

Bulgaria Business Forecast Report Q4 2013

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Abstracts

Core Views

The country's political situation will remain precarious for the foreseeable future given the weak state of the current government and ongoing popular protests. As a result, we do not rule out a return to elections at some point in late 2013 or 2014.

We believe that the incipient recovery in early 2013 will be choked off by recent political events, which will dampen consumption and investment. Bulgaria now looks highly unlikely to record any significant improvement in growth readings this year or next, and we do not rule out another recession.

Major Forecast Changes

We have revised down our real GDP growth forecast for 2013 and 2014, to 0.5% and 1.5% respectively, from 1.5% and 2.9% previously, on the back of recent political unrest. With ongoing commitment to fiscal consolidation likely to occur regardless of who wins the next election, we now see limited prospects for a near-term recovery in domestic demand.

The prospect of weaker domestic demand has prompted us to revise our current account deficit forecast, which we now project to narrow to just 0.3% of GDP in 2013 before widening to 1.2% in 2014. We do not forecast a return to surplus any time soon, as we believe the currency board arrangement will serve to cap Bulgaria's export competitiveness.

On the back of a weaker growth outlook, we have revised our expectations for Bulgaria's fiscal deficit, which we now expect to arrive at 1.8% of GDP, from a previous forecast of 0.3%

Key Risk To Outlook

While the domestic risks to growth have increased over the past few months, Bulgaria remains heavily exposed to further deterioration in periphery eurozone economies given its trade and financial linkages with Greece and Italy. Although this risk is somewhat mitigated by the European Central Bank's pledge to do all it can to save the single currency, in the event of another blow-up in the eurozone sovereign debt crisis, we would be forced to revisit our forecasts for Bulgaria across the board.

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The two-month-old Bulgarian government continues to face the same levels of public protests that plagued its predecessor. It will struggle to address protesters' discontent with recent declines in living standards. However, we do not see any major changes to Bulgaria's generally market-friendly economic policies and pro-EU policy orientation.

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Challenges Remain Despite EU Membership

We expect EU membership to remain key to Bulgaria's long-term political outlook, helping to 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 ensure a more stable economic and political situation over the next 10 years. Below we outline these challenges and possible scenarios for political change.

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In light of the weaker growth outlook and lower-than-expected inflation, we are revising our forecast for Bulgaria's fiscal deficit, which we now expect to arrive at 1.8% of GDP, against our previous forecast of 0.3%. While this marks a substantial widening from last

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We foresee no major changes to Bulgaria's long-standing currency board arrangement, which pegs the lev to the euro at BGN1.95/EUR. We do not expect Bulgaria to push ahead with eurozone accession ambitions over the near-term, and current international reserve levels are more than sufficient to guarantee currency stability. Deflation remains the main risk in 2013, and the authorities' limited ability to stimulate price growth could prove problematic.

Table: MONETARY POLICY

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Weak Domestic Demand To Narrow Current Account Deficit

Driven by a deteriorating consumption and investment outlook, we forecast Bulgaria's current account deficit to narrow from 1.3% of GDP in 2012 to 0.3% in 2013. Given our expectation that sluggish growth in the medium term will limit foreign direct investment, we forecast continued low-level current account deficits in the coming years and cannot rule out a return to a current account surplus.

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