

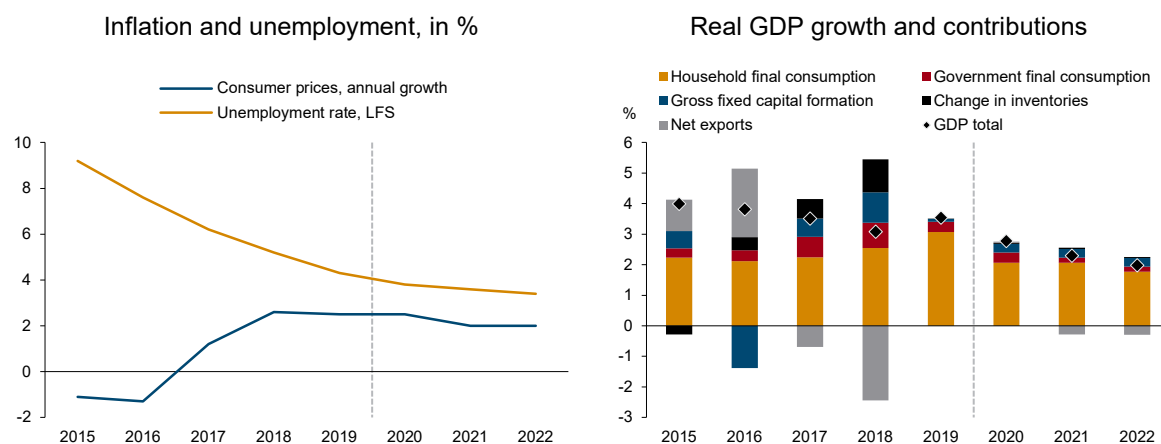


BULGARIA: Slowdown likely to continue

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After an upturn in the first half of 2019, economic activity subsided in the second semester. The slowdown was triggered by a weakening of external demand, while private consumption remained relatively strong. The labour market tightened further and continued to exert pressure on wages. The short-term prospects have deteriorated, and GDP growth is expected to decelerate to below 3% in 2020 – and may slow further in the coming years.

Figure 6.4 / Bulgaria: Main macroeconomic indicators



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

Economic performance was uneven in the course of 2019: after an upturn in the first half of the year, economic activity slowed in the second semester. GDP growth for the year as a whole came to 3.5%, but this was mostly due to the strong growth in the first quarter.

The slowdown was pronounced in most sectors of economic activity. Manufacturing output in 2019 grew by less than 2%, while the real exports of goods and services (national accounts definition) basically stagnated. The same was true of real imports, reflecting the weaker demand for intermediates and investment goods. In current euro terms, imports of goods actually shrank by some 2% in 2019.

Among the main factors behind the slowdown was the dwindling demand in all key export markets. Gross fixed capital formation also weakened, especially in the second half of the year. Private consumption was the main (and practically the sole) growth driver on the demand side, fuelled by the ongoing rise in real incomes.

Last year was marked by a further tightening of the labour market. In the third quarter of 2019, the LFS rate of unemployment fell to 3.7%, which was the lowest rate on record. Labour demand has been rising steadily in recent years: between 2015 and 2019, the total number of employed people increased by 6.7% and the employment rate rose from 63% to 71%. However, the age structure of the

economically active population is highly unfavourable, and the growth in employment was almost entirely due to higher activity and employment rates among the older population. Thus, between 2015 and 2019, the share of those aged 45 and above in total employment increased from 44.6% to 48.0%. During the same period, the employment rate in the cohort aged 55-64 grew by 10.5 percentage points, from 54.6% to 65.1%. At the same time, the labour market is characterised by striking regional disparities: in 2019, employment rates across Bulgaria's districts (national territorial units) varied from 81.5% to 45.5%. So while, from the macro perspective, there are still some labour reserves, these may be difficult to mobilise, due to a mismatch between regional supply and demand, and generally low labour mobility.

Labour shortages have become persistent, generating tensions between businesses, unions and the government. Labour shortages are most acute in blue-collar jobs, tourism, teaching and health care. In recent business sentiment surveys, most Bulgarian firms indicate labour shortages as the main impediment to future expansion. In February 2020, the government adopted a national Plan of Action on Employment, which will seek to raise further the activity and employment rates through active labour market measures. Businesses have also been lobbying the authorities to relax the constraints on hiring personnel from third countries, especially seasonal workers. In 2019, the government adopted regulations that will speed up the issuing of visas to such workers. The government is also considering special incentives to attract young Bulgarians graduating abroad to embark on a career in Bulgaria.

The shortages in the labour market have continued to exert pressure on wages. Real wages grew by 7.8% in 2019, well above the rate of productivity growth. Related to that, inflation was also on the rise until mid-year. In the second semester, the cost-push factors were apparently offset by weakening domestic demand, and so the annual average rate of the HICP in 2019 was 2.5%.

However, in December 2019 and January 2020 inflation started to pick up again, fuelled by an upsurge in food prices. Actually, the annual average rate of growth for food prices in 2019 rose to 6.2%, up from 2.2% in 2018. One of the main factors behind this was the sharp hike in the price of pork, following a severe outbreak of African swine fever in 2019. According to tentative estimates, between 15% and 20% of the total pig population in the country were culled on infected farms and areas, in order to prevent the further spread of the infection. It remains to be seen whether the higher prices will persist in coming months.

Credit activity in 2019 was moderate. The stock of outstanding household credit in December 2019 was 9.5% higher than a year earlier; this was below the rate of growth in the previous year (11.2%). As for credit to non-financial corporations, that increased by 6.5% in 2019, roughly repeating the dynamics of the previous year (6.2%). In 2019, Bulgarian commercial banks continued to cleanse their balance sheets of substandard and non-performing loans. During the period 2018-2019, a total of BGN 3 billion of such assets were sold to debt collection companies. In September 2019, the share of non-performing loans in the total loan portfolio of Bulgarian commercial banks amounted to 7.5%, roughly the same level as a year earlier.

Last year was also marked by a record high current account surplus. This resulted, in the first place, from a combination of a shrinking deficit in the trade in goods and a further expansion of the surplus in the trade in services. The FDI inflow – which usually contributes to the negative part of the current account balance through imports of investment goods – was modest in 2019. A current account surplus of this proportion is definitely a handicap for an emerging economy such as Bulgaria's, and so policymakers may need to consider some counterbalancing measures.

For the first time since 2015, the consolidated general government balance slid into negative territory in 2019. The net outcome in 2019 was affected by a big one-off fiscal outlay – the purchase of eight F-16 fighter jets, worth BGN 2.1 billion. At the same time, the total revenue in the consolidated general government budget in 2019 was 13.1% higher than in 2018. This windfall triggered a massive public spending spree in December: the government allocated public spending of BGN 6.6 billion – more than double the usual monthly amount. This practice of extravagant spending of surplus revenue – bypassing parliamentary scrutiny – keeps being repeated year after year.

Income growth is a key policy focus in the 2020 budget. In January, the minimum wage was raised from BGN 560 to BGN 610, an increase of 8.9%. The budget also envisages an average 10% increase in public sector wages. Some categories of public sector employees will benefit from larger pay rises: school teachers will get 17.5% and social workers – 15%. A 6.7% increase in pensions is scheduled for July 2020. Other than that, the 2020 budget does not envisage any significant changes in economic policy.

The Bulgarian authorities are maintaining their intention of applying to participate in ERM II at the earliest possible date. In 2019 the ECB conducted an asset quality review and stress test, which found capital shortfalls at two of the six Bulgarian banks surveyed. The two banks in question have hastened to adopt action plans to cover the capital shortfalls. In February 2020, parliament passed amendments to the law governing the Bulgarian National Bank, clearing up some technical details associated with Bulgaria's participation in ERM II. Nevertheless, at the time of writing, no dates have been fixed, and it remains to be seen whether entry to ERM II will happen in 2020.

Recent months have been marred by a series of local crises, accompanied by political scandals. The most serious was related to a severe water shortage in Pernik, a city of 100,000 inhabitants not far from Sofia, caused by blatant mismanagement of the supply of drinking water. At almost the same time, it was also brought to the public's attention that large quantities of waste had been imported and illegally dumped at various unauthorised tips. These scandals provoked public unrest and were used by the opposition socialist party to seek a vote of no confidence in the government. However, the motion was voted down by the ruling coalition, which has a majority in parliament.

In early February, President Rumen Radev issued a public statement effectively withdrawing his political confidence in the government, claiming a deep crisis in Bulgarian society. While this was a purely symbolic gesture (the president has no constitutional powers to remove a government from office), it was indicative of the growing tensions both among different public institutions and within society at large. So far it appears unlikely that this will trigger early elections, but political instability has been on the rise.

The short-term prospects for the Bulgarian economy have deteriorated. The 2020 budget was compiled on the assumption that real GDP growth would amount to 3.3%. However, given the recent trends and the expected continued economic sluggishness in the EU, we expect a further slowdown in the Bulgarian economy in 2020 and the following years. Private consumption should remain strong, but this will not be sufficient to support robust growth. Consequently, we expect GDP to grow at below 3% in 2020. If external demand remains weak, economic growth could decelerate further in 2021 and 2022. Unless there is a policy shift to stimulate domestic demand, the economy will continue to generate large current account surpluses.

Table 6.4 / Bulgaria: Selected economic indicators

	2015	2016	2017	2018	2019 ¹⁾	2020	2021	2022	
							Forecast		
Population, th pers., average	7,178	7,128	7,076	7,025	6,950	6,900	6,850	6,800	
Gross domestic product, BGN mn, nom.	89,333	95,092	102,308	109,695	116,400	122,600	127,900	133,000	
annual change in % (real)	4.0	3.8	3.5	3.1	3.5	2.8	2.3	2.0	
GDP/capita (EUR at PPP)	13,800	14,300	14,900	15,700	16,600	.	.	.	
Consumption of households, BGN mn, nom.	54,703	56,846	60,932	64,849	69,300	.	.	.	
annual change in % (real)	3.6	3.5	3.8	4.3	5.2	3.5	3.5	3.0	
Gross fixed capital form., BGN mn, nom.	18,684	17,554	18,795	20,624	21,000	.	.	.	
annual change in % (real)	2.7	-6.6	3.2	5.4	0.5	1.5	1.5	1.5	
Gross industrial production ²⁾									
annual change in % (real)	2.9	2.7	3.4	1.1	0.7	0.5	0.5	0.5	
Gross agricultural production									
annual change in % (real)	-8.2	1.7	6.3	-0.4	-1.9	.	.	.	
Construction industry ³⁾									
annual change in % (real)	11.1	-16.7	4.6	1.6	3.6	.	.	.	
Employed persons, LFS, th, average	3,032	3,017	3,150	3,153	3,233	3,250	3,260	3,270	
annual change in %	1.7	-0.5	4.4	0.1	2.6	0.5	0.4	0.3	
Unemployed persons, LFS, th, average	305	247	207	173	143	130	120	120	
Unemployment rate, LFS, in %, average	9.2	7.6	6.2	5.2	4.3	3.8	3.6	3.4	
Reg. unemployment rate, in %, eop	10.0	8.0	7.1	6.1	5.9	.	.	.	
Average monthly gross wages, BGN	878	948	1,037	1,146	1,274	1,370	1,460	1,550	
annual change in % (real, gross)	7.0	8.9	7.2	7.5	7.8	5.0	4.5	4.0	
Consumer prices (HICP), % p.a.	-1.1	-1.3	1.2	2.6	2.5	2.5	2.0	2.0	
Producer prices in industry, % p.a.	-2.2	-3.1	5.0	3.9	3.0	2.5	2.0	2.0	
General governm. budget, EU-def., % of GDP									
Revenues	38.7	35.1	36.0	38.3	40.0	40.0	39.0	39.0	
Expenditures	40.4	35.0	35.0	36.5	41.5	40.0	39.0	39.0	
Net lending (+) / net borrowing (-)	-1.7	0.1	1.1	1.8	-1.5	0.0	0.0	0.0	
General gov. gross debt, EU def., % of GDP	26.0	29.3	25.3	22.3	20.5	21.0	20.0	19.0	
Stock of loans of non-fin. private sector, % p.a.	-1.6	0.8	3.3	7.7	7.4	.	.	.	
Non-performing loans (NPL), in %, eop	14.5	13.2	10.4	7.8	6.5	.	.	.	
Central bank policy rate, % p.a., eop ⁴⁾	0.01	0.00	0.00	0.00	0.00	0.0	0.0	0.0	
Current account, EUR mn	55	1,551	1,825	3,002	5,901	3,900	3,400	3,400	
Current account in % of GDP	0.1	3.2	3.5	5.4	9.9	6.2	5.2	5.0	
Exports of goods, BOP, EUR mn	21,919	23,104	26,950	27,744	28,876	29,500	30,000	30,500	
annual change in %	4.2	5.4	16.6	2.9	4.1	2.2	1.7	1.7	
Imports of goods, BOP, EUR mn	24,542	24,088	27,716	29,602	29,004	29,800	30,500	31,200	
annual change in %	3.1	-1.8	15.1	6.8	-2.0	2.7	2.3	2.3	
Exports of services, BOP, EUR mn	7,316	8,050	8,256	9,133	9,208	9,400	9,800	10,200	
annual change in %	7.8	10.0	2.6	10.6	0.8	2.1	4.3	4.1	
Imports of services, BOP, EUR mn	4,236	4,640	5,203	5,572	5,196	5,500	5,800	6,000	
annual change in %	-0.2	9.5	12.1	7.1	-6.8	5.9	5.5	3.4	
FDI liabilities, EUR mn	1,956	1,313	1,759	1,057	827	1000	.	.	
FDI assets, EUR mn	105	754	446	744	479	600	.	.	
Gross reserves of NB excl. gold, EUR mn	19,022	22,475	22,257	23,620	23,072	.	.	.	
Gross external debt, EUR mn ⁵⁾	33,855	34,655	34,211	33,156	34,500	34000	33500	33000	
Gross external debt, % of GDP ⁵⁾	74.1	71.3	65.4	59.1	58.0	54.0	51.0	49.0	
Average exchange rate BGN/EUR	1.9558	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.