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Bulgaria economy briefing:
Trends and Forecasts for the Development of the Bulgarian Economy in the Aftermath of the Covid-19 Pandemic

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Trends and Forecasts for the Development of the Bulgarian Economy in the Aftermath of the Covid-19 Pandemic

At the onset of the COVID-19 pandemic, macroeconomic conditions in Bulgaria were relatively favorable. At 3.4%, GDP growth in 2019 was robust for the fifth year in a row, mainly driven by growing household consumption. This positive trend has been interrupted by the COVID-19 outbreak.

The Bulgarian economy is small and significantly exposed to the economic impact of the COVID-19 pandemic, which presents a near-term downside risk to its performance. Fitch Rating's revised forecast for GDP for Bulgaria expects it to contract by 5.1% this year (compared with previous Fitch review forecast of 3.2% growth), before returning to 4.2% growth in 2021. The contraction is expected to be more intense compared with emerging markets' GDP decline median of 2.8%.

On the other side the European Commission has much more pessimistic prognosis for Bulgarian economy. It expects Bulgaria's gross domestic product (GDP) to shrink by 7.2% in 2020 due to the adverse impact of measures taken to contain the spread of the coronavirus pandemic, before growing by 6% in 2021. According to the EU Commission Spring 2020 Economic Forecast the sectors directly subject to these measures (e.g. retail, transport, hotels and restaurants, art and entertainment) are estimated to be operating at 30-40% of their capacity, while important negative spillover effects are also expected on the rest of the economy. Domestic demand - the main driver of Bulgaria's GDP growth in the past few years, is projected to strengthen in the third quarter of 2020 and continue growing in the fourth. However, household consumption is expected to fall by almost 6% in 2020, while investment is set to shrink by 18% this year on account of current and expected financial hardship at the firm level due to drastically reduced cash flows.

Investment, however, is expected to follow a slower recovery path with an annual growth of only one per cent, as high uncertainty and still weak business finances are set to suppress and postpone investment activity.

The lower investment will contribute to the projected 12% drop in imports, while the impact of the COVID-19 pandemic on international trade is expected to lead to a 13% decrease in exports.

Bulgaria's unemployment rate has increased significantly since the COVID-19 containment measures were put in place, boosted in part by the return of workers from abroad.

The unemployment rate is expected to jump to 7% in 2020 from the historic lows of 4.2% achieved in 2019, with job losses expected to be most pronounced in the services sector. The country's unemployment rate is then seen declining to 5.75% in 2021 with nominal wage growth expected to amount to 3.5% in 2020 and 2.25% in 2021. Job losses are set to be most pronounced in the services sector (which accounts for more than 60 per cent of employment), where the disruption is likely to last longest.

Bulgaria's consumer price inflation is expected to fall from 2.5% in 2019 to 1.1% in 2020 and stay at that level in 2021, largely due to the drop in oil prices. Core inflation is set to fall to two per cent in 2020 reflecting lower prices in non-energy industrial goods and a slowdown in services inflation. In 2021, core inflation is forecast to decelerate further to 1.3 per cent due to a smaller price increase of processed food.

Indicators	**2019**	**2020**	**2021**
GDP growth (%, yoy)	3,4	-7,2	6,0
Inflation (%, yoy)	2,5	1,1	1,1
Unemployment (%)	4,2	7,0	5,8
Public budget balance (% of GDP)	2,1	-2,8	-1,8
Gross public debt (% of GDP)	20,4	25,5	25,4
Current account balance (% of GDP)	5,2	3,3	5,4

Source: *EU Commission Spring 2020 Economic Forecast*

Seventy-nine per cent of businesses, especially micro and small ones, surveyed in sociological research between April 13 and 22 through phone interviews with 500 companies in all sectors of production and services, reported direct or indirect losses because of the coronavirus crisis. A total of 21 per cent of businesses said that the crisis had not affected them much, with 3.5 per cent seeing an increased demand for their products and services, and just fewer than two per cent re-orientating themselves to other activities. About 56.4 per cent reported a contraction in revenue in the range of 20 to 50 per cent or 50 to 90 per cent. Fifteen per cent said that their revenue was down by 100 per cent. In spite of the shock of the crisis and the downturn in activity and revenue, most companies have made serious efforts to adapt, make organizational changes, or undertake temporary restructuring to retain employees and remain ready to restart soon. The fact that a significant portion of the country’s economy remained open and some anti-crisis measures were quickly taken has allowed more than three-quarters of firms not to cut jobs so far.

Regarding Bulgarian fiscal situation the analyses of the European Commission shows that Bulgaria is facing the Covid-19 pandemic from a strong fiscal positions. In 2019, the budget surplus reached 2.1 per cent of GDP. As part of the package of measures to contain the pandemic and its impact the government announced a higher spending on medical equipment, wage bonuses and increases for the medical and security staff, as well as subsidies, tax deferrals, state guarantees and a reallocation of investment funds to support the economy. The severe macroeconomic outlook is set to increase spending on unemployment and social benefits and curtail the revenue from taxes. The overall impact on the budget is estimated to be close to 5 pps. of GDP relative to the previous year, pushing the balance into a deficit of around 2¾% of GDP in 2020 after four years of surplus. In 2021, based on a no-policy-change assumption, the budget deficit is forecast at 1¾% of GDP, mainly due to the positive impact of higher economic growth on revenues and the fading impact of some expenditure measures.

General government debt is expected to increase and reach over 25 per cent of GDP in both 2020 and 2021, as a result of the primary deficit, the contraction in GDP and certain measures to support liquidity in the economy (e.g. the capital strengthening of the Bulgarian Development Bank to provide state guaranteed loans) that do not affect the deficit but which do weigh on debt

According to other economic analyses Bulgaria looks like it will be more resilient to pandemic-induced shocks than many other EU countries. Importantly, the exchange rate mechanism (ERM II) and the country entering the banking union is expected to help to stabilize expectations at a more favorable level and to keep funding costs under control. This will not only make it easier for private-sector companies to rollover liabilities falling due this year, but will also help the public sector keep yields on new debt issuance well under control, the lender added.

On April 30, Bulgaria has officially submitted documents to the European Central Bank for membership of the ERM II exchange rate mechanism. According to the central bank governor Dimitar Radev Bulgaria is ready to enter ERM II in July. The process of entering ERM-II is now back on track after it was halted for several months. Last month, Bulgarian National Bank (BNB) and the European Central Bank (ECB) agreed to set up a 2 billion euro ($2.2 billion) precautionary currency agreement (a swap line) to provide euro liquidity. The swap line will remain in place until the end of 2020, unless it is extended. This agreement between the two central banking Institutions is not a legal requirement for ERM II entry but it can be beneficial. Outside of the technical framework, the swap line agreement is a sign of trust towards Bulgaria and its central bank. It shows that the country has a good financial reputation, and Bulgarian government consider this as especially important given the current coronavirus crisis. Banks in Bulgaria do not need euro liquidity right now so the swap line is just a kind of guarantee. According to BNB financial sector and the banks are much better prepared to meet the devastating effect of the economic crisis now compared to 2008. The current coronavirus crisis, however, could be significantly deeper.

In conclusion we may say that the strength of Bulgarian economy and the positive external and fiscal balances before the outbreak of COVID-19 should help it recover from the large economic shock caused by the pandemic. Unemployment is already increasing, albeit from historic lows, even though government support is cushioning the blow to the labor market. Investment is projected to fall sharply in 2020 and to recover partially in 2021. Household consumption, improvements in the labor market and a return of export growth should drive a recovery in 2021. A rebound in economic activity is expected in the second half of 2020 with the gradual lifting of the confinement measures. Domestic demand is projected to strengthen already in the third quarter and should continue growing in the fourth.

Generally, the economy is expected to reach its pre-crisis output level in the middle of 2022, meaning the recovery will be much stronger and much faster than the recovery following the recession triggered by the global financial crisis in 2009.

Risks to this macroeconomic outlook arise from the uncertainty on the degree of take up and success of the measures to support the economy. It is quite alarming the fact that Bulgaria's business climate has deteriorated in all observed sectors in April, according to the National Statistical Institute (NSI), as the countrywide state of emergency imposed to limit the spread of coronavirus disease severely impacted businesses. According to the NSI statistics the overall business sentiment indicator dropped by 41.7 percentage points month-on-month in April, which is 37.0 pp below the long-term average for the last 10 years, and 4.4 pp above the long-term minimum registered in February 1997. Another sociological survey dedicated to the COVID-19 situation shows that over half of Bulgarians (57%) share pessimistic attitudes towards the economic development over the next year.

Whether these pessimistic expectations will be justified or whether the more optimistic forecasts for the Bulgarian economy will come true is a question to which research cannot give a definite answer so far, as there are too many unknowns in the equation.