

BULGARIAN MACRO ECONOMY OVERVIEW: 4Q 09

Banks Well Provisioned against Growing NPLs

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4Q 09

Economy Overview

SUMMARY

Section I: Bulgarian Economy Overview

- A. Lower purchase power and drying FDI inflow decreased Bulgaria's real GDP by 5.1% to €33.8B in 2009. (see p. 2)
- A. FDI inflow dropped by 57% YoY to €2.84B. Real estate and construction works were hit worst by the Crisis. (see p. 3)
- A. Annual inflation reached 0.6% from 7.8% in 2008. (see p. 4)
- A. C/A and foreign trade deficits decreased significantly as well. (see p. 5)
- A. GED slightly increased to €37.6B as of December 2009. (see p. 6)

Section II: Bulgarian Banking Sector

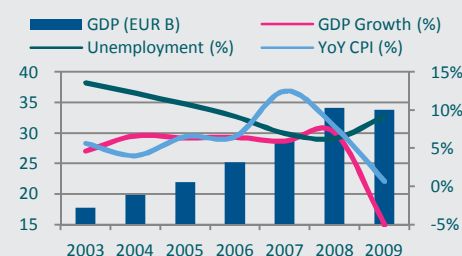
- A. Bulgaria's Banking System remained stable, liquid and profitable throughout 2009. (see p. 8)
- A. BIR dropped to 0.55%, but the volume of loans remained relatively unchanged. (see p. 8)
- A. Banks' reserves and long FCY positions increased significantly. (see p. 9)
- A. The shares of FCY-denominated loans and deposits increased to 62.4% and 63%, respectively. (see p. 10)
- A. NPLs reached 6.07%, but the System is sufficiently provisioned against losses. (see p. 10)

Table 1: Basic Bulgarian Economy Indicators

	2005	2006	2007	2008	2009
GDP (€M)	21,889	25,238	28,898	34,118	33,846
Real GDP Growth (%)	6.2	6.3	6.2	6.0	-5.1
Current Account (€M)	-2,706	-4,648	-7,274	-8,653	-2,912
Trade Balance (€M)	-4,410	-5,562	-7,245	-8,597	-4,084
FDI (€M)	3,152	6,221	8,596	6,549	2,845
• FDI / GDP (%)	14.4	24.7	29.7	19.2	8.4
• FDI / CA (%)	116.5	133.9	118.2	75.7	97.7
Unemployment Rate (%)	10.7	9.1	6.9	6.3	9.1
Avg. Monthly Wage (€)	166	184	220	279	302

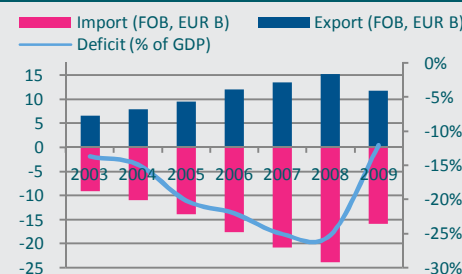
Source: BNB, NSI

Chart 1: GDP, CPI and Unemployment Rate



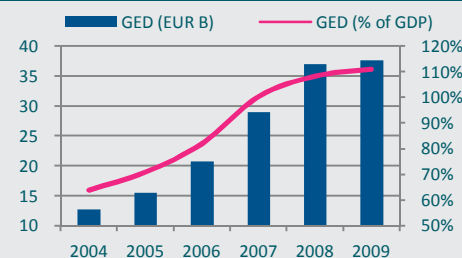
Source: NSI

Chart 2: Foreign Trade Deficit



Source: NSI, BNB

Chart 3: Bulgarian Gross External Debt



Source: BNB

I. BULGARIAN ECONOMY OVERVIEW

GDP and GVA

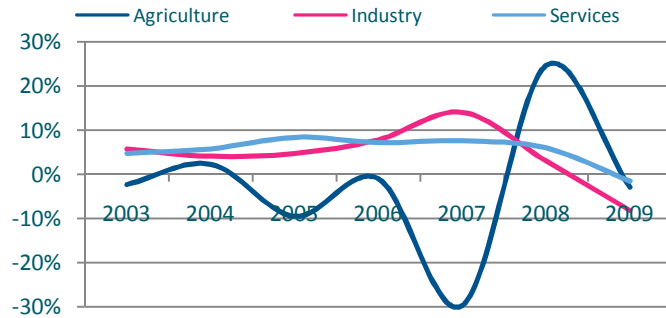
Bulgaria's real GDP dropped by 5.1% YoY in 2009...

Lower purchase power and drying FDI inflow decreased Bulgaria's real GVA by 3.6% YoY to €28.4B in 2009, while adjustments dropped by 11.9% YoY to €5.4B. As a result, Bulgaria's GDP also registered 5.1% negative growth rate and reached €33.8B.

Industry suffered the worst hit by the Crisis and dropped by 8.1% YoY. Although there is some improvement from 2Q 09's -9.7%, it can hardly be considered optimistic.

...due to the lower GVA of Agriculture and Industry, ...

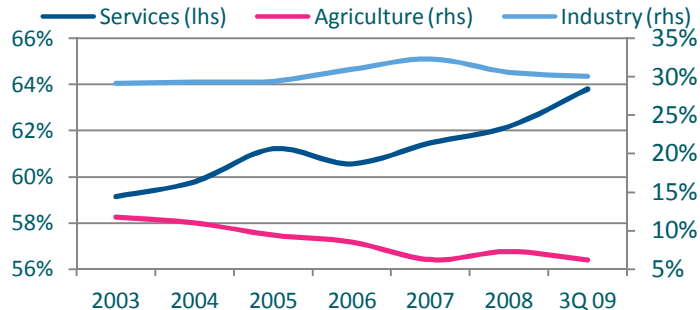
Chart 4: GVA Components –Real Growth



Source: NSI

As seen from Chart 4, the Agriculture has the highest extent of volatility among the GVA components. Following 2008's exceptional yield, the sector's value-added registered negative real growth and dropped from €2.05B in 2008 to €1.76B in 2009.

Chart 5: GVA Components by Share



Source: NSI

...while Services remained the only sector with stable performance throughout the year.

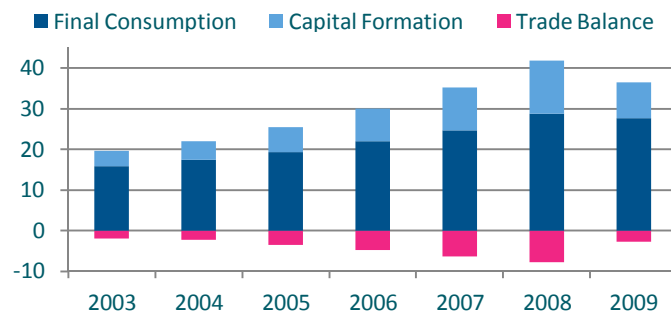
Services registered 1.9% real growth as of 1H 09, but the sector was not spared by the Crisis and ended the year at negative 1.5%.

Capital formation decreased by 32% YoY from 13B in 2008 to €9B in 2009.

As a result, the shares of Agriculture and Industry decreased by 1.1% and 0.5% YoY to 6.2% and 30%, respectively, at the expense of Services that already accounted for 63.8% of the total GVA.

Analysis of the expenditure approach for measurement of the GDP shows that the main reason standing behind the negative development of the economy is the 31.8% lower capital formation (€9B in 2009 vs. €13.1B in 2008), that was only partially covered by the improvement of the foreign trade deficit (€2.7B in 2009 vs. €7.8B in 2008).

Chart 6: GDP – Expenditure Method(€B)



Source: NSI

Overall, the relatively stable performance of the sector of Services was the only factor that protected Bulgaria's GDP from even stronger collapse, given its large share in the GVA of the economy.

The economy has solid funding potential, but the business cannot make use of it...

The stable and liquid Banking System, the availability of EU subsidies and funding from the European Investment Bank are real sources of capital for the economy and the real issue of the Bulgarian business is the lack of relevant projects and/or the inability of the SMEs to qualify for this funding. The country's low budget deficit (0.75% of the GDP) also provides for the cheaper and easier potential funding of the local entrepreneurs.

A gulp of fresh air for the private business is the redemption of the delayed payment of State debt that is expected to take place in the next few months, according to the information announced by the Government.

...and real GDP growth is not expected before the second half of 2010.

Positive real growth of the GDP is expected in the second half of the year, but it depends on the economy's ability to meet the challenges of the Financial Crisis, the crisis in Greece and the successful completion of the local political reforms.

Foreign Direct Investments

The inflow of FDI dropped by 5.8%

FDI inflow dropped by 5.8% on quarterly basis and by 57% YoY to €2.84B in

YoY to €2.8B in 2009...

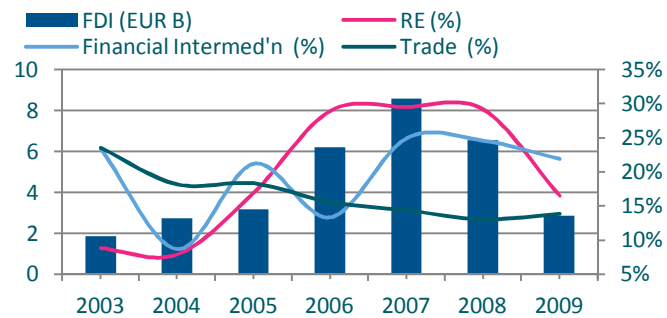
...and the sectors of real estate and construction works were hit the worst.

Social pressure and neglected infrastructure may result in State investments.

Cheaper food pushed Bulgaria's CPI down from 7.8% in 2008 to 0.6% in 2009...

2009. The sectors of real estate (-75% YoY), construction works (-65% YoY), financial intermediation (-61% YoY), trade (-54% YoY) and manufacturing (-51% YoY) were the worst hit by the international Credit Crunch, yet they attracted the biggest inflow of FDI in 2009.

Chart 7: FDI Inflow by Sector



Source: BNB

Foreign investments in the real estate sector decreased by €1.4B YoY and by €2.1B, compared to 2007, which put Bulgarian construction companies and RE agents on the edge of the bankruptcy.

Financial Minister Simeon Dyankov concentrated on the provision of a balanced fiscal budget as of the end of 2009, in order to prepare Bulgaria for its accession to the ERM II, but the critical condition of the construction companies, resulting in social pressure and growing unemployment rate, in addition to the sharp need of refurbishment of the national infrastructure (roads and highways; heat, sewage and water supply pipelines; irrigation channels; water purifying stations, etc.) – subject of numerous critics on behalf of the EC – may eventually result in significant State investments in large infrastructural projects.

So far, the bulk of the FDI in Bulgaria was speculative, with low rates of reinvestment and aiming at high profits and quick market exit. The low budget deficit, the stable banking system, the lowest corporate income tax and production costs in the EU and the attempts of the new Government to fight organized crime and corruption are expected to increase the volume of strategic long-term foreign investments in outsourcing, manufacturing, IT, etc.

Consumer Price Index

3.4% lower price of food and 2% cheaper housing pushed Bulgaria's annual inflation down from 7.8% in 2008 to 0.6% in 2009.

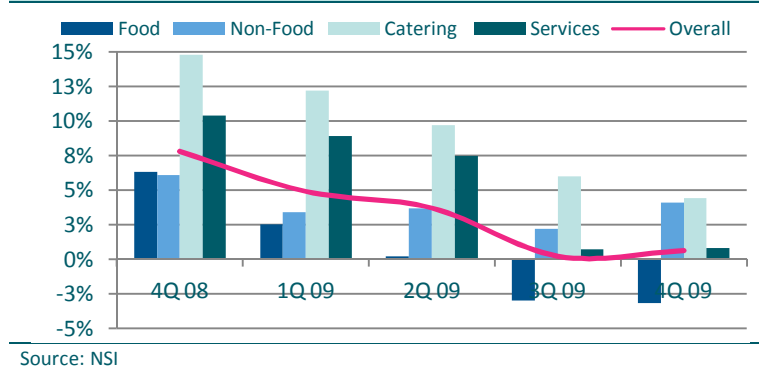
Alcohol, education and healthcare registered the biggest price growth, but their relatively smaller weights in the Bulgarian consumer basket limited their

...and we expect that it will remain stable in the near future.

influence on the total CPI.

Considering the Currency Board, pegging the BGN to the Euro (€1 = BGN 1.95583), and the expected negative real growth of the GDP, we expect that Bulgaria's CPI will remain stable during the first half of the year.

Chart 8: Annual Inflation by Components



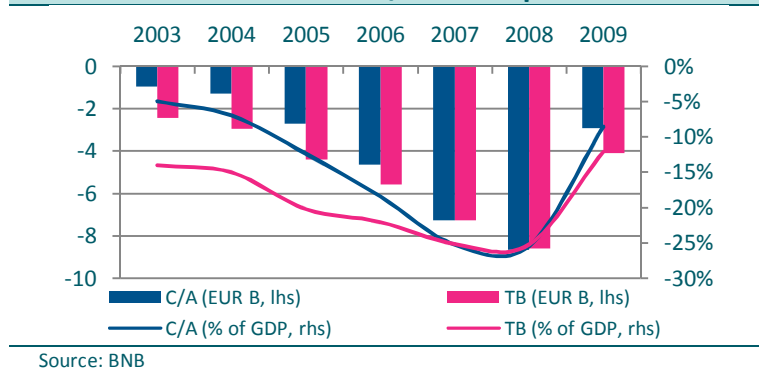
Source: NSI

Current Account and Foreign Trade Balance

C/A and trade deficits decreased significantly...

Following several years of strong foreign trade and current account deficits, they both registered significant improvement and decreased as a percentage of the GDP from 25.2% in 2008 to 12.1% in 2009 and from 25.4% to 8.6%, respectively.

Table 9: TB and C/A Development



Source: BNB

As seen from Chart 2, the improving trade balance made the lower inflow of FDI sufficient to cover 98% of the C/A deficit – an important factor, providing for the higher supply with money and, respectively, the lower interest rates.

...due to the 33% lower import YoY in 2009.

Decreased purchase power of the population dried the demand for fuels, machinery and materials, cutting import 33% down YoY to €15.6B – the lowest level since 2005, while export dropped by 22% YoY only to €11.8B.

As a result, both the foreign trade and the current account deficit decreased to €4.1B (12% of GDP) and €2.9B (8.6% of GDP), respectively.

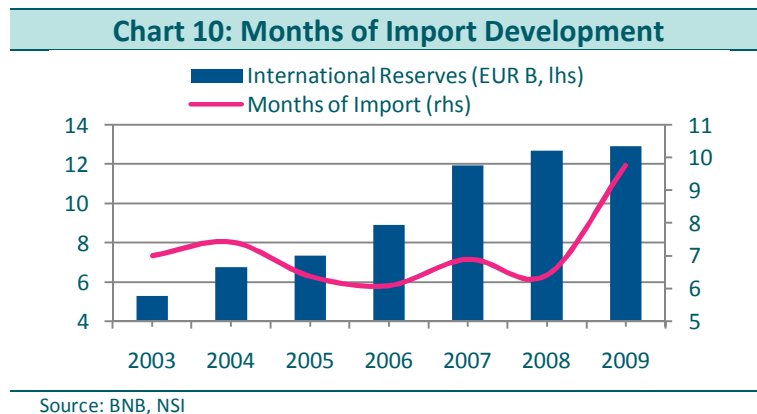
The FDI inflow covered 98% of the C/A deficit, ...

€MM	2008	2009	+/-	% Chg.
TB (FOB)	(8,597)	(4,084)	4,513	-52%
• Export (FOB)	15,204	11,784	(3,421)	-22%
• Import (FOB)	23,801	15,867	(7,934)	-33%
C/A	(8,653)	(2,912)	5,741	-66%
FDI	6,549	2,845	(3,704)	-57%
FDI / CA (%)	75.7%	97.7%	22%	29%
BNB Int. Reserves	12,713	12,919	206	2%

Source: BNB

As BNB's International Reserves increased by 2% in 3Q 09 to €12.4B, they were sufficient to cover Bulgaria's import for 9.8 months, compared to 6.4 months in 2008 and 9.5 months as of September 2009.

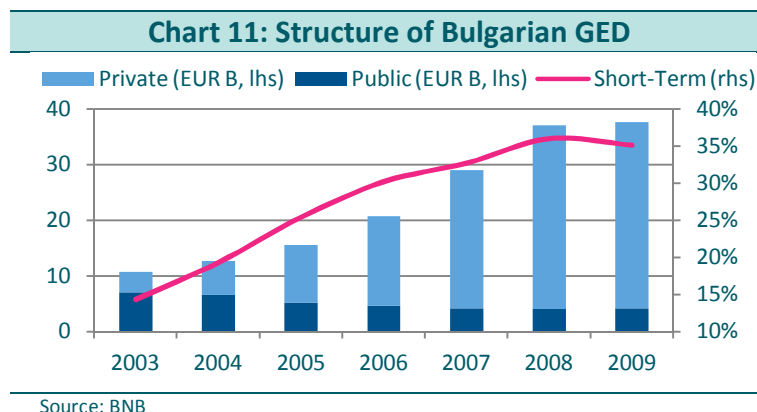
...while the BNB's international reserves were sufficient to cover the country's import for 9.8 months.



Gross External Debt

GED slightly increased to €37.6B in 2009.

Both public and private external debt increased by €169MM and €0.458MM, respectively, pushing Bulgaria's GED up by 2% YoY to €37.6B in 2009.



The share of short-term debt reached 34.6%, compared to 35.5% in 2008.

Short-term debt decreased by €106MM YoY to €13B or 34.6% of the total GED in 2009, compared to €13.1B or 35.5% of the GED in 2008.

The stable condition and the high liquidity of the Bulgarian banking system make us expect rather limited growth of the country's GED in the near future, because the major issue of the local economy is not the lack of capital, but the lack of good investment opportunities and the decreased volume of orders for the manufacturing industry.

Another source of potential GED growth is State investment in large-scale infrastructural projects that would most likely increase the long-term public debt.

II. BULGARIAN BANKING SECTOR

Overview

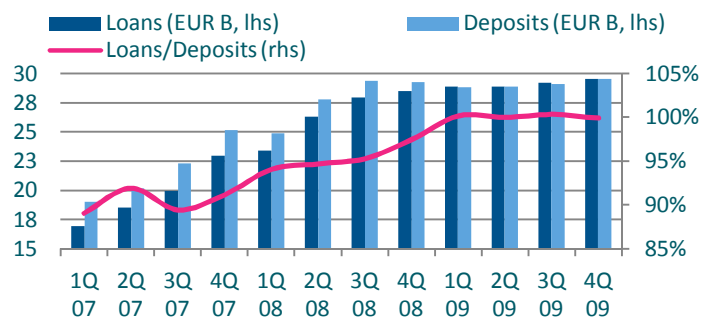
Bulgaria's Banking system was stable and liquid, ...

Bulgaria's Banking System remained stable, liquid and profitable. Total assets increased by 1.9% to €36.2B, while total liabilities remained stable at €31.4B YoY in 2009.

The System's capital adequacy ratio improved from 14.86% in 2008 to 17.04% in 2009, while the liquid assets ratio reached 21.90% from 21.71% in 4Q 08 and 20.82% in 3Q 09.

The loans-to-Deposits ratio decreased from 100.3% in 3Q 09 to 99.9% as of the end of the year, but increased by 2.5% on annual basis.

Chart 12: Loans and Deposits



Source: BNB

..while profitability decreased, yet remained positive.

The Crisis hampered profitability and net income decreased by 44% YoY from €709MM in 2008 to €0.399MM in 2009.

Overall, Bulgaria's Banking System remained stable, with high levels of liquidity and capital adequacy, and managed to avoid losses during the worst period of the Crisis, so far.

4Q 09 Summary

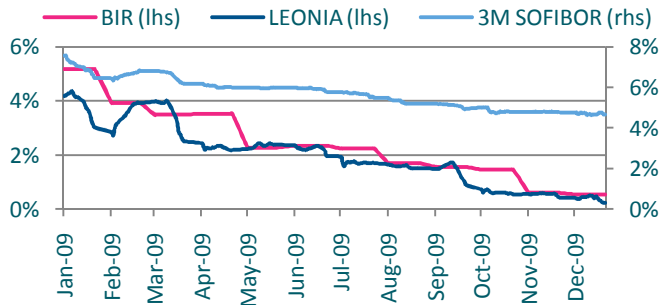
BIR dropped to 0.55% in December 2009, ...

The Base Interest Rate dropped from 1.57% in September to 0.55% in December 2009, but the total volume of loans registered only fictitious growth throughout the year, as seen from Chart 12 above.

...but the volume of loans did not increase significantly...

In other words, the interest rates decreased, but the banks are not prone to provide funding due to the high volatility of the local companies and their strong dependence on the currently stagnated EU economies.

Chart 13: BIR, LEONIA & 3M SOFIBOR

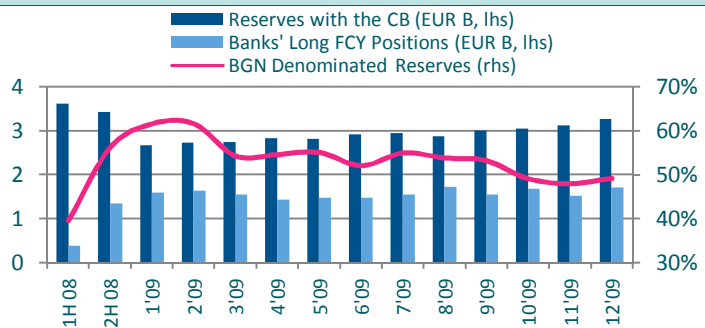


Source: BNB

...and banks' reserves with the Central Bank increased.

As a result, the Banking System's reserves with the Central Bank increased by whole 8.6% during 4Q 09 to €3.3B. Banks' FCY long position increased by 9.9% to €1.7B as well.

Chart 14: Banks' Reserves with Central Banks

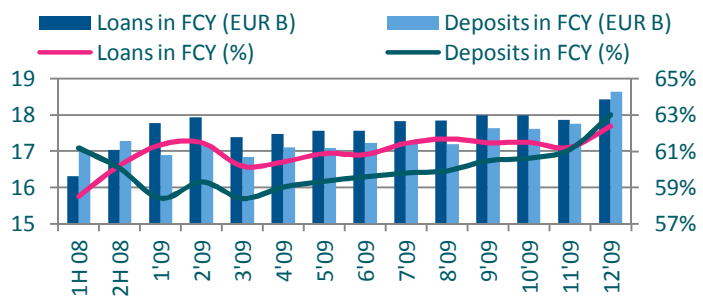


Source: BNB

The shares of FCY-denominated loans and deposits continued growing.

The shares of FCY-denominated loans continued growing to 62.4%, which means that both parties prefer operations in FCY due to the higher extent of security (banks) and the lower price (customers).

Chart 15: Loans & Deposits- CY Structure



Source: BNB

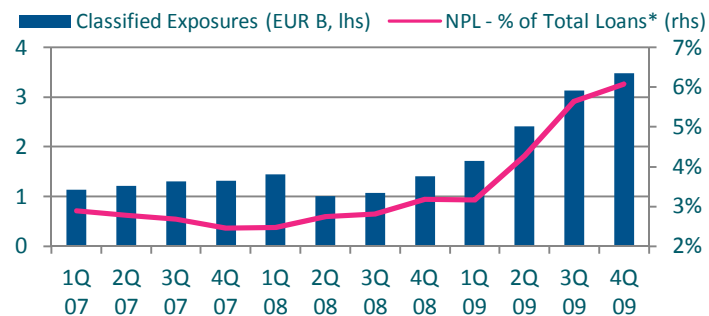
As seen from Chart 15, immediately after banks started stabilizing the interest

NPLs increased...

rates for deposits in BGN, the share of FCY-denominated ones increased steadily and currently accounts for 63% of all deposits, compared to 58.4% in 1Q 09.

Non-Performing Loans continued growing and remained the main issue and concern of the Bulgarian Banking System. The total amount of NPL and write-offs increased by 149% in 2009 to €3.48B or 6.07% of the total loans (excl. loans to credit institutions), compared to 4.27% in 1H 09 and 3.17% in 4Q 08.

Chart 16: Classified Exposures and NPL



¹ – NPL + write-offs as a percentage of Total Loans (excl. Credit Institutions)

Source: BNB

...but the System was sufficiently provisioned against write-offs.

Despite that, the actual results are better than the most pessimistic expectations and the classified loans are currently sufficiently provisioned. Although the increase in write-offs is an undeniable negative, the registered decrease in the exposures over 90 days due (€522MM in 4Q 09 vs. €552MM in 3Q 09) can be considered slightly optimistic, if we are brave enough to accept that the number of insolvent clients has started to decrease.

Summary

Bulgarian banks emphasized on liquidity, instead on profitability...

Emphasizing on liquidity, instead on profitability, Bulgarian Banking System remained stable throughout 2009, which can be considered a major achievement, given the international lack of liquidity and the growing share of NPLs in the country.

BNB cut the BIR to unprecedented levels and did actually manage to cut the interest rates, but the banks' pursuit of stable performance, at the expense of high returns, limited the volume of new loans.

...and had sufficient resources to provide funding to prospective clients.

Despite that, the System has the capacity and the potential to provide funding to high-quality and perspective projects, as announced by bankers, and the lack of new large-scale investment enterprises rather speaks of the shortage of such projects, than on the lack of available resources.

The growing NPLs were the major issue of the sector.

Both banks and clients prefer FCY-denominated operations, driven by the lower risk and price. As a result, the shares of both loans and deposits in FCY continued growing and reached 62.4% and 63%, respectively.

The increasing volume of NPLs remains the major issue and concern of the banks, but the actual results are better than the worst expectations and the Banking System is currently well provisioned against losses.

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