INTERNATIONAL MONETARY FUND

January 2014
IMF Country Report No. 14/23

BULGARIA

2013 ARTICLE IV CONSULTATION

January 30, 2014

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 2013 Article IV consultation with Bulgaria, the following documents have been released and are included in this package:

- The **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF for Executive Board's consideration on January 24, 2014, following discussions that ended on November 14, 2013, 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 December 23, 2013.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** summarizing the views of the Executive Board as expressed during its January 24, 2014 consideration of the staff report that concluded the Article IV Consultation with Bulgaria.
- A **Statement by the Executive Director** for Bulgaria.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

BULGARIA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

December 23, 2013

KEY ISSUES

Context. Macroeconomic and financial stability has been maintained despite the difficult environment globally—especially in neighboring Greece—and recent domestic discord, but growth remains tepid and unemployment high. Ambitious (and politically challenging) reforms are needed to achieve Bulgaria's objective of more rapid income convergence with Europe.

Outlook and risks. Domestic demand is projected to recover gradually while exports and foreign direct investment are expected to benefit from recovery in Europe. The domestic social and political situation and continued uncertainty about the outlook for external partners present downside risks.

Fiscal policy. The unchanged structural stance under the 2014 budget, which sets the deficit close to national fiscal limits, strikes an appropriate balance given low projected growth and a strong underlying fiscal position on the one hand and the importance of maintaining fiscal credibility (particularly in the context of the currency board) on the other. The budget is subject to implementation risk, especially as revenues may fall short of target. The intended increase in capital spending should be accompanied by appropriate project selection and monitoring procedures. Medium-term risks—in particular related to pensions and state-owned enterprises—will need to be addressed.

Financial sector policies. The financial system remains well-capitalized and liquid, but profitability is low. Gradual reduction of nonperforming loans through asset disposal will be important to reduce asset price uncertainty and support future investment.

Structural policies. Progress in addressing institutional and broader structural gaps (including those that contribute to corruption and cronyism) is needed to set the foundation for stronger growth and job creation.

Previous IMF advice. Policy implementation has generally been consistent with IMF recommendations. Prudent fiscal and supervisory policies have been pursued, allowing macroeconomic and financial stability to be maintained. However, recent reforms to strengthen the sustainability of the pension system have been reversed, and the bold structural reforms needed to accelerate growth require new momentum.

Approved By
Philip Gerson (EUR) and Vivek Arora (SPR)

Discussions were held in Sofia during November 6–14, 2013. The staff team comprised Ms. Shannon (head), Messrs. Lakwijk and Gracia (all EUR), Ms. Weber (FAD), Mr. Quill (MCM), and Mr. Tolosa (Resident Representative), and Ms. Paliova (Resident Representative Office, Economist), with research assistance from headquarters by Mr. Peterson and administrative assistance by Ms. Mahadewa. Mr. Manchev (OED) participated in the discussions. The mission met with Finance Minister Chobanov, Bulgarian National Bank Governor Iskrov, other senior officials, financial sector and industry representatives, labor unions, and civil society organizations. A press conference concluded the visit.

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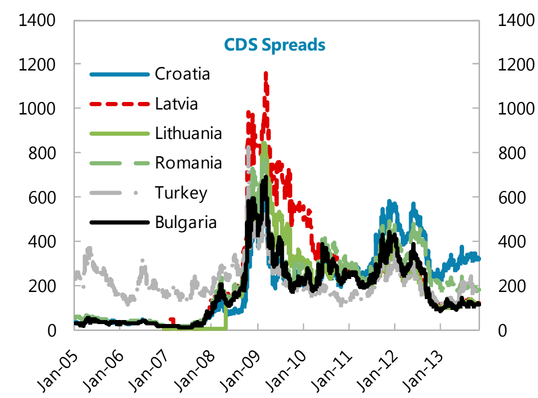
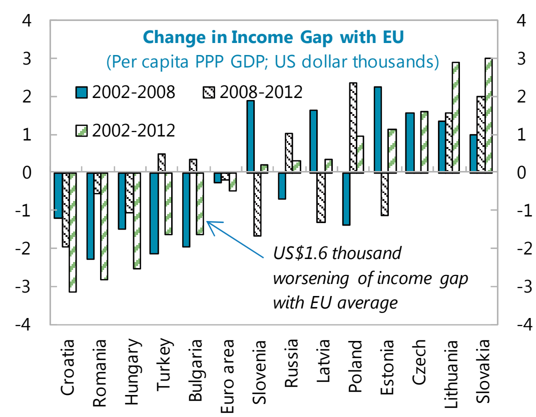
APPENDIX

CONTEXT: A NEED FOR GROWTH

1. Bulgaria has effectively pursued policies to support macroeconomic and financial stability for over a decade, but income convergence with the European Union (EU) has been slow. The stabilization policies established in the second half of the 1990s and firmly implemented since have insulated Bulgaria well against shocks from the global financial crisis, turmoil in neighboring Greece, and recent domestic discord. However, Bulgaria remains the poorest EU member, with income levels about half the EU average. While this marks an improvement in relative terms (up from one-third in 2002), using WEO data the gap in absolute incomes has widened over the last decade.



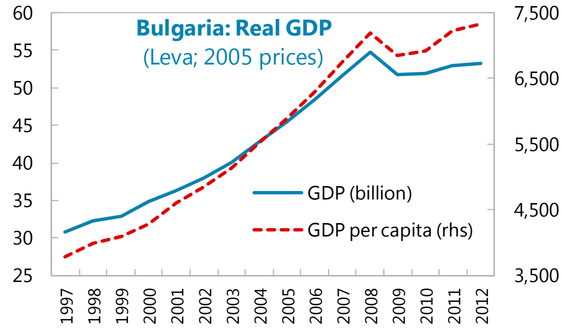


2. The current year has been marked by social and political turbulence. Underlying concerns include the still fragile recovery, high unemployment, significant poverty, and perceptions of widespread corruption and cronyism. In February, the right-of-center government resigned following street protests sparked by high electricity bills. Following elections, a left-of-center coalition was formed in May holding just half of the parliamentary seats, and the government has faced new protests prompted by a controversial appointment this summer.

3. More ambitious and politically challenging reforms will be needed for Bulgaria to increase the pace of convergence to European income levels. The authorities have rightly emphasized the need to safeguard stability while developing a new paradigm for growth and job creation that does not depend on the extraordinary inflows that characterized the pre-crisis period. Adverse demographic changes, accelerated by emigration, add to the challenge. Progress will require addressing long-standing institutional and broader structural rigidities to enhance domestic competition, reinforce the rule of law, address infrastructure gaps, and strengthen human capital.

BACKGROUND: LITTLE GROWTH MOMENTUM BUT SOLID FUNDAMENTALS

4. Growth in the aftermath of the global financial crisis has remained low. Output has not yet recovered to pre-crisis levels, and employment has fallen by 13 percent from its peak (Figure 1). Growth declined from 0.8 percent in 2012 to 0.2 percent in the first half of 2013 as domestic uncertainties undermined demand, with unchanged private consumption and a decline in investment (Figure 2 and Tables 1–3). Good agricultural performance, strong export growth (8.0 percent year-on-year), and higher government spending supported the economy. GDP began to recover in the third quarter of 2013 to an estimated 1.5 percent year-on-year as exports continued to perform well.



Sources: INS; and IMF staff

	2011	2012	2013H1
	(real percent change year on year)		
GDP	1.8	0.8	0.2
Private consumption	1.5	2.6	0.0
Public consumption	1.6	-1.3	3.5
Gross fixed investment	-6.5	0.8	-0.9
o/w: private	-5.6	-3.5	…
Net exports and inventories 1/	2.1	-0.9	-0.2

1/ Contribution to GDP.

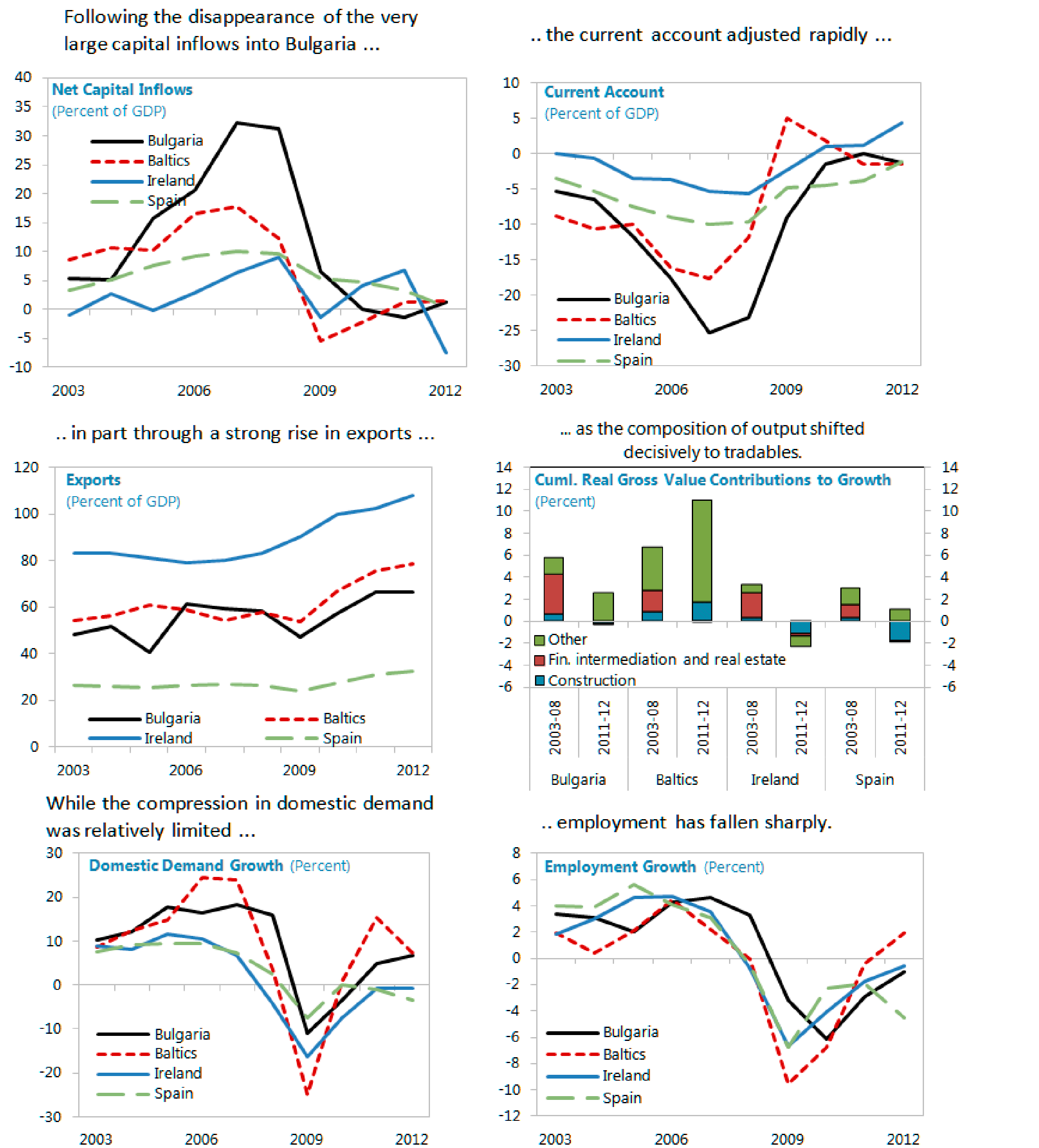
5. Strong macroeconomic and financial sector policies have mitigated vulnerabilities arising from the difficult external and domestic environment, but challenges remain:

- The current account, which reached a deficit of 25 percent of GDP in 2007, is now registering a small surplus, and reserves are comfortable with a reserve adequacy index of 129 (Table 1). Financial inflows are moderate and stable, consisting mostly of FDI at about 3 percent of GDP a year. The international investment position has improved in line with the fall in external debt (Figure 3, Tables 4–5). The reduction in banks' foreign liabilities has been gradual and is largely driven by plentiful bank liquidity, resulting in a positive net foreign asset position for the first time since 2006. Bulgaria was largely unaffected by the swings in capital flows to emerging markets following concerns about tapering last summer, as its stock market capitalization and domestic public debt are low, at about 10 percent of GDP each, and banks (three quarters of which are subsidiaries of EU banks) are funded mainly by domestic deposits.[1]

- The fiscal deficit fell to 0.5 percent of GDP in 2012, below the budgeted deficit of 1.3 percent of GDP (Figure 4). However, this performance was largely due to lower-than-planned public investment expenditure. Public debt, at 17.6 percent of GDP at end-2012, is the second lowest in the EU and the debt sustainability analysis shows it well contained (Appendix I).

[1] Inward spillovers occur more through trade with the euro zone (notably Germany and Italy) and neighboring countries (particularly Romania and Turkey), and direct investment primarily from the European Union (also see "Interconnectedness and Spillovers from the Euro Area to Bulgaria," 2012 Staff Report, Annex I).

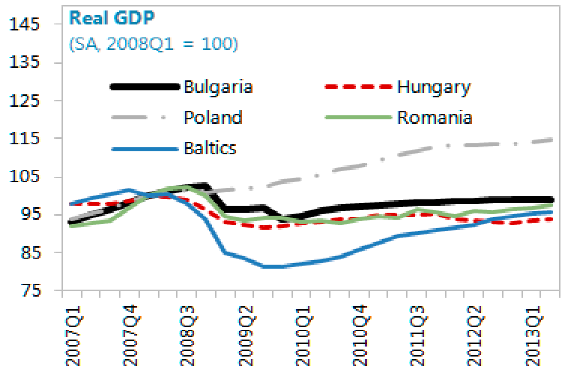
Figure 1. Bulgaria: Trends in Recovery Following Domestic Demand Collapse, 2003–12



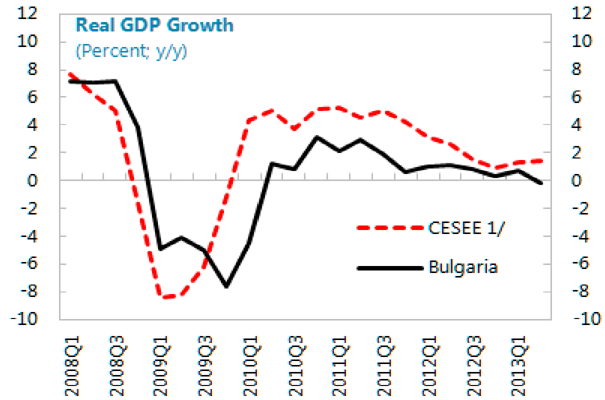
Source: Haver.

Figure 2. Bulgaria: Real Sector Developments, 2007–13

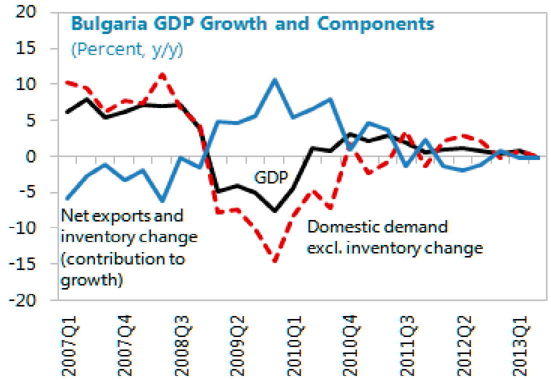
While some countries have been even more affected by the crisis...



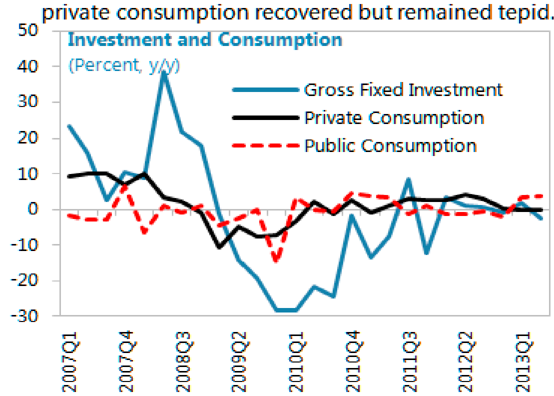
... growth in recent years has been lower in Bulgaria than in the region as a whole.



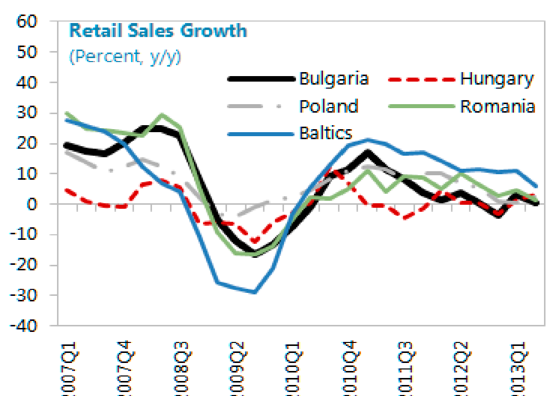
Net exports pulled the economy out of recession as ...



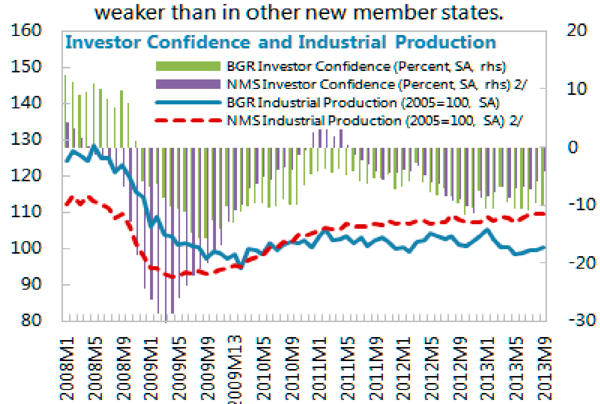
... the investment cycle ran its course, while private consumption recovered but remained tepid.



Retail sales growth has been relatively low recently ...



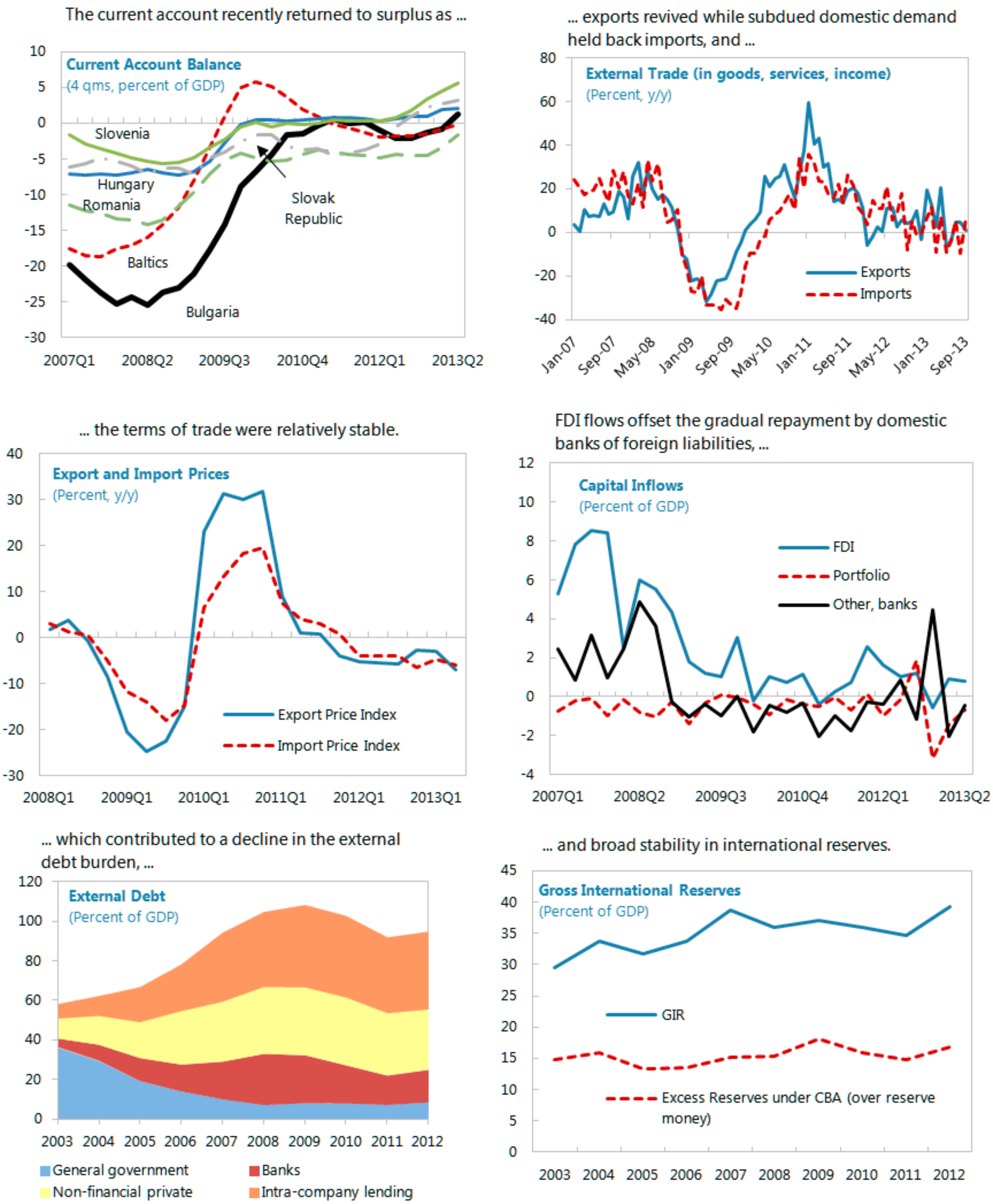
... and industrial production and investor confidence weaker than in other new member states.



1/ CESEE: Albania, Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Ukraine, and Turkey.
2/ NMS (=New Memeber States): Bulgaria, Czech Republic, Estonia, Hungary, Lithuania, Latvia, Poland, Romania, Slovakia, and Slovenia.

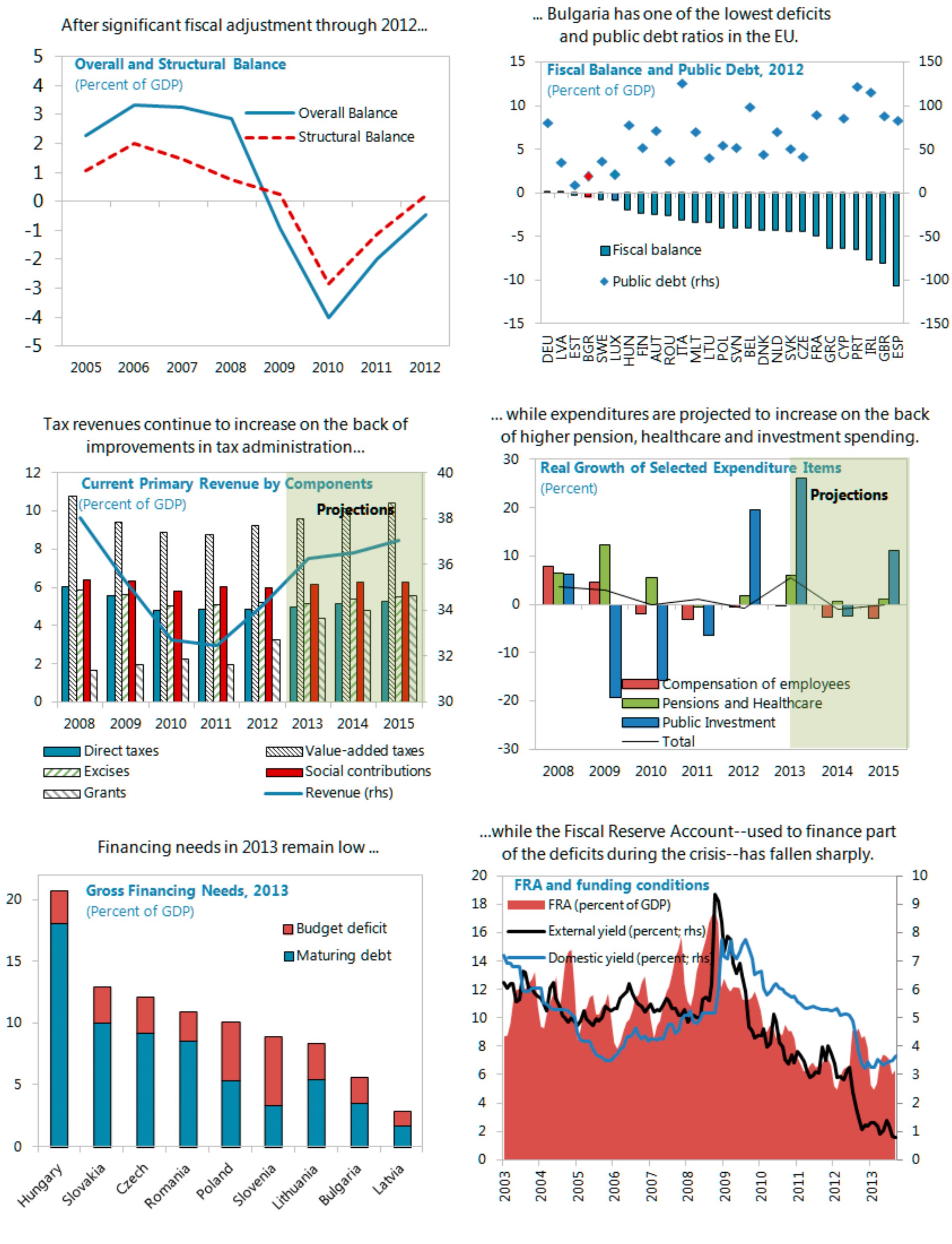
Sources: Haver; national authorities; and IMF staff calculations.

Figure 3. Bulgaria: External Sector Developments, 2003–13



Sources: Haver; BNB; and IMF staff estimates.

Figure 4. Bulgaria: Fiscal Developments, 2005–15



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

- Inflation has been low and in line with that of trading partners in recent years (Figure 5). Following reductions in administered electricity prices, inflation turned negative in the second half of 2013. Credit growth, which peaked at 63 percent in 2007, has been flat in 2013.

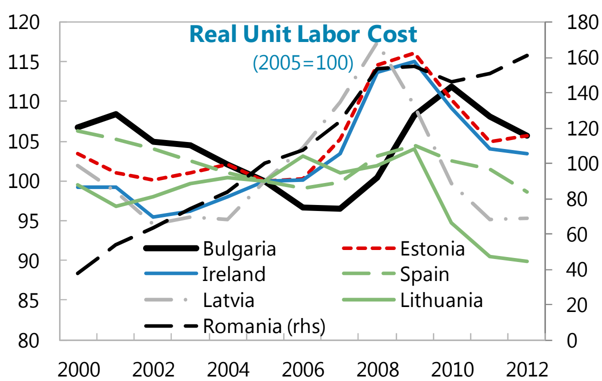
- Capitalization and liquidity of the financial sector are high (Figure 6). Although gross nonperforming loans (NPLs)—a legacy from the boom period and subsequent crisis—amounted to 17.2 percent of loans in September, coverage by provisions is comfortable at 72.7 percent.

- The REER is broadly in line with fundamentals. Estimates suggest that the exchange rate is slightly undervalued, the current account is somewhat stronger than the norm, and Bulgaria's export market share has gradually increased. However, real unit labor costs remain higher than in the boom years (with continued increases in nominal wages), international reserves remain broadly stable, and the rise in market share is consistent with Bulgaria's ongoing integration in the world economy.

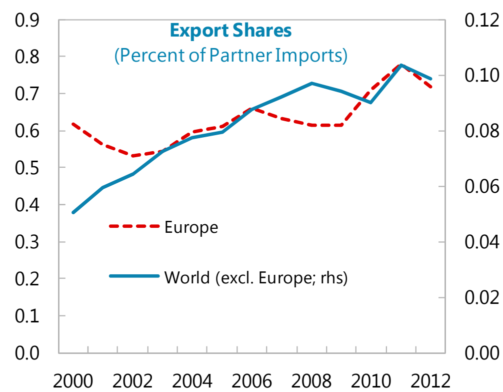
Bulgaria: Exchange Rate Assessment

Methodology	REER required adjustment	Underlying current	Current account
Macroeconomic balance approach :	4.9	-1.5	-3.3
External sustainability approach 1/	7.0	-1.5	-4.0
Equilibrium exchange rate	2.5	...	...

1/ The current account elasticity with respect to the REER is 0.3.

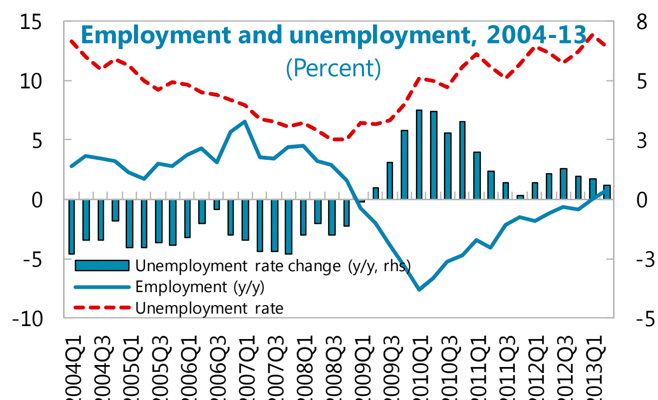


Source: Haver.



Source: DOTS

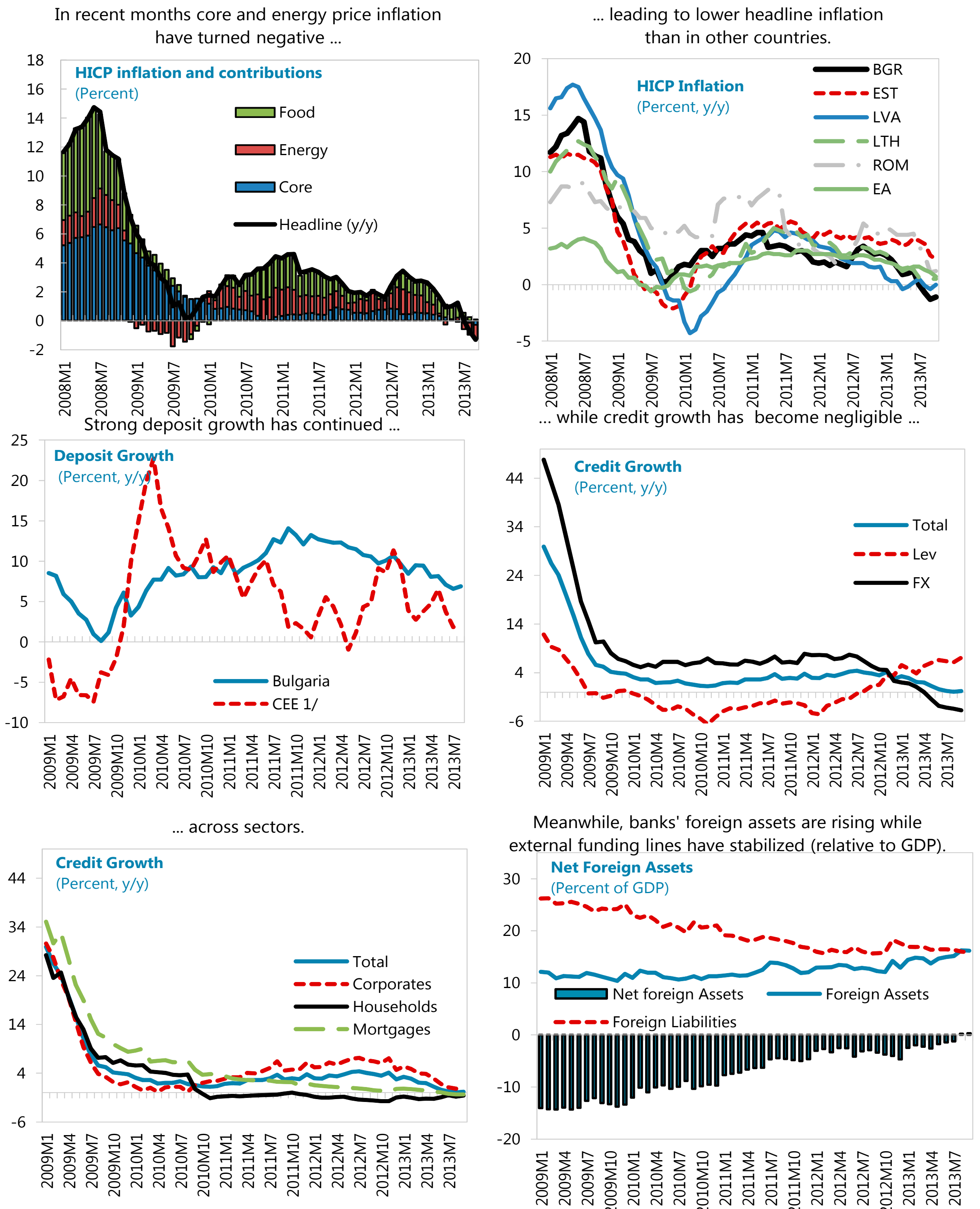
- Reductions in unemployment over the last decade have been erased as a result of the crisis. While employment rose slightly in 2013, the unemployment rate has not begun to decline as more of the population entered the workforce. Given that the output gap is not large, most of the unemployment is structural and characterized by significant age, gender, and regional disparities.[2]



Source: NSSI.

[2] See "Growth and Employment," Selected Issues Papers.

Figure 5. Bulgaria: Inflation and Credit Developments, 2008–13

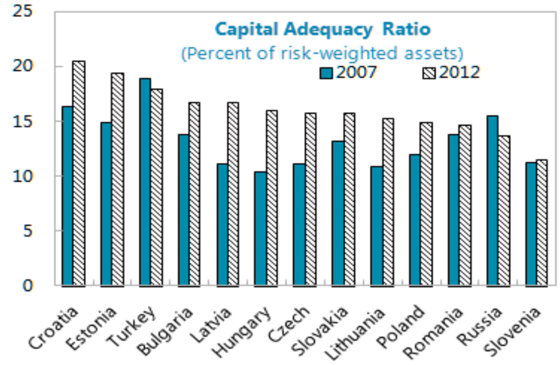


1/ Hungary, Slovakia, Czech Republic, Romania, Poland, Lithuania, Slovenia, Latvia, and Bulgaria.

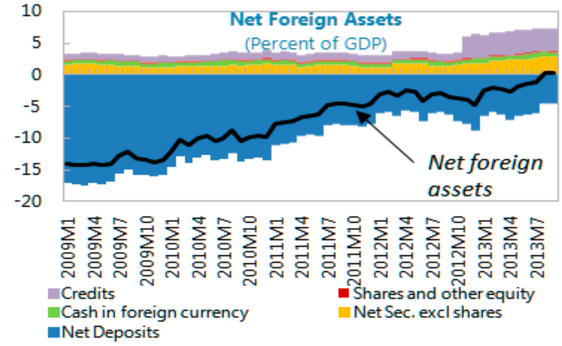
Sources: Haver; BNB; IFS; and IMF staff estimates.

Figure 6. Bulgaria: Financial Sector Developments, 2007–13

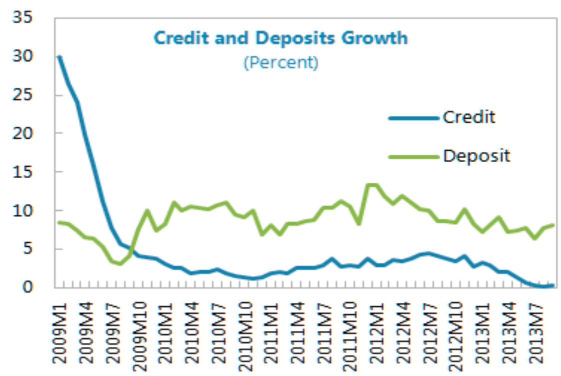
The banking system is well capitalized …



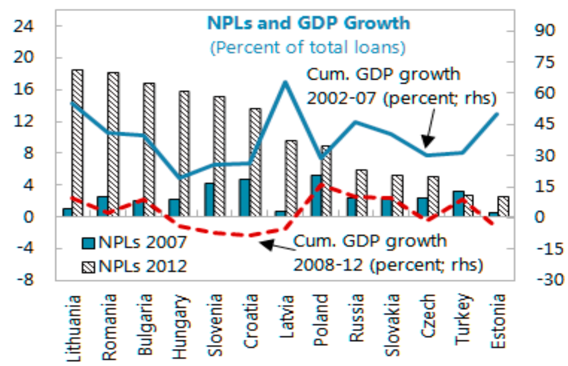
… and, since the crisis, has reduced foreign liabilities and increased foreign assets.



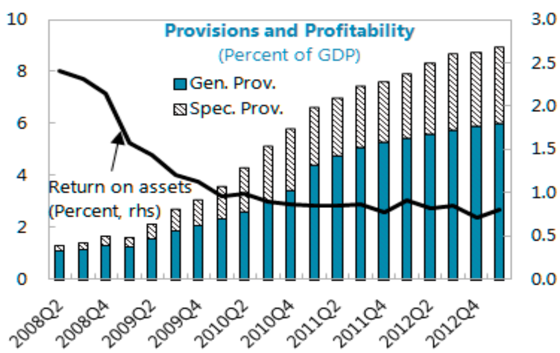
With low credit growth and high deposit growth liquidity is abundant …



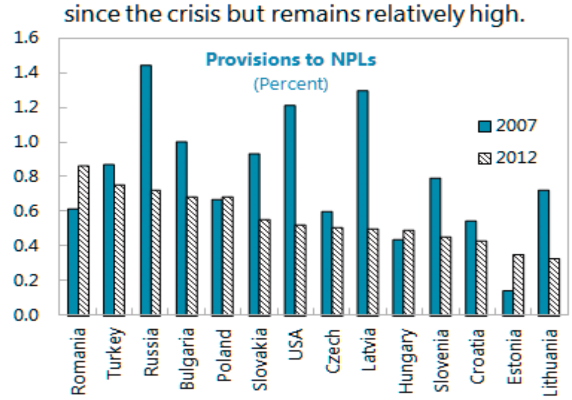
… but, although they seem to have stabilized, the crisis resulted in a large stock of NPLs …



… which has required more provisions and resulted in lower profits.



The coverage of NPLs by provisions has fallen since the crisis but remains relatively high.



Sources: National authorities; and IMF staff estimates.

ECONOMIC OUTLOOK AND RISKS

6. **Output is projected to recover slowly.** Domestic demand is projected to recover gradually, and exports and foreign direct investment will benefit from recovery in Europe. Inflation is projected to be positive but subdued in the short term and, given faster tradables sector productivity and wage growth, slightly above that in the EU in the medium term. The current account would return to a modest deficit in the medium term financed by FDI.

7. **Convergence to EU income levels over the coming decades requires accelerated growth.** In the baseline, GDP growth is projected to increase from ½ percent in 2013 to 3 percent in the medium term, whereas the EU is projected to reach a growth rate of 2 percent by 2018—a difference of 1 percentage point that implies only very gradual income convergence. Even with a sustained growth differential of 2 percentage points, full income convergence would still take four decades to be achieved.

8. **Staff's views on risks are summarized in the Risk Assessment Matrix (RAM)**.

- On the domestic side, the political situation remains strained, making needed structural reforms all the more difficult, although Bulgaria's track record suggests the risk of excessive fiscal relaxation is low. In the financial sector, continued high levels of NPLs, while well provisioned, imply a "collateral overhang" (bad loans backed by property that has not yet been seized and sold) that may deter new investment because of the uncertainty this can create about underlying asset values.

- On the external side, uncertainty regarding the economic situation in Europe or other partners may have adverse implications for trade and investment. External debt remains significant (92.7 percent of GDP at mid 2013) but has been falling and presents limited rollover risks (see Appendix I).

- In view of the risks, discussed further in the policies section below, it is imperative to move ahead with growth-enhancing reforms and reinforce defenses to support readiness to respond to adverse shocks. The response to sizable adverse shocks would include utilization of automatic stabilizers, as long as financing conditions permit.

9. **The authorities' views on the outlook and risks were close to the staff's.** They saw slightly more upside in the near term, with a stronger recovery in domestic demand; they also noted that their baseline projections do not take into account the "South Stream" gas pipeline, construction of which they expected to begin in 2014. They agreed on potential external downside risks, but also noted that ongoing diversification of exports to emerging markets was helping reduce their vulnerability to European shocks. Regarding the financial sector, they emphasized that buffers were significant and NPLs did not pose stability concerns, but they agreed that various structural constraints—including related to the legal system—had a negative effect on the pace of disposal of seized collateral by banks.

Bulgaria: Risk Assessment Matrix (as of November 14, 2013)[3]

(Scale: high, medium, or low)

Source of Risk	Relative Likelihood	Impact if Realized
1. Inadequate implementation of structural reforms to raise productivity and offset impact of emigration and aging (short/medium term).	**High** Intensified political and social discord postpones the structural reform agenda, including reforms that would reduce medium-term fiscal risks.	**High** Low potential growth and high structural unemployment resulting in a lack of income convergence; increased fiscal pressures.
2. Excess fiscal relaxation (medium term)	**Low** Heightened spending pressures in a context of political and social discord; lack of progress in addressing medium-term fiscal risks.	**High** Loss of standout Bulgarian advantage of fiscal prudence; increased vulnerability to shocks.
3. NPLs leave asset price uncertainty (short/medium term).	**Medium** Impediments to releasing collateral associated with NPLs, including judicial bottlenecks and administrative costs.	**Medium** Lower investment reduces growth.
4. Protracted period of slower European growth (medium term).	**High** Direct negative influence through trade and investment channels.	**High** Low potential growth, high structural unemployment and low FDI; continued downturn raises fiscal pressures.
5. Deeper emerging market slowdown (short/medium term).	**Medium** Negative surprise, mainly through trade channels.	**Medium** Low potential growth, high structural unemployment.
6. Financial stress in the euro area re-emerges (short term)	**Medium** Adverse effects from financial stress of parent banks/corporate and through trade and investment channels.	**Medium** Funding pressures; lower exports, employment, FDI, and growth; continued downturn raises fiscal pressures.

[3] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relatively likelihoods of risks listed is the staff's subjective assessment of the risks surrounding the baseline. The RAM reflects staff's views on the sources of risk and overall level of concern as of the time of discussions with the authorities.

POLICIES TO ACCELERATE GROWTH AND PRESERVE STABILITY

10. Thanks to its robust policy framework, Bulgaria has successfully withstood recent challenges. Following tumultuous early transition years and the 1997 crisis, a period of stabilization began with the establishment of the currency board and supporting policies, including low fiscal deficits and debt, as well as conservative banking supervision. The robust macroeconomic framework was instrumental in supporting growth and EU membership before the global financial crisis (albeit with extraordinary inflows fueling a boom). Buffers built up during the pre-crisis period helped to mitigate the worst effects of the crisis on growth, although unemployment increased sharply.

11. Looking forward, the authorities recognize the need to safeguard stability while setting the conditions for accelerated growth and job creation. The authorities remain committed to the policies that are needed to support the currency board—which introduced policy predictability and controlled inflation—as the natural bridge to eventual euro adoption. At the same time, they recognize the need for broader reforms to set the conditions for higher growth, lower unemployment, and reduced incentives for migration.

A. Fiscal Policy: Safeguarding Consolidation and Improving Spending Composition

Background

12. After several years of consolidation, the fiscal deficit is projected to increase to 2 percent of GDP in 2013, and the structural deficit to 1 percent of GDP. About half of the increase results from pension increases (after a three year freeze), while spending related to EU funds, largely offset by EU grants, is set to rise by 1¼ percent of GDP. Administrative improvements raised tax revenues to help contain the deficit. Public financing needs remain low, and the fiscal reserve is stable at about 6 percent of GDP (mostly comprising working balances and pledged funds), compared to a pre-crisis peak of 17 percent of GDP.

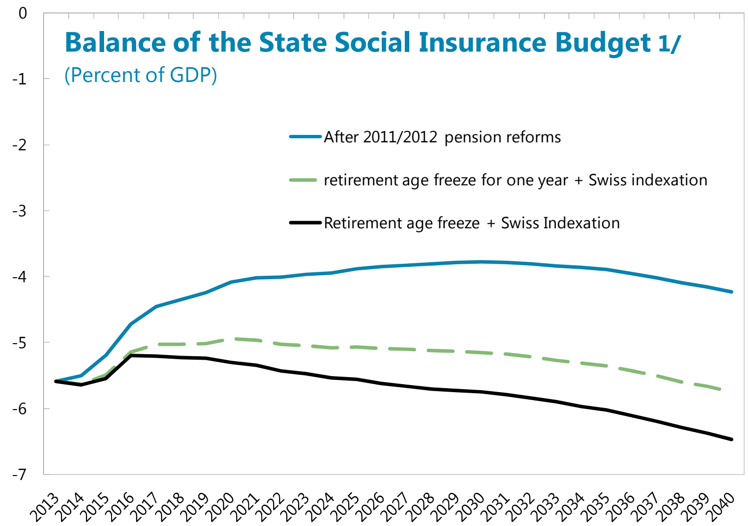
	2009	2010	2011	2012	2013
Capital spending (percent of GDP)					(Proj.)
Actual	5.1	4.3	3.9	4.6	5.9
Budgeted	7.6	5.8	4.8	6.8	6.8
EU funds absorption (percent)	3	10	19	27	50

Sources: Bulgarian authorities; and IMF staff estimates.

13. The 2014 budget, consistent with national rules and EU objectives, targets a deficit of 1.8 percent of GDP, leaving the structural deficit little changed. Tax revenues are budgeted to rise by about 1 percent of GDP, mainly through further administrative measures. A reversal of recent pension reforms will take effect in July (Box 1). An increase in social protection spending has been budgeted while operational expenditures are expected to be restrained. The new national investment fund (0.6 percent of GDP) is expected to finance municipal investment following a competitive bidding process overseen by the Council of Ministers. The government's 2014–16 fiscal framework implies a structural deficit of 1 percent of GDP, consistent with national rules and EU objectives, with spending increases concentrated on investment.[4]

Box 1. Pension Reform Reversals

Recent pension changes worsen pension sustainability. From July 2014, automatic indexation will be implemented based on the "golden Swiss rule" that links pension increases to the average growth of insurable income and CPI inflation. In addition, the gradual increase in the retirement age, part of the 2011 pension reform and started in 2012 (to reach 65 years for men by 2017 and 63 years for women by 2020), has been halted. Thus, the pension deficit by 2040 is now projected to be near 6 percent of GDP instead of 4 percent of GDP. The deficit is financed by the budget and crowds out other spending, which is increasingly coming under pressure as the population ages.



1/ Includes average pension increase of 9.3 percent as of April 1, 2013.
Source: NSSI Bulgaria.

14. **The new public finance law that enters into force in 2014 (as well as EU legislation) requires the government to set up an independent fiscal body.** The fiscal council that is being established consists of 5 members (including a chairperson) that will be elected by parliament, and one administrative staff. Its mandate will include issuing opinions on the draft budget and budget execution, the monitoring of fiscal rules, and the activation of corrective mechanisms and escape clauses.

Policy Issues

15. **The fiscal impulse in 2013 and the neutral fiscal stance for 2014 are appropriate.** Given the unanticipated slowing of the economy in 2013, the discretionary fiscal impulse was fortuitous. The composition of spending was improved through an increase in the share of investment

[4] Bulgaria's maximum structural deficit under the new public finance law and the EU medium-term objective is 1 percent of GDP (given that public debt is under 40 percent of GDP) on an accrual basis. National rules specify a headline cash deficit ceiling of 2 percent of GDP (the annual difference between cash and accrual is small with an average of 0.2 percent of GDP in recent years).

spending and greater absorption of EU funds, both particularly welcome given their positive long-term growth effects.[5] Increases in social protection spending beyond the pension increases were limited and targeted. In 2014, keeping the structural deficit unchanged strikes an appropriate balance between postponing consolidation given the modest projected growth and maintaining fiscal credibility—particularly important in the context of the currency board—by observing domestic deficit limits and EU objectives. There are, however, implementation risks with the 2014 budget. While the South Stream project provides potential revenue upside, revenues may underperform if domestic demand or administrative reforms disappoint, or, as projected by staff, inflation is subdued. In such a case and with the budgeted deficit already at or near deficit limits, expenditures would need to be restrained and heightened spending pressures carefully managed to meet the deficit target (see RAM). At the same time, it will be important to ensure efficiency and transparency in management of the new public investment fund, and the independence of the new fiscal council should be supported through adequate staff and resources.

16. Fiscal buffers should be rebuilt over time by targeting a balanced structural budget after 2016. This would allow a substantial liquidity buffer to be built up in the fiscal reserve in good times and automatic stabilizers to work in the event of a shock. As discussed in last year's Staff Report, rebuilding the fiscal reserve by saving fiscal surpluses would bolster the defenses that Bulgaria needs given shallow domestic financial markets, periodic closing of international markets, intervention limitations inherent in its currency board, and prevailing risks.

17. There is scope to improve the targeting and efficiency of social spending. While recent studies suggest that social protection spending helped to mitigate the income effects of the crisis in Bulgaria, they also point to relatively weak results in terms of poverty reduction, as well as substantial inefficiencies, particularly in health-related spending. Given constrained fiscal space, reforms should focus on improving the allocation of existing social protection spending, including to provide room for greater social assistance spending, for which coverage is currently low.[6]

18. Medium-term fiscal risks arise from the reversal of pension reform and from contingent liabilities related to some state-owned enterprises. The recent pension reform reversals, without compensatory measures, add to already substantial budgetary pressures from an aging population, with adverse budgetary implications that are limited in the early years but substantial over the longer term. The weak financial position of firms in the railroad sector and some segments of the energy sector, which staff discussed with the World Bank, could represent significant fiscal risks if not adequately addressed (Box 2). As suggested by the European Commission, details on such contingencies should be provided in budget documents.

[5] See "Making the Fiscal Framework and Policy More Supportive of Growth," 2012 Staff Report, Annex III; and Weber and Muir, "Fiscal Multipliers in Bulgaria: Low but Still Relevant," IMF, WP/13/49.

[6] See "Fiscal Policy and Social Protection," Selected Issues Papers.

Box 2. Energy and Railroad Sectors

Energy. With the economy highly energy intensive, the state-owned vertically-integrated Bulgaria Energy Holding (BEH) accounts for almost half of Bulgaria's generating capacity. A large BEH subsidiary, the National Electricity Company (NEK), faces financial difficulties given contractual obligations to high purchase prices coupled with low administered prices.[1] BEH has recently issued an international bond to provide NEK with liquidity and NEK's energy exports have been expanded. Sustained efforts to address NEK's situation, such as outlined by the World Bank, are needed to avoid future impact on the government's budget.

Railroads. Traffic has declined about 70 percent since the mid-1990s, and annual subsidies amount to ½ percent of GDP. The state railway operator defaulted in 2010 and is negotiating with its creditors. A reform agreed with the World Bank and privatization efforts for the freight company are currently on hold.

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[1] See http://documents.worldbank.org/curated/en/2013/05/17776422/republic-bulgaria-power-sector-rapid-assessment.

19. The authorities underlined their continued commitment to fiscal stability. They are committed to remaining within the 2 percent of GDP domestic deficit ceiling in 2014 and maintaining a structural deficit of about 1 percent of GDP through 2016. They agreed that a return to a balanced structural budget over time would be useful to help rebuild buffers. On spending composition, they see the creation of the public investment fund as a way to increase investment at the municipal level. They recognized the importance of pension sustainability and saw the halt in increases to the retirement age as temporary. On social spending, the authorities aim to improve the accessibility and effectiveness of social transfers and services, in particular for children and older people, and acknowledged the need for more efficient health care spending.

B. Financial Sector: Maintaining Stability and Supporting the Recovery

Background

20. The financial system remains stable and liquid, although profitability has declined. Liquidity remained plentiful due to rising deposits and low credit demand. At the same time, external liabilities of the banking system declined further to 16 percent of GDP compared to an end-2008 peak of 27 percent, and banks' net foreign assets reached a small surplus compared to a peak deficit of 18 percent of GDP in 2008. IFRS provisioning for NPLs has affected profits, but capital adequacy remains high with all banks meeting the minimum regulatory requirement of 12 percent and system-wide capital at 16.9 percent of risk-weighted assets as of September 2013.

21. NPLs have stabilized, but remain near their peak. As of September, 17.2 percent of loans were classified as impaired (with most of them in excess of 180 days past due). Some banks have recently been more proactive in resolving NPLs by claiming and removing associated collateral from their balance sheets, a process that is made difficult by a number of factors, including a depressed real estate market and an ineffective and unpredictable insolvency framework (see RAM and Box 3).

Box 3. Resolving NPLs in Bulgaria

A strategy to gradually reduce the stock of NPLs will improve the investment environment and help sustain the recovery while preserving stability. However, a number of constraints have limited progress:

With NPLs well provisioned, many banks see benefit in a "wait and see approach." Banks report that they expect collateral values to improve as the economy recovers and the current political uncertainty is resolved.

The foreclosure process is marked by uncertainty about its cost, length, and outcome. This uncertainty also contributes to the wait-and-see approach by banks.

Disincentives in the tax system for quick write offs. It is uncertain when losses can be recognized for tax purposes.

Limited scope for market-based solutions. Like in many Eastern and Central European countries, the market for distressed assets is underdeveloped, with limited experience with direct sales and securitization.

22. The EU Capital Requirements Directive (CRD IV) that becomes effective in 2014 will require supervisory changes. Capital–based ("specific") provisions will need to be phased out and the minimum capital adequacy requirements adapted to the new framework (Box 4).

Policy issues

23. Recent efforts by some banks to address the stock of distressed assets and claim associated collateral are steps in the right direction. Credit risk to regulatory capital is substantially mitigated by the current dual provisioning scheme, and plentiful liquidity implies that credit growth at present is not restricted by supply factors. Reduction of NPLs through asset disposal and release of associated collateral will also be important to reduce the administrative and legal costs to banks associated with managing these assets and, more broadly, to reduce asset price uncertainty and support future investment.

24. Recent improvements to the insolvency framework that limit the backdating of insolvencies are welcome but further reforms are needed. Recommendations in last year's Staff Report remain valid, including the introduction of a fast-track court approval procedure for pre-agreed reorganization plans and out-of-court debt restructuring guidelines, which in other countries have facilitated speedy, cost-effective, and market-friendly settlements. The treatment of loan losses in the tax system should be adjusted to remove potential disincentives to write offs.

Box 4. Transition to CRD IV

BNB supervisory authorities have maintained conservative capital buffers. Under IFRS, expected losses from future events and forward looking considerations are not taken into account. However, BNB supervisory authorities have complemented IFRS provisions with additional capital cushions ("specific provisions") calculated on an expected loss model and deducted from regulatory capital. Specific provisions are a segregated part of capital that do not affect reported profits (unlike IFRS provisions) but are excluded when computing regulatory capital.

Under CRD IV specific provisions will need to be phased out but the authorities are taking steps to preserve appropriate buffers. In order to promote capital conservation, BNB supervisors plan to use available national discretion under the CRD IV package. Specifically, the authorities will use the flexibility under Pillar 1 of the Basel Accord to impose the maximum capital conservation and systemic capital buffers on all banks. In addition, the BNB will use the national discretion afforded under Pillar 2 to impose higher capital requirements on those institutions exhibiting a higher risk profile.

25. The authorities will maintain their conservative approach to bank supervision under the new European framework. They view existing capital and liquidity buffers as critical to maintaining stability. They intend to use available flexibility to maintain high capital adequacy requirements and ensure conservative collateral valuation, which will be particularly important once specific provisions are eliminated. They view NPLs as adequately provisioned to insulate against risks to the stability of the system and recognize that their gradual reduction would be supported by greater efficiencies in the legal system. The authorities do not intend to participate in the close cooperation framework of the Single Supervisory Mechanism, noting the absence of liquidity and solvency support as well as the lack of voting rights in the Governing Council of the ECB for non euro area participants. They remain fully engaged in the reform process at the European level, however, and emphasized the importance of ensuring equal treatment in the new framework for all EU member states.

C. The Next Generation of Reforms

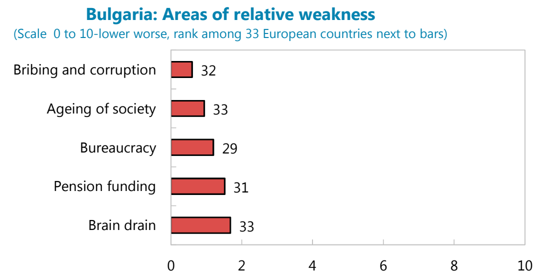
26. Bulgaria ranks favorably versus comparators on macro-policy outcomes but less so on other dimensions critical to the well functioning of the economy. Bulgaria is comparable to good performers in central Europe and the Baltics on fiscal and country risk, and the income tax system is also seen as favorable in competitiveness rankings. However, Bulgaria ranks much lower on measures such as enforcing contracts, resolving insolvencies, and some areas of red tape. More generally, the judicial system is viewed as problematic, and corruption and cronyism as widespread.

Corruption Perception in CESEE
(Rank in world, 2013)

Estonia	28
Poland	38
Slovenia	43
Lithuania	43
Hungary	47
Latvia	49
Turkey	53
Czech Republic	57
Croatia	57
Slovakia	61
FYR Macedonia	67
Montenegro	67
Romania	69
Serbia	72
Bosnia and Herzegovina	72
Bulgaria	**77**
Moldova	102
Kosovo	111
Albania	116
Belarus	123
Russia	127
Ukraine	144

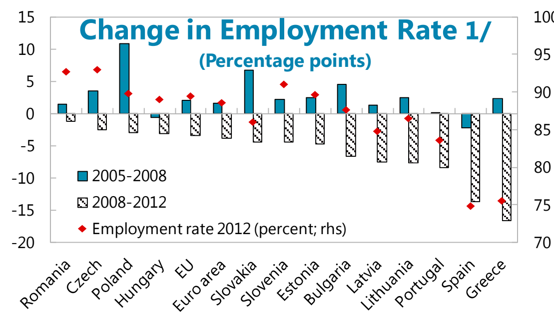
Source: Transparency International.

Source: IMD, World Competitiveness 2013.



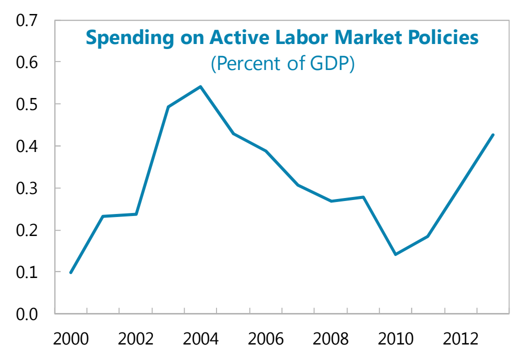
Source: IMD, World Competitiveness 2013.

27. While labor market institutions and regulations are generally flexible, employment losses following the crisis were large relative to comparators and to the fall in GDP. Unemployment has disproportionately affected the young and those in rural areas. One important factor was the nature of employment gains during the boom period. High demand for low skilled labor came from the construction and manufacturing sectors, but these sectors were particularly hard hit by the crisis. Infrastructure and education gaps also have contributed to low productivity. The use of active labor market policies, including training and subsidized employment, has been relatively limited but has recently increased.



Source: Eurostat (Haver).

1/ Employment rate is employment as percent of labor force.



Source: Bulgarian authorities.

Policy issues

28. Reviving growth and employment will require continued progress in tackling deep rooted structural rigidities. The complex nature of remaining structural challenges and the inherent difficulty of building needed consensus for the next generation of reforms are made all the more challenging given the difficult political context (see RAM). However, the strong progress achieved in the run-up to EU accession must be complemented with further reform if Bulgaria is to meet its objectives for convergence with EU partners

Source: Pew Global Attitudes Project 2009.

and strengthen public confidence in the reform process. Improvements in infrastructure and human capital as well as ease of doing business are necessary.[7] At the same time, it will be critical to confront corruption, rent-seeking behavior and institutional gaps which are hampering investment and the efficiency of goods and factor markets. Key areas for reform include the judiciary as well as the anti-monopoly and anti-corruption regimes.

29. In addition, wider swaths of the population need to benefit from better opportunities. Improved education and training, including for social groups that tend to be excluded (Roma), will be important while greater absorption of EU funds, given the infrastructure component, could also boost demand for low-skilled labor. Government actions that influence the cost of labor for the lower skilled and young, and minimum wage differentiation by region and age, need to be carefully weighed.

30. The authorities agreed that growth-enhancing structural reforms—along with continuation of stability-oriented policies—are critical. Reforms in the business environment, the judiciary, and anti-monopoly regime were viewed as important, and they highlighted ongoing efforts to reduce the administrative burden on businesses and improve public procurement. Improvements in education and active labor market policies were also being pursued. The authorities do not believe that a differentiated minimum wage would help reduce structural unemployment, noting in particular broader structural constraints to investment and employment in the hardest hit regions.

STAFF APPRAISAL

31. After the crisis of 1997 that destroyed banks and decimated savings, policymakers successfully established a robust policy framework tested under domestic and external shocks. However, whereas in terms of economic stability Bulgaria is performing well, in other areas performance lags. A strategy which complements continued macroeconomic and financial stability with accelerated efforts on removing key structural impediments is needed to boost growth and strengthen employment.

32. Fiscal policy is maintaining an appropriate balance. The limited consolidation implied by the 2014 budget is appropriate but there are implementation risks. The authorities should be prepared to adjust spending to achieve the deficit target which is near domestic and EU limits. The intended shift to capital spending is welcome but needs to be accompanied by appropriate project selection procedures. Fiscal buffers should be rebuilt by targeting a balanced structural budget over time. The additional spending pressures resulting from the recent reversal of pension reforms will need to be addressed.

[7] See Staff Reports for the 2011 and 2012 Article IV Consultations and Mitra and Pouvelle, 2012, "Productivity Growth and Structural Reform in Bulgaria: Restarting the Convergence Engine," IMF, WP/12/131.

33. The financial sector remains stable. The authorities' intention to maintain financial sector buffers under the new framework is appropriate. Recent steps taken by some banks to reduce NPLs through asset disposal should be further encouraged to reduce asset price uncertainty and support future investment. Steps taken by the authorities to preserve their conservative supervisory approach in the changing European framework are appropriate.

34. Structural policies require new impetus. A key issue is governance reform, including in the judicial system and anti-corruption and anti-monopoly regimes, to help support the macroeconomic performance and stability of the country over the medium term. EU funds should continue to be absorbed rapidly and further improvements in education and training are needed to reduce labor market rigidities.

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

Table 1. Bulgaria: Selected Economic and Social Indicators, 2010–18

	2010	2011	2012 Est.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
Output, prices, and labor market (percent change, unless otherwise indicated)									
Real GDP	0.4	1.8	0.8	0.5	1.6	2.5	3.0	3.0	3.0
Real domestic demand	-5.1	0.3	3.5	-0.9	1.5	3.1	3.7	3.5	3.5
Consumer price index (HICP, average)	3.0	3.4	2.4	0.4	0.8	1.8	2.3	2.5	2.5
Consumer price index (HICP, end of period)	4.4	2.0	2.8	-0.5	1.5	2.0	2.5	2.5	2.5
Nominal wages (national accounts definition)	11.2	8.6	5.6	4.5	5.0	5.5	5.5	5.5	5.5
Population	-0.8	-2.4	-0.6	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Employment	-6.1	-2.8	-1.1	0.1	0.8	0.9	0.6	0.5	0.4
Unemployment rate (percent of labor force)	10.3	11.3	12.4	12.4	11.9	11.3	10.7	10.1	9.5
Output gap (percent of potential GDP)	-3.2	-2.4	-1.8	-2.1	-1.8	-0.9	0.0	0.0	0.0
General government finances (percent of GDP)									
Revenue	32.7	32.4	34.2	36.3	36.5	37.1	37.1	37.2	37.3
o/w: Grants	2.3	1.9	3.1	4.3	4.1	4.3	4.1	4.2	4.2
Expenditure	36.7	34.4	34.6	38.3	38.3	38.6	38.2	37.8	37.3
Balance (net lending/borrowing on cash basis)	-4.0	-2.0	-0.5	-2.0	-1.8	-1.5	-1.1	-0.5	0.0
Privatization proceeds	0.1	0.3	0.1	0.2	0.2	0.0	0.0	0.0	0.0
External financing 1/	0.2	0.2	2.6	-0.7	3.7	-0.7	2.2	-1.8	0.2
Domestic financing	1.4	0.2	-0.9	1.6	0.5	0.9	0.4	0.4	0.4
Financing from fiscal reserves 2/	2.4	1.3	-1.4	1.4	-2.3	1.3	-1.5	1.9	-0.6
Net lending and other items	0.0	-0.1	0.0	-0.5	-0.3	0.0	0.0	0.0	0.0
Gross public debt 2/	14.9	15.4	17.6	17.5	21.2	20.5	22.0	19.5	19.0
Structural balance	-2.9	-1.1	0.2	-1.2	-1.1	-1.1	-1.1	-0.5	0.0
Money and credit (percent change)									
Broad money (M3)	6.4	12.2	8.4	8.7	5.9	5.5	5.9	6.2	6.7
Domestic private credit	1.3	3.8	2.8	0.3	3.6	5.3	6.7	9.0	9.0
Interest rates (percent)									
Interbank rate, 3-month SOFIBOR	4.1	3.8	2.3	...	...	...	...	...	...
Lending rate	11.1	10.6	9.7	...	...	...	...	...	...
Balance of payments (percent of GDP, unless otherwise indicated)									
Current account balance	-1.5	0.1	-1.3	0.4	-0.9	-1.9	-2.3	-2.5	-2.6
o/w: Merchandise trade balance	-7.7	-5.6	-9.1	-6.3	-7.1	-7.5	-8.1	-8.5	-9.1
Capital and financial account balance	-1.1	-1.3	7.0	-3.2	4.7	2.9	5.9	3.1	4.6
o/w: Foreign direct investment balance	2.7	3.1	3.3	2.8	3.5	3.9	4.0	4.0	4.1
International investment position	-95	-86	-81	-79	-78	-74	-71	-68	-65
o/w: Gross external debt	103	94	95	93	93	87	84	77	72
o/w: Gross official reserves	36	35	39	36	39	38	40	38	38
In months of imports	6.1	5.8	6.7	5.9	6.1	6.3	6.4	6.1	6.0
In percent of broad money	50	46	49	42	44	43	44	43	42
In percent of ST debt 3/	85	91	114	116	123	126	143	135	150
In percent of risk-weighted metric 4/	124	134	130	127	...	...	...	...	...
Exchange rates									
Leva per euro			Currency board peg to euro at lev 1.95583 per euro						
Leva per U.S. dollar (end of period)	1.48	1.45	1.47	...	...	...	...	...	...
Effective exchange rate (percent change)									
Nominal	-3.3	2.1	-1.9	...	...	...	...	...	...
Real (CPI based)	-3.9	2.7	-2.1	...	...	...	...	...	...

Social indicators (reference year in parentheses):

Per capita GNI (2011): US$ 6,550; income distribution (Gini index, 2007): 28.2; poverty rate (2007): 10.6 percent.

Primary education completion rate (2009): 95.5.

Births per woman (2010): 1.5; mortality under 5 (per 1,000) (2011): 12.1; life expectancy at birth (2010): 73.5 years.

Sources: Bulgarian authorities; World Development Indicators; and IMF staff estimates.

1/ Reflects €950 million Eurobond issued in 2012 and another assumed in 2014 and 2016.

2/ In projection period, largely reflects issuance and repayment of eurobonds.

3/ Short-term debt is at remaining maturity and includes deposits of foreign banks in local subsidiaries.

4/ See "Assessing Reserve Adequacy" (IMF Policy Papers, 2/14/2011).

Table 2. Bulgaria: Macroeconomic Framework, 2010–18

	2010	2011	2012 Est.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
GDP and prices (percent change)									
Real GDP	0.4	1.8	0.8	0.5	1.6	2.5	3.0	3.0	3.0
Real domestic demand	-5.1	0.3	3.5	-0.9	1.5	3.1	3.7	3.5	3.5
Of which: private	-5.8	0.7	3.7	-2.9	2.0	3.1	4.3	3.9	3.9
GDP deflator	2.8	4.9	2.2	1.1	0.8	1.8	2.3	2.5	2.5
Consumer price index (HICP, average)	3.0	3.4	2.4	0.4	0.8	1.8	2.3	2.5	2.5
Nominal wages (national accounts definition)	11.2	8.6	5.6	4.5	5.0	5.5	5.5	5.5	5.5
Real effective exchange rate, CPI based	-3.9	2.7	-2.1	...	...	...	...	...	...
Monetary aggregates (percent change)									
Broad money	6.4	12.2	8.4	8.7	5.9	5.5	5.9	6.2	6.7
Domestic private credit	1.3	3.8	2.8	0.3	3.6	5.3	6.7	9.0	9.0
Saving and investment (percent of GDP)									
Foreign saving	1.5	-0.1	1.3	-0.4	0.9	1.9	2.3	2.5	2.6
Gross national saving	21.4	22.0	22.5	21.7	21.2	20.9	21.2	22.0	22.8
Government	0.3	1.9	4.2	3.9	4.0	4.8	5.2	5.9	6.5
Private	21.1	20.1	18.3	17.8	17.3	16.0	16.0	16.1	16.3
Gross domestic investment	22.9	21.9	23.8	21.3	22.1	22.8	23.6	24.5	25.4
Government	4.3	3.9	4.6	5.9	5.8	6.3	6.3	6.4	6.5
Private	18.6	18.0	19.2	15.4	16.4	16.4	17.2	18.0	18.9
General government (percent of GDP)									
Revenue	32.7	32.4	34.2	36.3	36.5	37.1	37.1	37.2	37.3
Tax revenue (including social security contributions)	25.7	26.1	26.5	27.2	28.2	28.8	29.1	29.2	29.3
Non-Tax revenue	4.7	4.4	4.6	4.8	4.2	4.0	4.0	3.9	3.8
Grants	2.3	1.9	3.1	4.3	4.1	4.3	4.1	4.2	4.2
Expenditure	36.7	34.4	34.6	38.3	38.3	38.6	38.2	37.8	37.3
Balance (net lending/borrowing on cash basis)	-4.0	-2.0	-0.5	-2.0	-1.8	-1.5	-1.1	-0.5	0.0
Structural balance	-2.9	-1.1	0.2	-1.2	-1.1	-1.1	-1.1	-0.5	0.0
Balance of payments (percent of GDP)									
Current account	-1.5	0.1	-1.3	0.4	-0.9	-1.9	-2.3	-2.5	-2.6
Trade balance	-7.7	-5.6	-9.1	-6.3	-7.1	-7.5	-8.1	-8.5	-9.1
Services balance	5.2	6.0	6.0	5.9	6.0	6.0	6.0	6.0	6.0
Income balance	-3.1	-4.7	-3.4	-4.2	-4.9	-5.3	-4.9	-4.5	-4.1
Transfers balance	4.2	4.4	5.1	5.0	5.0	4.9	4.6	4.5	4.5
Capital and financial account	-1.1	-1.3	7.0	-3.2	4.7	2.9	5.9	3.1	4.6
of which: Foreign direct investment	2.7	3.1	3.3	2.8	3.5	3.9	4.0	4.0	4.1
Memorandum items:									
Gross international reserves (millions of euros)	12,977	13,349	15,553	14,412	16,001	16,428	18,022	18,327	19,347
Short-term external debt (percent of GDP) 1/	31	26	26	26	26	25	24	23	22
Export volume (percent change)	6.1	17.8	-1.0	9.0	5.9	5.9	6.0	6.1	6.2
Import volume (percent change)	-4.5	11.5	7.8	5.1	5.4	6.4	6.6	6.4	6.5
Terms of trade (percent change)	3.7	0.7	2.6	1.3	-1.3	0.0	-0.1	-0.2	-0.3
Output gap (percent of potential GDP)	-3.2	-2.4	-1.8	-2.1	-1.8	-0.9	0.0	0.0	0.0
Nominal GDP (millions of leva)	70,511	75,308	77,582	78,792	80,689	84,171	88,665	93,608	98,827
Nominal GDP (millions of euros)	36,052	38,504	39,667	40,286	41,256	43,036	45,334	47,861	50,529

Sources: Bulgarian authorities; and IMF staff estimates.

1/ At original maturity.

Table 3. Bulgaria: Real GDP Components, 2010–18

	2010	2011	2012 Est.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
				(Real growth rate, in percent)					
GDP	0.4	1.8	0.8	0.5	1.6	2.5	3.0	3.0	3.0
Domestic demand	-5.1	0.3	3.5	-0.9	1.5	3.1	3.7	3.5	3.5
Private demand	-5.8	0.7	3.7	-2.9	2.0	3.1	4.3	3.9	3.9
Public demand	-1.6	-1.0	3.0	8.1	-0.5	3.2	1.2	1.8	1.9
Final consumption	0.4	1.5	1.9	1.0	1.3	2.3	2.7	2.5	2.5
Private consumption	0.1	1.5	2.6	0.4	1.8	2.8	3.2	2.9	2.9
Public consumption	1.9	1.6	-1.3	3.4	-0.5	0.0	0.3	0.6	0.6
Investment	-21.2	-4.0	10.1	-7.5	2.3	6.3	7.4	7.1	7.0
Gross fixed investment	-18.3	-6.5	0.8	0.9	2.5	5.9	7.3	7.0	7.0
Private investment	-19.5	-5.6	-3.5	-5.3	3.5	3.8	8.7	7.8	7.7
Public investment	-12.4	-10.3	20.2	23.5	-0.5	12.0	3.4	4.6	4.8
Inventories 1/	-0.9	0.6	2.0	-1.9	0.0	0.1	0.0	0.0	0.0
Net exports 1/	6.1	1.5	-2.9	1.4	0.0	-0.8	-0.9	-0.8	-0.8
Exports of goods and services	14.7	12.3	-0.4	7.8	5.6	5.6	5.7	5.7	5.8
Imports of goods and services	2.4	8.8	3.7	5.0	5.2	6.2	6.3	6.1	6.1
				(Contribution to real GDP growth, in percent)					
Domestic demand	-5.7	0.4	3.7	-0.9	1.6	3.3	3.9	3.8	3.8
Private demand	-5.4	0.6	3.1	-2.6	1.7	2.7	3.7	3.4	3.4
Public demand	-0.3	-0.2	0.6	1.6	-0.1	0.7	0.3	0.4	0.4
Final consumption	0.4	1.3	1.6	0.8	1.1	2.0	2.3	2.1	2.1
Private consumption	0.1	1.0	1.8	0.3	1.2	2.0	2.2	2.0	2.0
Public consumption	0.3	0.2	-0.2	0.5	-0.1	0.0	0.0	0.1	0.1
Investment	-6.1	-0.9	2.2	-1.7	0.5	1.4	1.7	1.7	1.7
Gross fixed investment	-5.3	-1.5	0.2	0.2	0.5	1.3	1.6	1.6	1.7
Private investment	-4.6	-1.1	-0.6	-0.9	0.6	0.6	1.4	1.3	1.4
Public investment	-0.6	-0.5	0.8	1.1	0.0	0.7	0.2	0.3	0.3
Inventories	-0.9	0.6	2.0	-1.9	0.0	0.1	0.0	0.0	0.0
Net exports	6.1	1.5	-2.9	1.4	0.0	-0.8	-0.9	-0.8	-0.8
Exports of goods and services	7.7	7.3	-0.2	5.1	3.9	4.0	4.3	4.4	4.6
Imports of goods and services	1.6	5.8	2.6	3.7	4.0	4.9	5.2	5.1	5.4

Sources: Bulgaria National Statistical Institute; and IMF staff

1/ Contributions to GDP growth.

Table 4. Bulgaria: Balance of Payments, 2010–18

	2010	2011	2012 Est.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
				(Millions of euros)					
Current account balance	-533	39	-528	162	-369	-818	-1,064	-1,186	-1,300
Trade balance	-2,764	-2,156	-3,622	-2,553	-2,911	-3,236	-3,651	-4,083	-4,573
Exports (f.o.b.)	15,561	20,264	20,793	21,874	23,077	24,541	26,198	28,130	30,209
Imports (f.o.b.)	-18,325	-22,420	-24,415	-24,426	-25,988	-27,778	-29,849	-32,212	-34,783
Services balance	1,868	2,323	2,397	2,380	2,473	2,590	2,727	2,881	3,048
Exports of non-factor services	5,011	5,354	5,660	5,637	5,882	6,161	6,475	6,817	7,183
Imports of non-factor services	-3,144	-3,031	-3,263	-3,257	-3,409	-3,571	-3,748	-3,936	-4,135
Income balance	-1,134	-1,813	-1,342	-1,686	-2,006	-2,286	-2,207	-2,149	-2,048
Receipts	618	614	731	958	1,094	1,198	1,303	1,418	1,533
Payments	-1,752	-2,426	-2,073	-2,644	-3,100	-3,484	-3,510	-3,567	-3,580
Current transfer balance	1,497	1,685	2,039	2,021	2,075	2,114	2,068	2,165	2,273
Capital and financial account balance	-411	-492	2,757	-1,302	1,958	1,244	2,658	1,491	2,320
Capital transfer balance	256	464	514	514	515	516	517	519	520
Foreign direct investment balance	977	1,199	1,302	1,126	1,442	1,669	1,810	1,931	2,048
Portfolio investment balance	-660	-423	-964	-1,234	653	-709	341	-960	-328
Other investment balance	-984	-1,732	1,906	-1,707	-653	-232	-10	1	81
General government and monetary authorities	73	88	115	-35	-113	-105	-142	-167	-167
Domestic banks	-1,217	-1,889	1,483	-1,552	-651	-251	-50	26	101
Other private sector	160	69	307	-120	112	124	182	142	146
Errors and omissions	560	611	-68	0	0	0	0	0	0
Overall balance	-384	159	2,161	-1,140	1,589	426	1,595	305	1,020
Financing	384	-159	-2,161	1,140	-1,589	-426	-1,595	-305	-1,020
Gross international reserves (increase: -)	384	-159	-2,161	1,140	-1,589	-426	-1,595	-305	-1,020
				(Percent of GDP, unless otherwise indicated)					
Memorandum items:									
Current account balance	-1.5	0.1	-1.3	0.4	-0.9	-1.9	-2.3	-2.5	-2.6
Merchandise trade balance	-7.7	-5.6	-9.1	-6.3	-7.1	-7.5	-8.1	-8.5	-9.1
Exports	43.2	52.6	52.4	54.3	55.9	57.0	57.8	58.8	59.8
Imports	50.8	58.2	61.6	60.6	63.0	64.5	65.8	67.3	68.8
Foreign direct investment balance	2.7	3.1	3.3	2.8	3.5	3.9	4.0	4.0	4.1
Gross external financing requirement	45.1	36.5	38.1	29.4	27.9	29.0	29.2	30.2	27.4
Gross official reserves (millions of euro)	12,977	13,349	15,553	14,412	16,001	16,428	18,022	18,327	19,347
In percent of risk-weighted metric 1/	124	129	135	129	…	…	…	…	…
ST debt at original maturity (percent of reserves)	86.3	75.6	67.1	73.7	66.7	65.4	60.3	59.8	57.2
ST debt at remaining maturity (percent of reserves)	117.2	109.6	87.6	86.1	81.2	79.6	69.8	74.2	66.8
Terms of trade (merchandise, percent change)	3.7	0.7	2.6	1.3	-1.3	0.0	-0.1	-0.2	-0.3
Exports of goods (volume, growth rate)	6.1	17.8	-1.0	9.0	5.9	5.9	6.0	6.1	6.2
Imports of goods (volume, growth rate)	-4.5	11.5	7.8	5.1	5.4	6.4	6.6	6.4	6.5
Exports of goods (prices, growth rate)	25.4	10.5	3.6	-3.5	-0.4	0.4	0.7	1.2	1.1
Imports of goods (prices, growth rate)	20.9	9.8	1.0	-4.8	1.0	0.4	0.8	1.4	1.4
GDP (millions of euro)	36,052	38,504	39,667	40,286	41,256	43,036	45,334	47,861	50,529

Sources: Bulgarian authorities; and IMF staff estimates.

1/ See "Assessing Reserve Adequacy" (IMF Policy Papers, 2/14/2011).

Table 5. Bulgaria: External Financial Assets and Liabilities, 2010–18

	2010	2011	2012 Est.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
				(Millions of euros)					
International investment position	-34,384	-33,021	-32,044	-32,017	-32,010	-31,978	-32,191	-32,524	-33,031
Financial assets	23,445	24,805	28,001	29,092	31,677	32,894	35,075	35,864	37,317
Foreign direct investment	1,171	1,272	1,415	1,617	1,823	2,038	2,265	2,504	2,757
Portfolio investment	2,566	2,673	4,407	5,237	5,627	6,002	6,362	6,682	7,012
Other investments	6,730	7,512	6,626	7,826	8,226	8,426	8,426	8,351	8,201
Gross international reserves	12,977	13,349	15,553	14,412	16,001	16,428	18,022	18,327	19,347
Financial liabilities	57,829	57,826	60,045	61,109	63,687	64,872	67,266	68,389	70,348
Foreign direct investment	35,347	36,567	37,798	39,125	40,774	42,658	44,694	46,864	49,165
Equity	21,922	22,856	23,980	25,307	26,955	28,839	30,876	33,046	35,346
Intercompany debt	13,426	13,711	13,818	13,818	13,818	13,818	13,818	13,818	13,818
Of which: Banks	888	879	674	679	679	679	679	679	679
Portfolio investment	1,639	1,484	1,829	1,473	2,481	1,852	2,258	1,324	1,065
Loans	14,666	14,651	15,340	15,540	15,485	15,435	15,393	15,329	15,295
Other liabilities	6,177	5,124	5,079	4,971	4,948	4,926	4,921	4,872	4,823
				(Percent of GDP, unless otherwise indicated)					
International investment position	-95.4	-85.8	-80.8	-79.5	-77.6	-74.3	-71.0	-68.0	-65.4
Financial assets	65.0	64.4	70.6	72.2	76.8	76.4	77.4	74.9	73.9
Foreign direct investment	3.2	3.3	3.6	4.0	4.4	4.7	5.0	5.2	5.5
Portfolio investment	7.1	6.9	11.1	13.0	13.6	13.9	14.0	14.0	13.9
Other investments	18.7	19.5	16.7	19.4	19.9	19.6	18.6	17.4	16.2
Gross international reserves	36.0	34.7	39.2	35.8	38.8	38.2	39.8	38.3	38.3
Financial liabilities	160.4	150.2	151.4	151.7	154.4	150.7	148.4	142.9	139.2
Foreign direct investment	98.0	95.0	95.3	97.1	98.8	99.1	98.6	97.9	97.3
Equity	60.8	59.4	60.5	62.8	65.3	67.0	68.1	69.0	70.0
Intercompany debt	37.2	35.6	34.8	34.3	33.5	32.1	30.5	28.9	27.3
Of which: Banks	2.5	2.3	1.7	1.7	1.6	1.6	1.5	1.4	1.3
Portfolio investment	4.5	3.9	4.6	3.7	6.0	4.3	5.0	2.8	2.1
Loans	40.7	38.0	38.7	38.6	37.5	35.9	34.0	32.0	30.3
Other liabilities	17.1	13.3	12.8	12.3	12.0	11.4	10.9	10.2	9.5
Memorandum items:									
Gross external debt	102.7	94.1	94.8	92.7	92.7	87.3	83.6	77.0	72.3
Public 1/	8.0	7.2	8.5	7.4	9.3	7.2	7.3	4.5	3.4
Private	94.7	86.8	86.3	85.2	83.4	80.1	76.3	72.5	68.9
Short-term	31.1	26.2	26.3	26.4	25.9	25.0	24.0	22.9	21.9
Long-term	63.7	60.7	60.0	58.9	57.5	55.2	52.4	49.6	47.0
Gross external debt	102.7	94.1	94.8	92.7	92.7	87.3	83.6	77.0	72.3
Excluding intercompany lending	61.3	53.9	55.4	53.9	54.9	51.0	49.2	44.4	41.4
Net external debt 2/	66.7	59.4	55.6	56.9	54.0	49.1	43.9	38.7	34.0
Excluding intercompany lending	25.3	19.3	16.2	18.1	16.1	12.8	9.4	6.1	3.1
Gross external debt (percent of GNFS exports)	180.0	141.4	142.1	135.7	132.1	122.3	116.1	105.5	97.7

Sources: BNB; NSI; and IMF staff estimates.

1/ General government, excluding publicly-guaranteed private debt.

2/ Gross debt minus gross international reserves.

Table 6a. Bulgaria: General Government Operations, 2010–18 1/

(Millions of leva, unless otherwise indicated)

	2010	2011	2012 Est.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
Revenue	23,053	24,435	26,516	28,570	29,454	31,204	32,883	34,858	36,894
Taxes	14,044	15,085	15,933	16,563	17,686	18,918	20,231	21,532	22,888
Taxes on profits	1,353	1,496	1,478	1,519	1,579	1,685	1,840	1,940	2,048
Taxes on income	2,031	2,180	2,298	2,429	2,583	2,749	2,918	3,094	3,275
Value-added taxes	6,267	6,612	7,152	7,574	8,161	8,756	9,360	9,965	10,587
Excises	3,568	3,860	4,048	4,070	4,368	4,636	4,964	5,321	5,697
Customs duties	119	131	118	120	122	128	134	142	150
Other taxes	705	806	840	853	873	963	1,015	1,071	1,131
Social contributions	4,091	4,567	4,642	4,847	5,073	5,292	5,543	5,795	6,049
Grants	1,603	1,463	2,368	3,349	3,300	3,595	3,600	3,900	4,200
Other revenue 2/	3,315	3,321	3,573	3,810	3,395	3,399	3,509	3,631	3,757
Expenditure	25,877	25,923	26,874	30,169	30,904	32,465	33,879	35,367	36,898
Expense	21,514	22,483	22,910	24,849	25,253	25,955	26,756	27,840	29,023
Compensation of employees	4,147	4,152	4,239	4,345	4,345	4,345	4,345	4,519	4,740
Use of goods and services	4,208	4,421	4,444	4,892	4,919	5,087	5,209	5,333	5,460
Interest	486	547	573	875	692	780	782	826	872
External	336	350	374	654	418	468	407	429	453
Domestic	150	197	199	222	275	313	376	397	419
Subsidies	1,317	1,518	1,228	1,383	1,431	1,333	1,365	1,397	1,431
Grants 3/	670	779	809	908	905	980	1,051	1,051	1,051
Social benefits	10,583	10,949	11,482	12,335	12,864	13,332	13,907	14,616	15,371
Pensions	6,971	7,108	7,234	7,873	8,125	8,435	8,774	9,172	9,591
Social assistance	1,797	1,915	2,067	2,078	2,253	2,287	2,314	2,372	2,431
Transfers to Health Insurance Fund	1,815	1,927	2,181	2,384	2,486	2,610	2,819	3,073	3,349
Other expense	104	117	134	110	98	98	98	98	98
Contingency 4/	1,317	490	365	676	991	1,196	1,503	1,503	1,403
Net acquisition of nonfinancial assets /5	3,045	2,950	3,600	4,644	4,660	5,313	5,620	6,024	6,472
Net lending/borrowing 1/	-2,823	-1,488	-359	-1,600	-1,450	-1,261	-995	-509	-4
Primary balance	-2,338	-941	214	-724	-757	-481	-213	317	868
Financing	2,824	1,488	359	1,600	1,450	1,261	995	509	4
Privatization proceeds	46	239	76	141	151	38	32	0	0
Net external financing	161	134	2,047	-527	2,947	-602	1,920	-1,668	205
Disbursements		430	2,252	1,285	3,271	1,405	2,291	576	576
Amortization		-297	-205	-1,813	-325	-2,007	-371	-2,245	-371
Net domestic financing	2,634	1,160	-1,749	2,362	-1,426	1,849	-941	2,178	-201
Bank credit / Securities issuance	1,555	723	303	2,292	1,485	1,186	1,388	1,400	1,400
Amortization	-589	-576	-970	-1,006	-1,070	-467	-1,022	-1,033	-1,022
Fiscal Reserve Account	1,668	1,013	-1,082	1,077	-1,841	1,130	-1,307	1,810	-579
Net lending and other items	-19	-45	-16	-376	-222	-24	-15	0	0
Memorandum items:									
Fiscal reserve account	6,012	4,999	6,081	5,010	6,829	5,658	6,926	5,115	5,694
Gross public debt	10,532	11,629	13,674	13,768	17,129	17,246	19,532	18,231	18,814
Nominal GDP (percent change)	3.2	6.8	3.0	1.6	2.4	4.3	5.3	5.6	5.6
Real GDP (percent change)	0.4	1.8	0.8	0.5	1.6	2.5	3.0	3.0	3.0
HICP inflation (percent change)	3.0	3.4	2.4	0.4	0.8	1.8	2.3	2.5	2.5
Nominal private consumption (percent ch.)	2.6	6.2	6.2	0.9	2.5	4.8	5.8	5.4	5.2
Nominal imports (percent change)	10.2	18.6	8.7	0.0	6.2	6.6	7.2	7.6	7.7

Sources: Ministry of Finance; and staff estimates.

1/ On cash basis.

2/ Includes dividends.

3/ Contribution to EU budget.

4/ The contingency reserve in 2012 includes BGN 261 million for the Health Insurance Fund.

5/ Includes only acquisitions of nonfinancial assets, i.e., capital expenditure.

Table 6b. Bulgaria: General Government Operations, 2010–18 1/

(Percent of GDP, unless otherwise indicated)

	2010	2011	2012 Est.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
Revenue	32.7	32.4	34.2	36.3	36.5	37.1	37.1	37.2	37.3
Taxes	19.9	20.0	20.5	21.0	21.9	22.5	22.8	23.0	23.2
Taxes on profits	1.9	2.0	1.9	1.9	2.0	2.0	2.1	2.1	2.1
Taxes on income	2.9	2.9	3.0	3.1	3.2	3.3	3.3	3.3	3.3
Value-added taxes	8.9	8.8	9.2	9.6	10.1	10.4	10.6	10.6	10.7
Excises	5.1	5.1	5.2	5.2	5.4	5.5	5.6	5.7	5.8
Customs duties	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other taxes	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Social contributions	5.8	6.1	6.0	6.2	6.3	6.3	6.3	6.2	6.1
Grants	2.3	1.9	3.1	4.3	4.1	4.3	4.1	4.2	4.2
Other revenue 2/	4.7	4.4	4.6	4.8	4.2	4.0	4.0	3.9	3.8
Expenditure	36.7	34.4	34.6	38.3	38.3	38.6	38.2	37.8	37.3
Expense	30.5	29.9	29.5	31.5	31.3	30.8	30.2	29.7	29.4
Compensation of employees	5.9	5.5	5.5	5.5	5.4	5.2	4.9	4.8	4.8
Use of goods and services	6.0	5.9	5.7	6.2	6.1	6.0	5.9	5.7	5.5
Interest	0.7	0.7	0.7	1.1	0.9	0.9	0.9	0.9	0.9
External	0.5	0.5	0.5	0.8	0.5	0.6	0.5	0.5	0.5
Domestic	0.2	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4
Subsidies	1.9	2.0	1.6	1.8	1.8	1.6	1.5	1.5	1.4
Grants 3/	0.9	1.0	1.0	1.2	1.1	1.2	1.2	1.1	1.1
Social benefits	15.0	14.5	14.8	15.7	15.9	15.8	15.7	15.6	15.6
Pensions	9.9	9.4	9.3	10.0	10.1	10.0	9.9	9.8	9.7
Social assistance	2.5	2.5	2.7	2.6	2.8	2.7	2.6	2.5	2.5
Transfers to the Health Insurance Fund	2.6	2.6	2.8	3.0	3.1	3.1	3.2	3.3	3.4
Other expense	0.1	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Contingency 4/	1.9	0.7	0.5	0.9	1.2	1.4	1.7	1.6	1.4
Net acquisition of nonfinancial assets /5	4.3	3.9	4.6	5.9	5.8	6.3	6.3	6.4	6.5
Net lending/borrowing 1/	-4.0	-2.0	-0.5	-2.0	-1.8	-1.5	-1.1	-0.5	0.0
Primary balance	-3.3	-1.2	0.3	-0.9	-0.9	-0.6	-0.2	0.3	0.9
Financing	4.0	2.0	0.5	2.0	1.8	1.5	1.1	0.5	0.0
Privatization proceeds	0.1	0.3	0.1	0.2	0.2	0.0	0.0	0.0	0.0
Net external financing	0.2	0.2	2.6	-0.7	3.7	-0.7	2.2	-1.8	0.2
Disbursements		0.6	2.9	1.6	4.1	1.7	2.6	0.6	0.6
Amortization		-0.4	-0.3	-2.3	-0.4	-2.4	-0.4	-2.4	-0.4
Net domestic financing	3.7	1.5	-2.3	3.0	-1.8	2.2	-1.1	2.3	-0.2
Securities issuance			0.4	2.9	1.8	1.4	1.6	1.5	1.4
Amortization			-1.2	-1.3	-1.3	-0.6	-1.2	-1.1	-1.0
Fiscal Reserve Account	2.4	1.3	-1.4	1.4	-2.3	1.3	-1.5	1.9	-0.6
Net lending and other items	0.0	-0.1	0.0	-0.5	-0.3	0.0	0.0	0.0	0.0
Memorandum items:									
Gross public debt	14.9	15.4	17.6	17.5	21.2	20.5	22.0	19.5	19.0
Structural fiscal balance	-2.9	-1.1	0.2	-1.2	-1.3	-1.1	-1.1	-0.6	0.0
Output gap (percent of potential GDP)	-3.2	-2.4	-1.8	-2.1	-1.8	-0.9	0.0	0.0	0.0
Nominal GDP (millions of leva)	70,511	75,308	77,582	78,792	80,689	84,171	88,665	93,608	98,827

Sources: Ministry of Finance; and IMF staff estimates.

1/ On cash basis.

2/ Includes dividends.

3/ Contribution to EU budget.

4/ The contingency reserve in 2012 includes BGN 261 million for the Health Insurance Fund.

Table 7. Bulgaria: Monetary Accounts, 2010–18

(In billions of leva, unless otherwise stated)

	2010 Dec.	2011 Dec.	2012 Dec. Est.	2013 Dec. Proj.	2014 Dec. Proj.	2015 Dec. Proj.	2016 Dec. Proj.	2017 Dec. Proj.	2018 Dec. Proj.
Monetary Survey									
Net foreign assets	17.1	21.1	25.3	28.4	32.8	34.2	37.4	37.9	39.6
Net domestic assets	49.2	52.5	53.9	55.0	56.6	61.3	65.5	72.7	80.0
Domestic credit	50.0	53.7	55.1	56.5	58.2	62.8	66.9	74.2	81.4
General government	-2.3	-0.5	-0.7	0.6	0.2	1.8	1.8	3.1	4.0
Non-government	52.3	54.3	55.8	55.9	58.0	61.0	65.1	71.0	77.4
Broad money (M3)	50.7	56.9	61.7	67.1	71.0	74.9	79.3	84.2	89.9
Currency outside banks	7.4	7.8	8.5	9.0	9.3	9.7	10.3	10.8	11.4
Reserve money	14.1	14.9	17.4	18.7	19.0	19.4	19.8	20.3	20.8
Deposits 2/	43.4	49.1	53.2	58.1	61.7	65.2	69.1	73.4	78.5
Accounts of the Bulgarian National Bank									
Net foreign assets	24.0	24.6	29.0	28.2	31.3	32.1	35.3	35.9	37.9
Net foreign reserves (billions of euro)	12.2	12.6	14.8	14.4	16.0	16.4	18.0	18.3	19.4
Net domestic assets	-5.5	-5.0	-6.7	-5.6	-6.8	-4.8	-5.5	-3.2	-3.2
Net claims on government	-5.3	-4.2	-5.7	-4.6	-5.8	-4.0	-5.0	-2.8	-2.9
Base money	14.1	14.9	17.4	18.7	19.0	19.4	19.8	20.3	20.8
Currency in circulation	7.4	7.8	8.5	9.0	9.3	9.7	10.3	10.8	11.4
Banks reserves	6.8	7.1	8.9	9.7	9.7	9.6	9.6	9.5	9.4
Deposit money banks									
Net foreign assets	-6.9	-3.5	-3.6	0.2	1.5	2.1	2.2	2.0	1.7
Gross foreign assets	8.0	9.1	10.0	13.0	13.8	14.3	14.3	14.0	13.6
Gross foreign liabilities	14.8	12.6	13.7	12.8	12.3	12.2	12.1	12.0	11.9
Net domestic assets	54.2	56.5	59.3	59.3	62.2	65.1	70.2	75.2	82.7
Domestic credit	55.2	57.9	60.7	61.0	63.9	66.8	71.8	76.8	84.2
Memorandum items:			(Annual percentage change, unless otherwise indicated)						
Base money	9.0	5.6	16.7	7.4	1.7	1.9	2.4	2.4	2.5
Broad money	6.4	12.2	8.4	8.7	5.9	5.5	5.9	6.2	6.7
Domestic non-government credit	1.3	3.8	2.8	0.3	3.6	5.3	6.7	9.0	9.0
Domestic deposits	6.9	13.2	8.3	9.2	6.1	5.7	6.0	6.2	6.9
Domestic currency	11.9	21.0	17.0	7.5	6.5	6.1	6.4	6.6	7.3
Foreign currency	2.2	5.2	-2.1	11.6	5.6	5.1	5.5	5.7	6.4
Money multiplier (ratio)	3.59	3.82	3.55	3.59	3.74	3.87	4.00	4.15	4.32
Velocity (M3) (ratio)	1.39	1.32	1.26	1.17	1.13	1.12	1.11	1.11	1.09
GDP (millions of leva)	70,511	75,308	77,582	78,792	80,689	84,171	88,665	93,608	98,827

Sources: Bulgarian National Bank, National Statistics Institute, and Fund staff estimates and projections.

1/ Includes long term deposits and bank capital and reserves
2/ Includes deposits at central bank.
3/ Includes repurchase agreements.

Table 8. Bulgaria: Financial Soundness Indicators, 2010–13

(In percent)

	2010 Dec	2011 Dec	2012 March	2012 June	2012 Sept	2012 Dec	2013 March	2013 June
Core indicators								
Capital adequacy								
Capital to risk-weighted assets	17.5	17.5	17.5	16.7	16.6	16.7	16.8	17.0
Tier 1 capital to risk-weighted assets	15.2	15.7	15.8	15.2	15.1	15.2	15.4	15.6
Asset quality								
Nonperforming loans to total gross loans	11.9	14.9	16.2	16.9	17.3	16.6	16.9	17.1
Nonperforming loans net of provisions to capital	28.1	36.9	40.7	43.1	43.4	39.1	38.3	37.7
Large exposures to capital	87.9	112.2	109.4	120.2	126.4	115.1	127.2	120.8
Earnings and profitability								
Return on assets	0.9	0.8	0.9	0.8	0.9	0.7	0.8	0.8
Return on equity 1/	7.9	7.1	8.4	7.9	8.2	6.8	8.0	7.4
Net interest income to gross income	74.2	73.3	71.6	70.9	69.7	68.8	68.5	68.2
Noninterest expense to gross income	49.1	50.4	52.4	52.2	51.3	52.1	53.0	53.4
Personnel expense to total income	17.8	18.5	19.3	19.4	19.2	19.1	20.2	20.0
Trading and fee income to total income	24.7	25.0	24.5	27.3	28.1	27.8	30.0	27.9
Liquidity								
Liquid assets to total assets	20.9	21.9	22.1	22.6	22.4	22.4	23.2	22.3
Liquid assets to short-term liabilities	30.1	25.4	25.6	26.0	25.9	25.8	26.7	25.7
Liquid assets to total liabilities	24.2	28.9	29.7	30.2	30.2	30.0	31.0	29.6
Encouraged indicators								
Deposit-taking institutions								
Capital to assets 2/	10.5	10.8	10.7	10.3	10.3	10.1	10.1	10.4
Trading income to total income	5.4	4.9	5.3	7.3	7.8	7.4	8.1	5.7
Personnel expenses to noninterest expenses	36.3	36.6	36.9	37.3	37.3	36.7	38.1	37.4
Customer deposits to total (non-interbank) loans	87.8	95.2	97.0	97.3	99.4	100.2	102.9	102.9
Foreign currency denominated loans to total loans	61.3	63.8	64.1	64.6	64.3	64.0	64.0	62.5
Foreign currency denominated liabilities to total liabilities	58.6	54.8	54.0	54.1	52.1	51.8	51.9	51.5

Source: Bulgarian National Bank.

1/ Return on equity is calculated with Tier I capital as denominator.

2/ Capital to assets is based on Tier I capital.

Appendix I. External and Public Debt Sustainability Analyses

1. **External debt peaked in 2009 and has since declined.** With little change in public external debt relative to GDP, the decline in gross external debt from 108 percent of GDP at end-2009 to 95 percent of GDP at end-2012 was due to private sector deleveraging. Half of this decline was due to banks, where debt fell from 24 percent of GDP at end-2009 to 16 percent of GDP at end-2012. Excluding inter-company lending, which is relatively stable, external debt was 55 percent of GDP at end-2012, and this was largely offset by international reserves. Rollover risks in the nonbank private sector, which did not materialize during the global financial crisis, are contained by the moderate short-term exposure.

Bulgaria: Gross External Debt

	2012 Est.	2013 Proj.	2014 Proj.
	(Percent of GDP)		
Total	94.8	92.7	92.7
Excluding intercompany lending	55.4	53.9	54.9
Net of international reserves	16.2	18.1	16.1
Public	8.5	7.4	9.3
Private	86.3	85.2	83.4
o/w: Short term nonbank 1/	15.3	15.7	15.8
Loans	10.6	11.0	10.9
Trade credit	3.5	3.5	3.5
Amortization of MLT debt	1.1	1.2	1.3

Sources: BNB; NSI; and IMF staff estimates.

1/ At remaining maturity; excluding intercompany lending.

2. **The counterpart of the private sector deleveraging was the reduction in the current account deficit.** The current account moved from a deficit of 25 percent of GDP in 2007 and 9 percent of GDP in 2009 to a (projected) surplus in 2013. Baseline medium-term balance of payments projections indicate the current account returning to deficit, financed mainly by foreign direct investment flows.

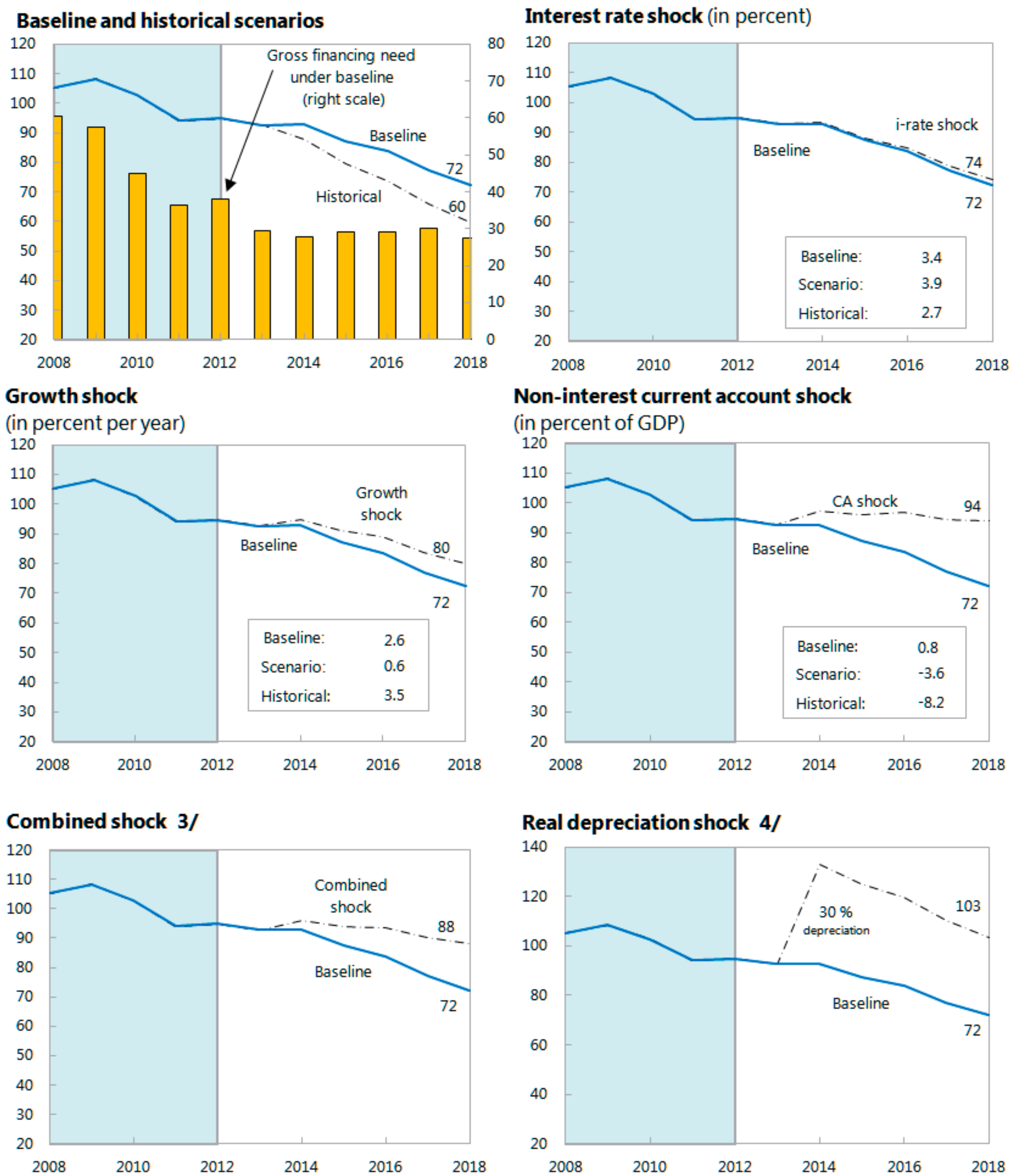
3. **Gross external debt in the baseline projections declines further.** It reaches around 72 percent of GDP by 2018 primarily due to nominal GDP growth, with relatively little change in nominal external debt (which falls by 3 percent from 2012 to 2018). In the historical DSA scenario the denominator effect on the debt-to-GDP ratio is even stronger because historical growth is higher than projected growth (Figure 1 and Table 1).

4. **The decline in external debt relative to the size of the economy appears well anchored.** Shocks applied to the interest rate, the growth rate and the current account deficit would shift the trajectory of external debt relative to GDP upwards. However, in these scenarios the highest level of external debt reached by 2017 is 86 percent of GDP, which would still imply declines in the ratio of external debt to GDP in coming years.

5. **Public debt remains at very manageable levels.** At around 20 percent of GDP in the baseline projections, Bulgaria's indebtedness remains low by international standards. In alternative scenarios, the public debt ratio remains well contained (Figure 2 and Table 2). However, risks from unaccounted contingent liabilities (and worse-than-assumed downside scenarios) could result in higher outcomes, as could aging-related spending pressures following the recent reversal of pension reforms.

Figure 1. Bulgaria: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: Bulgarian authorities; and IMF staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2014.

Table 1. Bulgaria: External Debt Sustainability Framework, 2008–2018

(In percent of GDP, unless otherwise indicated)

	Actual													Projections						
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012			2013	2014	2015	2016	2017	2018	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	63.5	58.1	62.2	66.7	78.1	94.3	105.1	108.3	102.7	94.1	94.8			**92.7**	**92.7**	**87.3**	**83.6**	**77.0**	**72.3**	**-5.7**
Change in external debt		-5.3	4.1	4.5	11.5	16.1	10.8	3.1	-5.6	-8.6	0.7			-2.1	0.1	-5.5	-3.6	-6.6	-4.7	
Identified external debt-creating flows (4+8+9)		-16.1	-12.4	-8.7	-7.2	-12.2	-6.0	12.0	0.0	-13.4	3.3			-4.2	-4.6	-4.7	-4.6	-4.4	-4.2	
Current account deficit, excluding interest payments		3.3	4.7	9.9	15.7	23.0	20.5	7.0	0.0	-1.8	-0.3			-2.6	-1.6	-1.7	-0.8	-0.3	0.3	
Deficit in balance of goods and services		10.2	11.3	15.4	17.5	19.7	20.5	8.2	2.5	-0.4	3.1			0.4	1.1	1.5	2.0	2.5	3.0	
Exports	50.2	51.3	55.2	56.0	61.2	59.4	58.1	47.6	57.1	66.5	66.7			68.3	70.2	71.3	72.1	73.0	74.0	
Imports		61.5	66.5	71.5	78.7	79.1	78.6	55.8	59.5	66.1	69.8			68.7	71.3	72.8	74.1	75.5	77.0	
Net non-debt creating capital inflows (negative)		-7.0	-8.1	-12.3	-16.3	-20.7	-10.9	-4.7	-3.2	-2.3	-2.9			-3.3	-4.0	-4.4	-4.5	-4.5	-4.6	
Automatic debt dynamics 1/		-12.5	-9.0	-6.3	-6.7	-14.4	-15.7	9.6	3.3	-9.3	6.5			1.7	1.0	1.4	0.6	0.4	0.1	
Contribution from nominal interest rate		1.9	1.6	1.6	1.9	2.1	2.4	2.1	1.4	1.7	1.8			2.2	2.5	3.6	3.1	2.8	2.3	
Contribution from real GDP growth		-2.7	-3.2	-3.5	-3.8	-4.0	-4.7	6.2	-0.4	-1.7	-0.8			-0.5	-1.5	-2.2	-2.5	-2.4	-2.2	
Contribution from price and exchange rate changes 2/		-11.6	-7.4	-4.4	-4.8	-12.6	-13.3	1.4	2.3	-9.3	5.5			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/		10.8	16.4	13.2	18.7	28.4	16.8	-8.8	-5.6	4.8	-2.6			2.1	4.6	-0.8	1.0	-2.2	-0.6	
External debt-to-exports ratio (in percent)	126.4	113.2	112.5	119.0	127.7	158.8	181.0	227.6	180.0	141.4	142.1			135.7	132.1	122.3	116.1	105.5	97.7	
Gross external financing need (in billions of US dollars) 4/		3.5	5.6	11.5	14.1	24.0	31.5	28.0	21.6	19.6	19.4			15.7	15.2	16.4	17.2	18.6	17.8	
in percent of GDP		17.0	22.3	39.6	42.3	56.8	60.4	57.5	45.1	36.5	38.1	10-Year	10-Year	29.4	27.9	29.0	29.2	30.2	27.4	
Scenario with key variables at their historical averages 5/														**92.7**	**87.9**	**79.6**	**73.6**	**65.9**	**59.9**	**-14.2**
Key Macroeconomic Assumptions Underlying Baseline												Historical Average	Standard Deviation							
Real GDP growth (in percent)		5.5	6.7	6.4	6.5	6.4	6.2	-5.5	0.4	1.8	0.8	3.5	4.1	0.5	1.6	2.5	3.0	3.0	3.0	
GDP deflator in US dollars (change in percent)		22.5	14.5	7.6	7.7	19.2	16.4	-1.3	-2.1	10.0	-5.5	8.9	9.5	4.4	0.0	1.1	1.5	1.8	1.8	
Nominal external interest rate (in percent)		3.8	3.4	2.9	3.3	3.5	3.1	1.8	1.3	1.9	1.8	2.7	0.9	2.4	2.7	4.1	3.8	3.5	3.1	
Growth of exports (US dollar terms, in percent)		32.1	31.6	16.1	25.3	23.1	20.9	-23.6	18.0	30.6	-4.5	17.0	17.8	7.5	4.4	5.3	5.6	6.2	6.2	
Growth of imports (US dollar terms, in percent)		36.4	32.1	23.0	26.4	27.5	22.8	-33.8	4.9	24.3	0.5	16.4	20.9	3.4	5.3	5.9	6.4	6.8	6.9	
Current account balance, excluding interest payments		-3.3	-4.7	-9.9	-15.7	-23.0	-20.5	-7.0	0.0	1.8	0.3	-8.2	8.9	2.6	1.6	1.7	0.8	0.3	-0.3	
Net non-debt creating capital inflows		7.0	8.1	12.3	16.3	20.7	10.9	4.7	3.2	2.3	2.9	8.8	6.2	3.3	4.0	4.4	4.5	4.5	4.6	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 2. Bulgaria: Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

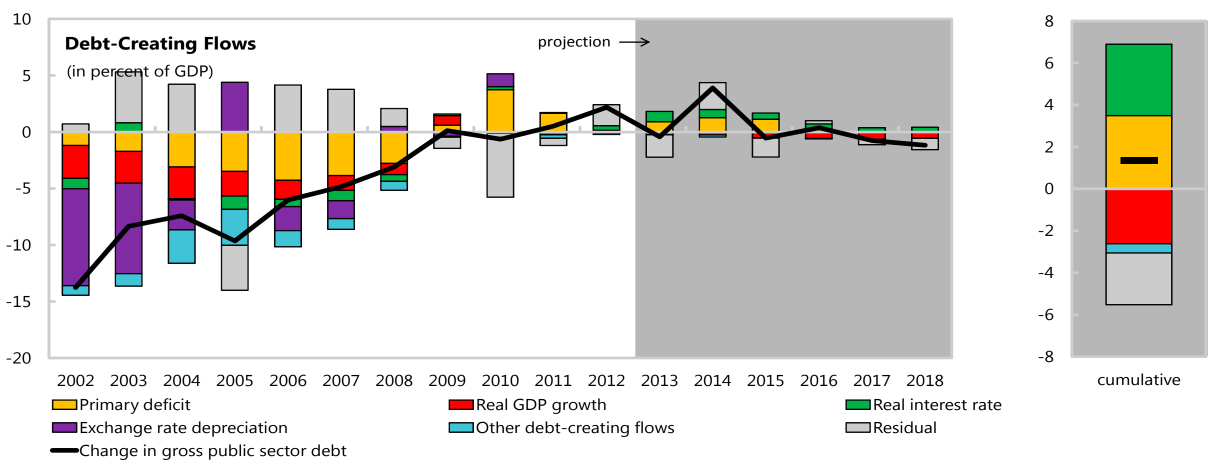
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2002-2010 [2/]	2011	2012	2013	2014	2015	2016	2017	2018
Nominal gross public debt	28.6	15.4	17.6	17.2	21.1	20.6	20.9	20.2	19.0
Public gross financing needs	3.1	3.1	2.1	5.2	3.4	4.6	2.3	3.9	1.9
Real GDP growth (in percent)	4.1	1.8	0.8	0.5	1.6	2.5	3.0	3.0	3.0
Inflation (GDP deflator, in percent)	5.6	4.9	2.2	1.1	0.8	1.8	2.3	2.5	2.5
Nominal GDP growth (in percent)	10.0	6.8	3.0	1.6	2.4	4.3	5.3	5.6	5.6
Effective interest rate (in percent) [4/]	4.5	5.2	4.9	6.4	5.1	4.6	4.5	4.5	4.6

As of November 15, 2013		
Sovereign Spreads		
EMBIG (bp) 3/		110
5Y CDS (bp)		125
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB	BBB
Fitch	BBB-	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2002-2010	2011	2012	2013	2014	2015	2016	2017	2018	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-6.0	0.5	2.2	-0.4	3.9	-0.5	0.4	-0.8	-1.2	1.4	
Identified debt-creating flows	-6.9	1.1	0.3	1.5	1.5	1.1	0.1	-0.3	-0.2	3.8	
Primary deficit	-1.8	1.7	0.1	0.9	1.3	1.1	0.3	-0.1	0.0	3.5	-0.2
Primary (noninterest) revenue and grants	36.0	32.0	33.8	35.9	36.1	36.7	36.7	36.9	36.9	219.1	
Primary (noninterest) expenditure	34.2	33.7	33.9	36.7	37.3	37.8	36.9	36.8	37.0	222.6	
Automatic debt dynamics [5/]	-3.8	-0.2	0.3	0.8	0.5	0.1	-0.2	-0.2	-0.2	0.8	
Interest rate/growth differential [6/]	-1.9	-0.2	0.3	0.8	0.5	0.1	-0.2	-0.2	-0.2	0.8	
Of which: real interest rate	-0.4	0.0	0.4	0.9	0.7	0.6	0.4	0.4	0.4	3.4	
Of which: real GDP growth	-1.5	-0.3	-0.1	-0.1	-0.3	-0.5	-0.6	-0.6	-0.6	-2.6	
Exchange rate depreciation [7/]	-1.9	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	-1.3	-0.3	-0.1	-0.2	-0.2	0.0	0.0	0.0	0.0	-0.4	
Net privatization proceeds (negative)	-1.3	-0.3	-0.1	-0.2	-0.2	0.0	0.0	0.0	0.0	-0.4	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	0.9	-0.6	1.9	-2.0	2.4	-1.7	0.3	-0.5	-1.0	-2.5	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period. It also reflects changes in the Fiscal Reserve Account.

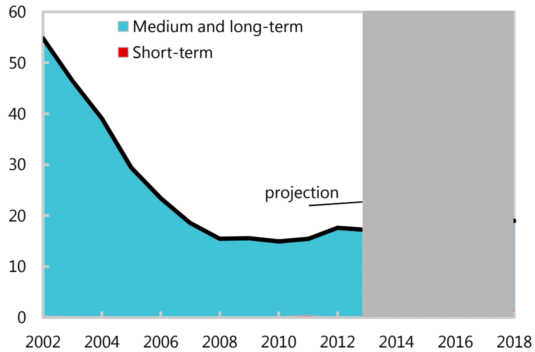
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 2. Bulgaria: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

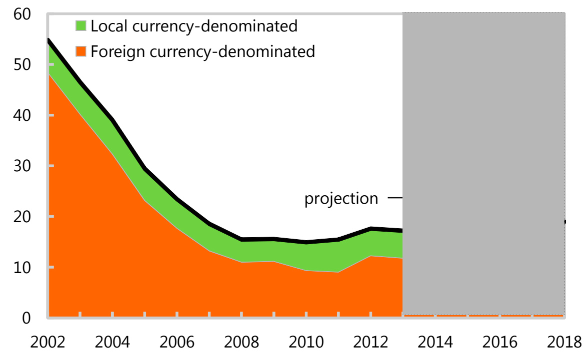
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

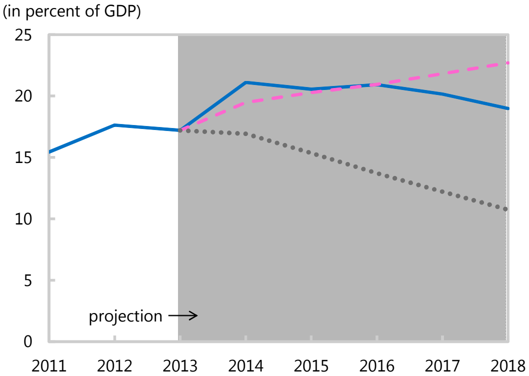


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

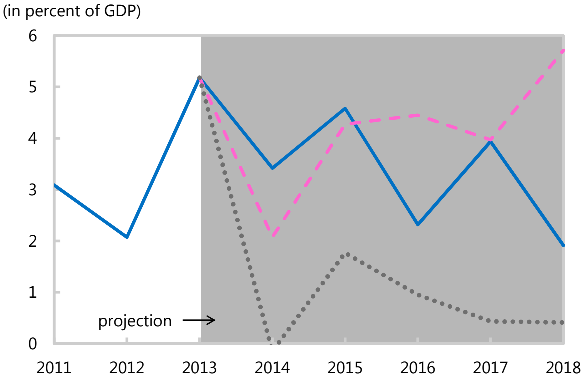
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	0.5	1.6	2.5	3.0	3.0	3.0
Inflation	1.1	0.8	1.8	2.3	2.5	2.5
Primary Balance	-0.9	-1.3	-1.1	-0.3	0.1	0.0
Effective interest rate	6.4	5.1	4.6	4.5	4.5	4.6
Constant Primary Balance Scenario						
Real GDP growth	0.5	1.6	2.5	3.0	3.0	3.0
Inflation	1.1	0.8	1.8	2.3	2.5	2.5
Primary Balance	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Effective interest rate	6.4	4.5	5.6	5.9	6.9	7.0

Historical Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	0.5	3.5	3.5	3.5	3.5	3.5
Inflation	1.1	0.8	1.8	2.3	2.5	2.5
Primary Balance	-0.9	1.3	1.3	1.3	1.3	1.3
Effective interest rate	6.4	4.5	5.9	6.0	7.0	7.6

Source: IMF staff.

INTERNATIONAL MONETARY FUND

BULGARIA

December 23, 2013

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department
(in consultation with other departments)

CONTENTS

FUND RELATIONS

(as of November 26, 2013)

Membership Status

Joined on September 25, 1990. Article VIII status assumed on September 24, 1998.

General Resources Account

	SDR Million	Percent Quota
Quota	640.20	100.00
Fund holdings of currency	606.11	94.68
Reserve position in Fund	34.10	5.33

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	610.88	100.00
Holdings	611.58	100.12

Outstanding Purchases and Loans: None.

Latest Financial Arrangements

	Date of Arrangement	Expiration Date	Amount Approved	Amount Drawn
			SDR million	
Stand By	8/6/2004	3/31/07	100.00	0.00
Stand By	2/27/2002	3/15/04	240.00	240.00
EFF	7/25/1998	9/24/01	627.62	627.62

Projected Payments to the Fund

(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2012	2013	2014	2015	2016
Principal	--	--	--	--	--
Charges/Interest	--	0.00	0.00	0.00	0.00
Total	--	0.00	0.00	0.00	0.00

Exchange Rate Arrangement:

The currency of Bulgaria is the lev. Since July 1, 1997, the Bulgarian National Bank has operated a currency board arrangement. From July 1, 1997 to December 31, 1998, the lev was pegged to the Deutsche Mark at BGN 1000 per Deutsche Mark. Since January 1, 1999 the lev has been pegged to the euro at BGN 1.95583 per euro. Bulgaria joined the European Union (EU) on January 1, 2007. Bulgaria has accepted the obligations of Article VIII, Sections 2–4, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transfers.

Article IV Consultations

The 2012 Article IV Board discussion took place on November 30, 2012. The Staff Report was published on December 13, 2012 (Country Report No. 12/328).

Resident Representative

Mr. Tolosa is the Regional Resident Representative, based in Bucharest. He took up the position in June 2013.

IMF-WORLD BANK RELATIONS

A. Partnership in Bulgaria's Development Strategy

1. The World Bank has been leading the policy dialogue in structural and institutional reforms aimed at Bulgaria's successful EU integration and convergence. On May 17, 2011 the Board of Directors discussed the Country Partnership Strategy (CPS) of the Bank which outlined the roadmap for the Bank's country support for the period 2011–13. The CPS maintains a strong focus on Bulgaria making the most of its EU membership. It aims to partner with Bulgaria in strengthening national institutions and capacity to meet EU targets and in accelerating the absorption of EU grant funds. The objective of the CPS is to support Bulgaria in strengthening institutions and policies to achieve smart, sustainable, and inclusive growth. The CPS proposes a program dominated by knowledge and advisory services complemented by a modest lending program. World Bank knowledge and advisory services focus on policy reforms, sector strategies and strengthening institutional capacity for increased EU funds absorption. The Bank continues to undertake substantial knowledge and advisory services on policy reforms in select sectors and themes of Bulgaria's National Reform Program 2011–2015 such as innovation, education, business regulation, transport, water, climate change, and social inclusion.

B. IMF-World Bank Collaboration in Specific Areas

2. The Fund team led by Ms. Shannon (mission chief) meets regularly with the World Bank Bulgaria team led by Mr. Markus Repnik (Country Manager for Bulgaria, the Czech Republic and Slovakia), to discuss macro-critical structural reforms and to coordinate the two teams' work. The most recent meeting took place in November 2013.

3. Bulgaria's main macroeconomic challenges are to maintain stability and enhance growth in a difficult external environment. Fiscal discipline and growth enhancing public spending are key to supporting the currency board arrangement and improving growth prospects. Continued prudent regulation and adequate capital buffers will help maintain financial system stability in a changing supervisory framework in Europe, while improvements in the business climate will facilitate more sustainable tradable-based growth.

4. Based on this shared assessment, the teams identified six structural reform areas as macro critical in view of their central role in achieving fiscal consolidation and enhancing growth.

- **EU funds absorption.** Increased absorption of EU funds through improvements of administrative capacity and upgrading planning, execution, and monitoring systems will play a vital role in supporting growth and investment.

- **Healthcare reform**. Mispricing and other distorted incentives have created financing pressures for the public health insurance fund, calling for a comprehensive reform focusing on efficiency and quality of the system—including through rationalizing in-patient care.
- **Education reform**. Building on past achievement, education reforms should focus on improving results. The areas of reform include measures to enhance the quality of student learning and to improve access to education.
- **Pension reform.** Reforms to improve the financial performance and equity of the pension system will be key to contain rising fiscal costs associated with aging and declining population.
- **Improving the environment for growth.** Anchoring wage growth in productivity growth and strengthening the business environment by improving the insolvency framework and reducing the regulatory costs for doing business are called for. Furthermore, reforms in the judicial system and anti-corruption and anti-monopoly regimes are necessary to underpin higher potential growth.
- **Basic infrastructure and energy.** Upgrading basic infrastructure and strengthening energy governance, security of supply, and energy efficiency are a high priority to improve competitiveness of the economy.

5. The teams agreed that the Bank and the Fund share responsibility on financial sector issues, revenue administration, and pension reforms, while the Bank will lead EU funds absorption, basic infrastructure, business environment, health and education reforms, and social inclusion. Both teams will keep the other apprised of upcoming missions and assessments. World Bank country economists participated in the Article IV Consultations in September 2012 and November 2013.

Bulgaria: Bank and Fund activities, April 2011– June 2015		
Work Program	Products	Delivery Date
World Bank	Technical assistance on pensions (analytic work and workshops)	April 2011
	Water Sector Strategy (advisory)	June 2011
	Poverty & Social Policy Monitoring (analytic work)	January 2012
	Competitiveness Through Innovation (analytic work)	February 2012
	Public Expenditures for Growth and Competitiveness (analytic work)	March 2012
	Gas Security of Supply Study (analytic work)	June 2013
	Health Sector Policy Note (analytic work)	October 2012
	Support for the implementation of the National Roma Integration Strategy (analytic work)	June 2013
	Regulatory Reform (analytic work)	June 2013
	Mitigating the Economic Impact of an Aging Population	September 2013
	FY11-FY13 Programmatic Education Sector (advisory)	September 2013
	Bulgaria Power Sector Diagnostic Assessment	May 2013
	Consumer Protection and Financial Advisory	June 2013
	Gender Dimensions of Roma Inclusion (analytic work)	October 2013
	Climate Change and Green Growth (analytic work)	December 2013
	Optimizing and Integrating social Benefits and Employment Services Provision (advisory)	March 2014
	Bulgaria Productivity Growth (analytic work)	June 2014
	Bulgaria Energy Dialogue	September 2014
	Financial Consumer Protection (advisory)	May 2014
	Competition Policy Reforms and Business Environment	June 2014
	Programmatic Education Sector FY14-15 (advisory)	June 2014
	Deposit Insurance (regional task)	June 2015
Fund	TA provision on public debt management (Spring 2011)	October 2011 report
	Staff visit	May 2012
	TA provision on national accounts	October 2012
	2012 Article IV Consultation	November 2012 Board
	Staff visit	July 2013
	2013 Article IV Consultation	November 2013
	Staff visit	Spring 2014
	2014 Article IV Consultation	Fall 2014

C. The World Bank Group Strategy and Lending Operations

6. The Bank's Country Partnership Strategy (CPS) for Bulgaria, discussed by the Bank's Board on May 17, 2011, is anchored in Bulgaria's National Reform Program to implement the Europe 2020 Strategy and focused on three main pillars: (i) policy reforms for the National Reform Program to implement Europe 2020 Strategy, (ii) strategies and institutions to accelerate EU funds absorption, and (iii) complementing EU financing.[1]

7. The active Bank portfolio in Bulgaria as of November 2013 consists of 3 operations at the original loan amount of US$230.5 million equivalent. The World Bank's lending program in Bulgaria to date comprises 46 IBRD operations with a total original commitment of US$3,003 million equivalent, consisting of 15 adjustment loans (US$1,725.8 million), 24 investment projects (US$1,123 million), one debt reduction loan (US$125 million), four Bank-managed Global Environmental Fund (GEF) grants, and two Bank-managed Prototype Carbon Fund (PCF) operations. Of these 46 operations, 43 have been completed (of which 13 have been fully or partially cancelled during implementation), and 3 operations are currently under implementation (Table 1).

8. Economic and Sector Work. The World Bank country diagnostic work completed over the last two years focuses on assessing the economic and fiscal impact of an aging population; governance, quality assurance and financing of higher education; health sector reform; programmatic crisis monitoring, and administrative barriers to private sector growth Recently completed analytical work includes: Mitigating the Economic Impact of an Aging Population, Power Sector Rapid Assessment, Health Sector Diagnosis. Strengthening Higher Education, Administrative Barriers to Businesses at Municipal Level, and Alternative Dispute Resolution for Financial Services. Three reimbursable advisory service (RAS) agreements for provision of World Bank advisory services were signed in 2012 focusing on water supply and sanitation, innovation, and roads. Currently RAS agreements in the field of health and irrigation are under preparation.

9. As of November, 2013, the IFC had 37 projects (completed and ongoing) in Bulgaria with total commitments of over US$895 million. The single biggest investment of IFC in the country is in the field of renewable energy in the form of a loan for the construction of the largest wind park in Bulgaria. IFC is also involved in the development of the *Galata* gas field near the Black sea cost. In line with the IFC's strategic goals for Bulgaria, IFC has supported a company investing in agricultural land and promoting land consolidation. In the financial sector, IFC is supporting two specialized SME banks; it established Bulgaria's first micro-lending bank and has invested in a venture fund, which is also targeting the SME sector. In other industries, IFC had contributed to key manufacturing projects—it has supported the modernization and expansion of an electronics producer, a large steel mill, and two glass processing plants. Some IFC projects entail an important environmental component. One of the manufacturing plants, for example, is purchasing equipment

[1] International Bank for Reconstruction and Development and International Finance Corporation Country Partnership Strategy for Bulgaria for the period 2011-2013 (April 20, 2011).

which would reduce its GHG emissions and the electronics producing company is making sensors for cars that monitor the emission of polluting gases and improve fuel efficiency.

Questions on World Bank activities in Bulgaria may be referred to Ms. Stella Ilieva (3592–9697–251) and Ms. Sylvia Stoynova (3592–9697–220).

Table 1. Bulgaria: Active World Bank Operations (Net of Cancellations)

	Operation	US$ million	Board date
1.	Second Trade and Transport Facilitation in Southeast Europe (TTFSE 2)	50.9	2007
2.			
2.	Social Inclusion Project	59.0	2008
3.	Municipal Infrastructure Development Project	118.7	2009

STATISTICAL ISSUES

Data provision is adequate for surveillance purposes. Bulgaria participates in the SDDS since 2003.

Real Sector

1. **The National Statistical Institute (NSI) is responsible for compiling national accounts, based on a system consistent with the *System of National Accounts 1993* (*SNA 1993*) and the *European System of Accounts 1995*.** GDP data by activity and expenditure categories are compiled and reconciled within an annual supply and use framework. Government output and final consumption are estimated on an accrual basis. Published national accounts include current and capital accounts for the five main domestic sectors (general government and its sub-sectors, financial corporations, non-financial corporations, nonprofit institutions serving households, and households). The INS publishes financial accounts and balance sheets by institutional sectors and sub-sectors on an annual basis.

2. **The NSI has compiled estimates of quarterly GDP by the production and expenditure approaches in current and constant prices since 1994.** The preliminary flash estimates of GDP and its components by production and expenditure side are produced and disseminated 42–44 days after the reference period, although persistent inconsistencies in the data have limited their usage. The quarterly updates are disseminated 65 days after the end of the reference quarter with final figures disseminated after approximately 5 quarters. The annual data are disseminated about 5 quarters after the end of the reference year. The estimates at constant prices, which follow international standards, use chain-linked indices. Problems remain in the coverage of private sector activities as well as regarding constant price estimates of capital formation and external trade, although progress has been made in the development of export and import deflators. Recent IMF TA advised on improving the seasonal adjustment procedure of quarterly GDP and volume measures of taxes on products.

3. **Regarding price data, the NSI produces a domestic consumer price index (CPI), a harmonized consumer price index (HICP) according to Eurostat methods, and a producer price index (PPI).** All are updated monthly. The CPI series begins in 1995, the PPI in 2000 and the HICP in 2005 (for earlier years it is set equal to the CPI). The coverage of the consumer price indices was extended, although they still exclude some important sectors, mainly owner-occupied housing and health and life insurance. Since 2004, financial services are included. Work has started on inclusion of owner-occupied housing in the HICP under a Eurostat project. The geographical coverage of the index is restricted to 27 urban areas that account for an estimated 65 percent of sales.

4. **The flow of customs data has improved significantly in recent years and a new system for processing customs records is near completion.** The development of export and import unit value indices is progressing smoothly and additional support is expected from Eurostat in this area.

The current indices are used as deflators for the import and export components of the national accounts. Each month the Foreign Trade Statistics Department of the NSI is in contact with the BNB to review data issues and ensure consistency between the NSI export and import data and the balance of payments data.

5. The national accounts data on employment and hours worked are compiled by the NSI based on a Labor Force Survey and Enterprises' survey on employment—"Quarterly survey on employees, hours worked, wages and salaries, and other expenditures paid by the employers" and "Annual enterprises survey on employment, wages and salaries, and other labor cost" are adjusted according to the ESA95 methodology. The NSI current monthly and quarterly estimates are based on the results from the quarterly sample survey of establishments – QLCS. The QLCS sample includes 13000 private sector enterprises out of approximately 223000. The public sector enterprises are covered exhaustively except for the schools and kindergartens for which from 2008 a sample is drawn as well. The NSI household labor force survey is an alternative source of data, but the methodological discrepancies between household and establishment survey need to be taken into account (especially regarding agricultural employment). Since the beginning of 2003 a quarterly Labour force survey, providing average quarterly results, is implemented.

6. The NSI also compiles and publishes quarterly wage data for various economic sectors. The main shortcomings include: (i) under-reporting of private sector wages; and (ii) reporting of average gross earnings only and not wages by occupation. Since 2002, a survey on earnings (Structure of Earnings Survey – SES) is conducted every four years providing information about average monthly and hourly earnings by economic activity, occupation, gender and education. The household budget survey provides an alternative source of data for private sector wages.

7. A Population Census was conducted in early 2011 and is a source for redesigning the household surveys conducted by the NSI, particularly the household budget survey and the labor force survey.

Government finance

8. In recent years, following the recommendations of a combined STA/FAD mission and within the framework of fiscal reporting requirements for EU accession, the authorities have made significant progress on implementing accrual accounting for government, budgetary and statistical systems. Consolidated data on a cash basis, covering general and central government operations, are routinely reported for publication in the *GFS Yearbook/Annual CD-ROM* and in *IFS*. In addition, quarterly accrual GFS data for the whole general government are reported for publication in *IFS*, through Eurostat. The major part of the GFS data is compiled by NSI and the transmissions to Eurostat are carried out by NSI. Since September 2008, the Ministry of Finance (MOF) prepares and submits the SDDS indicators for the central government finances in the IMF's GFSM 2001 format. The same indicators are published on the MOF's website on a monthly and quarterly basis.

9. The Ministry of Finance prepares data on the execution of the consolidated government budget on a monthly basis, following the national presentation. These data are not according to *GFS* standards. Aggregate data on revenue, expenditure, balance of the general government and composition of financing (in national formats) are published in the monthly bulletin and posted on the MOF's website, in addition to the GFSM 2001 data. Progress has been made in presenting data on a disaggregated basis, including expenditure by functional classification. In addition, a full economic classification of expenditure is now available, and the authorities have provided such data on an annual basis back to 1998.

Money and banking statistics

10. The BNB reports monetary data for publication in *IFS* based on the ECB framework for the collection and compilation of monetary data.

Balance of payments

11. Bulgaria provides quarterly balance of payments (BOP) statistics for dissemination in *IFS* on a timely basis. Yearly BOP data are disseminated in the Balance of Payments Statistics Yearbook up to 2012. The BNB derives other sectors' investment income data on reinvested earnings (debit) from the annual direct investment surveys of the NSI, as well as through quarterly surveys of the largest foreign-owned enterprises for preliminary estimates. Starting from 2002, data series on freight were revised according to a new methodology introduced jointly by the BNB and the NSI. Since joining the EU in January 2007, the trade data with EU countries are being collected following the INTRASTAT system. Data for imports and exports of goods with non-EU member states are based on SAD (Single Administrative Document) collected by Customs Agency while the movement of goods within the EU is based on Intrastat declarations collected by the National Revenue Agency.

Data Standards and Quality

12. Bulgaria is subject to the statistical requirements and reporting standards of Eurostat and the European Central Bank (ECB). Bulgaria subscribes to the Special Data Dissemination Standard (SDDS) since 2003, and the relevant metadata have been posted on the Dissemination Standards Bulletin Board. A data ROSC has been published in December 2003. The latest (2012) annual observation report for Bulgaria is posted on the Fund's website http://dsbb.imf.org/images/pdfs/AnnualReports/2012/BGR_SDDS_AR2012.pdf.

Bulgaria: Table of Common Indicators Required for Surveillance
(as of December 4, 2013)

	Date of latest observation	Date received[6]	Frequency of data[7]	Frequency of reporting[7]	Frequency of publication[7]
Exchange Rates	11/29/2013	11/29/2013	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	October2013	11/21/2013	M	M	M
Reserve/Base Money	October 2013	11/25/2013	M	M	M
Broad Money	October 2013	11/25/2013	M	M	M
Central Bank Balance Sheet	October 2013	11/25/2013	M	M	M
Consolidated Balance Sheet of the Banking System	October 2013	11/25/2013	M	M	M
Interest Rates[2]	October 2013	11/27/2013	M	M	M
Consumer Price Index	October 2013	11/12/2013	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2012	04/23/2013	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	October 2013	11/29/2013	M	M	M
Stocks of General Government and General Government-Guaranteed Debt[5]	September 2013	11/22/2013	M	M	M
External Current Account Balance	September 2013	11/15/2013	M	M	M
Exports and Imports of Goods and Services	August 2013	11/15/2012	M	M	M
GDP	2013 Q3	12/4/2013	Q	Q	Q
Gross External Debt	September 2013	11/25/2013	M	M	M
International Investment Position	2013 Q2	09/30/2013	Q	Q	Q

[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] On a gross cash basis. The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and local governments. [5] Including currency and maturity composition. [6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 14/30
FOR IMMEDIATE RELEASE
January 30, 2014

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with Bulgaria

On January 24, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bulgaria.[1]

In the aftermath of the global financial crisis growth has remained low and unemployment high. Real GDP growth is projected at about 0.5 percent in 2013 as domestic uncertainties undermined demand but exports are performing well. Domestic demand is projected to recover gradually, and exports and foreign direct investment (FDI) will benefit from recovery in Europe, allowing real GDP growth to rise to about 1.6 percent in 2014. The current account of the balance of payments is expected to be in surplus in 2013 but return to a modest deficit in the medium term, financed by FDI. Inflation is projected to be subdued in the short term, rising only from 0.4 percent in 2013 to 0.8 percent in 2014. With employment beginning to grow, unemployment is projected to decline slightly in 2014 but remain high.

Strong macroeconomic and financial sector policies have mitigated vulnerabilities arising from the difficult external and domestic environment. The fiscal deficit fell to 0.5 percent of GDP in 2012 and public debt remained the second lowest in the EU. The reduction in banks' foreign liabilities has been gradual and is largely driven by plentiful bank liquidity, resulting in a positive net foreign asset position for the first time since 2006, and capitalization of the financial sector is high. Although nonperforming loans (NPLs)—a legacy from the boom period and subsequent crisis—amounted to 17.2 percent of loans in September, coverage by provisions is comfortable at 72.7 percent.

[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.

Convergence to EU income levels over the coming decades will require accelerated growth. Bulgaria ranks favorably versus comparators on macro-policy outcomes but less so on other dimensions critical to the well functioning of the economy. Bulgaria is comparable to good performers in central Europe and the Baltics on fiscal and country risk, and the income tax system is also seen as favorable in competitiveness rankings. However, Bulgaria ranks much lower on measures such as enforcing contracts, resolving insolvencies, and some areas of red tape. More generally, the judicial system is viewed as problematic, and corruption and cronyism as widespread. These shortcomings will need to be addressed for Bulgaria to unlock its growth potential.

Executive Board Assessment[2]

Executive Directors commended the authorities for maintaining macroeconomic and financial stability despite external and internal challenges. Nevertheless, growth remains weak and unemployment is high. Directors emphasized the need to complement continued prudent policies with accelerated and decisive efforts to address structural impediments to higher growth, job creation, and a faster pace of income convergence with the European Union.

Directors generally agreed that the structural fiscal stance under the 2014 budget, which sets the deficit close to national limits under the fiscal rule, strikes an appropriate balance. While the strong fiscal position provides some room to support growth, they underscored the importance of maintaining credibility in the context of the currency board by observing national and EU deficit rules. Fiscal buffers should be rebuilt over time by targeting a balanced structural budget. In the event revenues fall short in the coming year, the authorities should be prepared to adjust spending to achieve the deficit target. While welcoming the intended increase in capital spending, Directors stressed the importance of appropriate project selection and monitoring procedures under the new public investment fund. They encouraged the authorities to improve the targeting and efficiency of social spending, including on healthcare; to reinstate the needed pension reforms; and to address risks associated with some state-owned enterprises.

Directors noted that the financial system is stable, well capitalized, and liquid, but that profitability is low. They encouraged further steps to reduce nonperforming loans through asset disposal in order to reduce asset price uncertainty in the market and support future investment. Directors supported the efforts to preserve the conservative supervisory approach under the new European framework.

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[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 emphasized that bold structural reforms are needed to lift growth, create jobs, and enhance productivity. Policies should focus on improving the business climate and the judicial system as well as anti-corruption and anti-monopoly regimes. Active labor market policies, including further improvements in education and training will be important to reduce labor market rigidities. Directors also encouraged continued efforts to ensure the rapid and efficient absorption of EU funds.

Bulgaria: Selected Economic and Social Indicators, 2009–14

	2009	2010	2011	2012 Est.	2013 Proj.	2014 Proj.
Output, prices, and labor market (percent change, unless otherwise indicated)						
Real GDP	-5.5	0.4	1.8	0.8	0.5	1.6
Real domestic demand	-12.8	-5.1	0.3	3.5	-0.9	1.5
Consumer price index (HICP, average)	2.5	3.0	3.4	2.4	0.4	0.8
Consumer price index (HICP, end of period)	1.6	4.4	2.0	2.8	-0.5	1.5
Employment	-3.1	-6.1	-2.8	-1.1	0.1	0.8
Unemployment rate (percent of labor force)	6.9	10.3	11.3	12.4	12.4	11.9
Nominal wages (national accounts definition)	9.4	11.2	8.6	5.6	4.5	5.0
General government finances (percent of GDP)						
Revenue	35.3	32.7	32.4	34.2	36.3	36.5
Expenditure	36.2	36.7	34.4	34.6	38.3	38.3
Balance (net lending/borrowing on cash basis)	-0.9	-4.0	-2.0	-0.5	-2.0	-1.8
External financing 1/	0.9	0.2	0.2	2.6	-0.7	3.7
Domestic financing (incl. fiscal reserve)	0.0	3.8	1.8	-2.2	2.7	-1.9
Gross public debt	15.6	14.9	15.4	17.6	17.5	21.2
Money and credit (percent change)						
Broad money (M3)	4.2	6.4	12.2	8.4	8.7	5.9
Domestic private credit	3.8	1.3	3.8	2.8	0.3	3.6
Interest rates (percent)						
Interbank rate, 3-month SOFIBOR	5.7	4.1	3.8	2.3	…	…
Lending rate	11.3	11.1	10.6	9.7	…	…
Balance of payments (percent of GDP, unless otherwise indicated)						
Current account balance	-8.9	-1.5	0.1	-1.3	0.4	-0.9
Capital and financial account balance	4.8	-1.1	-1.3	7.0	-3.2	4.7
o/w: Foreign direct investment balance	7.2	2.7	3.1	3.3	2.8	3.5
International investment position	-102	-95	-86	-81	-79	-78
o/w: Gross external debt	108	103	94	95	93	93
o/w: Gross official reserves	37	36	35	39	36	39
Exchange rates						
Leva per euro	Currency board peg to euro at lev 1.95583 per euro					
Leva per U.S. dollar (end of period)	1.34	1.48	1.45	1.47	…	…
Real effective exchange rate (percent change)	4.4	-3.9	2.7	-2.1	…	…

Social indicators (reference year in parentheses):

Per capita GNI (2011): US$ 6,550; income distribution (Gini index, 2007): 28.2; poverty rate (2007): 10.6 percent.

Primary education completion rate (2009): 95.5.

Births per woman (2010): 1.5; mortality under 5 (per 1,000) (2011): 12.1; life expectancy at birth (2010): 73.5 yrs

Sources: Bulgarian authorities; World Development Indicators; and IMF staff estimates.

1/ Reflects €950 million Eurobond issued in 2012 and another assumed in 2014.

Statement by Menno Snel, Executive Director for Bulgaria and Tsvetan Manchev, Advisor to Executive Director
January 24, 2014

The Bulgarian authorities highly appreciate the informative and candid exchange of views with the mission during the 2013 Article IV consultation, and thank staff for their appraisal. They remain committed to prudent macroeconomic policies, and attentive to the Fund's advice and recommendations.

Despite the external headwinds and domestic challenges, Bulgaria maintains macroeconomic and financial stability. Amid the uncertainty, the Currency Board Arrangement (CBA) continues to be the cornerstone for domestic policymaking, together with stringent prudential regulations and a strong underlying fiscal position. A new impetus for the structural reforms will come from improving public confidence in the reform process and further strengthening of the EU fund's utilization.

The authorities' near-term plan includes three main pillars: (1) increased attention to social issues, thereby reducing the number of people at risk of poverty or social exclusion through better targeting and increased efficiency of social spending; (2) further reduction of external and fiscal vulnerabilities through internal restructuring of the budget without deviating from the new medium-term structural deficit target; and (3) maintaining a conservative approach to bank supervision while implementing the new European Capital Requirements Directive IV (CRD IV) framework.

We focus our remarks on (1) recent macroeconomic developments; (2) fiscal sustainability; (3) the banking system; and (4) structural reforms.

Recent Macroeconomic Developments

The GDP dynamics in Q3 2013 suggested an acceleration of growth to 1.5 percent, which compared favourably to the EU average growth during the same period (0.3 percent)**.** Growth was mainly boosted by exports, up by 9.6 percent. Even as demand from export-oriented industries led to higher imports, up by 8.6 percent, net exports sustained their positive contribution. Final consumption increased by 1.2 percent driven by the rise in public spending. Consumer prices increased by 0.2 percent in October, thus breaking the deflationary path, and the negative annual HICP decelerated to 1.1 percent. Short-term indicators also confirm these early signs of recovery.

Labor productivity broke the negative trend observed in the previous quarter, and stepped up by 1.6 percent yoy in real terms in Q3. The upward industrial productivity trend was the main driver behind the quarterly reading, up by 4 percent (yoy). The seasonally adjusted unemployment rate marginally decreased in Q3, but the trend reversed in October, and its level remained unchanged in November (12.9 percent).

The current account balance recorded a surplus of more than €1.1 billion in January-October (2.8 percent of GDP). It has been improving (in yoy terms) in most of the 2013 months, mainly resulting from stronger export of goods. The cumulative trade deficit narrowed by 39.5 percent (yoy) in January-October. The current and capital account was positive for the same period, amounting to €1.43 billion, and at the end of 2013 international reserves reached €14.4 billion which covers more than 7 months of the import.

Fiscal Sustainability

Since the global crisis, the authorities have been facing the daunting task of striking the right balance between fiscal consolidation and supporting economic growth. The protracted slowdown and uncertainty in the Euro Area and the domestic discord in early 2013 necessitated a swift and firm political and policy response. While fully observing the restrictions set by the new Fiscal Compact and domestic fiscal rules, in April 2013 the caretaker government passed a small social assistance package of 0.05 percent of GDP. Given the uncertainty it also proposed a marginal relaxation of the medium-term balance target, and the 2013-2016 Convergence Program extended the path of fiscal consolidation toward achieving Bulgaria's MTO of a 0.5 percent structural deficit by one year, to 2017.

After the parliamentary elections in May 2013, the newly established parliamentary majority has taken power with the firm ambition to spur growth, while preserving the sound underlying fiscal position. Within the revised medium-term budgetary framework, in June, the new government passed a second small social assistance package of additional 0.03 percent of GDP, and in August the Parliament revised the 2013 Budget Law which provided an additional fiscal impulse of 0.7 percent of GDP. As a result, the fiscal deficit was set to reach 2.0 percent of GDP. The budget implementation parameters as of end-November and operational data for December outline an achievement of the revised fiscal targets for the year. At the end of 2013 the fiscal reserve also remained well above the minimum threshold set by the 2013 Budget Law.

The 2014 budget fully demonstrates the fiscal responsibility of the new government as well as continuity in the fiscal policy. It remains consistent with national fiscal rules and the Fiscal Compact. The budget envisages a deficit of 1.8 percent of GDP and a further decline to a deficit of 1.1 percent of GDP by 2016. In structural terms the deficit in 2016 is expected to be reduced to 1 percent of GDP which is in line with the MTO. Implementation of the new Public Finance Law is underway, and the 2014 budgetary execution will be the first to fully comply with the new rules. This year, however, the budget lays down taut and ambitious reforms in the public finance management, while restraining administrative and operational expenditures.

Within the budget envelop, the authorities aim at increasing the efficiency of capital spending in small municipalities with otherwise low administrative capacity through the establishment of a new special purpose investment fund (0.6 percent of GDP). A competitive bidding process will be implemented under the direct control of the Council of Ministers. Concise amendments in the existing administrative regulations have been adopted to increase efficiency of the active labor market policies at both the national and regional levels. In line with the staff advice, the authorities work on regulations to extend the coverage of the targeted social assistance, and to implement more flexible eligibility thresholds.

To increase the predictability of the government finances and better anchor market expectations, the new government continues to issue debt by priority denominated in domestic currency and at fixed interest rates, as proposed by the Government Debt Management Strategy for the period 2012-2014. The government also set more stringent limitations to public sector enterprises and municipalities on taking new contingent liabilities. In addition, the management of public enterprises has been recently strengthened, while the government works on a new and more transparent framework for monitoring and control of management's appointment and performance.

The Banking System

The Central Bank of Bulgaria (BNB) remains committed to sustain and further develop the capacity of the banking system and individual credit institutions to withstand shocks. The authorities are vigilant and aware that since the global crisis has erupted the Bulgarian banking system has been operating in a challenging low growth environment. The process of deleveraging as seen in many EU banking systems did not affect the Bulgarian banking system due to the on-going strong growth of local savings. The BNB continues its policy from the pre-crisis period towards maintaining the accumulated capital and liquidity buffers during the implementation of the new European CRD IV. The available opportunities under the pillar 2 of the Basel Accord will also be explored in a flexible manner, by imposing the maximum capital conservation and systemic capital buffers on all banks. Despite a cyclical compression of profitability, the banking system remains stable, well capitalized and highly liquid, and the same applies to individual banks. NPLs are reported in a conservative manner and covered with an additionally created capital buffer.

The authorities remain committed to further develop the domestic insolvency framework in line with the best international practices. As underlined by staff, the design and implementation of an effective strategy for addressing the existing NPL stock in Bulgaria remain seriously constrained by prevailing uncertainty and the current low stage of asset market development. The authorities, however, focus on the good provisioning of NPLs and acknowledge the benefits banks see in a "wait and see approach". In the interim period, the authorities will rely on conservative banking supervision. The BNB will continue to play a supportive role to encourage a steady but gradual process of reducing distressed assets and releasing the associated collateral that avoids unduly disturbing markets.

The authorities do not intend to participate in the close cooperation framework of the Single Supervisory Mechanism, noting the absence of liquidity and solvency support as well as the lack of voting rights in the Governing Council of the ECB for non euro area participants. Meanwhile, Bulgaria remains fully engaged in the financial sector reform at the European level.

Structural Reforms

The authorities remain committed to structural reforms. In compliance with the recommendations from the European Commission and the IMF to strengthen education and narrow skills mismatches, a new National Strategy for Lifelong Education has been adopted at the beginning of 2014. The implementation of pension reforms has been postponed for one year given the widespread discontent among the population about the perceived unfairness of the existing package, but has not been reversed. The authorities have enhanced cooperation with the interested stakeholders to reach an agreement in 2014 on the augmented package to overturn the long-run deficit in the pension system.