FINANCIAL SECTOR: ESTIMATES AND EXPECTATIONS

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The Financial Sector: Estimates and Expectations series of the Agency for Economic Analysis and Forecasting include four quarterly issues which 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 the respondents' answers remain anonymous and are not made public. The present survey was conducted from 10th April to 22nd April.

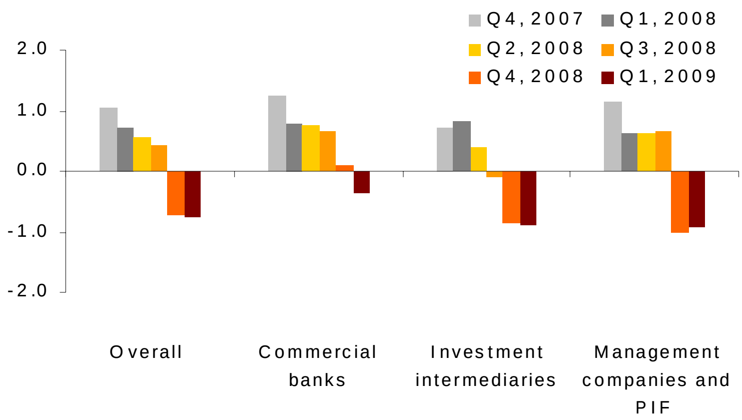
The commercial banks polled owned 56.7% of the assets in the banking system (as of the end of December'08), the investment intermediaries enjoyed a share of BSR turnover of 12.8% in the third quarter, the management companies ran 42% of the assets of the collective investment schemes as of the end of September'08, whereas the pension insurance companies managed some 33.4% of the assets of the pension funds under the various voluntary insurance schemes as of the end of December'08. The commercial banks filled in only that part of 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

The majority of market players remained downbeat about the current state of affairs in the economy due mostly to the continuous global crisis, high degree of uncertainty as to the depth of the recession world wide and clarity of vision as to when the economy will start recovering. The aggregate assessments of all intermediaries remained almost unchanged on a quarter earlier, but the assessments of the commercial banks as to the current business situation worsened (around 50% of the banks assessed the situation as unsatisfactory, and 12.5% of them as negative vs. 44.4% of the banks taking a negative view of the situation in the previous survey).

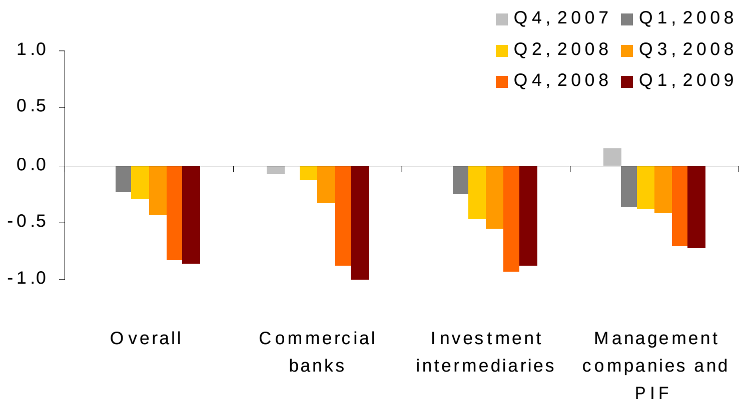
CURRENT ECONOMIC SITUATION



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 remained negative, too, being strongly influenced by the current state of affairs in the economy. Over 85.7% of the respondents pointed to a growth slowdown in the following quarter. All commercial banks expressed stronger pessimism. At the same time, despite the negative anticipations of the investment intermediaries, the last survey was indicative of a slight improvement in their growth expectations and their share stepped down from 93.3% in the preceding period to 88.9%.

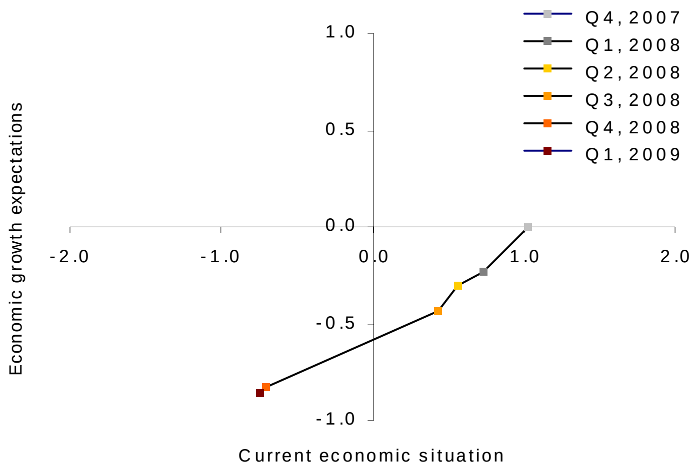
GROWTH EXPECTATION



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.

Both current business situation assessments and growth expectations remained downbeat without reporting any significant change on a quarter earlier. Apparently, the financial intermediaries regarded the slowdown as a long and continuous process, given their pessimistic expectations for another quarter in a row.

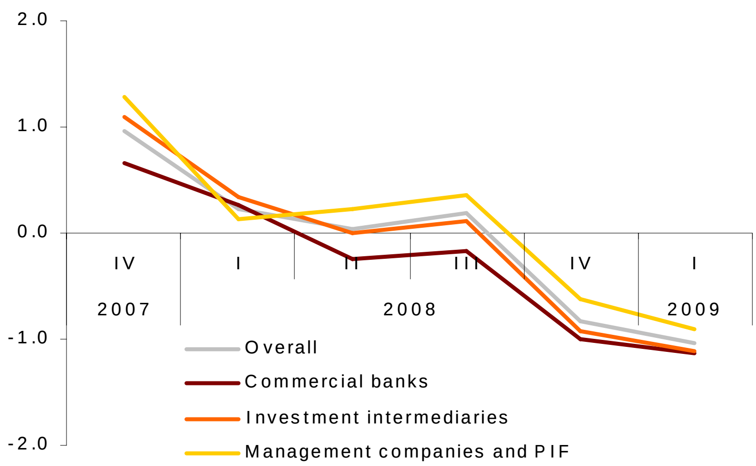
CURRENT AND FUTURE ECONOMIC SITUATION



2. Inflation

The slowdown world wide and deteriorating business activity in the country continued to exert a strong pressure on price dynamics, a view taken by 82.1% of the financial intermediaries polled, who pointed to a lower inflation rate in 2009. The lower inflation expectations were more pronounced with commercial banks (87.5% of the respondents expected a certain ease of the inflationary pressure). Price expectations remained almost unchanged and the inflationary pressure was to be further alleviated with a view to forecasts as to the dynamics of some basic raw material prices and eased pressure on wage growth in the local labour market.

INFLATIONARY EXPECTATIONS

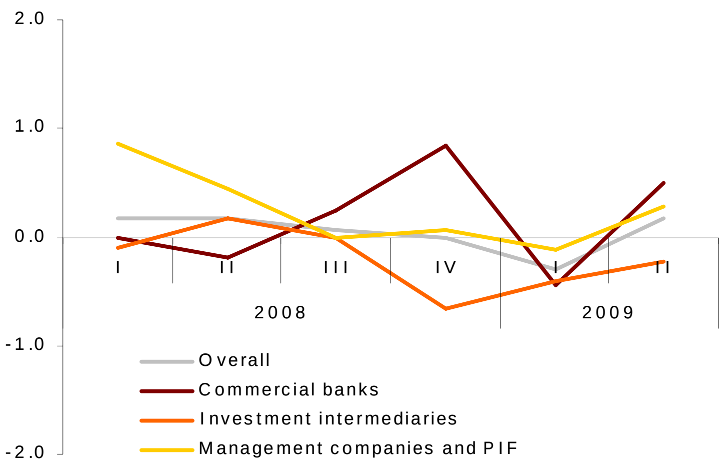


Note: The inflationary expectations of financial intermediaries are gauged, using a weighted indicator. A value of the indicator close to 2 implies that the respondents expect inflation to accelerate. And vice versa, a value of the indicator close to -2 indicates an expected decrease in inflation.

3. Foreign exchange rate

The consolidated expectations of all financial intermediaries as to the BGN/USD exchange rate pointed to a slight depreciation of the US currency in the second quarter (in the previous survey they were in favour of a stronger USD). And yet, the respondents' answers were not unequivocal, as 42.9% of them anticipated a certain increase in the BGN and 35.7% pointed to retention of the exchange rate. At the same time, some 62.5% of the commercial banks were unanimously of the opinion that the US currency would lose much of its ground to the BGN by mid-2009. About one-quarter of them expected the exchange rate to remain unchanged at its current levels. As for the investment intermediaries inquired, they were the only respondents retaining their confidence in the US dollar, though in a lesser degree on a quarter earlier (44.4% of them expected the exchange rate to remain unchanged, 22.2% of them favoured either a slight increase or decrease in the US currency, and 11.1% pointed to a very strong USD). The view taken by the management companies and the pension insurance funds stood closest to the average results of all respondents pointing to a slight appreciation of BGN (45.5%). Another 36.4% did not anticipate a change in the exchange rate, whereas 18.2% gave an advantage to USD.

EXPECTATIONS OF THE NOMINAL BGN/USD EXCHANGE RATE

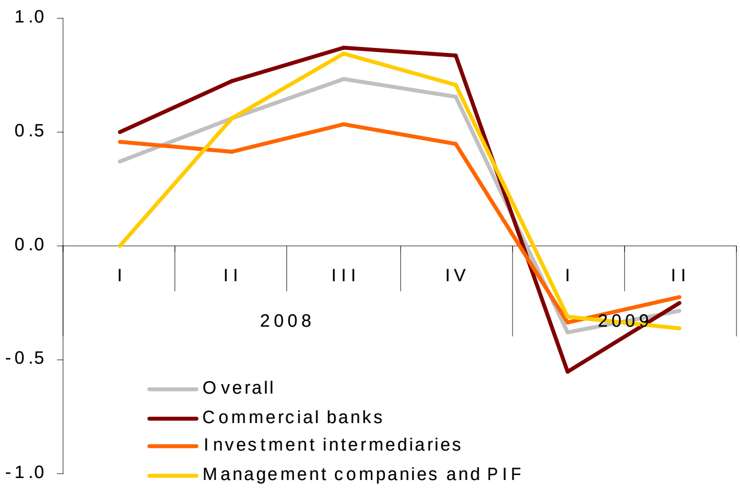


Note: The expectations of the respondents as to the nominal BGN/USD exchange rate dynamics are gauged using a weighted indicator. A value of the indicator close to 2 implies that financial intermediaries expect a strong appreciation of the BGN to the USD. Accordingly, a value approximating -2 is indicative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

4. Base interest rate

The liquidity injection as a result of the amended minimum reserve requirements of the Central Bank and follow-up credit crunch led to a steady decrease in the interbank market interest rates. The base interest rate (BIR) followed suit, going down significantly. Some 63.4% of the financial intermediaries did not expect a change in the interest rate level, and 32.1% of the respondents pointed to a continuous decrease. Compared to the previous survey, the financial intermediaries now took a more unanimous view of the future developments. The expectations of the commercial banks underwent the most significant change, with 50% of them expecting a retention of the base interest rate (no-one pointed this answer in the previous survey), and 37.5% anticipated a further decline (vs. 77.8% in the first 2009 edition).

EXPECTATIONS FOR THE BIR DYNAMICS IN THE NEXT QUARTER

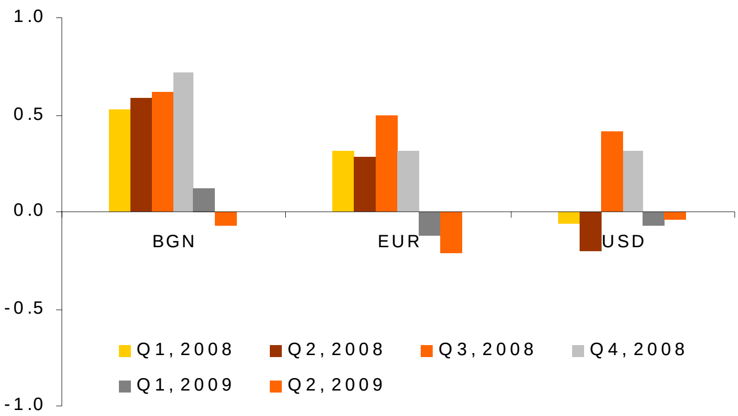


Note: The expectations of the respondents as to the base interest rate dynamics is gauged using a weighted indicator. A value of the indicator close to 1 implies that financial intermediaries expect an increase in the base rate. Accordingly, a value close to -1 indicates an expected decrease.

5. Deposit and loan interest rates

The loan and deposit interest rates had been steadily rising since mid-2008. However, the expectations of the respondents were suggestive of a certain slowdown if not even a turnaround in the trend, as only 10.7% of them pointed to a further increase in BGN deposit interest (vs. 31.7% on a quarter earlier) and 71.4% expected the interest rates to steady around the Q2 levels. Although the majority of intermediaries expected the BGN deposit interest rates to step down, none of the commercial banks pointed to that answer. The interest rates on EUR deposits were expected to either remain unchanged or report an insignificant drop by 57.1 and 32.1% respectively. The cost of US resources was not to change, as the expectations of the respondents reflected not only the actions of the US and EU central banks to be taken but also their concerns as to the growing fiscal deficits, which in a medium term may exert a pressure on the interest rate dynamics.

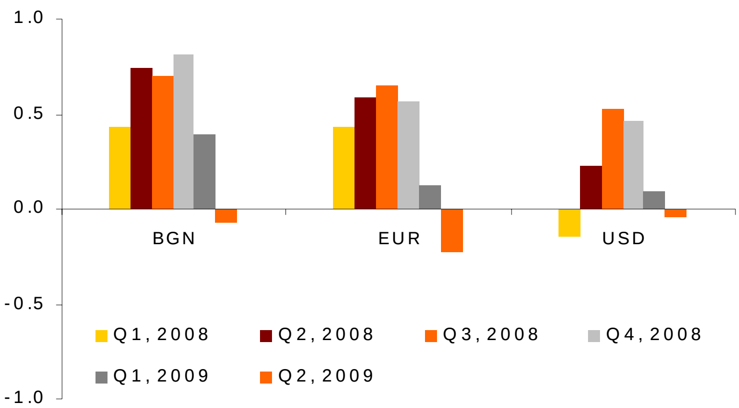
DEPOSIT INTEREST RATE EXPECTATIONS (BGN, EUR and USD)



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 shows an expected rise in deposit interest. Accordingly, a value approximating -1 is indicative of an expected decrease.

The expectations of the loan interest rates followed suit, stepping down in all currencies. EUR loan interest was expected to report the strongest decrease. At the same time, 77.8% of the respondents anticipated no change and 22.2% pointed to a certain slowdown. The cost of BGN loan resources was expected to remain unchanged, a view taken by 85.2% of the financial intermediaries. Some 11.1% of them anticipated a certain decrease in BGN loan interest rates, whereas all commercial banks pointed to retention of the BGN interest on loans.

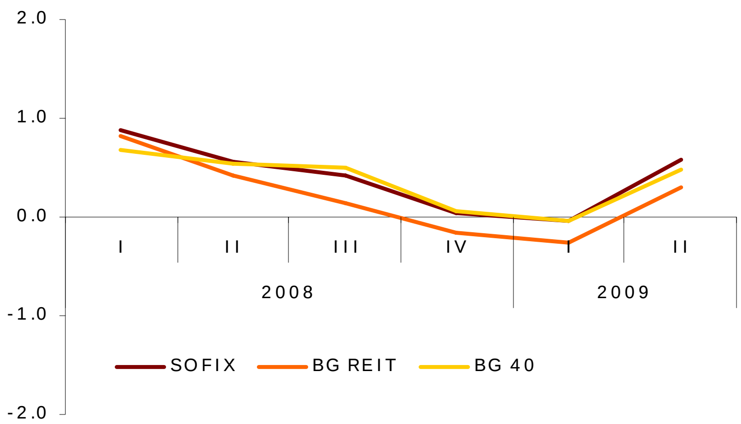
LOAN INTEREST RATE EXPECTATIONS (BGN, EUR AND USD)



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.

6. Stock indices

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.

The expectations of the respondents as to the stock market performance in the second quarter were markedly optimistic, fully contrasting, however, the survey answers on a quarter earlier. The average survey results stood very close to the findings of the second quarter of 2008. The answers can be said to be more categorical, with the share of respondents anticipating an improvement rising at the expense of all other answers. They expected SOFIX to post the strongest increase, followed by the broad BG 40. However, their view of BG REIT performance in the future was largely diversified as 42.3% of the answers pointed to retention of the current levels. The commercial banks were more unanimous as to SOFIX and BG 40, with 62.5% of them expecting an increase in both indices, whereas some 25% shared the opposite view. At the same time, they were the only group that remained downbeat about BG REIT, giving strongly diversified answers. The average results for SOFIX and BG 40 were the highest. Some 55.6% of them expected the indices to pick up and 22.2% did not anticipate a change in the stock index performance. Half of the respondents in this group were of the opinion that BG REIT would retain its levels while 37.5% were optimistic about the future developments. The management and pension insurance companies .were the most optimistic, pointing to an improvement in all the three indices of 45.5 %, 50% and 40% in SOFIX, BG REIT and BG 40 respectively. At the same time, some 20% of the respondents in this group anticipated BG 40 to further dip.

The upbeat anticipations of the financial intermediaries as to the performance of the local capital market were mainly triggered by an interplay of external factors. The upward trend of the global stock markets and a number of government measures to stabilize the financial sector worldwide as well as estimates that the economy was to start recovering by end of 2009 had a healthy effect on local investor sentiment. At the same time, as risk appetite has been gradually increasing, foreign investors are likely to turn back to Central and Eastern European markets where following the plunges, the price of securities is very attractive to new long-term investment portfolios. Furthermore, given the low stock market liquidity in Bulgaria, the comeback of major foreign investors will be key to stock exchange trading.

II. FACTORS SHAPING THE PERFORMANCE OF FINANCIAL INTERMEDIARIES

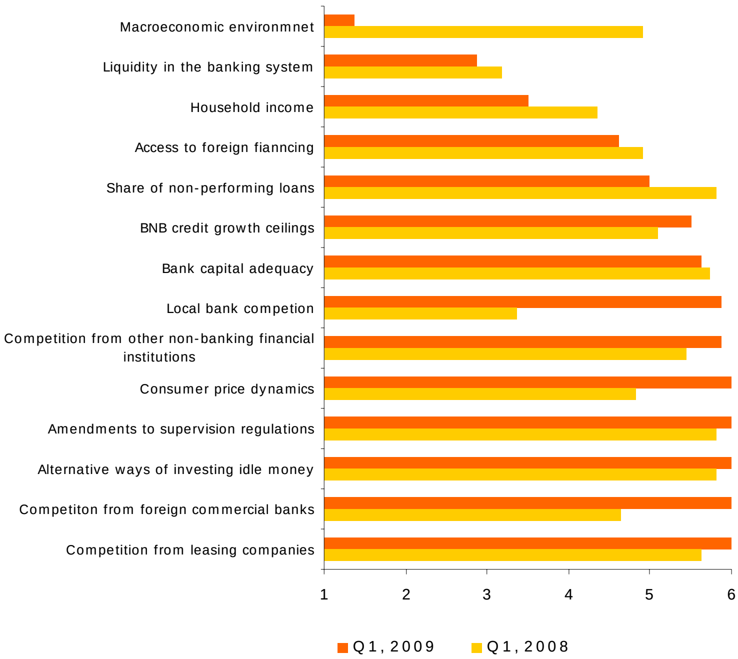
1. Commercial banks

Given the persistent recession that entailed greater market insecurity, the maintenance of macroeconomic stability is a crucial factor that can bring the economy back to normal. This was also the factor identified by all commercial banks as indispensable to bank lending in the first quarter of 2009.

On a year earlier, the relative weight of the *macroeconomic stability* factor underwent the most significant change outweighing all other factors. The respondents ranked liquidity in the banking system second. At the same time, competition, which was decisive to lending on a year ago, had now practically no impact on credit portfolio size and management. Household income stepped up in importance as creditworthiness and solvency were identified as a crucial factor for a loan size and approval.

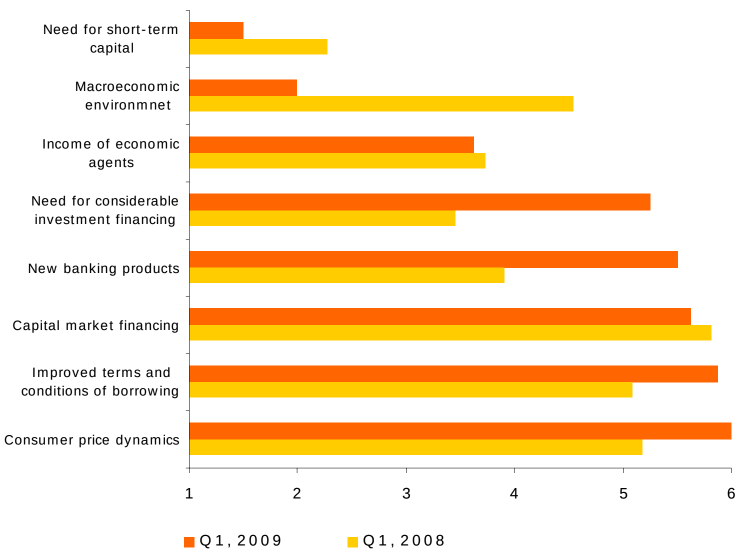
Credit demand was mostly associated with the need for short-term capital which, together with the country's *macroeconomic environment*, was pointed out as important factors at work by all respondents. At the same time, a leading factor in 2008, investment financing was now identified by only 25% of the respondents. The global market slump, ever-growing intra-firm indebtedness and shrinking sales had a crucial effect on the type of loans in demand by the private sector.

FACTORS INFLUENCING BANK LOAN EXTENSIONS



Note: For further detail see Methodological Notes.

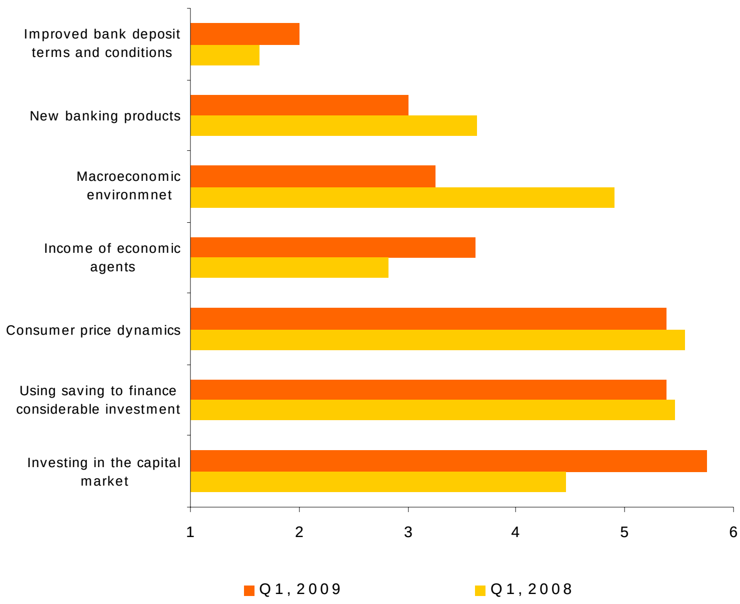
FACTORS INFLUENCING BANK LOAN DEMAND



Note: For further detail see Methodological Notes.

The higher deposit interest rates of late 2008 and early 2009 as well as the new banking products had the upper hand in deposit decisions. Furthermore, the macroeconomic environment factor stepped up in importance significantly on a year earlier. At the same time, saving in alternative instruments, e.g. capital market investment reported a lower weight.

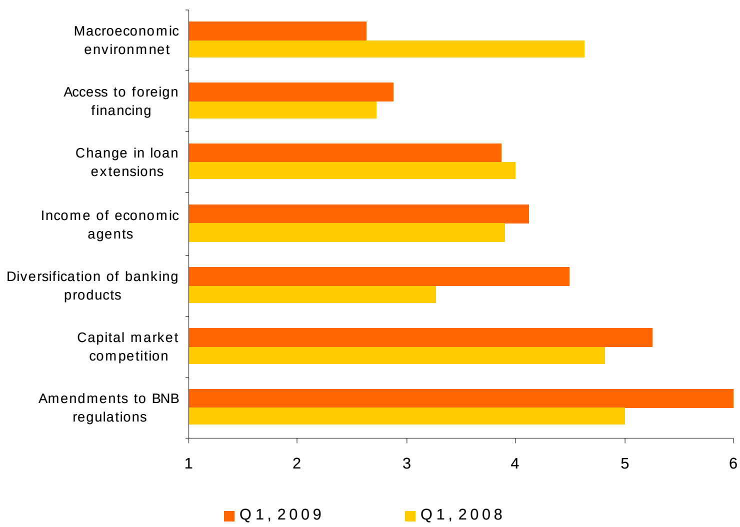
FACTORS INFLUENCING DECISIONS TO PUT IDLE MONEY IN BANK DEPOSITS



Note: For further detail see Methodological Notes.

Deposit taking in the first quarter of the year was by and large shaped by the country's macroeconomic environment and access to foreign financing, accounting for the main sources of bank resources, viz. resident deposits and foreign financing mostly extended by the mother banks. The amended BNB regulations (providing for differentiation of the minimum required reserve percentage in accordance with the source of the deposit taken) did not affect the deposit taking decisions of banks.

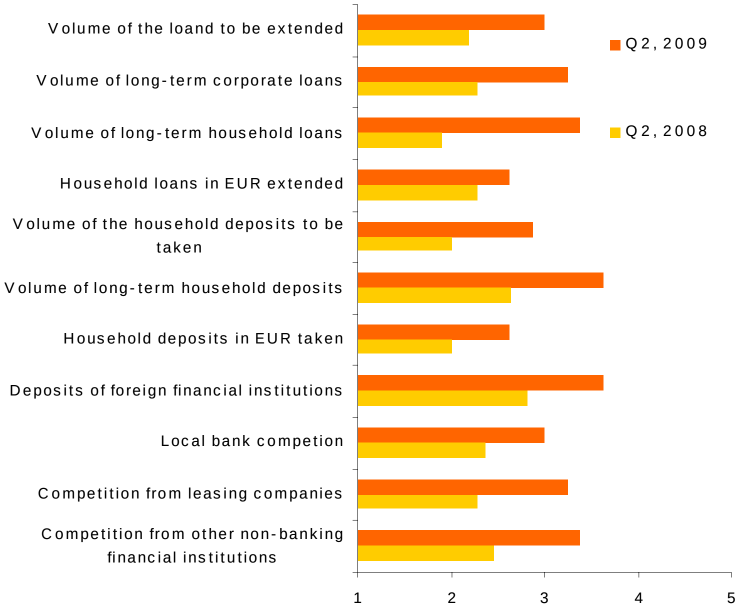
FACTORS INFLUENCING DEPOSIT TAKING



Note: For further detail see Methodological Notes.

Commercial banks expected a further slowdown in both lending and deposit volumes, with the trend becoming all the more distinct with long-term household and corporate credit, where the indicator had contracted to 3.38 and 3.25 respectively. Long-term household deposits and non-resident deposits were also expected to go on the decrease. All in all, the answers of the commercial banks outlined a gloomy outlook of a slower business activity and narrower markets. This, however, is not expected to result in stiffer competition but lower competition not only among banks but on the part of the non-banking financial institutions as well.

EXPECTATIONS OF COMMERCIAL BANKS IN RESPECT TO:

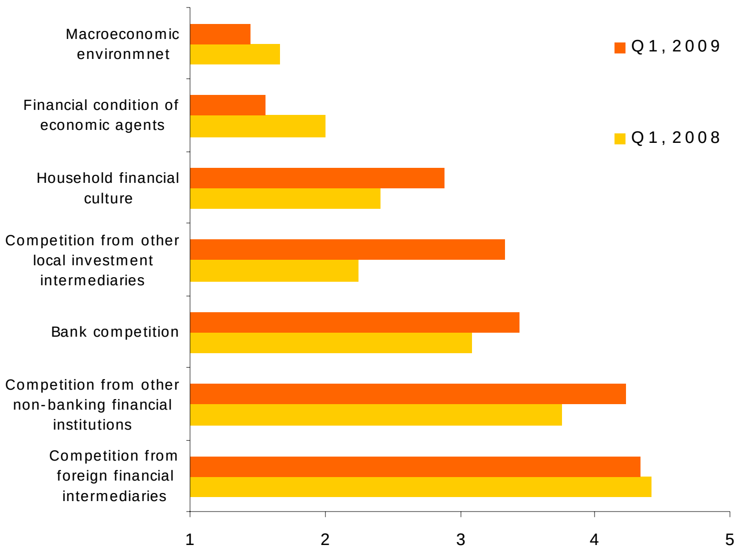


Note: The average weighted results have been obtained as the arithmetic mean of the answers given. When the indicator is close to 1, it indicates that commercial banks expect it to step up significantly. And vice versa, when it is close to 5, it implies that the respondents expect a significant decrease.

2. Investment intermediaries

Stepping up in importance, the country's macroeconomic environment continued to be the most decisive factor at work for the normal performance of the investment intermediaries, as pointed by 56% of them. The financial state factor ranked next, gaining further momentum relative to March'08. Some 44% of the respondents identified it as a factor of paramount importance. The two factors stand out, as they were ranked either first or second in importance. As for the other factors, they were rated in more or less the same order as in 2008, the only exception being household financial culture (reflecting the ability of the economic agents to make a rational investment choice when depositing their money, given the adverse macroeconomic environment), which outweighed local competition while stepping down in significance in the last four quarters. At the same time, competition on the part of all other financial intermediary groups was considered the least important.

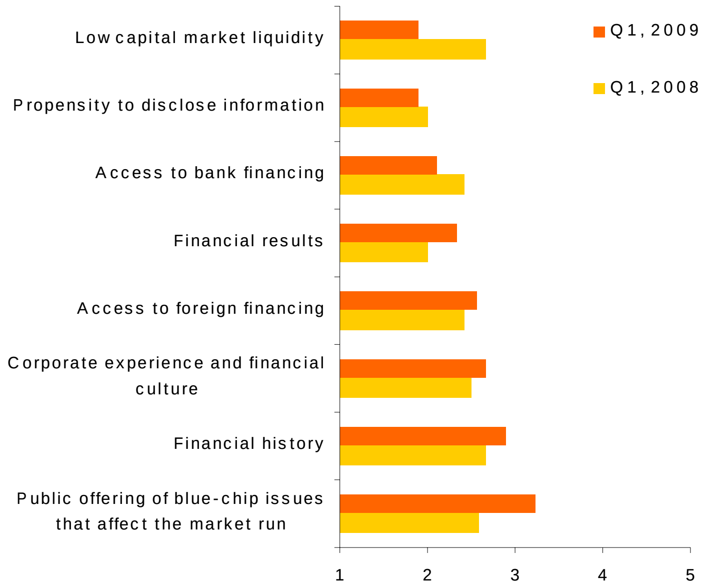
AVERAGE WEIGHTED ASSESMENT OF THE LEVEL OF SIGNIFICANCE OF THE FACTORS SHAPING THE PERFORMANCE OF INVESTMENT INTERMEDIARIES



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.

Relative to early 2008, the factors behind a company's decision to go public were now rated in a different way by the investment intermediaries. Having been considered the least important on a year earlier, low capital market liquidity was now ranked first with a view to the difficulties a company may have in raising the funds it needs on the stock exchange. At the same time, considered as significant as capital market liquidity, experience and corporate financial culture reported a heavier weight. Going slightly up, the propensity to disclose financial information ranked third again. Somewhat outweighed, financial performance continued to be a leading factor at work. The greater significance of the above two factors was by and large predetermined by the stronger impact of domestic factors on stock exchange trading. On a year earlier, access to bank financing went on the decrease due mostly to the weak growth in lending in the period surveyed. Access to foreign financing and the floating of blue-chip issues were ranked last, with the latter stepping drastically down in significance. The answers given were strongly diversified, as a result of which the various factors reported very close levels of significance.

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

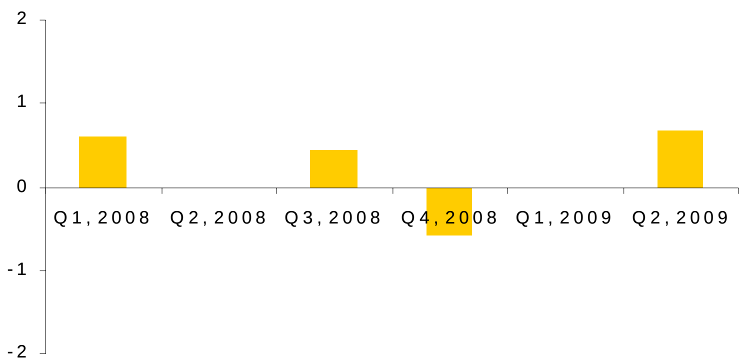


Note: The average weighted results have been obtained as the arithmetic mean of the answers given. When the indicator is close to 1, it enjoys a very high level of significance. And vice versa, when it is close to 5, it has a very low significance.

3. Collective investment schemes (CIS)

The management companies improved their expectations as to the CIS assets accumulated, having pointed to no change in the second quarter of 2008. By mid-2009, CIS assets are to go on the increase, according to 66.7% of the respondents, whereas 22.2% anticipated no change, and some 11.1% predicted to a drop in value.

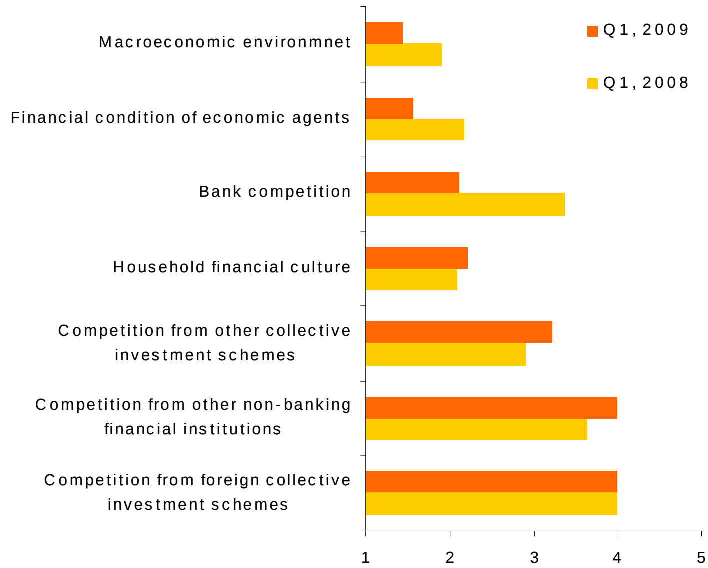
EXPECTATIONS FOR THE ACCUMULATED ASSETS IN CIS



Note: The expectations of the management companies as to the accumulated assets in the CIS are gauged on the basis of a weighted indicator. A value of the indicator close to 2 implies that the management companies expect a strong increase of the accumulated assets in the current quarter. Accordingly, a value approximating -2 indicates an expected decrease.

The factors, identified by CIS as crucial to their Q1 performance fully overlapped the factors important to the operation of the investment intermediaries for another quarter in a row. The country's *macroeconomic environment* and changes in the *financial state* of economic agents had again the upper hand. Ranked next, competition on the part of banks retained its weight. The aggressive deposit taking policies of banks, relatively high interest and viability of the local banking system made bank deposits a better option of saving for economic agents. *Household financial culture* was again considered a major factor at work, whereas *competition* on the part of other non-banking financial institutions, both local and foreign, was deemed the least important.

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



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.

Risk aversion was again the factor that enjoyed the heaviest weight in a household decision whether or not to invest their money in an investment scheme. Its significance carried on stepping up on a year earlier, having to do with the higher risk of portfolio investments. *High return on investment* went dramatically down, running negative due to the share price plunge in the Bulgarian Stock Exchange. *Tax legislation amendments*, *tax relief packages* and limited *bank lending* stepped up in importance and outweighed the risk taken by CIS in investing the assets accumulated.

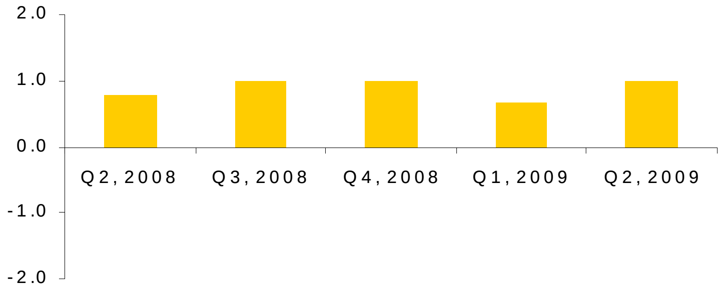
AVERAGE WEIGHTED ASSESSMENTS OF THE SIGNIFICANCE OF THE FACTORS INFLUENCING HOUSEHOLD DECISIONS TO INVEST IDLE MONEY IN COLLECTIVE INVESTMENT SCHEMES

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.

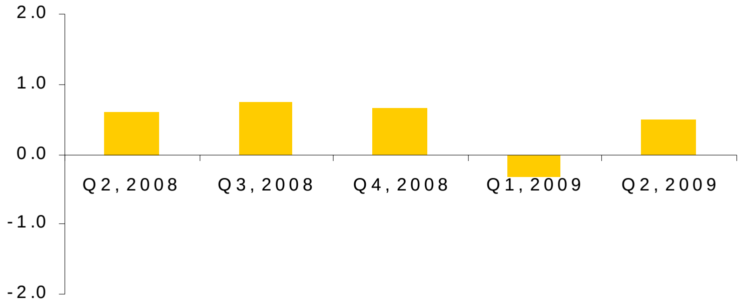
4. Pension funds

The pension insurance companies polled expected the assets accumulated under the additional compulsory insurance schemes to go on the increase. Though in a lesser degree, the same held true for the assets of the additional voluntary schemes as half of the respondents remained neutral to future developments.

EXPECTATIONS OF THE ACCUMULATED ASSETS IN THE ADDITIONAL COMPULSORY PENSION SCHEMES



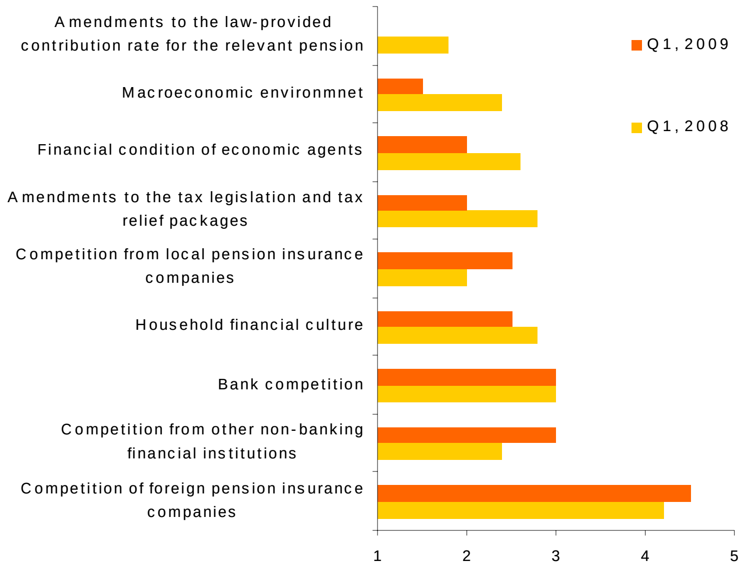
EXPECTATIONS OF THE ACCUMULATED ASSETS IN THE ADDITIONAL VOLUNTARY PENSION SCHEMES



Note: The expectations of the pension funds as to the accumulated assets in the additional pension schemes are gauged on the basis of a weighted indicator. A value of the indicator close to 2 implies that the pension funds expect a strong increase of the accumulated assets in the current quarter. Accordingly, a value approximating -2 indicates an expected decrease.

The higher contribution rate in force was considered crucial to PIF performance. Having stepped up considerably in importance on a year earlier, the country's *macroeconomic environment* ranked second, followed by the *financial state of economic agents*, which now enjoyed a heavier share in the poll. *Local competition* retained its weight, whereas *competition on the part of other financial intermediary groups* was considered the least important.

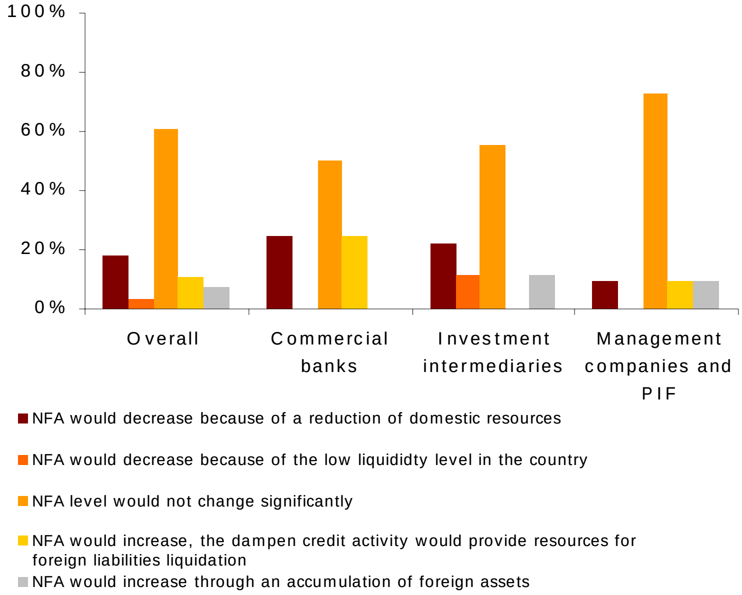
AVERAGE WEIGHTED ASSESSMENTS OF THE LEVEL OF SIGNIFICANCE OF THE FACTORS SHAPING THE PERFORMANCE OF PENSION INSURANCE FUNDS



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. EXPECTATIONS OF FINANCIAL INTERMEDIARIES AS TO THE DYNAMICS OF NET FOREIGN ASSETS

EXPECTED DYNAMICS OF NFA OF THE FINANCIAL INTERMEDIARIES



Bank lending activity in 2008 was by and large shaped by access to foreign financing most often provided by the mother companies. This was also true of non-banking financial intermediaries where foreign resources accounted for the bulk of liabilities. With a view to the difficulties the EU economies are experiencing, the dynamics of net foreign liabilities is an interesting question to tackle. At the same time, the slowdown in local bank lending may generate resources to cover foreign liabilities or augment investments abroad. All respondents were asked to answer a survey-specific question about the likely dynamics of net foreign assets by the end of the year. Some 60.7% of the financial intermediaries expected net foreign assets to remain unchanged by the end of 2009, a view predominantly taken by all financial intermediary groups, in particular the management companies and pension insurance funds. At the same time, it should be noted that the answers of the commercial banks were distinctly fragmentary. Half of them expected no significant change in net foreign assets while 25% of the banks pointed to an increase as net liabilities were to be met by way of resources generated by the lower bank lending activity. Such a structure of the answers is suggestive of a certain lack of homogeneity in the state of the banks and different net foreign asset management strategies.

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 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. Factors left out of consideration get 6. Thus, the aggregate 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 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 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 the decision of economic agents 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: Expectations of financial intermediaries as to the dynamics of net foreign assets

The respondents are asked to answer a survey-specific question (e.g. what are the expectations of financial intermediaries as to the dynamics of net foreign assets by the end of the year?). The five possible answers were as followed: a decrease in net foreign assets due to the limited domestic resources to provide for lending; a decrease in net foreign assets due to low liquidity; no significant change; an increase in net foreign assets triggered by the lower lending activity, which is expected to generate resources to cover liabilities; an increase in net foreign assets as result of the rise in foreign assets. The results have been visualized by a graph, showing the percentage of respondents, giving the respective answer, as broken down into the target groups polled.