

Anton Mihailov

Bulgaria: a year of solid growth

2004 was another year of sound economic performance in Bulgaria, combining robust growth with a stable macroeconomic environment. GDP is expected to have increased by some 5.5%, or even more, for the year as a whole, more than 1 percentage point above the rate in 2003. Manufacturing output surged, an upshot of several years of active restructuring. But in absolute terms, it was the service sector that made the most significant contribution to the growth of aggregate output, with a number of key industries (telecommunications, financial services and especially tourism) posting solid gains in 2004. A relatively good harvest contributed to an upturn in agricultural output.

In contrast to recent developments in other Central and Eastern European economies, the ongoing recovery in Bulgaria has been accompanied by relatively strong net job creation, especially in 2003 and 2004. This positive outcome partly reflects the fact that the restructuring effort had contributed to a significant reduction in the previously existing employment slack. The absence of slack facilitates the transmission of labour demand associated with output growth into net job creation. But the active labour market policies introduced in 2003 have also had a positive effect on employment. The unemployment rate remains relatively high (the average rate for 2004 as a whole was 12% according to labour force surveys) but this is mostly due to regional disparities. In large cities (especially the capital Sofia) there are already signs of labour shortages, especially as regards qualified labour.

The average annual rate of consumer price inflation rose somewhat (to 6.2%) in 2004, but this was mostly due to statistical carryover effects originating in the final months of 2003. The cumulative (January to December) change of CPI in 2004 was 4%, lower than the change in the corresponding period of 2003 (5.6%).

In current euro terms merchandise exports (BOP definition) increased by some 20% in 2004 underpinned by vibrant external demand and facilitated by the coming on stream of new, export-oriented manufacturing capacity. Merchandise imports also rose significantly (by more than 18% in 2004), partly reflecting the ongoing recovery in fixed investment but also strong import demand generated by the export-oriented industries. Robust exports and a strong outturn in the tourism industry contributed to a certain reduction in the current account deficit in the second half of 2004. At some 7% of GDP for the year as a whole the deficit still remains high; nevertheless, being fully covered by FDI inflows, it does not seem to pose immediate dangers for macroeconomic stability.

Domestic credit continued to expand at a brisk pace throughout the year. At the end of December 2004 the stock of outstanding credit to the non-government sector was almost 50% higher than a year earlier. Its fastest growing component was credit to households, which grew by some 75% during the same period. While providing a solid impetus to domestic economic activity, the credit boom became an issue of policy concern due to worries that it had fuelled a widening of the current account deficit at the beginning of the year. However, a series of policy measures (such as the withdrawal of government funds from commercial banks, increases in the mandatory reserves of commercial banks and tightening of the provisioning requirements on various types of credit) failed to put effective brakes on the growth of credit.

The credit boom sparked fears of overheating, an issue recently raised by the IMF. However, judging by several key macroeconomic indicators, both on the demand and on the supply side, these fears appear to be unsubstantiated, at least for the time being. Despite the healthy recovery in consumer demand (partly fuelled by borrowing), there are no signs of excessive growth in private consumption. In fact, during the first three quarters of 2004 private consumption increased by just 4.4% year on year, lagging behind GDP, which increased by 5.7% compared to the same period of 2003. Nor are there signs of acceleration in inflation: on the contrary, inflation has been on the decline through 2004. Despite the recovery, average capacity utilization in manufacturing still remains low (it was 63% at the end of December 2004) and cannot be a source of inflationary pressure. The recently emerging bottlenecks in some segments of the labour market are minor and their macroeconomic impact is negligible.

The fiscal outcome in 2004 proved to be much better than expected. According to preliminary data, the level of consolidated general government revenues in 2004 was by 10.4% higher than envisaged in the budget. This allowed the government to increase public expenditure (by 3.8% above those budgeted) and nevertheless achieve a healthy 1.7% surplus in the consolidated financial balance for 2004. However, the reported fiscal outcome excludes BGN 340 million set aside in December with the intention to establish a public investment company (a policy move likely targeting the upcoming parliamentary elections in June 2005); if the allocated funds are counted as expenditure for the year, the surplus in the general government financial balance comes to 0.8% of GDP. The swelling fiscal reserve allowed the government to implement, in January 2005, a second Brady buy-back (after a similar operation in July 2004), redeeming USD 937.5 million worth of Interest Arrears Bonds (IABs) maturing in 2011. This amounts to a reduction of public debt by the equivalent of 3.7% of GDP.

Fiscal policy issues came high on the agenda in a series of discussions with the IMF in the final months of 2004. The negotiations were difficult as the Fund, fearful of pre-election loosening, kept a rigid stance on a number of issues (the very idea of establishing a public

investment company being one of them). Ironically, despite an excellent macroeconomic performance, Bulgaria's relations with the IMF came near the freezing point at the beginning of 2005. The main stumbling block turned out to be a seemingly minor policy issue: by how much could the government afford to raise the regulated minimum monthly wage in the country? The Fund insisted on restraint in incomes policy, one of the few remaining policy instruments under the currency board arrangement, in fears of negative repercussions for the current account deficit. However, the government had pledged a 25% rise in minimum wages in 2005 (from BGN 120 to BGN 150), another blatant pre-election move. In the event, the two sides failed to agree on a mutually acceptable solution and in January the government went ahead with the planned wage increase. As the IMF remained opposed to this measure until the very last moment, the future of the current precautionary agreement looks uncertain.

On the positive side, the latest signals coming from Brussels have been generally favourable and the widely shared expectation is that the Accession Treaty will be signed in the coming months, opening the way for full EU membership in 2007. Furthermore, the authorities recently unveiled the ambitious target to join EMU by 2009 (implying the adoption of the ERM-2 immediately after accession to the EU in 2007). Nevertheless, the EU has played it safe, including (similarly to the case of Romania) 'safeguard clauses' to the Bulgarian Accession Treaty, which should act as another straitjacket for the government in implementing its commitments related to EU accession.

Despite the row with the IMF, the outlook for the Bulgarian economy in 2005 remains positive. Investment-driven restructuring is underway in full swing, providing an impetus for solid economic performance. However, compared to 2004, the pace of aggregate output growth may slow down somewhat, reflecting a certain worsening in the external conditions. The improvement in the labour market is set to continue while there are no signs of rising inflationary pressures. Some fiscal loosening cannot be excluded (as the upcoming parliamentary elections lay their print on the current policy agenda) but nevertheless macroeconomic fundamentals will remain generally sound. The goal of EU membership in 2007 – shared by all political parties – precludes major deviations from the current policy course after the 2005 elections. Thus, given the healthy state of the economy, it can be expected that robust economic performance, including further improvements in labour markets, will continue in 2006 as well.

Table BG

Bulgaria: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 ¹⁾	2005	2006
	forecast								
Population, th pers., end of period ²⁾	8230.4	8190.9	8149.5	7891.1	7845.8	7801.3	.	.	.
Gross domestic product, BGN mn, nom.	22421.1	23790.4	26752.8	29709.2	32335.1	34410.2	38250.0	41900	45700
annual change in % (real)	4.0	2.3	5.4	4.1	4.9	4.3	5.6	5	5
GDP/capita (EUR at exchange rate)	1377	1481	1674	1920	2101	2249	2510	.	.
GDP/capita (EUR at PPP - wiiw)	4650	4890	5330	5850	6100	6340	6830	.	.
Gross industrial production									
annual change in % (real) ³⁾	-8.5	-8.0	8.3	1.5	6.5	8.3	17.8	12	10
Gross agricultural production									
annual change in % (real)	-1.5	2.7	-9.1	-0.1	4.2	-1.4	.	.	.
Construction output total									
annual change in % (real)	-0.2	8.8	8.0	15.0	1.9	-17.2	.	.	.
Actual final consump. of househ., BGN mn, nom.	.	453.3	634.6	917.2	1151.4	1451.2	20750.2 ^{I-X}	.	.
annual change in % (real)	.	-1.1	0.2	6.8	3.1	7.1	4.4 ^{I-X}	.	.
Gross fixed capital form., BGN mn, nom.	2919.8	3600.5	4206.0	5415.2	5908.5	6733.1	5416.9 ^{I-X}	.	.
annual change in % (real)	35.2	20.8	15.4	23.3	8.5	13.8	12.4 ^{I-X}	.	.
LFS - employed persons, th, avg.	3034.8	2875.3	2794.7	2698.8	2739.6	2834.8	2922.5	.	.
annual change in %	-0.8	-5.3	-2.8	-3.4	1.5	3.5	3.1	.	.
Reg. employees in industry, th pers., avg.	802.5	722.5	662.0	658.4	666.8	689.5	685.1	.	.
annual change in %	-4.3	-10.0	-8.4	-0.5	1.3	3.4	-0.6	.	.
LFS - unemployed, th pers., average	497.5	534.0	566.8	663.9	592.4	448.7	399.7	370	350
annual change in % (real, average)	14.1	15.7	16.9	19.7	17.8	13.7	12.0	11	10
Reg. unemployment rate in %, end of period	12.2	16.0	17.9	17.3	16.3	13.5	12.2	11	10
Average gross monthly wages, BGN	183.3	201.0	224.5	240.0	257.6	273.3	299.0	.	.
annual change in % (real, gross)	20.7	6.9	1.3	-0.5	1.5	3.7	3.3	.	.
Consumer prices, % p.a.	18.7	2.6	10.3	7.4	5.8	2.3	6.2	4	4
Producer prices in industry, % p.a.	18.7	2.8	17.5	3.8	1.2	4.9	5.9	.	.
General governm. budget, nat. def., % GDP									
Revenues	39.7	40.7	41.4	39.8	38.7	40.9	41.5	.	.
Expenditures	38.4	40.6	42.0	40.7	39.4	40.9	39.7	.	.
Deficit (-) / surplus (+), % GDP	1.3	0.2	-0.6	-0.9	-0.7	0.0	1.7	.	.
Public debt in % of GDP	79.6	79.3	73.6	66.2	53.2	46.2	39.1 ^{XI}	33	28
Base rate of NB % p.a., end of period	5.2	4.5	4.7	4.7	3.4	2.9	2.4	.	.
Current account, EUR mn	-28.5	-586.9	-761.4	-1101.7	-925.5	-1505.2	-1400	-1300	-1300
annual change in % of GDP	-0.3	-4.8	-5.6	-7.3	-5.6	-8.6	-7.2	-6.1	-5.6
Gross reserves of NB excl. gold, EUR mn ⁵⁾	2290.9	2878.7	3390.6	3734.0	4247.1	4981.0	6443.0	.	.
Gross external debt, EUR mn ⁶⁾	9295.0	10863.9	12038.5	12046.0	10768.6	10681.1	12376.0	.	.
FDI inflow, EUR mn	478.0	775.0	1103.3	903.4	980.0	1253.9	1500 ⁷⁾	1500	1200
FDI outflow, EUR mn	0.1	16.3	3.5	10.8	28.9	19.2	200 ⁷⁾	.	.
Exports of goods, BOP, EUR mn	3746.9	3733.7	5253.1	5714.2	6062.9	6668.2	8000.0	9200	10300
annual growth rate in %	-11.9	-0.4	40.7	8.8	6.1	10.0	20.0	15	12
Imports of goods, BOP, EUR mn	4075.3	4741.4	6533.0	7492.6	7754.7	8867.8	10500.0	11750	13000
annual growth rate in %	2.7	16.3	37.8	14.7	3.5	14.4	18.4	12	11
Exports of services, BOP, EUR mn	1602.7	1686.2	2366.2	2384.8	2478.9	2790.8	3350.0	3750	4100
annual growth rate in %	-17.7	5.2	40.3	0.8	3.9	12.6	20.0	12	9
Imports of services, BOP, EUR mn	1249.4	1380.6	1818.6	1930.3	1992.9	2267.6	2600.0	2900	3200
annual growth rate in %	4.1	10.5	31.7	6.1	3.2	13.8	14.7	12	10
Average exchange rate BGN/USD	1.760	1.838	2.124	2.185	2.077	1.733	1.575	.	.
Average exchange rate BGN/EUR (ECU)	1.972	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956
Purchasing power parity BGN/USD, wiiw	0.507	0.518	0.543	0.564	0.597	0.604	0.639	.	.
Purchasing power parity BGN/EUR, wiiw	0.584	0.592	0.615	0.642	0.674	0.694	0.720	.	.

Notes: 1) Preliminary. - 2) From 2001 according to census March 2001. - 3) Other methodology than quarterly data. - 4) According to ESA'95, excessive deficit procedure. - 5) Converted from the national currency to EUR at the official exchange rate. - 6) Up to 2001 converted from USD to NCU, and from NCU to EUR at the official exchange rates. - 7) wiiw estimate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.