

## 2. BULGARIA

### Weak investment limits growth

Real GDP growth is expected to moderate from 1.7% in 2014 to 1.0% in 2015, before slightly picking up to 1.3% in 2016. An expected slowdown in public investment and continued weak private investment is likely to weigh on the growth outlook. Inflation is projected to remain negative well into 2015, but to turn positive towards the end of the year. After reaching 2.8% of GDP in 2014, the general government deficit is set to remain at 2.9% of GDP in both 2015 and 2016.

#### Growth outlook remains subdued

In the fourth quarter of 2014, real GDP of Bulgaria expanded by 0.4%, in line with the growth recorded in the previous quarter. Quarterly private consumption increased by 1.1%, its fastest pace in six quarters, probably also thanks to the boost in confidence provided by the pay-out of the guaranteed deposits of the collapsed Corporate Commercial Bank. Net exports also contributed positively to quarterly growth. Overall, real GDP growth is projected to have grown by 1.7% in 2014, supported by public investment and some recovery in private consumption after the latter dropped strongly in 2013. Economic growth is projected to moderate to 1.0% in 2015, before picking up slightly to 1.3% in 2016.

#### Domestic demand is projected to slowdown

After benefitting from low inflation and the fall in fuel prices towards the end of 2014, private consumption is expected to slow down in 2015 in line with weak wage and employment growth.

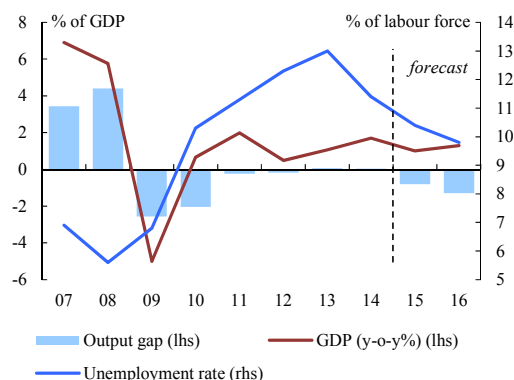
Private investment as a share of GDP has been declining since 2008, reflecting an unsupportive business environment and decreased risk appetite, also limiting foreign capital inflows. This situation is not expected to change noticeably in 2015 or 2016, as the uncertainty of the post-crisis period, prolonged by the domestic financial sector turbulence in 2014, is likely to continue to weigh on credit activity and investment decisions.

While public investment growth was the main driver of gross fixed capital formation in 2013 and 2014, mainly linked to increased use of available EU structural funds, its contribution to growth is projected to turn slightly negative in 2015, as the 2007-13 programming period is coming to an end and the government looks to implement important consolidation measures. Public investment is expected to weaken further in 2016 as EU co-financed projects under the new operational programmes take time to be implemented.

#### Net exports expected to contribute positively

Exports are expected to grow faster than imports over 2015 and 2016, as international demand increases and leads to a positive contribution of net exports to economic growth. Exporting industries are also expected to benefit from the depreciation of the euro, to which the level is pegged, especially given that a sizeable portion of Bulgarian exports goes to non-euro area countries. Imports growth is expected to remain modest, in line with weakening domestic demand.

Graph II.2.1: Bulgaria - Real GDP growth, output gap and unemployment



#### Labour market recovery remains slow

Employment stabilised in 2014, increasing by 0.4% after falling by the same amount the year before. The growth was mainly the result of an increased number of jobs in agriculture and trade. Employment in manufacturing also stabilised, increasing by 0.2%. Employment is expected to remain broadly unchanged in 2015 and 2016, while the decrease in the labour force should further reduce unemployment to below 10% in 2016 after having peaked at 13% in 2013.

#### Inflation to remain negative well into 2015

Bulgaria recorded the strongest consumer price decline in the EU in 2014, with the HICP at -1.6%,

due to a combination of domestic and external factors putting pressure on prices since mid-2013. The negative contribution coming from administratively-set prices faded away in 2014-Q4, largely due to the increase in electricity prices for households of around 10% in October. The contribution from import prices remained negative for a second consecutive year. Inflation is not expected to pick up until well into 2015, leaving the average rate for the year at around -0.5%, as private consumption weakens and international energy prices are projected to remain low. Nevertheless, consumer prices are expected to turn slightly positive in annual terms towards the end of 2015, as the base effects of administrative decreases, including in healthcare and telecommunications, drop out. Inflation is projected to pick up to 1.0% in 2016, once the effect from the previous fall in oil prices fades.

#### Risks appear to be balanced

On the positive side, private investment could turn out higher than expected if confidence and the business climate improve faster than expected. On the negative side, private consumption could be weaker if the observed labour market recovery,

driven by volatile sectors like agriculture and trade, proves short-lived. Both consumer and business sector confidence remains fragile and could deteriorate in case of further signs of instability in the financial sector.

#### Budget deficit to remain elevated

The general government deficit is projected to have increased from 0.9% of GDP in 2013 to 2.8% of GDP in 2014, as a result of some expenditure over-runs and weaker-than-expected revenues. There is a risk to the final headline deficit concerning the statistical recording of the financial sector support measures. The government deficit is estimated at 2.9% of GDP in 2015, mostly due to weaker indirect tax revenue, and to stay at 2.9% in 2016, based on a no-policy-change assumption. Bulgaria's structural deficit is projected at around 2½% over 2014-16, reflecting the negative output gap. General government gross debt increased from 18.3% at end 2013 to 27.6% of GDP at end 2014, reflecting the support to the financial sector as well as the increased budget deficit. By the end of 2016, government debt is expected to reach 31.2% of GDP.

Table II.2.1:

#### Main features of country forecast - BULGARIA

|  | 2013   |              |       | 95-10 | Annual percentage change |      |      |      |      |      |
|--|--------|--------------|-------|-------|--------------------------|------|------|------|------|------|
|  | bn BGN | Curr. prices | % GDP |       | 2011                     | 2012 | 2013 | 2014 | 2015 | 2016 |
| GDP  | 80.3   |              | 100.0 | 2.9   | 2.0                      | 0.5  | 1.1  | 1.7  | 1.0  | 1.3  |
| Private Consumption                                | 50.2   |              | 62.6  | 3.0   | 1.8                      | 3.9  | -2.3 | 2.0  | 1.0  | 1.5  |
| Public Consumption                                 | 13.3   |              | 16.5  | -0.3  | 1.8                      | -1.0 | 2.8  | 3.8  | 0.1  | 1.1  |
| Gross fixed capital formation                      | 17.1   |              | 21.3  | 8.1   | -6.6                     | 4.2  | -0.1 | 2.8  | -1.7 | -2.9 |
| of which: equipment                                | 7.3    |              | 9.1   | -     | 26.9                     | -5.4 | 1.0  | 2.0  | -1.5 | 4.5  |
| Exports (goods and services)                       | 54.9   |              | 68.4  | -     | 12.3                     | 0.1  | 9.2  | 2.2  | 3.1  | 4.0  |
| Imports (goods and services)                       | 55.4   |              | 69.0  | -     | 8.5                      | 4.5  | 4.9  | 3.8  | 2.0  | 3.0  |
| GNI (GDP deflator)                                 | 78.7   |              | 98.1  | -     | 0.6                      | 2.3  | 1.3  | 1.2  | 0.9  | 1.0  |
| Contribution to GDP growth:                        |        |              |       |       |                          |      |      |      |      |      |
| Domestic demand                                    |        |              |       | 3.8   | -0.1                     | 3.1  | -1.1 | 2.5  | 0.3  | 0.5  |
| Inventories  |        |              |       | 0.7   | 0.2                      | 0.1  | -0.5 | 0.3  | 0.0  | 0.0  |
| Net exports  |        |              |       | -     | 1.9                      | -2.8 | 2.6  | -1.1 | 0.7  | 0.7  |
| Employment   |        |              |       | -     | -2.2                     | -2.5 | -0.4 | 0.4  | 0.2  | 0.3  |
| Unemployment rate (a)                              |        |              |       | 12.2  | 11.3                     | 12.3 | 13.0 | 11.4 | 10.4 | 9.8  |
| Compensation of employees / head                   |        |              |       | -     | 6.8                      | 7.7  | 8.8  | 1.5  | 1.8  | 2.5  |
| Unit labour costs whole economy                    |        |              |       | -     | 2.4                      | 4.5  | 7.2  | 0.2  | 1.0  | 1.5  |
| Real unit labour cost                              |        |              |       | -     | -4.3                     | 2.9  | 8.0  | -0.5 | 0.7  | 0.9  |
| Saving rate of households (b)                      |        |              |       | -     | -                        | -    | -    | -    | -    | -    |
| GDP deflator                                       |        |              |       | 31.3  | 7.0                      | 1.6  | -0.8 | 0.6  | 0.4  | 0.6  |
| Harmonised index of consumer prices                |        |              |       | -     | 3.4                      | 2.4  | 0.4  | -1.6 | -0.5 | 1.0  |
| Terms of trade goods                               |        |              |       | -     | 2.9                      | -3.5 | -0.8 | 0.6  | -0.4 | -0.6 |
| Trade balance (goods) (c)                          |        |              |       | -11.2 | -4.8                     | -9.9 | -7.2 | -8.0 | -7.6 | -7.5 |
| Current-account balance (c)                        |        |              |       | -     | 0.9                      | -1.2 | 1.6  | 0.9  | 1.3  | 1.2  |
| Net lending (+) or borrowing (-) vis-a-vis ROW (c) |        |              |       | -     | 2.1                      | 0.1  | 2.9  | 2.3  | 2.6  | 2.5  |
| General government balance (c)                     |        |              |       | -1.0  | -2.0                     | -0.7 | -0.9 | -2.8 | -2.9 | -2.9 |
| Cyclically-adjusted budget balance (d)             |        |              |       | -1.3  | -1.9                     | -0.6 | -0.9 | -2.8 | -2.7 | -2.5 |
| Structural budget balance (d)                      |        |              |       | -     | -1.9                     | -0.6 | -0.9 | -2.6 | -2.6 | -2.5 |
| General government gross debt (c)                  |        |              |       | -     | 15.7                     | 18.0 | 18.3 | 27.6 | 29.8 | 31.2 |

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.

Note: Contributions to GDP growth may not add up due to statistical discrepancies.