ICEG European Center

NEWS OF THE MONTH

on EU-10 and CIS

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The ICEG European Center issues its monthly publication, which includes 2-4 brief analyses on macroeconomic and microeconomic issues. The publication focuses on two groups of countries: *Commonwealth of Independent States - CIS* (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan) and the ten post-soviet *New Member States of the European Union – EU-10* (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia).

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About us

ICEG European Center is an independent economic research institute based in Budapest, Hungary. The Center was founded by Dr. Pál Gáspár in 2001.

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Street Protests and Demonstrations – Early Elections in Bulgaria

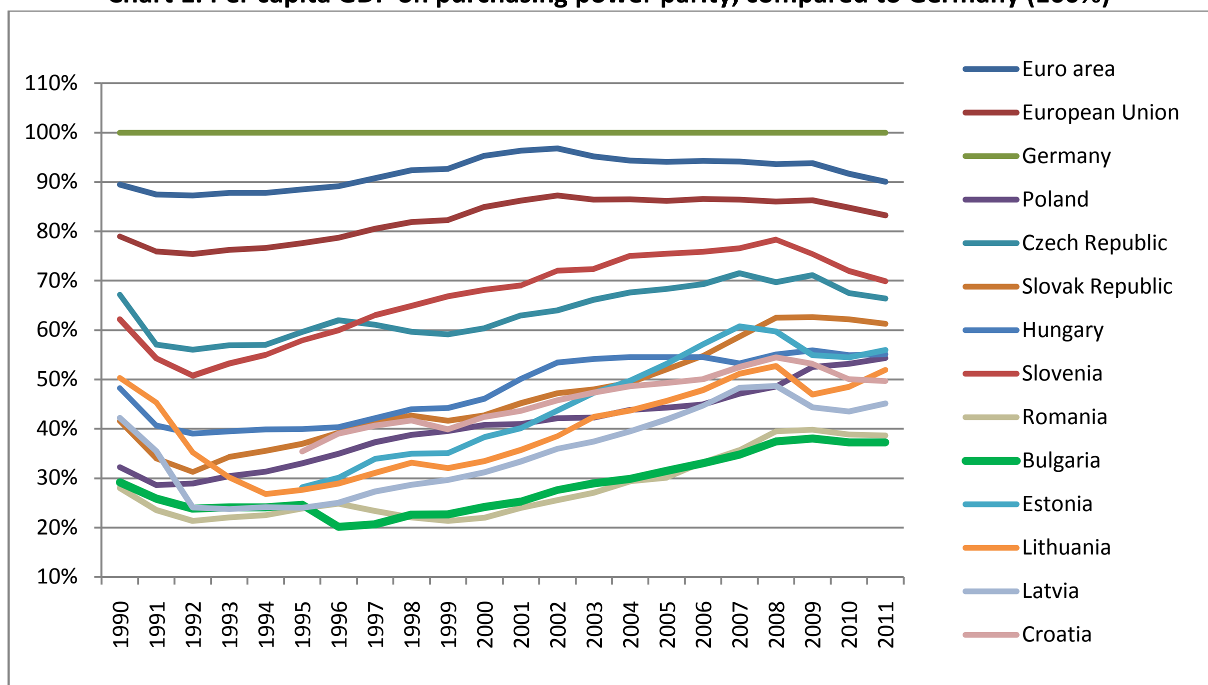
Péter Sulán

Bulgaria has recently joined to the group of countries where protests and demonstrations lead to political instability. Prime Minister Boyko Borissov would have had four more months to finish his four-year term but he resigned after street demonstrations against low wages and high energy prices.

The economic outlook seems to be better than for example in Slovenia or some other countries where economic output is shrinking for several years now. In Bulgaria, GDP grew by 1.7% in 2011, 0.8% in 2012 and forecasted to grow by 1.4% in 2013 according to the European Commission's recently published Winter Outlook.

The problem is that beside of the growing economy, Bulgaria is still the poorest country in Europe taking the gross domestic product on purchasing power parity.

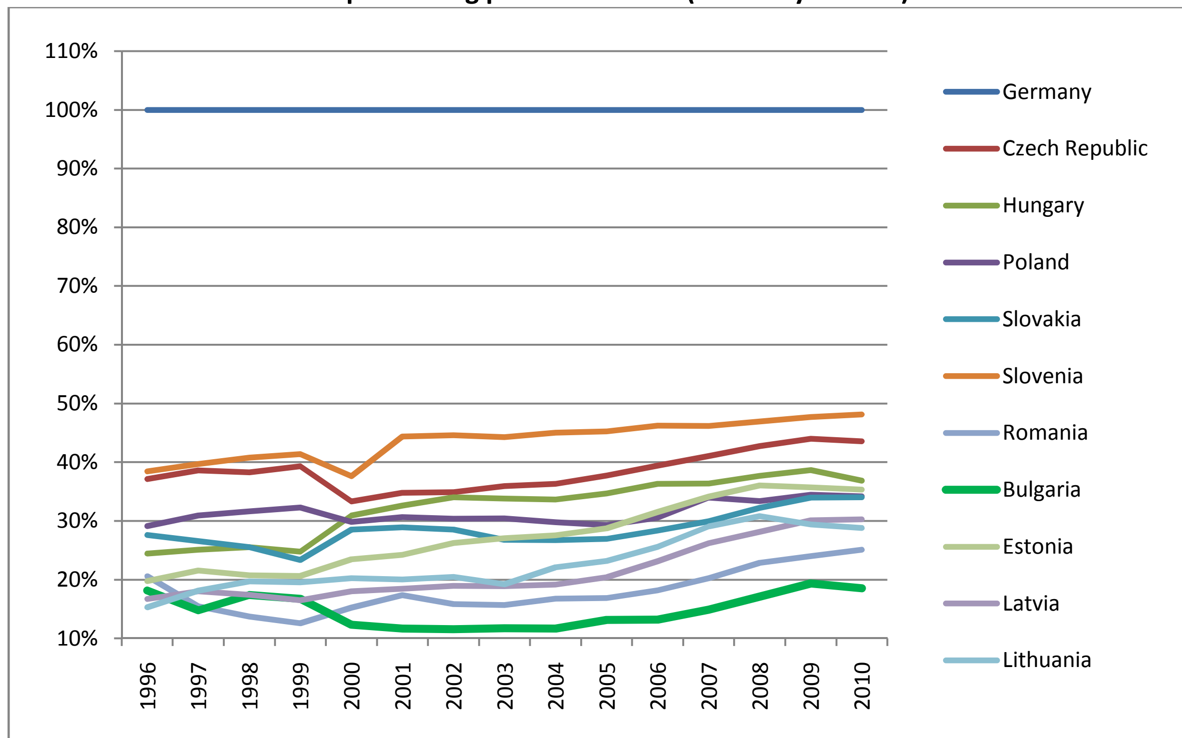
Chart 1. Per capita GDP on purchasing power parity, compared to Germany (100%)



Source: World Bank

If we also look at the average wages on purchasing power standard in Central and Eastern Europe, the situation of the Bulgarians is even more disappointing. The average wage is just slightly higher than it was 15 years ago compared to Germany.

Chart 2. Average wage of a single person without any children across Central and Eastern Europe on purchasing power standard (Germany = 100%)



Source: Eurostat

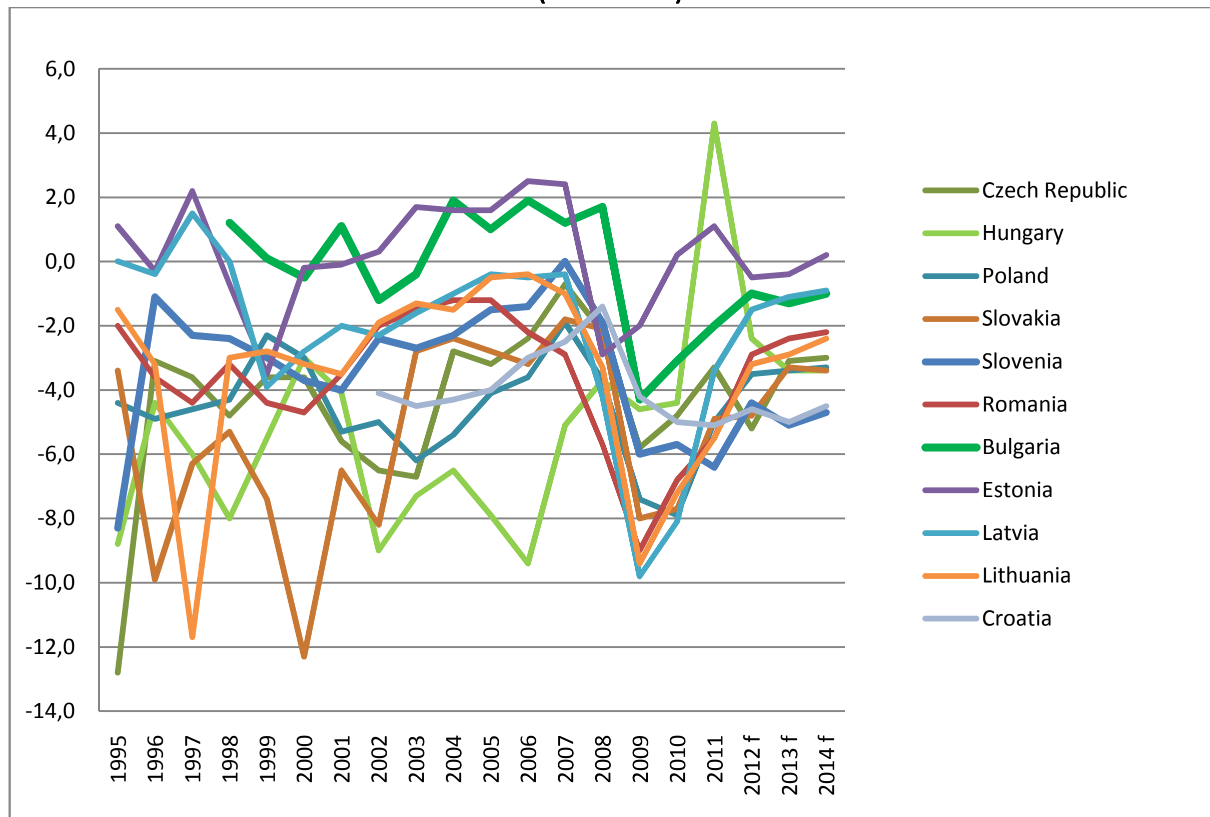
Another aspect of the above two charts is that in many countries in Central and Eastern Europe, apart from the impressive convergence of the GDP, average wages are lagging very much behind, and could only get closer to the German wages significantly in those years when the global financial bubbles were formed in the world markets.

Back to Bulgaria, where the wages are the lowest in Europe, the minimum wage reached only 35.3% of the average wage in 2011; however in 2008 this ratio stood at 39.5%. The ratio itself is not far from the average, there are countries in Europe both with higher and lower ratios, but during the years of the crisis, these all together were too much to be tolerated by the population.

On the other hand, the country runs a currency board regime since 1997, where the local currency (Lev) is fixed to the Euro (1 Euro equals to 1.9558 Levs). The exit of this regime should be the introduction of the Euro. Consequently, there is no way to use the nominal exchange rate to adjust competitiveness, but strict fiscal and labour market policies are required.

In order to meet these requirements, the government wanted to keep this year's budget deficit at 1.3% of the GDP, which would be the same level as in 2012. The country's fiscal track record is anyway one of the bests within the European Union, only Estonia has such exceptional figures.

Chart 3. General government budget balance in selected Central and Eastern European states (1995-2014)



Source: Eurostat; f: forecast by the European Commission

It is the same with the general government total debt to the GDP figures. While the 27 members' average gross debt expected to grow above 90% of the GDP in 2014, Estonia will only have 11.3%, and Bulgaria 17.3%.

Partly thanks to this strict fiscal policy, international competitiveness measured by export and foreign trade looks good, export of goods and services to the GDP stands close to 70%, which is the highest in the past more than 20 years. The deficit of the trade balance hit 25.1% of the GDP in 2007, but improved radically below 5%, while the balance on goods and services showed only -1.5% of the GDP in 2011.

To sum up, although the political instability does not help to the country, the reasons behind are understandable. On the other hand, the macroeconomic conditions are solid, and seem to give the necessary room for political consolidation for the next government.

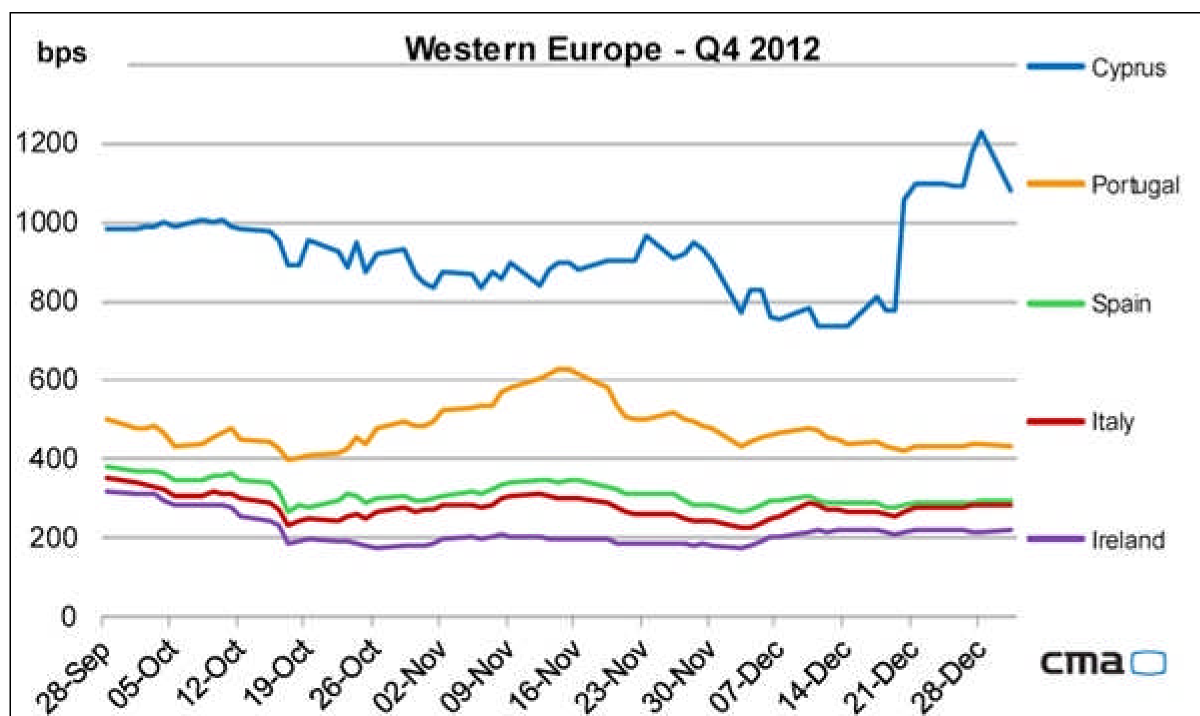
Judging the Italian Economy and its Implications on Baltic States

Olivér Kovács

Almost two years ago, Andrew Ang and Francis A. Longstaff pointed out that the empirical evidence suggests that systemic sovereign risk has its roots in financial markets rather than in macroeconomic fundamentals.[1]

The crisis-ridden Italy, which is now facing high level of political instability as well, has been manoeuvring not so dramatically since the end of 2012 when the Prime Minister Mario Monti resigned. In other words, the perceived sovereign risk is relatively stable over time (so far). Although the yield on Italian 10-year bonds soared dramatically in the aftermath of an electoral stalemate in February 2013, and while it is true that the yield seemed to be crossing the psychological limen (5% mark); it has then gone through a significant rehabilitation and stabilisation (in March 2013, Italian bonds were yielding 4.65% which is not so far from that of German bonds).

Chart 1. The trajectory of sovereign debt credit risk in Q4 2012



Source: CMA Sovereign Debt Credit Risk Report Q4 2012

Even if one takes a mere glimpse into the development of real GDP growth (-2.4% of 2012) or unemployment trends (11.3% of 2012), the reluctance and the appearing calmness of financial markets in case of Italy give us a feeling of surprise. Does it mean that international investors are

[1] See: Ang, A. – Longstaff, F. A. (2011): Systemic Sovereign Credit Risk: Lessons from the U.S. and Europe. NBER Working Paper No. 16982

contemplating not just the given country's current status of economic affairs, but taking into account the regional, what is more, the European-wide, or in case, global perspectives? (E.g. growing uncertainties over the French economy, succumb in the offshore haven, Cyprus and the growing young unemployment throughout the Iberian Peninsula and Greece). The Italian case pinpoints the importance of perceived reality created by investigating hard statistics combined with psychological factors like attitudes towards the eurozone's third-largest economy and the world's third-largest sovereign-debt market.

Since psychological factors play a crucial role and influence for instance how financial investors judge a country's perspectives, the Italian case made it possible to a certain extent for Baltic states ro regenerate relatively quickly. Italy is still a net contributor to the EU Budget, therefore its positive judgement helps it to maintain that role which in turn feeds into the perspectives of Baltic countries – that received larger net transfers beginning in 2008 than other peripheral economies such as Greece and Spain – through providing external stimulus via budget transfers.

Nonetheless, Italy has to be continuously aware of the importance of the decisive implementation of long-term structural reforms and such fiscal consolidation that encapsulates the need for stimulating the aggregate demand while placing debt-to-GDP ratio on a downward trend.