Euler Hermes Economic Research

Country Report

Bulgaria

Growth will lose some momentum but remain robust

General Information

GDP	USD49.0bn (World ranking 81, World Bank 2015)
Population	7.18mn (World ranking 102, World Bank 2015)
Form of state	Parliamentary Democracy
Head of government	Ognyan Gerdzhikov (interim Prime Minister)
Next elections	26 March 2017, early legislative

Strengths

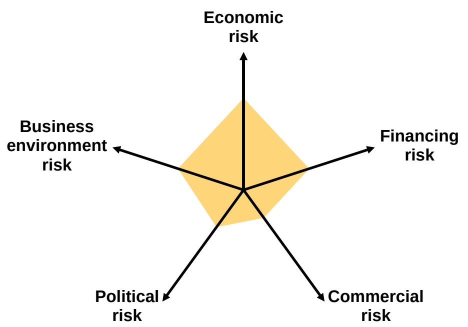
- EU membership and good international relations
- Relatively low systemic political risk
- Currency board has withstood global turbulences since 2008 and BGN is currently not overvalued
- History of prudent fiscal policies
- Current account surpluses since 2013
- Generally adequate business environment

Weaknesses

- Slow progress on EU-required judicial reform and anti-corruption measures
- Public discontent about living standards
- Tight credit markets (though gradually improving)
- High external debt burden
- Banking sector vulnerability to financial contagion from (potential) banking crises in the Eurozone

Country Rating

B2



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Germany	14%	1	13%	Germany
Italy	9%	2	9%	Russia
Romania	9%	3	8%	Italy
Turkey	8%	4	7%	Romania
Greece	7%	5	6%	Turkey

By product (% of total)

Exports		Rank		Imports
Machinery and transport equipment	21%	1	28%	Machinery and transport equipment
Food and live animals	11%	2	15%	Chemicals
Chemicals	10%	3	12%	Fuel and fuel products
Fuel and fuel products	9%	4	8%	Food and live animals
Crude materials, inedible (non-fuel)	7%	5	7%	Crude materials, inedible (non-fuel)

Source: National Statistical Institute of Bulgaria (2016)

Economic Overview

Growth rebalancing expected in 2017

Real GDP growth continued to grow robustly at +3.4% in 2016, slightly down from +3.6% in 2015. However, the GDP breakdown revealed a significant change: in 2016 growth was mostly driven by net external demand and inventories, a shift from 2015 when domestic demand was the key growth driver. Consumer spending growth decelerated to +2.1% in 2016 from +4.5% in 2015 and public spending slowed to +0.6% (+1.3% in 2015). Moreover, fixed investment dropped by -4% (after +2.7% in 2015) owing to the slowdown in EU funds absorption following the completion of the 2007-2013 programming period. However, inventories added +0.9pp to growth in 2016 (-0.2pp in 2015). Export expansion remained sound at +5.7% (unchanged from 2015) while imports slowed to +2.8% (+5.4% in 2015) thanks to low oil and energy prices, so that net exports contributed +1.9pp to growth in 2016 (+0.2pp in 2015).

Looking ahead, domestic demand, notably fixed investment, is expected to recover, which should also accelerate import growth so that net exports will be more balanced. At the same time, the inventory build-up should fade. Overall, Euler Hermes expects annual growth to ease to +2.8% or so in 2017-2018.

Banking sector weaknesses remain evident, but systemic crisis unlikely

Bulgaria's financial system weathered the impact of the 2008-2009 global financial crisis relatively well and has also been largely unaffected by the swings in capital flows to emerging markets since mid-2013. However, it was hit by a home-made "mini-crisis" in mid-2014 when deposit runs on two large domestic-owned banks caused concerns about financial stability, but swift action by the Bulgarian National Bank (BNB; central bank) helped contain the pressures and sustain confidence in the overall banking system. Corporate Commercial Bank (CCB; then 4th largest lender) was taken over by the BNB and First Investment Bank (FIB; 3rd largest lender) managed to restore confidence quickly with immediate BNB support. The banking sector came under stress again in 2015 due to spillovers from Greece but, again, the BNB successfully contained the impact and retained banking system stability. Nonetheless, banking sector weaknesses remain evident, including banks' heavy reliance on funding from EU parent banks – whose subsidiaries dominate the sector (approx. 22% Greece, 15% Italy, 12% Hungary) – which makes them vulnerable to financial contagion from banking crises in the Eurozone.

Regarding financial soundness, the banking sector overall has remained liquid, well-capitalized and profitable despite the turbulences, but the non-performing loans (NPL) ratio rose from an already high 14.6% in mid-2014 to around 20% in 2015 and has remained that high since then. This is the highest ratio in Central Europe. However, after two years of sharp decline, loans to NFCs eventually began to grow again at end-2016 (+0.3% y/y).

Currency board not at risk

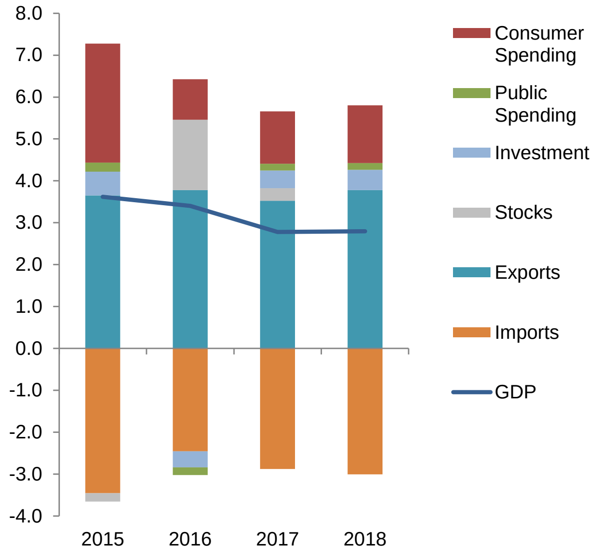
Bulgaria's currency board (BGN1.95583:EUR1) continues to appear stable. The real effective exchange rate indicates that Bulgaria enjoys relative competitiveness. Moreover, foreign exchange (FX) reserves continue to cover the monetary base (a requirement for a currency board) clearly. However, the currency board largely neutralizes monetary policy.

Key economic forecasts

	2015	2016	2017f	2018f
GDP growth (% change)	3.6	3.4	2.8	2.8
Inflation (%, end-year)	-0.4	0.1	1.6	2.2
Fiscal balance (% of GDP)	-1.7	-0.6	-1.0	-1.0
Public debt (% of GDP)	26.0	29.6	28.0	27.0
Current account (% of GDP)	0.4	3.9	2.0	1.5
External debt (% of GDP)	75.3	73.9	72.7	72.5

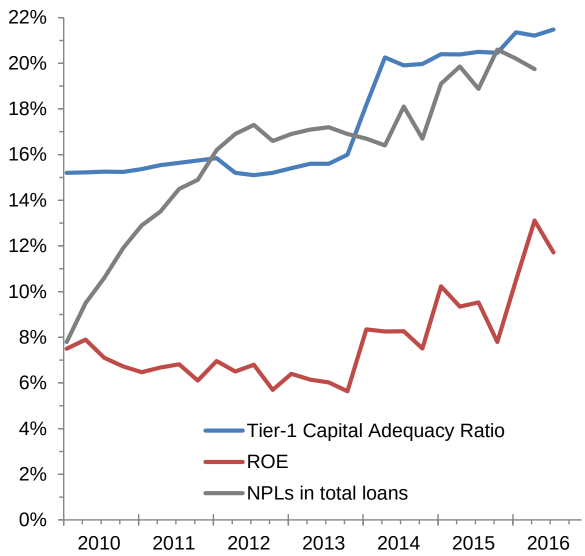
Sources: National sources, IHS, Euler Hermes

GDP growth (%) and contributions (pp)



Sources: National sources, Euler Hermes

Banking sector soundness indicators (%)



Sources: Bulgarian National Bank, IMF, Euler Hermes

Headline consumer price inflation was in negative deflationary territory for most of the period from August 2013 to end-2016, initially due to a protracted low growth environment, and then as a result of markedly falling energy import prices as well as lower food costs. But since late 2016, deflationary pressures have been waning amid recovering oil prices and headline inflation turned positive, reaching +1.4% in January 2017. Euler Hermes expects this trend to continue and average annual inflation of about +1.8% in 2017.

Public finances are unproblematic

Bulgaria has had a long-lasting commitment to fiscal prudence, reflected in many years of fiscal surpluses or acceptable deficits. Public debt declined rapidly from 71% of GDP in 2000 to just 13% in 2008 before gradually rising to 17% in 2013.

In 2014, the resolution of the banking crisis had a fiscal cost, for example the government replenished the State Deposit Guarantee Fund which had been depleted by the CCB failure. The fiscal deficit rose to -5.5% of GDP and public debt to 27% of GDP. However, the fiscal deficit narrowed rapidly to an estimated -0.6% of GDP in 2016 and public debt has stabilized. For 2017-2018, Euler Hermes forecasts the annual fiscal deficit to remain low at about -1% of GDP while public debt should stay below 30% of GDP, which is still very low by EU standards.

Current account balance is favorable but external debt remains the weak spot

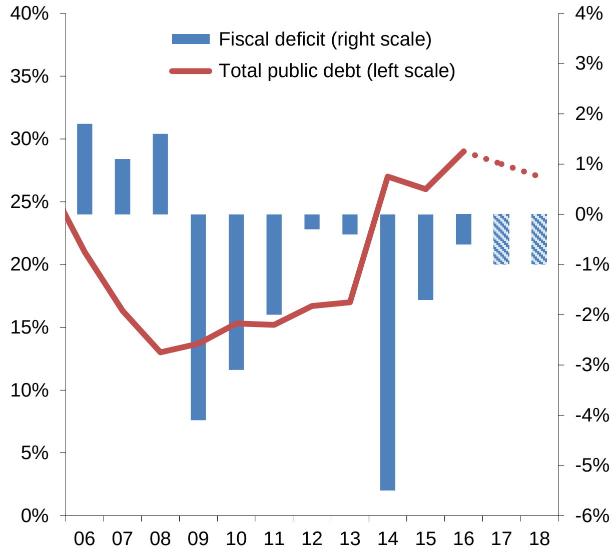
The current account surplus surged to +3.9% of GDP in 2016 as exports rose much faster than imports. Continued but more moderate external surpluses of +1.5% to +2% of GDP are forecast in 2017-2018.

However, the legacy of large current account deficits from 2003-2009 has left Bulgaria with a very high external debt burden. Even though gross external debt declined from the peak of EUR39bn in March 2015 to EUR35bn at the end of 2016, it still accounted for a worrisome 74% of GDP. The private sector share of external debt was 79%, while total short-term debt as a share of gross debt has fallen to 23% from the 36% peak in late 2008.

FX reserves have continued to rise

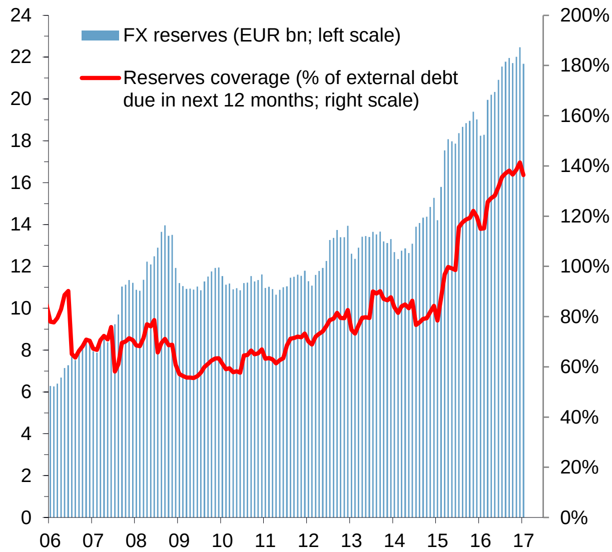
FX reserves have increased substantially since end-2013 and stood at EUR21.7bn in January 2017, a comfortable level with regard to import cover (more than seven months). Moreover, in other terms reserves now cover about 135% of the estimated external debt payments falling due in the next 12 months, a favorable ratio and a significant improvement from 80% two years ago.

Public finances (% of GDP)



Sources: Eurostat, Euler Hermes

Foreign exchange reserves and coverage of external debt payments falling due within 12 months



Sources: Bulgarian National Bank, Euler Hermes

Contact Euler Hermes Economic Research Team

research@eulerhermes.com

Last review: 2017-03-08
Country Risk Analyst:
Manfred Stamer
manfred.stamer@eulerhermes.com