



Weekly Briefing

**Bulgaria economy briefing:
Outlook of the Economic Challenges for Bulgaria in 2023**
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Outlook of the Economic Challenges for Bulgaria in 2023

Summary

Macroeconomic forecasts, which are made not only by experts in Bulgaria, but also by a number of international financial institutions, show that in 2023 Bulgarian economic growth will be close to zero - between 0 and 1%, which is not a good indicator of economic recovery. There is a real indication of deteriorated basic factors that determine the growth of the Bulgarian economy. First, it is the international environment. The world and European economies are in serious decline. The opportunities for increasing Bulgarian exports are deteriorating, which is essential due to the fact that the Bulgarian economy is export-oriented. Secondly, due to high inflation, consumption is shrinking and, according to expert analyses in 2023 it will not exceed more than 1% growth compared to the previous year. For 2023, the Ministry of Finance and the Council of Ministers expect inflation in Bulgaria to be around 6.4%, but according to other experts, it will be around 10%. The third important factor for the foreseen low GDP growth in 2023 is the decline in investment costs in Bulgaria, both through European funds and through national funding. Finally, one of the main economic challenges facing Bulgaria in 2023 will be the fulfillment of the criteria for Bulgaria's accession to the so-called Eurozone consisting of states of the European Union that have adopted the euro (€) as their primary currency and sole legal tender.

The past year 2022 was supposed to be the year of recovery from the coronavirus pandemic and the opening of economies. However, it turned out to be a year of war, rising inflation, an energy crisis, floods and droughts. 2022 was also the year central banks tried to fight inflation, as well as the year that changed Europe and ended cheap energy.

Against the background of all this, most economic experts say that it is very difficult to make forecasts for the year 2023. One thing that is certain is that the end of the war in Ukraine is not yet visible, and together with that, no end to the energy crisis and inflation can be predicted. Trade disputes are expected and even the coronavirus could visibly affect the global economy again.

According to the head of the International Monetary Fund, Kristalina Georgieva, the development of the world economy will reach the bottom before the recovery phase this year and will start to accelerate in 2024.¹

¹ <https://www.standartnews.com/biznes/kristalina-georgieva-se-namesi-s-prognoza-za-2023-g-514192.html>

However, all economic forecasts note that rising inflation will remain one of the challenges for the global economy in 2023. Expectations for the Eurozone are that inflation growth will be stronger and the economic crisis more difficult to control.

Again, according to the International Monetary Fund, a third of the global economy will be in recession this year, including half of European economies. Thus, 2023 will be more difficult than the past year 2022.²

Bulgarian economic prospects have considerably deteriorated as a result of Russia's invasion of Ukraine. The country's economy is very export-oriented, including the export of services (tourism), which makes it vulnerable to external shocks. Moreover, prior to the war, Bulgaria was heavily dependent on natural-gas imports from Russia. As a result, it was heavily impacted by the European energy crisis and EU trade sanctions against Russia.

Following a strong post-Covid-19 recovery with +7.6% real GDP growth in 2021, economic activity in Bulgaria slowed down markedly in 2022 amid surging inflation, higher interest rates, weakening external demand and deteriorating business confidence. The latter affected fixed investment in particular, which dropped again by -7% (after -8.3% in 2021). Thanks to strong fiscal measures – public spending increased by more than +6% – real GDP grew still by around +3% in 2022.

However, macroeconomic forecasts, made not only by experts in Bulgaria, but also by a number of international financial institutions are not very optimistic about the 2023 Bulgarian economic development. Most financial institutions forecast that in 2023 Bulgarian economic growth will be close to zero - between 0 and 1% which is not a good indicator of economic recovery.

The most problematic for the economic development of the country in 2023 are the energy supply issues, high inflation and tightening financial conditions throughout the main economic partners of the country.

There is a real indication of deteriorated basic factors that determine the growth of the Bulgarian economy. First, it is the international environment. The world and European economies are in serious decline. Bulgaria's main economic partners are the EU countries. When there is a deterioration of their economic indicators, then the possibility of increasing

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https://www.capital.bg/politika_i_ikonomika/ikonomika/2023/01/05/4434861_bulgarskata_ikonomika_v_och_akvane_na_zabaviane/

Bulgarian exports also decreases. This is an extremely important factor, as Bulgaria is an export-oriented economy and exports are of great importance for the economic growth.

Secondly, consumption is also important for the forecasted almost zero real GDP growth in 2023. Due to high inflation, the consumption is shrinking and, according to expert analyses, in 2023 it will not exceed more than 1% growth compared to the previous year.

The third important factor is investment costs. In 2022, there was a very serious drop in capital expenditure in Bulgaria, both through the European funds and through the national funding. This did not give a chance to increase economic growth and production based on high added value.

The hope of the economists It is that some of these investments will be done in 2023, mainly through the so called Recovery and Resilience Plan and other European programs, as well as the investments planned to be implemented with national funding - with money from the budget.

But in order all this to happen it is very important for Bulgaria to have a regular government which will accept its program and will take the responsibility for all the economic challenges. Unfortunately, this is not yet visible. Thus, the political crisis in the country further worsens the economic forecasts for the year.

Expectations are that the economy will stagnate this year and prices will continue to rise, albeit at a slower pace than in 2022.

According to one of the biggest financial Institutions in Bulgaria, Allianz Trade, it is expected also a mild recession in early 2023 as the impact of high inflation on consumers' purchasing power will rise while exports will weaken further amid an uncertain economic outlook for Western Europe, Bulgaria's main export destination. Domestic fiscal stimulus will also be dialed down due to rising financing costs. However, EU funding inflows should mitigate the impact on growth to some extent, while winter energy rationing in Europe is a key downside risk.³

Inflation for 2022 is expected to be slightly above 15%. For 2023, the Bulgarian Ministry of Finance and the Council of Ministers expect it to be around 6.4%, but most of the experts foresee an inflation in Bulgaria to be around 10%. It is expected these effects to fade only gradually in the next two years and the forecasted annual average inflation in 2024 is already about 4%.⁴

Ultimately, economists fear that low growth combined with high inflation leads to so-called stagflation.

³ https://www.allianz-trade.com/en_global/economic-research/country-reports/Bulgaria.html

⁴ https://www.allianz-trade.com/en_global/economic-research/country-reports/Bulgaria.html

In addition, unemployment is expected to stabilize around 5%, without sharp deviations. Regarding the income of the population, it is expected that for 2023 there will be an average increase of no more than 9%.⁵

Conclusion

A week ago, the World Bank lowered its forecasts for the expansion of the Bulgarian economy in 2023 and 2024. According to the international financial institution, Bulgaria's GDP is now expected to grow by 1.7% in 2023, which is a decrease of 2.2 percentage points compared to the bank's estimate from June last year. The forecast for 2024 is for growth to accelerate to 3.3%, with the correction for the following year being smaller - by 0.4 percentage points.⁶

However, Bulgaria has suffered a smaller terms-of-trade deterioration than most EU countries, as raw materials and intermediary products with low levels of processing dominate its export structure. The result has been a smaller deterioration in Bulgaria's trade balance than that of the most EU countries. Smaller terms-of-trade deterioration will remain an important growth-support factor in 2023.

Another important factor for economic growth could be the implementation of the Recovery and Resilience Plan.

Other significant challenges facing the Bulgarian economy in 2023 are related to the fulfillment of the criteria for Bulgaria's accession to the Schengen Agreement for free movement, which would also have a serious positive economic effect for the country.

There is a clear commitment to the admission of Bulgaria to Schengen in October 2023. The deadline was agreed upon by President Rumen Radev during a meeting of the European Council in Brussels. This was a result of the intensive work of the caretaker cabinet and the President Radev in the last weeks of last year.

From this moment, everything depends on the work of the parliament and the adoption of several reforms that are related to the rule of law.⁷

Last but not least, a key challenge for Bulgaria is the fulfillment of the criteria for the country's entry into the Eurozone. As a result of its long-standing prudent economic policies, Bulgaria was admitted to the Exchange Rate Mechanism II (ERM-II), the "waiting room" for eventual adoption of the EUR, in July 2020. In conjunction with ERM-II membership, Bulgaria

⁵ <https://www.standartnews.com/biznes/kak-da-se-spasim-ot-nay-mrachnite-prognozi-kiril-ananiev-pred-standart-514238.html>

⁶ <https://openknowledge.worldbank.org/bitstream/handle/10986/38030/GEP-January-2023.pdf>

⁷ <https://bta.bg/bg/news/bulgaria/379971-krum-zarkov-dogovorihme-yasen-srok-za-priemaneto-ni-v-shengen-prez-oktomvri-dog>

also joined the European banking union in October 2020. Bulgaria's entry into the Eurozone was expected to take place in 2024, but due to the current economic crisis and not particularly good forecasts, expectations are the country to adopt the EUR in 2025 at the earliest.

However, all this again depends on the successful overcoming of the political crisis in the country and the election of a regular government and a functioning parliament able to deal with all the economic challenges of 2023.