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Bulgaria: Economic stalemate continues

GDP in Bulgaria grew only marginally in 2012, failing to produce a noticeable mark on the weak economic trajectory of the latest years. A short-lived recovery in private consumption during spring and summer could not be sustained and the deteriorating external environment in the closing months of the year brought renewed concerns of a possible new downturn. The policy stance seems frozen in expectation of the general elections in mid-2013. There is little chance of change in this constellation in the short run, at least until the elections, and the economic growth is likely to remain unimpressive.

The year 2012 did not bring an end to the period of weak economic performance which has marked Bulgaria's economy since the start of the global economic and financial turmoil. According to the latest estimates and projections, Bulgaria's GDP in 2012 is expected to have grown by less than 1%. All indications are that economic sluggishness is likely to stay in Bulgaria for some time to come, in line with our previous forecasts.

According to preliminary non-seasonally adjusted quarterly national accounts data, GDP grew by 0.9% year-on-year during the first three quarters of 2012. If anything, preliminary current statistics on the fourth quarter suggest that growth may have slowed further, if not turning negative. The dynamics of monthly industrial output is a clear early warning signal in this respect: year-on-year indices slipped into the red starting in September. While still in the positive territory, merchandise exports also slowed down in this period.

A gradual weakening of aggregate final domestic demand contributed significantly to the lacklustre economic performance in the second half of the year. Real private consumption, which had shown signs of a modest recovery in the second quarter, lost even this humble momentum in the third quarter. Monthly indices of real retail sales turned negative year-on-year starting in September. A modest recovery in gross fixed capital formation (boosted by an upturn in engineering construction) was by far not sufficient to offset the negative impact of flagging private consumption on final domestic demand.

The weak performance of the largest EU economies (Bulgaria's main markets) was probably the most important among the external factors shaping Bulgaria's economic environment. Thus during the first eleven months of 2012 merchandise exports to the EU dropped (in current value terms) by some 3% year-on-year. By contrast, exports to third countries were much more vibrant: in the same period, they grew in value by 13% year-on-year. Notably, exports to China more than doubled in 2012 and China overtook Russia as Bulgaria's eighth largest export destination. Exports to Turkey (Bulgaria's largest third country market) also grew robustly, by 13.6% year-on-year.

In the absence of new economic impetus, the situation in the labour market continued to deteriorate. In the third quarter of 2012, the number of unemployed (LFS measure) was 13.5% higher than in the same quarter of 2011 and the unemployment rate rose by 1.3 percentage points from an year earlier, to 11.5%. The average rate of unemployment for 2012 as a whole is expected to be above 12% and by this measure Bulgaria is in the range of high-unemployment EU member states.

There was a modest revival in banks' credit activity in the business sector while the net withdrawal of credit to households continued. At the same time, there are signs that the process of deterioration in the quality of banks' portfolios is probably coming to an end, with no further rise in the share of substandard loans in the latest months. This was probably one of the factors for the banks' renewed appetite for corporate lending. Another factor was the gradual waning of the net outflow of funds from the banking sector (including the net withdrawal of funds by parent banks from their Bulgarian branches). While the balance is still negative, in 2012 it was considerably lower than what was observed in the period 2009-2011.

A new development in 2012 – reversing years of change in the opposite direction – was a process of some 'de-dollarization' of credit: the rise in net bank credit to the corporate sector was mostly due to new credit extended in domestic currency. This partly reflects the changing composition of banks' portfolios, mirroring the ongoing, albeit diminishing, net outflow of funds borrowed on international markets.

On 15 January 2013, Bulgaria retired EUR 879.85 million of matured foreign debt, the last remaining chunk of a 2002 Eurobonds emission. In anticipation of this repayment, the Bulgarian government issued in July 2012 new five-year benchmark Eurobonds worth EUR 950 million with a 4.25% annual coupon. The receipts from the 2012 emission were temporarily parked in the fiscal reserve and then the fiscal reserve was debited to make the January 2013 repayment. What concerns other pending foreign obligations, the next

repayment is due in 2015 when Bulgaria is to pay USD 1,086 million on another 2002 Eurobonds emission.

During the mandate of the GERB¹ government, the attitude of the Bulgarian authorities towards EMU accession underwent several swings. Back in 2009, the declared policy objective of the government was fast-track entry to ERM-2 and it was declared among the key national policy priorities. With the escalation of the euro debt crisis, accession to ERM-2 was gradually abandoned as an immediate policy goal. In that period there were public pronouncements that the authorities would put on hold the objective of EMU accession until the debt crisis in the euro area has been settled and even that the country would not seek membership in the euro area in its current state. In more recent pronouncements the authorities have softened this stance but nevertheless no concrete new plans and entry target dates have been announced.

The fiscal outturn for 2012 is likely to be better both than that in 2011 and compared to the target in the 2012 budget. The main factors for this outturn were higher than envisaged VAT revenue (largely thanks to the modest recovery of private consumption and related imports) and an ongoing restraint on selected items of public spending, especially public investment funded from national sources. As argued on previous occasions, this fiscal policy stance – which has been in place during the four years of ruling by the current government – has probably produced an unnecessary and lasting growth sacrifice for the economy, contributing at the same time to the worsening of the situation in the labour market.

Ironically, the 2013 budget was adopted with very little, if any, public and policy debate during the process. This apathy was probably related to the upcoming in mid-2013 general elections, with none of the major political actors willing to open a comprehensive debate on potentially controversial issues. Besides, the arguments against GERB's fiscal policy stance have been raised time and again during their term in office, but the government kept acting unilaterally, never showing interest in entering into such debates.

As a result, the 2013 budget largely follows the spirit and structure of that of previous years. Its macroeconomic framework envisages GDP growth of 1.9% in 2013, which may be rather optimistic, and a deficit of 1.3% of GDP, the same as in the 2012 budget. However, counter to the traditional conservative fiscal planning approach in Bulgaria, the

¹ GERB is the Bulgarian acronym for the name of the governing party: 'Citizens for European Development in Bulgaria'.

2013 budget incorporates a very optimistic projection of public revenue which is more than 10% higher in nominal terms than the expected outturn in 2012.

There are only a few new structural elements that are part of the 2013 budget and which entered into force on 1 January 2013. Among them are the following:

- For the first time Bulgaria introduced a tax (equal to the 10% flat rate) on interest earned on bank deposits (except current accounts).
- The minimum monthly wage was raised from BGN 290 (EUR 148) to BGN 310 (EUR 158). The practical importance of this change is related to the fact that a number of other regulatory parameters are chain-linked to the minimum wage.
- The retirement age was increased by 4 more months, reaching 60 years and 8 months for women and 63 years and 8 months for men (with the objective to gradually reach 63 years for women and 65 years for men by 2020). Retirement conditions for those serving in the military were further tightened.

At the time of writing this report there was no change in the expectation for economic activity in Bulgaria to remain sluggish in the short run. It is not unlikely that some populist moves during the pre-election period might provide a temporary boost to private consumption. On the other hand, as regards the external environment, it is likely to remain a drag on economic activity. So on balance, GDP growth in 2013 is expected to remain anaemic, around or little higher than that seen in 2012.

The external environment will remain a major determinant of economic performance in Bulgaria as regards the period thereafter as well. However, much will also depend on the outcomes of the 2013 general elections, in particular, on whether the new government would be willing to consider options of a more growth-oriented and supportive policy stance.

Table BG

Bulgaria: Selected Economic Indicators

	2008	2009	2010	2011	2012 ¹⁾	2013	2014 Forecast	2015
Population, th pers., average ²⁾	7623.4	7585.1	7534.3	7348.3	7330.0	7300	7270	7250
Gross domestic product, BGN mn, nom.	69295	68322	70511	75265	77600	80700	84600	89400
annual change in % (real)	6.2	-5.5	0.4	1.7	0.7	1.0	1.8	2.6
GDP/capita (EUR at exchange rate)	4600	4600	4800	5200	5400	5700	5900	6300
GDP/capita (EUR at PPP)	10900	10300	10700	11600	11900	.	.	.
Consumption of households, BGN mn, nom.	45766	42942	43990	45386	48300	.	.	.
annual change in % (real)	3.4	-7.6	0.0	-0.6	4.0	3.0	3.0	4.0
Gross fixed capital form., BGN mn, nom.	23283	19724	16077	15743	16200	.	.	.
annual change in % (real)	21.9	-17.6	-18.3	-9.7	0.0	3.0	5.0	6.0
Gross industrial production ³⁾								
annual change in % (real)	0.6	-17.4	1.1	5.8	-0.9	2.0	4.0	5.0
Gross agricultural production (EAA)								
annual change in % (real)	33.0	-1.6	-6.0	-2.5	-9.0	.	.	.
Construction industry ⁴⁾								
annual change in % (real)	12.2	-14.4	-14.5	-12.9	-0.8	.	.	.
Employed persons, LFS, th, average ⁵⁾	3360.7	3253.6	3052.8	2949.6	2940.0	2950	2980	3010
annual change in %	3.3	-3.2	-6.2	-3.4	-0.8	0.5	1.0	1.0
Unemployed persons, LFS, th, average ⁵⁾	199.7	238.0	348.0	372.3	410.0	383	368	353
Unemployment rate, LFS, in %, average ⁵⁾	5.6	6.8	10.2	11.2	12.3	11.5	11.0	10.5
Reg. unemployment rate, in %, end of period ⁵⁾	6.3	9.1	9.2	10.4	11.4	.	.	.
Average gross monthly wages, BGN	544.8	609.1	648.1	706.5	750.0	.	.	.
annual change in % (real, gross)	12.6	8.8	3.9	4.6	3.1	.	.	.
Consumer prices (HICP), % p.a.	12.0	2.5	3.0	3.4	2.4	3.0	3.0	3.0
Producer prices in industry, % p.a.	10.9	-6.5	8.6	9.4	4.4	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	40.1	37.1	34.3	33.6	34.3	.	.	.
Expenditures	38.4	41.4	37.4	35.6	35.3	.	.	.
Net lending (+) / net borrowing (-)	1.7	-4.3	-3.1	-2.0	-1.0	-1.5	-1.5	-2.0
Public debt, EU-def., % of GDP	13.7	14.6	16.2	16.3	17.0	18.0	18.0	19.0
Central bank policy rate, % p.a., end of period ⁶⁾	5.77	0.55	0.18	0.22	0.03	.	.	.
Current account, EUR mn	-8182	-3116	-534	104	-268	-900	-1100	-1300
Current account, % of GDP	-23.1	-8.9	-1.5	0.3	-0.7	-2.2	-2.5	-2.8
Exports of goods, BOP, EUR mn	15203	11699	15562	20265	20792	21600	22500	23800
annual growth rate in %	12.5	-23.0	33.0	30.2	2.6	3.9	4.2	5.8
Imports of goods, BOP, EUR mn	23802	15874	18326	22421	24386	25500	26700	28300
annual growth rate in %	14.7	-33.3	15.4	22.3	8.8	4.6	4.7	6.0
Exports of services, BOP, EUR mn	5355	4916	5012	5348	5671	6000	6300	6600
annual growth rate in %	12.5	-8.2	2.0	6.7	6.0	5.8	5.0	4.8
Imports of services, BOP, EUR mn	4045	3617	3143	3033	3146	3300	3450	3600
annual growth rate in %	12.8	-10.6	-13.1	-3.5	3.7	4.9	4.5	4.3
FDI inflow, EUR mn	6728	2438	1152	1746	1398	2000	2200	2300
FDI outflow, EUR mn	522	-68	174	169	169	.	.	.
Gross reserves of NB excl. gold, EUR mn	11928	11943	11612	11788	13935	.	.	.
Gross external debt, EUR mn	37246	37816	37026	35845	38400	.	.	.
Gross external debt, % of GDP	105.1	108.3	102.7	93.1	96.8	.	.	.
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.956	1.956	1.956
Purchasing power parity BGN/EUR	0.8355	0.8738	0.8746	0.8839	0.8909	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiw estimates. - 2) From 2011 according to census February 2011. - 3) Enterprises with 10 and more employees. - 4) All enterprises in public sector, private enterprises with 5 and more employees. - 5) From 2012 according to census February 2011. - 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: wiw Database incorporating Eurostat and national statistics. Forecasts by wiw.