

## Bulgaria: Strong support for populist parties raises downside risks to our scenario

- The center-right pro-European Union Citizens for European Development of Bulgaria (GERB) won Sunday's parliamentary elections but is likely to remain in opposition.
- The Bulgarian Socialist Party (BSP) was the main loser, as it came third in a parliamentary election for a second time in the modern history of the country.
- The protest vote was larger than expected. The newcomers from the "There is such a people" (ITN) party of popular TV presenter Slavi Trifonov were the main beneficiary.
- The election produced a fragmented parliament, with a significant presence of populist parties.
- Our baseline scenario is a minority government with parliamentary support from the BSP.
- The new coalition government is likely to have a limited mandate.
- We keep our baseline macroeconomic scenario unchanged, but see an increase in downside risks.

### Election results: stronger-than-expected support for populist parties backing last year's protest

As largely expected, the GERB, managed to win the parliamentary election last Sunday with 26.2% of the vote. However, the GERB's share of the total vote dropped by more than 7pp compared to the previous parliamentary election in 2017 (see Chart 1). Over the past twelve months, the GERB has seen its popularity fall sharply as the government struggled to respond to the anticorruption protests and the sharp recession triggered by the COVID-19 pandemic.

The BSP was the main loser. It finished third, with just 15.0% of the vote, which is its worst performance since the country became a parliamentary democracy more than three decades ago. The BSP failed to win the protest vote of the young, who flocked to the antiestablishment parties not represented in the last parliament. Moreover, the BSP failed to mobilize many of its traditional supporters, as the vote coincided with the peak of the third wave of the COVID-19 pandemic, which compelled many of the elderly to stay at home in order to reduce the risk of contracting the disease.

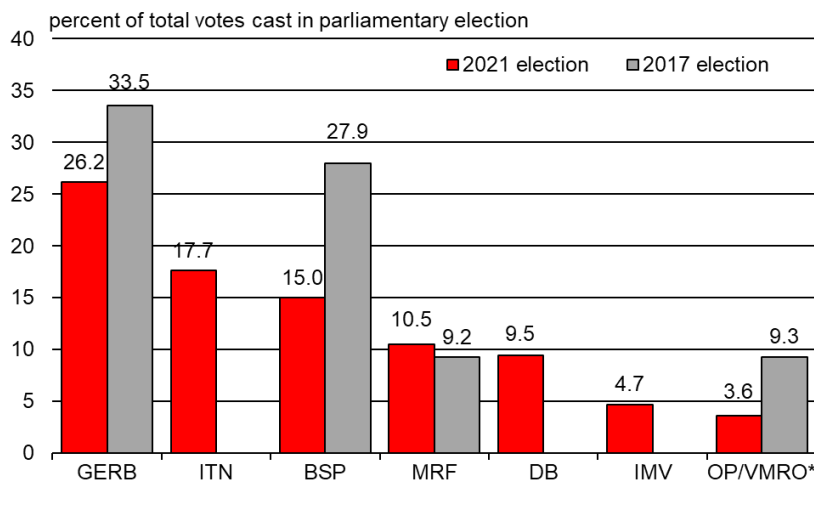
The protest vote was larger than expected. The newcomers from ITN of popular TV presenter Slavi Trifonov are the main beneficiary. They received 17.7% of the vote and came in second place, ahead of the BSP. The ITN emerged as one of the most vehement opponents of the restrictions imposed during the COVID-19 pandemic. Their campaign was based mostly on social media and was specifically targeted at young voters. Apart from that, the ITN campaign was very quiet, with Mr. Trifonov rarely leaving the studio of his own TV channel for other public appearances. This was a winning strategy, as the ITN won the support of first-time voters not only in the countryside, where the popularity of Mr. Trifonov has traditionally been very significant, but also in the Bulgarian diaspora (see Chart 2), where young voters were especially active on election day.

Another antiestablishment party, Stand Up! Mafia Out! (IMV), which was among the most vocal supporters of the protests against the government of Boyko Borisov last summer, managed to surpass the 4% threshold and will be represented in the next National Assembly (see Chart 1).

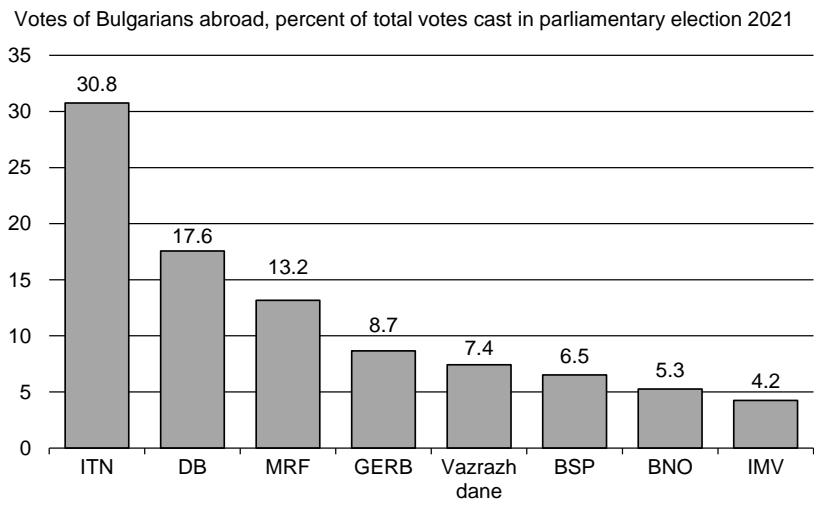
Bulgarian voters decided to leave all nationalist political formations outside the next parliament. All three parties that were present in the previous parliament opted to take part independently in Sunday's election, which, however, scattered the nationalist vote. Their performance was also affected by the strong showing of the ITN, which attracted many young voters that had been part of the traditional support base of the nationalist parties in previous elections.

Democratic Bulgaria (DB), an alliance of three mostly right-wing formations that took part independently in the 2017 parliamentary election, garnered 9.5% of the vote. Support for Bulgaria's ethnic Turkish party, the Movement for Rights and Freedom (MRF), at 10.5% of the vote, remained little changed compared to the previous parliamentary election.

**CHART 1: FRAGMENTED PARLIAMENT WITH STRONG SHOWING OF POPULIST PARTIES**



**CHART 2: NEWCOMERS FROM ITN OBTAIN SUPPORT OF BULGARIA'S DIASPORA**



Source: Central Election Commission (based on 100% of processed data), UniCredit Research

\*2017 election – United Patriots (OP) made up of the National Front for the Salvation of Bulgaria, VMRO and Ataka; 2021 election – only VMRO

**Low probability of a grand coalition running the country until the end of the pandemic**

In the immediate aftermath of the election, Mr. Borisov called for the formation of a technocratic government to run the country until the end of the COVID-19 pandemic.

However, the chances for the creation of a technocratic government backed by a grand coalition look slim, in our view, because all four parties (ITN, BSP, DB and IMV) that supported the protests against Mr. Borisov’s government last year have shown no appetite for any cooperation with the GERB.

### **A minority government with socialist support looks like the most likely scenario**

The Bulgarian constitution stipulates that the president should hand the first mandate to form a government to the largest party in parliament. That party is GERB. But as GERB's chances of forming a government look slim, the second-largest party, ITN, will receive the mandate shortly afterwards. The president has the right to choose which party should get the third and final mandate if the first two attempts at forming a government prove unsuccessful. If all three attempts fail, parliament will be dissolved and the president will appoint a caretaker government tasked with the organization of new parliamentary elections.

Under the most likely scenario, the populist parties (ITN and IMV), which benefited the most from the protest against the government of Mr. Borisov, will join forces with right-wing DB to form a minority coalition government, which will be backed by the BSP in parliament.

It will be very interesting to see how such a large number of political players with a very diverse ideological background will work together. Coordination of the political agendas in such a governing coalition will be a major challenge, in our view, especially when taking into account that some of its members have close to no prior political experience.

Negotiations among the ITN, BSP, DP and IMV are likely to be cumbersome. Tax policy could be an area where compromise will be particularly hard to reach. This is because the BSP promised to introduce progressive personal-income taxation and other tax changes benefiting low-income households, while right-wing DP and populist ITN have made pledges to further reduce taxation of companies, which in Bulgaria is already among the lowest in the entire EU.

It will be interesting to see how common ground will be found in energy-sector policy, where the BSP wants to build new nuclear power plants, while the DB has dismissed such projects on concerns related to their financial viability and the risk they might further increase the already significant geopolitical influence of Russia in the country's electricity generation.

Another possible division line includes euro adoption, where the BSP's attitude has been one of reservations and doubts, which could prove problematic, as it might further fuel the DB's suspicions that the BSP wants to shift the country's geopolitical orientation more toward Russia at the expense of less weight of Western Europe and Euro-Atlantic cooperation.

We think such a minority government will have a limited mandate. Its main task will be to accelerate the vaccination process, while also improving control over the spread of the disease via more focused and vigorous test, trace and isolation efforts. Second, the new government will have to press ahead with the preparation of the country's Recovery and Resilience Plan. This is important, because any delay in agreeing the list of projects supported by the new EU funding risks slowing the recovery of GDP growth in the short run, while also making it more difficult for the country to address the structural weaknesses holding back its socio-economic development in the long run.

Finally, the new ruling coalition needs to agree on the next steps to reform the judiciary. There seems to be enough backing for splitting the Supreme Judiciary Council (SJC) into two bodies – one for judges and one for prosecutors. Also, there is enough support for reducing the quota of the parliament in electing members for the SJC. Such a move would give judges and prosecutors a bigger say in electing SJC members, thereby boosting independence of the judiciary from political and business interests. In addition, all parties in the new parliament share the view that more needs to be done to ensure effective accountability and criminal liability of the Prosecutor General, as per the recommendations made by the Venice Commission.

### **Failure to form a government and snap election later this year cannot be ruled out**

Given large differences in the visions for the country's governance articulated by the parties supporting the protests against Mr. Borisov, we see risk of another election later this year.

Under this scenario, all political power will be shifted into the hands of the president, Rumen Radev, who would then appoint a caretaker government to prepare the next parliamentary election, which would most likely coincide with the next presidential election due at the end of October this year.

Failure to create a new government and take over responsibility for the country's governance looks like a risky scenario for the parties who supported the protests against GERB. This risk is further aggravated by the slow advancement of the vaccination program, which is likely to translate into another weak year for the country's hospitality sector, which has already been hit hard by the pandemic.

Prolonged political stalemate could further radicalize voters and produce even larger support for populist parties. This is a scenario well-established political players, such as GERB and BSP, would like to try to avoid, in our view. But this is also a risky scenario for the newcomers from ITN and especially IMV, because the patriotic formations that did not make it into the new parliament and other antiestablishment and populist parties are waiting for their chance.

### **We keep our baseline macro scenario unchanged but see an increase in the downside risks**

We have decided to keep our baseline macroeconomic scenario unchanged for the time being. We expect only partial GDP growth recovery of 2.6% this year, followed by an acceleration of growth to around 4.5% in 2022 once the health crisis recedes and absorption of NGEU funds gains stronger momentum. Under our baseline scenario, economic activity will recover to pre-crisis levels in 2Q22, while the economy is likely to reach full employment again toward the end of 2023.

However, the fragmented parliament and the larger-than-expected vote for populist parties that Sunday's parliamentary election has produced has increased the downside risks to our scenario.

The main downside risk to our baseline macro scenario is associated with timely completion of large infrastructure projects started by the GERB government and the utilization of EU funding. The winners in Sunday's election have called for a thorough investigation of Mr. Borisov's legacy. This could make it very difficult to nurture the dialogue among the various opposing groups in society that is so necessary, in our view, to address the country's predicaments. For example, there is a risk that the new minority government will be tempted to scrap some of the public procurement that has already been awarded by the outgoing GERB government, similar to what the BSP did in 2013. Moreover, the transition to a new government is likely to slow decision making in public administration. If these risks are not properly addressed, delays in the completion of some infrastructure projects and in greenlighting projects that the NGEU will finance can be expected. This would be bad news, not only for the pace of economic recovery this and next year, but also for the country's chances of addressing the structural weaknesses holding back its long-term social and economic development.

Another risk worth watching is related to a possible slump in tax revenues. Both the ITN and the DB have pledged to make large cuts to corporate taxes, while the BSP wants to introduce progressive taxation of personal income without specifying the fiscal impact such move would have. What's more, the DB wants to reduce the scope of companies paying VAT and partially or entirely scrap Ordinance N18, which regulates the use of fiscal devices in the wholesale and retail trade sector.

We think any such moves risk reversing much of the progress that GERB has made in improving tax collection. We think the authorities should abstain from a further reduction in corporate taxes, which in Bulgaria are already among the lowest in the EU. Instead, the focus should remain on improving tax collection and on using tax policy more effectively to reduce rising income inequality.

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