FitchRatings

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Fitch Affirms Bulgaria at 'BBB'; Outlook Positive

Fitch Ratings - Frankfurt am Main - 18 Oct 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 against 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 coalition governments. Perception of corruption is high relative to peers.

Positive Outlook: The Positive Outlook reflects the prospects for euro adoption, which would lead to further improvement in external metrics. Fitch considers that there is broad political commitment at the national and EU level to euro adoption, despite the process being likely delayed beyond the government's official target of January 2025 and continued political uncertainty.

Euro Adoption: Bulgaria met all the euro-adoption nominal convergence criteria apart from price stability according to the 2024 Convergence Report, which was released in mid-2024. Since then inflation in Bulgaria has continued to decline, narrowing the gap between average inflation in the country and that of the three best performing EU member states. In Fitch's view, Bulgaria could meet the price stability criterion at the beginning of 2025, depending on inflation developments across the EU.

In our baseline scenario, this would allow Bulgaria to request the reassessment of its progress on convergence criteria in 1H25 and would allow for eurozone entry as of January 2026. All legislative measures necessary to fulfil outstanding post-ERM II commitments have been approved by the parliament, while some measures await implementation. Nonetheless, a lack of stable government and potentially lengthy coalition negotiations could delay eurozone entry. Overall, we consider euro adoption as supportive of the rating.

Broadly Stable Inflation: HICP inflation was 1.5% in September 2024 and core inflation stood at 2.3%, suggesting a broad-based easing of price pressures. We expect that inflation will begin to increase gradually in coming months as base effects become less favourable and the inflationary effect of strong nominal wage growth feeds through to prices. We expect average HICP of 3% in 2024, 3.5% in 2025 and 3.1% in 2026, slightly above peer median.

Political Uncertainty Remains High: Bulgaria is heading for another snap election, its seventh since 2021, following unsuccessful coalition negotiations after the June 2024 vote. The election is scheduled for 27 October 2024 and it will likely produce another fragmented legislature with seven parties expected to enter the parliament. This increases the risk of another election early in 2025. Despite the political stalemate, we believe that euro adoption, full Schengen area entry and the implementation of the National Recovery Plan (NRP) will remain the priority of the political majority.

Gradual Growth Recovery: Fitch expects GDP growth of 2% in 2024, up from 1.8% in 2023, supported by solid private consumption and resilient investment activity, despite elevated political uncertainty and delays in implementation of NRP. Net exports will be a drag on growth as external demand remains weak and buoyant domestic demand boosts the import bill. We forecast GDP growth picking up to 2.5% in 2025 and 2.7% in 2026, slightly weaker than peers, mostly on the back of expected recovery of external demand.

Wider Medium-Term Fiscal Deficits: Fitch forecasts the budget deficit to widen to 2.8% of GDP in 2024, from 1.9% in 2023, reflecting higher costs of compensations and social spending. Lack of revenue-enhancing measures will keep the budget deficit unchanged at 2.9% in 2025-2026 (vs. 'BBB' median of 3.2% deficit).

The caretaker government intends to present the 2025 draft budget act and the medium-term fiscal-structural plan in autumn but Fitch does not expect much clarity on potential measures before government formation. Increased social spending, 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: Bulgaria's public debt ratio will remain very low compared with EU countries and among the lowest in the 'BBB' category. We project a gradual increase of public debt/GDP ratio to 24.7% in 2024, from 23.1% in 2023, and further to 30% 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 1.6% of revenue in 2026, up from 1.2% in 2023, but well below the current 'BBB' median of 9.4%.

Strong External Finances: Fitch expects the current account deficit to widen to 0.6% in 2024 (based on IMF data), from 0.2% in 2023, and further to 1.6% in 2026, compared with the current 'BBB' median of deficits of 0.7% and 1%. Due to the delays in the implementation of the NRP and lower funds' inflows at the beginning of the new financing period, we expect the capital account surplus to narrow to 0.7% in 2024 and gradually widen to 1.4% in 2026. Bulgaria's external position is further supported by sizeable foreign reserves (7.6 months of current external payments in 2024) and we expect the net external position to remain stable in 2024-2026 (surplus of 35.6% of GDP in 2023).

Stable Banking Sector; Strong Credit Growth: The Bulgarian banking sector remains stable, with solid capitalisation (total capital ratio at 20.8% at end-1H24) and improving asset quality. The ratio of gross impaired loans decreased to 3.6 % at end-1H24 from 6.5% at end-2021, according to Fitch's estimates. Loan growth accelerated across the major segments, with a strong contribution from retail mortgages and resilient demand among corporates.

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.

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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-
• senior unsecured	LT	BBB	Affirmed		BBB
• Senior Unsecured-Local currency	LT	BBB	Affirmed		BBB

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙

RATINGS KEY	OUTLOOK	WATCH
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, v2.0.2 (1)

Debt Dynamics Model, v1.3.2 (1)

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

Sovereign Rating Model, v3.14.1 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Bulgaria	EU Issued, UK Endorsed

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