24 Apr 2020 | Rating Changed Outlook to Stable

Fitch Revises Bulgaria's Outlook to Stable; Affirms at 'BBB'

Link to Fitch Ratings' Report(s): Bulgaria - Rating Action Report

Fitch Ratings-Frankfurt am Main-24 April 2020:

Fitch Ratings has revised the Outlook on Bulgaria's Long-Term Foreign-Currency Issuer Default Rating (IDR) to Stable from Positive and affirmed the rating at 'BBB'.

Under EU credit rating agency (CRA) regulation, the publication of sovereign reviews is subject to restrictions and must take place according to a published schedule, except where it is necessary for CRAs to deviate from this in order to comply with their legal obligations. Fitch interprets this provision as allowing us to publish a rating review in situations where there is a material change in the creditworthiness of the issuer that we believe makes it inappropriate for us to wait until the next scheduled review date to update the rating or Outlook/Watch status. The next scheduled review date for Fitch's sovereign rating on Bulgaria will be on 21 August 2020, but Fitch believes that developments in the country warrant such a deviation from the calendar and our rationale for this is laid out below.

Key Rating Drivers

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

MEDIUM

Fitch has sharply revised down its real GDP growth forecast for Bulgaria to -5.1% in 2020 (previous review: +3.2%, current peer median: -3.1%), reflecting the impact of an ongoing lockdown in response to the COVID-19 pandemic on economic activity. Bulgaria imposed a state of emergency on 13 March, which will remain in place at least until 13 May.

Inbound international travel alone contributed to 6.8% of foreign earnings for Bulgaria in 2018 (as calculated by Eurostat) and the travel and tourism sectors are likely to record sharply negative growth in 1H20. Unemployment increased by 0.5pp m/m to 6.7% in March 2020, highlighting the immediate impact of the crisis. While the situation is likely to improve in 2H20, our forecasts are subject to significant downside risks, given the evolving situation.

Growth is set to rebound in 2021 to 4.2%, as consumption and investment record strong growth.

Driven by strong domestic demand, the contribution of net exports to growth will remain small (0.1pp) in 2020.

Fitch expects Bulgaria's budgetary performance to deteriorate sharply in 2020 given the expected economic contraction and ongoing fiscal easing in response to the COVID-19 pandemic. Following four years of primary and headline surpluses, Bulgaria is likely to post primary and headline deficits of 2.8% and 3.6% of GDP, respectively. Fitch's forecasts are more conservative than the government's projections (fiscal deficit of 3%), given our assumptions around government guarantees crystallising on the sovereign balance sheet in 2020.

Bulgaria recorded a fiscal surplus of BGN1.4 billion (1.2% of GDP; cash basis) in 1Q20, driven by stable economic growth-enabled revenue collection. The government's fiscal response is expected to cumulatively amount to BGN4.5 billion (3.9% of projected 2020 GDP), of which direct budgetary support of BGN1.5 billion will be provided for healthcare and wage support measures.

BGN700 million (0.6% of GDP) in capital has been allocated to the Bulgarian Development Bank (BDB), which will be the primary channel for interest-free loans to individuals, and unsecured loans to companies affected by the crisis. Other measures include guarantees through the Fund Manager of Financial Instruments (Fund of Funds), which is expected to reach BGN170 million (0.1% of GDP) for the duration of the pandemic. Fitch assumes that up to 20% of outstanding guarantees are at heightened risk of being called, given the economic dislocation.

In response to the COVID-19 crisis, parliament approved an increase in the government debt ceiling from BGN2.2 billion to BGN10.0 billion (8.6% of GDP). Bulgaria is expected to announce a eurobond issuance in May, although details are unavailable at present. Fitch assumes that EUR2 billion will be issued in 2020 with a further EUR1 billion in 2021 (cumulatively amounting to 4.9% of GDP). However, these assumptions are subject to inherent uncertainty, given the evolving economic outlook.

Given the higher funding needs, Bulgaria's government debt ratio is likely to increase in 2020, reaching 28.5% of GDP (an annual increase of 8.1pps). However, this would still be well below the current peer median of 50%. The Fiscal Reserve Account, consisting of government deposits and receivables from the EU (1Q20: BGN10.3 billion (8.8% of GDP)) will act as another fiscal buffer.

Bulgaria has a track record of prudent fiscal policy with sustainable debt management, which we expect will continue. Bulgaria could also if necessary request assistance from the EU Solidarity Fund, European Investment Bank and the World Bank. Some reallocation of funds received from the EU under the Multi-Annual Financial Framework towards pandemic-related stimulus is also possible. However, at present, Fitch has not included these sources of funding in its forecasts.

The COVID-19 pandemic has increased uncertainty over the timeline for Bulgaria's simultaneous entry into the ERM-2 and the Banking Union and the ERM II, although in our view, the process has not been derailed. Fitch believes Bulgaria is unlikely to meet the end of April deadline for completion of the capital buffer increase of Fibank, a requirement under the European Central Bank's (ECB) Comprehensive Assessment. This in turn is a mandatory precursor for accession to ERM-2 by 3Q20. Investbank, the only other bank required to meet this condition, received shareholder approval for its capital increase plans in February. Fibank is currently in the process of an Initial Public Offering (IPO) to raise up to BGN200 million (EUR102 million), with its plans receiving approval from the domestic Financial Supervision Commission on 23 April.

Fitch expects that any delays in the process are themselves unlikely to jeopardise Bulgaria's simultaneous entry into the Banking Union and ERM-2. More positively, the government appears to be more decisively favouring the euro accession process, compared with earlier this year when Prime Minister Boyko Borissov expressed a willingness to slow the process, citing public opinion.

At the same time, given that the COVID-19 pandemic response is taking up significant resources with regard to political engagement at the EU-wide level, facilitating the Bulgarian lev's ERM2 accession may decline as a relative priority for European institutions. If concerns about risks ease and the process resumes, this would be 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 and joining the euro.

Bulgaria's 'BBB' rating also reflects the following rating drivers:

Bulgaria's external finances, including its net external creditor position, are an important rating strength. Bulgaria has recorded stable current account surpluses (CAS), averaging 3.3% of GDP in 2015-19, driven by strong export growth. Fitch expects the CAS to shrink to 2.5% of GDP in 2020, reflecting a fall in external demand as well as strong import compression (helped by lower oil prices), and further to 1.1% in 2021, as import growth will rebound faster than external demand. However, Bulgaria's external position will remain stable, with no risks to the long-standing currency peg, as international reserves will average 7.2 months of CXP over the forecast horizon.

On 22 April, the Bulgarian National Bank (BNB) agreed a precautionary currency swap line of up to EUR2 billion with the ECB, to last until at least end-2020. Fitch views this development as supportive of Bulgaria's external position as it enables the BNB to provide euro liquidity to domestic banks as necessary without tapping its international reserves.

Bulgaria has been a net external creditor since 2016, with net external debt/GDP reaching -17.8% in 2019 (current peer median: +11.4%). A combination of higher external borrowing and a falling CAS will cause the net external debt position to worsen to an average of -12.8% of GDP in 2020-21, which will still be comfortably above the peer median.

Bulgaria's banking sector is well-capitalised (2019: total capital ratio of 20.2%) with moderate asset quality (non-performing loans ratio: 9.2%) as of end-2019 (compared with 21% in 2015). The BNB has cancelled two scheduled increases of 0.5pp each in the Counter-Cyclical Capital Buffer (from the current 0.5%), due to take effect from April 2020 and January 2021, respectively, which should contribute to capital release for banks. Banks will almost certainly see a significant decrease in credit growth in 2020, although this would be from a high base (credit growth averaged 8.7% yoy in 2018-19). Furthermore, the BNB has approved banks' proposal for a debt repayment moratorium of up to six months (ending no later than December 2020) for performing loans, which will pressure banks' profitability to some extent.

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.

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, as is the case for all sovereigns. 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 60th percentile, reflecting its track record of unstable coalitions, relatively high perceptions of corruption and moderate institutional capacity.

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.

-Macroeconomic Performance, Policies and Prospects: -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

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Progress toward eurozone accession.

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

- Steady improvement in external and fiscal balance sheets.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

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

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

Best/Worst Case Rating Scenario

International scale credit ratings of Public Finance 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

Fitch expects the global economy to go through a deep but short-lived recession in 2020 due to the COVID-19 pandemic. In particular, eurozone GDP is expected to fall by 7% in 2020, followed by 4.3% growth in 2021, as described in Fitch's Global Economic Outlook dated 22 April 2020. There is an unusually high level of uncertainty around the projections at present, and risks are firmly to the downside.

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

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. 27 Mar 2020) (including rating assumption sensitivity)

Applicable Model

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

Country Ceiling Model, v1.7.1 (1)
Debt Dynamics Model, v1.2.0 (1)
Macro-Prudential Indicator Model, v1.4.0 (1)
Sovereign Rating Model, v3.11.0 (1)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Status
Endorsement Policy

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