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FOCUS NOTES: BULGARIA

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Bulgaria: Political turmoil persists

- **Inconclusive parliamentary elections have led to the formation of an unstable minority BSP-MRF government coalition**
- **Antigovernment rallies continue unabated undermining policy consistency and efficiency**
- **The Parliament rejected the Presidential veto on the amendment of the budget law which envisages a revision of the fiscal deficit target to 2% of GDP in order to increase discretionary public spending**

Inconclusive parliamentary elections resulted in the formation of a politically unstable government coalition

The resignation of the Borisov administration in last February led to early parliamentary elections on May 12th. The unexpected resignation came after days of violent protests in the streets of the main cities in Bulgaria. The rallies originally organized against the inflated electricity and heating bills, escalated to massive protests against energy monopolies, high unemployment, low wages and living standards.

The results of the parliamentary elections almost produced a stalemate. No party was able to gain absolute majority of the parliament seats to form a government. The ruling party Citizens for the European Development of Bulgaria (CEDB) came first, with 97 seats, the Socialist Party (BSP) followed with 84 in the 240 seat parliament. In contrast to polls expectations, only two smaller parties accomplished to receive enough votes to return to parliament: the Movement for Rights and Freedoms (MRF) and the ultra nationalist Ataka (Attack). MRF which represents ethnic Turks minority collected 36 seats, and the far-right Ataka (Attack) collected 23 seats.

No party was willing to provide parliamentary backing support to CEDB to form a new government cabinet. At the same time, the parliament arithmetic allowed only for a tripartite government coalition to be formed with the rest of all three parties. However, the agenda and policies between BSP-MRF and Ataka are diametrically opposed which complicated the formation of a coalition government. Negotiations resulted in the formation of a BSP-MRF coalition, which was in the government in 2005-2009 and which controlled 120 seats out of the 240 seat parliament, but still lacked absolutely majority in the parliament. Attaka deputies abstained from the vote of confidence thus providing implicit support to the new government coalition. Thus, the BSP-MRF new government cabinet under the leadership of Mr. Plamen Oreharski who served as the Finance Minister in the 2005-2009 administration secured majority in the parliament.

Antigovernment rallies continue unabated undermining policy consistency and efficiency. Early parliamentary elections in May 2014 cannot be ruled out

The post election landscape looks equally challenging. Mass protests have continued even after the parliamentary elections. The latest round of anti government protests began after appointment of media executive Mr. Delyan Peevski as head of the State Agency for National Security (DANS) on June 14. Nationwide demonstrations forced him to back off from the appointment. Protesters were not appeased by the subsequent cancellation of the decision and went on to demand the resignation of the BSP-led cabinet over ties with oligarchs.

In retrospect, political uncertainty has increased in the country following the inconclusive parliamentary in last May. The government coalition is fragile and is highly dependant on the mood of Attaka which can at any time launch or support a no confidence vote in the parliament and topple down the government. Political tensions have risen substantially so that the probability of early elections is very high. From that point of view, the most probable date for another round of early parliamentary elections is on May 2014. Although it is hard to predict if elections are going to coincide with European parliament elections, all political leaders have agreed upon to avoid another round of elections too soon.

The rise of political tensions have feed into policymaking as well. In an unprecented move for the contemporary history of politics in Bulgaria, the President vetoed the incoming government's plan to revise the fiscal target of the current year. As a result, the parliament had to approve this year's budget revision twice. The budget deficit target was revised to 2% of GDP against 1.3% previously. The revision reflects expected revenue shortfalls and expenditure overruns and provides for issuing up to 1 bn Leva in new debt (from 2bn to 3bn).

In our view, the revision is not an imminent threat to the sound fiscal position and macroeconomic stability of Bulgaria for the time being. The debt profile and fiscal fundamentals put Bulgaria among the few bright spots in EU-27. That is one of the reasons why the financial markets reaction is relatively muted (Figure 5. 6). The strong track record of fiscal prudence, the low deficit and debt stock is acknowledged by rating agencies so that Bulgaria never lost its investment grade status in the post Lehman period. Both FITCH and Standard & Poors have affirmed BBB rating for Bulgaria. Yet, the budget revision could be seen as a shift to more populist policies. The social and political turbulence could hurt the ability and will of the incoming government to deliver the so much needed reforms and adopt less pro market policies.

Macro indicators illustrated a picture of a decelerating economy in the 1H-2013. Growth performance is expected to improve gradually in the 2H-2013

Growth in the 1H was on a decelerating trend. GDP growth came at -0.1% qoq/+0.2% yoy in Q2 down from +0.1% qoq/ +0.4% yoy in Q1. The main driver behind feeble growth was net exports (1.3 pps in Q2 vs. 2.5pps in Q1) while domestic demand remained in recessionary territory (-1.1pps in Q2 vs. -2.1pps in Q1). Private consumption contracted by +0.1% qoq/-1.3% yoy in Q2 down from -1% yoy in Q1. Investments registered their negative quarter on quarter performance since Q4 2011. Investments slowed down to -2.4% qoq/+1.4% yoy in Q2 vs. +2.5% qoq/+5.0% yoy in Q1. Net exports were the bright spot for another quarter. Exports expanded by 4.5% yoy in Q2 down from 10.8% yoy in Q1. Accordingly, imports grew by +2.4% qoq/+2.0% yoy in Q2 down from +4.1% qoq/+5.6% yoy in Q1.

High frequency indicators suggest a strong start in third quarter after a weak 1H-2013. So far, the negative impact from the political turmoil on economic activity is contained. The issues and challenges that Bulgarian economy is confronted with have a lasting impact during the post-Lehman period. However, protracted political uncertainty coupled with the headwinds coming from the Euroarea sovereign debt crisis may lead consumers and corporates to postpone their consumption and investment decisions.

- **Industrial production:** The industrial production readings have disappointed expectations throughout 1H-2013. Industrial production recorded its steepest drop on an annual basis since February 2010 in last May, contracting by -2.7% mom/-6% yoy in working day adjusted terms. However, industrial output was also off to a strong start in Q3 with a +1.7% mom/ -2.6% yoy reading in July, but was still kept below its result from a year ago at -2.6% mom /-1.4% yoy.

- **Retail trade:** The only tentative signs of improvement in domestic demand come from the positive readings from retail sales. After contracting by -3.5%yoy in Q1, retail sales in volume terms increased by +1.7% yoy in Q2. The reading of July (+1% mom/+4.3% yoy in seasonally adjusted terms) was the strongest in the post-Lehman period.

- **Consumer sentiment:** Consumer confidence deteriorated in July as Bulgarians became more pessimistic about the economic situation in the country in the next 12 months and more concerned on unemployment prospects. The consumer confidence index came at -39.8, which was 2.1pps lower than in last April before the eruption of the political crisis.

- **Business sentiment:** The overall business climate indicator remained flat in August as a result of an improvement in services, construction and retail trade that was offset by deterioration in industry.

- **Trade balance**: Export activity registered negative annual growth rate in last May-June, so that the cumulative rise of exports slowed down to single digits in 1H-2013 (+7.8% yoy in Jan-June against +15.2% yoy in Jan-April). At the same period, imports declined by -0.1% yoy which helped contain the trade deficit down to -3.2% of GDP against – 5.6% in 1H-2012.

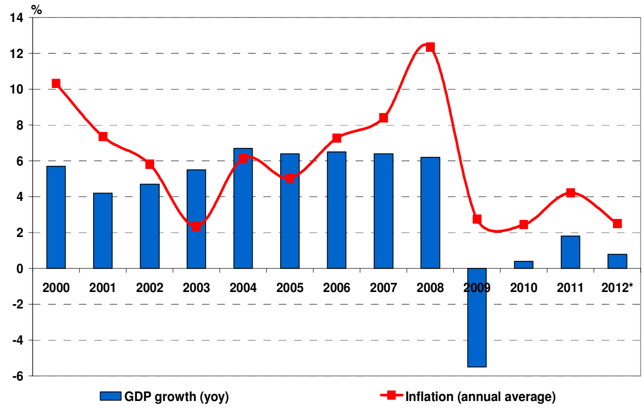
Overall, the 1H growth performance (+0.3% yoy in 1H-2013 vs. 1% yoy in 1H-2012) is disappointing and not supportive of our earlier full year forecast (+1% yoy in 2013). Yet we anticipate that

2H growth is going to be higher than the 1H, so that we now see full year growth to reach 0.7% for 2013.

The growth performance of 1H was primarily negatively affected by private consumption. However, private consumption and thus growth is going to receive support from a looser fiscal policy in the 2H. Lower expected inflation in is expected to provide support to real incomes as well. The most important inflation components, food and energy prices are on a declining trend which is expected to continue in Q4 (Figure 3). Moreover, employment has shown tentative signs of improvement that are going to be reinforced by the seasonal jobs increase in the 2H-2013 (total employment has increased by 20k during the last twelve months). Declining lending interest rates are expected to give some more breathing space to households and corporates. We also anticipate higher support for investment from EU funds absorption. Last but not least, the end of recession in Euroarea is expected to remove some of the pressure from Bulgarian exports (a large part of exports-around 60% head to EU-27).

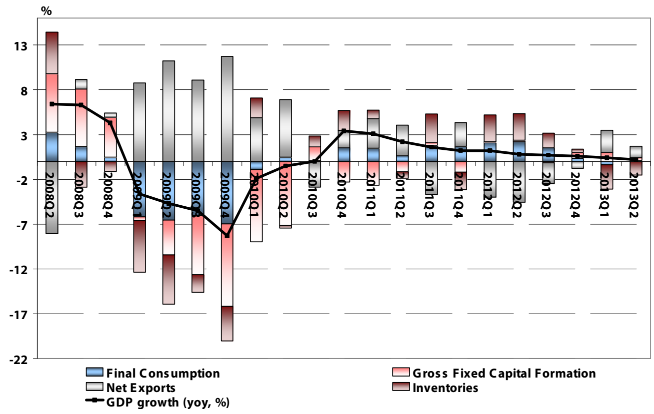
In any case the growth rebound from the great recession has been lackluster (Figure 1). At the expense of maintaining fiscal discipline, the previous administration policies neglected to boost growth. The Ministry of Finance is about to revise the official forecast for growth in 2013 for a second time in this year. The caretaker government had downgraded the growth forecast from 1.9% to 1% in last April. The incoming government is about to revise it further down to 0.6%-0.8%. The latest forecast of EU Commission stands at 0.9% in 2013. IMF and World Bank have lowered their individual forecasts to 1.2% from 1.3% and 1.9% respectively.

Figure 1: GDP & Inflation growth rates



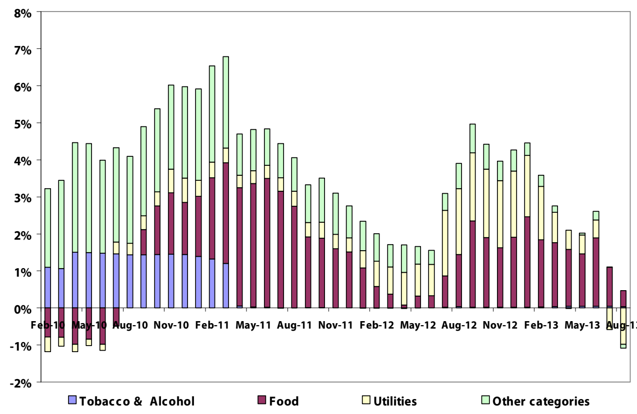
Source:National Statistics, Eurobank Research

Figure 2: GDP components



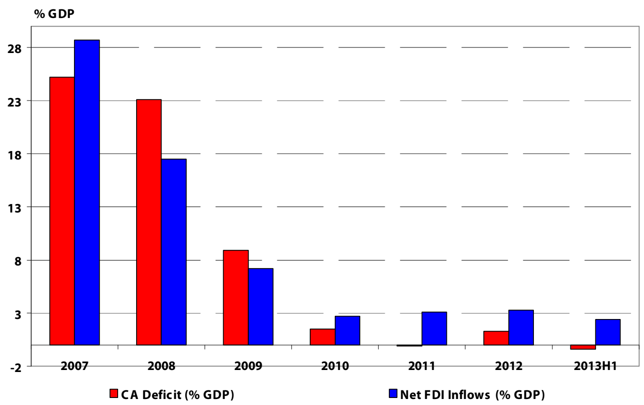
Source:National Statistics, Eurobank Research

Figure 3: Inflation measures



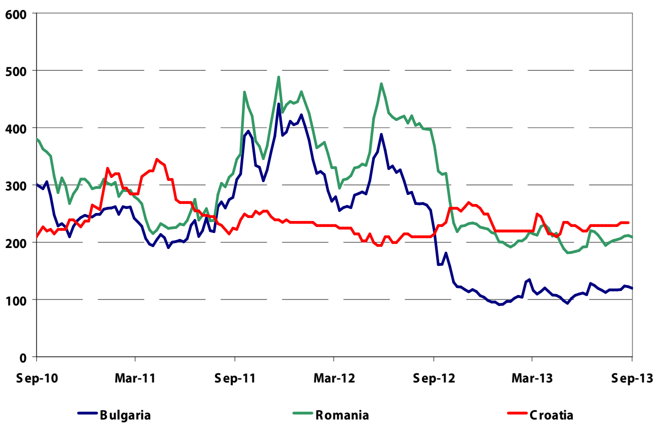
Source:National Statistics, Eurobank Research

Figure 4:CA Deficit & Net FDI



Source:BNB, Eurobank Research

Figure 5: Comparison of CDS



Source:Eurobank Research, Ecowin Reuters

Figure 6: Bulgaria's Government Benchmarks 5Y

Source:Reuters Ecowin

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