GOVERNMENT DEBT MANAGEMENT STRATEGY

2021–2023

Sofia, October 2020

Contents

Government debt management refers to the overall process coordinated by the development and implementation of a government debt management strategy. The strategy paper sets out the approach to achieving the objectives aimed at covering debt financing needs, taking into account the impact and constraints of external and domestic macroeconomic environment and potential risks.

The Government Debt Management Strategy for the period 2021-2023 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 2021-2023 Government Debt Management Strategy was developed on the basis of the 2020 SBRBA, taking into account the fiscal targets, policies and assumptions for the next three years, set in the development of the draft updated MTBF 2021–2023 and the draft SBRBA for 2021.

Debt management in the next three years, in a dynamic environment caused by the spread of COVID-19 and the economic consequences of the pandemic, will focus on providing the necessary funds for refinancing the debt outstanding, financing the planned state budget deficit and securing the statutory levels of the fiscal reserve, including ensuring the best possible costs of financing for the government, respectively reducing the costs of debt servicing in the medium term.

The parameters of the new debt will be in line with the current market situation 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 gradually extend debt`s average residual maturity and gradually smoothing its maturity structure.

Debt financing of the budget will be ensured by providing highly liquid, with an appropriate yield/risk ratio, debt instruments positioned in different maturity segments, as well as through government loan disbursements intended to finance government's social and economic measures to address the effects of the crisis caused by the spread of COVID-19 under the European Temporary Support Instrument to Mitigate the Unemployment Risks in an Emergency (SURE). A conservative approach will continue to be applied to the financing of investment projects and specific programmes with government and government guaranteed loans.

Within the forthcoming period 2021-2023, the possibility of assuming new government debt within the range of BGN 4.5-6.8 billion per year is envisaged, with planned volumes exceeding debt repayments for the same period (BGN 1.1 billion – BGN 3.0 billion), given the need to finance the forecast deficits in the government budget in the coming years.

In addition to the GS financing in next 2021, has been envisaged disbursement under the loan agreement in relation to the European instrument SURE, to the amount of BGN 530.0 million (EUR 271.0 million).

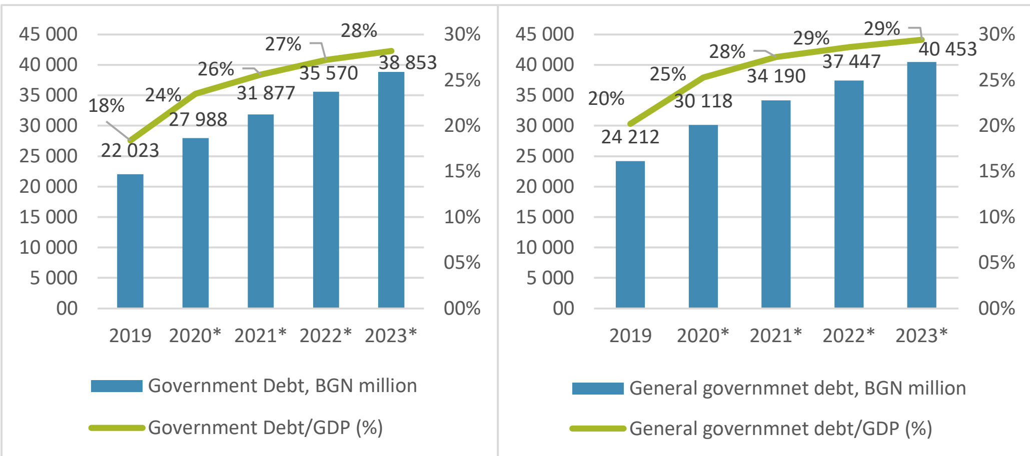
Table 1: Debt and interest expenditures - key parameters

Parameters	2019	2020	2021	2022	2023
	report	expected execution	project	forecast	forecast
Government Debt					
Government Debt, BGN million	22,023,0	27,988,2	31,877,3	35,570,0	38,853,2
Government Debt/GDP (%)	18,4%	23,5%	25,6%	27,2%	28,2%
Government guaranteed debt					
Government guaranteed debt, BGN million	1,741,4	1751,5	1734,7	1454,8	1249,6
Government guaranteed debt/GDP (%)	1,5 %	1,5 %	1,4 %	1,1 %	0,9 %
General governmnet debt					
General governmnet debt, BGN million	24 211,8	30,117,8	34,189,5	37,446,6	40,453,3
General governmnet debt/GDP (%)	20,2 %	25,3%	27,5%	28,6%	29,4%
Governmnent debt service cost					
Interest expenditure, BGN million	608,2	584,5	622,6	765,4	904,8
Interest expenditure/GDP (%)	0.5 %	0.5 %	0.5 %	0,6%	0,7%
GDP*, BGN million	119,772,3	119,088,8	124,540,5	130,875,9	137,701,5

Source: MoF

Government debt/GDP ratio is expected to reach 23.5% in 2020 (18.4% in 2019). In the period 2021-2023, based on assumptions and estimations of net debt financing, the government debt nominal value and its ratio to projected GDP will continue to increase from 25.6% at the end of 2021 to 28.2% in 2023, also affected by the nominal GDP growth.

Fig. 1: Government debt and General Government debt in 2019-2023



* According to the Autumn Macroeconomic Forecast of the Ministry of Finance, https://www.minfin.en/en/866

Source: MoF

The currency and interest rate debt structure in 2021-2023 will continue to change in the direction of reducing the impact of the main market variables on the size of government debt and the cost of its servicing. The share of the debt denominated in currencies other than BGN and EUR is expected to be within a range of 0.4% to

0.2% and the portion of floating interest rate liabilities within a range of 1.9% to 0.5%.

The trends for maintaining a low-risk structure of sovereign debt are reflected in the relatively low government debt service costs, which relative to the level of GDP thought the period 2021-2023, are expected to be below 1%.

The Government guaranteed Debt/GDP ratio as of December 31, 2020, is expected to remain at 1.5% compared to 2019 and will continue to decrease in each of the years in the projected period 2021-2023 to 0.9 % at the end of 2023.

By the end of 2020, the General Government Debt/GDP ratio is expected to stand at 25.3% (20.2% at the end of 2019) and will continue to increase over the three-year period, reaching a level of around 29.4% at the end of 2023. The projected values of the indicator are well below the maximum admissible reference threshold of the Maastricht convergence criterion of 60%. ■

2. Government and government guaranteed debt

2.1 Government debt

The nominal amount of the government debt at the end of 2020 marks a significant increase to BGN 28.0 billion, compared to the level of BGN 22.0 billion reported as of December 31, 2019. The value is below the debt ceiling for a maximum amount of government debt at the end of the year of BGN 31.5 billion provided for in the SBRBA for 2020 (modified by the budget amendment in the first half of the year)[1] and relative to GDP, the total debt burden reached 23.5% (18.4% as of December 31, 2019). The nominal growth in debt compared to the level recorded at the end of 2019 is objectively justified as a result of the outbreak and rapid spread of the COVID-19 pandemic and the fiscal targets for 2020 for the budget balance that were modified in this regard with amendment of SBRBA in the context of the deteriorating assumptions for the external and domestic economic environment. On this basis, the need to provide additional funds from debt sources, including for financing measures in response to the crisis caused by the spread of the virus, made it necessary, with the amendment of the State Budget Act for this year, to increase the ceiling for the maximum amount of the new government debt, which can be assumed within the budget year from up to BGN 2.2 billion to up to BGN 10 billion.

Despite of constantly changing global economic environment and the growing uncertainty in 2020, the main goal of debt management to provide the necessary debt financing for budgetary purposes in a timely manner was achieved through the active participation of the government as an issuer of GS, conducting a market-oriented borrowing policy and diversifying internal and external sources.

In the low interest rates environment in 2020, government securities with a total nominal value of BGN 1.2 billion were placed on the domestic market (new 5-year government securities denominated in BGN and reopening of a bond from 2019 with original maturity of 10 years and 6 months), providing good investment opportunities for a wide range of participants in the domestic market for sovereign debt. The total issued volume of 5-year government securities reached BGN 600 million in three auctions, with a negative weighted average yield – (-0.04%). The bond with a maturity of 10 years and 6 months, a benchmark for the assessment of the degree of convergence, which is one of the Maastricht criteria, was re-

[1] Law on Amendment and Supplementation of the Law on State Budget for 2020 (prom., State Gazette, issue 34 of 2020, effective as of 9 April 2020)

opened in three auctions, with a total volume of issued securities of BGN 600 million, with a weighted average yield of 0.27%.

As a result of the long-term efforts to maintain strict fiscal discipline, the low level of government indebtedness and the accession of our country to the Banking Union and the Bulgarian lev to the Exchange Rate Mechanism (ERM-2)[2], in September 2020 the Republic of Bulgaria successfully issued bonds under the GMTN Programme on ICM, after more than four years of absence[3]. The bonds are senior unsecured debt in Regulation S format, in two tranches of EUR 1.25 billion each and maturities of 10 and 30 years. The ten-year bond achieved the lowest ever coupon, respectively yield and spread. For the first time in its history, the Republic of Bulgaria issued a bond with a maturity of 30 years, which represents the longest tenor bond in the country's debt curve.

The achieved parameters of the two tranches can be compared to those of countries with a higher credit rating, including euro area countries: for the 10-year bond - an average price of 99,863 per 100 euro nominal, an interest rate coupon of 0.375% and a spread against an average interest rate swap (MS) of 60 basis points (yield: 0.389%); for the 30-year issue - an average price of 97.566 per 100 euro nominal, an interest rate coupon of 1.375 % and a spread against the swap of 145 basis points (yield: 1.476%).

The funds raised from the transaction are expected to be used to refinance existing debt, to finance the government`s social and economic measures related to the effects of the pandemic, as well as to finance the expected budget deficit.

As a result of the long-term Eurobonds issued in ICM, the average residual maturity of government debt at the end of December 31, 2020 is extended by nearly 2 years, compared to the level recorded in 2019, and reaches around 9 years.

The respective distribution between the share of external and domestic government debt as of December 31, 2020 is 79.8% and 20.2% (75.1% and 24.9% in 2019).

Implemented debt operations have a positive impact on the growth of debt instruments denominated in EUR and BGN to a level of about 99.6% as of December 31, 2020 (compared to 99.5% as of December 31, 2019) and of those with fixed interest rate coupons – 98.1% for 2020 (compared to 96.9% as of December 31, 2019) at the expense of the reduction of those in other currencies and with floating interest rates.

The maturity structure of the debt (residual term) at the end of 2020 is expected to decrease in segments up to 1 year - from 5% as of December 31, 2019 to 2.9%

[2] As of 1 October and 10 July 2020, respectively

[3] The last ICM transaction took place in March 2016 under the GMTN programme, when 7-year and 12-year Eurobonds were placed in a double tranche, with a total nominal value of EUR 1.994 billion.

at the end of the year, and from 1 year to 5 years - from 45.5% as of December 31, 2019 to 38.5% at the end of 2020. The debt with a residual maturity of more than 10 years shows the opposite trend - an increase to 27.9% in 2020 compared to 19% at the end of the previous year.

Table 2: Key indicators of government debt

Indicators	31.12.2019	30.09.2020	31.12.2020
	report	report	expected execution
Total government Debt, BGN million	22,023,0	27,688,4	27,988,2
GDP*, BGN million	119,772,3	119,088,8	119,088,8
Total government Debt /GDP, (%)	18,4%	23,3%	23,5%
Domestic government debt, BGN million	5,479,5	5,643,6	5,643,6
External government debt, BGN million	16,543,5	22,044,8	22,344,5
Domestic government debt/Total government debt (%)	24,9%	20,4%	20,2%
External government debt/Total government debt (%)	75,1%	79,6%	79,8%
Interest rate structure of the governmnet debt			
Fixed rate debt, BGN million	21,346,0	27,089,9	27,457,3
Floating rate debt, BGN million	677,0	598,6	530,9
Fixed rate debt (%)	96,9%	97,8%	98,1%
Floating rate debt (%)	3,1%	2,2%	1,9%
Currency structure of the governmnet debt			
Debt in EUR, BGN million	17,508,3	22,693,7	22,986,7
Debt in BGN, BGN million	4,415,3	4,902,2	4,902,2
Debt in USD, BGN million	-	-	-
Debt in other currency, BGN million	99,3	92,5	99,3
Debt in EUR (%)	79,5%	82,0%	82,1%
Debt in BGN (%)	20,0%	17,7%	17,5%
Debt in USD (%)	0,0%	0,0%	0,0%
Debt in other currency (%)	0,5%	0,3%	0,4%
Maturity structure of the governmnet debt (by residual term)			
Debt up to 1 year, incl., BGN million.	1,104,4	890,0	818,4
Debt from 1 year to 5 years, incl., BGN million	10,027,3	10,779,4	10,785,0
Debt from 5 year to 10 years, incl., BGN million	6,708,8	8,667,7	8,583,3
Debt of more than 10 years, incl., BGN million	4,182,5	7,351,4	7,801,5
Debt up to 1 year, incl. (%)	5,0%	3,2%	2,9%
Debt from 1 year to 5 years (%)	45,5%	38,9%	38,5%
Debt from 5 year to 10 years (%)	30,5%	31,3%	30,7%
Debt of more than 10 years, incl. (%)	19,0%	26,6%	27,9%
Average residual maturity of government debt (years)	7 y	9 y 2 m	9 y

Source: MoF

*GDP: According to the Autumn Macroeconomic Forecast of the Ministry of Finance for the 2020-2023 period, https://www.minfin.en/en/866

2.2 Government guaranteed debt

By the end of 2020, a minimal change in the nominal amount of GGD is envisaged to a level of BGN 1.8 billion (BGN 1.7 billion at the end of 2019) as a result of disbursement of government guaranteed loans. As a percentage of GDP in the current year, government guaranteed liabilities remain at the level of 2019 - 1.5%.

Most of it is formed by external government guaranteed loans provided by official creditors such as IBRD, EIB, EBRD, CEB, the JBIC, KfW, etc. The Domestic GGD consists of government guarantees issued by virtue of the Student and Doctoral-Candidate Loans Act, which, as of December 31, 2020, has an insignificant share of about 4,6% of the total GGD.

Table 3: Size and dynamics of government guaranteed debt

Government Guaranteed Debt, BGN million	31.12.2019 г.	30.09.2020 г.	31.12.2020 г.
	report	report	expected execution
Domestic government guaranteed debt	74,1	72,9	80,0
1. Guarantees under Student and Doctoral-Candidate Loans Act	74,1	72,9	80,0
External government guaranteed debt	1,667,3	1,613,2	1,671,5
1.IBRD /World Bank/	589,4	586,7	586,7
2.EIB	4,3	63,1	125,3
3.EBRD	586,7	586,7	586,7
4. Others (EUROATOM, JBIC, CEB, ect.)	486,9	376,6	372,7
Total government guaranteed debt	1,741,4	1,686,1	1,751,5
Government guaranteed debt/GDP (%)	1,5%	1,4%	1,5%

Source: MoF

In the second half of 2020, started the implementation of the IGB Interconnector Greece-Bulgaria project, financed with a government guaranteed loan from the EIB amounting to the currency equivalent of BGN 215 million.

On the occasion of the two instruments established at European Union (EU) level in response to the COVID-19 pandemic - the European Temporary Support Instrument to Mitigate the Unemployment Risks in an Emergency (SURE)[4] as a result of the outbreak of the pandemic caused by COVID-19 and the Pan-European Guarantee Fund, with changes in the provisions of Art. 70a and Art. 71 of the SBRBA for 2020[5] from June 2020, during the year the National Assembly ratified by law two

[4] Established by Council Regulation (EU) 2020/672 of 19 May 2020.

[5] The update of the SBRBA for 2020 in June 2020 provided an opportunity for the Council of Ministers to issue government guarantees within the year by concluding a guarantee

guarantee agreements with which our country was joined as a participating Member State to these instruments. With this participation, Bulgaria is expected to provide an opportunity for SMEs and public enterprises in the country to benefit from the support provided by the EIB Fund under favourable conditions to overcome the difficulties due to the economic impact of the COVID-19 pandemic, as well as to improve the stability of unemployment schemes in Bulgaria, and to help maintain employment.

The first-request guarantee agreement with the European Investment Bank in connection with the contribution agreement between the Republic of Bulgaria and the European Investment Bank in respect of the Pan-European Guarantee Fund in response to COVID-19 was ratified by law by the National Assembly, prom., State Gazette, issue 87 of 9 October 2020, effective as of October 9, 2020.

The National Assembly also ratified the voluntary guarantee agreement pursuant to Art. 11 of Council Regulation (EU) 2020/672 SURE - European Temporary Support Instrument to Mitigate the Unemployment Risks in an Emergency due to the outbreak of COVID-19, between the European Commission and the Republic of Bulgaria, prom., State Gazette, issue 82 of September 18, 2020.

agreement under both EU instruments, which imposed an increase in the envisaged limit for new government guarantees, which can be issued during the year from BGN 1,535 million to BGN 1,845.1 million.

3. Economic prospects for the period 2021-2023

3.1 Development of the national economy in 2020

The spread of the coronavirus in 2020 caused a serious economic shock globally and in Europe in the second quarter of the year. Bulgaria's economy was also affected, but the real decline in GDP was more moderate than the EU average both in the second quarter and the first half of 2020.

Real GDP is forecast to decrease by 3% in 2020, with a partial improvement in economic activity in the country expected in the second half of the year. This will be reflected in a slower decline in household consumption, and positive contribution to GDP from public consumption and investments. The overall contribution of the external sector to GDP for 2020 will be almost neutral.

The annual average decline in employment for 2020 is expected to be around 2.6% and the unemployment rate - 5.6%. The government has taken a number of measures to curb the negative effects of COVID-19, and in the area of the labour market the 60/40 measure has been found to have a positive impact and to limit the growth in number of the unemployed. The dismissal of employed and the significant reduction of the hours worked have led to a severe slowdown in the growth of compensation per employee in the second quarter of the year. Compensation per employee is expected to increase by 5% in 2020.

Annual inflation declined in the first half of 2020. In August, it was 0.6%, compared to 3.1% at the end of 2019. The main factor behind the disinflation in the country was the drop in energy prices, triggered by a decrease in international oil prices. Annual average inflation for 2020 is projected to be 1.4%.

Increased uncertainty in 2020 led to a higher aptitude to save, postponement of expenditure on durable goods and lower demand for credits. In 2020, the growth of claims on corporation is expected to be 0.6% and of claims on households - 5%.

3.2 Economic outlook for 2021–2023

GDP growth is projected to reach 2.5% in 2021. Household consumption will recover and exceed the 2019 level, supported by an increase in employment and disposable income. The drop in investments will continue, but at a slower pace. The expected favourable development of Bulgaria's main trading partners will lead to a full recovery of goods exports in 2021. At the same time, services exports will remain below pre-crisis levels despite the expected substantial real growth. The main reason is the delayed recovery of international travel. Imports of goods and services will follow trends in domestic demand and exports, with neither goods nor services reaching 2019 levels. As a result of the faster increase in exports compared to imports, net exports will have a positive contribution of 1.4 p.p. to GDP growth in 2021.

GDP growth will accelerate to 3 % in 2022 and 3.2 % in 2023. Higher consumer confidence and income growth will result in private consumption growth of around 3%. In 2022-2023, growth in goods exports will remain stable, in line with the development of the external environment. Exports of services will continue to increase at a high rate as a result of restored confidence of foreign tourists, tour operators and air carriers. Imports of goods will accelerate, supported by higher domestic demand. The contribution of net exports to GDP growth will shift from slightly positive to negative.

Employment will gradually start to recover, increasing by 0.9% in 2021 and by 1.5% in 2022, along with the acceleration of economic growth in the country. Reaching the number of employees observed in the pre-crisis year 2019 is expected to happen in the first months of 2023. In 2023, the dynamics of employment in the country will again be influenced by the unfavourable demographic development, which is also a major constraint for the extensive increase of labour resources to meet high demand. The unemployment rate is projected to re-establish its downward trend observed in the majority of the last ten years and the annual average of the indicator for 2021 is projected to decrease to 5.2 % and to 4.6 % in 2022. The indicator will then stabilise around the level reached in 2022 and its further reductions are expected to be marginal.

In 2021, compensation per employee will be characterised by an accelerated rate of increase, which is expected to reach around 6%. The latter will reflect the acceleration of the indicator both in the private sector and the effects of the further increase in income in the education sector, the planned new increase in personnel costs in public administration, in the structures charged with pandemic control activities and its consequences, the minimum wage, etc. The upward development of the indicator under review will continue in 2022-2023 and is expected to increase at a pace of around 7% at the end of the forecast period.

Inflation processes in 2021 will primarily depend on the rate of recovery of international commodity and oil prices. At the end of 2021, we expect inflation to accelerate to 2.8% and annual average inflation to 2.1%. In services, we expect an acceleration of price increases in 2022-2023, which will be due to a recovery in domestic demand. Over the last two years of the forecast period, we expect annual average inflation to be around 2.5-2.6%.

Demand for credit will begin to recover in 2021. The demand for credit by non-financial corporations will be lower and influenced by expectations of weak investment activity in the private sector. The growth of total claims on corporations at the end of 2021 is projected to be close to 1.9% and that of claims on households to accelerate to 5.6%. In total claims on the private sector will increase by 3.3% in 2021. The acceleration in private sector credit growth is projected to continue smoothly for both corporations and households over the 2022-2023 period, in line with the recovery in domestic demand. Overall, the annual growth in claims on corporations will accelerate to 3.8% and 4.6% in 2022 and 2023, respectively. The annual growth of claims on households in 2022 and 2023 is projected to be 6.7 % and 6.9% respectively. Overall, private sector claims' growth at the end of 2023 will be 5.5%.

3.3 Risks for the macroeconomic forecast

In the short term, the risks to the forecast are negative. Economic development depends on the dynamics of the epidemic situation both in the country and globally, and there is still no sustainable solution to cope with the pandemic.

As part of this forecast, an alternative macroeconomic scenario with a less favourable development of the external environment in 2020 and 2021 has been developed. The results of this simulation show deterioration of the overall GDP dynamics, with negative deviations in 2020 and 2021 of 2.2 and 4.3 p.p., respectively, compared to the baseline scenario. Throughout the forecast period, the level of GDP at current prices will be lower than in the baseline scenario.

There are also positive risks to the forecast. If globally the epidemic situation is dealt with faster, a much more favourable impact from the external environment can be observed, especially as regards accelerated recovery of international travel. there might a faster recovery of investments and a stronger increase in consumption given the recovery of the labour market. The funds under the Recovery Plan for Europe will also have a positive impact on the economy, especially in the 2021-2026 period. Bulgaria is expected to have access to more than EUR 10 billion under the new EU Recovery and Resilience Facility.

4. ANALYSIS OF THE RISKS RELATED TO GOVERNMENT DEBT STRUCTURE FOR THE 2021–2023 PERIOD

The provided risk analysis is based on the assumptions for new debt financing envisaged in the drafting of the SBRBA for 2021 and the MTBF for the 2021-2023 period, in accordance with the macroeconomic and budgetary framework, both for the current year and in mid-term perspective. Any deviation from the expected dynamics represents a potential risk for realisation of the results of the analysis with an effect on the status of measured indicators.

Taking into account the size, structure and parameters of the debt by the end of 2020, as well as the projections of their levels and their pace of change in the period 2021-2023, no negative changes in the risk profile of government debt are expected to significantly increase the impact of the risk.

Table 4: Risk assessment indicators

Risk	Indicator	2019 - report	2020 - expected excecution	2021 - project	2022 - forecast*	2023 - forecast*
Refinancing risk	Debt up to 1 year (by residual maturity as a share of government debt, %)	5,0%	2,9%	8,7%	7,8%	8,6%
	Average time to maturity (ATM) - (years)	6,6	8,8	8,7	9,3	10,0
Interest rate risk	Ratio between fixed interest rate debt and floating interest rate debt (%)	96,9% / 3,1%	98,1% / 1,9%	98,7% / 1,3%	99,1% / 0,9%	99,5% / 0,5%
	Average time to refixing (ATR) - (years)	6,6	8,8	8,7	9,3	10,0
	Duration - (years)	6,5	8,0	7,7	8,1	8,7
Currency risk	Ratio between external and domestic government debt (%)	75,1% / 24,9%	79,8% / 20,2%	78,6% / 21,4%	73,2% / 26,8%	68,6% / 31,4%
	Ratio between debt in risk-neutral currencies – BGN and EUR as compared to the share in other currencies debt (% of the total amount of the government debt)	99,5 %/ 0,5 %	99,6 % / 0,4%	99,7% / 0,3%	99,8% / 0,2%	99,8% / 0,2%
Liquidity risk	Ratio between debt up to 1 year (at residual maturity) and tax and social security revenues (%)	3,1%	2,3%	7,5%	7,0%	7,9%
Risk related to the debt size	Ratio between General government debt and GDP (%)	20,2%	25,3%	27,5%	28,6%	29,4%
	Ratio between Government debt and GDP (%)	18,4%	23,5%	25,6%	27,2%	28,2%
Risk related to governmnet guarantees	Ratio between government guaranteed debt and government debt (%)	7,9%	6,3%	5,4%	4,1%	3,2%
	Ratio between government guaranteed debt and GDP (%)	1,5%	1,5%	1,4%	1,1%	0,9%
Operational 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.					

*Note: * Forecast data. The assumptions for new debt financing laid down in the drafting of the estimates of the SBRBA for 2021 and MTBF for 2021-2023 have been taken into account.*

Source: MoF

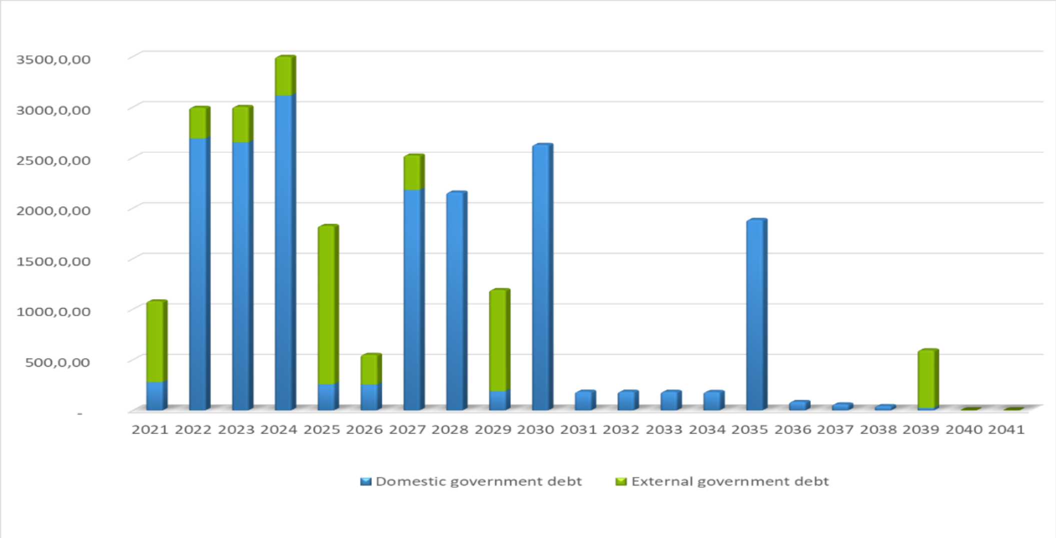
4.1 Refinancing risk

In the debt amortization structure, larger volumes of payments are concentrated in the years when bonds issued at ICM are maturing[6], mainly placed as part of the GMTN Programme. The expected amount of forthcoming repayments in 2022 and 2023 is BGN 2.7 billion - BGN 3.0 billion annually.

These maturities are a prerequisite for the majority of the required borrowing resources to be obtained through tradable instruments and market operations, both on the domestic and international capital markets, which incorporate good opportunities in terms time for execution and access to borrowing, respectively implementation of a more flexible issuance strategy.

Fig. 2: Redemption profile of government debt*

(BGN mln.)



* Active debt assumed as of September 30, 2020

Source: MoF

In September 2020 under the GMTN Programme, ratified by the National Assembly in 2015, Bulgaria issued two tranches of BGN 1.25 billion each – 10-year, and for the first time 30-year bonds. As a result of this transaction the sovereign debt curve of Bulgaria was extended and the liquidity of the Bulgarian debt was increased. The transaction improved the risk profile of the government debt, which was confirmed by the submitted data.

The share of government debt with a residual maturity of up to 1 year in the total government debt outstanding, after a slight decline of 2.9% in 2020, with the approach of upcoming Eurobond payments is expected to increase to a level of 8.6% at the end of 2023.

---

6 Currently, in the debt portfolio of the Republic of Bulgaria there are eight issues of Eurobonds placed on ICM – seven under the GMTN programme maturing in 2022, 2023, 2027, 2028, 2030, 2035 and 2050, and one with independent documentation maturing in 2024.

The Average time to maturity (ATM) parameter also shows a positive adjustment. Despite the forthcoming large payments, the data show an increase of its value from 8.8 years in 2020 to 10 years at the end of 2023, therefore the debt portfolio will be renegotiated less frequently.

4.2 Market risk

Over the next three-year period, the debt structure remains resilient in terms of the impact of market risks. As a result of the establishment of a borrowing policy, mainly oriented towards attracting financial resources in BGN and EUR, with a fixed interest rate, there are positive changes in the currency and interest rate composition of the debt during the entire analysed period 2021-2023.

The increase in liabilities in EUR and BGN, which prevail in the currency structure of the government debt with a total share of 99.6% as of the end of 2020, is expected to continue until the end of the period to a level of 99.8%. Reciprocally, the share of the debt in other currencies (JPY) decreases from 0.5% as of December 31, 2020 to 0.2% at the end of 2023.

Changes in the values of the individual segments (in EUR and in BGN) in a three-year perspective are foreseen for the liabilities in BGN, which increase to about 30.2% and those denominated in EUR – decrease to 69.7%. The existing imbalance between external and domestic government debt (as of the end of 2020, domestic debt accounts for 20%) is gradually reduced and at the end of 2023, the share of domestic debt represents 31.4%.

The interest rate structure of government debt is dominated by share maintains the liabilities with fixed interest rate. Their relative weight in the total amount of debt as of December 31, 2020 amounts to 98.1% and at the end of 2023 increases to 99.5%. The share of liabilities with floating interest rate remains negligible at 0.5% at the end of 2023 (1.9% in 2020).

For the period 2020-2023, a large part of the debt is resilient to the change in interest rate, which implies a portfolio with a lower degree of risk. The value of the indicator Average time to refixing (ATR) improves significantly, increasing from 8.8 years in 2020 to 10 years at the end of the period.

4.3 Liquidity risk

For the period 2021-2023, the main risk is related to the uncertainty regarding the development of the epidemic situation caused by the spread of COVID-19 both nationally and globally, and the rate of recovery of economic activity in Europe and the world, respectively. There are both positive and more negative scenarios compared to current forecasts, which could lead to a more favourable effect than expected or, on the contrary - further worsen the outlook. Under these conditions, the management of liquidity risk from the point of view of debt management requires timely and effective provision of funds for refinancing maturing debt, financing of the planned government deficit and securing the statutory levels of the fiscal reserve. As a liquidity management tool and a protective buffer, the existence of a fiscal reserve ensures that the negative impact of risks arising from liquidity changes is minimised.

The ratio of debt to 1 year/tax and social security revenues (a measure of liquidity risk) in the medium term is expected to increase from 3.1% in 2019 to 7.9 % in 2023.

4.4 Risk related to debt size

In the last few years, as a result of the disciplined and consistent fiscal policy, the General government debt/GDP ratio is among the lowest in the EU. Measures taken at national level to combat the spread of COVID-19 and redefine the fiscal targets have led to the need to secure additional debt financing in the current year and as expected, in the next three years. In this context, the General government debt registered a significant increase in absolute terms and relative to GDP to a level of 25.3% in 2020 (compered 20.2% at the end of 2019). This indicator is projected to rise in each year from the period 2021-2023, reaching 27.5%[7] in 2021, 28.6%[3] in 2022 and 29.4%[3] in 2023, respectively. Preliminary values for the variation of the parameter are well below the 60% debt rule ceiling and do not pose a threat to debt sustainability.

Similar dynamics is observed in the government debt/GDP ratio over the period under review, rising from 25.6 % in 2021 to 28.2 % at the end of 2023. Government debt is the component in the debt of the sector, respectively of the Central government sub-sector, with the highest share, which is why it has a leading importance and impact on the sector`s debt. The debt impact of the other two subsectors, Local Government and Social Security Funds over General government debt, remains neutral.

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

The presented levels of indicators show a low degree of vulnerability of the debt portfolio to the impact of the risk associated with government guaranteed liabilities.

The share of government guarantees in total government debt as of the end of 2020 is at a relatively low level. As of December 31, 2020, this indicator represents

[7] Compared to the projected level of GDP according to the Autumn Macroeconomic Forecast of the MF for the 2020-2023 period, https://www.minfin.en/en/866

6.3% and over the upcoming three-year period is projected to gradually decrease from 5.4% in 2021 to 3.2% at the end of 2023.

As of December 31, 2020, GGD nominal value increased slightly to BGN 1.8 billion compared to the level of BGN 1.7 billion recorded in the previous year, and stabilized within 1.5% of GDP. In the next three years, GGD marks a significant drop to BGN 1.2 billion or below 1% of GDP (0.9% in 2023).

In assessing the future impact of this risk, account should also be taken of the need to issue new government guarantees in order to provide support in priority areas of the economy, as well as the potential opportunities for materialisation of the risk of activating already issued government guarantees. Annually, in SBRBA will be set ceiling for the maximum amount of new government guarantees that can be issued in the relevant year and provisioning reserve funds to cover the risk of government guarantees being called. This approach minimises the manifestation of the negative effects of the impact of the risk, respectively the inability of the budget to meet the possible activation of these liabilities. An additional preventive measure is the highly restrictive and conservative approach is foreseen in the selection of projects financed by government guaranteed loans.

4.6 Operating risk

The organisation of government debt management activities is concentrated within a single structural unit and is based on widely applicable principles and sound practices for the implementation of monitoring and control systems. Financial management and control in the public sector are legally regulated, and within the developed rules and internal procedures for working in the unit responsible for debt management, the responsibilities of employees are clearly systematised, which in the future ensures minimisation of the impact of operational risk. Compliance with and application of these legal provisions and regulatory requirements improve the risk profile. The operational control is additionally ensured through continuous maintenance and improvement of the functionalities of the established information system for analysis, forecasting and management of the government debt (official register of government and government guaranteed debt under Art. 38 of GDA), automating the data processing procedures related to the management of government liabilities, which ensures quality, reliability and truthfulness of the generated information. In the future strict adherence to the rules and procedures established in this area reduces risk exposure. ■

5. Goals of government debt management policy

The main goal of debt management is provision of the necessary resources for refinancing the debt outstanding, financing the planned deficit in the state budget and ensuring the statutory levels of the fiscal reserve at the optimal 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

Analysing the reported results and prerequisites related to the debt burden in the coming years, the borrowing policy will not differ significantly from the one outlined in the previous Government Debt Management Strategy. Debt management will adhere to already established practices and statutory procedures when assuming new government debt. Of fundamental importance is the analysis and evaluation of the financial conditions of the loan resource in line with the longer-term objectives aimed at optimising the structure of the debt portfolio, extending its maturity curve and reducing the impact of refinancing risk.

The envisaged effects of the borrowing strategy are expected to take into account their impact on the main risk parameters, the cost of the debt financing, as well as the allocation of the upcoming maturities. The tendency to assume debt instruments with risk-neutral composition, mainly with fixed interest rate, in BGN and EUR, adhering to the reference debt values set in the state budget, will be maintained in the period 2021-2023. Efforts and measures in this direction aim at stability and predictability of budgetary costs for debt servicing. The annually determined debt ceilings for the maximum amount of new debt that can be assumed set in SBRBA for the respective year will reflect issuer's commitments regarding the volume and possible sources of new debt financing.

In the coming years, the policy of issuing new government guarantees and financing investment projects with government loans will be restrictive, strictly regulated, subject to statutory criteria and linked to budgetary risks.

- **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**

Measures aimed at maintaining a sustainable debt level well below the 60% Maastricht debt criterion's maximum allowable reference value to ensure its long-term fulfilment remain a priority.

In the last few years, the debt of the Republic of Bulgaria has been at a relatively low level, significantly below the average values for EU and Euro Area Member States. This factor, combined with macroeconomic stability and fiscal discipline, our accession to the single banking and monetary union (ERM II), as well as the planned membership in the euro area, are a prerequisite for investors to have confidence in our country as an issuer of sovereign debt.

To confirm this positive trend, the maximum amount of the government debt at the end of the year, the maximum amount of new government debt that can be assumed during the year and the new government guarantees that can be issued during the budget year, set in the SBRBA, make a significant contribution.

Notwithstanding projected state budget deficits, the need to smoothly refinance debt and secure the fiscal reserve in a three-year perspective, in the context of an outbreak of an epidemic and uncertainty surrounding its development, debt indicators are not expected to be significantly affected. Assumptions of debt growth, albeit at a slow pace in the medium term, do not imply that sovereign liabilities reach risk limits.

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 upcoming three-year period, in compliance with the debt restrictions provided for in the SBRBA for issuance of new government debt, mainly for the purpose of refinancing debt outstanding and securing financial resources to cover the planned budget deficits as a result of the shrinking economic activity, as a direct consequence of the outbreak of COVID-19, it is planned to use both issuances of GS on the domestic market and bonds on the ICM, which are also an impartial international benchmark for measuring the sovereign risk of the country. High levels of liquidity in the banking system and the expected maintenance of current low interest rates make market-oriented financing an effective source of debt financing for the budget. The issuance policy for the period 2021-2023 will aim to cover, where necessary, current liquidity needs and refinancing the upcoming payments of Eurobonds, as well as to maintain the statutory levels of fiscal reserve.

The determination of the new issue parameters will be based on the repayment profile of government debt, prevailing market conditions and investor demand. Standardized fixed rate debt instruments will be offered.

- **Measure: Maintain financing capacity through the Global Medium-Term Note Programme on International Capital Markets (GMTN Programme) to ensure maximum flexibility in the selection of funding structure in terms of markets, maturities and currencies**

The Global Medium Term Note Programme of the Republic of Bulgaria for issuance of bonds on ICM was established in the beginning of 2015 with the ratified by the National Assembly (State Gazette, issue 16 of 2015) Dealer Agreement, Agency Agreement and Deed of Covenant (promulgated in State Gazette, issue 25 of 2015). It 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. Through the established programme, the government has the opportunity to place bonds on both the European and USA markets, to use different alternatives in the selection of instruments, currencies, maturities, public or private placements and an appropriate time period for tapping the external markets.

The maximum aggregate nominal volume of the bonds that can be issued under the GMTN Programme (programme limit) was increased from EUR 8 billion to EUR 10 billion with the amended SBRBA for 2020.

So far, Eurobonds with an aggregate nominal volume of EUR 7,644 billion have been issued under the programme. The specific limit for the issuance of bonds under the GMTN Programme for each year will be within the debt limits provided for in the respective annual SBRBA. The maximum maturity of the securities that can be issued under the programme is 30 years. The inaugural 30-year tranche under the GMTN Programme was issued In September 2020 within extremely favourable conditions for the issuer. In September 2020, a tranche with such maturity was successfully issued under extremely favourable conditions for the issuer. The results of the transaction including bid- to- cover ratio and yield to maturity firmly strengthened the positions of the Republic of Bulgaria as a stable issuer on ICM with sustainable macroeconomic fundaments.

The specific maturity and volume of each tranche are determined during the so-called marketing process, during which the issuer is presented to the relevant investment community and the repayment profile of government debt is taken into account. 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 GS market

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

At the beginning of 2020, in connection with the provisions of Art. 24, para. 1, of Ordinance No. 5 of 2007 on the terms and conditions for acquisition, registration, payment and trading of government securities (prom., State Gazette, issue 85 of 2007, amended and supplemented, issue 100 of 2013, issue 56 of 2015 and issue 29 of 2017) and Art. 12 of Ordinance No. 15/2007 on the control of transactions with government securities issued by the Minister of Finance and the Governor of the Bulgarian National Bank (prom., State Gazette, issue 85 of 2007, amended, issue 29 of 2017) (Ordinance No. 15 of 2007), pursuant to § 5 of the Transitional and Final Provisions of Ordinance No. 15 of 2007, "Instruction for the preparation and provision of information for the purposes of regulating and controlling the registration of transactions with government securities on the secondary market" (the Instruction) was approved jointly by the Minister of Finance and the Governor of the Bulgarian National Bank. The purpose of the Instruction is to optimise the process of information provision by sub-depositaries of government securities, as well as to detail and define the scope of their data, which in turn will lead to an extension of the scope of monitoring of the secondary market of government securities, as well as of the control over the systems for registration of transactions. In this regard, the implementation and improvement of the System for Monitoring, Analysis, Registration and Trading of government securities (SMART) will continue in the 2021-2023 period, in line with the changing regulations in the area of sovereign bonds.

If necessary, in order to harmonise the Bulgarian legislation with the European legislation and to model market infrastructure of government securities, legislative changes will be introduced through building mechanisms for achieving the strategic objectives set for EU Member States in the field of government debt markets.

ABBREVIATIONS AND DEFINITIONS

Abbreviations

GDP	Gross Domestic Product
BNB	Bulgarian National Bank
BDB	Bulgarian Development Bank
CEDB	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
LSBRB	Law on State Budget of the Republic of Bulgaria
LGD	Law on Government Debt
KfW	Kreditanstalt für Wiederaufbau
ICM	International Capital Markets
MF	Ministry of Finance
IFI	International Financial Institutions
IBRD	International Bank for Reconstruction and Development
PD	Primary Dealers
MTBF	Mid-Term Budgetary Forecast
DIF	Deposit Insurance Fund
JBIC	Japan Bank for International Cooperation
GMTN Programme	Global Medium-Term Note Programme for Debt Issuance at International Capital Markets
MTF	Multilateral Trading Facility
OTC	Over-the-Counter Market
RM	Regulated Market
OTF	Organised Trading Facility

Definitions

Currency risk – Refers to the vulnerability of the debt portfolio, amortisations and servicing costs resulting from the depreciation of the value of national currency. Changes in exchange rates may have an impact on debt servicing costs and hence – on the budget. Debt denominated in foreign currency leads to volatility of debt servicing costs measured in national currency;

Interest rate risk - Refers to the vulnerability of debt portfolio as well as to government debt costs resulting from higher interest rates on the current market when the fluctuating interest rate debt and the maturing fixed rate debt undergo readjustment. Changes in market prices that affect debt servicing costs may cause deviations in the amount of government 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, commodity prices affecting debt servicing 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 liabilities. 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 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 associated with the amount of the debt - 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 associated with the contingent liabilities 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 up to 1 year (residual term) – The part of the debt that will mature within 1 year;

Average time 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 to maturity
Nom: nominal amount of outstanding debt
n: Final maturity of debt

Ratio between fixed interest rate debt and floating interest rate debt - Indicates 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 time **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 **to**;

t: time to maturity: calculated on the basis of the actual planned date of payment;

to: time for change in interest rates; for debt with variable interest rate it is accepted that **to**=0.5;

Nom: nominal value of 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 credit 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;

Repayment profile – The debt repayment profile is a series of depreciation payments that arises as a result of the outstanding debt;

Ratio of the debt in foreign currency to the total debt - Indicator contributing to currency and liquidity risk determination.