

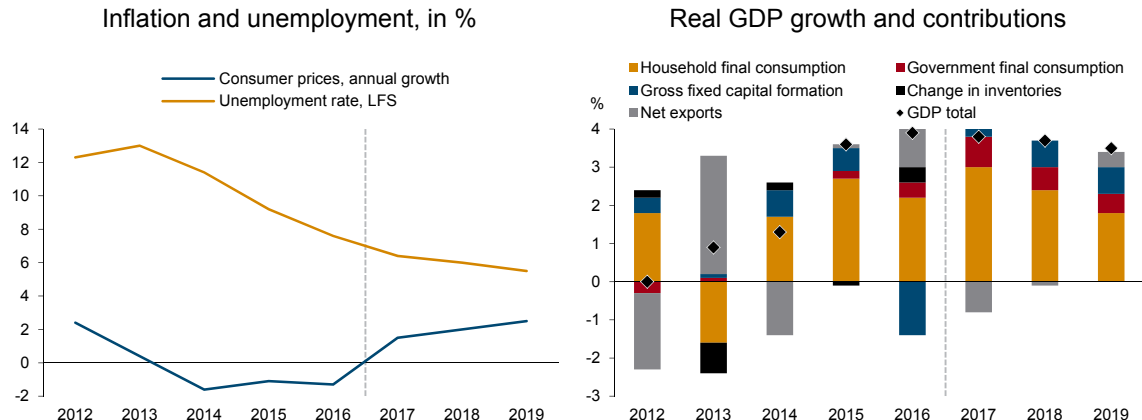


BULGARIA: Economy in good shape

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Bulgaria's broad-based economic upturn has continued, with positive output growth across all sectors of economic activity. The pattern of growth has switched from the export-led model of 2016 to a demand-driven type. However, labour shortages are causing supply constraints. The short-term prospects have improved and GDP growth for 2017 as a whole could come close to 4% and will remain in this range in the foreseeable future. Growth is balanced, with no imminent threats to macroeconomic stability.

Figure 33 / Bulgaria: Main macroeconomic indicators



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

Bulgaria's GDP grew by 3.7% year on year in the first half of 2017 which was above what the government and most analysts had expected. Revised national accounts data also indicate that GDP growth in 2016 was 0.5 percentage points higher than it was reported earlier. Importantly, the current economic upturn is broad-based and growth has not been accompanied by visible macroeconomic and/or external imbalances. In the first half of 2017, output growth was positive in all sectors of economic activity: export-led expansion strengthened both in manufacturing and high value-added services like ICT; the tourism boom continued for a second consecutive year and revenues reached a new record high; even the construction sector, which had been in a deep recession for about two years, started to recover in the second quarter.

The pattern of growth switched from the predominantly export-led model of 2016 to a demand-driven type. Private consumption has taken the lead as the main growth driver, supported by the ongoing surge in real wages and improving consumer confidence. In addition, household credit rebounded strongly in 2017 thanks to the combined effect of several factors including the households' positive expectations about their personal economic prospects and financial situation, the historically low interest rates and also the growing confidence by the banking sector in the borrowers' solvency. The new financial flows to the household sector are giving a boost to both personal consumption and to investments in the housing market, which is also recovering strongly in 2017.

After the contraction recorded in 2016, gross fixed capital formation started to recover in 2017 and made a positive contribution to GDP growth. The key factor behind this was the upturn in public investment, which reflects the phasing in of long-delayed public investment projects co-funded from EU sources. Robust final domestic demand boosted the imports of goods, which grew in the first half of 2017 by an impressive 20.6% year on year in current euro terms. While exports also continued growing strongly in this period, the strong upturn in imports resulted in a negative contribution of net exports to GDP growth in the first half of the year.

Matching the positive economic environment and improving expectations, hiring by businesses intensified. In consequence, the rate of unemployment fell to 6.6%, levels not seen since 2008. The net job creation has been associated with an overall expansion of the workforce: in the second quarter of 2017, the employment rate in Bulgaria reached 67.2%. This was 3.5 percentage points higher than a year earlier and the highest employment rate recorded after the end of central planning. At the same time, the labour market is becoming increasingly tight, which creates supply bottlenecks; more and more industries point to labour shortages as the main constraint to their possible future expansion. The biggest shortages concern professions such as electrical and mechanical engineers in manufacturing businesses as well as various machine operators. There are many vacancies also in the medical professions.

However, regional disparities in the labour market remain large. 70% of the 138,000 new jobs created during the 12 months to June 2017 were only generated in three fast growing regions: Sofia, Plovdiv and Stara Zagora. At the same time, despite the increasing internal labour migration to the regions in growth where labour shortages deepen, regional unemployment remains quite high in the North-Western and Southern parts of the country.

The growing demand for labour has been pushing wages up which, in turn, has translated into inflationary pressure. As a result, the deflationary trends which prevailed during the previous three years have been reversed and the rate of growth of consumer prices is expected to be positive in 2017 as a whole. The same is true for producer prices, which rebounded in 2017, reflecting both the conditions in international markets but also the cost push from rising wages.

Outmigration from Bulgaria has been declining in recent years. At present it mostly involves students leaving to study abroad and some high-skill occupations (such as the medical professions). Moreover, there has been some reversal in flows, in particular, young professionals returning to pursue career or business development in Bulgaria after graduating abroad.

Against this backdrop, **Bulgaria joined other Central and Eastern European economies in seeking to attract additional labour from abroad**, especially in seasonal jobs such as those in agriculture and tourism. Thus in 2017, the Employment Agency issued more than 3,000 work permits to non-EU citizens applying for seasonal work in Bulgaria. The majority of the applicants were from Ukraine, followed by Moldova, Macedonia and Albania; most of the seasonal foreign workers were employed in the tourism industry. The business sector has been actively lobbying for simplifying the administrative procedures for hiring seasonal workers from abroad. On top of that, some high value industries (such as ICT, other business services but also some manufacturing firms) seek to import skilled workers, in the first place from other EU countries (mostly from Central Europe). To do that, such businesses have to offer internationally competitive salaries, which is an additional upward push on wage levels and also leads to further differentiation in labour pay within the economy.

The economic upturn contributed to a notable cyclical improvement in Bulgaria's fiscal position.

In cash terms, the consolidated general government balance at the end of August reported a surplus of BGN 2.2 billion (more than 2% of annual GDP). There has been no formal revision of the 2017 budget so far but the government already started drafting hasty plans for the possible apportioning of the windfall. The first related – populist – decision refers to a significant (by 15% on average) rise of teachers' wages as of 1 September. It is very likely that demands for pay rises from other professions will mushroom after this move.

Despite the acceleration of import growth, the current account balance remained in positive territory thanks to the strong services exports. Notably, given the lasting export expansion (both in goods and services) and the current account surplus, the ongoing appreciation of the price-based real effective exchange rate and the continuing rise in real wages so far have not had a perceptible negative effect on Bulgaria's international competitiveness. One of the explanations is that the unit labour cost based real effective exchange rate has not appreciated, meaning that the productivity rises offset wage growth.

The policy front in Bulgaria is in a standstill. Since coming to office in March the third GERB-dominated²³ government led by Boyko Borisov has not come up with a noteworthy policy initiative. The governance programme agreed by the coalition of three parties in April looks more like a wish list of vaguely formulated priority policy areas and contains almost no concrete objectives or targets. The one area where there has been some progress is the initiative to reduce some administrative hurdles to businesses and citizens. It is difficult to trace policy-induced effects in the current economic upturn which in the first place reflects improvements in the external economic environment and the fruits of the slow but steady growth of the indigenous private sector of the economy over the years.

In any case, the short-term prospects for the Bulgarian economy have improved. GDP growth for 2017 as a whole may come close to 4% on the strength of private consumption and recovering gross fixed capital formation. Domestic demand is likely to continue to act as the main growth driver in the following years as well. However, the limited labour supply poses certain constraints on Bulgaria's future growth potential. The pool of the workforce at present is still some 7.5% below the level achieved in 2008. Taking into account the shrinking population of the country and unfavourable age structure, while there is still some room for mobilising new job seekers from within the economically inactive part of the

²³ The acronym for the name of the party 'Citizens for European Development in Bulgaria'.

population, these reserves are limited. Thus even if the external environment remains favourable, GDP growth will probably stay below 4% also in the following years 2018-2019. An extra push could only be expected in the case of large foreign capital inflows; however, at present there are no signs of this happening.

There do not seem to be imminent threats to macroeconomic stability. Maintaining a positive or balanced current account has contributed to deleveraging and reduction of Bulgaria's external debt. The fiscal balance also seems to be under control, which should contribute to further shrinking of public debt, which is not large anyway. The persistent tightness of the labour market will continue feeding inflationary pressure but this could be taken as an attribute of an ongoing catch-up process, with no negative macroeconomic implications.

Table 8 / Bulgaria: Selected economic indicators

	2013	2014	2015	2016 ¹⁾	2016	2017	2017	2018	2019
					January-June		Forecast	Forecast	
Population, th pers., average	7,265	7,224	7,178	7,128	.	.	7,100	7,050	7,000
Gross domestic product, BGN mn, nom.	82,166	83,634	88,571	94,130	42,168	44,215	99,200	104,900	111,300
annual change in % (real)	0.9	1.3	3.6	3.9	4.3	3.7	3.8	3.7	3.5
GDP/capita (EUR at PPP)	12,200	12,800	13,600	14,200	.	.	.	.	.
Consumption of households, BGN mn, nom.	50,660	51,963	54,831	56,715	26,334	27,569	.	.	.
annual change in % (real)	-2.5	2.7	4.3	3.5	4.5	4.7	5.0	4.0	3.0
Gross fixed capital form., BGN mn, nom.	17,365	17,653	18,612	17,484	7,796	8,477	.	.	.
annual change in % (real)	0.3	3.4	2.7	-6.6	-2.4	3.4	4.0	4.0	4.0
Gross industrial production ²⁾									
annual change in % (real)	-0.2	1.8	2.9	2.6	1.8	4.4	4.5	4.0	4.0
Gross agricultural production									
annual change in % (real)	14.2	-0.6	-8.2	-1.2	.	.	.	.	.
Construction industry ³⁾									
annual change in % (real)	-3.7	7.0	11.2	-16.8	-16.6	3.3	.	.	.
Employed persons, LFS, th, average	2,935	2,981	3,032	3,017	3,004	3,104	3,110	3,160	3,190
annual change in %	0.0	1.6	1.7	-0.5	0.8	3.3	3.0	1.5	1.0
Unemployed persons, LFS, th, average	436	385	305	247	273	219	210	200	190
Unemployment rate, LFS, in %, average	13.0	11.4	9.2	7.6	8.4	6.6	6.4	6.0	5.5
Reg. unemployment rate, in %, eop	11.8	10.7	10.0	8.0	8.4	6.8	.	.	.
Average monthly gross wages, BGN	775.1	821.7	877.9	961.6	934.0	1023.3	1,050	1,150	1,250
annual change in % (real, gross)	5.1	7.5	7.0	10.4	8.8	7.5	8.0	7.0	6.0
Consumer prices (HICP), % p.a.	0.4	-1.6	-1.1	-1.3	-1.7	1.1	1.5	2.0	2.5
Producer prices in industry, % p.a.	-1.5	-1.2	-1.9	-3.1	-4.9	4.5	3.0	3.0	3.0
General governm.budget, EU-def., % of GDP									
Revenues	37.2	36.6	39.0	34.9	.	.	38.5	38.0	38.0
Expenditures	37.6	42.1	40.7	34.9	.	.	38.0	38.0	38.0
Net lending (+) / net borrowing (-)	-0.4	-5.5	-1.6	0.0	.	.	0.5	0.0	0.0
Public debt, EU-def., % of GDP	17.0	27.0	26.0	29.0	.	.	27.4	25.9	24.5
Stock of loans of non-fin.private sector, % p.a	0.0	-8.2	-1.6	1.0	-1.5	2.1	.	.	.
Non-performing loans (NPL), in %, eop	16.9	16.7	20.4	18.3	19.7	17.0	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	0.02	0.02	0.01	0.00	0.00	0.00	0.0	0.0	0.0
Current account, EUR mn	536	35	-17	2,561	977	428	2,500	2,200	1,700
Current account in % of GDP	1.3	0.1	0.0	5.3	4.5	0.8	4.9	4.1	3.0
Exports of goods, BOP, EUR mn	21,218	21,027	21,920	23,104	10,728	12,376	25,500	26,700	27,800
annual change in %	7.8	-0.9	4.2	5.4	-2.1	15.4	10.4	4.7	4.1
Imports of goods, BOP, EUR mn	24,151	23,803	24,542	24,088	11,288	13,611	27,000	28,500	30,000
annual change in %	2.0	-1.4	3.1	-1.8	-6.7	20.6	12.1	5.6	5.3
Exports of services, BOP, EUR mn	5,889	6,738	6,967	7,591	3,181	3,076	7,800	8,200	8,500
annual change in %	1.2	14.4	3.4	8.9	12.7	-3.3	2.8	5.1	3.7
Imports of services, BOP, EUR mn	3,235	4,224	3,964	4,498	2,225	1,936	4,250	4,500	4,700
annual change in %	0.2	30.6	-6.2	13.5	18.5	-13.0	-5.5	5.9	4.4
FDI liabilities, EUR mn	1,509	1,539	2,430	1,042	975	495	700	.	.
FDI assets, EUR mn	266	657	101	702	240	140	400	.	.
Gross reserves of NB excl. gold, EUR mn	13,303	15,276	19,022	22,475	20,910	22,555	.	.	.
Gross external debt, EUR mn ⁵⁾	36,936	39,338	33,317	34,046	34,063	33,671	33,500	33,000	32,500
Gross external debt, % of GDP ⁵⁾	87.9	92.0	73.6	70.7	70.8	66.4	66.0	62.0	57.0
Average exchange rate BGN/EUR	1.9558	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) All enterprises in public sector, private enterprises with 5 and more employees. - 4) Base interest rate. This is a reference rate based on the average interbank LEONIA rate of previous month (Bulgaria has a currency board). - 5) BOP 5th edition.

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