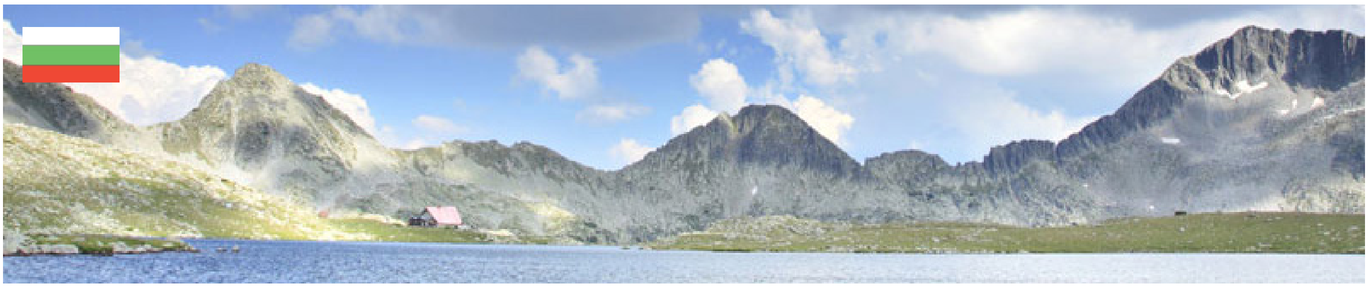

Bulgaria

Highlights

- **Gross domestic product (GDP) growth has remained relatively resilient in 2024.** The economy grew by 2.1 per cent year on year in the first half of 2024 as investment rebounded after years of weakness and strong wage growth supported the rise in private consumption.
- **Installed renewable capacity is increasing.** In 2023, solar accounted for 8.8 per cent of total electricity production, marking a 140 per cent increase in absolute generation compared with 2021. Bulgaria is becoming an important destination for renewable developers, particularly solar parks.
- **Political uncertainty has led to another revision of the Recovery and Resilience Plan (RRP).** With implementation of the RRP delayed, the caretaker government proposed revising the RRP by October 2024 to amend the investment plan. Bulgaria is also yet to receive approval of the REPowerEU chapter from the European Union (EU).

Key priorities for 2025

- **Absorption of RRF funds should be accelerated.** Bulgaria is facing delays in implementing and receiving funds from the Recovery and Resilience Facility (RRF). Still, while RRF implementation has been more difficult, Bulgaria is progressing well in absorbing the cohesion funds from the 2021-27 framework.
- **Complementary efforts towards greening the energy system are needed.** Despite the impressive progress in increasing solar capacity over the past two years, investments in storage, finalising market reforms and accelerating the phase-out of carbon-intensive production are still needed, alongside energy efficiency measures.
- **The authorities should promptly implement recommendations for improving anti-money laundering.** While significant progress has been made so far, Bulgaria needs to complete all recommended actions to remove the country from the Financial Action Task Force (FATF) grey list.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-3.2	7.8	4.0	1.9	2.2
Inflation (average)	1.2	2.8	13.0	8.6	3.1
Government balance/GDP	-3.8	-3.9	-2.9	-1.9	-2.6
Current account balance/GDP	0.4	-1.1	-2.6	0.9	0.3
Net FDI/GDP [neg. sign = inflows]	-4.0	-1.6	-4.0	-2.8	-0.2
External debt/GDP	62.9	57.9	50.8	48.0	na
Gross reserves/GDP	50.1	48.7	44.8	44.6	na
Credit to private sector/GDP	51.0	47.9	44.5	45.2	na

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Macroeconomic developments and policy response

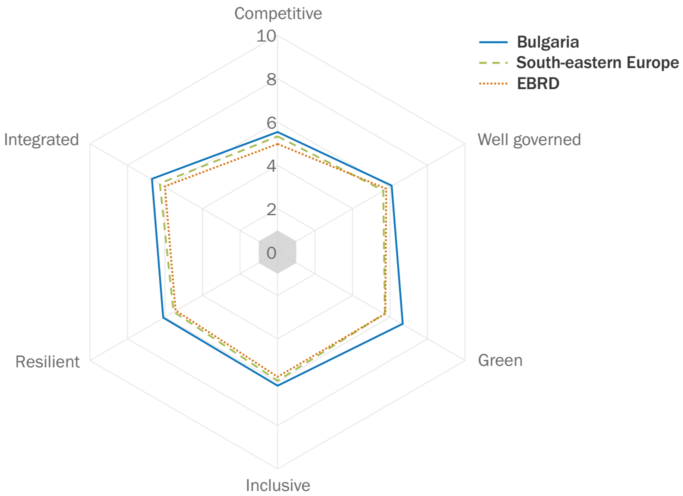
Weak external demand has constrained growth so far in 2024. After slowing to 1.9 per cent in 2023, real GDP growth was 2.1 per cent year on year in the first half of 2024, driven mainly by domestic demand. Amid strong wage growth, private consumption was resilient, and investment growth has held up year on year, given last year's low base. Rising incomes, a lack of alternative investment opportunities and low interest costs led to strong investment in construction, especially in the capital, Sofia. However, weak foreign demand translated into struggling industrial output, which declined by 5.2 per cent year on year in June 2024. As a result, the trade deficit widened in 2024, reflecting the strong domestic demand, after a significant destocking in 2023 led to a large drop in imports. The unemployment rate fell to just 4.3 per cent in the second quarter of 2024.

Real wages are growing strongly, putting pressure on inflation and threatening to delay the adoption of the euro. Average wages increased by 17.1 per cent year on year in the first half of 2024, driven by a 20 per cent minimum wage increase effective from January 2024. Meanwhile, inflation has stabilised since April 2024 at around 2.8 per cent, but fell from September due to lower fuel prices. In July 2024, the inflation rate was still 1.2 percentage points above the reference value (that is, the average of the three eurozone members with the lowest 12-month average inflation plus 1.5 percentage points) for eurozone entry. Fiscal policy has remained mildly expansionary, with a targeted budget deficit of 3 per cent of GDP in 2024, similar to 2023.

Retail credit demand accelerated in 2024. Private investment in Bulgaria improved in 2024, with investments in tangible assets rising by 5.3 per cent year on year in the second quarter. Still, most investments have been channelled to the construction and real-estate sectors, as industry, information and communications technology (ICT) and trade all marked annual declines. This is reflected in the structure of loans, as households increasingly take on mortgages motivated by low interest rates and expectations of euro adoption. As of July 2024, retail loans continued growing and reached 19.6 per cent year on year, while the corporate lending portfolio grew by 8.7 per cent in the first half of 2024.

Growth should remain resilient despite challenges. Considering the growth rate recorded in the first half of 2024, we forecast real GDP to expand by 2.2 per cent for the full year, driven by domestic demand as exports will likely remain weak. In 2025, the economy is forecast to grow by 2.9 per cent, albeit with downside risks related to the political uncertainty and slow absorption of EU funds. Potential euro adoption in 2025 could unlock some investments, support trade and boost the banking sector.

Assessment of transition qualities (1-10)



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Structural reform developments

Bulgaria is moving towards adopting the euro. The relevant law came into force in August 2024. All criteria for euro adoption have been met except for the inflation target. The authorities are aiming at January 2025 for eurozone membership, potentially moving this to July 2025 if the inflation criterion is not met by the end of 2024. Another positive development in Bulgaria's further integration with the EU was the partial entrance to the Schengen area in March 2024 via air and seaports, but there is no clear timeline for full Schengen membership.

Implementation of the RRP is facing substantial delays and challenges. As of September 2024, Bulgaria has submitted two payment requests and received €1.37 billion from the RRF. While some reforms and investments have started, implementation remains well behind schedule owing to frequent government changes. The second request remains blocked as four revised laws need to be approved again by parliament. The REPowerEU chapter is yet to be submitted to the European Commission, which represents a missed opportunity to accelerate the green transition. In addition, the caretaker government from summer 2024 proposed submitting another revised plan, given the limited time available for implementing some investments.

Bulgaria was included in the grey list of the Financial Action Task Force. In October 2023, the Council of Europe's MONEYVAL Committee assessed Bulgaria's framework for fighting money laundering and countering the financing of terrorism, which resulted in Bulgaria being subject to increased monitoring by the FATF. In turn, the country committed to an action plan to address the weaknesses. These included the investment-linked citizenship and residence schemes, beneficial ownership registers and enforcement against corruption and organised crime, in which the authorities have made some progress.

Public investment in infrastructure increased. After considerable declines in 2023, public investment in infrastructure recovered in 2024, supported in part by EU structural funds and Bulgaria's RRP. The government also initiated a large-scale grid modernisation programme in mid-2024, allocating significant EU funds to enhance the power system's capacity to integrate renewable energy sources.

Energy transition is progressing despite a lack of wider sectoral reforms. Bulgaria expanded its renewable energy capacity in 2024, despite challenges in deploying grid-scale storage and onshore wind projects. In 2023 and 2024, the country had around 80 per cent annual growth rates of electricity generation from solar panels. Amid the increasing reliance on solar, the Ministry of Energy announced in March 2024 a new energy storage incentive programme, offering tax credits for businesses and households investing in battery systems. This move is aimed at balancing the grid and supporting further renewable energy integration. The authorities also made some progress in diversifying energy sources, aiming to reduce reliance on Russian gas and promoting Bulgaria's role as a transit hub for energy. Plans to expand production capacity at the Kozloduy nuclear power plant also proceeded despite new plans to avoid using Russian components. Moreover, an EU-funded retraining programme for coal industry workers was launched in January 2024, focusing on skills needed for the renewable energy sector and thereby addressing potential job displacement concerns in coal-dependent regions.

The government is simplifying the process for foreign workers to obtain permits. This reform aims to tackle skills shortages in key sectors of the economy by digitising work visa applications and fast-tracking visa applications for high-skilled sectors such as IT, healthcare and manufacturing. For low-skilled sectors such as tourism and transportation, the government broadened the list of countries eligible for 90-day visa-free work permits. It also introduced regional incentives to attract workers to underdeveloped regions.

The banking system is technically ready for euro adoption. As part of the reform package for euro adoption, parliament approved in January 2024 a new law that addresses previous recommendations and brings the Bulgarian National Bank's operations in line with European Central Bank standards. The move enhances the central bank's independence and modernises its governance structure, which may help to boost political credibility and smooth out inflation expectations.