FINANCIAL SECTOR: ESTIMATES AND EXPECTATIONS

3 I 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, AEAF 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 economic agents perform in and pinpointing the factors that are significant to their behaviour.*

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

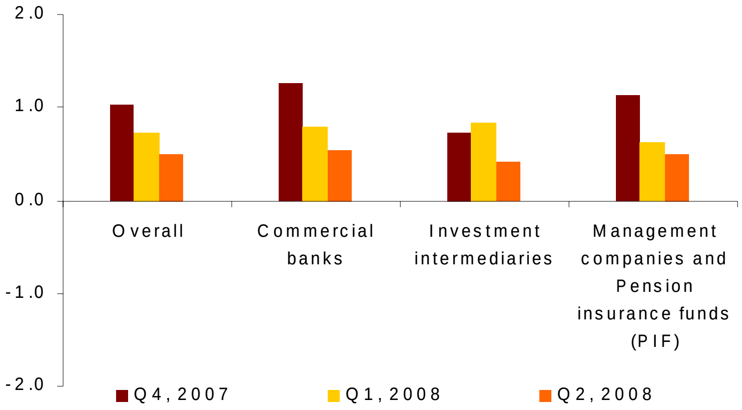
The surveys were conducted from 16th to 24th June 2008. The commercial banks that took part in the survey owned 54.75% of the assets in the banking system (as of the end of December 2007), the investment intermediaries enjoyed a share of BSE turnover of 55.29% (fourth-quarter data), whereas the management companies ran 48.85% of the assets of the collective investment schemes (as of the end of December 2007). Pension insurance funds managed some 70.3% of the assets of the pension funds under the voluntary insurance schemes as of the same period. 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

Q2 sustained the upbeat attitudes as to the current country's economic development, with assessments tending to somewhat deteriorate, however, due mostly to the adverse impact of external factors such as the ever-rising oil and food prices and strong financial market volatility worldwide. At the same time, it should be noted that there was discerned no significant difference in attitudes across the different groups of respondents. Commercial banks remained the most optimistic as to the current business situation, followed by management companies and pension insurance funds.

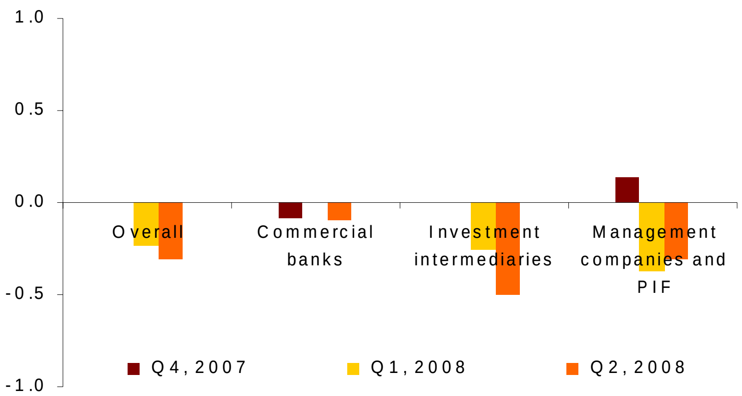
CURRENT ECONOMIC SITUATION



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 have been steadily worsening for some time, with Q2 financial survey data pointing to an even stronger slowdown. Financial intermediaries were the most downbeat as to economic growth in the following quarters. On the other hand, commercial banks remained the most optimistic, though expecting a certain slowdown on a quarter earlier when they pointed to retention of the levels. As for the group of commercial banks itself, a larger percentage of respondents now anticipated a decrease in growth (18.2% vs. 9.1% in the first quarter of 2008).

GROWTH EXPECTATIONS

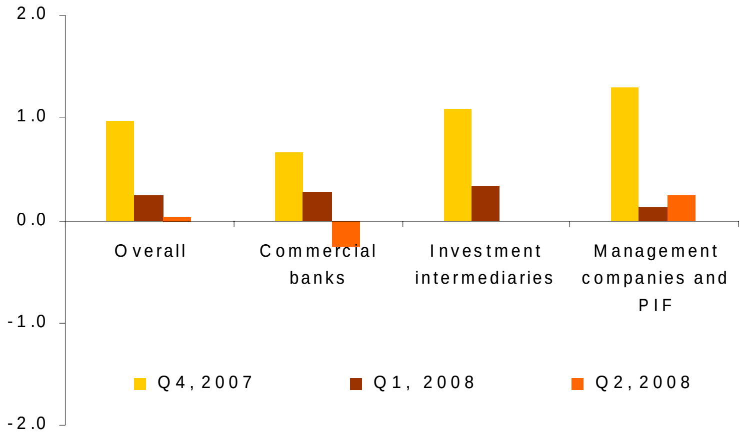


Note: Growth expectations are given as a weighted indicator. A value of the indicator close to 1 implies that financial intermediaries expect growth to pick up. Accordingly, a value of the indicator close to -1 is an indication of a slowdown in economic growth.

2. Inflation

Financial intermediaries took a more optimistic view of inflation in 2008, with inflationary expectations going on the decrease, compared to earlier surveys. The aggregated inflationary expectations pointed to retention of the current levels without any significant acceleration. The results were largely influenced by the answers of the commercial banks (about 50% of them anticipated a certain slowdown in 2008 inflation vs. 45.5% on a quarter earlier). Management companies and pension insurance funds expected inflation to pick up at a faster pace whereas investment intermediaries reported no change.

INFLATIONARY EXPECTATIONS

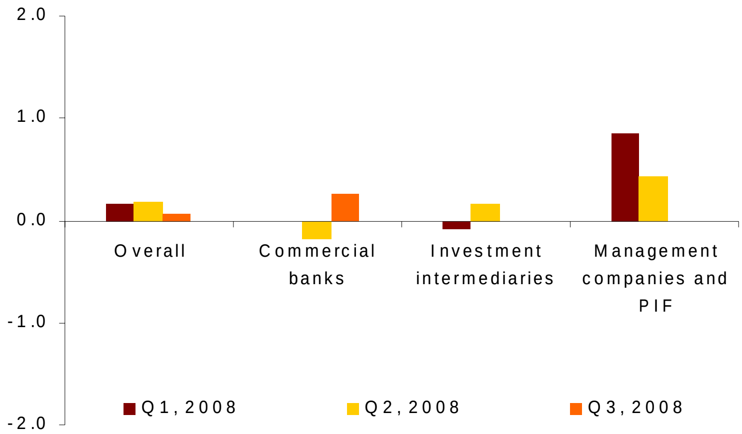


Note: The inflationary expectations of financial intermediaries are gauged, using a weighted indicator. A value of the indicator close to 2 implies that the respondents expect inflation to accelerate. And vice versa, a value of the indicator close to -2 indicates an expected decrease in inflation.

3. Foreign exchange rate

Compared to the preceding two surveys, the expectations of the respondents as to the BGN/USD exchange rate reported a change, pointing to a slight appreciation of the local currency, hence a cheaper USD. Although most commercial banks (62.5%) expected the exchange rate to hold steady at the current levels, the aggregate expectations of the group pointed to some depreciation of the USD. On the other hand, investment intermediaries, management companies and pension funds anticipated the exchange rate to remain unchanged on a quarter earlier. The answers were again largely diversified, with anticipations as to a possible appreciation or depreciation being completely balanced. As for investment intermediaries, the expectations for a slight increase or decrease in the BGN exchange rate prevailed (41.7% for each answer given by the respondents). At the same time, some 38.5% of the management companies and pension funds pointed to retention of the exchange rate. The above findings were by and large triggered by the performance of the US and EU economies. The rampant inflationary fears together with expectations for a certain growth slowdown on both sides of the Atlantic question the monetary policies of the Federal Reserve and the European Central Bank.

EXPECTATIONS OF THE NOMINAL BGN/USD EXCHANGE RATE

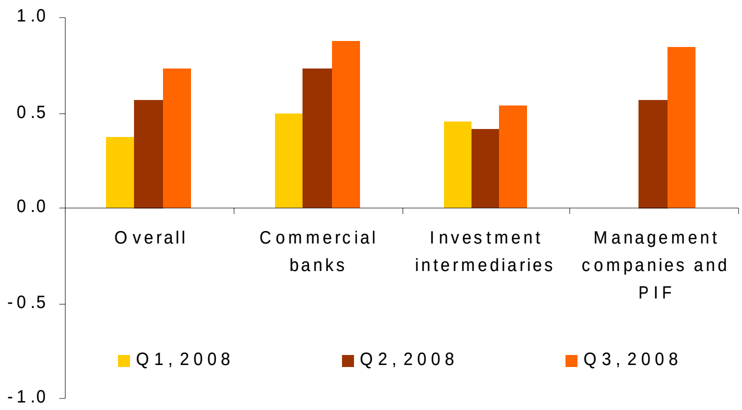


Note: The expectations of the respondents as to the nominal BGN/USD exchange rate dynamics are gauged using a weighted indicator. A value of the indicator close to 2 implies that financial intermediaries expect a strong appreciation of the BGN to the USD. Accordingly, a value approximating -2 is indicative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

4. Base interest rate (BIR)

Becoming all the more pronounced, BIR dynamics expectations indicated that financial intermediaries were unanimous as to a persistent upturn in the benchmark rate. The rising cost of foreign financial resources and strong market fluctuations worldwide shaped the expectations of the respondents as to BIR dynamics. The latter were enhanced by the July hike in the re-financing rate effected by the ECB. The most significant quarter-on-quarter change in attitudes was reported by management and pension insurance companies, most of which expected an increase in BIR (84.6% vs. 56.3% in the preceding quarter), and investment intermediaries, who had forecast a weaker rise in the rate a quarter earlier.

EXPECTATIONS FOR BIR DYNAMICS IN THE NEXT QUARTER

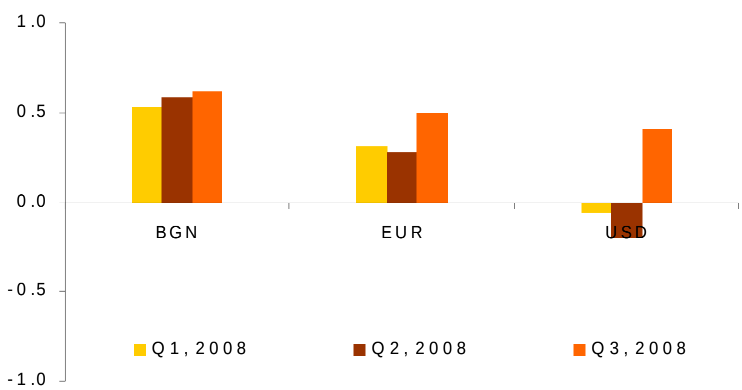


Note: The expectations of the respondents as to the base interest rate dynamics is gauged using a weighted indicator. A value of the indicator close to 1 implies that financial intermediaries expect an increase in the base rate. Accordingly, a value close to -1 indicates an expected decrease.

5. Deposit and loan interest rates

Financial intermediaries were again unanimous as to Q3 deposit interest dynamics. The aggregate results of the survey indicate that all respondents anticipated an increase in the deposit interest rates in BGN, EUR and USD. However, this was the first survey in which the financial intermediaries pointed to a rise in USD deposit interest probably prompted by expectations that the Federal Reserve would increase the benchmark rate as a result of the inflationary pressures in the economy. Another likely reason was the risk premium on USD deposits having to do with the strong depreciation of the US currency to the EUR.

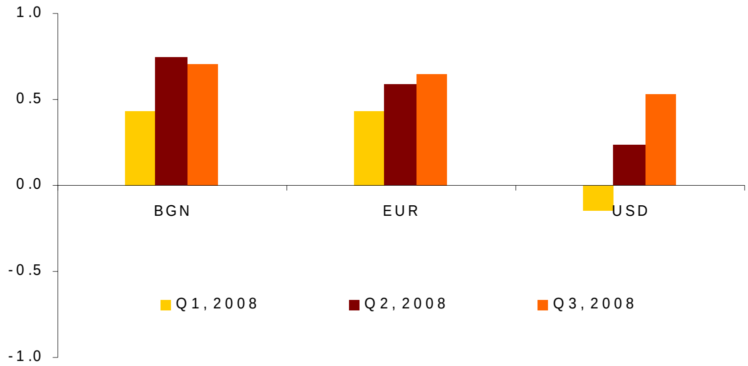
DEPOSIT INTEREST RATE EXPECTATIONS (BGN, EUR AND USD)



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.

As for loan interest rates, the respondents expected an increase in all the three currencies – BGN, EUR and USD, with growth in US loan interest anticipated to be stronger compared to the preceding quarter when financial intermediaries predicted an insignificant rise. Their expectations may have been due to the high risk premium having to do with the headlong depreciation of the US currency. As far as the interest rates on EUR credit go, they are to pick further up in the third quarter, whereas BGN loan interest is expected to report a rather modest rise.

LOAN INTEREST RATE EXPECTATIONS (BGN, EUR AND USD)

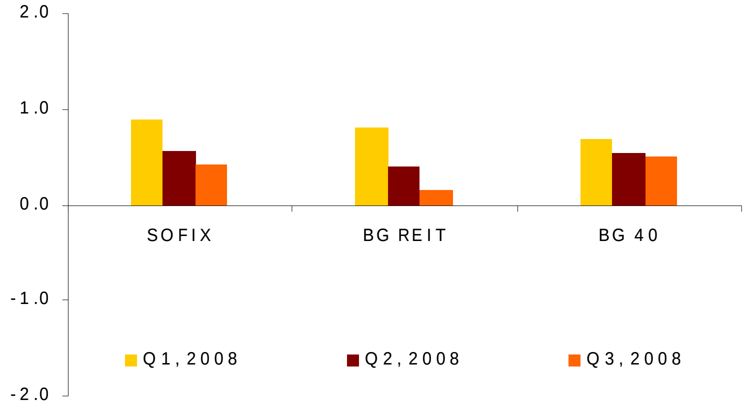


Note: The expectations of the respondents as to the dynamics of the loan interest rates in BGN, EUR and USD are gauged using a weighted indicator. A value of the indicator close to 1 shows an expected rise in loan interest. Accordingly, a value approximating -1 is indicative of an expected decrease.

6. Stock indices

The strong fluctuations and distinctly negative performance of the stock markets worldwide had an adverse effect on investor attitudes and the local capital market. The expectations that positive external factor would revive the market and trading would break out on an uphill did not come true (May being the only exception with insignificant volumes traded). Local financial intermediaries continued to expect the stock indices to go on the increase in the third quarter. However, the aggregate results of the survey point to a weaker rise on a quarter earlier. At the same time, their anticipations of BG REIT performance posted a most serious change, indicating a negligible advance by the end of September. The broad BG 40 is expected to pick up at a rather healthy clip, outpacing the other stock indices. By group of intermediaries, unlike the previous quarter, it was commercial banks alone that took a more optimistic view of the market run. Management and pension insurance companies made the most moderate assessments while the expectations of the investment intermediaries ran close to the survey average. The upbeat attitudes of the respondents can be associated with the fading unhealthy effect of the external factors. At the same time, their expectations for a quarter-on-quarter slowdown implies that it would take some time for stock trading to set back in a growth path.

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.

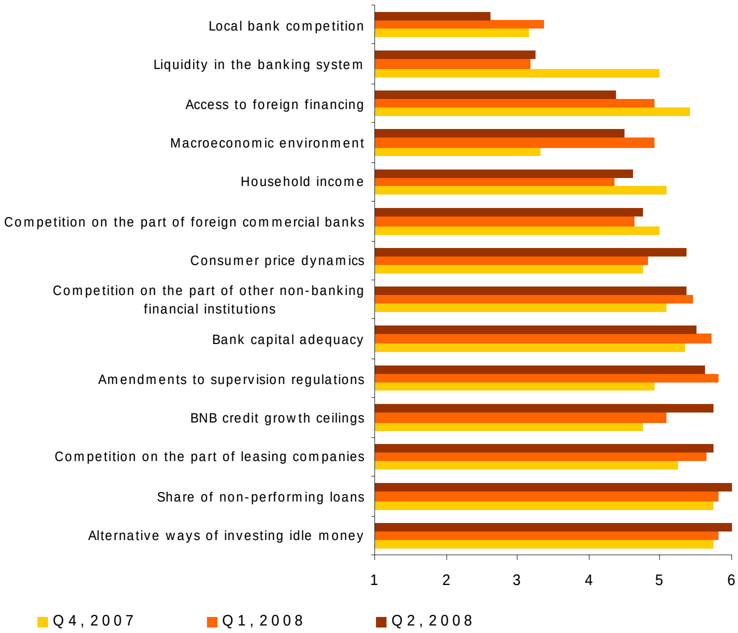
II. FACTORS SHAPING THE PERFORMANCE OF FINANCIAL INTERMEDIARIES

1. Commercial banks

Q2 corporate loans carried on rising, despite the growth slowdown having to do with the high last year's base. Local competition in the sector and liquidity were identified by commercial banks as the factors for corporate loan extensions in the quarter. Some 25% of the respondents were of the opinion that foreign financing had the upper hand in lending, identifying it as a key factor at work. Banks continued to rely heavily on foreign financial resources giving account of their expectations for an increase in EUR loan interest (the cost of foreign resources was comparatively high, as influenced by the rising interest rates in the Euro area). The country's macroeconomic stability and household income growth were also pointed as decisive to loan extension with a view to greater predictability and low credit risk in the economy. BNB credit growth ceilings carried on stepping down in importance probably due to the lack of any indications on the part of the Central Bank as to further policy tightening.

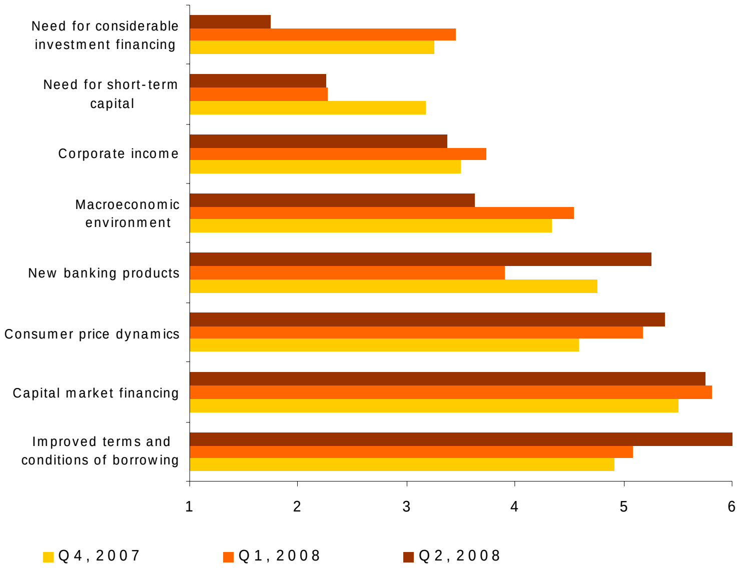
Credit demand was shaped by the same factors as in the preceding quarter, with the need for investment financing stepping up further in significance (37% of the banks identified it as the key factor at work). Credit demand was in addition influenced by corporate income and the need for short-term capital. At the same time, commercial banks were unanimous that capital market financing was not crucial to credit demand, which was most probably due to fact that economic agents opted to provide for their operations using loan resources or secure foreign sources of funding.

FACTORS INFLUENCING BANK LOAN EXTENSIONS



Note: For further detail see Methodological Notes.

FACTORS INFLUENCING BANK LOAN DEMAND

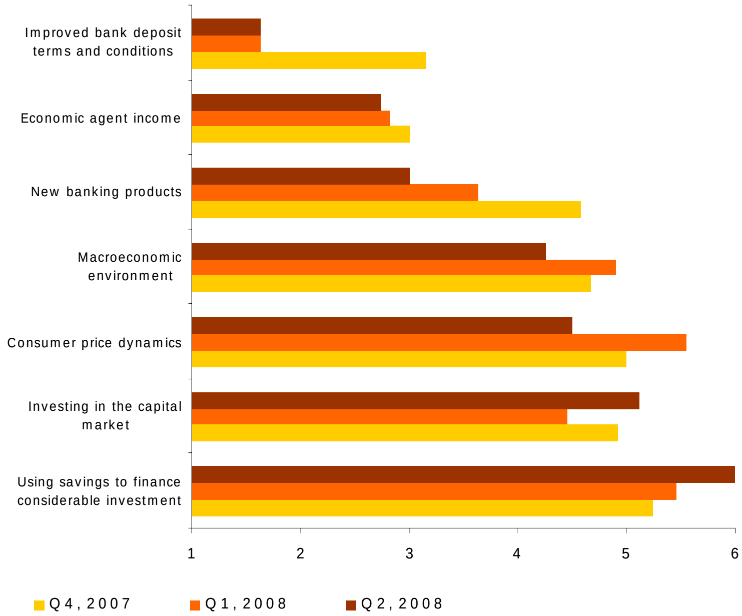


Note: For further detail see Methodological Notes.

According to commercial banks, Q2 corporate deposit supply was influenced by the same factors as in the preceding quarter, with the greatest importance being attached to the improved terms of deposit taking in the local market as well as corporate income growth. At the same time, capital market opportunities were significantly outweighed, if not completely as a factor shaping economic agents' decisions where and how to invest idle money due to the persistent market downturn, low volumes traded and plunging share prices. This tendency together with the improved deposit terms offered by banks made economic agents and households turn to alternative forms of savings.

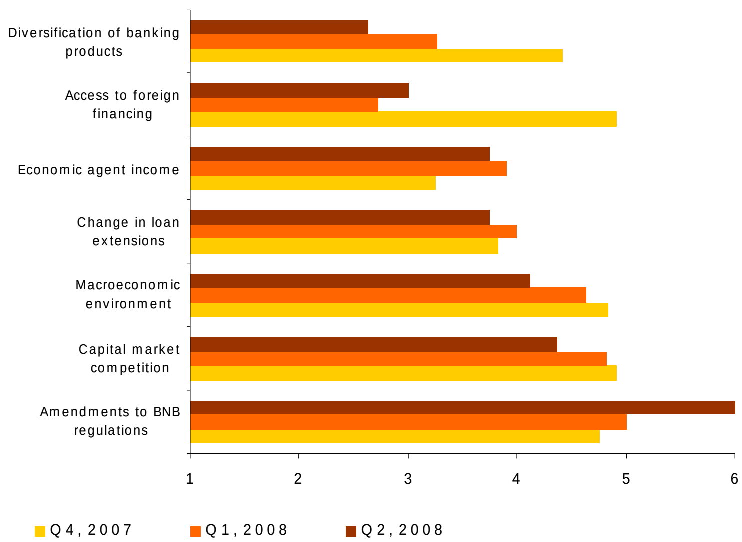
On a quarter earlier, the respondents ranked the factors that were decisive to deposit taking in more or less the same way, with banking product diversification and access to foreign financing in the lead (pointed by 87.5% of the banks). At the same time, corporate income and change in loan extensions stepped up in importance.

FACTORS INFLUENCING DECISIONS TO PUT IDLE MONEY IN BANK DEPOSITS



Note: For further detail see Methodological Notes.

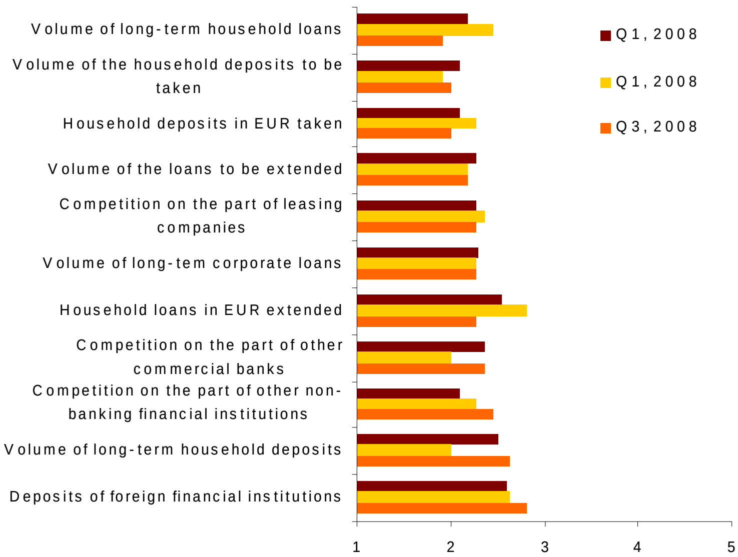
FACTORS INFLUENCING DEPOZIT TAKING



Note: For further detail see Methodological Notes.

Despite the growing expectations for higher loan interest rates, commercial banks anticipated a faster Q3 increase in long-term household credit due mostly to the rising importance of other factors such as corporate income growth. At the same time, they also expected to take larger amounts of deposits to provide for their lending activity (a weaker increase in long-term household deposits on a quarter earlier, hence a faster-paced growth in EUR household deposits). Their expectations as to long-term corporate loan volumes and credit portfolio size remained almost unchanged. As for competition, the respondents were of the opinion that inter-bank competition would decrease, whereas competition on the part of leasing companies would increase. It should be also noted that a growing number of banks are using inside sources of financing, explaining why they anticipated no rise in foreign deposits.

ECTATION OF COMMERCIAL BANKS IN RESPECT TO:

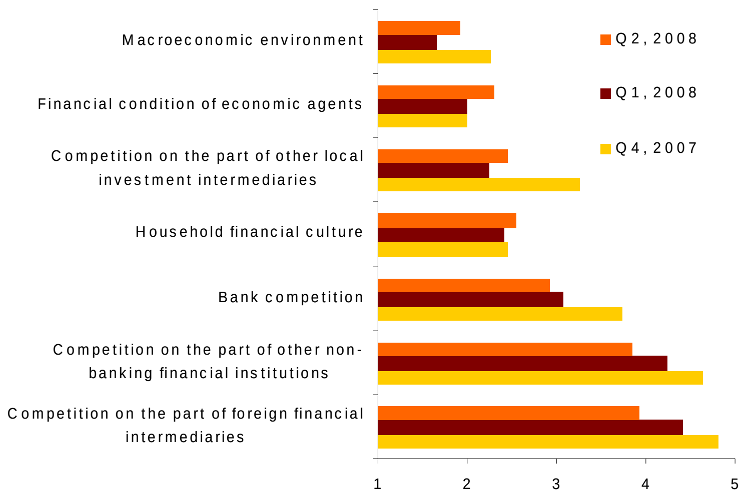


Note: The average weighted results have been obtained as the arithmetic mean of the answers given. When the indicator is close to 1, it indicates that commercial banks expect it to step up significantly. And vice versa, when it is close to 5, it implies that the respondents expect a significant decrease.

2. Investment intermediaries

The factors shaping the performance of investment intermediaries in the second quarter remained unchanged due to the persistent trends in the country's economic situation and local and world financial markets. The country's macroeconomic environment was again considered the most significant factor at work in line with the expectations for a certain slowdown in growth and more pessimistic views of the current business situation. The financial conditions of economic agents were ranked second in importance, followed by local competition. Foreign competition, on the other hand, was considered the least important with a view to the financial market downturn worldwide and decreased liquidity of international investors.

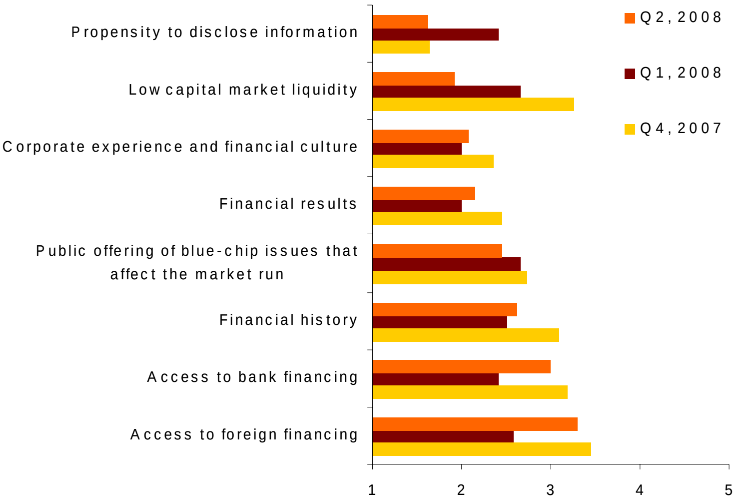
AVERAGE WEIGHTED ASSESSMENTS OF THE LEVEL OF SIGNIFICANCE OF THE FACTORS SHAPING THE PERFORMANCE OF INVESTMENT INTERMEDIARIES



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.

The aggregate assessments of investment intermediaries as to the factors influencing a company's decision to go public, reported significant changes. *Propensity to disclose financial information* had the upper hand in listing on the stock exchange, followed by capital market liquidity (the latter being pointed as a significant factor in the wake of the dull stock trading in the second quarter). Experience and corporate financial culture as well as financial results now enjoyed less importance. The financial results released in the first quarter were not equivocal, affecting the assessments of the investment intermediaries. Access to financing from local and foreign sources alike was considered the least important factor, with all respondents being a lot more unanimous as to the weight of the factors, compared to the previous quarter when all the factors had stepped up in significance relative to the last three months of 2007.

AVERAGE WEIGHTED ASSESSMENTS OF THE SIGNIFICANCE OF THE FACTORS THAT ARE DECISIVE TO A COMPANY'S DECISION TO LIST ON THE STOCK EXCHANGE



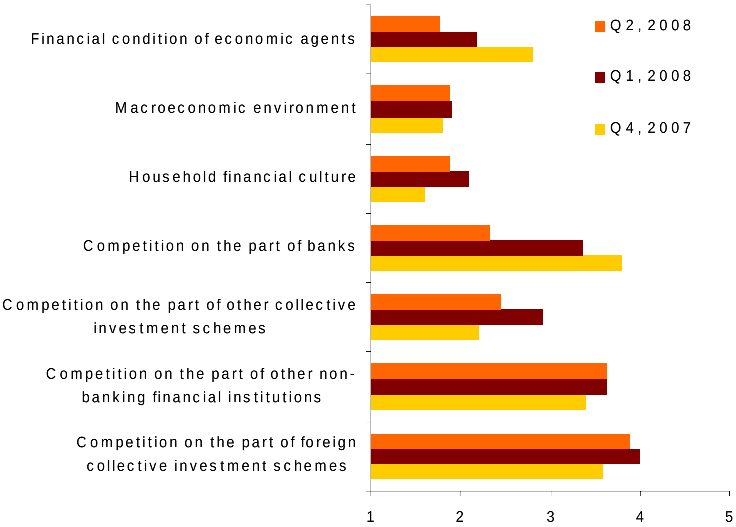
Note: The average weighted results have been obtained as the arithmetic mean of the answers given. When the indicator is close to 1, it enjoys a very high level of significance. And vice versa, when it is close to 5, it has a very low significance.

3. Collective investment schemes (CIS)

Management companies expected a slight increase in assets, taking a more optimistic view on a quarter earlier when the aggregate results of the survey had pointed to retention of the assets accumulated. Around 56% of the respondents were of the opinion that assets would report no change whereas the other half predicted a rise. Their assessments may have been affected by the positive market run and upturn in the performance of the stock indices.

The financial condition of economic agents was identified as the most significant factor for the operation of management companies. The country's macroeconomic environment, which enjoyed the heaviest weight in the preceding survey, now stepped down in importance, but together with household financial culture continued to be a decisive factor. The positive attitudes as to the current business situation

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

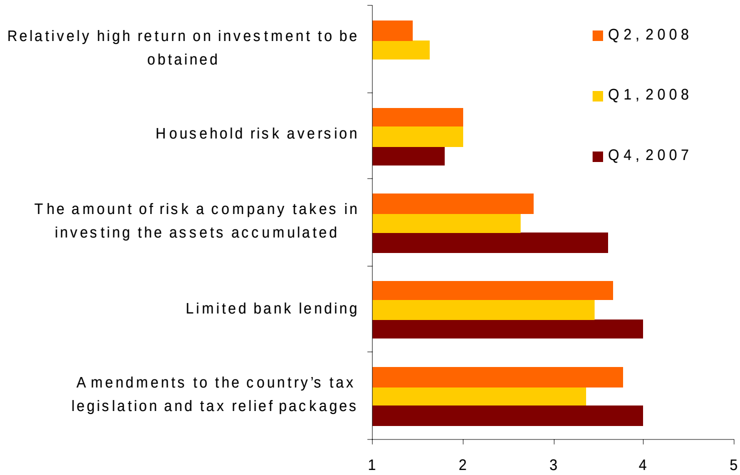


Note: The average weighted results have been obtained as the arithmetic mean of the answers given. When the indicator is close to 1, it enjoys a very high level of significance. And vice versa, when it is close to 5, it has a very low significance.

and the close relation of economic growth and corporate income provide solid evidence that the above factors had a healthy effect on the performance of the companies. Also, it should be noted that competition on the part of the banking system gained further importance on a quarter earlier due to the fact that bank deposits are one of the most conventional and comparatively less risky way of savings. Given the improved terms of deposit taking and flat capital market, competition between the two groups of financial intermediaries is expected to carry on increasing. At the same time, competition on the part of foreign CIS was considered the least important factor for a second quarter in a row.

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 the accumulation of 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, Q1 household financial conditions were considered the most crucial factor for CIS development, outweighing competition. The findings of the survey indicate 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 INFLUENCING HOUSEHOLD DECISIONS TO INVEST IDLE MONEY IN COLLECTIVE INVESTMENT SCHEMES



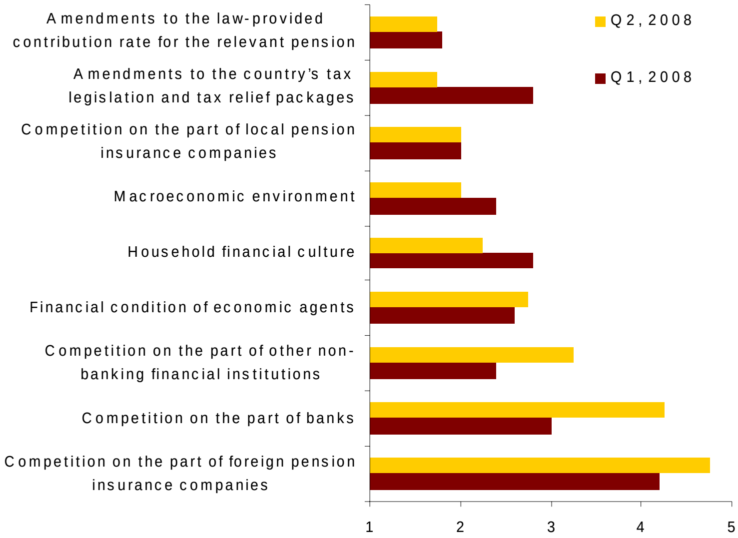
Note: The average weighted results have been obtained as the arithmetic mean of the answers given. When the indicator is close to 1, it enjoys a very high level of significance. And vice versa, when it is close to 5, it has a very low significance.

Another crucial factor for CIS performance has to do with the fact whether or not they are household first choice. In making a decision to invest in collective investment schemes individual players have to consider all alternative forms of saving from the point of view of return and the amount of risk they are likely to take to get the yield desired. The aggregate answers of the respondents indicate that it was the higher rate on return offered by CIS and their viability that were decisive to a household decision to put their money on the schemes. On a quarter earlier, the respondents showed greater unanimity, with some 56% (vs. 45% in the previous survey) of them identifying *return on investment* as the first and foremost economic consideration to invest. *Risk aversion* was ranked second, reporting no change in importance. The improving corporate financial culture in the economy augmented the above factor's weight. At the same time, tax legislation amendments and tax relief packages were pointed out as having the least weight in the household decision making process.

4. Pension funds

The respondents considered the amendments to the tax legislation and contribution rate as well as tax relief packages the most important factor for the development of the pension insurance market. Attaching almost equal significance, they ranked the country's macroeconomic environment and competition second. Pension insurance funds did not face any serious competition on the part of other non-banking institutions due mostly to the capital market downturn in the second quarter and decreasing investor confidence that affected the performance of other non-banking institutions too. Competition on the part of both the banking system and foreign investment funds were again identified as the least significant, stepping further down in importance on a quarter earlier.

AVERAGE WEIGHTED ASSESSMENTS OF THE LEVEL OF SIGNIFICANCE OF THE FACTORS SHAPING Q2 PERFORMANCE OF PENSION INSURANCE FUNDS



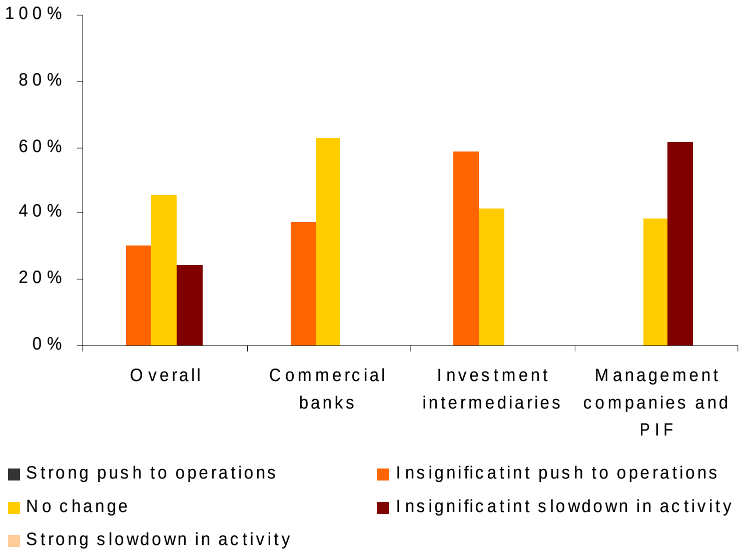
Note: The average weighted results have been obtained as the arithmetic mean of the answers given. When the indicator is close to 1, it enjoys a very high level of significance. And vice versa, when it is close to 5, it has a very low significance.

PIF continued to take an upbeat view of assets growth in the third quarter, being unanimous about an expected increase under both the additional compulsory and voluntary pension insurance schemes (75%). Their expectations drew upon moderately optimistic forecasts as to the short-term development of the capital market, macroeconomic environment and income.

III. Impact of the growing oil prices on the performance of local financial intermediaries

All respondents were asked to answer a survey-specific question about the impact the ever-rising oil prices worldwide on their operations. The aggregate results indicate that the largest group of financial intermediaries (45.5%) were of the opinion that the oil price had no impact on their performance. Some 30.3% of the respondents pointed to a positive effect, and 24.2% (mostly of the group of management and pension insurance companies) considered the soaring oil price to have produced a negative effect on their operations.

IMPACT OF THE INCREASING OIL PRICES ON ACTIVITY OF THE FINANCIAL INTERMEDIARIES



Investment intermediaries were the most optimistic about the oil price developments, with 58.3% of them pointing to a positive effect. On the whole, commercial banks took an upbeat attitude, too. Around 37.5% of them underlined the positive effect of the price increase, whereas the rest did not expect the oil price dynamics to have any impact on their performance. The upbeat attitudes of investment intermediaries may have been prompted by opportunities to join the international commodity markets by using financial derivatives based on oil prices and therefore making significant profit.

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 cases 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. The questions left unanswered are given a value of 6. Thus, the aggregated results for each question are obtained by average weighting of the answers.

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 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 has 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 ever-rising oil prices worldwide 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 ever-rising oil price worldwide on the performance of local financial intermediaries). 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.