



BULGARIA

May 2015

2015 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; 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 2015 Article IV consultation with Bulgaria, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 4, 2015, following discussions that ended on March 13, 2015, 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 April 16, 2015.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** summarizing the views of the Executive Board as expressed during its May 4, 2015 consideration of the staff report that concluded the Article IV consultation with Bulgaria.
- A **Statement by the Executive Director** for Bulgaria.

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

Selected Issues Paper

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

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BULGARIA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

April 16, 2015

KEY ISSUES

Context: Since the last Article IV consultation in November 2013, a large bank failure and a weakening in the fiscal balance have tested Bulgaria's hard-won macroeconomic and financial stability. Growth last year was broadly in line with projections, but deflation has been deeper than expected. Looking forward, risks to the outlook have increased. Political divisions and unaddressed governance issues have raised concerns about the prospects for actions needed to set macro-financial policies firmly back on track and to tackle structural rigidities. Weak external demand and regional tensions further weigh on activity, with limited relief from lower commodity prices. Developments in Greece contribute to uncertainty.

Key policy issues: The Article IV discussions focused on immediate policy actions to reduce macro-financial uncertainty and on medium-term reforms to support income convergence. Specifically,

- **Financial sector.** Decisive policy action—including through an independent asset quality review (AQR) and more forceful steps to support confidence in supervision, strengthen the resolution framework, ensure an adequate financial safety net, and address system-wide accountability—is needed. Further steps to manage NPLs and advance corporate deleveraging are also critical.
- **Fiscal policy.** While plans for fiscal consolidation following the 2014 slippage are welcome, a more ambitious path should be considered. Faster consolidation would provide room for additional spending in the event of a modest negative output shock and preserve space to cope with contingent risks—particularly important in the context of Bulgaria's currency board arrangement (CBA). Staff called for a thorough assessment of the impact of pension reforms currently under discussion.
- **Structural agenda.** Priority reforms include addressing gaps in health, education, infrastructure, and energy markets, as well as the fundamental concerns related to corruption and cronyism.

Past IMF advice: Previous advice, focused on the need to address structural gaps (including related to governance) to set the foundation for stronger growth and job creation, remains valid, with policy implementation in these areas having stalled. Past advice also pointed to the need for increased attention to medium-term fiscal risks, notably concerning the sustainability of the pension system.

Approved By
Philip Gerson (EUR)
and Alfred Kammer (SPR)

Discussions were held in Sofia during March 4–13, 2015. The staff team comprised Ms. Shannon (head), Ms. Goretti, and Mr. Zhan (all EUR), Ms. Mineshima (FAD), Mr. Quill (MCM), Mr. Tolosa (Resident Representative) and Ms. Paliova (Resident Representative Office, Economist). Mses. Chen and Mahadewa (all EUR) assisted the mission from headquarters. Mr. Manchev (OED) joined some of the meetings. The mission met with Finance Minister Goranov, Bulgarian National Bank Governor Iskrov, other senior officials, financial sector and civil society representatives, and labor unions.

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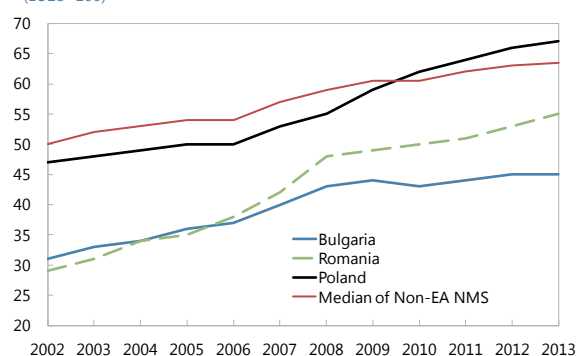
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CONTEXT: POLICY CREDIBILITY AND ECONOMIC STABILITY AT RISK

1. Bulgaria's reputation for macro-financial stability came under scrutiny in 2014. The year was marked by a severe test to the banking system and a sharp deterioration in the hitherto strong fiscal stance. Political turbulence and unaddressed governance issues heightened concerns about the direction of macro-financial policy, increasing strain on the economic outlook. The difficult external environment further weighed on economic activity. These developments led S&P to downgrade Bulgaria's credit rating to below investment grade and triggered the EC's February 2015 [decision](#) to step up the macroeconomic imbalances procedure for Bulgaria.¹

2. Urgent policy action is needed to address near-term challenges and anchor Bulgaria's medium-term convergence path. The currency board arrangement—which has served as an effective policy anchor since 1997 and helped Bulgaria successfully weather the global and Euro-area crises—both reinforces and relies on sustained, sound macro-financial policies, comfortable buffers, and progress in advancing the convergence agenda. Despite the uncertain mandate of the minority coalition government elected last fall, a comprehensive policy response is needed to reinforce economic stability, accelerate productivity growth, and resume convergence to EU income levels.

GDP per capita in PPP
(EU28=100)



Source: Eurostat.

3. Against this background, the Article IV discussion focused on twin objectives:

- **Addressing near-term risks:** Immediate policy steps are critical to rebuild buffers against potential shocks. In particular, the authorities' short-term strategy should address uncertainty concerning the financial sector and set the fiscal program firmly back on track.
- **Rebuilding reform momentum.** While macro-financial stability is necessary for growth, it is not sufficient. In line with past IMF advice, jumpstarting stalled structural reforms to strengthen human capital, improve infrastructure, and address institutional weaknesses and broader governance concerns is critical.

ECONOMIC DEVELOPMENTS AND OUTLOOK

Notwithstanding significant political and financial turbulence, growth in 2014 was broadly in line with earlier projections. Nevertheless, risks to the outlook have increased, reflecting sustained domestic uncertainty and a weaker external environment.

¹ As a result, the EC will carry out specific monitoring of the policies recommended by the Council, including regular reviews of progress in the relevant EU committees.

4. Despite a challenging environment, the economy expanded modestly last year, led by domestic demand. Export-driven recovery in 2013 proved short-lived as growth in European trading partners remained subdued. Nevertheless, sustained political uncertainty and the June bank failure did not prevent an improvement in domestic demand in the latter part of 2014, which was supported by an expansionary fiscal stance and rising absorption of EU funds. Unemployment declined, but remained high.

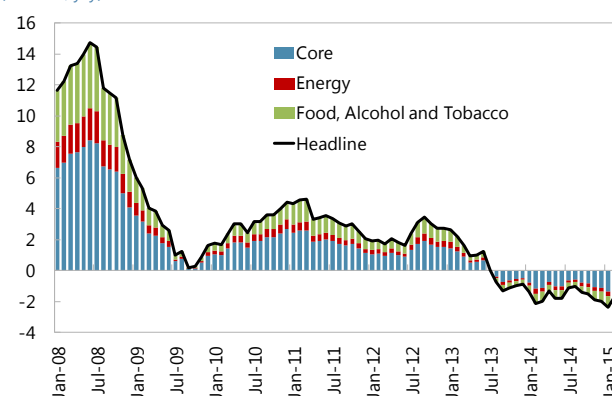
Bulgaria: Selected Macroeconomic Indicators, 2013–20

	2013	2014	2015	2016	2017	2018	2019	2020
			proj.					
Real GDP (percent change)	1.1	1.7	1.2	1.5	1.8	2.0	2.3	2.5
Unemployment rate (ILO, percent)	13.0	11.5	10.9	10.3	9.7	9.2	8.6	8.1
Annual average headline HICP inflation (percent)	0.4	-1.6	-1.0	0.6	1.2	1.8	2.1	2.1
Current account balance (percent of GDP)	2.3	0.0	0.2	-0.8	-1.1	-1.4	-1.7	-2.0
Output gap	-1.6	-1.4	-1.6	-1.5	-1.1	-0.5	0.0	0.0

Sources: BNB; NSI; and IMF staff estimate.

5. Deflationary pressures have continued. Inflation turned negative in the second half of 2013, driven by declining import prices and administrative price reductions, and deepened in 2014, with low growth in Europe, plunging commodity prices, and timid domestic demand recovery.² Headline and core consumer prices both declined by an average 1.6 percent last year, among the sharpest price level contractions in the EU.

Bulgaria: HICP inflation and contributions
(Percent, y/y)



Sources: National Statistical Institute; and IMF staff calculations.

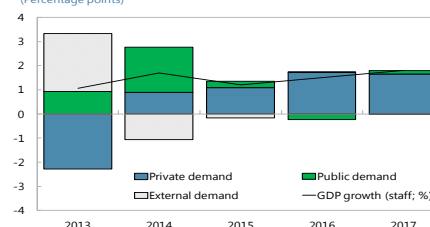
6. The current account registered a small surplus in 2014. Net exports declined with decelerating growth in export partners. Financial flows, mainly FDI, remained modest. External debt increased slightly, to about 90 percent of GDP, but reserves remain comfortable based on standard metrics (Appendix II).

Staff's views

7. Growth is projected to moderate before increasing gradually into the medium-term:

- For 2015, real GDP is projected to expand by 1¼ percent, supported by continued modest growth in private consumption and continued high EU funds absorption. While the sizable corporate debt overhang and high non-performing loans will continue to weigh on private investment, it is projected to stabilize after a 5-year contraction. Net

Bulgaria: Contribution to GDP Growth
(Percentage points)



Sources: Haver Analytics; and IMF staff calculations.

² See the Selected Issues Paper (SM/15/91) on "Inflation Determinants and Implications."

exports are expected to have a largely neutral effect on growth as the impact of lower oil prices on imports is offset by subdued external demand.

- While there is no strong evidence of a misalignment in Bulgaria's external position (Appendix I), lack of structural reforms to improve Bulgaria's productivity and subdued growth prospects in the region are projected in the baseline to limit net exports' contribution to growth over the medium term. More broadly, convergence to EU income levels will remain slow, with growth gradually reaching only 2½ percent and unemployment declining to about 8 percent. While year-on-year inflation is expected to turn positive late this year (driven by EU price levels and higher administered prices), it will remain subdued, rising slightly above the EU average in the medium term. A small current account deficit is projected into the medium term, with external debt slowly declining below 80 percent of GDP (Appendix III).

8. Risks to the outlook, as summarized in the Risk Assessment Matrix, have increased:

- **On the domestic side**, the minority coalition government may face challenges in pushing through the difficult measures needed to reduce macro-financial risks and raise growth. Sustained disinflationary pressures could adversely affect the fiscal accounts. High corporate debt and NPLs (as well as associated encumbered collateral) could act as an additional drag on future investment and growth if not addressed. Alternatively, ambitious steps to restore policy credibility and restart structural reforms would create a more supportive environment for growth.
- **On the external side**, a protracted slowdown in Europe would hinder export performance. While inward spillovers from geo-political tensions related to Russia and Ukraine have been limited to date, effects on trade and investment may increase in 2015. Although external debt vulnerabilities remain manageable, risks from renewed financial stress in the euro area could rise. In this context, given the still significant presence of Greek banks in Bulgaria, close monitoring and readiness to mitigate potential contagion from adverse developments in Greece remains key.³ Faster recovery in Europe, supported, for example, by ECB QE and lower commodity prices, could improve Bulgaria's growth prospects.

³ While Greek banks' affiliates in Bulgaria account for nearly 25 percent of total banking assets, since 2009, they have rebalanced their funding toward local depositors, reducing Bulgaria's foreign banking exposure to parent banks.

Bulgaria: Risk Assessment Matrix (as of March 12, 2015)⁴

(Scale: high, medium, or low)

Source of Risk	Relative Likelihood	Impact if Realized
1. Inadequate implementation of structural reforms to raise productivity and mitigate the impact of emigration and aging (short/medium term).	High Intensified political and social discord delays the structural reform agenda, including reforms that would reduce medium-term fiscal risks.	High Low potential growth and high structural unemployment resulting in a lack of income convergence; increased fiscal pressures.
2. Incomplete implementation of fiscal consolidation (short/medium term).	Medium Heightened spending pressures and materialization of implicit contingent liabilities; lack of progress in addressing medium-term fiscal risks.	High Loss of hard-won reputation of fiscal prudence; increased vulnerability to shocks and market reversal.
3. Inadequate actions to address weaknesses in the banking system (short term).	Medium Failure to restore confidence in the banking system and adequately identify and address any shortcomings in supervision through an independent asset quality review and a systematic review of the KTB failure.	High Reduced public confidence in banks; increased vulnerability to unanticipated shocks.
4. NPLs leave asset price uncertainty (short/medium term).	High Impediments to releasing collateral associated with NPLs, including judicial bottlenecks and administrative costs.	Medium Leave the system vulnerable to further collateral price declines; need for higher provisions lowers profits and capital; investment and growth prospects are in turn weakened.
5. Protracted period of slower European growth and deflation (short/medium term).	High Direct negative influence through trade and investment channels and price levels.	High Low potential growth, high structural unemployment and low FDI; continued fiscal pressures.
6. Financial stress in emerging markets and/or the euro area re-emerges (short term).	High Adverse effects from financial stress of parent banks/corporate and through trade and investment channels.	Medium Funding pressures; lower exports, employment, FDI, and growth; continued downturn raises fiscal pressures.
7. Intensification of geo-political tensions related to Russia and Ukraine.	Medium Negative spillovers from trade and investment channels.	Medium Adverse effect on economic activity and social tensions.

⁴ 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 relative 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.

Authorities' views

9. The authorities broadly agreed with staff's assessment of the outlook. The near-term growth projections underlying the budget are more conservative than staff's; the authorities noted in this context that envisaged fiscal consolidation was likely to dampen domestic demand. Given encouraging high frequency indicators, however, they raised their projections for 2015–16 following the mission to levels slightly above staff's. They shared staff's views on the medium-term outlook and broadly agreed on potential risks. However, they noted several mitigating factors, such as reduced political uncertainty domestically and favorable market conditions externally. They emphasized their commitment to the announced fiscal plan, steps to reinforce confidence in the financial sector, and broader structural reforms, discussed below. The successful Eurobond issuance in March has largely met their external financing needs in 2015. They recognized the importance of close monitoring of developments in Greece, including with relation to the financial sector, and noted the continued, strong liquidity position of the banking system. Finally, they stressed that rapid wage growth in recent years has been largely driven by non-tradable service sectors, thus limiting adverse impacts on competitiveness.

POLICY DISCUSSIONS: TACKLING NEAR-TERM RISKS, RESTORING BUFFERS, AND REBUILDING REFORM MOMENTUM

A. Safeguarding Financial Sector Stability

The failure of Corporate Commercial Bank (KTB) last summer exposed shortcomings in Bulgaria's supervision and crisis management frameworks, while also highlighting the link between financial and fiscal risks under the currency board. Decisive action is needed to improve financial sector supervision and secure confidence in the banking system. At the same time, strengthened measures to reduce NPLs and address the corporate debt overhang are needed.

Background

10. The banking system has shown substantial resilience to the damage to confidence resulting from the failure of KTB (Appendix IV). Strong system liquidity, along with the state liquidity support scheme introduced by the BNB and government (and extended to the largest domestic bank, First Investment Bank, FIB) helped calm depositors, averting system-wide spillovers. The injection of state funds into the deposit insurance fund (BDIF) also allowed for the payment of KTB insured deposits in December. Significant system liquidity has been maintained subsequent to the KTB failure, with positive year-on-year deposit growth at year-end 2014.

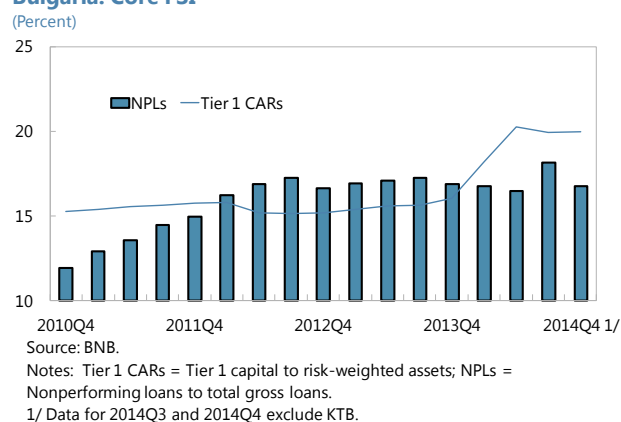
11. The KTB failure highlighted important gaps in financial sector oversight and the crisis management framework. External audits conducted while the bank was under conservatorship identified serious weaknesses in credit underwriting, related-party lending, and adherence to IFRS standards for nonperforming assets and loan-loss provisions, which were not identified by supervisors or KTB's auditors. Shortcomings in the legal framework for bank resolution also

narrowed available options and contributed to substantial delays in KTB resolution and the payout of insured deposits.

12. While reported capital buffers in the banking system are adequate in aggregate, balance-sheet repair is advancing only slowly.⁵

As of 2014Q4, aggregate CT1 and total capital ratios in the banking system were 20 and 22 percent, respectively. System-wide NPLs remained relatively flat at 16.7 percent (9.5 percent, net of reported provisions), with coverage of 58.4 percent. Credit growth remained sluggish, at 1 percent on an annual basis (adjusted for KTB).

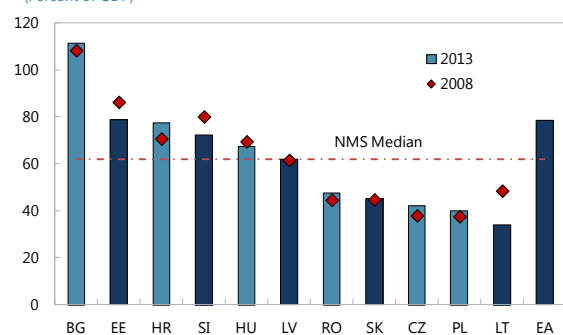
Bulgaria: Core FSI



13. High non-financial corporate indebtedness remains a key challenge.⁶ Bulgaria's corporate sector is among the most leveraged among new member states (NMS). Liabilities rose sharply during the pre-crisis boom and have declined only modestly since 2008. The high debt overhang heightens the risk of corporate bankruptcies in the event of negative shocks and acts as a drag on corporate profitability and investment. With corporate debt accounting for over 55 percent of banks' domestic loans, it also weighs on banks' balance sheets through increasing NPLs. While available data suggest average income coverage ratios are adequate, there is great heterogeneity at the firm level, with a significant number of firms presenting ratios below precautionary levels.

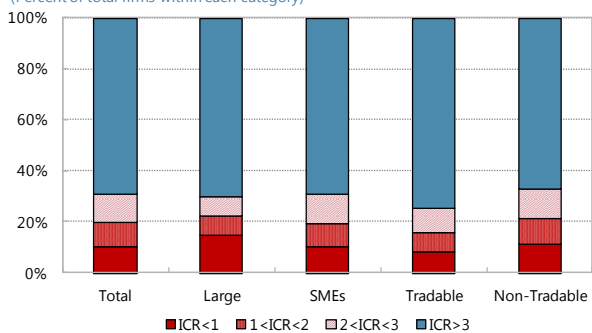
New Member States: Non-Financial Corporate Debt

(Percent of GDP)



Bulgaria: Firms with Debt at Risk by Size and Sector, 2013

(Percent of total firms within each category)



Staff's views

14. Decisive actions are needed to address the weaknesses exposed by the KTB failure, restore supervisory credibility, and strengthen crisis management tools. With the term of the BNB governor expiring and the selection of a new head of banking supervision pending, timely

⁵ The increase in regulatory capital between 4Q2013 and 1Q2014 reflects the amendments to the regulatory capital framework. In line with the implementation of the new European regulatory framework, effective from January 1, 2014, the deduction of specific provisions for credit risk from the capital base was discontinued.

⁶ Please refer to the Selected Issue Paper on "Corporate Debt Overhang in Bulgaria" for further analysis.

confirmation of individuals with a clear mandate to support a strong, independent, and accountable BNB is critical. At the same time, while several specific actions have been announced, further details and decisive follow-up is essential to restore confidence in financial system oversight:

- **Improving supervision.** The joint IMF/World Bank Basel Core Principles (BCP) Assessment, expected to be completed by midyear, should help identify areas for improvement in the supervisory framework for banks. This should be complemented by a candid, in-depth and independent review by outside banking experts of past supervisory activity, aimed at strengthening supervisory processes and drawing on lessons from the KTB case. An independent expert review of the Financial Supervision Commission's (FSC) supervisory framework would also be useful to reinforce confidence across the financial system.⁷
- **Strengthening system-wide accountability.** Concrete plans should be developed by the Commission of Public Oversight of Statutory Auditors (which also would benefit from independent expert input) to enhance the oversight and accountability of external parties conducting statutory audits. Based on inputs from the reviews noted above, the authorities should also consider strengthening BNB/FSC supervisory powers to investigate related-party lending. In addition, staff recommended specific steps to reinforce the supervisory enforcement culture. In this context, a formal enforcement policy is recommended, linking supervisory findings to specific remedial actions and establishing procedures for appropriate exceptions. Significant increases in sanctions across the oversight framework should also be considered to produce the desired deterrent effect.
- **Strengthening the resolution framework.** Last year's events demonstrated that Bulgaria's legal framework does not give the authorities adequate resolution tools. As such, timely transposition of the EU Bank Recovery and Resolution Directive (BRRD) into national law this summer is critical to address the gaps in the resolution and crisis management toolkit, and to provide for coordinated and timely remedial actions.
- **Ensuring an adequate financial safety net.** Staff discussed with the authorities the revised BDIF law to address gaps revealed by the KTB situation,⁸ including by facilitating timelier payout of insured deposits and emphasized that the law will need to be harmonized with that implementing the BRRD. Staff also welcomed the authorities' intention to promptly recapitalize the BDIF following the payout of insured KTB deposits.
- **Assessing banks.** The planned AQR is an important step to strengthen confidence in banks. Success will depend in part on establishing a clear timetable and affirming specific modalities for an arms-length and transparent process. Consistent with international practices, the authorities should develop a well-defined communication strategy and contingency plans in case

⁷ Also in relation to the FSC, the authorities should consider compensation arrangements to support acquiring and retaining the expertise needed to fulfill its mission.

⁸ Technical assistance by the World Bank, including through their assessment of the International Association of Deposit Insurers (IADI) core principles, is ongoing to assist the authorities in this area.

recapitalization needs materialize. The review will also provide useful inputs for a comprehensive risk and vulnerability assessment that will be undertaken by the IMF-WB Financial Sector Assessment Program.

- **Enhancing access to information.** While the BNB publishes a significant amount of financial data, mechanisms to promote availability and ready access to more bank-level data could facilitate analysis by interested parties and reduce uncertainty.

15. The systemic nature of the high private sector debt overhang and NPL problem in Bulgaria calls for a comprehensive strategy:

- Proactive steps by the BNB to ensure proper identification of NPLs and promote effective write-offs (and disposal of encumbered collateral) are critical to advance balance sheet clean-up and mitigate asset price uncertainty. Ongoing supervisory initiatives by the BNB to promote phased increases in provisioning in line with the aging of NPLs in selected banks are welcome, but staff noted that a more systematic approach might be warranted, for example, by introducing specific guidelines as done recently in other countries, including Romania. The BNB could complement these efforts with a systematic review—possibly with support from external workout specialists—of banks' debt recovery and restructuring processes (including workout tools, IT systems, and governance frameworks) to ensure these are adequate to manage NPLs.
- Staff also stressed the need to complement BNB action with other government-supported initiatives to facilitate an orderly corporate deleveraging process. In this context, guidelines for voluntary out-of-court debt workouts should be considered, along with measures to address judicial bottlenecks to timely and predictable insolvency proceedings. Staff also noted how [ongoing work](#) under the Vienna Initiative to foster an effective framework for NPL management in central and south-eastern Europe could provide the Bulgarian authorities with a useful platform to make advances in some of these areas.

16. The mission also sought an update regarding the authorities' views on close cooperation under the Single Supervisory Mechanism (SSM) prior to euro adoption. As recently discussed in the context of the NMS Policy forum, while the decision would need to take into account a range of considerations as well as the evolving financial architecture of the EA/EU, working toward SSM participation could generate reform momentum and act as a credibility anchor.⁹ Nonetheless, staff stressed that these efforts should not detract from prompt follow-through on the actions highlighted above, and indeed that such actions could be seen as integral to preparations for SSM participation.

Authorities' views

17. The authorities stressed their continued commitment to safeguarding financial stability. The BNB noted how the liquidity measures that followed the KTB closure had successfully supported depositors' confidence and maintained system-wide stability. They pointed to work

⁹ See also "Central and Eastern Europe: New Member States Policy Forum, 2014."

underway to rebuild confidence in financial sector oversight, including intensified on-site inspections, the external BCP assessment, BRRD implementation, and the forthcoming system-wide AQR. They recognized the importance of the appointment of the new head of supervision to reinforce these efforts and stressed the need for reforms that would reinforce regulatory independence. They saw current efforts to promote a gradual reduction in NPLs as having had some success, but also indicated openness to considering a more systematic approach. The authorities are also currently assessing the best means to recapitalize the BDIF and to ensure readiness for the planned AQR, including through appropriate contingency plans in case recapitalization needs materialize. They also recognized the importance of the timely confirmation of a new BNB governor.

18. While no timeframe has been announced, the authorities reconfirmed their commitment to both Euro adoption and participation in the SSM. With nominal triggers for Euro adoption within reach, they emphasized that movement toward Euro adoption will depend on greater progress in addressing structural rigidities to increase economic flexibility and accelerate income convergence. At the same time, they agreed that preparation for SSM could serve as a useful anchor for reforms.

B. Restoring Fiscal Discipline and Rebuilding Buffers

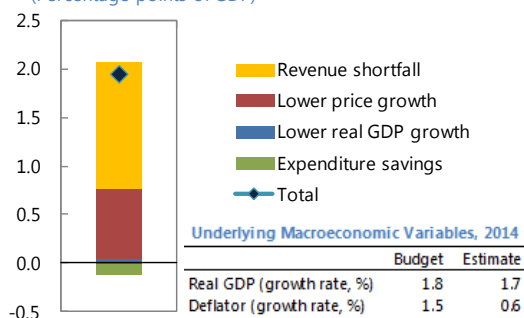
While partly reflecting deflation-related pressures, the deficit expanded substantially in 2014, breaching fiscal rules. Ambitious adjustment efforts—beyond those already planned—should be considered to support policy credibility, strengthen buffers and reduce medium-term risks.

Background

19. The fiscal deficit rose to 3.7 percent of GDP, twice the original budget target (cash basis). While some overshooting was to be expected given extraordinary deflationary pressures, the deficit increase also reflects a failure to adequately contain expenditure once it became clear that optimistic revenue projections would not materialize:

- **Revenues.** Large projected increases in tax collection (based on optimistic assumptions for price levels and efficiency gains, as highlighted in the 2013 Article IV Staff Report) were not realized, with grants also lower than projected.
- **Expenditures.** Expenditures were not adjusted to reflect revenue underperformance, while unprogrammed health-related expenditures added to spending pressure. Execution rates for EU-funded investments improved, but reimbursements were temporarily interrupted due to concerns related to procurement procedures and control systems.

Bulgaria: Decomposition of Increase in Government Deficit in 2014 Compared with the Original Budget
(Percentage points of GDP)



Sources: BNB; MoF; and IMF staff calculations.

Costs associated with the banking sector emergency support were fully recorded below the line, with no impact on the 2014 deficit. The expansionary fiscal stance breached the national fiscal rule (cash deficit ceiling of 2 percent of GDP).¹⁰

20. Public debt increased sharply in 2014, albeit from low levels. Total public debt rose 9 percentage points to 27 percent of GDP at end-2014, including a EUR 1.5 billion (3.6 percent of GDP) loan raised for state support to the banking sector. The fiscal reserve stood at BGN 8.1 billion on a cash basis at end-2014, well above the year-end minimum—including deposits associated with liquidity support to FIB and partial pre-financing for 2015 (Box 1). On March 20, 2015, Bulgaria successfully placed triple-tranche Eurobonds (7, 12, and 20 years) for €3.1 billion (7.4 percent of GDP), fulfilling the bulk of the 2015 financing requirements.

21. For 2015, the government's budget targets a 3 percent of GDP headline deficit

(cash basis), again above the national rule. This compares to a target of 1.5 percent of GDP in the [2014 Convergence Program](#).¹¹ The budget is underpinned by conservative revenue assumptions and entails a reduction in the structural deficit on a cash basis by about 0.8 percent of potential GDP versus 2014 (with this adjustment likely to be substantially smaller on accrual basis). Adjustment is driven mainly by reduction in compensation, health-related transfers, and contingency funds. Further reductions of the headline deficit by 0.5 percent of GDP in each of 2016 and 2017 are programmed.

Staff's views

22. The government's fiscal strategy recognizes the need to reduce deficits following last year's slippage, but faster consolidation should be considered. While debt remains relatively low, the recent jump in debt levels is not expected to be corrected under the authorities' baseline scenario. Moreover, medium-term debt dynamics are sensitive to macro-financial shocks and the materialization of contingent liabilities, including from the banking sector and state-owned companies (Appendix III). Given low fiscal multipliers¹² and substantial scope for efficiency gains, particularly in

Bulgaria: General Government Operations, 2013–14
(Millions of leva, unless otherwise indicated; cash basis)

	2013 Act	2014		Percent Change (%)	
		Original Budget (OB)	Act	2013 act to 2014 OB	2013 act to 2014 act
Revenue and grants	27,735	29,819	28,145	7.5	1.5
<i>Of which</i>					
Tax revenue	16,310	18,047	16,579	10.6	1.6
Nontax revenue	3,951	3,471	3,457	-12.1	-12.5
Grants	2,656	3,235	2,922	21.8	10.0
Expenditure	29,175	31,291	31,193	7.3	6.9
<i>Of which</i>					
Current	24,551	24,251	25,545	-1.2	4.0
Investment	3,981	4,975	4,895	25.0	23.0
Memo items					
NHIF expenditure	2,410	2,472	2,815	2.6	16.8
EU funds absorption (%) 1/	56	...	76	...	...

Sources: MoF; and IMF staff calculations.
1/ Cumulative execution rates since 2009.

Bulgaria: Government Cash Flow, 2014–17
(Percent of GDP, cash basis)

	2014	2015	2016	2017
Outflows	-10.2	-11.6	-4.6	-5.5
Deficits	-3.7	-3.0	-2.5	-2.0
Amortization	-4.6	-8.5	-2.1	-3.5
External	-0.4	-6.1	-0.4	-2.6
Domestic	-4.3	-2.5	-1.6	-0.9
Acquisition of financial assets/onlending	-1.9	0.0	0.0	0.0
Inflows	10.2	11.6	4.6	5.5
Eurobonds	3.5	8.3	2.3	3.4
Other external commercial	3.7	0.0	0.0	0.0
Other external official	0.3	0.6	0.3	0.3
Domestic banking	6.9	1.6	2.0	1.8
Privatization	0.0	0.0	0.0	0.0
FRA 1/	-4.2	1.0	0.0	0.0
FRA (mn Lev, end-year stock)	8,117	7,283	7,283	7,283
Debt-to-GDP ratio (%)	26.9	28.9	30.7	31.9

Sources: MoF; and IMF staff estimates.

1/ A negative (positive) sign indicates an accumulation (drawdown) of FRA.

¹⁰ While final data is not yet available, the accrual-base deficit is estimated by the government to be significantly lower based on timing issues related mainly to EU funds and tax-related flows. As a result, the deficit is estimated by the government to be within Maastricht limits. The 2014 first fiscal notification will be published from Eurostat in late April.

¹¹ The 2015 Convergence Program is expected to be published by end-April, 2015.

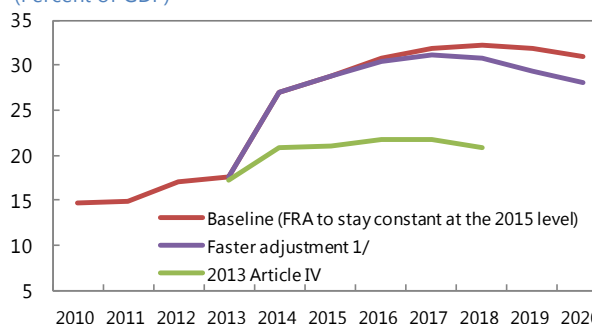
¹² See [Muir and Weber \(2013\)](#).

current spending, the potential negative growth effects of a more ambitious pace of consolidation are outweighed by the benefits of rebuilding fiscal buffers and strengthening policy credibility.

- **2015.** This year's 3 percent deficit target is achievable. However, with downside risks related to deflation and ambitious wage and health spending targets, expenditure restraint will again be critical. In the event these risks materialize, the authorities should seek savings in current spending—given scope for efficiency gains—and prioritize high-quality investment projects. Moreover, any revenue over-performance should be saved.

Bulgaria: Evolution of General Government Debt without Drawdown of FRA after 2015

(Percent of GDP)



Sources: BNB; MoF; and IMF staff calculations.

1/ Assuming an annual deficit reduction by 0.75% of GDP for 2016-19 to reach a balanced budget by 2019, and a balanced budget continues in 2020.

- **Medium-term fiscal path.** Targeting a structural balance by 2019—through an average adjustment of 0.75 percent of GDP per year—would allow the government to improve debt dynamics and build up a liquidity buffer in good times, creating space to cope with contingent risks and allowing automatic stabilizers to work fully in the event of a modest negative shock.

23. Concrete plans are needed to address medium-term fiscal risks. The aging population and continued emigration will create significant long-term public spending challenges. Measures to improve the composition and quality of expenditure and reduce contingent risks associated with state-owned enterprises, particularly related to transport and energy, will also be needed.

- **Improving the design and sustainability of the pension system.** Ensuring public pension sustainability, including through parametric reforms, remains critical, with concerns exacerbated by reversal and delays of earlier reforms.¹³ This will require a hard look at key features of the system—from retirement age to contributions and indexation formula to the operation of special and disability regimes. Last-minute provisions in the 2015 budget, allowing optional transfer from the second mandatory private pillar to the public system, represent a fundamental change in the design of Bulgaria's three-pillar pension system.¹⁴ Implementing regulations, including unorthodox provisions for an open-ended option to shift between public and private systems over time, are expected to be proposed shortly. In this context, sufficient time should be provided for thorough impact analysis and stakeholder consultations on specific recommendations to mitigate potential risks to both the public and private systems.

¹³ These include the change in the benefit formula from CPI indexation to the "golden Swiss rule" and the freezing of the retirement ages, which took place in 2014.

¹⁴ Final recommendations of a working group comprised of relevant ministries, NSSI, parliamentarians, and social partners are currently under discussion, with a view to draft a new law in time for implementation in January 2016.

- **Enhancing health system efficiency.** With the recent elimination of the National Health Insurance Fund's arrears, follow-through on plans to improve its financial strength and the efficiency of the broader health system will be critical. Measures are needed to strengthen cost control mechanisms, increase incentives for proper use of outpatient versus inpatient services, and upgrade IT systems to improve risk management capacity.
- **Strengthening fiscal risk management.** To further reinforce public information regarding fiscal policy, disclosure regarding budgetary risks should be enhanced. In addition, risk analysis of contingent liabilities—both explicit and implicit—as well as sustainability analysis of pension and health systems, could be expanded. The authorities are encouraged to consider a Fiscal Transparency Evaluation (Appendix V). Redressing delays in the establishment of a fiscal council with operational independence would also support policy credibility.

Authorities' views

24. The authorities intend to pursue continued fiscal consolidation in the coming years. For 2015, the authorities agreed that the 3 percent deficit target was achievable, given the measures taken on containing wage and health spending.¹⁵ They were also encouraged by strong revenue performance during the first two months of the year, which they emphasized was supported by enhanced revenue administration efforts. They were, however, cautious about a faster pace of consolidation given what they see as still fragile growth dynamics. On pension reforms, they indicated that the reforms would increase flexibility for individuals to select the system best suited to their needs and risk appetites, and that they were alert to the importance of careful assessment of design features before their adoption. The authorities broadly agreed on staff's recommendations to further enhance the transparency of fiscal indicators and the importance of strengthening the assessment of fiscal risks related to contingent liabilities as well as pension and health systems.

C. Advancing Structural Reforms

Tackling near-term challenges should not detract from accelerating progress in addressing critical structural rigidities, including rising costs and productivity drains associated with energy sector weaknesses.

Background

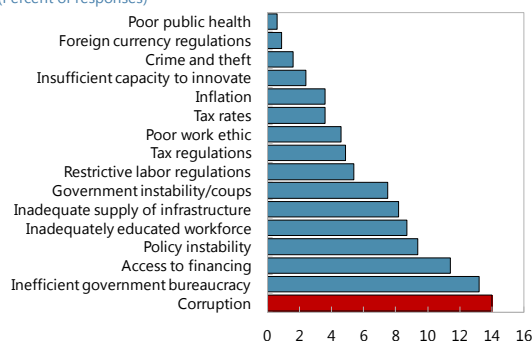
25. Bulgaria continues to see only slow income convergence with European Union counterparts. The country remains the poorest EU member, with income levels less than half the EU average and relatively high levels of structural unemployment, as well as significant age, gender, and regional disparities in income.¹⁶

¹⁵ This includes a planned 10 percent across-the-board cut in personal expenses and enhanced monitoring and controlling mechanism for health spending.

¹⁶ See "[Growth and Employment](#)", prepared as part of the 2013 Article IV consultation.

26. Recent political and financial turmoil has shined a light on longstanding governance and institutional issues. With Bulgaria's reputation for macro-financial stability having been tested in 2014, long-standing concerns related to corruption, weak institutions, and an ineffective judiciary have grown. Consistent with recent years, the [2014 Corruption Perception Index](#) ranked Bulgaria, together with Greece, Italy, and Romania, lowest among EU members, while weak institutions and corruption are among the country's most problematic factors in the [World Competitiveness Index](#). The EC recently reported under the [Cooperation and Verification Mechanism](#) that overall progress in the area of judicial reform, anti-corruption work, and the fight against organized crime is insufficient in Bulgaria, including when compared to neighboring Romania.

Bulgaria: The Most Problematic Factors for Doing Business
(Percent of responses)



Source: World Economic Forum.

27. Problems arising from inefficiencies in the power sector, notably in the national electricity supplier (NEK), have become acute. The financial results of NEK have deteriorated since 2007. Exacerbated by consecutive reductions in electricity prices, the NEK's reported debt is now estimated at around 4 percent of GDP (Box 2). However, cross-sector subsidies make it difficult to assess fully the financial situation of the energy sector, including contingent fiscal liabilities. With social pressures high, the burden of an inefficient sector is increasingly falling into the already stressed corporate sector, while risks to public finances are rising.

Staff's views

28. Actions to kick-start the structural reform agenda are needed to arrest skepticism about the authorities' commitment to tackling deeply-seated rigidities after several years of limited progress. Previous IMF advice, which focused on the need to address institutional and broader structural gaps to set the foundation for stronger growth and job creation, remains valid. The lack of structural reforms since EU accession has also come into starker relief following last year's bank failure, making all the more important early evidence of progress, most especially through measures to strengthen human capital, address infrastructure gaps, and increase the ease of doing business. At the same time, while comprehensive solutions will take time, clear momentum needs to be established now to demonstrate commitment to reduce corruption and cronyism, strengthen the rule of law, and set the foundation for renewed confidence in critical institutions.¹⁷ Active labor market policies, including further improvements in education and training, remain important to reduce labor market rigidities. Such progress would also catalyze the investment and productivity

¹⁷ A specialized anti-corruption unit, which will focus on corruption among high level officials, was established in early April 2015.

gains essential to unlock Bulgaria's economic potential, strengthen job creation, and accelerate income convergence.

29. Rising costs and productivity drains speak to the urgency of a comprehensive strategy for energy sector reform as part of a broader structural agenda. Recent amendments to the energy act can help reduce pressure on the public electricity company and, in turn, other participants in the market. Specifically, they provide a foundation to strengthen regulatory independence and to address rigidities in production costs, including by reducing the output share of inefficient power plants and re-negotiating long-term purchase agreements. Looking forward, the design and implementation of a comprehensive energy sector strategy can support the gradual establishment of a transparent and well-functioning electricity market, in line with EC and World Bank recommendations.¹⁸ As part of this, a well-designed and phased rationalization of electricity prices, taking advantage of the current low-cost environment, should proceed in parallel with initiatives to strengthen protections for the poor households. Finally, enhancements to the governance framework of major energy SOEs and to the operational capacity of the regulator remain critical.

Authorities' views

30. The authorities underscored their commitment to advance the structural agenda. Priority programs are expected to be highlighted in the April update to the National Reform Program under the EU framework. Regarding the energy sector, they noted that the new regulator will have increased independence from the government with the appointment of new members by Parliament (which occurred following the mission). One of the regulator's early priorities is to review the tariff structure. The authorities are optimistic that this will significantly improve NEK's financial condition. They also agreed on the importance of early progress in reforms to support a more open and transparent electricity market.

STAFF APPRAISAL

31. The Bulgarian economy and financial system have shown substantial resilience to last year's political and financial turmoil. Despite the challenging environment, modest growth and a small reduction in unemployment were achieved in 2014. However, deflationary pressures increased. Strong banking system liquidity prior to the KTB failure, along with the liquidity measures introduced by the BNB and government in its wake, helped calm depositors, averting system-wide spillovers. While inflation is expected to turn positive late in the year, growth is expected to moderate in 2015 and to remain below the level needed to accelerate income convergence into the medium term.

32. Bulgaria's hard-won policy credibility has come under scrutiny and the risks to the outlook have increased. Political turbulence and unaddressed governance issues have raised

¹⁸ See the 2014 [Country Specific Recommendations to Bulgaria](#) by the EC and "[Power Sector Rapid Assessment](#)" by the World Bank.

concerns about prospects for needed action to restore strong macro-financial policies and tackle structural rigidities. High corporate debt and NPLs, if not addressed, could be a drag on future investment. At the same time risks related to persistent deflationary pressures, weak external demand, and regional tensions could further weigh on activity, with limited relief from lower commodity prices. Developments in Greece, particularly related to the financial sector, further contribute to uncertainty and require continued close monitoring and contingency planning by the authorities.

33. A comprehensive policy response is needed to address near-term challenges and anchor Bulgaria's medium-term convergence path. Immediate policy steps should focus on rebuilding fiscal and financial sector buffers against potential shocks and addressing the gaps in financial sector oversight brought to light by last year's bank failure. At the same time, tackling near-term challenges should not detract from accelerating progress in addressing broader structural rigidities and governance challenges.

34. Decisive actions to strengthen the banking system and restore confidence in supervisory activity are critical. The bank failure has exposed serious shortcomings in supervision. Forceful steps to strengthen supervisory processes and address gaps in the accountability and crisis-management frameworks, together with an independent AQR of the banking system, are needed to strengthen confidence. Moreover, the systemic nature of the high private sector debt overhang and NPL problem in Bulgaria calls for a comprehensive strategy to advance balance sheet repair, reduce asset-price uncertainty, and promote an orderly deleveraging process.

35. While planned fiscal consolidation is welcome, a more ambitious path would help restore credibility, strengthen buffers, and reduce medium-term risks. This year's 3 percent of GDP deficit target is achievable, but, with downside risks related to deflation and ambitious wage and health spending targets, expenditure restraint will be critical. At the same time, any revenue upside should be saved. Looking ahead, targeting a structural balance by 2019 would support downward debt dynamics, create space to cope with contingent risks, and allow automatic stabilizers to work fully in the event of a modest negative shock. Concrete plans are also needed to address medium-term fiscal risks stemming from the aging population and to mitigate contingent liabilities arising from state-owned enterprises. In this context, the sustainability of the public pension system remains a key concern, and risks associated with ongoing reforms to both the first and second pillar systems need to be carefully assessed. Increased reporting of fiscal risks and the establishment of an independent fiscal council would also help to support policy credibility.

36. After several years of limited progress, the authorities need to jump-start the structural reform agenda. In particular, rising costs and productivity drains speak to the urgency of a comprehensive strategy for energy sector reform as part of a broader structural agenda. At the same time, clear momentum is needed to demonstrate commitment to reducing corruption and cronyism, strengthening the rule of law, and setting the foundation for renewed confidence in critical institutions. Progress in these areas would also catalyze the investment and productivity gains essential to unlocking Bulgaria's economic potential, strengthening job creation, and accelerating income convergence.

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

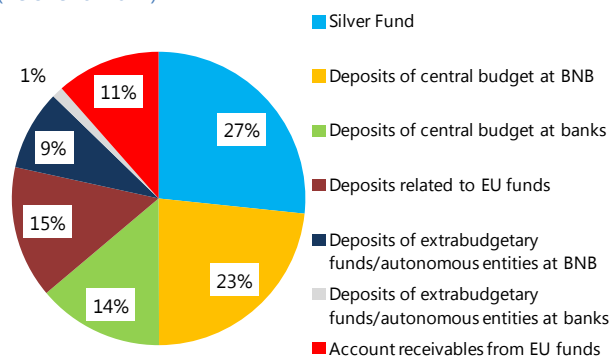
Box 1. Bulgaria: Fiscal Reserve Account and Fiscal Buffers¹⁹

Maintaining adequate fiscal buffers is important for Bulgaria's currency board framework. Such buffers can be achieved both access to private and official financing, as well as through savings in the fiscal reserve account (FRA).

The FRA serves multiple purposes, beyond backstopping emergency financing needs. The FRA comprises various fiscal reserve deposits and account receivables from EU funds for certified expenditures. At end-2014, about ¼ of the FRA was earmarked to the Silver Fund, which was established in 2006 to foster and guarantee the sustainability of the Pillar 1 state pension system.²⁰ The FRA also includes resources to cover operational needs of the government and balances of extra-budgetary funds and autonomous institutions. In addition, the FRA included deposits related to liquidity support to FIB for BGR 0.9 billion. Such composition suggests substantial FRA resources may not be available for emergency fiscal purposes.

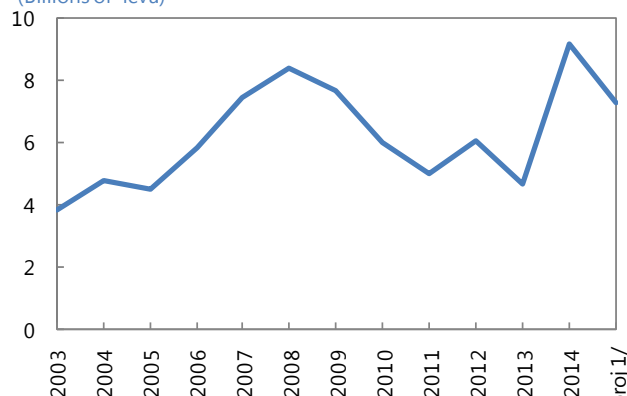
The FRA, on a generally declining trend since 2009, increased sharply in 2014 and is expected to remain at comfortable levels in 2015. Following a decline to BGN 4.7 billion at end-2013 versus a statutory end-year limit of BGN 4.5 billion, the FRA increased sharply to BGN 9.2 billion by end-2014.²¹ The increase was due to additional borrowing for bank resolution-related needs and pre-financing of large redemptions of a Eurobond in January 2015. Following the €3.1 billion Eurobonds issuances in March, which will cover the bulk of maturing external debt this year, the FRA is expected to remain comfortably above the minimum for end-2015.

Bulgaria: Composition of Fiscal Reserve Account
(As of end-2014)



Sources: MoF, and IMF staff estimates.

Bulgaria: Fiscal Reserve Account
(Billions of leva)



Sources: MoF, and IMF staff estimates.

1/ Excluding account receivables from EU funds.

¹⁹ See a fuller examination of the rule of the FRA in the [2012 IMF Country Report](#).

²⁰ Although designated as a pension fund, it does not operate along these lines as its resources are limited, kept very liquid (only short-term deposits) and, as a consequence, do not generate any return in the current low interest rate environment.

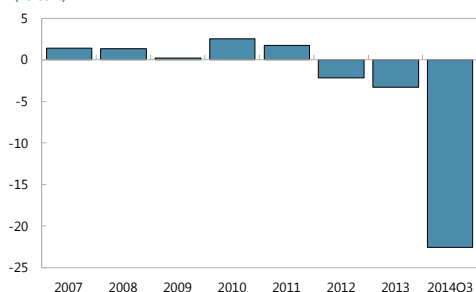
²¹ The FRA, excluding account receivables from EU funds, stood at BGN 8.1 billion at end-2014.

Box 2. Bulgaria: Electricity Sector Challenges

The electricity sector in Bulgaria faces significant financial challenges. A heavy debt burden and sustained losses from on-going operations have complicated the ability of the national electricity distributor, National Electricity Company (NEK), to meet its obligations to suppliers and distributors. In October 2013, the parent Bulgarian Energy Holding (BEH) issued bonds for EUR 500 million and on-lent the proceeds to NEK to help address arrears. Nevertheless, NEK continued to fail to meet its obligations in a timely manner.

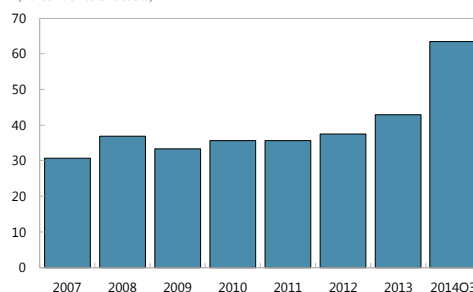
With three reductions in electricity tariff rates in 2013, NEK's financial conditions deteriorated rapidly in 2014. Loss write-offs consumed more than half of its equity in the four quarters since 2013Q3. Short-term liabilities to suppliers reached BGN 1.7 billion as of September 2014. These liabilities not only put at risk financial viability for upstream enterprises, including public and private sector generators, renewable energy producers, and combined heat and power producers (including district heating companies), but also forced NEK to delay or scale back urgently needed maintenance and investments. As of September 2014, NEK reported total debt of more than Lev 3.2 billion (4 percent of GDP). In addition, NEK's high leverage, with a debt to equity ratio of 174 percent and low liquidity (with its current asset covering only half of its short-term liabilities), raise further concerns about its financial sustainability. Given state ownership of NEK, sizable contingent liabilities to public finance could materialize in the event of NEK's inability to generate sufficient cash flows to service its debt.

NEK: Return on Equity
(Percent)



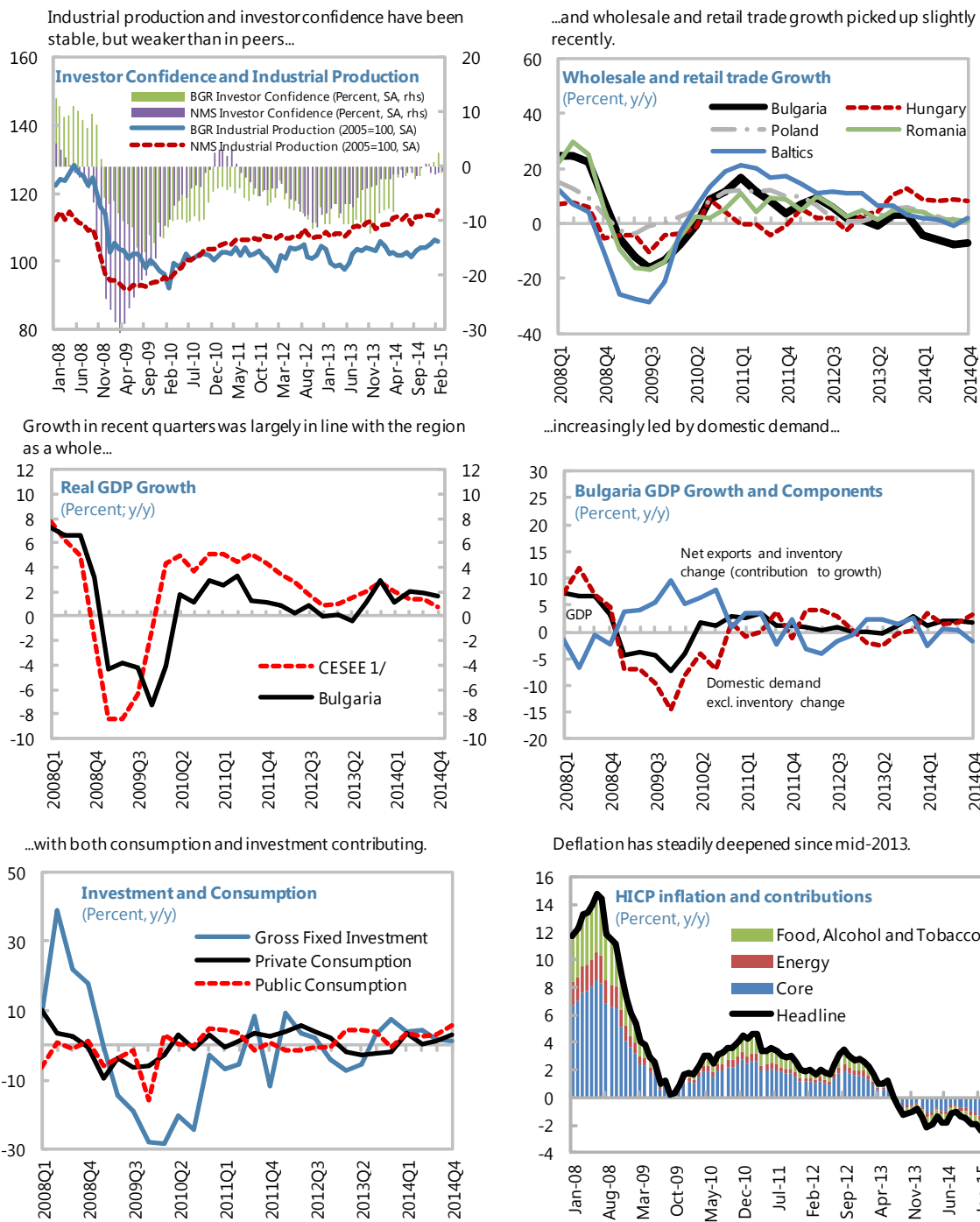
Sources: CSD and Ministry of Finance; and IMF staff calculations.

NEK: Total Debt
(Percent of total assets)



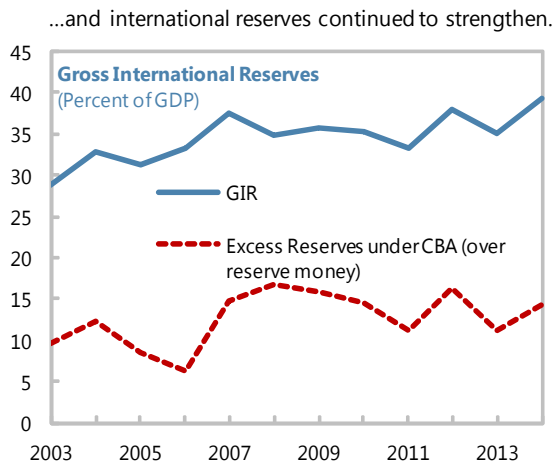
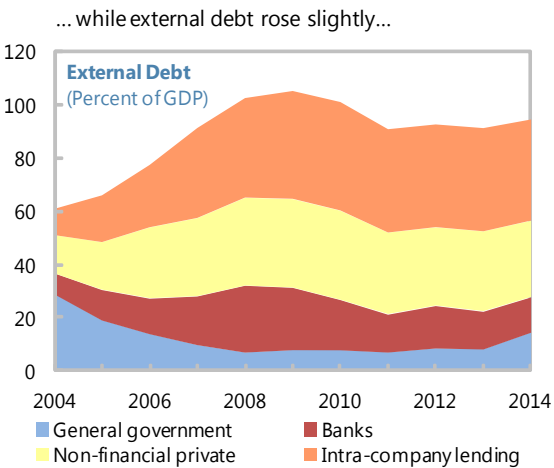
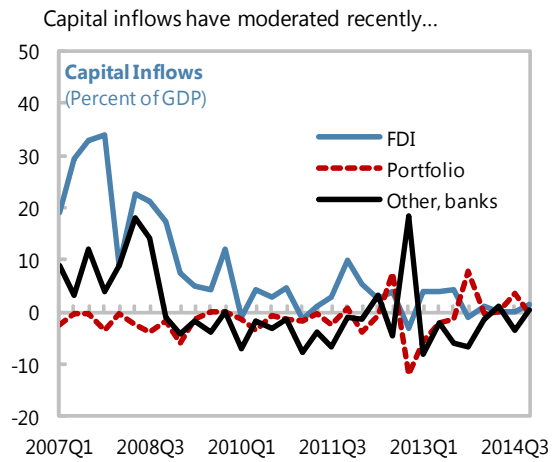
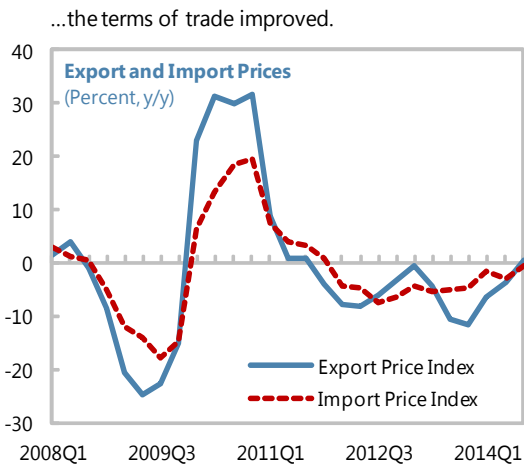
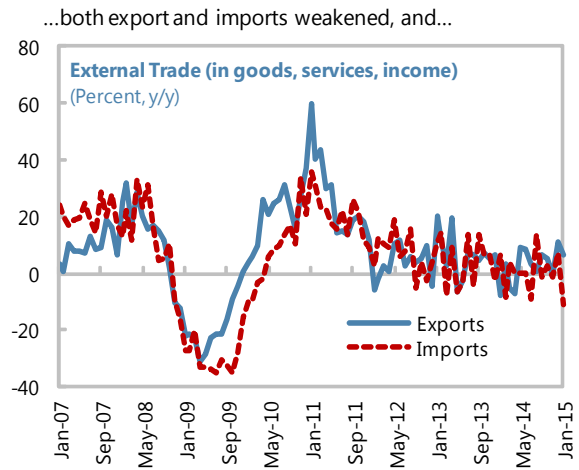
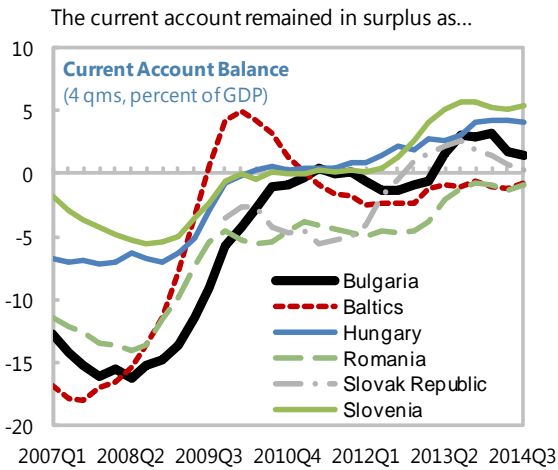
Sources: CSD; Ministry of Finance; and IMF staff calculations.

Figure 1. Bulgaria: Real Sector Developments, 2008–15



Sources: Haver; National authorities; and IMF staff calculations.
 1/ CESEE: Albania, Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Ukraine, and Turkey.

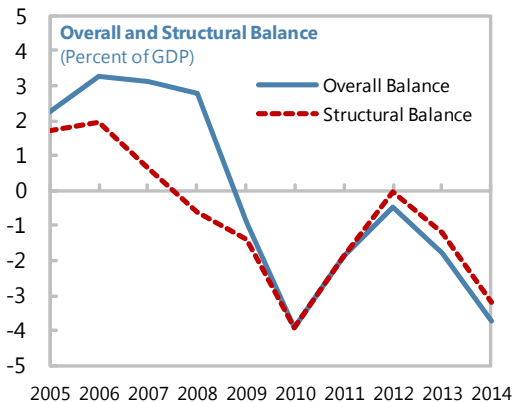
Figure 2. Bulgaria: External Sector Developments, 2003–15



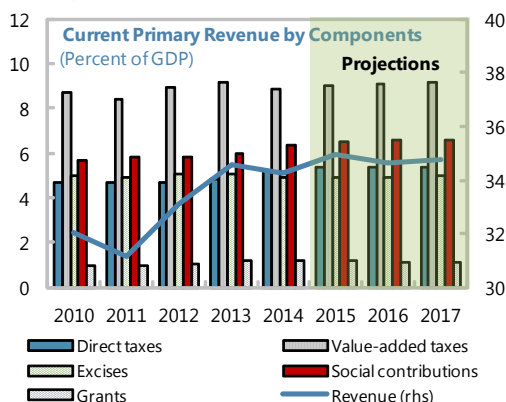
Sources: BNB; Haver; and IMF staff estimates.

Figure 3. Bulgaria: Fiscal Developments, 2005–17

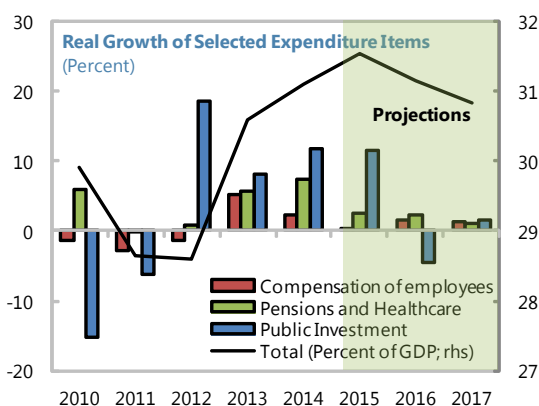
The headline deficit doubled in 2014 to 3.7% of GDP.



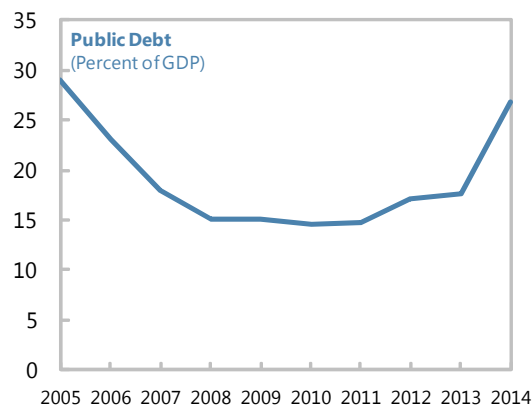
Tax revenue increased in 2014, but fell short of projections...



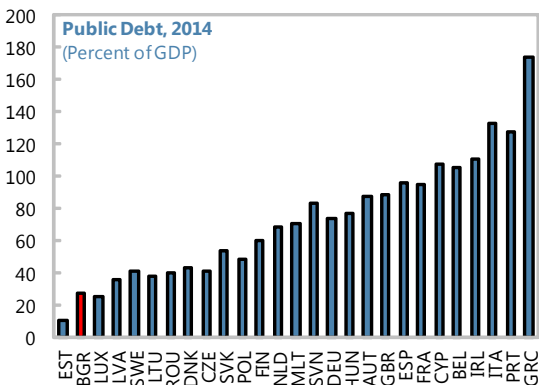
...while spending increased rapidly, especially on pension, health, and investment.



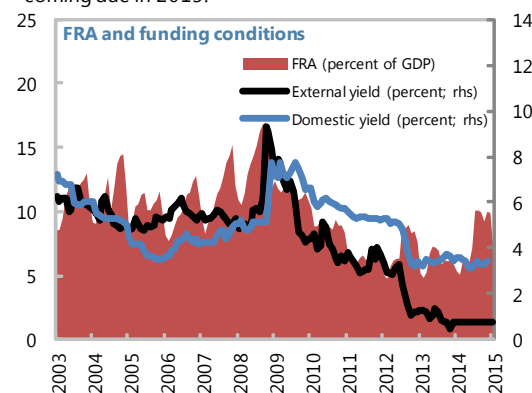
Public debt spiked as a result...



...although Bulgaria's debt remains among the lowest in the EU.



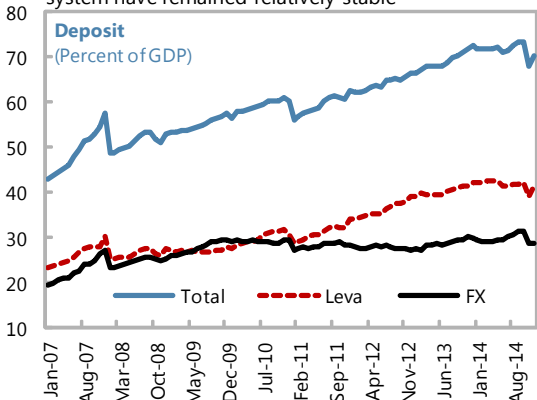
The Fiscal Reserve increased in 2014. Favorable market conditions supported the prefinancing of large debt coming due in 2015.



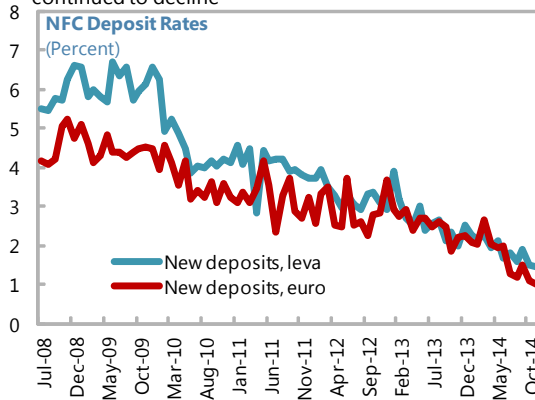
Sources: Bulgarian authorities; Eurostat; WEO; and IMF staff estimates.

Figure 4. Bulgaria: Monetary and Financial Sector Developments, 2007–14 1/

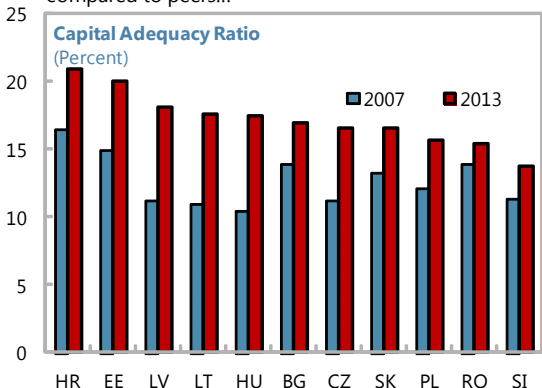
Despite the recent turmoil, deposits in the banking system have remained relatively stable



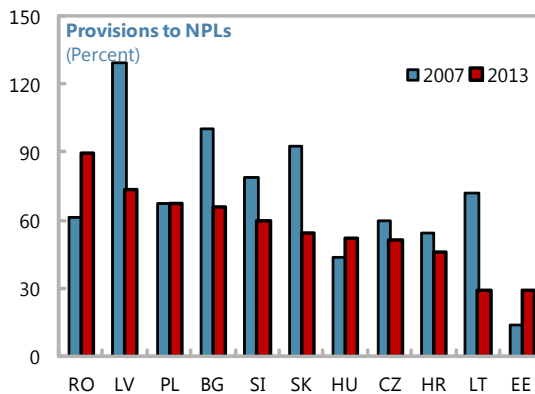
...with no pressures on deposit rates, which have continued to decline



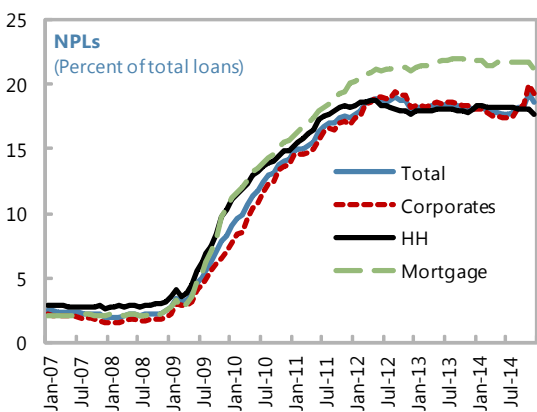
Capital adequacy ratio are reportedly comfortable, also compared to peers...



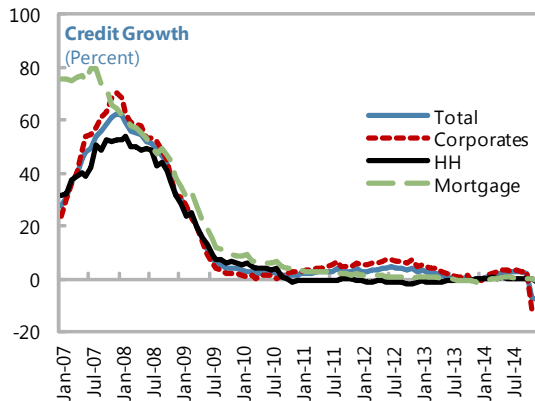
...although the NPL coverage has significantly declined



The stock of NPLs remains high...



...resulting in anemic credit growth, even after controlling for the KTB effect.



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 and Social Indicators, 2010–20
(Annual percentage change, unless noted otherwise)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
	Proj.										
Real GDP	0.7	2.0	0.5	1.1	1.7	1.2	1.5	1.8	2.0	2.3	2.5
Real domestic demand	-4.8	0.6	2.8	-1.3	2.7	1.3	1.5	1.8	2.0	2.2	2.5
Public consumption	2.0	1.8	-0.9	2.7	3.9	1.2	0.9	0.6	0.3	0.1	0.3
Private consumption	0.5	1.8	3.9	-2.3	2.0	1.7	2.6	2.4	2.6	2.9	3.2
Gross capital formation	-20.0	-3.6	2.1	-1.2	4.0	0.3	-1.4	0.6	1.5	1.8	1.8
Private investment	-19.6	-3.6	-2.0	-3.1	-4.0	-0.1	0.3	0.8	1.3	2.1	2.4
Public investment	-12.0	-9.0	20.4	11.4	25.2	1.1	-6.0	0.9	2.3	1.2	1.1
Stock building 4/	-0.7	0.2	0.0	-0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Net exports 4/	5.9	1.4	-2.3	2.4	-1.1	-0.2	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	17.2	11.5	0.8	9.2	2.2	1.6	2.8	4.5	5.5	6.0	6.3
Imports of goods and services	4.1	8.5	4.5	4.9	3.8	1.8	2.7	4.4	5.4	5.8	6.1
Resource utilization											
Potential GDP	2.2	1.9	1.7	1.5	1.5	1.4	1.4	1.4	1.4	1.8	2.5
Output gap (percent of potential GDP)	-0.1	0.0	-1.2	-1.6	-1.4	-1.6	-1.5	-1.1	-0.5	0.0	0.0
Unemployment rate (percent of labor force)	10.3	11.3	12.4	13.0	11.5	10.9	10.3	9.7	9.2	8.6	8.1
Price											
GDP deflator	1.2	7.0	1.6	-0.8	0.6	-1.0	0.6	1.2	1.8	2.1	2.1
Consumer price index (HICP, end of period)	4.4	2.0	2.8	-0.9	-2.0	0.3	0.9	1.5	2.1	2.1	2.1
Fiscal indicators											
General government net lending/borrowing (cash basis) 1/	-3.9	-1.9	-0.4	-1.8	-3.7	-3.0	-2.5	-2.0	-1.5	-1.0	-0.5
General government primary balance 1/	-3.3	-1.2	0.3	-0.9	-3.0	-2.0	-1.3	-0.7	-0.2	0.3	0.8
Structural overall balance (percent of GDP)	-3.9	-1.9	0.0	-1.2	-3.2	-2.4	-2.0	-1.6	-1.3	-1.0	-0.5
Structural primary balance (percent of GDP)	-3.2	-1.2	0.7	-0.3	-2.5	-1.4	-0.8	-0.3	0.0	0.3	0.8
General government gross debt 2/	14.6	14.8	17.1	17.6	26.9	28.9	30.7	31.9	32.2	31.9	31.0
Monetary aggregates 3/											
Broad money	6.4	12.2	8.4	8.9	1.1	3.7	5.4	5.6	5.8	6.0	6.3
Domestic private credit	1.3	3.8	2.8	0.3	-7.7	1.6	4.1	5.8	6.7	7.1	7.3
Exchange rates regime											
Leva per U.S. dollar (end of period)	1.47	1.51	1.48	1.42	1.61	...	...	...	...	...	...
Nominal effective rate	-3.2	2.1	-1.8	2.5	2.9	...	...	...	...	...	...
External sector											
Current account balance 1/	-1.5	0.1	-1.1	2.3	0.0	0.2	-0.8	-1.1	-1.4	-1.7	-2.0
o/w: Merchandise trade balance 1/	-7.5	-5.4	-8.5	-5.7	-6.9	-7.1	-8.1	-8.7	-9.2	-9.7	-10.1

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

1/ Percent of GDP.

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

3/ 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.

4/ Contribution to GDP growth.

Table 2. Bulgaria: Macroeconomic Framework, 2010–20

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
GDP and prices (percent change)											
Real GDP	0.7	2.0	0.5	1.1	1.7	1.2	1.5	1.8	2.0	2.3	2.5
Real domestic demand	-4.8	0.6	2.8	-1.3	2.7	1.3	1.5	1.8	2.0	2.2	2.5
Of which: private	-5.6	0.8	2.7	-2.7	1.1	1.4	2.2	2.1	2.3	2.7	3.0
GDP deflator	1.2	7.0	1.6	-0.8	0.6	-1.0	0.6	1.2	1.8	2.1	2.1
Consumer price index (HICP, average)	3.0	3.4	2.4	0.4	-1.6	-1.0	0.6	1.2	1.8	2.1	2.1
Nominal wages (national accounts definition)	11.2	8.6	5.6	4.5	3.0	3.0	3.0	2.5	3.2	3.7	3.9
Real effective exchange rate, CPI based	-3.9	2.7	-2.0	1.3	-0.5	...	...	...	...	...	...
Monetary aggregates (percent change) 1/											
Broad money	6.4	12.2	8.4	8.9	1.1	3.7	5.4	5.6	5.8	6.0	6.3
Domestic private credit	1.3	3.8	2.8	0.3	-7.7	1.6	4.1	5.8	6.7	7.1	7.3
Saving and investment (percent of GDP)											
Foreign saving	1.5	-0.1	1.1	-2.3	0.0	-0.2	0.8	1.1	1.4	1.7	2.0
Gross national saving	21.8	21.9	21.1	23.8	21.6	22.0	21.4	21.5	21.7	21.9	21.9
Government	0.3	1.9	4.0	3.2	2.3	2.9	3.0	3.5	4.0	4.5	5.0
Private	21.5	20.1	17.1	20.6	19.3	19.0	18.4	18.1	17.8	17.4	17.0
Gross domestic investment	23.2	21.8	22.2	21.5	21.6	21.7	22.2	22.6	23.2	23.6	24.0
Government	4.2	3.8	4.5	5.0	5.4	6.0	5.5	5.5	5.5	5.5	5.5
Private	19.0	18.1	17.7	16.6	16.1	15.8	16.7	17.2	17.7	18.1	18.5
General government (percent of GDP)											
Revenue	32.1	31.2	33.1	34.5	34.3	35.0	34.6	34.8	34.9	35.1	35.2
Tax revenue (including social security contributions)	25.2	25.1	25.7	26.3	26.5	27.1	27.2	27.3	27.5	27.6	27.8
Non-Tax revenue	4.6	4.2	4.5	4.9	4.2	4.2	4.2	4.2	4.2	4.2	4.2
Grants	2.2	1.9	3.0	3.3	3.6	3.6	3.2	3.2	3.2	3.2	3.2
Expenditure	36.0	33.1	33.6	36.3	38.0	38.0	37.1	36.8	36.5	36.1	35.7
Balance (net lending/borrowing on cash basis)	-3.9	-1.9	-0.4	-1.8	-3.7	-3.0	-2.5	-2.0	-1.5	-1.0	-0.5
Structural balance	-3.9	-1.9	0.0	-1.2	-3.2	-2.4	-2.0	-1.6	-1.3	-1.0	-0.5
Balance of payments (percent of GDP)											
Current account	-1.5	0.1	-1.1	2.3	0.0	0.2	-0.8	-1.1	-1.4	-1.7	-2.0
Trade balance	-7.5	-5.4	-8.5	-5.7	-6.9	-7.1	-8.1	-8.7	-9.2	-9.7	-10.1
Services balance	5.1	5.8	5.5	5.5	6.0	6.0	5.9	5.8	5.7	5.5	5.4
Income balance	-3.1	-4.5	-3.3	-3.3	-2.9	-4.5	-4.4	-4.3	-3.9	-3.7	-3.5
Transfers balance	4.1	4.2	5.0	5.8	3.8	5.8	5.8	6.1	6.1	6.1	6.2
Capital and financial account	-1.1	-1.0	4.4	-2.3	7.1	1.7	5.0	2.4	4.3	4.6	5.1
of which: Foreign direct investment	2.7	3.0	2.1	2.7	2.4	2.5	2.9	3.2	3.6	3.8	4.2
Memorandum items:											
Gross international reserves (millions of euros)	12,977	13,349	15,552	14,426	16,335	17,128	18,919	19,493	20,810	22,209	23,775
Short-term external debt (percent of GDP) 2/	30	25	25	24	24	24	24	23	23	22	21
Export volume (percent change)	6.4	17.6	-1.6	13.7	2.6	1.1	2.8	4.6	5.7	6.2	6.5
Import volume (percent change)	-5.2	11.4	6.8	4.8	2.0	1.7	3.2	4.5	5.5	6.0	6.4
Terms of trade (percent change)	2.7	0.8	2.9	-2.8	-2.8	0.7	-1.1	-0.8	-0.9	-0.7	-0.6
Output gap (percent of potential GDP)	-0.1	0.0	-1.2	-1.6	-1.4	-1.6	-1.5	-1.1	-0.5	0.0	0.0
Nominal GDP (millions of leva)	71,904	78,434	80,044	80,282	82,164	82,296	84,053	86,614	89,960	93,962	98,333
Nominal GDP (millions of euros)	36,764	40,102	40,926	41,047	42,010	42,077	42,975	44,285	45,996	48,042	50,277

Sources: Bulgarian authorities; and IMF staff estimates.

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/ At original maturity.

Table 3. Bulgaria: Real GDP Components, 2010–20

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
(Real growth rate, in percent)											
GDP	0.7	2.0	0.5	1.1	1.7	1.2	1.5	1.8	2.0	2.3	2.5
Domestic demand	-4.8	0.6	2.8	-1.3	2.7	1.3	1.5	1.8	2.0	2.2	2.5
Private demand	-5.6	0.8	2.7	-2.7	1.1	1.4	2.2	2.1	2.3	2.7	3.0
Public demand	-1.3	-0.5	3.2	4.6	9.0	1.2	-1.0	0.7	0.8	0.4	0.5
Final consumption	0.8	1.8	2.9	-1.3	2.4	1.6	2.2	2.1	2.1	2.4	2.6
Private consumption	0.5	1.8	3.9	-2.3	2.0	1.7	2.6	2.4	2.6	2.9	3.2
Public consumption	2.0	1.8	-0.9	2.7	3.9	1.2	0.9	0.6	0.3	0.1	0.3
Investment	-20.0	-3.6	2.1	-1.2	4.0	0.3	-1.4	0.6	1.5	1.8	1.8
Gross fixed investment	-18.3	-4.6	2.0	-0.1	2.8	0.2	-1.5	0.8	1.6	1.9	2.0
Private investment	-19.6	-3.6	-2.0	-3.1	-4.0	-0.1	0.3	0.8	1.3	2.1	2.4
Public investment	-12.0	-9.0	20.4	11.4	25.2	1.1	-6.0	0.9	2.3	1.2	1.1
Inventories 1/	-0.7	0.2	0.0	-0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Net exports 1/	5.9	1.4	-2.3	2.4	-1.1	-0.2	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	17.2	11.5	0.8	9.2	2.2	1.6	2.8	4.5	5.5	6.0	6.3
Imports of goods and services	4.1	8.5	4.5	4.9	3.8	1.8	2.7	4.4	5.4	5.8	6.1
(Contribution to real GDP growth, in percent)											
Domestic demand	-5.2	0.6	2.8	-1.3	2.8	1.4	1.5	1.8	2.0	2.3	2.5
Private demand	-4.9	0.7	2.2	-2.3	0.9	1.1	1.7	1.7	1.9	2.2	2.4
Public demand	-0.3	-0.1	0.6	0.9	1.9	0.3	-0.2	0.1	0.2	0.1	0.1
Final consumption	0.7	1.4	2.3	-1.1	1.9	1.3	1.8	1.7	1.7	1.9	2.1
Private consumption	0.3	1.1	2.5	-1.5	1.3	1.1	1.7	1.6	1.7	1.9	2.1
Public consumption	0.3	0.3	-0.1	0.4	0.6	0.2	0.1	0.1	0.0	0.0	0.0
Investment	-5.9	-0.8	0.5	-0.3	0.9	0.1	-0.3	0.1	0.3	0.4	0.4
Gross fixed investment	-5.2	-1.1	0.4	0.0	0.6	0.1	-0.3	0.2	0.3	0.4	0.4
Private investment	-4.6	-0.7	-0.4	-0.5	-0.7	0.0	0.1	0.1	0.2	0.3	0.4
Public investment	-0.6	-0.4	0.8	0.5	1.3	0.1	-0.4	0.0	0.1	0.1	0.1
Inventories	-0.7	0.2	0.0	-0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Net exports	5.9	1.4	-2.3	2.4	-1.1	-0.2	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	8.1	6.3	0.5	5.6	1.5	1.0	1.9	3.0	3.8	4.2	4.6
Imports of goods and services	2.3	5.0	2.8	3.1	2.5	1.2	1.9	3.0	3.8	4.2	4.6

Sources: Bulgaria National Statistical Institute; and IMF staff estimates.

1/ Contributions to GDP growth.

Table 4. Bulgaria: Balance of Payments, 2010–20

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
(Millions of euros)											
Current account balance	-533	33	-458	925	19	94	-362	-483	-659	-817	-1,019
Trade balance	-2,764	-2,156	-3,460	-2,353	-2,902	-2,967	-3,474	-3,841	-4,254	-4,657	-5,067
Exports (f.o.b.)	15,561	20,264	20,770	22,228	22,106	22,577	23,298	24,310	25,570	26,909	28,343
Imports (f.o.b.)	-18,325	-22,420	-24,230	-24,582	-25,009	-25,544	-26,772	-28,151	-29,824	-31,567	-33,410
Services balance	1,868	2,316	2,269	2,263	2,511	2,525	2,522	2,554	2,603	2,659	2,720
Exports of non-factor services	5,011	5,354	5,695	5,740	6,250	6,253	6,467	6,727	7,020	7,325	7,642
Imports of non-factor services	-3,144	-3,038	-3,426	-3,476	-3,739	-3,727	-3,944	-4,173	-4,417	-4,666	-4,922
Income balance	-1,134	-1,811	-1,332	-1,368	-1,203	-1,912	-1,890	-1,887	-1,793	-1,768	-1,782
Receipts	618	617	715	859	913	1,021	1,099	1,186	1,274	1,370	1,472
Payments	-1,752	-2,427	-2,047	-2,227	-2,117	-2,932	-2,989	-3,073	-3,067	-3,138	-3,254
Current transfer balance	1,497	1,685	2,065	2,383	1,614	2,448	2,480	2,692	2,785	2,950	3,110
Capital and financial account balance	-411	-403	1,795	-930	3,000	699	2,152	1,058	1,976	2,216	2,584
Capital transfer balance	256	471	529	534	1,010	535	536	537	538	538	539
Foreign direct investment balance	977	1,213	871	1,094	996	1,057	1,245	1,436	1,642	1,826	2,095
Portfolio investment balance	-660	-423	-920	-248	1,263	-703	344	-949	-317	-340	-350
Other investment balance	-984	-1,664	1,315	-2,311	-269	-191	27	34	113	192	300
General government and monetary authorities	73	88	114	249	1,008	-105	-142	-167	-167	-167	0
Domestic banks	-1,217	-1,889	1,573	-2,270	-1,413	-200	0	75	150	225	300
Other private sector	160	137	-372	-290	137	114	169	126	130	134	0
Errors and omissions	560	528	824	-594	-1,109	0	0	0	0	0	0
Overall balance	-384	159	2,161	-599	1,909	793	1,790	575	1,317	1,399	1,565
Financing	384	-159	-2,161	599	-1,909	-793	-1,790	-575	-1,317	-1,399	-1,565
Gross international reserves (increase: -)	384	-159	-2,161	599	-1,909	-793	-1,790	-575	-1,317	-1,399	-1,565
(Percent of GDP, unless otherwise indicated)											
Memorandum items:											
Current account balance	-1.5	0.1	-1.1	2.3	0.0	0.2	-0.8	-1.1	-1.4	-1.7	-2.0
Merchandise trade balance	-7.5	-5.4	-8.5	-5.7	-6.9	-7.1	-8.1	-8.7	-9.2	-9.7	-10.1
Exports	42.3	50.5	50.8	54.2	52.6	53.7	54.2	54.9	55.6	56.0	56.4
Imports	49.8	55.9	59.2	59.9	59.5	60.7	62.3	63.6	64.8	65.7	66.5
Foreign direct investment balance	2.7	3.0	2.1	2.7	2.4	2.5	2.9	3.2	3.6	3.8	4.2
Gross external financing requirement	44.2	35.1	36.8	32.5	25.1	27.9	28.0	30.0	29.9	28.6	31.3
Gross official reserves (millions of euro)	12,977	13,349	15,552	14,426	16,335	17,128	18,919	19,493	20,810	22,209	23,775
In percent of risk-weighted metric 1/	122	123	131	126	...	...	...	...	...	...	...
ST debt at original maturity (percent of reserves)	86.3	75.8	67.0	67.6	62.0	58.1	53.5	52.6	49.9	47.3	44.2
ST debt at remaining maturity (percent of reserves)	117.2	109.8	96.8	87.2	84.4	79.4	67.0	70.4	63.5	58.7	64.3
Terms of trade (merchandise, percent change)	2.7	0.8	2.9	-2.8	-2.8	0.7	-1.1	-0.8	-0.9	-0.7	-0.6
Exports of goods (volume, growth rate)	6.4	17.6	-1.6	13.7	2.6	1.1	2.8	4.6	5.7	6.2	6.5
Imports of goods (volume, growth rate)	-5.2	11.4	6.8	4.8	2.0	1.7	3.2	4.5	5.5	6.0	6.4
Exports of goods (prices, growth rate)	25.0	10.8	4.2	-5.9	-3.1	1.1	0.4	-0.2	-0.5	-0.9	-1.1
Imports of goods (prices, growth rate)	21.7	9.9	1.2	-3.2	-0.3	0.4	1.5	0.6	0.4	-0.2	-0.5
GDP (millions of euro)	36,764	40,102	40,926	41,047	42,010	42,077	42,975	44,285	45,996	48,042	50,277

Sources: Bulgarian authorities; and IMF staff estimates.

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

Table 5. Bulgaria: External Financial Assets Liabilities, 2010–20

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
(Millions of euros)											
International investment position	-49,065	-47,787	-46,637	-45,464	-45,649	-42,562	-42,209	-41,934	-41,808	-42,083	-42,561
Financial assets	23,421	24,736	28,384	29,394	33,033	34,611	36,976	38,018	39,744	41,499	43,366
Foreign direct investment	1,171	1,275	1,493	1,653	1,894	2,105	2,320	2,541	2,771	3,011	3,263
Portfolio investment	2,543	2,613	4,516	4,946	5,336	5,711	6,071	6,391	6,721	7,061	7,411
Other investments	6,730	7,500	6,823	8,369	9,467	9,667	9,667	9,592	9,442	9,217	8,918
Gross international reserves	12,977	13,349	15,552	14,426	16,335	17,128	18,919	19,493	20,810	22,209	23,775
Financial liabilities	72,486	72,523	75,021	74,858	78,682	77,173	79,185	79,951	81,552	83,582	85,928
Foreign direct investment	35,347	36,619	37,320	38,157	38,863	40,092	41,652	43,389	45,311	47,408	49,754
Equity	21,922	22,856	23,471	24,547	25,214	26,482	28,042	29,779	31,701	33,797	36,075
Intercompany debt	13,426	13,763	13,849	13,610	13,649	13,610	13,610	13,610	13,610	13,610	13,679
Of which: Banks	888	879	674	679	679	679	679	679	679	679	679
Portfolio investment	1,631	1,478	1,819	2,324	3,957	2,800	3,244	2,355	2,108	2,108	2,108
Loans	14,666	14,645	15,404	14,993	15,930	14,950	14,931	14,890	14,853	14,819	14,819
Other liabilities	20,843	19,781	20,478	19,384	19,931	19,330	19,358	19,317	19,280	19,247	19,247
(Percent of GDP, unless otherwise indicated)											
International investment position	-93.5	-82.5	-76.3	-74.1	-70.7	-65.5	-63.4	-61.0	-58.5	-56.7	-55.1
Financial assets	63.7	61.7	69.4	71.6	78.6	82.3	86.0	85.8	86.4	86.4	86.3
Foreign direct investment	3.2	3.2	3.6	4.0	4.5	5.0	5.4	5.7	6.0	6.3	6.5
Portfolio investment	6.9	6.5	11.0	12.0	12.7	13.6	14.1	14.4	14.6	14.7	14.7
Other investments	18.3	18.7	16.7	20.4	22.5	23.0	22.5	21.7	20.5	19.2	17.7
Gross international reserves	35.3	33.3	38.0	35.1	38.9	40.7	44.0	44.0	45.2	46.2	47.3
Financial liabilities	197.2	180.8	183.3	182.4	187.3	183.4	184.3	180.5	177.3	174.0	170.9
Foreign direct investment	96.1	91.3	91.2	93.0	92.5	95.3	96.9	98.0	98.5	98.7	99.0
Equity	59.6	57.0	57.3	59.8	60.0	62.9	65.3	67.2	68.9	70.3	71.8
Intercompany debt	36.5	34.3	33.8	33.2	32.5	32.3	31.7	30.7	29.6	28.3	27.2
Of which: Banks	2.4	2.2	1.6	1.7	1.6	1.6	1.6	1.5	1.5	1.4	1.4
Portfolio investment	4.4	3.7	4.4	5.7	9.4	6.7	7.5	5.3	4.6	4.4	4.2
Loans	39.9	36.5	37.6	36.5	37.9	35.5	34.7	33.6	32.3	30.8	29.5
Other liabilities	56.7	49.3	50.0	47.2	47.4	45.9	45.0	43.6	41.9	40.1	38.3
Memorandum items:											
Gross external debt	100.7	90.5	92.3	91.0	94.2	89.7	89.0	84.2	80.5	77.0	73.7
Public 1/	7.8	7.0	8.5	8.1	14.4	8.3	8.9	6.2	5.0	4.5	4.3
Private	92.9	83.6	83.8	82.8	79.8	81.4	80.1	78.1	75.5	72.5	69.4
Short-term	30.5	25.2	25.5	23.7	21.8	23.7	23.6	23.1	22.6	21.9	20.9
Long-term	62.4	58.3	58.4	59.1	58.0	57.8	56.6	54.9	52.9	50.6	48.5
Gross external debt	100.7	90.5	92.3	91.0	94.2	89.7	89.0	84.2	80.5	77.0	73.7
Excluding intercompany lending	60.1	51.8	53.8	52.3	56.3	52.0	52.0	48.4	46.0	43.9	42.0
Net external debt 2/	65.4	57.2	54.3	55.8	55.3	49.0	44.9	40.2	35.2	30.8	26.4
Excluding intercompany lending	24.8	18.5	15.8	17.2	17.4	11.3	8.0	4.4	0.7	-2.3	-5.3
Gross external debt (percent of GNFS exports)	180.0	141.7	142.8	133.5	139.5	131.0	128.5	120.2	113.6	108.0	103.0

Sources: BNB; NSI; and IMF staff estimates.

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

2/ Gross debt minus gross international reserves.

Table 6a. Bulgaria: General Government Operations, 2010–20 1/
(Millions of leva, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	23,054	24,435	26,516	27,735	28,145	28,768	29,107	30,101	31,426	32,946	34,635
Taxes	14,045	15,085	15,933	16,310	16,579	16,914	17,298	17,947	18,786	19,776	20,894
Taxes on profits	1,353	1,496	1,478	1,553	1,679	1,679	1,702	1,760	1,839	1,938	2,053
Taxes on income	2,031	2,180	2,298	2,348	2,596	2,737	2,785	2,870	3,009	3,173	3,352
Value-added taxes	6,267	6,612	7,152	7,366	7,264	7,409	7,613	7,917	8,294	8,719	9,198
Excises	3,568	3,860	4,048	4,056	4,039	4,065	4,152	4,323	4,525	4,777	5,069
Customs duties	119	131	118	146	149	142	145	150	155	162	170
Other taxes	706	806	840	840	851	881	900	927	963	1,006	1,053
Social contributions	4,091	4,567	4,642	4,818	5,187	5,367	5,525	5,704	5,922	6,183	6,467
Grants	1,603	1,463	2,368	2,656	2,922	2,994	2,717	2,774	2,900	3,000	3,100
Other revenue 2/	3,315	3,321	3,573	3,951	3,457	3,492	3,567	3,676	3,818	3,988	4,173
Expenditure	25,877	25,923	26,874	29,175	31,193	31,262	31,219	31,839	32,797	33,893	35,111
Expense	21,514	22,475	22,889	24,551	25,545	25,964	26,183	26,700	27,410	28,273	29,255
Compensation of employees	4,147	4,152	4,239	4,560	4,678	4,613	4,636	4,729	4,823	4,992	5,167
Use of goods and services	4,208	4,421	4,444	4,603	4,479	4,565	4,540	4,614	4,764	4,948	5,164
Interest	486	547	573	689	580	872	995	1,156	1,200	1,204	1,230
External	336	350	374	484	337	520	662	772	802	804	851
Domestic	150	197	199	204	243	352	333	384	399	400	378
Subsidies	1,317	1,518	1,228	1,307	1,452	1,461	1,447	1,472	1,472	1,506	1,545
Grants 3/	670	779	809	934	955	980	935	967	967	967	986
Social benefits	10,583	10,949	11,482	12,332	13,268	13,391	13,548	13,706	14,101	14,574	15,081
Pensions 4/	6,971	7,108	7,234	7,762	8,136	8,372	8,489	8,643	8,875	9,162	9,496
Social assistance	1,797	1,915	2,067	2,160	2,317	2,324	2,337	2,298	2,378	2,450	2,474
Health Insurance Fund	1,815	1,927	2,181	2,410	2,815	2,695	2,722	2,765	2,848	2,962	3,110
Other expense	104	109	114	127	133	82	83	82	82	82	82
Contingency 5/	1,317	498	385	644	1,186	392	397	402	452	470	491
Net acquisition of nonfinancial assets 6/	3,045	2,950	3,600	3,981	4,462	4,906	4,639	4,736	4,935	5,150	5,365
Net lending/borrowing 1/	-2,823	-1,488	-359	-1,441	-3,048	-2,495	-2,113	-1,738	-1,371	-947	-476
Primary balance	-2,337	-941	214	-752	-2,468	-1,623	-1,118	-582	-171	256	754
Financing	2,823	1,492	359	1,441	3,048	2,495	2,113	1,738	1,371	947	476
Privatization proceeds	46	239	76	16	18	38	32	0	0	0	0
Net external financing	161	137	2,047	-690	5,878	2,370	1,826	935	1,277	637	277
Disbursements		400	2,327	1,119	6,185	7,359	2,182	3,160	1,900	2,000	2,000
Amortization	-293	-263	-280	-1,809	-307	-4,989	-355	-2,225	-623	-1,363	-1,723
Net domestic financing	2,634	1,160	-1,749	2,151	-1,279	111	270	818	109	326	214
Bank credit / Securities issuance	1,555	723	303	1,757	5,654	1,312	1,640	1,602	1,594	1,810	1,698
Amortization	-589	-576	-970	-1,006	-3,497	-2,034	-1,370	-785	-1,485	-1,485	-1,485
Fiscal Reserve Account	1,668	1,013	-1,082	1,400	-3,436	834	0	0	0	0	0
Net lending and other items	-65	-44	-16	-38	-1,569	-24	-15	-15	-15	-15	-15
Memorandum items:											
Fiscal reserve account	6,012	4,999	6,081	4,681	8,117	7,283	7,283	7,283	7,283	7,283	7,283
Gross public debt	10,532	11,629	13,674	14,119	22,102	23,749	25,846	27,598	28,984	29,946	30,437
Nominal GDP (percent change)	1.9	9.1	2.1	0.3	2.3	0.2	2.1	3.0	3.9	4.4	4.7
Real GDP (percent change)	0.7	2.0	0.5	1.1	1.7	1.2	1.5	1.8	2.0	2.3	2.5
HICP inflation (percent change)	3.0	3.4	2.4	0.4	-1.6	-1.0	0.6	1.2	1.8	2.1	2.1
Nominal private consumption (percent ch.)	3.0	6.4	7.6	-4.3	1.6	0.6	2.8	3.3	4.1	5.1	5.5
Nominal imports (percent change)	10.2	18.6	8.6	1.5	2.5	1.7	4.8	5.1	5.8	5.7	5.7

Sources: Ministry of Finance; and staff estimates.

1/ On cash basis. Deficit projections for 2015–2020 are in line with the authorities' medium-term fiscal framework.

2/ Includes dividends.

3/ Contribution to EU budget.

4/ Projections do not assume the comprehensive pension reforms planned in 2015.

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

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

Table 6b: Bulgaria: General Government Operations, 2010–20 1/
(Percent of GDP, unless otherwise indicated)

	2010	2011	2012	2013	2014 Est.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.
Revenue	32.1	31.2	33.1	34.5	34.3	35.0	34.6	34.8	34.9	35.1	35.2
Taxes	19.5	19.2	19.9	20.3	20.2	20.6	20.6	20.7	20.9	21.0	21.2
Taxes on profits	1.9	1.9	1.8	1.9	2.0	2.0	2.0	2.0	2.0	2.1	2.1
Taxes on income	2.8	2.8	2.9	2.9	3.2	3.3	3.3	3.3	3.3	3.4	3.4
Value-added taxes	8.7	8.4	8.9	9.2	8.8	9.0	9.1	9.1	9.2	9.3	9.4
Excises	5.0	4.9	5.1	5.1	4.9	4.9	4.9	5.0	5.0	5.1	5.2
Customs duties	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other taxes	1.0	1.0	1.0	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1
Social contributions	5.7	5.8	5.8	6.0	6.3	6.5	6.6	6.6	6.6	6.6	6.6
Grants	2.2	1.9	3.0	3.3	3.6	3.6	3.2	3.2	3.2	3.2	3.2
Other revenue 2/	4.6	4.2	4.5	4.9	4.2	4.2	4.2	4.2	4.2	4.2	4.2
Expenditure	36.0	33.1	33.6	36.3	38.0	38.0	37.1	36.8	36.5	36.1	35.7
Expense	29.9	28.7	28.6	30.6	31.1	31.5	31.2	30.8	30.5	30.1	29.8
Compensation of employees	5.8	5.3	5.3	5.7	5.7	5.6	5.5	5.5	5.4	5.3	5.3
Use of goods and services	5.9	5.6	5.6	5.7	5.5	5.5	5.4	5.3	5.3	5.3	5.3
Interest	0.7	0.7	0.7	0.9	0.7	1.1	1.2	1.3	1.3	1.3	1.3
External	0.5	0.4	0.5	0.6	0.4	0.6	0.8	0.9	0.9	0.9	0.9
Domestic	0.2	0.3	0.2	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Subsidies	1.8	1.9	1.5	1.6	1.8	1.8	1.7	1.7	1.6	1.6	1.6
Grants 3/	0.9	1.0	1.0	1.2	1.2	1.2	1.1	1.1	1.1	1.0	1.0
Social benefits	14.7	14.0	14.3	15.4	16.1	16.3	16.1	15.8	15.7	15.5	15.3
Pensions 4/	9.7	9.1	9.0	9.7	9.9	10.2	10.1	10.0	9.9	9.8	9.7
Social assistance	2.5	2.4	2.6	2.7	2.8	2.8	2.8	2.7	2.6	2.6	2.5
Health Insurance Fund	2.5	2.5	2.7	3.0	3.4	3.3	3.2	3.2	3.2	3.2	3.2
Other expense	0.1	0.1	0.1	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Contingency 5/	1.8	0.6	0.5	0.8	1.4	0.5	0.5	0.5	0.5	0.5	0.5
Net acquisition of nonfinancial assets 6/	4.2	3.8	4.5	5.0	5.4	6.0	5.5	5.5	5.5	5.5	5.5
Net lending/borrowing 1/	-3.9	-1.9	-0.4	-1.8	-3.7	-3.0	-2.5	-2.0	-1.5	-1.0	-0.5
Primary balance	-3.3	-1.2	0.3	-0.9	-3.0	-2.0	-1.3	-0.7	-0.2	0.3	0.8
Financing	3.9	1.9	0.4	1.8	3.7	3.0	2.5	2.0	1.5	1.0	0.5
Privatization proceeds	0.1	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net external financing	0.2	0.2	2.6	-0.9	7.2	2.9	2.2	1.1	1.4	0.7	0.3
Disbursements		0.5	2.9	1.4	7.5	8.9	2.6	3.6	2.1	2.1	2.0
Amortization	-0.4	-0.3	-0.3	-2.3	-0.4	-6.1	-0.4	-2.6	-0.7	-1.5	-1.8
Net domestic financing	3.7	1.5	-2.2	2.7	-1.6	0.1	0.3	0.9	0.1	0.3	0.2
Securities issuance			0.4	2.2	6.9	1.6	2.0	1.8	1.8	1.9	1.7
Amortization			-1.2	-1.3	-4.3	-2.5	-1.6	-0.9	-1.7	-1.6	-1.5
Fiscal Reserve Account	2.3	1.3	-1.4	1.7	-4.2	1.0	0.0	0.0	0.0	0.0	0.0
Net lending and other items	-0.1	-0.1	0.0	0.0	-1.9	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Gross public debt	14.6	14.8	17.1	17.6	26.9	28.9	30.7	31.9	32.2	31.9	31.0
Structural fiscal balance	-3.9	-1.9	0.0	-1.2	-3.2	-2.4	-2.0	-1.6	-1.3	-1.0	-0.5
Output gap (percent of potential GDP)	-0.1	0.0	-1.2	-1.6	-1.4	-1.6	-1.5	-1.1	-0.5	0.0	0.0
Implementation rate of capital spending 7/	75.0	80.9	68.6	73.9	97.4	...	...	...	...	...	...
Absorption of EU funds 8/	10.0	19.0	37.6	55.8	76.0	...	...	...	...	...	...
Nominal GDP (millions of leva)	71,904	78,434	80,044	80,282	82,164	82,296	84,053	86,614	89,960	93,962	98,333

Sources: Ministry of Finance; and IMF staff estimates.

1/ On cash basis. Deficit projections for 2015-2020 are in line with the authorities' medium-term fiscal framework.

2/ Includes dividends.

3/ Contribution to EU budget.

4/ Projections do not assume the comprehensive pension reforms planned in 2015.

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

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

7/ Actual capital expenditure divided by capital expenditure in the original budget.

8/ Cumulative from 2009. Data for 2009-2011 cover Structural and Cohesion Funds only.

Table 7. Bulgaria: General Government Stock Position, 2007–14
(Percent of GDP, unless otherwise indicated)

	2007	2008	2009	2010	2011	2012	2013	2014 1/
Net financial worth	8.1	9.9	5.9	3.1	1.4	1.1	-1.4	-1.3
Financial assets	33.6	31.2	30.4	27.9	24.9	27.0	25.0	29.5
Monetary gold and SDRs	...	...	...	...	...	...	...	...
Currency and deposits	15.0	14.3	12.8	10.2	8.4	10.1	8.5	12.3
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	2.8	1.8	1.8	1.5	1.3	1.2	1.1	1.1
Equity and investment funds shares	10.2	9.5	11.0	11.7	10.7	10.4	8.9	9.2
Insurance, pensions, and standardized guarantee schemes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives and employee stock options	...	...	...	...	...	...	...	...
Other accounts receivable	5.5	5.6	4.8	4.5	4.5	5.2	6.4	6.9
Liabilities	25.5	21.3	24.5	24.7	23.5	25.8	26.4	30.8
Special Drawing Rights (SDRs)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	10.9	8.4	8.9	10.1	9.8	12.5	11.8	17.1
Loans	6.3	4.9	5.9	6.4	6.3	5.9	6.9	6.7
Equity and investment funds shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance, pensions, and standardized guarantee schemes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives and employee stock options	0.4	0.3	0.1	0.1	0.2	0.3	0.2	0.3
Other accounts receivable	7.9	7.7	9.6	8.1	7.3	7.1	7.4	6.8
<i>Memorandum items</i>								
Gross debt (at market value)	25.1	21.0	24.3	24.6	23.4	25.6	26.1	30.6
Gross debt (at face value)	24.5	21.0	23.7	24.0	23.0	25.1	25.8	30.3
Gross debt (Maastricht definition)	16.6	13.3	14.2	15.9	15.7	18.0	18.3	23.5
Nominal GDP (billions of leva)	62.4	71.3	70.6	71.9	78.4	80.0	80.3	82.2

Sources: Eurostat; and IMF staff calculations.
1/ Data as of Q3 2014.

Table 8. Bulgaria: Monetary Accounts, 2010–20
(Billions of leva, unless otherwise stated)

	2010	2011	2012	2013	2014 1/	2015	2016	2017	2018	2019	2020
	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.
						Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Monetary Survey											
Net foreign assets	17.1	21.1	25.3	28.4	35.0	38.6	42.4	43.6	46.1	48.6	52.3
Net domestic assets	49.2	52.5	53.9	55.8	50.5	49.8	53.4	56.1	60.4	63.9	70.1
Domestic credit	50.0	53.7	55.1	57.1	52.1	51.3	54.9	57.5	61.8	65.2	71.3
General government	-2.3	-0.5	-0.7	1.2	0.4	-1.1	0.3	-0.3	0.1	-0.9	0.5
Non-government	52.3	54.3	55.8	55.9	51.6	52.4	54.6	57.8	61.6	66.0	70.8
Broad money (M3)	50.7	56.9	61.7	67.2	68.0	70.5	74.4	78.6	83.1	88.1	93.7
Currency outside banks	7.4	7.8	8.5	9.1	10.2	11.8	13.5	15.3	16.3	16.8	17.6
Reserve money	14.1	14.9	17.4	17.3	19.2	20.6	22.5	24.3	25.5	26.3	27.4
Deposits 2/	43.4	49.1	53.2	58.2	57.8	58.8	60.8	63.3	66.8	71.2	76.0
Accounts of the Bulgarian National Bank											
Net foreign assets	24.0	24.6	29.0	26.8	30.8	35.3	35.9	40.6	40.3	46.5	47.7
Net foreign reserves (billions of euro)	12.2	12.6	14.8	13.7	15.7	18.1	18.4	20.7	20.6	23.8	24.4
Net domestic assets	-5.5	-5.0	-6.7	-5.7	-7.3	-7.1	-6.8	-5.8	-5.8	-5.4	-5.4
Net claims on government	-5.3	-4.2	-5.7	-4.3	-6.7	-6.5	-6.1	-5.1	-5.0	-4.6	-4.5
Base money	14.1	14.9	17.4	17.3	19.2	20.6	22.5	24.3	25.5	26.3	27.4
Currency in circulation	7.4	7.8	8.5	9.1	10.2	11.8	13.5	15.3	16.3	16.8	17.6
Banks reserves	6.8	7.1	8.9	8.2	9.1	8.8	8.9	9.0	9.2	9.5	9.7
Deposit money banks											
Net foreign assets	-6.9	-3.5	-3.6	1.6	4.2	4.9	4.9	4.6	4.2	3.7	3.0
Gross foreign assets	8.0	9.1	10.0	13.6	15.3	16.2	16.2	16.0	15.6	15.1	14.4
Gross foreign liabilities	14.8	12.6	13.7	12.1	11.1	11.4	11.4	11.4	11.4	11.4	11.4
Net domestic assets	54.2	56.5	59.3	59.9	56.9	56.1	59.3	61.0	65.2	68.3	74.4
Domestic credit	55.2	57.9	60.7	61.3	58.6	57.8	61.0	62.5	66.7	69.7	75.7
Memorandum items:											
	(Annual percentage change, unless otherwise indicated)										
Base money	9.0	5.6	16.7	-0.4	11.1	6.9	9.2	8.1	4.9	3.2	4.0
Broad money	6.4	12.2	8.4	8.9	1.1	3.7	5.4	5.6	5.8	6.0	6.3
Domestic non-government credit	1.3	3.8	2.8	0.3	-7.7	1.6	4.1	5.8	6.7	7.1	7.3
Domestic deposits	6.9	13.2	8.3	9.3	-0.6	1.6	3.6	4.0	5.6	6.6	6.7
Domestic currency	11.9	21.0	17.0	8.6	0.1	1.9	3.9	4.4	5.9	6.9	7.1
Foreign currency	2.2	5.2	-2.1	10.3	-1.5	1.1	3.1	3.5	5.0	6.0	6.2
Money multiplier (ratio)	3.6	3.8	3.5	3.9	3.5	3.4	3.3	3.2	3.3	3.3	3.4
Velocity (M3) (ratio)	1.4	1.4	1.3	1.2	1.2	1.2	1.1	1.1	1.1	1.1	1.1
GDP (millions of leva)	71,904	78,434	80,044	80,282	82,164	82,296	84,053	86,614	89,960	93,962	98,333

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

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 9. Bulgaria: Financial Soundness Indicators, 2010–14
(Percent)

	2010	2011	2012	2012	2012	2012	2013	2013	2013	2013	2014	2014	2014	2014
	Dec	Dec	March	June	Sept	Dec	March	June	Sept	Dec	March	June	Sept	Dec
Core indicators														
Capital adequacy														
Capital to risk-weighted assets	17.5	17.5	17.5	16.7	16.6	16.7	16.8	17.0	16.9	16.9	20.4	22.7	22.2	21.9
Tier 1 capital to risk-weighted assets	15.2	15.7	15.8	15.2	15.1	15.2	15.4	15.6	15.6	16.0	18.2	20.3	19.9	20.0
Asset quality														
Nonperforming loans to total gross loans	11.9	14.9	16.2	16.9	17.3	16.6	16.9	17.1	17.2	16.9	16.7	16.4	18.1	16.7
Nonperforming loans net of provisions to capital	28.1	36.9	40.7	43.1	43.4	39.1	38.3	37.7	37.0	36.0	45.8	46.7	46.2	43.6
Large exposures to capital	87.9	112.2	109.4	120.2	126.4	115.1	127.2	120.8	128.5	121.1	80.3	88.2	0.0	0.0
Earnings and profitability														
Return on assets	0.9	0.8	0.9	0.8	0.9	0.7	0.8	0.8	0.7	0.7	1.0	0.8	1.0	0.9
Return on equity 1/	7.9	7.1	8.4	7.9	8.2	6.8	8.0	7.4	7.2	6.6	8.6	6.7	8.3	7.6
Net interest income to gross income	74.2	73.3	71.6	70.9	69.7	68.8	68.5	68.2	69.1	68.5	70.0	70.2	69.8	67.4
Noninterest expense to gross income	49.1	50.4	52.4	52.2	51.3	52.1	53.0	53.4	53.5	53.9	51.9	51.9	50.9	49.5
Personnel expense to total income	17.8	18.5	19.3	19.4	19.2	19.1	20.2	20.0	20.0	19.8	19.9	19.5	19.4	18.5
Trading and fee income to total income	24.7	25.0	24.5	27.3	28.1	27.8	30.0	27.9	27.3	27.8	29.1	28.5	29.2	28.2
Liquidity														
Liquid assets to total assets	20.9	21.9	22.1	22.6	22.4	22.4	23.2	22.3	22.7	23.4	23.4	23.1	25.7	26.1
Liquid assets to short-term liabilities	30.1	25.4	25.6	26.0	25.9	25.8	26.7	25.7	26.2	26.9	26.9	26.5	29.5	29.9
Liquid assets to total liabilities	24.2	28.9	29.7	30.2	30.2	30.0	31.0	29.6	30.0	30.6	30.6	29.9	33.8	33.7
Encouraged indicators														
Deposit-taking institutions														
Capital to assets 2/	10.5	10.8	10.7	10.3	10.3	10.1	10.1	10.4	10.2	10.3	12.0	11.4	12.1	11.6
Trading income to total income	5.4	4.9	5.3	7.3	7.8	7.4	8.1	5.7	4.9	5.7	8.2	7.1	6.8	7.0
Personnel expenses to noninterest expenses	36.3	36.6	36.9	37.3	37.3	36.7	38.1	37.4	37.4	36.8	38.3	37.5	38.1	37.3
Customer deposits to total (non-interbank) loans	87.8	95.2	97.0	97.3	99.4	100.2	102.9	102.9	106.1	107.5	108.9	108.7	112.2	115.5
Foreign currency denominated loans to total loans	61.3	63.8	64.1	64.6	64.3	64.0	64.0	62.5	61.9	61.2	61.1	60.2	57.3	57.0
Foreign currency denominated liabilities to total liabilities	58.6	54.8	54.0	54.1	52.1	51.8	51.9	51.5	50.9	50.1	49.5	50.1	50.1	49.0

Source: Bulgarian National Bank.

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

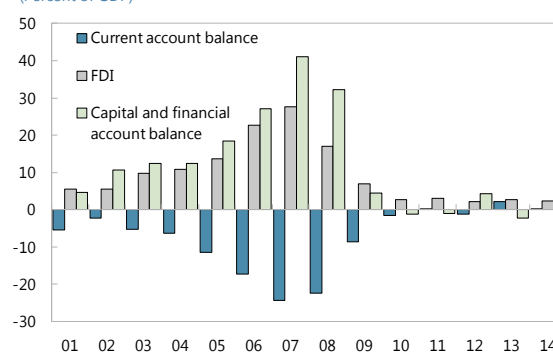
2/ Capital to assets is based on Tier I capital.

Appendix I. External Sector Assessment

Bulgaria's current account underwent a sizable adjustment with the collapse in capital inflows following the global financial crisis. The range of standard indicators and methodologies for external assessment paint a mixed picture, but Bulgaria does not appear to suffer from major price/cost competitiveness problems at this juncture, given continued strong export performance. Nonetheless, adjustment in the real effective exchange rate (REER) since its pre-crisis peak has been modest when compared to peers, and productivity gains will need to strengthen if Bulgaria is to meet its own convergence objectives in a sustainable manner.

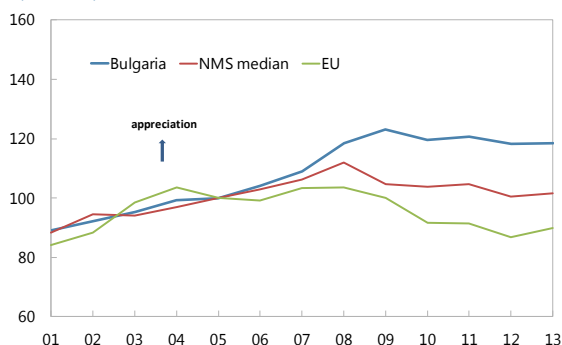
The current account has significantly adjusted following the global financial crisis. Prior to the crisis, ample and cheap foreign funds helped finance an investment boom, fueling an extraordinarily high current account deficit. The sharp reduction in capital inflows, including FDI, following the crisis forced a sharp current account adjustment, from a deficit of 24.3 percent of GDP in 2007 to a surplus in 2013 and 2014. Sharp import compression, driven by weakened domestic demand and a plunge in investment-related imports, played a dominant role in the immediate aftermath of the crisis, while resilient export performance also supported current account adjustment. The income balance has improved only modestly, driven by reduced repatriation of FDI-related earnings. Increasing EU current transfers have also supported adjustment.

External Development
(Percent of GDP)



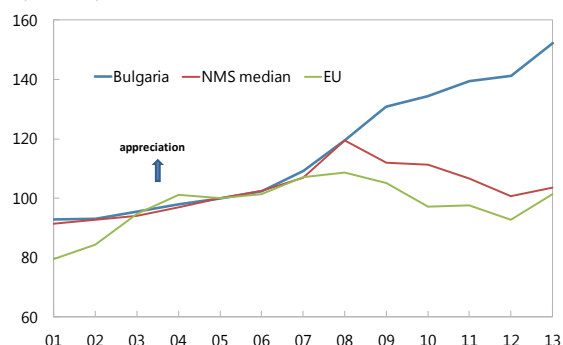
Sources: IMF, WEO; and IMF staff calculations.

CPI-Based REER
(2005=100)



Source: Eurostat.

ULC-Based REER
(2005=100)

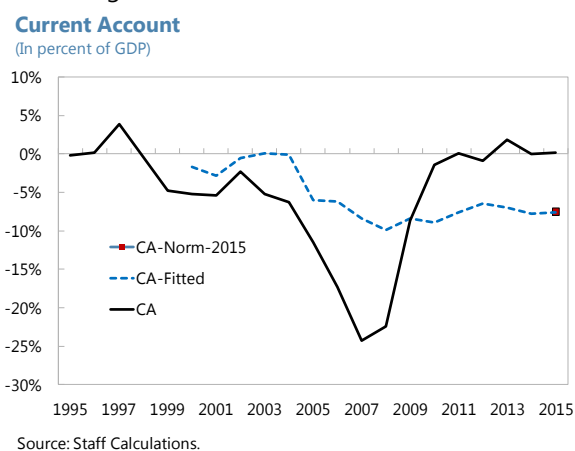


Source: Eurostat.

Bulgaria's real exchange rate continued to increase in the post-crisis period when compared to regional peers. The CPI-based REER in Bulgaria declined by about 4 percent through end-2013 from its pre-crisis peak, compared to 13 and 9 percent in EU and NMS countries, respectively. The ULC-based REER has increased since the onset of the global financial crisis (close to 30 percent cumulatively over 2008–13). That said, Bulgaria's market share in major export destinations has improved, including relative to its peers, in recent years. This was likely supported by substantially higher productivity gains in tradable industrial sectors than in non-tradable

service sectors.¹ Nonetheless, while some catch-up in wage rates is expected given that Bulgaria's average wage remains the lowest among EU members, continuation of high overall wage increases (well above productivity growth) will likely become more binding for Bulgaria's competitiveness in the medium-term, particularly as non-tradable sectors wage dynamics would be expected to affect the tradable sectors eventually through labor mobility. At the same time, there is room for Bulgaria to further improve the domestic value-added of exports (which, while growing, represents a declining share of overall exports) and move up the quality ladder.²

The estimates based on the EBA-lite methodology suggest sizable undervaluation, but should be interpreted with caution. Given a large gap (over 7 percent of GDP) between the actual current account and its calculated norm based on a cross-country panel regression, Bulgaria's REER is calculated to be undervalued by about 16 percent. Nevertheless, this result should be interpreted with caution, because the model does not seem to capture the specifics of the Bulgarian case. The sizable deviation of the actual from the fitted current account balance (close to 8 percent of GDP) appears largely related to difficulties in capturing structural factors related to the pre-crisis boom and the post-crisis adjustment. Specifically, exchange rate movements were not a primary factor behind the sizable current account movements, which as noted above were driven by capital account related development. In addition, it appears to underestimate the current account response to the output gap.



¹ See "Systematic Country Diagnostic—Sustainable Growth and Shared Prosperity: Today and Tomorrow" by the World Bank (forthcoming).

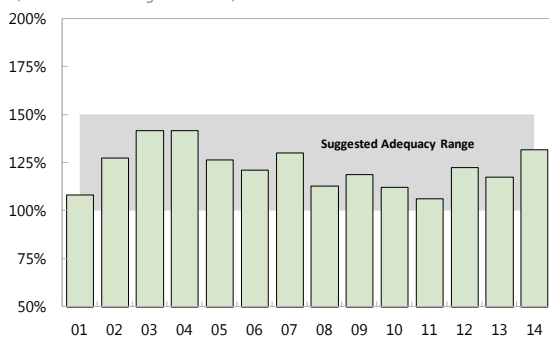
² See "Central and Eastern Europe: New Member States Policy Forum, 2014."

Appendix II. Reserve Adequacy

Bulgaria's international reserves remain well within the range suggested by IMF's ARA composite metric (see [Assessing Reserves Adequacy](#)). The ratio rose from about 120 percent at end-2013 to an estimated 130 percent as of end-2014. Over recent years, pressures on international reserves as calculated under the ARA framework have been limited, with fluctuations in short-term debt and broad money adequately covered by reserve accumulation.

Bulgaria: Reserve Adequacy

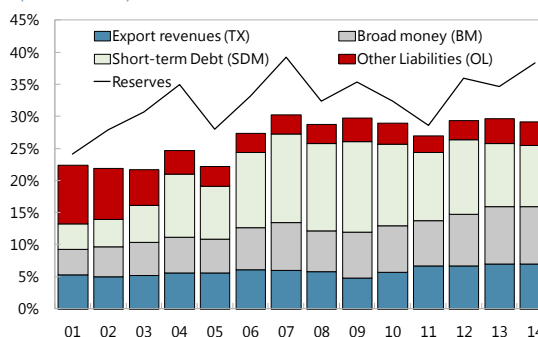
(Percent of risk-weighted metric)



Sources: IMF, WEO; and IMF staff calculations.

Bulgaria: ARA Metric Decomposition

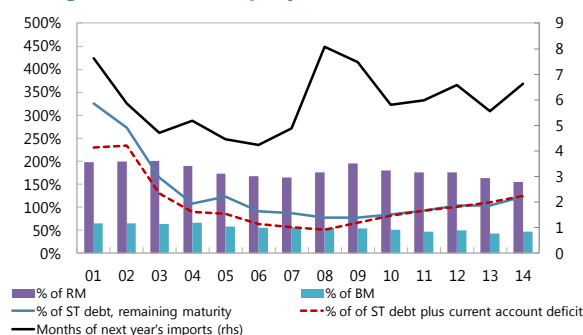
(Percent of GDP)



Sources: IMF, WEO; and IMF staff calculations.

Traditional indicators also point to a broadly adequate level of reserves. As of end-2014, reserves are estimated to cover over six months of 2015 projected imports, well above the conventional rule of thumb. In terms of both short-term debt at remaining maturity and the current account deficit, reserve coverage has improved notably since 2008, remaining above 100 percent since 2012, supported by a steadily decline in short-term debt and modest current account balances in recent years.

Bulgaria: Reserve Adequacy



Sources: IMF, WEO; and IMF staff calculations.

Bulgaria, like most other countries with currency board arrangements (CBAs), holds international reserves comfortably above its monetary base. The ratio of international reserves to the monetary base, while declining in recent years, remains above 150 percent as of end-2014. Nevertheless, in view of Bulgaria's sizable banking system, a broad-money coverage ratio is also a useful gauge of resilience to financial distress. Bulgaria's reserve coverage of broad money, while declining slightly in recent years, improved slightly in 2014, to nearly 50 percent.

Appendix III. Debt Sustainability

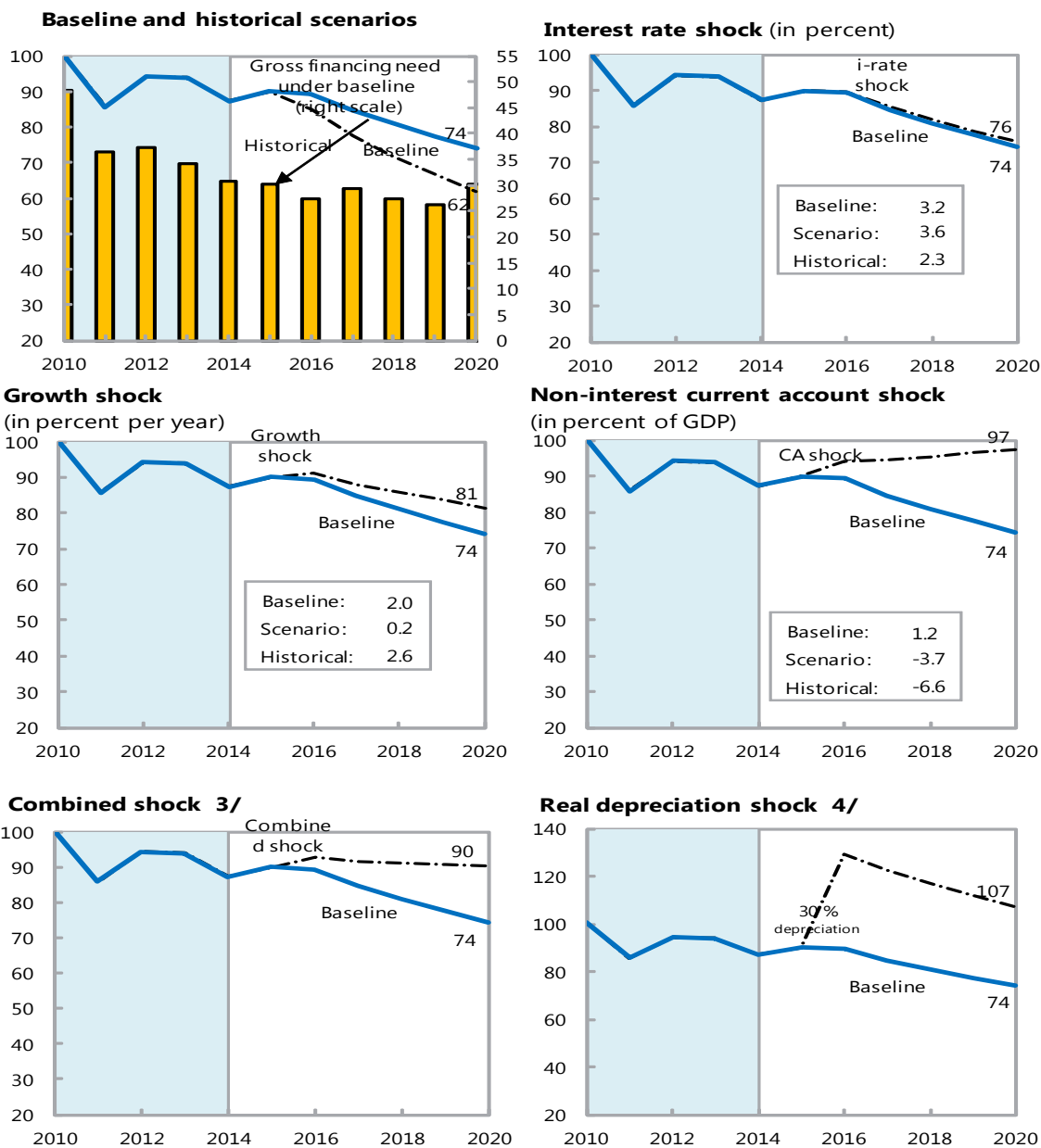
External debt peaked in 2009 and has broadly followed a downward trend since then. The overall decline in gross external debt from about 110 percent of GDP at end-2009 to around 90 percent of GDP at end-2014 was largely due to private sector deleveraging. More than half of this decline was due to banks, where debt fell from about 25 percent of GDP at its peak to under 14 percent of GDP at end-2014. Excluding intercompany lending, which is relatively stable, external debt was about a little over 55 percent of GDP at end-2014, and this was largely matched by international reserves. Rollover risks related to external exposure in the nonbank private sector, which did not materialize during the global financial crisis, are contained given moderate short-term exposure.

Gross external debt is expected to decline further under staff's baseline projections. External debt is set to reach under 80 percent of GDP by 2019, primarily due to nominal GDP growth, with relatively little change in nominal external debt. Under the historical DSA scenario, the denominator effect on the debt-to-GDP ratio is even stronger because historical growth is higher than projected growth.

External debt dynamics appear broadly resilient to shocks. Shocks to the interest rate, the growth rate, and the current account deficit would shift the trajectory of external debt relative to GDP upwards. However, under all the scenarios, the external debt to GDP ratio is projected to eventually resume its downward-sloping path over the medium term.

Public debt increased significantly in 2014, but remains at manageable levels. In the medium term, while debt levels remain low, the fiscal adjustment under the baseline scenario is not sufficient to secure debt firmly on a downward path. Assuming FRA balances remain at the projected 2015 level, there will be virtually no correction to the increase in debt levels during the projection period. Moreover, medium-term debt dynamics are sensitive to macro-financial shocks and the materialization of contingent liabilities. In particular, a combined macro-fiscal shock would bring the debt ratio above 40 percent by 2017. Risks from intensified deflationary pressures and unaccounted contingent liabilities, e.g., from SOEs and the banking sector, could also result in higher outcomes, as could spending pressures related to the aging population, given recent reversals in pension reforms and additional system changes currently under discussion, as well as inefficiencies in the health sector. Recent successful Eurobond issuance has substantially reduced the near-term refinancing risk while moderate refinancing needs are projected for the next five years. Nonetheless, addressing underlying fiscal vulnerabilities is important to preserve market access at favorable rates.

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. 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.

Bulgaria Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

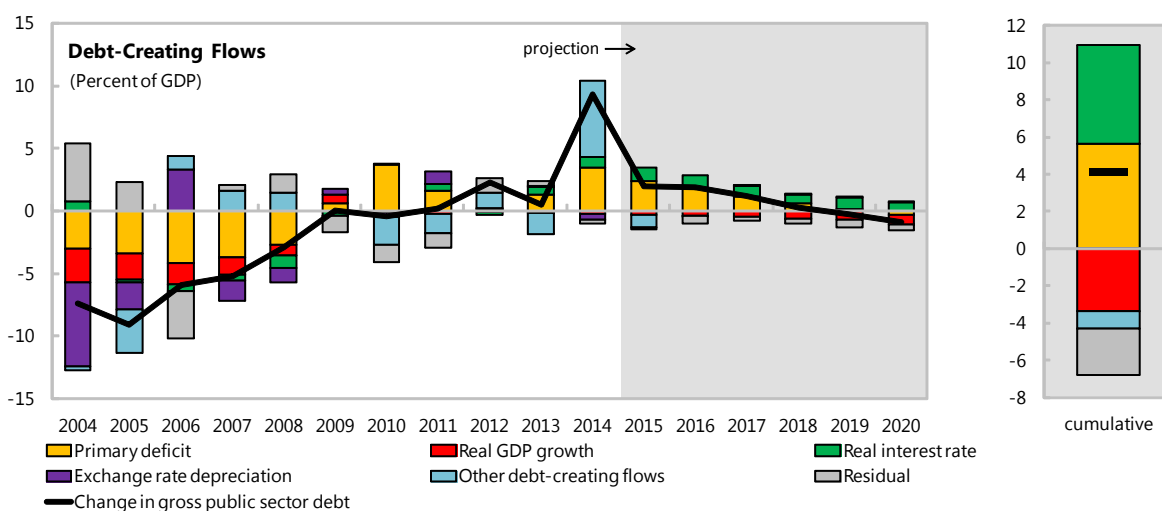
(Percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of March 16, 2015		
	2004-2012 ^{2/}	2013	2014	2015	2016	2017	2018	2019	2020	Sovereign Spreads		
Nominal gross public debt	20.5	17.6	26.9	28.9	30.7	31.9	32.2	31.9	31.0	German bonds	50	
Public gross financing needs	2.5	5.3	8.3	11.6	4.6	5.5	3.9	4.1	3.8	5Y CDS (bp)	171	
Real GDP growth (in percent)	3.3	1.1	1.7	1.2	1.5	1.8	2.0	2.3	2.5	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	5.8	1.6	-0.8	-0.1	1.1	2.2	2.5	2.6	2.6	Moody's	Baa2	Baa2
Nominal GDP growth (in percent)	9.3	0.3	2.3	0.2	2.1	3.0	3.9	4.4	4.7	S&Ps	BB+	BB+
Effective interest rate (in percent) ^{4/}	4.8	5.0	4.1	3.9	5.1	5.2	4.8	5.7	4.9	Fitch	BBB-	BBB

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020		
Change in gross public sector debt	-3.2	0.5	9.3	2.0	1.8	1.2	0.3	-0.2	-0.9	4.1	
Identified debt-creating flows	-3.4	0.1	9.6	2.1	2.4	1.5	0.7	0.4	-0.4	6.6	
Primary deficit	-1.2	1.3	3.4	2.4	1.8	1.1	0.6	0.1	-0.4	5.6	-0.1
Primary (noninterest) revenue and grants	34.5	34.2	33.8	34.5	34.2	34.3	34.5	34.7	34.8	207.1	
Primary (noninterest) expenditure	33.3	35.5	37.3	36.9	36.0	35.4	35.1	34.8	34.5	212.7	
Automatic debt dynamics ^{5/}	-1.9	0.5	0.1	0.7	0.7	0.3	0.1	0.2	-0.1	1.9	
Interest rate/growth differential ^{6/}	-1.1	0.4	0.6	0.7	0.7	0.3	0.1	0.2	-0.1	1.9	
Of which: real interest rate	-0.2	0.6	0.9	1.0	1.1	0.9	0.7	0.9	0.7	5.3	
Of which: real GDP growth	-0.9	-0.2	-0.3	-0.3	-0.4	-0.5	-0.6	-0.7	-0.8	-3.3	
Exchange rate depreciation ^{7/}	-0.8	0.1	-0.4	...	...	...	...	...	...	...
Other identified debt-creating flows	-0.3	-1.7	6.1	-1.0	0.0	0.0	0.0	0.0	0.0	-1.0	
Privatization receipts (negative)	-1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
On-lending to DF and change in FRA	0.8	-1.7	6.1	-1.0	0.0	0.0	0.0	0.0	0.0	-0.9	
Residual, including asset changes ^{8/}	0.3	0.4	-0.3	-0.1	-0.6	-0.3	-0.4	-0.6	-0.5	-2.5	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+grt)]$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate;

a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

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

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

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

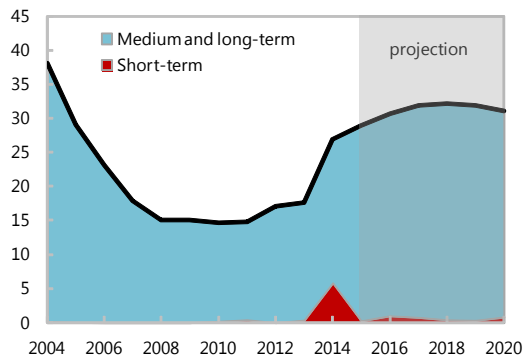
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Bulgaria Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

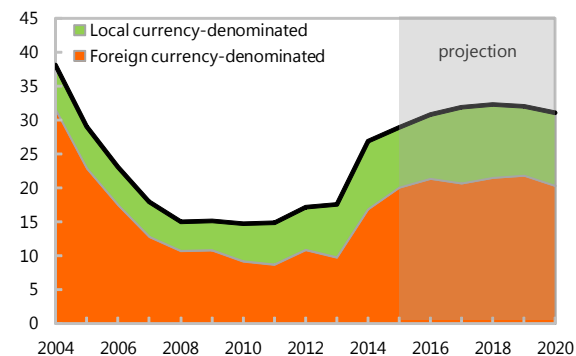
By Maturity

(Percent of GDP)



By Currency

(Percent of GDP)



Alternative Scenarios

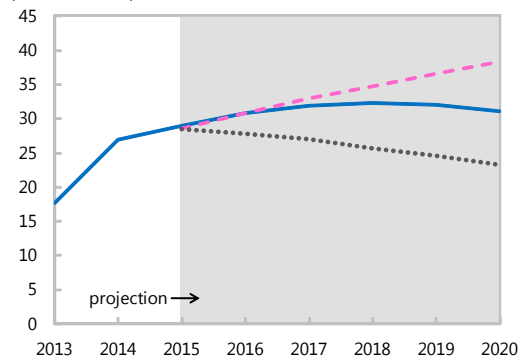
— Baseline

..... Historical

— Constant Primary Balance

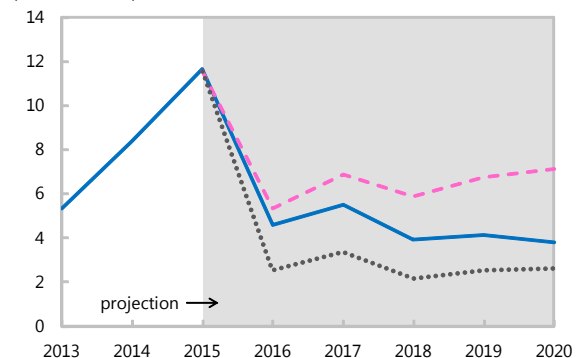
Gross Nominal Public Debt

(Percent of GDP)



Public Gross Financing Needs

(Percent of GDP)



Underlying Assumptions

(Percent)

Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	1.2	1.5	1.8	2.0	2.3	2.5
Inflation	-0.1	1.1	2.2	2.5	2.6	2.6
Primary Balance	-2.4	-1.8	-1.1	-0.6	-0.1	0.4
Effective interest rate	3.9	5.1	5.2	4.8	5.7	4.9
Constant Primary Balance Scenario						
Real GDP growth	1.2	1.5	1.8	2.0	2.3	2.5
Inflation	-0.1	1.1	2.2	2.5	2.6	2.6
Primary Balance	-2.4	-2.4	-2.4	-2.4	-2.4	-2.4
Effective interest rate	3.9	5.1	5.3	4.8	5.7	5.2

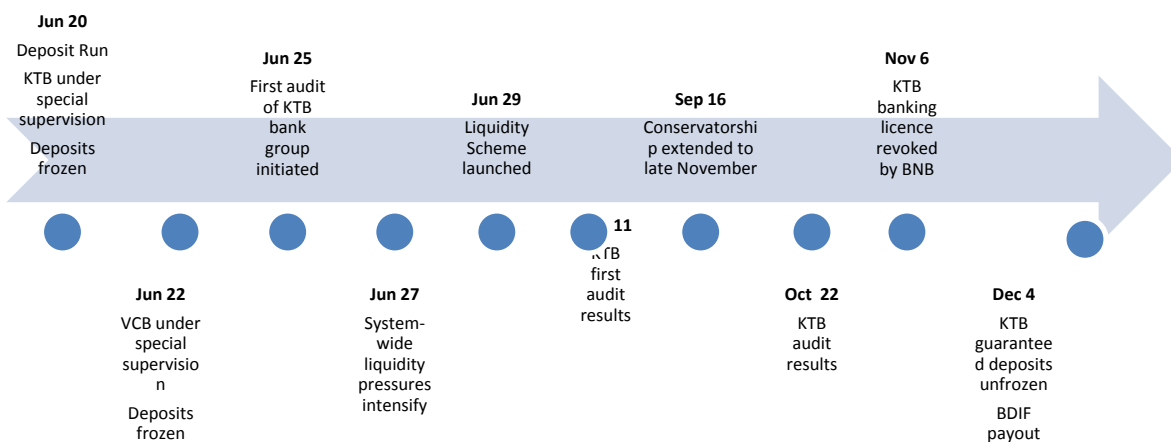
Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	1.2	2.6	2.6	2.6	2.6	2.6
Inflation	-0.1	1.1	2.2	2.5	2.6	2.6
Primary Balance	-2.4	0.3	0.3	0.3	0.3	0.3
Effective interest rate	3.9	5.1	5.0	4.1	4.8	3.6

Source: IMF staff estimates.

Appendix IV. Corporate Commercial Bank: Bank Failure and Resolution

Background. As of end-2013, Corporate Commercial Bank AD (KTB) was the fourth largest bank in Bulgaria in terms of assets, third in terms of net profits, and first in terms of deposit growth. Since late 2011, the bank had conducted an aggressive funding strategy, with interest rates on deposits well above those of other banks in the system, as it rapidly expanded its market share. The bank's commercial portfolio (concentrated in the corporate sector) and deposit base included sizable exposures to SOEs, notably in electricity and other network industries. As presented in its [2013 consolidated financial statement](#), KTB's capital adequacy ratio stood at 12.6 percent (compared to the BNB minimum requirement of 12 percent and a system average of 16.9 percent) as of end-December 2013. Reported NPL ratios, at 0.2 percent, were significantly below the system average of 16.9 percent. In June 2014, KTB acquired from Credit Agricole its Bulgarian subsidiary, later renamed Commercial Bank Victoria EAD (CBV).

Distress triggers and spillovers. On June 20, 2014, KTB was placed under conservatorship by the BNB's Governing Council, following a massive deposit run. Within days, the bank had lost BGN 1.2 billion or about 20 percent of its total deposits, following media speculation of a concerted attack by powerful interests and rising concerns about the bank's solvency position (including allegations of fraud and connected lending). On June 22, KTB's subsidiary, CBV was also placed under special supervision by BNB. As a result of BNB intervention, all payments to customers by the two banks were suspended (including access to guaranteed deposits). By Friday June 27, pressures had started to spread to the rest of the banking system—with First Investment Bank (FIB), the largest domestic bank, losing about 10 percent of its deposits and being forced to close in the afternoon. These events arose in the context of substantial domestic uncertainty, following the announced resignation of the government earlier in the month.



Immediate policy response. To weather the deposit run and avoid broader spillovers, on Sunday June 29, the President [announced](#) a broad-based consensus (supported by the government, opposition, and BNB) on a package of measures to preserve stability in the financial system. This included a liquidity assistance scheme (of up to BGN 3.3 billion or 4 percent of GDP), providing 5-month state deposits at market conditions to solvent Bulgarian

credit institutions in need of liquidity support.¹ The terms of the scheme were set in line with [EU state aid rules](#), as approved by the EC. The package was effective in calming depositors and allowed FIB and other banks to re-open on Monday June 30 with no need for deposit restrictions and only limited additional withdrawals. In particular, under the liquidity assistance scheme, FIB was granted a state deposit of BGN 1.2 billion. On November 28, FIB repaid BGN 0.3 billion of the state deposit while the remaining BGN 0.9 billion was extended, in line with [EU state aid rules](#), by a maximum of 18 months. FIB presented [a restructuring plan](#) to the EC on November 12, including a set of commitments to restore liquidity as well as to improve its corporate governance structure and risk management policies.

KTB audit results. On June 25, upon BNB's request, a review of KTB bank group's assets and liabilities was initiated by independent external auditors. However, on July 11, the preliminary audit results pointed to significant shortcomings in the availability of documentation on KTB's financial position and loan portfolio, requiring a more comprehensive audit of KTB assets. This delayed the initially planned re-opening of the bank by July 21. Moreover, while the bank's financial situation was being reviewed and pending BNB's decision on KTB's license revocation, all deposits remained frozen, with no authorized payments of protected depositors by the Deposit Insurance Fund (BDIF).² The [audit results](#) were published on October 22 and identified impairment deviations for about BGN 4.22 billion, of which BGN 3.4 billion (64 percent of KTB total loan portfolio) in loans extended to newly created investment companies without staff and other operational activity and where the necessary information for credit risk assessment was missing. After the recognition of the impairment deviations identified by the auditors, KTB showed a negative capital (of about BGN 3.75 billion).

Resolution strategy.

- **KTB.** On November 6, BNB formally revoked KTB's banking license based on the finding of negative capital. Lacking an existing legal framework for the restructuring of credit institutions (and pending implementation of the EU Directive on Bank Recovery and Resolution), liquidation represented the only available option for the resolution of KTB under existing legislation.³ Following the license revocation, BNB requested that the district court start the bank insolvency proceedings, in line with the Bulgarian law on bank bankruptcy. KTB's shareholders appealed against the BNB decision, which halted the insolvency proceedings. In the meantime, the revocation of the license triggered the conditions for the payout by the BDIF of guaranteed deposits as of December 4 (for up to up to BGN 196,000, i.e. EUR 100,000, per depositor), through selected servicing banks. With BGN 1.8 billion available in the BDIF, the funding gap to cover all protected depositors was estimated by the [BDIF](#) at approximately BGN 1.7 billion at end-October. To cover this gap, on December 3, the government approved a loan (provided for through amendments to the 2014 budget) to the BDIF of up to BGN 2 billion with a maturity of up to 5.5 years, at a fixed interest rate of 2.95 percent. The majority of the KTB guaranteed depositors' payments were carried out as deposits

¹ The package also included steps to reinforce supervision, including a call for a peer review of BNB supervision by the EBA and initiation of steps to join the Single Supervisory Mechanism.

² While the decision was in line with the existing Bulgarian law (which provided for the BDIF to pay out protected deposits only when the BNB revoked a bank's license), it resulted in conflict with Directive 94/19/EC. See the related EBA recommendation to the BNB and BDIF, [EBA/REC/2014/02](#), and subsequent exchanges.

³ Bulgaria's legal framework did not give the authorities adequate resolution tools. A [plan](#) for the restructuring of KTB and CBV was initially presented by the BNB but the proposed legislative changes to implement the plan did not find the necessary political support.

in other banks in the system. As a result, private sector deposit growth has remained positive for the system as a whole, at 1.5 percent y-o-y in December.

- **CBV.** The audit results on July 11 indicated that CBV's financial indicators were within the regulatory requirements, although the bank did not have sufficient liquid funds to meet its obligations. However, given KTB group's bankruptcy, CBV could not be granted state aid. Therefore, the sale of separate parts of its loan portfolio represented the only available option to secure the necessary liquidity. The selected bids by banks, as part of the tender procedure, closed on November 14, provided additional liquid funds to CBV for the full repayment of the bank's deposit obligations (both guaranteed and non-guaranteed). As a result, BNB authorized the bank to resume its banking activity and restart servicing its depositors without restrictions on December 12. The special supervision period expired on December 23.

Appendix V. Transparency of Fiscal Risks

Fiscal risks cause fiscal outcomes to differ from forecasts. Such risks include not only uncertainty about the evolution of fiscally-important macroeconomic variables (e.g., growth and inflation), but also specific sources (e.g., such as calls on government guarantees, tax disputes and other litigation, and changes in the values of the government's assets and liabilities). A government's ability to cope with fiscal risks depends on the quality of the information on risks, the power to limit its exposure to those risks that can be mitigated, and its capacity to absorb the fiscal consequences of those risks that cannot be mitigated ([IMF Manual on Fiscal Transparency](#)).

A first step towards strengthening the management of fiscal risks is enhancing disclosure. Making fiscal information available to the public in a timely manner and free of charge is a defining characteristic of fiscal transparency. The information should be also enhanced through analyzing risks to the public finances.

Bulgaria makes available basic information on broad fiscal risk indicators, but weaknesses remain in the areas where fiscal risks appear large. A preliminary analysis suggests scope to enhance disclosure and risk assessment in of the following areas:

- Some indicators are published, but (i) not frequently enough to reflect the rapidly changing environment (e.g., actuarial assessment of NSSI; government debt strategy); or (ii) not in a form that allows to easily conduct risk assessments (e.g., aggregated data on public corporations; litigations to the government).
- Risk analysis is conducted by the government in some areas, but the results are not regularly published: e.g., financial-sector stress tests; and environmental costs.
- In many areas, risk analysis is not conducted by the government: e.g., health sector (i.e., actuarial assessment of NHIF); contingent liabilities (e.g., the probability that guarantees are called).

Availability of Fiscal Risk Indicators⁴

DIMENSION	INDICATOR	STATUS
Sensitivity Analysis	Sensitivity of fiscal aggregates to macroeconomic shocks	Annual convergence reports discuss the impact of alternative macroeconomic scenarios on budgetary projections, but no probabilistic forecasts of fiscal outcomes are included.
Specific Risks to Fiscal Forecasts	Regular reporting of specific risks—not related to macroeconomic factors—to fiscal forecasts	Various fiscal risks are discussed in the budget report accompanying the annual budget law and medium-term budget forecast. While some specific risks are regularly reported in a quantitative manner (e.g., government guarantees), some are described only in a qualitative manner (e.g., implicit/explicit contingent liabilities associated with public corporations and the banking sector). Analysis of the financial position of public corporations is conducted periodically within the MoF for internal use.
Long-Term Fiscal Sustainability Analysis	Financial balance and projections of government funds	For both NSSI and NHIF, (i) the annual budget law is accompanied by policy analysis, and (ii) data on financial flows are published. Sustainability (actuarial) analysis is conducted for NSSI, but not frequently enough to reflect the rapidly changing environment. No actuarial analysis is conducted for NHIF.
Budgetary Contingencies	Annual budget includes adequate and transparent allocations for contingencies	The annual budget law includes contingency reserves that typically amount to 0.5–2 percent of GDP. However, the reserves comprise largely budgets of autonomous entities (e.g., judiciaries, state universities) and earmarked programs/projects of various ministries/agencies, suggesting contingency reserves are not fully dedicated to spending needs arising from unanticipated, but unavoidable, events. The use of contingency reserves excluding budgets of autonomous entities requires an approval from the Council of Ministers, accompanied by regular in-year reporting on its utilization. The use of budgets of autonomous entities is determined by respective managing bodies.
Asset and Liabilities	Risks relating to major assets and liabilities are disclosed and managed	The size of the general government's balance sheet and risks to debt are analyzed and disclosed in the context of Government Debt Management Strategy (full reports every three years with interim annual updates). <ul style="list-style-type: none"> • The government's payment arrears, which are not recorded as debt under a cash accounting, are reported regularly (quarterly). • Collective information on litigations to the government is not publicly available.

⁴ The table provides preliminary information on the availability of fiscal risk indicators in Bulgaria, and it is neither a substitute for a Fiscal Transparency Evaluation (FTE) nor binding for a future FTE.

DIMENSION	INDICATOR	STATUS
Natural Resources	Importance of resource revenues	Bulgaria does not have major natural non-renewable resources.
Government Guarantees	The government's guarantee exposure is regularly disclosed and authorized by law	The size of general government guarantees is published annually, but the estimate of the likely fiscal cost of called guarantees is not published. The maximum amount of new guarantees is determined by a budget law.
Financial Sector Exposure	Size of the government's potential fiscal exposure to the financial sector	The government discloses explicit support, including guarantees provided through National Guarantee Fund, but does not disclose exposure related to prospective systemic events or the results of bank stress tests.
Environmental Risks	Cost of natural disasters	The budget document discusses environmental risks in quantitative terms, but analyses done by relevant ministries are not published.
Public-Private Partnerships	Obligations under PPPs	There are so far only concession projects in Bulgaria. Information on individual concession projects is available in Bulgarian online at the National Concession Register.
Sub-national Governments	Exposure to sub-national government insolvency	The financial condition and performance of sub-national governments is published monthly, and there is a limit on their liabilities or borrowing.
Public Corporations	Financial state of public corporations	Financial statements of individual public corporations are available on the MoF website in the Bulgarian language. Starting in 2014, the National Statistics Institute has been compiling aggregated data on liabilities of all the public corporations that are not consolidated to the general government under the ESA 2010 standard and is reporting the outcome to Eurostat. There is no information or analysis done on implicit contingent liabilities with respect to public corporations.



BULGARIA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department
(in consultation with other departments)

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FUND RELATIONS

(as of February 28, 2015)

Membership Status

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

General Resources Account

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

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	610.88	100.00
Holdings	611.59	100.12

Outstanding Purchases and Loans: None.

Latest Financial Arrangements

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

Projected Payments to the Fund

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

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

Exchange Rate Arrangement:

The currency of Bulgaria is the lev. Since July 1, 1997, the Bulgarian National Bank has operated a currency board arrangement. From July 1, 1997 to December 31, 1998, the lev was 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 transfers.

Article IV Consultations

The 2013 Article IV Board discussion took place on January 24, 2014. The Staff Report was published on January 30, 2014 (Country Report No. 14/23).

Resident Representative

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

IMF-WORLD BANK RELATIONS

A. Partnership in Bulgaria's Development Strategy

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

B. IMF-World Bank Collaboration in Specific Areas

2. The Fund team led by Ms. Shannon (mission chief) meets regularly with the World Bank Bulgaria team led by Mr. Antony Thompson (Country Manager for Bulgaria, the Czech Republic and Slovakia), to discuss macro-critical structural reforms and to coordinate the two teams' work. The most recent meeting took place in March 2015.

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

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

- **Bank and non-bank financial institution (NBFI) regulation and supervision.** Strengthening the governance of all institutions responsible for financial sector stability is critical to restore confidence, attract needed private investment, and limit the need for government support.

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

5. The teams agreed that the Bank and the Fund share responsibility on financial sector issues, revenue administration, and pension reforms, while the Bank will lead EU funds absorption, basic infrastructure, business environment, health and education reforms, and social inclusion. Both teams will keep the other apprised of upcoming missions and assessments. World Bank country economists participated in the Article IV Consultations in September 2012, November 2013, and March 2015.

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

C. The World Bank Group Strategy and Lending Operations

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

7. The active Bank portfolio in Bulgaria as of March 2015 consists of 2 operations at the original loan amount of US\$177.7 million equivalent. The World Bank's lending program in Bulgaria to date comprises 46 IBRD operations with a total original commitment of US\$3,003 million equivalent, consisting of 15 adjustment loans (US\$1,725.8 million), 24 investment projects (US\$1,123 million), one debt reduction loan (US\$125 million), four Bank-managed Global Environmental Fund (GEF) grants, and two Bank-managed Prototype Carbon Fund (PCF) operations. Of these 46 operations, 44 have been completed (of which 14 have been fully or partially cancelled during implementation), and 2 operations are currently under implementation (Table 1).

8. Economic and Sector Work. The World Bank country diagnostic work completed over the last two years focuses on assessing the economic and fiscal impact of an aging population; productivity growth; unfair trading practices; governance, quality assurance and financing of early childhood development, pre-university and higher education, and quality of teachers; institutional and strategic framework for workforce development; health sector financing; and Roma inclusion. Recently completed analytical work includes: Mitigating the Economic Impact of an Aging Population, Productivity Growth (forthcoming), Addressing Unfair Trading Practices Early Childhood Development Assessment, Strengthening Higher Education, Teachers Assessment, Workforce Development Assessment, Health Sector Diagnosis, and Gender Dimensions of Roman Inclusion. Six reimbursable advisory service (RAS) agreements for provision of World Bank advisory services have been signed since 2012 focusing on water supply and sanitation strategy and regulation, innovation (completed), roads, health financing, and agriculture and hydro melioration.

9. As of March 2015, the IFC had 38 projects (completed and ongoing) in Bulgaria with total commitments of over US\$915 million. The single biggest investment of IFC in the country is in the field of renewable energy in the form of a loan for the construction of the largest wind park in Bulgaria. IFC is also involved in the development of the *Galata* gas field near the Black sea coast. In line with the IFC's strategic goals for Bulgaria, IFC has supported a company investing in agricultural land and promoting land consolidation. In the financial sector, IFC is supporting two specialized SME banks; it established Bulgaria's first micro-lending bank and has invested in a venture fund, which is also targeting the SME sector. In other industries, IFC had contributed to key manufacturing projects—it has supported the modernization and expansion of an electronics producer, a large

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

steel mill, and two glass processing plants. Some IFC projects entail an important environmental component. One of the manufacturing plants, for example, is purchasing equipment which would reduce its GHG emissions and the electronics producing company is making sensors for cars that monitor the emission of polluting gases and improve fuel efficiency.

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

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

Operation	US\$ million	Board date
1. Social Inclusion Project	59.0	2008
2. Municipal Infrastructure Development Project	118.7	2009

STATISTICAL ISSUES

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

Real Sector

1. The National Statistical Institute (NSI) is responsible for compiling national accounts, based on a system consistent with the *System of National Accounts 2008 (SNA 2008)* and the *European System of Accounts 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 current and capital accounts for the five main domestic sectors (general government and its sub-sectors, financial corporations, non-financial corporations, nonprofit institutions serving households, and households). The NSI publishes financial accounts and balance sheets by institutional sectors and sub-sectors on an annual basis.

2. The NSI has compiled estimates of quarterly GDP by the production and expenditure approaches in current and constant prices since 1995. The preliminary flash estimates of GDP and its components by production and expenditure side are produced and disseminated 42–44 days after the reference period, although persistent inconsistencies in the data have limited their usage. The quarterly updates are disseminated 65 days after the end of the reference quarter with final figures disseminated after 3 quarters. The annual data are disseminated about 5 quarters after the end of the reference year. The estimates at constant prices, which follow international standards, use chain-linked indices. Problems remain in the coverage of private sector activities as well as regarding constant price estimates of capital formation and external trade, although progress has been made in the development of export and import deflators. Recent IMF TA advised on improving the seasonal adjustment procedure of quarterly GDP and volume measures of taxes on products.

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

4. The flow of customs data has improved significantly in recent years and a new system for processing customs records is near completion. The development of export and import unit value indices is progressing smoothly and additional support is expected from Eurostat in this area. The current indices are used as deflators for the import and export components of the national accounts. Each month the Foreign Trade Statistics Department of the NSI is in contact with the BNB to review data issues and ensure consistency between the NSI export and import data and the balance of payments data.

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

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

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

Government Finance

8. In recent years, following the recommendations of a combined STA/FAD mission and within the framework of EU fiscal reporting , the authorities have made significant progress on implementing accrual accounting for government, budgetary and statistical systems.

Consolidated data on a cash basis, covering general and central government operations, were routinely reported for publication in the *GFS Yearbook/Annual CD-ROM* and in *IFS*. In addition, quarterly accrual GFS data for the whole general government are reported for publication in *IFS*, through Eurostat. The major part of the GFS data is compiled by NSI and the transmissions to Eurostat are carried out by NSI. Since September 2008, the Ministry of Finance (MOF) prepares and submits the SDDS indicators for the central government finances in the IMF's GFSM 2001 format. The same indicators are published on the MOF's website on a monthly and quarterly basis. As of 2014, the Bulgarian statistical authorities (NSI, BNB and MoF) have agreed to use the provided option by Eurostat for IMF data transmission. In this way GFS data becomes consistent with 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 Bulgarian National Statistical Institute as the institution responsible for compiling GFS tables under ESA'2010 has confirmed to Eurostat to use data from ESA tables 6 and 7 for reporting the annual GFS to IMF.

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

Money and Banking Statistics

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

Balance of Payments

11. Bulgaria provides quarterly balance of payments (BOP) statistics for dissemination in IFS on a timely basis. Balance of payments and international investment position (IIP) statistics are compiled according to the *Balance of Payments Manual, fifth edition (BPM5)*. The first transmission of International Investment Position (IIP) data on the basis of the *Balance of Payments and International Investment Position Manual, 6th edition (BPM6)* will take place in March 2015. Since joining the EU in January 2007, the trade data with EU countries are being collected following the

INTRASTAT system. Data for imports and exports of goods with non-EU member states are based on SAD (Single Administrative Document) collected by Customs Agency while the movement of goods within the EU is based on Intrastat declarations collected by the National Revenue Agency. 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 redissemination in the Quarterly External Debt Statistics (QEDS) database.

Financial Soundness Indicators

12. Bulgaria participates in the financial soundness indicators (FSIs) project. Annual data are posted on the FSI website for the period 2005 – 2013.

Data Standards and Quality

13. Bulgaria is subject to the statistical requirements and reporting standards of Eurostat and the European Central Bank (ECB). Bulgaria subscribes to the Special Data Dissemination Standard (SDDS) since 2003, and the relevant metadata have been posted on the Dissemination Standards Bulletin Board. A data ROSC has been published in December 2003. The latest (2013) annual observation report for Bulgaria is posted on the Fund's website http://dsbb.imf.org/images/pdfs/AnnualReports/2013/BGR_SDDS_AR2013.pdf

Bulgaria: Table of Common Indicators Required for Surveillance

(as of February 26, 2015)

	Date of latest observation	Date received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of publication ⁶
Exchange Rates	30/01/2015	02/02/2015	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	January 2015	18/02/2015	M	M	M
Reserve/Base Money	January 2015	24/02/2015	M	M	M
Broad Money	January 2015	24/02/2015	M	M	M
Central Bank Balance Sheet	January 2015	24/02/2015	M	M	M
Consolidated Balance Sheet of the Banking System	January 2015	24/02/2015	M	M	M
Interest Rates ²	January 2015	26/02/2015	M	M	M
Consumer Price Index	January 2015	15/02/2015	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	2013	06/27/2014	A	A	A
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	December 2014	2/2/2015	M	M	M
Stocks of General Government and General Government-Guaranteed Debt ⁵	December 2014	02/04/2015	M	M	M
External Current Account Balance	December 2014	16/02/2015	M	M	M
Exports and Imports of Goods and Services	December 2014	16/02/2015	M	M	M
GDP	February 2015 Q4	13/2/2015	Q	Q	Q
Gross External Debt	November 2014	27/01/2015	M	M	M
International Investment Position	2014 Q3	30/12/2014	Q	Q	Q

¹Includes reserve assets pledged or otherwise encumbered as well as net derivative positions. ²Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds. ³Foreign, domestic bank, and domestic nonbank financing. ⁴On a gross cash basis. The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and local governments. ⁵Including currency and maturity composition. ⁶Monthly (M); Quarterly (Q); Annually (A).



INTERNATIONAL MONETARY FUND



Press Release No. 15/215
FOR IMMEDIATE RELEASE
May 13, 2015

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

IMF Executive Board Concludes 2015 Article IV Consultation with Bulgaria

On May 4, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bulgaria.¹

Over the last year, Bulgaria's hard-won macroeconomic and financial stability has been tested by the failure of a large bank and deterioration in the fiscal balance. Nonetheless, modest growth was achieved in 2014 and is expected to continue in 2015, albeit at a lower rate. Consumer prices declined by an average 1.6 percent in 2014, among the sharpest contractions in the EU, but are projected to turn positive late in the year.

The banking system has shown substantial resilience to the damage to confidence resulting from the bank failure. Strong system liquidity and the liquidity support scheme introduced by the BNB and government helped avert system-wide spillovers. However, decisive actions are needed to address weaknesses exposed by the bank failure, restore supervisory credibility, and strengthen crisis management tools. While reported banking system capital buffers remain adequate in aggregate, balance-sheet repair is advancing only slowly.

The fiscal deficit rose to 3.7 percent of GDP, twice the original target. The budget targets a 3 percent of GDP deficit in 2015, and a further 0.5 percentage point reduction per year in coming years. Measures to improve the composition and quality of expenditure and mitigate contingent liabilities arising from state-owned enterprises remain key. At the same time, an aging population and emigration represent significant long-term public spending challenges.

Income convergence with EU counterparts is projected to remain slow with significant age, gender, and regional disparities in income. Decisive action to address long-standing concerns related to corruption remains key. The government has begun to take steps to address the increasingly acute problems arising from inefficiencies in the power sector.

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 Assessment²

Executive Directors noted that Bulgaria has shown resilience to political and financial sector turbulence in the past year, with modest growth and a small reduction in unemployment being achieved notwithstanding strong deflationary pressures. While inflation is projected to turn positive later this year, growth is expected to moderate further in 2015 and remain below levels needed to accelerate income convergence with EU partners. At the same time, risks to the outlook have increased from policy uncertainty and external developments. Directors called for a comprehensive policy response to address risks and restart reform momentum.

Directors urged decisive actions to address important gaps in financial sector oversight and the crisis-management framework in light of the failure of the large domestic bank (KTB). They encouraged prompt implementation of planned reforms to the resolution framework and early recapitalization of the deposit insurance fund. They also welcomed plans to initiate an asset quality review later this year. Directors highlighted the importance of a comprehensive strategy to address the high private sector debt overhang and nonperforming loans to help advance balance sheet repair, reduce asset-price uncertainty, and promote orderly deleveraging. They also underscored the need for ongoing monitoring and contingency planning related to developments in Greece.

Directors welcomed the authorities' plans to set the budget on a consolidation path following substantial fiscal slippage in 2014. Emphasizing the importance of rebuilding fiscal buffers and restoring policy credibility, particularly under the currency board arrangement, Directors agreed that the authorities should consider more ambitious medium-term consolidation. At the same time, a number of Directors noted the importance—and the challenge—of ensuring that such consolidation does not weaken domestic demand. Containing spending while enhancing its efficiency and prioritizing high-quality public investment, as well as saving revenue over-performance, will be important. Directors also underscored the need for concrete plans to address medium-term fiscal risks stemming from population aging and contingent liabilities from state-owned enterprises (SOEs). They encouraged the authorities to improve the design and sustainability of the pension system and enhance the efficiency of SOEs.

Directors welcomed recent energy sector reforms as important first steps in addressing rising costs and inefficiencies in the sector. They called for broader structural reforms to catalyze investment and productivity gains essential to unlocking Bulgaria's economic potential, strengthening job creation, and accelerating income convergence. They emphasized the importance of concrete progress in reducing corruption and strengthening the rule of law in

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

renewing confidence in critical institutions. They also pointed to the need to address gaps in health, education, infrastructure, and energy markets.

Bulgaria: Selected Economic and Social Indicators, 2011–16

	2011	2012	2013	2014	2015	2016
				Est.	Proj.	Proj.
Output, prices, and labor market (percent change, unless otherwise indicated)						
Real GDP	2.0	0.5	1.1	1.7	1.2	1.5
Real domestic demand	0.6	2.8	-1.3	2.7	1.3	1.5
Consumer price index (HICP, average)	3.4	2.4	0.4	-1.6	-1.0	0.6
Consumer price index (HICP, end of period)	2.0	2.8	-0.9	-2.0	0.3	0.9
Employment	-2.8	-1.1	-0.2	1.3	0.4	0.5
Unemployment rate (percent of labor force)	11.3	12.4	13.0	11.5	10.9	10.3
Nominal wages (national accounts definition)	8.6	5.6	4.5	3.0	3.0	3.0
General government finances (percent of GDP)						
Revenue	31.2	33.1	34.5	34.3	35.0	34.6
Expenditure	33.1	33.6	36.3	38.0	38.0	37.1
Balance (net lending/borrowing on cash basis)	-1.9	-0.4	-1.8	-3.7	-3.0	-2.5
External financing	0.2	2.6	-0.9	7.2	2.9	2.2
Domestic financing (incl. fiscal reserve)	0.2	-0.8	0.9	2.6	-0.9	0.3
Gross public debt	14.8	17.1	17.6	26.9	28.9	30.7
Money and credit (percent change)						
Broad money (M3)	12.2	8.4	8.9	1.1	3.7	5.4
Domestic private credit	3.8	2.8	0.3	-7.7	1.6	4.1
Interest rates (percent)						
Interbank rate, 3-month SOFIBOR	3.8	2.3	1.1	0.8	...	...
Lending rate	10.6	9.7	9.1	8.3	...	...
Balance of payments (percent of GDP, unless otherwise indicated)						
Current account balance	0.1	-1.1	2.3	0.0	0.2	-0.8
Capital and financial account balance	-1.0	4.4	-2.3	7.1	1.7	5.0
o/w: Foreign direct investment balance	3.0	2.1	2.7	2.4	2.5	2.9
International investment position	-83	-76	-74	-71	-66	-63
o/w: Gross external debt	91	92	91	94	90	89
o/w: Gross official reserves	33	38	35	39	41	44
Exchange rates						
Leva per euro	Currency board peg to euro at lev 1.95583 per euro					
Leva per U.S. dollar (end of period)	1.51	1.48	1.42	1.61	...	...
Real effective exchange rate (percent change)	2.7	-2.0	1.3	-0.5	...	...
Social indicators (reference year in parentheses):						
Per capita GNI (2012): US\$ 7,030; income distribution (Gini index, 2007): 28.2; poverty rate (2011): 21.2 .						
Primary education completion rate (2012): 98.1.						
Births per woman (2012): 1.5; mortality under 5 (per 1,000) (2012): 12.1; life expectancy at birth (2012): 74.3 yrs.						

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

**Statement by Menno Snel, Executive Director for Bulgaria and
Tsvetan Manchev, Advisor to Executive Director
May 4, 2015**

The Bulgarian authorities highly appreciate the constructive policy dialogue with the mission during the 2015 Article IV consultation, and thank staff for their appraisal. They also welcome the staff analyses in the Selected Issues paper. The authorities remain committed to prudent macroeconomic policies which promote sustainable growth, and broadly share the staff's policy advice as presented in the staff report.

The Currency Board Arrangement (CBA) continues to be the cornerstone for domestic policymaking amid the uncertainty. Along with this, the authorities use every window of opportunity to reinforce macroeconomic stability. The Bulgarian National Bank (BNB) took decisive actions to increase bank liquidity and support depositor confidence following the closure of the ailing Corporate Commercial Bank (KTB). In March 2015, Bulgaria successfully issued a €3.1 billion Eurobond which not only covers the 2015 external financing needs, but serves as an additional buffer. In April 2015, a new Law on the Fiscal Council was adopted, which establishes the Fiscal Council to serve as an independent consultative body to the Bulgarian Parliament.

Bulgaria has experienced significant political instability and financial distress since the last Article IV consultation. The minority coalition government elected last fall faces a difficult domestic and external environment. This situation further limits the policy options to preserve macroeconomic and financial stability, rebuild buffers against shocks, and advance with the already delayed structural reforms. With the local elections planned for later this year, every aspect of government activity is placed under deep scrutiny, which could make immediate policy steps even more difficult. A new impetus for structural reforms could only come from improving public confidence in the reform process and further strengthening of the EU fund's utilization.

The new government keeps focusing on social issues, while its near-term plan includes three main pillars: (1) gradual fiscal consolidation and enhanced revenue administration; (2) rebuilding confidence in the financial sector through system-wide legal amendments and institutional enhancements; and (3) structural reforms.

Recent Macroeconomic Developments

The authorities generally share staff's view on the macroeconomic developments and outlook. Since the last Article IV consultation, net export has not contributed positively to economic growth. The recently released 2015 government Spring Forecast has taken into account the published reporting data for 2014, the most recent developments in the external environment, and the more favorable expectations for the domestic economy from the beginning of 2015. The business climate and employment in the main sectors of the economy have slightly improved which has led to an upward revision of 2015 growth by 0.6 percentage points, to 1.4 percent. Driven by domestic demand, in the period 2016–18, growth is expected to gradually speed up and reach 2.3 percent, but it will remain insufficient

for income convergence with the European levels.

The subdued growth in 2015 reflects still cautious recovery of the private sector demand and lower contribution of the public sector. Some improvement in the external environment, expressed in slightly higher growth of the European and world economies, will lead to an increase in the real export of goods and services by 2.8 percent y-o-y, but the contribution of net export to growth will remain negative. The 2015 current account balance, however, will be slightly positive.

The authorities welcome staff's analysis on inflation determinants. They are fully aware that sustained deflation represents an important risk for the economic recovery and public finances given the limitations of the current fiscal stance and lack of independent monetary policy in a small open economy. Against this background, the authorities are committed to exercise tight control over the nominal wages in the public sector in the short term and keep closer alignment of utility tariffs with the cost structure. In line with staff's advice, these measures will be accompanied by enhanced protection of the poor and proactive management of the inflationary expectations to avoid a deflationary spiral.

Fiscal Sustainability

After the parliamentary elections in October 2014, the new parliamentary majority has clearly recognized the need to reduce budget deficits following earlier slippages. However, striking the right balance between the pace of fiscal consolidation and support for economic growth remains a daunting task for the authorities. The new minority government has consolidated around the strategy for gradual fiscal consolidation. Within the recently revised medium-term budgetary framework, the government envisages a nominal reduction of the fiscal deficit on cash basis by 0.5 percent per year until 2018. Respectively, the return to a structurally balanced budget by 2019 would allow the automatic stabilizers to work while the government builds up liquidity buffers in good times and contains debt accumulation.

The 2015 budget fully demonstrates the fiscal responsibility of the new government as well as its commitment to restore confidence in the management of the public finances. The budget envisages a deficit of 3 percent of GDP on cash basis and a reduction in the structural deficit by approximately 0.5 percent, mainly through improving the efficiency of spending. In addition, the budget lays down taut and ambitious reforms in the public finance management, while restraining administrative and operational expenditures. In the first quarter of 2015, the revenue administration has been strengthened, resulting in higher revenues compared with last year. The authorities are also committed to save much of the revenue overperformance.

The recently adopted Law on Fiscal Council stipulates that the members will be accountable to the Parliament, which aims to increase transparency of fiscal indicators and policies. The authorities are fully committed to immediately implement the law in order to get better understanding of fiscal risks and their attribution.

The Banking System

The authorities are fully aware that it is of utmost importance to restore confidence and credibility in the financial system. Since the KTB failure, they have implemented policy measures at various levels to stabilize the banking sector. First and foremost, the goal to avoid a spillover effect has been successfully achieved through the immediate adoption of a state liquidity support framework for the banking sector, in compliance with the EU state aid rules, and smooth repayment of the insured deposits in KTB. Second, the BNB has enhanced oversight over the individual bank liquidity management, and has strengthened liquidity requirements. Third, the CRD IV has been fully implemented to banks, additional capital buffers have been created, and the NPLs are continuously reported in a very conservative manner. In addition to the good provisioning, the banks have strengthened their internal strategies to handle the NPLs with encouraging preliminary results. These measures have supported depositors' confidence and assured system-wide stability.

Going forward, the authorities agree with staff that a clear strategy and additional measures will be needed to restore credibility in the financial system. In August 2014 the authorities requested a full FSAP. Since then, they have coordinated with the IMF on the next steps. An assessment of compliance with the Basle Core Principles for effective banking supervision was recently conducted by the IMF/WB team and the report will be published in the second quarter of 2015. Furthermore, the authorities have just announced in the National Reform Program Update a comprehensive action plan to: (1) finalize the assessment of compliance of the BNB supervisory practices with the Basel Core Principles, (2) establish a framework of the recovery and resolution of credit institutions, and (3) conduct an asset quality review (AQR) and stress test of the entire banking sector. The AQR and stress-test will be based on methodologies fully compliant with those of the European Central Bank and European Banking Authority. The authorities are open to the recommendations and will consider a more systematic approach toward the NPLs reduction, if it fits the country specifics. Given the uncertain low growth environment, the BNB stands ready to sustain and further develop the capacity of the banking system and individual credit institutions to withstand shocks.

Bulgaria remains fully engaged in the financial sector reform at the European level. The new domestic legislation transposing requirements of the EU Directives on Deposit Guarantee Schemes and Recovery and Resolution of Credit Institutions and Investment Firms is in the final stage of preparation and will be adopted by mid-2015. Accordingly, consistent mechanisms to recapitalize the Bulgarian Deposit Insurance Fund and to achieve a reasonable burden sharing will be steadily implemented. The authorities also envisage closer cooperation with the Single Supervisory Mechanism (SSM). At the same time, they mind the asymmetric treatment of non-euro area participants in the SSM because of the absence of liquidity and capital support as well as the lack of voting rights in the Governing Council of the ECB for these members. The preparations to join the SSM, however, will serve as a useful anchor for structural reforms on the road to the euro adoption.

Structural Reforms

The authorities recognize the importance of improving public confidence in the reforms. They are well aware that the near-term challenges should not prevent them from addressing the critical impediments to long-term economic growth. The reform priorities are stipulated in the updated National Reform Program, which will be submitted to the European Commission by the end of April. In 2015, the main focus of the reforms will be to reach a political consensus on the necessary amendments in the Constitution which would open the door to deep reforms in justice and intelligence. One of the priorities of the new government is also a fast development of electronic services of the administration. In addition, amendments to the Law on Access to Public Information will be adopted by June 2015 to increase the transparency of public information and assure full compliance with EU legislation.

Following recent amendments to the Energy Act, the Parliament appointed, last April, a new independent energy regulator. The energy tariff structure is under review. The government has also negotiated a more favorable long-term price with some of the key electricity suppliers, and at the same time has negotiated a schedule for settlement of the existing arrears.

Being aware of the widespread discontent among the population about the perceived unfairness of the existing pension package, last month, the authorities published a pension reform proposal. The proposal aims at reaching an agreement in 2015 on the augmented package to overturn the long-run deficit in the pension system.