MOODY'S
INVESTORS SERVICE

Rating Action: Moody's upgrades Bulgaria's ratings to Baa1, changes outlook to stable from positive

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Frankfurt am Main, October 09, 2020 -- Moody's Investors Service ("Moody's") has today upgraded the Government of Bulgaria's senior unsecured and long-term issuer ratings in foreign and local currency to Baa1 from Baa2 and changed the outlook to stable from positive. Concurrently, Moody's has also upgraded Bulgaria's senior unsecured MTN programme rating to (P)Baa1 from (P)Baa2.

Moody's decision to upgrade Bulgaria's ratings to Baa1 reflects the following key drivers:

• Enhanced institutional capacity and policymaking as the country enters a critical phase of euro area accession;

• Reduced exposure to foreign currency debt risk, large fiscal reserves and expectations that positive fiscal and debt dynamics post pandemic shock will preserve the government's strong balance sheet

The stable outlook reflects Moody's expectation that fiscal strength indicators will remain resilient even under an adverse scenario, and above the median for Baa1-rated peers. The stable outlook also balances intrinsic strengths in Bulgaria's improving economic and institutional framework with key credit challenges that predominantly relate to the negative impact of adverse demographics on medium-term potential growth, as well as continued challenges in the fight against corruption, judicial independence and the rule of law.

Bulgaria's long-term local currency bond and deposit ceilings have been raised to A1 from A3. The long-term foreign currency bond ceiling was also raised to A1 from A3 and the long-term foreign currency deposit ceiling to Baa1 from Baa2. Finally, the short-term foreign currency bond has been raised to Prime-1 from Prime-2, while the short-term foreign currency deposit ceiling is unaffected by this rating action and remains at Prime-2.

RATINGS RATIONALE

RATIONALE FOR THE UPGRADE TO Baa1

FIRST DRIVER: ENHANCED INSTITUTIONAL CAPACITY AND POLICYMAKING AS THE COUNTRY ENTERS A CRITICAL PHASE OF EURO AREA ACCESSION

The first driver of the upgrade is based on Bulgaria's progress towards euro area accession and the associated strengthening of institutional capacity and policymaking. On 10 July 2020, the president of the European Central Bank (ECB), euro area finance ministers and the finance ministers and central bank governors of Denmark and Bulgaria decided to include the Bulgarian lev in the Exchange Rate Mechanism (ERM II)I, which is one of the final critical steps prior to becoming a member of the euro area. The announcement amid the coronavirus disruption results from a comprehensive reform programme. As of July 2020, Bulgaria had fully completed the actions to which the country committed in the seven key following fields: 1) banking union, 2) macroprudential supervision, 3) non-banking supervision, 4) insolvency framework, 5) strengthening of the anti-money laundering framework, 6) modernization of the framework of State-owned enterprises (SOE's) in line with best international practices and 7) implementation of the law ratifying the agreement on the transfer and mutualisation of contributions to the single resolution fund. In parallel, the European Central Bank (ECB) and the Bulgarian National Bank (BNB) have established a close cooperation over bank supervision.

In Moody's view, the successful completion of the reform programme speaks to the credibility of Bulgaria's ambition to join the euro area. Moody's believes that Bulgaria's policy effectiveness has strengthened over the recent years. A key institutional setting, the currency board with the euro as a reserve currency is underpinned by sound monetary and macroeconomic policymaking, providing a stable framework for economic activity in a very uncertain international environment. The credibility of the currency board also relies on the country's structurally prudent fiscal stance.

Going forward, Moody's expects Bulgaria to continue to pursue sound economic and financial policies, as entering the euro area will require both sustainable economic convergence and readiness to participate in the banking union. On economic convergence, compliance with the convergence criteria is already advanced, as noted in the ECB's 2020 convergence report.

From a macroprudential and banking perspective, Moody's believes that the close cooperation between the ECB and the BNB and the inclusion of five of the largest banks operating in Bulgaria under the ECB's supervision will further enhance the system's regulatory environment and promote the adoption of best practices.

Finally, Bulgaria's legal framework will be strengthened as national legislation adapts to fully comply with Article 131 of the Treaty in the areas of central bank independence, monetary financing prohibition and legal integration into the Eurosystem.

SECOND DRIVER: REDUCED EXPOSURE TO FOREIGN CURRENCY DEBT RISK, LARGE FISCAL RESERVES AND EXPECTATIONS THAT POSITIVE FISCAL AND DEBT DYNAMICS POST PANDEMIC WILL PRESERVE THE GOVERNMENT'S STRONG BALANCE SHEET

The second driver for the upgrade relates to Bulgaria's strengthened fiscal credit profile despite the negative impact of the coronavirus pandemic. By entering ERM II, Bulgaria makes a major step towards the eurozone, an economic area with which the country has strong ties. In 2019, 80% of Bulgaria's general government debt was denominated in euros. Under Moody's Sovereign Ratings Methodology, a high share of foreign-currency denominated debt lowers our assessment of fiscal strength to reflect the risk of a sudden rise in interest costs and increase in debt stock in the case of a currency depreciation, thereby increasing the sovereign's overall debt burden and decreasing its debt affordability. In the case of Bulgaria, the highly credible currency board that has been in place for more than two decades already mitigates this risk. Entering ERM II further decreases this risk, as it brings Bulgaria closer to its predominant currency of issuance.

Bulgaria's credit profile also benefits from a strengthening of the government's strong balance sheet. Four years of growing structural fiscal surpluses have brought the debt/GDP ratio to 20.4% in 2019, the second lowest level in the European Union after Estonia. In light of declining financing costs, Bulgaria's debt affordability as measured by interest payments to general government revenues has significantly improved, to 1.5% in 2019 against 2.5% in 2016. The country also benefits from sizeable fiscal reserves, which Moody's expects to remain stable at around 10% of GDP.

This year, the coronavirus pandemic will negatively affect Bulgaria's public finances, as Moody's anticipates a 3.5% drop in GDP before a 2.7% recovery in 2021. The economic recession and the policy package to support activity will weigh on government revenues and public expenditure, pushing the deficit to 3.0% of GDP. For 2021, Moody's expects a 1.6% of GDP deficit. Debt affordability will remain strong, as the interest payments/revenue ratio stabilizes at around 1.4%. As a result, Moody's forecasts the debt ratio to reach 23.9% of GDP this year and 24.2% of GDP in 2021, before gradually declining to 23.5% of GDP in 2022.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's expectation that fiscal strength indicators will remain resilient to an adverse scenario, and above the median for Baa1-rated peers. The stable outlook also balances intrinsic strengths in Bulgaria's improving economic and institutional framework against key credit challenges that predominantly relate to the negative impact of adverse demographics on medium-term potential growth, as well as continued reform needs in the fight against corruption, judicial independence and the rule of law. Concerns in these areas have led to demonstrations in recent months. While some progress was noted in the European Commission's 2019 Cooperation and Verification Mechanism (CVM) report, Bulgaria's scope for progress in these policy areas remains ample. Finally, the stable outlook relies on the assumption that the future government of Bulgaria, to be set up following the general elections that will take place at the latest in March 2021, will remain committed to joining the euro area.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

Moody's takes account of the impact of environmental (E), social (S) and governance (G) factors when assessing sovereign issuers' economic, institutional and fiscal strength and their susceptibility to event risk. In the case of Bulgaria, the materiality of ESG to the credit profile is as follows.

Environmental considerations are not material to Bulgaria's credit profile, and the country has not been identified as being one of the sovereigns materially exposed to physical climate change risks. However, climate-change related weather events such as droughts and floods pose a risk to Bulgaria.

We regard the coronavirus outbreak as a social risk under our ESG framework, given substantial implications for public health and safety. The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines are creating a severe and extensive credit shock across many sectors, regions and markets. We believe that the combined negative effect of these developments will lead to temporary reversal of Bulgaria's otherwise improving credit metrics.

Governance considerations form an integral part of our credit analysis for Bulgaria and enhanced institutional capacity and policymaking is a key driver for today's rating action. Bulgaria's fiscal and monetary policy effectiveness have improved over the past years, supporting the country's entry into ERM II. Nonetheless, concerns regarding control of corruption and the rule of law remain a credit constraint.

GDP per capita (PPP basis, US$): 24,595 (2019 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 3.4% (2019 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 3.1% (2019 Actual)

Gen. Gov. Financial Balance/GDP: 2.1% (2019 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: 3% (2019 Actual) (also known as External Balance)

External debt/GDP: 56.3% (2019 Actual)

Economic resiliency: baa2

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 6 October 2020, a rating committee was called to discuss the rating of Bulgaria, Government of. The main points raised during the discussion were: The issuer's institutions and governance strength, have materially increased. The issuer's fiscal or financial strength, including its debt profile, has not materially changed. Other views raised included: The issuer's economic fundamentals, including its economic strength, have not materially changed.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

WHAT WOULD CHANGE THE RATING UP

Upward pressure on Bulgaria's outlook and, potentially, ratings, would arise from fundamental improvements in the quality of executive institutions and the judiciary, more specifically, the fight against corruption, efficiency of public sending and a strengthening of the rule of law, bringing the country's performance more in line with A-rated peers. Similarly, a clear and sustained convergence path towards better infrastructure and overall higher living and institutional standards would facilitate the entrance into the euro area, which would be credit positive.

WHAT WOULD CHANGE THE RATING DOWN

Conversely, a marked and permanent deterioration in the government's very strong balance sheet and long-term economic growth prospects would exert downward pressure on Bulgaria's rating. In addition, any signs of a weakening in the institutional framework would be credit-negative and could lead to a negative outlook and ultimately to a downgrade of the rating.

The principal methodology used in these ratings was Sovereign Ratings Methodology published in November 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1158631 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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