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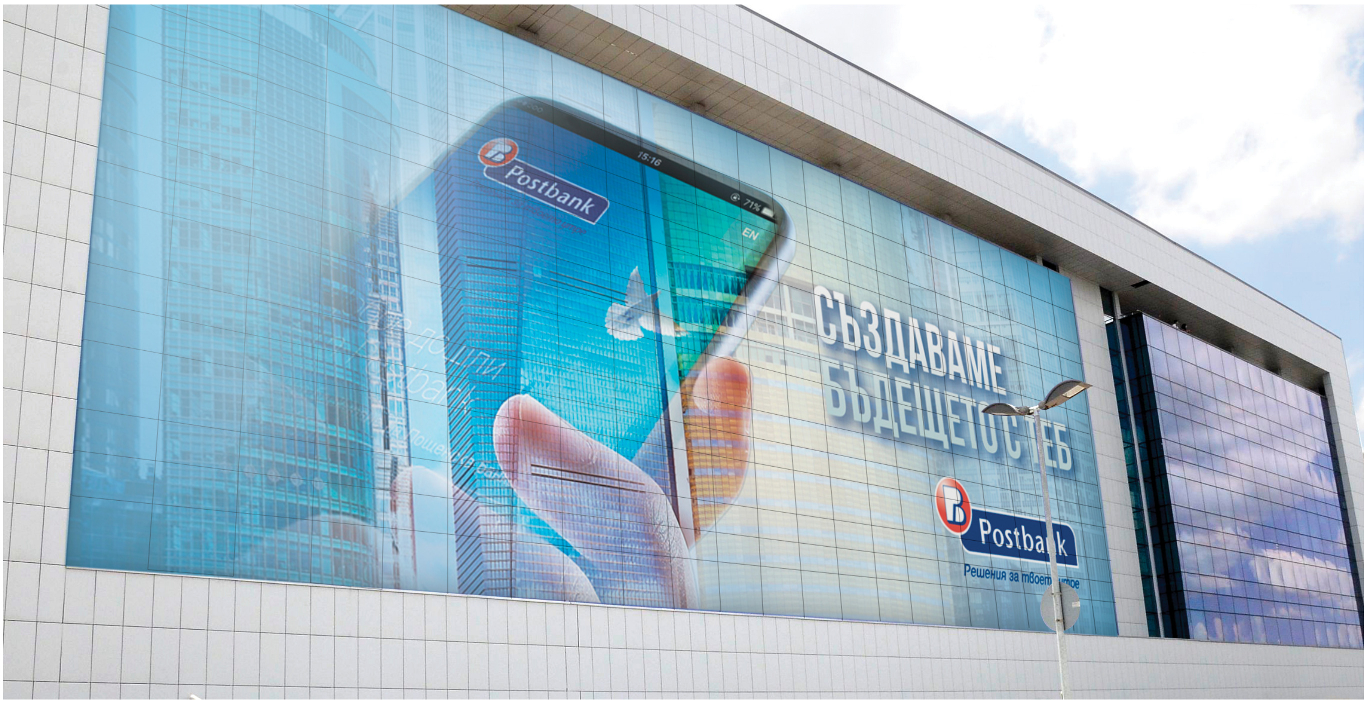
Bulgaria's hopes lie in the eurozone

Kit Gillet | 29/04/2021 11:37 am



Like much of the world, Bulgaria has been dealing with the economic and healthcare fallout of the global coronavirus pandemic. Bulgarian authorities have pumped billions into the economy through support schemes for small and medium-sized enterprises (SMEs), farmers and those working in tourism, as well as wage support schemes to preserve employment.

Even so, Bulgaria's gross domestic product (GDP) fell by 4.2% in 2020, after expanding by 3.7% in 2019. This compared with a combined drop of 6.2% for the EU as a whole in 2020. There were, however, hopes that 2021 would be a far better year for the country.

"We started the year with optimism, but the current third wave — which [has hit] Bulgaria particularly hard — and the significantly slower [rate] of vaccination, even compared with other EU countries, will harm the recovery," says Oliver Rögl, chief executive of Raiffeisenbank Bulgaria, who says they now expect growth of around 3% of GDP for 2021. "This will lead also to a recovery in loan growth and profitability, but for sure not as strong as we would like to see."

Good debt position

Bulgaria came into this crisis with a sovereign credit rating in the BBB range, with a very strong fiscal position compared to its peers, a debt position which was about half that of its peers, and relatively stable growth, says Arvind Ramakrishnan, a sovereign analyst at Fitch Ratings.

One major reason for this was the country's drive to adopt the euro, which requires a certain level of fiscal discipline. The Bulgarian lev was included in the Exchange Rate Mechanism II (ERM II), the system for managing exchange rate fluctuations, in July 2020, marking a key step towards this goal.

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Petia Dimitrova, Postbank

"They put themselves through a lot of fiscal discipline in order not to have [high] public debt," says Anca Ioana Ionescu, head of Bulgaria at the European Bank for Reconstruction and Development (EBRD). As a result, some important projects developed at a slower pace, with priority given to projects that could receive EU funding.

However, "not having such a big public debt is a plus now, for sure, given the pandemic," she adds. "Last year, Bulgaria issued Eurobonds with a yield of 0.3%; it was an amazing pricing and it was oversubscribed three times."

Eurozone by 2024

The continued push towards joining the eurozone is a major priority for the country, which Bulgarian authorities are targeting by January 2024. It is also hoping to join the border-free Schengen Area in the coming years.

"The process of accession to the eurozone is the most important process for Bulgaria in the next few years. This is a historical moment as, for the first time in a decade, we have the opportunity to join the elite European economic team," says Petia Dimitrova, chief executive of Postbank, the local subsidiary of Eurobank Group.

"The expectations are that this path will lead to an acceleration of the real convergence of the national economy to the eurozone, better confidence of foreign investors and, as a whole, more economic activity," she adds. "And this is an advantage for the entire society. The accession is also an incentive to implement certain structural reforms, which will lead to better economic competitiveness.

"This is an important prerequisite for an increase in incomes and more optimism among the business and the consumers," she notes.

EU funds

Bulgaria is set to be one of the main beneficiaries of EU funds over the coming years, which potentially includes €16.6bn as part of the 2021–2027 multi-annual financial framework and €7.5bn in grants as part of the NextGenerationEU Covid-19 recovery package. Combined, these would represent almost 40% of Bulgaria's 2020 GDP, according to Fitch estimates.

Given the support now available, Bulgaria has a chance to narrow the gap in terms of public investments. However, there are questions over the country's ability to take full advantage of this money.

"It will be crucial for the government to handle the absorption of funds from the resilience and recovery facility, which is almost €7bn that needs to be used within six years," says EBRD's Ms Ionescu. "The absorption capacity of these funds will be a test, and very important for the country, because if this opportunity is lost it will be a great pity."

"The next generation EU funds require countries to transition away from dirty fuel to clean energy," adds Mr Ramakrishnan. "We have doubts about Bulgaria's ability to actually absorb these funds and invest them. In terms of truly 'next generation', it's not just about making buildings energy efficient, but also making fundamental and sustainable shifts towards cleaner sources of energy. Bulgaria is going to face challenges with regards to that, and it will be a slow process."

SMEs are key

The impact of the pandemic on smaller companies operating in Bulgaria is a source of concern. Raiffeisenbank's Mr Rögl points out that SMEs, which employ three times as many people in Bulgaria as large enterprises and account for around 60% of assets in the economy, are particularly vulnerable to the pandemic. "These companies are highly dependent on the owner or manager, as well as their key specialists; if one of them falls ill, the whole enterprise suffers," he says, adding that these companies often have relatively weak capital bases.

In March, the European Investment Fund and Raiffeisenbank Bulgaria signed a guarantee agreement of €85m to support SMEs and small mid-caps companies with fewer than 500 employees.

There are also concerns that there could be a significant rise in Bulgaria's unemployment rate later this year, when the phasing out of job-retention schemes begins.

Ageing population

A longer-term challenge for Bulgaria is its demographics, with the country having seen an exodus of its skilled, working-age population since the country joined the EU in 2007. The population is considered to be the fastest-shrinking in the world, with the UN Population Division projecting in 2019 that Bulgaria would lose 23% of its population by 2050.

"There's no question that demographics are a key medium- to long-term challenge for Bulgaria," says Mr Ramakrishnan. "The working-age population is expected to reduce by about 12% every decade over the next three decades. It's difficult to actually turn that around, because you need to increase the working-age population, which can only really happen if more people choose to stay or you're allowing more immigration."

The brain drain is perhaps most visible in Bulgaria's understaffed healthcare and education sectors, but all areas of the economy are thought to be affected. Bulgaria has the lowest average salaries and the lowest minimum wage in the EU.

Still, some sectors are showing strong potential. "The Bulgarian manufacturing sector is the most cost-competitive one in the whole of the EU," says Teodora Petkova, chief executive and chair of the board at UniCredit Bulbank, Bulgaria's largest bank.

"Over the past decade, it has reinforced the transition from labour-intensive and low-value-added manufacturing towards a more capital-intensive and higher-value-added segment," she adds. "IT is also a rapidly growing part of the economy, with a very promising growth outlook."

When life returns to a degree of normalcy, these are areas for Bulgaria to focus on, as well as how best to utilise available EU funds to grow the economy and keep more young Bulgarians in the country.