[The change of banking system in Bulgaria throughout the years]

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Introduction

The Bulgarian banking system has a two-stage nature, characteristic of most market economies. On the first level, the Bulgarian National Bank (the central bank) is located with the main objective of maintaining price stability through securing the stability of the national currency by conducting monetary policy in accordance with statutory requirements, it also supervises the activities of other banks in the country for the purpose of maintaining the stability of the banking system, etc. A variety of universal banks is located on the second level, operating on competitive principles' these are the main suppliers of external financing for economic agents.

In recent years, the favorable external and internal environment appeared to provide a good basis for the growth of the banking sector and for maintaining its stability.

By 1 January 2007 – the date of the full membership of Bulgaria of the EU – the main indices characterizing the condition of the system were as follows: assets amounting to BGN 42.2bn (€21.6bn), reflecting a growth of 28.3% compared to the preceding year; and a realized profit amounting to BGN 786m – up by 37.2% on the preceding year. Despite the strengthening competition on the credit market in terms of interest rate levels for credit and the increase in the price of borrowed funds, the return on assets and the return on equity report quite good values: respectively 2.15% and 23.7%. [1]

In comparison, the average return on assets in the EU is about 1.2% and approximately 1.6% on equity. The improvement of the quality of the credit portfolio is also reported, the percentage of regular credit having increased from 92.3% at the end of 2005 to 93.9% at the end of 2006.

The Currency Board introduced after the unprecedented scale of the financial crisis in 1997 laid the beginnings of a new stage of economic development in Bulgaria.

The crisis provided a stimulus for the process of the reform of the banking sector. A substantial part of state-owned banks was taken private by strategic EU foreign investors, among which are leading names in the financial business, such as UniCredit, NBG, SG, OTP, EFG Eurobank, etc. The positive effect of privatization is significant – bank management improved; investments in new

[1] www.bnb.bg

technologies and know-how increased; and competition in the banking sector gradually increased, hence the variety and quality of services. As at the end of 2006, about 75% of assets in the banking system are managed by financial institutions with residences in member countries of the EU. In recent decades, the structure of banking systems worldwide has been undergoing deep changes. The entrance of foreign banks is a dominant and characteristic feature of that process, foreign banks (or domestic banks with foreign participation) in a number of countries have been becoming major players in domestic financial markets. It is assumed that the increased presence of foreign banks, especially in developing countries, is a result of the financial liberalization processes of local economies but, in some countries, banking crises and the consequent necessity of resources for the recapitalization of the banking system has helped the accelerated entry of foreign players.

Two main ways through which this has been done are known from practice: firstly, the acquisition of an existing domestic bank; and, secondly, an independent presence through an office or a branch. The separation of these two ways is of substantial significance as entry to a foreign market through independent representation increases the number of banks and the rate of competition , while the acquisition of operating banks is, in most cases, effected through mergers and takeovers which may reduce the number of credit institutions and the rate of competition .

Accordingly, the internationalization of banking systems is a result of increasing foreign direct investment in the non-financial sector. Increased competition in the Bulgarian banking market is a result of the entry of foreign banks, as well as resulting from the integration of Bulgarian banks in an over competitive European financial market after the accession of the country to full membership of the EU, imposes on banks the need to seek ways to create new forms of competitive advantage.

First reforms in Bulgarian banking sector began in 1981 when Mineral bank was established for providing credits to small and medium-size enterprises which were newly created. More serious impact on the development of the banking sector in Bulgaria had the establishment of seven new banks in 1989. The main goal of these banks was to provide credits in different branches.

The real banking sector reform in the country started in 1989 when the communist-era central banking was swapped for modern two-tier banking system with typical central bank and commercial banks, most of them established from the previous branches of the BNB. The legal framework for the functioning of the banking system was created with the passage of the Law on the Bulgarian

National Bank (1991) and the Law on Banks and Credit Activity (1992). In 1990 BNB licensed 61 banks. The total number of banks in Bulgaria in 1990 was 70.

Chapter 1: The Balkans

Despite the common denomination 'The Balkans', a one-dimensional image about the Balkans is not appropriate. The Balkans are a region that is not yet integrated - neither internally, nor to the European space or to the Adriatic space in the case of at least part of the region. It is well known that the Adriatic area includes a substantial portion of the Balkan states: FYROM, the Federal Yugoslav Republic, Bosnia and Herzegovina, Croatia, Slovenia and Albania.
A review of the spatial development of the Balkans will lead to the major conclusion that natural, normal and rational spatial development is absent. There are a variety of reasons for this state of the affairs: political, ethnical, religious, economic, infrastructural, etc.

The Balkans remain the sole region in Europe that features the most diverse conglomerate of political schemes. The exclusive diversity of management systems, block and economic alliances, does not always work in favor of the creation of a spirit of confidence and collaboration as a pre-condition for stability in the region. Different values govern also the East-West relationships. Quite often it is namely the political factor that determines the acceleration or retardation of the processes of collaboration and integration.

Ethnical problems are closely connected with political problems. The specific characteristics of the spatial development of the Balkans are very strongly influenced by ethnical problems.

The historical "encumberment" of state boundaries, the inclusion or exclusion of the areas of large regions after any latest-in-a row act of military operations, continue even now to be a significant element of the inter-state and interregional relations on the Balkans.[2]

All these political and ethnical problems are manifested with particular force in the development of infrastructure and the border cross points. A typical characteristic is also the distortion of the spatial development of the individual

[2] www.wikipedia.com

states. As a rule, border regions are the least developed ones, whereby the differences in the level of development are a function of the existing political relations between the countries at the given point of time.

The Balkans need above all a new policy with respect to their transformation and integration, both internal and in the European space. Transformation and integration should become the principal elements of the new policy on the Balkans: transformation and integration through economics, infrastructure, urban network, ecology, cultural and historical heritage. Transnational and transborder co-operation in the fundamental issues of sustainable spatial development and socio-economic transformation and cohesion are the real basis of the future strategy for re-integration of that region.

In economic terms the Balkans are still a "critical region", despite the great changes that have taken place in recent decades in the direction of development of a modern society. They possess a huge potential that should be adequately exploited in view of the endogenous development capacity of the region.
The general evaluation of the macro-economic medium in the region is determined by the following characteristics:

- low development level. In the Balkan countries the normalized values of the indices GDP per capita in purchasing power standards vary within the limits of 10 to 40 % of the national values (in percentage) of the state with the highest value of that indicator, while the differences with respect to the average values for Europe are in the range of 2 to 5 times;
- the overwhelming tendency of GDP drop in these states in the recent decade. This tendency is particularly crucial for the new democracies in that region - Albania, Bulgaria, Romania and FYROM.
- the high unemployment level (the highest in Europe) as a natural consequence of the economic processes taking place there.
- the low amount of foreign investments. An economic and political environment that still swarms with uncertainty is not sufficiently attractive for many foreign investors.
- production specialization strongly dependant on the primary sector, consumer goods, tourism. For instance, agriculture accounts for a relatively large share of the national economies - in the overwhelming majority of the states this share ranges from above 15 % up to 60 %

(Albania), as compared to the rest of the European countries, in which the share of this sector is some 2 to 10 %.

- ❖ limited opportunities to take advantage of support from the EU and other powerful international funding sources, because the only EU member-state from the region is Greece.

After many years of confrontation, isolation, mistrust, the Balkan states have begun to re-discover the rich opportunities for international trade and production co-operation. The region is gaining in importance as a transit route of passenger, goods, energy carriers and information traffic between the powerful economic potential of Western Europe and the Middle East, the Mediterranean region, Russia, Ukraine and the Caucasus area.

What can Balkan countries offer with a view to attracting economic activities and pull out the European economic space in South-Eastern direction?

- access to free labor force;
- a labor market that is capable of offering a well-educated and skilled labour force on the one hand, and a labor force for the mass production on the other hand, at a relatively lower price;
- the importance of the region as a world crossroads and a linking point between the economies of the East and the West, the North and the South.

The model of future integration of the Balkans and their joint integration in the European space is still unclear. However, if the Balkans really wish to become an equipollent part of the European space, such a model should be worked out and urgently implemented. The adequate model of the future common development should be found through assessment of the strong and weak aspects, the conditions in and potentials of the region, in order to achieve the synergy of this development.

The technical infrastructure which is the material basis for the flows (of people, input materials, goods, energy, technologies and information) comes to be a very important, even in a sense a critical factor for the economic and social prosperity of the territorial communities. There is a close interdependence between the social-economic development of a given territory and the conditions and prospects for the development of the technical infrastructure.

The infrastructure systems (transport, communications, energy and water) have an integral influence and determine to a considerable the general extent trends of development of countries and regions, they generate and precondition the

existence of certain processes and phenomena in them, which 'narrow' or 'expand' their physical space.
The present situation in the world and in Europe, presents a unique possibility to utilize the significant transport advantages of the geostrategic position of the Balkan peninsula bridging three continents - Asia, Europe and Africa.

The Balkan region is a unique cross-road of four international transport corridors. Four international transport channels cross each other here - the Three-continent diagonal highway Northwest-Southeast (London-Sofia-Istanbul-Calcutta-Melbourne), the Euro-African meridian highway (Helsinki-Moscow-Sofia-Thessaloniki-Cairo-Capetown), the Euro-African diagonal highway (Tunis-Duras-Sofia-Bucharest-Odessa-Omsk) and the developing transport corridor around 40th parallel from the Caspian Sea through the Black Sea to the Adriatic (Poti-Varna-Sofia-Skopje-Duras).

Despite the centuries-old conflicts, the Balkan states will soon come out on new economic horizons. This will generate new types of economic ties and new ideas about common infrastructures. The acceleration and optimization of the processes of implementation of the large infrastructure projects, information exchange, planning of investments and co-ordination of the investment processes are issues of primary importance.[3]

Chapter 2: The wave of FDI's in S.E. Europe

Economic theory has identified several effects of foreign direct investment (FDI) which result in increased growth rate of the host economy:

First, FDI's are a form of importing of capital. Thus domestic investment can be higher than domestic accumulation. That should increase the economic growth rate. But in recent years there have been some doubts about this. There is a question as to whether import of foreign accumulation really increases the investment rate or just replaces the role of domestic savings. That enables higher levels of current expenditure and living standards in developing countries. Such a tendency has been observed in many developing countries and is most

[3] **The Balkans and its Integration to European Space** *Assoc. Prof. Dr. Julia Spiridonova, National Centre for Regional Development and Housing Policy, Sofia, Bulgaria*

frequently seen in the least developed countries. The second relevant question is whether a higher investment rate necessarily leads to faster economic growth. In other words, is economic development a result of not just the investment level, but also of efficiency of investments?

Secondly the import of foreign capital (through FDI or in any other way) enables the financing of the current account deficit. That gives additional time to a country for necessary structural transformation. Restructuring of an economy is, almost without exception, linked with economic recession, growth of unemployment, social disturbances, etc. That could be a reason for foreign investors to avoid such a country. Economic growth and prosperity are among the leading factors in FDI attraction.

Third the opening of foreign companies' affiliation contributes to enhancing of competition level. That improves the consumers' choice and allows domestic producers to engage in the market game more actively, through reducing of costs, quality improvement, innovations, etc. But, there is empirical evidence that foreign competition has destroyed inefficient domestic firms. That creates economic, social and political problems in the country, at least in the short term.

Last are the foreign direct investments that represent a channel for international technology transfer. Increased technological levels in the FDI host sector can be transmitted to the rest of the domestic economy through a "spillover effect".

Among all the effects we have mentioned, the most significant is the last. Modern economic theory stresses that FDI foster economic growth primarily through improvement of the technological level of the economy. That effect is much more significant than importing of foreign accumulation.

There are three different forms of international technology transfer:

1. Import of high-tech products,
2. Learning through export, when domestic producers acquire new knowledge about available technology, and
3. Foreign direct investment.

FDI's are the most relevant source of technology transfer in developing countries and transition economies. However, it is not rare for FDI inflows in such countries to result in the so called dual economy, when sectors which are hosts to FDI become a developed oasis in an underdeveloped economy. In that case, the effect of FDI on economic growth is limited and small. For that reason, economists pay special attention to the so called spillover effect, when FDI inflows in one sector of the economy bring a technological boost that spreads through the whole economy. This knowledge diffusion (often referred

to as externalities or efficiency spillovers) can lead to improvements in productivity in local firms in several ways. A spillover can occur when a domestic firm copies some technologies used by a multinational corporation (MNC) in the local market. Another type of spillover occurs when local firms are forced to use existing technology and resources more efficiently, or to search for more efficient technologies, because a MNC's entry has increased competitive pressure in the market. A particularly significant channel for spillovers is through the linkages between the MNC affiliate and its local suppliers and customers. Countries should support this effect.

There is strong evidence that FDI improves productivity in host companies. The growth in productivity is the biggest in firms with total foreign ownership, less in joint ventures, while totally domestic firms have the smallest productivity growth. Although the spreading of technology through other sectors of the economy, as a result of FDI in one particular sector, is considered real, some recent studies have not found such evidence.

Factors in FDI influx into Central and East European countries

Flows of private capital depend on many factors: terms of demand, earning capacity, openness of the market, development of the financial sector, privatization, credit capability, investment risk, etc. Inflow of FDI into the region of CE (Central and East) Europe was negligible until 1990. The development of transition and with it the development of the privatization process created new opportunities for foreign capital owners which resulted in an increase of FDI into the region. The most important factors in FDI inflows into the region of CE Europe are as follows:

First the availability of natural resources has played a substantial role in attracting FDI into some countries in the region, at the very beginning of the transition. FDI in the extractive sector do not depend greatly on other economic and business policies in a given country, and consequently not on the achieved level of the economic reform process. Therefore, substantial amounts of FDI have arrived in Azerbaijan and Kazakhstan even though poor results were shown in terms of transformation of the economic system.

Secondly the development and the achieved level of the reforms in the transitional economies are important factors in FDI influx. Liberalization of the trade regime and the price system, as well as support in terms of tax-breaks and importation fees, have played an important role in attracting FDI into the CE Europe region. At the same time, development of the reforms represents a factor of decreased share of public capital in the overall financial influx.

Third the privatization also plays an important role in attracting FDI. The countries which allowed participation of foreign capital in the privatization process are the countries with the highest rates of influx of FDI per capita. The greatest portion of FDI went into the industrial sector, where privatization first took off. Liberalization and privatization of the services sector followed in all countries in the region in the last phase of transition. Influx of FDI into companies which were publicly or privately owned speeded up the process of their restructuring, significantly improved productivity and brought in new technologies, managerial skills and additional capital.

Finally, we should mention maybe the most important factor in attracting FDI into the region of the CE Europe – access to the EU market. During the 1990s all European countries in transition (except the region of the "Western Balkans") signed the agreement on accession to the EU, the so called "European Agreements". Its main characteristic is establishing a free trade zone among the signatory countries and the EU countries. Agreement involved step-by-step introduction of the free trade zone on a non-reciprocal basis, with exclusion of "sensitive" economic sectors.

This arrangement in fact represents an intermediary phase toward complete accession to the EU. The desire of the European countries in the transition to become members of the EU influenced the influx of FDI into the region in two ways.

First, by lowering investment risks through improvement of the business climate, dedication to the reforms, harmonization of the legislative regulations with the regulations that exist in the EU. Second, the agreement on accession allowed free access to the markets of the developed countries, allowing the investors to avoid trade barriers to the EU and to increase scale economies through larger quantities of goods sold. Simultaneously, the low paid work force in transitional countries has become more available to the multinational companies from more developed countries. The proximity of the EU market, as well as the prospect of future accession, resulted in geographical direction of the FDI, so that countries that are closer to the EU (in all aspects) received higher levels of FDI. [4]

[4] "DO FOREIGN DIRECT INVESTMENTS INCREASE THE ECONOMIC GROWTH OF SOUTHEASTERN EUROPEAN TRANSITION ECONOMIES?" NENAD STANISIC University of Kragujevac

2.1 Main features of FDI's in S.E.E

The surge of foreigner investments in the countries of Balkan region is a phenomenon relatively recent, specifically if it contemplates with the total picture of FDI's in worldwide scale. Even from the decade of '60 and afterwards in world level flows FDI are increased with rhythms of double than those of AEP15, her countries Europe, with the central planning, they were closed in the FDI. Only after the political changes of 1989, with the fall of the Wall of Berlin, the split of the Soviet Union and the consecutive liberalisation of economies some countries of Europe, FDI began to take up in percentages, which was increased dramatically by the means of decade the '90. The safety, the political and social stability and the growth of economy constituted the key for growth in the countries of region. Also to a large extent FDI were ideal for factors such as the low cost of production, worked out workforce, favourable taxation for the investments e.t.c. However, reforms in the Balkan countries delayed concerning countries of Central Europe. The last years show leaders countries such as Romania and Bulgaria and followers like Croatia and Serbia. On the other hand Albania, the Fyrom and the Bosnia-Herzegovina appear to fall short in comparison with the first team of countries, drawing much smaller number of investment programs. From the total of entering FDI in the 7 countries that were mentioned before, above the 90% it is assembled in first group.

From the countries that realise that FDI will distinguish them among the others are Germany, Austria, Italy, and Greece, and in smaller degree Holland, Belgium, etc. In general lines, the list of the basic countries that had FDI in most Balkan countries it is similarly. Few are the cases of countries with powerful presence via FDI in one and only Balkan country. Interests presents also, Slovenia, which is one of the most attractive countries for the foreigner investments, from 2000 and afterwards constitute basic country of origin FDI .For the remainder five states that resulted from the split of Yugoslavia. Slovenia has achieved intense economic growth and with Greece constituting the unique countries from the region that not only draws but also they realise FDI. In minimal other cases Balkan countries work out investment programs in abroad, as eg certain investments in the PGDM with origin Bulgaria, and in the Bosnia-Herzegovina with origin Croatia. *(See Table 6)*

In the Balkan economies the distribution of their FDI in productive sectors differs once again from the world model. Afterwards 1980 in a world level is observed a turn of FDI from the sector of transformation in the sector of

services. Most countries of origin are interested in investments in advanced technological manufacturing sectors and fundamentally in the sector of services.

However, in the Balkan states are distinguished two phases in the distribution of FDI. At all the duration of decade 1990 the majority of FDI it was assembled in the industrial sector. Widespreadest were the sectors of foods and the drinks, the tobacco, the ready clothing, the machines and chemists.

After 2000 via repurchases and consortia a big number of investments were put in the sector of telecommunications, banking and credit organisms, in companies of advisers of enterprises etc the sectors retail and wholesale trade he is from most attractive, special for the SME.

With regard to the Greek FDI in the Balkans their majority is assembled in certain only countries. In 1995-96 Bulgaria, Albania and Romania they assemble the 92,7% of total of Greek FDI. The political instability that characterized the western Balkans at the duration of previous decade, it does not constitute any longer an obstacle for the foreigner investors and Serbia has accomplished it by attracting important volume of Greek FDI over the last years. *(See Table 4)*

Up to 2005 more than 2.500 Greek enterprises have invested in sectors that present favourable prospects of growth. Between many sectors that attract most investments are the technologies information technology and telecommunications, the sector the banking and financing, the foods and the drinks, the oil and the energy, retail and wholesale trade, the building materials and the manufactures etc.

From only $35 millions in 1980 and $639 millions in 1990, surges FDI amounted in $25 billion in 1999 and $27 200 billions the 2001. [5]

The passage from a system of government owned intervention in a economy of free market could be the more important cause of this course, but they exist discreetly nationally characteristic traits that can also explain a big part the difference in the number of investment programs and the size surges FDI that assembles the each country. Even if in the total of region of S.E.E, the countries of Balkans have only attracted a small part of these the flows, with Hungary it been profited at the bigger part. We can classify the countries of Balkan roughly in three teams.

[5] www.unctad.org

Firstly we can include in the first team, even exclude from the further analysis of countries of reception FDI such as Greece and Slovenia, because these countries constitute the most developed countries of the Balkans, being members Of the Euro zone, that present remarkable differences concerning the remainder countries of region on one side, and on the other side because it is between main countries of origin FDI in level Balkans. In a second team we could include Bulgaria and Romania that are henceforth members to the EU from January 2007, and they draw the bigger part of FDI, with Croatia, constituting special case.

In the third team are the remainder four countries that resulted from the split of Yugoslavia and Albania.

2.2 Greek FDI's in S.E.E

Looking back at time the number of Greek enterprises with production in abroad it was relatively insignificant. Before the facts of 1989, that led with the fall the wall of Berlin and the split of Soviet Union and consequently to the liberalisation of economies Central and Eastern Europe, there were existed less than 10 Greek companies with activities in abroad. The extension of Greek enterprises is phenomenon of the last decay, with a very big of number investments.

In 1998 existed around 1270 programs of investments of Greek enterprises in a large percentage of the countries of S.E.E, number which increased from then on. The bigger percentage of these programs (the 82%) was assembled in three only Balkan countries (Bulgaria 41%, Albania 20% and Romania 20%). Despite the big number of investment programs in this countries, the majority of the invested capital it only belongs in few enormous enterprises.

More specifically, 10 companies recommend the 64% of total of Greek investments in 5 Balkan states most important among which they are the GREEK TELECOME of, 3rd, DELTA, the TITAN etc.. Certain private Greek enterprises possess above from the half invested capital (the GREEK TELECOME from alone him possesses the 46%).

The realised direct investments were of 2 types:

- with regard to the number of investments, dominate the small enterprises.

- with regard to the volume (the size) the investments dominated few big enterprises.

It could be said with regard to the Greek FDI in Europe, that are recorded three distinct phases at the decade the ' 90:

The first phase, in the beginning of decade the ' 90, was characterized from fast moved small scale transport of capital to marketing of foods and costume, specifically in Albania and Bulgaria. This phase was not so much prosperous for the businessmen, mainly because the policy and economy agitation that was connected with the initial steps of Balkan states to economy of free market.

The second phase began in the means of decade the ' 90 and was characterized from gradual establishment of Greek banks in the Balkan states, special in Bulgaria and Romania. This initiative of Greek banking sector, public and private, it prompted the big Greek enterprises follow since they could be profited from essential economic support. The big Greek enterprises assigned fast extensive research of the market, they formulated enterprising programs and developed many consortia with local enterprises that were in her stage privatisation.[6]

Running, third phase, the Greek FDI in the Balkans began in 1998. It is characterized by a powerful effort on behalf of important Greek enterprises to extend their activity in more than one Balkan market, creating accordingly networks of institutions where they can function in all the Balkan peninsula. This type of FDI was adopted from the GREEK TELECOME (the Greek enterprise of government owned telecommunications), the National Bank Greece (NBG, the bigger banking company of Greece), from the Alfa Credit Bank (ACB, the bigger private bank and second bigger banking company in Greece), from Delta SA (one from bigger companies of production of dairy products) e.t.c.

The occasion that is offered, therefore, from the collapse former Socialist economies and the voids that are created at the period of passage it is from each opinion unique for the Greek enterprises. The conditions, of course, that are shaped, as it is marked and previously, they are uniform for the total of countries of KAE. For the countries of Balkan particularly, this process is combined with intense political and social instability.

[6] www.Titan.gr, www.capital.gr, www.nbg.gr

2.3. Main factors for FDI's in S.E.E

Most analysts agree that the most important and defining factors that direct the FDI are the geographical proximity, for expected reasons, as the size of market and the institutional frame of country destination. In the case of Balkans, despite differences of type's problems, they exist also a line advantages that the foreigner investors can take advantage. Most important than these are:

- The low cost of productions, that it results from the low cost of work and the low values of ground.

- The high quality of human resources, with worked out and specialised workforce.

- The intense economic growth of region the last years, and the promotion important economic and developmental programs from the EU.

- a line of other factors as the coastal regions that encourage transports, the favourable conditions for the growth of tourism, economic relations with neighbouring countries(that are owed in common cultural characteristics between them), but also the traditional relations with her countries

The geographic proximity.

The importance of geographic proximity in the orientation of FDI is big. The changes in the countries, have led a lot of Greek enterprises they invest in them. This recent phenomenon of spread of Greek enterprises in the abroad is considered result of three basic factors.

First, the increasing importance of FDI in the world economy, secondly, in the tendency of SME at the decade the 90 to be internationalised, and finally in drastic change which happens in the countries of Balkan and him changes in "easy" objective for the Greek enterprises, mainly reason of geographic proximity.

The majority of Greek investment activity is directed almost exclusively in Bulgaria, Albania and Romania. Among the most important reasons is geographic proximity. Moreover in these three neighbouring countries the investments are assembled in the southern regions where they cooperating with Greece.

The change of strategy of Greek government towards Balkan states, by the end of the 90's Greece helped in stabilisation and the democratisation of Balkans. The safety, social - political stability and the economic growth of region, with the vision states for their intensity in the EU, it was the key of Greek foreigner and economic policy. Additionally, the Greek government encourages idea for investments in the Balkans from side of Greek public companies with collaboration and the support of private capital. Contrary to big multinational enterprises, what still consider Balkans as small market, the big Greek companies can profit from economies of scale. Moreover, Balkan is a difficult market, where informal activities are extensive, while the Greek businessman is usual it functions in such environments.

Chapter 3: FDI's in Bulgaria

The passage from the Socialist model to the economy of market and democracy did not exist painless for Bulgaria, as for no one of the countries South-eastern Europe and it has still not been completed. Moreover, the absence of rational financing and tax system, that paralysed process of economic adaptation, was progressively replaced from more simultaneously systems. The economic anarchy that prevailed at first post communist period, which allowed the extensive profiteering, it brought many of the Balkan countries in collapse and civilian clashes. The social cohesion and peace in Bulgaria were threatened at period 1996-97 when the banking system collapsed, as it happened little time later in Albania when was revealed the abuse of savings from pyramids type credit institutions.

Depending on the size two species of Greek enterprises are stronger in Balkan states. From the one hand a big number of small size of enterprises, which are activated mainly in ball of trade, and by the other few only big enterprises. In the enterprises of intermediate size, it is observed smaller mobility, feeling enough sure in the local market and often they do not want to take the risk of extension in the abroad.

3.1. Motives

In 2004 Bulgaria is found in one of the leading places that allured FDI per capita between the countries Central and Eastern Europe. In Bulgaria it corresponds the 2,0% of all Greenfield of investment programs in Europe for the year, accordingly not only regional, but also European competitor for such programs. The competition is increased, since Europe is a purchase of 30 countries with roughly 500 million consumers and powerful workforce of 300-millions roughly.

According to certain politicians and analysts, comparing the competition for foreigners investments Bulgaria can follow the example of Singapore and the South Korea in the 80's, Ireland in the 90's and Czech Republic before its integration in the EU offering specialised dexterities and a individual approach for the attraction of foreigner investments. [7]

Foreign experts did some research for the strategies of Bulgarian government with regard to the improvement of competitiveness and supported that educated and educated workforce should be the priority. In the running situation of intense competition for the attraction of programs and capital, exists a characteristic tendency the industrial investments to be directed to the countries with big internal market, lower cost and high productivity of work, as India, China and Russia.

Consequently Bulgaria should rather stress the growth of economy based on the knowledge and on the industry of services, where high qualifications and the support of state for the search of innovations it can compensate the relatively small internal market and the lower bioengineering productivity. Equally critical factors for the improvement of competitiveness are growth of infrastructures and the improvement of terms on the beginning and the growth a enterprise of (included administrative frame and administrative services). *(see Table 2)*

The privatisation

The disengagement of the government owned protection presupposed sale in private individuals of enterprises that took place under the control of state, something that happened not only in Bulgaria but also in the remainder Balkan states, so that enter their economies of these countries in competitive world

[7] www.investbulgaria.com

economy. The process was laborious and time-consuming. Despite all these, and although there was a lot of wasted time during the passed decade when also investment activity in Eastern Europe was encouraged by the increased fluidity and profitability, was progressively rendered perceptible the need of extensive privatisations.

Thus therefore the previous governments of Bulgaria abolished the drawings for the privatisation of enterprises of all types, included also various critical sectors. International economic tendencies and the need for modernisation and know-how have led to the opening even to the defensive industry, the energy, and the telecommunications and more generally into the work of infrastructure. Up to 2000, roughly the 78% of government owned enterprises were reproached for the privatisation.

The Forms of infiltration in the Market of Bulgaria

The infiltration of foreigner enterprises in the market of Bulgaria can become via each known form of extension. The foreigner investors can participate in consortia (Joint ventures), they create new enterprises, buy enterprises in the process of privatisation of Bulgaria, or they can acquire percent of the portfolios. The method of exterior extension (via fusion or via repurchase it) appears to be enough popular, except from that the foreigner enterprise is consolidated immediately in the domestic market, absorb and the share of market, as the installations and her network of shops local enterprise. The foundation of consortia also constitutes from usual way of penetration of enterprises in the Bulgarian market. This method is applied widely in new markets, as countries of Balkans and S.E.E.

The Basic Motives

In the frame of legislation 1987, a prosperous developmental institutional frame was applied for the aid of investments that provided mainly tax motives. There was delimitation in the extent of Bulgaria six free areas where enterprises with foreigner attendance can receive equal or preferential treatment. The most profitable free area is that of Plovdiv. Bulgaria has from the most liberal laws on the foreigner investments in region. In 2006 the Parliament imported a low tax percentage for enterprises (10%), making Bulgaria one of the more attractive countries for investments in the entire Europe. However, the liberal legislation on the investments it is not the only reason for the possessed increase of entering flows FDI in country, and particularly at the duration of

last decade. A remarkable improvement of macroeconomic situation takes place and that of the basic macroeconomic parameters of Bulgaria from 1997 and afterwards, which made the increasing investment interest for the region bigger.

The GNP of Bulgaria is increased with 6,2% annually, according to the elements of National Statistician Institute of Bulgaria for the first quarter 2005.

This is the higher rate of increase over the last seven years. In no other country the Greek presence is not as powerful as in Bulgaria. In the substance Bulgaria is the first country in which Greek enterprises created foreigner subsidiary companies from 1989. Led from the geographic proximity between the two countries, Greek businessmen decided to exploit the advantages that were offered by the Bulgarian market. The presence of big foreigner enterprises in Bulgaria was followed few years later, while from 2006 a new powerful wave FDI was observed, that is connected with the entry of country in the EU.

In 1992, the FDI were 34.4$, mainly from Austria and Hungary. In 1993, FDI went up in the 102.4 bn.$, 22 bn.$ from the privatisation and above half (56 bn.$) emanating from Germany. The elements of the Central Bank Bulgaria for period 1996-2003 where they are included in her table Invest Bulgaria (table 3.2, p. 9), to us they offer a analytic picture relatively.[8]

Chapter 4: Banking sector in Bulgaria

As already it has been reported the presence of Greek banks in Bulgaria is intense and it constitutes the main FDI in the country. Especially in the period after 2006 that is characterized by the turn of FDI from the industrial sector in the sector of services. We will see then that there is an important place of Greek banking sector in Bulgaria, but also in the remaining Balkan countries. Greek banks in the region during the last decade resulted in few years with the 20% of profits of domestic banks. Moreover it was considered useful be reported in certain characteristics of Capital, where it is assembled the bigger part of economic activities and the majority of FDI. *(see Table 3)*

[8] www.bnb.bg www.investbulgaria.com

In the second part of this capital we will be focused in domestic banking sector, where the Greek presence, as we will see is very intense.

The newly established commercial banks in Bulgaria were divided into several groups:

1. Large state-owned banks which were specialized in financing the bigger industrial branches

This group of banks consisted of Bulbank, Postbank, Mineralbank, Balkanbank, Economic Bank, Biochim, Electronica, Stroybank, Transport Bank, Agricultural and Cooperative Bank, State Saving Bank. These banks held a significant amount of total assets of the banking system. State Saving Bank held approximately 75 % of deposits of the population. During the period 1994-1995 eight from nine large banks with assets for more than 30 billion Leva were state-owned. At the end of 1995 these 9 banks (without State Saving Bank) held 74.9 % of all financial assets in the system. Although State Saving Bank didn't have the statute of a bank it was considered to be a bank.

2. Small and medium- sized commercial banks

Most of them were created out of former BNB branches. By the end of 1995 their assets were estimated to be bellow 30 billion leva. They held approximately 25.1 % from the total assets in the banking system.

3. Private banks

Establishment of private commercial banks began in 1991 and this process was especially active till 1993. There was a very liberal regime for commercial banks licensing and low startup capital requirements which ensured easy entry to banking. There was no case of revoked licenses till 1996. Additionally there were no special requirements for the origin of the funds used as a start-up capital and many private banks started their activities with borrowed funds. During this period legislative base of the banking in Bulgaria was imperfect and allowed establishment of private banks which goal was to provide credits to their major shareholders and/or to persons, connected with these shareholders. This was a perfect scheme for siphoning money through BNB`s and State Saving Bank's refinancing.

Private banking sector expansion had two major impacts on the banking sector. First, increased numbers of banks favored competition among them, although there was no significant improvement in their performance and service quality. The negative effect was dramatically increasing amount of big credits and the share of bad debts in private banks as a result of the fact that most private banks were closely connected with their debtors - shareholders and related to them individuals and firms (both state-owned and private).

As a result of the low entry barriers into banking sector the number of private banks increased significantly - from 2 in 1990 to 26 in 1995. Their assets to total assets of the banking system were 3.1 % in 1992, 6.4 % in 1993, 15.6 % in 1994 and 22.4 % in 1995. In 1996 private banks' assets to total banking sector assets decreased to 9% due to loss of public confidence in private banks. In 1997 it increased to 16.6%. During 1996 the number of foreign banks has also increased (Table 3). Apparently, the state has chosen to encourage the activity of foreign banks as a possible way to secure the liquidity of the banking system.

In 2007 the banking system had a considerable growth pace compared to the previous years. Banking assets increased by about 40% and reached a level of BGN 59 090 million compared to BGN 42 195 million at the end of 2006. The growth of the banking sector was financed by various sources. The increasing deposit base contributed to a great extent to the growth of the total banking assets and reached BGN 39 132 million at the end of 2007. During 2007 the deposits in the banking system increased by 46.3%, whilst the most considerable growth was recorded by the deposits from financial institutions (50.8%), non-financial institutions (38.8%) and households (29.3%). Throughout the year the deposits in local currency were dominant (49.8% of total deposits). In 2007 the volume of loans increased by 62%, from BGN 23 427 million to BGN 37 951 million. In 2007 the share of corporate loans was higher compared to the loans to individuals. At the end of 2007 corporate loans amounted to BGN 24 305 million and loans to individuals – BGN 12 972 million. The internal structure of the loan portfolio did not change during the year. Company loans represented the largest portion (64%) in the total loans of the banking system.

4.1 Some Important dates

1881 First Bulgarian coins

1929-1933 The years of Great Depression BNB was forced to impose restrictive administrative measures on the trade in foreign currency.

1991 Two-tired banking system was introduced

1992 Law on banks and Credit activity was enacted

4.2 Banking sector

The real reforms in the financial sector in Bulgaria started only in 1997 after the introduction of the currently operating currency board in the country.

Privatization, consolidation , decapitalisation and other similar initiatives that intended to be market driven were introduced but quite sporadically and in an inconsistent manner. The regulatory system in the sector was inadequate allowing personal deposits and state funds to be misallocated towards shady organizations.

All this resulted in a collapse of the Bulgarian banking sector at the end of 1996 when 14 out of 35 registered commercial banks failed. The overall cost of the government to bail out was equivalent of about 75% of GDP. In early 1997 international financial institutions had to step in and put a firm condition before the Bulgarian politicians to introduce a currency board and stabilize the national economy. The IMF provided more than 1 billion USD in support of the board to basically distance the government from control of the monetary policy in the country and to stop hyperinflation.

The first step in the transition to the new system was to liberalize the entry of new banks into the Bulgarian financial sector. By the end of 1990 there were 70 commercial banks of which seven sectoral, two specialized and 59 commercial banks.

However banks started experiencing negative equity with a high share of non-performing loans. Banks began to encounter liquidity problems amassing bad loans towards projects with low returns. The government established the Banking Consolidation Company (BCC) in 1992 in an effort to decrease the number of undercapitalized commercial state-owned banks by merging them into a smaller number of supposedly more financially viable banks with better perspectives for privatization.

After the consolidation the Bulgarian banking sector consisted of 35 commercial banks among which were both small, private, newly-established banks and state-owned banks. Quiet privatization became popular in the early years of transition

four banks increased their capital through the issue of new stock and sold them right away to private individuals closely related to the insider's circles.

Banking sectors in Bulgaria and Romania exhibit the three CPE legacies in the early 1990s but the banking sectors in Croatia and Slovenia inherited different legacies. Banks in the former republics of Croatia and Slovenia belonged to the Yugoslavian banking system. Beginning in the 1950s, Yugoslavia had a two-tier banking system in which republic-level, universal banks were engaged in the entire range of banking activities so that the structural segmentation found in the CPEs does not apply to the banking sectors of these former republics. Furthermore, Slovenian and Croatian banks were not state-owned initially; rather they were owned collectively according to the principles of Yugoslavian self-management. Moreover, each republic, except for Serbia, had only one main bank. The legacies in Bulgaria date to the 1980s when eight sectoral banks were established. In 1989, 59 commercial banks were created when each of the credit branches of the Bulgarian National Bank (BNB) was left to do business on its own as an individual bank. Hence, by 1991, there were 69 commercial banks in Bulgaria consisting of the eight specialty banks, the hived off commercial branches, and two new banks. A government-orchestrated consolidation period followed a voluntary merger of 22 of the newly formed commercial branches in 1993 to form United Bulgarian Bank (UBB). At that time, two banks dominated the Bulgarian banking sector. Derzhavna Spestovna Kassa (DSK), the state savings bank, operated as a narrow bank by collecting primary deposits and placing them with BNB or in the interbank market. Bulbank, the foreign trade bank, collected forex deposits and conducted trade financing. In 1995, 46 banks operated in Bulgaria. Of these, five foreign banks accounted for less than one percent of banking assets while 12 wholly state-owned banks held about 59% as Table 2 indicates. The mid-1990s were a period of significant financial distress for the Bulgarian banking system.8 The market share of state-owned banks increased dramatically due to government attempts to stem a banking crisis by multiple bank recapitalizations. In February 1997, a full-blown currency crisis erupted and a currency board was established in July.9 By the end of 1997, 28 banks continued to operate in Bulgaria; of these, seven were majority foreign-owned. Banking assets held by foreign-owned banks increased to 18% primarily because of the privatization of UBB to a consortium of investors. The sale of banks to foreigners was virtually complete by 2000; the National Bank of Greece acquired a 90% stake in the already privatized UBB and Bulbank was privatized with Unicredito Italiano taking a 93% stake. Of the major banks, only DSK and Biochim Bank, one of the eight specialty banks, had not been sold to a strategic

foreign investor by the end of 2000.10 At that time, less than 20% of banking assets remained with five state-owned banks while 25 foreign banks accounted for 74% of total banking assets. Since stabilization in mid-1997, foreign banks have moved rapidly to take a dominant position so that the Bulgarian banking sector is similar to the one in Croatia in this dimension.[9]

In Bulgaria,11 new legislation introduced in January 1991 permitted the creation of new financial institutions with private domestic or foreign capital. Within two years of the liberalisation of the banking sector, 80 commercial banks were established and organised as self-managed joint-stock companies. The activities and lending practices of these new institutions, however, quickly became identified with serious irregularities and illicit financing. The lack of effective regulatory scrutiny made the problem endemic. During the same period, state-owned banks continued, under government pressure, to extend loan facilities to money-losing enterprises. It is estimated that in 1995 alone total loses amounted to 15 per cent of GDP. By the end of that year, the system was insolvent. Many banks faced liquidity problems, temporarily alleviated through massive central bank refinancing. This consequent money creation affected the foreign exchange market, undermining confidence in the national currency and led to the devaluation of the Lev/US$ exchange rate from 10 in December 1995 to 3,200 in February 1996. The annual inflation rate climbed to over 1,000 per cent. By January 1997, one in every four banks was in receivership. Following the advice of the IMF, the Bulgarian government introduced a Currency Board accompanied by a package of structural reforms. This package included strict control and financial supervision of money-losing state enterprises, the liberalization of trade and a more rigorous privatisation policy. In July 1997, the Currency Board pegged the Lev to the Deutschmark and took measures to restrict government expenditure and the activities of the Central Bank, which was permitted to provide only three-month loans to commercial banks. The Board's policy was very effective in containing inflation, which was reduced to 1 per cent monthly by the end of the year. The policy of the Board, however, did not come without cost. Bulgaria experienced a severe depression and GDP contracted by 7.4 per cent in 1997, though it bounced back with a 4.5 per cent increase in 1998. After seven years of systematic restructuring, the banking sector in Bulgaria is considered well regulated and well supervised. The

[9] Banking in the Balkans: the structure of banking sectors in Southeast Europe John P. Bonin a,b,*
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credibility of its institutions has been restored and their viability has been improved through a series of mergers and acquisitions. In 2003, new regulations on internal control in line with the principles of the Basel Committee on Banking Supervision were adopted. In 2004, the loan classification and provisioning schemes were tightened in response to the credit 'boom' experienced in the economy. At the end of 2005, most of the 34 banks operating in the country were privately owned, while 23 were foreign-owned. Foreign investors controlled about 75 per cent of the total banking assets. During the same year, the capital adequacy ratio was 15.3 per cent, way over the required minimum (12 per cent), while new restrictive measures adopted by the central bank to curb the credit expansion decreased somehow the growth of total credits. Overall, the banking sector is fairly liquid, quite profitable and adequately capitalised. Banking intermediation, however, still remains low in comparison not only to the Western European countries, but also to other Central European transition countries.[10]

1996 crisis

Commercial bank losses entail decapitalization of the banking system which is evidenced by the nine largest loss-makers. In 1993 losses exceeded own capital for all small banks in the sample and one large bank, i.e. all they had a negative net worth.

The decapitalization of the banking system intensified in 1995. Already 19 banks recorded negative net worth at the end of the year - total LEV 96.5 billion (the capital adequacy requirements excluded), or 11.3% to GDP. State commercial banks would receive 74% of the total amount required for the recapitalization of the banking system. Bank decapitalization and the fact that provision requirements are not observed indicate that the banks' capital cannot protect the creditors' claims if banks incur current losses. Hence the growing instability in the deposit market in 1994 which faced the threat of a total disintegration in 1995.Commercial bank losses are largely due to bad loans.

1. Bad loans

[10] Regional Integration Challenges in South East Europe: Banking Sector Trends
George Stubos and Ioannis Tsikripis

There were two major sources of bad loans in Bulgarian banking sector: the non-performing loans extended to the SOEs in the pre-transition period, and the credit expansion of the most of the banks, and especially the private ones, after 1990.

1. **Bad loans inherited from the centrally-planned economy.**

After the price liberalization, most of the enterprises, like in other CEE countries, appeared to be ineffective and started to mount losses. Also, Bulgaria was strongly dependent on the former COMECON markets. Another problem was that most of these loans were denominated in hard currency, and therefore were not swept by the initial inflation and currency devaluation. All these factors led to debt arrears to the banking sector. As these loans were extended largely on the basis of administrative planning and not on market principles, the government felt it was its responsibility to remove this burden from the banks' balance sheets.

Series of measures have been undertaken starting in 1991, to resolve the problem. The common denominator of all measures was a sort of a triangle operation for replacing bad loans with state bond issues on the asset side of the banks' balance sheets, and replacing bank credits with state claims on the liabilities side of the enterprises' balance sheets. Partially this was implemented through the special bond issues in 1991 and 1992 which covered the nonperforming loans of some 120-130 enterprises. Finally, the "Law on the Settlement of Non- Performing Credits Negotiated Before 31 December 1990" (LSNC) was adopted in December 1993. Under this law, the state issued bonds to replace all remaining debt (negotiated before 1991) which is in arrears more than 180 days. The BGL denominated ZUNKs (named on the Bulgarian abbreviation) amounted BGL 32 billion (appr. $ 1 billion in end-1993), and the USD denominated ZUNKs amounted to $1.8 billion. Thus they turned out to be major item on the asset side of the balance sheets of several big state banks, especially Mineralbank and Economic Bank. As the yield of BGL denominated ZUNKs was only 1/3, 2 and 2/3 of the BNB basic interest rate for the first two, second two and third two year periods respectively, this caused serious disproportion in the asset/liabilities yield ratio.

2. **Non-performing loans contracted after 1991.**

One of the factors which led to new "bad borrowing" was the government policy for replacing direct budget subsidies to the real sector with quasifiscal

subsidies through new credit injections. There was no political will for closing the loss-makers until mid-1996, and they had to be kept alive through credit amnesties which even deepened the crisis in the banking sector. The only state-owned bank to avoid new doubtful lending was Bulbank, which finally aggregated 91% of all standard loans in end-1996. In 1996 Bulgaria entered into an economic and financial crisis which seemed impossible to resolve for many years to come.
The loss in confidence of both the Bulgarian lev and the commercial banks inflamed the banking crisis.

2. Several other reasons

1) No prudential regulation

2) Authorities in 1995 decreased the basic interest rate from 98% in March to a mere 39% in August

3) The inability to manage the non-performing credits in the banking sector

4) Before 1995 deposits insurance did not exist

The BNB responded with an acceleration of the refinancing of the commercial banks in an attempt to prevent an overall collapse of the banking system.

Privatization of the banking sector

New investors had to make a commitment to improve the performance of the banks, they bought through steps toward technological modernization and capital flow.

Criticism towards the privatization had two main sources: First, concerns about transparency and bias in choosing the buyers for the banks were raised with regard to the privatization of almost all of the state owned banks. Second, the question of the unemployment in the banking industry gained attention in a period where the average levels of unemployment were at a large scale. By the 2000 five Bulgarian banks were privatized

In the transition economies (TEs), the first step in banking sector reform was structural and involved the creation of a two-tier system with commercial and retail activities carved out of the portfolio of the mono-central bank. The new banking sector was made up of the newly created commercial banks, the specialty banks, foreign banks, and de novo domestic private banks. Specialty

banks were large and essentially monopolies over their core activities, e.g., the savings bank was often the only entity with an extensive enough branch network throughout the country to collect primary deposits. In some TEs, a single new bank assumed the entire commercial portfolio of the monobank. Hence, three or four large banks dominated the evolving banking sector and one of these was usually a monopoly retail bank. Except for the new entrants, all banks, i.e. the newly created commercial entities and the specialty banks, were state-owned. Hence, structural segmentation, state-ownership of a significant proportion of banking assets, and high concentration ratios are the major CPE legacies.[11]

4.3 Extension of Greek and other European banks in the Balkans

The expansion of large Greek banking groups in Southeast Europe was launched in early 1990 and emerged as a result of the gradual convergence of the Greek banking system and economy to the standards of more developed European countries. The apparent maturation of the Greek banking system was the need to expand abroad. The Balkans, the geographical proximity and cultural conditions create competitive advantages, and identified a new field for Greek banks.

The gradual adjustment of the Southeast European countries to market conditions, further structural changes, the extensive privatization programs and the prospects for economic development were essential to attract the Greek and other European banks in the region.

Initially, the expansion of Greek banks in the Balkans was aimed primarily at serving Greek enterprises active in the region by expanding their operations. Knowing the business and the credit risk of these enterprises, the Greek banks have accompanied the expansion in the Balkans. Later, Greek banks are progressively broadened its activities there to benefiting from the rising market in retail banking and exploiting investment opportunities in areas such as land acquisition and development of commercial and residential zones. Today, the large presence of Greek banks in the Balkans is not a financial holding occasional but long-term investment strategy plan, which occurs either through autonomous growth or through acquisitions of domestic banks. Overall in

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the region in 2005, 5 large Greek banking groups had created a network of 958 stores, employ over 15,000 people and had a market share allocations over 17%. In 2005 the profits of 5 major banking groups by its operations in the Balkan region exceeded € 138 million, while 2007 provided that this region will come to 20% of total profits. In some countries of the Balkans, the Greek banks are now leaders.
Greek banks through their expansion in the Balkans seeking to improve their profitability, and gradually the retail banking in Greece is approaching the levels of maturation of most euro countries. For example, the 2005 allocations to households and businesses as a percentage of GDP in the countries of Southeast Europe ranged from 14.5% (Albania) to 44% (Bulgaria), compared with 76% in Greece and 104% in the Eurozone.

Interested in the banking market in the Balkans not only manifested by the Greek banks and from banks in other countries of Western Europe, which fosters competition and increases the valuation of the purchased banks increasing the cost of penetration in these countries. Major European banks have shown important international orientation of the 1990s. Overall, in 2004, approximately 40% of the revenues of large banks in Europe came from international activities.
Main competitors of Greek banks in the region of Southeast Europe are:
• The Austrian Erste Bank, holds the 1st place in Romania after the acquisition of BCR and gather market share in assets under 14%.

• The Austrian Raiffeisen Zentral Bank, holds the 1st place in Albania, Serbia 1st and 3rd together in Romania and in asset-based market share of 11%.

• The French Société Générale, holds the 2nd position in Romania and brings in market share based on assets of 9%.

• The group of Italian UniCredito, occupies the 1st place in Bulgaria, together in market share based on assets of 8%. Also, the Italian Banca Intesa holds the 2nd place in Serbia.

• The Hungarian OPT Bank, holds the 2nd place in Bulgaria and gather market share in assets under 4%.

• Among the 5 largest Greek banking groups, the first position in Albania has

Piraeus Bank in Bulgaria National Bank, National Bank of Macedonia, Romania, the Alpha Bank and National Bank of Serbia.

Privatization in SEE countries are at an advanced stage, and the 2 / 3 of banking system assets controlled by foreign banks. The highest recorded rates of private banks in Albania, Bulgaria, Romania, Macedonia.

The 10 biggest banks that are activated in the current domestic banking market, focusing in the extension except borders are the four more powerful Greek banks. As it has been mentioned before, from year 2000 and afterwards the sector of banks developed with fast pace, with the annual rate of increase exceeding 26%. One of the most important reasons that have led to the increase it is the explosive increase of loans, especially during the period of 2004-2006.

Central Bank of Bulgaria existed only as a bank of deposits for transactions with citizens the DSK bank (Government owned Fund of Savings), who was founded 1951 and functioned monopolistically in the market until 1964 where, then was founded Bulbank, also state owned bank. With the passage to the free market that began in 1989 a big number of states and private banks were founded in Bulgaria, many which however did not accomplish their survival afterwards the economic crisis of 1996-97 that caused the collapse of the banking system. Today in the Central Bank are registered 29 commercial banks, most of have foreigner attendance.

The extensive privatisations that took place at the beginning of the new decade has limited considerably the number of Bulgarian banks. In the first 10 banks of country, only the CCB (Central Cooperative Bank) belongs with 67.7% in the Bulgarian Group of enterprises "Chimimport". In other two banks, the FIB (First Investment bank-Austria), and the EIB (Economic and Investment Bank - Ireland, 35%) the Bulgarian attendance exceeds the 20%, while in the remaining seven banks it is less than minimum.

From the team of big banks, the first foreigner bank that began activities in the Bulgarian market was the Bank Piraeus 1993. Then follows the ING in 1994, and one year later in 1995 Alpha Bank (Greece) and after Raiffeisen Bank (Austria). In 1996 opened her first shop the EIB, while four years later, in 2000 Group NBG via the privatisation acquired the 99.9% Bulgarian UBB, one of the three more powerful banks in the country. In 1998 via direct investment it entered in

the domestic market Citibank, who with her two shops (in Sofia and in the Varna), it has very limited cover and abstains a lot from sizes the first ten anks. The next three banks that realised investments in banking sector of Bulgaria is the Societe Generale, (Paris) via the repurchase of 97.95% of Expressbank, in 1999, the UniCredito Italiano in year 2000 via the repurchase of 86.14% government owned Bulbank and group EFG Eurobank Ergasias via the repurchase of 75.33% Bulgarian Postbank the 2002. Eurobank in dues of passed year it added in her asset and the 91.20% DZI Bank, strengthening considerably in this way her presence in entire country but also the share of market and her relative place in the sector.

4.3.1 UniCredit Bulbank - Short profile

The Bulbank covers the total of work and its activities financing sector in Bulgaria (universal banking profile). It is the biggest bank and leader in the banking market of Bulgaria. Recently its development was slower than of her main competitors and lost leading place in the market from bank DSK (member of OTP Group of - Hungary). The Bulbank has been founded in 1964 with the name Bulgarian Foreign Trade Bank, property of state with specialisation in the payments and financing of exterior trade.

1969-1985: Opening of representative offices of bank in London, Frankfurt and Vienna. The bank continued extending its network and in other countries of world.

1998- Began the process for the privatisation of Bulbank

2000-The privatisation of Bulbank is completed by the date of 2 Oktober.

2001-2005: Her efficiency begins drop and bank loses fast from its share of market.

2004- Bulbank celebrates the 40 years as the biggest bank in Bulgarian market and leader with base the size of asset, profits and the proper funds.

2007- On 27 April 2007 it was announced the merge of the Bulbank with HVB Bank and Hebros Bank. The new name of Bank is UniCredit Bulbank. The fusion (merger) concerns the creation of new corporate entity that has resulted from the conjunction of two companies. The fusions are similar with that of the acquisition or repurchase (acquisition). In the case of fusion however, the existing shareholders can be also two enterprises maintaining a common interest for the new company. In opposition, in the case of repurchase, an enterprise

(enterprise-purchaser) acquires the complete control of the second enterprise (enterprise-objective).

HVB Bank and Hebros Bank are subsidiaries of the Bank Austria Creditanstalt, member of group UniCredit Group. It is the biggest bank of Austria with action of value above the 7 billion Euros. The UniCredit Group is the biggest bank in Europe. With the union of its forces with the HVB in 2005, was created a really big European bank . Afterwards the fusion between the Bulbank , HVB Bank and the Hebros Bank, that was completed in April 2007, new bank UniCredit Bulbank becomes leader of Bulgarian banking market. The UniCredit Bulbank has assets that approach the 8 billions of leva (or approximately 4 billion euro), more than 1 million customers, around 4000 employees and more than 320 shops in all over the country. [12]

4.3.2 **Alpha Bank**

Alpha Bank was founded in 1879 and is one of the biggest banks in Greece. The bank knew big growth over the last decades. Today is the second in size bank in Greece and the biggest among the private ones. Except the offer of simple banking services and products, it also offers a wide spectrum of services. The Network of Bank in Greece numbers 370 shops. With 652 shops, the Group of Alpha Bank is also activated in international banking market, with presence in Cyprus (Alpha Bank Cyprus LTD), with network 29 shops, in five Balkan countries - in Romania (network 89 shops), in Bulgaria (network of 63 shops), in Serbia (network that exceed the 100 shops), in Albania (network of 16 shops), in Fyrom (network of 12 shops). Moreover the activities of Bank are extended beyond the limits of Europe, with shops in London, in New York and in the New Jersey. The upwards course of Alpha Bank is confirmed by the powerful improvement where they present her results in the first quarter 2007. In the possible points the period, is included the acceleration of organic growth of group in her region Europe but also the powerful growth of retail work in Greece. Concretely in the first quarter of 2007 the issuings of loans in the countries of Balkan have been increased by 81%. The net profits from Europe amount around 24,7 millions of Euros presenting an increase of 29%, while it deserves to be marked that Alpha bank constitutes the 10,3% of total.

In the Bulgarian market Alpha Bank opened first shop in Sofia 1995. In the dues of same year they opened in Sofia shops of her Ioniki bank and Popular Bank of

[12] www.bnb.bg

Greece. After their repurchase of in December 2000, new bank was renamed in Alpha Bank-Sofia Branch. (alphabank.bg, 2007) In the dues 2006 they had opened 45 shops, while today the number shops Alpha Bank in Bulgaria it reaches in the 63, covering all extent of country.

Except the city of Sofia (in the remainder extent of country that is to say), it is in function 45 branches of Alpha Bank. Thus the bank has also presence in the 28 prefectures of country, maintaining shops in 41 cities of Bulgaria.[13]

4.3.3 Bank Piraeus

The Group Piraeus constitutes one of the most dynamic groups of Greek economy. The Piraeus bank was founded 1916. Functioned as private Bank up to 1975. Later passed under government control, where it remained up to 1991. In December 1991 was privatised and until present continues rapid growth.

The Bank Piraeus materialised a line of strategic movements of (mainly repurchases and fusions with foreigner and domestic banks), aiming at its consolidation in the domestic market, and leading to the creation of one of the three biggest private banks in Greece.

Today the Bank Piraeus leads a Group of enterprises that cover total of work and activities of financing sector in Greece (universal bank). The electronic network banking Winbank, where it was created in the beginnings 2000 is the first completed service electronic banking in Greece.

In the beginning of 2005, the Group of Bank Piraeus materialised the strategy extension in the markets of South-eastern Europe and Eastern Mediterranean, as a reply of the repurchase of Bulgarian Bank by Eurobank. In 2005, realised the entry in the Serbian market with the purchase of Atlas Bank, but also in the Egyptian market with the repurchase of Egyptian Commercial Bank. The presence of Group of Bank Piraeus in abroad is focused in South-eastern Europe and Eastern Mediterranean, maintaining above 270 shops in the region. Concretely, in Bulgaria the Group controls over 73 shops Piraeus Bank Bulgaria, in Romania 70 shops of Piraeus Bank Romania, in Albania the Tirana Bank with 38 shops, in Serbia her 36 shops Piraeus Bank Beograd and, finally in Egypt the Piraeus Bank Egypt with 40 shops. At the same time the Bank has presence in his big financing centres London and the New York

[13] www.alpha.gr

The share of market of Bank by the 31.12.2006 on the total of commercial banks that function in Greece amounts in 12,5% in the issuing and 11,3% in deposits Main strategic objectives of Group Piraeus are the enlargement of shares of market in Greek and in its banking purchases abroad where is activated and the further aid of place of Group in retail banking and the small-intermediate enterprises.

The presence of Group of Bank Piraeus in Bulgaria began with the foundation of shop Sofia from the former Xiosbank in 1994. Today, the Group of Bank Piraeus allocates 73 shops and 59 ATMs having a good geographic cover of hinterland. In the dues 2006 it occupies more from 780 workers. The asset the Bank in the 31.12.2006 was 1.046 million, while the share of market amounted in the 6,7% of local market of issuings. The Bank Piraeus has been already 13 years in the Bulgarian market and covers the total work and activities of financing sector in Bulgaria (universal bank). December of 2006 the Bank Piraeus contracted strategic alliance with the ING Bank Bulgaria, according to the models of same collaboration in Greece.It is the first foreigner bank that functioned with complete rights in Bulgarian market.

In the end of year 2006 the Bank Piraeus possessed the 8th place in banking market of Bulgaria, with share of market 4.24%.

Piraeus is among the four big Greek banks where they are activated in the Bulgarian market, which allocates more shops in neighbourhoods despite in the centre of city. Although, concerning other banks, it has smaller number of shops in Sofia, it is the unique Greek bank that allocates shop in one from the suburbs of city, that is characterized from highly incomes, thin layout, and the higher cost of ground in the total of city. [14]

4.3.4 **National Bank of Greece**

The National Bank of Greece, with the largest and more powerful presence in Hellenic space, but also with her dynamic profile in South-eastern Europe and the Eastern Mediterranean is the leader and the most powerful Group financing services in Greece. It was founded in 1841 as commercial bank and up to the foundation of Bank of Greece in 1928 had editorial privilege. Thus NBG is the first Greek financing organism that imports with success its action in the biggest capital market of world. It has above of the 1/4 retail banking and has the biggest deposit base in Greece (25% share of market in the deposits). With

[14] www.piraeusbank.gr

network that numbers 559 shops and 1374 ATMs, covers the entire geographic extent of Greece. Today, afterwards the recent repurchases in the space of Europe, the network in the abroad through affiliated companies and shops includes 891 units.

With the repurchase of United Bulgarian Bank in Bulgaria (2000), the Stopanska Banka in Fyrom (2000), the Banca Romaneasca in Romania (2003), the Finansbank in Turkey (2006) and the Vojvodjanska Banka in Serbia (2006), NBG becomes the leading financier group in a market of 125 millions of residents.

It is included among the most powerful banking groups in European level (27th place). The presence of NBG in the Bulgarian market is through the subsidiary company of group the National bank, the UBB (United Bulgarian Bank). In year 2000 the NBG acquires share of 89,9% of UBB - the second, then, bigger Bulgarian bank, who already had a developed network of shops, that today it numbers 153 shops in all the extent of country. In 2004 the share of NBG in the UBB reaches 99,9% .[15]

4.3.5 **Eurobank EFG**

The group Eurobank EFG is a member of EFG Bank European Financial Group based in Geneva. EFG Eurobank Ergasias was founded in 1990 with initial name "Euroependitiki bank". With the release of market retail banking in Greece, the bank has followed an ascendant course, through dynamic organic growth. In 1994 acquired share of 75% of EFG Private Bank (Luxembourg).

Today, Eurobank is a European organism occupying 19.000 persons and provides the products and services so much through 1.300 points of presence, as through alternative networks.

In the wider region South-eastern and Central Europe, EFG group is included in the protagonists of banking developments in the countries in which it has presence. Concretely, the banking Group has developed the last years important presence in Bulgaria, Romania and Serbia while in 2006 it extended its presence and in other important markets. The repurchase of DZI Bank in Bulgaria (the second subsidiary company in the country) then follows the market of Universal Bank in Ukraine, the growth of network of shops in Poland and the market of Tekfenbank in Turkey, in 2006. Although it began its extension more recently comparing with others, Eurobank EFG has already an extended presence in 6

[15] www.nbg.gr

countries of New Europe, with network over 700 shops and a total of invested capital of 1 billion of Euros.

The penetration in Bulgaria began in 2002 with the acquisition of attendance 43% of PostBank. After the repurchase of DZI Bank, Eurobank EFG occupies today above 3.000 employees and it has invested more than 300 millions of Euros in the country.

The network of Postbank in Bulgaria is one of the best developed banking networks with 150 shops and representatives in more than 2000 post stations. The bank allocates shops in all 28 prefectures of country, in 93 cities globally. From the total of 153 shops only the 50 are found in Northern Bulgaria.[16]

4.4 Challenges and Prospects of the Greek Banks in the Balkans

Today the Balkans offer major growth potential of business to banks in European countries due to the high rate of credit expansion and low level of development of financial markets. However, as functionality is upgraded systems and products offered by European banks, the Greek banks are required to adjust their strategy in the face of growing competition.

The economic policy pursued by the Balkan countries oriented towards the objective of macroeconomic and financial stability and structural reforms in domestic economies converge to European standards. In the structural changes, these countries do not suffer from bottlenecks are the European economies, since there are no vested social models have put corporate interests of particular professional classes. Thus, convergence to appropriate modern standards is faster and adjustments in the economic environment easier. Therefore, in these countries, the liberalization of the financial system will be completed faster than other countries in the past. The rapid convergence of standards will inevitably affect the growth of demand for financial products and services, which will soon enter a phase of maturity. Thus the Greek banks are required to accelerate the consolidation of their position in South East Europe as the credit expansion is strong.

[16] www.eurobank.gr

The expansion of Greek banks in developing markets near the Balkans and the Mediterranean remains the centerpiece of their strategy. However, today more and more assessments of financial institutions in the region increased to such an extent that in some cases the purchase price is prohibitive for Greek banks. A typical example was the sale of the Romanian BCR, the price of 3.75 billion, which caused the match some of the largest European banks, and excluded the participation of Greek banks.

The high valuations make it more appropriate method of expansion in the organic development of Greek institutions and the remaining for sale banks are few and expensive. Even in less developed markets (eg in Serbia), takeovers are now conducted four times the book value of sales to banks, while just a few years, acquisitions were made at prices half times more than the book value. In some Balkan countries, privatization is almost complete (eg Romania, Bulgaria) and the degree of private control of banking sector is high (up to 90% of the total capital of the banking system). The entry of foreign banks and the development of new local banks will further reduce the market share for the remaining large banks state interests.

The next stage, and that lowering the concentration of the industry, is the domestic mergers and acquisitions, which will be forced banks with smaller market shares. The Greek banks have expanded rapidly and acquire a suitable size to have a leading role in the next stage of mergers and acquisitions in the region.

Bulgaria

The 2007 is a milestone year for Bulgaria as from January is a member of the European Union.

In 2005 GDP growth was strong (5.5%), and for 2006 is expected to remain high (5.6%), mainly due to strong domestic demand. Economic growth accompanied by rising inflation in Bulgaria. In 2006 inflation was 7.4% (from 5% in 2005), driven by the increase in international oil and metals prices and rising food prices due to the floods of 2005.

The trade deficit worsened to 20.4% of GDP in 2005 from 15.1% in 2004 due to acceleration of the growth rate of imports and slowing exports. The Bulgarian

exports benefited in the second half of 2005 in the revival of the duties imposed by the European Union on imported textiles from China. The current account deficit as a percentage of GDP has doubled to 11.8% in 2005 versus 5.8% in 2004. About 2 / 3 of the current account deficit "financed" by remittances and foreign direct investment inflows. In 2005 foreign direct investments in Bulgaria amounted to € 2,2 billion and accounted for 10.3% of GDP, from 7.9% of GDP in 2004.

The high rate of credit growth in Bulgaria is the result of increased demand for loans caused by the aid of disposable incomes and the resulting increased demand for consumer durables, housing and business fixed investment. The acceleration in credit growth raises concerns about the chances of both global economy and increase credit risk. In 2006, credit growth in Bulgaria remained strong, although the annual growth rate of loans slowed to 22.4% in June 2006 from 32.3% in 2005.

Since 2003, the retail banking is growing faster than the "wholesale" banking (June 2006: 22.4% vs. 14%). The further development of retail banking is expected, whereas Bulgaria has a very low rate of household borrowing as a percentage of GDP (2005: 15%, Greece 38% 53% Eurozone. The financial system in Bulgaria is dominated by the banking sector, which accounts for 90% of all funds of the credit system. The banking sector has grown faster than the overall economy, and global funds industry grew by 35% of GDP in 1999 to 78% in 2005.

In early 2005 the central bank of Bulgaria, to moderate credit expansion, credit limits imposed on banks. Credit limits should be lifted gradually, since their effectiveness does not last long. This is because firms and households to use alternative sources of borrowing. Already in 2006, many companies have replaced the lending by domestic banks by issuing bonds or borrowing from foreign banks. Also in 2006, banks in order to avoid the restrictions, transfer their receivables from customers in their balance sheet to companies known as' Special Purpose Companies.

The process of privatization in the banking sector has been completed, with 98% of total capital in the sector controlled by individuals. The Bulgarian banking system is dominated by foreign banks. The percentage of

total capital controlled by foreign banks increased gradually from 38% in 1999 to 76% in 2005. The banks purchased by foreigners went to a radical restructuring, but in the process lost some market share. For example, Bulbank in 1999 before the acquisition by UniCredito had a market share of assets under 25%, while 2005 had a share of 10%. Instead, local private banks tightened gradually increasing their market share by lending to customers at 21% in 2005 from 15% in 1999.

In 2005, 8 domestic private banks operating in the country controlled only 24% of funds in the banking system and the two state banks about 2%.

The banking system in Bulgaria has already entered a new phase of development through domestic mergers and acquisitions, which will generate significant new upheavals. Mergers and collaborations between two or more financial institutions are expected to set up a strategic leading position. The merger of the Italian UniCredit German Hypo-Vereinsbank, (HVB) that closed on June 15, 2005, resulted in the creation of new alliances in the banking market in Bulgaria. The UniCredit and HVB control three banks in Bulgaria, Bulbank (in terms of UniCredit) and HVB Biochim (formerly Biochim Commercial Bank) and Hebrosbank (in terms of HVB). The merger of Bulbank, HVB Bank Viochim HebrosBank and create a great institution, bringing together market share to competitors infeasible.

Additionally, the first half of 2006, the Association of Piraeus Bank and its subsidiary Piraeus Eurobank AD led to the creation of more bank occupies the 8th position in the ranking, ahead of the Economic Investment Vank, SG-Express Bank and DZI Bank in held respectively in the 8th, 9th, and 10th in 2005. Prominent in the banking market in Bulgaria is the group UniCredito share by assets 21.8% in 2005 and share allocations by 21.9%. Then followed Hungarian OPT Bank, after the acquisition of DSK Bank, with 13.6% share of assets and 16.3% share allocations.

Overall, the country with the largest penetration in the banking market in Bulgaria is Greece, after the recent acquisition of DZI Bank by EFG Eurobank-Labor. In June 2006, five large Greek banking groups together ended up with

totaling 23.6% of the funds of the banking system and 26.2% of loans to customers.

Chapter 5: Indicators by the end of 2008

The current global financial turmoil unveiled the vulnerabilities of the economy and its dependence on external financing due to the widening external imbalances. The latter include a massive current account deficit and gross external debt. In this uncertain environment, the worries of investors and rating agencies regarding the sustainability of the current account deficit and gross external debt have been intensified. In the first half of November, both Standard and Poor's and Fitch downgraded Bulgaria's sovereign credit rating one notch to BBB and BBB-, respectively, and revised the rating outlook to Negative and Stable. A month earlier, Moody's had already revised downwards the rating outlook to Stable from Positive. The unexpected widening of the current account deficit and the increase in the gross external debt were the main culprits of the aforementioned rating actions.

The current account deficit through September widened to 15.8% of the projected GDP for 2008 compared to 13.5% in the same period of the previous year. Similarly, the FDI coverage of the current account deficit plummeted to 68% for the first nine months of the year from 120.9% in the same period of the previous year. Subdued activity in the construction and real estate sectors, which attracted the bulk of FDIs in the previous year, will attract less net FDIs and challenge the financing of the current account deficit in the foreseeable future. By the same token, banks which are foreign affiliates will be reluctant to raise their market shares in Bulgaria following more conservative directives set by their parent institutions. Gross external debt is rising as well, amounting to 98.8% of GDP in the period January- August from 91.4% of GDP in the corresponding period last year. No signs of an economic slowdown have been detected as yet. In fact, real GDP growth was 6.5% in the first nine months of the year relative to 5.9% in the corresponding period of the previous year. According to a preliminary estimate, real GDP growth slowed down to 5.6% in 2008Q3 from 7.1% in the previous quarter but was above 4.9% recorded in 2007Q3. Similarly, retail sales expanded by 3.9% in September from 2.3% in the previous month, but remained below the readings in the first months of the year. Furthermore, industrial sales increased significantly by 2.5% in September from -5.4% in August. The IMF revised real GDP growth in 2009 downwards to

4.2% from the initial 4.75% due to global financial crisis. However, the Fund revised the real GDP Widening external imbalances led to downward revisions of the credit rating outlook FDI coverage plummeted in the first nine months of 2008 Signs of a slowdown are yet to be seen growth rate for 2008 upwards to 6.3% from 5.5% due to the unexpected high growth rate in 2008H1. Similarly, the uncertain global environment led the European Commission (EC) in its Autumn Economic Forecasts to revise downwards the real GDP growth rate to 4.5% in 2009 from 5.6% in the Spring Forecasts. Nevertheless, the EC revised upwards this year's forecasts to 6.5% from 5.8%.

Inflationary pressures eased in October. Headline inflation moderated to 10.9% in October from 11% in the previous month and harmonized inflation eased to 11.2% in October from 11.4% in the previous month. This was the fourth consecutive month of falling inflation. Similarly, producer's price inflation slumped to 12.6% in September from 14.4% in August and 15.4% in July signaling that the passing through of higher wholesale prices to final consumers will be limited. However, as of October 1st, gas prices increased by 23.9% signaling future hikes in prices, while it is expected that heating costs will increase, too. According to the IMF, inflation will hover at 12.2% in 2008 and 7% in 2009 respectively, while the current account deficit will widen to 24.4% of GDP in 2008 before moderating slightly to 21.5% next year. The EC envisages that inflation will moderate to 7.9% in 2009 from 12.4% in 2008, but it will remain above the Maastricht cutoff point necessary to qualify for entry into the euro area.

Inflation could have cooled off more the general budget surplus widened to 7.5% of GDP in January- September from 7% of GDP in the period January-August. We note a significant decrease in revenues signaling the adverse impact of the global financial crisis on the domestic economy. The government has revised its fiscal target for 2008 to 3% of GDP from previous 3.5% of GDP and plans massive one-off expenditures amounting to 1.8% of GDP on social transfers and investments. Finally, the targeted fiscal surplus for 2009 is 3% of GDP, but it can be revised to 2% of GDP subject to a hard landing of the economy due to adverse external shocks. [17]

[17] www.oecd.com www.eurostat.com www.bnb.bg www.imf.com

Chapter 6: Indicators by the end of 2009

A new government emerged after the landslide victory of the former Sofia mayor Boiko Borissov in the national elections held on 5 July. The GERB or Citizens for the European Development of Bulgaria party of Mr Borissov got 39.7% of the vote and won 116 of the 240 seats in the parliament pledging to fight corruption, maintain a balanced government budget and sustain economic development. However, the short term economic outlook does not appear rosy for the new government. The release of the final figures on real GDP for 2009Q1 verified that the economy has entered a recession after a protracted period of outstanding growth. Indeed, real GDP contracted by 3.5% as the global crisis stifled investment, industrial production and trade. In the second quarter, real GDP retrenched 4.9% and the economy slid into technical recession. Domestic consumption fell by 5.4% in 2009Q1, industrial output (31% of GDP) declined by 12.4% and agricultural output (4% of GDP) was down by 4% in 2009Q1 after gaining 26.7% in the previous quarter. Annual growth of services (65% of GDP) narrowed to 2.5% in 2009Q1 from 3.8% in the previous quarter.

All leading indicators point out that recovery is nowhere close. Also, the industrial production declined for eighth consecutive month in May by 22.1%, from 20.2% in April due to weakened demand. Similarly, industrial turnover dropped by 24% in May compared to 20.4% in April signaling further worsening of exports. Retail sales do not offer any glimpse of hope either, as they declined faster in the year in May relative to the previous month, while the unemployment rate galloped for a fourth consecutive month in June to 7.3%. According to the available estimate, the annual contraction of real GDP accelerated to 4.9% in 2009Q2. The negative contribution came primarily from domestic demand as final consumption declined by 6.3% and investments by 13.9%. Thankfully, imports fell more than exports making a positive contribution to GDP. Activity in the industrial and agricultural sectors contracted by 6.6% and 9.8%, respectively while activity is services rose by 0.3% in 2009Q2. After discounting the above disappointing data, we pencil in that real GDP will retreat by 6.25% in 2009 and we revise downwards our previous projection. Weak economic activity affected prices, as well. Indeed, inflation toppled for a third consecutive month in July to 1.6% from 3.7% in June and decelerated by 0.4% in the month. Inflation averaged 4.5% in January-July 2009 versus 5.1% in 2009H1. For the first time food prices began falling in the year, while prices for

services decelerated further. At the same time the annual growth of non-food and catering prices remained subdued. Favorable base effects from food prices contributed to the monthly drop of the Consumer Price Index (CPI).
However, we estimate that the disinflation impact of those effects will be short-lived, as the Ministry of Agriculture announced that the harvest will be weaker this year and consequently, food prices will most likely increase. On the positive side, producer prices fell for a fourth consecutive month in June by 5.1% after having declined by 3.2% in the previous month, signaling that the feedback to the end consumer prices will be muted in the coming months. We believe that inflationary pressures will remain subdued as the economy stagnates and inflation will average 5.5% throughout the year.
The new government is caught between a rock and a hard place with regard to fiscal management. On the one hand, the economic recession is eroding tax revenues, necessitating larger budgetary outlays in order to sustain economic growth. On the other hand, a sturdy fiscal surplus is required in order to support the fiscal reserve account which supports foreign exchange reserves at the Bulgarian National Bank (BNB) and, consequently, preserves the credibility of the currency board. In fact, the government would be content with a budget nearly balanced or with a small surplus by year-end. Yet, the realization of the fiscal management does not look promising. The budget of the general government posted a deficit of 0.6% of GDP in the first seven months of the year after a surplus of 0.3% of GDP in 2009H1 compared to a surplus of 4.3% of GDP in 2008H1. Apparently, the sizeable budget surplus of 6.3% in the period January-July 2008 is a reminiscent of the past. Revenues declined by 9.9% in the period January- July 2009 and expenditures expanded by 24.3% to 23.8% of GDP versus 18.3% of GDP in January-July 2008. Moreover, the fiscal reserve declined by 28.5% in July after it had contracted by 19.2% in June. The government admitted that, under the current fiscal management, the budget will post a deficit of 3.8% of GDP by year-end and that the initial annual target for a surplus of 0.5% of GDP is unattainable.
To that end, it promoted the so-called Stability Pact I which includes fifteen measures to stimulate the economy. We anticipate that those measures will increase the burden to the budget and have a limited positive impact in the short-term. Thus, we affirm our projection that the budget will record a shortfall of 1.2% of GDP by year-end. The current account deficit contracted for a seventh consecutive month in June by 86.4% after having narrowed by 62.3% in the previous month and by 52.3%YoY in 2009H1. It amounted to 6.3% of the full-year GDP estimate in 2009H1 compared to 13.1% in the corresponding

period of the previous year. The only negative development was the annual fall of current transfers. Other than that, the trade deficit narrowed down substantially and contributed to the shrinking of the current account deficit. Net Foreign Direct Investments (FDIs) declined by 53.5% in June and by 45.7% in 2009H1, but financed the 71.6% of the current account deficit in 2009H1 compared to 57.1% in the period January-May 2009 and 62.9% in the same period last year. We commend the government's intention to apply in November to join the Exchange Rate Mechanism (ERM) II, the European Union's two-year currency stability test before the country adopts the euro, and remain firm to our projection that the current account deficit will hover at 14% of GDP this year.

Tables

Table 1:Credit ratings for Bulgaria

INVEST BULGARIA | THE PREFERRED PARTNER OF INVESTORS SEEKING OPPORTUNITIES IN BULGARIA

CREDIT RATINGS FOR BULGARIA

Standard and Poor's Cradit Rating						
	Foreign Currency			Local Currency		
Date	Long-term	Short-term	Outlook	Long-term	Short-term	Outlook
23.11.199	B	B	Positive	B	B	Positive
10.5.2000	B+	B	Positive	BB-	B	Positive
07.11.200	BB-	B	Stable	BB	B	Stable
07.10.200	BB	B	Positive	BB+	B	Positive
22.5.2003	BB+	B	Stable	BBB-	A-3	Stable
24.6.2004	BBB-	A-3	Stable	BBB	A-3	Stable

Moody's				
	Foreign Currency			Local Currency
Date	Long-term Bonds and Notes	Long-term Bank Deposits	Outlook	Government Bonds
27.9.1996	B3	Caa	Stable	
03.7.1997	B3	Caa1	Positive	
16.12.199	B2	B3	Stable	
20.2.1998	B2	B3	Positive	
18.2.1999	B2	B3	Positive	B1
25.7.2000	B2	B3	Stable	B1
19.12.200	B1	B2	Stable	B1
16.12.200	B1	B2	Positive	B1
06.6.2003	Ba2	Ba3	Stable	Ba2
17.11.200	Ba1	Ba1	Positive	Ba1

Fitch				
	Foreign Currency			Local Currency
Date	Long-term	Short-term	Outlook	Long-term
17.04.199	B+	B	-	BB
03.08.200	B+	B	Positive	BB
14.01.200	BB-	B	Stable	BB
29.10.200	BB	B	Positive	BB+
24.07.200	BB+	B	Positive	BBB-
04.08.200	BBB-	F3	Stable	BBB

Table 2:Largest investors in Bulgaria

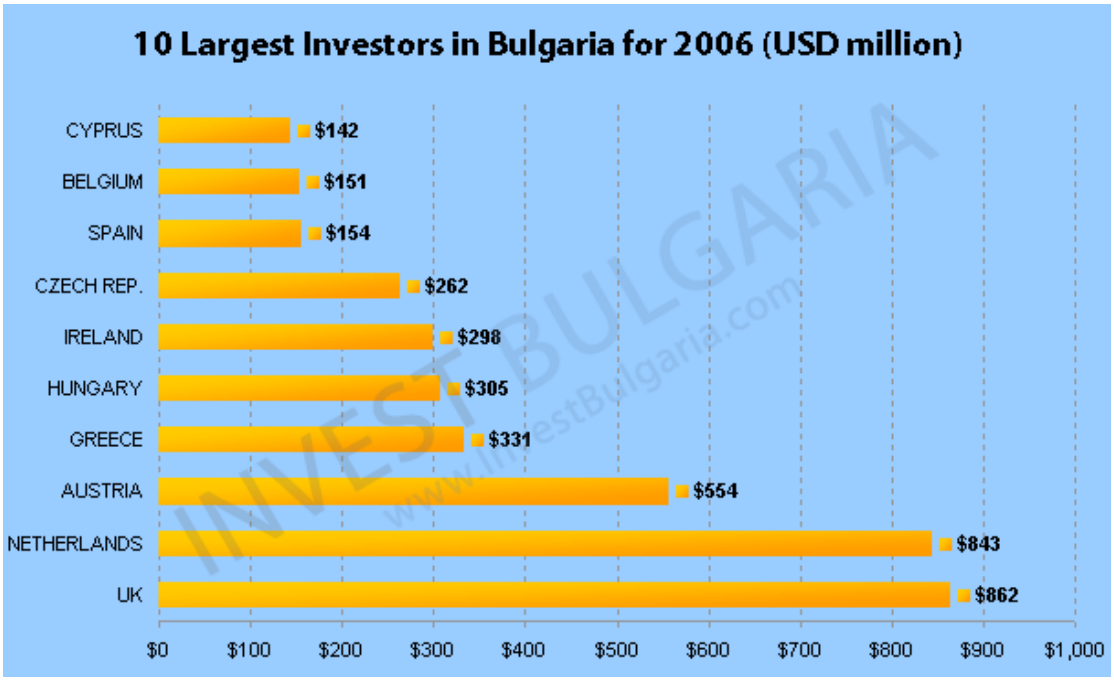


Table 3: TOTAL DIRECT INVESTMENT IN BULGARIA BY SECTOR (USD millions) Source: Bulgarian National Bank

	SECTOR	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
1	Financial intermediation	151	98	449	123	134	502	239	551	906	3152
2	Trade and repairs	112	135	117	122	229	485	365	905	560	3028
3	Real estate and business activities	34	40	3	13	57	182	142	735	1580	2785
4	Electricity, gas and water supply	2	5	20	2	67	8	925	355	247	1631
5	Petroleum, chemical, rubber and plastic products	41	165	72	-10	7	170	-3	474	294	1209
6	Telecommunications	23	14	15	237	205	127	402	182	-160	1045
7	Construction	2	20	48	17	33	5	55	184	523	888
8	Metallurgy and metal products	13	72	17	81	-19	67	54	71	503	860

9	Mineral products (cement, glass, etc.)	151	72	7	28	1	77	98	132	71	635
10	Food products	32	33	12	37	20	88	68	97	14	400
11	Textile and clothing	4	25	27	58	9	84	46	30	20	304
12	Hotels and restaurants	18	17	26	18	8	28	15	50	80	260
13	Machine building	21	18	65	13	38	1	14	11	51	232
14	Wood products, paper	37	25	38	3	17	70	-1	18	21	228
15	Electrical engineering, electronics, computers and communication equipment	12	6	29	28	18	29	-1	50	8	178
16	Transport	6	-12	10	6	8	45	29	-20	53	126
17	Mining	0	3	0	5	10	22	19	-10	2	50
18	Agriculture, forestry and fishing	7	2	7	1	1	3	-2	10	16	45
19	Leather and leather products	1	0	21	0	1	0	-3	2	1	22
20	Vehicles and other transport equipment	-1	2	0	5	2	2	-1	0	3	13

Table 4: Foreign Direct Investment in Bulgaria by Country Source: Bulgarian National Bank

	Country	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	**Tota**
1	AUSTRIA	13	1	15	1	12	13	47	75	70	94	161	238	908	1253	554	**3454**
2	NETHERLANDS	0	1	38	1	46	11	41	106	-10	80	31	243	457	189	843	**2075**
3	GREECE	0	5	3	30	15	16	3	2	99	240	239	225	256	355	331	**1819**
4	UK	6	6	2	14	7	16	59	28	-3	20	1	96	68	405	862	**1580**
5	GERMANY	0	57	111	16	53	31	56	40	39	67	85	108	358	81	104	**1207**

6	ITALY		0	5	2	1	0	2	7	338	147	45	101	105	133	74	**960**
7	HUNGARY	12	0	0	0	0	0	1	7	2	1	10	379	62	86	305	**865**
8	CZECH REP.			0	2	2	5	1	0	1	3	62	-7	373	148	262	**852**
9	BELGIUM		0	0	10	9	255	22	0	100	61	0	31	129	55	151	**823**
0	SWITZERLAND	0	7	0	8	23	31	7	9	25	34	36	145	142	320	35	**822**
1	USA		11	16	16	21	47	39	55	58	45	56	128	145	66	116	**818**
2	CYPRUS	0	1	0	1	8	21	109	162	75	18	-8	121	109	7	142	**767**
3	IRELAND			0	17	0	5	1	16	3	-6	-2	3	25	105	298	**465**
4	RUSSIA	0	1	2	15	14	2	15	100	22	-4	5	31	-21	105	85	**372**
5	SPAIN		0	0	0	0	50	57	4	1	5	0	5	10	53	154	**338**
6	FRANCE		0	4	5	7	1	3	78	37	15	9	23	63	34	56	**335**
7	TURKEY		10	1	14	7	10	24	12	25	-10	15	-5	73	47	49	**273**
8	DENMARK			1	0	0	1	2	-1	2	-1	4	49	17	23	96	**194**
9	ISRAEL			1	0	2	0	0	14	8	0	3	5	16	12	56	**117**
0	JAPAN			0	1	1	2	2	2	2	3	14	1	2	26	49	**102**
1	SWEDEN			0	0	1	2	1	0	2	6	29	7	11	15	20	**94**
2	MALTA				0	0	0	9	-1	1	3	1	8	4	6	47	**78**
3	LIECHTENSTEIN		1	0	0	0	3	1	5	4	7	6	13	13	4	0	**57**
4	CANADA					0				0	0	0	9	33	11	2	**56**
5	PANAMA							0	0	0	1	6	4	6	13	24	**54**
6	SLOVENIA									0	0	0	37	-4	7	7	**47**
7	LATVIA											0	1	1	9	35	**46**
8	ROMANIA											1	0	0	24	19	**43**
9	LITHUANIA										0		1	17	4	14	**36**
0	ESTONIA													1	13	20	**34**
1	LEBANON					0	1	0	2	0	-1	10	5	0	11	3	**31**
2	ICELAND														6	24	**30**
3	NORWAY						0	0		1		0	0	1	3	22	**27**
4	POLAND					2		0	0		0	1	-4	1	12	2	**14**
5	SLOVAKIA						6	2	0	2	0	0	-3	-1	3	1	**10**
6	CHINA											0	0	7	1	0	**9**

Table 5: Comparative unemployment

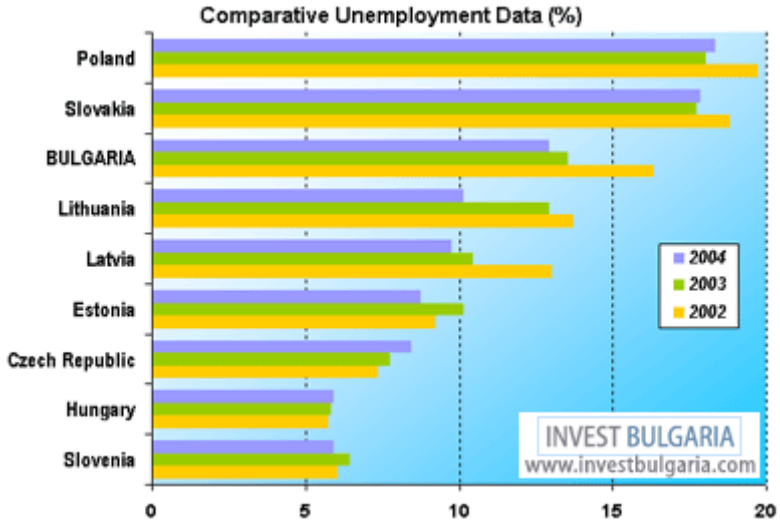
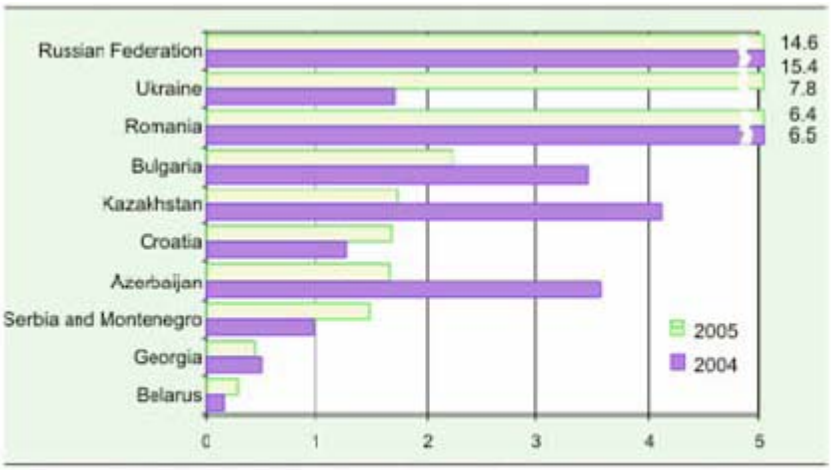


Table 6: S.E.E and FDI



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

[a] Ranked on the basis of the magnitude of the 2005 FDI inflows.

Table 7: Inflation and GDP(2006) Source *IMF Country Reports*

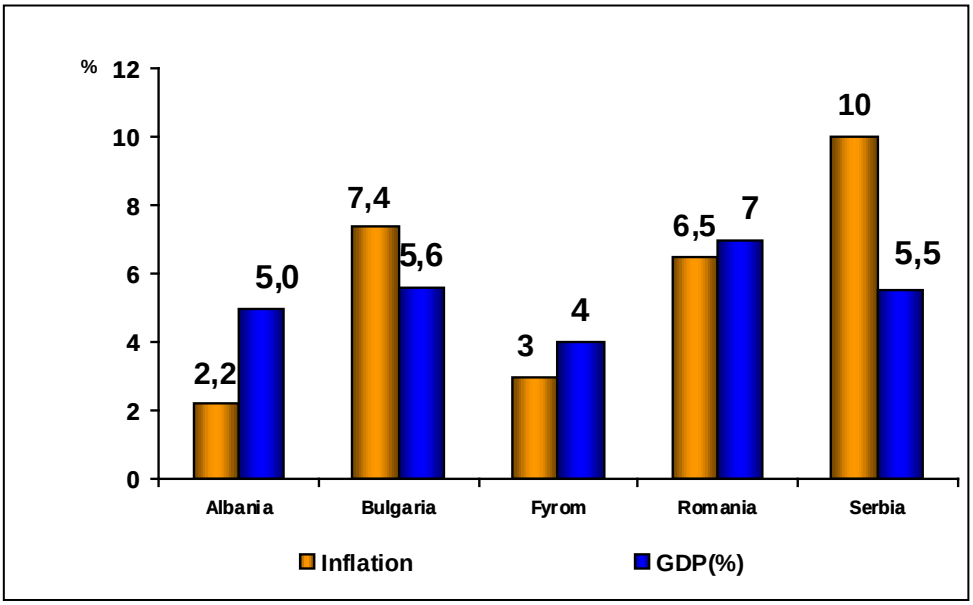


Table 8: Capital percentage banking system controlled from foreign banks 2005 source EBRD Transition Report, 2006

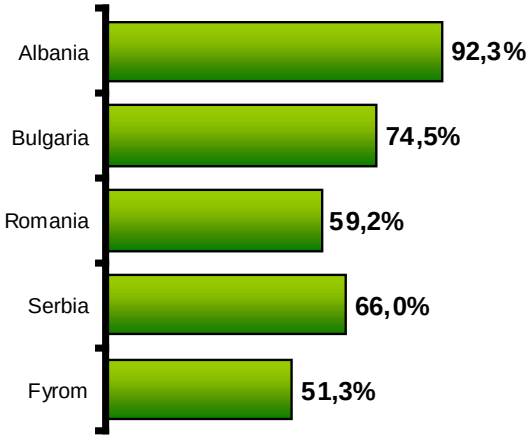
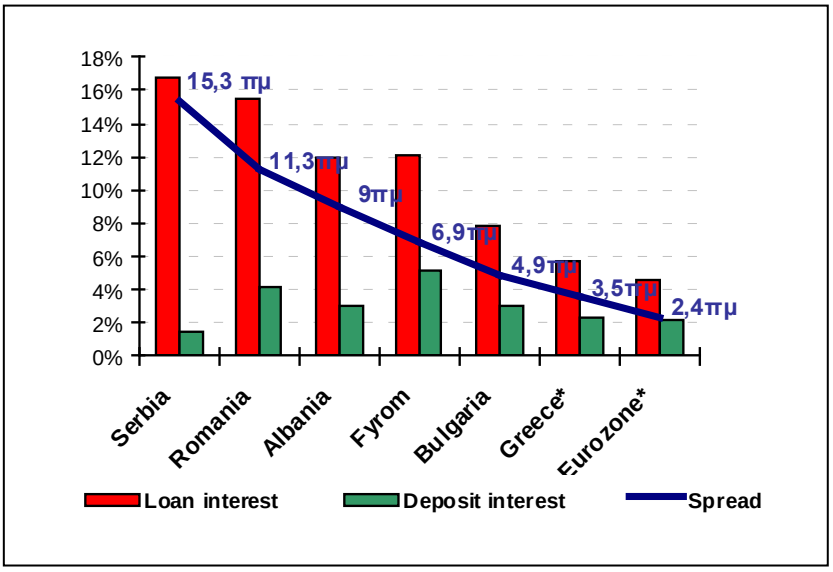


Table 9: Loan and deposit interests 2005

source EBRD Transition Report, 2006



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