PEST Analysis of Bulgaria

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PEST Analysis

Political Factors

Bulgaria’s transition to democracy and a market economy after the collapse of communism has not been easy and the country is still striving to boost low standards of living. Throughout the early 1990s Bulgaria was wracked by political instability and strikes. The former communists left a burdensome heritage. Although the end of the decade was more stable, there was little tangible progress with economic reform. Under Bulgaria's former king, Simeon II, who was prime minister between 2001 and 2005, market reforms designed to meet EU economic targets were applied. The country achieved stable growth, fall of unemployment, and decreasing inflation, but yet incomes and living standards remained low.

Bulgaria was not among the countries invited to join the European Union in 2004. However, it signed an EU accession treaty in April 2005 and joined in January 2007. EU officials set tough entry requirements, reflecting their concerns about corruption and organized crime. Brussels is monitoring closely the fight against organized crime and has threatened to withhold aid if there are no tangible results. Unfortunately the most recent report (23rd July 2008) of the European Commission (EC) states that Bulgaria has showed no significant improvement in anti-crime and anti-corruption measures since 2001. Strongest corruption is evident in the judicial system, political parties and health-care system. Another area of friction has been the Kozloduy nuclear power plant, which supplies around half of Bulgaria’s electricity and earns millions of euro for the country from electricity exports. Under pressure from the EU, Bulgarians agreed to shut the two oldest reactors at the end of 2002. Despite Bulgarian insistence that extensive safety improvements have been introduced in recent years, Brussels also wants two of the remaining four reactors closed.¹

Currently, the political climate in Bulgaria is stable.

Ruling Party

Bulgaria’s most recent parliamentary elections took place in June 2005, when the Bulgarian Socialist Party (BSP), under the leadership of Sergey Stanishev, won the largest number of votes but did not obtain majority that would enable it to form a government. The Socialist Party gained 34% of the vote (82 seats), while the centre-right party of ex-king, and former Prime Minister, Simeon Saxe-Coburg-Gotha, the Simeon II National Movement (SNM), gained 22% of the vote (53 seats). The predominately ethnic Turkish Movement for Rights and Freedoms (MRF) polled third with 14% of the vote (34 seats), and the Ataka (Attack) coalition, led by the newly formed national party, Ataka, obtained 8.8% of the vote (21 seats). On 15 August 2005, an agreement was reached between the three parties with highest votes (BSP, SNM and MRF), naming BSP’s leader Sergei Stanishev as the country’s new prime minister. Bulgaria’s three-party coalition cabinet controls 169 of the 240 seats in Bulgaria’s Parliament.²

EU confrontations

In the last few months Bulgaria has experienced serious problems with its cooperation with the European Union in the sphere of EU funded accession projects. The European Commission (EC) stopped Bulgarian financing under the PHARE, SAPARD and ISPA pre-accession programs. It also withdrew the accreditation of two government agencies charged with implementing funds under the PHARE pre-accession program. Additionally EUR 500 million designated for Bulgaria under the three programs have been frozen following investigations by the European Anti-Fraud Office, which

¹ http://news.bbc.co.uk/2/hi/europe/country_profiles/1059735.stm
indicated funds had been misused.\(^3\) EC is willing to unblock the funding on the programs after the government has taken the necessary measures for improving the financial management and control.

In addition, the EU is taking Bulgaria to court for failing to establish a national 112 emergency telephone number. According to EU telecommunications rules, people in every member-state must be able to call 112 free of charge, and operators must be in the position to provide adequate emergency services. Brussels has sent a formal notice to Sofia informing officials that it is launching the so-called infringement procedure for that and five other shortcomings.\(^4\)

### EU support

EU has also praised the country in the progress it has achieved. Many projects under the supervision of the union have been approved and further improve the economic and political stability in Bulgaria.

First installed at BCP Lesovo (at the border with Turkey) in 2006, the Single Fiche, a system for improving the border quality of service and security, has demonstrated serious benefits including faster processing, a strong deterrent against corruption, and more revenue to the national/EU budget. In a recent report on the progress achieved by Bulgaria in the context of the Cooperation and Verification Mechanism, the European Commission praised the Single Fiche system as a good practice and strong anti-corruption measure.\(^5\)

The European Commission (EC) has approved Bulgarian government's plans to build a new nuclear power plant. Last year Sofia picked the Russian firm Atomstroyexport to build two 1,000 megawatt reactors near the northern city of Belene located on the Danube River. The project will cost more than USD 5 billion.\(^6\)

### Trading Partners

Currently, the largest trading partner of Bulgaria is the EU, representing 59.3% of the country’s trade. The most important partners of Bulgaria from the union are Germany, Italy, and Greece. An expansion to other countries and markets is expected. For the last year Bulgaria had the astonishing 80% increase in its exports to Russia. However, this phenomenal increase was shadowed by the eightfold import boost from the Russian Federation.\(^7\) Nevertheless, Bulgaria has strong position in the Commonwealth of Independent States (CIS) which should be developed further. We must point out that some measures to decrease the cost of trade between Bulgaria and Russia have already been taken. In the beginning of the year an agreement was signed for the start of the Varna-Kavkaz ferryboat line. Such cooperation leads to more favorable trade conditions by eliminating intermediaries in the process. Last, but not least, Turkey is another key partner which can improve Bulgaria’s trade balance. This can be achieved by reducing the trade tariffs between the two countries as by not being a member of the EU, Turkey has higher tariffs and taxes on Bulgarian imports.\(^8\)

### Visa Free

One of the main advantages for the Bulgarian economy with the accession of the country to the EU is the free movement of people within the union. The opening of the borders facilitates to a large extent the business environment in the country and is a key factor for the increasing foreign direct investments. As for future plans, Romania and Bulgaria signed a declaration for their accession to the

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Schengen common border control and visa space. According to the document, the two countries are expected to become full-right members of the Schengen system by March 2011.9

Economic Factors

Economic Growth

In 2007 Bulgaria maintained its positive real economic growth which reached 6.5% for the year, with the industrial and services sectors being on the lead. This marks an increase of 0.4% in comparison to the 2006 figure.10 As a consequence, unemployment has dropped sharply which, however, indicates that work force shortages will increasingly constrain further growth.11 Inflation for the year reached 12.5%,12 mainly propelled by large food and energy prices hikes, but also reflecting a tighter labor market and accelerating nominal wage growth.13 In 2007 Bulgaria experienced 34% growth of the current account deficit, which now amounts to BGN 14.38 billion. In order to protect its stability, the country achieved a target fiscal surplus of 3% of the GDP. This figure is also the target for the current 2008. For 2008 the expected growth of the Bulgarian economy is 5.5%, decelerating to 4.75% in 2009. The end-period inflation in the country is expected to slow down to 7.25% in 2008 and to 5% in 2009.14

Macro Economic Factors

In 2007 the amount of FDI in Bulgaria was EUR 6.10 billion out of which EUR 3.2 billion were invested in real estate, financial services and trade.15 This number makes FDI the driving force for the expansion of the real estate market in the country. Some domestic factors also have great impact on the real estate sector. These are the following:

1. Interest Rates

Central bank statistics show that interest rates on mortgages have declined to an average of 7.17% versus 11% a year ago and 14-16% a couple of years ago.16 Therefore, in the beginning of December 2007, the central bank urged banks to raise lending rates and to keep a strict hand over its creditors. The recommendation from the central bank was also supported by the interest rate adjustments for the year which follow the trend set 3 years ago. The increase in the base interest rate mainly aims at curbing the expansion of credit in the country and securing the short-run stability of the economy.

2. Employment Growth

One of the most important factors concerning the real estate market is the employment in the country. Bulgaria has managed to substantially decrease its unemployment levels throughout the last few years which was achieved by the increase in the construction sector. In 2003-06 unemployment dropped sharply from 18% to about 7%.17 In 2007 alone, the unemployment rate declined by 2.3 percentage points. However, in March 2008, according to the NSI business inquiries, 19.3% of the

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12 http://overseasproperty.virginmedia.com/News/2008/January/17h.asp
industrial enterprises pointed out the labor shortage as one of the major factors limiting their activity and production.\textsuperscript{18}

Figure 1. Unemployment rate in Bulgaria (2000-2007)

3. Average wages

The most visible consequence of the growing Bulgarian economy is the increase in the average wages. According to the NSI, in December 2007 the average salary was BGN 480 or with 5.7% higher in comparison to the previous quarter.\textsuperscript{19} As people have increased their confidence and purchasing power, the real estate market has been positively influenced.

Figure 2. Average wages and salaries in Bulgaria (2003-Q1 2008)

\textsuperscript{18} \url{http://www.nsi.bg/KeyInd_e/KeyInd2008-04.pdf}
\textsuperscript{19} \url{http://www.nsi.bg/KeyInd_e/KeyInd2008-04.pdf}
Growth in the Credits Market
Under the influence of the stable increase in incomes and low unemployment, there has been a raise in the credits granted to households. In the period July – September 2007 the loans to households increased by 1,308 million levs, in comparison to the growth of 367 million levs for the same period in 2006. As by the end of September 2007, these credits had already reached 12,239 million levs. Housing loans continue to be the most dynamic segment of the credit market.

The volume of the mortgage credits, on the other hand, reached 5,890 million levs by the end 2007, which is an increase of 67.4% in only one year.20

Growth in Housing Prices and Construction
Despite the increase in supply of residential properties, the demand remains stronger. The interest in the housing real estate in the city of Sofia and the regional administrative centers of Plovdiv, Varna, Burgas and Ruse continues to be high. The demand for finished housing areas is above the supply, but with the advance of the numerous projects under construction, this ratio is expected to gradually change. In the year of 2007 the prices of the residential estates in the country grew up by 28.9%, compared to those in the end of 2006. The city with the largest price increase – 44.3% - was Targovishte, followed by the three largest cities on the Danube River – Ruse, (40.9%), Vidin (36.5%), and Silistra (38.7%). In the most expensive cities, Sofia and Varna, the prices grew by 35.1% and 33.9% respectively. 21

Social Factors
Key Income Trends
According to the NSI, in 2007 real household income has increased by 7.7% compared to the figure in 2006. For the period from 1999 to 2007 the real income has risen with 24.3%. However, Bulgaria still lags behind all other EU member states in terms of income per capita and workers productivity. The purchase power of Bulgarians remains the lowest in the European Union – 2,453 EUR per person per year.

![Figure 3. Average income per capita in Bulgaria in USD (1999-2008)](http://www.arcoreal.bg/vfs/3108/Real%20Estate%20Market%20in%20Bulgaria%20-%20UK.pdf)

Growth in Private Savings, Credits, Investments

According to Industry Watch analysis, a reputable local analyst, private savings have increased by 29.9% during the last year. Families are being conservative in their decisions of wealth allocation. Approximately 50% of them still prefer to keep savings in bank deposits and about 25% prefer cash. The deposits between 1,000 and 2,500 levs prevail. A positive trend is the increase in the number of deposits over 50,000 levs, which are significant for the development of the economy. The analysts expect that in the future, with the increase in wealth, the households would turn to riskier and more profitable investments. A major problem in the financial market is the fact that investments outweigh savings significantly.

Demographics

In the context of demographics, some important problems are evident in the country. The population has been declining constantly for the last 18 years and currently comes to a total of 7,640,240 people. The decline in population is attributed to the negative population growth of -5% and the constant emigration. According to Eurostat data, during the last five years, 2.4% of the workforce has left the country, placing it among the countries with the highest emigration rate in the EU. The trend shows that the population will continue to decline with approximately 40,000 people per year.

An important problem is the aging of the population - only 13.8% are people under 14 years compared to 17.1% over 65; this leads to a future decrease in the workforce. The average age of the population in 2007 was 41.5 years and the average lifespan in 2007 was 72.7 years; 69.2 years for men, 76.3 years for women. A major demographic trend is the urbanization. Currently, 70% of the population lives in the cities; 40% of those are concentrated in the 8 largest cities in the country. This process is due to the big discrepancy between the life and working conditions in the cities and in the villages. However, the analysis of NSI shows that this trend tends to reverse in 2007.

According to unofficial estimates, currently, the population in the capital city of Sofia adds to 2,000,000 people. The average number of people per household in Sofia is 2.7.

Figure 4. 2007 internal migration flows in Bulgaria

![Image of internal migration flows](http://www.fincity.bg/show.php?storyid=542)

![Image of internal migration flows](http://www.novinar.net/?act=news&act1=det&stat=center&mater=M1YzMTs4MQ==&sqi=M1YzMTs0Mw)

![Image of internal migration flows](http://evropa.dnevnik.bg/show?storyid=487504)

![Image of internal migration flows](http://www.nsi.bg/ZActual/Population07.htm)

![Image of internal migration flows](http://www.nsi.bg/Census/DomSemTable.htm)

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23 [http://www.novinar.net/?act=news&act1=det&stat=center&mater=M1YzMTs4MQ==&sqi=M1YzMTs0Mw](http://www.novinar.net/?act=news&act1=det&stat=center&mater=M1YzMTs4MQ==&sqi=M1YzMTs0Mw)
24 [http://evropa.dnevnik.bg/show?storyid=487504](http://evropa.dnevnik.bg/show?storyid=487504)
25 [http://www.nsi.bg/ZActual/Population07.htm](http://www.nsi.bg/ZActual/Population07.htm)
26 [http://www.nsi.bg/Census/DomSemTable.htm](http://www.nsi.bg/Census/DomSemTable.htm)
Cultural Perceptions
In Bulgaria, even during socialist regime, the majority of the nation lived in their own houses and apartments. This fact could be explained with deeply rooted psychological factors. People’s perceptions that property is among the most secure investments and will remain profitable are predominant. Consequently, Bulgaria is among the countries with the highest ownership rate. According to official statistics, approximately 91% of the people do own their place of residence. In the context of the membership in the European Union, Bulgarians have many opportunities for investment and development. Thus, currently, many programs are aimed at stimulating entrepreneurial spirit among students and businessmen.

Technological Factors
Online Selection and Purchase of Property
The Bulgarian real estate market has quickly adapted to the trends and the growing popularity of Internet in the Bulgarian society. In the first half of 2008 community real estate websites are some of the most often visited web sites in the local Internet space. The largest web sites – www.imot.bg and www.imoti.net administer more than 30,000 unique visitors per day, which accounts for more than 5,000 unique viewers per offer, weekly. In 2007 the two web sites managed to increase their earnings by more than 30%, a clear indicator for increased consumer demand. According to Mr. Strahil Ivanov, general manager of Yavlena Properties, a local real estate company, an increasing number of potential customers are doing preliminary selection of property online. This trend makes real estate firms invest in increased Internet presence. Even though the segment of real estate web sites is quite consolidated at the moment – around 80% of the deals are administered by 3-4 major websites – it has undoubtedly contributed to the diminishing of consumer risk, shortened the time for selection and purchase of property, and led to fair pricing.

The Use of Modern Engineering Techniques and High-quality Materials
Bulgaria’s architectural landscape has drastically changed its shape for the last several years. Grey blocks are now being obsolete; modern architecture is gradually shifting the look of urban centers. The modern design and engineering approach and the use of high quality materials and machines have shortened the construction process and at the same time increased the efficiency of the building. According to architect Mityo Videlov, chair of the Building of the Year competition, this trend is to remain positive in the long run. As of 2008, there appear the first real estate projects completed with the idea to create not only a highly technological, but also an eco-friendly environment. A notable example, according to Mr. Sergey Koinov, general manager of Forton International, is the Sofia Airport Center.

Despite the growing fears that modern techniques will further increase the supply of properties in the local market, experts, such as Mr. Sergey Koinov, and Mr. Valeri Leviev, general manager of Elta

28 http://www.capital.bg/show.php?storyid=467333
29 http://www.indeximoti.bg/show.php?storyid=445714
30 http://knigi.dnevnik.bg/show/?storyid=482559
Consult, an associated partner of CB Richard Ellis in Bulgaria, are firm that until 2010 no oversupply is expected.\textsuperscript{31,32}

\begin{itemize}
\item \textsuperscript{31} [Link](http://knigi.dnevnik.bg/show/?storyid=482559)
\item \textsuperscript{32} [Link](http://www.indeximoti.bg/show.php?storyid=397014)
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