Bulgaria

Baa2 positive/BBB stable/BBB stable*

Outlook

We now see a somewhat less severe economic contraction of 6% this year (previously 7.2%) and a less pronounced recovery of 3% next year (previously 6.7%). The road to full recovery is likely to be bumpier and to take longer than we anticipated three months ago. There are two main reasons for this shift. First, the end of the coronavirus pandemic is not yet in sight, as the production and wide application of a vaccine or successful medical treatment of the disease will need more time to materialize. Second, the escalation of the political confrontation will add to uncertainty, making firms and households even more cautious about their spending and investment decisions, at least until the next parliamentary elections are held early next year.

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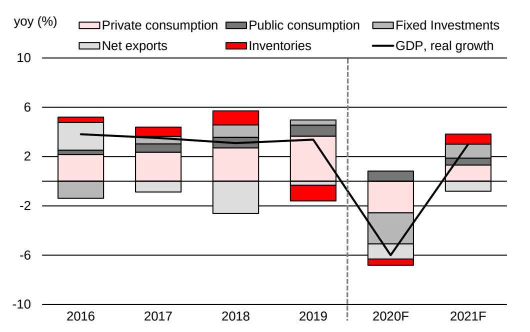
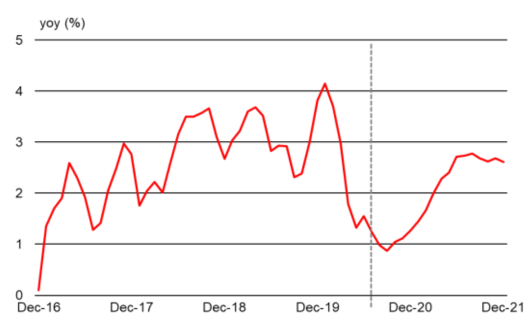
KEY DATES/EVENTS

- Oct/Nov: 2021 Government Budget
- 19 Oct, 13 Nov, 4 Dec: GDP data (revised data for 2019, 3Q20 flash estimate and structure)
- 16 Nov: Labour force 3Q20

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	58.1	61.3
Population (mn)	7.1	7.0	7.0	6.9	6.9
GDP per capita (EUR)	7 420	8 012	8 728	8 420	8 937
Real economy, change (%)					
GDP	3.5	3.1	3.4	-6.0	3.0
Private consumption	3.8	4.4	5.8	-4.0	2.0
Fixed investment	3.2	5.4	2.2	-13.3	6.5
Public consumption	4.3	5.3	5.5	4.9	3.0
Exports	5.8	1.7	1.9	-14.5	8.0
Imports	7.4	5.7	2.4	-12.5	9.0
Monthly wage, nominal (EUR)	530	586	651	686	728
Real wage, change (%)	7.3	7.7	8.0	3.5	3.7
Unemployment rate (%)	6.2	5.2	4.2	5.6	5.3
Fiscal accounts (% of GDP)					
Budget balance	1.1	2.0	2.1	-2.4	-3.6
Primary balance	1.9	2.7	2.7	-1.8	-3.0
Public debt	25.0	21.8	19.9	26.0	27.6
External accounts					
Current account balance (EUR bn)	1.8	0.6	1.8	2.0	1.4
Current account balance/GDP (%)	3.5	1.0	3.0	3.4	2.3
Extended basic balance/GDP (%)	6.8	3.3	5.5	6.0	6.1
Net FDI (% of GDP)	2.5	1.4	1.4	0.7	0.9
Gross foreign debt (% of GDP)	64.7	60.3	56.2	64.0	62.4
FX reserves (EUR bn)	23.7	25.1	24.8	29.9	32.1
Months of imports, goods & services	8.1	8.0	7.6	11.1	10.7
Inflation/monetary/FX					
CPI (pavg)	2.1	2.8	3.1	1.8	2.4
CPI (eop)	2.8	2.7	3.8	1.3	2.6
Central-bank reference rate (eop)	-0.39	-0.50	-0.61	-0.68	-0.60
USD/BGN (eop)	1.63	1.71	1.74	1.60	1.53
EUR/BGN (eop)	1.96	1.96	1.96	1.96	1.96
USD/BGN (pavg)	1.74	1.66	1.75	1.72	1.56
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

Political impasse could translate into a weaker recovery

Shallower contraction in economic activity is expected this year…

Economic activity is expected to contract less sharply in 2020 and to rebound less strongly in 2021 than we envisaged in June. For this year, we expect GDP to drop by 6% yoy, compared with the 7.2% fall we anticipated in June. There are two main reasons for this shift. First, the lockdown-driven contraction in 2Q20 (-10% qoq and -8.5% yoy) proved smaller than we had feared. Second, we raised our growth outlook for the euro area, which should help exports perform better than we had initially thought. At the same time, growth in 4Q20 is likely to be weaker than we predicted previously, as the escalation of the political confrontation has increased uncertainty, which will dampen spending and investment further.

…followed by a more muted recovery next year

For next year, we expect GDP to increase by 3% yoy (previously 6.7%). We now think that the road to full recovery will be bumpier and take longer to materialize. The economy is likely to need around two years to fully recoup output losses caused by the pandemic. Full employment is now not likely before 2024. As fiscal support measures will have to remain in place for a longer period and perhaps even rise next year, it will take more time to bring the budget position back in line with the Maastricht criteria. This makes euro adoption unlikely before 2025 (2023 forecasted three months ago), according to our revised macroeconomic scenario.

COVID-19 cases are likely to weigh on growth in the remaining months of 2020 and in 2021

If political tension does not ease, growth may be damaged further

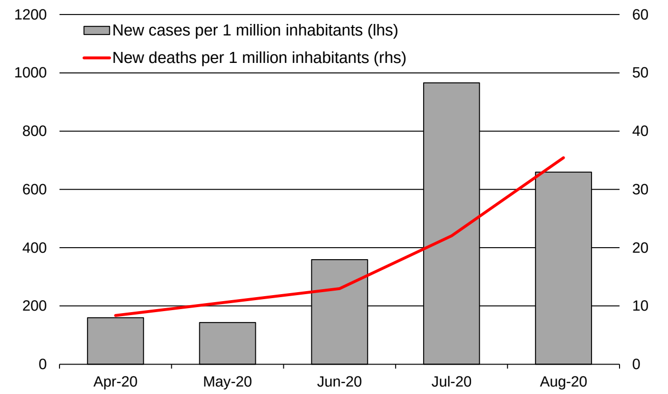
What is behind the revised speed and timing of the recovery in our projection? First, the end of the COVID-19 pandemic is not yet in sight (see chart), as production and wide-scale application of a vaccine that can eradicate the disease, is unlikely before 2H21. This means that sectors most exposed to the social-distancing measures, such as tourism and retail, will have another difficult year in 2021, which, in turn, is likely to increase permanent loses in the form of job redundancies and company bankruptcies. Second, increased political confrontation between the presidency and the government, at the same time, has caused uncertainty to reach proportions not seen since 2013. If the protests intensify further, the government's ability to introduce new measures to contain the pandemic will be constrained, since any tightening of social distancing measures could be interpreted as an attempt to dampen the protest by undemocratic means. In the worst case, political deadlock risks leaving the country with blocked public institutions amid the most severe recession since 1997. And while this is not our baseline scenario, only new elections can put these fears to rest permanently. However, elections would need time to be organized and held, thus prolonging the months in which households abstain from spending and companies postpone investment.

Hard data confirms that strong recovery continued in the first month of 3Q20

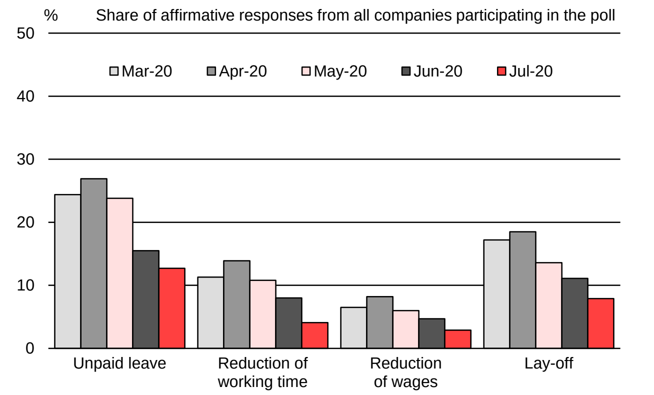
Sharp fall in household income requires more vigorous policy response

Rapid growth driven by "technical" factors is expected to have materialized in 3Q20. Industrial production rose 2.3% mom in July, after a very solid 6.1% rebound in June. The recovery in retail sales was subdued, however, reflecting large loses in household income, as the beneficiaries under the furlough scheme were entitled to receive only a small portion of their pre-crisis income, while, at the same time, income losses were exacerbated by wage cuts, working time reductions and a large number of workers on unpaid leave (see chart).

CORONAVIRUS PANDEMIC HAS SURGED IN JULY AND AUGUST



WEAK LABOR MARKET HAS EXACERBATED INCOME LOSSES



Source: Worldometer, national statistical institute, UniCredit Research

New measures amounting to 1.5% of GDP have been announced since June…

So far, the fiscal policy response has been in line with our expectations. New fiscal stimulus equivalent to 1.5% of GDP has been announced since June. These include increased compensation of income under the furlough scheme for workers in the hospitality sector, higher wages for some categories of public-sector workers (mostly, but not all, in the health-care sector), increased minimum daily unemployment benefit to BGN 12 from BGN 9 initially, and new measures to compensate corporate losses in the worst hit sectors. An additional monthly payment of BGN 50 was added to all pensions, which if it becomes a permanent measure, as we think it will, will help raise the average monthly pension by an additional 12% in 2020. For the whole of 2020, we expect actually implemented fiscal support measures to reach 4.3% of GDP, as further disbursements are likely in the remaining months of the current year.

…thus pushing total fiscal support measures announced toward the end of September to 4.5% of GDP

Bulgaria needs to consider strengthening its automatic stabilizers

Next year, we expect fiscal support to reach 5% of GDP, as most measures will be prolonged and expanded. In addition, the government will raise the minimum wage to BGN 650 (from BGN 610), which will also boost some social payments linked to it. Still, fiscal measures deployed this year and next are likely to fall short of what is needed and what is possible, given the ample room for more fiscal stimulus. To avoid this, the country should consider strengthening its automatic stabilizers to improve its capacity to deal with future downturns.

Furlough scheme prevented a sharp increase in the number of unemployed

Furlough scheme is likely to save 218k jobs this year. It is difficult to say how many of these people currently on temporary layoff will actually return to their jobs. It seems that a large proportion of jobs in the hospitality industry will be lost permanently. Still, if not for the furlough scheme, the unemployment rate in 2020 would have been 8.9%, instead of 5.6% (see chart).

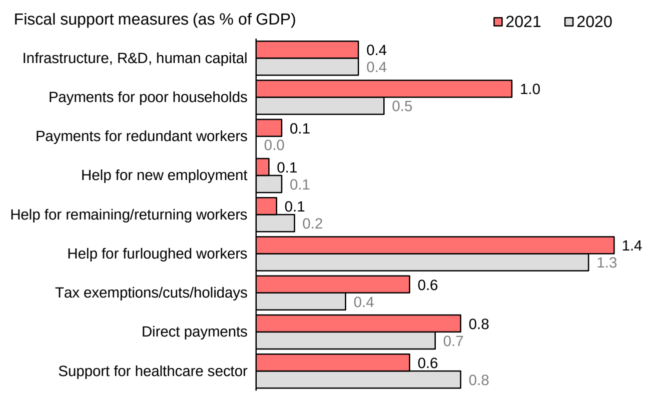
Our baseline scenario envisages a rise of antiestablishment parties and very fragmented parliament

We don't predict election outcome different from the key opinion polls available at the moment. However, caution is warranted as the situation is very dynamic and can rapidly change in the run up to elections. As things stand now, GERB is likely to remain the largest party in the next parliament. Six other parties have a realistic chance of passing the 4% entry threshold. If they do, it will produce a deeply fragmented parliament. Given how aggressive the election campaign promises to be, divisions will be very hard to deal with in the post-election period.

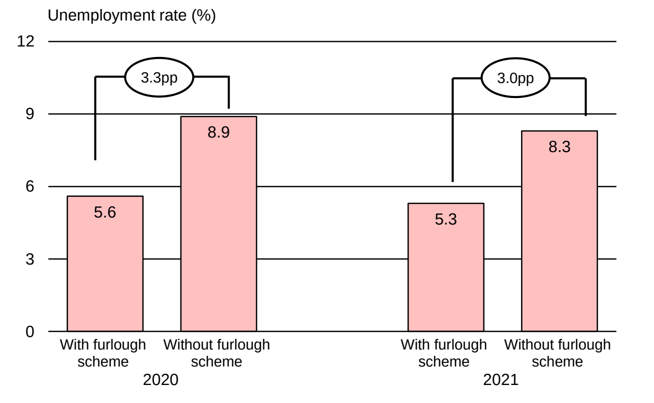
Coordination of the political agendas of the main players in the new coalition government is likely to become a cumbersome task, especially when taking into account that some will have almost no political experience

The upcoming elections are likely to produce a shift toward more dysfunctional policies. Public opinion polls suggest that the main antiestablishment party "There are such people" will garner a large share of the vote. Given extreme confrontation between the two main political players, GERB and BSP, the participation of "There are such people" in the next government is almost certain. Unfortunately, the party has made no serious efforts to develop and articulate any clear and coherent strategy for the country's economic development. To make things even more complicated, little is known about the party's ideological background and the values it stands for. This increases the uncertainty regarding the economic policy of the next government, which is worrisome, especially since it comes at a moment when uncertainty is already elevated due to the coronavirus pandemic. It could prove a challenge for this multitude of political players with such diverse ideological backgrounds to work together in the next government.

MODERATE SUPPORT PACKEGES ARE LIKELY IN 2020 AND 2021



FURLOUGH SCHEME PREVENTED A SHARP RISE IN JOB LOSSES



Source: national statistical institute, UniCredit Research

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