

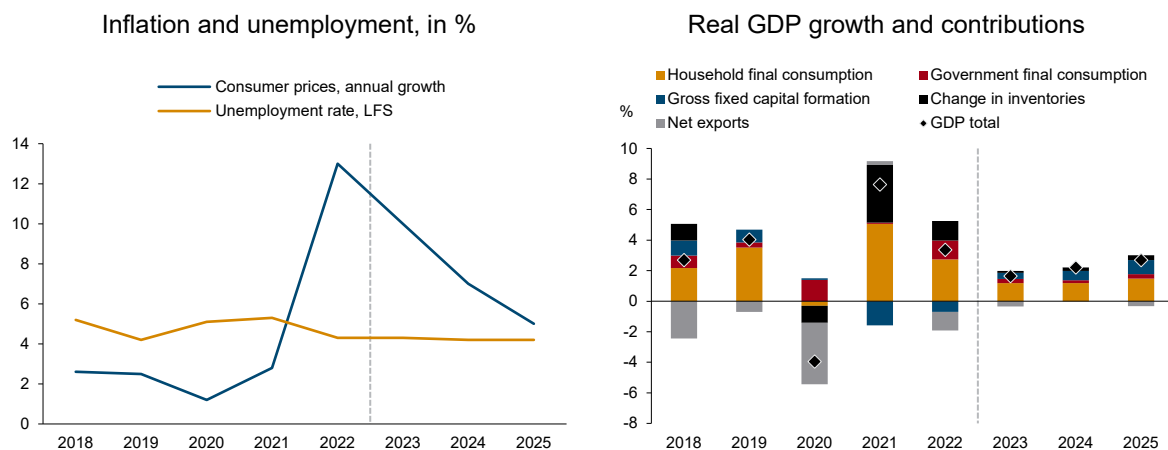


BULGARIA: Political mess drives the economy towards an unsustainable fiscal course

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The early general election held in April 2023 – the fifth in two years – has delivered no clear winner. The absence of a stable government over the past couple of years has resulted in fiscal destabilisation and delays to the country's planned accession to the euro area. While GDP growth in 2022 was above expectations (thanks to a surge in exports), in 2023 it will slow to 1.7%. Rebalancing the public finances requires a radical shift in fiscal policies – something that may be problematic given the current political environment.

Figure 5.4 / Bulgaria: Main macroeconomic indicators



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

On 2 April 2023, Bulgaria held an early parliamentary election – the fifth such poll within the space of two years. In the main, the results replicated the previous votes, and there were no clear winners. GERB, led by Boyko Borisov, which was the dominant political force during the 2010s, came first, closely followed by a coalition led by the relatively new formation 'We Continue the Change', which emerged as the winners in the November 2021 election. These two political forces are quite close in their political positioning (centre-right and Western-leaning), and in principle could form a stable government backed by a parliamentary majority. However, in the past couple of years personal rivalries have led to antagonism between them. This was reinforced by the arrest of Boyko Borisov on corruption charges while the coalition led by 'We Continue the Change' was in office (the charges were subsequently dropped). Most analysts are sceptical about the prospects of such a coalition following the April election, while the parliamentary arithmetic does not suggest any other possible stable coalition. So it cannot be ruled out that the Bulgarian people will be invited to the polls once again later this year.

The lasting inability of the political class to agree on a stable government has had grave economic consequences. The most alarming has been the opening-up of a large fiscal deficit, which already appears to be structural in nature. The Ministry of Finance recently estimated that, in the absence of urgent corrective measures, the cash deficit in 2023 could reach some 6-7% of GDP – and could remain in that range in the years to come. Given the continuing rise in interest rates, the future financing of this deficit will be both more difficult and more costly.

This deterioration in the country's fiscal position is largely a result of several ill-conceived populist policy measures taken by the various short-lived governments over the past couple of years. Examples from 2022 included significant exceptional spending, such as lavish compensation during the pandemic and lax across-the-board energy subsidies, on top of a generous rise in pensions and the minimum wage. It is estimated that over the period 2020-2022, the various support measures allocated through the budget totalled BGN 11.2bn (EUR 5.7bn), or 2.6% of average GDP over these three years. While similar measures were not uncommon in other countries during the pandemic, the fiscal repercussions in Bulgaria were also due to a lack of any provisions allowing the exercise of discretion and the absence of 'sunset clauses' in the application of the measures. In consequence, the exorbitant public spending has continued into 2023. Without a regular government, parliament could not adopt a budget for the current year; thus, in accordance with the rules set down, public spending must follow the previous year's budget – even though the rationale behind some of the emergency spending is no longer valid.

Rebalancing the public finances may require a radical reversal in the patterns of public spending and/or tax hikes. Such policy shifts will inevitably entail a range of unpopular measures, and any government that ventures such a course of action will suffer a serious loss of popular support. Well aware of the possible damage to their political standing, neither of the two big parties is eager to lead a government in the current economic situation. This makes it even more problematic to find a possible way out of the current crisis. To all intents and purposes, Bulgaria has slipped into a vicious cycle: any further delay in resolving the political mess will only exacerbate the fiscal imbalance; that, in turn, will create further disincentives to address the political crisis.

A direct negative consequence of this situation has been the enforced abandonment of the earlier declared target of adopting the euro in January 2024. As early as 2022, it was evident that Bulgaria had seriously deviated from the path that would allow it to achieve this target. This was clear even on purely formal grounds: apart from the budget deficit, inflation was way above the desired level – and indeed became out of control. Moreover, the surge in inflation that was observed in 2022 was partly home-grown, resulting as it did from inconsistent policies. The absence of a stable regular government has been another obstacle in the way to joining the euro area. This February, Bulgaria announced that it would not ask the European Commission and the European Central Bank to submit their regular Convergence Report, which was supposed to seal the country's readiness to join the euro area. No future target date for adoption of the euro has yet been announced.

A further adverse consequence of the political mess has been the blatant failure over the preparation and implementation of the country's Recovery and Resilience Plan. After several revisions, the plan was shown a tentative green light by the European Commission in April 2022, pending some additional elaborations. In consequence, the first instalment (non-repayable support) under the plan (amounting to EUR 1.37bn) was only received in December 2022. The disbursement of

the second instalment of non-repayable support (amounting to EUR 724m) is conditional on the implementation of 22 measures, which require changes to 16 laws. However, the absence of a functioning parliament has meant that this could not be attended to. The fate of the funds, which were due to be disbursed in February, remains unclear. According to most analysts, given the delays already incurred, Bulgaria will not be able to absorb the funds earmarked for 2023, and it is quite likely that a similar pattern will be repeated in the coming years.

While economic activity slowed throughout 2022, the rate of GDP growth for the year as a whole came to 3.4%, which was above the prevailing expectations. GDP growth in 2022 was mainly driven by private and public consumption, while gross fixed capital formation made a negative contribution. In turn, private consumption was underpinned by a boom in consumer credit. There was also a surge in the export of goods; however, the increase in the import of goods was even greater, and so net exports of goods subtracted from GDP growth. By contrast, net exports of services made a positive contribution, partly reflecting the recovery in tourism in 2022.

One of the factors that drove the export boom and the better-than-expected economic activity was the surge in the export of weapons to Ukraine. At present, Bulgaria is among Ukraine's most important suppliers of arms and ammunition – most of which complies with the old Soviet standards. However, as the majority of Bulgaria's population is against such supplies, most of these exports have not been officially announced, but have rather been channelled to Ukraine indirectly, in particular through Romania and Poland. There are no official statistics on the export of weaponry to Ukraine, but some experts have put the value in 2022 at more than EUR 1bn. In addition, Bulgaria has supported Ukraine's military activities by substantially increasing its export of fuels. In 2022, Bulgaria's total official exports to Ukraine almost tripled (to EUR 1.15bn), and fuel exports accounted for the lion's share of that increase. Ironically, the fuel was produced using oil imported from Russia.

In 2023, Bulgaria has continued to export weapons and fuel to Ukraine at the same (or greater) pace as in 2022. Some companies involved have already announced an expansion of their production facilities to meet the growing demand. These activities will again be a factor supporting Bulgaria's overall economic activity in 2023 – and probably for as long as the war continues.

The short-term indicators for the first months of 2023 suggest a significant slowing in the pace of both manufacturing production and goods exports. Private consumption – which in 2022 was underpinned by a surge in consumer credit, against the background of low interest rates – has also slowed with the rise in interest rates. Still, private consumption will probably remain the main growth driver in 2023. Annual consumer price inflation at the start of 2023 remains high (average annual inflation in February was as high as 14.0%), due to significant carry-over effects from the previous year. The figure for 2023 as a whole is likely to stay in double digits.

Overall, and in view of the worsening external and domestic environment, we expect GDP growth in 2023 to slow to 1.7%. GDP growth will remain moderate in coming years as well: in the range 2-3%. While inflation will gradually subside, it will probably stay in high single digits. The fiscal deficit will remain as the key challenge for policy makers, as its reduction will require considerable effort and political will.

Table 5.4 / Bulgaria: Selected economic indicators

	2019	2020	2021	2022 ¹⁾	2023	2024	2025
					Forecast		
Population, th pers., average	6,976	6,934	6,878	6,800	6,750	6,700	6,650
Gross domestic product, BGN m, nom.	120,396	120,553	139,012	165,384	184,900	202,200	218,000
annual change in % (real)	4.0	-4.0	7.6	3.4	1.7	2.2	2.7
GDP/capita (EUR at PPP)	16,610	16,570	18,640	20,680	.	.	.
Consumption of households, BGN m, nom.	70,436	69,776	80,454	98,240	.	.	.
annual change in % (real)	5.9	-0.5	8.7	4.7	2.0	2.0	2.5
Gross fixed capital form., BGN m, nom.	22,404	22,981	22,720	25,412	.	.	.
annual change in % (real)	4.5	0.6	-8.3	-4.3	2.5	4.0	6.0
Gross industrial production ²⁾							
annual change in % (real)	0.6	-5.9	9.8	12.7	2.0	2.5	3.0
Gross agricultural production							
annual change in % (real)	-1.2	-11.1	18.0	-7.7	.	.	.
Construction industry ³⁾							
annual change in % (real)	3.8	-5.3	2.6	0.4	.	.	.
Employed persons, LFS, th, average ⁴⁾	3,233	3,122	3,077	3,151	3,170	3,190	3,210
annual change in %	2.6	-3.4	-0.6	2.4	0.5	0.5	0.5
Unemployed persons, LFS, th, average ⁴⁾	143	169	171	140	140	140	140
Unemployment rate, LFS, in %, average ⁴⁾	4.2	5.1	5.3	4.3	4.3	4.2	4.2
Reg. unemployment rate, in %, eop	5.9	6.7	4.8	4.7	.	.	.
Average monthly gross wages, BGN	1,267	1,391	1,561	1,761	1,940	2,100	2,250
annual change in % (real, gross)	7.2	7.9	8.7	-2.2	0.0	1.0	2.0
Consumer prices (HICP), % p.a.	2.5	1.2	2.8	13.0	10.0	7.0	5.0
Producer prices in industry, % p.a.	3.0	-2.0	15.5	38.1	20.0	12.0	10.0
General governm. budget, EU def., % of GDP							
Revenues	38.4	37.7	36.7	38.0	37.0	37.0	38.0
Expenditures	36.3	41.5	40.6	43.0	42.0	41.0	41.0
Net lending (+) / net borrowing (-)	2.1	-3.8	-3.9	-5.0	-5.0	-4.0	-3.0
General gov. gross debt, EU def., % of GDP	20.0	24.5	23.9	22.4	24.0	26.0	27.0
Stock of loans of non-fin. private sector, % p.a.	7.4	4.5	8.3	12.2	.	.	.
Non-performing loans (NPL), in %, eop	6.6	7.5	6.0	4.6	.	.	.
Central bank policy rate, % p.a., eop ⁵⁾	0.00	0.00	0.00	1.30	2.5	2.5	2.0
Current account, EUR m	1,148	24	-1,316	-578	-500	-300	300
Current account in % of GDP	1.9	0.0	-1.9	-0.7	-0.5	-0.3	0.3
Exports of goods, BOP, EUR m	29,120	27,272	34,405	45,927	46,500	47,000	48,000
annual change in %	5.0	-6.3	26.2	33.5	1.2	1.1	2.1
Imports of goods, BOP, EUR m	32,028	29,213	37,292	50,816	51,000	51,500	52,500
annual change in %	5.2	-8.8	27.7	36.3	0.4	1.0	1.9
Exports of services, BOP, EUR m	10,237	7,320	9,184	11,886	12,000	13,000	14,000
annual change in %	11.3	-28.5	25.5	29.4	1.0	8.3	7.7
Imports of services, BOP, EUR m	5,342	4,171	5,104	6,560	7,000	7,500	8,000
annual change in %	5.5	-21.9	22.4	28.5	6.7	7.1	6.7
FDI liabilities, EUR m	1,983	3,154	2,084	3,014	.	.	.
FDI assets, EUR m	745	395	781	1,005	.	.	.
Gross reserves of CB excl. gold, EUR m	23,072	28,830	32,490	36,198	.	.	.
Gross external debt, EUR m	37,716	38,991	41,214	44,431	45500	46000	47000
Gross external debt, % of GDP	61.3	63.3	58.0	52.5	48.0	44.0	42.0
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary and wiiw estimates. - 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) 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.