21 Feb 2020 | Affirmation

Fitch Affirms Bulgaria at 'BBB'; Outlook Positive

Fitch Ratings-Frankfurt am Main-21 February 2020:

Fitch Ratings has affirmed Bulgaria's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'BBB' with a Positive Outlook.

Key Rating Drivers

Bulgaria's ratings are supported by its strong external and fiscal balance sheets and credible policy framework, underpinned by EU membership and gradual progress towards euro membership. The ratings are constrained by slightly lower income levels compared with the current 'BBB' median and unfavourable demographics, which could hinder growth over the long term. Governance indicators are in line with peers.

The process to simultaneously join the Exchange Rate Mechanism (ERM II) and the Banking Union is nearing completion. All ERM II commitments have been finalised, while two domestically-owned banks, Fibank and Investbank are in the process of strengthening their capital positions following the results of the ECB's comprehensive assessment released in July 2019 (which identified capital shortfalls of EUR262.9 million and EUR51.8 million, respectively, under the adverse stress test scenario). Fibank's large stock of impaired loans (26.3% in 3Q19 according to IFRS 9 stage 3 loans consolidated data) and repossessed assets present a challenge, but there appears to be enough commitment for both banks to reach their capital plans by the April 2020 deadline.

Increased public debate about euro adoption and the mechanics surrounding the leva peg under ERM II has also raised the risk of further delays. However, Fitch believes that both the Bulgarian and European authorities remain committed to finalising the process, with a likely positive final decision in 2H2020 following a review process by the ECB and European institutions (most likely in July). This could pave the way for euro adoption by 2023 at the earliest. All else being equal, Fitch would be likely to upgrade Bulgaria's Long-Term Foreign-Currency IDR by one notch on admission to ERM II and one further notch when formally joining the euro area.

Fitch continues to expect a solid fiscal performance in 2020-21, supported by stable macro conditions and prudent policies. Fiscal outturns surprised on the upside last year thanks to strong revenue, with the general government cash deficit reaching only 1% of GDP, versus the amended budget target of 2.1%. In accrual terms Bulgaria posted an estimated surplus of 1% of GDP, the fourth consecutive surplus year and comparing favourably with the BBB median deficit estimate of 1.8%. We expect stable revenue growth in the next two years, reflecting solid domestic demand. Expenditure growth will be driven by measures to boost incomes, including this year´s 10% hike in public wages, and on capital projects as the EU funding cycle reaches its peak. We see the surplus narrowing to 0.1% of GDP by 2021.

Fiscal risks are broadly balanced. Bulgaria has a strong track-record of fiscal prudence across the electoral cycle, limiting downside risk ahead of general elections due May 2021. Entry into ERM II would also serve as an additional anchor for maintaining fiscal stability over the medium term. High government deposits (7.2% of GDP at end-2019), low financing costs and low and declining debt levels provide fiscal space. Fitch forecasts general government debt to fall to 17.9% of GDP in 2021, compared with the current 'BBB' median of 41.4% and consistent with Bulgaria's Convergence Programme Targets.

Bulgaria's very strong external finance metrics are a rating strength and provide a cushion against external shocks. According to IMF balance of payments data, the current account surplus (CAS) exceeded 11% of GDP in 1Q-3Q19, and we estimate a full year CAS of 10.1%. It is Bulgaria´s highest CAS on record and the highest in the 'BBB' and 'A' categories. The surprising performance in 2019 is due in part to a contraction in goods and services imports and sharp drop in income debits due to lower dividend payments. However, it also reflects the strengthening of the goods and services export sectors over the past few years. Fitch expects the CAS to narrow, first substantively in 2020 as import growth picks up, and then more gradually in 2021 as trends stabilise. This will continue to support the country´s external balance sheet, with Bulgaria´s net external asset position expected to increase to 26.8% of GDP by 2021 compared with the current 'BBB' median net debtor position of 7%.

We maintain our GDP growth forecast of 3.3% in 2020-2021, broadly in-line with the 'BBB' median. Weakness in the external environment, and particularly in the eurozone, has not yet significantly affected Bulgaria, with quarterly GDP growth falling only very slightly in 3Q and 4Q19 (to 0.8% and 0.7%, respectively) and annual growth reaching 3.7% (from 3.1% in 2018). However, ongoing external uncertainty and a projected recovery in imports (thanks in part to a pickup in investment), will likely lead to sharper slowdown in headline growth in the coming quarters. As in other countries in the region, domestic demand will support growth, underpinned by favourable financing conditions and a strong labour market.

Fitch expects headline inflation to average 2.4% in 2020-21, broadly in line with the 'BBB' peer median of 2.5% and consistent with a further weakening of the economic cycle. The harmonised index of consumer prices accelerated in 4Q19 and further to 3.4% yoy in January (the highest rate since October 2018), but it was mostly driven by one-off factors affecting food prices. Core inflation remains low (CPI excluding energy, food, alcohol and tobacco was 1.8% in December), with limited pass through from higher wages (up by an estimated 6% in 2019). Nevertheless, if upside risks to inflation materialize, this could complicate Bulgaria´s inflation targets once it is admitted into ERMII.

Bulgaria´s banking sector performance continues to improve gradually, helped by favourable macro conditions and robust credit growth. Overall credit growth stood at 7.5% in 2019, with household credit rising by closer to 10% in line with higher residential mortgage lending. Similar growth rates are expected in 2020. The Bulgaria National Bank remains cautious about credit developments, and in December 2019 decided to raise its counter-cyclical capital buffer further from 1% (effective from April 2020) to 1.5% in early 2021. The NPL ratio continues to fall, falling to 6.5% in 2019, although the situation at individual banks can differ substantially.

Bulgaria's governance indicators remain in line with its 'BBB' peers. Despite a history of unstable governments and various institutional constraints, there is broad-based political consensus in terms of macro-economic policy and in favour of integration with the eurozone.

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 (LT FC) IDR scale.

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:

-Macroeconomics: -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.

RATING SENSITIVITIES

The main factors that could, individually or collectively, lead to positive rating action are:

- Formal admission into ERM II.

- An improvement in growth potential that leads towards faster convergence with income levels of higher rate peers without creating imbalances.

- Continued improvement in external and fiscal balance sheets.

The main factors that could, individually or collectively, lead to negative rating action are:

- A halt to the euro accession process.

- Re-emergence of external imbalances and/or deterioration of external competitiveness.

- A sharp rise in public debt driven by fiscal easing or the materialisation of contingent liabilities on the sovereign's balance sheet

Key Assumptions

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

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 highly relevant to the rating and a key rating driver with a high weight.

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. Some of these issues have held back implementation of structural reforms and hindered medium-term growth potential.

Bulgaria has an ESG Relevance Score of 4 for Human Rights and Political Freedoms as World Bank Governance Indicators, which have the highest weight in Fitch's Sovereign Rating Model (SRM), are relevant to the rating and a rating driver.

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.

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, which is relevant for the rating in combination with other factors.

Bulgaria; Long Term Issuer Default Rating; Affirmed; BBB; RO:Pos
----; Short Term Issuer Default Rating; Affirmed; F2
----; Local Currency Long Term Issuer Default Rating; Affirmed; BBB; RO:Pos
----; Local Currency Short Term Issuer Default Rating; Affirmed; F2
----; Country Ceiling; Affirmed; A-
----senior unsecured; Long Term Rating; Affirmed; BBB

Contacts:
Primary Rating Analyst
Federico Barriga Salazar,
Director
+49 69 768076 145
Fitch Deutschland GmbH
Neue Mainzer Strasse 46 - 50
Frankfurt am Main D-60311

Secondary Rating Analyst
Arvind Ramakrishnan,
Director
+49 69 768076 271

Committee Chairperson
Charles Seville,
Senior Director
+1 212 908 0277

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email:
peter.fitzpatrick@thefitchgroup.com

Additional information is available on www.fitchratings.com

Applicable Criteria
[Country Ceilings Criteria (pub. 05 Jul 2019)]
[Sovereign Rating Criteria (pub. 26 May 2019)]

Additional Disclosures

[Dodd-Frank Rating Information Disclosure Form](#)

[Solicitation Status](#)

[Endorsement Policy](#)

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, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. 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 RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

 In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a

---

ENDORSEMENT POLICY - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.