Bulgaria

Baa2 positive/BBB positive/BBB positive*

Outlook

The GDP is likely to shrink by 7.8% in 2020, with a 16% qoq contraction in 2Q20, as social distancing measures have brought many sectors of the economy to a virtual standstill. The labor market is already under serious pressure, and the unemployment rate is likely to temporarily exceed 10% this year. On the positive side, we expect recovery to be much stronger and much faster than the recovery following the recession triggered by the global financial crisis in 2009. Importantly, ERM2 and the country entering the banking union will help to stabilize expectations at a more favorable level and to keep funding costs under control.

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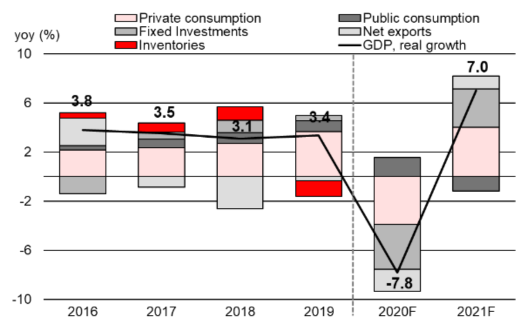
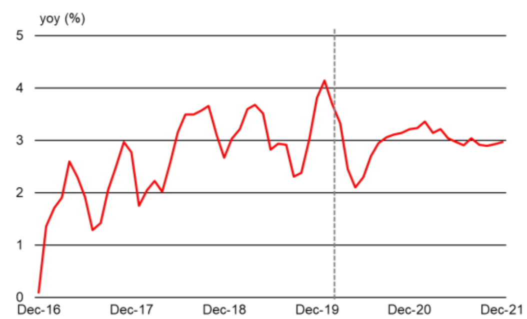
KEY DATES/EVENTS

- 15 May, 4 June: 1Q20 GDP (flash, structure)
- 15 May: labor force survey data for 1Q20
- 18 May, 15 June: Unemployment rate
- 29 May: sovereign rating update from S&P

GDP GROWTH FORECAST



INFLATION FORECAST



Source: National Statistical Institute, UniCredit Research

MACROECONOMIC DATA AND FORECASTS

	2017	2018	2019	2020F	2021F
GDP (EUR bn)	52.3	56.1	60.7	57.7	63.5
Population (mn)	7.1	7.0	7.0	6.9	6.9
GDP per capita (EUR)	7 420	8 012	8 728	8 356	9 264
Real economy, change (%)					
GDP	3.5	3.1	3.4	-7.8	7.0
Private consumption	3.8	4.4	5.8	-6.1	6.1
Fixed investment	3.2	5.4	2.2	-19.3	18.8
Public consumption	4.3	5.3	5.5	9.4	-6.0
Exports	5.8	1.7	1.9	-22.0	19.9
Imports	7.4	5.7	2.4	-19.1	17.2
Monthly wage, nominal (EUR)	530	586	651	674	710
Real wage, change (%)	7.3	7.7	8.0	0.7	2.2
Unemployment rate (%)	6.2	5.2	4.2	9.0	5.9
Fiscal accounts (% of GDP)					
Budget balance	1.1	1.8	1.1	-6.2	-2.9
Primary balance	1.9	2.4	1.7	-5.6	-2.3
Public debt	25.0	21.8	19.9	26.7	27.8
External accounts					
Current account balance (EUR bn)	1.8	0.8	2.5	1.3	1.8
Current account balance/GDP (%)	3.5	1.4	4.0	2.2	2.8
Extended basic balance/GDP (%)	6.8	3.6	6.5	5.0	5.5
Net FDI (% of GDP)	2.5	1.3	1.3	0.5	1.3
Gross foreign debt (% of GDP)	65.4	59.1	56.2	59.2	54.7
FX reserves (EUR bn)	23.7	25.1	24.8	26.2	28.3
Months of imports, goods & services	8.1	8.0	7.8	10.9	9.5
Inflation/monetary/FX					
CPI (pavg)	2.1	2.8	3.1	2.9	3.1
CPI (eop)	2.8	2.7	3.8	3.2	3.0
Central-bank reference rate (eop)	-0.39	-0.50	-0.61	-0.58	-0.54
USD/BGN (eop)	1.63	1.71	1.74	1.76	1.74
EUR/BGN (eop)	1.96	1.96	1.96	1.96	1.96
USD/BGN (pavg)	1.74	1.66	1.75	1.77	1.75
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

Economy braces for a deep but short recession

Our central scenario envisages social distancing measures to be eased in the end of May or perhaps even in June, but to remain part of our life for an extended period of time

So far, the spread of COVID-19 is following the relatively benign trajectories experienced in China outside Wuhan and Hubei province. The numbers suggest that the peak of epidemic should be expected several weeks after the peak is reached in the most badly affected countries in Europe.

The economic fallout from the pandemic will depend on the stringency and length of the social distancing measures

The introduction of the necessary social distancing measures to contain the spread of the disease has essentially shut down large parts of the economy. Travel, entertainment and tourism sectors are likely to be very badly affected. Transportation and storage and the export-oriented manufacturing sectors could also suffer significant output losses due to supply chain disruptions and aggregate demand contraction caused by the pandemic. Many services sectors (particularly those based on human interaction) have been partially paralyzed. Although there are very little hard data to gauge the magnitude of the downturn, indications coming from business confidence surveys, polls conducted among members of business organizations and particularly reports of surging jobless claims, all imply a massive double-digit contraction in real GDP growth in 2Q20.

Household spending will be hit hard, as consumers avoid crowded shopping malls, travel less and postpone purchases of big-tickets items

Once the epidemic curve flattens, we expect containment measures to be eased and output to rebound strongly in 2H20. However, recovery is likely to be bumpy. The scope and scale of social distancing measures is likely to be reduced in 2H20, but they will have to remain in place until either a vaccine is developed or collective immunity is amassed in proportion, which will prevent a second wave of the outbreak. This is bad news for the economy because many companies and households will adopt a wait-and-see approach toward investment and consumption of non-essential items could remain depressed for longer. Recovery could be further damaged by firms' bankruptcies, particularly if job losses take very large and potentially destabilizing proportions which, although not part of our baseline macro scenario, still remains a key downside risk. Even very competitive firms that do not face significant falls in aggregate demand and are unlikely to suffer major supply chain disruptions could find it difficult to operate in this environment.

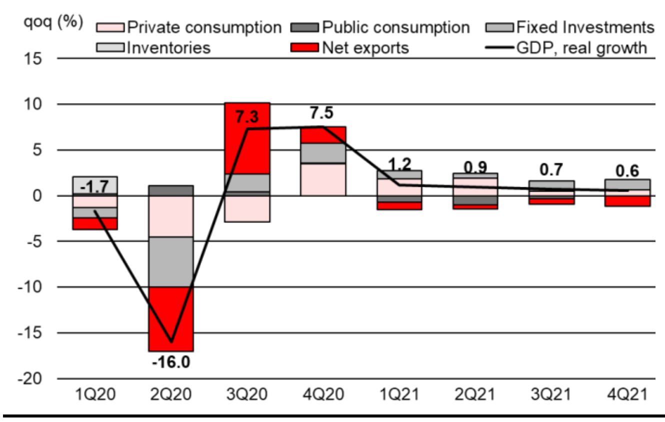
We expect the COVID - 19 pandemic to push the economy into a short-lived but very sharp recession…

We expect a 7.8% drop in real GDP this year, meaning that the recession caused by the coronavirus pandemic will be sharper than the one triggered by the global financial crisis in 2009. On the positive side, we expect the recovery to be much stronger this time around, with GDP growing by 7.0% in 2021. Thus, the economy would reach its pre-crisis output level in the mid of 2022. This would be much better than a decade ago when it took four years for the economy to recoup the output losses suffered in 2009.

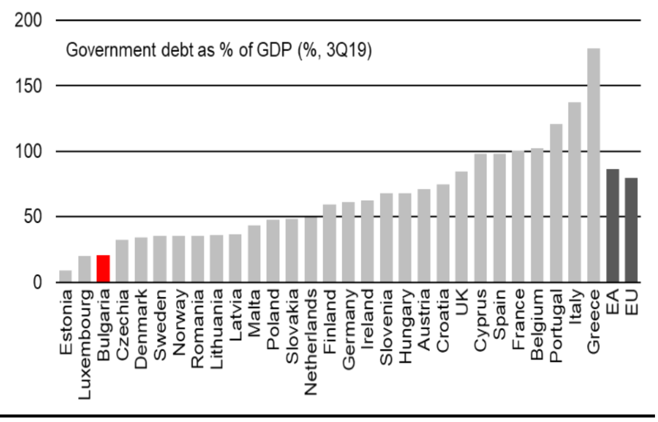
… but recovery would be much stronger than that which followed 2009's downturn

There are several important mitigating factors that are likely to make the recession in Bulgaria shallower and shorter than in most European countries. First, Bulgaria has some of the strongest fiscal fundamentals in Europe. Not only is public debt very low but the country's budget ended with a small surplus last year. This will help to use fiscal policy to compensate for income loss during the downturn and to support the recovery to a greater extent than in most European economies.

PANDEMIC TO CAUSE A SHORT-LIVED BUT SHARP RECESSION



BULGARIA HAS VERY STRONG FISCAL FUNDAMENTALS



Source: Eurostat, National Statistical Institute, UniCredit Research

Bulgaria looks like it will be more resilient to pandemic induced shocks than many other EU countries

Second, Bulgaria's hospitality sector is relatively small, which is positive in the current circumstances, since it is likely to be among the sectors that will suffer the largest drop in output.

Third, the country is a large net energy importer, which should also help given the massive drop in oil prices forecast in 2020. Importantly, with the decisive help of the European Commission, Bulgaria negotiated a cut of more than 40% in the price of gas suppled from Gasprom, which helped to reduce central heating and domestic gas prices just at a moment when household income is badly squeezed by the COVID-19 induced economic downturn.

Fourth, Bulgaria has one of the highest wage-adjusted labor productivity levels in the EU. In the current economic environment this is important for at least two reasons. First, it should mitigate the negative impact of the shocks that COVID-19 pandemic has unleashed on the local economy. And second, and perhaps more importantly, it will put the country in a more favorable position once a recovery starts and the process of rewiring of the global supply chains that the crisis has disrupted eventually begins in 2021.

Bulgaria's ERM2 entry will help to keep funding costs under control

Above all, ERM2 and the country's entry into the banking union, which we expect to take place at the end of April as originally planned, will help to improve liquidity and stabilize expectations. This will not only make it easier for private-sector companies to rollover liabilities falling due this year, but will also help the public sector keep yields on new debt issuance well under control. Expectations will stabilize at a more favorable levels, which will contain output losses during the downturn and, more importantly, boost recovery process when it starts later this year.

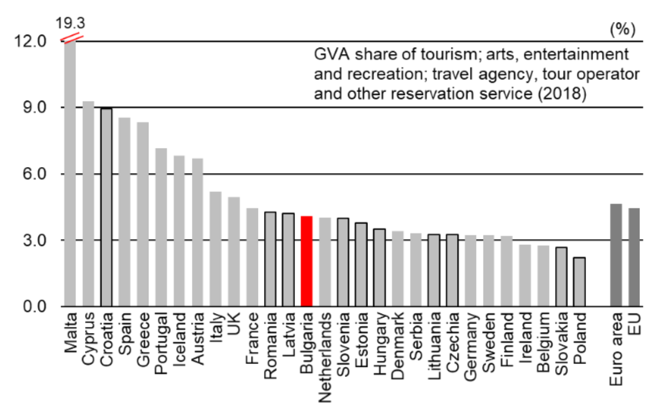
Initially, around 2.2% of GDP will go to fiscal support measures and another 0.4% of GDP to public health support measures

Fiscal measures undertaken so far in Bulgaria look less ambitious than those in other European countries and are likely to be deployed with some delay. The government has allocated 0.4% of GDP in support of public-health measures. Another 0.6% of GDP has been allocated to finance interest-free loans to workers who have been urged to take unpaid leave. The Bulgarian Development Bank received a capital injection equivalent to 0.6% of GDP to finance liquidity support measures for SMEs. The deadlines for utility bills and tax payments have been extended, while all companies that have suffered a drop in revenues of more than 20% were made eligible to receive government support in the form of co-financing of employee remuneration costs. Funding equivalent to 1% of GDP was initially made available for this particular measure, and the government stands ready to provide more funding if it is needed.

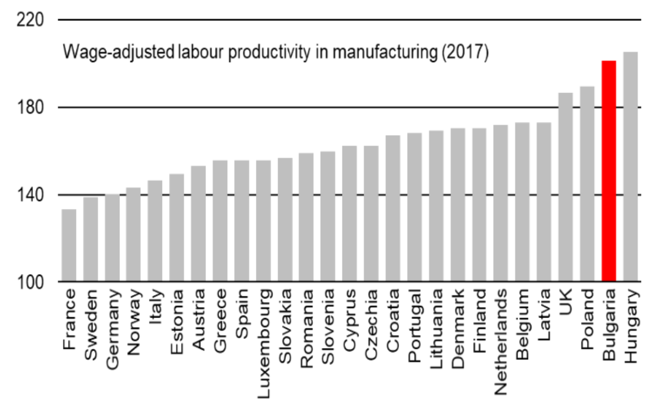
A number of measures were implemented to strengthen the local banking sector's resilience to shocks

The BNB has done most of what seems possible given the limitation of the fixed exchange-rate regime. To strengthen banks' capital positions, the BNB has urged banks to capitalize entire profits from 2019 and has canceled the planned increase of the countercyclical buffer. In line with the EBA guidance, a loan repayment moratorium for borrowers who had regularly serviced loans prior to the pandemic was introduced. Importantly, a shift toward a more lenient supervisory stance is likely to be implemented to help banks deal with the anticipated drop in asset quality.

BULGARIA HAS A RELATIVELY SMALL HOSPITALITY SECTOR



WAGE-ADJUSTED LABOR PRODUCTIVITY IS A KEY STRENGTH



Source: Eurostat, UniCredit Research

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