Bulgaria

Baa2 positive/BBB stable/BBB stable*

Outlook

Bulgaria has remained on the periphery of the coronavirus pandemic. Stepped up fiscal support will help the country avoid a sharp increase in unemployment. However, this is unlikely to prove enough to prevent a major drop in household income and purchasing power, which will send the economy into its deepest recession since 1997. ERM II membership and the lack of major excesses in the expansion period preceding the coronavirus-induced recession will be the main stabilization factors.

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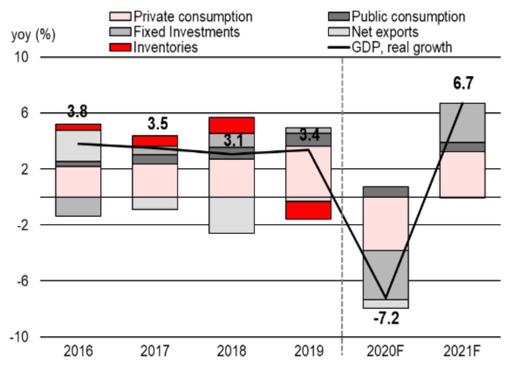
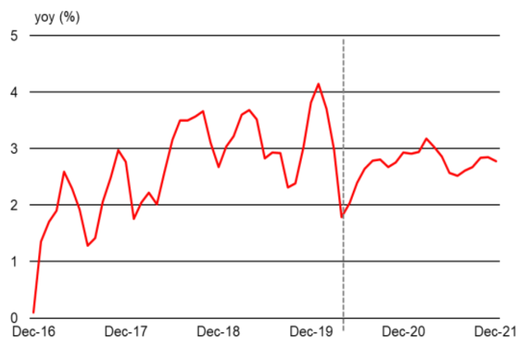
KEY DATES/EVENTS

- 15 July, 17 Aug, 15 Sep: CPI
- 12 Aug: Labor force (2Q20)
- 14 Aug, 04 Sep: 2Q20 GDP (flash, structure)
- 21 Aug: rating review from Fitch

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	58.0	63.5
Population (mn)	7.1	7.0	7.0	6.9	6.9
GDP per capita (EUR)	7 420	8 012	8 728	8 395	9 261
Real economy, change (%)					
GDP	3.5	3.1	3.4	-7.2	6.7
Private consumption	3.8	4.4	5.8	-6.0	5.0
Fixed investment	3.2	5.4	2.2	-18.5	16.9
Public consumption	4.3	5.3	5.5	4.5	3.5
Exports	5.8	1.7	1.9	-18.8	18.0
Imports	7.4	5.7	2.4	-17.7	17.6
Monthly wage, nominal (EUR)	530	586	651	667	705
Real wage, change (%)	7.3	7.7	8.0	-0.3	3.0
Unemployment rate (%)	6.2	5.2	4.2	7.0	5.6
Fiscal accounts (% of GDP)					
Budget balance	1.1	2.0	2.1	-3.3	-1.6
Primary balance	1.9	2.7	2.7	-2.7	-1.0
Public debt	25.0	21.8	19.9	24.8	25.5
External accounts					
Current account balance (EUR bn)	1.8	0.8	2.5	1.2	1.8
Current account balance/GDP (%)	3.5	1.4	4.0	2.1	2.9
Extended basic balance/GDP (%)	6.8	3.6	6.5	4.9	7.4
Net FDI (% of GDP)	2.5	1.3	1.3	0.5	1.2
Gross foreign debt (% of GDP)	64.7	60.3	56.2	58.8	54.6
FX reserves (EUR bn)	23.7	25.1	24.8	25.9	29.5
Months of imports, goods & services	8.1	8.0	7.8	10.7	10.0
Inflation/monetary/FX					
CPI (pavg)	2.1	2.8	3.1	2.7	2.8
CPI (eop)	2.8	2.7	3.8	2.9	2.8
Central-bank reference rate (eop)	-0.39	-0.50	-0.61	-0.58	-0.50
USD/BGN (eop)	1.63	1.71	1.74	1.70	1.66
EUR/BGN (eop)	1.96	1.96	1.96	1.96	1.96
USD/BGN (pavg)	1.74	1.66	1.75	1.73	1.67
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

Fiscal support will not prevent a sharp fall in income

The length and severity of the recession will depend on the stringency of the lockdown measures as well as the magnitude and the quality of the policy response

So far, Bulgaria has remained on the periphery of the COVID-19 pandemic. Both the number of registered cases and the number of deaths from COVID-19 infection calculated per one million inhabitants, continued to follow the benign trajectory experienced in CEE. As Bulgaria was among the less affected countries, the lockdown measures implemented in its economy were less stringent than those deployed in most countries in Europe. This is positive for the economy because the damage that the lockdown has inflicted is likely to prove smaller.

Faster and more robust recovery than the one following the recession in 2009 remains our baseline scenario

To reflect the latter, along with the upward revision in our growth scenario for the euro area, we are raising our 2020 real GDP growth forecast for Bulgaria to -7.2% from the -7.8% we had anticipated in April. We expect GDP to contract by around 14% qoq in 2Q20. The pace and shape of recovery remains very uncertain. Still our baseline scenario is for a "V" shaped recovery, which should start in 2H20, if there is no second wave of the disease.

Public capex and investment in residential construction will recover soon…

…but investments in machinery and equipment will likely lag behind

Public capex will play an important role in the recovery process. The government remains committed to fully implementing its public capex plan envisaged for the current year. Construction of the Hemus highway, financed from the budget surpluses posted in 2018 and 2019, is progressing rapidly. However, the big difference is EU's Next Generation Plan, where Bulgaria is likely to be among the main beneficiaries. Importantly, banks are now in a much stronger position than a decade ago and will continue to provide credit to the real economy. Investment in residential construction is also likely to shift up a gear soon, in our view, as housing prices are more in line with household income and there have been no major excesses during the expansion years preceding the coronavirus-induced recession.

More increases in direct fiscal support are likely by the end of the year

After a slow start, the authorities have stepped up fiscal support. The furlough scheme was extended until September and will most likely be in force at least until the end of this year, while, at the same time, its scope was expanded to include all sectors of the economy. Special support measures were put in place for the most badly affected sectors. Including all the new measures, the total direct fiscal support is set to increase to around 3% of GDP in 2020.

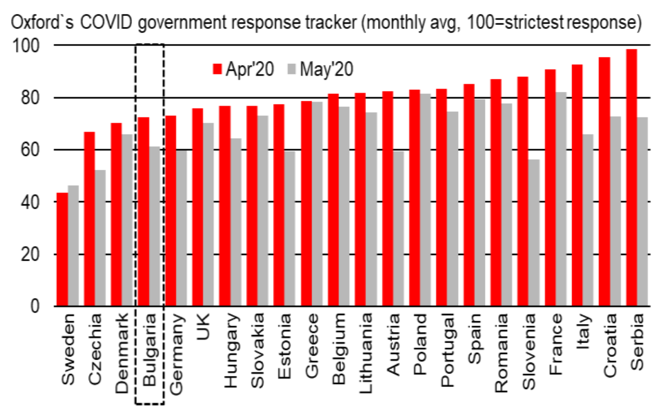
Saving so many jobs this time around would be a remarkable success

We think that, if deployed in full and without major delays, the fiscal support measures will prevent a sharp increase in unemployment. They are likely to keep 240k jobs (5.4% of the working age population) on the payroll, thereby reducing average job losses to 114k in 2020. This would be a remarkable improvement compared to the 2009 recession, when 428k jobs (8.4% of the working age population) were lost and unemployment peaked at 13.8% in 1Q13.

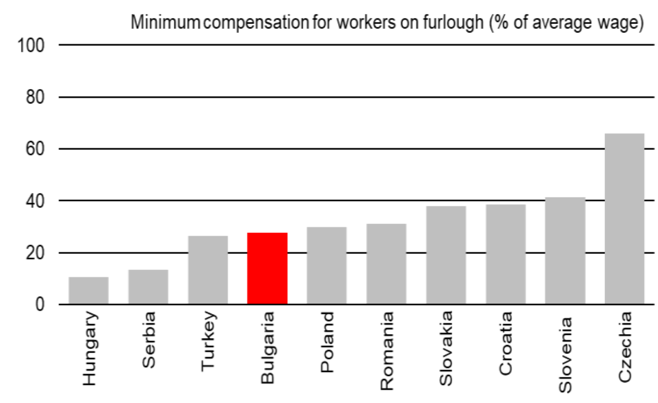
Due to the large grey economy, the design of the furlough scheme significantly reduces the compensated income

However, this is likely to prove insufficient to prevent a major drop in household income. The problem is that while furlough scheme will stave off major job losses, the beneficiaries will be entitled to receive only a small portion of their pre-crisis income. To make matters worse, the sectors worst hit by the pandemic are some of those with the largest share of the grey

LOCKDOWN IN BULGARIA WAS LESS STRINGENT



MINIMUM COMPENSATION OF INCOME LOOKS SMALL



Source: Oxford University, UniCredit Research

While assisting citizens and businesses is the right thing to do, the structure of this assistance is important. This is more so in Bulgaria, where poverty indicators were already elevated before the pandemic

economy. As the size of benefit, under the furlough scheme, is linked to the volume of social contributions paid prior to the pandemic, the resulting income compensation is small. In the hospitality sector, for example, remuneration reported for contribution payment purposes is usually close to the minimum wage, while the amount actually paid is often more than two times higher. As a result, the furlough scheme in this sector rarely compensates for more than one third of the lost income from the pre-pandemic period. Losses of income have been further exacerbated by the fact that some employees were urged to take unpaid leave, while others have seen their wages cut (see charts). Calculating precise household income losses resulting from wage cuts is impossible at such an early stage. However, there is evidence that these may prove significant as, for example, 8.2% of managers in a poll conducted in April responded that they had already implemented wage cuts, while another 17% planned to do so in May.

Increasing number of companies are resorting to reducing wages

The possibility of the economy being significantly crippled justifies an even larger increase in both the scope and scale of government interventions

To fix the problem the government could raise the minimum compensation under the furlough scheme, which currently stands at EUR 187. On the positive side, this would help to increase the compensated income, amid the deepest recession since 1997. On the negative side, it could undermine confidence in the scheme, as the link between the volume of contributions paid and the benefits received will be lost. Alternatively, the authorities could take the opportunity to broker a deal with the representatives of business and trade unions, under which unemployment benefit is raised and the volume of income compensation under the furlough scheme is increased immediately, with the proviso that the unemployment contribution rate and minimum employment income for insurance contribution purposes will be increased when the crisis is over.

There is enough fiscal space to double the proportion of lost income compensated for by the government

The design of the fiscal measures will also matter

It is now clear that the pandemic will last longer than we thought when the fiscal measures were initially deployed. This implies that the fiscal measures may have to be extended well into 2021, as some sectors, such as mass tourism and other sectors related to international travel, for example, will remain under pressure for longer. The magnitude of the ongoing shock means that there will be some permanent losses of income, as some companies will go bankrupt and employees will lose their jobs. Therefore, the design of the measures will be important. The aim should be to concentrate on the viable companies that the coronavirus-induced recession is threatening and provide support to them instead of just prolonging the life of weaker players.

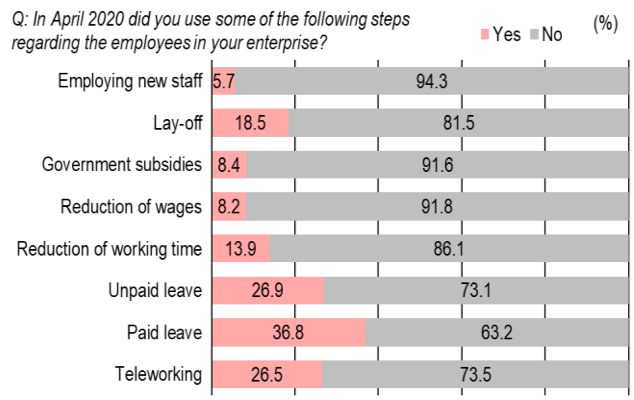
The last remaining obstacle before ERMII membership was removed

The amount paid for a 19% share stake in First Investment Bank was BGN 140 mn, or less than 0.1% of the country's GDP

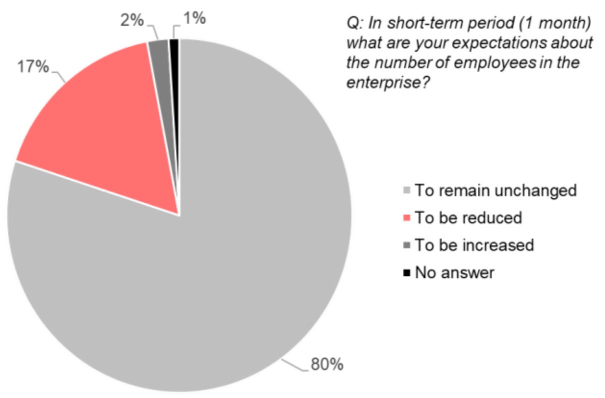
Our baseline scenario envisages Bulgaria to join the euro area on January 1, 2023

The government took part in the capital increase of First Investment Bank. The move was largely anticipated, as attracting capital from the private sector amid the ongoing economic downturn became difficult even in a country like Bulgaria, where banking is a very profitable business. Once the remaining formalities are addressed, we expect Bulgaria to become part of the ERM II and the banking union in the next few months. The years the country will spend in the ERM II will be important. The focus will be on boosting the supervisory capacity of the banks regulator and on preparing the BNB for Eurosystem membership. Above all, the country will have to press ahead with the structural policies needed to ensure that its economy will remain competitive within the fixed exchange rate regime and will fully benefit from being part of the EU's inner core.

SOME COMPANIES IMPLEMENTED WAGE CUTS IN APRIL



MANY COMPANIES ARE CONSIDERING LAYOFFS IN MAY



Source: National Statistical Institute, UniCredit Research

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