# Bulgaria

## Baa2 positive/BBB- positive/BBB positive*

### Outlook

We expect growth to accelerate this year before the economy slows next year, as several external factors will weigh on its performance according to our global scenario. The ruling party GERB looks well placed to win local elections amid solid income growth and record low unemployment. The country has made solid progress in the implementation of its euro adoption plan, which was noted by rating agencies, with all three now having a positive outlook on their Bulgarian sovereign ratings.

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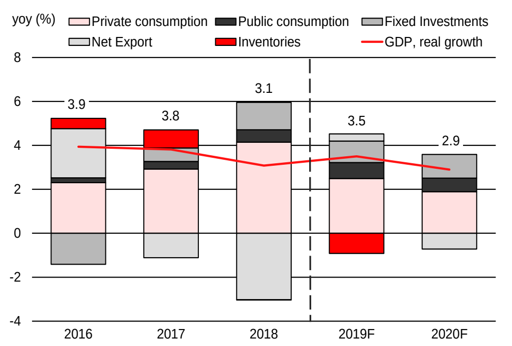
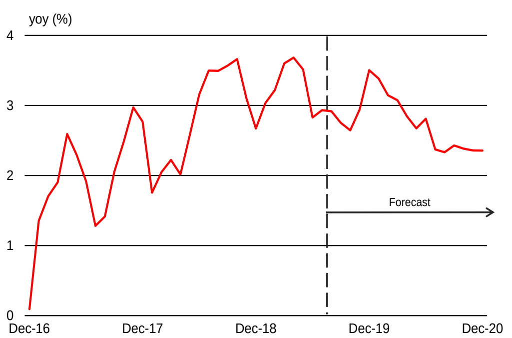
### KEY DATES/EVENTS

- Oct/Nov: 2020 Government Budget
- 27 Oct: Municipal elections
- 3 Oct, 14 Nov, 5 Dec: GDP data (revised data for 2018, 3Q19 flash estimate, 3Q19 structure)
- 14 Oct, 13 Nov, 16 Dec: CPI inflation

### GDP GROWTH FORECAST




### INFLATION FORECAST




Source: NSI, UniCredit Research

### MACROECONOMIC DATA AND FORECASTS

| | 2016 | 2017 | 2018 | 2019F | 2020F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 48.1 | 51.7 | 55.2 | 58.8 | 62.1 |
| Population (mn) | 7.1 | 7.1 | 7.0 | 7.0 | 6.9 |
| GDP per capita (EUR) | 6,777 | 7,328 | 7,883 | 8,465 | 9,000 |
| **Real economy, change (%)** | | | | | |
| GDP | 3.9 | 3.8 | 3.1 | 3.5 | 2.9 |
| Private Consumption | 3.5 | 4.5 | 6.4 | 3.7 | 2.8 |
| Fixed Investment | -6.6 | 3.2 | 6.5 | 5.0 | 5.4 |
| Public Consumption | 2.2 | 3.7 | 4.8 | 4.0 | 4.1 |
| Exports | 8.1 | 5.8 | -0.8 | 4.0 | 2.8 |
| Imports | 4.5 | 7.5 | 3.7 | 3.3 | 3.7 |
| Monthly wage, nominal (EUR) | 485 | 530 | 580 | 638 | 694 |
| Real wage, change (%) | 8.8 | 7.3 | 6.6 | 6.9 | 6.0 |
| Unemployment rate (%) | 7.6 | 6.2 | 5.2 | 4.3 | 4.0 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance | 0.1 | 1.2 | 2.1 | -1.1 | -0.6 |
| Primary balance | 1.0 | 2.0 | 2.9 | -0.5 | 0.0 |
| Public debt | 28.6 | 25.4 | 22.1 | 20.8 | 20.5 |
| **External accounts** | | | | | |
| Current account balance (EUR bn) | 1.6 | 1.8 | 3.0 | 3.2 | 2.8 |
| Current account balance/GDP (%) | 3.2 | 3.5 | 5.4 | 5.5 | 4.5 |
| Extended basic balance/GDP (%) | 6.4 | 6.9 | 6.9 | 8.2 | 7.4 |
| Net FDI (% of GDP) | 1.2 | 2.5 | 0.6 | 1.5 | 1.5 |
| Gross foreign debt (% of GDP) | 71.1 | 65.5 | 60.4 | 55.0 | 50.5 |
| FX reserves (EUR bn) | 23.9 | 23.7 | 25.1 | 26.9 | 28.2 |
| Months of imports, goods & services | 9.4 | 8.1 | 8.1 | 8.4 | 8.4 |
| **Inflation/Monetary/FX** | | | | | |
| CPI (pavg) | -0.8 | 2.1 | 2.8 | 3.1 | 2.7 |
| CPI (eop) | 0.1 | 2.8 | 2.7 | 3.7 | 2.4 |
| Central bank reference rate (eop) | 0.00 | -0.39 | -0.50 | -0.49 | -0.49 |
| USD/BGN (eop) | 1.86 | 1.63 | 1.71 | 1.72 | 1.66 |
| EUR/BGN (eop) | 1.96 | 1.96 | 1.96 | 1.96 | 1.96 |
| USD/BGN (pavg) | 1.77 | 1.74 | 1.66 | 1.75 | 1.69 |
| EUR/BGN (pavg) | 1.96 | 1.96 | 1.96 | 1.96 | 1.96 |

Source: BNB, Eurostat, NSI, UniCredit Research

*Long-term foreign currency credit rating provided by Moody's, S&P and Fitch, respectively

## Bulgarians go to the polls amid record low unemployment

**Two positive developments were behind the upward revision in our 2019 GDP forecast**

We upwardly revised our real GDP growth forecast for this year to 3.5% from 3.3%, while downwardly revising our 2020's estimate to 2.9% from 3.1%. The upward revision of growth this year reflects a combination of stronger-than-expected export growth and solid improvement in labor market conditions, amid a marked rebound in job creation and wage growth.

**External factors will weigh on growth next year**

However, GDP growth is set to slow in 2020, as external factors including weaker eurozone demand, global trade and US growth would act as a drag according to our global scenario. These three factors would not only lead to weaker demand for Bulgarian exports, but also to increased uncertainty, which will likely weigh on business investment growth. The latter was already visible in recent sentiment surveys, where global uncertainty topped the list of industry managers' concerns after a prolonged period when labor shortages were the number one factor constraining Bulgarian companies' expansion plans (see chart).

**Domestic demand will remain resilient next year**

Domestic demand will remain robust next year, although it might not fully mitigate the impact of the external shocks envisaged in our global scenario. The ruling GERB party plans another 10% increase in public sector wages and salaries in 2020, which in the context of tight labor market conditions should spill over onto the rest of the economy, triggering a private sector wage increase of a broadly similar proportion. Improvement in the purchasing power of households is anticipated to draw support not only from the ongoing labor market strength, but also from the acceleration of retail credit which could peak this or next year. Another factor that will likely support private consumption growth in 2020 would be easing inflation, due to cheaper oil prices and the EUR-USD exchange rate moving higher in our global scenario.

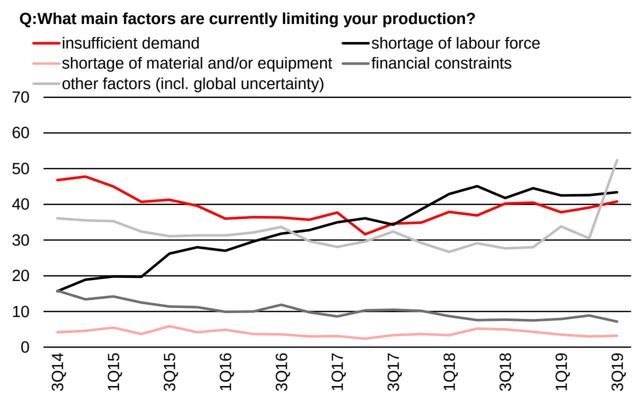
**Fiscal policy will also help the economy avoid a sharper growth deceleration**

Fiscal stimulus in the form of stronger infrastructure anticipated next year will also help to mitigate the impact of the external shocks. Three large infrastructure projects will be of particular importance. These are the Hemus motorway (for the completion of which BGN 1.2bn was already set aside from the budget surplus last year), reconstruction of the Sofia-Plovdiv railroad (an EU funded project already awarded to an international consortium which is likely to start in 2020 when all appealing procedures are over), and completion of the most complex sections of the Struma highway (another EU funded project that remained blocked for years by a dispute about the selection of the final route before a compromise emerged early this year).

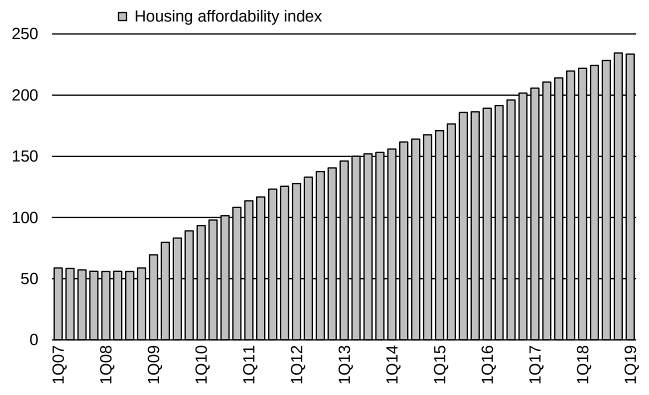
**Despite rising wages and scarce labor, the real estate contribution to investment is set to increase**

Investment will also be spurred by real estate. Demand for housing remains very strong as affordability ratios (reflecting housing prices, wages and price of credit) improved to their highest levels since joining the EU (see chart). Demand is unlikely to weaken even if economic growth slows moderately next year, as housing prices are likely to rise further, while regulators do not seem inclined yet to tighten prudential regulations via introduction of caps on prudential ratios.

**FACTORS LIMITING PRODUCTION IN INDUSTRY**




**HOUSING AFFORDABILITY REACHED ITS HIGHEST LEVEL**




Source: Eurostat, NSI, UniCredit Research

**Solid progress was achieved in the implementation of the euro adoption road map**

The comprehensive review which the ECB conducted on six Bulgarian banks offered no surprises. All six banks met the minimum own funds requirements of Art.92 of Regulation (EU), No 575/2013 of the European Parliament and the Council (see chart). At the same time, the comprehensive review came to the conclusion that two lenders need to strengthen their capital positions. In response to the follow-up actions undertaken by the BNB the two banks are currently in a process of preparation and coordination of capital plans, which should address the capital shortages identified during the asset quality review and the stress tests. Tangible progress was also made in other areas which are part of the road map to euro adoption. These include strengthening the implementation of the anti-money laundering framework, improving the governance of state-owned enterprises, and developing a macro-prudential framework. All these have boosted Bulgaria's chances to soon join simultaneously ERM II and the Banking Union, in line with the agreement signed with the finance ministers of EA member states and the ECB in June 2018. The latter was noted by credit rating agencies, with all three now having a positive outlook on their long-term foreign currency ratings of the Bulgarian sovereign.

**GERB is well placed to keep control over local administrations**

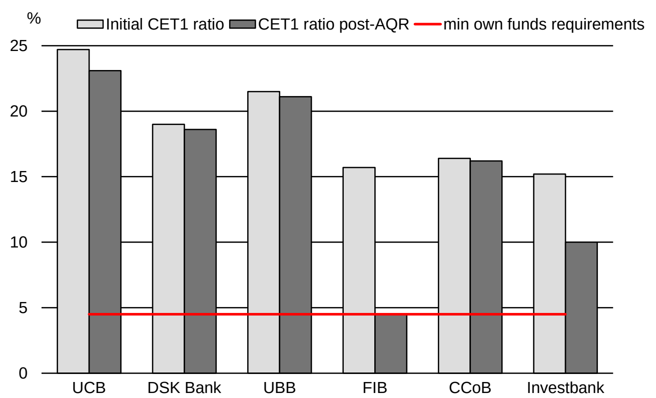
Bulgarian voters will go to the polls for municipal elections on 27 October (with a run-off on 10 November). The vote comes at a time when the economy is in its fifth year of expansion, while unemployment is at its lowest level in 30 years. Surveys available in early September suggest that there are no major changes in voters' preferences when compared with the EU parliamentary elections in May. The most likely scenario is that GERB will keep its control over local administrations, although some losses can be expected, especially in the northern parts of the country where incomes, employment and public infrastructure investment are lagging.

**The vote in the capital city Sofia is likely to be the most polarizing and unpredictable…**

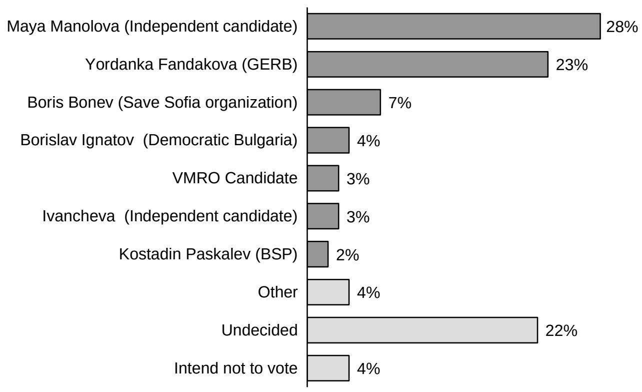
**…it will be a testing ground for a potential change in the balance of political power on a national level**

The election outcome in Sofia is particularly hard to predict (see chart). Sofia has traditionally been a stronghold of right-wing parties. In the last decade, it has been ruled by the second most prominent figure in the GERB party, Mrs. Yordanka Fandakova, who announced her decision to run for a third term. It is hard to say whether the pragmatic and results-oriented approach of Mrs. Fandakova will prove appealing to voters once again. The problem is that the scandal with the purchases of luxury apartments at below market prices by GERB leaders which erupted in May and already led to the resignation of one of the party's deputy chairmen, will hurt her. It is still fresh in voters' memory and may weigh heavily not only on her but also on the GERB's performance in the rest of the country, particularly if the size of the protest vote proves significant. Her opponent, former Ombudsman Maya Manolova, understands this and is likely to turn the election campaign into a morality play, promising to provide an alternative to the mainstream political culture. Such a strategy may backfire, however, given some controversial episodes in her own political career and particularly her involvement in the nomination of Delyan Peevski, a local oligarch and media mogul, as head of the powerful state agency for national security back in 2013, which sparked widespread anticorruption protests that eventually led to the resignation of Prime Minister Oresharski's left-wing government.

**ALL BANKS MET THE MINIMUM OWN FUNDS REQUIREMENTS**




**THE CAPITAL CITY SOFIA BRACES FOR CRUNCH ELECTIONS**




Source: Bulgarian polling agency Gallup International, ECB, UniCredit Research

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