

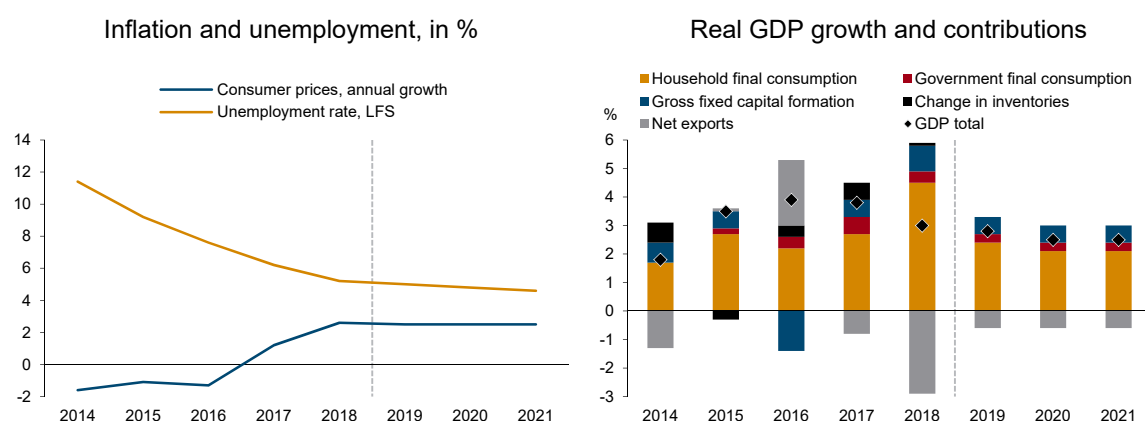


BULGARIA: Economy loses pace

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The 3% increase in GDP in 2018 was below the rates of growth in the preceding years. The slowdown mirrors a weakening of exports which became a drag on economic activity. The tight labour market was adding supply constraints to growth. By contrast, private consumption surged, providing an impetus to economic activity in 2018. We expect further moderation of GDP growth in the period 2019-2021. In the absence of external shocks, the macroeconomic situation will remain stable and under control.

Figure 6.4 / Bulgaria: Main macroeconomic indicators



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

Growth continued to moderate in Bulgaria throughout 2018. GDP grew by a modest 2.7% year on year in the third quarter after rising by 3.2% in the second and by 3.5% in the first quarter. Preliminary estimates indicate that the average annual rate of GDP growth for the year as a whole can be expected to be around 3%. The economic slowdown mirrors a notable weakening of exports in 2018. Given the concomitant upturn in imports, net exports made a large negative contribution to GDP growth.

By contrast, private consumption surged, providing the main impetus to growth. In fact, the 7.5% rate of growth of private consumption in 2018 was the strongest since 2007. Several factors contributed to this outcome. Real wages (and, parallel to that, real income) have been steadily rising in recent years which has helped to improve consumer confidence. Thus, while GDP per capita grew by 26% between 2011 and 2018, real wages increased by a cumulative 66% during the same period. Adding to that, 2018 witnessed a surge in household borrowing boosted by both consumer confidence and low interest rates. In December 2018, the stock of outstanding consumer credit was up by 17.7% from a year earlier and

the stock of outstanding mortgage credit was up by 11.4%. For comparison, the corresponding numbers in December 2017 were 5.8% and 7.4% while those at end-2016 were 0.8% and 1.8%, respectively.

Gross fixed capital formation also made a positive contribution to GDP growth in 2018. However, after a solid start, investment activity slowed down in the second half. Fixed investment by the private sector remained modest, including that supported by inward FDI. While spending on public investment on average was relatively strong thanks to increased EU funding, actual construction remained behind schedule which added to the overall weakening of fixed investment activity in the second half of the year.

Exports of goods weakened considerably in 2018 mostly due to the contraction of exports to non-EU countries. The latter partly owes to a high base period (2016) but it also reflects reduced orders from some traditional non-EU partners such as Russia and Turkey. By contrast, merchandise exports to the EU increased by 9.5% in value terms. These exports are increasingly dominated by the participation of Bulgarian manufacturers in global value chains dominated by large EU companies. Moreover, there has been a steady rise in the value-added content of these exports due to an increasing number of local producers moving up the value chain.

Exports of high value added services also expanded in 2018. Bulgaria's outsourcing sector, which is dominated by IT services, is estimated to contribute to some 5% of GDP and the exports of such services have been growing at double-digit rates in recent years. Tourism also reported record revenues in 2018.

In fact, the large surplus in the balance of trade in services in recent years largely offsets the deficit in the trade in goods. In 2018, the current account surplus contracted slightly but still remained sizeable.

However, the relatively favourable average economic performance numbers for the year as a whole are not indicative of the full picture. In fact the second half of the year witnessed a gradual weakening of economic activity. Exports to the EU started to decelerate, reflecting the weakening of economic growth in the major West European economies. Mirroring the slowdown in exports, manufacturing output was also decelerating in the course of the year: the rate of growth of gross manufacturing output for 2018 as a whole came to a meagre 2.1%, down from 5.4% in 2017.

Apart from the worsening external environment, the tight labour market was also adding supply constraints to growth. In recent business sentiment surveys, most Bulgarian firms indicate labour shortages as the major impediment to their future expansion. There are indications that at present the Bulgarian economy is probably close to full employment. The LFS unemployment rate in 2018 fell to 5.2% and is well below the EU average. During the four years of moderate growth (from 2015 to 2018) when GDP grew by a total of 15%, net job creation amounted to just 180,000 jobs, or a cumulative increase of employment by some 6%. 2018 was marked by another paradox: while the rate of unemployment fell by 1 percentage point from the previous year, the total number of employed remained virtually unchanged, suggesting a shrinking of the economically active population, a consequence of its unfavourable age structure. There is growing pressure from the business community for liberalising the access to the local labour market to non-EU applicants but so far only some partial measures have been agreed.

The tight labour market has also been pushing wages up and this was one of the main factors for their continued surge in 2018. Given this cost-push pressure, inflation was also on the rise but so far it has remained within a reasonable range. Still, at its present levels, inflation may prompt some concern as regards the declared intention of the Bulgarian authorities (which was recently reconfirmed) to apply for joining ERM II by July 2019.

Judging from the cash budget balance the fiscal stance remained relatively tight in 2018. A closer look at the numbers suggests that this was mostly due to two factors. On the one hand, this is the excessively conservative projection of public revenue. This has been a chronic feature of the Bulgarian budgetary process which results in a persistent revenue surplus compared to the numbers fixed in the budget. On the other hand, 2018 saw considerable delays in the implementation of some public investment programmes which produced an unintended cash surplus.

Faced with a large surplus at the end of the year, the government made several large-scale fiscal allocations in December. According to preliminary reports, the government allocated some BGN 7.3bn in December which is almost triple the regular monthly budgetary allocations. This practice of ad hoc allocation of public funds has been subject to wide and persistent criticism by both political opponents and by experts due to the fact that such spending bypasses parliamentary scrutiny and control. However, it has been continued year after year for exactly the same reason: the fiscal windfall provides the government in office with supplementary degrees of freedom that it can use to its own advantage.

Indications are that the conservative approach to budgetary planning prevails in the 2019 budget as well. At the same time, the new budget features some openly populist elements which are clearly targeted to the two ballots envisaged in 2019: the European Parliament elections in May and the municipal elections in autumn. Among these are the envisaged increase of wages in the public sector by 10% in 2019; the minimum wage in Bulgaria was also raised by 10% in January.

Despite these moves, recently the standing of the Bulgarian government has been shaken by a series of internal conflicts within the ruling broad and heterogeneous centrist coalition. So far Prime Minister Boyko Borisov has managed to keep the political situation under control but it is not certain whether he will be able to continue mastering the balance until 2021 when the next regular parliamentary elections are due to take place.

The short-term prospects for the Bulgarian economy have deteriorated somewhat since wiiw's Autumn 2018 Forecast. The weakening of EU demand will weigh on the further expansion of Bulgaria's exports. The supply constraints on future growth have also become all too visible.

In addition, the current pattern of demand-driven growth cannot be sustained for a long period of time. The observed level of economic activity in 2018 was mostly supported by borrowing and increased indebtedness of households and this obviously has its limits. In recent times, there have not been notable inflows of foreign capital (neither FDI nor portfolio investment) and under the currency board arrangement the domestic financial system has limited capacity to support a sustained rise in lending. On the other hand, while private borrowing did provide an impetus to economic activity in the short run, its excessive rise may pose risks to financial stability and there was a recent statement by the central bank governor to this effect.

In these circumstances we envisage further moderation of economic growth in the short run.

GDP can be expected to grow by some 2.8% in 2019, decelerating to 2.5% in the two following years.

This reflects the assumptions of relatively meagre export demand in the short run coupled with a moderation in the expansion of domestic demand, resulting in a reduced impetus to economic activity. In the absence of unexpected external shocks, the macroeconomic situation will remain stable and under control.

Table 6.4 / Bulgaria: Selected economic indicators

	2014	2015	2016	2017	2018 ¹⁾	2019	2020	2021
						Forecast		
Population, th pers., average	7,224	7,178	7,128	7,076	7,000	6,950	6,900	6,850
Gross domestic product, BGN mn, nom.	83,756	88,575	94,130	101,043	106,800	112,500	118,200	124,200
annual change in % (real)	1.8	3.5	3.9	3.8	3.0	2.8	2.5	2.5
GDP/capita (EUR at PPP)	12,900	13,700	14,200	14,800	15,600	.	.	.
Consumption of households, BGN mn, nom.	51,963	54,831	56,715	60,694	67,500	.	.	.
annual change in % (real)	2.7	4.3	3.5	4.5	7.5	4.0	3.5	3.5
Gross fixed capital form., BGN mn, nom.	17,653	18,612	17,484	18,717	21,000	.	.	.
annual change in % (real)	3.4	2.7	-6.6	3.2	5.0	3.0	3.0	3.0
Gross industrial production ²⁾								
annual change in % (real)	1.8	2.9	2.7	3.4	0.8	1.5	1.5	1.5
Gross agricultural production								
annual change in % (real)	-0.6	-8.2	1.7	6.3	-3.1	.	.	.
Construction industry ³⁾								
annual change in % (real)	7.0	11.1	-16.7	4.6	1.3	.	.	.
Employed persons, LFS, th, average	2,981	3,032	3,017	3,150	3,153	3,160	3,170	3,180
annual change in %	1.6	1.7	-0.5	4.4	0.1	0.2	0.2	0.2
Unemployed persons, LFS, th, average	385	305	247	207	173	170	160	150
Unemployment rate, LFS, in %, average	11.4	9.2	7.6	6.2	5.2	5.0	4.8	4.6
Reg. unemployment rate, in %, eop	10.7	10.0	8.0	7.1	6.1	.	.	.
Average monthly gross wages, BGN	821.7	877.9	948.3	1,037.3	1,135.1	1,230	1,320	1,410
annual change in % (real, gross)	7.5	7.0	8.9	7.2	6.4	5.5	5.0	4.5
Consumer prices (HICP), % p.a.	-1.6	-1.1	-1.3	1.2	2.6	2.5	2.5	2.5
Producer prices in industry, % p.a.	-1.2	-2.2	-3.1	5.0	3.9	3.5	3.0	3.0
General governm.budget, EU-def., % of GDP								
Revenues	37.7	38.8	35.3	36.2	39.0	38.0	38.0	38.0
Expenditures	43.1	40.5	35.1	35.1	38.0	37.5	38.0	38.0
Net lending (+) / net borrowing (-)	-5.4	-1.7	0.2	1.1	1.0	0.5	0.0	0.0
General gov.gross debt, EU def., % of GDP	27.1	26.2	29.6	25.6	22.6	21.5	20.5	19.5
Stock of loans of non-fin.private sector, % p.a.	-8.2	-1.6	1.0	3.3	7.5	.	.	.
Non-performing loans (NPL), in %, eop	16.7	14.5	12.9	10.2	7.6	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	0.02	0.01	0.00	0.00	0.00	0.0	0.0	0.0
Current account, EUR mn	531	-15	1,244	3,368	2,539	1,700	1,200	700
Current account in % of GDP	1.2	0.0	2.6	6.5	4.6	3.0	2.0	1.1
Exports of goods, BOP, EUR mn	21,027	21,920	23,104	26,950	27,427	28,000	28,500	29,000
annual change in %	-0.9	4.2	5.4	16.6	1.8	2.1	1.8	1.8
Imports of goods, BOP, EUR mn	23,803	24,542	24,088	27,716	29,676	31,000	32,000	33,000
annual change in %	-1.4	3.1	-1.8	15.1	7.1	4.5	3.2	3.1
Exports of services, BOP, EUR mn	6,787	6,967	7,688	7,813	8,450	8,800	9,200	9,500
annual change in %	15.3	2.7	10.3	1.6	8.1	4.1	4.5	3.3
Imports of services, BOP, EUR mn	4,244	3,964	4,628	5,048	5,137	5,400	5,600	5,800
annual change in %	31.2	-6.6	16.8	9.1	1.8	5.1	3.7	3.6
FDI liabilities, EUR mn	803	2,342	1,390	1,896	1,936	.	.	.
FDI assets, EUR mn	657	101	774	817	713	.	.	.
Gross reserves of NB excl. gold, EUR mn	15,276	19,022	22,475	22,257	23,620	.	.	.
Gross external debt, EUR mn ⁵⁾	39,338	33,493	34,221	33,397	32,716	32500	32000	31500
Gross external debt, % of GDP ⁵⁾	91.9	74.0	71.1	64.6	60.0	57.0	53.0	50.0
Average exchange rate BGN/EUR	1.9558	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) 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.