

GOVERNMENT DEBT MANAGEMENT STRATEGY

2019–2021



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Government debt management refers to the overall process coordinated by the development and implementation of a government debt management strategy. This strategic document outlines the approach adopted in pursuing the objectives aimed at meeting debt financing needs, while taking into account the influence and constraining effects of external and domestic macroeconomic environment and potential risks.

The Government Debt Management Strategy for the period 2019-2021 has been developed by the Minister of Finance by virtue of Art.16, paragraph 1 of the Government Debt Act and Art.77a of the Public Finances Act for the period of the relevant MTBF. The Strategy is focused on the government debt – both domestic and external, assumed by virtue of the Government Debt Act. ■

1. PROSPECTS FOR THE DEVELOPMENT OF DEBT MANAGEMENT – BASIC ASSUMPTIONS

The basis for the development of the GDMS for the period 2019-2021 is the SBRBA 2018, taking into account the fiscal targets, policies, forecasts and assumptions for the next three years set in the development of the draft Updated MTBF for the period 2019-2021 and the draft SBRBA for 2019.

The high level of the fiscal reserve in 2018, the ongoing fiscal consolidation and the underlying fiscal policy objectives of maintaining a close to balanced position of the budget balance over the medium term allow for a flexible government debt management policy tailored to the specific market conditions to minimize liquidity risks in budget implementation, and the declining need for debt financing while preserving the sustainability of key debt parameters.

Determining the specific characteristics of the new debt will be in line with the current domestic GS market situation and the profile of debt in circulation, taking into account the possibilities of reducing the risk of government debt refinancing and smoothing debt maturity structure. It is planned that debt financing of the budget will be mainly secured on the domestic market by GS issues, as well as through absorption of already contracted government loans for co-financing of projects implemented with EU funds for the programming period 2014-2020.

In the period 2019-2021, debt financing of the budget in the form of GS is envisaged within about BGN 0.8-1.0 billion per annum, based on the amount of maturing outstanding debt (annually in a range of around BGN 1.1 billion to BGN 1.4 billion). The domestic debt market is singled out as the main source of market-oriented financing during the reference period. In addition to the GS financing, in the period 2019-2021 has been envisaged disbursement of funds to the amount of approximately BGN 586.7 million for GL already contracted.

Table 1: Debt and interest expenditures – key parameters

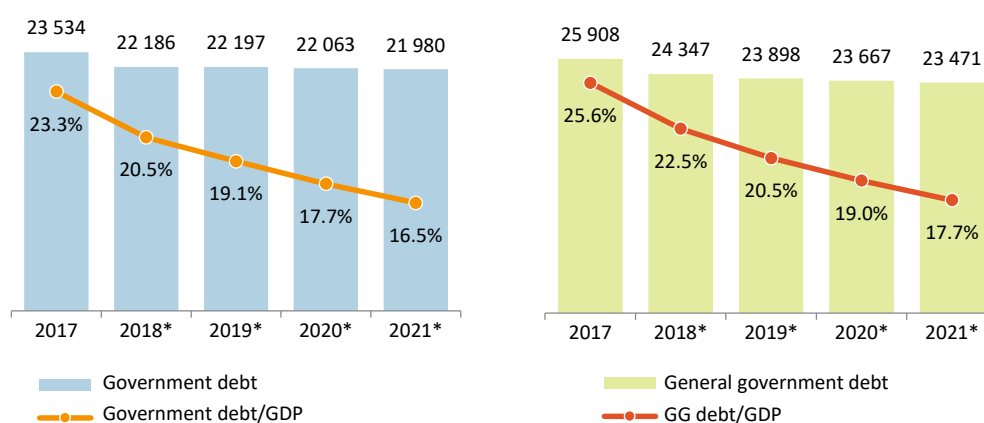
Parameter	2017	2018	2019	2020	2021
	report	expected	project	forecast	forecast
Government debt					
Government debt, BGN million	23 534.1	22 186.3	22 196.8	22 063.0	21 979.8
Government debt/GDP, %	23.3%	20.5%	19.1%	17.7%	16.5%
Government guaranteed debt					
Government guaranteed debt, BGN million	1 996.8	1 908.7	1 782.0	1 664.3	1 560.7
Government guaranteed debt /GDP, %	2.0%	1.8%	1.5%	1.3%	1.2%
General Government debt					
General Government debt, BGN million	25 907.8	24 347.2	23 898.1	23 667.3	23 471.3
General Government debt /GDP, %	25.6%	22.5%	20.5%	19.0%	17.7%
Government debt service expenditures					
Interest expenditures on debt, BGN million	754.6	650.0	633.3	639.8	622.7
Interest expenditures on debt /GDP, %	0.7%	0.6%	0.5%	0.5%	0.5%
GDP, BGN million (autumn macroeconomic forecast of MoF 2018)	101 043	108 141	116 412	124 627	132 884

Source: MoF forecast

According to the assumptions made and the estimated net debt financing in 2018, “government debt / GDP” ratio decreases to 20.5% (against 23.3% in 2017). In nominal terms, government debt size decreases slightly in the 2019–2021 period. Taking into account the projected higher GDP growth, the value of the debt / GDP ratio will show a significant drop from 19.1% at the end of 2019 to 16.5% in 2021.

Fig. 1: Government debt amount in 2017–2021 r.

(mln BGN)



* The data are estimates (based on MoF forecasting)

Source: MoF

Current currency and interest rate government debt composition, which are expected to be preserved in the upcoming medium-term period, are prerequisites that under assumptions about a possible change in the levels of main market variables (exchange rates and interest rates) these will not have a significant impact on debt nominal value and on the amount of funds required for its servicing.

A prevailing share of risk neutral currencies (BGN and EUR) and fixed interest coupons remain again in the foreign currency and interest rate structure of the government debt in 2017. The part of the debt denominated in BGN and EUR registers a level of 99.4% and the share of fixed interest rate liabilities amounts to about 95.5%. According to forecasts for the period 2018-2021, the share of debt denominated in currencies other than BGN and EUR is expected to be below 1%. The portion of floating rate debt is also projected to remain at low levels, ranging from 2.0% to 4.0%.

The interest expenditures to GDP ratio will be preserved at a level of less than 1% over the entire period 2019–2021.

The Government Guaranteed Debt / GDP ratio as of 31 December 2018 is expected to mark a decrease from 2.0% to 1.8% compared to 2017 and it will continue to decrease to a level of 1.2% in the period to 2021.

Ex-ante estimates for the General government debt-to-GDP ratio show that in the next three-year period (2019-2021) this indicator will remain at low levels well below the maximum admissible reference value of the Maastricht convergence criterion of 60%. It is estimated that by 2018 General government debt will stand at 22.5% of GDP compared to 25.6% at the end of 2017. In 2019-2021, the indicator's value is planned to decrease in each of the years under review, reaching a level of around 17.7% at the end of the period. The main contribution and component with greatest impact on the sector's debt belongs to the Central government sub-sector with a share of about 98.0%, which is a prerequisite for preserving the subsector's leading role for the debt dynamics of the General government sector in the future. ■

2. GOVERNMENT AND GOVERNMENT GUARANTEED DEBT

2.1 Government debt

As a result of the repayment in 2018 of government securities issued on the domestic market and the regular repayments on government loans, the debt level is expected to decline by the end of 2018 to around BGN 22.2 billion or below the debt threshold set in the SBRBA 2018 for a maximum amount of government debt at the end of the year of BGN 23.5 billion.

The relative share of external government debt in the government debt structure as of 31 December 2018 increases to 75.4%, at the expense of the domestic debt which reaches a share of 24.6%, compared to 71.5% and 28.5% in 2017.

Risks arising from a change in the underlying market variables are minimized, given the prevailing share of risk neutral currencies (BGN and EUR) and fixed interest coupons in the currency and interest rate structure of government debt. The share of debt in EUR and BGN as of 31 December 2018 is expected to stabilize at around 99.4%. There is a slight increase in debt with fixed interest rate coupons at the expense of that with floating rates as a result of the expected dominant borrowing of financial resources at fixed interest rates. Their relative weights in the total government debt at the end of 2018 are expected to be 96.1% and 3.9%, compared to 95.5% and 4.5% respectively in 2017.

In the maturity structure of debt (by remaining maturity) is observed an increase in the maturity segment of 1 to 5 years from 25.3% as at 31.12.2017 to 34.5% at the end of 2018. The opposite trend is reported for debt with a residual maturity of up to 1 year, from 5 to 10 years and over 10 years, whose shares are projected to decrease by the end of 2018, reaching 4.3%, 44.4% and 16.8% respectively.

The implementation of the state budget as of 30.09.2018 and the expected positive balance on the consolidated fiscal program are contributing for reduced debt financing need. The accumulated resource in the fiscal reserve will allow smooth debt servicing until the end of 2018, in line with the agreed amortization plans, without issuing new GS.

Compared to the end of the previous year, the average residual maturity of the government debt at the end of December 31, 2018 was reduced to 7 years and 4 months.

Table 2: Key indicators of government debt

Indicators	31.12.2017	30.09.2018	31.12.2018
	report	report	Expected implementation
Total government debt, BGN million	23 534.1	22 275.5	22 186.3
GDP, BGN million	101 042.5	108 141.0	108 141.0
Total government debt /GDP, (%)	23.3%	20.6%	20.5%
Domestic government debt, BGN million	6 711.6	5 647.5	5 454.3
External government debt, BGN million	16 822.5	16 628.1	16 731.9
Domestic government debt / Total government debt (%)	28.5%	25.4%	24.6%
External government debt /Total government debt (%)	71.5%	74.6%	75.4%
Interest rate structure of the government debt			
Fixed rate debt, BGN million	22 469.6	21 346.8	21 323.0
Floating rate debt, BGN million	1 064.5	928.7	863.3
Fixed rate debt (%)	95.5%	95.8%	96.1%
Floating rate debt (%)	4.5%	4.2%	3.9%
Currency structure of the government debt			
Debt in EUR, BGN million	18 240.7	18 038.7	17 933.3
Debt in BGN, BGN million	5 146.5	4 113.5	4 113.0
Debt in USD, BGN million	37.5	15.9	16.3
Debt in other currencies, BGN million	109.3	107.4	123.7
Debt in EUR (%)	77.5%	81.0%	80.8%
Debt in BGN (%)	21.9%	18.5%	18.6%
Debt in USD (%)	0.2%	0.1%	0.1%
Debt in other currencies (%)	0.5%	0.5%	0.5%
Maturity structure of the government debt (by residual term)			
Debt of up to and including 1 year, BGN million	1 304.5	1 149.6	958.9
Debt of more than 1 up to and including 5 years, BGN million	5 947.8	7 503.7	7 655.1
Debt of more than 5 up to and including 10 years, BGN million	10 593.6	9 703.6	9 852.7
Debt over and including 10 years, BGN million	5 688.2	3 918.7	3 719.5
Debt of up to and including 1 year (%)	5.5%	5.2%	4.3%
Debt of more than 1 up to and including 5 years (%)	25.3%	33.7%	34.5%
Debt of more than 5 up to and including 10 years (%)	45.0%	43.6%	44.4%
Debt over and including 10 years (%)	24.2%	17.6%	16.8%
Average residual maturity of the government debt (years)	7 y. 8 m.	7 y. 4 m.	7 y. 4 m.

* GDP: 2017 – based on NSI data; 2018 – according to the autumn macroeconomic forecast of the MoF October, 2018, <http://www.minfin.bg/bg/866>.

Source: MoF

2.2 Government guaranteed debt

At the end of 2018 a minimum reduction of GGD to BGN 1.9 billion is expected, against BGN 2.0 billion at the end of 2017. Most of it is formed by external government guaranteed loans, provided by official creditors such as IBRD, EBRD, CEB, KfW, JBIC, etc., the reduction reported being due to their regular repayments. The domestic GGD consists of government guarantees issued by virtue of the Loans for Student and Doctoral-Candidate Loans Act, which as of September 30, 2018 holds a share of about 3.6% of the total GGD. As a percentage of GDP in

2018, government guaranteed debt is expected to be reduced to 1.8% compared to 2.0% at the end of the previous year.

No new government guarantees on external credit agreements have been issued in 2018.

Table 3: Size and dynamics of the government guaranteed debt

Government guaranteed debt, BGN million	31.12.2017	30.09.201	31.12.2018
	report	report	expected implementation
Domestic government guaranteed debt	68.6	67.2	85.0
1. Guarantees under the Student and Doctoral-Candidate Loans Act	68.6	67.2	85.0
External government guaranteed debt	1 928.2	1 809.2	1 823.7
1. IBRD /World Bank/	560.6	597.1	594.6
2. EIB	3.1	3.2	7.6
3. EBRD	586.7	586.7	586.7
4. Other (EURATOM, JBIC, CEB, etc.)	777.7	622.2	634.7
Total amount of government guaranteed debt	1 996.8	1 876.4	1 908.7
Government guaranteed debt /GDP (%)	2.0%	1.7%	1.8%

Source: MoF

3. ECONOMIC PROSPECTS FOR THE PERIOD 2019–2021

3.1 Development of the national economy in 2018.

In the first half of 2018, the increase of gross domestic product slowed down to 3.4% over the same period in 2017. By components, the growth was entirely driven by domestic demand. Final consumption grew by 6.9%, with private consumption being the major contributor to growth. The rise in wages and household loans supported private consumption growth and it reached 7.9%. Public consumption also marked an increase of 3.2%, mainly driven by higher personnel and maintenance costs. Investments in fixed capital increased by 8.5%, supported by both private and public investment activity.

For the first half of 2018, exports of goods and services decreased by 0.7% as a result of a decline in trade with third countries. At the same time, stronger domestic demand supported the growth of imports of goods and services of 4.8%. As a result, net exports had negative contribution to GDP growth for the first half of the year.

GDP is expected to grow by 3.6% in real terms in 2018. Final consumption will increase by 4.8%, while investment growth will reach 8.9%. Private consumption is expected to remain leading for GDP growth until the end of the year, but its rise will begin to slow down in the second half of the year. The increase in gross fixed capital formation will be supported by upward dynamics in both public and private investment.

In the second half of 2018 negative contribution of net exports will decrease, reaching 1.8 percentage points for the year due to the expected more favourable export dynamics and a more limited increase in domestic demand.

3.2. Economic outlook for 2019–2021

Economic growth will increase slightly to 3.7% in 2019 due to the expected growth of public investment and consumption. The growth of total investment in fixed capital is expected to reach 9.5%. Private consumption will keep its relatively high growth rate, but compared with the previous year, the pace will slow down slightly due to a more limited increase in employment. Negative impact of trade with third countries is expected to be limited in 2019, which will be reflected in an acceleration of the overall growth of exports of goods and services. Final demand acceleration against 2018 will also drive higher growth in imports and increase the negative contribution of net exports to GDP growth to 2.4 percentage points.

During the period 2020 - 2021, GDP is expected to increase by 3.5%. Domestic demand (both the consumption and investment) will remain the driving force behind GDP growth. While lower government spending on consumption and investment will lead to lower domestic demand in 2020, growth in public spending will accelerate at the end of the projection horizon and will result in higher growth of investment and of domestic demand respectively. Growth in private consumption will be limited in the coming years in line with developments in the labour market, which are related to almost exhausting employment opportunities. The negative effect on GDP related to net exports is expected to slow down to around 1.1 percentage points on average for 2020-2021.

Between 2019 and 2021, labour supply in the economy will be more limited under the conditions of a decreasing working-age population and exhausting potential free labour resources of the unemployed and persons outside the workforce (mostly discouraged). In 2019, the number of employed will increase by 0.3% and the unemployment rate is expected to decrease to 4.8%. In the period 2020-2021, employment will gradually move from a 0.2% growth rate to stabilization, with a downward trend in 2021. Unemployment rate will continue to decline, reaching 4% at the end of the projected horizon.

In 2019, nominal growth rate of the compensation per employee will accelerate to 8.4%, in line with expectations of continued labour productivity growth, prices as well as planned additional increases in the minimum wage and wage increases work in the budget sector. In the context of a slower increase in the number of employees and exhausting the effect of the increase in social security contributions, the dynamics of compensation per employee is expected to slow down after 2019 and reach 6.4% in 2021. In the period 2019-2021, estimates of real labour productivity growth and nominal unit labour costs amount to 3.4% and 3.6%, respectively on average per annum.

The average annual inflation rate in 2019 is expected to be 3% and will be driven mainly by higher prices of services, given the projected domestic demand growth. In 2020 and 2021, the growth rate of prices will slow down in line with assumptions for a decline in international oil and non-energy commodity prices.

In 2019, the negative impact of trade with third countries is expected to be limited, that will support the real growth of exports, which along with acceleration of final consumption and investment, will accelerate imports of goods and services. In the next two years, the real export growth rate will decrease in line with expectations of a slowdown in economic activity, both in the EU and globally. The limited increase in domestic and external demand will lead to a slowdown in import growth. Nevertheless, its nominal growth will be characterized by faster pace than that of export, which will be a major factor for shrinking the current account surplus and turning it into a deficit of 0.3% of GDP in 2021. FDI inflow will continue to increase gradually, with its pace close to the nominal GDP

growth. As a result, inward FDI will amount to around 3.5-3.6% of GDP per annum for the entire forecasting period.

In the period 2018-2021, private sector credit will continue to grow in line with expectations for favourable economic activity, relatively high growth of households' consumption and positive labour market dynamics. Attracted deposits in the banking system are expected to continue to grow for the entire forecast period, as well. Their pace of growth will at the same time reflect labour market developments, in particular dynamics of employment and income growth. In 2020 and 2021, annual growth rate of claims on private sector is projected to be 6.9% and 7.3%, respectively.

3.3 Risks for the macroeconomic forecast

The main risks for the forecast, which affect public finances and the level of government debt, are associated with uncertainty about the development of international trade, the dynamics of international prices.

The main external risks are related to the volatile geopolitical situation and the growing number of protectionist measures introduced by some countries. The violation of generally economic agreements restricts foreign trade and adversely affects investment activity, which may lead to serious negative consequences for certain economic sectors, regions and/or countries, depending on the degree of exacerbation. As the EU and other major trading partners of Bulgaria are part of these processes, increasing uncertainty or spreading of protectionist policies can significantly affect both Bulgaria's exports and the ability to provide the necessary quantity and quality of imported raw materials - both would have negatively affected the economic activity in the country. The prolonged depreciation of the new Turkish lira led to a negative balance of foreign trade with the country. The lack of clear and predictable expectations about the exchange rate of the Turkish currency makes it difficult to conclude long-term contracts between economic agents and limits the competitiveness of Bulgaria's export. A new devaluation of the currency or a slowdown in Turkey's economic growth would have a negative effect on our country's exports. In addition, the uncertainty about the way the UK will exit the EU, and in particular the difficult negotiations under the trade agreement, could further shrink the growth of export. The realization of these risks would increase the negative contribution of net exports to the economic growth and lead to a larger increase in the current account deficit.

International prices are another major factor influencing nominal GDP and its components' growth. This forecast is made with the assumption of a minimal decline in oil prices in dollar terms in 2019. However, a possible rise in the price in 2019 will result in higher inflation. A stronger price increase in turn would contribute to higher nominal GDP and its components' growth in 2018, with the ef-

fect on GDP and consumption remaining significant in 2019, despite the fact that real growth would be curtailed.

Despite the negative effects on economic activity, a realisation of the aforementioned risks combination would lead to an increase of the budget parameters within the current forecasting horizon. On the one hand, lower exports, on equal terms, are associated with higher net cash receipts from consumption and import taxes. In addition, an increase in the price of oil would lead to a nominal increase in imports and, hence, to higher VAT receipts from imports and excise duties, which account for the bulk of indirect tax revenues. On the other hand, reporting of higher inflation in the current year would automatically affect in the same direction the maintenance costs as well as those for pensions in the following year through the indexation mechanism. Thus, the cumulative effect of realizing the risks on the budget balance and, respectively, on the need for funding would be neutral. ■

4. ANALYSIS OF THE RISKS RELATED TO GOVERNMENT DEBT STRUCTURE

Over the next three-year period, the debt structure remains resilient to risks impact, as confirmed by the results of the analysis for the period from 2019 to 2021. Comparing the projections for the key observed parameters related to its assessment that are included in the Government Debt Management Strategy for the period 2018-2020, no significant deviations are observed in their values. For the purpose of developing the analysis, planned debt financing has been taken into account, in line with the assumptions set out in the draft updated MTBF for the period 2019-2021 and the 2019 SBRBA draft, estimated in accordance with the macroeconomic and fiscal forecasts.

Table 4: Risk assessment indicators

Risk	Indicator	2017 report	2018 expected	2019 project	2020 forecast *	2021 forecast*
Refinancing risk	Debt up to 1 year (per residual maturity as share of government debt, %)	5.5	4.3	5.0	3.7	12.6
	Average time to maturity (ATM) (years)	7.2	6.8	6.3	5.9	5.3
Interest rate risk	Ratio between fixed interest rate debt and floating interest rate debt (%)	95.5 / 4.5	96.1 / 3.9	96.8 / 3.2	97.5 / 2.5	98.0 / 2.0
	Average time to refixing (ATR) (years)	7.2	6.8	6.3	5.9	5.3
	Duration (years)	6.9	6.5	6.1	5.7	5.1
Currency risk	Ratio between domestic and external government debt (%)	71.5 / 28.5	75.4 / 24.6	75.2 / 24.8	75.0 / 25.0	74.9 / 25.1
	Ratio between debt in risk-neutral currencies – BGN and EUR as compared to the debt share in other currencies (% of the total amount of the government debt)	99.4 / 0.6	99.4 / 0.6	99.5 / 0.5	99.5 / 0.5	99.6 / 0.4
Liquidity risk	Ratio between debt up to 1 year (at residual maturity) and tax and social security revenues (%)	4.4	3.2	3.2	2.2	7.2
Risk related to debt size	Ratio between consolidated debt of “General government sector” and GDP (%)	25.6	22.5	20.5	19.0	17.7
	Ratio between government debt and GDP (%)	23.3	20.5	19.1	17.7	16.5
Risk related to contingent liabilities	Ratio between government guaranteed debt **and government debt (%)	8.5%	8.6%	8.0%	7.5%	7.1%
	Ratio between government guaranteed debt and GDP (%)	2.0%	1.8%	1.5%	1.3%	1.2%
Operating risk	– Established stable institutional structure for government debt management, having clearly delegated staff responsibilities, which operates within the framework of the Ministry of Finance;					
	– Maintenance of the information system for analysis, forecasts and management of the government and government guaranteed debt - an official register of the government and government guaranteed debt;					
	– Pursuing an operating risk reduction policy by applying and complying with internal standards and control systems;					
	– Detailed rules and procedures about the organization of the operation of the structural unit in charge of government debt management.					

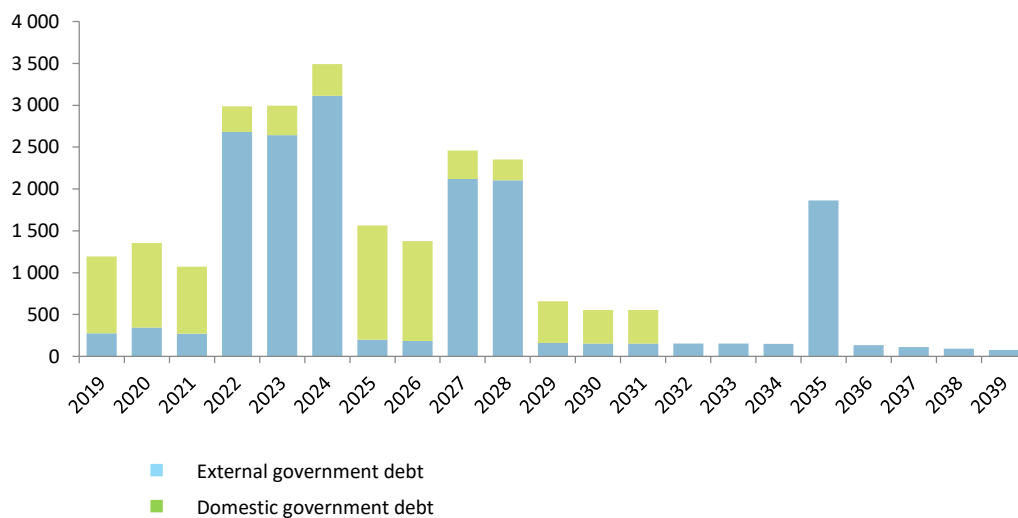
Notes: * The data are estimates. They take into account the forecasts about the financing pursuant to the updated MTBF for 2019-2021

4.1 Refinancing risk

The time distribution and the amount of principal payments in the debt portfolio are presented in the Figure 2 below. A concentration of payments was observed in the years when bonds issued on the ICM¹ matured, which is a prerequisite for applying of appropriate debt refinancing instruments in these years. A key priority when determining the specific structure of the new borrowing is the good positioning of future amortization payments on government debt.

Figure 2: Redemption profile of government debt *

(BGN million)



* On debt assumed as of 30 September 2018 and forecasts for assuming debt in line with estimates in the updated MTBF 2019-2021.

Source: MoF

In the period 2018-2020, the indicator "share of government debt with a residual maturity of up to 1 year in total government debt outstanding" recorded a decrease from 4.3% to 3.7%, remaining at a level that does not imply debt portfolios to be exposed to disturbances in refinancing. At the end of 2021, this indicator is expected to reach 12.6% as a result of the maturity in 2022 of the 7-year Eurobonds issue placed as part of the first transaction under the underlying GMTN programme in March 2015.

A subsequent change in the context of the upcoming debt maturing in 2022 is recorded in the Average Time to Maturity (ATM) parameter as well, which decreases from 6.8 years in 2018 to 5.3 years at the end of the 2021.

¹ At present, the debt portfolio of the Republic of Bulgaria consists of six Eurobonds issues placed on the ICM - five under the GMTN programme, maturing in 2022, 2023, 2027, 2028 and 2035, and one stand-alone transaction, maturing in 2024

4.2 Market risk

The foreign currency and interest structure of the government debt expected at the end of 2018, with a prevailing share of liabilities in BGN and EUR - of about 99.4% and with fixed interest coupons - 96.1%, is planned to be maintained throughout the entire period 2019 -2021. The neutral impact of the change in main market variables on debt and its servicing costs does not indicate a dependence of the debt portfolio on the impact of market risks.

In the future, following an approach of borrowing mainly with fixed interest rates and risk neutral currencies, in the context of the existing currency board arrangement at a fixed BGN/EUR exchange rate, will minimize the impact of market risks and provides better predictability of debt servicing costs.

For the period 2018-2021, the average time to refixing decreases from 6.8 years to 5.3 years, mainly due to the maturing 7-year Eurobonds issued on the ICM in 2015 under the underlying GMTN programme. Despite the change, the level of the parameter does not indicate a serious sensitivity of the debt portfolio to the impact of market risk.

4.3 Liquidity risk

In the medium term, due to the consistent fiscal policy in recent years and the goals set for achieving and maintaining a close to balanced budget position and low debt-to-GDP ratio, risks to the sustainability of government indebtedness are also low. Managing liquidity risk and bringing it down to acceptable levels in the context of debt management requires an issuance policy to be associated with the ability to raise and provide, where necessary, liquidity to meet the government's short-term liabilities, including refinancing of debt outstanding. Maintaining a stable liquidity position and availability of sizable fiscal reserves² (in reporting data to 31.08.2018 – BGN 10.9 billion) has a preventive function and helps minimising liquidity risks impact.

The level of the debt up to 1 year debt/tax and social security revenues ratio (a measure of liquidity risk) ranges in the medium term from 3.2% in 2018 to 2.2% in 2020. The upcoming maturity of the 7-year Eurobonds placed in 2015 under the GMTN programme for issuing debt on the ICM, has a subsequent impact when measuring this indicator and the ratio rising to 7.2% by the end of 2021.

4.4 Risk related to debt size

Ex-ante assessments of the “General government debt/GDP” ratio dynamics over the current and next three years (2019-2021) remain far below of the 60% Maas-

² The scope of the fiscal reserve indicator is in accordance with § 1, item 41 of the additional provisions of the Public Finance Act.

tricht convergence criterion and ensure that the level of government indebtedness is within sustainable limits.

Based on the latest annual data published by Eurostat in October 2018, the General government debt-to-GDP ratio at the end of 2017 was 25.6% (compared to 29.6% at the end of 2016)). The current value of the indicator ranks the Republic of Bulgaria for the consecutive year the third place among the EU member states with the lowest state indebtedness. According to estimates, the level of this parameter is expected to gradually decrease each year of the 2018-2021 period, reaching 22.5%³ in 2018, 20.5%³ in 2019, 19.0%³ in 2020 and 17.7%³ in 2021.

The government debt assumed under GDA, with its major share of about 91% at the end of 2017, continues to be the component with the most significant impact on the sector's debt. This fact determines the leading importance of debt policy pursued in the context of the change in consolidate obligations. Under reduced need for debt financing of the budget, a good budget position and a favourable macroeconomic environment, the government debt ratio in nominal terms for the period 2018-2021 is projected to decrease to BGN 22.0 billion. The government debt/GDP ratio also tends to decrease throughout the period under consideration from 20.5% in 2018 to 16.5% by the end of 2021 respectively.

4.5 Risk related to contingent liabilities in the form of government guarantees

In 2018-2019 there was an improvement in the change of the indicators for assessing this type of risk - the GGD to GDP ratio and GGD to the total amount of government debt ratio.

The GGD is projected to record a decline both in nominal terms and as a ratio to GDP. As a ratio to GDP, the GGD is projected to report a level of 1.8% at the end of 2018 (compared to 2.0% at the end of 2017), and to the level of government debt to 8.6% (compared to 8.5% at the end of 2017). In 2021, GGD is expected subsequent decline to 1.2% of GDP and to 7.1% of government debt.

An additional positive effect is also expected from the strictly regulated, subject to specific criteria and risk assessment based approach for approving new government guarantees. The ongoing monitoring of beneficiaries financial state, the risk assessment of existing contingent liabilities materialization, the annual determination of the maximum amount of the new government guarantees that may be issued throughout the respective year as well as the provision of funds in the annual SBRBA for covering the risk of government guarantees being call also help limiting the risk impact and maintain it at a safe level.

³ Compared to the forecasting GDP level in the October 2018 autumn forecast of the MoF <http://www.minfin.bg/bg/866>

4.6 Operating risk

In the period 2019-2021 it is envisaged a preservation of the organizational activities related to the management and control of the sovereign liabilities directly related to the implementation of a consistent and standardised internal control system. The approach of following the statutory financial management and control provisions in the public sector so far, as well as the rules and procedures developed in this respect on the operation of the unit in charge of debt management at MoF, specifying clear-cut well-systematized responsibilities for the employees, will continue to be applied in the future. Ongoing maintenance and improvement of the functional capabilities of the established official register of government and government-guaranteed debt, software - automating data processing processes related to the government debt management and ensuring the quality and reliability of the information improves additionally the risk profile. ■

5. GOALS OF THE GOVERNMENT DEBT MANAGEMENT POLICY

The main goal of debt management is provision of the necessary resources for refinancing the debt outstanding, financing state budget when necessary and ensuring stability of the fiscal reserve at an optimal possible price and acceptable level of risk.

5.1 Sub-objective: Maintaining control over the pace of change of government debt parameters:

■ Measure: Conducting a policy of new borrowing pursuant to the statutory terms and procedures

In the forthcoming three-year period 2019-2021, the new borrowing policy will be implemented in strict compliance with the statutory terms and procedures and in compliance with the debt constraints set out in the State Budget Act. The borrowing policy will be determined by the sustainable economic growth achieved, the improvement of the budget parameters and the accumulated funds in the fiscal reserve. The budget financing needs, including for the purpose of providing funds to refinancing the debt outstanding, will continue to be secured through priority lending in EUR and BGN at fixed interest rates. This approach, preceded by a comprehensive analysis of market sources and an assessment of respective debt instruments, will provide both good predictability in terms of debt servicing costs and sustainability of changes in its main features.

Approving of new investment projects to be funded with government and government guaranteed loans within the period under review (2019-2021) will continue to be restrictive in the context of meeting government priorities to promote development of key sectors in the economy. A consistent analytical approach and reporting on the implementation of the normative terms and conditions⁴ will be followed in accordance with the degree of readiness for project implementation and financing and the future impact of debt financing on the state budget. In 2018 as well, in the framework of the procedure under the Ordinance for 2019, no new investment projects were approved whose financing requires conclusion of government loan agreements or new projects, for which a government guarantee needs to be issued under the loans for their financing.

⁴ Ordinance on the requirements to be met by investment projects financed by government loans and projects applying for financing by a government guarantee, and the procedure for their consideration, adopted by Decree of the Council of Ministers No. 337 of 2015 (promulg. SG is. 94 of 4.12.2015).

■ Measure: Maintaining the amount of government and government guaranteed debt at levels which do not exceed the legally planned ceilings and the Maastricht criterion for the debt/GDP ratio

Given the topicality of the sub-objective defined and as a part of the measures to improve the country's budgetary position, the government's policy of adherence to the statutory level of government indebtedness will continue. To achieve the underlying objective, with a view to preventing uncontrollable government debt growth and maintaining it at a sustainable level, it is envisaged that this will be ensured in the medium term by setting debt ceilings in the annual state budget acts. Given the expectations for a good state budget execution in 2018, leading to a reduced need for debt financing and the absence of large maturing debt payments over the period, government debt is expected to remain at the level of about 22.2 billion levs or 19.1% of the projected GDP. With a forecast for favourable macroeconomic developments and maintaining a sustainable and relatively high GDP growth rate and a decreasing need for securing financial resources from debt sources, the government debt-to-GDP ratio is projected to decline. Towards the end of 2021 the debt will amount to about BGN 22.0 billion or 16.5% of GDP.

5.2 Sub-objective: Provision of opportunities for market-oriented debt financing guaranteeing budget stability

■ Measure: Conducting a well-balanced borrowing policy by applying an analytical approach to the selection of new debt instruments

The absence of peak payments on external Eurobonds during the period 2019-2021 and the ongoing fiscal consolidation make domestic debt market the most effective accessible source for securing debt financing of the budget. The issue policy during this period will aim at securing, if necessary, the current liquidity needs of the budget and refinancing maturities of government securities issued on the domestic market.

The choice of new debt securities maturity structure will be consistent with the existing debt repayment profile, prevailing market conditions and investor demand, as well as with the maintenance of a benchmark bond for a harmonized long-term interest rate to assess the degree of convergence, which is one of the Maastricht criteria for Euro area membership.

■ Measure: Preserving the opportunity for financing by way of the Global Medium Term Note Programme for Debt Issuance on the International Capital Markets (GMTN programme) in order to ensure maximum flexibility when choosing financing structure in respect of markets, maturities and currencies

The Global Medium-Term Programme of the Republic of Bulgaria for issuance of bonds on the ICM was established in the beginning of 2015. The program is an instrument that is standardised for the international investment community for issuing bonds subject to English law, registered for trading on the Luxembourg Stock Exchange, with clearing and settlement in Euroclear and Clearstream. The maximum amount of debt that can be borrowed under the programme is EUR 8 billion, with Eurobonds with a total nominal value of EUR 5,144 billion being issued to date. A condition for the assumption of debt under the program is the approval to do so in the respective annual state budget act adopted by the National Assembly, which also sets an annual limit for the issuance of securities under the programme. The programme provides flexibility to choose the most optimal strategy for implementing issue policy.

Planned fiscal consolidation in the medium term, maintenance of a stable fiscal position and absence of peak government debt payments in the period 2019-2021 do not foresee the use of this instrument to secure the necessary debt financing over the next three years.

5.3 Sub-objective: Development of the GS market

▪ Measure: Taking steps to extend the scope of secondary government securities market monitoring

The secondary trading of government securities on the multilateral trading system (E-Bond Bulgaria) and on the regulated market (Bulgarian Stock Exchange - Sofia AD) started simultaneously at the end of 2017, thus expanding the scope of both the government securities market and is monitoring by the MoF.

In this respect, in 2018, the process of building an integrated information system (Monitoring System, Analysis, Registration and Trading of Government Securities / SMART) was launched in order to ensure monitoring of the secondary market of government securities in accordance with the dynamically changing new regulations in the financial services sector and potential change in the methodology for performance evaluation and selection of primary dealers of government securities.

■ Measure: Prospects for the development of the secondary GS Market in 2019-2021

In this respect, the implementation and improvement of the envisaged system will continue in the period 2019-2021, with which, as well as on the basis of analyses of the GS market, a change of the primary dealership system will be imple-

mented as well as of the Criteria for Evaluation of Government Securities Primary Dealers so that PD cover the transparency and liquidity requirements of the GS secondary market.

In the period 2019-2021, it is envisaged to further develop the additional SMART functionality for maintaining information on short selling and some aspects of credit default swaps in the implementation of the Minister of Finance's powers to implement Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on Short Selling and certain aspects of Credit Default Swaps (Regulation 236/2012).

Legislative changes are envisaged for harmonising Bulgarian legislation with the European one and for modelling market infrastructure by establishing mechanisms to achieve the strategic targets imposed on Member States on prudential requirements for credit institutions and investment firms and to provide the appropriate powers needed by the supervising bodies to perform their functions.■

ABBREVIATIONS AND GLOSSARY

▪ Abbreviations used

GDP	Gross domestic product
BNB	Bulgarian National Bank
BDB	Bulgarian Development Bank
CEB	Council of Europe Development Bank
GGD	Government guaranteed debt
GL	Government loans
GIL	Government investment loans
GS	Government securities
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
EC	European Commission
EU	European Union
ECB	European Central Bank
SBRBA	State Budget of the Republic of Bulgaria Act
GDA	Government Debt Act
MFIA	Markets in Financial Instruments Act
KfW	Kreditanstalt für Wiederaufbau (KfW)
CFP	Consolidated fiscal programme
ICM	International capital markets
MoF	Ministry of Finance
IFI	International financial institutions
IBRD	International Bank for Reconstruction and Development
PD	Primary dealers
MTBF	Medium-term budget forecasting
GDMS	Government debt management strategy
BDIF	Bulgarian Deposit Insurance Fund
FR	Fiscal reserve
JBIC	Japan Bank for International Cooperation
GMTN	Global Medium-term Note Programme for Debt Issuance Programme on the International capital markets
MTF	Multilateral Trading Facility
OTC	Over-the-counter market
RM	Regulated market
OTF	Organised Trading Facility

■ Glossary

Currency risk – It is related to the vulnerability of the debt portfolio, amortizations and its servicing costs resulting from the depreciation of the value of national currency. The changes in exchange rates may have an impact on the debt servicing cost and hence – on the budget. A debt denominated in foreign currency will lead to a volatility of debt servicing costs, measured in the national currency;

Interest rate risk – It is related to the vulnerability of the debt portfolio, as well as to the government debt costs resulting from higher interest rates on the market at the moment when the fluctuating interest rate debt and the maturing fixed rate undergo readjustment. Market prices changes that influence the debt servicing costs may result in deviations from the amount of debt servicing costs set forth in the state budget;

Market risk – Risk related to unexpected changes in the levels of market variables such as exchange rates, interest rates, prices of goods, which affect debt service costs.

Liquidity risk – It is determined by the need of liquidity funds to cover short-term obligations and accounts for the probability of liquidity problems for the budget when covering these obligations. It is a variety of the refinancing risk and is directly related to the market risk;

Refinancing risk – It is related mainly to the possible inability to obtain new financing, when the debt reaches its maturity (the maturing debt will not be subject to refinancing) or to receiving a new financing at a much higher price only. It is measured by the amount of debt, which shall be refinanced during the specific period (typically a year);

Risk related to debt size – It is associated with the level of government debt, which may generate significant threats on certain occasions to the financial stability of the country;

Risk related to contingent obligations in the form of government guarantees – Government guarantees have significant impact on the sustainability of government debt. It is associated with the risk of the guarantees being called at a certain time and therefore it is important to take into account the potential risk for their activation;

Operational risk – It is identified most of all with the form of organization of the activities related to the management and control of government debt;

Debt of up to 1 year (at residual term) – that part of the debt which will mature within a term of up to 1 year;

Average term to maturity (ATM) - the average period to maturity, which is an average weighted of the repayments as per the time to their maturity. It does not take into consideration the payment of interests, so it does not provide information about the overall risk which debt servicing poses on budget;

$$ATM = \sum_{t=0}^n \frac{t \cdot R_t}{Nom}$$

R_t : Repayments at time t

t : Period till maturity

Nom : Nominal value of due debt

n : Final debt maturity

Ratio between fixed interest rate debt and floating interest rate debt – shows the exposure of the debt portfolio to interest rate risk;

Average time to refixing of debt portfolio interest rate (ATR)

$$ATR = \sum_{t=0}^n \frac{t.RF_t + t_0.RV}{Nom}$$

RF_t: Repayments at the moment **t**, which is determined on the basis of the planned payment date as a ratio of the days from the end date of the reference report to the days of the year when the payment is consigned;

RV: Floating interest rate debt at the moment **t₀**;

t: period to maturity: it is calculated on the basis of the actual payment date planned ;

t₀: time for change in interests rates; for floating interest rate debt it is accepted to be **t₀=0.5**;

Nom: nominal amount of the debt (total amount: fixed interest rate debt and floating interest rate debt);

n: last debt maturity; maximum term within which the debt of all selected credited instruments is paid in full;

The measuring of the risk does not take into consideration the cash flows of interest rate payments.

Duration – it is used as a unit measure for the average period with fixed interest rate, which indicates how quickly the changes in interest rates will have an impact on debt related costs. Short duration means that the changes in interest rates will influence actual debt costs fast, while long duration means that the interest rate will not be changed over a long period of time for a major part of the debt portfolio;

Redemption profile – the redemption debt profile consists of a series of amortisation payments resulting from the debt outstanding;

Ratio of the debt in foreign currency to the total debt – an indicator contributing to determining currency and liquidity risk.