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Assessment of the 2019 Convergence Programme for

Bulgaria

(Note prepared by DG ECFIN staff)

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EXECUTIVE SUMMARY

Bulgaria is subject to the preventive arm of the Stability and Growth Pact. With gross public debt below 60% of GDP, Bulgaria is compliant with the debt criterion and is expected to remain compliant with its medium-term budgetary objective in 2019 and 2020.

The Bulgarian economy expanded in real terms by 3.1% in 2018 and, according to the Commission 2019 spring forecast, economic growth is expected to be 3.3% in 2019 and 3.4% in 2020. Growth is expected to be mainly driven by strong domestic demand. The external sector, which weakened significantly in 2018, largely due to one-off events, is expected to slowly recover but to continue contributing negatively to growth. The output gap is forecast to remain positive and increasing as a percentage of potential GDP. Employment growth is expected to be positive and unemployment to continue declining, reaching 5% in 2020. Prices are set to decelerate in 2019 and 2020, while wage growth is forecast to remain strong in the medium term. The macroeconomic scenario included in the Convergence Programme is plausible, broadly in line with the 2019 Commission spring forecast.

In 2018, the general government budget balance reached a surplus of 2% of GDP, following both revenue increases and expenditure reductions as a percentage of GDP. Government spending increases remained below expectations due to implementation lags, especially in public investment. According to the Convergence Programme, the general government budget balance is expected to turn negative at -0.3% of GDP in 2019 mainly driven by significantly higher public investment and subsidies planned for this year and increases in social expenditure. It is set to be again positive at 0.4% in 2020, as almost all expenditure categories are set to fall as a percentage of GDP and to remain in surplus, albeit somewhat contained, in 2021 and 2022.

In structural terms, based on the recalculated structural balance ([1]), the surplus increased to 1.9% of GDP in 2018, well above the medium-term budgetary objective (set at -1%). According to the Convergence Programme, the structural balance is expected to decline to a deficit of 0.4% of GDP in 2019, and increase again to a surplus of 0.3% in 2020.

The budgetary projections in the Convergence Programme are subject to upside risks especially due to factors that could lead to lower than planned expenditure. This is particularly the case of public investment, where there is high uncertainty concerning the timing of some defence and transport infrastructure projects. The programme also includes higher spending projections on social transfers and subsidies than explained by the underlying policy plans.

[1] Recalculated by the Commission on the basis of the information in the programme according to the commonly agreed methodology.

1. INTRODUCTION

On 24 April 2019, Bulgaria submitted its 2019 Convergence Programme (hereafter called Programme), covering the period 2019-2022, the same day the government approved it.

Bulgaria is currently subject to the preventive arm of the Stability and Growth Pact (SGP) and should preserve a sound fiscal position, which ensures compliance with the medium-term budgetary objective (MTO).

This document complements the Country Report published on 27 February 2019 and updates it with the information included in the Programme.

Section 2 presents the macroeconomic outlook underlying the Programme and provides an assessment based on the Commission 2019 spring forecast. Section 3 presents the recent and planned budgetary developments, according to the Programme. In particular, it includes an overview of the medium-term budgetary plans, an assessment of the measures underpinning the Programme and a risk analysis of the budgetary plans based on the Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview of long-term sustainability risks and Section 6 includes an overview of recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

Real GDP growth in Bulgaria slowed to 3.1% in 2018, compared to 3.8% in 2017. This was due to weak export performance, while domestic demand remained supportive of economic expansion. Final consumption grew by 6% in 2018, compared to 4.3% a year earlier. In the same year, investment growth increased to 6.5% in real terms, from 3.2% in 2017. According to the Programme, the Bulgarian economy is expected to grow by 3.4% in 2019 and 3.3% in 2020.

In 2019, real GDP growth will be supported by both domestic demand and a recovery in exports. Private consumption is expected to expand, albeit at a slower rate compared to the previous year. This deceleration would be driven by both a base effect from 2018 and a deterioration in consumer confidence registered from the second half of 2018 onwards. The uncertain external environment would weigh on the dynamics of private investment. Exports are set to return to growth as the 2018 one-off negative effects disappear, while external demand from EU countries will continue to support exports. For 2020, the Programme projects real GDP growth to decrease slightly to 3.3%, due to lower government spending for consumption and investment. The weaker rise in income levels and employment is set to limit private consumption growth, while the expected increase in external demand would underpin further export growth.

For the period 2019-2020, the Commission forecast an evolution in output similar to the Programme’s forecast. The Commission projects GDP growth of 3.3% in 2019 and 3.4% in 2020. By components, the Programme forecasts higher contribution of domestic demand, while in the Commission 2019 spring forecast export recovery plays a more prominent role.

Table 1: Comparison of macroeconomic developments and forecasts

	2018		2019		2020		2021	2022
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	3.1	3.1	3.3	3.4	3.4	3.3	3.3	3.3
Private consumption (% change)	6.4	6.4	4.0	4.6	3.8	4.5	4.1	3.9
Gross fixed capital formation (% change)	6.5	6.5	6.8	9.9	5.2	5.0	6.3	6.8
Exports of goods and services (% change)	-0.8	-0.8	3.3	1.8	2.9	2.0	1.8	1.7
Imports of goods and services (% change)	3.7	3.7	5.0	5.0	3.3	3.3	3.2	3.2
Contributions to real GDP growth:								
- Final domestic demand	5.8	5.8	4.3	5.5	3.8	4.1	4.2	4.2
- Change in inventories	0.1	0.1	0.1	0.0	-0.1	0.1	0.1	0.1
- Net exports	-2.8	-2.8	-1.1	-2.1	-0.3	-0.9	-0.9	-0.9
Output gap[1]	0.2	0.2	0.6	0.3	1.3	0.4	0.5	0.8
Employment (% change)	-0.1	-0.1	0.1	0.4	0.1	0.2	-0.1	-0.3
Unemployment rate (%)	5.2	5.2	5.0	4.6	4.8	4.1	4.0	4.0
Labour productivity (% change)	3.2	3.2	3.2	3.0	3.3	3.1	3.4	3.6
HICP inflation (%)	2.6	2.6	2.0	1.8	1.8	2.5	2.3	2.2
GDP deflator (% change)	3.6	3.6	2.7	3.4	2.2	3.0	2.8	2.7
Comp. of employees (per head, % change)	5.6	5.6	6.9	7.8	5.9	6.6	6.3	6.1
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	3.6	6.0	2.9	3.9	2.8	2.7	2.0	0.5

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Commission 2019 spring forecast (COM); Convergence Programme (CP).

Both the Programme and the Commission assess the cyclical position of the Bulgarian economy as rather neutral for 2018. Nevertheless, the Programme envisages a more gradual widening of the output gap to 0.4% by 2022. The 2019 Commission spring forecast predicts a positive output gap of 1.3% already in 2020. The output gap as recalculated by the Commission based on the information provided in the Programme following the commonly agreed methodology, coincides with the Commission's estimate of 0.2% for 2018. In contrast with the Commission forecast, the (recalculated) output gap is expected to widen more slowly and to reach 0.8% in 2022. The difference between the recalculated output gap and the 2019 Commission spring forecast is attributed to higher contributions of all factors of production: labour, capital and total factor productivity (efficiency).

Turning to the labour market, the Convergence Programme projects nominal growth in aggregate compensation per employee to accelerate and reach 7.8% in 2019 on the back of positive price dynamics, productivity gains and favourable labour market developments. The annual indexation of the minimum wage and hikes in public wages would also push up average labour income. In 2020 compensation per employee is set to grow by 6.6%. The unemployment rate is forecast to decline further to 4.6% in 2019 and 4.1% in 2020. The Commission projects a more gradual decline in the unemployment rate, to 5% in 2019 and 4.8% in 2020, and slower growth in compensation per employee – 6.9% in 2019 and 5.9% in 2020.

Annual average HICP inflation reached 2.6% in 2018 on the back of higher food and services prices. The authorities forecast inflation at 1.8% and 2.5% in 2019 and 2020, respectively. The projected inflation in the Programme is higher than the Commission forecast, which is 2% in 2019 and 1.8% in 2020.

Overall, there are no major differences between the Commission 2019 spring forecast and the Programme, which is based on plausible macroeconomic assumptions.

3. Recent and planned budgetary developments

3.1. Deficit developments in 2018 and 2019

Bulgaria's budgetary surplus increased further in 2018, to 2% of GDP, from 1.2% of GDP in 2017. The Programme's recalculated structural balance improved from a surplus of 1.1% of GDP in 2017 to a surplus of 1.9% of GDP in 2018. The improvement of the budgetary balance was mainly due to increases in revenues, by about 0.6% of GDP, almost entirely driven by a rise in revenues from social security contributions following strong wage increases, a rise in social security contributions rates and thresholds, and a somewhat better collection this year. The total expenditure to GDP ratio decreased by about 0.3 percentage points. Lower social transfers and other current and capital expenditure were the main drivers of the expenditure reduction as a percentage of GDP, while wages and public investment expenditure strengthened.

Compared to the 2018 Convergence Programme, the general government balance of 2018 was 2% of GDP better than planned. This was due to 1.5% of GDP lower expenditure and 0.5% of GDP higher revenues, driven by non-tax revenues. On the expenditure side, public investment and social transfers turned out lower than planned by 1.4% and 0.5% of GDP respectively. Subsidies is the only expenditure item that was higher than projected in 2018 Convergence Programme as the Electricity System Security Fund increased its compensation to electricity producers, but this was offset by increases in the corresponding fee, which took effect in the middle of the year boosting the non-tax revenue. On the tax revenue side, indirect taxes turned out significantly lower than projected, by 0.5% of GDP. This can be due to lower public investment and slower improvement in the tax collection than originally expected.

For 2019, the fiscal policy targets a deficit of 0.3% of GDP. This corresponds to a recalculated structural deficit of 0.4% of GDP. The significant downward change of the general government balance by 2.3 percentage points of GDP, is due to the planned increase in public investment (by 1.6% of GDP), in subsidies (by 1.1% of GDP) and in social expenditure (by 0.5% of GDP) relative to the previous year. Compensation of employees is also projected to increase by 0.2% of GDP as a result of planned pay raises in the public sector. Total expenditure is planned to increase by 3.2% of GDP. On the revenue side, the total improvement of 0.9% of GDP is fuelled by the taxes on production and imports (indirect taxes) under the assumption of significantly higher pubic investment and improvements in collection. Taxes on income are not expected to increase as a percentage of GDP, while the receipts from social security contributions are expected to be higher by 0.2% of GDP. For a detailed presentation of the measures see Section 3.3.

The target of a deficit of 0.3% of GDP in 2019 marks a deterioration of the government projections compared to the 2018 Programme of a surplus of 0.3% of GDP. Expenditure is projected to be higher by 1.7% of GDP and revenue by 1.1% of GDP. The main driver of the revision of the expenditure plans is subsidies, which are higher by 1.3% of GDP, partly due to subsidies to electricity producers by the Electricity System Security Fund (see above). Compared to 2018 the 2019 Convergence Programme envisages somewhat higher revenue from indirect taxes, 0.4% of GDP and higher revenue from other sources such as the electricity fee and the introduction of a new toll system.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2018	2019		2020		2021	2022	Change: 2018-2022
	COM	COM	CP	COM	CP	CP	CP	CP
Revenue	**36.8**	**37.9**	**37.7**	**37.7**	**37.3**	**36.9**	**36.1**	**-0.7**
of which:								
- Taxes on production and imports	14.8	14.8	15.7	14.7	15.5	15.4	15.1	0.3
- Current taxes on income, wealth, etc.	5.9	5.9	5.9	5.9	6.0	6.0	5.9	0.0
- Social contributions	8.8	8.9	9.0	9.0	9.0	8.9	8.7	-0.1
- Other (residual)	7.3	8.3	7.1	8.2	6.8	6.6	6.4	-0.9
Expenditure	**34.8**	**37.0**	**38.0**	**36.7**	**36.9**	**36.7**	**36.0**	**1.2**
of which:								
- Primary expenditure	34.1	36.5	37.4	36.1	36.3	36.2	35.5	1.4
of which:								
Compensation of employees	9.5	9.8	9.7	9.9	9.8	9.7	9.2	-0.3
Intermediate consumption	5.1	4.8	4.8	4.6	4.5	4.4	4.4	-0.7
Social payments	13.2	13.3	13.7	13.1	13.7	13.6	13.4	0.2
Subsidies	1.4	2.0	2.5	1.9	2.3	2.2	2.0	0.6
Gross fixed capital formation	2.9	4.1	4.5	4.4	4.0	4.4	4.5	1.6
Other (residual)	2.0	2.4	2.2	2.1	2.0	1.9	1.9	-0.1
- Interest expenditure	0.7	0.6	0.6	0.5	0.6	0.5	0.5	-0.2
General government balance (GGB)	**2.0**	**0.8**	**-0.3**	**1.0**	**0.4**	**0.2**	**0.1**	**-1.9**
Primary balance	**2.7**	**1.4**	**0.3**	**1.5**	**0.9**	**0.7**	**0.6**	**-2.1**
One-off and other temporary	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	**2.0**	**0.8**	**-0.3**	**1.0**	**0.4**	**0.2**	**0.1**	**-1.9**
Output gap[1]	0.2	0.6	0.3	1.3	0.4	0.5	0.8	0.5
Cyclically-adjusted balance[1]	1.9	0.7	-0.4	0.6	0.3	0.0	-0.1	-2.0
Structural balance[2]	**1.9**	**0.7**	**-0.4**	**0.6**	**0.3**	**0.0**	**-0.1**	**-2.0**
Structural primary balance[2]	2.6	1.2	0.2	1.2	0.9	0.5	0.4	**-2.2**

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Convergence Programme (CP); Commission 2019 spring forecasts (COM); Commission calculations.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

The medium-term target of the Programme is to achieve and maintain a small fiscal surplus over the period 2020-2022. From a small negative budgetary position in 2019, the Programme targets a general government surplus of 0.4% of GDP in 2020, 0.2% in 2021 and 0.1% in 2022. As the output gap (at face value) remains positive, a structural surplus of around 0.3%

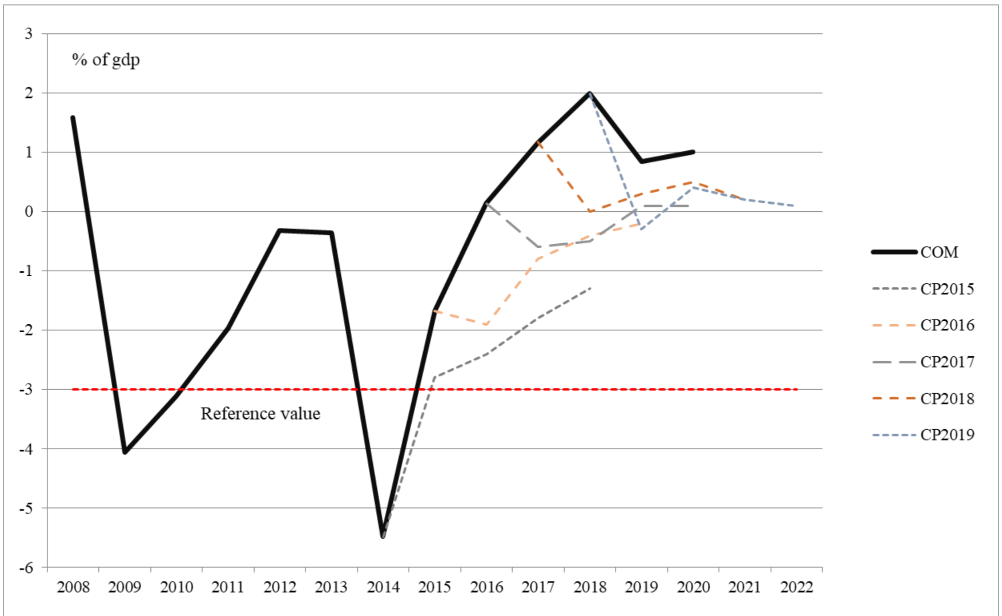
of GDP (at face value) is projected for 2020, converging to zero by 2022. According to the Programme's calculations, the reduction of the structural surplus (at face value) is 2 percentage points of GDP between 2018 and 2022. This adjustment path corresponds to a deterioration of the (recalculated) structural balance of 2.1 percentage points of GDP between 2018 and 2022.

Both the headline and structural balance plans remain within the limits set by the national Public Finance Act[2] and the SGP over the entire Programme period and with a large margin. The MTO, set at -1% of GDP by the Public Finance Act, is more stringent than what the Pact requires as it also needs to respect the stricter provisions of the Treaty on the Stability, Coordination and Governance in the Economic and Monetary Union.

As in the 2018 Convergence Programme, the Programme targets a budgetary surplus for the period beyond 2019. In 2020, the planned budgetary improvement to a surplus of 0.4% of GDP is driven almost entirely by lower expenditure. Total revenue, as percentage of GDP, is also expected to decrease.

The Commission 2019 spring forecast projects a different fiscal path for the years 2019 and 2020, with a surplus of 0.8% of GDP in 2019 and of 1% of GDP in 2020. The surpluses in the Commission forecast reflect mainly the different assumptions regarding the evolution of public investment, social payments and subsidies, as the available information on measures cannot explain in full the increases presented in the Programme. Moreover, the Commission forecast although based on a lower projected growth of domestic demand in 2019, which affects tax revenues, assumes higher transfers from the EU and other current revenue based on past trends and policy measures. For a more detailed presentation of the measures see Section 3.3.

Figure 1: Government balance projections in successive programmes (% of GDP)



Source: Commission 2019 Spring Forecast. Convergence programmes

[2] See "Public Finance Act" SG No. 15/15.02.2013, effective 1.01.2014, amended, SG No. 95/8.12.2015, effective 1.01.2016, amended and supplemented, SG No. 43/7.06.2016.

The planned targets in successive programmes significantly changed in the last few years (Figure 1). The current Convergence Programme, which aims at general government deficit in 2019 and small surpluses thereafter is relatively less ambitious than the one of the previous year.

3.3. MEASURES UNDERPINNING THE PROGRAMME

The Programme contains both revenue and expenditure increasing measures, specified in some detail for 2019 and 2020. For 2021-2022 the programme assumes no change of policies except for the continuation of adopted decisions on wages and pensions.

In 2019, the estimated impact of the main expenditure measures amounts to about 1.8% of GDP, out of which 0.4% concerns increases in pensions and other social expenditure, 0.4% of GDP additional expenditure on defence equipment and 0.3% increases in wages in the education sector. Higher spending of 0.5% of GDP for subsidies by the Electricity System Security Fund and the cost of 0.2% of GDP related to the introduction of a new toll system in the country's highways are planned to be financed by equal amount increases in the revenues from corresponding fees.

On the revenue side, the main positive impact, 0.5% of GDP, is expected from the planned increases in public sector wages and minimum wage and the increase in the maximum social insurance income. However, the Programme does not specify the budgetary impact of each of these two different policy initiatives. Both measures could translate into higher revenues from income taxes and social security contributions, but according to the Programme only the social security contributions are set to increase as percentage of GDP, by 2 percentage points. There are no discretionary measures affecting the level of taxes on production and imports, however, the Programme projects an increase by 0.9% of GDP in this category. Programme's projections can be party explained by the higher than the Commission's forecast public investment level in 2019, which may have an impact on VAT revenues.

In 2020, the main expenditure measures are the continuation of the increases in the remuneration of the pedagogical staff (0.3% of GDP) and the continued implementation of the 2015 pension reform (0.2% of GDP). The Programme does not specify measures on the revenue side in this year, other than the higher tax revenue linked to the wage increases.

The Commission 2019 spring forecast has taken into account, the impact of all the tax and social security contribution and other revenue measures for 2019 and 2020, as well as the envisaged increases in pension and personnel expenditures presented in the programme. For the difference in the underlying assumptions between the Commission forecast and the Programme see also Sections 3.2 and 3.5.

Main budgetary measures included in the Programme

Revenue	Expenditure
2018	
• Increase of excise duty on tobacco (0.1% of GDP) • Increase in the social security contributions to the pension fund by 1 percentage point (0.2% of GDP) • Increase in the minimum social security thresholds (0.1% of GDP) • Increase in the contribution to the Electricity System Security Fund (0.6% of GDP)	• Parametric changes in the pension system (0.2% of GDP) • Increases in minimum pension and support to lower pensions (0.3% of GDP) • Increases in social benefits (0.1% of GDP) • Increases in personel expenditure (0.6% of GDP) • Increase in subsidies by the Electricity System Security Fund (0.6% of GDP)
2019	
• Increase in the contribution to the Electricity System Security Fund (carry over 0.5% of GDP) • Introduction of a toll fee and electronic vignette (0.2% of GDP) • Increases in revenues due to increases in public sector wages, the minimum wage and the minimum social insurance income and threshold (0.5% of GDP)	• Increase in subsidies by the Electricity System Security Fund (carry over 0.5% of GDP) • Expenses related to the introduction of a toll system (0.2% of GDP) • Increase in the remuneration of pedagogical staff (0.3% of GDP) • Parametric changes in the pension system (0.4% of GDP) • Increases in defense spending (0.4% of GDP)
2020	
• Introdution of a toll fee and electronic vignette (0.2%)	• Increase in the remuneration of pedagogical staff (0.3% of GDP) • Pension increases under the Social Security Code (0.2% of GDP)
2021	
	• Increase in the remuneration of pedagogical staff (0.3% of GDP) • Pension increases under the Social Security Code (0.2% of GDP)
2022	
	• Pension increases under the Social Security Code (0.2% of GDP)
Note: The table refers to the main measures included in the 2019 Convergence Programme that have an incremental budgetary impact over the programme period. The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.	

3.4. DEBT DEVELOPMENTS

According to the Programme, the public debt-to-GDP ratio is expected to decrease from 22.6% in 2018 to 16.7% in 2022. The Bulgarian state has a significant cash reserve, following the creation of a cash buffer for possible support of the financial sector in 2014 and 2015, which was not used in that time. In 2018, the better than planned fiscal performance and to some extent the use of the buffer decreased the general government debt by 3% of GDP. The envisaged primary balances and the positive macroeconomic conditions are set to lead to a further reduction of public debt over the Programme period.

The debt reduction trend projected in the Programme is in line with the Commission 2019 spring forecast. However, the Commission projects a faster pace of reduction in 2020 mainly due to the larger primary surplus in the Commission forecasts.

Table 3: Debt developments

(% of GDP)	Average 2013-2017	2018	2019		2020		2021	2022
			COM	CP	COM	CP	CP	CP
Gross debt ratio[1]	**25.1**	**22.6**	**20.5**	**20.6**	**18.4**	**19.1**	**17.8**	**16.7**
Change in the ratio	1.8	-3.0	-2.1	-2.0	-2.1	-1.5	-1.3	-1.1
Contributions[2]*:*								
1. Primary balance	**0.4**	**-2.7**	**-1.4**	**-0.3**	**-1.5**	**-0.9**	**-0.7**	**-0.6**
2. “Snow-ball” effect	**-0.2**	**-0.9**	**-0.7**	**-0.9**	**-0.6**	**-0.7**	**-0.6**	**-0.5**
Of which:								
Interest expenditure	0.8	0.7	0.6	0.6	0.5	0.6	0.5	0.5
Growth effect	-0.7	-0.7	-0.7	-0.7	-0.7	-0.6	-0.6	-0.6
Inflation effect	-0.4	-0.9	-0.6	-0.7	-0.4	-0.6	-0.5	-0.5
3. Stock-flow adjustment	**1.6**	**0.6**	**0.0**	**-0.9**	**0.0**	**0.1**	**0.0**	**0.0**
Of which:								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

Notes:

[1] End of period.

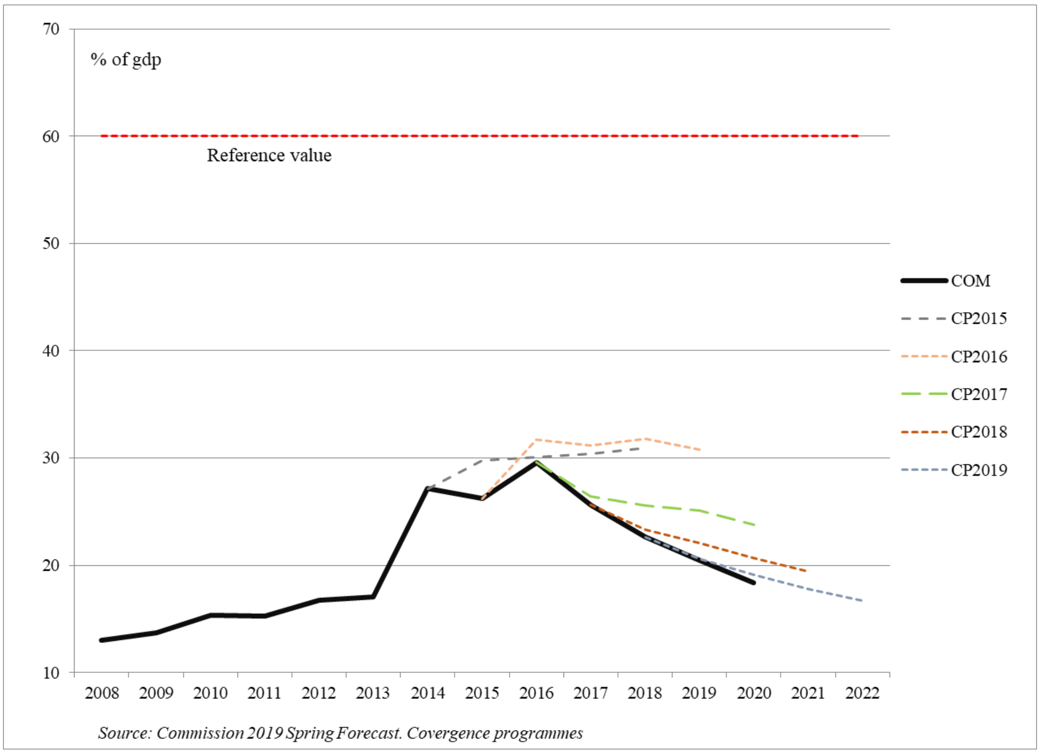
[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

Commission 2019 spring forecast (COM); Convergence Programme (CP), Commission calculations.

The previous updates of the Programme had projected a higher debt ratio over the medium-term period. In the 2018 Convergence Programme this was mainly due to the lower by 2% of GDP expected primary surplus and some uncertainty over the accumulation and the use of the cash buffer. The better-than-expected fiscal performance in 2018, combined with the projected accumulation of surpluses and some use of the cash buffers as indicated by the stock-flow adjustments, have significantly improved the medium-term debt profile relative to the previous convergence programmes despite the less ambitious general government balance plans.

Figure 2: Government debt projections in successive programmes (% of GDP)



3.5. RISK ASSESSMENT

Compared to the Commission 2019 spring forecast, the Programme adopts a broadly similar macroeconomic scenario. In terms of components, the Programme forecasts a higher contribution of domestic demand and lower from exports than the Commission in 2019. In both cases, risks to the growth outlook are broadly balanced. The main downside risk in Bulgaria, given the openness of the economy, stems from external factors such as lower demand from the main trading partners. On the upside, higher income, employment and consumer confidence could translate into higher demand.

The budgetary projections in the Programme are subject to upside risks. The Programme relies on measures and policy intentions, most of which were taken into account in the Commission 2019 spring forecast at face value. However, the Programme expects significant increases in public investment, subsidies and social payments in 2019. Commission forecast takes into account most of the public investment plans, but it does not include the impact of projects with no specified financing and implementation schedules, such as some military procurement and transport infrastructure projects. This results to a lower public investment forecast. For subsidies and social payments, on the other hand, the existing policy intentions and measures seem to explain only part of the presented spending increases.

On the revenue side, the risks on total revenue are overall balanced. The higher domestic demand growth compared to the Commission forecast explains to some extent the significantly higher revenue from indirect taxes. At the same time, according to the Commission forecast, the size of non-tax revenue is likely to be higher due to higher transfers from the EU and other non-tax revenue, such as sales and fees, for which the Programme seems to adopt a very prudent forecast.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Box 1. Council recommendations addressed to Bulgaria
The Council did not address recommendations to Bulgaria in the area of public finances.

Bulgaria is subject to the preventive arm of the Stability and Growth Pact and should ensure compliance with its MTO. Under the European Semester in July 2018 the Council considered that Bulgaria complied with the Stability and Growth Pact.

The general government budget surplus increased from of 1.2% of GDP in 2017 to 2% of GDP in 2018, complying with the 3% of GDP reference value of the Treaty and is expected to remain compliant over the Programme period. According to the Commission 2019 spring forecast, the fiscal improvement in structural terms was equal to 0.8% of GDP (from 1.1% of GDP in 2017 to 1.9% of GDP in 2018) suggesting that Bulgaria overachieved its MTO, of -1% of GDP, and is compliant with the Pact preventive arm requirements in 2018.

According to the Programme, the (recalculated) structural balance is expected to worsen from a surplus of 1.9% of GDP in 2018 to a deficit of 0.4% of GDP in 2019 and to improve again in 2020, remaining above the MTO. Compliance with the MTO is confirmed by the Commission 2019 spring forecast, albeit with a different path, according to which the structural surplus is projected to be 0.7% of GDP in 2019 and 0.6% in 2020 under the no-policy-change assumption. Therefore, Bulgaria is projected to be in compliance with the requirements of the preventive arm of the Pact in both 2019 and 2020.

Beyond 2020 and over the Programme period, the structural balance is set to remain above the MTO.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2018	2019		2020	
Background budgetary indicators[1]					
Medium-term budgetary objective (MTO)	-1.0	-1.0		-1.0	
Structural balance[2] (COM)	1.9	0.7		0.6	
Setting the required adjustment to the MTO					
Structural balance based on freezing (COM)	0.7	0.7		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		At or above the MTO	
Required adjustment[4]	0.0	0.0		0.0	
Required adjustment corrected[5]	-2.1	-1.7		-1.7	
Corresponding expenditure benchmark[6]	9.8	10.1		9.6	
Compliance with the required adjustment to the MTO					
	COM	**CP**	**COM**	**CP**	**COM**
Structural balance pillar					
Change in structural balance[7]	Compliant				
One-year deviation from the required adjustment[8]					
Two-year average deviation from the required adjustment[8]					
Expenditure benchmark pillar					
Net public expenditure annual growth corrected for one-offs[9]					
One-year deviation adjusted for one-offs[10]					
Two-year deviation adjusted for one-offs[10]					
Finding of the overall assessment					

Legend

'*Compliance*' - the recommended structural adjustment or a higher adjustment is being observed.

'*Some deviation*' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'*Significant deviation*' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage point is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.). In case of a SDP, the requirement corresponds to the Council recommendation when available; otherwise it refers to the Commission recommendation to the Council.

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[7] Change in the structural balance compared to year t-1. Ex post assessment (for 2018) is carried out on the basis of Commission 2019 spring forecast.

[8] The difference of the change in the structural balance and the corrected required adjustment.

[9] Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Convergence Programme (CP); Commission 2019 spring forecast (COM); Commission calculations.

5. DEBT SUSTAINABILITY ANALYSIS AND FISCAL RISKS

Bulgaria does not appear to face fiscal sustainability risks in the short run.[3]

Based on Commission 2019 spring forecasts and a no-fiscal policy change scenario beyond the forecast horizon, government debt, projected at 20.5 % of GDP in 2019, is expected to decrease to 8.5 % in 2029, thus remaining below the 60 % of GDP Treaty threshold. Over this period, government debt is projected to peak in 2019 at 20.5 % of GDP. Sensitivity analysis shows similar risks.[4] Overall, there is low risk for the country from debt sustainability analysis in the medium term. The full implementation of the Convergence Programme would, nonetheless, put debt on an increasing path by 2029 although remaining below the 60% of GDP reference value in 2029.

The medium-term fiscal sustainability risk indicator S1[5] is at -4.6 percentage points of GDP, primarily related to the low level of government debt, contributing with -3.1 percentage points of GDP, thus indicating low risks in the medium term. The full implementation of the Convergence Programme would put the sustainability risk indicator S1 at -4.5 percentage points of GDP. Based on the debt sustainability analysis and the S1 indicator, overall medium-term fiscal sustainability risks are low. Fully implementing the fiscal plans in the Convergence Programme would not significantly affect these risks.

The long-term fiscal sustainability risk indicator S2 is at 1.5% of GDP. Therefore, in the long term, Bulgaria appears to face low fiscal sustainability risks, primarily related to the initial budgetary position contributing -0.8 percentage points of GDP. Full implementation of the Convergence Programme would put the S2 indicator at 2.4% of GDP, leading to a higher long-term risk. [6] The debt sustainability analysis discussed above points to low risks so that, overall, long-term fiscal sustainability risks are assessed as low for Bulgaria.

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[3] This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 5 for a definition of the indicator.

[4] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Fiscal Sustainability Report 2018 for more details).

[5] See the note to Table 5 for a definition of the indicator.

[6] The projected costs of ageing that are used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the projections of the 2018 Ageing Report.

Table 5: Debt sustainability analysis and sustainability indicators

Time horizon			Commission Scenario		Convergence Programme Scenario	
Short-term			**LOW risk**			
S0 indicator [1]			0.3			
Fiscal subindex			0.0	LOW risk		
Financial & competitiveness subindex			0.4	LOW risk		
Medium-term			**LOW risk**			
DSA [2]			LOW risk			
S1 indicator [3]			-4.6	LOW risk	-4.5	LOW risk
of which	Initial Budgetary Position		-1.9		-1.2	
	Debt Requirement		-3.1		-3.8	
	Cost of Ageing		0.4		0.4	
	of which	Pensions	-0.1		0.1	
		Health care	0.2		0.1	
		Long-term care	0.0		0.0	
		Other	0.2		0.2	
Long-term			**LOW risk**			
DSA [2]			LOW risk			
S2 indicator [4]			1.5	LOW risk	2.4	MEDIUM risk
of which	Initial Budgetary Position		-0.8		0.0	
	Cost of Ageing		2.2		2.4	
	of which	Pensions	1.4		1.6	
		Health care	0.3		0.2	
		Long-term care	0.1		0.1	
		Other	0.5		0.5	

Source: Commission services; 2019 Convergence Programme.

Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2019 forecast until 2020. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.

[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.

[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections*.

[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2033. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2021 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.

[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.

* For more information see Fiscal Sustainability Report 2018.

6. FISCAL FRAMEWORK

The structural balanced budget rule, which sets the lower limits for the Bulgarian MTO in line with the Fiscal Compact, was complied with in 2018 since there was a structural surplus according to the authorities' estimate. According to the Convergence Programme, the structural balance is set to remain well above the country's MTO throughout the entire Programme period. The general government headline balance in ESA terms was recorded at a surplus of 2% of GDP in 2018; and it is expected to remain compliant over the 2019-2022 period with the national threshold for the maximum general government deficit of 3% of GDP.

In 2018, the general government balance in cash terms remained positive, overshooting the target of the 2018 budget. Consequently, Bulgaria was compliant by a large margin with the national nominal deficit rule that stipulates that the deficit in cash terms cannot exceed 2% of GDP. Similarly, the general government total expenditures in cash terms was well below the threshold of 40% of GDP set by the national fiscal rule.[7]

The domestic fiscal rules also require that the general government debt-to-GDP ratio is below 60%. This provision was also fulfilled by a large margin in 2018 and is foreseen to continue to be so over the Programme horizon, as the general government debt is planned to continuously decrease and falling below 20% of GDP already in 2020.

Based on information provided in the Convergence Programme and in national budget documents, the fiscal performance in Bulgaria complies in full with the requirements of the applicable national numerical fiscal rules. The same conclusion applies to the fiscal plans for the period 2019-2022.

The Fiscal Council was not involved in the endorsement or the ex-ante assessment of the macroeconomic scenario underpinning the Programme.

7. SUMMARY

In 2018, Bulgaria's fiscal position improved further to 2% of GDP. The headline and structural budgetary surpluses increased, with the structural balance remaining above the MTO. Bulgaria plans to decrease its budgetary surplus to a deficit in 2019 and to return in surplus from 2020 onwards. At the same time, it is expected to remain above the MTO. The Commission 2019 spring forecast points to a more positive profile of Bulgaria's public finances and also expects the structural balance to stay above MTO from 2018 onwards. In conclusion, Bulgaria is expected to remain compliant with the provisions of the preventive arm of the SGP.

[7] Except for the general government deficit thresholds in ESA (3 % of GDP) and cash terms (2 of GDP), the Bulgarian fiscal rules also contain provisions on the maximum growth of the general government expenditures in line with the preventive arm of the Stability and Growth Pact. The expenditure developments in 2017 complied with these provisions.

8. ANNEX

Table I. Macroeconomic indicators

	2001-2005	2006-2010	2011-2015	2016	2017	2018	2019	2020
Core indicators								
GDP growth rate	5.7	3.6	1.5	3.9	3.8	3.1	3.3	3.4
Output gap [1]	-0.7	1.5	-0.9	-0.7	0.1	0.2	0.6	1.3
HICP (annual % change)	5.5	6.5	0.7	-1.3	1.2	2.6	2.0	1.8
Domestic demand (annual % change) [2]	8.1	2.9	1.4	1.6	4.8	6.2	4.4	3.7
Unemployment rate (% of labour force) [3]	14.7	7.7	11.4	7.6	6.2	5.2	5.0	4.8
Gross fixed capital formation (% of GDP)	21.1	27.8	21.1	18.6	18.5	19.0	19.5	19.6
Gross national saving (% of GDP)	17.0	16.4	22.1	24.5	26.3	23.2	22.8	22.9
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	0.5	-0.5	-2.0	0.1	1.2	2.0	0.8	1.0
Gross debt	44.6	15.9	20.5	29.6	25.6	22.6	20.5	18.4
Net financial assets	5.2	6.5	-2.5	-1.7	-0.9	n.a	n.a	n.a
Total revenue	39.3	36.3	36.0	35.2	36.2	36.8	37.9	37.7
Total expenditure	38.9	36.9	37.9	35.1	35.0	34.8	37.0	36.7
of which: Interest	2.4	0.9	0.8	0.9	0.8	0.7	0.6	0.5
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	-1.7	-8.0	5.8	9.4	7.4	7.8	9.0	9.5
Net financial assets; non-financial corporations	-75.6	-165.8	-165.1	-155.6	-169.1	n.a	n.a	n.a
Net financial assets; financial corporations	-2.5	-12.6	5.0	-0.9	5.3	n.a	n.a	n.a
Gross capital formation	18.8	24.1	15.4	13.3	15.5	15.3	14.5	14.3
Gross operating surplus	27.0	27.5	29.8	30.3	31.3	31.5	31.8	31.8
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	-4.6	-5.4	-1.2	-2.2	-1.5	-6.2	-7.0	-7.7
Net financial assets	49.4	62.0	89.8	108.4	111.9	n.a	n.a	n.a
Gross wages and salaries	31.5	30.3	33.9	36.9	38.1	37.7	37.9	37.9
Net property income	2.9	2.3	2.7	2.8	4.2	4.0	3.8	3.6
Current transfers received	14.9	13.4	15.1	14.1	14.5	14.2	14.0	13.7
Gross saving	-4.2	-3.3	-0.2	-0.2	0.4	-3.7	-4.4	-4.9
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	-5.9	-14.0	2.7	7.3	7.2	3.6	2.9	2.8
Net financial assets	25.8	112.4	75.9	52.8	55.5	n.a	n.a	n.a
Net exports of goods and services	-10.7	-13.4	-0.8	4.3	3.7	0.8	0.1	0.1
Net primary income from the rest of the world	1.1	-3.5	-1.9	-0.3	1.3	0.5	0.4	0.4
Net capital transactions	0.4	0.4	2.0	2.0	1.0	1.1	1.2	1.3
Tradable sector	50.8	45.4	47.1	49.5	49.6	48.6	n.a	n.a
Non tradable sector	36.1	40.0	39.5	36.8	37.1	38.0	n.a	n.a
of which: Building and construction sector	4.5	6.9	4.5	3.4	3.6	3.7	n.a	n.a
Real effective exchange rate (index, 2000=100)	75.5	90.8	112.6	120.8	131.8	134.7	135.7	135.6
Terms of trade goods and services (index, 2000=100)	85.6	97.0	102.4	107.0	107.2	107.3	107.9	108.4
Market performance of exports (index, 2000=100)	79.3	95.3	115.3	122.2	121.2	117.3	118.3	116.8

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2015 market prices.

[2] The indicator on domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source :
AMECO data, Commission 2019 spring forecast

Mandatory variables not included in the Convergence Programme

A small number of variables were not included in the Convergence Programme. These are: the primary balance and stock-flow adjustment (Table 4), total revenue for the years 2030, 2040, 2050 and 2060 (Table 7), growth of relevant foreign markets and world import volumes, excluding EU (Table 9). However, the non-included mandatory variables do not impede the Commission's ability to assess the Convergence Programme on the basis of the Programme's assumptions.