

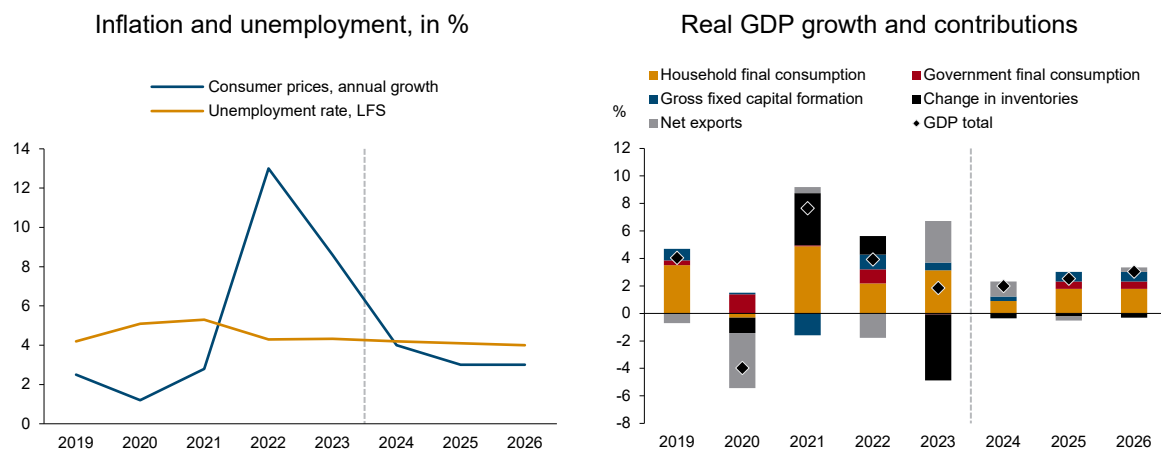


BULGARIA: Prospects not bright, with political stalemate and fresh snap elections

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Bulgarians are being summoned to the polls again in June, in the fifth snap election since 2021. Growth slowed in 2023 and weak performance has continued in the first months of 2024. Inflation has fallen back thanks to a downturn in the non-core component. GDP growth is expected to be around 2% in 2024 and should remain moderate in the coming years. It is anticipated that the external economic environment will remain unfavourable and that growth will predominantly be driven by domestic demand.

Figure 6.4 / Bulgaria: Main macroeconomic indicators



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

Bulgaria is heading for a fresh snap election just a year after the previous one. The flaky coalition (which called itself a ‘non-coalition’) that has been in power for the past nine months disintegrated just as the previously agreed rotation of the cabinet was about to take place. The divergent stances on many policy issues, as well as the bitter rivalries among the governing parties, made it impossible for them to continue under the previous scheme. The snap election is expected to be held on 9 June, coinciding with the elections to the European parliament.

This will be the fifth snap election since 2021. The situation – which is a result of recurrent fragmented parliaments – reflects, on the one hand, the deep political divide within society and, on the other, society’s inability to generate a political constellation capable of leading it out of the protracted crisis. Regrettably, the new snap election will most likely have a similar outcome. At the same time, the caretaker government that will be in office until the polls does not have the power to shape a new policy course.

The policy stance of the outgoing government was dominated by populist moves and a lack of clear direction, reflecting the heterogeneity of the ruling coalition. In fact, it was just a continuation of the lasting political and policy stalemate that has prevailed in Bulgaria since 2021. Among the most visible repercussions of this persistent mayhem have been the failure of Bulgaria's attempts to join the euro area and, more recently, the critical delay in agreeing a Recovery and Resilience Plan with the European Commission. On the domestic front, the governance limbo has led to a chronic weakening of the country's fiscal position, with long-lasting negative implications.

Last year was marked by a sharp economic slowdown. GDP grew by just 1.8%, down 2.1 percentage points on the previous year. Industry sank into deep recession, reflecting the worse external environment and unfavourable price conditions. Electricity production dropped by more than 20%, as local producers suffered a loss of competitiveness against the background of a plunge in international energy prices. The export of goods dropped off considerably both in nominal and in real terms, mirroring the weakening in the major EU markets.

In statistical terms, all the major components of final demand made a positive contribution to GDP growth. Household consumption continued to grow in 2023, bolstered by the continued rise in real wages and a surge in consumer credit. There was a turnaround in gross fixed capital formation, after a decline in both 2021 and 2022. Despite a fall in real exports, net exports of goods and services contributed positively to GDP growth, thanks to the larger drop in real imports. However, a reduction of inventories made a significant negative contribution to GDP growth, as companies dumped the large stockpiles accumulated over the previous two years.

Disinflation prevailed throughout 2023, but average annual growth in consumer price inflation remained high at 8.6%, due to carryover effects from the previous year. The external factors that had been driving non-core inflation (high international energy and food prices) have gradually subsided, and this effect is reflected in the recent dynamics of CPI. The remaining pro-inflationary factors are mostly of a domestic nature: chronic disproportionate growth in incomes and the resulting demand push.

There were divergent trends on the financial markets. While lending to the corporate sector slowed in 2023 as economic activity weakened, lending to households (both consumer credit and house-purchase loans) accelerated. This latter trend, together with rising real incomes, was one of the factors behind the sharp growth in private consumption and was a source of pro-inflationary pressure. Recently the Bulgarian National Bank took some soft policy steps (such as the recommendations for tightening credit screening) designed to cool the credit expansion.

The labour market tightened further in 2023, and the shortages of manpower in some sectors have intensified. The labour force in Bulgaria continued to shrink – a lasting trend mirroring the population ageing. This has resulted in chronic labour shortages and upward pressure on wages. In 2023, wages kept growing faster than labour productivity, with real wages rising by 3.9%. The unemployment rate remained unchanged from 2022, at 4.3%.

The 2024 budget epitomises the current policy impasse. While lavishly expansionary in terms of spending, it is unrealistically optimistic on the revenue side. Thus, the first months of 2024 indicated that some important revenue items (such as VAT) were significantly off target. On the other hand, the budget incorporates a commitment to a considerable rise in some expenditure items, in particular social

spending. The likely outcome will be a deficit well above the 3% cash target. During a recent visit, an International Monetary Fund (IMF) review team for the first time criticised the rudimentary and simplistic flat tax in Bulgaria (initially introduced in the country in 1997 on the insistence of the IMF), referring to it as outdated and not relevant to the current socioeconomic conditions in the country. However, so far there has not been any debate on possible changes to the system of taxation.

The further delays in the European Commission's approval of the national Recovery and Resilience Plan – inevitable, given the political crisis – will also have fiscal repercussions. The 2024 budget has factored in spending items that are conditional on the Commission's transfers under the Plan. However, in the current situation, it is unlikely that these transfers will materialise in 2024 (so far, Bulgaria has received only a first advance payment under the Plan, back in 2022). The upshot will be that some investment projects contained in the 2024 budget will have to be cancelled or deferred.

The slowdown has continued in the first months of 2024. The downturn in manufacturing deepened in line with the ongoing decline in exports to key EU markets and unfavourable price conditions. The continuing slump in many industries has led to a weakening in labour demand, including in those sectors facing acute labour shortages, such as information and communications technology. There have also been signs of a moderation in lending, as credit conditions become less attractive. Retail sales have also slowed. Recent business confidence indicators offer no hint of optimism in the short run.

Overall, GDP growth is expected to be moderate in 2024, at around 2%. Growth will remain predominantly driven by domestic demand, but the growth push from personal consumption is likely to weaken in view of the expected tightening of credit. The prospects for public fixed investment will depend partly on the implementation of projects under the Recovery and Resilience Plan – something that remains in question. The external economic environment is expected to remain unfavourable for Bulgarian manufacturers. Moreover, given the anticipated low external demand, real exports of goods could decline further in 2024, repeating the 2023 pattern.

Consumer inflation should decelerate further, to some 4% in 2024. This will mainly be a result of changing macroeconomic fundamentals, rather than deliberate policy actions: such a development is consistent with the ongoing decline in producer prices and the almost certain relaxation of the situation on the labour market.

Developments over the coming two years are expected to follow a similar pattern. The political situation will probably remain shaky, and policy will continue to lack clear direction. The chances of more favourable economic performance will depend on the external environment improving.

Table 6.4 / Bulgaria: Selected economic indicators

	2020	2021	2022	2023 ¹⁾	2024	2025	2026
					Forecast		
Population, th pers., average ²⁾	6,934	6,878	6,643	6,400	6,350	6,300	6,250
Gross domestic product, BGN m, nom.	120,492	138,979	167,809	183,743	194,900	205,800	218,400
annual change in % (real)	-4.0	7.7	3.9	1.8	2.0	2.5	3.0
GDP/capita (EUR at PPP)	16,440	18,540	22,020	24,060	.	.	.
Consumption of households, BGN m, nom.	69,748	80,213	96,703	109,068	.	.	.
annual change in % (real)	-0.5	8.4	3.8	5.4	1.5	3.0	3.0
Gross fixed capital form., BGN m, nom.	22,981	22,720	28,627	31,796	.	.	.
annual change in % (real)	0.6	-8.3	6.5	3.3	2.0	4.0	4.0
Gross industrial production ³⁾							
annual change in % (real)	-5.9	9.8	12.7	-8.3	1.0	2.0	3.0
Gross agricultural production							
annual change in % (real)	-11.1	18.7	-8.2	-4.8	.	.	.
Construction industry ⁴⁾							
annual change in % (real)	-5.4	2.7	0.5	-1.4	.	.	.
Employed persons, LFS, th, average ⁵⁾	3,122	3,077	3,151	2,932	2,950	2,960	2,970
annual change in %	-3.4	-0.6	2.4	-0.3	0.5	0.5	0.5
Unemployed persons, LFS, th, average ⁵⁾	169	171	140	132	130	130	120
Unemployment rate, LFS, in %, average ⁵⁾	5.1	5.3	4.3	4.3	4.2	4.1	4.0
Reg. unemployment rate, in %, eop ⁵⁾	6.7	4.8	4.7	5.6	.	.	.
Average monthly gross wages, BGN	1,391	1,561	1,770	2,012	2,160	2,310	2,470
annual change in % (real, gross)	7.9	8.7	-1.7	3.9	3.0	4.0	4.0
Consumer prices (HICP), % p.a.	1.2	2.8	13.0	8.6	4.0	3.0	3.0
Producer prices in industry, % p.a.	-1.9	15.9	40.1	-10.6	-2.0	2.0	3.0
General governm. budget, EU def., % of GDP							
Revenues	37.7	37.7	38.5	38.0	38.0	38.0	38.0
Expenditures	41.5	41.7	41.4	41.0	42.0	41.0	41.0
Net lending (+) / net borrowing (-)	-3.8	-4.0	-2.9	-3.0	-4.0	-3.0	-3.0
General gov. gross debt, EU def., % of GDP	24.6	23.9	22.6	22.5	24.0	25.0	26.0
Stock of loans of non-fin. private sector, % p.a.	4.5	8.3	12.2	11.1	.	.	.
Non-performing loans (NPL), in %, eop	7.5	6.0	4.6	3.6	.	.	.
Central bank policy rate, % p.a., eop ⁶⁾	0.00	0.00	1.30	3.80	3.5	3.0	2.5
Current account, EUR m	24	-1,225	-1,200	-251	-200	-600	-1,000
Current account in % of GDP	0.0	-1.7	-1.4	-0.3	-0.2	-0.6	-0.9
Exports of goods, BOP, EUR m	27,272	34,405	47,146	43,335	43,500	44,000	45,000
annual change in %	-6.3	26.2	37.0	-8.1	0.4	1.1	2.3
Imports of goods, BOP, EUR m	29,213	37,292	52,220	46,963	46,000	47,000	48,000
annual change in %	-8.8	27.7	40.0	-10.1	-2.1	2.2	2.1
Exports of services, BOP, EUR m	7,320	9,231	12,223	14,109	13,200	13,500	14,000
annual change in %	-28.5	26.1	32.4	15.4	-6.4	2.3	3.7
Imports of services, BOP, EUR m	4,171	5,041	6,973	7,420	7,400	7,600	8,000
annual change in %	-21.9	20.8	38.3	6.4	-0.3	2.7	5.3
FDI liabilities, EUR m	3,154	2,029	3,131	4,083	.	.	.
FDI assets, EUR m	395	781	1,032	1,017	.	.	.
Gross reserves of CB excl. gold, EUR m	28,830	32,490	36,198	39,480	.	.	.
Gross external debt, EUR m	38,991	41,317	44,249	45,414	46000	47000	48000
Gross external debt, % of GDP	63.3	58.1	51.6	48.3	46.0	45.0	43.0
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

Note: Introduction of new index 2021=100 (new weights) for gross industrial production, construction and producer prices in industry.

1) Preliminary and wiiw estimates. - 2) From 2022 according to census 2021. - 3) Enterprises with 10 and more employees. - 4) Enterprises with 5 and more employees. - 5) From 2023 according to census 2021. From 2021 new LFS methodology in line with the Integrated European Social Statistics Regulation (IESS). - 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.