



## BULGARIA: Economy seeking direction

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Economic activity in Bulgaria was anaemic in 2013, for the second year in a row, curbed by weak domestic and external demand. The signs of a possible upturn that are observable at present in the main reflect the shift towards a more proactive policy stance undertaken by the current government. In particular, the government envisages a sustained rise in public capital expenditure as well as support to low-income earners. However, these impulses are relatively modest and will take time to feed into the economy. In the absence of a more notable upturn in export demand, economic growth is expected to remain moderate in 2014 and the following years.

After a weak first semester, a modest economic upturn was registered in the second half of 2013. However, on the whole, economic activity in Bulgaria remained subdued in 2013: average annual GDP growth for the year as a whole comes to below 1%. Bulgaria's economy remains in a limbo, lacking a visible growth momentum after the global 2008-2009 financial turmoil and without a clear direction even for the short-term future.

Net exports made a positive contribution to growth through 2013 thanks to the relatively good export performance while the recovery of imports was lagging behind. Signs of a moderate upturn in domestic demand were observable in the second half of the year thanks to a more proactive fiscal policy stance by the new government. The most significant change in this direction was the rise in public capital expenditure as well as an increase in social spending.

Another major departure from the past was the settlement of public sector arrears to the business sector. The GERB<sup>1</sup> government, which ruled until February 2013, tended to delay significantly payments due for services provided by businesses in an ill-fated strife to reduce cash deficit – with no effect on the ESA'95 deficit. By the end of 2013 the accumulated arrears that had kept piling up in the previous three years were basically cleared. The real effects of the easing of this financial pressure on business sector activity are yet to be seen but this measure already contributed to rising business confidence.

Despite some positive symptoms, on balance, the economic situation in Bulgaria remains precarious. Even though exports rose, gross manufacturing output for the year as a whole stagnated and the trends in the last months of the year were even negative. While domestic demand started recovering in the second half of the year, this could not fully compensate the negative trends of the first semester. Another

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<sup>1</sup> The Bulgarian acronym for the name of the party 'Citizens for European Development in Bulgaria'.

indication of stagnation was the standstill in credit activity: at the end of December 2013, the stock of outstanding credit to both the corporate and the household sectors was virtually unchanged from a year earlier. At the same time, household deposits increased by almost 9% year on year.

The price dynamics in 2013 basically mirrored the weak domestic environment: in average annual terms, consumer prices grew by a mere 0.4% while producer prices even retracted. The labour market was equally stagnant: the average annual LFS measure of total employment remained virtually unchanged as against 2012 while there was a slight further increase in the rate of unemployment.

The good export performance was among the few positive economic outcomes in 2013. According to preliminary data, the growth of exports (both in real and in nominal terms) outpaced significantly that of imports, contributing to a sizeable surplus in the current account balance for the year as a whole. As another noteworthy result, for the first time in the past more than two decades since the start of economic transformation, Bulgaria recorded a positive merchandise trade balance (CIF-FOB) vis-à-vis its largest trading partner, Germany. The latest published surveys also provide some grounds for a more optimistic outlook: according to those, both business and consumer sentiment were on the rise.

The current centre-left government is implementing at present important changes in the course of public policy that were declared already when the government took office in mid-2013. The policy changes are reflected both in the 2014 budget and in some programmatic documents with medium-term orientation that have been adopted in recent months.

One of the immediate shifts in the policy priorities of the current government was the emphasis towards greater social orientation of fiscal policy. Some first measures were introduced already in the amendments to the 2013 budget, while the 2014 budget made further steps in this direction. Thus minimum wages were increased by 10% effective 1 January 2014 as a preparatory step towards an overall increase of public sector wages (an average rise of 8% is being discussed at present). Indexation of pensions was also reintroduced in the context of the so-called 'Swiss rule' (with pensions rising by a weighted average of productivity and inflation changes) which had been abandoned by the previous government. A range of additional measures were adopted that target increased levels of social protection of different segments of society.

The government has declared that it will rely on exports and investment as the key growth drivers. One of the most significant departures from the past is the great priority that the government assigns to public investment. Thus, according to a recent statement by Prime Minister Oresharski, the government will target the doubling of public capital expenditure in 2014-2016 as compared to the previous three-year period. As regards the investment priorities, the current government will seek a more balanced investment portfolio supporting its policy objectives across the board. This is also in contrast to the policy of the GERB government which was almost exclusively focused on highway construction.

However, it remains to be seen whether these rather ambitious goals are achievable in view of the actual absorptive capacity of the economy. Moreover, the above targets are still more like policy intentions that have not been translated into concrete investment programmes yet. Among the new steps already taken in early 2014 was the early disbursement of budgetary allocations for capital investment from the central budget to municipalities to ensure the local co-financing of EU-funded projects. These disbursements were on average 20% higher than in 2013 and were allocated with

priority to regions with high unemployment. However, the government still has not come up with targeted policy efforts to improve the investment climate with a view to stimulating private investment.

Regarding the reliance on exports, the new policy places key emphasis on competitiveness as the basis for raising the export potential of the economy. In this regard, a range of medium-term measures are envisaged targeting education and vocational training, resource efficiency, improvements in infrastructure and in the framework conditions for innovation activity. The government has also developed a medium-term programme in support of SMEs, with a particular focus on export-oriented and high-tech/knowledge-intensive innovative SMEs.

It should be noted that all these policy programmes are rather modest in scope and, in accordance with the government's medium-term fiscal framework, they would be implemented within the Maastricht fiscal limits. In any case, they represent a major shift as compared to the policy stance of the previous government, which did not engage in any proactive measures in support of the economy. There are no plans to raise taxes yet and the authorities have stated that they will mostly rely on improved efficiency of tax collection to support the envisaged higher public spending.

As soon as the envisaged policy support measures start feeding into the economy, they should provide support to domestic demand and could therefore contribute to a gradual strengthening of economic activity. The current context thus suggests that even in the absence of a strong external export pull, the economy could embark on a path of gradual recovery, backed by a modest domestic demand pull. As regards export demand, it is expected to remain moderate in 2014 with a gradual further improvement in the years after.

In view of the above, the current forecast envisages a moderate recovery in 2014 and a certain further acceleration of GDP growth in 2015-2016, depending on the effect of the external environment and the strength of the export pull. Throughout this forecast period, growth is expected to remain predominantly driven by domestic demand. The implied policy shifts will be moderate in relative size and within the scope of prudent macroeconomic management. The situation in the labour market will only be improving marginally and inflation will remain low. While the current account balance would shift to negative values, no major external imbalances are expected.

Table 1 / Bulgaria: Selected Economic Indicators

	2009	2010	2011	2012	2013 <sup>1)</sup>	2014	2015 Forecast	2016
Population, th pers., average <sup>2)</sup>	7444.4	7395.6	7348.3	7305.9	7300.0	7270	7250	7230
Gross domestic product, BGN mn, nom.	68322	70511	75308	77582	78400	80700	84200	88200
annual change in % (real)	-5.5	0.4	1.8	0.8	0.7	1.5	2.3	2.7
GDP/capita (EUR at exchange rate)	4600	4800	5200	5400	5500	5700	5900	6200
GDP/capita (EUR at PPP)	10500	11000	11700	12000	12300	.	.	.
Consumption of households, BGN mn, nom.	42942	43990	46725	49595	50200	.	.	.
annual change in % (real)	-7.6	0.0	1.5	2.5	0.3	2.0	3.0	3.5
Gross fixed capital form., BGN mn, nom.	19724	16077	16225	16600	16400	.	.	.
annual change in % (real)	-17.6	-18.3	-6.5	0.8	0.0	3.0	5.0	7.0
Gross industrial production <sup>3)</sup>								
annual change in % (real)	-18.2	2.1	5.8	-0.3	-0.4	2.0	4.0	6.0
Gross agricultural production								
annual change in % (real)	-1.6	-6.0	-2.5	-10.0	0.4	.	.	.
Construction industry <sup>4)</sup>								
annual change in % (real)	-14.5	-14.9	-12.8	-0.7	-5.5	.	.	.
Employed persons, LFS, th, average <sup>5)</sup>	3253.6	3052.8	2949.6	2934.0	2934.9	2940	2950	2960
annual change in % <sup>5)</sup>	-3.2	-6.2	-3.4	-1.1	0.0	0.3	0.4	0.5
Unemployed persons, LFS, th, average <sup>5)</sup>	238.0	348.0	372.3	410.3	436.3	420	400	380
Unemployment rate, LFS, in %, average <sup>5)</sup>	6.8	10.2	11.2	12.3	12.9	12.5	12.0	11.5
Reg. unemployment rate, in %, end of period <sup>2)</sup>	9.1	9.2	10.4	11.4	11.8	.	.	.
Average monthly gross wages, BGN	609.1	648.1	685.8	731.1	760.0	.	.	.
annual change in % (real, gross)	8.8	3.9	1.5	3.5	4.5	.	.	.
Consumer prices (HICP), % p.a.	2.5	3.0	3.4	2.4	0.4	1.5	2.0	2.0
Producer prices in industry, % p.a.	-5.9	8.5	9.2	4.4	-1.5	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	37.1	34.3	33.6	35.2	37.0	.	.	.
Expenditures	41.4	37.4	35.6	35.9	38.5	.	.	.
Net lending (+) / net borrowing (-)	-4.3	-3.1	-2.0	-0.8	-1.5	-1.5	-1.0	-1.5
Public debt, EU-def., % of GDP	14.6	16.2	16.3	18.5	20.0	20.7	20.9	21.4
Central bank policy rate, % p.a., end of period <sup>6)</sup>	0.55	0.18	0.22	0.03	0.02	.	.	.
Current account, EUR mn	-3116	-534	33	-521	831	400	0	-600
Current account, % of GDP	-8.9	-1.5	0.1	-1.3	2.1	1.0	0.0	-1.3
Exports of goods, BOP, EUR mn	11699	15562	20265	20771	22200	23300	24300	25500
annual change in %	-23.0	33.0	30.2	2.5	6.9	5.0	4.3	4.9
Imports of goods, BOP, EUR mn	15874	18326	22421	24231	24535	25650	27000	29000
annual change in %	-33.3	15.4	22.3	8.1	1.3	4.5	5.3	7.4
Exports of services, BOP, EUR mn	4916	5012	5354	5740	5642	5800	6000	6300
annual change in %	-8.2	2.0	6.8	7.2	-1.7	2.8	3.4	5.0
Imports of services, BOP, EUR mn	3617	3143	3037	3412	3572	3750	3900	4100
annual change in %	-10.6	-13.1	-3.4	12.3	4.7	5.0	4.0	5.1
FDI inflow, EUR mn	2438	1152	1330	1480	1229	1200	1500	1500
FDI outflow, EUR mn	-68	174	117	271	114	.	.	.
Gross reserves of NB excl. gold, EUR mn	11943	11612	11788	13936	13303	.	.	.
Gross external debt, EUR mn	37816	37026	36295	37635	37500	.	.	.
Gross external debt, % of GDP	108.3	102.7	94.3	94.9	93.5	.	.	.
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
Purchasing power parity BGN/EUR	0.8753	0.8680	0.8777	0.8816	0.8708	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census February 2011. - 3) Enterprises with 10 and more employees. - 4) All enterprises in public sector, private enterprises with 5 and more employees. - 5) From 2012 according to census February 2011. - 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.