UniCredit Bulbank

BULGARIA

Quarterly Macroeconomic Review 4Q2025

Macroeconomic and Market Research

„The re-emergence of political instability is unwelcome news“

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This quarterly macroeconomic review of Bulgarian economy was published on 09 December 2025. It employs statistical data and information available as of 05 December 2025.

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Outlook

The debate over raising direct taxes and contribution rates has become so polarized that the government was forced to withdraw the draft budget and launch a new budget-preparation procedure. The country now appears to be facing new snap parliamentary elections, which will most likely be held concurrently with the presidential elections scheduled for the autumn of 2026.

The return of political instability is likely to slow decision-making processes in the public sector. Absorption of EU funds is expected to deteriorate, as progress on meeting the associated requirements and indicative deadlines will be delayed. Public capex will need to be reduced to prevent a scenario where budget deficit increases threaten to take dangerous proportions. The re-emergence of political instability may also lead to the postponement of some private capex, while household savings may temporarily increase, both of which will negatively affect GDP growth. Furthermore, the authorities may find it more difficult to counter speculative price increases in the initial months following the introduction of the euro. Taken collectively, these developments have led us to revise our GDP growth forecast downward and to raise our inflation projection for 2026.

For the time being, the size of the budget deficit does not pose an immediate risk to the economy, as the main fiscal indicators remain very strong. Nevertheless, this situation is unlikely to be sustainable over the medium term, and efforts to reach an agreement on measures to reduce public spending and increase tax and contribution rates will need to be resumed soon.

MACROECONOMIC DATA AND FORECASTS

	2022	2023	2024	2025E	2026F	2027F
GDP (EUR bn)	86.1	94.7	103.7	113.7	123.8	133.6
Population (mn)	6.4	6.4	6.4	6.4	6.4	6.4
GDP per capita (EUR)	13 351	14 694	16 112	17 719	19 359	20 966
Real economy, yoy change (%)						
GDP	4.1	1.7	3.4	3.4	2.8	2.7
Private Consumption	4.0	1.1	4.9	7.6	4.0	3.5
Public Consumption	8.0	1.1	3.6	6.9	2.5	2.7
Fixed Investment	6.5	10.2	1.5	9.2	-0.7	7.2
Exports	12.1	0.0	1.8	-3.0	3.5	4.5
Imports	15.3	-5.5	3.9	3.9	3.5	6.7
Labor market						
Monthly wage, nominal (EUR)	905	1 043	1 188	1 328	1 454	1 579
Real wage, change (%)	-1.9	5.6	11.4	7.1	5.0	4.9
Unemployment rate (%)	4.1	4.3	4.2	3.6	3.4	3.2
Fiscal accounts (% of GDP)						
Budget balance (ESA 2010)	-3.0	-2.0	-3.0	-3.1	-3.4	-4.0
Budget balance (cash basis)	-0.8	-3.0	-3.0	-3.1	-3.4	-3.2
Public debt	22.0	22.3	23.6	27.9	30.9	32.3
External accounts (% of GDP)						
Current account balance	-2.7	-0.9	-1.6	-2.1	-0.9	-2.6
Net FDI	4.1	4.2	2.0	2.9	3.2	3.7
Gross foreign debt	50.3	47.5	47.4	47.4	47.9	49.0
Prices stability, yoy change (%)						
Inflation (CPI), avg	15.3	9.6	2.4	4.7	4.5	3.7
Inflation (CPI), eop	16.9	4.7	2.2	5.7	4.1	3.3
Housing Price Index (HPI)	13.8	9.9	16.5	14.8	8.8	7.2
Monetary sector, yoy change (%)						
Loans to households	14.6	15.9	20.8	19.2	12.8	12.5
Loans to non-financial corporations	10.4	7.3	10.1	9.1	9.4	8.6
Deposits on households	8.3	11.0	11.8	15.2	4.5	7.9
Deposits on non-financial corporations	26.6	9.0	7.0	11.8	7.2	7.9

Source: National Statistical Institute, Bulgarian National Bank, Ministry of Finance, UniCredit Bulbank

THE POLITICAL ENVIRONMENT HAS BECOME UNSTABLE AGAIN

Poor communication of the measures to tighten fiscal policy has led to social tensions

The extreme radicalization of the debate over measures needed to tighten fiscal policy led to tensions, followed by widespread public demonstrations of discontent. This forced Prime Minister Rosen Zhelyazkov's government to withdraw the draft budget for 2026 and initiate a new budget-preparation procedure. From today's perspective, it appears that the government will receive a limited vote of confidence from parliament to complete the remaining steps necessary for the introduction of the euro at the beginning of next year. Beyond this limited mandate, which is likely to cover no more than the first half of 2026, the prospects for Rosen Zhelyazkov's government to continue governing the country appear constrained.

Our baseline scenario now assumes new elections in the autumn of 2026

At the same time, the prospect of forming a new government by the Fifty-First National Assembly appears slim, and new snap parliamentary elections are most likely to be scheduled. The date of the elections remains uncertain, from today's perspective, but it seems most logical for them to be held concurrently with the presidential elections, which are scheduled for the autumn of next year.

GDP GROWTH WILL SLOW IN 2026, BUT THE STRUCTURE WILL IMPROVE

GDP growth will remain on a high trajectory in 2025

The stronger-than-expected data published over the past few months have led us to raise our GDP growth forecast for 2025 to 3.4%, up from 3.2% in July. In the new forecast, real growth in private consumption is estimated to reach a record 7.6% yoy, which is the highest level observed since 2008, excluding the very large positive adjustment during the year of the economy's recovery after the coronavirus pandemic.

Private consumption will slow in 2026 due to lower credit growth

Our baseline scenario projects real GDP growth of 2.8% yoy in 2026. The model we use anticipates a moderate slowdown in the growth rate of private consumption to 4.0% yoy in 2026. This reflects our forecasted deceleration in household credit growth to 12.8% yoy in 2026, compared with an expected increase of 19.2% in 2025 (see chart). This forecast is close to the one published four months ago, as both in July and now we assume that the Bulgarian National Bank will undertake some tightening of borrower-based measures in order to cool consumption and limit the accumulation of risks in the local real estate market.

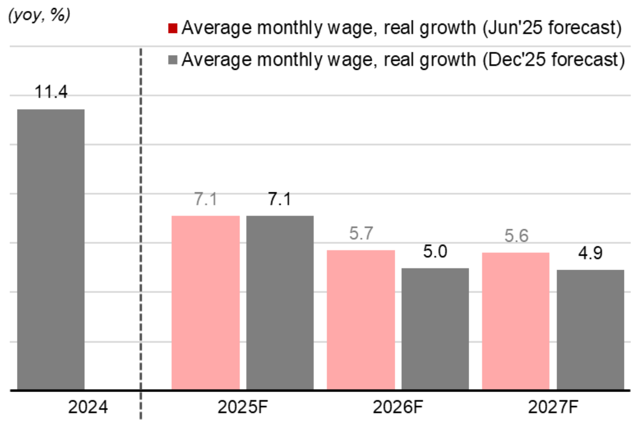
Elevated inflation will limit the real growth of incomes

The slowdown in private consumption growth will also be influenced by the deceleration in income growth. In the new forecast, we expect the growth of the average wage in 2026 to slow to 5.0% in real terms, compared with 5.7% in the forecast published in July (see chart). This reflects our upwardly revised projection for inflation, which we now expect to remain elevated not only in 2025 but also in 2026.

The return of political instability will slow decision-making processes in the public sector. The implementation of structural measures required for the absorption of funds under the Recovery and Resilience Plan (RRP) is expected to lose momentum. Given the limited remaining time, we anticipate that the total amount

CHART 1: THE PACE OF RETAIL CREDIT GROWTH IS FORECAST TO SLOW IN 2026

CHART 2: WAGE GROWTH IN 2026 WILL SLOW MORE THAN WE ANTICIPATED IN JULY



Source: National Statistical Institute, Bulgarian National Bank, UniCredit Bulbank

Political instability will lead to a slowdown in investment

of RRP funds absorbed will reach 74% (see chart). This is lower than our July forecast, which projected the absorption of 85% of the funds Bulgaria is entitled to receive. For the same reasons, the absorption of funds from the Multiannual Financial Framework will also be delayed. The possibility of a temporary halt in the construction of infrastructure projects that rely on national funding cannot be excluded, as priority may be given to securing funds for other budgetary expenditures such as pensions and social payments.

The outlook for external demand is set to improve next year

We forecast an improvement in the GDP growth structure, with the gap between the positive contribution of domestic demand and the negative contribution of net exports narrowing. Weak external demand and prolonged capital overhauls in two of the country's most important export-oriented firms are expected to lead to a 3.0% decline in real export growth in 2025. This is expected to undergo a significant transformation in 2026, when we anticipate the contribution of net exports to growth to improve to 0.0 percentage points of GDP, compared with a negative contribution of 4.1 percentage points expected in 2025.

THE EASING OF INFLATION WILL REQUIRE MORE TIME THAN WE PREVIOUSLY EXPECTED

We have raised our inflation forecast

We forecast that the annual average inflation, calculated according to the national methodology, will remain high in 2025 (4.7%) and 2026 (4.5%). A moderate slowdown in inflation to 3.7% is expected in 2027. This is above our July forecast of 3.4% consumer price inflation in 2026 and 3.1% in 2027.

The reasons for raising our consumer price inflation forecast are related to the rise in inflation expectations and the re-emergence of political instability.

The rise in inflation expectations needs to be addressed

Inflation expectations continued to rise over the past few months, after having stabilized at relatively low levels in March and April 2025. Between June and November, inflation expectations increased across all sectors except for the services sector (see chart). Contributing to the rise in inflation expectations is the continued high growth in housing prices, which reached 15.5% yoy in the second quarter of 2025, the second-highest rate among EU-27 countries and well above the EU-27 average of 5.4%.

The rise in inflation expectations suggest that reducing inflation may require a stronger policy tightening than initially anticipated, and that the transition to lower inflation is likely to take more time to materialize.

The return of political instability will make the fight against speculative price increases more difficult

The limited credibility of the incumbent government following the mass protests in December will make it more difficult for the authorities to counter cases of speculative price increases in the months immediately following the euro's introduction. The risk of speculative price hikes appears to be greatest in sectors with high levels of concentration, where firms have significant power to influence the prices of the goods and services they offer. Conversely, in sectors with lower levels of concentration, the risk is smaller, as the presence of more competition will limit any attempts at unjustified price increases.

CHART 3: THE RE-EMERGENCE OF POLITICAL INSTABILITY WILL HAVE A NEGATIVE EFFECT ON THE ABSORPTION OF EU FUNDS

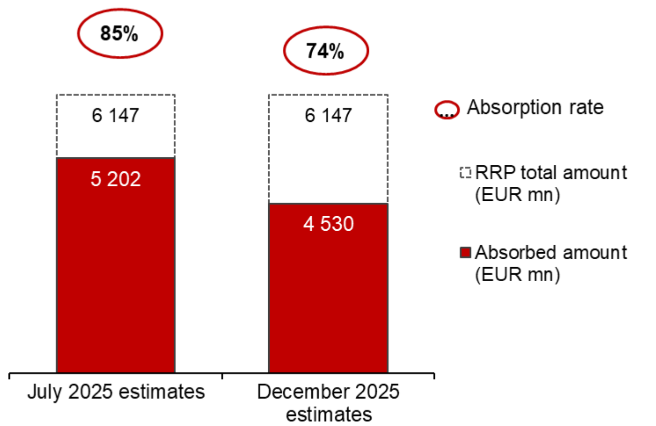
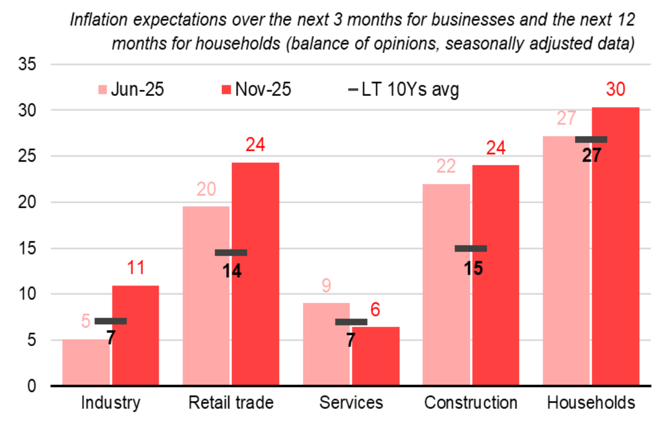


CHART 4: RISING INFLATION EXPECTATIONS WILL DELAY THE EASING OF CONSUMER PRICE INFLATION



Source: Eurostat, Information system for management and monitoring of EU funds in Bulgaria, UniCredit Bulbank

EXTREME CONFRONTATION HAS BLOCKED EFFORTS TO REACH AN AGREEMENT ON THE MEASURES NEEDED TO CONSOLIDATE PUBLIC FINANCES

Efforts to reach an agreement on the measures to reduce the budget deficit were postponed

We do not expect the new budget-preparation procedure to bring significant changes to income policy, as the country is heading towards new elections and there is no time for such change. For the same reason, an increase in taxes (beyond rises in taxes with peripheral importance such as those on gambling, or the introduction of more ambitious plans to raise excise duties on alcohol, cigarettes, and tobacco products) seems unlikely, especially since resistance to higher direct taxes and social contributions was the main reason that led to the termination of the initial budgetary-preparation procedure.

Under our new baseline scenario, public sector financed investments will be cut to avoid a sharp increase in the budget deficit. Plans to improve tax collection will also have to wait until the formation of the next regular government. Amid increased political uncertainty, incentives to evade taxes will rise, putting additional downward pressure on the country's public finances.

DELAYING ACTION ON THE HIGH BUDGET DEFICIT IS NOT SUSTAINABLE IN THE LONG RUN

The risk to the budget deficit is increasing

The deferral of addressing the country's high budget deficit cannot be sustained for long. Without corrective measures in the next one to two years, the risk of the country's public finance deficit spiraling out of control will rise significantly.

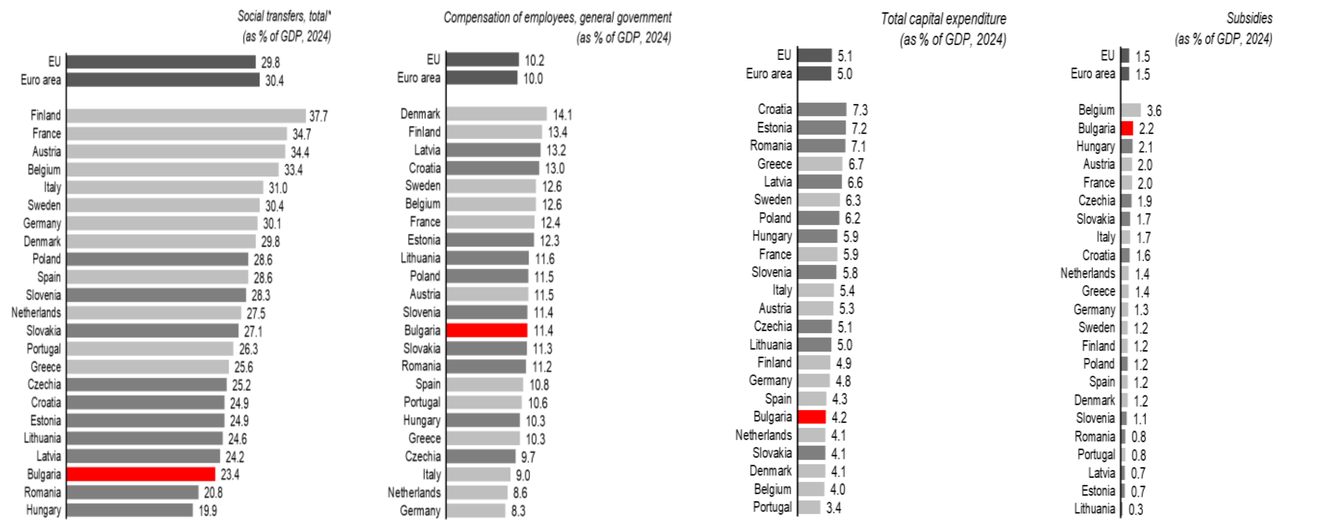
Fiscal consolidation measures with a total volume of at least 4% of GDP are needed

Measures to consolidate the budget should target a cumulative effect of at least 4% of GDP. The reason for this is that, in addition to the already chronic budget deficit of 3% of GDP, the negative impact on public finances from the rapid aging of the population must be considered, as well as the additional fiscal space required to increase spending on defense, the energy transition, infrastructure, and interest payments.

Population aging and other needs must be taken into account when setting targets

According to an IMF study, the negative impact of population aging on Bulgaria's public finances is estimated at over 3% of country's GDP for the period 2015–2050. Approximately one-third of this effect has likely already materialized and is therefore one of the reasons for the chronically high budget deficit recorded in recent years. This negative effect, which mainly manifests in the form of increased spending on pensions and healthcare, will continue to put pressure on the public finances. If additional resources are not provided, the ratio of the average pension to the average wage, which is already low (38% in 2024), will deteriorate further. Likewise, the share of Bulgarian pensioners at risk of poverty and social exclusion (37% in 2024), which is already one of the highest in the EU-27, will continue to worsen.

CHART 5: THE POSSIBILITIES FOR REDUCING EXPENDITURES APPEAR TO BE LINKED TO WAGE AND MAINTENANCE COSTS, AS WELL AS TO SUBSIDIES



Source: European Commission (AMECO), UniCredit Bulbank

*These represent government expenditures for social transfers and benefits. The main components include healthcare, social services, education, housing and other individual services; pensions; social assistance; and other social insurance benefits (for temporary incapacity for work, maternity, accidents, etc.).

The possibilities for reducing expenditures are limited

We believe that expenditures could be reduced by an amount equivalent to around 0.5% of country's GDP, with the main focus being on cutting spending on salaries and maintenance, as well as on subsidies (see chart on p. 5). Any attempt at larger expenditure reductions would de facto mean a return to a policy of strict fiscal austerity. Such a policy, if it could even be sustained for a sufficiently long period, would most likely create more problems than it could solve.

Political instability hinders efforts to reduce the informal economy

If the country's experience over recent years is used as a reference point, it appears that measures to reduce the shadow economy could lead to an increase in tax and social security revenues of around 1.5–2% of GDP over the medium term. For this to happen, a stable pro-European government with a strong political commitment and a clearly articulated, coherent plan to reduce the shadow economy will be necessary. Importantly, the plan to reduce the grey economy should receive sufficient support not only from the major parties present in parliament but also from other key stakeholders.

Reducing the deficit will require a moderate increase in taxes

In the context of a continuously deteriorating demographic outlook and a rapidly aging population, reducing the budget deficit will also require raising taxes. Available data show that indirect taxes already make a significant contribution to total tax revenues in Bulgaria (see chart). Therefore, to help reduce inequalities, the next logical step would be to increase direct taxes and social security contributions. To build public support for such a move, the decision should be made following an extensive discussion involving all relevant stakeholders and in the most non-confrontational way possible.

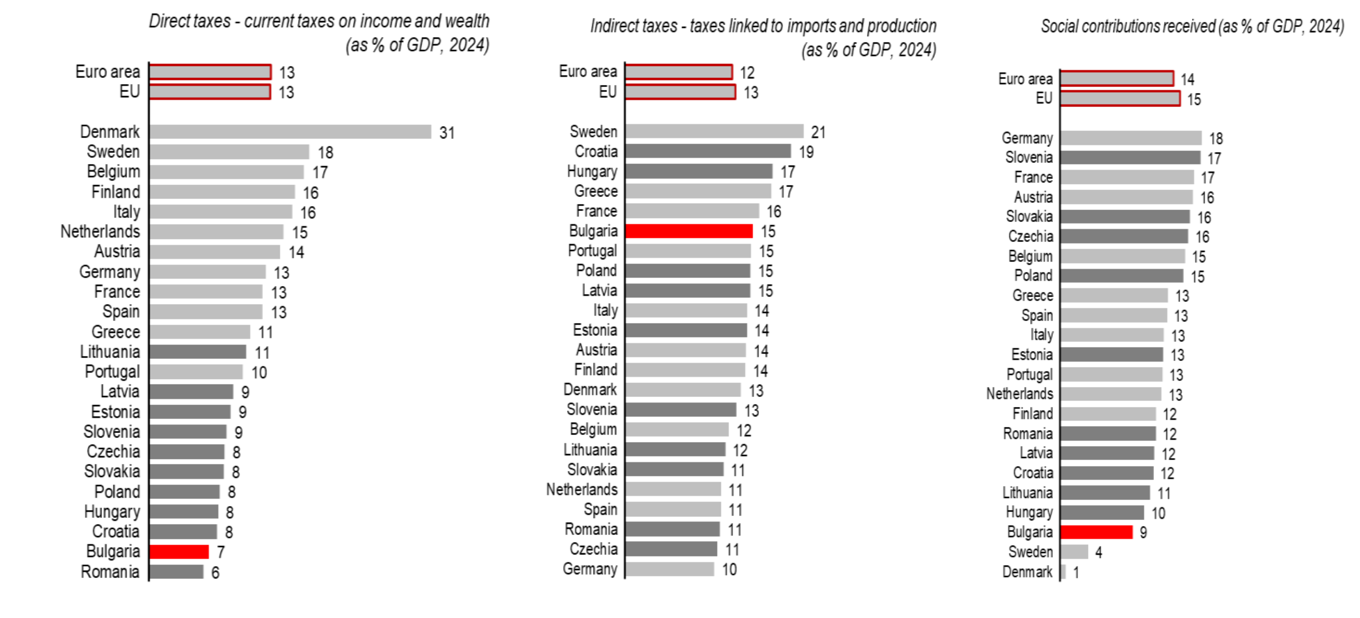
Addressing the chronic efficiency problems of the public administration will be key

To be successful, efforts to reduce the budget deficit must also include measures to address the chronic inefficiencies in the public sector. At a minimum, this means strengthening the link between pay levels and performance, adopting a mechanism for optimizing the number of employees by taking into account the use of new technologies and the expansion of electronic services, and improving oversight mechanisms in order to increase accountability and reduce waste of resources.

The moment to act is now

We believe that, as a society, we have a long road ahead. The first step toward reaching agreement on the measures to eliminate the budget deficit will need to be the abandonment of extreme forms of confrontation and division in the interest of renewing dialogue and cooperation.

CHART 6: FISCAL REVENUES ARE DOMINATED BY INDIRECT TAXES, WHICH MAKES THE TAX SYSTEM REGRESSIVE



Source: European Commission (AMECO), UniCredit Bulbank

Note: According to the ESA 2010 classification: Direct taxes include the following main groups of taxes – Personal income tax; Corporate tax (profit tax); Taxes on capital gains; Property taxes, and others. Indirect taxes include the following main groups of taxes – VAT; Excise duties; Import duties; Taxes on specific products (e.g., environmental fees, insurance premium tax, gambling tax, motor vehicle registration tax); Licensing and registration fees for business activities; Tax on financial transactions, and others.

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GDP AND INFLATION FORECAST REVISIONS

	Forecast as of December 2025				Forecast as of July 2025				Revision (percentage change)			
	2024	2025F	2026F	2027F	2024	2025F	2026F	2027F	2024	2025F	2026F	2027F
Real yoy growth (%)												
GDP	**3.4**	**3.4**	**2.8**	**2.7**	**2.8**	**3.2**	**3.0**	**2.8**	**0.6**	**0.2**	**-0.2**	**-0.1**
Private Consumption	4.9	7.6	4.0	3.5	4.2	5.1	3.6	3.1	0.7	2.5	0.4	0.4
Public Consumption	3.6	6.9	2.5	2.7	4.5	4.9	3.4	3.0	-0.9	2.0	-0.9	-0.3
Fixed Investment	1.5	9.2	-0.7	7.2	-1.1	11.1	5.4	8.3	2.6	-1.9	-6.1	-1.0
Exports	1.8	-3.0	3.5	4.5	-0.8	-0.5	3.9	4.2	2.6	-2.5	-0.4	0.3
Imports	3.9	3.9	3.5	6.7	1.3	5.0	5.5	6.4	2.6	-1.1	-2.0	0.3
Contribution to growth (%)												
GDP	**3.4**	**3.4**	**2.8**	**2.7**	**2.8**	**3.2**	**3.0**	**2.8**	**0.6**	**0.2**	**-0.2**	**-0.1**
Private Consumption	2.9	4.5	2.5	2.2	2.5	3.0	2.2	1.9	0.4	1.5	0.3	0.3
Public Consumption	0.7	1.3	0.5	0.5	0.8	0.9	0.7	0.6	-0.2	0.4	-0.2	-0.1
Fixed Investment	0.3	1.6	-0.1	1.3	-0.2	1.9	1.0	1.6	0.5	-0.3	-1.1	-0.3
Exports	1.1	-1.8	2.0	2.6	-0.5	-0.3	2.2	2.4	1.6	-1.5	-0.2	0.2
Imports	-2.2	-2.3	-2.0	-3.9	-0.7	-2.8	-3.2	-3.8	-1.5	0.6	1.1	-0.1
YoY growth, average (%)												
CPI inflation, total	**2.4**	**4.7**	**4.5**	**3.7**	**2.4**	**4.1**	**3.4**	**3.1**	**0.0**	**0.6**	**1.1**	**0.6**
Foods	2.6	6.2	5.4	-	2.6	6.2	3.5	-	0.0	0.0	1.9	-
Energy	-4.3	-4.6	-2.0	-	-4.3	-5.0	-2.3	-	0.0	0.4	0.3	-
Administered prices	5.4	3.9	4.1	-	5.4	3.9	4.7	-	0.0	0.0	-0.6	-
Core inflation	2.7	6.5	6.2	-	2.7	4.7	3.9	-	0.0	1.8	2.3	-
Contribution to growth (%)												
CPI inflation, total	**2.4**	**4.7**	**4.5**	**3.7**	**2.4**	**4.1**	**3.4**	**3.1**	**0.0**	**0.6**	**1.1**	**0.6**
Foods	0.9	1.9	1.8	-	0.9	2.0	1.1	-	0.0	0.0	0.6	-
Energy	-0.4	-0.3	-0.2	-	-0.4	-0.4	-0.2	-	0.0	0.1	0.0	-
Administered prices	1.1	0.8	0.9	-	1.1	0.8	1.0	-	0.0	0.0	-0.1	-
Core inflation	0.8	2.3	2.4	-	0.8	1.7	1.7	-	0.0	0.6	0.7	-

Source: National Statistical Institute, UniCredit Bulbank

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