



Bulgarian National Bank

ANNUAL REPORT • 2008



BANQUE NATIONALE DE BULGARIE



Bulgarian National Bank

ANNUAL REPORT • 2008

Published by the Bulgarian National Bank
1, Knyaz Alexander I Square, 1000 Sofia
Tel.: (+359 2) 9145 1351, 9145 1209, 9145 1231, 9145 1978
Fax: (+359 2) 980 2425, 980 6493
Printed in the BNB Printing Centre

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ISSN 1313-1494

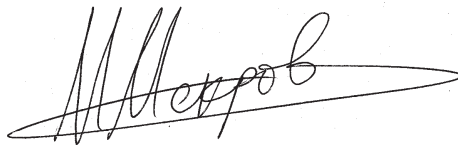
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The cover shows an engraving of the BNB building
from the 1938 banknote with a nominal value of 5000 levs.

Honourable Chairman of the National Assembly,
Honourable People's Representatives,

*Under the provisions of Article 1, paragraph 2 and Article 51 of the
Law on the Bulgarian National Bank, I have the honour of presenting
the Bank's 2008 Annual Report.*

A handwritten signature in black ink, appearing to read 'I. Iskrov', with a long horizontal flourish extending to the right.

Ivan Iskrov
Governor
of the Bulgarian National Bank

BNB Governing Council



Sitting from left to right: Tsvetan Manchev, Ivan Iskrov, Rumen Simeonov, Dimitar Kostov.
Standing from left to right: Oleg Nedyalkov, Penka Kratunova, Statty Stattev.

Governing Council

Ivan Iskrov

Governor

Tsvetan Manchev

Deputy Governor

Issue Department

Dimitar Kostov

Deputy Governor

Banking Department and
Fiscal Services Department

Rumen Simeonov

Deputy Governor

Banking Supervision Department

Penka Kratunova*

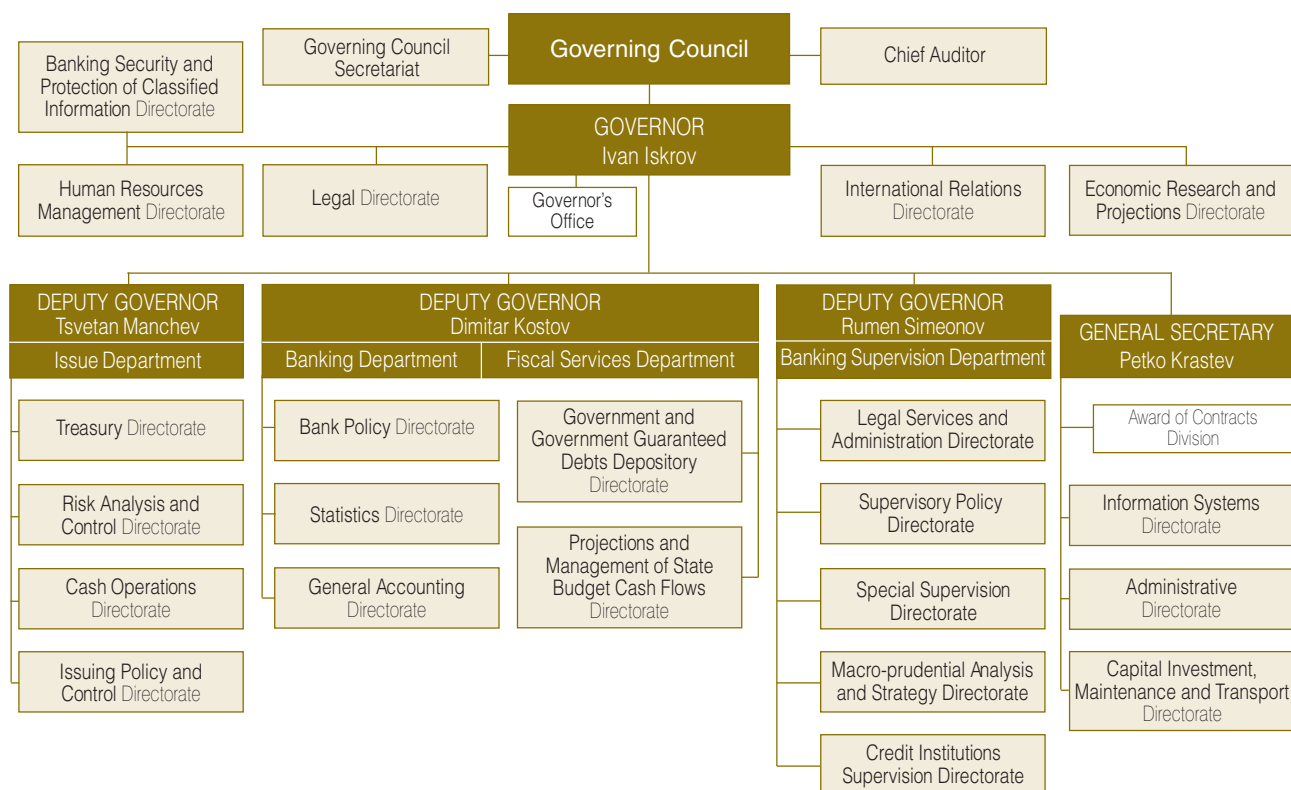
Statty Stattev

Oleg Nedyalkov

* As of 12 June 2008 Penka Kratunova is a member of the BNB Governing Council. Until 11 June 2008 Nikolay Nenovsky was a member of the BNB Governing Council.

Organizational Structure of the BNB

(as of 1 January 2009)



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Abbreviations

BIR	Base interest rate
BIS	Bank for International Settlements, Basle, Switzerland
BISERA	System for servicing customer payments initiated for execution at a designated time
BNB	Bulgarian National Bank
BORICA	Banking Organization for Payments Initiated by Cards
BSE	Bulgarian Stock Exchange
CB	Commercial Banks
CEFTA	Central European Free Trade Association
CIF	Cost, Insurance, Freight
CM	Council of Ministers
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
ECOFIN	Economic and Financial Council
EFTA	European Free Trade Association
EMU	Economic and Monetary Union
ESCB	European System of Central Banks
EU	European Union
FLIRBs	Front-loaded Interest Reduction Bonds
FOB	Free on Board
GDDS	General Data Dissemination System
GDP	Gross Domestic Product
HICP	Harmonized Index of Consumer Prices
IFO	Institute of Economic Research, Germany
IFI	International financial institutions
ILO	International Labour Organization
IMF	International Monetary Fund
MF	Ministry of Finance
NHIF	National Health Insurance Fund
NLO	National Labour Office
NSI	National Statistical Institute
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
RINGS	Real-time Interbank Gross Settlement System
SBL	State Budget Law
SDR	Special Drawing Rights
TFP	Transitional and Final Provisions
VAT	Value Added Tax
ZUNK	Bulgarian abbreviation of the Law on Settlement of Non-performing Credits Negotiated prior to 31 December 1990 (LSNC)

Summary

In 2008 Bulgaria's economy developed against the backdrop of a rapidly deteriorating external environment. The financial turmoil which emerged with the US sub-prime mortgage market grew into the deepest and fastest developing crisis in a Century. Financial difficulties at leading transnational investment banks and funds completely eroded confidence among financial institutions, while the Lehman Brothers' failure in September practically paralysed international financial markets. Market malfunctions and tighter credit policy spilled over into the real sector. Over the last quarter of 2008 the global financial crisis grew into a global economic crisis whose severity in the advanced economies was defined as the severest in scope and scale since the 1930s' Great Depression.

Fiscal stimulus packages by developed countries' governments to recapitalise straitened banks and protect deposits, and leading central banks' measures to provide liquidity, including unprecedented coordinated interest rate cuts in October had a limited effect. World markets remained unstable, banks continued to tighten credit conditions and standards, and global lending contracted significantly. Continuing investor risk aversion and reduced liquidity affected capital inflows into emerging markets which faced collapsing share prices and increasing private and public debt spreads. Difficulties in attracting external financing led to significant devaluations for some national currencies and financial support agreements with the IMF and other international institutions.

In the last quarter of 2008 the European Central Bank cut the repo rate by 225 basis points to 2.50 per cent at the end of the year and undertook further measures to provide liquidity to banks by extending temporarily the list of eligible collateral, offering unlimited refinancing in euro and US dollars at a fixed exchange rate across the entire maturity spectrum, and narrowing the corridor of standing facilities for financial institutions. This was intended both to improve the liquidity of euro area banks and to subdue interest rate volatility in relevant market segments.

At the end of November 2008 the European Commission presented a special Recovery Plan to restore confidence in the European economy. Banking stability was defined as the first and most important priority to overcoming recession and stimulating fast and sustainable recovery. The plan entailed the bulk of financial support from Member States being directed at the banking sector to restore confidence in it, normalise lending, and guarantee the passing-on of central bank interest cuts in lending rates. Only given banking system stabilisation was it possible to implement short-term measures to stimulate demand and create jobs, and investment programmes to boost productivity and achieve the sustainable long-term growth laid down in the Recovery Plan. Providing fiscal stimuli amounting to 1.5 per cent of GDP to EU economies is one short-term measure. To achieve the required effect, fiscal measures may differ in individual Member States depending on their fiscal positions. Countries which have used the period of economic growth to attain sustainable fiscal positions and improve competitiveness are better placed to resist the global crisis.

The BNB, through its Governor as member of the General Council of the European Central Bank (ECB) and participant in informal ECOFIN meetings, took part in deliberating the global crisis and EU measures against it. Bulgaria joined other EU members' decision on minimum deposit guarantees by amending the Bank Deposit Guarantee Law cover from BGN 40,000 to BGN 100,000. The government adopted three packages of measures for counteracting the crisis, with relevant finance included in the 2009 State Budget Law. Amendments to Ordinance No 21 on the Minimum Required Reserves Maintained with the Bulgarian National Bank by Banks aimed to help Bulgarian banks manage liquidity better. Government and Bank measures correspond to common EU decisions while being specific to Bulgaria's particular needs.

In 2008 the Bulgarian economy posted comparatively high growth of 6 per cent, with significant moderation over the fourth quarter when GDP rose by 3.5 per cent on an annual basis. The last year's fixed capital investment trend contributed most to GDP growth. Household consumption increased at relatively high rates until the third quarter amid fast growing wages and favourable credit conditions. Over the fourth quarter, however, it moderated significantly while still increasing at 1.5 per cent annually in real terms. The contribution of foreign trade balance to GDP remained negative in 2008, though improving on the prior year. In 2008 inflation moderated to 7.2 per cent, with services contributing most to price rises.

In the context of increasing uncertainty, shrinking external demand, and falling international prices since mid-2008, exports and imports started to slow down, with declines on 2007 in the fourth quarter. The adverse international environment affected mainly manufacturing whose exports had a large share of total sales. Despite worsened international financial markets, local economic agents retained access to foreign finance. Based on preliminary data, foreign direct investment remained relatively high, ensuring almost 74 per cent cover of the balance of payments current and capital account deficits. The inflow of finance into the balance of payments exceeded the current and capital account deficits which boosted international foreign currency reserves.

The currency board plays a key role in maintaining Bulgarian macroeconomic stability. Under it, all BNB monetary liabilities are fully covered by full highly liquid foreign reserves, and the Bank has a duty to sell and purchase euro against leva at a legally set fixed exchange rate. The benefits of the currency board as a specific monetary policy regime are clearly evident in the current global crisis. The fixed lev/euro rate is a strong nominal anchor guaranteeing exchange rate stability; the floating exchange rates of some EU currencies underwent significant devaluations in 2008, contributing to worsening internal environments. The stability of the currency board was supported by prudent fiscal policy and stringent banking supervision which ensured the accumulation of significant financial reserves in the period of high economic growth.

Preserving the currency board in Bulgaria until entry into the euro area under the fixed exchange rate is a BNB priority supported by parliament, government, and the public. At the same time, the Bank will continue using available levers actively to influence the financial system and mitigate the negative effects of the crisis.

BNB policy over recent years was implemented amid high economic growth and expanding credit to the non-government sector. BNB measures to curb credit growth and related risks to financial stability had a clear anti-cyclic nature. Continuing its counter-cyclic policy in a changed external environment, in October 2008 the BNB Governing Council amended Ordinance No 21 on minimum required reserves to recognise half of cash in vaults as reserve assets. In addition, the method of calculating penalty interest under the Ordinance changed to give banks easier access to their BNB reserves. From 1 December the minimum reserve rate was cut from 12 to 10 per cent on all attracted funds and from 1 January 2009 it was cut to 5 per cent on non-residents' funds and to zero on central and local government funds. Significant liquidity was released, with the total effect of the amendments reaching some BGN 3 billion. This helped banks manage liquidity amid world financial market turmoil. The liquidity release did not automatically boost lending, since it depends on household and corporate demand and on banks' risk assessments.

The Bulgarian National Bank regulates and supervises banks to ensure their stability and protect depositors. The past year was marked by more intensive supervisory activity directed at improving the regulatory framework and tools of effective supervision over individual credit institutions, and strengthening BNB commitments on supervisory cooperation within the EU. This was dictated both by trends in international financial markets and the impact of the global financial and economic crisis and by the need to take preventive measures to preserve the financial resource accumulated by banks and further strengthen their base. In a rapidly changing environment, Banking Supervision promoted the ability of banks to overcome the economic crisis.

In June the IMF and the World Bank assessed the stability of the Bulgarian banking system under the Financial Sector Assessment Programme (FSAP) periodically implemented in all IMF shareholder countries. Banking and financial system sensitivity to various types of risk was addressed. A stress-test model was developed and implemented jointly with credit institutions to look at economic macroscenarios and gauge individual bank and system sensitivity to each scenario. The findings were of a stable, well capitalised banking system with good liquidity and high profitability. Under the scenario of significant business deterioration in an economic crisis, changes in loan quality remained acceptable and the system retained equilibrium. An aspect of the assessment involved the quality of supervisory systems and their compliance with the core Basel principles of effective banking supervision and strengthening financial system reliability. The assessment concluded that the regulatory framework and supervisory capacity met the challenges of the rapidly changing environment.

In 2008 banks maintained good asset quality, taking timely measures for risk classification and loans impairment where relevant. At the end of December 2008 past due exposures and those classified for other reasons were comparatively rare at 3.96 per cent of gross banking assets. However, they were growing in the second half of the year which could result in a larger weight of classified receivables with higher risk. At the end of 2008 the share of non-performing risk exposures (loans and receivables past-due over 90 days) was 2.42 per cent (2.05 per cent at the end of 2007). Their growth rate, however, was 59 per cent higher than the banking credit portfolio. Accumulated system provisions covered non-performing loans by 114 per cent and granted the system significant capacity to absorb shocks due to more stringent supervisory requirements on impairment rate and on classifying loans and receivables.

Banking system profits by the end of December were BGN 1374 million: up BGN 223 million on 2007. Though the annual result was high, quarterly profits tended downwards, especially in the fourth quarter when the growing price of liabilities cut the net margin to 4.91 per cent. At the end of 2008 return on average assets (ROA) reached 2.12 per cent, down 25 basis points on December 2007. Return on equity (ROE) also fell slightly, more so in the fourth quarter of 2008 when it was affected by equity growth (BGN 1.7 billion in 2008). Positive capital adequacy ratio dynamics was reported in December 2008, the level of 14.93 per cent reflecting capital growth higher than statutory requirements.

Gross international reserves are managed in compliance with the Law on the Bulgarian National Bank and international financial market opportunities. At the end of 2008 the market value of gross international reserves was EUR 12,738 million: an increase of EUR 789 million or 6.59 per cent on the end of 2007. In the first three quarters BNB gross international foreign exchange reserves increased markedly, while in the fourth quarter they fell from EUR 14.7 billion to EUR 12.7 billion as a result of reduced minimum required reserves and end-2008 government spending. Due to uncertainty and rising risk in gross international reserves management on international financial markets, the BNB retained its constraint on the maximum duration of euro-denominated assets at up to six months. Income from international reserve investment in 2008 came to EUR 612.56 million (4.47 per cent yield), reflecting constraints and the opportunities offered by international financial markets.

In 2008 the BNB continued improving its organisation and efficiency. In late April the Cash Services Company took over the receipt, storage and supply of valuable packages of banknotes and coins at an announced value. Some BNB staff transferred to the new company, the Governing Council accordingly cutting the establishment from 1007 to 963. Updating information systems is a key BNB priority in organisational and operational efficiency improvement. 2008 saw the launch of the new Core Banking Information System. The updated version of the system for BNB cash reporting, control and management (the Cash System) also went live along with technological updating of the Central Credit Register and all systems servicing the government securities trade. Investing in updates and modernising the information infrastructure focused on ensuring business continuity and high systems security.

The two-year twinning project between the BNB and the consortium of the Banca d'Italia, De Nederlandsche Bank, and the Banque de France (managed by the latter), which ended successfully in 2008, achieved significant progress to BNB participation in the Eurosystem, particularly in payment systems, statistics, accounting, research and forecasting, financial market monitoring, cash in vaults management and risk management. The BNB improved existing systems and structures and developed staff skills to ESCB requirements and best practice.

The meeting of the governors of the central banks of Albania, Bosnia and Herzegovina, Cyprus, Macedonia, Greece, Montenegro, Romania and Serbia, as well as the Heads of the Banking Agencies of Bosnia and Herzegovina and Serbia was a major international event. The 3 October 2008 meeting was at the invitation of the BNB Governor under the multilateral Memorandum of Understanding to enhance South Eastern Europe bank supervisory cooperation and safeguard financial stability.

The BNB expanded its cooperation with other central banks by providing technical assistance and experience exchanges. In 2008 Bank experts met colleagues from the central bank and the Ministry of Finance of Bosnia and Herzegovina to address fiscal policy forecasting and analysis. Cooperation with the central bank of Albania intensified in bank security, information, and payment systems control. Work continued within the Central Bank Governors' Club of the Black Sea Region. The BNB joined the Banque de France, De Nederlandsche Bank and the Banca d'Italia as a partner in technical assistance projects for non-ESCB central banks financed by the European Union and managed by the European Central Bank. A nine-month programme of technical assistance to the Narodna Banka Srbije began to be implemented in the area of financial services consumer protection. BNB experts took part in the three-year cooperation programme with the central bank of Egypt on bringing banking supervision into line with Basel II principles.

I. Economic Development in 2008

1. The External Environment

The financial crisis which started in mid-2007 as a US sub-prime mortgage crisis continued to deepen and expand in 2008, turning into a global financial crisis. Financial difficulties at leading transnational investment banks and funds completely eroded confidence among financial market participants. The volume of interbank transactions dramatically fell and banks greatly tightened lending standards and conditions. After the Lehman Brothers failure in September which delivered an adverse shock to markets, the global financial crisis turned into a global economic crisis. In December 2008 world industrial output contracted by almost 10 per cent and trade by 7 per cent. Some industrialised countries entered recession. The crisis spilled over into emerging markets whose exports fell considerably over the last quarter of the year. By the close of 2008 economic conditions had worsened dramatically in line with the negative trends in economic activity.

Major Macroeconomic Indicators (average annual change)

(%)

	Growth			Inflation			Unemployment		
	2006	2007	2008	2006	2007	2008	2006	2007	2008
EU (27)	3.2	2.9	0.9	2.3	2.4	3.7	8.2	7.1	7.0
Euro area (15)	3.0	2.6	0.7	2.2	2.1	3.3	8.3	7.4	7.5
Newly acceded countries (9)	6.6	6.2	3.9	3.3	4.2	6.3	10.1	7.7	6.5
USA	2.8	2.0	1.1	3.2	2.9	3.8	4.6	4.6	5.8
Japan	2.1	2.4	-0.7	0.2	0.1	1.4	4.1	3.9	4.0
China	11.6	13.0	9.0	1.5	4.8	5.9	4.1	4.0	

Note: Inflation in newly acceded countries is measured by weighing individual Harmonized Index of Consumer Prices (HICP) by the EU-27 weights in HICP.

Sources: Eurostat, Bureau of Labor Statistics, Bureau of Economic Analysis, the Japanese Statistics Bureau, the National Bureau of Statistics of China, BNB estimates.

Over the year real GDP growth in the euro area slowed down to 0.7 per cent on an annual basis. Country data show that the recession had arrived in Germany as early as June. The US National Bureau of Economic Research (NBER)¹ officially announced that the recession in the USA had started in early 2008. Although US economic growth was positive for the year, in the second half of 2008 the real rate was negative.

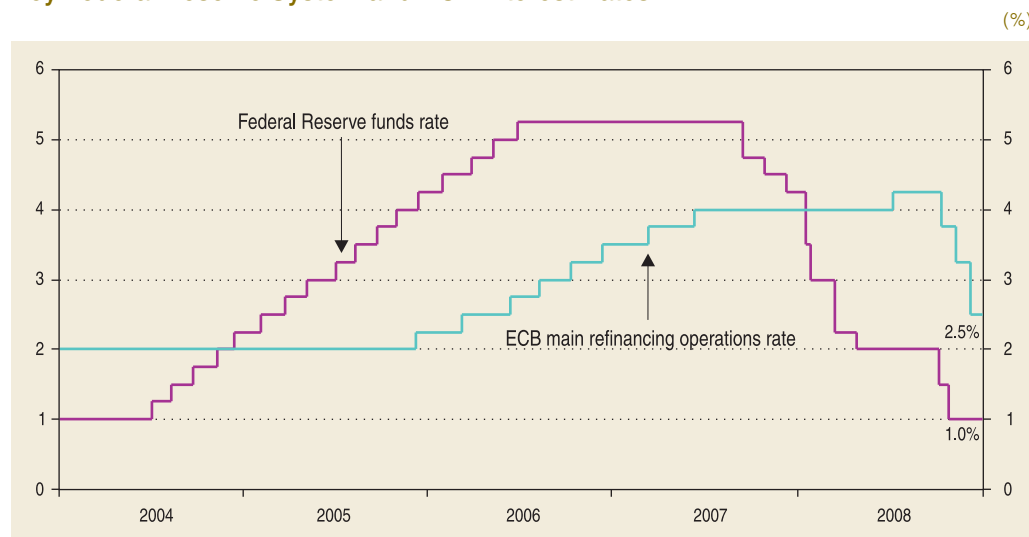
Global inflation reached high levels in the first half of 2008 driven by high fuel and food prices. However, it started declining rapidly in the second half of the year, and especially in the fourth quarter. Overall economic slowdown reduced demand for major commodities and fuels. At the same time food supply increased due to better weather compared to 2007. Average monthly inflation in the euro area was 3.3 per cent, moderating to 1.6 per cent in December on an annual basis, while US inflation was 3.8 per cent (0.1 per cent on an annual basis in December). The Brent oil price fell to about USD 40 *per* barrel in December 2008, a 70 per cent decrease on July. Food prices showed an analogous trend: an increase of 22 per cent in the first half of 2008 followed by a drop by some 35 per cent in the second half. Over the second half of the year contracting industrial and construction output pushed metal prices down by 38 per cent on July.

Central banks responded assertively to rapid economic slowdown and declining inflation by cutting reference interest rates significantly. The developing global financial cri-

¹ *Determination of the December 2007 Peak in Economic Activity*, National Bureau of Economic Research (NBER), 11 December 2008.

sis forced the use of various intervention instruments. In addition to standard operations for providing liquidity in money markets, central banks launched programmes to support falling financial asset prices. Governments urgently adopted fiscal stimulus packages to recapitalise straitened banks. Government bank deposit guarantees rose to EUR 50,000 to restore confidence in banks, with individual countries extending their scope beyond deposits.

Key Federal Reserve System and ECB Interest Rates



Sources: ECB, Federal Reserve System.

At the end of November 2008 the European Commission presented a special Recovery Plan to restore confidence in the European economy. Banking stability was defined as the first and most important priority to overcoming recession and stimulating fast and sustainable recovery. The plan entailed the bulk of financial support from Member States being directed at the banking sector to restore confidence in it, normalise lending, and guarantee the passing-on of central bank interest cuts in lending rates. Only in the context of banking stabilisation is it possible to implement short-term measures to stimulate demand and create jobs, and investment programmes to boost productivity and achieve sustainable long-term growth as laid down in the Recovery Plan. Providing fiscal stimuli amounting to 1.5 per cent of GDP to EU economies is one short-term measure. To achieve the required effect, fiscal measures may differ in individual Member States depending on their fiscal positions. Countries which have used the period of economic growth to attain sustainable fiscal positions and improve competitiveness are better placed to resist the global crisis.

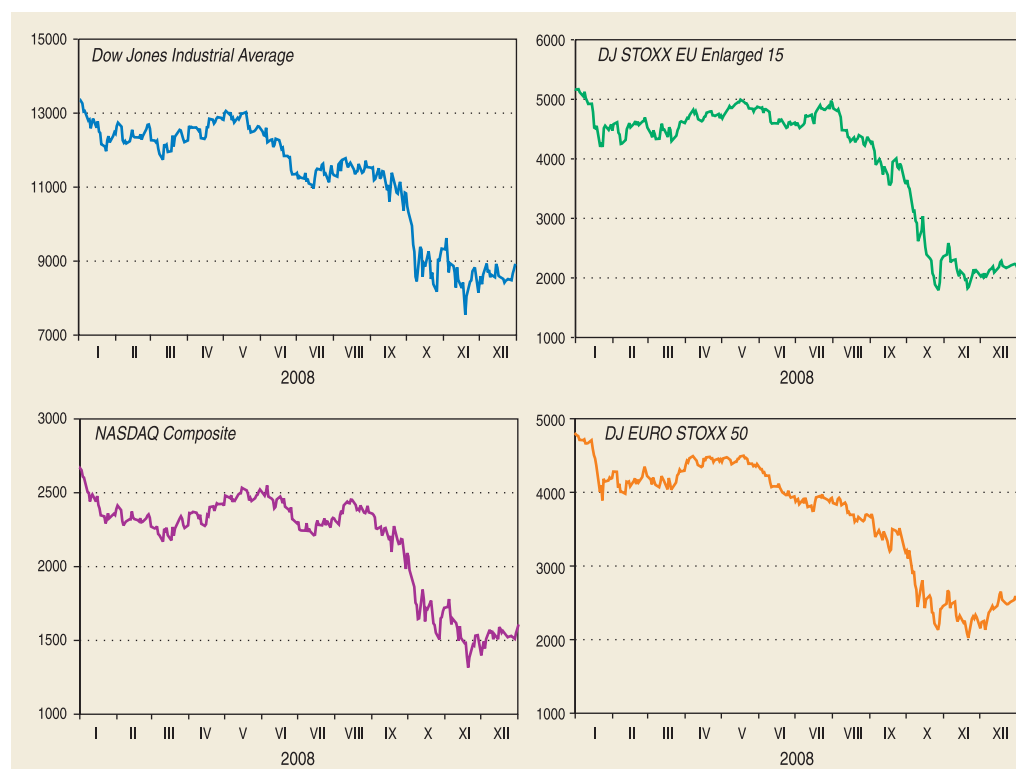
ECB monetary policy underwent significant changes in 2008. The main refinancing rate was 4.0 per cent in early 2008 (marginal lending facility at 5.0 per cent and deposit facility at 3.0 per cent). In July the ECB raised this by 25 basis points to 4.25 per cent, retaining this level until the end of the third quarter. Amid negative developments in the fourth quarter, the ECB cut the rate greatly in several steps. The first step in October was in coordination with the Federal Reserve System and other leading central banks which cut reference rates by 50 basis points or more in several steps. In under two months the ECB cut its cumulative reference rate by 175 basis points to 2.50 per cent at the close of 2008.² In response to increasing financial market imbalances and further expectations of slowing economic activity, the Federal Reserve System cut its cumulative reference rate more aggressively than the ECB: by 400 basis points from 4.25 per cent in early 2008 to 0/0.25 per cent at the year's close.³

² In early 2009 (in January and March) the ECB cumulatively cut the main refinancing rate by 100 b.p. to 1.5 per cent (marginal lending facility at 2.5 per cent and deposit facility at 0.5 per cent).

³ A decision of the Federal Open Market Committee as of 16 December 2008.

Financial market stabilisation took top priority in Federal Open Market Committee decisions after the Lehman Brothers bankruptcy.⁴ The collapse *de facto* paralysed an essential part of financial markets due to investor risk aversion. Concerns about the growing financial crisis forced the Federal Reserve System to introduce a number of new operating programmes. Some of them aim to improve bank liquidity, and others to stabilize the prices of particular assets through directing liquidity at specific market segments. Other measures have reduced mortgage interest to relieve end borrowers and mitigate the risks to the economy.

Major Stock Indices



Sources: Dow Jones, STOXX, NASDAQ.

In 2008 stock markets registered some of the heaviest losses in their history. Significant turbulence was observed in February and March, July and August, and especially November. Factors involved the US sub-prime mortgage crisis and global risk revaluation. In Europe, the Dow Jones EURO STOXX 50 and Dow Jones STOXX EU Enlarged 15 went down 49.0 per cent and 58.8 per cent respectively. In the USA, the NASDAQ Composite and Dow Jones Industrial fell by 42.7 per cent and 35.9 per cent. Financial and industrial shares fell most dramatically: by over 50 per cent on 2007.

2. The Bulgarian Economy

Real Bulgarian GDP growth in 2008 remained comparatively high at 6 per cent on average on the prior year.⁵ In the first half of the year it reached 7 per cent, slowing in individual economic sectors by the third quarter. As the global financial crisis hit real sectors worldwide in the fourth quarter, the Bulgarian economy was no exception in terms of economic activity, with annual real GDP growth slowing to 3.5 per cent.

⁴ For details on the policy of the ECB, Federal Reserve System and other central banks and its influence on international financial markets see Section II.

⁵ For detailed analysis of Bulgarian economy and external environment developments see the *Economic Review* quarterly (BNB website, Publications).

Real GDP Growth by Expenditure Component

(%)

	2007		2008	
	growth	contribution	growth	contribution
GDP	6.2	6.2	6.0	6.0
Final consumption	4.9	4.2	3.9	3.3
Household consumption	5.3	3.7	4.9	3.3
Government consumer expenditure	2.7	0.2	1.9	0.1
Collective consumption	3.4	0.3	-1.4	-0.1
Gross fixed capital formation	21.7	5.6	20.4	6.1
Physical change in inventories	20.4	1.2	-15.2	-1.1
Balance (exports – imports)	26.1	-4.9	10.6	-2.3

Source: NSI.

Gross Value Added Real Growth

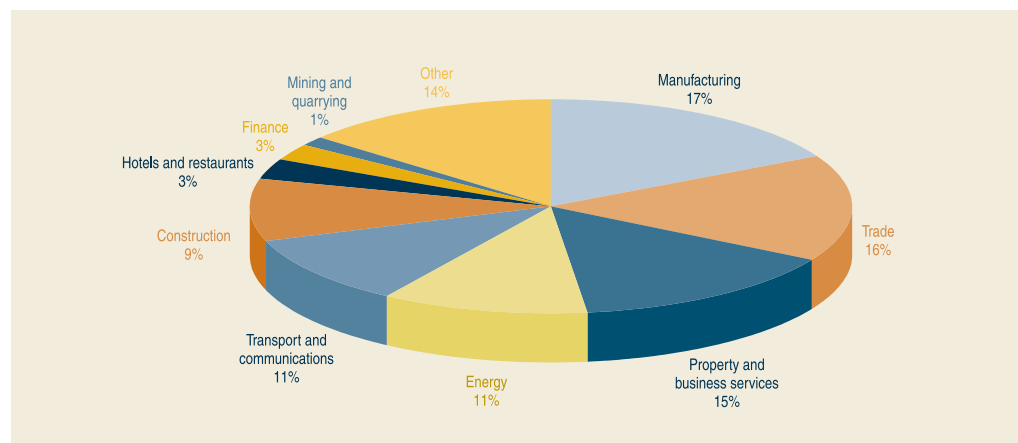
(%)

	2007		2008	
	growth	contribution	growth	contribution
Gross value added growth	6.3	6.3	6.1	6.1
Agriculture and forestry	-29.7	-2.5	24.6	1.5
Industry	14.0	4.3	3.0	1.0
Services	7.5	4.5	5.9	3.6

Source: NSI.

Recent years' fixed capital investment trends contributed most to GDP growth. Production capacity renewal covered all sectors.

Structure of Expenditure on Acquisition of Fixed Assets by Economic Activity in 2008

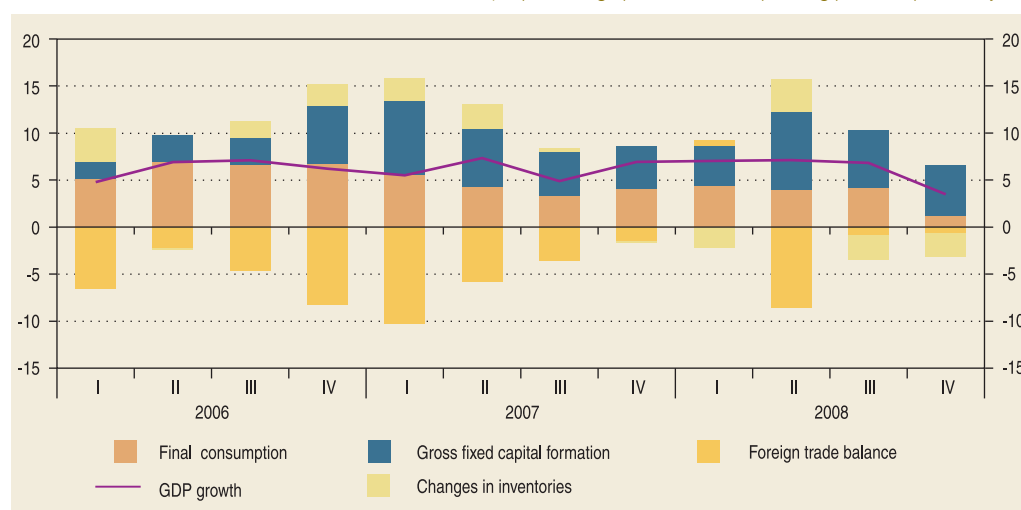


Source: NSI.

Final household consumption increased by 4.9 per cent during the year and played a key role in final consumer expenditure. Government spending under a restrictive fiscal policy was neutral as regards economic growth. Fourth quarter household consumption growth slowed to 1.5 per cent, with non-food consumption and net tourism revenue bringing negative contributions.

Contribution of Final Use Constituents to GDP Growth

(%, percentage points, on corresponding period of previous year)

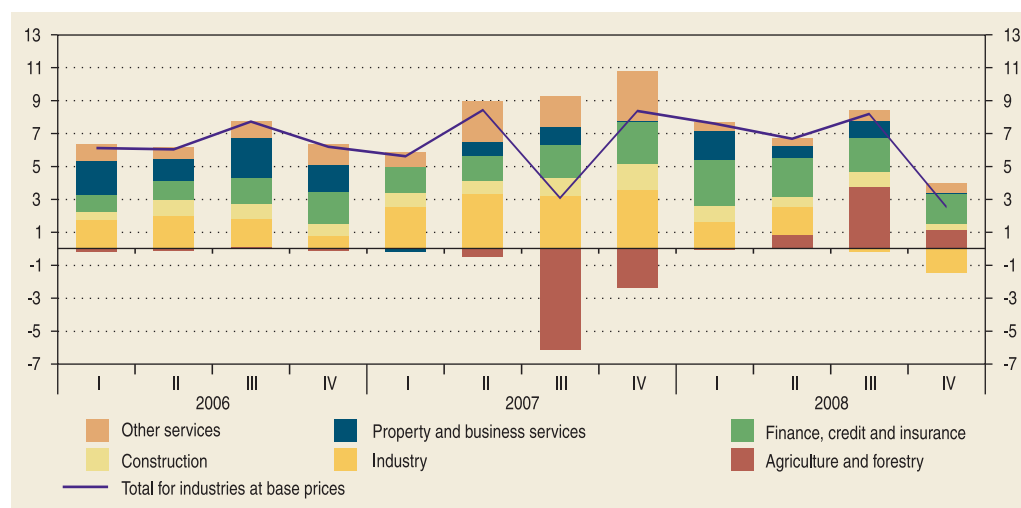


Source: NSI.

The balance of foreign trade contributed negatively to real GDP growth in 2008, yet at -2.3 percentage points, less so than in previous years. Amid growing uncertainty, shrinking demand and falling commodity prices, exports and imports slowed down in the second half of 2008, with nominal and real declines in the fourth quarter. Due to the recession in the euro area, Bulgaria's major trading partner, in the fourth quarter exports of goods and non-factor services decreased in real terms by 6 per cent on an annual basis (in 2008 exports rose by 2.9 per cent in real terms). Imports, reflecting intensive investment in Bulgaria, began to fall, though this lagged behind exports. Real growth in imports was also negative in the fourth quarter at 3.2 per cent, against a positive real growth rate of 4.9 per cent in 2008.

Value Added Growth and Contribution by Sector

(%; percentage points, on corresponding quarter of previous year)



Source: NSI.

Manufacturing, an export-oriented industry with a sizable share of exported output, began feeling the global economic crisis by the third quarter of 2008 and its value added over the fourth quarter declined by 5 per cent on an annual basis. Amid falling external demand, companies tried to boost efficiency and cut expenses, downward trends in commodity and energy prices supporting their efforts. Over the fourth quarter annual wage growth in manufacturing fell to 16 per cent from nearly 25 per cent in the first nine months.

Better farming weather in 2008 compared with 2007 contributed 26.7 per cent to the high real growth in agriculture (a 1.6 percentage point contribution to real GDP growth) which partially offset the significant real drop of 29.7 per cent in 2007.

The services sector rose by 5.9 per cent in real terms over 2008, with financial intermediation contributing most with 3.6 percentage points. Financial intermediaries' efficiency improved over the year, productivity rising by almost 16 per cent on an annual basis. Lower household consumption growth by the close of 2008 hit value added growth in retail, which fell to 1.6 per cent. Services, other than dominant state owned sectors, retained their positive growth in 2008 as well.

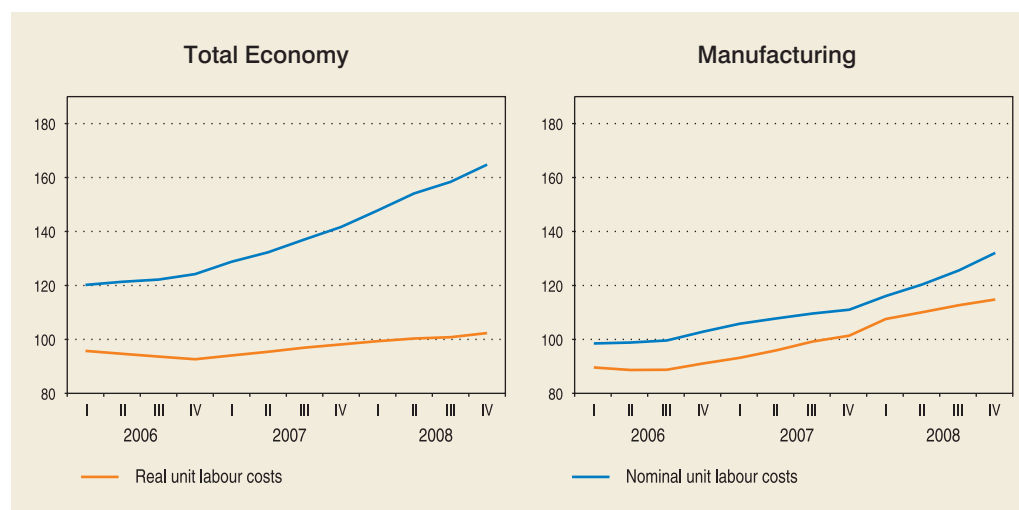
Construction and property and business services retained their high growth rates in 2008: 8.5 and 5.5 per cent respectively. However, they fell dramatically in the last quarter to 4.4 and 0.6 per cent respectively. The number of building permits issued and the results of the latest surveys show that growth in these sectors is expected to slow further.

Labour demand remained high over the year due to strong economic growth. Supply continued to improve, with economically active 15 to 64-year-olds comprising 67.8 per cent of the total number in 2008 against 66.3 per cent in 2007. Improved trading in 2008 boosted the number of employed people by 3.3 per cent, unemployment falling to 5.6 per cent.

After falls in real unit labour cost between 2004 and 2006 which contributed to businesses' finances, in 2007 and 2008 wages grew faster than productivity. Major factors pushing up wages appear to be higher labour productivity due to significant fixed capital investments, and sharply falling unemployment with attendant shortages of qualified personnel in some industries. Nominal wage dynamics in 2008 was also affected by the 22 per cent rise in minimum monthly pay and the 25 per cent increase in minimum social security thresholds. Amid rapid growth, higher wages did not worsen enterprises' financial performance, as confirmed by the constant rise in gross operating surplus.

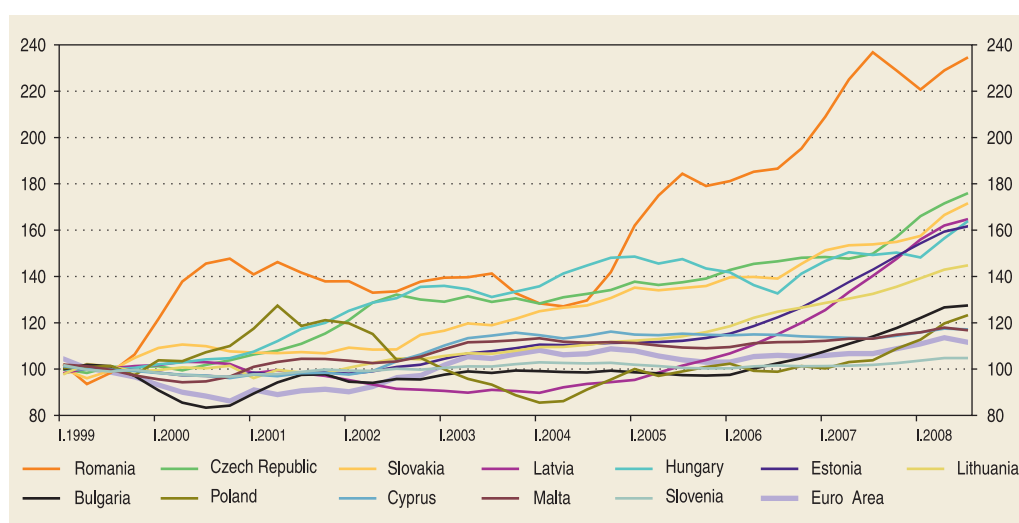
Unit Labour Costs

(moving average, 2000 = 100)



Sources: NSI, BNB.

Real Effective Exchange Rate Based on Unit Labour Costs (vis-à-vis 36 industrialised countries, 1999 = 100)*



Source: EC, Price and cost competitiveness, January 2009.

After comparatively high rates in 2007, inflation moderated to 7.2 per cent in 2008. At 3.4 percentage points, services had the major contribution to accumulated inflation. Indirect effects of food and fuel price rises on public catering and transportation between mid-2007 and mid-2008 were among the factors behind fast growing service prices during the year. Another factor behind inflation in services was the high growth rate of wages which increased the pressure of unit labour costs on prices while helping maintain consumer demand. The second half of the year saw a significant decline in overall inflation, underpinned by moderating food and fuel prices. Lower growth in food prices reflected greater supply due to the good harvest in Bulgaria and the region, and the base effect of food inflation in the second half of 2007. Fuel price drops in late 2008 followed the downward trend in world oil prices, partially compensated by higher excise duty from early 2008.

HICP Inflation Accumulated since Year's Start and Contribution* (Eurostat Classification)

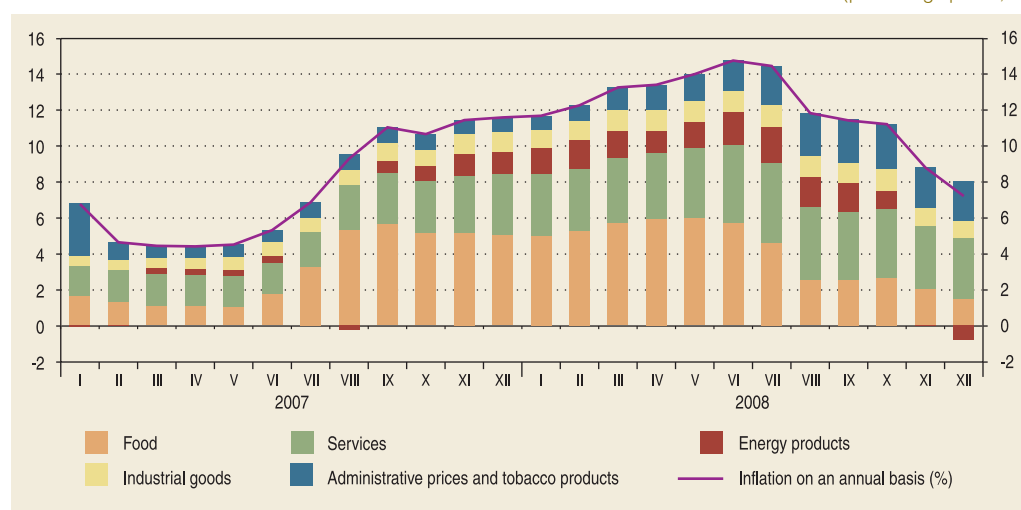
	January – December	
	2007	2008
Inflation (%)	11.60	7.20
Contribution (percentage points)		
Services	3.36	3.41
Public catering	1.96	1.58
Goods with administratively set prices	1.06	1.65
Foods	5.06	1.46
Processed foods	4.11	0.82
Unprocessed foods	0.94	0.65
Industrial goods	1.12	0.95
Energy products	1.23	-0.80
Transportation fuels	1.17	-1.01
Tobacco products	-0.26	0.52

* This structure matches the Eurostat classification, with tobacco products and goods with administratively set prices shown as separate items.

Sources: NSI, BNB.

Inflation on an Annual Basis and Major Commodity Groups and Services

(percentage points; %)



Sources: NSI, BNB.

The balance of trade deficit reached EUR 8.8 billion in 2008 (25.7 per cent of GDP) and increased by EUR 1.5 billion on 2007, with imports growing faster than exports and energy prices higher.⁶ Nominal goods exports in 2008 rose by EUR 1.8 billion (13.1 per cent) on the prior year and goods imports grew by EUR 3.3 billion (15.8 per cent). Major contributors to export growth were raw materials for the food industry (4.2 percentage points), oil products (2.4 percentage points) and machines, vehicles, and appliances (1 percentage point). Fuels, machines, vehicles, and appliances and food, drink, and cigarettes boosted imports most at 4.8, 1.5 and 1.4 percentage points respectively.

According to preliminary data, foreign direct investment inflow came to EUR 6.2 billion in 2008 (18.1 per cent of GDP) covering 73.7 per cent of the balance of payments current and capital account deficit which was EUR 8.4 billion (24.5 per cent of GDP) for the year, the current account deficit reaching EUR 8.6 billion (25.3 per cent of GDP).⁷ Foreign direct investment, coupled with the larger net external obligations of the private non-bank sector (EUR 2.3 billion) and non-residents' local bank deposits (EUR 2 billion) formed an EUR 11.1 billion surplus in the balance of payments financial account. Comparing net financial flows into Bulgaria over the fourth quarter *vis-à-vis* the same period of 2007 shows a decrease of EUR 3 billion. This may be due to the preliminary nature of available data, and to the effects of central bank and government actions. The BNB reduced the minimum required reserve rate in October and December,⁸ releasing significant funds to banks. The accumulated surplus on the consolidated state budget in the first nine months of 2008 enabled significant government expenditure, in particular under the Supplementary Social and Investment Programme approved by parliament. Central bank and government actions increased liquidity markedly at the end of 2008, allowing banks to boost foreign assets and reduce foreign liabilities.

In the first nine months BNB gross international foreign exchange reserves increased strongly, falling over the fourth quarter from EUR 14.7 billion to EUR 12.7 billion as a result of the above measures. In 2008 gross international reserves rose by EUR 789 million at market value.

Balance of payments data show that local businesses made continuing use of external finance into the fourth quarter. Bulgaria's gross external debt increased by EUR 7.8 billion to EUR 36.7 billion (107.7 per cent of GDP) in 2008. The gross amount of public and

⁶ In 2008 the average price in euro of imported crude oil rose by 22.9 per cent on the previous year. Changes in the prices of crude oil, oil products and natural gas over the year boosted the current account deficit by EUR 558.5 million.

⁷ Data on foreign direct investment are periodically revised on the basis of the information submitted by enterprises. Recent years' practice shows systematically revised data on the inflow of foreign direct investment with a positive sign which makes the comparison between initial data for 2008 and repeatedly revised data for 2007 incorrect.

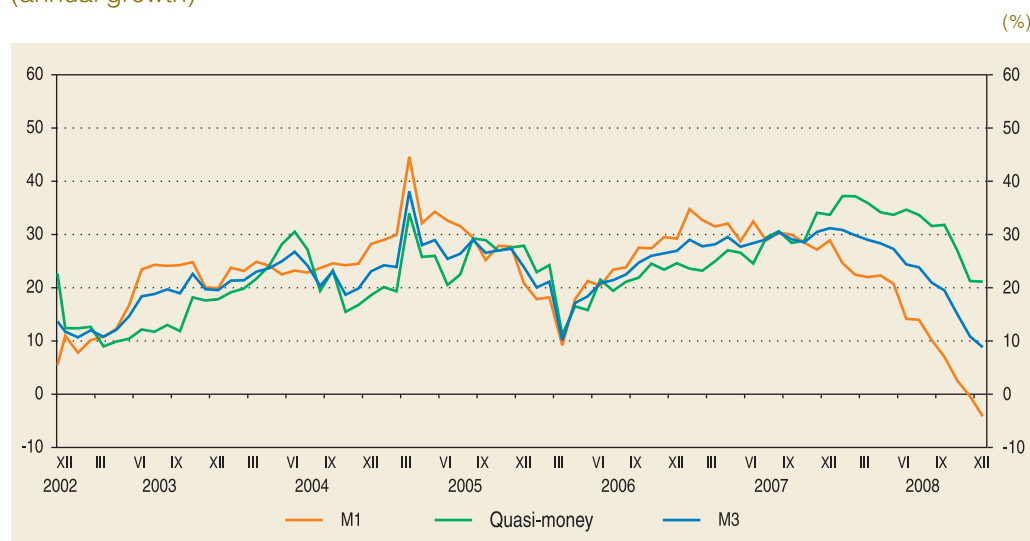
⁸ For more details see Section IV.

publicly guaranteed debt remained broadly unchanged in 2008, with the early payment of loans to the World Bank being offset by the growing publicly guaranteed debt. Private non-guaranteed external debt grew by a total of EUR 7.8 billion in 2008, with banks' debt increasing by EUR 3.3 billion.

Fiscal policy had an important role in maintaining macroeconomic stability and investor confidence in the Bulgarian economy. Over 2008 consolidated fiscal programme surplus came to BGN 1989.8 million or 3 per cent of reported GDP for the year. Despite a certain moderation in consolidated budget receipts at the end of 2008, total revenue rose by 13.5 per cent, with tax revenue growing by 14.7 per cent. Further increases in fuel and tobacco excise in 2008 gave excise duty the highest growth rate (22.2 per cent on an annual basis) among indirect taxes. Despite a slowdown in value added tax revenue, it still increased by 13.4 per cent. Total consolidated budget expenditure (EU budget contribution included) rose by 14.6 per cent on an annual basis. Current expenditure, including EU budget contribution, picked up by 15 per cent annually, reflecting mainly pension and wage indexation and the supplementary social security package by the budget at the close of the year. Capital expenditure grew by 18.1 per cent due to extra fourth quarter investment on infrastructure projects which fall within the government plan approved by parliament.

Money and credit dynamics in 2008 reflected mostly foreign capital inflows. By the end of the year monetary aggregate growth slowed due to the slower growth of bank deposits and currency in circulation, reflecting a high base and international financial market turmoil. Broad money increased by BGN 3.7 billion or 8.8 per cent on an annual basis, while the M1 monetary aggregate fell by 4.4 per cent, with currency outside banks rising by 8.0 per cent and overnight deposits declining by 11.0 per cent.

Monetary Aggregates (annual growth)



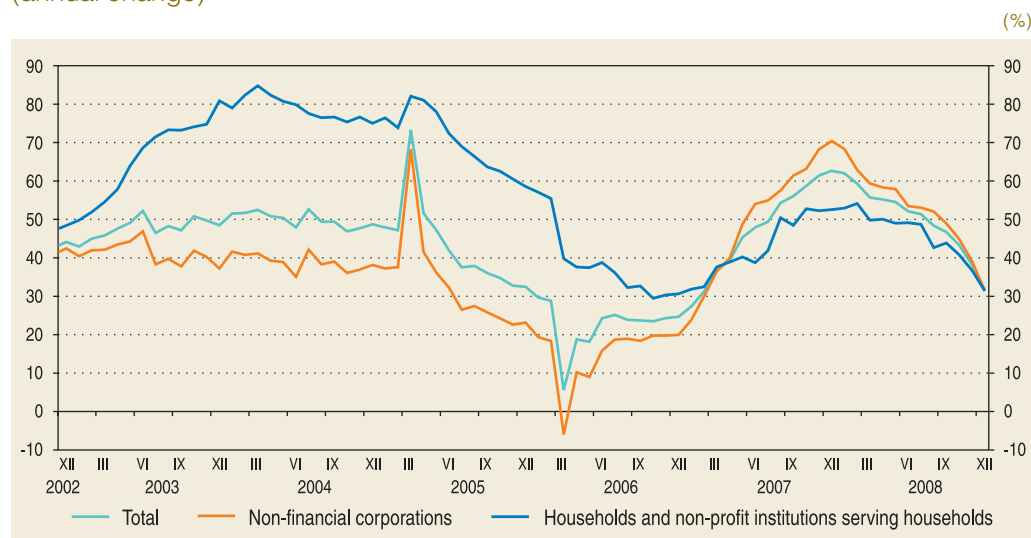
Source: BNB.

Claims on the non-government sector, which posted a nominal growth rate of 62.5 per cent at the end of 2007, began to slow down from the very beginning of 2008 as a result of a higher minimum required rate since late 2007⁹, the rising world cost of financing and tightened lending in Bulgaria. After September 2008 the annual growth rate of bank lending to the non-government sector slowed more rapidly than in early 2008 due to poor external conditions. Over the year bank claims on the non-government sector rose by BGN 11,925.2 million (against BGN 14,527.1 million in 2007), their annual growth decreasing to 31.6 per

⁹ At its meeting of 19 July 2007, the BNB Governing Council increased as from 1 September 2007 the minimum required reserve rate from 8 per cent to 12 per cent of the deposit base as a further step in curbing growth rates of credit to the private sector and in controlling risks in the banking system.

cent at the close of the year. The annual growth rate of claims on non-financial corporations fell from 70.2 per cent at the end of 2007 to 31.4 per cent at the end of 2008, while that of claims on households decreased from 52.4 per cent to 31.3 per cent over the same period. Despite the moderation in lending growth, the *claims on the non-government sector to GDP* ratio accelerated by 7.6 percentage points to 74.5 per cent in 2008.

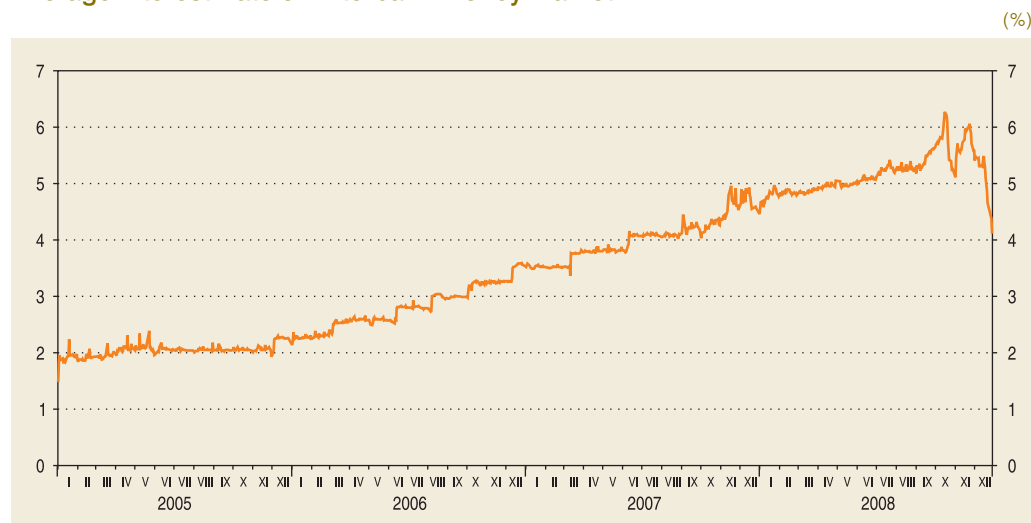
Claims on Non-government Sector (annual change)



Source: BNB.

The total volume of interbank money market transactions picked up BGN 34.6 billion (49.1 per cent) on the previous year. Of them, deposit transactions grew by 30.8 per cent, while repo agreements rose more than five times, mainly due to changed requirements for government securities primary dealers from early 2008. The average monthly interest rate on interbank market transactions increased from 4.75 per cent in January to 5.74 per cent in November, falling back to 5.20 per cent in December. Its overall increase was driven by the worsening situation in international financial markets. The subsequent decrease at the close of the year was due to lower interest rate on ECB main refinancing operations and the reduced rate of minimum required reserves with the BNB at the end of 2008 which released banking liquidity.¹⁰

Average Interest Rate on Interbank Money Market



Source: BNB.

¹⁰ See Section IV.

In 2008 foreign currency market turnover more than doubled on 2007 to EUR 557 billion.¹¹ Foreign currency traders reported growth in both final customer (25 per cent) and interbank trading, including transactions with the BNB (more than double). Net euro purchases from banks largely reflected changes in mandatory minimum required reserves. In 2007 when their rate was raised to 12 per cent, net euro purchases from banks rose, while when the rate was cut in late 2008 purchases declined.¹²

The recent years' fiscal policy of budget surpluses contributed to the decrease in public debt and its servicing. Government securities supply gradually decreased. In 2008 government securities denominated in BGN included three-month discount treasury bills and five and ten-year fixed rate treasury bonds. Issues of three-month discount government securities were less frequent (three in 2008 against four in 2007), total nominal placement value falling to BGN 45 million from BGN 60 million in 2007. The placement of five-year government securities fell by 47.1 per cent to BGN 84.8 million in nominal value, while that of ten-year ones dropped by 32.6 per cent to BGN 168.5 million in nominal value. Average annual yield rose in all maturities.

Outright transactions in domestic government securities between banks (including investment intermediaries approved as primary dealers) in the secondary government securities market totaled BGN 2.528 billion (up 77.2 per cent on 2007).¹³ BGN-denominated bond turnover doubled to reach BGN 2.512 billion. EUR-denominated bond turnover dropped to BGN 7.9 million, from BGN 180.5 million in 2007, while trade in USD-denominated bonds issued under ZUNK almost tripled to BGN 8.5 million. At the close of 2008 prices of Bulgarian government securities denominated in other currency (euro bonds maturing in 2013 and global US dollar bonds maturing in 2015) averaged 100 per cent and prices of US dollar denominated ZUNK bonds also hovered around 100 per cent.

The total volume of *bourse* trade in corporate and municipal bonds fell by 37.9 per cent on 2007 to BGN 247.4 million. The volume of the primary share capital market on the Bulgarian Stock Exchange, Sofia was insignificant: BGN 1.4 million rights on shares. OTC placement of several companies' shares was also reported. The turnover of secondary market shares decreased significantly to BGN 1.851 billion, while the volume of OTC transactions on the Bulgarian Stock Exchange, Sofia platform came to BGN 738.5 million.

Stock exchange indices declined greatly in 2008, the SOFIX falling from 1737.4 to 358.7 points and the *BG40* from 516.5 to 107.8 points. The global financial crisis impacted the Bulgarian stock exchange, particularly in the second half of 2008, which led to a 57 per cent decline in market capitalization which reached BGN 12.461 billion (18.7 per cent of 2008 GDP) at the close of the year.

¹¹ The turnover includes transactions with banks (including the BNB) in foreign currency against levs with value date of payment up to two business days and the doubled amount of interbank trading.

¹² See the table *Largest Cash Flows* in Section II.

¹³ Data based on the statistics of operations with a flow on current accounts with the BNB.

II. Gross International Reserves

The BNB manages its gross international reserves with regard to the requirements and constraints of the Law on the Bulgarian National Bank and opportunities offered by international financial markets.¹⁴ The Bank's gross international reserves comprise the assets on the Issue Department's balance sheet and their role is to provide complete cover for monetary liabilities under the fixed exchange rate.¹⁵ The excess of gross international reserves over monetary liabilities forms the *Banking Department Deposit* or the net value in the Issue Department's balance sheet.¹⁶

1. The Amount and Structure of Gross International Reserves

At the end of 2008 the market value of gross international reserves was EUR 12,738 million: an increase of EUR 789 million or 6.59 per cent on the end of 2007.

Largest Cash Flows

(million EUR)

External flows	2008	2007
Total for the period	56	2 545
Purchases and sales of euro	1 222	2 410
At tills	-54	-60
Banks, incl.	1 275	2 458
purchases by banks	125 543	54 467
sales to banks	-124 268	52 008
Flows on accounts of banks, the MF, etc.	-1 166	135
Minimum required reserves	-657	827
Government and other depositors	-509	-691

Source: BNB.

Positive external flows over the year were attributable mainly to net purchases of reserve currency by the BNB to the amount of EUR 1275 million, while some EUR 657 million was released to banks as part of reduced minimum required reserves.¹⁷

The currency structure of reserves remained almost unchanged on 2007, with euro-denominated assets occupying the largest share at 93.05 per cent on average over the period. Monetary gold came to 5.8 per cent.

¹⁴ The period under review saw no Law on the BNB amendments concerning the regulatory framework for gross international reserve management.

¹⁵ In accordance with Article 28, paragraph 2 of the Law on the BNB monetary liabilities of the Bulgarian National Bank consist of all banknotes and coins in circulation issued by the Bulgarian National Bank and any balances on accounts held by other parties with the BNB, with the exception of the accounts held by the IMF.

Article 28, paragraph 3 of the Law on the BNB comprehensively lists assets which may comprise gross international reserves. These are: monetary gold; Special Drawing Rights; banknotes and coins in freely convertible foreign currency; funds in freely convertible foreign currency held by the BNB on accounts with foreign central banks, other foreign financial institutions or international financial organizations whose obligations are assigned one of the two highest ratings by two internationally recognized credit rating agencies; government securities issued by foreign countries, central banks, other foreign financial institutions or international financial organizations assigned one of the two highest ratings by two internationally recognized credit rating agencies; the balance on accounts receivable and payable on BNB forward or repo agreements with, or guaranteed by, foreign central banks or public international financial organizations whose obligations are assigned one of the two highest ratings from two internationally recognized credit agencies; and BNB futures and options which bind non-residents and which are payable in freely convertible foreign currency. The law stipulates that these assets are estimated at market value.

¹⁶ According to Article 28, paragraph 1 of the Law on the BNB, 'the aggregate amount of monetary liabilities of the Bulgarian National Bank shall not exceed the lev equivalent of gross international reserves,' with the lev equivalent determined on the basis of the fixed exchange rate.

¹⁷ As noted in Section I, net euro purchases from banks reflected largely changes in the regulation of minimum required reserves. In 2007 when their rate was raised to 12 per cent, net euro purchases from banks rose, while at the end of 2008 when the rate was cut by the BNB, these purchases declined.

Currency Structure of International Reserves

(%)

Currency	Issue Department balance sheet assets	
	2008	2007
EUR	93.05	92.77
USD	0.86	0.27
Gold	5.78	6.56
SDR	0.30	0.39
CHF	0.01	0.01

Note: Average data for the period.

Source: BNB.

The structure of assets by financial instrument changed, with the share of investment in securities growing by over 81 per cent on average for the period at the expense of a decrease in investment into money market instruments, which were mostly short-term deposits or cash with top-rated foreign banks (see table below). Following developments in the world financial crisis, BNB exposure to foreign counterparty banks was further reduced both in maturity and amount.

Structure of Gross International Reserves by Financial Instrument

(%)

Instruments	2008	2007
Vault cash*	2.37	11.18
Deposits**	14.24	12.87
Securities**	81.07	73.32
Gold in the vault	2.32	2.63

* Balances on accounts and payments.

** Including instruments in foreign currency and gold.

Note: Average data for the period.

Source: BNB.

The structure of international reserves by residual term to maturity underwent slight changes compared to the 2007 average: the share of short-term investment (with maturity of up to a year) decreased by some 2 per cent at the expense of insignificant increases in other maturity sectors of five to 30 years.

Structure of Gross International Reserves by Residual Term to Maturity

(%)

Maturity sectors	2008	2007
Up to 1 year	80.97	88.82
From 1 to 3 years	10.19	9.08
From 3 to 5 years	1.36	1.51
From 5 to 10 years	1.08	0.59
From 10 to 30 years	0.40	0.00

Note: Average data for the period.

Source: BNB.

2. Gross International Reserve Risk and Yield

The Market Environment

The year featured dramatic fluctuations in all financial market segments, reflecting the deepening and expanding crisis on international financial markets, which turned into a global economic crisis by the close of 2008.¹⁸ Over the year, two events were particularly noteworthy due to their strong market impact. In March *Bear Stearns*, one of the world's largest investment banks, avoided bankruptcy following intervention by regulatory authorities which financed its buyout by *JP Morgan*. In September the Lehman Brothers' bankruptcy led to a slump in financial market confidence, giving rise to serious straits at a number of large financial institutions.

¹⁸ See also Section I.

The crisis of confidence in banking institutions following the *Lehman Brothers'* bankruptcy led to contractions in the interbank deposit market trade. Short-term interest rates in the euro area grew significantly. On 8 October three and six-month EURIBOR rates reached 5.39 per cent and 5.44 per cent respectively against a reference repo interest rate of 4.5 per cent. In response to the heightened demand for liquidity European and US central banks took extraordinary actions to refinance banks, prolong the term of payment on liquidity provision, and expand the range of acceptable security.

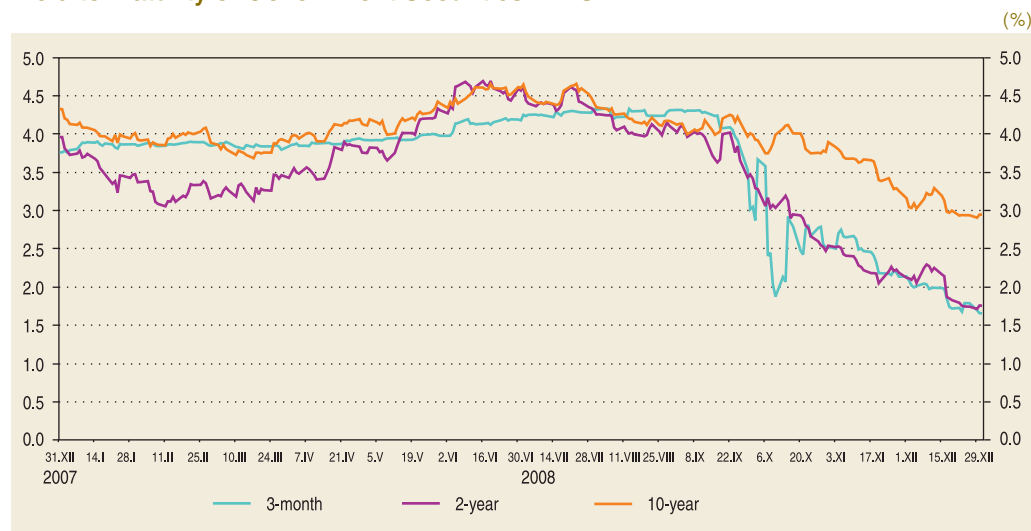
In mid-October the ECB temporarily enlarged the scope of assets accepted as security by allowing banks to participate in refinancing operations. While trying to stabilize interbank interest rates, at the end of the same month the euro area central bank began distributing unlimited liquidity through operations in euro and US dollars in all maturity sectors and at fixed interest rates. The ECB agreed on a swap line with the central bank of Switzerland for providing refinancing in Swiss francs to banks in the euro area. The Polish and Hungarian central banks joined the agreement later.

Another extraordinary measure was the narrowing of the corridor of standing facilities for banks. Between October 2008 and January 2009 ECB deposit and credit operations rates moved within the range of 50 basis points below and above the reference repo rate. This improved banks' ability to manage liquidity through operations with the ECB, which did not allow the interbank market to restore its liquidity allotment functions. As a result, overnight deposits with the ECB rose to exceptional levels of almost EUR 300 billion. In practice, banks were accumulating liquidity on their balances and keeping it within the banking system. This cut overnight rates to below the ECB deposit rate. Under normal market conditions, the spread between LEONIA¹⁹ and the ECB deposit rate is positive, while between early November and late December 2008 it reached an average of -15 basis points (-35 basis points at the close of the year). BNB overnight deposit quotations to banks under normal conditions are on average some 4 basis points below the LEONIA overnight index.

Government Securities Yield Curve in the Euro Area

The year saw a considerable decline in European government securities yield (market value appreciation). Yield dynamics can be divided into two periods. During most of the first six months yield grew amid high inflation and ECB repo rate rises. Yield in the up to two year maturity sectors went up until it matched those of over 10 years. In the second half year yield dipped driven by expectations of falls in ECB reference repo rates. The downward trend was clearest in the last quarter amid a flight to quality following *Lehman Brothers'* bankruptcy in September.

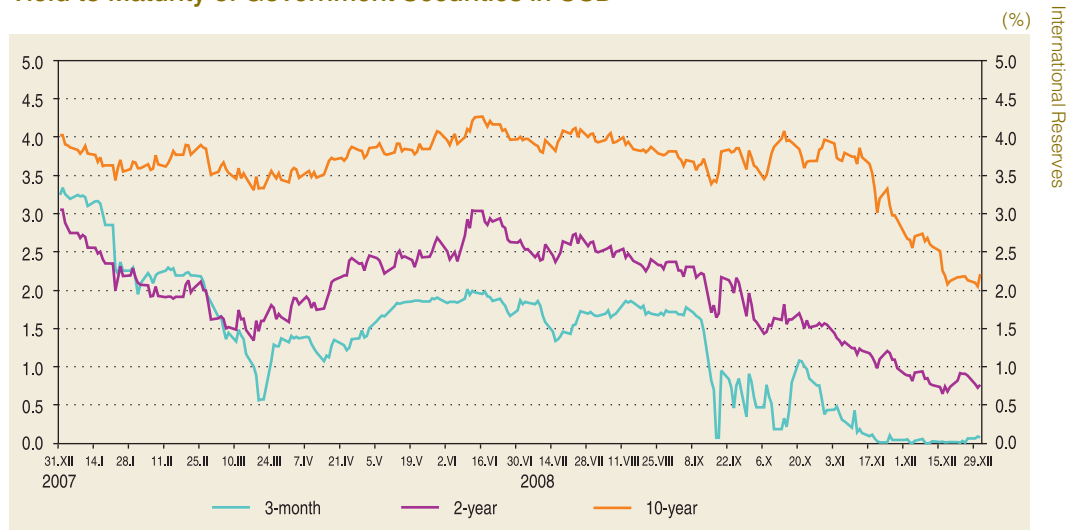
Yield to Maturity of Government Securities in EUR



Source: BNB.

¹⁹ The overnight interest rate on interbank deposits in euro between banks in the euro area.

Yield to Maturity of Government Securities in USD



Source: BNB.

Spreads on Euro Area Countries' Government Securities

By the end of 2008 spreads on euro area countries' government debt picked up to unusual peaks against German benchmark government securities. The change in spreads on individual countries' five-year government debt was between some 40 basis points and over 130 basis points. Euro area recession and the outlook of persistent public finance worsening in Greece, Ireland, Italy, Portugal and Spain were among the major factors at play. Large scale measures to stabilize finances and support economies increased government and government guaranteed debt, additionally pushing up yield demand. Spreads on government securities widened depending on countries' initial fiscal and debt positions and degrees of impact of the global crisis. Spreads in the five-year maturity sector in Belgium (+104 basis points), Ireland (+127 basis points), Italy (+131 basis points), and Portugal (+121 basis points) changed most. In response to deteriorating prospects, in early 2009 agencies lowered the ratings on Greek, Portuguese and Spanish debt and put the Irish rating under watch with a negative outlook. Credit risk premia on French (+42 basis points) and Dutch (+57 basis points) government securities went up less.

Over the year credit spreads on euro area bank debt fluctuated to unprecedented degrees. Peaks were marked during the *Bear Stearns* crisis in mid-March and the *Lehman Brothers*' bankruptcy in September. Amid a deepening financial crisis and growing money markets uncertainty, investors gradually hiked assessments of key financial institutions' creditworthiness to historic peaks.

Looking to constrain the financial crisis and limit its impact, during the fourth quarter of 2008 EU governments and central banks took unprecedented measures such as increasing bank deposit guarantees, recapitalising banks, and guaranteeing newly issued debt. Nationalised banks include *Northern Rock* and *Bradford and Bingley* in the UK, *Glitnir* and *Landsbanki* in Iceland, and *Fortis* in Belgium, Luxemburg and the Netherlands. The crisis hit *Dexia* and *ING* badly and their governments recapitalized them with EUR 6.4 billion and EUR 10 billion respectively. In October the UK government announced GBP 37 billion of capital support to *RBS*, *Lloyds*, and *HBOS*.

Gold and the Exchange Rate

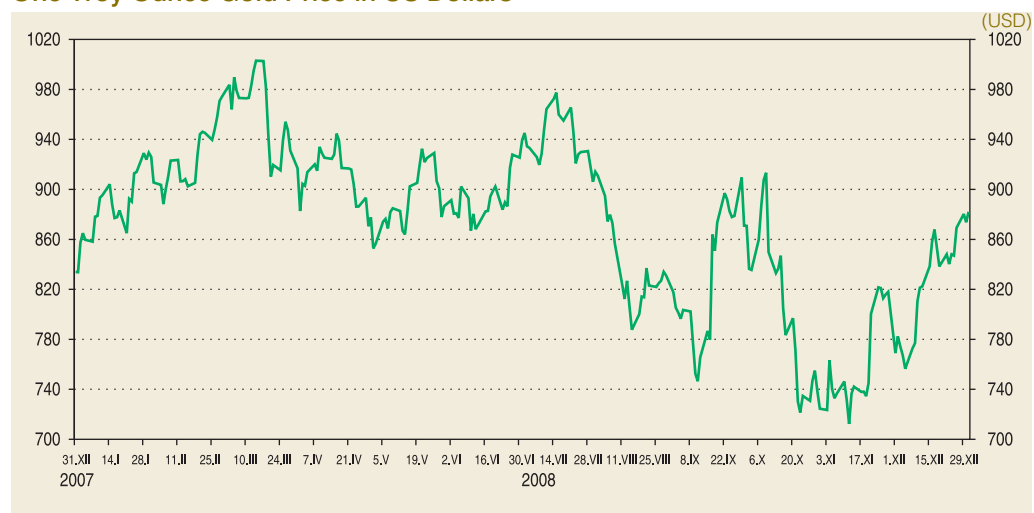
In 2008 cumulative US dollar appreciation against the euro was 4.4 per cent. The average exchange rate of the euro against the US dollar reached 1.47, compared with 1.37 during the prior year. This rate moved within the exceptional range of 1.2454 to 1.5992, as did the fluctuation magnitudes, especially during the last three months of the year. The dollar appreciated most in the last quarter as demand for low risk US dollar assets grew owing to global financial crisis.

US Dollar Price in EUR



Source: BNB.

One Troy Ounce Gold Price in US Dollars



Source: BNB.

One Troy Ounce Gold Price in Euro



Source: BNB.

The price of gold in US dollars rose by 5.5 per cent in 2008 as a result of investment demand for the commodity as a safe haven. The price of gold in euro went up by 9.4 per cent due to euro depreciation against the US dollar. The year saw significant gold price fluctuations caused by flights to quality.

Major Types of Risk

In early 2008 the Governing Council of the BNB set the current year's risk value of the Banking Department's deposit with the Issue Department at $VaR^{20} = 0\%$ at 95 per cent confidence level. The BNB did not exceed this risk tolerance over the review period.

Over 2008 international reserve **interest rate risk** measured by reserves' average *modified duration* (for the whole reporting period) was almost 0.50. It was insignificantly higher than the same indicator for 2007 (0.44). Maximum interest rate risk restriction (maximum duration of assets in euro at six months) was retained due to continuing high uncertainty and world financial market fluctuations.

International reserve **currency risk** is constrained by the Law on the BNB stipulation that the sum of the absolute values of open foreign currency positions²¹ in currencies other than euro, SDR, and monetary gold, should not exceed 2 per cent of the market value of monetary liabilities in these currencies. In the period under review minimal open currency positions were maintained in currencies other than euro. The open position in monetary gold posed the major currency risk to the Bank.

As the credit and liquidity crisis on international markets deepened in 2008, the BNB took additional measures to cut international reserve **credit risk**. The maximum term to maturity of short-term foreign currency deposits was cut markedly and deposits in monetary gold were discontinued. Additional limits were imposed on credit risk at counterparties to which the Bank may have exposures. Foreign currency operations with some financial institutions reporting higher credit risk were suspended, while others were taken off the BNB list following credit rating decreases. Some of the measures were temporary and were lifted by the year's end after relative market stabilisation following interventions by leading economies' governments and central banks. Over the period average exposure to non-resident banks fell thus to some 13.9 per cent of total assets compared with 23.9 per cent in 2007. Funds invested into assets with the highest credit rating (AAA²²) averaged 50 per cent.

Operational risk continued to be managed by strict monitoring and control under the business procedures for international reserve management.

Yield and Efficiency

In 2008 the BNB retained the restriction to interest rate risk of international reserves imposed in the first quarter of 2006 due to growing financial market uncertainty. The maximum duration of the euro-denominated asset portfolio remained six months.

BNB income from international reserve investment came to EUR 612.56 million: 4.64 per cent annual yield; significantly higher than in 2007. Total currency imbalance²³ yielded EUR 141.76 million over the review period. This stemmed mainly from the open position in gold and the strong appreciation of gold on international markets. Interest on Issue Department balance sheet liabilities²⁴ was EUR 135.32 million. As a result of these three components, net earnings from international reserve management came to EUR 618.85 million: 4.67 per cent net profitability over the period.

²⁰ Net value risk measured by $VaR = -X\%$ ($X > 0$) at 95 per cent confidence level and allowing for normal international reserve yield allocation means that 95 per cent of the time maximum net value loss would not exceed X per cent.

²¹ An open foreign currency position is the difference between the value of assets and liabilities in any currency other than euro.

²² Under investment restrictions, financial instruments into which the Bank may invest, and counterparties where it may place short-term deposits, have to have at least an AA- rating by *Standard & Poor's* and *Fitch Ratings* or Aa3 by *Moody's*. All financial instruments or counterparties should have one of the above ratings assigned by at least two internationally recognized credit rating agencies.

²³ Currency imbalance yield is the sum total of effects from exchange rate movements on open foreign currency positions of assets and liabilities.

²⁴ Data on Issue Department are not maintained directly by the information system for international reserve management; they are provided to it via the accounting system.

Earnings and Profitability of International Reserves

(million EUR)

		Earnings, net	Investment earnings	Earnings from currency revaluation of assets and liabilities	Expenditure (interest) on liabilities
Total earnings, million EUR	2008	618.85	612.56	141.76	-135.32
	2007	371.28	368.62	100.96	-98.30
Total profitability of international reserves, %	2008	4.67	4.64	1.05	-1.13
	2007	3.63	3.71	0.89	-0.97

Source: BNB.

Compared with 2007, external cash flows to the Issue Department balance sheet fell dramatically, mainly due to changed minimum required reserves by banks: in 2008 they amounted to EUR 55.49 million compared with EUR 2545.48 million in 2007.

The change in the net value corresponding to the *Banking Department Deposit* in the Issue Department balance sheet resulted from two major factors: a net international reserve management yield contribution of EUR 618.85 million (56.05 per cent net yield for the period), and a financial 2007 contribution to the state budget worth EUR 128.15 million plus budgeted expenditure which led to a decrease in the net value.

International reserves are split operationally into portfolios depending on currency and investment goal. Each portfolio has a benchmark, investment goals and investment limits. Major BNB portfolios and results from their management are presented in the table below.

Yield and Risk of Portfolios

Portfolio	Portfolio base currency	Yield		Risk (volatility)		Information ratio***
		Absolute (%)	Relative* (basis points)	Absolute (%)	Relative** (basis points)	
Investment 1	EUR	4.94	12	33	32	1.55
Investment 2	EUR	4.94	12	34	28	1.73
External manager A	EUR	7.09	-6	202	20	-0.62
External manager B	EUR	7.39	24	238	58	0.39
Liquidity	USD	2.25	48	31	25	7.89
Liquidity	EUR	3.87	-7	3	1	-23.45

* The positive relative yield for a given portfolio is the attained profit against the respective benchmark. Where relative yield is negative, it is interpreted as an opportunity cost in portfolio management. The relative yield is rounded to a basis point. Where it falls between -0.5 and 0, it is marked with -0 and where it falls between 0 and 0.5, it is marked +0.

** The relative risk against benchmark indicates the deviation of portfolio risk characteristics from those of the benchmark as a result of active portfolio management. The risk is on an annual basis.

*** This indicator is the ratio of expected portfolio relative yield to its relative risk on an annual basis.

Source: BNB.

In 2008 a proportion of international reserves (some 5.7 per cent) was managed externally. Besides achieving additional diversification, using external managers helped gain experience of international market investment. Liquid portfolios were formed to assist immediate payment needs. To diversify management styles and reduce operational risk, the bulk of euro-denominated assets continued to be split into two investment portfolios with identical benchmarks and investment limits, managed by different teams.

III. The Payment Systems

The Law on the Bulgarian National Bank assigns the Bank payment system organisation, support, and development through implementing, operating, and managing efficient payment mechanisms. Reducing systemic risk and creating conditions for Bulgarian integration into euro area payment infrastructure were among the Bank's major goals.

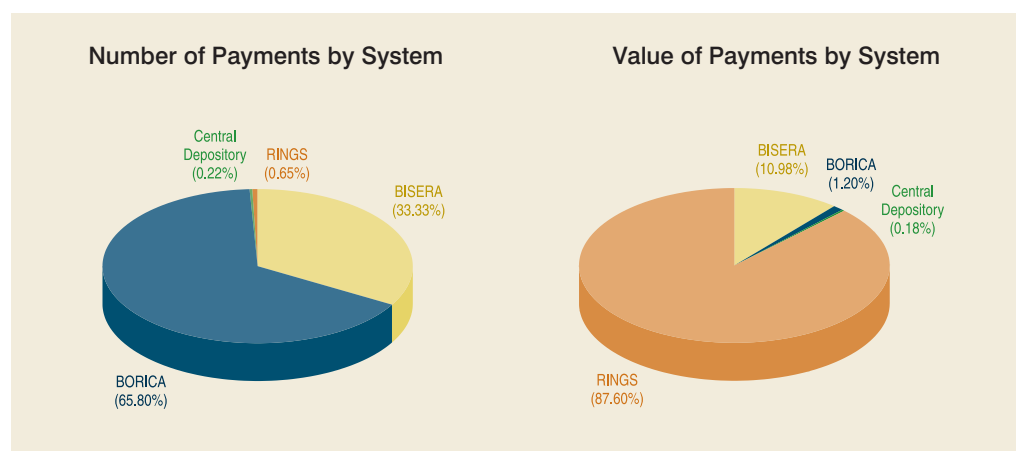
Bulgaria's payment systems are:

- RINGS (the real-time gross settlement system) operated by the Bulgarian National Bank;
- Ancillary systems:
 - BISERA (a system for servicing customer payments initiated for execution at a designated time) operated by Bankservice;
 - BORICA (a Bulgarian card payment system operated by BORICA AD, a MasterCard Europe member service provider and Visa International processor);
 - SEP (a mobile phone payment system operated by SEP Bulgaria).

Securities settlement systems in Bulgaria are:

- The BNB System for Servicing Payments on Transactions in Book-entry Government Securities;
- The Central Depository's System for Servicing Payments on Transactions in Book-entry Securities.

Distribution of Payments in Bulgaria by Payment System



Source: BNB.

In 2008 RINGS processed over 87 per cent of payments in Bulgaria. Values around 80 per cent are considered the optimum for real-time gross settlement systems. RINGS processed 0.7 per cent of non-cash payments. The growing RINGS' share of the value and number of processed payments indicated rising public confidence and helped subdue payment risks.

Payments processed by BORICA rose by 7.6 per cent in number and 21.2 per cent in value on 2007, with the average payment value picking up by 12.7 per cent on 2007. The increased number of processed payments reflected consumer willingness to use bank cards for easy access to bank accounts in payments and money withdrawals. The rising trend in the number and value of ATM transactions continued (up 22.5 per cent and 32.5 per cent respectively). Compared with 2007 transactions through BISERA rose by 17.3 per cent in value and 10.7 per cent in number. Equity market trading declines driven by the global financial crisis resulted in a dramatic drop in the value (by 71.5 per cent) and number (by 25.9 per cent) of Central Depository transactions.

The SEP share of transactions in Bulgaria was significantly smaller. The system was launched in mid-December and a handful of Bulgarian banks participated in it. Mobile payments, a new way of effecting non-cash transfers in Bulgaria, allow banks to broaden customer payment options. This, alongside promised high payment security, should make them popular and raise their share in Bulgarian payments.

1. The RINGS Real-Time Gross Settlement System

Processing most payment value through RINGS cuts payment risks: one of the Bank's major payment systems goals. In the review period RINGS processed 1,094,097 payments totalling BGN 792,357 million. Compared with 2007, the daily average number of payments rose by 18.8 per cent, while daily average value picked up by 81.4 per cent, reflecting dramatic average daily value rises in interbank transactions. Increases in the value and number of RINGS payments indicates a rise in average payment value (52.7 per cent), more significant in interbank than customer payments.

Over the review period 32.1 per cent of payments by value were processed by noon and 63.7 per cent by 2:30 pm. The trend to a rise in payment value in later hours continued. As regards system traffic, 85.5 per cent of RINGS payments were effected by 2:30 pm: down 7 percentage points on 2007.

In 2008 no payments were rejected by the close of the RINGS' system day due to insufficient funds on participants' accounts, indicating good liquidity management by banks. Over the review period there was no recourse to the Reserve Collateral Pool established as an interbank insurance mechanism to guarantee settlement of system operators' orders.

During 2008 the RINGS offered 99.85 per cent availability:²⁵ slightly down on the same period of 2007. Operational problems were handled under RINGS contingency rules and procedures.

In 2008 the number of RINGS participants rose to 30 as Bank Leumi Romania SA Sofia Branch, joined the system.

2. Regulatory Changes

In February 2008 the Governing Council amended BNB Ordinance No 3 on Funds Transfers and Payment Systems. This settled licensing and operation issues at money remittance companies as required by the Law on Funds Transfers, Electronic Payment Instruments and Payment Systems. The amendment also covers BNB accounts for government securities transactions by primary dealers and nominees of the Minister of Finance and the Governor of the BNB.

Amendments to the Law on Funds Transfers, Electronic Payment Instruments and Payment Systems and BNB Ordinance No 3 transpose into Bulgarian statute the requirements of Article 36 of Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, providing the legal foundation for Regulation (EC) No 1781/2006 of the European Parliament and of the Council on information on the payer accompanying transfers of funds.

An important change introduced by Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 aimed at a modern harmonised payment services market in the European Union. In 2008 the BNB incorporated the Directive's provisions into the draft of the Law on Payment Services and Payment Systems. The Law was passed in early 2009, specifying the rights and duties of parties in payment services and regulating the actions of payment institutions: a new category of payment service provider.²⁶

²⁵ The ratio of time when the system is fully operational to the system operating time.

²⁶ The Law was published in the State Gazette, issue 23 of 27 March 2009 and shall come into force as of 1 November 2009.

In April 2008 the BNB website published for the first time statistical summaries on BISERA, BORICA and RINGS operations in the second half of 2006 and first half of 2007 (under Guidelines to BNB Ordinance No 3) and statistics on bank cards and associated operations (under Guidelines to BNB Ordinance No 16). The BNB started compiling these data in October 2006. The summaries enable banks to assess their shares of money transfer services, payment cards and related transactions.

3. Payment System Developments

Payment system development in Bulgaria involves BNB and banking integration into European payment mechanisms. To this end, on 24 January 2008 the Governing Council decided on a TARGET2 integration project. After analyses, a report on BNB participation in TARGET2 was prepared and in November 2008 the Governing Council approved the joining by the BNB and Bulgarian banks of the real time gross settlement system for euro payments (TARGET2). The integration project comprises development, implementation, and operation of a national system component (TARGET2 – BNB), related legal, business, and technical actions, and awareness raising.

4. Payment System Oversight

Limiting system risk and improving Bulgarian payment systems' reliability and efficiency were the major goals of payment systems supervisors. They monitored observance of standards and recommendations by the Bank for International Settlements, the International Organisation of Securities Commissions, the European Central Bank, and the European System of Central Banks.

Under the amended BNB Ordinance No 3 on Funds Transfers and Payment Systems, the following money remittance companies operating when the Law on the Amendments to the Law on Funds Transfers, Electronic Payment Instruments and Payment Systems came into force obtained money remittance licences *per* BNB Governing Council Resolution of 7 October 2008: MoneyGram Payment Systems Bulgaria EOOD, Coinstar Money Transfer (Bulgaria) EOOD, Master Envios Bulgaria EOOD, Bankservice AD, Change-Centre Bulgaria EOOD, and M Secured OOD.

Western Union service will be through agents of Western Union International Bank GmbH (WUIB) licenced by the Austrian Finanzmarktaufsicht (FMA), the BNB having been advised of this by the FMA.

In 2008 the BNB conducted a supervisory inspection of EPAY AD to review the company's services in the context of the Law on Funds Transfers, Electronic Payment Instruments and Payment Systems and its statutory instruments. Inspectors found that the company acted in line with statutory requirements.

In November 2008 the BNB initiated a supervisory inspection at the United Bulgarian Bank AD to ascertain how open loan bank cards are issued and how non-bank payment cards issued by Transcart AD are accepted by UBB AD POS terminals.

IV. Bank Reserves at the BNB

Amendments to BNB Ordinance No 21 in the fourth quarter of 2008 gave banks greater liquidity management flexibility. The measures followed BNB anti-cycle policy with regard to banks' minimum required reserves, capital adequacy, and provisioning.

In July 2007 minimum required reserves maintained with the BNB by banks went up from 8 to 12 per cent with effect from September. This aimed to curb buoyant lending and moderate private sector credit growth and followed the Bank's 2003 anti-cycle policy. From the fourth quarter of 2008 the effects of the global financial and economic crisis were felt more strongly in Bulgaria. As part of its anti-cycle policy, the BNB facilitated banks' liquidity by releasing liquidity buffers accumulated in earlier years.

The amendments to Ordinance No 21 were as follows:

1. Nominating half of cash in vaults as reserve assets and giving banks easier access to their reserves with the BNB from 1 October 2008.
2. Reducing minimum required reserves on all funds attracted by banks from 12 per cent to 10 per cent from 1 December 2008.
3. Reducing minimum required reserves on funds attracted by banks from abroad from 10 per cent to 5 per cent and removing reserve requirements on funds attracted from state and local government budgets from 1 January 2009.

These amendments released some BGN 1.8 billion of bank funds at the BNB in the fourth quarter of the year. Recognizing half of the cash in vaults as reserve assets covered BGN 710 million. The reduction of reserve requirements from 1 December released a further BGN 1.1 billion. The additional decrease in the minimum required reserve rate on funds from abroad from 1 January 2009 lowered the cost of attracting foreign capital. After 1 January 2009 average effective minimum reserves for the banking system fell to some 7 per cent and the overall effect of BNB measures was a release of BGN 3 billion of funds. This would not automatically boost lending: lending depends on demand for credit by the public and businesses, and on banks' risk assessment. Bulgarian banks' behaviour does not appear to differ significantly from that of euro area banks which, irrespective of the cut in ECB interest rates and eased liquidity, curbed lending.

To give banks easier access to their reserves, the methodology for calculating Ordinance No 21 penalty interest was changed to:

- remove Article 11.4 penalty interest for using more than half of reserve assets within a day. Now banks pay interest equal to the LEONIA rate for that day;
- remove Article 13 penalty interest of a 12th of minimum reserves where failing to meet the minimum reserve requirement. Now banks pay interest on the shortfall equal to the average LEONIA rate for the maintenance period.

Though not all banks took advantage of the new penalty policy, the changes had a favourable effect on the market as the reserves cut had a strong effect and interest rates fell below their October and November levels.

The increase in the annual amount of banking systems borrowed funds in levs and the lev equivalent of borrowed funds in foreign currency was 21.86 per cent and 45.64 per cent respectively on the prior year. Due to the higher average annual rate of minimum required reserves (8 per cent until August 2007 and 12 per cent between early September 2007 and October 2008), the average amount of required reserves grew faster than the reserve base. The increase in required reserves in levs and foreign currency liabilities was 45.78 per cent and 77.31 per cent respectively (an overall increase of 63.12 per cent).

The average annual amount of reserve assets in levs grew by 53.60 per cent on 2007, their absolute amount exceeding settlement needs twofold. Foreign currency assets also saw a sizable increase of 49.56 per cent, their relative share fluctuating between 57.73 per cent and 69.61 per cent in individual months.

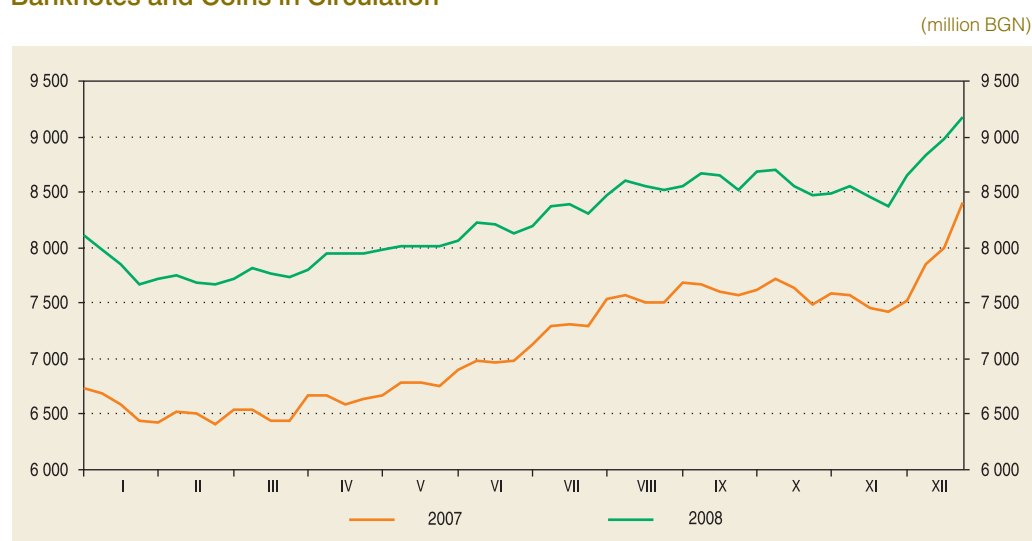
V. Cash in Circulation

The BNB holds the Bulgarian banknote and coin monopoly.²⁷ Cash issued by the Bank is legal tender at full face value mandatorily without restriction. The BNB prints banknotes, mints coins, and safeguards uncirculated and withdrawn cash.

At the close of 2008 cash in circulation²⁸ was worth BGN 9179.4 million in nominal value, up by BGN 768.6 million or 9.14 per cent on the end of 2007. The greatest increase came in December as usual of the year's end.

Banknotes and Coins in Circulation (Outside BNB Vaults)

Banknotes and Coins in Circulation



Source: BNB.

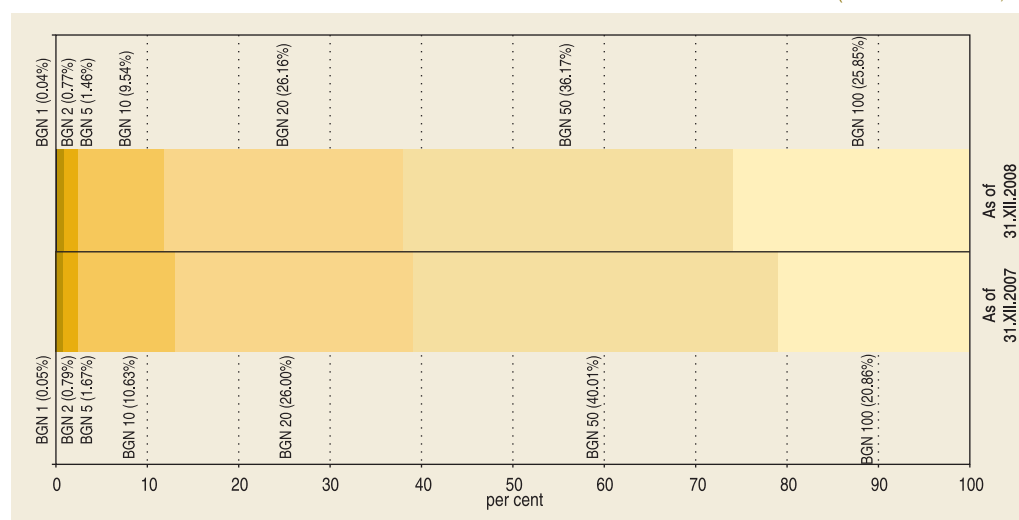
By the close of 2008, 358.2 million banknotes worth BGN 9032.1 million were in circulation. In a year their number increased by 14.4 million (4.20 per cent) and their value by BGN 747.3 million (9.02 per cent). On 31 December 2008 banknotes accounted for 98.39 per cent of the value of cash outside BNB vaults. The average value of a circulating banknote at the close of 2008 was BGN 25.21, up BGN 1.11 or 4.61 per cent. This resulted from the 2008 trend for the circulation of BGN 100 banknotes to grow faster than that of other denominations.

²⁷ Article 2, paragraph 5 and Article 25 of the Law on the BNB.

²⁸ Banknotes and circulating and commemorative coins issued after 5 July 1999. Under Resolution No. 110 of 6 October 2005 of the BNB Governing Council, banknotes and coins in circulation whose exchange term has not expired and which have not been returned to BNB vaults were deducted from cash in circulation.

Denomination Composition of Circulating Banknotes

(share of total value, %)

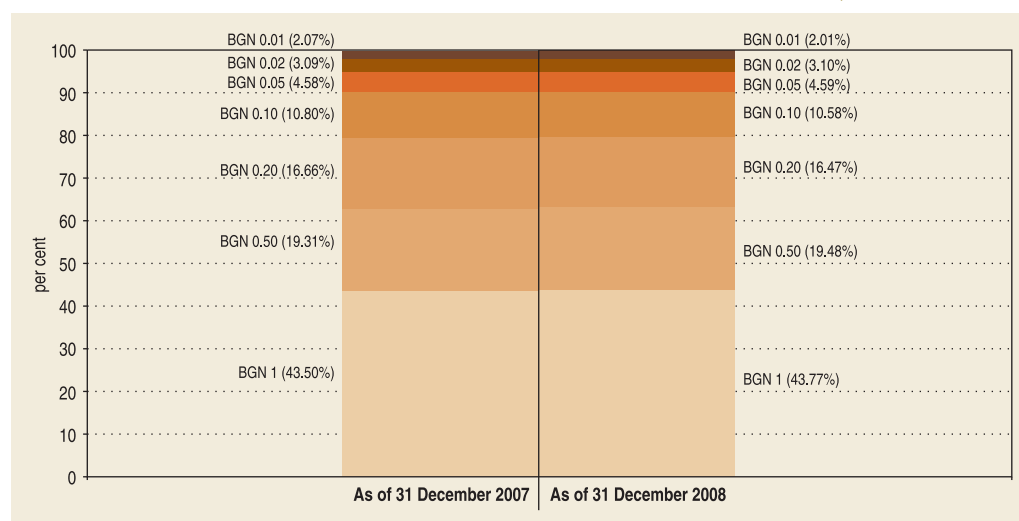


Source: BNB.

At the end of 2008, 1027.4 million coins worth BGN 142.9 million were in circulation. This number was 141.0 million (15.91 per cent) more than at the end of 2007 and its value grew by BGN 20.8 million (17.07 per cent). That value in turn was 1.56 per cent of that of cash outside BNB vaults on 31 December 2008. The average circulating coin over the review period matched its late 2007 level at BGN 0.14. In recent years commemorative coins have retained a relatively steady 0.05 per cent share of circulating cash.

Structure of Circulating Coins by Nominal Value

(share of total value, %)



Source: BNB.

Non-genuine Banknotes and Coins

Under Article 27 of the Law on the Bulgarian National Bank, the BNB National Analysis Centre (the NAC) assesses Bulgarian and foreign cash of suspect genuineness. In 2008, 8787 Bulgarian banknotes were retained: 690 prior to entering circulation and 8097 afterwards. The number of reported non-genuine banknotes rose by 669 on 2007. BGN 20 banknotes formed 80.60 per cent of this, followed by BGN 10 and BGN 50 banknotes at 11.40 and 6.84 per cent respectively. Reported non-genuine BGN 2 and BGN 5 banknotes numbered 102 (1.16 per cent). The amount of retained BGN 20 banknotes increased to 1944 compared with the prior year. The NAC found 608 non-genuine Bulgarian coins: 596 of BGN 0.50 and 12 of BGN 1.

By the close of 2008 non-genuine Bulgarian banknotes came to 0.002453 per cent of the total number of circulating banknotes, while coins came to 0.000059 per cent. This number was deemed insignificant and cash circulation security remained very high.

As regards suspect foreign cash, in 2008 the NAC retained 3580 euro banknotes, 1016 US dollar banknotes, and 389 other banknotes.

The BNB continued advising credit institutions, exchange bureaus, financial houses and the public of reported non-genuine Bulgarian banknotes, methods for identifying them, and ways of verifying counterfeit protection features in halting the spread of non-genuine Bulgarian banknotes.

The BNB takes consistent measures to protect Bulgarian banknotes against counterfeiting. A 2008 issue BGN 10 nominal value banknote entered circulation in the fourth quarter. It features improved counterfeit protection while retaining the size, design, and colouring of the 1999 issue BGN 10 banknote which remains legal tender.

BNB Cash Operations

In 2008, 157.3 million new banknotes and 105 million new coins worth BGN 2615.2 million were supplied under contracts with producers. The BNB launched the six commemorative coins planned in its minting programme.²⁹

Credit institutions deposited and withdrew BGN 25,219.8 million in cash at and from the BNB in 2008. This included Bulgarian cash deposits of BGN 12,230.0 million (up BGN 4574.0 million or 59.74 per cent on 2007) and Bulgarian cash withdrawals of BGN 12,989.8 million (up BGN 3807.3 million or 41.46 per cent in a year).

To maintain the quality of cash circulation, in 2008 sorting machines tested 748.4 million banknotes and 82.5 million coins totalling BGN 12,966.9 million deposited with the BNB and the Cash Services Company. The number of banknotes processed in 2008 rose by 219.4 million on 2007 (41.47 per cent), while that of coins fell by 17.9 million (17.84 per cent). BGN 10 and BGN 20 banknotes and BGN 0.10 and BGN 0.20 coins were most frequently processed. In 2008 the average recirculation of banknotes at BNB tills rose by 0.08 percentage points on the prior year to 1.68 times per year.

Banknotes retained as unfit numbered 109.3 million: down 14.6 million (11.75 per cent) compared with 2007. Unfit coins numbered 0.3 million or 27.30 per cent less on the previous year.

The BNB is implementing a long-term cash circulation restructuring strategy. An important stage of market reform in the field was the launch of Cash Services Company. Established in 2007 by the Bank and several credit institutions, the Company has operated since the second quarter of 2008, also taking over customer till operations at its Pleven, Varna, and Plovdiv regional cash centres from the BNB. Between April and December 2008 a substantial part of BNB cash turnover was effected by the Cash Services Company. The BNB continued to provide standard cash services to customers in Sofia to the *BNB General Terms of Customer Service with Announced Value Banknotes and Coins*.

The number of professional cash processors in Bulgaria gradually grew over the year. A competitive environment boosts service quality and determines market pricing, while improving the quality of circulating cash.

To ensure the security and quality of circulating cash, credit institutions and service providers follow BNB cash processing rules and supply ATMs with machine-verified banknotes. The BNB continued circulating information on trends in Bulgarian cash operations. In line with statutory requirements, the Bank keeps an up-to-date list of sorting machines and customer-operated machines tested to identification and fitness standards published on the BNB website. The BNB monitored adherence to statutory requirements and tested sorting machines used by credit institutions and professional cash handlers.

In 2008 construction and equipping of a new cash centre in Sofia continued to the schedule set in the BNB Strategy. BNB representatives worked closely with the architect, contractor and other project participants to ensure completion of the cash centre on schedule within the next year.

²⁹ Information on new issues of banknotes and circulating and commemorative coins is published on the BNB website.

VI. Maintaining Banking System Stability

1. State of the Banking System

The Bulgarian banking system in 2008 was subject to two major influences. The global financial and economic crisis impacted the national economy and financial system most clearly in the second half of the year, the first half having featured *high rates of growth in major balance sheet aggregates* (assets, loans, and deposit taking). The other group of factors are related to the effect which the measures initiated to strengthen financial stability, including the actions of various institutions in Bulgaria, had on the banking system and business activity. The change had effect on several aspects:

- a significant slowdown in lending growth in the third and particularly fourth quarters of 2008;
- a decline in general economic activity and attempts to stabilise finance sources through more aggressive deposit taking;
- positive expectations from the cut in minimum required reserves and boosted deposit guarantees.

Data for the reporting period allowed an assessment of results from the BNB's anti-cyclic policy over recent years. Tighter requirements on own funds and capital adequacy, conservative treatment of eligible security, provisioning and classifying receivables to criteria exceeding accounting standards on impairment, and a ban on dividends helped banks accumulate buffers worth approximately 4 per cent of GDP through purely statutory instruments. Minimum required reserves at rates well above the EU average stabilised liquidity even in the highly crisis-prone third and fourth quarters of 2008. As a result the banking system's financial base remained highly resilient to shocks over the review period.

Structural Changes in the Banking System Balance Sheet

By December 2008 banking sector *total assets* came to BGN 69.6 billion posting an increase of 17.7 per cent (BGN 10.5 billion) over 12 months.

Changes in banking's balance sheet reflect divergences between acute competition in the first half-year and credit restrictions in the absence of alternative interest rate instruments for investment in the second half-year. The search for market niches and competitive advantage did not change the overall market positions of major credit institutions.

The market share of the five largest banks remained almost unchanged at 57.1 per cent at the end of 2008. EU banks' subsidiaries increased their market shares to 76.4 per cent from 75.3 per cent at end-2007 despite a fourth quarter decline. Domestic credit institutions experienced a decline on the prior year despite rises in the last months of the period.

Market Shares of Local and Foreign Banks

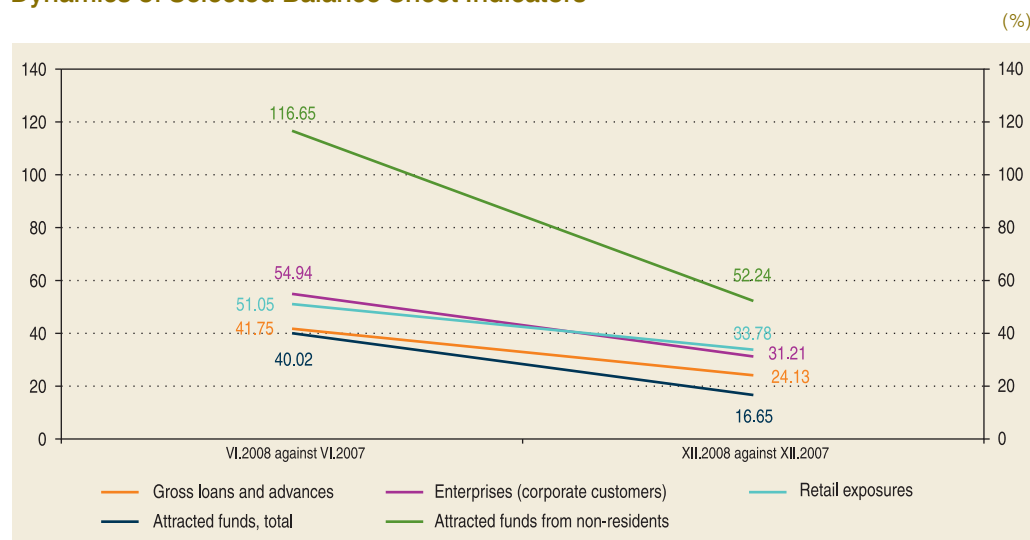


Source: BNB.

Credit Activity

Lending continued to lead banking operations, trends in it clearly reflecting developments in the sector: a first half-year of high growth and a moderation in the second half.

Dynamics of Selected Balance Sheet Indicators



Source: BNB.

Slower lending growth (on an annual basis) at 31.2 per cent for corporates and 33.7 per cent for households reflected a dramatic drop between October and December.

Attracted Funds

Though banking system's resource base remained stable over the year, differences in the profile of attracted funds were evident between the first and second halves. Amid the favourable economic environment of the first two quarters, both domestic funds and those from non-residents (provided mostly by parent institutions) financed lending.

Share of Funds Borrowed from Non-residents in Loans and Advances* (excluding credit institutions)



Source: BNB.

Since summer the split between these financing sources changed, partly reflecting tighter credit resources. Funds from institutions other than credit institutions contracted, their share in attracted funds falling from 38.6 per cent at the end of 2007 to 32.7 per cent a year later. Funds from parent institutions stabilised, with no significant transfers recorded from domestic subsidiaries to foreign parents. Financing from individuals and households (36.4 per cent) remained unchanged, making them key to resource generation given falls elsewhere.

The currency structure changed substantially. At the close of December euro positions came to 54 per cent of attracted funds, lev resources came to 40 per cent, and other currencies to 6 per cent.

Balance sheet equity

Balance sheet equity reported a positive trend throughout 2008, growing faster than loans and advances in the last quarter. Its annual growth for 2008 was 27.6 per cent, including 17.7 per cent asset growth and 24.2 per cent loans and advances growth. Faster balance sheet equity growth strengthens shock resilience and indicates adequate risk buffers.

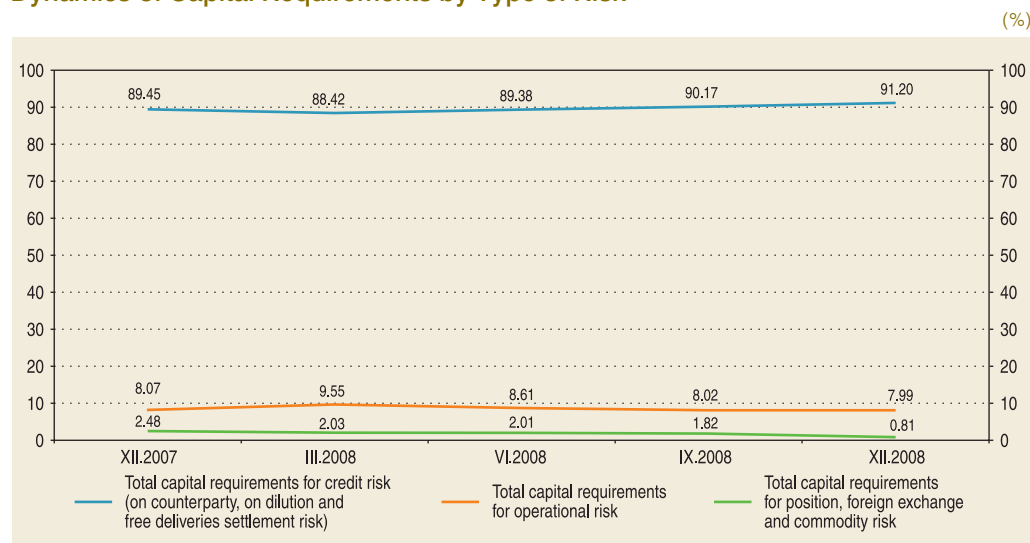
Audited banking system profits for 2008 were BGN 1374 million: up by BGN 223 million (19.4 per cent) on 2007.

Banking system risk profile

Credit risk was the key banking system risk profile factor in 2008. Though institutions managed their assets prudently, to good banking practice, developments affected their risk sensitivity. Coming periods could test their ability to parry shocks.

- While the share of loans in banking system assets limits mobility as a response to changes in the business environment, it increases institutions' sensitivity to changes in the quality of assets;

Dynamics of Capital Requirements by Type of Risk



Source: BNB.

- The balance sheet structure of recent years makes it impracticable to restructure assets *sufficiently rapidly* to reduce concentrations as regards risk types, maturities, and exposures to sectors or clients;
- Changes in the structure and quality of business financing mean that *banks are increasingly dependent on households' deposits* whose reliability and extent amid a deepening crisis are hard to assess;
- Non-resident funds have essentially come from parent companies whose capacity to offset drops in deposit components is now limited;
- The worsened business environment will also require a flexible response from institutions.

Though the above factors were clearly pronounced in the second half of the review period (November to December 2008), nervousness on the part of some leading market players contributed to a *general perception of increasing volatility in the banking system*.

Asset Quality

In 2008 banks maintained good asset quality, undertaking timely risk classification and loan impairment measures. The *level of past due exposures and those classified for other reasons*³⁰ in gross banking assets (3.96 per cent) *appears relatively low* by the close of 2008, yet the second half of the year saw *processes that could increase the weight of higher risk classified receivable*. The share of *non-performing risk exposures* (past-due over 90 days) was 2.42 per cent at the close of 2008 against 2.05 per cent a year earlier. This 59 per cent year on year increase is higher than the annual growth of the banking loan portfolio.

Accumulated provisions, a cushion against credit risk, provide 114 per cent cover for non-performing loans. This would have been lower, lowering the capacity to absorb shocks, had banking supervision been more liberal in respect of classification criteria for loans and receivables.

Yield

At the close of 2008 banking system profit was BGN 1374 million, up BGN 223 million on 2007. Despite the high value, return on average assets (ROA) was 2.12 per cent: down 25 basis points on December 2007. The year saw a *steady downward trend in the annual growth rates of financial results*: 50.2 per cent in March, 48.5 per cent in June, 28.6 per cent in September, and 19.4 per cent for 2008 annual audited data. Concurrently, the growth rate of average assets was 33 per cent. Under great pressure, the *net interest rate margin* remained unchanged in the first half-year at 5.05 per cent; however, *over the third*

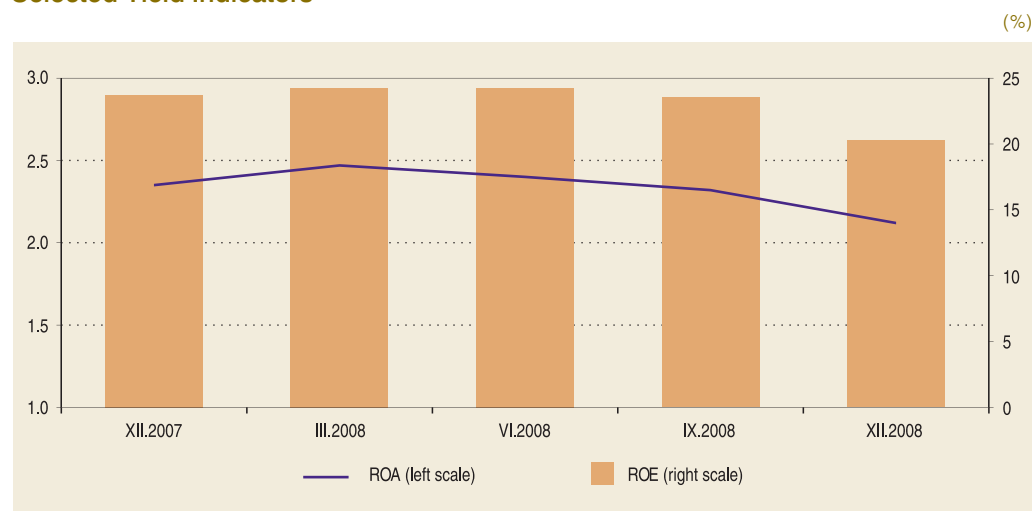
³⁰ The indicator includes all classified exposures under classification criteria established in Ordinance No 9 of the BNB.

and fourth quarters the increasing price of liabilities reduced it to 4.91 per cent. It remains higher than in a number of EU countries.

The share of all other revenue components (fees and commissions from financial instrument operations and foreign currency transactions) and other operating income declined on 2007. Banks succeeded in boosting fee revenue by 16 per cent in 2008; however, it remained volatile and occupied 20 per cent of operating income.

As did other key profitability ratios, return on assets (ROA) *decreased slightly, more so in the fourth quarter of 2008*, when the BGN 1.7 billion annual equity growth seriously affected it.

Selected Yield Indicators



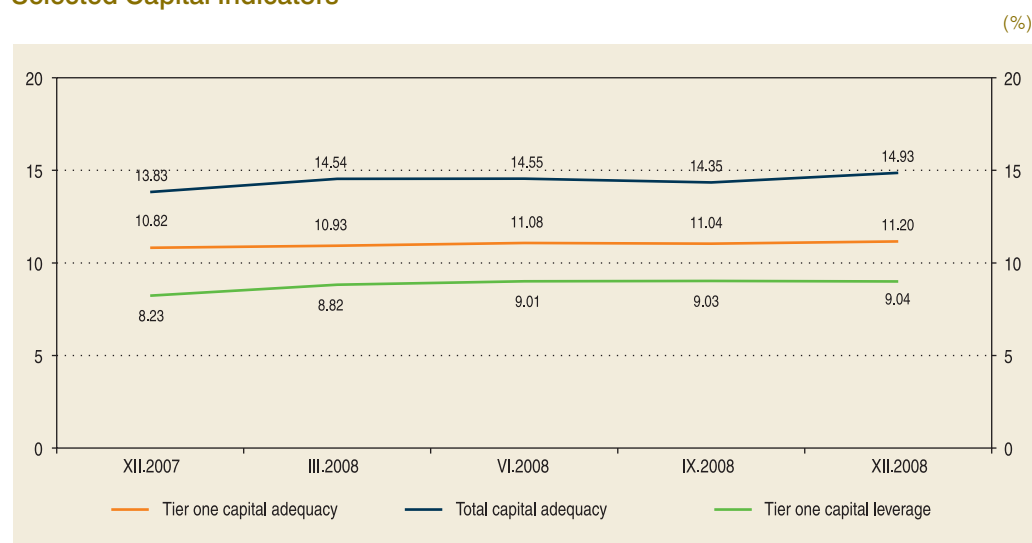
Source: BNB.

Equity

At the end of 2008 the capital position was stable and able to cover banking sector risk profile. The banking system has sufficient resources to meet any change in asset quality. The BGN 1.5 billion capital surplus in December 2008 was sufficient to cover worsened quality classified exposures (excluding non-performing ones). The system also has an additional capital cushion formed by 2008 profits of BGN 1243 million.

Positive developments in capital adequacy ratio were evident in December 2008: its level of 14.93 per cent showed that the capital base was growing faster than statutory requirements.

Selected Capital Indicators



Source: BNB.

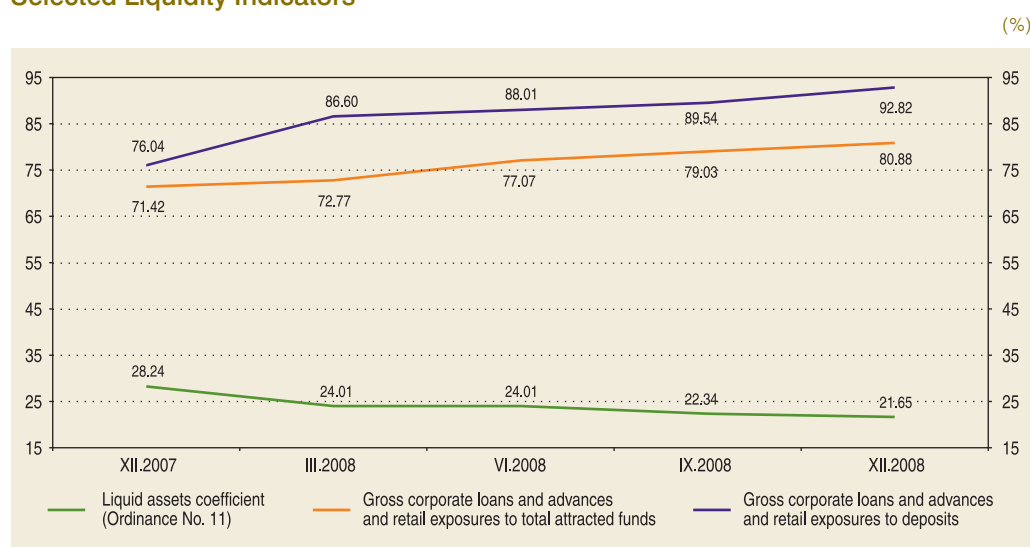
As regards tier one capital action by banks and regulatory authorities within and outside the EU, this indicator for Bulgarian banking was 11.2 per cent.

Risk parameter developments over 2008 give grounds for optimism that banking sector capital would not erode abruptly if factors determining system stability continue to fluctuate moderately and gradually.

Liquidity

Amid a complex market environment, Bulgarian institutions continued to manage their liquidity positions and to discharge their duties as financial intermediaries without difficulties. The downward trend in liquidity indicators (within an annual horizon) was clearest in the last quarter of 2008. Liquidity pressure on banking resulting from tensions in the interbank market and lower deposit base, the significant rise in the cost of attracted funds, and ongoing credit growth sharpened banking system sensitivity. Changes to minimum required reserves released significant cash. Banks invested the bulk of released funds into higher earning assets which gradually changed some liquidity indicators.

Selected Liquidity Indicators



Source: BNB.

Financial Stability Assessment

In June the IMF and the World Bank assessed Bulgarian banking stability under the Financial Sector Assessment Program (the FSAP) implemented in all IMF shareholder countries. The objectives were:

- To study banking and financial system sensitivity to various types of risks. To this end, credit institutions developed and applied a stress-test model comprising diverse macroeconomic scenarios to assess individual banks' and system sensitivity to them;
- To assess the quality of supervisory systems, their compliance with Basel core principles of effective banking supervision, and the stability of Bulgaria's financial system.

The assessment found that:

- Financial stability indicators showed good bank solvency. Individual bank indicators exceed the 12 per cent minimum, varying between 14 and 30 per cent. Liquidity ranged between 22 and 39 per cent, return on equity between 18 and 29 per cent, and non-performing loans past due over 90 days between 0.2 and 2.4 per cent. Almost half the banking system balance sheet was denominated in euro, positions were balanced, and despite the dominance of foreign banks, the system relied mostly on domestic deposits;

(continued)

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- The macro-parameter stress test assumed currency board retention. Data confirmed the existence of a sound and disciplined banking system whose solvency depended on the currency board;
- The banking stress test suggested that the change in asset quality was the major source of risk for the banking system. Nevertheless, most institutions would parry shocks provided financial changes were acceptable and system balance was sustained. This reflected a combination of factors, including capital stability at banks of systemic significance, the large share of liquid assets, and limited exposure to risk instruments (including no 'toxic assets');
- Individual banks and the system have sufficient resources to meet putative liquidity shocks. High minimum required reserve levels ensuring a liquidity cushion were stated as a positive factor;
- Challenges were not unique to Bulgaria. Strong lending growth, balance of payments imbalances, and the increase in foreign financing, were typical of Central and Eastern Europe.

2. Compliance with Prudent Banking Requirements

The monitoring of credit institutions' operations in 2008 assessed banks' risk profiles, financial stability and shock absorbing capacity, and their compliance with regulatory requirements for prudent banking.

Capital Adequacy

Preventive regulatory control focused on the stability and sensitivity of banks' capital positions and the accuracy of their capital adequacy reports. Where departures from requirements were established, relevant corrective measures were initiated.

Large Exposures

Continuous monitoring focused on the state and dynamics of risk concentrations attending large exposures. Where values were close to regulatory limits, strict and continuous supervisory control was exercised, with individual breaches reflected in supervisory strategies in respect of relevant banks.

Internal Loans

Though breaches of the Law on Credit Institutions and BNB Ordinance No 7 were sporadic and did not threaten the system, the institutions concerned were subjected to diverse supervisory measures.

Investment into Fixed Assets

All banks stayed within the limits set by the Law on Credit Institutions and BNB Ordinance No 17.

3. Banking Supervision

The year saw more intensive supervision prompted by trends in international markets and the global financial and economic crisis and by measures to preserve accumulated banking system resource and bolster its base. Major priorities included:

- Further improvements to the statutory framework of supervision;
- Improving the tools of effective supervision over individual institutions through continuous reporting and on-site target inspections;
- Studying and analysing the transmission mechanisms of the financial crisis to Bulgaria's banking and financial sector;
- Proactive action to identify risks early and test scenarios of banking and business developments;
- Preventing and neutralising attempts to use the banking system for fraud and money laundering;

- Strengthening the BNB's commitment to supervisory cooperation within the EU.

Despite rapidly changing developments, at the close of the year the Banking Supervision Department was satisfied that credit institutions had sufficient administrative and expert capacity to tackle the financial and economic crisis.

While basic effort entailed traditional supervision (supervisory policy, supervision over credit institutions, macro-analyses, special supervision, and supervisory administration), funds were also allocated to new areas.

- Banking Supervision Department experts participated in regular meetings of EU committees and working groups related to banking development and supervision: the Committee of European Banking Supervisors (the CEBS) and its working groups, the European Banking Committee (the EBC), the Joint Committee of Financial Conglomerates (the JCFC), the ECB Banking Supervision Committee (the BSC), and the regional Group of Banking Supervisors from Central and Eastern Europe (the BSCEE).
- Negotiations on a project under the technical assistance programme were launched between the central bank of Egypt and the ECB related to implementing the Basel II capital framework. ECB project partners are the BNB and the central banks of the Czech Republic, France, Germany, Greece, Italy, and Romania.
- Expert analyses prepared BNB representatives for participation in ECB structures and various fora in Bulgaria and abroad. The *Banks in Bulgaria* information bulletin and monthly press releases on banking sector performance were regularly published.
- The successive phase of the Single Data Depository/Banking Supervision Reports project was completed and the transfer of financial statements for supervisory purposes to electronic format began.
- Banking supervision experts took part in specifying the Central Credit Register regulatory data extension.

Supervisory Policy

Bringing national regulatory framework into line with EU Directives on credit institution supervision was a supervisory policy priority over the reporting year. Full BNB membership in the European System of Central Banks offered the Bank experience from French, Italian and Dutch central bank supervisory authorities.

Work on drafting statutory changes concentrated on evaluating and classifying banks' risk exposures and establishing specific credit risk provisions. Amendments to BNB Ordinance No 9 on risk exposure classification implement uniform practice to provision allocations at international banking groups. The more conservative approach to risk associated with worsening exposure quality remained an element of BNB policy intended to accumulate capital cushions. Statutory synchronisation also aimed to prepare banks for the Basel II credit risk internal ratings based approach.

Ordinance No 8 on capital adequacy of credit institutions was amended to allow banks to include semi-annual profits into their capital bases to the strict requirements of Directive 2006/48/EC of the European Parliament and the Council relating to the taking up and pursuit of the business of credit institutions.

To help European supervisory convergence and reflect changes in the CEBS framework, the BNB issued four guidelines on bank portfolio interest risk management, concentration risk management, and stress testing as part of supervisory reviews under Pillar 2 of the Basel II Supervisory Discipline.

Preparations to transpose other CEBS guidelines continued with requirements on outsourcing being drawn up and internal models being implemented (validated). The BNB also developed a policy for international cooperation between consolidating and hosting supervisory bodies and set out supervisory criteria for specialised lending.

There was staged development of information applications for the Framework for Consolidated Financial Reporting to the single financial reporting package (FINREP) of credit institutions in EU Member States.

The establishment of joint international colleges of supervisors was launched in 2008 as fora for information exchange, fair assessment, and supervisory action in respect of cross-border banks and banking groups.

A project on summarising banking practice cases and supervisory solutions was implemented, with information posted and regularly updated on the BNB website. This is another step to greater supervisory transparency.

Regular contacts were established with authorities fighting fraud and money laundering under guidelines in the EC progress assessment reports for Bulgaria. Analyses of patterns used in concealing illicit trading were performed for law enforcers.

In the autumn the BNB hosted the international meeting of central bank governors and supervisory bodies from South Eastern Europe. This took important decisions on supervisory practice convergence, the convening of a supervisors' contact group and an expert group for exchanging supervisory stress test results, and set the framework for supervisory colleges based on coordinated action between interested countries.

Supervisory Administration, Licenses, and Permits

Licensing and supervisory measures are tools for maintaining banking system stability. Banking supervision aimed to remedy departures in credit institutions' operations in a timely manner and to raise the standards for admission to the Bulgarian banking market.

The Governing Council turned down a 2008 bank licensing application on the grounds of prudence and conservatism set out in *The Major Principles of BNB Licensing Policy*.

The period under review did not see significant changes in the shareholder structure of domestic banks. The BNB allowed 49.99 per cent of the Bulgarian-American Credit Bank's equity to be sold to the Allied Irish Banks Plc of Dublin. Technical requirements having been met, the Bank Leumi Romania SA Sofia Branch started operating. The BNB received advice of EU Member State bank branch openings whose launches are pending.

Over the review year no onerous supervisory measure was imposed. The limited number of remedial actions at several institutions took the form of written warnings, breaches being duly removed.

On-site Supervision (Inspections)

In 2008 the goal of on-site supervision was to analyse and assess risks, the efficiency of risk control and risk management systems, and legal observance. Risk profile assessment of institutions involved thorough analysis under CAMELOS criteria. Monthly assessments of data and indicators reported by banks began in mid-2008. In addition to general risk profile work, there were more than 20 target inspections. The stress was on credit and liquidity risk management and assessments of capital adequacy and risks attending it.

Particular care was applied in the fourth quarter as the financial crisis became worldwide. Regular reports and on-site inspections show that Bulgarian banks maintained statutory solvency levels and satisfactory liquidity levels, and that they managed credit risk prudently under conditions much worse than the prior year.

Over the year inspectors found 67 formal breaches of banking legislation and supervisory regulations and issued 161 recommendations to inspected banks' management and control bodies.

Off-site Supervision

The major priority of off-site supervision was to monitor and analyse banking risk. It aimed at establishing increased risk zones early so as to prompt timely and adequate maintenance of banking stability.

Negative trends in international markets intensified exchanges between the BNB and foreign institutions and supervisors. The capacity of the system and individual institutions to absorb shocks was subject to constant monitoring. The methodology for stress testing by major risk types (credit, liquidity, market) improved. Analyses and investigations supported managements' toolkits for diminishing the crisis impact on institutions and the system.

Proactive supervision produced surveys which assisted crisis countering, such as the review of institutions' market expectations and crisis assessments, including indicators measuring default probabilities and recoverable value of loans classified as non-performing. Banks' expectations of major risks and unstable areas were examined and surveys of liquidity risk management models and possible liquidity risk sharpening scenarios were also surveyed. Special attention was paid to banks' business plans for 2009, enabling leading business behaviour models under the assumption of a continuing crisis to emerge.

Special Supervision

Consistent action aimed to increase the transparency of banks' capital structures. Supervisory efforts painted clear pictures of banks' direct and indirect equity holders and gave unbiased assessments of their finances, legal compliance, and ability to support capital.

Consistent measures also targeted money laundering and terrorist financing and fraud. Banks and finance houses implemented adequate policies and procedures compliant with international standards to minimise transfers of funds with unclear or criminal origins. The BNB's effective risk management was highly appreciated in the third round evaluation report of the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL).

Currency Law enforcement addressed banking and financial transparency in foreign currency transactions.

Substantial efforts were made to converge and improve supervisory practice on strengthening corporate management. This was studied in the light of a World Bank methodology and a survey of legal approaches by banks to customers was made with help from the Anti-Money Laundering Task Force (AMLTF) CEBS Working Group.

Amid the increasing supply of financial services by institutions, proposals for statutory changes were made following a study of Community regulations.

VII. The Central Credit Register

The Central Credit Register (the CCR) kept by the BNB provides information to banks and their financial subsidiaries on customers' debt to the banking system. CCR business is regulated by BNB Ordinance No 22 on the Central Credit Register of Banks. The Register covers all loans by banks and their subsidiary financial institutions irrespective of amount, except debit card overdrafts of up to BGN 1000 (provided they are classified as standard), loans to government, loans to the BNB, and interbank loans. The system ensures reliable information submission and storage. Financial institutions which participate in the CCR exchange data with the Register online. Authorised officers access the system *via* digital certificates issued by the BNB.

New information requirements on customer loans and debt to banks came into force in mid-November 2008. This expansion and renovation of the Register was dictated by lending growth, the challenges of Bulgarian EU membership, and calls for better information. The scope and functionality of the system have changed.

The updated CCR was installed on a new platform (database servers and application servers) and allows multiple increases of users and borrower check numbers.

The structure of incoming Register data expanded, with Banks receiving information on borrower history and repayment behaviour over a five-year period. This historical background will help banks avoid unfair borrowers and increase borrower discipline.

Statement information is expanded, allowing more thorough analyses and assessments of credit risk and providing data for calculating individual financial stability indicators. Register data expansion allows banks to improve credit risk evaluation of loan applicants. Credit risk evaluation will become yet more effective with the pending inclusion of non-bank financial institutions into the CCR.

In 2008 the number of loans logged in the Central Credit Register and of persons checked by banks and their subsidiaries continued increasing.

By the end of December 2008, 3,149,843 loans were registered (against 2,698,093 at the end of 2007) worth BGN 49,716 million (against BGN 37,434 million by 31 December 2007). By the end of 2008 borrowers numbered 1,806,694 of whom:

- 1,695,413 individuals bearing UIN;
- 9054 freelancers and craftspeople with UIN (this is a new borrower class kept in the Register since November 2008);
- 98,237 corporates with BULSTAT numbers;
- 3990 non-residents without BULSTAT numbers or UIN.

In 2008 banks accessed the Register 4,551,000 times, of which 3,503,000 concerned individuals and 1,048,000 corporates, an increase of some 613,000 on 2007's total of 3,938,000. The monthly average number of certificates in 2008 was 379,000 or over 17,000 a business day. This growing number indicates the Register's reliability and growing importance to banks in managing their loan portfolios.

VIII. The Fiscal Agent and State Depository Function

The Bulgarian National Bank is the state's fiscal agent and depository. Under contracts with the Ministry of Finance (MF) to market principles, the BNB collects information on budget entities' domestic bank accounts for the Ministry and acts as the government's debt agent.

In pursuing this functions, the Bank continually develops and improves its systems: the GSAS system for conducting auctions and sale subscriptions of government securities, the ESROT system for registering and servicing government securities trading, the system for government securities settlement (GSSS), the Register of pledges, the AS ROAD automated system for registering and servicing external debt and the IOBFR electronic system for budget and fiscal reserve information servicing.

In line with tighter MF requirements on system development and with changes in the volume of services provided by the Bank, in 2008 MF fees increased to BGN 786,000 from BGN 759,000 in 2007. Fees and commissions to the BNB as agent were BGN 1,246,600.

Information Service

Under Article 43 of the Law on the BNB and standing joint instructions by the Minister of Finance and the BNB Governor, daily and periodical data on budget entities' budget, extra budgetary, deposit, suspense, and letter-of-credit accounts at the BNB and other Bulgarian banks in leva and foreign currency were submitted to the MF *via* IOBFR. The total balance on these accounts at the close of the reporting year was BGN 9486.5 million, of which BGN 8148.2 million³¹ was on accounts in the fiscal reserve. By comparison, on 31 December 2007 the total balance on budget entities' accounts was BGN 8762.8 million, of which BGN 7150.3 million was on accounts in the fiscal reserve.

At MF request, the frequencies of regular and supplementary budget information increased in 2008 to help manage and control consolidated fiscal programme revenue and spending. As a result, report forms grew from 728 to 743, of which 301 on the fiscal reserve. At the same time, the number of first level budget spending entities with BNB-certified quarterly reports increased to 53 against 49 at the end of 2007.

Over the review period AS ROAD registered 19 foreign financial obligations of the Bulgarian government as specified by the MF, on which the BNB acted as calculating and paying agent. Payments numbered 42 worth EUR 581.6 million,³² of which 33 regular payments of EUR 272.6 million (EUR 100.4 million principal and EUR 172.2 million interest). The early year saw nine advance repayments to the Japanese Bank for International Cooperation worth JPY 4579.7 million and to the World Bank worth EUR 264.1 million and USD 12.7 million. By 31 December 2008, the total of obligations registered by the system was EUR 2381.0 million.³³

Servicing Government Securities Trading

MF-scheduled auctions for three-month, five-year, and ten-year government securities nominally worth BGN 298.3 million were held *via* GSAS; the ten-year bonds totalled BGN 168.5 million. Demand continued exceeding supply, with a 2.57 average bid-to-cover ratio. Of the 76 average primary dealers' bids *per* auction, 29 were approved. The demand for five-year government securities was highest: of the 99 bids *per* auction on average, 42 were approved, with a 2.70 average bid-to-cover ratio. The average annual yields of three-month, five-year, and ten-year issues attained at the auctions was 4.13 per cent, 5.59 per cent, and 5.69 per cent respectively.

³¹ Balances on foreign currency accounts included in the fiscal reserve are recalculated in the respective currency at the BNB exchange rate for 31 December 2008.

³² The total amount of payments was recalculated in euro at the BNB rate for 31 December 2008.

³³ The total amount of payments was recalculated in euro at the BNB rate for 31 December 2008.

Total initial acquisitions of government securities, registered in ESROT in principal and interest repayment on maturing securities and reverse repurchases directly from individuals, was BGN 881.9 million against BGN 1163.8 million in the corresponding period of 2007, of which BGN 583.4 million³⁴ were principal and interest at maturity.

The number of secondary market transactions in government securities grew, 16,446 transactions being registered against 6919 in 2007: a 137.7 per cent increase. In 2008 the aggregate nominal value of government securities subject to transactions was BGN 76,603.8 million³⁵ against BGN 19,825.6 million in the corresponding year (up 286.4 per cent). Repo agreements had the largest share (59.6 per cent) followed by blocking and unblocking transactions (31.6 per cent), transactions with and on behalf of customers (5.0 per cent), and outright purchases and sales (3.8 per cent). In 2008 17,900 notifications/requests for registering transactions in government securities were submitted to ESROT, of which 4250 through SWIFT using ISO 15022 and 13,650 through the ESROT web interface using universal electronic signature. During the review period 25 transactions were refused registrations due to insufficient securities stocks; there were no refusals due to insufficient funds on participants' accounts. During 2008 ESROT offered 99.2 per cent availability.³⁶ Operational problems were handled under mutual redundancy contingency rules for BNB systems.

The bulk of blocking and unblocking operations in government securities, registered by ESROT (domestic government securities), related to securing funds in budget entities' bank accounts under § 26³⁷ of the Transitional and Final Provisions of the Republic of Bulgaria 2008 State Budget Law. Average daily nominals of blocked domestic government securities were BGN 1207.9 million, EUR 127.4 million and USD 58.8 million respectively. To secure budget accounts, servicing banks also blocked government securities not registered by ESROT (foreign government securities) by transferring them to dedicated BNB accounts. The average daily nominals of these securities came to BGN 272.0 million, EUR 155.1 million and USD 233.3 million.

In 2008, 42 statements of circumstances related to raising or redeeming pledges on government securities were lodged with the Register of Pledges, blocking and unblocking BGN 89.0 million and BGN 43.4 respectively of government securities.³⁸ By 31 December 2008 the total amount of government securities blocked in ESROT on registered special pledges came to BGN 89.3 million: up 110.6 per cent on 31 December 2007.

By the end of 2008 1801 accounts were kept with the government securities settlement system under BNB Ordinance No 31 on Government Securities Settlement, including 46 for government securities of the issuer (the MF), 708 for participants' own government securities portfolios, 615 for government securities participants' customers, and 432 for encumbered government securities. Government securities on these accounts totalled BGN 3073.3 million in nominal value.

In 2008, under Ordinance No. 15 on Control over Transactions in Government Securities of the MF and BNB and based on a joint MF and BNB instruction, there were on-site inspections of 22 ESROT participants acting as subdepositories on account of customers and of ESROT participants who are not subdepositories of government securities. The inspections monitored adherence to statutory provisions on registering government securities transactions. Results showed that subdepositories kept ledgers and accounts for customer assets so as to guarantee security and customer title.

³⁴ The lev equivalent of payments on foreign currency denominated government securities issues was calculated at the BNB rate on the date of payment.

³⁵ The lev equivalent of transactions in foreign currency denominated government securities transactions was calculated at the BNB rate on the date of transaction.

³⁶ The ratio of the time when the system was actually operational against overall system operating time.

³⁷ According to § 26, paragraph 2 funds in all the accounts, deposits and letters of credit in the domestic and in foreign currencies of budget entities, including those of municipalities, with banks are secured by servicing banks in favour of the MF through blocking Bulgarian domestic and external debt government securities. Government securities are blocked with the BNB and this has the legal effect of a special pledge on them in favour of the MF. Only government securities without any encumbrances or collateral are blocked.

³⁸ The lev equivalent of blocked/unblocked currency denominated government securities is calculated at the BNB rate on the date of transaction.

In line with the duty of transparency on depository systems' actions, 2008 also saw updated questionnaires by specialised bodies (the Association of Global Custodians, the CPSS-IOSCO Disclosure Framework, and Thomas Murray) for reporting ESROT and GSSS data.

System Development

In 2008 systems were developed to current European initiatives for an integrated and stable financial market infrastructure.

GSSS functionality expansion continued during the year further to the October 2007 MF and BNB Ordinance No 5 on the Terms and Procedure for Acquisition, Registration, Redemption and Trade in Government Securities and to a BNB and MF schedule of providing technical support for changes to primary market government securities acquisition. Modifications enabled system users to submit non-competitive bids on their behalf and account at auctions and competitive bids on their behalf and on account of their customers at auctions for replacement, where allowed. New statements of primary dealers' participation in MF government securities auctions were also prepared.

Further to internal audit recommendations to minimise operational risk, ESROT compilation and TurboSWIFT transfer to the Treasury Directorate of MF orders for payment of amounts due on foreign currency government securities was automated in 2008. Additional statements for government debt management in accordance with issuer set scope and structure were also input into the system's statistical component at MF request.

To meet a Giovannini Barrier on cross-border clearing and settlement of government securities, The Harmonisation of Corporate Actions Processing in Europe Procedure, development of a new ESROT functionality was assigned to enable the system automatically to notify participants of principal and interest payments on government securities with forthcoming maturity through standard SWIFT messages MT564 Corporate Action Notification and MT566 Corporate Action Confirmation.

Studies of European initiatives to develop and improve securities market infrastructure continued in 2008, with the accent on the ECB's TARGET2-Securities project. Discussions on broadening the scope of the European Code of Conduct for Clearing and Settlement and debt instruments with fixed maturity were monitored jointly with the MF as regulator and supervisor of the government securities market.

The advisory group on Bulgarian government securities settlement system inclusion in European securities settlement structures³⁹ consulted participants in the Government Securities Depository and the Ministry of Finance on the ECB's 23 May 2008 invitation to European government securities depositories to join TARGET2-Securities. The participants supported the project, and the payment system operator believed that transferring management of cash account settlement from the BNB to TARGET2-Securities should be considered only in the context of settlement of transactions in EUR-denominated securities. The BNB Governing Council's Resolution No 108 of 6 November 2008 backed TARGET2-Securities. The Government Securities Depository will join the project after Bulgarian entry into the euro area. In a 24 November 2008 letter, the Governor advised the ECB of the resolution.

Under its Directive 98/26/EC Article 10 duty on settlement finality in payment and securities settlement systems, the Bank advised the European Commission of Bulgarian payment and settlement systems (including the system for government securities settlement) and of national bodies to be notified by courts of bankruptcy suits against system operators or participants under Directive Article 6, paragraph 2.

During the year the Consultative Group on Budget Payments continued deliberating the transfer of specific data to the MF under public sector SEPA scheme application. To avoid budget information deterioration, the Group identified potential problems and risks, ways of tackling them, and opportunities for expanding IOBFR functionality depending on the adopted approach.

³⁹ The advisory group was appointed by an order of the Chairman of the National Payment Systems Council and comprises representatives of the BNB, MF and of government securities market participants.

IX. International Relations and Participation in the ESCB

During 2008 the BNB was actively involved in international institutions' actions against the global crisis, and in related discussions.

Participation in the European System of Central Banks

The BNB Governor is a member of the ECB General Council and participates in its meetings along with central bank governors from all EU Member States and the President and Vice-President of the ECB. In 2008 the BNB Governor took part in four regular and one ad hoc meeting in the ECB General Council to approve the regular ECB Convergence Report for 2008 on implementation of euro area accession criteria. At its regular meetings, the ECB General Council deliberates macroeconomic and monetary policy issues and national central bank compliance with Articles 101 and 102 of the Treaty Establishing the European Community (the TEC).

BNB representatives took part in 12 ESCB committees, 31 working groups, and the Human Resources Conference. Through representatives on ESCB bodies, committees and working groups, the Bank contributed to drafting ECB legal instruments, forming and developing monetary and banking infrastructure, reporting on payment and settlement systems and statistics, and participates in deliberations on other central banking issues.

In line with the duty of EU Member States to consult the ECB in writing on legislation within its purview, in 2008 the BNB brought three draft laws before the ECB's attention: Amendments to the Law on the Bulgarian National Bank, Amendments to the Law on Credit Institutions, and the Law on Payment Services and Payment Systems. Over the review period the Bulgarian government consulted the ECB on amendments to the Law on Statistics. Meanwhile the ECB advised relevant authorities and the BNB that it had not been consulted on the Law on Conflict of Interests Prevention and Disclosure.

Participation in ECOFIN Meetings, Council and Commission Committees and Working Groups

The BNB Governor participates in the informal meetings of EU economy and finance ministers (ECOFIN). At its September meeting in Nice, France, ECOFIN focused on the global crisis and in particular on assessments of the economic environment and risks to financial stability, and on policy approaches to tackle challenges. The meeting agreed on consistent and coordinated tackling of EU issues related to the global crisis. A discussion addressed actions to improve the financial stability framework and improve coordination in supervising the financial sector and large participants in it. This involved setting up a working group to assess policy approaches for reducing the pro-cyclical effects of the crisis on the financial system and enhance cooperation between supervisors and central banks on macroprudential issues.

BNB representatives participate in the Economic and Financial Committee (IFC) and in EU Council and European Commission committees and working groups. The Bank actively participates in EU policy on issues related to the Community's economic performance and initiatives launched both at EU level and internationally, in moves to broaden and strengthen the financial stability framework, reshape international financial architecture, and in drawing up annual assessments and drafting ECOFIN opinions on EU Member State stability and convergence programmes. In 2008 the focus fell on implementation of the three ECOFIN Road Maps adopted in late 2007 after that summer's financial upsets and which specify EU and Member State actions. In this connection, there was broad discussion on the EU financial stability framework and the Lamfalussy process⁴⁰. Injecting a European dimension into national supervisors' mandates and establishing a 'colleges of

⁴⁰ The *Lamfalussy* process is a four-level regulatory approach for the adoption, implementation and enforcement of legislation and implementing measures across securities, banking and insurance sectors.

supervisors' for large financial groups were among the main results of the Lamfalussy process review.⁴¹

A Memorandum of Understanding on cross-border financial stability among EU supervisory authorities, finance ministries, and central banks entered into force on 1 June 2008 to strengthen the financial stability framework.

In July 2008 the European Commission published a proposal to regulate credit rating agency authorisation, operation, and supervision. Consultation on the proposal is at an advanced stage and is expected to end in early 2009. In October 2008 the European Commission proposed an amendment to the Capital Requirement Directive. BNB representatives actively participated in all related deliberations.

After the crisis intensified with the failure of Lehman Brothers, in October EU Member States took coordinated action. On 7 October 2008 the ECOFIN Council raised the minimum deposit guarantee threshold to EUR 50,000. Euro area countries then approved a set of Common Principles on 12 October 2008, endorsed by Member States at the 15–16 October European Council meeting. This specifies shared aspects of Member State intervention and guarantees the funding and recapitalisation of banks.

To this end, active participation by BNB representatives in EU Council and European Commission committees and the Financial Services Committee (FSC), the Committee of European Banking Supervisors (CEBS) and its working groups, the European Banking Committee, and European Commission financial services working groups, was significant in formulating national positions on financial services and on anti-crisis measures.

Ten Years of Economic and Monetary Union

In May the European Commission celebrated the tenth anniversary of the decision launching the euro as a single currency by publishing *EMU@10: Successes and Challenges after 10 years of Economic and Monetary Union*; the Bank captured the opportunity of raising public awareness of EMU and the euro by translating and publishing the report in Bulgarian.

The BNB continued translating and publishing ECB *Monthly Bulletins* on a quarterly basis, the special ECB tenth anniversary issue, ECB *Convergence and Annual Reports*, and General Documentation on Eurosystem monetary policy instruments and procedures, making them available on the BNB website.

Convergence Reports

The regular convergence reports of the European Central Bank and of the European Commission published on 7 May 2008 assessed the convergence of EU Member States not yet in the euro area (Member States with derogation). Those assessed in both reports were Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania, Slovakia, and Sweden.⁴² The reports examine the compatibility between legislations and national central bank statutes with the TEC and the Protocol and Statute of the ESCB and the ECB, and fulfilment of TEC nominal convergence criteria by Member States with derogation. The assessment of Slovakia prompted an 8 July 2008 decision by the ECOFIN Council for that country to introduce the euro from 1 January 2009.

The BNB analysed the convergence reports and on the basis of recommendations on its regulatory framework drafted amendments to the Law on the Bulgarian National Bank in coordination with the ECB. On publication of the convergence reports, the Bank advised stakeholders and the public with its recommendations for Bulgaria.

Participation in the European Affairs Coordination Mechanism

The BNB representative on the Council for European Affairs helped make national policy on issues within the Bank's purview: payment systems, banking and financial services, supervisory practice convergence, and the financial stability framework.

At the invitation of the Governor, the Bank hosted the 125th session of the Council for European Affairs where the BNB shared experience in establishing effective ESCB, Eu-

⁴¹ Colleges of supervisors are permanent, although flexible structures for exchange of information and cooperation among the authorities responsible for and involved in the supervision of banking groups and financial conglomerates and taking measures in emergency situations.

⁴² The United Kingdom and Denmark were not included in the convergence reports since they have opt-out clauses from joining the euro area. These reports assessed for the first time the progress made by Bulgaria and Romania.

International Relations and Technical Support

European Commission, EU Council committee and working group participation. Members of the Council were advised of the regulatory framework for internal coordination to brief BNB representatives for meetings and with the Document Management System.

The BNB pursued a transparent policy of raising awareness of its participation in the European process. Overviews of European policy and regulations in banking and finance are prepared periodically and presented to relevant bodies. The Bank jointly with other institutions holds regular seminars for government, banking, and financial executives. In December the Bank held a seminar on *Changes in European Financial Services Legislation: the Effect on the Bulgarian Financial Market* with the Ministry of Finance and the Financial Supervision Commission.

In line with the policy of cooperating with other bodies and of coordinating European issues, in June the BNB initiated a meeting with Bulgarian Members of the European Parliament to discuss topical Economic and Monetary Union issues, forthcoming changes in European regulations and Bulgaria's positions on the internal market in financial services, financial sector supervision, and consumer protection in financial and payment services. The BNB regularly communicates Bulgaria's positions on financial issues to Bulgarian MEPs.

The BNB Governor attended the bimonthly meetings of Bank for International Settlements (BIS) central bank governors: a major forum where member central banks discuss world economic development and prospects, financial markets, and challenges to central banking from globalised financial systems. The Governor took part in the Annual General Meeting of BIS member central banks in late June 2008. The BIS Board of Governors declared a dividend of SDR 144.7 million (SDR 265 *per share*) to participating central banks, payable in July 2008. BNB representatives took part in the annual meetings of technical assistance coordinators to review the extended assistance and specify the need for technical assistance to Member States.

The BNB actively participates in European Commission EFC sub-committee meetings on IMF issues (SCIMF). In April, after consulting with the Ministry of Finance, the BNB Governor voted in favour of the IMF Board of Governors' Resolution on Quota and Vote Reforms and on broadening the Fund's investment authority. Quota and vote reform will reflect the relative weight of member countries in the world economy better and will enhance the participation of low-income members in the institution. IMF funding restructuring resulted from the need for a new budgetary framework to ensure Fund independence and enable it to fulfil objectives. The new framework covers the restructuring of the IMF income model by broadening the Fund's authority to invest.

The IMF Dutch Group, of which Bulgaria is a member, and the World Bank held their regular meeting in early June. IMF Managing Director Mr Dominique Strauss-Kahn was a special invitee to the meeting. A Bulgarian delegation headed by the BNB Governor met him and discussed key government objectives after EU accession: prudent fiscal policy, stable macroeconomic environment, and further structural reform.

On 2 October a two-year BNB twinning project with the Banca d'Italia, De Nederlandsche Bank, and the Banque de France as leader ended successfully. Under it, the BNB improved systems and structures in place and developed the skills and competence of its staff to participate in the ESCB and follow best world practice. Significant progress was marked to eventual participation in the Eurosystem, particularly as regards payment systems, statistics, accounting, research and forecasting, financial market monitoring, cash in vaults management, and risk management. All planned results in the two areas covered by the project were attained.

The twinning covenant covered a report on BNB participation in the TARGET2 project. Following completion of the project, the Bank continued to cooperate with the Banca d'Italia on joining TARGET2 and the Single Euro Payment Area (SEPA). To support BNB operational risk management system development, the Bank explored Banque de France experience. On the basis of tables describing various processes and operations, internal control mechanisms were analysed and a risk assessment matrix was developed to identify residual risks attending GSAS, ESROT, RSP, AS ROAD, and the electronic sys-

tem for book-entry government securities settlement accounts (IOBFR). An action plan addressed risks classified as unacceptable. Within the twinning covenant, the BNB hosted a seminar on EU central banking procedures and forecasting models in April 2008.

Fruitful bilateral cooperation with the Deutsche Bundesbank continued. Experience was exchanged in various fields, including analysing non-genuine banknotes and fighting money counterfeiting.

In 2008 the BNB joined the Banque de France, De Nederlandsche Bank and the Banca d'Italia as a partner in technical assistance projects for non-ESCB central banks financed by the EU and managed by the ECB. A nine-month programme of technical assistance with the National Bank of Serbia was launched on 1 September 2008. Within it, the BNB provides expert assistance in the financial services consumer protection. Within the three-year cooperation programme with the Egyptian central bank, on bringing banking supervision into line with Basel II principles, BNB experts provide high-level assistance on issues related to own funds, standardised approach to credit risk and accountability.

The BNB established cooperation with the National Bank of Kazakhstan on issues related to internal audit.

In 2008 the BNB policy of enhancing cooperation with Balkan central banks, including the provision of technical assistance, was pursued through intensive talks and various initiatives. Experience was exchanged and fruitful meetings held with experts from the central bank and the Ministry of Finance of Bosnia and Herzegovina on methods and approaches in fiscal policy forecasting and analysis. Fruitful cooperation with the central bank of Albania intensified as experience was exchanged on bank security and on control over information and payment systems. Enhanced cooperation continued within the Central Bank Governors' Club of the Black Sea Region.

At the invitation of the BNB, the governors of the Bank of Albania, the central bank of Bosnia and Herzegovina, the central bank of Cyprus, the National Bank of the Republic of Macedonia, the Bank of Greece, the central bank of Montenegro, the National Bank of Romania and the National Bank of Serbia, and the heads of the Banking Agencies of Bosnia and Herzegovina and the Republic of Serbia held their regular meeting in Sofia on 3 October 2008. The meeting was within the framework of the multilateral Memorandum of Understanding on enhancing South East Europe cooperation in banking supervision and safeguarding regional financial stability.

X. Statistics

The Bulgarian National Bank collects, compiles and disseminates statistics under Article 42 of the Law on the BNB and as ESCB member under Article 5 of the Protocol and Statute of the ESCB and the ECB.

In 2008 the Bank began publishing interest statistics in accordance with Regulation ECB/2001/18 concerning statistics on interest rates applied by monetary financial institutions to deposits and loans *vis-à-vis* households and non-financial corporations, adding many new indicators: annual percentage rates on consumer and housing loans; rates and volumes of outstanding amounts on deposits with agreed maturities and loans other than overdrafts; rates and volumes on new business by time of initial fixing.

Interest statistics information system functionality was extended through automated preliminary checking of data sent to the ECB.

Under commitments to the ECB, the Bank began reporting on *other financial institutions, including lease companies, institutions specialised in extending loans, financial vehicle corporations for securitisation of transactions, investment funds, insurance companies and pension funds*. Work continued on statistics for the non-bank financial sector and began on statistics concerning *companies specialised in extending loans*.

The BNB completed ECB surveys on establishing the facts and evaluating the costs of new securitisation rules, and on reporting cross-border securitisation. The surveys related to proposed ECB regulation on asset and liability statistics concerning financial vehicle corporations for securitisation of transactions.

The BNB and banks signed an agreement to observe Article 8 of Council Regulation (EC) No 2533/98 concerning the collection of statistical information by the European Central Bank and Article 25 of the Law on Statistics, and to preserve detailed monetary and interest rate statistics.

In 2008 the Bank started reporting on pension funds and insurance companies to its own methodology.

Monthly and quarterly balance of payments data with geographical breakdowns began to be reported to the ECB from March 2008. Work continues on international investment position statistics with geographical breakdowns, through which the BNB will meet requirements for euro area member states. Work is in hand to allow non-bank institutions to submit balance of payments statistics electronically.

Fieldwork ended on *random sample border surveys of Bulgarian and foreign nationals*. Results will improve data on the *Travel* and other balance of payments items.

Preparation was ending on a methodology for complete direct reporting of economic agent data for balance of payments and international investment position figures. Import and export reporting forms were designed and development began on a balance of payments statistical register.

In cooperation with the ESCB, the BNB continued active support for the Centralised Securities Database project and launched development of a Bulgarian securities database. Access to the centralised securities database was provided in October 2008 and information on securities issued by residents was subjected to a preliminary examination.

Technical terms of reference for an integrated statistics system were drawn up in 2008. This will automate statistics gathering, management, processing, and dissemination, helping reporting entities and servicing the rising demand for statistics.

Under the accessibility and clarity principle of the European Statistics Code of Practice, the Bank intends to increase information volumes and improve accessibility.

The Balance of Payments and Gross External Debt periodicals were updated with supplementary tables with longer time series. All publications and statistics press releases in Bulgarian and English began to be recorded in the period under review. Since early 2008 the BNB has published quarterly information on investment funds in Bulgaria under

Regulation ECB/958/2007 concerning statistics on the assets and liabilities of investment funds.

The Bank published its first series of long-term interest rates with geographical breakdowns for the purposes of convergence of Bulgaria's balance of payments statistics.

The BNB continued compiling and reporting the quarterly financial accounts of the General Government sector to ECB and EUROSTAT under European Parliament and Council Regulation 501/2004. Regular reporting of data on government finance statistics in compliance with ECB requirements continued⁴³.

In cooperation with the NSI, the Bank continued to send the ECB information on macroeconomic indicators and supplementary methodological data on administratively set prices in HICP. Regular data updates and metadata certification under the *Special Data Dissemination Standard* were made to IMF methodological requirements and to a set calendar.

⁴³ Guideline of the European Central Bank of 17 February 2005 on the statistical reporting requirements of the European Central Bank and the procedures for exchanging statistical information within the European System of Central Banks in the field of government finance statistics (ECB/2005/5).

XI. Research

Economic research, analyses of Bulgarian economic processes, and macroeconomic forecasts support the Bank's management in decision making and formulating economic policy. In 2008 research reflected the BNB priorities of successful participation in the ESCB in 2008. Work focused on improving assessments of nominal and real convergence and on developing macroeconomic models for forecasting.

Specialised research under the Research Plan for the 2007 to 2008 Period supported BNB operations by analysing individual economic processes and issues and by improving forecasting and modelling tools. The review period saw research on forecasting tools and modelling of price dynamics, Bulgarian competitiveness, financial integration and the monetary policy transmission mechanism, the long-term sustainability of public finance and long-term interest rates. The impact of macroeconomic factors on banking was analysed. Research results were published in technical reports and presented at seminars held by the BNB for banking experts, academics and NGOs.

In February 2008 an IMF technical mission helped the BNB apply dynamic stochastic general equilibrium models. The experts reviewed progress, consulted the BNB on modelling specific issues and outlined future goals.

In April 2008 the BNB hosted a seminar on EU central bank forecasting models and procedures. The workshop brought together the ECB, the Banque de France, the Banca d'Italia, the Latvijas Banka, the Lietuvos Bankas, the Magyar Nemzeti Bank, the Central Bank of Malta, De Nederlandsche Bank, the Narodowy Bank Polski, the Banca Națională a României, the Národná banka Slovenska, the Agency for Economic Analysis and Forecasts, the Ministry of Finance, the Bulgarian Academy of Science, the University of Sofia, the National Social Security Institute, and NGOs.

In November 2008 the BNB and the IMF co-organised a seminar on Systems for Analysing and Forecasting Economic Policy at which the central banks of Albania, Belarus, Croatia, the Czech Republic, Estonia, Greece, Hungary, Macedonia, Moldova, Poland, Russia, Serbia, Slovakia, Turkey, and Ukraine, were represented. The workshop was preceded by an IMF technical mission which helped BNB experts develop dynamic stochastic general equilibrium models for the financial sector.

The year under review saw testing and honing of the new basic model for improving BNB macroeconometric forecasting. The technical documentation to the model was improved in the light of recommendations by experts from De Nederlandsche Bank and the IMF.

The Guest Researcher Programme supports BNB research and helps establish fruitful cooperation with experts from Bulgaria and abroad on subjects of interest to the BNB. In 2008 five guest researchers worked on modelling the labour market, estimating the size and scope of the grey economy, establishing the ratio between inside and outside money in the early years of the Bulgarian monetary system (1879 to 1912), the impact of the exchange rate regime on current account medium term dynamics, and the efficiency of the banking system in Bulgaria during the transition period.

Through its Discussion Papers research series, the BNB continued to encourage the research potential of Bulgarian economic science and practice in macroeconomics, finance, and economic history. In 2008 the Discussion Papers Editorial Board reviewed nine submissions, of which eight were published (seven in the Macroeconomics and Finance section and one in the Economic History section) and one rejected.

The BNB continued to develop the South Eastern Europe Monetary and Financial History Study Network as cofounder and active participant. On 14 March 2008 the Bank of Greece hosted the third annual conference of the Network, with the BNB represented by three staff. Within the Network, the BNB worked intensively on the project for compiling a historical database of monetary indicators and marked the second stage of the project by publishing the indicators up to World War I.

A large-scale publications programme was approved and launched to celebrate the 130th anniversary of the BNB and by the close of 2008 the Bank had published the first book on the theory and practice of managing Bulgaria's international foreign currency reserves.

XII. Information Infrastructure

All plans under a broad range of long-term projects to utilise new information technology, ensure business continuity and implement high security were implemented in 2008.

The year saw the new OBIS Core Banking Information System go live. The system for BNB cash reporting, control and management (the Cash System) was also updated, addressing:

- Functional upgrades;
- Generation of all required accounting operations;
- Maintenance of the subgeneral ledger;
- Servicing customers through universal front office workstations;
- Interfacing to the Core Banking Information System;
- Providing for ongoing seamless system development.

OBIS was also interfaced with the International Reserve Management System (Trema FinanceKit).

Work on the EHD Single Data Depository/Banking Supervision Reports project continued in 2008. Two main milestones were implementation of a provision for electronic signing of report forms and the elimination of paper documents. The project also includes:

- Input of all reporting-relevant legislative amendments into the system;
- Continuing information input;
- Building dynamic series of historical data.

Updating the BNB Central Credit Register and expanding its functionality ended successfully in 2008 with these improvements:

- Hardware and software updates to handle increased demand and boost security and reliability;
- Additional credit data required by the Banking Supervision Department;
- Additional statement types to supervisory policy requirements;
- Inclusion of historical debt statements.

The ESROT Electronic System for Registration and Servicing Trade in Government Securities gained new functionalities ensuring higher reliability and more complete automation. New functional modules include:

- Staff qualifications;
- Staff recruitment;
- Staff training at the BNB.

The human resource and payroll systems were also upgraded.

Work began on the ISIS integrated statistical information system with terms of reference drawn up and a contractor selected. ISIS will automate all Statistics Directorate operations involving statistics collection, processing and dissemination, to BNB and ECB requirements for statistics quality, security, and confidentiality. It will comprise a single technological environment with common functional subsystems (modules) and subsystems by type of statistical data. The terms of reference call for an interface with the Monetary and Interest Rate Statistics system, *e-Gate*, and the EHD Single Data Depository.

Terms of reference were drawn up and a contractor was selected for a system to process information from payment system operators and participants, bank card issuers and acquiring banks, and electronic money issuers.

Work modes changed from administrative and hierarchical to project and team-focused as laid down in the Strategy for BNB Development and the budgetary framework. The specific goals and tasks of structural units were defined. A multifunctional project management system was launched in support of project-oriented organisation, and uniform standard project management methods in line with international standards and practice were introduced.

Step-by-step replacement of personal computers continued during 2008. All amortised configurations were replaced and new workstations equipped. Measures to standardise workstations and improve installation and assembly were taken. A new mail server was installed and the software delivery server was updated to support workstations. Printers were also replaced with network-ready monochrome and colour laser units.

The Harmful Code Protection System was also updated, with new software installed to integrate all Internet threats. Protection from peripheral data storage devices was introduced to improve information protection in line with the Bank's information security policy. Best practice was introduced in IT service provision: staff training and self-training, and Service Desk software integrated with other service provision systems.

Work continued on:

- Assessing IT risks to ECB methodology;
- Developing a user password selection and use procedure;
- Test switching SWIFT communications through the Alliance 2 backup server;
- Preparing SWIFT knot communication for RMA message authorisation;
- Providing compatibility between the RINGS and SAP systems;
- Developing and testing a new RINGS version compatible with SEP Bulgaria AD, the new Bulgarian system operator;
- Admitting a new gross settlement system participant (Bank Leumi Romania SA Sofia Branch);
- Helping draft the *BNB Participation in the TARGET2 Project* paper;
- Preparing Oracle10g test installation in RINGS;
- Developing the Incident Management system for RINGS use.

Ongoing work included:

- Monitoring and ensuring RINGS functioning;
- Operational monitoring and system technical maintenance and administration of SWIFTAlliance as a RINGS module under an agreement between the BNB RINGS Technical Maintenance Division and the Payment Systems Division;
- Testing and launching on 4 December 2008 a RINGS version compatible with SEP Bulgaria AD;
- Managing RINGS rotation;⁴⁴
- Testing and replacing RINGS users' digital certificates;
- Updating the RINGS portal;
- Reorganising RINGS portal main and backup servers;
- Developing new RINGS statements for banks and RINGS payment analyses and statistics for the Payment Systems Division;
- Testing and adapting Oracle10g to its test server to improve security, stability, promptness of RINGS operation and using opportunities for maintenance by Oracle;
- Logging issues into the RINGS Incident Management System;
- Completing transition to SWIFTNet Phase2. From 31 October 2008 message traffic with RINGS participants is based on RMA authorisation using only PKI signatures;
- Installing, testing and activating SWIFT Standards Release and Message Format Validation Rules 2008;
- Analysing and preparing the TARGET2 payment system accession project.

⁴⁴ On 11 November 2008 RINGS operations were transferred to the reserve server with a synchronised process on the main server. On 12 November 2008 the normal system configuration was restored.

XIII. Human Resource Management

During 2008 human resource management aimed at increasing efficiency through boosting staff qualifications and at improving Bank structure and organisation in line with overall policy and the Strategy for Bulgarian National Bank Development between 2004 and 2009. Major priorities involved reducing ancillary and supplementary tasks, improving the organisational structure, boosting staff training and skills, and increasing staff mobility.

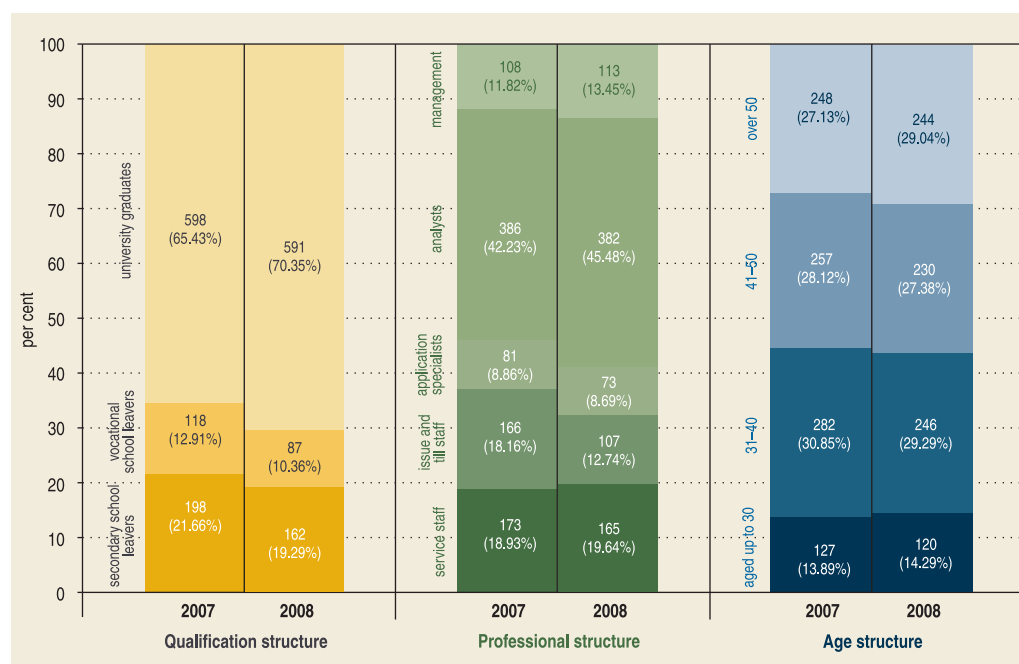
Pursuing the BNB Strategy objective of reducing ancillary and supplementary tasks, in April the Cash Services Company took over the receipt, storage, and forwarding of banknotes and coins. The Company was partly staffed by former BNB employees, allowing the Governing Council to cut the establishment from 1007 to 963.

Improving efficiency in applying European standards and modernising processes required qualified staff. Attracting competent and ambitious experts continued to be a priority in BNB human resource management. In 2008, 117 employees joined the Bank, of whom 48 below the age of 30. A greater number of employees left due to restructuring and retirement (185 against 99 in 2007).

Staff Structure

(as of 31 December of the corresponding year)

(number, per cent)



Source: BNB.

No essential changes in staff age structure occurred in 2008, as may be seen from the chart. The share of analysts rose by more than 3 percentage points on 2007 at the expense of cash operations personnel as a result of the Cash Services Company launch. As regards qualifications, the upward trend in the share of university graduates continued as consistent with a professional structure dominated by analysts.

Internal and external staff mobility was further encouraged. Moving between units became common practice. This boosted staff expertise and intensified the exchange of knowledge and experience within the Bank. In 2008 34 employees moved to other structural units.

External mobility, mostly to the ECB and EU bodies, was also active. March and April 2008 saw a staff swap between the BNB Internal Audit Department and the National Bank of Belgium, with employees of both institutions given the opportunity to learn new technologies and processes. Over the review period seven BNB employees took on short-term ECB appointments.

ESCB accession boosted BNB efforts to improve staff expertise. Training, a priority in BNB human resource management, aimed to raise staff educational and professional attainment. In recent years, opportunities to participate in various forms of training have become a leading stimulus for BNB employees and a way for them to join BNB corporate culture and boost career development motivation.

The Educational and Professional Training Programme approved on an annual basis is the main road to boosting qualifications. The Programme inducts new employees into BNB functions and operations, history and tradition, the duties of ESCB membership in the context of future integration into the Eurosystem, and their rights and duties in labour law and internal rules. Induction training has evolved significantly in recent years to include new topics and trainers. In 2008 61 new employees were trained in three groups.

Staff interested in improving educational attainments at leading Bulgarian universities. In 2008 27 employees took advantage of this on a part time basis. Employees on distance learning courses increased further, with participation for the first time in the Association of Chartered Certified Accountants' programme.

The BNB cooperates with a number of European central banks and international financial institutions which offer specialized courses in various central banking areas. The year offered more opportunities for participation in seminars organized by ESCB banks and European supervisory bodies. Training focused mainly on macroeconomics, monetary policy, international reserves and risk management, banking supervision, monetary and banking statistics, accounting, banking and financial law, human resource management, and internal audit.

For the first time the list of participants in foreign courses and seminars was broadly compiled at the stage of adopting the annual programme. This improved planning and organisational effectiveness. More BNB employees took part in training related to ESCB membership. In 2008, 124 BNB employees participated in international scientific and practical courses and seminars.

The qualification programme was mainly focused on learning foreign languages. Language training ensures a minimum level of foreign language proficiency for all employees and high proficiency levels for BNB representatives at the ESCB and other EU bodies.

English courses were attended by 84 employees. By 31 December 2008, 489 employees (83 per cent of all 591 positions with a required level of proficiency) had attained the target level. By comparison, a year earlier this indicator had been 73 per cent.

Traineeships were also available, with 37 awarded in 2008 and two trainees appointed by the Bank. To promote various opportunities for employees and trainees, the BNB took a stand at the Karieri 2008 student training and career forum. Participation in the forum confirmed the high standing the Bank enjoys among the general public as a reliable employer with a long-standing and professional reputation. Using new channels for communicating with the public significantly boosted the flow of candidates in various programmes in the summer and autumn of 2008.

Health and safety at work is a human resource management priority. Over the review period labour and insurance legislation changed to reflect European requirements on workforce quality, pay, and the working environment. Integration of health and safety legislation into BNB practice was the task of all structural units. Their support was key to the equipment safety policy and to the adoption of internal BNB rules on health and safety.

XIV. Facilities Management

The BNB mainly trades from owned premises and properties. This provides the degree of independence, security and protection required of a central bank. No properties were acquired or disposed of in 2008.

Property spending was mainly on implementing the investment programme in line with the BNB annual budget and included construction, refurbishment and modernisation, deliveries and equipment, repairs, vehicles, supplying assets and cash processing consumables, storing and using consumables and office materials at structural units, and optimizing power, heating, and water use at the BNB building in Sofia. Budget expenditure for 2008 was as follows: 99.6 per cent on construction, refurbishment and modernisation; 58.5 per cent on acquisition of plant and equipment, motor vehicles and sundry apparatus. The construction, refurbishment and modernisation items related entirely to the BNB Cash Centre.

In May 2008 the BNB equipped a new computer room for the Department of European Studies at the Sveti Kliment Ohridski University of Sofia.

XV. Internal Audit

More important audits in 2008 addressed cash circulation maintenance, information and analysis, and administration.

The cash circulation maintenance audit reviewed the ability of regional cash centres to work with the Cash Services Company AD. Internal audit experts helped prepare documentation (contracts and internal rules) for joint BNB and Cash Services Company work. Cash service and BNB operations changed significantly with the launch of the Cash Services Centre where banknotes and coins are counted. The audit addressed organisation and control, processing, storage and reporting to new requirements after the start of joint cash operations.

The BNB Cash Centre Project was part of the Strategy for Bulgarian National Bank Development between 2004 and 2009. The audit aimed to evaluate its implementation, deadline observance and budget implementation. Auditors focused on operational organisation and the degree to which internal control systems promoted the BNB's strategic goals. Internal auditors will continue monitoring the implementation of the BNB Cash Centre project on a continuous basis.

The 30 June 2008 audit of major BNB financial statement positions aimed to evaluate their accuracy, scope, reliability, and the adequacy of the control systems used when statements are drawn up. In the middle of the reporting period the new SAP bank information system went live and information from the old accounting system was transferred to it. The General Accounting Directorate operational organization under the new conditions was also examined.

The Central Credit Register information system was audited to assess the adequacy of security control measures and their compliance with regulations, together with risk management quality relating to system improvements.

Audits Conducted under the BNB Internal Audit Programme

BNB functions	Audits
Maintaining cash circulation	Audit of cash processing in the BNB regional cash centres and cooperation with the cash centres of the Cash Services Company
	BNB Cash Centre Project
Information and Analytical	The BNB financial statement as of 30 June 2008
	Weekly and monthly balance sheets
	Central Credit Register
Administrative	Supplier selection
	Concluded and executed delivery contracts

Source: BNB.

In 2008 two audits were completed under the ESCB Internal Auditors Committee programme: *Maintenance and Utilisation Review of Infrastructure and Information Systems for Eurosystem/ESCB Tasks Focusing on Incident and Problem Management and a Project on Compiling a Centralised ESCB Securities Database for Statistical Purposes*. The two audits aimed to provide reasonable assurance on the adequacy and efficiency of risk management and control of the examined units.

Audits Conducted under the ESCB Internal Auditors Committee

ESCB functions	Audits
Information and communication technologies	Maintenance and Utilisation Review of Infrastructure and Information Systems for Eurosystem/ESCB Tasks Focusing on Incident and Problem Management
Statistics	Centralised ESCB Securities Database

Source: BNB.

In line with ESCB Internal Auditors Committee requirements, BNB Internal Audit quality was assessed in late 2008. The external auditor's conclusion states that BNB Internal Audit operates in line with the *Standards for the Professional Practice of Internal Auditing* and with the *Code of Ethics* established by the Institute of Internal Auditors.

Over the review period the *BNB's operational risk management system* went live. The Bank developed and approved *Guidelines on Implementing BNB Operational Risk Management Policy*. The methodology for assessing and developing a common risk matrix in the Guidelines was tested in selected BNB Banking and Issue Department units. These units' major operations were described and controls were discussed, a core database on risk identification and management being created. Risk management training seminars were held and a new *Operational Risk Methodology and Consolidation Division* was established under the BNB Chief Auditor.

XVI. BNB Budget Implementation

The BNB budget was adopted by the BNB Governing Council at its 8 November 2007 meeting by Resolution No 122.

The Report on the Bank's budget comprises two sections: operational expenditure and the investment programme, pursuant to the BNB Governing Council's Internal Rules on Setting, Implementing, and Reporting the BNB Budget.

1. Operational Expenditure

BNB operational expenditure in 2008 came to BGN 74,846,000 or 88.8 per cent of the annual budget.

Over 2008 currency circulation cost BGN 22,872,000 or 92.6 per cent of the annual budget. Banknote and coin production cost BGN 21,932,000 or 94.7 per cent of BNB budget for 2008, including BGN 16,706,000 or 97.4 per cent of budget on banknote printing. Coin minting cost BGN 5,226,000, of which BGN 4,833,000 on circulating coins. Commemorative coin spend was in line with a BNB Governing Council programme and came to BGN 393,000.

Funds went on designing new banknotes and coins, banknote and coin scrapping and consumables. Spending on machines for servicing circulating cash came to BGN 172,000 or 84.3 per cent of budget.

Renting premises at the BNB Printing Works, at the State Mint and at the Cash Services Company cost BGN 528,000.

Materials, services, and depreciation spending totalled BGN 28,933,000 or 84.1 per cent of budget. Of this, materials comprised BGN 950,000. Major expenditure in this group comprised, *inter alia*, BGN 282,000 on office consumables and BGN 309,000 on fuel and spares for the transport fleet.

Expenditure on hired services was BGN 13,194,000 or 78.7 per cent of the annual budget. More significant items concerned Bloomberg, Reuters, internet and other system provision at BGN 1,262,000. Software maintenance came to BGN 3,122,000. Equipment maintenance was BGN 1,022,000. Mail, telephone, and telex came to BGN 437,000. Property and refuse levies were BGN 883,000, and electric bills were BGN 434,000. The Bank spent BGN 2,236,000 on its security contract with the Ministry of the Interior. Over 2008 expenses on major building maintenance totalled BGN 1,736,000.

In 2008 the BNB spent BGN 395,000 on, *inter alia*, legal and actuarial services, a representative survey for the purposes of the Statistics Directorate, a quality assessment of BNB Internal Audit by Deloitte Audit OOD.

Depreciation expenditure amounted to BGN 14,789,000 or 89.6 per cent of budgeted funds.

Under internal rules on remuneration compliant with labour and insurance legislation, the Law on the Bulgarian National Bank, and BNB Governing Council resolutions, salaries, social, and healthcare costs totalled BGN 18,805,000 or 97.6 per cent of annual budget. In accordance with IAS 19, Income of Hired Persons, the Bank reported BGN 359,000 of expenditure on current retirement obligations and unused paid leave under this item.

Social expenditure amounted to BGN 1,775,000 or 95.3 per cent of budgeted funds.

Other administrative expenditure for 2008 was BGN 1,281,000 or 56.1 per cent of annual budget. Inland travel involved mainly supplying banknotes and coins to BNB regional cash centres and conducting checks there and cost BGN 68,000.

Foreign travel covered participation in seminars and staff training. BGN 403,000 was spent here, or 65.7 per cent of budget.

Distance learning, seminars, and language courses to improve BNB participation in ESCB common tasks under the BNB Staff Education and Professional Training Programme cost BGN 549,000 or 53.3 per cent of budget. In 2008, 25 employees took distance learning programmes, 124 participated in training courses by foreign banks and financial institutions, and over 120 employees took short-term training (CISCO Academy CCNA and CSS courses, and National Union of Legal Advisers, Trud i Pravo Publishing, International Banking Institute, Institute of Internal Auditors in Bulgaria and other seminars) on the latest changes in Bulgarian legislation. Seventy three employees attended licensed language schools at a cost of BGN 26,000.

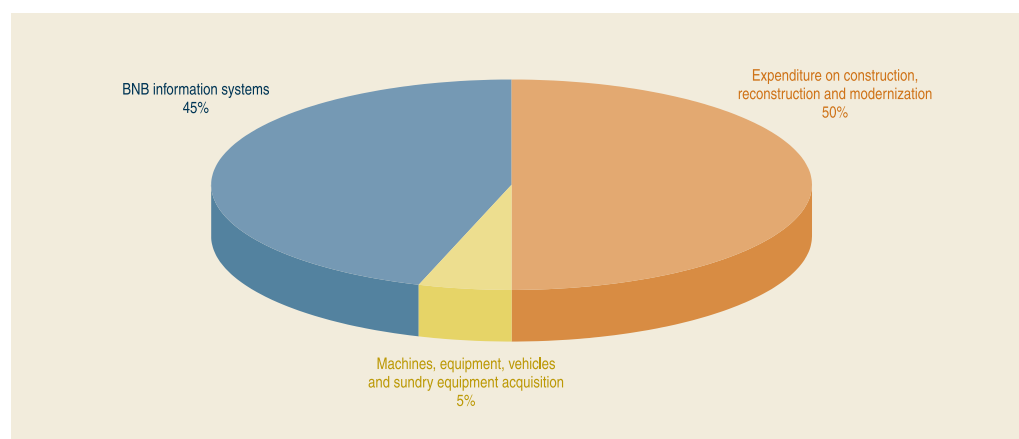
Bank representative and protocol expenses for 2008 totalled BGN 234,000.

During 2008 expenses related to the participation in the ESCB came to BGN 1,180,000. The cost of BNB representatives' participation in 23 ESCB committees and 57 subcommittees and working groups and other EU bodies was BGN 487,000. The cost of training and seminars organised by the ECB amounted to BGN 15,000. The annual fee for ESCB membership totalled BGN 178,000, telecommunications spend was BGN 493,000, and protocol expenditure was BGN 8000.

2. The Investment Programme

Budgeted investment funds totalled BGN 35,724,000, of which BGN 32,979,000 or 92.3 per cent was utilised.

Structure of Investment in 2008



Source: BNB.

Construction, reconstruction and modernisation in 2008 came to BGN 16,664,000 or 99.6 per cent of funds budgeted for construction of the BNB Cash Centre. The building was topped off and some finishing works and system installations were completed. This includes BGN 3,840,000 for certificated vault security systems.

In 2008, BGN 1,639,000 went on machines and equipment, vehicles, and sundry equipment; this accounted for 58.5 per cent of annual projections and 5 per cent of the investment programme.

Cost of machines and equipment for servicing currency circulation amounted to BGN 520,000 or 31.1 per cent of the budgeted funds, including BGN 182,000 on spares for banknote handling machines, BGN 180,000 for their adaptation, BGN 135,000 on BPS200 check sensors for the Cash Services Company and BGN 23,000 on other equipment.

Security equipment spend was BGN 537,000 or 99.5 per cent of budgeted funds, including expenditure on security systems in the BNB main building, the building at 7, Moskovska Str., and cash centres.

The Bank spent BGN 581,000 (or 98.5 per cent of budgeted funds) on office furniture, office equipment and vehicles, including BGN 134,000 on two cars, BGN 92,000 on six Xerox multifunction copiers, BGN 126,000 on air-conditioning systems and BGN 229,000 on other equipment.

Investment funds went mostly on implementing the BNB information and communications technology development strategy, with top priorities improvements to existing systems, strengthening security and improving management. In 2008 funds invested into information systems totalled BGN 14,676,000, or 92.8 per cent of budget and 45 per cent of total investment for 2008. Software licenses cost BGN 1,087,000 or 64.9 per cent of budget, including BGN 670,000 on Oracle, BGN 146,000 on SAP, BGN 31,000 on graphic software products, BGN 17,000 on SWIFTNet, BGN 96,000 on switchboard licenses, BGN 83,000 on computer-assisted translation software, and sundry expenses of BGN 44,000.

In 2008 investment into hardware development totalled BGN 6,410,000 or 94.4 of budgeted funds, including BGN 4,004,000 on the SAP core banking information system, BGN 571,000 on the Single Data Depository, BGN 498,000 on SOFI changes, BGN 395,000 on developing the cash system, BGN 162,000 on the system for managing a portfolio of projects, BGN 158,000 on modernising the RINGS-SWIFT interface, BGN 159,000 on developing the Credit Register, BGN 147,000 on designing a new website, BGN 132,000 on improving the GSAS, ESROT, and AIS systems for securities transactions, BGN 67,000 on the Statistics analytical application, BGN 64,000 in developing the personnel system, and BGN 53,000 on other systems.

In 2008 funds invested into computer equipment totalled BGN 6,705,000 or 99.1 per cent of budget, including BGN 4,606,000 on a disc data storage system, BGN 1,158,000 on servers, BGN 570,000 on computer workstations and monitors, BGN 323,000 on improving information system security, and BGN 48,000 on UPS devices, printers, and sundry computer equipment.

Spending on communication equipment was BGN 474,000 or 79.8 per cent of budget, including BGN 446,000 on developing the switchboard and BGN 28,000 on cabling.

No investment associated with BNB membership in the ESCB was made in 2008.

Implementation of the BNB Budget as of 31 December 2008

Indicators	Report 31 Dec. 2008 (BGN'000)	Budget 2008 (BGN'000)	Implemen- tation (%)
Section I. BNB operational expenditure	74 846	84 243	88.8
Currency circulation expenditure	22 872	24 702	92.6
Materials, services and depreciation expenditure	28 933	34 385	84.1
Salaries and social security expenditure	18 805	19 268	97.6
Social activity expenditure	1 775	1 862	95.3
Other administrative expenditure	1 281	2 283	56.1
BNB expenditure on membership in ESCB	1 180	1 743	67.7
Section II. Investment programme	32 979	35 724	92.3
Expenditure on construction, reconstruction and modernization	16 664	16 730	99.6
Expenditure on machines, equipment, vehicles and sundry equipment	1 639	2 800	58.5
Expenditure on BNB computerization	14 676	15 822	92.8
Investment related to BNB participation in ESCB	0	372	0

XVII. Bulgarian National Bank Consolidated Financial Statements for the Year Ended 31 December 2008

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INDEPENDENT AUDITOR'S REPORT TO THE GOVERNING COUNCIL OF THE BULGARIAN NATIONAL BANK

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of the Bulgarian National Bank and its subsidiaries, which comprise the consolidated balance sheet as at 31 December 2008, the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting principles made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Bulgarian National Bank and its subsidiaries as at 31 December 2008, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Report on Other Legal and Regulatory Requirements

Annual report of the activities of the Bank according to Article 33 of the Accountancy Law

As required under the Accountancy Law, we also report that the historical financial information prepared by Management and presented in the annual report of the activities of the Bank, as required under Article 33 of the Accountancy Law, is consistent, in all material aspects with the financial information disclosed in the annual consolidated financial statements of the Bank as at and for the year ended 31 December 2008. Management is responsible for the preparation of the annual report of the activities of the Bank which was approved by the Governing Council of the Bank on 23 April 2009.



KPMG Bulgaria OOD

Sofia, 23 April 2009

37 Fridtjof Nansen Str.
1142 Sofia
Bulgaria

Statement of Responsibilities of the Governing Council of the Bulgarian National Bank

The Law on the Bulgarian National Bank requires the Governing Council of the Bulgarian National Bank to prepare financial statements to present the Bank's financial position and performance for the period.

The financial statements of the Bulgarian National Bank approved by the Governing Council are prepared in accordance with the International Financial Reporting Standards adopted by the European Commission.

The Governing Council of the Bulgarian National Bank is responsible for maintaining proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bulgarian National Bank. It has overall responsibility for taking such steps to safeguard the assets of the Bulgarian National Bank and to prevent or detect fraud and other irregularities.

A handwritten signature in black ink, appearing to read 'Ivan Iskrov', with a large, sweeping horizontal stroke underneath.

Ivan Iskrov
Governor of the BNB

Consolidated Income Statement for the Year Ended 31 December 2008.

(BGN'000)

	Note	31 Dec. 2008	31 Dec. 2007
Interest income	7	1,045,533	688,104
Interest expense	7	(302,689)	(210,312)
Net interest income		742,844	477,792
Fee and commission income		8,356	8,332
Fee and commission expense		(3,831)	(4,530)
Net fee and commission income		4,525	3,802
Net profit/(loss) from financial assets and liabilities at fair value through profit or loss	8	326,802	257,408
Other operating income	9	34,532	36,445
Total income from banking operations		1,108,703	775,447
Administrative expenses	10	(95,326)	(81,567)
Profit for the period		1,013,377	693,880

Profit distribution as of 31 December 2008:

(BGN'000)

	Note	31 Dec. 2008	31 Dec. 2007
Profit for the period		1,013,377	693,880
Transfer to special reserves:	23	(313,008)	(239,016)
Result after transfer to special reserves		700,369	454,864
Transfer to other reserves	23	299,259	204,088
Minority interest		155	142
Planned contribution to the budget of the Republic of Bulgaria		400,955	250,634
Result after transfer to special reserves		700,369	454,864

The accompanying notes on pages 79 to 103 form an integral part of the consolidated financial statements.

Consolidated Balance Sheet for the Year Ended 31 December 2008

(BGN'000)

	Note	31 Dec. 2008	31 Dec. 2007
ASSETS			
Cash and deposits in foreign currencies	11	2,655,053	3,507,981
Gold, instruments in gold and other precious metals	12	1,559,116	1,432,666
Financial assets at fair value through profit or loss	13	20,600,510	18,356,669
Financial assets available for sale	14	1,424,016	1,391,586
Tangible assets	15	207,827	151,430
Intangible assets	16	15,270	14,935
Other assets	17	51,471	46,359
Total assets		26,513,263	24,901,626
LIABILITIES			
Banknotes and coins in circulation	18	9,179,414	8,410,867
Due to banks and other financial institutions	19	5,006,486	5,783,538
Liabilities to government institutions and other liabilities	20	7,487,687	6,753,822
Borrowings from international financial institutions against participation	21	1,302,601	1,275,420
Other liabilities	22	109,763	45,750
Total liabilities		23,085,951	22,269,397
EQUITY			
Capital	23	20,000	20,000
Reserves	23	3,403,764	2,608,836
Minority interest	24	3,548	3,393
Total equity		3,427,312	2,632,229
Total liabilities and equity		26,513,263	24,901,626

The accompanying notes on pages 79 to 103 form an integral part of the consolidated financial statements.

Consolidated Statement of Cash Flows for the Year Ended 31 December 2008

(BGN'000)

	Note	31 Dec. 2008	31 Dec. 2007
Operating activities			
Net profit		1,013,377	693,880
Adjustments for matching with the net cash flow from operating activities:			
Dividend income		(4,501)	(4,486)
Depreciation	15, 16	20,994	15,548
Profit on disposal of tangible assets		(21)	21
Gains on financial assets and liabilities arising from market movements		(310,878)	(243,784)
Profit of associates		(2,581)	(1,164)
Other adjustments		-	(35)
Net cash flow from operating activities before changes in operating assets and liabilities		716,390	459,980
Change in operating assets			
(Increase) in gold, instruments in gold and other precious metals		(4,016)	(485)
(Increase) in financial assets at fair value through profit or loss		(2,059,348)	(6,350,866)
Decrease in receivables from the Government		-	498,024
(Increase) in other assets		(6,470)	(5,901)
Change in operating liabilities			
Increase in currency in circulation		768,547	1,522,291
Increase/(decrease) in due to banks and other financial institutions		(777,052)	2,189,924
Increase in due to government institutions and other liabilities		733,865	1,653,165
(Decrease) in borrowings from international financial institutions		-	(498,024)
Increase in other liabilities		61,844	26,450
Net cash flow from operating activities		(566,240)	(505,442)
Investing activities			
Purchase of tangible and intangible assets		(41,711)	(11,269)
Dividends received		4,501	4,486
Increase in BNB's equity investment		-	(10,874)
Net cash flow from investing activities		(37,210)	(17,657)
Financing activities			
Payments to the Government		(250,634)	(170,630)
Net cash flow from financing activities		(250,634)	(170,630)
Net decrease/increase in cash and cash equivalents		(854,084)	(693,729)
Cash and cash equivalents at beginning of period		3,536,469	4,230,198
Cash and cash equivalents at end of period	11,17	2,682,385	3,536,469

The accompanying notes on pages 79 to 103 form an integral part of the consolidated financial statements.

Consolidated Statement of Changes in Equity for the Year Ended 31 December 2008

(BGN'000)

Source of changes in equity	Capital	Minority interest	Revaluation reserves from non-monetary assets	monetary assets	commemorative coins	Other reserves	Total
Balance as at 1 January 2007	20,000	3,286	103,947	887,481	735	1,095,884	2,111,333
Unrealized gain on revaluation of gold	-	-	-	205,564	-	-	205,564
Unrealized loss on revaluation of foreign currency (net)	-	-	-	(3,734)	-	-	(3,734)
Unrealized gain on revaluation of financial assets at fair value through profit or loss (net)	-	-	-	37,116	-	-	37,116
Unrealized loss on revaluation of financial assets available for sale	-	-	(1,328)	-	-	-	(1,328)
Payment of the prior year contribution to the budget of the Republic of Bulgaria	-	-	-	-	-	(170,630)	(170,630)
Planned current year contribution to the budget of the Republic of Bulgaria	-	-	-	-	-	250,634	250,634
Profit for the year after the contribution to the budget of the Republic of Bulgaria and minority interest	-	142	-	-	-	117,088	117,230
Other special reserves	-	-	-	-	-	87,000	87,000
Other transfers	-	(35)	(801)	-	(134)	14	(956)
Balance as at 31 December 2007	20,000	3,393	101,818	1,126,427	601	1,379,990	2,632,229
Unrealised gain on revaluation of gold	-	-	-	122,434	-	-	122,434
Unrealised gain on revaluation of foreign currency (net)	-	-	-	2,169	-	-	2,169
Unrealised gain on revaluation of financial assets at fair value through profit or loss (net)	-	-	-	184,493	-	-	184,493
Movement in revaluation reserves due to redemption of securities	-	-	-	3,912	-	(3,912)	-
Unrealized gain on revaluation of financial assets available for sale	-	-	460	-	-	-	460
Payment of the prior year contribution to the budget of the Republic of Bulgaria	-	-	-	-	-	(250,634)	(250,634)
Planned current year contribution to the budget of the Republic of Bulgaria	-	-	-	-	-	400,955	400,955
Profit for the year after the contribution to the budget of the Republic of Bulgaria and minority interest	-	155	-	(212)	-	180,471	180,414
Other special reserves	-	-	-	-	-	119,000	119,000
Revaluation of real estate	-	-	36,085	-	-	-	36,085
Other transfers	-	-	(91)	(4,543)	(202)	4,543	(293)
Balance as at 31 December 2008	20,000	3,548	138,272	1,434,680	399	1,830,413	3,427,312

The accompanying notes on pages 79 to 103 form an integral part of the consolidated financial statements.

Notes to the Consolidated Financial Statements

1. Organisation and principal activities

The Bulgarian National Bank (the 'Bank') is 100 per cent owned by the Republic of Bulgaria. The Bank is the central bank of the Republic of Bulgaria. The operation of the Bank is governed by the Law on the Bulgarian National Bank (LBNB), which has been effective from 10 June 1997.

Under this Law, the principal activities of the Bank may be summarised as:

- Maintaining price stability by ensuring national currency stability;
- Having the exclusive right to issue banknotes and coins;
- Regulating and supervising other banks' activities in the country with a view to banking system stability maintenance;
- Ensuring the establishment and operation of efficient payment systems and their oversight.
- The Bank may not provide credit to the government or government institutions, other than credit for the purchase of Special Drawing Rights (SDR) from the International Monetary Fund (IMF) in accordance with the terms set by law;
- The Bank may not provide credit to banks except in the case of liquidity risk threatening to the stability of the banking system;
- The Bank may not deal in Bulgarian government securities;
- The Bank may not issue Bulgarian levs in excess of the Bulgarian lev equivalent of the gross international foreign currency reserves;
- Under terms agreed with the Minister of Finance, the Bank acts as agent for government debts or for government guaranteed debts;
- The Bank acts as a Central Depository of government securities.

The Governing Council of the BNB approved the consolidated financial statements set out on pages 79 to 103 on 23 April 2009.

2. Applicable standards

These financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Commission. A list of the applicable standards is given in Note 30.

3. Basis of preparation

The financial statements are presented in Bulgarian levs (BGN) rounded to the nearest thousand. The financial statements are prepared on a historical cost basis, except for derivative financial instruments, financial assets and liabilities for trading and available-for-sale assets which are presented at fair value.

The Bank consistently applies its accounting policy from the previous year.

When preparing the financial statements in conformity with IFRSs, the Bank makes judgements, estimates and assumptions that affect the reported amounts of assets and liabilities for the following financial year. Estimates and judgements are continually updated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under certain circumstances.

4. Basis of consolidation

Subsidiaries

Subsidiaries are the enterprises controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The financial statements of the subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. All receivables and payables, income and expenses as well as intragroup profits resulting from transactions between Group companies are eliminated unless they are immaterial. The share in the net assets of the Bank's subsidiaries, which corresponds to the minority shareholders' proportionate share, is disclosed separately in *Capital and reserves* under the *Minority interest item*.

Associates

Associates are those entities in which the Bank has significant influence, but which are neither subsidiary enterprise nor joint venture. Investments in associates are included in the Bank's consolidated financial statements on an equity accounted basis as an amount corresponding to the Bank's share in the associates' own funds as at the end of the reporting period. The Bank's share of associates' net results subsequent to acquisition is disclosed in the income statement as investment income/expenses and is added to the carrying value of the investment.

5. Principal accounting policy elements

(a) Income recognition

Interest income and expense are recognised in the income statement on an effective interest rate basis. The effective interest rate is the rate which precisely discounts the expected future cash payments and income over the term of the financial asset or liability to the book value of the asset or liability. The effective interest rate is determined on the initial recognition of the financial asset or liability and does not change thereafter.

The calculation of the effective interest rate includes all commissions received or paid and any discounts or premiums which are integral parts of the effective interest rate. Transaction costs are intrinsic costs directly attributable to the acquisition, issue or derecognition of a financial asset or liability.

Interest income and expense in the income statement include:

- interest on financial assets and liabilities at amortised cost calculated by the effective interest rate method;
- interest on investment securities available for sale calculated by the effective interest rate method.

Dividends are recognised in the income statement when the Bank establishes the right to their receipt. Exchange rate gains or losses from available-for-sale investments are recognised in the income statement.

(b) Financial instruments

(i) Classification

For the purposes of measuring financial instruments subsequent to initial recognition, the Bank classifies the financial instruments into four categories:

Financial instruments at fair value through profit and loss are those that the Bank holds primarily for the purpose of short-term profit. These include investments that are not designated for any particular purpose, effective hedging instruments and liabilities from short-term sales of financial instruments. Net receivables under derivatives held for trading (positive fair value), as well as options purchased, if any, are reported as trading assets. All net liabilities under derivatives for trading (negative fair value), as well as options written, if any, are reported as trading liabilities.

Loans and receivables are instruments, created by the Bank through lending money to a debtor, other than assets held with the intention of short-term profit taking.

Held-to-maturity financial assets are assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity.

Available-for-sale financial assets are all assets that cannot be classified in any other category and are classified as available for sale, as well as any financial asset intended for this category at its initial recognition.

(ii) Initial recognition

The Bank recognises trading financial assets and investments, the bank's loans and receivables, and financial assets at amortised cost on the settlement date. All other financial assets and financial liabilities are recognised on the trade date when the Bank becomes a party to the financial instruments contracts. From that moment on, any gains and losses arising from changes in their fair value are recognised.

Financial instruments are initially recognised at fair value, and the financial instruments which are not recognised at fair value through profit or loss include the transaction costs.

(iii) Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured upon the initial recognition, minus principal repayments, plus or

minus cumulative amortisation, using an effective interest rate for the difference between the initially recognised amount and the amount at maturity minus depreciation costs.

(iv) Fair value measurement and disclosure principles

Fair value is the amount at which an asset can be exchanged or a liability can be settled, between informed consenting parties in a direct deal on the measurement date.

Whenever possible, the bank measures the fair value of an instrument using quoted prices in an active market of this instrument. A market is considered active if quoted prices are regular and easily accessible and there are actual regular and direct market transactions. If the market of a financial instrument is not active, the bank shall measure the fair value using evaluation techniques. The evaluation techniques include recent direct deals between informed consenting parties (if any), comparison with the current fair values of other similar instruments, analysis of discounted cash flows, and models with option prices. The chosen evaluation technique maximally uses market data, relies to the least possible extent on specific for the bank measurements, includes all factors which market participants would take account of in pricing, and agrees with the adopted pricing methods for financial instruments.

The data for the evaluation techniques adequately present the market expectations and measures of the risk factors and profitability of the financial instrument. The Bank checks the evaluation techniques and tests their validity using prices of current market transactions in the same instrument seen in the market, or the prices are based on other available market data.

The best indicator of a financial instrument's fair value upon its initial recognition is the deal price, i.e. the fair value of the given or received investment, unless the fair value of this instrument is defined in comparison with other evident current market transactions in the same instrument (i.e. without changes or regroupings) or on the basis of evaluation techniques whose variables include only data obtained from the market. When the deal price is the best indicator of the fair value upon the initial recognition, the financial instrument is initially measured at deal price, and every difference between this price and the value obtained at first from the evaluation model is recognised later through profit or loss depending on the facts and circumstances of the transaction, but not later than the time when the measurement is entirely supported by evident market data or the transaction is completed.

Assets and long positions are measured at 'ask' price; and liabilities and short positions are measured at 'bid' price. When the Bank has positions with set-off risk, average market prices are used to measure the positions with set-off risk, and an adjustment by respectively 'ask' or 'bid' price is made only for the net open position. Fair values reflect the credit risk of the instrument and unclude adjustments for the credit risk of the Bank and of the counterparty if necessary. The fair value measures obtained from the model are adjusted according to all other factors, such as liquidity risk or uncertainty of the model, to the extent in which the Bank believes that a third party in the market would take them into consideration in evaluating a transaction.

(v) Derecognition

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the rights to the receipt of the contractual cash flows from the financial asset in the transaction in which all material risks and profits from the holding of the financial asset are transferred. Any holding in transferred financial assets, which has been originated or kept by the Bank, is recognised as a separate asset or liability.

The Bank derecognises a financial liability when its contractual obligations have been fulfilled or cancelled or have extinguished.

The Bank conducts transactions for transferring assets recognised in the balance sheet, but it keeps all or almost all material risks and profits from the transferred assets or a portion of them. If some or all material risks and profits have been kept, then the transferred assets are not derecognised from the balance sheet. A transfer of assets with keeping some or all material risks and profits is, for instance, a securities lending agreement or a repurchase transaction.

In transactions where the Bank does not keep, nor does it transfer, all material risks and profits from the holding of a financial asset, it derecognises the asset if it does not keep control of that asset. The rights and obligations kept in the transfer are recognised separately as assets and as liabilities respectively. In transactions where control of the asset is

kept, the Bank goes on recognising the asset up to its participation, depending on the extent to which the Bank is exposed to changes in the value of the transferred asset.

In some transactions, the Bank keeps its obligation to service the transferred financial asset against payment. The transferred asset is fully derecognised if it meets the derecognition criteria. The asset or liability is recognised in the service contract depending on whether the service charge is more than sufficient (asset) or less than sufficient (liability) for the service.

(vi) Set off

Financial assets and liabilities are set off and the relevant net value is entered in the balance sheet when the Bank has a legal right to set off the recognised values and intends to settle the asset and the liability on a net basis.

Income and expenses are reflected on a net basis only in the cases allowed by the accounting standards, or from profits or losses arising from a group of similar transactions, such as those resultant from the Bank's trading operations.

(vii) Impairment of assets

Financial assets which are not recognised at fair value through profit or loss are reviewed at each balance sheet date to determine whether there is evidence of impairment. A financial asset is impaired if there is objective evidence of impairment as a result of a loss event that occurred after the initial recognition of the asset and that the loss event had an impact on the estimated future cash flows of the asset and a reliable estimate of the loss can be made.

Objective evidence of impairment loss from financial assets, including equity instruments, is a default or a borrower's inability to repay his obligations, restructuring of loans under unfavourable for the bank financial conditions, indications that a borrower or the issuer of a financial instrument would go out of business, the disappearance of an active security market, or another public information. Furthermore, in case of a continuous or significant fall in the market value of an investment in equity instruments there is objective evidence of impairment of these equity instruments.

The Bank judges the need of impairment of loans or investments to maturity on an individual or group basis. All individually important loans and investments to maturity are evaluated for specific impairment. All individually important loans and investments to maturity on which no specific impairment losses have been charged are evaluated on a portfolio basis. Loans and investments to maturity which are not individually important are evaluated for impairment as a group by forming groups of loans and securities to maturity with similar risk characteristics. For the impairment on a portfolio basis, the Bank uses statistical models based on historical experience of non-repayment probability, the time for the reversal of impairment losses, and the loss amount which is adjusted according to the management's judgement whether the current economic and credit conditions are such that the actual losses are higher or lower than the results from the historical modelling. The default percentages, losses, and the expected period of reversal of losses are regularly compared with real data so as to validate the evaluation models.

Impairment losses from assets entered at amortised cost are measured as the difference between the book value of the financial asset and the present value of the approximately estimated future cash flows discounted by the initial effective interest rate of the asset. Losses are recognised in profits and losses and go to a corrective account against loans and receivables. Interest on the impaired asset is still recognised through depreciation of the discount. When a subsequent event reduces the impairment loss, the reduction in the impairment loss is reversed in profits and losses.

Impairment losses from available for sale investment securities are recognised by transferring the accumulated loss directly recognised in the own funds to profits and losses. The accumulated loss transferred from equity and recognised in profits and losses is the difference between the purchase price, net of all principal repayments and depreciations, and the present fair value minus all impairment losses recognised before that in profits and losses. If in a subsequent period the fair value of an impaired debt security available for sale increases and the increase can be objectively linked to an event that occurred after the impairment loss had been recognised in profits and losses, then the impairment loss is reversed and the reversed amount is recognised in profits and losses. Any subsequent recovery in the fair value of an impaired equity instrument available for sale, however, is directly recognised in equity.

(viii) Financial assets/liabilities held for trading

Financial assets at fair value through profit or loss include instruments for trading which the Bank holds primarily for the purpose to sell or repurchase them in short terms or holds them as part of a portfolio which is managed as a whole with the purpose of short-term profit.

Financial assets and liabilities for trading are initially recognised at fair value in the balance sheet and the purchase costs go directly to the income statement. All changes in the fair value are recognised as net income from trading operations in the income statement. Financial assets and liabilities for trading may not be reclassified after their initial recognition and over the year the amended IAS 39 Reclassification of Financial Assets (amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures) has not been applied.

Investments are initially recognised at fair value, and the fair value of the investments which are not recognised at fair value through profit or loss includes the direct costs for the acquisition of the investments. Upon any subsequent measurement, depending on the classification, investments are entered as investments to maturity or available for sale.

(ix) Investments**(1) Investments held to maturity**

Held-to-maturity financial assets are non-derivative assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity, are not classified at fair value through the income statement, and are not available for sale financial assets.

Held to maturity investments are recognised at amortised cost on the basis of an effective interest rate. In case of sale or reclassification of more than an insignificant part of the assets held to maturity which do not mature in the near term, there should be a reclassification of the entire portfolio of investments held to maturity in the group of available for sale investments. As a result of this reclassification, the Bank may not classify investments as investments held to maturity in the current year, and in the next two years.

(2) Available-for-sale investments

Available-for-sale investments are non-derivative assets that cannot be classified in any other category of financial assets. Equity investments not quoted in the market and whose fair value cannot be reliably defined are recognised at cost. All other available for sale assets are recognised at fair value.

Differences in the fair value are recognised directly in equity until the investment is sold or fully depreciates, when the cumulative income and expense recognised in equity are recognised in the income statement.

(c) Gold and other precious metals

Gold and other precious metals are valued at market value based on the euro fixing of the London Bullion Market at the balance sheet date.

(d) Equity investments

For the purposes of measuring the equity investments subsequent to initial recognition, they are classified as available-for-sale financial assets and are reported at fair value.

Details of investments held by the Bank are set out in note 14.

(e) Property, plant, equipment and intangible assets

The Bank pursues a policy of recognising land and buildings at revaluated cost as per the alternative approach allowed in IAS 16 Property, Plant and Equipment. The other groups of property, plant, equipment and intangible assets are stated in the balance sheet at their acquisition cost, less accumulated depreciation and impairment losses.

Land and buildings are recognised at fair value which is regularly assessed by professional qualified evaluators. The revaluation of property is done asset by asset, and the accrued depreciation at the revaluation date is derecognised on the gross balance sheet account on the assets side, and the net value is recalculated against the revaluation of the asset. When the value of assets increases as a result of revaluation, the increase goes directly to the revaluation reserve in the own funds. When the value of assets decreases as a result of revaluation, the decrease is recognised decreasing the revaluation reserve in the own funds, and in case of shortage the difference is recognised as expense in the income statement.

(i) Subsequent expenditure

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately is capitalized. All other subsequent expenditures are capitalized only when they increase the future economic benefits from the item of property, plant and equipment. All other expenditures are recognised in the income statement as the expense is incurred.

(ii) Depreciation

Depreciation is charged on a straight-line basis as per established norms with a view to carrying as expenditure the value or measurement of property, plant, equipment and intangible assets over their estimated useful lives. Land is not depreciated. The annual depreciation rates used are as follows:

(%)

Buildings	2–4
Plant and Equipment	3–15
Computers	30–33.3
Fixtures and fittings	15–20
Motor vehicles	8–25
Intangible fixed assets	20–25

Expenditures incurred for the acquisition of property, plant, equipment and intangible assets are not depreciated until they are brought into use.

(iii) Calculation of recoverable amount of assets

The recoverable amount of the Bank's property, plant and equipment is the bigger of the two – the net selling price or value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using the Bank's incremental borrowing rate of interest that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

(iv) Reversals of impairment

In respect of property, plant and equipment, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only up to the amount of the asset's carrying amount before recognizing of impairment loss.

(f) Foreign currency

Income and expenditure in foreign currencies are translated to BGN at the official rates of exchange on the transaction date. Monetary assets and liabilities denominated in foreign currencies are translated to BGN at the closing exchange rate of the Bank. Foreign exchange gains and losses resulting from the revaluation of monetary assets and liabilities are recognised in the income statement. Foreign currency denominated non-monetary assets and liabilities are valued at the exchange rate on the date of acquisition or at latest revaluation at fair value.

Outstanding forward contracts in foreign exchange are marked to market. The gains and losses on revaluation of outstanding forward contracts are recognised in the income statement.

The exchange rates of the major foreign currencies as at 31 December 2008 and 31 December 2007 are as follows:

Currency	31 December 2008	31 December 2007
US dollar (USD)	1 : BGN 1.38731	1 : BGN 1.33122
Euro (EUR)	1 : BGN 1.95583	1 : BGN 1.95583
Special Drawing Rights (SDR)	1 : BGN 2.14729	1 : BGN 2.10130
Gold (XAU)	1 troy ounce : BGN 1198.280	1 troy ounce : BGN 1102.460

(g) Taxation

The Bank is not subject to income tax on income from its main activities. Tax on the profits of the subsidiaries for the period comprises current tax and deferred tax. Current tax comprises tax payable calculated on the basis of the expected taxable income for the period, using the effective tax rate or the current one on the balance sheet date. Deferred tax is derived by using the balance sheet liability method on all temporary differences between the carrying amounts for financial reporting purposes and the amounts used for taxation purposes.

(h) Profit distribution policy of the Bank

The Bank's policy of distribution of profit from banking operations is defined in the Law on the BNB. BNB Financial Statements and Accounting Policy Internal Rules were adopted by a resolution of the BNB Governing Council in accordance with Article 36, paras. 1 and 2 of the Law on the BNB and are effective from 1 January 2007. According to these rules, the Bank allocates to special reserves the unrealised gains and losses arising from revaluation of assets and liabilities denominated in foreign currency or gold. According to the requirements of Article 8, para. 2 of the Law on the BNB, the Bank sets aside 25 per cent of the excess of its annual revenue over its annual expenditure into a Reserve Fund. According to Article 8, para. 3 of the Law on the BNB, after the allocation to the Reserve Fund, the Bank may allocate reserves to cover market risk losses and other reserves by a decision of the Governing Council. Subsequent to the allocation of reserves as required by the Law on the BNB, the Bank stipulates the remainder to be paid into the State Budget.

(i) Cash in hand and deposits in foreign currency

Cash and cash equivalents consist of cash in hand, current accounts and time deposits with maturities of up to three months.

(j) Implementation of relevant international financial reporting standards published but not yet effective as of the balance sheet date

A number of new standards, changes in current standards and interpretations, which have not yet come into effect as at 31 December 2008 and have not been applied in preparing these financial statements:

Amendments to IFRS 2 Share-based Payment – Vesting Conditions and Cancellations (effective from 1 January 2009). These changes clarify the definition of vesting conditions and introduce the concept of not vesting conditions. These conditions should be taken into consideration in the fair value on the arrangement date, and the inability to fulfil the not vesting conditions is generally considered to be cancellation. The amendment to IFRS 2 will become mandatory for the financial statements for the year 2009 with a retrospective application. The management believes that the amendments to IFRS 2 will not have any effect on the Bank as the Bank does not plan any share-based payments.

IFRS 8 – Operating Segments (effective from 1 January 2009). The standard requires disclosure of segments based on Bank's components, which the management monitors for operating decision-making purposes. The Bank's operating segments are components of the Bank, for which discrete financial information is available, that is regularly reviewed by a chief operating decision maker to make decisions on resource allocation and to assess the performance of operating segments. The management is of the view that IFRS 8 is not relevant to the Bank's activities.

Revised IAS 1 – Presentation of Financial Statements (effective for the annual periods beginning on and after 1 January 2009). This revised standard requires that the information in financial statements should be aggregated by similar characteristics. The standard introduces the notion of statement of comprehensive income.

The items of the income statement and the components of the comprehensive income statement can be presented either in one comprehensive income statement (effectively combining the income statement and all changes in equity from transactions with non-owners), or in two separate statements (an income statement followed by a separate comprehensive income statement).

Revised IAS 23 – Borrowing Costs eliminates the option of recognizing all borrowing costs as expenses immediately upon their occurrence and requires entities to capitalize borrowing costs directly related to acquisition, construction, or production of a qualifying asset as part of the cost of that asset. The management believes that the revised IAS 23 is not relevant to the Bank's activities.

IFRIC 13 – *Customer Loyalty Programmes* addresses accounting by entities operating or participating in customer loyalty programmes. This Interpretation deals with customer loyalty programmes under which customers may exchange the loyalty credits collected by them for awards such as free of charge or discounted goods or services. The management believes that IFRIC 13 is not relevant to the activities pursued by the Bank.

The management believes that it should mention the following revised standards, new interpretations of and changes to existing standards which at the balance sheet date are incorporated into the general IFRS framework approved by the International Accounting Standards Board (IASB), but have not yet been approved for application by the European Commission and, therefore, have not been taken into consideration by the Bank in preparing these financial statements:

- 35 amendments to 24 IFRSs and IASs (2008);
- Revised IFRS 3 Business Combinations (2008);
- Revised IFRS 1 First-time Adoption of International Financial Reporting Standards;
- Amendments to IFRS 1 and IAS 27 regarding the cost of an investment in a subsidiary, jointly controlled entity or associate;
- Amendments to IAS 32 and IAS 1 regarding options for the sale of financial instruments and obligations arising on liquidation;
- Amendments to IAS 39 regarding admissible hedged items and transitional provisions;
- IFRIC 12 – Service Concession Agreements;
- IFRIC 15 – Agreements for the Construction of Real Estate;
- IFRIC 16 – Hedges of a Net investment in a Foreign Operation;
- IFRIC 17 – Distributions of Non-cash Assets to Owners.

As at the date of these financial statements, the Bank's management has not finished the analysis of the possible effects from the future application of the above revised standards, new interpretations of and changes to existing standards when they are approved by the European Commission for application in the European Union.

6. Financial risk management policy disclosure

(a) Introduction and overview

The Bank is exposed to the following types of risk in relation to its operations in financial instruments:

- Credit risk;
- Liquidity risk;
- Market risk;
- Operational risk.

This note provides information on the Bank's goals, exposures to each one of the above risks and the policies and processes for risk measurement and management.

General provisions of risk management

The BNB management of the gross international reserves looks to the security and high liquidity of the investment assets first, and then the intention of maximizing income in the context of the international markets conditions. Its investment strategy mainly depends on the specific functions of a central bank operating under a strictly regulated currency board arrangement and in accordance with the requirements of the Law on the BNB.

The major portion of BNB's foreign currency reserves is invested in low-risk discount and coupon bonds issued by countries, state agencies or supranational financial institutions, short-term foreign currency and gold deposits placed with first rate foreign banks. The remaining portion is held in SDRs, and in monetary gold kept in the Bank's vaults.

The foreign currency reserve risks are managed by an independent risk management unit. It is directly responsible for the strategic asset allocation and the determination of the foreign exchange reserves benchmark, and prepares and submits for approval the investment management limits. On a quarterly basis, an overall review is made of the changes in the market conditions, the amount and structure of foreign currency reserves, and if required, the investment limits and benchmarks are updated. The observance of underlying limits, rules, and procedures is monitored on a daily basis. Reports are regularly prepared both for the needs of foreign currency reserves operating management, and for providing updated information to the Bank's management.

All approved financial instruments and asset classes in which the BNB may invest are given in the document *Investment Guidelines and Benchmarks for the Management of the*

Gross International Reserves. The same document defines the main portfolios and the model portfolios (benchmarks) corresponding to them, as well as all limits to credit, interest, currency and operational risk. The document contains an exhaustive list of approved issuers of debt instruments which the BNB may invest in, and a list of foreign financial institutions acting as BNB counterparties.

The foreign currency reserve management is governed by rules of behaviour and procedures regulating the performance of the functions and tasks of the main structural units responsible. The rules and procedures are included in the document *Manual of Business Procedures for Foreign Currency Reserve Management*.

(b) Credit risk

The BNB is exposed to credit risk through its trading operations and investment activities and in cases where it acts as an intermediary on behalf of the Government or other public institutions. The Bank assumes credit risk also in operations of purchase and sale of foreign currency with commercial banks. In general, this credit risk is associated with the probability of insolvency or bankruptcy of a BNB's counterparty or the bankruptcy or insolvency of a debt issuer, in whose debt instruments the Bank has invested its own funds. Credit risk is limited by setting strict requirements for high credit ratings assigned by internationally recognised credit rating agencies.

From credit risk perspective, the Bank can currently invest in the following types of financial instruments:

- Investment programmes with central banks;
- Automatic securities lending/borrowing with the main depository;
- Lending of securities deposited with an agent-bank;
- Foreign currency deposits (time deposits and funds on current accounts) with counterparties from group one and/or with central banks;
- Gold deposits with group one counterparties, central banks or supranational financial institutions (time deposits and funds on current accounts);
- Commercial paper issued by:
 - countries or state-guaranteed;
 - supranational institutions or agencies;
 - non-state guaranteed specialized financial institutions or agencies;
 - banks;
 - issuers of secured Eurobonds;
- Bonds issued by:
 - countries or state-guaranteed agencies;
 - supranational institutions;
 - specialized financial agencies;
 - banks: secured German bonds of the type *Jumbo Pfandbrief* and secured Irish bonds of the type *Irish Asset Covered Securities*;
 - other financial institutions: secured French bonds of the type *Obligations Foncières*;

All bonds must be with a one-off payment of their face value on the maturity date and without any embedded options.

- Purchase and sale of foreign currency;
 - with a value date of up to 2 business days (spot);
- Futures (bond and interest rate) (long and/or short positions are eligible) traded on the international regulated markets;

According to the BNB Policy for counterparties in foreign currency reserve management, foreign financial institutions acting as BNB counterparties are divided into two groups:

- Group One – financial institutions to which the BNB may have a credit exposure. These should have long-term credit rating higher or equal to AA- according to S&P and Fitch Ratings, or Aa3 according to Moody's by at least two of the above indicated agencies;
- Group Two – financial institutions with which the BNB may conclude DVP (Delivery Versus Payment) transactions for the sale or purchase of securities. They should have a short-term credit rating higher or equal to A-1 according to S&P, F-1 according to Fitch Ratings or P-2 according to Moody's by at least two of the above agencies.

The investment limits of the BNB incorporate a system of limits to the maximum exposures to individual counterparties. The set limits are calculated on the basis of internal credit ratings and the capital of the counterparty. The internal credit rating, on its part, is a function of long-term ratings by the above three credit rating agencies. In addition, based on

the internal credit rating, limits are set to the maximum term of the deposits in gold and foreign exchange placed with commercial banks, and of the commercial paper issued by them.

In 2008 the BNB took a number of additional measures for limiting the credit risk in the foreign currency reserve management as the credit and liquidity crisis in the international markets intensified to evolve later into a global economic crisis. The maximum term to maturity of short-term foreign currency deposits was strongly limited, while placements of monetary gold deposits were temporarily stopped. As to counterparties with which the BNB may maintain a credit exposure, additional provisional limits mitigating the credit risk were introduced. Foreign currency operations with some of the financial institutions with higher credit risk were stopped in the interim, while some others completely fell out of the BNB list after their credit ratings dropped. A part of these measures were of temporary character and were cancelled late in the year as a result of the relative stabilisation of the markets after the decisive intervention of some governments and central banks of leading economies.

(c) Liquidity risk

Liquidity risk arises in the funding of the Bank's core activities and in the management of positions, and has two aspects, the first aspect being the risk for the Bank of being unable to meet its obligations when due, and the second aspect – the risk of being unable to liquidate an asset on international markets for fair prices within an appropriate time frame as per the relevant market conventions.

The Bank's customers are determined by the Law on the BNB. It attracts funds by means of a number of instruments – deposits/investment accounts, a structured indexed account (SIA), settlement accounts and other borrowed funds established by law. The Bank seeks to maintain a balance between the maturity of borrowed funds and that of assets through investments in financial instruments with a range of maturities. Limits are set to ensure minimum liquidity by type of currency. Liquidity is provided on a daily basis, thus ensuring all BNB foreign currency payments. There are limits on the residual term to maturity for the financial instruments of those asset classes approved for investment.

The Bank continually assesses liquidity risk by identifying and monitoring changes in funding required for meeting its goals and targets set in terms of the overall Bank strategy. As part of its overall liquidity risk management strategy, the Bank has defined some requirements for the management of a portfolio of liquid assets denominated in euro and for maintaining assets denominated in other currencies for the purposes of meeting its cash inflows and outflows.

The Bank's financial assets and liabilities, analyzed by residual term to maturity from the balance sheet date to the date of the any subsequent agreement or agreed maturity, are as follows:

(BGN'000)

As at 31 December 2008	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Undefined maturity	Total
Financial assets							
Cash and deposits in foreign currencies	2,655,053	-	-	-	-	-	2,655,053
Gold, instruments in gold, and other precious metals	369,057	552,988	-	-	-	637,071	1,559,116
Financial assets at fair value through profit or loss	4,026,423	3,938,690	9,259,585	2,934,965	440,847	-	20,600,510
Financial assets available for sale	71,994	-	-	-	-	1,352,022	1,424,016
Total financial assets	7,122,527	4,491,678	9,259,585	2,934,965	440,847	1,989,093	26,238,695
Financial liabilities							
Banknotes and coins in circulation	-	-	-	-	-	9,179,414	9,179,414
Liabilities to banks and other financial institutions	5,006,486	-	-	-	-	-	5,006,486
Liabilities to government institutions and other borrowings	6,313,608	680,079	494,000	-	-	-	7,487,687
Borrowings against Bulgaria's participations in international financial institutions	-	-	-	-	-	1,302,601	1,302,601
Total financial liabilities	11,320,094	680,079	494,000	-	-	10,482,015	22,976,188
Asset-liability maturity mismatch	(4,197,567)	3,811,599	8,765,585	2,934,965	440,847	(8,492,922)	3,262,507

(BGN'000)

As at 31 December 2007	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Undefined maturity	Total
Financial assets							
Cash and deposits in foreign currencies	3,507,981	-	-	-	-	-	3,507,981
Gold, instruments in gold, and other precious metals	88,248	756,624	-	-	-	587,794	1,432,666
Financial assets at fair value through profit or loss	3,112,942	4,182,918	8,048,728	2,749,597	262,484	-	18,356,669
Financial assets available for sale	70,023	-	-	-	-	1,321,563	1,391,586
Total financial assets	6,779,194	4,939,542	8,048,728	2,749,597	262,484	1,909,357	24,688,902
Financial liabilities							
Banknotes and coins in circulation	-	-	-	-	-	8,410,867	8,410,867
Liabilities to banks and other financial institutions	5,783,538	-	-	-	-	-	5,783,538
Liabilities to government institutions and other borrowings	6,140,774	601,727	11,321	-	-	-	6,753,822
Borrowings against participations in international financial institutions	-	-	-	-	-	1,275,420	1,275,420
Total financial liabilities	11,924,312	601,727	11,321	-	-	9,686,287	22,223,647
Asset-liability maturity mismatch	(5,145,118)	4,337,815	8,037,407	2,749,597	262,484	(7,776,930)	2,465,255

The outstanding contractual maturities of the Bank's financial liabilities are as follows:

(BGN'000)

	Book value	Gross nominal outgoing cash flow	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years
As at 31 December 2008							
Banknotes and coins in circulation	9,179,414	9,179,414	-	-	-	-	9,179,414
Due to banks and other financial institutions	5,006,486	5,006,486	5,006,486	-	-	-	-
Liabilities to government institutions and other borrowings	7,487,687	7,493,560	6,314,142	681,963	497,455	-	-
Borrowings against Republic of Bulgaria's participation in international financial institutions	1,302,601	1,302,601	-	-	-	-	1,302,601
	22,976,188	22,982,061	11,320,628	681,963	497,455	-	10,482,015
As at 31 December 2007							
Banknotes and coins in circulation	8,410,867	8,410,867	-	-	-	-	8,410,867
Due to banks and other financial institutions	5,783,538	5,783,538	5,783,538	-	-	-	-
Liabilities to government institutions and other borrowings	6,753,822	6,758,799	6,130,862	605,605	22,332	-	-
Borrowings against participation in international financial institutions	1,275,420	1,275,420	-	-	-	-	1,275,420
	22,223,647	22,228,624	11,914,400	605,605	22,332	-	9,686,287

(d) Market risk**Market risk**

All financial instruments are subject to market risk, i.e. the risk of impairment as a result of changes in the market conditions. The instruments are evaluated on a daily basis at fair market value which best reflects current market conditions for the respective type of financial instrument. The Bank manages its portfolios in response to changing market conditions. Exposure to market risk is managed in accordance with the risk limits formally set in the Investment Limits to the Management of the Gross International Foreign Currency Reserves.

The table below presents one important measure of market risk, i.e. Value at Risk (VaR). VaR is an indicator of the maximum loss over a certain period of time (holding period) and with a certain probability (confidentiality level). The VaR used in this report is based on 95 per cent confidentiality level and a 1-day holding period.

Although VaR is an important tool in measuring market risk, the assumptions on which the model is based have some limitations:

- the 95 per cent confidentiality level means that even within this model there is a 5 per cent probability that losses may exceed the VaR;
- the use of historical data (30 days time series) as the basis of determining the probable exits does not cover all possible scenarios, especially those of unusual nature;
- VaR depends on the Bank's positions and the volatility of market prices. VaR of a position of an unchanged volume decreases when market prices volatility diminishes, and *vice versa*.

The Table below describes VaR of BNB Issue Department assets.

(BGN'000)

	As at 31 December	Average	Maximum	Minimum
2008				
Currency risk	(28,169)	(26,572)	(40,126)	(11,862)
Interest rate risk	(3,654)	(2,898)	(6,120)	1,214
Correlation	(0.22)	0.11	0.52	(0.40)
Total:	(17,450)	(23,393)	(38,355)	(6,616)
2007				
Currency risk	(22,814)	(14,074)	(24,701)	(4,399)
Interest rate risk	(591)	(1,104)	(4,682)	846
Correlation	0.26	(0.05)	0.49	(0.32)
Total:	(22,438)	(12,493)	(24,867)	(4,041)

Interest rate risk

The Bank's operations are subject to the risk of interest rate fluctuations which affect the prices of interest-earning assets (including investments) and interest-bearing liabilities. The Bank uses modified duration as a key measurement for interest rate risk. Modified duration measures the effect of the change in the market value of an asset (liability) in percentage points in response to 1 percentage point change in the interest rate levels. In addition, portfolios' technical parameters such as convexity, duration in a fixed point of the yield curve, etc. are monitored on a daily basis. For each portfolio held by the BNB, the interest rate is limited by a benchmark (model portfolio) and by the investment limits for a maximum allowable deviation of the modified duration of the portfolio from that of the respective benchmark.

Assets and liabilities with floating interest rates involve the risk of changes in the base which serves to determine the interest rates.

(BGN'000)

As at 31 December 2008	Effective rate (%)	Total	Floating rate instruments	Fixed rate instruments		
				Less than 1 month	Between 1 month and 3 months	Between 3 months and 1 year
Interest-earning assets						
Cash and deposits in foreign currencies	2.1	2,570,471	15,498	2,554,973	-	-
Gold, instruments in gold and other precious metals	0.55	921,234	-	369,045	-	552,189
Financial assets at fair value through profit or loss	2.48	20,194,593	49,963	3,924,901	3,865,219	12,354,510
Financial assets available for sale		71,994	-	71,994	-	-
Other interest-earning assets		27,332	3,644	-	-	23,688
Total		23,785,624	69,105	6,920,913	3,865,219	12,930,387
Interest-earning liabilities						
Due to banks and other financial institutions		5,006,486	-	5,006,486	-	-
Liabilities to government institutions and other borrowings	1.13	6,701,059	146,687	5,380,858	679,514	494,000
Total		11,707,545	146,687	10,387,344	679,514	494,000
Asset/liability gap		12,078,079	(77,582)	(3,466,431)	3,185,705	12,436,387

(BGN'000)

As at 31 December 2007	Effective rate (%)	Total	Floating rate instruments	Fixed rate instruments		
				Less than 1 month	Between 1 month and 3 months	Between 3 months and 1 year
Interest-earning assets						
Cash and deposits in foreign currencies	4.15	3,416,197	4,810	3,411,387	-	-
Gold, instruments in gold and other precious metals	0.16	844,752	-	88,245	756,507	-
Financial assets at fair value through profit or loss	4.11	18,241,492	98,029	3,091,809	4,172,759	10,878,895
Financial assets available for sale		70,023	-	70,023	-	-
Other interest-earning assets		28,488	-	28,488	-	-
Total		22,600,952	102,839	6,689,952	4,929,266	10,878,895
Interest-earning liabilities						
Due to banks and other financial institutions		5,783,538	-	5,783,538	-	-
Liabilities to government institutions and other borrowings	3.44	5,011,875	146,687	4,254,188	600,000	11,000
Total		10,795,413	146,687	10,037,726	600,000	11,000
Asset/liability gap		11,805,539	(43,848)	(3,347,774)	4,329,266	10,867,895

For managing interest rate risk and the band of interest rate changes we monitor the sensitivity of financial assets and liabilities to various standard and non-standard interest rate movement scenarios.

The standard scenarios include 100 basic points instant and parallel increase and decrease in all yield curves globally and 50 basic points increase and decrease in the yield curves for a period of over 12 months. The second two scenarios assume that the change in yields takes place at the beginning of the period and the next year the yield curve remains unchanged.

The analysis of the Bank's sensitivity to changes in interest rates, assuming a constant balance sheet position and excluding asymmetrical movement of yield curves, is as follows:

(BGN'000)

	100 b.p. parallel increase	100 b.p. parallel decrease	50 b.p. parallel increase in 1 year	100 b.p. parallel decrease in 1 year
2008				
As at 31 December	(154,460)	154,460	644,649	555,912
2007				
As at 31 December	(102,790)	102,790	451,069	443,321

Currency risk

Currency risk exists where there is a difference between the currency structure of assets and that of liabilities. From an accounting point of view, the Bank is exposed to currency risk when conducting transactions in financial instruments denominated in currencies other than the Bank's base currency (euro).

With the introduction of the currency board arrangement in Bulgaria and the fixing of the Bulgarian currency to the euro, the Bank's financial statements, prepared in the Bulgarian lev, are affected by movements in the exchange rate of the lev against the currencies other than the euro.

To minimize currency risk, there is a limit to the mismatches between the currency structure of assets and that of liabilities. According to Article 31(3) of the Law on the BNB, the market value of assets in a currency other than the euro, SDR and monetary gold, may not deviate by more than +/-2 per cent of the market value of the liabilities denominated in these currencies.

(BGN'000)

	31 Dec. 2008	31 Dec. 2007
Assets		
Bulgarian lev and euro area currencies	23,303,953	22,063,825
US dollar	264,595	34,353
Japanese yen	72	68
Pound sterling	66	230
SDR	1,405,595	1,368,157
Gold	1,536,815	1,429,006
Other	2,167	5,987
	<u>26,513,263</u>	<u>24,901,626</u>
Liabilities		
Bulgarian lev and euro area currencies	24,870,085	23,591,210
US dollar	264,211	34,148
Japanese yen	72	-
Pound sterling	81	-
SDR	1,376,652	1,274,243
Other	2,162	2,025
	<u>26,513,263</u>	<u>24,901,626</u>
Net position		
Bulgarian lev and euro area currencies	(1,566,132)	(1,527,385)
US dollar	384	205
Japanese yen	-	68
Pound sterling	(15)	230
SDR	28,943	93,914
Gold	1,536,815	1,429,006
Other	5	3,962

(e) Using accounting judgements and assumptions

The Governing Council discusses the development, choice, and disclosure of essential accounting policies and measurements, as well as their implementation.

These disclosures supplement the notes to the financial risk management.

The Bank is operating in an intensely changing worsened global economic and financial environment which at the end of 2008 negatively affected the Bulgarian market as well and would have an impact on the Bank's results and risk. The management has already taken measures, and its major priorities in the next few years will still be to keep the Bank's stable liquidity position and the continuous improvement in its evaluation methods, exchange rate reserves quality control and management.

Major sources of evaluation uncertainty:**(i) Determination of fair values**

The determination of fair values of financial assets and liabilities for which there is no monitored market price requires the use of evaluation techniques described in the accounting policy. For rarely traded financial instruments whose price is not transparent, the fair value is less objective and requires various degrees of judgement depending on liquidity, concentration, market factors uncertainty, price assumptions, and other risks affecting the particular instrument.

(ii) Measurement of financial instruments

The Bank measures the fair value of financial instruments using the following hierarchy of methods:

- A market quote or a price for closing positions for which there is a reliable market;
- Evaluation techniques based on actual market information. This category of methods is used to evaluate debt securities for which there is no reliable market.

The fair values of financial assets and liabilities traded in international financial markets for which there is accessible market information are based on market quotes or prices formed at the closing of a market. The use of actual market prices and information reduces the need of managerial judgement and assumptions, and the uncertainty surrounding the determination of fair values. The availability of actual market prices and information varies depending on products and markets and changes because of specific events and the general conditions of financial markets. The Bank determines the fair values of all other financial instruments for which there are no current market quotes by using an evaluation technique based on a net present value. The net present value is computed by means of market yield curves and credit spreads, where necessary, for the relevant instrument. The purpose of the evaluation techniques is to determine a fair value which reflects the price of the financial instrument on the reporting date.

The Bank has established a control environment for measuring fair values. The fair values of financial instruments are set by an independent risk analysis and control unit. Specific controls include: checking the actual price information; regular reviews of current evaluation models and, if necessary, development, approval and introduction of new evaluation models; follow-up verification by means of analysis and comparison of data from various information sources, etc.

The next table analyses financial instruments reported at fair value by evaluation models. The data does not include equity instruments reported at cost (Note 14).

(BGN'000)

	Market quotes in active market	Evaluation techniques using market data	Total
31 December 2008			
Cash and deposits in foreign currency	2,655,053	-	2,655,053
Gold, instruments in gold and other precious metals	1,559,116	-	1,559,116
Financial assets at fair value through profit or loss	12,310,407	8,290,103	20,600,510
Total	16,524,576	8,290,103	24,814,679

7. Interest income and expense

(BGN'000)

	31 Dec. 2008	31 Dec. 2007
Interest income		
– on securities	912,310	525,689
– on deposits	132,696	162,388
– on other	527	27
	<u>1,045,533</u>	<u>688,104</u>
Interest expense		
– on deposits	252,821	204,329
– on other	49,868	5,983
	<u>302,689</u>	<u>210,312</u>

Interest expense paid on government deposits in BGN as at 31 December 2008 is BGN 205,415 thousand and BGN 42,253 thousand in foreign currency. Interest expense paid on deposits in BGN of other government organisations as at 31 December 2008 is BGN 1585 thousand and BGN 3568 thousand in foreign currency.

8. Net gains/(losses) from financial assets and liabilities entered at fair value through profit or loss

(BGN'000)

	31 Dec. 2008	31 Dec. 2007
Net gains from operations in securities	13,615	18,346
Net gains from operations in foreign currency	179	116
Net revaluation gains/(losses) on futures	(3,402)	9,387
Net revaluation gains on securities	191,807	27,729
Net revaluation gains/(losses) on foreign currency assets and liabilities	2,169	(3,734)
Net revaluation gains on gold and precious metals	122,434	205,564
	<u>326,802</u>	<u>257,408</u>

9. Other operating income

(BGN'000)

	31 Dec. 2008	31 Dec. 2007
Net income from disposal of non-current assets	-	300
Turnover of subsidiaries	24,914	21,044
Income from associated companies	2,581	1,164
Income from sale of coins	1,585	1,580
Dividend income	4,501	4,486
Other income, net	951	7,871
	<u>34,532</u>	<u>36,445</u>

10. Total administrative expenses

(BGN'000)

	31 Dec. 2008	31 Dec. 2007
Personnel costs	28,187	26,255
Administrative expenses	42,930	35,784
Depreciation	20,994	15,566
Other expenses	3,214	3,962
	<u>95,326</u>	<u>81,567</u>

Personnel costs include salaries, social and health insurance costs charged under the local legislation provisions as at 31 December 2008, respectively for the BNB – BGN 20,580 thousand, for the Printing Works AD – BGN 5092 thousand, and for the Bulgarian Mint EOOD – BGN 2515 thousand. The number of employees of the Bank and its subsidiaries is 1207 in 2008 (2007: 1253), including the BNB staff of 840 in 2008 (2007: 914).

According to the Labour Code requirements, on termination of the employment contract of an employee who has become entitled to retirement, the Bank is obliged to pay him/her compensation amounting to twice his/her gross monthly salary. If the employee has been employed by the Bank in the last ten years, the amount of this compensation is six gross monthly salaries at the time of his/her retirement.

Based on actuarial calculations, the Bank has accrued its retirement compensation liabilities to the personnel and unused annual leave – BGN 359 thousand (31 December 2007: BGN 610 thousand). The retirement compensation and unused annual leave for the Bank's subsidiaries as at 31 December 2008 are BGN 434 thousand (31 December 2007: BGN 353 thousand).

Administrative expenses include also the BNB's currency circulation expenses of BGN 22,872 thousand as at 31 December 2008 (31 December 2007: BGN 20,522 thousand).

11. Cash and deposits in foreign currencies

(BGN'000)

	31 Dec. 2008	31 Dec. 2007
Foreign currency cash	84,397	87,944
Current accounts in other banks	13,932	4,917
Deposits in foreign currency	2,556,724	3,415,120
	<u>2,655,053</u>	<u>3,507,981</u>

Cash and deposits in foreign currencies with correspondents are disclosed as follows:

(BGN'000)

	31 Dec. 2008	31 Dec. 2007
Euro area residents		
in EUR	2,539,839	1,204,545
In other foreign currencies	923	144
	<u>2,540,762</u>	<u>1,204,689</u>
Non euro area residents		
In EUR	95,950	2,264,465
In other currencies	18,311	38,827
	<u>114,261</u>	<u>2,303,292</u>
	<u>2,655,053</u>	<u>3,507,981</u>

12. Gold, instruments in gold and other precious metals

	31 Dec. 2008		31 Dec. 2007	
	'000 troy ounces	BGN'000	'000 troy ounces	BGN'000
Gold bullion in standard form	513	614,769	513	565,609
Gold deposits in standard form	768	922,046	766	844,872
Gold in other form	17	20,036	17	18,526
Other precious metals	-	2,265	-	3,659
		<u>1,559,116</u>		<u>1,432,666</u>

Gold in standard form includes gold held with correspondents, which earns interest at rates between 0.3 per cent and 1.00 per cent per annum. Gold in other form includes jubilee and commemorative gold coins of BGN 17,030 thousand. Other precious metals include silver commemorative coins of BGN 227 thousand and platinum commemorative coins of BGN 2,038 thousand. Gold deposits are held with banks whose liabilities are rated with one of the two highest ratings given by two internationally recognised rating agencies.

13. Financial assets at fair value through profit or loss

(BGN'000)

Securities at fair value through profit or loss	31 Dec. 2008	31 Dec. 2007
Foreign treasury bills, notes and bonds	20,600,510	18,356,669
	<u>20,600,510</u>	<u>18,356,669</u>

Securities comprise both coupon and discount securities denominated in EUR. The coupon interest of the EUR-denominated securities reached 3.85 per cent in 2008 (31 December 2007: 3.9 per cent).

The value of securities pledged as collateral on futures transactions amounted to BGN 19,469 thousand as at 31 December 2008 (31 December 2007: BGN 19,606 thousand).

The securities issued by foreign governments and other issuers with credit rating graded by at least two of the three credit rating agencies – Standard & Poor's, Fitch Ratings, or the corresponding Moody's ratings – are disclosed as follows:

(BGN'000)

	Issuer's credit rating	31 Dec. 2008	31 Dec. 2007
Investment graded securities	AAA	13,324,715	11,213,991
	AA+	2,365,381	4,860,584
	AA	10,121	1,545,181
	AA-	4,242,979	348,812
	A+	657,314	388,101
		<u>20,600,510</u>	<u>18,356,669</u>

14. Financial assets available for sale

(BGN'000)

	31 Dec. 2008	31 Dec. 2007
Republic of Bulgaria's quota in the IMF	1,372,575	1,345,663
Equity investments in international financial institutions	30,926	27,989
Equity investments in associates	20,515	17,934
	<u>1,424,016</u>	<u>1,391,586</u>

The Republic of Bulgaria's quota in the IMF is SDR 640,200 thousand. The amount of BGN 71,994 thousand of the Republic of Bulgaria's quota in the IMF represents the reserve tranche held with the IMF. The IMF pays remuneration (interest) to those members who have a remunerated reserve tranche position, at an average rate of 2.87 per cent annually. Equity investments in international financial institutions include the equity investment in the Bank for International Settlements (BIS), Basle, and 25 per cent of the equity investment in BIS Basle is paid up. The current value of 10,000,000 shares in SDR amounts as at 31 December 2008 to BGN 23,950 thousand while as at 31 December 2007: BGN 22,341 thousand – ref. note 28 (i).

The capital subscribed but not paid in has an option to be paid in within three months upon a decision of the BIS Board of Governors.

Equity investments in international financial institutions do not exceed 10 per cent of the subscribed share capital of the respective institution.

When the Republic of Bulgaria joined the European Union on 1 January 2007, the BNB became a member of the ESCB. In accordance with the current regulatory framework, the national banks of the countries which have not adopted the euro pay effectively 7 per cent of the subscribed equity investment. The BNB's capital contribution in the ESCB is EUR 3,561,868.99 or BGN 6966 thousand.

Pursuant to a decision of the BNB Governing Council, the Bank has an interest in the capital of the new Cash Services Company with both cash and non-cash contributions, and subscribes 2500 shares of its capital with a par value of BGN 1000 each.

The Bank exercises substantial influence on the financial and operational policies of the associated companies listed below, and its investments in domestic companies can be analysed as follows:

Name of institution	Share holding per cent	Principal activity
Associated companies		
Bankservice AD	35.85	Interbank clearing
BORICA AD	36.24	Servicing bank card payments
International Bank Institute OOD	42.31	Financial training and research
Central Depository AD	20.00	Depository for corporate securities
Cash Services Company AD	25.00	Handling of sealed parcels of Bulgarian coins and banknotes coming from the BNB and banks

15. Tangible assets

(BGN'000)

	Land and buildings	Machinery and equipment	IT equipment	Office equipment	Other equipment (incl. motor vehicles)	Tangible assets in progress	Total
As at 1 January 2008	122,463	68,455	17,226	4,877	5,051	4,163	222,235
Additions	215	7,467	111	113	239	25,814	33,959
Disposals	(12,080)	(92)	(510)	(63)	(74)	-	(12,819)
Transfers	298	1,160	3,077	210	153	(4,898)	-
Revaluation	36,064	-	-	-	-	21	36,085
As at 31 December 2008	146,960	76,990	19,904	5,137	5,369	25,100	279,460
Depreciation and impairment loss							
As at 1 January 2008	(15,888)	(37,889)	(11,038)	(2,652)	(3,338)	-	(70,805)
Charge for the period	(3,280)	(5,964)	(3,391)	(448)	(526)	-	(13,609)
On disposals	1	355	229	62	75	-	722
Revaluation	12,059	-	-	-	-	-	12,059
As at 31 December 2008	(7,108)	(43,498)	(14,200)	(3,038)	(3,789)	-	(71,633)
Net book value as at 31 December 2008	139,852	33,492	5,704	2,099	1,580	25,100	207,827
Net book value as at 31 December 2007	106,575	30,566	6,188	2,225	1,713	4,163	151,430

When revaluating non-current tangible assets, the Bank writes off the accrued depreciation at the expense of the gross book value of assets, and their net value is recalculated against their revaluation.

16. Intangible assets

(BGN'000)

	Software	Other intangible assets	Intangible assets in progress	Total
As at 1 January 2008	19,854	44	4,253	24,151
Additions	4	1	7,747	7,752
Disposals	(84)	-	(32)	(116)
Transfers	11,659	-	(11,659)	-
As at 31 December 2008	31,433	45	309	31,787
Depreciation and impairment loss				
As at 1 January 2008	(9,181)	(35)	-	(9,216)
Charge for the period	(7,382)	(3)	-	(7,385)
On disposals	84	-	-	84
As at 31 December 2008	(16,479)	(38)	-	(16,517)
Net book value as at 31 December 2008	14,954	7	309	15,270
Net book value as at 31 December 2007	10,673	9	4,253	14,935

Software includes, as at 31 December 2008, all licenses purchased by the BNB in the total amount of BGN 10,936 thousand (31 December 2007: BGN 9923 thousand), and software products in the amount of BGN 19,916 thousand (31 December 2007: BGN 9353 thousand).

17. Other assets

(BGN'000)

	31 Dec. 2008	31 Dec. 2007
Balances of subsidiaries held with local banks	27,332	28,488
Commemorative coins for sale	264	467
Inventories	14,209	8,543
Accounts receivable	6,935	3,699
Prepaid expenses	1,449	1,244
Other receivables	1,282	3,918
	<u>51,471</u>	<u>46,359</u>

18. Banknotes and coins in circulation

(BGN'000)

	31 Dec. 2008	31 Dec. 2007
Banknotes in circulation	9,032,131	8,284,832
Coins in circulation	<u>147,283</u>	<u>126,035</u>
	<u>9,179,414</u>	<u>8,410,867</u>

19. Liabilities to banks and other financial institutions

(BGN'000)

	31 Dec. 2008	31 Dec. 2007
Demand deposits from banks and other financial institutions		
– in BGN	2,625,265	2,117,513
– in foreign currency	2,381,221	3,666,025
	<u>5,006,486</u>	<u>5,783,538</u>

The Bank does not pay interest on demand deposits from banks and other financial institutions. Demand deposits include BGN 5003 million representing the required reserves which banks are required to maintain with the Bank on their current accounts with the BNB (31 December 2007: BGN 5295 million).

20. Liabilities to government institutions and other borrowings

(BGN'000)

	31 Dec. 2008	31 Dec. 2007
Current accounts:		
– in BGN	533,793	1,038,243
– in foreign currency	419,036	846,282
Time deposit accounts:		
– in BGN	5,099,000	3,520,929
– in foreign currency	1,435,858	1,348,368
	<u>7,487,687</u>	<u>6,753,822</u>

Deposits and current accounts of government institutions with the Bank comprise funds held on behalf of state budget and other government organizations. No interest is payable on the current accounts. Government deposit accounts in USD earn interest between 0 per cent and 1.58 per cent. Government deposit accounts in EUR and BGN earn interest between 1.23 per cent and 4.08 per cent.

21. Borrowings against the Republic of Bulgaria's participation in international financial institutions

The borrowings against Bulgaria's participation in the IMF as at 31 December 2008 amount to BGN 1,236,559 thousand – SDR 605,072 thousand (as at 31 December 2007: BGN 1,270,866 thousand – SDR 605,276 thousand).

Borrowings from the IMF are denominated in SDRs. Borrowings related to Bulgaria's quota in the IMF are non-interest bearing with no stated maturity. This note includes account No. 1 of the IMF for administrative expenses amounting to BGN 3336 thousand (as at 31 December 2007: BGN 3554 thousand).

22. Other liabilities

(BGN'000)

	31 Dec. 2008	31 Dec. 2007
European Commission funds	97,403	32,914
Salaries and social security payable	2,153	1,720
Deferred income	1,806	1,765
Other liabilities	8,401	9,351
	<u>109,763</u>	<u>45,750</u>

As from 1 January 2007 the Republic of Bulgaria, in its capacity as an EU member state, participates in the funding of EC budget. Pursuant to Art. 9 of Council Regulation No 1150 of 2000 the BNB has opened and services accounts in EUR and in BGN for the funds of the European Commission. The payment instructions for transactions on these accounts are given by authorized persons of the European Commission.

23. Capital and reserves

The capital of the Bank is determined in the Law on the BNB and amounts to BGN 20,000 thousand.

Non-monetary asset and commemorative coin revaluation reserves comprise the net change in fair values of certain groups of tangible non-current assets, equity investments and commemorative coins.

In accordance with the Law on the Bulgarian National Bank, unrealised gains/losses arising from the revaluation of assets and liabilities denominated in foreign currencies or gold are transferred to a special reserve account. The special reserve includes the monetary asset revaluation.

Other reserves include 25 per cent of the annual excess of revenue over expenditure and reserves set up upon a decision of the Bank's Governing Council.

Pursuant to Art. 8, para. 3 of the Law on the Bulgarian National Bank, as at 31 December 2008 upon a decision of the Governing Council, BGN 119 million was allocated to the special reserves fund 'Additional impairment loss reserves'.

The profits distribution for 2008, as per the policy disclosed in note 5 (h), is as follows:
(BGN'000)

	31 Dec. 2008	31 Dec. 2007
Profit for the period	1,013,377	693,880
Allocation to/from special reserve:		
Unrealised (gains) from gold revaluation	(122,434)	(205,564)
Unrealised (gains) from revaluation of financial assets, recognised at fair value through profit or loss	(191,807)	(37,116)
Unrealised foreign currency valuation (gains)/losses	(2,169)	3,734
Other unrealised (gains)/losses	3,402	(70)
Result after allocation to/from special reserve, including:	700,369	454,864
Allocation to other reserves and minority interest	180,414	117,230
Allocation to a special-purpose fund	119,000	87,000
Planned contribution to the state budget	400,955	250,634

24. Minority interest

BNB Printing Works AD is a joint-stock company with two shareholders: the BNB and the Government represented by the Minister of Finance. The Bulgarian National Bank holds 95.6 per cent of the company's equity. In 2005 the Government as represented by the Minister of Finance acquired 4.4 per cent of the company's capital – 3093 shares of BGN 1000 par value each.

25. Monetary liabilities and gross international foreign exchange reserves

(BGN'000)

	31 Dec. 2008	31 Dec. 2007
Gross international foreign exchange reserves		
Cash and deposits in foreign currencies	2,655,053	3,507,981
Monetary gold and other instruments in gold	1,536,814	1,410,480
Debt securities investments	20,600,510	18,356,669
Equity investments and quota in the IMF	71,994	70,023
	<u>24,864,371</u>	<u>23,345,153</u>
Monetary liabilities		
Banknotes and coins in circulation	9,179,414	8,410,867
Dues to banks and other financial institutions	5,006,376	5,783,339
Liabilities to government institutions	7,294,721	6,446,827
Other borrowings	290,479	340,108
	<u>21,770,990</u>	<u>20,981,141</u>
Surplus of gross international foreign exchange reserves over monetary liabilities	<u>3,093,381</u>	<u>2,364,012</u>

Interest receivable and interest payable are carried to the relevant financial assets and liabilities.

Monetary gold and other instruments in gold are revaluated on a daily basis based on the euro fixing of the London Bullion Market.

26. Related party transactions

Bulgarian Government

International Monetary Fund

All the borrowings of the Government of the Republic of Bulgaria from the IMF are undertaken (on-lent) through the Bank. The Government's borrowings from the IMF are matched by a receivable of the Bank from the Government. For the Bank to eliminate any exchange rate fluctuations, the government receivables are denominated also in SDR.

The interest on these borrowings is paid by the Government. Accordingly, no interest revenue is included in these accounts for the receivable from the Government, nor is any interest expense included on the Government's portion of the IMF borrowings.

The Republic of Bulgaria's quota in the IMF is secured by promissory notes jointly signed by the Bank and the Government (ref. note 21).

Government bank accounts

Government budget organizations and other government organizations have current accounts and time deposits with the Bank (ref. note 20).

Fiduciary activities

In accordance with the Law on the BNB and under the terms agreed upon with the Minister of Finance, the BNB acts as an agent in government or government-guaranteed debts. With regard to this role, BNB performs agent and central depository services related to the administration and management of government securities issued by the Ministry of Finance. The Bank receives commission for providing these services. These government securities are not assets or liabilities of the BNB and are not recognised in its consolidated balance sheet. The Bank is not exposed to any credit risk relating to government securities as it does not guarantee them. As at 31 December 2008 the par value of the government securities held in custody was BGN 3064 million (31 December 2007: BGN 3190 million).

27. Subsidiaries

(%)

Ownership interest	31 Dec. 2008	31 Dec. 2007
State Mint EOOD	100	100
BNB Printing Works AD (ref. note 26)	95.6	95.6

The net income from subsidiaries for the period includes the net profit of BGN 986 thousand from Bulgarian Mint EOOD (31 December 2007: BGN 1000 thousand) and BGN 3529 thousand from the BNB Printing Works AD (31 December 2007: BGN 3252 thousand).

28. Commitments and contingencies

(i) Participation in the Bank for International Settlements

The Bank holds 8000 shares of the capital of BIS, Basle, each one amounting to SDR 5000. Twenty-five per cent of the equity investment in BIS, Basle is paid up. The capital subscribed but not paid in is with an option to be paid in within three months following a decision of the BIS Board of Governors. The contingent amount as at 31 December 2008 is BGN 64,422 thousand (31 December 2007: BGN 63,039 thousand).

(ii) IMF quota and borrowings

The IMF quota and borrowings are secured by promissory notes jointly signed by the Bank and the Government of the Republic of Bulgaria amounting to BGN 1,236,559 thousand.

(iii) Capital commitments

As at 31 December 2008 the Bank has committed to BGN 25,702 thousand to purchase non-current assets (31 December 2007: BGN 27,924 thousand).

(iv) Other commitments and liabilities

There are no other outstanding guarantees, letters of credit or commitments to purchase or sell either gold, other precious metals or foreign currency.

29. Events subsequent to the balance sheet date

There are no events subsequent to the balance sheet date of such a nature that they would require additional disclosure or adjustments to the Bank's consolidated financial statements.

30. Applicable standards

IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-Based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations
IFRS 6	Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 7	Cash Flow Statements
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events After the Balance Sheet Date
IAS 11	Construction Contracts
IAS 12	Income Taxes
IAS 14	Segment Reporting
IAS 16	Property, Plant, and Equipment
IAS 17	Leases
IAS 18	Revenue
IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	Effects of Changes in Foreign Exchange Rates
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Consolidated and Separate Financial Statements
IAS 28	Investments in Associates
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 31	Interests in Joint Ventures
IAS 32	Financial Instruments: Disclosure and Presentation
IAS 33	Earnings per Share
IAS 34	Interim Financial Reporting
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement
IAS 40	Investment Property
IAS 41	Agriculture
IFRIC 1	Changes in Existing Decommissioning, Restoration and Similar Liabilities
IFRIC 2	Members' Shares in Co-operative Entities and Similar Instruments
IFRIC 4	Determining Whether an Arrangement Contains a Lease
IFRIC 5	Rights to Interests Arising from Decommissioning, Restoration and Environmental Funds

IFRIC 6	Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment
IFRIC 7	Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies
IFRIC 8	Scope of IFRS 2
IFRIC 9	Reassessment of Embedded Derivatives
IFRIC 10	Interim Financial Reporting and Impairment
IFRIC 11	IFRS 2: Group and Treasury Share Transactions
IFRIC 12	Service Concession Arrangements
IFRIC 14	The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction
SIC 7	Introduction of the Euro
SIC 10	Government Assistance – No Specific Relation to Operating Activities
SIC 12	Consolidation – Special Purpose Entities
SIC 13	Jointly Controlled Entities – Non-Monetary Contributions by Venturers
SIC 15	Operating Leases – Incentives
SIC 21	Income Taxes – Recovery of Revalued Non-Depreciation Assets
SIC 25	Income Taxes – Change in the Tax Status of an Enterprise or its Shareholders
SIC 27	Evaluating the Substance of Transactions Involving the Legal Form of a Lease
SIC 29	Disclosure – Service Concession Arrangements
SIC 31	Revenue – Barter Transactions Involving Advertising Services
SIC 32	Intangible Assets – Web Site Costs

Major Resolutions of the BNB Governing Council

24 January	As of 21 February 2008 the BNB put into circulation a silver commemorative coin '130 Years from the Liberation of Bulgaria' of BGN 10 nominal value, issue 2008.
6 February	Updated selling prices of Bulgarian banknotes and coins sold by the BNB at prices other than nominal value were approved.
12 February	As of April 2008 the BNB will cease processing banknotes and coins at a value announced in the BNB regional cash centres in Pleven, Plovdiv and Varna. Processing activities will be undertaken by the territorial units of the Cash Services Company AD.
15 February	Ordinance on Amendment of Ordinance No. 3 of 2005 on Funds Transfers and Payment Systems was adopted.
25 March	As of 21 April 2008 the BNB put into circulation a silver commemorative coin 'Shooting Sports' of BGN 10 nominal value, issue 2008.
3 April	A new Ordinance No. 9 on the Evaluation and Classification of Risk Exposures of Banks and the Allocation of Specific Provisions for Credit Risk was adopted.
	Ordinance on Amendment of BNB Ordinance No. 8 of 2006 on the Capital Adequacy of Banks was adopted.
	The report on BNB Budget Implementation as of 31 December 2007 was adopted.
23 April	The BNB Annual Report for 2007 was approved.
	As of 19 May 2008 the Bulgarian National Bank put into circulation a partially gold-plated silver commemorative coin 'Sevt III', the Treasures of Bulgaria series with a nominal value of BGN 10, issue 2008.
	Amendments to BNB Internal Rules for Selection and Work with BNB Scholarship Students of 12 October 2006 were adopted.
22 May	A decision was taken to launch the Core Banking Information System as of 1 June 2008.
5 June	A decision for issuance of a silver commemorative coin '100 Years of Bulgaria's Independence' of BGN 10 nominal value, issue 2008, was adopted.
3 July	Ordinance on Amendment of BNB Ordinance No. 3 of 2005 on Funds Transfers and Payment Systems was approved.
17 July	As of 15 September 2008 the Bulgarian National Bank put into circulation a silver commemorative coin '100 Years of Bulgaria's Independence' of BGN 10 nominal value, issue 2008.
	The Commemorative Coin and Banknote Production Programme for 2009 was adopted.
18 September	The report on BNB Budget Implementation as of 30 June 2008 was adopted.
	As of 27 October 2008 the Bulgarian National Bank put into circulation a silver three-component commemorative coin 'Nikolay Gyaurov', 'The Great Bulgarian Voices' series, of BGN 10 nominal value, issue 2008.

- 7 October** The BNB Report for January – June 2008 was approved.
- The BNB granted licenses for effecting cash transfers to:
 Bankservice AD, Sofia;
 Change-centre – Bulgaria EOOD;
 Coinstar Money Transfer (Bulgaria) EOOD, Varna;
 M Secured OOD, Sofia;
 Master Envios Bulgaria EOOD, Sofia, and
 MoneyGram Payment Systems Bulgaria EOOD, Sofia.
- The BNB was informed about the application of *Western Union International Bank GmbH (WUIB)*, Austria, its agents to be entered in the register under Article 26a, paragraph 6 of the Law on Funds Transfers, Electronic Payment Instruments and Payment Systems.
- 21 October** Ordinance on Amendment of BNB Ordinance No. 21 of 1998 on the Minimum Required Reserves Maintained with the Bulgarian National Bank by Banks was approved.
- On the occasion of the BNB 130th anniversary, the BNB Governing Council granted five scholarships to students reading for bachelors, masters and doctors.
- 6 November** The BNB Budget for 2009 was approved.
- As of 8 December 2008 the BNB put into circulation as a legal tender a banknote of BGN 10 nominal value, issue 2008. Banknotes of BGN 10 nominal value, issue 1999, continue to be in circulation.
- As of 15 December 2008 the BNB put into circulation a gold commemorative coin 'St. Tsar Boris I the Baptist' of BGN 20 nominal value, issue 2008.
- 27 November** Ordinance on Amendment of BNB Ordinance No. 21 of 1998 on the Minimum Required Reserves Maintained with the Bulgarian National Bank by Banks was approved.
- 19 December** Upon conclusion of the competition on the occasion of the 130th BNB anniversary, the Governing Council granted scholarships to four Bulgarian students for 2009.