Bulgaria: economic rebound continues

The economic rebound continued in the first quarter of 2003, despite the unfavourable external environment. Surprisingly – given the weak external demand – manufacturing sector output grew at double-digit rates in the first quarter, led by a surge in export activity. The continuing recovery is matched by an improving domestic business climate and generally positive economic expectations.

According to the preliminary national accounts, quarterly GDP increased by 3.8% year on year in the first quarter, boosted by the fast expansion of manufacturing output. Aggregate growth would have been higher if it were not for the weak performance in the agricultural sector whose output shrank by 1.8% year on year. On the demand side, both private consumption and, especially, gross fixed investment continued to grow strongly in the first quarter (by 7.1% and 15.8% year on year, respectively), providing support to domestic economic activity.

The recovery in the manufacturing industry continued for the fourth consecutive quarter and accelerated sharply in the first quarter of 2003, with total industrial output increasing by 17.2% from the same period of 2002. This robust performance was underpinned by the unexpectedly strong recovery of exports: in euro terms, quarterly exports increased by almost 20% compared to their level a year earlier. Both manufacturing production and exports expanded across the board in terms of products, industries and export destinations; as a result Bulgaria gained further market shares in its main EU markets such as Italy, Germany and Greece.

There are several features that make the current recovery look different from previous growth episodes during the past decade. First of all, this is the first case when the main supply push to aggregate output comes from a continuing, export-led upturn in the manufacturing sector. During the first decade of economic transformation, the Bulgarian manufacturing sector was the main loser of reforms, shrinking by almost 60% from its pre-transition level. In that period, the upturns in the manufacturing industry were short-lived and selective, usually only involving a few industries endowed with excessive capacities that benefited from favourable demand conditions. Secondly, the strong and broadly based export expansion in a rather unfavourable external environment suggests that the key factors of success should be sought for on the supply side. These are signs of a new type of manufacturing growth which originates in newly emerging, export-oriented manufacturing capacities. While the first decade of transition was a period of downsizing and scrapping of obsolete industries that could not prove their viability under market conditions, it appears that we are observing the positive outcomes of a process of re-industrialization in the country which started towards the end of the 1990s. Although somewhat belated and in a more modest scale – compared to the early reformers of

Central Europe – it likely has a similar effect on the Bulgarian economy, serving as the main engine of recovery. Thirdly, the strong export sales suggest that this new manufacturing capacity has been able to penetrate niches where it enjoys comparative advantage. This is especially pronounced in the labour-intensive textile industry, which was among the fastest growing in recent years and which benefits from the low-cost local labour. But it should also be noted that in the last couple of years there has been a resurgence in some technologically advanced, high value-added industries as well. Finally, one of the specific features of Bulgaria's re-industrialization is the fact that the small and medium-size enterprises emerge as the main basis of the new manufacturing industry. It turned out that in recent years, most greenfield investments in manufacturing – both by foreign and domestic investors – were made in small production units. While, with a few exceptions, Bulgaria turned out not to be very attractive to big investors (whose absence created the false impression of dearth of greenfield investment), on the whole recently there was a considerable amount of new investment, however, dispersed in numerous smaller-scale projects.

There were positive developments in the labour market as well. In May, the rate of registered unemployment fell to 14.3%, the lowest rate registered since September 1999; the recent labour force surveys suggest a similar dynamics of the unemployment rate. Notably, the manufacturing industry has been making a positive contribution to net job creation during the last couple of years, and this trend was upheld in the first quarter of 2003. The introduction in January of a new set of active labour market policies also contributed to the improvement of the situation in the labour market.

Inflation remained subdued in the first months of the year, despite a small, one-time surge in January prompted by the rise in some excise taxes. The inflationary pressures were largely mitigated by low imported inflation caused by the depreciating dollar and the general weakness in world market commodity prices. The planned rise in regulated energy prices (due to take place in the summer) is not expected to trigger a significant surge in the overall price level.

After a period of contraction in mid-2002, the trade and current account deficits started to swell again towards the end of the year and this trend continued in the first quarter of 2003. However, in relative terms, the magnitude of the external imbalances has been reduced considerably thanks to the depreciation of the dollar and the continuing economic expansion. As a percentage of GDP, the foreign official debt has shrunk by 10 percentage points, reaching 44.1% of GDP at the end of March. At the present dollar exchange rate, total public debt is estimated at around 50% of GDP, a level that does not pose immediate problems for macroeconomic management. This dramatic easing in the debt burden prompted some of the leading credit agencies to raise Bulgaria's credit ratings. Bulgaria's foreign currency credit ratings now stand just one notch below investment grade while S&P already granted the lowest investment grade to local currency ratings.

Progress in large-scale privatization was mixed. The biggest failure was the collapse of the negotiated sale of Bulgartabac, the tobacco monopoly, to a financial investor (allegedly backed by Deutsche Bank): the deal fell apart in the very last phase of fine-tuning the final terms of the contract. The reasons for the failure were complex, ranging from vested interests in the tobacco industry (which lobbied against the sale) to widespread allegations of corruption and conflict of interest. This fiasco was especially humiliating for the authorities as it came after a hasty change in the privatization law, especially tailored to this deal. The privatization of BTC (the Bulgarian Telecom) is also in limbo after a ruling by the Supervisory Board of the Privatization Agency about irregularities in the bidding and negotiation procedure. At the same time, the sale of the last remaining state-owned bank DSK (the successor of the mono-savings bank) to Hungary's OTP Bank for EUR 311 million is widely considered as the most successful privatization deal in Bulgaria so far.

In May the government survived a non-confidence vote initiated by the opposition United Democratic Forces. Despite the recent defection of ten deputies from the ruling party, the political situation remains relatively stable and the government still enjoys a comfortable majority in Parliament thanks to the continuing support by the Movement for Rights and Freedoms (the Turkish minority party). The short-term outlook for Bulgaria remains positive. The fiscal position of the government remains strong and the overall macroeconomic situation does not pose any immediate threats. The tourism industry expects a good season and if the pace of manufacturing output is maintained, the government's goal of achieving 4.8% GDP growth in 2003 can be regarded as a realistic target.

Table BG

Bulgaria: Selected Economic Indicators

	1998	1999	2000	2001	2002 [1]	2002 1st quarter	2003 1st quarter	2003 forecast	2004 forecast
Population, th pers., end of period	8230.4	8190.9	8149.5	7891.1	7845.5	.	.	.	.
Gross domestic product, BGN mn, nom.	22421.1	23790.4	26752.8	29709.2	32323.7	6958.6	7294.2	35200	38500
annual change in % (real)	4.0	2.3	5.4	4.1	4.8	3.4	3.8	4.5	5
GDP/capita (USD at exchange rate)	1543	1577	1542	1696	1978	.	.	.	.
GDP/capita (USD at PPP - wiiw)	6270	6540	7070	7680	8290	.	.	.	.
Gross industrial production									
annual change in % (real)	-7.9	-8.0	8.2	1.6	0.6	-4.4	17.2	4	5
Gross agricultural production									
annual change in % (real)	-1.5	2.7	-9.4	-0.6	4.1	.	.	.	.
Goods transport, public, mn t-kms [2]	84308	88538	88136	81937	76377	.	.	.	.
annual change in % [2]	-8.4	5.0	.	-7.0	-6.8	.	.	.	.
Gross fixed capital form., BGN mn, nom.	2919.8	3600.5	4206.0	5415.2	5858.9	1035.1	1213.1	.	.
annual change in % (real)	35.2	20.8	15.4	23.3	9.3	4.6	15.8	.	.
Construction output total									
annual change in % (real)	-0.2	8.0	8.1	12.8	-23.0	.	.	.	.
Dwellings completed, units	4942	9824	8795	5937	6153	.	.	.	.
annual change in %	-33.7	98.8	-10.5	-32.5	3.6	.	.	.	.
Employment total, th pers., average	3152.6	3087.8	2980.1	2968.1	2992.2	.	.	.	.
annual change in %	-0.2	-2.1	-3.5	-0.4	0.8	.	.	.	.
Employees in industry, th pers., average	802.5	722.5	662.0	658.4	649.1	649.8	667.0	.	.
annual change in %	-4.3	-10.0	-8.4	-0.5	-1.4	1.0	2.8	.	.
Reg. unemployed, th pers, end of period	465.2	610.6	682.8	662.3	602.0	659.0	581.3	550	520
Reg. unemployment rate in %, end of period	12.2	16.0	17.9	17.3	16.3	17.2	15.7	15	14
LFS - unemployment rate in %, average	14.1	15.7	16.9	19.7	17.8	19.5	15.6	18	17
Average gross monthly wages, BGN	183.3	201.0	224.5	240.0	272.0	255.7	272.0	.	.
annual change in % (real, gross)	20.7	6.9	1.3	-0.5	7.1	-0.7	1.1	.	.
Retail trade turnover, BGN mn	7214.2	8023.3	9725.9	10868.0	11642.0	.	.	.	.
annual change in % (real)	18.6	12.3	12.7	4.8	1.6	2.2	2.4	.	.
Consumer prices, % p.a.	18.7	2.6	10.3	7.4	5.8	8.2	0.6	3	4
Producer prices in industry, % p.a.	18.7	2.8	17.5	3.8	1.2	0.0	7.9	.	.
Central government budget, BGN mn									
Revenues	4449.5	5199.3	6120.9	6525.3	7289.4	1588.6	1937.0	.	.
Expenditures	4156.0	4736.8	6304.8	7189.5	7286.0	1377.4	1846.2	.	.
Deficit (-) / surplus (+)	293.6	462.5	-183.8	-664.2	3.4	205.6	90.8	.	.
Deficit (-) / surplus (+), % of GDP	1.3	1.9	-0.7	-2.2	0.0	3.0	1.2	.	.
Money supply, BGN mn, end of period [3]									
M1, Money	2960.8	3302.1	3976.3	4883.8	5542.7	4594.2	5089.2	.	.
Broad money	6814.2	7662.1	10061.3	12600.1	14146.5	12503.1	14001.4	.	.
Base rate of NB % p.a., end of period	5.2	4.5	4.7	4.7	3.4	4.5	2.6	.	.
Current account, USD mn	-61.4	-651.7	-701.6	-842.2	-677.4	-237.5	-391.0	-700	-600
Current account in % of GDP	-0.5	-5.0	-5.6	-6.2	-4.4	-3.4	-5.4	-3.4	-2.6
Gross reserves of NB excl. gold, USD mn	2679.4	2892.0	3154.9	3289.6	4406.8	2923.7	4435.2	.	.
Gross external debt, USD mn	10891.9	10913.9	11201.8	10618.7	10946.2	10474.8	11048.2	.	.
Exports total, fob, EUR mn [4]	3841.2	3733.8	5253.1	5714.2	6058.5	1356.8	1617.6	6800	7200
annual change in %	-12.1	-0.4	40.7	8.8	6.0	-3.0	19.2	12	6
Imports total, cif, EUR mn [4]	4475.8	5139.9	7084.9	8127.8	8404.6	1775.7	2070.5	9200	9600
annual change in %	2.6	16.4	37.8	14.7	3.4	-0.2	16.6	10	4
Average exchange rate BGN/USD	1.760	1.838	2.124	2.185	2.077	2.232	1.822	1.7	1.7
Average exchange rate BGN/EUR (ECU)	1.972	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956
Purchasing power parity BGN/USD, wiiw	0.433	0.443	0.462	0.482	0.495	.	.	.	.
Purchasing power parity BGN/EUR, wiiw	0.472	0.483	0.507	0.529	0.535	.	.	.	.

Notes: 1) Preliminary. - 2) From 2000 new methodology. - 3) According to International Accounting Standards. - 4) From 1999 new methodology. Converted from the national currency to EUR at the official exchange rate.

Source: **wiiw** Database incorporating national statistics; **wiiw** forecasts.