20. BULGARIA

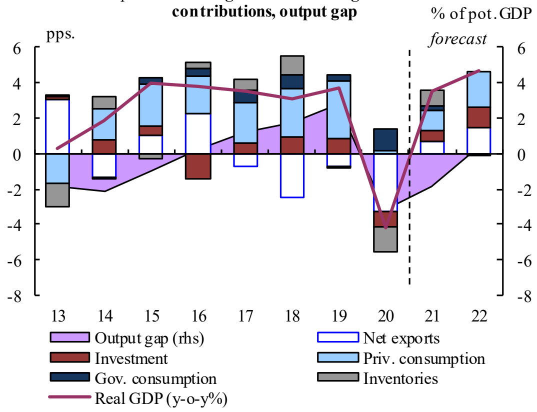
Economic activity in Bulgaria was strongly affected by the COVID-19 pandemic in 2020, mainly through the fall in exports of goods and services. Domestic demand and exports are set to lead the recovery with an important impetus to investment from the implementation of the Recovery and Resilience Plan. After an initial deterioration, the labour market situation stabilised with the help of publically financed employment retention measures and is expected to improve. Budget deficits have returned after four years and are expected to persist.

Sharp recession and a robust recovery

Due to the COVID-19 pandemic, Bulgaria's economy contracted by 4.2% in 2020. Exports of goods and services have been the major drag on economic activity with a gross negative contribution of 7.3 pps (not accounting for the import component). Private consumption remained unchanged in 2020 compared to 2019 levels and followed closely the changes in intensity of containment measures over the year. Private consumption has been supported by job retention schemes and positive wage dynamics, the sound financial situation of households at the onset of the crisis and relatively optimistic expectations about economic activity. Investment contracted sharply in the first half of last year, driven by higher ecomonic uncertainty and an increase in spare industrial production capacity. With the gradual recovery of capital utilisation rates and the pick-up in public sector investment in the second half of 2020, capital formation returned to pre-crisis levels. Government consumption supported aggregate demand in the second half of 2020. Imports contracted by 6.6% in 2020, mainly on account of the import component of exports and to a lesser extent due to the decline in investment.

Looking forward, economic activity is expected to rebound from the second quarter of this year and then gain further momentum. GDP growth is set to accelerate from 3.5% in 2021 to 4.7% in 2022, conditional on the absorbtion profile of RRF funds adopted by the government on 28 April. Goods exports are forecast to lead the recovery in 2021 on the back of improved foreign demand. The dynamics of services exports will depend largely on developments in tourism sector. They are expected to regain some ground compared to the crisis last year, but to remain around one quarter below pre-crisis levels in the current year before narrowing the gap further in 2022. Domestic demand is also set to contribute to the economic expansion. The gradual relaxation of containment measures is assumed to encourage pent-up demand in the second half of 2021, while positive labour market developments are forecast to support consumer spending in 2022. A key factor for the upswing in investment will be the successful implementation of Bulgaria's Recovery and Resilience Plan.

Graph II.20.1: **Bulgaria - Real GDP growth and contributions, output gap**



The risks to the forecast are broadly balanced. The positive second-round effects from the Recovery and Resilience Plan on private consumption and investment could potentially be larger, especially through the expectation channel, i.e. by bringing forward domestic demand. On the downside, delays and inefficiencies in the implementation of the RRP could hamper overall economic activity.

Labour market stabilises with the help of job retention schemes

The unemployment rate has increased significantly since the onset of the COVID-19 pandemic but it started to stabilise in the second half of 2020. Government's job retention schemes have played a significant role by supporting more than 270,000 employees across nearly 12,400 companies. The largest share of the support went to the manufacturing sector, followed by the hospitality sector, which was the worst affected. The unemployment rate levelled off at 5.1% in 2020. In line with the economic recovery, employment is expected to gradually pick up, by 0.6% and 1.3% in 2021 and 2022 respectively. The unemployment rate is set to reach 4.8% in 2021 and to fall below its pre-crisis level of 4.2% in 2022. Real wages are expected to continue their upward trajectory as labour market slack continues to diminish at a more restrained pace.

Headline inflation to accelerate

HICP inflation fell throughout 2020 due to lower energy prices and lower price increases in processed and unprocessed foods. The seasonal price hikes in tourism services were less pronounced over the summer last year, which helped contain overall services inflation. Inflation is set to accelerate to 1.6% in 2021 on the back of assumed higher energy prices and second-round effects from increased fuel prices. In 2022, HICP inflation is expected to reach 2%, supported by envigorated economic growth and the closing output gap.

The fiscal deficit is set to remain stable

Bulgaria’s relatively favourable fiscal position was reverted in 2020 as a result of the COVID-19 pandemic and implemented support measures. The general government deficit is estimated at 3.4% of GDP in 2020. Despite the significant improvement in the macroeconomic outlook including the positive impact expected from investement financed by the RRF, the budget deficit is forecast to remain above 3% in 2021. The economic recovery and additional investment should have a positive impact on revenues, but a number of expenditure measures to preserve jobs and to support incomes through public wage increases and social benefits is set to strongly increase expenditure. The budget deficit is forecast to decrease to 1.9% of GDP in 2022, mainly due to the expected ending of the remaining emergency measures.

General government debt is expected to decrease to 24.5% of GDP in 2021 despite the persistent primary deficit, mainly thanks to the positive impact of the higher economic growth. In 2022, the government debt-to-GDP ratio is projected to decrease further to 24% of GDP.

Table II.20.1:
Main features of country forecast - BULGARIA

	2019		Annual percentage change						
bn BGN	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP	119.8	100.0	3.6	3.5	3.1	3.7	**-4.2**	**3.5**	**4.7**
Private Consumption	70.5	58.9	4.3	3.8	4.4	5.5	**0.2**	**1.9**	**3.6**
Public Consumption	20.1	16.8	1.4	4.3	5.3	2.0	**7.5**	**1.3**	**0.0**
Gross fixed capital formation	22.4	18.7	4.9	3.2	5.4	4.5	**-5.1**	**3.4**	**6.1**
of which: equipment	10.0	8.4	5.1	4.4	8.8	15.1	**-3.7**	**4.7**	**3.7**
Exports (goods and services)	76.9	64.2	7.3	5.8	1.7	3.9	**-11.3**	**7.0**	**8.3**
Imports (goods and services)	73.0	61.0	7.6	7.4	5.7	5.2	**-6.6**	**6.0**	**6.1**
GNI (GDP deflator)	121.3	101.3	3.7	5.1	3.1	3.7	**-4.0**	**3.3**	**4.7**
Contribution to GDP growth: Domestic demand			4.3	3.6	4.5	4.4	**0.4**	**2.0**	**3.1**
Inventories			0.0	0.6	1.1	0.0	**-1.4**	**0.9**	**0.0**
Net exports			-0.7	-0.7	-2.5	-0.7	**-3.2**	**0.7**	**1.5**
Employment			0.4	1.8	-0.1	0.3	**-2.3**	**0.6**	**1.3**
Unemployment rate (a)			11.1	6.2	5.2	4.2	**5.1**	**4.8**	**3.9**
Compensation of employees / head			8.3	10.5	9.7	6.9	**5.9**	**5.0**	**5.2**
Unit labour costs whole economy			5.0	8.7	6.3	3.5	**7.9**	**2.0**	**1.8**
Real unit labour cost			0.7	4.6	2.2	-1.7	**4.5**	**-2.9**	**-1.1**
Saving rate of households (b)			:	:	:	:	**:**	**:**	**:**
GDP deflator			4.2	3.9	4.0	5.3	**3.3**	**5.0**	**3.0**
Harmonised index of consumer prices			3.8	1.2	2.6	2.5	**1.2**	**1.6**	**2.0**
Terms of trade goods			1.4	0.3	0.7	1.9	**4.4**	**-0.8**	**0.6**
Trade balance (goods) (c)			-14.1	-1.5	-4.8	-4.7	**-3.0**	**-2.1**	**-2.2**
Current-account balance (c)			-5.9	6.1	5.0	5.6	**4.1**	**6.0**	**7.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-4.9	7.1	6.2	7.2	**6.0**	**6.8**	**8.0**
General government balance (c)			-0.6	1.2	2.0	2.1	**-3.4**	**-3.2**	**-1.9**
Cyclically-adjusted budget balance (d)			-0.6	0.8	1.5	1.3	**-2.5**	**-2.6**	**-2.0**
Structural budget balance (d)			-0.9	0.8	1.5	1.3	**-2.5**	**-2.6**	**-2.0**
General government gross debt (c)			27.0	25.3	22.3	20.2	**25.0**	**24.5**	**24.0**

(a) Eurostat definition. (b) gross saving divided by adjusted 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.