Bulgaria

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Outlook

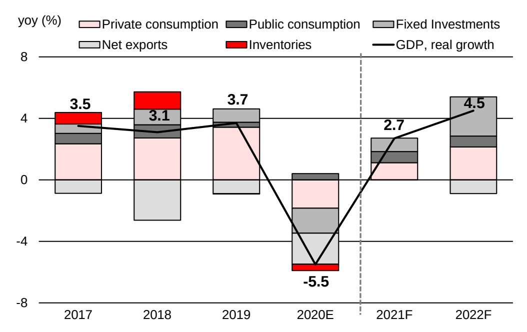
Additional fiscal measures were announced at the end of 2020 to mitigate the damages caused by the second wave of the COVID-19 pandemic. We expect the early phase of the recovery in Bulgaria to be somewhat weaker than in most CEE economies for two reasons. First, Bulgaria was among the countries worst hit by the second wave of COVID-19 infections. Second, Parliamentary elections will lead to a slow start for the NGEU program and to delays in some infrastructure projects initiated under the previous government. However, economic recovery is likely to gain stronger momentum in 2022 and 2023 once the health crisis ends and Bulgaria's absorption of NGEU funds shifts to a higher gear.

Author: **Kristofor Pavlov,** Chief Economist (UniCredit Bulbank)

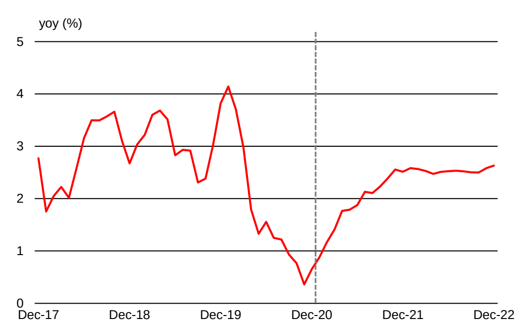
KEY DATES/EVENTS

- Mid-Feb: Labor force 4Q20 data
- Mid-Feb, Early-Mar: GDP data (4Q20 flash estimate and structure, preliminary data for 2020)
- End March or early April: General elections

GDP GROWTH FORECAST



INFLATION FORECAST



Source: National Statistical Institute, UniCredit Research

MACROECONOMIC DATA AND FORECASTS

	2018	2019	2020E	2021F	2022F
GDP (EUR bn)	56.1	60.7	58.4	61.1	65.4
Population (mn)	7.0	7.0	6.9	6.9	6.8
GDP per capita (EUR)	8,012	8,728	8,458	8,909	9,603
Real economy, change (%)					
GDP	3.1	3.7	-5.5	2.7	4.5
Private consumption	4.4	5.5	-2.9	1.7	3.3
Fixed investment	5.4	4.5	-8.4	4.7	13.3
Public consumption	5.4	2.0	2.5	4.2	4.0
Exports	1.7	3.9	-12.5	5.6	7.5
Imports	5.7	5.2	-9.3	5.3	8.5
Monthly wage, nominal (EUR)	586	651	701	748	806
Real wage, change (%)	7.7	8.0	5.9	4.9	5.2
Unemployment rate (%)	5.2	4.2	5.4	5.6	4.7
Fiscal accounts (% of GDP)					
Budget balance	2.0	2.1	-3.7	-5.6	-2.8
Primary balance	2.7	2.7	-3.1	-5.0	-2.2
Public debt	21.8	19.9	25.0	28.3	29.1
External accounts					
Current account balance (EUR bn)	0.6	1.8	1.6	1.9	2.2
Current account balance/GDP (%)	1.0	3.0	2.7	3.2	3.4
Extended basic balance/GDP (%)	3.3	5.5	6.3	7.3	8.7
Net FDI (% of GDP)	1.4	1.4	1.7	1.5	2.1
Gross foreign debt (% of GDP)	60.3	58.0	66.1	65.2	63.2
FX reserves (EUR bn)	25.1	24.8	28.9	31.6	34.2
Months of imports, goods & services	8.0	7.6	10.3	10.3	9.9
Inflation/monetary/FX					
CPI (pavg)	2.8	3.1	1.7	1.9	2.5
CPI (eop)	2.7	3.8	0.7	2.5	2.6
Central-bank reference rate (eop)	-0.50	-0.61	-0.70	-0.60	-0.56
USD/BGN (eop)	1.71	1.74	1.66	1.53	1.47
EUR/BGN (eop)	1.96	1.96	1.96	1.96	1.96
USD/BGN (pavg)	1.66	1.75	1.72	1.59	1.50
EUR/BGN (pavg)	1.96	1.96	1.96	1.96	1.96

Source: Bulgarian National Bank, Eurostat, National Statistical Institute, UniCredit Research

*long-term foreign-currency credit ratings as provided by Moody's, S&P and Fitch, respectively

Difficult start to recovery but strong medium-term outlook

The outlook is for a subdued economic recovery in 2021

After GDP contracted by around 5.5% in 2020, our baseline scenario envisages only a partial recovery of 2.7% this year. Recovery will take a stronger hold in 2022 and 2023, when we anticipate GDP growth to accelerate to something between 4% and 5% annually. We expect GDP to return to its pre-crisis level in mid-2022. Getting back to full employment is likely in the end of 2023. Uncertainty over the near-term outlook remains elevated. Risks to our baseline macro scenario are dominated by pandemic dynamics and local politics related factors.

Bulgaria was hit hard by the second wave

The economy faces a difficult winter. The main reason is the surge in COVID-19 infections (see lhs chart) that have led to the adoption of new restrictions in November. The new restrictions are milder than those implemented during the first wave of the pandemic, but are likely to remain in place for longer. We expect the economy to contract in both 4Q20 and 1Q21. The fall in GDP is likely to be more modest compared to the first wave of the pandemic, because some sectors are excluded from the restrictions, including most importantly the manufacturing sector.

In 2021, economic growth will depend on path of virus

A genuine relaxation of the restrictions will start in March, when we expect the pandemic curve to become more promising. The spring will limit the spreading of the disease, similarly, to what we witnessed in 2020. We expect GDP to rebound in 2Q21 and beyond, as the direct impact of the pandemic on the economy eases, and fiscal stimulus provide further support.

Another difficult season for summer tourism is expected

However, consumption in tourism and other sectors most exposed to the pandemic's impact will remain subdued. This is because the positive impact from vaccination will take time to materialize, thereby causing many people to continue behaving cautiously and maintaining some sort of voluntary physical distancing throughout the summer months of 2021.

Share of vaccinated people to become the most closely watched indicator

The strength and speed of the recovery will depend on the timing and effectiveness of the roll-out of the vaccines. Opinion poll conducted by Alpha research in December suggests that the share of the population who want to be vaccinated is similar to the rest of Europe (see rhs chart). We hope that the share of people wishing to be vaccinated will increase, as information about the pros and cons of doing so becomes more widely available and as leaders in politics, business and the arts presumably lead a large-scale campaign to boost vaccination rates.

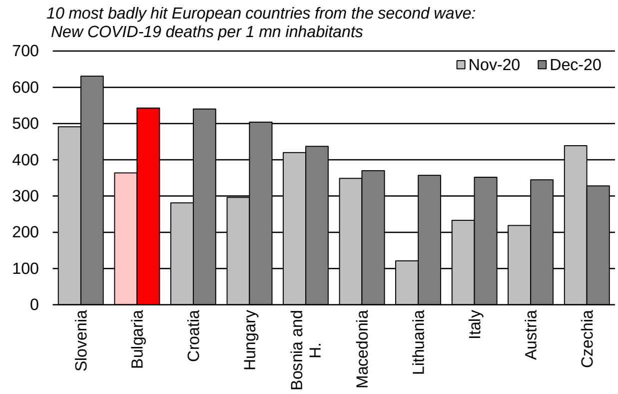
No need for new restrictions in winter 2021-22

Rising vaccination levels (closer to the one required to reach collective immunity) will prevent the need for new restrictions in winter 2021-22. We expect spending to rise and consumption patterns to slowly start to normalize, boosting GDP growth in 4Q21 and further into 2022.

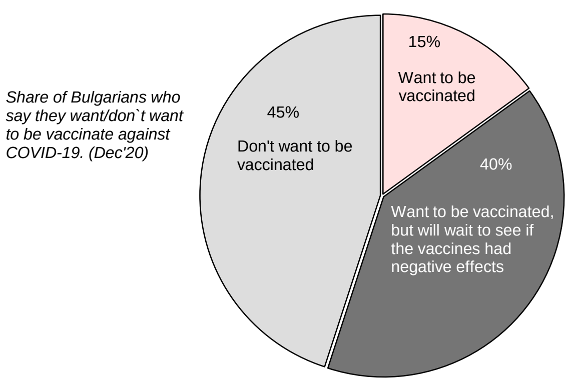
Fiscal support likely to increase in 2021

The strength of the recovery will depend on the size and efficiency of the fiscal policy response. Initially, Bulgaria's fiscal policy response was more delayed and timid than in the other CEE countries. The scale of the fiscal support was gradually increased thereafter and we expect it to have reached 3.2% of GDP in 2020.

BULGARIA BADLY HIT BY SECOND WAVE OF PANDEMIC



WILLINGNESS TO GET COVID -19 VACCINE IS MORE THAN 50%



Source: Worldometer, Alpha Research, UniCredit Research

As Bulgaria was among the countries hit hardest by the second wave of the pandemic, and because it is one of the economies with the largest free fiscal room available, we expect fiscal support to increase this year (see lhs chart).

Government to start withdrawing fiscal support from 2022

If our estimates are broadly right, fiscal support will increase to around 4.0% of GDP in 2021. On top of that, the government has raised public sector wages, pensions and some social payments, which are likely to cost some 2.0% of GDP. All of these spending increases will drive the fiscal deficit on an accrual basis to 5.6% of GDP in 2021, up from 3.7% in 2020, making Bulgaria the only CEE country where budget deficit is expected to rise this year. We think the government will start withdrawing fiscal support only very gradually and when economic recovery is likely to have already taken a stronger hold. Other less fiscally strong economies in CEE, however, will have to start withdrawing fiscal support earlier, perhaps beginning from the 2H21, potentially hampering their economic recovery prospects.

Wage subsidies and short-time work schemes have helped prevent a massive increase in unemployment

Absent policies to facilitate a rapid reallocation of workers, significant rise in unemployment rate is likely toward the end of 2022, when phasing out of job retention schemes should begin

The unemployment rate has increased only modestly thanks to the widespread use of job retention schemes. Indeed, the sharp reduction in overall hours worked in the 2Q20 and 3Q20 (see rhs chart) was mostly driven by a reduction in hours per worker and not by excessive job losses. In fact, the unemployment rate increased to only 4.8% in 3Q20, from all-time low of 3.7% in 3Q19. The decline in the participation rate, which was mostly attributable to the labor market stress and the related exit of discouraged workers from the labor force, also helped moderating the rise in the unemployment rate. Following the rise in the unemployment rate to an average of 5.4% in 2020, we expect a further increase to 5.6% in 2021 on average. After values above 6% mark in 4Q20 and 1Q21, the situation is not expected to ease until later in the current year. The acceleration of GDP growth, which is expected to begin in 2022, is likely to help economy get back to full employment toward the end of 2023.

Bulgarian are likely to go to the polls on 28 March

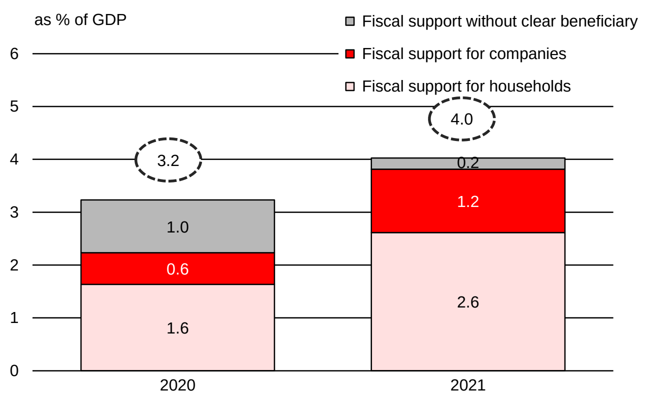
The president intends to schedule the next regular parliamentary elections on the earliest possible date envisaged by the law. If such decision is eventually taken, it will shorten the election campaign time and is likely to benefit large and well-established political parties. Small parties will face even more difficulties in the preparation of the election, because the vote will be organized and held amidst the worst health crisis in the country's modern history.

GERB likely to remain largest party…

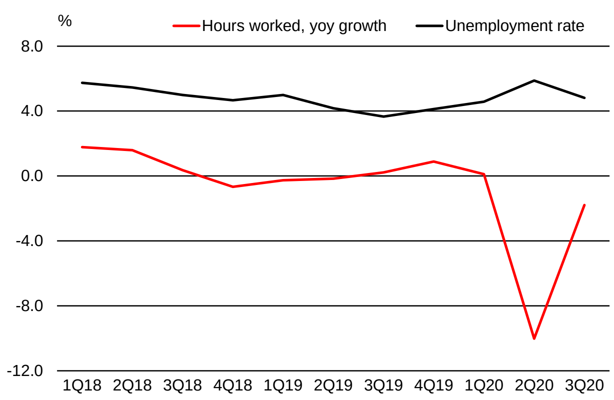
…but BSP more likely to form next government

The GERB is likely to remain the largest party in the new parliament. However, the BSP is more likely to form the next government. If the past has any clues to offer, the transition to a new government will slow down decision making in the public administration. This, in turn, is likely to cause some delays in starting NGEU-funded projects and in the completion of some key infrastructure projects initiated under the GERB, which will negatively affect the pace of recovery in 2021. Importantly, the BSP is likely to remove the flat personal income tax, which we expect to support growth, as those at the bottom of the income distribution will benefit.

ROLE OF FISCAL POLICY SUPPPORT TO RISE IN 2021



LABOR MARKET ADJUSTMENT WAS LESS PAINFULL THIS TIME



Source: Eurostat, National Statistical Institute, Ministry of Finance, UniCredit Research

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