

BULGARIA

Key conditions and challenges

Table 1 2022

Population, million	6.5
GDP, current US\$ billion	89.0
GDP per capita, current US\$	13772.6
International poverty rate (\$2.15) ^a	0.2
Lower middle-income poverty rate (\$3.65) ^a	1.4
Upper middle-income poverty rate (\$6.85) ^a	4.5
Gini index ^a	40.5
School enrollment, primary (% gross) ^b	85.2
Life expectancy at birth, years ^b	71.5
Total GHG emissions (mtCO2e)	51.5

Source: WDI, Macro Poverty Outlook, and official data.
 a/ Most recent value (2020), 2017 PPPs.
 b/ WDI for School enrollment (2020); Life expectancy (2021).

Following robust growth in 2022, the Bulgarian economy is set to slow down in line with EU trends. Inflation remains elevated, threatening plans for euro adoption in 2025. The fiscal deficit is expected to remain below the 3 percent Maastricht ceiling, possibly at the expense of reduced public investment. A new regular government is hoped to step up reform momentum. Poverty reduction is expected to slow down as Bulgaria faces slower growth and elevated inflation. Energy affordability remains a pressing concern.

Bulgaria's development path over the past two decades has been characterized by gradual convergence to average real incomes in the EU. By 2022, it reached 59 percent of the average GDP per capita in the EU in purchasing power parity terms but remained the poorest member state. Yet, income convergence was much slower in the last decade, as reforms lost momentum while adverse demographic trends resulted in a rapid decline in the working-age population. Moreover, investment ran into diminishing returns, and factor accumulation leveled off as the country became richer.

Despite substantial progress in reducing poverty, Bulgaria's poverty rates remain among the highest in the EU, while income inequality was the largest in 2021. Child poverty remains a particularly serious issue, with 26 percent of children at risk of poverty in 2021. Energy affordability is also a challenge, with about 22.5 percent of households unable to keep their homes warm in 2021, the highest in the EU. This share rises to 42.7 percent among poor households.

The country needs a new set of policies and ambitious reforms to spur economic growth, so that it can reach average EU income levels in the next 15 years. Bulgaria needs to address its institutional and governance weaknesses and ensure fair competition to boost firms' efficiency

and private sector expansion. Investment in people's skills will also help move the economy closer to the productivity frontier. If Bulgaria succeeds in overcoming these challenges with an ambitious reform agenda, it could accelerate its economic growth to above 4 percent in the period up to 2050. Under a no-reform scenario, however, growth may slow down to 1.2 percent by the middle of the century.

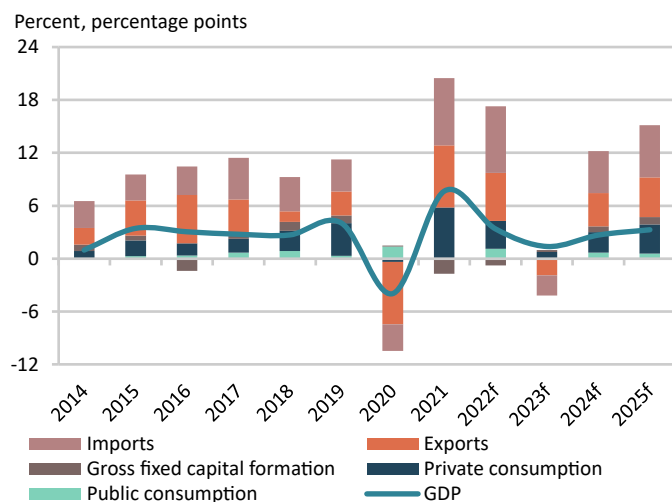
In parallel, the country needs to address persistent inequalities, including income inequality but also inequalities of opportunities, which limit human capital formation and growth, and further undermine growth prospects. Fiscal policy currently has a very limited impact on reducing child poverty. Yet, significant improvements can be achieved by fine-tuning certain measures, such as improved targeting and adequacy of means-tested child benefits.

Recent developments

GDP growth continued to decelerate in early 2023, in tune with trends in Western Europe. The economy's expansion slowed down to 1.8 percent y/y in Q2 as final consumption growth cooled off, while export growth adjusted downward, mirroring the soft landing in key export markets in the EU.

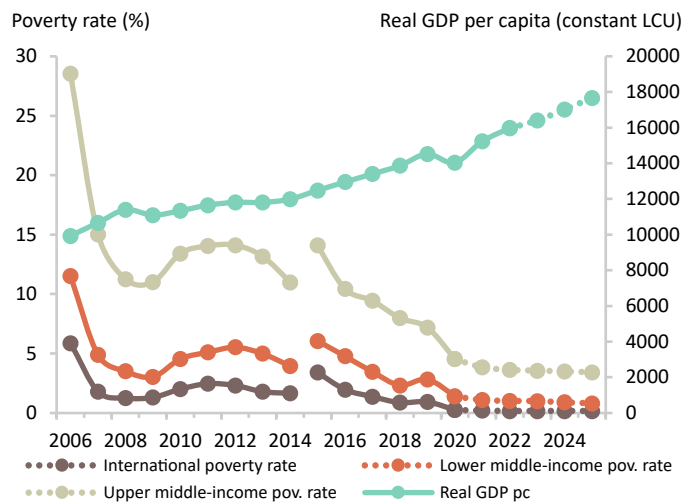
A declining working-age population has led to labor shortages across most sectors and skill sets, and a decrease in overall employment, accompanied by real wage increases since the start of 2023. Yet, the

FIGURE 1 Bulgaria / Real GDP growth and contributions to real GDP growth



Sources: World Bank and Bulgarian National Statistical Institute.

FIGURE 2 Bulgaria / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

working-age population is diminishing more rapidly than the overall decrease in employment, resulting in a still-rising employment rate.

Following 2022, when Bulgaria recorded one of the highest inflation rates in the EU, consumer price growth has slowed down in the early part of 2023, reaching 8.5 percent y/y in July. Even if energy and food price inflation gradually subsided in H1, food prices retained above-average growth and even resumed their rise in July, which impacts disproportionately the poorest segments of society. Moreover, core inflation also picked up in July, which may be attributed to still-strong demand pressures. Food and energy inflation can increase poverty by 1 percentage point (\$6.85 line), slowing down overall poverty reduction in 2022. Energy price ripples, influencing core inflation, could amplify impacts up to 1.8 percentage points. Energy affordability remains a major concern: the World Bank's rapid survey in July reveals that 15 percent of households struggled to heat homes last winter, 30 percent faced summer cooling challenges, and 73 percent deemed existing energy price caps insufficient.

Following the rapid deterioration of the fiscal position in early 2023, the balance

improved in June-July and returned to positive territory (+0.2 percent) for January-July. This became possible after the new government took steps to increase tax and non-tax revenue collection. For the full year, the government foresees a deficit of 3 percent on an accrual basis, with the aim of meeting the line Maastricht criterion of up-to-3 percent deficit and joining the euro area in 2025. The EC's Convergence Report on Bulgaria's readiness for accession is expected in spring 2024. While the fiscal balance target appears within reach, eurozone accession plans may stumble upon the Maastricht criterion for inflation. As of June 2023, Bulgaria's annual average HICP inflation is 5.3pp above the corresponding benchmark. Faster disinflation will be needed if the country is to align with the criterion by early 2024.

Outlook

Bulgaria's economy is expected to slow down substantially in 2023 – to 1.4 percent – in tune with the ongoing cooling off in the eurozone. Growth may be further suppressed if Bulgaria fails to deliver on the reform milestones under the National

Recovery and Resilience Plan, resulting in further delays of upcoming tranches.

Inflation will continue to subside but remain elevated in 2023, putting at risk the official eurozone accession target for 2025. The government's 3 percent fiscal deficit target in 2023 is achievable but may come at the expense of lower-than-planned capital spending, which could hurt growth prospects going forward. The current account is projected to move to a slight surplus in 2023-2025 due to the expected downward adjustment of import prices of key raw materials and the increase of net services export.

Political risks have declined markedly following the formation of a regular coalition government in June 2023. The new government's priorities include speeding up the implementation of the NRRP, as well as preparing the country for near-term Schengen Area and eurozone accession. Yet, the upcoming local elections in October may increase pressure on the ruling coalition, and political uncertainty may re-escalate.

Given the growth deceleration and potentially persistent inflation, poverty (using the 6.85\$ UMIC poverty line) is expected to continue declining slowly, reaching 3.5 percent in 2023.

TABLE 2 Bulgaria / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-4.0	7.6	3.4	1.4	2.7	3.3
Private consumption	-0.6	8.8	4.8	1.1	3.5	4.9
Government consumption	8.3	0.4	6.5	0.4	3.9	3.2
Gross fixed capital investment	0.6	-8.3	-4.3	1.3	4.0	5.1
Exports, goods and services	-10.4	11.0	8.3	-2.7	5.7	6.6
Imports, goods and services	-4.3	10.9	10.5	-3.0	6.5	7.8
Real GDP growth, at constant factor prices	-4.0	8.0	3.4	1.4	2.7	3.3
Agriculture	-3.3	28.8	-0.8	0.5	1.5	1.2
Industry	-8.2	1.7	11.9	-3.5	6.7	5.2
Services	-2.5	8.7	1.0	3.3	1.4	2.7
Inflation (consumer price index)	1.7	3.3	15.3	9.8	5.6	4.2
Current account balance (% of GDP)	0.0	-1.9	-0.7	1.6	1.9	0.9
Net foreign direct investment inflow (% of GDP)	4.5	1.8	2.4	1.8	2.6	2.9
Fiscal balance (% of GDP)	-2.9	-2.7	-0.8	-2.9	-2.9	-2.3
Revenues (% of GDP)	36.8	37.7	39.2	39.5	40.6	41.3
Debt (% of GDP)	24.5	23.9	22.9	22.5	22.7	22.1
Primary balance (% of GDP)	-2.4	-2.3	-0.4	-2.5	-2.5	-1.9
International poverty rate (\$2.15 in 2017 PPP)^{a,b}	0.2	0.2	0.2	0.2	0.2	0.2
Lower middle-income poverty rate (\$3.65 in 2017 PPP)^{a,b}	1.4	1.1	1.0	1.0	0.9	0.8
Upper middle-income poverty rate (\$6.85 in 2017 PPP)^{a,b}	4.5	3.8	3.6	3.5	3.5	3.4
GHG emissions growth (mtCO₂e)	-3.7	7.0	7.7	1.5	3.5	3.0
Energy related GHG emissions (% of total)	80.2	78.5	75.2	74.0	72.3	71.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.

Notes: e = estimate, f = forecast.

a/ Calculations based on ECAPOV harmonization, using 2021-EU-SILC. Actual data: 2020. Nowcast: 2021-2022. Forecasts are from 2023 to 2025.

b/ Projection using neutral distribution (2020) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.