Rating Action: Moody's Ratings affirms Bulgaria's Baa1 ratings, maintains stable outlook

24 Jan 2025

Paris, January 24, 2025 -- Moody's Ratings (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 three main rating drivers. Firstly, the affirmation reflects our expectation that Bulgaria's debt burden and debt affordability metrics will remain significantly stronger than its rating peers, despite a gradual weakening in coming years. Secondly, the affirmation also reflects our expectation that the Bulgarian economy will continue to grow at a robust rate in 2025 and beyond, leading to further income convergence with peers. Bulgaria's credit profile will also be supported by the likely adoption of the euro in the foreseeable future. Thirdly, these strengths are balanced by a weakening of institutional effectiveness, most notably evidenced by the slow and halting progress on key reforms and access to funding under Bulgaria's EU-funded Recovery and Resilience Plan (RRP).

The stable outlook reflects the balance of risks at the Baa1 level. On the upside, economic and fiscal outcomes could turn out better than our current expectations, particularly if institutional quality and progress on structural reforms improves under Bulgaria's recently appointed government. However, on the downside, we see a broadly equal chance that the weakening of fiscal strength will be more significant than our current expectations and that institutional challenges increasingly affect policy making also beyond the RRP.

Bulgaria's long-term country ceilings for local and foreign currency bonds remain unchanged at Aa2. The five notch-gap between the local currency 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 foreign currency ceiling, at the same level as the local currency ceiling, reflects strong policy effectiveness with a longstanding currency board, under which the Bulgarian lev is fixed to the euro. Both ceilings benefit from Bulgaria's prospective adoption of the euro, which has 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 single currency. For euro area countries, a six-notch gap between the local currency 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

BULGARIA'S LOW DEBT BURDEN AND FAVOURABLE DEBT AFFORDABILITY METRICS

We expect Bulgaria's government debt burden to increase moderately in coming years, reaching 27% of GDP at the end of 2025 and around 29% at the end of 2026, up from an estimated 24.8% at the end of 2024. The headline deficit will stay close to 3% of GDP in 2025 and 2026. Coupled with a slowdown in nominal GDP growth as inflation normalises to average around 2.6% in 2025-2026, this will drive a gradual increase in debt in coming years. Nevertheless, Bulgaria's debt burden will remain around half as high as that of the median of its Baa1-rated peers.

We also expect Bulgaria's debt affordability metrics to continue to weaken somewhat, as the debt burden grows and maturing debt is refinanced at higher rates. That said, we still expect the ratio of interest payments to government revenues for Bulgaria will be less than one-third of the median of its Baa1 rating peers in 2025 and 2026.

Bulgaria's fiscal strength is also supported by the credibly fixed exchange rate of the lev to the euro, which will be further embedded with the likely adoption of the euro in January 2026. As a result, Bulgaria's largely euro-denominated government debt burden is not exposed to any tangible foreign exchange risk.

By contrast, the planned construction of two new nuclear reactors at the site of the Kozloduy nuclear power plant risks raising government contingent liability risks in the form of an increase in government-guaranteed debt over the medium to long-term, weighing on fiscal strength.

BULGARIA'S SOLID MEDIUM-TERM GROWTH PROSPECTS AND CONTINUED CONVERGENCE OF INCOME LEVELS

We expect Bulgaria's real GDP will grow at rates of 2.5% in 2025 and 2.7% in 2026. This is broadly in line with the economy's potential growth rate, albeit somewhat below the forecast median growth rate of Bulgaria's Baa1 peer group. Growth will continue to be driven principally by private consumption as real wage growth remains very strong in an environment of significant labour shortages and low inflation.

Although difficulties in accessing funding from the EU's Recovery and Resilience

Facility (RRF, 6.1% of 2023 GDP) will weigh on growth rates in 2025 and 2026, growth will be supported by a pick-up in the absorption rate of regular EU Cohesion Funds (10.7% of 2023 GDP) under the bloc's 2021-2027 long-term budget in coming years.

We expect that Bulgaria's full membership of the Schengen-area of passport-free European travel since the beginning of 2025 will help support the country's tourism and transport services sectors while also improving business conditions for goods exporters. The prospect of euro adoption in 2026 should also support further integration with the economies of the euro area and a strengthening of the Bulgarian economy over time. That said, we expect the economy's potential growth rate will slow over the long-term due to the country's shrinking working-age population.

Nevertheless, we expect continued robust economic growth will continue to narrow the gap in per capita incomes between Bulgaria and its Baa1-rated peers, while also strengthening the economy's resilience to future shocks. In spite of the numerous shocks that have affected Bulgaria and its main European trading partners in recent years, the Bulgarian economy has maintained a solid rate of growth since the pandemic-driven contraction in 2020. This has led to a very rapid increase of incomes levels, with GDP per capita in purchasing power parity terms increasing to 93% of the median of Bulgaria's Baa1-rated peers in 2023, up from 86% in 2019.

A WEAKENING OF GOVERNANCE AND INSTITUTIONAL EFFECTIVENESS, HAMPERING REFORM EFFORTS AND ACCESS TO EU FUNDING

We expect that the weakening of Bulgaria's institutions and governance which has been observed in recent years will continue to hamper reform efforts and institutional effectiveness. The seven parliamentary elections held since April 2021 have so far failed to produce a government that has proven to be stable and effective, leaving the country to be governed by caretaker governments for the majority of the past four years.

On 16 January, a new regular government led by the centre-right GERB-SDS coalition was appointed following snap elections in October 2024. While the new government could come to last longer than the two previous regular governments formed in late 2021 and mid-2023 respectively (neither of which remained in office longer than nine months) we see significant risks to its long-term stability and effectiveness in advancing reforms.

The clearest evidence of weakening institutional effectiveness is Bulgaria's limited progress on advancing key reforms under its EU-funded Recovery and Resilience Plan (RRP). To date, Bulgaria has only received one payment tranche, equivalent to around one quarter of the 6.1% of 2023 GDP in EU-funded grants the country has been allocated under its RRP. Bulgaria submitted its request for a second RRP payment in the autumn of 2023 but this has failed to clear for disbursement over the government's inability to fulfill key reform milestones notably related to energy market liberalization, decarbonization and control of corruption. Furthermore, Bulgaria has also failed to negotiate the RePowerEU chapter of the RRP which would offer additional funding to support reforms and investments in the energy sector.

We expect that the recently appointed government will struggle to advance the key reforms holding up the disbursement of the second tranche and that it will also struggle to absorb the majority of funding available under subsequent payment tranches ahead of the end-2026 deadline. Many of the potentially most impactful reforms under the RRP are also unlikely to be implemented, to the detriment of Bulgaria's long-term potential growth rate.

RATIONALE FOR THE STABLE OUTLOOK:

The stable outlook reflects the balance of risks at the Baa1 level. On the potential upside, economic and fiscal outcomes could turn out better than our current expectations, particularly if institutional quality and progress on structural reforms markedly improves under Bulgaria's recently installed government.

However, on the downside, we see a broadly equal chance that deficits will be higher and the increase in the government debt burden will be more significant than our current baseline expectations. The weakening of institutional strength also risks holding back key reforms to bolster Bulgaria's institutional and business environment as well as its long-term growth prospects beyond the challenges in implementing the RRP.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

Bulgaria's Credit Impact Score is CIS-2, reflecting low exposure to environmental risks, moderate social risks and an overall solid governance profile.

Bulgaria's overall E issuer profile score is E-2. 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 at E-3.

Bulgaria's social risks include adverse demographics stemming from an ageing population, which will increasingly restrict the economy's labour supply over coming decades and act as a drag on its potential growth rate. The European Commission's 2024 Ageing Report projects that Bulgaria's working age population will decline by 7% from 2023 to 2030. Overall, we assess Bulgaria's S issuer profile at S-3.

Bulgaria's governance risk score is G-2. This is underpinned by the government and the central bank's high credibility in managing Bulgaria's currency board, contributing to the likely adoption of the euro in 2026. However, weaknesses with regard to control of corruption and the rule of law remain a constraint to the credit profile.

GDP per capita (PPP basis, US$): 36,861 (2023) (also known as Per Capita Income)

Real GDP growth (% change): 1.9% (2023) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 5% (2023)

Gen. Gov. Financial Balance/GDP: -2% (2023) (also known as Fiscal Balance)

Current Account Balance/GDP: 0.9% (2023) (also known as External Balance)

External debt/GDP: 47.6% (2023)

Economic resiliency: baa1

Default history: At least one default event (on bonds and/or loans) has been recorded since 1983.

On 21 January 2025, a rating committee was called to discuss the rating of the Government of Bulgaria. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have materially increased. The issuer's institutions and governance strength, have materially decreased. The issuer's fiscal or financial strength, including its debt profile, has materially increased. The issuer's susceptibility to event risks has not materially changed.

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

FACTORS THAT COULD LEAD TO AN UPGRADE

Upward pressure could build on Bulgaria's ratings if there is evidence of improved institutional effectiveness in implementing structural reforms, raising our expectations for Bulgaria's long-term potential growth rate. A conduct of government fiscal policy that leads to a more modest weakening of government fiscal metrics than we currently expect could also add to upward rating pressures.

FACTORS THAT COULD LEAD TO A DOWNGRADE

Downward pressure could build on Bulgaria's ratings if we were to see a substantial and sustained weakening of the government's key fiscal metrics beyond our current expectations, or if the economy were to significantly undershoot our expectations for its medium to long-term potential growth rate. Such developments could at least in part be the result of a continued weakening of Bulgaria's institutions and governance profile, something which could add to potential negative pressures on the ratings.

The principal methodology used in these ratings was Sovereigns published in

November 2022 and available at https://ratings.moodys.com/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.

Bulgaria's "baa2" economic strength is set below the initial score of "a3" to reflect long-term structural impediments on Bulgaria's medium-term growth prospects, including a declining population and the relatively weak quality of its infrastructure. This leads to a final scorecard-indicated outcome of A2-Baa1, compared to an initial scorecard-indicated outcome of A1-A3. The assigned rating is within the final scorecard-indicated outcome.

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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At least one ESG consideration was material to the credit rating action(s) announced and described above.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/rmc-documents/435880.

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