

Bulgaria: is a prolonged period of political instability about to end?

- The center-right pro-European Union Citizens for European Development of Bulgaria (GERB) party won the most votes in the parliamentary election held last Sunday and will receive the first exploration mandate to form a new government.
- Support for parties with a pro-Russian geopolitical orientation increased moderately but was far below what their leaders had hoped to achieve. However, the pro-Russian vote seemed to become more radicalized, with Vazrazhdane (Revival) Party, representing the most extreme pro-Russian supporters, garnering 14.2% of the vote.
- Our baseline scenario envisages the formation of a pro-European coalition government, which will mark the end of a prolonged period of political instability. In this scenario, four out of the five parties with a pro-European geopolitical orientation put aside their differences and form a grand coalition with a comfortable majority of 142 seats in Bulgaria's 240-seat parliament.
- There is a solid chance key constitutional amendments that are necessary to reform the judiciary to pass the parliament.
- We think that a referendum as to whether Bulgaria should adopt the euro will be a tough test for the country because the current cost-of-living crisis is far from over, and people and businesses alike remain particularly worried about inflation. We think that a positive turnaround is possible if there is sufficiently strong political will to invest time and effort into this priority.
- We have assigned a 40% probability to Bulgaria's joining the eurozone in January 2025 and a 30% probability to its joining later, if authorities postpone the referendum to 2024, in order to give more time to voters to make up their minds.
- Another caretaker government and new elections are likely in case there is limited desire to end political bickering and to seek compromise.

Support for pro-European parties remained little changed, amounting to around two-thirds of the total, while support for parties with a pro-Russian geopolitical orientation seemed to become more radicalized

GERB won the parliamentary election, with 26.5% of the vote (Charts 1 and 2), after all voting lists were aggregated by the central election committee. GERB's share of the total vote increased by 1.2pp compared to the previous election, in 2022.

In our view, a solid showing by GERB reflects voters' tiredness amid a prolonged period of political instability, which has crippled the country's response to an ongoing cost-of-living crisis and disrupted the use of EU funds to support the modernization of Bulgaria's economy. At the same time, most pro-European voters recognized GERB as the main opponent to the policy of Bulgarian President Rumen Radev, who has publicly expressed skepticism towards Western sanctions against Russia and toward Western military support for Ukraine. Another factor that helped GERB improve its showing was a change in the technology of the voting process. The use of paper ballots in parallel with machines encouraged more elderly people to exercise their right to vote, which underpinned the performance of more-established parties in the country, as we suggested in our CEE Quarterly publication in January.

An alliance between the centrist We Continue the Change (PP) and the liberal Democratic Bulgaria (DB) finished second, with 24.5% of the vote, or 3.1pp fewer votes than both parties garnered in the previous parliamentary election.

The pro-Russian Vazrazhdane (Revival) party achieved the sharpest increase in support among all parties in the new parliament. It finished third, with 14.2% of the vote, which was 4pp above its result in the election held in 2022 (Charts 1 and 2). Revival attracted the most extreme Russia supporters, by reiterating Moscow's propaganda claims and using aggressive rhetoric against its opponents. Adept use of social media – Revival clocked more interactions than all its rivals combined – also underpinned Revival's strong showing, according to Goran Georgiev, analyst at the Center for the Study of Democracy in Sofia.

Furthermore, an anti-euro campaign helped Revival reach many voters by successfully linking concerns about inflation with the euro-adoption process. According to party sources, Revival collected more than 400,000 signatures in support of a referendum on delaying Bulgaria's adoption of the euro for two decades. If confirmed, this is likely to force the government to hold such a referendum later this year, perhaps in parallel with municipal elections scheduled for autumn.

The mostly ethnic Turkish party, the Movement for Rights and Freedoms (MRF), finished third, with 13.7% of the vote, ahead of the Bulgarian Socialist Party (BSP), the successor to the Cold War-ruling Bulgarian Communist Party, which garnered 8.9% of the vote. Support for BSP, which until recently was Bulgaria's largest party with a pro-Russian geopolitical orientation, was little changed compared to the election in 2022 (Chart 1 and 2). This suggests that the sharp rise in Revival's approval rating was, above all, attributable to waning support for three smaller political parties with pro-Russian geopolitical sentiments. This time, however, these smaller parties failed to attain the 4% threshold and remained outside the new parliament.

We estimate that the proportion of the vote going towards parties sympathetic to Russia increased to slightly more than 30%. While this is a small increase compared to 2022's parliamentary elections, it is far below the results that the leaders of these parties hoped to achieve. However, the vote for pro-Russian parties seemed to become more radicalized. Revival, which is thought to represent the most extreme Russia supporters in Bulgaria, garnered almost half of all votes cast by voters claiming to have sympathetic views toward Russia.

The last party to clear the 4% hurdle for parliamentary entry was the There is Such a People (ITN) party. ITN, which emerged as one of the most vehement opponents of restrictions imposed during the COVID-19 pandemic, received 4.1% of the vote. This time, ITN based its election campaign on far less-confrontational rhetoric, which is likely to improve its chances of taking part in forthcoming consultations regarding the formation of a new coalition government.

VOTER SUPPORT FOR MORE-TRADITIONAL PARTIES TURNS OUT TO BE MORE DEEPLY ENTRENCHED THAN THOUGHT

Chart 1: seven parties will be present in the new parliament

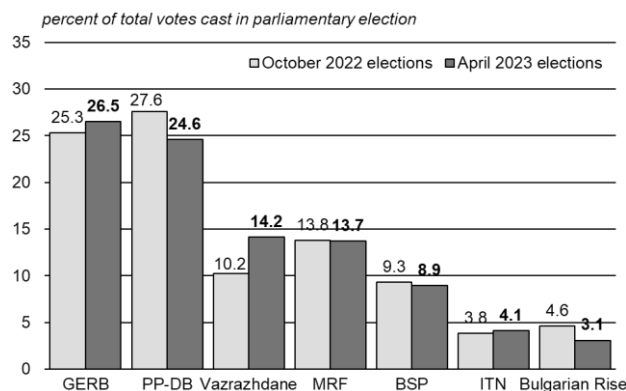
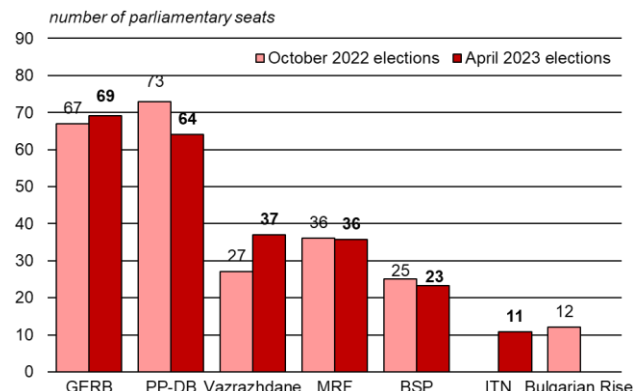


Chart 2: pro-European parties will have more than two-thirds of MPs



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

Our baseline scenario envisages a pro-European coalition government

Our baseline scenario envisages the formation of a pro-European coalition government, which would end the prolonged period of political instability.

In this scenario, four out of the five parties with a pro-European geopolitical orientation (GERB, DB, MRF and ITN) put aside their differences and form a grand coalition with a comfortable majority of 142 seats in Bulgaria's 240-seat parliament. Pro-Russian parties, the BSP and especially Revival, are excluded from coalition talks.

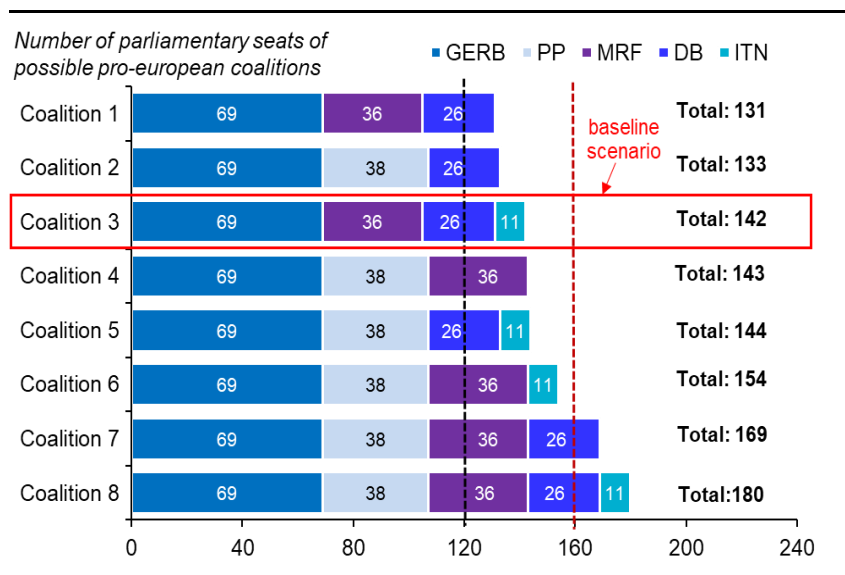
Importantly, PP decides to reject GERB's invitation to participate in a new pro-European government. However, PP is likely to support efforts to reform Bulgaria's judiciary, if there are concrete steps that are in line with their own election pledges. The latter could help build broadly based consensus around constitutional amendments needed to press ahead with judiciary reform, because a comfortable constitutional majority of 180 seats would then be possible.

What makes us optimistic that such an outcome is likely is that main political players' positions on judiciary reform is an area where differences in election programs have decreased significantly compared to where they were one year ago, when a confrontation between the two main pro-European blocs was at a climax. The positions of all seven parties present in the new parliament are described in more detail in the last column of Table 1. The data suggest that all these parties, and especially parties with a pro-European geopolitical orientation, share many common views on what needs to be done to reform the judiciary. What is more, the concrete reforms that pro-European parties would like to see implemented seem to be in line with the recommendations made by the Venice Commission.

It is encouraging to see that similarities in the main pro-European parties' election promises do not end with judiciary reform. Fiscal policy is another area where many similarities come to fore. As Table 1 indicates, all these parties have singled out fiscal consolidation as an important policy priority in their election programs. They all support keeping budget deficit below 3% of GDP and see no need to undertake significant changes to both the level and structure of taxation in the country.

However, there are some differences when it comes to the details. For example, GERB wants to increase public spending to education to 5% of GDP, while PP and DB want to further increase the threshold for VAT registration. Nevertheless, these seem to be areas of secondary importance, where if compromise proves hard to achieve, the proposals could probably be watered down during the coalition talks in order to achieve compromise on fiscal policy priorities that matter most.

CHART 3: THERE ARE EIGHT FEASIBLE COALITIONS THAT PRO-EUROPEAN PARTIES COULD FORM



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

Another policy area where coalition talks are likely to produce little controversy is euro entry. As Table 1 indicates, pro-European parties not only want to swap the BGN for the euro, which, in our view, is a logical step forward for a country that has had a fixed exchange rate to the euro for more than two decades, but also support the economic policies needed to make that happen. If a pro-European coalition government is formed, and especially if such a coalition were to implement constitutional amendments needed to complete judiciary reform first, then Bulgaria's adoption of the euro would be a logical next step, in our view.

We think that a referendum on the country's adoption of the euro will be a tough test because the cost-of-living crisis is far from over and because people and businesses alike remain particularly worried about inflation. Adding to such a challenge would be the strong position of the No camp, which several surveys conducted at the beginning of the year by independent local agencies showed as having a leading position. We think that the Yes camp should engage the No voters in a constructive dialogue about Bulgaria's European future.

TABLE 1: SELECTED POLICIES OF POLITICAL PARTIES IN THE NEW PARLIAMENT

	Fiscal policy	Taxation	NATO / EU/ stance on war in Ukraine / Euro adoption	Measures to address cost of living crisis	Judiciary reform
GERB	Keep budget deficit below 3% of GDP. Support fiscal decentralization. Increase public capex. Increase public spending for education to 5% of GDP. Higher wages for public health care and education.	Keep existing level of taxes and model of taxation. Against the idea of the caretaker government for one-off tax on windfall profit.	Pro-NATO and pro-EU. Supports provision of weapons to Ukraine. Supports EU common defence policy. Press ahead with the efforts to create EU common foreign policy. Press ahead with euro adoption plan, with 2025 as a new target date.	Took tougher approach to large retail chains in order to cutback unfair trading practices. Press ahead with the measures to strengthen competition in the sectors with high concentration.	The GERB party is ready to support all ideas of the PP-DB for Judiciary reform. On top of that propose reducing the quota of the parliament in electing Supreme Judicial Council (SJC) members.
PP-DB	Keep budget deficit below 3% of GDP. Maintain low public debt and high fiscal buffers. Introduce capital budgeting. Adopt long-term capital spending program based on cost-benefit analysis.	Keep existing level of taxes and model of taxation. Against the idea of the caretaker government for one-off tax on windfall profit. Increase the threshold for mandatory VAT registration up to the cap of BGN 166,000, allowed in the EU.	Pro-NATO and pro-EU. Provide more military aid to Ukraine. Increase presence of NATO forces in Bulgaria. Increase total defense budget to at least 2% of GDP. Press ahead with euro adoption plan, with 2025 as a new target date.	Increase subsidies for SME producers of milk, meat, fruit and vegetables. Shorten supply chains to eliminate middlemen. Help farmers undertake collective actions to achieve greater scale and lower cost.	Mechanism to investigate prosecutor general (PG). Split the SJC into two bodies - one for prosecutors and another for judges. Introduce "double majority" (of all members and of judges elected directly by judges) for some decisions. Judicial control over a prosecutor's refusals to initiate pre-trial proceedings. Mechanism for control of excessive delays in court cases.
Vazrazhdane	Aim at balanced budget. Cut unnecessary budget spending, including those for administrative purposes.	Lower taxation for businesses. Tax incentives for investment and for transport vehicles with low CO2 emissions.	Against NATO. Against sanctions on Russia. Against sending weapons to Ukraine. Unification of Bulgaria and Republic of North Macedonia should be country's main priority. Against euro adoption. Collected more than 400K signatures in support of a referendum against joining the eurozone.	BNB to use all its arsenal to reduce money supply, including by increasing minimum required reserves. Tighten fiscal policy to reduce inflation. Remove sanctions on Russia in order to reduce energy and other commodity prices. Full energy market liberalization should be reconsidered.	National Investigation Service (NIS) to be granted independent status and its head to exercise control over the PG. Expand the range of those who can submit inquiries to Constitutional Court in case of constitutional rights and freedoms violation.
MRF	Preserve prudent fiscal policy. More pension increases.	Keep existing level of taxes and model of taxation.	Pro-NATO and pro-EU. Supports provision of weapons to Ukraine. Press ahead with euro adoption plan, with 2025 as a new target date	Increase public support for local agricultural producers. Public support for households to target those most in need. Strengthen competition in sectors with high concentration.	Split the SJC into two bodies - one for the judges and another for prosecutors. Reduce the quota of the parliament in electing SJC members. Increase accountability of the PG.
BSP	Increase public capex via public-private partnership. Leave more tax revenues to municipalities. More pension increases. Cost-free drugs for people above 75.	Introduce tax free allowance on personal income equal to the poverty line. Shift to progressive scale for taxation of personal income in the long-run. Cut VAT on drugs. Remove personal income tax for people below 26 years.	Against sanctions on Russia. Normalization of diplomatic relations with Russia. Maintaining constructive dialog with Russia. Euro adoption is an important long-term priority, but the country is not ready to join the eurozone in the short-to-medium run.	Introduction of caps on prices of basic goods and services. Introduce markup cap. Make markups applied in the supply chains for basic goods and services more transparent.	Introduce judicial control over the acts of the PG. Streamline the legislative process to reduce the undue influence of lobbyists. Expand the range of those who can submit inquiries to Constitutional Court. Introduction of personal property liability of officials who violate the fundamental rights of citizens (regressive liability).
ITN	Keep budget deficit below 3% of GDP. Reduce redistribution of resources through the budget.	Introduce tax free allowance on personal income. Cut income tax for families with children.	Pro-NATO and pro-EU. Supports provision of weapons to Ukraine. Return the veto on Republic of North Macedonia's EU membership negotiations. Press ahead with euro adoption plan, with 2025 as a new target date.	Introduce energy allowances for pensioners. Define what constitutes an energy-poor household and make sure energy subsidies are channelled to them predominately.	Summon a grand national assembly to change the form of government from a parliamentary republic to a presidential republic. Split the SJC into two bodies - one for prosecutors and another for judges.

Source: political parties' programs, interviews conducted by local media, UniCredit Research

In our view, the anti-euro campaign of Revival should serve as a wakeup call for all parties, civil-society organizations and citizens that support euro adoption. It should be made clear that, if the euro is rejected, the negative effects for the economy could be significant and far-reaching. We think that positive turnaround is possible if resources made available to public institutions find their way into the right hands and if there is strong enough political will to invest sufficient time and effort into this key priority.

We have assigned a 40% probability to Bulgaria's joining the eurozone in January 2025 and 30% to its joining later, if authorities postpone the referendum to 2024, in order to give more time to voters to make up their minds.

Another caretaker government and new elections are likely in case there is limited desire to end political bickering and seek compromise

Under this scenario, parliament fails to produce a functioning government again, as personal antipathy between the leaders of the two main pro-European blocks proves too high a hurdle to forming a coalition government.

Such an outcome would deepen Bulgaria's political crisis, and this might profoundly shift support for the main parties and likely lead to the emergence of new anti-establishment parties when the next parliamentary election is held in the autumn.

Failure to form a stable government would leave political power in the hands of Mr. Radev, who is often cited as being very sympathetic to the Kremlin. This would likely undermine Bulgaria's position in the alliance of countries supporting Ukraine. The latter would not only cutback export of ammunitions in the short run, but would also likely negatively affect the country's positions in friend-shoring and near-shoring processes, which are set to play a key role in shaping the economy in the long run.

Structural reforms are likely to lose momentum even further, thereby crippling the country's response to the ongoing cost-of-living crisis and hampering the capacity of the public administration to utilize EU funds to modernize the economy.

In this scenario, the No camp is likely to win a referendum on Bulgaria's adoption of the euro later this year. This would have the potential to shake the economy's foundations and send the cost of credit for firms and households at levels not seen in decades.

If such a scenario materializes, we stand ready to downwardly revise our outlook towards the Bulgarian economy, once more details about economic policies and a timeline of actions of the next caretaker government have been made available.

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