



UniCredit Bulbank



Bulgarian economy in 2015: Acceleration of structural reforms and unchanged growth trajectory, despite lack of fiscal stimuli

Prepared for EU Club meeting at the BCCI on 15 January 2015



Andrea Casini, Deputy Chairman of the MB and COO of UniCredit Bulbank

Sofia, 15 January 2015

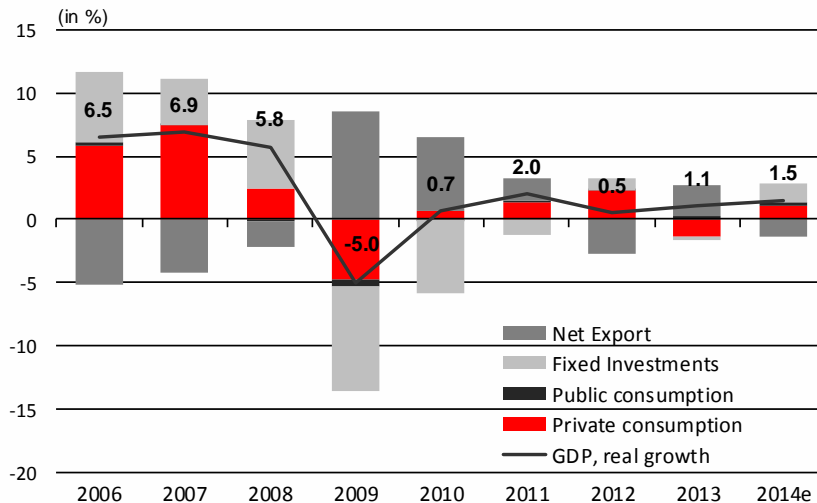
2014 was lost for structural reforms, but brought a shift toward more growth supportive fiscal policy

The negative impact that political instability, frozen EU funds and June's bank crisis had on the pace of the Bulgarian economic recovery was compensated for by a pronounced shift towards a more growth supportive fiscal policy.

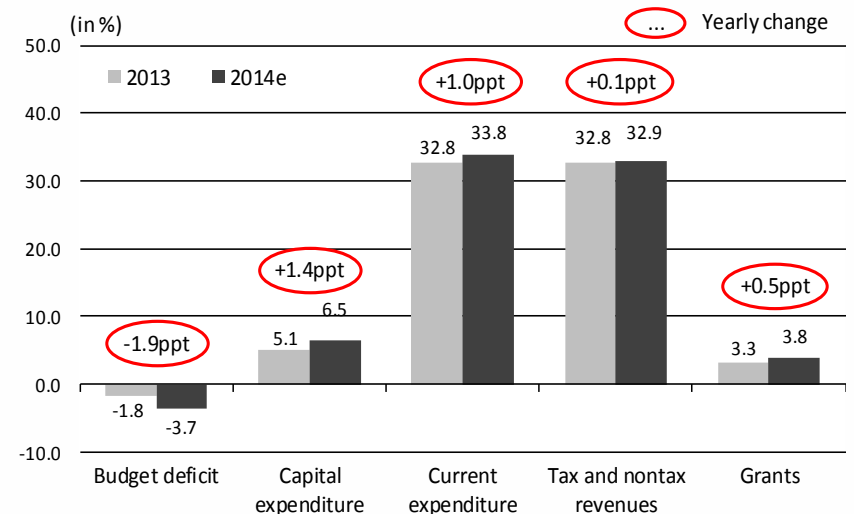
GDP growth became more broadly based, with investments and to a lesser extent household consumption joining industry and exports, as drivers of economic recovery.

The shift toward more growth supportive fiscal policy allowed government capital expenditure to rise by 1.4 ppt of GDP to expected level of 6.5% of GDP in 2014, from 5.1% one year earlier and 4.5% on average in the period 2010 – 2012.

GDP growth and contribution to growth, yoy, swda (2006 – 2014e)



Consolidated fiscal program, as % of GDP (2013 – 2014e)



Source: NSI, MF, UniCredit Bulbank

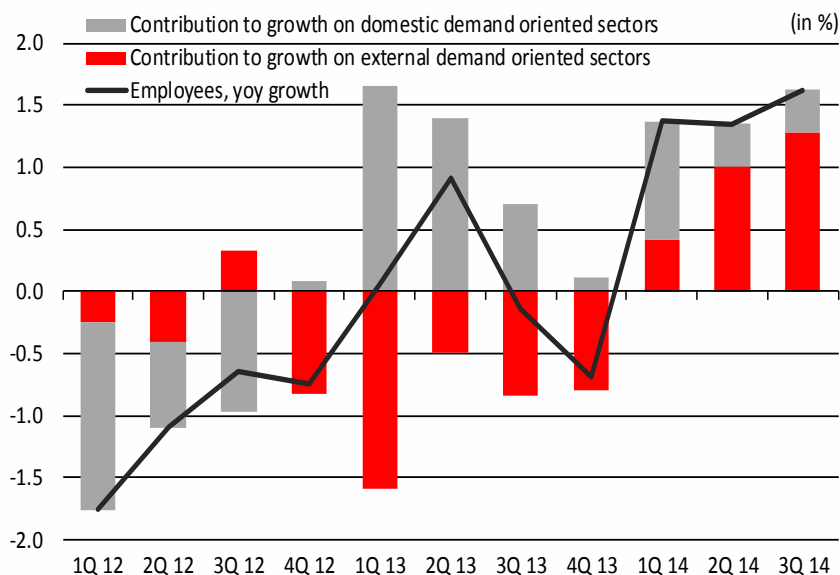
2014 was the best year for Bulgarian labor market since the start of global crisis in 2008

Practically all key labor market indicators improved last year.

For the 9Ms of the previous year, 43 thousand jobs were added in the economy, which corresponds to 1.4% yoy rise. There is also positive news in the fact that almost two-third of this jobs increase came from the external demand oriented sectors.

This is very encouraging, when taking into account that external demand oriented sectors have continued losing jobs for the whole period from 2008 until early 2014, despite the fact that real exports in end-2013 was already more than a quarter above its pre-crisis level.

YoY growth on employees and contribution to growth by sectors (1Q 2012 – 3Q 2014)



Yearly change of employees by economic sectors (2009 – 9M 2014)

| Yearly change (number) | 2009 | 2010 | 2011 | 2012 | 2013 | 9M 2014 |
|---|---------------|---------------|--------------|--------------|------------|-------------|
| Agriculture, forestry and fishing | -20.5 | -22.6 | -7.1 | -12 | 6.5 | 15.9 |
| Manufacturing and Mining & Quarrying | -56.8 | -77.5 | -51.1 | 10.2 | -27.1 | 2.5 |
| Transportation and storage | -1.9 | -10.3 | -3.6 | 2.6 | 4.5 | -6.2 |
| Accommodation and food service activities | -0.1 | -9.0 | -0.5 | -6.5 | -6.6 | 8.4 |
| Construction and Real estate activities | -18.8 | -57 | -40.6 | -24.2 | 2.8 | 10.3 |
| Wholesale and retail trade | -2.1 | 3.2 | 13.3 | -17.5 | -1.4 | -8.5 |
| Electricity, Gas, Water, Waste | -3.0 | 0.2 | 8.3 | -1.2 | -6.8 | -5.0 |
| Other sectors | -3.9 | -27.8 | -6.2 | 17.5 | 28.9 | 25.2 |
| Total employees | -107.1 | -200.8 | -87.5 | -31.1 | 0.8 | 42.6 |

Source: NSI, UniCredit Bulbank

There are rising signals that Bulgaria is on course to press ahead with some long-delayed structural reforms

The government looks resolved to implement some of the painful steps needed to balance the pension system including tightening access to disability pensions, abolishing of early retirement privileges for some categories of public sector workers and perhaps criminalizing most severe cases of contribution nonpayment. Possible increase in the pension contribution payments, higher retirement age and reform of private pension companies regulation are also among policy moves under discussion.

The government plans to reform emergency medical services and to strengthen the link between results and public funding channeled to the education sector.

Populist cuts in energy prices undertaken by the previous administration were already reversed.

GERB looks resolved to create a working mechanism for channeling of EU funds into projects aimed at improving energy efficiency of residential buildings.

Consensus is gradually building up around some long contested measures for reform in the judiciary sector, which when implemented should strengthen independence of courts and help prevent corruption practices.

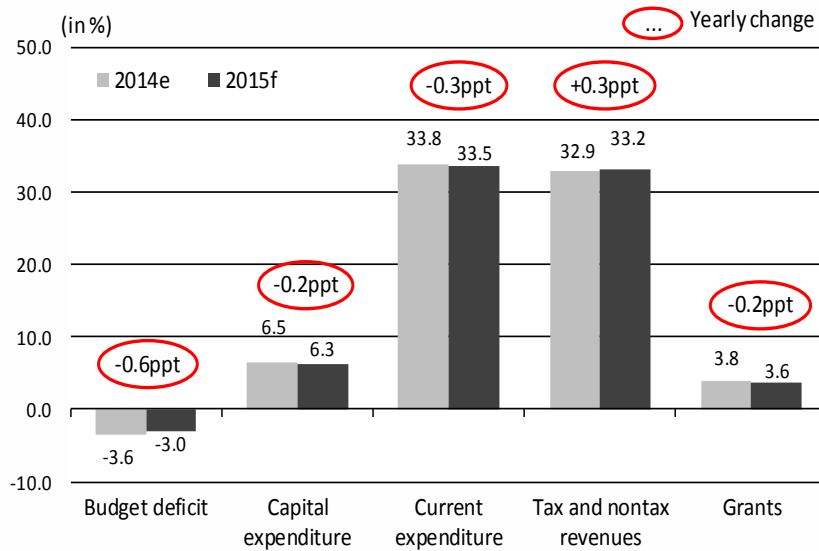
While 2014 brought a pronounced shift to a more growth supportive fiscal stance, we expect fiscal policy to remain growth neutral in 2015

Government has embarked on a gradual fiscal consolidation this year.

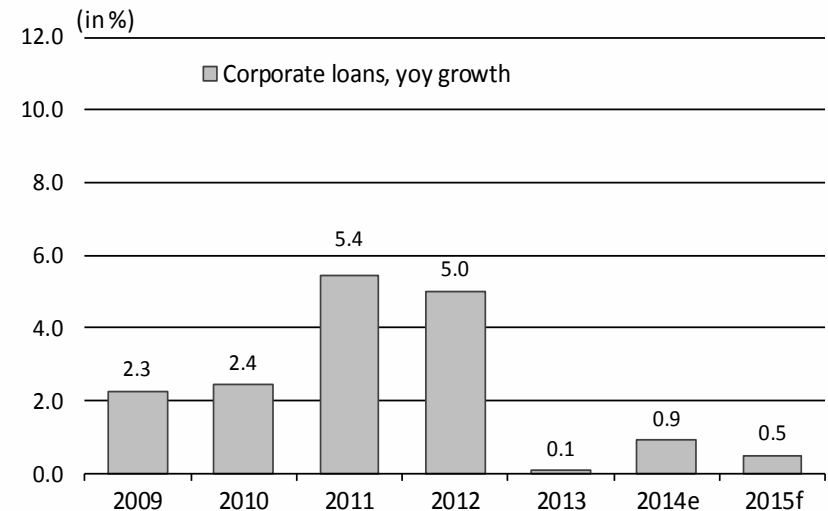
The bulk of the deficit narrowing this year is planned to materialize via lower compensation of government employees and improved tax collection, while only a tiny part will come from lower public investments.

The good news is not only that the government has abandoned previous plans for aggressive fiscal consolidation, which given still elevated unemployment and broadly based deflationary pressure threatens to push the economy into a new recession, but also that policy makers want to cut the deficit in a way which is least detrimental for growth and jobs recovery in the short run.

Consolidated fiscal program, as % of GDP (2014 – 2015f)



YoY growth rate on corporate loans* (2009 – 2015f)



Source: NSI, BNB, MF, UniCredit Bulbank

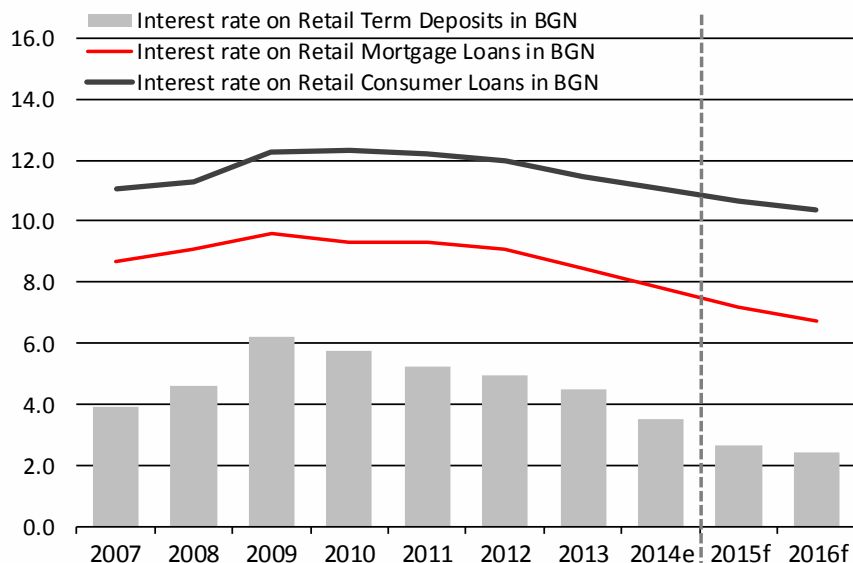
* Corporate loan growth projections are adjusted with CoCB numbers

Interest rates on loans and deposits are trending downward

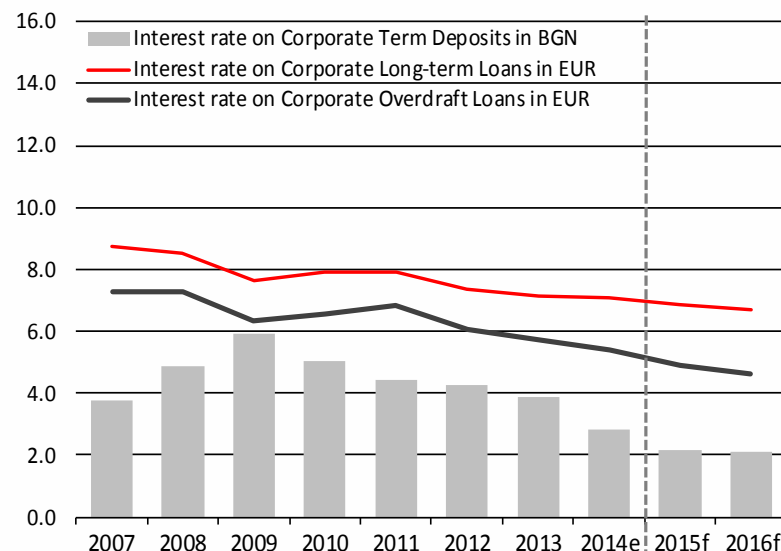
In the aftermath of June's events almost all local lenders embarked on a pronounced reduction in the price of domestically attracted deposits, which is a welcomed adjustment given pronounced deflationary pressure.

We think interest rates will continue trending downward this year and perhaps even next year, which is a clear positive, as it helps to redirect some stimuli from those who save to those who borrow.

Interest rates on outstanding retail loans and deposits, average (2007 – 2016f)



Interest rates on outstanding corporate loans and deposits, average (2007 – 2016f)



Source: BNB, UniCredit Bulbank



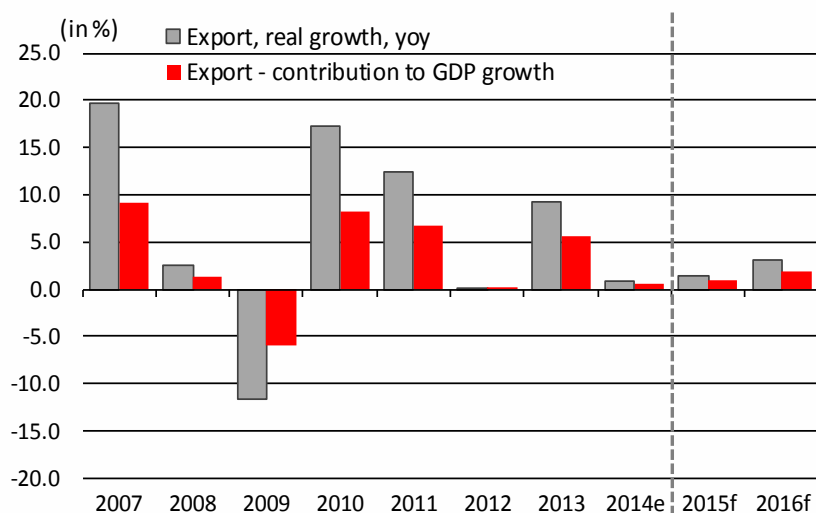
Exports are forecast to make a notch stronger positive contribution to growth this year

Despite weaker euro, Bulgarian exports recovery is likely to progress only very gradually this year.

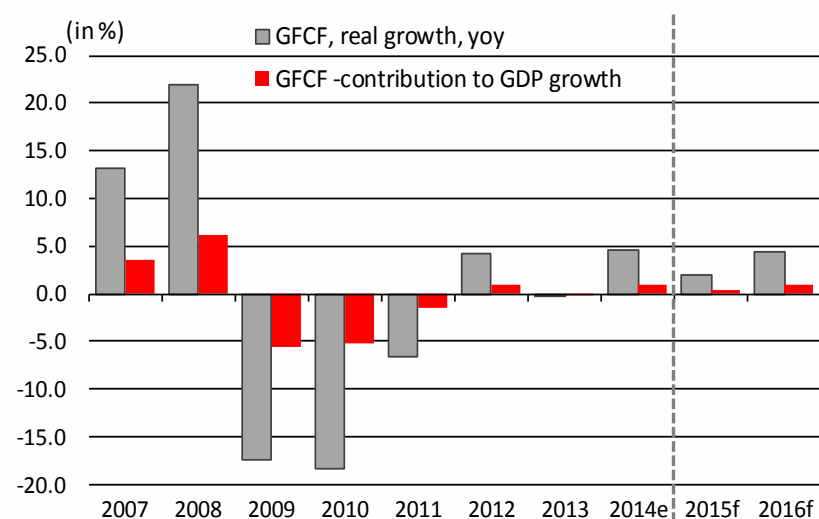
This is because GDP growth in our key trading partners from the EU area remains weak, while demand for investment goods in China is cooling down.

Rising geopolitical risks will also weigh on global trade outlook this year.

Export of goods and services - real growth and contribution to GDP growth, swda (2007 – 2016f)



Gross fixed capital formation (GFCF) - real growth and contribution to GDP growth, swda (2007 – 2016f)



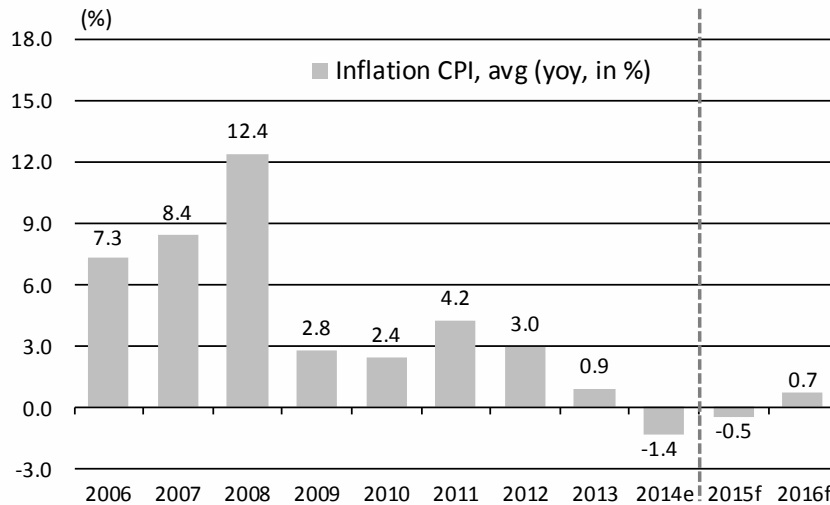
Source: NSI, UniCredit Bulbank

Lower crude oil prices should help GDP growth and balance of payments to improve

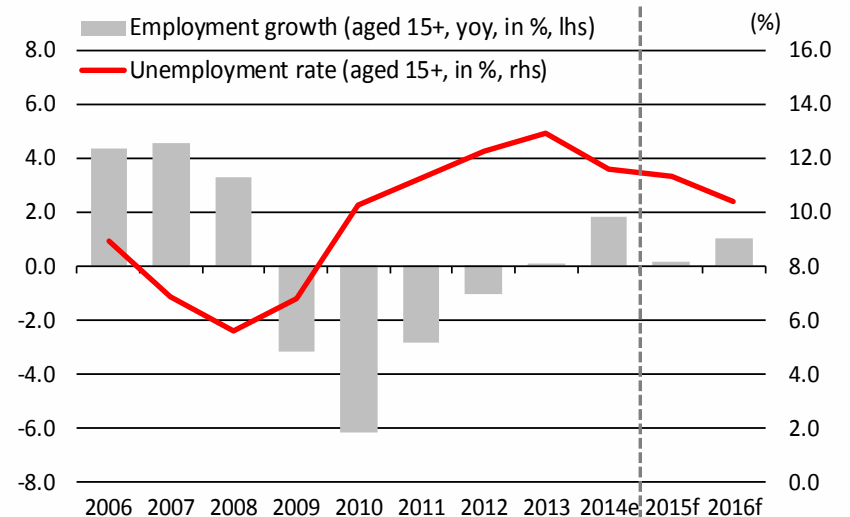
If lower crude oil prices are not reversed in the course of 2015, a significant wealth transfer from oil producing to oil consuming countries will follow, with Bulgaria also being among those to benefit.

Tentative labor market recovery seen last year will carry over into 2015. But the pace of the unemployment rate improvement is set to lose some momentum due to the job cuts in the public sector, which are planned as part of the fiscal consolidation and structural reform efforts.

Inflation (CPI), yoy (2006 – 2016f)



Employment growth and Unemployment rate (2006 – 2016f)



Source: NSI, UniCredit Bulbank



Instead of conclusions

| Macroeconomic scenario of UniCredit Bulbank | | | | | | |
|--|-------------|-------------|-------------|--------------|--------------|--------------|
| | 2011 | 2012 | 2013 | 2014e | 2015f | 2016f |
| GDP (EUR bn) | 40.1 | 40.9 | 41.0 | 41.1 | 41.5 | 42.6 |
| Population (mn) | 7.3 | 7.3 | 7.2 | 7.2 | 7.2 | 7.1 |
| GDP per capita (EUR) | 5 473 | 5 618 | 5 665 | 5 704 | 5 798 | 5 989 |
| GDP per capita, real yoy (%) | 2.6 | 1.1 | 1.6 | 1.9 | 2.2 | 2.6 |
| Real economy, yoy change (%) | | | | | | |
| GDP | 2.0 | 0.5 | 1.1 | 1.5 | 1.5 | 2.0 |
| Private Consumption | 1.9 | 3.2 | -1.8 | 1.5 | 1.4 | 1.9 |
| Public Consumption | 0.6 | 0.5 | 3.6 | 2.7 | 0.6 | -0.3 |
| Fixed Investment | -6.6 | 4.2 | -0.1 | 4.5 | 1.9 | 4.3 |
| Exports | 12.3 | 0.1 | 9.2 | 0.9 | 1.5 | 3.0 |
| Imports | 8.5 | 4.5 | 4.9 | 3.0 | 1.3 | 3.3 |
| Labour market | | | | | | |
| Monthly wage, nominal (EUR) | 351 | 374 | 413 | 419 | 432 | 450 |
| Unemployment rate (%) | 11.3 | 12.3 | 12.9 | 11.6 | 11.3 | 10.4 |
| Fiscal accounts (% of GDP) | | | | | | |
| Budget balance | -2.0 | -0.4 | -1.8 | -3.7 | -3.1 | -2.9 |
| Public debt | 15.3 | 17.6 | 17.9 | 27.1 | 28.0 | 30.0 |
| External accounts | | | | | | |
| Current account balance / GDP (%) | 0.1 | -1.1 | 2.1 | 2.4 | 2.8 | 0.1 |
| Basic balance ¹ / GDP (%) | 3.1 | 1.0 | 4.5 | 4.8 | 5.8 | 3.9 |
| Net FDI (EUR bn) | 1.2 | 0.9 | 1.0 | 1.0 | 1.2 | 1.6 |
| Net FDI / GDP (%) | 3.0 | 2.1 | 2.4 | 2.4 | 3.0 | 3.8 |
| FX reserves / GDP (%) | 33.3 | 38.0 | 35.2 | 39.4 | 42.7 | 44.4 |
| Debt sustainability indicators (%) | | | | | | |
| Gross foreign debt / GDP | 90.3 | 92.2 | 91.0 | 91.8 | 88.9 | 86.6 |
| Debt-service payments-to export ratio | 9.5 | 7.7 | 8.0 | 8.0 | 8.8 | 9.7 |
| Debt / Export ratio | 141 | 143 | 133 | 135 | 133 | 127 |
| Inflation | | | | | | |
| CPI (pavg) | 4.2 | 3.0 | 0.9 | -1.4 | -0.5 | 0.7 |
| CPI (eop) | 2.8 | 4.2 | -1.6 | -0.7 | -0.3 | 1.0 |

We expect Bulgarian GDP to defy gravity and to rise by another 1.5% in real terms this year.

In a low-export growth environment in combination with limited room for more expansionary fiscal policy, we think that improved absorption of EU funds and some support for private consumption, via lower energy prices and a declining savings rate, will be the main GDP growth drivers.

Acceleration of some long-postponed structural measures is also expected this year, which if implemented should not only boost capacity of the economy to produce more goods and services in the long run, but should also help to economic recovery and jobs creation via its positive impact on sentiments.

Despite weaker euro, Bulgarian export recovery is likely to progress only very gradually this year.

Lower crude oil prices should help GDP growth and balance of payments to improve.

Tentative labor market recovery seen last year will carry over into 2015.

Source: BNB, NSI, MF, UniCredit Bulbank

¹Basic balance – the sum of the current account and net FDI.



THANK YOU FOR YOUR ATTENTION!

Disclaimer

This document is based upon public information sources, that are considered to be reliable, but for the completeness and accuracy of which we assume no liability. All estimates and opinions in the document represent the independent judgment of the analyst as of the date of the issue. We reserve the right to modify the views expressed herein at any time without notice, moreover we reserve the right not to update this information or to discontinue it altogether without notice.

This document is for information purposes only, and is not intended to and (i) does not constitute or form part of any offer for sale or subscription or solicitation of any offer to buy or subscribe for any financial instruments (ii) does not constitute an advice for solicitation of any offer to buy or subscribe for any financial instruments, or any advice in relation of an investment decision whatsoever.

The information is given without any warranty on an “as is” basis and should not be regarded as a substitute for obtaining individual investment advice. Investors must take their own determination of the appropriateness of investments referred to herein, based on the merits and risks involved, their own investment strategy and their legal, fiscal and financial positions.

As this document does not qualify as direct or indirect investment recommendation, neither this document nor any part of it shall form the basis of, or be relied on in connection with or act as an inducement to enter into any contract or commitment whatsoever.

Neither UniCredit Bulbank, nor any of its directors, officers or employees shall accept any liability whatsoever vis-a-vis any recipient of this document or any third party for any loss howsoever arising from any use of this document or its contents herewith.

This document is not intended for private customers and the information contained herewith may not be disclosed, redistributed, reproduced or published for any purpose, without prior consent by UniCredit Bulbank.