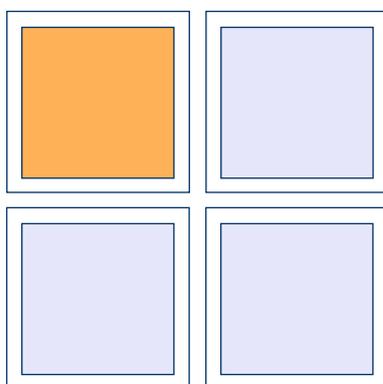
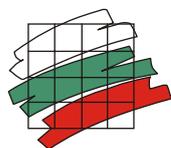


FINANCIAL SECTOR: ESTIMATES AND EXPECTATIONS



1 | 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 macroeconomic 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 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 20th November to 20th December 2007. The commercial banks that took part in the survey owned 76.9% of the assets in the banking system (as of the end of September 2007), the investment intermediaries enjoyed a share of BSE turnover of 54.9% (third-quarter data), whereas the management companies managed 43.5% of the assets of the collective investment schemes (as of the end of September 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.

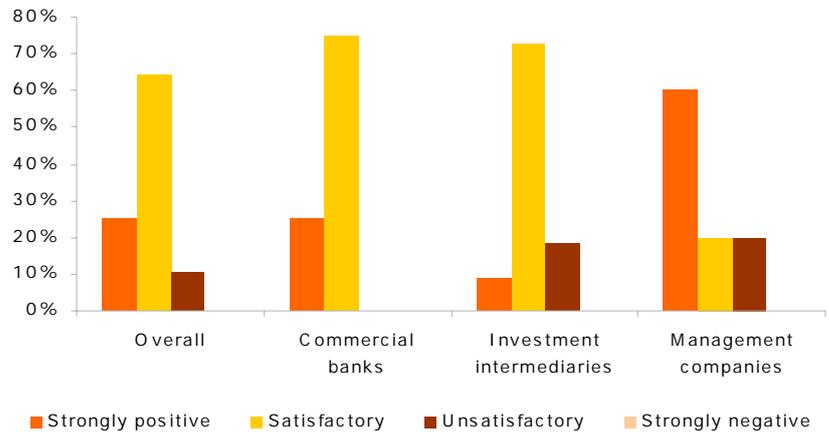
I. ECONOMIC SITUATION

1. Current state of affairs and economic growth

Financial intermediaries assessed the country's stable economic development as positive. According to the prevailing attitudes, the current state of affairs remained satisfactory (over 60% of the respondents), whereas nearly one-fourth of the respondents assessed the current economic situation as strongly positive.

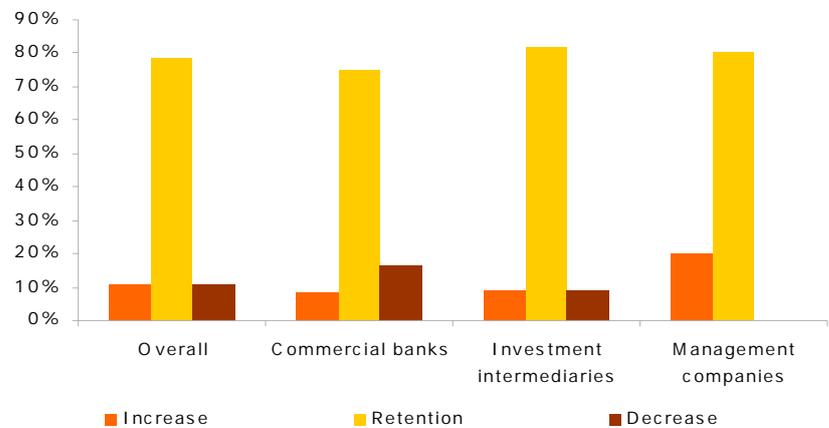
As for growth expectations, the majority of respondents expected the current growth rate in the economy to be further sustained (78.6%), with their share in the different groups of financial intermediaries remaining relatively the same. Management companies were the most optimistic, with around 20% of them pointing to faster growth in the economy. At the same time, of all groups of financial intermediaries, commercial banks were the most downbeat as to economic growth, with only 8.3% of them expecting a speed-up and around 16.7% pointing to a slowdown. However, the average weighted assessments of all groups indicated that fourth-quarter growth would be retained (see *Methodological Notes* at the back of the survey).

CURRENT ECONOMIC SITUATION



Note: the percentage of respondents, answering a question, in a given group is given for the different groups of financial intermediaries.

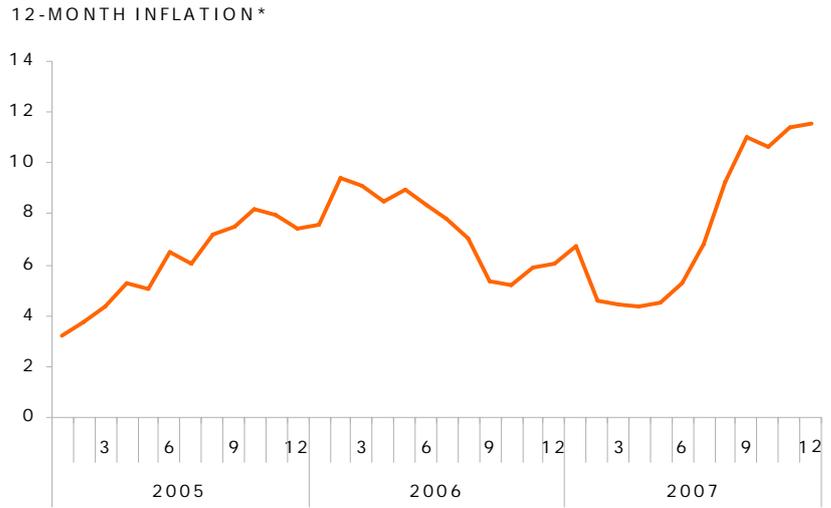
GROWTH EXPECTATIONS



Note: the percentage of respondents, answering a question, in a given group is given for the different groups of financial intermediaries.

2. Inflation

The relatively high inflation reported in the last couple of months has affected the inflationary expectations of financial intermediaries. NSI consumer and business surveys have given similar indications. Therefore, it can be assumed that the expectations of a relatively high price rise in the next 12 months are rather stable. Commercial banks reported the most moderate inflationary expectations whereas investment intermediaries and management companies anticipated a stronger increase.



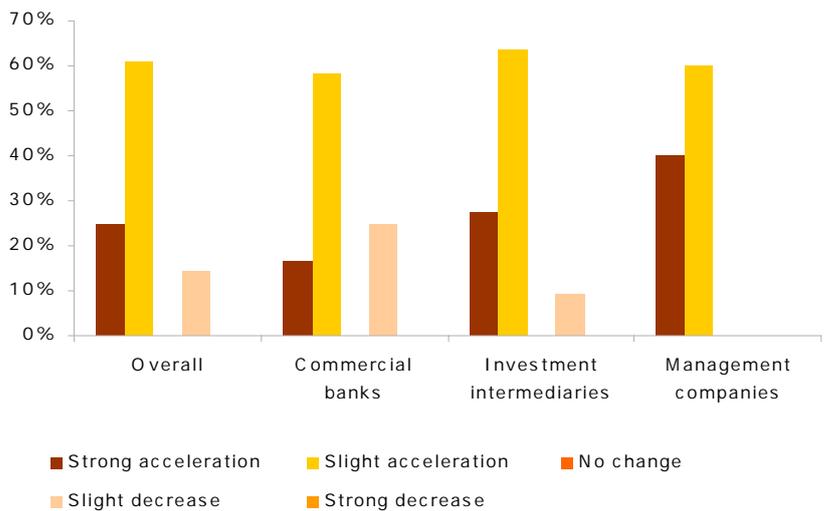
* The harmonized consumer price index

Source: NSI

3. Foreign exchange rate

The USD depreciated significantly to the EUR in the last quarter of 2007 due mainly to the stepwise cuts of 25 b.p in the benchmark rate to 4.25% in the US economy. At the same time, the European Central Bank effected no changes in its interest rate policies while placing special emphasis and enhancing price stability in the Euro area. However, the US currency gained some ground in the end of the year, following the release of data evidencing a certain increase in the key price index, which in turn gave rise to strong expectations that the feds rate would no longer be lowered. In addition, the profits realized by the market players overseas underpinned the US currency.

INFLATIONARY EXPECTATIONS FOR 2008



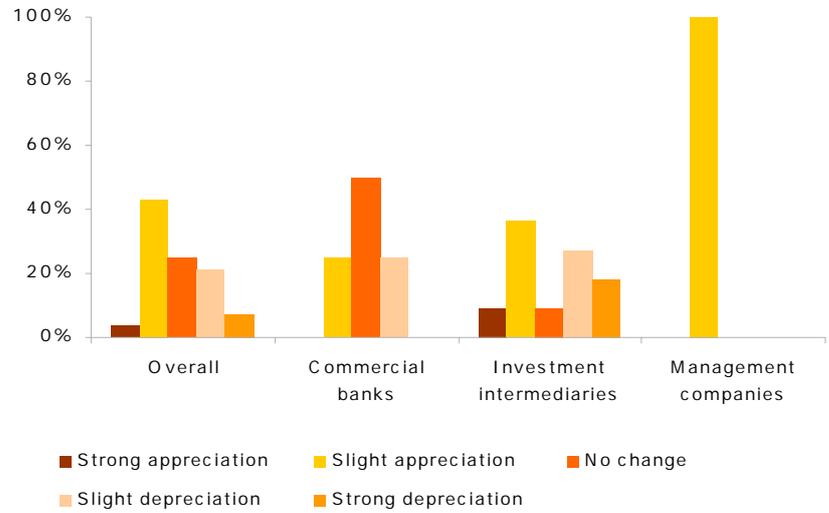
NOMINAL BGN/USD EXCHANGE RATE



Source: BNB

The expectations of the Bulgarian financial intermediaries as to the USD/BGN exchange rate dynamics differed considerably. On the whole, the respondents anticipated a slight depreciation in the USD, hence a slight increase in the local currency. Commercial banks pointed to retention of the current exchange rate levels, with some 50% of the respondents expecting no abrupt changes in the BGN exchange rate to the USD. On the other hand, all management companies expected an insignificant appreciation of the BGN. The average weighted expectations of investment intermediaries as to the nominal BGN exchange rate to the US currency indicate a slight increase in the BGN, hence an insignificantly stronger USD.

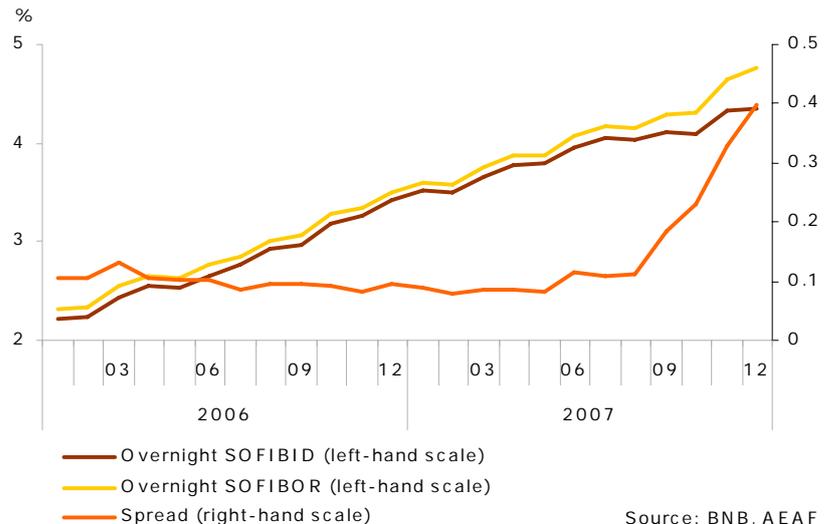
EXPECTATIONS OF THE NOMINAL BGN/USD EXCHANGE RATE



4. Base interest rate (BIR)

Interest rates in the global financial markets have been picking up at a rather fast pace since the start of the year, as spurred by the tightened monetary policies of a number of central banks and the liquidity crisis of July and August. Global market trends manifested themselves in the local economy, too with a certain lag and at a more moderate pace, though. Interest rates are expected to step up even higher as a result of BNB action to curb credit growth by increasing bank minimum required reserves in September.

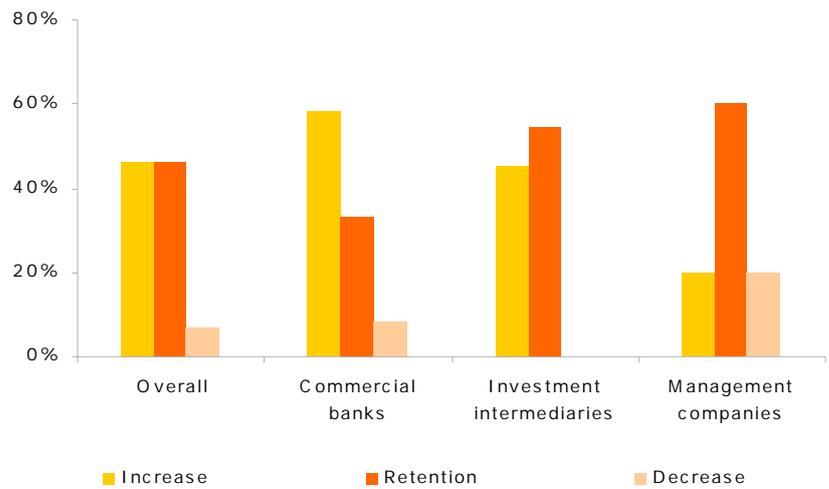
SOFIBID AND SOFIBOR



Source: BNB, AEA F

The expectations of financial intermediaries reflected partly the upward trend in interest rates. It can therefore be assumed that both commercial banks and financial intermediaries expect a stronger rise in interest rates compared to management companies. The number of respondents, pointing to no change in BIR was the same as the number of respondents, anticipating higher interest rates. All this has evidenced some uncertainty as to the interest rate dynamics in the short run. These findings have been further supported by data on the interbank market interest rates. The spread between SOFIBID and SOFIBOR has been steadily widening over the last couple of months, which together with the growing spread between short- and mid-term interest rates is an indication of market nervousness and uncertainty.

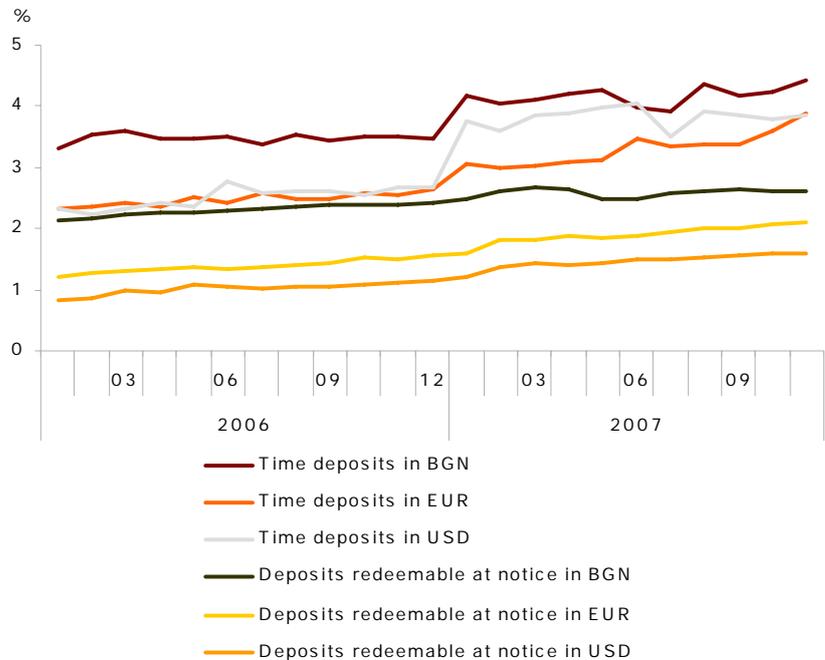
EXPECTATIONS FOR BIR DYNAMICS IN THE NEXT QUARTER



5. Deposit and loan interest rates

The interest rate dynamics in the markets worldwide and rising interest in the interbank market have also pushed deposit and loan interest rates up. This tendency was further reinforced by BNB action to curb credit growth by raising for another time the minimum reserve requirements as of last September. Deposit interest in BGN, EUR and USD has posted a most notable increase over the past couple of months. Commercial banks carried on offering deposit products at a higher interest rate, trying to pull in more and more financial resources from economic agents to provide for their lending activity. Time deposit interest in BGN and EUR stepped up at a faster rate, whereas interest rates on time deposits in USD remained relatively unchanged.

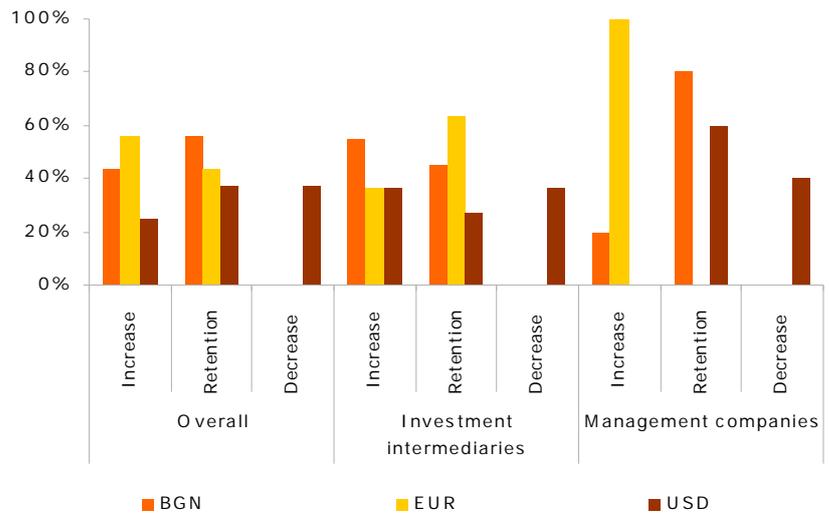
INTEREST RATES ON TIME DEPOSITS IN BGN, EUR AND USD REDEEMABLE AT NOTICE



Source: BNB

The average weighted answers to the anticipated deposit interest rate dynamics in the key currencies pointed to relative retention of the BGN deposit interest and a further rise in the deposit interest rates in EUR in the next quarter. The expectations of the financial intermediaries inquired as to the short-term dynamics of USD deposit interest are not unequivocal, and therefore impossible to strictly define due to the even distribution of answers, favouring retention of the current rates or a possible increase.

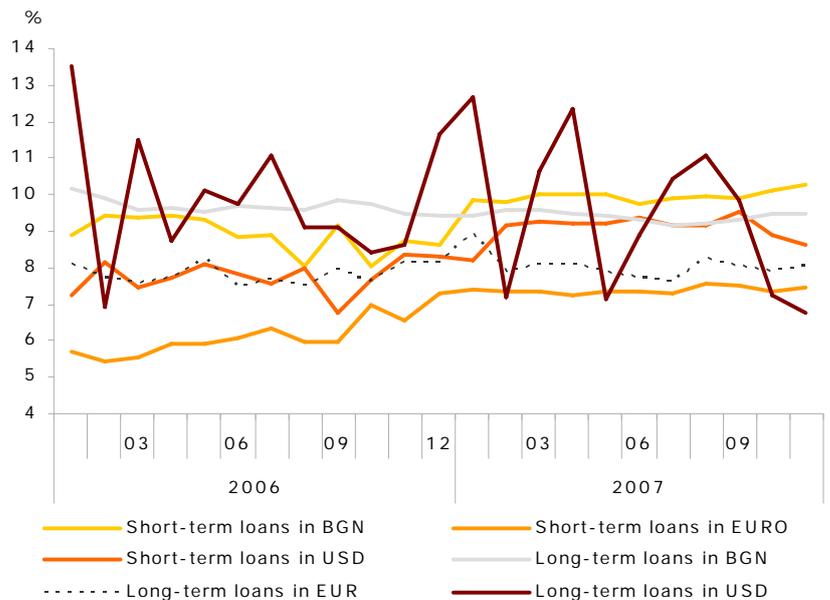
DEPOSIT INTEREST RATE EXPECTATIONS (BGN, EUR AND USD)



Note: investment intermediaries and management companies were the only ones asked this question.

The interest rates on short- and long-term loans in BGN and EUR have been steadily rising in the past few months, whereas USD credit interest has been declining. A possible explanation has to do not only with the interest rate dynamics in the interbank market, which push up the benchmark rates in setting the overall interest rate on loans, but the stronger credit demand in BGN and EUR too.

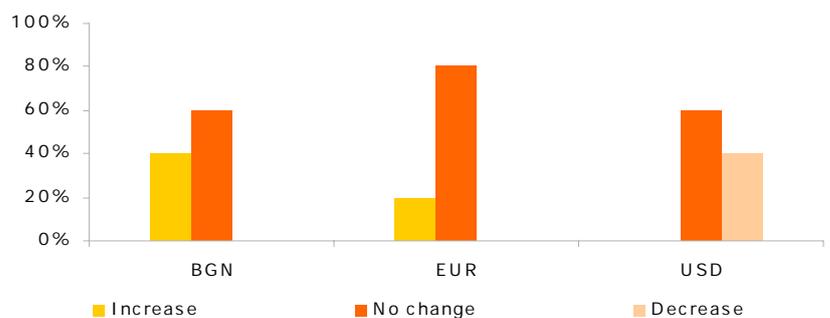
INTEREST RATES ON SHORT- AND LONG-TERM LOANS IN BGN, EUR AND USD



Source: BNB

The average weighted assessments of the loan interest dynamics in the key currencies have indicated that the current trends are expected to persist well into the first quarter of 2008, i.e. the interest rates on BGN and EUR loans will carry on rising while USD credit interest rates will further decline.

EXPECTED DYNAMICS OF THE STOCK EXCHANGE INDICES

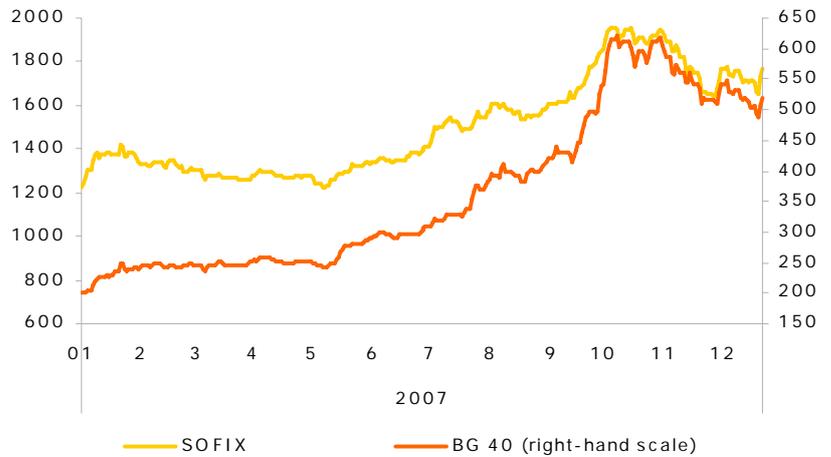


Note: Management companies were the only respondents asked to answer this question.

6. Stock exchange indices

The Bulgarian Stock Exchange indices went on the decrease in the last quarter of 2007. The usual end-of-year market repose, comparatively few public offerings, absence of fundamental reasons for a price increase in securities and higher propensity to consume were the factors, accounting for the above development. The shares of several companies with special investment purpose were floated in December resulting in market agitation and hence a positive change in BG REIT performance in early 2008.

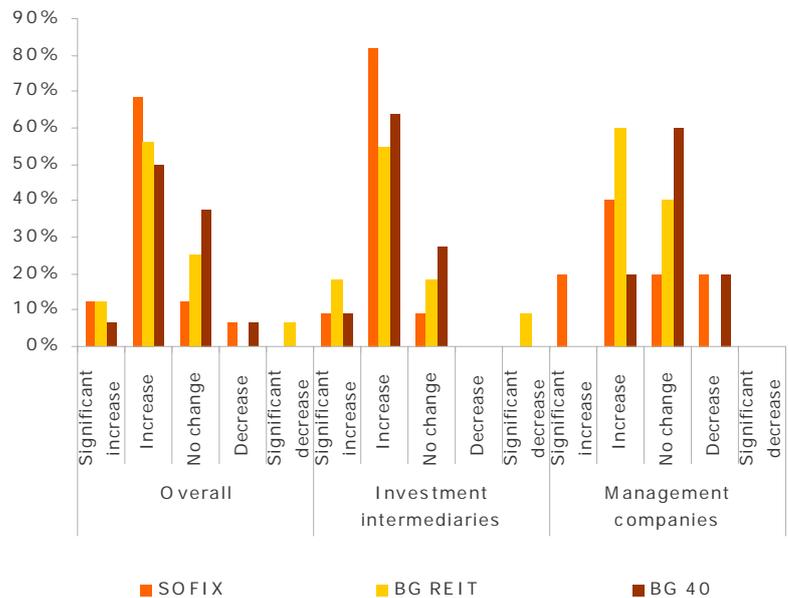
SOFIX AND BG40 DYNAMICS



Source: BSE

Both investment intermediaries and management companies remained upbeat about the 1st quarter dynamics of all the three indices. The aggregated results indicate they will carry on advancing, with SOFIX taking the upper hand. At the same time, compared to management companies, investment intermediaries were more optimistic about a first-quarter rise in SOFIX, with 81.8% of them pointing to an increase vs. some 40% of the management companies expecting an improvement. As for BG REIT, management companies took a more optimistic view, with 60% of them expecting a rise vs. 40% pointing to retention of the current levels. Most investment intermediaries (63.6% of the respondents) anticipated a stronger performance of the broad index whereas a significant part of them (27.3%) expected the index to remain unchanged. The majority of management companies did not report expectations for a change in BG 40.

EXPECTED DYNAMICS OF THE STOK EXCHANGE INDICES



II. FACTORS SHAPING THE PERFORMANCE OF FINANCIAL INTERMEDIARIES

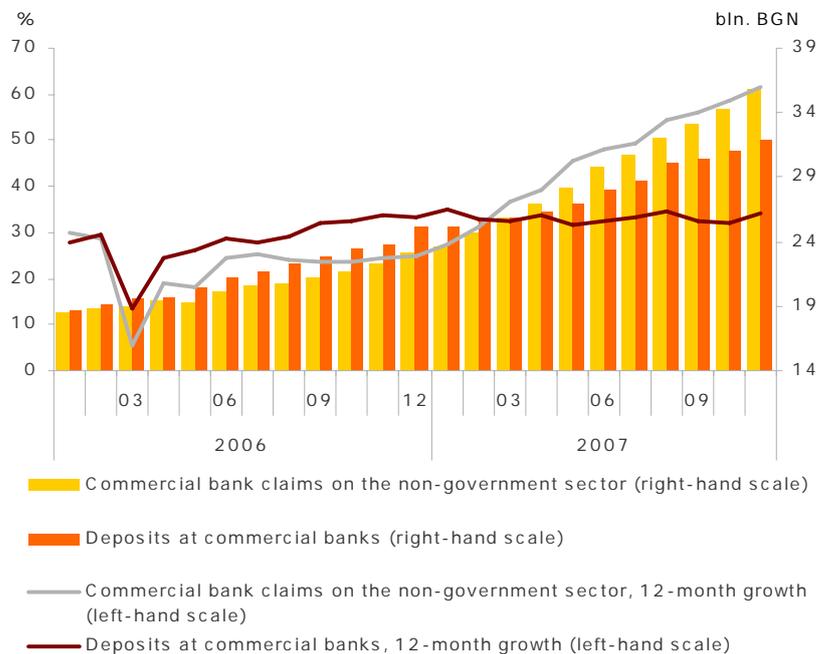
1. Commercial banks

In the survey conducted commercial banks were asked to identify the key factors affecting decision making on the supply and demand side in the last quarter of 2007. Over the same period, private-sector credit stepped up significantly (as of the end of November bank claims on the non-government sector posted a 12-month growth of 61.5%), despite the measures of the Central Bank to curb credit growth in the economy by raising bank minimum reserve requirements. At the same time, the quarter also witnessed a sustainable increase in the deposits taken from economic agents (34% up) regardless of the relatively high inflation rate reported.

Competition and macroeconomic stability are the factors that commercial banks pointed as having the heaviest weight in decision making and credit approvals. BNB measures aimed at tightening monetary policies by raising bank minimum reserved requirements were regarded as a factor of special importance to normal bank lending activity. At the same time, although a credit approval does as a rule rely heavily on the credit history and income of borrowers, the *income* factor was pointed out by only one-fourth of the respondents and outweighed by the *liquidity* factor (50% of the respondents). Most probably, the heavier weight of the latter had to do with the liquidity problems suffered by the global markets in the last quarter of 2007 which added to local market jitteriness in early 2008.

One of the reasons behind the stronger demand for credit had to do with the ever-growing needs of economic agents for operating capital

DEPOSITS AND COMMERCIAL BANK CLAIMS



Source: BNB, AEA F

WHICH WERE THE MOST SIGNIFICANT FACTORS FOR LOAN EXTENSION IN THE LAST QUARTER?

	Average weighted	Share of the banks indicating the factor
Local bank competition	2.22	75%
Macroeconomic environment	2.44	75%
Liquidity in the banking system	4.00	50%
Price dynamics	3.00	42%
BNB credit growth ceilings	2.25	33%
Amendments to the supervision regulations	2.75	33%
Foreign bank competition	3.00	33%
Competition on the part of leasing companies	3.75	33%
Change in household income	2.33	25%
Competition on the part of other non-banking financial institutions	2.33	25%
Capital adequacy of the bank	3.33	25%
Access to foreign financing	2.50	17%

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

and investment financing. It is noteworthy that the respondents were more unanimous in identifying the factors affecting credit demand rather than supply.

The aggregated results of the survey show that the factors producing the strongest effect on the credit market in the fourth quarter of 2007 had to do with competition, BNB's credit growth ceilings and ever-growing need for financing consumption and the investment process.

According to the commercial banks inquired, Q4 deposit supply was mostly shaped by economic agents' income and the terms and conditions of putting their savings in a bank. At the same time, the role of the capital market as an alternative to the traditional bank deposit has been widely recognised and was considered a relatively significant factor by one-third of the respondents. In addition, as the capital market is currently swiftly advancing, the expectations are that investment in securities will gain further momentum and the bulk of the savings in the economy will be re-channelled to capital market outlets. However, special importance was attached to bank product diversification by half of the respondents.

Deposit taking was mostly boosted by the growing income of economic agents and changes in commercial banks' credit portfolios. At the same time, a significant part of the respondents stressed the importance of the active measures undertaken by banks to attract loan resources as a way of diversifying their banking products. Furthermore, a large share of respondents pointed to credit portfolio dynamics as another important factor at work. It follows that more and more banks are now turning away from foreign financing while striving for more efficiency of liability management and diversification.

Commercial banks expect both corporate and household loans to carry on rising in volume terms. All this implies that as of today they have not regarded the Central Bank's measures to curb credit growth and curtail liquidity in economy as hampering their lending activity. However, it should be noted that the standard deviations reported by the indicators were relatively high and

WHICH WERE THE MOST SIGNIFICANT FACTORS SHAPING CREDIT DEMAND ON THE PART OF ECONOMIC AGENTS IN THE LAST QUARTER?

	Average weighted	Share of the banks indicating the factor
Need for short-term capital	2.22	75%
Income of economic agents	2.67	75%
Need for considerable investment financing	1.88	67%
Macroeconomic environment	3.14	58%
New banking products	3.86	58%
Price dynamics	2.60	42%
Better terms and conditions of borrowing	3.40	42%

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

WHICH WERE THE MOST SIGNIFICANT FACTORS FOR DEPOSITING IDLE MONEY IN A BANK IN THE LAST QUARTER?

	Average weighted	Share of the banks indicating the factor
Income of economic agents	2.00	75%
Improved deposit terms and conditions	2.22	75%
New banking products	3.17	50%
Macroeconomic environment	2.80	42%
Alternative investment in the capital market	3.40	42%
Price dynamics	3.60	42%

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

there were banks expecting a volume-term drop in loan extensions. At the same time, commercial banks on the whole anticipated a strong increase in EUR-denominated household credit. As a rule, quite a good few of the household loans extended are denominated in foreign currencies, mostly in EUR, the latter enjoying a share of 19% as of the end of November and clustering in the mortgage market segment. It can therefore be assumed that commercial banks have geared up for a persistent increase in mortgage loans in the first quarter of 2008.

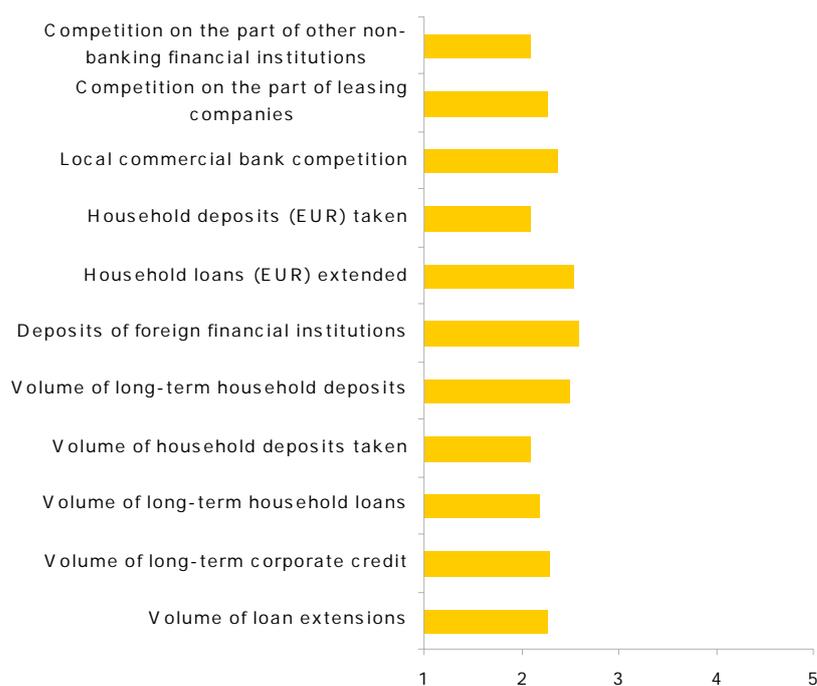
The expectations are that lending will be by and large financed by way of household deposits rather than relying on foreign loan resources. At the same time, competition on the part of leasing companies and other non-banking financial intermediaries is to step up significantly.

WHICH WERE THE MOST SIGNIFICANT FACTORS FOR TAKING DEPOSITS FROM ECONOMIC AGENTS IN THE LAST QUARTER?

	Average weighted	Share of the banks indicating the factor
Income of economic agents	1.88	67%
Credit portfolio change	2.75	67%
Diversification of banking products	2.20	42%
Macroeconomic environment	3.20	42%
Access to foreign financing	3.40	42%
Competition on the part of capital markets	3.40	42%
Amendments to BNB regulations	2.25	33%

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

EXPECTED DYNAMICS OF:



Note: 1 stands for a significant increase, 2 for an increase, 3 for no change, 4 for a decrease and 5 for a significant decrease

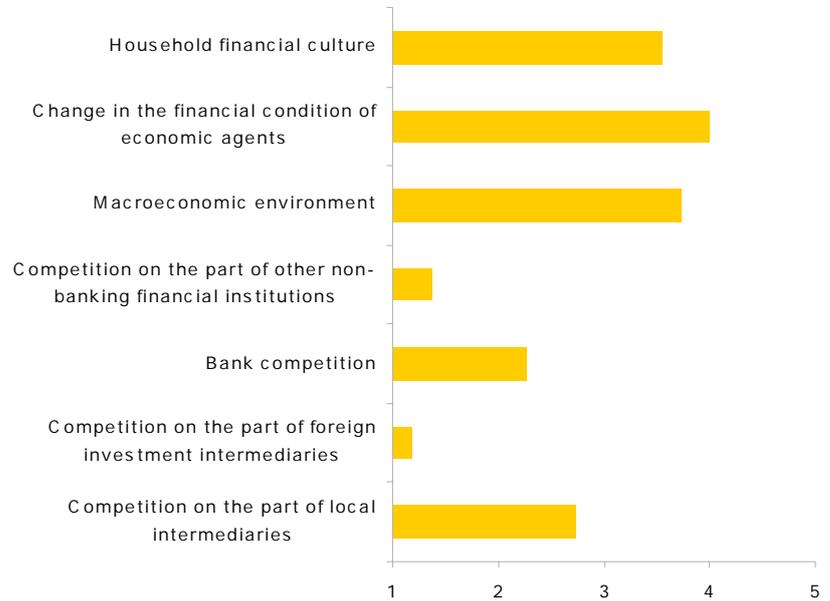
2. Investment intermediaries

Investment intermediaries were doing brisk trade throughout 2007, contracting BGN 14.7 billion worth of transactions in the nine months to October, or twice as high as the 2006 turnover. As a result, the capital market posted robust growth rates.

According to the respondents, the improved financial condition of economic agents was the factor boosting the demand for their services. *Macroeconomic stability* and *household financial culture*, too, enjoyed a rather heavy weight as factors shaping the performance of the investment intermediaries. Macroeconomic stability creates conditions for transparency and well-calculated risk, enabling intermediaries to expand, given a stronger demand on the part of investors. Household financial culture, on the other hand, also promotes the services rendered by investment intermediaries, as it helps households make the right decision as to where and how to invest their money. At the same time, competition on the part of foreign investment and other non-banking financial intermediaries was not considered a factor undermining the operations of investment intermediaries. Competition on the part of banks and other local investment intermediaries enjoyed greater significance because as it often happens it may result in a lower market share.

Floating blue-chip issues of shares and bonds is crucial to keeping a bull market run. As it often happens several new offerings may drive the whole market up. However, whether to raise capital in the financial markets or borrow a loan instead is ultimately a company's decision. Investment intermediaries assessed the propensity to disclose information as the factor having the strongest effect on a company's decision to list on the stock exchange. Second in importance ranked the floating of blue-chip issues that may propel the market to record highs. (This may, in turn, raise the price of a company's

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



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

shares when going public.) Experience and corporate financial culture were also considered important factors to a company's decision to list on the stock exchange. At the same time, capital market liquidity and access to bank financing were pointed out as the least significant factors. The low significance attached to bank lending and higher number of companies listed on BSE¹ indicate that companies have become more aware of the opportunities given by the capital market to raise capital. It should be also noted that the answers of the respondents to the significance of the factors listed above differed considerably.

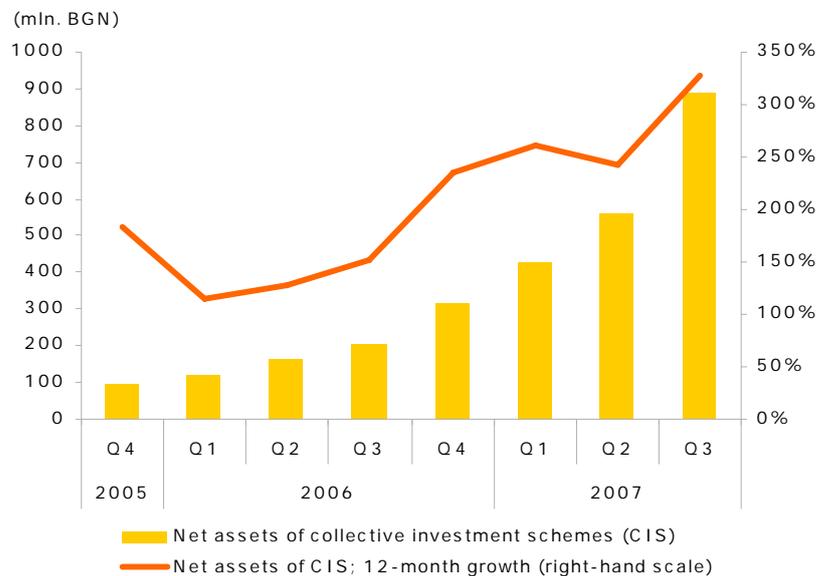
3. Collective investment schemes

Collective investment schemes (CIS) have been performing rather robustly in the last couple of years and managed to pool in large amounts of resources. They have been given further impetus by some legal amendments introducing contractual funds. Net assets were growing at a healthy 12-month clip, amounting to BGN 890.2 million as of the end of September, having tripled on a year earlier

The aggregated expectations of the management companies pointed to a steady upward trend in CIS assets, with some 60% of the respondents anticipating a rise in the first quarter of 2008. The rest of the respondents expected assets to remain unchanged. The expectations for a

more moderate Q1 rise (compared to the nine months to October 2007) or even retention of the Q4 levels are indicative of some uncertainty as to the short-term CIS asset dynamics. However, the fact remains that the respondents were not unanimous as to the indicator's movement and its magnitude in the short run due to the wide capital market fluctuations and Q4 corrections reported by a big number of companies traded in the stock exchange.

NET ASSETS OF COLLECTIVE INVESTMENT SCHEMES (CIS)

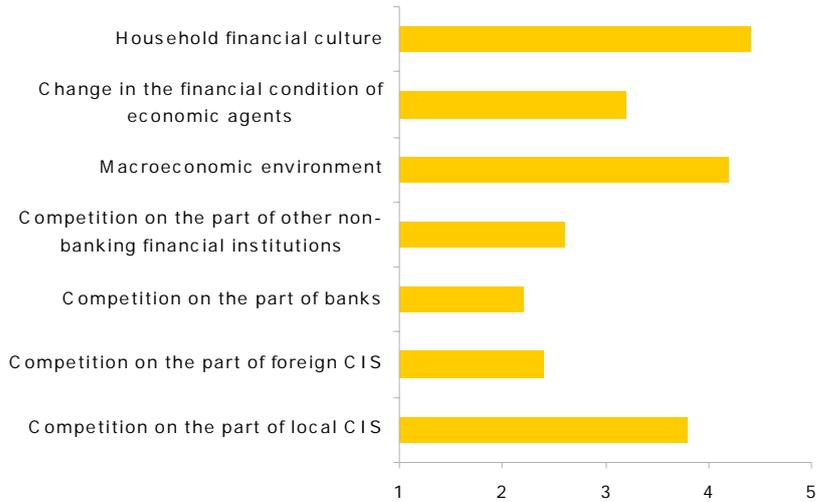


Source: FSC, AEA F

¹ As of the end of 2007, the companies listed on BSE numbered 369, going up by another 5 in the last quarter only.

The performance of the collective investment schemes is shaped by a number of factors that are key to a household decision to mobilize idle money in CIS as well as by factors which are decisive to the development of the schemes themselves. Drawing upon the findings of the surveys, it can be said that there are two factors that are crucial to a household decision to invest or not in a collective investment scheme. All the respondents emphasized the relatively high return as the first and foremost household economic consideration. CISs are characterized by greater diversification of their investment portfolio. They invest in both safer and riskier instruments, bearing a fairly good yield. This is further evidenced by the return on investment reported by some investment companies and contractual funds, which varied from 4.40 to over 190% on an annual basis as of the end of September. Second in significance came risk aversion. At the same time, respondents identified *amendments to the tax legislation, possible tax relief packages and plans, as well as limited bank lending* as the least important to a household decision to invest money. Furthermore, a likely change in the loan extension amounts will not affect significantly the investment intentions and willingness of households, which in turn implies that they rely on their own sources of income rather than loan resources.

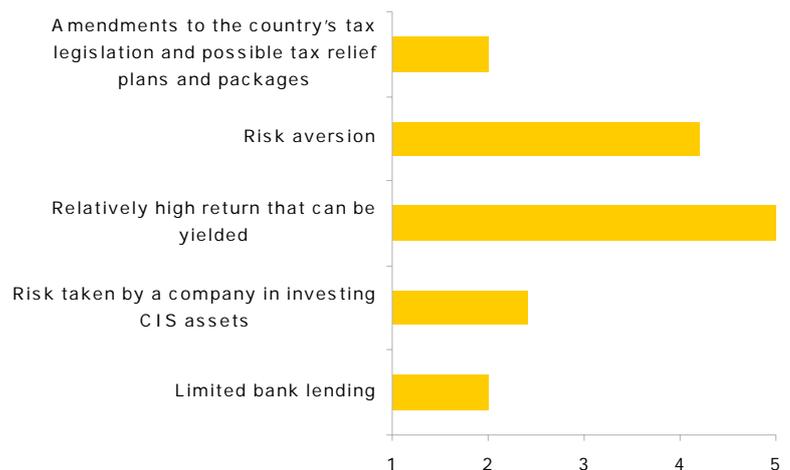
AVERAGE WEIGHTED ASSESSMENTS OF THE SIGNIFICANCE OF THE FACTORS SHAPING CIS PERFORMANCE IN THE FOURTH QUARTER OF 2007



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

The respondents have also identified the factors that are crucial to the performance of the CIS segment of the financial market, i.e. *household financial culture* and the country's *macroeconomic stability*. Macroeconomic stability provides for the long-term income growth in the economy, augmenting the pool of assets managed by CIS. Another important factor shaping their performance has to do with the stiff competition in the market segments, promoting innovative schemes of participation with diversified investment portfolios. As of the end of September, the number of CIS had stepped up to 61 vs. 39 on a year earlier. At the same time, competition on the part of banks was pointed out as the least important factor at work behind the development of the market segment, with only 20% of the respondents giving it an A+ ranking.

AVERAGE WEIGHTED ASSESSMENTS OF THE SIGNIFICANCE OF THE FACTORS THAT ARE DECISIVE TO HOSEHOLD DECISIONS TO PUT IDLE MONEY IN CIS



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

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. In addition, some of the target groups have been asked to answer specific questions about the loan and deposit interest rate dynamics and expected performance of the stock-exchange indices. The expectations of the different groups of financial intermediaries have been visualized by way of graphs, accounting for the percentage of respondents, giving the relevant answer. Furthermore, the groups of financial intermediaries have been broken down into subgroups as follows: commercial banks, investment intermediaries and management companies.

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 results for each indicator are obtained as the arithmetic mean of the weights stated.

Investment intermediaries and management companies

The special part of the survey, which had to be filled in by the 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.
