

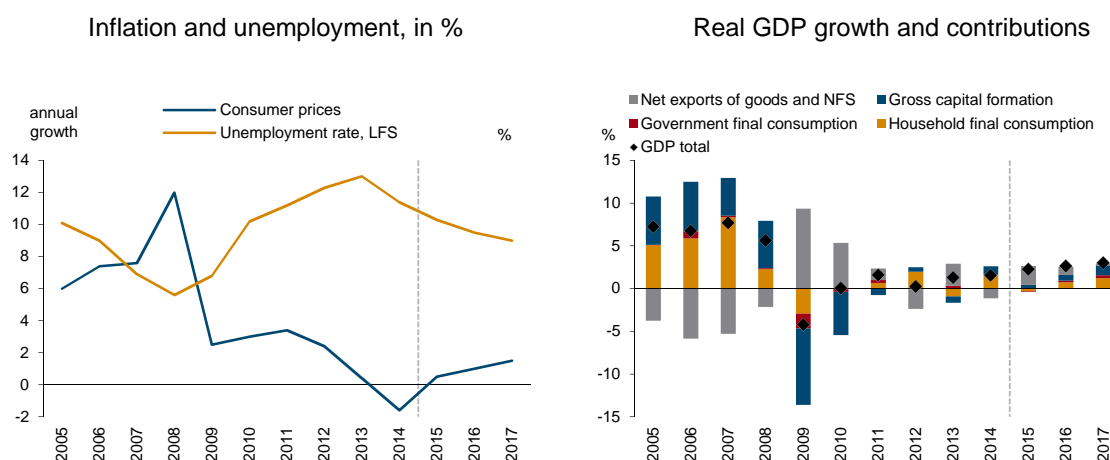


## BULGARIA: Modest recovery continues

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GDP growth in the first half of 2015 was supported by a robust upturn in exports in the first quarter. The strengthening in the labour market contributed to the unemployment dropping to below 10% by mid-year. However, economic performance was uneven across sectors, while progress in key policy reform areas was limited. Overall, the chances are that a moderate recovery will continue in the short term with GDP rising higher than 2% for 2015 as a whole.

**Figure 42 / Bulgaria: Main macroeconomic indicators**



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

The recent major revisions of Bulgaria's national accounts going back to 2005, published recently by the National Statistical Institute, suggest a different picture of the macroeconomic dynamics both during the past decade and in 2015 as compared to that depicted by the previous NSI estimates. While the revised rate of GDP growth in the first half of 2015 was lower than that published earlier, it was still almost 1 percentage point higher than the average annual GDP growth for 2015 expected at the beginning of the year. On the supply side, all main sectors of economic activity apart from construction registered positive growth in this period. On the demand side, growth in the first half was exclusively propelled by a surge in exports in the first quarter; both private consumption and gross fixed capital formation made a negative contribution to GDP growth.

The export boom during the first months of the year was probably the most important factor for the overall economic upturn. In particular, total merchandise exports to the EU in current euros grew at double-digit rates both in the first and in the second quarter of the year. Exports to non-EU countries rose at similar rates in the first quarter but in the later months their growth decelerated while still remaining positive. Such dynamics of the trade flows contributed to an even higher current account surplus.

The manufacturing industry both contributed to and benefited from the recovery in export markets: real manufacturing output continued to recover steadily while at the same time the industry was absorbing increasing numbers of employees. The high-tech service sector has been another source of recent growth: between 2008 and 2014, the export of IT services from Bulgaria quadrupled. The IT sector at present contributes around 2% of Bulgaria's GDP; this share increased threefold during the past decade making it the fastest growing sector of the economy. The ICT sector, the manufacturing industry and other business services have also been the main sources of net job creation during the last couple of years (some 70 ths. between mid-2013 and mid-2015).

The situation in the labour market has improved notably in the course of 2015: by mid-year, the rate of unemployment (both registered and LFS) fell below 10% for the first time since 2009. In turn, the growing labour demand, especially for skilled labour, has been pushing wages up: average real gross wages grew by 7.7% year-on-year in the first half of 2015, giving a boost to consumer sentiment. The ICT sector is a clear leader both in the absolute level and in the growth of wages. Albeit slowly, these labour market developments have started to generate an upward pressure on prices as well: after two deflationary years, the cumulative monthly CPI change in 2015 was marginally positive (0.2%) at the time of writing this report.

The recovery in economic activity contributed to a better than expected cash fiscal outcome in 2015: cash fiscal revenue of the consolidated government in the first seven months of 2015 was 5.8% higher than a year earlier (driven by higher tax revenue and better tax collection) while cash expenditure grew by 4.5%. The consolidated government cash balance reversed to the positive territory in 2015 and, unless there is a revision of the budget, is expected to remain there for the year as a whole. However, in ESA95 terms, the fiscal situation is much less clear due to the fiscal implications of the Corporate Commercial Bank (CCB) failure in 2014. As a part of the bankruptcy procedure, the Deposit Insurance Fund was to reimburse households who own CCB deposits eligible for repayment a total of some BGN 3.6 billion (about 4.4% of GDP in 2014), and most of these have already been paid. This liability was fixed in the amendment of the 2014 budget law but, apparently, the resulting fiscal commitments is so far not reflected in the official 2014 ESA95 fiscal deficit (-2.8%). Therefore either the 2014 number will have to be revised subsequently, or these extraordinary fiscal commitments will be reflected in the 2015 ESA95 fiscal balance.

Up to now the refugee influx to Europe has largely bypassed Bulgaria. After an initial inflow in 2014 which met with a very unwelcome reception in the country, refugees have sought to avoid this transit route. However, with the gradual tightening of internal EU borders along the traditional refugee routes, it is not excluded that a larger flow of migrants may try again to penetrate into Europe through Bulgaria.

Despite the relatively good economic outcome, there was rather limited progress on the policy front. The GERB government that came to power in 2014 with an ambitious reform agenda addressing most

aspects of economic and social life (including the business environment, the public administration, the pension system, the health care system and the judiciary). So far, some progress has only been made with the reforms in the pension and healthcare systems. Just before the summer break, the National Assembly adopted changes in the social security legislation that introduced a modest reform in the pension system, envisaging a further gradual increase in the retirement age which is now due to reach 65 years both for men and women by the year 2037. The reform also envisages a gradual increase in the mandatory payroll pension contributions to the National Social Security Institute (the first pillar of the pension system). A modest step was undertaken in reforming the healthcare system with the introduction of elements of competition among hospitals for the funding from the National Health Insurance Fund.

Within the set of planned reforms, the energy sector remains the biggest pain for the government. In the course of the past decade, several governments have been taking a range of commitments to support the development of renewable energy sources which in effect were equivalent to the undertaking of contingent fiscal liabilities under the assumptions that these would be gradually passed to consumers and businesses through price increases. However, up to now all such attempts have faced fierce social opposition and actually led to the fall of the first GERB government in 2013. In the meantime, deficits related to various public sector commitments kept accumulating in the state-owned National Electricity Company, reaching BGN 3.7 billion (some 4.4% of GDP) in September 2015. So far the government has not come up with any practically workable policy solution to these problems.

While the aggregate economic outturn in the first half of the year was generally positive, there were also drags on economic activity and the sustainability of the recovery is far from certain. The tourist industry was badly hit by the shrinking numbers of tourists from Russia by some 25% compared to the previous year. The upturn in business services exports could not offset these losses and the exports of services as a whole dropped year-on-year in the summer months. There was also a downturn in housing construction in 2015 which led to a generally anaemic performance of the construction industry. Exports of goods, the main growth driver in the first months of the year, also started losing steam after the first quarter, mostly due to lower EU import demand.

Given the limited progress in policy reforms and the lack of clearly declared focus on growth in the policy agenda, it is difficult to expect visible policy-induced growth impetus in the short to medium run. Hence the current forecast assumes that Bulgaria's growth will mostly depend on the small but dynamic new economic sectors and the intensity of export demand. Notwithstanding the existing uncertainties, the short-term prospects of the Bulgarian economy have improved somewhat compared to the beginning of the year.

The current wiiw forecast assumes that exports of goods will continue to provide moderate positive impulses to economic activity while improving consumer and investor expectations will support a modest recovery in domestic demand. Under these assumptions, modest aggregate growth will continue in the second half of the year as well. The average annual GDP growth in 2015 could thus be above 2%. The strengthening in the labour market should also continue while the price dynamics will gradually turn to the positive territory. The forecast for 2016-2017 assumes that the current growth factors will be combined with a strengthening of private consumption and fixed investment, leading to a gradual shift towards a domestically demand-driven type of growth. Under these favourable assumptions, the rate of GDP growth could be expected to be in the range of 2.5% to 3% over the forecast horizon.

Table 9 / Bulgaria: Selected economic indicators

	2011	2012	2013	2014 <sup>1)</sup>	2014 January-June	2015	2015 Forecast	2016 Forecast	2017
Population, th pers., average <sup>2)</sup>	7,348	7,306	7,265	7,224	.	.	7,250	7,230	7,200
Gross domestic product, BGN mn, nom. <sup>3)</sup>	80,100	81,544	81,971	83,612	37,022	38,931	85,900	89,000	93,100
annual change in % (real)	1.6	0.2	1.3	1.5	1.5	2.2	2.3	2.6	3.0
GDP/capita (EUR at exchange rate) <sup>3)</sup>	5,600	5,700	5,800	5,900	.	.	6,100	6,300	6,600
GDP/capita (EUR at PPP) <sup>3)</sup>	11,800	12,100	12,100	12,500	.	.	.	.	.
Consumption of households, BGN mn, nom. <sup>3)</sup>	49,582	53,022	50,906	52,207	24,476	24,453	.	.	.
annual change in % (real)	1.1	3.2	-1.4	2.7	3.1	-1.8	-0.5	1.2	2.0
Gross fixed capital form., BGN mn, nom. <sup>3)</sup>	16,896	17,443	17,365	17,653	7,674	7,627	.	.	.
annual change in % (real)	-4.4	1.8	0.3	3.4	5.7	-3.0	2.0	3.0	5.0
Gross industrial production <sup>4)</sup>									
annual change in % (real)	5.8	-0.4	-0.1	1.8	3.9	3.2	3.0	4.0	5.0
Gross agricultural production									
annual change in % (real)	-2.5	-10.0	14.2	-5.0	.	.	.	.	.
Construction industry <sup>5)</sup>									
annual change in % (real)	-12.8	-0.8	-3.7	1.8	3.1	1.7	.	.	.
Employed persons, LFS, th, average <sup>6)</sup>	2,950	2,934	2,935	2,981	2,937	2,981	3,030	3,080	3,130
annual change in %	-3.4	-1.1	0.0	1.6	1.4	1.5	1.7	1.5	1.5
Unemployed persons, LFS, th, average <sup>6)</sup>	372	410	436	385	407	340	350	320	310
Unemployment rate, LFS, in %, average <sup>6)</sup>	11.2	12.3	13.0	11.4	12.2	10.3	10.3	9.5	9.0
Reg. unemployment rate, in %, end of period	10.4	11.4	11.8	10.7	10.7	9.6	.	.	.
Average monthly gross wages, BGN	685.8	731.1	775.1	827.7	806.5	869.2	890	930	970
annual change in % (real, gross)	1.5	3.5	5.1	8.3	4.5	7.7	7.0	4.0	3.0
Consumer prices (HICP), % p.a.	3.4	2.4	0.4	-1.6	-1.7	-1.2	0.5	1.0	1.5
Producer prices in industry, % p.a.	9.2	4.4	-1.5	-1.2	-2.0	-0.6	0.0	1.0	2.0
General government budget, EU-def., % of GDP									
Revenues	31.9	33.9	36.6	35.8	.	.	37.0	37.0	37.0
Expenditures	33.9	34.5	37.5	38.6	.	.	41.0	38.0	38.0
Net lending (+) / net borrowing (-)	-2.0	-0.6	-0.8	-2.8	.	.	-4.0	-1.0	-1.0
Public debt, EU-def., % of GDP	15.3	17.6	18.0	27.1	.	.	30.4	30.4	30.0
Central bank policy rate, % p.a., end of period <sup>7)</sup>	0.22	0.03	0.02	0.02	0.05	0.02	.	.	.
Current account, EUR mn <sup>8)</sup>	375	-108	765	495	-83	332	700	400	0
Current account in % of GDP <sup>8)</sup>	0.9	-0.3	1.8	1.2	-0.4	1.7	1.6	0.9	0.0
Exports of goods, BOP, EUR mn <sup>8)</sup>	19,056	19,668	21,208	21,017	9,775	10,903	22,000	22,800	23,500
annual growth rate in %	34.4	3.2	7.8	-0.9	-3.3	11.5	4.7	3.6	3.1
Imports of goods, BOP, EUR mn <sup>8)</sup>	21,704	23,615	24,099	23,752	11,265	11,820	24,800	26,000	27,000
annual growth rate in %	22.5	8.8	2.0	-1.4	-2.8	4.9	4.4	4.8	3.8
Exports of services, BOP, EUR mn <sup>8)</sup>	6,471	6,845	6,860	6,749	2,644	2,904	7,300	7,600	7,800
annual growth rate in %	6.0	5.8	0.2	-1.6	-5.2	9.8	8.2	4.1	2.6
Imports of services, BOP, EUR mn <sup>8)</sup>	3,571	4,114	4,124	4,219	1,915	2,117	4,500	4,700	5,000
annual growth rate in %	3.5	15.2	0.3	2.3	-2.3	10.5	6.7	4.4	6.4
FDI liabilities (inflow), EUR mn <sup>8)</sup>	1,537	1,383	1,509	1,486	900	799	1,500	.	.
FDI assets (outflow), EUR mn <sup>8)</sup>	348	315	266	650	445	44	200	.	.
Gross reserves of NB excl. gold, EUR mn	11,788	13,935	13,303	15,276	13,085	17,866	.	.	.
Gross external debt, EUR mn	36,295	37,714	36,936	39,356	37,396	35,889	38,000	37,000	36,000
Gross external debt, % of GDP	88.6	90.5	88.1	92.1	87.5	81.7	87.0	81.0	76.0
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	0.9259	0.9195	0.9302	0.9222	.	.	.	.	.

1) Preliminary. - 2) According to census February 2011. - 3) According to ESA 2010. - 4) Enterprises with 10 and more employees. - 5) All enterprises in public sector, private enterprises with 5 and more employees. - 6) From 2012 according to census February 2011. - 7) Base interest rate. This is a reference rate based on the average interbank LEONIA rate of previous month (Bulgaria has a currency board). - 8) BOP 6th edition

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