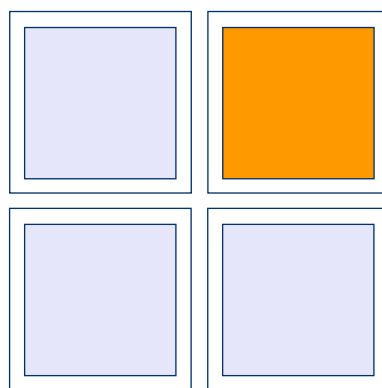


FINANCIAL SECTOR: ESTIMATES AND EXPECTATIONS



2 | 2008



AGENCY FOR
ECONOMIC
ANALYSIS AND
FORECASTING

This study encompasses the estimates and expectations of the different groups of financial intermediaries as to some key macro-economic indicators and factors. They may not overlap with the analysis and forecasts of the Agency for Economic Analysis and Forecasting, and therefore should not be taken as a recommendation to the investment process or any decision to use the services rendered by financial intermediaries. Furthermore, AEF shall not be held liable for any damage or loss incurred by third parties as a result of the information published herein.

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The Agency for Economic Analysis and Forecasting has started the publication of a series Financial Sector: Estimates and Expectations including 4 quarterly issues which will give account of the expectations of a large number of financial intermediaries as to the key macroeconomic indicators and factors that are decisive to their operation. The publication is aimed at assessing the environment the economic agents perform in and pinpointing the factors that are significant to their behavior.

The study draws upon surveys, with the information gathered being summarized in a way that answers remain anonymous and are not made public.

The surveys were conducted from 18th March to 31th March 2008. The commercial banks that took part in the survey owned 51.5% of the assets in the banking system (as of the end of December 2007), the investment intermediaries enjoyed a share of BSE turnover of 62.9% (third-quarter data), whereas the management companies managed 67.2% of the assets of the collective investment schemes (as of the end of September 2007). The pension insurance companies managed 45.3% of the assets of voluntary pension insurance funds as of end-December 2007. The commercial banks filled in the survey that was strictly bank-oriented, despite the fact that some of them operated also as investment intermediaries.

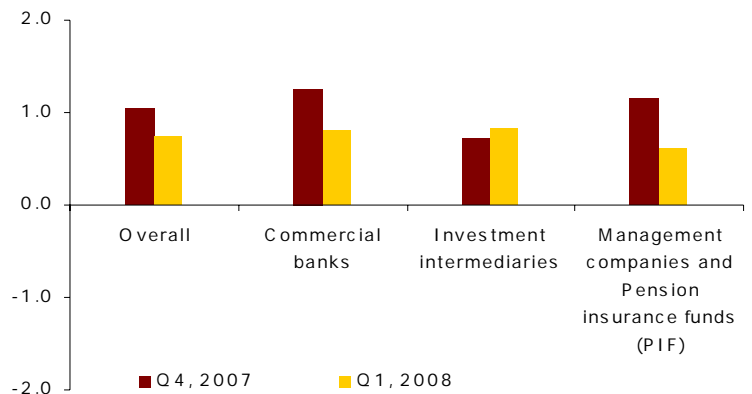
I. ECONOMIC SITUATION

1. Current state of affairs and growth expectations

In the first quarter of 2008 financial intermediaries carried on assessing the country's stable economic development as positive, with no significant differences being discerned across the different groups of respondents. However, it was investment intermediaries alone that remained upbeat about the current state of affairs, as the rest of the groups pointed to some deterioration on a quarter earlier. Most probably, the adverse global financial market trends have affected their assessments, bringing about a change in their attitudes towards the performance of the Bulgarian economy too.

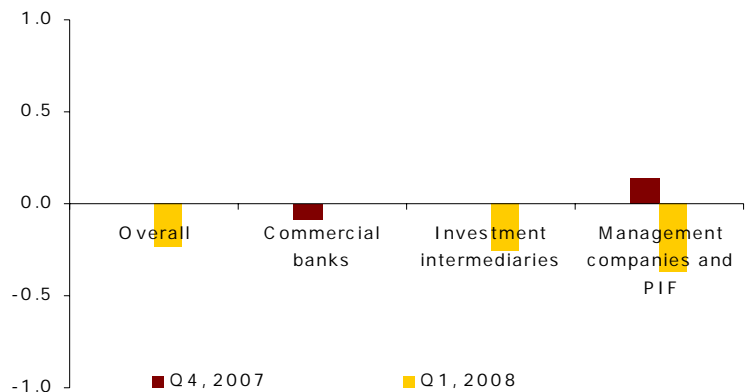
As for Q1 growth expectations, assessments were more negative, compared to the fourth quarter of 2007. Most financial intermediaries expected a certain slowdown, with management and pension insurance companies being the most pessimistic, pointing to a strong deceleration of GDP. Having expected a growth slowdown in the fourth quarter of 2007, commercial banks now adopted a more optimistic attitude, with most of them (81.8% vs. 75% on a quarter earlier) pointing to retention of the current growth rates.

CURRENT ECONOMIC SITUATION



Note: The assessments of financial intermediaries are given as a weighted indicator. When the indicator is close to 2, the current state of affairs in the economy is assessed as strongly positive. And vice versa, when the indicator is close to -2, the current economic situation is assessed as strongly negative.

GROWTH EXPECTATIONS

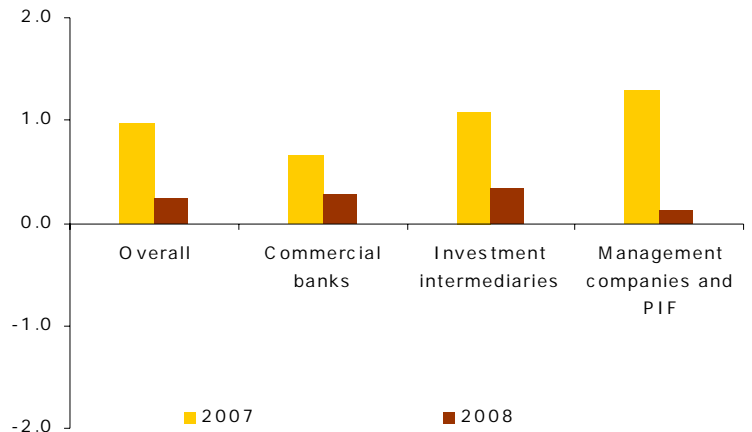


Note: Growth expectations are given as a weighted indicator. A value of the indicator close to 1 implies that financial intermediaries expect growth to pick up. Accordingly, a value of the indicator close to -1 is an indication of a slowdown in economic growth.

2. Inflation

On a quarter earlier, the inflationary expectations of financial intermediaries stepped down, indicating no significant acceleration, i.e. most respondents expected price inflation to slow down on a 12-month basis, with the most significant change in attitudes being reported by management and pension insurance companies.

INFLATIONARY EXPECTATIONS



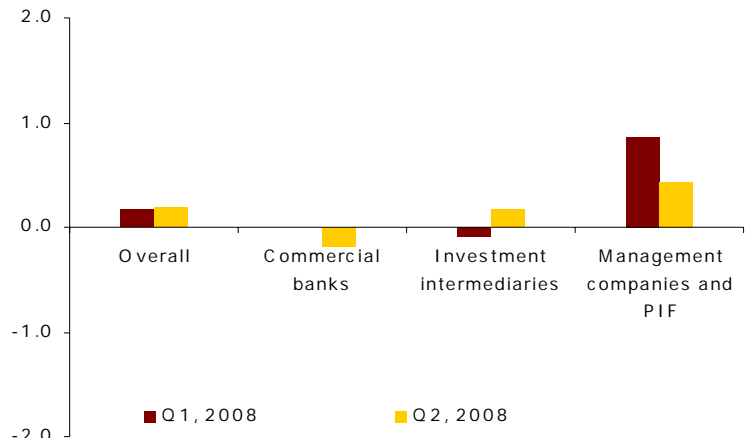
Note: The inflationary expectations of financial intermediaries are gauged, using a weighted indicator. A value of the indicator close to 2 implies that the respondents expect inflation to accelerate. And vice versa, a value of the indicator close to -2 indicates an expected decrease in inflation.

3. Foreign exchange rate

Overall, Q1 expectations reflected the smooth upward trend of the BGN to the US currency. By group of respondents, however, assessments turned out to be more diversified, highlighting some quarter-on-quarter changes in attitudes. Commercial banks expected the USD to break out on an uphill, recovering some fragment of its value by mid-2008. Unlike in the fourth quarter of 2007, investment intermediaries now remained rather downbeat as to the US currency, expecting it to go on depreciating. Both management and pension insurance companies shared the same view of the USD.

The expectations of further appreciation of the Bulgarian currency to the USD in the second quarter had to do with a spate of bad news on the US economy. In addition, as the European Central Bank effected no changes in the benchmark rates for fears of price stability risks, the interest rate spread further widened in favour of the single European currency, hence the BGN.

EXPECTATIONS OF THE NOMINAL BGN/USD EXCHANGE RATE

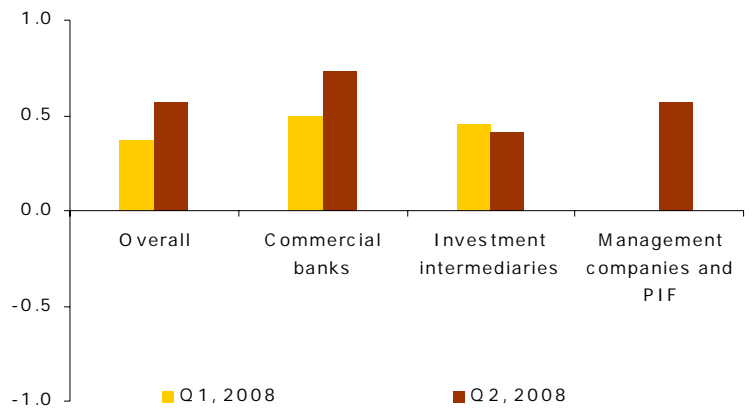


Note: The expectations of the respondents as to the nominal BGN/USD exchange rate dynamics are gauged using a weighted indicator. A value of the indicator close to 2 implies that financial intermediaries expect a strong appreciation of the BGN to the USD. Accordingly, a value approximating -2 is indicative of a strong depreciation of the local currency.

4. Base interest rate (BIR)

BIR dynamics expectations show that financial intermediaries were unanimous as to further hikes in the interest rates. The higher minimum required reserves as well as the increased cost of foreign loan resources in the wake of the liquidity crisis and growing non-confidence in the global financial markets only underpinned the rise in local interest rates while consolidating the above anticipations. The expectations of all respondents reported significant changes on a quarter earlier, with the strongest fluctuations being recorded by management and pension insurance companies. However, it should be noted that Q1 assessments of the indicator's value were largely shaped by their expectations of retention of the current BIR levels (60% of the respondents indicated that they anticipated BIR to hold steady at its Q1 levels, whereas an increase or a decrease was pointed by 20% each).

EXPECTATIONS FOR BIR DYNAMICS IN THE NEXT QUARTER

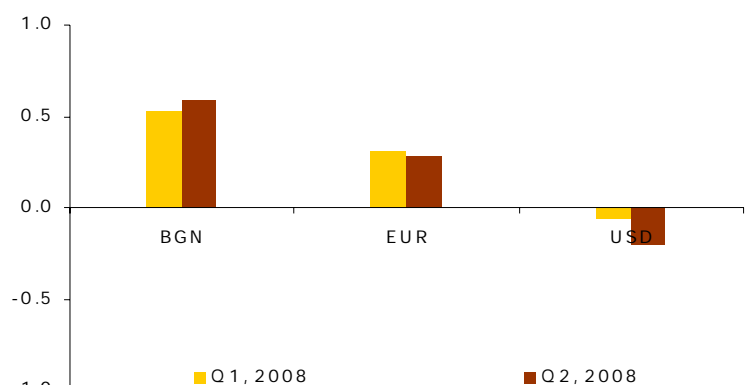


Note: the expectations of the respondents as to the base interest rate dynamics is gauged using a weighted indicator. A value of the indicator close to 1 implies that financial intermediaries expect an increase in the base rate. Accordingly, a value close to -1 indicates an expected decrease.

5. Deposit and loan interest rates

Q2 expectations of the deposit and loan interest dynamics in BGN and EUR remained more or less unchanged on a quarter earlier. It was the US-denominated instruments alone that posted some significant change, as triggered, above all, by the series of steps on the part of the Federal Reserve aimed at lowering the feds rate in response to the stronger data on a commencing recession in the US economy. On the other hand, the above action led to a most serious plunge of the USD to EUR and hence a higher risk premium on investment in USD-denominated assets. Local financial intermediaries anticipated USD deposit interest to further plummet and the cost of USD loans to go on the increase as a result mostly of the higher risk premium.

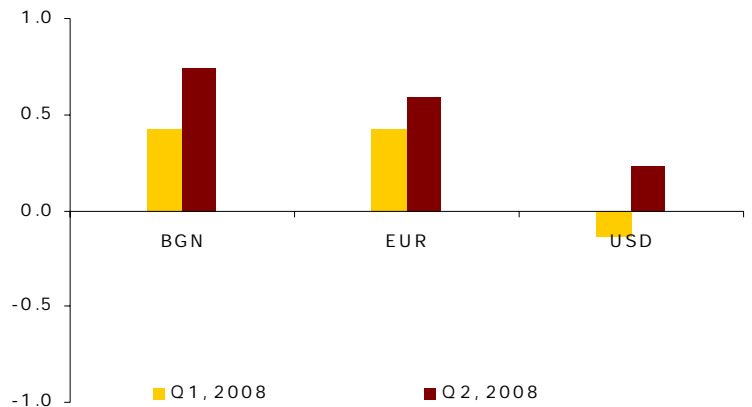
INTEREST RATES ON TIME DEPOSITS IN BGN, EUR AND USD



Note: The expectations of the respondents as to the dynamics of the deposit interest rates in BGN, EUR and USD are gauged using a weighted indicator. A value of the indicator close to 1 shows an expected rise in deposit interest. Accordingly, a value approximating -1 is indicative of an expected decrease.

At the same time, the respondents were a lot more unanimous as to a quarter-on-quarter increase in loan interest rates in EUR and BGN. But whether it will affect the loan volumes extended and servicing of earlier debt or not, depends largely on the actual interest rate dynamics. As of the end of February'08, long-term loan interest in BGN stepped up by 0.36 percentage points, whereas the interest rate on short-term BGN credit advanced by 1.65 percentage points.

DEPOSIT INTEREST RATE EXPECTATIONS (BGN, EUR AND USD)

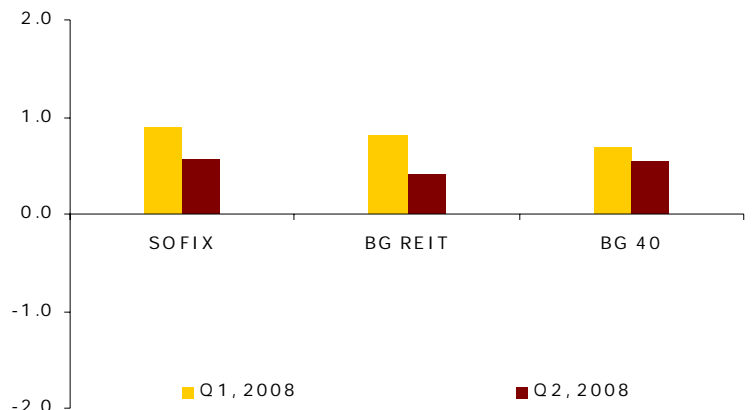


Note: The expectations of the respondents as to the dynamics of the loan interest rates in BGN, EUR and USD are gauged using a weighted indicator. A value of the indicator close to 1 indicates that financial intermediaries expect a rise in loan interest. And vice versa, a value approximating -1 indicates an expected decrease.

6. Stock indices

Financial intermediaries remained upbeat about the stock market outlook. Despite the duller Q1 activity and plunge of the stock indices, they were by and large unanimous that there would be a turnaround in the indices' downswing and the latter would break out on an uphill again, expecting a lower increase vis-à-vis their Q1 anticipations, though. At the same time, they took a most pessimistic view of the BG REIT dynamics, pointing to the least rise on a quarterly basis. As for BG40 and SOFIX, they are expected to step up insignificantly. On the whole, however, the expectations of the stock market movements indicated a more moderate increase on a quarter earlier, having to do with the downward trends of the preceding few months. By group of intermediaries, investment intermediaries were the most optimistic while management and pension insurance companies remained the most pessimistic. The persistent positive attitudes of financial intermediaries as to the performance of the stock market had to do with their expectations of a weaker effect of the external environment and realization of positive effects as a result of the interplay of internal factors. Their assessments can also be taken to be an indirect indication of the comeback of institutional investors to the market, which is to give the stock indices a strong push upwards.

EXPECTED DYNAMICS OF THE STOCK EXCHANGE INDICES



Note: The expectations of the respondents as to the performance of the stock indices are gauged on the basis of a weighted indicator. A value of the indicator close to 2 implies that financial intermediaries expect a strong increase in the stock indices. Accordingly, a value approximating -2 indicates an expected decrease.

II. FACTORS SHAPING THE PERFORMANCE OF FINANCIAL INTERMEDIARIES

1. Commercial banks

In the first quarter, bank loan extensions to corporate customers carried on rising, despite the slowdown. Most respondents pointed to liquidity in the banking system and retained market share as the main factors behind the increased lending to the private sector. At the same time, household income was decisive to loan approvals. In addition, commercial banks also identified the country's stable macroeconomic environment as an important factor for their lending activity. On a quarter earlier, a decreasing number of banks were now identifying BNB credit growth ceilings as crucial to their credit portfolio decisions, which was probably associated with the lack of any indications as to further policy tightening or the launch of new restrictions.

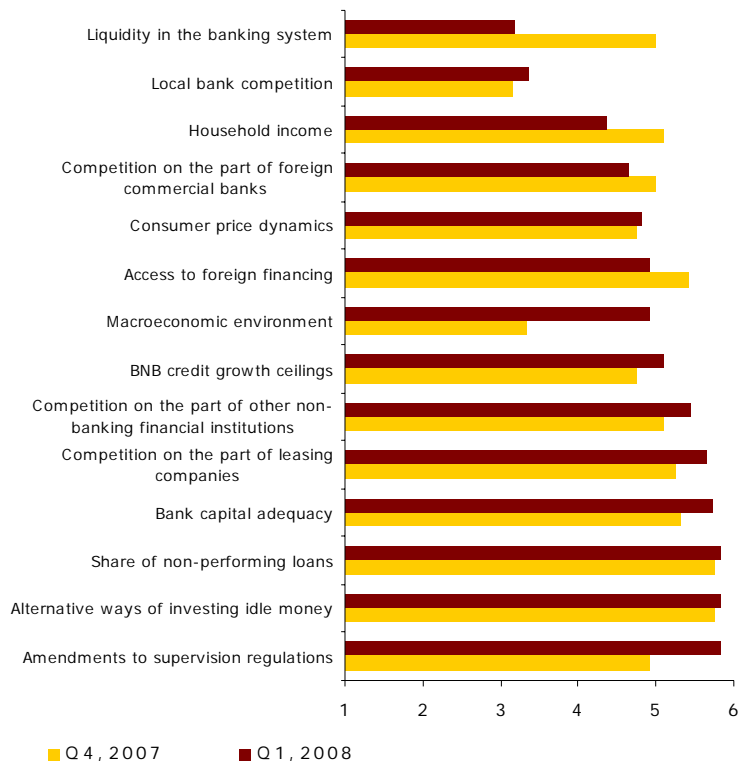
Q1 credit demand was shaped by the same factors as in the preceding survey. Nevertheless, banks were significantly more unanimous in pointing to the need for short-term capital and income of economic agents as the factors affecting the demand for loans in the economy.¹

The aggregate results of the survey indicate that the main factors at work behind the performance of the loan market in the first quarter had to do with liquidity and competition in the banking system as well as the need of economic agents for short-term capital to provide for their operations.

The increased minimum required reserves and higher cost of loan resources in the markets worldwide made banks set on taking deposits from local economic agents mainly. According to commercial banks, the factors influencing the deposit supply on the part of economic

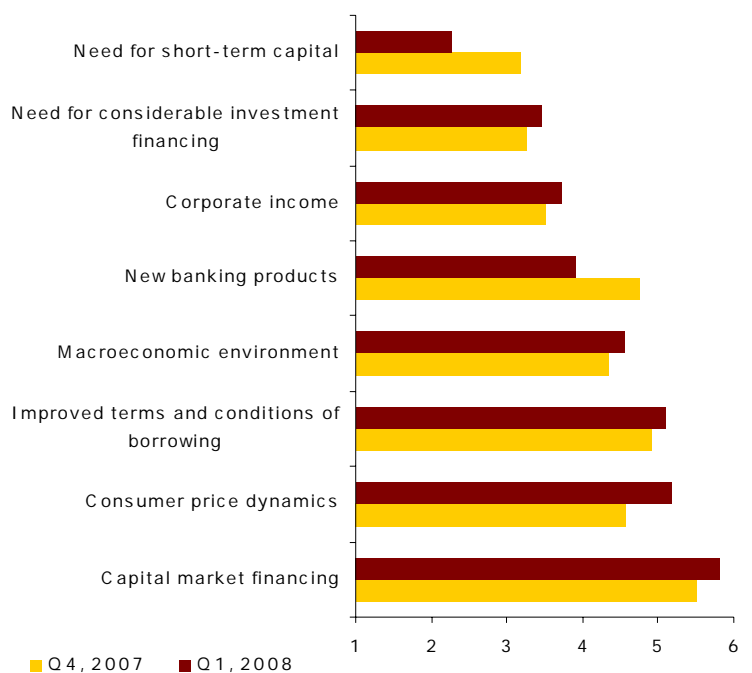
¹ In this survey, 90.9% of the banks considered short-term capital needs an important factor for loan demand vs. 75% on a quarter earlier. Corporate income was pointed out by 81.7% of the commercial banks inquired vs. 75% in the last quarter of 2007.

FACTORS INFLUENCING BANK LOAN EXTENSIONS



Note: For further detail see Methodological Notes.

FACTORS INFLUENCING BANK LOAN DEMAND

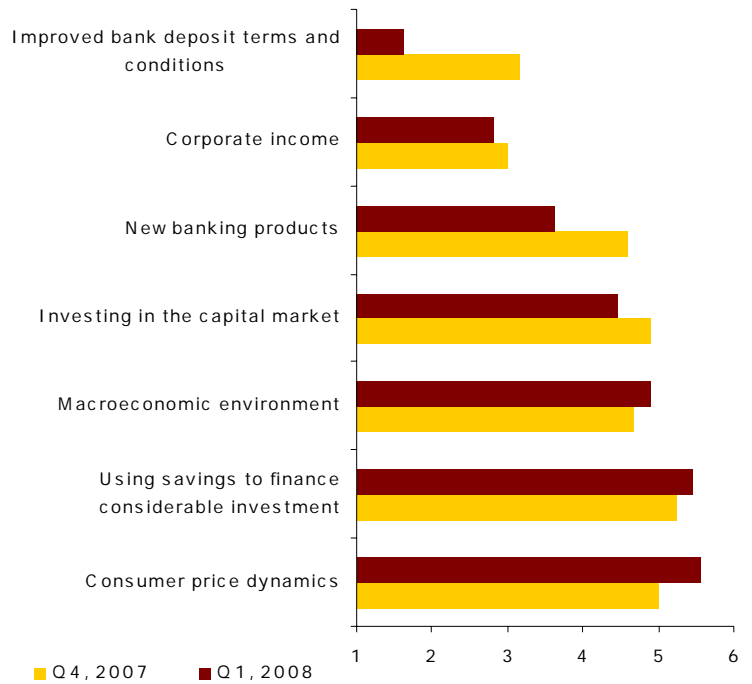


Note: For further detail see Methodological Notes.

agents had to with the new improved deposit terms and greater diversification of banking products. However, the above inference draws on the assumption that corporate income allowed for savings too. A larger number of banks identified investment opportunities in the capital market as an important alternative for economic agents' decisions where to invest their savings. At the same time, it should be noted that the stock market posted a serious plunge against its peak values of mid-2007 and the second half of the year, affecting market players' decisions while making them re-assess the risk-return ratio of the different savings instruments.

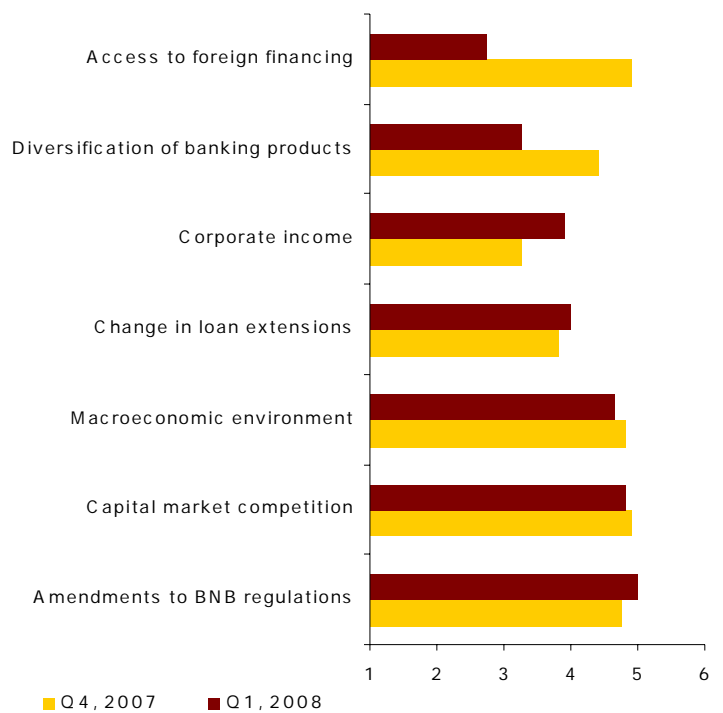
The way commercial banks ranked the factors that were crucial to deposit taking indicated that the growing lack of confidence and rising risk premium in the world financial markets had made a major impact on the domestic market. Access to foreign financing was pointed out by almost all respondents. As a rule, the local banking system relies heavily on foreign financing support, secured most often by the mother bank. Impeded access to financing as well as the costlier foreign loan resources had forced banks to start working more actively on their deposit portfolio diversification and viability (73% of the respondents answered that product diversification was an important factor for deposit taking. The upbeat bank expectations as to deposit taking had to do with their attitude towards credit supply dynamics.

FACTORS INFLUENCING DECISIONS TO PUT IDLE MONEY IN BANK DEPOSITS



Note: For further detail see Methodological Notes.

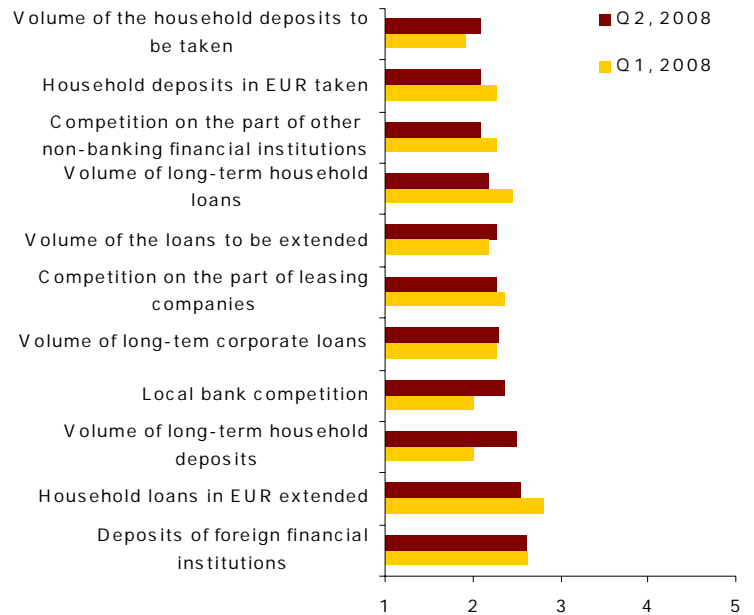
FACTORS INFLUENCING DEPOSIT TAKING



Note: For further detail see Methodological Notes.

Relative to the survey of the end of 2007, banks' expectations as to some key indicators underwent major changes. Most respondents expected a relatively stronger Q2 impetus in long-term household loans while relying by and large on corporate deposit growth, as estimates pointed to a decrease in the deposits of foreign financial institutions in the country. According to commercial banks, household deposits and loans in EUR are to step up at a stronger pace on a quarter earlier. At the same time, the competition that banks are facing on the part of non-banking institutions other than leasing companies is to go on the decrease.

EXPECTATION OF COMMERCIAL BANKS IN RESPECT TO:

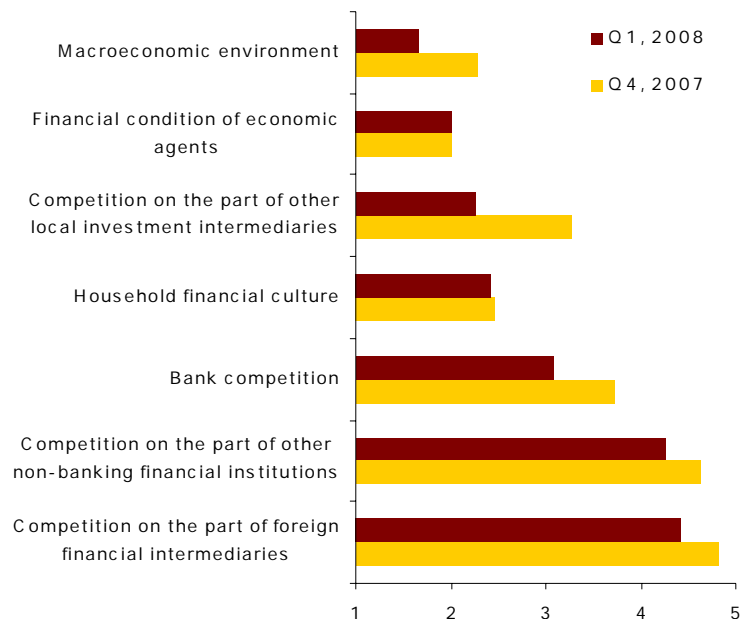


Note: The average weighted results have been obtained as the arithmetic mean of the answers given. When the indicator is close to 1, it indicates that commercial banks expect it to step up significantly. And vice versa, when it is close to 5, it implies that the respondents expect a significant decrease.

2. Investment intermediaries

The early-2008 performance of investment intermediaries was shaped by the same factors as on a quarter earlier, with the weight of the country's macroeconomic stability gaining in importance. Special emphasis has been again laid on the country's macroeconomic environment as it promotes income generation in the economy, which in turn gives savings a strong push up and makes economic agents turn to investment intermediation, seeking to achieve a higher return on investment at reasonable risk levels. At the same time, on a quarter earlier, more and more respondents now pointed to the growing significance of intra-branch competition as most companies continued to strive for a higher market share. In addition, though gaining in importance, competition on the part of other non-banking financial intermediaries and foreign investment intermediaries was not considered decisive to the performance of local investment intermediaries.

AVERAGE WEIGHTED ASSESSMENTS OF THE LEVEL OF SIGNIFICANCE OF THE FACTORS SHAPING THE PERFORMANCE OF INVESTMENT INTERMEDIARIES



Note: The average weighted results have been obtained as the arithmetic mean of the answers given. When the indicator is close to 1, it enjoys a very high level of significance. And vice versa, when it is close to 5, it has a very low significance.

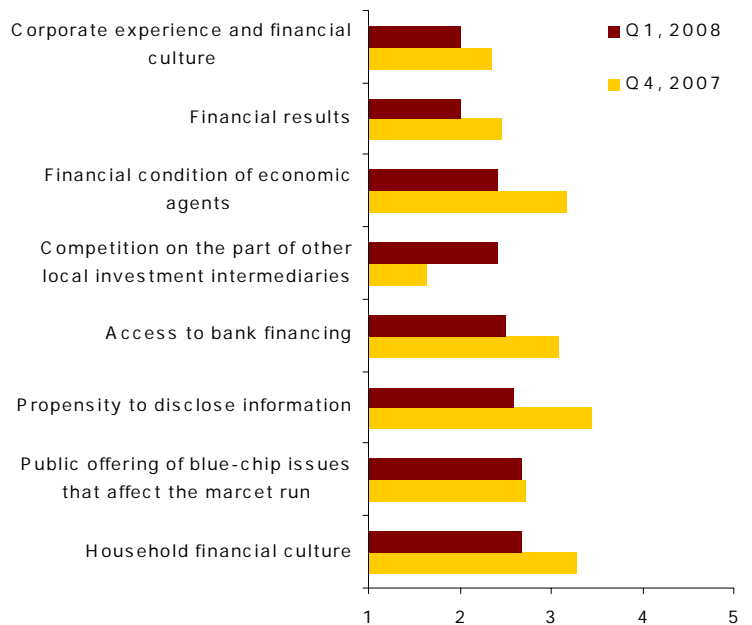
Investment intermediaries were more unanimous as to the factors determining their decision whether to go public or not, with the factors themselves enjoying more or less the same weight. In addition, the respondents identified experience, financial culture and the financial results achieved as the factor having the strongest effect on a company's decision to list on the stock exchange. *Propensity to disclose financial information*, ranked first three months earlier, was now stepping down in significance. At the same time, *access to foreign financing* gained in importance as local companies were seeking ways to ensure alternative sources of loan resources in the wake of the capital market slump worldwide. Alternative financing is a common practice local companies have often resorted to, as evident from the dynamics of the ever-growing foreign private debt. The least important factors for a company to go public had to do with capital market liquidity and the floating of blue-chip issues, affecting the market run.

3. Collective investment schemes (CIS)

The aggregated Q2 expectations of the management companies indicated that CIS assets were to remain unchanged on a quarter earlier. However, compared to the first quarter when the respondents anticipated a rise in assets, they now took a more pessimistic view. It should be also noted that once again they were not unanimous in their assessments. Some 45.5% of the management companies expected no change in CIS assets. The changing expectations were largely triggered by the Q1 stock market disturbances, continuous decline in share prices as well as the altered investor attitudes in the wake of the financial market plunge worldwide.

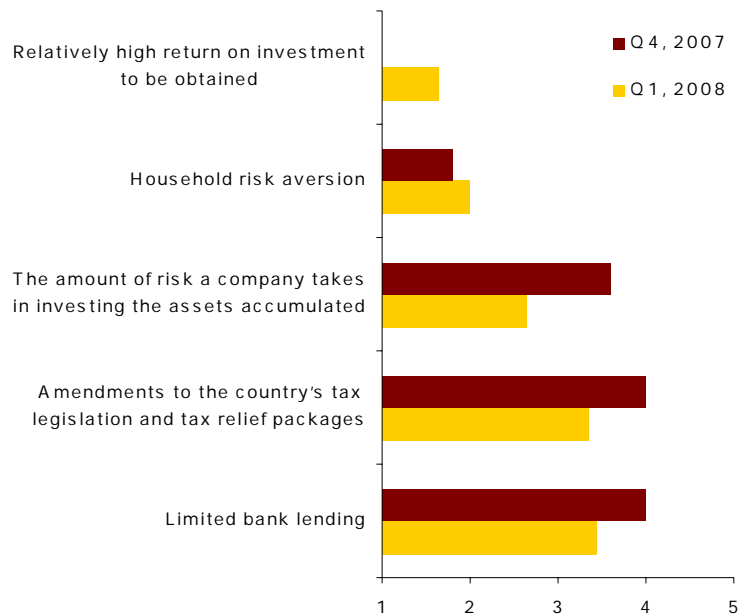
The performance of collective investment schemes is shaped by a number of factors that are specific to their operation as well as by factors that are key to a household decision whether or not to invest idle money in this form of savings. The aggregated findings of the survey indicated that all respondents identified *return on investment* as the first and foremost

AVERAGE WEIGHTED ASSESSMENTS OF THE LEVEL OF SIGNIFICANCE OF THE FACTORS DETERMINING A COMPANY'S DECISION TO GO PUBLIC



Note: The average weighted results have been obtained as the arithmetic mean of the answers given. When the indicator is close to 1, it enjoys a very high level of significance. And vice versa, when it is close to 5, it has a very low significance.

AVERAGE WEIGHTED ASSESSMENTS OF THE LEVEL OF SIGNIFICANCE OF THE FACTORS INFLUENCING HOUSEHOLD DECISIONS TO INVEST IDLE MONEY IN COLLECTIVE INVESTMENT SCHEMES

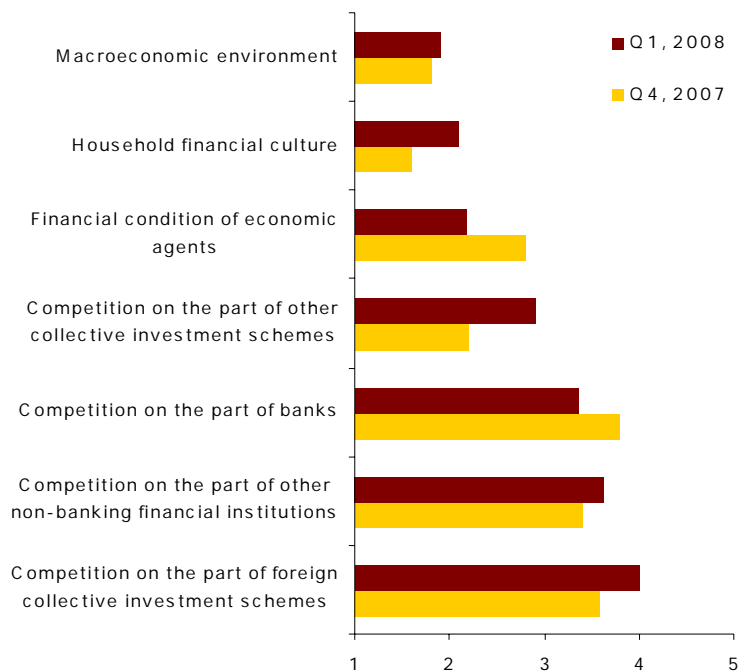


Note: The average weighted results have been obtained as the arithmetic mean of the answers given. When the indicator is close to 1, it enjoys a very high level of significance. And vice versa, when it is close to 5, it has a very low significance.

economic consideration to invest in a CIS although the significance of this factor somewhat stepped down on a quarter earlier. *Risk aversion* remained a factor of decisive importance. As for the rest of the factors, they now enjoyed a heavier weight, compared to the previous quarter. Given the stock market slump, it was also more important for households to know what amount of risk a company was taking in investing their assets. At the same time, *limited bank lending* was again considered the least significant factor, implying that households carried on relying on their own sources of income rather than loan resources when investing in CIS. However, all this does not exert any additional pressure on the banking system because in the event of any unfavourable developments on the stock market or in case of losses suffered by households the latter will continue to service their bank loans.

The management companies identified the country's macroeconomic stability as the most decisive factor for CIS performance, as it provided for income generation in the economy, hence accumulation of more assets in investment companies and contractual funds. On the other hand, the stable macroeconomic environment keeps confidence high and ensures a greater amount of predictability of the economic processes underway. Household financial culture also enjoyed a rather heavy weight though stepping down a little relative to the last quarter of 2007 when it was pointed out as the most important factor. At the same time, household financial conditions were considered the most crucial factor for CIS development, outweighing competition. The findings of the survey indicated that competition on the part of foreign collective investment schemes was given the least importance as result of the sharp fluctuations in the world financial markets, hence the decrease in investment fund assets abroad. The losses suffered by foreign CIS and uncertainty as to return on investment are not likely to put the operation of local CIS at risk.

AVERAGE WEIGHTED ASSESSMENTS OF THE LEVEL OF SIGNIFICANCE OF THE FACTORS SHAPING THE PERFORMANCE OF COLLECTIVE INVESTMENT SCHEMES



Note: The average weighted results have been obtained as the arithmetic mean of the answers given. When the indicator is close to 1, it enjoys a very high level of significance. And vice versa, when it is close to 5, it has a very low significance.

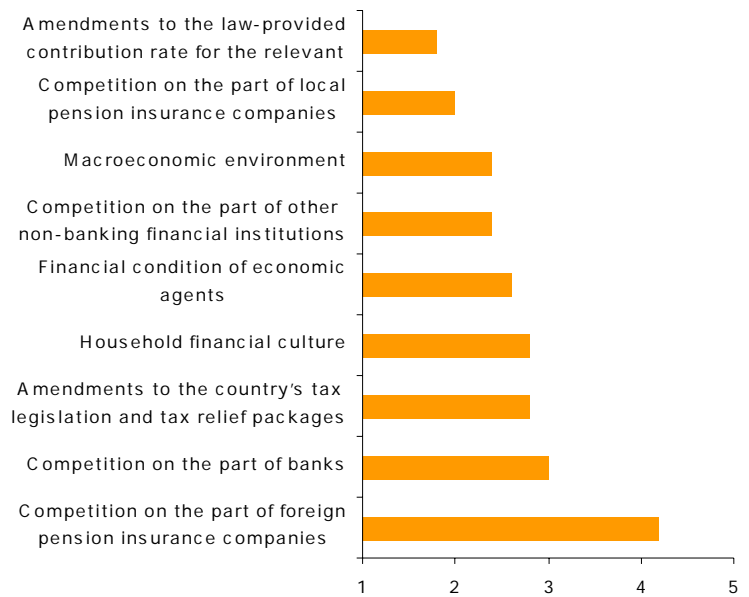
4. Pension insurance funds (PIF)

The respondents considered the potential amendments to the law-provided insurance contribution rates the most important factor for the development of the pension insurance market for it was associated with faster and stronger growth in pension fund assets as a result of the higher contribution rate. Local competition was another factor given great importance because it helped reduce the strong concentration of assets with only a few pension funds. As of the end of 2007, the four largest pension insurance funds held 82.1% of total assets in the *additional pension insurance* segment of the market (vs. 84.5% at the end of 2006). The pension insurance market is currently highly fragmented as to the insured numbers, calling for greater effort on the part of pension insurance companies to attract more customers. The macroeconomic environment and competition on the part of other non-banking financial institutions were also identified as factors of great significance. Non-banking financial institutions are offering households an alternative form of savings

bearing a comparatively higher yield and making competition crucial to their performance. At the same time, competition on the part of foreign pension insurance companies was attached the least importance.

PIF were upbeat as to the dynamics of pension fund assets in the second quarter, with 80% of the respondents pointing to an increase in assets under both the additional compulsory and additional voluntary pension insurance schemes. The positive attitudes of the respondents fully matched expectations of the capital market developments in the short run, suggesting no decrease in the share prices of the companies listed on the stock exchange and hence no repercussions for pension fund assets.

AVERAGE WEIGHTED ASSESSMENTS OF THE LEVEL OF SIGNIFICANCE OF THE FACTORS SHAPING Q1 PERFORMANCE OF PENSION INSURANCE FUNDS



Note: The average weighted results have been obtained as the arithmetic mean of the answers given. When the indicator is close to 1, it enjoys a very high level of significance. And vice versa, when it is close to 5, it has a very low significance.

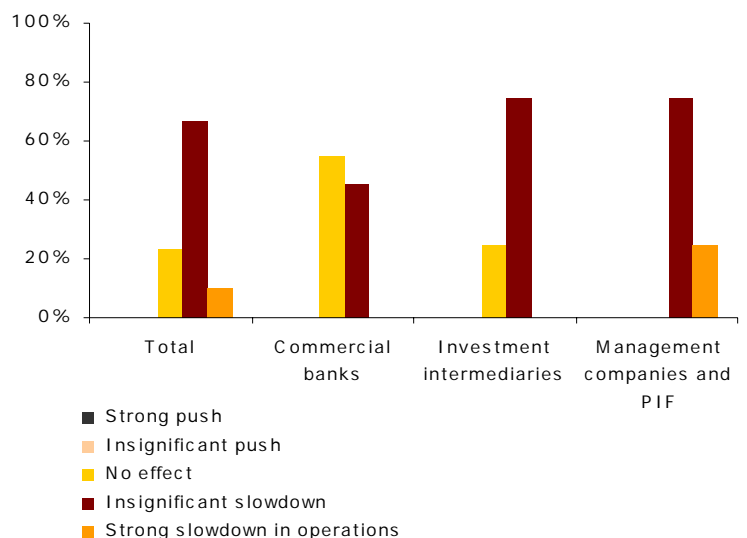
III. IMPACT OF THE US MORTGAGE

MARKET CRISIS ON THE PERFORMANCE OF LOCAL FINANCIAL INTERMEDIARIES

The US mortgage market crisis came as a result of systematic risk underestimation and affected other segments of the financial markets. The large banking institutions with significant exposure to the US sub-prime market suffered heavy losses. What followed was a sharp increase in risk premiums, turmoil in the financial markets further undermined by the lack of confidence, and a credit crunch. Meanwhile as risk attitudes changed and investor confidence plunged, the credit market crisis has grown into a crisis of confidence and liquidity. The ongoing crisis therefore raises the question as to its effect on the Bulgarian economy, in particular the local financial system, and its magnitude.

Financial intermediaries were more or less unanimous as to the effect of the US sub-prime market crisis on their operations. The survey findings indicate that 66.7% of the

IMPACT OF THE US SUB-PRIMA MARKET CRISIS ON THE PERFORMANCE OF LOCAL FINANCIAL INTERMEDIARIES



respondents expected a slowdown in their activity, whereas some 23.1% anticipated no change in their operations. Commercial banks took a most optimistic view, with 54.5% of them stating that the US mortgage market crisis would fail to produce an adverse effect on their performance. At the same time, the majority of investment intermediaries (75%) pointed out that the crisis would bring about a certain slowdown in their activity. Their expectations reflected largely the local capital market downswing, which was triggered by the altered risk attitudes of investors as a result of the financial market disturbances worldwide. However, the US market crisis is expected to affect collective investment schemes and pension insurance funds most adversely, as 25% of the management companies and PIF pointed out that the crisis would lead to a slowdown in their activity, and the remainder expected it to have no serious repercussions on their operations.

Methodological Notes

I. Economic Situation

The General Part dwells on an analysis of the aggregated expectations of financial intermediaries as to the current state of affairs in the economy, economic growth, inflation, base interest rate and the BGN's exchange rate to the US currency. The expectations of the different target groups of financial intermediaries have been gauged, using a weighted indicator. The different positive assessments (in some cases two, in others –only one) are given the values 1 and 2, as follows: 2 if there are two positive answers, and 1 if there is only one positive answer. A neutral answer gets 0. Negative assessments are given the value of -1 and -2, as follows: -2 if there are two negative answers, and -1 if there is only one negative answer. The percentages of respondents, giving the respective answer, are used as weights in calculating the indicator. An indicator close to 1 (in some cases close to 2) stands for an increase (hence a significant increase) in the variable dealt with. Accordingly, an indicator close to -1 (in some case close to -2) stands for a decrease (or a significant decrease) in the variable. In addition, a value of the indicator approximating 0 is a sign of a strong lack of homogeneity of expectations or else of expectations of an invariable pattern of performance of the economic variable.

II. Factors Shaping the Performance of Financial Intermediaries

Commercial banks

The **Special Part** addresses two basic types of questions, i.e. first, assessment of the factors, affecting their performance in the last quarter and second, their expectations of the key macroeconomic indicators having to do with their specific operations.

The first type of questions requires that respondents should identify up to 5 factors, which they think are important to the operations of their bank. The factors have to be rated from 1 to 5, where 1 stands for the most significant factor, and 5 for the factor of least importance. Thus, the aggregated results for each question are obtained by average weighting of the answers. Therefore, in interpreting the findings of the survey, account should be taken of the fact that each factor has been pointed out by a different number of banks. This has been taken into consideration when analyzing the results – the factors closer to 1 and pointed by the most banks have been rated as the most significant.

In the second part of the survey the respondents are asked to rate the expected dynamics of the relevant indicator on a scale from 1 to 5 (significant increase, increase, without change, decrease, significant decrease), where 1 stands for a significant increase, and 5 for a significant decrease. The questions left unanswered are given a value of 6. The results for each indicator are obtained as the arithmetic mean of the weights stated.

Investment intermediaries, management companies and pension insurance funds

The special part of the survey, which had to be filled in by management companies, contains questions the answers to which are based on the rating of a number of factors that are significant to the operations of the respondents or their decision to use the services rendered by financial intermediaries. Again, they are rated on a scale from 1 (the least significant) to 5 (the most significant). Thus, the aggregated results for each factor are obtained on the basis of the average weighted answers.

III. Specific issues: Impact of the US sub-prime market crisis on the performance of local financial intermediaries

Respondents are asked to answer a survey-specific question (e.g. What is the likely impact of the US sub-prime market crisis on the performance of local financial intermediaries in the Q1 issue of the survey). The effect is being evaluated by pointing to one of the following five answers: a strong push to operations/an insignificant push to operations/no change/insignificant slowdown in activity/ a strong slowdown in activity. The results have been visualized by a graph, showing the percentage of respondents, giving the respective answer, as broken down into the target groups surveyed.