

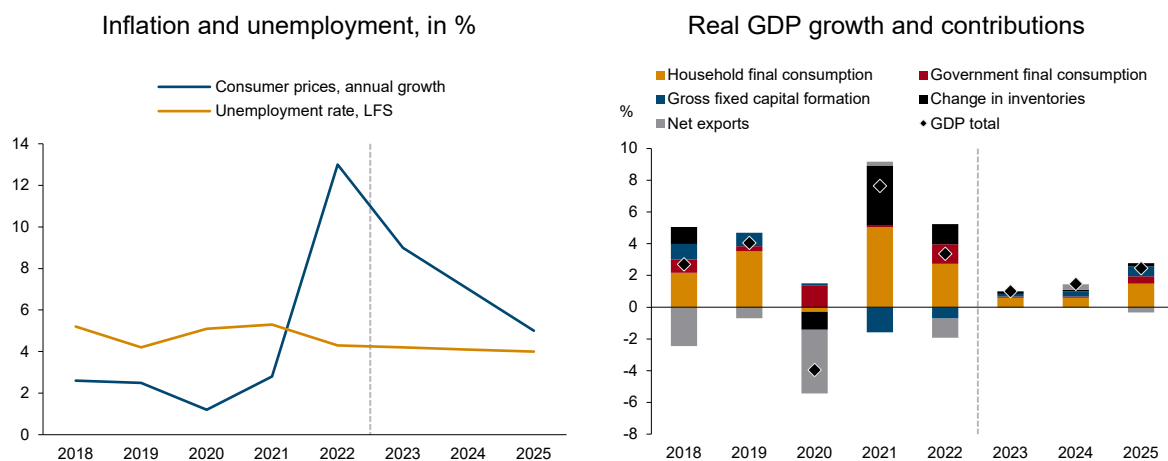


BULGARIA: Economic weakness likely to persist

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Economic slowdown became more pronounced over the course of the year, and industry actually plunged into a deep recession. Export performance was dismal against the background of shrinking demand in Western Europe. A new government took office in May, supported by the two main political parties. Its foundations are shaky, however, as the parties have not signed a coalition agreement. Economic weakness will persist: GDP will grow by 1.0% in 2023 and by 1.5% and 2.5% in 2024 and 2025, respectively.

Figure 6.4 / Bulgaria: Main macroeconomic indicators



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

Over the course of 2023 there has been a continuous slowdown, provoked by both external and domestic factors. Economic weakening became more perceptible in Q2, with year-on-year GDP growth slowing to 1.8% (after 2.1% in Q1). The industrial sector actually plunged into a deep recession, with gross industrial output down 10.6% year on year in Q2 and manufacturing output dropping by 7.0%. The poor manufacturing and export performance was mostly due to the shrinking of import demand in Western Europe, coupled with falling export prices. In current euro terms, exports of goods and services to the EU in H1 2023 dropped by 6.3%, compared to the same period in 2022, while the year-on-year decline in Q2 alone amounted to 16.0%.

The low growth figures for 2023 also partly reflect the effect of a high base in 2022. Last year – quite aside from the generally favourable external environment – some Bulgarian manufacturers recorded windfall profits, thanks to exceptionally high exports to Ukraine of military equipment, fuel and other war-related products.

On the demand side, both private consumption and gross fixed capital formation increased in H1 and contributed positively to GDP growth. Consumer and investor confidence in that period was underpinned by still low interest rates. At the same time, there was destocking on a massive scale, reflected in the national accounts item 'change in inventories' (probably related to seasonal factors in the production of military equipment), which made a sizeable negative contribution to GDP growth.

The political horse-trading following the April elections produced a government supported by the two main parties – GERB and 'We Continue the Change'. The new majority, however, did not sign a formal coalition agreement. The informal agreement between them amounts to a formula for a 'rotating government', with the parties taking it in turns to nominate the prime minister (and hence the composition of the cabinet) every six months. The first such government – nominated by 'We Continue the Change' – took office on 22 May.

The formation of a regular government put an end to the series of caretaker governments that had been in office over the past couple of years. In principle, this represents a break from the long political stalemate, as only a regular government, backed by a parliamentary majority, is empowered to take key policy decisions with lasting implications. However, the new quasi-coalition government is faced with the need to deal with serious economic problems, and it remains to be seen whether it will cope with the momentous challenges that lie ahead.

Following the endorsement of the government, in July parliament finally adopted a budget for the year 2023 (up until then, public spending had been governed by provisional rules). While this budget envisages a cash deficit of only 3% of GDP for the year, most analysts consider that to be barely achievable on account of the unrealistic assumptions: it is overly optimistic regarding revenue and overlooks some fiscal liabilities. In particular, the new budget envisages full absorption of the EU transfers envisaged for Bulgaria under the Recovery and Resilience Plan for 2023 – even though the country is still a long way off meeting the Commission's conditionalities for disbursement of those funds. Aside from that, the current statistics available suggest that some revenue items in 2023 have fallen significantly behind target. As an example, the nominal revenue from VAT imposed on imports in the period January-July was 14.5% lower than in the same period of 2022.

Furthermore, Bulgaria's main fiscal problem is the structural deficit that has opened up in the last couple of years. Addressing this deficit will require the introduction of some tough and unpopular measures. The 2023 budget fell short of addressing any of the structural fiscal problems, and the ruling quasi-coalition has not yet even hinted that it intends to deal with them.

The uncertainties surrounding the political situation in the country remain, due to the absence of stable and agreed operating principles for the present government. The first major test for the current political constellation will be the important local elections scheduled for 29 October. If the results diverge significantly from those of the last parliamentary election, that could shake the foundations of the current informal agreement between GERB and 'We Continue the Change'.

There has been little change in the labour market, which remains tight. A stagnant (or even shrinking) labour force and chronic labour shortages in many sectors have maintained upward pressure on wages, which has been a persistent feature of recent years. Between 2017 and 2022, average nominal wages in Bulgaria increased by 69.7%, with an annual rate of growth of 11.2%. Wage inflation

continued in 2023 as well. Since it has, by and large, outstripped gains in productivity, the result has been a significant rise in unit labour costs. The deterioration in competitiveness may be another factor behind the dismal export performance this year.

Headline inflation slowed somewhat in H1 2023. However, the annual average rate of consumer price inflation (CPI) this year is likely to remain high, due to carry-over effects from 2022 and such cost-push factors as the persistent surge in nominal wages. By contrast, following the general global trend, producer prices have been on the slide, due to falling energy prices and lower external demand.

The central bank raised the minimum reserve requirements in two steps: to 10% in May (from 5%) and then to 12% in July. This was an attempt to cool the credit expansion of 2022 and early 2023, which was regarded as pro-inflationary. Consequently, starting in June and continuing through September, lending rates have been rising in an effort to curb consumer credit, which was an important driver of private consumption in previous months. Apart from the dampening effect on economic activity and consumer spending, rising interest rates will mean higher costs of financing the fiscal deficit.

At present there is no sign of a reversal in the ongoing deterioration in the domestic and external environment. Under these circumstances, the economic slowdown is likely to continue in the remaining months of 2023. Our current forecast is for GDP to grow by 1.0% in 2023 – 0.7 percentage points down on the spring forecast. The average rate of CPI for the year as a whole will stay high, at close to 10%, under pressure from domestic cost-push factors. The fiscal deficit will remain a headache for the government, especially in view of the absence of agreed measures to tackle the structural fiscal problems.

There are no indications of a possible sustained recovery in the coming years either. We now expect GDP growth of 1.5% in 2024 and 2.5% in 2025 – both below the spring forecast. In the absence of strict containment measures, inflation will remain relatively high in the forecast period. Given the persistent problems with ensuring price stability and sound and sustainable public finances, Bulgaria's declared intention of joining the euro zone may remain just an aspiration in the foreseeable future.

Table 6.4 / Bulgaria: Selected economic indicators

	2020	2021	2022 ¹⁾	2022 January-June	2023	2023 Forecast	2024 Forecast	2025
Population, th pers., average ²⁾	6,934	6,878	6,465	.	.	6,400	6,350	6,300
Gross domestic product, BGN m, nom.	120,553	139,012	165,384	72,995	82,285	182,100	197,700	212,700
annual change in % (real)	-4.0	7.6	3.4	4.1	1.9	1.0	1.5	2.5
GDP/capita (EUR at PPP)	16,570	18,640	20,710	.	.	.	.	.
Consumption of households, BGN m, nom.	69,776	80,454	98,240	42,061	50,036	.	.	.
annual change in % (real)	-0.5	8.7	4.7	3.7	4.9	1.0	1.0	2.5
Gross fixed capital form., BGN m, nom.	22,981	22,720	25,412	10,516	12,937	.	.	.
annual change in % (real)	0.6	-8.3	-4.3	-9.6	8.6	1.0	2.0	4.0
Gross industrial production ³⁾								
annual change in % (real)	-5.9	9.8	12.7	17.2	-7.7	-4.0	1.0	2.0
Gross agricultural production								
annual change in % (real)	-11.1	18.0	-7.8	.	.	.	.	.
Construction industry ⁴⁾								
annual change in % (real)	-5.3	2.6	0.4	1.8	-0.7	.	.	.
Employed persons, LFS, th, average ⁵⁾	3,122	3,077	3,151	3,095	2,921	2,950	2,960	2,970
annual change in %	-3.4	-0.6	2.4	1.6	1.1	0.0	0.5	0.5
Unemployed persons, LFS, th, average ⁵⁾	169	171	140	155	138	130	130	120
Unemployment rate, LFS, in %, average ⁵⁾	5.1	5.3	4.3	4.8	4.5	4.2	4.1	4.0
Reg. unemployment rate, in %, eop ⁵⁾	6.7	4.8	4.7	4.2	5.0	.	.	.
Average monthly gross wages, BGN	1,391	1,561	1,761	1,667	1,920	2,000	2,200	2,360
annual change in % (real, gross)	7.9	8.7	-2.2	-1.3	2.1	4.0	3.0	2.0
Consumer prices (HICP), % p.a.	1.2	2.8	13.0	11.1	11.0	9.0	7.0	5.0
Producer prices in industry, % p.a.	-2.0	15.5	38.1	37.2	0.5	20.0	12.0	10.0
General governm. budget, EU def., % of GDP								
Revenues	37.7	37.7	38.5	.	.	37.0	37.0	38.0
Expenditures	41.5	41.6	41.3	.	.	42.0	41.0	41.0
Net lending (+) / net borrowing (-)	-3.8	-3.9	-2.8	.	.	-5.0	-4.0	-3.0
General gov. gross debt, EU def., % of GDP	24.5	23.9	22.9	.	.	24.0	26.0	27.0
Stock of loans of non-fin. private sector, % p.a.	4.5	8.3	12.2	12.4	10.9	.	.	.
Non-performing loans (NPL), in %, eop	7.5	6.0	4.6	5.2	3.8	.	.	.
Central bank policy rate, % p.a., eop ⁶⁾	0.00	0.00	1.30	0.00	2.96	4.0	3.5	3.0
Current account, EUR m	24	-1,316	-578	190	723	-500	-300	300
Current account in % of GDP	0.0	-1.9	-0.7	0.5	1.7	-0.5	-0.3	0.3
Exports of goods, BOP, EUR m	27,272	34,405	45,927	22,743	22,470	45,000	46,000	47,000
annual change in %	-6.3	26.2	33.5	39.8	-1.2	-2.0	2.2	2.2
Imports of goods, BOP, EUR m	29,213	37,292	50,816	24,515	23,525	49,500	50,500	51,500
annual change in %	-8.8	27.7	36.3	42.0	-4.0	-2.6	2.0	2.0
Exports of services, BOP, EUR m	7,320	9,184	11,886	5,199	5,417	12,000	13,000	14,000
annual change in %	-28.5	25.5	29.4	35.0	4.2	1.0	8.3	7.7
Imports of services, BOP, EUR m	4,171	5,104	6,560	2,978	2,885	7,000	7,500	8,000
annual change in %	-21.9	22.4	28.5	33.1	-3.1	6.7	7.1	6.7
FDI liabilities, EUR m	3,154	2,084	3,014	1,387	2,061	2100	.	.
FDI assets, EUR m	395	781	1,005	717	473	800	.	.
Gross reserves of CB excl. gold, EUR m	28,830	32,490	36,198	31,195	32,940	.	.	.
Gross external debt, EUR m	38,991	41,214	44,431	41,743	44,056	45500	46000	47000
Gross external debt, % of GDP	63.3	58.0	52.5	49.4	47.3	49.0	46.0	43.0
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary. - 2) From 2022 according to census 2021. - 3) Enterprises with 10 and more employees. - 4) Enterprises with 5 and more employees. - 5) From 2023 according to census 2021. Comparable growth rate for employed persons in H1 2023 of 1.1% is based on the H1 2022 value of 2,891 th persons. From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 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.