BRITISH BULGARIAN CHAMBER OF COMMERCE

AMERICAN CHAMBER OF COMMERCE IN BULGARIA

Bulgaria as an Inward Investment Location and the Opportunities for Growth in Trade and Investment

Meeting with Aidan Manktelow of the Economist Intelligence Unit 29th May 2012

120 Members and Friends of the BBCC and AmCham met on 29th May with Guest Speaker **Aidan Manktelow** of the Economist Intelligence Unit (EIU)**. Bill Drysdale**, Chairman of the British Bulgarian Chamber of Commerce, warmly welcomed participants at this first joint meeting of BBCC and AmCham. The American Chamber of Commerce in Bulgaria has been generous in its support and encouragement since last year's re-launch of the BBCC, recognizing the importance of all business promotion agencies and chambers collaborating to bring trade and FDI to Bulgaria.

Irena Komitova, representative of *The Economist* in Bulgaria for the past 16 years, introduced Mr Manktelow as a senior editor of the Magazine and one of the leading figures at the EIU who has been at the heart of preparing reports on our region. He has special expertise in the Balkans, specializing in risk assessment with a focus on emerging markets. The big question today is: we know all the positives, but a range of negatives are stacked up against us – so how can business grow?

Aidan Manktelow's Presentation

Bulgaria: Delayed recovery - The outlook for growth and investment

In setting the scene Aidan Manktelow reminded that we are in the fourth year since the financial crisis. Though there is some recovering and powering ahead on the global scene, Bulgaria is bouncing along the bottom. There are domestic factors at work, and the country's competitiveness programme is faltering. The economic outlook is uncertain and the drivers for that will be addressed in this presentation.

The global economy wobbles

Despite some mitigating factors, the global economy has weakened again. In November-December it was in complete knockdown with many signs of failing. Purchasing Managers' Indices tell an important story. The US economy is healthy and fears that it might tip into recession are gone or quite weak. But the continuing oil crisis is starting to affect consumer demand. The Chinese economy is a bright spot. The big problem is the Euro zone, especially Spain and the renewed uncertainty over Greece. We should not forget that the EU economy is still the second largest economy in the world, not the Chinese. The overall message is clear: global recovery continues, but is weak.

Greece looms large

Greek banks are in Bulgaria's top 10, which is a worry; they are reluctant to sell their Bulgarian subsidiaries: bank ownership changes could prompt financial turbulence. Greece's problems are a big factor in weak credit and FDI in Bulgaria. Elections in Greece in June have rightly been seen as a referendum on the Euro. The big question is can Greece stay in the Euro zone? From the Greek perspective, the economic benefits from staying are predominant. Public opinion shows that two-thirds of Greeks favour the Euro zone. There are high risks attached to a Grexit. Disorderly Greek default would create serious financial turbulence for Bulgaria. The question is whether the Euro zone is ready to cut Greece?

Scenarios for the Euro-zone

Against this uncertain background, Aidan Manktelow presented two fundamental scenarios for the Euro-zone which *The Economist* regards as the principal options:

1. A base-case where the crisis is contained and recovery continues with probability of occurring 70%. In 2012 Euro-zone is in recession with fiscal austerity, tight lending and weak confidence. European Central Bank injections take place where needed. A new strategy is taking shape. Austerity measures may soften in favour of selective spending for growth. A major departure from current policy of fiscal austerity can be expected. Germany is to allow salaries to rise. The path to a more balanced approach becomes evident. Recovery continues but oil prices go up. Bulgaria will be impacted through financing, trade and confidence. Growth expected to pick up in 2012.

2. Euro-zone break-up with probability of occurring 30%. Downside risks predominate and the underlying problems of the periphery prevail. Triggered by Grexit, the likely outcome prompts the breakup. Several countries default and exit the Euro-zone. Massive financial disruption. Unemployment in some countries may rise to 50%. Global recession and depression. Bulgaria is very exposed but less so than in 2008-2009.

Slow recovery in SEE

Regionally, the best we can expect is a slow turnaround in South East Europe. Recovery has lagged even in the low-cost transition economies in SEE. Romania and Bulgaria were still contracting in 2010. In 2011, the region saw positive growth but countries failed to build competitiveness, with no export-driven recovery. However, Bulgarian exports are doing OK based on the latest numbers. Bulgaria and Romania were already overextended before the crisis, coinciding with the peak of global financial exuberance. Pre-crisis boom focused on non-productive investments (predominantly in property) which led to a bubble and a long hangover. Domestic demand has been very slow to return. The labour market is still adjusting to weaker demand and high unemployment. Signs in 2011 were of things getting back on track but 2012 has been disappointing. The Euro zone crisis has come at a bad time for Bulgaria and set back recovery.

Bulgaria – still seeking growth

Here at home *The Economist's* prognosis for Bulgaria is cautious but not wholly negative. Bulgaria is still seeking domestic growth: the economy is still rebalancing. Contraction in major European markets is not, as hoped, being balanced by more exports to Asia – whose economies are growing more slowly even if not contracting. Bulgaria continues to struggle: there is stabilization but not a rebound. Exports and industrial output have turned down again. GDP growth of just 0.8% is forecasted for 2012. Pick-up is expected in 2013 as external climate improves and problems solved but no return to the boom years. The economic growth in Bulgaria will recover to 3.3% on average in 2013 – 2016 but will not reach the pre-crisis levels of over 6%.

Investment – some encouraging trends

FDI have collapsed since the crisis. On the upside, several progressive countries are resuming investments in Bulgaria. Trends are more positive, though a return to pre-crisis levels cannot be expected. There is a reasonable prospect of Bulgaria getting back to USD 4 billion a year, which is not bad.

Key positive trends:

• Price and low cost-base give advantage to Bulgaria. Multinationals will continue to move production to cheaper destinations. Developed economies' weakness encourages firms to seek cost savings.

• Return of investment from Asia because of rising costs and efficiency issues there: time sensitive supply chain, low exposure to delays, etc.

• Investment by emerging market multi-national corporations looking to supply Europe and Turkey. Having Turkey on our doorstep is a massive advantage and something Bulgaria needs to capitalize on.

• Services offshoring, especially in IT (software development, IT support, etc.). These jobs require language skills. Bulgaria can benefit by providing convergence of very good skills and low costs.

Finally, competition for FDI will be tough: more progress on reforms is needed in Bulgaria. Government should boost R&D, innovation and value chain, as well as make best use of the EU structural funds. Demographically, Bulgaria has limited supply of graduates. As a whole, Bulgaria is not moving as fast as other Balkan countries.

Conclusion – Delayed recovery

Many actions and inspired leadership are needed to kick-start the delayed recovery. Bulgaria is still suffering from a hangover. Euro-zone problems have set back a return to strong growth. The EIU still expects the Euro-zone crisis to be contained but risks are very high. Growth in Bulgaria will start to pick-up from 2013. Some encouraging trends in investment are evident, especially services offshoring. But more reforms by Government are needed to take full advantage of FDI.

Appreciation

Thanking Aidan Manktelow for his inspiring though cautious presentation, Bill Drysdale highlighted the top rank audience of business people, economists, bankers, entrepreneurs and opinion leaders. A lot for everyone to think about – an objective external view that we can't dismiss lightly. However, Mr Drysdale stressed that having worked here for 15 years, he is more optimistic: low wages, low tax, low state borrowing give Bulgaria a triple advantage to attract investment. Some conspicuous multinationals are already invested here big time, they drive incoming exports from their countries, and they are also Bulgaria's top exporters: a win, win, win situation! Should Greek banks have to divest, that too creates its own opportunities – perhaps for a British bank to come in. The reality is that Bulgaria is a better place than some analysts are prepared to admit!

Q&A and Commentary

A unique feature of the meeting, outperforming the average response to any speaker in the BBCC's experience to date, was the lively and well-balanced Q&A and Commentary session which followed. Highlights included:

- What about Spain? - The Spanish problem can be contained. Spanish banks are healthy in general. Only the regional banks are in difficulty.
- Presentation gives a rather pessimistic view of Bulgaria. How do we compare to other countries in the region? - Bulgaria's fundamentals are quite strong. As a market it has a lot of catch-up potential. Polish and Slovak markets are more mature and are shifting the management to western European operations. Romania and Bulgaria are still emerging markets. Companies expect growth to come from this region and it would really help Bulgaria if Romania is doing better. Bulgaria has opportunities to supply the Turkish market. The country should be seen as a supplier for Turkey in order to attract more FDI. Many countries are working out their strategies for the Turkish market. Bulgaria must promote itself as a supplier. Turkey is a very prospective export market for Bulgaria.
- Are there justifiable concerns over Turkey overheating? - Turkey's advantages are dynamism and demographics. Turkey is one of the top ten markets for the next decade. Get there as quickly as possible!
- Bulgarian exports: Potential for growth is based on domestic and neighbouring markets. Bulgaria must buy in to the EU Competitiveness programme funds. Expected internal growth, following the property fiasco. Growth to pick up in 2013. Domestic demand to grow.
- If there is a Grexit and Greek banks collapsing, subsidiaries of Greek banks in Bulgaria exposed but it's containable. Bulgarian National Bank must react quickly. Instead of financial meltdown scenario, pressure on Bulgarian subsidiaries should be applied to maintain capital adequacy.
- AmCham just completed a business road show in the USA where the biggest selling points were: Bulgaria is a very stable member of the EU and it's a crossroad and a gateway to the EU periphery, Turkey and Russia. How can Bulgaria take advantage of countries nearby? - Bulgaria has a particularly advantageous geographical location and it is culturally linked with Russia and Turkey, which makes it a very attractive proposition. But Bulgaria needs to fix its infrastructure to be able to supply the countries nearby and be a preferred destination for FDI!
- Is your projection for growth in Bulgaria to pick up in 2013 related to the elections that year? - It is normal for the economic projections to be based somewhat on the elections and general political situation.
- Feedback from businesspeople: the present Bulgarian government is trying to impose restrictions and restraints on business, monopolies are growing. Mr Manktelow's prediction is despite that, the ruling political party will be re-elected next year as part of a coalition.

- Based on the latest aging report, the working force in Bulgaria will be reduced by 40%, as well as the general population. How will that affect FDI in the future? - The country needs to encourage young people to come back and stay. Everything possible should be done to boost job creation. Countries like Bulgaria should become much more open to immigration. There is a need for targeted immigration programmes.
- What are the expectations about the real estate market? - The oversupply will continue. There will be long period of flat prices ahead.
- Bulgaria has an image problem (associated with corruption, bureaucracy, gray economy, weak judiciary system) which hinders the flow of FDI. Government is taking certain measures (preferential treatment of big investors, road shows, advertisements, etc.) for encouraging investments but with no visible results. It's not proactive enough. The Economy minister recently made a statement at an investment conference that the decision for investment in Bulgaria is based 80% on the low taxes! What would you advise the Bulgarian Government to do in order to attract more FDI? - Low taxes do help but are only one of a number of factors. The government must listen to business more. It's a high time it sets up a one-stop-shop for investors. Not an easy thing to achieve, but doable and competing counties have succeeded with it.
- 4% GDP growth in Bulgaria does not create jobs. Are there more positive scenarios? - Progress on reforms by Government has not been spectacular. A growth boost by the Government needed. Banks being too cautious with their lending. Getting back to 6% GDP is desirable, but not feasible.
- Any advice to SMEs in Bulgaria? Mr Drysdale: there are a lot of enterprising smaller businesses in Bulgaria; it's a tremendous opportunity to get alongside those people. LinkedIn Bulgarian CEO Club a striking incubator in this regard.

Conclusion and recommendations

Bringing the meeting to a close, **Mr Peter Lithgow**, President of AmCham Bulgaria, thanked the Guest Speaker and the Audience, and concluded with some firm recommendations:

- ✓ How do we give advice to the government? AmCham and BBCC are bringing together the leaders of the business community. We would like to have a one-stop-shop for foreign investors and must present a strong and urgent case for it before the Government.
- ✓ We have a leadership role. There are new channels emerging to talk to Government and be heard.
- ✓ Branding Bulgaria: we have to showcase our story. We have our obligation as well to get out there and speak loudly.
- ✓ Counter the negative stories with the positive ones. The reality is we do have the opportunity to engage.
- ✓ Today is visible proof that we can cooperate. For both Chambers it has been a great exercise working together. Having a united voice gives added leverage.