

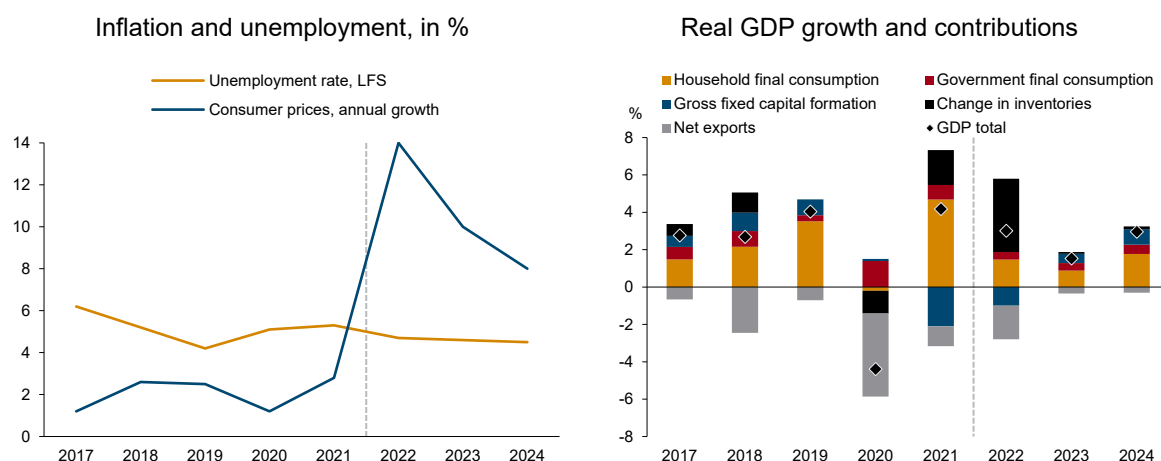


BULGARIA: Snap election unlikely to reconcile the deep political rifts

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The outcome of the early election held on 2 October offers no ready solutions to the political stalemate in Bulgaria. Despite the political turmoil and the war-related shocks, GDP grew by 4.5% in the first half of the year, thanks to robust exports and strong industrial output. However, surging inflation and a large fiscal imbalance remained a serious concern. By mid-year the economic environment had worsened and output had weakened. We expect GDP to grow by 3% in 2022, with a weaker performance of 1.5% in 2023.

Figure 6.4 / Bulgaria: Main macroeconomic indicators



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

The early election held on 2 October failed to produce any clear winners. The GERB party came first, but fell far short of a governing majority. The previous leading party – We Continue the Change – lost votes and came second. As the two parties regard each other as implacable rivals, it is difficult to see how the result will resolve the political stalemate in Bulgaria.

The previous two snap elections, both held in 2021, also produced a scattered vote, reflecting the country's deep societal rifts. The four-party government that was in office in the first half of 2022 pursued inconsistent policies, mirroring the diffuse nature of the coalition. This followed a messy policy agenda over the previous two years that was dominated by populist initiatives emanating from different ends of the political spectrum.

Despite the ongoing political turmoil and the war-related shocks, the economy performed relatively well in the first months of 2022. GDP grew by 4.5% in the first half of the year, boosted by booming exports and relatively robust private consumption in that period. Bulgaria focuses on the export of such products as electricity, fuel and vegetable oil, and so it benefited from the rising demand and the soaring international prices for these products. The war in Ukraine has been associated with rising international demand for armaments, and Bulgaria also specialises in certain specific categories of military equipment.

The favourable external environment contributed to an unprecedented surge in exports and industrial production in the first half of the year. The export of goods in current euros grew by almost 41% year on year (an increase of 7.6% in real terms over the same period), while real gross industrial production increased by 17.8%. This booming activity was accompanied by an even bigger rise in imports, and so in statistical terms the contribution of net exports to GDP growth turned out to be negative. Quite unusually, stockpiling made the largest positive contribution to GDP growth. Unfortunately, the information available at the time of writing is insufficient to provide any meaningful interpretation of this state of affairs.

However, the balance of factors affecting the economy changed rapidly, and by mid-year negative factors had come to the fore. The most serious concern was the uncertainty related to the supply of gas. Bulgaria refused to comply with the new payment conditions imposed by Gazprom, and this resulted in the abrupt discontinuation of gas deliveries from Russia, the country's largest supplier. At the time of writing, the authorities were still seeking to negotiate deliveries from alternative sources. The possible impact of gas shortages on the energy sector as a whole will be relatively limited, as gas is mostly used for heating and industrial production, rather than for electricity generation; however, the social implications could be grave.

The surging inflation has also been a serious concern. In August, year-on-year consumer price inflation topped 15%, while year-on-year producer price inflation exceeded 50%. Apart from the effect of common global factors, inflation in Bulgaria accelerated as a result of policy incoherence, including a series of populist measures and excessive public spending. In 2022, these policies backfired, as real wages fell by 1.3% year on year in the first six months. Real wages for the year as a whole are expected to decline by an even higher figure – the first time this will have happened in more than 20 years.

The changing international environment due to the war in Ukraine necessitated a revision of the 2022 budget. In July, when it was already clear that the country was heading for fresh early elections, parliament hastily adopted a revision to the budget. What happened during the drafting of the revision was typical of the policy inconsistency of the quadripartite coalition then in office: each party tried to promote measures that were aligned with its own agenda, and was prepared to support measures initiated by other parties simply in order to have its own measures adopted. The upshot was that, in the absence of meaningful reform, public expenditure ballooned. Accordingly, in order to provide scope to finance the increased spending, the revised budget raised the ceiling for new public borrowing in 2022 by BGN 3bn, to BGN 10bn.

One disturbing event in 2022 was the opening up of a large fiscal gap. According to the recent update of the mid-term budgetary framework prepared by the caretaker government, the expected cash fiscal deficit in 2022 will be close to 6% of GDP. The Ministry of Finance stated that, unless a major fiscal correction is undertaken, the cash deficit in the period 2023-2025 could remain in the range of 6-7%.

One immediate consequence of the imprudent policy course being pursued in the country was a surge in the cost of public borrowing. Thus, in mid-September, Bulgaria issued Eurobonds worth EUR 2.25bn at quite a high price: seven-year Eurobonds with a nominal value of EUR 1.5bn were sold with a 4.125% coupon (realised yield of 4.33%), while 12-year bonds worth EUR 0.75bn were sold with a coupon of 4.625% (realised yield of 4.81%). Later in September, the Ministry of Finance could not even place the whole envisaged BGN 200m issue of five-year government securities on the local market, due to the high yield required by investors. Only BGN 150m of the issue were sold, at a coupon of 4.13%.

The June 2022 European Commission Convergence Report contained an important warning about the worsening macroeconomic situation in Bulgaria. It concluded that Bulgaria did not fulfil the conditions for adoption of the euro, citing two problem areas: 1) its failure to fulfil the criterion on price stability; and 2) legislation in the monetary field is not fully compatible with the requirements of the euro area. Thus, Bulgaria's target date for joining the euro area (1 January 2024) now seems unrealistic.

Bulgaria also endured considerable delay in finalising its Recovery and Resilience Plan. After several iterations, the Commission gave it a provisional green light only in April 2022, conditional upon further policy steps being taken. The first funding claim under the plan was submitted to the Commission by the caretaker government only at the beginning of September. Given the delays already encountered, it is unlikely that the country will be able to avail itself of all the funds earmarked under the Recovery and Resilience Facility (RRF). These delays had a very damaging impact on public investment in 2022, as many of the budgeted investment projects for the year were contingent on RRF funding.

Output performance weakened in the second half of the year. Yet, thanks to the strong performance in the first half, we have revised our growth forecast for 2022 upwards. We now expect annual GDP growth of 3%, 0.5 percentage points higher than was envisaged in the Summer Forecast. In statistical terms, private consumption and stockpiling will remain the main growth drivers in 2022, while the contribution of gross fixed capital formation will be negative. Imports will continue to outpace exports, so net exports for the full year are expected to make a negative contribution to GDP growth. The recent deterioration in the current account balance suggests that it will likely remain in negative territory for the year as a whole. While the pace of inflation has subsided somewhat in recent months, average annual consumer price inflation will be the highest for 15 years – some 14%.

At the same time, in view of the worsening external environment and the uncertainties surrounding the energy sector, we have revised our forecast for 2023 downwards. We now expect much lower GDP growth in 2023 (1.5%) than was forecast in summer (3.7%). Inflation should gradually subside in the coming years, but it will remain high compared to recent figures. We also expect the current account balance to remain negative, albeit shrinking in 2023-2024.

Table 6.4 / Bulgaria: Selected economic indicators

	2019	2020	2021 ¹⁾	2021 January-June	2022	2022 Forecast	2023 Forecast	2024
Population, th pers., average	6,976	6,934	6,878	.	.	6,800	6,750	6,700
Gross domestic product, BGN m, nom.	120,395	119,951	132,744	58,193	71,769	155,900	174,100	193,600
annual change in % (real)	4.0	-4.4	4.2	3.4	4.5	3.0	1.5	3.0
GDP/capita (EUR at PPP)	16,670	16,410	17,850	.	.	.	.	.
Consumption of households, BGN m, nom.	70,435	69,892	78,193	34,873	41,340	.	.	.
annual change in % (real)	5.9	-0.3	8.0	7.4	4.2	2.5	1.5	3.0
Gross fixed capital form., BGN m, nom.	22,404	22,981	21,993	9,586	10,516	.	.	.
annual change in % (real)	4.5	0.6	-11.0	-5.3	-6.6	-6.0	3.0	5.0
Gross industrial production ²⁾								
annual change in % (real)	0.6	-5.9	8.9	7.0	17.8	15.0	1.0	3.0
Gross agricultural production								
annual change in % (real)	-1.2	-11.0	17.5	.	.	.	.	.
Construction industry ³⁾								
annual change in % (real)	3.8	-5.3	2.6	3.9	1.9	.	.	.
Employed persons, LFS, th, average ⁴⁾	3,233	3,122	3,077	3,045	3,095	3,100	3,120	3,140
annual change in %	2.6	-3.4	-0.6	-0.7	1.6	0.8	0.5	0.5
Unemployed persons, LFS, th, average ⁴⁾	143	169	171	193	155	150	150	150
Unemployment rate, LFS, in %, average ⁴⁾	4.2	5.1	5.3	6.0	4.8	4.7	4.6	4.5
Reg. unemployment rate, in %, eop	5.9	6.7	4.8	5.2	4.2	.	.	.
Average monthly gross wages, BGN	1,267	1,391	1,551	1,494	1,667	1,680	1,850	2,040
annual change in % (real, gross)	7.2	7.9	8.0	11.2	-1.3	-5.0	0.0	2.0
Consumer prices (HICP), % p.a.	2.5	1.2	2.8	1.2	11.1	14.0	10.0	8.0
Producer prices in industry, % p.a.	3.0	-2.0	15.5	7.7	37.2	40.0	20.0	12.0
General governm. budget, EU def., % of GDP								
Revenues	38.4	38.1	39.0	.	.	40.0	40.0	40.0
Expenditures	36.3	42.0	43.1	.	.	46.0	45.0	44.0
Net lending (+) / net borrowing (-)	2.1	-4.0	-4.1	.	.	-6.0	-5.0	-4.0
General gov. gross debt, EU def., % of GDP	20.0	24.7	25.1	.	.	31.0	34.0	36.0
Stock of loans of non-fin. private sector, % p.a.	7.4	4.5	8.3	6.2	12.4	.	.	.
Non-performing loans (NPL), in %, eop	6.6	7.5	6.0	6.7	5.2	.	.	.
Central bank policy rate, % p.a., eop ⁵⁾	0.00	0.00	0.00	0.00	0.00	1.0	2.0	2.0
Current account, EUR m	1,148	24	-351	7	708	-1,000	-900	-500
Current account in % of GDP	1.9	0.0	-0.5	0.0	1.9	-1.3	-1.0	-0.5
Exports of goods, BOP, EUR m	29,119	27,272	34,405	16,265	22,915	40,000	38,000	39,000
annual change in %	5.0	-6.3	26.2	23.6	40.9	16.3	-5.0	2.6
Imports of goods, BOP, EUR m	32,028	29,213	37,291	17,263	24,460	45,000	42,500	43,000
annual change in %	5.2	-8.8	27.7	25.5	41.7	20.7	-5.6	1.2
Exports of services, BOP, EUR m	10,237	7,320	9,196	3,858	5,091	8,800	9,200	9,500
annual change in %	11.3	-28.5	25.6	16.5	32.0	-4.3	4.5	3.3
Imports of services, BOP, EUR m	5,342	4,171	5,114	2,241	2,933	4,200	4,700	5,000
annual change in %	5.5	-21.9	22.6	19.2	30.9	-17.9	11.9	6.4
FDI liabilities, EUR m	1,983	3,158	1,769	1,311	1,254	1,200	.	.
FDI assets, EUR m	745	396	782	577	683	500	.	.
Gross reserves of CB excl. gold, EUR m	23,072	28,830	32,490	27,763	31,195	.	.	.
Gross external debt, EUR m	37,716	39,297	41,491	39,522	41,677	43,500	44,000	44,500
Gross external debt, % of GDP	61.3	64.1	61.1	58.2	52.0	55.0	49.0	45.0
Average exchange rate BGN/EUR	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) 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.