

26 APR 2024

## Fitch Affirms Bulgaria at 'BBB'; Outlook Positive

Fitch Ratings - Frankfurt am Main - 26 Apr 2024: 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 credible policy framework, underpinned by EU membership and a long-standing currency board. This is balanced by low labour productivity and unfavourable demographics, which weigh on potential growth and government finances over the long term. World Bank Governance Indicators (WBGi) have worsened in recent years, reflecting a history of unstable coalitions and a relatively high perception of corruption.

**Positive Outlook:** The Positive Outlook reflects the prospects for euro adoption, which would lead to further improvement in external metrics. Despite the euro adoption process being delayed beyond January 2025 and renewed political uncertainty, Fitch considers that there is broad political commitment locally and at the EU level to euro adoption. All legislative measures to address the post-ERMII commitments have been adopted and await implementation, while the Law on the Central Bank was passed in February 2024.

**Euro Adoption:** Bulgaria's HICP inflation has considerably eased but remains above that of the three best performing EU member states, and Fitch expects that Bulgaria will not comply with the price stability criterion in mid-2024. Bulgaria intends to request a reassessment of its progress on convergence criteria in 2H24, which should allow for eurozone entry later in 2025. In Fitch's view, Bulgaria could comply with the price stability criterion in 4Q24 at the earliest, conditional on inflation developments across the EU.

Bulgaria is on course to meet all other euro-adoption nominal criteria (public finances, interest rate and exchange rate). Nonetheless, a lack of stable government and potentially lengthy coalition negotiations could delay the eurozone entry beyond 2025. Overall, we consider euro adoption as supportive to the rating.

**Renewed Political Uncertainty:** Bulgaria is heading for its sixth parliamentary vote in just over three years, with a snap election scheduled for June 2024. This follows a failed government rotation between the two largest parties WCC-DB and GERB, due to clashes over administrative positions and the reform agenda. The upcoming snap vote will likely produce another fragmented legislature, similar to the last ballots, with pro-European parties holding a majority.

**Gradual Growth Recovery:** The Bulgarian economy grew by 1.8% in 2023, supported by robust household spending, positive net export and solid investment growth. Weak external demand, renewed political uncertainty and slow absorption of EU funds will impede economic activity in 1H24, while positive real wage growth and strong credit growth will support private consumption. Fitch expects real GDP growth to accelerate to 2.4% in 2024 and further to 3.1% in 2025.

**Medium-Term Growth Challenges:** While Bulgaria could receive up to EUR17 billion (2.4% of GDP annually) of funds under various EU programmes by 2030, we see risks of under-execution due to institutional capacity and delays in programme implementation. In Fitch's view, unfavourable demographics and persistent labour shortages will weigh on Bulgaria's medium-term growth potential, unless labour productivity increases. Labour productivity stood at 56.8% of EU27 average at end-2023 and was the lowest in the EU.

**Disinflation Dynamics to Ease:** Harmonised inflation (HICP) was 3.1% in March 2024, above the EU27 rate of 2.6%, but down from a peak of 15.6% in September 2022. The decline was mainly due to the base effects, lower prices of energy and slower food price inflation. We expect HICP inflation to continue to ease, albeit more slowly. In our view, the government's measures and tax changes should be broadly neutral for inflation. We expect the average HICP to be 3.3% in 2024 and 2.9% in 2025, down from 8.6% in 2023.

**Wider Medium-Term Fiscal Deficits:** The general government budget deficit stood at 1.9% of GDP in 2023. A robust labour market boosted revenue from personal income tax and social contributions, while higher social and capital spending weighed on expenditure. We forecast a budget deficit of 2.9% in 2024 and 3% in 2025. Rising social needs, delays in reform implementation and a lack of credible medium-term fiscal planning, due to the instability of recent cabinets, has weakened Bulgaria's fiscal position in recent years.

**Low Public Debt:** Despite wider fiscal deficits, Bulgaria's public debt ratio will remain very low compared with EU countries and 'BBB' peers. We project a gradual increase of public debt/GDP ratio to 24.9% in 2024, from 23.1% in 2023, and further to 30.7% by 2028. Almost all government debt is fixed rate, with a long average maturity, which reduces Bulgaria's exposure to interest rate changes abroad. General government interest payments will rise to 1.9% of revenue in 2025, up from 1.2% in 2023, but well below the current 'BBB' median of 8.8% in 2025.

**Strong External Finances:** The current account deficit (CAD) narrowed to 0.2% of GDP in 2023, as wider trade and services surplus was offset by larger primary income deficit. Fitch expects the CAD to average 0.6% in 2024-2025, as goods export recovery lags and solid domestic demand boosts goods imports. Given the delays in the implementation of the National Recovery Plan, we expect the capital account surplus to average 1.1% in 2024-2025, down from 1.6% in 2023. Bulgaria's net external position should remain stable in 2024-2025 (surplus of 33.3% of GDP in 2023).

**Stable Banking Sector:** The Bulgarian banking sector remains stable, with solid capitalisation (total capital ratio at 21.7% at end-2023) and improving asset quality. The ratio of gross impaired loans decreased to 4.0% at end-2023 from 6.5% at end-2021, according to Fitch's estimates. Loan growth

remained strong across the major segments, with a strong contribution from retail mortgages and resilient demand among corporates.

In October 2023, the Financial Action Task Force (FATF) placed Bulgaria on the 'Grey List' of countries under special scrutiny due to deficiencies in the prevention of money laundering. The Bulgarian authorities have stated that they are committed to implementing all the necessary reforms outlined by the FATF's action plan, and the country has already reported progress on some of the reforms.

**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. These scores reflect the high weight that the WBGI have in our proprietary Sovereign Rating Model. Bulgaria has a medium WBGI ranking at 52nd percentile reflecting a history of unstable coalitions, relatively high perception of corruption and moderate institutional capacity versus a 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/ Structural:** Lack of progress in eurozone accession due to persistent political instability or a failure in meeting convergence criteria.

**-Macro/Structural:** Weaker economic growth prospects, for example, as a result of adverse political developments that weigh on reform implementation.

### Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

**-External Finances:** Further progress towards euro adoption, for example, through confirmation that Bulgaria has met convergence criteria and greater certainty regarding 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 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.

## Country Ceiling

The Country Ceiling for Bulgaria is 'A-', two notches above the LT FC IDR. This reflects strong constraints and incentives, relative to the IDR, against capital or exchange controls being imposed that would prevent or significantly impede the private sector from converting local currency into foreign currency and transferring the proceeds to non-resident creditors to service debt payments.

Fitch's Country Ceiling Model produced a starting point uplift of +1 notch above the IDR. Fitch's rating committee applied a further +1 notch qualitative adjustment to this, under the Long-Term Institutional Characteristics pillar, as we view trade and financial integration as stronger than the model outputs, supported by EU membership.

## 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.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores,

visit [www.fitchratings.com/topics/esg/products#esg-relevance-scores](http://www.fitchratings.com/topics/esg/products#esg-relevance-scores).

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## Rating Actions

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Bulgaria	LT IDR	BBB 	Affirmed	BBB 
	ST IDR	F2	Affirmed	F2
	LC LT IDR	BBB 	Affirmed	BBB 
	LC ST IDR	F2	Affirmed	F2
	Country Ceiling	A-	Affirmed	A-

ENTITY/DEBT	RATING	RECOVERY	PRIOR
• senior unsecured <sup>LT</sup>	BBB	Affirmed	BBB

## RATINGS KEY OUTLOOK WATCH

POSITIVE	⊕	◊
NEGATIVE	⊖	◊
EVOLVING	◊	◆
STABLE	◐	

## Applicable Criteria

[Country Ceiling Criteria \(pub.24 Jul 2023\)](#)

[Sovereign Rating Criteria \(pub.06 Apr 2023\) \(including rating assumption sensitivity\)](#)

## Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v2.0.1 [\(1\)](#)

Debt Dynamics Model, v1.3.2 [\(1\)](#)

Macro-Prudential Indicator Model, v1.5.0 [\(1\)](#)

Sovereign Rating Model, v3.14.1 [\(1\)](#)

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