Bulgaria: 2022 Article IV Consultation - Press Release; and Staff Report for Bulgaria

INTERNATIONAL MONETARY FUND

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BULGARIA

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2022 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT FOR BULGARIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2022 Article IV consultation with Bulgaria, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse-of-time basis, following discussions that ended on April 15, 2022, with the officials of Bulgaria on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 2, 2022.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.

The documents listed below have been or will be separately released.

Selected Issues

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

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Washington, D.C.

IMF Executive Board Concludes 2022 Article IV Consultation with Bulgaria

FOR IMMEDIATE RELEASE

Washington, DC – June 24, 2022

On Friday, June 17, 2022, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bulgaria and considered and endorsed the staff appraisal without a meeting.[1]

The Bulgarian economy showed resilience through the pandemic. Owing to policy support, the economy rebounded in 2021 despite the health crisis and protracted political uncertainty that weighed on investment. GDP surpassed its pre-crisis level by mid last year, and growth reached 4.2 percent in 2021, thanks to strong consumption supported by significant fiscal support and buoyant wage growth, on the back of a strong labor market recovery. However, as in many other countries, inflation accelerated significantly, pushed by, rising commodity prices, global supply-chains disruptions, increasing labor costs, and strong domestic demand. It reached double-digit in March 2022 and was broad-based.

Executive Board Assessment[2]

In concluding the Article IV consultation with Bulgaria, Executive Directors endorsed the staff's appraisal as follows:

The war in Ukraine has clouded the outlook, heightened uncertainty, and increased downside risks. While the economic recovery from the COVID-19 crisis was gaining momentum, the war is dampening growth and accelerating inflation. High energy dependance from Russia is a significant vulnerability. With events unfolding rapidly, uncertainty is high. Key risks include stronger spillovers from the war, including disruptions in energy supply, a resurgence of COVID-19, protracted supply-chain disruptions, and faster-than-anticipated tightening of global financing conditions.

Fiscal policy needs to be flexible given the large uncertainty. The 2022 budget adopted in February strikes a reasonable balance between supporting the recovery, which is still incomplete and faces strong headwinds from the war, and not fueling inflation further. The planned mid-year budget revision should be approached flexibly as new needs and priorities may emerge, warranting further reprioritization of spending and, if activity disappoints significantly, possibly also a looser fiscal stance.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team normally visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. In this case, discussions were held from headquarters through videoconferencing.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

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A review of the composition of public spending is needed already this year. The budged reorientation of spending toward more public investment is welcome. However, the magnitude of the planned increase may run against absorption capacity and requires phasing in new projects more gradually. Conversely, the nominal freeze of the wage bill is no longer desirable with inflation running high. The mid-year budget revision should also account for new needs emerging from the war, such as supporting refugees. To help the economy and the population cope with high energy prices, existing subsidies to companies and price caps should be gradually shifted to direct support to vulnerable households. Also, the reduction in VAT rates should be discontinued, as the measure is regressive and no longer needed.

The planned medium-term fiscal consolidation is broadly appropriate and should be accompanied by expenditure and revenue-management reforms. An aging and shrinking population, the currency board arrangement, and the need to preserve buffers considering the uncertain external environment call for fiscal prudence. Fiscal space to address long-term social and investment needs could be expanded by increasing the efficiency of public spending and reviewing taxation to increase revenue and redistribution. These reforms would enhance physical and human capital and foster higher and more inclusive growth. Furthermore, a holistic review of the pension system would help design reforms that target both its sustainability and an adequate level of pensions.

The authorities need to continue watching for possible increases in credit risk. Macroprudential measures during the pandemic strengthened banks' balance sheet and helped maintain credit flows. Also, considering the accelerating credit growth to households, the authorities have recently rightly tightened macroprudential policy. Overall, the banking sector remains well capitalized and liquid, and the financial sector has very little direct exposure to Russia or Ukraine. Therefore, systemic risks appear low. However, credit risk may rise because of the impact of surging commodity prices and supply-chain disruptions on corporates, rising interest rates, the lagged impact of withdrawing COVID-19 related support, or an emergence of imbalances in the housing market. Hence, the authorities should continue to monitor asset quality and ensure that banks proactively manage risks and maintain strong capital positions.

Accelerating structural reforms is crucial to raise living standards and promote more a competitive, inclusive, and green economy. With the euro area accession in sight, policies that help foster income convergence with EU partners are even more important. The government's focus on strengthening governance and fighting corruption is welcome. Steadfast efforts to improve the effectiveness of the judicial and anticorruption systems are essential to strengthen the rule of law. Ongoing efforts to harness digital technologies and foster innovation are needed to raise productivity. The effective implementation of planned investment in renewables and energy efficiency will strengthen energy security and reduce carbon footprints. When energy prices decline, incentives for green transition could usefully be supported by price-based mechanism and fiscal tools. NGEU funds have a key role to play to support efforts in these areas.

Table 1. Bulgaria: Selected Economic Indicators, 2018–22
(Annual Percent Change, Unless Otherwise Indicated)

	2018	2019	2020	2021	2022
					Proj.
Real GDP	2.7	4.0	-4.4	4.2	2.8
Real domestic demand	5.5	4.9	0.1	6.0	3.6
Public consumption	5.4	2.0	8.3	4.0	6.2
Private consumption	3.7	6.0	-0.4	8.0	2.6
Gross capital formation	10.9	4.1	-5.0	2.0	4.5
Private investment	-2.3	3.6	6.7	-5.5	-1.7
Public investment	36.8	7.2	-16.6	-30.5	37.1
Stock building 1/	1.2	0.0	-1.2	2.7	0.1
Net exports 1/	-2.7	-0.9	-4.5	-2.2	-1.1
Exports of goods and services	1.7	4.0	-12.1	9.9	3.9
Imports of goods and services	5.8	5.2	-5.4	12.2	5.0
Resource utilization					
Potential GDP	3.0	4.1	-1.4	2.3	2.0
Output gap (percent of potential GDP)	0.1	0.2	-3.1	-1.2	-0.5
Unemployment rate (percent of labor force)	5.3	4.3	5.2	5.3	5.1
Price					
GDP deflator	4.2	5.2	4.2	6.2	13.9
Consumer price index (HICP, average)	2.6	2.5	1.2	2.8	12.2
Consumer price index (HICP, end of period)	2.3	3.1	0.0	6.6	11.6
Fiscal indicators (percent of GDP)					
General government net lending/borrowing (cash basis)	0.1	-1.0	-2.9	-2.9	-2.8
General government primary balance	0.7	-0.4	-2.4	-2.5	-2.4
Cyclically adjusted overall balance (percent of potential GDP)	0.1	-1.0	-1.7	-2.4	-2.6
General government gross debt	20.1	18.3	23.3	23.8	23.1
Monetary aggregates					
Broad money	8.8	9.9	10.9	10.7	16.6
Domestic private credit	8.9	9.7	4.5	8.8	15.8
Exchange rates regime					
Leva per U.S. dollar (end of period)	1.7	1.8	1.6	1.7	...
Nominal effective rate	3.3	-0.1	2.8	1.6	...
External sector (percent of GDP)					
Current account balance	0.9	1.9	-0.1	-0.4	-1.3
o/w: Merchandise trade balance	-4.8	-4.7	-3.2	-4.9	-6.1
Net international investment position	-37.0	-30.2	-27.1	-19.7	-16.3

Sources: Bulgarian authorities; and IMF staff estimates.
1/ Contribution to GDP growth.

BULGARIA

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION

June 2, 2022

KEY ISSUES

Context and outlook. The economy showed resilience through the pandemic, but the war in Ukraine has clouded the outlook, heightened uncertainty, and increased downside risks. With policy support, growth rebounded in 2021 despite the lingering COVID-19 crisis and protracted political uncertainty that hampered investment. Inflation accelerated significantly, pushed by global factors and strong domestic consumption. GDP growth is projected to slow below 3 percent and average inflation to exceed 12 percent in 2022. In this context, policies must navigate difficult trade-offs as they need to support activity, meet needs from the war, and contain inflation, while raising living standards, reducing inequalities, and supporting the green transition.

Key Policy Recommendations

Navigating through uncertainty. The fiscal stance embedded in the initial 2022 budget strikes a reasonable balance between providing adequate health and economic support and not adding to inflationary pressures. However, fiscal policy will need to remain flexible to respond to new needs and priorities through reprioritization and, possibly, a looser fiscal stance depending on the scale of the economic impact of the war. Already, there is a need to review the composition of spending in 2022, including with respect to investment, wages, energy subsidies, and pensions. Financial sector policies should continue guarding against potential increases in credit risks.

Addressing structural challenges. The planned fiscal consolidation over the medium term is warranted given demographics pressures and the need to preserve buffers considering uncertainty. At the same time, fiscal space to address large investment and social needs can be created through taxation reforms to increase revenue and fiscal redistribution, and improved efficiency of spending to enhance physical and human capital and foster higher and more inclusive growth. The government's priorities appropriately focus on improving governance and fighting corruption to strengthen the rule of law, fostering digitalization and innovation, and greening the economy and bolstering energy security through investment in renewables and energy efficiency. Steadfast implementation of reforms and investment plans in these areas will be crucial to improve competitiveness and foster higher and more inclusive growth. Next Generation EU (NGEU) funds have a key role to play to support these efforts.

Approved By
Laura Papi (EUR) and Maria Gonzalez (SPR)

Discussion took place in Sofia during April 5–15, 2022 and a mission concluding statement was issued on April 15. The staff team comprised Jean-François Dauphin (head), Jean-Jacques Hallaert, Hajime Takizawa, and Iglika Vassileva (all EUR). Nadeem Ilahi (Senior Regional Representative, EUR) attended some of the meetings. Bonolo Namethe, Joel Turkewitz (both LEG), and Silvia Sgherri (SPR) participated in selected meetings virtually. Wei Zhao and Karen Cerrato (EUR) assisted in the preparation of the report.

The mission met with Deputy Prime Minister for EU Funds and Minister of Finance Vassilev, Bulgarian National Bank Governor Radev, Deputy Prime Minister for Climate Policies and Minister of Environment and Water Sandov, Minister of Innovation and Growth Lorer, Minister of Labor and Social Policy Gyokov, Minister of Energy Nikolov, other senior officials, and representatives of labor and business organizations, think tanks, commercial banks, and international organizations. Tsvetan Manchev (OED) attended most of the meetings.

CONTENTS

TABLES

ANNEXES