UniCredit

March 2021

CEE Macro & Strategy Research

CEE Quarterly

Bulgaria

Baa1 stable/BBB stable/BBB positive*

Outlook

New restrictions caused Bulgaria's economy to get off to a weak start into 2021. Vaccines and medical treatments for COVID-19 are expected to support a gradual recovery in 2H21. Receding health concerns and acceleration in Next Generation EU (NGEU) fund absorption should set the economy on course to achieve solid growth in both 2022 and 2023. We do not expect the economic policy of the new government to deviate significantly from its current path. Spending on active labor-market policies will have to be increased to support the reallocation of resources from sectors most affected by the pandemic to higher-productivity sectors. We expect to see a moderate rise in social spending, while wage policy in the public sector is unlikely to be changed much.

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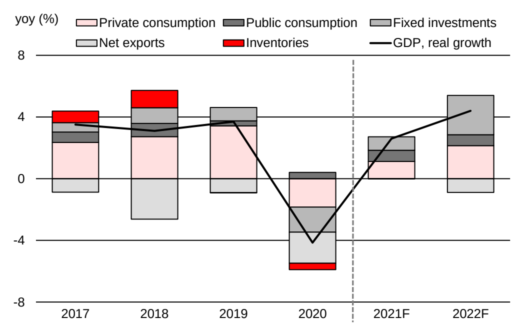
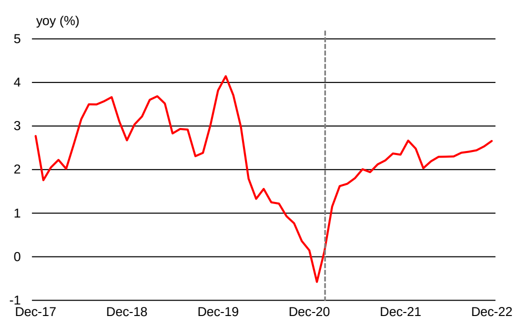
KEY DATES/EVENTS

- 04 Apr: parliamentary elections
- 17 May: labor force survey data for 1Q21
- 18 May, 8 June: 1Q21 GDP (flash, 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	63.2	67.5
Population (mn)	7.0	7.0	6.9	6.9	6.8
GDP per capita (EUR)	8 016	8 809	8 785	9 215	9 910
Real economy, change (%)					
GDP	3.1	3.7	-4.2	2.6	4.4
Private consumption	4.4	5.5	0.2	1.6	3.0
Fixed investment	5.4	4.5	-5.1	2.3	12.4
Public consumption	5.4	2.0	7.5	3.5	3.5
Exports	1.7	3.9	-11.3	5.6	7.7
Imports	5.7	5.2	-6.6	4.8	8.4
Monthly wage, nominal (EUR)	586	648	709	755	816
Real wage, change (%)	7.7	7.5	7.7	4.9	5.7
Unemployment rate (%)	5.2	4.2	5.1	5.8	4.9
Fiscal accounts (% of GDP)					
Budget balance	2.0	1.9	-3.5	-5.4	-2.9
Primary balance	2.7	2.7	-3.1	-5.0	-2.2
Public debt	21.8	19.7	24.4	27.7	28.4
External accounts					
Current account balance (EUR bn)	0.5	1.1	-0.4	1.1	1.4
Current account balance/GDP (%)	0.9	1.8	-0.7	1.7	2.1
Extended basic balance/GDP (%)	3.2	4.8	3.9	6.6	7.0
Net FDI (% of GDP)	1.3	1.9	3.2	2.7	2.1
Gross foreign debt (% of GDP)	60.2	57.4	60.7	60.9	59.3
FX reserves (EUR bn)	25.1	24.8	30.8	33.3	35.1
Months of imports, goods & services	8.0	7.4	10.4	10.4	9.7
Inflation/monetary/FX					
CPI (pavg)	2.8	3.1	1.7	1.6	2.4
CPI (eop)	2.7	3.8	0.1	2.3	2.7
Central-bank reference rate (eop)	-0.50	-0.61	-0.70	-0.70	-0.60
USD/BGN (eop)	1.71	1.74	1.61	1.60	1.56
EUR/BGN (eop)	1.96	1.96	1.96	1.96	1.96
USD/BGN (pavg)	1.66	1.75	1.71	1.64	1.57
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

Local policy-related factors to come to the fore

We are not changing much our growth projections for this year and next

After contracting by 4.2% in 2020, GDP is likely to expand by 2.6% in 2021 and by 4.4% in 2022. We expect economic activity to recover to its pre-crisis level in the middle of 2022. Full employment is not likely before the end of 2023. Uncertainty is elevated, as the path to recovery remains shaped by a combination of medical and local policy-related developments.

Activity at the turn of the year was resilient thanks to soft restrictions…

…but restrictions will be tightened from March

Although Bulgaria was among the countries most affected by the second wave of COVID-19 infections (see chart), measures to contain the spread of the disease were among the softest in CEE. This helped Bulgaria's economy to remain resilient at the turn of the year, as suggested by a host of high-frequency indicators (see chart). At the time of writing, the country was entering a third wave of COVID-19, and this led to a new round of restrictions, which we expect will remain in place through the first part of April, before warmer weather and a pickup in vaccination levels lead to easing health concerns.

The timeline of the rollout of vaccination will define the pace of normalization of household spending patterns

We do not expect to see any meaningful boost to growth throughout 1H21. However, as the share of total country's population that has been vaccinated increases in 2H21, we expect confidence to rise and consumption patterns to slowly start normalizing, thus boosting GDP growth toward the end of 2021. Economic recovery is forecast to shift into a higher gear next year, once the health crisis recedes and absorption of NGEU funds has gained momentum.

Bulgaria's next parliamentary election is scheduled for 4 April 2021

Bulgarians will head to the polls on 4 April 2021. The outlook is for a fragmented parliament in which the two main parties in the country, GERB and the BSP, have the possibility of creating a coalition government that includes some of country's smaller political factions.

No major changes in economic policy are expected

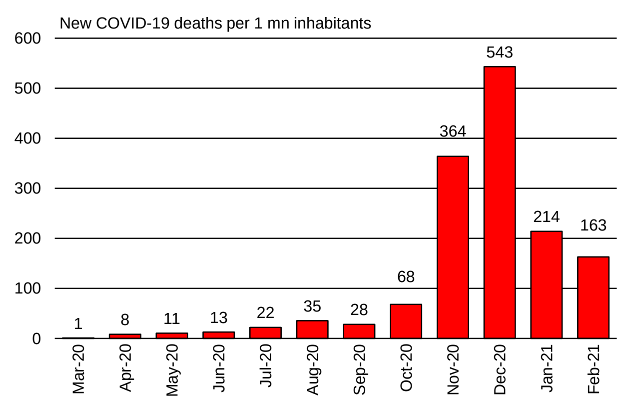
More spending increases seems likely

We do not expect the economic policy of Bulgaria's new government to deviate significantly from the current path. The next government is likely to pursue a moderately conservative fiscal policy no matter who wins the election. After a prolonged period of very tight fiscal policy, it is only normal some spending increases to be seen, especially when one takes into account that the country is currently experiencing its worst health crisis since the start of transition. Precisely what form spending increases could take remains unclear. Importantly, such spending increases are unlikely to pose a major risk to Bulgaria's budget, as they are likely to be relatively small, given the pledges the main political parties have made so far in their election campaign. The BSP wants to replace regressive taxation of personal incomes with a progressive one, which is positive, as it should help reduce poverty and boost GDP growth. However, it remains to be seen whether the BSP will be able to convince their coalition partners to support such a move, if it is part of Bulgaria's next government.

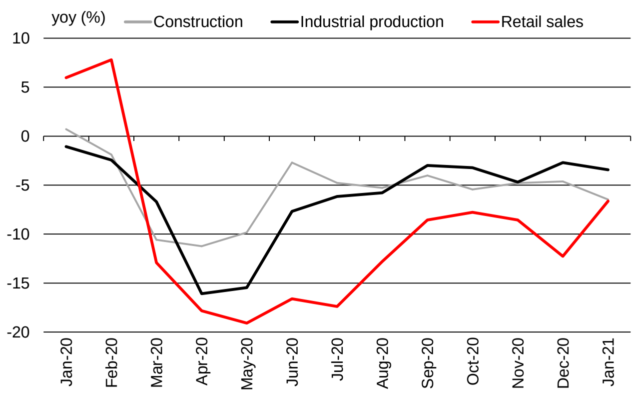
Bulgaria's next government is likely to continue to raise public-sector wages

No matter who wins the next election, public-sector wages are likely to continue growing at a pace close to that seen in the past several years. Given where wages are now, such a policy is unlikely to pose a major risk to competitiveness in the short run.

BULGARIA WAS GREATLY AFFECTED BY THE SECOND WAVE…



…BUT ITS ECONOMY REMAINED RESILIENT



Source: Worldometer, National Statistical Institute, UniCredit Research

However, the authorities should be careful, as the country cannot afford losing its cost competitiveness without building up other sources of competitive advantage that may successfully replace it.

Fiscal policy to support growth and jobs recovery this year

Fiscal policy is likely to play a more constructive role this year. The country has a plenty of firepower on the fiscal front, and there are signs that the authorities are learning how to use it more effectively. The size of fiscal support is likely to rise to 4.0% of GDP this year (from 3.1% in 2020, one of the lowest in the region). No matter who wins April's election, some temporary pandemic support is likely to be transformed into a permanent rise in public spending. This welcome shift in fiscal policy will help to prevent an unnecessary blow to Bulgaria's economic recovery, as restrictions are eased and health concerns fade later this year.

Consumption patterns have experienced a major shift

The COVID-19 pandemic has caused a shift in the composition of consumption. Consumption of goods increased, while consumption of services, and particularly of tourism and leisure-related services, has declined (see chart). This pattern of consumption is likely to persist at least into the next several quarters, as some people are likely to continue to behave more cautiously and to maintain some sort of social distancing voluntarily.

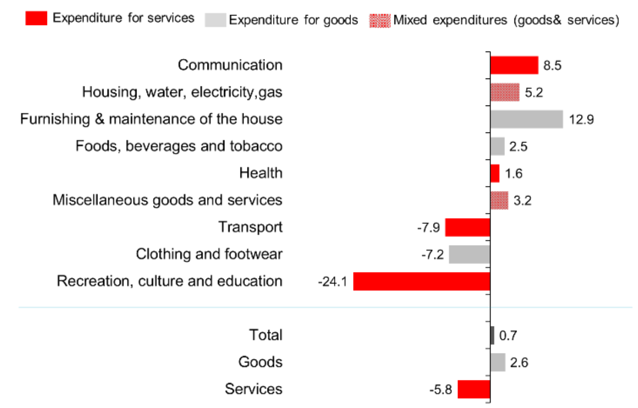
To avoid higher unemployment, Bulgaria's public sector should support the reallocation of labor across sector

Absent policies to facilitate a rapid reallocation of workers, a significant rise in unemployment rate is likely to occur later this year, when a phasing out of job-retention schemes should begin. This will require the reallocation of labor and capital away from services and towards goods producing sectors. Hospitality, which has been most affected by the COVID-19 pandemic, tends to utilize a large number of low-skilled and low-income labor. Reallocating this labor to other sectors may prove difficult and could push long-term unemployment upwards. To address this challenge, spending on active labor-market policies will have to be increased and directed more toward training programs that are specifically targeted at those workers who are most at risk of dropping permanently out of the labor force. On the positive side, if workers from the tourism sector and other sectors that have been greatly affected by the COVID-19 pandemic are re-employed in sectors associated with higher productivity, this reallocation process could have the potential to boost overall productivity.

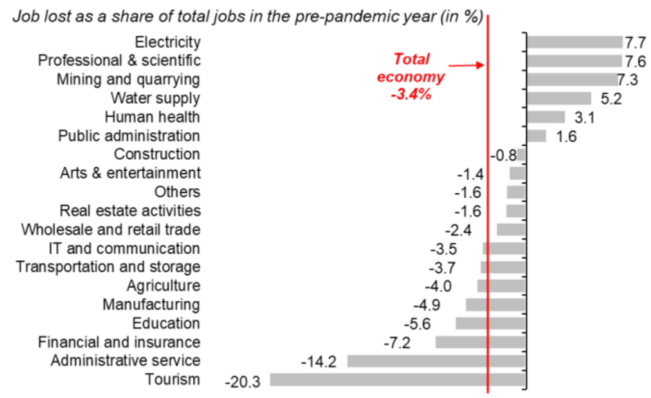
Getting back to full employment would need more time to materialize

Despite the widespread use of wage subsidies and short-time-work support schemes, Bulgaria's economy lost 111,000 jobs last year. This amounts to 3.4% of the total number of jobs that existed in the pre-pandemic year and is slightly more than the number of jobs lost in Bulgaria in the wake of the global financial crisis in 2009. Importantly, this fall in employment was more broadly based than expected (see chart). The fact that job losses have not been limited to a small number of contact-dependent industries suggests that job recovery is unlikely to be automatic and is not going to take place rapidly after the health crisis ends and restrictions are lifted. Moreover, we think economy is set to lose another 34,000 jobs when the government starts withdrawing job-retention schemes later this year. However, country's employment is likely to rise again in 2022, when GDP growth is set to shift to a higher gear.

PANDEMIC-INDUCED CONSUMPTION PATTERNS TO CHANGE



JOB LOSSES WERE MORE BROADLY BASED LAST YEAR



Source: National Statistical Institute, UniCredit Research

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