Bulgaria

Fiscal Council of Bulgaria

Country note, January 2018

Key messages:

- **The economy is running close to its potential, from 2018 onward output gap will be positive**
- **The labour market is already a problem, the wage levels are increasing faster than the productivity rate**
- **The low inflation prevents us from speaking about overheating yet, there is some room for manoeuvring in the next 2 years**
- **The consolidation path of the budget targets is too cozy**
- **Taking into account all of this, the BFC stresses the need for higher budget surpluses in 2018 and in the next years to come**

Macroeconomic outlook

After experiencing economic growth of 3.9% in 2016 the economy continues to grow in a steady way. Close to the same levels of growth are expected in 2017 and 2018 as well. The output gap will be closed in 2018, and will stay around 1% in 2020. Inflation is under control, around 1.8% (% y-to-y) and BoP is positive in spite of the very fast growing rates of the wages and the internal demand. The labor market is already problematic both in terms of quality and quantity of the employees. The labor market is seen as the main source of risk in the next years. The export orientated sector lags behind the good economic performances. The consumption growth is supported by very low interest rates and fast rising wages. The trend of increasing the share of consumption in GDP will continue in the next 2 years as well.

Short-term fiscal outlook

Besides having been estimated as a balanced one by the MoF, the budget is expected to run a surplus of around 1% of GDP by the end of 2017, which will be the second year in a row defined by budget surpluses. The good results are mainly due to the low absorption of planned capital expenditure and discretionary revenues. The public debt will decrease to 25% of GDP reaching the lowest level since 2013. The fiscal target for 2018 is -1%, which in our view is slightly procyclical due to the plans of the Government to increase the absorption of the EU funded programs. The planned increases in incomes and social expenditure are broadly in line with the macroeconomic outlook. The BFC believes that the consolidation efforts of the Government should be much stronger.

Medium-term fiscal outlook

In terms of the fiscal policy the main difference between the BFC and the Government relates to the viewpoint on the recommended speed of the budgetary consolidation. We believe that the Government plans should be more ambitious and the General Government balance should be running in surplus at a minimum of 1.5% of GDP, despite the plans for a broadly balanced ratio of 0.1% of GDP at the end of the projection in 2020. The revenues are projected cautiously, and some buffers are provided. The main challenges come from postponing the structural reforms in different sectors and the need for an increased prioritization and efficiency of the budget spending. We do not see any significant risks for the public debt. The plans of the government to decrease the level of the public debt ratio close to 21 % of GDP are realistic and coherent with the overall fiscal policy.

Fiscal framework and national fiscal rules

On the basis of the available data, the BFC has endorsed the MTBF 2018-2020. All the rules are met, yet a small deviation from the expenditure rule for 2018 is also observed. Some sectoral problems stemming from the postponed reforms might burden the budget. The risk for the MTBF is low because of the sizeable built-in buffers.

		2015	2016	2017 *	2018 f	2019 f	2020
Real GDP growth rate	[% y-to-y]	3,60	3,40	3,00	3,10	3,20	3,2
Output Gap	[%]	-0,40	-0,30	-0,30	-0,20	-0,10	0,1
GG balance	[% of GDP]	-2,10	0,00	-0,60	-0,50	0,10	0,1
GG debt	[% of GDP]	26,70	29,50	26,40	25,60	25,10	23,8
GG structural balance	[% of GDP]	-1,90	0,10	-0,50	-0,40	0,10	0,1
MTO	[% y-to-y]	-1,00	-1,00	-1,00	-1,00	-1,00	-1,0
Discretionary revenue measures	[% of GDP]	0,20	0,30	0,60	0,60	0,20	0,2

** estimates based on II1 qtr.*

Chart 1: GDP growth rates 2017-2020

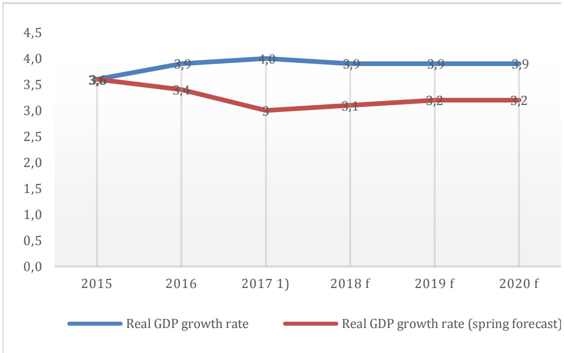

Chart 2: Fiscal targets for 2018-2020

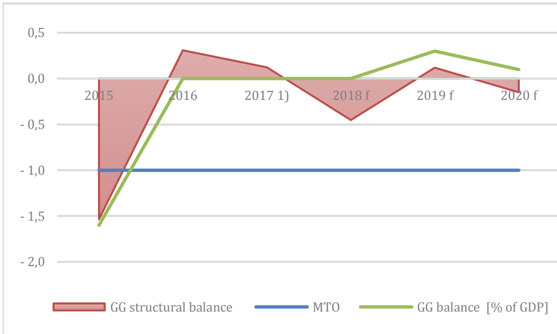

Chart 3: GG debt (% of GDP)