BULGARIA

Highlights

- **Strong growth has continued into 2017.** After growing 3.9 per cent in 2016, the economy expanded by 3.6 per cent and 3.9 per cent in the first two quarters of 2017. Domestic demand and net exports led growth in 2016, while in the first half of 2017 growth was driven by private consumption. After several years of declining prices, inflation turned positive in December 2016.
- **The government budget returned to surplus in 2016.** A mid-term fiscal framework to continue the fiscal consolidation process was approved in April 2016, which helped achieve a cash-based budget surplus of 1.6 per cent of GDP in 2016, following a deficit of 2.9 per cent in the previous year. The budget surplus continued during the first half of 2017.
- **Confidence has returned to the banking system.** The main banks have proved to be resilient in stress tests, and non-performing loans (NPLs) declined to 12.1 per cent in the first half of 2017, from 13.2 per cent at the end of the previous year.

Key priorities for 2018

- **Energy market liberalisation and integration are priorities.** Following the completion of a natural gas interconnector with Romania in November 2016, further interconnectors are planned with other neighbouring countries. The government is preparing a roadmap, to be published in late 2017, to full energy market liberalisation.
- **Further progress under the European Union's Cooperation and Verification Mechanism is needed.** In particular, the government needs to implement a newly drafted law for a special court focusing on high-level corruption, and a new money laundering law, which aligns the current framework with that of the European Union (EU).
- **Bulgaria needs to sustain efforts to reduce administrative burdens on businesses.** This is an explicit goal of the new coalition programme. Notably, a focus is needed on alleviating procedures for starting a business, getting electricity and paying taxes. At the same time, efforts are also needed to address long-term issues of governance, as well as insufficient education levels among the labour force.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	0.9	1.3	3.6	3.4	3.5
Inflation (average)	0.4	-1.6	-1.1	-1.3	1.1
Government balance/GDP	-1.8	-3.6	-2.8	1.6	-1.4
Current account balance/GDP	1.3	0.1	-0.1	4.2	2.5
Net FDI/GDP [neg. sign = inflows]	-3.6	-3.6	-5.5	-2.4	-3.4
External debt/GDP	87.9	92.0	73.6	70.7	n.a.
Gross reserves/GDP	35.6	35.6	44.1	48.0	n.a.
Credit to private sector/GDP	66.3	59.6	55.4	53.6	n.a.

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Macroeconomic performance

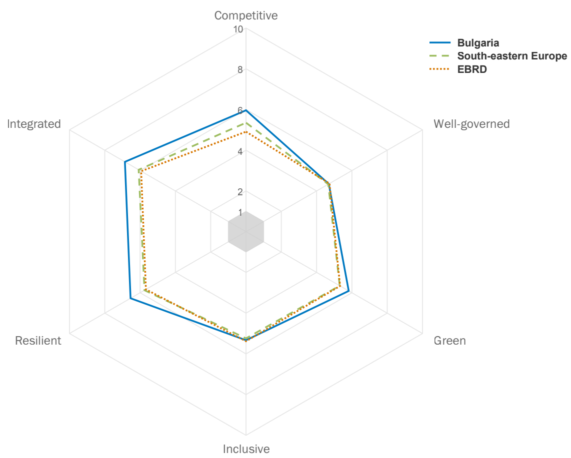
Strong economic growth has continued into 2017. The economy grew by 3.9 per cent in 2016, followed by a consumption-driven growth of 3.7 per cent in the first half of 2017. Net exports, driven by the upswing in key export markets including the EU, contributed to a current account surplus of 4.2 per cent of GDP. Private consumption also made an important contribution to growth in 2016, as unemployment fell and wages surged by a record 10 per cent year-on-year. However, investment dropped as a result of the cyclical fall in the disbursement of EU funds.

Inflation has turned positive again. In recent years, declining global oil prices and falling food prices had resulted in persistent deflation since August 2013. However, consumer prices started to rise in December 2016, driven by growing domestic demand, and year-on-year inflation averaged 2 per cent in the first half of 2017.

Fiscal performance has improved. Fiscal tightening in 2016, alongside higher tax collection, led to a cash-based budget surplus of 1.6 per cent of GDP and a primary surplus of 3.2 per cent. The budget surplus continued throughout the first half of 2017, standing at 1.8 per cent of the estimated 2017 GDP at the end of June. Public debt stood at 29.5 per cent of GDP at the end of 2016, rising slightly compared with the previous year but remaining low by regional and EU standards.

Short-term growth is likely to remain at current levels. Growth is expected to stabilise at around 3.5 per cent in 2017, with inflation of around 1.0 per cent. Domestic demand is expected to continue to drive growth, supported by improving labour market conditions and robust wage growth, with rising consumption limiting the contribution of net exports. Government consumption will remain limited due to the ongoing fiscal consolidation. Investment will strengthen as work starts on infrastructure projects financed under the EU's 2014-2020 budget. Growth is expected to remain robust in 2018, again at around 3.2 per cent. Key risks to the outlook are prolonged weakness in major trade partners and worsening of investor sentiments towards emerging markets, as well as any renewed difficulties in the financial sector. With GDP per capita (PPP) standing at 48 per cent of the EU average in 2016, convergence-based growth prospects in the medium term are positive but will require structural reforms to be reinvigorated.

Assessment of transition qualities (1-10)



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Major structural reform developments

Bulgaria made notable progress under the Cooperation and Verification Mechanism (CVM) in 2016, according to the 2017 report of the European Commission. Advances were noted in the implementation of judicial reforms, although the country still does not fully meet any of the six benchmarks the report monitors. At the same time, the report highlighted key challenges, including increasing the transparency of the election of the Supreme Judicial Council and ensuring that judicial appointments are transparent and merit-based. Meanwhile, the government has prepared a draft law for a special court focusing on high-level corruption and a money laundering law aligning the current legal framework with that of the EU.

Bulgaria continues to perform well compared with its regional peers in the business environment, although there remains room for improvement. According to the latest World Bank *Doing Business 2018* report, Bulgaria ranked 50th out of 190 countries in ease of doing business. Procedures for starting a business, paying taxes and getting electricity remain burdensome. Businesses surveyed in the World Economic Forum's *Global Competitiveness Index 2018* report indicate corruption and education of the labour force as the key challenges in the business environment. The new coalition programme aims at reducing the administrative burdens on businesses, which would be likely to improve the business environment if implemented.

Fiscal sustainability is being enhanced. The new government elected in March 2017 has adopted a coalition programme representing a continuation of the previous government's economic policies and fiscal framework. A three-year fiscal framework was approved in May 2017, foreseeing increases in the minimum wage and pensions. Following the approval of a pension reform package in July 2015, the retirement age has started to increase to enhance the sustainability of the state pension system. From its current levels of 63 years and 10 months for men and 60 years and 10 months for women, it will be equalised at 65 for both men and women by 2037.

Improvements in energy infrastructure have continued, strengthening energy sector integration. A natural gas interconnector with Romania was completed in November 2016, and the government plans new interconnectors with other neighbouring countries. However, there has been only limited progress in energy market liberalisation, an area that the new government has prioritised. The coalition agreement calls for the full liberalisation of the electricity and gas markets, and the government is currently preparing a roadmap to full energy market liberalisation and integration into the EU common market. The roadmap, expected to be published in late 2017, will be based on the guidelines from a 2016 World Bank study, and on EC Directives.

Confidence and resilience in the banking sector have strengthened. An Asset Quality Review (AQR) of the banking sector was completed in August 2016. The AQR showed that almost all banks comfortably meet local minimum capital adequacy requirements, with foreign-owned banks performing particularly well, while two domestic-owned banks had their capitalisation significantly trimmed, albeit still remaining above the minimum required. NPLs have continued to decline, and the first successful sale of corporate secured NPLs took place in January 2017. Nevertheless, Bulgaria's NPL levels of 12.1 per cent in the first half of 2017 remain significantly above the EU average of 5 per cent. Asset quality reviews in the insurance and pension sectors were also concluded in early 2017, with the results showing that most institutions were resilient to stress test scenarios, and no significant concerns reported.