FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Bulgaria at 'BBB'; Outlook Positive

Fri 18 Nov, 2022 - 5:01 PM ET

Fitch Ratings - Frankfurt am Main - 18 Nov 2022: 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

Credit Fundamentals: Bulgaria's ratings are supported by its strong external and public balance sheets versus 'BBB' peers and a credible policy framework, underpinned by EU membership and a long-standing currency board. This is balanced by unfavourable demographics, which weigh on potential growth and government finances over the long term. World Bank Governance Indicators (WBGI) have worsened in recent years but are in line with the peers.

Positive Outlook: The Positive Outlook reflects the prospect of euro adoption, which would lead to further improvements in external metrics. Despite renewed political instability, we believe the authorities remain committed to euro adoption by 2024, with risks around the timeline mainly tied to meeting convergence criteria. Given high uncertainty about the inflation trajectory over the next two years, the risks of a delay in euro adoption beyond 2025 have increased. This is balanced against a clear commitment at the local and EU level to expedite the process.

Euro Adoption: The implementation of Bulgaria's ERM II post-entry commitments is ongoing and Bulgaria is expected to request the assessment of its progress on convergence criteria in May 2023 (the key date for 2024 euro adoption). In Fitch's view, Bulgaria should meet legal requirements for eurozone accession but the biggest obstacle remains the price stability criterion. HICP inflation in Bulgaria has been running above the rate of the three best performing EU member states since the beginning of the year and is expected to remain elevated throughout 1Q23.

Meeting all other criteria is less challenging, and as long as political commitment remains firm in Bulgaria and the EU, we would expect flexibility in the convergence assessment (as shown in Croatia). 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 the inclusion of the Bulgarian lev into ERM II to joining the euro.

Renewed Political Instability: The four-party coalition government led by We Continue to Change (WCC) collapsed following a successful no-confidence vote at the end of June 2022, leading to the fourth snap election in less than two years. The vote resulted in a highly fragmented legislature with limited prospects around formation of a stable coalition. The political instability will likely extend into 2023 with another election possible in early 2023. Nevertheless, we believe that there is a broad-based political commitment and institutional support for euro adoption and reforms linked to the National Recovery Plan.

Weakening Growth Outlook: We expect this year's GDP growth to be 3.5% (previous review: 3.0%) due to better-than-expected performance in 1H22. In 2H22, solid performance of energy sectors and strong export growth should partially offset the negative impact of reduction in real disposable income and drop in investments. Unfavourable carry-over effects, and slowing private and public consumption will push next year's growth down to 1.4% (vs. 3.8% expected at the June review). Investments growth should pick up in line with the increased inflow of EU funds. We expect growth to normalise in 2024 and return to about 3%.

Limited Risk of Energy Rationing: Cessation of Russian natural gas deliveries at the end of April 2022 accelerated Bulgaria's plans to decouple from Russian energy imports. Given secured gas deliveries, favourable weather and lower gas consumption, the risk of energy rationing in the 2022-2023 heating season is low. Nevertheless, uncertainty around the 2023-2024 winter is high, given that gas supply is likely to remain scarce in the absence of gas flows from Russia. The long-term agreement with Azerbaijan ensures delivery of 1 billion cubic meters (bcm) of natural gas (about a third of annual gas consumption) with a possible extension to 2bcm. The country secured 25% of capacity of the LNG terminal in Greece (about 0.7bcm), which should be operational by the end of 2023.

Increased Inflationary Pressures: We have raised our average HICP inflation forecast to 13.1% in 2022 and 9.2% in 2023 from 11.8% and 6.0%, respectively, in June. We expect HICP inflation to remain in double digits throughout 1Q23 and to decelerate toward 5.5% yoy by end-2023. Food, energy and transport prices are the key inflation drivers. However, price pressures are also increasing in other subsectors, especially services. The spill-over of high energy prices into non-energy components could limit the positive impact of the base effects next year and will likely push core inflation up.

Uncertain Fiscal Outlook: Fitch forecasts the deficit to remain broadly unchanged in 2022-2023 at around 3.8% of GDP, in line with the current 'BBB' median. The caretaker government decided to extend the 2022 budget into 2023, keeping the expenditure and introduced measures unchanged. Slower economic growth will result in lower tax revenues, while expected dividend payments from state-owned energy companies should keep total revenues broadly unchanged in 2023.

Energy Support Measures: As a response to the energy crisis, a subsidy scheme covering households and companies has been introduced. The government earmarked about BGN7.1 billion (4.3% of GDP) for the subsidy this year. The amount of the subsidy scheme next year is yet unclear, given planned adjustments to reflect recent EU regulation on emergency intervention to address high energy prices. The energy subsidy scheme should be broadly budget neutral due to its financing sources. The cost of schemes is covered from an extra dividend payment by state-owned energy companies, while EUR2.5 billion (2.9% of 2022 GDP) has been allocated for corporate support under the EU mechanism REPowerEU.

Public Debt to Gradually Increase: Despite wider deficits expected in the medium term, Bulgaria's public debt rate will remain very low compared with EU countries and 'BBB' peers. We expect the public debt/GDP ratio to remain below 30% during the forecast horizon. Almost all public debt is at a fixed rate, with average maturity of 8.5 years for FX-denominated debt and five years for local-currency bonds. This leaves Bulgaria somewhat less exposed to recent sharp yield increases. We expect general government interest payments to increase to 2.2% of revenues in 2023 (vs. 1.3% of revenues in 2021), well below the current 'BBB' median of 7.2% and the lowest in the category.

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. Theses scores reflect the high weight that the WBGI have in our proprietary Sovereign Rating Model. Bulgaria has a medium WBGI ranking in the 55th 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:

-External Finances: A significant delay in the timeline of eurozone accession due, for example, to a failure in meeting convergence criteria or adverse policy developments.

-Macro: A period of energy shortages in Bulgaria or in key trading partners, or increased risk of such a scenario that materially lowers growth prospects compared with Fitch's current expectation

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

-External Finances: 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.

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 did not adjust the output from the SRM score to arrive at the final LT FC IDR.

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.

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 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.

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 unsecured	LT	BBB	Affirmed	BBB

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Malgorzata Krzywicka
Associate Director
Primary Rating Analyst
+49 69 768076 105
malgorzata.krzywicka@fitchratings.com
Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Federico Barriga Salazar
Director
Secondary Rating Analyst
+49 69 768076 145
federico.barrigasalazar@fitchratings.com

Shelly Shetty
Managing Director
Committee Chairperson
+1 212 908 0324
shelly.shetty@fitchratings.com

MEDIA CONTACTS

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

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Country Ceilings Criteria (pub. 01 Jul 2020)

Sovereign Rating Criteria (pub. 12 Jul 2022) (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, v1.3.1 (1)

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

Sovereign Rating Model, v3.13.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Bulgaria	EU Issued, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (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. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

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 or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) 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.

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 report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to

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