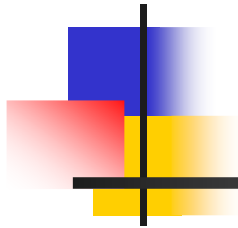


# **The Global Financial Turmoil and its Implications for CEE and SEE: Does Bulgaria Need to Worry?**



**Presentation by Rumen Dobrinsky  
UN Economic Commission for Europe  
Public Discussion Panel, 27 March 2008**



# The nature of the current global financial turmoil: a crisis of mature and deregulated financial market

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- **Three main ingredients of the crisis**
  - Widespread financial derivatives
  - Aggressive investment banks
  - The financial institutions involved are not subject to regulation
  - As a result – contagion to markets that contain these ingredients
- **Difference from previous similar episodes**
  - Derivatives have proliferated in global financial markets (a major difference from the Fannie Mae Freddie Mac crisis!)
  - Governments and regulators have very few instruments and options to intervene, once the crisis struck
- **Were there options to avert the crisis?**
  - Yes, by imposing additional prudential regulations (e.g. Spain, where the Central Bank required that that Spanish banks post an 8 per cent capital charge against SIV assets)



## **Are there risks for direct contagion in Bulgaria (a catching up SEE economy)?**

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- **Overall, the ingredients of the crisis are not in place in Bulgaria!**
  - Local financial derivatives are virtually non-existent as financial products
  - No specialized investment banks; investment banking is only emerging as financial activity and trading in financial derivatives plays only marginal role (if any)
  - As a results, the financial system is covered almost entirely by regulation and regulation is stringent
  - As a result, no conditions and risks for direct contagion



# **No major sources of macroeconomic and financial instability in Bulgaria**

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- **Stable growth**
- **Massive inflows of FDI**
- **Major improvements in the labour market**
- **Persistent budget surplus in recent years**
- **Large current account deficit, but fully covered by FDI**
- **Credit boom (potential source of vulnerability!)**
  - 62% growth of the stock of credit to non-government credit in 2007
  - Corporate credit grew by 70%
  - Household mortgage lending alone increased by 75%
  - But the quality of bank's portfolios is relatively good (4.8% substandard loans; 2.0% overdue credit)



# Are there other related risks for the Bulgarian economy?

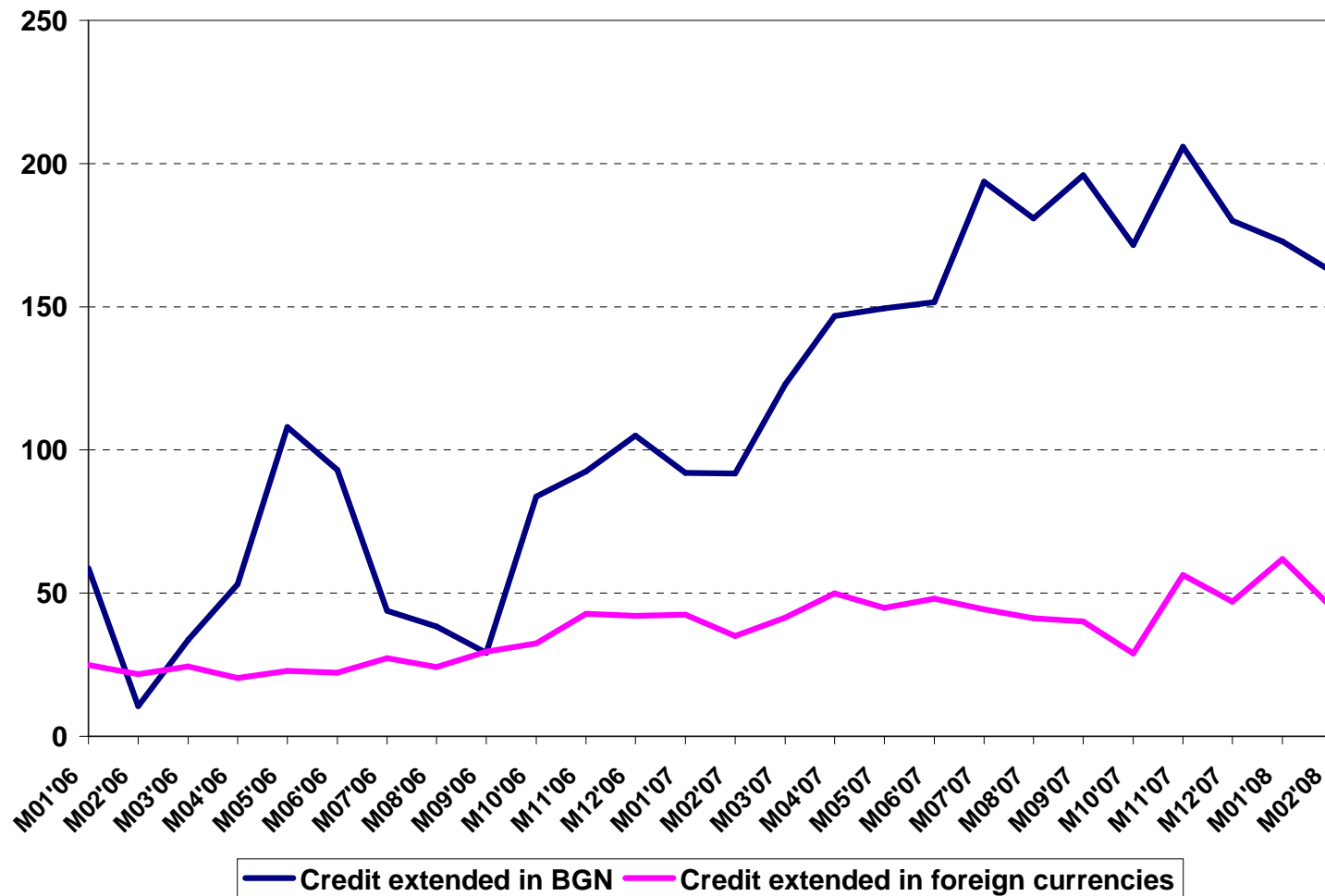
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- **Yes, there are risks of indirect negative effects, transmitted through different channels:**
  - Foreign borrowing by Bulgarian banks is adversely affected by the global liquidity squeeze
  - As a result, deterioration in the domestic borrowing conditions, which may have negative implications on economic activity
  - If the global financial turmoil triggers a global recession, this will also have adverse effect on the real economy
  - The rising global uncertainties may affect negatively the flow of FDI to Bulgaria

# Net change in the stock of credit to the corporate sector , 2006-2008 (mn EUR)



# Net change in the stock of credit to the household sector, 2006-2008 (mn EUR)





# **The biggest potential risk: the domestic housing market**

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- **Fast growth of mortgage lending**
- **Fast growth of housing prices (real estate bubble?)**
- **Risks for the banks exposed to mortgage lending**
  - A major economic slowdown may result in insolvency
  - If housing prices collapse, there may be a similar effect on the banks
- **Overall, still there are no signs of this happening**



# Housing and consumer prices in Bulgaria, 1999-2007 (Indexes, 1999=100)

