INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/83

BULGARIA

March 2019

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; STAFF SUPPLEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR BULGARIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Bulgaria, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 20, 2019 consideration of the staff report that concluded the Article IV consultation with Bulgaria.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 20, 2019, following discussions that ended on February 1, 2019, 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 March 4, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Bulgaria.

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

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INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 19/87
FOR IMMEDIATE RELEASE
March 22, 2019

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

IMF Executive Board Concludes the 2019 Article IV Consultation with Bulgaria

On March 20, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Bulgaria.

The Bulgarian economy continues to grow strongly, supported by buoyant domestic demand. Growth exceeded 3 percent in 2018 and is projected to maintain its momentum in 2019. Capacity constraints are becoming more binding yet inflationary pressure has eased after peaking in August last year, reflecting developments in commodity and tourism-related prices. The unemployment rate has reached a historical low and wages are rising rapidly amid increasing skill shortages. The current account surplus remained sizable in 2018 but is projected to decline. Risks are tilted to the downside especially from weaker-than-expected growth of trading partners.

The fiscal balance recorded a small surplus of 0.1 percent of GDP in 2018, exceeding the budgeted deficit of 1 percent of GDP, owing to strong revenue performance and capital underspending. Credit growth has picked up across the board. The banking sector is profitable and asset quality continues to improve. Non-performing loans have fallen below 9 percent of total loans in 2018Q3. The central bank has made steady progress in strengthening banking sector supervision.

Robust economic performance needs to translate into sustainable and inclusive growth. Bulgaria’s income level is still half of the EU average and income inequality is high among EU countries. It also faces long-term growth and fiscal challenges due to demographic headwinds.

The Bulgarian authorities and ERM II parties have agreed that Bulgaria will join ERM II and the banking union simultaneously upon completing several commitments. These include strengthening financial sector supervision, improving SOE governance, and strengthening the anti-money laundering (AML) framework.

[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.

Executive Board Assessment[2]

Executive Directors welcomed Bulgaria's robust economic growth, historically low unemployment, and improved financial sector conditions. While prospects remain good, Directors considered that downside risks have recently risen, emanating mostly from the weakening in trading-partner growth and global trade. With sound macroeconomic policies in Bulgaria, Directors emphasized the need to implement broad-based structural reforms to boost potential growth, accelerate EU income convergence, and address unfavorable demographic dynamics. Improving the efficiency of public spending, the quality of public institutions, and the governance framework will be key to bolstering prospects.

Directors welcomed the strong fiscal outturn in 2018, and supported the authorities' fiscal policy plan to preserve buffers against downside risks. They were reassured that Bulgaria's low public debt provides ample room to allow automatic stabilizers to operate in the event of a negative shock. Directors encouraged the authorities to continue to improve revenue and spending efficiency.

Directors highlighted that sound institutions are important to support inclusive and sustainable growth over the medium term, and encouraged the authorities to maintain the reform momentum through effective implementation. They considered that stronger public investment management will have dual benefits of improving investment efficiency and strengthening public institutions. Directors welcomed recent progress on reforms to improve the judiciary and the fight against corruption, and commended the authorities' plan to strengthen the anti-money laundering framework and governance of state-owned enterprises.

Directors stressed that improving education and healthcare and addressing labor market bottlenecks would enhance human capital and mitigate labor shortages and skill mismatches. Directors emphasized that effective labor market policies and a deeper collaboration between educational institutions and business could help alleviate these challenges.

Directors commended the authorities' progress in strengthening financial supervision, including operationalizing the new governance framework, strengthening legislation for related-party lending, and formalizing the supervisory review and evaluation process. They welcomed the recent decline in non-performing loans (NPLs), and encouraged the central bank to ensure that banks with high NPLs maintain sufficient capital buffers.

Directors noted that Bulgaria's preparations for ERM II and the banking union would help support reforms and enhance the quality of institutions, including by strengthening financial sector supervision.

[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 summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Bulgaria: Selected Economic Indicators, 2015–19 1/					
	2015	2016	2017	2018 Est.	2019 Proj.
Real GDP	3.5	3.9	3.8	3.2	3.3
Real domestic demand	3.3	1.7	4.9	6.3	4.9
Public consumption	1.4	2.2	3.7	3.8	4.2
Private consumption	4.5	3.5	4.5	7.0	5.0
Gross capital formation	1.5	-4.3	7.3	5.7	5.2
Private investment	-3.4	-1.5	6.4	2.4	4.0
Public investment	20.3	-18.6	-5.9	13.5	10.1
Stock building 2/	-0.2	0.5	0.8	0.2	0.0
Net exports 2/	0.1	2.2	-1.1	-3.2	-1.8
Exports of goods and services 3/	5.7	8.1	5.8	-1.5	2.7
Imports of goods and services	5.4	4.5	7.5	3.2	5.3
Resource utilization					
Potential GDP	2.7	3.0	3.2	3.2	3.2
Output gap (percent of potential GDP)	-1.2	-0.4	0.2	0.2	0.2
Unemployment rate (percent of labor force)	9.2	7.7	6.2	4.7	5.0
Price					
GDP deflator	2.2	2.2	3.4	3.1	2.9
Consumer price index (HICP, average)	-1.1	-1.3	1.2	2.6	2.4
Consumer price index (HICP, end of period)	-0.9	-0.5	1.8	2.3	2.2
Fiscal indicators (percent of GDP)					
General government net lending/borrowing (cash basis)	-2.8	1.6	0.8	0.1	-0.6
General government primary balance	-2.0	2.3	1.6	0.8	-0.1
Structural overall balance	-2.4	1.7	0.8	0.1	-0.7
Structural primary balance	-1.6	2.5	1.5	0.7	-0.1
General government gross debt	25.6	27.4	23.3	20.5	19.3
Monetary aggregates					
Broad money	8.8	7.6	7.7	8.8	8.0
Domestic private credit	-1.6	1.8	4.5	8.9	7.1
Exchange rates regime					
Leva per U.S. dollar (end of period)	1.8	1.9	1.6	1.7	...
Nominal effective rate	-1.2	2.5	3.1	5.0	...
External sector (percent of GDP)					
Current account balance	0.0	2.6	6.5	4.6	2.2
o/w: Merchandise trade balance	-5.8	-2.0	-1.5	-4.1	-4.9

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

1/ Data as of February 28, 2019.

2/ Contribution to GDP growth.

3/ Exports suffered from maintenance work in the main refinery in 2018 and are expected to recover in 2019.

INTERNATIONAL MONETARY FUND

BULGARIA

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

March 4, 2019

KEY ISSUES

Context. Economic performance remains robust but risks to the outlook are tilted to the downside amid slowing external demand. Sound macroeconomic policies notwithstanding, Bulgaria faces a sizable income gap vis-à-vis the EU average and unfavorable demographic prospects. The main policy challenge is to raise growth potential, which calls for broad-based structural reforms to improve public goods provision and institutions. Bulgaria's preparations for ERM II and the banking union are strengthening financial sector supervision and are generally conducive to reforms.

Key policy issues. The Article IV discussions focused on medium-term reforms to improve public goods provision and raise potential growth and on near-term policies to enhance financial sector stability.

- **Fiscal policy.** Fiscal policy is broadly appropriate but the efficiency of spending and revenue administration could be further improved. Public debt is low and maintaining a balanced budget over the medium term would help preserve buffers. There is ample space to allow automatic stabilizers to operate when needed.
- **Structural agenda.** Priority reform areas include the quality of institutions (notably government efficiency), infrastructure, education and healthcare. Stronger public investment management would improve investment efficiency and transparency. Better performance of state-owned enterprises (SOEs) would help raise growth potential and mitigate fiscal risks.
- **Financial sector.** The authorities are advancing financial sector reforms, including to join ERM II and the banking union. Bank profits have risen and non-performing loans (NPLs) have continued to decline, although they are still high among EU countries. The central bank should ensure that banks with high NPLs have adequate capital buffers.

Approved By
Jörg Decressin (EUR) and Yan Sun (SPR)

Discussions were held in Sofia during January 21 – February 1, 2019. The team comprised Messrs. Lee (head) and Wu, Ms. Suphaphiphat (all EUR), Messrs. Hallaert (FIN), Miyamoto (FAD) and Hajdenberg (Resident Representative), and Ms. Vassileva (local Economist). Messrs. Doornbosch and Manchev (OED) joined some of the meetings. The mission met with Ministers Goranov (Finance), Ananiev (Health), and Petkova (Energy), Bulgarian National Bank Governor Radev, other senior officials, and representatives of labor and business organizations, financial institutions, and civil society.

CONTENTS

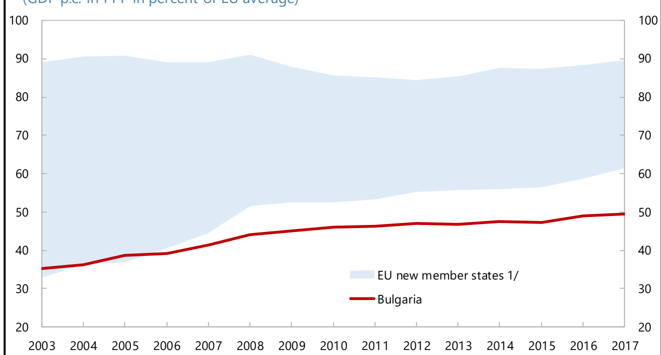
ANNEXES

APPENDIX

CONTEXT

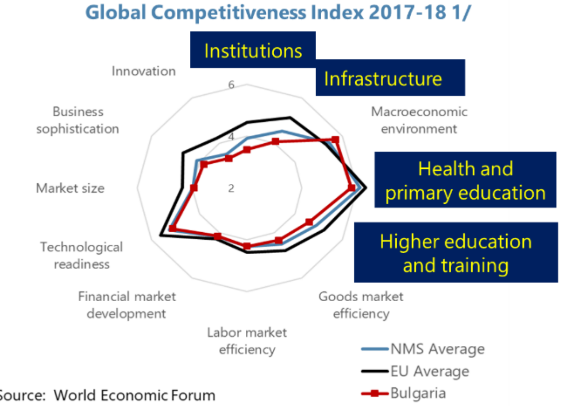
1. **Translating robust economic growth in recent years into sustainable and inclusive medium-term income convergence remains the key policy challenge.** Growth picked up since 2015 after having been hit by the global and euro-area crises. But Bulgaria's income level is still half of the EU average and income inequality is high among EU countries. It also faces long-term growth and fiscal challenges due to emigration and population aging. Sustaining inclusive growth and faster income convergence requires better public goods provision in infrastructure, the judiciary, education, and healthcare.

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



Sources: World Development Indicators; and IMF staff calculations.
1/ EU new member states excluding Bulgaria are: Croatia, Czech Republic, Hungary, Poland, Romania, Slovak Republic, Slovenia, Estonia, Latvia, and Lithuania.

Global Competitiveness Index 2017-18 1/



Source: World Economic Forum
1/ The indicators are based on official data and opinion survey of business executives. Point estimates are subject to uncertainty. Higher score means better outcome.

2. **The preparation for entry into ERM II and the banking union will be one of the key priorities of the government in 2019 (Box 1).** The Bulgarian authorities and ERM II parties have agreed that Bulgaria will join ERM II and the banking union simultaneously. Bulgaria has already met the Maastricht criteria to join the euro area (other than participating in ERM II for at least two years). This was achieved under the currency board arrangement, which has anchored macroeconomic policies since 1997. ERM II will be the logical next step to fulfill Bulgaria's ultimate EU commitment to join the euro area, likely boosting further confidence in its policy framework. This is also an election year, with European parliament and municipal elections to be held in May and October 2019, respectively.

Box 1. Bulgaria's ERM II Application

Bulgaria will likely be the first country to join ERM II after the establishment of the banking union and is expected to set a precedent for future candidates. The application process will involve adapting to the current form of the monetary union, which includes the banking union and anti-money laundering (AML) measures.

In consultation with ERM II parties, the Bulgarian authorities have made several commitments.

- Entering into close cooperation with the ECB (namely joining the banking union as a non-euro area country).
- Providing the legislative basis for borrower-based macroprudential measures.
- Enhancing the supervision of the non-banking financial sector.
- Identifying gaps in the insolvency framework and preparing a roadmap to address them.
- Strengthening the anti-money laundering (AML) framework by addressing any issues identified in the transposition into national legislation of the fourth EU AML directive and transposing the fifth AML directive into national legislation.
- Improving the SOE governance by aligning legislation with the OECD Guidelines on Corporate Governance of SOEs.

The ECB is undertaking a comprehensive assessment of six Bulgarian banks. This covers the three largest banks (all foreign) and three large domestic banks. It involves an asset quality review (AQR) and a stress test using 2018 data, with results expected to be published in July 2019. A positive assessment may still identify certain conditions to be met to join the banking union.

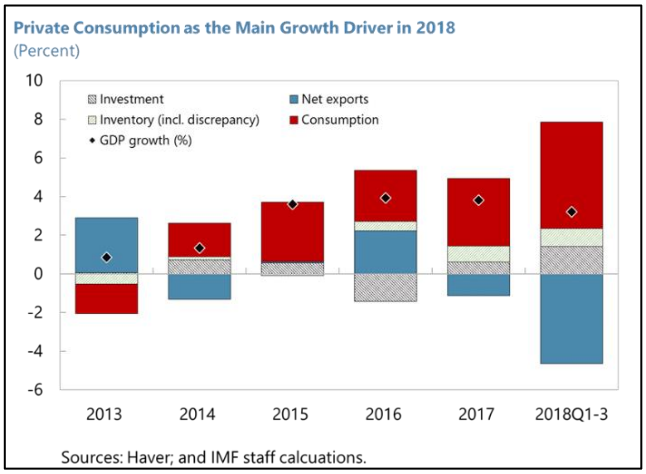
The ERM II parties also called on the Bulgarian authorities to thoroughly implement the reforms monitored under the Cooperation and Verification Mechanism (CVM). These are in the areas of judicial reform and the fight against corruption and organized crime, which are also important for financial stability. However, the CVM will remain a separate process.

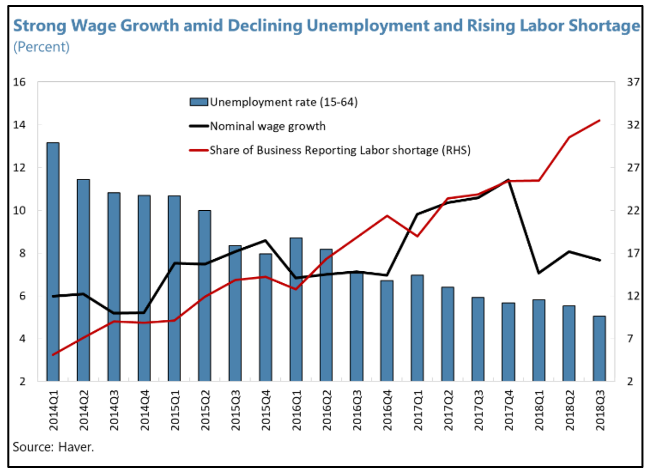
The macroeconomic impact of joining ERM II could be minimal, while enhancing market confidence. The authorities have announced their intention to maintain the currency board arrangement (like Estonia did in 2004), and ERM II transition is likely to be smooth. Still, joining ERM II and the banking union would enhance market confidence in Bulgaria's policy framework, while the entry preparations would help strengthen institutions (e.g., financial supervision).

Joining the euro area, after the ERM II participation, would bring a greater role for Bulgaria in the EU's decision-making bodies and further economic benefits of integration (e.g., enhanced confidence and reduced funding costs). Once in the euro area, the exit option is virtually foregone and Bulgaria would be exposed to greater two-way spillover effects from and to other members. The euro-area membership raises the premium of a strong and flexible economy as well as greater real convergence.

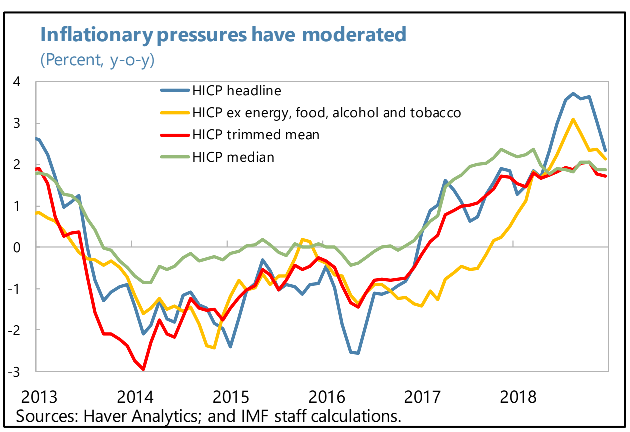
RECENT DEVELOPMENTS

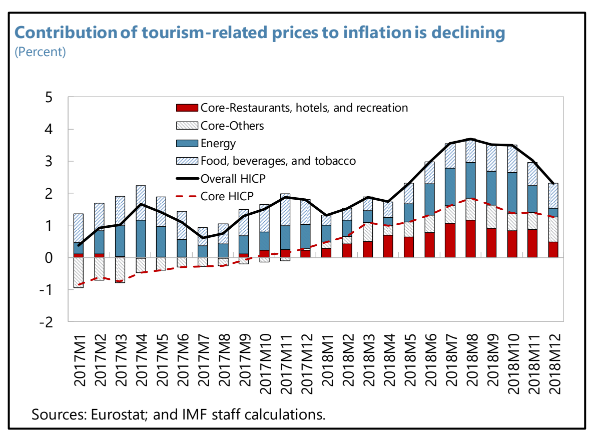
3. Economic performance remains robust. The Bulgarian economy is estimated to have grown by 3.2 percent in 2018, and the output gap to have closed. Consumption and business confidence is high. Strong household consumption (supported by continued rapid wage growth) and a rise in public investment helped offset lower export growth. The unemployment rate has declined to a historical low of 4.7 percent, and labor shortage is widespread. The fiscal balance has remained in surplus in 2018 (paragraph 10).





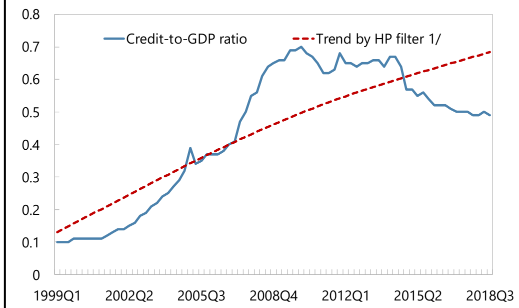
4. Inflation pressure has eased. Inflation peaked at 3.7 percent y/y in August 2018, pushed up by rising wages, tourism-related prices (accommodation), and commodity prices, but started to moderate afterwards. Headline inflation slowed to 2.3 percent in December, and core inflation declined from September—as the pressure on accommodation prices eased—to 2.1 percent by December. Other indicators of inflationary pressure (HICP trimmed mean or median) also point to a moderation of underlying inflationary pressure.





5. **Credit growth has picked up.** Both consumer and mortgage loan growth has been buoyant, accompanied by strong housing price increases (averaging 7.5 percent y/y since 2016). Credit to corporates has also been recovering and reached 5.4 percent y/y in 2018, the highest level since 2013, while credit standards have slightly tightened or remained unchanged recently. But non-financial corporate debt remains high among the new member states (NMS)[1]—notwithstanding a marked decline from 106 percent of GDP in 2008 to 80 percent of GDP in 2017. Overall credit-to-GDP ratio remains below the historical trend, with the ratio substantially below the peak reached in 2010.

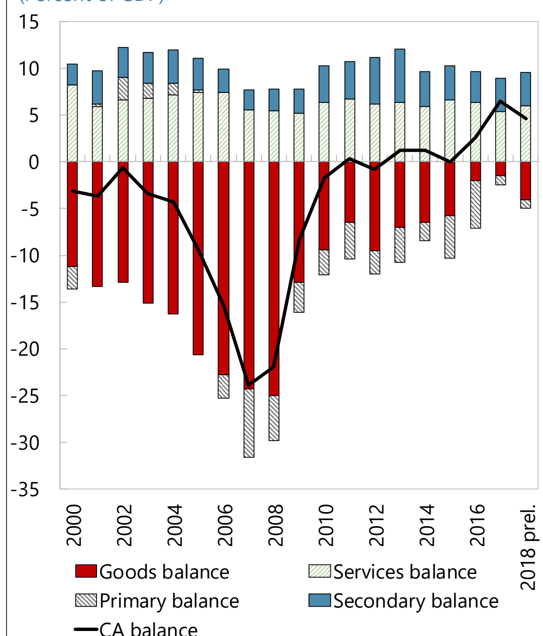
Credit Gap



Sources: Haver Analytics and IMF staff estimates.
1/ HP filter with λ set to 400,000 to capture the long-term credit trend.

6. **The current account surplus remained sizable in 2018.** According to preliminary data, the current account surplus reached 4.6 percent of GDP in 2018, smaller than in 2017 as export performance weakened owing to maintenance work in the country's main oil refinery and a deterioration in demand, notably from Turkey. The financial account balance was driven by large net portfolio outflows. This reflects net acquisition of foreign debt securities, including the repayment of maturing sovereign and private external bonds, as domestic investment opportunities were limited in the absence of sovereign debt issuance.[2]

Current Account
(Percent of GDP)



Sources: Haver and IMF staff.

OUTLOOK AND RISKS

7. **GDP growth in 2019 is projected to remain similar to last year's but to slow over the medium term.** A pickup in EU-funded capital expenditure, a recovery of the production and exports of petroleum products, and a strong wage increase could help offset the negative impact of a further decline in external demand in 2019, while still-low interest rates would continue to support growth. Medium-term growth (projected at 2.8 percent) is constrained by a declining labor force, despite

[1] NMS includes Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia.

[2] Moreover, the BNB discourages bank's excess reserves by maintaining a deposit rate lower than the ECB, which provides incentives for foreign-owned banks to reallocate funds abroad.

ongoing reform efforts. The current account surplus is expected to fall over the medium term as private savings decreases from the historical highs of 2017−18. Average headline inflation is forecast to moderate to 2.4 percent in 2019 with lower energy and food price growth. Considering current account and exchange rate indicators, staff assesses the external position of Bulgaria to be stronger than warranted by fundamentals and desirable policy settings, while noting large statistical and model uncertainty (Annex I). External debt, at about 60 percent of GDP, is sustainable (Annex IV).

8. **Risks are tilted to the downside (Annex II).** External risks dominate the near-term outlook. Weaker-than-expected growth in the EU and Turkey, rising policy and geopolitical uncertainties including about Brexit and protectionism, and tightening global financial conditions could weigh on trade and growth. Domestic risks include excessive wage growth, which could accelerate inflation and eventually erode competitiveness. Political uncertainty related to the elections could delay policy implementation. Upside risks include stronger growth induced by higher private consumption and EU funds absorption, as well as faster progress in structural reforms.

Authorities' Views

9. **The authorities expect higher growth both in the near term and over the medium term.** For 2019, the authorities expect a stronger boost to growth from the recovery of net exports, though they concur that the risks are to the downside—mainly from the external side. They also expect stronger productivity growth and lower unemployment over the medium term. The authorities do not foresee a risk of losing competitiveness in the near future, as exporters still have margins to absorb higher wages. They agree that Bulgaria's external position is currently stronger than warranted by fundamentals, but have reservations on the model specification and fit, and cautioned on likely data revision (Annex I).

POLICY DISCUSSIONS

With fiscal policy broadly appropriate, the main challenges revolve around pushing ahead with broad-based reforms to strengthen institutions and public goods provision, to improve education and healthcare sectors, and to address labor market bottlenecks. Sustained reforms in these areas will help slow emigration and stimulate productivity growth. The short-run policy priority is to complete the ERM II preparation process and continue strengthening financial system resilience.

A. Fiscal Policy

10. **The 2018 fiscal balance recorded a small surplus of 0.1 percent of GDP.** This exceeded the budgeted deficit of 1 percent of GDP, on account of revenue overperformance and

underspending of EU-funded capital projects. The budget surplus on accrual basis amounted to 1.8 percent of GDP.[3]

(In percent of GDP)	2018		2019		2020
	Budget	Est.	Budget	Proj.	MTBF
Revenue excluding grant	31.4	33.2	33.6	34.1	32.6
Tax revenue	20.4	21.2	20.8	21.1	20.4
Non-tax revenue 1/2/	4.3	4.9	5.7	5.8	5.1
Grants	2.2	2.0	2.3	2.3	2.2
Expenditure	34.6	35.1	36.4	37.1	34.7
Wages	5.3	5.4	5.6	5.7	5.6
Capital expenditure 1/	5.6	4.9	5.6	5.7	4.9
Fiscal balance	-1.0	0.1	-0.5	-0.6	0.0
Public debt	22.3	20.5	19.1	19.3	17.7

1/ Non-tax revenue includes the Sofia Airport concession fee (0.6 percent of GDP for 2019), which will be transferred to the state-owned railway company BDZ and included in capital expenditure. A concession fee of 0.4 percent of GDP was envisaged in the 2018 Budget but did not materialize.

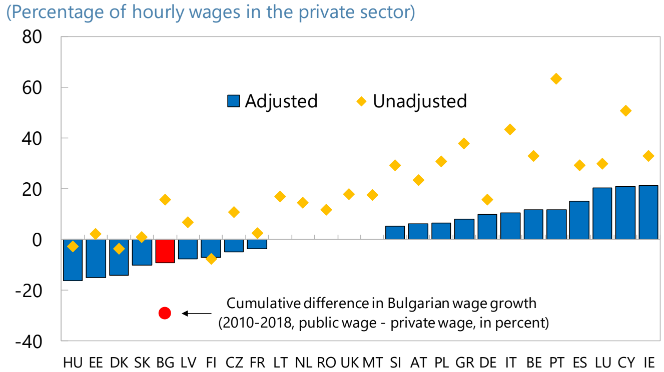
2/ The Electricity Power Security Fund was incorporated into the Consolidated Fiscal Program since July 2018. The impact on the budget balance is neutral as both non-tax revenue and subsidies are raised equally.

11. The authorities aim at a small cash deficit in 2019 and a balanced budget in subsequent years. The 2019 budget envisages increased capital expenditure—reflecting a projected increase in EU funds absorption—and higher spending on education and health. The budget also introduces a 10 percent increase in the wage bill while eliminating 1,600 redundant jobs (somewhat less than 2 percent of total government employees). The wage bill includes a 20-percent increase in teachers' wages announced in 2017. Nevertheless, with a higher revenue projection on the back of robust nominal GDP growth, the budget envisages a deficit of 0.5 percent of GDP in 2019 as in the previous medium-term budget framework (MTBF). Over the medium term, a moderate rise in non-wage spending (a reduction in percent of GDP) would help achieve a balanced budget over 2020−21, notwithstanding increases in defense spending. Public debt is projected to decline from 20.5 percent of GDP in 2018 to 17.1 percent of GDP in 2021.

12. The government's fiscal plan is broadly appropriate. The fiscal impulse will be positive in 2019 but the temporary stimulus reflects capital spending delayed from last year and higher expenditures on education and health—expenditures with medium-term payoffs. The government wage increase is to be performance-based and applies to all ministries, helping to narrow the negative public-wage premium that is likely to have widened from that estimated in 2013 (controlling for worker characteristics). Staff recommends a comprehensive functional review of public sector employment and wages, which could further improve public employment management. The medium-term targets are consistent with the need to preserve buffers in light of more volatile external demand prospects and the currency board arrangement. Bulgaria's low level of public debt provides ample space for allowing automatic stabilizers to operate freely in response to unexpected shortfalls in external demand or other shocks.

Public-Private Wage Premium

(Percentage of hourly wages in the private sector)



Sources: Haver Analytics and de Castro et al., 2013, "The Gap between Public and Private Wages: New Evidence from the EU." European Commission Economic Papers No. 508.

Note: "Adjusted" represents the public-private wage premium controlling for worker characteristics. "Unadjusted" represents the raw wage differential between public and private sectors.

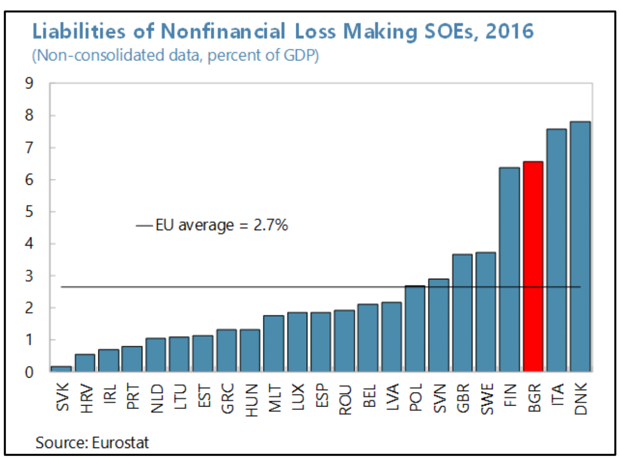
[3] The difference between the cash and accrual balances mainly reflects BGN1.3 billion (1.2 percent of GDP) allocation in December for the construction of a highway expected to start in 2019.

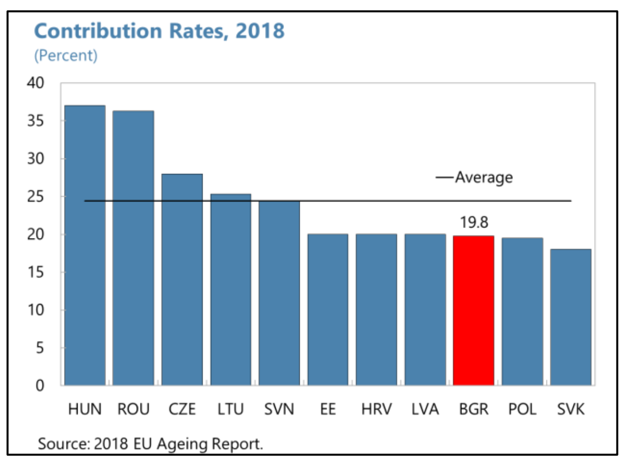
13. Revenue mobilization can be improved further. The MTBF envisages increasing tax collection through combating tax fraud and evasion, and the Single National Strategy (SNS) 2015−17 has been extended in 2018 to tackle the shadow economy (estimated to be relatively large compared with regional peers). Staff advises technical assistance (Tax Administration Diagnostic Assessment Tool) to assess the capacity of revenue administration, with a view to developing a comprehensive strategy to improve efficiency. One area will be to reduce the sizable VAT compliance gap. Given flat 10 percent personal and corporate income tax rates, Bulgaria relies heavily on indirect taxes, with VAT revenue amounting to almost half of total tax revenue in 2018.

14. Contingent liabilities from SOEs and unfavorable demographics pose long-term fiscal risks.

- The SOE debt—8.1 percent of GDP at end-2016—is lower than the EU average and the MTBF projects it to decline. However, several SOEs, notably in the energy and transport sectors, have significant debt. More generally, the bulk of liabilities are with loss-making SOEs, in contrast to elsewhere in the EU. The authorities could establish a fiscal risk management unit to monitor SOE fiscal risks (also see paragraph 19).

- The 2015 pension reforms increased the social security contribution rate and statutory retirement age, with retirement age envisaged to be raised further based on life expectancy after it reaches 65 by 2037. Nevertheless, given the unfavorable demographic trend, the social security system's annual deficit is projected to rise from 3.6 percent of GDP in 2018 to about 6 percent of GDP by 2050. Further pension-related reforms would eventually be needed to ensure long-term fiscal sustainability. The 2015 reforms also introduced unlimited transfers between Pillar I and Pillar II, although the transfers have been small so far (1.3 percent of eligible insured persons).





Authorities' Views

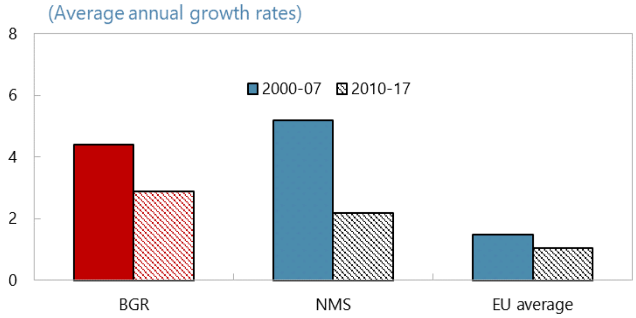
15. The authorities reiterated their commitment to fiscal discipline. They noted that a weak growth would set automatic stabilizers in motion, while they in principle prefer a balance or small surplus on the government account. The authorities note that the implementation of the SNS has led to some progress in improving tax compliance and collection, and that there has been some decline in the VAT gap in recent years. They welcome further IMF technical assistance to improve revenue administration. The authorities acknowledge that further reforms may be needed to ensure the long-term stability of the public pension system, but indicate that no near-term changes are envisaged for the 2015 reforms.

B. Structural Reforms

16. A shrinking labor force and slowing productivity growth have been weighing on Bulgaria's growth and convergence. Persistent net emigration and population aging continue to reduce the labor force, aggravating already-pressing labor shortages and skill mismatches. Labor productivity growth—a potential offset—has declined after the global financial crisis. This productivity slowdown applied to firms across the board, while firms with higher innovative assets and lower debt distress had relatively higher productivity growth (see selected issues paper (SIP) "Corporate Productivity in Bulgaria").[4]

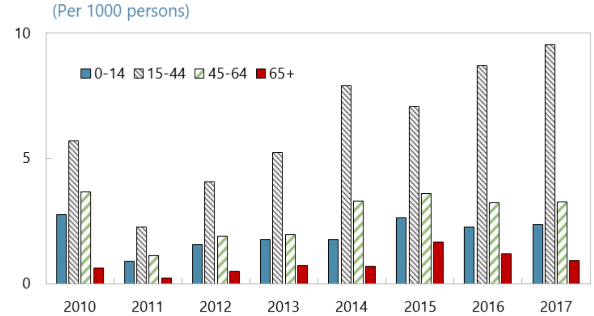
17. Sustained and broad-based reforms are needed to address the challenges of emigration and slowing productivity growth. Past analysis attributes these to structural and institutional obstacles that limit efficient use of available technologies and resources (IMF 2016a, b)[5]. Reforms to strengthen productivity growth and mitigate the impact of emigration include (i) improving the quality of institutions, including government efficiency and legal systems; (ii) upgrading infrastructure quality; (iii) increasing the quality of education and healthcare; and (iv) increasing labor force participation. In many of these areas, Bulgaria has significant gaps relative to other EU countries (Box 2).

Productivity Growth in Selected Countries
(Average annual growth rates)



Sources: Eurostat and IMF staff calculations.

Emigration Rate by Age
(Per 1000 persons)



Source: NSI and IMF staff calculations.

[4] Foreign-affiliated firms have also led productivity growth and made large economic contributions (Annex III).

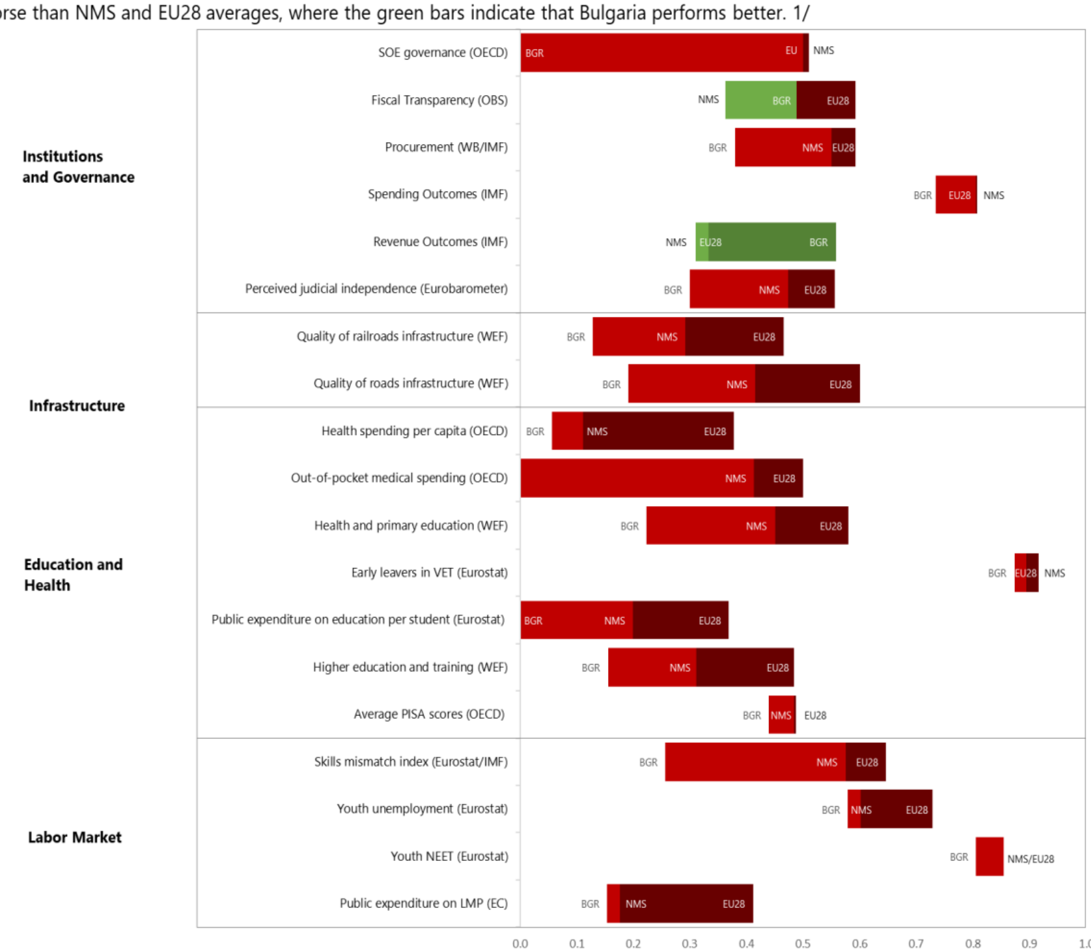
[5] International Monetary Fund (IMF), 2016a, Regional Economic Issues: Central, Eastern, and Southeastern Europe, Washington, DC. May; and IMF, 2016b, Regional Economic Issues: Central, Eastern, and Southeastern Europe, Washington, DC. November.

Box 2. Structural Gap Analysis

Compared to the NMS and EU averages, Bulgaria shows significant gaps in some areas of institutions and governance, infrastructure quality, education and health, and labor market. These are consistent with the Global Competitiveness index (see paragraph 1), and suggest that reforms to narrow these gaps should strengthen Bulgaria's growth potential.

Structural Gaps

The table shows Bulgaria's position vis-a-vis other NMS countries and EU-28 averages on various structural indicators. Indicators are normalized between 0 (worst among EU-28) to 1 (best among EU-28). The red bars correspond to indicators where Bulgaria performs worse than NMS and EU28 averages, where the green bars indicate that Bulgaria performs better. 1/



1/ Cross-country comparisons should be interpreted with caution as each country has different institutional settings. Multiple third-party indicators, including quantitative and perception-based indicators, are used to compare various aspects of governance. Point estimates of these indicators are subject to uncertainty.

Sources: European Commission, Eurostat, OECD, Open Budget Survey, Transparency International, World Bank, World Economic Forum, and Worldwide Governance Indicator.

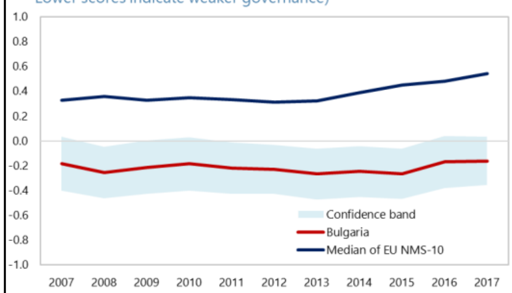
18. Stronger public investment management will have dual benefits of improving investment efficiency and strengthening public institutions. Though comparable to peers in size, Bulgaria's infrastructure is assessed below average in quality, calling for greater efficiency. Establishing guidelines for project appraisal and developing selection criteria for nationally funded investment projects would increase efficiency and reduce vulnerabilities to corruption, together with other recommendations on public investment management (Text table). Staff recommends developing an action plan to improve public investment management institutions. For EU-funded spending, the government has reduced administrative costs and improved the communication with managing authorities and beneficiaries of EU-funded projects to improve absorption. Better planning and developing a pipeline of projects early would help avoid heavy back-loading in the next funding cycle, which may adversely affect the quality of investment. Staff welcomes the ongoing project to adopt an E-procurement system, which could increase transparency and strengthen the procurement process (SIP "Bulgaria's Governance Reforms").

Key Public Investment Management Recommendations
Planning Sustainable Levels of Investment
Develop standard guidelines for project appraisal.
Establish a Public Investment Management Unit in the Deputy Prime Minister's Office.
Allocating Investment
Improve the quality of the capital expenditure forecasts in the MTBF.
Systematically record and update detailed cost information at the project level.
Develop a project pipeline and selection criteria for all major projects.
Implementing Investment
Address loopholes in the procurement appeals process and adopt E-procurement system.
Develop and systemize ex-post reviews for project monitoring and follow up
Legal and Regulatory Framework
Strengthen the legal basis for Public Investment Management.
IT Systems and Support
Expand the coverage of the Unified Management Information System to major infrastructure ministries, departments, and agencies.

19. Efforts to strengthen SOE governance are welcome. Given the importance of SOEs in network industries such as railways and energy, improving SOE governance and efficiency would help improve infrastructure and potential growth, as well as strengthening institutions. The forthcoming alignment of SOE legislation with OECD guidelines, an ERM II commitment, would help strengthen SOE governance. The guidelines recommend, among other things, developing a unified ownership policy, appointing well-qualified board members, and adopting high-quality accounting and disclosure standards. Sound implementation of new standards will be critical to improving SOEs' performance and accountability, which in turn would help contain fiscal risks (paragraph 14).

20. According to the latest CVM report, progress is being made on judicial independence and control of corruption. These are cornerstones of a sound set of institutions and support per capita income convergence over the medium run. Bulgaria is perceived among the worst in the EU on control of corruption and judicial independence, and the 2017 Eurobarometer showed that 62 percent of respondents—among the highest in the EU—considered corruption a problem when doing business in Bulgaria. The government has advanced reforms under the CVM, including by establishing the unified anti-corruption commission and strengthening the independence of judges and prosecutors in the Supreme Judicial Council. Acknowledging the progress made, the latest CVM report indicated the possibility of concluding the mechanism in 2019. Pending recommendations include implementing the newly-adopted anti-corruption framework and improving the public reporting of the implementation of the national anti-corruption strategy and corruption cases. Steadfast implementation should further improve governance, and with it, the business environment.

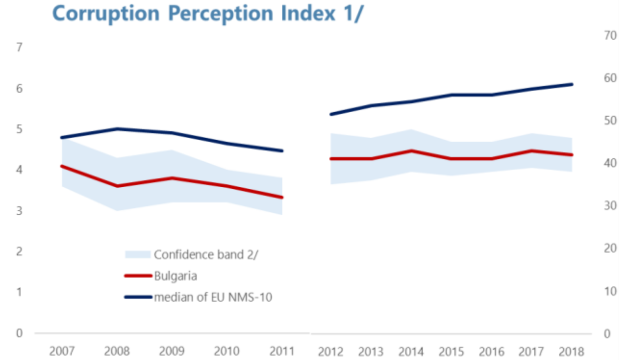
Control of Corruption Index 1/
Lower scores indicate weaker governance)



Source: Worldwide Governance Indicators, D. Kaufmann (Natural Resource Governance Institute and Brookings Institution) and A. Kraay (World Bank), 2017.

1/Use of this indicator should be considered carefully, as they are derived from perception-based data, which represent a combination of opinion surveys and expert assessments of corruption. Ranges are for a 90 percent confidence interval. Confidence intervals for peer group averages are negligible.

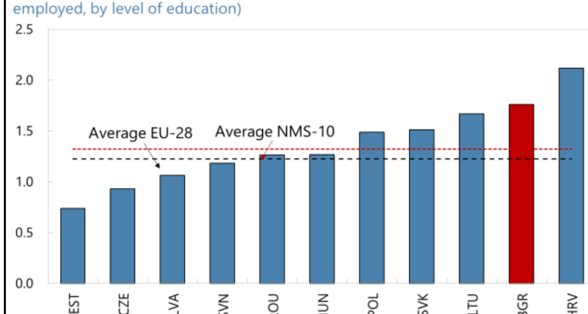
Corruption Perception Index 1/



Source: Transparency International.
1/Due to methodological changes, Index is not comparable before and after 2012. Axis of the series after 2012 is on right hand side.
2/Use of this indicator should be considered carefully, as they are derived from perception-based data, which represent a combination of opinion surveys and expert assessments of corruption. Ranges are for a 90 percent confidence interval. Confidence intervals for peer group averages are negligible.

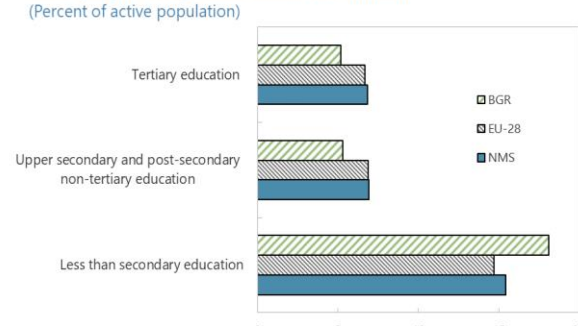
21. **Sustaining education reform would improve labor productivity and support vulnerable groups.** While Bulgaria's government spending on education is relatively low in the EU, strong government finances provide room to allocate additional resources with a view to closing the gap with peers in educational outcomes. Better and more equal access to quality education also enhances the equality of opportunity. Staff supports ongoing efforts aimed at promoting inclusion and modernizing the education system. As reflected in the MTBF, they include initiatives to ensure equal access to quality education; reduce the high rate of early leavers from education and training (which has begun to bear fruit); update curricula in both general and vocational education based on key competencies and to better reflect evolving work demand; and enhance extracurricular activities related to science, technology, engineering and mathematics (STEM). Doubling teachers' salaries over 2017-21 would help attract young people into the profession, helping to address the low teacher-student ratio and rejuvenate the most rapidly aging teacher body in the EU. Also welcome are plans to introduce special teacher training and retraining programs.

Skill Mismatch, 2017
(Squared difference in proportions between population and employed, by level of education)



Sources: Eurostat and IMF staff calculations.

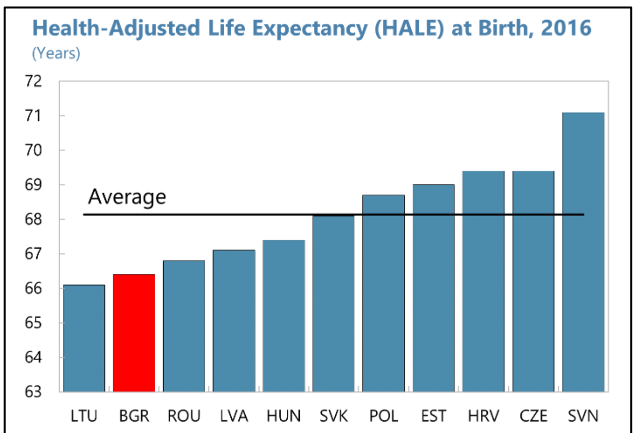
Unemployment by Educational Attainment
(Percent of active population)



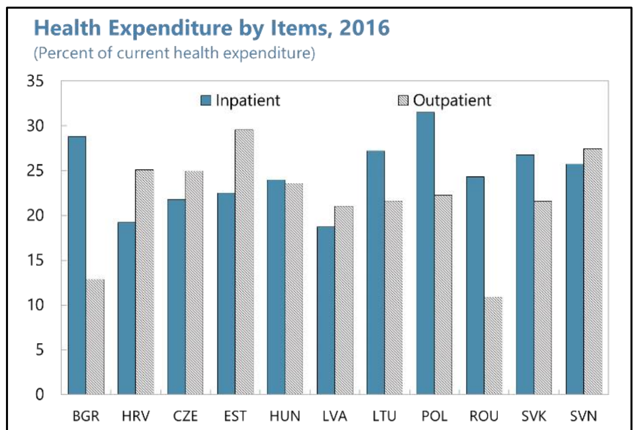
Sources: NSI and IMF staff calculations.

22. Many policies are in operation to address skill mismatches and across-the-board labor shortages, but challenges remain. The government is making efforts to bring back overseas Bulgarians and has signed worker import agreements with neighboring countries. The Youth Guarantee program supports training and job search for the NEET (Not in Employment, Education, or Training) population, but its coverage needs to be increased to help reduce the still high unemployment for the less-educated. Together with tertiary education reforms, training programs have also been introduced to address skilled-labor shortages in highly affected sectors, including information and communications technology, teaching, health, and engineering. Deepening the collaboration between educational institutions and businesses can help reduce skill mismatches.

23. There is scope to improve the public health system, in particular in spending efficiency and quality of services. Out-of-pocket payments are high and the cost of healthcare is high for the outcomes achieved. This reflects relatively low public health spending, high cost of pharmaceuticals and medical goods, and a high share of inpatient care (resulting from a hospital-centered healthcare system). The government is taking steps to enhance public health spending efficiency, including implementing a plan to optimize medicine spending and establish an E-healthcare system. Staff sees the need for further reforms to strengthen primary and preventive (outpatient) care.



Source: World Health Organization



Source: Eurostat

Authorities' Views

24. The authorities agree with the objective to improve public sector efficiency, quality of institutions, and human capital through structural reforms. While appreciating many of the public investment management recommendations, the authorities indicated they will conduct internal discussions to determine future actions. They agree with the importance of improving governance, but point out the limitations of public perceptions as a gauge of some aspects of governance. They also observe that it takes a long time for perceptions to change in response to ongoing reforms. Finally, the authorities consider labor shortages and skill mismatches as key challenges to the economy both in the short term and over the medium term, and concur that deep-rooted reforms in education, healthcare and labor market are necessary to achieve sustainable growth and faster real convergence.

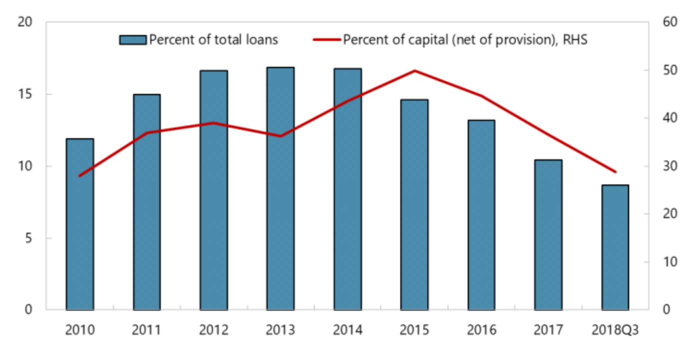
C. Financial Sector

25. The Bulgarian National Bank (BNB) has made steady progress in strengthening banking sector supervision. Consistent with the recommendations of the 2017 Financial Sector Stability Assessment, the BNB has strengthened the legislation for related-party lending and formalized the supervisory review and evaluation process (SREP), with the calibration of the bank-specific Pillar II capital add-on expected to be finalized by March 2019. Furthermore, the BNB has operationalized the new governance framework, which vests the decision-making authority on banking supervision and payments in the Governing Council. The BNB also announced that the countercyclical capital buffer will be raised from 0 to 0.5 percent as of October 2019.

26. Banks' profitability and asset quality continue to improve. Higher lending activity and lower impairment costs have helped raise banking sector profitability to its highest levels since the global financial crisis. There have also been a number of mergers and acquisitions in the banking sector in recent years, which could improve efficiency and profitability if they come with streamlining of operations and cost reduction. The share of foreign currency lending has continued to decline, down from 64 percent in 2011 to 34 percent in 2018. Non-performing loans (NPLs) have also declined, from 16.9 percent of total loans in 2013 to 8.7 percent in 2018Q3.

27. Continued efforts would help further reduce NPLs. The BNB intends to comply with the EBA guidelines on NPLs, which will enter into force in mid-2019. Given that Bulgaria's NPL ratio remains well above the EU average, the BNB should maintain its vigilance on NPLs. The implementation of the SREP should ensure that banks with high NPLs have sufficient capital buffers. Staff advises that improving the insolvency framework and the NPL market (which has been supported by high liquidity in financial markets) would also help.

NPLs are declining but remain high
(Percent)



Source: Financial Soundness Indicators (IMF).

28. The authorities are also taking steps to fulfill the ERM II commitments.

- The BNB is supporting the ECB's comprehensive assessment of the banking sector. Joining the banking union thereafter at the same time as ERM II will further strengthen banking supervision, with the ECB as the central supervisor of Bulgaria's financial institutions and Bulgaria also joining the single resolution mechanism. The BNB Act has been amended to align central bank independence provisions with EU legislation.

- The legal framework for borrower-based macroprudential measures has been established.

- The authorities are working on strengthening the AML framework including transposing the fifth AML directive into national legislation. This should also contribute to stronger governance.

- The authorities have made progress with regard to the nonbank financial sector, including implementing a risk-based supervisory system for insurers and pension funds, and adopting guidelines for the valuation of assets and liabilities.

- In cooperation with the EC's Structural Reform Support Service, the authorities are conducting a review to develop an efficient procedure for publishing information about insolvency proceedings. Work is also underway to identify inefficiency and weakness in the insolvency process.

Authorities' Views

29. The authorities broadly agree with staff's views. They highlight the sizable decline in NPLs in recent years and note that the SREP would help address the NPL stock (as the capital add-on would be higher, other things equal, for banks with high NPLs and low provision coverage). Some among the authorities view a rise in interest rates as a potential source of credit risk as loans have been issued under very low interest rates.

STAFF APPRAISAL

30. The economy remains robust, while risks to the outlook are tilted to the downside. With robust economic growth, unemployment is at historical lows, the output gap has closed, and credit growth has been on an upward trend. Growth is expected to remain similar in 2019 and inflation to remain stable. The external position is assessed to be stronger than warranted by fundamentals and desirable policy settings, albeit subject to substantial uncertainty. The main risks to this outlook stem from a growth slowdown of trading partners, rising protectionism and retreat from multilateralism, and fast wage growth.

31. Fiscal policy remains conservative, preserving buffers against downside risks. The fiscal outturn has been better than budgeted in 2018, reflecting revenue overperformance and capital underspending. Near- and medium-term fiscal targets are broadly appropriate, helping preserve buffers in light of external uncertainty. With public debt low, automatic stabilizers should be allowed to operate fully in the event of a negative shock. Contingent pension liabilities resulting from aging will likely call for further reforms in the future to ensure the sustainability of the public pension system.

32. Broad-based structural reforms are needed to improve public goods provision and bolster growth prospects. Better education and training, more effective labor market policies, and improved healthcare could raise human capital and employment, and mitigate labor shortages and skill mismatches, which are constraints to faster convergence. There is also room to improve the efficiency of government spending and revenue administration. Stronger public investment management will have dual benefits of improving investment efficiency and strengthening public institutions. Enhancing SOE oversight and performance would help raise potential growth and contain fiscal risks.

33. Bulgaria's preparation for ERM II and the banking union will facilitate reforms. While the macroeconomic impact of joining ERM II is likely to be minimal as the authorities plan to maintain the currency board arrangement, the preparations and the banking union membership would enhance the quality of institutions, including by strengthening financial sector supervision and the credibility of the overall policy framework. Eventual euro membership would fulfill Bulgaria's EU commitment and raise the premium for economic flexibility and higher income convergence.

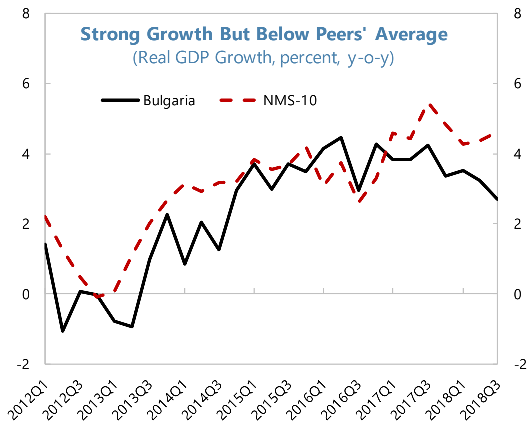
34. The government needs to maintain the reform momentum to further strengthen governance. Building on the progress made to improve the judiciary and reduce corruption vulnerability, continued efforts are needed to ensure effective implementation of the new anti-corruption framework. These should complement efforts to improve governance in the utilization of public resources, SOE management, and the AML framework. Stronger governance and institutions would support a business environment more conducive to investment and growth.

35. Financial supervision has been strengthened and reform efforts should continue. The BNB has operationalized the new governance framework, strengthened the legislation for related-party lending, and formalized the SREP. NPLs continue to decline, although they are still high compared to other EU countries. The BNB should remain vigilant on NPLs, including by ensuring that banks with high NPLs have sufficient capital buffers. The authorities have implemented a risk-based supervisory system for insurance companies and pension funds.

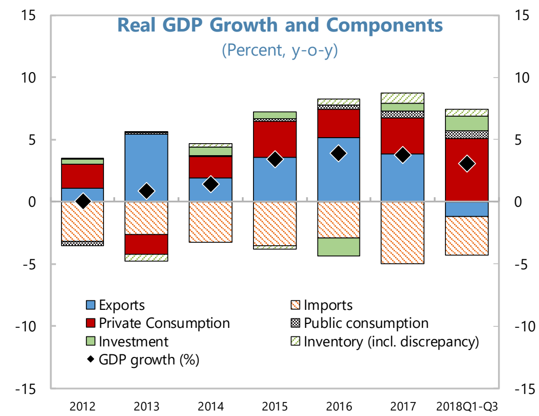
36. It is proposed that Bulgaria remain on the standard 12-month Article IV cycle.

Figure 1. Bulgaria: Real Sector Developments, 2008-18

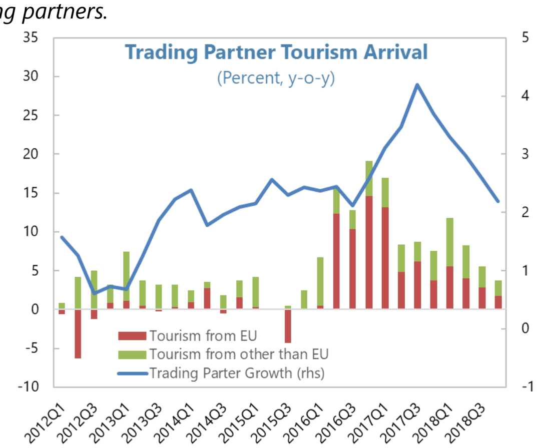
Bulgaria's growth has been below its peers in recent years.



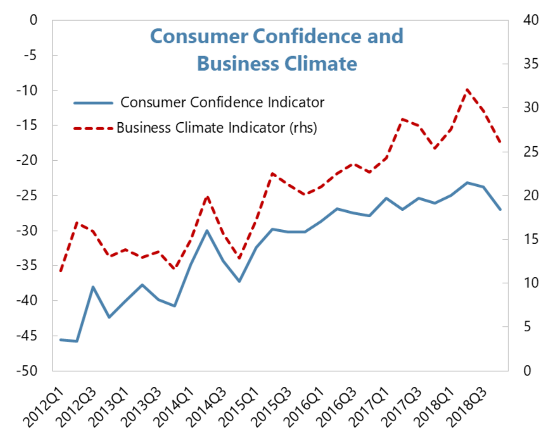
Private consumption was the main contributor to growth in 2018 …



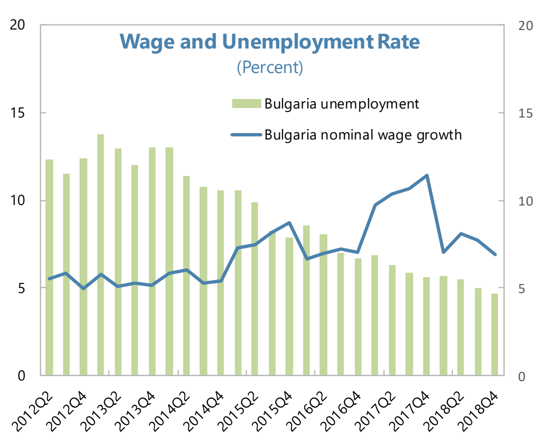
…while the negative contribution from net exports widened due to temporary contraction of refinery production and lower growth from trading partners.



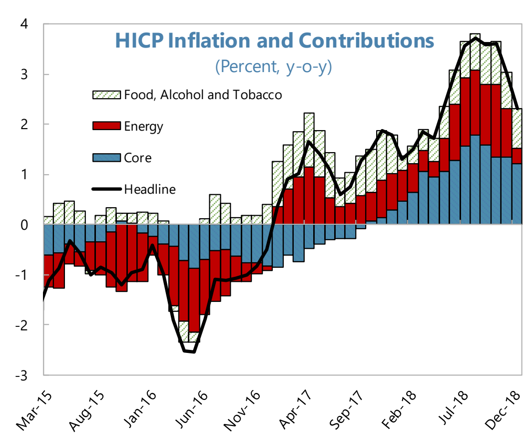
Consumer confidence and business climate remained strong despite some deterioration in Q3.



The unemployment rate reached a record low while nominal wage growth has moderated…



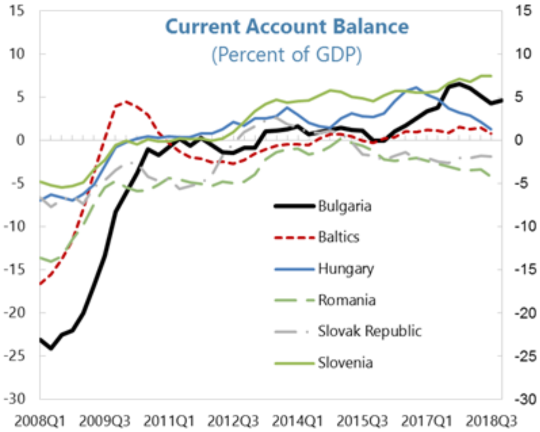
After rising sharply, headline inflation has stabilized while core inflation has slightly declined.



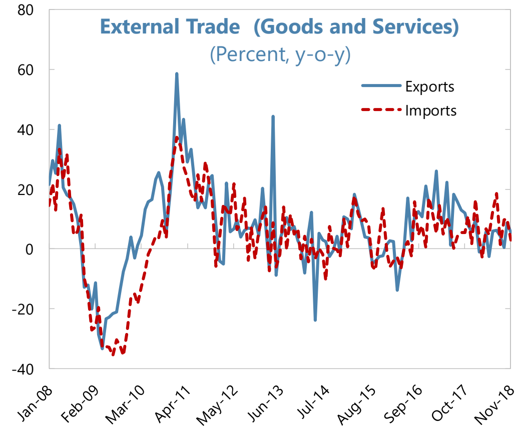
Sources: Haver Analytics; National authorities; and IMF staff calculations.

Figure 2. Bulgaria: External Sector Developments, 2008-18

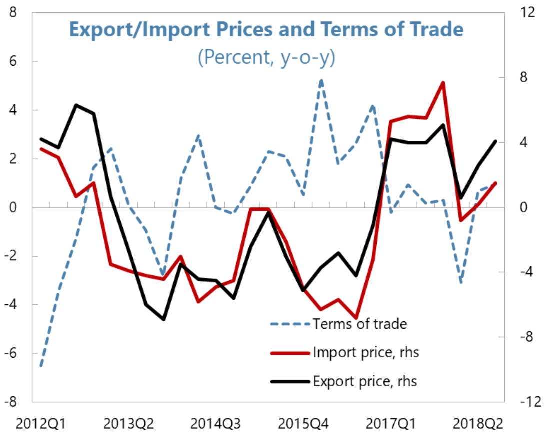
The current account surplus remained sizable in 2018 though smaller than in 2017.



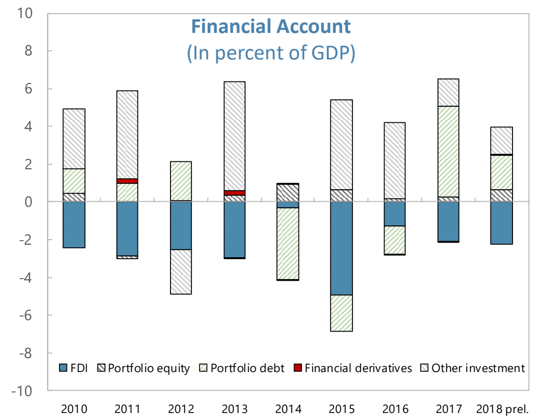
Weak goods exports partly due to temporary factors were offset by dynamic services exports.



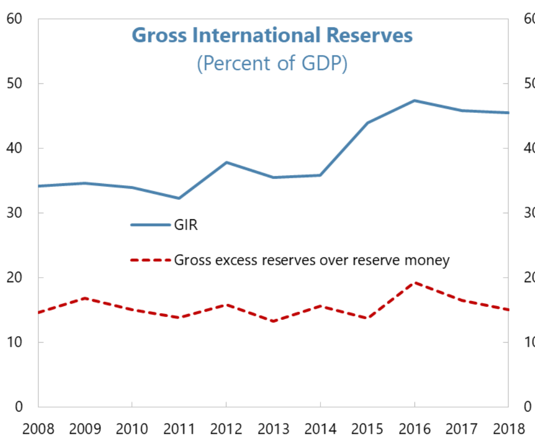
The terms of trade recovered from the sharp decline in the first quarter of 2018.



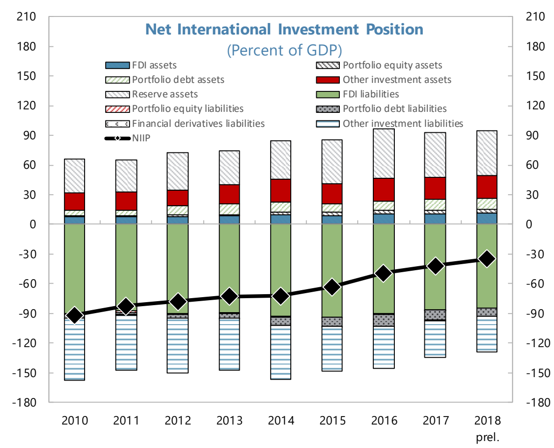
Financial outflows driven by portfolio largely offset the current account surplus…



… resulting in broadly stable gross international reserves …



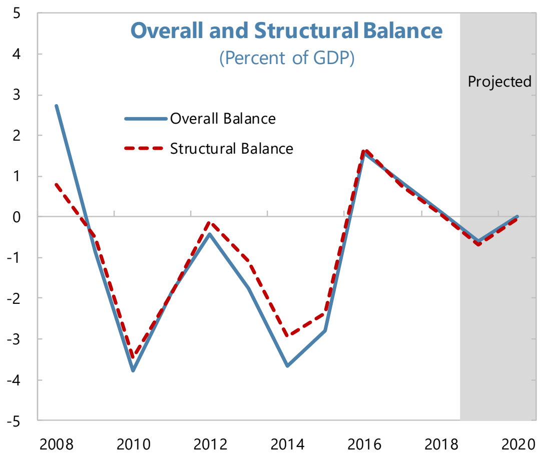
… and continued improvement of the net international investment position.



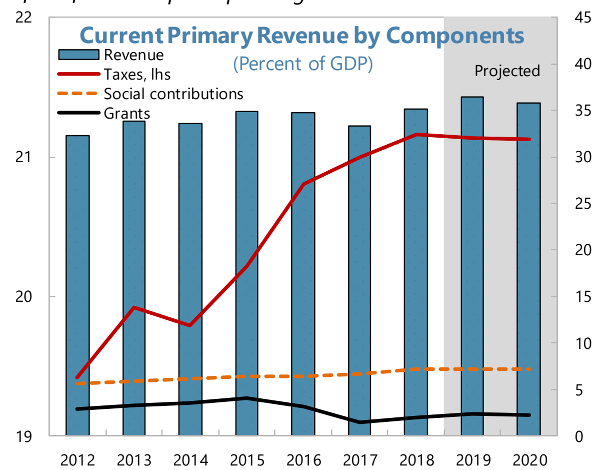
Sources: BNB; Haver; and IMF staff estimates.

Figure 3. Bulgaria: Fiscal Developments, 2008-20

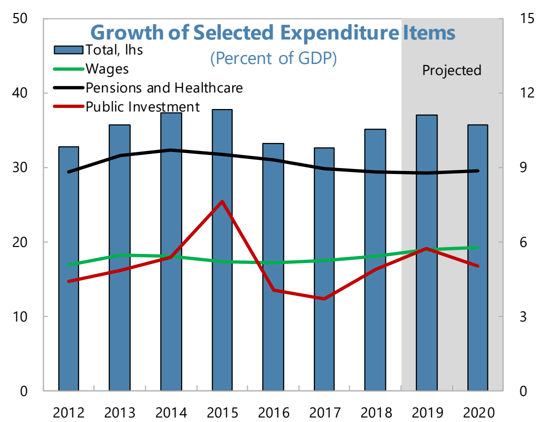
A small cash fiscal surplus is estimated for 2018…



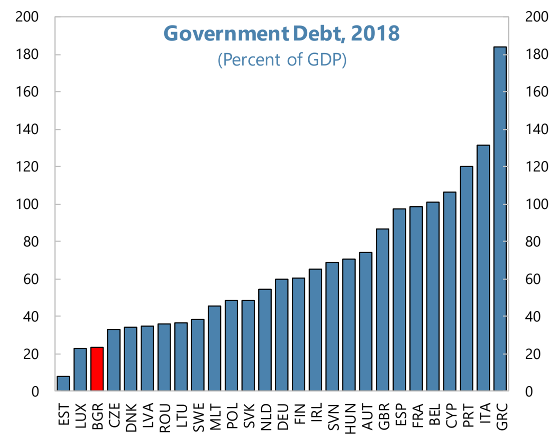
…due to strong revenue performance and underexecution of EU-funded capital spending.



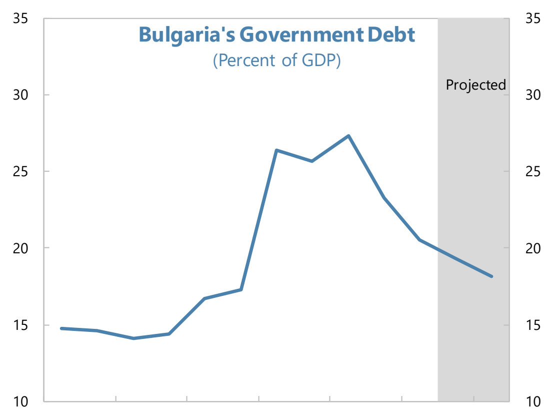
Expenditure is expected to rise in 2019 due to increases in wages, education, healthcare, and capital spending.



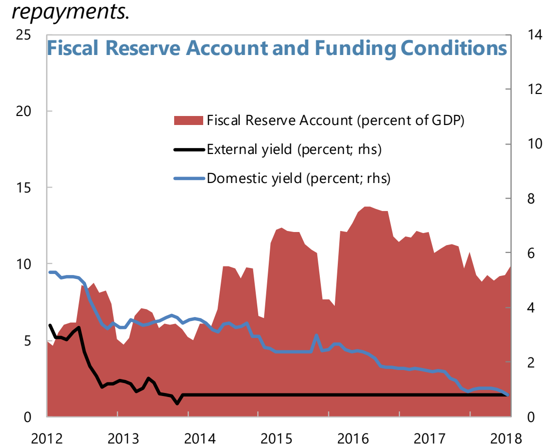
Bulgaria's public debt remains among the lowest in the EU…



…and is projected to decline further in the medium term.

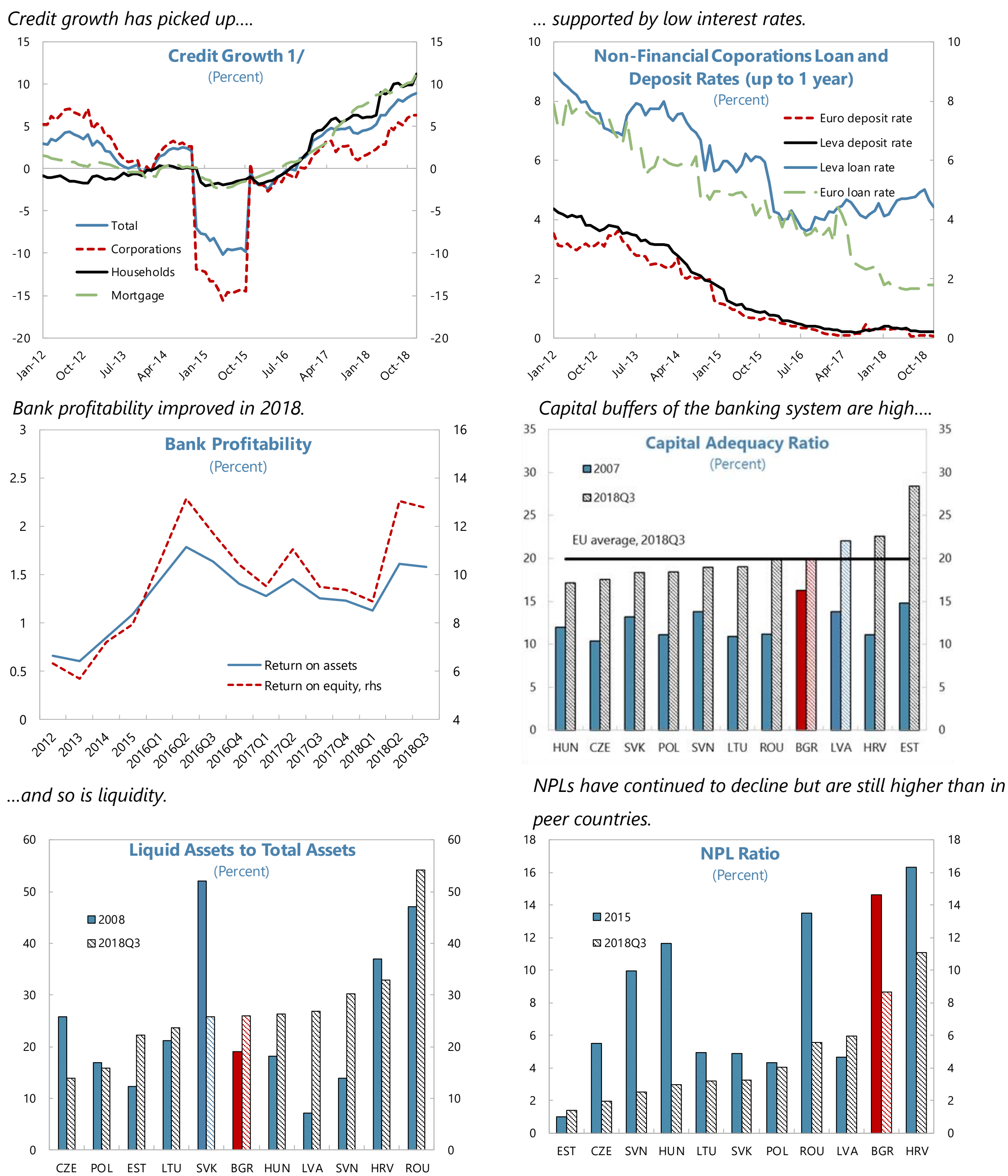


The fiscal reserve declined in 2018 due to Eurobond repayments.



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

Figure 4. Bulgaria: Monetary and Financial Sector Developments, 2008-18



Sources: BNB, IMF FSI, and IMF staff calculations.

1/ Due to the revocation of the banking license of KTB, the bank is excluded as a reporting agent from the monetary statistics data used in the panel charts starting in November 2014.

Table 1. Bulgaria: Selected Economic Indicators, 2015–24

(Annual percentage change, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Est.			Proj.			
Real GDP	3.5	3.9	3.8	3.2	3.3	3.0	2.8	2.8	2.8	2.8
Real domestic demand	3.3	1.7	4.9	6.3	4.9	4.1	3.6	3.4	3.3	3.1
Public consumption	1.4	2.2	3.7	3.8	4.2	3.3	3.2	3.1	3.0	2.2
Private consumption	4.5	3.5	4.5	7.0	5.0	4.2	3.7	3.7	3.5	3.5
Gross capital formation	1.5	-4.3	7.3	5.7	5.2	4.3	3.7	3.0	2.9	2.4
Private investment	-3.4	-1.5	6.4	2.4	4.0	3.2	3.9	3.7	3.5	4.6
Public investment	20.3	-18.6	-5.9	13.5	10.1	7.9	3.9	2.3	2.2	-3.1
Stock building 1/	-0.2	0.5	0.8	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Net exports 1/	0.1	2.2	-1.1	-3.2	-1.8	-1.3	-1.1	-0.9	-0.8	-0.5
Exports of goods and services 2/	5.7	8.1	5.8	-1.5	2.7	2.6	2.7	3.0	3.1	3.5
Imports of goods and services	5.4	4.5	7.5	3.2	5.3	4.2	3.9	3.9	3.9	3.8
Resource utilization										
Potential GDP	2.7	3.0	3.2	3.2	3.2	3.1	3.0	2.8	2.8	2.8
Output gap (percent of potential GDP)	-1.2	-0.4	0.2	0.2	0.2	0.1	0.0	0.0	0.0	0.0
Unemployment rate (percent of labor force)	9.2	7.7	6.2	4.7	5.0	5.0	5.0	5.0	5.0	5.0
Price										
GDP deflator	2.2	2.2	3.4	3.1	2.9	2.8	2.8	2.8	2.8	2.8
Consumer price index (HICP, average)	-1.1	-1.3	1.2	2.6	2.4	2.3	2.3	2.3	2.3	2.3
Consumer price index (HICP, end of period)	-0.9	-0.5	1.8	2.3	2.2	2.3	2.3	2.3	2.3	2.3
Fiscal indicators (percent of GDP)										
General government net lending/borrowing (cash basis)	-2.8	1.6	0.8	0.1	-0.6	0.0	0.0	0.0	0.0	0.0
General government primary balance	-2.0	2.3	1.6	0.8	-0.1	0.5	0.5	0.5	0.5	0.5
Structural overall balance	-2.4	1.7	0.8	0.1	-0.7	-0.1	0.0	0.0	0.0	0.0
Structural primary balance	-1.6	2.5	1.5	0.7	-0.1	0.5	0.5	0.5	0.5	0.5
General government gross debt 3/	25.6	27.4	23.3	20.5	19.3	18.2	17.1	16.2	15.3	14.5
Monetary aggregates										
Broad money	8.8	7.6	7.7	8.8	8.0	7.6	7.5	7.5	7.5	7.5
Domestic private credit	-1.6	1.8	4.5	8.9	7.1	6.7	6.5	6.5	6.5	6.5
Exchange rates regime										
Leva per U.S. dollar (end of period)	1.8	1.9	1.6	1.7	...	...	...	...	...	...
Nominal effective rate	-1.2	2.5	3.1	5.0	...	...	...	...	...	...
External sector (percent of GDP)										
Current account balance	0.0	2.6	6.5	4.6	2.2	1.6	1.2	0.9	0.6	0.1
o/w: Merchandise trade balance	-5.8	-2.0	-1.5	-4.1	-4.9	-4.9	-4.7	-4.7	-4.8	-4.8

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

1/ Contribution to GDP growth.

2/ Exports suffered from maintenance work in the main refinery in 2018, and are expected to recover in 2019.

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

Table 2. Bulgaria: Macroeconomic Framework, 2015–24
(Annual percentage change, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Est.			Proj.			
GDP and prices										
Real GDP	3.5	3.9	3.8	3.2	3.3	3.0	2.8	2.8	2.8	2.8
Real GDP per working age population	5.0	5.4	5.2	4.3	4.3	4.0	3.7	3.7	3.6	3.6
Real GDP per capita	4.2	4.7	4.6	3.8	3.9	3.6	3.4	3.4	3.4	3.4
Real domestic demand	3.3	1.7	4.9	6.3	4.9	4.1	3.6	3.4	3.3	3.1
Of which: private	4.5	3.5	4.5	7.0	5.0	4.2	3.7	3.7	3.5	3.5
GDP deflator	2.2	2.2	3.4	3.1	2.9	2.8	2.8	2.8	2.8	2.8
Consumer price index (HICP, average)	-1.1	-1.3	1.2	2.6	2.4	2.3	2.3	2.3	2.3	2.3
Nominal wages	6.8	8.0	9.4	7.1	8.9	5.9	5.7	5.6	5.6	5.6
Real effective exchange rate, CPI based	-3.1	0.1	2.2	4.2	...	...	...	...	...	...
Monetary aggregates (percent change)										
Broad money	8.8	7.6	7.7	8.8	8.0	7.6	7.5	7.5	7.5	7.5
Domestic private credit	-1.6	1.8	4.5	8.9	7.1	6.7	6.5	6.5	6.5	6.5
Saving and investment (percent of GDP)										
Foreign saving	0.0	-2.6	-6.5	-4.6	-2.2	-1.6	-1.2	-0.9	-0.6	-0.1
Gross national saving	21.2	21.7	26.6	23.9	21.2	20.3	19.8	19.6	19.4	19.3
Government	4.8	5.6	4.5	5.0	4.5	5.0	4.9	5.0	5.0	4.1
Private	16.3	16.1	22.1	18.8	16.7	15.4	14.9	14.5	14.4	15.2
Gross domestic investment	21.2	19.1	20.1	19.2	19.0	18.7	18.5	18.6	18.8	19.3
Government	7.6	4.0	3.7	4.9	5.1	5.0	4.9	5.0	5.0	4.1
Private	13.6	15.1	16.4	14.3	13.9	13.7	13.6	13.6	13.8	15.1
General government (percent of GDP)										
Revenue	34.9	34.7	33.4	35.2	36.4	35.7	35.3	35.5	35.5	34.6
Tax revenue (including social security contributions)	26.7	27.2	27.7	28.3	28.3	28.3	28.2	28.2	28.2	28.2
Non-Tax revenue	4.2	4.4	4.2	4.9	5.8	5.2	5.2	5.2	5.2	5.2
Grants	4.1	3.1	1.5	2.0	2.3	2.2	1.9	2.1	2.1	1.3
Expenditure	37.7	33.1	32.5	35.1	37.1	35.8	35.3	35.5	35.5	34.6
Balance (net lending/borrowing on cash basis)	-2.8	1.6	0.8	0.1	-0.6	0.0	0.0	0.0	0.0	0.0
Structural balance	-2.4	1.7	0.8	0.1	-0.7	-0.1	0.0	0.0	0.0	0.0
Balance of payments (percent of GDP)										
Current account	0.0	2.6	6.5	4.6	2.2	1.6	1.2	0.9	0.6	0.1
Trade balance	-5.8	-2.0	-1.5	-4.1	-4.9	-4.9	-4.7	-4.7	-4.8	-4.8
Services balance	6.6	6.4	5.4	6.0	5.5	5.2	5.0	4.7	4.5	4.2
Primary income balance	-4.5	-5.0	-1.0	-0.8	-1.4	-1.6	-1.7	-1.7	-1.8	-1.9
Secondary income balance	3.6	3.3	3.6	3.5	3.0	2.8	2.6	2.7	2.7	2.5
Capital and financial account	4.6	0.8	-3.4	-0.3	1.0	1.1	1.1	1.3	1.3	0.6
Of which: Foreign direct investment	-5.0	-1.3	-2.1	-2.2	-2.2	-2.2	-2.2	-2.2	-2.2	-2.2
Memorandum items:										
Gross international reserves (billions of euros)	20.3	23.9	23.7	25.0	26.9	28.5	30.1	31.6	32.9	33.5
Short-term external debt (percent of GDP) 1/	16.7	15.7	15.1	15.2	14.7	14.4	14.4	14.1	13.8	13.3
Export volume (goods, percent change)	6.7	7.9	8.3	-2.8	3.8	4.8	4.3	3.9	3.8	3.8
Import volume (goods, percent change)	6.2	4.5	7.1	3.2	6.1	5.3	4.0	4.0	3.9	3.8
Terms of trade (percent change)	1.5	3.5	0.3	1.0	0.4	0.3	0.0	-0.1	-0.1	-0.1
Output gap (percent of potential GDP)	-1.2	-0.4	0.2	0.2	0.2	0.1	0.0	0.0	0.0	0.0
Nominal GDP (millions of leva)	88,575	94,130	101,043	107,541	114,329	121,012	127,883	135,145	142,819	150,929
Nominal GDP (millions of euros)	45,288	48,129	51,663	54,986	58,457	61,873	65,387	69,100	73,023	77,170

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

Table 3. Bulgaria: Balance of Payments, 2015–24
(Millions of euros, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Est.			Proj.			
Current account balance	-16	1,244	3,368	2,539	1,293	973	814	653	408	53
Trade balance	-2,622	-984	-766	-2,248	-2,875	-3,045	-3,075	-3,258	-3,476	-3,673
Exports (f.o.b.)	21,920	23,104	26,950	27,427	28,425	29,703	31,039	32,233	33,487	34,684
Imports (f.o.b.)	24,542	24,088	27,716	29,675	31,300	32,748	34,114	35,492	36,962	38,357
Services balance	3,004	3,060	2,765	3,313	3,238	3,236	3,268	3,260	3,251	3,232
Exports of non-factor services	6,967	7,688	7,813	8,450	8,628	8,851	9,097	9,303	9,523	9,719
Imports of non-factor services	3,963	4,628	5,048	5,137	5,391	5,614	5,828	6,043	6,272	6,487
Primary Income balance	-2,037	-2,417	-496	-463	-807	-968	-1,091	-1,205	-1,323	-1,445
Receipts	973	1,140	1,313	1,349	1,384	1,422	1,460	1,498	1,537	1,577
Payments	3,010	3,557	1,809	1,812	2,192	2,390	2,551	2,704	2,860	3,022
Secondary income balance	1,640	1,585	1,865	1,937	1,737	1,749	1,712	1,856	1,956	1,938
Capital account balance	1,422	1,071	530	778	914	1,058	1,123	1,319	1,370	956
Financial account balance	-651	668	2,261	968	356	383	406	428	451	475
Foreign direct investment balance	-2,241	-615	-1,079	-1,223	-1,300	-1,376	-1,454	-1,537	-1,624	-1,716
Portfolio investment balance	-582	-630	2,616	1,347	829	882	933	986	1,042	1,101
Other investment balance	2,157	1,930	747	801	803	853	903	954	1,009	1,066
Errors and omissions	1,672	1,820	-1,736	-987	0	0	0	0	0	0
Overall balance	3,730	3,467	-99	1,362	1,851	1,648	1,531	1,544	1,327	534
Financing	-3,730	-3,467	99	-1,362	-1,851	-1,648	-1,531	-1,544	-1,327	-534
Gross international reserves (increase -)	-3,730	-3,467	99	-1,362	-1,852	-1,649	-1,532	-1,545	-1,328	-535
	(Percent of GDP, unless otherwise indicated)									
Memorandum items:										
Current account balance	0.0	2.6	6.5	4.6	2.2	1.6	1.2	0.9	0.6	0.1
Merchandise trade balance	-5.8	-2.0	-1.5	-4.1	-4.9	-4.9	-4.7	-4.7	-4.8	-4.8
Exports	48.4	48.0	52.2	49.9	48.6	48.0	47.5	46.6	45.9	44.9
Imports	54.2	50.0	53.6	54.0	53.5	52.9	52.2	51.4	50.6	49.7
Foreign direct investment balance	-4.9	-1.3	-2.1	-2.2	-2.2	-2.2	-2.2	-2.2	-2.2	-2.2
Terms of trade (merchandise, percent change)	1.5	3.5	0.3	1.0	0.4	0.3	0.0	-0.1	-0.1	-0.1
Exports of goods (volume, growth rate)	6.7	7.9	8.3	-2.8	3.8	4.8	4.3	3.9	3.8	3.8
Imports of goods (volume, growth rate)	6.2	4.5	7.1	3.2	6.1	5.3	4.0	4.0	3.9	3.8
Exports of goods (prices, growth rate)	-2.3	-2.4	7.7	4.7	-0.2	-0.3	0.2	-0.1	0.1	-0.2
Imports of goods (prices, growth rate)	-2.9	-6.0	7.5	3.7	-0.6	-0.6	0.2	0.0	0.2	-0.1
GDP (millions of euro)	45,288	48,129	51,663	54,986	58,457	61,873	65,387	69,100	73,023	77,170

Sources: Bulgarian authorities; and IMF staff estimates.

Table 4. Bulgaria: External Financial Assets and Liabilities, 2015–24

(Millions of euros, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Est.			Proj.			
International investment position	-28,542	-23,663	-21,600	-19,237	-17,029	-14,997	-13,059	-11,086	-9,307	-8,297
Financial assets	38,865	46,362	48,176	52,381	57,607	62,875	68,243	73,845	79,460	84,523
Foreign direct investment	4,127	4,937	5,520	6,233	6,991	7,793	8,640	9,536	10,483	11,483
Portfolio investment	5,050	6,280	7,386	8,203	9,525	10,931	12,418	13,990	15,651	17,407
Other investments	9,353	11,193	11,567	12,851	14,167	15,567	17,049	18,614	20,269	22,017
Gross international reserves	20,285	23,899	23,662	25,024	26,876	28,524	30,056	31,601	32,929	33,464
Financial derivatives	49	54	41	70	48	60	80	104	128	152
Financial liabilities	67,407	70,025	69,776	71,618	74,636	77,872	81,302	84,932	88,767	92,820
Foreign direct investment	42,407	43,591	44,581	46,516	48,574	50,752	53,053	55,486	58,056	60,772
Portfolio investment	4,448	6,105	5,564	5,035	5,527	6,051	6,605	7,191	7,810	8,464
Other liabilities	20,476	20,231	19,522	20,005	20,519	21,065	21,644	22,255	22,901	23,584
Financial derivatives	77	98	109	62	16	4	0	0	0	0
	(Percent of GDP, unless otherwise indicated)									
International investment position	-63.0	-49.2	-41.8	-35.0	-29.1	-24.2	-20.0	-16.0	-12.7	-10.8
Financial assets	85.8	96.3	93.3	95.3	98.5	101.6	104.4	106.9	108.8	109.5
Foreign direct investment	9.1	10.3	10.7	11.3	12.0	12.6	13.2	13.8	14.4	14.9
Portfolio investment	11.2	13.0	14.3	14.9	16.3	17.7	19.0	20.2	21.4	22.6
Other investments	20.7	23.3	22.4	23.4	24.2	25.2	26.1	26.9	27.8	28.5
Gross international reserves	44.8	49.7	45.8	45.5	46.0	46.1	46.0	45.7	45.1	43.4
Financial derivatives	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2
Financial liabilities	148.8	145.5	135.1	130.2	127.7	125.9	124.3	122.9	121.6	120.3
Foreign direct investment	93.6	90.6	86.3	84.6	83.1	82.0	81.1	80.3	79.5	78.8
Portfolio investment	9.8	12.7	10.8	9.2	9.5	9.8	10.1	10.4	10.7	11.0
Other liabilities	45.2	42.0	37.8	36.4	35.1	34.0	33.1	32.2	31.4	30.6
Financial derivatives	0.2	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Gross external debt	74.0	71.1	64.6	61.5	58.1	54.8	52.1	49.4	46.7	43.8
Public 1/	12.3	14.1	11.1	10.2	9.6	8.9	8.4	8.0	7.8	7.4
Private	61.7	57.0	53.6	51.2	48.5	45.9	43.7	41.4	38.9	36.4
Short-term	16.7	15.7	15.1	15.2	14.7	14.4	14.4	14.1	13.8	13.3
Long-term	44.9	41.3	38.5	36.0	33.8	31.5	29.3	27.3	25.1	23.1
Net external debt 2/	29.2	21.4	18.8	16.0	12.1	8.7	6.1	3.7	1.6	0.5

Sources: BNB; NSI; and IMF staff estimates.
1/ General government, excluding publicly-guaranteed private debt.
2/ Gross debt minus gross international reserves.

Table 5a. Bulgaria: General Government Operations, 2015–24 1/

(Millions of leva, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Est.			Proj.			
Revenue	30,951	32,671	33,733	37,861	41,637	43,218	45,207	47,986	50,743	52,296
Taxes	17,909	19,585	21,216	22,778	24,141	25,549	26,940	28,452	30,065	31,781
Taxes on profits	1,860	2,076	2,308	2,464	2,621	2,781	2,941	3,108	3,284	3,471
Taxes on income	2,731	2,961	3,336	3,668	3,889	4,088	4,278	4,518	4,773	5,042
Value-added taxes	7,740	8,553	9,320	10,064	10,772	11,421	12,050	12,719	13,440	14,215
Excises	4,525	4,805	4,985	5,203	5,393	5,709	6,033	6,375	6,737	7,120
Customs duties	159	173	194	226	240	255	269	284	300	317
Other taxes	893	1,017	1,073	1,151	1,224	1,296	1,369	1,447	1,529	1,616
Social contributions	5,699	6,029	6,782	7,673	8,219	8,685	9,158	9,671	10,216	10,792
Grants	3,648	2,907	1,521	2,111	2,683	2,703	2,472	2,850	3,050	1,890
Other revenue 2/	3,696	4,150	4,215	5,300	6,594	6,280	6,637	7,014	7,412	7,833
Expenditure	33,437	31,203	32,888	37,724	42,369	43,265	45,204	47,975	50,748	52,289
Expense	25,907	26,996	28,748	32,254	35,575	36,977	38,679	40,932	43,267	45,724
Compensation of employees 3/	5,644	5,777	6,275	6,917	7,383	7,855	8,306	8,792	9,305	9,849
Wages and salaries	4,616	4,847	5,275	5,848	6,516	6,966	7,395	7,828	8,287	8,772
Other compensation	1,028	929	1,000	1,069	867	889	912	964	1,019	1,077
Use of goods and services 4/	3,318	3,728	3,941	4,384	4,883	4,863	5,053	5,340	5,643	5,964
Interest	698	734	792	688	669	672	652	689	729	770
External	431	447	546	447	456	455	451	476	503	532
Domestic	267	288	247	241	213	217	202	213	225	238
Subsidies 5/	1,623	1,645	1,959	3,043	3,953	3,902	3,864	4,083	4,315	4,560
Grants 6/	946	859	888	1,083	1,282	1,362	1,583	1,673	1,768	1,869
Social benefits	13,543	14,109	14,734	15,959	17,268	18,185	19,083	20,218	21,369	22,575
Pensions	8,433	8,734	9,039	9,491	10,034	10,693	11,265	11,956	12,638	13,348
Social assistance	2,424	2,543	2,621	2,824	3,118	3,116	3,146	3,325	3,514	3,713
Health Insurance Fund	2,687	2,832	3,074	3,643	4,116	4,376	4,672	4,937	5,217	5,514
Other expense	134	144	159	180	137	137	137	137	137	137
Contingency	767	401	425	192	227	237	246	290	305	321
Net acquisition of nonfinancial assets 7/	6,763	3,806	3,715	5,277	6,566	6,051	6,279	6,753	7,176	6,244
Net lending/borrowing	-2,485	1,468	846	137	-732	-47	2	11	-5	7
Primary balance	-1,787	2,202	1,638	825	-63	625	655	700	724	777
Financing	2485	-1468	-846	-137	732	47	-2	-11	5	-7
Privatization proceeds	4	3	3	4	5	4	35	0	0	0
Net external financing	1449	3519	-2176	-219	-45	-148	-77	117	356	-13
Disbursements	6438	3876	17	120	230	196	196	2800	3000	3100
Amortization	-4988	-357	-2193	-339	-275	-344	-272	-2683	-2644	-3113
Net domestic financing	-925	-558	4	-1243	84	41	36	-131	-354	2
Bank credit / Securities issuance	-19	4812	-536	-770	1000	1050	800	173	-4	382
Amortization	-2234	-1051	-785	-1243	-920	-1013	-799	-304	-350	-380
Fiscal Reserve Account	1328	-4319	1325	770	4	4	35	0	0	0
Net lending and other items	1953	-4435	1320	1316	688	150	4	4	4	4
Memorandum items:										
Fiscal reserve account	6,789	11,108	9,783	9,013	9,008	9,004	8,969	8,969	8,969	8,969
Gross public debt	22,714	25,751	23,534	22,066	22,101	21,990	21,914	21,899	21,901	21,890
Nominal GDP (percent change)	5.8	6.3	7.3	6.4	6.3	5.8	5.7	5.7	5.7	5.7
Real GDP (percent change)	3.5	3.9	3.8	3.2	3.3	3.0	2.8	2.8	2.8	2.8
HICP inflation (percent change)	-1.1	-1.3	1.2	2.6	2.4	2.3	2.3	2.3	2.3	2.3
Nominal private consumption (percent change)	5.7	3.5	6.9	10.8	7.6	6.6	6.1	6.0	5.9	5.9
Nominal imports (percent change)	1.6	0.7	14.1	6.3	5.4	4.6	4.1	4.0	4.1	3.7

Sources: Ministry of Finance; and IMF staff estimates.

1/ On cash basis.

2/ Includes dividends. For 2019, includes the Sofia Airport concession revenue BGN 660 million, which will be transferred to the state-owned railway company BDZ and included in capital expenditure. The amendment to the Energy Act of 01.07.2018 changes the mechanism for raising revenue and executing expenditure toward electricity producers through the budget of the EPSF. That leads to an increase of the non-tax revenue, and the subsidy expenditure respectively. The impact on the budget balance is neutral, as the revenue and expenditure are increased with the same amount.

3/ Includes other remuneration since 2014, which were previously integrated in use of goods and services.

4/ From 2014, with the adoption of the Public Finance Act, other remunerations are re-classified to the compensation of employees.

5/ Since July 2018, includes expenditure of the Electricity Power Security Fund.

6/ Contribution to EU budget.

7/ Includes only acquisitions of nonfinancial assets, i.e., capital expenditure. For 2019, includes concession revenue BGN 660 million for the Sofia Airport.

Table 5b. Bulgaria: General Government Operations, 2015–24 1/

(Percent of GDP, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Est.			Proj.			
Revenue	34.9	34.7	33.4	35.2	36.4	35.7	35.3	35.5	35.5	34.6
Taxes	20.2	20.8	21.0	21.2	21.1	21.1	21.1	21.1	21.1	21.1
Taxes on profits	2.1	2.2	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Taxes on income	3.1	3.1	3.3	3.4	3.4	3.4	3.3	3.3	3.3	3.3
Value-added taxes	8.7	9.1	9.2	9.4	9.4	9.4	9.4	9.4	9.4	9.4
Excises	5.1	5.1	4.9	4.8	4.7	4.7	4.7	4.7	4.7	4.7
Customs duties	0.2	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	1.1
Social contributions	6.4	6.4	6.7	7.1	7.2	7.2	7.2	7.2	7.2	7.2
Grants	4.1	3.1	1.5	2.0	2.3	2.2	1.9	2.1	2.1	1.3
Other revenue 2/	4.2	4.4	4.2	4.9	5.8	5.2	5.2	5.2	5.2	5.2
Expenditure	37.7	33.1	32.5	35.1	37.1	35.8	35.3	35.5	35.5	34.6
Expense	29.2	28.7	28.5	30.0	31.1	30.6	30.2	30.3	30.3	30.3
Compensation of employees 3/	6.4	6.1	6.2	6.4	6.5	6.5	6.5	6.5	6.5	6.5
Wages and salaries	5.2	5.1	5.2	5.4	5.7	5.8	5.8	5.8	5.8	5.8
Other compensation	1.2	1.0	1.0	1.0	0.8	0.7	0.7	0.7	0.7	0.7
Use of goods and services 4/	3.7	4.0	3.9	4.1	4.3	4.0	4.0	4.0	4.0	4.0
Interest	0.8	0.8	0.8	0.6	0.6	0.6	0.5	0.5	0.5	0.5
External	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Domestic	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Subsidies 5/	1.8	1.7	1.9	2.8	3.5	3.2	3.0	3.0	3.0	3.0
Grants 6/	1.1	0.9	0.9	1.0	1.1	1.1	1.2	1.2	1.2	1.2
Social benefits	15.3	15.0	14.6	14.8	15.1	15.0	14.9	15.0	15.0	15.0
Pensions	9.5	9.3	8.9	8.8	8.8	8.8	8.8	8.8	8.8	8.8
Social assistance	2.7	2.7	2.6	2.6	2.7	2.6	2.5	2.5	2.5	2.5
Health Insurance Fund	3.0	3.0	3.0	3.4	3.6	3.6	3.7	3.7	3.7	3.7
Other expense	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Contingency	0.9	0.4	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Net acquisition of nonfinancial assets 7/	7.6	4.0	3.7	4.9	5.7	5.0	4.9	5.0	5.0	4.1
Net lending/borrowing	-2.8	1.6	0.8	0.1	-0.6	0.0	0.0	0.0	0.0	0.0
Primary balance	-2.0	2.3	1.6	0.8	-0.1	0.5	0.5	0.5	0.5	0.5
Financing	2.8	-1.6	-0.8	-0.1	0.6	0.0	0.0	0.0	0.0	0.0
Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net external financing	1.6	3.7	-2.2	-0.2	0.0	-0.1	-0.1	0.1	0.2	0.0
Disbursements	7.3	4.1	0.0	0.1	0.2	0.2	0.2	2.1	2.1	2.1
Amortization	-5.6	-0.4	-2.2	-0.3	-0.2	-0.3	-0.2	-2.0	-1.9	-2.1
Net domestic financing	-1.0	-0.6	0.0	-1.2	0.1	0.0	0.0	-0.1	-0.2	0.0
Bank credit / Securities issuance	0.0	5.1	-0.5	-0.7	0.9	0.9	0.6	0.1	0.0	0.3
Amortization	-2.5	-1.1	-0.8	-1.2	-0.8	-0.8	-0.6	-0.2	-0.2	-0.3
Fiscal Reserve Account	1.5	-4.6	1.3	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Net lending and other items	2.2	-4.7	1.3	1.2	0.6	0.1	0.0	0.0	0.0	0.0
Memorandum items:										
Gross public debt	25.6	27.4	23.3	20.5	19.3	18.2	17.1	16.2	15.3	14.5
Structural fiscal balance	-2.4	1.7	0.8	0.1	-0.7	-0.1	0.0	0.0	0.0	0.0
Output gap (percent of potential GDP)	-1.2	-0.4	0.2	0.2	0.2	0.1	0.0	0.0	0.0	0.0
Nominal GDP (millions of leva)	88,575	94,130	101,043	107,541	114,329	121,012	127,883	135,145	142,819	150,929

Sources: Ministry of Finance; and IMF staff estimates.

1/ On cash basis.

2/ Includes dividends. For 2019, includes the Sofia Airport concession revenue BGN 660 million, which will be transferred to the state-owned railway company BDZ and included in capital expenditure. The amendment to the Energy Act of 01.07.2018 changes the mechanism for raising revenue and executing expenditure toward electricity producers through the budget of the EPSF. That leads to an increase of the non-tax revenue, and the subsidy expenditure respectively. The impact on the budget balance is neutral, as the revenue and expenditure are increased with the same amount.

3/ Includes other remuneration since 2014, which were previously integrated in use of goods and services.

4/ From 2014, with the adoption of the Public Finance Act, other remunerations are re-classified to the compensation of employees.

5/ Since July 2018, includes expenditure of the Electricity Power Security Fund.

6/ Contribution to EU budget.

7/ Includes only acquisitions of nonfinancial assets, i.e., capital expenditure. For 2019, includes concession revenue BGN 660 million for the Sofia Airport.

Table 6. Bulgaria: Monetary Accounts, 2011–18 1/
(Billions of leva, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017	2018
Monetary Survey								
Net foreign assets	21.1	25.3	28.4	35.0	40.7	49.7	51.7	56.1
Net domestic assets	52.5	53.9	55.8	50.5	51.7	49.7	53.7	57.9
Domestic credit	53.7	55.1	57.1	52.1	53.2	51.0	54.4	58.5
General government	-0.5	-0.7	1.2	0.4	2.4	-0.7	0.4	-0.4
Non-government	54.3	55.8	55.9	51.6	50.8	51.7	54.0	58.9
Broad money (M3)	56.9	61.7	67.2	68.0	74.0	79.6	85.7	93.3
Currency outside banks	7.8	8.5	9.1	10.2	11.4	12.8	14.1	15.6
Reserve money	14.9	17.4	17.3	19.2	27.5	28.6	29.6	32.6
Deposits 2/	49.1	53.2	58.2	57.8	62.6	66.8	71.6	77.7
Accounts of the Bulgarian National Bank								
Net foreign assets	24.6	29.0	26.8	30.8	38.1	44.9	44.7	47.4
Net foreign reserves (billions of euro)	12.6	14.8	13.7	15.7	19.5	23.0	22.9	24.2
Net domestic assets	-5.0	-6.7	-5.7	-7.3	-6.4	-11.8	-10.8	-10.6
Net claims on government	-4.2	-5.7	-4.3	-6.7	-6.0	-11.0	-10.1	-9.4
Base money	14.9	17.4	17.3	19.2	27.5	28.6	29.6	32.6
Currency in circulation	7.8	8.5	9.1	10.2	11.4	12.8	14.1	15.6
Banks reserves	7.1	8.9	8.2	9.1	16.1	15.8	15.4	17.0
Deposit money banks								
Net foreign assets	-3.5	-3.6	1.6	4.2	2.6	4.9	7.0	8.6
Gross foreign assets	9.1	10.0	13.6	15.3	10.6	12.4	14.5	16.8
Gross foreign liabilities	12.6	13.7	12.1	11.1	8.1	7.6	7.5	8.1
Net domestic assets	56.5	59.3	59.9	56.9	57.4	60.7	63.8	67.4
Domestic credit	57.9	60.7	61.3	58.6	59.1	61.9	64.4	67.8
Memorandum items:			(Annual percentage change, unless otherwise indicated)					
Base money	5.6	16.7	-0.4	11.1	43.0	4.0	3.5	10.1
Broad money	12.2	8.4	8.9	1.1	8.8	7.6	7.7	8.8
Domestic non-government credit	3.8	2.8	0.3	-7.7	-1.6	1.8	4.5	8.9
Domestic deposits	13.2	8.3	9.3	-0.6	8.2	6.8	7.1	8.5
Domestic currency	21.0	17.0	8.6	0.1	9.2	10.1	10.8	10.3
Foreign currency	5.2	-2.1	10.3	-1.5	6.8	1.9	1.3	5.4
Money multiplier (ratio)	3.8	3.5	3.9	3.5	2.7	2.8	2.9	2.9
Velocity (M3) (ratio)	1.4	1.3	1.2	1.2	1.2	1.2	1.2	1.2
GDP (millions of leva)	80,759	82,040	81,866	83,756	88,575	94,130	101,043	107,541

Sources: BNB and IMF (http://data.imf.org/?sk=B83F71E8-61E3-4CF1-8CF3-6D7FE04D0930).

1/ Due to the revocation of the banking license of KTB, the bank is excluded as a reporting agent from the monetary statistics data starting in November 2014.

2/ Includes deposits at central bank.

Table 7. Bulgaria: Financial Soundness Indicators, 2011–18

(Percent)

	2011	2012	2013	2014	2015	2016	2017	2018Q3
Core indicators								
Capital adequacy								
Capital to risk-weighted assets	17.6	16.6	17.0	21.9	22.2	22.2	22.1	20.0
Tier 1 capital to risk-weighted assets	15.7	15.1	16.0	20.0	20.5	20.9	20.9	19.0
Asset quality								
Nonperforming loans to total gross loans	15.0	16.6	16.9	16.7	14.6	13.2	10.4	8.7
Nonperforming loans net of provisions to capital	36.9	38.9	36.2	43.5	49.8	44.7	36.6	28.9
Large exposures to capital	111.6	115.1	119.7	64.3	51.4	58.2	57.7	83.6
Earnings and profitability								
Return on assets	0.6	0.7	0.6	0.8	1.1	1.4	1.2	1.6
Return on equity 1/	5.7	6.3	5.7	7.2	7.9	10.4	9.3	12.7
Net interest income to gross income	73.2	68.8	68.5	67.4	66.2	69.2	69.4	66.6
Noninterest expense to gross income	50.6	52.1	54.0	49.9	47.3	44.0	45.7	44.1
Personnel expense to total income	18.5	19.1	19.8	18.5	17.2	18.4	20.3	20.5
Liquidity								
Liquid assets to total assets	22.0	22.4	23.4	26.1	31.1	32.4	33.1	26.0
Liquid assets to short-term liabilities	29.1	30.0	30.6	33.7	40.2	41.0	41.5	31.8
Liquid assets to total liabilities	25.4	25.7	26.9	29.9	39.2	40.3	41.3	32.0
Encouraged indicators								
Deposit-taking institutions								
Capital to assets 2/	10.8	10.1	10.4	11.6	12.0	11.6	11.4	11.1
Trading income to total income	5.0	7.4	5.8	7.0	7.9	10.3	2.3	10.0
Personnel expenses to noninterest expenses	36.5	36.7	36.7	37.1	36.3	41.7	44.5	46.5
Customer deposits to total (non-interbank) loans	95.4	100.2	107.4	115.5	127.7	134.7	138.8	138.2
Foreign currency denominated loans to total loans	63.7	64.0	61.2	57.0	50.0	45.1	38.5	37.3
Foreign currency denominated liabilities to total liabilities	54.8	51.8	50.2	49.0	42.6	41.7	39.4	39.4

Sources: BNB and IMF (http://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA&sId=1411569045760).

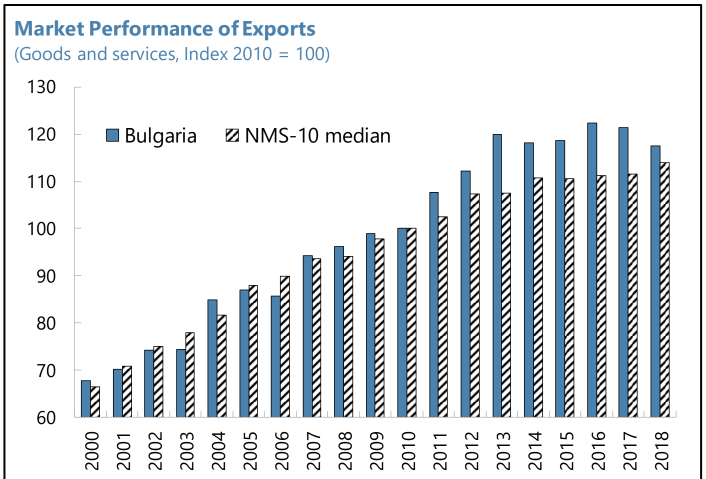
1/ Return on equity is calculated with Tier I capital as denominator.

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

Annex I. Competitiveness and External Sector Assessment

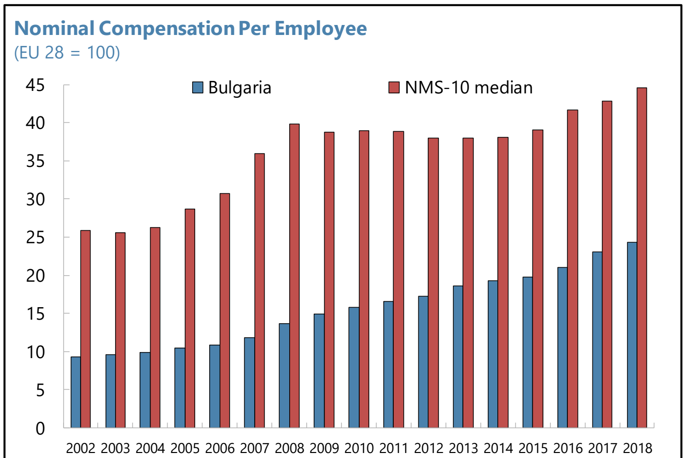
Staff overall assessment is that Bulgaria's external position is stronger than fundamentals and desirable policy settings. This assessment is subject to substantial statistical and model uncertainty. As real wage growth persistently outpaces productivity growth, competitiveness may be eroding.

1. **Bulgaria's export performance, which improved until 2013, has since remained broadly stable.** And the small decline registered in 2017 continued in 2018 as the increase in tourism receipts was offset by poor merchandise export performance due to temporary factors affecting oil exports and a slowdown in demand from major export markets.

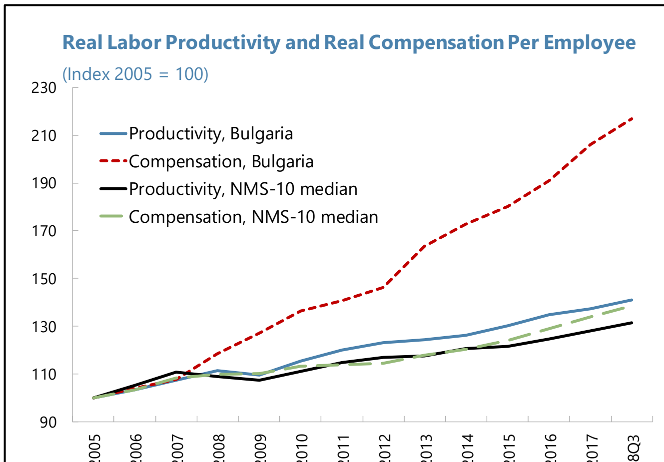


Sources: European Commission.

2. **Beyond temporary and exceptional factors, a structural factor affecting export competitiveness is the rapid wage growth.** Though compensation remains well below what is observed in other EU new member states (NMS), it is rising rapidly, and, in real terms, it has persistently outpaced labor productivity since 2008.



Sources: European Commission; and IMF staff calculations.



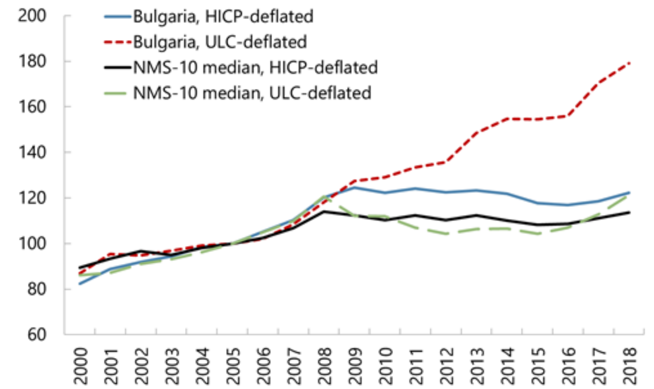
Sources: Haver and IMF staff calculations.

Real Effective Exchange Rate

3. **As a result, Bulgaria's cost competitiveness as measured by the ULC-based Real Effective Exchange Rate (REER) has deteriorated significantly in the past decade while it remained broadly stable in the NMS median.** This indicates a weakening of cost competitiveness. In contrast, the deterioration of price competitiveness has been more contained and, in recent years, the HIPC-based REER evolves broadly in line with the NMS median.

4. **According to the REER model of the External Balance Assessment (EBA-Lite), in 2018, the REER (CPI based) is broadly consistent with fundamentals and desired policy settings.** The REER is estimated to be virtually at its norm pointing to a slight overvaluation of 1.1 percent in 2018. The CPI-based analysis, however, is likely to be underestimating the weakening of cost competitiveness, which is better measured by the ULC comparison.

Real Effective Exchange Rates
(Index 2005 = 100)



Sources: European Commission and IMF staff calculations.

EBA-Lite REER Approach	
Ln(REER) Actual	4.66
Ln(REER) Fitted	4.65
Ln(REER) Norm	4.65
Residual	0.01
REER Gap (in percent)	1.1
Policy Gap	0.00

Current Account

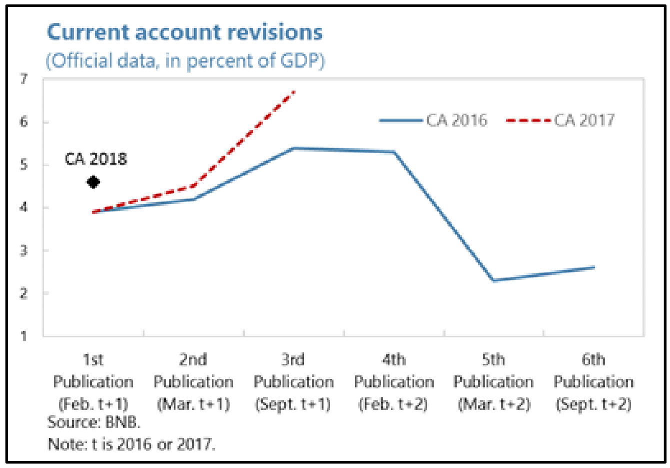
5. **The current account model suggests that the projected current account is 5.9 percent of GDP higher than the level that is consistent with fundamentals and desirable policy settings.** It points to an undervaluation of 13 percent and estimates the CA-Norm at -1.3 percent of GDP.

6. **These results are subject to sizable model uncertainty.** Only 35 percent of the 5.9 percent CA-gap (2.1 percent of GDP) is explained by a deviation of policy from the desirable policy in the medium term. The residual is thus large and reflects the importance of structural factors and distortions that are not captured by the model.

EBA-Lite CA Approach, 2018 (in percent of GDP)	
CA-Actual	4.6
Cyclical Contributions (from model)	0.0
Cyclically adjusted CA	4.6
CA-Norm	-1.3
Cyclically adjusted CA Norm	-1.3
Multilaterally Consistent Cyclically adjusted CA Norm	-0.8
CA-Gap	5.9
of/which Policy gap	2.1
Elasticity	-0.47
REER Gap (in percent)	-13
CA-Fitted	1.1
Residual	3.5
Natural Disasters and Conflicts	0.3

7. **The estimated current account gap is also subject to substantial statistical uncertainty:**

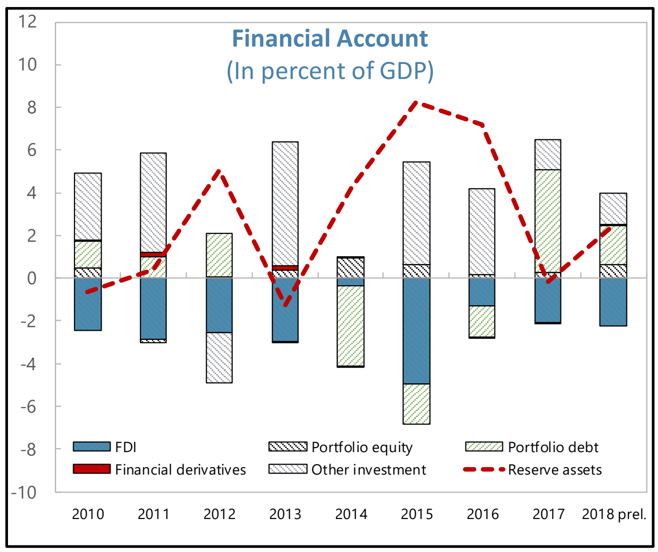
- First, the balance of payments is frequently and substantially revised affecting the model results. Revisions of the current account are due to long lags in compiling trade data and payment of direct investment income data. For instance, the 2016 current account balance was first estimated to be 3.9 percent of GDP, revised up to 5.4 percent of GDP, and finalized to 2.6 percent of GDP.



- Second, very large errors and omissions in historical data (e.g., and - 1.8 percent of GDP or - 39 percent of current account in 2018, after - 3.4 percent of GDP or - 52 percent of current account in 2017) suggest that the current account balance suffers from significant measurement issues. [1]

Financial Flows

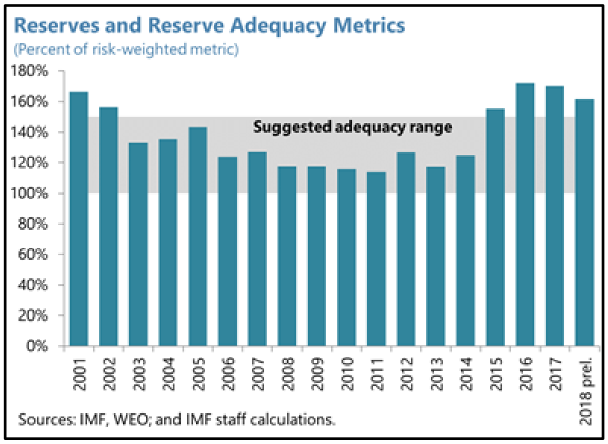
8. **In 2017, net portfolio debt outflows resumed.** Reaching 4.8 percent of GDP, they were historically large and driven by the repayment of a sovereign Eurobond and a large increase in investments in long-term debt securities by non-monetary financial institutions (insurance companies, pension funds, and investment funds). As a result, with net FDI inflows remaining relatively low and despite a decline in other investment, the financial account reached 4.4 percent of GDP. Although preliminary data suggest that they were more limited than in 2017, portfolio outflows would remain large in 2018 (2.4 percent of GDP) because some large corporate bonds matured. Other investments outflows remained broadly stable in 2018, mainly due to the change in late 2017 of the deposit rate for bank's excess reserves from - 0.4 percent to - 0.6 percent.

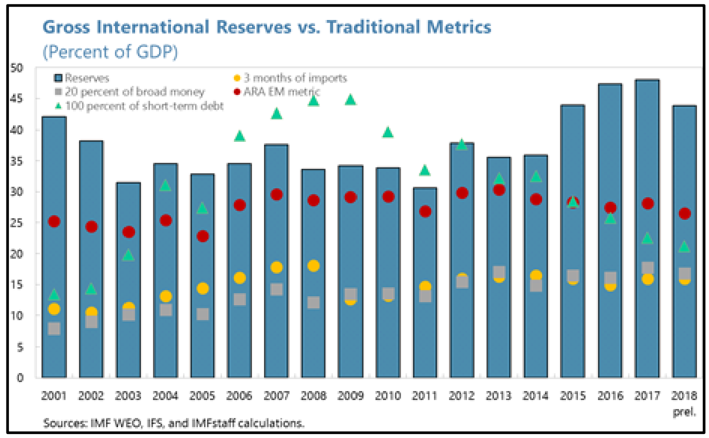


[1] Over the period 2014-18, errors and omissions ranged from -3.4 percent of GDP to +3.8 percent of GDP or from - 198 percent to + 146 percent of current account (this range excludes 2016, when the current account was close to balance).

Reserves

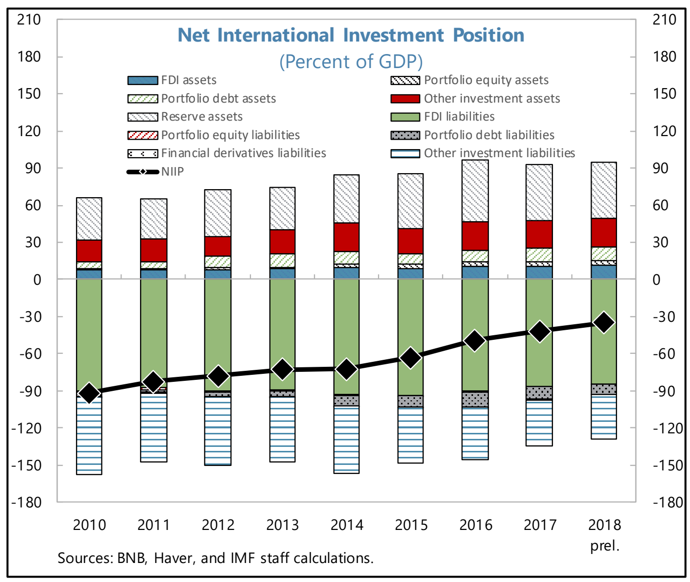
9. Reserves remain adequate. They exceed the upper bound of the suggested adequacy range and the coverage ratio required for the functioning of the currency board, and are well above the traditional metrics.[2]





Net International Investment Position (NIIP)

10. The NIIP (Table 5) does not raise sustainability concern. The NIIP improved from - 92 percent of GDP in 2010 to - 35 percent of GDP in 2018 and is projected to reach - 11percent of GDP by 2024. Over 2010-17, the improvement in the NIIP has been driven by an increase in assets and, to a lesser extent, a reduction in liabilities. However, in 2018, the improvement in the NIIP (by 6.8 percentage points of GDP) was due to an across the board reduction in liabilities (- 4.8 percentage points of GDP) and, to a lesser extent, an increase in assets (+ 2.0 percentage points of GDP).



Overall Assessment

11. Staff's overall assessment is that Bulgaria's external position is stronger than warranted by fundamentals and desirable policy settings, considering both current account and exchange rate indicators. The current account model points to a 13 percent

[2] Under the currency board, reserves are required to cover currency in circulation, liabilities to banks, liabilities to the government, and liabilities to other depositors. End-November 2018, the reserves coverage ratio exceeded 113 percent. Reserves also accounted for 289 percent of short term debt, for 284 percent of foreign exchange deposit of the population.

undervaluation, as it suggests that the current account is 5.9 percent of GDP substantially higher than the level that is consistent with fundamentals and desirable policy settings. In contrast, the REER model suggests that the external position is broadly consistent with fundamentals and desirable policy settings. It points to a 1.1 percent overvaluation, and an analysis of competitiveness highlights a stronger appreciation of the ULC-based REER than of the CPI-based REER. Moreover, the estimated current account gap is subject to substantial statistical uncertainty (large errors and omission and frequent revisions of data) and model uncertainty (more than half of the gap is accounted for by the residual, suggesting that the model does not capture important structural factors and distortions). These factors introduce some uncertainty in assessing the overall external position. Nevertheless, drawing on both the estimated CA and REER gaps, staff's assessment is that the external position in 2018 was stronger than fundamentals and desirable policies, although subject to considerable uncertainty. It should also be kept in mind that Bulgaria needs to maintain a current account surplus over the medium term to further improve the net international investment position and to maintain adequate official reserves in the context of capital outflows and a currency board arrangement.

Authorities' Views

12. The authorities agree that Bulgaria's external position is currently stronger than warranted by fundamentals and desirable policy settings. However, they caution that current account data is likely to be revised down and have reservations on the model results (large residual and the fact that the CA-Gap is increased by the estimated impact of natural disasters and conflicts that Bulgaria does not experience) and specification (inclusion of health spending). They consider that faster wage growth than productivity growth may affect competitiveness only in the medium-term as exporters appear to still have margin to absorb unit labor cost increases.

Annex II. Risk Assessment Matrix[1]

	Source of Risks	Relative Likelihood	Impact if Realized	Policy Responses
Domestic	1. A faster than expected wage growth (short term)	**High** Public wage and minimum wage increases could also accelerate private sector wage hike, resulting in inflationary pressure and further widen the gap between wage growth and productivity.	**High/Medium** Strong domestic demand, and inflation acceleration. Widening wage growth and productivity could lead to eroding competitiveness.	Growth-friendly fiscal consolidation, structural reforms to increase quality labor supply.
	2. Slow progress in structural reforms to raise potential growth and mitigate unfavorable demographics (short/medium term)	**High/Medium** Political uncertainties could delay the structural reform agenda	**High** Lower potential growth, high structural unemployment, stalling real convergence, and increased fiscal risks.	Accelerate implementation of structural reforms.
	3. Limited progress to address weaknesses in the banking system, as identified by the AQR/stress test and the FSAP (short term).	**Medium** Banks identified by AQR/stress test are unable to raise high quality private capital and/or inadequate progress in implementing a comprehensive supervisory strategy for them.	**High/Medium** Increased vulnerability to unanticipated shocks. Financial sector stability weakened.	Ensure that banks have sufficient capital buffers.
Global	4. Weaker-than-expected growth in the Euro area and Turkey. (short/medium term)	**Medium** Bulgaria's exports of goods and services are highly dependent on these two markets. Weaker-than-expect growth in the Euro area could also negatively affect investment.	**High** Lower FDI, deterioration in external accounts, and lower growth.	Accelerate structural reforms, and allow automatic stabilizers to operate.
	5. Sharp tightening global financial conditions (Fed normalization and tapering by ECB) (short term)	**High** Negative impact through increase in funding costs for banks, corporates, and households.	**Medium** Lower investment and growth.	Allow automatic stabilizer to operate in the short term; over the medium term, build reserve buffers and strengthen financial-sector resilience.
	6. Rising protectionism and retreat from multilateralism including uncertainty on Brexit negotiation (short/medium term)	**High** Doubts about the benefits of globalization leads to protectionism, reducing global and regional policy and regulatory collaboration	**Medium** Negative impacts or trade, capital and labor flows, and long-term growth.	Accelerate structural reforms to increase growth potential.

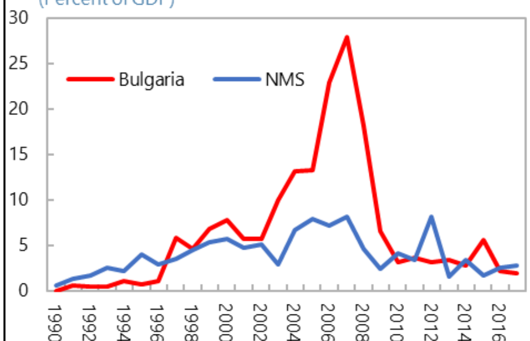
[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relatively likelihoods of risks listed is the staff's subjective assessment of the risks surrounding the baseline. The RAM reflects staff's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

Annex III. Foreign Direct Investment

1. FDI flows into Bulgaria are low by historical standards, but earlier levels were unsustainable and the recent trend is in line with regional peers. Very large inflows in the previous decade reflected the low foreign capital penetration and the attractiveness of Bulgaria as a new EU member state. They were mirrored by large external current account deficits. The stock of FDI is now the highest as a share of GDP among peers, although proportional to Bulgaria's relatively low level of per capita income. Convergence towards EU income levels and further FDI inflows should be mutually reinforcing.

Large inflows, related to EU accession, have slowed down and have recently been in line with regional flows.

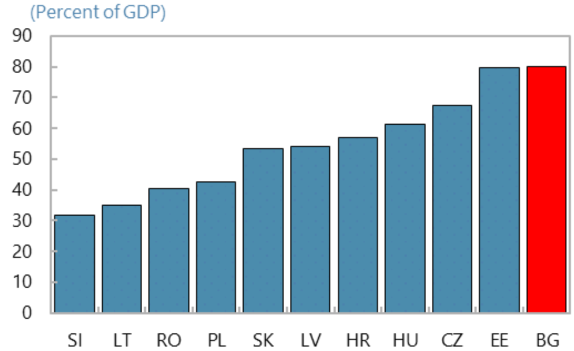
FDI Inflows
(Percent of GDP)



Sources: UNCTAD

The stock of FDI as a percent of GDP is the highest among peers.

FDI Stocks in the New Member States, 2017
(Percent of GDP)



Source: WIID database.

2. Foreign investment has been important to finance the acquisition of physical capital and has played a big role in the development of the exports sector and raising productivity (as shown also in the accompanying SIP on firm productivity). FDI has led to the establishment of a large number of firms with mixed foreign and Bulgarian capital, which also exhibit higher productivity and salaries than purely domestic ones, in line with studies on the diffusion of knowledge through FDI.

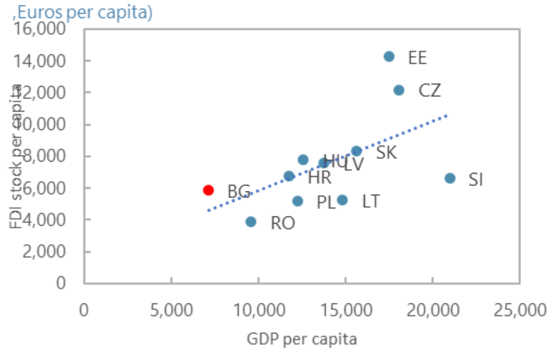
3. Improving the institutional framework offers the greatest potential to attract greater investment, which could lead to additional productivity gains and income convergence. A recent Fund study estimated that closing gaps with respect to European leaders in skills shortages, institutional quality, and public infrastructure could result in gains in FDI of 5-7 percentage points of GDP.[1]

[1] J. La-Bhus Fah and J. Rhaman, IMF Working Paper/18/187.

Bulgaria: Foreign Direct Investment

FDI stocks in the region, including in Bulgaria, are broadly proportional to GDP per capita

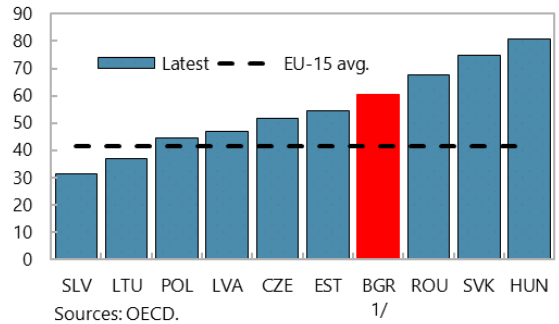
FDI stock and GDP (2017)
(Euros per capita)



Sources: WIID database and World Economic Outlook.

Foreign capital has helped developing Bulgaria's export sector...

Share of foreign firms in exports
(Percent)



Sources: OECD.
1/ 2011 data.

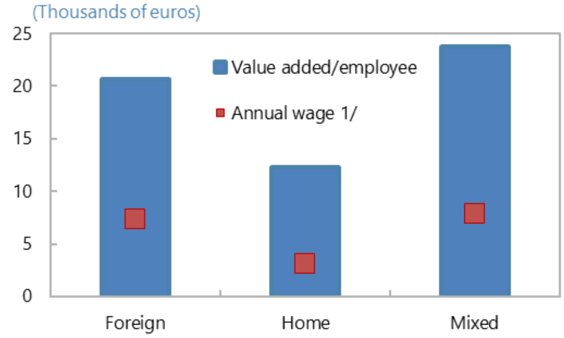
...and establishing foreign-owned as wells as mixed companies, which are on average larger than purely domestic ones...

Turnover and employment

Sources: Orbis database

...they are also more productive and pay higher salaries...

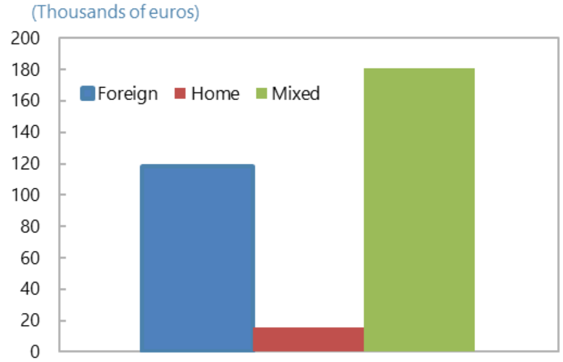
Productivity and wages
(Thousands of euros)



Sources: Orbis database

...and engage in more sophisticated activities.

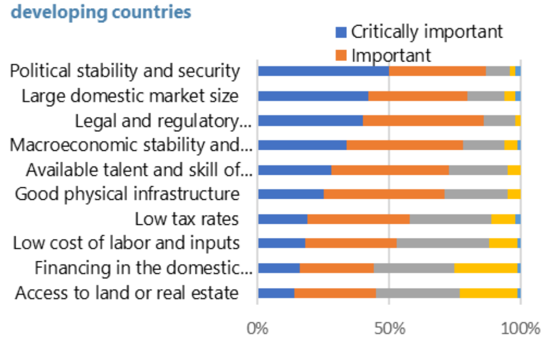
Intangible assets
(Thousands of euros)



Sources: Orbis database

Attracting FDI, to further raise productivity and per capita income, requires special focus on improving the institutional framework and structural weaknesses.

Factors affecting investment decisions in developing countries



Source: The World Bank, "How developing countries can get most out of direct investment", 2017.

Sources: Orbis database

Annex IV. Debt Sustainability Analysis

External DSA

1. **Bulgaria external debt has declined from its peak of slightly above 100 percent of GDP in 2009 to a projected about 60 percent of GDP in 2018.** Over this period, the decline has been driven by a deleveraging of the private sector whose external debt-to-GDP ratio declined by about 42½ percentage points. The deleveraging was broad-based (banks, non-bank sector, and direct investment firms) but partly offset by a 2½ percentage points increase in the public external debt-to-GDP ratio.[1]

2. **Under Staff baseline, gross external debt is projected to continue to decline over the medium term and is sustainable.** External debt is projected to continue to decline reaching 44 percent of GDP in 2024 because of a dynamic nominal GDP growth that would outpace increase in nominal external debt. The current account surplus excluding interest payments (declining from 2.9 percent of GDP in 2019 to 0.7 percent of GDP in 2024) is projected to be significantly above the debt stabilizing level (-4.4 percent of GDP). Gross financing needs are projected to increase from their 2018 level but would remain low by historical standards.

3. **External debt appears broadly resilient to various shocks.** Bulgaria's external debt is particularly sensitive to a real depreciation shock. A 30 percent real depreciation in 2018, which appears unlikely given the currency board, the peg to the euro, and the large share of the euro area in trade exports (almost half of exports), would trigger an increase in external debt to 82½ percent of GDP in 2020 which would then decline to 66 percent of GDP by the end of the projection period. Under all other standard shocks and the historical scenario, including the combined shock scenario, Bulgaria's external debt-to-GDP ratio would be below its 2018 level during the whole projection period.

Public DSA

4. **General government gross debt is projected to decline over the medium term.** In 2017, public debt declined to 23.3 percent of GDP, which was the third lowest among the EU countries. The decline was due to the positive impact of the primary surplus and debt repayment of the Eurobonds. For 2018, the government debt is estimated to be BGN 23.0 billion in nominal terms, which represents 20.5 percent of the estimated GDP. This is owing to the fiscal surplus, the high nominal GDP growth, and the authorities' decision not to issue new external debt in 2018. The authorities might decide to issue new securities on the domestic market of up to BGN 1 billion in 2019. However, the total government debt should not surpass BGN 22.2 billion at end-2019, according to the draft budget law. The authorities have no plan to issue new external bonds in 2019. The medium-term budget framework envisages to achieve the balanced budget by 2020. Fiscal consolidation and a favorable growth-interest rate differential will help reduce general government

[1] The public external debt-to-GDP ratio increased by about 7 percentage points between 2009 and 2016 but has been declining rapidly since in large part due to the Eurobond repayment in 2017.

debt over the medium term. Assuming Fiscal Reserve Account (FRA) balance remain unchanged from the projected 2021 level, staff projects a steady decline in the debt-to-GDP ratio from 20.5 percent in 2018 to 14.5 percent in 2024. If the authorities were to draw down FRA for financing, the pace of debt reduction could be faster. Alternative scenarios indicate that public debt would likely remain below 25 percent of GDP under various shocks. Gross financing needs are also projected to remain well below 5 percent of GDP under shocks.

Bulgaria: External Debt Sustainability Framework, 2008-2024

(In percent of GDP, unless otherwise indicated)

	Actual													Projections						
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018			2019	2020	2021	2022	2023	2024	Debt-stabilizing non-interest current account 6/
Baseline: External debt	93.3	106.4	96.7	83.3	91.8	91.1	85.4	72.6	67.8	67.8	59.2			**58.4**	**55.0**	**52.3**	**49.5**	**46.9**	**44.0**	**-4.4**
Change in external debt		13.1	-9.7	-13.4	8.5	-0.7	-5.7	-12.8	-4.8	0.0	-8.5			-0.8	-3.4	-2.7	-2.7	-2.7	-2.9	
Identified external debt-creating flows (4+8+9)		6.1	2.0	-14.6	3.7	-7.0	-3.5	6.3	-8.0	-14.8	-13.9			-6.5	-5.6	-5.1	-4.7	-4.2	-3.7	
Current account deficit, excluding interest payments		5.8	-0.1	-2.3	-1.3	-3.1	-2.6	-1.2	-3.6	-7.4	-5.3			-2.9	-2.3	-1.9	-1.6	-1.2	-0.7	
Deficit in balance of goods and services		7.7	3.0	-0.2	3.3	0.7	0.5	-0.8	-4.3	-3.9	-1.9			-0.6	-0.3	-0.3	0.0	0.3	0.6	
Exports	55.7	44.7	50.3	59.1	60.8	64.8	65.1	63.9	64.0	67.3	65.2			63.4	62.3	61.4	60.1	58.9	57.5	
Imports		52.3	53.3	58.9	64.1	65.5	65.6	63.0	59.7	63.4	63.3			62.8	62.0	61.1	60.1	59.2	58.1	
Net non-debt creating capital inflows (negative)		-6.8	-2.4	-2.8	-2.6	-2.9	-0.2	-4.9	-1.2	-2.4	-2.4			-2.4	-2.4	-2.4	-2.4	-2.4	-2.4	
Automatic debt dynamics 1/		7.0	4.5	-9.5	7.6	-1.0	-0.7	12.5	-3.2	-5.1	-6.2			-1.2	-0.9	-0.8	-0.7	-0.6	-0.6	
Contribution from nominal interest rate		2.5	1.8	2.0	2.2	1.8	1.4	1.2	1.0	0.9	0.7			0.7	0.7	0.7	0.7	0.7	0.7	
Contribution from real GDP growth		3.5	-1.4	-1.6	0.0	-0.4	-1.6	-3.4	-2.7	-2.4	-1.9			-1.9	-1.6	-1.4	-1.4	-1.3	-1.2	
Contribution from price and exchange rate changes 2/		1.0	4.1	-9.8	5.5	-2.3	-0.4	14.6	-1.4	-3.6	-5.0			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/		7.1	-11.7	1.2	4.8	6.3	-2.3	-19.2	3.2	14.8	5.4			5.7	2.2	2.3	2.0	1.6	0.8	
External debt-to-exports ratio (in percent)	167.5	238.3	192.2	141.0	151.0	140.6	131.2	113.7	105.9	100.7	90.8			92.2	88.2	85.1	82.4	79.6	76.4	
Gross external financing need (in billions of US dollars) 4/		28.7	24.2	19.9	19.7	19.6	17.2	18.5	12.9	9.9	10.8			12.7	13.7	14.5	16.8	17.8	19.2	
in percent of GDP		55.3	47.7	34.7	36.6	35.4	30.3	36.9	24.2	17.1	16.7	10-Year	10-Year	19.0	19.2	19.0	20.7	20.7	21.0	
Scenario with key variables at their historical averages 5/														**58.4**	**57.8**	**57.2**	**56.3**	**54.9**	**52.7**	**-3.0**
Key Macroeconomic Assumptions Underlying Baseline												Historical Average	Standard Deviation							
Real GDP growth (in percent)		-3.6	1.3	1.9	0.0	0.5	1.8	3.5	3.9	3.8	3.2	1.6	2.3	3.3	3.0	2.8	2.8	2.8	2.8	
GDP deflator in US dollars (change in percent)		-1.1	-3.7	11.3	-6.2	2.6	0.4	-14.6	2.0	5.6	7.9	0.4	7.4	-0.1	3.9	3.4	3.5	3.2	3.5	
Nominal external interest rate (in percent)		2.6	1.7	2.3	2.4	2.0	1.5	1.3	1.4	1.4	1.1	1.8	0.5	1.2	1.3	1.3	1.4	1.5	1.5	
Growth of exports (US dollar terms, in percent)		-23.5	9.9	33.2	-3.4	9.9	2.7	-13.3	6.3	15.2	8.0	4.5	15.6	0.3	5.2	4.7	4.2	4.0	3.9	
Growth of imports (US dollar terms, in percent)		-33.8	-0.6	25.3	2.2	5.2	2.5	-15.1	0.5	16.4	11.2	1.4	16.4	2.3	5.7	4.7	4.7	4.5	4.4	
Current account balance, excluding interest payments		-5.8	0.1	2.3	1.3	3.1	2.6	1.2	3.6	7.4	5.3	2.1	3.5	2.9	2.3	1.9	1.6	1.2	0.7	
Net non-debt creating capital inflows		6.8	2.4	2.8	2.6	2.9	0.2	4.9	1.2	2.4	2.4	2.9	1.8	2.4	2.4	2.4	2.4	2.4	2.4	

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.

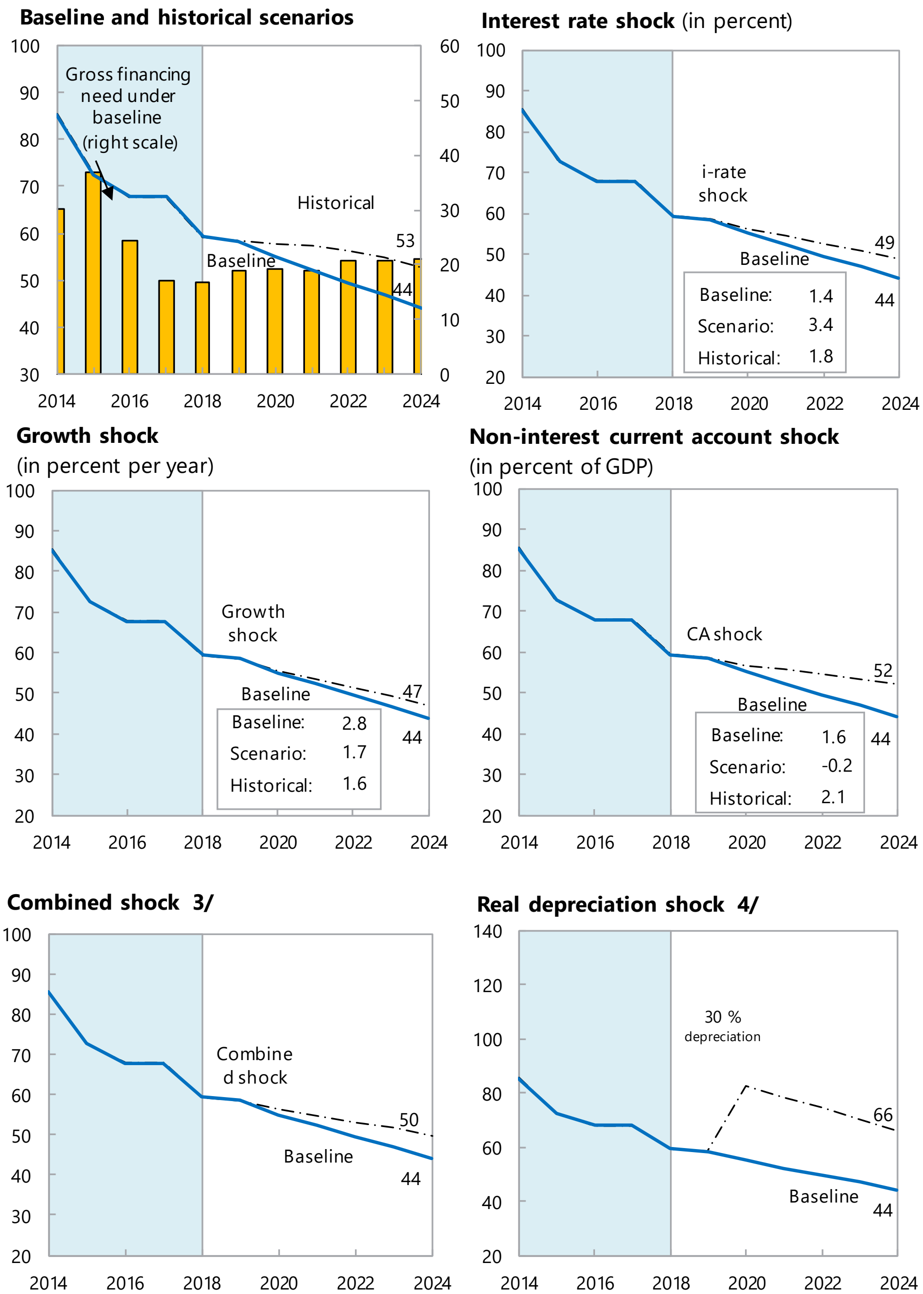
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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.

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

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks, except in case of the interest rate shock where a 200 bp shock is assumed. 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 2018.

Bulgaria: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP, unless otherwise indicated)

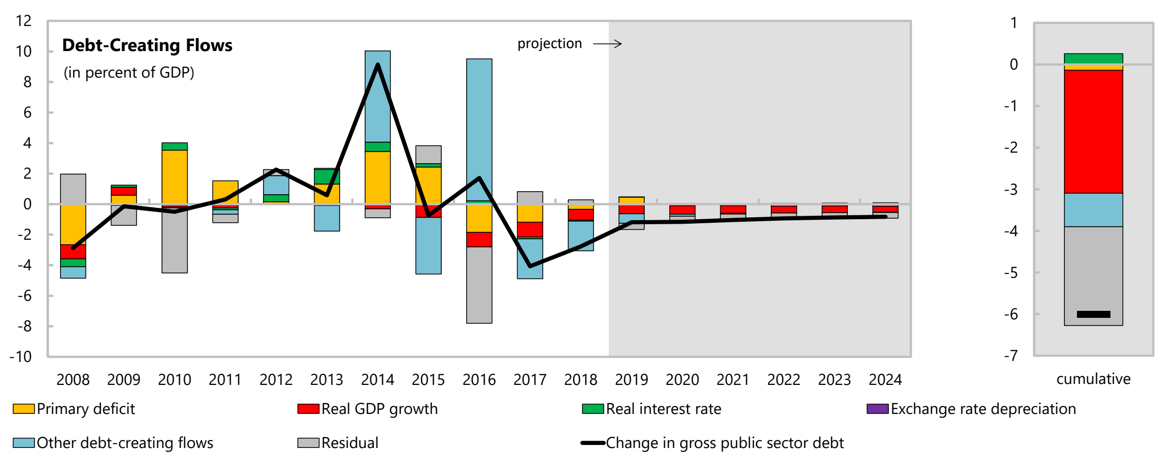
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	19.0	23.3	20.5	19.3	18.2	17.1	16.2	15.3	14.5
Public gross financing needs	4.0	2.1	1.3	1.7	1.2	0.8	2.2	2.1	2.3
Real GDP growth (in percent)	1.7	3.8	3.2	3.3	3.0	2.8	2.8	2.8	2.8
Inflation (GDP deflator, in percent)	2.8	3.4	3.1	2.9	2.8	2.8	2.8	2.8	2.8
Nominal GDP growth (in percent)	4.6	7.3	6.4	6.3	5.8	5.7	5.7	5.7	5.7
Effective interest rate (in percent) [4/]	4.5	3.1	2.9	3.0	3.0	3.0	3.1	3.3	3.5

As of February 21, 2019		
Sovereign Spreads		
EMBIG (bp) 3/		149
5Y CDS (bp)		79
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB-	BBB-
Fitch	BBB	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing
Change in gross public sector debt	1.1	-4.1	-2.8	-1.2	-1.2	-1.0	-0.9	-0.9	-0.8	-6.0	primary
Identified debt-creating flows	2.0	-4.9	-3.1	-0.8	-0.8	-0.6	-0.5	-0.5	-0.5	-3.6	balance [9/]
Primary deficit	0.9	-1.2	-0.3	0.5	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3
Primary (noninterest) revenue and grants	32.8	32.9	34.8	36.0	35.3	35.0	35.1	35.1	34.3	210.8	
Primary (noninterest) expenditure	33.8	31.8	34.4	36.5	35.2	34.8	35.0	35.0	34.1	210.7	
Automatic debt dynamics [5/]	-0.1	-1.1	-0.8	-0.6	-0.5	-0.5	-0.4	-0.4	-0.3	-2.7	
Interest rate/growth differential [6/]	-0.1	-1.1	-0.8	-0.6	-0.5	-0.5	-0.4	-0.4	-0.3	-2.7	
Of which: real interest rate	0.3	-0.1	-0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.3	
Of which: real GDP growth	-0.3	-1.0	-0.7	-0.6	-0.5	-0.5	-0.5	-0.4	-0.4	-3.0	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	1.1	-2.6	-1.9	-0.6	-0.1	-0.1	0.0	0.0	0.0	-0.8	
0 (negative)	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loans)	1.3	-2.6	-1.9	-0.6	-0.1	0.0	0.0	0.0	0.0	-0.8	
Residual, including asset changes [8/]	-0.9	0.8	0.3	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-2.4	



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 - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) 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 - π (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.

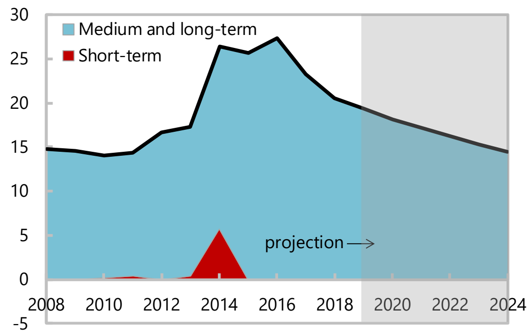
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Bulgaria: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

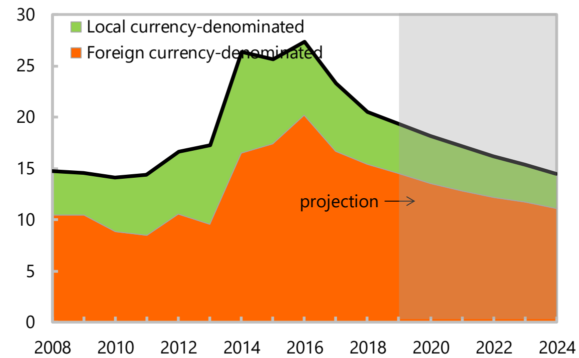
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

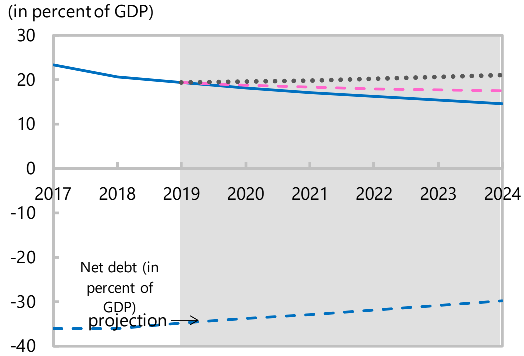


Alternative Scenarios

Baseline | Historical | Constant Primary Balance

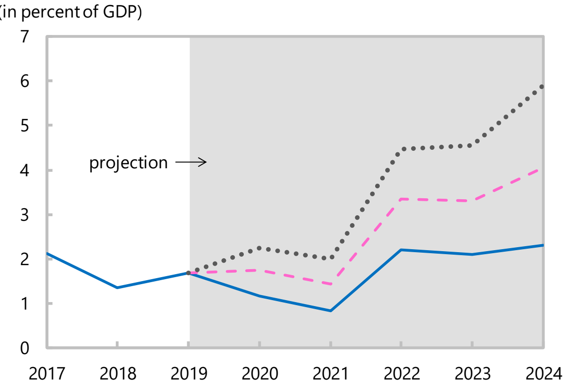
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

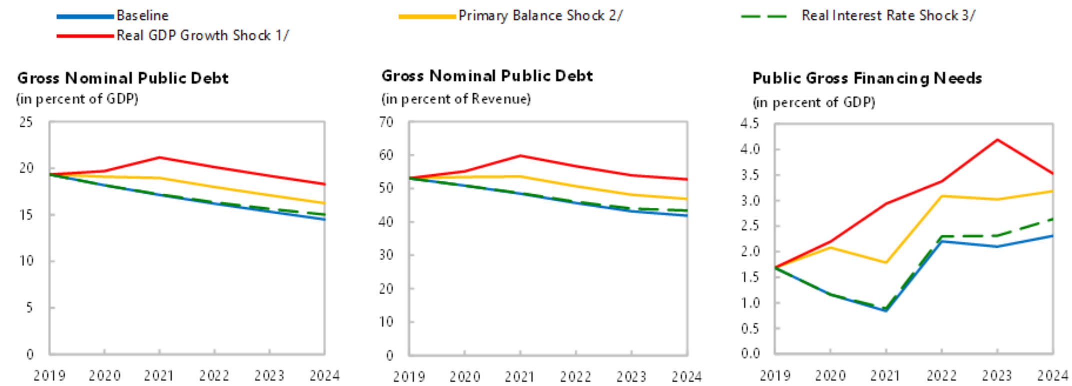
Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	3.3	3.0	2.8	2.8	2.8	2.8
Inflation	2.9	2.8	2.8	2.8	2.8	2.8
Primary Balance	-0.5	0.1	0.1	0.1	0.1	0.1
Effective interest rate	3.0	3.0	3.0	3.1	3.3	3.5
Constant Primary Balance Scenario						
Real GDP growth	3.3	3.0	2.8	2.8	2.8	2.8
Inflation	2.9	2.8	2.8	2.8	2.8	2.8
Primary Balance	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Effective interest rate	3.0	3.0	3.0	3.2	3.4	3.7

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	3.3	1.6	1.6	1.6	1.6	1.6
Inflation	2.9	2.8	2.8	2.8	2.8	2.8
Primary Balance	-0.5	-1.0	-1.0	-1.0	-1.0	-1.0
Effective interest rate	3.0	3.0	3.1	3.4	3.9	4.4

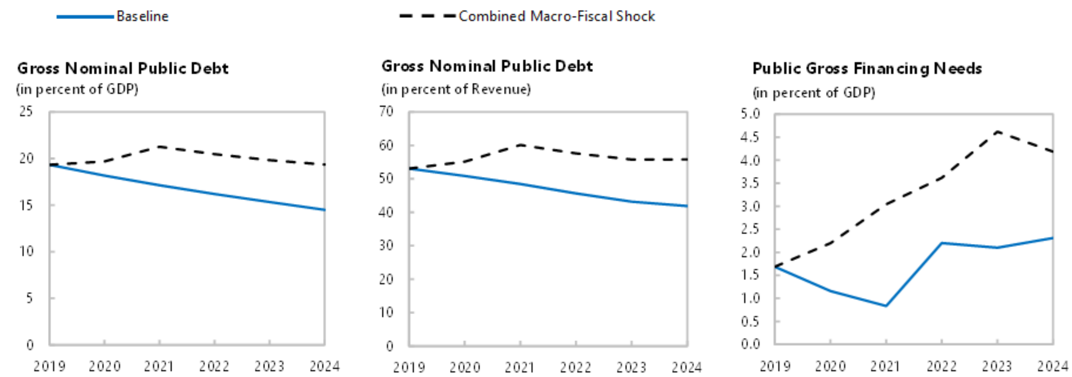
Source: IMF staff.

Bulgaria: Public DSA – Stress Tests

Macro-Fiscal Stress Tests

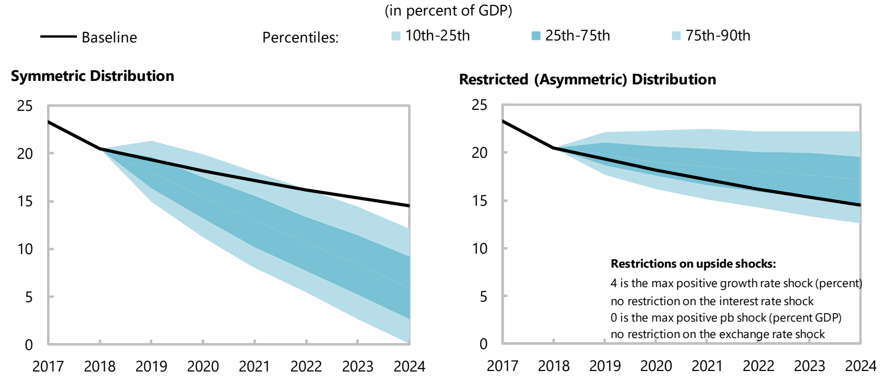


Additional Stress Tests



Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Source: IMF staff.

1/ Real GDP growth shock scenario assumes (i) real GDP growth is reduced by 1 standard deviation for 2020-21; (ii) revenue-to-GDP ratio remains the same as in the baseline; (iii) level of non-interest expenditures is the same as in the baseline; (iv) deterioration in primary balance lead to higher interest rate; and (v) decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth).

2/ Primary balance shock scenario assumes (i) the primary balance for 2020-21 to be below the baseline projections by 50 percent of the 10-year historical standard deviation; and (ii) additional borrowing leads to increase in interest rate of 25bp per 1 percent of GDP worsening of the primary balance.

3/ Real interest rate shock scenario assumes nominal interest rate increases by the difference between the maximum real interest rate over history (last 10 years) and the average real interest rate level over projection.

Appendix I. Main Recommendations of the 2017 Article IV Consultation and Authorities' Actions

IMF 2017 Article IV Recommendations	Policy Actions
Fiscal Policy	
Save the revenue overperformance in 2017 to strengthen fiscal buffers. Design targeted policies to reduce the VAT gap.	The fiscal balance (0.8 percent of GDP) substantially exceeded the original budget target. The authorities received a VAT gap TA from the IMF which found a sizable VAT compliance gap.
Improve public spending efficiency and effectiveness including for EU funds. Conduct a PIMA.	The authorities received a PIMA TA from the IMF. It identified weakness in public investment management institutions and made policy recommendations.
Need further pension reforms to address long-term fiscal pressures.	No near-term pension reform is planned, following the reform in 2015.
Structural Reforms	
Public goods	
Improving the quality of public goods, including education and training and public health. Pay increases should reflect the findings of a functional review of public sector employment and wages. Active labor market policies need to be more targeted to address skill mismatches and regional disparities.	Functional review of public sector employment and wages is to be further considered. The government will soon adopt an E-procurement system, and recently signed bilateral agreements with neighboring countries to import workers. Other ongoing reforms include training and job search for NEET and education reforms (e.g. updating curricula and increasing teachers' salaries).
SOEs	
Enhance the oversight and efficiency of SOEs to reduce contingent liabilities and raise growth potential. Establish a fiscal risk management unit.	The MTBF started to include SOE contingent liabilities. The government plans to align SOE legislation with OECD guidelines to improve SOE governance and efficiency. No plan to establish a fiscal risk management unit at this stage.
Governance	
Establish a track record in demonstrating judicial independence and effectiveness, and to step up the fight against high-level corruption.	An anti-corruption commission has been established. The Supreme Judicial Council was split into a College of Judges and a College of Prosecutors to improve independence.
Financial Sector Policies	
Put in place necessary operating procedures for the new BNB governance model.	The new BNB governance model is now fully operational.
Introduce a comprehensive strategy for NPL reduction.	The BNB plans to adopt the NPL guidelines by the EBA.
Complete a multi-year action plan to continue strengthening banking supervision.	The BNB has continued strengthening banking supervision, while prioritizing other tasks (most recently the application for the banking union and ERM II) over a multi-year action plan.

IMF 2017 Article IV Recommendations	Policy Actions
Two of the banks identified by the AQR and stress test still require larger capital buffers.	The smaller bank has raised capital via issuing new shares and the systemic bank raised capital using retained earnings.
Complete the regulations and enforce remedies to address concentration and related party risks on the basis of 2017 inspections.	The BNB has adopted a regulation on related parties.

INTERNATIONAL MONETARY FUND

BULGARIA

March 1, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department
(in consultation with other departments)

CONTENTS

FUND RELATIONS

(as of January 31, 2019)

Membership Status

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

General Resources Account

	SDR Million	Percent Quota
Quota	896.30	100.00
Fund holdings of currency	798.18	89.05
Reserve position in Fund	98.13	10.95

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	610.88	100.00
Holdings	612.52	100.27

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	9/25/1998	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				
	2019	2020	2021	2022	2023
Principal	--	--	--	--	--
Charges/Interest	0.01	0.01	0.01	0.01	0.01
Total	0.01	0.01	0.01	0.01	0.01

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 fixed to the Deutsche Mark at BGN 1000 per Deutsche Mark. Since January 1, 1999 the lev has been fixed 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 transactions, aside from restrictions notified to the Fund pursuant to Decision No. 144-(52/51).

Article IV Consultations

Bulgaria is on the 12-month consultation cycle. The 2017 Article IV Board discussion took place on February 14, 2018. The Staff Report was published on February 21, 2018 (Country Report No. 18/46).

Financial Sector Assessment Program

Bulgaria received a joint IMF-World Bank mission on the Financial Sector Assessment Program (FSAP) in October 2016 and January 2017. The Financial Sector Assessment Report (FSSA) was discussed at the Board on May 22, 2017 and was published on May 23, 2017 (Country Report No. 17/132).

Technical Assistance

Bulgaria received a technical assistance on public investment management assessment from the Fiscal Affairs Department (FAD) in FY2018.

Resident Representative

Mr. Hajdenberg is the Regional Resident Representative, based in Bucharest. He took up the position in April 2016.

COLLABORATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

- As of February 14, 2019, Bulgaria has collaborations with the World Bank Group, the European Bank for Reconstruction and Development, and the European Investment Bank.

- Further information can be obtained from the following hyperlinks.

International Financial Institution	Hyperlink
The World Bank Group	https://www.worldbank.org/en/country/bulgaria/overview#4
The European Bank for Reconstruction and Development (EBRD)	https://www.ebrd.com/bulgaria.html
The European Investment Bank	https://www.eib.org/en/projects/regions/european-union/bulgaria/index.htm

STATISTICAL ISSUES

(As of February 14, 2019)

I. Assessment of Data Adequacy for Surveillance
General: *Data provision is adequate for surveillance purposes.*
National Accounts **The National Statistical Institute (NSI) is responsible for compiling national accounts, based on the *2010 European System of Accounts (ESA 2010)*.** 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 production, income, capital accounts, and financial accounts for the five resident institutional sectors (general government and its sub-sectors, financial corporations, non-financial corporations, nonprofit institutions serving households, and households). **The NSI released revised national accounts estimates in September 2016, for 2000 to 2014, reflecting its latest efforts to fully implement the *ESA 2010***. Some of the key improvements to the estmates include using a market-equivalent rental approach to derive estimates of value added for owner-occupied dwellings; improving the coverage of consumption of fixed capital to include purchases of software and software produced on own-account by the general government; and improving the data sources used to derive estimates of household final consumption expenditure. Despite, these improvements, some weaknesses remain. The IMF mission in February 2018 found that the method used to derive taxes on products (VAT) in constant prices is not consistent with international best practice, which recommends that the change in VAT in constant prices moves in line with changes in final consumption expenditure in constant prices. The mission set a target date of September 2019 to resolve this issue. **Labor Market Statistics** **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" (QLCS) and "Annual enterprises survey on employment, wages and salaries, and other labor cost" are adjusted according to the ESA2010 methodology. The NSI current monthly and quarterly estimates are based on the results from the sample– QLCS. The QLCS sample includes 13100 private sector enterprises out of approximately 203000. The public sector enterprises are covered exhaustively except for the schools and kindergartens for which a sample is drown as well from 2008. The NSI household labor force survey provide average quarterly results and 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).

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.

Price Statistics

The NSI produces a monthly consumer price index (CPI), harmonized index of consumer prices (HICP), a producer price index (PPI), and a housing price index. The CPI series began in 1995, the PPI in 2000, the HICP in 2005 (for earlier years it is set equal to the CPI), and the housing price index in 2015. The CPI's geographical coverage is restricted to 27 urban areas that account for an estimated 65 percent of sales. A monthly PPI covers the mining and manufacturing, the production and distribution of electricity and steam, and natural gas and air conditioning supply.

Government Finance Statistics

In recent years, following the recommendations of a combined STA/FAD mission and within the framework of EU fiscal reporting, the authorities have made significant progress in implementing accrual accounting for government, budgetary and statistical systems. Quarterly GFS data on an accrual basis for the general government are reported for publication in the *IFS*, through Eurostat. The major part of the GFS data is compiled by the NSI and the transmissions to Eurostat are carried out by the NSI. Since September 2008, the Ministry of Finance (MoF) prepares and submits the SDDS monthly indicators for the central government finances in the IMF's GFSM 2001 format. Since June 2016 general government operations for the SDDS Plus are prepared quarterly on accrual basis by the NSI and the BNB. High frequency data filled in Statement II (Sources and Uses of Cash) template in the GFSM 2001 format are published on the MoF's website on a monthly and quarterly basis. As of 2014, the Bulgarian statistical authorities (NSI, BNB and MoF) agreed to use the provided option by Eurostat for IMF data transmission. In this way GFS data become consistent with the ESA/EDP data not only by adding accrual data, but also in terms of scope, including all units of GG sector in accordance with ESA rules. The NSI as the institution responsible for compiling GFS tables under ESA'2010 has confirmed to Eurostat to use data from ESA tables 6 and 7 (flows and stocks data of assets and liabilities) for reporting the annual GFS to IMF. The data for Statement II of the IMF GFS Yearbooks on a cash basis are still submitted by the MoF. Since 2015 it has been presented in the IMF GFSM 2014 format.

The MoF prepares data on the execution of the consolidated government budget on a monthly and quarterly 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 with a 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.
Monetary and Financial Statistics: The BNB reports monetary data for publication in the *IFS* based on the ECB framework for the collection and compilation of monetary data, beginning with data starting in February 2004. Data comply with the *MFSM* methodology, with some minor deviations documented in the *IFS* metadata.
Financial Sector Surveillance: Bulgaria participates in the financial soundness indicators (FSIs) project. Annual data are posted on the FSI website for the period 2008–17. Quarterly data are available for the period 2015Q1–2018Q3.
External Sector Statistics **Bulgaria compiles quarterly balance of payments and international investment position (IIP) statistics according to the *Balance of Payments and International Investment Position Manual, sixth edition (BPM6)***. In addition, the BNB publishes monthly balance of payments data on its official website. The Data Template on International Reserves and Foreign Currency Liquidity is disseminated monthly and quarterly external debt data are reported to the World Bank for re-dissemination in the Quarterly External Debt Statistics (QEDS) database. In line with the Special Data Dissemination Standard Plus (SDDS Plus) requirements, Bulgaria participates in: (i) the Coordinated Direct Investment Survey (CDIS) with inward data separately identifying equity and debt instruments positions and providing further breakdown of gross asset and liability debt instrument positions; (ii) the Coordinated Portfolio Investment Survey (CPIS) providing semiannual core data as well as the following encouraged items: currency of denomination, sector of the holder, liabilities, sector of the issuer, cross-sectors classifications, and short or negative positions; and (iii) the Currency Composition of Official Foreign Exchange Reserves (COFER).
II. Data Standards and Quality
Bulgaria started to adhere to the SDDS Plus in 2016.

Bulgaria: Table of Common Indicators Required for Surveillance

(as of February 14, 2019)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	1/08/2018	1/10/2018	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	December 2018	1/19/2018	M	M	M
Reserve/Base Money	December 2018	1/24/2019	M	M	M
Broad Money	December 2018	1/24/2019	M	M	M
Central Bank Balance Sheet	December 2018	1/24/2019	M	M	M
Consolidated Balance Sheet of the Banking System	December 2018	1/24/2019	M	M	M
Interest Rates[2]	December 2018	2/12/2019	M	M	M
Consumer Price Index	December 2018	1/15/2019	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2017	10/22/2018	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3]– General Government[4]	December 2018	1/31/2019	M	M	M
Revenue, Expenditure, Net operating balance, Gross operating balance, Net lending/borrowing, Net acquisition of assets, Net incurrence of liabilities [5] – General Government	2018 Q3	12/28/2018	Q	Q	Q
Revenue, Expenditure, Balance, Net acquisition of assets, Net incurrence of liabilities, Net change in the stock of cash [5] – Central Government	December 2018	1/31/2019	M	M	M
Stocks of General Government and General Government-Guaranteed Debt[6]	December 2018	1/31/2019	M	M	M
External Current Account Balance	November 2018	1/18/2019	M	M	M
Exports and Imports of Goods and Services	November 2018	1/18/2019	M	M	M
GDP	2018 Q3	12/07/2018	Q	Q	Q
Gross External Debt	November 2018	1/29/2019	M	M	M
International Investment Position	2018 Q3	12/31/2018	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] Indicators presented in adherence with the SDDS Plus.
[6] Including currency and maturity composition.
[7] Monthly (M); Quarterly (Q); Annually (A).

INTERNATIONAL MONETARY FUND

BULGARIA

March 12, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

Prepared By	European Department

This supplement provides information that has become available since the issuance of the staff report. The information does not alter the thrust of the staff appraisal.

On March 7, preliminary GDP data for 2018 was released. Real GDP growth stood at 3.1 percent, 0.1 percentage point lower than previously estimated in the staff report. While the data release confirmed that 2018 growth was driven by domestic demand, the negative contribution from net exports was more moderate than previously estimated. This preliminary data has little impact on the economic outlook for 2019 and policy advice.

Bulgaria: Updated Estimates and Projections, 2018-24

	2018	2019	2020	2021	2022	2023	2024
	Est.			Proj.			
Real GDP growth (percent)							
Staff Report	3.2	3.3	3.0	2.8	2.8	2.8	2.8
Revised Staff's Projections	3.1	3.3	3.0	2.8	2.8	2.8	2.8
Real domestic demand (percent)							
Staff Report	6.3	4.9	4.1	3.6	3.4	3.3	3.1
Revised Staff's Projections	6.1	5.0	4.1	3.6	3.5	3.3	3.1
Net exports (percentage point contribution to GDP growth)							
Staff Report	-3.2	-1.8	-1.3	-1.1	-0.9	-0.8	-0.5
Revised Staff's Projections	-3.0	-1.8	-1.3	-1.0	-0.9	-0.8	-0.5
GDP deflator (percent)							
Staff Report	3.1	2.9	2.8	2.8	2.8	2.8	2.8
Revised Staff's Projections	3.6	2.9	2.8	2.8	2.8	2.8	2.8
Nominal GDP (millions of leva)							
Staff Report	107,541	114,329	121,012	127,883	135,145	142,819	150,929
Revised Staff's Projections	107,925	114,738	121,444	128,340	135,628	143,329	151,468
General government net lending/borrowing (percent of GDP)							
Staff Report	0.1	-0.6	0.0	0.0	0.0	0.0	0.0
Revised Staff's Projections	0.1	-0.6	0.0	0.0	0.0	0.0	0.0
General government gross debt (percent of GDP)							
Staff Report	20.5	19.3	18.2	17.1	16.2	15.3	14.5
Revised Staff's Projections	20.4	19.3	18.1	17.1	16.1	15.3	14.5
Current account balance (percent of GDP)							
Staff Report	4.6	2.2	1.6	1.2	0.9	0.6	0.1
Revised Staff's Projections	4.6	2.2	1.6	1.2	0.9	0.6	0.1
Gross external debt (percent of GDP)							
Staff Report	61.5	58.1	54.8	52.1	49.4	46.7	43.8
Revised Staff's Projections	59.3	55.9	52.7	49.9	47.2	44.4	41.5

Statement by Mr. Doornbosch, Alternate Executive Director for Bulgaria and Mr. Manchev, Advisor to the Executive Director
March 20, 2019

My Bulgarian authorities thank Mr. Lee and his team for the report and constructive policy discussions during the Article IV mission. They welcome the well-balanced appraisals, the elaborations in the Selected Issues Papers on the policy challenges, and strong encouragement to continue economic adjustments to the slowing external demand.

Bulgaria's immediate priority is to simultaneously join the European Exchange Rate Mechanism II (ERM II) with the existing currency board arrangement (CBA), at the current fixed rate of the Bulgarian lev against the euro, and establish a close cooperation between the Bulgarian National Bank (BNB) and the European Central Bank (ECB). These are important and timely steps for the country to enhance economic and financial convergence toward the euro adoption. In line with this, the authorities take the necessary steps to further strengthen the financial sector supervision and macroprudential policy framework and advance the cooperation with the European Structural Reform Support Service to close gaps in the insolvency framework, the governance of the state-owned enterprises (SOEs), and strengthening the Anti-Money Laundering Framework. They are committed to further boost competitiveness and growth potential by strengthening the public finance management, accelerating the EU funds utilization and efficiency of the public capital spending, and improving the business environment and oversight of the SOEs.

The authorities consent to the publication of the Staff Report and Selected Issues papers and will take the staff comments into consideration during the design and implementation of future reforms aimed at addressing the challenges to the economy. Encouraged by staff's acknowledgement of the Bulgarian solid macroeconomic policies and robust economic performance, we will focus our remarks on the following issues: (1) recent developments and outlook (2) fiscal stability and sustainability, (3) structural reforms to strengthen economic potential, and (4) the way forward to enhance financial stability.

Recent Economic Developments and Outlook

The Bulgarian economy continues to demonstrate resilience to multiple shocks. Despite growing geopolitical uncertainty and moderation of the current EU economic cycle, GDP growth remains robust and has accelerated to 3 percent y-o-y in Q4/2018, up from 2.7 percent y-o-y in the previous quarter. Growth acceleration was mainly supported by investment and export, while final consumption eased to 3.4 percent y-o-y pressured by the base effect. In early 2019, the HICP inflation went down and stabilized (2.4 percent in February), after the slight acceleration observed last summer.

The authorities call for a cautious interpretation of the overall assessment that Bulgaria's external position is stronger than fundamentals suggest. In principle, the Bulgarian current account surplus of recent years cannot be easily explained by policy distortions or the EBA-lite model, as well demonstrated in Annex I of the Staff Report. The authorities encourage further methodological work by the IMF on the EBA-lite model to address the large residual, overestimation of the natural disasters and conflicts impact, and improve model specifications to better reflect the country specifics. From their side, the authorities work in close cooperation with the international partners to further strengthen the data quality and timelines and guarantee reliable BOP statistics in line with the IMF Special Data Dissemination Standard Plus.

Fiscal Stability and Sustainability

The authorities will continue their conservative fiscal strategy, compliant with the European Stability and Growth Pact. In 2018 the authorities progressed with the fiscal consolidation at a slightly faster pace than initially anticipated thanks to higher economic growth, further strengthening of the revenue mobilization, and under-execution of capital spending. Consistent with its principal policy strategy, the government used most of the revenue overperformance to strengthen fiscal buffers and contain the cyclicality of private demand. In line with the goal to ensure a structurally balanced budget by 2020-21, the 2019 budget has been carefully crafted to guarantee higher capital expenditures consistent with the projected increase in EU funds absorption, as well as sufficient financing needed for the ongoing reforms of the education, health and defense sectors. The tax policy remained broadly unchanged in line with the authorities' long-standing commitment to maintain a predictable and low tax environment.

Bulgaria has a sound track record of more than 20 years of maintaining fiscal stability and sustainability. It includes building up liquidity buffers in good times and containing excessive debt accumulation during downturns. As a result, budget surpluses have been recorded in almost half of the period and public debt (20.5 percent to GDP at the end of 2018) is among the lowest in the EU. Without deviating from their concept of a broadly balanced budget in the medium-term, the authorities adhere to the Fund's advice on risks in the current juncture and stand ready to set automatic stabilizers in motion. Given the long-term challenges to the pension system, the social security contribution rate was increased by an additional percentage point at the beginning of 2018. In the near-term, the authorities do not plan additional changes to the pension reform package, which has been steadily implemented since 2015 to allow for a proper assessment of the outcomes and build consensus on future policies.

While strictly observing the hard budget constraints, the authorities make steadfast progress with the fiscal structural reforms. Last year, supported by IMF Technical Assistance (TA), they started developing a framework to improve public investment management aimed at increasing the efficiency of capital spending, thus enhancing the productivity of public investment. The IMF TA also supported the Bulgarian National Revenue Agency to improve the tax gap assessment process and tax compliance and collection. The authorities will continue this collaboration to strengthen the revenue administration. Building on the earlier TA from the Fund on management of SOEs, the authorities and OECD currently implement a project to fully align the Bulgarian legislation with the best international practices. The next steps in the public education and health care reforms have been implemented in line with the authorities' plan to preserve fiscal sustainability of the sectors, while narrowing the existing negative public wage premiums and improving the quality of services.

Structural Reforms and Growth Potential

Bulgaria has progressed with the key structural reforms. The 2018 European Commission Report[1] on progress in Bulgaria under the Cooperation and Verification Mechanism (CVM) acknowledged this progress through closing the monitoring on three out of six areas under the mechanism: judicial independence, legislative framework and organized crime. The Commission also expressed[2] its firm confidence that Bulgaria will be able to fulfil all the remaining recommendations and meet the outstanding benchmarks before the end of this Commission's mandate in November 2019, thus concluding the CVM process for Bulgaria by that date. In line with earlier Fund recommendations, the 2018 amendments to the Public Procurement Act significantly streamlined the procurement process without sacrificing transparency. The government has already established an electronic public procurement system, for which user trials are currently conducted. The new system should be available for general use by the beginning of the second half of 2019 at the latest. Further progress has been made to address air pollution in the big cities through expansion of environment-friendly transport.

The authorities agree with Fund staff that Bulgaria's growth potential should be strengthened. As discussed in the staff report, many policies are in operation to address unfavorable demographic prospects, emigration and to close the structural and income gaps vis-à-vis the EU average. The government has also made decisive efforts to increase public awareness in the needed structural and institutional reforms, aiming to consolidate public confidence and accelerate the reform process. Staff correctly noted "the apparent dissonance between governance reform efforts and public perception could reflect several factors" [3]. In any case it takes a long time for perceptions to change in response to ongoing reforms. They will only gradually adjust to the changing realities.

Financial Stability

The Bulgarian banking sector is resilient, and institutions continue to build capital buffers. In the low-for-long global interest rate environment, banks' profitability, liquidity and capitalization have further improved since the last Article IV Consultation. The BNB has adopted a comprehensive Supervisory Review and Evaluation Process Manual (SREPM), including an explicit and detailed supervisory Pillar 2 capital requirement. Supported by the BNB, the process of market-driven changes in banks' ownership structure and consolidation has continued, and four acquisition deals have been completed since 2017. Credit growth has further strengthened, driven by the low interest rates, the high credit demand and the overall economic and employment recovery. Potential spillover risks for the Bulgarian banking system remain well contained thanks to the stable domestic deposit funding and low reliance on both domestic and international wholesale financial markets.

The BNB's prospect to enter a regime of *"close cooperation" with the ECB* leads to a steady adoption of the procedures and methodologies developed in the Single Supervisory Mechanism (SSM). To prepare for the application of a common decision process for most

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[1] https://ec.europa.eu/info/files/progress-report-bulgaria-2018-com-2018-850_en
[2] http://europa.eu/rapid/press-release_IP-18-6364_en.htm
[3] Selected Issue Paper "Bulgaria's Governance Reforms", Paragraph 21, p.23.

administrative acts under the SSM, the Bulgarian parliament adopted at the end of 2018 the necessary legislative amendments to pave the way for introduction of these procedures and methodologies. The BNB has started synchronising its supervisory practices with those of the ECB, including the IT systems and statistics. In parallel, the BNB supports the ECB's[4] asset quality review and the stress test of six Bulgarian banks, of which the results are expected to be announced in July.

The BNB has taken a similar approach to prepare for participation in the Single Resolution Mechanism (SRM) after entering a regime of "close cooperation" with the ECB. It is expected that the Bulgarian Parliament will adopt the necessary legal amendments by the end of this quarter. The BNB is currently working on the overall framework of determining the amount of funds to be contributed by banks to the Single Resolution Fund (SRF) and the amount and process of transferring funds from the Bank Resolution Fund in Bulgaria, which was set up in 2015, to the SRF. At the final stage, distribution of responsibilities and tasks between the Single Resolution Board and the BNB should be clarified to facilitate planning and conduction of the resolution activities.

[4] https://www.bankingsupervision.europa.eu/press/pr/date/2018/html/ssm.pr181112.en.html