

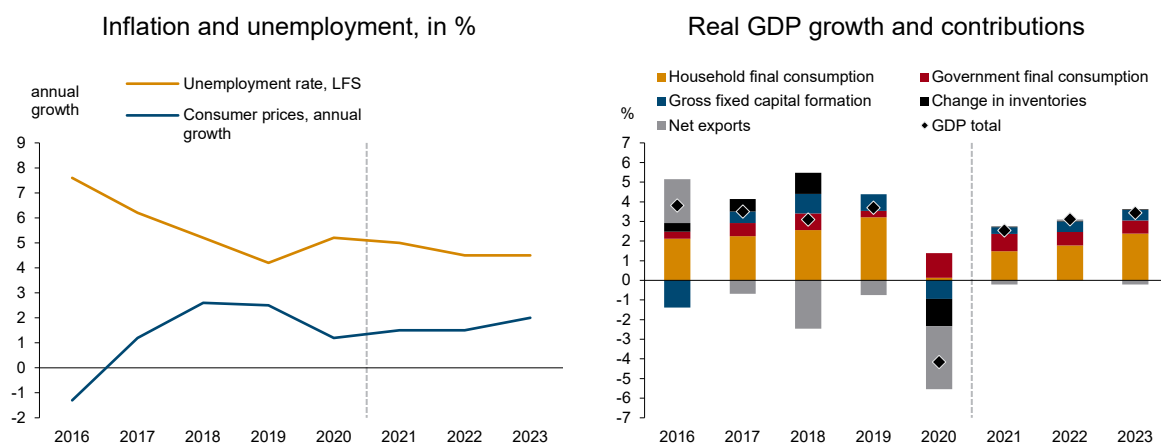


BULGARIA: Moderate post-COVID recovery

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After a year of protests and social turmoil, Bulgaria is entering a new electoral cycle with uncertain outcomes. The negative macroeconomic impact of the pandemic in 2020 was moderate. The shocks were partly mitigated by the policy support measures launched by the authorities. The post-COVID recovery is also expected to be moderate, with GDP growth of 2.5% in 2021 and slightly higher in the following two years.

Figure 4.4 / Bulgaria: Main macroeconomic indicators



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

The year 2020 in Bulgaria was dominated not only by the pandemic but also by a political crisis.

This took the form of prolonged mass street protests to demand the resignation of the government and reflected public frustration with ten years of almost uninterrupted rule by the GERB party (Citizens for European Development of Bulgaria), led by the prime minister, Boyko Borisov. This period has been marked by a continuous degradation of Bulgaria's social and political fabric, owing to the undermining of the constitutional separation of powers and the establishment of a system of de facto autocratic rule. However, the protest rallies of the summer and autumn did not succeed in bringing down the government. Protest fatigue translated into the scattering of the core of dissenters whose main common political objective had been the ousting of the government. In consequence, in the lead-up to the parliamentary elections scheduled for 4 April 2021, those who took part in the protests have turned to different opposition parties.

Opinion polls generally suggest a desire by the public for a change in leadership in the new electoral cycle. However, the current rulers have established a system of strongholds throughout the country: they hold most of the key administrative positions at regional and local level, and exercise a

strong grip on the mass media. The Bulgarian Socialist Party, which is the main opposition force, is torn apart by infighting, which has undermined its popular appeal. In addition, the elections are to be held amid the backdrop of the pandemic, which could suppress voter turnout. Therefore, given the dispersed protest vote, the elections may yield some surprises; there are also fears that they may result in a hung parliament and inability to form a new government.

At the beginning of the pandemic, the rapid implementation of rigid containment measures enabled Bulgaria to avert mass infections. However, the second wave that began in the late autumn of 2020 was quite severe, both in terms of the number of cases and the mortality rate. The country did not manage to overcome this phase fully before it was hit by a third wave and reintroduced a full lockdown in March.

By international comparison, the negative macroeconomic effect of the pandemic was moderate, with GDP dropping by 4.2% in 2020. The two fiscal policy support packages launched in 2020 helped to mitigate some of the negative effects. Remarkably, government final consumption expenditure (which in principle constitutes a small share of final demand) made a 1.3-percentage-point positive contribution to GDP growth. By contrast, gross fixed capital formation and net exports made sizeable negative contributions to GDP growth, while that of private consumption was nil.

The worst-hit sector of the Bulgarian economy was the hospitality industry: the number of foreign tourists in Bulgaria plunged by 60% in 2020. Compared with the situation in other CEE countries, the manufacturing sector as a whole was less affected, partly because Bulgaria is less integrated into the automotive global value chain than other countries in the region. Nevertheless, reflecting the plunge in demand in most external markets, gross manufacturing output weakened throughout the year and continued to do so in the early months of 2021. By contrast, given the boom in the demand for online services, the information technology (IT) industry fared very well, reporting growth in output of almost 10% in 2020.

However, the upturn in the exports of IT services could not offset the slump in tourism and transportation revenue. Total exports of services in 2020 fell by one-third from the 2019 level. Services imports also fell, by 23%, reflecting the drop in reverse services flows. The contraction in the exports and imports of goods was less pronounced, at 6.7% and 9.7%, respectively. Overall, these changes brought about a major shift in the current-account balance: from a surplus of 3% of GDP in 2019 to close to zero in 2020.

The shock to the labour market was mitigated by the public support measures. For the year as a whole, businesses received employment support compensation amounting to BGN 650m (equivalent to 0.55% of GDP). These measures were continued in 2021, with new outlays amounting to BGN 300m by mid-March, owing to the REACT-EU (Recovery Assistance for Cohesion and the Territories of Europe) initiative. The labour market impact of the pandemic was seen mostly in transitions from employment to inactivity; the average annual rate of unemployment increased by just 0.9 percentage point from 2019, to 5.1%.

The large-scale support measures translated into an expansionary fiscal stance. According to preliminary estimates, the general government balance in 2020 was relaxed by almost 6 percentage points compared with the previous year. The government engaged in substantial new borrowing on the

international financial markets by selling Eurobonds amounting to EUR 2.5bn. Part of the new borrowing was spent on financing the deficit and some was used to replenish fiscal reserves. Despite the overall fiscal relaxation, public capital expenditure in 2020 was down by 33% from its 2019 level.

The fiscal stance is set to remain loose in 2021. The budget for the year was adopted, with a deficit of BGN 5.5bn (4.5% of GDP). This reflects both the continued COVID-related public support measures but also a large socially oriented policy package that is not directly related to the pandemic. The latter includes significant rises in public-sector wages and pensions, which will not be of a one-off nature but will be carried over in future budgets as well. Consequently, a lasting shift towards a looser fiscal stance can be expected.

Bulgaria will be eligible for significant EU transfers in the coming years. These include EUR 16.6bn from the 2021-2027 Multiannual Financial Framework and EUR 6.2bn in grants from the Recovery and Resilience Facility. The grants envisaged for Bulgaria amount to close to 10% of GDP, which place it among the three countries (together with Croatia and Greece) that benefit the most in relative terms from this facility. In addition, Bulgaria can access loans amounting to up to EUR 4.5bn from the New Generation EU recovery fund. In principle, this generous funding should provide a solid boost to the economy; however, it remains to be seen whether Bulgaria will be capable of absorbing these funds.

In July 2020 Bulgaria officially joined the ERM-2 mechanism. According to the most recent plans, it will aim to join the euro area on 1 January 2024. The authorities are preparing a national plan for the adoption of the euro.

Economic activity remained subdued in early 2021 and, given the recent trends, it is difficult to expect a rapid rebound. The important hospitality industry will continue to suffer the shock of meagre tourist inflows, owing to the restrictive measures on international travel. Policy support will be prolonged, but despite its positive effect, this will not be sufficient to spur robust growth.

In these circumstances, we expect only a moderate recovery in 2021. Growth in the short term will be predominantly driven by domestic demand. Given the increasing social orientation of the budget, we expect a continued general rise in real disposable incomes, which should support private consumption. Gross fixed capital formation should also rebound, but the speed of its recovery will depend on two factors: the return of private investor confidence and the pace of absorption of EU funds. Domestic demand will also provide a boost to imports. The dynamics of exports will depend on the speed of recovery of global and EU import demand.

We expect Bulgaria's GDP to grow by 2.5% in 2021. Its growth rates in 2022 and 2023 are likely to be in the 3.0-3.5% range. The realignment of trade flows should contribute to a lasting downward shift in the current-account balance compared with recent years; nevertheless, it will probably remain in positive territory. Given the current budgetary stance and the envisaged continued policy support, we also expect a lasting downward shift in the fiscal position, which should translate into a negative general government balance in the coming years.

Table 4.4 / Bulgaria: Selected economic indicators

	2017	2018	2019	2020 ¹⁾	2021	2022	2023
					Forecast		
Population, th pers., average	7,076	7,025	6,976	6,900	6,850	6,800	6,750
Gross domestic product, BGN m, nom.	102,345	109,743	119,772	118,605	123,400	129,200	136,300
annual change in % (real)	3.5	3.1	3.7	-4.2	2.5	3.1	3.4
GDP/capita (EUR at PPP)	14,690	15,530	16,510	16,200	.	.	.
Consumption of households, BGN m, nom.	60,969	64,936	69,853	70,353	.	.	.
annual change in % (real)	3.7	4.3	5.4	0.2	2.5	3.0	4.0
Gross fixed capital form., BGN m, nom.	18,795	20,624	22,404	21,137	.	.	.
annual change in % (real)	3.2	5.4	4.5	-5.1	2.0	3.0	3.0
Gross industrial production ²⁾							
annual change in % (real)	3.4	0.3	0.6	-5.9	2.0	3.0	3.5
Gross agricultural production							
annual change in % (real)	6.3	-0.4	-1.4	-12.0	.	.	.
Construction industry ³⁾							
annual change in % (real)	4.6	1.6	3.8	-5.3	.	.	.
Employed persons, LFS, th, average	3,150	3,153	3,233	3,122	3,140	3,170	3,200
annual change in %	4.4	0.1	2.6	-3.4	0.5	1.0	1.0
Unemployed persons, LFS, th, average	207	173	143	169	170	150	150
Unemployment rate, LFS, in %, average	6.2	5.2	4.2	5.2	5.0	4.5	4.5
Reg. unemployment rate, in %, eop	7.1	6.1	5.9	6.7	.	.	.
Average monthly gross wages, BGN	1,037	1,146	1,267	1,387	1,520	1,650	1,790
annual change in % (real, gross)	7.2	7.5	7.2	7.6	8.0	7.0	6.5
Consumer prices (HICP), % p.a.	1.2	2.6	2.5	1.2	1.5	1.5	2.0
Producer prices in industry, % p.a.	5.0	3.9	3.0	-2.0	1.0	1.5	2.0
General governm.budget, EU-def., % of GDP							
Revenues	36.0	38.5	38.2	36.5	37.0	37.5	37.0
Expenditures	34.9	36.6	36.3	40.5	40.5	39.5	39.0
Net lending (+) / net borrowing (-)	1.1	2.0	1.9	-4.0	-3.5	-2.0	-2.0
General gov.gross debt, EU def., % of GDP	25.3	22.3	20.2	26.5	29.0	29.0	30.0
Stock of loans of non-fin.private sector, % p.a.	3.3	7.7	7.4	4.5	.	.	.
Non-performing loans (NPL), in %, eop	10.4	7.8	6.6	7.5	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	0.00	0.00	0.00	0.00	0.0	0.0	0.0
Current account, EUR m	1,825	554	1,848	68	300	300	100
Current account in % of GDP	3.5	1.0	3.0	0.1	0.5	0.5	0.1
Exports of goods, BOP, EUR m	26,951	27,745	29,120	27,164	28,100	29,000	30,200
annual change in %	16.6	2.9	5.0	-6.7	3.4	3.2	4.1
Imports of goods, BOP, EUR m	27,716	30,443	32,011	28,892	30,200	31,600	33,200
annual change in %	15.1	9.8	5.1	-9.7	4.5	4.6	5.1
Exports of services, BOP, EUR m	8,256	9,187	10,191	6,898	7,300	8,200	9,000
annual change in %	2.6	11.3	10.9	-32.3	5.8	12.3	9.8
Imports of services, BOP, EUR m	5,203	5,058	5,316	4,088	4,400	4,800	5,200
annual change in %	12.1	-2.8	5.1	-23.1	7.6	9.1	8.3
FDI liabilities, EUR m	1,760	1,539	1,472	600	.	.	.
FDI assets, EUR m	446	760	647	187	.	.	.
Gross reserves of CB excl. gold, EUR m	22,257	23,620	23,072	28,830	.	.	.
Gross external debt, EUR m ⁵⁾	33,852	34,487	35,178	36,825	37000	36500	36000
Gross external debt, % of GDP ⁵⁾	64.7	61.5	57.4	60.7	59.0	55.0	52.0
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) 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.