Bulgaria

Baa2 positive/BBB positive/BBB positive*

Outlook

We expect growth to slow to 3% in 2020, after growth in 2019 is anticipated to amount to 3.7%. Weaker external demand will likely weigh on export performance, while labor shortages will constrain job creation – thereby lowering private consumption and to a lesser extent investment. While available free fiscal space is significant, we expect to see only moderate fiscal stimulus in 2020. Outlook is likely to improve again in 2021, when stronger global growth should provide a fresh boost to exports and investment.

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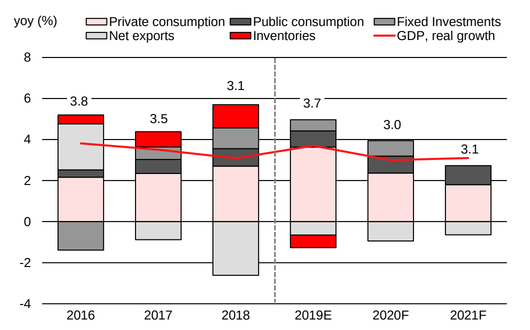
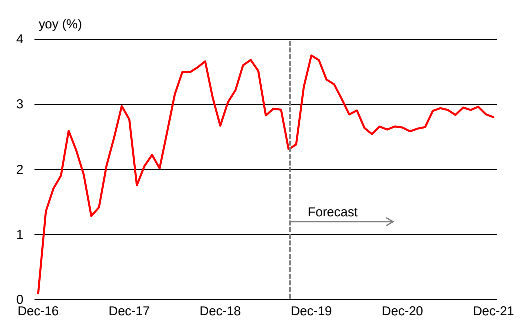
KEY DATES/EVENTS

- Mid-Feb: GDP flash estimates for 4Q19
- Mid-Feb: labor force survey data for 4Q19
- 21 Feb: sovereign rating update from Fitch
- End-Mar: nationwide house-price index for 4Q19

GDP GROWTH FORECAST



INFLATION FORECAST



Source: National Statistical Institute, UniCredit Research

MACROECONOMIC DATA AND FORECASTS

	2017	2018	2019E	2020F	2021F
GDP (EUR bn)	52.3	56.1	59.9	63.3	67.0
Population (mn)	7.1	7.0	7.0	6.9	6.9
GDP per capita (EUR)	7,420	8,012	8,613	9,165	9,777
Real economy, change (%)					
GDP	3.5	3.1	3.7	3.0	3.1
Private Consumption	3.8	4.4	5.8	3.7	2.8
Fixed Investment	3.2	5.4	2.9	4.0	5.3
Public Consumption	4.3	5.3	4.8	5.0	5.5
Exports	5.8	1.7	1.8	1.4	2.6
Imports	7.4	5.7	2.8	2.8	3.5
Monthly wage, nominal (EUR)	530	586	647	711	773
Real wage, change (%)	7.3	7.7	7.3	7.3	5.9
Unemployment rate (%)	6.2	5.2	4.1	3.6	3.3
Fiscal accounts (% of GDP)					
Budget balance	1.1	1.8	1.1	0.4	-0.1
Primary balance	1.9	2.4	1.7	1.0	0.5
Public debt	25.0	21.8	20.5	20.2	21.7
External accounts					
Current account balance (EUR bn)	1.8	3.0	3.8	3.6	3.5
Current account balance/GDP (%)	3.5	5.4	6.3	5.8	5.3
Extended basic balance/GDP (%)	6.8	6.8	8.8	8.4	8.3
Net FDI (% of GDP)	2.5	0.6	1.2	1.2	1.6
Gross foreign debt (% of GDP)	64.7	59.1	56.1	53.9	51.5
FX reserves (EUR bn)	23.7	25.1	25.6	26.2	27.9
Months of imports, goods & services	8.1	8.1	8.3	8.1	8.0
Inflation/Monetary/FX					
CPI (pavg)	2.1	2.8	3.1	2.7	2.8
CPI (eop)	2.8	2.7	3.8	2.6	2.8
Central bank reference rate (eop)	-	-	-	-	-
USD/BGN (eop)	1.63	1.71	1.76	1.69	1.66
EUR/BGN (eop)	1.96	1.96	1.96	1.96	1.96
USD/BGN (pavg)	1.74	1.66	1.75	1.71	1.67
EUR/BGN (pavg)	1.96	1.96	1.96	1.96	1.96

Source: Bulgarian National Bank, Eurostat, NSI, UniCredit Research

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

Fiscal impulse in 2020 is likely to be only moderate

Growth is set to lose some momentum this year before picking up gradually in 2021

GDP growth will likely slow to 3.0% in 2020, from 3.7% in 2019, as weaker eurozone demand weighs on export performance, while increasing labor shortages constrain both the creation of new jobs and investment. Economic growth could pick up gradually to 3.1% in 2021, as external demand gradually improves in line with that envisaged in our global macro scenario.

Growth last year was accompanied by very strong job creation

Despite slower growth in some of the main trading partners, there have been no signs of labor-market easing in the export-oriented part of the economy. Current vacancy levels are close to an all-time high, while the economy is likely to have created 65,000 new jobs last year – the second strongest annual rise in the current period of expansion. Importantly, job creation remained broadly based and included not only domestic-demand-oriented services and construction, which drew support from a surge in new housing and infrastructure projects, but also export-oriented manufacturing, where job numbers rose to their highest level in eight years.

The more-challenging external environment should weigh on the outlook this year

The negative spillover effect from export-oriented manufacturing into the services sector is likely to be smaller than it is in other, more-open CEE economies

However, this positive picture is likely to slowly come to an end. Weaker demand for exports is likely to adversely affect industrial production and wage bargaining in some export-oriented sectors. This impact is likely to be more pronounced in investment-goods manufacturing and weaker in consumer-goods manufacturing. The latter reflects the assumption that the slowdown in the euro area is mainly attributable to weaker exports, while consumption growth is likely to remain resilient. The negative impact of external demand is likely to be less pronounced in Bulgaria when compared with the more-open CEE economies, such as Czechia, Hungary, Slovakia and Slovenia, as Bulgaria remains less integrated into eurozone production chains.

After peaking in 2019, consumption's contribution to growth is likely to diminish in 2020

We also expect consumption to have lower contribution to growth due to the negative impact that an increasing labor shortage has had on job creation. After economy has already reached full employment, we expect the number of newly created jobs to slow to 19,000 in 2020 and further to 12,000 in 2021 (after 65,000 in 2019 and 43,000 on average were added between 2015 and 2018), as Bulgaria has one of the most rapidly shrinking and aging population in Europe.

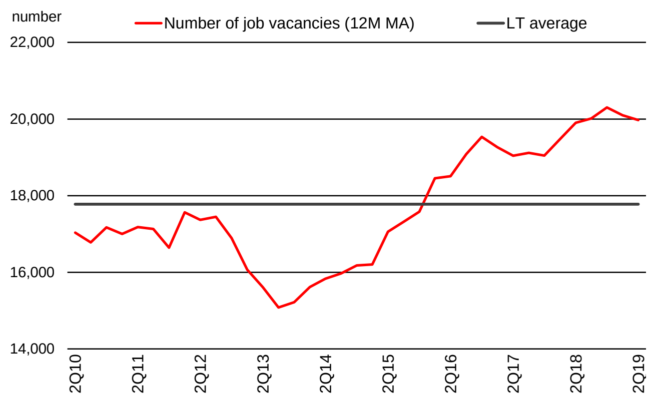
The resilience of factors supporting domestic demand is likely to start to wane

Strong wage growth and easing inflation should boost private consumption

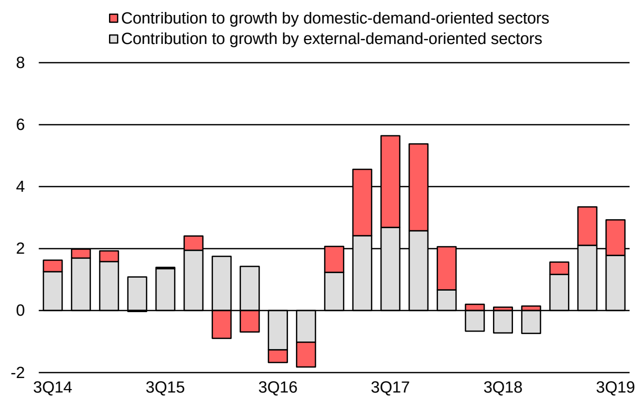
Fast income growth should nevertheless help households to weather external headwinds this year. Growth is likely to mostly draw support from a 10% increase in public-sector wages, which in the context of the tight labor market is likely to spill over into the rest of the economy. Households' disposable income will also benefit from slowly decreasing debt-servicing costs and easing inflation, after energy prices are set to go down due to a combination of lower crude-oil prices envisaged in our global scenario and some country-specific developments.

Investment in equipment will likely remain subdued, but investment in infrastructure could pick up if the absorption of EU funds increases as planned. Investment in equipment lost momentum last year and is set to remain subdued in 2020, before external demand starts to recover again in 2021.

VACANCY LEVELS ARE CLOSE TO AN ALL-TIME HIGH



JOB CREATION HAS REMAINED BROADLY BASED



Source: Eurostat, NSI, UniCredit Research

Last year, EU-funded investments disappointed after falling short of EU funds utilized in the same year of the previous planning period. This looks set to change in 2020, as the final stage of the ongoing planning period draws near and fund absorption is likely to surge.

Lower energy prices should dampen inflation

High labor cost increases will slowly feed into higher core prices this year and next

Annual average CPI will likely slow to 2.7% in 2020, before inching higher to 2.8% in 2021. Any easing in inflation anticipated this year is likely to be almost entirely attributable to lower energy prices. This should reflect the lower crude-oil prices envisaged in our global scenario and a soon-to-be-agreed gas-price cut (anticipated to range from 5% to 10%), which Gazprom is expected to negotiate with the governments of five CEE countries including Bulgaria. This is expected to occur after the European Commission has reached a settlement with Gazprom to withdraw charges related to alleged market-power abuse in exchange for price concessions for five CEE countries members of the EU. At the same time, we expect food prices to be a tad higher this year as the draught in the past autumn is likely to affect some crops. Somewhat higher core prices are also expected as economy slowly approaches the final stages of the ongoing expansion cycle, when labor-cost hikes should increasingly translate into higher core-price inflation.

Last year, Bulgaria prepaid BGN 2.1bn for the purchase of new military aircraft and set aside BGN 0.5bn for the completion of Hemus highway, in a move similar to the one in 2018, when BGN 1.4bn was put into a special account for the same purpose

Bulgaria will be among the EU countries with the largest free fiscal space in 2020. Budget posted a deficit equivalent to 1.0% of GDP on a cash basis last year (better than the 2.1% deficit target). This includes a BGN 2.6bn (2.2% of GDP) impact from prepaid capex. Thus, when prepaid capex is excluded, budget ended 2019 with a surplus of 1.2% of GDP. When calculated on accrual basis, budget is likely to have ended 2019 with a surplus of roughly the same size (1.1% of GDP). This means that budget ended with a surplus for a fourth year in a row, a record matched only by a handful of EU countries, such as Germany and the Netherlands.

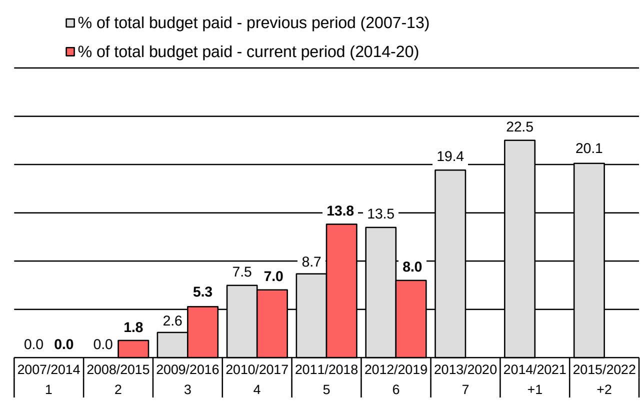
As the dense election cycle of last year has now come to an end, we expect only a moderate fiscal impulse in 2020

Following its victory on municipal elections GERB is unlikely to substantially change its fiscal policy. The government is likely to only moderately loose its fiscal stance in order to mitigate any impact from the anticipated deceleration in growth in the euro area. Thus, only a small surplus equivalent to 0.4% of GDP on an accrual basis (or balanced budget on a cash basis) is expected in 2020. No major changes in taxation have been made apart from the introduction of somewhat-higher taxation of real estate deals and higher vehicle-emission taxes. Apart from higher capex related to the anticipated improvement in EU-fund absorption, the budget will finance an increase in social payments. This will include a 10% rise in public sector wages, a 6.7% rise in pensions and moderately higher welfare payments for the most vulnerable. All these would be financed from a higher budget deficit, improved tax collection and fees from toll road system introduction.

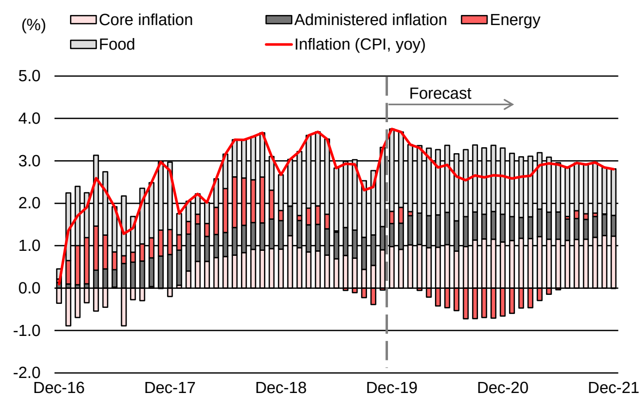
Chances have increased for Bulgaria to receive invitation to join ERM II in April this year

Commitment to fiscal prudence seems even more likely now when the country looks very close to receiving an invitation to join ERM II. Bulgaria has achieved solid progress in all areas of its Euro adoption plan. This includes a number of issues which are of importance for the smooth transition to ERM II and Banking Union. What's more, very strong profitability performance of banks seems to provide enough reasons to believe that remaining capital shortages, which ECB's comprehensive review identified in two local lenders, are likely to be addressed soon.

EU-FUNDED INVESTMENT LOST MOMENTUM IN 2019



LOWER ENERGY PRICES SHOULD PUSH INLFATION DOWN



Source: European Structural and Investment Funds web portal, NSI, UniCredit Research

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