2. BULGARIA

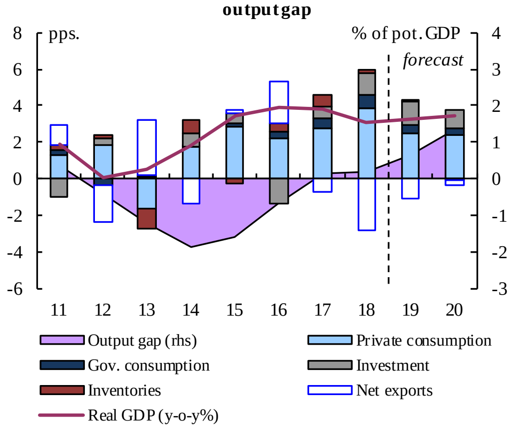
Steady growth ahead

Economic growth in Bulgaria is expected to recover, curbed somewhat by waning foreign demand, labour market tightness and reduced consumer sentiment. Exports are forecast to recover from last year's slump as some temporary effects on exports fade away. In the absence of external price shocks, inflation pressures are expected to abate. The government balance is set to remain in surplus and public debt should continue falling.

More moderate GDP growth

Real GDP growth in Bulgaria moderated to 3.1% in 2018 from 3.8% in 2017. Domestic demand supported GDP growth, while net exports were a drag on economic activity. Positive labour market outcomes, strong lending activity and consumer confidence spurred private consumption in the first three quarters of 2018. However, private consumption lost momentum in the last quarter of the year as consumer confidence deteriorated, albeit from elevated levels. Investment activity, both private and public, contributed to the strong domestic demand in 2018, underpinned by favourable financing conditions, high capacity utilisation and greater use of EU funds.

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



Exports underperformed in 2018, mainly driven by lower exports to Turkey, a negative base effect in exports to Russia and the temporary shutdown of an oil refinery in the spring.

Real GDP growth is expected to recover slightly to 3.3% in 2019 and 3.4% in 2020. Domestic demand should continue to expand but at a slower pace, due to more moderate private consumption. Consumer confidence remained subdued in the first few months of 2019, suggesting more cautious spending behaviour through the year. However, favourable labour market trends are expected to support household expenditure through higher real wages. Investment is projected to remain strong. Exports are set to recover, as the one-off effects of 2018 dwindle. This should hold even if the subdued demand from major trading partners continue to weigh on the exports.

Risks to the growth forecast are broadly balanced. On the upside, private consumption may grow faster than expected, provided that the labour market tightens further and consumers' confidence improves. The main downside risk is the possibility of a sharp contraction in major export markets.

Inflation pressures ease

Inflation pressures from high energy prices and one-off statistical effects in services gathered pace throughout most of 2018, but eased by the end of the year. Headline inflation declined to 2.3% in December. Elevated food prices, due to a bad harvest in 2018 and relatively high international prices, are forecast to push up price levels in the first half of 2019. Energy price hikes introduced in 2018 have exerted pressure on prices at the beginning of the year, but are expected to gradually dissipate. Inflation is set to decline to 2.0% in 2019 and 1.8% in 2020.

Favourable labour market trends continue

Employment growth is projected to reach 0.1% for 2019 and 2020 as unemployment has fallen to historically low levels. The unemployment rate was 5.2 % in 2018 and is set to further decline to 5.0% in 2019 and 4.8% in 2020. Real wage growth is forecast to remain high, owing to the tight labour market and planned government wage increases.

Sustained budget surpluses

The general government surplus rose to 2% of GDP in 2018. This was mainly due to increases in tax revenues and decreases in some expenditure categories such as social transfers and other capital expenditure as a percentage of GDP. Public investment strengthened but the impact on public finances was partly offset by higher transfers from the EU.

The budget balance is expected to remain positive over the forecast period, but to narrow to 0.8% of GDP in 2019 and to reach 1.0% of GDP in 2020. Public investment is set to be the main driver of budgetary developments, as a number of projects financed either by EU funds or national resources are starting or gaining pace. Moreover, the compensation of employees is forecast to increase as a result of public sector and minimum wage increases. The social transfers are set to rise slightly due to higher spending on health support schemes for vulnerable groups.

On the revenue side, tax revenues are forecast to increase as the economy improves slightly relative to 2018. Other current revenue are also set to strengthen as a percentage of GDP, benefitting from EU transfers and the impact of the increase in the contribution to the Electricity System Security Fund introduced in 2018.

The budget forecast is subject to some uncertainty. In particular, the implementation schedule of some of the investment plans financed by national resources is not yet clear.

The structural surplus is set to decrease from around 2% of potential GDP in 2018 to around $^{2}/3$ % of potential GDP in 2019 and 2020, reflecting the changes in the headline balance and the significantly higher and increasing output gap. Interest spending is decreasing and public debt is forecast to drop to 18.4% 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	**3.1**	**3.3**	**3.4**
Private Consumption	61.3	60.6	4.8	4.5	3.6	4.5	**6.4**	**4.0**	**3.8**
Public Consumption	15.8	15.6	0.8	1.3	2.2	3.7	**4.7**	**3.0**	**2.3**
Gross fixed capital formation	18.7	18.5	7.3	2.7	-6.6	3.2	**6.5**	**6.8**	**5.2**
of which: equipment	7.5	7.4	7.9	9.8	-14.9	4.3	**7.1**	**9.4**	**7.5**
Exports (goods and services)	68.1	67.4	3.8	5.7	8.1	5.8	**-0.8**	**3.3**	**2.9**
Imports (goods and services)	64.4	63.7	7.3	5.4	4.5	7.5	**3.7**	**5.0**	**3.3**
GNI (GDP deflator)	102.4	101.3	2.9	2.3	5.8	5.4	**2.2**	**3.2**	**3.3**
Contribution to GDP growth:	Domestic demand		4.9	3.6	1.2	3.9	**5.8**	**4.3**	**3.8**
	Inventories		-0.1	-0.3	0.4	0.6	**0.1**	**0.1**	**-0.1**
	Net exports		-1.9	0.1	2.3	-0.8	**-2.8**	**-1.1**	**-0.3**
Employment			-0.1	0.4	0.5	1.8	**-0.1**	**0.1**	**0.1**
Unemployment rate (a)			11.8	9.2	7.6	6.2	**5.2**	**5.0**	**4.8**
Compensation of employees / head			8.6	5.6	5.8	10.5	**5.6**	**6.9**	**5.9**
Unit labour costs whole economy			5.5	2.5	2.3	8.4	**2.4**	**3.6**	**2.5**
Real unit labour cost			0.9	0.2	0.1	4.8	**-1.2**	**0.9**	**0.3**
Saving rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			4.5	2.2	2.2	3.4	**3.6**	**2.7**	**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	**0.0**	**0.4**	**0.4**
Trade balance (goods) (c)			-15.3	-5.8	-2.0	-1.5	**-4.7**	**-5.3**	**-5.3**
Current-account balance (c)			-6.8	0.6	5.3	6.2	**2.5**	**1.6**	**1.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-6.2	3.9	7.3	7.2	**3.6**	**2.9**	**2.8**
General government balance (c)			-0.6	-1.7	0.1	1.2	**2.0**	**0.8**	**1.0**
Cyclically-adjusted budget balance (d)			-0.3	-1.2	0.3	1.1	**1.9**	**0.7**	**0.6**
Structural budget balance (d)			-	-1.1	0.3	1.1	**1.9**	**0.7**	**0.6**
General government gross debt (c)			32.8	26.2	29.6	25.6	**22.6**	**20.5**	**18.4**

(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.