BULGARIA

Highlights

- **Growth has been robust in the past year.** The economy grew by a healthy 3.8 per cent in 2017, helped by continuing strong domestic demand.
- **Reforms in the energy sector have continued.** The authority of the energy regulator has been strengthened in line with the relevant EU legislation, while an independent energy exchange for intraday trading has been launched.
- **Non-performing loans (NPLs) continue to decline steadily.** As a result of successful portfolio sales, the gross NPL ratio declined below 10 per cent in 2018. While the gross NPL ratio remains above the EU average, the banking sector has accumulated a capital surplus which fully covers net NPLs.

Key priorities for 2019

- **Further efforts are required within the framework of the EU's Cooperation and Verification Mechanism.** In particular, the government needs to implement the new anti-corruption law, further improve the independence and efficiency of the judiciary, and step up the fight against organised crime by improving the legislative framework and increasing transparency.
- **Reforms aiming to prepare the country for joining ERM II and the Banking Union need to continue.** While Bulgaria currently meets the macroeconomic conditions to become part of ERM II, the Bulgarian authorities need to remain committed to undertaking key reforms, including entering into close cooperation with the European Central Bank (ECB), introducing new macro-prudential instruments and amending the existing insolvency and anti-money laundering frameworks.
- **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. Efforts need to focus on reforming the business environment as outlined in the coalition programme, retaining qualified workers and improving the skills of the existing labour force.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	1.3	3.6	3.9	3.8	3.6
Inflation (average)	-1.6	-1.1	-1.3	1.2	2.6
Government balance/GDP	-3.6	-2.8	1.6	0.9	-0.1
Current account balance/GDP	0.2	0.0	2.3	4.6	2.4
Net FDI/GDP [neg. sign = inflows]	-3.6	-5.4	-3.1	-2.9	-3.1
External debt/GDP	85.5	81.6	76.4	74.0	n.a.
Gross reserves/GDP	44.2	47.3	49.9	44.3	n.a.
Credit to private sector/GDP	59.5	55.3	52.7	51.8	n.a.

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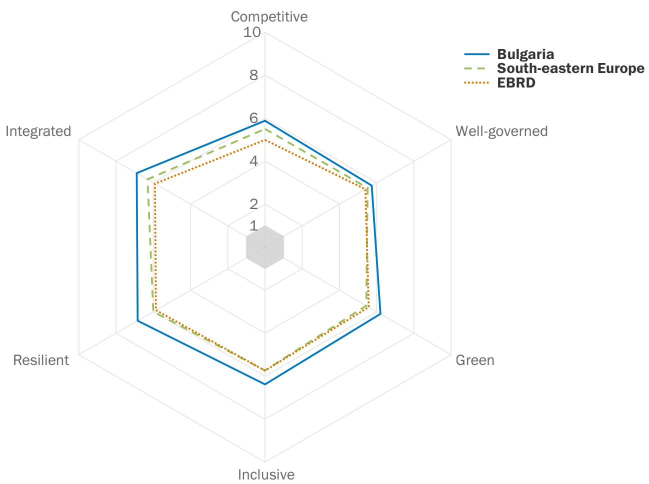
Macroeconomic performance

Growth has remained robust while inflation is rising. The economy grew by 3.8 per cent in 2017 and by 3.4 per cent year-on-year in the first half of 2018. Private consumption has been the main driver of growth, as the tightening labour market as well as minimum and public sector wage hikes pushed real wages up and unemployment down to 5.2 per cent in August 2018. Investment has also been strong, helped by the growing disbursement of EU funds since the second half of 2017. As a result of the recovering energy and food prices, inflation returned to positive levels in 2017, averaging 1.2 per cent, with a further rise in 2018, reaching a five-year high of 3.7 per cent in August 2018.

Fiscal policy has remained prudent and public debt levels have declined. Fiscal consolidation has continued in the past two years with revenue growth outstripping expenditure growth, resulting in two consecutive years of budget surpluses in 2016 and 2017. A significant surplus has been reported for the first half of 2018 and the government expects a positive budget out-turn for the year as a whole of around 0.5 per cent of GDP. Helped by sizeable primary surpluses, the public debt-to-GDP ratio has decreased by 3.4 per cent in 2017 to stand at 25.6 per cent, one of the lowest levels in the European Union.

Growth is expected to remain strong over the next two years. Private consumption is likely to underpin stable GDP growth rates, currently projected at 3.6 per cent in 2018 and 3.4 per cent in 2019. Public and private investment will also contribute positively to growth, as the absorption of EU funds will continue. In addition, fiscal policy is expected to support growth due to an increase in the public sector wage bill. Key risks to the outlook are: prolonged weakness in major trading partners, not least Turkey; exacerbation of current labour shortages and worsening of investor sentiments towards emerging markets. While convergence prospects remain high, with GDP per capita standing at 49 per cent (purchasing power parity-adjusted) of the EU average, sustaining the current high growth rates in the long run will require structural reforms to be reinvigorated.

Assessment of transition qualities (1-10)



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Major structural reform developments

Steps have been taken to integrate Bulgaria further into the EU's financial architecture. At the end of June 2018 the Bulgarian authorities officially declared their intention to join the eurozone's exchange rate mechanism, ERM II, and the Banking Union by July 2019, and ultimately the eurozone. The action plan adopted by the government in August 2018 lays out the reforms in financial sector regulation and economic governance to be undertaken over the next year.

There was some progress in implementing the Cooperation and Verification Mechanism (CVM). In February 2018 parliament adopted an Anti-corruption and Forfeiture of Assets Act, thus creating a powerful anti-corruption commission, introducing new conflict of interest regulations and regulating the seizure of illegally acquired assets. Parliament also adopted in March a new Anti-Money Laundering Act, bringing the legal framework in line with the relevant EU directive. Secondary legislation is expected to be published later in 2018.

Bulgaria's business environment remains close to the regional average, although there is room for improvement. According to the latest World Bank *Doing Business 2019* report, Bulgaria ranked 59th out of 190 countries in ease of doing business, dropping nine places compared with the previous year. The report points out that there were no reforms to improve the business environment over the past year. Procedures for starting a business, paying taxes and getting electricity remain burdensome, although Bulgaria performs better than the regional average in importing and exporting procedures.

Energy market liberalisation has advanced, and energy infrastructure improvements have continued. A two-way gas pipeline with Turkey was completed in August while the construction of a new interconnector with Greece is expected to start in late 2018. As part of the efforts to liberalise the market, the Independent Bulgarian Energy Exchange (IBEX) launched intraday trading in April 2018. From 1 July 2018 the electricity market in Bulgaria was further liberalised: all electricity producers with installed capacities above 4 MW, which used to benefit from preferential prices and long-term contracts, are now obliged to sell electricity on the free market. The recent amendments to the Energy Act transpose European legislation by giving the energy regulator powers to strengthen integrity and transparency of the wholesale electricity market for the benefit of end-consumers.

Confidence in the financial sector has improved. NPLs have continued to decline in the past year, as many banks have followed successful policies since early 2017 for the reduction of NPLs, including write-offs and sales of corporate secured NPLs. Even though Bulgaria's gross NPL ratio of 9.1 per cent as of June 2018 remains above the EU average of around 4.0 per cent, net NPLs are fully covered by the capital surplus accumulated in the banking sector. Meanwhile, the banking sector consolidation that started in 2014 has continued into 2018, including the merger of UBB and CIBANK, which was completed in February 2018.