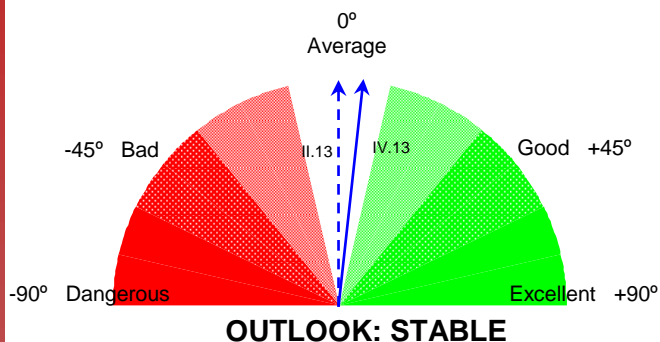


expat compass

8 May 2013

EXPAT CURRENCY BOARD WATCH



We are not worried about the currency board and see no immediate danger of devaluation. Now that there is a pretty good caretaker government in place, the country has calmed down. The major parties are committed to keeping the currency board.

GUEST COMMENTS

BISER MANOLOV: EMOTIONS MAY CAUSE A LOT OF TROUBLE
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THE EASY ROAD DOWN THE SLIDE
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EDITORIAL COMMENT

Bulgaria has gone back to normal

- A new caretaker government led by Marin Raykov is in place. It has already managed to calm down the country
- The cabinet looks fiscally conservative (good) but is unlikely to undertake major reforms (expected but not good)
- The transparency and fairness of the 12 May parliamentary elections is a key factor for the future political stability of the country

The financial outlook is now better than in February

- The caretaker government is by no means populist and is far from a spending spree
- The cabinet's answer to the protests was a small BGN41m social package. However, these are not new expenses but transfers from some sectors to others (good)
- Fiscal reserves have risen again to BGN5bn, partly due to some transfers from the EC (good)

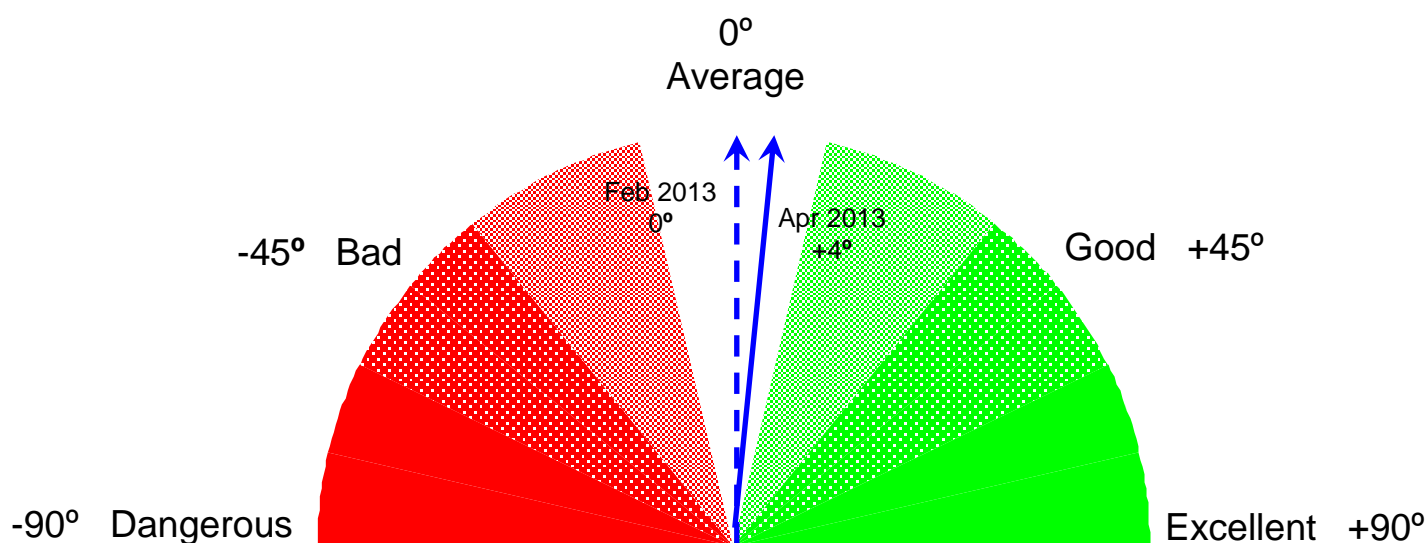
For the first time, we are making political comments – still without taking sides

- We are providing a brief analysis of the caretaker government (page 5)
- We give 2 scenarios for the composition of the future government: 1) a GERB-led [minority] government; 2) BSP + DPS + others (page 7)
- We are presenting our comments on some of the economic policy views of the two major parties (page 9)
- We see the nomination of Plamen Oresharski as the candidate for Prime Minister of the socialist party as a positive sign for financial stability

A more positive reading of the Compass

- After our negative February issue, we are now a bit more optimistic about the economic developments in the country
- We are moving the needle of the Compass from 0° to +4°, as well as raising the Outlook from Negative to Stable
- However, to be more positive, we have to see the next government and its intentions

OUTLOOK: STABLE



Bulgaria has overcome the government crisis by appointing a caretaker government and scheduling parliamentary elections for 12 May 2013. The initial trend of all parties for more populist rhetoric has been partially mitigated. Whoever wins the next elections, the country will hardly change course dramatically. As usual, the country's ability to borrow is very high, the forex reserves are large, and there is a lot of room for maneuvering. We keep our positive assessment of the stability of the currency board, now with a stable outlook.

We are not worried about the currency board and see no immediate danger of devaluation. We will be watching the composition and the policies of the next government.

In the future months and years, we will continue to monitor constantly the development of the relevant economic indicators in order to assess the health of the currency board and potentially to predict any negative events, should they ever occur.

It is becoming more difficult to draw all the arrows and the dates in the picture. That is why we are also providing a table with all the historical data. The measure is angular degrees (°). The reading of the Compass can change between +90° (horizontal to the right, Excellent) and -90° (horizontal to the left, Dangerous). 0° is a neutral (vertical upwards, Average) reading.

Date	Reading of the Compass (Angular Degrees)	Change	Comment
2005	+64°		Currency board very stable
2008	+44°	-20°	Deterioration due to current account concerns
Jan 2010	+20°	-24°	Deterioration due to budget and recession concerns
Mar 2010	+9°	-11°	Deterioration due to budget and reforms concerns
Jun 2010	0°	-9°	Deterioration due to budget and reforms concerns
Oct 2010	+4°	+4°	Improvement due to exports growth
Feb 2011	+8°	+4°	Improvement in many economic indicators
May 2011	+10°	+2°	Smaller concerns about the budget
Aug 2011	+12°	+2°	Small budget and trade deficits
Dec 2011	+14°	+2°	Conservative 2012 budget, some pension measures
Feb 2012	+20°	+6°	Troubles in the Eurozone; good 2012 budget
May 2012	-5°	-25°	Fiscal reserves falling sharply. Intentions to spend the Silver Fund
Nov 2012	+5°	+10°	Successful Eurobond; good budget; Silver Fund forgotten
Jan 2013	+15°	+10°	Almost balanced 2012 budget
Feb 2013	0°	-15°	Government resigns; fiscal reserves depleted; pre-election populism
Apr 2013	+4°	+4°	Good caretaker government; no street protests; rising fiscal reserves

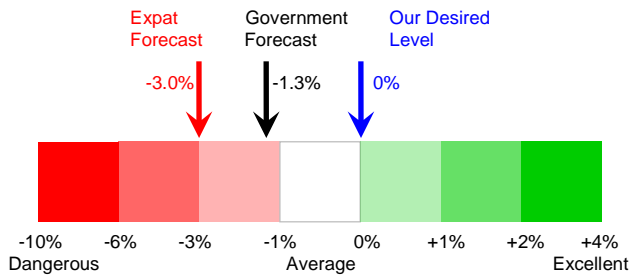
How to assess the stability of the currency board and to predict any danger of devaluation? We suggest the following check-list of 16 questions and provide our answers:

ISSUE	OLD	NEW	COMMENTS
I. Political issues			
1. Does the government support the currency board?	+	⊕	Major parties support it
2. Does the Central Bank support the currency board?	+++	+++	Yes, absolutely
3. Do the European institutions (EC, ECB) support Bulgaria in joining the ERM II and the Eurozone?	--	--	Not much
II. Budget and debt			
4. Budget balance	-	-	Deficit risks for 2013
5. Budget spending	-/+	⊖	Spending risks in 2013
6. Government debt	+	⊕	Very low, rising
7. Foreign liabilities of the private sector	--	--	High, falling
8. Fiscal reserves	--	⊖	Improved a bit
III. Economic cycle related issues			
9. GDP growth	-	-	Just above zero
10. Inflation	+	⊕	Low
11. Unemployment	--	--	Average, rising
12. Strength of the banking system	+	+	Average
IV. External balances			
13. Current account deficit, trade deficit	-	-	Back to negative
14. Foreign direct investment	-	⊖	Low-to-average
15. Revenues from international tourism	++	⊕	Good
16. Foreign exchange reserves	++	⊕	High

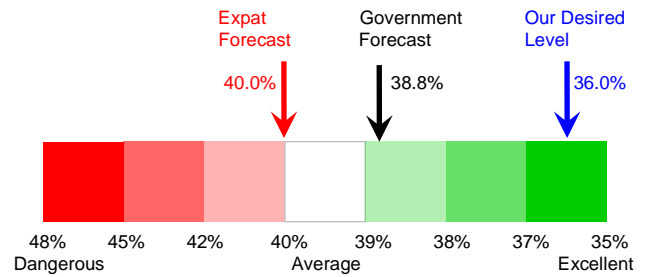
Legend: ■ Good ■ Bad

INDICATORS, 2013

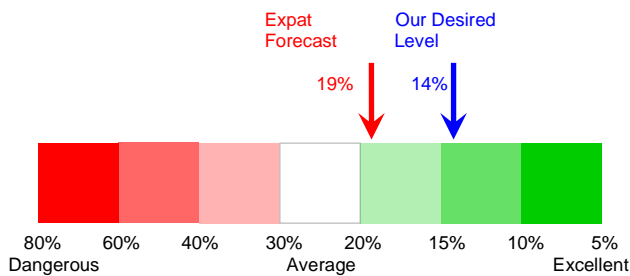
I) Budget Surplus/Deficit, % GDP, 2013



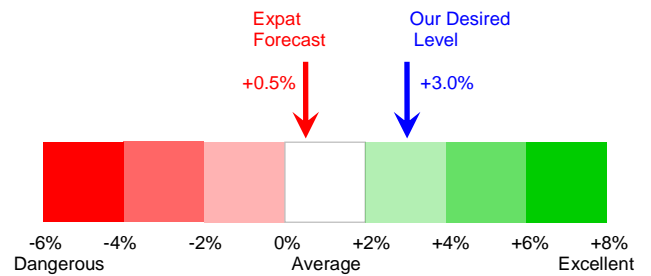
II) Budget Spending, % GDP, 2013



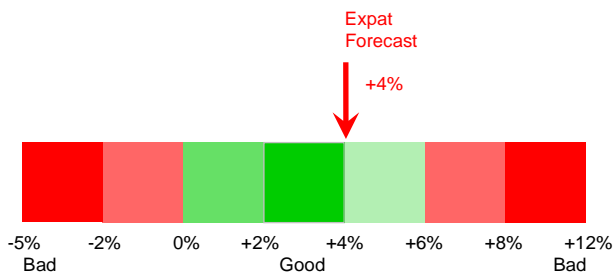
III) Government Debt, % GDP, 2013, Year-End



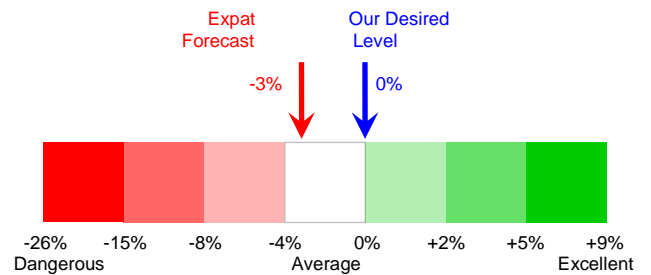
IV) Real GDP Growth, %, 2013



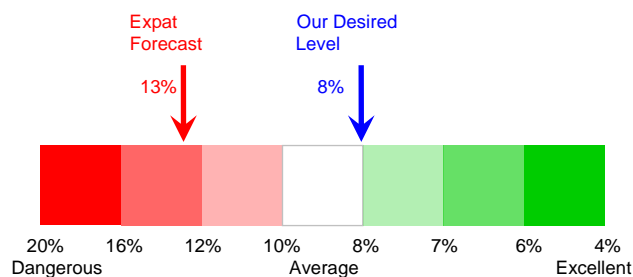
V) Inflation, %, 2013, Year-End



VI) Current Account Deficit, % GDP, 2013



VII) Unemployment, %, 2013, Year-End*



* The changed methodology results in lower reported unemployment rates

THREE PRIORITIES AND TWO REFORMS FOR THE CARETAKER GOVERNMENT

Important political developments since February

The political events in Bulgaria have developed dynamically since February 2013:

- Numerous street protests broke out in what had been a relatively quiet country before. The protests were initially directed against the high electricity bills and the unfair power of the utility-monopolies, but then turned against the political status-quo in general.
- Prime Minister Boyko Borisov resigned unexpectedly. Some analysts considered this move a sign of weakness and a lack of courage to face the protesters. Others saw it as a shrewd step which would keep Borisov's chances to be re-elected. Ironically, both might turn out to be true.
- An interim, 'caretaker' government was appointed, headed by Marin Raykov.
- The 41st National Assembly was dissolved.
- Early parliamentary elections were scheduled for Sunday, 12 May 2013.

President Plevneliev appointed a caretaker cabinet headed by Marin Raykov

Following the constitutional procedure, the President of the Republic Rosen Plevneliev appointed a so-called caretaker government. Our assessment is as follows:

- Plevneliev demonstrated tougher character and more independence than it had been expected by some observers.
- The President has appointed a professional team of cabinet members, most of whom have impressive CVs.
- Prime Minister Marin Raykov had been Deputy Minister of Foreign Affairs in two right-wing governments, as well as an ambassador to France, also twice.
- The ministers seem to be reformists rather than populists. So far, so good.
- Anecdotal evidence suggests that 2/3 of the ministers are Borisov's appointees, while 1/3 are close to Plevneliev – so that you do not think that GERB is somehow out of power.

Three tasks of the caretaker government

In our view, Raykov's government has three most important tasks. In the next issue of Expat Compass, we are going to assess this government's work according to 3 criteria:

- 1) Has the government managed to calm down the street protests? So far, the answer is YES.
- 2) Will the government organize fair elections without the doubt that the results have been rigged? So far, the rhetoric has been fine, but we shall see what

happens on the election day. Until recently, the public had expected the following elections to be the least fair and transparent since 1990.

- 3) Has the government been conservative on the spending side? We will consider Kalin Hristov a successful finance minister, if he manages to:
 - Keep spending low. LIKELY. A BGN41m social package was voted by the government in March – this is just 0.05% of GDP – insignificant. These are not new expenses, but internal transfers from some sectors to others. However small, this package has played a role in reducing the public tension. Good.
 - Maintain the general feeling of financial stability: banking system, budget, currency, credit rating. LIKELY. The rhetoric has been very appropriate.
 - Improve tax collection. UNCERTAIN. Economic activity might slow down additionally, hurting tax revenues.
 - Achieve a balanced budget for January – May 2013. LESS LIKELY, ALTHOUGH POSSIBLE. The January-February deficit was high at BGN732m.

How long will the caretaker government last?

Theoretically, 2 months till the 12 May elections, plus a few weeks till a new cabinet is voted in. However:

- It is unclear how quickly a new cabinet will be formed. In 2005, it took 2 months.
- A 'hung parliament' is very possible – see the analysis below.
- Some of the ministers might achieve high public opinion ratings and might stay in a future government, especially if the government is right-of-centre.

Are any reforms likely?

In theory, the caretaker government has a chance to achieve a lot because there is no opposition and no parliament to control and direct it. In practice, this is not our expectation. Much of its time has passed without anything special for us to notice or remember. Rather, a '*feed the animals and do not touch anything*' approach (as in an old joke) might prevail. Not so bad, in our view, as long as there is no extravagant spending or populist policies. Still, we would expect the government to achieve at least two particular things:

- 1) In the **transport sector**: avoid the bankruptcy of BDZ, the state railways, as well as finalize the privatization of BDZ Freight Services (separate from the Passenger Services which are not for sale at the moment). POSSIBLE, but we fear the deal might not happen for 2 reasons:

- there might be no bids by 29 April 2013 (the deadline has been put off again – to 10 June 2013, so that the caretaker government does not need to take responsibility), or
 - the government might lack the courage to disregard certain populist demands to stop the deal (deja-vu)
- 2) Urgently improve the very difficult situation in the **energy sector**:
- Explain persuasively to the public whether the December-January bills were massively overstated or not – after all, this is why the government fell. UNLIKELY. We do not see any steps in this direction.
 - Resume exports of electricity (the latest structure of the transmission fees has made exports uncompetitive). UNLIKELY. We do not see any steps in this direction.
 - Improve the situation of the investors in renewable energy, most of whom are facing financial difficulties after the change of course of government policy in 2012. UNLIKELY. The intentions are rather the opposite.

- Successfully refinance the state-owned companies in the energy sector. Some large loans are due soon. LIKELY.

3) We would allow ourselves a third idea: **to clean up the mess at Sofia Airport**. The steps we have in mind would take very little time and almost no money to achieve. Some examples:

- The airport is dirty and untidy
- The walls are bare – not enough advertisements or nice pictures
- Many signs are printed on A4 paper and sound rude to foreigners...
- The to-do list is longer. We can provide it, should anyone listen.

The list of urgent tasks in all sectors can go on. But as you can see, it is our view that such steps might be too ambitious for a caretaker government. We would be happy to be proved wrong here, but this is also UNLIKELY. 😊

Note: In this article, we have used the official transliteration rules when writing the names of politicians. In other sources, other Latin spellings might be observed.

PRE-ELECTION POLITICAL COMPASS – PARLIAMENTARY ELECTIONS ON 12 MAY 2013. TWO SCENARIOS FOR THE NEXT COALITION

Expat Compass has been politically impartial

Due to the fact that the managing partners of Expat Capital and the authors of Expat Compass had been PEPs (*using private banking language, Politically Exposed Persons*), in the first 12 issues of our economic bulletin we have tried to be as impartial and politically neutral as possible. We have followed several rules:

- Avoid mentioning names of political parties
- Avoid mentioning names of politicians, especially in the context of belonging to a certain party
- Although we have supported reformist policies, we have avoided expressing concrete political preferences

Our goal has been to provide independent economic research and comments on the general economic policy in Bulgaria, with special attention to the health of the currency board. True, the c. 20 Bulgarian external ‘guest analysts’ have been almost exclusively from the reformist (right-of-centre) camp, while the c. 10 foreigners have represented a wider political and economic spectrum.

We will temporarily soften these rules

While we will continue refraining from expressing concrete political preferences, we will try to comment the expected election results and to predict the composition of the future government. Needless to say, the next cabinet’s policies will be directly related to the financial stability of the country and the health of the currency board.

How many parties are likely to enter the parliament?

As of today, we expect a parliament with 5 parties, 2 larger and 3 smaller, with the following ranking:

- 1) GERB = Citizens for European Development of Bulgaria – the previous ruling party headed by the previous prime minister Boyko Borisov (2009 – Feb 2013); member of the EPP; in theory center-right, but also populist
- 2) BSP = Bulgarian Socialist Party – headed by the previous prime minister (2005 – 2009) Sergey Stanishev who is also President of PES, the Party of European Socialists
- 3) DPS = Movement for Rights and Freedoms – the Turkish ethnic party, member of ELDR (liberals). Its new leader is Lyutvi Mestan
- 4) Ataka = Attack – an anti-European and anti-minority party, led by Volen Siderov
- 5) Bulgaria of the Citizens – a right-wing new party headed by Meglena Kuneva, former European Commissioner and 2011 presidential candidate. In the table below, we will use the name Kuneva for simplicity.

It is theoretically possible that other parties might surprisingly pass the 4% threshold, but as of today, we think none of them will even be close.

As none of the parties is expected to win by a large margin, a ‘hung parliament’ is a very likely outcome – where it will be very difficult to form any government. That is why, we will express our views about the compatibility of these 5 parties.

Potential coalitions and combinations

Table 1. Compatibility among the parties

	GERB	BSP	DPS	Ataka	Kuneva
GERB		No	No/Yes	No/Yes	Yes
BSP	No		Yes	No/Yes	No/Yes
DPS	No/Yes	Yes		No	Yes
Ataka	No/Yes	No/Yes	No		No
Kuneva	Yes	No/Yes	Yes	No	

Source: Expat Capital assessment

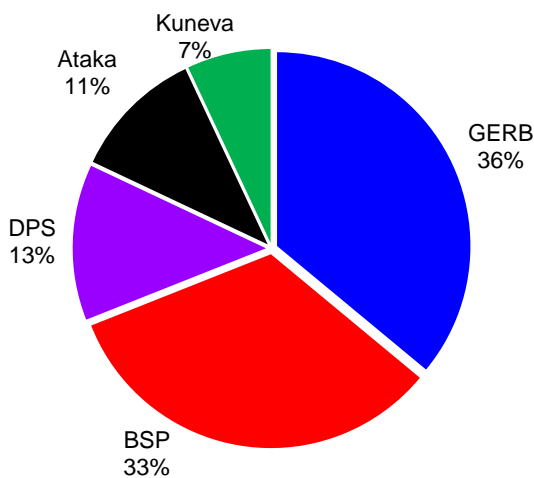
Here are our comments about the possible combinations:

- A grand coalition between GERB and BSP is extremely improbable. Having said that, Bulgaria was in the same situation in 2005 when the parties number 1 (BSP), 2 (NDSV – King Simeon’s party), and 3 (DPS) formed a joint government in order to bring the country into the EU.
- Bulgaria of the Citizens (Kuneva) will be a desired partner both by GERB and BSP. Ideologically, they are closer to GERB (center-right). Before the elections, they will claim they will not team up with any of the 2 large parties. However, we think that after the elections they will participate in any government, right-wing or left-wing.
- DPS is completely incompatible with Ataka.
- Ataka is not a desired partner for anyone as its standing in Europe is negative. However, Ataka might more or less support any government – silently or not – in which DPS is not present. This is what happened after 2009 when Ataka supported GERB for 1-2 years.
- BSP is compatible with DPS (they were in a 3-party coalition in 2005-2009), but would need Kuneva to form a government for 2 reasons: to achieve a potential parliamentary majority, and to avoid a pure BSP-DPS coalition, which would be more unpopular.

- GERB – DPS? A tough call. Both parties will be passionately denying the possibility of such partnership before the elections. Most observers do not believe such a combination is possible at all because: 1) GERB came to power in 2009 mostly with anti-DPS rhetoric; 2) there have been too many bitter feelings between the 2 parties since 2009. Although today we agree with all this, we would still leave the door open for surprising co-operation between GERB and DPS after the elections.

Our Scenario 1: A government around GERB

Chart 1. Our forecast for the next parliament, % of the seats, 240 in total



While many sociologists try to estimate how many seats the different parties will get, few dare to predict what government will be formed.

- GERB is likely to win more seats than the socialists. Thus, it should get the first opportunity to form a majority.
- If Kuneva (Bulgaria of the Citizens) makes it into the parliament, as we expect, she will be a desired partner for GERB for 2 reasons: a) international considerations – Kuneva’s European standing is positive, and b) relative ideological compatibility – both parties are EPP-oriented.
- The key questionable combination is GERB – DPS. Compared to Ataka, DPS is a more stable and reliable partner, more acceptable in Europe as well. Really, if GERB does not win a surprising landslide victory as in 2009 (which is not probable at the moment), and if it cannot form a coalition with DPS, it might not be able to form any government.
- In a 4-party parliament without Kuneva (this is not our prediction), the solutions are a GERB – DPS coalition, or a minority GERB government supported by Ataka – something like a remake of 2009.

Our Scenario 2: BSP – DPS – Kuneva

If the sociologists are not right and BSP wins the elections, a coalition with DPS will be the solution. If Kuneva is also in the parliament, she will definitely be invited to join. Her situation would then resemble that of NDSV in 2005 when it joined exactly such a coalition, and dropped out of the parliament in 2009. Although Kuneva’s ideology is not leftist at all, a compromise is possible, if the government is labelled non-leftist. All kinds of adjectives or attributes such as broad, centrist, programme, expert, national salvation... would be used to describe such a government. We generally do not have faith in such attributes, though.

The same combination would be possible if BSP ranks a close second, but GERB cannot form a government.

Other less likely scenarios

Scenario 3: A “hung” parliament

Mathematically, there might be a situation with 4 parties where:

- GERB + DPS would have a majority of 121+ MPs but do not want to cooperate
 - GERB + Ataka – the same
- ... or a parliament with 5 parties where:
- Kuneva does not want to join either GERB or BSP

... then we would have no government. New parliamentary elections will be scheduled, and the caretaker cabinet will have a longer life. This scenario would be the worst for the economy and the political stability – similar to the situation in Italy in the spring of 2013 (finally, a broad left-right coalition was formed). However, Scenario 3 is not our expectation.

Note: In this article, we have used the official transliteration rules when writing the names of politicians. In other sources, other Latin spellings might be observed.

IMPLICATIONS OF THE ELECTION RESULTS FOR THE ECONOMIC POLICY AND THE CURRENCY BOARD

We expect a bit more populism after the elections, but without going to extremes

Whoever wins the next elections and whatever government is formed afterwards, we are afraid that the general trend would be towards less reforms and more populist policies. However, we do not expect such policies to endanger the stability of the currency board. In the table below, we have tried to summarize our predictions for certain economic policies depending on who runs the country in the next four years.

Our predictions about the main economic policies of the two major parties

No.	Issue	GERB-Led Government	BSP-Led Government	Our Comment
1	Currency board	Support (+)	Support (+)	Support
2	Inflation	Low (+)	Low (+)	With the currency board, we are not worried about inflation
3	Budget deficit, % of GDP	Moderate, larger than in 2009-2013 (-)	Moderate, larger than in 2009-2013 (-)	We support a balanced budget policy
4	Public debt	Rising slowly as in 2009-2013 (-)	Rising slowly as in 2009-2013 (-)	We favour balanced budgets and falling debt levels, both in nominal terms and as % of GDP (as in 1998-2008)
5	Credit rating	Probably unchanged from the current levels around BBB (+/-)	Probably unchanged from the current levels around BBB (+/-)	We would prefer policies leading to credit rating upgrades by at least 3 notches (single A) within 4 years
6	Budget spending, % of GDP	Moderate, larger than in 2009-2013 (-)	Larger than in 2009-2013 (-)	We would favour lower spending, as in 2009-2013
7	10% corporate profit tax rate	Probably keep (+)	Probably keep (+)	We favour keeping the rate low at 10%
8	Flat 10% personal income tax	Probably keep (+)	Very likely to abolish it and introduce a progressive tax (-)	We favour the flat tax of 10%
9	Non-taxable income minimum	Probably keep the current situation without a minimum	Likely to introduce a non-taxable income minimum	We are neutral on this issue as we believe this is less important than keeping the maximum rate at 10%
10	Social security contributions	Probably keep (+)	Likely to increase them (-)	We favour (the current) lower rates of social security contributions combined with better tax collection
11	Privatization	Very slow progress, as in 2009-2013 (-)	Likely to stop the whole privatization (-)	We favour the fast privatization of the energy sector and anything else left in the hands of the state, incl. hospitals
12	Concessions	Very slow progress, as in 2009-2013 (-)	Likely to forget about concessions (-)	We favour concession deals for all ports, airports, water utilities; as well as for selected highways and railway facilities
13	Nationalization of already privatized utilities	Unlikely (+). Having said that, the only 2 nationalizations since 1989 have happened in 2009-2013 (the stock exchange, and a small part of the private pension funds)	Unlikely (+) despite some limited pre-election rhetoric	We strongly disapprove any mentioning of the word 'nationalization'
14	Pension reform (e.g. retirement age increases)	Mild progress, as in 2009-2013 (+/-)	Stop all reforms (-)	We support bolder and faster reforms: enhanced role of the private funds; raising the average retirement age
15	Pension spending	Moderate, higher than in 2009-2013 (+/-)	Larger increases (-)	Sorry, we favour lower pension spending as % of GDP

	GERB-Led Government	BSP-Led Government	Our Comment
Conclusion	We believe a second mandate of GERB will resemble the first one: broadly reformist rhetoric but little implementation. More populism, but no danger for the currency board.	We believe a BSP-led government will be moderate in its economic policies – neither reformist nor blatantly populist. Similar to 2005-2009 – which would be good. No danger for the currency board.	Our reform agenda would be more ambitious than any of the parties' intentions. While we are not very optimistic about the general direction the country will take, we are not worried about the currency board at this stage.

BSP's candidate for Prime Minister – Plamen Oresharski

Before the start of the election campaign, surprisingly to us, BSP announced that its prime ministerial candidate would not be Sergey Stanishev but Plamen Oresharski. A few words about both of them.

Sergey Stanishev has been party chairman since the former chairman Georgi Parvanov became president in late 2001. Stanishev was the first socialist prime minister since 1989 to serve a whole 4-year term (2005-2009). On 29 September 2012, he was elected President of PES, the Party of European Socialists – the first East European to receive such recognition in any of the European political families. Broadly, the socialist leader is perceived as intelligent, tolerant, and pro-European. Normally, one would expect a party leader to use this international leverage in order to run for prime minister in his home country for a second time. However, Stanishev himself decided to bring Oresharski to the fore and announce him as BSP's prime ministerial candidate.

As a consequence of the winter street protests, all political parties' rhetoric shifted towards populism. BSP even started losing votes to the extreme left represented by Ataka. This shift started scaring some of the centrist voters away from the socialists. BSP did not manage to catch up with GERB's ratings, according to all public opinion polls. Thus, Stanishev saw little chance of winning outright, and decided to promote Oresharski instead.

Plamen Oresharski is a well-known right-wing economist and finance professor. He served as deputy minister of finance under Kostov (1997-2001) and was a successful finance minister under Stanishev (2005-2009). During the latter period, he followed prudent fiscal policies characterized by:

- Large fiscal surpluses of >3% of GDP per year
- Strong reduction of public debt
- Keeping the lowest direct taxes in Europe
- Strong tax collection
- Large fiscal and foreign exchange reserves

All these are policies that we strongly favour. There is always a danger that they might be reversed by a future socialist government. Oresharski's critics from the right would agree with all these achievements but would add 2 factors which facilitated his success story:

- The global economic boom which ended around 2008
- The fact that exactly these policies were promoted not by the socialists but by their coalition partners, NDSV and DPS

Either way, Oresharski obviously has the support of Stanishev, and is respected by all economic observers, mostly from the right.

Oresharski's appointment as a prime ministerial candidate has appeased people like us as any extravagant populist policies are now less likely with a BSP-led government. Ironically, a second GERB government might now be more populist – Viktor Orbán style (Hungary).

GERB's pre-election rhetoric sounds reformist

They say the usual things an EPP-member (European People's Party) would say – low taxes, prudent economic policies, some privatization. Whether they would actually deliver on these statements has to be seen.

Have we been impartial, after all?

We hope we have made some comments and predictions without taking sides. ☺

EMOTIONS MAY CAUSE A LOT OF TROUBLE BISSER MANOLOV

Bisser Manolov is a financial consultant. He was Chairman of the Management Board of the Bulgarian Deposit Insurance Fund for two mandates and is now a Board Member. He has been working in the banking sector since 1990. Mr. Manolov was one of the founders of the Bulgarian Dealers' Association and its President in 1998-2002. He is a Member of the Executive Council of the International Association of Deposit Insurers. Bisser Manolov holds a Master's degree in Economics from the University of National and World Economy, Sofia.



The article was published in the author's blog – www.bissermanolov.com

Interesting times we live in. Public anger flooded the streets as a deep river. Politicians are in a shock, everyone talks about everything – this is democracy. The 'street' dictates the terms. One thing has to be understood – the 'street' is always right. In the investments field, we have a very popular sentence: 'There is no 'wrong' market, there is only a wrong decision.' If we paraphrase these words in the light of the current events, they would probably sound like this: 'In terms of political governance of the country, every decision is wrong if it fails the test of the street.' The political, social and economic systems are in a total imbalance. For the past four years, the country has been governed in a wrong way. You do not believe it? Look out of the window and see what is happening in the street. Are you interested?

A poisonous cocktail is being stirred in our society – that of people's anger heavily sweetened with political populism. The street feels cheated because of the high electricity bills and has the absolute right to demand retribution. Confused politicians immediately flooded the TV channels. The street asked not to pay the electricity bills, and politicians added the idea of nationalization of electricity distribution companies. The proclamation for pension and minimum wage increases became a favorite refrain of the nationalist and left-oriented parties. If the 'street' asked for doubling the minimum wage and pensions, the latter parties would immediately start talking about tripling and quadrupling the numbers. We are witnessing a total imbalance. Emotion dominates, and this is the most appropriate time to do the greatest damage.

Logically, 'wise' economists appear and started presenting their 'scientifically justified' theories about the abolishment of the currency board. This is not only irresponsible, but mildly criminal at the moment. Do these 'experts' know that over 85% of the total loans in the banking system are euro-denominated? Are these gentlemen aware of the fact that the total indebtedness of the country exceeds 95% of GDP now? Bluntly said, speaking on such 'socially important' topics is extremely dangerous at this very moment. The currency board was adopted by law. Formally, it could be canceled only by a law, but that is not the problem. The currency board is a form of public control over the financial situation of the country, which does not depend on political attitudes, populism, and imprudent fiscal policy. Is this not exactly what the 'street' wants – control? In the simplified form of the currency board, foreign exchange reserves should cover 100% of the notes and coins in circulation.

In Bulgaria, we have a 'firm type' currency board where foreign exchange reserves cover not only coins and notes in circulation but also the minimum reserve requirements of the commercial banks, the fiscal reserves, the assets of state-

owned companies at the Bulgarian National Bank (BNB). At present banknotes and coins in circulation are just under BGN9bn. Everyone knows that if they have two levs in their pocket, there should be more than one euro as collateral with the BNB, and the deposit of the Central Bank's Banking Directorate. I would like to emphasize that this is a real guarantee. The latter, however, is not granted but a matter of financial regulation. Now, answer the question: What if these experts implement their idea for the removal of the currency board? I will tell you – our poverty now will look like a fairytale.

It is extremely dangerous and irresponsible to fool around with the currency board. The currency board is very well secured. Of course, people in the street actively repeat that 'someone was going to pull it down'. I want to make a clarification as a man with nearly 25 years of experience in financial markets. Technically, such a development of the current situation is not possible, and I will explain why. In Bulgaria, we have a closed money market. This means that trading BGN is executed only between local players or, more precisely, between financial institutions which are regulated by local regulatory authorities. Hypothetically, if that 'someone' wants to pull the currency board down, he would have to borrow a huge amount of free BGN to start buying EUR from BNB. I want to emphasize that we are not talking about hundreds of millions but about billions of levs. I responsibly declare that this is absolutely impossible. No commercial bank in Bulgaria has such physical resources and is ready to provide them to 'this' someone. Moreover, no local financial player is interested in such a development of the situation.

BNB's reserves are about BGN27bn. Any attempt for panic implanting of the thesis about the 'fall' of the currency board is purely speculative. However, politicians should be very careful. It is really 'sweet' to talk about 'large expenditures' and unreasonable personal income increases. Every politician wants that. Every politician wants to increase pensions. The last is very important regarding the victory in the elections. I deeply believe that the society will regain its common sense. Keep the balance in every sense. One country is genuine when a political crisis does not transform into financial chaos. We have succeeded so far. I have nothing against civil quotas. Every political decision has to be explained as much as necessary. The topic about the currency board is of extreme importance for the financial stability. The public debate on it should not be whether to remove it or not but how to keep it until entering the Eurozone. I am a firm supporter of Bulgaria's entering the Eurozone as soon as possible. However, this is not realistic for now.

Interesting times we live in...

GUEST COMMENT

ANALYSIS OF THE LUXURY REAL ESTATE MARKET IN BULGARIA

VESELA ILIEVA

Vesela Ilieva has 15 years of experience in the real estate sector, four of which in a senior management position at AG Capital. For the past 7 years, she has headed Unique Estates – a company for luxury properties.

She holds an MA in corporate real estate, finance, and strategy from the City University London, and a Master's degree in marketing and advertising, and a Bachelor's degree in economics and management of massmedia from the University of National and World Economy – Sofia. Vesela Ilieva is a certified residential specialist in the National Real Property Association of Bulgaria and a member of the RICS.



A 17% growth was registered in the luxury property market in 2012. The rise of the deal activity is a fact despite the slowdown of economic growth in the country. The prices marked stabilization, and the number of the concluded deals actively grew in the second half of the year – moreover, with a shortening of the period for accomplishment of a sale. The most expensive deal accomplished by Unique Estates in 2012 was for a house at the foot of the Vitosha Mountain for a total amount of above EUR1,000,000. The highest price for an apartment was again above EUR1,000,000, and the luxury property is located in the southern part of Sofia city.

The most demanded luxury properties in 2012 were aristocratic homes in old central buildings in Sofia that need renovation. The next most common demand was for modern houses, mainly in Boyana, with a yard of at least 1,000 sq.m. Younger buyers were interested in penthouse apartments with panoramic views.

The market activity in 2012 was due to the increased demand – potential buyers were mostly entrepreneurs or managers in big international companies. In 2012, the inflow of fresh capital was accelerated, and the presence of international companies in the country was expanded. Despite the Eurozone crisis, Bulgarian exports are still growing by 3% per year, and household consumption has increased by BGN3bn for the last 12 months. The higher profits of companies selling both in the foreign and domestic markets allowed the income of the managing staff to grow with double-digit rates. As a result, in 2012 the financial riches of the wealthy households reached new record levels. The total amount of deposits above EUR100,000 surpassed BGN3.8bn. A part of the savings the households accumulated as a buffer during the crisis is targeted at luxury properties which are an effective way to preserve the purchasing power of savings in terms of lower interest rates and higher inflation globally.

Luxury properties are still a niche segment – no more than 10% of the total housing market, but their importance has been permanently increasing in the last years. The price of most luxury apartments starts from EUR250,000, while a house in the highest segment costs at least EUR700,000. The prices of luxury homes are usually in the range of EUR1,500-1,650 per sq.m, but in some cases they reach even EUR2,500 per sq.m. Currently, luxury properties in the country are more

accessible to potential buyers with stable income and accumulated savings. Properties became cheaper by 30-40% in 2008-2011, and the prices of prestigious homes in Sofia are among the lowest in Central and Eastern Europe.

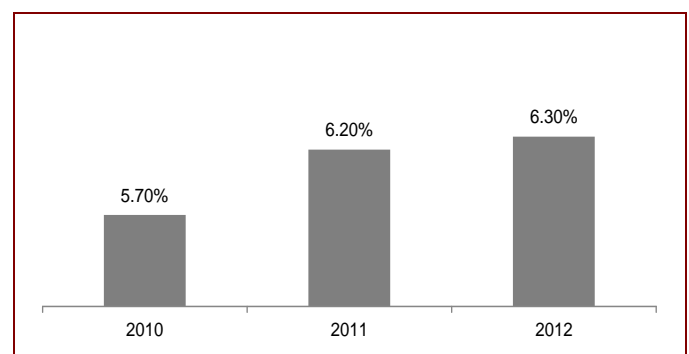
Chart 2. Dynamics of the prices of luxury properties in Europe



Red – lower prices; Blue – growth, White – stabilization

Luxury homes rents range between EUR5 and EUR7 per sq.m and reach EUR12 per sq.m for the highest quality properties. The average rent for an apartment marked a slight increase – EUR6 per sq.m in 2011 to EUR6.5 per sq.m currently, the levels for houses remain stable – about EUR5 per sq.m.

Chart 3. Average annual income from rental of luxury property



The luxury property market in 2013

- The inflow of foreign capital began to revive in 2012, and this trend will continue in 2013 too. The entry of fresh capital is of exceptional importance to the business growth and hence to the demand for luxury properties.
- The presence of foreign companies in the Bulgarian market will continue to expand, which means greater demand for luxury property rentals or purchases by expatriates.
- Compared to similar homes in other countries in Central and Eastern Europe, Bulgarian luxury properties seem undervalued, which is a prerequisite for attracting the interest of foreigners seeking more lucrative investment alternatives in terms of zero interest rates in a global scale.
- The return on an investment in luxury real estate (about 6% annually) exceeds the average interest rate on bank deposits and is among the highest in Europe. The new tax on deposit interest rates reduces further the real return on bank deposits in 2013. As a result, the majority of the passively managed household wealth, until now kept in banks or in cash, will be directed to luxury real estate and other real assets.
- The period for accomplishment of sales will continue falling, and the liquidity of luxury properties will improve.
- The prices of luxury properties will probably mark a slight increase in 2013, and the concluded sales will increase compared to the current levels.



Unique Estates was established in 2006 as a company focused on working with special clients and luxury properties. The company is part of the largest real estate holding in Bulgaria – AG Capital. With its experience and the knowledge gained during the partnership with Christie's Great Estates – the largest international network of brokers in the world, specialized in marketing and luxury property sales – Unique Estates is able to offer luxury properties in Bulgaria and around the world, personal attention, high quality service that meets international standards.

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THE PERILS OF PROTECTIONISM HONG KONG TRADER

www.hktdc.com

With the world economy unlikely to turn around anytime soon, the tide of protectionism is expected to prevail in the medium term. That's despite the unusually restrained approach to trade restrictions since the onset of the 2008 global financial crisis. It won't be just in the United States and the European Union, however, that traders can expect punitive measures. Emerging markets, including Brazil and Argentina, are posing protectionist threats to Hong Kong exporters.

Protectionism, which embraces a wide array of tools and practices to restrict trade, has a long history. It tends to arise in times of economic crisis, with an array of tariffs and non-tariff barriers. But protectionism always damages the industries and people that governments seek to help, hurting the well-being of both importing and exporting economies.

Remembering the Depression

The Great Depression serves as a vivid example. It was the longest and deepest global economic downturn of the last century, triggered by the US stock market crash in October 1929. While the underlying causes of the Great Depression were multifold, trade protectionism legislation, in addition to faulty fiscal and monetary policies, played a significant role in making a bad situation worse. In June 1930, the US enacted the Smoot-Hawley Tariff Act to protect local industries, raising import tariffs on more than 20,000 items to record levels. Even today, there is no consensus on the extent of protection that the Smoot-Hawley Tariff Act afforded to US industries. But the act contributed negatively to combatting the global economic downturn.

Higher US tariffs sparked retaliation, pushing the world into the Great Depression. In the lead-up to the Smoot-Hawley Tariff Act, it was Canada, the US' largest trading partner, which substantially raised the import tariffs on products that constituted the bulk of its US exports. Europe followed suit. Consequently, such policies led to a slump in world trade. Between 1929 and 1932, US imports from Europe fell by more than 70%, while US exports to Europe declined by nearly two-thirds. It was a harbinger of trade destruction.

In the wake of the Smoot-Hawley Tariff Act, the world made great efforts after the Second World War to prevent a repeat. The guiding principles in international trade has been that tariffs and other trade barriers should be lowered, primarily through multilateral agreements under the umbrella of the General Agreement on Tariffs and Trade and the World Trade Organization (WTO). Trade barriers have duly been greatly reduced in successive rounds of multilateral trade liberalisation, and international trade has expanded rapidly to benefit exporters, producers and consumers.

Protectionism Amid Financial Crisis

As if heeding the lessons of the Great Depression, there seems to be no pervasive resort to trade restrictions in the financial crisis of the past few years, leading to a rebound of world growth and international trade. The fallout from the financial crisis remains, however. Following a strong rally in 2010, world growth and trade have slackened markedly since mid-2011. This insipid performance was initially caused by the disastrous earthquake in Japan, then the slower-than-expected recovery in the US and, more seriously, the deepening sovereign debt crisis in Europe.

Against this backdrop, the undercurrent of protectionism has become more apparent recently, fueling trade tensions that could help derail global recovery. According to the WTO, 124 new trade restrictive measures were introduced by G20 members from mid-Oct 2011 to mid-May 2012, affecting some 1.1 per cent of G20 imports, or 0.9% of world imports, compared with 0.6% and 0.5% over the preceding period, respectively.

The accumulation of trade restrictions since October 2008, excluding those that were removed, covered 3.8% of G20 imports, or 2.9% of world imports, as of mid-May 2012. According to the WTO, the most popular restrictive measures have been such trade remedies as anti-dumping, countervailing and safeguards, tariff increases, import licenses and customs controls. In terms of trade coverage, the most affected products have been optical and other precision instruments, motor vehicles, machinery and mechanical appliances, electrical machinery, iron and steel, and meat.

Failure of Doha Round

Apart from the renewed downturn of the global economy and trade, the failure of the Doha Round has also played a part in igniting protectionism. The latest round of multilateral trade negotiations, under the auspices of the WTO, started in November 2001, with an objective of further liberalising global trade and lifting living standards worldwide.

It covers trade in industry products, agriculture, services and a number of issues more indirectly related to trade. According to the Peterson Institute for International Economics, the Doha Round could lead to a potential gain in exports of about US\$280bn per annum. Initially scheduled for a conclusion in 2005, the Doha Round has missed several deadlines for reaching a final deal. As many hurdles obstructing the Doha negotiations are political, especially relating to agriculture, prospects remain uncertain. Without a compromise on Doha, the WTO's dominance in the world trading system is diminishing, and more and more bilateral agreements are replacing the multilateral framework. By all indications, the stream of support for free trade is waning.

Persistent Protectionism

The poor outlook of the global economy, plus the murky prospects of further multilateral market liberalization, suggests that threats of protectionism are not expected to subside over the medium term. Premising the rising trend of using anti-dumping and countervailing actions by the EU, the European Commission officially launched an anti-dumping investigation in early September 2012, to determine whether solar panels manufactured in the Chinese mainland are sold in the EU below cost. The case is the EU's highest valued anti-dumping investigation, as it covers imports from the mainland worth EUR21bn, with the EU market accounting for 80% of Chinese solar equipment sales worldwide.

Also in September, the EU's ProSun, the industry association led by Germany's SolarWorld, filed an anti-subsidy complaint at the Commission, alleging that Chinese authorities are providing massive and illegal subsidies to Chinese solar manufacturers. To complicate matters, US trade relations with China were politicized in the run-up to the presidential and congressional elections in early November.

Apart from anti-dumping and countervailing actions, the most notable development involving the mainland was the filing by the US, in mid-September, of a WTO dispute settlement case against certain export subsidies provided by the mainland to the domestic automobile and auto-part industries. China-bashing was an abiding feature of the American political debate, but its intensity usually decreases after presidential and congressional campaigns. Given lingering economic problems, however, protectionist sentiment in the US is unlikely to fade.

Environmental Protection Measures

The proliferation of health, safety and environmental protection measures is also a cause for concern. The EU will maintain its focus on safeguarding consumers and the environment, exemplified by the continuing enhancement of directives concerning electronic and electrical equipment, chemicals, toys and eco design. In the US, too, consumer and environmental protection is catching up fast, with states addressing a number of issues to fill the gap left by federal legislation.

Another worrying development is the escalation of protectionism in some emerging markets, such as Brazil and Argentina. Anti-dumping actions aside, safeguard measures, in tandem with import tariff increases and a number of non-tariff barriers, have been commonly taken by emerging countries to protect domestic producers.

In some cases, trade barriers appear in the form of procedural requirements to hinder import clearance, making market access more difficult as uncertainties facing traders increase, and as the risks and costs of doing business rise. The use of safety and environmental protection measures, like their counterparts in the developed world, is also on the rise in emerging markets.

Survival Tips for Exporters

Hong Kong, which relies heavily on the Chinese mainland as its production hinterland, is highly vulnerable to trade protectionism. To lessen the adverse impact of protectionist measures, Hong Kong exporters and manufacturers should take heed of trade and regulatory developments in overseas markets, covering not only traditional markets such as the US and the EU, but also emerging markets, which are also raising barriers to international trade.

To plan ahead, they should identify and monitor the possible sectors most likely subject to protectionist action. Protectionist measures will target the hot items that hit the mass markets. To avoid being over-exposed to the low-to-medium-end of the market, it's advisable for Hong Kong suppliers to actively identify market niches higher up the scale.

While keeping an unbiased focus on creating more value for their products, Hong Kong traders have to work consistently on product differentiation, upgrading quality, image and style. If anti-dumping or countervailing proceedings have been initiated, exporters should participate in the investigations to reduce the adverse effect of the allegations.

At an industry level, companies should join forces, possibly through coordinating with trade associations, to mount well-organized, speedy responses to any allegations. Individual companies should respond to questionnaires during investigations and provide the information requested. Otherwise, investigators would base their findings on the best information available to them, which could be particularly disadvantageous to exporters.

Similarly, traders or manufacturers not named in proceedings should participate in investigations. Otherwise, anti-dumping or countervailing duties much higher than those imposed on other companies might be applicable. Hong Kong exporters are also advised to maintain a diversified production and sourcing base rather than solely concentrate on the mainland, which is frequently the target of overseas protectionism, due to its size and sustained competitiveness.

By operating in a global setting rather than putting all their eggs in one basket, Hong Kong suppliers can ensure that their deliveries to overseas buyers will not be handicapped by any restrictive measures on mainland imports.

Given the proliferation of health, safety and environmental-protection measures, Hong Kong exporters should also keep an eagle eye on relevant regulatory developments. Enhancing product design, using the right parts and components, beefing up production, as well as strengthening testing and inspection, are among the crucial tasks to perform.

THE DETRIMENTAL REGULATION OF CREDIT RATING AGENCIES

NIKOLAY VASSILEV, CFA

Published in Trud Daily

Bulgaria can be proud of its achievements after 1997 in areas such as direct taxes, public debt, budget deficit, credit rating, and job cuts in the administration. Whenever these topics are discussed within the EU, we should be in the centre of the discussion. Unfortunately, we have not managed to push our ideas through in any of these areas so far. This also relates to the latest proposals of the Internal Market and Services Commissioner for restrictions on credit rating agencies – no one is interested in the opinion of Bulgaria. And yet, we are champions in reducing public debt (1997-2008) and we are among the few countries with credit rating upgrades lately. So we do not have problems with the rating agencies, do we?

What is the EU proposing?

The propositions are for more 'transparency' in the work of the credit rating agencies (well, the EU will not say that they will tie up their eyes and mouth in order to prohibit them from telling the inconvenient truth – which in reality is their goal):

- Sovereign credit ratings will be assigned on a preliminary schedule only and will be announced only at certain times of the day. For example, if Greece or another country is headed for bankruptcy next week, no bad news should be released because the timing has not been 'scheduled'. Or, the opposite – in December 2012, Standard&Poor's upgraded Greece's rating by as much as 6 notches. Would this be banned as well, or would the ban refer just to the downgrades?
- Ratings should be more 'motivated' and 'profound'. Not bad, but what is the actual purpose? It is to make the job of the rating agencies more difficult. If they assign a negative rating to the next European country (other ratings apart from negative ones are not expected soon), they will be rejected because they are not well 'motivated'.
- Creating rules for switching from one agency to another. In other words, to be able to switch to those agencies which will give 'the right' ratings.
- Prosecuting rating agencies. In case they deprive the US and France of their AAA ratings, which has already happened. Well, under governments' pressure, the court will not use exactly these words regarding the committed 'crime' but will say that 'the rights of the investors have been violated', 'there is a conflict of interest' or some other nonsense. But if the highest rating of AAA or even AAAAA is assigned, then no government will say that there is a rules violation.
- Creating a European credit agency by 2016. Europe can create as many agencies as it wants. We already have more than enough agencies across the world – over 100, among which is even the

respected Bulgarian Credit Rating Agency (BCRA). 100 is not a small number at all – more than the car brands offered in the European market. And what will be the role of this new European agency? In my opinion, it will have only one goal: to say that everything on the continent is fine and to assign the highest AAA rating from Athens to Dublin. The EU countries will use this 'properly motivated' and 'transparent' agency, and not the 'bad' Americans who are 'monopolists' and 'the main causers of the crisis'.

The opponents of the rating agencies expect even more regulation than the proposed so far. For example, to prohibit assigning ratings to countries in certain cases.

It would be like students regulating teachers

If anyone is in a conflict of interest, that would be the European policy-makers. They play a triple role: 1) they are the causers of the crisis and are unable to get us out if it, 2) countries as issuers of debt securities are rated by rating agencies, 3) the policy-makers want to regulate the agencies. It would be like students telling teachers what grades to assign.

Are rating agencies to blame for the failure of a whole generation of leaders?

During the last decade (even before the crisis) many countries made catastrophic economic mistakes:

- Chronic budget deficits – the highest after World War II
- Unreasonable increases in social spending to historically highest levels – especially in pensions...
- ...amid a worsening demographic situation in Europe
- Accumulation of unsustainable public debt which mathematically cannot be serviced and paid back
- High direct taxes

I would also like to criticize the rating agencies but from the opposite direction – they waited too long before they durst to tell the truth about the most indebted countries. They should have downgraded them even more abruptly. But we have to admit that agencies do not have it easy either. The president of Standard&Poor's Deven Sharma got fired after downgrading the U.S. I admire his bravery.

What does it mean for ratings to be 'more motivated'? If an average student of medicine sees that a patient weighs 100 kg, and each year she/he puts on another 10 kg and still does not want to stop smoking and drinking – should the student be a Nobel Prize winner to be able to conclude that the patient is at a risk of a heart attack and has many other problems?

It would not matter if the student wrote a diagnosis on a napkin or produced a 'motivated and profound' thesis; it would not even matter if the student did it urgently or on a 'preliminary schedule' because the net effect would still be the same – the patient is more likely to go to the emergency room rather than to the next Olympic Games. The sooner a fair rating is assigned, the better for everyone.

In the same way, if they asked a good economist whether a country with a 70-100% debt/GDP ratio, a budget deficit around 10% (does this not look like the figures of the US, the UK, and France?) and without political will for reforms (like Greece) deserved a AAA credit rating, the answer would be NO. No matter how they regulate and force the rating agencies, nor what kind of schedules and motivations they come up with – the fair answer would still be NO. Even if 10 European or alien agencies announce the opposite, investors would not pay attention at all.

The activities of rating agencies are highly professional

Hundreds of qualified analysts and economists work for them. I accept all their grades which I have used as objective and useful, and my overall opinion regarding their work is good.

Are credit agencies capable of making mistakes? Everybody is. Agencies assign grades to thousands of companies and many countries. From time to time, it is possible for a company with not a bad rating to go bankrupt, and this is used by critics as an example of a failure for many years after. For example, Lehman Brothers unexpectedly went bankrupt and had a rating around A (and not AAA as many mistakenly think). But why do we forget the 99% of the cases when independent agencies are right? Is it better to get rid of them when they make mistakes sometimes? It would be like shutting down an entire hospital because of one unsuccessful medical intervention (which may not be a mistake at all) and banning doctors in general. Would the world be a better place then?

Professional investors such as banks, pension and investment funds, and insurance companies use many sources of information and analysis when making investment decisions. Credit rating agencies are only one of these sources. But if the work of the agencies gets ruined, investors will be less successful.

This regulation looks like censorship on the media

If in a democratic country the free media attack more and more often politicians because of their incompetence and dishonesty, what should politicians do then? The right answer is to correct their behavior so there are no more objective reasons for criticism. But if they pass a law according to which:

- politicians can be discussed only on a preliminary schedule
- in certain cases it is prohibited to criticize certain politicians
- journalists can be sued not only for libel, but also for disseminating unpleasant information (portrayed as lack of transparency, conflict of interest, or lack of motivation and depth)
- they can change the criticizing journalists with 'better' ones
- they can ban the most 'untransparent' media and substitute them with more 'European' ones which will give the 'right' opinions....,

this will look like Orwell's book '1984'.

The world has never had more regulation than today

The left-wing critics of the neoliberal model in Europe plead for more regulation in all sectors – banks, financial markets, and rating agencies. If all this continues, more and more businesses will keep on relocating to Asia, and there will be no investment, therefore growth in Europe.

The correct decisions are different. Instead of blaming credit rating agencies, the European leaders should take other measures:

- Ban budget deficits in their countries' constitutions
- Decrease debts
- Stabilize banks and regain confidence
- Radically reform pension systems
- Decrease direct taxes so they can stimulate investment and growth
- Cut down the lavish budget expenditures

Yes, they can lose the next elections because of these measures (lately, ruling parties across Europe have been losing anyway) but the alternative for Europe is to wait the entire 21st century. It may sound pretentious, but excluding the pension reform (which is happening neither in Bulgaria, nor in Europe) the continent should be doing what Bulgaria successfully achieved after 1997.

WHAT COULD A (PRIME) MINISTER DO FOR 50 DAYS?

NIKOLAY VASSILEV, CFA

Published in Trud Daily

Some will say that the caretaker government cannot achieve anything significant. While it takes power and looks around, time will run out. Laws cannot be passed because there is no parliament. The administration will block all radical intentions of the so-called experts without any administrative experience. One example – for several years now, the civil servants have disregarded the idea of swapping the buildings of Sofia Municipality and the Ministry of Agriculture – let alone for two months.

However, in my opinion, everything depends on the leadership qualities of the ‘caretaker’ ministers and on the choice of priorities. A lot could be achieved for a short period of time. The times are dynamic now, and the events in the next two months will be more deciding than March and April of any other year, which we would not remember for a single thing.

Society needs to calm down, and democracy has to be stabilized

By irradiating professionalism and confidence, the caretaker Prime Minister could quickly ease the tension. The key tasks before him are:

- Quick analysis of the activity of the energy companies – bills, pricing, eligible costs. The protests began over electricity. If everyone stopped paying their bills because they consider them unfair (while they might not be such), the energy sector would collapse.
- Organizing transparent elections – which we all doubted previously. The feeling of massive election fraud may give birth to an illegitimate parliament and to a new government crisis. And our image as a corrupt country will be strengthened.

Institutions should continue working. No leaks should be allowed

It is no secret that around every change of government the administration does not work for months with the required pace, and thousands of people are switching jobs. In 2009, the system was completely paralyzed because of the total rejection of the past, the ubiquitous ‘revisions’ and the intimidation. In 2013, we need more continuity and stability.

In transitional periods of interregnum, there is a threat of a drop in tax collection, an increase in crime rates, frauds and losses in state-owned companies – as if it is ‘for the last time’. Is it not the same in the private sector when a general manager has been replaced? I recommend that the responsible ministers freeze all spending in the state-owned companies and in the whole public sector. Only in the energy, transport, and healthcare sectors – with no control – another billion might be wasted until the summer.

The populism in the economy is a bad thing. So is the deficit

If anyone thinks that the caretaker ministers would magically lower the electricity prices, raise incomes, and create thousands of jobs, they will be disappointed. What is more important is the opposite – in such a short period, it is less important to build a lot and it is more important not to destroy a lot. In times of political crisis, investments are freezing, business turnover is falling, we are all watching TV. If it is true that the ‘fridge has defeated the TV’, it is also true that the TV alone will not fill the fridge. Business and investors need stability and predictable environment.

The task of the caretaker government is not to allow any doubt in the iron stability of the currency and the banks. The budget is the key factor. Not only no pouches should be untied, but exact the opposite – taxes should be collected rigorously, and non-priority expenses (repairs, cars and many others) should be completely cancelled. It is absolutely real and desirable that the caretaker cabinet should leave the budget with a surplus and the fiscal reserves increased by one billion. You will say – this is difficult and impossible. Was it easy for caretaker Prime Minister Sofianski in 1997? Measured in dollars, earnings back then were more than 100 times lower, and people were even poorer.

Some processes could be completed – privatization and concession deals in progress, priority procurements, European projects. Others could not. It is not realistic to start new major deals and projects (the seventh reactor of the Kozloduy nuclear power plant, a new bridge over the Danube River, the purchase of fighter jets). In conservative systems such as healthcare, justice, and defense, substantial reforms could not take place.

A particular emphasis on EU funds

There is no appropriate time for a government to fall, but during the negotiations of the seven-year EU budget frame the time is not appropriate at all. If there is a sector where continuity is needed the most that would be the absorption of EU funds. Project payments should continue. A highly respected political figure should participate in the European Council for the negotiation of the resources. If the confidence of Brussels falls, it will take us years to recover it. The situation with Schengen is similar.

Regardless of the sector, the tasks are similar

Every caretaker minister should take a flying start and perform several tasks:

- Preserve the working teams and maintain high morale in the ministry
- Save the budget and spend for almost nothing. Leave the tiles to be repaired in the autumn...
- Choose 1-2 problems of great public importance which can be solved urgently and fairly – VMZ Sopot, the ski slopes in Pirin, transparency (not populism) in the utility services bills, and in the bank contracts
- Firmly ‘tighten the screws’ of state-owned companies, agencies and other structures that may accomplish abuses in large amounts in the ‘muddy water’
- Refrain from mass dismissals, except of obviously compromised managers

A few modest ideas

Everyone could make many suggestions about what needs to be done urgently. Some of these suggestions would require a lot of time or would not have funding from the budget. Others would be controversial and would need a political debate (the GMOs). The third type of suggestions would require large changes in legislation and even in the Constitution – and this is unrealistic.

For me, there are three important priorities of the caretaker government:

1. Keeping the civil peace
2. Consolidating the financial stability and not rushing in populist spending
3. Organizing transparent elections

Here are some other miscellaneous ideas which do not require long deadlines and resources:

- Provide sufficient resources for everyone in need of in vitro procedures. Several million BGN.
- Conduct a campaign against the corruption with university exams. This does not cost anything.
- Not allow NEC and BDZ to fail in the refinancing of maturing loans.
- Support investors in renewable energy by adjusting (via the State Energy and Water Regulatory Commission) last year’s controversial decision of the latter commission. It does not cost the budget anything.
- Reduce the feeling of strong police intervention, phone-tapping and excessive presence of vehicles with blue lamps in the streets. It does not cost money.

The list is not exhaustive.

Leadership is not less important than money

Each step of the caretaker government will be critically observed by millions of people. Sometimes it is not that important what is said and done, but who and how says it and does it. Personal example is important. Eventhough it is not controlled by parties and Parliament, the caretaker government carries a huge responsibility. However, the responsibility of business and the citizens is not less important. The caretaker government’s mandate is not timelessness. Companies should continue to work; all of us should pay our taxes and bills. The caretaker government can return the nation’s faith in democracy, in the institutions, and in the future. It can show that there are decent and honorable people who work in the interest of the citizens. That is why people are protesting. Was this not the reason we all protested in 1989 and 1997?

THE EASY ROAD DOWN THE SLIDE

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Recently, a lot of unexpected and unusual things have happened around the world. In Italy, comedians are trendy nowadays, and it is very likely that the stalemate will lead to failure in forming a reasonable government. I would not rule out the option for Rome to become unable to service its debt. In recent years, among the major European countries Germany has been the only pillar of stability and normality – thanks to Merkel. But lately, Euro-skepticism has been growing even there – 25% would vote for a political party which is against the euro. The extravagant ideas of Francois Hollande for higher taxes and expenses are well known. In the US, Obama is spending more than ever. One day the Americans will pay the bill – most likely with a weak dollar which will have lost its leading global role in favour of the Chinese yuan.

Bulgaria is not behind in the race towards abnormality either. From all directions, we hear calls for wrong actions which not only would not lead us out of the crisis, but would more likely accelerate us down the slide. The bad thing is that political parties are competing to please the street and repeat these calls. Here are some examples.

1. Stop the privatization of X

It does not matter if it is BDZ Freight Services or any other state-owned company. Do the protestors have answers to the following questions:

- If we do not sell BDZ Freight Services, how many days will it take for BDZ Passenger Services to go bankrupt as well?
- Who said that the company would be sold for dozens of times less than its real value?
- Is BDZ so well managed now that it should remain state-owned?

2. Nationalize Y

President Plevneliev said it well: ‘People want nationalization but do not trust the state.’ For 23 years, how many state-owned enterprises have prospered, have developed competitive products, have dominated world markets or have managed to defeat corruption? The contrary examples of plunder and collapse because of mismanagement and abuse are numerous: Plama, Balkankar, Vidachim, Varna Shipyard, VMZ Sopot ... Do the people who want nationalizations have answers to the following questions:

- Is nationalization constitutional? Or maybe the Constitution is also not something of value anymore?
- How much and how will the government pay the electricity distribution companies? A billion? Or do

we want expropriation like the one after 9 September 1944?

- Are the future ministers going to manage the companies in a more efficient and transparent way – maybe like Sofia Heating?

3. Not pay our electricity bills

It does not matter if it will be for a few months or for the entire winter period. If power supply will not be shut down for those who do not pay their bills from December to May, this would be an official invitation for 5 million Bulgarians not to pay their electricity bills at all. Then we may rename the capital city to Stolipinovo (a Roma ghetto in Plovdiv). Whoever offers this should have answers to the following questions:

- In how many months will the entire energy sector go bankrupt?
- Will there be any ‘stupid’ people left to pay the bills of the others?
- Is this not actually going to raise the electricity price? But wasn’t the main idea that prices should go down, especially for people who find it hardest to pay their bills?

4. Take a new government loan and spend it

This is constantly repeated as a universal cure which will automatically increase incomes. It is something like to get a consumer credit and squander it away immediately. And then what? Actually, this is what many countries were doing for many years, including Greece, Hungary, and much of Western Europe. That vicious circle ‘debt – spending – deficit – huge debt’ led to the global crisis and recession (read: poverty) in many countries.

Someone will say: other countries may have high debt but they are already rich and we are not. I do not agree with such a superficial observation. No need to look for examples thousands of kilometers away – let us look at Bulgaria in 1998-2008. In the years when we sharply reduced our debt as % of GDP, we managed to achieve higher growth than the ‘spending countries’ and to attract record investments. Prudent macroeconomic policies created TRUST – in our currency, price stability, and good business conditions. Trust led to investments, growth, and jobs. Even if we do not want to accept it, we have to admit that incomes rose multifold.

We should not forget that in the past Bulgaria took a lot of debt. I do not know how well we lived in the 80’s (what car were you driving then?) but in 1990 we went bankrupt and we know what happened afterwards with hyperinflation. Twice.

Two different scenarios for the next governments

Scenario A: 'Down the slide' debt – spending – deficit	Scenario B: 'Slowly moving upwards' currency board – balanced budget – low debt
<ul style="list-style-type: none"> • we take a new loan • we increase salaries, pensions – we are happy for 2 months • the budget deficit grows out of proportion and it cannot be stopped • interest rates of loans go up • a substantial increase of interest expenses in the budget – because of the larger debt, and the higher interest rate on it. Instead of increasing pensions and building roads, we will be paying more interest to banks and creditors • the credit rating plummets to 'Junk' • no one wants to invest in Bulgaria • no one in Bulgaria would even remember what a 'stock exchange' was • a new recession • the worst case scenario – farewell to the currency board and the strong currency... • which means high inflation, high interest rates • speculators will be just fine but the poor will suffer the most – and that were exactly the people we started the big spending for in the first place • we will most definitely not be able to pay our electricity bills, if there is still a company to produce electricity <p>It might sound familiar because this was what happened in 1996-1997. This was the time when we had the largest deficit and the highest nominal increase in incomes accompanied by the biggest real impoverishment.</p>	<ul style="list-style-type: none"> • we forget about extravagant ideas such as more debt and spending, and we start spending more time at work rather than in front of the TV • balanced budget – we do not spend more than what we actually have • then the currency board will be solid • fiscal and currency reserves grow • interest rates and inflation remain low • public debt stays low • all this leads to low interest expenses for the budget • we will have a higher credit rating than Italy • we have to simplify the regulatory regimes • we have to keep low direct taxes • a new rally in the capital markets • privatization and concessions • new inflow of national and foreign investment • higher growth... • ...and then steadily increasing incomes • decrease in the unemployment rate • contrary to some people's beliefs, the aforementioned policies (especially the currency board) protect the living standard and incomes of the poor <p>We have forgotten what happened in 1998-2008? Then we should listen to the following anecdote:</p> <p><i>Radio Yerevan was asked: When is the situation going to get better?</i></p> <p><i>Answer: It already was.</i></p>

How to evaluate the work of the new Finance Minister

My recommendations list:

1. Say out loud and clear that no one should question the currency board. It would look good on Kalin Hristov.
2. Leave his successor a budget surplus instead of a deficit.
3. Withstand the pressure for higher expenditures – especially for pensions and salaries. Pension expenditures as % of GDP are already high, and we are expecting a planned increase on 1 April. More of that would be unreasonable.

4. Maintain the credit rating of the country at the current level, least.
5. Keep yields on government debt at the current low levels.

These 5 recommendations are aimed primarily at the Ministry of Finance but in fact the entire government must resist the populist demands which would start the process of sliding down. If it at least does these things, this government has a chance to be remembered as a successful one – like the previous two caretaker governments.

THE MUTUAL FUND EXPAT NEW EUROPE PROPERTIES CHANGES ITS NAME AND INVESTMENT PROFILE – BECOMES EXPAT GLOBAL EQUITIES

The Financial Supervision Commission has approved changes in the name and the Rules of the mutual fund Expat New Europe Properties. By this decision, the fund has been renamed to Expat Global Equities. Its main investment focus will now be investments in shares of listed companies in global markets.

Previously, Expat New Europe Properties was intended mainly to investments in REITs and other financial products related to real estate markets in Central and Eastern Europe. Expat Global Equities will now provide access to liquid stock markets worldwide. By changing the investment focus, the fund's risk profile becomes high (in comparison, the risk profile of Expat New Europe Properties was rated as moderate to high).

There are no changes in the purchase and redemption charges. There are changes in the management fees – the fixed annual management fee is reduced from 2.50% to 1.90% of the net asset value (NAV) of the fund on an annual basis. A performance fee (success fee) is introduced – it is 15% of the positive return calculated according to the “high watermark rule” considering the absolute increase in NAV (i.e. the positive difference (if any) between the NAV for the current day and the highest NAV achieved in the same calendar year).

Expat Global Equities (previously Expat New Europe Properties) was established in 2008. Currently, the net asset value of the fund is more than BGN476,000, the NAV per share as of 30 April is BGN1,006.45 – one of the highest values since the issuance of the fund. Expat Asset Management is a licensed asset management subsidiary wholly-owned by Expat Capital. The company manages hundreds of individual investment portfolios and three mutual funds – Expat New Europe Stocks focused on equity markets in Central and Eastern Europe, New Europe and the CIS countries, Expat Bonds focused on global bond markets, and Expat Global Equities with its new profile.

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