

Bulgaria: greater political uncertainty, but changes to economic policy unlikely

- On Wednesday, Prime Minister Kiril Petkov lost the vote of no confidence in his government.
- There are two equally likely scenarios from here, in our view. In the first, we think it is likely that the four parties of the outgoing coalition will form a new government.
- The second scenario, in which all three attempts to form a government fail, parliament would be dissolved, the president would appoint a caretaker government and a new election would be held in the autumn.
- Either way, we do not expect any major changes in economic policy. We continue to see euro adoption in 2024 as more likely than not.
- In addition, parliament is likely to vote to approve budget changes designed to raise public pensions and support the most vulnerable citizens in the context of rapidly rising energy and food prices.

On Wednesday, Prime Minister Kiril Petkov lost the vote of no confidence in his government.

The vote came after the four-party ruling coalition lost its majority in parliament last week over disagreements about whether Bulgaria should unlock North Macedonia's EU accession talks.

There are two equally likely scenarios from here, in our view. In the first, we think it is likely that the four parties in the outgoing coalition will form a new government. For this scenario to materialize, we think that the ruling WCC party should propose a prime minister other than Kiril Petkov. The new nomination should be a person who can maintain a more constructive tone of communication with the other three parties in the coalition.

Importantly, such a scenario would require all four parties in the ruling coalition to put aside as many as possible of their disagreements and ideological differences and to agree on a limited list of priorities.

The number-one priority should be to press ahead with the judiciary reform, aimed at reducing corruption and control by powerful oligarchs. This would not be easy and would require a constructive dialog with the representatives of the ruling coalition, while also actively seeking support for government's reform efforts from all other parties in the parliament.

Second, the new coalition government should remove all remaining obstacles to complete the country's euro adoption, as planned, in 2024. There are not many such obstacles, as the government already has its action plan, the implementation of which is well under way. The most important thing that is perhaps missing is to initiate a broad-based campaign to address people's concerns that euro adoption would fuel inflation. This is important because consumer price inflation in Bulgaria is already elevated due to the combination of shocks triggered by the COVID-19 pandemic and the war in Ukraine.

Third, and very importantly, the new government needs to unlock public-sector financed investments. At the moment, public-sector funded capex is lagging behind, as suggested by its 20% yoy drop so far this year, which comes after already very weak performance in the previous year. This is fueling concern that the massive increase in planned public capex projects in 2022 is not in line with the absorption capacity of the institutions responsible for their implementation. The new government needs to fix this fast, otherwise Bulgaria runs the risk of failing to reach its goals related to green transition and digitalization, while, at the same time, the lack of investment in public infrastructure continues to hold back the country's economic growth and modernization efforts.

In the second scenario, all three attempts to form a government fail and the parliament is dissolved, the president would then appoint a caretaker government, and new elections would be held in the autumn.

Either way, we do not expect any major changes in economic policy. This is because we think that Bulgaria's position on North Macedonia's EU accession talks was the key reason for the collapse of Mr. Petkov's government, not its economic policy. We

continue to see euro adoption in 2024 as more likely than not, since the parties with a pro-Western geopolitical orientation can count on the combined support of three-fifths of the electorate. No matter what comes next, parliament is likely to vote to approve budget changes designed to raise public pensions and provide more fiscal support to the most vulnerable citizens, as food and fuel prices have surged to levels not seen in decades.

Finally, it is very positive to see that Bulgarian politicians are poised to reach an agreement to lift the veto on the start of EU accession talks with North Macedonia. The agreement looks imminent as four parties controlling 176 seats in the 240 strong parliament support lifting the veto: the ruling WCC party, the junior coalition partner in the outgoing government DB, the mainly ethnic Turkish party MRF and the main opposition GERB party. The decision is set to unlock the process of the EU's eastern expansion, whose importance has increased significantly since the beginning of the war in Ukraine. Importantly, we expect the start of EU accession talks with North Macedonia and Albania to reduce political instability and boost economic cooperation among the countries in the Western Balkans.

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This report was completed and first published on 23 June 2022 at 16:39.

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