FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Bulgaria at 'BBB'; Outlook Positive

Fri 23 Jul, 2021 - 5:02 PM ET

Fitch Ratings - Frankfurt am Main - 23 Jul 2021: Fitch Ratings has affirmed Bulgaria's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'BBB' with a Positive Outlook.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

Bulgaria's ratings balance its strong external and public balance sheets and credible policy framework, underpinned by EU membership and a long-standing currency-board arrangement, against weak potential growth, partly due to unfavourable demographics, which could weigh on government finances over the long term. Governance indicators and income levels are slightly above peers.

The Positive Outlook reflects the dissipation of macroeconomic risks stemming from the Covid-19 pandemic, underpinned by a more resilient economy, as well as continued gradual progress towards euro adoption. In Fitch's view, short-term downside risks tied to the coronavirus pandemic and prolonged electoral uncertainty are more than offset by prospects of substantial funding for investment from the EU and a broad commitment to macro and fiscal stability (anchored by the inclusion of the Bulgarian lev into Exchange Rate Mechanism II; ERMII).

Fitch now expects the economy to expand by 4.7% in 2021, compared with 3% previously and in line with the 'BBB' median. The upward revision reflects better-than-expected 1Q21 GDP, largely due to resilient private consumption, despite a more challenging health situation (Bulgaria recorded one of the highest Covid-19-related death rates in Europe in winter). Recent indicators point to further strengthening of domestic demand, while exports (which have struggled in recent quarters) are likely to pick up in 2H21 thanks to cyclical factors. Bulgaria's very low vaccination rate (12.6% fully vaccinated as of 20 July, versus an EU average of 43%) raises some downside pandemic-related risks, although the authorities are unlikely to put in place severe containment measures that would significantly affect economic activity.

Investment will be a key driver of growth over the medium term, as Bulgaria will be one of the main beneficiaries of EU transfers in the coming years, including EUR16.6 billion (27% of 2020 GDP) in the 2021-27 Multi Annual Framework and EUR5.9 billion (10% of 2020 GDP) in grants under the EU's Recovery and Resilience Facility (RRF). Bulgaria has yet to submit its national recovery and resilience plan to access RRF funds (original deadline was end-April), partly due to electoral considerations and challenges around the plan's project and reform priorities. Further delays to the process are possible and could potentially impact disbursement of the first tranches, which could affect growth in 2022. There are also concerns about absorption capacity, given a modest record and weak business environment that could limit effectiveness of investment. However, given the sheer size of funds we still expect the RRF to play a key role in supporting GDP growth of 3.9% in 2022-23.

Fitch has yet to assess the impact of the RRF on longer-term growth potential, as there is little clarity on the timetable and milestones of the reform programme. Key reforms are likely to focus on long-standing structural issues in education, health, social and labour markets, in addition to efforts at improving energy transition. If these reforms successfully increase productivity, they could help offset the negative impact of an ageing population. The European Commission estimates an average 12% decline in the labour force in each of the next three decades (one of the sharpest falls in the EU), with a significant impact on potential growth from 2025 onwards.

We project a modest widening of the fiscal deficit in 2021, to 5.0% of GDP versus 5.5% for the 'BBB' median, reflecting an increase in pandemic-related expenditure (of around 3pp of GDP according to authorities). Preliminary cash data for January-May point to a solid revenue performance, underpinned by economic recovery and efforts to improve compliance. The authorities plan to make a one-off increase in pensions more permanent, which could cost the budget around 1pp of GDP from this year onwards. This is likely to be partly offset by improved expenditure efficiency elsewhere.

Under our baseline scenario, we expect the fiscal deficit to narrow gradually to 2% of GDP in 2023 thanks to the unwinding of support measures. This will keep public debt/GDP at below 30% over the forecast horizon, broadly in line with the authorities' convergence programme and well below the 'BBB' median of 57%. There is some uncertainty about the fiscal path beyond 2021 given the electoral situation. However, Fitch maintains its view that risks are contained by a long record of fiscal prudence that is well entrenched across the political spectrum.

Bulgaria has held two successive parliamentary elections (April and July) that have resulted in a highly fragmented legislature with limited prospects of a stable government. The country's established parties, centre-right GERB and centre-left BSP, have lost significant support but the other parties have been unable to agree a ruling coalition, in part as they lack a clear majority. At present, the most likely options appear to be a weak minority government (potentially led by now largest party ITN), or new elections that could be held at same time as the presidential poll in 4Q21. Prolonged uncertainty has been a feature of Bulgaria's political scene in the past and can impact confidence and investment. However, at present Fitch does not see major risks to economic policy or to Bulgaria's commitment to the EU/euro area accession, with these issues playing an insignificant role during the campaigns.

The authorities have stated their commitment to adopting the euro by 2024, a timeline that Fitch considers realistic. The county currently meets all convergence criteria except for inflation, which is just above the estimated reference value. Like other countries in the region, headline inflation has accelerated due to supply side and temporary factors (the harmonised index of consumer prices reached 2.4% in June), while core inflation has remained stable. At present, we see limited inflation pressures beyond 2021, but risks could increase if demand-side pressures accelerated. Overall, we consider euro adoption as supportive of the rating, as underlined by our view that all things being equal, we would upgrade Bulgaria's Long-Term Foreign-Currency IDR by two notches between admission to the ERM II to joining the euro.

Bulgaria's solid external finances are a rating strength and a factor that has helped reduce macro vulnerabilities. We expect the current account to remain in deficit, averaging 0.9% of GDP in 2021-23 as service exports continue to struggle and import demand picks up in line with stronger investment growth. The capital account will be boosted by large EU transfers, which combined with ongoing external deleveraging by the private sector, will keep the net external creditor position at close to 28% of GDP in 2021-23 (compared with the 'BBB' median net debtor position of 7%).

The country's banking sector remains liquid and well capitalised (total capital ratio of 22.5% in 1Q21), with the Bulgarian National Bank maintaining a cautious approach to safeguard the sector. Asset quality remains broadly stable, with the ratio of non-performing loans falling to 5.4% in 1Q21 versus 6.4% a year earlier, reflecting the impact of moratoria measures. These measures are expected to be in place until end-2021, after which the NPL ratio is likely to increase modestly. The sector is well positioned to absorb these losses and the authorities are likely to put pressure on banks to promptly address delinquency issues.

ESG - Governance: Bulgaria has an ESG Relevance Score (RS) of '5[+]' for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption. These scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model. Bulgaria has a medium WBGI ranking in the 61th percentile, reflecting a history of unstable coalitions, relatively high perceptions of corruption and moderate institutional capacity versus track record of peaceful transitions and above average regulatory quality.

RATING SENSITIVITIES

FACTORS THAT COULD, INDIVIDUALLY OR COLLECTIVELY, LEAD TO NEGATIVE RATING ACTION/DOWNGRADE:

-Macro/Structural: Adverse policy developments, for example following a period of political paralysis, which reduce confidence in economic growth prospects and the policy framework.

-Fiscal: A prolonged rise in public debt driven for example by persistent fiscal easing, the materialisation of contingent liabilities on the sovereign's balance sheet or weaker growth prospects.

FACTORS THAT COULD, INDIVIDUALLY OR COLLECTIVELY, LEAD TO POSITIVE RATING ACTION/UPGRADE:

-Structural/External: Progress toward eurozone accession, including greater confidence in Bulgaria meeting membership criteria and the likely timing of euro adoption.

-Macro: An improvement in growth potential, for example via the implementation of structural and governance reforms to improve the business environment and/or effective use of EU funds, that leads to faster convergence with income levels of higher rated peers, which would cause the removal of the -1 QO notch on Macro.

SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)

Fitch's sovereign rating committee adjusted the output from the SRM to arrive at the final LT FC IDR by applying its QO, relative to rated peers, as follows:

Macro: -1 notch, to reflect Fitch's view that adverse demographic trends and slow progress on structural reform constrain potential growth over the long term.

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 LT 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.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

KEY ASSUMPTIONS

The global economy performs broadly in line with Fitch's latest Global Economic Outlook published on 15 June 2021, which projects eurozone growth at 5.0% in 2021 and 4.5% in 2022.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Bulgaria has an ESG Relevance Score of '5[+]' for Political Stability and Rights as World Bank Governance Indicators have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and a key rating driver with a high weight. As Bulgaria has a percentile rank above 50 for the respective Governance Indicator, this has a positive impact on the credit profile.

Bulgaria has an ESG Relevance Score of '5[+]' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as World Bank Governance Indicators have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and are a key rating driver with a high weight. As Bulgaria has a percentile rank above 50 for the respective Governance Indicators, this has a positive impact on the credit profile.

Bulgaria has an ESG Relevance Score of '4[+]' for Human Rights and Political Freedoms as the Voice and Accountability pillar of the World Bank Governance Indicators is relevant to the rating and a rating driver. As Bulgaria has a percentile rank above 50 for the respective Governance Indicator, this has a positive impact on the credit profile.

Bulgaria has an ESG Relevance Score of '4[+]' for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Bulgaria, as for all sovereigns. As Bulgaria has a track record of 20+ years without a restructuring of public debt and captured in our SRM variable, this has a positive impact on the credit profile.

Bulgaria has an ESG Relevance Score of 4 for Demographic Trends as a falling and ageing population hinder the economy's medium-term growth potential. This is relevant to the rating and a rating driver.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Bulgaria	LT IDR	BBB Rating Outlook Positive	Affirmed	BBB Rating Outlook Positive
•	ST IDR	F2	Affirmed	F2
•	LC LT IDR	BBB Rating Outlook Positive	Affirmed	BBB Rating Outlook Positive
•	LC ST IDR	F2	Affirmed	F2
•	Country Ceiling	A-	Affirmed	A-
• senior	LT	BBB	Affirmed	BBB

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Federico Barriga Salazar
Director

Primary Rating Analyst
+49 69 768076 145
federico.barrigasalazar@fitchratings.com
Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Arvind Ramakrishnan
Director
Secondary Rating Analyst
+49 69 768076 271
arvind.ramakrishnan@fitchratings.com

Paul Gamble
Senior Director
Committee Chairperson
+44 20 3530 1623
paul.gamble@fitchratings.com

MEDIA CONTACTS

Peter Fitzpatrick
London
+44 20 3530 1103
peter.fitzpatrick@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Country Ceilings Criteria (pub. 01 Jul 2020)

Sovereign Rating Criteria (pub. 26 Apr 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v1.7.2 (1)

Debt Dynamics Model, v1.2.1 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.12.2 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Bulgaria	EU Issued, UK Endorsed

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, THE FOLLOWING HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR WHICH THE LEAD ANALYST IS BASED IN AN ESMA- OR FCA-REGISTERED FITCH RATINGS COMPANY (OR BRANCH OF SUCH A COMPANY) CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

READ LESS

COPYRIGHT

the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Sovereigns Europe Bulgaria
