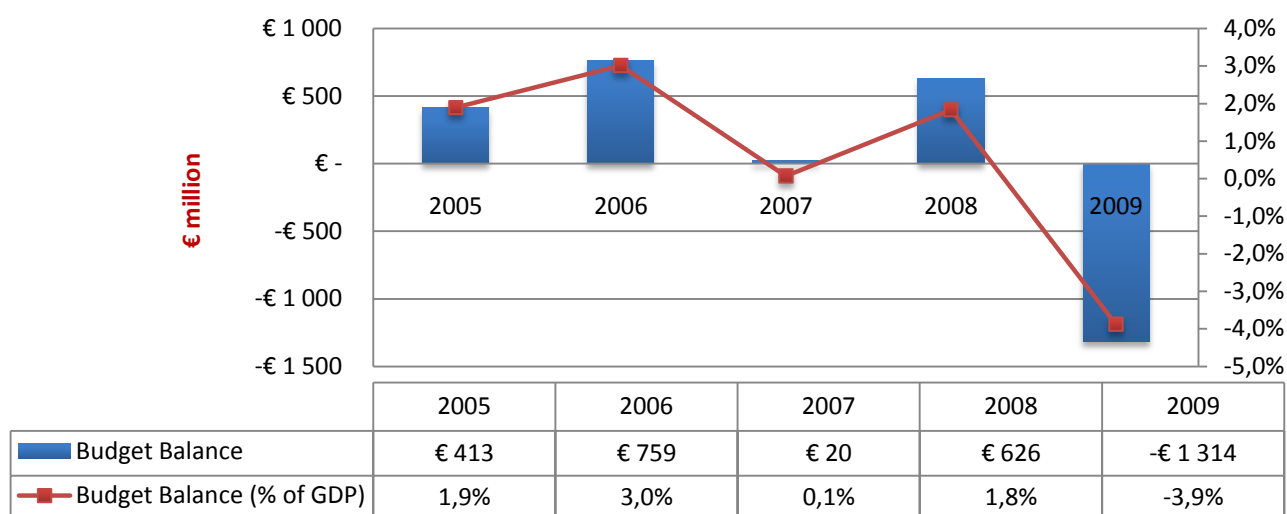


Source: Bulgarian National Bank

- ❖ Bulgaria's budget deficit for 2009 was revised from 1.8% to 3.9%. The new government uncovered annexes that require more than one billion Euros of additional expenditures. Nevertheless, Bulgaria remains one of the countries with the lowest budget deficit in the EU. The consolidated budget cash deficit for the five months of 2010 amounted to € 1.36 billion due to lower revenues, higher social security expenditures and belated payments to businesses. Meanwhile, the parliament amended the budget for the current year and the government plans to implement cost cutting measures worth 2% of GDP. Thus, Bulgaria targets budget deficit of 4.8% of GDP on cash basis corresponding to 3.8% deficit on accrual basis. Still, the country enjoys some of the strongest fiscal metrics in Europe.

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Budget Balance



Source: Eurostat (ESA '95 Methodology)

Fiscal Metrics - end 2009

	Budget Deficit/GDP	Public Debt/GDP	Interest Spending to Serve Public/GDP
EU - 27	-6,80%	73,60%	2,60%
Bulgaria	-3,90%	14,80%	0,80%
Czech Republic	-5,90%	35,40%	1,30%
Estonia	-1,70%	7,20%	0,30%
Latvia	-9,00%	36,10%	1,60%
Lithuania	-8,90%	29,30%	1,00%
Hungary	-4,00%	78,30%	4,70%
Poland	-7,10%	51,00%	2,60%
Romania	-8,30%	23,70%	1,50%
Slovenia	-5,50%	35,90%	1,40%
Slovakia	-6,80%	35,70%	1,50%
Greece	-13,80%	115,10%	5,00%

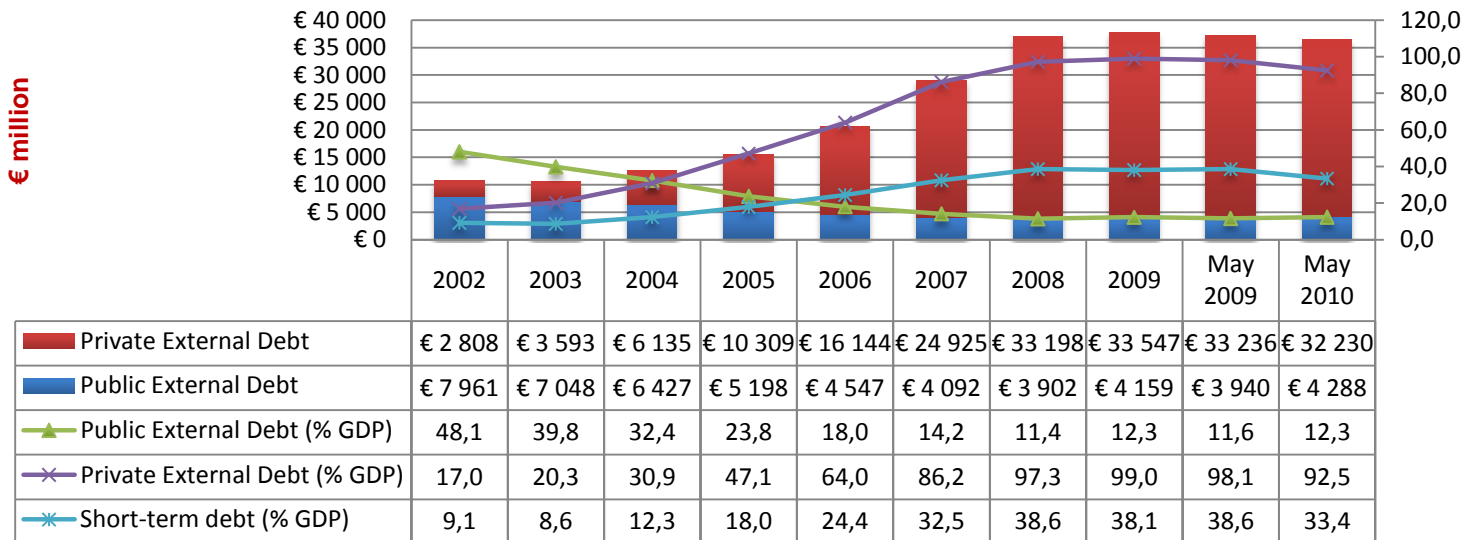
Source: Eurostat, UniCredit Research

- ❖ Bulgaria has experienced steady decrease in its external public debt since 2002 in accordance with the prudent fiscal policy required under the currency board arrangement. Thus, it enjoys one of the lowest public debt to GDP ratios in the EU. However, the private external debt increased

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dramatically as the Bulgarian economy became more dependent on foreign financing to sustain its GDP growth rate. It declined by almost 1 billion as banks decreased their foreign liabilities.

External Debt

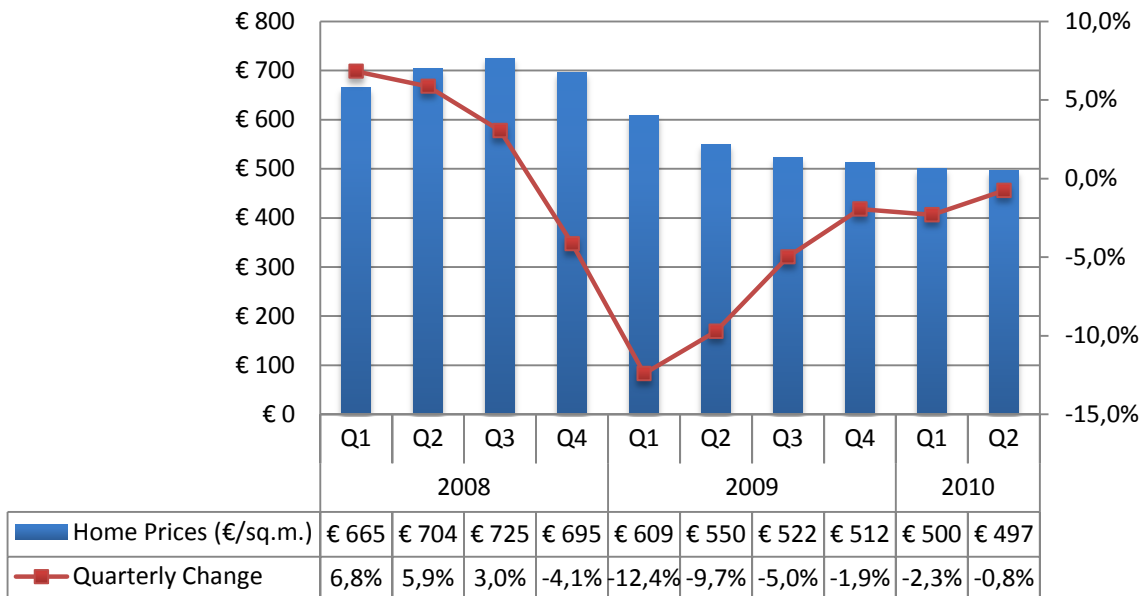


Source: Bulgarian National Bank

- ❖ Average home prices in Bulgaria continued to decline in Q2 2010, albeit at slower pace. The quarterly decline was just 0.8% but the cumulative decline since the peak in Q3 2008 is 32%. Thus, the housing market is undergoing a major correction after the recent real estate boom.

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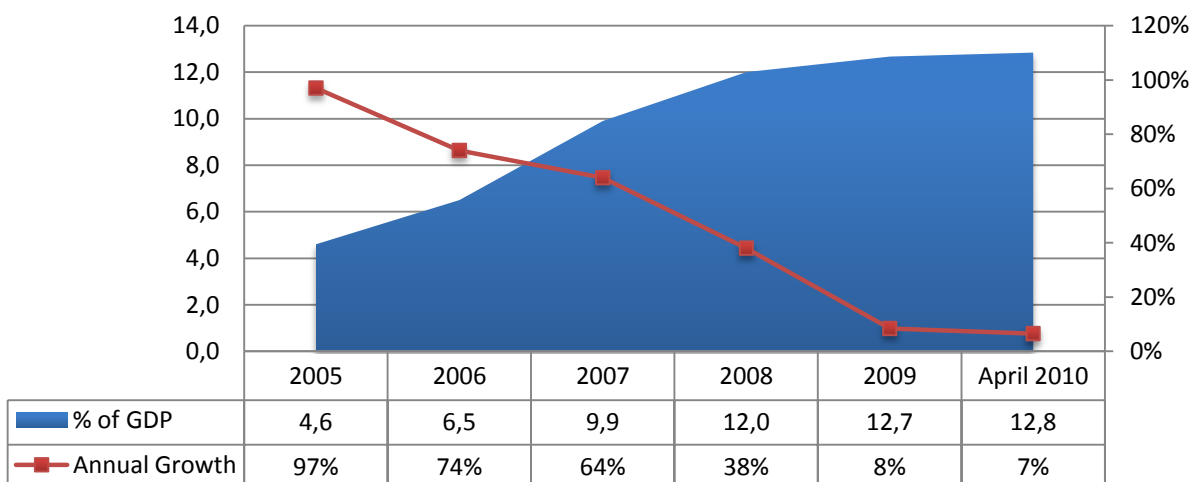
Average Home Prices - Bulgaria



Source: National Statistical Institute

- ❖ The mortgage market started from a very low level in proportion to the total economy but started to grow exponentially and recorded a staggering increase of 97% in 2005. The growth rate remained very high in the following years in line with the general credit expansion. It contracted abruptly in 2009 as the economy went into recession.

Home Mortgages Penetration



Source: Industry Watch

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Key Macroeconomic Indicators

	2005	2006	2007	2008	2009	Q1 2010	Q2 2010
GDP (€ million)	€ 21 882	€ 25 238	€ 28 898	€ 34 118	€ 33 876	€ 7 184	N/A
GDP per capita	€ 2 827	€ 3 278	€ 3 773	€ 4 475	€ 4 466	N/A	N/A
GDP Growth Rate (%)	6,3	6,3	6,2	6	-5	-3,6	N/A
Annual Inflation (%)	6,5	6,5	12,5	7,8	0,6	1,3	1,4
Unemployment (%)	10,7	9,1	6,9	6,3	9,1	10,1	9,3
FDI (€ million)	€ 3 152	€ 6 222	€ 9 052	€ 6 697	€ 3 213	€ 131	N/A
FDI/Current Account (%)	116,5	133,9	116,7	81,7	100,5	25,19823	N/A
Capital & Financial Account/Current Account	155,7	156,3	168,8	142,4	82,9	-115	N/A
Budget Balance (% of GDP)	1,9	3	0,1	1,8	-3,9	N/A	N/A
Money M3 (€ million)	€ 12 915	€ 16 393	€ 21 506	€ 23 406	€ 24 384	€ 24 720	€ 25 153
Base Interest Rate (%)	2	2,7	3,9	5,1	2,4	0,27	0,18
Interbank Money Market (%)	2,05	2,87	4,08	5,29	2,43	0,36	0,33
3-month Sofibor (%)	3,62	3,69	4,9	7,14	5,72	4,31	4,19
Yield on long-term government securities (%)	-	3,9	4,2	5	5,5	4,8	5,3
BGN/USD Exchange Rate	1,7	1,5	1,3	1,4	1,4	1,5	1,6

Bulgaria's Ten Largest Cities according to present address registration

City	Population by Current Address Registration
Sofia	1 404 590
Plovdiv	375 374
Varna	352 524
Burgas	208 572
Ruse	166 056
Stara Zagora	151 283
Pleven	120 042
Sliven	101 542
Dobrich	101 377
Shumen	93 427

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