Bulgaria

Baa1 stable/BBB stable/BBB positive*

Outlook

Following a prolonged period of political instability, there is a good chance that a stable government can be formed, which is our baseline scenario. A second possible scenario, one with a moderate likelihood of materializing, involves a new parliamentary election later this year, when the next municipal elections are due in the autumn. We decided to keep our real GDP growth forecast for 2023 unchanged at 1.3%. However, we have lowered our 2024 real-growth forecast to 2.3% (from 3.3%) to reflect stickier inflation than previously expected and a more pronounced deterioration in global monetary conditions, as central banks in advanced economies are set to tighten interest rates by more than we expected three months ago.

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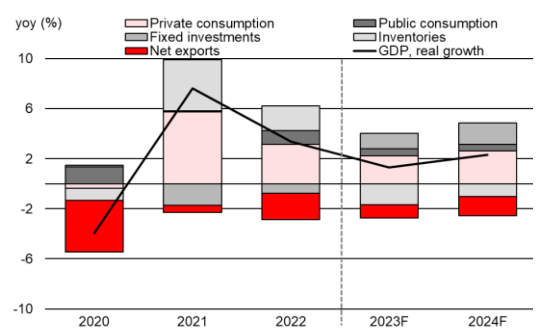
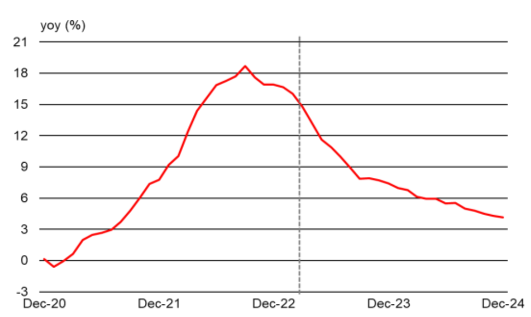
KEY DATES/EVENTS

- 02 April: parliamentary elections
- 12 May: sovereign-rating review by Fitch
- 18 April, 16 May, 14 June: CPI
- 16 May, 08 June: 1Q23 GDP (flash, structure)

GDP GROWTH FORECAST



INFLATION FORECAST



Source: National Statistical Institute, UniCredit Research

MACROECONOMIC DATA AND FORECASTS

	2020	2021	2022	2023F	2024F
GDP (EUR bn)	61.6	71.1	84.6	96.2	105.0
Population (mn)	6.9	6.8	6.8	6.7	6.6
GDP per capita (EUR)	8 912	10 393	12 489	14 353	15 826
Real economy, change (%)					
GDP	-4.0	7.6	3.4	1.3	2.3
Private consumption	-0.6	8.8	4.8	3.3	3.8
Fixed investment	0.6	-8.3	-4.3	7.7	9.8
Public consumption	8.3	0.4	6.5	3.2	3.0
Exports	-10.4	11.0	8.3	1.0	5.0
Imports	-4.3	10.9	10.5	2.3	6.4
Monthly wage, nominal (EUR)	711	798	900	1011	1107
Real wage, change (%)	8.0	9.0	-2.5	1.2	4.0
Unemployment rate (%)	5.1	5.3	4.3	4.0	3.8
Fiscal accounts (% of GDP)					
Budget balance	-4.0	-4.1	-2.8	-3.4	-2.9
Primary balance	-3.5	-3.6	-2.3	-2.9	-2.4
Public debt	23.9	23.4	22.4	23.1	24.1
External accounts					
Current-account balance (EUR bn)	0.0	-1.3	-0.6	-0.8	-1.1
Current-account balance/GDP (%)	0.0	-1.9	-0.7	-0.9	-1.0
Extended basic balance/GDP (%)	5.8	1.1	2.5	1.6	3.2
Net FDI (% of GDP)	4.5	1.8	2.4	1.9	2.0
Gross foreign debt (% of GDP)	63.8	58.4	51.9	49.4	47.8
FX reserves (EUR bn)	30.8	34.6	38.4	39.0	39.8
Months of imports, goods & services	10.4	9.3	7.7	6.6	5.8
Inflation/monetary/FX					
CPI (pavg)	1.7	3.3	15.3	11.1	5.5
CPI (eop)	0.1	7.8	16.9	7.4	4.1
LEONIA (eop)	-0.70	-0.53	1.82	3.87	3.15
USD/BGN (eop)	1.72	1.65	1.86	1.75	1.69
EUR/BGN (eop)	1.96	1.96	1.96	1.96	1.96
USD/BGN (pavg)	1.61	1.73	1.85	1.79	1.70
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

Outlook to remain challenging in both 2023 and 2024

Another parliamentary election is due next weekend

Bulgaria is set for its fifth election in two years. Polls available in mid-March suggested that at least five parties would be present in the next national assembly, while the approval rating of three smaller parties were hovering around the 4 percent barrier for entry into parliament.

The results are likely to again test the resolve of parties to seek compromise

Difficult consultations lie ahead. Following a prolonged period of political instability there are good chances that a stable government can be formed, which is also our baseline scenario. A second possible scenario, one with a moderate likelihood of materializing, involves a new parliamentary election later this year, when the next municipal elections are due in the autumn.

Prolonged political crisis has come at a cost…

…as country's efforts to adopt the euro were disrupted

A failure to form a stable government would leave the country without a clear policy direction at a time when the cost-of-living crisis looks far from over, while country's choices regarding the Russia-Ukraine war are likely to shape its future for the next several decades. The country and its economy also need stable government because decisions need to be made that would be costly to postpone. Many structural reforms have come to a halt, including the judicial reform that aims to reduce the number of cases of defendants with money and connections managing to escape justice. The volume of public capex continued to disappoint. Euro adoption, which serves as a main policy anchor and plays a key role in shaping expectations, is struggling, as pro-Russian nationalists from Vazrazhdane party have already collected the signatures needed to force parliament to call a referendum on euro entry later this year.

Economy to slow in 2023

Against this challenging internal and external backdrop, we have decided to keep our real GDP growth forecast for 2023 unchanged at 1.3% (see chart), as consumers are limiting spending due to inflation (see chart) and business are cutting back production due to worsening external demand and in order to bring inventories down to more sustainable levels.

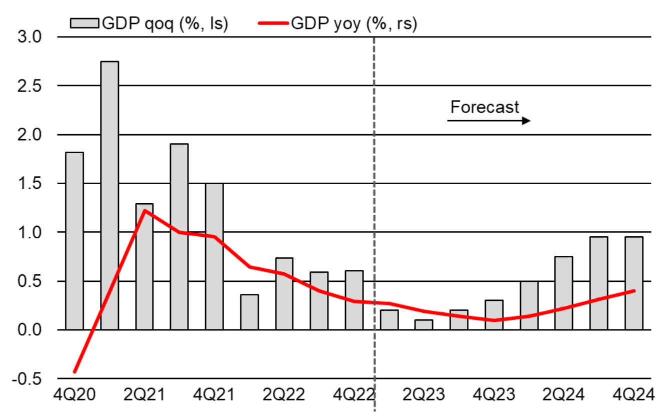
Only a gradual recovery is likely next year

We have lowered our 2024 real-growth forecast to 2.3% (from 3.3%) for two main reasons. First, inflation has been stickier than previously expected, which implies weaker purchasing power of household income and therefore weaker consumption growth. Second, and equally importantly, the more pronounced deterioration in global monetary conditions, as central banks in advanced economies look set to tighten interest rates by more than we expected three months ago, would translate into stronger headwinds for domestic demand and therefore weaker consumption and private investment growth in 2024 than we previously thought.

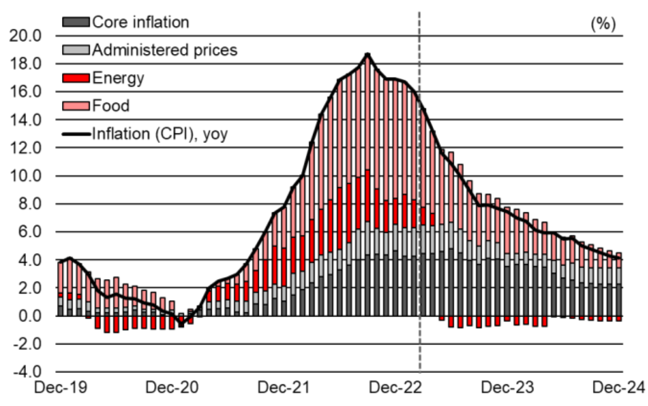
Inventories reduction will become a major drag to grow

Roughly half of real GDP growth in the past two years was driven by rising inventories, as companies had to increase stock building against the backdrop of supply chain disruptions caused by the coronavirus pandemic and the war in Ukraine. However, recent data suggest that this trend ended in 3Q22 and started to reverse in 4Q22. Our baseline scenario

LOWEST QOQ GDP GROWTH READING IS EXPECTED IN 2Q23



CORE PRICES WOULD NEED MORE TIME TO PEAK



Source: National Statistical Institute, UniCredit Research envisages companies cutting production in order to reduce inventories to more normal levels. This is likely to be a protracted process, just as the increase in inventories took around two years to materialize. We expect inventories to stabilize at around 4% of GDP toward the end of 2024, which we see as the new normal in the post-pandemic environment. If our calculations are broadly right, the inventory reduction will become a major drag to growth in the period of the forecast. More specifically, we forecast they will subtract 1.7pp and 1pp from GDP growth in 2023 and 2024, respectively, after contributing 4.1pp and 2pp in 2021 and 2022.

Cost of credit adjustment would need more time to materialize

The transmission of higher interest rates in advanced economies to a higher cost of credit for local companies and households has been surprisingly slow thus far (see charts below). We remain of the view that this will prevent a sharp contraction of GDP growth this year. However, a higher and later peak in core inflation in advanced economies is likely to push their central banks to tighten monetary conditions by more than we anticipated three months ago. This would lead to credit conditions at home deteriorating by more than we previously thought. Importantly, the timing of the deterioration in the cost of credit would be pushed back to 2024 rather than being concentrated almost entirely in 2023. The result would be weaker real GDP growth in 2024, as the full effect of aggressive monetary policy tightening undertaken in the advanced economies in 2022 and 2023, would need more time to filter through to the local economy.

Inflation turned out to be stickier than we thought

Despite downwardly revised energy prices in our global scenario, we increased our CPI forecast for 2023 and 2024. We now see average inflation at 11.1% in 2023 and 5.5% in 2024 (up from 9.7% in 2023 and 4.8% in 2024 in our previous forecast). We forecast core inflation to peak later (in June rather than in April) and at a higher level (14.1% rather than 13.6% previously).

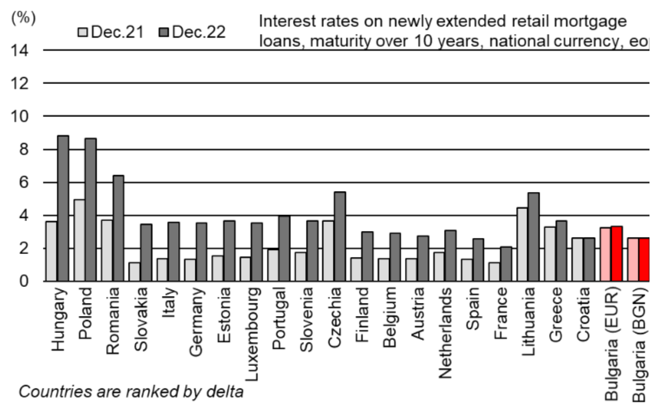
Structural factors are behind our upwardly revised inflation forecast

Structural factors pushed inflation higher at the start of 2023. Regulators found cases where local wholesale and retail traders seemed to have unjustifiably hiked the prices of products. In some extreme cases, regulators found that retail prices of goods were up to 90% above what had been charged by producers. To make things worse, the caretaker government found itself short of tools to do much about the situation. This is because so-called unfair trading practices have not been clearly specified in local legislation. Moreover, the maximum fine local regulators can impose is BGN 50,000, which is low compared to other EU countries, where fines can be up to several percentage points of a trader’s total turnover.

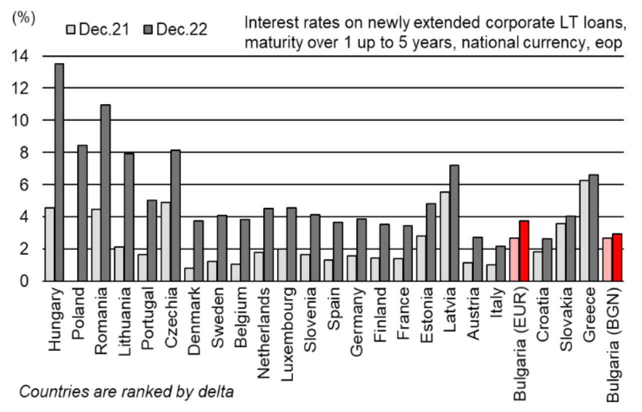
More needs to be done to boost competition in some sectors

We were surprised by the extent to which unfair trading practices can add to inflation. It seems that high concentration in some product and services markets have enabled companies in these markets to acquire a lot of pricing power. We welcome the authorities’ resolve to address the issue as we think that if abuses of pricing power are not dealt with properly, this risks becoming another stumbling block for country’s aspirations to adopt the euro at the beginning of 2025.

BULGARIA HAS ONE OF THE LOWEST MORTGAGE RATES…



…AND LONG-TERM CORPORATE LOAN RATES IN EUROPE



Source: European Central Bank, UniCredit Research

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