S&P Global
Ratings

Research

Bulgaria

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Bulgaria

This report does not constitute a rating action.

Key Rating Factors

Sovereign Credit Rating
BBB/Stable/A-2

Institutional and economic profile	Flexibility and performance profile
Strong domestic demand has limited the economic contraction so far, but slow vaccination efforts could extend the expected economic recovery. • After a comparatively shallow contraction last year, S&P Global Ratings expects muted external demand will delay some of the economic recovery into 2022. • In the medium term, EU fund inflows, including from the Next Generation EU (NGEU) instrument, will support growth; Bulgaria is eligible for total grants of over 50% of GDP until 2027. • The recent election produced a fragmented parliament from which no viable coalition emerged; it remains uncertain whether the July snap elections will improve the chance of government formation significantly.	Fiscal deficits will remain low in 2021, which will enable swift consolidation thereafter, supported by EU fund inflows. • Narrow fiscal deficits mean Bulgaria's government debt burden will remain low. • The Bulgarian lev (BGN) was included in the European Exchange Rate Mechanism (ERM) II last year, an important milestone on the path to eurozone accession. However, we expect the process will still take several years to complete. • The balanced current account, record-high reserves at the Bulgarian National Bank (BNB), and low net external debt provide buffers against external headwinds.

Outlook

The stable outlook reflects that, following a relatively limited contraction last year, we expect Bulgaria's economic recovery over the next two years will not incur any external or financial sector imbalances. This should enable quick fiscal consolidation and keep public debt low.

Upside scenario

We could raise the ratings if Bulgaria's economic recovery coincides with quicker fiscal consolidation or stronger external performance than we currently project. In the long run, we could raise the ratings on Bulgaria in the course of its accession to the eurozone.

Downside scenario

We could lower the ratings if the economic contraction proves deeper or the subsequent recovery is delayed. This would likely result in protracted fiscal consolidation and continuously rising net public debt over the next few years. Although unlikely over the medium term, we could also take a negative rating action if we observe the emergence of imbalances in Bulgaria's financial sector.

Rationale

Bulgaria's economic contraction has been relatively mild so far, mostly due to resilient domestic demand. However, slow progress on vaccination and a potential resurgence of the COVID-19 pandemic could mean a slower-than-expected rebound of external demand, which will push some of the expected recovery into 2022. Over the medium term through 2024, high fund inflows from the previous and current EU Multiannual Financing Frameworks (EU MFFs) as well as additional funds from the NGEU instrument will provide a solid backdrop for Bulgaria's economic growth.

Although the results of the recent elections highlight political fragmentation and confrontational decision-making, we do not believe that these developments will delay the most important political undertakings, such as progress on eurozone accession, or EU funds absorption.

Even against this challenging domestic political environment and in the course of the pandemic, Bulgaria has retained a solid fiscal position. Starting in 2022, we expect consolidation will narrow deficits further, keeping government debt, net of liquid assets, at a low 20% of GDP over the next years. External risks also appear manageable after several years of external net deleveraging, thanks to recurring current and capital account surpluses, which we expect to continue. The lev was included in the ERM II and Bulgaria joined the Banking Union in July 2020. Although the current currency board provides an important anchor of economic stability, our ratings also factor in the country's limited monetary policy flexibility under this arrangement.

The ratings are constrained by the country's moderate GDP per capita in a global comparison and remaining structural institutional impediments.

Institutional and economic profile: The timing and magnitude of near-term recovery will depend on the speed of vaccination efforts and a rebound of external demand; medium-term growth on EU fund absorption

Bulgaria, like many Central and Eastern European countries, has experienced a significant increase in COVID-19 cases since October-November last year. Despite several episodes of lockdowns and an imposed state of emergency since then, most restrictions have been less stringent than other European countries, which has limited the fallout for domestic demand. However, vaccination efforts lag those of most other European countries. Although vaccination rates might pick up over the coming months, the delay means the timing and strength of economic recovery is less visible, particularly in the tourism sector. Foreign visitors' receipts represented about 6%-7% of Bulgaria's GDP before the pandemic and these arrivals reduced about 60% in 2020; we only expect a partial recovery this year to about 70% of pre-pandemic arrivals.

In contrast, domestic demand has remained strong. This primarily explains why Bulgaria's economic contraction last year, at 4.2% of real GDP, was mild in a global and regional comparison. Current statistical office figures indicate that private consumption did not contract last year. We believe this comparatively mild COVID-19-related economic hit in 2020 is due to a low initial direct health impact from the pandemic; generally strong growth dynamics before 2020; and policy support to cushion the economic effects. The most important fiscal measures last year included a comprehensive labor market support scheme; additional health care expenditure and wage increases; higher social outlays; and increased funds for public sector financial institutions, such as the Bulgarian Development Bank and the "Fund of Funds" aimed at fostering lending to the private sector. Several measures, such as increased social expenditure, labor market support schemes, and high health care expenditure, will remain in place in 2021.

We expect Bulgaria's economy to recover to about 3% growth in 2021, and over 4% growth in 2022. We remain cautious on the recovery of the tourism sector this year. In the five years before the pandemic, Bulgaria's growth was robust at an annual average of 3.6%, and this was not accompanied by macroeconomic imbalances. We expect Bulgaria's medium-term economic development beyond 2022 will also be supported by the intake of significant EU funds under the various programs from the MFF 2014-2020 and 2021-2027, as well as the NGEU instruments. We currently estimate that Bulgaria could be eligible for EU grants totaling €30 billion-€35 billion until 2027, with potential absorption of these funds extending to 2030. This represents well over 50% of pre-pandemic GDP. Although some programs under the NGEU relate to relatively quickly available funds, such as the estimated €660 million under REACT-EU, we do not believe the absorption rate will increase significantly from current levels before second-half 2022. Overall, we believe it could be difficult for Bulgaria to absorb the full funds over the next few years, but the absorption rate should remain high.

On the downside, we think demographics could hamper potential growth over the medium term because the labor force continues to shrink due to aging and some emigration. At this point, we don't think a return of Bulgarian workers after the pandemic could change this trend greatly. These challenges highlight the need for continued structural reforms, for example through measures that address skill mismatches, improve the business environment, spur income growth, and ultimately help slow net emigration.

Such structural reforms may prove challenging in the current political environment. Last year saw the rise of a significant protest movement for several months and this year's general elections produced a fragmented parliament from which no viable government coalition could be formed. This highlights the high degree of political volatility and contention in Bulgaria. It is uncertain whether the snap elections in early July will improve the chance of a majority government coalition. It is likely a period of protracted coalition formation could follow the snap elections, and we cannot exclude the possibility of a minority government. In any case, we expect the political decision-making process to remain complicated over the coming years.

Importantly, we note that Bulgaria's EU membership and eurozone accession have consensus across the political spectrum. We therefore think that the current political environment will not impede progress on eurozone accession and might only temporarily delay the absorption of some EU funds from newly established programs. Overall, we think EU membership provides an important policy anchor for Bulgaria. We believe that some EU institutions could continue to highlight the necessity for structural reforms regarding specific deficiencies surrounding the rule of law in the country, particularly since such assessments are likely to be tied to the absorption of EU funds going forward.

However, we do not expect that such potential assessments will represent a continuous obstacle, given Bulgaria's past track record of adhering to the EU's recommendations and its uncontentious relations with the European Commission (EC). Bulgaria's progress in some of these areas has already been acknowledged in recent years, for example under the EC's Cooperation and Verification Mechanism in 2019. The inclusion of the Bulgarian lev in the ERM II and the country's Banking Union accession also highlights its legislative efforts to strengthen macroprudential supervision, insolvency proceedings, state-owned enterprise management, nonbanking supervision, and anti-money-laundering. We expect continuous progress on these items over the next years.

Flexibility and performance profile: Despite the pandemic, fiscal deficits will remain low and the rise in public debt contained

Bulgaria's fiscal deficits in 2020 were much lower than those of most other sovereigns, which we view as a continuation of the country's fiscal prudency. As several of the fiscal support programs have been extended into 2021, and social spending to support household incomes will increase, deficits will decrease only slightly this year. However, the low budget deficit should make fiscal consolidation relatively easy to achieve after 2021. Due to the projected economic recovery from 2022, the economy will likely not require continuous fiscal stimulus over the coming years, which should decrease public deficits to below 1% of GDP relatively soon. At the same time, we consider that Bulgaria has built a very credible track record of tight fiscal management, not least fostered by the currency board, which resulted in general government surpluses over 2016-2019.

The continuously tight fiscal stance has also supported public deleveraging over recent years, which halted in 2020. In our view, general government debt, net of liquid government assets, will rise to about 20% of GDP in 2022 and remain at this level for the subsequent years. Although this government debt level is very low in a global comparison, it still represents a significant increase from about 12% of GDP before the pandemic. Despite slightly increased future financing needs, we believe that the government's funding options remain plentiful. In addition to a liquid domestic banking system, the current and credible monetary policy arrangements have allowed Bulgaria to tap the deep eurozone capital markets at very favorable terms over recent years, which has almost halved the effective interest rate on government debt over the past 10 years. As a result, most of Bulgaria's debt is denominated in euros and about 50% is held by nonresidents.

In general, Bulgaria's banking sector is profitable, very liquid, and adequately capitalized, which is why we believe it does not pose a contingent liability for the government. We expect at most a slight deterioration in asset quality over the coming months as the payment moratorium runs out. With the transposition of the EU Banking Resolution and Recovery Directive in 2015, the failure of a bank will necessitate a bail-in of shareholders, creditors, and then--if necessary and under certain conditions--a resolution fund. Only after exhausting these options and in an extraordinary situation of a systemic crisis would a bank be able to resort to government support. The BNB has consistently implemented measures to ensure the stability of banks (including subsidiaries), among other measures, by strengthening their liquidity and capital buffers. Close cooperation with the European Central Bank (ECB) will also lead to further alignment of supervisory practices. The government-owned Bulgarian Development Bank assumed additional capital of BGN140 million from First Investment Bank's BGN195 million capital increase ahead of Bulgaria's ERM II accession last year, but we believe that this has effectively resolved the matter. Furthermore, the energy sector has also been a source of fiscal risk for the government. The government provided interest-free loans to some entities in the electricity sector in the past, and continues to subsidize it. However, the authorities have reduced their direct liability to the sector.

The lev was included in the ERM II and Bulgaria joined the Banking Union last year. The ERM II represents the waiting room for ultimate eurozone membership, which we expect will occur only after a few more years, given that political considerations outside Bulgaria's control could have an influence. The ultimate decision lies with the eurozone's and Denmark's finance ministers, as well as with the ECB. We expect that as of now, ERM II membership will have limited effects on the BNB's operations. We expect the ECB and BNB will further strengthen their close cooperation, particularly with respect to Bulgaria's integration into the Single Supervisory Mechanism.

Bulgaria's central bank has been operating under a currency board since 1997. The arrangement effectively guarantees the convertibility of the lev into euros and vice versa at the fixed exchange rate. Therefore, for our measure of useable reserves, we subtract the country's monetary base. Over the past two decades, authorities have accumulated fiscal and external buffers to underpin their commitment to the fixed exchange rate regime. That commitment has not wavered, despite a series of external and domestic political shocks since Bulgaria's 2007 accession to the EU. The currency board regime and the BNB charter allow provision of liquidity support to the banking system only to the extent that the BNB's foreign exchange reserves exceed its monetary liabilities. Even then, support can occur only under certain conditions and for short periods, against highly liquid collateral.

Bulgaria's current account moved into a slight deficit last year, mostly due to a contraction of tourism receipts, which generally represent about 40% of services exports, as well as lower remittance inflows. Both items should recover, which is why we expect a narrow current account surplus over the coming years. This will support Bulgaria's strong external position, which was characterized by significant net external deleveraging over the past few years before the pandemic. In our view, Bulgaria's liquid external assets will continue to exceed external debt significantly, by about 40% of current account payments over the next three years. Reserve levels have also risen since last year, mainly reflecting the increase in banks' excess reserves because of measures undertaken by the BNB in March 2020 aimed at strengthening the capital and liquidity position of the banking system. We expect external liquidity will remain at comfortable levels, with annual gross external financing needs at only slightly over 100% of current account receipts and usable reserves over the coming years.

Key Statistics

Table 1

Bulgaria Selected Indicators

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Economic indicators (%)										
Nominal GDP (bil. LC)	89	95	102	110	120	119	124	132	140	147
Nominal GDP (bil. $)	51	54	59	66	69	69	75	81	85	90
GDP per capita (000s $)	7.0	7.5	8.3	9.4	9.8	9.9	10.9	11.7	12.5	13.2
Real GDP growth	4.0	3.8	3.5	3.1	3.7	(4.2)	2.9	4.3	3.5	3.3
Real GDP per capita growth	4.6	4.5	4.3	3.9	4.4	(3.5)	3.4	4.8	4.0	3.8
Real investment growth	2.7	(6.6)	3.2	5.4	4.5	(5.1)	3.0	5.0	5.8	5.8

Table 1

Bulgaria Selected Indicators (cont.)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Investment/GDP	21.0	19.0	19.9	21.3	21.1	19.0	18.9	19.1	19.6	20.1
Savings/GDP	21.0	22.1	23.2	22.2	22.9	18.3	19.4	20.5	20.9	21.1
Exports/GDP	64.0	64.0	67.3	65.8	64.2	56.1	58.6	59.1	58.7	58.5
Real exports growth	6.4	8.6	5.8	1.7	3.9	(11.3)	7.5	5.0	3.0	3.0
Unemployment rate	9.2	7.6	6.2	5.2	4.2	5.1	5.8	5.0	4.8	4.8
External indicators (%)										
Current account balance/GDP	(0.0)	3.1	3.3	0.9	1.8	(0.7)	0.5	1.4	1.4	1.0
Current account balance/CARs	(0.0)	4.3	4.4	1.3	2.6	(1.1)	0.8	2.2	2.1	1.6
CARs/GDP	71.7	71.5	75.1	73.2	71.4	61.5	64.6	65.2	64.7	64.5
Trade balance/GDP	(5.8)	(2.0)	(1.5)	(4.8)	(4.7)	(3.1)	(2.4)	(2.1)	(2.5)	(3.0)
Net FDI/GDP	4.1	1.2	2.5	1.3	1.9	3.2	1.5	2.0	2.0	2.0
Net portfolio equity inflow/GDP	(0.7)	(0.2)	(0.8)	(0.8)	0.7	(1.7)	(0.5)	(0.5)	(0.5)	(0.5)
Gross external financing needs/CARs plus usable reserves	118.6	107.8	100.1	104.2	103.8	108.8	108.3	107.4	108.6	108.7
Narrow net external debt/CARs	(16.1)	(24.1)	(30.0)	(31.8)	(34.0)	(45.5)	(40.9)	(40.4)	(41.0)	(41.0)
Narrow net external debt/CAPs	(16.1)	(25.2)	(31.4)	(32.3)	(34.8)	(45.0)	(41.2)	(41.3)	(41.9)	(41.7)
Net external liabilities/CARs	73.4	52.4	50.4	40.6	37.1	44.2	37.8	32.6	29.1	26.2
Net external liabilities/CAPs	73.4	54.7	52.8	41.1	38.1	43.8	38.1	33.4	29.7	26.6
Short-term external debt by remaining maturity/CARs	43.6	30.1	25.6	26.6	25.5	30.3	30.6	29.1	28.5	27.9
Usable reserves/CAPs (months)	2.5	2.1	2.6	2.5	2.3	2.5	2.4	2.2	2.0	2.0
Usable reserves (mil. $)	6,430	9,315	9,790	9,012	8,835	9,692	9,567	9,019	9,402	9,523
Fiscal indicators (general government; %)										
Balance/GDP	(1.7)	0.2	1.2	2.0	2.1	(3.4)	(2.8)	(1.9)	(1.1)	(0.8)
Change in net debt/GDP	1.7	(0.1)	(1.1)	(1.1)	0.4	5.1	2.8	1.9	1.1	0.8
Primary balance/GDP	(0.8)	1.1	2.0	2.7	2.7	(2.9)	(2.2)	(1.2)	(0.4)	(0.2)
Revenue/GDP	38.9	35.1	36.1	38.6	38.5	39.5	38.5	38.0	37.5	37.5
Expenditures/GDP	40.6	34.9	34.9	36.6	36.3	42.9	41.3	39.9	38.6	38.3
Interest/revenues	2.4	2.5	2.2	1.7	1.5	1.4	1.7	1.7	1.8	1.8
Debt/GDP	26.0	29.3	25.3	22.3	20.2	25.0	26.5	26.8	26.4	25.9
Debt/revenues	66.8	83.5	70.1	57.7	52.5	63.5	68.7	70.5	70.4	69.0
Net debt/GDP	18.1	16.9	14.6	12.6	11.9	17.2	19.2	20.0	20.0	19.8
Liquid assets/GDP	7.9	12.4	10.7	9.7	8.3	7.9	7.2	6.8	6.4	6.1
Monetary indicators (%)										
CPI growth	(1.1)	(1.3)	1.2	2.6	2.4	1.2	1.5	1.7	2.0	2.0
GDP deflator growth	2.4	2.5	3.9	4.0	5.3	3.3	1.8	2.0	2.1	2.2
Exchange rate, year-end (LC/$)	1.79	1.86	1.63	1.71	1.74	1.59	1.65	1.63	1.63	1.63
Banks' claims on resident non-gov't sector growth	(1.6)	1.8	4.5	8.9	9.7	4.6	5.0	6.0	5.0	5.0
Banks' claims on resident non-gov't sector/GDP	56.9	54.4	52.9	53.7	54.0	57.0	57.2	57.0	56.6	56.4

Table 1

Bulgaria Selected Indicators (cont.)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Foreign currency share of claims by banks on residents	33.1	29.0	25.3	23.6	23.5	20.4	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	40.3	38.7	36.9	35.9	34.6	36.1	N/A	N/A	N/A	N/A
Real effective exchange rate growth	(3.3)	0.2	1.1	3.3	0.5	2.8	N/A	N/A	N/A	N/A

Sources: Eurostat (economic indicators), Bulgarian National Bank (external indicators), Eurostat (fiscal indicators), and Bulgarian National Bank, IMF (monetary indicators).
Adjustments: Usable reserves adjusted by subtracting monetary base from reported international reserves.
Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Bulgaria Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	4	Reduced predictability of future policy responses, for example in episodes of heightened political volatility. Transparency and checks and balances can at times be hampered.
Economic assessment	4	Based on GDP per capita (US$) and growth trends as per Selected Indicators in Table 1.
External assessment	2	Based on narrow net external debt and gross external financing needs/(CAR + useable reserves) as per Selected Indicators in Table 1.
Fiscal assessment: flexibility and performance	2	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1.
Fiscal assessment: debt burden	1	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in Table 1.
		80% of gross government debt is denominated in foreign currency.
Monetary assessment	5	The lev has been fixed to the euro via a currency board.
		The Bulgarian National Bank (BNB) has been successful in maintaining a currency board, supported by political commitment to prudent fiscal policies. As per its charter--and according to the currency board regime under which it operates--the BNB's ability to act as a lender of last resort is limited.
Indicative rating	bbb-	As per Table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	1	A change in the fiscal assessment or the external assessment could lead to a multi-notch change in the indicative rating. We think that the weakening of the fiscal assessment might prove transitory after the COVID-19 pandemic given Bulgaria's strong track record of fiscal prudency. At the same time, a quicker recovery of the export base or a further increase in reserve levels could result in an improvement of the external score.
Final rating		
Foreign currency	BBB	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt.

Table 2

Bulgaria Ratings Score Snapshot (cont.)

Key rating factors	Score	Explanation
Local currency	BBB	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings List, May 21, 2021
- Sovereign Ratings History, May 21, 2021
- Sovereign Ratings Score Snapshot, May 5, 2021
- Economic Research: European Economic Snapshots: Unlike The Rest Of Europe, The U.K. Is Looking Beyond COVID-19, April 28, 2021
- Next Generation EU Will Shift European Growth Into A Higher Gear, April 27, 2021
- Sovereign Risk Indicators, April 12, 2021; a free interactive version is available at http://www.spratings.com/sri
- Default, Transition, and Recovery: 2020 Annual Sovereign Default And Rating Transition Study, April 12, 2021
- Global Sovereign Rating Trends: First-Quarter 2021, April 9, 2021
- Sovereign Debt 2021: Global Borrowing Will Stay High To Spur Economic Recovery, March 1, 2021
- Bulgaria's And Croatia's Entry Into ERM II Will Gradually Strengthen Their Monetary Arrangement, July 13, 2020

Ratings Detail (As Of May 31, 2021)*	
Bulgaria	
Sovereign Credit Rating	BBB/Stable/A-2
Transfer & Convertibility Assessment	A
Senior Unsecured	BBB
Short-Term Debt	A-2

Ratings Detail (As Of May 31, 2021)*(cont.)	
Sovereign Credit Ratings History	
29-May-2020	BBB/Stable/A-2
29-Nov-2019	BBB/Positive/A-2
01-Jun-2018	BBB-/Positive/A-3
01-Dec-2017	BBB-/Stable/A-3
02-Jun-2017	BB+/Positive/B

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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