2. BULGARIA

Robust growth amid ongoing fiscal consolidation

Real GDP growth is expected to have reached 3.3% in 2016 and is forecast to decline slightly over the forecast horizon. Domestic demand continues to be the main growth driver. Inflation is forecast to turn positive in 2017 after a period of deflation since 2013. Unemployment is expected to continue decreasing in the coming years. Fiscal consolidation continued in 2016, mainly due to higher tax revenues and reduced public investment. Risks to the growth outlook are tilted to the downside.

Strong private consumption growth

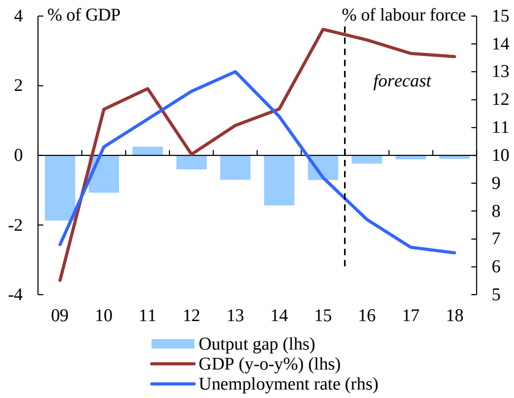
Real GDP continued its robust performance in 2016. Private consumption was particularly buoyant, as also reflected in the strengthening of consumer confidence throughout 2016.

Growth is estimated at 3.3% in 2016, slightly better than expected in the autumn forecast. Growth is then estimated to slightly taper off to 2.9% and 2.8% in 2017 and 2018, respectively, as estimated in the previous forecast. Domestic demand was the main growth driver in 2016, contributing an estimated 2.1 pps. to real GDP growth, with net exports contributing 1.2 pps. Investment is expected to have slightly contracted in 2016, mainly due to the slowdown in EU funds absorption. However, investment is forecast to gain momentum with growth of 3.2% in 2017, as the implementation of projects under the 2014-2020 EU programming period is expected to accelerate.

Robust growth led to a narrowing of the negative output gap to -0.2% in 2016, which is however not projected to fully close over the forecast horizon. Meanwhile, income convergence with the EU is continuing at a slow pace.

Risks to the growth outlook are tilted to the downside. As a domestic downside risk, a significantly slower than expected implementation of EU funds could dent investment and growth. Political uncertainty related to the upcoming elections could also delay consumption and investment decisions. Given the openness of the economy, weaker import demand from the main trading partners, especially in Europe, and surging oil prices would pose external downside risks. However, faster progress with structural reforms could lift the relatively low potential and real growth rates.

Graph II.2.1: **Bulgaria - Real GDP growth, output gap and unemployment**



Declining current-account surplus

Driven by stable demand from its EU trading partners as well as a strong tourism season due to favourable geopolitical factors, Bulgaria's exports continued to perform well in 2016. As a result, the current-account balance is estimated at 2.6% of GDP in 2016, but is expected to decline to 1.4% in 2017 and 0.8% in 2018, as strong domestic demand and the expected rise in energy prices fuel import growth. Tourism exports in 2017 are also expected to grow at a slower pace compared to 2016, mainly due to negative base effects.

Inflation to turn positive in 2017

Annual HIPC inflation was negative in 2016, but is expected to reach 0.8% in 2017 due to strong domestic demand, rising prices for processed food as well as recovering energy prices. This should reverse the deflationary trend experienced since 2013, which was mainly driven by declining import prices, subdued domestic demand, and reductions in administered prices.

Unemployment and labour market conditions continue to improve

Employment growth is projected to increase to 1.1% in 2016 and to slow down slightly in 2017 and 2018, supported mainly by the recovery in domestic demand. Together with the expected decrease in the labour force due to population ageing and emigration, this is likely to further reduce the unemployment rate to 7.1% in 2017 and slightly lower in 2018.

Fiscal consolidation continued in 2016

The public deficit is estimated to have decreased from 1.7% in 2015 to 0.4% of GDP in 2016. In structural terms, this corresponds to a reduction of about 1 pps. of GDP. Tax revenue increases and public investment reductions were the key drivers of the fiscal adjustment in 2016. Tax revenues performed better than expected not only due to the improved macroeconomic conditions, but also due to the impact of certain revenue-enhancing measures (such as increases in the rates of excise duties for liquid heating fuels), and thanks to improved tax collection. This overperformance more than offset the lower revenue from EU capital transfers. On the expenditure side, the slow transition to the new cycle of EU fund programming is reflected in lower-than-expected capital and current spending.

The general government deficit is forecast at 0.5% of GDP in 2017. On the revenue side, a major positive impact is expected from the increase in social security contributions as of 1 January. Total expenditure, however, is expected to grow by a higher rate than revenue, mainly as a result of increases in the public wage bill and public investment. Under a no-policy-change assumption, the headline deficit in 2018 is forecast at 0.3% of GDP. The structural budget deficit is forecast to remain below ½% of GDP in both 2017 and 2018.

Contingent liabilities of state-owned enterprises (SOEs) pose downside risks to public finances over the entire forecast horizon. The fiscal performance might also be influenced by political uncertainties.

The general government debt in 2016 is estimated at 29% of GDP in 2016, 3 pps. of GDP higher than in 2015. This increase is mainly due to a temporary increase in cash buffers envisaged to partly cover debt repayments in 2017. The general government debt is forecast to decline in 2017 and reach 26% of GDP in 2018.

Table II.2.1:

Main features of country forecast - BULGARIA

	2015		Annual percentage change						
bn BGN	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP	88.6	100.0	3.0	0.9	1.3	3.6	**3.3**	**2.9**	**2.8**
Private Consumption	55.4	62.5	3.5	-2.5	2.7	4.5	**3.2**	**2.9**	**2.8**
Public Consumption	14.3	16.1	2.9	0.6	0.1	1.4	**1.1**	**2.0**	**2.3**
Gross fixed capital formation	18.6	21.0	12.4	0.3	3.4	2.7	**-0.5**	**3.2**	**3.6**
of which: equipment	8.1	9.2	-	1.2	13.9	9.8	**-0.5**	**5.0**	**3.5**
Exports (goods and services)	56.8	64.1	2.3	9.6	3.1	5.7	**5.1**	**4.4**	**4.5**
Imports (goods and services)	56.6	64.0	6.5	4.3	5.2	5.4	**3.2**	**4.3**	**4.6**
GNI (GDP deflator)	86.8	98.0	3.8	0.0	2.7	2.4	**4.2**	**2.1**	**2.3**
Contribution to GDP growth:	Domestic demand		4.7	-1.5	2.5	3.6	**2.1**	**2.8**	**2.8**
	Inventories		0.5	-0.8	0.2	-0.1	**0.0**	**0.0**	**0.0**
	Net exports		-2.2	3.1	-1.3	0.1	**1.2**	**0.2**	**0.0**
Employment			-0.3	-0.4	0.4	0.4	**1.1**	**0.5**	**0.2**
Unemployment rate (a)			11.7	13.0	11.4	9.2	**7.7**	**7.1**	**6.8**
Compensation of employees / head			27.6	8.8	5.6	5.6	**3.8**	**4.8**	**5.1**
Unit labour costs whole economy			23.5	7.4	4.6	2.3	**1.6**	**2.3**	**2.4**
Real unit labour cost			0.2	8.2	4.1	0.1	**2.0**	**1.3**	**0.9**
Saving rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			23.3	-0.7	0.5	2.2	**-0.4**	**1.0**	**1.4**
Harmonised index of consumer prices			-	0.4	-1.6	-1.1	**-1.3**	**0.8**	**1.2**
Terms of trade goods			1.0	-0.8	0.7	0.6	**0.5**	**-0.5**	**0.2**
Trade balance (goods) (c)			-13.7	-7.0	-6.5	-5.8	**-4.7**	**-5.1**	**-5.4**
Current-account balance (c)			-6.1	1.2	0.0	0.4	**2.6**	**1.4**	**0.8**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-5.7	2.3	2.2	-1.5	**0.9**	**-0.1**	**-0.6**
General government balance (c)			-0.1	-0.4	-5.5	-1.7	**-0.4**	**-0.5**	**-0.3**
Cyclically-adjusted budget balance (d)			-0.1	-0.2	-5.0	-1.5	**-0.3**	**-0.5**	**-0.3**
Structural budget balance (d)			-	-0.2	-1.8	-1.4	**-0.3**	**-0.5**	**-0.3**
General government gross debt (c)			40.5	17.0	27.0	26.0	**29.0**	**27.3**	**26.0**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.

Note : Contributions to GDP growth may not add up due to statistical discrepancies.