

## Research Update:

### Ratings On Bulgaria Affirmed At 'BBB/A-2'; Outlook Stable

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## Table Of Contents

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Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

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## Overview

- In our opinion, the Bulgarian government's policies will continue to support the sovereign's macrofinancial stability, including consolidation of its finances, despite the subdued economic growth environment.
- We are therefore affirming the sovereign credit ratings on Bulgaria at 'BBB/A-2'.
- The outlook is stable.

## Rating Action

On Dec. 13, 2012, Standard & Poor's Ratings Services affirmed its long- and short-term foreign and local currency sovereign credit ratings on the Republic of Bulgaria at 'BBB/A-2'. The outlook is stable. The transfer and convertibility (T&C) assessment is 'A'.

## Rationale

The ratings on Bulgaria reflect our view of the government's strong track record of fiscal prudence; low and declining deficit and debt stock, despite subdued economic growth; and the country's strong medium-term growth prospects, particularly if they are backed by increased private investment; and improving absorption of EU funds. These strengths are partially offset by Bulgaria's relatively low GDP per capita, which we estimate at \$6,900 in 2012; its high, albeit declining, external financing needs; and limited monetary flexibility owing to the country's currency board arrangement.

Economic recovery since the 2009 recession has been slow, driven mainly by export performance, as domestic demand remained muted until early 2012. We expect real GDP growth of about 1.7% in 2013 and an average of 2.0% from 2013-2015, supported by a recovery in both domestic and external demand. We expect the current account deficit to remain close to balance in 2012, before slipping back into a deficit as domestic demand gradually recovers and the trade deficit widens over the next three years. Nevertheless, the government's recent announcement about reducing gas prices for households and corporates could benefit next year's current account balance and the GDP growth outlook. In our view, net direct investment flows combined with EU transfers will finance the current account deficit in the coming years.

The government has continued to consolidate its finances following budgetary deterioration in 2009, despite the low growth in the past two years, and has

complied with the requirements of the recently adopted national fiscal pact. Though the government has stated that it is postponing plans to join the European Exchange Rate Mechanism (ERM II), the precursor to entry into the European Economic and Monetary Union (eurozone), we do not expect this to lead to a change in its commitment to sound economic policy.

We expect the general government deficit to reach 1.3% in 2012 and stay broadly the same in 2013, though there is a risk of fiscal slippage with parliamentary elections scheduled for mid-2013. However, there is a potential for higher-than-budgeted privatization revenues that could be used to restore the fiscal buffer or provide cofinancing projects. The general government debt is low at an estimated 17% of GDP in 2012 and net general government debt is estimated at 10% of GDP. The fiscal reserve covers at least one year of amortization and interest payments. General government interest expenditure is also low at slightly less than 2% of general government revenues in 2012 and is expected to broadly remain at this level over 2013-2015.

In our view, the banking system appears well-capitalized, with a capital adequacy ratio of 16.7% and core Tier I ratio of 15.2% at end-June 2012. With an increase in the domestic savings rate matched by robust growth in domestic deposits over the past three years, banks have paid down their external debt, largely owed to parent banks, by \$4.7 billion between 2008 and 2011. The banking system is predominantly foreign-owned and problems that affect foreign parent banks, such as dislocations in the financial sectors of other European economies, may have knock-on effects on their Bulgarian subsidiaries in our opinion. Greek-owned banks own slightly less than one-quarter of banking system loans; however, we note that the regulatory and prudential frameworks have been strengthened so as to mitigate the risk of a funding or capital withdrawal by parent banks. In terms of asset quality, the ratio of gross nonperforming loans (NPLs) to total loans is still high at 16.9% at end-June 2012 (NPLs net of loan loss provisions: 11.3%) and we expect asset quality deterioration to peak and reverse by end-2013.

## **Outlook**

The stable outlook balances our view of Bulgaria's macrofinancial stability, favorable fiscal position, and economic growth prospects against its relatively low levels of wealth, external debtor position, and limited monetary flexibility.

If the sovereign's fiscal position weakens or its external liquidity position deteriorates significantly, downward pressure could build on the ratings.

On the other hand, if external conditions for the financial system ease further and exports, combined with capacity-enhancing investment, lead economic growth toward a more balanced structure, while further reducing the external financing requirements, we could consider raising the ratings.

## Related Criteria And Research

- Sovereign Government Rating Methodology And Assumptions, June 30, 2011
- Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

## Ratings List

Ratings Affirmed

Bulgaria (Republic of)	
Sovereign Credit Rating	BBB/Stable/A-2
Transfer & Convertibility Assessment	A
Senior Unsecured	BBB

NB: This list does not include all ratings affected.

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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