

# GOVERNMENT DEBT MANAGEMENT STRATEGY

2020–2022



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**G**overnment 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 2020–2022 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 Finance 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 2020–2022 Government Debt Management Strategy has been developed on the basis of the 2019 SBRBA, taking into account the fiscal targets, policies and assumptions for the next three years, set in the development of the draft updated MTBF 2020–2022 and the draft SBRBA for 2020.

The stable level of the fiscal reserve in 2019 and the main fiscal policy objectives of maintaining a close to balanced budget position in the medium term make it possible to implement a government debt management policy with a priority on debt sustainability.

The specific characteristics of the new debt will be adopted to the current market conditions and the debt outstanding profile, taking into account the possibilities of reducing the refinancing risk of government debt. In accordance with the debt management policies implemented by the EU Member States, measures are planned to extend debt's average residual maturity and gradually smoothing its maturity structure. Debt financing of the budget will be ensured by providing highly liquid debt instruments at an appropriate yield / risk ratio, positioned in different maturity segments, as well as through disbursements of already contracted government loans for co-financing of projects implemented with EU funds. Currently applied conservative approach will be maintained with regard to financing investment projects and specific programmes with government and government guaranteed loans.

Within the forthcoming period 2020–2022, it is envisaged that new government debt may be issued on the GS market in amounts exceeding debt repayments for the same period to accumulate funds in the fiscal reserve. The purpose is to partially prefinance upcoming payment in the beginning of 2023 when Eurobonds issued on the ICM in 2016 with a nominal value of EUR 1.1 billion (BGN 2.2 billion) mature. Accumulated fiscal reserve and expectations for a positive development of the macroeconomic environment would allow flexible debt management pursuant to the specific market conditions while minimizing liquidity risks in budget execution and refinancing debt outstanding. This would also ensure the best price for debt financing and respectively reducing the cost of debt servicing in the medium term. Disbursements of funds under already contracted government loans are planned amounting to EUR 100.0 million (BGN 195.6 million) per annum.

**Table 1: Debt and interest expenditures – key parameters**

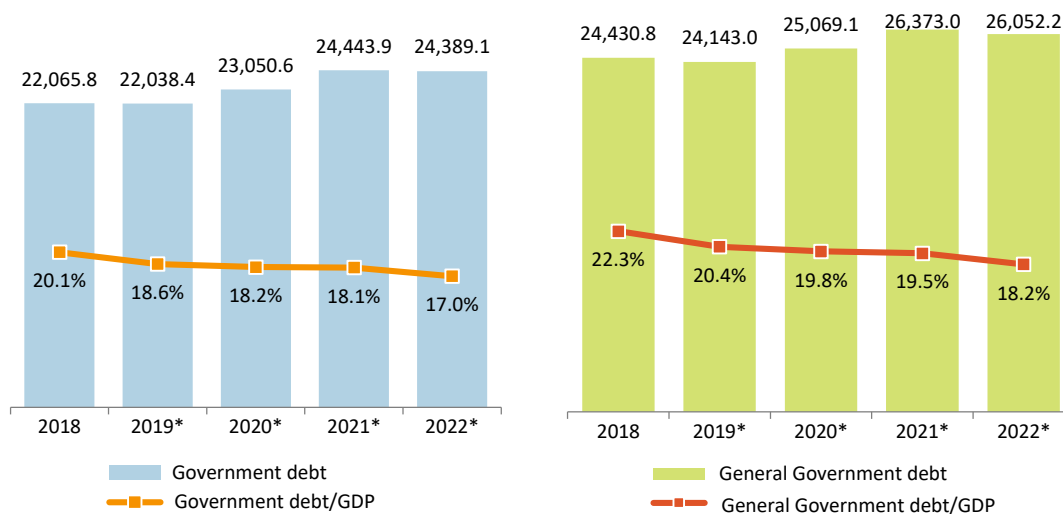
Parameter	2018	2019	2020	2021	2022
	report	expected execution	project	forecast	forecast
<b>Government debt</b>					
Government debt, BGN million	22 065.8	22 038.4	23 050.6	24 443.9	24 389.1
Government debt/GDP, %	20.1 %	18.6 %	18.2 %	18.1 %	17.0 %
<b>Government guaranteed debt</b>					
Government guaranteed debt, BGN million	1 876.6	1 759.4	1 807.0	1 730.5	1 449.7
Government guaranteed debt /GDP, %	1.7 %	1.5 %	1.4 %	1.3 %	1.0 %
<b>General Government debt</b>					
General Government debt , BGN million	24 430.8	24 143.0	25 069.1	26 373.0	26 052.2
General Government debt /GDP, %	22.3 %	20.4 %	19.8 %	19.5 %	18.2 %
<b>Government debt service expenditures</b>					
Interest expenditures on debt, BGN million	649.8	608.4	621.6	641.5	720.1
Interest expenditures on debt /GDP, %	0.6 %	0.5 %	0.5 %	0.5 %	0.5 %
<b>GDP, BGN million</b> (autumn macroeconomic forecast of MoF 2019)	109 694.8	118 624.6	126 769.1	134 915.2	143 355.4

Source: MoF forecast

With these assumptions outlined, government debt / GDP ratio is expected to decrease to 18.6 % in 2019 (20.1 % in 2018). In the 2020–2022 period in nominal value government debt will increase, but as a ratio to GDP – decline from 18.2 % at the end of 2020 to 17.0 % in 2022. Debt to GDP ratio is expected to be affected by the nominal GDP growth forecasts.

**Figure 1: Government debt and General Government debt in 2018–2022**

(BGN million)



\* The data are estimates (based on MoF forecasting)

Source: MoF

A positive development in currency and interest rate debt structure is observed during the period 2019–2022 continue reducing the influence of main market variables on size of government debt and the cost of its servicing. Respectively, the share of debt denominated in currencies other than BGN and EUR is expected to be within a range of 0.5-0.3 % and the portion of floating interest rate liabilities – within a range of 3.1-1.3 %.

Maintaining a low-risk structure of government liabilities is reflected in the relatively low government debt service costs, which in relation to GDP throughout the 2020–2022 period are below 1 %.

As of December 31, 2019 Government Guaranteed Debt to GDP ratio is expected to decrease from 1.7 % to 1.5 % compared to 2018, and it will continue to decrease throughout the projection period (2020–2022).

General Government Debt to GDP ratio is expected to be 20.4 % at the end of 2019 (22.3 % at the end of 2018) and it is projected to decrease over the three-year horizon, reaching a level of about 18.2 % at the end of 2022, far below the maximum threshold of the Maastricht convergence criterion of 60 %. The Central government sub-sector debt has a main influence on General Government Debt with a share of about 97.0 %, which is a prerequisite to keep its dominant influence on General Government Debt in the future. ■

## 2. GOVERNMENT AND GOVERNMENT GUARANTEED DEBT

### 2.1 Government debt

As a result of the new government debt assumed in 2019, GS issued on the domestic debt market maturity and regular repayments of government loans, the debt is projected to reach BGN 22.0 billion by the end of 2019 (compared to BGN 22.1 billion as of December 31, 2018). This value is below the ceiling set in the SBRBA for 2019 for a maximum amount of government debt at the end of the year of BGN 22.2 billion, and the total debt related to the GDP is 18.6 % (compared to 20.1 % as of 31.12.2018).

The proportion between foreign and domestic government debt as of December 31, 2019 is 75.1 % and 24.9 % (75.3 % and 24.7 % in 2018).

Other indicators related to government debt structure are also expected to be improved. Debt instruments denominated in EUR and BGN are projected to increase to around 99.5 % as of December 31, 2019 (compared to 99.4 % as of December 31, 2018) and those with fixed interest coupons – to 96.9 % for 2019 (compared to 96.1 % as of December 31, 2018) at the expense of the decrease in those in other currencies and with floating interest rates.

In the debt maturity structure (by remaining maturity) a decrease is observed in the segment over 5 years up to 10 years from 45.0 % as of 31.12.2018 to a level of 30.9 % at the end of 2019. The opposite trend is reported for debt with a residual maturity of up to 1 year, over 1 to 5 years and over 10 years, whose shares are projected to grow at the end of 2019, reaching up to 5.0 %, 45.5 % and 18.5 % respectively.

The consistent fiscal policy pursued and set out in recent years main goal for achieving and maintaining a close to balanced budgetary position have enabled issuance policy to be in compliance with specific market conditions, to minimizing liquidity risks in budget execution and the need for debt financing while maintaining the sustainability of main debt parameters. In the low interest rates environment and within the ceiling for assuming new government debt set in SBRBA for 2019, the Ministry of Finance as an issuer offered for sale two new long-term open type GS issues – a 10.5 years one with a maturity in 2029 and a 20 years one with a maturity in 2039, which were subsequently reopened during the year. The 20-year GS issue is the longest outstanding government bond auctioned in the domestic market. With the 10.5-year GS, the achieved<sup>1</sup> yield was at a record low for this maturity segment – 0.36 %. A total of 6 for sale of GS auctions were conducted in the domestic market with a total nominal value of BGN

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<sup>1</sup> Weighted yield



969.8 million, including: a 10.5-year issue with a par value of BGN 400.0 million and a 20-year issue with a par value of BGN 569.8 million.

The average residual maturity of government debt at the end of December 31, 2019 remains at the level reported in 2018 – around 7 years.

**Table 2: Key indicators of government debt<sup>2</sup>**

Indicators	31.12.2018	30.09.2019	31.12.2019
	report	report	Expected execution
<b>Total government debt, BGN million</b>	22 065.8	21 881.8	22 038.4
GDP, BGN million	109 694.8	118 624.6	118 624.6
<b>Total government debt /GDP, (%)</b>	20.1 %	18.4 %	18.6 %
Domestic government debt, BGN million	5 454.1	5 410.3	5 479.5
External government debt, BGN million	16 611.6	16 471.5	16 558.9
Domestic government debt / Total government debt (%)	24.7 %	24.7 %	24.9 %
External government debt /Total government debt (%)	75.3 %	75.3 %	75.1 %
<b>Interest rate structure of the government debt</b>			
Fixed rate debt, BGN million	21 208.3	21 129.1	21 358.1
Floating rate debt, BGN million	857.4	752.7	680.2
Fixed rate debt (%)	96.1 %	96.6 %	96.9 %
Floating rate debt (%)	3.9 %	3.4 %	3.1 %
<b>Currency structure of the government debt</b>			
Debt in EUR, BGN million	17 829.9	17 427.1	17 511.6
Debt in BGN, BGN million	4 113.0	4 346.1	4 415.3
Debt in USD, BGN million	16.1	-	-
Debt in other currencies, BGN million	106.8	108.6	111.5
Debt in EUR (%)	80.8 %	79.6 %	79.5 %
Debt in BGN (%)	18.6 %	19.9 %	20.0 %
Debt in USD (%)	0.1 %	-	-
Debt in other currencies (%)	0.5 %	0.5 %	0.5 %
<b>Maturity structure of the government debt ( by residual term)</b>			
Debt of up to and including 1 year, BGN million	958.7	1 058.2	1 104.4
Debt of more than 1 up to and including 5 years, BGN million	7 655.1	10 143.5	10 027.3
Debt of more than 5 up to and including 10 years, BGN million	9 927.5	6 303.9	6 820.4
Debt over and including 10 years, BGN million	3 524.4	4 376.2	4 086.3
Debt of up to and including 1 year (%)	4.3 %	4.8 %	5.0 %
Debt of more than 1 up to and including 5 years (%)	34.7 %	46.4 %	45.5 %
Debt of more than 5 up to and including 10 years (%)	45.0 %	28.8 %	30.9 %
Debt over and including 10 years (%)	16.0 %	20.0 %	18.5 %
<b>Average residual maturity of the government debt (years)</b>	7 y 2 m	7y. 2 m	7 y 0 m

\* GDP: based on data of the autumn macroeconomic forecast of the MoF October, 2019, <https://www.minfin.bg/en/866..>

Source: MoF

<sup>2</sup> Due to rounding up, some of the totals in the table are not equal to the sum of their constituent numbers.



## 2.2 Government guaranteed debt

By the end of 2019, a minimal change in the nominal amount of GGD is envisaged to a level of BGN 1.8 billion (BGN 1.9 billion at the end of 2018), mainly due to the regular repayments of government guaranteed loans. Most of it is formed by external government guaranteed loans, provided by official creditors such as IBRD, EBRD, CEB, JBIC KfW, etc. The domestic GGD consists of government guarantees issued by virtue of the Student and Doctoral-Candidate Loans Act, which as of September 30, 2019, holds a share of about 3.7 % of the total GGD. Compared to the end of 2018, government guaranteed debt as a percentage of GDP have been reduced from 1.7 % to 1.5 % in 2019.

The loan agreement with EIB for financing of the BEH IGB Interconnector Greece-Bulgaria project amounting to the currency equivalent of BGN 215 million (EUR 109.9 million) is expected to be ratified by the National Assembly until the end of 2019.

**Table 3: Size and dynamics of the government guaranteed debt<sup>3</sup>**

Government guaranteed debt, BGN million	31.12.2018	30.09.2019	31.12.2019
	report	report	Expected execution
Domestic government guaranteed debt	68.1	65.3	70.0
1. Guarantees under the Student and Doctoral-Candidate Loans Act	68.1	65.3	70.0
External government guaranteed debt	1 808.6	1 698.1	1 689.4
1. IBRD (World Bank)	594.6	592.0	589.4
2. EIB	3.6	3.7	7.6
3. EBRD	586.7	586.7	586.7
4. Other (EURATOM, JBIC, CEB, etc.)	623.6	515.6	505.7
<b>Total government guaranteed debt</b>	<b>1 876.6</b>	<b>1 763.4</b>	<b>1 759.4</b>
<b>Government guaranteed debt /GDP (%)</b>	<b>1.7 %</b>	<b>1.5 %</b>	<b>1.5 %</b>

Source: MoF

<sup>3</sup> Due to rounding up, some of the totals in the table are not equal to the sum of their constituent numbers.

## 3. ECONOMIC PROSPECTS FOR THE PERIOD 2020–2022

### 3.1 Development of the national economy in 2019

Bulgaria as well as other Central and Eastern European countries is experiencing stable economic growth, compared to the sharp slowdown in economic activity of some of the large countries in the euro area. For the first half of the current year, Bulgaria's real GDP growth was 4.1 % yoy. Higher growth was generated in the first quarter, while in the second one real GDP growth slowed down, largely influenced by a decline in export and a reduction of stocks. GDP growth is expected to slow down in the second half of the year and for the whole 2019 growth of 3.4 % is expected. Private consumption will be the major growth driver. Growth in fixed capital investment is expected to remain relatively low (1.9 %) as the uncertain external environment will result in lower private investment.

In the first half of 2019, the number of persons employed increased and the unemployment rate reached a historic low. Unemployment is projected to fall to 4.4 % in 2019 and the average employment growth rate for the entire year to reach 0.4 %. Growth of compensation per employee is projected at 8 % in 2019, supported by both private and public sectors, as a result of the income policy in sectors such as education and government.

Inflation was higher than projected for the first eight months of 2019. This was largely due to the increase in foods and services prices. End of period inflation in 2019 is projected to reach 2.8 % and the annual average inflation will be – 2.5 %. The impact (direct and indirect of energy goods) on inflation in the country is expected to gradually fade out.

In the period January – August 2019, positive dynamics in both credit to non-financial corporations and households continued, accompanied by a faster decline in bad and restructured loans in all segments of the credit market and improved quality of banks' balance sheets. The annual growth in claims on enterprises is projected at 5.9 % on households – at 9.8 % in 2019.

### 3.2 Economic outlook for 2020–2022

GDP growth will reach 3.3 % in 2020 driven by domestic demand. Final consumption will increase by 5.2 %. Private consumption spending will maintain its relatively high growth rate, but compared to the previous year the rate will slightly slow down due to more limited employment growth. The increase in public sector wages will also have a positive impact on consumption. Fixed capital investments will grow by 3.9 %, supported by both private and public investments. Despite the expected recovery of exports, higher domestic

demand will result in an increase in imports and higher negative contribution of net exports of 1.5 pps.

Economic growth will remain at the rate of 3.3 % in 2021–2022. Domestic demand will continue to be the main driver of GDP growth in terms of both consumption and investment. At the same time, final consumption growth is expected to slow down at the end of the projection period as a result of lower public consumption and slower private consumption growth in line with the decreasing potential for employment increase. On the other hand, the increase in investment will be accelerated, supported mainly by public investment dynamics. The negative effect of net exports on GDP is expected to decline to 0.8 pps. at the end of the forecast horizon.

In 2020, employment growth is expected to slow down to 0.2 %, driven by labour supply constraints. They are brought about by both steady downward trend in the working-age population and by rapid depletion of the free labour resource of unemployed and inactive (discouraged) people who could most quickly meet the demand for labour. The unemployment rate is expected to slow down and reach 4.1 % of the workforce. In the 2021–2022 period, the positive employment dynamics is expected to discontinue, with a tendency towards a more pronounced decrease at the end of the forecast horizon. The unemployment rate will slightly decrease to 4 % at the end of the projection period.

The increase in the compensation per employee is expected to slow down to 7.4 % in 2020 as a result of the weakening of labour market positive dynamics. This will be particularly true for the private sector, where the slower rate of wage growth in labour income is driven by the expected slowdown in the pace of increase of the number of employees. With the gradual discontinuation of the employment growth, the increase in the compensation per employee will continue to slow down in the 2021–2022, reaching about 6.7 % at the end of the forecast horizon.

In 2020 end of period inflation is forecasted at 2.3 % and the annual average inflation – at 2.1 %. Pro inflationary pressures from international commodity prices, especially crude oil, are expected to be limited. Food prices will continue to increase, but at a slower pace. Over the next two years, inflation is expected to slow down slightly, due to the expected lower levels of international oil prices and stabilization of other commodity prices. Domestic inflationary factors will remain little changed, stemming from higher households demand, backed by rising incomes and credit and low unemployment.

The annual growth in claims on enterprises is projected to accelerate over the forecast horizon and reach 8.3 % by the end of 2022. The pace of growth in credit to households will slow down in line with expectations for decelerating growth in the compensation per employee and gradual slowdown in house prices over the forecast horizon. This will limit house purchases for investment purposes. Total claims on households will increase by 8.2 % yoy at the end of the forecast period.

### 3.3 Risks for the macroeconomic forecast

The volatile geopolitical environment and the implications of the rising protectionism gradually began to affect economic activity in both developing and developed countries. The main risk to the forecast is the deterioration of the external environment, which might hinder the growth of Bulgaria's export. As a result of the introduced trade restrictions, economic activity in China has started to slow down, which has affected a number of countries, incl. some of Bulgaria's major trading partners. The risks of a deepening recession in Turkey still remain. There is still uncertainty about the scenario of BREXIT, which in turn may also limit export growth. The materialization of these risks would increase the negative contribution of net export to GDP growth and will reduce the current account surplus.

In the context of a deteriorating external environment, limiting budget revenue can hamper planned policies implementation due to lack of sufficient resources, which can negatively affect both budgetary outcomes and government debt.

In the last three years, fiscal surpluses were realized using the so-called "Good times" with a higher than average EU economic growth, which allowed for a significant government debt reduction. The risks to the long-term sustainability of public finances are assessed by the MoF and the EC as low due to the low government debt. This provides sufficient stability and space to react in the event of an economic turmoil. The budget balance is expected to be close to and nearly balanced over the next three years. This is in line with the medium-term budgetary objective and is consistent with the expected economic development – slightly above potential. In case of a short-term slowdown of the economic development of the country, a sufficient margin exists for implementation of the planned spending policies. ■

## 4. ANALYSIS OF THE RISKS RELATED TO GOVERNMENT DEBT STRUCTURE

This risk analysis aims to present the main results of the debt policy pursued during the period under review and its impact on the dynamics of risk indicators measured. The scope of the analysis focuses on assessment of the effect of the change in the observed variables, taking into account assumptions for new debt financing in accordance with the updated MTBF draft for the period 2020–2022 and the 2020 SBRBA draft, calculated in accordance with the macroeconomic and fiscal forecasts.

As a result of the analysis performed, no potential adverse effects should be expected due to the risks associated with the debt's size and structure. The main conclusions are given below:

**Table 4: Risk assessment indicators**

Risk	Indicator	2018 report	2019 expected execution	2020 project*	2021 forecast *	2022 forecast*
<b>Refinancing risk</b>	Debt up to 1 year (per residual maturity as share of government debt, %)	4.3%	5.0%	3.6%	11.3%	11.4%
	Average time to maturity (ATM) (years)	6.7	6.5	6.1	6.1	6.5
<b>Interest rate risk</b>	Ratio between fixed interest rate debt and floating interest rate debt (%)	96.1/3.9 %	96.9/3.1 %	97.6/2.4 %	98.3/1.7 %	98.7/1.3 %
	Average time to refixing (ATR ) (years)	6.7	6.5	6.1	6.1	6.5
	Duration (years)	6.5	6.2	5.9	5.8	6.0
<b>Currency risk</b>	Ratio between domestic and external government debt (%)	75.3/24.7 %	75.1/24.9 %	71.2/28.8%	66.7/33.3 %	56.4/43.6 %
	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 %	99.5/0.5 %	99.6/0.4 %	99.6/0.4 %	99.7/0.3 %
<b>Liquidity risk</b>	Ratio between debt up to 1 year (at residual maturity) and tax and social security revenues (%)	3.0 %	3.2 %	2.2 %	7.0 %	6.8 %
<b>Risk related to debt size</b>	Ratio between consolidated debt of "General government sector" and GDP (%)	22.3 %	20.4 %	19.8 %	19.5 %	18.2 %
	Ratio between government debt and GDP (%)	20.1 %	18.6 %	18.2 %	18.1 %	17.0 %
<b>Risk related to contingent liabilities</b>	Ratio between government guaranteed debt and government debt (%)	8.5 %	8.0 %	7.8 %	7.1 %	5.9 %
	Ratio between government guaranteed debt and GDP (%)	1.7 %	1.5 %	1.4 %	1.3 %	1.0 %
<b>Operating risk</b>	– 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.					

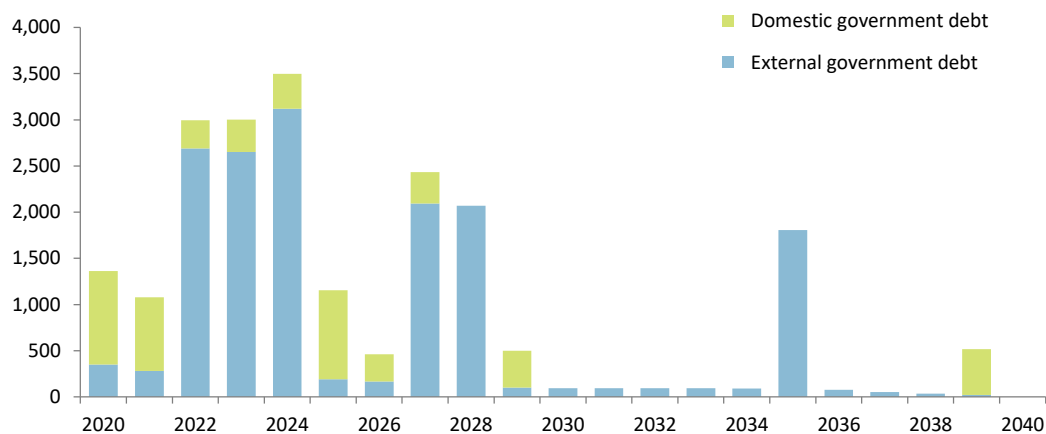
Notes: \* The data are estimates. They take into account the forecasts about the financing pursuant to the updated MTBF for 2020–2022

## 4.1 Refinancing risk

The redemption profile presented in Fig. 2 shows the accumulation of payments in the years when bonds issued on the ICM<sup>4</sup> mature. This circumstance necessitates the taking of measures mainly aimed at improving debt profile, incl. better positioning of future payments and extending maturity. Such an effect is planned to be achieved in the future by applying a more flexible issuance policy, with a predominant borrowing from the domestic GS debt market, mainly in national currency, by offering highly liquid, market-oriented debt instruments with an appropriate yield / risk ratio, positioned in various maturity segments, without excluding the possibility of issuing debt on the ICM.

**Figure 2: Redemption profile of government debt\***

(BGN Million)



Notes: \* On debt assumed as of 30 September 2019

Source: MoF

The concentration of high debt payments in 2022 and 2023 due to the amortization of the Eurobonds issued in 2015 and 2016 under the GMTN programme affect also the dynamics of the other two indicators reflecting debt portfolio sensitivity to refinancing risk: share of government debt with a residual maturity of up to 1 year in total government debt outstanding and Average Time to Maturity (ATM).

With the approaching Eurobonds maturities, the share of government debt with a residual maturity of up to 1 year in total government debt outstanding is expected to rise to a level from 4.3 % in 2018 to 11.3 % and 11.4 % in 2021 and 2022.

A slight decrease from 6.7 years in 2018 to 6.1 years at the end of 2021 is registered for the average time to maturity parameter, and it is projected to reach a level of 6.5 years at the end of the period considered, indicating a practical neutrality of the portfolio to this risk indicator.

<sup>4</sup> At present, the debt portfolio of the Republic of Bulgaria consists of six Eurobonds issued on 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 priority of actions aimed at minimizing the risks related to the interest and exchange rates vulnerabilities in the past and in the following years, predetermine positive changes in the debt portfolio, respectively its weak dependence on market risks impact. Their effect is reflected in the intention to smoothly reduce the existing imbalance between domestic and external debt, and by the end of 2022, the share of domestic debt is expected to grow smoothly to 43.6 % of total government debt compared to the one at the end of 2018 (as of December 31, 2018 – 24.7 %).

As of 31.12.2018, the debt portfolio is characterized by a predominance of the fixed interest rate coupons share – 96.1 %, and this tendency is planned to continue throughout the whole 2019–2022 period. Regarding to the debt currency composition, EUR and BGN components remain dominant throughout the analyzed period, accounting for an aggregate share of 99.7 % at the end of 2022. The possible change in the values of individual segments (in EUR and BGN) is of interest here, and within three-year perspective liabilities in BGN should increase to about 41.7 % at the expense of those denominated in EUR – 58.0 %. For comparison, at the end of 2018 the coefficients of the debt denominated in BGN and of the one denominated in EUR are respectively 18.6 % and 80.8 %. Such a profile will have a positive impact in the course of meeting the aim pursued of keeping debt service costs low at an acceptable risk level.

For the period 2018–2022, the Average Time to Refixing value is not expected to undergo significant changes, ranging from 6.7 years to 6.5 years. ATR value indicates that most of the debt is neutral to the change in the short-term interest rate coupons and implies a lower degree of risk.

## 4.3 Liquidity risk

In assessing liquidity risk future impact, respectively the need for liquid funds to cover short-term liabilities, including the refinancing maturing debt, maintenance of a stable level of the fiscal reserve and the underlying fiscal policy goals of achieving a sustainable tendency for a close-to-balanced budget position in the medium term, provide a good basis for maintaining liquidity risk at a safe level. These expectations allow for more flexible debt management in the short and medium term, with a focus on providing financial resources more than annual debt repayments and accumulating funds in the fiscal reserve in order to prefinance partially Eurobonds issued in 2016 and maturing in 2023.

At the same time, the dynamics of ratio between debt up to 1 year (at residual maturity) and tax and social security revenues (a measure of liquidity risk) in the medium term shows a change in the years 2022 and 2023 when Eurobonds mature, which fall within the short-term debt at the end of the year, remaining at around 7.0 %. This value of the indicator is further influenced by the estimated tax



revenue growth in the period 2020–2022 and ensures neutrality regarding liquidity risk impact.

#### 4.4 Risk related to debt size

The assessment of the debt burden, both on the basis of its present condition and on the basis of the assumptions for a change, does not define risks to government debt sustainability. By the end of 2018 General government debt / GDP ratio decreased by 3 percentage points from 25.3 % at the end of 2017 to 22.3 %. The reported indicator is almost three times lower than the EU average, which at the end of 2018 is 80.4 %, and its current level ranks for a consecutive year the Republic of Bulgaria a leader among the EU Member States with a low government debt. Preliminary expectation for the level of this parameter is gradually to decrease during the whole 2019–2022 period, reaching respectively 20.4 %<sup>5</sup> in 2019, 19.8 %<sup>3</sup> in 2020, 19.5 %<sup>3</sup> in 2021 and 18.2 %<sup>3</sup> in 2022.

Central government sub-sector has a main contribution in the general government debt change over the next three-year period. The highest share in Central government debt is government debt. Local Government and Social Security Funds sub-sectors have an almost neutral impact on the total debt size. Hence the direct correlation between the government debt policy pursued and the increase / decrease of consolidation liabilities.

On the basis of the projections for new debt financing and the main fiscal and macroeconomic aggregates, a positive dynamics of the government debt / GDP ratio is observed, which also follows a downward trend over the whole period considered, from 18.6 % in 2019 to 17.0 % at the end of 2022 respectively.

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

Under the current debt structure, the impact of risk related to government guarantees is limited, given the low relative share of 8.0 % of government guarantees in total government and government guaranteed debt at the end of 2019. Within the next three-year period the level of this indicator is projected to decrease from 7.8 % in 2020 to 5.9 % at the end of 2022. As of 31.12.2019, GGD in nominal value decreases from BGN 1.9 billion in 2018 to BGN 1.8 billion in 2019, mainly due to regular repayments made, and relative to GDP – from 1.7 % to 1.5 % respectively. These trends will continue over the next three years, reaching BGN 1.4 billion, or about 1 % of GDP.

To mitigate the potential negative effects as a result of the impact of this risk and in accordance with the requirements of the PFA, annually SBRBA includes ceiling

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<sup>5</sup> Compared to the forecasting GDP level in the October 2019 autumn macroeconomic forecast of the MoF <http://www.minfin.bg/bg/866>

on the maximum amount of new government guarantees that can be issued in the respective year. Apart from this, maintenance of the established practice of provisioning reserve funds to cover the risk of government guarantees being call is foreseen. In order to insure risk prevention, a conservative approach is foreseen in the selection of projects financed by government guaranteed loans.

#### **4.6 Operating risk**

Compliance with the public sector financial management and control regulations applied so far, as well as the operational rules and procedures developed in this respect in the unit responsible for debt management at the MoF, with clearly systematic responsibilities for employees in the future, contribute to operational risk minimising. In addition, the risk profile will be improved in the context of providing continuous maintenance and improvement of the functionality of the information system for analysis, forecasting and management of the government debt created, which automates data processing processes related to government debt management and ensures quality, truthfulness and reliability of the information generated. ■

## 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 sustainable government debt parameters

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

Taking into account the need for debt financing, debt management will adhere to the legal procedures when assuming new government debt in the coming years. Maintaining maximum flexibility in the selection of financing structure requires ongoing monitoring and analysis of possible sources of financing, as well as monitoring of the status and development of the domestic and foreign markets. The choice of new loan commitments accompanied by an assessment of the specific financing conditions is in line with the objective of modelling a well-structured debt portfolio, extending its maturity curve and reducing the impact of refinancing risk. Efforts are foreseen to focus primarily on assuming market based new debt, taking into account the particular specificities and liquidity of the debt market. Moreover, particular emphasis will also be placed on the gradual increase of domestic debt relative share at the expense of reduced external financing through the implementation of a flexible issuance policy. Determining the loan resource characteristics will take into account the effects of the borrowing strategy taken on the main risk parameters, the cost of the loan resource, as well as the need for a more rational allocation of upcoming maturities. Within the 2020–2022 period it is intended to maintain the trend of assuming risk-neutral debt instruments, mainly compounded with fixed interest rate coupons, in BGN and EUR, within the limits of debt benchmarks set in the budget. This approach is combined with the need to maintain stability and predictability of debt service costs. The debt ceilings set annually for the maximum amount of new debt assumed, regulated by the SBRBA, will reflect issuer's commitments regarding the new debt financing volume.

The selection of investment projects applying for financing with government and / or government-guaranteed loans in the coming years will again be based on a restrictive approach in line with the statutory terms and conditions.

**■ 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**

Maintaining a low level of debt far below the Maastricht debt criterion, which ensures its long-term fulfilment, is a paramount priority in terms of implementing government debt management policy. The preventive control of its increase is carried out by the yearly setting in the SBRBA of the maximum amount of the government debt at the end of the year, of the new government debt that can be assumed during the year and regarding the new government guarantees that can be issued during the budget year. An additional positive contribution to the overall debt burden is expected in relation to projected GDP growth for 2020–2022 (3.3 % per annum), maintaining the drive for a close to balanced budgetary position and a disciplined fiscal policy. The downward trend in the debt / GDP indicator over the coming years provides an opportunity to improve debt portfolio characteristics.

No serious risks to the medium-term debt sustainability are expected taking into account data on debt amount, structure and parameters presented above, as well as the forecasts concerning its level and rate of change.

**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**

In the coming three-year period, subject to the restrictions in the SBRBA for issuance of new government debt mainly for the purpose of refinancing debt outstanding, it is planned to use primarily GS issues on the domestic market. The high levels of liquidity in the banking system, ongoing fiscal consolidation, and expectations that current low interest rate conditions will be maintained, make the domestic debt market an effective source of securing debt financing of the budget. The issuance policy for the period 2020–2022 will be aimed at addressing the current liquidity needs and refinancing the upcoming maturities of bonds, including partially pre-financing the forthcoming maturities in 2022 and 2023 of Eurobonds placed under the GMTN programme of the Republic of Bulgaria.

The maturity structure of the new debt securities will be adapted to the specific conditions and the need to extend debt the average residual maturity of the debt. Among the basic factors in determining the parameters of the new issues are the existing government debt repayment profile, prevailing market conditions and investor demand. The MoF as an issuer intends to offer standardized fixed rate debt instruments, mainly in BGN, with a view to improving the debt currency structure.

- **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**

Issues on international capital markets will continue to be analysed and monitored as a basis of comparison, both in terms of price levels and as sources of alternative to the domestic market or a complementary financing.

The Global Medium-Term Note Programme of the Republic of Bulgaria for issuance of bonds on the ICM, established in the beginning of 2015, is a standardized instrument for the international investment community for issuance of 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 taken under the programme is EUR 8 billion, with Eurobonds with a total nominal volume of EUR 5.144 billion being issued to date. The specific limit for the issuance of bonds under the medium-term programme for each year will be within the debt limits stipulated in the respective annual SBRBA. The maximum maturity of the securities that can be absorbed under the programme is 30 years, with the specific maturity and volume of each tranche being determined during the so-called marketing process through which the issuer presents itself to the respective investment community, and is consistent with the repayment profile of the government debt. The existence of a legal framework for the issuance of a series of tranches on the ICM gives the flexibility to choose the best possible strategy for the implementation of the issuing policy and to manage government debt risk profile more effectively.

### **5.3 Sub-objective: Development of the secondary GS market**

- **Measure: Taking steps to extend the scope of secondary GS market monitoring and control over GS transactions registration systems**

Actions for completion of the integrated information system for monitoring the secondary GS market (System for monitoring, analysis, registration and trading in GS / SMART) continued in 2019 in accordance with the changing regulations in the field of sovereign bonds.

Activities on the implementation and refinement of the this system will continue in the period 2020–2022, optimizing in the medium term activities on monitoring the GS market and controlling the systems for registering transactions in them.

Where necessary, legislative changes will be made to align Bulgarian legislation with European Union Law and model the GS market infrastructure by establishing mechanisms to achieve the strategic goals set by EU Member States in the field of government debt markets. ■

## 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 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)**

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

**RF<sub>t</sub>**: 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 **t<sub>0</sub>**;

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

**t<sub>0</sub>**: time for change in interests rates; for floating interest rate debt it is accepted to be **t<sub>0</sub>=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. ■