Bulgaria

Country note, July 2018

Fiscal Council of Bulgaria

Key messages:

- Bulgarian economy is reaching potential GDP growth closing the output gap already in 2018. Real GDP growth is projected over 3.7% in the forecast years.
- Macroeconomic and fiscal risks stem from low quality and level of investment as well as poor labour market outcomes which could affect negatively potential GDP growth.
- Fiscal developments show traditionally good outcomes: continuous budget surpluses after 2016 and achievement of the MTO. Structural balances are positive but fiscal policy needs to address cyclicality better. Quality of forecasts in terms of accuracy needs to be significantly improved as well as efficiency of public spending.
- BFS stresses the need for the government to follow anticyclical fiscal policy and improve the quality and accuracy of budget forecasts. Structural reforms in key sectors have to be focused on achieving efficient results.

Macroeconomic outlook

After slowing down to 3.6% in 2017, the economy is projected to grow by 3.7 – 3.9% in the coming years. Output gap is projected to close in 2018 and remain positive in the forecast years. Inflation is low reaching 2.1% at the end of the period. Labour market shows some positive signs with falling unemployment while compensation of employees decelerates in line with the slowdown of consumption. Still there are risks associated with the labour market: productivity is away from desired EU average, number of employees is lower by more than 200 000 compared to 2008 and quality of labour force still doesn't match labour market needs. Net export is still contributing negatively to the GDP growth and trade balance is negative. FDI-s reach 2.8% of GDP but their level is still low for sustainable development.

Short-term fiscal outlook

Fiscal balance for 2017 reached a surplus of 0.9% of GDP even though previous projections foresaw a deficit. It is due to the lower absorption of capital expenditure and EU funds and better than expected revenue collection. Those factors are well within the management and planning capabilities of the government and revenue forecasting needs to be improved. In 2018 the budget balance is expected to worsen to 0% which corresponds to a closed output gap and a neutral fiscal stance.

Medium-term fiscal outlook

In the medium term fiscal developments show increasing budget surpluses reaching 0.5% of GDP in 2020. This combined with the opening of the output gap leads us to believe that the government should increase the surpluses by more in order to counteract the cyclicality at the end of the period. The main challenges in the medium term are to project accurately the revenue and to increase the efficiency of government spending which at the moment is quite low. BFC estimates show that mean average errors of MOF forecast are larger than the averages calculated by the EC for the EU so accuracy needs to be improved. Delayed structural reforms in key public sectors erode long-term growth potential. At the moment the stock and structure of public debt does not place serious concern upon debt sustainability of public finance.

Fiscal framework and national fiscal rules

Fiscal rules are generally met in the MTBF 2018-2020. Deviations in the rules are observed in certain reporting periods but usually not in the forecasts. Risks of non-compliance with the rules are small as there are built-in buffers in the budget. There are some discrepancies in the data used for the calculations of the rules between MoF and BFC which have to be addressed in the future.

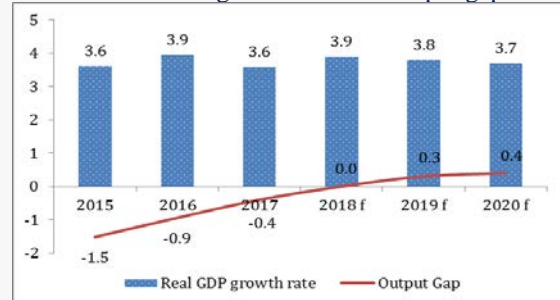Chart 1: GDP real growth rate and output gap 2015-2020
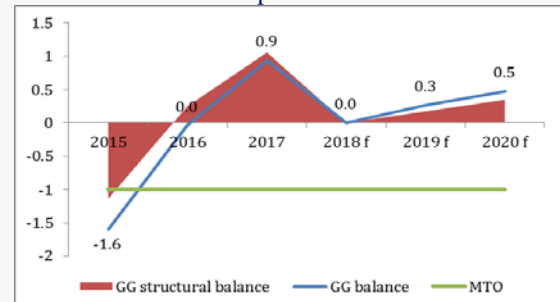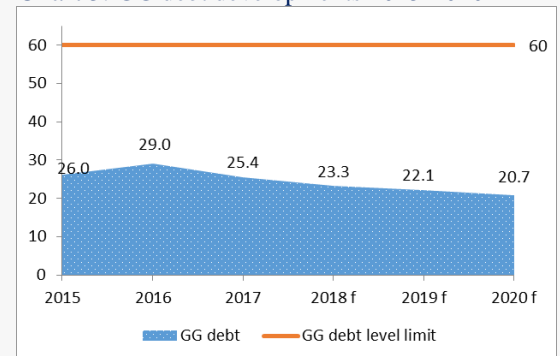
Chart 2: Fiscal developments 2015-2020

Chart 3: GG debt developments 2015-2020

Key indicator forecast		2015	2016	2017	2018 f	2019 f	2020 f	Sources
Real GDP growth rate	[% y-to-y]	3.6	3.9	3.6	3.9	3.8	3.7	1), 2)
Output Gap	[%]	-1.5	-0.9	-0.4	0.0	0.3	0.4	2)
GG balance	[% of GDP]	-1.6	0.0	0.9	0.0	0.3	0.5	1), 2)
GG debt	[% of GDP]	26.0	29.0	25.4	23.3	22.1	20.7	1), 2)
GG structural balance	[% of GDP]	-1.1	0.3	1.1	0.0	0.2	0.3	2)
Adjusted nominal GG expenditure growth	[% y-to-y]	-2.5	0.6	6.6	-0.3	6.3	4.4	3)
Discretionary revenue measures	[% of GDP]	0.2	0.2	0.1	0.6	0.4	0.4	2)

Sources: 1) National Statistical Institute 2) Ministry of finance 3) Bulgarian Fiscal Council