# Bulgaria

## Baa1 stable/BBB stable/BBB positive*

### Outlook

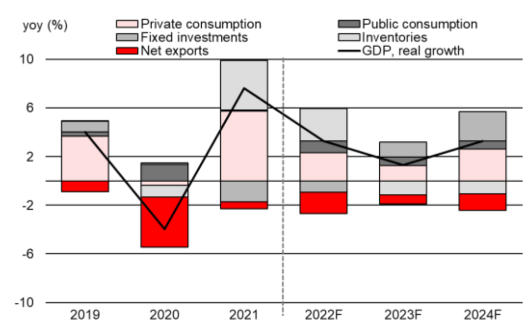
We expect Bulgaria's current political crisis to end soon. The next government is unlikely to diverge from euro-adoption pledges, and we think the country will adopt the euro in 2024. We are also optimistic with regard to the likelihood that the country will adopt constitutional amendments that will make the country's chief prosecutor more accountable. Apart from that, we think that weaker-than-initially-expected terms-of-trade deterioration, generous subsidies to energy consumers and slow transmission of higher euro-area interest rates into BGN-denominated-loan rates will provide support to growth that is stronger than we expected three months ago. As a result, we have revised upward our real-growth forecast for 2023 by 0.8%, to 1.3%.

**Author: Kristofor Pavlov,** Chief Economist (UniCredit Bulbank)

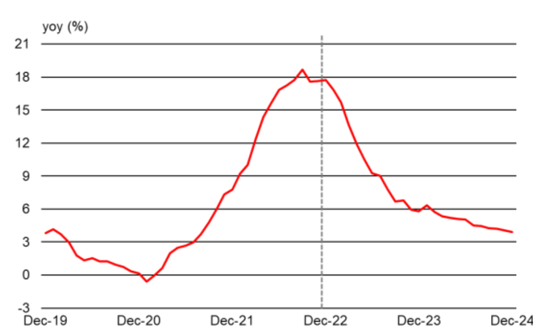
**KEY DATES/EVENTS**

- 3 Feb: sovereign-rating review by Moody's
- Mid-Feb, early Mar: 4Q22 GDP (flash, structure)
- Mid-Feb: labor-force survey data for 4Q22
- End-Mar: nationwide house-price index for 4Q22

**GDP GROWTH FORECAST**




**INFLATION FORECAST**




Source: National Statistical Institute, UniCredit Research

**MACROECONOMIC DATA AND FORECASTS**

| | 2020 | 2021 | 2022F | 2023F | 2024F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 61.6 | 71.1 | 85.3 | 95.9 | 105.0 |
| Population (mn) | 6.9 | 6.8 | 6.8 | 6.7 | 6.6 |
| GDP per capita (EUR) | 8 912 | 10 393 | 12 595 | 14 300 | 15 824 |
| **Real economy, change (%)** | | | | | |
| GDP | -4.0 | 7.6 | 3.3 | 1.3 | 3.3 |
| Private consumption | -0.6 | 8.8 | 3.5 | 1.9 | 4.0 |
| Fixed investment | 0.6 | -8.3 | -5.3 | 7.7 | 14.4 |
| Public consumption | 8.3 | 0.4 | 5.5 | 4.0 | 3.5 |
| Exports | -10.4 | 11.0 | 7.7 | 2.3 | 5.1 |
| Imports | -4.3 | 10.9 | 9.5 | 3.1 | 6.3 |
| Monthly wage, nominal (EUR) | 709 | 793 | 893 | 994 | 1093 |
| Real wage, change (%) | 7.7 | 8.5 | -2.7 | 1.6 | 5.2 |
| Unemployment rate (%) | 5.1 | 5.3 | 4.3 | 4.4 | 4.0 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance | -4.0 | -4.1 | -2.8 | -3.3 | -2.8 |
| Primary balance | -3.5 | -3.6 | -2.3 | -2.8 | -2.3 |
| Public debt | 23.9 | 23.4 | 22.1 | 22.9 | 24.3 |
| **External accounts** | | | | | |
| Current-account balance (EUR bn) | 0.0 | -0.4 | -1.2 | -1.8 | -0.5 |
| Current-account balance/GDP (%) | 0.0 | -0.5 | -1.4 | -1.9 | -0.5 |
| Extended basic balance/GDP (%) | 5.8 | 2.0 | 0.6 | -0.2 | 3.7 |
| Net FDI (% of GDP) | 4.5 | 1.4 | 1.1 | 1.2 | 2.0 |
| Gross foreign debt (% of GDP) | 63.8 | 58.4 | 51.9 | 49.6 | 48.8 |
| FX reserves (EUR bn) | 30.8 | 34.6 | 36.7 | 39.7 | 45.0 |
| Months of imports, goods & services | 10.4 | 9.3 | 7.1 | 6.2 | 6.3 |
| **Inflation/monetary/FX** | | | | | |
| CPI (pavg) | 1.7 | 3.3 | 15.3 | 9.7 | 4.8 |
| CPI (eop) | 0.1 | 7.8 | 16.6 | 6.0 | 3.9 |
| LEONIA (eop) | -0.70 | -0.53 | 1.82 | 1.92 | 1.45 |
| USD/BGN (eop) | 1.72 | 1.65 | 1.86 | 1.83 | 1.75 |
| EUR/BGN (eop) | 1.96 | 1.96 | 1.96 | 1.96 | 1.96 |
| USD/BGN (pavg) | 1.61 | 1.73 | 1.85 | 1.89 | 1.78 |
| 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

## Resilience in 2022 is not likely to last into 2023

**The current political crisis is likely to end soon**

Our baseline scenario envisages a government being formed after snap elections in March.

**With winter soon over, parties' motivations will likely change**

Parties' motivation to take part in the government is set to rise in the spring because the worst periods of the projected recession and the standard-of-living crisis are likely to be over. Municipal elections in 2023 are likely to provide even more motivation for the parties to do so, because governing parties are in a more-favorable position to organize votes. Above all, there are decisions that would be costly if left in the hands of a caretaker government. A caretaker government would not be able to complete euro adoption. Absorption of funding related to the Recovery and Resilience Plan (RRP) would stall because disbursement depends on implementation of a long list of structural measures that require sufficiently strong cooperation between the government (executive branch) and the parliament (law-making branch).

**Amendments to the country's voting system should bring about some redistribution of votes**

**The number of feasible coalitions is likely to increase**

The removal of the compulsory use of machines, via amendments to the electoral code that were passed by parliament in November, would favor parties that tend to receive a large share of votes cast by the elderly. These mostly include more-traditional and well-established parties, such as the Bulgarian Socialist Party (BSP), Citizens for European Development of Bulgaria (GERB) and the Movement for Rights and Freedoms (MRF), in that order, while other parties will have little to gain, if anything. In addition, a rift between Bulgarian President Rumen Radev and the leadership of the We Continue the Change party (WCC) is likely to undermine support for the latter at the expense of more votes for the Bulgarian Rise party (BR), whose policies seem more in line with those advocated by Mr. Radev. When combined, these two are likely to push support for GERB and BR so that a coalition between these two and the MRF will be possible in the next parliament. This is important because the potential for assembling such a coalition was already tested in December 2022, when GERB's proposed technocratic government fell short of gaining approval in the 240-seat parliament by only 7 votes.

**Commitment to euro adoption to be reconfirmed**

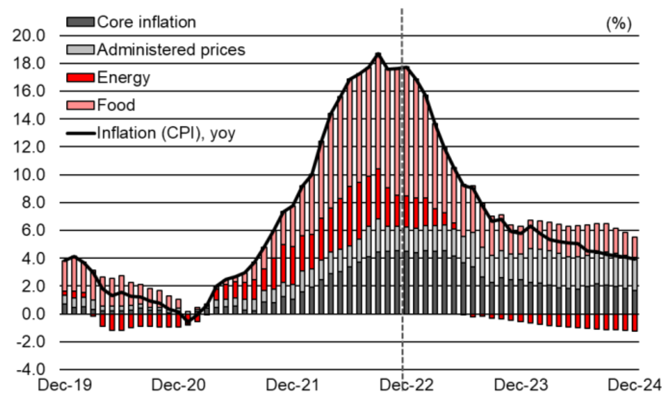
**Compromise on constitutional amendments is likely**

We expect to see solid economic policy continuity under the new government. Euro adoption will remain a priority, and we think the country is likely to swap the lev for the euro in 2024. Importantly, GERB and the MRF, which opposed judiciary reform in the past, have now adopted a more-constructive stance. It is therefore more likely that the constitutional changes needed to hold the country's chief prosecutor responsible for systematic inaction on important cases would be passed by parliament. Such reforms are required for a second tranche of funding under the country's RRP to be released, and we do not think that any political party would risk rejecting it because serious volume of EU financial aid to Bulgaria depends on its implementation.

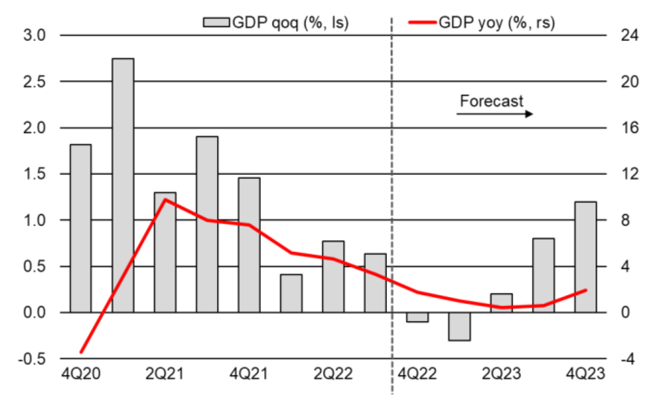
**A short and shallow recession is expected to occur this winter**

Bulgaria's economic outlook remains clouded. We expect high inflation (see chart) to weigh on demand, dragging down growth and pushing the economy into recession this winter (see chart).

**PRICES TO REMAIN ELEVATED FOR A SECOND YEAR IN A ROW**




**A MILD AND SHORT-LIVED RECESSION LIES AHEAD**




Source: National Statistical Institute, UniCredit Research

**We have revised upward our growth forecast for 2023**

However, we have raised our 2023 real-growth forecast by 0.8%, to 1.3%, to reflect a weaker-than-initially-expected deterioration in the country's terms of trade. This will be positive for companies' hiring decisions and is likely to keep inflation somewhat lower than we thought three months ago. Importantly, a generous energy subsidy scheme deployed by the authorities should result in stronger exports than forecasted in October, which should also support growth this year. Growth is likely to pick up to 3.3% in 2024, as inflation eases, terms-of-trade deterioration ends and global interest-rate tightening undertaken in 2023 is partially reversed.

**The structure of the economy resulted in smaller terms-of-trade deterioration…**

A series of adverse shocks triggered by the conflict in Ukraine has led to major terms-of-trade deterioration. Prices of raw materials have soared, led by energy prices and, to a lesser degree, food prices, which has opened large gaps in the trade balances of many EU member states relative to the world's main commodity exporters. However, Bulgaria has suffered a smaller terms-of-trade deterioration than most EU countries, as raw materials and intermediary products with low levels of processing dominate its export structure. The result has been a smaller deterioration in Bulgaria's trade balance than that of the most EU countries (see chart).

**…and this will be an important growth-support factor in 2023**

Smaller terms-of-trade deterioration will remain an important growth-support factor in 2023. We think that the conflict between Russia and Ukraine will limit both countries roles in a large number of global supply chains, and this should help Bulgaria to continue running its electricity generation as well as food and metal manufacturing sectors at full capacity. The latter should support employment and boost incomes and from here consumption and growth in 2023.

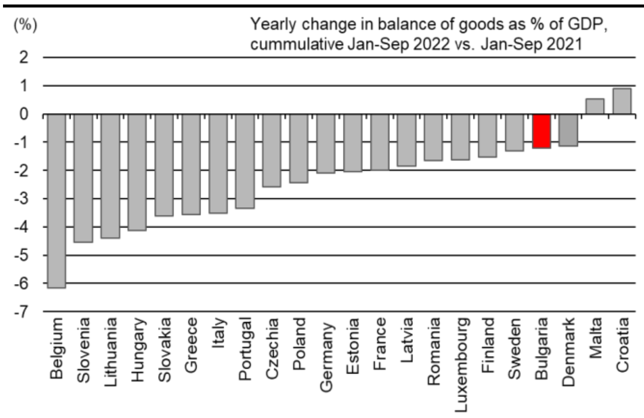
**Generous energy subsidies will give energy-intensive firms an advantage**

Generous energy subsidies are set to play a similar growth-supporting role. The government has earmarked about BGN 7.7bn (4.7% of GDP) for energy subsidies in 2022, and this can be increased to BGN 14.4bn (7.6% of GDP) in 2023 if the scheme's design is not changed and if electricity prices remain little changed. While, in the long run, the scheme's design should reduce incentives for firms to press ahead with green-transition- related investments and rollouts of energy-saving solutions, it should support growth and employment in the short run, as many energy-intensive manufacturers are encouraged to expand local production.

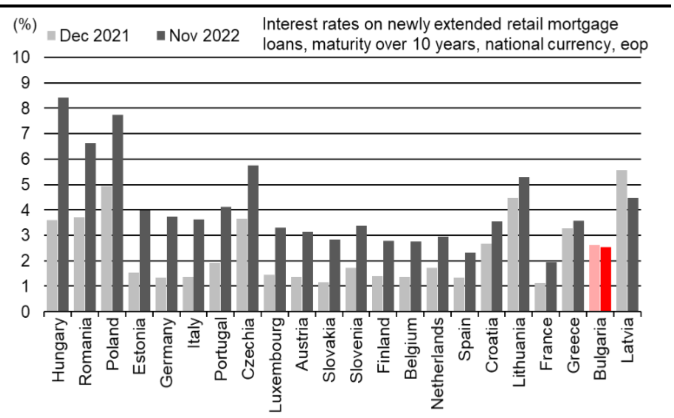
**Slowly raising rates of BGN-denominated loans will be positive for growth in 2023**

The slow transmission of ECB rates into the Bulgarian economy should mitigate growth contraction this year. For the time being, interest rates applied to BGN-denominated loans to firms and households have been tightening very slowly (see chart), despite the sharp rise in ECB rates last year. The slow transmission of higher ECB interest rates into higher costs of BGN-denominated credit would prevent a sharper contraction of real growth this year. This is because, while the timing of interest-rate tightening of BGN-denominated loans coincides with other recessionary forces at work in the economy this winter, the scale of such tightening is set to be rather gradual, and far from the proportions anticipated in the rest of EU.

**BULGARIA'S TRADE-BALANCE DETERIORATION WAS SMALLER THAN IN MOST EU MEMBER STATES**




**SLOW TRANSMISSION OF ECB RATES INTO BULGARIA WILL BE A KEY GROWTH-SUPPORT FACTOR IN 2023**




Source: Eurostat, ECB, UniCredit Research

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