

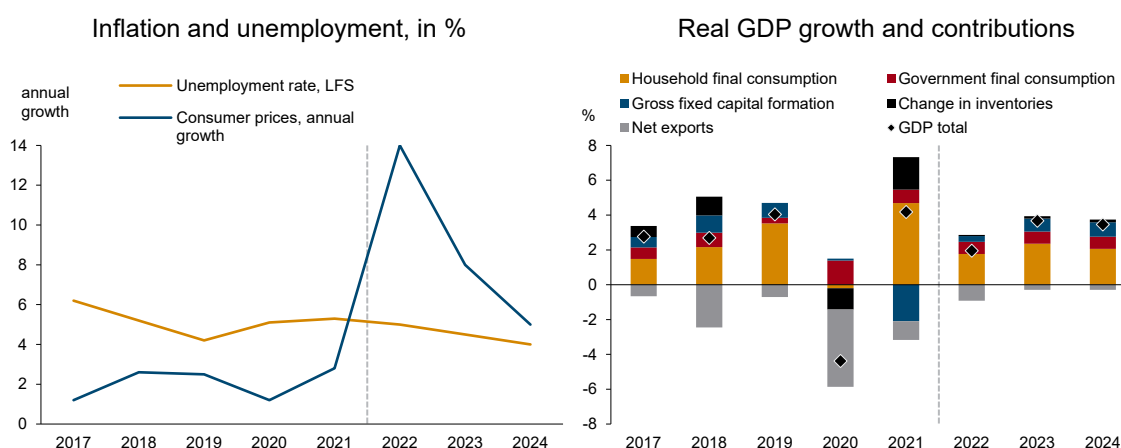


## BULGARIA: A weak government struggles with mounting challenges

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Bulgaria is facing numerous challenges, on account of its chronic economic problems and the shocks resulting from the war in Ukraine. The diversity of the new government is in itself a source of weakness and is constraining its policy course. The recovery that was under way before the Russian invasion of Ukraine has come to a halt. The delays over approval of the National Recovery and Resilience Plan will mean a reduction in the transfer of EU funds in 2022. GDP is expected to grow by some 2% in 2022, and a moderate upturn is expected in 2023.

Figure 4.4 / Bulgaria: Main macroeconomic indicators



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

**During its first hundred days, the new government that took office in December 2021 failed to come up with a coherent programme and to create a distinctive political image.** Backed as it is by a broad and diverse coalition that draws together four parties from the left, the right and the centre, the government has no clear stance either on economic issues or on foreign policy. In most cases, the need for compromise leads to a 'lowest common denominator' solution, avoiding the most sensitive and controversial policy issues.

**In the economic sphere, the main cost of the compromise has been a missed opportunity to initiate debate on some chronic problems, such as those faced by the tax, pension and healthcare systems.** In the ten years of lax rule under the populist Mr Borisov, no major reforms were undertaken in any of those spheres, and as a consequence the associated problems only intensified (e.g. the widening deficit in the pension system, the surge in income inequality and the deteriorating

quality of public health care). Sooner or later, Bulgarian policy makers will have to address the problems in these spheres. However, if that did not occur during the 'honeymoon' phase of the new government, it is unlikely to happen at all during its time in office. Hence the problems will continue to get worse, making any future reform even more challenging.

**Because of the delay in forming the government, Bulgaria's 2022 budget was only adopted in January.** The budget itself is a reflection of the eclectic nature of the new government's policy course: it envisages increased spending in many areas (under different pressures from the four parties), but contains no indication of reform intentions in any of the above spheres. The planned cash deficit in this budget amounts to BGN 5.9bn, or 4.1% of GDP – the highest figure for Bulgaria's public finances in the past two and a half decades.

**The immediate economic consequences of the war in Ukraine – such as the latest hikes in energy prices – have given rise to fresh challenges for the authorities.** The fact is that Bulgaria is one of the EU countries most dependent on gas and oil supplies from Russia, and is also the EU economy with the highest energy intensity. Due to this, the pass-through of energy cost increases to all other goods and services is more pronounced in Bulgaria than elsewhere in Europe. Moreover, the recent surge in energy prices has come on top of the significant rise in world commodity prices seen in 2021, which was already having a tangible effect on local prices.

**As a result, the biggest surge in domestic prices for a quarter of a century is making itself felt.** In January, the producer price index was 32.6% higher than a year before, and the short-term statistics suggest no reversal of this trend. Undoubtedly, this will also be reflected in consumer prices, albeit with a certain time lag. The expectations are that average annual consumer price inflation in 2022 will be well above the 10% mark.

**Before the Russian invasion of Ukraine, the Bulgarian economy was on the path to moderate recovery, with GDP growing by 4.2% in 2021.** Aggregate output growth was supported by both private consumption and exports. Private consumption in 2021 surged by an impressive 8% on the strength of improving consumer confidence. Real exports of goods and services grew by 9.9% – and real exports of services alone increased by 24.6% compared to the previous year, thanks to the recovery in tourism. Exports continued to grow strongly in the first two months of this year.

**However, the war-related shocks will undoubtedly cause a reversal of this trend.** The first noticeable sign of this has been the disruption to some supply chains for products traditionally imported from Russia and Ukraine, such as steel. The possibility also remains of disruption to the supply of Russian oil and gas. The tourist industry, which enjoyed a full winter season, is bracing itself for a very poor summer. There will also be secondary implications, due to the anticipated weakening of demand in key European markets. The influx of refugees from Ukraine has so far been relatively limited (compared to other European countries); but even so, it has been piling extra strain on Bulgaria's public finances.

**Given the war-related shocks, the 2022 budget will most likely have to be revised.** The budgetary framework contained the rather optimistic assumption of GDP expansion of 4.8% in 2022. It is already clear that such growth will not materialise this year. On the other hand, it is also obvious that in 2022 inflation will substantially overshoot the 5.6% envisaged in the government's budgetary forecast. In view of the new developments, some of the generous spending provisions will probably have to be scaled

back. The budget revision will also need to reallocate some funds for the unanticipated support of Ukrainian refugees.

**It is likely that the budgetary revisions will also affect planned public investment in 2022.** Public investment in 2021 was 33% down on 2020, due to delays in mobilising EU funds from the new Multiannual Financial Framework. The expectation was that these delays would be partly overcome in 2022, and that the new transfers would to some extent offset their underutilisation in 2021.

**However, at the time of writing, Bulgaria still does not have an operational National Recovery and Resilience Plan.** In March, the European Commission failed to approve the version submitted by the new government and returned it for further amendment. For all practical purposes, the delay in approving the plan means that Bulgaria will not be able to avail itself of a large tranche of the generous grant allocations from the Recovery and Resilience Facility (RRF) that were offered to the country. According to the RRF regulation, 70% of the amount available for non-repayable financial support should be legally committed by 31 December 2022, and the remaining 30% between 1 January and 31 December 2023. Given these tight deadlines, it is technically next to impossible for Bulgaria to submit projects worth a total of EUR 4.6bn – and have them approved – in the time envisaged under the RRF framework.

**Such an outcome could have both budgetary and macroeconomic implications.** The 2022 budget adopted in January foresaw significant revenue in the shape of the European Commission transfers, which were to go on financing a substantial part of the planned 2022 public investment. If major downward revisions occur on the revenue side, public investment in 2022 will be way below the budget target, which will also have an impact on gross fixed capital formation.

**So far, increases in nominal incomes have not kept pace with rising inflation.** Thus it is to be expected that the erosion of real incomes will curb private consumption, which was the main growth driver in 2021.

**In view of the increasing downside risks, at this point in time we expect GDP to grow by some 2% in 2022, which is 1.3 percentage points down on the January forecast.** Despite an expected slowdown, private consumption should continue to support growth in 2022. Gross fixed capital formation may pick up from its meagre level in 2021; however, we do not expect it to contribute significantly to GDP growth in 2022. We anticipate that imports of goods will outpace exports in the short run. And the shock to the tourist industry is likely to result in a year-on-year decline in the export of services in 2022. Consequently, we expect the current account balance in 2022 to stay in negative territory.

**If the war-related shocks are limited to 2022, we would expect output growth to strengthen in 2023.** However, it will probably remain at below the level that it would have reached had there been no shocks. GDP will continue to be predominantly driven by domestic demand, while the current account balance will remain negative. If inflation is not contained through aggressive policy moves, it could become a major concern, given Bulgaria's declared intention of joining the euro area in the next few years.

**Table 4.4 / Bulgaria: Selected economic indicators**

	2018	2019	2020	2021 <sup>1)</sup>	2022	2023	2024
					Forecast		
Population, th pers., average	7,025	6,976	6,934	6,850	6,800	6,750	6,700
Gross domestic product, BGN m, nom.	109,964	120,395	119,951	132,744	154,300	172,800	187,700
annual change in % (real)	2.7	4.0	-4.4	4.2	2.0	3.7	3.5
GDP/capita (EUR at PPP)	15,610	16,670	16,410	17,860	.	.	.
Consumption of households, BGN m, nom.	65,161	70,435	69,892	78,193	.	.	.
annual change in % (real)	3.6	5.9	-0.3	8.0	3.0	4.0	3.5
Gross fixed capital form., BGN m, nom.	20,624	22,404	22,981	21,993	.	.	.
annual change in % (real)	5.4	4.5	0.6	-11.0	2.0	4.5	5.0
Gross industrial production <sup>2)</sup>							
annual change in % (real)	0.3	0.6	-5.9	8.9	3.0	4.0	3.0
Gross agricultural production							
annual change in % (real)	0.0	-1.2	-11.0	17.5	.	.	.
Construction industry <sup>3)</sup>							
annual change in % (real)	1.6	3.8	-5.3	2.6	.	.	.
Employed persons, LFS, th, average <sup>4)</sup>	3,153	3,233	3,122	3,077	3,080	3,100	3,120
annual change in %	0.1	2.6	-3.4	.	0.0	0.5	0.5
Unemployed persons, LFS, th, average <sup>4)</sup>	173	143	169	171	160	150	130
Unemployment rate, LFS, in %, average <sup>4)</sup>	5.2	4.2	5.1	5.3	5.0	4.5	4.0
Reg. unemployment rate, in %, eop	6.1	5.9	6.7	4.8	.	.	.
Average monthly gross wages, BGN	1,146	1,267	1,391	1,551	1,890	2,170	2,430
annual change in % (real, gross)	7.5	7.2	7.9	8.0	7.0	6.5	6.5
Consumer prices (HICP), % p.a.	2.6	2.5	1.2	2.8	14.0	8.0	5.0
Producer prices in industry, % p.a.	3.9	3.0	-2.0	15.5	25.0	10.0	8.0
General governm. budget, EU def., % of GDP							
Revenues	38.7	37.6	37.8	40.0	40.0	40.0	40.0
Expenditures	36.9	35.5	41.8	43.0	45.0	44.0	43.0
Net lending (+) / net borrowing (-)	1.7	2.1	-4.0	-3.0	-5.0	-4.0	-3.0
General gov. gross debt, EU def., % of GDP	22.1	20.0	24.7	26.5	30.0	31.0	32.0
Stock of loans of non-fin. private sector, % p.a.	7.7	7.4	4.5	8.3	.	.	.
Non-performing loans (NPL), in %, eop	7.8	6.6	7.5	6.0	.	.	.
Central bank policy rate, % p.a., eop <sup>5)</sup>	0.00	0.00	0.00	0.00	0.0	0.0	0.0
Current account, EUR m	532	1,148	-41	-271	-1,200	-1,200	-700
Current account in % of GDP	0.9	1.9	-0.1	-0.4	-1.5	-1.4	-0.7
Exports of goods, BOP, EUR m	27,742	29,120	27,272	34,278	36,500	37,500	38,500
annual change in %	2.9	5.0	-6.3	25.7	6.5	2.7	2.7
Imports of goods, BOP, EUR m	30,449	32,028	29,213	37,574	41,000	42,000	43,000
annual change in %	9.8	5.2	-8.8	28.6	9.1	2.4	2.4
Exports of services, BOP, EUR m	9,195	10,237	7,260	9,277	8,800	9,200	9,500
annual change in %	11.5	11.3	-29.1	27.8	-5.1	4.5	3.3
Imports of services, BOP, EUR m	5,063	5,342	4,171	4,783	4,200	4,700	5,000
annual change in %	-2.5	5.5	-21.9	14.7	-12.2	11.9	6.4
FDI liabilities, EUR m	1,542	1,983	3,182	1,778	.	.	.
FDI assets, EUR m	785	745	397	640	.	.	.
Gross reserves of CB excl. gold, EUR m	23,620	23,072	28,830	32,490	.	.	.
Gross external debt, EUR m	37,190	37,716	39,813	41,965	42500	44000	46000
Gross external debt, % of GDP	66.1	61.3	64.9	61.8	54.0	50.0	48.0
Average exchange rate BGN/EUR	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) Enterprises with 5 and more employees. - 4) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 5) 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.