

Bulgaria Business Forecast Report Q2 2014

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Abstracts

Core Views

Bulgaria's economy will see growth accelerate in light of higher public spending and elevated export growth. However, elevated political risk will dampen fixed investment and household spending in the economy.

Political risk is threatening to undermine Bulgaria's sovereign credentials, which could further derail the country's convergence process with the EU and cloud the economic outlook over the coming years. Stronger manufactured goods exports to Europe and the prospect of rising remittance flows following the lifting of travel restrictions in the EU for Bulgarian nationals informs our view that the current account is set to remain in surplus for the foreseeable future.

Bulgaria's exchange rate peg to the euro will remain comfortably in place, as an internal devaluation has seen the economy correct its external imbalances. A current account surplus and rising foreign reserves suggest that the peg faces few risks over the coming years.

Major Forecast Changes

We revised up our current account surplus forecast from 0.7% of GDP to 2.1% in 2014 and 1.6% in 2015 from our previous forecast of 0.5%.

We have raised our current account deficit forecast for 2011 to 8.0% of GDP from 6.6% previously on account of surging imports in the first half of the year, driven by loose monetary policy at home and higher global commodity prices.

Key Risks To Outlook

We note that the near-term risks are to the downside, given the possibility of another early election this year and the ongoing legislative deadlock.

With economic growth set to accelerate over the coming quarters, our current projections for Bulgaria's current account may be underestimating the prospect of stronger domestic demand and higher import growth over the course of 2014 and 2015.

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Political Instability Threatens Future Convergence Process

Widespread disillusionment with Bulgaria's political elite and a legislative deadlock threaten to escalate the country's deteriorating political risk position over the course of 2014. Despite a solid fiscal profile and a low public debt pile, political risk is threatening to undermine Bulgaria's sovereign credentials, which could further derail the country's convergence process with the EU and cloud the economic outlook over the coming years.

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Long-Term Political Outlook

Challenges Remain Despite EU Membership

We expect EU membership to remain key to Bulgaria's long-term political outlook, helping underpin investor sentiment in the country and steady economic growth. However, we note that despite having already joined the bloc, Bulgaria has a number of challenges it must yet tackle to improve its business environment and help ensure a more stable economic and political situation over the next 10 years. Below we outline these challenges and possible scenarios for political change.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Ratings

Economic Activity

Low Confidence To Overshadow Recovery

Higher government outlays and early signs of rising fixed investment growth suggest that Bulgaria's economy will begin to break away from the anaemic growth rates seen over the past two years. Having said that, we temper our outlook on the economy due to an uncertain political situation and still overwhelmingly negative sentiment among

businesses and households alike.

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Fiscal Deficit Widening To Continue

Bulgaria's budget deficit will continue to gradually widen over the coming years, as policymakers move away from several years of austerity in the context of recent political instability. Nevertheless, we expect the deficit to remain well contained, posing few risks to Bulgaria's debt credentials, particularly in light of a low public debt stock.

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Current Account Surplus Here To Stay

The recent rebalancing of Bulgaria's economy has seen a secular shift into current account surpluses following a decline in domestic demand. Although the ongoing economic recovery suggests that goods import growth is set to accelerate and will provide an increasing drag on the current account, stronger manufactured goods exports to Europe and the prospect of rising remittance flows following the lifting of travel restrictions in the EU for Bulgarian nationals informs our view that the current account is set to remain in surplus for the foreseeable future.

Table: BALANCE OF PAYMENTS (Euro)

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No Risk To Currency Peg, But Deflation To Affect Economy

Bulgaria's exchange rate peg to the euro will remain comfortably in place, as an internal devaluation has seen the economy correct its external imbalances. A current account surplus and rising foreign reserves suggest that the peg faces few risks over the coming years.

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