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**Statement by Mr. Hilbers and Mr. Manchev on Bulgaria
Executive Board Meeting
January 27, 2021**

The Bulgarian authorities would like to thank the Mission Chief Mr. Lee and his team for the report and close cooperation, particularly in this difficult environment. They highly value the staff engagement in the discussions and appreciate the analysis, which rightly focuses on the most pressing challenges posed by the COVID-19 global crisis and the authorities' policy response. The authorities consent to the publication of the Staff Report and will take staff's comments into consideration during the design and implementation of future reforms aimed at addressing the challenges to the economy.

The authorities agree with staff on the need for continued support to the economy until the recovery has firmly taken hold. In line with the authorities' firm commitment to the existing currency board arrangement, the 2021 fiscal measures will continue to provide counter-cyclical financial assistance to both firms and households. The fiscal policy priority will remain preserving the sustainability of the health care system and medical services to save lives.

The authorities are committed to improving inclusiveness through raising the disposable income of lower-income households, strengthening e-governance, and addressing some of the most pressing long-term structural deficiencies, like energy dependence and public infrastructure gaps. They also continue to monitor and accurately record emergency spending and will undertake ex-post audits of pandemic-related spending compliant to the European Union (EU) requirements. As part of the commitment to strong policies under the agreement on the participation of the lev in Exchange Rate Mechanism Two (ERM II), the authorities have also committed to implementing specific policy measures on the non-banking financial sector, state-owned enterprises, the insolvency framework, and the anti-money laundering framework.

Recent Economic Developments and Outlook

Despite the experience gained during the first wave of the pandemic in the spring of 2020, the second wave this winter appears to be more challenging for the healthcare system and economy. The recently enforced measures, together with the on-schedule roll-out of vaccines, are expected to

bring about a decline in new infections and soften the economic shock to both demand and supply. However, the recent increase in infections could further delay the start of a sustainable recovery, as suggested by the decline of industrial production, construction and retail sales in October and November. The authorities expect that economic activity will pick up again and show a strong recovery over the course of 2021, contingent on a reduced infection rate and the full implementation of the vaccination plan.

The authorities agree with staff that Bulgaria's potential growth should be further strengthened. However, despite comprehensive policy support and measures to preserve jobs and human resource capacity during the pandemic, unemployment has moderately increased to an average 5.6 percent in 2020. This, together with the lower contribution of gross capital formation to growth over the medium term, is expected to adversely affect potential growth. In response, the authorities have already launched various policies to address unfavorable demographic prospects, emigration, and the structural and income gaps vis-à-vis the EU average.

Fiscal Stability and Sustainability

In view of the volatile situation, the 2021 budget was adopted in November with built-in flexibility to ensure enough financing for the authorities' near-term priorities. It projects a deficit of about 3.9 percent of GDP, and includes wide-ranging but well-targeted grants, tax deferrals, social spending, and increased childcare benefits. Some of them are directly linked to the utilization of the EU funds. The 2021 budget also envisages maintaining the temporary relief from import duties and the value-added tax (VAT) exemption on imports of certain medicine and medical equipment until end-April, as well as a reduced VAT rate on certain goods and services until end-2021. The authorities are well-aware that the increase of education and training expenditures, as a part of the commitment to progress with this reform, will take time to yield positive economic outcomes. They, however, prefer education to fiscal redistribution to better address inequality compared to higher direct social spending or the introduction of progressive taxation.

The 2021 budget is in line with the authorities' medium-term budgetary framework and strategy to further improve public finance management. It is fully compliant with the European Stability and Growth Pact and aims at rebuilding fiscal buffers, minimizing economic hardship, reducing the risk of economic scarring, and enabling a strong and sustainable economic recovery while limiting the public debt burden to the next generation. Bulgaria continues maintaining fiscal stability and sustainability through a balanced budget in the medium-term, while steadily progressing with fiscal structural reforms. In 2020 Bulgaria was placed in the "no imbalances" category for the first time since the introduction of the EU Macroeconomic Imbalances Procedure in 2012. The capacity enhancement of the newly created Agency for Public Enterprises and Control, tasked with coordinating and overseeing the government's policy for state-owned enterprises, will further reduce fiscal risks stemming from state-owned enterprises.

Macro-critical Structural Reforms

The authorities appreciate staff's in-depth analysis of inequality, poverty, and social protection.

They agree that this crisis should be used as an opportunity to prepare the next generation of structural reforms. The need to adapt during the crisis to maintain vital economic and social activities has already resulted in increasing digitalization and efficiency gains, especially in trade, finance, and the education system. The urgent need to assist employees has also created useful institutional foundations to deploy more efficient active labor market policies to promote reskilling and upskilling during the recovery. Going forward, the authorities will allocate more resources to training programs and better integrate them within the education reform.

The authorities are preparing the next steps to further strengthen governance in line with the newly established EU's rule of law framework.

The authorities intend to improve the model of the public administration structure, together with higher quality administrative service delivery standards and user feedback methods. The new strategy for the development of the Public Procurement Sector in the period 2021-2027 aims at strengthening the administrative capacity, standardization, effective cooperation between procurement policy institutions, and measures to increase traceability and transparency in the awarding and execution of public contracts. The authorities also place a strong emphasis on the green transition through amendments to the Climate Change Mitigation Act, which introduces the requirements of the European legislation to meet the commitments made under the Paris Agreement and to enhance cost-effective emission reductions and low-carbon investments.

Financial Stability

The Bulgarian banking sector entered the pandemic in a strong initial position. Banks entered the pandemic with high profitability, capital adequacy and liquidity ratios, by far exceeding the minimum standards. Supported by the prudent behavior of individual banks, the BNB took additional measures to reinforce the banks' capital and liquidity positions during the pandemic.

The Bulgarian National Bank (BNB) closely monitors the effect of the pandemic on the resilience of the banking sector. The BNB remains vigilant as the current operating environment poses challenges for banks. A protracted slowdown would imply a worsened financial profile of borrowers and reverse the overall declining non-performing loans trend from the last few years. Considering the protracted impact of the pandemic on the economy, with the ensuing financial stability concerns, the BNB intends to utilize the tools from its macroprudential mandate, which has remained a national remit. While the extension of the moratorium on bank loan repayments delays the realization of some credit risk accumulated in the banking sector, the BNB has decided to maintain its measures to guarantee banks' strong liquidity and capital position, including the prohibition of banks' profit distribution.

In 2021, the BNB's focus will also be on operationalizing the membership in the Single Supervisory Mechanism and the Single Resolution Mechanism. Banking supervision and resolution of credit institutions are in a process of full synchronization with the European Central

Bank (ECB) and SRM. Organizational changes have been adopted and new staff has been employed in the supervisory and resolution areas to provide enough capacity to deal with the increased workload. The financing model for bank supervision and resolution has also been overhauled by introducing fees for performing the central bank's supervision and resolution services, which had been previously financed from the monetary income of the BNB.

Inclusion of the lev into ERM II in mid-2020 and the establishment of “close cooperation” between the BNB and ECB in October 2020 are important steps in the process of joining the euro area. Bulgaria has significant buffers to maintain fiscal and monetary stability. The medium-term policy priority is to prevent a deterioration during the post-pandemic recovery and progress towards euro adoption in the specified time horizon. In line with this priority, the authorities have requested technical assistance from the Dutch government in preparation for the next stages in the process.