INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/163

BULGARIA

June 2024

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR BULGARIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2024 Article IV consultation with Bulgaria, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 3, 2024 consideration of the staff report that concluded the Article IV consultation with Bulgaria.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 3, 2024, following discussions that ended on March 19, 2024, with the officials of Bulgaria on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 10, 2024.
- An **Informational Annex** prepared by the IMF staff.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR24/215

IMF Executive Board Concludes 2024 Article IV Consultation with Bulgaria

FOR IMMEDIATE RELEASE

Washington, DC – **June 3, 2024:** The Executive Board of the International Monetary Fund (IMF) concluded the 2024 Article IV consultation[1] with Bulgaria on June 3, 2024.

The Bulgarian economy has shown resilience through a succession of shocks and is achieving a soft landing. Growth slowed in 2023 to 1.8 percent driven by a decline in private investment due to uncertainty and by the unwinding of the inventory buildup of 2021–22. Growth is expected to rebound this year thanks to the recovery in demand from key trading partners, which will spur exports and private investment, while public investment is to be supported by EU funds. Despite sustained wage and pension growth and inflationary pressures from an expansionary 2024 budget, inflation is projected to continue declining owing to the projected continued fall in global food and energy prices, but it has remained higher than in many European peers.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the Bulgarian economy's resilience to successive shocks over the past four years. While the country's economic growth is expected to pick up and disinflation to continue, considerable uncertainty and downside risks cloud the outlook. Against this background, Directors underscored the importance of implementing reforms to boost the country's potential economic growth, improve income convergence, and enhance resilience. They welcomed the authorities' commitment to undertake efforts toward a timely euro area accession.

Considering the challenges ahead, Directors recognized that fiscal policy faces difficult trade-offs. They generally agreed that, in the short term, a neutral fiscal stance would strike the appropriate balance between supporting the ongoing disinflation and preserving the expected rebound in growth. Over the medium term, Directors recommended maintaining a prudent fiscal policy, given the uncertain environment, domestic pressures, and fiscal risks. Noting the large investment and social spending needs, they encouraged the authorities to implement a broad package of fiscal reforms. This package should include measures to permanently increase tax revenue and make the tax system fairer, enhance spending efficiency by strengthening public financial and investment management, reduce informality, reform the pension system, and improve the productivity of state-owned enterprises to prevent the buildup of contingent liabilities. Appropriate sequencing and prioritization will be important to ensure the success and viability of policy measures, and Fund advice can play a helpful role.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

Directors noted that the systemic risks faced by the banking system remain moderate but called for vigilance. In view of the rapid rise in real estate lending, they commended the authorities' recent action to increase the countercyclical capital buffer and recommended reinforcing the macroprudential framework with borrower-based measures.

Directors emphasized the importance of addressing medium-term challenges through broad-based structural reforms. They stressed that addressing declining potential growth and slow income convergence requires policies to contain the decline in labor force participation, foster productivity growth, increase domestic and foreign investment, improve competitiveness, and further Bulgaria's integration into global and regional value chains. Along with timely implementation of the authorities' Recovery and Resilience Plan, achieving these goals requires strengthening transparency and governance, addressing corruption, continuing to enhance the AML/CFT framework, investing in infrastructure and human capital, and bolstering the green transition while preserving energy security.

Bulgaria: Selected Economic Indicators, 2020–25

Population (2022): 6.4 million

Per capita GDP (2022, €): 13, 115

Quota: SDR 896.3 million

Inequality/At risk poverty rate (2022): 38.4/32.2 1/

Main products and exports: non-ferrous metals, petroleum products, vegetables, clothing and footwear, and machines and equipment.

Key export markets: Germany, Italy, Romania, and Turkey.

	2020	2021	2022	2023	2024	2025
					Projections	
Output						
Real GDP growth (%)	-4.0	7.7	3.9	1.8	2.7	2.9
Output gap (% potential GDP)	-4.0	0.5	1.4	0.3	0.0	0.0
Employment						
Unemployment (%)	5.2	5.3	4.2	4.4	4.3	4.2
Prices						
Inflation (average; %)	1.2	2.8	13.0	8.6	3.2	2.7
General government finances						
Revenue (% GDP)	34.9	35.8	36.9	34.7	36.3	36.3
Expenditure (% GDP)	37.8	38.6	37.7	37.7	39.1	39.2
Fiscal Balance (% GDP)	-2.9	-2.8	-0.8	-3.1	-2.7	-3.0
Structural fiscal balance (% GDP)	-1.4	-3.5	-1.3	-3.2	-2.7	-3.0
Public debt (% GDP)	22.8	22.5	21.5	22.0	23.4	24.9
Money and credit						
Broad money (% GDP)	10.9	10.7	13.2	8.7	8.1	7.4
Credit to the private sector (% change)	4.5	8.8	12.5	12.2	9.5	8.1
Balance of payments						
Current account (% GDP)	0.0	-1.7	-1.4	-0.3	-0.8	-1.8
FDI (% GDP)	-4.5	-1.8	-2.4	-3.3	-3.3	-3.3
Reserves (% short term debt) 2/	313.4	522.9	353.1	…	…	…
External debt (% GDP)	63.3	58.1	51.6	48.3	46.0	45.8
Exchange rate						
REER, CPI-based (% change)	2.9	1.3	4.8	4.9	…	…

Sources: Bulgarian authorities; World Bank; Eurostat; and IMF staff estimates.

1/ Gini coefficient of equivalized disposable income. The at-risk-of-poverty rate or social exclusion (Eurostat) corresponds to the share of people in the population with either: i) an equivalized disposable income below the threshold (60 percent of the national median equivalised disposable income after social transfers); ii) severely materially deprived; and iii) living in households with very low work intensity.

2/At remaining maturity.

INTERNATIONAL MONETARY FUND

BULGARIA

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

May 10, 2024

KEY ISSUES

Context and outlook. For two years in 2021–23, a political stalemate hampered policymaking as Bulgaria needed to stir the exit from the pandemic, cope with the global inflation shock and the fallout of Russia's war in Ukraine, secure its energy supply, implement reforms to unlock EU Funds, and prepare for euro adoption. The government formed in June 2023 prioritized euro and Schengen areas accession, NGEU funds delivery, and judicial reforms. It fell in March 2024, increasing the risk of delays in key policy decisions. Despite the succession of international and domestic shocks, the economy showed resilience and can achieve a soft landing if inflation decelerates towards 2 percent as expected under the baseline. Moreover, longstanding intertwined challenges remain: convergence toward EU average income is lagging peers, investment is low, perception of corruption is large, inequality is high, poverty is widespread, the population is shrinking, and the growth model still relies largely on brown energy.

Key policy recommendations.

A neutral fiscal stance in 2024 would appropriately balance protecting the expected growth rebound and supporting disinflation. However, the budget is expansionary. A lower fiscal deficit, achieved through measures to permanently increase revenue, is desirable. A tight fiscal stance is also needed in the medium term to preserve buffers considering the uncertain and shock-prone environment, demographic pressures, and prevailing fiscal risks, and to secure fiscal space for future investment.

Fiscal reforms are crucial to meet large investment and social needs. Fiscal space can be created through tax reforms to increase revenue, improved efficiency of spending to enhance physical and human capital, and reforms of the pension system to improve its financial sustainability and adequacy. Reforms are also needed to prevent the buildup of contingent liabilities from state-owned enterprises and improve their productivity.

Deep structural reforms are needed to foster higher and more inclusive growth. Addressing declining potential growth and slow income convergence requires containing the decline in the labor force, more investment, higher productivity, greater competitiveness, and further integration into global and regional value chains. Along with the timely implementation of the Recovery and Resilience Plan, supporting these goals requires strengthening governance, increasing transparency, investing in infrastructure and human capital, and bolstering the green transition while preserving energy security.

Though the banking system is resilient and systemic risks remain moderate, continued vigilance to incipient risks is needed. Considering the risks of a house prices-mortgage credit spiral and rising credit risks amidst elevated uncertainty, reinforcing the macroprudential framework with borrower-based measures would help preserve asset quality.

Approved By
Helge Berger (EUR)
S. Jay Peiris (SPR)

Discussions took place in Sofia during March 6–19, 2024. A mission concluding statement was issued on March 19. The staff team comprised Jean-François Dauphin (head), Jean-Jacques Hallaert, Giacomo Magistretti (all EUR), Iglika Vassileva (local economist, EUR), and Anh Dinh Minh Nguyen (FAD). Geoff Gottlieb (Senior Regional Representative, EUR) attended some of the meetings. Heena Gupta and Nusula Nassuna (both LEG) participated in selected meetings virtually. Tina Kang and Sabiha Mohona (EUR) assisted in the preparation of the report.

The mission met with President of the Republic of Bulgaria Radev, then-Prime Minister Denkov, then-Minister of Finance Vassilev, Bulgarian National Bank Governor Radev, the Budget and Finance Commission of the National Assembly, other senior officials, and representatives of labor and business organizations, think tanks, commercial banks, real estate firms, and international organizations. On April 25, 20224, the mission met virtually Caretaker Deputy Minister of Finance Metodiev. Nina Stoyanova (OED) attended most of the meetings.

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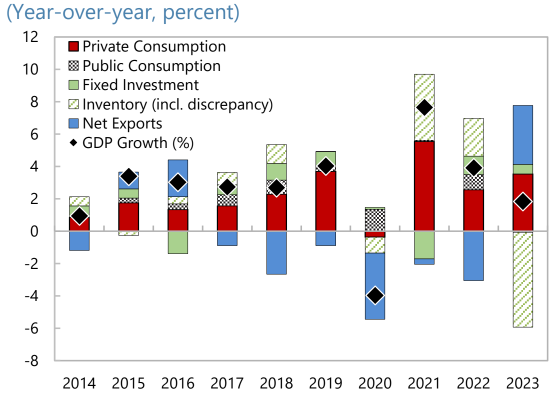
RESILIENCE IN A CHALLENGING ENVIRONMENT

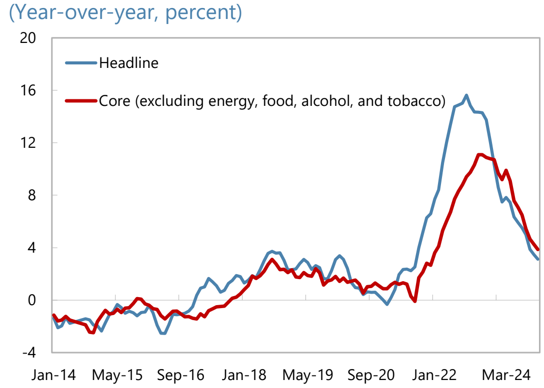
1. **The authorities are focused on euro adoption.** The government in place from June 2023 to March 2024 prioritized euro and Schengen areas accession, Next Generation EU (NGEU) funds absorption, and judicial reforms. Given high domestic inflation and legislative delays, the target date for euro accession was postponed by a year to January 2025. A partial Schengen accession (limited to air and sea borders) took place at end-March 2024. Progress in meeting the NGEU milestones has been insufficient to unlock expected funds and only the first tranche was disbursed, in December 2022. Some reforms of the judicial system have been initiated. After the fall of the government in March 2024, a caretaker cabinet, limited by law in its policy-making capacity, was appointed. Euro adoption remains its priority. Bulgaria will hold its sixth parliamentary election in three years on June 9, 2024.

2. **A soft landing is within reach, but more disinflation is needed.** Growth slowed to 1.8 percent in 2023. Private consumption gained momentum in 2023, supported by real wage growth exceeding 5 percent. Net exports also contributed positively to growth. Conversely, private investment declined reflecting an uncertain global and political environment, and the inventory buildup of 2021–22 sharply reversed. Although the labor market softened, it remained tight, with the unemployment rate at 4.3 percent in 2023:Q4. Headline inflation decelerated to 3.1 percent in March 2024, driven by slower energy and food price inflation. However, core inflation remains stickier (3.9 percent), with services prices still growing by 5 percent.

Real GDP Growth Decomposition
(Year-over-year, percent)



Inflation Dynamics
(Year-over-year, percent)



Sources: Eurostat and IMF staff calculations.

3. **The fiscal deficit widened in 2023.** Despite higher spending on pensions, wages, and investment, expenditure remained stable in percent of GDP, mostly owing to a significant reduction in the cost of electricity subsidies. Revenue declined by 2.2 percent of GDP, primarily due to weaker nontax revenues, VAT, and grants. As a result, the deficit on a cash basis increased by 2.3 percentage points (ppts) to 3.1 percent of GDP.[1] At 22 percent of GDP, public debt is the second lowest in the EU (Annex I).

[1] This deficit includes an advance payment (0.7 percent of GDP) for municipal projects (Box 1).

4. The current account was close to balance. Price effects, domestic demand slowing faster than external demand, and destocking led to larger drop in imports than exports. The improved balance in trade in goods and services carried to the current account despite a worse income balance that largely reflected a 46 percent increase in investment income payments. With higher capital account surplus and financial account balance, gross international reserves increased. The external position is assessed to be moderately stronger than implied by medium-term fundamentals and desirable policies (Annex II).

5. Credit growth was elevated, and bank profitability increased. In a currency board tied to the euro, the BNB announced increases in the base rate in line with ECB's policy. However, transmission beyond interbank rates has been limited, especially to household lending rates, due to ample systemic liquidity and close competition among banks. Despite an increase in minimum reserve requirements (MRR) and countercyclical capital buffers (CCyB), robust deposit collection has been supporting double-digit private credit growth since March 2022, notably mortgages. The banking system, which is dominated by subsidiaries of foreign banks, remains well capitalized, liquid, and reported record profits in 2023. At 4.4 percent of total loans in February, non-performing loans (NPLs) remain relatively elevated but have been steadily declining over the last decade.

UNCERTAIN OUTLOOK AMIDST INCREASED RISKS

6. In the baseline scenario, growth is expected to pick up and disinflation to continue. Assuming the stabilization of the inventory cycle and EU funds delivery, growth will accelerate to 2.7 percent in 2024. An expected moderate pickup in demand from key trading partners will support exports and private investment. The latter, however, is projected to remain subdued and constrain growth below its potential, recovering more robustly only from 2025 with the anticipated euro adoption and reduced domestic uncertainty. The projected continued fall in global food and energy prices will support the decrease in headline inflation and spill over to core. The decline in core inflation, however, will be slowed by sustained wage and pension growth, whilst the expansionary 2024 budget also increases inflationary pressures.

7. Long-term growth prospects remain marred by low productivity growth, insufficient investment, and a shrinking labor force. In the next few years, growth under the baseline scenario is expected to be in line with potential, supported by robust consumption and EU-funded investment. In the longer run, it will decelerate to about 2½ percent, dragged by a declining working-age population, lower investment than peers, and low productivity growth. As a result, income convergence will likely continue lagging. Despite a projected steady improvement in the terms of trade, the current account is projected to persistently register small deficits due to a relatively high merchandise trade deficit. Current policies aim to keep the fiscal deficit at 3 percent of GDP throughout 2029. Public debt is expected to reach about 30 percent of GDP in 2029.

8. The outlook is subject to considerable uncertainty and downside risks. Global risks are compounded by heightened domestic political and policy uncertainties (Annex III). If, as during 2021–23, the June 2024 snap elections do not lead to a clear majority, protracted political instability may continue hampering policy making, undermine confidence and investment, and further delay

NGEU funds disbursement. Less-than-full absorption of NGEU funds by the 2026 deadline would hinder growth, green transition, and income convergence. Although the caretaker government is committed to joining the euro area, more difficult policymaking could delay euro adoption beyond 2025, which would negatively affect economic sentiment and investment. Overrun in current expenditures may be offset by lower public investments to maintain the fiscal deficit at 3 percent of GDP, affecting long-term growth. Credit growth persisting at elevated levels could deteriorate asset quality and engender a house prices-mortgage credit spiral. Moreover, continued wage growth outpacing productivity would undermine competitiveness, further dragging growth. The pickup in trading partners' demand may be smaller than anticipated, while an intensification of regional conflicts could sharply increase commodity prices, rekindling inflation. On the positive side, timely euro area accession would likely boost confidence and spur investment.

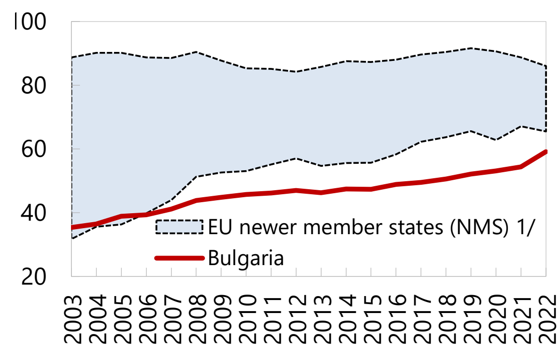
Authorities' Views

9. The authorities broadly agree with the outlook and risks. They share staff's views that the baseline scenario is that of a rebound in growth and continued disinflation, although they see the latter at a slightly faster pace than staff. They concur that the outlook is highly uncertain and see the same key risks as staff. The BNB also noted that some delayed passthrough from high input prices and wages to consumer prices may still materialize.

POLICY DISCUSSION

10. The authorities face significant policy challenges. Bulgaria is the poorest EU member state and prospects for fast income convergence are dim absent significant reforms and investment. Moreover, the economy remains overly dependent on brown energy. In the short run, policies should aim at securing disinflation with a minimal impact on growth. In the long term, meeting large development needs requires fiscal reforms to increase resources for high-return investment in infrastructure and human capital, and structural reforms to boost productivity and competitiveness, including by strengthening governance, reducing corruption risks, and facilitating the green transition.

Lagging Income Convergence Since the Global Financial Crisis
(GDP p.c. in PPP in percent of EU-28 average)



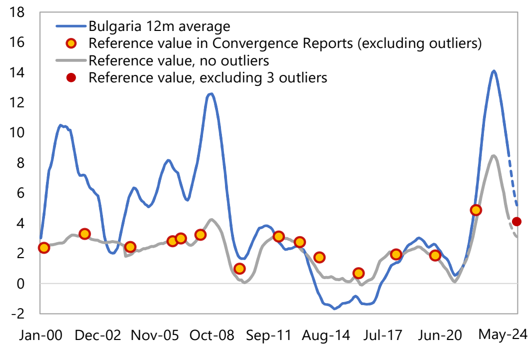
Sources: World Development Indicators and IMF staff calculation.
1/ EU newer member states (NMS) excluding Bulgaria are: Croatia, Czech Republic, Hungary, Poland, Romania, Slovak Republic, Slovenia, Estonia, Latvia, and Lithuania.

A. Balancing Disinflation and Growth

11. Inflation has remained a challenge for euro adoption. At this stage, price stability is the only unmet quantitative convergence criterion for euro adoption. However, the pace of the ongoing disinflation seems insufficient to meet the new January 2025 deadline. Euro adoption later in 2025—

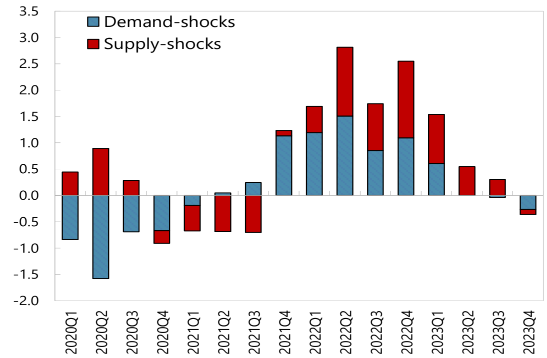
an option considered by the authorities—remains realistic if policies or exogenous shocks do not derail disinflation.

Price Stability Criterion[1/]
(Based on HICP inflation, percent)



Sources: Haver Analytics, IMF World Economic Outlook, and IMF staff calculation.
1/ The criterion requires a 12-month average inflation rate not more than 1.5 ppts above the average rate of the three best performing member states, excluding "outlier" countries whose inflation is deemed not representative of euro area price dynamics.

Drivers of Core Inflation Dynamics
(Quarter-on-quarter, percent)



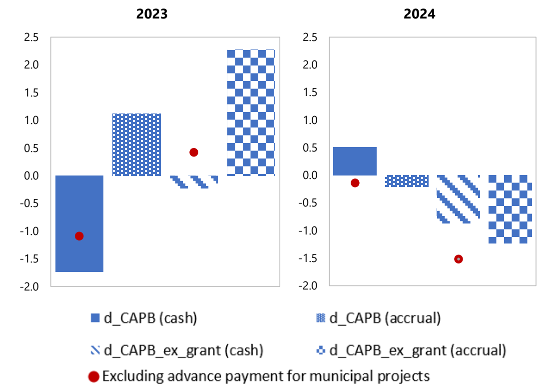
Source: IMF staff calculation.
Note: Core inflation: total excluding energy and unprocessed Food. Deterministic contributions and initial conditions of inflation that are not explained by model-based structural shocks are excluded.

12. The 2024 budget is expansionary while a neutral stance would strike an appropriate balance between growth and disinflation. Fiscal policy played an important role in supporting the recovery from the pandemic but contributed to the inflation surge. Staff estimates that fiscal policy explains 1.3 ppts of inflation in 2021 and about 3 ppts in 2022, while it likely helped somewhat reduce demand pressures in 2023. Staff assesses the 2024 budget to be expansionary (Box 1). A neutral stance in 2024 would balance protecting the expected small rebound in growth with not jeopardizing the ongoing disinflation dynamics considering upside risks to inflation, weak transmission of ECB's monetary policy tightening, and the anticipated increase in bank liquidity upon joining the euro area as the BNB's MRR (currently, 12 percent) will drop to the ECB's level (currently, 1 percent). Reaching a neutral fiscal stance would mean reducing the planned deficit in 2024 by about 1 percentage point of GDP.

Box 1. Fiscal Stance in 2023–24

Changes in the cyclically-adjusted primary balance (CAPB) typically serve to assess the fiscal impact on aggregate demand. However, the CAPB may not fully capture the fiscal stimulus provided by EU funds because the related expenditure is offset by grants from the EU that, in themselves, have no bearing on aggregate demand. Thus, measuring the change in CAPB excluding net EU grants may provide a more appropriate assessment of the economic impulse from fiscal policies. This concept broadly aligns with the measure used by the European Commission.

Fiscal Stance in 2023–24
(Percent of potential GDP)



Source: IMF staff calculation.
Note: *d_CAPB* is the change in CAPB and *d_CAPB_ex_grant* is the change in CAPB excluding EU grants. The red dot shows the corresponding measure excluding the advance payment for municipal investments in December 2023.

In 2023, on a cash basis, both the traditional CAPB and the measure excluding EU grants net of contributions indicate an expansionary stance in 2023. However, the 2023 cash deficit data includes an advance payment of 1.2 billion leva (0.65 percent of GDP) for municipal projects recorded as capital investment but that was simply transferred to a special account outside the general government. Thus, this operation did not impact aggregate demand. Excluding it, the deficit in 2023 would be lower, suggesting a slightly tight stance for the measure excluding net EU grant. On an accrual basis, both measures, with and without EU grants, indicate a contractionary fiscal stance in 2023.

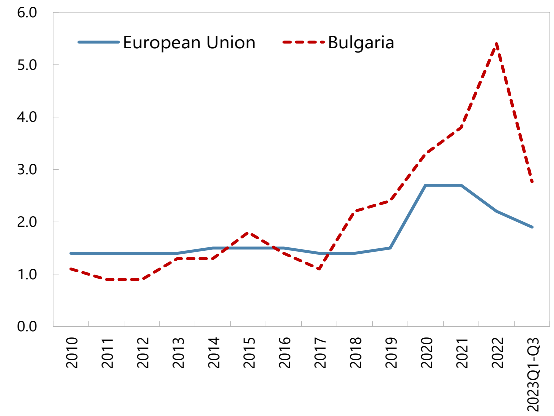
In 2024, the fiscal stance is expansionary. Although the cash-basis CAPB with no adjustment for EU grants suggests a slightly contractionary stance, it is expansionary when adjusting the advance payment to municipalities, and even more so when adjusting for EU grants. On accrual basis, all measures indicate an expansionary stance.

13. **The 2024 budget seeks to increase social spending and investment but lacks revenue reforms.** Staff projects that expenditure will increase by 1.3 ppts of GDP in 2024, driven by social spending (notably an 11-percent increase in pensions), and public investments (largely financed by EU funds). However, most revenue measures included in the budget are ad-hoc and will not help meet expenditure needs on a permanent basis. The increase in the maximum insurable income (the cap on social contributions, Box 2) is a welcome but insufficient first step. The budget also assumes an optimistic 0.4 percent of GDP revenue increase from improvement in tax collection and set the dividends of state-owned companies at 100 percent of their profits. Discretionary tax policy measures to raise revenues include an increase in the CIT rate to 15 percent for big multinational corporations in line with EU directives, fees on the gambling sector, and an elimination of some of the reduced VAT rates introduced during the pandemic.

14. **A neutral fiscal stance should ideally be achieved through measures that permanently raise revenue.** Fully reversing the reduced VAT tax rates that are no longer necessary, eliminating the cap on social contributions, and increasing PIT rates, would help achieve the neutral stance and increase revenue permanently. These measures should be introduced within well-designed reforms (see below) and be complemented by a policy-driven reduction in subsidies. Failure to implement revenue adjustments would result in a looser stance that would further fuel inflation. However, a

worst outcome would be to cut investment (often the adjustment variable of first resort in recent years), which would further weigh on long-term growth.

Fiscal Subsidies
(Percent of GDP)



Sources: Eurostat, Haver, and IMF staff calculation.

Authorities' Views

15. The authorities see the disinflation process on track for joining the euro in 2025 under current fiscal policy. The authorities estimate that the price stability criterion will be met in late 2024. When that happens, they intend to request an *ad hoc* convergence report and move ahead with euro adoption during 2025. Regarding the 2024 fiscal stance, the caretaker government is bound by the 2024 budget while parliament may take initiatives that can affect the fiscal balance.

B. Fiscal Reforms to Support Economic and Social Objectives

16. Although debt is low and public spending needs are large, fiscal policy must remain cautious in the medium-term. The medium-term budget framework (MTBF) plans deficits of 3 percent of GDP annually over 2024–26. Although fiscal sustainability is not an immediate concern, several factors call for a tighter stance over the medium term, consistent with a broadly stable debt level. First, accumulating debt would only be justified for high-return investment, which requires strengthening governance and public finance management to address the low efficiency of spending and improve tax collection. Second, buffers remain needed considering the uncertain, shock-prone global environment and prevailing fiscal risks (e.g., from state-owned enterprises (SOEs) and pensions). Third, while a large share of capital expenditure is currently EU-financed, fiscal space should be preserved for future investment once EU funding gradually recedes. Fourth, recurrent deficits could be perceived as a deviation from hard-won fiscal discipline under the currency board, potentially widening risk premia.

17. Fiscal reforms are crucial to sustainably raise social spending and investment in infrastructure and human capital and improve governance. Increasing revenues and improving the allocation and efficiency of spending should be immediate priorities. Key reforms to that effect involve:

- ***Raising spending efficiency.*** Improving fiscal transparency, public investment management, and governance, including procurement (e.g., publishing beneficial ownership information of contract awardees), would free resources and strengthen the capacity to absorb EU funds. Efficiency gains are also potentially large for social spending (social protection, health, and education), which would help improve social protection coverage and boost human capital. Furthermore, as noted in previous staff reports, wage policy should be informed by a comprehensive review of public wages.

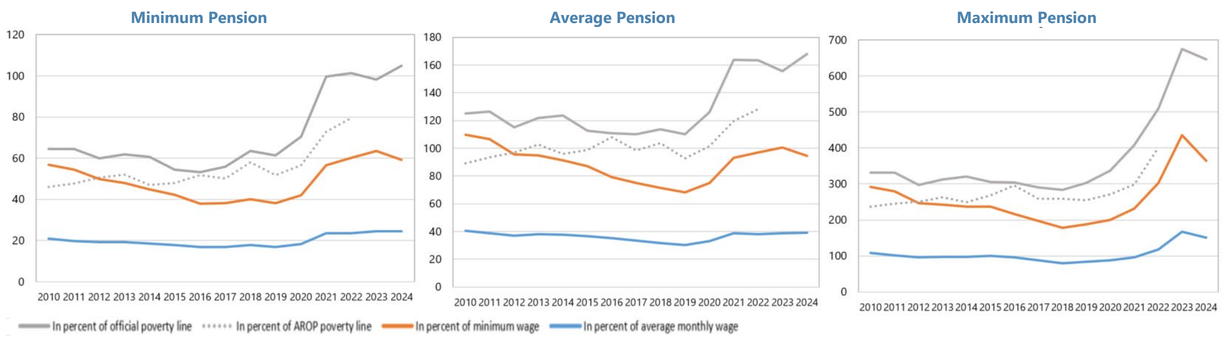
- ***Increasing the financial sustainability of the pension system while improving the pension adequacy.*** The pension system deficit has increased markedly since the pandemic. It is covered by large fiscal transfers, crowding out more productive spending. The MTBF does not project any reduction in transfers in coming years, while, due to the aging of the population, spending pressures will increase over time. At the same time, old-age poverty is widespread, reflecting the low level of pensions. Improving the sustainability of the pension system while improving the adequacy of pensions requires significant reforms (Box 2).[2]

Box 2. Pension System: Adequacy and Sustainability

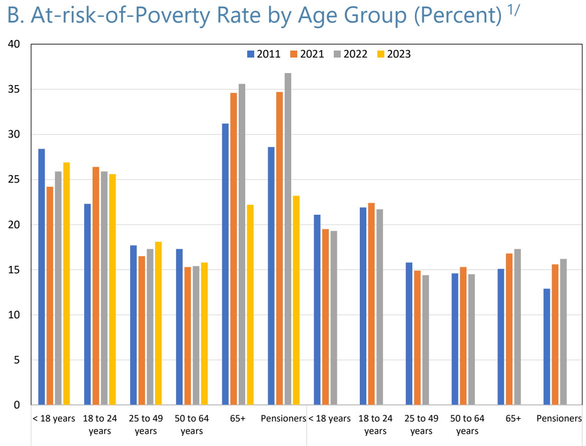
The Bulgarian pension system has been marred for years by a financial situation unsustainable on its own, thus requiring sizable budgetary transfers, and pensions levels that keep many elderlies in poverty. During the pandemic, more than half of the fiscal support provided to households targeted pensioners. As a result, pension adequacy increased noticeably. Still, although declining, old-age and pensioners poverty remains high by EU standards. Notably, the minimum pension (received by almost half of pensioners at end-2023) is close to the official poverty line and is equivalent to about 60 percent of the minimum wage and less than a one-quarter of the average wage.

Pension Adequacy

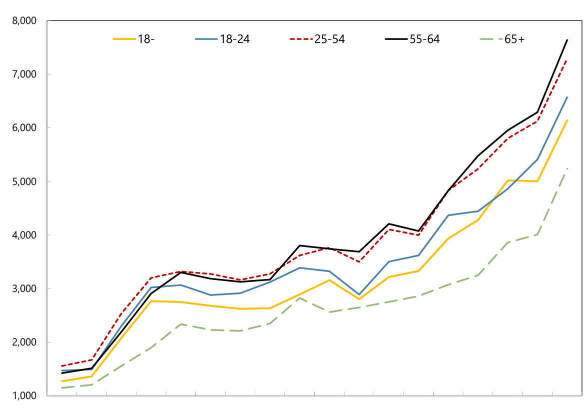
A. Pensions vs. Wages and Poverty Line (Percent)



B. At-risk-of-Poverty Rate by Age Group (Percent) 1/



C. Median Equivalized Net Income by Age Group (Euros)



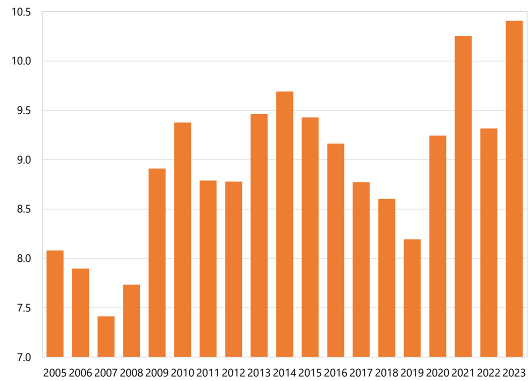
1/ Cut-off point: 60 percent of median equivalized income after social transfers.
Sources: NSSI, Eurostat, and IMF staff calculation.

[2] Accompanying Selected Issue Paper (SIP) "The Bulgarian Pension System: Caught Between Adequacy and Sustainability."

Box 2. Pension System: Adequacy and Sustainability (Concluded)

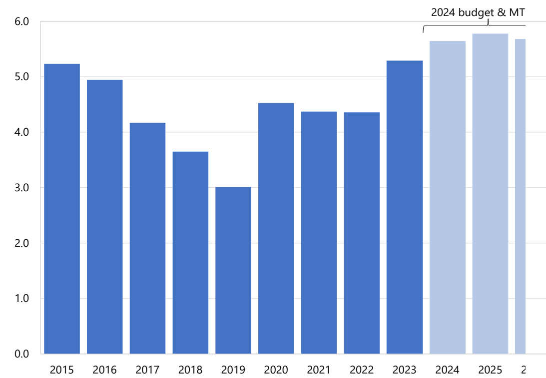
The increase in pensions was not matched by adequate revenue measures. As a result, fiscal transfers to cover the deficit increased to reach 5½ percent of GDP.

Pension Spending
(Percent of GDP) 1/



Sources: NSSI, Eurostat and IMF staff calculation.
1/ Payment to pensioners.

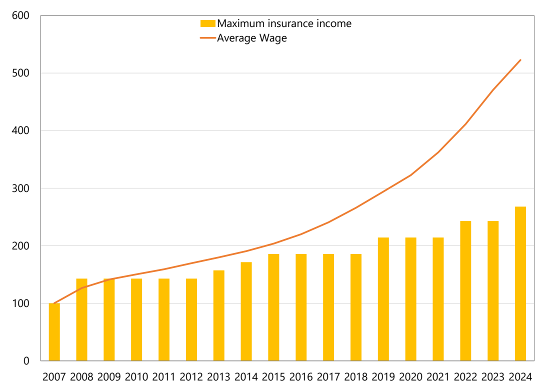
Fiscal Transfers to Cover Deficits
(Percent of GDP)



Sources: NSSI and Eurostat.

Low pension adequacy combined with sustainability issues point to insufficient revenue. Staff recommends increasing incentives to contribute by (i) introducing in the benefit formula a direct link with contributions actually paid, (ii) eliminating the ceiling on contributions (the "maximum insurable income", which has grown more slowly than wages, leading to substantial forgone revenue and making social contributions regressive) and the ceiling on pensions (which only marginally limits pension payments), and (iii) increasing the contribution rate, which is comparatively low.

Maximum Insurable Income and Wages
(Index 2007=100)



Sources: NSSI and IMF staff calculation.

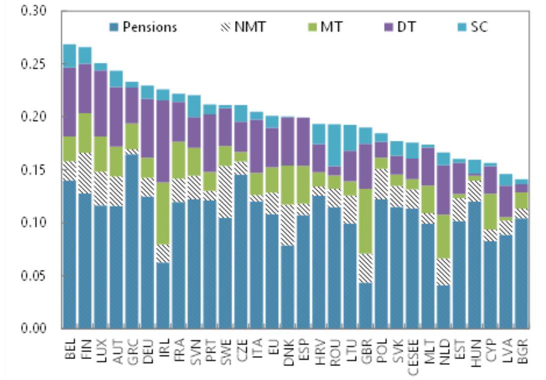
Maximum Insurable Income and Maximum Pension (Percent)

	2019	2020	2021	2022	2023	2024 Proj.
Maximum pension as a share of						
Payments to pensioners	5.7	4.6	2.6	2.5	0.3	0.4
Numbers of pensioners	1.3	2.0	1.3	0.0	0.1	0.1
Contributions at maximum insurable income as a share of						
Total contributions	13.6	15.2	17.8	18.2	21.1	21.2
Number of contributors	6.4	8.4	10.9	11.1	14.2	14.2

Sources: NSSI and IMF staff calculation.

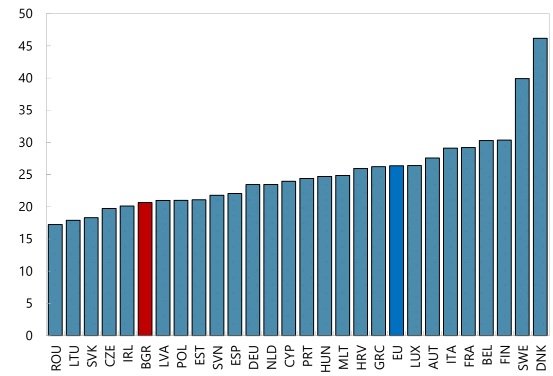
- ***Reforming the tax system to make it fairer and address rising spending needs.*** Tax revenue is one of the lowest in the EU. Raising the CIT rate to 15 percent for big multinational corporations will help, but revenue gains will be limited. Moving from the low flat corporate and personal income tax rates of 10 percent to higher and progressive (for PIT) rates would help reduce inequalities and raise more revenue. An increase in the coverage of carbon taxation would help achieve emission targets and generate revenues to spur green investment and support vulnerable households affected by the transition.

Fiscal Redistribution by Instrument
(2020, Reduction in the Gini Coefficient, scale: 0 to 1)



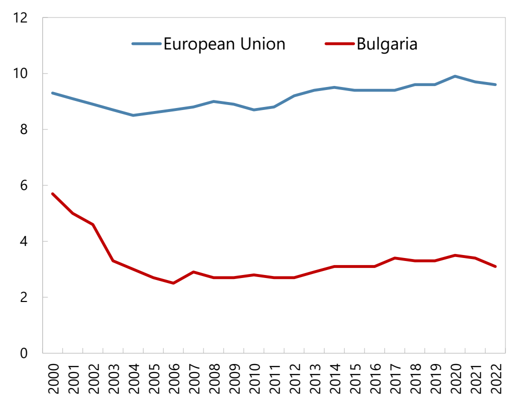
Sources: Euromod; and IMF staff calculation.
Notes: SC = Social Contributions; DT = Direct Taxes; MT = Means-tested social spending; and NMT = Non-means-tested social spending. CESEE are NMS excluding Slovenia.

General Government Tax Revenue
(Average over the period 2010-22, percent of GDP)



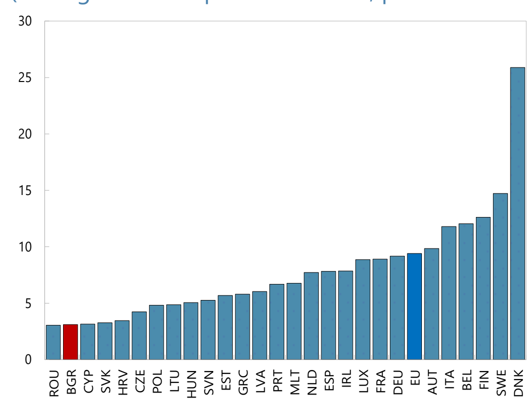
Sources: Eurostat and IMF staff calculation.

Personal Income Tax
(Percent of GDP)



Sources: Eurostat and IMF staff calculation.

Personal Income Tax
(Average over the period 2010–22, percent of GDP)



Sources: Eurostat and IMF staff calculation.

- ***Addressing informality and widening the tax bases.*** Partly due to underreported wages, the informal economy is widespread. Revenue collection could be improved by ensuring the compliance of large taxpayers and in high-risk sectors, strengthening control and auditing processes, and further training tax administration staff on operational risks. This would be particularly needed to avoid an increase in tax evasion at the high-income end if progressive taxation is implemented. The planned merger of National Revenue Agency and Custom Agency should be handled carefully to ensure the quality of their core functions. More broadly, strengthening governance and reducing corruption will enhance trust in institutions and improve tax compliance.

- ***Preventing the buildup of contingent liabilities from SOEs.*** Although the total outstanding liabilities of government-controlled entities classified outside the general government is smaller than in many other European countries, fiscal risks related to SOEs exist. About 55 percent and 30 percent of SOEs reported losses in 2020 and 2021, respectively. Several key SOEs continuously make losses (about 0.3 percent of GDP on average over 2015–22), although high energy prices temporarily improved the financial situation of some loss-making SOEs in the energy sector in 2021–22. Moreover, SOEs are significantly less profitable than private firms and several large SOEs face liquidity pressures and increasing difficulties to service their debt. These vulnerabilities constitute a fiscal risk that requires monitoring and calls for SOE governance reforms (Box 3).[3]

Authorities' Views

18. The authorities broadly agreed on the need for fiscal reforms but cautioned against moving to progressive personal income taxation at this stage. They agreed that efficiency of spending, pension, tax collection, and SOEs are areas that deserve attention. They emphasized that fiscal reforms need to be sequenced carefully to ensure that their fiscal costs and benefits do not deteriorate outcomes in the short term, and that they are politically and socially feasible. They are not convinced that Bulgaria is at a stage when introducing progressive taxation would be desirable. They are also concerned that raising the marginal taxation rate would lead to further tax evasion. They see the need to further assess what would be the macroeconomic, distributional and fiscal impact of such policy.

Box 3. Fiscal Risks from State-Owned Enterprises

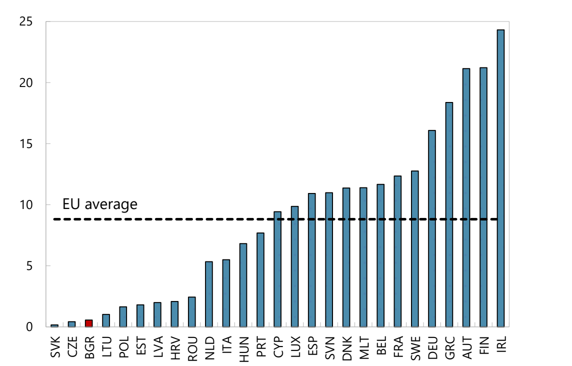
SOEs play a key role in Bulgaria's economy, particularly in the energy and transportation sectors. They account for about 4 percent of employment and 5 percent of total value added. Therefore, their economic and financial performance may have important fiscal risk implications.

From an aggregate perspective, the explicit state-guaranteed debt of SOEs reached 0.5 percent of GDP on average over 2010–21, far below the average of 9 percent in EU countries, suggesting marginal fiscal risk. However, the negative net budgetary flows from SOEs coupled with contingent liabilities estimated at of 12 percent of GDP (56 percent of tax revenue) could lead to long-term fiscal challenges.

Total Stock of Government Guarantees

(Percent of GDP) [1]

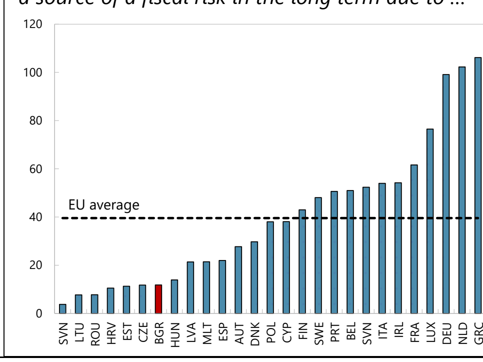
Despite a low level of state-guaranteed debt, …



Contingent Liabilities of SOEs

(Percent of GDP) [1]

…a contingent liability of 12 percent of GDP could be a source of a fiscal risk in the long term due to …

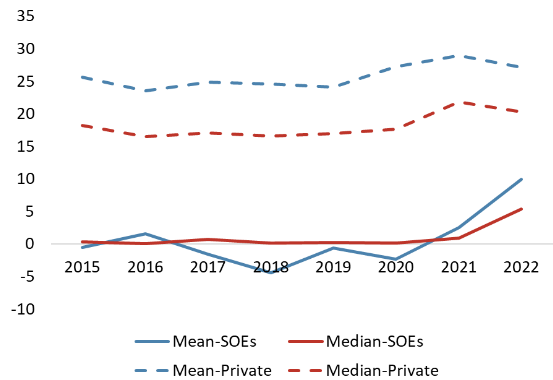


[3] Accompanying SIP "Bulgaria: Fiscal Risks from State-owned Enterprises."

Box 3. Fiscal Risks from State-Owned Enterprises (Concluded)

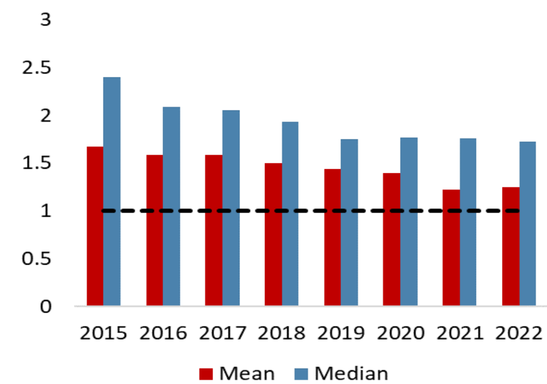
SOEs' Return on Equity (ROE)
(Percent)

…low profitability of SOEs and …



Average Cost of Employee: SOEs-to-Private Firms Ratio

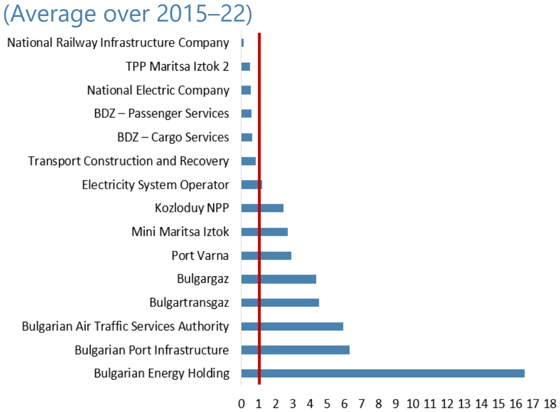
…and their inefficient resource allocation.



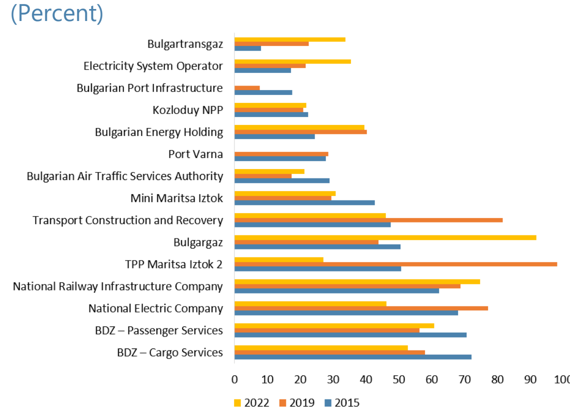
Sources: Eurostat, Orbis database, and IMF staff calculations.
[1] The average is the simple average. Contingent liabilities are total outstanding liabilities of government-controlled entities classified outside general government (in percent of GDP).

A firm-level analysis focusing on 15 large SOEs in the energy and transportation sectors suggest that SOEs are less profitable than private firms, in part due to lower efficiency. The difference in return-on-equity between SOEs and private firms exceeds the 4 percentage-point gap found in countries with good governance scores. Notably, some key SOEs continuously lacked liquid assets to meet short-term liabilities, leading to debt arrears accumulation to their suppliers. In addition, the increase in debt-to-assets ratio in several major SOEs, when combined with low profitability, raises concerns about the ability to service debt.

Current Assets to Current Liabilities Ratio
(Average over 2015–22)



Debt to Assets
(Percent)



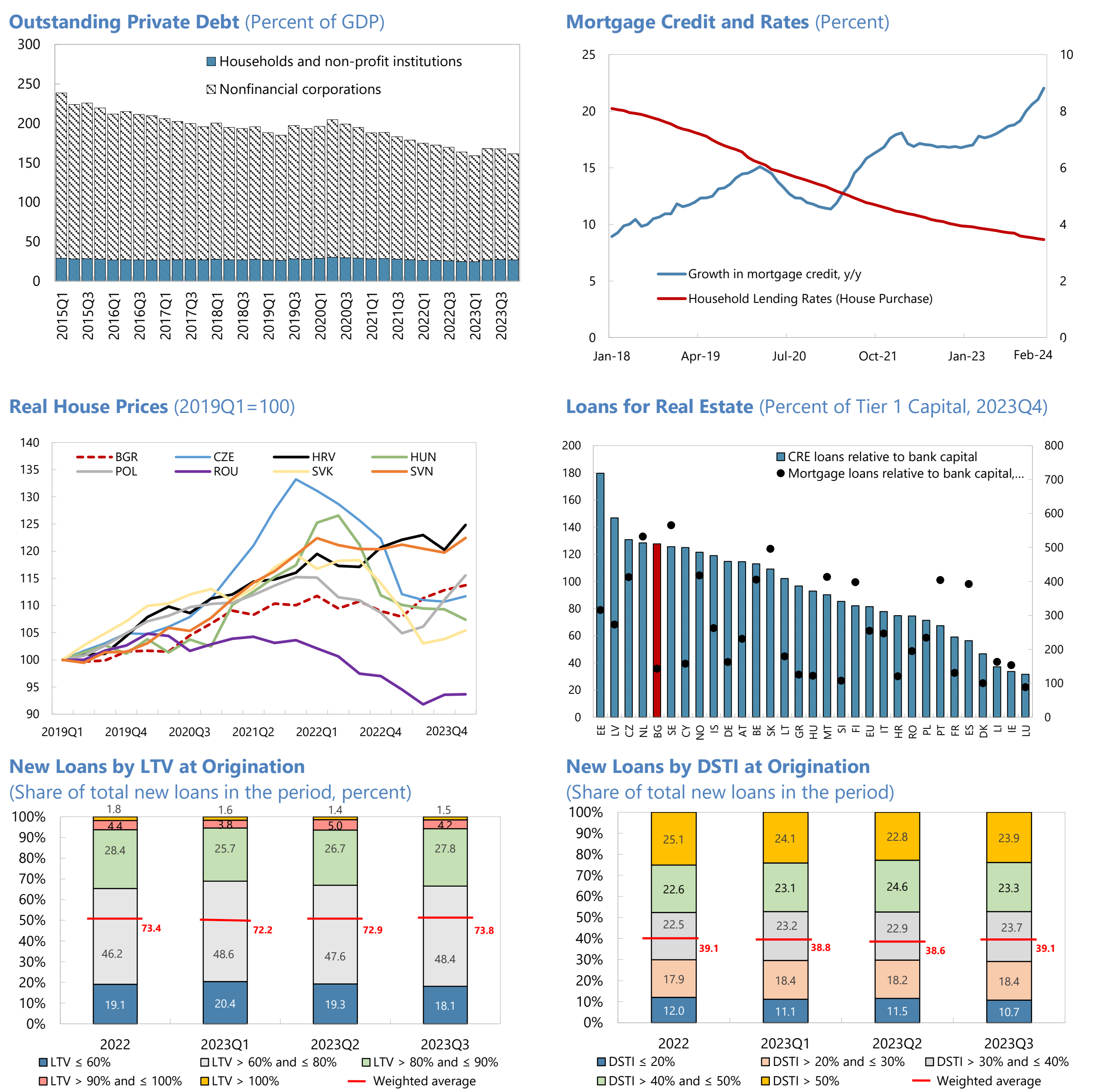
Sources: Orbis database and IMF staff calculations.

C. Addressing Financial Sector Risks

19. **Private credit is rising rapidly, especially for residential real estate.** At less than 30 percent of GDP, households' debt remains low. However, credit growth is particularly strong in the mortgage segment and reached 22 percent y/y in February. Households have been ramping up their investment in real estate given some of the lowest mortgage rates in the EU (less than 3 percent in February) reflecting weak monetary policy transmission, rising house prices (which grew

by 4.4 percent in real terms in 2023), and a preference for real estate over other investment vehicles. With no material change vis-à-vis 2022, about one third of newly originated loans in the first nine months of 2023 had loan-to-value ratios (LTVs) above 80 percent, and almost half had debt-service-to-income ratios (DSTIs) above 40 percent. Banks' exposure to commercial real estate (CRE) is also relatively high, a potential source of vulnerability that requires close monitoring.

20. Systemic risks remain moderate, but tightening macroprudential policy would help address potential rising risks from real estate lending. Considering the risks of a possible house prices-mortgage credit spiral and rising credit risks amidst elevated uncertainty, the recent increase in the CCyB was appropriate. The banking system is resilient and buffers are ample, with the capital adequacy ratio standing at 21.6 percent at end-2023, and the liquidity coverage ratio at 228 percent.



Sources: BNB, European Banking Authority Risk Dashboard, Haver Analytics, and IMF staff calculation.

Nonetheless, strengthening the macroprudential framework by introducing borrower-based measures would help uphold asset quality and prevent the development of pockets of vulnerability that could create risks should, for example, the labor market softens. An enhanced macroprudential toolkit will also help avoid that the additional liquidity that will be released from asset risk re-weighting and the MRR reduction upon joining the euro will not increase systemic risks. Preparations are underway and banks are confident that they will be technically ready to introduce the euro.

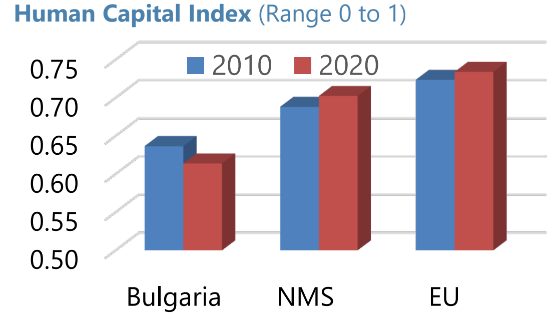
Authorities' Views

21. The authorities assess recent credit developments to be driven by fundamentals. They point to the limited transmission of ECB rates to domestic rates, especially for households, and to rising incomes and preference for real estate investment as the main drivers of strong mortgage lending growth. They report limited signs of overheating in the real estate market. While they are carefully monitoring the credit market and stand ready to intervene, they currently do not see the need for borrower-based macroprudential measures as banks maintain high capital buffers and did not relax their lending standards. They do not expect substantial changes in banks' lending behavior upon joining the euro area as systemic liquidity is already ample.

D. Raising Living Standards and Address Structural Challenges

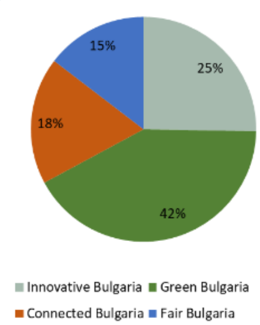
22. Accelerating structural reforms is necessary to foster productivity, promote income convergence and, eventually, successfully navigate integration into the euro area. Preventing a decline in potential growth and fostering income convergence requires measures to contain the decline in labor force, boost productivity, stimulate investment, preserve competitiveness, and further integrate into global and regional value chains. Efforts should be stepped up to strengthen governance, invest in human capital and infrastructure (notably in transportation and communication networks, energy security, and green transition) and foster digitalization and innovation—all priorities of Bulgaria's recovery and resilience plan (RRP). Many of these investments will also help Bulgaria better prepare for transformations brought about by artificial intelligence (AI) and reap its productivity benefits, while guarding against its risks, especially on the labor market. Improving the productivity of SOEs will also be important considering their central role in the economy.

Human Capital Index (Range 0 to 1)



Sources: World Bank and IMF Staff calculation.
Note: Simple average for NMS and EU (EU27 excluding Malta).

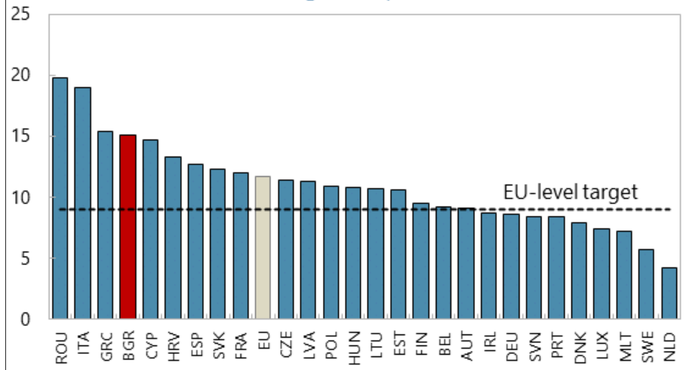
Recovery and Resilience Facility's Four Pillars (Share of EUR 5.69bn)



Source: European Commission.

23. Preventing further decline in labor force would alleviate labor force shortages and support potential growth. The sharp decline in Bulgarian population combined with aging reduces markedly the labor force. Despite the progressive increase in retirement age, the working age population declined on average by about 1½ percent each year in the past decade, constraining growth. This contributes to the longstanding labor shortages that have reached historically high levels. Labor market policies that would integrate the young neither in employment nor education and training (NEET) into the labor market could have a significant impact.

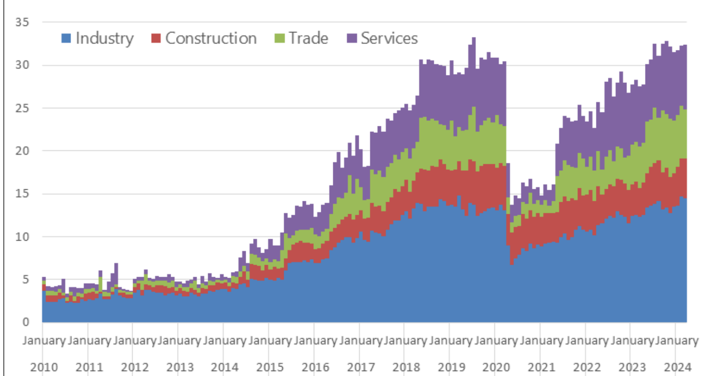
Young People (aged 15–29) Neither in Employment nor in Education and Training (2022, percent)



Source: Eurostat.

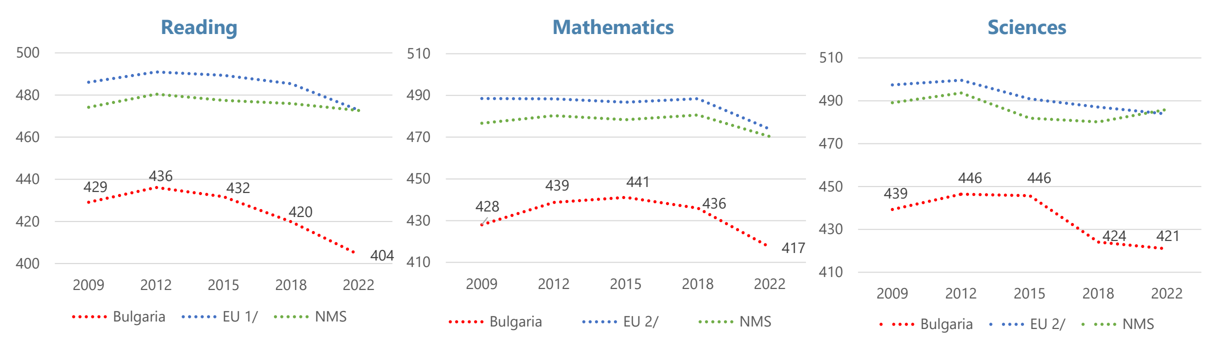
24. A reform of the education system and efficient investment in human capital are also critical to boost potential growth and buttress competitiveness. Staff estimates that a more efficient use of current public spending on education could increase educational outcome measured by the Programme for International Student Assessment (PISA) score by up to 11 percent. Reforming the school curricula, promoting greater inclusion of disadvantage students, and reducing drop-out and early leavers, combined with measures to increase life-long training, would also help boost human capital, reduce skill mismatch, and continue bridging the digital skill gap. Bridging the digital skill would help increase gains from digitalization, improve AI preparedness, and accelerate firms' adoption of AI.

Firms Reporting Labor Shortage as A Factor Limiting Their Activity
(Percent of firms, not seasonally adjusted)



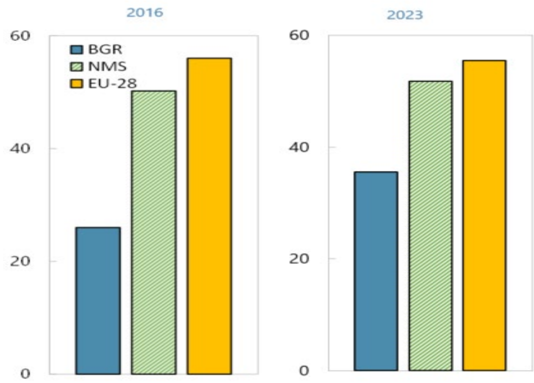
Sources: National Statistical Institute (Business Survey) and IMF staff calculation.

Mean PISA Score (2009–22)



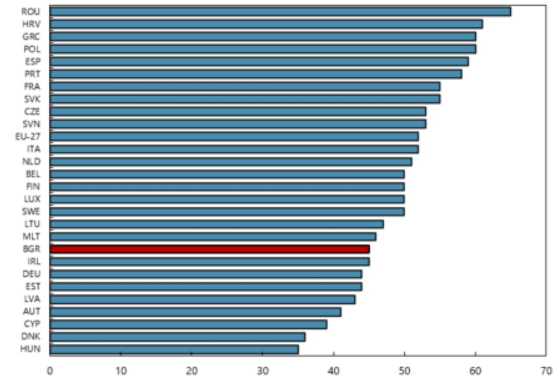
Sources: OECD and IMF staff calculation.
1/ Excludes Austria, Cyprus, Luxembourg, Malta, and Spain due to data limitations.
2/ Excludes Austria, Cyprus, Luxembourg, and Malta due to data limitations.

Digital Skills
(Percent of individuals)[1]



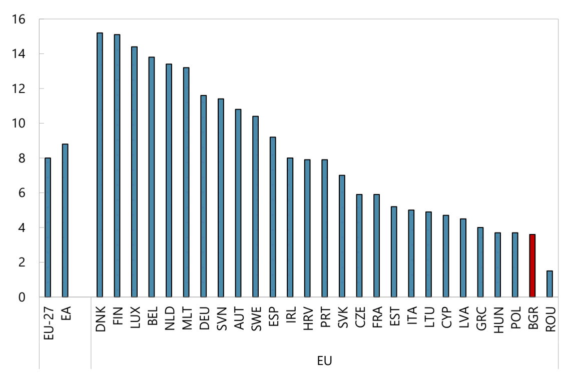
Source: OECD.
1/ Individuals who have basic or above basic overall digital skills.

Digital Skills Gaps in the European Union[1]
(2021, in percent)



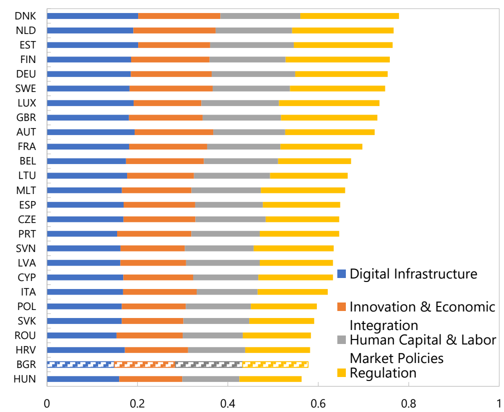
Sources: Cedefop's European skills and jobs survey (Cedefop an EU's decentralized agencies. Data are from an EU-wide survey based on a representative sample of adult workers on a set of core variables)
[1] Difference between the level of ICT skills needed to do the job and the percent of individuals who have at least basic or above basic overall digital skills.

Enterprises Using AI Technologies, 2023
(Percent of enterprises)[1/]



Source: Eurostat.
1/ Enterprises with 10 or more employees.

AI Preparedness Index



Sources: ILO, Cazzaniga and others (2024), and IMF staff calculation.

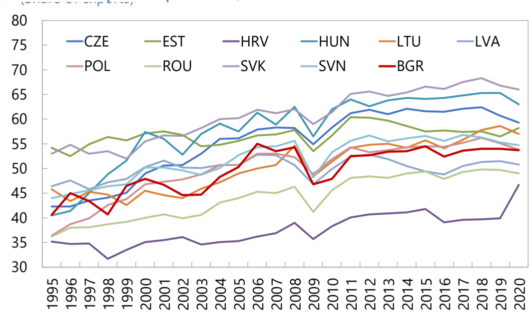
25. Investment in physical and digital infrastructure will also help deepen participation in global value chains (GVCs), enhancing the gains of euro and Schengen areas accession. Following a common trend in the region, Bulgaria's integration in GVCs slowed significantly in the last decade, limiting the benefits stemming from the exchange of goods and knowledge, expanded market access, FDI, and human capital enrichments inherent to global economic integration. Investment in infrastructure and improvements in governance would boost Bulgaria's competitiveness notwithstanding a convergence of wages toward the EU average. Such enhancements would make the country an increasingly attractive destination for investors, including those looking to relocate in Europe amidst geoeconomic fragmentation (Box 4).[4]

[4] Accompanying SIP "Bulgaria in Global Value Chains: Leveraging the Integration with the European Union."

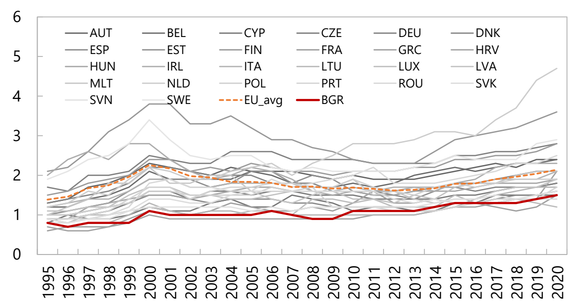
Box 4. Integration in Global Value Chains

Bulgaria's integration in GVCs has flattened in the last decade after twenty years of growth before the global financial crisis. Bulgaria's GVCs are well diversified, although still mostly concentrated in low-technology, labor-intensive industries. Both forward linkages (i.e., domestic value-added content of foreign exports) and backward linkages (i.e., foreign value added embodied in domestic exports) with the EU are among the lowest compared to other EU newer member states (NMS). Links with Russia have been historically large, especially in fuel and energy products, but decoupling is ongoing after Russia's invasion of Ukraine.

Integration in GVCs
(Share of exports, percent)



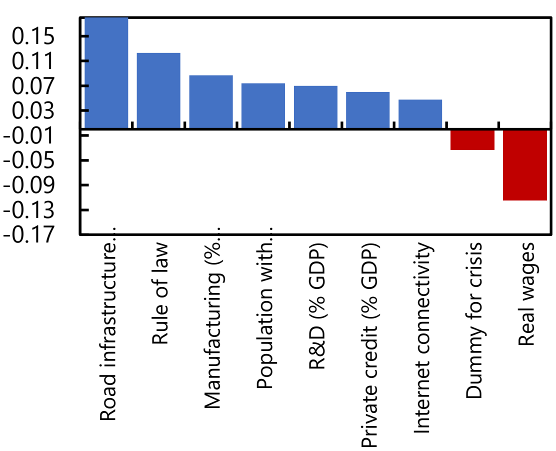
Forward Linkages in Information Industries
(Share of exports, percent)



Sources: OECD Trade in Value Added, 2023, and IMF staff calculations.
Note: Integration in GVCs is computed as the sum of backward linkages and forward linkages. Information industries include production of computers and electronics and the provision of communication, IT, and information services.

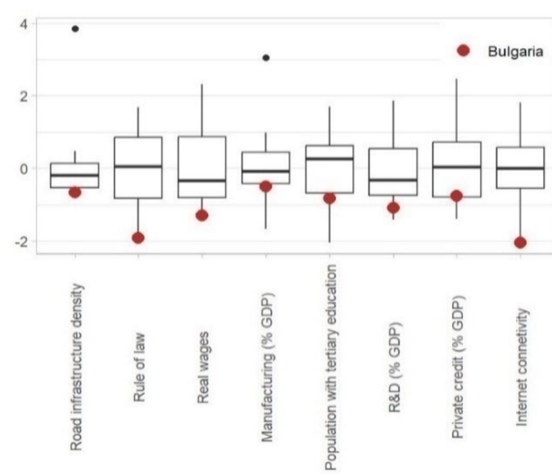
To boost integration, Bulgaria should invest in infrastructure and improve governance. Staff's analysis shows that these are important drivers of integration that are particularly lagging in Bulgaria. Fostering innovation through R&D will also help. As domestic wages rise, it is important that Bulgaria focuses on non-price elements of its economy to remain competitive and benefit from a deeper integration with EU partners.

Drivers of GVC integration in EU countries
(Weighted average of SHAP values from six machine learning models)[1/]



Sources: Eurostat, World Bank, OECD, IMF staff calculation.
1/ Models are linear regression, elastic net, support vector machine, random forest, extreme gradient boosting and k-nearest neighbors, estimated with data for EU countries over 2002-20. Variables are considered in percent of EU average.

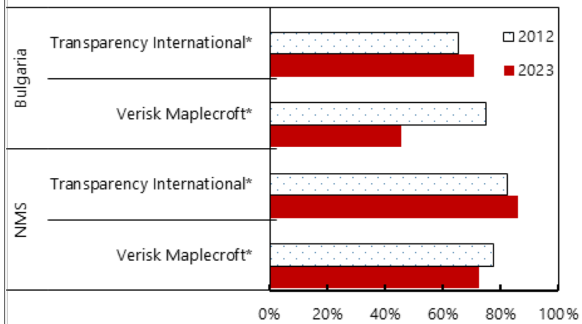
Bulgaria's position with respect to GVC drivers in 2021[2]



Sources: Eurostat, World Bank, OECD, IMF staff calculation.
2/ Boxplots show the distribution of the centered and normalized indicators for all EU countries.

26. Continued efforts are needed to strengthen the governance framework and mitigate corruption. In comparison to other EU member states, Bulgaria is perceived as having substantial levels of corruption and weak rule of law. Notably, public procurement is an area seen as being at high risk of corruption. The RRP appropriately prioritizes key anti-corruption and rule-of-law reforms. In 2023, the constitution was amended to restrict the power of the Prosecutor General, restructure the Supreme Judicial Council, ensure the transparent selection of regulators, and reduce the role of the President in appointing caretaker governments. Considering progress on anti-corruption and judicial reforms, the European Commission closed its Cooperation and Verification Mechanism in 2023, and Bulgaria is currently monitored through the Commission's annual rule-of-law reports.

Corruption Perception Indices
(Percent of EU average)



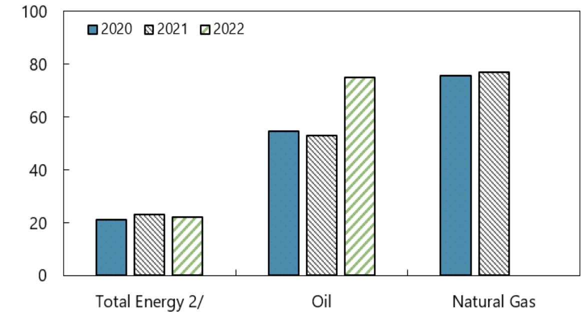
Sources: Verisk Maplecroft, Transparency International, and IMF staff calculations.
Notes: Transparency International's Corruption Perception Index and Verisk Maplecroft's Corruption Risk Index measure perception of corruption (higher value means lower perceived corruption). The accuracy of the indices can be biased by experts' views (instead of facts on corruption).

27. The effective implementation of recently introduced reforms will be critical. Important legal reforms were enacted, including the adoption of the whistleblower protection law (2023), improved human resources management in the judiciary, digitalization of the judiciary (e.g., e-justice rules), and the establishment of a mechanism for greater accountability in the Prosecutor General's operations. However, the implementation of some RRP milestones related to anti-corruption and rule-of-law reforms such as judicial reforms and asset recovery has been delayed, hampering EU funds delivery. Moreover, the slow implementation of legislative reforms such as the Counteracting Corruption Act 2023, which mainly created the commission on countering corruption and the commission for confiscation of illegally acquired assets, remains a concern. The effectiveness of investigation and prosecution of high-level cases of corruption also needs to be addressed.

28. Bulgaria is committed to improving its AML/CFT system and will benefit from accelerated efforts to exit the Financial Action Task Force's (FATF) "grey list." Bulgaria entered the grey list in 2023 and committed to an action plan to address strategic deficiencies. Swift implementation of the plan will be important as grey listing can have significant negative economic consequences, through higher costs for foreign investors and reduced correspondent banking relationships. The main risks identified by the FATF arise from organized crime, corruption, and misuse of EU funds. Fast-track investment-linked citizenship programs are now abolished, but residency schemes remain as a threat. Vulnerable economic sectors and channels include real-estate, the formal financial system, professional enablers, and misuse of legal structures. Recent legislative improvements to customer due diligence obligations are crucial for risk mitigation in regulated sectors and any residual gaps should be addressed swiftly. Bulgaria has made commendable efforts to put in place beneficial ownership registers, however the accuracy of the registered data requires improvement. Investigative and enforcement mechanisms need strengthening, including the adoption of policy procedures for confiscating illicit proceeds while legislative developments are underway.

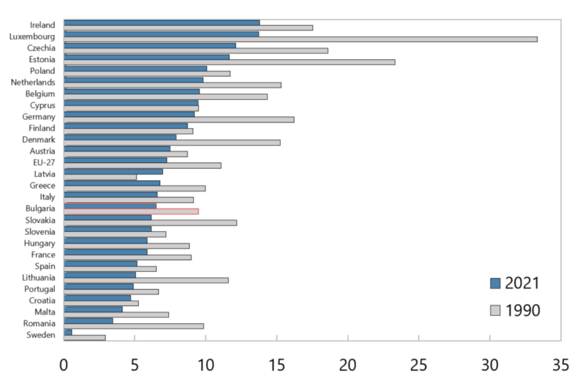
29. Strengthening energy security and accelerating the green transition are key priorities to sustain long-term growth. Bulgaria pivoted away from Russian gas when Russia abruptly cut its supply in the spring of 2022. It is replacing Russian nuclear fuel with U.S. fuel. The dependence on Russian oil increased under a derogation from the EU embargo but is expected to decline as the exemption ended in 2024Q1. Moreover, Bulgaria suffers from the highest greenhouse gas emissions intensity in the EU. The surge in commodity prices and the determination to reducing energy dependence on Russia led to an update of the initial green transition strategy in the RPP.[5] Slow progress in further revising the RRP, including to incorporate RepowerEU, largely reflects the difficult political economy of transitioning out of coal. This may further delay NGEU funding and the green transition. Following the adoption of Bulgaria's Territorial Just Transition Plans, the EC will provide over 1 percent of GDP to help phase out coal and reach energy and climate targets. The second tranche of the RFF may also be delayed as Parliament postponed by a year the electricity market liberalization, initially scheduled to take place in July 2024, out of concern for its impact on prices for households. Maintaining incentives for energy saving and efficiency, investment in renewables, and reduction of coal use through price-based mechanisms and fiscal tools should be considered, while protecting vulnerable households. Increased production of green energy would strengthen energy security and could be fostered by a review of regulation and addressing the bottleneck that limit the connection to the grid.

Energy Dependence on Russia[1/]
(Percent)

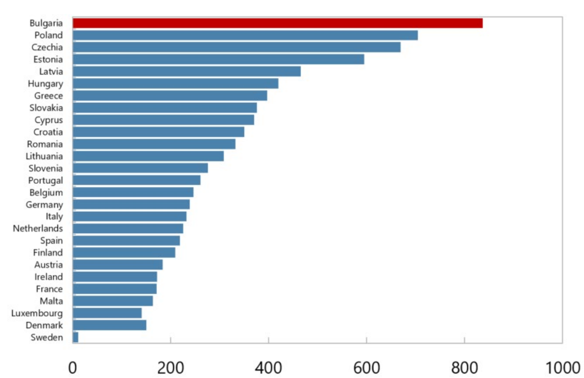


Sources: UN Comtrade and IMF staff calculation.
1/ Estimated as share of Russia in energy imports times the ratio of net imports to gross inland energy consumption.
2/ Includes crude petroleum, refined petroleum, petroleum gas, and coal. Excludes nuclear fuel.

Net Greenhouse Gas Emissions per Capita in the EU
(tCO2 equivalent)



Net Greenhouse Gas Emissions per GDP in the EU
(2021, tCO2 per million euros at 2015 price)



Sources: European Environment Agency (EEA) and IMF staff calculation.

[5] Country Report 2022/191.

Authorities' Views

30. **The authorities concurred with the need to boost labor force participation, highlighting that several initiatives targeting minorities and the young are in place.** They indicated that, in addition to active labor market policies, reducing the NEET ratio would require increasing access to transportation, education, health services (including to reduce the need to care for elderly parents), and potentially tax incentives. Parliament is working toward increasing the seasonal work opportunities for foreigners.

31. **The authorities noted the progress on the governance and AML/CFT legislative reforms in 2023.** They are working on the implementation of their action plan to exit the grey list as soon as possible and have already taken actions in this regard. For instance, they issued ordinances for registering virtual asset service providers and passed law amendments on customer due diligence and beneficial ownership transparency. The BNB assesses that FATF's grey-listing did not have a significant impact on the financial sector.

32. **The authority emphasized recent initiatives to diversify the energy mix while maintaining production capacity.** They consider that Bulgaria is on track to meet its decarbonization target. The reconversion of coal regions is an economic and social challenge, but the authority noted that economic considerations will lead to a phase out of coal use earlier than envisaged in the plan adopted by parliament as coal usages becomes less profitable than alternatives.

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33. **The economy has shown resilience through successive shocks, and a soft landing is within reach.** After slowing in 2023, growth is expected to accelerate this year, and inflation to continue declining with core inflation remaining stickier. The outlook is subject to high uncertainty and large risks, as global headwinds are compounded by heightened domestic political and policy uncertainties. The external position in 2023 is assessed to be moderately stronger than implied by medium-term fundamentals and desirable policies.

34. **Fiscal policy should target a broadly neutral stance in 2024.** Fiscal policy needs to protect the expected rebound in growth while not running against disinflation. Balancing these two objectives requires a neutral fiscal stance rather than the expansionary 2024 budget. This more conservative policy should be achieved by sustainable revenue-increasing measures, as the budget appropriately seeks to increase social spending and investment.

35. **Prudent fiscal policy remains needed in the medium-term to preserve buffers.** A higher primary fiscal balance than planned under the medium-term budget framework is advisable as buffers remain needed considering the uncertain and shock-prone global environment, domestic pressures, and prevailing fiscal risks. Moreover, fiscal space should be preserved for future investment once EU funding gradually recedes. Also, recurrent deficits could be perceived as a deviation from hard-won fiscal discipline, potentially raising borrowing costs. In addition,

strengthening public finance management to address the low efficiency of spending is a prerequisite to ensuring that any new debt finances investment with high return.

36. Fiscal reforms are crucial to create space for large investment and social needs. Key reform should aim at: (i) raising spending efficiency, (ii) reforming the pension system to reduce large fiscal transfers that crowd out more productive spending and improve both the sustainability of the system and the adequacy of pensions, (iii) widening the tax base and reforming the tax system to make it fairer and address rising spending needs; and (iv) preventing the buildup of contingent liabilities from SOEs.

37. The banking system is resilient and systemic risks remain moderate, but vigilance to rising risks is needed. Overall, the banking sector is well capitalized, liquid, and profitable. However, real estate lending is rising rapidly, although households' debt remains low. Considering the risks of a house price-mortgage credit spiral and rising credit risks amidst elevated uncertainty, the recent increase in the countercyclical capital buffer was appropriate. Reinforcing the macroprudential framework with borrower-based measures would help preserve asset quality amidst high credit growth, especially ahead of the expected increase in banks' liquidity upon joining the euro area.

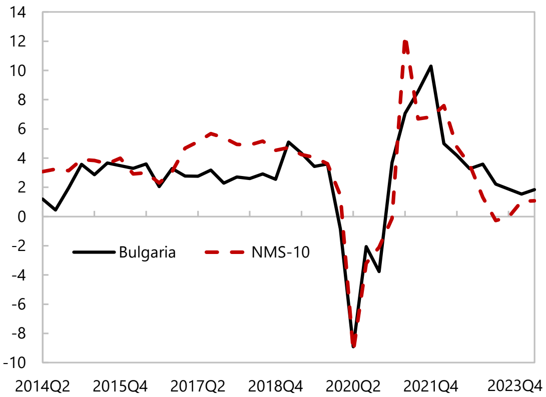
38. Accelerating structural reforms is necessary to foster productivity, promote income convergence and, eventually, successfully integrate into the euro area. Addressing declining potential growth and slow income convergence requires increased labor force participation, higher productivity, more domestic and foreign investment, greater competitiveness, and further integration into global and regional value chains. Along with the timely implementation of the Recovery and Resilience Plan, supporting these goals requires strengthening transparency, governance and AML/CFT frameworks, addressing corruption, investing in infrastructure and human capital, and bolstering the green transition while preserving energy security.

39. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Figure 1. Bulgaria: Real Sector Developments

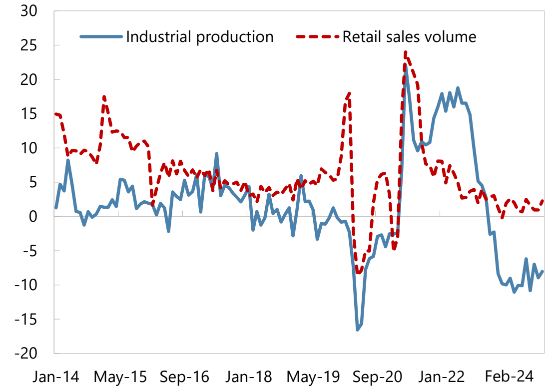
Growth weakened in 2023, although less than peers.

Real GDP Growth
(Percent, y-o-y)



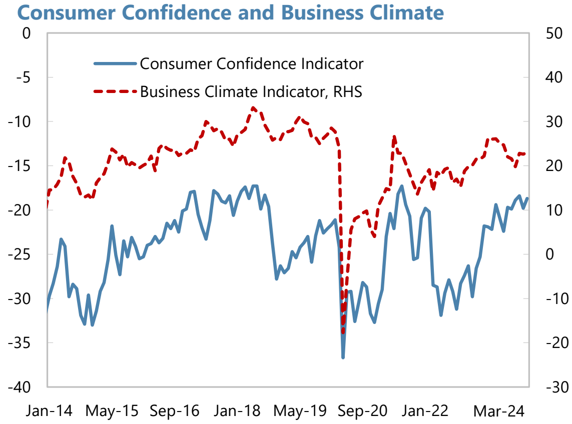
While retail sales held up, industrial production contracted…

Industrial Production and Retail Sales Volume
(Percent, y-o-y)



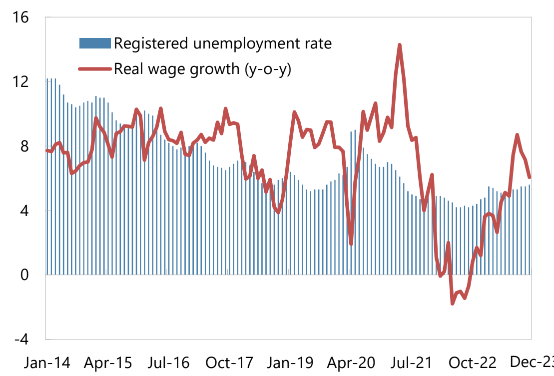
…and business confidence has yet to return to pre-pandemic levels.

Consumer Confidence and Business Climate



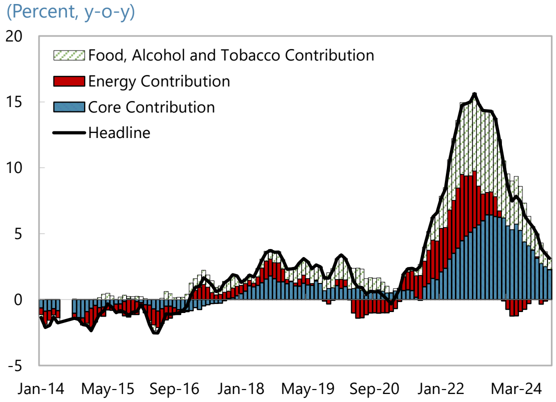
The unemployment rate ticked up but remains low and wage growth is still robust.

Wage and Unemployment Rate
(Percent)



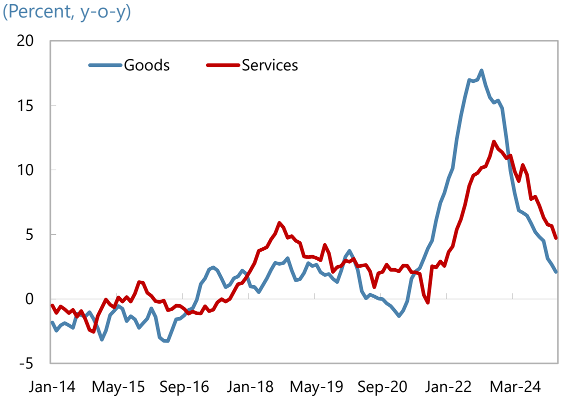
Inflation is declining fast, driven by energy and food prices…

HICP Inflation and Contributions
(Percent, y-o-y)



…while the growth of services prices remains elevated.

HICP Inflation
(Percent, y-o-y)

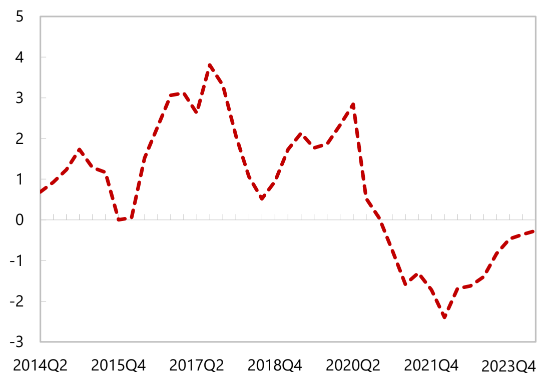


Sources: Haver Analytics; National authorities; and IMF staff calculation.

Figure 2. Bulgaria: External Sector Developments

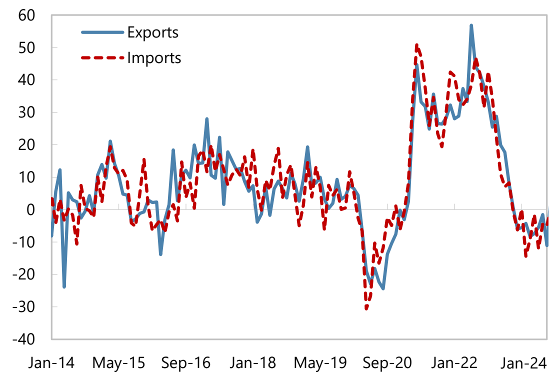
The current account deficit that appeared during the pandemic has gradually diminished.

Current Account Balance
(Percent of GDP, 12 months value)



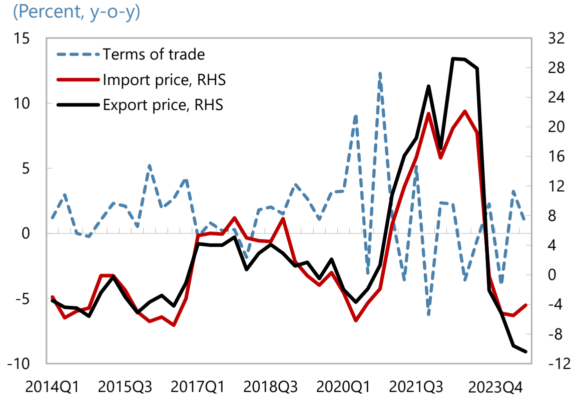
Exports and imports declined as the drop in volume...

External Trade (Goods and Services)
(Percent, y-o-y)



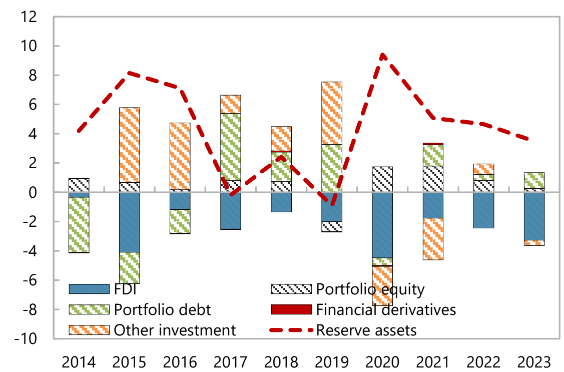
...was magnified by a drop in prices.

Export/Import Prices and Terms of Trade
(Percent, y-o-y)



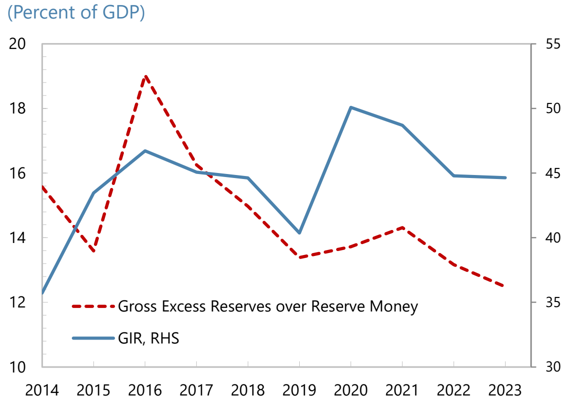
FDI and Eurobond issuance drove the financial account balance.

Financial Account
(In percent of GDP)



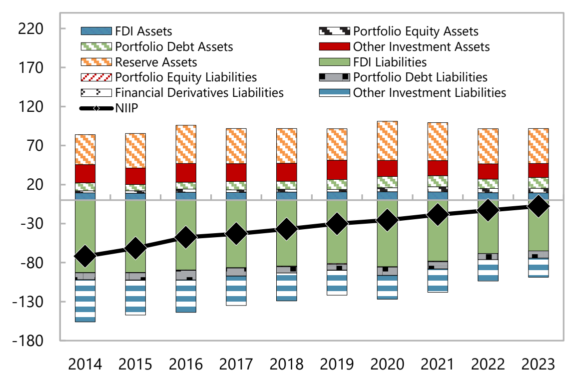
Gross international reserves were stable...

Gross International Reserves
(Percent of GDP)



....and the NIIP continued to improve.

Net International Investment Position
(Percent of GDP)

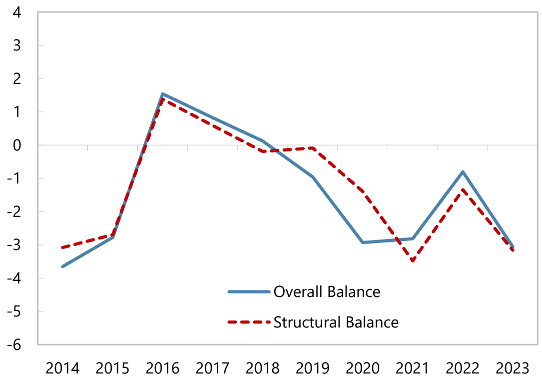


Sources: BNB; Haver; and IMF staff estimates.

Figure 3. Bulgaria: Fiscal Developments

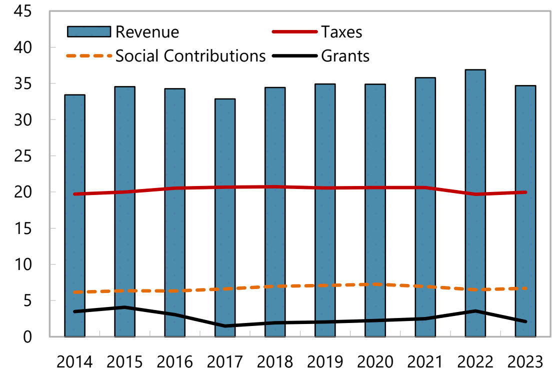
The fiscal deficit increased in 2023…

Overall and Structural Balance
(Percent of GDP)



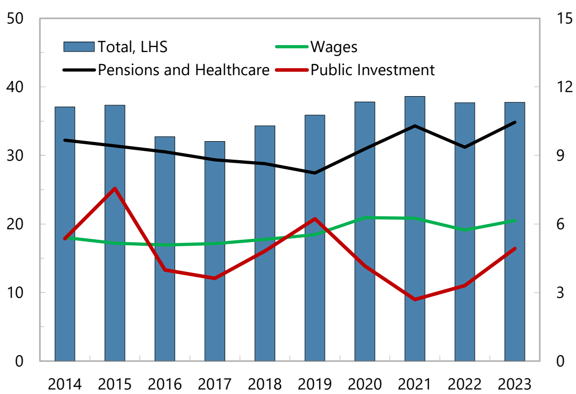
…as revenue fell…

Current Primary Revenue by Components
(Percent of GDP)



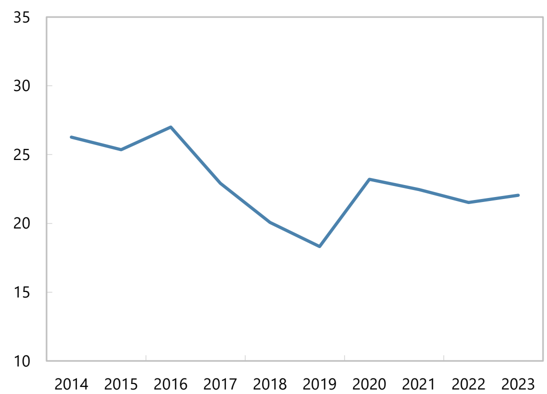
…while expenditure remained stable.

Growth of Selected Expenditure Items
(Percent of GDP)



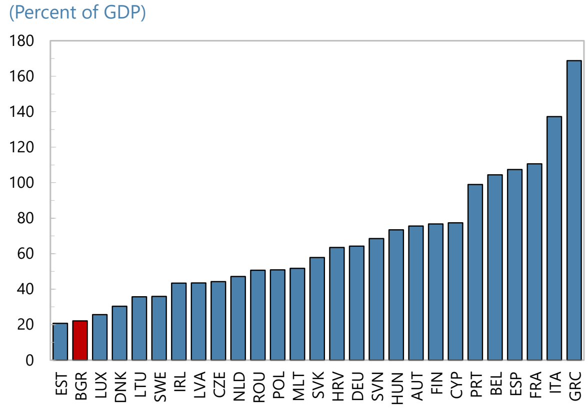
Public debt remained broadly stable…

Government Gross Debt
(Percent of GDP)



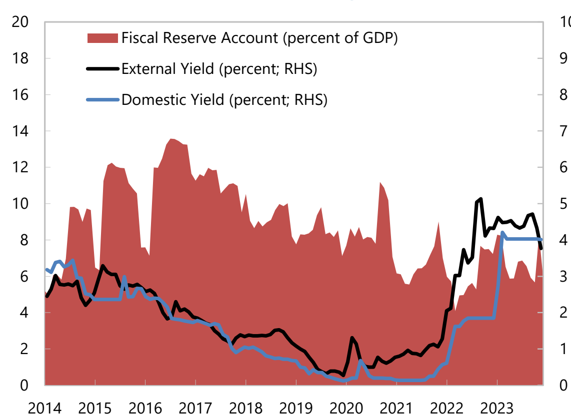
…and continues to be among the lowest in the EU.

Government Debt, 2023
(Percent of GDP)



Fiscal reserves remained broadly unchanged in 2023.

Fiscal Reserve Account and Funding Conditions

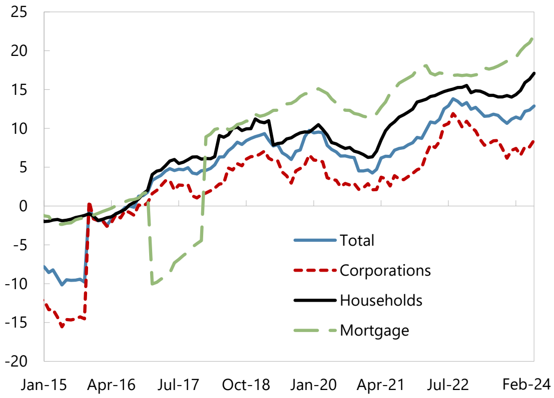


Sources: Bulgarian authorities; Eurostat; Bloomberg Finance L.P.; and IMF staff estimates.

Figure 4. Bulgaria: Monetary and Financial Sector Developments

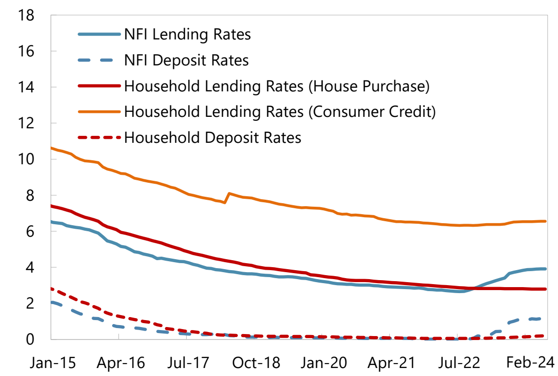
Despite softer corporate lending, total credit growth accelerated, led by mortgage loans…

Credit Growth
(Percent)



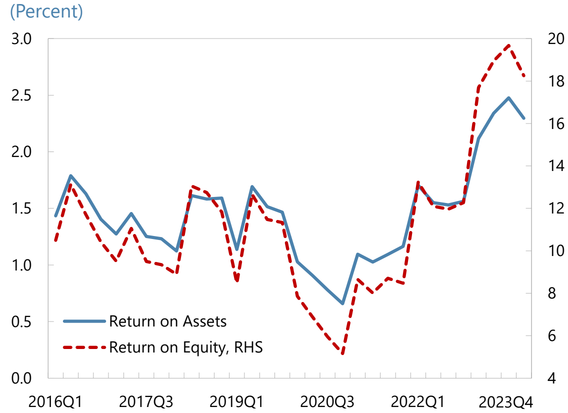
…as mortgage rates kept declining, while Euribor-linked interest (and deposit) rates for NFIs increased.

Lending and Deposit Rates
(Percent)



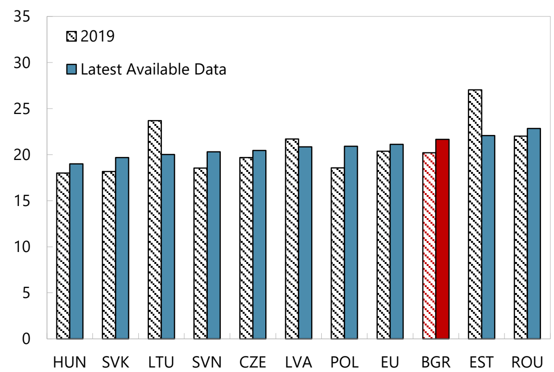
The banking sector recorded record profitability…

Bank Profitability
(Percent)



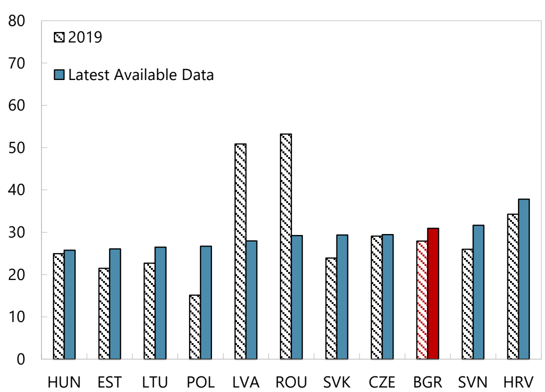
…while remaining well capitalized…

Capital Adequacy Ratio
(Percent)



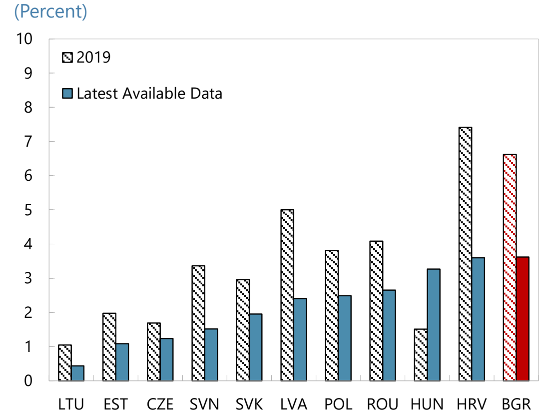
…and liquid.

Liquid Assets to Total Assets
(Percent)



NPLs remain comparatively high but continue to decline.

NPL to Total Gross Loans
(Percent)



Sources: BNB; Haver; and IMF FSI.

Table 1. Bulgaria: Selected Economic Indicators, 2020–29
(Annual percentage change, unless otherwise Indicated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
							Projections			
Real GDP	-4.0	7.7	3.9	1.8	2.7	2.9	2.9	2.7	2.7	2.6
Real domestic demand	0.1	7.3	5.8	-0.9	3.9	4.9	2.4	2.6	2.8	2.6
Public consumption	8.3	0.4	5.5	-0.4	0.9	-1.8	0.9	1.9	2.0	1.5
Private consumption	-0.6	8.5	3.8	5.4	3.6	3.8	3.7	3.6	3.2	3.2
Gross fixed capital formation	0.6	-8.3	6.5	3.3	7.6	15.0	-0.8	-0.2	2.4	1.4
Private investment	1.4	-7.3	10.2	-2.8	2.5	6.7	8.1	4.0	2.6	1.4
Public investment	-3.2	-13.2	-12.2	42.9	29.6	43.4	-23.5	-15.6	1.8	1.3
Stock building 1/	-1.2	4.0	1.4	-4.9	0.0	0.0	0.0	0.0	0.0	0.0
Net exports 1/	-4.1	-0.3	-3.0	3.6	-0.8	-2.3	0.4	-0.1	-0.3	-0.1
Exports of goods and services	-10.4	11.2	11.6	-1.9	3.5	3.7	3.4	3.1	3.0	2.9
Imports of goods and services	-4.3	10.7	15.0	-6.3	4.4	6.5	2.6	3.0	3.1	2.9
Resource utilization										
Potential GDP	2.5	2.8	3.0	3.0	3.1	2.9	2.9	2.7	2.7	2.6
Output gap (percent of potential GDP)	-4.0	0.5	1.4	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Unemployment rate (percent of labor force)	5.2	5.3	4.2	4.4	4.3	4.2	4.2	4.2	4.2	4.2
Price										
GDP deflator	4.3	7.1	16.2	7.5	3.6	3.4	2.4	2.3	2.2	2.2
Consumer price index (HICP, average)	1.2	2.8	13.0	8.6	3.2	2.7	2.1	2.0	2.0	2.0
Consumer price index (HICP, end of period)	0.0	6.6	14.3	5.0	2.8	2.2	2.1	2.0	2.0	2.0
Core consumer price index (HICP, average)	1.2	1.4	7.6	8.9	3.6	3.5	2.5	2.1	2.0	2.0
Core consumer price index (HICP, end of period)	0.9	2.7	11.1	5.4	3.9	2.7	2.2	2.0	2.0	2.0
Fiscal indicators (percent of GDP)										
General government net lending/borrowing (cash basis)	-2.9	-2.8	-0.8	-3.1	-2.7	-3.0	-3.4	-2.7	-2.7	-2.7
General government primary balance	-2.4	-2.4	-0.4	-2.6	-2.2	-2.2	-2.4	-1.7	-1.7	-1.6
Structural overall balance	-1.4	-3.5	-1.3	-3.2	-2.7	-3.0	-3.4	-2.7	-2.7	-2.7
Structural primary balance	-0.9	-3.0	-1.0	-2.7	-2.2	-2.2	-2.4	-1.7	-1.7	-1.6
Cyclically-adjusted overall balance (percent of potential GDP)	-1.3	-3.0	-1.4	-3.2	-2.7	-3.0	-3.4	-2.7	-2.7	-2.7
General government gross debt	22.8	22.5	21.5	22.0	23.4	24.9	27.0	28.4	29.7	31.0
Monetary aggregates										
Broad money	10.9	10.7	13.2	8.7	8.1	7.4	7.1	6.9	6.7	6.6
Domestic private credit	4.5	8.8	12.5	12.2	9.5	8.1	6.1	5.7	5.0	4.9
Exchange rates regime										
Leva per U.S. dollar (end of period)	1.6	1.7	1.8	...	...	...	...	...	...	...
Nominal effective rate	3.0	2.0	1.5	...	...	...	...	...	...	...
External sector (percent of GDP)										
Current account balance	0.0	-1.7	-1.4	-0.3	-0.8	-1.8	-1.4	-0.7	-0.7	-0.7
o/w: Merchandise trade balance	-3.2	-4.1	-5.9	-3.9	-4.6	-5.7	-4.9	-4.8	-4.8	-4.8
Net international investment position	-25.6	-18.6	-12.9	-7.6	-5.2	-4.2	-3.2	-1.0	1.1	3.3
Gross external debt	63.3	58.1	51.6	48.3	46.0	45.8	45.6	44.6	43.6	42.6

Sources: Bulgarian authorities; World Development Indicators; and IMF staff estimates.
1/ Contribution to GDP growth.

Table 2. Bulgaria: Macroeconomic Framework, 2020–29
(Annual percentage change, unless otherwise indicated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections					
GDP and prices										
Real GDP	-4.0	7.7	3.9	1.8	2.7	2.9	2.9	2.7	2.7	2.6
Real GDP per working age population	-2.7	8.5	12.0	3.3	3.6	3.8	3.8	3.5	3.6	3.4
Real GDP per capita	-3.5	8.9	10.2	2.5	3.4	3.5	3.6	3.3	3.4	3.2
Real domestic demand	0.1	7.3	5.8	-0.9	3.9	4.9	2.4	2.6	2.8	2.6
Of which: private	-0.6	8.5	3.8	5.4	3.6	3.8	3.7	3.6	3.2	3.2
GDP deflator	4.3	7.1	16.2	7.5	3.6	3.4	2.4	2.3	2.2	2.2
Consumer price index (HICP, average)	1.2	2.8	13.0	8.6	3.2	2.7	2.1	2.0	2.0	2.0
Nominal wages	9.7	12.3	13.4	13.7	8.9	8.9	8.0	7.6	7.6	7.5
Real effective exchange rate, CPI based	2.9	1.3	4.8	4.9	…	…	…	…	…	…
Monetary aggregates (percent change)										
Broad money	10.9	10.7	13.2	8.7	8.1	7.4	7.1	6.9	6.7	6.6
Domestic private credit	4.5	8.8	12.5	12.2	9.5	8.1	6.1	5.7	5.0	4.9
Saving and investment (percent of GDP)										
Gross national saving	20.4	19.4	22.0	18.6	18.1	19.1	18.6	18.7	18.6	18.3
Government	1.2	-0.1	2.5	1.9	2.3	2.1	1.2	1.3	1.3	1.2
Private	19.2	19.5	19.5	16.7	15.9	17.0	17.4	17.4	17.3	17.1
Gross domestic investment	20.3	21.1	23.4	18.8	18.9	20.8	20.0	19.4	19.3	19.0
Government	3.3	2.7	2.3	3.2	4.1	5.6	4.2	3.4	3.4	3.3
Private	17.0	18.4	21.1	15.6	14.8	15.2	15.9	16.0	15.9	15.7
General government (percent of GDP)										
Revenue	34.9	35.8	36.9	34.7	36.3	36.3	35.7	35.7	35.6	35.6
Tax revenue (including social security contributions)	27.9	27.5	26.2	26.7	27.6	27.8	27.8	27.8	27.8	27.8
Non-Tax revenue	4.8	5.8	7.1	5.9	5.1	5.3	5.3	5.3	5.3	5.3
Grants	2.2	2.5	3.6	2.1	3.6	3.2	2.5	2.5	2.5	2.5
Expenditure	37.8	38.6	37.7	37.7	39.1	39.2	39.0	38.4	38.4	38.3
Balance (net lending/borrowing on cash basis)	-2.9	-2.8	-0.8	-3.1	-2.7	-3.0	-3.4	-2.7	-2.7	-2.7
Cyclically-adjusted overall balance (percent of potential GDP)	-1.3	-3.0	-1.4	-3.2	-2.7	-3.0	-3.4	-2.7	-2.7	-2.7
Balance of payments (percent of GDP)										
Current account	0.0	-1.7	-1.4	-0.3	-0.8	-1.8	-1.4	-0.7	-0.7	-0.7
Trade balance	-3.2	-4.1	-5.9	-3.9	-4.6	-5.7	-4.9	-4.8	-4.8	-4.8
Services balance	5.1	5.9	6.1	7.1	7.0	7.1	7.1	7.1	7.1	7.1
Primary income balance	-3.5	-4.7	-3.2	-5.0	-5.0	-5.0	-4.9	-4.9	-4.8	-4.9
Secondary income balance	1.6	1.2	1.6	1.5	1.9	1.8	1.3	1.8	1.8	1.8
Capital account	1.4	0.7	0.9	1.6	2.9	2.7	2.4	3.0	3.0	3.1
Financial account	-6.0	-1.3	-0.5	-2.3	-2.0	-2.8	-1.8	-1.9	-2.0	-2.0
Of which: Foreign direct investment	-4.5	-1.8	-2.4	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3
Memorandum items:										
Gross international reserves (billions of euros)	30.9	34.6	38.4	41.9	46.1	50.2	53.3	58.1	63.4	69.1
Short-term external debt (percent of GDP) 1/	9.7	9.7	10.3	8.9	7.6	6.7	5.7	4.6	3.5	2.5
Export volume (goods, percent change)	-4.4	7.9	8.8	-4.1	3.5	3.7	3.4	3.1	3.0	2.9
Import volume (goods, percent change)	-2.9	9.9	13.5	-7.1	2.8	2.8	3.3	3.0	3.1	2.9
Terms of trade (percent change)	4.3	0.6	2.1	-1.0	-0.7	1.0	0.5	0.2	0.1	0.0
Output gap (percent of potential GDP)	-4.0	0.5	1.4	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Nominal GDP (billions of leva)	120.5	139.0	167.8	183.7	195.6	208.3	219.6	230.6	242.2	253.9
Nominal GDP (billions of euros)	61.6	71.1	85.8	93.9	100.0	106.5	112.3	117.9	123.8	129.8

Sources: Bulgarian authorities; and IMF staff estimates.
1/ At original maturity.

Table 3. Bulgaria: Balance of Payments, 2020–29
(Billions of euros, unless otherwise indicated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
							Projections			
Current account balance	0.0	-1.2	-1.2	-0.3	-0.8	-1.9	-1.6	-0.8	-0.9	-0.9
Trade balance	-1.9	-2.9	-5.1	-3.6	-4.6	-6.1	-5.5	-5.6	-5.9	-6.2
Exports (f.o.b.)	27.3	34.4	47.1	43.3	45.2	47.8	50.2	52.6	55.3	58.2
Imports (f.o.b.)	29.2	37.3	52.2	47.0	49.8	53.8	55.7	58.3	61.2	64.4
Services balance	3.1	4.2	5.3	6.7	7.0	7.5	8.0	8.4	8.8	9.3
Exports of non-factor services	7.3	9.2	12.2	14.1	14.7	15.6	16.3	17.1	18.0	18.9
Imports of non-factor services	4.2	5.0	7.0	7.4	7.7	8.0	8.4	8.8	9.2	9.7
Primary Income balance	-2.2	-3.4	-2.8	-4.7	-5.0	-5.3	-5.5	-5.8	-6.0	-6.3
Receipts	1.7	2.3	2.5	2.8	2.9	3.0	3.2	3.3	3.4	3.5
Payments	3.9	5.6	5.3	7.5	7.9	8.3	8.7	9.0	9.4	9.9
Secondary income balance	1.0	0.8	1.4	1.4	1.9	1.9	1.5	2.2	2.2	2.3
Capital account balance	0.9	0.5	0.8	1.5	2.9	2.9	2.7	3.5	3.7	4.0
Financial account balance	-3.7	-0.9	-0.4	-2.2	-2.0	-3.0	-2.0	-2.2	-2.4	-2.6
Foreign direct investment balance	-2.8	-1.2	-2.1	-3.1	-3.3	-3.5	-3.7	-3.8	-4.0	-4.2
Portfolio investment balance	0.8	2.3	1.1	1.2	1.0	1.3	1.5	1.6	1.6	1.7
Other investment balance	-1.6	-2.0	0.6	-0.3	0.2	-0.9	0.2	0.1	0.0	-0.1
Errors and omissions	1.2	3.4	4.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	5.8	3.6	4.0	3.3	4.2	4.0	3.1	4.8	5.3	5.7
Financing	-5.8	-3.6	-4.0	-3.3	-4.2	-4.0	-3.1	-4.8	-5.3	-5.7
Gross international reserves (increase -)	-5.8	-3.6	-4.0	-3.3	-4.2	-4.1	-3.1	-4.9	-5.3	-5.7
Memorandum items:			(Percent of GDP, unless otherwise indicated)							
Current account balance	0.0	-1.7	-1.4	-0.3	-0.8	-1.8	-1.4	-0.7	-0.7	-0.7
Merchandise trade balance	-3.2	-4.1	-5.9	-3.9	-4.6	-5.7	-4.9	-4.8	-4.8	-4.8
Exports	44.3	48.4	54.9	46.1	45.2	44.9	44.7	44.7	44.7	44.8
Imports	47.4	52.5	60.9	50.0	49.8	50.6	49.6	49.4	49.5	49.6
Capital account balance	1.4	0.7	0.9	1.6	2.9	2.7	2.4	3.0	3.0	3.1
Foreign direct investment balance	-4.5	-1.8	-2.4	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3
Terms of trade (merchandise, percent change)	4.3	0.6	2.1	-1.0	-0.7	1.0	0.5	0.2	0.1	0.0
Exports of goods (volume, growth rate)	-4.4	7.9	8.8	-4.1	3.5	3.7	3.4	3.1	3.0	2.9
Imports of goods (volume, growth rate)	-2.9	9.9	13.5	-7.1	2.8	2.8	3.3	3.0	3.1	2.9
Exports of goods (prices, growth rate)	-2.0	16.9	26.0	-4.1	0.7	2.0	1.5	1.8	2.0	2.2
Imports of goods (prices, growth rate)	-6.0	16.2	23.4	-3.2	1.4	0.9	1.0	1.5	1.9	2.1
Net international investment position	-25.6	-18.6	-12.9	-7.6	-5.2	-4.2	0.0	-30.2	-25.6	-18.6
GDP (billions of euro)	61.6	71.1	85.8	93.9	100.0	106.5	112.3	117.9	123.8	129.8

Sources: Bulgarian authorities; and IMF staff estimates.

Table 4a. Bulgaria: General Government Operations, 2020–29[1/]

(Billions of leva, unless otherwise indicated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections					
Revenue	42.0	49.7	61.9	63.7	71.1	75.5	78.3	82.3	86.3	90.4
Taxes	24.8	28.6	33.0	36.7	40.1	43.0	45.4	47.7	50.0	52.4
Taxes on profits	2.7	3.4	4.6	5.0	5.7	6.1	6.4	6.8	7.1	7.4
Taxes on income	4.2	4.9	5.3	6.2	6.8	7.1	7.3	7.5	7.8	8.0
Value-added taxes	11.0	13.0	15.3	16.2	18.0	19.7	20.8	22.0	23.2	24.4
Excises	5.4	5.7	5.7	6.1	7.2	7.7	8.1	8.5	8.9	9.3
Customs duties	0.2	0.3	0.5	0.3	0.3	0.4	0.4	0.4	0.4	0.4
Other taxes	1.2	1.5	1.6	2.8	2.1	2.2	2.3	2.5	2.6	2.7
Social contributions	8.7	9.6	10.9	12.3	13.8	14.8	15.7	16.5	17.3	18.1
Grants	2.7	3.5	6.0	3.8	7.1	6.7	5.6	5.9	6.1	6.4
Other revenue 2/	5.8	8.0	12.0	10.9	10.0	11.0	11.6	12.2	12.8	13.5
Expenditure	45.6	53.7	63.2	69.3	76.4	81.7	85.7	88.5	92.9	97.2
Expense	40.3	48.3	57.3	59.9	66.2	70.7	75.3	78.8	82.7	86.7
Compensation of employees	9.0	10.4	11.6	13.7	14.1	14.7	15.2	16.0	16.8	17.6
Wages and salaries	7.6	8.7	9.6	11.3	12.5	13.1	13.6	14.3	15.0	15.7
Other compensation	1.4	1.7	2.0	2.4	1.6	1.6	1.7	1.7	1.8	1.9
Use of goods and services	5.1	5.1	7.1	7.2	8.1	7.8	8.1	8.5	8.9	9.3
Interest	0.6	0.6	0.7	0.8	1.0	1.5	2.3	2.4	2.5	2.6
External	0.4	0.5	0.5	0.7	0.9	1.2	1.7	1.6	1.6	1.6
Domestic	0.2	0.1	0.2	0.1	0.2	0.3	0.6	0.7	0.8	1.0
Subsidies	5.1	7.3	10.5	6.2	6.1	6.7	7.1	7.3	7.6	8.0
Grants 3/	1.3	1.7	1.7	1.8	2.3	2.1	2.3	2.4	2.5	2.6
Social benefits	19.0	22.9	25.5	29.7	34.4	37.7	40.1	42.1	44.1	46.2
Pensions	11.2	14.3	15.7	19.2	21.2	23.4	25.0	26.2	27.5	28.8
Social assistance	3.5	3.6	4.1	4.1	5.6	5.8	5.9	6.2	6.5	6.8
Health Insurance Fund	4.3	5.0	5.6	6.4	7.6	8.5	9.2	9.6	10.1	10.6
Other expense	0.2	0.3	0.3	0.4	0.2	0.3	0.3	0.3	0.3	0.3
Contingency	0.2	1.6	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.5
Net acquisition of nonfinancial assets 4/	5.0	3.7	5.5	9.0	9.8	10.5	10.0	9.2	9.7	9.9
Net lending/borrowing	-3.5	-3.9	-1.3	-5.6	-5.4	-6.2	-7.5	-6.3	-6.6	-6.8
Primary balance	-2.9	-3.3	-0.7	-4.8	-4.3	-4.6	-5.2	-3.9	-4.1	-4.1
Financing	3.5	3.9	1.3	5.6	5.4	6.2	7.5	6.3	6.6	6.8
Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net external financing	5.7	0.7	2.5	4.6	2.6	5.8	6.7	4.7	4.9	5.0
Net domestic financing	0.2	1.7	-0.2	1.4	2.7	0.3	0.5	1.6	1.6	1.7
Net lending and other items	-2.4	0.2	-3.4	1.3	0.0	0.1	0.2	0.0	0.1	0.1
Memorandum items:										
Fiscal reserve account	8.5	9.7	12.1	10.4	10.4	10.4	10.4	10.4	10.4	10.4
Gross public debt	27.5	31.2	36.1	40.5	45.9	51.9	59.2	65.4	72.0	78.6
Nominal GDP (percent change)	0.1	15.3	20.7	9.5	6.5	6.5	5.4	5.0	5.0	4.9
Real GDP (percent change)	-4.0	7.7	3.9	1.8	2.7	2.9	2.9	2.7	2.7	2.6
HICP inflation (percent change)	1.2	2.8	13.0	8.6	3.2	2.7	2.1	2.0	2.0	2.0
Nominal private consumption (percent change)	-1.2	15.0	20.6	12.7	8.1	6.3	5.9	5.8	5.2	5.2
Nominal imports (percent change)	-10.7	26.8	39.8	-8.1	5.9	7.5	3.6	4.6	5.1	5.1

Sources: Ministry of Finance; and IMF staff estimates.

1/ On cash basis. The data correspond to the Consolidated Fiscal Program of the government.

2/ Includes dividends. For 2021, it includes the Sofia Airport concession revenue BGN 660 million.

3/ Contribution to EU budget.

4/ Includes only acquisitions of nonfinancial assets, i.e., capital expenditure. For 2021, includes concession revenue BGN 660 million for the Sofia Airport.

Table 4b. Bulgaria: General Government Operations, 2020–29[1/]

(Percent of GDP, unless otherwise indicated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
							Projections			
Revenue	34.9	35.8	36.9	34.7	36.3	36.3	35.7	35.7	35.6	35.6
Taxes	20.6	20.6	19.7	20.0	20.5	20.7	20.7	20.7	20.6	20.6
Taxes on profits	2.3	2.5	2.7	2.7	2.9	2.9	2.9	2.9	2.9	2.9
Taxes on income	3.5	3.5	3.2	3.4	3.5	3.4	3.3	3.3	3.2	3.2
Value-added taxes	9.1	9.3	9.1	8.8	9.2	9.5	9.5	9.6	9.6	9.6
Excises	4.5	4.1	3.4	3.3	3.7	3.7	3.7	3.7	3.7	3.7
Customs duties	0.2	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other taxes	1.0	1.1	1.0	1.5	1.1	1.1	1.1	1.1	1.1	1.1
Social contributions	7.2	6.9	6.5	6.7	7.1	7.1	7.1	7.2	7.1	7.1
Grants	2.2	2.5	3.6	2.1	3.6	3.2	2.5	2.5	2.5	2.5
Other revenue 2/	4.8	5.8	7.1	5.9	5.1	5.3	5.3	5.3	5.3	5.3
Expenditure	37.8	38.6	37.7	37.7	39.1	39.2	39.0	38.4	38.4	38.3
Expense	33.5	34.8	34.2	32.6	33.9	34.0	34.3	34.2	34.2	34.2
Compensation of employees	7.4	7.5	6.9	7.4	7.2	7.0	6.9	6.9	6.9	7.0
Wages and salaries	6.3	6.2	5.7	6.2	6.4	6.3	6.2	6.2	6.2	6.2
Other compensation	1.2	1.2	1.2	1.3	0.8	0.8	0.8	0.8	0.8	0.8
Use of goods and services	4.2	3.7	4.2	3.9	4.1	3.7	3.7	3.7	3.7	3.7
Interest	0.5	0.5	0.4	0.5	0.5	0.7	1.0	1.0	1.0	1.0
External	0.4	0.4	0.3	0.4	0.4	0.6	0.8	0.7	0.7	0.6
Domestic	0.2	0.1	0.1	0.1	0.1	0.2	0.3	0.3	0.3	0.4
Subsidies	4.2	5.3	6.3	3.4	3.1	3.2	3.3	3.2	3.2	3.2
Grants 3/	1.1	1.2	1.0	1.0	1.2	1.0	1.0	1.0	1.0	1.0
Social benefits	15.8	16.5	15.2	16.2	17.6	18.1	18.3	18.2	18.2	18.2
Pensions	9.3	10.3	9.4	10.5	10.9	11.2	11.4	11.4	11.4	11.3
Social assistance	2.9	2.6	2.5	2.2	2.8	2.8	2.7	2.7	2.7	2.7
Health Insurance Fund	3.6	3.6	3.4	3.5	3.9	4.1	4.2	4.2	4.2	4.2
Other expense	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Contingency	0.2	1.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Net acquisition of nonfinancial assets 4/	4.2	2.7	3.3	4.9	5.0	5.1	4.6	4.0	4.0	3.9
Net lending/borrowing	-2.9	-2.8	-0.8	-3.1	-2.7	-3.0	-3.4	-2.7	-2.7	-2.7
Primary balance	-2.4	-2.4	-0.4	-2.6	-2.2	-2.2	-2.4	-1.7	-1.7	-1.6
Financing	2.9	2.8	0.8	3.1	2.7	3.0	3.4	2.7	2.7	2.7
Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net external financing	4.8	0.5	1.5	2.5	1.3	2.8	3.1	2.0	2.0	2.0
Net domestic financing	0.2	1.3	-0.1	0.8	1.4	0.1	0.2	0.7	0.7	0.7
Net lending and other items	-2.0	0.2	-2.0	0.7	0.0	0.0	0.1	0.0	0.0	0.0
Memorandum items:										
Gross public debt	22.8	22.5	21.5	22.0	23.4	24.9	27.0	28.4	29.7	31.0
Output gap (percent of potential GDP)	-4.0	0.5	1.4	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Nominal GDP (billions of leva)	120.5	139.0	167.8	183.7	195.6	208.3	219.6	230.6	242.2	253.9
CAPB ex. grants (percent of potential GDP)	-2.1	-3.8	-3.5	-3.5	-4.7	-4.4	-3.9	-3.4	-3.4	-3.3

Sources: Ministry of Finance; and IMF staff estimates.

1/ On cash basis. The data correspond to the Consolidated Fiscal Program of the government.

2/ Includes dividends. For 2021, it includes the Sofia Airport concession revenue BGN 660 million.

3/ Contribution to EU budget.

4/ Includes only acquisitions of nonfinancial assets, i.e., capital expenditure. For 2021, includes concession revenue BGN 660 million for the Sofia Airport.

Table 5. Bulgaria: Monetary Accounts, 2020–29[1/]

(Billions of leva, unless otherwise indicated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections					
Monetary Survey										
Net foreign assets	66.6	71.3	82.7	87.3	95.6	103.2	109.3	118.8	129.1	140.2
Net domestic assets	69.7	78.5	84.4	97.8	111.9	126.2	140.2	153.0	165.7	178.6
Domestic credit	70.3	78.7	84.5	96.8	110.9	125.2	139.2	152.1	164.8	177.8
General government	2.8	5.2	1.8	4.0	9.4	15.5	22.7	29.0	35.5	42.2
Non-government	67.5	73.5	82.6	92.7	101.5	109.7	116.5	123.2	129.3	135.6
Broad money (M3)	113.6	125.8	142.4	154.8	167.2	179.6	192.2	205.5	219.2	233.6
Currency outside banks	19.3	22.4	25.0	27.1	29.4	30.7	35.3	40.7	46.1	52.2
Reserve money	43.8	47.8	53.1	59.1	63.3	66.7	72.5	79.0	85.6	92.7
Deposits 2/	94.3	103.4	117.4	127.6	137.8	148.8	156.9	164.8	173.0	181.4
Accounts of the Bulgarian National Bank										
Net foreign assets	58.8	63.8	71.1	78.0	86.2	94.1	100.2	109.7	120.0	131.1
Net foreign reserves (billions of euro)	30.0	32.6	36.4	39.9	44.1	48.1	51.2	56.1	61.3	67.0
Net domestic assets	-9.9	-11.1	-13.1	-12.1	-9.5	-9.3	-8.8	-7.3	-5.7	-4.1
Net claims on government	-8.3	-8.8	-11.6	-10.6	-7.8	-7.6	-7.0	-5.5	-3.8	-2.2
Base money	43.8	47.8	53.1	59.1	63.3	66.7	72.5	79.0	85.6	92.7
Currency in circulation	19.3	22.4	25.0	27.1	29.4	30.7	35.3	40.7	46.1	52.2
Banks reserves	24.5	25.4	28.1	31.9	33.9	35.9	37.1	38.3	39.4	40.5
Deposit money banks										
Net foreign assets	7.9	7.4	11.6	9.3	9.4	9.1	9.1	9.2	9.2	9.1
Gross foreign assets	15.8	17.1	24.1	24.1	24.3	24.1	24.3	24.5	24.6	24.7
Gross foreign liabilities	8.0	9.7	12.5	14.8	14.9	15.0	15.2	15.3	15.4	15.6
Net domestic assets	78.5	87.7	96.4	108.9	120.2	134.2	147.6	158.9	169.9	181.2
Domestic credit	78.5	87.3	95.9	107.2	118.6	132.7	146.2	157.5	168.6	179.9
Memorandum items:				(Annual percentage change, unless otherwise indicated)						
Base money	34.9	9.1	11.1	11.3	7.1	5.4	8.7	9.0	8.3	8.4
Broad money	10.9	10.7	13.2	8.7	8.1	7.4	7.1	6.9	6.7	6.6
Domestic non-government credit	4.5	8.8	12.5	12.2	9.5	5.1	6.4	7.2	7.2	7.3
Domestic deposits	10.6	9.6	13.5	8.7	8.0	8.0	5.4	5.0	5.0	4.9
Domestic currency	8.0	13.8	13.3	12.2	8.2	47.6	5.4	5.0	5.0	4.8
Foreign currency	15.6	2.3	13.9	2.0	7.5	-78.4	6.0	5.5	5.5	5.4
Money multiplier (ratio)	2.6	2.6	2.7	2.6	2.6	2.7	2.7	2.6	2.6	2.5
Velocity (M3) (ratio)	1.1	1.1	1.2	1.2	1.2	1.2	1.1	1.1	1.1	1.1
GDP (billions of leva)	120.5	139.0	168	184	196	208	220	231	242	254

Sources: BNB and IMF.
1/ Due to the revocation of the banking license of KTB, the bank is
excluded as a reporting agent from the monetary statistics data
2/ Includes deposits at central bank.

Table 6. Bulgaria: Financial Soundness Indicators, 2016–23
(Percent)

	2016	2017	2018	2019	2020	2021	2022	2023			
								Q1	Q2	Q3	Q4
Core indicators											
Capital adequacy											
Capital to risk-weighted assets	22.2	22.1	20.4	20.2	22.7	22.6	21.0	21.4	21.7	22.1	21.6
Tier 1 capital to risk-weighted assets	20.9	20.9	19.4	19.5	22.1	22.0	20.6	20.4	20.5	20.9	20.5
Asset quality											
Nonperforming loans to total gross loans	13.2	10.4	7.8	6.6	5.8	5.9	4.5	4.1	3.8	3.8	3.6
Nonperforming loans net of provisions to capital	44.7	36.6	28.2	23.9	20.8	16.5	14.3	12.4	11.8	11.3	10.7
Large exposures to capital	61.7	61.0	80.8	91.7	58.6	69.4	74.1				
Earnings and profitability											
Return on assets	1.4	1.2	1.6	1.5	0.7	1.2	1.6	2.1	2.3	2.5	2.3
Return on equity 1/	10.4	9.3	11.8	11.3	5.2	8.5	12.3	17.7	18.9	19.7	18.2
Net interest income to gross income	69.2	69.4	65.1	65.0	63.7	57.3	56.7	60.5	63.7	64.5	65.9
Noninterest expense to gross income	44.0	45.7	44.8	46.9	57.0	52.1	49.6	48.8	43.8	42.1	42.9
Personnel expense to total income	18.4	20.3	20.3	20.9	21.8	20.3	19.3	16.5	16.7	16.6	17.1
Liquidity											
Liquid assets to total assets	32.4	33.1	28.9	27.9	30.3	30.7	29.7	30.6	29.2	28.1	30.9
Liquid assets to short-term liabilities	41.0	41.5	35.8	33.9	36.3	39.0	38.6	40.0	37.8	35.9	39.3
Encouraged indicators											
Deposit-taking institutions											
Capital to assets 2/	11.6	11.4	10.8	11.6	11.9	11.1	9.9	9.8	10.2	10.4	10.0
Trading income to total income	10.3	2.3	8.9	8.1	4.5	5.5	4.6	4.7	4.7	4.7	4.4
Personnel expenses to noninterest expenses	41.7	44.5	45.2	44.5	38.2	38.9	38.9	33.9	38.2	39.4	39.9
Customer deposits to total (non-interbank) loans	134.7	138.8	139.2	139.2	144.7	139.1	141.1	139.9	135.5	134.9	136.2
Foreign currency denominated loans to total loans	32.0	26.7	25.2	24.5	23.4						

Sources: BNB; and IMF.
1/ Return on equity is calculated with Tier I capital as denominator.
2/ Capital to assets is based on Tier I capital.

Annex I. Public Debt Sustainability Analysis

Annex I. Figure 1. Bulgaria: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Low	The overall risk of sovereign stress is low, reflecting a relatively low level of vulnerability in the near-term and medium term. Public debt is the second lowest in the EU and is sustainable.
Near term 1/			
Medium term	Moderate	Low	Medium-term risks are mainly associated with an upward trend in debt, caused by the sustained deficit. However, the upper bound of debt in the fanchart simulation remains below 60 percent of GDP by 2030. Staff's assessment of the medium-term risks is low.
Fanchart	Moderate	...	
GFN	Low	...	
Stress test	...	...	
Long term	...	Moderate	Long-term risks are moderate as aging-related expenditures on health and social security feed into debt dynamics.
Sustainability assessment 2/	Not required for surveillance countries	....	Not required for surveillance countries
Debt stabilization in the baseline			No

DSA summary assessment

Commentary: Bulgaria is at a low overall risk of sovereign stress. Public debt is sustainable and is the second lowest in the EU. In the medium term, the persistent deficit putting debt on an upward trend can be a concern. Nevertheless, debt remains below 60 percent of GDP. Over the longer run, Bulgaria should continue with reforms, particularly on the revenue side, to tackle fiscal risks arising from population aging associated with pension deficit.

Source: IMF staff estimates and assessments

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Annex I. Figure 2. Bulgaria: Debt Coverage and Disclosures

1. Debt coverage in the DSA: 1/

CG	GG	NFPS	CPS	Other
	GG (chosen)			

1a. If central government, are non-central government entities insignificant? n.a.

2. Subsectors included in the chosen coverage in (1) above:

Sector grouping		Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	Not applicable
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	Yes	
CPS / NFPS / GG: expected	4	State governments	Yes	
CPS / NFPS / GG: expected	5	Local governments	Yes	
CPS / NFPS	6	Public nonfinancial corporations	No	
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	

3. Instrument coverage:

Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/
chosen coverage	chosen coverage	chosen coverage	Missing from recommended coverage	Missing from recommended coverage

4. Accounting principles:

Basis of recording		Valuation of debt stock		
Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/
	chosen	chosen		

5. Debt consolidation across sectors: Consolidated (chosen) | Non-consolidated

Color code: chosen coverage; Missing from recommended coverage; Not applicable

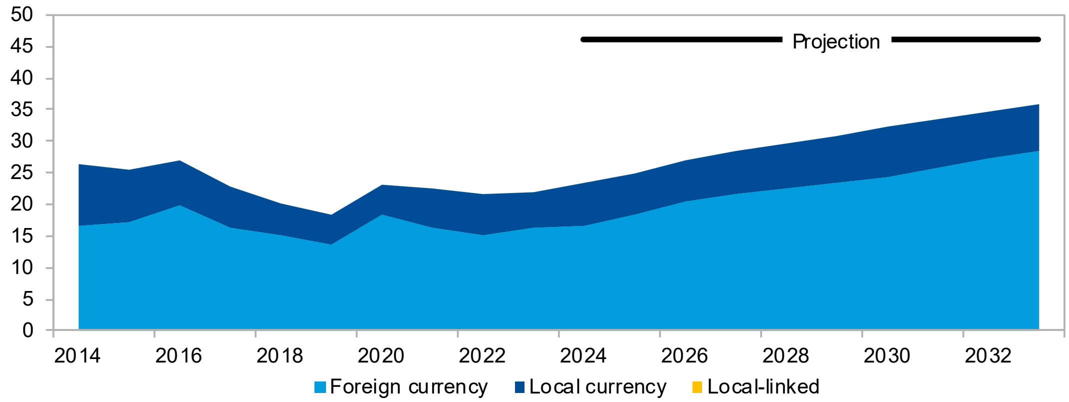
Reporting on Intra-Government Debt Holdings

Sector grouping		Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS / NFPS / GG: expected / CG	1	Budget. central govt									0
CPS / NFPS / GG: expected / CG	2	Extra-budget. funds									0
CPS / NFPS / GG: expected / CG	3	Social security funds									0
CPS / NFPS / GG: expected	4	State govt.									0
CPS / NFPS / GG: expected	5	Local govt.									0
CPS / NFPS	6	Nonfin pub. corp.									0
CPS	7	Central bank									0
CPS	8	Oth. pub. fin. corp									0
		Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

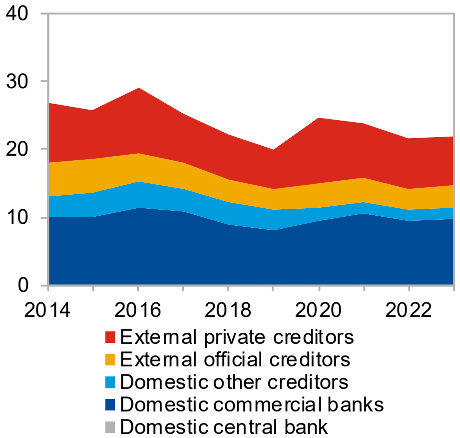
Annex I. Figure 3. Bulgaria: Public Debt Structure Indicators

Debt by currency (percent of GDP)



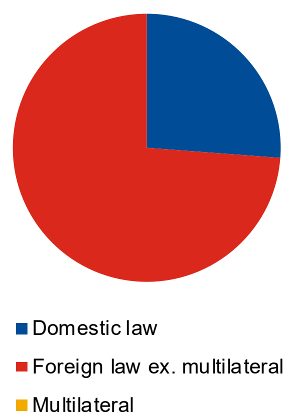
Note: The perimeter shown is general government.

Public Debt by Holder (Percent of GDP)



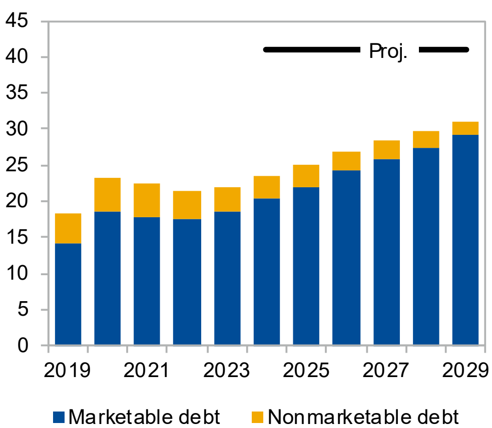
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (Percent)



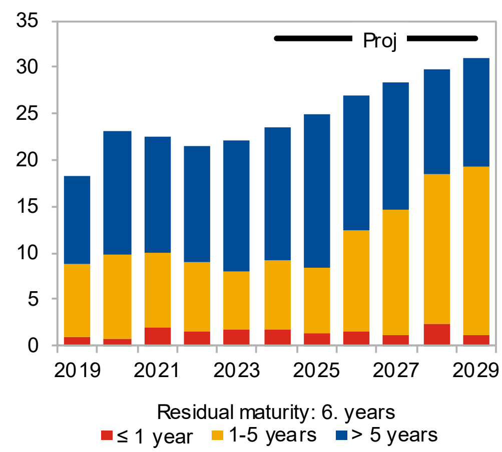
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)



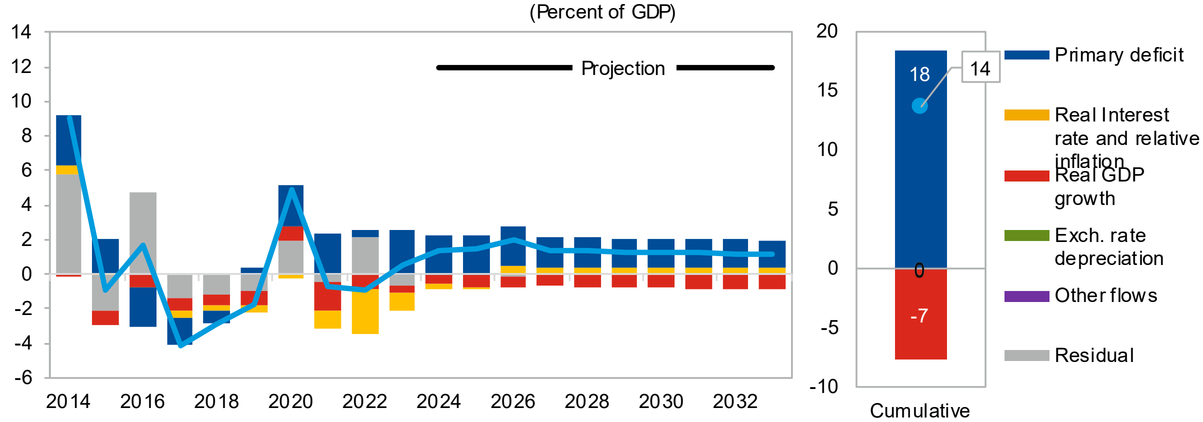
Note: The perimeter shown is general government.

Source: IMF staff estimates.

Annex I. Figure 4. Bulgaria: Baseline Scenario
(Percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	22.0	23.4	24.9	27.0	28.4	29.7	31.0	32.2	33.4	34.6	35.7
Change in public debt	0.5	1.4	1.5	2.0	1.4	1.4	1.2	1.2	1.2	1.2	1.1
Contribution of identified flows	1.2	1.4	1.5	2.1	1.4	1.4	1.3	1.2	1.2	1.1	1.1
Primary deficit	2.6	2.2	2.2	2.4	1.7	1.7	1.6	1.6	1.6	1.6	1.6
Noninterest revenues	34.7	36.3	36.3	35.7	35.7	35.6	35.6	35.6	35.6	35.6	35.6
Noninterest expenditures	37.3	38.5	38.5	38.0	37.4	37.3	37.2	37.2	37.2	37.2	37.2
Automatic debt dynamics	-1.4	-0.8	-0.7	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.5	-0.5
Real interest rate and relative inflation	-1.0	-0.2	0.0	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3
Real interest rate	-1.0	-0.2	0.0	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-0.4	-0.6	-0.7	-0.7	-0.7	-0.8	-0.7 .	-0.8	-0.8	-0.8	-0.9
Real exchange rate	0.0	…	…	…	…	…	… .	…	…	…	…
Other identified flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contribution of residual	-0.7	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	4.7	4.5	4.7	4.6	4.3	3.8	4.9	3.7	7.2	6.1	7.0
of which: debt service	2.1	2.3	2.5	2.3	2.6	2.1	3.3	2.1	5.6	4.5	5.4
Local currency	0.3	0.3	1.8	1.4	0.9	0.5	1.1	0.3	1.7	1.5	1.3
Foreign currency	1.8	2.0	0.7	0.9	1.7	1.6	2.1	1.8	3.8	3.0	4.2
Memo:											
Real GDP growth (percent)	1.8	2.7	2.9	2.9	2.7	2.7	2.6	2.6	2.6	2.6	2.6
Inflation (GDP deflator; percent)	7.5	3.6	3.4	2.4	2.3	2.2	2.2	2.2	2.2	2.2	2.2
Nominal GDP growth (percent)	9.5	6.5	6.5	5.4	5.0	5.0	4.9	4.9	4.9	4.9	4.9
Effective interest rate (percent)	2.3	2.5	3.3	4.3	4.0	3.8	3.6	3.5	3.5	3.3	3.2

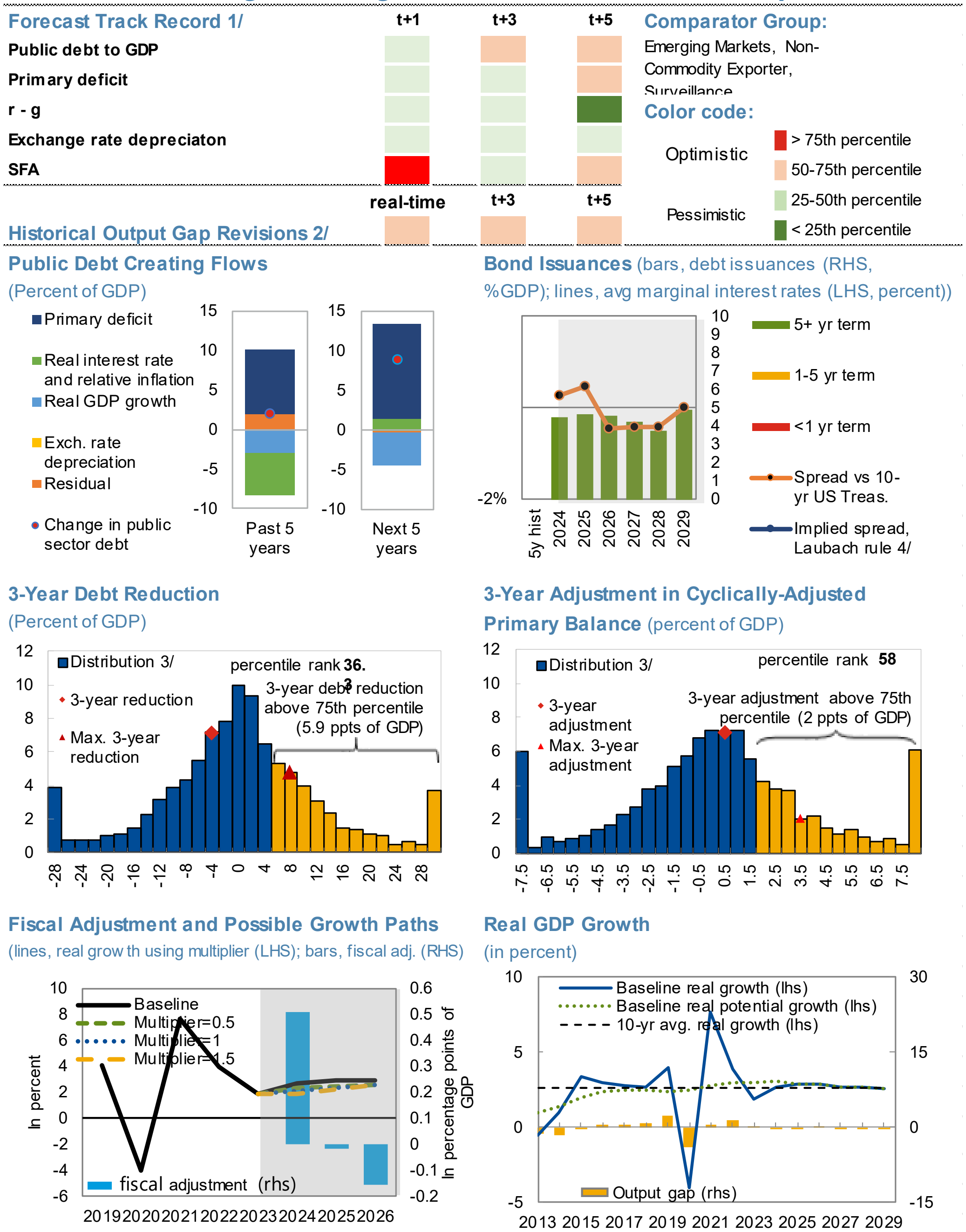
Contribution to Change in Public Debt
(Percent of GDP)



Source: IMF staff estimates.

Staff commentary: The projection assumes that under no policy changes, the deficit will sustain. This results in an increase in debt over time. Even in this case, debt remains below 60 percent of GDP.

Annex I. Figure 5. Bulgaria: Realism of Baseline Assumptions



Commentary: Realism analysis does not point to major concerns.

Source : IMF staff estimates.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates and final estimates in the latest October WEO) in the total distribution of revisions across the data sample.

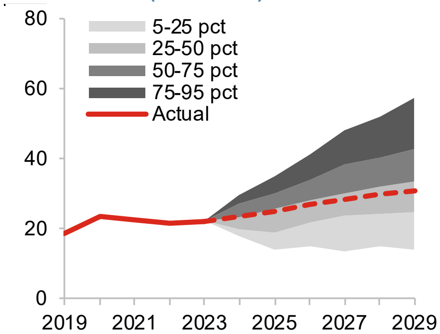
3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

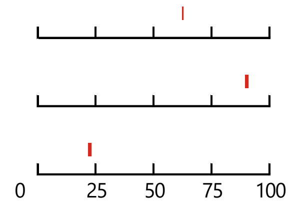
Annex I. Figure 6. Bulgaria: Medium-Term Risk Assessment

	Value	Contrib 1/	Percentile in peer group 2/

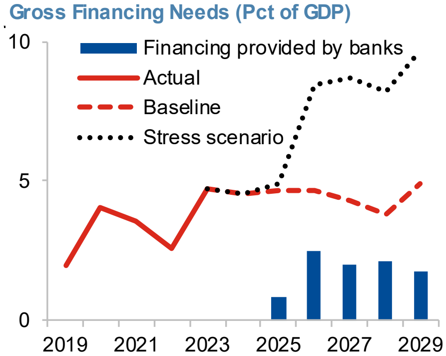
Final Fanchart (Pct of GDP)



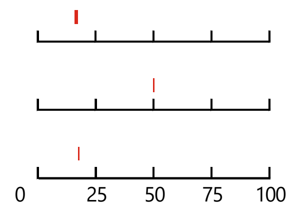
Debt Fanchart Module	Value	Contrib 1/
Fanchart width *(percent of GDP)*	43.5	0.6
Probability of debt non-stabilizaiton *(percent)*	99.9	0.8
Terminal debt-to-GDP x institutions index	18.6	0.4
Debt fanchart index (DFI)		1.9
Risk signal: 3/		Moderate



Gross Financing Needs (Pct of GDP)

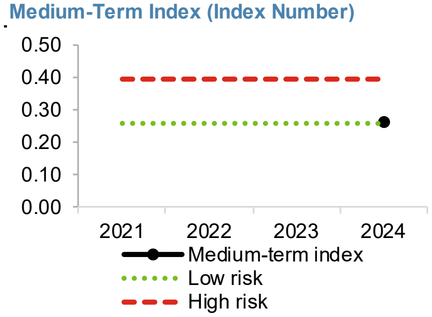


Gross Financing Needs (GFN) Module	Value	Contrib 1/
Average baseline GFN *(percent of GDP)*	4.5	1.5
Banks' claims on the ge govt *(pct bank assets)*	9.1	3.0
Chg. In banks' claims in stress *(pct banks' assets)*	4.0	1.3
GFN financeability index (GFI)		5.8
Risk signal: 4/		Low



Banking crisis Commodity prices Exchange rate Contingent liab. Natural disaster

Medium-Term Index (Index Number)



Medium-Term Risk Analysis

	Value	Value	Weight	Contribution
Debt fanchart index (normalized)	1.87	0.42	0.50	0.21
GFN finaceability index (normalized	5.80	0.11	0.50	0.06
Medium-term index		0.3		
Risk signal: 5/		Moderate		
Final assessment:		Low		

Prob. of missed crisis, 2024-2029, if stress not predicted: 18.2 pct.
Prob. of false alarms, 2024-2029, if stress predicted: 39.8 pct.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.

2/ The comparison group is emerging markets, non-commodity exporter, surveillance.

3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.

4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.

5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Annex II. External Sector Assessment

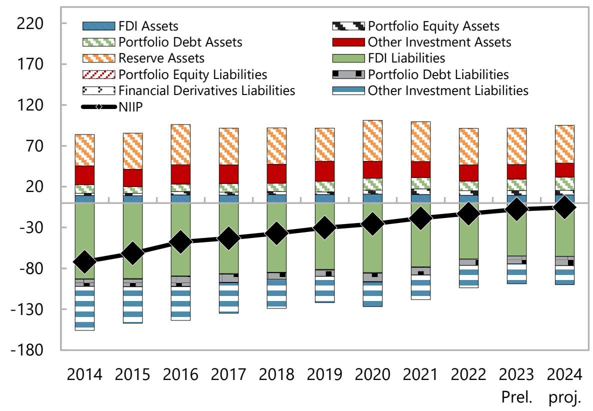
Overall Assessment: *Based on preliminary data, the external position in 2023 is assessed to be moderately stronger than implied by medium-term fundamentals and desirable policies. However, this assessment is subject to frequent and large data revisions. The current account is expected to record a small deficit over the projection period (except in 2025 due to the imports of military fighter jets).*

Potential Policy Responses: *Ensuring that the external position remains consistent with medium-term fundamentals will require structural policies to foster investment, raise Bulgaria's potential growth, facilitate its economic transformation, and ensure that the expected euro accession brings all the potential benefits. For that, it will be key to make effective and efficient use of EU funds, which are large but have been delayed.*

Foreign Assets and Liabilities: Position and Trajectory

Background. From a trough of -92 percent of GDP in 2010, the NIIP steadily improved to -7.6 percent in 2023. The main factors include the decrease in liabilities (other investment and FDI liabilities). Positive current account developments and sustained economic growth performance during most of the period have also contributed to the favorable NIIP trend.

Net International Investment Position
(Percent of GDP)



Assessment. The NIIP is projected to continue to improve and reach -5.2 percent of GDP by end-2024. Over the medium term, the NIIP-to-GDP ratio is expected to further improve and turn positive on account of faster increase of assets (notably portfolio assets and to a lesser extent reserve assets) than liabilities. Bulgaria's overall NIIP financing vulnerabilities appear low, as foreign direct investment accounts for a large share of the position.

2023 (% GDP)	NIIP	Gross Assets	Debt Assets	Gross Liabilities	Debt Liabilities
	-7.6	91.7	14.0	-99.4	-9.3

Current Account

Background. Bulgaria's external balance recorded sizable current account surpluses every year from 2013 to 2019. During the pandemic, the current account contracted sharply, posting a deficit of 1.7 percent of GDP in 2021 (down from a surplus of 1.9 percent of GDP in 2019). The deficit decreased to 1.4 percent of GDP in 2022 and preliminary data for 2023 point to a further reduction in the deficit to 0.3 percent of GDP mostly due to a larger decline in imports than in exports. Data uncertainty remains high, due to frequent and substantial revisions as documented in the 2019 Article IV. Preliminary errors and omissions are small by historical standards but subject to large changes.

Assessment. Staff estimates the 2023 cyclically-adjusted current account to be 2.0 percent of GDP higher than the norm (estimated at - 1.1 percent of GDP). Unidentified residuals are large, potentially reflecting other idiosyncratic factors not captured by the model. The assessment is also subject to high uncertainties related to underlying data issues.

Bulgaria: EBA-Lite Model Results, 2023

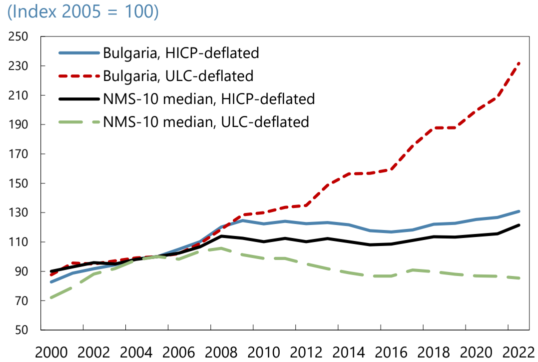
	CA model 1/	REER model 1/	ES model
	(in percent of GDP)		
CA-Actual	**-0.3**		
Cyclical contributions (from model) (-)	0.1		
Natural disasters and conflicts (-)	-1.2		
Adjusted CA	**0.9**		
CA Norm (from model) 2/	**-1.1**		
Adjustments to the norm (-)	0.0		
Adjusted CA Norm	**-1.1**		
CA Gap	**1.97**	**-3.5**	**2.8**
o/w Relative policy gap	4.2		
Elasticity	-0.4		
REER Gap (in percent)	**-4.4**	**8.0**	**-6.4**

1/ Based on the EBA-lite 3.0 methodology
2/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

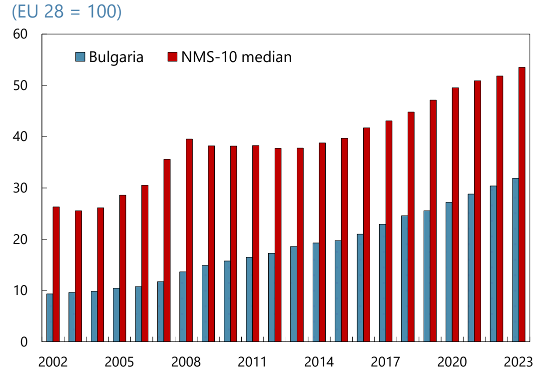
Background. With wage growth outpacing productivity growth by a wide margin in recent years, ULC-based REER has deviated from the CPI-based REER and appreciated significantly since 2009. This suggests that the CPI-based REER may underestimate the weakening of cost competitiveness, as Bulgarian firms have continued to report increasing labor shortages and needed to compete on offered remuneration. Nonetheless, Bulgaria's 2023 wage level was still substantially below the median NMS level and, though they have declined recently, corporate profits (measured by gross operating surplus) have grown faster than in most N MS. Bulgaria's share in merchandise exports continues to grow, but FDI inflows and participation in GVCs remain below pre-GFC levels.
Assessment. In line with the assessment implied by the current account model—while considering all estimates and uncertainties around them, staff assesses the 2023 REER gap in the -4.4 to 8.0 percent range. The EBA-Lite REER index model estimates a REER overvaluation of 9.7 percent. The REER gap derived from the IMF staff's CA gap assessment, with an estimated elasticity of -0.44, implies a REER undervaluation of 4.4 percent. The assessment is subject to high uncertainties related to underlying data issues.

Real Effective Exchange Rates
(Index 2005 = 100)



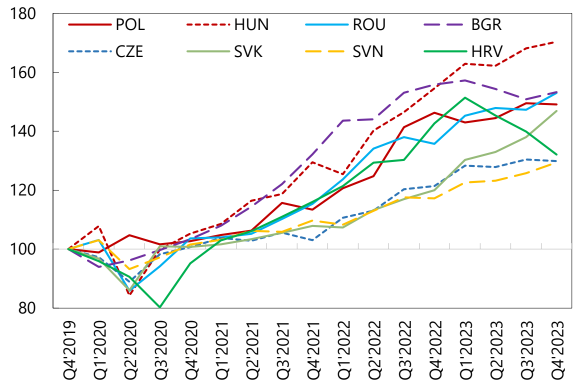
Sources: European Commission; and IMF staff calculations.

Nominal Compensation per Employee
(EU 28 = 100)



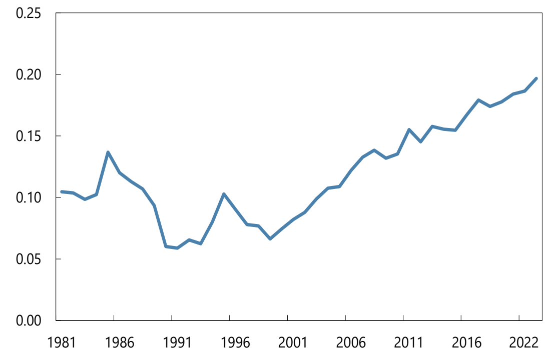
Sources: European Commission; and IMF staff calculations.

Gross Operating Surplus
(Index, Q4'2019=100)



Sources: Haver Analytics and IMF staff calculations.

Bulgaria's Share of World Export
(Percent, Merchandise trade)



Sources: International Monetary Fund/Haver Analytics.

Capital and Financial Accounts: Flows and Policy Measures

Background. Bulgaria's gross external-debt-to-GDP ratio declined continuously during the last decade. The rebound during the pandemic was limited (as the increase in external public debt ratio was largely offset by the continued decline in private external debt ratio) and short-lived. In 2023, the ratio is about half the size of its level of 2013. Based on preliminary BOP data, Bulgaria is projected to experience a net financial balance of – 2.3 percent of GDP driven by growing net inflow of FDI (- 3.3 percent of GDP).

Authorities' Planned Public External Borrowing and Amortization

		2023	2024	2025	2026	2027	2028	2029
			Projections					
Amortization	Millions of Euros	2,648	3,117	261	256	2,259	2,232	3,771
	Percent of GDP	2.8	3.0	0.3	0.2	2.2	2.2	3.7
Borrowing 1/	Millions of Euros	7,277	7,843	8,312	9,114	n.a.	n.a.	n.a.
	Percent of GDP	7.6	7.7	8.1	8.9	n.a.	n.a.	n.a.

Source: Ministry of Finance and IMF Staff calculations,
1/ No Short-term borrowing,

Assessment. The high share of long-term debt in total gross external debt (81.6 percent as of end-2023) has reduced the economy's vulnerability to potential volatility of international capital flows. The service of external obligations by Bulgarian residents is rising but expected to remain favorable. The amortization of public external debt in 2024 has been secured by borrowing in 2023 and will decline significantly in 2025 and 2026. The external-debt-to-GDP ratio is projected to decline over the projection period as the increase in nominal terms (driven by the planned increase in public borrowing) is expected to be smaller than the nominal GDP growth.

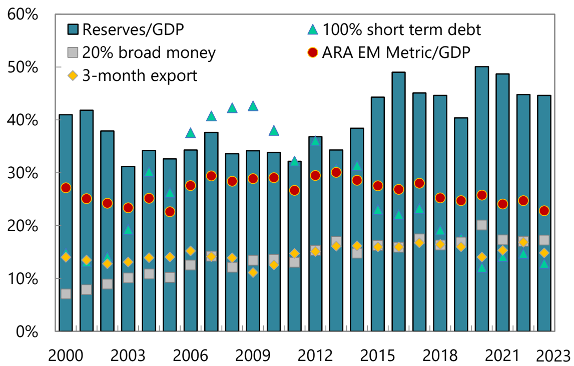
FX Intervention and Reserves Level

Background. Gross international reserves reached EUR 41.9 bn at end 2023 (44½ percent of GDP), up from EUR 38.4 bn at end 2022.

Assessment. Foreign exchange reserves are assessed to be adequate under a currency board arrangement.[1] Available FX reserves are expected to exceed the upper bound of the IMF metric's suggested adequacy range and the coverage ratio required for the functioning of the currency board, while remaining well above traditional metrics.

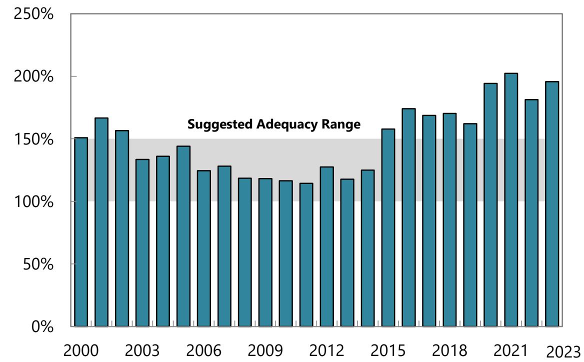
[1] Under a currency board regime, reserves are required to cover currency in circulation, liabilities to banks, the government, and other depositors

Gross International Reserves vs. Traditional Metrics
(Percent of GDP)



Sources: IMF, WEO, and IMF staff calculations.

Reserves as Percent of Metric
(Percent of risk-weighted metric)



Sources: IMF, WEO, and IMF staff calculations.

Annex III. Risk Assessment Matrix[1]

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
External Risks				
Intensification of regional conflicts. Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	High	ST	Medium An escalation of conflicts would affect the economy mainly via indirect spillovers, through lower external demand from Europe. Direct energy and trade links with Russia and Ukraine have decreased and financial links are extremely low. Disruptions of commodity trade would rekindle inflation from higher commodity prices.	Fiscal stimulus and well-targeted, temporary support for groups most vulnerable to lower growth and higher inflation.
Commodity price volatility. A succession of supply disruptions (e.g., due to conflicts, export restrictions, and OPEC+ decisions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability.	High	ST, MT	Medium Commodities have a large weight in the CPI basket and a sharp rise in their price would trigger a substantial increase in inflation. Adverse terms of trade shock would weaken the external position.	Targeted and temporary support for the most vulnerable groups should be offset to avoid a larger fiscal deficit that further fuels inflationary pressures.
Abrupt global slowdown. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market	Medium	ST, MT	High A sharp downturn in key trading partners would dampen economic growth and weaken external position. Supply disruptions could increase again commodity prices and reignite inflationary	With a low external debt, a fiscal stimulus and targeted support for the most vulnerable groups would be possible provided that the access to international financial markets is secured and inflation is not a renewed concern. Preemptively

[1] The risk assessment matrix shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenario highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
fragmentation causing sudden stops in EMDEs. **Europe:** Intensifying fallout from the war in Ukraine, supply disruptions, tight financial conditions, and real estate market corrections delay the economic downturn.			pressures. A steep correction of the real estate price may weaken the financial sector.	reduce emerging real estate risks for the financial system and deploy available capital buffers to absorb credit losses.
Monetary policy miscalibration. Amid high economic uncertainty, major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets and weakening the credibility of central banks.	**Medium**	**ST, MT**	**Medium** Disinflation would be more difficult to achieve.	Under the currency board, the monetary policy setting is beyond the direct control of the BNB. Breaking the effects of a wage-price spiral would require discretionary fiscal tightening and a consensus on multi-year wage restraint.
Systemic financial instability. High interest rates and risk premia and asset repricing amid economic slowdown and political uncertainty (e.g., from elections in major advanced economies) trigger market dislocations, with cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks.	**Medium**	**ST, MT**	**Medium** NPLs and default rates may increase, possibly generating financial strains.	With a large share of the banking sector being foreign owned, the BNB should increase monitoring, strengthen macroprudential policy for ex-ante risk prevention, and ensure a well-functioning financial crisis management framework.
Bulgaria-Specific Risks				
Political uncertainty. Lack of a stable government after the parliamentary election of June 9th that prolongs the yearslong political instability in the country.	**High**	**ST**	**High** Political stalemate hampers policy making, and a protracted period of uncertainty undermines confidence. Insufficient progress in reforms delay NGEU grants delivery.	Seek to build up a consensus on critical policies that may allow the formation of a ruling government and accelerate reforms necessary for EU Fund disbursements.
Longer delay in euro adoption if renewed inflationary pressures make meeting the inflation criterion more difficult.	**High**	**ST,MT**	**Medium** Further postponement may negatively affect economic sentiment and weaken domestic demand.	Adjust the communication strategy to reiterate the goal of joining the euro and conduct a fiscal policy consistent with reducing demand pressures.

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
Continued elevated credit growth could affect the financial sector.	High	**ST**	**Medium** Credit growth persisting at elevated levels could deteriorate asset quality and engender a house prices-mortgage credit spiral.	Consider further increase in the CCyB and strength the macroprudential framework by introducing borrower-based measures to help uphold asset quality.

Annex IV. Main Recommendations of the 2022 Article IV Consultation and Authorities' Actions

IMF 2022 Article IV Recommendations	Policy Actions
Fiscal Policy	
Existing subsidies to companies and price caps should be gradually shifted to direct support to vulnerable households.	The 2024 budget preserves the subsidy for the business justifying it by the need to keep inflation in check.
The reduction in VAT rates should be discontinued, as the measure is regressive and no longer needed.	VAT rate reduction is gradually discontinued. Some of the reduced rates remain in place but the authorities planned to eliminate them by mid-year (tourist services and sport facilities as well as flour and bread) while other reduced rate were extended till end 2024 (restaurants and hotels).
The planned medium-term fiscal consolidation [...] should be accompanied by expenditure and revenue-management reforms. [....] Increase the efficiency of public spending and reviewing taxation to increase revenue and redistribution.	The authorities received IMF technical assistance for the reform of the revenue administration, but the implementation of recommendations was delayed by political situation. Bulgaria benefitted from Tax Administration Diagnostic Assessment Tool reports (TADAT). No other fiscal reform progressed.
Structural Reforms	
A holistic review of the pension system would help design reforms that target both its sustainability and an adequate level of pensions.	No holistic review was undertaken.
Steadfast efforts to improve the effectiveness of the judicial and anticorruption systems are essential to strengthen the rule of law.	Several reforms have been initiated as described in paragraphs 26 and 27 of this report.
Financial Sector Policies	
Continue to monitor asset quality and ensure that banks proactively manage risks and maintain strong capital positions.	The BNB increased the CCyB to 2 percent from October 2023 to help reduce liquidity in the banking system and bolster buffers. The BNB is monitoring the rapid credit growth. It considers that home valuation is still moderate, borrowers' indebtedness is low, banks' credit standards remain high, and capital buffers are ample.

Annex V. Data Issues

Table 1. Bulgaria: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/

A							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	A	A	A	A	A	B	A
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	A	A	B	A	A		
Granularity 3/	B		A	A	B		
			A		A		
Consistency			A	C		B	
Frequency and Timeliness	A	A	A	A	A		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance* , January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Limited data weaknesses does not affect staff's analysis of macroeconomic and financial risks. However, the frequent and large revisions of the BOP and large errors and omissions require caution in the analysis and limit the relevance of the EBA assessment.

Changes since the last Article IV consultation. No change since the last Article IV consultation.

Corrective actions and capacity development priorities. The data provided to the Fund is adequate for surveillance. Regarding the coverage of GFS, more detailed information on the budgetary flows between budget and SOEs would help identify and monitor fiscal risks.

Use of data and/or estimates different from official statistics in the Article IV consultation. N.A.

Other data gaps. N.A.

Table 2. Bulgaria: Data Standards Initiatives

Bulgaria adheres to the Special Data Dissemination Standard (SDDS) Plus since May 2016 and publishes the data on its National Summary Data Page. The latest SDDS Plus Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

Table 3. Bulgaria: Table of Common Indicators Required for Surveillance

As of April 15, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Bulgaria	Expected Timeliness[6,7]	Bulgaria
Exchange Rates	15-Apr-24	15-Apr-24	D	D	D	...	...	...
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Apr-24	Mar-24	M	M	M	M	1W	1W
Reserve/Base Money	Feb-24	Mar-24	M	M	M	M	2W	2W
Broad Money	Feb-24	Mar-24	M	M	M	M	1M	NLT 1M
Central Bank Balance Sheet	Feb-24	Mar-24	M	M	M	M	2W	2W
Consolidated Balance Sheet of the Banking System	Feb-24	Mar-24	M	M	M	M	1M	NLT 1M
Interest Rates[2]	15-Apr-24	15-Apr-24	D	D	D	...	...	...
Consumer Price Index (HICP)	Mar-24	Apr-24	M	M	M	M	1M	NLT 2W
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	Feb-24	Mar-24	M	M	A/Q	Q	2Q/12M	4M
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Feb-24	Mar-24	M	M	M	M	1M	1M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Feb-24	Mar-24	M	M	Q	Q	1Q	1Q
External Current Account Balance	Jan-24	Mar-24	M	M	Q	M	1Q	7W
Exports and Imports of Goods and Services	Jan-24	Mar-24	M	M	M	M	8W	6W
GDP/GNP	Dec-23	Mar-24	Q	Q	Q	Q	1Q	NLT 90D
Gross External Debt	Jan-24	Mar-24	M	M	Q	M	1Q	2M
International Investment Position	Dec-23	Mar-24	Q	Q	Q	Q	1Q	3M

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("I") irregular; and ("NA") not available.
[7] Recommended frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected.