

BULGARIA

Recent developments

Table 1 **2018**

| | |
|---|------|
| Population, million | 7.0 |
| GDP, current US\$ billion | 617 |
| GDP per capita, current US\$ | 8792 |
| International poverty rate (\$ 19) ^a | 15 |
| Lower middle-income poverty rate (\$3.2) ^a | 3.8 |
| Upper middle-income poverty rate (\$5.5) ^a | 8.7 |
| Gini index ^a | 37.4 |
| School enrollment, primary (% gross) ^b | 94.8 |
| Life expectancy at birth, years ^b | 74.6 |

Source: WDI, Macro Poverty Outlook, and official data.
Notes:

(a) Most recent value (2014), 2011 PPPs.

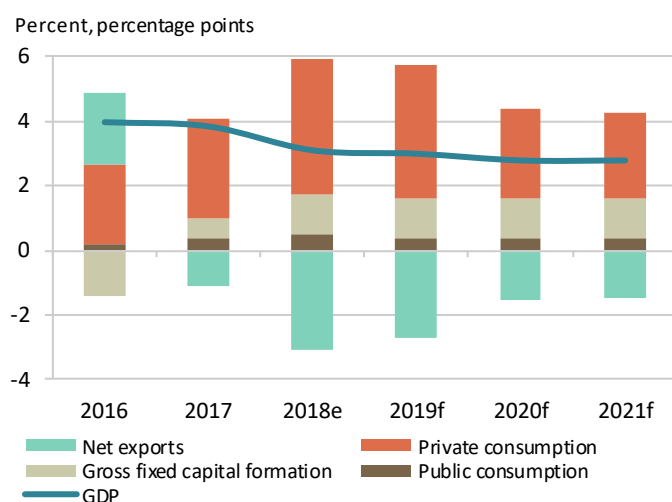
(b) Most recent WDI value (2016)

Bulgaria's economy grew by 3.1 percent in 2018 driven by private consumption and investment. Labor capacity constraints led to rising wages and pushed down the unemployment rate to a post-crisis low. Output and employment growth contributed to a reduction in poverty. Further gains in growth, poverty reduction and shared prosperity hinge on the implementation of policies to boost productivity. Renewed attention should be given to strengthening institutions to support planned ERM2 accession, enhancing the skills of the labor force, and improving the effectiveness and efficiency of public spending.

Economic growth remained strong in 2018, projected at 3.1 percent yoy, albeit expanding at a slower pace compared to 2017. Growth was driven mainly by private consumption (up 5.7 percent yoy) supported by rising wages and cheap credit and invigorating investment (up 6.5 percent yoy) which benefited from the recovery in the EU investment funding. On the production side, the greatest contribution came from real estate (up 9.3 percent yoy); finance (up 6.7 percent yoy), construction (up 4.0 percent yoy). Industry grew by 0.8 percent yoy, reflecting a weaker external demand from non-EU countries, including neighboring Turkey. Strong domestic demand and weaker external demand in the major export markets contributed to the widening of the trade deficit. However, the current account balance remained positive at 4.6 percent on the back of strong performance of services and higher inflows of EU grants. Headline inflation accelerated to 2.8 percent in 2018 due to higher energy prices, robust domestic demand and higher unprocessed food prices reflecting a disappointing agriculture year. Fiscal performance remained positive on the back of improved revenue collection. Fiscal revenues grew by 18.1 percent yoy in the first nine months of 2018 thanks to strong economic activity, better compliance, and higher minimum wages. Despite higher public wages resulting in a 12.4 percent increase in the public wage

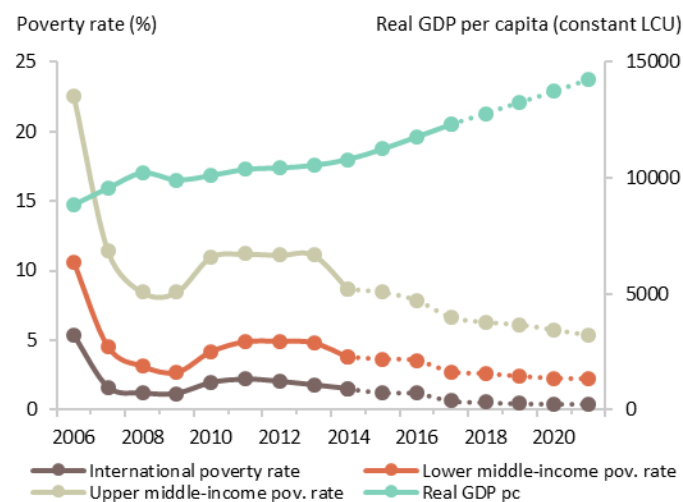
bill and additional budget resources allocated to police and municipalities, the fiscal accounts remained in surplus at 0.8 percent of annual GDP. Robust economic growth and a tighter labor market led to a decline in the unemployment rate to 5.2 percent, as of end 2018, a post-crisis low. At 73.5 percent as of Q3 2018, the employment rate (20-64) also improved. However, the working age population continued to shrink constraining expansion of potential growth. Labor and skill shortages as well as a rising minimum wage pushed real wages up, albeit at a slower pace than in 2017. Improvements in labor market conditions, including low unemployment and wage and income growth, supported a return in 2015 of poverty rates to pre-crisis levels. Poverty measured using the Upper Middle-Income Class line of \$5.5 per day (in 2011 PPP terms) is projected to have declined from 8.5 percent in 2015 to 7.1 percent in 2018. Bulgaria has the most unequal distribution of disposable income in the EU, and inequality has been increasing since 2013. The high level of inequality reflects the relatively low redistributive impact of Bulgaria's fiscal system. When inequality is seen through the lens of market income, before taxes and transfers are paid, Bulgaria's inequality is close to EU averages. However, Bulgaria's system of taxes and transfers is relatively less redistributive than in other countries, contributing to Bulgaria's Gini coefficient of disposable income being 40 percent higher than the average in the EU-28 in 2016. Unemployment has declined significantly but regional variations and long-term

FIGURE 1 Bulgaria / Real GDP growth and contributions to real GDP growth



Sources: NSI, World Bank

FIGURE 2 Bulgaria / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

and youth unemployment remain high. Inactivity among certain groups of the population persists and many citizens – including the elderly, those living in rural areas, and the Roma – are excluded from economic opportunities.

Outlook

Growth is expected to remain robust over the medium-term. GDP will likely expand by around 3 percent in 2019. Domestic demand will continue to be the main driver of growth supported by labor market tightening and additional public-sector wage increases. Investment sentiment might be affected by increasing uncertainty in external markets, but private and public investment should remain strong supported by low interest rates and EU funding. Strong domestic demand coupled with weaker external demand will put pressure on the trade balance. The current account balance is likely to remain positive, but the surplus will narrow significantly. The fiscal balance is expected to remain positive in 2019 and beyond through a moderate rise in spending on non-wage items and robust revenue collection. This will further push down public debt from 25.6 percent of GDP in 2017

to 21.1 percent in 2021. However, the lack of improvement in spending efficiency in health, public order, and infrastructure could undermine fiscal consolidation and limit the potential of public spending to enhance growth. Poverty reduction is expected to continue at a modest pace in the near term. Sustained improvements in employment and wages, as well as recent increases in the minimum pension, should support real incomes and therefore further reductions in poverty. Poverty is projected to fall to 6.9 percent in 2019, as measured at \$5.5 a day in 2011 PPP, to 6.5 percent in 2020, and further to 6 percent by 2021.

Risks and challenges

Risks to the outlook remain broadly balanced. Weaker growth momentum in Bulgaria's main EU trading partners and further slowdown in Turkey, mainly acting through the trade channel, could undermine export growth, while tightening global financial market conditions could increase the cost of lending to the private sector with negative implications for investment. Continued wage growth at a faster pace than productivity could translate into increasing unit labor costs and therefore undermine competitiveness.

Further acceleration of real estate prices in large cities could negatively affect the quality of bank portfolios. Upside factors likely to lead to higher-than expected growth are an enhanced economic sentiment in Europe and stronger global economic activity. The key challenges for Bulgaria are to accelerate convergence with the rest of the EU and to build a more inclusive society. Accelerating convergence requires improvements in productivity and labor force participation as the demographic transition is weighing on the size of the working age population. Employment rates of those aged 20-64 remain in the bottom third of those seen in the EU-28, suggesting substantial potential to increase participation. Inclusion can be supported through reducing inequality of opportunities across groups and regions and ensuring that the fiscal system plays its role in alleviating rather than deepening poverty. Enhancing productivity growth requires addressing governance challenges, critical also for planned ERM2 accession. Boosting the skills and employability of all Bulgarians, more effective and efficient public spending on health, pensions and long-term care are also needed to ensure inclusiveness and sustainability of growth in the face of demographic changes.

TABLE 2 Bulgaria / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

| | 2016 | 2017 | 2018 e | 2019 f | 2020 f | 2021 f |
|---|------|------|--------|--------|--------|--------|
| Real GDP growth, at constant market prices | 3.9 | 3.8 | 3.1 | 3.0 | 2.8 | 2.8 |
| Private Consumption | 3.4 | 4.3 | 5.7 | 5.5 | 3.6 | 3.5 |
| Government Consumption | 2.5 | 4.4 | 6.3 | 4.8 | 4.2 | 4.1 |
| Gross Fixed Capital Investment | -6.6 | 3.2 | 6.5 | 6.3 | 6.1 | 6.1 |
| Exports, Goods and Services | 8.1 | 5.8 | -0.8 | 0.6 | 2.4 | 2.5 |
| Imports, Goods and Services | 4.5 | 7.5 | 3.7 | 4.5 | 4.4 | 4.3 |
| Real GDP growth, at constant factor prices | 3.4 | 4.2 | 3.0 | 3.0 | 2.8 | 2.8 |
| Agriculture | 5.3 | 8.9 | -1.1 | 1.0 | 1.0 | 1.0 |
| Industry | 5.9 | 4.0 | 0.8 | 1.4 | 1.8 | 2.1 |
| Services | 2.2 | 3.9 | 4.2 | 3.8 | 3.3 | 3.2 |
| Inflation (Consumer Price Index) | -0.8 | 2.1 | 2.8 | 2.9 | 3.0 | 3.0 |
| Current Account Balance (% of GDP) | 2.6 | 6.5 | 4.6 | 3.7 | 2.8 | 2.1 |
| Net Foreign Direct Investment (% of GDP) | 2.1 | 2.7 | 2.8 | 3.0 | 3.0 | 3.0 |
| Fiscal Balance (% of GDP) | 0.2 | 1.1 | 0.2 | 0.0 | 0.4 | 0.4 |
| Debt (% of GDP) | 29.6 | 25.6 | 24.0 | 22.7 | 21.9 | 21.1 |
| Primary Balance (% of GDP) | 1.0 | 1.9 | 1.0 | 0.8 | 1.1 | 1.1 |
| International poverty rate (\$1.9 in 2011 PPP)^{a,b} | 1.2 | 1.0 | 0.8 | 0.7 | 0.6 | 0.6 |
| Lower middle-income poverty rate (\$3.2 in 2011 PPP)^{a,b} | 3.6 | 3.3 | 3.2 | 2.9 | 2.8 | 2.7 |
| Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{a,b} | 7.9 | 7.5 | 7.1 | 6.9 | 6.5 | 6.0 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2014-EU-SILC. Actual data: 2014. Nowcast: 2015-2018. Forecast are from 2019 to 2021.

(b) Projection using neutral distribution (2014) with pass-through = 0.87 based on GDP per capita in constant LCU.