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## **Bulgaria: EU accession reforms high on the policy agenda**

The drama surrounding the actual date of EU accession dominates entirely Bulgarian policy and politics. The EC monitoring report published in May fell short of pronouncing the Commission's position on the issue, adding a further thrill to the political show. The Bulgarian authorities have mobilized all their resources to show progress in the lagging areas, most notably the reform of the judiciary and the fight against organized crime and corruption, but also in agriculture, financial control (money laundering) and energy. In early June, the government adopted – after consultation with the EC – an Action Plan with urgent measures in these areas that have to be adopted and put in place until September, the earliest date when the EC may announce its recommendation. Some of these measures imply legislative changes and their adoption will require active support from the parliament.

The planned velvet divorce from the IMF – after a decade and a half of difficult relations – has not materialized so far, although the authorities had initially announced that the current precautionary agreement would not be renewed after it expires in September. However, in view of the uncertainty in the EC's position on accession, the authorities have agreed to extend the precautionary agreement for a further six months, until March 2007, which means that both the execution of the 2006 budget and the drafting of the budget for the next year will still be done under close IMF scrutiny.

The consequences of continuing strong IMF presence are already visible in the macroeconomic arena. The authorities have confirmed that they are likely to stick to the 3% budget surplus target for 2006 pushed forward by the IMF (the actual budget for 2006 was adopted in December 2005 with a zero surplus; it was taken for granted that after the expected IMF departure the 3% surplus target would be abandoned altogether). The announced tentative macroeconomic framework for the 2007 budget suggests a continuation of the relatively tight fiscal stance: the government announced that it would aim for a 1% budget surplus next year (the IMF is pressing for a 2% surplus). Admittedly, the precise budgetary framework for 2007 will depend on the date of EU accession.

At the same time the authorities – obviously with IMF consent – announced that they would gradually relax the highly controversial and inefficient administrative credit controls. The declared justification of this relaxation is the decline in the year-on-year rates of credit growth in recent months. What remains questionable is whether the credit controls had any effect at all on the dynamics of credit (as credit continued to grow at a rate of more than 50% throughout 2005 while these controls were fully in place) or whether this dynamics

just reflects fundamental determinants of demand, which has now reached a point of relative saturation (as these rates of growth are clearly unsustainable for a longer period).

Notwithstanding the hectic rush towards EU accession, the economy remains in good shape. In the first quarter of 2006, aggregate output continued to grow at a healthy rate, with GDP increasing by 5.6% year-on-year. The booming construction and tourism industries, as well as some manufacturing sectors (textiles, leather, metals, mechanical and electrical engineering) contributed the most to this outcome. Gross fixed capital formation surged in the first quarter, boosted by robust construction demand and healthy FDI inflows, and this was coupled with a rather extensive replenishment of inventories. Compared to 2005, the pace of private consumption lost some steam in the first quarter but still remained buoyant. After a slowdown in the second half of 2005, exports started to gather speed at the beginning of 2006, but this was coupled with an even faster pace of import growth.

The situation in the labour market continued to improve. During the first quarter of 2006 the rate of unemployment (both registered and LFS) was some 2 percentage points lower than a year earlier and in May registered unemployment fell below 10% for the first time ever since reporting began in 1991. In fact, labour shortages are beginning to surface in some segments of the labour market, in particular in some high-skill professional categories but also in sectors such as construction and services (especially tourism). So far there are no indications of a wage cost push related to these tensions but if these emerge, they may add to the current inflationary pressures which are mostly due to rises in controlled prices.

Despite the improvements in export performance, both the merchandise trade and the current account deficit continued to swell in the first quarter of 2006, pushed by the continuing import surge. A new record-high current account deficit figure is expected for the year as a whole.

In March-April 2006, the Bulgarian National Bank undertook revisions in the balance of payments for 2001-2005 after introducing some methodological changes in the statistics. The most important changes – reportedly in accordance with international accounting standards – concern the recording of revenue and expenditure for commercial cargo, revaluation of FOB imports as well as better reporting of remittances from abroad (in the past the BOP statistics included only bank transfers above EUR 2500; now they include all bank transfers from abroad as well as estimates of remittances from informal economic activity abroad). As a result of these methodological changes, there were notable shifts in the positive direction (roughly by some three percentage points of GDP) in the current account balance for the whole period 2001-2005. For example, the final current account deficit in 2005 now amounts to 11.8% of GDP (from 14.7% earlier); the figure for 2004 is

now 5.8% (from 8.4% earlier), etc. The amounts of FDI inflows were also revised, resulting in a slight upward shift in some years.

The Bulgarian economy should continue to perform well in the short run. Economic growth is expected to remain strong throughout 2006, with GDP increasing by some 5.5%. The improvements in the labour market should continue with rising employment and falling unemployment rates. Carryover effects from the second half of 2005 and the first months of 2006 (related to energy hikes and rises in other administrative prices) will push up average annual inflation in 2006 significantly above earlier expectations. In contrast, the fiscal stance is likely to be much tighter than envisaged in the 2006 budget. Despite that, the current account deficit can be expected to widen further, reflecting the persistent strength of import demand.

Table BG

## Bulgaria: Selected economic indicators

	2001	2002	2003	2004	2005 <sup>1)</sup>	2005 1st quarter	2006	2006 forecast	2007
Population, th pers., end of period	7891.1	7845.8	7801.3	7761.0	7718.8	.	.	.	.
Gross domestic product, BGN mn, nom.	29709.2	32335.1	34546.6	38275.3	41948.1	8755.2	9815.4	47000	51800
annual change in % (real)	4.1	4.9	4.5	5.7	5.5	5.9	5.6	5.5	5
GDP/capita (EUR at exchange rate)	1920	2101	2258	2515	2771	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5840	6090	6470	6920	7530	.	.	.	.
Gross industrial production									
annual change in % (real) <sup>2)</sup>	1.5	6.5	14.1	13.8	8.4	6.6	7.3	8	8
Construction output total									
annual change in % (real)	14.2	2.7	5.6	35.2	1.0	.	.	.	.
Actual final consump.of househ., BGN mn, nom.	23009.1	24822.9	26846.0	29324.5	33066.7	7286.4	8345.4	.	.
annual change in % (real)	4.6	3.4	7.1	4.9	7.4	7.1	5.4	.	.
Gross fixed capital form., BGN mn, nom.	5415.2	5908.5	6694.4	7969.4	9971.1	1790.0	2345	.	.
annual change in % (real)	23.3	8.5	13.9	13.5	19.0	11.2	21.4	18	15
LFS - employed persons, th, avg.	2698.8	2739.6	2834.8	2922.5	2980.0	2838.4	2940.5	3100	3200
annual change in %	-3.4	1.5	3.5	3.1	2.0	2.0	3.6	4	3
Reg. employees in industry, th pers., avg.	658.4	666.8	689.5	695.8	709.4	718.5	700.6	.	.
annual change in %	-0.5	1.3	3.4	0.9	1.9	4.5	-2.5	.	.
LFS - unemployed, th pers., average	663.9	592.4	448.7	399.7	334.2	362.3	315.2	300	270
LFS - unemployment rate in %, average	19.7	17.8	13.7	12.0	10.1	11.3	9.7	9	8
Reg. unemployment rate in %, end of period	17.3	16.3	13.5	12.2	10.7	12.7	10.8	9.5	8.5
Average gross monthly wages, BGN	240.0	257.6	273.3	292.4	319.5	299.0	329.0	.	.
annual change in % (real, gross)	-0.5	1.5	3.7	0.8	4.1	3.2	1.9	.	.
Consumer prices, % p.a.	7.4	5.8	2.3	6.1	5.0	3.8	8.0	8	5
Producer prices in industry, % p.a.	3.8	1.2	4.9	6.0	6.9	6.2	8.9	7	5
General governm.budget, nat.def., % GDP									
Revenues	39.8	38.7	40.7	41.4	42.9	47.6	44.6	.	.
Expenditures	40.4	39.4	40.7	39.7	39.7	42.1	40.2	.	.
Deficit (-) / surplus (+), % GDP	-0.6	-0.7	0.0	1.7	3.2	5.5	4.4	3	1
Public debt in % of GDP <sup>3)</sup>	66.2	53.2	46.2	38.8	31.9	32.5	27.8	25	23
Base rate of NB % p.a., end of period	4.7	3.4	2.9	2.4	2.1	1.9	2.3	.	.
Current account, EUR mn	-1101.6	-925.5	-1630.2	-1131.3	-2530.7	-550.7	-1052.4	-3400	-3500
Current account in % of GDP	-7.3	-5.6	-9.2	-5.8	-11.8	-12.3	-21.0	-14.1	-13.2
Gross reserves of NB excl. gold, EUR mn	3734.0	4247.1	4981.0	6443.0	6815.7	6325.1	6399.6	.	.
Gross external debt, EUR mn	11934.9	10768.9	10640.6	12571.6	14530.3	13120.1	15175.9	.	.
FDI inflow, EUR mn	903.4	980.0	1850.5	2727.5	1789.0	392.0	755.4	2500	2500
FDI outflow, EUR mn	8.7	29.0	23.3	-165.6	256.5	15.2	15.8	.	.
Exports of goods, BOP, EUR mn	5714.2	6062.9	6668.2	7984.9	9454.1	2080.6	2666.7	11300	13000
annual growth rate in %	8.8	6.1	10.0	19.7	18.4	21.1	28.2	20	15
Imports of goods, BOP, EUR mn	7492.6	7754.7	8867.8	10938.4	13823.2	2785.4	3705.2	16500	18500
annual growth rate in %	14.7	3.5	14.4	23.3	26.4	22.5	33.0	19	12
Exports of services, BOP, EUR mn	2384.8	2478.9	2790.9	3261.8	3444.3	508.5	530.3	3800	4200
annual growth rate in %	0.8	3.9	12.6	16.9	5.6	9.0	4.3	10	11
Imports of services, BOP, EUR mn	1930.3	1992.9	2267.7	2569.3	2777.5	586.0	728.7	3300	3600
annual growth rate in %	6.1	3.2	13.8	13.3	8.1	7.2	24.4	19	9
Average exchange rate BGN/USD	2.185	2.077	1.733	1.575	1.574	1.492	1.627	.	.
Average exchange rate BGN/EUR (ECU)	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956
Purchasing power parity BGN/USD	0.561	0.582	0.583	0.607	0.599	.	.	.	.
Purchasing power parity BGN/EUR	0.643	0.675	0.683	0.710	0.720	.	.	.	.

Notes: 1) Preliminary. - 2) Different methodology for quarterly data. - 3) According to ESA'95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; Eurostat; wiiw forecasts.