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Assessment of the 2018 Convergence Programme for

Bulgaria

(Note prepared by DG ECFIN staff)

CONTENTS

1. INTRODUCTION

On 19 April 2018, Bulgaria submitted its 2018 Convergence Programme (hereafter called the Programme), covering the period 2018-2021. The government approved the Programme on 18 April 2018.

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 7 March 2018 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 2018 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 of the main conclusions.

2. MACROECONOMIC DEVELOPMENTS

The Bulgarian economy showed robust growth in 2016 and 2017. While in 2016 growth was driven by net exports, in 2017 imports growth surpassed that of exports, and domestic demand became the main growth driver. Real GDP growth was 3.9 % in 2016 and 3.6 % in 2017. According to the Programme, the Bulgarian economy is expected to grow by 3.9 % in 2018 and 3.8 % in 2019.

In 2018, real GDP growth is expected to be driven by domestic demand. Improved consumer confidence, the continued rise in employment and higher real household disposable income will support private consumption growth. Government consumption and investment are also forecast to increase. Despite the projected slowdown in global growth the Programme expects exports to grow at the same level as in 2017. Rising domestic demand and exports will support the growth of imports. Overall, the negative net export's contribution to GDP growth is set to increase. The projected GDP growth for 2018 in the Programme is 3.9 %, while the Commission forecasts growth at 3.8 % in the same year. The Commission also expects domestic demand to be the engine of growth, but with lower contribution from investment.

For 2019, the Programme projects real GDP growth to decrease slightly to 3.8 %. This is due to a slower growth of domestic demand mainly from slower public investment growth. Private consumption is expected to increase, supported by higher credits to households. The lower growth of domestic demand is set to decrease the import growth and therefore to reduce the negative contribution from net exports. Real GDP growth in the Commission forecast is also projected to decline by 0.1 percentage point in 2019, to 3.7 %, driven by lower growth in domestic demand. The negative contribution from net exports is also set to decrease. According to the Programme, for 2020-2021, real GDP is expected to reach 3.7 %, still driven by domestic demand. The negative contribution from net exports is expected to remain stable.

According to the Commission 2018 spring forecast, Bulgaria has entered into a mature phase of its economic cycle and the output gap, which turned slightly positive in 2017, is projected to widen further in the medium term as GDP continues growing above its potential. The Programme, however, sees the economy to be in an earlier stage of its business cycle. The output gap as recalculated by Commission based on the information in the Programme, following the commonly agreed methodology, was slightly negative in 2017. In contrast with the Commission forecast, the (recalculated) output gap is expected to close in 2018 and turn negative again in 2019. Thereafter, it is expected to turn positive and to reach 0.6 % in 2021.

Turning in the labour market, the Programme projects compensation of employee per head to grow by 7.4 % and 6.9 % in 2018 and 2019 respectively. This is broadly in line with the Commission spring forecast, where it is expected to grow at 7.6 % in 2018 and 7.0 % in 2019. In comparison with the Commission, the Programme forecasts lower growth in employment and consequently higher growth in labour productivity. Favourable employment trends are supported by positive developments in economic activity, but employment growth is set to slow due to a limited labour supply.

Following a long period of deflation, annual HICP inflation reached 1.2 % in 2017 on the back of rising energy and administrative prices. The authorities forecast inflation at 1.8 % and 2.0 % in 2018 and 2019, respectively. This is broadly in line with the Commission forecast at 1.8 % in both years. Both energy prices and core inflation are expected to continue to rise.

Overall, there are no major differences between the Commission 2018 spring forecast and the Programme, which is based on plausible macroeconomic assumptions.

Table 1: Comparison of macroeconomic developments and forecasts

	2017		2018		2019		2020	2021
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	3.6	3.6	3.8	3.9	3.7	3.8	3.7	3.7
Private consumption (% change)	4.8	4.8	4.9	4.9	4.5	4.8	4.6	4.4
Gross fixed capital formation (% change)	3.8	3.8	8.7	10.1	6.8	6.6	6.9	7.0
Exports of goods and services (% change)	4.0	4.0	5.0	4.9	4.8	4.9	4.7	4.6
Imports of goods and services (% change)	7.2	7.2	7.4	8.1	6.2	7.0	5.9	5.8
Contributions to real GDP growth:								
- Final domestic demand	4.2	4.2	5.3	5.8	4.6	5.1	4.4	4.5
- Change in inventories	1.1	1.1	0.0	0.1	-0.1	0.1	0.1	0.1
- Net exports	-1.7	-1.7	-1.5	-2.0	-0.9	-1.4	-0.8	-0.8
Output gap[1]	0.1	-0.1	0.4	0.0	0.5	-0.2	0.1	0.6
Employment (% change)	1.8	1.8	1.1	0.6	0.4	0.3	0.2	0.0
Unemployment rate (%)	6.2	6.3	5.5	5.9	5.3	5.7	5.5	5.4
Labour productivity (% change)	1.7	1.7	2.7	3.3	3.3	3.5	3.5	3.7
HICP inflation (%)	1.2	1.2	1.8	1.8	1.8	2.0	2.1	2.1
GDP deflator (% change)	1.2	1.2	2.2	2.1	2.3	2.3	2.3	2.2
Comp. of employees (per head, % change)	7.5	7.5	7.6	7.4	7.0	6.9	6.5	6.3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	4.7	5.0	3.2	3.1	2.7	2.6	2.3	1.7

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 2018 spring forecast (COM); Convergence Programme (CP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2017 AND 2018

Bulgaria's budgetary surplus increased further in 2017, to 0.9 % of GDP, from 0.2 % of GDP in 2016. The Programme recalculated structural balance improved from a surplus of 0.3 % of GDP to a surplus of 1 % of GDP in the same years. In 2017, the improvement of the budgetary balance was due to both higher revenue and somewhat lower expenditure as percentage of GDP. Total revenue increased by 1 % of GDP compared to the previous year. This increase was mostly driven by the increase in social security contributions rates and in direct tax revenue following rising wages in the economy. The total expenditure ratio decreased by 0.3 % of GDP. This reduction was mostly driven by expenditure such as gross fixed capital formation and social payments, which experienced significant drops as a percentage of GDP. At the same time, wages and other current expenditure, increased significantly as a percentage of GDP.

Compared to the 2017 Convergence Programme, the general government balance of 2017 was 1.5 % of GDP better than planned. Total revenue turned out 0.6 % of GDP higher than envisaged and total expenditure 0.9 % of GDP lower. On the revenue side, the main difference between the 2017 Programme and outturn data lies in non-tax revenue, including sales and other current transfers (mostly from the EU), which performed better than expected. On the expenditure side, as a number of investment plans did not materialise as expected and gross fixed capital formation turned out significantly lower than projected (by 2.1 % of GDP), as for also social transfers (by 0.5 % of GDP). On the contrary, wages and other current expenditure (such as capital transfers) were higher than planned.

For 2018, the fiscal policy target is a balanced budget. The elimination of the general government surplus is planned to be mainly driven by an increase in total expenditure by 1.1 % of GDP, while total revenue is forecast to increase by a 0.2 % of GDP. The main impact on expenditure stems from the envisaged recovery of public investment, by 2.2 % of GDP, as a result of higher spending on both EU programmes and national investment projects, including defence procurement. Moreover, the authorities plan the implementation of a number of expenditure measures with a total impact of 1 % of GDP. On the revenue side, the envisaged measures are set to have a positive impact of 0.3 % of GDP. For a more detailed presentation of the measures see Section 3.3.

The target of a balanced budget for 2018 is significantly improved compared to the 2017 Convergence Programme target of a deficit of 0.5 % of GDP. This new path is mainly due to the base effect of the over-performance of the budgetary target in 2017. The total revenue of 2018 is projected to be 0.2 % higher than in last year's Programme, mainly due to non-tax revenue. The 2018 Programme's projection on total expenditure is lower by 0.3 % of GDP than in the last year's Programme. The items with higher envisaged spending include wages and "other" expenditure (mainly transfers), while lower expenditure (as a percentage of GDP) is projected for social transfers and investment. The new path for the headline balance corresponds to a fiscal expansion of 1.0 % of GDP, versus a broadly neutral fiscal stance planned in the 2017 Convergence Programme.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

The medium-term target of the Programme is to achieve and maintain fiscal surpluses over the period 2019-2021. From a balanced budget in 2018, the Programme projects a headline budgetary surplus of 0.3 % of GDP in 2019, 0.5 % in 2020 and 0.2 % in 2021. As the output gap (at face value) is set to turn positive in 2019, a structural surplus of 0.2 % and 0.3 % of GDP (at face value) is projected for 2019 and 2020 respectively and a balance structural outcome is planned for 2021. 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 1 percentage point of GDP between 2017 and 2021. According to the Programme's calculations, the reduction of the structural surplus is 1.1 percentage points of GDP over the same period.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2017	2018		2019		2020	2021	Change: 2017-2021
	COM	COM	CP	COM	CP	CP	CP	CP
Revenue	**36.1**	**36.4**	**36.3**	**36.4**	**36.6**	**36.1**	**35.8**	**-0.4**
of which:								
- Taxes on production and imports	15.1	15.1	15.3	15.1	15.3	15.2	15.1	0.0
- Current taxes on income, wealth, etc.	5.9	5.9	5.8	5.9	6.0	6.1	6.1	0.2
- Social contributions	8.6	8.6	8.8	8.6	8.9	8.9	8.8	0.2
- Other (residual)	6.6	6.8	6.4	6.9	6.4	5.9	5.8	-0.8
Expenditure	**35.2**	**35.8**	**36.3**	**35.8**	**36.3**	**35.6**	**35.6**	**0.3**
of which:								
- Primary expenditure	34.4	35.1	35.6	35.1	35.7	35.0	35.0	0.5
of which:								
Compensation of employees	9.3	9.6	9.5	9.7	9.6	9.6	9.4	0.1
Intermediate consumption	4.9	4.7	5.0	4.4	4.8	4.6	4.5	-0.4
Social payments	13.6	13.8	13.7	13.5	13.8	13.7	13.5	-0.1
Subsidies	1.1	1.3	1.0	1.4	1.2	1.1	1.0	-0.1
Gross fixed capital formation	2.1	2.9	4.3	3.5	4.6	4.4	4.7	2.6
Other (residual)	3.4	2.9	2.1	2.5	1.6	1.6	1.8	-1.6
- Interest expenditure	0.8	0.7	0.7	0.7	0.6	0.6	0.6	-0.2
General government balance (GGB)	**0.9**	**0.6**	**0.0**	**0.6**	**0.3**	**0.5**	**0.2**	**-0.7**
Primary balance	**1.7**	**1.3**	**0.7**	**1.3**	**0.9**	**1.1**	**0.8**	**-0.9**
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	**0.9**	**0.6**	**0.0**	**0.6**	**0.3**	**0.5**	**0.2**	**-0.7**
Output gap[1]	0.1	0.4	0.0	0.5	-0.2	0.1	0.6	0.7
Cyclically-adjusted balance[1]	0.9	0.5	0.0	0.5	0.4	0.5	0.0	-1.0
Structural balance[2]	**0.9**	**0.5**	**0.0**	**0.5**	**0.4**	**0.5**	**0.0**	**-1.0**
Structural primary balance[2]	1.7	1.2	0.7	1.1	1.0	1.1	0.6	-1.1

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:

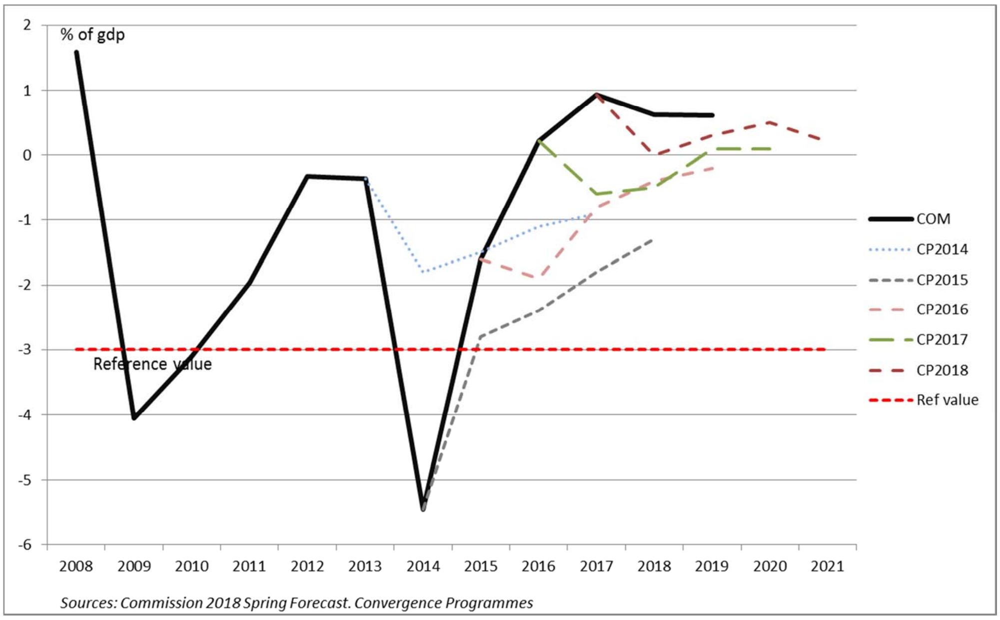
Convergence Programme (CP); Commission 2018 spring forecasts (COM); Commission calculations.

Both the headline and structural balance plans remain within the limits set by the national Public Finance Act[1] 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 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 2017 Programme, the current Programme, starting from a significantly better fiscal position of a balanced envisaged budget in 2018, targets higher budgetary surpluses over 2019-2021.

In 2019, the planned budgetary improvement to a surplus of 0.3 % of GDP is driven almost entirely by higher revenues from income tax and social security contributions, mainly as a result of planned increases in wages. Total expenditure, as percentage of GDP, is expected to remain unchanged. However, the expenditure composition is planned to change in favour of gross fixed capital formation, wages and social payments, while intermediate consumption and other expenditure are projected to decrease. The Commission 2018 spring forecast projects a different fiscal path for the years 2018 and 2019, with a surplus of 0.6 % of GDP in both years. The 2018 and 2019 surpluses in the Commission forecast reflect the different macroeconomic scenarios, which affect revenues, and different assumptions regarding mainly the evolution of 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 more ambitious than the previous three programmes.

[1] 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.

3.3. MEASURES UNDERPINNING THE PROGRAMME

The Programme contains both revenue and expenditure increasing measures, specified in detail for 2018 and to some extent for 2019-2021. In 2018, the estimated impact of the main expenditure measures amounts to about 1.6 % of GDP, out of which 0.6 % concerns increases in social expenditure, 0.4 % of GDP additional expenditure on defence equipment, 0.3 % increases in wages in the education sector and 0.3 % higher spending on other personnel costs mainly for the reinforcement of staff in the areas of public order and safety and defence. On the revenue side, a positive impact of 0.2 % comes from the continuation and completion of the increase in social security contributions, a 0.1 % of GDP from the increase in the minimum social security contribution income threshold and 0.1 % of GDP from the last phase of the increase in excise duty for tobacco products.

In 2019, the main expenditure measures described in the Programme are related to the continued implementation of the 2015 pension reform with an impact of 0.2 % of GDP and an envisaged expenditure 0.2 % of GDP for the establishment of a toll system in the Bulgarian national road network. The Programme does not specify measures on the revenue side, other than the higher tax revenue linked to the wage increases.

All of the tax and social security contribution measures for 2018, as well as the envisaged increases in pension and personnel expenditures have been taken into account in the 2018 Commission spring forecast. However, the Commission forecast did not take into account the envisaged spending on defence procurement and the expected expenditure and revenue on the toll systems due to uncertainties around their implementation plans.

Main budgetary measures

Revenue	Expenditure
2017	
• Increase in tobaco excise duty (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 remuneration of employees in the education sector (0.1 % 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 social security contributions to the PSS pension fund by 1 percentage point (0.2 % of GDP) • Increase in the minimum social security thresholds (0.1 % 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 (0.3 % of GDP) • Increase in the remuneration of employees in the education sector (0.3 % of GDP) • Increase in expenditures on defence (0.4 % of GDP)
2019	
	• Parametric changes in the pension system (0.2 % of GDP) • Expenses related to the introduction of a toll system (0.2 % of GDP)
2020	
• Toll fees (0.2 % of GDP)	• Parametric changes in the pension system (0.2 % of GDP)
2021	
• Toll fees (0.3 % of GDP)	• 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 Programme, the public debt ratio is expected to decrease from 25.4 % in 2017 to 19.4 % in 2021. The Bulgarian state has a significant reserve, following the creation of a cash buffer for possible support of the financial sector, which was not used. Moreover, in 2017, the better than planned fiscal performance increased further the available cash buffer. The envisaged primary balances and the positive macroeconomic conditions are the main drivers of the debt reduction over the Programme period.

The debt reduction trend projected in the Programme is in line with the Commission 2018 spring forecast. However, the Commission projects a faster pace of reduction in 2019 mainly due to the larger primary surplus the Commission forecasts and the underlying assumptions about stock flow adjustment.

Table 3: Debt developments

(% of GDP)	Average 2012-2016	2017	2018		2019		2020	2021
			COM	CP	COM	CP	CP	CP
Gross debt ratio[1]	**23.1**	**25.4**	**23.3**	**23.3**	**21.4**	**22.1**	**20.7**	**19.4**
Change in the ratio	2.8	-3.6	-2.1	-2.1	-1.9	-1.2	-1.4	-1.3
Contributions[2] :								
1. Primary balance	**0.7**	**-1.7**	**-1.3**	**-0.7**	**-1.3**	**-0.9**	**-1.1**	**-0.8**
2. "Snow-ball" effect	**0.1**	**-0.5**	**-0.7**	**-0.7**	**-0.7**	**-0.7**	**-0.7**	**-0.6**
Of which:								
Interest expenditure	0.8	0.8	0.7	0.7	0.7	0.6	0.6	0.6
Growth effect	-0.5	-1.0	-0.9	-0.9	-0.8	-0.8	-0.8	-0.7
Inflation effect	-0.3	-0.3	-0.5	-0.5	-0.5	-0.5	-0.5	-0.4
3. Stock-flow adjustment	**2.0**	**-1.4**	**0.0**	**-0.7**	**0.0**	**0.5**	**0.4**	**0.1**
Of which:								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

Notes:

[1] End of period.

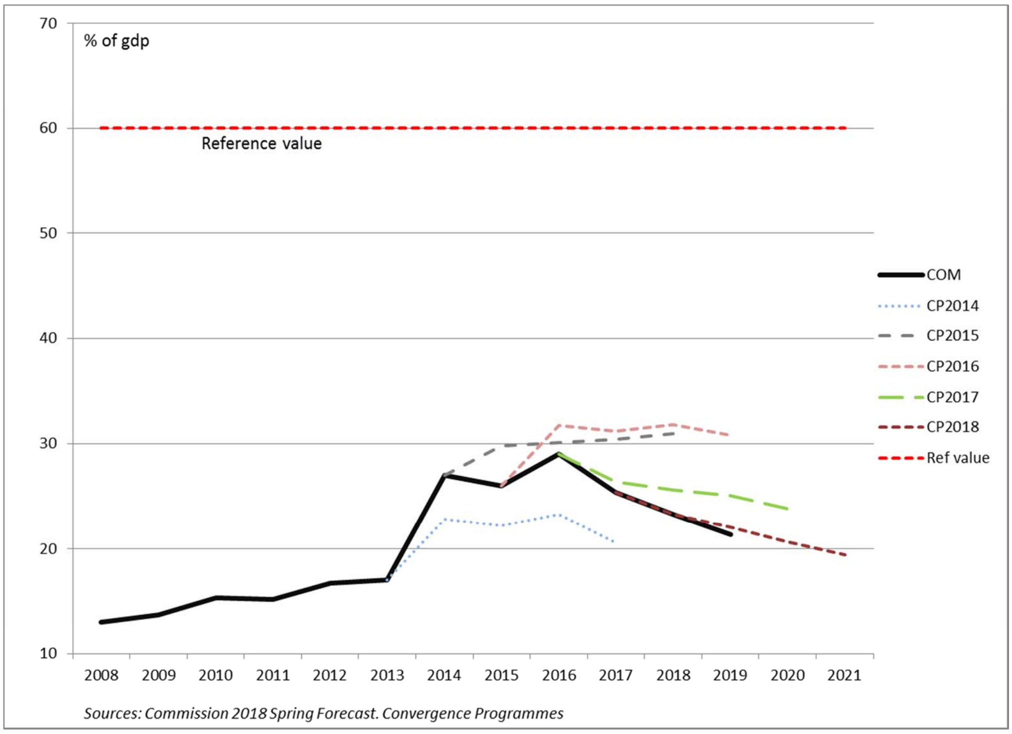
[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets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

Source :

Commission 2018 spring forecast (COM); Convergence Programme (CP), Commission 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 2017, combined with the decision to use a part of the buffers for the repayment of loans (including the pre-financing of a 2017 eurobond), and the envisaged accumulation of surpluses have significantly improved the medium-term debt profile.

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



3.5. RISK ASSESSMENT

Compared to the Commission 2018 spring forecast, the 2018 Convergence Programme adopts a slightly more optimistic macroeconomic scenario. 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 and rising oil prices. On the upside, higher income, employment and consumer confidence could translate into higher demand. Also, investment activity could turn out stronger than expected, given the rise in new orders, the high utilisation of production capacity, favourable credit conditions and EU funds mobilisation.

The fiscal projections in the 2018 Programme are subject to upside risks. Compared to the Commission's 2018 spring forecast, the Programme expects significantly higher expenditure in 2018, driven by public investment. However, part of these investments are subject to major uncertainties related to the financing and implementation schedules of specific projects, which can cause delays and expand the expenditure over a longer time period. For the rest of the expenditure, the Programme mostly relies on well specified measures, such as planned increases in wages, pensions and personnel. This, combined with the positive budget execution track-record of the government, increases the plausibility of the current expenditure forecast. On the revenue side, the Programme takes into account the macroeconomic developments and the announced measures. Its overall projection is plausible. Some uncertainty, however, exists in the size of non-tax revenue, especially that related to the implementation of EU funds.

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. The general government budget surplus increased from of 0.2 % of GDP in 2016 to 0.9 % of GDP in 2017, complying with the 3 % of GDP reference value of the Treaty. It is expected to remain compliant over the Programme period.

According to the Commission 2018 spring forecast, the fiscal improvement in structural terms was equal to 0.7 % of GDP (from 0.2 % of GDP in 2016 to 0.9 % of GDP in 2017) suggesting that Bulgaria overachieved its MTO, of -1 % of GDP, and is compliant with the Pact preventive arm requirements in 2017.

According to the 2018 Convergence Programme the (recalculated) structural balance is expected to worsen from a surplus of 1 % of GDP in 2017 to a balanced outcome in 2018 and to improve again in 2019, remaining above the MTO. Compliance with the MTO is confirmed by the Commission 2018 spring forecast, albeit with a slightly different path, according to which the structural surplus is projected to be 0.5 % of GDP in both 2018 and 2019 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 2018 and 2019.

Beyond 2019 and over the Programme period, 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)	2017	2018		2019	
Initial position[1]					
Medium-term objective (MTO)	-1.0	-1.0		-1.0	
Structural balance[2] (COM)	0.9	0.5		0.5	
Structural balance based on freezing (COM)	0.0	0.5		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2017**	**2018**		**2019**	
	COM	**CP**	**COM**	**CP**	**COM**
Structural balance pillar					
Required adjustment[4]	Compliance				
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]					

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 2017) is carried out on the basis of Commission 2018 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.

Source :

Convergence Programme (CP); Commission 2018 spring forecast (COM); Commission calculations.

5. FISCAL SUSTAINABILITY

Bulgaria does not appear to face fiscal sustainability risks in the short run.[2]

Based on Commission 2018 spring forecasts and a no-fiscal policy change scenario beyond the forecast horizon, government debt, at 25.4 % of GDP in 2017, is expected to decrease to 10.7 % in 2028, thus remaining below the 60 % of GDP Treaty threshold. Over this period, government debt peaks in 2017. Sensitivity analysis shows similar risks.[3] Overall, this highlights low risk for the country from debt sustainability analysis in the medium term. The full implementation of the Stability Programme would put debt on a clearly decreasing path by 2028, although remaining below the 60% of GDP reference value in 2028.

The medium-term fiscal sustainability risk indicator S1[4] is at -4.5 % of GDP, primarily thanks to the low level of government debt, contributing with -2.9 percentage points of GDP, thus indicating low risks in the medium term. The full implementation of the Stability Programme would put the sustainability risk indicator S1 at -4.6 percentage points 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 Stability Programme would further 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 1.5 % of GDP. In the long term, Bulgaria therefore appears to face low fiscal sustainability risks, due to the initial budgetary position contributing with -0.7 percentage points of GDP, which counterbalances the risks associated with the projected ageing costs contributing with 2.1 percentage points of GDP. Full implementation of the Programme would put the S2 indicator at 2.2 % of GDP, leading to a higher long-term risk.[5]

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[2] 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.

[3] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Debt Sustainability Monitor 2017 for more details).

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

[5] The projected costs of ageing used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on updated projections, endorsed by the EPC on 30 January 2018, and to be published in the forthcoming Ageing Report 2018.

Table 5: Sustainability indicators

Time horizon			Commission 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]			-4.5	LOW risk	-4.6	LOW risk
of which						
	Initial Budgetary Position		-1.8		-1.4	
	Debt Requirement		-2.9		-3.6	
	Cost of Ageing		0.2		0.4	
	of which					
		Pensions	-0.2		0.0	
		Health-care	0.2		0.1	
		Long-term care	0.0		0.0	
		Other	0.2		0.2	
Long Term			**LOW risk**		**MEDIUM risk**	
S2 indicator [4]			1.5		2.2	
of which						
	Initial Budgetary Position		-0.7		-0.2	
	Cost of Ageing		2.1		2.4	
	of which					
		Pensions	1.2		1.5	
		Health-care	0.3		0.2	
		Long-term care	0.1		0.1	
		Other	0.5		0.5	

Source: Commission services; 2018 stability/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 2018 forecast covering until 2019 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 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 2032. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2020 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 2015 and Debt Sustainability Monitor 2017.

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 2017 since there was a structural surplus according to the authorities estimate. According to the Programme, the structural balance is set to remain well above the country's MTO throughout the entire Programme period. Likewise, the general government balance in ESA terms was in a surplus in 2017 and it is forecast to remain either in balance or in a small surplus over the period 2018-2021, thereby compliant with the national threshold for the maximum general government deficit in ESA terms of 3 % of GDP.

Moreover, in 2017, the general government surplus in cash terms amounted to 0.9 % of GDP, overshooting the target of the 2017 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 34.9 % 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 around 35 percentage points of GDP in 2017 and is foreseen to continue to be so over the 2018-2021 horizon, as the general government debt is planned to decrease throughout the Programme horizon and to dip even below 20 % of GDP in 2021.

Based on information provided in the 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 2018-2021.

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

[6] 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.

7. SUMMARY

In 2017, Bulgaria's fiscal position improved further as it increased the headline and structural budgetary surplus and remained well above the MTO. Bulgaria plans to decrease its budgetary surplus to zero in 2018 and to return in surplus in 2019 onwards. In structural terms, the balance is expected to remain, by a large margin, above the MTO set by the national Public Finance Act. The Commission's 2018 spring forecast includes a more positive profile for the development of public finances. In conclusion, Bulgaria is expected to remain fully compliant with the provisions of the preventive arm of the SGP.

8. ANNEX

Table I. Macroeconomic indicators

	2000-2004	2005-2009	2010-2014	2015	2016	2017	2018	2019
Core indicators								
GDP growth rate	5.3	4.8	1.1	3.6	3.9	3.6	3.8	3.7
Output gap [1]	-1.0	1.4	-0.8	-1.3	-0.3	0.1	0.4	0.5
HICP (annual % change)	6.4	7.1	1.5	-1.1	-1.3	1.2	1.8	1.8
Domestic demand (annual % change) [2]	7.6	5.6	0.0	3.4	1.6	5.5	5.4	4.6
Unemployment rate (% of labour force) [3]	16.0	7.7	11.7	9.2	7.6	6.2	5.5	5.3
Gross fixed capital formation (% of GDP)	19.3	28.5	21.3	21.0	18.6	19.2	20.0	20.5
Gross national saving (% of GDP)	16.4	15.3	22.2	21.8	24.5	23.9	23.0	22.8
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**0.2**	**0.3**	**-2.2**	**-1.6**	**0.2**	**0.9**	**0.6**	**0.6**
Gross debt	**53.5**	**18.2**	**18.2**	**26.0**	**29.0**	**25.4**	**23.3**	**21.4**
Net financial assets	**7.0**	**7.0**	**-0.7**	**-6.5**	**-2.6**	**n.a**	**n.a**	**n.a**
Total revenue	39.8	37.3	34.6	39.1	35.2	36.1	36.4	36.4
Total expenditure	39.6	37.0	36.8	40.7	35.0	35.2	35.8	35.8
of which: Interest	2.9	1.1	0.8	0.9	0.9	0.8	0.7	0.7
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**0.8**	**-7.9**	**8.0**	**7.1**	**6.3**	**3.4**	**2.8**	**2.5**
Net financial assets; non-financial corporations	**-67.7**	**-151.2**	**-170.1**	**-152.9**	**-156.0**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**0.2**	**-18.0**	**7.5**	**1.8**	**-0.6**	**n.a**	**n.a**	**n.a**
Gross capital formation	17.1	25.4	16.0	13.8	13.3	15.6	15.8	16.5
Gross operating surplus	25.9	27.0	29.6	30.6	27.1	26.7	26.6	26.9
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**-5.9**	**-8.6**	**-3.7**	**-1.6**	**1.1**	**0.7**	**-0.3**	**-0.3**
Net financial assets	**48.7**	**59.3**	**81.3**	**104.6**	**109.0**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	30.5	30.3	33.0	36.1	36.9	37.6	38.5	38.9
Net property income	0.3	0.4	0.0	3.3	2.8	2.3	2.0	1.6
Current transfers received	14.9	13.2	15.1	15.2	14.3	15.3	15.0	14.7
Gross saving	-5.6	-6.6	-2.7	-0.6	3.1	2.9	1.8	0.8
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**-4.9**	**-16.2**	**2.0**	**3.9**	**7.3**	**4.7**	**3.2**	**2.7**
Net financial assets	**14.3**	**105.2**	**85.4**	**55.8**	**53.1**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	-8.9	-15.8	-1.4	0.1	4.3	1.5	0.2	-0.4
Net primary income from the rest of the world	0.6	-3.1	-1.9	-2.0	-0.3	-0.1	-0.6	-0.9
Net capital transactions	0.2	0.4	1.6	3.3	2.0	1.7	1.8	2.0
Tradable sector	51.4	46.3	46.3	48.1	49.5	48.2	n.a	n.a
Non tradable sector	36.1	38.7	40.5	38.3	36.8	38.4	n.a	n.a
of which: Building and construction sector	4.3	6.7	5.0	3.8	3.4	3.6	n.a	n.a
Real effective exchange rate (index, 2010=100)	73.7	86.3	108.6	119.6	120.7	128.5	135.0	137.1
Terms of trade goods and services (index, 2010=100)	84.5	94.5	101.7	103.5	107.0	105.3	105.5	106.0
Market performance of exports (index, 2010=100)	74.3	92.4	111.6	118.9	123.0	120.1	119.2	118.8

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 2018 spring forecast