Bulgaria

Baa1 stable/BBB positive/BBB positive*

Outlook

An increase in the protest vote resulted in an even more fragmented National Assembly. However, pro-European parties have a strong majority in the national legislature and are most likely to form the next government. We remain optimistic about Bulgaria meeting the inflation criterion for euro adoption in 4Q24. Once the inflation criterion has been met, Bulgaria is likely to request a reassessment in 4Q24, which should pave the way for eurozone entry in the course of 2025. Against this favorable backdrop, our baseline macro scenario envisages real GDP growth accelerating to 2.5% this year and further to 3.1% next year.

Strategy

Bulgaria is likely to tap the Eurobond market in 4Q24, after having met the inflation criterion for euro adoption. A solid increase in domestic borrowing is likely this year and next, because the sovereign needs to roll over large volumes of maturing domestic debt, while, at the same time, it is likely to be willing to sterilize some of the additional liquidity that the drop in the rate of minimum required reserves (to 1% upon euro entry from 12% now) would generate over the course of next year.

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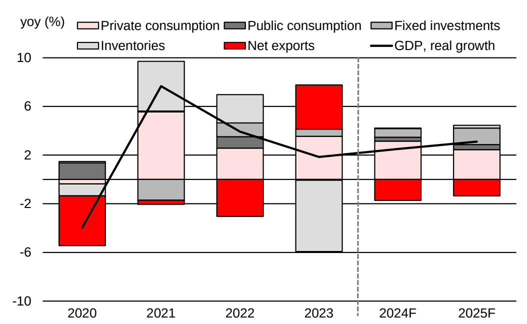
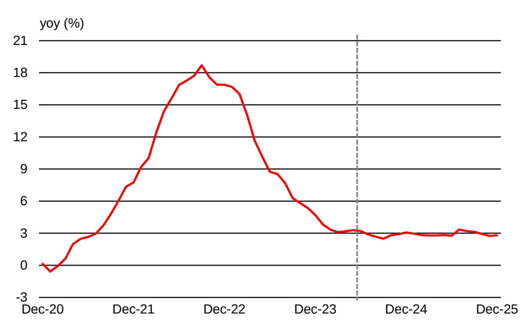
KEY DATES/EVENTS

- 26 July: sovereign-rating review by Moody's
- 15 July, 16 August, 16 September: CPI
- 14 August, 5 September: 2Q24 GDP (flash, structure)
- 24 September: nationwide house-price index for 2Q24

GDP GROWTH FORECAST



INFLATION FORECAST



Source: National Statistical Institute, UniCredit Research

MACROECONOMIC DATA AND FORECASTS

	2021	2022	2023	2024F	2025F
GDP (EUR bn)	71.1	85.8	93.9	100.3	107.7
Population (mn)	6.8	6.4	6.4	6.4	6.3
GDP per capita (EUR)	10 390	13 307	14 576	15 788	17 191
Real economy, change (%)					
GDP	7.7	3.9	1.8	2.5	3.1
Private consumption	8.5	3.9	5.4	4.6	3.5
Fixed investment	-8.3	6.5	3.3	3.9	7.4
Public consumption	0.4	5.5	-0.4	1.9	2.5
Exports	11.2	11.6	-1.9	2.3	4.4
Imports	10.7	15.0	-6.3	4.5	5.9
Monthly wages, nominal (EUR)	798	905	1029	1134	1223
Real wages, change (%)	9.0	-1.9	4.0	7.3	5.1
Unemployment rate (%)	5.3	4.1	4.3	4.3	4.0
Fiscal accounts (% of GDP)					
Budget balance	-3.9	-2.9	-1.9	-2.9	-3.0
Primary balance	-3.5	-2.5	-1.7	-2.4	-2.5
Public debt	23.4	22.1	22.5	24.5	25.9
External accounts					
Current-account balance (EUR bn)	-1.2	-1.2	-0.3	-0.6	0.1
Current-account balance/GDP (%)	-1.7	-1.4	-0.3	-0.5	0.1
Extended basic balance/GDP (%)	1.1	1.9	4.4	4.4	5.5
Net FDI (% of GDP)	1.8	2.4	3.3	3.2	3.5
Gross foreign debt (% of GDP)	58.1	51.6	48.3	46.4	44.3
FX reserves (EUR bn)	34.6	38.4	41.9	43.5	46.4
Months of imports, goods & services	9.4	7.4	9.0	8.7	8.5
Inflation/monetary/FX					
CPI (pavg)	3.3	15.3	9.6	2.9	2.8
CPI (eop)	7.8	16.9	4.7	3.1	2.7
LEONIA (eop)	-0.53	1.82	3.80	3.10	EUR
USD-BGN (eop)	1.65	1.86	1.81	1.79	1.73
EUR-BGN (eop)	1.96	1.96	1.96	1.96	EUR
USD-BGN (pavg)	1.73	1.85	1.80	1.82	1.76
EUR-BGN (pavg)	1.96	1.96	1.96	1.96	EUR

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

New pro-European government to try to end political impasse

Surge in support for populist parties has made parliament even more fragmented

The snap general election held in parallel with the European Parliament election produced a surge in support for populist parties. Another ultra-nationalist, Eurosceptic, populist party, Grandeur (Velichie), benefited most from the protest vote and cleared the 4% hurdle for entry into parliament. As a result, Bulgaria's legislature has become even more fragmented, with the number of parties in it having increased to seven (see chart). However, while support for populist parties, including pro-Russian parties, increased and became more radicalized, pro-European parties remain in control of the local legislature. When taken together, the three largest pro-European parties in Bulgaria have 154 MPs in the 240-seat parliament.

Pro-European government looks most likely

In our view, the two largest pro-European parties will form a government, perhaps supported by the supposedly more moderate nationalist-conservative party There is Such a People (ITN). Euro adoption and full entry to the Schengen area will then remain key priorities. Improving absorption of EU funds from the Recovery and Resilience Plan (RRP) would be also important, since the process has entered a crucial phase, when any further delay in the implementation of the structural measures needed to unlock the funding would be impossible to make up. Commitment to fiscal prudence is another priority we expect to be reconfirmed, although it is not clear whether the government would be able to free more room for public capex in the budget next year while keeping the deficit in line with the 3% requirement in the Growth and Stability Pact.

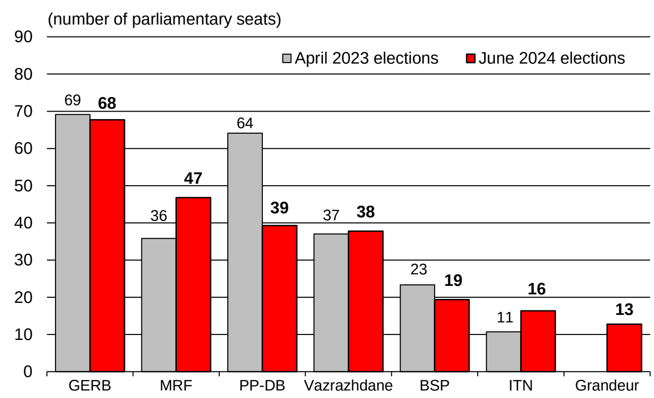
We have kept our GDP growth forecast for 2024 unchanged

We have kept our forecast for an acceleration of GDP growth to 2.5% in 2024 (from 1.8% in 2023), while we have made some changes to the composition of growth drivers. We now expect stronger private consumption growth this year, on the back of a more pronounced acceleration of real wage growth and household credit growth than we anticipated three months ago. The latter would be offset by a weaker positive contribution to growth from investment. We think political uncertainty will weigh on private sector investment and will delay the implementation of structural measures needed to push through the absorption of EU funds from the country's RRP. More specifically, we think that Bulgaria will receive three tranches from its RRP by the end of next year, compared to the four that we anticipated three months ago. Real GDP growth is likely to accelerate further to 3.1% yoy in 2025 as improved EU funds absorption and stronger external demand should help exports and investment growth to gain momentum.

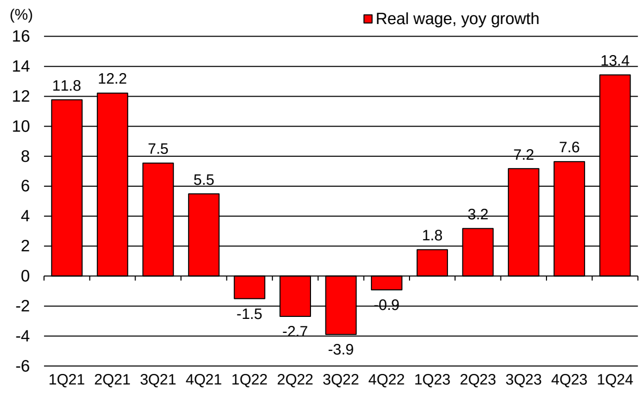
Real wage growth is set to moderate in 2025

In 1Q24, real wages posted their strongest yoy growth reading since 4Q08 (see chart). This can hardly be seen as a surprise, however, because collective bargaining on wages in most economic sectors takes place in the end of the year, which means that the last such cycle materialized in the context of very elevated inflation. Next year, wage growth is set to moderate, in our view, because the forthcoming cycle of wage negotiations will take place in November and December, when inflation is likely to bottom out at levels close to 2.5% yoy.

NEXT LEGISLATURE WILL BE EVEN MORE FRAGMENTED



RECORD HIGH REAL WAGE GROWTH WAS POSTED IN 1Q24



Source: National Statistical Institute, Central Electoral Commission, UniCredit Research

Disinflation has eased but has not bottomed out yet

We now expect average consumer price inflation to drop to 2.9% in 2024, 0.2pp lower than the projection we prepared three months ago. Lower food and energy prices in the past three months were behind the downward revision to our inflation projection. On the other side, record-high wage growth in 1Q24, which is likely to persist for most of 2024 before slowing gradually in 2025, suggests that core price inflation is set to remain sticky this year and next.

Bulgaria is likely to meet price-stability criterion in 4Q24

We remain optimistic about Bulgaria meeting the inflation criterion for euro area entry in 4Q24, after the country's 12-month average HICP went down in May to 5.1%, or 2.0pp above the reference rate (calculated as the average of the three EU countries with lowest inflation, plus 1.5pp; see chart).

Support for eurozone entry is solid locally and at the EU level

Euro adoption remains a priority for the main political parties. The preparation for Bulgaria's full membership in the euro area in terms of legislation, IT systems' connectivity and logistics of the euro currency changeover is in its final phase. At the same time, political and institutional support for Bulgaria's entry into the euro area remains very solid at the EU level.

Eurozone entry later in 2025 is our baseline scenario

We think that Bulgaria will request a reassessment in 4Q24, once it has met the inflation criterion, which should pave the way for euro area entry later in 2025. According to local and EU authorities, euro adoption later in a year is technically feasible, although it has never been done before.

Snap parliamentary vote later this year should not be ruled out

Failure to end the power struggle among pro-European parties could result in a snap election later this year. In such a scenario, companies would likely take wait-and-see approach, which would negatively affect private investment. Public investment would also suffer, because the already slow utilization of EU funds from the country's RRP (see chart) would come to a halt in 3Q24. Households would likely become more cautious about their spending, which would translate into weaker consumption than that envisaged in our baseline scenario. When taken together, these developments would likely prevent real GDP growth from rising above 2.0% yoy this year.

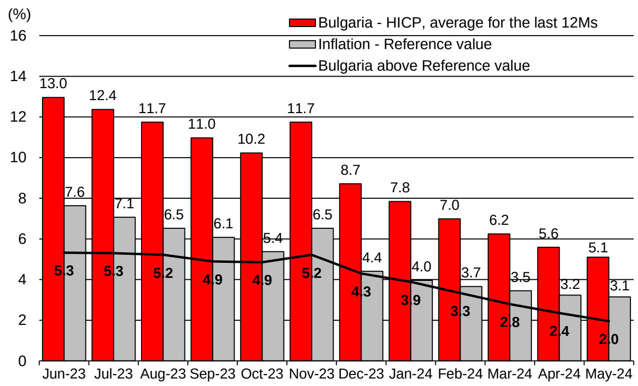
New election could negatively affect GDP growth this year

This scenario would increase risks for budget execution, which, in turn, could delay the timely completion of the euro adoption process. Large infrastructure projects and structural measures necessary to make growth more inclusive and to reduce poverty would have to wait as well.

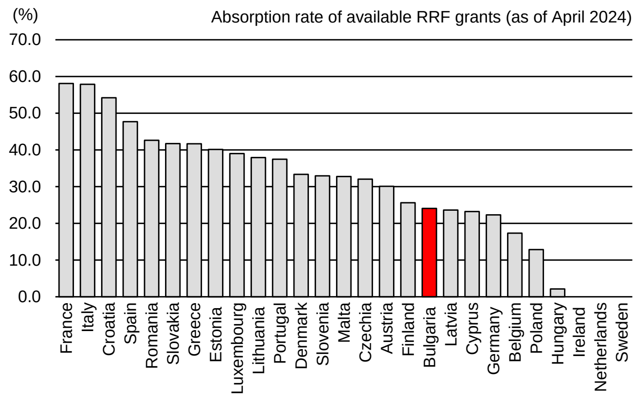
Uncertainty would increase significantly if Eurosceptic parties were to form a government

In the worst-case scenario, the new snap vote would produce a parliament in which populist and Eurosceptic parties have a majority and form a government. This could temporarily shift the course of policymaking away from the deepening of EU integration and the underlying structural reforms. It is hard to say from today's perspective what exactly policymaking would look like in this scenario, because the populist and Eurosceptic parties have so far failed to articulate a clear alternative vision for the country's future. What appears certain, however, is that support for Ukraine would end, because the main priority would be to shift the country's geopolitical orientation more toward Russia at the expense of less weight of Western Europe and Euro-Atlantic cooperation. In addition, euro adoption can be temporarily scrapped. These would likely undermine confidence, which would negatively affect investment that is crucial for the country's efforts to modernize its economy and boost its living standards.

BULGARIA LOOKS CLOSE TO MEETING INFLATION CRITERION



ABSORPTION OF RRP-RELATED FUNDING HAS BEEN SLOW



Source: Eurostat, European Commission, UniCredit Bulbank

Note: The reference value is calculated as 1.5% plus the average of the three best performers in terms of price stability, excluding countries currently in deflation.

Domestic bonds issuance to rise this year and next

Lack of stable government has not negatively affected fiscal performance

Political instability, which caused another snap vote in June, has not negatively affected fiscal performance for the time being. The state budget posted a surplus of 0.1% of GDP for January-May 2024, compared to a 0.6% deficit in the same period last year. However, the stronger fiscal result in 2024 largely reflects BGN 1.2bn that was transferred back into the budget from a special fund that had been set aside from the fiscal revenue overperformance in 2023 to finance small municipal infrastructure projects. When this is taken out, the budget balance so far this year is equal to that of last year, which is positive for two reasons. First, this is because there has not been a major increase in fiscal expenditure, despite the easing of spending control that usually occurs as a result of elections (on top of the extra costs associated with organizing polling stations). Second, and more importantly, this is because the risk that the lack of a stable government will encourage tax evasion and cause fiscal revenues to slow has not materialized, according to data available at the time of writing.

Maintaining fiscal discipline will remain a priority

We see no major risks for budget execution this year. This is because all parties that are likely to form the next government seem committed to maintaining fiscal prudence. At the same time, stronger-than-expected wage growth this year is likely to push personal income tax revenues and social-contribution payments higher than initially planned, while a gradual recovery in Bulgaria's main trading partners that our global macro scenario envisages in 2H24 is likely to provide additional support to fiscal revenues in the remainder of the year. Next year, we see less room for fiscal policy to stimulate consumption, because public capex will have to increase, since absorption of EU funds from the country's RRP enters its most crucial phase.

Domestic borrowing increased to BGN 900mn

Three more auctions have been held since April, pushing the cumulative amount of domestic borrowing to BGN 900mn so far this year. In addition, the minister of finance in the caretaker government revealed plans to issue BGN 1.95bn of bonds on the domestic market throughout the rest of 2024. If a total of BGN 2.85bn in domestic bonds are issued this year, we expect EUR 3.8bn worth of bonds to be issued externally. We think the sovereign will tap the Eurobond market in 4Q24, after Bulgaria has met the inflation criterion for euro area entry.

Record high domestic issuance looks likely next year

The volume of domestic borrowing will increase to a record high of BGN 4.5bn next year, in our view. This seems justified, because Bulgaria would need to roll over maturing domestic debt worth BGN 3.4bn in 2025. On the other hand, it would help to sterilize some of the additional liquidity that the drop in the rate of MRR (to 1% upon euro area entry from 12% now) would generate in a local financial-services market that is already considered flush with liquidity.

GROSS GOVERNMENTAL FINANCING REQUIREMENTS

EUR bn	2023	2024F	2025F
Gross financing requirement	**4.2**	**5.0**	**5.6**
Budget deficit	2.8	3.0	3.2
Amortization of public debt	1.4	2.0	2.4
Domestic	0.0	0.3	2.2
Bonds	0.0	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	**4.2**	**5.0**	**5.6**
Domestic borrowing	0.0	1.4	2.3
Bonds	0.0	1.4	2.3
Bills	0.0	0.0	0.0
Loans/other	0.0	0.0	0.0
External borrowing	4.2	3.8	3.2
Bonds and loans	3.8	3.8	3.2
IMF/EU/other IFIs	0.4	0.0	0.0
Privatization/other	0.0	0.0	0.0
Change in fiscal reserves (- =increase)	0.0	-0.2	0.1

GROSS EXTERNAL FINANCING REQUIREMENTS

EUR bn	2023	2024F	2025F
Gross financing requirement	**23.5**	**23.7**	**21.8**
C/A deficit	0.3	0.6	-0.1
Amortization of medium- and long-term debt	6.1	5.9	4.3
Government/central bank	1.4	1.7	0.2
Banks	1.1	1.4	1.5
Corporates/other	3.6	2.8	2.6
Amortization of short-term debt	17.2	17.2	17.7
Financing	**23.5**	**23.7**	**21.8**
FDI (net)	3.1	3.2	3.8
Portfolio equity, net	-1.2	-2.4	-2.4
Medium and long-term borrowing	8.6	6.5	5.0
Government/central bank	4.2	3.8	3.2
Banks	1.8	1.5	1.5
Corporates/other	2.6	1.2	0.3
Short-term borrowing	17.2	17.7	18.1
EU structural and cohesion funds	1.3	1.7	2.0
Other	-2.0	-1.3	-1.9
Change in FX reserves (- = increase)	-3.5	-1.6	-2.9
Memorandums:			
Nonresident purchases of LC gov't bonds	0.0	0.0	0.0
International bond issuance, net	2.6	2.3	3.2

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

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