



BULGARIA

Highlights

- **Growth has remained solid during 2019.** The economy grew by an estimated 3.1 per cent in 2018, following an average growth rate of 3.8 per cent in 2015-17. The economy grew robustly at 4.2 per cent year-on-year in the first half of 2019.
- **Reforms in the energy sector have continued.** Bulgaria is also developing a number of gas infrastructure projects, with the aim of becoming a major gas hub and transit route in the region.
- **Steps have been taken to advance Bulgaria's integration into the financial architecture of the European Union (EU).** Bulgaria is aiming to join the eurozone and has officially announced its intention to join the European Exchange Rate Mechanism (ERM II) and the EU's banking union simultaneously.

Key priorities for 2020

- **Reforms needed to prepare the country for joining ERM II and the EU's banking union should be stepped up.** While Bulgaria consistently meets the macroeconomic requirements to become part of ERM II, the authorities should remain committed to key structural reforms needed to achieve this goal.
- **Bulgaria should continue working on implementation of the commitments within the framework of the EU's Cooperation and Verification Mechanism (CVM).** According to the latest CVM report, the European Commission considers that the progress made by Bulgaria under the mechanism is sufficient to meet the country's commitments made at the time of its accession to the EU.
- **Reforms on improving the business environment need to be implemented.** Bureaucratic processes remain an impediment to doing business, while access to skilled labour is a growing challenge. Attention should be turned to reforming the business environment, retaining qualified workers and improving the skills of the existing labour force.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	4.0	3.8	3.5	3.1	3.7
Inflation (average)	-1.1	-1.3	1.2	2.6	2.0
Government balance/GDP	-1.7	0.1	1.1	1.8	0.8
Current account balance/GDP	0.0	2.3	4.4	2.4	1.6
Net FDI/GDP [neg. sign = inflows]	-5.0	-1.3	-3.9	-2.6	-2.4
External debt/GDP	72.6	67.8	68.7	58.2	n.a.
Gross reserves/GDP	44.0	47.3	48.0	43.8	n.a.
Credit to private sector/GDP	54.9	52.1	51.3	51.9	n.a.

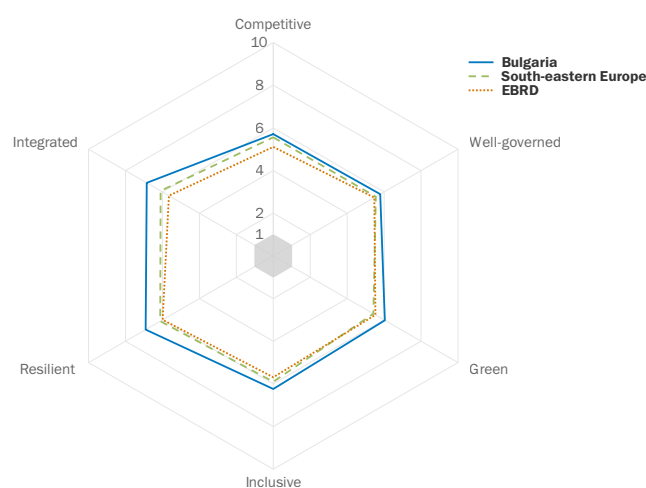
Macroeconomic performance

Economic growth remains solid. The economy grew by an estimated 3.1 per cent in 2018, following an average growth rate of 3.7 per cent in 2015-17. Private consumption has been the main driver of growth, fuelled by increased earnings and a higher employment rate amid the tightening labour market. Unemployment was down to almost 4.0 per cent as of June 2019, while nominal wages kept growing at high single-digit rates. The government raised the monthly minimum wage by 10.0 per cent in January 2019, to €286. Investment has also been strong, with growth of about 6.0 per cent in 2018, helped by the growing disbursement of EU funds. Meanwhile, net exports have weighed on growth in 2018 as strong private consumption has pushed up imports, while exports experienced a small decline, not least because of the downturn in the economy in Turkey, an important trading partner. Real gross domestic product (GDP) expanded by 4.2 per cent year-on-year in the first half of 2019. Household consumption has continued to be the main source of growth. Inflation reached a high of 3.7 per cent in August 2018, averaging 2.6 per cent in 2018, but has since come down to 2.5 per cent as of August 2019.

Fiscal policy has remained tight. A period of fiscal tightening resulted in three consecutive years of budget surpluses in 2016-18, reaching 1.8 per cent of GDP in 2018, which places Bulgaria among the top performers in the EU. Government spending rose in 2019, mainly due to a large one-off army-related expense, and the budget may be in deficit after three consecutive years of budget surpluses. Nevertheless, public debt continues to decline and stands at around 21.0 per cent of GDP, one of the lowest percentages in the EU.

Growth is expected to remain solid. The economy is expected to grow by 3.7 per cent in 2019 and 3.0 per cent in 2020, the latter being broadly in line with the country's current growth potential. Growth is likely to be underpinned by private consumption, which traditionally fuels economic activity. Investment should also contribute positively to growth, as the absorption of EU funds is accelerated towards the end of the 2014-20 funding period. Fiscal policy is expected to remain tight, limiting the contribution of government spending to growth. Key risks to the outlook are: prolonged weakness of major trading partners, particularly that of the eurozone and exacerbation of current labour shortages (due to the declining population, emigration of skilled workers and a skills gap in the workforce). While convergence prospects remain high, with GDP per capita (in purchasing power standards) standing at just half of the EU average, sustaining high growth rates in the long term will require the reinvigoration of structural reforms.

Assessment of transition qualities (1-10)



Major structural reform developments

Plans for euro adoption are advancing. In November 2018, the parliament adopted legislative changes to strengthen the autonomy of the central bank, as recommended by the European Central Bank (ECB). This was a necessary step for the country's entry into the EU's banking union. Bulgaria is eager to join the eurozone and has stated its firm intention to apply to the ERM II, having met all the nominal criteria for membership, namely, a stable currency (fixed peg to the euro), low inflation and healthy public finances. The ECB has undertaken a comprehensive analysis of six Bulgarian banks as part of the procedure for the country's parallel entry into the banking union. The analysis, published in July 2019, identified a capital shortfall in two domestically owned banks. Additional commitments relate to other financial-sector issues and institutional quality and governance.

There was further progress in implementing the Cooperation and Verification Mechanism (CVM). According to the latest CVM report, published in October 2019 by the European Commission, Bulgaria's progress has been assessed as sufficient to meet the country's commitments at the time of its EU accession.

The business environment remains problematic in some areas. According to the latest World Bank *Doing Business 2020* report, published in October 2019, Bulgaria ranked 61st out of 190 countries in ease of doing business, dropping two places compared with the previous year. This is among the lowest rankings in the EU. Procedures for starting a business, paying taxes and getting electricity remain burdensome, although, similar to most EU members, Bulgaria performs well in trading across borders.

Energy infrastructure improvements have continued. Construction of the Turkish gas stream, aimed at bringing Russian gas to central Europe through Bulgaria, Serbia and Turkey, is progressing. In June 2019 the Competition Protection Commission restored a Saudi Arabian-Italian consortium (Arkad) as the tender winner for the construction of the Turkish stream extension in Bulgaria. Subsequently, in September 2019 the Bulgarian natural gas transmission system operator Bulgartransgaz and Arkad signed a contract for the delivery of materials, investment project design and the development and commissioning of the gas pipeline. Also, construction of the long-delayed €220 million Bulgaria-Greece gas interconnector was launched in May 2019, a week after Greece's J&P AVAX was selected to execute the project. The interconnector will help diversify natural gas sources for Bulgaria, which, at present, mainly depends on Russian gas. Meanwhile, in December 2018, the European Commission's anti-trust body fined the state-owned energy firm Bulgarian Energy Holding and its gas infrastructure subsidiary Bulgartransgaz €77 million for blocking access to natural gas infrastructure in Bulgaria during 2010-15, thus not allowing potential competitors to enter wholesale gas supply markets in Bulgaria. Also, the Czech energy company ČEZ Group has decided to withdraw from Bulgaria over longstanding disputes with the Bulgarian authorities. In June 2019, Bulgarian financial and insurance group Eurohold signed a deal with ČEZ to buy its local assets for €335 million, including an electricity distribution business with two million customers and two renewable plants. However, in October 2019, Bulgaria's competition regulator blocked the acquisition, saying that the deal could hinder competition.

Transport infrastructure is being developed. In April 2019, the government launched the construction of a 56-kilometre section of the Hemus motorway heading eastwards from the junction with the Veliko Tarnovo-Ruse road to the city of Targovishte. The Hemus motorway links Sofia to the Black Sea port of Varna through the northern part of the country. In December 2018, the government decided to allocate €690 million for the construction of a 134-kilometre stretch of the Hemus motorway, to be built by the state-owned civil engineering company Avtomagistrali, which was given the contract without a public procurement procedure. Meanwhile, the EU has allocated €293 million to fund the modernisation of the railway between two of Bulgaria's biggest cities, Plovdiv and Burgas, which would reduce travel time significantly. In July 2019, the government picked SofConnect – a consortium between French-registered Meridiam Eastern European Investments, the Austrian construction company Strabag and the Munich Airport operator – as the 35-year concessionaire for Sofia Airport. The decision, however, was appealed in front of Bulgaria's Commission for the Protection of Competition by the other four bidders.

Consolidation and change of ownership in the banking system are ongoing. In June 2019, the Eurobank-owned Post Bank acquired the Bulgarian subsidiary of Piraeus Bank. Following the acquisition, Post Bank will become one of the largest banks in Bulgaria, with a market share of around 10 per cent. The operational integration should be completed by the end of the year. In January 2019, DSK Bank, owned by OTP Bank, closed the acquisition of Société Générale's Bulgarian unit, Expressbank, which has a market share of 6 per cent. This will further strengthen OTP Bank's market position in Bulgaria and boost its market share to almost 20 per cent after the acquisition. Profits in the banking sector, as a whole, increased by 43 per cent in 2018 to €860 million.
