

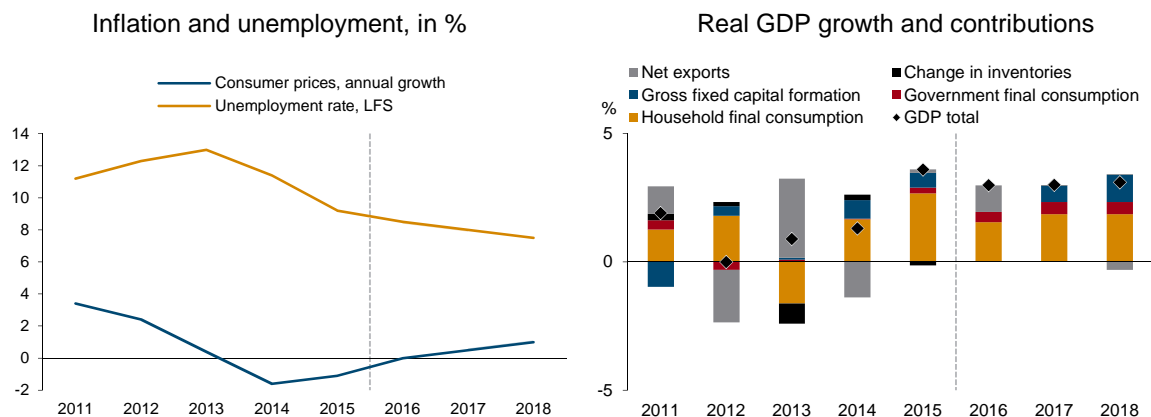


BULGARIA: Upturn in private consumption supports moderate growth

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GDP grew by 3.5% in the first half of 2016, at the same rate as in the previous year. Growth remained relatively balanced, with both private consumption and exports lending impetus. The continuing upturn contributed to a cyclical improvement in the fiscal position and a large headline surplus. Moderate GDP growth is likely to continue in the short term; it is projected to be around 3% per annum over the period 2016-2018.

Figure 26 / Bulgaria: Main macroeconomic indicators



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

GDP grew by 3.5% in the first half of 2016, replicating the growth performance in the previous year. The Bulgarian economy seems finally to have departed from the trap of subdued performance that characterised the period 2009-2014. While modest, the current rates of output growth likely reflect the own potential of the economy in the present circumstances of a weak external environment. GDP growth remained relatively balanced, reflecting an impetus from both domestic demand (primarily private consumption) and exports.

Aggregate output growth could have been higher had it not been for the slump in fixed investment: while the continuing recovery in private consumption provided a strong support to GDP growth, the contribution of gross fixed capital formation was negative. The main reason for the weakening in fixed investment was the drop in public capital expenditure due to delays in the launch of public investment projects under the new EU financial framework 2014-2020. In the period January-July total public capital

expenditure in nominal terms was just 44% of the expenditure in the same period of 2015; its share in total public expenditure dropped from 13.8% in January-July 2015 to 6.4% a year later. In the main, this reflects a plunge in the absorption of EU funds supporting public investment projects: in the first 7 months of 2016 Bulgaria reported a mere 14% of the funds absorbed in the same period of 2015.

Export activity also continued to provide support to GDP growth. According to national accounts data, real exports of goods and services grew by more than 4% year-on-year in the first half and net exports made a positive contribution to GDP growth. At the same time, both exports and imports of goods in current euros dropped year-on-year in the first half of 2016. Apart from the effect of the price dynamics (with some exporters experiencing falling prices in 2016), the contraction of the nominal trade flows is to some extent a statistical phenomenon due to an abnormally high base in the same period of 2015. In turn, the latter was due to some large but one-off sales of military weapons and equipment to non-EU countries effectuated in 2015. Due to the confidential nature of the deals, no details are publicly available but most likely producing the armaments also involved imports of intermediate goods. The inflated but atypical base prevents an accurate assessment of the underlying dynamics of the trade in goods in 2016.

The economic rebound has contributed to a cyclical improvement in the fiscal position: in the period January-July 2016, the total revenue of the consolidated general government was 8.0% higher in nominal terms than a year earlier. At the same time, the total expenditure of the consolidated general government actually dropped by 5.3% in nominal terms year-on-year, reflecting the fact that public capital expenditure was much below targets. As a result, the public sector has been reporting a large headline surplus. It is not likely that the government will manage to catch up on its delayed public investment projects in the remaining months of 2016 so the headline surplus will probably stay for the year as a whole. It can be expected that there will be a cyclical improvement in Bulgaria's fiscal position also in ESA95 terms, although it will not be so pronounced.

The situation in the labour market also continued its trend improvement: total employment has been growing by some 1.5% per annum since 2014 while the unemployment rate (both registered and LFS-measured) fell to some 8% in the summer of 2016. Bulgaria had not seen such low rates of unemployment since 2009. Labour shortages, especially for skilled workers, are being reported in more and more sectors. The tightening labour market has been putting upward pressure on wages and they continued their rise in real terms. Sooner or later rising wages and income and the ensuing strong consumer demand should give rise to inflationary pressures. There were signs of this happening in the first half of the year but later they were offset by the seasonal weakening of CPI in the summer when abundant produce contributed to a seasonal fall of food prices and added negatively into the average index.

Manufacturing, tourism and some business services added the most to GDP growth in the first half. By contrast, construction activity fell year-on-year and agricultural output was basically flat. The employment dynamics by sectors matched the dynamics of output: labour shortages are most acute in the ICT sector, in manufacturing as well as in the tourism industry.

There was also some revival in credit activity after several years of squeeze. A new development has been the recent switch in the preferences of corporate borrowers to BGN-denominated credit, which grew much faster than forex-denominated credit. The drop in lending rates in local currency (by some 2-3 percentage points year-on-year at mid-2016) must have contributed to this change in borrowing preferences.

Despite the recovery in domestic demand, the current account balance remained in the positive territory and a relatively large surplus can be expected for the year as a whole. The main reason for this was the substantial positive balance in services trade thanks to tourism and business services. The tourist industry benefited from the turmoil in neighbouring Turkey, diverting some flows of West European and Russian tourists in 2016, while the exports of business services (mostly ICT) have grown steadily in recent years as Bulgaria was recognised as an attractive destination for outsourcing. The continuing upturn in the exports of services has been a persisting trend and this may underpin a lasting switch of the Bulgarian economy towards a positive current account balance, at least as regards the near future.

As for policy, the cash fiscal surplus is becoming somewhat of a headache for the government. On the one hand, the public investment programme is far behind schedule, which is the source of the surplus. Most of the delay can be attributed to the slow preparation of new EU-funded projects which generates both domestic discontent and some tensions in the relations with the EC. On the other hand, the presence of a large and idle cash fiscal surplus is a source of bewilderment both for the cash-strapped public sectors and for the public at large and provokes new claims for unplanned public spending. Moreover, the government undertook in 2016 large precautionary borrowing targeted at future servicing of maturing public debt. These funds are also now 'frozen' in the fiscal reserve; some of them will probably not be used for the initial purpose in view of the availability of a cash surplus. So it remains to be seen how the government will tackle this issue in the remaining months of the current year. While some of the current cash fiscal surplus is of a cyclical nature, its persistence will likely prompt higher future public spending and hence some relaxation of the structural fiscal stance. This is noticeable already in the preliminary deliberations on the 2017 budget although no target figures have been announced yet.

One unanticipated spending item for the government will be the payment of EUR 550 million to Russian 'Atomstroyexport' (ACE) as per a judgment of the International Court of Arbitration for commissioned, but unpaid until now, equipment for the nuclear power project in Belene which was put on hold. The problem is aggravated additionally by the fact that the title holder of the liability is the National Electricity Company (NEC), which is a commercial company but is unable to raise the necessary cash. So the Bulgarian parliament recently adopted a special law for extending a special loan to NEC from public funds. However, it is not clear whether the European Commission will endorse such a loan as it may consider it as an implicit illegal subsidy.

Other unforeseen public spending may come from the growing influx of refugees and migrants. While these flows used to bypass the country, with the gradual closure of easier routes, migrants opt more and more often for Bulgaria as a transit path on their way to Europe, and some of them choose to stay in the country.

In the present circumstances, moderate growth may be expected to continue supported by both private consumption and exports. However, a possible further weakening of EU manufacturing may have a negative effect on Bulgarian exports in the second half of the year so the external impetus to growth may weaken in the short run. At the same time, public investment should start to pick up and will contribute to aggregate output growth. Hence current expectations are for GDP growing by close to 3% for 2016 as a whole. While domestic demand will likely continue to recover in 2017 and 2018, the prospects for GDP growth in this period will also depend on the external environment. If EU growth and import demand remain weak, it would be difficult for Bulgaria's economy to achieve rates of growth above the moderate range.

Table 9 / Bulgaria: Selected economic indicators

	2012	2013	2014	2015 ¹⁾	2015 January-June	2016	2016 2017 Forecast	2018	
Population, th pers., average	7,306	7,265	7,224	7,178	.	.	7,150	7,100	7,050
Gross domestic product, BGN mn, nom.	82,040	82,166	83,634	88,571	40,043	41,499	91,200	94,400	98,300
annual change in % (real)	0.0	0.9	1.3	3.6	3.5	3.5	3.0	3.0	3.1
GDP/capita (EUR at exchange rate)	5,700	5,800	5,900	6,300	.	.	6,500	6,800	7,100
GDP/capita (EUR at PPP)	12,200	12,300	12,800	13,600	.	.	.	.	.
Consumption of households, BGN mn, nom.	53,346	50,660	51,963	54,831	25,629	25,634	.	.	.
annual change in % (real)	2.9	-2.5	2.7	4.3	1.6	1.8	2.5	3.0	3.0
Gross fixed capital form., BGN mn, nom.	17,443	17,365	17,653	18,612	7,911	7,879	.	.	.
annual change in % (real)	1.8	0.3	3.4	2.7	-0.9	0.4	0.0	3.0	5.0
Gross industrial production ²⁾									
annual change in % (real)	-0.3	-0.2	1.8	2.9	3.3	2.0	2.5	3.0	3.5
Gross agricultural production									
annual change in % (real)	-10.0	14.2	-0.6	-10.2	.	.	.	.	.
Construction industry ³⁾									
annual change in % (real)	-0.8	-3.7	7.0	2.4	3.7	-9.6	.	.	.
Employed persons, LFS, th, average	2,934	2,935	2,981	3,032	2,981	3,004	3,080	3,130	3,180
annual change in %	-1.1	0.0	1.6	1.7	1.5	0.8	1.5	1.5	1.5
Unemployed persons, LFS, th, average	410	436	385	305	340	273	290	270	260
Unemployment rate, LFS, in %, average	12.3	13.0	11.4	9.2	10.3	8.3	8.5	8.0	7.5
Reg. unemployment rate, in %, end of period	11.4	11.8	10.7	10.0	9.6	8.4	.	.	.
Average monthly gross wages, BGN	731.1	775.1	821.7	893.7	869.2	934.0	940	980	1,020
annual change in % (real, gross)	3.5	5.1	7.5	8.9	7.7	8.8	5.0	4.0	3.0
Consumer prices (HICP), % p.a.	2.4	0.4	-1.6	-1.1	-1.2	-1.7	0.0	0.5	1.0
Producer prices in industry, % p.a.	4.4	-1.5	-1.2	-1.9	-0.6	-4.9	-4.0	0.0	1.0
General government budget, EU-def., % of GDP									
Revenues	34.2	37.2	36.6	37.2	.	.	37.5	37.0	37.0
Expenditures	34.5	37.6	42.1	39.2	.	.	38.5	38.0	37.5
Net lending (+) / net borrowing (-)	-0.3	-0.4	-5.4	-2.0	.	.	-1.0	-1.0	-0.5
Public debt, EU-def., % of GDP	16.7	17.0	27.0	26.0	.	.	27.7	27.7	27.1
Central bank policy rate, % p.a., end of period ⁴⁾	0.03	0.02	0.02	0.01	0.02	0.00	.	.	.
Current account, EUR mn	-358	536	35	172	-90	780	1,000	1,000	1,000
Current account in % of GDP	-0.9	1.3	0.1	0.4	-0.4	3.7	2.1	2.1	2.0
Exports of goods, BOP, EUR mn	19,675	21,218	21,027	21,920	10,960	10,582	22,000	22,500	23,000
annual change in %	3.2	7.8	-0.9	4.2	12.1	-3.4	0.4	2.3	2.2
Imports of goods, BOP, EUR mn	23,667	24,151	23,803	24,542	12,098	11,398	23,700	24,200	24,800
annual change in %	8.8	2.0	-1.4	3.1	7.1	-5.8	-3.4	2.1	2.5
Exports of services, BOP, EUR mn	5,817	5,889	6,738	7,080	1,898	3,165	7,200	7,350	7,500
annual change in %	9.3	1.2	14.4	5.1	9.8	66.7	1.7	2.1	2.0
Imports of services, BOP, EUR mn	3,229	3,235	4,224	3,998	1,898	2,075	4,000	4,100	4,200
annual change in %	26.0	0.2	30.6	-5.4	-1.0	9.3	0.1	2.5	2.4
FDI liabilities (inflow), EUR mn	1,383	1,509	1,539	1,661	1,058	1,063	1,500	.	.
FDI assets (outflow), EUR mn	315	266	657	65	104	220	200	.	.
Gross reserves of NB excl. gold, EUR mn	13,935	13,303	15,276	19,022	17,866	20,910	.	.	.
Gross external debt, EUR mn ⁵⁾	37,714	36,936	39,356	34,091	35,591	34,891	34,200	33,500	33,000
Gross external debt, % of GDP ⁵⁾	89.9	87.9	92.0	75.3	78.6	74.8	73.0	69.0	66.0
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	0.9167	0.9224	0.9039	0.9017	.	.	.	.	.

1) Preliminary. - 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.