

Bulgaria: economic consolidation making headway

Economic activity in Bulgaria remained relatively strong in the second half of 2002, defying the fears of a notable slowdown. According to preliminary estimates announced by the government, real GDP grew by 4.3% in 2002 as a whole which was above the 4% official growth target incorporated in the budgetary framework for the year. If these estimates are confirmed they would imply that the rate of GDP growth in the second half of the year was between 4.1% and 4.7% year on year, about the same as reported in the first half.

According to the quarterly national accounts data, the fastest expansion was recorded in the services sector whose output in the first three quarters rose by 6.1% over the same period of 2001. The tourist industry contributed the most to this outcome, reporting its best results in more than a decade: in January-October tourist receipts (BOP basis) grew 10% year on year (and in absolute terms were larger than the annual figures for 2001) while in January-November the number of foreign tourists was 8% larger than it was a year earlier. On the demand side, fixed investment was the fastest growing aggregate demand item although its rate of growth was lower than in previous years (7.4% year on year in January-September, compared to almost 20% in 2001 as a whole). Private consumption increased less than GDP, by 2.5% year on year in the first three quarters.

In some manufacturing sectors such as the textiles and leather industry, wood products, metal processing and the pulp and paper industry there was an upturn of economic activity in the second half of the year. Notably, after more than a decade of decline, there was a strong output recovery also in some electrical engineering branches such as appliances, IT and communications equipment. Manufacturing sales as a whole were gradually picking up in the course of the year. The significant gap between output and sales growth figures – in the order of some 7-8 percentage points in the first quarter, indicating large stock-building – dropped to some 3-4 percentage points in the fourth quarter. While the discrepancy still remains, its decline suggests that a considerable part of the previously accumulated stocks were cleared.

The revival in manufacturing sales was largely driven by the notable recovery in exports, especially in the third quarter, when they rose in current euro terms by more than 12% year on year. The upturn in shipments can also be traced in the rise of their physical volume: in January-September the volume of Bulgaria's total merchandise exports reportedly increased by some 8.1% from the same period of 2001, while in the first half of the year the rate of growth had been only 3.0%. As to the direction of trade, the EU continued to gain

market shares and contributed the most to the recovery of exports. By contrast, Russia and other CIS countries kept on losing market shares (Russia is now not even among Bulgaria's top 10 export destinations). There was also a revival of exports to other CEE economies which can be partly attributed to the liberalization of trade with some of these countries after Bulgaria and Romania joined CEFTA.

Another positive development that started in 2001 and strengthened considerably in 2002 was the revitalization of financial intermediation. The introduction of the currency board in 1997 was followed by several years of a severe credit crunch: banks were reducing their exposure to the corporate sector and were investing abroad a large share of their assets. 2002 marked a notable reversal in this trend: a significant amount of bank assets (USD 354 million in the first ten months of the year) were transferred back to the country and banks' credit activity intensified considerably. At the end of November the stock of outstanding credit to the corporate sector was 23% larger than it had been a year earlier. But the fastest growing segment of the credit market both in 2001 and in 2002 was that of household credit: after growing 45% over the course of 2001, the stock of outstanding household credit increased by a further 40% in the 11 months to November 2002.

The macroeconomic balance remains in a good shape. Annual inflation turned out to be below the official targets (which were revised upwards at the beginning of the year): in December the CPI was 3.8% higher than a year earlier while the average annual CPI inflation amounted to 5.8%. The final months of the year brought about a substantial reduction in registered unemployment, which fell between October and December by 1.1 percentage points to 16.3%, the lowest level in three years. However, it remains to be seen whether this reflects a genuine decline in joblessness or is related to the envisaged reform in registration schemes in 2003 (which involves an attempt to substitute part of the unemployment assistance with different forms of public works). The fiscal stance remained relatively tight: according to preliminary estimates, the consolidated general government deficit for the year was 0.7%, which was within the 0.8% target and below the 2001 level (0.9%). The two foreign debt restructuring deals undertaken in 2002 and the weakening of the US dollar helped to substantially reduce the level of public debt, which at the end of September fell to 59% of GDP (from 70% at the end of 2001).

The current account deficit declined sharply in 2002: by the end of October it was just USD 216 million, down from USD 585 million a year earlier (also in October, the 12-month rolling current account deficit was USD 515 million, down from USD 885 million in December 2001). Three main factors contributed to this development. First, the worsening of the merchandise trade balance was arrested and the trade deficit even started to decline, largely due to the low oil prices during most of 2002 (this reversed, however, later in the year). In the second place, there was an improvement in the balance of trade in

services thanks to the booming tourist industry. And thirdly, the shrinking of the current account deficit reflects a weakening in the inflow of FDI, as the two largest privatization deals (the Bulgarian Telecom and Bulgartabac, the tobacco monopoly) failed to materialize in 2002.

The policy debate on the 2003 budget brought about the first serious row with the IMF since 1997. The main point of contention was the budget of the National Social Security Institute (NSSI, the first pillar of the new three-pillar pension system) for 2003. As part of the ongoing pension reform, the government introduced as of the beginning of 2003 lower limits ('insurance thresholds') for the minimum payroll contributions to the NSSI, because of massive tax evasion. Due to the perceived high level of taxation of labour costs, a large number of firms (mostly small private ones) seem to be formally paying to their employees the minimum wage only; accordingly, they use this low basis also to make their contributions to the NSSI. Another portion of the actual remuneration apparently is being paid in the shadow economy, thus avoiding taxation (both income and payroll taxes). By introducing the insurance thresholds the government is hoping to be able to reduce the level of tax evasion at least with respect to the payroll taxes.

However, the IMF considered the 2003 revenue targets of the NSSI as rather optimistic and expressed doubts whether the new measures would allow the government to increase the level of aggregate social security contributions to 8.8% of GDP in 2003 (as envisaged in the budget) from their current level of 7.2% of GDP. Similarly, it was considered that the expected VAT revenues in 2003 were overestimated. According to the IMF's more conservative estimates, the consolidated budget deficit in 2003 would not be 0.7% (as envisaged in the government target) but could reach some 2% of GDP, and so it insisted on further expenditure cuts. During two rounds of consultations with the government, the sides could not narrow their positions, raising serious policy concerns: the lack of the IMF stamp on the budget would mean that funding under the current two-year stand-by agreement might be suspended, which could be an extremely negative signal for the markets.

Only during a third round of negotiations in December was the deadlock broken, thus averting the worst-case scenario. While the final agreement did not imply formal changes in the parameters of the 2003 budget, some important contingency measures were introduced. Thus, as part of the funding conditionality, public revenues will be monitored by the IMF on a monthly basis; in case they fall below the target levels in the absence of external shocks, the government undertook a commitment to reduce public spending. On the other hand, the postponement of the large privatization deals allowed the government to carry forward this expected revenue as a possible funding source of future fiscal deficits.

The Bulgarian authorities achieved their main foreign policy objectives in 2002: at the Prague NATO summit in November Bulgaria received an invitation to join NATO, and at the Copenhagen EU summit in December, Bulgaria and Romania managed to push through 2007 as the target date for their EU accession in the final summit documents. Although there is still a long and difficult way to go before these targets materialize, both these events are likely to have a positive impact on investor confidence.

The outlook for 2003 is moderately positive. The favourable outcomes for 2002 raise hopes that the government's target of 4.8% of GDP growth in 2003 could be achieved. If output strengthens, this may bring about a further fall in the level of unemployment. Provided the government continues to pursue a prudent fiscal stance, no immediate threats to macroeconomic stability can be foreseen in 2003. The financing of the current account deficit does not seem to be a source of serious concern either. However, these favourable forecasts will be – probably to a considerable extent – conditional on the strength of the recovery in western Europe and on the absence of major external shocks.

Table BG

Bulgaria: Selected economic indicators

	1996	1997	1998	1999	2000	2001	2002 ¹⁾	2003	2004 forecast
Population, th pers., end of period	8340.9	8283.2	8230.4	8190.9	8149.5	7891.1	.	.	.
Gross domestic product, BGN mn, nom.	1761.2	17432.6	22421.1	23790.4	26752.8	29618.1	32600	35300	38500
annual change in % (real)	-9.4	-5.6	4.0	2.3	5.4	4.0	4.3	4.5	5
GDP/capita (USD at exchange rate)	1198	1251	1543	1577	1542	1690	1990	.	.
GDP/capita (USD at PPP - wiiw)	5020	5920	6270	6540	7090	7680	8250	.	.
Gross industrial production									
annual change in % (real)	5.1	-5.4	-7.9	-9.3	10.3	-2.4	2.6	4	5
Gross agricultural production									
annual change in % (real)	-11.5	13.7	-1.5	2.7	-9.1	-0.3	.	.	.
Goods transport, public, mn t-kms ²⁾	79850	86543	82122	85568	84878	78624	.	.	.
annual change in % ²⁾	-8.4	8.4	-5.1	4.2	.	-7.4	.	.	.
Gross fixed capital form., BGN mn, nom.	238.5	1913.5	2919.8	3600.5	4206.0	5260.0	.	.	.
annual change in % (real)	-21.2	-20.9	35.2	20.8	15.4	19.9	7.4 ^{I-X}	.	.
Construction output total									
annual change in % (real)	-14.0	-4.4	-0.2	8.0	8.1	-6.5	.	.	.
Dwellings completed, units	8099.0	7452.0	4942.0	9824.0	8795.0	5937.0	.	.	.
annual change in %	18.8	-8.0	-33.7	98.8	-10.5	-32.5	.	.	.
Employment total, th pers., average	3285.9	3157.4	3152.6	3087.8	2980.1	2940.3	.	.	.
annual change in %	0.1	-3.9	-0.2	-2.1	-3.5	-1.3	.	.	.
Employees in industry, th pers., average ³⁾	728.1	838.7	802.5	722.5	662.0	632.2	.	.	.
annual change in % ³⁾	-5.5	-2.7	-4.3	-10.0	-8.4	-4.5	.	.	.
Reg. unemployed, th pers., end of period	478.5	523.5	465.2	610.6	682.8	662.3	602.0	550	520
Reg. unemployment rate in %, end of period	12.5	13.7	12.2	16.0	17.9	17.3	16.3	15	14
LFS - unemployment rate in %, average	14.1	14.4	14.1	15.7	16.9	19.7	17.8	18	17
Average gross monthly wages, BGN ³⁾	14.0	127.9	183.3	201.0	224.5	248.3	262.9 ^{I-X}	.	.
annual change in % (real, gross) ³⁾	-17.1	-16.6	20.7	6.9	1.3	3.0	1.9 ^{I-X}	.	.
Retail trade turnover, BGN mn ⁴⁾	723.7	5469.3	7214.2	8023.3	9725.9	10593.0	.	.	.
annual change in % (real) ⁴⁾	-7.6	-36.4	18.5	12.3	12.7	2.1	2.2 ^{I-X}	.	.
Consumer prices, % p.a.	121.6	1058.4	18.7	2.6	10.3	7.4	5.8	4	4
Producer prices in industry, % p.a.	130.0	971.1	16.5	3.2	17.1	7.3	3.0 ^{I-XI}	.	.
Central government budget, BGN mn									
Revenues	350.0	2983.3	4245.6	4543.5	5136.7	5429.6	12510 ⁵⁾	.	.
Expenditures	540.8	3650.0	3930.8	4132.0	5377.4	6012.7	12742 ⁵⁾	.	.
Deficit (-) / surplus (+)	-190.9	-666.7	314.7	411.6	-240.7	-583.1	-232 ⁵⁾	.	.
Deficit (-) / surplus (+), % of GDP	-10.8	-3.8	1.4	1.7	-0.9	-2.0	-0.7 ⁵⁾	.	.
Money supply, BGN mn, end of period ⁶⁾									
M1, Money	241.3	2433.9	2960.8	3302.1	3976.3	4883.8	5542.7	.	.
Broad money	1329.0	6163.3	6814.2	7662.1	10061.3	12600.1	14146.5	.	.
Base rate of NB % p.a., end of period	342.1	6.8	5.2	4.5	4.7	4.7	3.4	.	.
Current account, USD mn	163.7	1046.3	-61.4	-651.7	-701.6	-842.2	-650	-600	-500
Current account in % of GDP	1.6	10.1	-0.5	-5.0	-5.6	-6.2	-4.1	-3.1	-2.3
Gross reserves of NB excl. gold, USD mn	483.4	2121.0	2679.4	2892.0	3154.9	3289.6	4406.8	.	.
Gross external debt, USD mn ⁷⁾	9601.6	10408.5	10891.9	10913.9	11201.8	10618.7	10550.0 ^{Nov}	.	.
Exports total, fob, EUR mn ⁸⁾	3901.1	4368.3	3841.2	3733.8	5253.1	5714.2	5900	6200	6600
annual change in %	-5.8	12.0	-12.1	-0.4	40.7	8.8	3	5	6
Imports total, cif, EUR mn ⁸⁾	4047.6	4361.4	4475.8	5139.9	7084.9	8127.8	8100	8250	8500
annual change in %	-7.5	7.8	2.6	16.4	37.8	14.7	0	2	3
Average exchange rate BGN/USD	0.176	1.677	1.760	1.838	2.124	2.185	2.077	.	.
Average exchange rate BGN/EUR (ECU)	0.220	1.896	1.972	1.956	1.956	1.956	1.956	1.956	1.956
Purchasing power parity BGN/USD, wiiw	0.042	0.354	0.433	0.443	0.462	0.481	0.500	.	.
Purchasing power parity BGN/EUR, wiiw	0.045	0.389	0.475	0.483	0.501	0.522	0.540	.	.

Notes: 1) Preliminary. - 2) From 2000 new methodology. - 3) In 1996 public sector only. - 4) From 1996 according to NACE classification. - 5) General government budget. - 6) According to International Accounting Standards. - 7) From 1997 including trade credits to companies. - 8) From 1999 new methodology. Converted from the national currency to EUR at the official exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.