Rating_Action: Moody's affirms Bulgaria's Baa1 ratings, maintains stable outlook

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Paris, February 03, 2023 -- Moody's Investors Service ("Moody's") has today affirmed the Government of Bulgaria's long-term issuer and senior unsecured ratings at Baa1, while also affirming the Senior Unsecured MTN programme rating at (P)Baa1. The outlook remains stable.

The affirmation of Bulgaria's Baa1 ratings balances the following key rating drivers:

1) Moody's expectation that the European energy crisis will not materially weaken Bulgaria's economic and fiscal strength

2) The support to Bulgaria's credit profile stemming from the prospect of euro adoption, despite the risk of delays to adoption beyond 2024.

3) Risks to government effectiveness and progress on key policy priorities stemming from Bulgaria's protracted domestic political deadlock.

The stable outlook reflects Moody's expectation that Bulgaria's key credit metrics for economic and fiscal strength are unlikely to significantly change over the coming 12 to 18 months. It also reflects the balance of risks between the potential negative effects on the credit profile stemming from the country's political deadlock, and the potential positive effects from eventual adoption of the euro.

Bulgaria's local currency (LC) and foreign currency (FC) ceilings remain unchanged at Aa2. The five notch-gap between the LC ceiling at Aa2 and the sovereign rating at Baa1 reflects strong policy predictability and reliability of institutions as well as moderate political risk and external imbalances. The FC ceiling, at the same level as the LC ceiling, reflects strong policy effectiveness with a longstanding currency board, under which the Bulgarian lev is fixed to the euro. Both ceilings benefit from euro accession plans, which have supported institutional development and minimize transfer and convertibility risk. Bulgaria is not yet a euro area member but has entered the final stages prior to full adoption of the euro. For euro area countries, a six-notch gap between the LC ceiling and the sovereign rating as well as a zero-notch gap between the local and foreign currency ceiling is typical.

RATINGS RATIONALE

RATIONALE FOR AFFIRMING THE Baa1 RATINGS

FIRST DRIVER: MOODY'S EXPECTATION THAT THE EUROPEAN ENERGY CRISIS WILL NOT MATERIALLY WEAKEN BULGARIA'S ECONOMIC AND FISCAL STRENGTH

The European energy crisis and the broader economic fallout from the Russian invasion of Ukraine represents a significant economic shock to Bulgaria and its main European trading partners. However, despite rising producer and consumer prices and a broader European economic downturn, the available data until November 2022 point to both industrial production and private consumption in Bulgaria being relatively resilient to these shocks. Moody's estimates that the Bulgarian economy grew by 2.7% of GDP in 2022. While the rate of growth is expected to slow to 1.4% of GDP in 2023, Moody's expects that this will be among the more robust growth rates among European sovereigns this year, and that growth will pick up to 2.9% in 2024, broadly in line with Bulgaria's pre-pandemic average growth rate

Bulgaria's status as a net exporter of electricity generated from nuclear, lignite and hydropower, and the strong performance of the energy sector is one important factor behind the relative strength of industrial production and the overall economy over the past year. The windfall gains of state-owned energy utilities from exporting electricity at elevated market prices have also helped fund one of the most generous energy price subsidy schemes for non-household consumers in Europe, which has also supported the broader resilience of Bulgaria's industry and manufacturing sector in the current crisis. The government's ability to provide such support to industry without weakening its fiscal strength is an important factor why Moody's does not expect that the energy crisis will cause significant lasting economic scarring on the Bulgarian economy. Moody's also expects that strong nominal wage growth will continue to support private purchasing power and consumption in 2023, even though inflation will be high but declining towards 6.0% by the end of 2023, from 14.3% at the end of 2022.

Bulgaria's principal credit strength remains its very low level of government debt, which Moody's estimates stood at 23.1% of GDP at the end of 2022. This is significantly below the median of its Baa1-rated peers of 52.3% of GDP and also the second-lowest government debt burden of any EU member state. Despite the successive shocks of the coronavirus pandemic and the European energy crisis, Moody's estimates that Bulgaria's government debt burden was only about three percentage points of GDP higher at the end of 2022 than at end-2019, prior to the outbreak of the coronavirus pandemic. The debt burden of its Baa1-rated peers increased by 18.6 percentage points of GDP over the corresponding period.

Moody's estimates that Bulgaria's headline government deficit reached 3.0% of GDP in 2022, down from a pandemic high of 3.9% in 2021. Fiscal forecasts are made more uncertain by the fact that parliament, due to the absence of a regular government, has not yet adopted a budget for 2023. However, Bulgaria's caretaker government currently operates under a prolongation of the 2022 budget, which, together with the need for Bulgaria to hold its deficit below 3% of GDP to meet the euro area convergence criteria, leads Moody's to expect that the headline deficit will remain broadly stable around 3% of GDP also in 2023 and 2024. Coupled with a high but slowing rate of nominal GDP growth, Moody's expects this will lead to a slight increase of Bulgaria's debt burden to 23.8% and 24.7% of GDP at the end of 2023 and 2024 respectively, keeping Bulgaria's overall fiscal strength broadly intact.

SECOND DRIVER: THE SUPPORT TO BULGARIA'S CREDIT PROFILE STEMMING FROM THE PROSPECT OF ADOPTION OF THE EURO, DESPITE THE RISK OF DELAYS TO ADOPTION BEYOND 2024

Bulgaria entered the final stage prior to adoption of the euro, when the Bulgarian lev was included in the Exchange Rate Mechanism II, in July 2020, and the Bulgarian authorities maintain a target of adopting the euro at the start of 2024. However, Bulgaria was assessed as not yet meeting the convergence criteria for adoption of the euro in the European Commission's (EC) and the European Central Bank's (ECB) June 2022 Convergence Reports. Most notably, the EC and ECB judged that Bulgaria did not yet meet the price stability criterion, which requires the country's average 12-month rate of inflation to be in line with that of the three best performing member states in terms of price stability in the EU.

Although Bulgaria could still meet its 2024 target for adoption of the euro, Moody's baseline scenario is that adoption will eventually occur but is likely to be delayed at least until 2025. Moody's estimates that Bulgaria is currently even further away from meeting the price stability criterion for euro adoption than last June, while the country's protracted political deadlock also jeopardises the prospect of euro adoption already in 2024.

The eventual adoption of the euro will be credit positive for Bulgaria, most clearly as it will eliminate any remaining foreign currency risks for euro-denominated government debt. Over the longer term, euro adoption will also support economic strength through deeper economic integration with the euro area and also provide evidence of the strength of institutions and governance in steering the country into the euro. Conversely, a more protracted delay or evidence of more fundamental political or economic obstacles to completing the process of euro adoption could be detrimental to Moody's assessment of the strength of Bulgaria's institutions and governance.

THIRD DRIVER: INCREASING RISKS TO GOVERNMENT EFFECTIVENESS AND PROGRESS ON KEY POLICY PRIORITIES STEMMING FROM BULGARIA'S PROTRACTED DOMESTIC POLITICAL DEADLOCK

Bulgaria is undergoing a protracted period of domestic political deadlock, which increasingly risks weighing on the government's ability to make progress on key policy priorities and respond to shocks. Since the scheduled parliamentary elections of April 2021, the country has been governed by caretaker governments apart from a seven-month period from late 2021 to mid-2022. The country has also held three snap elections following the April 2021 elections to enable the formation of a stable coalition government. The most recent snap elections were held in October 2022, but have since failed to result in the formation of a new government. New snap elections will be held this spring, albeit with limited prospects that this will create a markedly stronger parliamentary basis for forming a stable governing coalition.

The country's protracted political deadlock increasingly risks having a tangible negative effect on the government's ability to make progress on key policy priorities. Aside from increasing the risk of a prolonged delay to euro adoption, the absence of a stable governing coalition will complicate progress towards meeting the policy milestones necessary to unlock further tranches of funding under the EU's Recovery and Resilience Facility in 2023 and beyond. Bulgaria is one of the main recipients of RRF funding relative to GDP, with total grant funding amounting to close to 10% of 2021 GDP available to be spent before the end of 2026.

The absence of a stable governing coalition also risks complicating the government's response to any unforeseen events. That said, despite being governed by a caretaker government for much of the period since being cut off from Russian gas supplies by Gazprom in April 2022, the Bulgarian government has proven effective in strengthening alternative gas supply routes via Greece (Ba3 stable) and Turkiye (B3 stable) as well as alternative supplies of natural gas, most notably from Azerbaijan (Ba1 stable).

RATIONALE FOR THE STABLE OUTLOOK:

The stable outlook reflects Moody's expectation that Bulgaria's key credit metrics for economic and fiscal strength are unlikely to significantly change over the coming 12 to 18 months, with the economy returning to pre-pandemic growth levels in 2024 and the government debt burden remaining very low relative to rating peers. The stable outlook also reflects the balance of risks between the potential negative effects on government effectiveness and progress on key policy priorities stemming from the country's political deadlock, and the positive effects from eventual adoption of the euro.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

Bulgaria's ESG Credit Impact Score is neutral to low (CIS-2), reflecting low exposure to environmental risks, moderate social risks and low governance risks.

Bulgaria's exposure to environmental risks is generally low across the factors we assess for this category such as physical climate risks, water management, natural capital and waste and pollution. Although coal still accounts for around 20% of Bulgaria's total energy supply, this is significantly lower than regional peers such as Poland, for which we assess carbon transition and overall environmental risks to be moderately negative. Bulgaria's overall E issuer profile score is therefore neutral to low (E-2).

Bulgaria's social risks include adverse demographics due to an ageing population. Access to basic services is satisfactory. Overall, we assess Bulgaria's S issuer profile score as moderately negative (S-3).

Bulgaria's governance risk score is low (G-2). This is underpinned by the government and the central bank's high credibility in managing Bulgaria's currency board with the euro, which allowed the Bulgarian lev to be included in the ERM II in July 2020. However, weaknesses with regard to control of corruption and the rule of law remain a weakness and a constraint on the credit profile.

GDP per capita (PPP basis, US$): 26,051 (2021) (also known as Per Capita Income)

Real GDP growth (% change): 7.6% (2021) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 6.6% (2021)

Gen. Gov. Financial Balance/GDP: -3.9% (2021) (also known as Fiscal Balance)

Current Account Balance/GDP: -0.5% (2021) (also known as External Balance)

External debt/GDP: 58.4% (2021)

Economic resiliency: baa2

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

On 31 January 2023, a rating committee was called to discuss the rating of the Bulgaria, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have not materially changed. The issuer's institutions and governance strength, have not materially changed. The issuer's fiscal or financial strength, including its debt profile, has not materially changed. The issuer has become less susceptible to event risks.

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

FACTORS THAT COULD LEAD TO AN UPGRADE

Upward pressure on Bulgaria's outlook and, potentially, rating, would arise from fundamental improvements in the quality of executive institutions and the judiciary, more specifically, the fight against corruption, organized crime, improving efficiency of public spending and strengthening of the rule of law. Improved long-term economic prospects from enhancements in infrastructure, the institutional environment, coupled with euro adoption could also put upward pressure on the rating.

FACTORS THAT COULD LEAD TO A DOWNGRADE

A marked and permanent deterioration in the government's very strong balance sheet and/or long-term economic growth prospects would exert downward pressure on Bulgaria's rating. In addition, signs of a weakening in the institutional framework or of a failure to complete the euro adoption process in the next few years would also 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 Sovereigns published in November 2022 and available at https://ratings.moodys.com/api/rmc-documents/395819. Alternatively, please see the Rating Methodologies page on https://ratings.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 on https://ratings.moodys.com/rating-definitions.

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