

Bulgaria

Baa1 stable/BBB stable/BBB positive*

Outlook

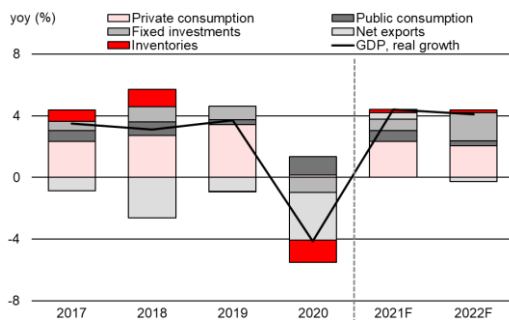
The stronger-than-expected pace of economic recovery so far this year triggered an upward revision to our GDP growth forecast for 2021. With Bulgarians set to head to the polls in July for a second time this year, the outlook is for a fragmented parliament with large support for the populist parties backing last year's protests. Under the most likely scenario, the populist parties, ITN and IMV, will join forces with the right-wing DB to form a minority government, which will rely on the parliamentary support of the BSP. We remain of the view that the economic policy of the new government will not deviate significantly from the path pursued by the GERB over the past four years. The main downside risk to our favorable baseline scenario is related to another COVID-19 wave during the winter months.

Author: Kristofor Pavlov, Chief Economist (UniCredit Bulbank)

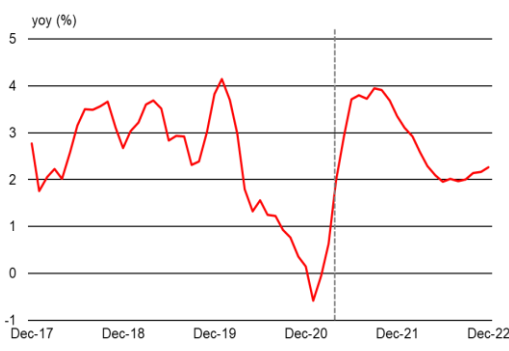
KEY DATES/EVENTS

- 11 July – parliamentary elections
- 23 July – rating update from Fitch
- 17 Aug, 07 Sep: 2Q21 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	65.6	70.5
Population (mn)	7.0	7.0	6.9	6.9	6.8
GDP per capita (EUR)	8 016	8 809	8 768	9 544	10 333
Real economy, change (%)					
GDP	3.1	3.7	-4.2	4.4	4.1
Private consumption	4.4	5.5	0.2	3.5	3.1
Fixed investment	5.4	4.5	-5.1	3.8	9.6
Public consumption	5.4	2.0	7.5	3.9	1.7
Exports	1.7	3.9	-11.3	7.2	7.5
Imports	5.7	5.2	-6.6	6.1	7.5
Monthly wage, nominal (EUR)	586	648	709	776	841
Real wage, change (%)	7.7	7.5	7.7	6.8	6.1
Unemployment rate (%)	5.2	4.2	5.1	5.2	4.1
Fiscal accounts (% of GDP)					
Budget balance	2.0	2.1	-3.4	-5.5	-2.8
Primary balance	2.7	2.7	-3.0	-5.1	-2.4
Public debt	21.8	19.7	24.4	26.7	27.4
External accounts					
Current account balance (EUR bn)	0.5	1.1	-0.4	0.6	1.6
Current account balance/GDP (%)	0.9	1.8	-0.7	1.0	2.3
Extended basic balance/GDP (%)	3.2	4.8	3.9	5.4	7.7
Net FDI (% of GDP)	1.3	1.9	3.2	2.2	2.6
Gross foreign debt (% of GDP)	61.5	57.6	63.4	61.0	59.3
FX reserves (EUR bn)	25.1	24.8	30.8	32.8	36.3
Months of imports, goods & services	8.0	7.4	10.4	9.8	9.8
Inflation/monetary/FX					
CPI (pavg)	2.8	3.1	1.7	2.6	2.3
CPI (eop)	2.7	3.8	0.1	3.4	2.3
Central-bank reference rate (eop)	-0.50	-0.61	-0.70	-0.63	-0.55
USD/BGN (eop)	1.71	1.74	1.60	1.60	1.56
EUR/BGN (eop)	1.96	1.96	1.96	1.96	1.96
USD/BGN (pavg)	1.66	1.75	1.71	1.62	1.58
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

A V-shaped recovery is on track, but downside risks are up

Solid growth in 1Q21 triggered an upward revision to our 2021 growth forecast

We have significantly raised our real GDP growth forecast for 2021 to 4.4% (from 2.6%). This mostly reflects the stronger-than-expected recovery so far this year, as Bulgarian authorities decided to keep the economy as open as possible during the second and third wave of the COVID-19 pandemic. Our growth forecast for 2022 is now changed to 4.1% (from 4.4%). We now see output recovering to its pre-pandemic level in 4Q21. A decline in the unemployment rate close to the level associated with full employment is now anticipated toward mid-2022.

Economic activity improved in 1Q21...

Less-stringent restrictions and poor compliance contributed to GDP growth surprising on the positive side in 1Q21. The solid growth of activity indicators in April underlined that a strong recovery continued at the start of 2Q21. With most high-frequency indicators in April already above their pre-pandemic level (left chart below), the overall picture is one of an economy that is on track for a V-shaped recovery. However, Bulgaria paid a heavy price for the solid pace of GDP growth in 4Q20 and in 1Q21. While the country was not affected as badly by the first wave of the corona virus pandemic, the early relaxation of restrictions caused the number of deaths to rise sharply during the second and the third wave (right chart below).

...at the cost of letting COVID-19 infections spread unchecked

The US treasury imposed sanctions on three local citizens...

Just one month before the next election, the US imposed sanctions on three local citizens using the Magnitsky Act. The sanctions seem to target two murky business figures and local oligarchs - Vassil Bozhkov and Delyan Peevski. The former was sanctioned for "using bribery to create a channel for Russian political leaders to influence Bulgarian government officials", while the latter was sanctioned for "using influence peddling and bribes to protect himself from public scrutiny and exert control over key institutions and sectors in Bulgarian society". On balance, the US sanctions are likely to have a positive impact, as they should add to the pressure on local politicians to press ahead with their anticorruption efforts. Importantly, they will undermine the chances of Mr. Bozhkov's party, Bulgarian Summer (BS), to enter the next parliament. Several public opinion polls showed that prior to the announcement of the US sanctions, BS, the political creation of Mr. Bozhkov, looked likely to surpass the 4% threshold required for entry into parliament on 11 July, after gaining 3.1% of the vote in April.

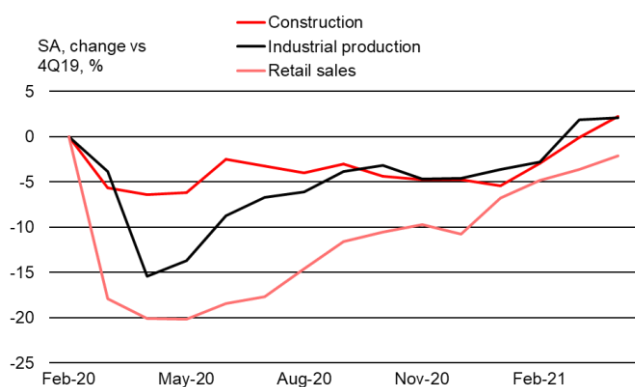
...just six weeks before the next parliamentary election

The parties that benefited the most from the protest against GERB are likely to form the next government

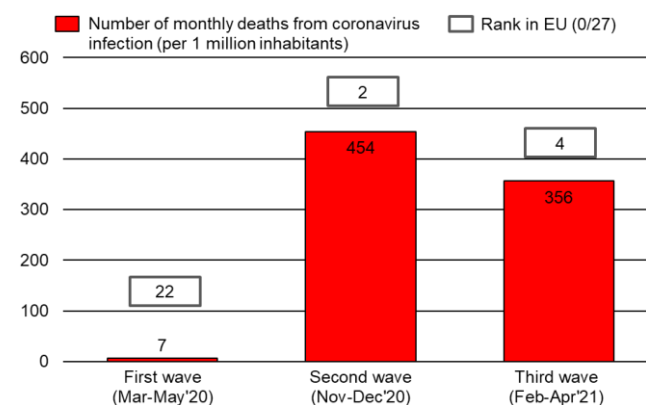
With Bulgarians set to head to the polls in July for a second time this year, the outlook is for a fragmented parliament with large support for the populist parties backing last year's protests. Recent opinion polls show that GERB is likely to remain the largest party in parliament, but GERB is in isolation and its chances to form a government are slim. Under the most likely scenario, the populist parties, ITN and IMV, will join forces with the right-wing DB to form a minority government, which will rely on the parliamentary support of the BSP.

The risk of some form of fiscal populism is limited. Across-the-board increases in public sector

MOST ACTIVITY INDICATORS ARE ABOVE PRE-PANDEMIC LEVEL



BULGARIA PAID A HEAVY PRICE FOR THE SOLID GDP GROWTH



Source: Worldometer, National Statistical Institute, UniCredit Research

Across-the-board increases in public sector wages are likely to be replaced by a more selective approach

wages pursued by GERB over the past four years are likely to be replaced by a more selective approach, where the focus will be on sectors (such as education and health care) that are key to boosting the country's competitiveness. The reasons for this policy change are partly ideological, as the DB are the staunchest supporters of the small government doctrine and want to see public sector wage increases scaled down, and partly more pragmatic, as higher public sector spending pursued by GERB has exhausted some of the free fiscal space available prior to the pandemic. In addition, the pandemic-linked temporary increase in pensions (amounting to 0.8% of GDP annually) by the GERB, is likely to be made permanent by the new government, which would further squeeze any free fiscal space left unused after two hard years of unprecedented fiscal stimulus to support the pandemic-hit economy.

Minimum wages will lose in importance as a tool to support income convergence

Only small (if any) increases in minimum wages are likely if the DB dominate the economic policy making of the new government. Such shift seems disappointing to us. We regard minimum wages as one of the very few instruments available to the government to impact income levels. If used wisely, minimum wages can support income convergence and help to bring down to more sustainable levels the already elevated income inequality in the country.

No major changes in taxation anticipated

Under the most likely scenario, there would be no major changes in taxation. The BSP would have to abandon its plan to remove the regressive taxation of personal income, as no support for such move is likely to come from the right-wing DB, which made preserving a flat income tax its priority. The DB's plan for a reduction of small companies' taxation would also have limited chances to materialize, at least in the short-run, as the immediate priority of the new coalition government would be to demonstrate that it can sustain fiscal prudence, despite the alleged lack of sufficient expertise of some of its founding members.

Introduction of tax-free allowance on personal income looks likely

The only tax amendment we expect is the introduction of a tax-free allowance on personal income. This is because all parties likely to be represented in the next parliament, apart from GERB, have voiced support for such a move. While there is no clarity as to the size of the allowance and whether it will apply to all earners or only to the poor, we regard this tax change as growth-positive, since it should help those at the bottom of the income distribution.

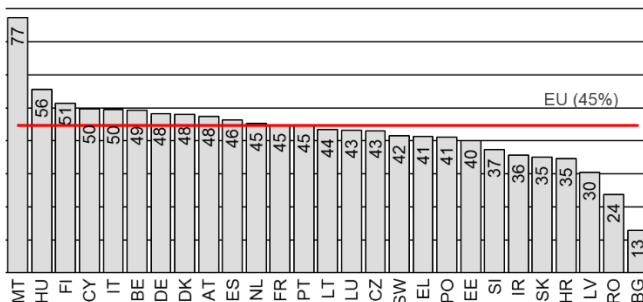
The risk of another wave of COVID-19 in the winter is significant

The main downside risk to our baseline scenario is related to another wave of COVID-19 infections in the winter, as only 13% of the population has been vaccinated as of mid-June (left chart below). It is particularly worrisome that the amount of people willing to get the vaccine is much lower than what is needed to achieve herd immunity (right chart below), according to recent polls. We think urgent efforts are needed by the government and private sector to increase vaccination rates. The leaders in politics, business and art should organize and hold a large-scale campaign aimed at making widely available all relevant information regarding the pros and cons of vaccination.

Boosting vaccination rates should be the upmost priority

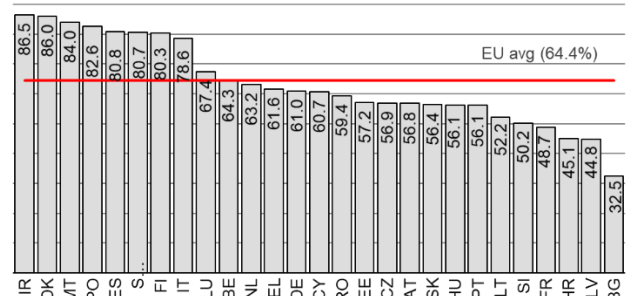
URGENT EFFORTS ARE NEEDED TO ACCELERATE VACCINATION

Share of the total population that have received at least one dose of COVID-19 vaccine (15 June 2021)



RISK OF ANOTHER PANDEMIC WAVE IS LARGE

Intention to get vaccinated in EU countries (as % of population over 18 years, May'21)



Source: Worldometer, Eurofound, UniCredit Research

DISCLAIMER

This document is based upon public information sources, that are considered to be reliable, but for the completeness and accuracy of which we assume no liability. All estimates and opinions in the document represent the independent judgment of the analyst as of the date of the issue. We reserve the right to modify the views expressed herein at any time without notice, moreover we reserve the right not to update this information or to discontinue it altogether without notice.

This document is for information purposes only, and is not intended to and (i) does not constitute or form part of any offer for sale or subscription or solicitation of any offer to buy or subscribe for any financial instruments (ii) does not constitute an advice for solicitation of any offer to buy or subscribe for any financial instruments, or any advice in relation of an investment decision whatsoever.

The information is given without any warranty on an “as is” basis and should not be regarded as a substitute for obtaining individual investment advice. Investors must take their own determination of the appropriateness of investments referred to herein, based on the merits and risks involved, their own investment strategy and their legal, fiscal and financial positions.

As this document does not qualify as direct or indirect investment recommendation, neither this document nor any part of it shall form the basis of, or be relied on in connection with or act as an inducement to enter into any contract or commitment whatsoever.

Neither UniCredit Bulbank, nor any of its directors, officers or employees shall accept any liability whatsoever vis-a-vis any recipient of this document or any third party for any loss howsoever arising from any use of this document or its contents herewith.

This document is not intended for private customers and the information contained herewith may not be disclosed, redistributed, reproduced or published for any purpose, without prior consent by UniCredit Bulbank.