(TENTATIVE) CONCLUSIONS

The Bulgarian crisis was obviously multi-dimensional. We have chosen to focus our attention on specific features of the crisis, arguing that they could provide a fairly good explanation of what happened: the timing and causal relationships between the banking panic of 1996 and the currency crisis of 1996-1997. These relationships have been assessed through four different approaches: i) an overview of the literature on financial crises; ii) a comparison of the Bulgarian experience with other transition economies; iii) a detailed chronology of the banking and currency crises in Bulgaria; and iv) an empirical analysis of the magnitude and causes of portfolio shifts during the crisis.

The literature survey indicated a number of possible links between banking and currency crises. We suggested that the Bulgarian crisis most resembled a "standard" crisis, with fiscal and monetary slippages induced by problems in the banking sector, and leading to a flight from domestic currency. We also highlighted the role of international reserves in the formation of household expectations, in the tradition of Krugman (1979), Dooley (1997) or Sachs (1998); a proposition put forth in a recent working paper by Berlemann, Hristov and Nenovsky.

The analysis of financial crises in a sample of transition economies revealed that Bulgaria was the only country (in the sample) that went through a severe currency crash in conjunction with its banking problems. We argued that the singularity of the Bulgarian economy in that respect could be explained by (at least) two factors: the extremely large fiscal and quasi-fiscal costs associated with the

resolution of the banking crisis in Bulgaria (in absolute terms, and as a percentage of GDP); and a large amount of domestic liquidity (M2) relative to the level of international reserves - from the inception of market reforms in 1991 through 1996.

A detailed chronological account of Bulgaria's twin crises indicated that the two crises were largely intertwined. The "crisis" however, seems to have originated in the banking sector (although tensions in the foreign exchange market preceded, for seemingly independent reasons, the first bank runs); spread into the domestic debt market, and eventually led to an acceleration of reserve money growth and a rapid depreciation of the Lev. The joint movements in foreign exchange reserves and bank deposits also led to the hypothesis that the central bank's reserves might have acted as a signal of the government's ability to act as a lender of last resort in the banking crisis (although causality could not be ascertained). Finally, the day-by-day analysis of exchange rate movements in January and February 1997 suggested that the political events of that time were important in explaining the observed burst of inflation and exchange rate overshooting.

Empirical results from the estimation of a simple model of asset substitution borrowed from the literature, and adjusted to Bulgarian conditions, confirmed most of the hypotheses and (descriptive) findings reported in the paper. In particular, it was found that expected depreciation alone could not explain the shifts in currency holdings during the crisis; suggesting that other factors were governing households' portfolio choices. Secondly, the analysis substantiated the central role of international reserves in the decision to hold domestic versus foreign currency, and indirectly, in the formation of household expectations. As stated in the conclusions to Chapter 4, however, the empirical analysis was limited by serious data limitations;

most of which pertaining to the lack of quality time series on foreign cash holding and/or capital flight. A number of suggestions were made to improve and further the analysis.