Bulgaria

Baa1 stable/BBB stable/BBB stable*

Outlook

More-severe and longer-lasting supply bottlenecks and higher-than-expected inflation are likely to slow the pace of growth this year, compared with our previous forecast. All four parties supporting Bulgaria's new coalition government have agreed that low vaccination rates and high inflation are the immediate challenges they face. Apart from these, the government aims to eradicate corruption, reform the judiciary, streamline state institutions and adopt the euro in 2024, as originally planned.

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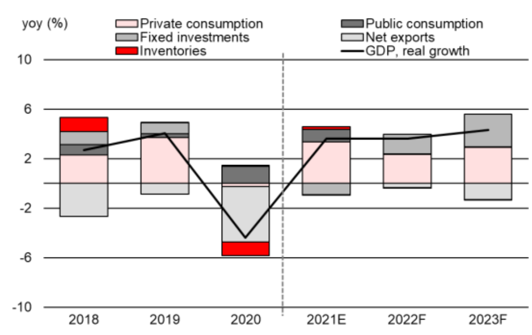
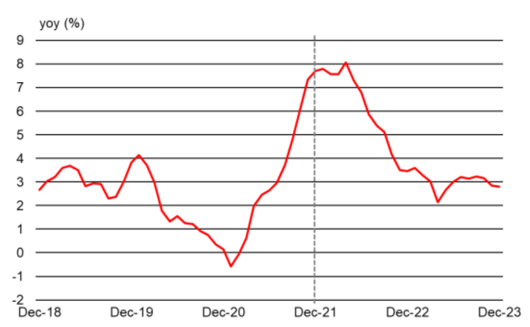
KEY DATES/EVENTS

- 21 Jan: sovereign rating review from Fitch
- Mid-Feb, Early-Mar: 4Q21 GDP (flash, structure)
- Mid-Feb: labor force survey data for 4Q21
- End-Mar: nationwide house-price index for 4Q21

GDP GROWTH FORECAST



INFLATION FORECAST



Source: National Statistical Institute, UniCredit Research

MACROECONOMIC DATA AND FORECASTS

	2019	2020	2021E	2022F	2023F
GDP (EUR bn)	61.6	61.3	66.5	74.0	80.5
Population (mn)	7.0	6.9	6.9	6.8	6.8
GDP per capita (EUR)	8 855	8 867	9 684	10844	11888
Real economy, change (%)					
GDP	4.0	-4.4	3.6	3.6	4.3
Private consumption	6.0	-0.4	5.1	3.5	4.4
Fixed investment	4.5	0.6	-4.5	8.5	13.3
Public consumption	2.0	8.3	5.5	0.1	0.2
Exports	4.0	-12.1	8.7	8.1	7.3
Imports	5.2	-5.4	8.0	7.9	8.4
Monthly wage, nominal (EUR)	648	709	787	845	924
Real wage, change (%)	7.5	7.7	7.7	1.3	6.4
Unemployment rate (%)	4.2	5.1	5.4	5.0	4.3
Fiscal accounts (% of GDP)					
Budget balance	2.1	-3.4	-3.5	-4.3	-2.7
Primary balance	2.7	-3.1	-5.0	-2.2	-1.9
Public debt	19.6	24.2	25.2	27.1	28.3
External accounts					
Current account balance (EUR bn)	1.1	-0.2	-0.8	0.0	0.1
Current account balance/GDP (%)	1.9	-0.3	-1.2	0.0	0.1
Extended basic balance/GDP (%)	5.0	4.5	1.7	4.1	4.8
Net FDI (% of GDP)	2.0	3.5	1.6	1.9	2.4
Gross foreign debt (% of GDP)	62.3	65.3	61.5	56.8	54.1
FX reserves (EUR bn)	24.8	30.8	29.3	30.9	33.5
Months of imports, goods & services	7.4	10.4	8.0	7.3	7.0
Inflation/monetary/FX					
CPI (pavg)	3.1	1.7	3.3	6.0	3.0
CPI (eop)	2.7	3.8	7.7	3.5	2.8
LEONIA (eop)	-0.61	-0.70	-0.53	-0.50	-0.48
USD/BGN (eop)	1.74	1.60	1.72	1.78	1.81
EUR/BGN (eop)	1.96	1.96	1.96	1.96	1.96
USD/BGN (pavg)	1.75	1.71	1.66	1.76	1.79
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

Growth to remain lackluster amid inflation-related woes

Tight supply and high inflation are expected to take a toll on growth

We have lowered our real GDP growth forecast for 2022 to 3.6% yoy (from 3.9%), amid supply bottlenecks and the expectation that high inflation will last longer than anticipated previously. We now expect 4.3% real GDP growth in 2023, when the unemployment rate is also forecast to go down to levels consistent with full employment, according to our baseline scenario.

The health situation is projected to gradually improve in 2022

The outlook for the economy will continue to depend on how the coronavirus pandemic develops. The Omicron variant of COVID-19 is adding to the headwinds in the short term and is forecast to dampen economic activity in 2022. However, we assume that the effectiveness of current vaccines will not fade substantially and that the share of the vaccinated population will slowly rise, although it is likely to remain below the level needed to achieve collective immunity. Under these assumptions, the health situation should improve, and the negative impact of new pandemic waves on the growth trajectory should be more limited than in the past.

We have substantially raised our inflation forecast for 2022

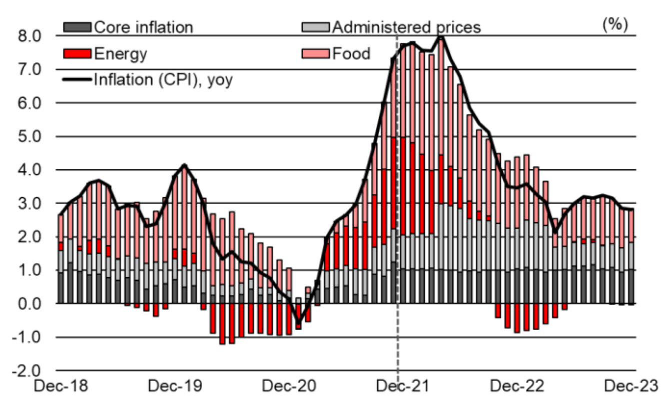
We expect average CPI inflation to rise to 6.0% yoy in 2022 before falling back to 3.0% in 2023 (see chart). We still think that high inflation mostly reflects temporary factors, including elevated energy prices, supply bottlenecks and base effects. However, inflation has recently become more broadly based and is likely to last longer. This is because supply bottlenecks, which have weighed on production and pushed up core prices substantially, are expected to normalize back to pre-pandemic levels only in 2023, significantly later than we had previously anticipated. Furthermore, there are two country-specific reasons why inflation in Bulgaria is likely to be perhaps even higher than in the rest of the CEE region. First, a rapid increase in food prices is likely to prove more persistent, in our view, because an ongoing shortage of fertilizers is likely to cut harvest volumes in 2022. If this scenario materializes, headline inflation will increase to a larger degree in Bulgaria than in the rest of the CEE region, because food accounts for the largest share of Bulgaria's CPI basket. Second, the pass-through of higher commodity prices to consumer prices in Bulgaria is likely to be amplified by the fact that the country has a relatively large number of sectors that are characterized by elevated concentration, which suggests that Bulgaria's share of companies with large pricing power is significant as well.

There is no indication that high inflation will lead to higher labor costs

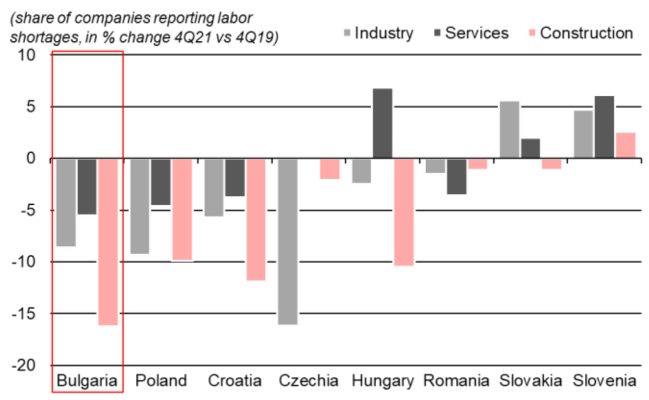
Our inflation forecast assumes household electricity and central-heating prices will rise by 15% in April 2022. Feedback from higher costs to higher prices and wages (so-called second-round effects) is likely to be small, in our view. This is because employment rate suggest that there is still some slack in Bulgaria's labor market. Also importantly, the share of business managers reporting labor shortages now compared to the period before the start of the pandemic is significantly smaller in Bulgaria than in the rest of the CEE region (see chart).

The composition of GDP growth is likely to change. Private consumption will contribute less to growth in 2022 than in 2021. This mostly reflects higher consumer price inflation, which in 2022, is set to cut disposable to a much larger degree than in 2021.

WE EXPECT HIGH INFLATION TO PERSIST



BULGARIA HAS SMALLER LABOR SHORTAGES THAN THE CEE



Source: Eurostat, National Statistical Institute, UniCredit Research

Weaker pension and public-sector wage growth will cut into consumption growth

However, this is not the only reason why we expect that consumption growth will be weaker in 2022. The boost from election-induced increases in public sector wages and pensions is fading, and the economy faces the prospect of less-expansionary fiscal policy. The draft budget for 2022 envisages public-sector wages and pensions rising by 5% and 8% respectively, which is broadly in line with expected inflation and only around a third of the 15% increase in public-sector wages and 22% rise in pensions reported last year. Private-sector wage increases would not help much either, since wage bargaining will take place in a context of persistent supply bottlenecks and higher commodity prices, which will limit the capacity of the employees to negotiate any marked rise in wages. Against this backdrop, we expect households to use some of their savings to cushion the impact from this squeeze in the real income, but low consumer confidence (see charts) suggests that consumption growth is likely to be only modest.

Higher inflation has hurt consumer confidence

Public capex is set to accelerate from 2022 onwards

In contrast, investment are likely to pick up, driven by stronger public capex, while private capex is set to rebound at a slower pace, due to supply bottlenecks lasting for longer than we had expected previously. Importantly, public capex in green transition and digitalization financed by Next Generation EU (NGEU) funds will boost potential growth, if the needed reforms are made.

A comprehensive coalition agreement was signed

All four parties supporting the new government have signed a comprehensive coalition agreement. This has helped address ideological differences among them and was instrumental in reducing uncertainty as to the priorities of the new government. Apart from its immediate challenges, which include low vaccination rates and high inflation, the government aims to eradicate corruption, streamline the state and adopt the euro in 2024, as originally planned.

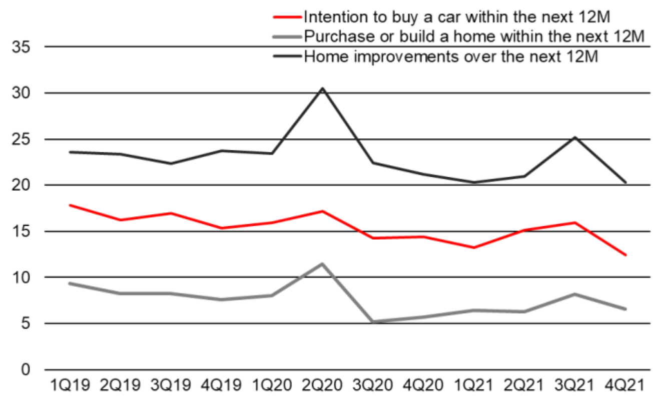
Euro adoption in 2024 remains an important priority

Economic policy will be shaped by a need to strike the balance between two priorities: to sustain the ongoing economic recovery, after a prolonged and painful health crisis, on one side, and to preserve the medium-term sustainability of public finances ahead of Bulgaria's adoption of the euro, on the other. To this end, the government aims to reduce public administration, improve tax collection, cut administrative burden and reexamine the structure and functions of regulatory agencies, while also shortening the mandates of those sitting in their governing bodies.

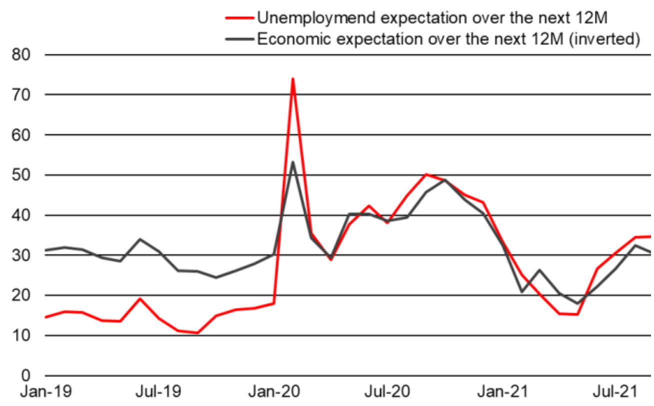
A shift back to neoliberal policies seems to be underway

A shift back to neoliberal policies also includes reducing the tax burden for high-income households, in the form of cutting inheritance tax and abolishing so-called weekend tax, as well as taxing income from bank deposits. SMEs will also benefit, as the threshold for VAT registration will increase. At the same time, it is encouraging that an agreement was reached to raise child benefits and improve spending control in the health sector, while abandoning the GERB's plans to replace the existing state monopoly with a poorly regulated private oligopoly. Positively, the government also plans to prepare a list of projects to apply for loans from the NGEU facility, which will raise the volume of green transition and digitalization related capex.

HOUSEHOLDS ARE NOT IN THE MOOD FOR HIGH-VALUE PURCHASES



HOUSEHOLDS' EXPECTATIONS ARE GETTING WORSE



Source: Eurostat, UniCredit Research

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