Bulgaria

Baa1 stable/BBB stable/BBB positive*

Outlook

Bulgaria's government has consolidated its position after successfully passing constitutional amendments and after the most recent public opinion polls reconfirmed that there has not been a major increase in support for euro-sceptic parties.

Real GDP growth is likely to accelerate to 3% in 2024 and further to 3.3% in 2025 on the back of improved absorption of EU funds, which will boost investment, and a tight labor market, which will help solid wage growth push private consumption.

Euro adoption remains a key priority that will shape policymaking in the forecast period. To this end, the government aims to achieve a budget deficit below the 3% of GDP mark and to concentrate on the reforms needed to unlock the significant volume of EU funding that Bulgaria is entitled to receive in the next several years.

Strategy

Increased external borrowing and more spending from fiscal reserves will cover higher sovereign funding needs this year.

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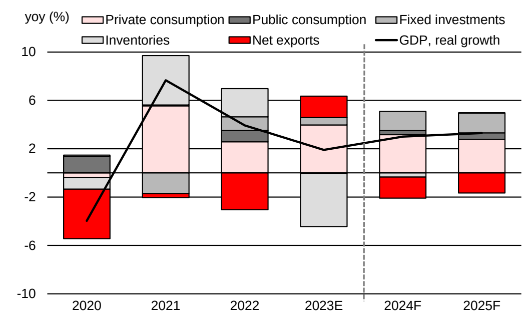
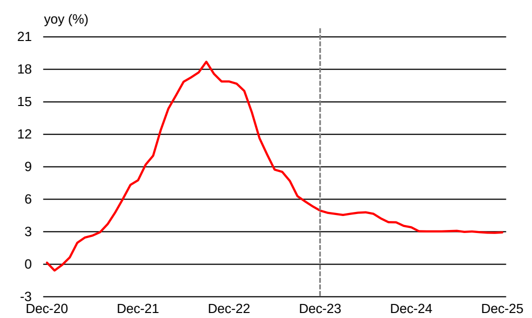
KEY DATES/EVENTS

- 26 Jan: sovereign rating review by Moody's
- Mid-Feb, early Mar: 4Q23 GDP (flash, structure)
- Mid-Feb: labor-force survey data for 4Q23
- End-Mar: nationwide house-price index for 4Q23

GDP GROWTH FORECAST



INFLATION FORECAST



Source: National Statistical Institute, UniCredit Research

MACROECONOMIC DATA AND FORECASTS

	2021	2022	2023E	2024F	2025F
GDP (EUR bn)	71.1	85.8	96.9	105.4	113.5
Population (mn)	6.5	6.4	6.4	6.3	6.3
GDP per capita (EUR)	10 899	13 307	15 176	16 658	18 117
Real economy, change (%)					
GDP	7.7	3.9	1.9	3.0	3.3
Private consumption	8.5	3.9	6.0	4.6	4.0
Fixed investment	-8.3	6.5	3.4	8.7	8.5
Public consumption	0.4	5.5	-0.1	2.0	3.1
Exports	11.2	11.6	-0.8	3.5	4.4
Imports	10.7	15.0	-3.0	5.5	6.1
Monthly wages, nominal (EUR)	798	900	1021	1124	1215
Real wages, change (%)	9.0	-2.5	3.7	5.8	5.1
Unemployment rate (%)	5.3	4.1	4.3	4.0	3.8
Fiscal accounts (% of GDP)					
Budget balance	-4.0	-2.9	-2.2	-2.9	-3.0
Primary balance	-3.5	-2.5	-1.7	-2.4	-2.5
Public debt	23.4	22.1	21.9	23.1	24.6
External accounts					
Current-account balance (EUR bn)	-1.2	-1.2	-0.7	-1.2	-1.2
Current-account balance/GDP (%)	-1.7	-1.4	-0.7	-1.2	-1.1
Extended basic balance/GDP (%)	1.1	1.9	3.5	4.2	4.2
Net FDI (% of GDP)	1.8	2.4	3.0	3.2	3.4
Gross foreign debt (% of GDP)	58.1	51.6	46.3	43.3	40.9
FX reserves (EUR bn)	34.6	38.4	38.3	32.6	28.9
Months of imports, goods & services	9.4	7.4	7.9	6.1	4.9
Inflation/monetary/FX					
CPI (pavg)	3.3	15.3	9.7	4.3	3.0
CPI (eop)	7.8	16.9	4.9	3.4	2.9
LEONIA Plus (eop)	-0.53	1.82	3.80	3.15	2.42
USD-BGN (eop)	1.65	1.86	1.81	1.73	1.70
EUR-BGN (eop)	1.96	1.96	1.96	1.96	1.96
USD-BGN (pavg)	1.73	1.85	1.80	1.75	1.72
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

Euro adoption to shape policymaking

There have been no major shifts in the approval ratings of key parties

Eight months after a general election in April and two months after a municipal election in October, there have been no major shifts in the approval ratings of the main political parties in the country, according to public opinion polls conducted at the end of last year. At the same time, support for euro-sceptic parties has failed to increase by much. In our view, this suggests that polarization in the Bulgarian society is slowly decreasing and that the share of voters who support compromise as a means to address country's challenges remains significant.

Constitutional amendments will help reduce corruption

The parties supporting the government agreed on constitutional amendments to improve the functioning of the judiciary system and to reduce corruption. The amendments limit the functions of the prosecution service to criminal lawsuit procedures, thereby divesting it of powers to exercise general supervision as to the legality of acts and steps taken by state bodies. The constitutional amendments set up a special mechanism for the investigation of the prosecutor general if he or she is suspected of committing a publicly prosecutable offence. They also ensure that most of the members of the Supreme Judiciary Council are elected directly by judges, which should limit the ability of politicians to interfere with the work of the court.

Amendments will improve the balance of power between institutions

The constitutional amendments should improve the balance of power between state institutions. They deny the president full discretion to appoint a caretaker prime minister and limit his or her choice to a small number of predefined high-ranking state officials. If early elections need to be held, the parliament will not be dissolved and will retain its credentials until the MPs from the next legislature are sworn in. According to the amendments, the president must schedule parliamentary elections within two months after the appointment of a caretaker cabinet. Importantly, a two-thirds majority will be required when the parliament elects members of the regulatory authorities. Lastly, the amendments envisage that persons with dual nationalities will be eligible to become members of both the administration and the parliament.

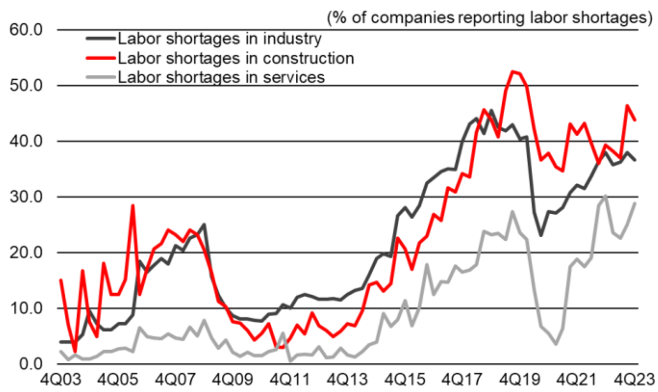
GDP growth to accelerate

The pace of economic expansion is likely to gain more-solid momentum in 2024, with real GDP growth accelerating to 3% yoy. GDP growth could accelerate further to around 3.3% in 2025, when we expect private capex and exports to rebound amid stronger foreign demand.

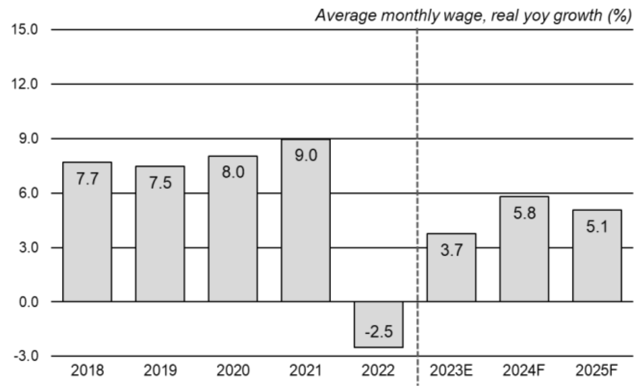
Private consumption will remain resilient

According to the demand-side components of GDP, private consumption will remain the key driver. Disinflation will help the purchasing power of incomes to rise, while deepening labor shortages (see chart) will keep real wage growth (see chart) above productivity. Although to a lesser degree, private consumption will draw support from rising public transfers envisaged in the state budget. These transfers include a 20% rise in Bulgaria's minimum wage, 12% growth in the average pension and double-digit increases in some social spending. However, real growth in consumption is likely to lose some momentum in 2024, compared to 2023.

DEEPENING LABOR SHORTAGES ARE PART OF THE PICTURE



REAL WAGE GROWTH LOOKS SET TO REBOUND IN 2024



Source: Eurostat, National Statistical Institute, UniCredit Research

The latter will be driven by a sizeable downward base effect and a deceleration in retail credit growth, as borrowing costs associated with BGN-denominated loans are likely to rise, although the scale and timing of such increases seem highly uncertain at the moment.

Better EU-fund absorption should push investment recovery

Gross fixed-capital formation is set to play a key role in acceleration of GDP growth in both 2024 and 2025. After tangible deceleration of growth in 2022 and 1H23, fixed investments are likely to post a solid rebound. The latter mostly reflects our expectation for a significant increase in public capex, as absorption of EU funds has improved, following a prolonged period of political uncertainty when many infrastructure projects had come to a standstill. Residential construction is likely to lose some momentum but will nevertheless remain relatively high due to a large volume of newly started residential construction over the past several years (see chart). Deceleration in residential construction is likely to be more than offset by strong growth in machinery and equipment investment. We think that most projects in 2024 will aim to increase energy efficiency rather than to expand production capacity. However, increasing signs of de-risking from China, along with a rebound in external demand envisaged in our global scenario, should help projects aimed at expanding production capacity to rise in 2025.

Foreign direct investment (FDI) to rise amid stronger foreign demand

Disinflation to slow in 2024

Disinflation will play a key role in boosting demand in 2024 and 2025. Easing commodity prices, base effects and government measures to cap price rises for essential commodities all helped push consumer-price inflation down to 5.4% at the end of November (see chart). However, we expect disinflation to slow in 2024 and particularly in 2025. Somewhat lower commodity prices envisaged in our global baseline macro scenario will help reduce consumer-price inflation in 2024 and, to a somewhat smaller degree, further in 2025. At the same time, double-digit labor-cost increases are likely to keep service prices sticky, while the withdrawal of VAT cuts envisaged in the 2024 state budget will put pressure on the prices of some essential goods, such as bread, flour, electricity, gas and central heating. Finally, there are several sectors in the local economy where companies have significant pricing power, which is likely to further undermine the strength of disinflationary forces acting in the period of the forecast.

The impact of past inflationary shocks fade away

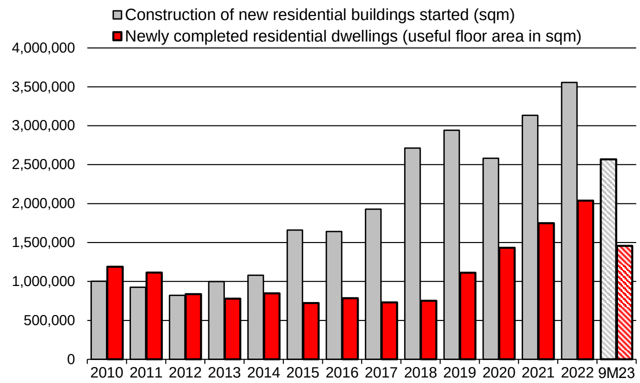
Euro adoption remains a key policy priority

Economic policy will be shaped by a need to strike a balance between two main priorities: to sustain strong income growth on one side and to preserve the medium-term sustainability of public finances ahead of euro adoption next year on the other. To this end, the Bulgarian government aims to achieve a budget deficit in line with the EU's 3% of GDP rule in both 2024 and 2025, after running a cash deficit equivalent to 2.8% of the country's GDP in 2023.

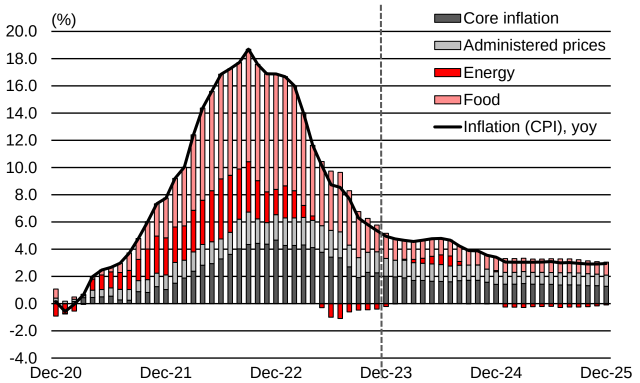
Stronger progress in EU funds absorption lies ahead

All but 4 of the 66 requirements linked to the second tranche of the country's Recovery and Resolution Plan (RRP) have been implemented, and funds are expected to be released in February. Stronger progress ahead looks likely, in our view, because Bulgarian authorities say they are strongly committed to the reforms envisaged in the country's RRP, while requirements linked to the payment of the next three tranches look somewhat less challenging to implement.

CONSTRUCTION OF RESIDENTIAL BUILDINGS TO REMAIN HIGH



DISINFLATION IS SET TO SLOW IN 2024 AND FURTHER IN 2025



Source: National Statistical Institute, UniCredit Research

Increase in debt issuance looks likely this year

The Bulgarian government met its budget-deficit target last year

Bulgaria's ministry of finance posted a cash deficit equivalent to 2.8% of GDP last year. The result is in line with both the government target and the limit established in the Stability and Growth Pact. What is more, the result is far better than the 6.4% of GDP deficit envisaged in the forecast of the caretaker government in March 2023, which, at that time, put at risk euro entry in 2025.

Fiscal policy to support growth this year

The consolidated fiscal program for 2024 contains several measures aimed at supporting economic growth. The state budget envisages increasing funding allocated to pensions and health care, as well as to other social costs related to an aging population, by around 1pp of GDP. This will be added on top of an increase in public capex equivalent to around 1pp of GDP, which should contribute to domestic-demand expansion this year.

Some important spending increases are envisaged this year

Fiscal revenues are set to increase in broadly the same proportions, keeping the country's budget deficit at 3% of GDP. These include discontinued support for households (introduced to mitigate the impact from a cost-of-living crisis in 2020), equivalent to 0.2% of GDP; a higher contribution payment (including due to a higher income cap for contribution payments), equivalent to 0.4% of GDP; higher taxes (due to the introduction of a 15% minimum profit tax on large companies plus higher taxes on gambling), equivalent to 0.2% of GDP. The rest should come from higher EU funding plus measures to improve tax collection, which include but are not limited to the compulsory preliminary declaration of cargo associated with high fiscal risk. This already helped boost collection last year when it was launched for the first time.

Dangerous fiscal slippage looks very unlikely

Risks that there will be a major deterioration in the country's budget deficit seem small. This is because high inflation and measures to improve collection will continue pushing revenues higher, while delays to some projects in the public capex program could easily save billions of leva.

External borrowing will dominate the picture

We expect to see a moderate increase in debt issuance to BGN 9.8bn this year, from BGN 7.4bn last year. A moderately larger volume of maturing debt and a somewhat larger cash deficit will be behind higher anticipated debt issuance in 2024. We think the government will satisfy only a small portion of its funding needs on the domestic bond market (BGN 500mn), while external borrowing (EUR 4.75bn) will dominate the picture. A small decline in fiscal reserves will likewise play a part in covering the funding needs of the Bulgarian sovereign in 2024.

GROSS GOVERNMENTAL FINANCING REQUIREMENTS

EUR bn	2023E	2024F	2025F
Gross financing requirement	**4.5**	**5.2**	**5.8**
Budget deficit	2.7	3.2	3.4
Amortization of public debt	1.7	2.0	2.4
Domestic	0.3	0.3	2.2
Bonds	0.3	0.3	2.2
Bills	0.0	0.0	0.0
Loans/other	0.0	0.0	0.0
External	1.4	1.7	0.2
Bonds and loans	1.2	1.5	0.0
IMF/EU/other IFIs	0.2	0.2	0.2
Financing	**4.5**	**5.2**	**5.8**
Domestic borrowing	0.0	0.3	1.3
Bonds	0.0	0.3	1.3
Bills	0.0	0.0	0.0
Loans/other	0.0	0.0	0.0
External borrowing	3.8	4.8	4.5
Bonds and loans	3.8	4.8	4.5
IMF/EU/other IFIs	0.0	0.0	0.0
Privatization/other	0.0	0.0	0.0
Change in fiscal reserves (- =increase)	0.6	0.2	0.0

GROSS EXTERNAL FINANCING REQUIREMENTS

EUR bn	2023E	2024F	2025F
Gross financing requirement	**22.7**	**23.5**	**21.9**
C/A deficit	0.7	1.2	1.2
Amortization of medium- and long-term debt	5.4	5.4	3.6
Government/central bank	1.4	1.7	0.2
Banks	1.1	1.0	1.1
Corporates/other	2.9	2.7	2.3
Amortization of short-term debt	16.6	16.9	17.2
Financing	**22.7**	**23.5**	**21.9**
FDI (net)	2.9	3.4	3.9
Portfolio equity, net	-1.3	-1.0	0.0
Medium and long-term borrowing	5.8	5.8	4.4
Government/central bank	3.8	4.8	4.5
Banks	1.0	1.1	1.2
Corporates/other	1.0	-0.1	-1.3
Short-term borrowing	16.9	17.2	17.5
EU structural and cohesion funds	1.1	2.3	2.0
Other	-2.8	-9.9	-9.4
Change in FX reserves (- = increase)	0.1	5.8	3.6
Memoranda:			
Nonresident purchases of LC gov't bonds	0.0	0.0	0.0
International bond issuance, net	2.6	3.3	4.5

Source: Bulgarian National Bank, Bulgarian Ministry of Finance, UniCredit Research

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