

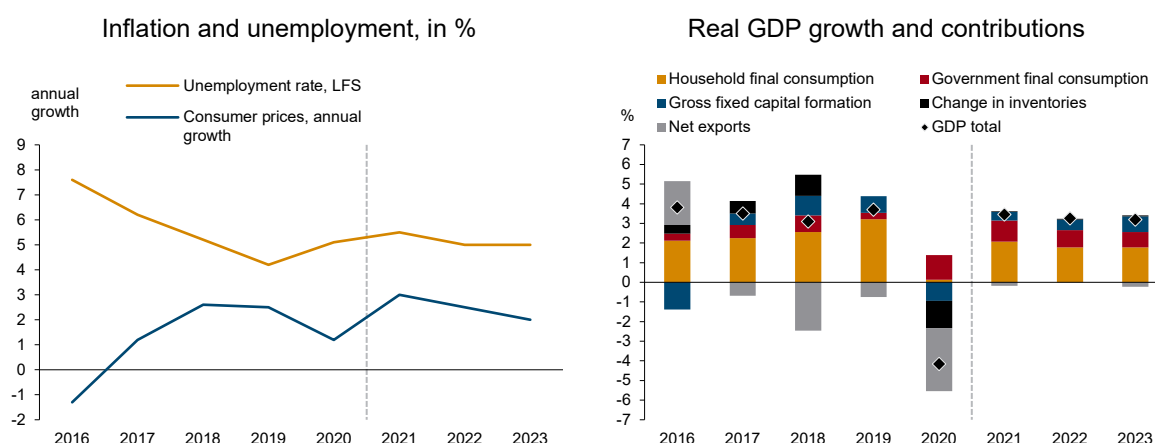


BULGARIA: Moderate recovery continues, despite the political stalemate

RUMEN DOBRINSKY

Bulgaria goes to the polls in November for the third time in 2021, after two failed attempts in parliament to form a government. Despite the political impasse, a moderate recovery has been under way, mostly driven by domestic demand. In early autumn, the country was hit by a new and powerful wave of COVID-19 – in large part a consequence of the very low vaccination rate. The short-term outlook has improved slightly and GDP is expected to grow by 3.5% in 2021 as a whole. Growth is expected to remain moderate in the coming years.

Figure 4.4 / Bulgaria: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The year 2021 has been marked by protracted political stalemate. On two occasions – first, after the regular elections in April, and then after a snap election in July – the parliamentary parties failed to form a regular government. On both occasions, the group of recently emerged centre-right political parties that initiated the protests in 2020 against Mr Borisov's long-ruling GERB government could, in principle, have formed a coalition government with the Bulgarian Socialist Party. However, the new players were totally wrapped up in their own agendas and disregarded all possible compromise solutions – either with each other or with the socialists. Consequently, fresh snap elections are to be held in November, the third vote of 2021. In the meantime, the country's administration has been run by a caretaker government appointed by President Rumen Radev.

Despite the continuing political impasse, a modest but broad-based recovery has been under way. GDP grew by 6.4% year on year in the second quarter; this meant year-on-year GDP growth of 3.1% in the first semester. Manufacturing output has rebounded: its growth accelerated through the first

six months of the year, keeping pace with a notable recovery in exports. On the other hand, gross construction output remained subdued, as public investment fell below its 2020 level.

On the demand side, the upturn was mostly driven by domestic demand. Private consumption bounced back, supported by a recovery in household credit and a continued rise in personal incomes. Net exports of services made a positive contribution to GDP growth in the first half of the year, thanks to robust growth in exports of business services and a strong recovery in the tourist industry. Though there was an upturn in goods exports, imports of goods grew even faster, mirroring strong domestic demand; thus, net exports of goods contributed negatively to GDP growth in both the first and the second quarters.

Although the pandemic subsided during the early summer, a fresh wave emerged in August and has since intensified. The severity of the new wave is largely due to Bulgaria's very low vaccination rate – the lowest in the EU: just 19.5% of the total population was fully vaccinated at the end of September. At the time of writing, the capacity of the country's healthcare system to cope with COVID cases is stretched to its limits and the authorities are contemplating the reintroduction of restrictions, including a partial lockdown. Bulgaria's vaccination failure is starkly reflected in its rising COVID-related mortality rate, which tops the EU statistics.

Producer prices have been rising, largely mirroring such global factors as higher energy and food prices, and supply-chain disruptions. In the early part of the year, the annualised consumer price index (CPI) dynamics remained more or less stable; but it is only a matter of time before these inflationary pressures are passed on to consumers. Consequently, the CPI for 2021 as a whole could approach 3%, significantly above the 2020 figure.

Real disposable incomes have continued their robust growth. Between 2014 and 2020, real monthly gross earnings grew by an annual average of 7.5%. Taking 2021 as a whole, however, the resurgence of inflation means that the rise in real average monthly gross wages is likely to fall short of what we have seen in recent years. Nevertheless, rising real disposable incomes have continued to boost consumer confidence and are an important factor underpinning buoyant private consumption. They have also encouraged households' appetite for real estate: this shows up in a notable rise in demand for mortgage loans. This has even prompted the Bulgarian National Bank to increase its countercyclical capital buffer rate, which applies to the local credit risk exposure of commercial banks.

The absence of a regular government has significantly complicated the management of public finances. The 2021 budget set out fiscal support measures for only the first few months of the year, given the uncertainties surrounding COVID-19. The implicit assumption was that the regular government – expected to be in office after the April elections – would propose a revised budget for the year that reflected the actual situation with the pandemic. The 2021 budget was actually adopted by the previous GERB government in late 2020 and was a very conservative one (in view of the prevailing uncertainties at the time of its adoption). As it turned out, the economic recovery contributed to a significant improvement in the fiscal outturn: in January-July 2021, the consolidated general government revenue was 15.8% higher than in the same period the previous year. However, the administration was not in any position to use the extra revenue, since, according to the Bulgarian constitution, a caretaker government has only limited fiscal freedom.

When even the July parliament failed to form a regular government, the fiscal situation became precarious. Any deviations in fiscal expenditure from approved budget lines (such as additional spending on policy support measures) need to be approved by parliament. However, in the absence of a working parliamentary majority, the necessary budgetary revisions became problematic. In the end, after hectic, last-minute debates, the July parliament adopted a hastily prepared and cobbled-together revision of the 2021 budget, which turned out to be the only piece of legislation that this parliament managed to pass.

Given the chaotic process of adopting the changes and the absence of agreed policies, the budget revision lacked overall coherence. The higher-than-expected fiscal revenues enabled total planned expenditure for 2021 to be raised by BGN 2.3bn (or 4.4% of the initial plan). The revised budget envisages a continuation of the pandemic-related policy support measures until the end of 2021 and generous new social assistance measures, including pension rises. Despite these spending hikes, the cash deficit for 2021 should remain broadly unchanged from the initial budget plan, at around 3.6% of GDP.

The National Recovery and Resilience Plan became another casualty of the messy political situation. While the caretaker government has continued to work on the draft of the plan, in consultation with the European Commission, it has kept postponing formal submission, as that is considered the prerogative of a regular government. Even if the caretaker government decides to submit it (now that the second attempt to form a government has failed), it is by no means certain that the plan will obtain the approval of the European Commission in the remaining months of 2021.

At the time of writing, the uncertainties regarding the future political situation remain. The novelty of the November ballot is that it will be 'two-in-one' poll, combining parliamentary and presidential elections. Such a situation is unprecedented in the past 30 years and may have an unpredictable effect on voter behaviour. At the same time, there is no certainty that these fresh snap elections will help to resolve the political stalemate. The ugly political infighting and horse-trading among the 'new parties' has resulted in a considerable deterioration in relations among them. Meanwhile, the political scene has been enriched with even newer players on the centre-right, and that may contribute to a very different outcome in November.

The outlook for 2021 has improved since our spring forecast. Bulgaria's GDP is now forecast to grow by 3.5% for the year as a whole, compared to 2.5% forecast in March. However, the downside risks in the external environment remain significant, and if the economy continues to rely mainly on domestic demand, this growth rate will probably not be sustained in the years to come. Another negative factor is the delay in accessing EU funds, which is already having an adverse impact on public investment.

Given the above constraints, GDP growth in 2022-2023 will remain modest, in the range 3.0-3.5%. The rise in prices seen in 2021 is likely to have been a one-off event, and inflation should moderate in the coming years, remaining at below 3% a year on average. In the absence of a strong export push, the current account balance will likely stay in negative territory in the coming years.

Table 4.4 / Bulgaria: Selected economic indicators

	2018	2019	2020 ¹⁾	2020 January-June	2021	2021 Forecast	2022 Forecast	2023
Population, th pers., average	7,025	6,976	6,934	.	.	6,850	6,800	6,750
Gross domestic product, BGN m, nom.	109,743	119,772	118,605	53,767	58,221	126,400	133,800	140,800
annual change in % (real)	3.1	3.7	-4.2	-3.8	3.1	3.5	3.3	3.2
GDP/capita (EUR at PPP)	15,530	16,510	16,270	.	.	.	.	.
Consumption of households, BGN m, nom.	64,936	69,853	70,353	32,562	34,901	.	.	.
annual change in % (real)	4.3	5.4	0.2	-0.7	6.1	3.5	3.0	3.0
Gross fixed capital form., BGN m, nom.	20,624	22,404	21,137	8,739	9,586	.	.	.
annual change in % (real)	5.4	4.5	-5.1	-11.2	3.0	2.5	3.0	4.5
Gross industrial production ²⁾								
annual change in % (real)	0.3	0.6	-5.9	-7.8	8.4	3.5	3.0	3.0
Gross agricultural production								
annual change in % (real)	-0.4	-1.4	-12.0	.	.	.	.	.
Construction industry ³⁾								
annual change in % (real)	1.6	3.8	-5.3	-7.1	3.9	.	.	.
Employed persons, LFS, th, average ⁴⁾	3,153	3,233	3,122	3,093	3,045	3,010	3,010	3,030
annual change in %	0.1	2.6	-3.4	-3.5	.	-0.5	0.0	0.5
Unemployed persons, LFS, th, average ⁴⁾	173	143	169	171	193	180	160	160
Unemployment rate, LFS, in %, average ⁴⁾	5.2	4.2	5.1	5.3	6.0	5.5	5.0	5.0
Reg. unemployment rate, in %, eop	6.1	5.9	6.7	8.3	5.2	.	.	.
Average monthly gross wages, BGN ⁵⁾	1,146	1,267	1,387	1,327	1,494	1,510	1,650	1,790
annual change in % (real, gross)	7.5	7.2	7.6	4.4	11.2	6.0	6.5	6.5
Consumer prices (HICP), % p.a.	2.6	2.5	1.2	2.0	1.2	3.0	2.5	2.0
Producer prices in industry, % p.a.	3.9	3.0	-2.0	-1.5	7.7	4.0	3.0	3.0
General governm.budget, EU-def., % of GDP								
Revenues	38.6	38.5	39.5	.	.	40.0	39.5	39.0
Expenditures	36.6	36.3	42.9	.	.	43.0	42.0	41.0
Net lending (+) / net borrowing (-)	2.0	2.1	-3.4	.	.	-3.0	-2.5	-2.0
General gov.gross debt, EU def., % of GDP	22.3	20.2	25.0	.	.	25.5	26.0	27.0
Stock of loans of non-fin.private sector, % p.a.	7.7	7.4	4.5	4.9	6.2	.	.	.
Non-performing loans (NPL), in %, eop	7.8	6.6	7.5	8.1	6.7	.	.	.
Central bank policy rate, % p.a., eop ⁶⁾	0.00	0.00	0.00	0.00	0.00	0.0	0.0	0.0
Current account, EUR m	532	1,148	-161	598	-380	-800	-1,000	-900
Current account in % of GDP	0.9	1.9	-0.3	2.2	-1.3	-1.2	-1.5	-1.3
Exports of goods, BOP, EUR m	27,742	29,120	27,272	13,155	16,138	30,500	30,800	31,300
annual change in %	2.9	5.0	-6.3	-6.5	22.7	11.8	1.0	1.6
Imports of goods, BOP, EUR m	30,449	32,028	29,218	13,759	17,378	33,000	33,500	35,000
annual change in %	9.8	5.2	-8.8	-11.6	26.3	12.9	1.5	4.5
Exports of services, BOP, EUR m	9,195	10,237	7,211	3,266	3,837	7,300	8,000	9,000
annual change in %	11.5	11.3	-29.6	-22.4	17.5	1.2	9.6	12.5
Imports of services, BOP, EUR m	5,063	5,342	4,152	1,870	2,053	4,400	5,200	5,700
annual change in %	-2.5	5.5	-22.3	-25.3	9.8	6.0	18.2	9.6
FDI liabilities, EUR m	1,542	1,983	2,384	845	1,050	1600	.	.
FDI assets, EUR m	785	745	267	203	641	300	.	.
Gross reserves of CB excl. gold, EUR m	23,620	23,072	28,830	25,972	27,763	.	.	.
Gross external debt, EUR m	37,190	37,716	39,627	37,058	39,581	40500	41000	41500
Gross external debt, % of GDP	66.3	61.6	65.3	61.1	61.2	63.0	60.0	58.0
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary. - 2) Enterprises with 10 and more employees. - 3) Enterprises with 5 and more employees. - 4) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 5) Half-year data excluding annual bonus payments. - 6) Base interest rate. This is a reference rate based on the average interbank LEONIA rate of previous month (Bulgaria has a currency board).

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.