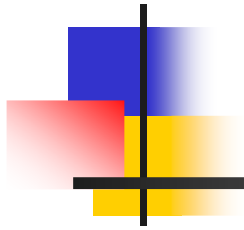


**The impact of the economic crisis on
Europe's emerging economies:
How reliable are warning signals?**



**Presentation by Rumen Dobrinsky
UN Economic Commission for Europe
Public Discussion Panel
Vienna, 22 March 2012**



Structure of the presentation

- **Macroeconomic imbalances and crises**
- **The “Alert Mechanism” of the EC and how different member states fared according to it**
- **Bulgaria’s economic performance during the crisis and why there was no destabilization despite the “alerts”**
- **Some lessons and conclusions**



Macroeconomic imbalances and crises

- Macroeconomic imbalances are the root causes of any crisis
- Macroeconomic imbalances emerge as a result of imbalanced growth
- Destabilization/crisis and imbalances are mutually reinforcing
- In a globalized economy crises are increasingly international – cross-country contagion
- Susceptibility/vulnerability to contagion: depends on a myriad of factors
- Emerging economies are generally (considered to be) more vulnerable/prone to contagion
- It is useful to be prepared and be aware of the vulnerability of the economy to destabilization/crisis
- **But: what is “macroeconomic imbalance” – do we really know?**



The “Alert Mechanism” of the EC

- **Surveillance procedure for the prevention and correction of macroeconomic imbalances (Macroeconomic Imbalance Procedure – MIP)**
- **Scoreboard indicators with indicative thresholds (most of them – average for past 3 years)**
 - External imbalances and competitiveness (5 indicators)
 - Internal imbalances (5 indicators)
 - Additional indicators used in the “economic reading” (18 indicators)
- **“Alerts” are signalled when thresholds are surpassed**



The “Alert Mechanism” of the EC

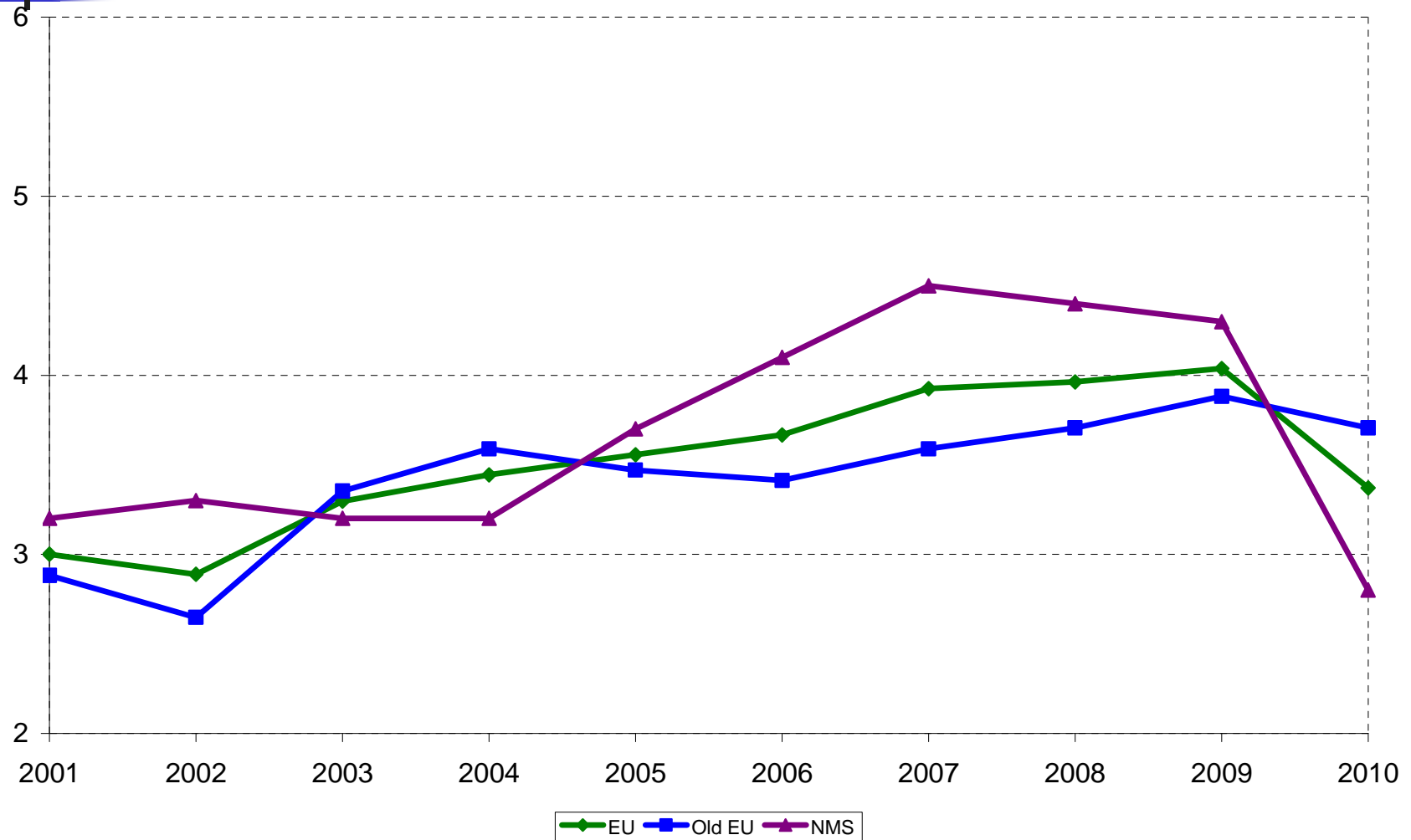
■ What kind of “alerts” are signalled

- Indicators contain significant lags (most of them are averages for past 3-5 years)
- They reveal consequences of past events but not the causes of the events
- Differentiate between public and private sector imbalances
- Most are nominal variables (indicate nominal imbalances)
- Economic growth per se is not among the “alert” indicators
- No indicators of “social imbalances” (unemployment is the closest to such)

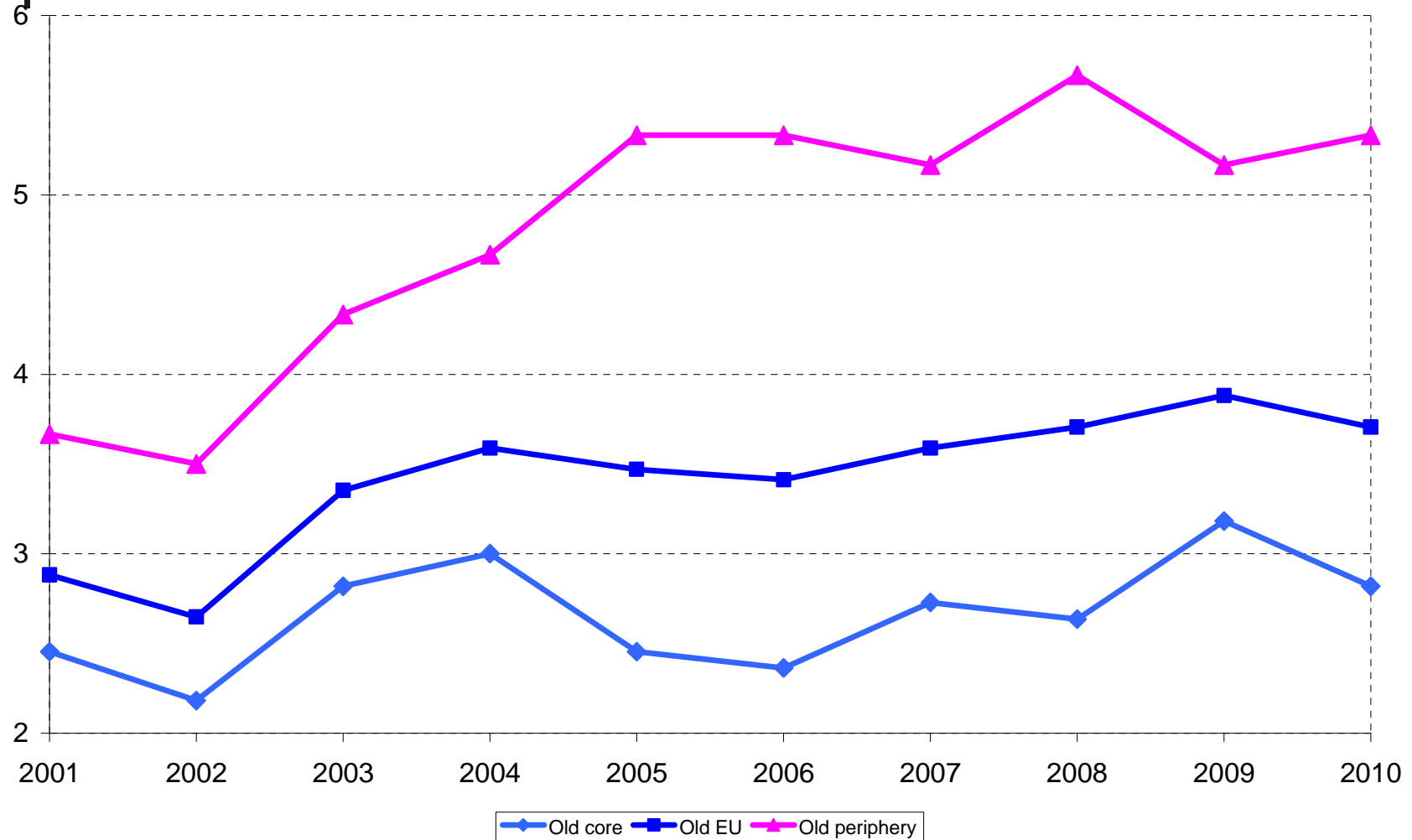
■ First report is cautious in interpretation

- 4 countries (Greece, Ireland, Portugal and Romania) are already under enhanced economic surveillance – not considered under the MIP
- “further in-depth analysis is warranted to closer examine issues” in 12 member states
- No alerts for 11 member states

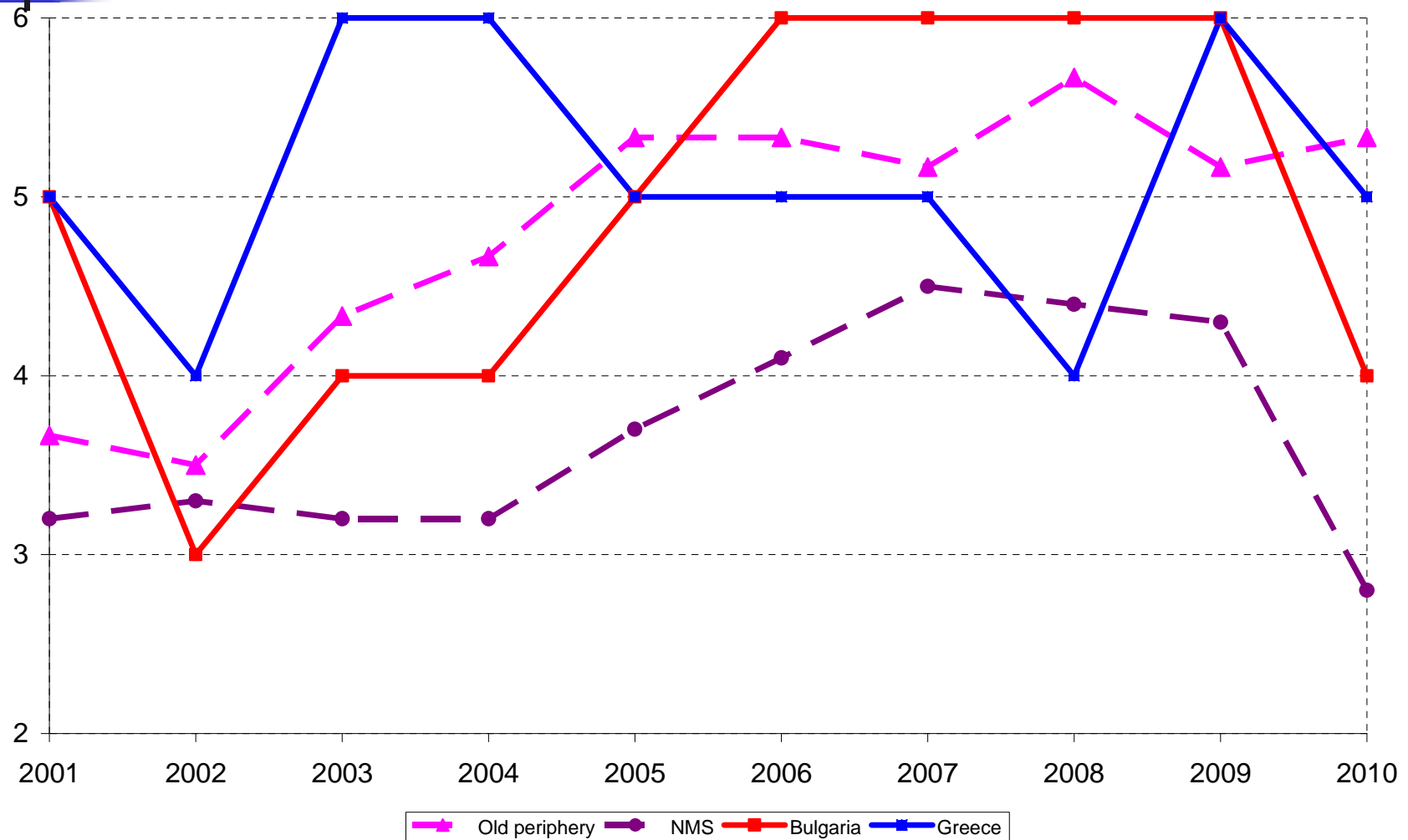
Average number of "alerts" in EU member states



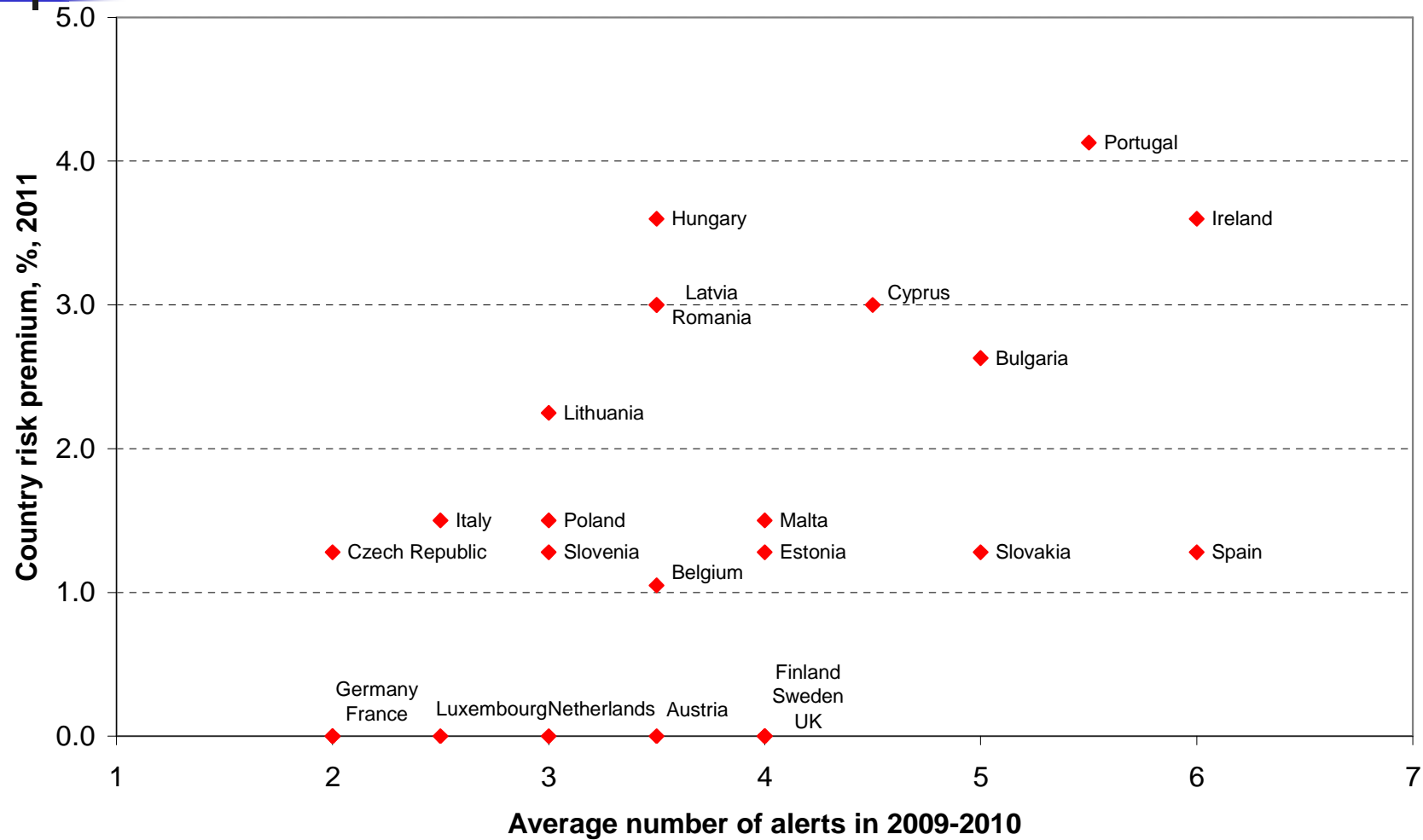
Average number of "alerts" in old EU member states



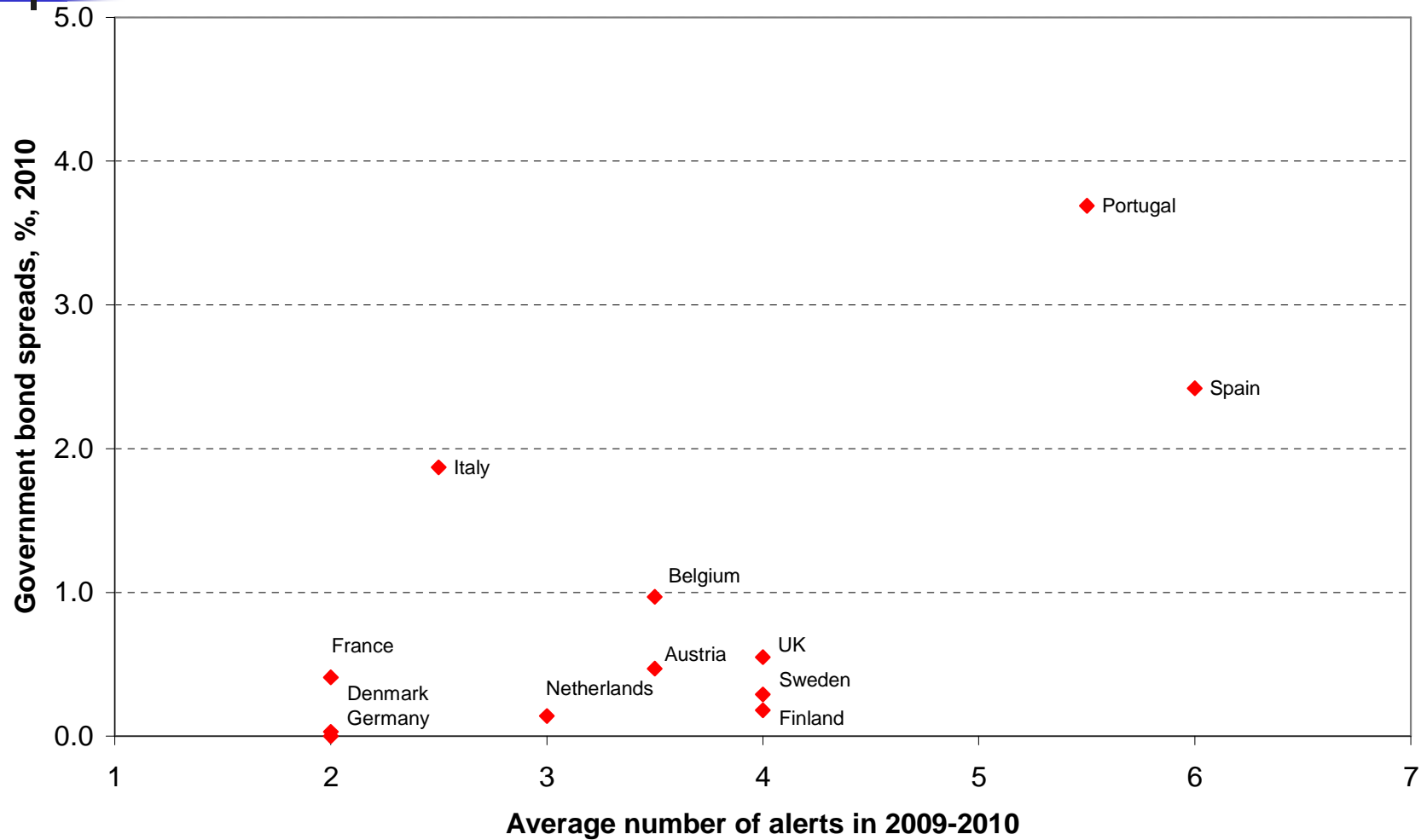
Average number of "alerts" in selected EU member states



Country alerts and country risk premiums, 2009-2011



Country alerts and government bond spreads (over bunds), 2009-2010

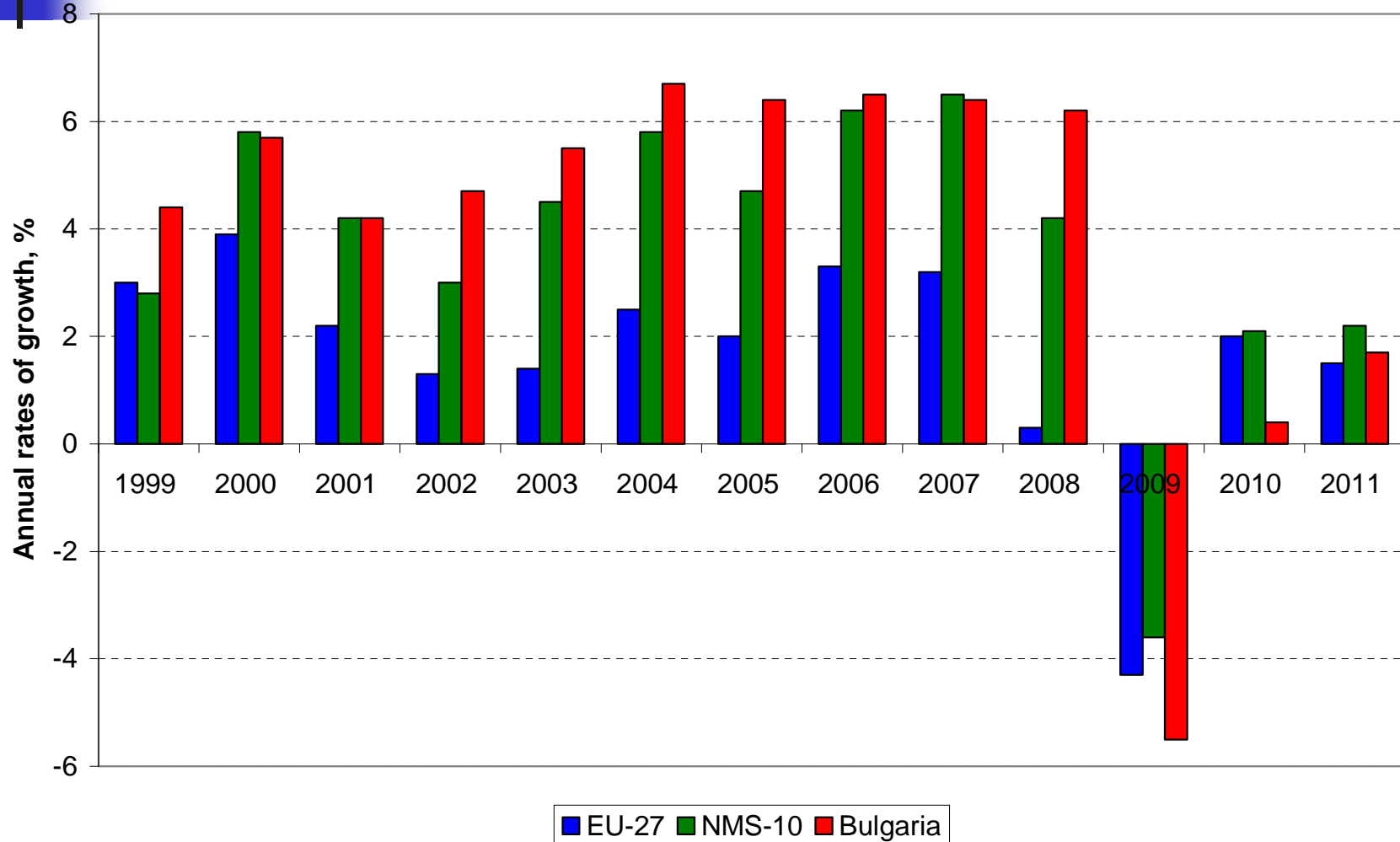




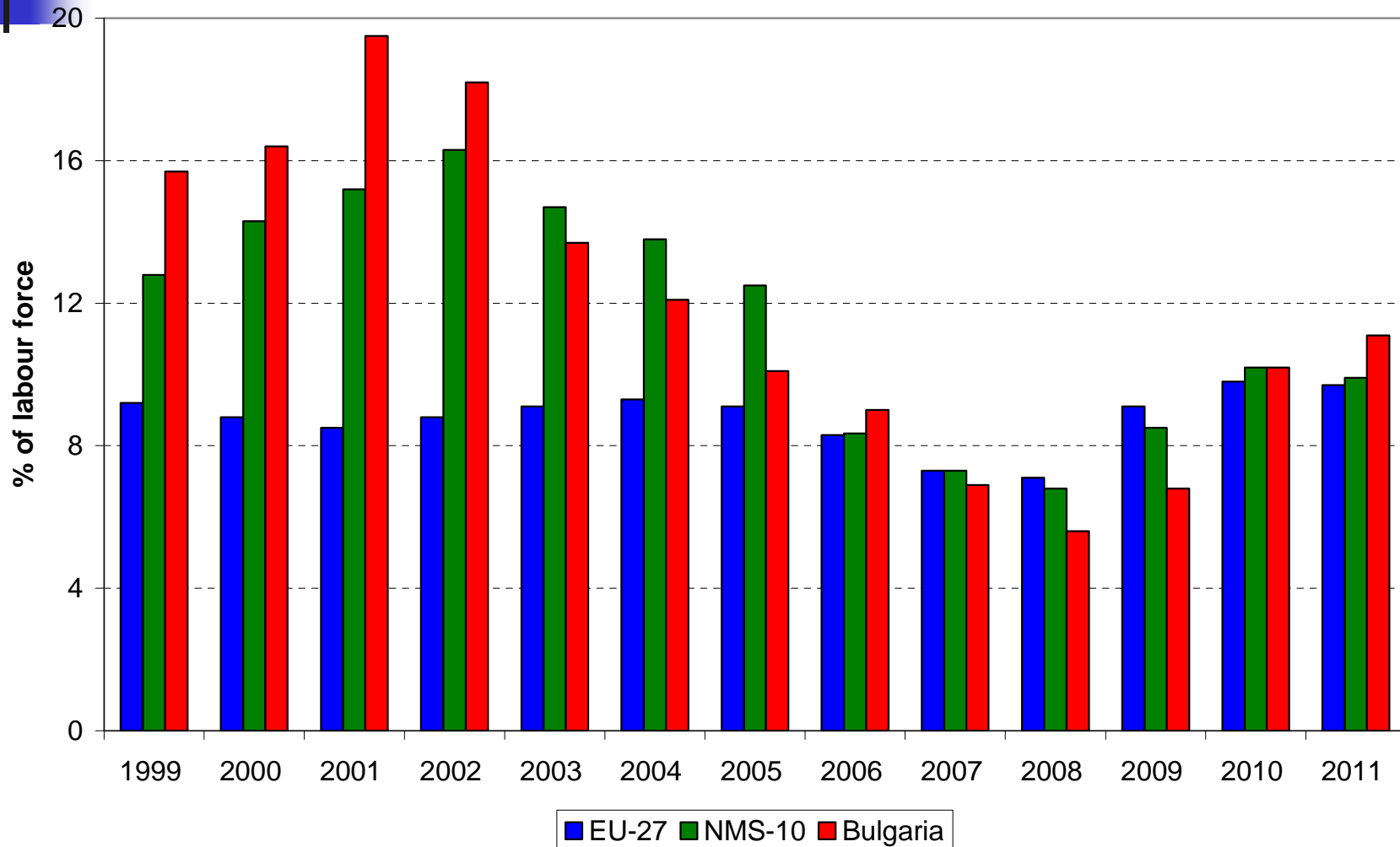
An overview Bulgaria's economic performance during the crisis

- **Bulgaria as an NMS and an emerging economy**
 - **questions to be asked:**
 - How BG performance compares with other EU member states (old/mature and NMS)?
 - Was high level of risk "alert" associated with abnormal macroeconomic performance?
 - What were the main macroeconomic effects of the crisis?

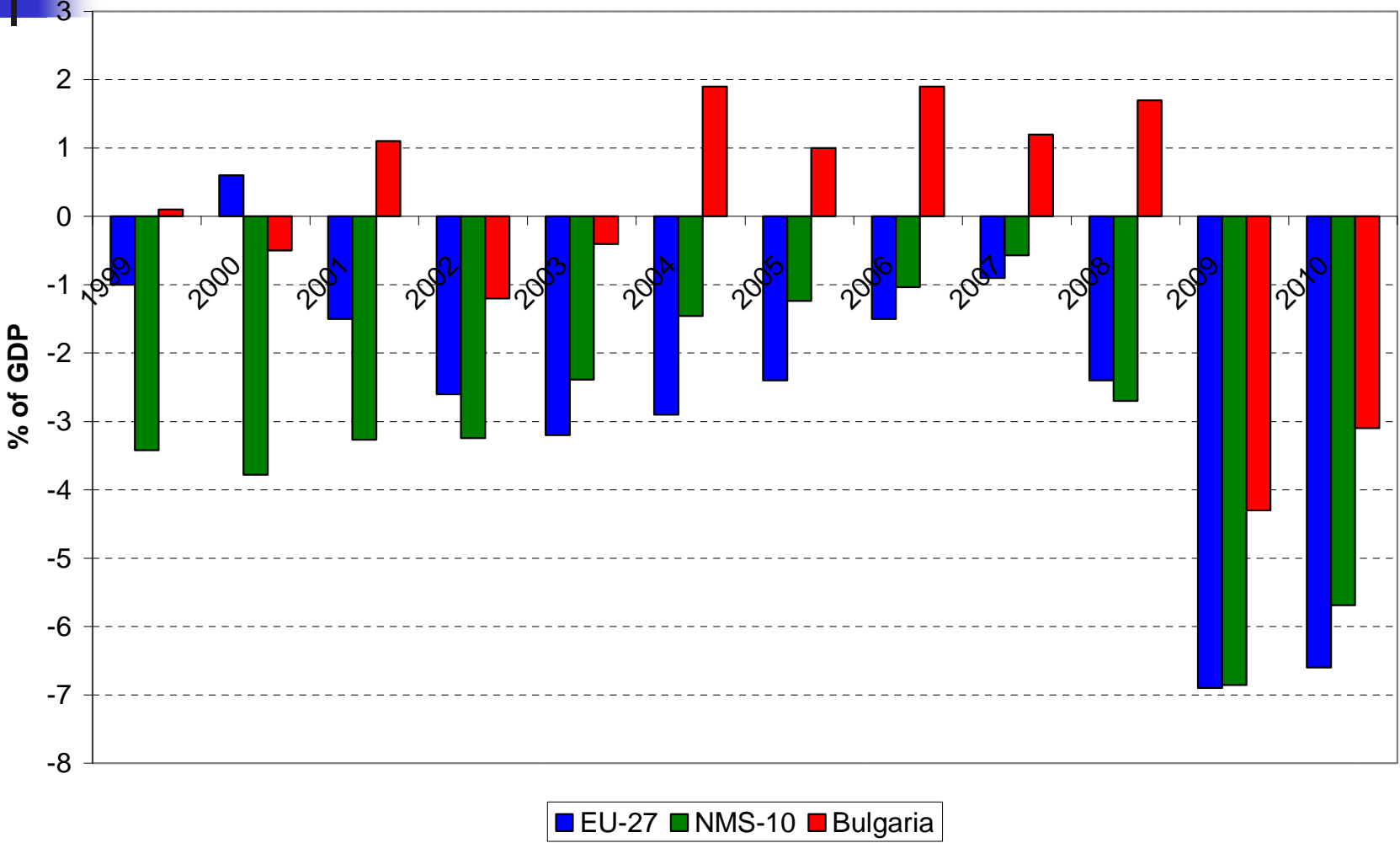
Bulgaria vs. the EU: GDP growth



Bulgaria vs. the EU: rates of unemployment



Bulgaria vs. the EU: fiscal balance

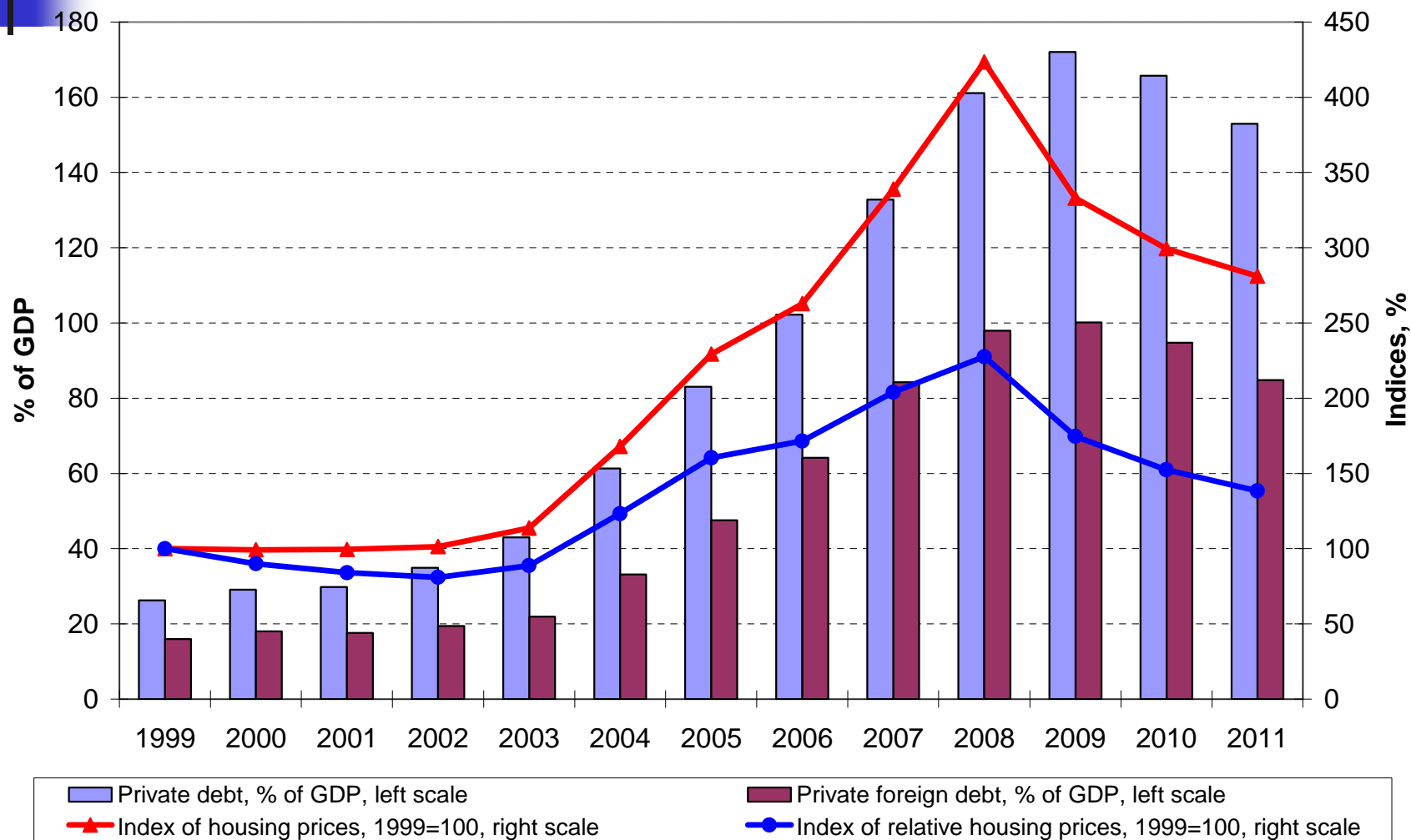




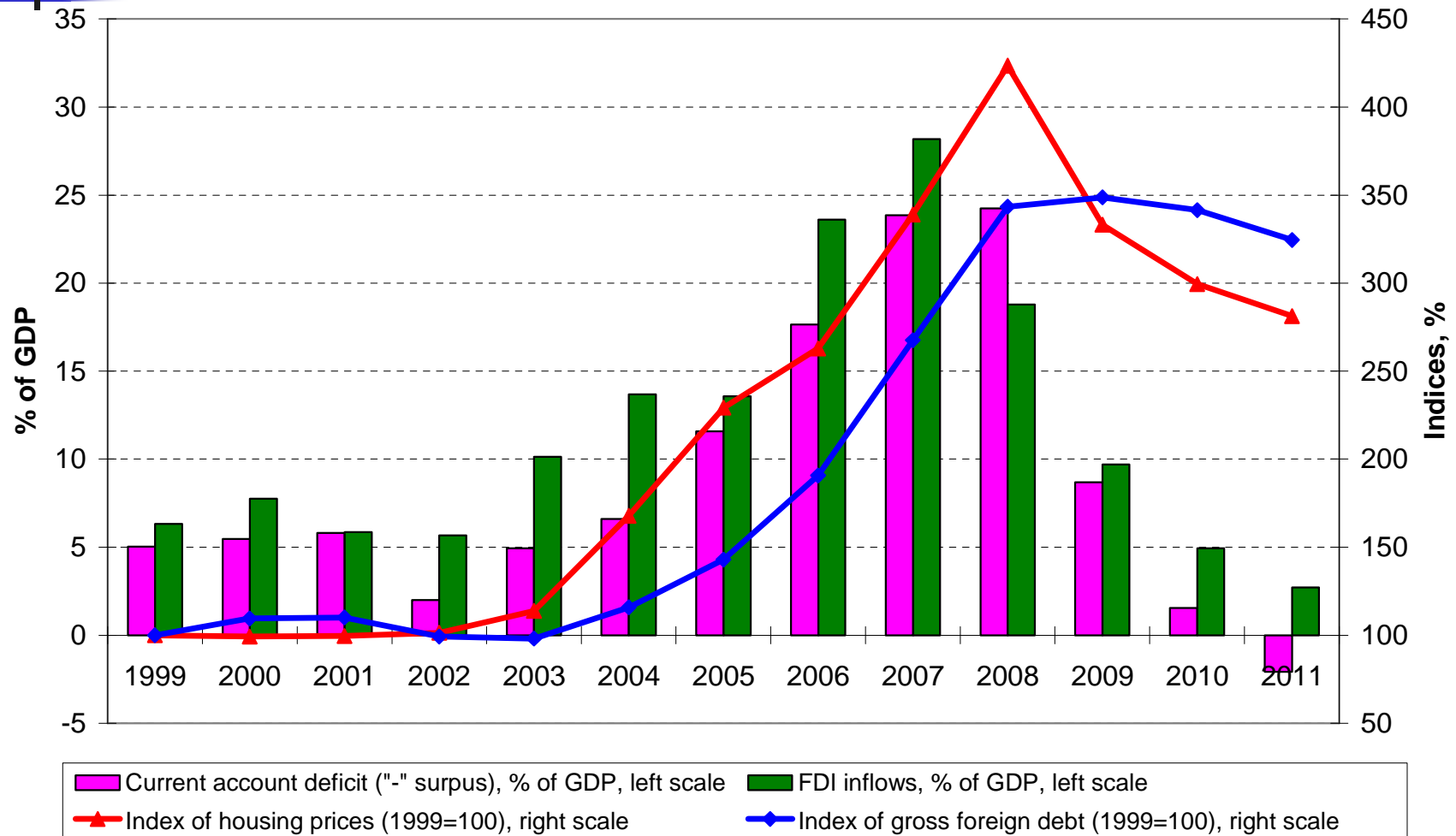
Bulgaria's economic performance during the crisis

- **Housing price bubble**
- **Credit boom**
- **Accumulation of debt (private, external)**
- **Appreciation of the real effective exchange rate**
- **Large trade and current account deficit**
- **CA deficit mirrored in large inflows of FDI (economy attracting foreign saving)**

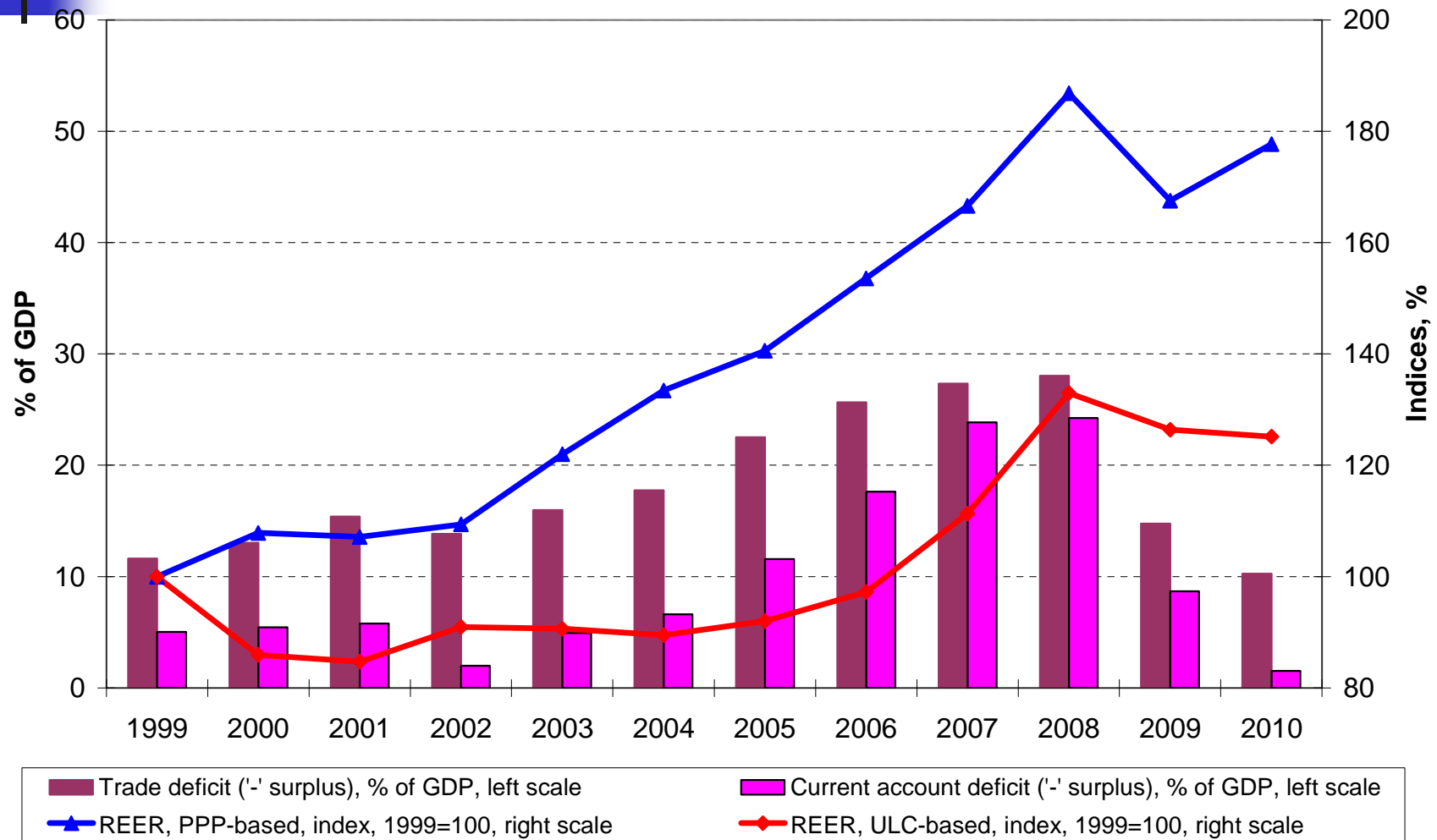
Housing prices and private sector indebtedness in Bulgaria, 1999-2011



The housing price bubble and its effects on Bulgaria's external balance



Bulgaria's real effective exchange rate (REER) and external balance, 1999-2010

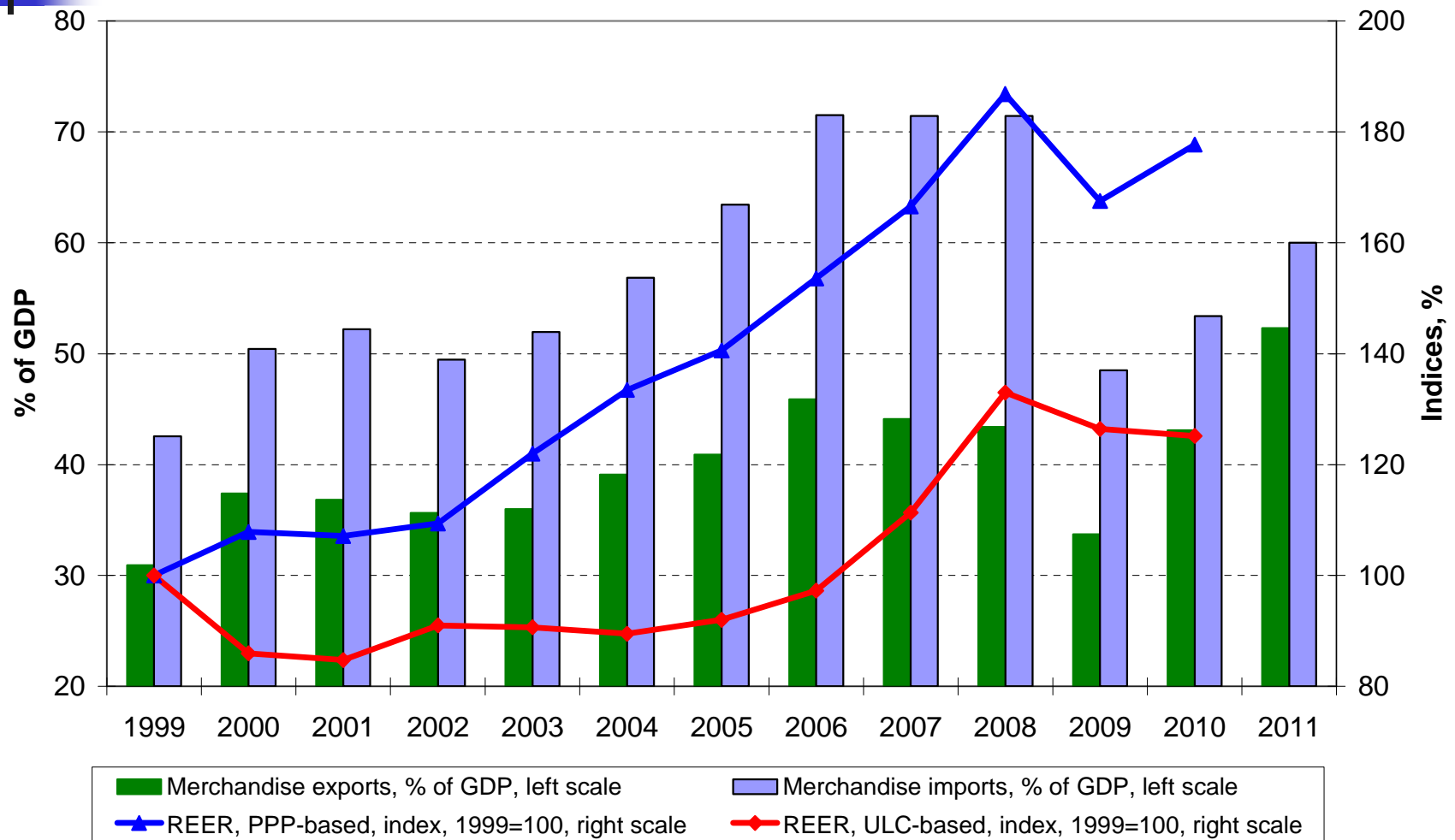


No macroeconomic destabilization in Bulgaria despite these alerts. Why?

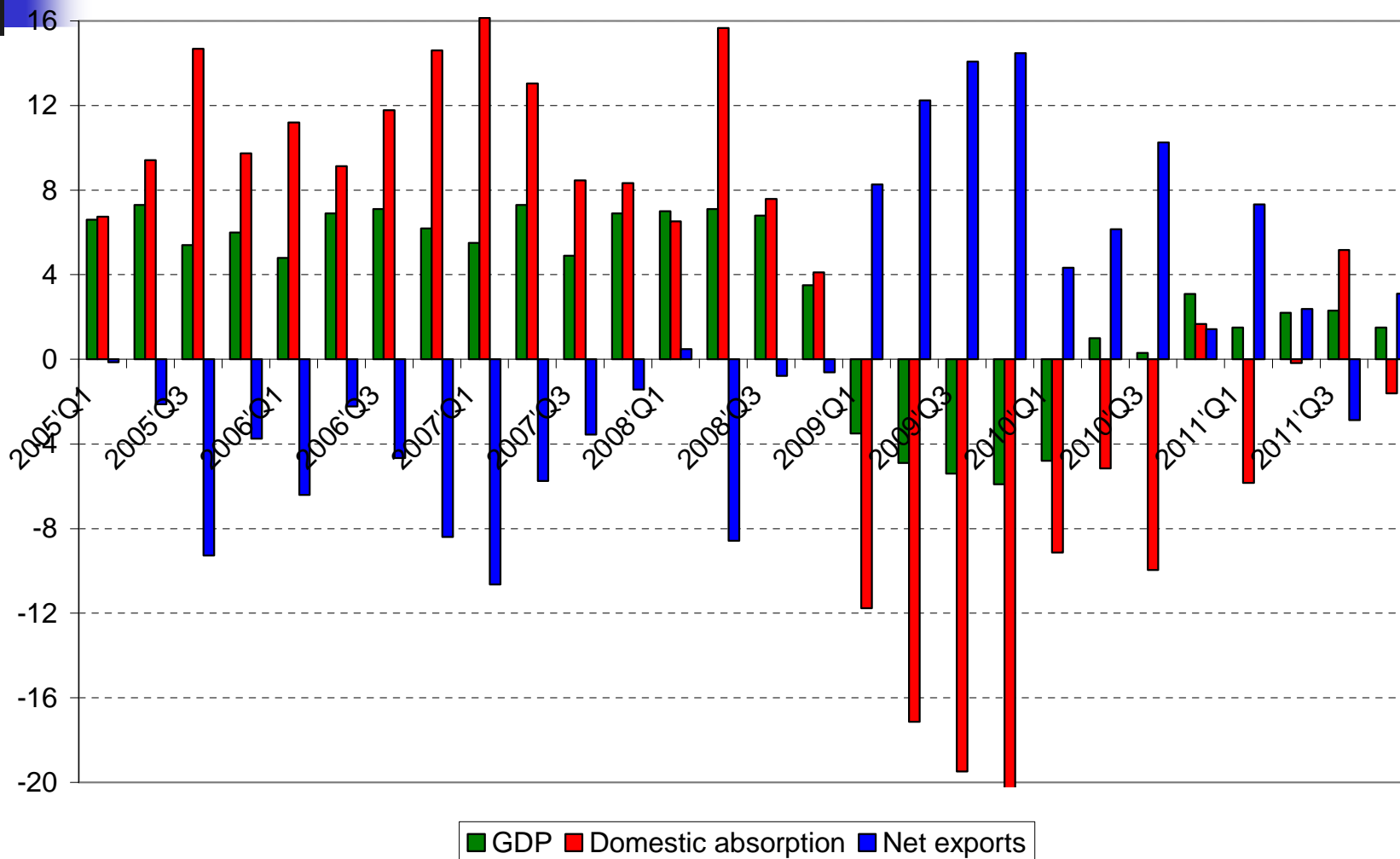


- REER appreciation did not lead to loss of competitiveness (catch-up under way)
- Prudent fiscal policy during the boom years (accumulation of fiscal reserve which was used to finance deficits during the crisis)
- Rebalancing of saving-investment balances between government and private sector during the crisis
- Specific structure of the foreign debt with significant shares accounted for by inter-firm loans and long-term external debt by firms
- The situation is not completely rosy:
 - Build-up of bad loans
 - Bleak growth prospects

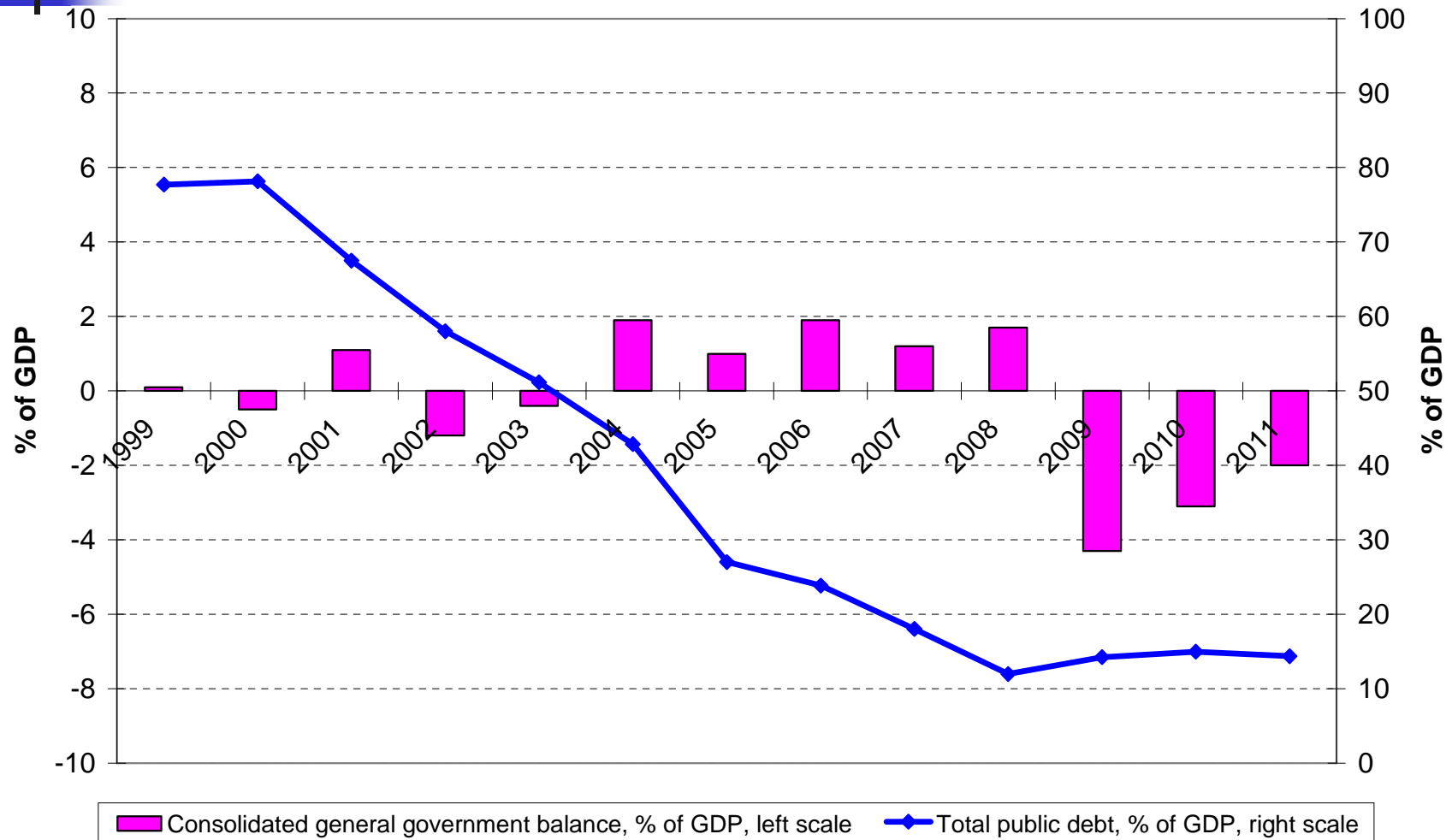
Bulgaria's real effective exchange rate (REER) and trade performance, 1999-2011



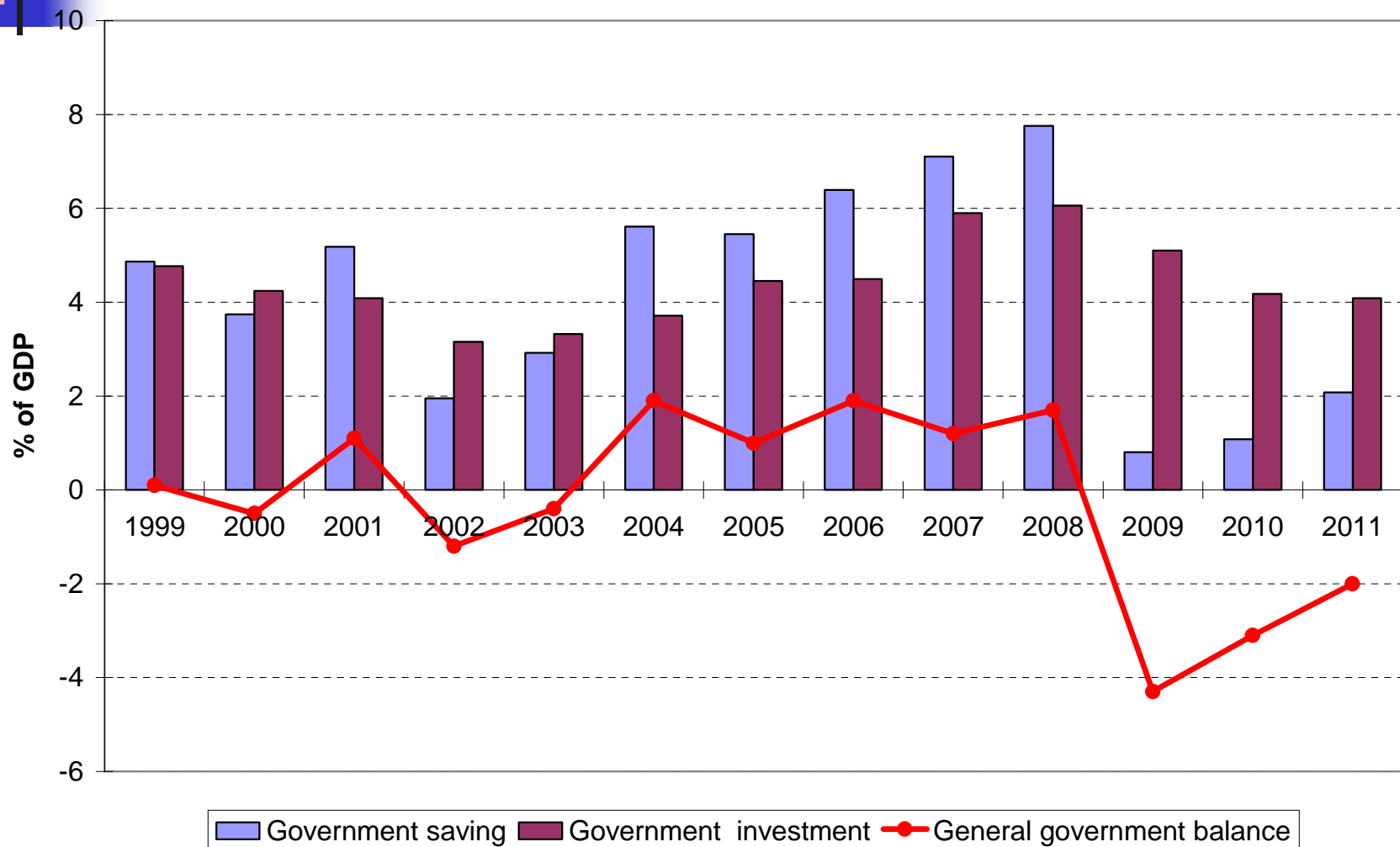
Contributions to Bulgaria's GDP growth, 2005-2011, %



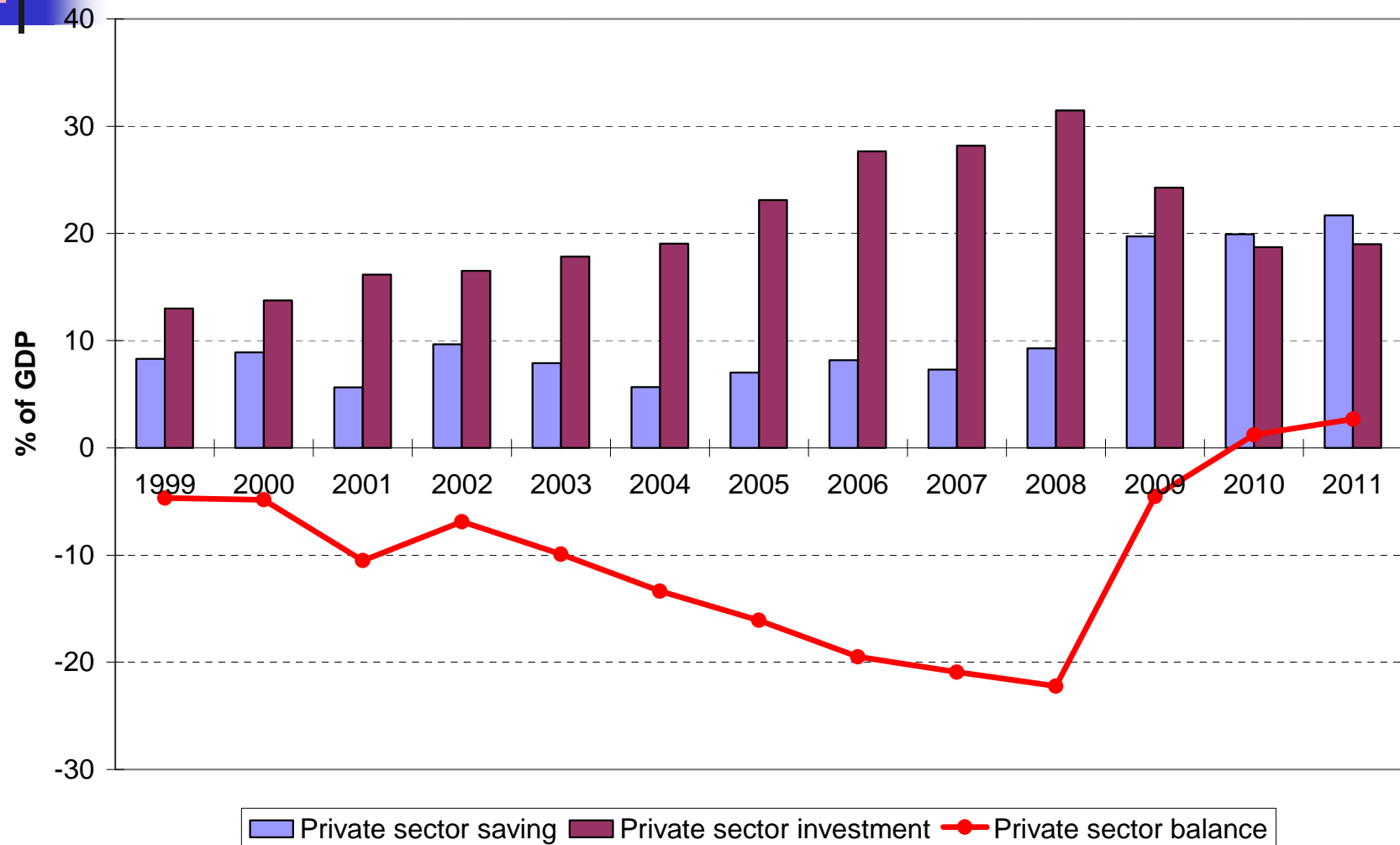
Bulgaria's fiscal position, 1999-2011



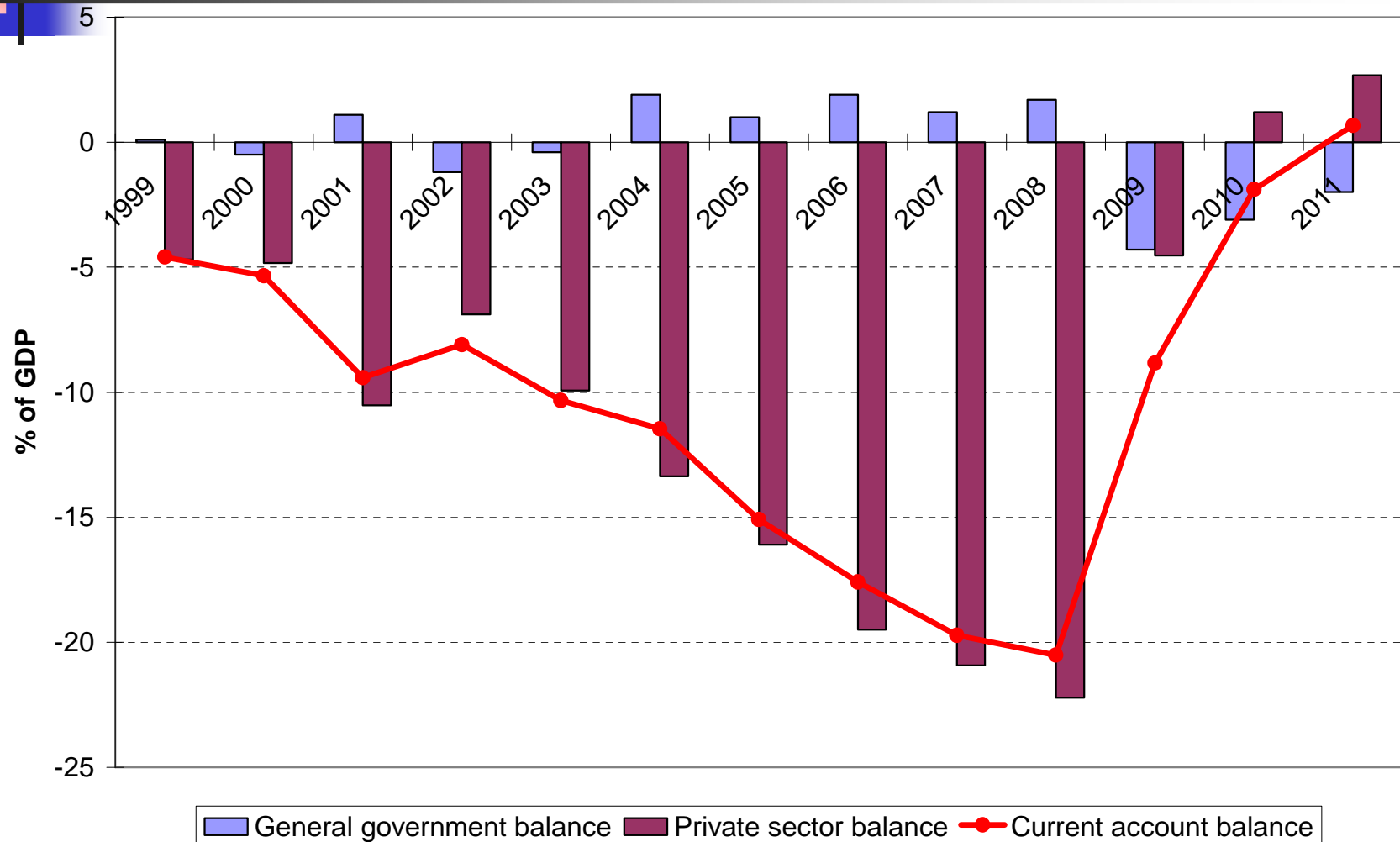
Bulgaria's saving-investment balance: government sector, 1999-2011



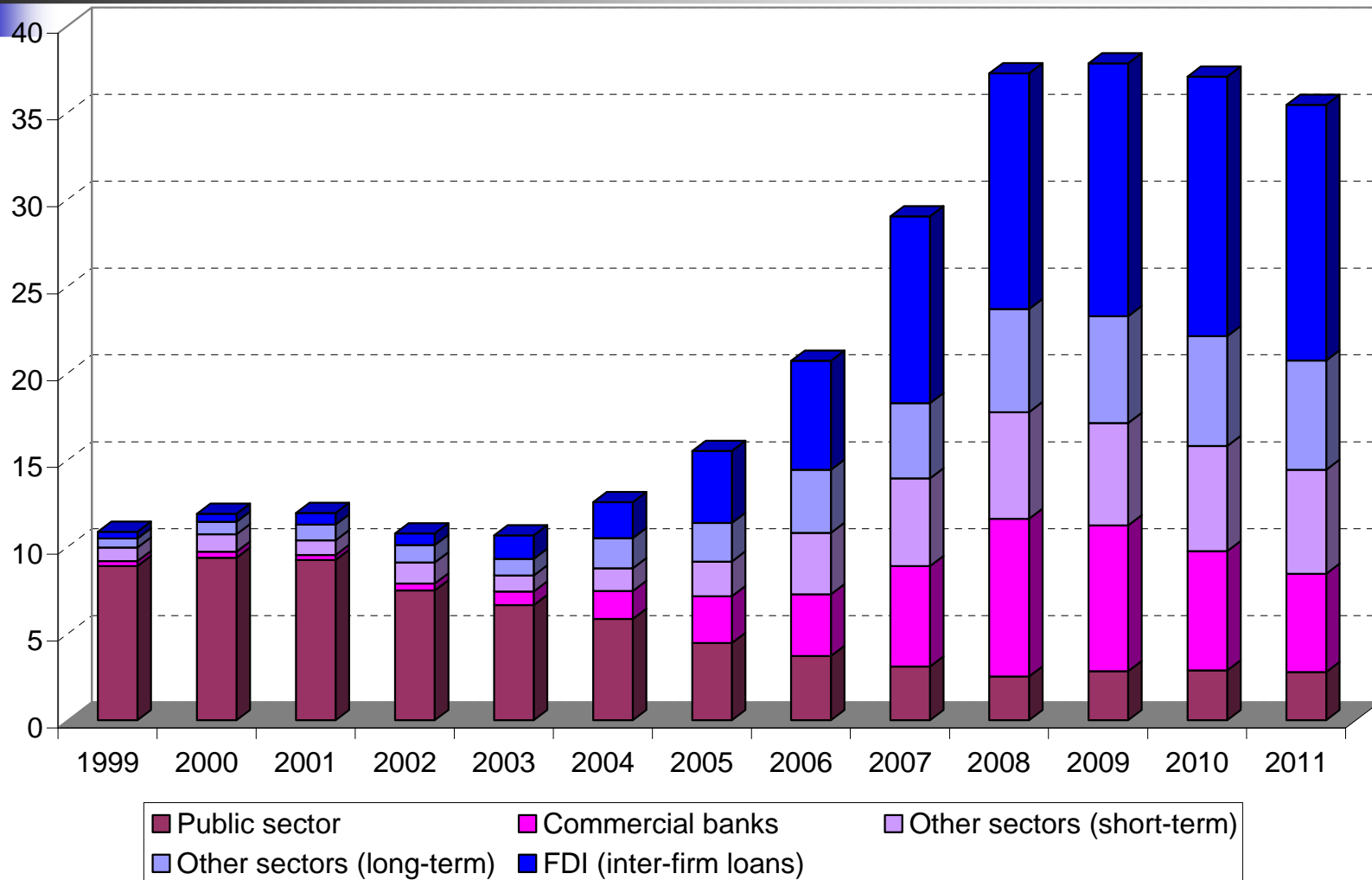
Bulgaria's saving-investment balance: private sector, 1999-2011



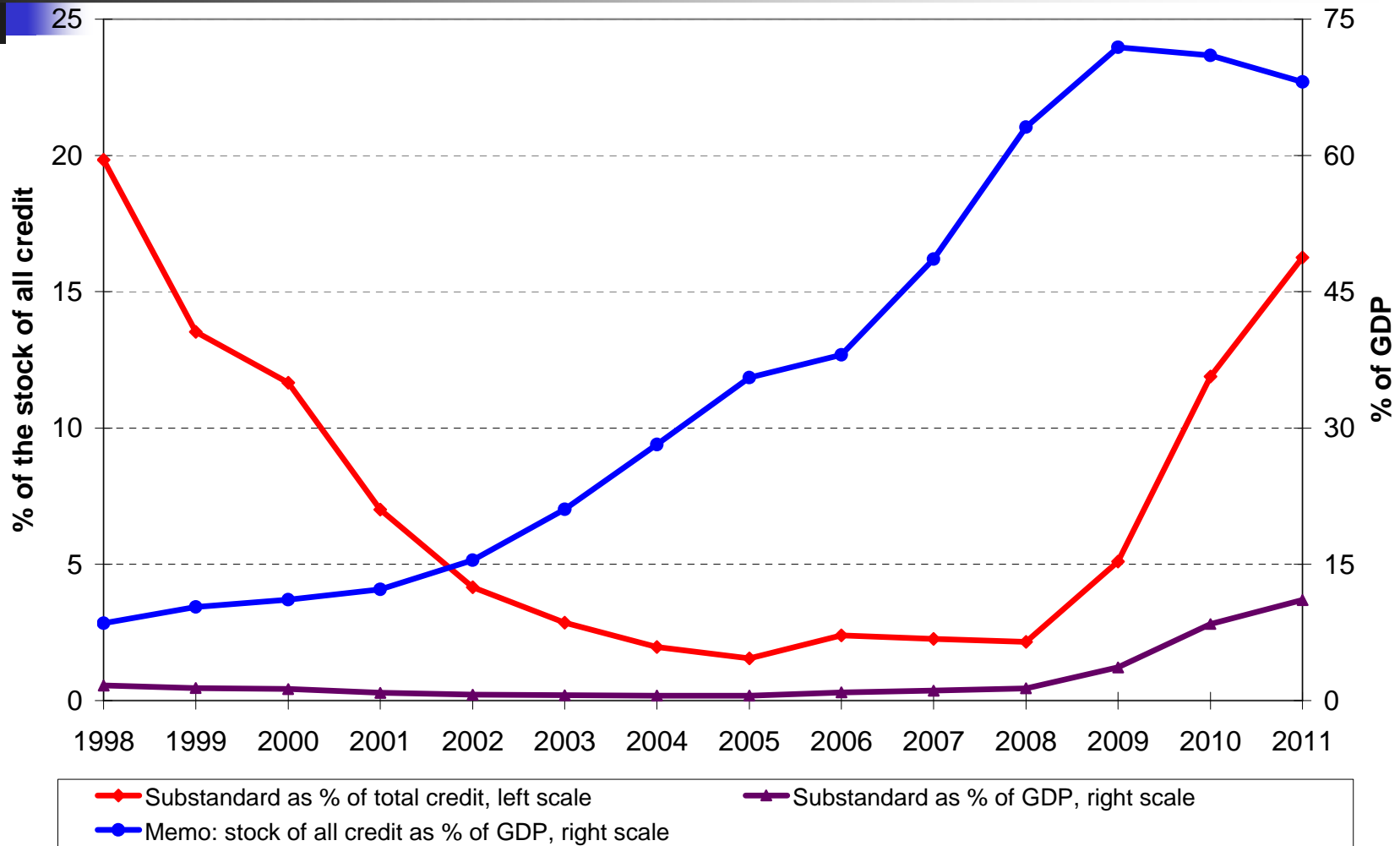
Bulgaria's current account balance by sectors, 1999-2011



Breakdown of Bulgaria's gross foreign debt by institutional sectors, € bn, 1999-2011



Substandard loans in the Bulgarian economy, 1998-2011



Some conclusions: imbalances and risks in BG



- **Despite the identified “alerts”, the crisis did not trigger macroeconomic destabilization in Bulgaria (an emerging economy!)**
 - Currency board with ample coverage of currency in circulation by foreign reserves (some 2 x) + stringent regulation of the banking system
 - Fiscal cushion thanks to large fiscal reserve accumulated during boom years
 - No apparent competitiveness loss despite REER appreciation – ongoing catch up process
 - Low volatility of capital inflows (limited capital outflow during the crisis)
 - Relatively flexible labour market (absorbing some of the shocks)
- **The main casualty of the crisis in BG: growth and employment**
 - Growth in boom years (and the catching up) was “borrowed” abroad and this source dried out
 - Policy under the CB arrangement has little degrees of freedom and even those available were not used efficiently
 - Post-crisis years in BG will likely be years of *economic anemia*
 - **Summing up: not much risks to macroeconomic stability but elevated risks for growth and catching up**



Some more general conclusions on imbalances and risks

- We still have no reliable warning signals of macroeconomic risks
- Market risks perception seems to be only weakly correlated with “alerts” or “surveillance risks”
- Countries’ macroeconomic performance during the crisis is also only weakly associated with “alerts”
- EC’s surveillance procedure is useful as a retrospective overview of risks but not sufficient as warning signal(s) of possible future macroeconomic destabilization
- Risks to growth should be considered as an essential component of the “surveillance risks”
- If nominal stabilization implies excessive growth sacrifice, this may generate “social imbalances” – these need to be taken into account!
- What will probably be needed is to complement the Macroeconomic Imbalance Procedure with “growth surveillance” identifying major risks to growth, employment and social cohesion



Thank You!

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