

Macroeconomic bulletin

Autumn 2022

November
2022



Sovereign credit rating

Bulgaria

MOODY'S
Baa1 stable

S&P Global
Ratings
BBB stable

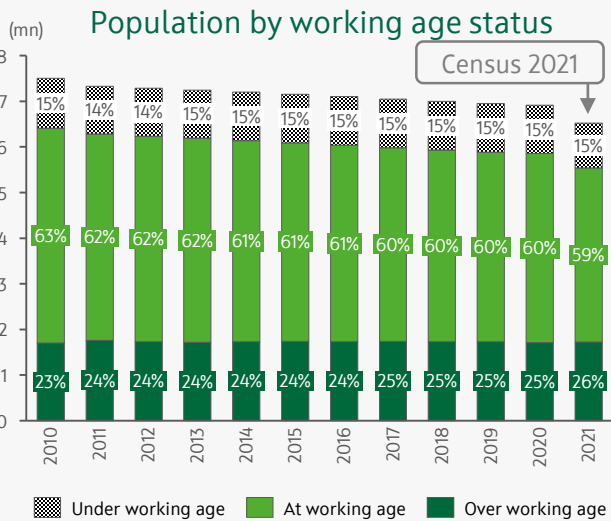
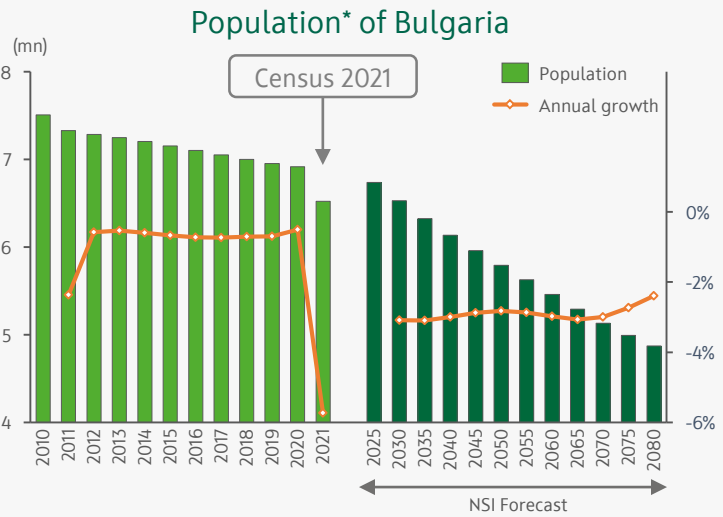
FitchRatings
BBB positive

- ❖ The energy crisis that has emerged in Europe in the fallout of the Russian invasion of Ukraine and all of the economic uncertainties that have emerged as a result continue to dominate the economic outlook for the entire continent, including Bulgaria. In the subsequent months it became clear that the war will most likely last much longer than expected initially (possibly for years) and the implications of the geopolitical and economic divorce between the European Union and Russia, will have deeper and longer-lasting consequences than we realized back then.
- ❖ Our macroeconomic forecast aims to account for these consequences in greater detail, especially as they pertain to the short-term energy supply issues from which the entire European Union is suffering. The jeopardizing of Europe's energy security has also further exacerbated already existing inflationary trends and has caused a full-blown inflationary crisis, with inflation reaching its greatest levels for the past two to three decades, across all EU member states. Thus, the overarching theme of our framework, in all of its scenarios, are the macroeconomic risks posed by the energy-inflationary crisis.
- ❖ In addition to the complicated international geopolitical and economic environment, we also take into account the unstable political situation in Bulgaria, which may further worsen the macroeconomic environment, especially in the fiscal sector.

Demographics

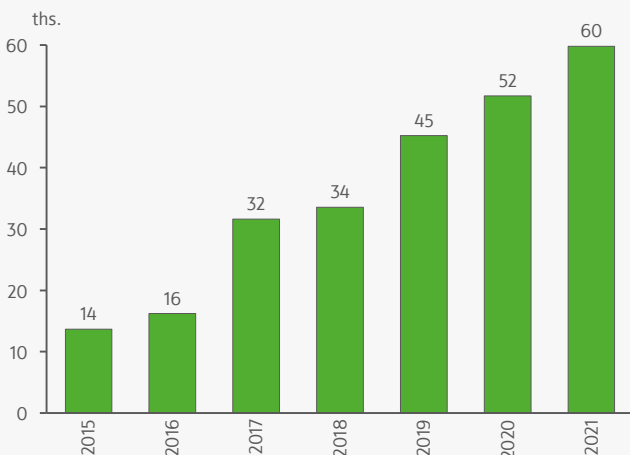
Without a radical demographic strategy, the population will continue to decline

After the population census conducted in the fall of 2021, the results confirm the deepening of the negative demographic trends that have existed in the country for the last 30 years - reduction and aging of the population, depopulation of individual territories of the country as a result of negative natural growth and migration processes.

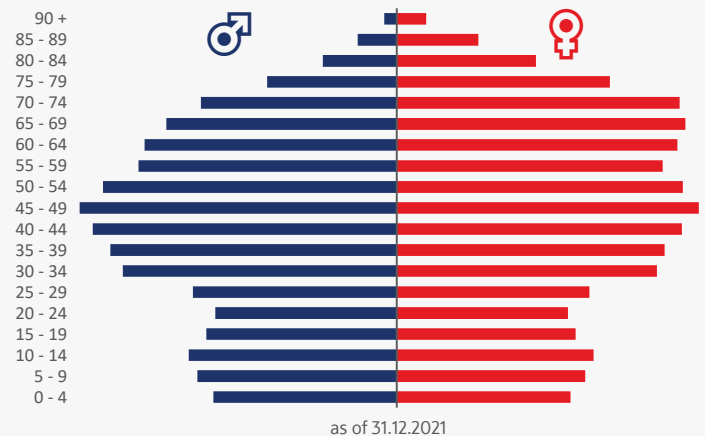


If urgent long-term social measures are not taken, the demographic processes will deepen in the long term. Bulgarian business is already feeling the consequences of the demographic crisis in the form of a labor shortage, incl. and qualified. The indicator measuring the business climate in the country shows this trend as being most tangibly felt in the "Construction" and "Industry" sectors, which are one of the most important sectors for strong and constant economic growth of the GDP.

3-country nationals holders of long-term/permanent residence



Population pyramid: The process of ageing continues



* Population forecast to 2080 are based on the 2011 Census.

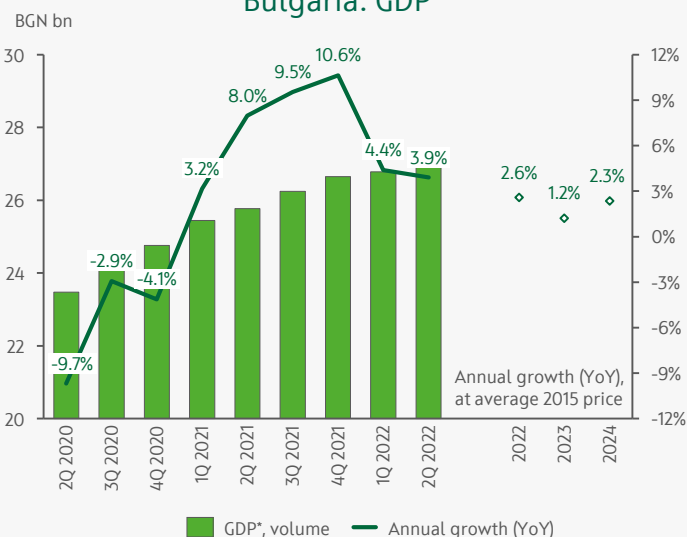


Gross Domestic Product

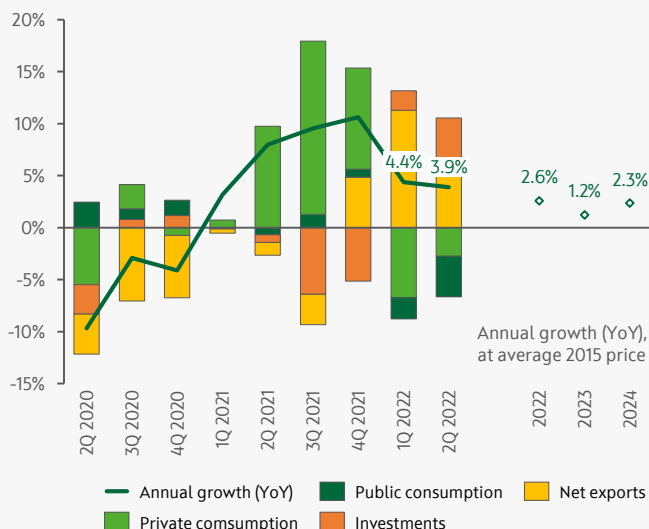
2Q 2022: Relatively strong quarter for GDP

The breakdown of GDP by components shows that the positive contribution of **net export** has been the key driver of GDP growth over the past two quarters. **Private consumption** growth will slow over the forecast period as a result of inflationary pressures and increased economic and geopolitical uncertainty. This decline is expected to be partially offset by increased **public consumption** aimed at supporting households and businesses from rising energy prices, along with increased incomes for the population relatively more affected by rising prices. This points to a further deterioration in the contribution of private consumption to GDP in the near-term.

Bulgaria: GDP

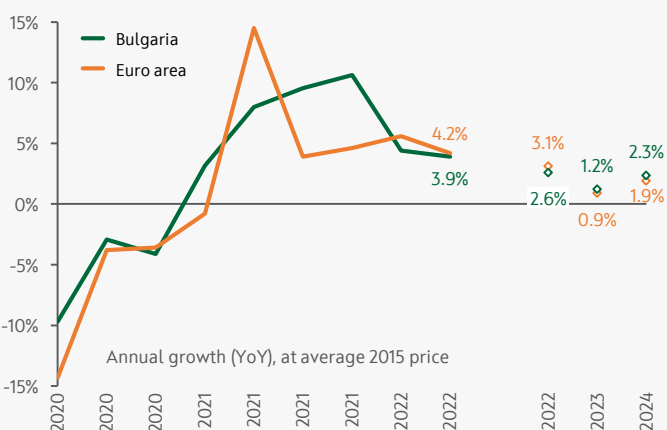


GDP* by components



For 2022, **investments** will make a negative contribution to GDP growth, although by mid-2022 they are making a positive contribution. The high sensitivity of the **investments** to the uncertain

GDP, Bulgaria vs. Euro area



political environment and rising interest rates, they are not expected to see significant increases or decreases in the medium term overall. The approach to fiscal policy in Budget 2023 is likely to remain quite similar to the one characterizing Budget 2021 & 2022 with a large focus on social spending, generous discretionary spending in general and a rising deficit. Based on the external macroeconomic environment and the recent trend in foreign trade, we expect the positive contribution of **net exports** to GDP to remain similarly large throughout the rest of 2022.

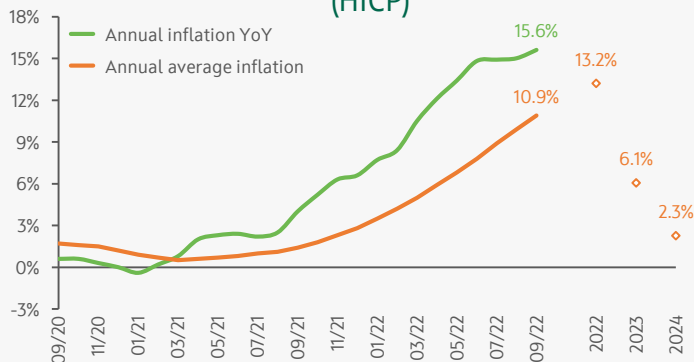
*Seasonally and calendar adjusted data



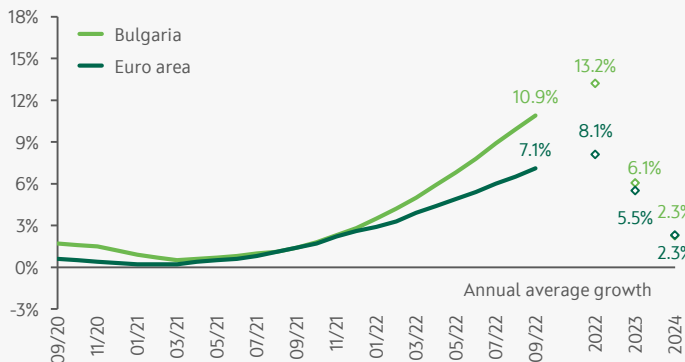
Inflation

The main driver for inflationary pressure remains the prices of energy sources

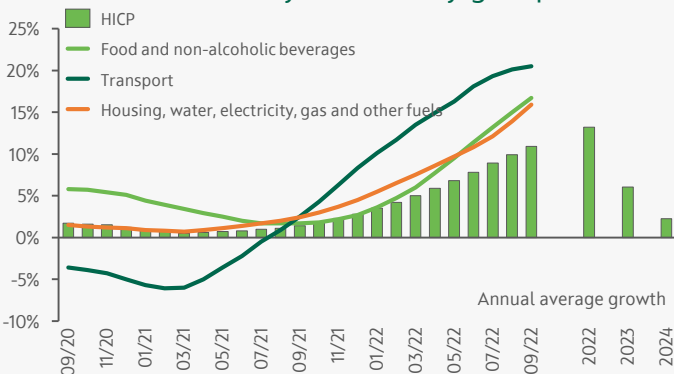
Harmonized Indices of Consumer Prices (HICP)



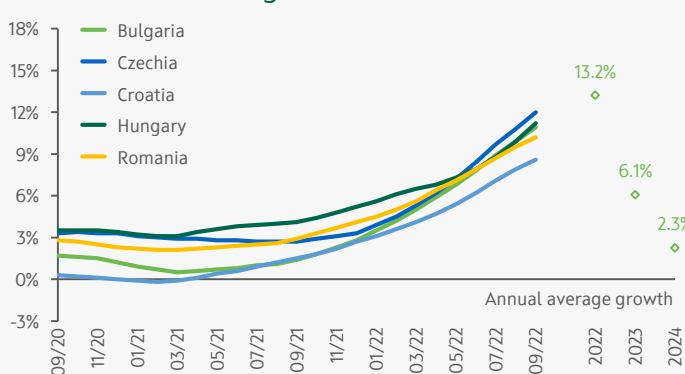
HICP, Bulgaria vs. Euro area



HICP by commodity group*

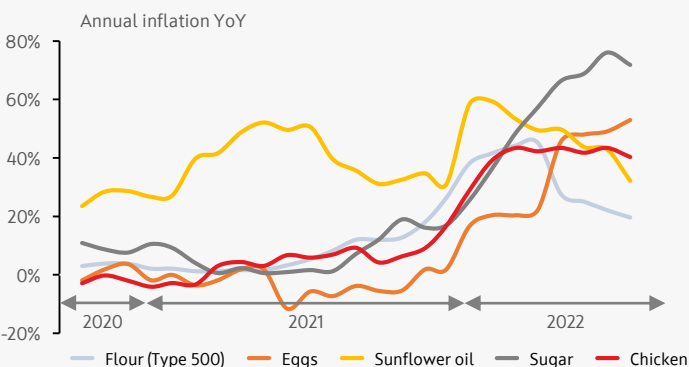


HICP, Bulgaria vs. CEE countries



The latest NSI data shows that in September **inflation** in Bulgaria reached a new high since the hyperinflationary crisis of the 1990's. We expect consumer price **inflation** to remain very high, but stabilize and likely slightly ease by 4Q 2022. For the year overall, we expect it to be 13.2%. The energy crisis, which is significantly exacerbated by the Russian invasion of Ukraine remains a very acute issue and its negative impact on EU economies in our view will peak in 4Q 2022 and 1Q 2023. This is our assumption, under which the crisis for EU states will be mostly resolved by 2H 2023, with alternative energy sources available by then, leading to a decline of natural gas prices.

Basic food inflation



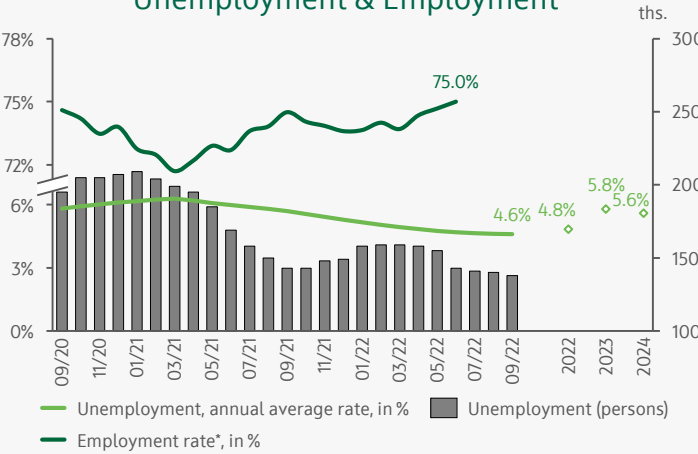
As a result of the expected slowdown in energy **inflation** by 2H 2023, we expect overall inflationary pressures to abate in 2023 and consumer **inflation** to ease to 6.1%. Thereafter, we expect inflation to ease further to 2.3% in 2024 as the energy crisis is completely resolved by then, under our baseline assumption.

*Three consumer groups with the largest weights in the HICP general basket are presented.

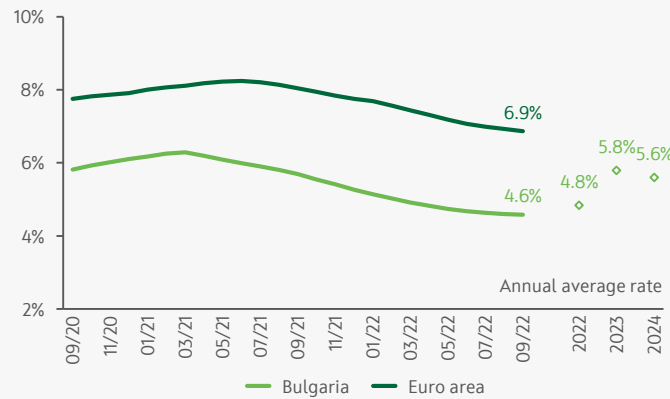
Labor market


Business needs skilled workers, the nominal wage continues to rise

Unemployment & Employment*

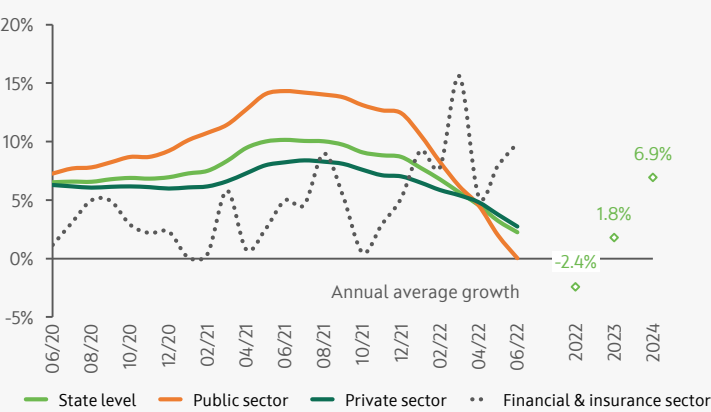


Unemployment, Bulgaria vs. Euro area

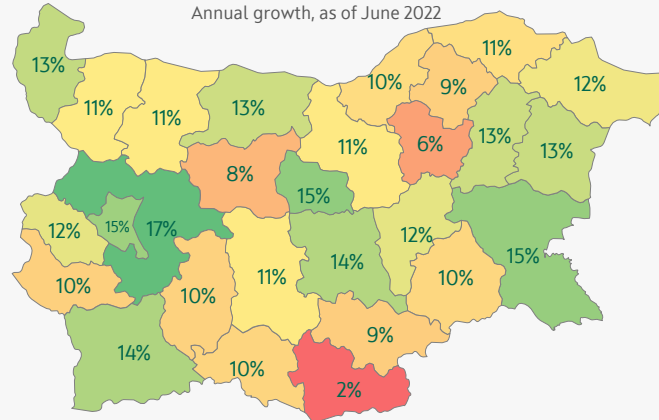



 **Labour market** data suggests that from 3Q 2022 onwards the Bulgarian economy has been operating at or very close to full employment. The unemployment rate has stayed below 5% since 3Q 2021, very close to the record pre-pandemic lows of 2019. We note that the **labour market** in Bulgaria has been very tight, with shortages of qualified workers plaguing many sectors in recent years. Recent data suggests that this tightness may have made the **labour market** less sensitive to GDP growth dynamics.

Real wage by sectors



Nominal wage by location



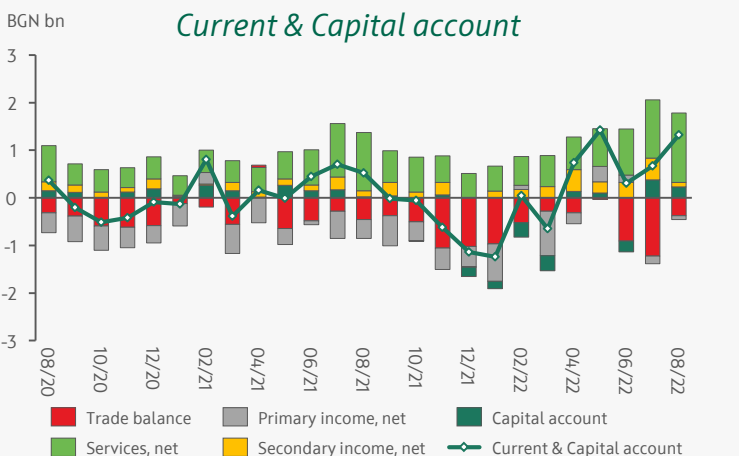
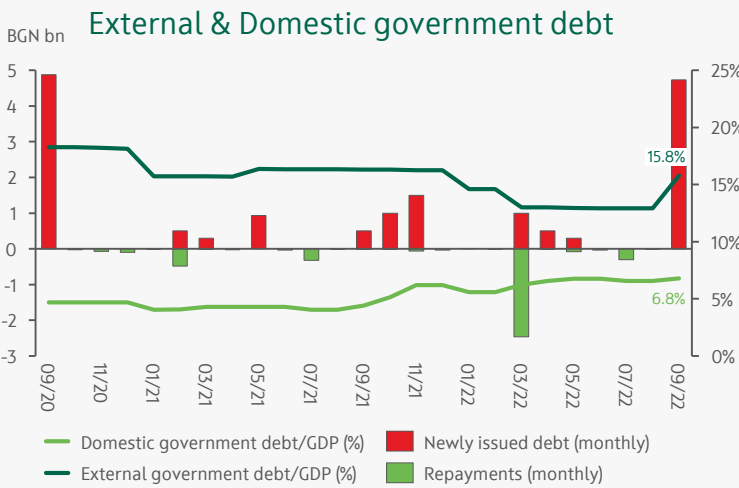
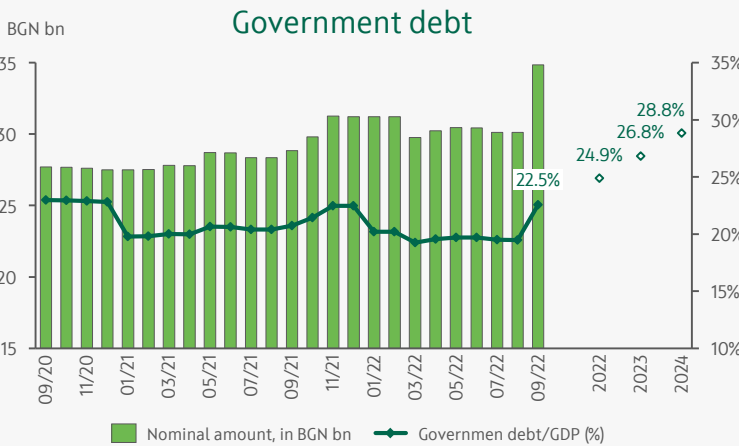
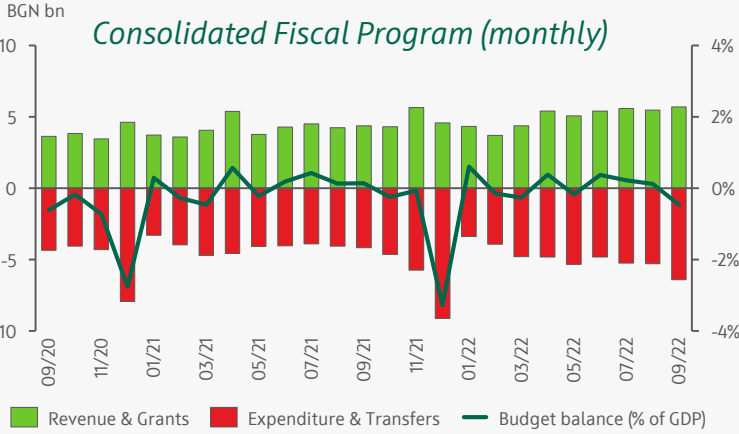
 **Nominal wage** growth has continued to rise at a strong pace recently. We expect it to slightly decelerate, but maintain a double-digit pace in 3Q and 4Q, totaling 12.2% for 2022 overall. However, despite this otherwise strong rate of growth, in **real terms wages** are likely to contract in 2022, as inflation exceeds nominal wage growth by several percentage points. As output growth eases and **unemployment** rises, **wage** growth will ease by about 300 bps in 2023, but **real wages** will post a slight increase as inflation decelerates. We expect wage growth to reach ca. double-digit pace by 2024 as GDP growth picks up again and **unemployment** falls below 6%.

*Unemployment rate is for the age range of 20 - 64 years of age.



State budget

Ongoing political volatility in Bulgaria is the key downside risk



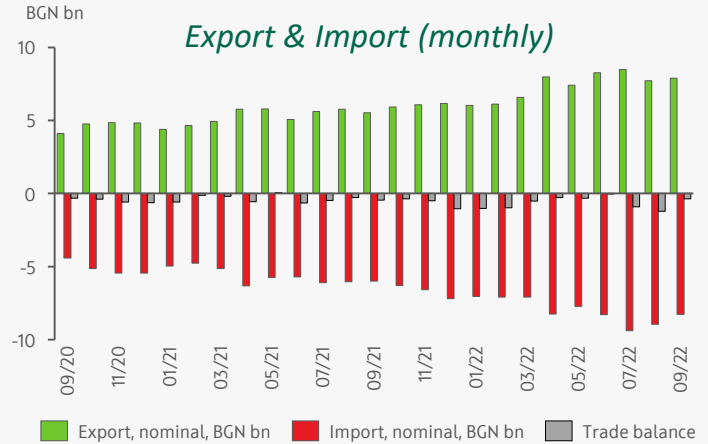
We expect the government deficit target of 4.1% of GDP to be met in 2022, despite the expected slowdown in economic growth. The very high level of inflation has boosted nominal tax revenue and has led to a better than expected revenue outturn in 1H 2022. In addition, given the budget execution trend so far, we think that the execution of capital spending will most likely fall below what was planned in Budget 2022. As a result of lower-than-planned execution of capital expenditures at the end of the year a surplus will be generated. We think that given the volatile political situation in the country and under the pressure of energy prices in the winter, any such surplus is likely to be directed towards support measures for household and businesses, while the planned deficit of 4.1% of GDP is maintained.

Ongoing political volatility in Bulgaria is the key downside risk to our fiscal projections, and we note that if political instability persists, the fiscal deficit may remain at a deeper level than what we expect, even in the context of an improving macroeconomic environment.

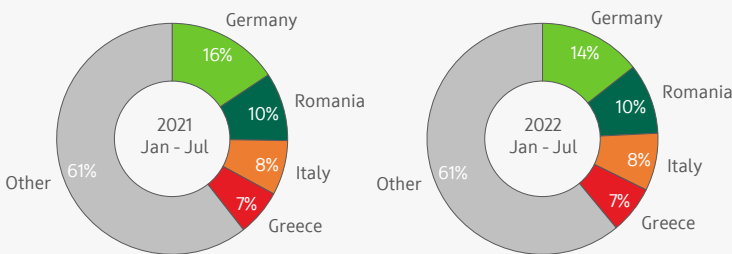
Trade & Investment

Energy resource prices are a major factor in the significant annual growth of net exports

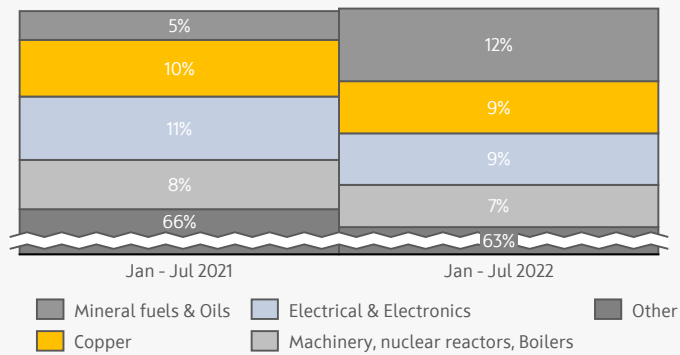
The positive contribution of net exports to GDP in 1H 2022 rose to the highest level since 2008. Based on developments in the external macroeconomic environment, and the recent trend in foreign trade data, we expect the positive contribution to remain similarly large throughout the rest of 2022.



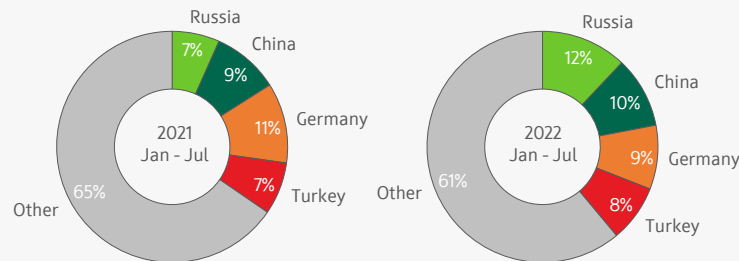
Export, main trade partners



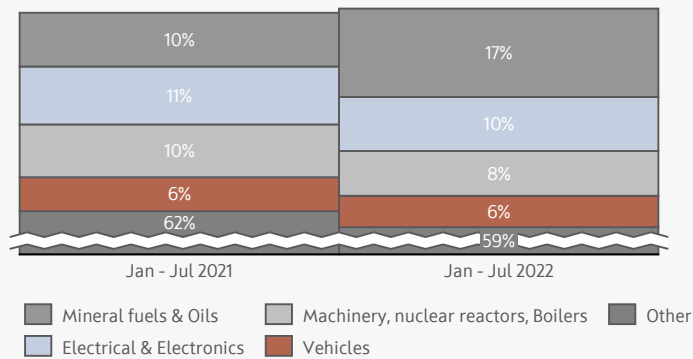
Export by category



Import, main trade partners



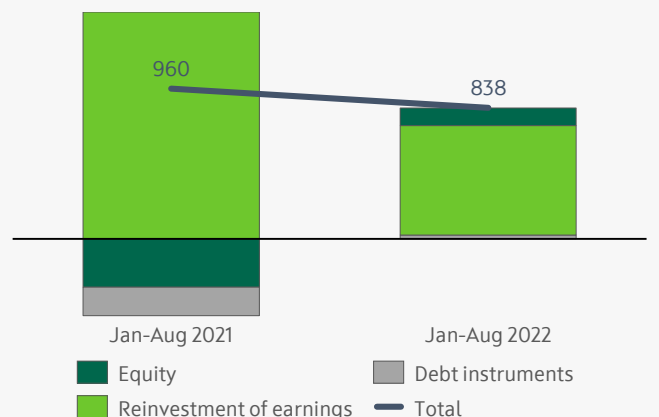
Import by category



Export & Import: Economic activity in the last year has seen significant growth, and this determines the serious growth of net export both to EU members and to Non-EU countries. Despite the increased economic activity, one of the main drivers for the dynamic of net export remains inflation/prices of energy sources.

Investment is falling down and this trend is expected to continue in long-term.

Direct Foreign Investments (DFI)



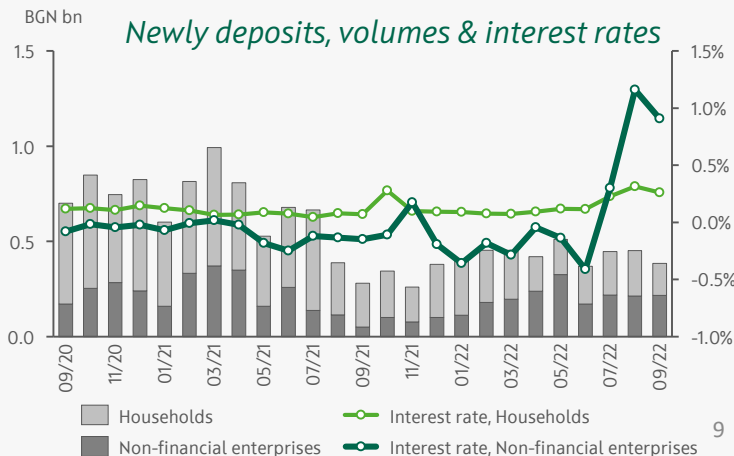
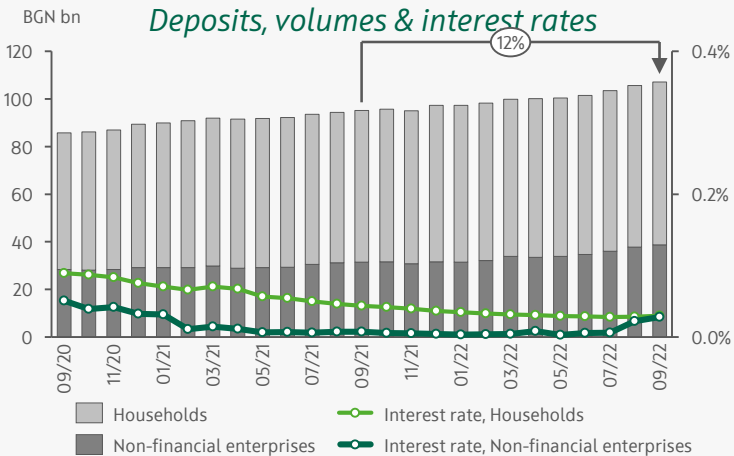
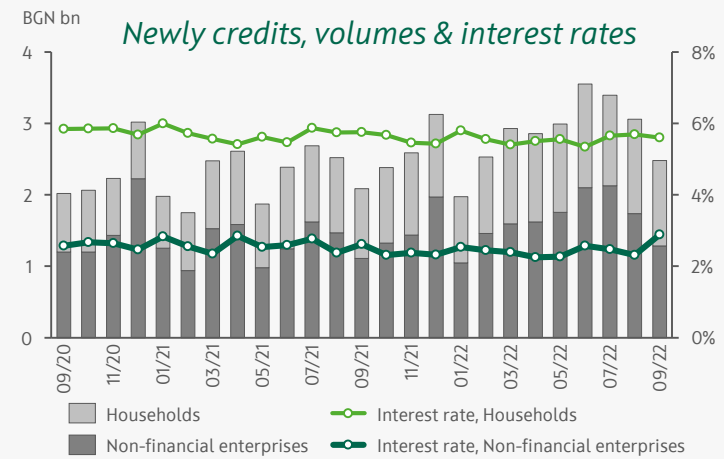
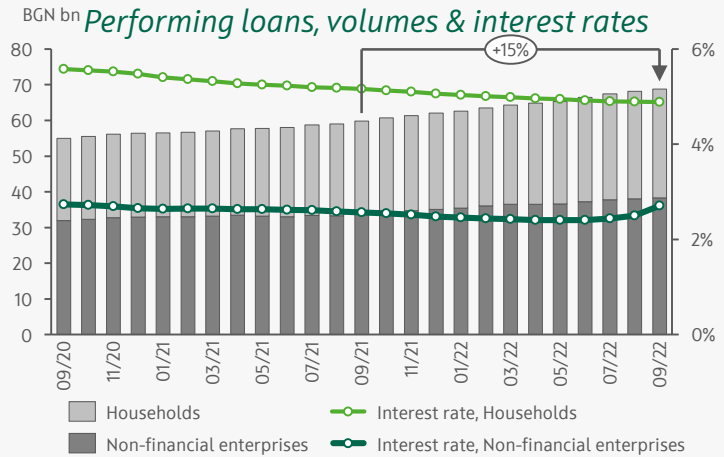
Banking system

The profitability of Bulgaria's banking sector continued to improve in Q3 2022

Credit growth also continued to be very high in H2 2022, but we expect a slowdown in both lending and deposit growth towards the end of 2022 and especially in 2023. This projection is based on several key macroeconomic developments. Although Bulgaria is not part of the Eurozone, its banking system is very closely integrated in the Eurozone banking market, and the tightening of the monetary policy of the European Central Bank will apply an upward pressure on interest rates.

The rise in interest rates will depress credit demand, as the financial situation of households and businesses is significantly strained due to the inflationary crisis. Under the assumption that inflation will start easing substantially in the latter half of 2023 and will normalize in the following year, we expect ECB's hiking cycle to end by that point, and lending growth to start trending upwards once again.

We expect deposit growth to slightly ease in the short-term as inflationary pressures weigh on household and business finances, but will start recovering by 2024, similar to the trend in lending.



Sources

Actual data



NATIONAL STATISTICAL INSTITUTE



MINISTRY OF FINANCE, BULGARIA



BULGARIAN NATIONAL BANK



STATISTICAL OFFICE OF THE EU



MINISTRY OF AGRICULTURE, BULGARIA

Forecasts



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