BULGARIA

THE AUTHORITIES AIM TO ADOPT THE EURO IN 2024

GDP growth was resilient in the first three quarters of 2022 but is expected to slow down significantly in 2023. Inflation will be a key feature to monitor as price stability is one of the economic convergence criteria for Bulgaria's future entry into the Eurozone in 2024. Another point of concern is that the political scene continues to be subject to uncertainty given the many changes in the government over the past 20 months. Investment has suffered as a result of this situation. However, the commitment of the authorities towards reforms does not appear to have been affected.

In the third quarter, GDP growth remained positive, despite multiple shocks caused by the war in Ukraine. Economic activity rose by 0.6% quarter-on-quarter (3.3% year-on-year) after 0.8% and 0.4% in the previous quarters. While consumer spending and net exports contributed positively to growth, investment and changes to stock levels fell. Consumer spending held up quite well in the first three quarters of 2022, despite the sharp rise in consumer prices. This resilience is explained by salary growth and fiscal measures in favour of households (and companies) in the face of rising prices in the energy sector. Investment has been affected by prevailing domestic political uncertainties, with 4 elections in the last 20 months.

Economic growth will be relatively solid in 2022 with a carry-over of 3.7% at the end of the third quarter. Conversely, the outlook is significantly dimmed for 2023. External demand will be weaker due to the expected slowdown in the Eurozone, Bulgaria's main trading partner. Similarly, domestic demand, and in particular consumption,may slow down.

ECONOMIC INDICATORS ARE SOFTENING

Economic indicators are showing signs of weakening. Household confidence has been declining for several months and retail sales growth slowed to 0.5% year-on-year in October after 1.8% and 2.0% in the two previous months. The automotive sector has recorded a sharp drop in vehicle sales in recent months (-10.1% year-on-year in October, -10.8% in September).

Furthermore, the cost of mortgage loans has increased with the rise in interest rates, in a context where almost all mortgage loans are contracted on a variable rate basis. This will have an impact on household budgets. On the positive side, the labour market still remains dynamic, with an unemployment rate that has been improving for several months. It stood at 4% in October compared to 4.6% in January 2022.

Industrial activity has weakened since September. Furthermore, the country is not immune from a scenario of energy rationing , which would affect industrial activity.

However, there are some reassuring elements. Gas only represents a marginal share of the energy mix. Conversely, oil and coal make up 39%. Storage of gas was at 94% of its capacity at the end of November. Bulgaria has stopped importing gas from Russia since April 2022, but has found other sources of supply. Azerbaijan is expected to supply part of Bulgaria's annual consumption. In addition, a new gas pipeline between Bulgaria and Greece has become operational since October 2022. With regard to oil, the country has obtained an exemption from the European Union, allowing it to continue importing Russian oil until the end of 2024.

FORECASTS

	2020	2021	2022e	2023e	2024e
Real GDP growth (%)	-4.0	7.1	3.6	0.8	2.9
Inflation (HICP, year average, %)	1.2	2.8	13.5	8.3	3.9
Gen. Gov. balance / GDP (%)	-3.8	-3.9	-3.7	-4.9	-3.1
Gen. Gov. debt / GDP (%)	24.5	23.9	24.1	26.1	26.7
Current account balance / GDP (%)	0.0	-0.5	-0.7	-1.0	0.5
External debt / GDP (%)	63.8	58.4	49.9	46.3	44.3
Forex reserves (EUR bn)	31	31	33	35	37
Forex reserves, in months of imports	12.1	9.6	8.5	7.9	8.3

TABLE 1

e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

BULGARIA: INDUSTRIAL PRODUCTION AND RETAIL SALES

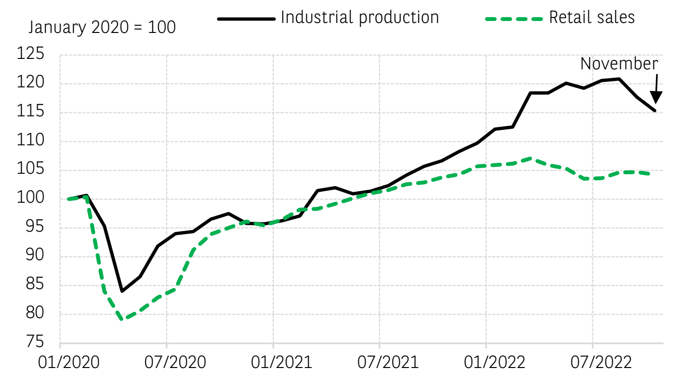

CHART 1

SOURCE: EUROSTAT, BNP PARIBAS

CONVERGENCE CRITERIA FOR ADOPTION OF THE EURO IN 2024

As the Bulgarian government is aiming to adopt the euro on 1st January 2024, 2023 will be a decisive year. Indeed, the convergence report from the European Commission and the European Central Bank, due in June, will decide whether or not the 4 economic convergence criteria have been met.

These criteria relate to price stability, the sustainability of public finances, exchange rate stability and long-term interest rates. When the previous convergence report was published in June 2022, Bulgaria fulfilled all of the conditions except price stability.

This year, the criteria relating to exchange rate stability and long-term interest rates should not pose major problems. By contrast, inflation and public accounts do raise questions. The budget deficit is expected to deteriorate further in 2023. Inflation will be an important element to monitor this year. According to the rules on convergence, the average inflation rate over one year should not exceed that of the three best-performing Member States by more than 1.5 points.

By way of comparison, Croatia joined the Eurozone on 1st January 2023 and met all of the convergence criteria last year. In the penultimate convergence report published in 2020, Croatia did not meet the exchange rate criterion.

HIGH INFLATIONARY PRESSURES

The inflation rate has accelerated since the end of 2021, reaching a peak of 15.6% year-on-year last September. Subsequently it has fallen back, to 14.8% in October and 14.3% in November. The slight drop in inflation can be explained by the lower contribution from the "energy" component in November. On the other hand, the "food" component continues to drive inflation upwards. Core inflation rose by 10.3% and contributed 6 points to headline inflation . In the coming months, the contribution from the «energy» and «food» components will probably be smaller given the relative easing of energy and food prices on the international markets. Nonetheless, core inflation is likely to remain high due to wage pressures. In 2022, salaries were higher, with an increase of 10% in the third quarter year-on-year after 7.2% and 8.6% in previous quarters.

Amid the rise in prices, the Central Bank's room for manoeuvre has been limited. The implementation of monetary policy is linked with that of the European Central Bank. Bulgaria has adopted the European exchange rate mechanism since July 2020 with a view to future membership in the Eurozone. This means that the Bulgarian lev is anchored to the euro.

As a result, the extent of monetary tightening has been much less in Bulgaria than in other countries in the region. The key rate was raised by 142 basis points cumulatively in 2022, compared to 1010 basis points in Hungary and 450 basis points in Poland.

Within the Eurozone, France, Spain and Finland are currently experiencing relatively lower rates of inflation than other Member States. These three countries would probably serve as a benchmark for assessing convergence in terms of price stability.

THE DETERIORATION IN PUBLIC ACCOUNTS REMAINS MANAGEABLE

The Covid-19 pandemic shock has tipped public accounts into the red. After several years of budget surpluses, the public deficit reached 3.8% of GDP in 2020 and 3.9% in 2021. The deficit will remain high in the short term, reflecting the government's support measures for dealing with the price shock in the energy and food sectors. They are estimated at 5.3% of GDP in 2022, according to the Bruegel Institute.

This situation does not present major concerns for the sustainability of the public debt. The public debt ratio compared to Bulgaria's GDP (at 23.9%) is in fact the lowest in the region after Estonia, and is unlikely

BULGARIA: INFLATION

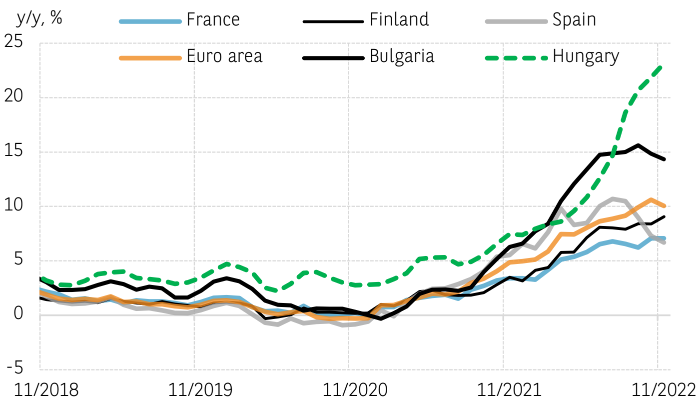

CHART 2

SOURCE: EUROSTAT, BNP PARIBAS

to exceed 30% of GDP over the next 3 years. The public accounts have been well managed in recent years, the credibility of the currency board within the framework of the European mechanism requiring a strengthening of public finances.

The government will most likely remain committed to the fiscal consolidation process in the short term. Debt servicing remains affordable despite the recent rise in government bond rates. In 2021, the interest charge on the debt remained low, representing 1.3% of government revenues. Other factors also tend to reassure. In particular, European funds under the resilience plan, amounting to 6.3bn euros, should contribute to financing the budget.

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