

MACROECONOMIC FORECAST

Spring 2019

Ministry of Finance of the Republic of Bulgaria

The spring macroeconomic forecast of the Ministry of Finance takes into account assumptions about the international environment such as external demand and prices that are actual at the time of its preparation. Compared to the autumn forecast the world and the European economic growth are expected to be significantly lower in 2019 and are revised downwards also for 2020–2022. The external assumptions show a slight improvement in 2020 compared to 2019. In the next two years, the growth rate of the global economy will remain unchanged, while the EU economy will grow at a slower pace.

Bulgaria's GDP grew by 3.1% in 2018. The lower growth was due to the weak export dynamics. At the same time, domestic demand reported higher growth than expected, driven mainly by the strong increase in private consumption. GDP will rise by 3.4% in 2019. The planned increase in public investment and the rise in export will lead to higher GDP growth than the one reported in 2018. Private consumption will continue to grow but at lower pace compared to the previous year.

In 2018 the number of employed made a marginal 0.1% decrease due to the decline in agriculture. In 2019 the employment growth is estimated at 0.4%, as the numbers in industry and services will increase but at a slower pace compared to the previous year. The unemployment rate is expected to decrease to 4.6% and this will be accompanied with an increase of the working-age labour force participation rate. In 2019 the upward dynamics of incomes of 7.8% will be supported by both public and private sectors.

The average inflation in 2018 was 2.6%. Considering the assumptions about the expected dynamics of international commodity prices in 2019, the upward pressure on the Bulgarian producer and consumer prices in 2019 is much lower than in the autumn of 2018. The average inflation is projected to be 1.8% in 2019.

Unstable geopolitical environment, increasing number of protectionist trade measures and stronger than expected deceleration in EU growth are among the main negative risks to the Bulgarian economy, coming from the external environment. If materialized, these risks would increase the negative contribution of net export to the economic growth and lead to a larger increase in the current account deficit. Possible higher uncertainty among economic agents in the country linked to the unpredicted external environment could lead to postponement of the willingness for consumption and investment. ●

1. External Environment

Global economic growth continued at a stable pace in 2018. At the same time, many of the negative risks related to the external environment have materialized, which resulted in worsened mid-term expectations.

According to international financial institutions' forecasts, global economy will expand at a lower pace in 2019, due to weakened activity in both developing and developed economies. Increased protectionism, mainly from the United States, will continue to restrict external trade. It is expected that the economic activity in Turkey will remain subdued and GDP will decline. Economic growth in the EU and the USA will also falter. The European Commission revised downwards the forecasts for most of the Member States, expecting that the weak momentum from late 2018 will continue into 2019.

In 2020 economic growth in the EU is expected to speed up slightly, driven by euro area economies. Higher growth is expected also for the global economy, due to higher economic activity among developing economies (incl. Turkey). European economy will expand at a decelerating pace in the forecast horizon, while global growth will remain unchanged.

The assumption for the BGN/USD exchange rate is based on the pegged exchange rate of the local currency vis-à-vis the euro and a technical assumption for the USD/EUR exchange rate. The latter is assumed to remain unchanged over the projection horizon at the average levels for the ten-working-day period ending on the cut-off date. In the current publication, actual daily data was available up until 15.03.2019. Under the current technical assumption for the exchange rate dynamics, USD will appreciate against the EUR (BGN) in 2019, reaching 1.13 USD for EUR and the rate will be kept unchanged till 2022.

International prices are expected to remain relatively stable in 2019, following the sharp dynamics in 2018. The price of a barrel of Brent crude oil is expected to decline by 13.4% yoy to USD 61.5. Recalculated in BGN the price effect will be partly offset by the appreciation of the USD and the decline is expected to be 9.5%. In 2020-2022, crude oil price will continue to decline gradually, down by 0.2, 1.5 and 0.9%, respectively, in USD terms. As regards non-energy goods, international prices in USD are expected to decline in 2019, rebound in 2020 and preserve slight upward dynamics in the projection horizon. ●

External assumptions. Difference from the previous forecast.

| | Spring forecast 2019 | | | | Autumn forecast 2018 | | | Difference from the previous forecast | | |
|---|----------------------|------|------|------|----------------------|------|------|---------------------------------------|-------|-------|
| | 2019 | 2020 | 2021 | 2022 | 2019 | 2020 | 2021 | 2019 | 2020 | 2021 |
| World real GDP growth (%) | 3.5 | 3.6 | 3.6 | 3.6 | 3.9 | 3.7 | 3.7 | -0.4 | -0.1 | -0.1 |
| EU 28 real GDP growth (%) | 1.5 | 1.7 | 1.6 | 1.5 | 2.0 | 1.8 | 1.7 | -0.5 | -0.1 | -0.1 |
| USD/EUR exchange rate | 1.13 | 1.13 | 1.13 | 1.13 | 1.16 | 1.16 | 1.16 | -0.03 | -0.03 | -0.03 |
| Oil price, Brent (USD/barrel) | 61.5 | 61.4 | 60.5 | 60.0 | 70.8 | 67.7 | 65.0 | -9.3 | -6.3 | -4.5 |
| Non-energy commodity prices in USD (annual percentage change) | -0.2 | 1.1 | 0.7 | 0.6 | -0.1 | 0.0 | 0.3 | -0.1 | 1.1 | 0.4 |

Source: MF, EC, IMF

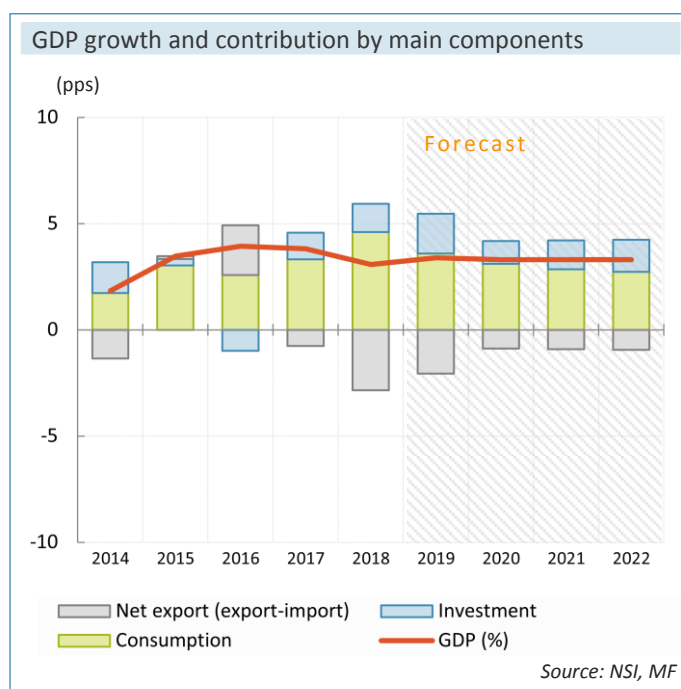
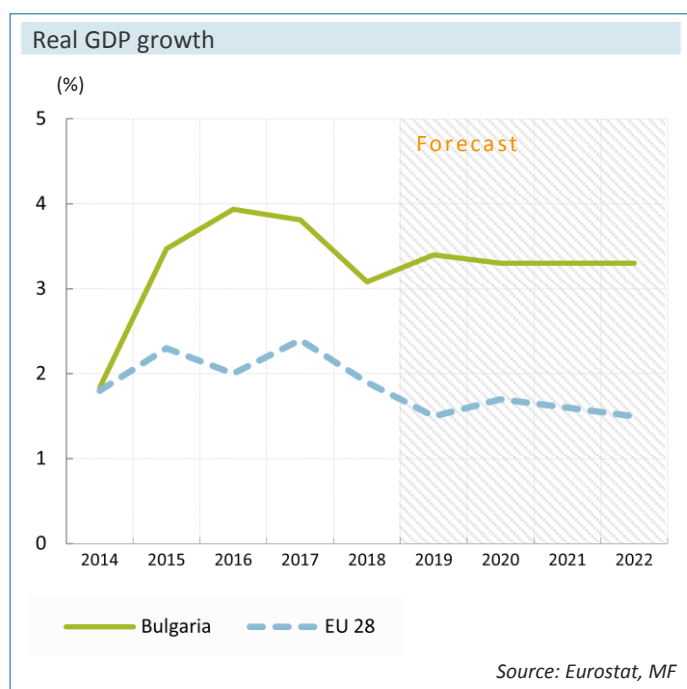
2. Gross Domestic Product

Bulgaria's GDP grew by 3.1% in 2018, compared to expected growth of 3.6% in the autumn forecast. The lower growth was due to the weak export dynamics, which led to a negative contribution of net export of 2.8 pps. At the same time, domestic demand reported higher growth than expected, driven mainly by the strong increase of private consumption.

According to the spring forecast of the Ministry of Finance, GDP will rise by 3.4% in 2019. The planned increase in public investment and the rise in export will lead to higher GDP growth than the one reported in 2018. Private consumption will continue to grow but at lower pace than in the previous year. The growth of private consumption slowed down significantly in the last quarter of 2018, despite the continuing increase in households' incomes and loans to households. Lower growth is linked to the deterioration in consumer confidence in the second half of 2018, which is a prerequisite for a more moderate increase in households' expenditures in 2019. The high base of

2018 will also have an impact and will contribute to the weaker increase in private consumption. Elevated uncertainty linked to the unstable external environment will also result in lower increase of private investment. In 2019, as negative one-off effects of 2018 fade away, the positive dynamics of export is expected to recover. External demand from EU countries will continue to support the growth of Bulgaria's export, but the contribution will be limited due to the expected slowdown in economic activity among most of the Member States. At the same time, Bulgaria's export to Turkey will remain negatively impacted by the decline in economic activity in the country. The demand for export-oriented industries and the upward dynamics of investment will lead to higher import growth. Foreign trade will have a more favourable impact on GDP growth, with net export's negative contribution falling to 2.1 pps.

Economic growth will slightly slow down to 3.3% in 2020 due to lower government expenditure for con-



sumption and investment. The development of private investment is expected to improve, while further acceleration of private consumption's growth will be limited by weaker increase of incomes and employment. The expected improvement of external environment, both in the EU and in some third countries, will result in higher export growth in 2020. Meanwhile, the increase of import of goods and services will decelerate due to weaker domestic demand and will restrict the negative impact of the external sector to GDP growth to 0.9 pps.

3. Balance of Payments

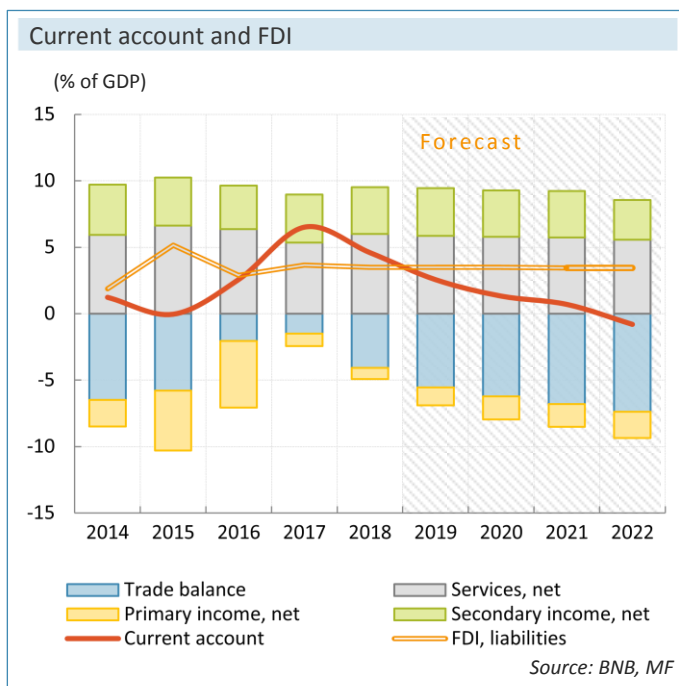
In 2018 current account balance remained positive, but the surplus lowered to 4.6% of GDP. Although the change corresponds to the one expected in the autumn forecast, the balance turned out much higher than forecasted. The better surplus resulted from higher positive balance on services (due to higher export as well as lower import) and lower income deficit (the registered repayment of investment income remained subdued). At the same time, the balances on goods and secondary income were in line with projections.

The assumptions in the current forecast, suggest improved terms in trade in 2019 (higher growth in export prices than in import). The positive price effect, combined with rebound in real export growth will result in higher nominal export growth in 2019 than in 2018. Nevertheless, the pace of increase in export (4.1%) will remain lower than in import (7.2%) and will lead to further widening in the trade deficit (to 5.5% of GDP). Services balance will remain almost unchanged at 5.9% of GDP. The expected increase in the operating surplus, which is a proxy for companies' profit, will be reflected in higher repayment of in-

GDP will increase by 3.3% during the period 2021–2022. As in the previous forecast, domestic demand (both consumption and investment) will drive the GDP growth. While investment activity is expected to increase moderately, the dynamics of private consumption will be limited by the labour market's developments linked to the exhaustion of the opportunities for employment growth. The increase of import will continue to outpace export growth, resulting in negative contribution of the external sector to GDP growth until the end of the forecast period. •

vestment income and, respectively, lower surplus on the incomes articles. As a result, current account balance will decline compared with 2018, but will remain positive at 2.6% of GDP.

In 2020–2022 nominal export growth of goods and services will moderate due to lower price deflators and decelerating EU growth in the end of the forecast



horizon. Import growth will continue to outpace export and the deficit on trade with goods and services will increase. Positive secondary income balance will remain solid, supported by inward transfers related to the closure of the EU programming period. Primary income deficit will increase slightly as a ratio to GDP. Current account surplus will decline gradually and turn into a slight deficit by 2022. Although lower, the

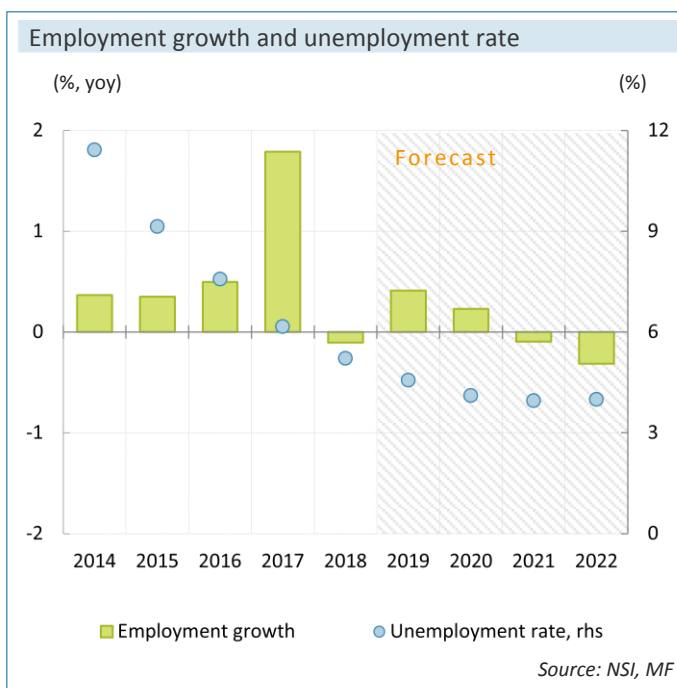
balance will be enough to provide a sustainable external position.

Positive FDI dynamics will extend into the forecast horizon. As in the previous forecast, FDI are expected to increase steadily with a pace close to the nominal GDP growth. As a result, inward FDI will amount to around 3.5% of GDP per annum for the entire forecast period. ●

4. Labour Market and Incomes

The main difference from the labour market developments in the autumn 2018 forecast result from the reported lower employment dynamics in H2 2018 and the expected acceleration of the employment growth in 2019 compared to the slowdown projected in the last forecast. In the medium term we keep our expectations for moderation of the employment growth towards stabilization and decline beyond 2020. The unemployment rate remains close to previous forecast, while the participation rate of the working-age population (15-64) is 0.5 to 0.1 pps lower till the end of the forecast period.

In 2018 the number of employed (ESA 2010) made a marginal 0.1% decrease compared to the expected growth of 0.6%. This was due to the weaker increase in industry and services in H2 2018, as well as the continuing decrease in agriculture. In 2019 the employment growth is estimated to gain momentum to 0.4% on account of the smaller expected decrease in agriculture compared to the reported considerable drop down of 6.1% in 2018. The dependence of the agricultural sector developments on weather conditions cumpers the estimate of employment dynamics but expectations for its further decrease follow from the high share of the self-employed (84.1% in 2018) and the restructuring of the labour force from small farms



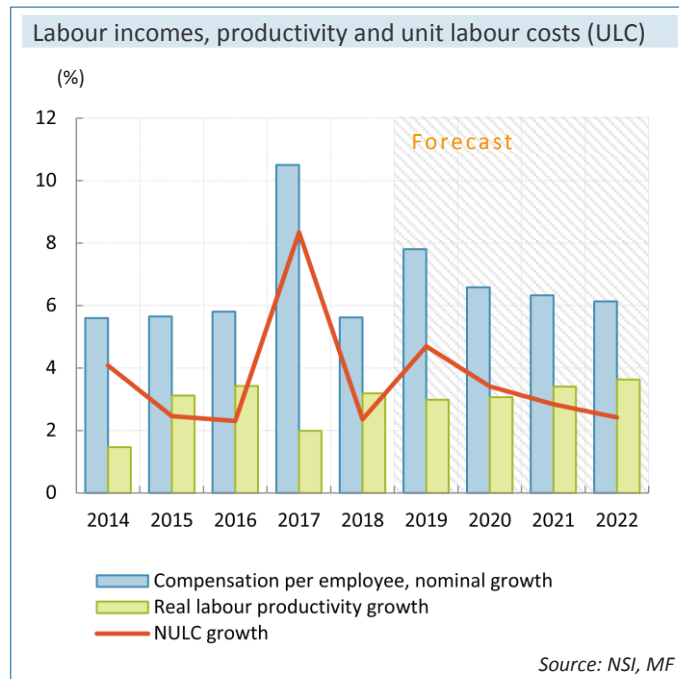
counting on family work force towards bigger farms which hire employees. The number of employed in industry and services is expected to increase in 2019 but at a slower yoy rate. The inertia of the weakened labour demand in manufacturing since mid-2018 will transmit in H1 2019, and in spite of the revival expected in H2 due to the improvement of the export performance, the employment growth in manufacturing for the whole 2019 will remain close to 2018. In line with the increasing supply of construction, the

employed number is expected to continue on growing up but slowly after the strong performance in 2018. The stable domestic demand developments support the employment growth in services, which similarly to industry is also expected to decelerate. The unemployment rate will decrease to 4.6%¹, and this will be accompanied with an increase in the participation rate (15-64) to 72.3%, after the indicator's marginal improvement in 2018.

In 2020–2022 the employment performance will moderate and turn to a decrease of 0.1% in 2021 and 0.3% in 2022. These expectations reflect the limitations from the labour supply due to the negative demographic trends and the decrease in the labour force, but also have to do with the depletion of the available labour resource of unemployed and people out of the labour force (discouraged) who could meet the demand of labour. The unemployment rate will keep the downward trend, albeit at a decelerating pace, to reach 4% in 2021–2022. In the context of the population and labour force decrease, the participation rate (15-64) will continue to grow up to 74.5% in the end of the forecast period.

Medium-term outlook on labour income is largely unchanged compared to the autumn forecast. The differences are mainly related to 2018 and 2019 as the compensation per employee growth for both years is slightly weaker than previously expected.

Compensation per employee growth will gain momentum to 7.8% in 2019, up from 5.6% in 2018 on account of both public and private sector. For the private sector the upward income dynamics will be supported by the expected further increase in real productivity, consumer prices, the number employees and minimum wage (up by 9.8% yoy). A strong contribution from public sector is expected as well following the



policy on broad wage increases since the end of 2017. The decomposition of compensation per employee shows that the impact coming from wage bill dynamics will be stronger than that of social security contributions (SSCs) which reflects the fading-out effect of the SSCs increase in 2018.² Afterwards the nominal compensation per employee growth is projected to slow down to 6.1% in 2022 in line with the lower contribution coming from public sector and downward employees' dynamics, which will be even negative at the end of the forecast horizon. Generally, the medium-term labour income outlook will support private consumption growth as the latter is expected to decelerate in 2019, but to remain above the historically average level in the post-crisis period.

Real labour productivity growth is estimated at an annual average rate of 3.3% in 2019–2022. In line with the spring expectations productivity growth stepped up to 3.2 in 2018. Throughout the entire forecast period productivity dynamics will be close to historical average since 2010 supported by the expected fa-

¹ According to the definition of the Labour force survey.

² Social security contributions for pension insurances, up by 1 pp in 2018

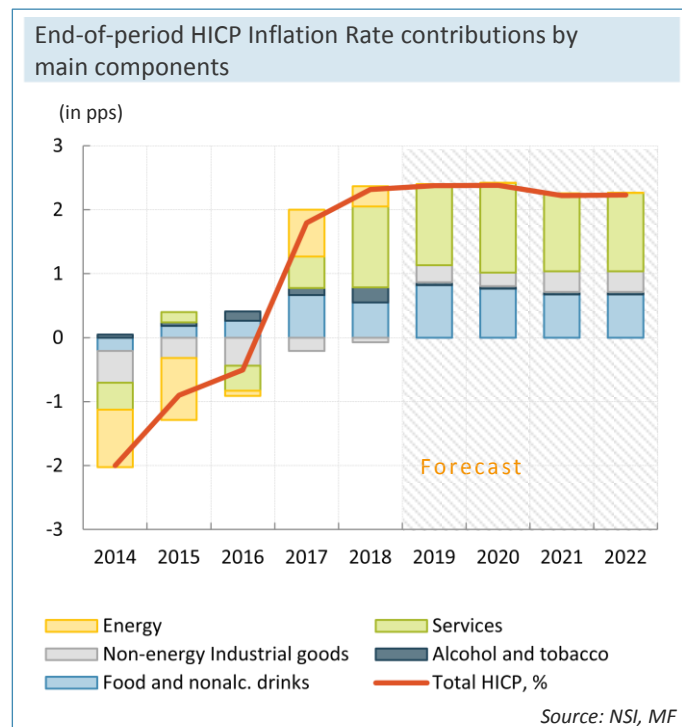
vourable outlook on investment, credit to enterprises and export. The relatively stronger wage growth expectations compared to productivity are not modified as well. The upward trend in nominal unit labour costs

5. Inflation

The average inflation in 2018 was 2.6%, and was close to the autumn forecast of 2.7%. End of period inflation was 2.3%. In the last two months of 2018 the annual inflation fell sharply, largely due to the prices of liquid fuels which were influenced by the drop in the crude oil prices (down by 30% for the two months).

Considering the assumptions about the expected dynamics of international commodity prices in 2019, the upward pressure on the producer and consumer prices in Bulgaria in 2019 is much lower than in the autumn of 2018. On the other hand, the domestic inflationary factors remain, although the household consumption is expected to grow at a slower pace this year. Due to the expected limited effect of international commodity prices, it is projected that the year will end with much lower price pressures on the consumer goods than on the services. End of period inflation in 2019 is projected to be 2.4%, slightly higher compared to the end of 2018. Food prices are projected to be higher due to output and value added drop in agriculture and increased energy costs from the previous year as well as by the expected increase in international prices of certain cereals in 2019. A slight increase in prices for non-energy industrial goods is also expected, since their prices have been declining following the crisis. The average annual inflation is projected to be 1.8%, technically due to the reported monthly figures in 2018. The end of period core inflation is expected to reach 2.5%, up from 2.1% in 2018.

(NULC) growth up to 2019 will be partially offset by its deceleration at the end of the forecast period. Thus, NULC are projected to grow by an annual rate of 3.3% on average in 2019–2022. •



In the end of the forecast period a slight slowdown in the end of year inflation is expected, due to lower oil prices, price stabilization in other commodities, and slowing domestic demand growth. Due to the lower price level of services versus goods, the relative price of services is expected to grow at a higher rate than the overall price level in the medium term.

An increase in some of the administered prices is possible during the forecast period. Such adjustments are not incorporated in the current projections due to a lack of official guidelines for the future dynamics of these prices. •

6. Monetary sector

In the period 2019–2022, private sector credit will continue to grow in line with expectations for favourable economic activity, higher disposable income and increasing consumption of households. Attracted deposits in the banking system are expected to continue to grow for the entire forecast period, as well.

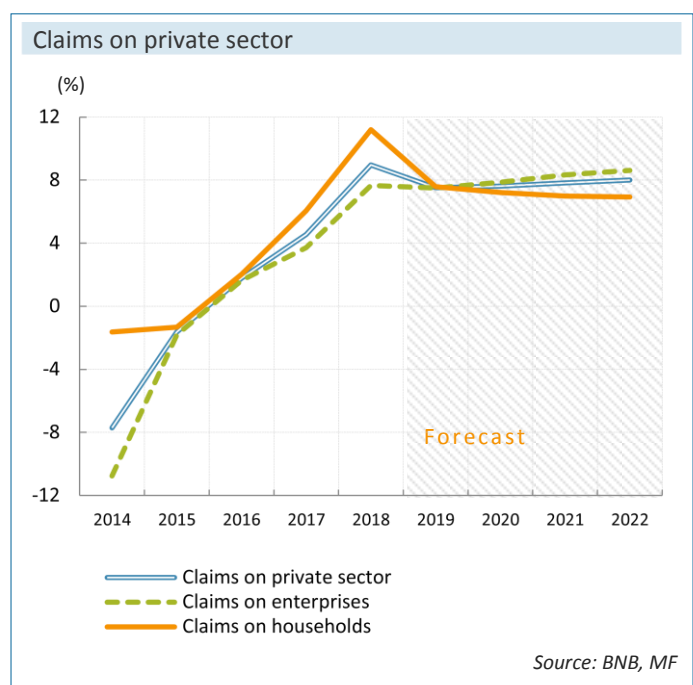
Compared to the autumn forecast, expectations for private sector credit developments are revised taking into account current developments and information on the National Programme for Energy Efficiency of Multi-Family Residential Buildings. At the end of 2018 growth of claims on private sector was 9% vs. expected 7.5% in the autumn forecast. This was mainly due to the higher growth in households' claims, which at the end of 2018 was 11.2% driven by consumer and loans for house purchases. Credit to non-financial corporations accelerated more gradually during the year, with annual growth of 5.4% at the end of December and those of claims on enterprises – 7.7%³.

In 2019 we expect the annual growth in households' credit to slow down. This will reflect the completion of one-off effects in 2018, and those coming from remaining government repayments on loans extended under the National Program for Energy Efficiency of Multifamily Residential Buildings. On the other hand, it also reflects expectations consumer loans' growth to slow down because of the lower projected growth in households' consumption. The annual growth rate of loans for house purchases will slow down, as well in line with the downward trend in house prices' growth in 2018, which is expected to continue in 2019. The annual growth in private sector claims will slow down too, and is expected to be 7.5% in the end 2019.

Additional factors in this direction could be higher rate of the countercyclical capital buffer, which will be effective from October 2019, as well as banks' actions to improve the quality of their balance sheet assets. Factors that will drive households' credit upwards are the higher growth of compensation per employee in 2019 and the expectation that a relatively high demand for borrowing funds will continue.

Credit to non-financial corporations will continue gradually to grow in 2019, and in the period 2020–2022 the increase will also reflect dynamics of private investment.

The annual growth of claims on enterprises is projected to be around 8.6% at the end of 2022. Households' credit will slightly slow down its annual growth rate by the end of the forecast horizon, in line with expectations for a slowdown in households' consumption growth.



³ Data refer to non-financial and financial corporations from BNB monetary statistics.

Claims on private sector will have an upward dynamic in the period 2020–2022, as well (with increasing contribution from non-financial corporations), and their

7. Risks

Unstable geopolitical environment, increasing number of protectionist trade measures and stronger than expected deceleration in EU growth are among the main negative risks for the Bulgarian economy, coming from the external environment. Trade uncertainties and restrictions have already started to affect economic performance in some developing economies. The deceleration in global trade might result in further slow-down in EU growth. With the lack of clear and predictable expectations for the dynamics of the Turkish economy, there is a risk of another decline in Bulgaria's export to the southern country. In addition, the difficult negotiations on the Brexit agreement weigh on trade outlook not only for Bulgaria, but for all Member States. If materialized, these risks would increase the negative contribution of net export to the economic growth and lead to a larger increase in the current account deficit.

Possible higher uncertainty among economic agents in the country linked to the unpredicted external envi-

ronment could lead to postponement of the willingness for consumption and investment.

annual growth is expected to be close to 8% at end of the forecast horizon. ●

The implementation of planned public investment projects will define to a large extent the overall investments dynamics in 2019. Postponement of public capex would moderate economic growth in the current year and shift their direct positive contribution to the following years.

The main factors that will determine risk to private credit forecast and may result in lower than expected credit demand are: increased uncertainty for the economic environment, deterioration of consumer confidence. Additional factors that bring risks to the forecast are banks' actions involved in the sales of credit portfolios, as well as potential effects on their credit activity as a result of the higher rate of the countercyclical capital buffer and new macroprudential tools regarding bank lending. ●

| MAIN ECONOMIC INDICATORS | ACTUAL DATA* | | PROJECTIONS | | | |
|---|--------------|---------|-------------|---------|---------|---------|
| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
| International Environment | | | | | | |
| World real GDP (%) | 3.7 | 3.7 | 3.5 | 3.6 | 3.6 | 3.6 |
| EU28 real GDP (%) | 2.4 | 1.9 | 1.5 | 1.7 | 1.6 | 1.5 |
| USD/EUR exchange rate | 1.13 | 1.18 | 1.13 | 1.13 | 1.13 | 1.13 |
| Crude oil, Brent (USD, bbl) | 54.4 | 71.1 | 61.5 | 61.4 | 60.5 | 60.0 |
| Non-energy commodity prices (in USD, %) | 5.3 | 2.1 | -0.2 | 1.1 | 0.7 | 0.6 |
| Gross Domestic Product | | | | | | |
| Nominal GDP (mIn BGN) | 101 043 | 107 925 | 115 437 | 122 827 | 130 464 | 138 433 |
| Real GDP growth (%) | 3.8 | 3.1 | 3.4 | 3.3 | 3.3 | 3.3 |
| Consumption | 4.3 | 6.0 | 4.6 | 4.0 | 3.6 | 3.5 |
| Gross fixed capital formation | 3.2 | 6.5 | 9.9 | 5.0 | 6.3 | 6.8 |
| Export of goods and services | 5.8 | -0.8 | 1.8 | 2.0 | 1.8 | 1.7 |
| Import of goods and services | 7.5 | 3.7 | 5.0 | 3.3 | 3.2 | 3.2 |
| Labour Market and Prices | | | | | | |
| Employment growth (SNA, %) | 1.8 | -0.1 | 0.4 | 0.2 | -0.1 | -0.3 |
| Unemployment rate (LFS, %) | 6.2 | 5.2 | 4.6 | 4.1 | 4.0 | 4.0 |
| Compensation per employee (%) | 10.5 | 5.6 | 7.8 | 6.6 | 6.3 | 6.1 |
| GDP deflator (%) | 3.4 | 3.6 | 3.4 | 3.0 | 2.8 | 2.7 |
| Annual average HICP inflation (%) | 1.2 | 2.6 | 1.8 | 2.5 | 2.3 | 2.2 |
| Balance of Payments | | | | | | |
| Current account (% of GDP) | 6.5 | 4.6 | 2.6 | 1.3 | 0.7 | -0.8 |
| Trade balance (% of GDP) | -1.5 | -4.1 | -5.5 | -6.2 | -6.8 | -7.4 |
| Foreign direct investments (% of GDP) | 3.7 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 |
| Monetary Sector | | | | | | |
| Money M3 (%) | 7.7 | 8.8 | 8.9 | 8.7 | 8.6 | 8.5 |
| Claims on enterprises (%) | 3.7 | 7.7 | 7.5 | 7.9 | 8.3 | 8.6 |
| Claims on households (%) | 6.1 | 11.2 | 7.6 | 7.2 | 7.0 | 6.9 |

* The forecast is based on statistical data up to 15 March 2019, unless noted otherwise

Source: IMF, EC, MF, NSI, BNB