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REGIONAL ECONOMICS & MARKET STRATEGY FOCUS NOTE

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BULGARIA
GERB wins snap general elections

- With nearly all (99.98%) of the votes counted, the centre-right pro-EU ruling Citizens for European Development of Bulgaria (GERB) won Sunday's snap general election ballot with a share of 32.66%. Former Prime Minister Boyko Borissov's party won the national polls for the third time in five years.

- Recall that the elections were called earlier this year after Prime Minister Boyko Borisov handed in his government's resignation in Parliament in the wake of the November Presidential elections that saw the defeat of his party's candidate. The 43rd National Assembly was dissolved in January and a caretaker government had been appointed since then to steer the country towards the March 26th general elections. The elections took place two years ahead of schedule and mark the country's return to national polls for the third time in four years.

- The second largest party in Parliament, the Bulgarian Socialist Party (BSP), was the runner up having scored 27.19%, in a renewed indicator that polls are not a reliable predictor of election results as they had pitted GERB and BSP as running neck and neck. Three more political parties managed to pass the 4% threshold to enter the 240-seat Parliament. Namely, the nationalist coalition United Patriots (9.07%), the Movement for Rights and Freedoms DPS (8.99%) which represents primarily the ethnic Turkish minority and the newly formed "Volya" (4.15%) led by businessman Veselin Mareshki. Turnout on Sunday was reportedly around 50%.

- As was broadly anticipated GERB fell short of obtaining the necessary absolute majority in order to rule on its own. At the same time, GERB is rather unlikely to form an alliance with BSP. This was also confirmed by the latter party's leader Korneliya Ninova, who underscored that her party will not take part in negotiations with GERB, if it is invited, citing divergence of policies and lack of ground for common action. Hence, support from smaller parties will prove essential for the formation of a new government. A coalition between GERB and United Patriots is currently being speculated as the most probable scenario. Together they are seen occupying a small majority of 123 seats in parliament, as the former is estimated to have obtained 96 seats and the latter 27 out of the 240 total.

- Among pre-election promises, GERB has pledged to continue pursuing prudent fiscal policies supportive of the Currency Board Arrangement, increase public wages and improve the business environment, while United Patriots oppose immigration and call for increases in pensions and maintain low electricity prices. A three-party coalition cannot be ruled out either. Such an alliance including "Volya", which is estimated to have won 12 seats in the National Assembly, will strengthen the government's mandate. Another possible scenario is that of a minority government with the tacit support of other parliamentary groups. Coalition negotiations are expected to kick off after final results are announced on Wednesday. If GERB fails to receive parliamentary support to form a government, then the President will entrust this task to the second parliamentary group, the BSP. All in all, a GERB-led administration implies a pro-EU policy continuity and disciplined fiscal stance. However, the participation of other parliamentary groups in such an alliance will likely cast a populist tone.

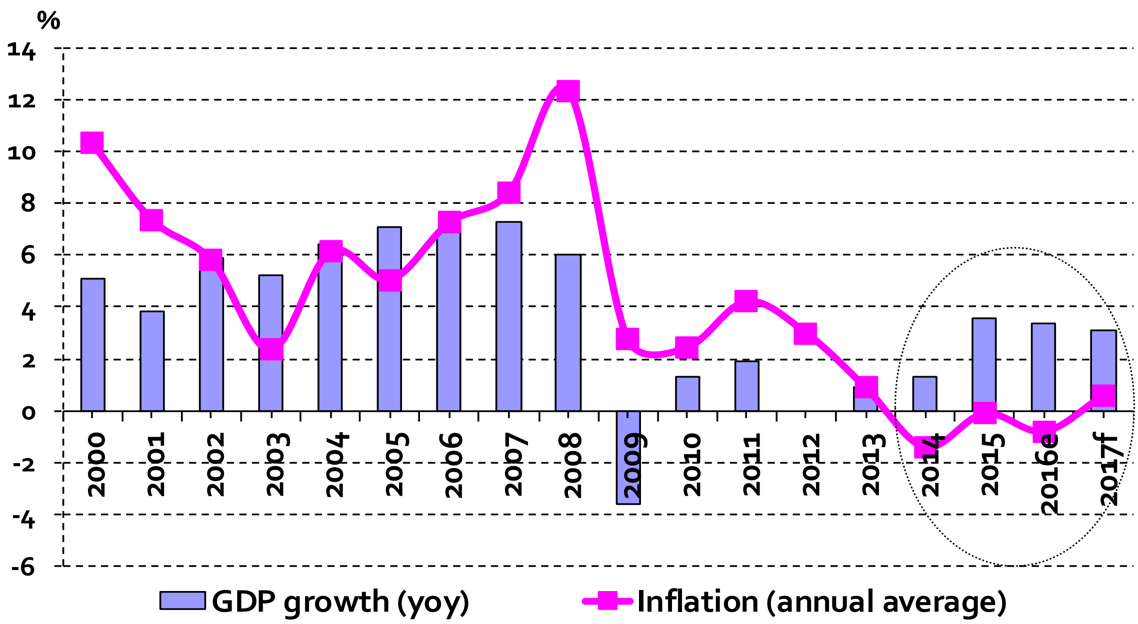
- The domestic stock market reacted positively to the election's outcome. In more detail, the main SOFIX index rose to a new near decade high in mid European Monday trade, bucking the negative trend in the CESEE region. Similarly, the yield on Eurobonds maturing in September 2024 fell 5bps to a multi-month lows below 1.50%.

- Growth remained on track in Q4-2016, bringing the FY2016 at 3.4%, an inch down from 3.6% in FY2015. Sustained labor market improvement coupled with real positive wage growth (9.4% YoY in 2016 vs. 9.9% YoY in 2015) supported private consumption recovery throughout the past year (+2.1% YoY in FY16). The unemployment rate declined further to 7.1% in FY16 vs. 9.2% in FY15 (7.1% in Q4 down from 8% in Q4-2015) as the economy adds new jobs in the areas of specialized services. On the other hand, gross fixed capital formation was in deep red in FY16 (-4.0% YoY). The decline mirrors the negative base effects as a result of the increased EU funds absorption in the past year ahead of the closing of the programming period 2007-2013, the underperformance of the public investments program due to the political uncertainty erupted in the aftermath of Presidential elections last year and lower FDI inflows (€702mn in FY16 vs. €2.54bn in FY15). Finally, net exports recovered in 2H after a poor reading in 1H (Exports: +5.7% YoY & Imports: +2.8% in FY16) and had an additional positive boost on growth as well.

- Bulgaria is expected to register a second consecutive year of strong-above potential growth in 2017. Private consumption dynamics are broadly set to remain strong as the economy benefits from a more expansionary fiscal policy stance, an improving labor market, catching up wages and still relatively low energy prices. Investments are going to receive support from improved EU funds absorption in the new programming period, while a vibrant export oriented manufacturing sector and an emerging tourism industry boosts net exports. Our growth forecast for 2017 stands currently at 3.1%, little above the recently released BNB quarterly economic review forecast of 2.8%.

- From a macro fundamentals point of view, the country is now in much better shape to withstand an internal or external shock. The country's external and fiscal position is strong - the banking sector capital position is solid and the buffers (fiscal and FX reserves) are sizeable. Budget execution outperformed the target by a wide margin in 2016 (+1.6% of GDP surplus vs - 2.0% deficit target). The CA balance -in surplus for the fourth consecutive year-climbed to +3.9% of GDP in FY16 up from -25.2% in FY07.

Figure: GDP growth switched gear in 2015-2017



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