

## FITCH REVISES BULGARIA'S OUTLOOK TO POSITIVE; AFFIRMS IDR AT 'BBB-'

Link to Fitch Ratings' Report: Bulgaria - Rating Action Report  
<https://www.fitchratings.com/site/re/899261>

Fitch Ratings-London-02 June 2017: Fitch Ratings has revised Bulgaria's Outlook to Positive from Stable while affirming the sovereign's Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BBB-'. The issue ratings on Bulgaria's senior unsecured foreign and local currency bonds have also been affirmed at 'BBB-'. The Country Ceiling has been affirmed at 'BBB+'. The Short-Term Foreign and Local Currency IDRs have been affirmed at 'F3'.

### KEY RATING DRIVERS

The revision of the Outlook to Positive reflects the following key rating drivers and their relative weights:-

#### High

-Bulgaria's external metrics have improved markedly. A prolonged and steady deleveraging and positive current account trends helped Bulgaria turn into a small net external creditor to the tune of 1.6% of GDP in 2016. This compares with the 0.5% of GDP median net debtor position of its 'BBB' peers, and demonstrates a strong adjustment from a peak net debtor position of 45.2% in 2009.

-In 2016, Bulgaria recorded a current account surplus of 4.2% of GDP, outperforming the median 1.5% deficit of its 'BBB' peers, and above the five-year average of 0.9% of GDP. Gains in export performance and competitiveness are set to underpin current account surpluses forecast by Fitch at an average of 3% for 2017-2019. The improvement in external finances is bolstered by foreign reserves covering 8.7 months of current external receipts (BBB median 6.6 months), which provide strong support to Bulgaria's long-standing and credible currency board regime.

#### Medium

-Bulgaria's public finances compare favourably with 'BBB' peers. Fitch forecasts a fiscal deficit of 0.6% of GDP in 2017, well below the projected 'BBB' median (2.4% of GDP). Fitch expects public debt will decline to 26.7% of GDP in 2017, below rated peers (40.9% of GDP), due to the repayment of a pre-financed bond. Public debt sustainability is supported by a low share of interest payments to revenue (2.3%, 2016) and a long average residual debt maturity.

-GDP growth has strengthened. After average growth of 1% over 2010-14, real GDP accelerated to 3.5% in 2015-16. Fitch forecasts Bulgaria's economy to grow 3% in 2017-18, in line with the five-year median growth of its 'BBB' peers. Risks to the growth outlook are balanced and highly dependent on both private and public sector investment activity. Higher growth can come from higher-than-forecast public expenditure of EU structural funds and/or a sustained resumption of credit growth. An underperformance of both factors would risk lower economic growth.

-Fitch views the domestic banking sector as a lower probability of risk as a contingent liability on the sovereign's balance sheet, following the results of a sector-wide asset quality review (AQR) published in August 2016. However, shortcomings have been identified in the latest published

IMF Financial Sector Assessment (FSAP), which called for a strengthening of supervision and governance, a more robust financial safety net for times of crisis management, as well as a resolution of the high level of non-performing loans (NPLs) in the sector.

Bulgaria's 'BBB-' IDRs also reflect the following key rating drivers:-

-The appointment of a new government in early May offers economic and fiscal policy continuity. Prime Minister Boyko Borissov of the centre-right GERB party with its junior coalition partner nationalists United Patriots replaces the former GERB-Reformist Bloc cabinet, and will have the task of preparing Bulgaria for its EU Presidency in 2H18. A history of unstable governments means the stability of a GERB-United Patriots coalition is not guaranteed. While there is broad-based political commitment towards pro-EU policies, a changeable political environment can disrupt effective policy-setting - the latest example being related to changes in budgetary measures. World Bank governance indicators are in line with the peer median.

-Bulgaria's GDP per capita is below the median level of 'BBB' peers and higher rated sovereigns. Progress in income convergence will depend on how effective authorities push ahead structural reform, where labour market rigidities remain a key challenge against worsening demographics.

#### SOVEREIGN RATING MODEL (SRM) and QUALITATIVE OVERLAY (QO)

Fitch's proprietary SRM assigns Bulgaria a score equivalent to a rating of 'BBB' on the Long-Term Foreign Currency IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM to arrive at the final the Long-Term Foreign Currency IDR by applying its QO, relative to rated peers, as follows:

-Macroeconomics: -1 notch, to reflect Fitch's view that sustained and higher potential growth is limited by lack of progress on reforms to address the economy's structural bottlenecks.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three year-centred averages, including one year of forecasts, to produce a score equivalent to a the Long-Term Foreign Currency FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

#### RATING SENSITIVITIES

The main factors that could, individually or collectively, could lead to an upgrade are:

- Stronger potential GDP growth and progressive convergence towards peer income levels;
- Higher economic growth without the re-emergence of external imbalances;
- Fiscal stability supporting the sustainability of public debt.

The Rating Outlook is Positive. Consequently, Fitch's sensitivity analysis does not currently anticipate developments with a high likelihood of leading to a negative rating change. However, future developments that could individually, or collectively, result in the Outlook being revised to Stable include:

- Larger fiscal deficits that result in a rapid deterioration of the public debt trajectory;
- Materialisation of contingent liabilities on the sovereign's balance sheet; for example, from state-owned enterprises.

#### KEY ASSUMPTIONS

Fitch assumes the Bulgarian authorities will maintain continuity in economic and fiscal policy.

The global economy performs in line with Fitch's Global Economic Outlook.

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#### Applicable Criteria

Country Ceilings (pub. 16 Aug 2016)  
<https://www.fitchratings.com/site/re/885997>  
Sovereign Rating Criteria (pub. 18 Jul 2016)  
<https://www.fitchratings.com/site/re/885219>

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