2. BULGARIA

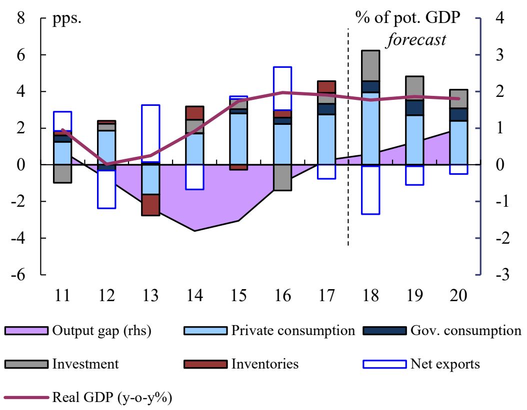
Robust growth ahead

Bulgaria's growth momentum is expected to remain strong, mainly thanks to solid domestic demand, with private consumption supported by real wage growth. High demand, increased capacity utilisation and EU funding are set to boost investment, while imports should outpace exports, leading to a further reduction in the current account surplus. Energy prices and domestic demand increases are expected to lift inflation. The government balance is set to remain positive and public debt should continue falling.

Steady, robust growth

Real GDP growth in Bulgaria is expected to reach 3.5% this year, driven by strong domestic demand dynamics as seen in the first half of this year. Private consumption growth is supported by positive developments in the labour market, increased real disposable income and positive consumer sentiment. Capacity utilisation has continued to increase, which bodes well for investment. Both private and public investment remain strong, enjoying the support of the low interest rate environment and EU funding.

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



Export growth in 2017 has been significantly revised upward. This strong base effect, as well as some one-off events and a decline in exports to Turkey, led to a slow-down of export growth in 2018. At the same time, strong domestic demand is set to keep import growth above that of exports, resulting in a negative contribution of net export to GDP growth.

In 2019 and 2020, real GDP growth is forecast to increase slightly to 3.7% and 3.6%, respectively. Domestic demand is expected to remain the engine of growth in both years. In 2019, public consumption is set to accelerate due to additional rises in public sector wages and intermediate consumption. Strong consumer confidence and increases in real disposable income will continue to support private consumption, although somewhat more moderately than in 2018.

Investment is set to contribute further to the economy's growth, as more projects co-financed by the EU get underway or progress. The contribution of the external sector to growth is forecast to be less negative in 2019 and 2020 as exports are expected to rebound, while import growth is set to moderate somewhat. The positive output gap is projected to widen.

Risks to the growth outlook are tilted to the downside. These mainly concern external demand, which could be hampered by political and economic risks in some major trading partners. On the positive side, a tightening labour market could lead to higher-than-expected increases in wages and income, which in turn could have a stronger positive impact on private consumption.

Inflation is set to moderate in 2019 and 2020

Overall, headline inflation has further increased and is projected to reach 2.6% on average in 2018. This is due to the rise in energy prices passing through to service prices, while strong domestic demand and increases in unprocessed food prices due to a lower harvest over the summer added to inflationary pressures. Over the remaining forecast period, inflation is expected to decrease somewhat to 2.0% in 2019 and 1.8% in 2020 as a result of base effects, despite the support of strong demand and high wage growth.

Record low unemployment

The unemployment rate in Buglaria came close to its pre-crisis low in 2017, thanks to strong employment growth. The unemployment rate is set to reach 6.0% in 2018 and to further decline to 5.7% by 2020. Labour shortages and planned government wage increases are expected to drive wage growth above productivity growth over the forecast period.

Sustained positive budget balance

The supportive macroeconomic environment and an overall prudent approach to fiscal policy should lead to sustained budget surpluses over the forecast period. The general government surplus is expected to narrow slighty from 1.1% of GDP in 2017 to 0.8% of GDP in 2018 due to more dynamic public investment and public sector pay rises. At the same time, revenues are expected to increase significantly as transfers from EU funds accelerate and tax collection improves thanks to both macroeconomic conditions and tax compliance measures.

In 2019 and 2020, the general government surplus is forecast to decrease a bit more to 0.6% of GDP mainly due to the government plans to further increase public sector wages and capital spending from national resources. Strong GDP growth and higher wages in the economy are expected to boost tax revenue and balance the expected current expenditure increases. At the same time, EU funds are set to continue finance a large part of public investment growth.

The budget forecast is subject to some uncertainty, particularly as regards the nationally funded component of the public investment. A large investment in the railway sector, which depends on a yet-to-be-contracted Sofia airport concession and some announced military procurement could have a significant impact on budget balances in the next few years, but for both cases the time schedule is not clear as yet.

The structural budget surplus is set to decrease over the forecast period from around 1% of GDP in 2017 to around ¼% in 2020, reflecting the changes in the headline balance and the positive output gap. Meanwhile, interest spending is reducing and public debt is forecast to drop to below 20% of GDP by 2020.

Table II.2.1:

Main features of country forecast - BULGARIA

	2017		Annual percentage change						
	bn BGN Curr. prices	% GDP	99-14	2015	2016	2017	2018	2019	2020
GDP	101.0	100.0	2.9	3.5	3.9	3.8	**3.5**	**3.7**	**3.6**
Private Consumption	61.3	60.6	4.8	4.5	3.6	4.5	**6.5**	**4.3**	**3.8**
Public Consumption	15.8	15.6	0.8	1.3	2.2	3.7	**3.9**	**5.2**	**4.3**
Gross fixed capital formation	18.7	18.5	7.3	2.7	-6.6	3.2	**9.0**	**6.8**	**5.2**
of which: equipment	7.5	7.4	7.9	9.8	-14.9	4.3	**9.9**	**9.3**	**7.5**
Exports (goods and services)	68.1	67.4	3.8	5.7	8.1	5.8	**0.7**	**2.9**	**3.4**
Imports (goods and services)	64.4	63.7	7.3	5.4	4.5	7.5	**4.8**	**4.6**	**4.2**
GNI (GDP deflator)	102.4	101.3	3.1	2.3	5.8	5.4	**3.4**	**2.5**	**3.5**
Contribution to GDP growth: Domestic demand			4.9	3.6	1.2	3.9	**6.2**	**4.8**	**4.1**
Inventories			-0.1	-0.3	0.4	0.6	**-0.1**	**-0.1**	**0.0**
Net exports			-1.9	0.1	2.3	-0.8	**-2.6**	**-1.0**	**-0.5**
Employment			-0.1	0.4	0.5	1.8	**0.5**	**0.3**	**0.2**
Unemployment rate (a)			11.8	9.2	7.6	6.2	**6.0**	**5.8**	**5.7**
Compensation of employees / head			8.6	5.6	5.8	10.5	**8.0**	**7.6**	**6.3**
Unit labour costs whole economy			5.5	2.5	2.3	8.4	**4.8**	**4.0**	**2.8**
Real unit labour cost			0.9	0.2	0.1	4.8	**2.2**	**1.6**	**0.6**
Saving rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			4.5	2.2	2.2	3.4	**2.6**	**2.4**	**2.2**
Harmonised index of consumer prices			4.8	-1.1	-1.3	1.2	**2.6**	**2.0**	**1.8**
Terms of trade goods			-1.0	0.6	3.9	0.3	**0.1**	**0.4**	**0.4**
Trade balance (goods) (c)			-15.3	-5.8	-2.0	-1.5	**-4.6**	**-4.8**	**-5.0**
Current-account balance (c)			-6.8	0.6	5.3	8.2	**5.9**	**4.6**	**5.1**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-6.2	3.9	7.3	9.2	**7.1**	**5.9**	**6.5**
General government balance (c)			-0.6	-1.7	0.2	1.1	**0.8**	**0.6**	**0.6**
Cyclically-adjusted budget balance (d)			-0.4	-1.2	0.3	1.1	**0.7**	**0.4**	**0.3**
Structural budget balance (d)			-	-1.2	0.3	1.1	**0.7**	**0.4**	**0.3**
General government gross debt (c)			32.8	26.2	29.6	25.6	**23.3**	**21.3**	**19.5**

(a) as % of total labour force. (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.