

Bulgaria and the financial crisis

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Is Bulgaria safe?

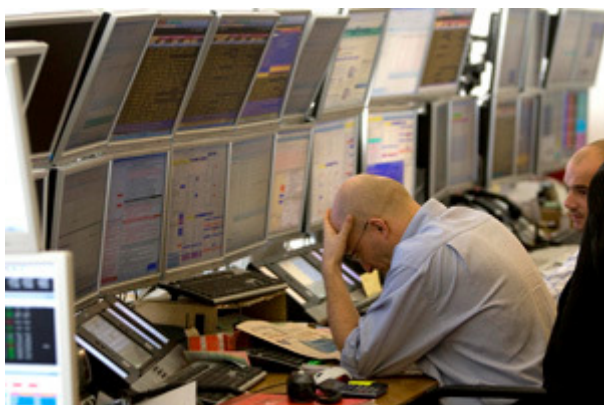


Photo: Reuters

The announcement of the preliminary data on gross domestic product (GDP) for the second quarter and first half of 2008 by the National Statistics Institute coincided with the deterioration of the international financial markets. Main stock market indexes plunged sharply and major international banks fell into the grip of panic.

At a time like this people and investors usually start asking to what extent the Bulgarian economy will be influenced by this crisis in light of an increasingly globalised market.

The numbers

The facts are that real GDP growth for the second quarter of the year in Bulgaria reached 7.1 per cent, which was yet another high growth rate in the year.

The GDP growth and the gross value added amounts up to 7.1 per cent for the first six months of the year. The main contributory growth factor was industries and services, which increased by 7.4 per cent and seven per cent respectively, while the agricultural sector grew by 6.5 per cent. While the first two sectors of the economy have previously demonstrated comparable growth rate to the latest data, the latter displays an unusual pick-up in economic activity since for the period 2004-2007 there has been a steady decline. However, the trade balance deficit decreased slightly in relative terms to 27.2 per cent of GDP, while in the first quarter of the year it accounted for 27.7 per cent of the GDP. So in terms of numbers the Bulgarian economy is experiencing the third highest growth rate in Europe in the second quarter of 2008, with only Romania (9.3 per cent) and Slovakia (7.6 per cent) performing better.

The reasons

The positive development of the economy can be attributed to greater investment in various industries and services. This, in return, has led to increased productivity and supply. On the other hand, demand is stimulated by more money being ploughed in to the economy which alone results from incoming capital flows and rapid growth of loans in recent years. By contrast, investments in the agricultural sector are still very limited as there are many problems such as the fragmentation of land and the use of outdated technologies which makes production highly dependent on weather conditions and does not allow predictable yields.

Warning

The prospects for the Bulgarian economy, however, are not that encouraging in the context of the tempestuous financial situation. The announcement of bankruptcy by Lehman Brothers, the difficulties within Merrill Lynch, AIG and other large companies in the financial sector, including the bonds' sectors in the US, is an obvious sign of a major financial crisis. The European Central Bank and the Federal Reserve show unequivocal willingness to inject liquidity into the banking system, which in the short term should aid economic agents but, in the longer term, such a rapid increase in liquidity would extend the period of adaptation to the new conditions and contribute to the rate of inflation. At a later

stage central banks would need to raise the main interest rate to target low inflation over the medium term.

Prospects

As far as Bulgaria is concerned, risks to the development of the economy emerge as a direct result of the unfavourable external economic environment and some internal factors as well. Saturation of the real estate and construction sectors would not reach again the same growth rates as previously exhibited. The crisis in the financial markets is likely to jeopardise funding prospects due to increases in long-term interest rates and thus fewer projects would stay profitable on the market. In the short term, it is likely that the growth of prices and wages would slow down. As a result economic activity and employment would relatively decrease and incite higher unemployment.

The bankruptcy of large international banks has shown that no one is insured against economic misallocations, especially in times of crisis. Risks will always remain and must be managed carefully even though there are protection mechanisms such as banking supervision, guaranteed deposits in banks and possible refinancing by central banks in case of systemic shortage of resources. In such conditions it is critically important that government policy is directed towards expanding economic freedom, which creates a more flexible environment to deal with external shakedowns. However, given that elections are coming up in 2009, it seems more likely that needed reforms will be delayed for a much later time.