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Assessment of the 2017 convergence programme for

Bulgaria

(Note prepared by DG ECFIN staff)

CONTENTS

1. INTRODUCTION

On 17 May 2017, Bulgaria submitted its 2017 convergence programme (hereafter called programme), covering the period 2017-2020. The government approved the programme on 17 May 2017.

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 objective.

This document complements the Country Report published on 28 February 2017 and updates it with the information included in the convergence programme.

Section 2 presents the macroeconomic outlook underlying the convergence programme and provides an assessment based on the Commission 2017 spring forecast. Section 3 presents the recent and planned budgetary developments, according to the convergence programme. In particular, it includes an overview of the medium term budgetary plans, an assessment of the measures underpinning the convergence programme and a risk analysis of the budgetary plans based on the Commission's 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 of the main conclusions.

2. MACROECONOMIC DEVELOPMENTS

Real GDP growth has been robust, at 3.6% and 3.4% in 2015 and 2016, respectively.[1] The 2016 growth outturn was mainly driven by buoyant net exports and private consumption, alongside a positive contribution from inventories. In 2017, the growth of the Bulgarian economy is expected to slightly slow to 3% according to the convergence programme, which is in line with a projected GDP growth of 2.9% in the Commission's 2017 spring forecast. In 2017, the expected decrease of GDP growth is the result of a declining positive contribution of net exports, while investment growth is forecast to be positive (following the negative outturn for 2016 especially for public investment). In addition, continuing favourable developments for employment and the real disposable income of households are expected to continue supporting private consumption growth in 2017.

In 2018, the authorities assume that real GDP growth is set to marginally increase to 3.1%, with private consumption and investment as the main drivers. Growth in the Commission forecast for 2018 is expected to reach 2.8%, lower by 0.3 pps. than the authorities' estimates, mainly due to lower consumption growth. According to the convergence programme for 2019–2020, real GDP growth is projected to rise to 3.2%, with private consumption and investment remaining the main contributors.

[1] This includes a substantial GDP data revision by the National Statistical Institute (NSI) during autumn 2016. In particular, real GDP growth for 2015 was revised upwards from 3 to 3.6% and for first half of 2016 from 3 to 3.5% y-o-y. The main drivers for the GDP upward revision in 2015 were domestic demand, especially private consumption, as well as a weaker outturn of net exports.

The output gap as recalculated by the Commission[2] based on the convergence programme, amounts to -0.4% of GDP in 2017 and 2018. On account of the robust growth rates, the negative output gap is forecast to fully close in 2019 and move into positive territory in 2020 at 0.5%. According to the convergence programme, the negative output gap is expected to steadily improve from 2017 onwards and to turn positive in 2020 at 0.1%. Overall, there are only some minor differences between the programme's recalculated output gaps and the output gaps presented in the programme. For instance, the recalculated negative output gap closes in 2019, while the negative output gap presented in the programme only fully closes in 2020.

In the programme, compensation of employees per head is expected to grow by 4.2% and 4.9% in 2017 and 2018 respectively. This is broadly consistent with the dynamic in the Commission forecast, where compensation of employees is expected to grow at 4.9% in 2017 and 4.2% in 2018. As mentioned above, favourable employment trends continue to support private consumption and economic growth.

Following a negative annual inflation rate of -1.3% in 2016, the authorities forecast inflation at 1.2% and 1.3% in 2017 and 2018, respectively, according to the convergence programme. This is broadly in line with the Commission forecast of 1.3% and 1.5% for 2017 and 2018, respectively.

Overall, there are no notable differences between the Commission's 2017 spring forecast and the convergence programme as regards the macroeconomic outlook. The 2017 convergence programme is based on plausible macroeconomic assumptions.

[2] The recalculation of the output gap is based on the commonly agreed methodology.

Table 1: Comparison of macroeconomic developments and forecasts

	2016		2017		2018		2019	2020
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	3.4	3.4	2.9	3.0	2.8	3.1	3.2	3.2
Private consumption (% change)	2.1	2.1	2.7	2.3	2.7	3.0	3.5	3.6
Gross fixed capital formation (% change)	-4.0	-4.0	4.3	2.8	3.8	3.8	4.6	4.9
Exports of goods and services (% change)	5.7	5.7	4.6	5.2	4.8	5.4	5.4	5.6
Imports of goods and services (% change)	2.8	2.8	4.7	4.8	4.9	5.3	5.6	5.9
Contributions to real GDP growth:								
- Final domestic demand	0.6	0.6	2.8	2.6	2.7	2.9	3.1	3.1
- Change in inventories	1.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	1.8	1.8	0.1	0.4	0.1	0.2	0.1	0.0
Output gap[1]	-0.2	-0.5	-0.1	-0.4	-0.1	-0.4	0.0	0.5
Employment (% change)	0.5	0.5	0.6	0.5	0.6	0.6	0.5	0.4
Unemployment rate (%)	7.6	7.6	7.0	6.9	6.4	6.5	6.3	6.2
Labour productivity (% change)	2.9	2.9	2.3	2.5	2.2	2.5	2.7	2.8
HICP inflation (%)	-1.3	-1.3	1.3	1.2	1.5	1.3	1.7	1.8
GDP deflator (% change)	1.1	1.1	1.0	1.8	1.5	1.8	2.0	2.0
Comp. of employees (per head, % change)	3.1	3.1	4.9	4.2	4.5	4.9	5.3	5.5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	6.1	6.1	4.1	5.9	3.4	6.1	6.0	5.8

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 2017 spring forecast (COM); convergence programme (CP).

3. Recent and planned budgetary developments

3.1. Deficit developments in 2016 and 2017

Following a deficit of 1.6% of GDP in 2015, Bulgaria achieved a balanced budget in 2016. In structural terms, the general government balance improved from a deficit of 1.4% of GDP to a surplus of 0.1% of GDP. In 2016, general government expenditure and revenue were mostly affected by a significant impact of EU funds; specifically, the base effect of excess spending for the closure of 2007-2013 programmes in 2015, combined with the low spending from the new 2014-2020 programmes in 2016. The total expenditure ratio decreased by 5.2% of GDP compared with 2015. A large part of this reduction (about 3.7% of GDP) was linked to lower gross fixed capital formation, while the remainder was mainly the result of the strict implementation of expenditure ceilings, especially in wages, and the reductions in other spending categories such as subsidies and interest payment. On the revenue side, in 2016 the total reduction amounted to 3.6% of GDP compared to the previous year. The impact of EU funds on the revenue side is reflected in capital transfers and other current revenue, which were jointly reduced by 4.1% of GDP. However, an increase in tax revenue, by 0.4% of GDP, partly compensated for that loss.

Compared to the 2016 convergence programme, the general government balance was 1.9% of GDP better than planned. Total expenditure and total revenue turned out respectively 3% of GDP and 1.1% of GPD lower than envisaged. The main reason behind these differences lies in a more optimistic scenario regarding EU programme implementation and a more pessimistic projection on the evolution of key expenditure items such as wages and social spending. Moreover, the upward revision of GDP in late 2016 created a small positive denominator effect, but also revealed a higher than originally estimated contribution of private consumption to GDP and thus a higher tax base mostly for indirect taxes, which was not known when the 2016 convergence programme was drafted. Finally, the impact of tax collection improvements had not been taken into account in 2016 programme.

For 2017, the fiscal target is a deficit of 0.6% of GDP. The deterioration of the general government balance is mainly due to increases in total expenditure by 0.6 % of GDP. The main impact on public expenditure stems from the envisaged recovery of public investment by 1.4% of GDP, including investment in defence. Moreover, increases in wages of the staff in education sector and additional spending on education programmes are expected to have an impact of around 0.3% of GDP and increases in the lower pensions an impact close to 0.1% of GDP. On the revenue side, a positive impact is expected from higher revenue from the EU funds, by 0.7% of GDP and from the impact of a number of tax and social security contribution measures amounting to almost 0.5% of GDP. Despite these positive effects, the ratio of total revenues to GDP is expected to remain unchanged compared to 2016. This indicates a conservative projection, especially for indirect taxes and for other revenue items, without providing any detailed explanation.

The fiscal target for 2017 is marginally lower compared to the 2016 convergence programme target of a deficit of 0.8% of GDP. However, while in the previous programme 2017 was a year of a fiscal consolidation of 1.1% of GDP (from an envisaged headline deficit of 1.9% of GDP in 2016 to 0.8% of GDP in 2017) in the current update, the 2017 fiscal target marks an expansionary fiscal stance equal to 0.6% of GDP. This change in the fiscal policy direction reflects to some extent the impact of new policy measures, but also a prudent fiscal forecast. The updated 2017 deficit target is based on lower projections on expenditure and revenue, by 1.4% of GDP and 1.3% of GDP respectively, as a result of the higher (compared to the 2016 programme) GDP and the lower base effect in 2016.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

The medium term target of the programme is to achieve and sustain a close-to-balanced budgetary position over the period 2018-2020. From a headline deficit of 0.6% of GDP in 2017, the programme projects a deficit of 0.5% of GDP in 2018 and surpluses of 0.1% of GDP in 2019 and 2020. This adjustment path corresponds to a deterioration of the structural balance, as recalculated by the Commission based on the information in the programme following the commonly-agreed methodology, of 0.2 pps. of GDP between 2016 and 2020. According to the programme, the structural balance in the same period remains unchanged.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2016	2017		2018		2019	2020	Change: 2016-2020
	COM	COM	CP	COM	CP	CP	CP	CP
Revenue	**35.5**	**36.3**	**35.5**	**36.6**	**36.1**	**35.7**	**35.3**	**-0.2**
of which:								
- Taxes on production and imports	15.6	15.5	15.5	15.5	15.5	15.3	15.1	-0.5
- Current taxes on income, wealth, etc.	5.5	5.4	5.7	5.4	5.8	5.9	5.9	0.4
- Social contributions	8.0	8.2	8.4	8.2	8.7	8.7	8.7	0.7
- Other (residual)	6.4	7.2	5.9	7.4	6.1	5.8	5.6	-0.8
Expenditure	**35.5**	**36.8**	**36.1**	**36.9**	**36.6**	**35.5**	**35.1**	**-0.4**
of which:								
- Primary expenditure	34.7	35.9	35.3	36.1	35.9	34.8	34.4	-0.3
of which:								
Compensation of employees	9.0	9.2	8.9	9.2	9.1	9.1	9.0	0.0
Intermediate consumption	5.1	5.1	5.2	5.1	5.2	5.0	4.8	-0.3
Social payments	14.0	13.8	14.1	13.8	14.2	14.1	14.0	0.0
Subsidies	1.0	1.1	1.0	1.1	1.0	1.0	1.0	0.0
Gross fixed capital formation	2.8	4.0	4.2	4.2	4.7	3.9	4.0	1.2
Other (residual)	2.8	2.7	1.8	2.7	1.6	1.7	1.7	-1.1
- Interest expenditure	0.8	0.8	0.8	0.8	0.7	0.7	0.7	-0.1
General government balance (GGB)	**0.0**	**-0.4**	**-0.6**	**-0.3**	**-0.5**	**0.1**	**0.1**	**0.1**
Primary balance	**0.8**	**0.4**	**0.2**	**0.5**	**0.2**	**0.8**	**0.8**	**0.0**
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	**0.0**	**-0.4**	**-0.6**	**-0.3**	**-0.5**	**0.1**	**0.1**	**0.1**
Output gap[1]	-0.2	-0.1	-0.4	-0.1	-0.4	0.0	0.5	0.8
Cyclically-adjusted balance[1]	0.1	-0.4	-0.5	-0.3	-0.4	0.1	-0.1	-0.2
Structural balance[2]	**0.1**	**-0.4**	**-0.5**	**-0.3**	**-0.4**	**0.1**	**-0.1**	**-0.2**
Structural primary balance[2]	0.9	0.4	0.3	0.5	0.3	0.8	0.6	-0.2

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 :

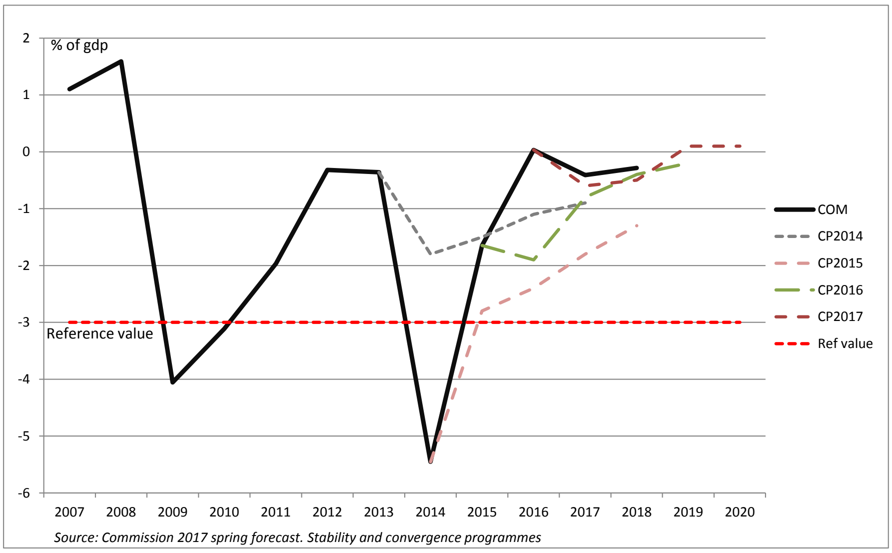
Convergence programme (CP); Commission 2017 spring forecasts (COM); Commission calculations.

Both headline and structural balance plans remain within the limits set by the Public Finance Act[3] and the Stability and Growth Pact over the entire programme horizon and with a large margin. The MTO, set at -1% of GDP by the Public Finance Act, is more stringent[4] 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.

Compared to the 2016 programme, the current programme, starting from a lower deficit in 2017, targets a similar medium term adjustment path.

In 2018, the small adjustment (by 0.1% of GD) is driven by the recovery of revenues by 0.6% of GDP against an increase in expenditure by 0.5% of GDP. In terms of composition, direct taxes and social security contributions are expected to increase further, consistent with the macroeconomic and labour market projections, as well as the with the higher social contribution rates applied. The Commission 2017 spring forecast projects a similar fiscal path for the years 2017 and 2018. According to this, the general government balance of 2017 is expected at -0.4% of GDP and at -0.3% of GDP in 2018. The 2018 deficit in the Commission forecast reflects different assumptions regarding mainly the evolution of tax revenue and public investment.

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



The planned targets in successive programmes significantly changed in the last few years (Figure 1). Nevertheless, the current programme, which aims at achieving a headline general government surplus in the medium-term, is the most ambitious of the previous three programmes.

[3] 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.

[4] The MTO selected by the Member State is more ambitious than the minimum MTO by more than ½ percentage point. The minimum MTOs are country-specific and calculated based on an agreed methodology.

3.3. MEASURES UNDERPINNING THE PROGRAMME

The programme contains both revenue and expenditure increasing measures, specified in detail for 2017 and to some extent for 2018. In 2017, the estimated impact of the main expenditure measures amounts to about 1% of GDP, out of which 0.4% of GDP concerns additional expenditure on defence equipment, 0.3% increase in wage and non-wage spending in the education sector and 0.3% higher spending on pensions and social benefits. On the revenue side, increases in social security contributions account for a positive impact of 0.4% of GDP and the envisaged increases in excise taxes for tobacco product for an additional 0.1% of GDP.

For 2018, the main expenditure measures described in detail in the programme are the parametric changes of the pension reform (of 2015) with an impact of a 0.2% of GDP. On the revenue side, a positive impact of 0.4% stems from the continuation and completion of the increase in excise tax rates for tobacco products (0.1% of GDP), an additional 1 pp. increase in health contributions (0.2% of GDP) and the increase in minimum insurable income (0.1% of GDP).

Given that the 2017 convergence programme was submitted with delay, some of the measures with a relatively high impact on the budget, namely the non-wage related increases in education spending and the increases in minimum pensions, were not yet officially announced in sufficient detail and thus were not included in the Commission 2017 spring forecast.

Main budgetary measures

Revenue	Expenditure
2017	
• Increase of excise duty on tobacco (0.1% of GDP) • Increase in the health contributions by one percentage point (0.2% of GDP) • Increase in pension contributions by 20 percentage points in some professions (0.2% of GDP) • Increase in the minimum insurance income (0.02% of GDP)	• Increase in expenditures on defence (0.4% of GDP) • Increase in expenditure on education (0.1% of GDP) • Increase in the remuneration of employees in the education sector (0.2% of GDP) • Increases in pensions and social benefits (0.3% of GDP)
2018	
• Increase of excise duty on tobacco (0.1% of GDP) • Increase in the health contributions by 1 percentage point (0.2% of GDP) • Increase in the minimum insurance income (0.1% of GDP)	• Parametric changes in the pension system (0.2% of GDP)
2019	
•	• Parametric changes in the pension system (0.2% of GDP)
2020	
•	• Parametric changes in the pension system (0.2% of GDP)
Note: 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 Convergence Programme, the public debt ratio is expected to decrease from 29.5% in 2016 to 23.8% in 2020. Bulgarian state has a significant reserve following the creation of a cash buffer for possible support of the financial sector, which was not finally used. Moreover, in 2016, the better than planned fiscal performance and the issuance of public bonds above the debt financing needs in view of the favourable macroeconomic environment and the low interest rates increased further the available cash buffer. The use of reserves to cover most of the state financing needs in 2017, the envisaged primary balances and the positive macroeconomic conditions are the main drivers of the debt reduction over the programme horizon.

The debt reduction trend projected in the Programme is in line with the Commission 2017 spring forecast. However, the Commission projects a slower pace of reduction in 2017 and 2018 mainly due to different assumption on the use of reserves, reflected in the stock flow adjustment for 2017, as well as to the slightly different profile of the primary balance and the underlying assumptions about inflation and growth affecting the "snow-ball" effect in these two years.

Table 3: Debt developments

(% of GDP)	Average 2011-2015	2016	2017		2018		2019	2020
			COM	CP	COM	CP	CP	CP
Gross debt ratio[1]	**20.4**	**29.5**	**26.8**	**26.4**	**26.0**	**25.6**	**25.1**	**23.8**
Change in the ratio	2.1	3.5	-2.7	-3.1	-0.8	-0.8	-0.5	-1.3
Contributions [2] :								
1. Primary balance	**1.1**	**-0.8**	**-0.4**	**-0.2**	**-0.5**	**-0.2**	**-0.8**	**-0.8**
2. "Snow-ball" effect	**0.2**	**-0.4**	**-0.3**	**-0.6**	**-0.3**	**-0.5**	**-0.6**	**-0.5**
Of which:								
Interest expenditure	0.8	0.8	0.8	0.8	0.8	0.7	0.7	0.7
Growth effect	-0.3	-0.9	-0.8	-0.8	-0.7	-0.8	-0.8	-0.8
Inflation effect	-0.3	-0.3	-0.3	-0.5	-0.4	-0.5	-0.5	-0.5
3. Stock-flow adjustment	**0.8**	**4.7**	**-2.0**	**-2.3**	**0.0**	**0.0**	**0.9**	**0.1**
Of which:								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

Notes:

[1] End of period.

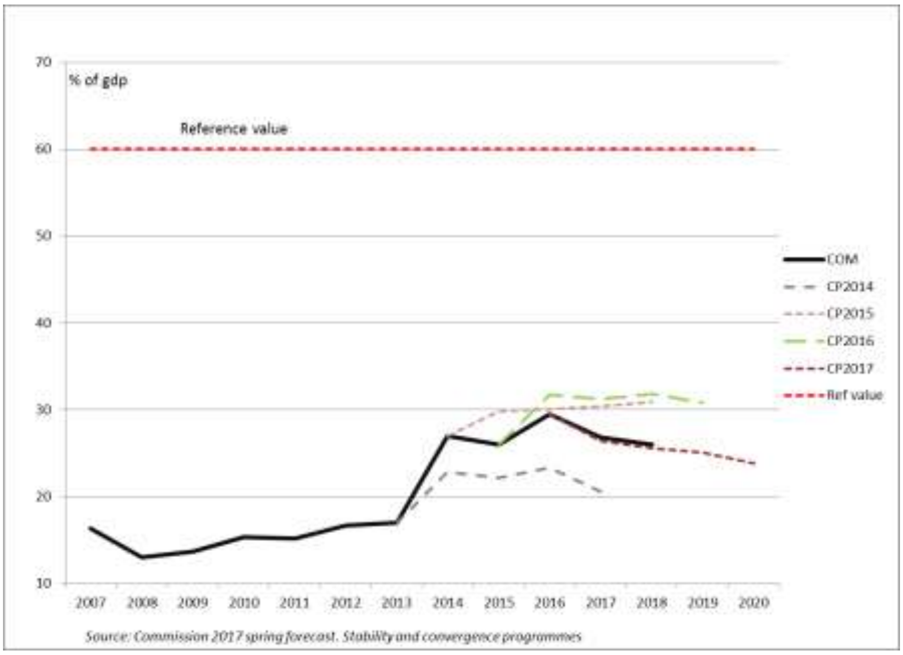
[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets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

Source :

Commission 2017 spring forecast (COM); convergence programme (CP), Comission calculations.

The previous updates of the programme had envisaged a higher debt ratio over the medium-term horizon. This was mainly due to the higher deficit forecast and some uncertainty over the accumulation and the use of the cash buffers. The better-than-expected fiscal performance in 2016, combined with the decision to use part of the buffers for the repayment of loans (including the pre-financing of 2017 eurobond), significantly improved the medium-term debt profile over the programme horizon.

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



3.5. RISK ASSESSMENT

Compared to the Commission 2017 spring forecast, the 2017 convergence programme adopts a slightly more optimistic macroeconomic scenario, but in both cases risks to the growth outlook are broadly balanced. On the downside, Bulgaria, as a small and very open economy, is particularly exposed to external factors. A weaker import demand from the main trading partners and surging oil prices could negatively impact on growth rates, mainly through the external sector. As a domestic downside risk, further delays in the implementation of the EU funds could lead to lower growth, mainly due to slower recovery of public investment and to some extent through lower public consumption. On the upside, stronger-than-expected consumer confidence and faster progress with reform implementation could lift real GDP growth rates and tax revenues.

The fiscal projections are broadly based on prudent assumptions despite the improving macroeconomic outlook, while Bulgaria exhibits a track record of overall consolidated budgets, low debt levels and performance which positively exceeds targets. In the same context, an additional positive impact on revenue, compared to the projections of the programme, could be expected from the ongoing efforts to improve tax collection. Downside risks to public finances stem from the contingent liabilities of the state-owned enterprises (SOEs). An additional risk to the fiscal outlook relates to the expected assessment and decision by Eurostat on the classification of the allocated state-aid in the form of a loan to the national energy company (NEK).

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

Box 1. Council recommendations addressed to Bulgaria

On 12 July 2016, the Council addressed recommendations to Bulgaria in the context of the European Semester. In particular, in the area of public finances the Council recommended to Bulgaria to achieve an annual fiscal adjustment of 0.5 % of GDP towards the medium-term budgetary objective in 2016 and in 2017.

Bulgaria is subject to the preventive arm of the Stability and Growth Pact. Based on the outturn data and the Commission 2017 spring forecast, the general government budget adjusted from a deficit of 1.6% of GDP in 2015 to a balanced position in 2016, complying with the 3% of GDP reference value of the Treaty. It is expected to remain compliant over the programme horizon.

In structural terms the adjustment was equal to 1.5% of GDP (from -1.4% of GDP in 2015 to 0.1% of GDP in 2016) suggesting that Bulgaria overachieved both the fiscal adjustment, which was required by the Council recommendation and its MTO, of -1% of GDP, and is compliant with the preventive arm requirements.

According to the 2017 convergence programme the (recalculated) structural balance is expected to temporarily worsen from a surplus of 0.1% of GDP in 2016 to a deficit of 0.5% in 2017 and to start improving in 2018, remaining above the MTO. The compliance with the MTO is confirmed by the Commission 2017 spring forecast, albeit with a slightly different path, according to which the structural deficit is projected to reach 0.4% of GDP in 2017 and to improve to 0.3% in 2018 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 2017 and 2018.

Beyond 2018 and over the programme horizon, the programme indicates that the structural balance is set to remain with a large margin above the MTO.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2016	2017		2018	
Initial position[1]					
Medium-term objective (MTO)	-1.0	-1.0		-1.0	
Structural balance[2] (COM)	0.1	-0.4		-0.3	
Structural balance based on freezing (COM)	0.1	-0.4		-	
Position vis-a -vis the MTO[3]	Not at MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2016**	**2017**		**2018**	
	COM	**CP**	**COM**	**CP**	**COM**
Structural balance pillar					
Required adjustment[4]	Compliant				
Required adjustment corrected[5]					
Change in structural balance[6]					
One-year deviation from the required adjustment [7]					
Two-year average deviation from the required adjustment [7]					
Expenditure benchmark pillar					
Applicable reference rate[8]					
One-year deviation adjusted for one-offs[9]					
Two-year deviation adjusted for one-offs[9]					
PER MEMORIAM: One-year deviation [10]					
PER MEMORIAM: Two-year average deviation [10]					
Conclusion					
Conclusion over one year					
Conclusion over two years					

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 points (p.p.) 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.).

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

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2014) is carried out on the basis of Commission 2015 spring forecast.

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

[8] 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.

[9] 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.

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law 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.

<u>*Source*</u> :

Convergence programme (CP); Commission 2017 spring forecast (COM); Commission calculations.

5. FISCAL SUSTAINABILITY

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

Based on the Commission forecast and a no-fiscal policy change scenario beyond forecasts, government debt, at 29.5% of GDP in 2016, is expected to decrease to 17.9% in 2027, thus remaining below the 60% of GDP Treaty threshold. This highlights low risks for the country from debt sustainability analysis in the medium term. The full implementation of the convergence programme would put debt on a clearly decreasing path by 2027, remaining below the 60% of GDP reference value in 2026.

The medium-term fiscal sustainability risk indicator S1 is at -3.9% of GDP, primarily related to the low level of government debt, contributing with -2.5 pps. of GDP thus indicate low risks in the medium term. The full implementation of the convergence programme would put the sustainability risk indicator S1 at -4.9% of GDP, leading to lower medium-term risk. Overall, risks to fiscal sustainability over the medium-term are, therefore, low. Fully implementing the fiscal plans in the programme would decrease those risks.

The long-term fiscal sustainability risk indicator S2 (which shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path) is at 1.1% of GDP. In the long-term, Bulgaria therefore appears to face low fiscal sustainability risks, primarily related to the projected ageing costs contributing with 1.1 pps. of GDP. Full implementation of the programme would put the S2 indicator at 1.4% of GDP, leading to a similar long-term risk.

Table 5: Sustainability indicators

Time horizon				No-policy Change Scenario		Stability / 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]			-3.9	LOW risk	-4.9	LOW risk
	of which						
		Initial Budgetary Position		-1.1		-1.7	
		Debt Requirement		-2.5		-3.2	
		Cost of Ageing		-0.3		-0.1	
		of which					
			Pensions	-0.3		-0.1	
			Health-care	0.1		0.1	
			Long-term care	0.0		0.0	
			Other	-0.1		0.0	
Long Term				**LOW risk**		**LOW risk**	
	S2 indicator [4]			1.1		1.1	
	of which						
		Initial Budgetary Position		0.0		-0.3	
		Cost of Ageing		1.1		1.4	
		of which					
			Pensions	0.7		1.0	
			Health-care	0.3		0.2	
			Long-term care	0.1		0.1	
			Other	0.0		0.1	

Source: Commission services; 2017 stability/convergence programme.

Note: the 'no-policy-change' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2017 forecast covering until 2018 included. 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 2015 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 2031. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2019 for No-policy Change 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 2015 and Debt Sustainability Monitor 2016.

6. FISCAL FRAMEWORK

The structural balanced budget rule, which set the lower limits for the Bulgarian MTO in line with the Fiscal Compact, was complied with in 2016, since there was a small structural surplus according to the authorities estimate. The structural deficit is envisaged in the convergence programme to remain below the country's MTO throughout the entire programme horizon.

In 2016, the general government surplus in cash terms amounted to 1.7% of GDP, overshooting the targets of the 2016 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.[5] Similarly, the general government total expenditures in cash terms decreased to close to 34% of GDP, well below the threshold of 40% of GDP set by the national fiscal rule.[6]

The domestic fiscal rules also require that the general government debt-to-GDP ratio is below 60%. This provision was fulfilled by more than 30 pps. of GDP in 2016 and is foreseen to continue to do so over 2017-2020 horizon, as the general government debt is planned to decrease throughout the programme horizon.

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 programme period 2017-2020.

The recently established Fiscal Council has recruited a small support staff and is now operational. However, the available resources and the limited financial autonomy granted to the institution could be a bottleneck for fully playing its role in the national fiscal framework. The Fiscal Council was not involved in the endorsement or the ex-ante assessment of the macroeconomic scenario underpinning the Convergence Programme.

5 The general government budget in ESA-terms was in balance in 2016. The general government deficit is envisaged to remain below 1% of GDP over the programme period. Therefore, the deficit outcome in 2016 and the outlook for the period 2017-2020 comply with the national threshold for the maximum general government deficit of 3% of GDP in ESA-terms. For more details see section 4.

6 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 2016 complied with these provisions.

7. SUMMARY

In 2016, Bulgaria achieved a balanced general government budget and a small surplus in structural terms (0.1% of GDP). This translates into an adjustment of 1.5% of GDP in both nominal and structural terms. Having achieved this fiscal outcome, Bulgaria remains with a large margin within the requirements of the SGP, and is fully compliant with the 2016 country specific recommendation by the Council, which required an annual fiscal adjustment of 0.5% of GDP in 2016 and 2017.

In 2017, despite the planned deterioration of the general government balance to -0.6% of GDP, Bulgaria is expected to remain well below the Treaty reference value for the headline deficit. In structural terms, the estimated deficit of 0.5% of GDP is below, by a large margin, the MTO set by the national Public Finance Act. Similarly, in 2018, Bulgaria is expected to remain fully compliant with the provisions of both the preventive and the corrective arms of the SGP, as the convergence programme envisages some fiscal improvement.

8. ANNEX

Table I. Macroeconomic indicators

	1999-2003	2004-2008	2009-2013	2014	2015	2016	2017	2018
Core indicators								
GDP growth rate	2.6	6.8	0.1	1.3	3.6	3.4	2.9	2.8
Output gap [1]	-1.9	2.0	-0.8	-1.5	-0.8	-0.2	-0.1	-0.1
HICP (annual % change)	5.7	7.8	2.3	-1.6	-1.1	-1.3	1.3	1.5
Domestic demand (annual % change) [2]	7.4	9.5	-2.7	2.7	3.4	1.6	2.9	2.8
Unemployment rate (% of labour force) [3]	16.0	8.7	10.7	11.4	9.2	7.6	7.0	6.4
Gross fixed capital formation (% of GDP)	18.4	27.2	22.7	21.1	21.0	19.1	19.3	19.4
Gross national saving (% of GDP)	16.1	14.7	21.3	21.4	21.5	24.5	23.0	22.6
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-0.2**	**1.5**	**-2.0**	**-5.5**	**-1.6**	**0.0**	**-0.4**	**-0.3**
Gross debt	**61.5**	**22.6**	**15.6**	**27.0**	**26.0**	**29.5**	**26.8**	**26.0**
Net financial assets	**7.8**	**6.7**	**1.7**	**-6.5**	**-4.8**	**n.a**	**n.a**	**n.a**
Total revenue	39.7	38.2	34.3	36.6	39.0	35.5	36.3	36.6
Total expenditure	39.9	36.8	36.3	42.1	40.7	35.5	36.8	36.9
of which: Interest	3.3	1.3	0.7	0.9	0.9	0.8	0.8	0.8
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**0.3**	**-8.2**	**5.5**	**15.0**	**11.6**	**13.9**	**13.9**	**13.9**
Net financial assets; non-financial corporations	**-66.3**	**-131.2**	**-172.1**	**-163.4**	**-152.4**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**1.2**	**-19.9**	**8.8**	**-1.3**	**-0.6**	**n.a**	**n.a**	**n.a**
Gross capital formation	16.1	25.2	17.2	14.5	13.1	15.6	14.7	14.8
Gross operating surplus	23.8	26.6	29.7	30.1	29.4	29.7	29.4	29.3
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**-4.6**	**-9.0**	**-4.2**	**-5.8**	**-7.6**	**-8.2**	**-9.7**	**-10.5**
Net financial assets	**48.3**	**57.9**	**72.3**	**101.7**	**104.9**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	29.7	30.6	32.1	36.0	36.0	36.0	36.4	36.8
Net property income	0.2	0.4	0.0	-3.8	-5.6	-5.7	-6.5	-6.9
Current transfers received	14.6	13.3	15.0	13.4	14.4	13.7	13.3	13.0
Gross saving	-4.3	-7.6	-2.1	-7.9	-8.9	-8.3	-9.2	-9.6
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**-4.5**	**-15.9**	**-0.7**	**2.2**	**2.4**	**6.1**	**4.1**	**3.4**
Net financial assets	**11.5**	**88.6**	**92.5**	**72.4**	**55.7**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	-7.5	-16.4	-2.9	-0.9	0.1	3.1	2.5	2.7
Net primary income from the rest of the world	0.1	-2.4	-2.1	-0.9	-2.0	-0.9	-1.9	-2.3
Net capital transactions	0.0	0.3	1.1	2.2	2.1	1.9	1.7	1.6
Tradable sector	51.5	47.4	45.6	47.6	48.1	48.1	n.a	n.a
Non tradable sector	36.6	37.3	41.1	39.2	38.3	38.2	n.a	n.a
of which: Building and construction sector	4.4	5.9	5.9	3.9	3.8	3.7	n.a	n.a
Real effective exchange rate (index, 2000=100)	71.8	81.7	104.2	119.6	119.4	117.9	119.6	119.6
Terms of trade goods and services (index, 2000=100)	82.5	92.4	101.1	102.1	103.5	105.6	104.6	104.9
Market performance of exports (index, 2000=100)	75.9	89.6	107.7	118.0	118.7	120.7	120.9	120.8

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 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 2017 spring forecast