

The recovery and potential of the Bulgarian retail market?

Toby Iles

Deputy Editor/Economist

Eastern Europe, Country Analysis

June 2010

How it was – the boom years

- In 2002-08 real GDP growth averaged 6% per year
- Retail sales (volume) grew by 13.5% per year, as published by Eurostat
- The average for CEE was 6.6%*
- Retail sales (value) grew by 18.3% per year
- FMCG companies in EIU CN surveys reported double-digit growth

*weighted average of Bulgaria, Czech Republic, Hungary, Poland, Romania and Slovakia

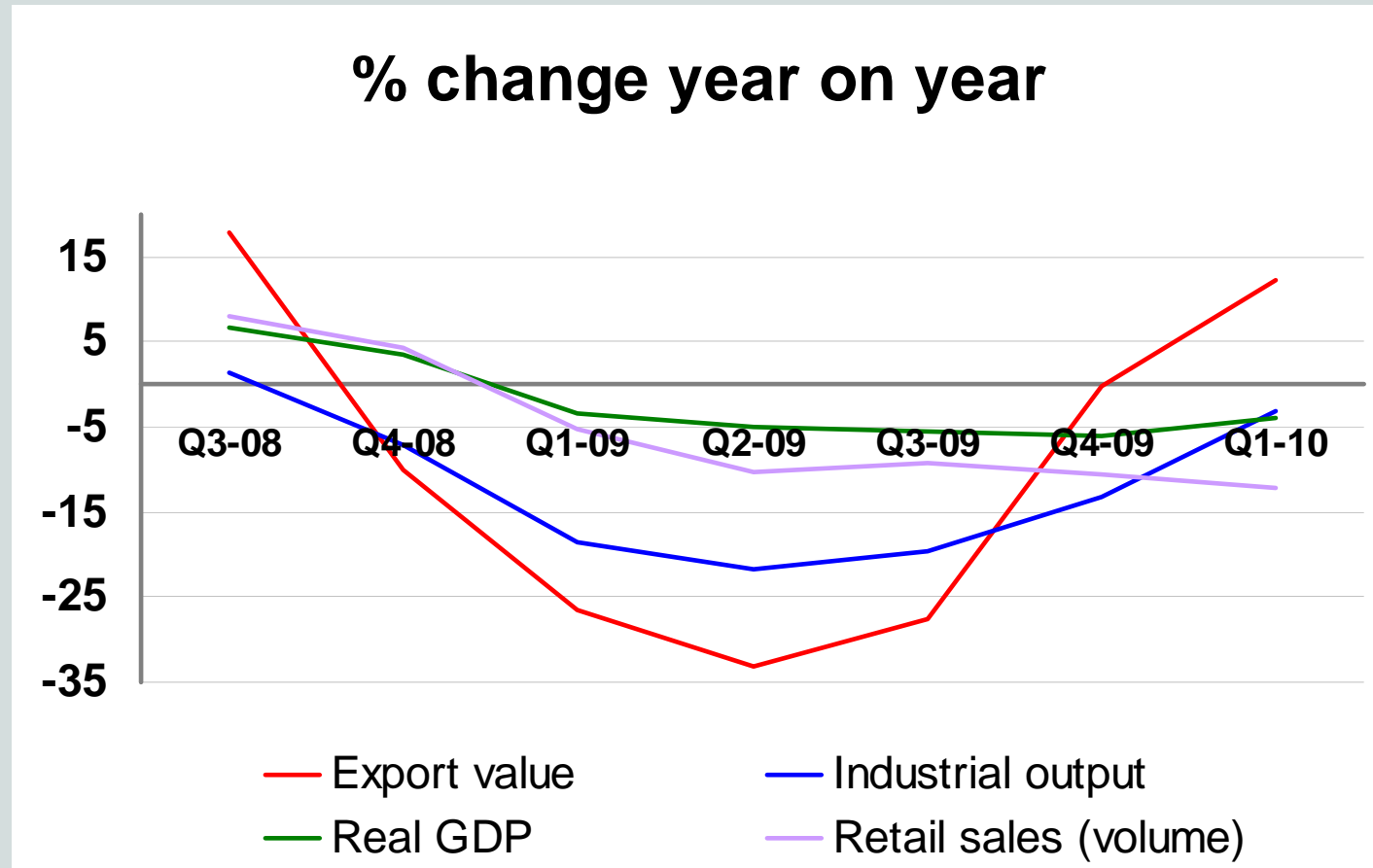
Downturn during the economic crisis

- The downturn started in late 2008...
- ...and intensified in 2009 when real GDP declined by 5%:
 - Lack of foreign demand for exports
 - Tightening of external financing; dramatic fall in credit growth
 - Incomes hit by unemployment and collapse of house prices
- Retail sales (volume) fell by 8.9%

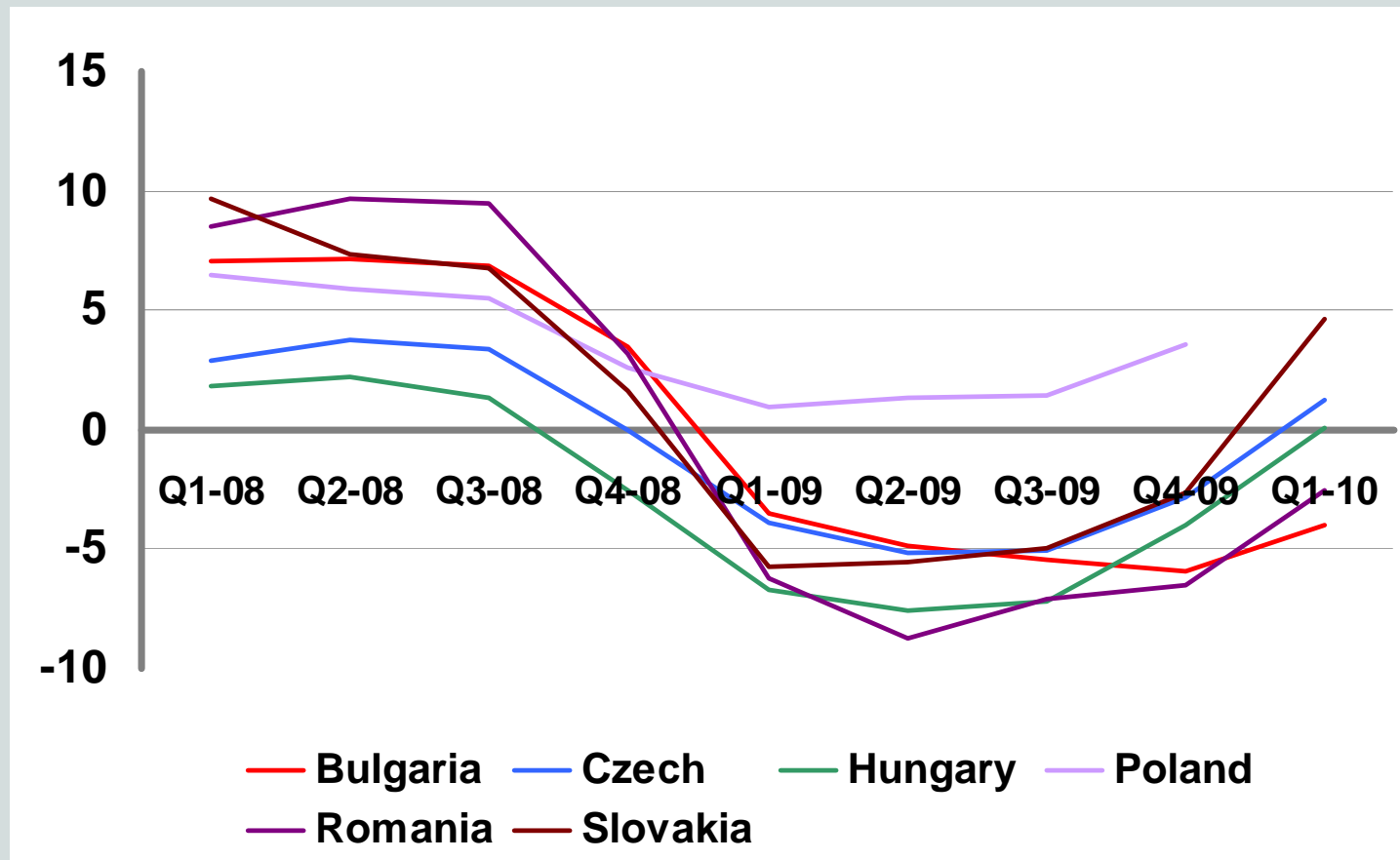
What stage is the recovery at?

- Real GDP declined by 5.9% year on year in the fourth quarter of 2009
- In the first quarter of 2010 the decline was a preliminary 4% year on year
- Slightly worse than expected
- Industrial output started to pick up, but construction is struggling, and unemployment is at elevated levels
- Retail depressed: -12.1% y-o-y in Q1

Export-led recovery



Year-on-year real GDP growth (%)



Macro outlook for 2010-11

- We forecast only a weak recovery in GDP growth in 2010, of just 0.1%
- Domestic demand will remain subdued...
- ...and the pick-up in euro zone demand for exports will be limited
- Stronger recovery, of 2.8%, in 2011
- But the balance of risks to this forecast remains on the downside

Domestic demand remains weak

- Subdued private consumption:
 - High unemployment and slower wage growth
 - Limited borrowing
 - Negative wealth effect from lower house prices
- The painful reversal in the real estate sector will dampen investment
- No stimulus from fiscal policy

Stronger growth in 2011

- Households and companies will have worked through some of the necessary balance-sheet adjustments
- Demand will start to strengthen, helped by better borrowing conditions...
- ...stronger labour markets
- ...and a marginally more positive outlook in the euro zone

What risks remain (1)?

- The fiscal crisis in Greece could affect GDP growth in Bulgaria:
 - Reduced export demand -- about 10% of Bulgaria's exports go to Greece
 - Lower investment
 - Strains in the banking sector: Greek banks account for 30% of total banking assets in Bulgaria and 40% of loans

What risks remain (2)?

- We forecast growth in the euro zone of 0.7% in 2010 and 0.8% in 2011
- The need for fiscal consolidation could lead to even slower growth
- The malaise in the Bulgarian property market could last beyond 2010
- The rise in non-performing loans could be above expectations – weaker recovery of credit

External vulnerability still a risk

Foreign reserve coverage of short-term external debt
(€ m)



Source: Bulgarian National Bank.

What does this mean for retail?

- Retail sales to remain in negative territory for most of 2010
- Before growth in 2011
- Our macro outlook suggests that this pick-up will be gradual and weak
- But the more crucial question may be:
 - What will happen to demand in Bulgaria in the medium term?

Global: Recoverology



Bounce-back theory: “V”

- The sharper the contraction, the stronger the recovery

Financial-impairment theory: “U”, “L”

- Recoveries following financial crises are much slower than normal recoveries

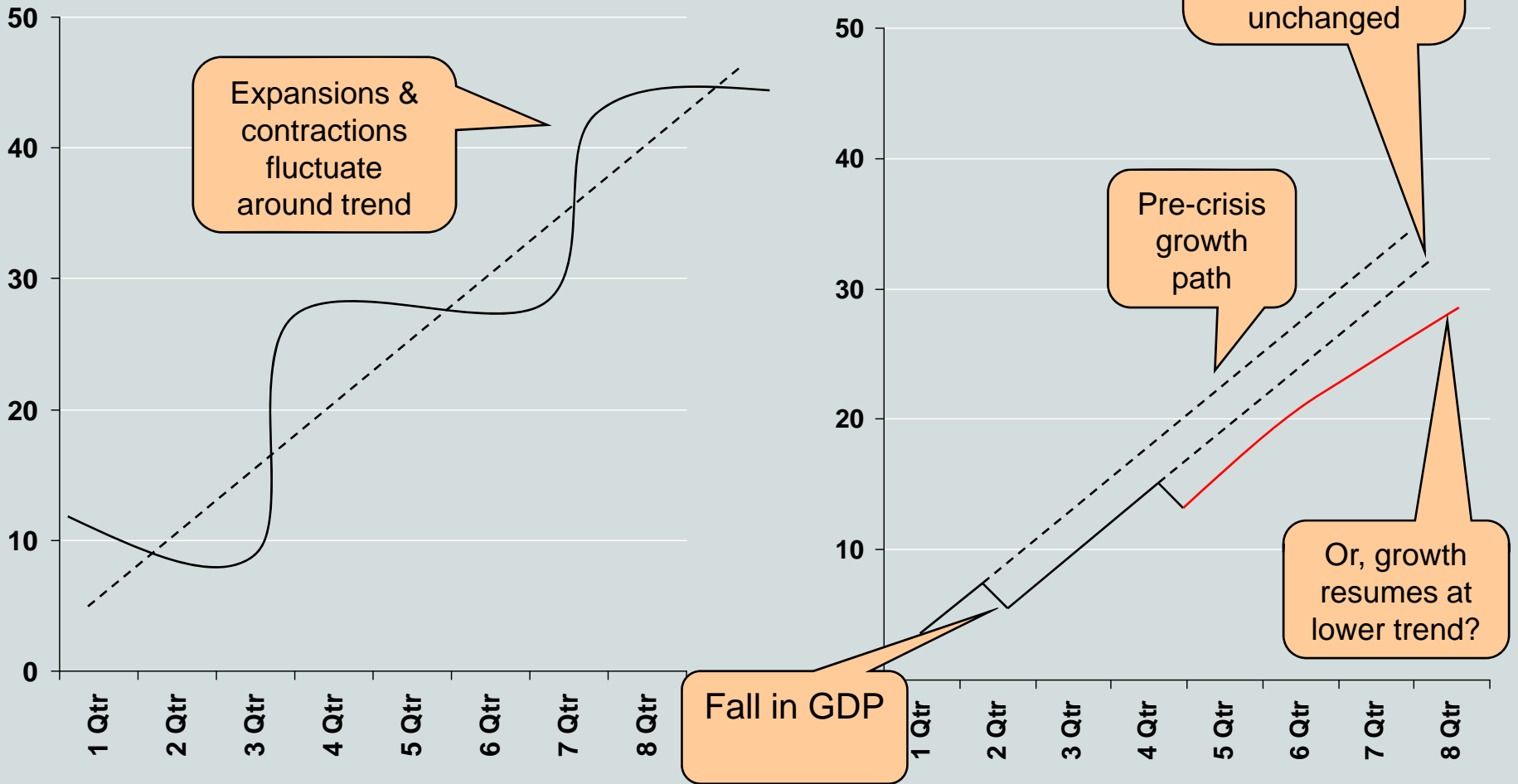
Borrowed-time theory: “W”

- Stimulus boosts economy at the cost of weakness later

Armageddon theory: “Q”

- Too grim to talk about

The new normal?



Closer look at retail potential (1)

- In the medium term we see lower potential GDP growth in Bulgaria
- We forecast average growth of 4.3% in 2012-14
- This will affect retail growth, but the potential remains significant
- We forecast around 8% growth in retail (volume) per year in 2012-14
- Compared with less than 5% in CE4

Closer look at retail potential (2)

- Lower GDP growth than before, but stronger than more mature markets and many CEE markets
- Robust wage and income growth as Bulgaria trends on convergence path
- But much slower credit growth and housing market will be more sedate
- GDP per cap to grow from US\$6,659 in 2008 to US\$11,608 by 2020

Rising incomes to drive retail

