Bulgaria

Economic growth has been robust, but is projected to weaken somewhat in 2020 and 2021. Exports have been hit by slowing demand from key trading partners. Higher growth of private consumption and investment compared to exports is expected going forward. Private consumption – the most important driver of growth – is set to continue to expand due to rising real wages.

The currency-board arrangement with the euro has resulted in historically low interest rates, fuelling consumer, mortgage and corporate credit growth. Inflation will remain above 2% given high wage growth due to the tight labour market. Growth will be supported in 2020 by a projected rise in public investment due to one-off expenditures.

Economic growth remains strong

The economy is set to expand by 3.4% in 2019 and unemployment has fallen to a post-crisis low. Growth has been driven by a large rise in domestic demand, with private consumption expanding by 6% in 2019 on the back of a substantial rise in real wages due to tight labour market conditions and a sizable rise in public sector pay. Consumer and mortgage credit growth has been strong, benefitting from an increase in demand due to high wage rises and historically low interest rates. Exports have contracted, hit by the slowdown in the country’s main trading partners. Inflation remained elevated in the first half of the year, but then began to moderate due to a deceleration in food prices and lower rises in regulated energy tariffs.

The tight labour market has led to rising wages

Private consumption has become the main contributor to growth

Source: OECD Economic Outlook 106 database.

StatLink  
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Bulgaria: Demand, output and prices

More effective government spending and structural reforms would boost productivity

Monetary conditions are expansionary due to the hard peg to the euro, and rising public investment is estimated to have provided a positive impulse to growth in 2019 due to one-off expenditures on the infrastructure network and military equipment. Fiscal buffers should be adequate to deal with a deeper-than-expected slowdown given that public debt is low and the government plans to be close to a budget balance over 2020-21. It will be important not to underspend on the capital side and to increase public investment by more than currently planned if growth is not as strong as expected. Improving the effectiveness of government spending, particularly on education, health and pensions, will be critical to increasing potential growth, particularly given the rapidly ageing population.

High emigration and an ageing resident population have led to a shrinking labour force, which has worsened labour shortages and skills mismatches, and contributed to rapidly increasing real wages. While recent wage growth has been associated with a rising labour force, the working-age population is due to continue to shrink by about 1% a year. A critical policy agenda is to implement labour and social reforms to support increased integration in the labour force of left-behind groups: women, the elderly, the young and minorities. Reversing the slowdown in labour productivity growth will also be key to compensate for demographic developments. This will require broad structural reforms, ranging from improving skills to strengthening the environment for investment, competition and innovation.

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Growth is projected to moderate

Growth is due to moderate slightly to just below 3% in 2020 and 2021. Continued economic expansion will rely on increased private consumption and investment due to rising wages, cheap credit and a rise in public investment. Exports are expected to expand, though not at the high rates seen prior to 2018. External risks dominate, but domestic vulnerabilities, particularly related to competitiveness, are present. The main domestic risk is excessively high wage growth, which could bring higher inflation and reduce competitiveness. Lower-than-expected public investment is a further factor that could weaken growth. Private sector credit is projected to continue to expand following a period of muted growth since the last economic crisis, but credit expansion could be slower than expected if global financial conditions tighten, despite the increase in domestic banking sector profitability and asset quality.