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**United Bulgarian Bank**  
**Bulgaria: Macroeconomic Update**  
**July 2022**

Chief Economist Department

- **The global economy is gradually being pushed towards a stagflationary scenario.** On the back of weak consumer confidence, persistent supply chain disruptions and tightening labour markets, European economies show in general a weakening of retail sales and industrial production. Despite strong growth resilience in the first quarter, we expect most home markets to move towards a more stagflationary scenario in the coming quarters. The stagflationary tendencies are moderate in the **base scenario**. However, in the case of the cut of gas for EU from Gazprom in Q4 2022 **the pessimistic scenario** is leading to even more inflation and recession in 2023.
- **Energy markets are tightening further, triggering additional negative supply shocks and reinforcing the current stagflationary tendencies.** European gas markets inject new inflationary pressure while also weighing on economic growth. **Externally imposed gas embargos remain a major risk for the European economies.** Headline inflation continues to accelerate globally as price pressures broaden and core inflation gains momentum. Several CEE home markets, in particular Bulgaria, Czechia and Slovakia, have been hit by derailing inflation with HICP inflation well above 10% and national inflation gauges at even higher levels in some cases. The political instability in Bulgaria and the early elections are an additional factor of uncertainty for the Bulgarian economy.
- **The increasing inflationary pressures along with tightening labor markets are increasing the pressure on central banks to normalize monetary policy.** The July monetary policy meetings by the Fed and the ECB provided strong policy responses to accelerating inflation and paved the way for unusually rapid policy tightening. The combination of higher, more persistent inflation along with tighter monetary policy will provide a hit to economic growth. Higher inflation erodes savings and reduces purchasing power, as real wage growth remains negative and negative wealth effects arise. Meanwhile higher real interest rates and elevated uncertainty drive up (precautionary) savings while discouraging investments and consumption.
- **Currently, Bulgaria does not meet some of required euro convergence criteria, especially the inflation criterion – 5.9% annual average HICP inflation vs 4.9% reference rate for April 2022.** We expect that also next year Bulgaria will not meet this criterion. Also, the compatibility of legislation hasn't been (sufficiently) achieved and there is a risk that insufficient time would leave the public authorities and the banking system technically insufficiently prepared for the euro adoption. This makes the government's stated goal of joining the euro area in 01.01.2024 seem too ambitious. In 2024 Bulgaria will be able to meet the criteria for EU membership and this will be confirmed by the regular Convergence Report. Otherwise, Bulgaria would have to request an extraordinary convergence report in 2023, which would not be able to confirm compliance for inflation and legislation.

# Bulgaria – Outlook 2021 - 2024

The current forecast has two scenarios - basic and pessimistic. In the base scenario, the stagflationary tendencies are moderate. In the pessimistic scenario, after the cut of gas for EU from Gazprom in Q4 2022 the main trading partner euro area would go into recession in 2023. This would have long-term implications for both curbing domestic demand and investments and increasing negative net exports.

Bulgaria	Base scenario					Pessimistic scenario				
	2020	2021	2022	2023	2024	2020	2021	2022	2023	2024
July 22, 2022										
Real GDP growth (in %)	-4	4	1.8	2.3	3.5	-4	4	1.1	-1.3	2
Inflation (in %, harmonised CPI, average )	1.2	2.8	12.5	6.5	3	1.2	2.8	15.5	9.1	3.4
Unemployment rate (% , end of year, Eurostat definition)	6.3	4.6	6	5.3	4.8	6.3	4.6	6.5	7	6
Government budget balance (in % of GDP)	-4	-4.1	-5	-2	-1.2	-4	-4.1	-5	-6	-1.7
Gross public debt (in % of GDP)	24.7	25.1	27	29.8	30	24.7	25.1	29.8	34	35
Current account balance (in % of GDP)	0.1	-0.2	-2.5	-2.4	-1.5	0.1	-0.2	-3.5	-3.1	-2
Long-term interest rate, 10Y Government Bond Yield	0.4	0.70	3.20	3.70	3.70	0.4	0.70	2.70	3.00	3.10
House prices (annual %-change, existing and new dwellings, Eurostat def.)	5.4	8.7	9.5	5	3.5	5.4	8.7	3.5	2.0	0

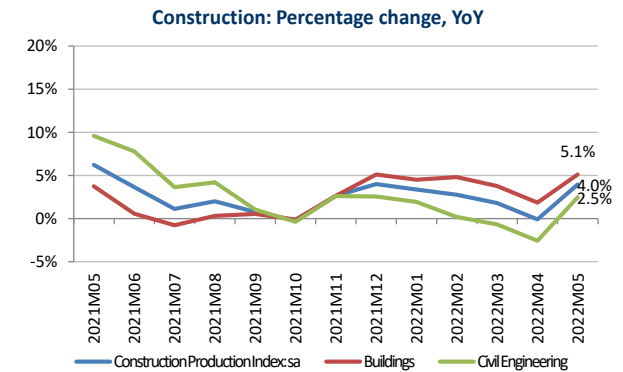
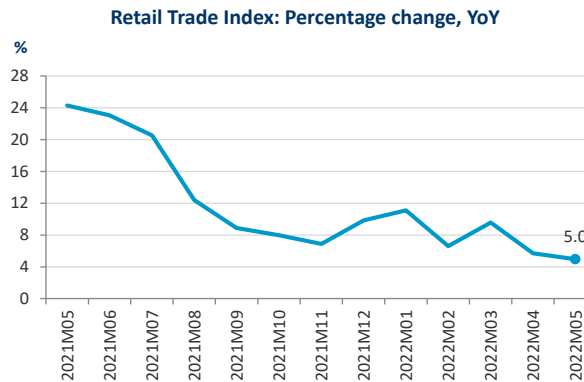
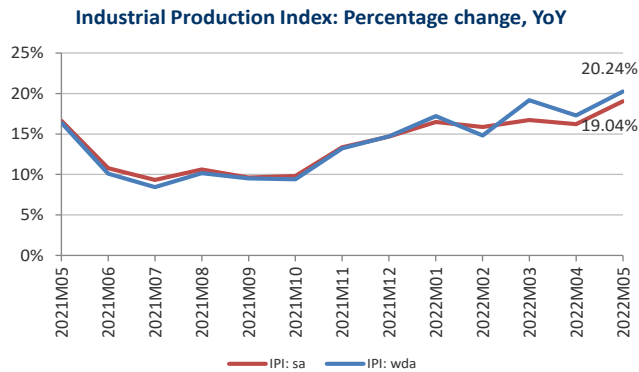
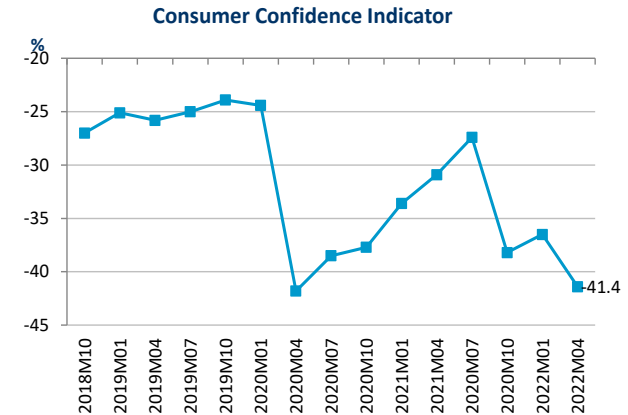
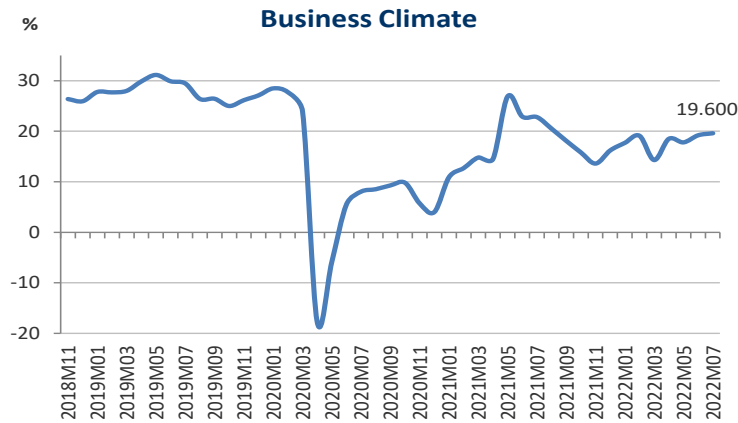
Source: KBC, UBB

BULGARIA: Real GDP Growth (%)	2022	2023	2024
KBC /UBB (May 2022)	1.8	2.3	3.5
World Bank (April 2021)	2.6	4.3	3.7
EC (July 2022)	2.8	2.3	n.a.
OECD (June 2021)	2.5	2.3	n.a.
IMF (June 2022)	2.8	4.0	4.1
MF (April 2022)	2.6	2.8	3.6
BNB (July 2022)	1.9	1.7	3.7
UniCreditBulbank (June 2021)	2.7	2.0	n.a.

BULGARIA: Harmonised CPI (%)	2022	2023	2024
KBC /UBB (May 2022)	12.5	6.5	3
World Bank (April 2021)	9.3	3.4	2
EC (July 2022)	12.5	6.8	n.a.
OECD (June 2021)	14.1	8.5	n.a.
IMF (June 2022)	12.2	4.1	1.8
MF (April 2022)	10.4	5.1	2.7
BNB (July 2022)	14.7	3.8	3.1
UniCreditBulbank (June 2021)	13.7	7.8	n.a.

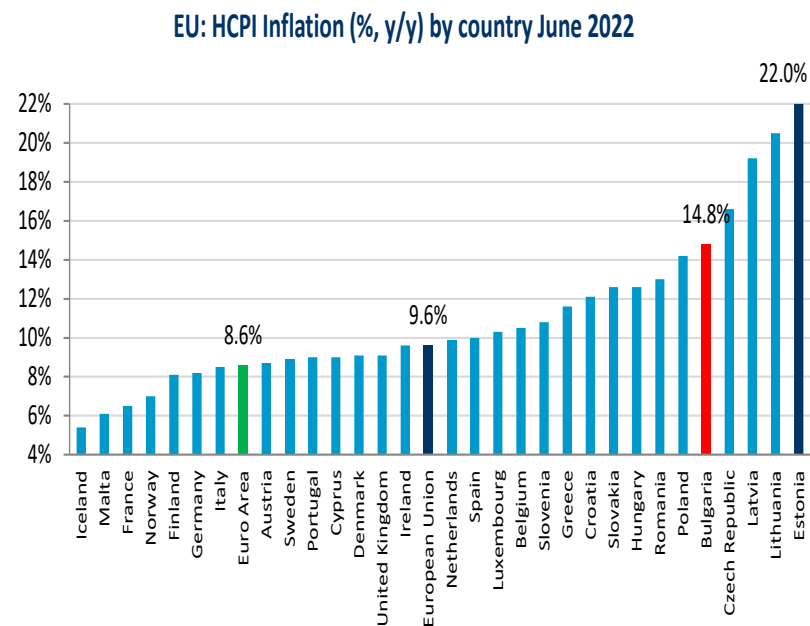
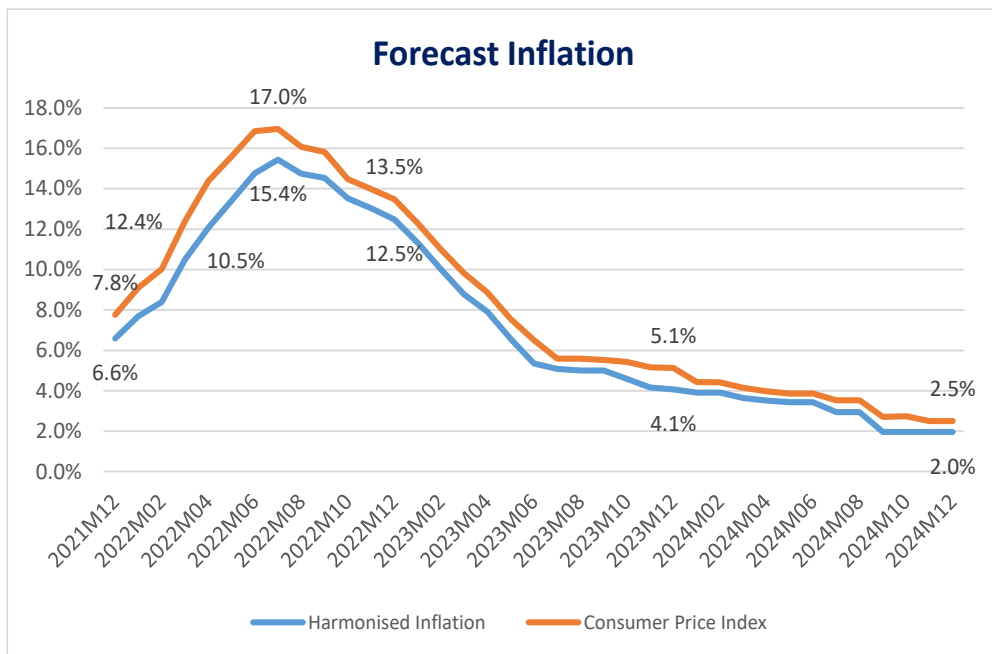
# Bulgaria: Main Frequency Indicators

The most of high frequency indicators are increasing in May. Industrial production increased from 16.2 to 19.4 and construction increased from -0.1 to 4.0, mainly for buildings. Also, business climate indicator increased at the end of July from 19.2 to 19.6. Only retail trade decreased from 5.7 to 5.0. Only retail trade decreased from 5.7 to 5.0.



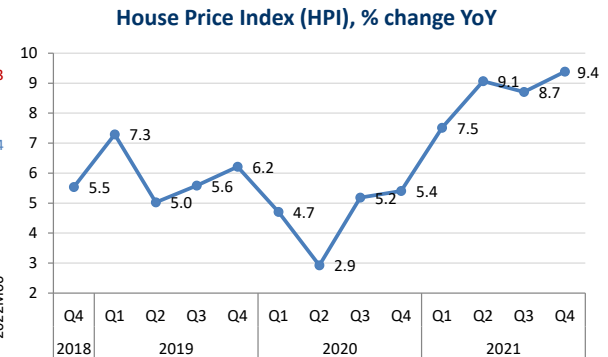
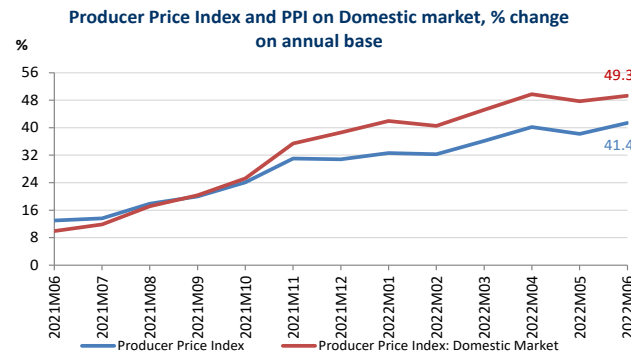
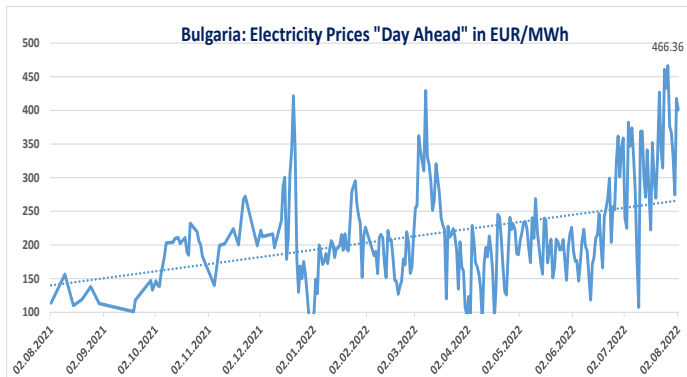
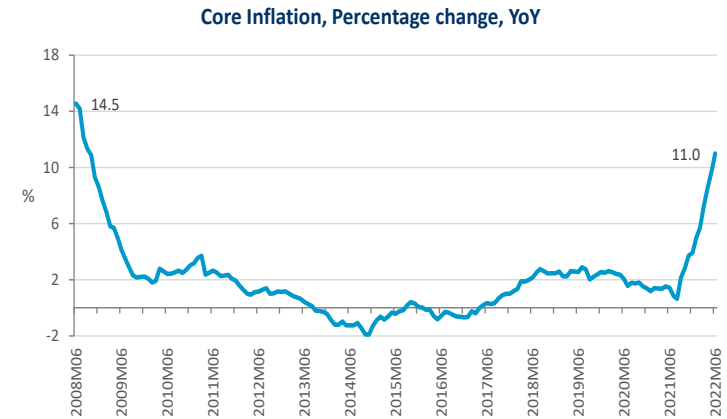
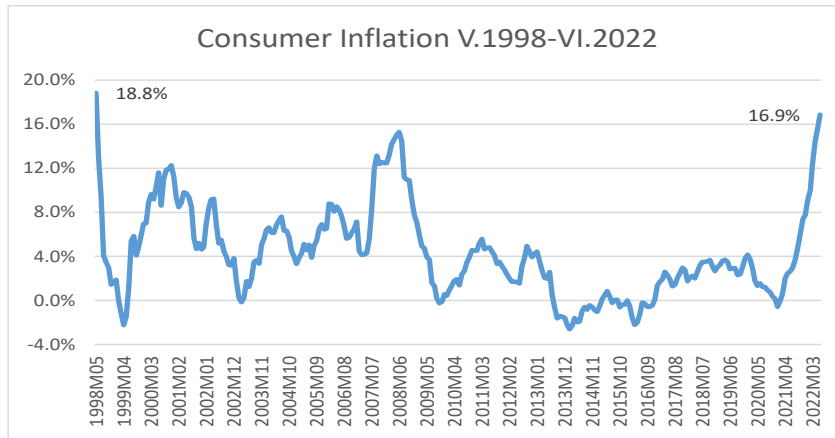
# Bulgaria – Inflation (1)

Inflation in June increased to 14.8% yoy HICP and 16.9% CPI. This is the highest value in 24 years. **Our current forecast is average annual inflation of 12.5% HICP for 2022 and 6.5% for 2023.** We suppose that we will see double-digit inflation rates throughout the year. Our forecast for the inflation at end of 2022 year-on-year is 13.5% CPI and 12.5% HICP. **In the pessimistic scenario** there should be even more acceleration of inflation with the long lasting consequences: 15.5% average annual HICP in 2022 and 9.1% in 2023.



# Bulgaria: Inflation (2).

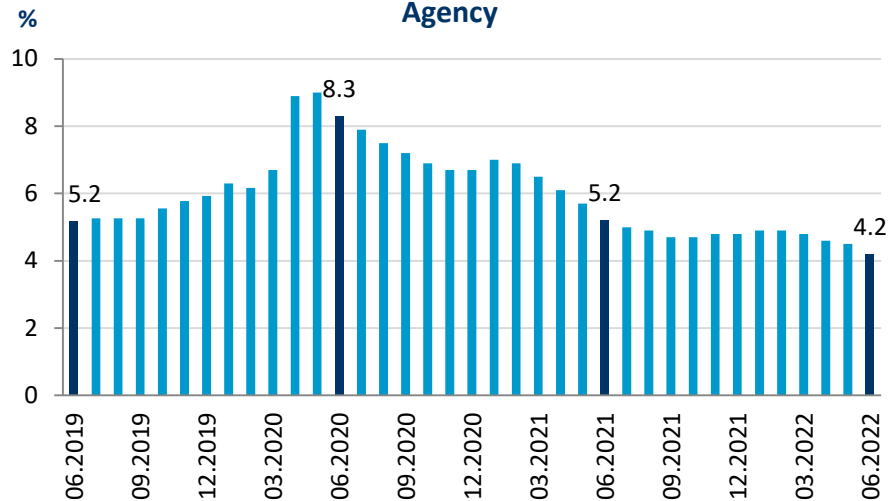
Both Bulgarian CPI and harmonized inflation has the highest record since May 1998. The core inflation is lower than the overall inflation (11% vs 14.8% in 06.2022). This reflects the impact of high commodity prices and especially energy prices. The big increase in the Producers Price Index 41.4% yoy is also evidence for this process. Low interest rates on bank deposits has led to increase in demand for housing and house prices.



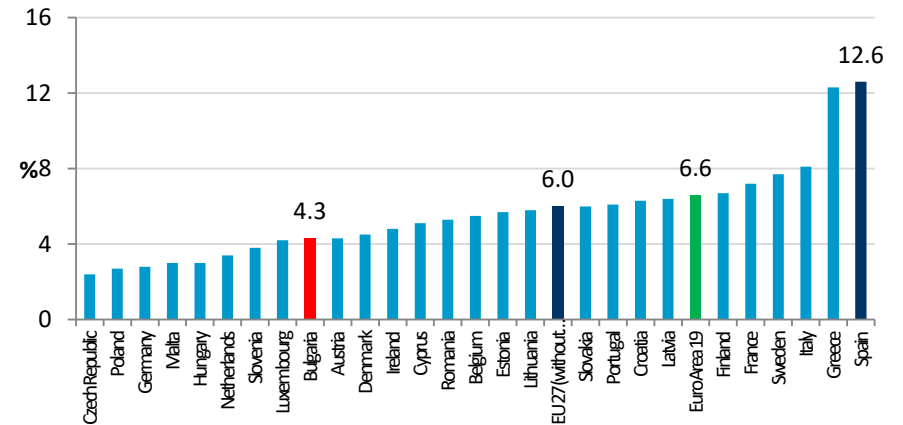
# Bulgaria: Labor market

The labor market situation is assessed as tight as a result of the economic recovery and employment retention measures. According to Agency of employment in June 2022 the rate of registered unemployment is 4.2%, hitting another all time record low. In June 2022 the harmonized unemployment rate in Bulgaria is 4.3% and is well below the average of EU. **We expect moderate increase of unemployment of 6.0% for this year and 5.3% for the next year. In the pessimistic scenario we should increase our forecast for unemployment of 6.5% for 2022, 7% for 2023 and 6% for 2024.**

**Unemployment Rate Bulgaria: National Employment Agency**



**EU: Unemployment rate seasonally adjusted by country, June 2022**



**Note:**

According to the definition of the NSI, unemployed are persons aged 15 - 74 years who: 1) do not have a job during the observed period; 2) actively looking for work for a period of four weeks, incl. observed week, or have already found a job that they expect to start within three months after the end of the observation period, 3) have the opportunity to start work within two weeks after the end of the observed period.

The NSI assessment is based on a sample "Labor Force Survey", in which Bulgarian households are interviewed on a rotating basis. The labor force survey is performed on a two-stage nesting sample, including about 19.6 thousand households each quarter (about 0.65% of the households in the country). The definition of unemployment of the NSI is according to Regulation of the European Commission (EC) № 1897/2000.

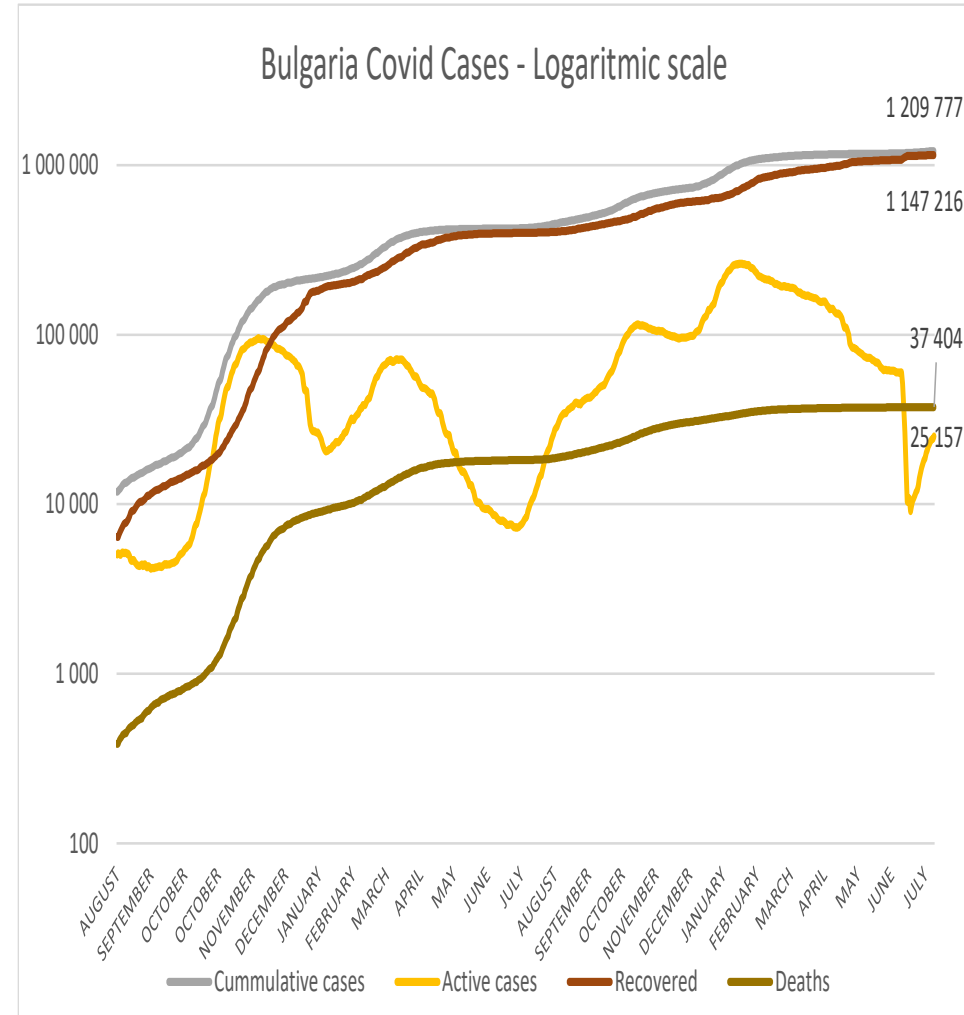
The Employment Agency considers unemployed only persons who have registered with the labor offices.

# COVID-19 Status

In mid-July, the new wave of Covid 19 Omicron subvariant began to rise . The active cases increased from 9 091 on July 12, 2022 to 25 157 active cases on August 02, 2022. Mortality is still very small 37 404 on August 02, 2022.

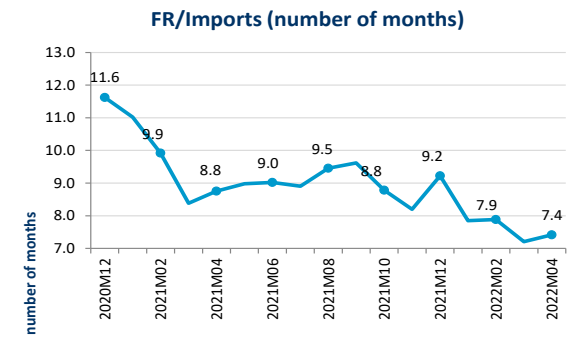
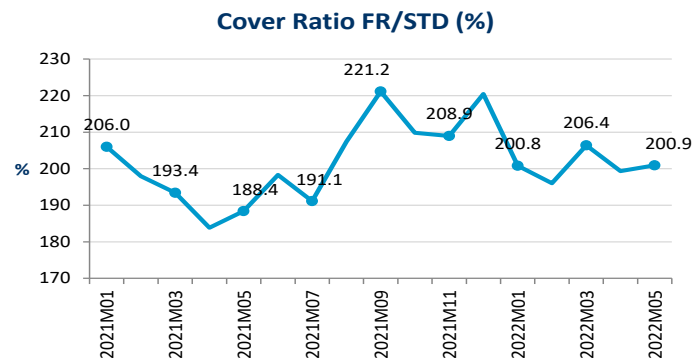
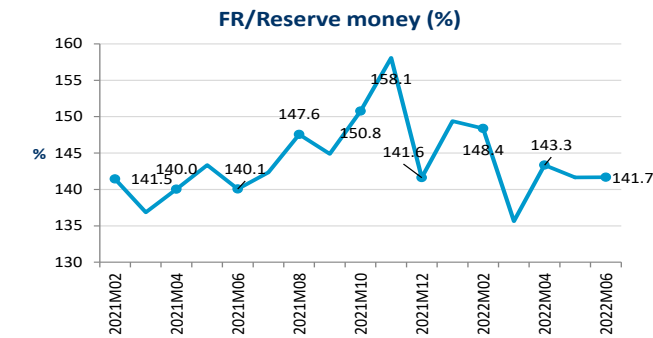
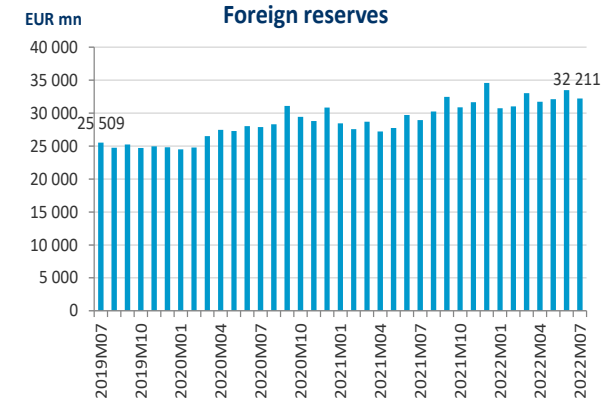
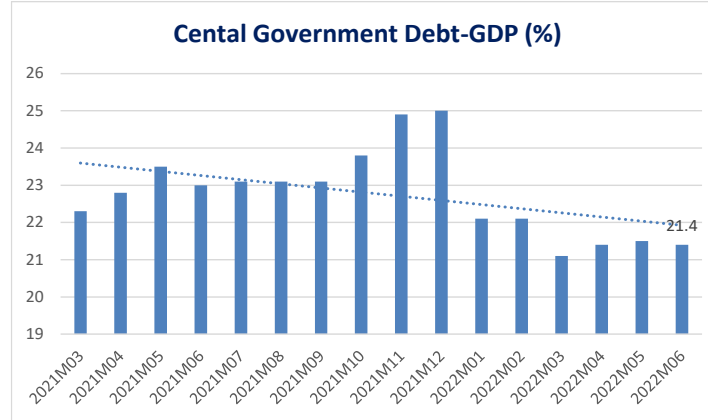
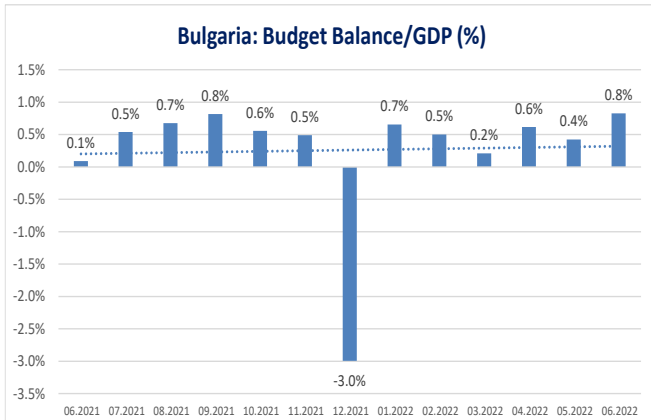
**The vaccination process has practically stopped.** The fully vaccinated as of August 02, 2022 are 30% of population and 12% are with buster. The percentage of fully vaccinated was the same three months ago.

We don't expect a new emergency epidemiological situation to be imposed in the summer, but it is possible in the autumn. At this stage we don't expect the pandemic to be a significant obstacle to economic growth.





# Bulgaria: Currency board indicators are stable.



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