BULGARIA

Highlights

- **The Bulgarian economy has been negatively affected by the coronavirus crisis.** The economy is experiencing recession in 2020 after recording growth of 3.7 per cent in 2019, but a bounce-back is expected in 2021.
- **The government has taken crisis response measures similar to those in other peer countries, although somewhat smaller.** The focus has been on preserving jobs, helping vulnerable groups and providing support to firms.
- **Bulgaria has joined the European Union (EU)'s Exchange Rate Mechanism (ERM II), paving the way for euro adoption.** Bulgaria has also joined the Banking Union, and therefore the European Central Bank (ECB) will be in charge of supervision of the major banks in the country.

Key priorities for 2021

- **Supporting firms' liquidity and preserving jobs from crisis through recovery is needed.** Providing liquidity to the economy, particularly small and medium-sized enterprises (SMEs), and revenue support to vulnerable individuals affected by the crisis are important measures for a quicker post-Covid-19 recovery.
- **The authorities should focus on the key structural reforms required to improve the country's competitiveness.** While important reforms have been taken in recent years, as reflected by the country's entry into ERM II and the Banking Union, further progress is needed with regards to improving the overall quality of institutions and governance.
- **Further work is needed to improve the rule of law and strengthen anti-corruption efforts.** Progress under the EU's Cooperation and Verification Mechanism (CVM) has been praised in the previous years' reports. Nevertheless, proving the irreversibility of the reforms will be key to fulfilling the country's commitments to the EU.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.8	3.5	3.1	3.7	-5.5
Inflation (average)	-1.3	1.2	2.6	2.5	1.0
Government balance/GDP	0.1	1.1	2.0	1.9	-2.8
Current account balance/GDP	3.2	3.5	1.4	4.0	1.9
Net FDI/GDP [neg. sign = inflows]	-1.1	-2.5	-1.3	-1.3	-0.5
External debt/GDP	67.1	67.8	58.1	55.7	n.a.
Gross reserves/GDP	46.9	47.4	43.1	40.6	n.a.
Credit to private sector/GDP	51.5	49.5	49.7	49.3	n.a.

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Covid-19: macroeconomic implications

The coronavirus pandemic has hit the economy. Following growth of 3.7 per cent in 2019, which was driven mainly by private consumption, the country is experiencing a recession in 2020. The state of emergency, declared in mid-March, imposed tough restrictions on travel and economic activity, resulting in a sharp decrease in economic activity in March and April. Economic activity started to gradually recover from May onwards amid the lifting of most restrictions. In the first quarter of 2020, the economy was still expanding by 1.2 per cent year-on-year, and growth was broad-based. The full impact of the crisis was seen in the second quarter, when real GDP dropped by 8.7 per cent year-on-year. This resulted in a decline of 4.2 per cent year-on-year in the first half of the year, with private consumption decreasing by 2.4 per cent year-on-year and investments by more than 8 per cent year-on-year. The mitigating factor came from the government crisis response package of about 4 to 5 per cent of GDP, the focus of which was on preserving jobs and providing support to firms.

Exports and tourism have declined. Exports of goods, which account for about 50 per cent of GDP, making Bulgaria only moderately dependent on trade, decreased by about 3 per cent year-on-year in the first half of 2020. A more important impact on the balance of payments, as well as on the decline in economic activity, was the enormous disruption to the important tourism sector, which in normal times accounts for about 10 per cent of GDP. Foreign arrivals stopped almost completely in April and May 2020 and have been slow to recover since, declining by 75 per cent year-on-year in June and 65 per cent year-on-year in July. The government expects a decline of tourism revenues for the year as a whole of more than 50 per cent compared with last year.

The government redrafted the budget to accommodate a higher deficit. After four consecutive years of budget surpluses, and with public debt at 20 per cent of GDP, Bulgaria is among the least indebted countries in the EU. Notwithstanding the pandemic-induced economic slowdown, budget execution data up to mid-year show a cumulative surplus of 1.3 per cent of GDP in the first half of 2020. However, the Covid-19 crisis is putting great pressure on the fiscal account, and with a deterioration expected in the second half on the back of lower tourism receipts and government support measures employed, in April 2020 the government projected a new deficit at -2.9 per cent of GDP for the year as a whole (assuming a recession of 3 per cent), compared with a previously planned balanced budget. In April and May 2020, respectively, Fitch and Standard & Poor's maintained the BBB rating on Bulgaria's sovereign credit but downgraded the outlook from positive to stable on the back of Covid-19 related risks.

Economic activity is expected to recover in 2021. We project GDP to fall by 5.5 per cent in 2020 and bounce back with a 3.0 per cent growth rate in 2021. This is based not only on the assumption of a gradual normalisation of economic activity in Bulgaria in the second half of 2020, but also among its main economic partners. The main risks to the outlook are on the downside and are associated with a possible prolonged Covid-19 crisis, both in Bulgaria and elsewhere.

Policy response to Covid-19

Crisis response measures mainly focused on preserving jobs. The overall measures taken so far by the government are estimated at 4 to 5 per cent of GDP, and are similar to those in other countries. Government support during the pandemic mainly focused on sustaining employment. One of the key measures has been the coverage of 60 per cent of salary costs in the crisis-affected sectors, which has been extended until the end of the year. The government also introduced wage subsidies for hiring the unemployed, as well as for retaining jobs in the tourism and transportation sectors (a monthly subsidy of BGN 290 [€148] per employee for up to six months), and provided support for the self-employed (such as freelancers working in the cultural sector). Additional remuneration was provided to those in the ministries of health, interior and defence, as well as one-off transfers to parents forced to be on unpaid leave.

Several measures were taken to support firms. In April 2020, the government announced that the payment of corporate taxes would be deferred until 30 June, and the value-added tax rate reduced from 20 per cent to 9 per cent for certain categories including restaurant services, tourist operators, sports facilities, wine and beer, as well as books and baby food, until the end of 2021.

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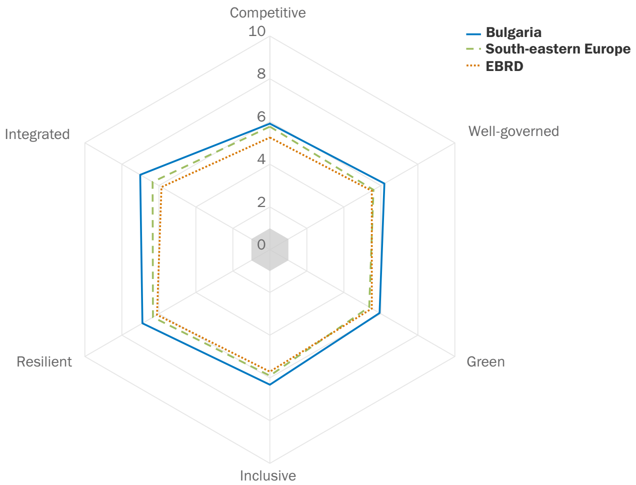
In terms of direct firm liquidity support, the government increased the capital of the state-owned Bulgarian Development Bank (BDB) by BGN 700 million (€357 million) so that it could provide BGN 500 million (€255 million) of support for portfolio guarantees to commercial banks for the extension of corporate loans, and the remaining BGN 200 million (€102 million) for interest-free loans to employees on unpaid leave. The government also reallocated about BGN 350 million (€179 million) of EU funds to directly support companies affected by the Covid-19 crisis through grants, and an additional BGN 1,024 million (€532 million) to the state-owned company "The Fund of Funds" for further on-lending, particularly to SMEs.

Further measures were adopted in July 2020 under an additional crisis support package. Key measures, effective from 1 August, include additional payments to personnel involved in activities to contain the spread of the pandemic, an increase in subsidies to hospitals, extra payments for children's healthcare, and more money for social assistance and pensioners. In the tourism sector, state subsidies of €35 per seat for charter flights are provided, as well as BGN 210 (€105) worth of tourism vouchers for people involved in addressing the pandemic. The minimum amount of unemployment benefit was also increased (from BGN 9 to 12 [€4.6 to €6.1] per day) as well as the minimum payment period (from four to seven months), in effect since October.

The Bulgarian National Bank took measures to increase the liquidity of the banking sector. Key policy measures introduced during the Covid-19 crisis included: (i) capitalisation of 2019 profit in banking system (BGN 1.6 billion, 1.4 per cent of GDP); (ii) reduction of foreign exposures of commercial banks (BGN 7 billion, or 5.8 per cent of GDP); and (iii) cancellation of the increase of the countercyclical capital buffer planned for 2020 and 2021, in effect amounting to BGN 0.7 billion (0.6 per cent of GDP). In addition, the central bank, following guidance from the European Banking Authority, and after consultation with the Association of Banks in Bulgaria, approved the deferral of loan payments for up to six months for impacted firms and individuals. It also established a €2 billion swap line with the ECB until the end of 2020 or as long as necessary to ensure liquidity.

Assessment of transition qualities (1-10)



Structural reform developments

Bulgaria's eurozone membership has advanced following ERM II accession. In July 2020 the ERM II parties, that is, the ECB together with the eurozone member states and Denmark, decided to include the Bulgarian lev in the ERM II, following the request sent by Bulgaria in July 2018, at the central rate set at 1 euro = 1.95583 leva, the same rate Bulgaria has had under its currency board arrangement since 1997. After two years, a new assessment of the country's readiness for eurozone membership will be taken; if positive, Bulgaria would join the eurozone.

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The decision followed the introduction of a number of important reforms in the financial sector, which strengthened institutional quality and governance. In the same month, Bulgaria joined the Banking Union and therefore, from 1 October 2020, the ECB is in charge of the direct supervision of the major banks in Bulgaria, as well as the oversight of others.

Liberalisation and diversification of the gas market have advanced. Amendments to the Energy Act were adopted in October 2019 towards the liberalisation of the gas market, including rules on gas balancing and the setting up of an organised trading point, as well as those regarding the functioning of the public supplier. The new rules will allow for a gradual transition from a regulated market to one based on freely negotiated prices. The gas supply is also being diversified, following progress in the development of new transmission links with neighbouring countries. The construction of the gas pipeline connecting the country's existing gas transmission system with Turkey and with Serbia, with the aim of carrying gas from the Turkish Stream, is progressing. Moreover, the construction of the gas connection with Greece advanced with financial support from the European Investment Bank (EIB), and one with Serbia is also planned. In addition, in August 2020 Bulgartransgaz acquired a 20 per cent interest in a Greek liquefied natural gas terminal in Alexandroupolis.

Transport infrastructure development is progressing. Road infrastructure works have continued at the Hemus motorway (linking Sofia with the Black Sea port of Varna through the northern part of country), while the contract for the last pending section of 89 km between Veliko Tarnovo and Buhovtsi-Belokopitovo, was awarded to the state-owned Avtomagistrali in December 2019, with full completion expected in 2024. The Gabrovo bypass, part of the I-5 road (linking the Danube port Russe to the Greek border) including Bulgaria's longest concrete bridge, was finalised in June 2020. Contracts for railway modernisation, including the Plovdiv node, as well as the EIB-funded Elin Pelin-Kostenets railway line (part of the Sofia-Plovdiv route), were signed in July. Also in late July, the government and SofConnect, a consortium of the French-registered Meridiam Eastern Europe Investments, the Austrian construction company Strabag, and the Munich Airport operator, signed a deal on a 35-year concession of Sofia airport.