

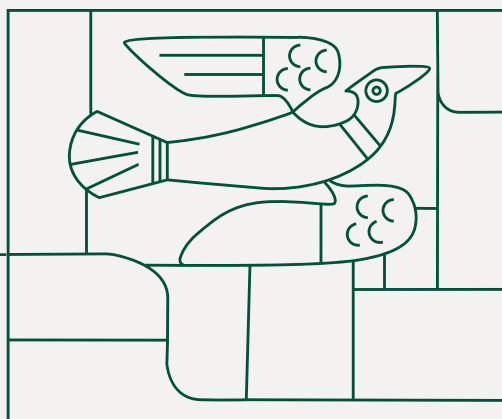


BULGARIAN
NATIONAL BANK
EUROSYSTEM

Topical Research and Highlights

Analysis of Labour Market Conditions
and Their Impact on Inflation
in Bulgaria

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Analysis of Labour Market Conditions and Their Impact on Inflation in Bulgaria

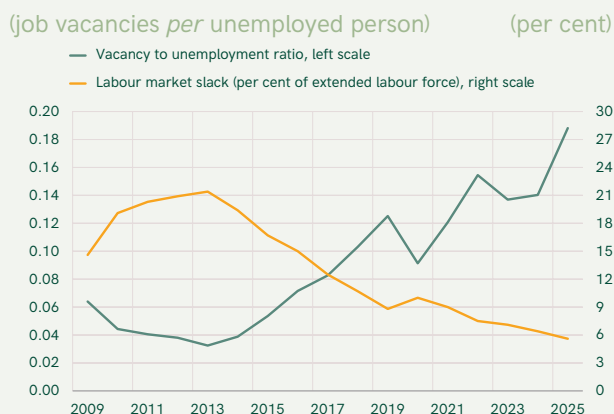
Over the past few years, Bulgaria's labour market has been characterised by persistently tight labour conditions, driven by both strong labour demand and limited labour supply. This resulted in high wage growth, which in turn underpinned a strong growth in private consumption and an increase in its share of GDP. Along with its effect on the economic activity, the high growth rate of labour costs became an increasingly important factor for inflation dynamics in Bulgaria. This topical research aims to present the main labour market developments in recent years, to assess their role in wage and inflation dynamics and to highlight their importance in shaping expectations for the development of the Bulgarian economy.

In 2025, a number of indicators reflecting labour demand and supply in Bulgaria reached record highs, with our country standing out among the Central and Eastern European and euro area countries with some of the tightest labour market conditions.

As regards demand-side indicators, the unemployment rate reached a historical low of 3.5 per cent¹ in 2025, and the share of enterprises pointing to labour shortages as a factor limiting their productive activity increased to a record high of 33.2 per cent on average². A historical peak was also recorded in the ratio of job vacancies to the number of unemployed persons in the country (Chart 1).

CHART 1

Labour Market Tightness in Bulgaria



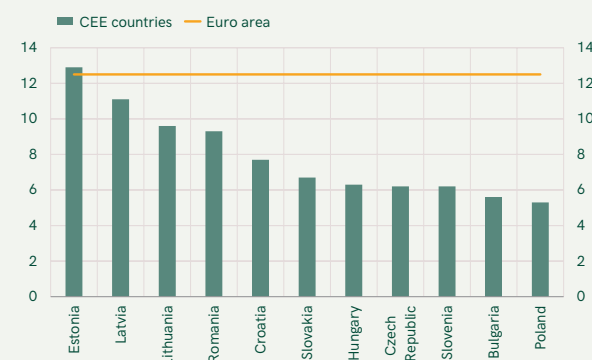
Notes: Lower labour market slack implies a reduction in potential labour supply and hence tightening of labour market conditions, and *vice versa*. The ratio of job vacancies to unemployed persons is interpreted in reverse: a lower value implies that labour supply exceeds demand and therefore labour market conditions are less tight. Labour market slack data for Bulgaria before 2009 are not available.

Source: Eurostat.

CHART 2

Labour Market Slack in 2025

(per cent of extended labour force)



Note: As of 2026, the euro area comprises 21 Member States.

Source: Eurostat.

Data on labour market slack³ also suggest that labour market conditions in Bulgaria were tighter in 2025 than in other Central and Eastern European (CEE) countries⁴, with the exception of Poland, and the corresponding indicator for the euro area (Chart 2). In addition, the number of persons employed in Bulgaria rose by 2.2 per cent in 2025, which represents the strongest growth since 2008 and is the highest growth rate in employment among the CEE countries (Chart 3).

¹ Labour Force Survey (LFS) data refer to the age group 15 and over.

² According to NSI's Business Situation Survey data.

³ Labour market slack measures the potential reserve of persons that could be included in employment. It covers unemployed, part-time workers, people seeking a job but not immediately available to work, as well as people available to work but not seeking. The indicator is presented as a percentage of the potential labour force, which includes, in addition to the labour force, the last three categories of labour slack.

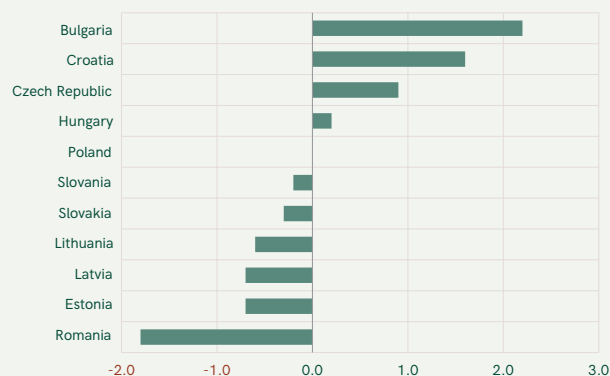
⁴ The CEE countries comprise Bulgaria, the Czech Republic, Estonia, Croatia, Latvia, Lithuania, Hungary, Poland, Romania, Slovenia, and Slovakia.

At the same time in 2025, the vacancy rate in the CEE countries was lower than in the euro area (except the Czech Republic), suggesting lower demand pressures (Chart 4). The number of job vacancies in Bulgaria also remained below the 2019 level in the course of the year. Concurrently, job vacancy rates in the euro area and most of the CEEC declined in 2025, while Lithuania and Bulgaria recorded growth, suggesting that demand pressures on the labour market increased in these two countries.

CHART 3

Employment Growth in the CEE Countries in 2025

(per cent, annual change)

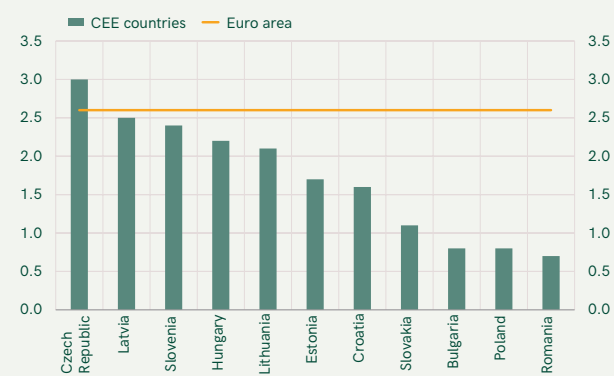


Source: Eurostat.

CHART 4

Job Vacancy Rate in 2025

(three-year average)



Note: As of 2026, the euro area comprises 21 Member States.

Source: Eurostat.

On the supply side, adverse demographic developments, which are reflected in a shrinking working-age population, can be identified as the main factor leading to tight labour market conditions in Bulgaria and most of the other CEE countries. The working age population (15–74 years) fell by 8.5 per cent in the region between 2001 and 2025, while the euro area recorded an increase of 5 per cent over the same period (Chart 5). The declining labour supply is particularly relevant for Bulgaria, which stands out as the country with the worst demographic trends among the CEE countries, where the working-age population declined by 24.3 per cent between 2001 and 2025 (Chart 6). In the aftermath of the COVID-19 pandemic, a number of CEE countries, including Bulgaria, recorded positive net migration, mainly as a result of returning nationals. However, these migration flows are not sufficient to offset population decline and ageing, especially in Bulgaria. Even if positive net migration flows persist, labour market conditions in Bulgaria are expected to remain very tight as the negative effect of an ageing and declining population significantly exceeds the positive effect of net migration and will continue to lead to a decrease in the working-age population, according to Eurostat's demographic projections⁵. According to a study by Karagyozyova-Markova (2015)⁶, the continued increase in the retirement age under the 2015 pension reform in Bulgaria will also not be sufficient to fully offset population decline.

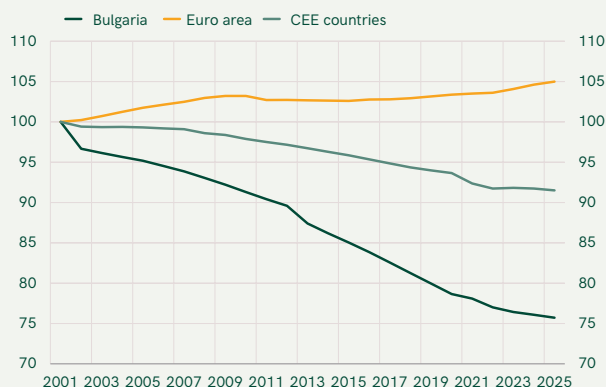
⁵ For more information, see Eurostat population projection data for the 15–74 age group under a higher migration scenario.

⁶ For more details, see Karagyozyova-Markova (2015), *Population Aging and Long-Term Sustainability of Public Finances in Bulgaria*, Sofia University, St. Kliment Ohridski.

CHART 5

Working Age Population, 15–74 Years

(Index, 2001=100)



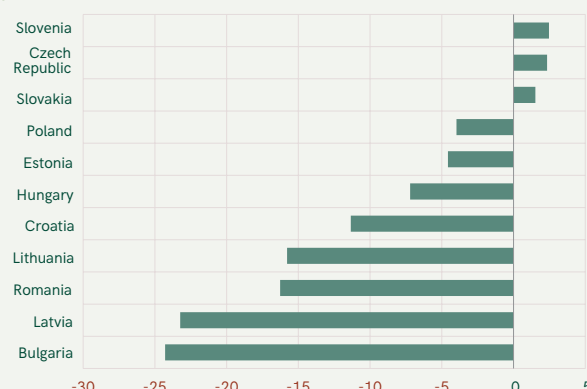
Note: As of 2026, the euro area comprises 21 Member States.

Source: Eurostat.

CHART 6

The Change of the Working Age Population in the CEE Countries over the 2001–2005 Period, 15–74 Years

(per cent)



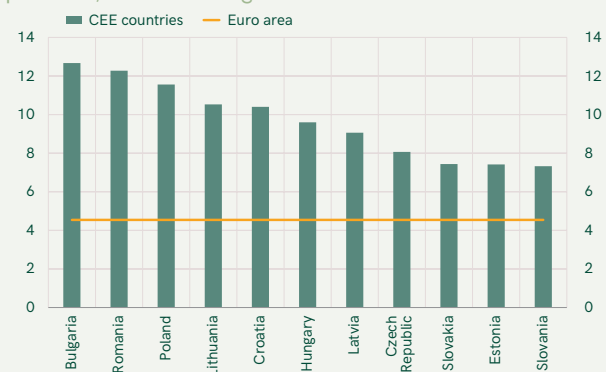
Source: Eurostat.

Bulgaria's labour market conditions thus described are likely to have led to an increase in the bargaining power of workers in wage setting, which is a factor for high nominal wage growth exceeding the corresponding growth in labour productivity and inflation. Nominal compensation *per* employee in Bulgaria rose by 12.7 per cent on average over the period 2021–2025, while average annual inflation and real labour productivity growth for the same period came to 6.1 per cent and 2.9 per cent, respectively. Wage growth in Bulgaria was higher than in the other CEE countries in the period 2021–2025 (Chart 7), reflecting both a lower base and a more limited labour supply as a result of ongoing adverse demographic developments in Bulgaria. Similar developments were recorded for unit labour cost growth rates (Chart 8).

CHART 7

Average CPE Growth in the CEE Countries for the 2021–2025 Period

(per cent, annual change)



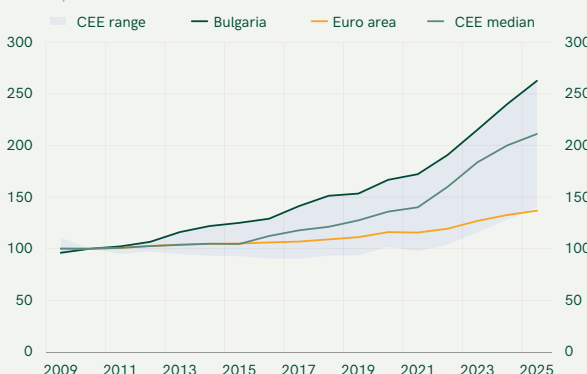
Note: As of 2026, the euro area comprises 21 Member States.

Source: Eurostat.

CHART 8

Nominal Unit Labour Cost

(index, 2010=100)



Source: Eurostat.

In addition to tight labour market conditions, other factors that have supported wage growth in Bulgaria in recent years include the introduction of an automatic minimum wage setting mechanism⁷, which creates a close relationship between the minimum and the average wage, as well as the strong increase in public sector wages⁸, which was also accompanied by a significant rise in the number of employees in this sector⁹.

⁷ As of 1 January 2024, the minimum wage amounts to 50 per cent of the average gross wage for the previous 12 months.

⁸ Compensation *per* employee in the general government sector; education; human health and social work activities rose by 13 per cent on average over the period 2021–2025, with an increase of 12.7 per cent in compensation *per* employee for the total economy over the same period.

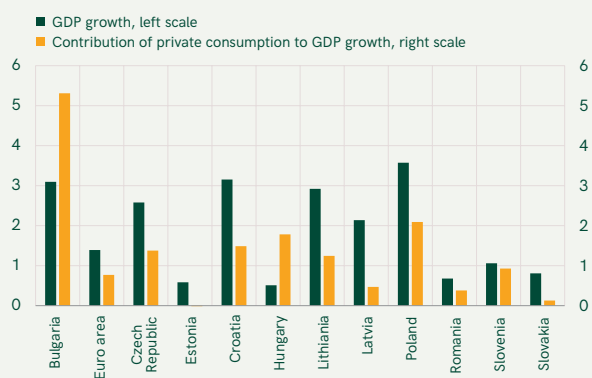
⁹ Employees in the general government sector; education; human health and social work activities increased by 2.7 per cent on average over the period 2001–2025, compared with an average growth of 1.1 per cent for total employment in the economy over the same period.

High wage growth in Bulgaria resulted in a strong increase in private consumption, which contributed most to GDP growth (Chart 9). Private consumption growth stood at 7.8 per cent in 2025, representing the highest increase among the CEE countries (Chart 10). In the context of a strong domestic consumption, firms were able to pass on higher labour costs to end-users, which resulted in persistently high services inflation. The current BNB forecast projects these developments to remain in the coming years given the expectations of continued tight labour market conditions. As a result, the relationship between wages and consumer prices can be expected to continue to strengthen. However, the pass-through of rising wages to final consumer prices in Bulgaria is still lower than in most CEE countries and the euro area, based on both data on the share of compensation of employees in gross value added (Chart 11), and on data on the share of wages in total firms' expenses on goods and services (Chart 12). As a result, wage growth in Bulgaria can be expected to remain among the highest in the CEE region in the coming years, supported by convergence processes and a shrinking labour force.

CHART 9

Contribution of Consumption to GDP Growth in 2025

(per cent, annual change) (percentage points)

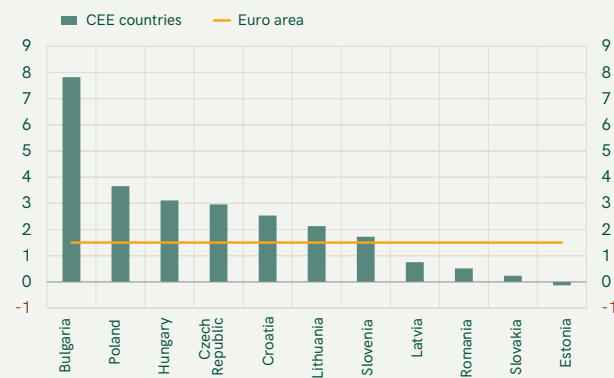


Source: Eurostat.

CHART 10

Private Consumption Growth in CEE Countries in 2025

(per cent, annual change)



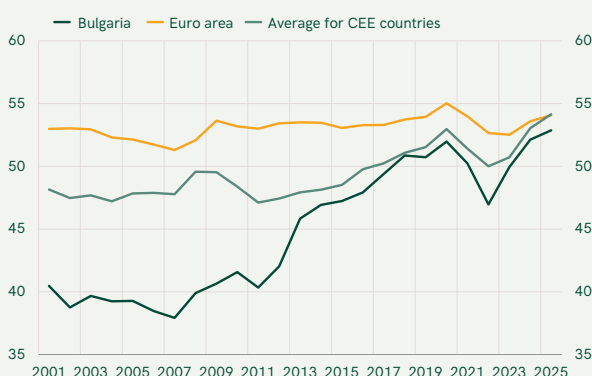
Note: As of 2026, the euro area comprises 21 Member States.

Source: Eurostat.

CHART 11

Share of Compensation of Employees in Gross Value Added

(per cent)



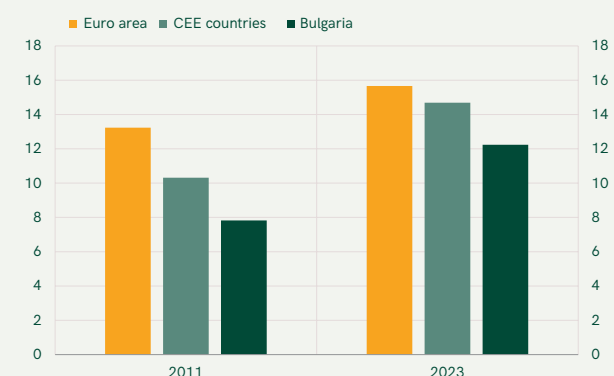
Note: As of 2026, the euro area comprises 21 Member States.

Source: Eurostat.

CHART 12

Share of Wages in Total Firms' Expenses on Goods and Services

(per cent)



Note: Data available up to 2023.

Source: Eurostat.

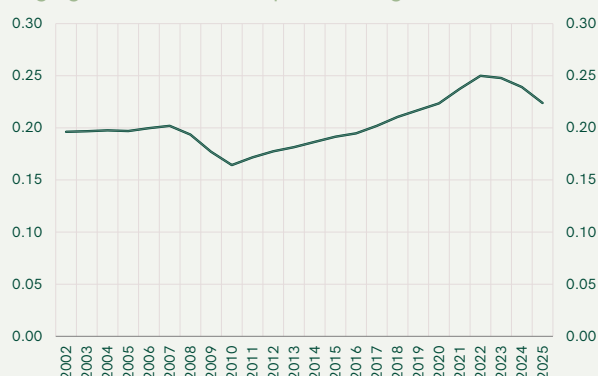
According to Kasabov's study (2024)¹⁰ the relationship between wages and consumer prices in Bulgaria is estimated using a model that incorporates the unemployment rate, unit labour costs and import prices by allowing the coefficients to vary over time. The results show that the relationship between inflation and wages has gradually strengthened over the past 15 years (Chart 13) and also indicate that it is dependent on the inflation regime and shocks in the economy.

¹⁰ For more information, see: Kasabov (2024), *The Impact of Labour Costs on Prices in Bulgaria*, BNB Discussion Paper 121, 2025.

CHART 13

Labour Cost Pass-through in the Long-run

(wage growth to inflation pass-through ratio)



Note: The chart shows the cumulative change in HICP inflation within 12 quarters following an increase in unit labour costs by 1 per cent.

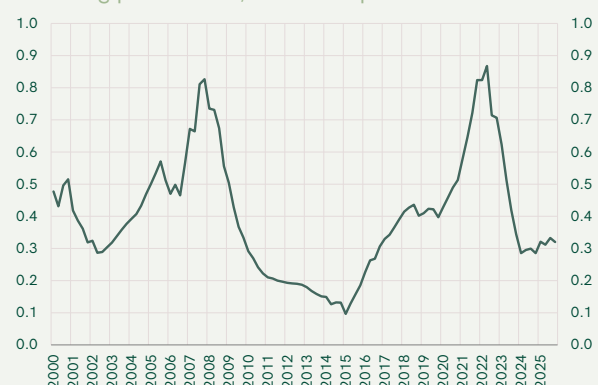
Source: Kasabov (2024)

CHART 14

Core Inflation Persistence

(persistence ratio)

1 = strong persistence, 0 = weak persistence)



Note: The chart shows the results for the time-varying persistence of core inflation, for which a state-space regression has been calculated, modelling the dynamics of core inflation, and the series presented on the line represents the time-varying coefficient of the regression of the first lag of core inflation. Values close to 0 should be interpreted as low inflation persistence, while values close to 1 should be interpreted as periods of high core inflation persistence.

Sources: NSI, BNB calculations.

A growing number of studies support the claim that inflation dynamics depends on the inflation regime, as the effect and transmission of shocks vary depending on the inflationary environment (Borio et al., 2023¹¹). Kasabov and Slavova study (2025)¹² confirms this hypothesis for Bulgaria, and the results show that developments in consumer prices in Bulgaria depend on the inflationary regime. The study uses a non-linear Markov regime switching model, which endogenously identifies low and high inflation regimes and assesses how the pass-through of economic shocks to consumer prices between the two regimes changes. According to the study's estimates, the economy enters a high-inflation regime when it exceeded 4.6 per cent, which is the period in Bulgaria from the end of 2021 to the end of 2023. High inflation regimes are characterised by a stronger pass-through of both internal and external shocks, higher inflation persistence and stronger joint dynamics of individual price categories.

Estimates include data up to the end of 2025 and thus do not cover the energy commodity price shock following the war in the Middle East that started in March 2026. Data until the end of 2025 give grounds to believe that the Bulgarian economy has exited the high inflation regime that started at the end of 2021, with volatility and persistence of underlying inflation (Chart 14) having decreased significantly and inflation having again started to be largely driven by variations in individual sub-groups (idiosyncratic factors) (Chart 15). At the same time, according to estimates based on the analysis of the main components¹³, a common factor continues to explain a large part of the price developments across the different HICP components up to the end of 2025 (Chart 16). Lower volatility coupled with significant simultaneous price develop-

ments suggest that, despite the slowdown in inflation, there is still a strong common factor that is unobservable but weighs on the growth rates of final consumer prices in Bulgaria. This is most likely due to domestic labour cost pressures, which remain elevated and have become a main driver of inflation in Bulgaria. As a result of the escalation of the conflict in the Middle East in March 2026, inflation in energy products in Bulgaria rose sharply between March and May 2026, while headline inflation in April and May 2026 remained above 4.6 per cent, which can be considered as a threshold for a new transition of the economy to a high-inflation regime, characterised by a stronger

¹¹ For more information, see: Borio et al. (2023), *The two-regime view of inflation*, BIS Paper 133, 2023.

¹² For more information, see Kasabov and Slavova (2025), *From Low to High Inflation: Regime Shifts and Changes in Economic Shock Transmission*, BNB Discussion Paper 125, 2025.

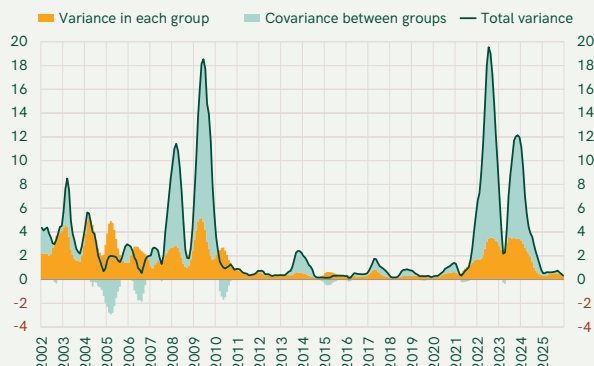
¹³ The analysis of the main components summarises the information from a large set of variables into a smaller set of unobserved components, which reflect the underlying dynamics of variation in data.

pass-through of both internal and external shocks, higher inflation persistence and stronger joint dynamics of individual price categories.

CHART 15

Inflation Variance

(per cent, percentage points)

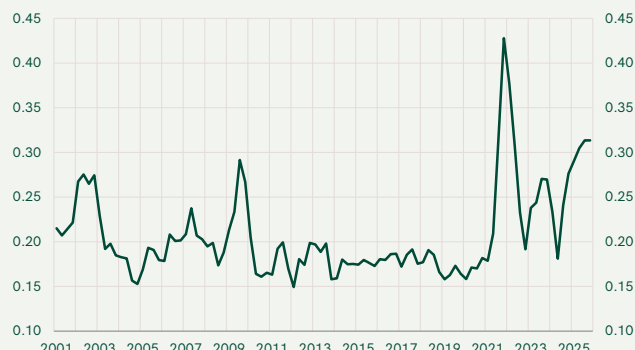


Sources: NSI, BNB calculations.

CHART 16

Degree of Co-movement across HICP Groups

(per cent)



Note: The chart shows the share of total variation attributable to the first main component based on the analysis of the main components, calculated as an 18-month moving average.

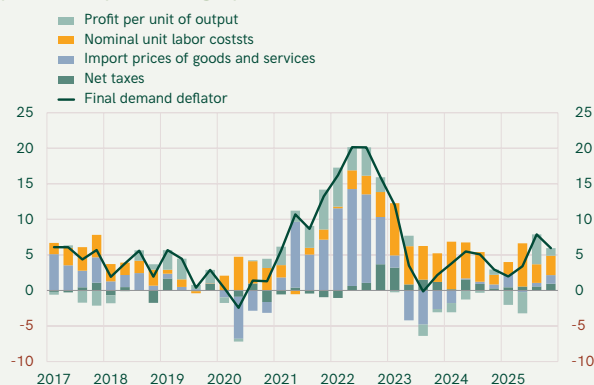
Sources: NSI, BNB calculations.

The dominant role of domestic price pressures in inflationary developments in Bulgaria in recent years, except for the periods of external energy price shocks in 2021–2022 and beyond March 2026, can be illustrated by a decomposition of the final demand deflator. This indicator makes it possible to distinguish between the contribution of domestic and external price factors to inflation developments. Over the past few years, the final demand deflator has followed a steady upward trend, with its growth outpacing HICP inflation (Chart 17). The decomposition of the deflator into components indicates that the external environment has an almost neutral impact on prices after the decrease in importance of prices of imported goods and services in 2023, while labour costs continued to make a significant positive contribution throughout the period. At the same time, almost all of the price increase, measured by the final demand deflator after 2023, can be explained by unit labour cost growth. This is a deviation from observed historical dependencies before the 2022 high inflation period. As unit labour costs continue to grow and private consumption remains high, firms have limited incentives to absorb the increased costs at the expense of their profits and may thus largely pass them on to final consumer prices. To some extent, this is also reflected in firms' inflation expectations, which remain at relatively high levels, particularly in the retail trade sector (Chart 18).

CHART 17

Final Demand Deflator

(per cent, percentage points)

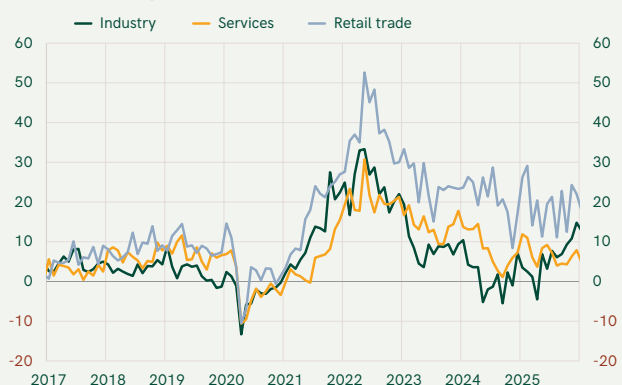


Sources: NSI, BNB calculations.

CHART 18

Inflation Expectations

(balance of opinions)



Source: NSI.

Finally, the analysis shows that the factors driving inflation dynamics in Bulgaria have changed materially in recent years, with domestic factors gaining significantly more importance than before 2020. The combination of very tight labour market conditions and a pro-cyclical fiscal policy paves the way for persistent domestic inflationary pressures. At the same time, the Bulgarian economy remains highly sensitive to external inflationary shocks due to the relatively high energy intensity of GDP and the significant share of foreign value added in final demand. Therefore, a persistent increase in energy commodity prices, including as a result of a renewed escalation of the conflict in the Middle East, would further fuel inflationary pressures and increase significantly the risk of a prolonged high-inflation regime in Bulgaria.

