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## **Bulgaria: Economy stalls as politics overshadows policy debates**

***In the first months of the current year, public debate in Bulgaria was dominated entirely by expectations of early elections in May, while economic policy per se was largely sidelined. The economy was left with no clear sense of direction and lacked both internal and external driving forces. Although the new government, which took office at the end of May, has pledged to lay greater emphasis on counter-cyclical policy measures, the impact of those measures is unlikely to be felt in the course of 2013.***

The early elections held in May 2013 shifted completely the focus of public debates in Bulgaria away from economic policy issues. The caretaker government did not engage in any meaningful policy measures, leaving that task to the forthcoming new cabinet. As a result, since the beginning of the year 2013, the economy has been basically left in an 'autopilot mode', with no clear policy signals or directions. The external environment did not generate any visible positive growth impetus either.

Consequently, with GDP growing by just 0.3% year-on-year in the first quarter of 2013, the Bulgarian economy remained close to the freezing point. Flash estimates based on seasonally adjusted data even suggest deceleration compared to the previous quarter but at very low absolute levels of the growth figures. On the supply side, manufacturing posted a modest recovery, mostly thanks to an upturn in exports to both EU and non-EU markets. On the demand side, private consumption fell 2.4% year-on-year in the first quarter, reinforcing the downward trend that started in the second half of 2012. The only positive signal regarding the state of domestic demand in the first quarter was the modest upturn year-on-year in gross fixed capital formation.

In effect, the economy was seemingly motionless at the macroeconomic level, most of the performance changes recorded in the first months of the year (both positive and negative) being so marginal that they could hardly make any perceptible difference. The only possible exception was the labour market where LFS data suggest a modest trend of reintegration of previously discouraged job seekers into the labour market. In consequence, while the number of employed in the first quarter of 2013 was virtually

unchanged from a year earlier, there was a rise by about one percentage point in the rate of LFS unemployment over the same period. Inflation subsided further in the first months of the year both as regards consumer and producer prices. The downward pressure on consumer prices came both from the weak consumer demand and also from forced downward adjustment in some regulated prices (such as electricity) triggered by the protests at the beginning of the year.

The modest upturn in exports which had started around the middle of 2012 continued in the first months of 2013 as well, while imports were losing steam, curbed by the weakening private consumption. These developments were putting a brake on the trade and current account deficits which probably will turn out to be lower in 2013 than earlier expected. Public finances in general seem to be under control but there has been some deterioration on the revenue side compared to a year earlier. Corporate credit was on a downward trend while substandard and non-performing loans in the banking system resumed their growth in April 2013 after a brief period when it appeared that they had peaked off.

The resignation of the GERB<sup>1</sup> government in February and the early elections held in May 2013 dominated the political scene in Bulgaria. The political turmoil that led to the resignation of the government was all but helpful for the conduct of a meaningful policy course. The protests of the beginning of the year brought to the forefront of public debates the accumulated public discontent with a range of chronic problems that politicians have been unable or unwilling to address over years and even decades, such as the regulation of public monopolies, the state of the health care system, the dysfunctionality of some public institutions, the lack of transparency in public decision-making and corruption. Public expectations remain high as regards future policy actions on some of these fronts.

However, the early elections did not produce any results that could support more resolute moves and policies in implementing major reforms. The protest movements that had brought down the GERB government did not transform into political entities capable of challenging the existing political establishment. Somewhat surprisingly, GERB remained the leading party in terms of the share of votes received at the early elections. However, lacking a parliamentary majority, they were not able to form a government as all other parliamentary parties rejected a coalition with GERB. The Bulgarian Socialist Party (BSP) came as the second leading party in the new parliament. The other political parties that managed to surpass the parliamentary threshold (4% of the votes) were the Movement for Rights and Freedoms (MRF) supported by the Turkish minority and the nationalist Ataka; these parties are on two ideological extremes.

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

On the other hand, the election results do reflect the heterogeneous state of the Bulgarian society which is split among values and yearnings that are hardly compatible with each other. The outcome of the post-election political bargaining was a government proclaimed as technocratic but openly supported by BSP and MRF while Ataka for the time being has remained neutral but not openly opposing the formation of the above government. The new prime minister, Plamen Oresharski, is a respected and pragmatic financial expert and a former minister of finance. The government itself is mostly composed of experts; only a few of the new cabinet members can be traced to have clear political roots in the BSP and MRF establishment.

The new government has pledged to deal with some of the issues that have been in the focus of public attention such as the efficient regulation of monopolies, boosting the transparency and efficiency of the public administration, measures to invigorate the labour market, and reversal of the negative trends in pensions, minimum wages and welfare benefits. The policy stance of the new government is more likely to be leaning towards the centre rather than to the left. The government has declared its commitment to pragmatic economic management and preserving macroeconomic stability while at the same time engaging in some forms of soft industrial policy. Overall, given the high expectations throughout the Bulgarian society of changes towards the better, one could assume a somewhat more lax spending stance, at least in this initial period of the government's term in office.

If the new government puts in place some of the envisaged stimulus measures, a number of the current negative economic trends could be reversed in the second half of the year. However, given the weakening of consumer demand already incurred in the first quarter, it is difficult to expect a major turnaround in the short run. No positive surprises are expected from the EU economy in 2013 either. On balance, the GDP growth rate in Bulgaria in 2013 is likely to remain in a range comparable to that recorded in 2012. A more pro-active fiscal policy stance however may push the budget deficit further into the red. A revision of the 2013 budget adopted by the previous government cannot be excluded.

The forecasts for 2014 and 2015 incorporate the assumption that a more supportive policy stance would lead to a gradual improvement in the domestic environment. As regards the external environment, somewhat stronger demand for Bulgarian exports is expected thanks to a recovering global and European economy. These assumptions provide the basis for a slight upward revision of the expected rates of GDP growth in this period which nevertheless would still remain modest.

Table BG

**Bulgaria: Selected Economic Indicators**

	2009	2010	2011	2012 <sup>1)</sup>	2012 1st quarter	2013	2013	2014	2015
							Forecast		
Population, th pers., average <sup>2)</sup>	7585.1	7534.3	7348.3	7304.6	.	.	7300	7270	7250
Gross domestic product, BGN mn, nom.	68322	70511	75308	77582	15750	16577	80200	84300	89400
annual change in % (real)	-5.5	0.4	1.8	0.8	1.0	0.8	0.9	2.0	3.0
GDP/capita (EUR at exchange rate)	4600	4800	5200	5400	.	.	5600	5900	6300
GDP/capita (EUR at PPP)	10300	10700	11600	12100	.	.	.	.	.
Consumption of households, BGN mn, nom.	42942	43990	46725	49595	11203	11534	.	.	.
annual change in % (real)	-7.6	0.0	1.5	2.5	2.6	0.0	0.8	2.5	3.5
Gross fixed capital form., BGN mn, nom.	19724	16077	16225	16600	2893	3024	.	.	.
annual change in % (real)	-17.6	-18.3	-6.5	0.8	3.6	1.8	3.0	5.0	6.0
Gross industrial production <sup>3)</sup>									
annual change in % (real)	-18.2	2.1	5.8	-0.3	-2.2	1.4	2.0	4.0	6.0
Gross agricultural production (EAA)									
annual change in % (real)	-1.6	-6.0	-2.5	-9.0	.	.	.	.	.
Construction industry <sup>4)</sup>									
annual change in % (real)	-14.5	-14.9	-12.8	-0.7	-1.8	-1.4	.	.	.
Employed persons, LFS, th, average <sup>5)</sup>	3253.6	3052.8	2949.6	2934.0	2853.2	2855.0	2940	2950	2970
annual change in % <sup>5)</sup>	-3.2	-6.2	-3.4	-1.1	-1.8	0.1	0.3	0.5	0.8
Unemployed persons, LFS, th, average <sup>5)</sup>	238.0	348.0	372.3	410.3	421.4	456.4	420	400	390
Unemployment rate, LFS, in %, average <sup>5)</sup>	6.8	10.2	11.2	12.3	12.9	13.8	12.5	12.0	11.5
Reg. unemployment rate, in %, end of period <sup>5)</sup>	9.1	9.2	10.4	11.4	11.5	11.8	.	.	.
Average gross monthly wages, BGN <sup>6)</sup>	609.1	648.1	707.3	777.0	746.0	778.3	.	.	.
annual change in % (real, gross)	8.8	3.9	4.7	6.9	9.3	0.7	.	.	.
Consumer prices (HICP), % p.a.	2.5	3.0	3.4	2.4	1.9	2.1	2.5	3.0	3.0
Producer prices in industry, % p.a.	-5.9	8.5	9.2	4.4	3.8	1.7	.	.	.
General governm.budget, EU-def., % of GDP									
Revenues	37.1	34.3	33.6	34.9	39.1	.	.	.	.
Expenditures	41.4	37.4	35.6	35.7	39.8	.	.	.	.
Net lending (+) / net borrowing (-)	-4.3	-3.1	-2.0	-0.8	-0.6	.	-2.0	-2.0	-2.0
Public debt, EU-def., % of GDP	14.6	16.2	16.3	18.5	16.7	.	20.0	21.0	22.0
Central bank policy rate, % p.a., end of period <sup>7)</sup>	0.55	0.18	0.22	0.03	0.15	0.01	.	.	.
Current account, EUR mn	-3116	-534	40	-527	-561	-421	-700	-1000	-1300
Current account, % of GDP	-8.9	-1.5	0.1	-1.3	-7.0	-5.0	-1.7	-2.3	-2.8
Exports of goods, BOP, EUR mn	11699	15562	20265	20793	4620	5217	21600	22700	24000
annual change in %	-23.0	33.0	30.2	2.6	-2.9	12.9	3.9	5.1	5.7
Imports of goods, BOP, EUR mn	15874	18326	22421	24415	5561	5695	25500	27000	28700
annual change in %	-33.3	15.4	22.3	8.9	10.2	2.4	4.4	5.9	6.3
Exports of services, BOP, EUR mn	4916	5012	5354	5661	839	754	6000	6400	6800
annual change in %	-8.2	2.0	6.8	5.7	2.7	-10.2	6.0	6.7	6.3
Imports of services, BOP, EUR mn	3617	3143	3031	3264	749	681	3350	3500	3700
annual change in %	-10.6	-13.1	-3.6	7.7	11.5	-9.1	2.6	4.5	5.7
FDI inflow, EUR mn	2438	1152	1314	1479	673	257	1500	1800	2000
FDI outflow, EUR mn	-68	174	116	177	32.0	10.0	.	.	.
Gross reserves of NB excl. gold, EUR mn	11943	11612	11788	13936	11594	12893	.	.	.
Gross external debt, EUR mn	37816	37026	36228	37592	36604	37346	.	.	.
Gross external debt, % of GDP	108.3	102.7	94.1	94.8	92.3	91.1	.	.	.
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
Purchasing power parity BGN/EUR	0.8738	0.8746	0.8839	0.8812	.	.	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary. - 2) From 2011 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) From 2012 based on new exhaustive enterprises survey. - 7) 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 Database incorporating Eurostat and national statistics. Forecasts by wiiw.