

Growth moderates amid weak investment

General Information



GDP	USD55.7bn (World ranking 79, World Bank 2014)
Population	7.23mn (World ranking 100, World Bank 2014)
Form of state	Parliamentary Democracy
Head of government	Boyko BORISOV (Prime Minister)
Next elections	2016, presidential



Strengths

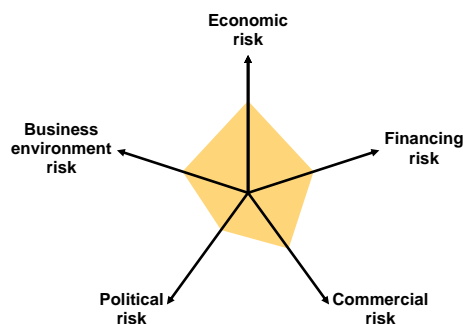
- EU membership and good international relations
- Relatively low systemic political risk
- Currency board has withstood global turbulences since 2008 and BGN is currently not overvalued
- History of prudent fiscal policies
- Current account close to balance since 2010
- Generally adequate business environment

Weaknesses

- Very slow progress on EU-required judicial reform and anti-corruption measures
- Public discontent about living standards
- Continued tight credit markets
- Deflationary pressures since August 2013
- High external debt burden
- Banking sector vulnerability to financial contagion from the Eurozone debt/banking crisis; concern about banking supervision due to deposit runs on two domestic banks in 2014

Country Rating

B2



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
Germany	12% 1	16% Russia
Turkey	9% 2	12% Germany
Italy	9% 3	7% Italy
Romania	8% 4	7% Romania
Greece	7% 5	6% Turkey

By product (% of total)

Exports	Rank	Imports
Machinery and transport equipment	19% 1	25% Machinery and transport equipment
Fuel and fuel products	13% 2	20% Fuel and fuel products
Food and live animals	10% 3	13% Chemicals
Chemicals	9% 4	8% Crude materials, inedible (non-fuel)
Crude materials, inedible (non-fuel)	7% 5	7% Food and live animals

Source: National Statistical Institute of Bulgaria (2014)



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Economic Overview

Growth to ease slightly in 2016-2017

Real GDP growth continued to accelerate to +3% in 2015 from +1.6% in 2014. The breakdown of GDP reveals a return to largely export-led growth from domestic demand-driven expansion in 2014. Private consumption increased by just +0.8% in 2015 (+2.7% in 2014), public consumption by +0.3% (+0.1% in 2014) and fixed investment by +2.5% (+3.4% in 2014), while inventories subtracted about -0.3pps from 2015 growth (+0.2pps in 2014). Net exports made a positive contribution of +2.2pps to 2015 growth (-1.1pps in 2014) thanks to strong export expansion of +7.6% (-0.1% in 2014) while imports picked up more moderately to +4.4% (+1.5% in 2014).

In Q1 2016, real GDP grew by +2.9% y/y according to a preliminary estimate. Final consumption increased by +2.4% y/y but fixed investment contracted by -3.9% y/y. External trade activity lost steam as well, with exports declining by -0.3% y/y and imports even more by -2.8% y/y, so that net trade still made a positive contribution to Q1 growth. Euler Hermes expects somewhat less economic momentum in 2016 as a whole and forecasts full-year growth of +2.6%, followed by +2.7% in 2017.

Banking sector turmoil in 2014, but systemic crisis unlikely

In June 2014, 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 immediate market response was calm: The government raised EUR1.5bn in a Eurobond with a yield at just 3.1% shortly after the "mini crisis". Overall, the banking sector has remained liquid and well-capitalised, and the non-performing loans (NPL) ratio, though still quite high (14.4% in March 2016), is declining. However, note that the NPL ratio of non-financial corporations stood at 23.4% in March 2016. Bulgaria's financial system had also 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. Nonetheless, some concerns remain owing to banks' heavy reliance on funding from EU parent banks – whose subsidiaries dominate the sector (25% Greece, 15% Italy, 12% Hungary) – which still makes them vulnerable to financial contagion from the Eurozone debt/banking crisis. Moreover, deleveraging by Eurozone banks continues to retard credit growth.

Currency board limits scope of monetary policy to tackle deflation

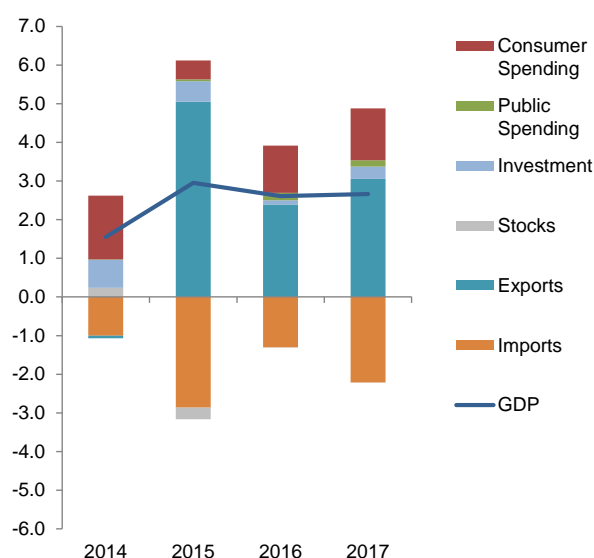
Bulgaria's currency board (BGN1.95583:EUR1) has withstood the pressures from the 2008-2009 global financial crises well and does not appear to be at risk in the short term as the real effective overvaluation of the BGN, which exceeded 15% from early 2008 to mid-2009, has given way to stabilisation, indicating that Bulgaria has regained 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

	2014	2015	2016f	2017f
GDP growth (% change)	1.6	3.0	2.6	2.7
Inflation (% , end-year)	-0.9	-0.4	0.3	1.0
Fiscal balance (% of GDP)	-5.4	-2.1	-2.6	-2.4
Public debt (% of GDP)	27.0	26.7	27.5	28.0
Current account (% of GDP)	0.9	1.4	0.9	0.8
External debt (% of GDP)	92.1	77.2	73.0	72.0

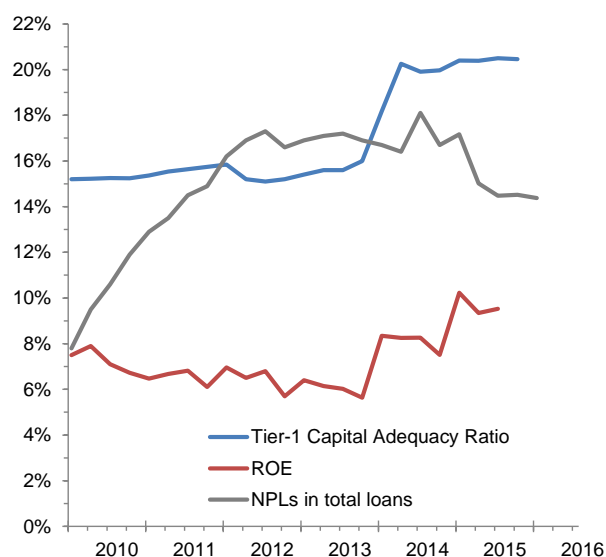
Sources: National sources, IHS, Euler Hermes

GDP growth (%) and contributions (pps)



Sources: National sources, Euler Hermes

Banking sector soundness indicators (%)



Sources: Bulgarian National Bank, Euler Hermes

Headline consumer price inflation entered deflationary territory in August 2013 amid a protracted low growth environment and reached a low of -2.6% y/y in February 2014. Although the economy has recovered since, deflationary pressures have persisted and even intensified again in early 2016 (-2.2% y/y in April 2016) mainly owing to lower oil/energy costs and falling food prices. Euler Hermes expects deflationary pressures to continue for some time before positive inflation may perhaps return by the end of 2016.

Public finances remain adequate

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 banking sector turbulences have had a fiscal cost, for example the government lent BGN2 bn to the State Deposit Guarantee Fund. The fiscal deficit rose to -5.4% of GDP and public debt to 27% of GDP. In 2015, the fiscal deficit narrowed again to -2.1% of GDP and public debt stabilised. As growth moderates, Euler Hermes forecasts the annual fiscal deficit to edge up slightly to about -2.5% of GDP in 2016-2017 while public debt should remain below 30% of GDP, which is still very low by EU standards.

External debt declines but is still high

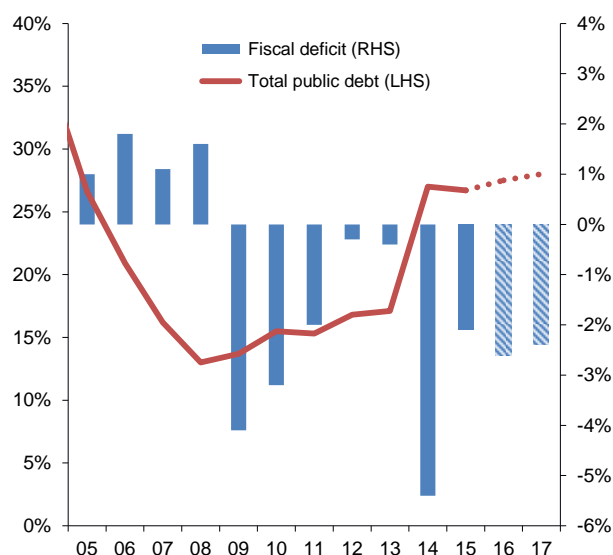
The current account has been close to balance since 2010 and should remain so in 2016-2017. Foreign direct investment inflows have remained robust and amounted to 3.6% of GDP in 2015.

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 by -EUR5bn in 2015 to EUR34bn at year-end, it still accounted for a worrisome 77% of GDP. The private sector share of external debt was 82%, while total short-term debt as a share of gross debt has fallen to 23% from the 36% peak in late 2008. The external debt service ratio rose to 28% in 2015 and should remain close to 30% in 2016.

FX reserves have markedly increased

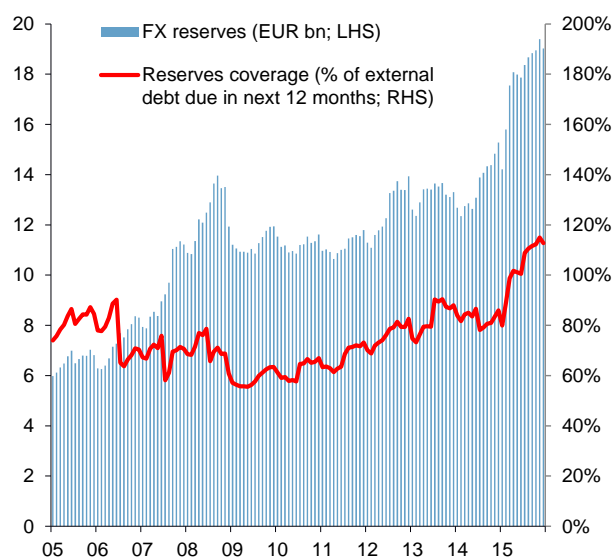
FX reserves have increased substantially since end-2013 and stood at EUR20.2bn in April 2016, a comfortable level with regard to import cover (more than seven months). Moreover, in other terms reserves now cover about 120% of the estimated external debt payments falling due in the next 12 months, an adequate ratio and an improvement from 80% two years ago.

Public finances (% of GDP)



Sources: National sources, IMF, Euler Hermes

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



Sources: National sources, Euler Hermes

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