

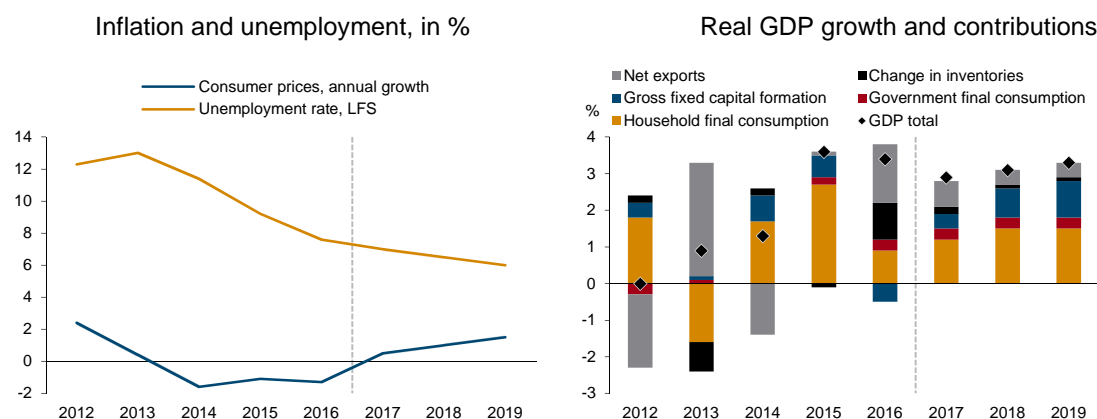


BULGARIA: On track for moderate growth

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Bulgaria has a new president and is expecting a new government after the early elections in March 2017. The economy is in relatively good shape, with GDP increasing by 3.4% in 2016. Growth was balanced, driven by both private consumption and exports; however, fixed investment became a drag on growth, due to delays in public investment programmes. There are no visible external or domestic imbalances, and the economy seems set to remain on the path of moderate growth in the foreseeable future.

Figure 36 / Bulgaria: Main macroeconomic indicators



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

The presidential elections held in November 2016 had some unexpected outcomes. The candidate of the ruling centre-right GERB party lost to the independent candidate Rumen Radev, who was supported by the opposition Bulgarian Socialist Party. This was followed by a major political shake-up and triggered the resignation of the GERB government led by Boyko Borisov. In January, newly elected President Rumen Radev appointed a caretaker government and called early elections for 26 March 2017. The caretaker government is led by Ognyan Gerdzhikov, a respected lawyer who served as chairman of the National Assembly a decade ago, and is composed of non-partisan experts.

The political turbulence had no visible economic consequences. There are signs that the economy has finally overcome the lasting shocks of the 2008-2009 global financial crisis. Revised national accounts data for 2015 indicate higher GDP growth (3.6%) than reported earlier (3.0%). Subsequent

revisions of quarterly national accounts for 2016 also point to higher GDP growth than reported by first estimates. The latest statistics suggest a rate of GDP growth of 3.4% for 2016 as a whole.

There was a shift in the main growth drivers in 2016. While domestic demand (both private consumption and gross fixed capital formation) was the main factor behind GDP growth in 2015, in 2016 economic growth was mostly export driven, and net exports made the largest contribution to GDP growth. Domestic factors played a mixed role: private consumption continued to make a positive contribution to GDP growth, but the contribution of gross fixed capital formation was negative. On the supply side, industry (in particular manufacturing) and business services (especially tourism and ICT services) contributed most to preserving the growth momentum. Gross manufacturing continued to expand steadily for the third consecutive year, while 2016 was a record year in terms of the number of tourists and tourism revenue (this reflecting both a one-off surge in Russian tourists in a period when Turkey was closed as a destination, and a continued rise in tourists from other countries). These were also the sectors that contributed most to the export expansion.

Real gross fixed capital formation actually fell year on year in 2016. The main reason for this was the underperformance of public investment programmes in 2016. This was mostly related to the delays in launching new public investment projects supported by the EU 2014-2020 Multiannual Financial Framework (MFF). While bureaucratic reshuffles at the EC did play a part, the main reason for the delays was the slow reorganisation of the local application procedures for funding under the 2014-2020 MFF. Mirroring the downturn in fixed investment, real gross construction output was deep in negative territory.

Export performance varied in the course of 2016, but taken as a whole it was a notable support to output performance. This was mostly thanks to exports to the EU, which grew steadily throughout the year. The EU-directed export expansion could be traced across the board (in terms of destinations and main commodity groups), and so it should be attributed to the general improvement in EU economic performance. Exports to non-EU markets were uneven, but after a weak start in the first months of the year they also resumed robust growth in the second half of 2016.

The labour market also continued recovering in 2016: the number of those employed rose for the fourth consecutive year, while the rate of unemployment dropped to levels not seen since 2009. The tightening of the labour market was matched by a surge in real wages, which continued to rise at a pace exceeding productivity growth. In turn, rising real wages and growing consumer confidence were among the factors that propped up private consumption. Real incomes received an additional boost from the lasting deflationary trends of the past three years.

So far, the seemingly disproportionate rise in real wages has not had any visible negative effects on international competitiveness: in current euro terms, exports of goods have been rising steadily (which was not the case for imports of goods), while the positive balance in the trade in services has actually been improving, thanks to the surge in exports of ICT services and steady tourist inflows. Exports of ICT services have grown strongly in recent years as Bulgaria has come to be recognised as one of the top European destinations for outsourcing.

The current account balance has been positive for the past four years. The level of the surplus in 2016 was surprisingly high, but it mirrors both the above-mentioned trends in the trade in goods and

services and the continuing gradual process of deleveraging by Bulgarian firms and banks. Transfers (both private and from the EU budget) have also stayed high over the past few years. While 2016 was probably an exceptional year in terms of tourism revenues, one could still expect these to remain at decent levels. Thus, a current account surplus is probably shaping up as a lasting feature of Bulgaria's economic performance. Gross external debt was little changed in absolute terms and continued to fall in relative terms.

There was also a modest improvement in domestic credit activity after several years of stagnation. With the dramatic fall in interest rates, the preferences of both firms and households notably shifted towards credit denominated in the local currency. Reflecting these changes, the stock of outstanding bank claims denominated in euro has been declining since 2014. By contrast, new deposits are almost evenly split between BGN and euro.

On the negative side, foreign direct investment (FDI) inflows were disappointing in 2016. It is now clear that there is no chance of a return to anything like the levels seen before the global financial crisis, when, for almost a decade, annual inward FDI flows exceeded 20% of GDP. The 'new normal' levels seem to be in the range of 3-4% of GDP per annum; moreover, no large-scale FDI projects are envisaged in the immediate future.

There was an improvement in public finances: for the first time since 2009, the consolidated general government balance reported a cash surplus in 2016. However, the cash surplus was largely a result of poor public investment performance, which (as noted above) fell far below the targets. Nominal public capital expenditure in 2016 dropped by 44% from the 2015 level, while public investment financed from EU funds was a mere 13% of the previous year's level. Overall, while nominal cash revenue in 2016 rose by 5.4% year on year, cash spending dropped by 1.8%. Understandably, the ESA fiscal balance will look different, as most cash savings from committed but deferred projects will still have to be reported as 2016 spending. Moreover, during its last month in office, the outgoing government decided to allocate a large chunk of the 2016 cash surplus to some extraordinary unforeseen spending items, such as a doubling of public financial resources earmarked to support the energy-efficiency renovation of apartment blocks. Still, given the good revenue performance, the ESA fiscal balance (which has not yet been published) probably also improved in 2016.

The 2017 fiscal year may be a transitory one, due to the current political uncertainties. While the outgoing government and parliament did adopt a public budget for the current year, if the new elections bring to power a government backed by a different parliamentary configuration, the new government may be tempted to revise the 2017 budget half-way through. However, the latest opinion polls suggest that parliament may be deeply split after the early elections; this may block both the formation of a new government and the adoption of a different fiscal programme.

By and large, we expect the present path of moderate GDP growth to continue in the short to medium term. The central forecast scenario for 2017 envisages EU-backed public investment programmes gradually being brought back on track, allowing for a reversal in public capital expenditure. Private consumption should also contribute positively to GDP growth in 2017 and in the following years. Strong export performance should continue on the expectation of an ongoing moderate upturn in the key EU markets, but a recovery in domestic demand and imports would lead to a reduction in the growth contribution of net exports. On the other hand, the lingering political uncertainties are not very conducive

to the business environment in the country, and this might lead to a slight deceleration in output growth in the current year. Overall, however, the GDP growth rates should remain in the range of 3% per annum in the coming three years. The continued tightening of the labour market and rising real wages suggest that inflationary pressures may reappear, reversing the prolonged deflationary trend. The current account can be expected to remain in positive territory, allowing a further reduction in the gross external debt.

Table 7 / Bulgaria: Selected economic indicators

	2012	2013	2014	2015	2016 ¹⁾	2017	2018	2019
						Forecast		
Population, th pers., average	7,306	7,265	7,224	7,178	7,150	7,100	7,050	7,000
Gross domestic product, BGN mn, nom.	82,040	82,166	83,634	88,571	92,196	95,300	99,200	104,000
annual change in % (real)	0.0	0.9	1.3	3.6	3.4	2.9	3.1	3.3
GDP/capita (EUR at PPP)	12,200	12,200	12,800	13,600	14,200	.	.	.
Consumption of households, BGN mn, nom.	53,346	50,660	51,963	54,831	55,700	.	.	.
annual change in % (real)	2.9	-2.5	2.7	4.3	1.5	2.0	2.5	2.5
Gross fixed capital form., BGN mn, nom.	17,443	17,365	17,653	18,612	17,600	.	.	.
annual change in % (real)	1.8	0.3	3.4	2.7	-2.2	2.0	4.0	5.0
Gross industrial production ²⁾								
annual change in % (real)	-0.3	-0.2	1.8	2.9	2.7	3.0	3.5	4.0
Gross agricultural production								
annual change in % (real)	-10.0	14.2	-0.6	-8.2	-1.2	.	.	.
Construction industry ³⁾								
annual change in % (real)	-0.8	-3.7	7.0	2.4	-10.0	.	.	.
Employed persons, LFS, th, average	2,934	2,935	2,981	3,032	3,017	3,020	3,020	3,020
annual change in %	-1.1	0.0	1.6	1.7	-0.5	0.0	0.0	0.0
Unemployed persons, LFS, th, average	410	436	385	305	247	230	210	190
Unemployment rate, LFS, in %, average	12.3	13.0	11.4	9.2	7.6	7.0	6.5	6.0
Reg. unemployment rate, in %, end of period	11.4	11.8	10.7	10.0	8.0	.	.	.
Average monthly gross wages, BGN	731.1	775.1	821.7	877.9	960.3	1,040	1,120	1,210
annual change in % (real, gross)	3.5	5.1	7.5	7.0	10.3	8.0	7.0	6.0
Consumer prices (HICP), % p.a.	2.4	0.4	-1.6	-1.1	-1.3	0.5	1.0	1.5
Producer prices in industry, % p.a.	4.4	-1.5	-1.2	-1.9	-3.1	0.0	0.5	1.0
General government budget, EU-def., % of GDP								
Revenues	34.1	37.1	36.6	39.0	37.0	37.5	38.0	38.0
Expenditures	34.5	37.6	42.1	40.7	38.0	38.0	38.0	38.0
Net lending (+) / net borrowing (-)	-0.3	-0.4	-5.5	-1.7	-1.0	-0.5	0.0	0.0
Public debt, EU-def., % of GDP	16.7	17.0	27.0	26.0	29.0	28.6	27.4	26.2
Stock of loans of non-fin.private sector, % p.a	2.8	0.0	-8.2	-1.6	1.0	.	.	.
Non-performing loans (NPL), in %, Dec	16.6	16.9	16.7	20.4	18.3	.	.	.
Central bank policy rate, % p.a., end of period ⁴⁾	0.03	0.02	0.02	0.01	0.00	0.0	0.0	0.0
Current account, EUR mn	-358	536	35	172	1,810	1,700	1,600	1,500
Current account in % of GDP	-0.9	1.3	0.1	0.4	3.8	3.5	3.2	2.8
Exports of goods, BOP, EUR mn	19,675	21,218	21,027	21,920	22,643	23,400	24,200	25,000
annual change in %	3.2	7.8	-0.9	4.2	3.3	3.3	3.4	3.3
Imports of goods, BOP, EUR mn	23,667	24,151	23,803	24,542	24,433	25,300	26,200	27,200
annual change in %	8.8	2.0	-1.4	3.1	-0.4	3.6	3.6	3.8
Exports of services, BOP, EUR mn	5,817	5,889	6,738	7,080	7,567	7,700	7,900	8,200
annual change in %	9.3	1.2	14.4	5.1	6.9	1.8	2.6	3.8
Imports of services, BOP, EUR mn	3,229	3,235	4,224	3,998	4,197	4,300	4,400	4,500
annual change in %	26.0	0.2	30.6	-5.4	5.0	2.5	2.3	2.3
FDI liabilities, EUR mn	1,383	1,509	1,539	1,661	1,088	.	.	.
FDI assets, EUR mn	315	266	657	65	545	.	.	.
Gross reserves of NB excl. gold, EUR mn	13,935	13,303	15,276	19,022	22,475	.	.	.
Gross external debt, EUR mn ⁵⁾	37,714	36,936	39,338	34,088	34,200	33,500	33,000	32,500
Gross external debt, % of GDP ⁵⁾	89.9	87.9	92.0	75.3	72.6	69.0	65.0	61.0
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) All enterprises in public sector, private 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.