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Bulgaria: countercyclical measures help mitigate the shocks of the crisis

Bulgaria's economy experienced a notable downturn in the first quarter of the year but the depth of the recession was probably not as great as had been prompted by the slump in exports and industrial production. According to the preliminary national accounts figures (which may still be revised), GDP in the first quarter dropped by 3.5% from a year earlier, while in the same period the decline in real industrial output was close to 18% year-on-year whereas total exports in nominal terms dropped by some 20% year-on-year. The national accounts figures also indicate a notable downturn in the main components of domestic demand (both private consumption and fixed investment). Real retail sales in the first quarter were some 9% below their level in the same period of 2008.

The economic downturn has been associated with a certain deterioration of the situation in the labour market but so far it has been far from dramatic. Nevertheless, expectations are that the rise in unemployment will accelerate in the months to come. Since the start of the crisis, there has been a sharp change in the price dynamics, especially as regards producer prices: the PPI level in April 2009 was 7% below the level of April 2008. Consumer prices have notably slowed down their pace as well.

This type of macroeconomic performance reflects a major shift in the patterns of growth as a result of the crisis. During the previous eight years (from 2001 to 2008), economic growth in Bulgaria was exclusively driven by domestic demand. The first quarter of 2009 marked a striking departure from this pattern: while domestic absorption made a hefty negative contribution (-12.3%) to GDP growth (with almost identical contributions of private consumption and gross fixed capital formation), the positive contribution of net exports amounted to 8.8%. This positive contribution resulted from a structural adjustment, namely, a considerable reduction of the deficit in the trade balance (which still remained negative). Compared to the same period of the previous year, the current account deficit in the first quarter also dropped considerably.

The massive countercyclical measures initiated by the government may have also contributed to the softening of the negative shocks. Already in October 2008, the government announced a series of anti-crisis measures, some of which were subsequently incorporated in the 2009 budget. The core of the programme is public investment in infrastructure with a target figure of total public capital expenditure in 2009 amounting to BGN 5.6 billion (over 8% of GDP), which is a significant increase both in absolute and in relative terms. Another important component of crisis management was the launching of a Development Bank (initially funded with BGN 500 million), a public fund aimed at supporting SMEs through different financial instruments.

In March, the government adopted a new infrastructure package (amounting to BGN 250 million) including supplementary funding of national and local projects. In particular, additional targeted subsidies amounting to BGN 155 million are to be allocated among some 200 municipalities in support of local infrastructure projects. The newly established Development Bank was given a swift start and began operational activity at the beginning of 2009. By mid-May, it had disbursed some BGN 151 million of funding (or more than 60% of its initial endowment of disbursable funds) to projects initiated by 246 small businesses. The maximum amount of funding to a borrower is BGN 2 million and the interest rate is fixed at 8% for a period of up to 10 years with a 3-year grace period (some 3.5 percentage points below the current market interest rate on new commercial loans of similar maturity). The Bank now envisages a bond issue in order to be able to finance new projects. In addition to this, public subsidies for research and innovation in 2009 were increased by 50% compared to 2008 to reach BGN 120 million.

In early 2009, the anti-crisis programme was supplemented with a wide-ranging package of measures – both new and expanded existing ones – in support of the labour market, covering several areas:

- Employment protection and support. These include: partial compensation of lost income to employees obligated to switch to part-time work due to the crisis; career start support to both university and school graduates; hiring additional social workers from within the pool of unemployed, etc.
- Human resources development. Measures include: extended forms of support to vocational training and new career start to laid off workers and various categories of employed and unemployed persons; hiring additional child care personnel from among older-age unemployed; support to part-time vocational training to young employees forced to work part-time; support for the start of new businesses.
- Unemployment benefits have been reorganized to stimulate active job search. The entitlements have been differentiated over time (higher at the beginning and lower at the end of the period) while the maximum duration of the unemployment benefit has been reduced.

As regards incomes policy, the government has manifested relative restraint and has managed to avoid excessive, populist pre-election spending. Thus the increase in public sector wages planned for 2009 has been put on hold. At the same time, two steps of increases in different types of pensions (one in January and another one in July) are being implemented as envisaged in the 2009 budget.

The anti-crisis measures have been associated with a considerable loosening of the fiscal stance compared to the pre-crisis period (in the first quarter of the year, consolidated general government revenue was 5% down from the same period of 2008, while expenditure was 22.5% up). Nevertheless, the general government balance still remained in surplus, reflecting the existing ample cushion in Bulgaria's state coffers. The authorities have been financing some of the anti-crisis measures from the fiscal reserve, which dropped by BGN 427 million between end-December and end-March. Despite this spending, the fiscal reserve remained at the respectable level of BNG 7.95 billion at the end of the first quarter.

Overall, Bulgarian banks have preserved financial stability and remain fairly sound despite the substantial reduction in the access to external funding related to the global financial squeeze. The key factor contributing to the stability in the banking system has been the stringent prudential regulation introduced after the 1996-1997 crisis, which is much stricter than what is required from Basel II regulations. Since the start of the crisis, there has been some increase in the amount of non-performing loans in the banking system (from 2% in 2008 to some 3.5% in March 2009); however, they still remain at a level which does not pose systemic risks. Thanks to this financial stability, there has been no need of government intervention in the financial sector and such need is unlikely to emerge in the immediate future.

Within the existing constraints, the Bulgarian National Bank adopted some regulatory measures equivalent to a moderate monetary easing aiming to soften the credit squeeze. In particular, the provisioning requirements for credit risk were relaxed somewhat in February, allowing the banks to release some previously blocked funds and re-allocate them for credit activity. Credit activity has slowed down considerably but has not come to a halt: in April 2009 the stock of outstanding credit to the corporate sector was up 21% compared to April 2008 while the stock of outstanding credit to the household sector was 20% higher than a year earlier. Actually, after an abrupt downfall in the second half of 2008, new credit to households started to accelerate again in the first months of 2009.

Despite the loosening of the fiscal stance, the authorities have stated their commitment to overall fiscal discipline and have not abandoned the target of maintaining a surplus in the general government balance for 2009 as a whole (however, the target was reduced to 1% from the initially envisaged 3%). In view of this, in early June the government announced its intention to cut planned public expenditure in 2009 by BGN 500 million. It remains to be seen, however, what the policy stance of the new government due to take over after the parliamentary elections in July will be.

The outlook for the Bulgarian economy continues to be dominated by downside risks. Needless to say, Bulgaria's short-term economic prospects depend to a large degree on how the overall economic situation in Europe will evolve in the months ahead. This notwithstanding, the most likely scenario for 2009 is the recessionary one, but probably Bulgaria will not be among the countries with the deepest recessions. Given the magnitude of the negative shock, it is not very likely to see positive GDP growth in Bulgaria in 2010 either.

While the labor market still has not experienced the full shock of the recession, this is likely to happen in the second half of the year. These negative effects will probably be of a more lasting nature, suggesting that unemployment rates both in 2009 and in the following years will remain on the higher side. By contrast, given the weak domestic demand and absence of imported inflationary pressure, the price dynamics will be dominated by disinflation or even deflation. The adjustment in the balance of payments is likely to continue and it can be expected that the current account deficit in 2009 and the following years will be substantially lower than that seen in 2007-2008.

Table BG

Bulgaria: Selected Economic Indicators

	2005	2006	2007	2008 ¹⁾	2008 1st quarter	2009	2009	2010	2011
							Forecast		
Population, th pers., average	7739.9	7699.0	7659.8	7621.2	.	.	.	.	.
Gross domestic product, BGN mn, nom. ²⁾	42797.4	49361.0	56519.8	66728.1	13483.5	13961.1	66000	67300	71500
annual change in % (real) ²⁾	6.2	6.3	6.2	6.0	7.0	-3.5	-3	0	3
GDP/capita (EUR at exchange rate)	2800	3300	3800	4400	.	.	.	.	.
GDP/capita (EUR at PPP)	7800	8600	9300	9800	.	.	.	.	.
Consumption of households, BGN mn, nom. ²⁾	29841.5	34554.3	38826.5	45200.7	10343.8	10260.3	.	.	.
annual change in % (real) ²⁾	6.1	9.5	5.3	4.9	6.5	-6.3	0	1	3
Gross fixed capital form., BGN mn, nom. ²⁾	10346.5	12805.2	16832.5	22253.9	4100.8	3615.7	.	.	.
annual change in % (real)	23.3	14.7	21.7	20.4	15.5	-14.1	-8	0	6
Gross industrial production									
annual change in % (real) ^{3/4)}	6.7	5.9	9.2	0.8	3.6	-17.6	-14	-3	6
Gross agricultural production									
annual change in % (real)	-6.0	-0.1	-21.0	32.4	.	.	.	.	.
Construction industry (build.& civil engin.) ^{4/5)}									
annual change in % (real)	31.8	13.5	20.0	11.9	-2.5	-6.5	.	.	.
Employed persons - LFS, th, average	2981.9	3110.0	3252.6	3360.7	3289.9	3262.8	3220	.	.
annual change in %	2.0	4.3	4.6	3.3	4.9	-0.8	-4.2	.	.
Unemployed persons - LFS, th, average	334.4	305.7	240.2	199.7	228.8	222.2	280	.	.
Unemployment rate - LFS, in %, average	10.1	9.0	6.9	5.6	6.5	6.4	9	9	8
Reg. unemployment rate, in %, end of period	10.7	9.1	6.9	6.3	6.8	6.9	.	.	.
Average gross monthly wages, BGN	323.7	360.3	431.2	524.5	484.3	563.0	.	.	.
annual change in % (real, gross)	5.4	3.7	10.4	8.3	11.2	10.6	.	.	.
Consumer prices (HICP), % p.a.	6.0	7.4	7.6	12.0	12.4	5.1	2	2	3
Producer prices in industry, % p.a. ⁴⁾	7.9	12.1	8.4	10.6	13.9	-3.2	-5	.	.
General governm.budget, EU-def., % GDP ⁶⁾									
Revenues	41.2	39.5	41.5	39.0	.	.	.	.	.
Expenditures	39.3	36.5	41.5	37.4	.	.	.	.	.
Net lending (+) / net borrowing (-)	1.9	3.0	0.1	1.5	.	.	-2.0	-2.0	-1.0
Public debt, EU-def., in % of GDP ⁶⁾	29.2	22.7	18.2	14.1	14.0	12.7	.	.	.
Base rate of NB % p.a., end of period ⁷⁾	2.1	3.3	4.6	5.8	4.8	3.5	.	.	.
Current account, EUR mn	-2705.7	-4652.0	-7268.0	-8634.0	-1980.1	-1272.0	-4700	-4200	-3900
Current account in % of GDP	-12.4	-18.4	-25.2	-25.3	-24.2	-17.8	-13.9	-12.2	-10.7
Exports of goods, BOP, EUR mn	9466.3	12012.0	13512.0	15278.0	3648.7	2669.5	12000	11800	12500
annual growth rate in %	18.6	26.9	12.5	13.1	25.8	-26.8	-21.5	-2	6
Imports of goods, BOP, EUR mn	13876.1	17575.0	20758.0	24036.0	5427.4	3808.2	18000	17500	18000
annual growth rate in %	26.9	26.7	18.1	15.8	21.9	-29.8	-25	-2.8	2.9
Exports of services, BOP, EUR mn	3564.1	4186.0	4743.0	5372.0	826.3	780.7	4300	4300	4500
annual growth rate in %	9.3	17.4	13.3	13.3	14.8	-5.5	-20	0	4.7
Imports of services, BOP, EUR mn	2745.2	3264.0	3990.0	4544.0	1069.5	835.4	3300	3100	3200
annual growth rate in %	5.3	18.9	22.2	13.9	22.5	-21.9	-27	-6	3
FDI inflow, EUR mn	3152.1	6159.0	8480.0	6163.0	1202.1	750.4	3300	3000	3000
FDI outflow, EUR mn	249.1	138.0	198.0	477.0	410.1	15.6	.	.	.
Gross reserves of NB excl. gold, EUR mn	6813.9	8309.1	11215.9	11927.6	11355.5	10928.6	.	.	.
Gross external debt, EUR mn	15506.9	20674.3	28952.7	36729.8	30250.4	36410.8	.	.	.
Gross external debt in % of GDP	70.9	81.9	100.2	107.7	88.7	107.9	.	.	.
Average exchange rate BGN/EUR	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956
Purchasing power parity BGN/EUR	0.715	0.743	0.791	0.869	.	.	.	.	.

1) Preliminary. - 2) According to ESA95 (FISIM adjusted and real change based on previous year prices). - 3) Enterprises with more than 10 employees. - 4) Quarterly data and forecasts according to NACE Rev. 2. - 5) Enterprises with more than 5 employees. - 6) According to ESA'95, excessive deficit procedure. - 7) The BNB basic interest rate is not a policy rate but a monthly reference rate computed by the BNB as the average interbank LEONIA rate of previous month (valid from 2005).

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