

Economic Outlook for Bulgaria 2015-2017

Project LINK Fall Meeting
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1. Recent Trends

It is not until 2014 that Bulgarian economy managed to reach its pre-crisis level of 2008 (Figure 1). However, investments went on lagging significantly behind. So, the recovery of the economy can hardly be described as stable.

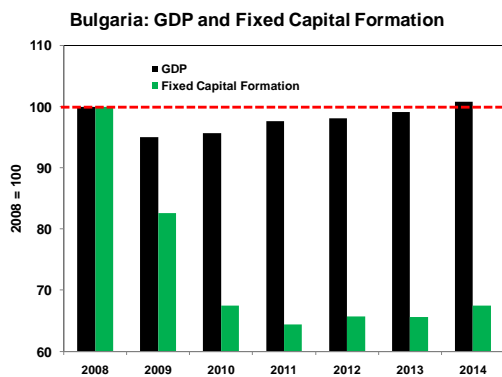


Figure 1

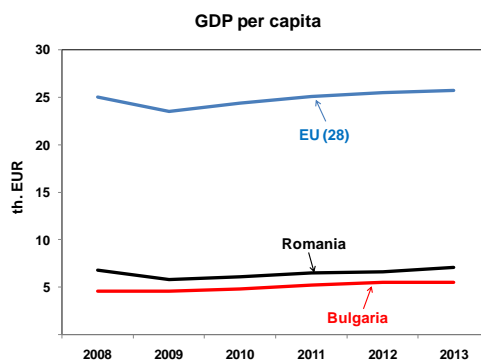


Figure 2

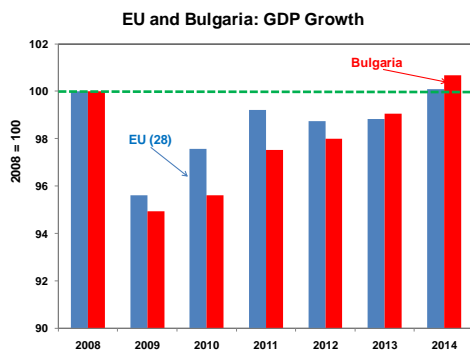


Figure 3

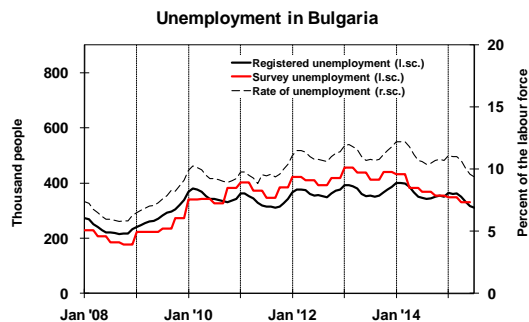


Figure 4

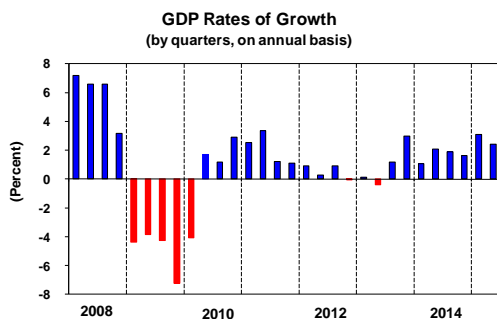


Figure 5

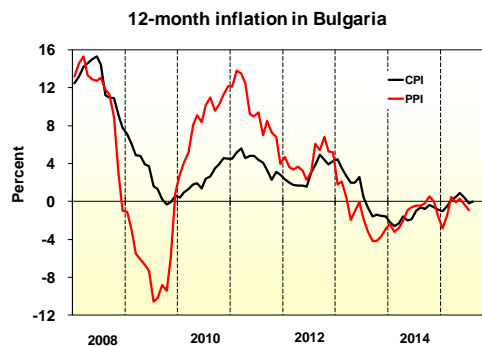


Figure 6

Having in mind how much in arrears it is from the EU (Bulgaria is the poorest country in the EU in terms of GDP per capita (Figure 2)) the GDP growth recorded is considered totally insufficient. Bulgaria has felt more sharply the financial and economic crisis of 2008 but the speed of the economy's recovery, however, goes in parallel with that of the EU, i.e. the absolute divergence between the economies of Bulgaria and the EU has been growing (Figure 3).

Unemployment is still at relatively high levels despite seasonal fluctuations (Figure 4). There has been a trend for shrinking unemployment over the last one or two years but it is still quite shy. What is interesting is the relationship between registered unemployment and survey unemployment, on the other hand. Before the crisis, registered unemployment was higher, which might be accounted for by the possibility for the active population to earn some additional income (in the shadow economy including). During the crisis this trend was reversed – registered unemployment was lower. A kind of despair became noticeable – the formal registration in the job centers was considered useless and respectively, avoided. By the end of the period of this survey there seem to be some prospects for a return to the pre-crisis correlations. This could be a good sign.

The high spirits of the managerial elite are connected with the positive GDP growth rates by quarters for the last two years and most of all of the first two quarters of the current year (Figure 5). The lasting positive trend, however, is yet to establish itself firmly. A similar movement of the economy was noticed before too (for instance in the early 2011) but it did not manage to further develop, though.

Under an economic upturn demand rises: this is linked to a more significant rise in prices. In Bulgaria, however, the deflationary tend prevails (Figure 6). This suggests that there are no grounds yet to anticipate a significant improvement of economic growth.

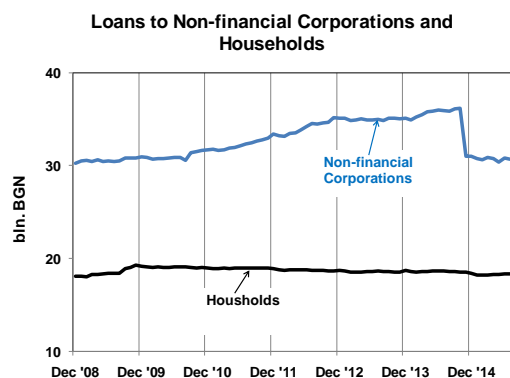


Figure 7

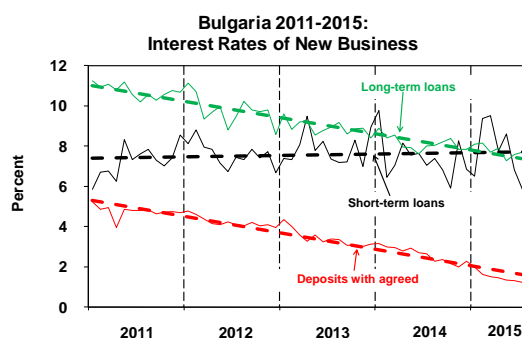


Figure 8

Another unfavorable fact is frozen lending (Figure 7). During the second half of 2014 the banking system was shaken up by the bankruptcy of the fourth largest commercial bank in the country. Figure 7 illustrates the decline in loans to non-financial corporations by the end of 2014. The latter is a reflection of the bankruptcy of this bank. The situation was put under control by means of a solid financial injection on behalf of the Ministry of Finance and thus financial panic was avoided. Serious infringements of lending discipline were revealed. Tightened control together with the expectations for assets quality management exercised by the ECB has further shrunk the sluggish lending anyway. Under these circumstances recovery of economic growth will have to be postponed in time.

The lending behavior of commercial banks becomes clearer when changes in interest rates are studied (Figure 8). Interest rates on new lending are kept high which speaks about problems with bad debts. It is indicative that interest rates on short-term loans by the end of the period started to exceed those on long-term credits – the demand for long-term credits, which underlie economic growth, declined and economic agents maintained their economic operations through short-term loans. At the same time interests on deposits fell following the low levels of inflation and the shrinking consumer demand of households.

2. Assumptions on National Policy and External Environment

In the fall of 2014, there were pre-term parliamentary elections. Not a single political party has managed to get an absolute majority and so, eight political parties joined the parliament – a record number for the country. A broad coalition government was formed, involving three parties and enjoying the parliamentary support of a fourth one. Given this distribution of power, decision-making in Parliament is difficult and as a rule achieved with a lot of compromises. A telling fact is that, only a year later after the formation of the currently acting coalition government, voices are being raised for new pre-term elections.

In the fall of the current 2015 local elections for the management of municipalities are to take place. Here too, the competition among the political parties is at the highest level. Painful reforms are delayed or settlements by compromise are enforced without a real positive impact on the running of social and economic processes in the country.

The usual justification of the macroeconomic elite for the low level of economic activities in the country is the negative impact of external factors. Actually, however, the claims for the decisive external negative impact are not seriously grounded. The causes for the emergence of the global financial and economic crisis lie with the developed economies and have no specific real manifestations in our home economy. There are reasons to claim that the financial and economic crisis the country is going through are to be found above all in the nature of the home social and economic management.

A passing glance at the commercial and economic relationships does not give grounds for anxiety from the operation of a negative external influence. The volume of foreign trade really dropped significantly in 2008 (Figure 9) but the exports of commodities and services recovered much faster compared to that of the imports of commodities and services. As early as 2010, exports exceeded their pre-crisis level of 2008, whereas imports took four years for that. As a whole, imports go on exceeding exports and by the end of the period too, but at a much lower extent.

Official statistics shows that foreign direct investments in non-financial enterprises kept on rising during the crisis years of 2009-2010 (Figure 10). Over the following two years they fell but the reasons are to be sought in the domestic macroeconomic management including, which did not manage to create a favorable investment environment. The rates of growth over the following years are positive but unsatisfactory (low!) and again, the reasons should be found most of all in the particularities of the home macroeconomic management.

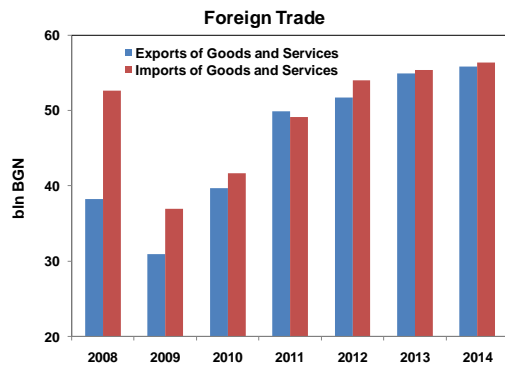


Figure 9

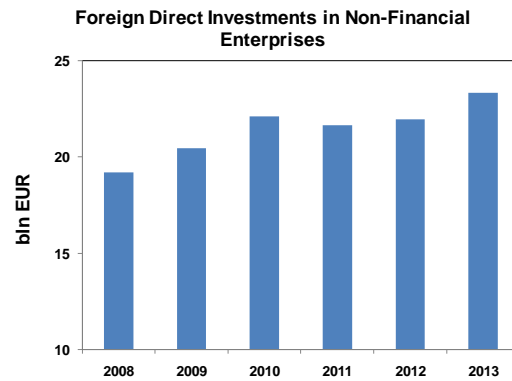


Figure 10

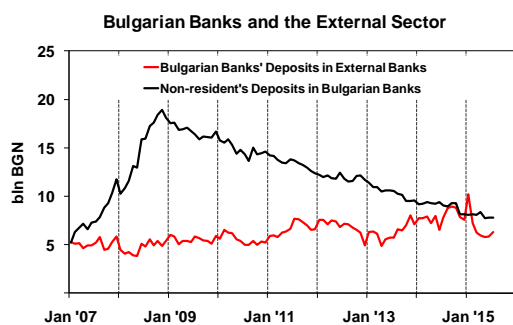


Figure 11

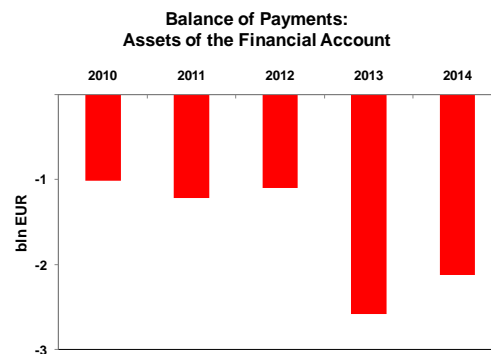


Figure 12

The country has experienced negative external impacts over the last years. The ostensible influence of the debt crisis in Greece is still to be felt but by the end of 2015 there are not yet any serious worries. Nearly 30% of the capital of commercial banks in Bulgaria is of Greek origin but nevertheless, it is under the control of the Central Bank of Bulgaria (Bulgarian National Bank). All the same there is some leakage of foreign banking capital from Bulgaria but it started with the beginning of the financial and economic crisis (2008) and the reasons cannot be connected with the debt troubles of Greece. Along with the leakage of foreign banking capital a trend of a transfer of local banking assets abroad is recorded. This process becomes more worrying if the volume of local capital exported from the country is taken into account (Figure 12). It is obviously seeking a safer application (not very lucrative though) abroad, primarily in the EU.

By the current 2015 the EU is shaken by the refugee problem. It can't be considered as very substantial from the economic point of view for Bulgaria. This is due to the strivings of the Afro-Asian migrants to settle in the developed countries of West Europe and in addition, Bulgaria has very limited possibilities to receive them. The tightened border control played a positive influence too. It manages to restrict the criminal refugee transfer.

At present the economic problems of the country may be described as institutional rather than parametric. The solution to the problems necessitates improving the institutions, not just a change in one or another parameter of management. It seems that this is exactly what the country's macroeconomic elite does not seem to understand. The local currency has been pegged to the Euro since 1997 which contributed to the security of foreign currency transactions and exchange. A flat tax of 10% on individual and corporate income is in force in the country and

this is supposed to encourage investments. Despite that they are still weak and unsatisfactory.

The inefficiently operating institutions periodically stir some social tension which often transforms itself in large-scale street protests. This is what makes the social and economic development difficult to forecast.

3. Forecast Summary

Anyway, the forecast suggested should be treated as conditional. This country needs average annual rates of growth of minimum about 4-5% and manages to attain hardly 1-2%. The upturn presumes a substantial change in the nature and principles of macroeconomic management. Such beginnings are not yet to be seen. Parties should become aware that they are not formations of a business company type whose goals are primarily and most of all to satisfy the interests of their own members and that they should rise above the narrow party interests. This can only take place provided there is a much more active and conscious participation of the predominant part of the population in the political process in the country, i.e. it presumes a necessary maturing of the people. The process of such a maturing will influence decisively the speed of economic growth.

It is expected that economic growth will be accelerated to about 3% by the end of the forecasted period. Given a normalization of development we should expect an overtaking price development inside the country compared to the EU as far as Bulgaria's price level is about half of the EU's one. The respective indicators accompanying economic growth will change in parallel.

4. Policy Issues and Uncertainties

The main focuses of social and economic policies should be aimed at improving the quality of the institutions' functioning. There has been a prolonged debate in the country about a change in the status and character of the legal system and the radical decision is still postponed. Recently, an attempt has been made at adopting a modern anti-corruption law but Parliament voted against it. The acting laws are amended much too often because of lobbyist interests or simply oversight. All this creates insecurity and drives investors back. The impression made is that political parties are only interested in the prosperity of their own members and let frequent and serious domestic political blunders happen.

A great part of the population approaches the election process with previously set minds (hard core voters), which creates a propitious environment for the party centrals to reproduce themselves. At the same time more and more people begin to realize their own responsibility for the current social and economic realities. For this reason there have been lately a growing civil participation and presence at the working out of macroeconomic policies of varied nature. The process of „maturing” of voters will continue and the issue is when it will be able to exercise an essential and efficient control on the macroeconomic elite to bring about a radical change in the character and principles of management. Such switching over might prove painful and be paid with another delay in economic growth or at least with postponed higher and steady rates of growth. As a matter of fact, this represents the most serious uncertainty in the mid-term for the economic development of the country.

The EU, in its existence over the last 6-7 years, has been faced with serious challenges. Most likely new ones will emerge in the future too, which cannot be

predicted now. Bulgaria has had the chance to become a member of a prospering society and the favorable effects of this membership are constantly felt. One may definitely say that Bulgaria would have been in a much more unfavorable situation if it had not been a member of the EU. The experience so far gives grounds to claim that any possible and probable future shock social and economic effects for Bulgaria will be overcome with the help and thanks to the EU.

5. Summary Table for Forecast

Table 1

Bulgaria: LINK Forecast Fall '15

	2012	2013	2014	2015	2016	2017
Aggregate Demand (current m BGN)						
Individual Consumption	58520	56710	58188	58396	61135	64481
Collective Consumption	6001	6759	6854	6858	7123	7512
Gross Capital Formation	17246	17108	17291	17827	19256	21732
Export	51710	54907	55791	57860	59714	61567
Import	53990	55372	56376	59229	61232	66388
Gross Domestic Product	80044	80282	82164	83232	85367	90112
Aggregate Demand (2011 m BGN)						
Individual Consumption	56463	55447	56777	57913	59650	61440
Collective Consumption	5857	6068	6183	6288	6425	6617
Gross Capital Formation	17018	17001	17477	18176	19226	20714
Export	50313	54942	56151	58367	60118	61921
Import	51360	53877	55924	59799	61232	63408
Gross Domestic Product	78826	79693	81048	82538	84516	87519
GDP Growth Rate (%)	0,5	1,1	1,7	1,8	2,4	3,6
Balance of Payments (current m EUR)						
- - Exports of Goods and Services - -						
	26513	28067	28654	29583	30471	31385
- - Imports of Goods and Services - -						
	27729	28223	29035	30283	31307	33944
- - Goods and Services Net - -						
	-1216	-156	-381	-700	-837	-2559
Key Economic Indicators						
Exchange Rate, Annual (BGN/USD)	1,52	1,47	1,43	1,70	1,64	1,72
Exchange Rate, Annual (BGN/ EUR)	1,96	1,96	1,96	1,96	1,96	1,96
CPI, Annual Average (%)	3,0	0,9	-1,4	0,0	2,1	3,0
GDP Deflator, Annual (%)	1,5	-0,8	0,6	-0,5	0,2	1,9
Individual Consumption Deflator (%)	3,6	-1,3	0,2	-1,6	1,6	2,4
Export Deflator (%)	2,8	-2,8	-0,6	-0,2	0,2	0,1
Import Deflator (%)	5,1	-2,2	-1,9	-1,7	1,0	4,7
Employment (Th., eoy)	3436	3380	3375	3365	3350	3350
Registered Unemployment (Th., eoy)	376	439	416	370	328	276
Unemployment Rate (% , eoy)	11,4	11,8	11,2	10,0	8,9	7,5
Labor Productivity (Th. 2011 BGN)	24,7	25,5	25,8	26,0	26,4	26,9
Annual Wage (current BGN)	8773	9301	9500	9766	10127	10638

Government Surplus (% GDP)	-0,4	-1.8	-3.7	-1,7	-2,2	-2,4
Government Debt (% of GDP)	17,1	17,6	26,9	28,1	29,7	31,6
Money Supply M1 (current m BGN)	23014	27039	32221	34680	37116	39179
Money Supply M2 (current m BGN)	61608	67163	73690	79269	81302	85821
Money Supply M3 (current m BGN)	61722	67236	75194	81721	82961	87573

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