# GOVERNMENT DEBT MANAGEMENT STRATEGY

# 2022–2024

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

The proposed Government Debt Management Strategy for 2022–2024 has been developed using the best international practices and by virtue of Art. 16, para 1 of the Government Debt Act and Art. 77a of the Public Finance Act. The object of the Strategy is the government debt - domestic and external, assumed under the Government Debt Act.

# 1. PROSPECTS FOR THE DEVELOPMENT OF DEBT MANAGEMENT - BASIC ASSUMPTIONS

The Government Debt Management Strategy for 2022 - 2024 has been developed in accordance with the implementation of the indicators of the State Budget for 2021 and on the basis of the assumptions under which the drafts of state budget Act for 2022 and the updated Medium-term budgetary framework for 2022 – 2024 have been elaborated. Any deviation from the planned fiscal perspectives, incl. the risks from the dynamics of the pandemic situation both in the country and globally represent a potential risk to the implementation of the pre-formulated strategy, with an effect both on the parameters of the government debt and on the possibilities for financing the planned state budget deficits.

As the state budget has not been adopted by the National Assembly until the beginning of the budget year 2022, on the basis of the regulation of Art. 87, para. 2 of the Public Finance Act, in 2022 (until the adoption of the State Budget Act) the Council of Ministers will be able to assume government debt only for refinancing the outstanding debt and up to the annual amount of repayments of government debt incurred until the beginning of 2022. Given the legal provision, the new debt that could be assumed will be equal to the total amount of repayments of government debt in 2022, amounting to BGN 3.0 billion, incl. BGN 2.4 billion on Eurobonds issued under the GMTN programme of Republic of Bulgaria and BGN 304 million on government securities issued on the domestic market. The rest of the total amount of debt repayments represents government loans amortizations.

The concentration of issuance activity in the third quarter of 2021, during which nearly two thirds of the required debt financing through government securities was executed, contributed to the increase in the cost of debt financing. As a result of that and due to the strong volatility in international markets, government debt yields returned to positive levels. Increased funding volumes over the next three years imply limiting the capacity of the internal market to absorb the full amount of debt financing, which will lead to the need to be supplemented by borrowing from the external markets in the medium term.

In the period 2022 - 2024, the debt financing of the state budget is planned to be secured mainly through the issue of government securities, both on the domestic debt market and on international markets, assuming acceptable limits and elements of tolerance with regard to risk profile. Determining the structure of newly incurred debt is expected to be in line with prevailing market conditions and the investment base, taking into account the possibilities for reducing the refinancing risk of the government debt and minimizing liquidity risks to the state budget.

In addition to the market-oriented financing of the state budget, it is envisaged to provide legal basis for the possibility of taking on new external government debt through loans under EU financial instruments and/or from international financial institutions. A conservative approach will continue to be applied to the financing of investment projects and specific programs with government and government guaranteed loans.

Within the period 2022 - 2024, it is envisaged the possibility to assuming new government debt in the range of BGN 7.3 billion - BGN 9.1 billion per year, and the amount of outstanding debt for refinancing to amount to BGN 3.0 billion - BGN 3.5 billion per year.

**Table 1: Debt and interest service cost - key parameters**

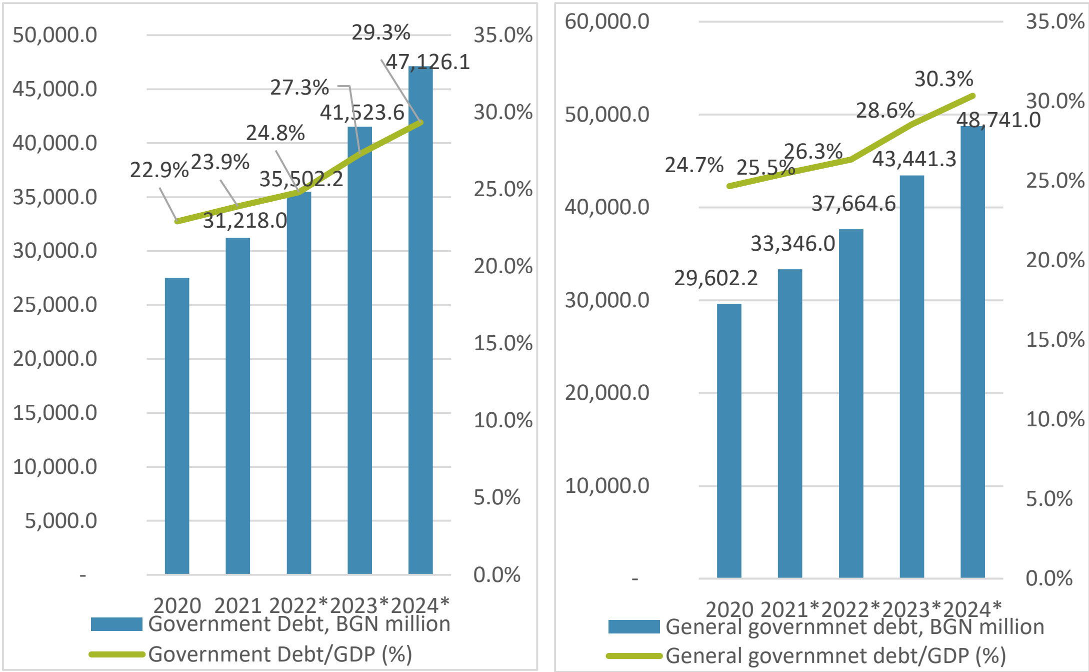
| Indicator | 2020 г. | 2021 | 2022* | 2023* | 2024* |
|---|---|---|---|---|---|
| | report | report | project | forecast | forecast |
| **Government Debt** | | | | | |
| Government Debt, BGN million | 27,504.8 | 31,218.0 | 35,502.2 | 41,523.6 | 47,126.1 |
| Government Debt/GDP (%) | 22.9% | 23.9% | 24.8% | 27.3% | 29.3% |
| **Government guaranteed debt** | | | | | |
| Government guaranteed debt, BGN million | 1,743.2 | 1,938.5 | 1,750.1 | 1,545.0 | 1,289.1 |
| Government guaranteed debt/GDP ( %) | 1.5% | 1.5% | 1.2% | 1.0% | 0.8% |
| **General governmnet debt** | | | | | |
| General governmnet debt, BGN million | 29,602.2 | 33,346.0 | 37,664.6 | 43,441.3 | 48,741.0 |
| General governmnet debt/GDP (%) | 24.7% | 25.5% | 26.3% | 28.6% | 30.3% |
| **Governmnent debt service cost** | | | | | |
| Interest expenditure, BGN million | 584.3 | 590.8 | 629.8 | 784.3 | 1,002.5 |
| Interest expenditure/GDP (%) | 0.5% | 0.5% | 0.4% | 0.5% | 0.6% |
| **GDP*, BGN million** | 119,951.1 | 130,614.2 | 143,024.1 | 152,152.6 | 160,640.4 |

* according to the forecast of the Ministry of Finance

Source: Ministry of Finance

In 2021, government debt to GDP ratio reached a level of 23.9% (compared to 22.9% in 2020). In the period 2022 - 2024, based on assumptions and estimations of new debt financing, the nominal amount of government debt and its ratio to projected GDP will continue to increase from 24.8% at the end of 2022 (BGN 35.5 billion) to 29.3% in 2024 (BGN 47.1 billion).

**Fig. 1: Government debt and general government debt for the period 2020-2024**




* according to the forecast of the Ministry of Finance

Source: Ministry of Finance

Dynamics of ratios of the currency and interest rate debt structure in 2022 – 2024 will continue to change into the direction of reducing the share of debt denominated in currencies other than BGN and EUR (JPY) from 0.2% to 0.1% and the portion of liabilities with floating interest rate - in the range between 0.9% and 0.3%. In fact, at the end of the period about 99.9% of the debt liabilities will be denominated in EUR and BGN (respectively 66.3% in EUR and 33.6% in BGN), and with fixed interest rates about 99.7%, with reciprocal reduction of those in other currencies (JPY) and with floating interest rates.

Despite the emerging prospects for the rate of change in government debt and the risks associated with issuing on new government debt, the ratio of interest expenditures to projected GDP over the three-year period will remain below 1.0%, thus avoiding additional burdens on the state budget.

Regarding the government guaranteed debt/GDP ratio as of 31st December 2021 is expected to remain at the level of this indicator from 2020 at 1.5%, and to decrease in each of the years in the period 2022-2024 until level of 0.8% at the end of 2024.

At the end of 2021, the General Government Debt/GDP ratio is expected to increase to 25.5% (from 24.7% at the end of 2020), as in a three-year period outlook it will continue to increase, reaching a level around 30.3% at the end of 2024. Despite these developments, the projected values of the indicator remain below the maximum admissible reference threshold of the Maastricht convergence criterion of 60 %.

# 2. GOVERNMENT AND GOVERNMENT GUARANTEED DEBT

## 2.1 Government debt

At the end of 2021, the nominal amount of government debt marks a significant increase to BGN 31.2 billion, compared to the level of BGN 27.5 billion reported as of 31 December 2020. The value is below the debt ceiling for maximum amount of government debt at the end of year of BGN 31.9 billion provided in the State Budget Act of Republic of Bulgaria for 2021[1], and the total debt burden relative to GDP reaches 23.9% (compared to 22.9% as of 31.12.2020). The highest contribution to the formed nominal increase of the debt has the new domestic and external financing received during the year, which exceeds the amount of the repayments made. The corresponding share of external and domestic government debt as of 31 December 2021 is 72.3% and 27.7% (compared to 79.5% and 20.5% in 2020).

One of the pre-set goals of the borrowing policy in 2021 was to provide market-oriented financing by pursuing a flexible and active issuance policy and diversification of domestic and external debt sources. In order to achieve this goal, the policy of priority raising of the necessary debt financing for the budgetary purposes continued through the active participation of the state as an issuer of government securities, mainly in the domestic market and strengthening the role of government securities as the main instrument for financing of the state needs of borrowing.

In 2021, within the ceiling for maximum amount of new government debt which can be assumed up to BGN 4.5 billion set out in the State Budget Act for 2021, government securities were issued on the domestic market with a total nominal amount of BGN 3.8 billion (including, issues with maturities of 3 years and 6 months, 5 years, 7 years and 6 months, and 10 years and 6 months, denominated in BGN), providing good investment opportunities to a wide range of participants in the domestic sovereign debt market.

An auction was held for the issue with a maturity of 3 years and 6 months in November, at which government securities with a nominal value of BGN 500 million were placed, with a weighted average yield of 0.13 %.

The total realized volume of the 5-year government securities issue from the five auctions held until the beginning of November 2021 reached BGN 1.7 billion, with a weighted average yield of 0.02 %.

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[1] with the adopted by the 46$^{th}$ National Assembly Law of Amendments and Supplementations of the State Budget Act for 2021 no changes were made regarding the debt ceilings and the government debt;

The issue with a maturity of 7 years and 6 months was placed at the last auction for 2021, held at the end of November. Government securities worth BGN 500 million were sold at the auction, with a weighted average yield of 0.49 %.

The issue with maturity of 10 years and 6 months (reference for the convergence indicator and one of the Maastricht criteria) was placed in three auctions by the end of October 2021, with a total issued volume of government securities amounting to BGN 1.1 billion, with achieved weighted average yield for the entire issued volume of 0.34 %.

The rest of the debt financing received in 2021 represents the disbursement of the loan[2] provided under European instrument for temporary support to mitigate unemployment risks in an emergencies (SURE) following the COVID-19 outbreak (OB, L 159/1 of 20 May 2020), amounting to EUR 511.0 million or BGN 999.4 million.

As a result of the debt issued during the year, the average residual maturity of government debt at the end of 31 December 2021 is decreased by nearly 10 months, comparing with the level reported in 2020 and reaches about 8 years and 2 months.

For debt instruments with fixed interest rate coupons are reported an increase to 98.7% in 2021 (from 98.1% as of 31.12.2020) corresponding to a decrease in debt instruments with floating interest rates (from 1.9% at the end in 2020 to 1.3% at the end of 2021). In the currency structure, the predominant share of liabilities denominated in EUR and BGN remains with a total combined share of 99.8% (compared to 99.7% at the end of 2020), while those in other currencies decrease to 0.2 % (against 0.3% at the end of 2020).

In the tenor structure of the debt (by residual maturity) at the end of 2021 the dominant position is occupied by debt with maturity of 1 year to 5 years - 33.5%, although it decreased compared to the level of 39.2% in 2020. Next one is the segment from 5 to 10 years, which increased to 33.1%, compared to 31.2% at the end of the previous year. Significant increase is also observed in the debt with residual maturity up to 1 year - from 3% as of 31.12.2020 to 8.9% as of 31.12.2021, influenced by upcoming maturity of Eurobonds in 2022, issued on the ICM under GMTN programme. In the share of debt with residual maturity of over 10 years, the opposite trend is observed - it decreased to 24.5% in 2021 from 26.6% at the end of the previous year.

[2] The Loan Agreement between the European Union as a lender and Republic of Bulgaria as a borrower, signed by the European Commission on 11 December 2020 and by Republic of Bulgaria on 26 November 2020 and ratified by law by the National Assembly on 22 December 2020, promulgated, SG No. 109/22.12.2020

## Table 2: Key indicators of government debt

| Indicator | 31.12.2020 r. | 31.12.2021 r. |
|---|---|---|
| | report | report |
| **Total government Debt, BGN million** | 27,504.8 | 31,218.0 |
| GDP*, BGN million | 119,951.1 | 130,614.2 |
| **Total government Debt /GDP, (%)** | 22.9% | 23.9% |
| Domestic government debt, BGN million | 5,643.6 | 8,637.1 |
| External government debt, BGN million | 21,861.1 | 22,580.9 |
| Domestic government debt/Total government debt (%) | 20.5% | 27.7% |
| External government debt/Total government debt (%) | 79.5% | 72.3% |
| **Interest rate structure of the governmnet debt** | | |
| Fixed rate debt, BGN million | 26,973.9 | 30,810.7 |
| Floating rate debt, BGN million | 530.9 | 407.3 |
| Fixed rate debt (%) | 98.1% | 98.7% |
| Floating rate debt (%) | 1.9% | 1.3% |
| **Currency structure of the governmnet debt** | | |
| Debt in EUR, BGN million | 22,517.3 | 22,966.1 |
| Debt in BGN, BGN million | 4,902.2 | 8,179.3 |
| Debt in USD, BGN million | - | - |
| Debt in other currency, BGN million | 85.3 | 72.6 |
| Debt in EUR (%) | 81.9% | 73.6% |
| Debt in BGN (%) | 17.8% | 26.2% |
| Debt in USD (%) | 0.0% | 0.0% |
| Debt in other currency (%) | 0.3% | 0.2% |
| **Maturity structure of the governmnet debt (by residual term)** | | |
| Debt up to 1 year, incl., BGN million. | 818.4 | 2,771.5 |
| Debt from 1 year to 5 years, incl., BGN million | 10,785.0 | 10,476.3 |
| Debt from 5 year to 10 years, incl., BGN million | 8,571.3 | 10,324.1 |
| Debt of more than 10 years, incl., BGN million | 7,330.1 | 7,646.1 |
| Debt up to 1 year, incl. (%) | 3.0% | 8.9% |
| Debt from 1 year to 5 years (%) | 39.2% | 33.5% |
| Debt from 5 year to 10 years (%) | 31.2% | 33.1% |
| Debt of more than 10 years, incl. (%) | 26.6% | 24.5% |
| **Average residual maturity of government debt (years)** | 9 y. | 8 y. and 2 months |

* GDP: Macroeconomic forecast of the Ministry of Finance, part of the Updated Medium-Term Budget Forecast (UMTBF) for the period 2022 - 2024.

Source: Ministry of Finance

## 2.2 Government guaranteed debt

By the end of 2021, the nominal amount of government guaranteed debt (GGD) increased to the level of BGN 1.9 billion (compared to BGN 1.7 billion at the end of 2020), as a result of the issued state guarantees under EU instruments. In 2021 government guaranteed debt remains at the level of 2020 as a percentage of GDP, i.e. 1.5%.

Most of the GGD is formed by external government guaranteed loans, provided mainly by official creditors such as IBRD, EIB, EC, EBRD, CEB, JBIC, KfW and others. The domestic GGD consists of government guarantees issued by the virtue of the Student and Doctoral-Candidate Loans Act, which as of 31 December 2021 has an insignificant share of about 3.5% of the total amount of GGD.

**Table 3: Size and dynamics of government guaranteed debt**

| Government Guaranteed Debt, BGN million | 31.12.2020 г. | 31.12.2021 г. |
|---|---|---|
| | report | report |
| Domestic government guaranteed debt | 72.4 | 67.1 |
| 1. Guarantees under Student and Doctoral-Candidate Loans Act | 72.4 | 67.1 |
| External government guaranteed debt | 1,670.9 | 1,871.3 |
| 1.IBRD /World Bank/ | 586.7 | 586.7 |
| 2.EIB | 63.6 | 181.3 |
| 3.EBRD | 586.7 | 586.7 |
| 4. Others (EUROATOM, JBIC, CEB, ect.) | 433.7 | 516.5 |
| **Total government guaranteed debt** | 1,743.2 | 1,938.5 |
| **Government guaranteed debt/GDP (%)** | 1.5% | 1.5% |

Source: Ministry of Finance

# 3. ECONOMIC PROSPECTS FOR THE PERIOD 2022-2024

## 3.1 Development of the national economy in 2021

2021 saw a recovery of the global economy from the crisis caused by the COVID-19 pandemic. It progressed differently in diverse economic sectors. The intensification of the vaccination process has resulted in the easing of second-quarter restrictions in many developed countries and a significant increase in GDP. At the same time, supply remained lower than demand, problems in production and supply chains exacerbated, there was a significant rise in raw material prices, which gradually shifted to end-user prices.

Bulgaria's GDP growth for 2021 is projected to be 3.7%. Household consumption growth will slow in the fourth quarter due to the worsening pandemic in the country, which began in September 2021, and fixed capital investment is expected to decline throughout the year. The contribution of net exports to GDP growth will be less negative than in 2020. Both exports and imports of goods are projected to recover to their 2019 levels.

The estimate for the number of employees in the economy is to remain almost at the level of 2020 (minimum increase of 0.1%). The average annual unemployment rate is estimated at 5.4%, and the economic activity rate of the population will remain almost the same as in 2020 at 55.4%. For 2021, the nominal growth of compensation per employee is estimated at 8.9 %.

In line with expectations for higher prices for oil and non-energy commodities in 2021, inflation in Bulgaria is expected to reach 6.7% at the end of the year and its annual average to be 2.9%.

The trade deficit is expected to be 4.2% of GDP in 2021, which will be a major factor in forming a negative current account balance of 1% of GDP. In services, given the significant decline in 2020, there will be a significant increase in both exports and imports, especially in transport services and travels. The surplus of the services item is projected to increase to 6% of GDP.

In 2021, the growth of corporate credit will accelerate in line with expectations of improved economic activity, but growth will be limited by the emerging weak investment activity in the private sector. For households, the forecasted higher demand for credit is supported by the development of consumption, construction and the housing market. The annual increase in borrowings by enterprises is forecasted at around 4.2% and the borrowings by households – 12.6 %.

## 3.2 Expectations for economic development in 2022-2024

GDP growth will accelerate to 4.8% in 2022, driven by investment. Public investment will be supported by the National Recovery and Resilience Plan (NRRP). Private co-financing under the NRRP will also stimulate private investment. It will also increase due to improved expectations related to reduced uncertainty among economic agents and increased demand. In line with the expected more moderate growth rates of international trade and economic activity in our main trading partners, the growth of exports of goods will slow down compared to the previous year. The dynamics of imports of goods and services will be determined on the one hand by the more limited growth of demand for raw materials from export-oriented industries, along with more moderate growth in consumption, and on the other - by the significant increase in investment. The negative contribution of net exports to GDP growth will remain almost unchanged. In 2023 and 2024, economic growth will slow to 3.7% and 3.4%, respectively. Household consumption will grow supported by declining unemployment, steady growth in income and credit. Exports will have a lower contribution to real GDP growth in both years due to the slowdown in external demand. The contribution of net exports to GDP growth will remain negative.

For 2022, a relatively high growth in the number of employees of 1% is forecasted, which will be determined simultaneously by the improvement of the pandemic situation in the world and in particular in Bulgaria, as well as the positive effect of the first financial flows under the NRRP. As a result of the positive dynamics of employment, the unemployment rate for 2022 is expected to decrease to 5% and the economic activity of the population to increase to 56.2%. In the period 2023-2024, employment growth will remain high (in the range of 0.8% - 1.2%), and the unemployment rate will continue its downward trend, expected to reach an annual average of 4.3 % in 2024.

The average annual increase in the HICP in 2022 is forecasted to be 5.6%, and inflation at the end of the year will slow to 3.1%. In line with market expectations, the international price of Brent oil is expected to fall by slightly over 12% by the end of 2022, which will lead to cheaper transport fuels for the period. The contribution of core inflation will increase both due to the increase in domestic demand and due to the secondary effects of rising energy prices. In 2023 and 2024, energy goods will have a negative contribution due to the expected downward dynamics of international prices. Core inflation will have a leading contribution to headline inflation in the country, but it will narrow toward the end of the forecast period. The average annual inflation rate will be 2.7% in 2023 and 2.2% in 2024.

In 2022, the expected continued rise in prices of most internationally traded goods will support the maintenance of double-digit nominal growth in trade in goods, despite more moderate increases in traded quantities. Supported by higher investment activity, import will continue to outpace export, which will contribute to an increase in the trade deficit to 6.2% of GDP. During the year, the growth of tourist receipts will accelerate, which will be at the heart of the increase -in the surplus of trade with services (6.9% of GDP). The current account deficit will remain almost unchanged (1.3% of GDP).

In the period 2023-2024, the nominal growth of imports of goods will continue to outpace that of exports and contribute to the growth of the trade deficit. The current account deficit will increase in relation to GDP to 1.9% and 2.5%, in 2023 and 2024, respectively.

In 2022, the growth of credit to households is forecasted to slow down to 9.4%, reflecting the end of the private moratorium, expectations for cooling in the housing market along with slower growth of compensation of employees and consumer expenses. In the period 2023-2024, credit to households will continue to grow at a relatively high but slowing pace. Credit to non-financial corporations will accelerate in 2022 and 2023 in line with the recovery of private investment, also supported by the NRRP. Total claims on the private sector in 2022 will increase by 6.6% yoy, and in 2023 - by 6.8% yoy.

## 3.3 Risks to the macroeconomic forecast

The presented forecast depends on the development of the pandemic situation both in the country and in the world. The realization of the forecast is highly dependent on the emergence and spread of new variants of the virus and the extent to which the health situation, respectively measures to tackle the pandemic are affecting the economy. With the imposition of strict and lasting measures against the spread of COVID-19, it is possible to observe weaker-than-expected economic activity in the first half of 2022. Different than expected dynamics of stabilization of the health situation may lead to significant deviations in the forecast for the whole forecast horizon.

Continuation of supply chain problems in 2022 may be reflected in the postponement of orders for future periods or even in a permanent decline in external demand. This will have a negative impact mainly on export-oriented industries.

The risks to the inflation forecast in 2022 are mainly on the upside and are related to stronger than-expected price increases of all major commodity groups.

Rising inflation, which will limit real income growth, may lead to a larger-than-expected slowdown in household consumption growth in 2022. High uncertainty could also delay the recovery of private investment. A risk in the period 2022 - 2024 is also the realization of investments under the NRRP projects and the projects financed under the Multiannual Financial Framework of the EU. Delays in the start of NRRP projects would have a negative impact on GDP growth in 2022.

# 4. ANALYSIS OF THE RISKS RELATED TO THE GOVERNMENT DEBT STRUCTURE FOR THE PERIOD 2022 - 2024

Degree of influence of particular risks on the profile and parameters of the government debt was assessed through performed risk analysis. The results of the analysis, reviewed below, reflect the effects on the characteristics of government debt for assuming new debt financing, provided for in the draft of the State Budget Act for 2022 and the updated medium-term budget forecast (UMTBF) for the period 2022 - 2024. The dynamics of the observed indicators is predetermined by the main fiscal parameters and indicators of the state budget framework, as well as the impact of current macroeconomic forecasts. The assessment of the change in the debt indicators is a kind of a guide in determining the limits of the permissible debt exposure and aims to minimize the risks generated by the debt structure.

**Table 4: Risk assessment indicators**

| Risk | Indicator | 2020 r. - report | 2021 r. - report | 2022 r.- project | 2023r.- forecast* | 2024 r. - forecast* |
|---|---|---|---|---|---|---|
| Refinancing risk | Debt up to 1 year (by residual maturity as a share of government debt, %) | 3.0% | 8.9% | 7.9% | 8.0% | 5.5% |
| | Average time to maturity (ATM) - (years) | 8.6 | 8.0 | 8.6 | 9.7 | 10.2 |
| Interest rate risk | Ratio between fixed interest rate debt and floating interest rate debt (%) | 98,1% / 1,9% | 98,7% / 1,3% | 99,1% / 0,9% | 99,5% / 0,5% | 99,7% / 0,3% |
| | Average time to refixing (ATR ) - (years) | 8.6 | 8.0 | 8.6 | 9.7 | 10.3 |
| | Duration - (years) | 7.6 | 7.3 | 7.7 | 8.5 | 8.9 |
| Currency risk | Ratio between external and domestic government debt (%) | 79,5% / 20,5% | 72,3% / 27,7% | 68,1% / 31,9% | 66,3% / 33,7% | 65,4% / 34,6% |
| | 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) | 99,7% / 0,3% | 99,8% / 0,2% | 99,8% / 0,2% | 99,8% / 0,2% | 99,9% / 0,1% |
| Liquidity risk | Ratio between debt up to 1 year (at residual maturity) and tax and social security revenues (%) | 2.3% | 7.0% | 6.2% | 7.0% | 5.2% |
| Risk related to the debt size | Ratio between General government debt and GDP (%) | 24.7% | 25.5% | 26.3% | 28.6% | 30.3% |
| | Ratio between Government debt and GDP (%) | 22.9% | 23.9% | 24.8% | 27.3% | 29.3% |
| Risk related to governmnet guarantees | Ratio between government guaranteed debt and government debt (%) | 6.3% | 6.2% | 4.9% | 3.7% | 2.7% |
| | Ratio between government guaranteed debt and GDP (%) | 1.5% | 1.5% | 1.2% | 1.0% | 0.8% |
| 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: * Data are estimates. The assumptions for new debt financing set in the preparation of the estimates under the draft of the State Budget Act for 2022 and the draft of the UMTBF 2022-2024 have been taken into account.*

Source: Ministry of Finance

## 4.1 Refinancing risk

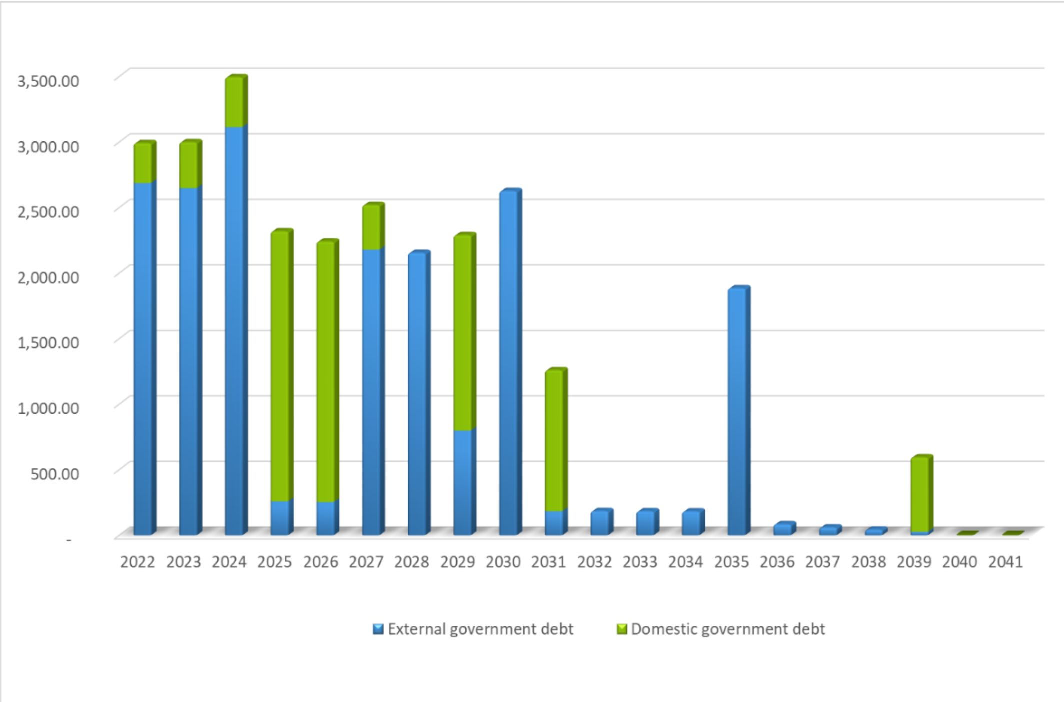
Degree of influence of the refinancing risk is a function of the time distribution and the amount of upcoming debt payments, in direct dependence both on the possibilities to accumulate the necessary funds to cover them and on the cost of financing.

During the three-year period 2022 - 2024, the amortization profile of the government debt is characterized by upcoming maturities of bonds issued on the ICM, mainly placed as part of the established Global Programme for Issuance of Debt on the ICM[3]. During this period the amount of forthcoming redemption of Eurobonds is in the range of BGN 2.4 billion - BGN 2.9 billion per year, and the total aggregate volume of government debt repayments in the range between BGN 3.0 billion and BGN 3.5 billion per year, respectively**.**

The presence of large volume of forthcoming maturities in the debt structure is the main factor for the formulation of the borrowing strategy to obtain the necessary financial resources to refinance the debt outstanding. On this basis, the predominant part of the necessary debt resources is planned to be provided through market-oriented tradable instruments, both on the domestic and international capital markets, positioned in different maturity segments, incl. diversification of the offered instruments taking into account the accompanying risks. An important priority complementing these measures is to prevent further concentration of payments in years with large debt repayment.

**Fig. 2: Redemption profile of government debt ***

( BGN, mln.)




* On active debt assumed as of 31 December 2021 Source: Ministry of Finance

[3] At present, the debt portfolio of Republic of Bulgaria has eight Eurobond issues placed on the ICM - seven under the GMTN program maturing in 2022, 2023, 2027, 2028, 2030, 2035 and 2050, as well as one with separate documentation maturing in 2024.

With the approach of the forthcoming redemption of Eurobond issues the share of government debt with a residual maturity of up to 1 year to the total amount of government debt outstanding increases to 8.9% in 2021, and in the period 2022 - 2024 decreases, as ranging between 8.0% and 5.5 %.

The forecasted values of the Average time to maturity (ATM) parameter show an extension of its value from 8 years in 2021 to about 10 years at the end of 2024. These expectations are also based on the remaining term to maturity and the size of debt amortization payments. Debt maturity extension helps to limit and reduce the impact of refinancing risk.

## 4.2 Market risk

Instruments denominated in risk-neutral currencies (EUR and BGN) and those with fixed interest rates represent the dominant part in the debt portfolio during the entire reviewed period. The analytical forecasted data show that the share of denominated in currencies other than the EUR and the BGN debt decreased from 0.2% at the end of 2021 to 0.1% at the end of 2024. In parallel, the share of debt with fixed interest rates increases to 99.7% at the end of 2024 (from 98.7% as of 31.12.2021). Respectively, the ratios of debt in BGN and EUR and that with floating interest rate as of 31.12.2024 represent 99.9% and 0.3% (compared to 99.8% and 1.3% at the end of 2021).

Given the outlined currency and interest rate debt structure, in the scenario of possible rapid changes in the levels of exchange rates and interest rates, both the nominal value of debt and the planned financial resource for its servicing would not change, i.e. no serious dependence of the debt portfolio on the impact of market risks is indicated. At the same time, this provides better predictability in terms of the cost of servicing government debt and relieves pressure on the state budget**.**

During the period 2021 - 2024 the value of the Average time to refixing (ATR) indicator increases by about two years, and at the end of the forecast period 2024 its level registers a value of about 10 years. Expectations of higher ATR values show a neutrality of a large part of the debt regarding the change in interest rate coupons in the short term and implies lower risk vulnerability.

## 4.3 Liquidity risk

Liquidity risk is associated with the likelihood of liquidity difficulties for the state budget in meeting short-term government obligations. During the period of the strategy among the factors influencing it are the uncertainty related to the spread of COVID-19, the degree of recovery of economic activity in Europe and the world, as well as the main risks to the development of the Bulgarian economy. Taking into account these developments, and in order to achieve the set goals of debt management in the medium term, it is necessary to coordinate them with the general fiscal goals of the government. As a result, the main focus of debt management is on securing the funds in volumes needed to refinance maturing debt and finance planned state budget deficits.

In the "debt up to 1 year/tax-insurance income" ratio, a measure of liquidity risk, no significant fluctuations are expected in the medium term. In the period 2021 - 2024 the indicator decreases, moving in the range between 7.0% - 5.2%. The indicator is mainly influenced by the forthcoming of Eurobonds repayments.

## 4.4 Risk related to debt size

Long-standing fiscal discipline and the low debt burden of our country in the EU represent a good starting point and provide fiscal space in the future. As a result of the identified need for the period 2022 - 2024 to obtain significant financing from debt sources, the size of debt follows a steady upward trend, both in nominal terms and as a ratio to GDP.

The general government debt, relative to GDP, is projected to increase to 25.5% in 2021 (from 24.7% at the end of 2020). Preliminary expectations indicate that the value of the indicator will continue to increase in each year of the period 2022-2024, reaching 26.3%[4] in 2022, 28.6%[3] in 2023 and 30.3%[3] in 2024, respectively. Preliminary values of the change of the parameter remain well below the 60% debt rule, due to which the risks to debt sustainability remain low.

The growth rate of consolidated liabilities is mainly influenced by the rate of change in government debt, the debt component of the sector with the highest share, which is experiencing similar growth. In the period under review the government debt-to-GDP ratio reaches from 24.8% in 2022 to 29.3% at the end of 2024. Over the next three years, the impact of the other two subsectors, Local Government and Social Security Funds, remained with neutral effect on the General Government debt.

[4] Compared to the forecast level of GDP according to the macroeconomic forecast of the Ministry of Finance, part of the Updated Medium-Term Budget Forecast for the period 2022 - 2024.

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

Estimates show low levels of key indicators that measure the impact of government guarantee risk. Positive effects are expected both in terms of the ratio of government guaranteed debt to total government debt and relative to GDP.

The relative share of government guarantees in the total amount of government debt is 6.2% at the end of 2021, and over the next three years it is projected to gradually decrease from 4.9% in 2022 to 2.7 % at the end of 2024.

At the end of 2021, the GGD (Government Guaranteed Debt) in nominal value slightly increased to BGN 1.9 billion compared to the level of BGN 1.7 billion reported in the previous year, and stabilized within 1.5 % of GDP. In 2022-2024, the GGD gradually decreases to BGN 1.3 billion at the end of 2024 or below 1% of GDP (0.8% in 2024). The approach of issuing new government guarantees will remain strictly regulated, subject to regulatory rules and criteria, and will be linked to risk assessment to the state budget.

When assessing the future impact of the risk and in order to prevent potential negative effects from it, the need to take on new government guarantees to support priority areas will be taken into account, incl. such one arising from the international obligations of Republic of Bulgaria and initiatives taken within the European Union, as well as the potential opportunities for realizing the risk of activation of already issued government guarantees. The established practice within the annual State Budget Act to set ceilings on the maximum amount of new government guarantees that can be issued in the respective year and to plan funds to cover the risk of government guarantees being called is maintained. This approach is a prevention against possible liquidity difficulties for the state budget in the implementation of a scenario for materialization of contingent liabilities. At present, the obligations secured by government guarantees are serviced regularly and in accordance with the signed agreements, and the funds to cover the risk of government guarantees being called provided in the state budget have not been used.

## 4.6 Operational risk

Minimising the operational risk is closely related to the form of organising the government debt management activities. At present, they are structured within one administrative unit in compliance with widely applicable principles and sound practices to implement monitoring and control systems. In accordance with the developed rules and internal working procedures within the debt management unit, the responsibilities of the employees are clearly systematized, which in the future ensures minimizing the impact of operational risk. Compliance with and application of these legal provisions and regulated requirements improve the risk profile. Through continuous maintenance and improvement of the functional capabilities of the designed information system for analysis, forecasting and management of government debt (official register of government and government guaranteed debt under Article 38 of the Government Debt Act), automating data processing processes related to government debt management, the quality, reliability and authenticity of the generated information are guaranteed. Strict adherence to the rules and procedures established in this area will continue to have a positive effect on the risk profile.

# 5. GOALS OF GOVERNMENT DEBT MANAGEMENT POLICY

**The main goal of the debt management is to provide the necessary resources to refinancing the debt outstanding and finance the planned state budget deficit**

## 5.1 Sub-objective: Maintaining sustainable government debt parameters

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

Focus of Government debt management policy for the period 2022 - 2024 will be mainly timely provision of necessary resources for financing the state budget, as well as for covering the significant amounts of debt outstanding. Issuing of new government debt will be carried out in compliance with the already established practices and statutory procedures. The set annual ceilings for the maximum amount of new debt which can be assumed during the year, regulated by the annual State Budget Act, reflects the issuer's commitments regarding the volume and possible sources of new debt financing.

Selection of new borrowings and the identification of sources of financing will be accompanied by an analysis of the prevailing market conditions and the cost of financing, as well as an assessment of opportunities provided by borrowing through EU instruments and/or international financial institutions. This approach ensures optimal selection in providing the necessary funds from debt sources, minimizing liquidity risks in the implementation of the state budget and refinancing risk while maintaining the stability of key debt parameters.

In order to ensure stability and predictability of government debt service costs, the trend of assuming debt denominated in BGN and EUR and at fixed interest rate will be maintained, without excluding other possible alternatives.

In the coming years, the policy on issuing new government guarantees and on financing investment projects with government loans will be restrictive, strictly regulated, subject to the regulatory defined criteria and linked to the risks to the state budget.

- **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**

Increased needs for securing new debt financing in large volumes, directly related to the conducted budget policy and the need for funds to finance government needs, incl. of measures to overcome the consequences of the ongoing COVID-19 pandemic are a determining factor in the dynamics of the level of government debt in the coming years. Significant volume of debt financing planned on this basis will have an impact on debt growth in the medium term. This, in turn, requires efforts to focus on continuous ongoing monitoring of the size and profile of debt in order to prevent deterioration of its parameters and resilience, while ensuring compliance with statutory debt limits. However, despite the expected increase in debt, the level of consolidated liabilities is expected to remain below the maximum allowable reference value of the Maastricht debt criterion of 60%. The limits set in the annual State Budget Acts for maximum values of government debt at the end of the year, the maximum amount of new government debt that can be assumed within the year and the new government guarantees that may be issued during the budget year will further contribute to achieve these goals.

## 5.2 Sub- objective: Provision of opportunities for market-oriented debt financing, ensuring the state budget sustainability

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

In the period 2022 - 2024, the issuance policy will continue to be flexible, incl. by diversifying the instruments offered and aimed at ensuring access to debt markets for raising necessary debt recourses.

As a result of the negative impact of the COVID-19 pandemic on the economic and social sphere and in compliance with debt restrictions provided in the annual State Budget Act to assume new government debt, mainly in order to refinance the debt outstanding and provide financial resources to cover the planned state budget deficits it is envisaged to use both government securities issues on the domestic market and bonds on the ICM, which represent an objective and internationally tradable benchmark for assessing the country. The high levels of liquidity of market participants and access to a wide range of investors with a strong interest in acquiring Bulgarian sovereign debt make market-oriented financing an effective and main source of debt financing for the state budget. In view of the effective current management of the budget cash flows and the liquidity of the public finances, the possibility of offering short-term government securities, issued and maturing within the respective budget year and not burdening the government debt payments in the following years is preserved.

The determination of new issues' parameters will be based on the repayment profile of the government debt, the prevailing market conditions and the investor's demand. Standardized debt instruments at a fixed interest rate, in BGN and EUR, will be offered as major borrowing currencies.

- **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 Programme of Republic of Bulgaria for Issuance of Bonds on the ICM was established in early 2015 with dealership agreement, agency agreement and deed of acceptance of obligations ratified by the National Assembly by law (SG, issue 16 of 2015) and promulgated in SG, issue 25 of 2015. It is a standardized instrument for the international investment community for issuing of bonds subject to English law listed on the Luxembourg Stock Exchange, with clearing and settlement in Euroclear and Clearstream. The state has the opportunity to place bonds on both the European and American markets through the established programme, and to use different alternatives in the choice of instruments, currencies, maturities, public or private placement and a suitable time period for entering foreign markets.

The maximum aggregate nominal volume of bonds that can be issued under the medium-term debt issuance programme of the ICM (programme limit) was increased from EUR 8 billion to EUR 10 billion with the update of the State Budget Act of Republic of Bulgaria for 2020.

By the beginning of October 2021, Eurobonds with a total nominal volume of 7.644 billion euros had been issued under the programme, or the remainder under the programme amounts to EUR 2.356 million. In view of the expectations for increased debt financing in the period 2022-2024 and in view of the flexibility in choosing a financing instrument, it is necessary to update the maximum total nominal volume of bonds (from EUR 10 billion to EUR 12 billion) that can be issued in implementation of the medium-term programme. The specific limit for issuing bonds under the medium-term programme for each year will be within the debt limits provided in the respective annual State Budget Act. The maximum maturity of the securities that can be taken on under the programme is 30 years, and in September 2020 for the first time an issue with such maturity was successfully launched in extremely favourable conditions for the issuer. The results of the transaction as a ratio of coverage and profitability definitely strengthened the position of Republic of Bulgaria on the ICM as a stable issuer with sustainable macroeconomic foundations.

Specific maturity and volume of each tranche are determined throughout the so-called marketing process when the issuer presents itself to the respective investment community and complies with the repayment profile of government debt. The existence of a legal framework for issuing a series of tranches on the ICM provides an opportunity for flexibility in choosing the optimal strategy to implement the issuance policy and more effective management of the risk profile of government debt.

## 5.3 Sub-objective: Developing the government securities market

### ▪ Measure: Taking steps to expand the scope of monitoring the secondary government securities market and introducing the market-making system

At the beginning of 2021, the Committee of Primary Dealers (PD) of Government Securities (the Committee) was established between the Minister of Finance and the PD of Government Securities, following the established practice in the Member States (MS) of the European Union (EU). The Committee has advisory functions and serves for mutual exchange of information and recommendations between the issuer and the PD of government securities. At the end of 2021, by Order No. 1358 of 31.12.2021, the Criteria for selection of government securities PD were approved, adding qualitative criteria which include determination of obligations for government securities quotations by PD (market-makers) at the relevant trading venues, in order to synchronize with established good practices in all EU MS. In addition, from the beginning of 2022, a technical method to automate the process of reporting data on market-making is used.

At the end of February 2021, the actual activity of the process to build an integrated information system - "System for monitoring, analysis, registration and trading of government securities" (SMART) has begun and during the year three of the modules were completed - "Applied Administration", "Input data" and "Register of short sales", and by the end of 2022 the other two modules "Static information" and "Dynamic information" will be developed.

In parallel, the MoF has taken a legislative initiative to ensure the process of information provision by the Financial Supervision Commission to the MoF with a view to implement Regulation (EU) No. 236/2012 of the European Parliament and of the Council of 14 March 2012 on short sales and some aspects of credit default swaps, in connection with Art. 17a, para. 1 of the Government Debt Act. Legal changes will be implemented in 2022, and subsequently it is planned to provide an automated exchange of information between the two institutions through building secure mechanisms, provided technologically by the two institutions.

Efforts will continue to take into account national specificities and achievement of positive economic effects in the integration of the internal sovereign debt market into the European single market, including the market infrastructure servicing it, through regulatory and infrastructural changes to promote the participation of foreign investors on the local market of sovereign debt, also in the context of future accession to the Euro Area. ▪

# ABBREVIATIONS AND GLOSSARY

## Abbreviations

| | |
|---|---|
| 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 |
| SBARB | State Budget Act of Republic of Bulgaria |
| GDA | Government Debt Act |
| KfW | Kreditanstalt für Wiederaufbau (KfW) |
| 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 forecast |
| BDGF | Bank Deposit Guarantee Fund |
| JBIC | Japan Bank for International Cooperation |
| GMTN | Global Medium Term Notes programme |
| OTC | Over-the-counter market |
| SMART | System for monitoring, analysis, registration and trading of government securities |

## Glossary

**Currency risk** – It refers to the vulnerability of the debt portfolio, amortizations and the cost of servicing it in case of devaluation of the value of the national currency. Changes in exchange rates can have an impact on debt service costs and hence on the state budget. Debt denominated in foreign currency leads to volatility of debt service costs measured in national currency;

**Interest rate risk** – It concerns the vulnerability of the debt portfolio, as well as the cost of government debt at higher market interest rates at a time when variable interest rate debt and maturing fixed interest rate debt are being revalued. Changes in market prices that affect debt service costs may cause deviations from the amount of government debt service costs set in the state budget;

**Market risk** – Risk associated with unexpected changes in the levels of market variables such as exchange rates, interest rates, commodity prices that affect debt service costs.

**Liquidity risk** – It is determined by the need for liquid funds to cover short-term liabilities and takes into account the likelihood of liquidity difficulties for the state budget in meeting these liabilities. It is a type of refinancing risk and is directly related to market risk;

**Refinancing risk -** It is mainly related to the probability of not being able to obtain new financing when the debt reaches maturity (maturing debt cannot be refinanced), or of obtaining new financing only at a very high price. It is measured by the amount of debt to be refinanced over a period of time (usually one year);

**Risk related to the debt size** – Associated with the level of government debt, which in some cases can generate significant threats to the country's financial stability;

**Risk related to contingent liabilities in the form of government guarantees** – Government guarantees have a significant impact on the resilience of government debt. It is related to the danger of realization of the guarantees in time, therefore it is important to take into account the potential risk of their activation;

**Operational risk** – It is primarily identified with the form of organization of activities for management and control of government debt;

**Debt up to 1 year (for the remaining term**) – Part of the debt that will mature within 1 year;

**Average Time to Maturity (ATM)** – Average time to maturity, which is the average weighted amount of repayments according to the time to maturity. It does not take into account interest payments, so it does not provide information on the overall risk of debt service for the state budget;

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

$R_t$: Repayments at the moment t;
t: Period until maturity
Nom: nominal value of the outstanding debt
n: Final maturity of the debt

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

**Average time until the next fixing of the interest rate of the debt portfolio (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 the ratio of the days from the end date of the report to the days of the year in which the payment falls ;

**RV** : Debt with floating interest rates at the moment **$t_0$**;

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

**$t_0$** : time to change interest rates; for debt with a variable interest rate is accepted **$t_0$**=0.5;

**Nom**: nominal debt value o(total amount: fixed interest rate debt and variable interest rate debt);

**n**: last maturity of the debt; maximum term in which the debt for all selected credit instruments is repaid in full;

Risk measurement does not take into account cash flows from interest payments;

**Duration –** It is used as a unit of measure for the average fixed interest rate period, which shows how quickly changes in interest rates will affect debt costs. Short-term means that changes in interest rates will affect the actual cost of debt quickly, while long-term means that interest rates will not change for a long time for much of the debt portfolio.;

**Repayment profile –** Debt repayment profile is a series of amortization payments that arise as a result of unpaid debt;

**Foreign currency debt to total debt ratio** – Indicator contributing to the determination of currency and liquidity risk.