

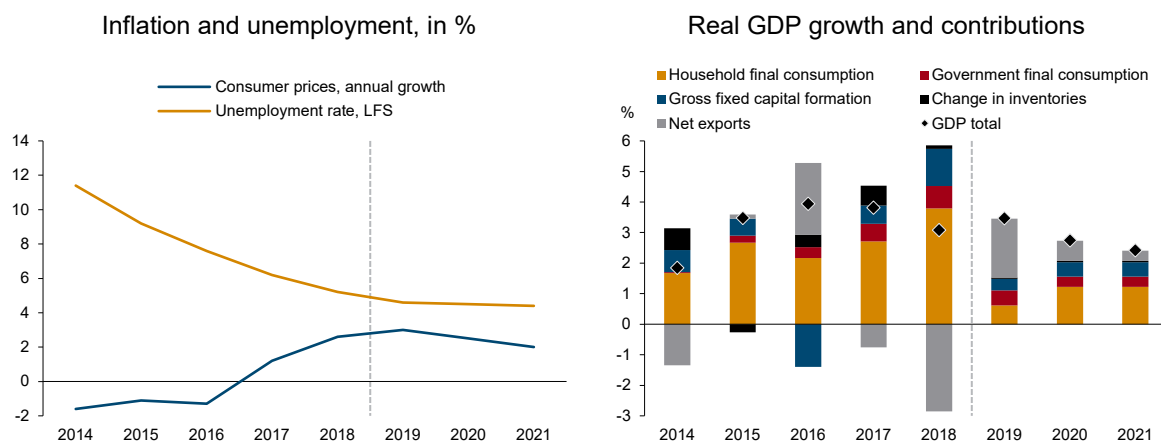


BULGARIA: Uneven growth signalling a slowdown

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After a strong first quarter, GDP growth slowed down reflecting a worsening domestic and external environment. Cost-push inflationary pressures were partly offset by the weaker domestic demand and inflation stopped rising. Domestic and external demand are expected to weaken further and this will be coupled with continued labour shortages. The rate of GDP growth for 2019 as a whole will still be decent, at some 3.5%, but it is expected to slow down in the following years.

Figure 5.4 / Bulgaria: Main macroeconomic indicators



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

The unexpectedly strong economic upturn in the first quarter when GDP grew by 4.8% was not sustained in the course of the year. GDP growth moderated to 3.7% year on year in the second quarter and recent business statistics suggest an even more pronounced slowdown in the summer months.

Uneven export performance was one of the main factors behind both the upturn in the first quarter and the moderation that followed. In current euro terms, the exports of goods in the summer months almost came to a standstill while the exports of services went into the red partly due to weaker tourism revenues. After the first quarter, exports to all major destinations, both EU and non-EU countries, were slowing down in parallel with the global economic slowdown. Mirroring these dynamics, manufacturing activity weakened considerably in the summer months. Recent business sentiment surveys suggest a trend of further worsening of expectations in industry. If this slowdown continues, manufacturing performance for the year as a whole may turn out to be the worst since 2013.

Domestic demand was also losing steam in the course of the year. After decent year on year growth in the first trimester, both private consumption and gross fixed capital formation stalled in the second quarter. In fact, domestic absorption made a negative contribution to GDP growth in the second trimester. Paradoxically, in statistical terms, despite the worsening export performance, net exports made the biggest contribution to GDP growth in the first half of the year but this was due to the negative year on year growth of real imports of goods and services in this period.

Such dynamics of trade flows led to a sharp contraction in the merchandise trade deficit and a parallel surge in the current account surplus. This surplus has been growing rapidly since 2016 and current expectations are that the year 2019 will end with the highest surplus on record. This development, which indicates that the country has become a net lender to the rest of the world, cannot be considered as favourable for an emerging economy such as Bulgaria.

As noted, investment activity was losing steam in the course of the year. One of the factors behind this was the uneven pace of implementation of EU-supported public investment projects. As evident in the dynamics of engineering construction in 2019, real business investment also subsided, reflecting worsening expectations by the business sector. Only housing construction recorded positive growth backed by still strong mortgage lending.

Bank lending was also moderating on a par with business activity. The year on year growth of the stock of outstanding credit to non-financial corporations fell from 5.8% in January to 3.3% in August. The corresponding growth numbers for the stock of household credit were 10.8% and 8.8% respectively.

There was further improvement in the quality of assets in the banking system. During the past several years Bulgarian commercial banks were actively engaged in the cleaning up of their balance sheets from substandard and non-performing loans, in the first place, to households. They did that by selling such assets (at largely discounted prices) to debt collection companies. This became possible after several large foreign debt collection companies entered the Bulgarian market. Thus during the year 2018 alone, Bulgarian banks sold some BGN 1.5 billion of substandard and non-performing loans to such debt collection companies. Accordingly, by June 2019 the share of non-performing loans in the total loan portfolio of Bulgarian commercial banks fell to 7.2%, compared to 14.5% in 2015.

The labour market remained very tight with persistent labour shortages both for high skilled and low skilled labour. Hiring rose in the first half of the year mostly thanks to the economic upturn in the first quarter. The number of employed in the second quarter of 2019 was up by 2.5% (106000 persons) from a year earlier. The rate of unemployment (both LFS and registered) fell to historically low levels and so did the employment rate which reached 75.7% for the age group from 20 to 64 years. Mirroring the tight labour market, wage pressures intensified and average real wages rose by 8.5% in the first half of the year. However, these processes are likely to subside in the short run in line with the expected further economic slowdown.

Cost-push inflationary pressures were partly offset by the weaker domestic demand in 2019. After a period of deflation between 2014 and 2016, CPI had been accelerating since the beginning of 2017. However, this process likely came to an end around March 2019 and since that time inflation had been gradually subsiding in average annual terms. For the year as a whole, the rise in the HICP should not surpass the 3% level.

Bulgaria's fiscal position remains strong but the final outcome in 2019 will be affected by a big one-off fiscal outlay. In June, the government concluded a long negotiated BGN 2.1 billion deal for the delivery of eight F-16 fighter jets. The prolonged public tender for this deal was marred by recurrent corruption allegations due to changes in the tender conditions during the process which, it was claimed, pre-determined the winner. Apart from the fact that the final delivery price was considerably higher than the preannounced ceiling, the final deal implied full advance payment of the delivery, something that was also precluded in the initial tender conditions. To implement the deal, the government passed a budget amendment increasing the cash deficit for the year by BNG 1.83 billion. Therefore we now expect a deterioration of the fiscal balance for the year by some 2 percentage points from what was envisaged earlier.

Despite an earlier announced firm intention by the government to apply for participation in ERM II in July of this year, this did not happen in reality. No explanation was given for abandoning this plan and actually in recent months the authorities kept silent on the topic. One could just speculate that the main reason is grounded in the current conditions specified in the EU legal framework, namely the requirement that Bulgaria simultaneously joins ERM II and the Banking Union. In relation to the latter, the ECB recently conducted an asset quality review complemented by a stress test exercise in six large Bulgarian banks. The results of this review are probably key for ECB's judgment on whether Bulgaria can join the EU Banking Union under the Close Co-operation Mechanism. So far the ECB has not announced its overall conclusions regarding Bulgaria's membership in the Banking Union but according to a press release published in July, the asset quality review found capital shortages in two of the surveyed banks.

The political situation in the country was marked by rising tensions in the ruling centre-right coalition. A series of social protests by different interest groups added to these tensions. The most serious test for the government in 2019 will be the local elections scheduled for 27 October which may bring about some reshuffling in the country's political balance.

In the current circumstances it can be expected that the slowdown of the Bulgarian economy will continue. There are no signs of reversal in the dynamics of the waning domestic demand which is coupled with an ongoing weakening in the Euro Area. However, thanks to the relatively high rate of GDP growth in the first half of the year, the rate of GDP growth for 2019 as a whole will still be decent, at some 3.5%. However, under the assumptions of a further weakening of domestic and external demand and continued labour shortages, the slowdown is likely to continue in the following years. Thus GDP growth in 2020 and 2021 is likely to slow down to below 3.0%. Unless there is a policy shift towards the support of domestic demand, such economic dynamics will continue to generate large current account surpluses. There are no imminent threats to macroeconomic stability.

Table 5.4 / Bulgaria: Selected economic indicators

	2015	2016	2017	2018 ¹⁾	2018 January-June	2019	2019 Forecast	2020 Forecast	2021
Population, th pers., average	7,178	7,128	7,076	7,025	.	.	6,950	6,900	6,850
Gross domestic product, BGN mn, nom.	88,575	94,130	101,043	107,925	48,291	53,763	115,000	121,100	126,500
annual change in % (real)	3.5	3.9	3.8	3.1	3.4	4.2	3.5	2.7	2.4
GDP/capita (EUR at PPP)	13,700	14,200	14,800	15,500	.	.	.	.	.
Consumption of households, BGN mn, nom.	54,831	56,715	60,694	66,179	31,146	32,066	.	.	.
annual change in % (real)	4.3	3.5	4.5	6.3	7.9	1.4	1.0	2.0	2.0
Gross fixed capital form., BGN mn, nom.	18,612	17,484	18,717	20,549	9,382	9,619	.	.	.
annual change in % (real)	2.7	-6.6	3.2	6.5	8.5	1.0	2.0	2.5	2.5
Gross industrial production ²⁾									
annual change in % (real)	2.9	2.7	3.4	1.1	1.6	1.7	0.5	1.0	1.0
Gross agricultural production									
annual change in % (real)	-8.2	1.7	6.3	-3.1	.	.	.	.	.
Construction industry ³⁾									
annual change in % (real)	11.1	-16.7	4.6	1.6	3.1	4.0	.	.	.
Employed persons, LFS, th, average	3,032	3,017	3,150	3,153	3,128	3,205	3,190	3,200	3,210
annual change in %	1.7	-0.5	4.4	0.1	0.8	2.5	1.2	0.2	0.2
Unemployed persons, LFS, th, average	305	247	207	173	185	154	150	150	150
Unemployment rate, LFS, in %, average	9.2	7.6	6.2	5.2	5.6	4.6	4.6	4.5	4.4
Reg. unemployment rate, in %, eop	10.0	8.0	7.1	6.1	5.7	5.2	.	.	.
Average monthly gross wages, BGN	878	948	1,037	1,135	1,101	1,234	1,260	1,360	1,450
annual change in % (real, gross)	7.0	8.9	7.2	6.4	5.2	8.5	8.0	5.0	4.5
Consumer prices (HICP), % p.a.	-1.1	-1.3	1.2	2.6	2.0	2.6	3.0	2.5	2.0
Producer prices in industry, % p.a.	-2.2	-3.1	5.0	3.9	4.1	3.0	3.0	2.5	2.0
General governm.budget, EU-def., % of GDP									
Revenues	38.8	35.2	36.2	36.8	.	.	37.5	37.0	37.0
Expenditures	40.5	35.1	35.0	34.8	.	.	39.0	37.0	37.0
Net lending (+) / net borrowing (-)	-1.7	0.1	1.2	2.0	.	.	-1.5	0.0	0.0
General gov.gross debt, EU def., % of GDP	26.2	29.6	25.6	22.6	.	.	23.5	22.5	21.5
Stock of loans of non-fin.private sector, % p.a.	-1.6	0.8	3.3	7.7	3.8	4.6	.	.	.
Non-performing loans (NPL), in %, eop	14.5	13.2	10.4	7.8	9.3	7.2	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	0.01	0.00	0.00	0.00	0.00	0.00	0.0	0.0	0.0
Current account, EUR mn	55	1,551	1,825	3,002	389	2,020	3,500	2,700	2,100
Current account in % of GDP	0.1	3.2	3.5	5.4	1.6	7.3	6.0	4.4	3.2
Exports of goods, BOP, EUR mn	21,920	23,104	26,951	27,745	13,171	13,849	28,500	29,200	30,000
annual change in %	4.2	5.4	16.6	2.9	2.1	5.1	2.7	2.5	2.7
Imports of goods, BOP, EUR mn	24,542	24,088	27,716	29,603	14,264	14,361	30,000	31,200	32,500
annual change in %	3.1	-1.8	15.1	6.8	7.0	0.7	1.3	4.0	4.2
Exports of services, BOP, EUR mn	7,316	8,050	8,256	9,133	3,673	3,869	8,600	8,800	9,000
annual change in %	7.8	10.0	2.6	10.6	3.0	5.3	-5.8	2.3	2.3
Imports of services, BOP, EUR mn	4,236	4,640	5,203	5,573	2,698	2,514	5,100	5,200	5,400
annual change in %	-0.2	9.5	12.1	7.1	9.7	-6.8	-8.5	2.0	3.8
FDI liabilities, EUR mn	1,956	1,313	1,760	1,057	321	468	1100	.	.
FDI assets, EUR mn	105	754	446	744	371	128	500	.	.
Gross reserves of NB excl. gold, EUR mn	19,022	22,475	22,257	23,620	22,114	23,578	.	.	.
Gross external debt, EUR mn ⁵⁾	33,855	34,655	34,211	33,156	34,288	33,989	34000	34500	35000
Gross external debt, % of GDP ⁵⁾	74.8	72.0	66.2	60.1	62.1	57.8	58.0	56.0	54.0
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary. - 2) Enterprises with 10 and more employees. - 3) 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.