

Bulgaria

Baa1 stable/BBB stable/BBB positive*

Outlook

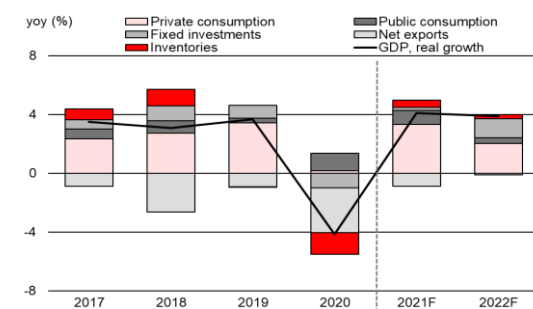
The failure of the vaccination campaign and the sharp fall in public capex has triggered a downward revision of our growth forecast. We now expect 4.1% growth in 2021 (from 4.4%) and 3.9% in 2022 (from 4.1%). The next parliamentary elections will be held together with the first round of the presidential elections on 14 November. Polls show that support for the protest parties has declined, as voters appear to be disappointed by their repeated failure to form a government. We see a coalition between the protest parties and the left wing BSP as the most likely post-election scenario. A coalition between GERB and some of the smaller right-wing parties should also not be ruled out, especially if some of nationalist formations make it into the next parliament.

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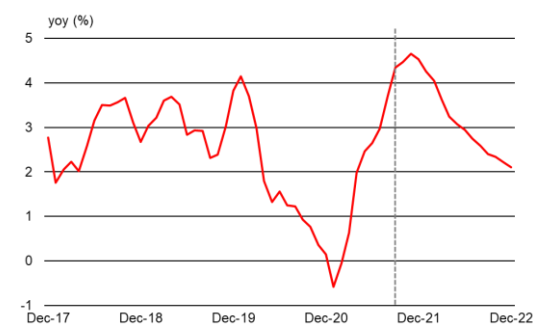
KEY DATES/EVENTS

- 14 Nov: presidential and parliamentary elections
- 15 Nov: labor force survey data for 3Q21
- 22 Oct, 16 Nov, 07 Dec: GDP data (revised data for 2020, 3Q21 flash estimate and structure)

GDP GROWTH FORECAST



INFLATION FORECAST



Source: National Statistical Institute, UniCredit Research

MACROECONOMIC DATA AND FORECASTS

	2018	2019	2020	2021F	2022F
GDP (EUR bn)	56.1	61.2	60.6	65.4	70.6
Population (mn)	7.0	7.0	6.9	6.9	6.8
GDP per capita (EUR)	8 016	8 809	8 768	9 523	10355
Real economy, change (%)					
GDP	3.1	3.7	-4.2	4.1	3.9
Private consumption	4.4	5.5	0.2	5.0	3.0
Fixed investment	5.4	4.5	-5.1	1.1	7.0
Public consumption	5.4	2.0	7.5	5.2	2.2
Exports	1.7	3.9	-11.3	6.6	8.0
Imports	5.7	5.2	-6.6	7.5	7.5
Monthly wage, nominal (EUR)	586	648	709	787	843
Real wage, change (%)	7.7	7.5	7.7	8.4	4.2
Unemployment rate (%)	5.2	4.2	5.1	5.5	4.7
Fiscal accounts (% of GDP)					
Budget balance	2.0	2.1	-3.4	-5.5	-5.0
Primary balance	2.7	2.7	-3.0	-5.1	-4.6
Public debt	21.8	19.7	24.4	24.0	29.5
External accounts					
Current account balance (EUR bn)	0.5	1.1	-0.4	-1.0	1.1
Current account balance/GDP (%)	0.9	1.8	-0.7	-1.5	1.5
Extended basic balance/GDP (%)	3.2	4.8	3.9	2.3	6.8
Net FDI (% of GDP)	1.3	1.9	3.2	2.2	2.6
Gross foreign debt (% of GDP)	66.3	62.6	66.1	62.4	59.1
FX reserves (EUR bn)	25.1	24.8	30.8	30.0	31.2
Months of imports, goods & services	8.0	7.4	10.4	8.6	8.0
Inflation/monetary/FX					
CPI (pavg)	2.8	3.1	1.7	2.6	3.0
CPI (eop)	2.7	3.8	0.1	4.5	2.1
Central-bank reference rate (eop)	-0.50	-0.61	-0.70	-0.63	-0.55
USD/BGN (eop)	1.71	1.74	1.60	1.63	1.59
EUR/BGN (eop)	1.96	1.96	1.96	1.96	1.96
USD/BGN (pavg)	1.66	1.75	1.71	1.64	1.61
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

Slow vaccination rollout will take its toll on the economy

We have made a downward revision to our growth forecast

We have lowered our real GDP growth forecast for 2021 to 4.1% (from 4.4%) and for 2022 to 3.9% (from 4.1%). Output is now likely to recover to its pre-pandemic level in 1Q22 (from 4Q21 in the previous forecast), while a fall in the unemployment rate to levels close those associated with full employment is now expected in 2023 (from mid-2022 in the previous forecast).

Low vaccination rate means the health crisis is not over

There are three main reasons why we have lowered our GDP growth forecast. First, the vaccination campaign has failed to produce the desired results (see chart). Since the start of the campaign the rollout of the vaccines has been so slow that Bulgaria is unlikely to reach collective immunity any time soon, given the evidence of a decrease in vaccine efficacy over time. Against this disappointing backdrop, the spread of the highly transmissible Delta variant has driven a sharp rise in virus cases, hospitalizations and deaths in September (see chart). In response to the start of the fourth wave, the caretaker government tightened containment measures and promised to prolong provision of fiscal support to households and business hit by the pandemic.

The fourth wave will take its toll on the economy

Despite soft containment measures and very loose compliance, the fourth wave will take its toll on the economy. Tourist arrivals this winter will be lower than they might have been, as people are likely to be reluctant to visit a country where health-related risks remain elevated. Consumption will suffer, because people will probably continue to behave cautiously and maintain some sort of voluntary physical distancing until the fourth wave starts to subside at some point later this year. The public sector will have to provide more fiscal support to households and businesses suffering from the negative impact of the fourth wave of the pandemic, causing the budget deficit to increase.

Transition to a new government delayed the completion of some infrastructure projects

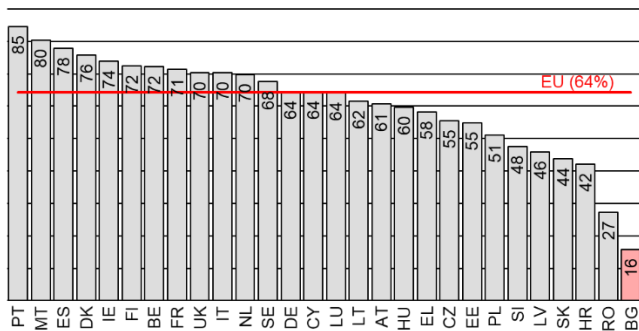
Second, another wave of the COVID-19 pandemic was not the only downside risk to our baseline macroeconomic scenario that has materialized. Similar to what happened in 2013, the caretaker government discontinued some of the large infrastructure projects initiated under GERB. This has reversed the positive trend of rising public capex over the past several years, pushing them down to an expected 3.5% of GDP in 2021. If this forecast materializes, public capex this year will be lower than both those posted last year (4.3%) and the budget target for 2021 (4.8%). This is bad news for growth in 2021 and perhaps in 2022, unless the new government urgently restarts these projects once it is formed in November.

Delays in the RRP submission has negatively affected the investment recovery

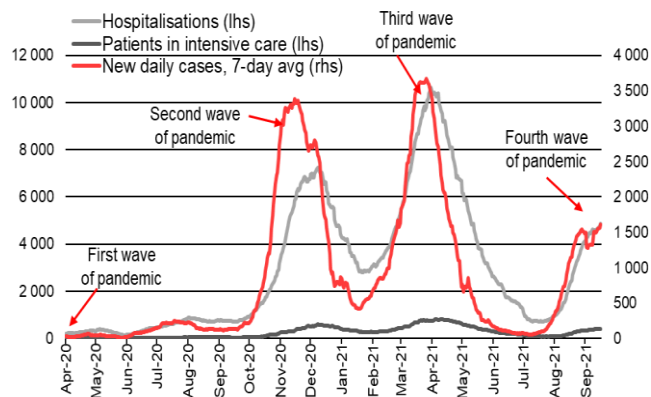
Finally, the authorities have not yet submitted the country's Recovery and Resilience Plan (RRP). This means that the positive impact that we expected the RRP to have on the economy this year will not materialize and the positive impact next year may likewise be smaller than we anticipated earlier. In the worst case, the delayed submission of the RRP will shorten the period in which the country can use money from the NextGenerationEU (NGEU) facility, thereby reducing the overall utilization rate. Our macro scenario assumes Bulgaria will absorb 90% of the funding the country is eligible to draw from the NGEU. We will keep this assumption intact for now but will closely watch the underutilization risk and will factor it into our future forecasts, if necessary.

ROLLOUT OF VACCINES HAS BEEN DISSPOINTINGLY SLOW

Share of the total population that have received at least one dose of COVID-19 vaccine (31 August 2021)



THE FORTH WAVE HIT THE COUNTRY IN EARLY AUGUST



Source: Worldometer, Ministry of Health, UniCredit Research

Wheat harvest surprised on the positive side

On the positive side, the wheat harvest this year reached 7mn tons, from 4.6mn last year. This will boost GVA in the agriculture sector moderately but will not fully offset the negative impact on growth stemming from the slow vaccination campaign and the drop in public capex.

Fiscal support is likely reach 7% of GDP in 2021

The fourth wave of the COVID-19 pandemic forced the government to prolong the fiscal support measures. Thus, fiscal support is likely to rise to 5.1% of GDP this year, from 4% of GDP initially envisaged in the state budget. When adding all pension and public sector wages increases this year, the fiscal support is likely to have reached almost 7% of GDP, according to our calculations.

At around 4% of GDP, the country's cash deficit will be the lowest in CEE this year

The caretaker government has focused on reducing cash deficit in the budget as an important priority. To this end, the authorities cut back public capex to its lowest level in two decades, while also postponing 0.5% of GDP in payments due to private road construction companies. As a result, the cash deficit is unlikely to exceed 4% of GDP this year (5.5% on accrual basis), but will increase again next year to 5.2% of GDP (and 5% of GDP on an accrual basis), according to our forecast.

Tight deadlines envisaged in the constitution made it even more difficult to form a government

Bulgaria's political scene was thrust into uncertainty after all three attempts to form a government failed and the president dissolved parliament for a third time this year. Deep fragmentation within parliament proved an insurmountable hurdle to end the political deadlock. This was further aggravated by the lack of experience of local politicians in forming large and complex coalitions that are supported by multiple players with diverse ideological backgrounds. Tight deadlines did not help either. Bulgaria's constitution allows parties only a few weeks to form a government, unlike in some other countries, where it is normal for coalition talks to take several months.

In November, Bulgarians will head to the polls for a third time this year

The next parliamentary elections will be held simultaneously with the first round of the presidential elections on 14 November. The same six parties that are in the current parliament are likely to be represented in the next one, according to opinion polls available in mid-September. Three small nationalist parties, Vazrazhdane, NFSB and VMRO, have a chance of surpassing the threshold for parliamentary entry, especially if they form some sort of alliance.

Failure to form a government is likely to reduce support for protest parties

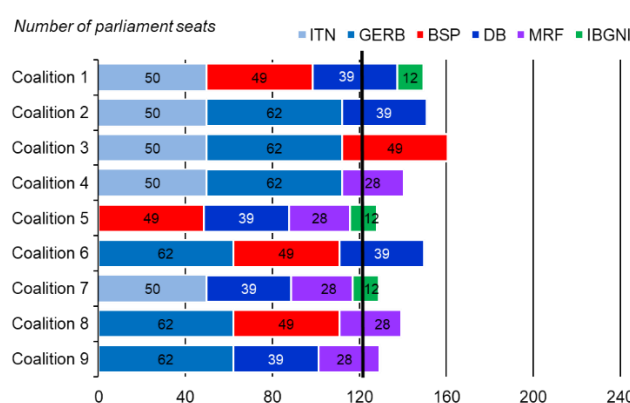
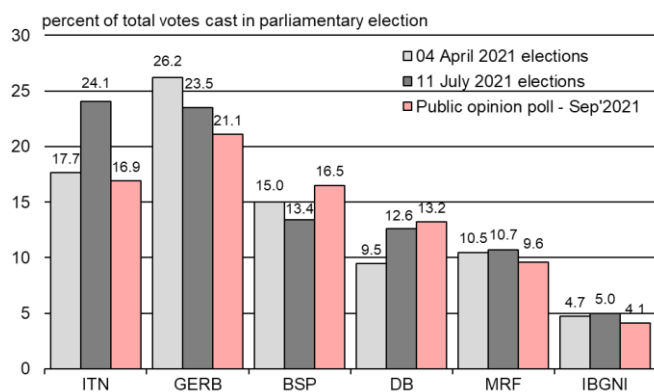
After the election in July, support for the protest parties (including the three parties – ITN, DB and IBGNI – that benefited most from the protest against GERB) rose to 112 MPs, from 92 MPs in April. However, following their failure to form a government for a second time this year, the combined support for the protest parties has dropped to some 100 MPs, according to recent polls. Support for the two main parties (the right wing GERB and the left wing BSP) has risen as a result.

Coalition between the main left wing party, the BSP, and the protest parties remains our most likely scenario

Of the nine possible coalitions in the next parliament, we see only two as feasible (see chart). The first is essentially a repetition of the coalition between the three protest parties plus the main left wing BSP. Although these four parties have repeatedly failed to put a coalition agreement together, we still think they have the strongest chance of forming the next government. Whereas in the past it had seemed certain that the GERB would be excluded from the coalition talks, they are now running first in the opinion polls, which has increased GERB's chances of getting back into power, especially if some of the nationalist parties make it into the next parliament.

SUPPORT FOR THE PROTEST PARTIES IS LIKELY TO GO DOWN

ONLY TWO POSSIBLE COALITIONS SEEMS FEASIBLE TO US



Source: Central Election Commission, Alpha Research poll, UniCredit Research

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