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Bulgaria: Heading for a downturn?

In Bulgaria, GDP increased by 1.6% in 2011 but economic activity was weakening in the final months. While the export performance for the year as a whole was robust, sluggish domestic demand was a drag on economic growth. The process of macroeconomic rebalancing in 2011 was accompanied by a net outflow of financial resources. Short-term prospects have deteriorated and the economy is likely to stagnate in 2012.

According to flash estimates, Bulgaria's GDP grew by 1.6% for 2011 as a whole which was below the earlier expectations. There were visible signs that economic activity was losing pace in the second half of the year both on the supply and on the demand side. While export growth remained in the positive territory, there was a notable slowdown in the second semester. Concomitantly, the pace of manufacturing also decelerated, investment activity continued to decline while private consumption grew only marginally throughout the year.

Overall, against the backdrop of a general economic sluggishness in much of Europe, Bulgaria's export performance in 2011 was quite impressive: according to preliminary data, exports of goods and services in current prices rose by 30.7% for the year as a whole while exports to the EU grew by 33.3%. As to destinations other than the EU, exports to Turkey, Macedonia, Ukraine, Georgia, China, India and Egypt also rose significantly in 2011. Total non-EU exports grew by 24.4%. The structure of Bulgaria's exports is still dominated by minerals and fuels; however, manufactured products including machinery and equipment have been steadily growing in recent years and continued to do so in 2011. Much of the export growth however was recorded in the first half of the year when in some cases monthly exports were growing at a pace of 50% and more year on year. But exports to all destinations were losing steam in the second semester.

The sharp and continuing reduction in the merchandise trade deficit after 2009 was the main factor behind the reversal in the current account balance which turned positive in 2011, after a decade in the red, and alarming proportions in the years prior to the crisis.

Ultimately, this outflow of financial resources reflects amortization of external debt by the corporate sector and repayments of foreign funds borrowed by the banks, which is a complete reversal of the flows that prevailed before the crisis. The outflow of funds mirrors both weak domestic demand and a persistent squeeze in new foreign borrowing. Ultimately, the nominal stock of Bulgaria's gross foreign debt dropped both in 2010 and in 2011. As a share of GDP, gross foreign debt fell below the 100% mark in 2011.

So far the Bulgarian banking system has not experienced severe external shocks related to the financial and euro debt crisis. Quite the opposite – and quite ironically – part of the capital flight that has been accompanying the Greek crisis has reportedly been directed to Bulgaria. Apparently, these inflows have contributed to the recent persistent growth of deposits in the Bulgarian banking system which is otherwise difficult to explain in the current weak economic environment. Thus the total stock of deposits in the banking system in December 2011 grew by EUR 1.8 billion (or 11%) over December 2010.

The growth of the deposit base – which is increasingly becoming the main source of financial resources for Bulgarian banks in view of the draining of external resources – was probably one of the factors that contributed to some revival in credit activity in the second half of 2011, after more than two years of credit squeeze. The state of the banks' credit portfolios continued to deteriorate in 2011, with the share of substandard loans reaching 17.4% in December, an increase by 3.2 percentage points from the same month of the previous year. The deterioration was most pronounced as regards mortgage loans whereas there was almost no further increase in the share of bad corporate loans in the second half of the year. Mirroring that, the increase in new bank credit in this period was entirely directed to the corporate sector (the stock of outstanding credit to the corporate sector increased by 4.2% between June and December).

Nominal interest rates were generally on the decline in 2011: thus the annual average long-term interest rate for convergence assessment purposes dropped from 6.0% in 2010 to 5.4% in 2011; the average interest on short-term credit in domestic currency fell from 11.2% to 10.9% and that on new short-term corporate credit fell from 10.2% to 9.6%. Viewed against the producer price index, the real interest rate on new short-term corporate credit in 2011 was close to 0%.

The sluggish economic performance has done little to ease the situation in the labour market and in 2011 employment continued to decline for the third year in a row. More than 400 thousand jobs (some 12% of total employment) have been lost since the start of the crisis. In 2011, the rate of unemployment peaked above 10% (both by registrations and by

LFS) for the first time since 2005. While the rate of unemployment in Bulgaria is not among the highest in the EU, some of the underlying long-term and structural factors are worrying. Thus among the EU member countries, Bulgaria has the highest share of young people who are either out of job or out of study or vocational training. Average wages continued to grow in 2011 both in nominal and in real terms but as noted above, this was largely due to job cuts so overall there was no loss in competitiveness in terms of economy-wide unit labour costs.

On paper, public finances in Bulgaria are in a better shape than those in many EU countries but this has come at a very high price. Regrettably, since the start of the crisis, policy has done next to nothing to counter any of the negative economic trends outlined above. The lack of a pro-active stance coupled with excessive fiscal austerity featured also in 2011. One indication of the overall inefficiency of fiscal policy is the fact that the modest recovery in 2011 did not bring about a rise in consolidated public revenue as a share in GDP.

Probably the most damaging development in recent years (which will also have severe long-term implications) has been the continuous curtailing of public investment. Thus public investment expenditure from national sources in 2011 was a mere 44% (in nominal terms) of the spending in 2008. As a share in GDP, national public investment expenditure dropped from 5.4% in 2008 to 2.2%. Public investment financed from EU funds in 2011 was roughly at the same level as in 2010 but was 23% below those planned in the 2011 budget.

The present policy stance seems to be cemented also in the 2012 budget. Moreover, the macroeconomic framework under which the budget was adopted and which envisages 2.9% GDP growth in 2012 already seems outdated and unduly optimistic. It is therefore very likely that actual public revenues in 2012 will fall below the planned figures and major adjustments in spending will be needed. The government's track record suggests that among the most likely candidates for slashing will be the planned expenditure on public investment.

The recent trends suggest a significant slowdown in the Bulgarian economy and there are no solid arguments for optimism for the year 2012. Much will depend on whether the EU as a whole will manage to arrest the downturn but, given the recent downgrading of most forecasts, the likelihood of a turnaround in Europe as a whole is not very high.

In the present circumstances and in the absence of a more pro-active domestic policy, there are no visible growth drivers in the Bulgarian economy in the short term: the short-lived phase of export-led growth seems to be coming to an end while domestic demand, which was sluggish anyway, seems to be weakening further. Exports to non-EU countries may be less affected in the short run but probably this will not be sufficient to generate an economy-wide pull effect. Unless there is a reversal in these factors, the Bulgarian economy is likely to stagnate in 2012, bringing about further deterioration in the labour market situation. The net outflow of financial resources is likely to continue in 2012; coupled with weak domestic demand, this should keep the current account balance slightly positive or close to zero. The ongoing increase in substandard loans in the banking system is one of the worrying recent developments. While the situation still seems to be under control, it calls for careful monitoring of future developments.

Even if the external conditions start improving in 2012, no miracles can be expected in the outlook for 2013 and 2014. The net outflow of financial resources seems to have become a lasting trend related to the overall process of financial and macroeconomic rebalancing in Europe and is likely to continue in the following years. Even if EU demand for Bulgarian exports rebounds in 2013 and 2014, its potential role as a pull factor will be relatively limited due to constraining domestic supply factors. In an optimistic scenario, one can also expect a recovery in investor and consumer confidence. However, even if this materializes, it is likely to be a gradual process without a significant effect on domestic economic activity.

Table BG

Bulgaria: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 ¹⁾	2012	2013 Forecast	2014
Population, th pers., average ²⁾	7699.0	7659.8	7623.4	7585.1	7534.3	7364.6	7330	7300	7270
Gross domestic product, BGN mn, nom.	51783.1	60184.6	69295.0	68321.6	70474.3	76170	78500	81900	86600
annual change in % (real)	6.5	6.4	6.2	-5.5	0.1	1.6	0	1.3	2.7
GDP/capita (EUR at exchange rate)	3400	4000	4600	4600	4800	5300	.	.	.
GDP/capita (EUR at PPP)	9000	10000	10900	10300	10700	11300	.	.	.
Consumption of households, BGN mn, nom.	34761.9	41300.8	45765.7	42942.1	42844.4	45150	.	.	.
annual change in % (real)	8.7	9.1	3.4	-7.6	-1.3	1.4	1	1.5	2
Gross fixed capital form., BGN mn, nom.	14297.5	17263.9	23282.6	19724.3	16546.4	16000	.	.	.
annual change in % (real)	13.1	11.8	21.9	-17.6	-16.5	-7	0	4	6
Gross industrial production ³⁾									
annual change in % (real)	6.0	9.6	0.6	-17.4	1.1	4.9	3	5	6
Gross agricultural production (EAA)									
annual change in % (real)	-0.1	-21.0	33.0	-1.6	-5.1	-2.1	.	.	.
Construction industry ⁴⁾									
annual change in % (real)	23.9	27.9	12.6	-14.5	-17.9	-12.8	.	.	.
Employed persons - LFS, th, average	3110.0	3252.6	3360.7	3253.6	3052.8	2949.6	2930	2960	3000
annual change in %	4.3	4.6	3.3	-3.2	-6.2	-3.4	-0.7	1.0	1.4
Unemployed persons - LFS, th, average	305.7	240.2	199.7	238.0	348.1	372.3	.	.	.
Unemployment rate - LFS, in %, average	9.0	6.9	5.6	6.8	10.2	11.2	12	11	10
Reg. unemployment rate, in %, end of period ²⁾	9.1	6.9	6.3	9.1	9.2	10.4	.	.	.
Average gross monthly wages, BGN	360.3	430.6	544.8	609.1	647.4	706.5	.	.	.
annual change in % (real, gross)	3.8	10.3	12.6	8.8	3.8	4.7	.	.	.
Consumer prices (HICP), % p.a.	7.4	7.6	12.0	2.5	3.0	3.4	3	3	3
Producer prices in industry, % p.a.	12.0	7.7	10.9	-6.5	8.6	9.4	.	.	.
General governm.budget, EU-def., % GDP									
Revenues	36.2	40.9	40.0	36.3	34.9	35	.	.	.
Expenditures	34.4	39.8	38.3	40.7	38.1	37	.	.	.
Net lending (+) / net borrowing (-)	1.9	1.2	1.7	-4.3	-3.1	-2	-1.8	-1.5	-1.5
Public debt, EU-def., in % of GDP	21.6	17.2	13.7	14.6	16.3	17.1	18	19	20
Central bank policy rate, % p.a., end of period ⁵⁾	3.26	4.58	5.77	0.55	0.18	0.22	.	.	.
Current account, EUR mn	-4648	-7755	-8183	-3116	-476	744	500	0	-500
Current account in % of GDP	-17.6	-25.2	-23.1	-8.9	-1.3	1.9	1.2	0.0	-1.1
Exports of goods, BOP, EUR mn	12012	13512	15204	11699	15561	20097	21400	22800	24800
annual growth rate in %	26.9	12.5	12.5	-23.1	33.0	29.1	6	7	9
Imports of goods, BOP, EUR mn	17574	20757	23802	15873	18325	21942	23500	25500	28000
annual growth rate in %	26.7	18.1	14.7	-33.3	15.4	19.7	7	9	10
Exports of services, BOP, EUR mn	4187	4760	5355	4916	5164	5395	5600	5900	6300
annual growth rate in %	17.5	13.7	12.5	-8.2	5.0	4.5	4	5	7
Imports of services, BOP, EUR mn	3264	3587	4046	3617	3149	2994	3150	3350	3700
annual growth rate in %	18.9	9.9	12.8	-10.6	-12.9	-4.9	5	6	10
FDI inflow, EUR mn	6222	9052	6728	2437	1779	1064	1000	1300	1500
FDI outflow, EUR mn	141	206	522	-68	193	125	.	.	.
Gross reserves of NB excl. gold, EUR mn	8309	11216	11928	11943	11612	11788	.	.	.
Gross external debt, EUR mn	20691	29017	37246	37816	37042	35431	.	.	.
Gross external debt in % of GDP	78.1	94.3	105.1	108.3	102.8	91.0	.	.	.
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.956	1.956	1.956
Purchasing power parity BGN/EUR	0.7456	0.7839	0.8355	0.8712	0.8729	0.9138	.	.	.

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 and wiiw estimates. - 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) 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.