Tuesday, July 7, 2009

Country Focus – Bulgaria

An assessment of the July 5 parliamentary-elections outcome

With all of the votes in the July 5 general election having been counted, preliminary results showed that the centre-right opposition party, the Citizens for European Development of Bulgaria (*GERB*), achieved a significant victory. It obtained a share of 39.71%, in a 20-year high turnout of 60.2%, faring much better than in the European Union elections earlier this year as well as the most recent opinion surveys conducted ahead of Sunday's ballot. (*The final result of the July 5 vote is expected to be announced on Thursday*). The GERB will occupy 116 seats out of the 240 in parliament. It is short just five of obtaining an outright majority to rule alone. The party of the ruling Socialists (*BSP*) is trailing far behind, having scored 17.70%, corresponding to 40 MPs, while their junior coalition partner, the ethnic Turkish MRF, collected 14.46%, or 38 seats. The ultranationalist Attack obtained 9.36% for 21 seats and the Blue Coalition 6.76%, or 15 seats. The last party which passed the 4% threshold to enter parliament was the Order, Law and Justice which achieved 4.13% (*10 seats*). On Monday, the GERB said it would start coalition talks to form a government. At present, the most likely scenario is a pro-euro, pro-reform, GERB-Blue Coalition partnership. Both parties have signaled they are highly in favour of such an alliance. The GERB has repeatedly said that, if in power, would fiercely tackle corruption and immediately initiate negotiations with the IMF in order to secure a Stand-By financial aid program to cushion the spillover impact of the global financial crisis. It has also highlighted its intention to revise the budget and employ spending cuts so as to avoid fiscal slippages and maintain investor confidence towards the Currency Board Agreement (CBA).

Following nearly a decade of hefty fiscal surpluses, Bulgaria is faced with the risk of running a deficit this year. This may not echo alarming at first, as most of its fellow Central Eastern Europe countries operate on budget shortfalls. But in Bulgaria's case surpluses are key for the sustainability of the CBA. In view of the BGN's peg to the euro, the main tool that the government has at its disposal to intervene in the domestic economy is fiscal policy. However, this year is proving to be dire. The global financial crisis is taking a hefty toll on the domestic economy. And growing concerns about the sustainability of Latvia's currency peg are spilling over to Bulgaria. In line with global developments, domestic and external demand in Bulgaria is collapsing and the troubles in the labour market have further to run. As a result, the fiscal performance is being severely hurt. Depicting the sharp deterioration in the government's finances, the budget recorded a surplus of just BGN 555.4mn (*or ca USD 400mn*) in the first five months of the year, down 17.8% on a monthly basis and 83.2% compared to the same period a year earlier. This was due to a combination of increased spending in the run-up to the July elections and lower tax revenues (*-6.1%yoy*) due to the domestic economic downturn. Under local accounting standards the January-May surplus corresponds to a meager 0.8%-of-GDP which compares with the official surplus target of 3%-of-GDP (*the government recently suggested that a downward revision to 1.0%-of-GDP is on the cards*).

Taking into account that most of fiscal spending is customarily realized towards the end of the year (*the budget ran a surplus of 5.36%-of-GDP in January-May 2008, but ended the year at 3.0%-of-GDP*), the generation of a budget surplus in 2009 now seems out of reach. On a less worrying note, the fiscal reserve account, which the government is compelled to maintain under the CBA, amounted to BGN8.3bn in May and along with ample foreign exchange reserves provided a strong buffer of support to the currency board (*equivalent to around 43%-of-GDP, according to our calculations*). Nonetheless, the country's high external financing requirement, primarily the result of a widening gap between national savings and investments in recent years, has raised concerns that the country will not be able to navigate through the crisis without external financial assistance, the provision of which financial markets eagerly await. In these lines, the July 5 elections outcome is considered to be favorable for financial markets. Provided that the GERB will manage to form a coalition government, a swift revision to the 2009 budget targets should be expected, including additional spending cuts and a temporary freeze of the capital outlays. An IMF agreement could also help to ease investor concerns about a domestic financial crisis and force the new government to follow strict policy guidelines to cushion the effects of the global turmoil. Although such a programme would not prompt a speedy rebound from the recession (*we still expect contraction of 2.0%yoy in 2009 followed by a marginally flat-to-negative growth in 2010*), it should promote much needed reforms, favourable for growth in the longer-term. Looking further ahead, a pro-euro government will also support convergence towards euro zone countries and the eventual adoption of the single currency.

From a political standpoint, a swift agreement between the GERB and the Blue coalition, which looks highly likely at present, is crucial as it would alleviate the threat of lengthy coalition negotiations and the prospect of prolonged political instability. Sunday's result also allays the risk of a multi-party coalition government which could lack coherence of opinion. The high majority the GERB is set to enjoy in parliament suggests that a strong government will be more capable of pursuing necessary reforms to support the domestic economy and the CBA. The GERB is officially led by the former deputy mayor of Sofia, Tsvetan Tsvetanov. However, the party's actual leader is the incumbent mayor of Sofia and former firefighter and bodyguard Boyko Borisov. He is tipped to become the next Prime Minister. And for many, he is the "Batman" - as Borisov is dubbed due to his passion for action – who has been appointed to lead Bulgaria out of recession. Not surprisingly, fighting corruption and organized crime will likely be amongst his key priorities.

Bulgaria: Macroeconomic indictaros

	2007	2008	2009f	2010f
Real GDP (YoY, %)	6.2	6.0	-2.0	-0.3
Private consumption	5.3	4.8	-0.5	0.0
Gov´t consumption	3.1	0.1	0.2	0.2
Total investment	21.7	20.4	-13.0	-2.0
Exports of g&s	5.2	2.9	-11.5	2.0
Imports of g&s	9.9	4.9	-11.8	1.0
Output gap w.r.t. potential GDP	3.6	3.7	-2.4	-5.5
Labor market & social statistics				
Unemployment rate (%, YoY)	6.9	5.6	7.5	8.0
GDP per capita (%, YoY)	6.2	6.5	-1.5	0.0
Prices, money & credit				
Harmonised CPI (%, YoY p.a.)	7.6	12	3.6	3.5
Compensation of employees/head (%, YoY)	17.9	19.3	6.5	4.2
ULCs - whole economy (%, YoY)	14.2	16.2	5.9	3.3
Labour productivity *(Real GDP/occupied person) (%, YoY)*	3.3	2.7	0.6	0.9
Fiscal accounts (% GDP)				
General gvn´t balance	0.1	1.5	-0.5	0.0
Gross debt, general gvn´t	18.2	14.1	16.0	17.5
External accounts (% GDP)				
Current account balance	-22.5	-25.3	-14.0	-10.0

Source: National statistics, EC, Eurobank EFG Research

Galatia Phoka
Emerging Markets Analyst
Tel: (+30) 210 371 8922
e-mail: gphoka@eurobank.gr

Research Team:
Gikas Hardouvelis, *Chief Economist and Director of Research*
Platon Monokroussos, *Head of Financial Markets Research*
Paraskevi Petropoulou, *Economist*
Galatia Phoka, *Economist*

Sales Team:
Fokion Karavias, *Treasurer*
Nikos Laios, Danai Manoussaki, Kostas Karanastasis

EFG Eurobank Ergasias, 8 Othonos Str,GR 105 57, Athens,Tel:(30210) 3718 906, 3718 999, Fax:(30210) 3337 190, Reuters Page: EMBA,Internet Address: http://www.eurobank.gr