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BULGARIA

November 2016

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR BULGARIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2016 Article IV consultation with Bulgaria, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its November 4, 2016 consideration of the staff report that concluded the Article IV consultation with Bulgaria.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 4, 2016, following discussions that ended on September 19, 2016, 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 October 18, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Bulgaria.

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

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November 10, 2016

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IMF Executive Board Concludes 2016 Article IV Consultation with Bulgaria

On November 4, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bulgaria.[1]

The Bulgarian economy has been resilient to multiple shocks in recent years and macroeconomic developments have been encouraging. The economy is expected to grow 3.3 percent this year and around 2.5 percent in the medium term. Deflation has recently showed signs of gradual easing, supported by decelerating energy price declines and a pick-up in food prices.

Fiscal consolidation is advancing faster than anticipated. Driven by administrative revenue measures, stronger economic activity, and under-execution of EU-funded capital spending, the cash fiscal deficit is projected to decline to around 0.7 percent of GDP—or lower—in 2016. Looking ahead, the main threats to the fiscal accounts are posed by poor performance of state-owned enterprises (SOEs), weak finances of subnational governments, and concerns regarding the viability of Pillar 2 private pension funds. Over the long run, the projected aging of, and decline in, Bulgaria's population will likely lead to significant fiscal pressures.

Gaps in banking supervision and resolution are being addressed. In August, the Bulgarian National Bank completed an assessment of the banking system, consisting of an asset quality review (AQR) and stress test. The results showed that most banks were well-capitalized but three banks—the largest domestically-owned bank and two small ones—had to restore the coverage of their capital buffers. One bank has raised needed capital and the other two have submitted plans to achieve the capital target by mid-2017. A Financial Sector Assessment Program is being undertaken by the IMF and the World Bank and will provide a more in-depth assessment of the financial 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.

Adverse investment, population, and productivity developments have weighed on Bulgaria's growth potential since the global financial crisis. With slow convergence, the country's per capita income (on a purchasing power parity basis) remains less than half of the EU average. Persistent concerns regarding the rule of law and corruption add to challenges and undermine the business environment. In addition, many SOEs in infrastructure sectors have become bottlenecks that inhibit growth and productivity.

Executive Board Assessment[2]

Executive Directors noted that the Bulgarian economy has been resilient to shocks in recent years. Macroeconomic developments have been encouraging with output growing at a steady pace, unemployment at its lowest level in seven years, and deflation showing signs of gradual easing. Directors noted that growth is expected to moderate in the medium term and remain below the levels needed to accelerate income convergence to the EU average. While agreeing that risks to the outlook were balanced, they called for continued efforts to safeguard financial stability, raise potential growth, and address long-term fiscal costs of aging and emigration.

Directors welcomed the completion of the asset quality review (AQR) and stress test, and considered it a positive step toward strengthening confidence in the banking sector and the Bulgarian National Bank's (BNB) ability to supervise it. While most banks remained well capitalized after the AQR adjustments, a few domestically-owned banks have capital buffer shortfalls which require prompt action. Directors welcomed the authorities' readiness to attract new bona fide investors in the identified banks and to intervene if these banks are not able to successfully restore capital buffers to the required levels within the announced time frame. At the same time, they noted that the high stock of non-performing loans requires further attention. Directors welcomed recent progress to strengthen the institutional framework for financial system oversight, and encouraged the authorities to continue these reforms and pursue a more risk-based supervisory review and evaluation process. They looked forward to the findings of the FSAP, which is underway and will be finalized in the first half of 2017.

Directors noted that fiscal consolidation is advancing faster than anticipated, and commended the authorities for their successful efforts in strengthening revenue administration. They supported the authorities' plan to save the revenue overperformance for 2016, noting the need to strengthen fiscal buffers to address unanticipated needs that could arise from contingent liabilities. Directors also encouraged the authorities to better utilize EU funds to strengthen public investment. They considered the authorities' medium-term plan to attain fiscal balance appropriate, and stressed that contingent liabilities, from state-owned enterprises and other sources, should be better

[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.

estimated and incorporated in fiscal planning. Over the longer term, there is a need to ensure fiscal sustainability in the face of the projected rise of aging-related spending.

Directors noted that raising Bulgaria’s potential growth will require progress on several structural fronts. Key priorities include mitigating the effects of aging and emigration through active labor market policies and fostering conditions for emigrants to return, stimulating private investment through reducing red-tape and corruption, and improving the competitiveness and governance of state-owned enterprises. Directors also encouraged greater efforts to develop human capital through education and training.

Bulgaria: Selected Economic and Social Indicators, 2012–17						
	2012	2013	2014	2015	2016 Proj.	2017 Proj.
Output, prices, and labor market (percent change, unless otherwise indicated)						
Real GDP	0.0	0.9	1.3	3.6	3.3	2.9
Real domestic demand	2.0	-1.9	2.6	3.5	2.9	3.1
Consumer price index (HICP, average)	2.4	0.4	-1.6	-1.1	-1.3	0.6
Consumer price index (HICP, end of period)	2.8	-0.9	-2.0	-0.9	-0.8	1.4
Employment	-1.1	-0.2	1.3	1.6	0.7	0.7
Unemployment rate (percent of labor force)	12.4	13.0	11.5	9.2	8.2	7.1
Nominal wages	6.6	6.0	6.0	8.8	8.1	7.4
General government finances (percent of GDP)						
Revenue	32.3	33.8	33.7	35.0	34.8	35.7
Expenditure	32.8	35.5	37.3	37.8	35.6	36.8
Balance (net lending/borrowing on cash basis)	-0.4	-1.8	-3.6	-2.8	-0.7	-1.1
External financing	2.5	-0.8	6.9	1.6	4.1	-2.3
Domestic financing	-2.1	2.6	-1.5	-1.0	-3.4	3.5
Gross public debt	16.7	17.2	26.4	25.6	28.7	25.4
Money and credit (percent change)						
Broad money (M3)	8.4	8.9	1.1	8.8	5.6	4.9
Domestic private credit	2.8	0.3	-7.7	-1.6	1.2	6.5
Interest rates (percent)						
Interbank rate, 3-month SOFIBOR	2.3	1.1	0.8	0.5	…	…
Lending rate	9.7	9.1	8.3	7.5	…	…
Balance of payments (percent of GDP, unless otherwise indicated)						
Current account balance	-0.9	1.3	0.1	0.4	1.6	0.5
Capital and financial account balance	1.3	1.1	2.2	3.1	2.3	2.2
o/w: Foreign direct investment balance	-2.5	-3.0	-2.1	-3.5	-3.1	-3.0
International investment position	-78	-73	-75	-60	-54	-50
o/w: Gross external debt	90	88	92	76	78	72
o/w: Gross official reserves	37	34	39	45	47	46
Exchange rates						
Leva per euro	Currency board peg to euro at lev 1.95583 per euro					
Leva per U.S. dollar (end of period)	1.5	1.4	1.6	1.8	…	…
Real effective exchange rate (percent change)	-2.0	1.3	-0.5	-3.2	…	…
Social indicators (reference year in parentheses):						
Per capita GNI (2015): US$ 7,220; income distribution (Gini index, 2012): 36.0; poverty rate (2013): 21.8.						
Primary education completion rate (2013): 98.0.						
Births per woman (2013): 1.5; mortality under 5 (per 1,000) (2013): 11.5; life expectancy at birth (2013): 74.9 yrs.						

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

BULGARIA

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

October 18, 2016

KEY ISSUES

Context. The Bulgarian economy has shown resilience since the last Article IV consultation. Growth over the last 4 quarters exceeded expectations. The authorities took concrete steps to correct the fiscal slippage in 2014 and efforts are underway to strengthen confidence in the health of the financial system. Looking ahead, risks to the outlook are broadly balanced. Downside risks stem mostly from weak external demand, possible regional tension, and reversal in domestic policy reforms.

Key policy issues. The Article IV discussions focused on near-term policy actions to enhance financial stability, medium-term options to raise Bulgaria's growth prospects, and measures to ensure long-term fiscal sustainability.

- ***Financial stability.*** It is essential to follow-up on the recently completed asset quality review and stress test to restore capital buffers of identified banks to required levels, use the information acquired during the banking assessment to pursue a more risk-based supervisory review and evaluation process, and devote adequate resources to more inspections. The upcoming FSAP will provide a more in-depth assessment of the financial sector and help guide future banking supervision and resolution reforms.

- ***Growth prospects.*** Raising Bulgaria's potential growth will require policies to offset the adverse impact from emigration and population-aging; enhance SOE competitiveness and governance; and reduce perceptions of corruption.

- ***Fiscal sustainability.*** The authorities' plans to save recent revenue overperformance are welcome. The risks from contingent liabilities and longer-term fiscal pressures from aging and emigration are significant. Further pension, health, and education reforms will be required to ensure fiscal sustainability in the long term.

Past IMF advice. Many recommendations during the 2015 Article IV consultation have been broadly reflected in Bulgaria's policies. A banking sector assessment was completed in mid-August and fiscal performance this year has been better than expected. There has been less progress in reducing contingent liabilities and structural reforms to boost growth.

Approved By
Philip Gerson (EUR) and Yan Sun (SPR)

Discussions were held in Sofia during September 6–17, 2016. The team comprised Messrs. Baqir (head), Zhan, Böwer (all EUR), Mr. Garrido and Ms. Stetsenko (LEG), Ms. Mineshima (FAD), and Mr. Bayle (MCM), Mr. Hajdenberg (Resident Representative) and Ms. Paliova (Resident Representative Office, Economist). Mses. Chen, Madaraszova, and Mahadewa and Mr. Jovanovic (all EUR) assisted the mission from headquarters. Mr. Manchev (OED) joined some discussions. The mission met with Prime Minister Borissov, Finance Minister Goranov, Bulgarian National Bank Governor Radev, other senior officials, and representatives of labor and business organizations, financial institutions, and civil society.

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CONTEXT

1. **The Bulgarian economy has been resilient to shocks**. Repercussions from the failure of a large domestically-owned bank in 2014 and spillovers on Bulgarian banks from the Greek crisis in 2015 were largely contained and, since then, macroeconomic conditions have been steadily improving. The output gap is narrowing, unemployment continues to decline, and the current account is broadly in line with fundamentals. The fiscal balance improved significantly in 2015 and the outturn through August 2016 points to considerable overperformance in 2016. Public debt, despite a noticeable increase in 2014, is still among the lowest in Europe. Non-financial corporate sector debt remains high, although a significant share consists of inter-company debt.

2. **Nevertheless, there are important challenges: solidifying financial stability, raising potential growth, and addressing the fiscal costs of aging and emigration**. The failure of a large domestically-owned bank in 2014 triggered a number of welcome steps to strengthen the financial sector. Continuing these efforts is essential to strengthen confidence and support growth. While there has been recent economic momentum, Bulgaria's per capita income on a purchasing power parity (PPP) basis remains less than half of the EU-28 average. Estimates of potential growth have fallen since the global financial crisis, reflecting declining investment, diminishing gains in productivity, and especially adverse demographic trends (Appendices I and II). There is an urgent need to improve infrastructure and accelerate structural reforms, especially in the energy sector and state-owned enterprises. Difficult reforms will also be required to protect long-term fiscal sustainability in the face of the projected rise of health and pension related spending pressures.

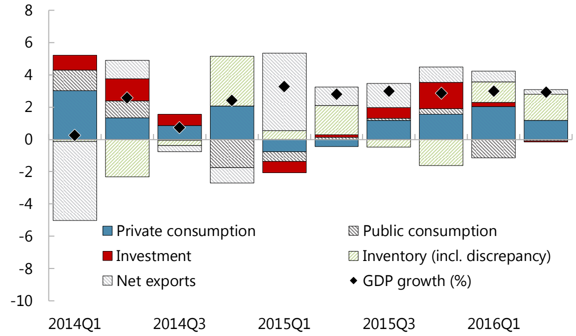
3. **Against this background, this Article IV report focuses on three key areas:**

- ***Financial stability.*** It discusses the recent banking sector assessment (consisting of an asset quality review (AQR) and stress test) and identifies reforms to strengthen the financial system.
- ***Growth prospects.*** It analyzes the key drivers of medium-term growth, including the role played by emigration and state-owned enterprises in key infrastructure sectors.
- ***Long-term fiscal sustainability.*** It assesses recent fiscal developments, the magnitude of long-term demographic-related spending pressures, and discusses options for addressing them.

RECENT ECONOMIC DEVELOPMENTS

4. Economic activity has been buoyant, supported increasingly by domestic demand. Real output grew by 3 percent in 2015, benefiting from stronger-than-expected demand from European markets. Domestic demand picked up in the second half of 2015 on account of improved labor market conditions and the rush to utilize EU funds available under the 2007–13 program period. GDP continued to grow at around 3 percent during the first half of 2016, with private consumption overtaking exports as the main driver of growth, offsetting weakening export growth and a slump in EU-fund related public investment.

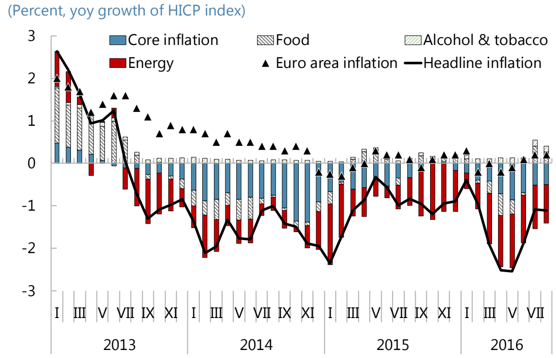
Contributions to Real GDP Growth
(In percentage points unless otherwise noted)



Sources: Haver; and staff calcuations and estimates.

5. Deflation has largely been driven by international commodity prices. Prices have fallen more than in the euro area in recent months as energy and commodity prices have a larger weight in the Bulgarian Harmonized Index of Consumer Prices (HICP) basket than in the euro area. While the major driving forces of deflation are external, some internal factors, including food and communication prices, have also contributed. Most recent data point to a gradual easing of deflation, supported by decelerating energy price declines and a pick-up in food prices.

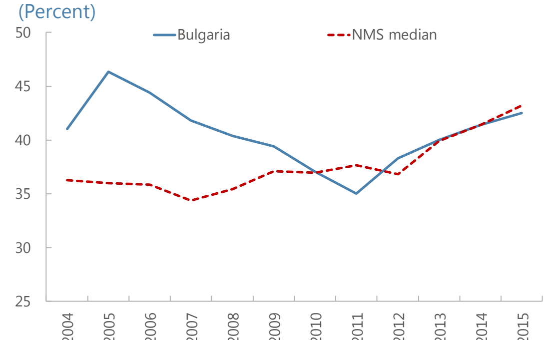
Inflation Contributions
(Percent, yoy growth of HICP index)



Sources: National Statistical Institute, ECB: and IMF staff calculations.

6. The labor market has continued to tighten, with wage pressure increasing. The Labor Force Survey-based unemployment rate declined to 8.2 percent in Q2 2016, reflecting growing employment opportunities and a shrinking labor force. Nominal wages in the private sector rose by around 10 percent in 2015 and by about 8 percent year-on-year during the first half of 2016 on the back of strong private sector labor demand and an increase in the monthly minimum wage of 8.6 percent in 2015 and 13.6 percent in January 2016.[1] Recent trends in the minimum wage and its ratio to the average wage have been in line with those of regional peers.

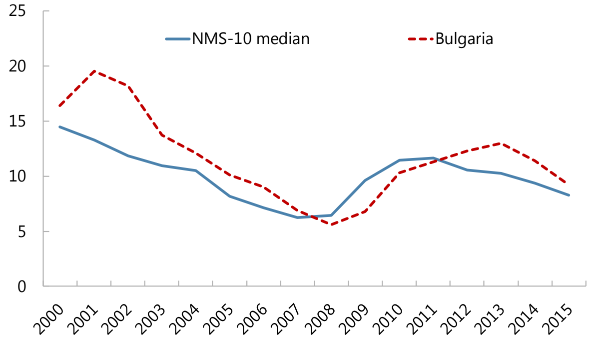
Minimum-to-Average-Wage Ratio
(Percent)



Source: IMF Cross-Country Report on Minimum Wages 16/151.

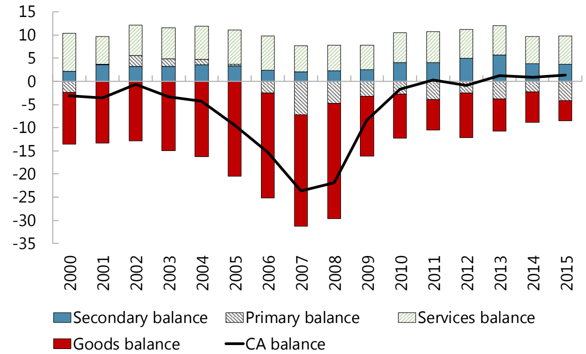
[1] The minimum amounted to €189 on average in 2015, and was increased to €215 in January 2016.

Unemployment Rates
(Percent of labor force)



Source: European Commission. NMS-10 includes Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia.

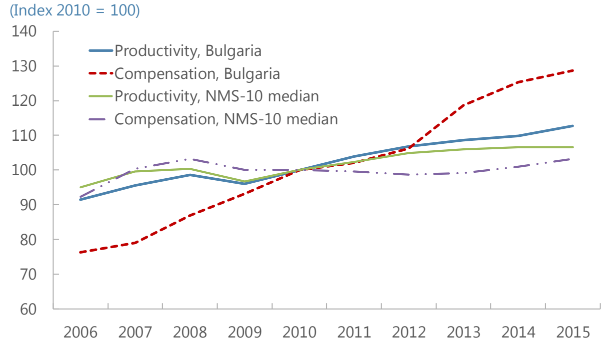
Current Account
(In percent of GDP)



Sources: IMF, WEO.

7. **The external position has continued to strengthen.** The current account registered a surplus of 1.4 percent of GDP in 2015 and stood at 2.8 percent of projected 2016 GDP during January-July 2016. FDI has remained subdued. External debt declined modestly, to about 77 percent of GDP at end-July 2016, reflecting lower liabilities by both public and private debtors. The external sector assessment (Annex I) finds that Bulgaria's exports have remained competitive and the HICP-based real exchange rate has moved in line with that of peers in recent years. Nevertheless, the ULC-based real exchange rate has appreciated faster than in peers reflecting in large part catching-up, as Bulgaria's wage level is still the lowest in the EU. Competitiveness concerns could arise should wages continue to grow faster than productivity. Bulgaria's reserves were 159 percent of the standard IMF metric in 2015, slightly above the 100–150 percent range considered appropriate.

Real Labor Productivity and Real Compensation Per Employee
(Index 2010 = 100)

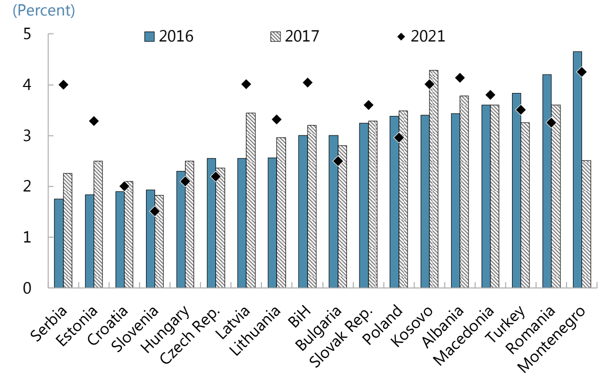


Sources: European Commision; and IMF staff calculations.

OUTLOOK AND RISKS

8. Real GDP growth is projected at 3 percent in 2016 and around 2½ percent in the medium term. Private consumption is expected to remain the major contributor to growth, supported by continued strong labor market developments. In light of the transition to the new programming period for use of EU funds, public investment is expected to contract in 2016. Private investment is expected to recover over the near term. In the medium term, staff projects a constrained growth outlook reflecting slow progress in structural reforms and in turn limited productivity growth; modest investment due to weaknesses in the business environment; and a shrinking labor force due to continued emigration and population aging. This projected medium-term growth is considerably below both the average for Central, Eastern, and Southeastern European (CESEE) countries and what is needed to ensure a desirable pace of convergence.

Real GDP Growth Projections
(Percent)



Sources: IMF, WEO.

9. Risks to the growth outlook are broadly balanced. On the external front, a protracted slowdown in the euro area or in Turkey would adversely affect Bulgaria's export performance. While the direct effects of Brexit on Bulgaria appear limited so far, the indirect effects through the impact on the EU and sustained uncertainty could be more significant. On the domestic front, delays in absorption of EU funds would weigh on growth and contingent liabilities pose a threat to the fiscal position. On the upside, ambitious steps to restart structural reforms and faster recovery in Europe could improve Bulgaria's growth prospects. In particular, strong political will to tackle governance concerns, reduce red-tape and improve the business environment, and enhance SOEs' governance and competitiveness would accelerate income convergence.

Authorities' Views

10. The authorities expected slightly lower growth in the near-term but higher growth in the medium-term. The authorities' most recent projections available at the time of the mission were more conservative than staff's due to lower contributions from consumption and investment. Over the medium-term, the authorities projected slightly higher growth than staff, expecting stronger structural reforms and investment. The authorities agreed that risks were broadly balanced. They highlighted downside risks from potential instability in Turkey, given Bulgaria's relatively large export exposure and geographic proximity.

Bulgaria: Risk Assessment Matrix (as of September 28, 2016)[1] (Scale: high, medium, or low)		
Source of Risk	**Relative Likelihood**	**Impact if Realized**
1. Weak progress in structural reforms to raise productivity and mitigate the impact of emigration and aging (short/medium term).	**High/Medium** Lack of political support delays / reverses the structural reform agenda, including reforms that would reduce medium-term fiscal risks.	**High** Lower potential growth and higher unemployment resulting in slow income convergence and increased fiscal pressures.
2. Inadequate actions to address weaknesses identified by the AQR and stress test (short term).	**Medium/Low** Identified banks are unable to raise high quality private capital and/or undertake measures to strengthen their business model and reduce/mitigate the risks discovered during the AQR and stress test so as to strengthen confidence in the banking system.	**High/Medium** Reduced public confidence in the identified banks; increased vulnerability to unanticipated shocks.
3. Protracted period of slower euro-area growth and deflation (short/ medium-term).	**High/Medium** Direct negative influence through trade and investment channels and negative inflation spillovers.	**High** Lower potential growth, higher unemployment, lower FDI; slower process of fiscal consolidation.
4. Instability in Turkey.	**Medium** Direct negative impact through trade channel and refugee inflow.	**High** Lower exports, employment, and growth; higher social and fiscal pressure from refugee inflow.
5. Protracted uncertainty associated with the timing and negotiating of Brexit arrangements (short/medium-term).	**Medium** Spill-over effects of euro area growth slowdown via heightened uncertainty, reduced export demand, and investment growth.	**Medium** Reduced growth outlook.
6. Significant slowdown in large EMs (short/medium-term).	**Medium** Adverse effects through trade and investment channels.	**Medium** Lower exports, employment, FDI, and growth; slower process of fiscal consolidation.

[1]The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The 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. Non-mutually exclusive risks may interact and materialize jointly.

POLICY DISCUSSIONS

A. Financial Sector

11. Following a large bank (KTB) failure in 2014, the authorities have taken welcome steps to strengthen supervision and confidence in the banking system.[2] First, to strengthen bank supervision and resolution, the authorities undertook the Basel Core Principle (BCP) and the International Association of Deposit Insurers (IADI) assessments and are implementing a detailed reform plan to follow-up on their recommendations (Appendix III).[3] In this regard, a law was passed in Parliament to expand the Bulgarian National Bank's (BNB) powers for imposing supervisory measures, including dismissing senior management and replacing bank auditors. Second, to reduce uncertainty and enhance transparency, the authorities have recently concluded an AQR and stress test of the banking system (Appendix IV). Third, the authorities have taken steps to strengthen crisis resolution management and rebuild the banking system's safety net. The transposition of the European Bank Recovery and Resolution Directive (BRRD) into Bulgarian law has been a major step forward in this respect but significant work remains for its effective implementation. Another important step was the replenishment of the Bulgarian Deposit Insurance Fund (BDIF), which had been depleted by the 2014 KTB failure. In the first half of 2016, the BDIF secured two government-guaranteed loans from the WB and EBRD of €300 million each to shore up its financial capacity. Finally, the authorities have requested an FSAP, which is expected to be completed in the first half of 2017 and should provide guidance for further reforms.

12. The authorities' efforts to strengthen the banking system will support growth and help boost the provision of credit to businesses and households. Private sector credit growth has remained tepid since the global financial crisis, although in a large part reflecting weak credit demand with high capital adequacy and high liquidity for most banks. Access to financing is ranked number one among the concerns for business in Bulgaria, based on the World Economic Forum's (WEF's) Global Competitiveness Report. While this is a constraint facing all business, it is more binding in the case of innovation and for SMEs in particular.[4] In this context, weaknesses in the legal and institutional framework for debt resolution and restructuring constitute important constraints in improving the lending and investment environment. To better target these obstacles the authorities are interested in setting up a system allowing continuous assessment and monitoring of the developments in the debt resolution processes, with a focus on insolvency.[5] Asset prices have stayed broadly stable over the last year. The pressure from a confluence of macro-financial factors continued to abate, benefiting from improved growth outlook, the strengthened fiscal position,

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[2] The failure of Corporate Commercial Bank (KTB) was discussed in Appendix VI of the 2015 Article IV consultation staff report.

[3] Plan for Reform and Development of Banking Supervision, adopted by the BNB in 2015.

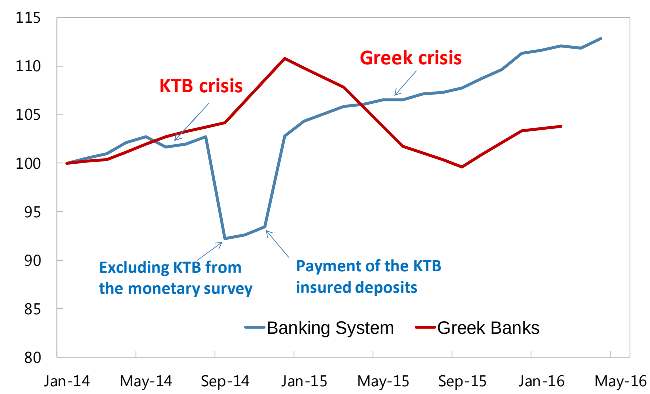
[4] World Bank (2015), "Productivity in Bulgaria. Trends and Options."

[5] See the Selected Issues Paper of "Assessing the Efficiency of the Insolvency and Enforcement System in Bulgaria."

deleveraging external borrowing, a clearer picture about the banking system health (see para. 14), and improvements in the bank supervision framework.

13. The banking system came under stress in 2015 due to spillovers from Greece but the authorities successfully managed the episode and the system remained stable.[6] Overall, the impact was largely contained, with a smooth redistribution of about 3 percent of the system's deposits from Greek-affiliated banks to other banks. The authorities' crisis management measures focused on close monitoring and ex ante steps to forestall spillover channels. They included daily reporting of liquidity and deposits, higher liquidity requirements (30 percent) for Greek affiliate banks, a requirement to reduce cross exposures between parent banks and affiliates, and prohibition of dividend distribution and repayment of subordinated debt. The successful sale of Alpha Bank's branches in Bulgaria to Eurobank's Bulgarian subsidiary in March 2016 further enhanced the BNB's leverage in the event of an adverse shock.

Household Deposits
(January 2014=100)



Sources: BNB; Haver; and IMF staff calculation.

14. The recently completed assessment of the banking system provided needed transparency. The results showed that most of the system remains well-capitalized after the AQR adjustments, particularly the foreign-owned banks, which represent 76 percent of total system assets. In aggregate terms, the AQR adjustments amounted to 1.3 percent of risk-weighted assets, to be reflected in the banks' end-2016 financial statements. Nevertheless, there were significant differences in the results across banks. First Investment Bank (FIB), the largest domestic bank (with about 10 percent of the banking system assets and a history of problems) and two small banks were found to have shortfalls against capital buffers required by the BNB (Appendix IV). Additional buffers may also be needed to cover Pillar II capital requirements that may arise from extrapolating the AQR findings and from an assessment of banks' risk profiles highlighted by the Stress Test (ST).

15. Bank recovery strategies should seek to decisively restore credibility in the identified banks. One of the small banks has already raised capital, and the other two banks are pursuing private sector solutions to restore their capital buffers by mid-2017. Sourcing equity from new bona fide investors would help improve credibility and address governance concerns, especially for FIB, which has had protracted connected-lending issues. The BNB will need to be confident that new capital—whether from external or domestic sources—does not rely on borrowed funds. It would

[6] As of mid-2014, Greek affiliates accounted for 24 percent of assets and 22 percent of deposits of the banking system.

also be important to comply with the stipulated timeline and for the authorities to be ready to intervene if the banks are not able to restore capital buffers to required levels.[7]

16. The authorities need to persevere in their efforts to strengthen the banking system. While a new governance structure at the BNB has been put in place (Appendix III), efforts are still needed in other areas indicated by the IADI and BCP recommendations. The ongoing reforms would usefully be informed by the findings of the FSAP expected in the first half of 2017, but already identified areas for reform are as follows:

- **Asset quality.** The NPL ratio in Bulgaria rose after the global financial crisis and has remained broadly stable in recent years.[8] As of 2016Q1 it stood at 14½ percent (EBA definition), which is more than double the EU average.[9] The AQR has helped to properly identify NPLs and to ensure that banks set aside appropriate provisions against expected losses, which, together with improving public confidence, should help to foster credit growth going forward. Nevertheless, there is a need to strengthen efforts to reduce NPLs, particularly for banks with lower capital ratios. High NPLs could constrain credit provision by such banks and, more generally, pose a threat to banking stability in an adverse scenario. To reduce NPLs, the authorities should take proactive measures to promote effective write-offs within a reasonable time frame. For example, they could require explicit operational targets for banks to engage borrowers in loan restructuring discussions. Further steps are also needed to remove impediments to releasing collateral associated with NPLs, including judicial bottlenecks and the lack of out-of-court workout mechanisms. Reduced concerns about loan and collateral valuation following the AQR should help deepen the market for distressed debt.

- **Bank governance.** Important deficiencies in bank governance have yet to be addressed. They include the need to strengthen the regulatory requirements for transparency of groups' operational and ownership structures (including through stricter rules on the definition and monitoring of banks' ultimate beneficial owners and related parties), and to upgrade the Boards' governance and its involvement in setting the risk appetite framework.

- **Bank supervision.** There is a need to enhance risk-based supervision in the BNB. The recent BCP assessment report pointed out that while the methodologies for the analysis and assessment are sound, the actual implementation is undercut by the scarcity of resources. To bridge this gap significant efforts would be required in terms of organization, staffing, processes and guidelines, in addition to further legislative and regulatory amendments. Particular emphasis needs to be put on implementation of the Supervisory Review and Evaluation Process, building on the information collected through the AQR and ST about the banks' risk profile. It

[7] At this stage, neither bank resolution nor public support is envisaged.

[8] The increase in the ratio between 2014Q4 and 2015Q1 is in large part due to the adoption of a stricter definition in accordance with EU standards starting from 2015.

[9] This ratio increases to about 20 percent if loans to financial sectors are excluded, consistent with the Bulgarian reporting standards to the IMF FSI database.

would also be important for the BNB to announce a comprehensive set of indicators for early intervention in banks.

- **Financial safety net.** The BDIF's net asset position remains negative (-1.5 percent of GDP as of July 2016). Given current bank contributions (0.3 percent of GDP each year), it will be years before it can fully repay its debt and reach the targeted funding level of 1 percent of the total amount of covered deposits with banks. The recently-created Bank Resolution Fund started to collect fees from banks in late 2015. To backstop confidence on the banking system, the authorities should consider speeding up the progress in moving towards the targeted coverage ratios, and keep those ratios under periodic reviews against potential needs.

17. Ongoing reviews of the private pension funds and insurance companies will shed light for the first time on this relatively small but increasingly important sector. Concerns about the sector have persisted, including about related party transactions, the quality of supervision, and the adequacy of supervisory resources. The reviews of pension funds' assets and insurance companies' balance sheets, overseen by the Financial Supervisory Commission with a newly appointed head, are expected to be completed by year-end.

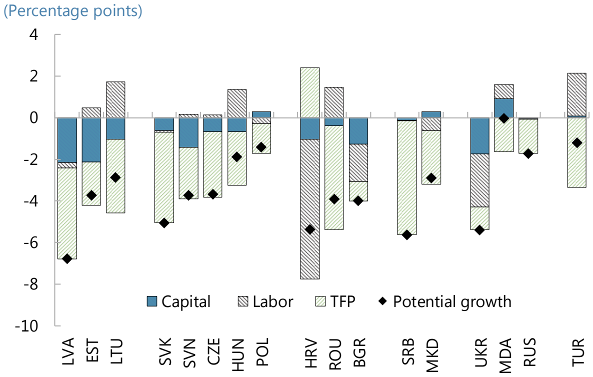
Authorities' views

18. The authorities stressed their commitment to address issues identified by the AQR and ST in the banking sector. They plan to use the information collected during the assessment process to upgrade banking supervision capacity. The authorities are in the process of developing a new plan on reforms and development of banking supervision and resolution. They plan to wait for the recommendations from the upcoming FSAP before finalizing their reform plan.

B. Structural Reforms

19. Adverse investment, population, and productivity developments have weighed on Bulgaria's growth potential. Bulgaria's pre-global crisis boost in growth was driven by favorable capital, labor and productivity dynamics. Since the late 2000s investment has slumped, labor contributions turned negative, and productivity growth came to a virtual standstill (Appendix I). The fall in potential growth is in line with that of many other countries in the region although in Bulgaria's case the potential growth decline was driven by all three factors—labor, capital and total factor productivity—with labor accounting for the largest share.

Potential Growth, Change over 2013-15 vs. 2002-08
(Percentage points)

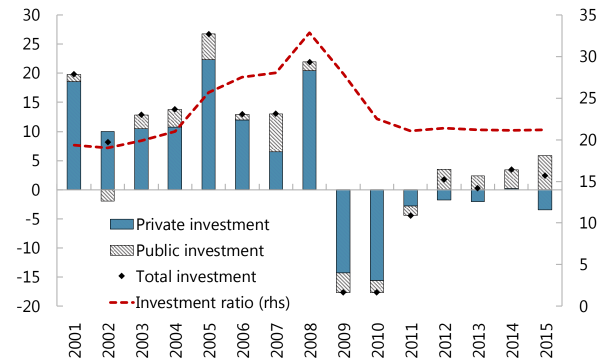


Source: IMF Regional Economic Issues, CESEE, May 2016.

20. Private investment has been subdued for the last five years, notwithstanding a pick-up in public investment supported by EU funds. After the investment boom associated with EU accession in 2007 and supported by foreign capital inflows prior to the financial crisis, private investment contracted sharply on account of a slump in FDI (Appendix I). There remain important constraints to private investment, including red-tape, inefficiency in the provision of public services, and a shortage of skilled labor. Public investment has been growing since 2012, supported by EU funds. The overall investment share has remained largely flat at around 21 percent of GDP since 2011, falling short of the level of around 25 percent typically considered necessary for a catching-up economy.[10]

Real Growth of Investment and Investment Share

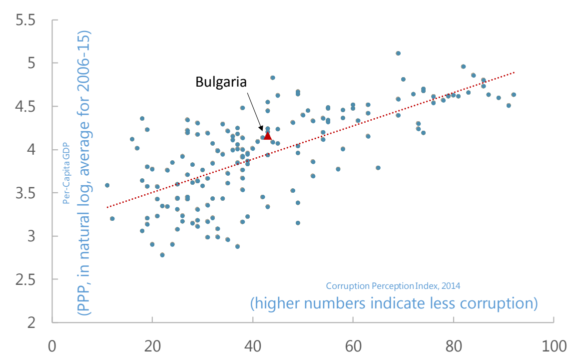
(Percentage; investment ratio in percent of GDP)



Sources: National Institute of Statistics; IMF staff calculations.

21. Persistent concerns regarding the rule of law and corruption add to business environment challenges and undermine confidence in the macro-financial system. Corruption is an important business obstacle.[11] Empirically, higher levels of corruption have been shown to be associated with lower per-capita GDP. Corruption weakens the state's capacity to perform its core functions and affects growth via increased cost of investment, limited build-up of human capital, and productivity-hampering rent-seeking.[12] While the EU's 2016 Cooperation and Verification Mechanism report acknowledged that some steps in judicial reform and the fight against corruption had been taken, important challenges remain.

Corruption and Per-Capita GDP



Sources: Transparency International, WEO; and IMF staff calculations.

22. Emigration has led to a declining working age population and lower productivity. Bulgaria's population has declined significantly during recent decades, reflecting emigration and aging developments. Country-specific push factors coupled with overall pull factors have induced large migration waves from Bulgaria to Western EU countries. Emigration, notably of the skilled

[10] Spence, M. (2008), "The Growth Report Strategies for Sustained Growth and Inclusive Development", World Bank.

[11] See World Bank Governance Indicators, WEF Global Competitiveness Indicators, Transparency International, EU Eurobarometer, and German Chamber of Commerce in Bulgaria.

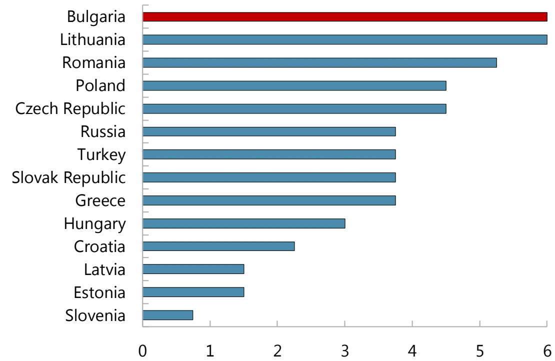
[12] IMF (2016), "Corruption: Costs and Mitigating Strategies", IMF Staff Discussion Note 16/05.

labor force, has weighed on labor productivity and GDP growth via lower investment and consumption as well as higher wages and taxes.[13]

23. Staff analysis shows that many SOEs in infrastructure sectors have become bottlenecks that inhibit higher growth and productivity. Several SOEs, notably in the energy and transport sectors, are loss-making and have accumulated significant debts, accounting for fiscal contingent liabilities of about 14 percent of GDP in 2014. In addition, SOEs tend to be less profitable and less efficient in their allocation of capital and labor resources than their private peers.[14] Ineffective SOE governance, political interference, and poor output quality, notably in the electricity sector, weigh on competitiveness and investment.

Restrictiveness of SOE Governance

(Index 0-6; higher denotes more restrictive)



Source: OECD Product Market Indicators 2013.

24. Decisive structural reform efforts are needed to support short-term growth and to boost Bulgaria's medium-term growth potential. Specifically,

- **Improving the conditions for investment would help both short-term growth and medium-term potential.** The Bulgarian authorities have been working on an action plan to raise investment. Their plans include improving infrastructure, removing regulatory bottlenecks for investment, strengthening vocational educational quality and skill development to improve the employability of workers, and enhancing the consistency and efficiency of administrative procedures. Swift implementation will be key to achieve tangible effects on the investment climate in Bulgaria.
- **Ensuring a smooth transition to the new programming period will enable Bulgaria to reap maximum growth benefits from EU-funded public investment in the near and medium terms.** It will be important to ensure timely implementation of the laws on EU funds and on public procurement, including enhanced ex-ante control and e-procurement procedures. Training programs to build capacity at the municipal level will help improve EU fund absorption.
- **Fighting corruption and adopting a comprehensive judiciary overhaul would provide better conditions for investment and productivity growth.** In particular, the authorities should adopt a comprehensive anti-corruption law, free of amendments that compromise its effectiveness, and establish a single agency with adequate powers and independence, consolidating the anti-corruption work currently being performed in an uncoordinated manner. Stepped-up efforts are also needed to establish a track record of successful

[13] Atoyan et al. (2016), "Emigration and Its Economic Impact on Eastern Europe", IMF Staff Discussion Note 16/07.

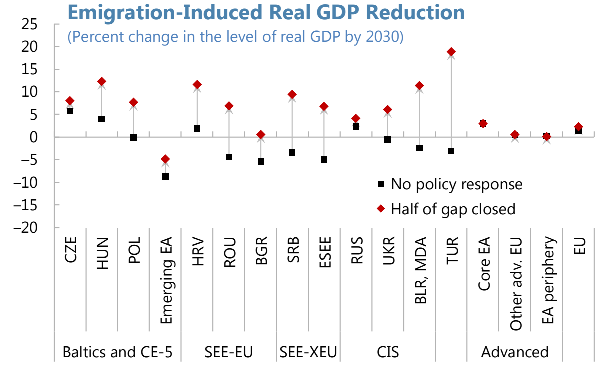
[14] See the Selected Issues Paper of "Bulgaria: State-owned Enterprises in Regional Perspective."

investigations and prosecutions of alleged high-level corruption. In this regard, BNB's efforts to ensure that banks apply specific due diligence measures on accounts related to politically exposed persons are welcome and should be strengthened, notably to ensure that the source of wealth is established, when appropriate.

- **The impact of emigration on potential growth calls for active labor market policies and institutional reforms.** Recent IMF analysis shows that targeted labor market policies can mitigate effects of emigration.[15] Closing half of the gap of labor participation rates between Bulgaria and the EU frontier has the potential to fully offset the harmful effects of emigration on future growth. Active labor market policies can be made more effective by enhancing awareness among potential participants, improving cooperation between employers and social authorities, and better targeting training and education to reduce skill mismatch. Such measures can raise labor participation, as the number of participants in active labor market policy programs relative to the population of long-term unemployed individuals is among the lowest in the EU.[16] Moreover, upgrading Bulgaria's institutional environment and creating opportunities for reintegration—for example by accelerating recognition of foreign qualifications and deregulating service-sector professions—would promote return migration.

Impact of Increasing Labor Force Participation on Emigration-Induced Real GDP Reduction

(Percent change in the level of real GDP by 2030)



Source: Atoyan et al. (2016), IMF Staff Discussion Note 16/07.

Notes: Results are based on simulations in a semi-structural general equilibrium model using UN migration projections. Black squares denote the estimated GDP impact on real GDP by 2030 (percentage change in the level). Red diamonds indicate the impact on GDP by 2030 if half the labor force participation gap via-à-vis the EU frontier were to be closed.

- **Enhancing the governance and performance of state-owned enterprises would help reduce contingent liabilities and improve productivity.** Bulgaria would benefit from a comprehensive SOE governance reform, oriented at international best practices as formulated by the OECD. Specifically, defining the scope and mandate of SOEs, ensuring effective oversight of their financial performance and fiscal risks in a dedicated unit in government, establishing clear performance targets and evaluation tools for SOEs, as well as professionalizing SOE boards would significantly improve the coherence and effectiveness of SOE governance.[14] Moreover, deregulation, opening up for foreign investors, and enhancing competition in SOE-dominated industries, in particular the energy sector, have been shown to strengthen productivity across all service-dependent sectors of the economy.[17] These

[15] Atoyan et al. (2016), "Emigration and Its Economic Impact on Eastern Europe", IMF Staff Discussion Note 16/07.

[16] European Commission (2016), "Active Labor Market Policies", European Semester Thematic Fiche.

[17] World Bank (2015), "Productivity in Bulgaria. Trends and Options."

measures, combined with a strategy to reduce contingent liabilities, would help enhance SOE performance, lower fiscal risks, and support productivity and growth in the economy.

Authorities' views

25. The authorities broadly agreed with staff recommendations. They stressed their commitment to improve the business environment by implementing their action plan for attracting private investment. Regarding public investment, they intended to further improve EU funds absorption during this programming period, and noted ongoing efforts to improve administrative capacity. The authorities also reiterated their commitment to advance the anti-corruption agenda. Emigration was acknowledged as a key economic challenge and the authorities noted that they are pursuing some active labor market policies to improve labor force participation. The authorities are considering legislation to better monitor SOEs' financial performance and fiscal risks, and expressed interest in Fund advice in this area.

C. Fiscal Policy

26. Fiscal consolidation is proceeding faster than expected. The cash deficit declined to 2.9 percent of GDP in 2015, driven largely by administrative revenue measures and higher-than-expected growth. This represented an adjustment of about ½ percent of GDP in structural terms and partially reversed the slippage in 2014.[18] In 2016, the outturn through August showed significant overperformance relative to the budget, reflecting increases in excise rates, sustained administrative measures (Appendix V), faster-than-expected growth, and under-execution of EU-funded capital spending at the beginning of a new program period.

27. The recent revenue overperformance should be saved. In 2016, tax revenue is projected to outperform the budget target by ¾ percent of GDP. Saving this gain is appropriate given the need to strengthen fiscal buffers to address any unanticipated needs that could arise from contingent liabilities in the energy, financial, and other sectors. It is also supported from a cyclical perspective—as recent consumption growth has been above trend. Assuming the revenue overperformance is saved and EU-funds spending accelerated, the cash deficit for 2016 is projected to decline to 0.8 percent of GDP, significantly below the budget target of 2 percent of GDP.[19]

28. The authorities' medium-term plans appropriately target cash fiscal balance by 2020. The cash deficit is projected to widen to 1.2 percent of GDP in 2017 as some delayed EU-funded capital spending is expected to be executed in 2017; the deficit should fall on an accrual basis.[20] The

[18] The 2014 cash deficit was 3.6 percent of GDP, compared to the original target of 1.8 percent of GDP. In the structural terms, the deficit declined from 2.8 percent of GDP in 2014 to 2.2 percent of GDP in 2015.

[19] The headline deficit, but not the structural deficit, could be higher if a recently approved government loan is reclassified from being below the line to above the line; see para. 33 for further information.

[20] EU-funded projects are 85 percent financed by EU grants and 15 percent by national co-financing. The timing difference between EU fund-related spending and its reimbursement affects fiscal balances on a cash basis, but not on an accrual basis.

deficit, then, is expected to gradually decline to zero by 2020, as required by the Public Finance Act.[21] Adhering to the authorities' consolidation plan and maintaining a structural balanced budget thereafter will help reduce government debt gradually to below 25 percent of GDP. Keeping public debt low is especially important in the context of Bulgaria's currency board arrangement.

29. The authorities' medium-term consolidation plans are based on a combination of expenditure restraint and revenue measures. The authorities plan to reduce government's personal expenses by 10 percent and limit spending on goods and services. To ensure efficiency gains, it is important that the cut in personal expenses be supported by measures to enhance efficiency in the provision of public services as laid out in the Development Strategy of the State Administration 2015–2020.[22] On the revenue side, the authorities plan to raise excises and social security contribution rates in 2017–18. If the envisaged expenditure savings do not materialize, the authorities could consider additional growth friendly tax measures, for instance raising the property tax.

30. There are significant long-term fiscal pressures associated with demographic trends.[23] Bulgaria's current pension system comprises three pillars: a defined benefit pay-as-you-go scheme with annual deficits of around 5½ percent of GDP (Pillar 1), a mandatory defined contribution private pension scheme (Pillar 2), and a voluntary defined contribution private pension scheme (Pillar 3). A shrinking and aging population will have fiscal implications through its effects on economic activity, and on health and Pillar 1 pension spending. To mitigate pension spending pressures, Bulgaria implemented parametric reforms to the Pillar 1 system in 2015 (Appendix VI). These reforms would help reduce Pillar 1 annual deficits moderately in the next decade. However, long-term fiscal sustainability concerns remain. First, over a longer time horizon (i.e., through 2100) there could be a significant increase in pension and health related spending.[24] Second, due to public concerns about the performance of the Pillar 2 system, the 2015 reforms introduced an unorthodox option to allow unlimited shifts of balances between Pillar 1 and 2 and reduced Pillar 2 fees. Sustainability would be undermined if concerns about the viability of private pension funds were to lead to large shifts to Pillar 1.

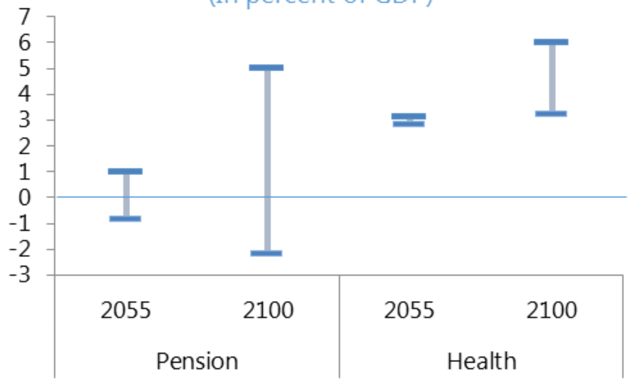
[21] The Public Finance Act sets the target for the general government sector (in the national definition) as the attainment and/or maintenance of a zero or positive balance (Article 25). The Act also determines that the general government deficit in the European System of Accounts (ESA) 2010 basis shall not exceed 3 percent of GDP. The main difference between the national and ESA definitions include the accounting basis (i.e., the former is on a cash basis while the latter on an accrual basis) and coverage (e.g., the former excludes the BDIF while the latter includes it).

[22] For example, direct subsidies for farmers are sizable at 1.6 percent of GDP in 2016. However, several different farmer support instruments are not aligned to the social and macroeconomic goals, suggesting a scope for efficiency gains. Studies also suggest the inefficiencies of social protection spending (IMF, 2014).

[23] See the Selected Issues Paper of "Fiscal Implications of Demographic Changes in Bulgaria."

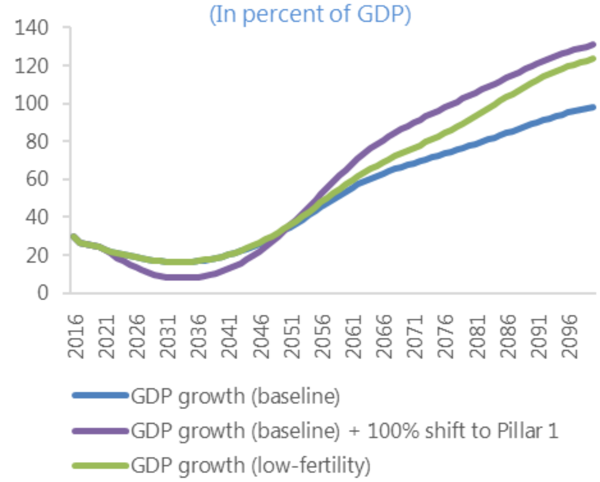
[24] Age related spending is sensitive to demographic projections which are subject to significant uncertainties.

Bulgaria: Additional Age-Related Spending1/
(In percent of GDP)



1/ The ranges show additional annual pension- or health-related spending in 2055 or 2100 to the 2015 actual pension- or health-related spending under four demographic scenarios (see SIP for more details).
Sources: UN 2015, IMF staff estimates.

Bulgaria: Long-Term Government Debt Projections
(In percent of GDP)

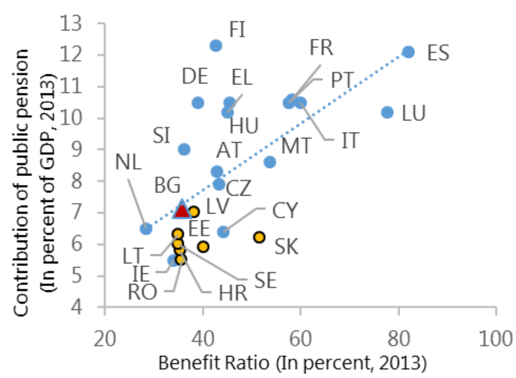


Sources: NSSI, UN 2015, IMF staff estimates

31. Addressing long-term spending pressures will require further pension reforms. Further parametric reforms—raising the social security contribution rate and/or statutory retirement age—would be needed in the long term to support the sustainability of public pension system. Changes to each parameter, however, have different macroeconomic and social implications and careful consideration should be given when deciding between them. In addition, reducing incentives for shifting to Pillar 2 through improving Pillar 2 performance will also help mitigate spending pressures from the public pension system

- **Raise the social security contribution rate.** Similar to other European countries with a mandatory private pension scheme, Bulgaria's public pension system has relatively low contribution collections and income replacement rates. To enhance the sustainability of the public pension system while preventing an increase in old-age poverty, the social contribution rates could be raised further while paying attention to potential impact on competitiveness.

Public Pension Contribution and Benefit Ratio



Note: Those in yellow, including Bulgaria, have a mandatory private pension scheme.
Source: 2015 EU Ageing Report

- **Increase the statutory retirement ages.** Bulgaria's statutory retirement ages for men and women are expected to remain below the EU medians even after reaching 65 years by 2029 for men and by 2037 for women. The 2015 pension reforms introduced an automatic link between the statutory retirement ages and life expectancy once the statutory retirement ages reach 65 years. To de-politicize further reforms, the modalities of adjusting the retirement ages need to be fleshed out. Raising the retirement age, however, should be accompanied by measures—such as active labor market policies or wage subsidies—to facilitate old-age employment. In addition, the government should be alert that increasing the retirement age could disproportionately affect low-income workers given their shorter life expectancy, thereby reducing the progressivity of the public pension system.

- **Revamp Pillar 2 and 3 private pension schemes depending on the results of the asset quality review.** Sound defined-contribution pension schemes would help reduce old-age poverty while minimizing the risks to public finance. The ongoing review of private pension funds' assets is expected to help identify the weaknesses of the system, including investment in related companies.

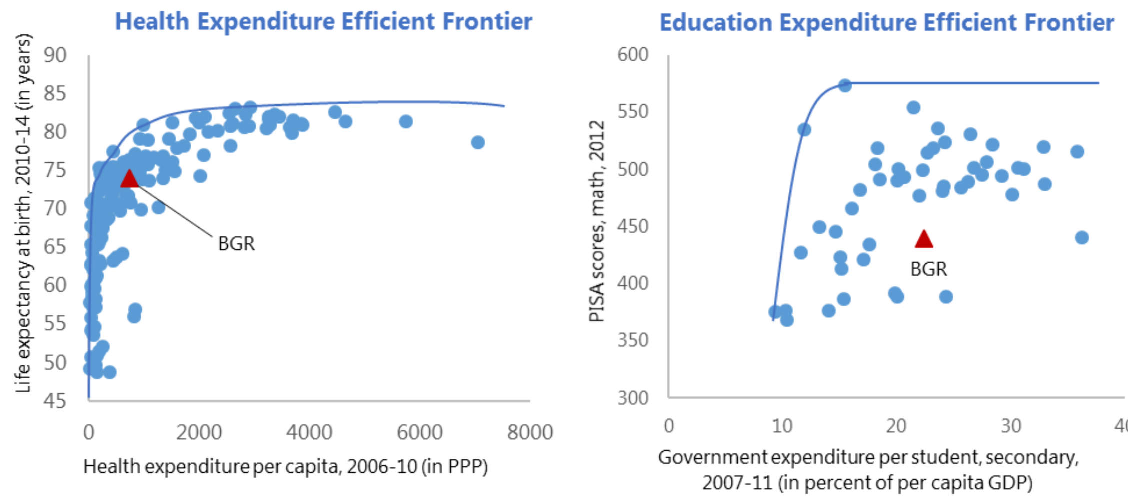
32. Structural reforms can help achieve fiscal sustainability while enhancing long-term growth. Bulgaria's spending efficiency on education, health, and public investment lags that of its peers, suggesting ample scope for efficiency gains.

- **Health.** Measures to address Bulgaria's low use of preventive measures and outpatient services and overuse of inpatient care could improve the health outcomes. In addition, recent measures to address the over-supply of hospitals treating a low number of patients and contain pharmaceutical pricing would help. Demand for long-term care (LTC) services is bound to increase strongly with aging. Providing high-quality LTC services while ensuring financial sustainability requires a legislative amendment to enhance synergy between the social services system and health care system.

- **Education.** Labor productivity could be enhanced by modernizing vocational education and encouraging adult participation in lifelong learning. In addition, education could be improved by integrating vulnerable groups as envisaged in the Strategy for Educational Integration of Children from Ethnic Minorities, 2015–2020.

- **Public investment.** To enhance the productivity of public investment, the appraisal, selection, and approval of investment projects needs to be made more rigorous and transparent. In this regard, enhancing the capacity for assessing economic and social evaluation of project proposals beyond engineering analysis would help. Strengthening procurement practices—such as greater transparency, faster procurement, and more competition—would also help improve public investment.[25]

[25] The 2011 CVM report found a general irregularity rate of 60 percent among all verified tenders related to EU funds and irregularity in almost 100 percent of large public infrastructure projects where the authorities had an obligation for ex-ante control. The 2016 CVM report also indicated that compared with other EU member states, the European Anti-Fraud Office has a relatively high number of ongoing investigations with Bulgaria related to EU funds. These cases are mainly related to possible corruption, irregularities, and fraud with public procurement carried out by municipal authorities. The recently-enacted Public Procurement Act is expected to help reduce public procurement deficiencies.



33. There are sizeable fiscal contingent liabilities which the authorities need to monitor closely and reflect in fiscal planning.

- **SOEs:** The weak performance of several SOEs, including NEK and the Bulgarian State Railways (BDZ), has prompted concerns about rising contingent liabilities (see also paragraph 23). Given potentially substantial fiscal risks from SOEs, the MOF should be given a more prominent oversight role. A case in point is the recent ruling by the International Court of Arbitration, ordering Bulgaria's state-owned National Electricity Company (NEK) to pay Russia's Atomstroyexport for equipment already produced for the cancelled Belene nuclear power plant project (Appendix VII). Parliament recently approved an interest free loan to help NEK to clear this obligation. Based on available information this loan is treated below the line. If NEK's repayment capacity is considered insufficient, it would be treated above the line as an expense and could increase the 2016 deficit by 1.4 percent of GDP. [26]

- **Subnational governments:** Municipalities in Bulgaria have many autonomous powers, including debt financing albeit within limits. Such autonomy often creates tension with the MOF's mandate on fiscal policy. To address the financial problems in a number of municipalities, the government has recently amended the Public Finance Act, giving municipalities access to interest-free loans, on the condition that municipalities adopt MOF approved financial recovery plans and comply with the criteria stimulated in the amended Public Finance Act. [27]

[26] The implementation of the law is conditional to the EC's positive decision, which is yet to be issued.

[27] According to the MOF, more than a half of Bulgaria's 265 municipalities now have overdue loans, and in some cases the late payments account for over 90 percent of their budgets. The financial problems of the municipalities tend to be linked to the absorption of the European programs: the local authorities have to fund the EU regional development projects that they manage in advance and await recovery of their investments, which creates holes in their budgets.

- **Large shifts from Pillar 2 to Pillar 1.** Short-term budget implications of such shifts are likely positive as the increases in social security contribution would outpace the increases in pension payments, but the long-term adverse implications on the budget could be sizable.

Authorities' views

34. The authorities plan to save the revenue overperformance in 2016 and confirmed their plans for continued fiscal consolidation to attain fiscal balance by 2020. They saw a possibility of ending 2016 with a deficit under 0.8 percent of GDP given difficulties in accelerating EU-funds absorption. Regarding recent strong revenue collection, the authorities highlighted the concerted efforts being led by the Prime Minister to reduce smuggling, improve tax compliance and combat the shadow economy under a single national strategy for 2015–17.[28] The authorities agreed that while the 2015 reforms were a step in a right direction, additional parametric reforms will be needed in the long term to fully address the sustainability concerns of the public pension system. They also noted that these administrative measures would be sustained. Regarding pensions, the authorities stressed that the ultimate risks related to the shifts from Pillar 2 to Pillar 1 systems came from public concerns regarding the viability of private pension funds. If such risks materialized, the government would be compelled to help pensioners because participation in the Pillar 2 private pension system was obligatory until the 2015 reforms.

STAFF APPRAISAL

35. The Bulgarian economy has shown resilience to shocks. The economy withstood well the failure of the fourth largest bank in 2014 and negative spillovers from Greece in 2015. Output is growing at a steady pace, unemployment is at its lowest level in seven years, and the external current account has remained in surplus. The fiscal balance improved significantly in 2015 and the outturn so far points to a considerable revenue overperformance in 2016. Government debt, despite a noticeable increase in 2014, is among the lowest in Europe.

36. The completion of the AQR and the stress test is a welcome step towards strengthening confidence in the banking sector and the BNB's ability to supervise it. It is essential that identified banks restore capital buffers to required levels promptly. Participation of new bona fide investors would help improve credibility and governance. If the two identified banks are not able to successfully bring capital buffers to required levels within the announced time frame, it would be important for the authorities to intervene promptly.

37. Recent reforms to strengthen the institutional framework for financial system oversight are welcome and should continue. The central bank should use the information acquired as part of the AQR and stress test to pursue a more risk-based supervisory review and

[28] Single National Strategy for Improving the Tax Collection, Tackling The Shadow Economy and Reducing the Compliance Costs, 2015–17.

evaluation process, with adequate resources secured to facilitate more inspections. Following the Basel Core Principles assessment, there is a need to tighten the legal framework pertaining to ultimate beneficial owners and related party lending, and for the BNB to announce a comprehensive set of indicators for early intervention in banks. The upcoming FSAP will provide a more in-depth assessment of the financial sector and its findings would help guide future reforms including for supervision of non-banks.

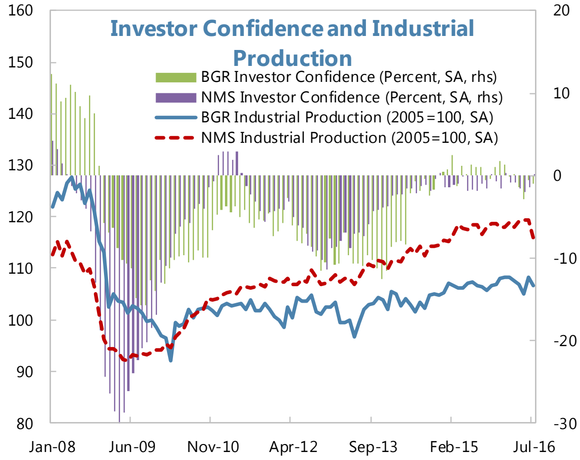
38. Raising Bulgaria's potential growth will require progress on several structural fronts. The effects of aging and emigration should be mitigated through active labor market policies and fostering conditions for emigrants to return. Reducing red-tape and corruption will improve the business environment and help reverse several years of decline in private investment. Improving the competitiveness and governance of SOEs would not only reduce fiscal contingent liabilities but also help enhance productivity.

39. Recent fiscal developments have been encouraging but longer-term challenges remain. The authorities' plans to save revenue overperformance in 2016 are welcome. At the same time, the execution of EU-funded capital spending should be accelerated. Medium-term plans to reach fiscal balance will strengthen fiscal buffers. Contingent liabilities in the energy, financial, and other sectors should be estimated and incorporated in fiscal planning. Over the longer-term, reforms will be required to protect fiscal sustainability in the face of the projected rise of health- and pension-related spending pressures. Steps may also be needed should concerns arise regarding the viability of private pension funds, in order to discourage excessive shifts to the public pension system and protect fiscal sustainability.

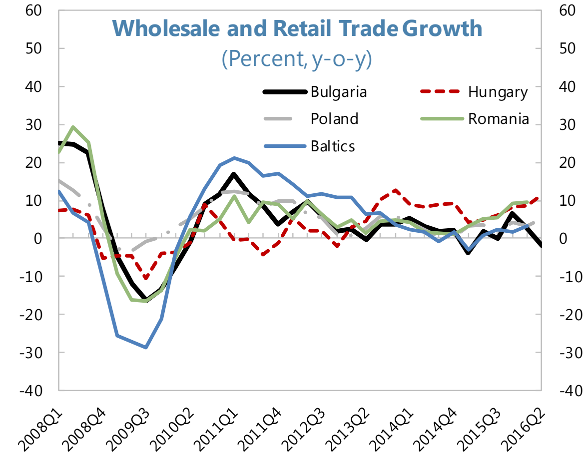
40. It is proposed that the next Article IV consultation with Bulgaria take place on the standard 12-month cycle.

Figure 1. Bulgaria: Real Sector Developments, 2008–16 1/

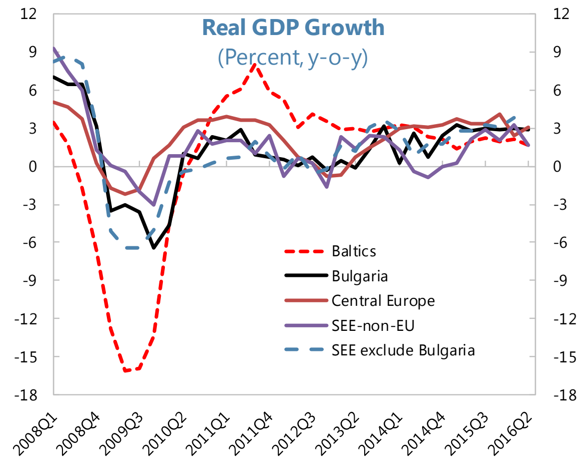
Industrial production and investor confidence have been on an upward trend, albeit weaker than in peers...



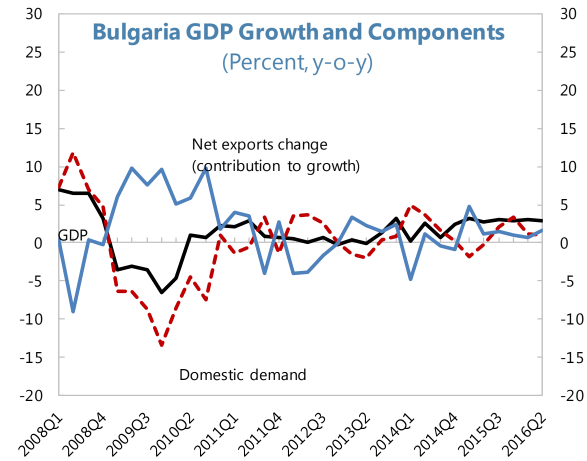
...while wholesale and retail trade growth has eased recently.



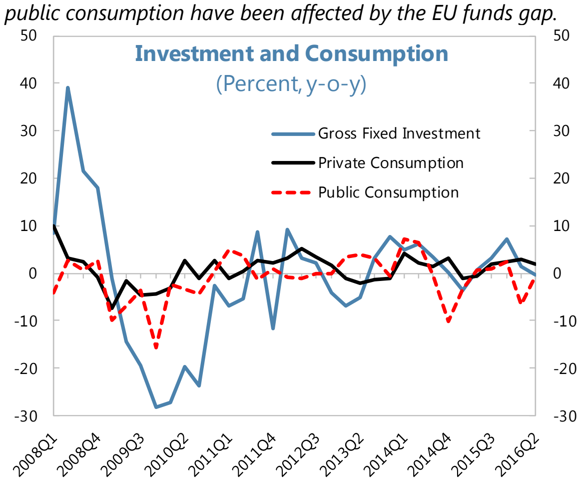
Growth has been steady in recent quarters...



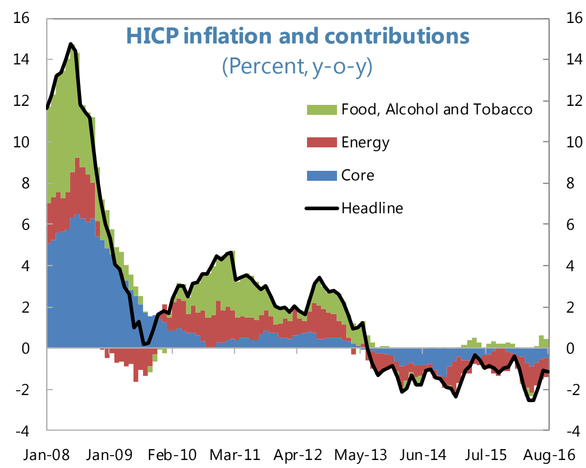
...supported by external and domestic demand...



...with private consumption on the rise while investment and public consumption have been affected by the EU funds gap.

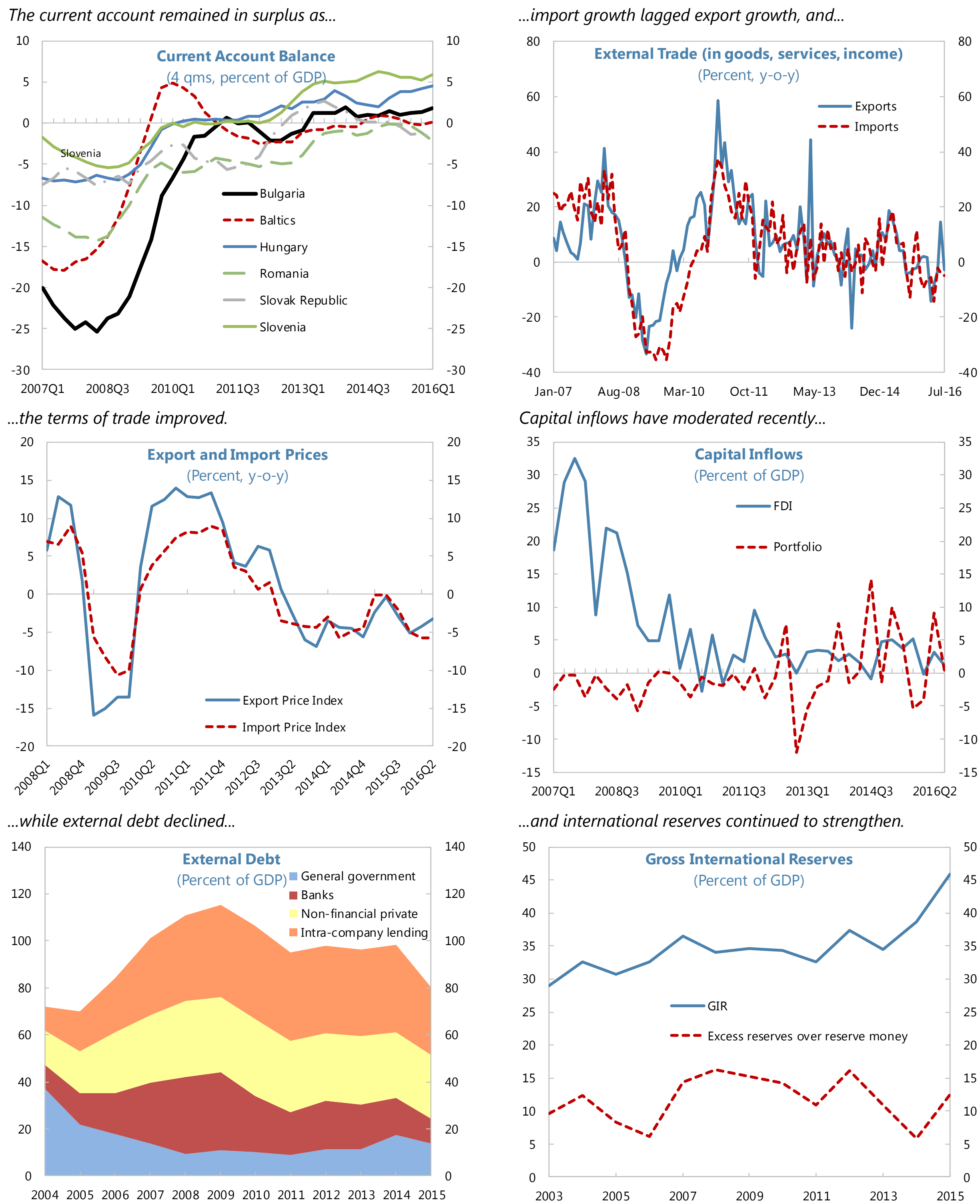


Deflation started to ease recently.



Sources: Haver; National authorities; and IMF staff calculations.
1/ Baltics: Estonia, Latvia, Lithuania; Central Europe: Czech Republic, Hungary, Poland, Slovak Republic, Slovenia; SEE-non-EU: Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, Montenegro, Serbia; SEE: Croatia, Romania.

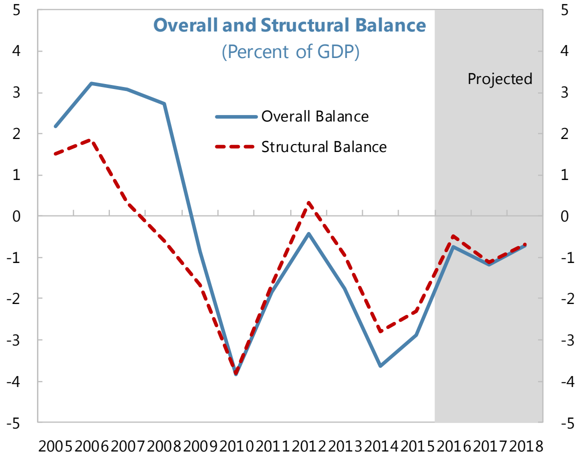
Figure 2. Bulgaria: External Sector Developments, 2003–16



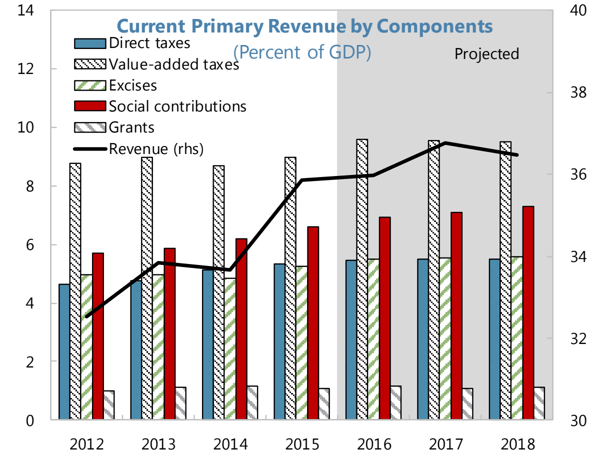
Sources: BNB; Haver; and IMF staff estimates.

Figure 3. Bulgaria: Fiscal Developments, 2006–18

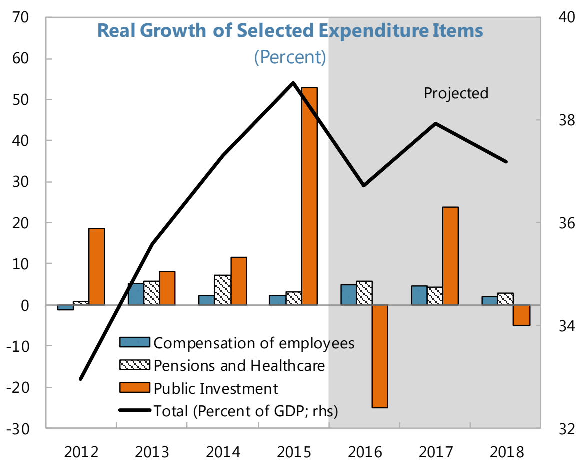
Fiscal adjustment to correct a large slippage in 2014 and achieve medium-term objective is proceeding...



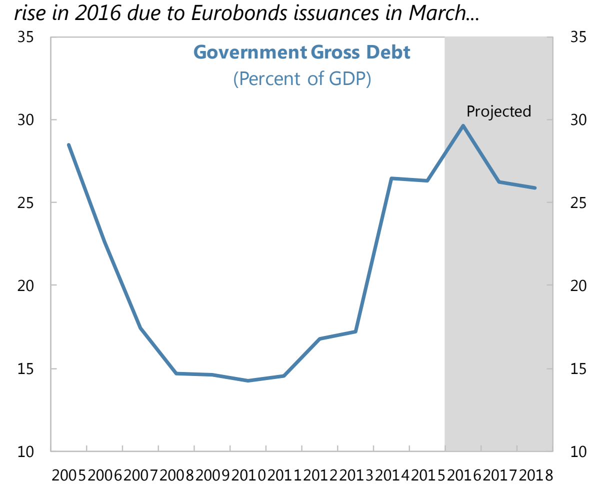
...driven by strong revenue performance on the back of the increases in excise rates, administrative efforts, and buoyant economic activities...



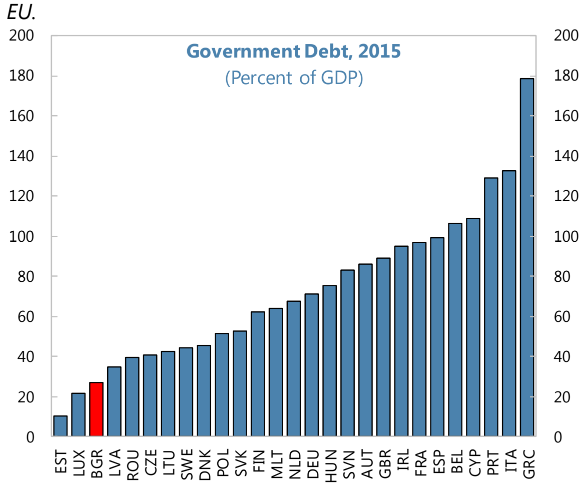
...and deceleration of spending growth in 2016 onwards.



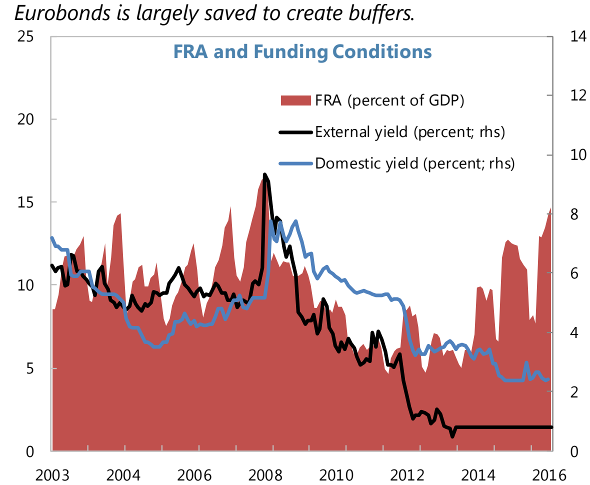
Despite the deficit reduction, government debt is projected to rise in 2016 due to Eurobonds issuances in March...



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



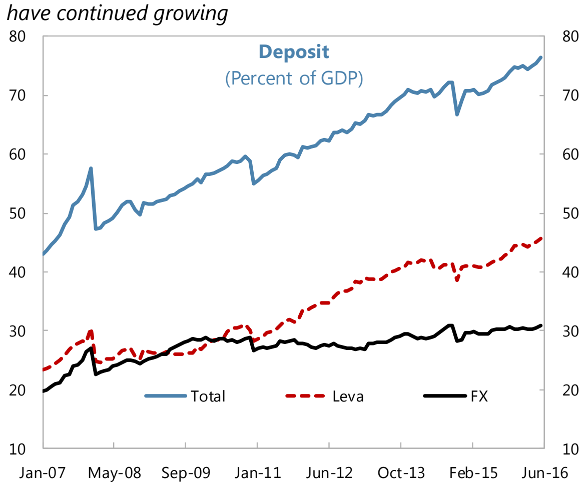
The Fiscal Reserve is on a rise as the fund raised by the recent Eurobonds is largely saved to create buffers.



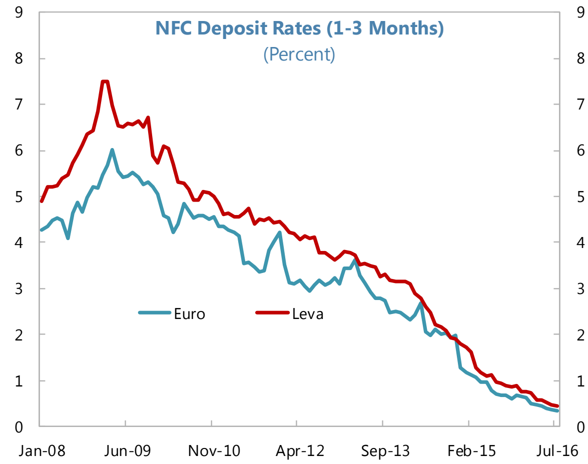
Sources: Bulgarian authorities; Eurostat; WEO; and IMF staff estimates.

Figure 4. Bulgaria: Monetary and Financial Sector Developments, 2007–16 1/

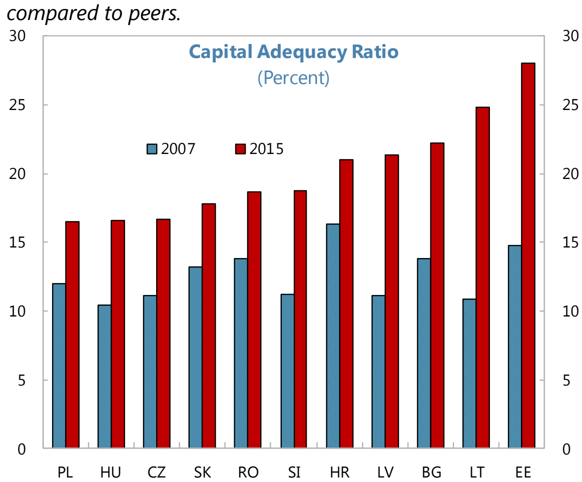
Despite the recent turmoil, deposits in the banking system have continued growing



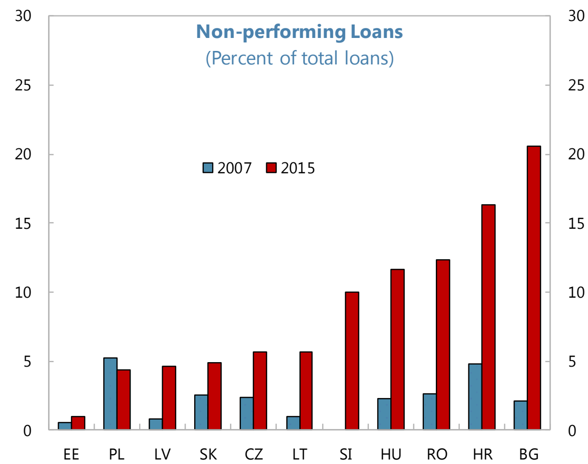
...with no increase on deposit rates, which have continued to decline.



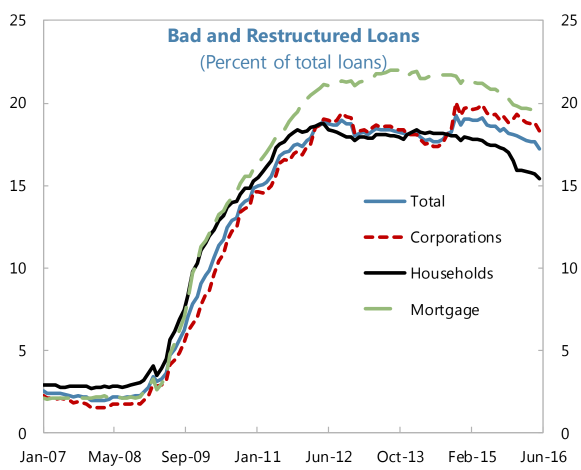
Capital adequacy ratio are reportedly comfortable, also compared to peers.



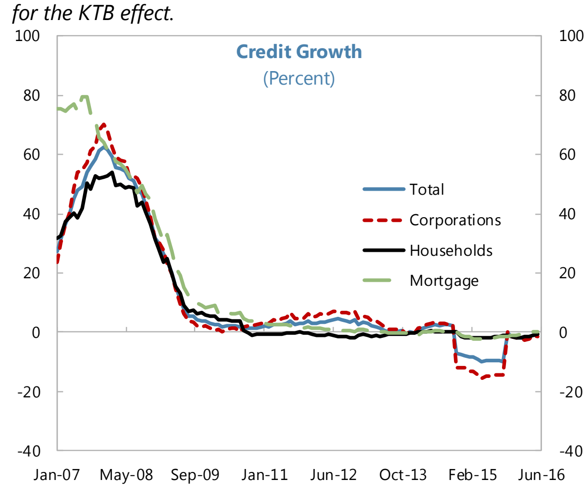
Nevertheless, NPLs remained high....



...in all lending segments,...



... contributing to anemic credit growth, even after controlling for the KTB effect.



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

Note: 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 staring in November 2014.

Table 1. Bulgaria: Selected Economic and Social Indicators, 2012–21

(Annual percentage change, unless noted otherwise)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
							Proj.			
Real GDP	0.2	1.3	1.5	3.0	3.0	2.8	2.5	2.5	2.5	2.5
Real domestic demand	2.5	-1.0	2.6	1.0	2.8	3.1	2.7	2.7	2.5	2.5
Public consumption	-0.4	2.2	-0.1	0.2	2.8	2.5	1.8	1.4	1.1	2.0
Private consumption	3.3	-1.4	2.7	0.8	3.8	3.3	3.0	3.0	2.7	2.6
Gross capital formation	2.1	-2.3	4.1	2.3	0.1	2.7	2.5	2.6	2.7	2.7
Private investment	-2.1	-2.6	0.3	-4.6	4.0	2.6	1.9	1.9	1.9	1.9
Public investment	20.3	11.4	14.0	23.2	-8.7	3.4	4.1	4.3	4.6	4.8
Stock building 4/	0.1	-0.6	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net exports 4/	-2.3	2.4	-1.1	1.9	0.2	-0.3	-0.2	-0.2	0.0	0.0
Exports of goods and services	0.8	9.2	-0.1	7.6	3.4	3.4	3.6	3.8	4.0	4.0
Imports of goods and services	4.5	4.9	1.5	4.4	3.2	3.8	3.9	4.1	4.0	4.0
Resource utilization										
Potential GDP	1.9	1.3	1.7	2.1	2.2	2.3	2.4	2.4	2.5	2.5
Output gap (percent of potential GDP)	-2.2	-2.2	-2.3	-1.5	-0.7	-0.2	-0.1	0.0	0.0	0.0
Unemployment rate (percent of labor force)	12.4	13.0	11.5	9.2	8.2	7.1	6.9	6.7	6.6	6.5
Price										
GDP deflator	1.6	-0.7	0.4	0.3	-0.7	0.6	1.6	1.9	2.1	2.1
Consumer price index (HICP, end of period)	2.8	-0.9	-2.0	-0.9	-0.8	1.4	1.8	2.0	2.1	2.1
Fiscal indicators										
General government net lending/borrowing (cash basis) 1/	-0.4	-1.8	-3.6	-2.9	-0.8	-1.2	-0.7	-0.3	0.0	0.0
General government primary balance 1/	0.3	-0.9	-3.0	-2.1	0.0	-0.2	0.2	0.6	0.9	0.9
Structural overall balance (percent of GDP)	0.3	-1.0	-2.8	-2.3	-0.5	-1.1	-0.7	-0.3	0.0	0.0
Structural primary balance (percent of GDP)	1.0	-0.1	-2.1	-1.5	0.3	-0.2	0.2	0.6	0.9	0.9
General government gross debt 2/	16.8	17.2	26.4	26.3	29.7	26.3	25.9	25.1	24.0	23.0
Monetary aggregates 3/										
Broad money	8.4	8.9	1.1	8.8	3.6	4.5	5.6	5.9	6.2	6.2
Domestic private credit	2.8	0.3	-7.7	-1.6	2.9	6.0	7.1	7.2	7.4	7.4
Exchange rates regime										
Leva per U.S. dollar (end of period)	1.48	1.42	1.61	1.79	...	...	...	...	...	...
Nominal effective rate	-1.8	2.5	2.9	-1.3	...	...	...	...	...	...
External sector										
Current account balance 1/	-0.9	1.3	0.9	1.4	0.8	0.0	-0.3	-0.5	-0.9	-1.7
o/w: Merchandise trade balance 1/	-9.6	-7.0	-6.5	-4.3	-4.7	-5.3	-5.3	-5.3	-5.4	-5.4

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, 2012–21

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
							Proj.			
GDP and prices (percent change)										
Real GDP	0.2	1.3	1.5	3.0	3.0	2.8	2.5	2.5	2.5	2.5
Real domestic demand	2.5	-1.0	2.6	1.0	2.8	3.1	2.7	2.7	2.5	2.5
Of which: private	2.2	-2.3	2.4	-0.3	3.8	3.1	2.8	2.8	2.6	2.4
GDP deflator	1.6	-0.7	0.4	0.3	-0.7	0.6	1.6	1.9	2.1	2.1
Consumer price index (HICP, average)	2.4	0.4	-1.6	-1.1	-1.6	0.6	1.6	1.9	2.1	2.1
Nominal wages	6.6	6.0	6.0	8.8	8.1	7.4	6.7	6.0	5.3	4.6
Real effective exchange rate, CPI based	-2.0	1.3	-0.5	-3.2	...	...	...	...	...	...
Monetary aggregates (percent change) 1/										
Broad money	8.4	8.9	1.1	8.8	3.6	4.5	5.6	5.9	6.2	0.0
Domestic private credit	2.8	0.3	-7.7	-1.6	2.9	6.0	7.1	7.2	7.4	7.4
Saving and investment (percent of GDP)										
Foreign saving	0.9	-1.3	-0.9	-1.4	-0.8	0.0	0.3	0.5	0.9	1.7
Gross national saving	21.2	22.7	22.3	22.7	22.8	22.5	22.0	21.8	21.7	21.0
Government	4.0	3.1	1.7	4.9	4.9	5.5	5.4	5.9	6.3	6.4
Private	17.2	19.6	20.6	17.8	17.9	17.0	16.6	15.9	15.4	14.6
Gross domestic investment	22.1	21.4	21.4	21.3	22.0	22.4	22.3	22.3	22.5	22.7
Government	4.4	4.9	5.3	7.8	5.7	6.7	6.1	6.2	6.3	6.4
Private	17.7	16.5	16.1	13.5	16.3	15.7	16.2	16.1	16.3	16.3
General government (percent of GDP)										
Revenue	32.5	33.8	33.7	35.8	36.0	36.8	36.5	36.7	36.9	37.0
Tax revenue (including social security contributions)	25.2	25.8	26.0	27.3	28.7	28.9	29.1	29.2	29.2	29.2
Non-Tax revenue	4.4	4.8	4.1	4.3	4.4	5.1	4.4	4.4	4.4	4.4
Grants	2.9	3.2	3.5	4.2	2.9	2.8	3.0	3.1	3.3	3.4
Expenditure	33.0	35.6	37.3	38.7	36.7	37.9	37.2	37.0	36.9	37.0
Balance (net lending/borrowing on cash basis)	-0.4	-1.8	-3.6	-2.9	-0.8	-1.2	-0.7	-0.3	0.0	0.0
Structural balance	0.3	-1.0	-2.8	-2.3	-0.5	-1.1	-0.7	-0.3	0.0	0.0
Balance of payments (percent of GDP)										
Current account	-0.9	1.3	0.9	1.4	0.8	0.0	-0.3	-0.5	-0.9	-1.7
Trade balance	-9.6	-7.0	-6.5	-4.3	-4.7	-5.3	-5.3	-5.3	-5.4	-5.4
Services balance	6.2	6.3	5.9	6.1	6.2	6.0	5.9	5.8	5.8	5.7
Primary income balance	-2.5	-3.8	-2.3	-4.1	-3.8	-3.8	-4.1	-4.5	-4.8	-5.5
Secondary income balance	5.0	5.7	3.8	3.7	3.2	3.1	3.1	3.4	3.5	3.5
Capital and financial account	1.3	1.1	2.5	3.3	2.3	2.3	2.2	2.1	2.2	2.2
of which: Foreign direct investment	-2.5	-2.9	-2.2	-3.5	-3.0	-2.9	-3.0	-3.2	-3.4	-3.6
Memorandum items:										
Gross international reserves (billions of euros)	15.6	14.4	16.5	20.3	21.7	22.5	23.7	24.7	25.7	26.2
Short-term external debt (percent of GDP) 2/	24.8	22.8	23.3	18.2	17.7	17.2	16.3	15.9	15.1	14.4
Export volume (percent change)	-2.5	11.2	1.8	8.7	2.6	3.9	3.8	4.0	3.9	4.2
Import volume (percent change)	2.7	5.3	1.9	5.2	3.2	3.8	3.9	4.1	4.0	4.0
Terms of trade (percent change)	2.7	0.3	0.1	-1.3	-0.7	-0.8	0.2	0.0	-0.3	-0.2
Output gap (percent of potential GDP)	-2.2	-2.2	-2.3	-1.5	-0.7	-0.2	-0.1	0.0	0.0	0.0
Nominal GDP (millions of leva)	81,544	81,971	83,612	86,373	88,341	91,361	95,159	99,400	103,986	108,824
Nominal GDP (millions of euros)	41,693	41,911	42,750	44,162	45,168	46,712	48,654	50,822	53,167	55,641

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, 2012–21

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
							Proj.			
(Real growth rate, in percent)										
GDP	0.2	1.3	1.5	3.0	3.0	2.8	2.5	2.5	2.5	2.5
Domestic demand	2.5	-1.0	2.6	1.0	2.8	3.1	2.7	2.7	2.5	2.5
Private demand	2.2	-2.3	2.4	-0.3	3.8	3.1	2.8	2.8	2.6	2.4
Public demand	3.5	4.2	3.2	6.2	-0.7	2.7	2.5	2.2	2.1	2.8
Final consumption	2.5	-0.7	2.2	0.7	3.6	3.1	2.8	2.7	2.4	2.5
Private consumption	3.3	-1.4	2.7	0.8	3.8	3.3	3.0	3.0	2.7	2.6
Public consumption	-0.4	2.2	-0.1	0.2	2.8	2.5	1.8	1.4	1.1	2.0
Investment	2.1	-2.3	4.1	2.3	0.1	2.7	2.5	2.6	2.7	2.7
Gross fixed investment	1.8	0.3	3.4	2.5	0.1	2.8	2.5	2.6	2.7	2.8
Private investment	-2.1	-2.6	0.3	-4.6	4.0	2.6	1.9	1.9	1.9	1.9
Public investment	20.3	11.4	14.0	23.2	-8.7	3.4	4.1	4.3	4.6	4.8
Inventories 1/	0.1	-0.6	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net exports 1/	-2.3	2.4	-1.1	1.9	0.2	-0.3	-0.2	-0.2	0.0	0.0
Exports of goods and services	0.8	9.2	-0.1	7.6	3.4	3.4	3.6	3.8	4.0	4.0
Imports of goods and services	4.5	4.9	1.5	4.4	3.2	3.8	3.9	4.1	4.0	4.0
(Contribution to real GDP growth, in percent)										
Domestic demand	2.5	-1.1	2.6	1.0	2.8	3.1	2.7	2.7	2.5	2.5
Private demand	1.8	-1.9	2.0	-0.3	3.0	2.5	2.2	2.2	2.0	1.9
Public demand	0.7	0.8	0.7	1.3	-0.1	0.6	0.5	0.5	0.4	0.6
Final consumption	2.0	-0.6	1.7	0.5	2.8	2.5	2.2	2.1	1.9	2.0
Private consumption	2.1	-0.9	1.7	0.5	2.4	2.1	1.9	1.9	1.8	1.7
Public consumption	-0.1	0.3	0.0	0.0	0.4	0.4	0.3	0.2	0.2	0.3
Investment	0.5	-0.5	0.9	0.5	0.0	0.6	0.5	0.5	0.6	0.6
Gross fixed investment	0.4	0.1	0.7	0.5	0.0	0.6	0.5	0.5	0.6	0.6
Private investment	-0.4	-0.4	0.0	-0.7	0.6	0.4	0.3	0.3	0.3	0.3
Public investment	0.8	0.5	0.7	1.3	-0.6	0.2	0.2	0.3	0.3	0.3
Inventories	0.1	-0.6	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net exports	-2.3	2.4	-1.1	1.9	0.2	-0.3	-0.2	-0.2	0.0	0.0
Exports of goods and services	0.5	5.4	-0.1	4.8	2.3	2.3	2.4	2.6	2.7	2.7
Imports of goods and services	2.7	3.1	1.0	2.9	2.1	2.5	2.6	2.8	2.7	2.8

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

1/ Contributions to GDP growth.

Table 4. Bulgaria: Balance of Payments, 2012–21

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
							Proj.			
				(Millions of euros)						
Current account balance	-358	536	365	609	358	16	-168	-260	-471	-953
Trade balance	-3,992	-2,933	-2,777	-1,917	-2,142	-2,461	-2,560	-2,669	-2,867	-3,011
Exports (f.o.b.)	19,675	21,218	21,026	22,184	21,247	22,634	23,717	24,724	25,771	27,093
Imports (f.o.b.)	23,667	24,151	23,803	24,101	23,389	25,095	26,277	27,393	28,639	30,104
Services balance	2,589	2,653	2,514	2,704	2,787	2,793	2,874	2,934	3,073	3,162
Exports of non-factor services	5,817	5,888	6,738	7,151	7,090	7,410	7,708	7,973	8,342	8,700
Imports of non-factor services	3,229	3,235	4,224	4,448	4,303	4,617	4,834	5,039	5,269	5,538
Primary Income balance	-1,053	-1,581	-989	-1,818	-1,712	-1,777	-2,004	-2,263	-2,555	-3,071
Receipts	724	874	935	952	979	1,007	1,040	1,075	1,112	1,151
Payments	1,777	2,455	1,923	2,770	2,691	2,783	3,044	3,338	3,667	4,221
Secondary income balance	2,099	2,396	1,616	1,640	1,426	1,460	1,522	1,738	1,878	1,967
Capital and financial account balance	1,503	1,356	680	4,208	2,458	2,128	2,003	1,873	1,867	1,487
Capital transfer balance	546	469	960	1,418	1,050	1,057	1,086	1,067	1,169	1,220
Foreign direct investment balance	-1,068	-1,243	-877	-1,516	-1,350	-1,347	-1,453	-1,617	-1,792	-1,975
Portfolio investment balance	891	132	-1,212	-576	-323	-157	-62	35	137	243
Other investment balance	-984	2,424	20	1,139	1,677	1,715	1,273	1,326	1,385	1,449
Errors and omissions	768	-118	-1,604	764	0	0	0	0	0	0
Overall balance	1,145	1,892	1,045	4,817	1,392	848	1,146	1,049	954	537
Financing	-1,145	-1,892	-1,045	-4,817	-1,392	-848	-1,146	-1,049	-954	-537
Gross international reserves (increase: -)	-2,121	532	-1,807	-3,730	-1,392	-847	-1,146	-1,049	-954	-536
				(Percent of GDP, unless otherwise indicated)						
Memorandum items:										
Current account balance	-0.9	1.3	0.9	1.4	0.8	0.0	-0.3	-0.5	-0.9	-1.7
Merchandise trade balance	-9.6	-7.0	-6.5	-4.3	-4.7	-5.3	-5.3	-5.3	-5.4	-5.4
Exports	47.2	50.6	49.2	50.2	47.0	48.5	48.7	48.6	48.5	48.7
Imports	56.8	57.6	55.7	54.6	51.8	53.7	54.0	53.9	53.9	54.1
Foreign direct investment balance	-2.6	-3.0	-2.1	-3.4	-3.0	-2.9	-3.0	-3.2	-3.4	-3.6
Terms of trade (merchandise, percent change)	2.7	0.3	0.1	-1.3	-0.7	-0.8	0.2	0.0	-0.3	-0.2
Exports of goods (volume, growth rate)	-2.5	11.2	1.8	8.7	2.6	3.9	3.8	4.0	3.9	4.2
Imports of goods (volume, growth rate)	2.7	5.3	1.9	5.2	3.2	3.8	3.9	4.1	4.0	4.0
Exports of goods (prices, growth rate)	5.9	-3.1	-3.2	-3.8	-6.0	3.3	0.8	0.2	0.6	1.1
Imports of goods (prices, growth rate)	5.9	-3.0	-2.7	-2.9	-6.6	2.5	1.0	0.2	0.3	0.9
GDP (millions of euro)	41,693	41,912	42,751	44,162	45,169	46,713	48,655	50,823	53,168	55,641

Sources: Bulgarian authorities; and IMF staff estimates.

Table 5. Bulgaria: External Financial Assets and Liabilities, 2012–21

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
							Proj.			
	(Millions of euros)									
International investment position	-32,710	-30,657	-32,029	-26,869	-25,397	-24,339	-23,435	-22,642	-21,958	-21,705
Financial assets	30,254	31,265	36,073	37,856	39,127	40,577	42,447	44,351	46,298	47,974
Foreign direct investment	3,405	3,575	4,049	4,053	4,219	4,441	4,672	4,913	5,165	5,429
Portfolio investment	4,373	4,939	5,519	4,997	4,965	5,105	5,351	5,707	6,178	6,771
Other investments	6,925	8,326	9,972	8,520	8,266	8,506	8,754	9,013	9,283	9,565
Gross international reserves	15,553	14,426	16,534	20,285	21,677	22,524	23,670	24,719	25,673	26,209
Financial liabilities	62,964	61,923	68,102	64,725	64,525	64,916	65,882	66,993	68,256	69,679
Foreign direct investment	37,814	37,500	40,936	39,902	41,418	42,986	44,670	46,528	48,572	50,812
Portfolio investment	1,935	2,389	3,948	4,455	4,746	5,044	5,352	5,672	6,007	6,357
Other liabilities	23,131	22,023	23,143	20,291	18,360	16,886	15,860	14,792	13,677	12,510
	(Percent of GDP, unless otherwise indicated)									
International investment position	-78.3	-73.0	-74.9	-60.7	-56.2	-52.1	-48.2	-44.6	-41.3	-39.0
Financial assets	72.6	74.6	84.4	85.7	86.6	86.9	87.2	87.3	87.1	86.2
Foreign direct investment	8.2	8.5	9.5	9.2	9.3	9.5	9.6	9.7	9.7	9.8
Portfolio investment	10.5	11.8	12.9	11.3	11.0	10.9	11.0	11.2	11.6	12.2
Other investments	16.6	19.9	23.3	19.3	18.3	18.2	18.0	17.7	17.5	17.2
Gross international reserves	37.3	34.4	38.7	45.9	48.0	48.2	48.6	48.6	48.3	47.1
Financial liabilities	151.0	147.7	159.3	146.6	142.9	139.0	135.4	131.8	128.4	125.2
Foreign direct investment	90.7	89.5	95.8	90.4	91.7	92.0	91.8	91.5	91.4	91.3
Portfolio investment	4.6	5.7	9.2	10.1	10.5	10.8	11.0	11.2	11.3	11.4
Other liabilities	55.5	52.5	54.1	45.9	40.6	36.1	32.6	29.1	25.7	22.5
Memorandum items:										
Gross external debt	90.5	88.1	92.1	78.1	80.5	75.4	72.4	69.5	66.2	62.6
Public 1/	8.6	8.1	14.1	12.8	16.7	13.7	13.4	12.8	12.5	11.9
Private	81.9	80.0	78.0	65.3	63.8	61.6	59.0	56.7	53.7	50.6
Short-term	24.8	22.8	21.0	18.2	17.7	17.2	16.3	15.9	15.1	14.4
Long-term	57.0	57.2	56.9	47.1	46.0	44.4	42.7	40.7	38.6	36.2
Net external debt 2/	53.2	53.7	53.4	32.2	32.5	27.2	23.7	20.8	17.9	15.5

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, 2012–21 1/

(Millions of leva, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
					Proj.					
Revenue	26,516	27,735	28,145	30,964	31,782	33,585	34,708	36,470	38,355	40,264
Taxes	15,933	16,310	16,579	17,909	19,238	19,917	20,738	21,682	22,701	23,765
Taxes on profits	1,478	1,553	1,679	1,860	1,964	2,020	2,097	2,187	2,286	2,392
Taxes on income	2,298	2,348	2,596	2,731	2,858	2,996	3,122	3,246	3,394	3,550
Value-added taxes	7,152	7,366	7,264	7,740	8,481	8,713	9,048	9,478	9,917	10,376
Excises	4,048	4,056	4,039	4,525	4,859	5,075	5,312	5,560	5,838	6,122
Customs duties	118	146	149	159	163	168	175	183	191	200
Other taxes	840	840	851	893	913	944	984	1,028	1,075	1,125
Social contributions	4,642	4,818	5,187	5,699	6,118	6,485	6,947	7,321	7,664	8,016
Grants	2,368	2,656	2,922	3,648	2,544	2,569	2,840	3,100	3,420	3,700
Other revenue 2/	3,573	3,951	3,457	3,709	3,882	4,615	4,182	4,368	4,570	4,782
Expenditure	26,874	29,175	31,193	33,449	32,451	34,665	35,395	36,787	38,355	40,234
Expense	22,889	24,551	25,545	25,930	27,047	28,091	29,051	30,104	31,300	32,748
Compensation of employees	4,239	4,560	4,678	4,712	4,887	5,033	5,159	5,288	5,447	5,675
Use of goods and services	4,444	4,603	4,479	4,263	4,749	4,960	5,161	5,337	5,472	5,698
Interest	573	689	580	698	695	855	851	881	922	965
External	374	484	337	431	431	581	572	574	601	629
Domestic	199	204	243	267	264	275	279	307	321	336
Subsidies	1,228	1,307	1,452	1,634	1,535	1,655	1,724	1,801	1,884	1,972
Grants 3/	809	934	955	946	1,010	1,001	1,056	1,067	1,116	1,168
Social benefits	11,482	12,332	13,268	13,543	14,082	14,495	15,008	15,638	16,368	17,179
Pensions	7,234	7,762	8,136	8,433	8,727	8,957	9,271	9,646	10,045	10,511
Social assistance	2,067	2,160	2,317	2,424	2,445	2,529	2,634	2,751	2,899	3,049
Health Insurance Fund	2,181	2,410	2,815	2,687	2,909	3,009	3,102	3,241	3,424	3,619
Other expense	114	127	133	134	90	91	91	91	91	91
Contingency 4/	385	644	1,186	767	407	462	495	496	539	563
Net acquisition of nonfinancial assets 5/	3,600	3,981	4,462	6,751	4,997	6,113	5,849	6,187	6,516	6,922
Net lending/borrowing 1/	-359	-1,441	-3,048	-2,484	-669	-1,080	-687	-317	0	30
Primary balance	214	-752	-2,468	-1,786	26	-225	164	564	922	995
Financing	359	1,441	3,048	2,484	669	1,080	687	317	0	-30
Privatization proceeds	76	16	18	4	32	0	0	0	0	0
Net external financing	2,047	-690	5,784	1,449	3,739	-2,213	152	17	277	-4
Disbursements	2,327	1,119	6,091	6,438	4,094	0	500	293	2,000	2,700
Amortization	-280	-1,809	-307	-4,988	-355	-2,213	-348	-276	-1,723	-2,704
Net domestic financing	-1,749	2,151	-1,279	-925	-3,086	3,447	550	315	-262	-11
Bank credit / Securities issuance	303	1,757	5,654	-19	793	800	1,771	1,313	758	1,023
Amortization	-970	-1,006	-3,497	-2,234	-1,051	-1,179	-1,244	-1,021	-1,021	-1,021
Fiscal Reserve Account	-1,082	1,400	-3,436	1,328	-2,828	3,447	24	23	1	-13
Net lending and other items	-16	-38	-1,587	1,952	-15	-15	-15	-15	-15	-15
Memorandum items:										
Fiscal reserve account	6,081	4,681	8,117	6,789	9,617	6,170	6,146	6,123	6,122	6,135
Gross public debt	13,674	14,119	22,102	22,714	26,195	23,982	24,661	24,970	24,984	24,982
Nominal GDP (percent change)	1.8	0.5	2.0	3.3	2.3	3.4	4.2	4.5	4.6	4.7
Real GDP (percent change)	0.2	1.3	1.5	3.0	3.0	2.8	2.5	2.5	2.5	2.5
HICP inflation (percent change)	2.4	0.4	-1.6	-1.1	-1.6	0.6	1.6	1.9	2.1	2.1
Nominal private consumption (percent ch.)	7.0	-3.9	2.7	0.0	2.2	3.9	4.6	5.0	4.8	4.7
Nominal imports (percent change)	10.6	1.8	2.3	1.9	-3.0	7.3	4.7	4.2	4.5	5.1

Sources: Ministry of Finance; and staff estimates.

1/ On cash basis. The 2016 projections do not reflect the government loan to the National Electricity Company that is currently under discussion.

2/ Includes dividends.

3/ Contribution to EU budget.

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

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

Table 6b. Bulgaria: General Government Operations, 2012–21 1/

(Percent of GDP, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
					Proj.					
Revenue	32.5	33.8	33.7	35.8	36.0	36.8	36.5	36.7	36.9	37.0
Taxes	19.5	19.9	19.8	20.7	21.8	21.8	21.8	21.8	21.8	21.8
Taxes on profits	1.8	1.9	2.0	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Taxes on income	2.8	2.9	3.1	3.2	3.2	3.3	3.3	3.3	3.3	3.3
Value-added taxes	8.8	9.0	8.7	9.0	9.6	9.5	9.5	9.5	9.5	9.5
Excises	5.0	4.9	4.8	5.2	5.5	5.6	5.6	5.6	5.6	5.6
Customs duties	0.1	0.2	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	1.0	1.0	1.0	1.0	1.0
Social contributions	5.7	5.9	6.2	6.6	6.9	7.1	7.3	7.4	7.4	7.4
Grants	2.9	3.2	3.5	4.2	2.9	2.8	3.0	3.1	3.3	3.4
Other revenue 2/	4.4	4.8	4.1	4.3	4.4	5.1	4.4	4.4	4.4	4.4
Expenditure	33.0	35.6	37.3	38.7	36.7	37.9	37.2	37.0	36.9	37.0
Expense	28.1	30.0	30.6	30.0	30.6	30.7	30.5	30.3	30.1	30.1
Compensation of employees	5.2	5.6	5.6	5.5	5.5	5.5	5.4	5.3	5.2	5.2
Use of goods and services	5.4	5.6	5.4	4.9	0.0	5.4	5.4	5.4	5.3	5.2
Interest	0.7	0.8	0.7	0.8	0.8	0.9	0.9	0.9	0.9	0.9
External	0.5	0.6	0.4	0.5	0.5	0.6	0.6	0.6	0.6	0.6
Domestic	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Subsidies	1.5	1.6	1.7	1.9	1.7	1.8	1.8	1.8	1.8	1.8
Grants 3/	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Social benefits	14.1	15.0	15.9	15.7	15.9	15.9	15.8	15.7	15.7	15.8
Pensions	8.9	9.5	9.7	9.8	9.9	9.8	9.7	9.7	9.7	9.7
Social assistance	2.5	2.6	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8
Health Insurance Fund	2.7	2.9	3.4	3.1	3.3	3.3	3.3	3.3	3.3	3.3
Other expense	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Contingency 4/	0.5	0.8	1.4	0.9	0.5	0.5	0.5	0.5	0.5	0.5
Net acquisition of nonfinancial assets 5/	4.4	4.9	5.3	7.8	5.7	6.7	6.1	6.2	6.3	6.4
Net lending/borrowing 1/	-0.4	-1.8	-3.6	-2.9	-0.8	-1.2	-0.7	-0.3	0.0	0.0
Primary balance	0.3	-0.9	-3.0	-2.1	0.0	-0.2	0.2	0.6	0.9	0.9
Financing	0.4	1.8	3.6	2.9	0.8	1.2	0.7	0.3	0.0	0.0
Privatization proceeds	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net external financing	2.5	-0.8	6.9	1.7	4.2	-2.4	0.2	0.0	0.3	0.0
Disbursements	2.9	1.4	7.3	7.5	4.6	0.0	0.5	0.3	1.9	2.5
Amortization	-0.3	-2.2	-0.4	-5.8	-0.4	-2.4	-0.4	-0.3	-1.7	-2.5
Net domestic financing	-2.1	2.6	-1.5	-1.1	-3.5	3.8	0.6	0.3	-0.3	0.0
Securities issuance	0.4	2.1	6.8	0.0	0.9	0.9	1.9	1.3	0.7	0.9
Amortization	-1.2	-1.2	-4.2	-2.6	-1.2	-1.3	-1.3	-1.0	-1.0	-0.9
Fiscal Reserve Account	-1.3	1.7	-4.1	1.5	-3.2	3.8	0.0	0.0	0.0	0.0
Net lending and other items	0.0	0.0	-1.9	2.3	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Gross public debt	16.8	17.2	26.4	26.3	29.7	26.3	25.9	25.1	24.0	23.0
Structural fiscal balance	0.3	-1.0	-2.8	-2.3	-0.5	-1.1	-0.7	-0.3	0.0	0.0
Output gap (percent of potential GDP)	-2.2	-2.2	-2.3	-1.5	-0.7	-0.2	-0.1	0.0	0.0	0.0
Nominal GDP (millions of leva)	81,544	81,971	83,612	86,373	88,341	91,361	95,159	99,400	103,986	108,824

Sources: Ministry of Finance; and IMF staff estimates.

1/ On cash basis. The 2016 projections do not reflect the government loan to the National Electricity Company that is currently under discussion.

2/ Includes dividends.

3/ Contribution to EU budget.

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

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

Table 7. Bulgaria: General Government Stock Position, 2008–15

(Percent of GDP, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	2014	2015
Net financial worth	9.6	5.7	3.0	1.4	1.1	-1.4	-3.2	-5.3
Financial assets	30.4	29.4	27.2	24.4	26.5	24.4	31.3	28.0
Monetary gold and SDRs	…	…	…	…	…	…	…	…
Currency and deposits	13.9	12.4	9.9	8.2	10.0	8.3	11.1	8.7
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	1.8	1.7	1.5	1.3	1.2	1.1	2.1	1.5
Equity and investment funds shares	9.3	10.7	11.4	10.5	10.2	8.7	10.1	9.6
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	5.4	4.6	4.4	4.4	5.1	6.3	8.0	8.1
Liabilities	20.8	23.7	24.1	23.0	25.4	25.8	34.6	33.3
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	8.2	8.6	9.8	9.6	12.3	11.6	16.6	20.0
Loans	4.8	5.7	6.3	6.1	5.8	6.7	10.6	6.8
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	0.3	0.1	0.1	0.2	0.2	0.2	0.2	0.3
Other accounts receivable	7.5	9.3	7.9	7.2	7.0	7.3	7.2	6.3
Memorandum items								
Gross debt (at market value)	20.5	23.5	24.0	22.9	25.1	25.6	34.3	33.1
Gross debt (at face value)	20.5	23.0	23.4	22.5	24.6	25.3	34.2	33.0
Gross debt (Maastricht definition)	13.0	13.7	15.5	15.3	17.6	18.0	27.0	26.7
Nominal GDP (billions of leva)	73.1	72.8	73.8	80.1	81.5	82.0	83.6	86.4

Sources: Eurostat; and IMF staff calculations.

Table 8. Bulgaria: Monetary Accounts, 2012–21
(Billions of leva, unless otherwise stated)

	2012 Dec.	2013 Dec.	2014 1/ Dec.	2015 Dec.	2016 Dec.	2017 Dec.	2018 Dec.	2019 Dec.	2020 Dec.	2021 Dec.
							Proj.			
Monetary Survey										
Net foreign assets	25.3	28.4	35.0	40.7	43.3	44.9	47.7	50.4	53.2	56.3
Net domestic assets	53.9	55.8	50.5	51.7	51.8	53.3	56.3	60.9	65.0	68.4
Domestic credit	55.1	57.1	52.1	53.2	53.2	54.7	57.6	62.2	66.3	69.6
General government	-0.7	1.2	0.4	2.4	1.0	-0.7	-1.7	-1.4	-2.0	-3.7
Non-government	55.8	55.9	51.6	50.8	52.3	55.4	59.3	63.6	68.3	73.3
Broad money (M3)	61.7	67.2	68.0	74.0	76.6	80.0	84.5	89.5	95.0	100.9
Currency outside banks	8.5	9.1	10.2	11.4	12.6	13.4	14.0	14.3	14.8	15.3
Reserve money	17.4	17.3	19.2	27.5	28.9	30.1	31.3	32.4	33.7	35.1
Deposits 2/	53.2	58.2	57.8	62.6	64.0	66.6	70.5	75.1	80.2	85.6
Accounts of the Bulgarian National Bank										
Net foreign assets	29.0	26.8	30.8	38.1	40.1	38.7	45.1	45.1	51.8	52.4
Net foreign reserves (billions of euro)	14.8	13.7	15.7	19.5	20.5	19.8	23.0	23.0	26.5	26.8
Net domestic assets	-6.7	-5.7	-7.3	-6.4	-8.9	-9.1	-10.5	-10.5	-10.8	-10.9
Net claims on government	-5.7	-4.3	-6.7	-6.0	-8.5	-8.6	-9.9	-9.9	-10.2	-10.2
Base money	17.4	17.3	19.2	27.5	28.9	30.1	31.3	32.4	33.7	35.1
Currency in circulation	8.5	9.1	10.2	11.4	12.6	13.4	14.0	14.3	14.8	15.3
Banks reserves	8.9	8.2	9.1	16.1	16.3	16.7	17.4	18.1	18.9	19.8
Deposit money banks										
Net foreign assets	-3.6	1.6	4.2	2.6	4.9	4.6	4.2	3.7	3.0	2.3
Gross foreign assets	10.0	13.6	15.3	10.6	16.2	16.0	15.6	15.1	14.4	13.7
Gross foreign liabilities	13.7	12.1	11.1	8.1	11.4	11.4	11.4	11.4	11.4	11.4
Net domestic assets	59.3	59.9	56.9	57.4	60.0	61.7	66.0	70.6	75.1	78.4
Domestic credit	60.7	61.3	58.6	59.1	61.7	63.2	67.4	72.0	76.4	79.8
Memorandum items:	(Annual percentage change, unless otherwise indicated)									
Base money	16.7	-0.4	11.1	43.0	5.1	4.2	3.9	3.6	3.9	4.0
Broad money	8.4	8.9	1.1	8.8	3.6	4.5	5.6	5.9	6.2	6.2
Domestic non-government credit	2.8	0.3	-7.7	-1.6	2.9	6.0	7.1	7.2	7.4	7.4
Domestic deposits	8.3	9.3	-0.6	8.2	2.3	4.1	5.8	6.5	6.8	6.8
Domestic currency	17.0	8.6	0.1	9.2	2.6	4.4	6.2	6.9	7.1	7.1
Foreign currency	-2.1	10.3	-1.5	6.8	1.8	3.6	5.3	6.0	6.2	6.2
Money multiplier (ratio)	3.5	3.9	3.5	2.7	2.6	2.7	2.7	2.8	2.8	2.9
Velocity (M3) (ratio)	1.3	1.2	1.2	1.2	1.1	1.1	1.1	1.1	1.1	1.1
GDP (millions of leva)	81,544	81,971	83,612	86,373	88,341	91,361	95,159	99,400	103,986	108,824

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, 2010–16

(Percent)

	2010 Dec	2011 Dec	2012 Dec	2013 Dec	2014 Dec	2015 Dec	2016 March
Core indicators							
Capital adequacy							
Capital to risk-weighted assets	17.5	17.5	16.7	16.9	21.9	22.2	22.9
Tier 1 capital to risk-weighted assets	15.2	15.7	15.2	16.0	20.0	20.5	21.4
Asset quality							
Nonperforming loans to total gross loans	11.9	14.9	16.6	16.9	16.7	20.6	20.2
Nonperforming loans net of provisions to capital	28.1	36.9	39.1	36.0	43.6	52.1	48.7
Large exposures to capital	87.9	112.2	115.1	121.1	67.2	65.4	65.8
Earnings and profitability							
Return on assets	0.9	0.8	0.7	0.7	0.9	1.0	1.4
Return on equity 1/	7.9	7.1	6.8	6.6	7.6	7.4	10.5
Net interest income to gross income	74.2	73.3	68.8	68.5	67.4	66.0	74.3
Noninterest expense to gross income	49.1	50.4	52.1	53.9	49.5	48.7	46.2
Personnel expense to total income	17.8	18.5	19.1	19.8	18.5	17.6	19.3
Trading and fee income to total income	24.7	25.0	27.8	27.8	28.2	29.2	20.9
Liquidity							
Liquid assets to total assets	20.9	21.9	22.4	23.4	26.1	31.6	31.7
Liquid assets to short-term liabilities	30.1	28.9	30.0	30.6	33.7	40.5	41.2
Liquid assets to total liabilities	24.2	25.4	25.8	26.9	29.9	36.7	36.5
Encouraged indicators							
Deposit-taking institutions							
Capital to assets 2/	10.5	10.8	10.1	10.3	11.6	11.6	12.2
Trading income to total income	5.4	4.9	7.4	5.7	7.0	8.0	-1.9
Personnel expenses to noninterest expenses	36.3	36.6	36.7	36.8	37.3	36.1	41.7
Customer deposits to total (non-interbank) loans	87.8	95.2	100.2	107.5	115.5	128.0	130.2
Foreign currency denominated loans to total loans	61.3	63.8	64.0	61.2	57.0	50.7	49.9
Foreign currency denominated liabilities to total liabilities	58.6	54.8	51.8	50.1	49.0	42.7	43.2

Source: Bulgarian National Bank.

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

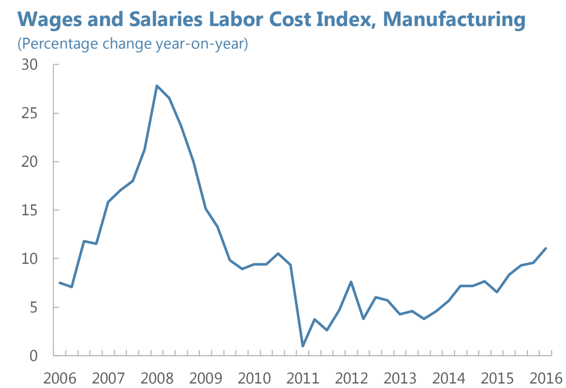
2/ Capital to assets is based on Tier I capital.

Annex I. Competitiveness and External Sector Assessment

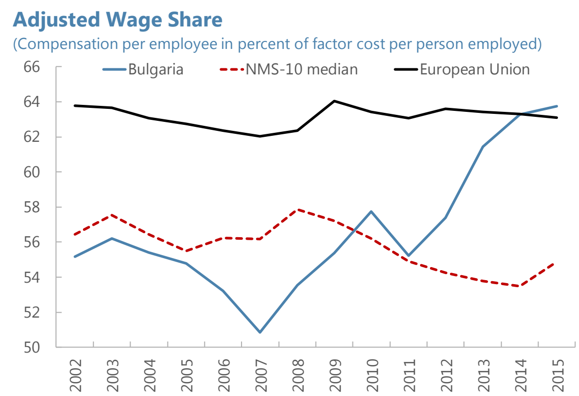
Staff's overall assessment is that Bulgaria's external position in 2015 was broadly in line with fundamentals. However, continued labor cost increase in excess of productivity growth could pose risks to competitiveness going forward. Achieving a balanced fiscal position in line with the authorities' consolidation plan will help to sustain external sustainability.

Competitiveness developments

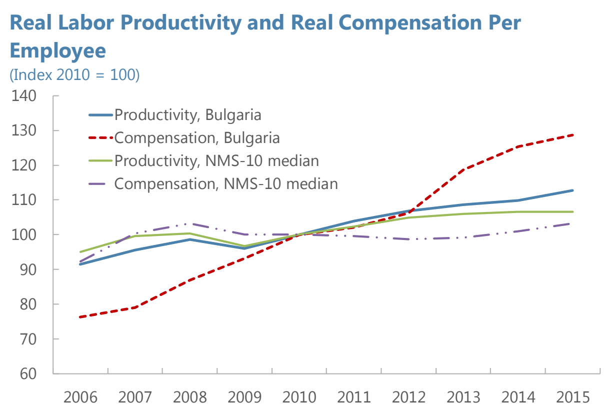
1. Wages and labor cost have been on an increasing trend, outpacing productivity growth. After the post-crisis correction, manufacturing labor costs picked up again in 2011 and have been on an accelerated growth trend since 2014. Bulgaria's adjusted wage share development decoupled from regional peers in 2011 and has reached EU levels in 2014. Since 2012, wage growth in Bulgaria has surpassed labor productivity growth, highlighting risks to competitiveness in Bulgaria going forward. In regional peer countries, wage growth developed more in line with productivity.



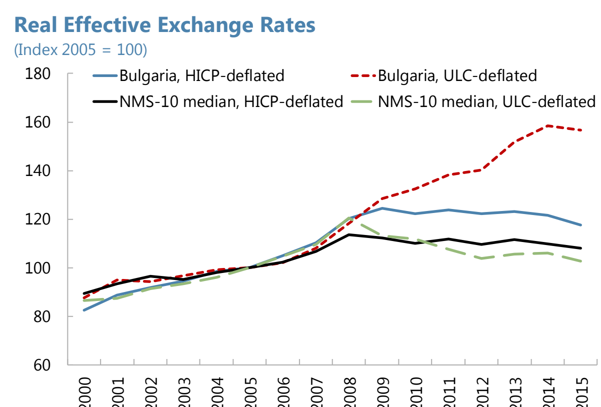
Source: National Statistical Institute.



Sources: Eurostat; and IMF staff calculations.



Sources: European Commision; and IMF staff calculations.

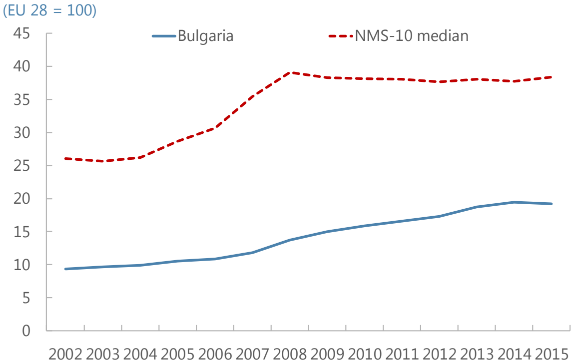


Sources: European Commission; and IMF staff calculations.

2. The analysis of Bulgaria's real effective exchange rates paints a mixed picture. Driven by rising labor costs, Bulgaria's REER based on ULC has strongly appreciated well beyond the financial crisis. The consumption-based REER, however, was broadly stable during the post-crisis low-inflation environment and has depreciated recently in view of imported deflation, largely on the back of falling international energy prices. With a few exceptions, HICP-based and ULC-based REERs were more aligned in regional peer countries (see box). According to the REER model of the extended External Balance Assessment ("EBA-lite"), the gap between the actual and REER norm is estimated at 3 percent. Although pointing to slight overvaluation, this result is within the range considered in line with fundamentals. Due to the large cross-country coverage of the model, the employed REER is based on consumer prices. The divergence between consumption-based and ULC-based REER developments in Bulgaria raises the question of potential overvaluation risks.

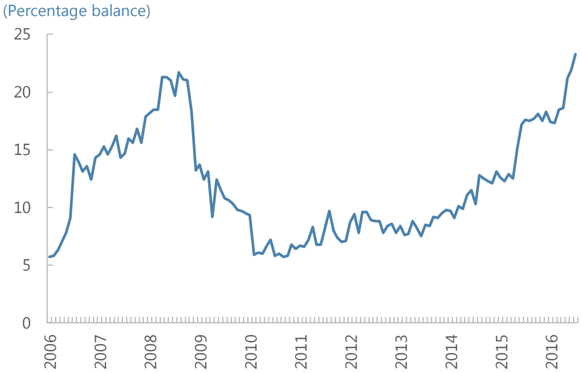
3. Wages are catching up from a very low level and have been pushed by increasing labor shortage. Bulgaria's wage level is still the lowest among EU countries and has been increasing with accelerated speed since EU accession in 2007. While catching-up dynamics explain part of Bulgaria's rapid wage growth, cyclical factors, unfavorable demographics and continuous emigration of high-skilled workers have contributed to rising wages in recent years. Labor shortage has increasingly been reported as a binding factor limiting business activity in the industry sector.

Nominal Compensation Per Employee
(EU 28 = 100)



Sources: European Commission; and IMF staff calculations.

Labor Shortage as a Limiting Factor to Industrial Activity
(Percentage balance)

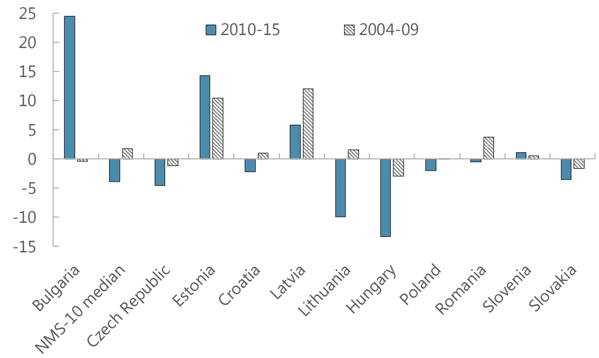


Source: National Statistical Institute.

Competitiveness Developments in Regional Peer Countries

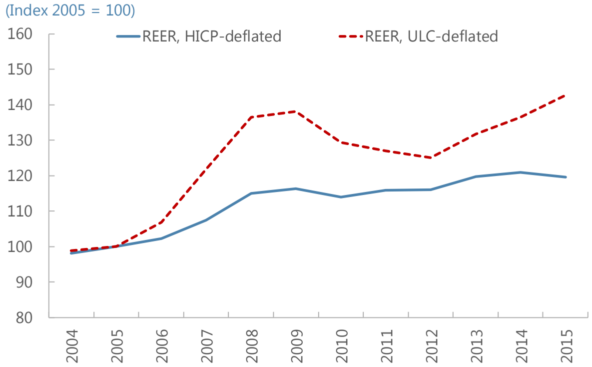
Across Central, Eastern, and Southeastern EU countries, Bulgaria stands out with the largest gulf between HICP-based and ULC-based REERs. Bulgaria's divergence between price and wage developments is unmatched among peer countries. Only Estonia and Latvia exhibit a notable positive difference between ULC-based and HICP-based REER trajectories, pointing to excessive wage developments. In Lithuania and Hungary, on the other hand, ULC developments have surpassed consumer price-driven appreciation since the beginning of the decade.

Difference in REERs Based on ULC and HICP
(Average difference)



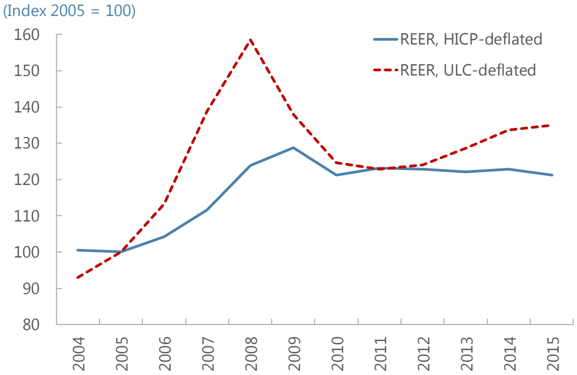
Sources: European Commission; and IMF staff calculations.

Estonia: Real Effective Exchange Rates
(Index 2005 = 100)



Source: European Commission.

Latvia: Real Effective Exchange Rates
(Index 2005 = 100)

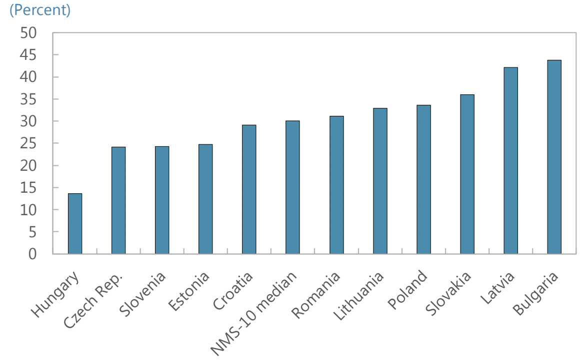


Source: European Commission.

Estonia and Latvia underwent significant internal devaluation in the wake of the financial crisis while keeping their exchange rates fixed. In both countries, sharp increases of ULC-based REERs at the height of the boom period had opened large gaps between wage and price developments. The bust in the financial sectors of Estonia and Latvia put their fixed exchange rates under pressure and resulted in significant internal devaluations, reflected in marked nominal wage reductions as expressed by falling ULC-REERs. Since 2012, wage growth has recovered and ULC-based REERs have started to appreciate again while price-based REERs continued to be stable. As Bulgaria was not affected by the financial boom-bust cycle to the same extent as the Baltic countries, the correction pressure on nominal wages in the presence of fixed exchange rates was lower and did hence not result in notable ULC-REER corrections.

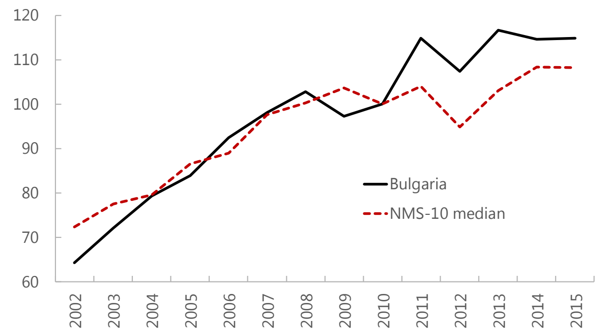
4. Bulgaria's export performance has been resilient so far. Bulgaria's goods export volume grew by 44 percent between 2010 and 2015, exceeding export growth in peer countries among the EU's other new member states. The world market share of Bulgarian exports has been increasing steadily and, despite some slowdown since 2013, has outperformed peer countries. This performance was likely supported by higher productivity gains in tradable industries than in non-tradable service sectors, as well as by improvements in non-cost competitiveness.[1]

Export Volume Growth, 2015-2010
(Percent)



Sources: Eurostat; and IMF staff calculations.

Export Market Share
(Index 2010 = 100)



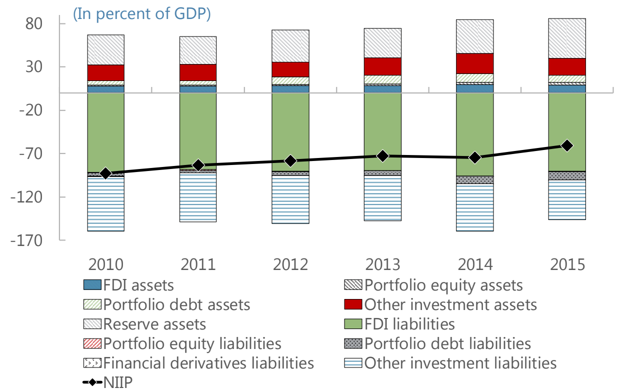
Sources: Haver; and IMF staff calculations.

5. Overall, risks to Bulgaria's competitiveness are limited but might be rising. So far, increasing wages do not appear to have seriously impaired Bulgaria's export performance as labor cost are still at comparable low levels. Going forward, competitiveness concerns could arise should the current trend of divergence between wage growth and productivity growth continue.

International investment position

6. Bulgaria's international investment position has been on an improving trend. Between 2010 and 2015, the IIP increased from -93.2 percent to -60.7 percent of GDP. The improvement has mainly been driven by an increase in reserve assets and a reduction in other liabilities, the latter reflecting private-sector deleveraging. According to the External Sustainability approach of EBA-lite, stabilizing the IIP at the 2015 level would imply a CA norm of -4.5 of GDP and a REER gap of -6.7 percent. In light of expected continued private-sector deleveraging, however it would seem appropriate to further improve the IIP, implying a higher CA norm and a lower REER gap (see table).

Net International Investment Position
(In percent of GDP)



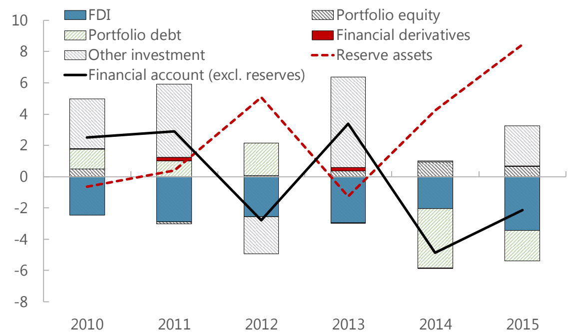
Sources: IMF; and IMF staff calculations.

[1] World Bank (2015), "Bulgaria's Potential for Sustainable Growth and Shared Prosperity", Systematic Country Diagnostic.

Capital flows

7. Direct investment has increased and portfolio investment inflows have resumed recently. Net FDI inflows have been fairly stable at around 2.5 percent of GDP over time and increased slightly to 3.4 percent of GDP in 2015. Portfolio debt inflows have resumed in 2014, reflecting renewed investor confidence in Bulgaria. Private-sector deleveraging is ongoing, as other investment positions abroad have been reduced. Reserve accumulation has picked up on the back of current and capital account surpluses, FDI and portfolio inflows.

Capital Flows
(In percent of GDP)

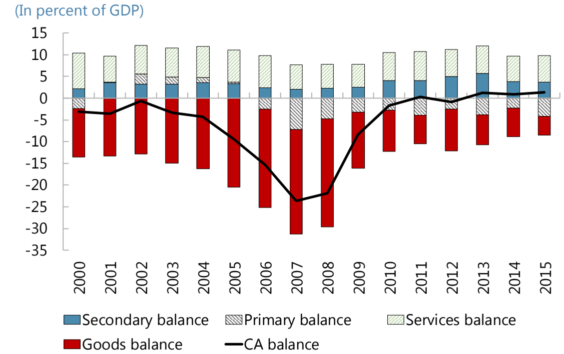


Sources: IMF; and IMF staff calculations.

Current account developments

8. The current account has corrected sharply since the financial crisis. After a deficit of -23.7 percent in 2007, the current account adjusted rapidly in light of the abrupt reduction in capital inflows, including FDI. The current account correction was mainly driven by compressed imports on the back of weaker domestic demand and investment-related imports while exports remained resilient. Since 2010, the current account has been broadly balanced, recording a small surplus of 1.4 percent in 2015.

Current Account
(In percent of GDP)



Sources: IMF, WEO.

9. The staff-assessed external position of Bulgaria is broadly consistent with fundamentals and desirable policy settings. The CA model of the EBA-lite framework estimates a cyclically-adjusted CA norm of -5.7 percent of GDP. However, the model does not fully capture the temporary adjustment factors at play during the sharp current account correction since 2007 which was mainly driven by import compression on the back of weakened demand and investment-related imports. While the excessive pre-crisis conditions are unlikely to return, a gradual strengthening of domestic demand is expected to contribute to a decline in the current account over the medium term. Staff estimates a cyclically-adjusted CA, removing temporary factors primarily related to imports, of

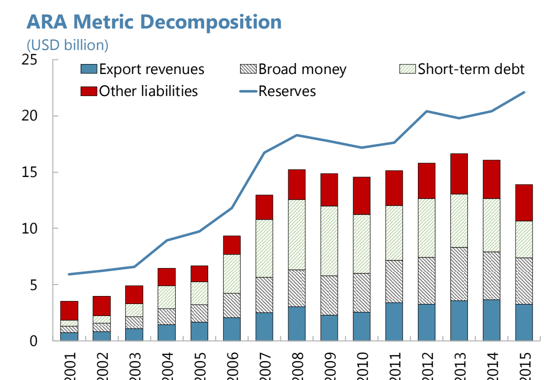
EBA-Lite Results, 2015
(percent of GDP)

EBA-Lite External Sustainability Approach			
IIP stabilization at 2015 level (-60.7 percent of GDP)		IIP stabilization at -50 percent of GDP within 10 years	
Underlying CA	-1.7	Underlying CA	-1.7
CA norm	-4.5	CA norm	-3.3
CA gap	2.8	CA gap	1.6
REER gap	-6.7	REER gap	-3.7
EBA-Lite REER Approach			
REER gap	3.0		
EBA-Lite CA Approach			
Standard version		Adjusted version	
Actual CA	1.4	Actual CA	1.4
Cyclically-adjusted CA	1.1	Cyclically-adjusted CA (removing all temporary factors)	-1.7
CA norm	-5.5	CA norm	-5.5
Cyclically-adjusted CA norm	-5.7	Cyclically-adjusted CA norm (including adjustments)	-3.6
CA gap	6.8	CA gap	1.8
o/w policy gap	0.3	o/w policy gap	0.3
Elasticity	-0.4	Elasticity	-0.4
REER gap	-15.6	REER gap	-4.2

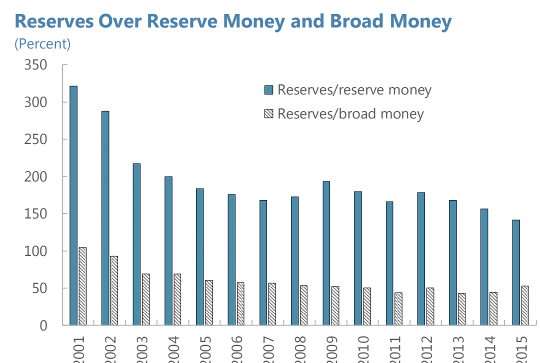
around -1.7 percent of GDP. Furthermore, the EBA-lite regression features a large constant term which reflects a sizeable unexplained need for external financing across the large emerging market country sample, compared to the smaller constant in the EBA regression. As Bulgaria is not facing the same unexplained need for external financing as the EBA-lite country sample of emerging markets, staff considers it appropriate to adjust the cyclically-adjusted CA norm upward by about 2 percentage points. As a result, the revised cyclically-adjusted CA norm amounts to -3.6 percent of GDP, implying a CA gap of 1.8 percent and a REER gap of -4.2 percent. This scenario builds on the authorities' plan to achieve a balanced structural budget position in the medium term. In light of Bulgaria's larger uncertainty in the balance of payments, with a CA standard error of 9 percent compared to the EBA sample standard error of 5 percent, Bulgaria's external position is considered broadly consistent with fundamentals and desirable policy settings.

International reserves

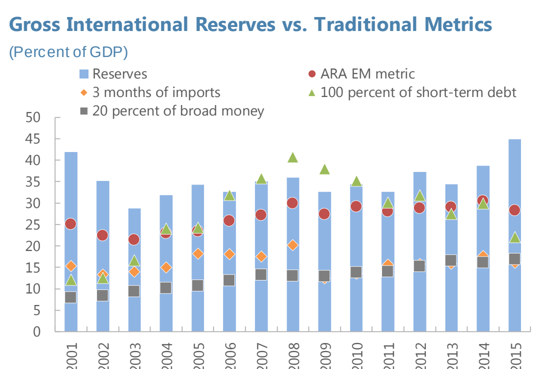
10. Bulgaria's international reserves have further increased and remain at an adequate level. The ratio of reserves over GDP increased from 36 to 45 percent from 2014 to 2015, remaining well above the standard rules of thumb, namely three months' coverage of prospective imports and 20 percent of broad money. In 2015, reserves also exceeded 100 percent of short-term debt as well as the IMF's metric for assessment of reserve adequacy (ARA) in emerging markets by a large margin. In light of Bulgaria's currency board arrangement, the ratio of reserves over the monetary base declined recently but still amounted to a comfortable level of 141 percent in 2015. The broad money coverage ratio, gauging the resilience to financial distress, increased lately to 53 percent.



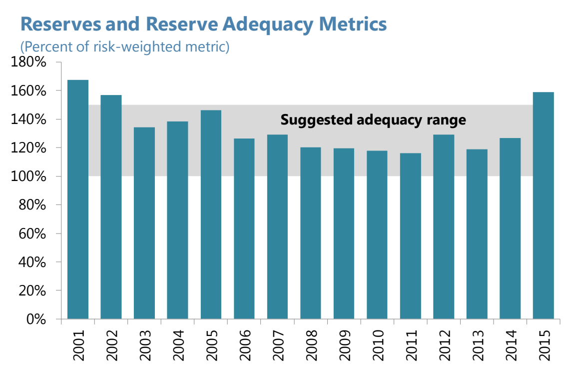
Sources: IMF, WEO; and IMF staff calculations.



Sources: IMF, WEO; and IMF staff calculations.



Sources: IMF WEO, IFS, and IMF staff calculations.



Sources: IMF, WEO; and IMF staff calculations.

Annex II. Debt Sustainability

1. **External debt has accelerated its downward trend.** Since its peak at 110 percent of GDP at end-2009, gross external debt has declined mainly on account of private sector deleveraging in the banking sector. From end-2014 to end-2015 alone, gross external debt fell from 92.1 to 77.2 percent of GDP, driven by banks but also a substantial decline in inter-company lending. Excluding inter-company lending, external debt declined to 49.4 percent by end-2015, remaining largely covered by international reserves. Rollover risks related to external exposure in the non-bank private sector are contained given moderate short-term exposure; these risks also did not materialize during the global financial crisis.

2. **Gross external debt is expected to decline further under staff's baseline projections**. After increasing to a projected 81 percent of GDP in 2016 on the back of a Eurobond issuance (see below), external debt is set to decline further to around 63 percent of GDP by 2021. The medium-term decline in gross external debt is largely driven by nominal GDP growth whereas nominal external debt is expected to remain broadly stable. While private-sector deleveraging is projected to continue, external public sector lending will slightly increase, broadly offsetting each other. The historical scenario, projecting external debt on the basis of 10-year averages of key determinants, generates a very similar trajectory.

3. **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. The external debt to GDP ratio is projected to eventually resume its downward-sloping path over the medium-term under all scenarios except for the current account shock where external debt is projected to reach 85 percent over the medium-term.

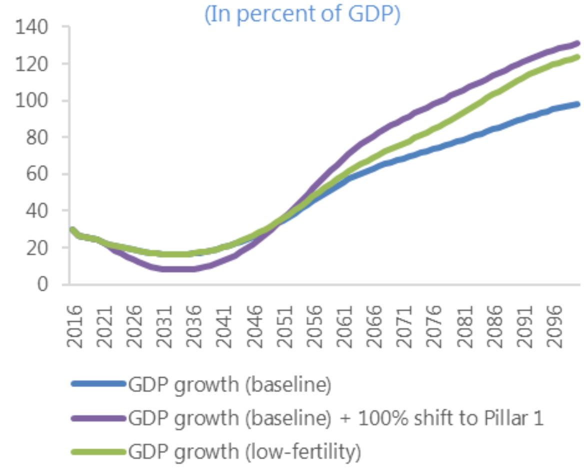
4. **General government gross debt is projected to increase in 2016 to 30 percent of GDP, but remains at manageable levels.** Under the IMF's standard DSA methodology, Bulgaria is considered a "lower scrutiny" country given its relatively moderate level of debt and gross financing needs. Public debt rose sharply between 2010 and 2015 driven by the loan to the Bulgarian Deposit Insurance Fund and liquidity support to the banking sector, as well as the deterioration of the primary balance and interest-growth dynamics, but is projected to begin declining in the medium term on account of the government's medium-term consolidation plan and improve in interest-growth dynamics. In the near term, public debt is projected to increase in 2016 by 3.8 percentage points of GDP over 2015 due to deflation and the recent sizable Eurobonds issuance (EUR 2 billion, 4.6 percent of GDP). Part of the Eurobonds-related inflows, however, are expected to be used for creating buffers ahead of the AQR, resulting in an increase in Fiscal Reserve Account (FRA) by 2.5 percent of GDP in 2016. [In light of the uneventful outcomes of the AQR and stress test, the authorities plan not to issue new Eurobonds in 2017 and limit new external borrowing to refinancing the amortizations due in 2018 thereafter.] In the medium term, fiscal consolidation and a favorable growth-interest rate differential will help decrease general government debt over time. Assuming FRA balances to remain unchanged from the projected 2017 level (BGN 6.2 billion, 6¾ percent of the 2017 GDP) for 2017–2021, general government debt would decline to 23 percent of GDP, below

the pre-2014 level, by 2021. If the government were to drawdown FRA for financing, the pace of debt reduction could be faster.[1]

5. Alternative scenarios indicate that general government debt would likely remain below 40 percent of GDP under most shocks. The fan chart analysis shows that under a scenario where the primary balance is not expected to over perform (but may under-perform) and where growth shocks are more likely to be negative than positive, debt may exceed 40 percent of GDP by 2021 with a 15 percent chance, or by 2019 with a 10 percent chance. Gross financing needs are also expected to remain well below 10 percent of GDP under various shock scenarios. The outcomes, however, could be significantly higher if contingent liabilities—especially those related to SOEs and the banking sector—materialize, pointing to the importance of sound fiscal risk assessment and management.[2]

6. In the longer term, spending pressures from the aging population can create additional fiscal challenges. Assuming (i) the overall balance to evolve from the balanced position in 2021 by the projected increases in age-related spending net of the projected increases in social security contribution revenue through 2100 and (ii) the baseline scenario on GDP growth where the demography changes in line with the UN's medium-fertility rate scenario, debt would first decline to around 16½ percent of GDP by 2030, which will then start increasing and exceed 60 percent of GDP by the mid-2060s. The debt trajectory is sensitive to growth path. Assuming the UN's low-fertility rate scenario, debt would start rising rapidly from the 2040s and exceed 100 percent of GDP by 2085. If a 100 percent shift from Pillar 2 to Pillar 1 takes place in 2016, government debt could rise to 60 percent of GDP by 2059 even assuming the baseline GDP growth projections, and would reach 130 percent of GDP by 2100.

Bulgaria: Long-Term Government Debt Projections
(In percent of GDP)

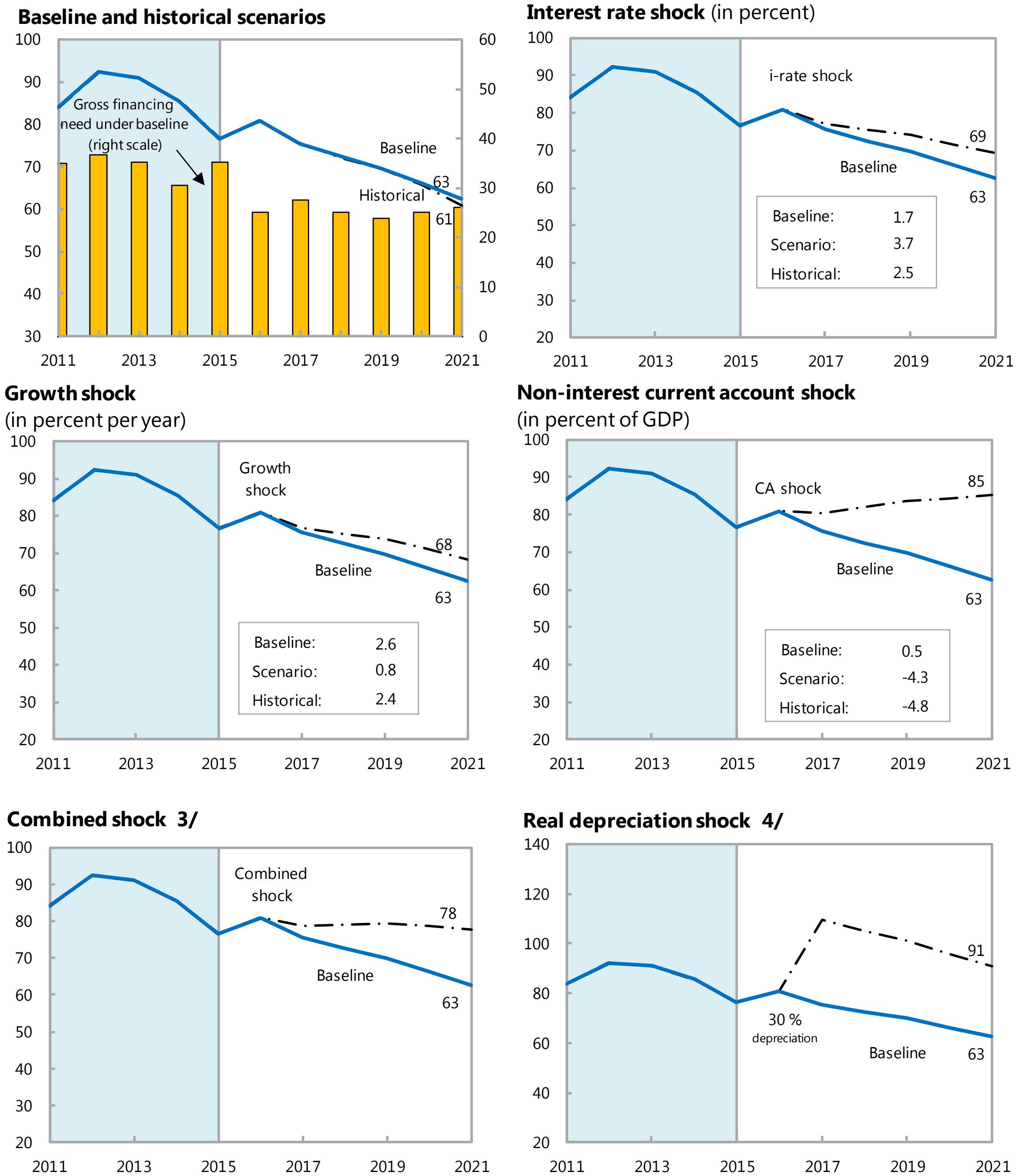


Sources: NSSI, UN 2015, IMF staff estimates

[1] The minimum balance of FRA is determined in the annual budget law. For 2016, the minimum balance is set at BGN 4.5 billion.

[2] The total SOE liabilities stood at 13.4 percent of GDP at end-2014. The average fiscal cost of 91 financial crises across advanced and emerging markets economy was about 10 percent of GDP (IMF, 2016).

Figure 1. Bulgaria: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks, except in case of the interest rate shock where a 200 bp shock is assumed. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2017.

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

(in percent of GDP unless otherwise indicated)

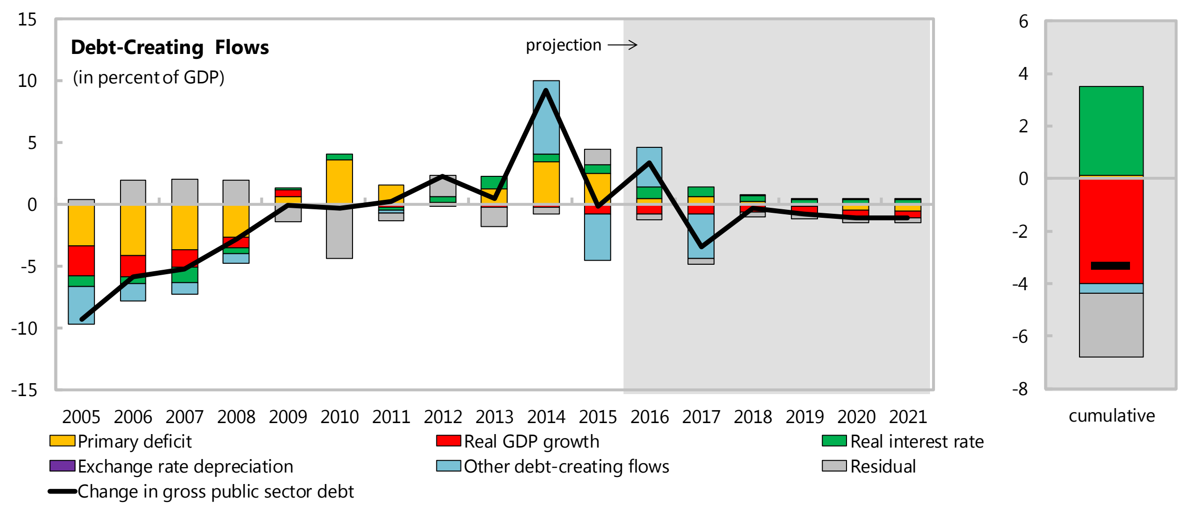
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021
Nominal gross public debt	17.9	26.4	26.3	29.7	26.3	25.9	25.2	24.1	23.0
Public gross financing needs	2.6	8.2	11.2	2.3	4.9	2.4	1.6	2.6	3.4
Real GDP growth (in percent)	2.9	1.5	3.0	3.0	2.8	2.5	2.5	2.5	2.5
Inflation (GDP deflator, in percent)	5.0	0.4	0.3	-0.7	0.6	1.6	1.9	2.1	2.1
Nominal GDP growth (in percent)	8.2	2.0	3.3	2.3	3.4	4.2	4.5	4.6	4.7
Effective interest rate (in percent) [4/]	4.9	4.1	3.2	3.1	3.3	3.5	3.6	3.7	3.9

As of July 18, 2016		
Sovereign Spreads		
EMBIG (bp) 3/		201
5Y CDS (bp)		151
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB	BBB
Fitch	BBB+	BBB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.3	9.2	-0.1	3.4	-3.4	-0.3	-0.8	-1.1	-1.1	-3.3	
Identified debt-creating flows	-2.3	9.8	-1.4	3.8	-3.0	0.1	-0.4	-0.7	-0.7	-0.9	
Primary deficit	-0.7	3.4	2.5	0.4	0.7	0.2	-0.2	-0.5	-0.5	0.1	-0.2
Primary (noninterest) revenue and gra	33.5	33.2	35.4	35.5	36.4	36.1	36.3	36.5	36.6	217.3	
Primary (noninterest) expenditure	32.7	36.6	37.9	35.9	37.0	36.3	36.1	36.0	36.1	217.5	
Automatic debt dynamics [5/]	-0.9	0.4	0.0	0.2	0.0	-0.2	-0.2	-0.2	-0.2	-0.6	
Interest rate/growth differential [6/]	-0.9	0.4	0.0	0.2	0.0	-0.2	-0.2	-0.2	-0.2	-0.6	
Of which: real interest rate	-0.2	0.6	0.7	1.0	0.8	0.5	0.4	0.4	0.4	3.4	
Of which: real GDP growth	-0.7	-0.3	-0.8	-0.8	-0.8	-0.6	-0.6	-0.6	-0.6	-4.0	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.7	6.0	-3.8	3.2	-3.6	0.0	0.0	0.0	0.0	-0.4	
Privatization receipts (negative)	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
On-lending to DF and change in FRA	0.0	6.0	-3.8	3.2	-3.6	0.0	0.0	0.0	0.0	-0.3	
Residual, including asset changes [8/]	0.0	-0.6	1.2	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	-2.4	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

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

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

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

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

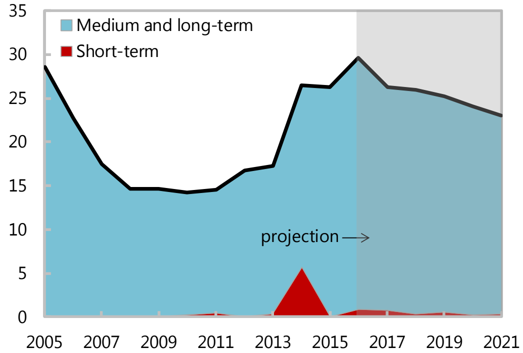
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Bulgaria Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

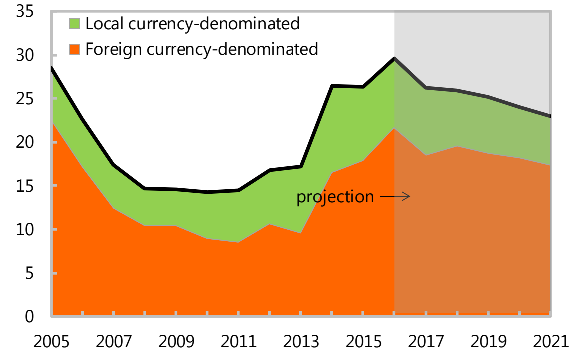
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

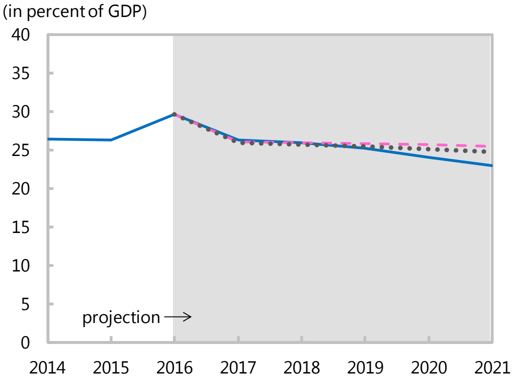


Alternative Scenarios

Baseline — Historical — Constant Primary Balance

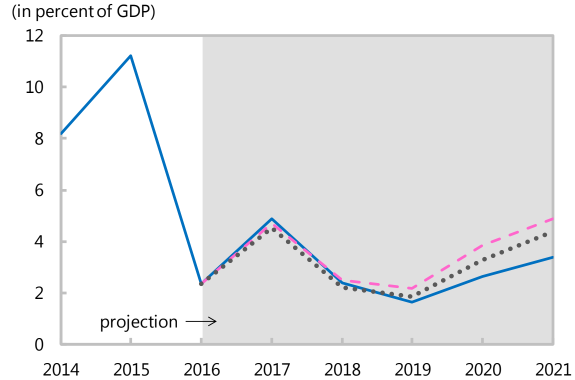
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

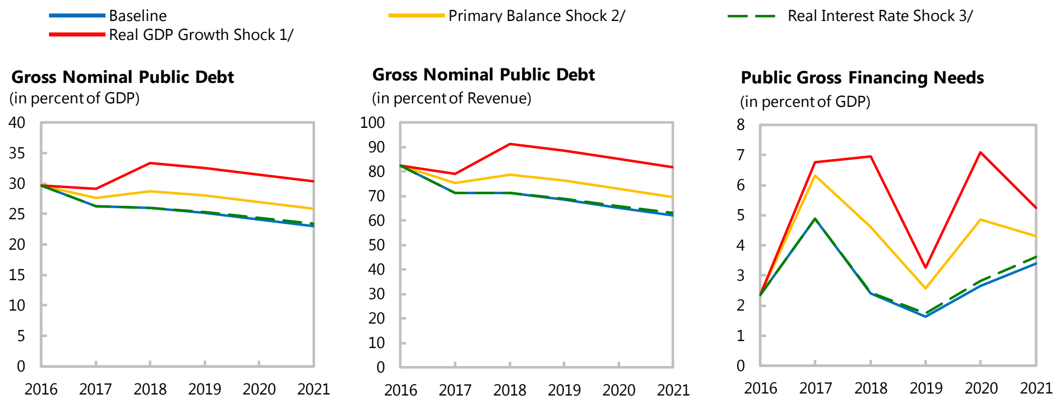
Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	3.0	2.8	2.5	2.5	2.5	2.5
Inflation	-0.7	0.6	1.6	1.9	2.1	2.1
Primary Balance	-0.4	-0.7	-0.2	0.2	0.5	0.5
Effective interest rate	3.1	3.3	3.5	3.6	3.7	3.9
Constant Primary Balance Scenario						
Real GDP growth	3.0	2.8	2.5	2.5	2.5	2.5
Inflation	-0.7	0.6	1.6	1.9	2.1	2.1
Primary Balance	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Effective interest rate	3.1	3.3	3.6	3.6	3.7	3.9

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	3.0	2.4	2.4	2.4	2.4	2.4
Inflation	-0.7	0.6	1.6	1.9	2.1	2.1
Primary Balance	-0.4	-0.3	-0.3	-0.3	-0.3	-0.3
Effective interest rate	3.1	3.3	3.5	3.4	3.5	3.6

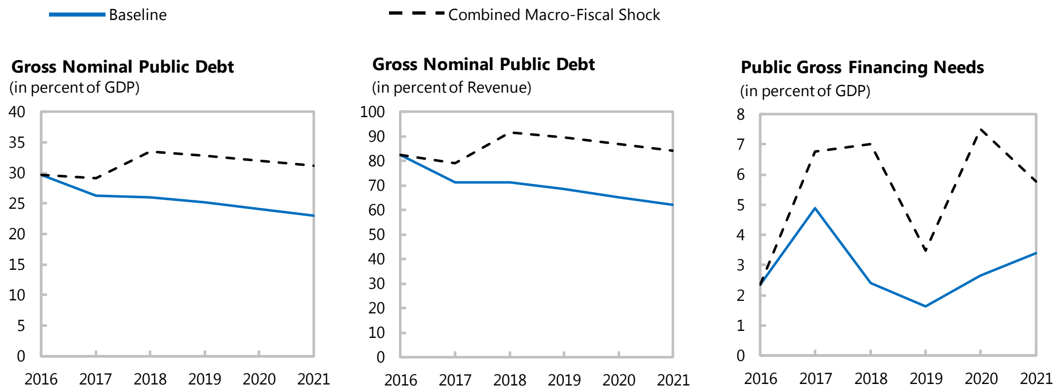
Source: IMF staff.

Bulgaria Public DSA - Stress Tests

Macro-Fiscal Stress Tests



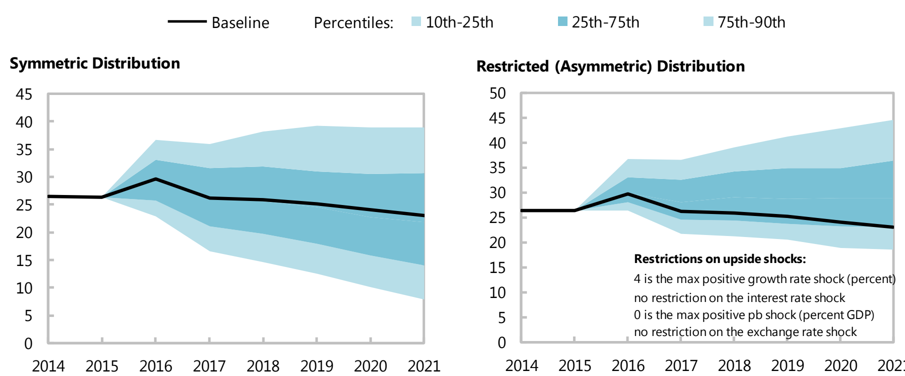
Additional Stress Tests



1/ Real GDP growth shock scenario assumes (i) real GDP growth for 2017-18 to be below the baseline projections by a 10-year historical standard deviation; (ii) the primary balance deteriorates; (iii) additional borrowing leads to increases in interest rate of 25 bbp per 1 percent of GDP worsening of the primary balance; and (iv) inflation declines by 0.25 percentage point per 1 percentage point decrease in GDP growth.
2/ Primary balance shock scenario assumes (i) the primary balance for 2017-18 to be below the baseline projections by 50 percent of the 10-year historical standard deviation; and (ii) additional borrowing leads to increase in interest rate of 25 bbp per 1 percent of GDP worsening of the primary balance.
3/ Real interest rate shock scenario assumes nominal interest rate increases by the difference between the maximum real interest rate over history (last 10 years) and the average real interest rate level over projection.

Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)

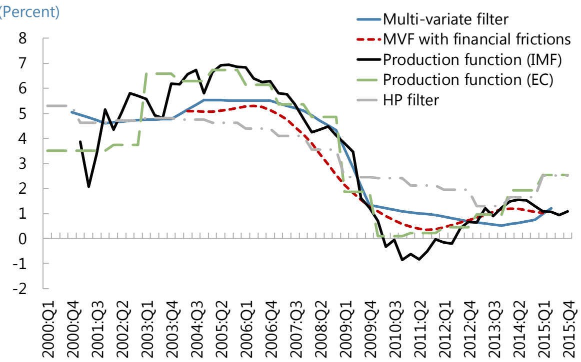


Source: IMF staff.

Appendix I. Potential Growth

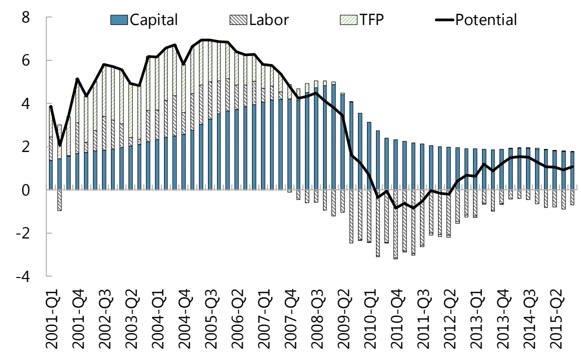
1. **Potential growth in Bulgaria has declined significantly.** In the wake of the global financial crisis, estimated potential growth rates in Bulgaria dropped markedly, from around 5–7 percent during the peak in the mid-2000s to around 1–2 percent in recent years. Potential growth is notoriously difficult to gauge when structural breaks like economic transition and the financial crisis affect economies such as Bulgaria and supply-side effects are often hard to disentangle from demand-side effects. Recent IMF analysis has addressed this challenge by estimating potential output for a large set of Central, Eastern and Southeastern European countries with a number of different approaches.[1] While the results of these different estimation methodologies need to be interpreted with caution and vary somewhat, the overall picture tends to indicate a significant decline in potential growth over the last 10 years.

Potential Growth
(Percent)



Sources: Podpiera et al., IMF Working Paper (forthcoming); European Commission; and IMF staff estimations.

Contributions to Potential Growth
(Percentage)

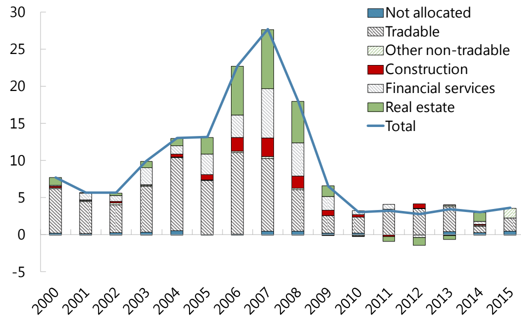


Sources: Podpiera et al., IMF Working Paper (forthcoming); and IMF staff calculations.

2. **Capital accumulation has been the major consistent driving force of potential growth in Bulgaria.** While capital and total factor productivity (TFP) contributed almost equally to potential growth in the early 2000s, the capital share increased steadily until the onset of the financial crisis, on the back of a surge in capital inflows and investment in anticipation of EU accession in 2007. By then, FDI inflows had surged to 27 percent of GDP, reflected in a current account deficit of 24 percent in the same year. Large parts of FDI inflows during the boom years went into non-tradable sectors, such as financial services and real estate. They contributed fairly little to expanding the economy's productive capacity and laid the foundation for subdued potential growth subsequently. With the sudden stop in capital inflows, FDI slumped—largely on account of the nontradable sector—and the current account corrected sharply. Since the beginning of the decade, FDI has plateaued at around 3 percent of GDP.

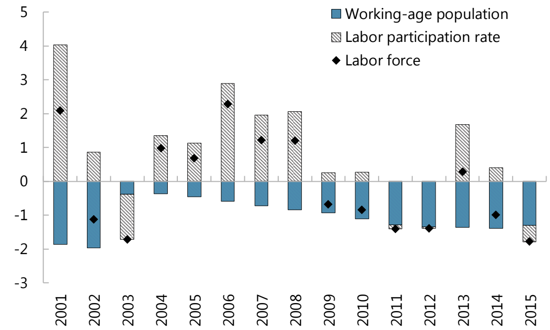
[1] Podpiera et al. (forthcoming), "A Fresh Look at Potential Output in Central, Eastern, and Southeastern European Countries", IMF Working Paper.

Contributions to FDI in Bulgaria
(Percent of GDP)



Sources: Bulgarian National Bank; IMF staff calculations.

Labor Force Growth and Contributions
(Percentage points)



Sources: European Commission; IMF staff calculations.

3. Contributions from labor turned negative in 2007, reflecting demographic trends and falling labor participation. Labor contributions to potential growth peaked during the pre-accession boom before receding and turning negative when Bulgaria entered the EU in 2007. The chart shows that labor force growth had been driven by increasing participation rates during most of the 2000s, offsetting negative effects from reductions in the working-age population. When participation rates dropped in the late 2000s and population decline accelerated, overall labor force growth turned negative. The secular decline in Bulgaria's population is driven by low birth rates and sizeable emigration which accelerated with EU accession (see Appendix VII on emigration for more details). At the same time, an increasing natural unemployment rate, measured as the non-accelerating wage rate of unemployment (NAWRU), put additional pressure on labor contributions.

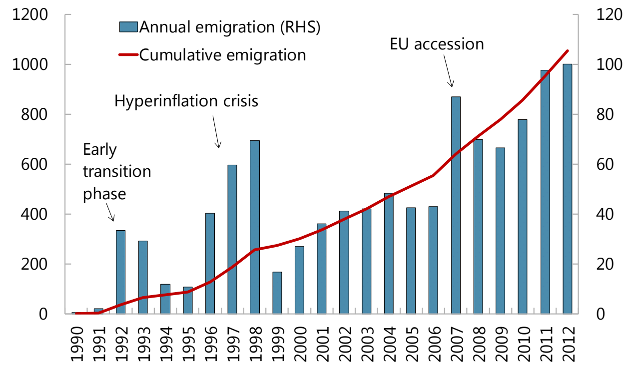
4. TFP growth stalled after the crisis, reflecting global and country-specific factors. Recent IMF analysis shows that strong productivity growth before the crisis was broad-based across CESEE countries and largely associated with favorable external or common factors, notably potential growth in trading partners, expansion of global supply chains, global trade as well as FDI.[2] For Bulgaria, these effects were likely catalyzed already during the mid-2000s by the country's prospective EU accession. In terms of country-specific drivers of productivity, a number of structural and institutional obstacles are identified which hamper technical efficiency and hence TFP growth. These factors include unfavorable economic structures (a relatively low share of the service sector), weak institutions (notably the lack of judicial independence and impartiality of courts), ineffective healthcare systems (reflected by relatively low life expectancy), as well as restrictive business and FDI regulations. In Bulgaria, most of these factors have likely added to global downward trends in TFP growth.

[2] IMF (2016), "How to Get Back on the Fast Track", Regional Economic Issues Central, Eastern, and Southeastern Europe.

Appendix II. Emigration

1. **Bulgaria has experienced significant emigration of young and highly-skilled people over the last two decades**, losing around 12 percent of its population between 1990 and 2012. The working-age share of migrants was markedly above their share in the Bulgarian population. Moreover, migrants were significantly better educated than the Bulgarian average as the share of tertiary education among migrants was substantially higher than among average Bulgarians. These developments point towards a brain drain for Bulgaria, with detrimental effects for the country's growth potential. Long-term projections by the United Nations predict a continuing decline in Bulgaria's population, driven by further emigration as well as aging developments.

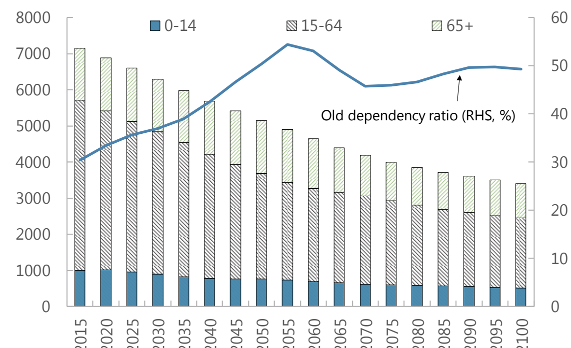
Emigration from Bulgaria
(In thousand persons)



Source: Atoyan et al. (2016), IMF Staff Discussion Note 16/07.

2. **Emigration from Bulgaria has been driven by both push and pull factors.** Relatively low per-capita income and high unemployment, compared to most EU countries, coupled with high inequality, represent key push factors for emigration. Moreover, a high level of corruption in a poor institutional environment is perceived as limiting the career prospects by skilled young people, resulting in a brain drain for Bulgaria. These push factors are magnified by cyclical conditions and country-specific shocks such as the mass lay-offs during the early transition period and the hyperinflation crisis during the late 1990s. EU accession in 2007 created a major pull factor, opening the opportunity for Bulgarian nationals to enjoy free movement within the EU's Single Market, even though certain limitations applied during a transition period. Besides better work prospects, Western EU countries also offer more generous social benefits which act as a pull factor particularly for unskilled migrants. And increasing Bulgarian expat communities in certain countries tend to make the destination more attractive for others to follow. As income and institutional convergence takes time, these factors can be expected to remain powerful drivers of migration between Bulgaria and other EU countries.

Evolution of Demography
(Baseline projections, thousands)

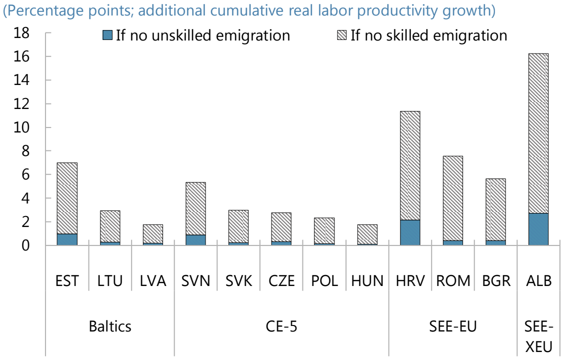


Sources: United Nations; and IMF staff calculations.

3. Emigration has adversely affected labor productivity and growth. According to recent IMF analysis, the impact of emigration on labor productivity and growth is sizeable.[1] In Bulgaria, mainly the emigration of skilled labor has been detrimental to productivity growth—without emigration, cumulated real labor productivity growth between 1995 and 2012 could have been around 6 percent stronger than actually the case. The estimated cumulative loss of real GDP growth during the same period amounts to around 8 percent—again mainly on account of skilled emigration. Going forward, continued emigration has the potential to dampen Bulgaria's growth performance. Based on multi-region model simulations using UN projections for 2015–30, the cumulative output loss could amount to around 5 percent. The main channels through which emigration is modeled to impact growth include lower investment and consumption, lost competitiveness through higher wages, and higher taxes on labor in response to social spending pressures.

Emigration and Real Labor Productivity Growth, 1995–2012

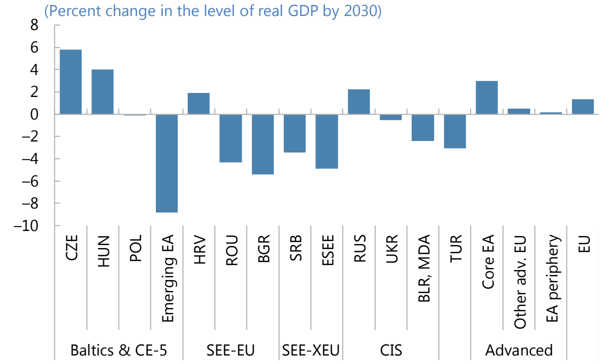
(Percentage points; additional cumulative real labor productivity growth)



Source: Atoyan et al. (2016), IMF Staff Discussion Note 16/07.

Impact on Real GDP

(Percent change in the level of real GDP by 2030)



Source: Atoyan et al. (2016), IMF Staff Discussion Note 16/07.

[1] Atoyan et al. (2016), "Emigration and Its Economic Impact on Eastern Europe", IMF Staff Discussion Note 16/07.

Appendix III. Improving Bank Supervision

Following the BCP assessment and the audit by the National Audit Office, a Plan on Reforms and Development of Banking Supervision was published by BNB in October 2015. This plan is intended to address BCP and audit recommendations in three broad areas: (i) governance and organization of banking supervision, (ii) regulatory framework and supervisory processes, and (iii) crisis management and preparedness. This Action Plan is subject to a regular follow-up to support transparency and accountability in banking supervision.

The governance of banking supervision at the BNB has been revised so as to provide more internal checks and balances as well as better support for the decision-making. Main changes so far relate to the increased accountability of the Deputy Governor in charge of banking supervision to the BNB Governing Council and his reliance on a newly created internal advisory Council on the issues related to the implementation of supervisory measures. The separation of the on-site and off-site inspection teams have been completed. Substantial recruitment and training of staff is under way.

The legal framework has been slightly revised to expand BNB's powers for imposing supervisory measures (such as dismissing members of Boards or senior management, or replacing bank auditors). Substantial effort is also being carried out to upgrade the effectiveness of the supervisory function, with the support of IMF staff. Main efforts aim at finalizing a comprehensive supervisory manual, which outlines the supervisory process by defining the rights and obligations of the Banking Supervision Department and its individual directorates and clarifies their interactions. Thereafter priority will be given to the full review of ordinances, internal rules and supervisory guidelines with the purpose to enhance them, and align them with Basel principles where necessary. This will include further work in respect of banks' governance, internal control and risk management, and the reduction of connected/related-party lending.

Appendix IV. The Banking Sector Assessment, 2016

The authorities have just completed an assessment of the banking sector. The exercise included a review of asset quality as of end-2015 and a stress test to assess banks' resilience to hypothetical adverse scenarios, while taking account of adjustments arising from the AQR. The assessment was conducted by the BNB, and about 900 experts were directly involved, including staff from BNB and those from Deloitte Bulgaria as external consultant and 9 AQR providers. To ensure consistency with similar exercises, the BNB held periodic discussions with the EC and EBA. The CA covered all 22 banks in the sector, excluding foreign bank branches. On methodology, it broadly followed the ECB AQR methodology as outlined in the Phase 2 Manual published in March, 2014, except in the area of the risk-based portfolio selection where supervisors' local knowledge of Bulgaria's banking sector and available supervisory data were factored in. The assets covered by the AQR averaged about 60 percent and reached 95 percent in some banks to take into account connected lending. About 75 percent of the banks' corporate and large SME loan books were individually reviewed.
The results showed that the banking system at the aggregate level is well capitalized and resilient to adverse shocks even after the AQR adjustments. The total AQR adjustment, of which most came from the adjustment due to loan provisioning, amounted to BGN 665 million, 1.3 percent of risk-weighted assets or 0.7 percent of total assets. The impact of these adjustments on the banking system's capital adequacy is minimal as it reduced the system's CET1 capital ratio by merely 1 percentage point to 18.9 percent, well above the sum of regulatory minimum (4.5 percent), capital conservation buffer (2.5 percent), and systemic risk buffer (3 percent). In the subsequent stress test, AQR-adjusted capital and risk-weighted assets were shocked by two macroeconomic scenarios over a three-year horizon (2016–18). Under the baseline scenario, which was consistent with the BNB macro forecast of March 2016, the banking system's CET1 capital ratio is expected to improve to 22.2 percent by end-2018. Under the adverse scenario, the banking system's CET1 capital ratio will decline to 14.4 percent, suggesting that the banking system's ability—on an aggregate basis—to absorb shocks remains strong.

Nevertheless, individual bank results vary considerably. Although all banks stayed above the regulatory minimum CET 1 capital adequacy ratio, three banks, including the largest domestic bank FIB, failed to meet the combined capital conservation buffer and systemic risks buffer requirements. FIB saw its CET1 capital ratio drop to only slightly above the regulatory minimum, resulting in a shortage of capital buffer of about BGN 205 million (¼ of one percent of GDP). Two small banks have shortage of capital buffer of BGN 33 million and 3 million, respectively. In the stress test, one bank under the baseline scenario and a number of banks under the adverse scenario will likely experience double digit declines in their CET1 ratios by end 2018, raising questions about the sustainability of their business models.

The BNB has agreed with individual banks on follow up actions. These actions were published together with the individual bank results. They ranged from recommendations to review and improve certain policies, procedures, and operational rules to requirements to restore capital buffers to their required levels. One of the small banks addressed its capital deficiency by additional owner contribution in early 2016. The other two banks have submitted their capital conservation plans to the BNB, and are expected to restore capital adequacy by end-June 2017. These banks will also be subject to intensive supervision during this period. While the stress test results are not subject to a pass/fail threshold, they will be incorporated in the annual Supervisory Review and Evaluation Process, which, together with the impact of the projection of AQR's findings on the un-sampled portfolios, may subsequently lead to changes in banks' capital plans.

Appendix V. Recent Revenue Administrative and Policy Measures

Single National Strategy

The strong revenue performance since 2015 is underpinned by several tax administrative measures set out in *Single National Strategy for Improving the Tax Collection, Tackling the Shadow Economy and Reducing the Compliance Costs 2015–17*. Its over-arching measures to enhance tax collection are as follows:

- Provide a clear and accurate regulatory framework.
- Improve the quality of administrative services.
- Use resources relative to risk levels.
- Strengthen the quality of the control activity.
- Enhance the collection of overdue public claims.
- Optimize the provisions on administrative sanctions and penalties.
- Improve the processes of eliminating public liabilities.

The strategy also aims for coordinated inter-institutional actions—including the National Revenue Agency (NRA), Customs Agency (CA), Ministry of Finance (MoF), Ministry of Interior (MoI), NSSI, NHIF, and other relevant agencies—to ensure the following:

- Effective prevention and counteraction of tax fraud and tax evasion.
- Effective detection and prevention of tax frauds and of tax evasion schemes.
- Effective administrative and criminal proceedings.
- Establishment of a common approach for preventing and combating tax frauds and tax evasion.
- Improvement of the capacity for control actions which are based on risk assessment and are supported by effective and efficient information systems.

Enhanced Control of High Risk Goods

The government has enhanced the control of the movement of high fiscal risk goods, including excisable goods. 41 new fiscal control points were opened in 2015. At the same time, an intern-institutional coordination center for counteracting smuggling and control was also set up with a view to ensure the coordination between the CA, NRA, MoI, and other relevant institutions. Control of the supplies and movement of excisable goods was also strengthened through legislative amendments in 2015. The main changes include the introduction of (i) requirements in the excise tax documents to improve reporting and track excisable goods in the supply chain to end uses, (ii) requirements to use measuring and control devices at the points of entry or departure of energy products from and to the oil pipeline or oil product pipeline, part of the tax warehouse, to and from the points of production and /or warehousing, and (iii) bans on using marked fuels for automotive machines or hating by persons who do not have storage tanks or heating installation.

Reverse VAT Charge Mechanism

The government introduced a reverse VAT charge mechanism for supplies of cereals and industrial crops (valid through end-2018), which can be a powerful tool to combat VAT fraud at early stages of a VAT chain. The EU VAT system is characterized by fractionalized payment—VAT is collected at each stage of the production and distribution chain after offsetting the input VAT paid on purchases against the output VAT received on sales. In other words, a supplier of goods and services (say "Company A") collects VAT from the customer (say "Company B," which purchases goods and services from Company A as inputs for its outputs) and transfers the VAT collected from Company B to the state while deducting VAT paid to the inputs purchased for producing the goods and services. Company B, in turn, can deduct the VAT paid to Company A while collecting VAT on its sales to its customer (say "Company C"). This system, however, is susceptive to "missing trader" fraud, where, for example, Company B evades paying to the state the VAT collected on sales to Company C while Company C has the right to deduct VAT on the basis of a valid tax invoice. Under a reverse VAT charge mechanism, the customer—instead of the supplier—is in charge of paying the VAT on its own purchases while the equal amount is deducted simultaneously via the same VAT return. This framework eliminates the cash risks as no actual payment of the VAT takes place. However, it brings on the retail sector the charge of collecting the VAT due for the whole chain on the consumption.

In 2014, Bulgaria introduced a reverse VAT charge mechanism for the domestic supplies of cereals and industrial crops. These sectors are known to be susceptive to VAT fraud not only in Bulgaria but also in other European countries: for example, "ghost" companies are established and function during the agricultural campaign and disappear when they should make tax returns and pay obligations to the state budget, including VAT. The reverse charge mechanism can eliminate such fraud as "ghost" companies do not receive VAT on their sales. The mechanism is currently applied for supplies of the concerning products within the territory of Bulgaria that are received by a VAT registered person and the supplier is a tax liable or non-liable person.

Additional measures have also been implemented to prevent a shift in tax fraud to later stages of a VAT chain or other economic sectors following the introduction of the reverse VAT charge mechanism:

- Identify the persons using the reverse charge mechanism and strengthened control over their activities;
- Enhance interaction between the NRA and the State Fund Agriculture bodies for exchanging information on cereal and industrial crops producers and areas sown;
- Conduct joint inspections by the NRA and the National Grain and Feed Service of the entities subject of control, such as agricultural producers, traders, grain storage facilities, public warehouses and processors;
- Strengthen control over the cereal and industrial crops processing sectors; and
- Strengthen control over the export of cereal and industrial crops and over the transport vehicles transporting cereal and industrial crops, such as trucks, railway wagons, and ships.

Increases in Excise Duty Rates

The strong revenue performance has also been supported by increases in excise duty rates. The government has been raising gradually the rates for energy products used as heating fuel and cigarettes during 2015–18. The increases in the excises also have positive effects on VAT on the excisable goods.

Appendix VI. Summary of the 2015 Pension Reforms

Pillar 1 Parametric Reforms

- Increase the contribution rates by 1 percentage point each year in 2017 and 2018 (combined employer and employee) for old-age, survivors, and disability benefits from 17.8 percent to 19.8 percent for those who contribute only to Pillar 1 (from 12.8 percent to 14.8 percent for those who contribute to both Pillar 1 and 2 while the contribution rate for Pillar 2 remains unchanged at 5 percent).

- Raise the retirement age for women and men to 65 from currently 60 years and 8 months for women and 63 years and 8 months for men: (i) women—by 2 months per year until 2029, and by 3 months from 2030 until 2037; and (ii) men—by 2 months in 2016 and 2017 and starting from 2018 by 1 month per calendar year until 2029. Thereafter, the retirement age will be linked to the increase in life expectancy.

- Raise the retirement age for miners, pilots, and workers in nuclear power plants to 55 from the current retirement ages of 52 years and 8 months for men and 47 years and 8 months for women.

- Increase the required length of service for retirement of employees by 2 months per year until 2027, reaching 40 years for men and 37 years for women.

- For employees with insufficient length of service (but no less than 15 years of actual pensionable service) the retirement age for men and women will grow smoothly until reaching 67 years of age in 2029: (i) in 2016 and 2017 growth will be 2 months per year; (ii) from 2018 it will continue to rise by 1 month per year.

- Improve the adequacy of pensions through modifying (i) the individual coefficient and (ii) the weight of the length of service for the benefit formula from 1.2 to 1.5 by 2026.

- Allow people with disabilities who were born after December 31, 1959 and currently receiving disability pensions move their accumulated assets from Pillar 2 to Pillar 1 in order to receive higher pension benefits today. Their pension from Pillar 2 will otherwise be available only when they reach the retirement age.

Introduction of Unlimited Shifts Between Pillar 1 and Pillar 2

- Under the new rule, people are allowed to shift between Pillar 1 and Pillar 2 unlimitedly until five years before the retirement. If an individual decides to shift from Pillar 2 to Pillar 1, his assets will be transferred to the government (the Silver Fund) but maintained under his unique account so that he can shift his assets back to Pillar 2 if he decides to do so. While being maintained by the Silver Fund, the transferred Pillar 2 assets do not earn interest.

- Regardless of the time vested in Pillar 2, an individual whose final decision is to permanently shift to the Pillar 1 system will receive undiscounted amount of pension benefits from Pillar 1, which will be broadly equivalent to 60 percent of his social security income.

- The framework provides incentive for people to maximize Pillar 2 assets throughout the career and decide at the latest possible timing—five years before the retirement—whether to switch to Pillar 1 or not by comparing the amount of Pillar 2 assets to give up and projected additional Pillar 1 benefits to receive from switching.

- Given no interest will be earned on the assets transferred from Pillar 2 to Pillar 1, frequent switches between Pillar 1 and 2 are likely limited in normal times—when investment returns of Pillar 2 are positive.

Appendix VII. The Belene Case

1. On June 14, 2016, the International Arbitration Court's ruling ordered Bulgaria's state-owned National Electricity Company (NEK)—100 percent owned by a state-owned Bulgaria Energy Holding (BEH)—to pay the amounts due to Russia's Atomstroyexport for the equipment already produced for the cancelled Belene Nuclear Power Plant (NPP) project. The court declined other claims, such as the escalating price claims, lost profits for expenses incurred beyond the subject contract, and demobilization costs. The NEK's obligation amounts to EUR 646 million (including principal and accumulated interests) by end-2016 and will further accumulate interest at an annual rate of about 10 percent if not paid.

2. The history of the Belene NPP project goes back to the 1970s. The plant was expected to be built 3 km from Belene in northern Bulgaria as Bulgaria's second NPP. The Belene site was approved for construction by a Council of Ministers decree on March 20, 1981. By 1990, 40 percent of the construction work of reactor 1 was finished and 80 percent of the equipment was supplied. However, the project was abandoned in 1990 due to the restoration of capitalism in Bulgaria.

3. In 2004, the Council of Ministers decided to resume the construction of the Belene NPP with maximum installed capacity of 2000 MW, which in 2005 was decided to be a national priority. In October 2006, NEK and Russian's Atomstroyexport, which was the contractor selected through a competitive procurement procedure, signed an agreement whereby the parties would conclude a future contract for engineering, procurement, and construction of the Belene NPP. The deadline for signing the contract was repeatedly extended, and never signed.

4. In 2008, absent a contract, production of equipment (e.g., reactor, installation, stream generators, systems of passive protection, refueling machine, turbine installation) for the plant started in accordance with an Appendix to the 2006 agreement. For the production, the Bulgarian government made an advance payment amounting to EUR 89 million in 2008.

5. In 2012, the Council of Ministers decided to discontinue the Belene NPP project, which was also supported by Parliament. Meanwhile, the International Arbitration Court initiated the arbitration proceedings.

6. The Bulgarian government's current priority is to prevent further accumulation of interest on NEK's obligation as a priority. To do so, the Parliament has recently adopted a special law to extend an uncollateralized interest-free loan to NEK by mobilizing the government deposits. The implementation of the law is conditional to the EC's positive opinion. At the same time, the government is exploring a permanent solution—that is to remove the equipment from NEK's balance sheet. The Ministry of Energy indicated that options for the permanent solution include (i) selling the equipment to a third country, and (ii) resume the project by attracting private investors. The former option requires Atomstroyexport's agreement.

INTERNATIONAL MONETARY FUND

BULGARIA

October 18, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By
European Department
(in consultation with other departments)

CONTENTS

FUND RELATIONS

(as of September 30, 2016)

Membership Status

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

General Resources Account

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

SDR Department

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

Outstanding Purchases and Loans: None.

Latest Financial Arrangements

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

Projected Payments to the Fund

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

	Forthcoming				
	2016	2017	2018	2019	2020
Principal	--	--	--	--	--
Charges/Interest	--	0.02	0.02	0.02	0.02
Total	--	0.02	0.02	0.02	0.02

Exchange Rate Arrangement:

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

Deutsche Mark at BGN 1000 per Deutsche Mark. Since January 1, 1999 the lev has been fixed to the euro at BGN 1.95583 per euro. Bulgaria joined the European Union (EU) on January 1, 2007. Bulgaria has accepted the obligations of Article VIII, Sections 2–4, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Article IV Consultations

The 2015 Article IV Board discussion took place on May 4, 2015. The Staff Report was published on May 13, 2015 (Country Report No. 15/119).

Resident Representative

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

RELATIONS WITH THE WORLD BANK

The World Bank has been leading the policy dialogue on structural and institutional reforms in support of accelerating Bulgaria's convergence to EU income levels. On May 19, 2016 the Board of Directors endorsed the Country Partnership Framework (CPF) for Bulgaria of the World Bank Group (WBG) which outlined the roadmap for the WBG's country support for the period FY17-FY22. The CPF marks a renewed engagement with Bulgaria, including the first new lending operations since FY11. The program sets out a selective engagement with ambitious objectives in two key areas with strong government ownership and demand for the WBG support. Within these two broad areas of engagement the program identifies five objectives. The first area on "Strengthening institutions for sustainable growth" aims to: (i) Improve resilience and stability of the financial sector; (ii) Strengthen electricity sector and improved energy efficiency; and (iii) Better protect natural assets and improved efficiency in use of resources. Objectives of the second area on "Investing in people" are: (i) Enhanced school outcomes for better employability, and (ii) Improved access to essential services (housing, water, ECD, long-term care) for bottom 40 and marginalized groups. The objectives are strongly correlated with the WBG's twin goals of poverty reduction and shared prosperity.

A. International Bank for Reconstruction and Development (IBRD)

Bulgaria's active portfolio consists of active investment projects totaling US$430 million in net commitments, which are complemented by Bank-funded analytical pieces and RASs.

- The two active investment projects focus on the development of municipal infrastructure and the strengthening of the deposit insurance fund.
- Analytical tasks include an assessment of Bulgaria's Housing Sector; a Poverty and Social Impact Analysis of improving energy efficiency in Bulgaria; an assessment on how to improve access to essential services, such as education, water, housing, health and long-term care and social welfare; a study on citizen engagement; an update of the Bulgaria FSAP (in collaboration with the IMF); and a Spending Review. In addition, there are two EC funded regional tasks on Poverty Mapping and Sub-national Doing Business under implementation.
- There are six Reimbursable Advisory Services (RAS) under implementation and one task is at an advanced stage of preparation Reimbursable Advisory Services cover key areas of engagement. Under the current programming period, the World Bank is providing advice on policy formulation and strategy development in climate change adaptation; shared services; pre-university education; water and sanitation services, energy sector reform.

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

	Operation	US$ million	Board date
1.	Municipal Infrastructure Development Project	102.6	2009
2.	Deposit Insurance Strengthening Project	327.5	2016

B. International Finance Corporation (IFC)

As of June 2016, the IFC had 39 projects (completed and ongoing) in Bulgaria with total commitments of over US$975 million. The single biggest investment of IFC in the country is in the retail sector in the form of a loan for the expansion and improvement of energy efficiency of the largest discount supermarket chain in Bulgaria. Its buildings are awarded with certificate for highest environmental performance. IFC was also involved in the development of the Galata gas field near the Black sea cost, helping diversification of natural gas supply. 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 had supported two specialized SME banks; helps trade operations through its Global Trade Finance Program; 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, particle board producer, a large steel mill, and two glass processing plants. IFC maintains large portfolio in renewable energy in the country, including investments in the largest wind and photovoltaic power producers. 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.

STATISTICAL ISSUES

Bulgaria—STATISTICAL ISSUES APPENDIX

As of October 13, 2016

I. Assessment of Data Adequacy for Surveillance

General: *Data provision is adequate for surveillance purposes.*

National Accounts

The National Statistical Institute (NSI) is responsible for compiling national accounts, based on 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 production, income, and capital accounts for the five resident institutional sectors (general government and its sub-sectors, financial corporations, non-financial corporations, nonprofit institutions serving households, and households). The NSI publishes financial accounts and balance sheets by institutional sectors and sub-sectors on an annual basis.

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.

Labor Market Statistics

Data on employment and hours worked are compiled by the NSI based on a Labor Force Survey and Enterprises' survey on employment—"Quarterly survey on employees, hours worked, wages and salaries, and other expenditures paid by the employers" (QLCS) and "Annual enterprises survey on employment, wages and salaries, and other labor cost" are adjusted according to the ESA2010 methodology. The NSI current monthly and quarterly estimates are based on the results from the sample– QLCS. The QLCS sample includes 13100 private sector enterprises out of approximately 203000. The public sector enterprises are covered exhaustively except for the schools and kindergartens for which a sample is drown as well from 2008. The NSI household labor force survey provide average quarterly results and is an alternative source of data, but the methodological discrepancies between household and establishment survey need to be taken into account (especially regarding agricultural employment). .

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

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.

Price Statistics

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

Government Finance Statistics

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

The Ministry of Finance prepares data on the execution of the consolidated government budget on a monthly and quarterly basis, following the national presentation. These data are not according to *GFS* standards. Aggregate data on revenue, expenditure, balance of the general government and composition of financing (in national formats) are published with a monthly bulletin and posted on the MOF's website, in addition to the GFSM 2001 data. Progress has been made in presenting data on a disaggregated basis, including expenditure by functional classification. In addition, a full economic classification of expenditure is now available, and the authorities have provided such data on an annual basis back to 1998.
Monetary and Financial Statistics: The BNB reports monetary data for publication in the *IFS* based on the ECB framework for the collection and compilation of monetary data, beginning with data starting in February 2004. Data comply with the *MFSM* methodology, with some minor deviations documented in the *IFS* metadata. Data for other financial corporations are not currently reported to the IMF.
Financial Sector Surveillance: Bulgaria participates in the financial soundness indicators (FSIs) project. Annual data are posted on the FSI website for the period 2005–15.
External Sector Statistics **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 and International Investment Position Manual, sixth edition (BPM6)* and reported to STA on quarterly basis. The BNB publishes monthly balance of payments data and quarterly international investment position data on its official website in accordance with the Statistical Data Release Calendar. Since joining the EU in January 2007, the trade data with EU countries are being collected following the INTRASTAT system. The flow of customs data has improved significantly in recent years and a new system for processing customs records is near completion. 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. 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 re-dissemination in the Quarterly External Debt Statistics (QEDS) database. In line with the Special Data Dissemination Standard Plus (SDDS Plus) requirements, Bulgaria participates in: (i) the Coordinated Direct Investment Survey (CDIS) with inward data separately identifying equity and debt instruments positions and providing further breakdown of gross asset and liability debt instrument positions; (ii) the Coordinated Portfolio Investment Survey (CPIS) providing semiannual core data as well as the following encouraged items: currency of denomination, sector of the holder, liabilities, sector of the issuer, and cross-sectors classifications; and (iii) the Currency Composition of Official Foreign Exchange Reserves (COFER).
II. Data Standards and Quality
Bulgaria started to adhere to the SDDS Plus in 2016.

Bulgaria: Table of Common Indicators Required for Surveillance
(as of October 13, 2016)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	30/09/2016	10/03/2016	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	August 2016	09/15/2016	M	M	M
Reserve/Base Money	August 2016	09/21/2016	M	M	M
Broad Money	August 2016	09/21/2016	M	M	M
Central Bank Balance Sheet	August 2016	09/21/2016	M	M	M
Consolidated Balance Sheet of the Banking System	August 2016	09/21/2016	M	M	M
Interest Rates[2]	September 2016	10/06/2016	M	M	M
Consumer Price Index	August 2016	09/13/2016	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2014	06/30/2015	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3]– General Government[4]	April 2016	05/31/2016	M	M	M
Revenue, Expenditure, Net operating balance, Gross operating balance, Net lending/borrowing, Net acquisition of assets, Net incurrence of liabilities [5] – General Government	2016 Q1	07/31/2016	Q	Q	Q
Revenue, Expenditure, Balance, Net acquisition of assets, Net incurrence of liabilities, Net change in the stock of cash [5] – Central Government	August 2016	09/30/2016	M	M	M
Stocks of General Government and General Government-Guaranteed Debt[6]	August 2016	09/30/2016	M	M	M
External Current Account Balance	June 2016	09/17/2016	M	M	M
Exports and Imports of Goods and Services	June 2016	09/17/2016	M	M	M
GDP	2016 Q2	09/15/2016	Q	Q	Q
Gross External Debt	March 2016	07/20/2016	M	M	M
International Investment Position	2016 Q1	07/12/2016	Q	Q	Q

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

BULGARIA

October 31, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION— SUPPLEMENTARY INFORMATION

Prepared By

European Department

The purpose of this supplement is to inform the Board about recent revisions of Bulgaria's national accounts and the latest economic developments. This information does not change the thrust of the staff appraisal.

1. **Revised national accounts data from Bulgaria's National Statistical Institute show higher real and nominal GDP growth in 2015.** Real GDP growth was revised up from 3.0 to 3.6 percent for 2015 and from 3.0 to 3½ percent for the first half of 2016 (y/y). Domestic demand, especially private consumption, turned out to be stronger in 2015 than suggested by the previous data, while the contribution from net exports was weaker. Along the same lines, the current account surplus in 2015 was revised downward by about 1 percentage point of GDP, as a slightly better service balance was not enough to offset lower trade and primary income balances. The GDP deflator was also revised up, resulting in an upward revision of 2015 nominal GDP growth by 2½ percentage points. The text table shows key changes in the data.[1]

Bulgaria: Selected Economic Indicators Affected by the Revision, 2012–2015
(Annual percentage change, unless noted otherwise)

	Pre-revision				Post-revision			
	2012	2013	2014	2015	2012	2013	2014	2015
Real GDP	0.2	1.3	1.5	3.0	0.0	0.9	1.3	3.6
Final consumption	2.5	-0.7	2.2	0.7	2.0	-1.9	2.2	3.8
Investment	2.1	-2.3	4.1	2.3	2.3	-2.1	4.2	2.2
Net exports 1/	-2.3	2.4	-1.1	1.9	-2.0	2.8	-1.3	0.1
GDP deflator	1.6	-0.7	0.4	0.3	1.6	-0.7	0.5	2.2
Current account 2/	-0.9	1.3	0.9	1.4	-0.9	1.3	0.1	0.4

Source: Bulgarian authorities. 1/ Contribution to GDP growth. 2/ Percent of GDP.

[1] The revised national accounts data for Bulgaria cover the period 2000–2015

2. **Based on the revised data, staff has raised the GDP growth projection for 2016 to 3¼ percent from 3 percent in the staff report**. This change reflects increased carryover from 2015 and the stronger outturn for the first half of 2016. The projections for medium-term actual growth and potential growth were maintained at around 2½ percent as the longer term constraints to higher growth as laid out in the staff report remain unchanged (see paragraph 8 of the staff report). The revised growth projection does not change staff's overall assessment about Bulgaria's external position in 2015 (see Annex I of staff report) or about the country's debt sustainability (see Annex II of the staff report).

3. **The revision to nominal GDP implies a small improvement in key macroeconomic ratios.** For example, as a result of the higher denominator, the 2015 government debt-to-GDP ratio declined to 25.6 percent of GDP (from 26.3 percent previously), and the 2015 fiscal cash deficit fell to 2.8 percent of GDP (compared to 2.9 percent). Similarly, the external debt dropped to 76.1 percent of GDP (from 78.1 percent previously). Staff projections for government and external debt and fiscal deficit in terms of GDP have also been revised slightly downward. A complete set of tables with the revised historical data and updated projections is attached.

4. **Based on new releases staff has also slightly raised the inflation projection for 2016.** Recent data releases show a decelerating pace of declines in energy and transportation prices. Incorporating these data, staff has revised up the average HICP inflation projection for 2016 to -1.3 percent from -1.6 percent in the staff report.

Table 1. Bulgaria: Selected Economic and Social Indicators, 2012–21

(Annual percentage change, unless noted otherwise)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
							Proj.			
Real GDP	0.0	0.9	1.3	3.6	3.3	2.9	2.5	2.5	2.5	2.5
Real domestic demand	2.0	-1.9	2.6	3.5	2.9	3.1	2.7	2.7	2.5	2.5
Public consumption	-1.9	0.6	0.0	1.3	2.6	2.6	1.8	1.4	1.1	2.0
Private consumption	3.0	-2.5	2.7	4.5	3.8	3.4	3.0	3.0	2.8	2.6
Gross capital formation	2.3	-2.1	4.2	2.2	0.5	2.6	2.5	2.6	2.6	2.6
Private investment	-2.1	-2.6	0.3	-3.7	4.5	2.4	1.9	1.9	1.9	1.8
Public investment	20.3	11.4	14.0	21.4	-9.0	3.4	4.1	4.3	4.6	4.8
Stock building 4/	0.1	-0.5	0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net exports 4/	-2.0	2.8	-1.3	0.1	0.3	-0.2	-0.2	-0.2	0.0	0.0
Exports of goods and services	2.0	9.6	3.1	5.7	4.2	3.5	3.6	3.8	4.0	4.0
Imports of goods and services	5.5	4.3	5.2	5.4	3.6	3.7	3.9	4.1	4.0	4.0
Resource utilization										
Potential GDP	2.2	1.5	1.6	2.3	2.4	2.4	2.5	2.5	2.5	2.5
Output gap (percent of potential GDP)	-1.7	-2.4	-2.7	-1.4	-0.5	-0.1	0.0	0.0	0.0	0.0
Unemployment rate (percent of labor force)	12.4	13.0	11.5	9.2	8.2	7.1	6.9	6.7	6.6	6.5
Price										
GDP deflator	1.6	-0.7	0.5	2.2	-0.3	0.6	1.6	1.9	2.1	2.1
Consumer price index (HICP, end of period)	2.8	-0.9	-2.0	-0.9	-0.8	1.4	1.8	2.0	2.1	2.1
Fiscal indicators										
General government net lending/borrowing (cash basis) 1/	-0.4	-1.8	-3.6	-2.8	-0.7	-1.1	-0.7	-0.3	0.0	0.0
General government primary balance 1/	0.3	-0.9	-3.0	-2.0	0.0	-0.2	0.2	0.6	0.9	0.9
Structural overall balance (percent of GDP)	0.2	-0.9	-2.7	-2.3	-0.5	-1.1	-0.7	-0.3	0.0	0.0
Structural primary balance (percent of GDP)	0.9	0.0	-2.0	-1.5	0.2	-0.2	0.2	0.6	0.9	0.9
General government gross debt 2/	16.7	17.2	26.4	25.6	28.7	25.4	25.1	24.3	23.2	22.2
Monetary aggregates 3/										
Broad money	8.4	8.9	1.1	8.8	5.6	4.9	5.5	5.9	6.0	6.1
Domestic private credit	2.8	0.3	-7.7	-1.6	1.2	6.5	7.2	7.2	7.3	7.3
Exchange rates regime										
Leva per U.S. dollar (end of period)	1.48	1.42	1.61	1.79	...	...	...	...	...	...
Nominal effective rate	-1.8	2.5	2.9	-1.3	...	...	...	...	...	...
External sector										
Current account balance 1/	-0.9	1.3	0.1	0.4	1.6	0.5	0.0	-0.4	-1.0	-1.7
o/w: Merchandise trade balance 1/	-9.5	-7.0	-6.5	-5.8	-6.3	-6.9	-6.9	-6.9	-7.0	-7.0

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, 2012–21

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
							Proj.			
GDP and prices (percent change)										
Real GDP	0.0	0.9	1.3	3.6	3.3	2.9	2.5	2.5	2.5	2.5
Real domestic demand	2.0	-1.9	2.6	3.5	2.9	3.1	2.7	2.7	2.5	2.5
Of which: private	2.0	-3.1	2.4	2.7	3.9	3.2	2.8	2.8	2.6	2.4
GDP deflator	1.6	-0.7	0.5	2.2	-0.3	0.6	1.6	1.9	2.1	2.1
Consumer price index (HICP, average)	2.4	0.4	-1.6	-1.1	-1.3	0.6	1.6	1.9	2.1	2.1
Nominal wages	6.6	6.0	6.0	8.8	8.1	7.4	6.7	6.0	5.3	4.6
Real effective exchange rate, CPI based	-2.0	1.3	-0.5	-3.2	...	...	...	...	...	...
Monetary aggregates (percent change) 1/										
Broad money	8.4	8.9	1.1	8.8	5.6	4.9	5.5	5.9	6.0	0.0
Domestic private credit	2.8	0.3	-7.7	-1.6	5.1	6.4	7.2	7.2	7.3	7.3
Saving and investment (percent of GDP)										
Foreign saving	0.9	-1.3	-0.1	-0.4	-1.6	-0.5	0.0	0.4	1.0	1.7
Gross national saving	21.1	22.6	21.5	21.6	23.6	22.9	22.3	21.8	21.3	20.7
Government	4.0	3.1	1.7	4.8	4.7	5.4	5.3	5.7	6.1	6.2
Private	17.1	19.5	19.8	16.8	18.8	17.5	17.0	16.1	15.3	14.6
Gross domestic investment	21.9	21.3	21.4	21.2	21.9	22.4	22.2	22.2	22.4	22.5
Government	4.4	4.8	5.3	7.6	5.5	6.5	5.9	6.0	6.1	6.2
Private	17.6	16.5	16.1	13.6	16.4	15.9	16.3	16.2	16.3	16.3
General government (percent of GDP)										
Revenue	32.3	33.8	33.7	35.0	34.8	35.7	35.4	35.6	35.8	35.9
Tax revenue (including social security contributions)	25.1	25.7	26.0	26.7	27.8	28.1	28.3	28.4	28.4	28.4
Non-Tax revenue	4.4	4.8	4.1	4.2	4.3	4.9	4.3	4.3	4.3	4.3
Grants	2.9	3.2	3.5	4.1	2.8	2.7	2.9	3.0	3.2	3.3
Expenditure	32.8	35.5	37.3	37.8	35.6	36.8	36.1	35.9	35.8	35.9
Balance (net lending/borrowing on cash basis)	-0.4	-1.8	-3.6	-2.8	-0.7	-1.1	-0.7	-0.3	0.0	0.0
Structural balance	0.2	-0.9	-2.7	-2.3	-0.5	-1.1	-0.7	-0.3	0.0	0.0
Balance of payments (percent of GDP)										
Current account	-0.9	1.3	0.1	0.4	1.6	0.5	0.0	-0.4	-1.0	-1.7
Trade balance	-9.5	-7.0	-6.5	-5.8	-6.3	-6.9	-6.9	-6.9	-7.0	-7.0
Services balance	6.2	6.3	5.9	6.8	7.2	7.2	7.1	7.0	7.0	6.9
Primary income balance	-2.5	-3.8	-3.1	-4.3	-2.4	-2.8	-3.3	-3.9	-4.5	-5.2
Secondary income balance	5.0	5.7	3.8	3.6	3.1	3.0	3.1	3.4	3.4	3.5
Capital and financial account	1.3	1.1	2.2	3.1	2.3	2.2	2.2	2.1	2.1	2.2
of which: Foreign direct investment	-2.5	-3.0	-2.1	-3.5	-3.1	-3.0	-3.1	-3.3	-3.5	-3.6
Memorandum items:										
Gross international reserves (billions of euros)	15.6	14.4	16.5	20.3	21.7	22.4	23.3	24.0	24.4	24.5
Short-term external debt (percent of GDP) 2/	24.7	22.8	23.3	17.7	17.1	16.4	15.4	14.9	14.0	13.2
Export volume (percent change)	-2.5	11.2	3.1	6.8	2.5	3.7	3.8	4.0	3.9	4.2
Import volume (percent change)	2.7	5.3	3.4	6.2	3.6	3.7	3.9	4.1	4.0	4.0
Terms of trade (percent change)	2.7	0.3	0.1	-0.9	-0.7	-0.8	0.2	0.0	-0.3	-0.2
Output gap (percent of potential GDP)	-1.7	-2.4	-2.7	-1.4	-0.5	-0.1	0.0	0.0	0.0	0.0
Nominal GDP (millions of leva)	82,040	82,166	83,634	88,571	91,220	94,431	98,357	102,740	107,480	112,480
Nominal GDP (millions of euros)	41,947	42,011	42,762	45,286	46,640	48,282	50,289	52,530	54,954	57,510

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, 2012–21

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
							Proj.			
				(Real growth rate, in percent)						
GDP	0.0	0.9	1.3	3.6	3.3	2.9	2.5	2.5	2.5	2.5
Domestic demand	2.0	-1.9	2.6	3.5	2.9	3.1	2.7	2.7	2.5	2.5
Private demand	2.0	-3.1	2.4	2.7	3.9	3.2	2.8	2.8	2.6	2.4
Public demand	2.1	2.9	3.2	6.4	-0.8	2.8	2.5	2.2	2.0	2.8
Final consumption	2.0	-1.9	2.2	3.8	3.5	3.2	2.8	2.7	2.4	2.5
Private consumption	3.0	-2.5	2.7	4.5	3.8	3.4	3.0	3.0	2.8	2.6
Public consumption	-1.9	0.6	0.0	1.3	2.6	2.6	1.8	1.4	1.1	2.0
Investment	2.3	-2.1	4.2	2.2	0.5	2.6	2.5	2.6	2.6	2.6
Gross fixed investment	1.8	0.3	3.4	2.7	0.5	2.7	2.5	2.6	2.6	2.7
Private investment	-2.1	-2.6	0.3	-3.7	4.5	2.4	1.9	1.9	1.9	1.8
Public investment	20.3	11.4	14.0	21.4	-9.0	3.4	4.1	4.3	4.6	4.8
Inventories 1/	0.1	-0.5	0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net exports 1/	-2.0	2.8	-1.3	0.1	0.3	-0.2	-0.2	-0.2	0.0	0.0
Exports of goods and services	2.0	9.6	3.1	5.7	4.2	3.5	3.6	3.8	4.0	4.0
Imports of goods and services	5.5	4.3	5.2	5.4	3.6	3.7	3.9	4.1	4.0	4.0
				(Contribution to real GDP growth, in percent)						
Domestic demand	2.1	-2.0	2.6	3.6	3.0	3.1	2.7	2.7	2.5	2.5
Private demand	1.7	-2.6	2.0	2.2	3.1	2.6	2.2	2.3	2.1	2.0
Public demand	0.4	0.6	0.7	1.4	-0.2	0.6	0.5	0.5	0.4	0.6
Final consumption	1.6	-1.5	1.7	3.1	2.9	2.6	2.2	2.2	2.0	2.0
Private consumption	1.9	-1.6	1.7	2.9	2.5	2.2	1.9	2.0	1.8	1.7
Public consumption	-0.3	0.1	0.0	0.2	0.4	0.4	0.3	0.2	0.2	0.3
Investment	0.5	-0.5	0.9	0.5	0.1	0.6	0.5	0.5	0.6	0.5
Gross fixed investment	0.4	0.1	0.7	0.6	0.1	0.6	0.5	0.5	0.5	0.6
Private investment	-0.4	-0.4	0.0	-0.6	0.7	0.4	0.3	0.3	0.3	0.3
Public investment	0.7	0.5	0.7	1.2	-0.6	0.2	0.2	0.2	0.3	0.3
Inventories	0.1	-0.5	0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net exports	-2.0	2.8	-1.3	0.1	0.3	-0.2	-0.2	-0.2	0.0	0.0
Exports of goods and services	1.1	5.5	1.9	3.6	2.7	2.2	2.4	2.5	2.7	2.7
Imports of goods and services	3.2	2.6	3.2	3.5	2.4	2.5	2.6	2.7	2.7	2.8

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

1/ Contributions to GDP growth.

Table 4. Bulgaria: Balance of Payments, 2012–21

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
							Proj.			
					(Millions of euros)					
Current account balance	-358	536	35	172	766	250	21	-202	-573	-1,003
Trade balance	-3,992	-2,933	-2,777	-2,622	-2,929	-3,327	-3,459	-3,604	-3,838	-4,007
Exports (f.o.b.)	19,675	21,218	21,026	21,920	20,983	22,298	23,372	24,367	25,405	26,731
Imports (f.o.b.)	23,667	24,151	23,803	24,542	23,912	25,625	26,831	27,971	29,243	30,739
Services balance	2,589	2,653	2,514	3,083	3,363	3,470	3,583	3,671	3,847	3,979
Exports of non-factor services	5,817	5,888	6,738	7,080	7,245	7,644	7,953	8,227	8,610	8,986
Imports of non-factor services	3,229	3,235	4,224	3,998	3,881	4,174	4,371	4,556	4,764	5,007
Primary Income balance	-1,053	-1,581	-1,319	-1,930	-1,097	-1,357	-1,669	-2,037	-2,469	-2,972
Receipts	724	874	929	951	979	1,008	1,041	1,076	1,113	1,152
Payments	1,777	2,455	2,248	2,881	2,077	2,365	2,710	3,113	3,583	4,124
Secondary income balance	2,099	2,396	1,616	1,642	1,429	1,464	1,566	1,768	1,887	1,997
Capital and financial account balance	1,503	1,356	677	4,568	2,867	2,363	2,273	1,982	1,775	1,488
Capital transfer balance	546	469	960	1,422	1,050	1,057	1,126	1,093	1,174	1,246
Foreign direct investment balance	-1,068	-1,243	-882	-1,596	-1,443	-1,444	-1,554	-1,723	-1,903	-2,091
Portfolio investment balance	891	132	-1,212	-578	-341	-178	-85	12	112	218
Other investment balance	-984	2,424	22	1,577	2,170	2,234	1,813	1,888	1,973	2,064
Errors and omissions	768	-118	-1,277	1,552	0	0	0	0	0	0
Overall balance	1,145	1,892	713	4,740	1,418	681	960	700	405	40
Financing	-1,145	-1,892	-713	-4,740	-1,418	-681	-960	-700	-405	-40
Gross international reserves (increase: -)	-2,121	532	-1,807	-3,730	-1,418	-681	-959	-699	-405	-39
					(Percent of GDP, unless otherwise indicated)					
Memorandum items:										
Current account balance	-0.9	1.3	0.1	0.4	1.6	0.5	0.0	-0.4	-1.0	-1.7
Merchandise trade balance	-9.5	-7.0	-6.5	-5.8	-6.3	-6.9	-6.9	-6.9	-7.0	-7.0
Exports	46.9	50.5	49.2	48.4	45.0	46.2	46.5	46.4	46.2	46.5
Imports	56.4	57.5	55.7	54.2	51.3	53.1	53.4	53.2	53.2	53.4
Foreign direct investment balance	-2.5	-3.0	-2.1	-3.5	-3.1	-3.0	-3.1	-3.3	-3.5	-3.6
Terms of trade (merchandise, percent change)	2.7	0.3	0.1	-0.9	-0.7	-0.8	0.2	0.0	-0.3	-0.2
Exports of goods (volume, growth rate)	-2.5	11.2	3.1	6.8	2.5	3.7	3.8	4.0	3.9	4.2
Imports of goods (volume, growth rate)	2.7	5.3	3.4	6.2	3.6	3.7	3.9	4.1	4.0	4.0
Exports of goods (prices, growth rate)	5.9	-3.1	-4.7	-2.9	-6.0	3.3	0.8	0.2	0.6	1.1
Imports of goods (prices, growth rate)	5.9	-3.0	-3.9	-2.4	-6.6	2.5	1.0	0.2	0.3	0.9
GDP (millions of euro)	41,947	42,011	42,762	45,286	46,641	48,282	50,290	52,531	54,954	57,511

Sources: Bulgarian authorities; and IMF staff estimates.

Table 5. Bulgaria: External Financial Assets and Liabilities, 2012–21

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
							Proj.			
				(Millions of euros)						
International investment position	-32,710	-30,657	-32,271	-27,219	-25,339	-24,046	-22,913	-22,036	-21,449	-21,220
Financial assets	30,254	31,265	36,022	38,005	39,571	41,127	43,095	44,945	46,652	48,154
Foreign direct investment	3,405	3,575	4,011	4,078	4,245	4,467	4,699	4,941	5,195	5,460
Portfolio investment	4,373	4,939	5,526	5,050	5,036	5,194	5,458	5,833	6,325	6,939
Other investments	6,925	8,326	9,951	8,591	8,587	9,082	9,594	10,128	10,686	11,269
Gross international reserves	15,553	14,426	16,534	20,285	21,703	22,384	23,343	24,043	24,448	24,487
Financial liabilities	62,964	61,923	68,293	65,224	64,910	65,173	66,007	66,981	68,102	69,375
Foreign direct investment	37,814	37,500	41,122	40,272	41,882	43,548	45,334	47,300	49,456	51,812
Portfolio investment	1,935	2,389	3,948	4,502	4,829	5,166	5,514	5,877	6,256	6,653
Other liabilities	23,131	22,023	23,149	20,373	18,199	16,460	15,159	13,804	12,389	10,909
				(Percent of GDP, unless otherwise indicated)						
International investment position	-77.9	-72.8	-75.4	-60.0	-54.3	-49.8	-45.6	-41.9	-39.0	-36.9
Financial assets	72.1	74.4	84.2	83.9	84.8	85.2	85.7	85.6	84.9	83.7
Foreign direct investment	8.1	8.5	9.4	9.0	9.1	9.3	9.3	9.4	9.5	9.5
Portfolio investment	10.4	11.8	12.9	11.2	10.8	10.8	10.9	11.1	11.5	12.1
Other investments	16.5	19.8	23.3	19.0	18.4	18.8	19.1	19.3	19.4	19.6
Gross international reserves	37.1	34.3	38.7	44.8	46.5	46.4	46.4	45.8	44.5	42.6
Financial liabilities	150.1	147.4	159.7	144.0	139.2	135.0	131.3	127.5	123.9	120.6
Foreign direct investment	90.1	89.3	96.2	88.9	89.8	90.2	90.1	90.0	90.0	90.1
Portfolio investment	4.6	5.7	9.2	9.9	10.4	10.7	11.0	11.2	11.4	11.6
Other liabilities	55.1	52.4	54.1	45.0	39.0	34.1	30.1	26.3	22.5	19.0
Memorandum items:										
Gross external debt	89.9	87.9	92.0	76.1	77.7	72.5	69.3	66.3	62.9	59.2
Public 1/	8.5	8.1	14.1	12.5	16.2	13.3	12.9	12.4	12.1	11.6
Private	81.4	79.8	77.9	63.7	61.5	59.1	56.4	53.9	50.8	47.7
Short-term	24.7	22.8	21.0	17.7	17.1	16.4	15.4	14.9	14.0	13.2
Long-term	56.7	57.0	56.9	45.9	44.5	42.8	41.0	39.0	36.8	34.5
Net external debt 2/	52.8	53.6	53.4	31.4	31.2	26.1	22.9	20.5	18.4	16.7

Sources: BNB; NSI; and IMF staff estimates.

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

2/ Gross debt minus gross international reserves.

Table 6a. Bulgaria: General Government Operations, 2012-21 1/

(Millions of leva, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
							Proj.			
Revenue	26,516	27,735	28,145	30,964	31,782	33,688	34,835	36,607	38,483	40,393
Taxes	15,933	16,310	16,579	17,909	19,238	20,018	20,865	21,817	22,828	23,893
Taxes on profits	1,478	1,553	1,679	1,860	1,964	2,060	2,170	2,283	2,396	2,519
Taxes on income	2,298	2,348	2,596	2,731	2,858	2,996	3,122	3,246	3,394	3,550
Value-added taxes	7,152	7,366	7,264	7,740	8,481	8,718	9,068	9,484	9,920	10,375
Excises	4,048	4,056	4,039	4,525	4,859	5,130	5,343	5,593	5,851	6,123
Customs duties	118	146	149	159	163	168	175	183	192	201
Other taxes	840	840	851	893	913	945	985	1,028	1,076	1,126
Social contributions	4,642	4,818	5,187	5,699	6,118	6,482	6,944	7,317	7,660	8,012
Grants	2,368	2,656	2,922	3,648	2,544	2,569	2,840	3,100	3,420	3,700
Other revenue 2/	3,573	3,951	3,457	3,709	3,882	4,619	4,186	4,373	4,574	4,787
Expenditure	26,874	29,175	31,193	33,449	32,451	34,726	35,500	36,899	38,482	40,381
Expense	22,889	24,551	25,545	25,930	27,047	28,152	29,140	30,200	31,409	32,877
Compensation of employees	4,239	4,560	4,678	4,712	4,837	4,982	5,131	5,285	5,459	5,691
Use of goods and services	4,444	4,603	4,479	4,263	4,799	5,017	5,221	5,344	5,452	5,689
Interest	573	689	580	698	695	855	851	881	922	965
External	374	484	337	431	431	581	572	574	601	629
Domestic	199	204	243	267	264	275	279	307	321	336
Subsidies	1,228	1,307	1,452	1,634	1,535	1,705	1,776	1,856	1,941	2,031
Grants 3/	809	934	955	946	1,010	1,001	1,056	1,067	1,116	1,168
Social benefits	11,482	12,332	13,268	13,543	14,082	14,500	15,013	15,675	16,427	17,241
Pensions	7,234	7,762	8,136	8,433	8,727	8,957	9,271	9,677	10,098	10,566
Social assistance	2,067	2,160	2,317	2,424	2,445	2,531	2,637	2,754	2,901	3,052
Health Insurance Fund	2,181	2,410	2,815	2,687	2,909	3,012	3,105	3,244	3,427	3,623
Other expense	114	127	133	134	90	91	91	91	91	91
Contingency 4/	385	644	1,186	767	407	462	511	512	557	582
Net acquisition of nonfinancial assets 5/	3,600	3,981	4,462	6,751	4,997	6,113	5,849	6,187	6,516	6,922
Net lending/borrowing 1/	-359	-1,441	-3,048	-2,484	-669	-1,039	-665	-292	0	12
Primary balance	214	-752	-2,468	-1,786	26	-183	186	589	922	977
Financing	359	1,441	3,048	2,484	669	1,039	665	292	0	-12
Privatization proceeds	76	16	18	4	32	0	0	0	0	0
Net external financing	2,047	-690	5,784	1,449	3,739	-2,213	152	17	277	-4
Disbursements	2,327	1,119	6,091	6,438	4,094	0	500	293	2,000	2,700
Amortization	-280	-1,809	-307	-4,988	-355	-2,213	-348	-276	-1,723	-2,704
Net domestic financing	-1,749	2,151	-1,279	-925	-3,086	3,266	528	290	-262	7
Bank credit / Securities issuance	303	1,757	5,654	-19	793	800	1,773	1,311	759	1,028
Amortization	-970	-1,006	-3,497	-2,234	-1,051	-1,179	-1,244	-1,021	-1,021	-1,021
Fiscal Reserve Account	-1,082	1,400	-3,436	1,328	-2,828	3,266	0	0	0	0
Net lending and other items	-16	-38	-1,587	1,952	-15	-15	-15	-15	-15	-15
Memorandum items:										
Fiscal reserve account	6,081	4,681	8,117	6,789	9,617	6,351	6,351	6,351	6,351	6,351
Gross public debt	13,674	14,119	22,102	22,714	26,195	23,982	24,663	24,970	24,985	24,988
Nominal GDP (percent change)	1.6	0.2	1.8	5.9	3.0	3.5	4.2	4.5	4.6	4.7
Real GDP (percent change)	0.0	0.9	1.3	3.6	3.3	2.9	2.5	2.5	2.5	2.5
HICP inflation (percent change)	2.4	0.4	-1.6	-1.1	-1.3	0.6	1.6	1.9	2.1	2.1
Nominal private consumption (percent ch.)	6.7	-5.0	2.7	5.7	2.4	4.0	4.6	4.9	4.8	4.6
Nominal imports (percent change)	10.6	1.8	2.3	1.8	-2.6	7.2	4.7	4.2	4.5	5.1

Sources: Ministry of Finance; and staff estimates.

1/ On cash basis. The 2016 projections do not reflect the government loan to the National Electricity Company that is currently under discussion.

2/ Includes dividends.

3/ Contribution to EU budget.

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

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

Table 6b. Bulgaria: General Government Operations, 2012-21 1/

(Percent of GDP, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
							Proj.			
Revenue	32.3	33.8	33.7	35.0	34.8	35.7	35.4	35.6	35.8	35.9
Taxes	19.4	19.9	19.8	20.2	21.1	21.2	21.2	21.2	21.2	21.2
Taxes on profits	1.8	1.9	2.0	2.1	2.2	2.2	2.2	2.2	2.2	2.2
Taxes on income	2.8	2.9	3.1	3.1	3.1	3.2	3.2	3.2	3.2	3.2
Value-added taxes	8.7	9.0	8.7	8.7	9.3	9.2	9.2	9.2	9.2	9.2
Excises	4.9	4.9	4.8	5.1	5.3	5.4	5.4	5.4	5.4	5.4
Customs duties	0.1	0.2	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	1.0	1.0	1.0	1.0	1.0
Social contributions	5.7	5.9	6.2	6.4	6.7	6.9	7.1	7.1	7.1	7.1
Grants	2.9	3.2	3.5	4.1	2.8	2.7	2.9	3.0	3.2	3.3
Other revenue 2/	4.4	4.8	4.1	4.2	4.3	4.9	4.3	4.3	4.3	4.3
Expenditure	32.8	35.5	37.3	37.8	35.6	36.8	36.1	35.9	35.8	35.9
Expense	27.9	29.9	30.5	29.3	29.7	29.8	29.6	29.4	29.2	29.2
Compensation of employees	5.2	5.5	5.6	5.3	5.3	5.3	5.2	5.1	5.1	5.1
Use of goods and services	5.4	5.6	5.4	4.8	5.3	5.3	5.3	5.2	5.1	5.1
Interest	0.7	0.8	0.7	0.8	0.8	0.9	0.9	0.9	0.9	0.9
External	0.5	0.6	0.4	0.5	0.5	0.6	0.6	0.6	0.6	0.6
Domestic	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Subsidies	1.5	1.6	1.7	1.8	1.7	1.8	1.8	1.8	1.8	1.8
Grants 3/	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.0	1.0	1.0
Social benefits	14.0	15.0	15.9	15.3	15.4	15.4	15.3	15.3	15.3	15.3
Pensions	8.8	9.4	9.7	9.5	9.6	9.5	9.4	9.4	9.4	9.4
Social assistance	2.5	2.6	2.8	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Health Insurance Fund	2.7	2.9	3.4	3.0	3.2	3.2	3.2	3.2	3.2	3.2
Other expense	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Contingency 4/	0.5	0.8	1.4	0.9	0.4	0.5	0.5	0.5	0.5	0.5
Net acquisition of nonfinancial assets 5/	4.4	4.8	5.3	7.6	5.5	6.5	5.9	6.0	6.1	6.2
Net lending/borrowing 1/	-0.4	-1.8	-3.6	-2.8	-0.7	-1.1	-0.7	-0.3	0.0	0.0
Primary balance	0.3	-0.9	-3.0	-2.0	0.0	-0.2	0.2	0.6	0.9	0.9
Financing	0.4	1.8	3.6	2.8	0.7	1.1	0.7	0.3	0.0	0.0
Privatization proceeds	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net external financing	2.5	-0.8	6.9	1.6	4.1	-2.3	0.2	0.0	0.3	0.0
Disbursements	2.8	1.4	7.3	7.3	4.5	0.0	0.5	0.3	1.9	2.4
Amortization	-0.3	-2.2	-0.4	-5.6	-0.4	-2.3	-0.4	-0.3	-1.6	-2.4
Net domestic financing	-2.1	2.6	-1.5	-1.0	-3.4	3.5	0.5	0.3	-0.2	0.0
Securities issuance	0.4	2.1	6.8	0.0	0.9	0.8	1.8	1.3	0.7	0.9
Amortization	-1.2	-1.2	-4.2	-2.5	-1.2	-1.2	-1.3	-1.0	-1.0	-0.9
Fiscal Reserve Account	-1.3	1.7	-4.1	1.5	-3.1	3.5	0.0	0.0	0.0	0.0
Net lending and other items	0.0	0.0	-1.9	2.2	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Gross public debt	16.7	17.2	26.4	25.6	28.7	25.4	25.1	24.3	23.2	22.2
Structural fiscal balance	0.2	-0.9	-2.7	-2.3	-0.5	-1.1	-0.7	-0.3	0.0	0.0
Output gap (percent of potential GDP)	-1.7	-2.4	-2.7	-1.4	-0.5	-0.1	0.0	0.0	0.0	0.0
Nominal GDP (millions of leva)	82,040	82,166	83,634	88,571	91,220	94,431	98,357	102,740	107,480	112,480

Sources: Ministry of Finance; and IMF staff estimates.

1/ On cash basis. The 2016 projections do not reflect the government loan to the National Electricity Company that is currently under discussion.

2/ Includes dividends.

3/ Contribution to EU budget.

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

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

Table 7. Bulgaria: General Government Stock Position, 2007–2014

(Percent of GDP, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	2014	2015
Net financial worth	9.7	5.7	3.0	1.4	1.1	-1.4	-3.2	-5.2
Financial assets	30.6	29.4	26.8	24.2	26.3	24.4	31.3	27.3
Monetary gold and SDRs	...	...	...	...	...	...	...	...
Currency and deposits	14.0	12.3	9.8	8.1	9.9	8.3	11.1	8.5
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	1.8	1.7	1.5	1.3	1.2	1.1	2.1	1.5
Equity and investment funds shares	9.3	10.7	11.2	10.4	10.1	8.7	10.1	9.4
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	4.6	4.3	4.3	5.1	6.3	8.0	7.9
Liabilities	20.9	23.6	23.8	22.8	25.2	25.8	34.5	32.5
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	8.3	8.6	9.7	9.5	12.2	11.5	16.6	19.5
Loans	4.8	5.7	6.2	6.1	5.8	6.7	10.6	6.6
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	0.3	0.1	0.1	0.2	0.2	0.2	0.2	0.3
Other accounts receivable	7.6	9.3	7.8	7.1	6.9	7.3	7.2	6.2
Memorandum items								
Gross debt (at market value)	20.6	23.5	23.7	22.7	25.0	25.5	34.3	32.2
Gross debt (at face value)	20.6	23.0	23.1	22.3	24.5	25.2	34.1	32.2
Gross debt (Maastricht definition)	13.0	13.7	15.3	15.2	17.5	17.9	27.0	26.0
Nominal GDP (billions of leva)	72.8	73.0	74.8	80.8	82.0	82.2	83.6	88.6

Sources: Eurostat; and IMF staff calculations.

Table 8. Bulgaria: Monetary Accounts, 2012–21

(Billions of leva, unless otherwise stated)

	2012 Dec.	2013 Dec.	2014 1/ Dec.	2015 Dec.	2016 Dec.	2017 Dec.	2018 Dec.	2019 Dec.	2020 Dec.	2021 Dec.
							Proj.			
Monetary Survey										
Net foreign assets	25.3	28.4	35.0	40.7	43.3	44.9	47.7	50.4	53.2	56.3
Net domestic assets	53.9	55.8	50.5	51.7	50.3	55.4	60.2	65.2	69.3	72.6
Domestic credit	55.1	57.1	52.1	53.2	51.8	56.8	61.6	66.5	70.5	73.8
General government	-0.7	1.2	0.4	2.4	0.4	2.1	2.9	3.5	2.9	1.3
Non-government	55.8	55.9	51.6	50.8	51.4	54.7	58.7	62.9	67.5	72.5
Broad money (M3)	61.7	67.2	68.0	74.0	78.1	81.9	86.5	91.5	97.0	103.0
Currency outside banks	8.5	9.1	10.2	11.4	12.8	13.6	14.1	14.4	14.8	15.2
Reserve money	17.4	17.3	19.2	27.5	29.4	30.8	31.9	33.0	34.2	35.4
Deposits 2/	53.2	58.2	57.8	62.6	65.4	68.3	72.3	77.1	82.3	87.8
Accounts of the Bulgarian National Bank										
Net foreign assets	29.0	26.8	30.8	38.1	40.1	38.7	45.1	45.1	51.8	52.4
Net foreign reserves (billions of euro)	14.8	13.7	15.7	19.5	20.5	19.8	23.0	23.0	26.5	26.8
Net domestic assets	-6.7	-5.7	-7.3	-6.4	-9.6	-6.3	-5.8	-5.6	-5.9	-6.0
Net claims on government	-5.7	-4.3	-6.7	-6.0	-9.1	-5.8	-5.3	-5.0	-5.3	-5.3
Base money	17.4	17.3	19.2	27.5	29.4	30.8	31.9	33.0	34.2	35.4
Currency in circulation	8.5	9.1	10.2	11.4	12.8	13.6	14.1	14.4	14.8	15.2
Banks reserves	8.9	8.2	9.1	16.1	16.7	17.2	17.8	18.6	19.4	20.3
Deposit money banks										
Net foreign assets	-3.6	1.6	4.2	2.6	4.9	4.6	4.2	3.7	3.0	2.3
Gross foreign assets	10.0	13.6	15.3	10.6	16.2	16.0	15.6	15.1	14.4	13.7
Gross foreign liabilities	13.7	12.1	11.1	8.1	11.4	11.4	11.4	11.4	11.4	11.4
Net domestic assets	59.3	59.9	56.9	57.4	59.2	61.0	65.3	70.0	74.3	77.7
Domestic credit	60.7	61.3	58.6	59.1	60.8	62.6	66.8	71.4	75.7	79.0
Memorandum items:	(Annual percentage change, unless otherwise indicated)									
Base money	16.7	-0.4	11.1	43.0	7.1	4.5	3.8	3.4	3.6	3.7
Broad money	8.4	8.9	1.1	8.8	5.6	4.9	5.5	5.9	6.0	6.1
Domestic non-government credit	2.8	0.3	-7.7	-1.6	1.2	6.5	7.2	7.2	7.3	7.3
Domestic deposits	8.3	9.3	-0.6	8.2	4.4	4.5	5.9	6.6	6.7	6.7
Domestic currency	17.0	8.6	0.1	9.2	4.8	4.9	6.2	6.9	7.1	7.0
Foreign currency	-2.1	10.3	-1.5	6.8	3.9	4.0	5.4	6.1	6.2	6.2
Money multiplier (ratio)	3.5	3.9	3.5	2.7	2.7	2.7	2.7	2.8	2.8	2.9
Velocity (M3) (ratio)	1.3	1.2	1.2	1.2	1.2	1.2	1.1	1.1	1.1	1.1
GDP (millions of leva)	82,040	82,166	83,634	88,571	91,220	94,431	98,357	102,740	107,480	112,480

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, 2010–16

(Percent)

	2010 Dec	2011 Dec	2012 Dec	2013 Dec	2014 Dec	2015 Dec	2016 March
Core indicators							
Capital adequacy							
Capital to risk-weighted assets	17.5	17.5	16.7	16.9	21.9	22.2	22.9
Tier 1 capital to risk-weighted assets	15.2	15.7	15.2	16.0	20.0	20.5	21.4
Asset quality							
Nonperforming loans to total gross loans	11.9	14.9	16.6	16.9	16.7	20.6	20.2
Nonperforming loans net of provisions to capital	28.1	36.9	39.1	36.0	43.6	52.1	48.7
Large exposures to capital	87.9	112.2	115.1	121.1	67.2	65.4	65.8
Earnings and profitability							
Return on assets	0.9	0.8	0.7	0.7	0.9	1.0	1.4
Return on equity 1/	7.9	7.1	6.8	6.6	7.6	7.4	10.5
Net interest income to gross income	74.2	73.3	68.8	68.5	67.4	66.0	74.3
Noninterest expense to gross income	49.1	50.4	52.1	53.9	49.5	48.7	46.2
Personnel expense to total income	17.8	18.5	19.1	19.8	18.5	17.6	19.3
Trading and fee income to total income	24.7	25.0	27.8	27.8	28.2	29.2	20.9
Liquidity							
Liquid assets to total assets	20.9	21.9	22.4	23.4	26.1	31.6	31.7
Liquid assets to short-term liabilities	30.1	28.9	30.0	30.6	33.7	40.5	41.2
Liquid assets to total liabilities	24.2	25.4	25.8	26.9	29.9	36.7	36.5
Encouraged indicators							
Deposit-taking institutions							
Capital to assets 2/	10.5	10.8	10.1	10.3	11.6	11.6	12.2
Trading income to total income	5.4	4.9	7.4	5.7	7.0	8.0	-1.9
Personnel expenses to noninterest expenses	36.3	36.6	36.7	36.8	37.3	36.1	41.7
Customer deposits to total (non-interbank) loans	87.8	95.2	100.2	107.5	115.5	128.0	130.2
Foreign currency denominated loans to total loans	61.3	63.8	64.0	61.2	57.0	50.7	49.9
Foreign currency denominated liabilities to total liabilities	58.6	54.8	51.8	50.1	49.0	42.7	43.2

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.

Statement by Anthony De Lannoy, Executive Director for Bulgaria
and Tsvetan Manchev, Advisor to Executive Director
November 4, 2016

The Bulgarian authorities had a constructive dialogue with the mission during the 2016 Article IV consultation, and thank staff for the papers. Since the authorities broadly agree with staff that they should continue their policies aimed at increasing resilience against ongoing domestic and external challenges, we would like to make the following points for emphasis.

Amid the high global and regional uncertainty, the authorities continue to build their policies around the currency board monetary regime, which remains the cornerstone for anchoring macroeconomic, monetary and financial stability. The authorities maintain macroeconomic stability, and aim to strengthen the medium term growth prospects of the economy. The 2016 fiscal consolidation is ahead of schedule, mainly thanks to the higher-than-initially expected growth and comprehensive administrative revenue measures. The coalition government also works hard to reduce contingent liabilities, improve public confidence in the reform process, and further strengthen the EU funds' utilization. The Bulgarian National Bank (BNB) continues with the decisive actions to further strengthen confidence in the banking system through implementing its comprehensive plan for strengthening the banking supervision, and addressing issues identified by the recent asset quality review (AQR) and stress test.

Recent Macroeconomic Developments and Outlook

The authorities generally share staff's view on the macroeconomic developments and remain cautious in their outlook given the high uncertainty in the external environment. As highlighted by staff, Bulgaria's recent economic performance has been by far stronger than initially anticipated. Going forward, the authorities will implement an action plan to improve the business environment and advance the anti-corruption agenda in order to attract more private investment.

The deflationary pressures are related to the impact of international prices and they are gradually easing. The labor market continues to tighten. Active labor market policies will continue to stimulate labor force participation and mitigate the effect from emigration. In line with staff's advice, these measures will encompass better protection of the poor. In this regard, staff's analysis on the fiscal implications stemming from demographic changes is very helpful.

Financial Stability

Since the last Article IV Consultation the central bank has focused on improving banking supervision, implementing the institutional framework for bank resolution and conducting AQR and stress tests in the banking sector. Progress in all three areas has been significant.

In 2015, the IMF and the WB, together with the central bank, undertook an assessment of compliance of supervisory regulations and practices with the Basel Core Principles (BCP). Following the BCP assessment, the BNB adopted a detailed Plan on Reforms and Development of Banking Supervision in October 2015. This plan envisages coordinated actions in three areas - governance and organization of banking supervision, regulatory framework and supervisory processes, and crisis management and preparedness. So far, the legal framework and governance of banking supervision have been strengthened, and the Supervisory Review and Evaluation Process Manual has been created in line with the decisions of the European Banking Authority on common procedures and methodologies.

The authorities have taken steps to strengthen crisis resolution management by transposing the European Bank Recovery and Resolution Directive (BRRD) into Bulgarian law in mid-August 2015. The BNB swiftly established a new directorate on bank resolution. In August 2016, as mandated and scheduled under the 2015 Law on Recovery and Resolution of Credit Institutions and Investment Firms, the BNB concluded an AQR and stress test of the banking system. The AQR has confirmed the comfortable position of banks' balance sheets as of end-2015, as only minor adjustments have appeared necessary to be reflected in the banks' 2016 financial statements (BGN 665 million, or 1.3% of the total risk-weighted assets). The impact of these adjustments has already been mitigated, after taking into consideration the amount of realized net income and additional impairments in the banks performed until mid-2016, as well as relevant capital-related developments and measures by banks throughout 2016. The results of the stress test confirmed the strong capital position and resilience to shocks of the banking system. The AQR and stress test and their results were positively reflected by the international financial institutions, markets, credit rating agencies, and professional analysts.

Since the last Article IV Consultation, several other policies have been implemented to strengthen financial stability. In 2015, the BNB successfully contained the spillovers from Greece and the domestic banking system remained stable. The BNB measures focused on close monitoring and oversight over the individual bank liquidity management and ex-ante steps to forestall spillovers and strengthen liquidity requirements. In the first half of 2016, the Bulgarian Deposit Insurance Fund (BDIF) signed agreements with the WB and the EBRD for two government-guaranteed loans that will be used to repay the BDIF loan from the Ministry of Finance. With regard to the non-banking financial system, the Financial Supervision Commission intends to complete an AQR of the pension funds and insurance companies and a stress test of the insurance and re-insurance industry by the end-2016. In the second half of the 2016, an IMF/WB FSAP started and its results will be presented to the IMF Board in May 2017.

Fiscal Sustainability

In the highly uncertain and volatile external environment, the government remains committed to a conservative medium-term fiscal consolidation strategy. The 2016 fiscal consolidation is proceeding faster than expected due to inter alia the unanticipated acceleration of the economic activity, better revenue collection, and a slower start of the implementation of the 2014-2020 EU budgetary framework. The authorities are committed to save the 2016 revenue over performance in order to strengthen fiscal buffers and contain cyclicality of the private demand. 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 further debt accumulation.

The preparation of the 2017 budget is at an advanced stage. The consolidated government deficit is projected at 1.4 percent of GDP on cash basis, and the structural deficit will further decline and reach 0.5 percent to GDP. In line with the long-standing public consensus, Bulgaria maintains a predictable tax system, and the 2017 tax policy and tax-to-GDP ratio will remain broadly unchanged. Given that Bulgaria's public pension system has relatively low contribution collection and income replacement rates, the social security contributions will be increased by one percentage point in the next two years. As described in the staff report, the next steps in the public education and health care reforms will be implemented to achieve a more targeted and efficient public expenditure and to enhance the productivity of public investment. The recently-enacted Public Procurement Act in line with the well-established European practices will help reducing public procurement deficiencies. In 2017, Bulgaria does not plan to tap into international financial markets, and domestic debt operations will be limited to the refinancing of the matured securities.

The authorities are fully aware of the increasing medium- and long-term fiscal pressures stemming from the adverse demographic trends, contingent liabilities of the state-owned enterprises (SOEs) and subnational governments, and other structural rigidities. The budget procedure has already been amended to include the state-owned enterprises in the General Government sector and ensure better monitoring of their impact on the budgetary balance and government debt position. In line with the international practices, a mechanism for financial recovery of the municipalities has been introduced through amendments in the Public Finance Law. In 2016, the members of the Fiscal Council were appointed, and the Parliament set up conditions for its functioning in order to get a better and deeper understanding of various fiscal risks and attribution. Going forward, the authorities also remain open to discuss and implement best international practices in the corporate governance, output quality, and financial performance of the SOEs.

Structural Reforms

Emigration of young people and skilled labor, continues to be a key challenge. It will be comprehensively addressed by promoting child care support, enhancing vocational training and skill development to improve the employability of workers, and rationalizing administrative procedures. In the same vein, legislative amendments will be launched to enhance synergy between social services and health care system, and the authorities will proceed with a gradual increase of the statutory retirement ages.

In late 2015, the widespread discontent among the population about the perceived unfairness of the public pension system was addressed by a reform package creating an automatic link between the statutory retirement ages and the life expectancy once the statutory retirement age reaches 65 years. To reduce the deficit in the public pension system, however, the authorities will continue active labor market policies to ensure old-age employment, while striking the right balance between ensuring fiscal sustainability and preventing old-age poverty.

The government is also committed to boosting productivity by further improvements in the EU funds' absorption during the existing program period. The implementation of the new Public Procurement Act adopted in April 2016 will enhance the ex-ante control and e-procurement procedures. A comprehensive set of measures to strengthen the administrative capacity and to broaden the electronic public services is also underway. In June 2016 the Law on Electronic Governance was adopted, and in September the government created an independent state agency with a mandate to oversee other governmental structures in charge of e-government development.