S&P Global
Ratings

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Summary:
Bulgaria

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Summary:
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Issuer Credit Rating	BBB-/Positive/A-3

Key Rating Factors

Institutional and economic profile	Flexibility and performance profile
The economy continues to expand but structural challenges remain. • Bulgaria's institutions are developing, and we consider its EU membership a credit strength. • The near-term growth outlook remains favorable, despite high emigration and worsening labor shortages. • However, over the longer term, structural constraints, for example the gap between skills in demand and those supplied by the educational system, will drag on potential growth.	Bulgaria's fiscal and external balance sheets remain strong, and it is progressing toward joining the European Exchange Rate Mechanism II (ERM II). • Bulgaria has a long track record of fiscal prudence, in keeping with its rigid monetary arrangement. • Bulgaria aims to join ERM II and the banking union by July 2019. • Levels of public and external debt remain low.

Outlook

The positive outlook reflects our view that Bulgaria is likely to join the ERM II in the next 12 months. ERM II membership would bolster Bulgaria's financial and monetary stability, and help serve as a policy anchor, particularly because the Bulgarian lev is pegged to the Euro under a binding currency board arrangement.

We could raise the ratings on Bulgaria if the country enters ERM II, further strengthening the credibility and effectiveness of its monetary policy. Progress in addressing remaining structural and institutional impediments could also support our ratings.

We could revise the outlook to stable if pressures on Bulgaria's balance of payments or financial sector emerged, for example due to a buildup of macroeconomic imbalances. We could also revise the outlook to stable if Bulgaria's progress toward eurozone membership stalled for a prolonged period.

Rationale

Our ratings on Bulgaria reflect the country's long track record of prudent fiscal policy, with very low government debt and moderate levels of external debt. The ratings also take into account our view of Bulgaria's limited monetary policy flexibility under the currency board, although the board has been an important anchor of stability for the country. We believe Bulgaria's ERM II accession will further strengthen its monetary arrangements. However, challenges will remain because Bulgaria's institutions are still developing, and the country's GDP per capita is the lowest among EU member states.

Institutional and economic profile: Elections could impact policymaking, but growth should be resilient

We expect the Bulgarian economy will expand by 3.3% in 2019, and growth rates will moderate to 3% by 2022. This reflects robust domestic demand, with rising wages driving private consumption, and government capital expenditure (capex), as well as EU-funded projects, propelling investments. We also project stronger export growth this year compared with 2018, when exports decreased in real terms. Our forecast of a rebound in exports is despite our expectation of lower external demand in 2019 because of an economic slowdown in Bulgaria's key European trading partners.

EU funds and government infrastructure spending will drive investments over the coming two to three years. EU fund absorption is usually skewed toward the end of the programming period, with an additional three years to spend allocated funds after its end. In the current 2014-2020 implementation period, allocated funds for Bulgaria amount to over 20% of GDP, and the absorption rate has reached over 30% in 2019.

We forecast growth will decelerate slightly over 2019-2022, reflecting limited growth prospects for employment in the medium term. Bulgaria's population has decreased by 1.2 million over the past 20 years to approximately 7 million, and we expect it will shrink by another 10% by 2035 due to aging and emigration. After 2020, we expect employment growth will slow, as the positive effects of wage rises and government policies wear off. Instead, growth will be hampered by labor limitations, which companies in Bulgaria already cite as a key concern. That said, Bulgaria's labor market is increasingly tight, and we project the unemployment rate will fall further toward 4% by 2022.

While falling unemployment has translated into robust wage growth in recent years (nominal compensation per employee increased by 5.6% in 2018, albeit down from 10.5% in 2017), we do not expect this will endanger cost competitiveness, not least because labor costs still compare favorably with those of other new EU member states. With regards Bulgaria's income convergence with the EU average, we note the shift in its exports toward those with a significantly higher gross value added over the past 15 years.

Bulgaria's demographic challenges highlight the need for continued structural reforms. For example, measures to address skill mismatches could at least partly address labor market pressure. Continued structural reforms, for example sustainable efforts to improve judiciary system efficiency, could benefit the business environment, spur further income convergence, and contribute to slowing net emigration. Furthermore, it remains crucial, in our view, to further lend credibility to the reformed anti-corruption legislation by building a track record of successfully fighting illicit activities.

The current government coalition of center-right GERB and the United Patriots has faced several high-level resignations in recent months. We think that political volatility in Bulgaria could re-emerge, despite GERB securing the largest share of votes in the European elections. This could depend on the results of local elections in fall 2019. However, we think that important issues, such as Bulgaria's ERM II accession, have political consensus across the spectrum, and therefore provide an important policy anchor.

Flexibility and performance profile: Bulgaria is making progress on its ERM II accession plan

Bulgaria aims to enter ERMII, the waiting room for eurozone membership, by July 2019. In its application last year, Bulgaria committed to join ERM II and the Banking Union simultaneously. Currently, the European Central Bank (ECB) is conducting an asset quality review of six Bulgarian banks. This in preparation of close cooperation between Bulgaria and the ECB, and the country's integration into the Single Supervisory Mechanism.

Bulgaria has made significant progress in fulfilling its commitments for ERM II accession, with most either completed or in progress according to the government's action plan. For example, Bulgaria imposed EU legislation on the central bank and macro-prudential supervision. Other measures concern the insolvency framework, the framework for state-owned enterprise (SOE) management, non-banking supervision, and the anti-money laundering framework.

While the Bulgarian authorities are pressing ahead with the July 2019 target date, we think the timeline will hinge on Bulgaria's readiness to join the Banking Union at the same time as ERM II. Political support elsewhere in Europe could also influence the ultimate timeline. Therefore, progress on institutional convergence and the strength of its financial sector are likely important considerations in allowing Bulgaria to join ERM II, given the country's strong performance against the Maastricht criteria.

We project harmonized index of consumer prices inflation will average 2.3% in 2019-2022, above our forecast of 1.5% for the eurozone. Our forecast of a slight deceleration takes into account favorable international commodity price assumptions, which counterbalance pressure from domestic wage inflation

Bulgaria committed to improve its framework for its SOE sector as an ERM II accession prerequisite. The authorities have worked with the Organization for Economic Co-operation and Development in order to bring the management of SOEs in line with international good practices. In the past, the energy sector has been a source of contingent fiscal risks. Several SOEs in the energy sector, including Natsionalna Elektricheska Kompania, incurred losses in 2018, against the trend for SOEs in general. The government has launched a process to find a new investor to revive the Belene nuclear power plant project, without financial support from the government.

Bulgaria posted general government surpluses in 2016-2018, reflecting its very prudent fiscal policies. For 2019, we expect the general government balance will swing to a small deficit, reflecting expenditure increases, for example on teachers' wages, as well as accelerated investment spending. We expect these trends will continue, and anticipate potential investment (for example on military equipment) and the emergence of income policy spending pressure. Thus, we project a small average general government deficit in 2019-2022. This compares with the authorities' forecast of surpluses after 2019. Bulgaria's track record of conservative fiscal policies have contributed to the country's net general government debt level being the third-lowest in the EU. We expect general government debt net of liquid assets will decrease further to 11% in 2022 from 13% in 2018.

Bulgaria's track record and commitment to fiscal prudency also underpins the credibility of its currency board regime. In 1997, Bulgaria introduced a currency board regime, which effectively guarantees the convertibility of euros (originally Deutsche Mark) into the lev at a fixed exchange rate. Over the past two decades, the authorities have accumulated fiscal and external buffers to underpin their commitment to the fixed exchange rate regime, and that commitment has not wavered, despite a series of external and domestic political shocks, since Bulgaria's 2007 accession into the EU. Bulgaria's foreign currency reserves comfortably cover the monetary base by about 1.5x as of year-end 2018. As per its charter--and according to the currency board regime under which it operates--the Bulgarian National Bank's (BNB's) ability to act as a lender of last resort is limited. BNB can provide liquidity support to the banking system only to the extent that its reserves exceed its monetary liabilities. Even then, support can occur only under certain conditions and for short periods, against liquid collateral.

We project Bulgaria's current account will swing into deficit by 2020, following surpluses in 2016-2019. Our forecast mainly reflects weaker external demand from Bulgaria's European trading partners, while resilient domestic demand continues to drive imports. We project net foreign direct investment will average less than 2% in the coming years. This reflects generally lower capital flow and high savings, but removing perceived impediments to the business climate could also contribute to reviving direct investment flows. We also note that foreign direct investment in the manufacturing sector has been positive in recent years, a key difference to the high pre-2009 inflows into real estate investment, which contributed to the build-up of macroeconomic imbalances. Additionally, the structure of Bulgarian exports now shows a much higher share of machinery exports versus lower value added goods. Bulgaria's tourism sector has benefitted from instability in competing destinations, contributing to a strong surplus of the services balance.

Banks' claims on the resident non-government sector increased by 8.5% in March 2019 year on year, with growth in both the corporate and the household segments. Going forward, we expect a slight deceleration in line with moderating domestic demand. Nonperforming loans in the banking sector have declined to 7.4% of total loans from 10.2% at the end of 2017.

The Bulgarian banking sector is profitable and generally adequately capitalized. With Bulgaria's transposition of the EU Banking Resolution and Recovery Directive in 2015, the failure of a bank will necessitate a bail-in of shareholders, creditors, and then a resolution fund. Only after exhausting these options would a bank be able to resort to government support. Banking supervision and regulation has been strengthening following the lessons learned from the liquidity pressure and the collapse of KTB (Corporate Commercial Bank) in 2014. For example, the BNB has consistently implemented measures to ensure the stability of banks (including subsidiaries), among other measures by strengthening their liquidity and capital buffers. The BNB recently announced a further increase in the counter-cyclical capital buffer effective April 2020 (it will already increase as of October 2019), as a stock-based measure to safeguard the system from cyclical risks linked to credit growth and real estate price growth. The close cooperation procedure under the auspices of the ECB will also lead to further alignment of supervisory practices as the country moves toward joining the Banking Union.

Key Statistics

Table 1

Bulgaria--Selected Indicators

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Economic indicators (%)										
Nominal GDP (bil. LC)	81.9	83.8	88.6	94.1	101.0	107.9	114.9	122.2	129.4	136.8
Nominal GDP (bil. $)	55.6	56.8	50.2	53.2	58.2	65.1	66.9	74.8	82.3	87.3
GDP per capita (000s $)	7.6	7.8	7.0	7.4	8.2	9.2	9.5	10.7	11.8	12.6
Real GDP growth	0.5	1.8	3.5	3.9	3.8	3.1	3.3	3.2	3.0	3.0
Real GDP per capita growth	1.1	2.4	4.1	4.6	4.6	3.8	3.8	3.6	3.4	3.4
Real investment growth	0.3	3.4	2.7	(6.6)	3.2	6.5	9.0	6.0	6.3	6.3
Investment/GDP	21.1	21.5	21.2	19.1	20.1	20.7	21.7	22.3	23.1	23.9
Savings/GDP	22.3	22.8	21.2	21.7	23.1	25.3	22.5	22.2	22.7	23.3
Exports/GDP	64.9	64.9	64.1	64.0	67.4	64.5	63.2	61.1	59.6	58.3
Real exports growth	9.6	3.1	5.7	8.1	5.8	(0.8)	1.8	2.1	2.2	2.2
Unemployment rate	13.0	11.4	9.2	7.6	6.2	5.2	4.8	4.5	4.3	4.3
External indicators (%)										
Current account balance/GDP	1.3	1.2	(0.0)	2.6	3.1	4.6	0.8	(0.1)	(0.4)	(0.6)
Current account balance/CARs	1.7	1.7	(0.0)	3.6	4.1	6.4	1.2	(0.1)	(0.6)	(0.9)
CARs/GDP	74.2	72.5	71.3	71.1	74.7	72.4	70.8	68.2	66.3	64.9
Trade balance/GDP	(7.0)	(6.5)	(5.8)	(2.0)	(1.5)	(4.1)	(5.1)	(5.4)	(5.7)	(5.8)
Net FDI/GDP	3.0	0.3	5.0	1.3	3.9	2.6	1.9	1.9	1.9	1.9
Net portfolio equity inflow/GDP	(0.4)	(0.9)	(0.6)	(0.2)	(0.3)	(0.7)	(0.5)	(0.5)	(0.5)	(0.5)
Gross external financing needs/CARs plus usable reserves	117.4	120.2	118.9	108.1	100.1	100.1	105.0	104.9	105.9	104.9
Narrow net external debt/CARs	0.7	(3.2)	(16.8)	(24.9)	(30.8)	(32.9)	(33.7)	(34.5)	(35.5)	(36.6)
Narrow net external debt/CAPs	0.7	(3.2)	(16.7)	(25.8)	(32.1)	(35.1)	(34.1)	(34.5)	(35.3)	(36.3)
Net external liabilities/CARs	93.5	81.0	74.8	53.9	52.9	40.6	37.6	32.9	29.2	26.9
Net external liabilities/CAPs	95.2	82.4	74.8	55.9	55.2	43.4	38.0	32.9	29.1	26.6
Short-term external debt by remaining maturity/CARs	41.6	41.0	44.2	30.1	25.6	27.2	26.1	25.6	24.2	23.6
Usable reserves/CAPs (months)	2.3	1.9	2.6	2.1	2.7	2.7	2.3	2.4	2.1	2.2
Usable reserves (mil. $)	6,543.9	7,640.2	6,429.7	9,314.7	9,790.2	9,011.8	10,069.0	9,746.8	10,577.3	11,410.6
Fiscal indicators (general government; %)										
Balance/GDP	(0.4)	(5.5)	(1.7)	0.1	1.2	2.0	(0.2)	(0.2)	(0.2)	(0.3)
Change in net debt/GDP	2.0	6.7	1.7	(0.1)	(1.1)	(1.1)	0.2	0.2	0.2	0.3
Primary balance/GDP	0.4	(4.6)	(0.7)	1.0	2.0	2.7	0.4	0.4	0.4	0.3
Revenue/GDP	37.3	37.7	38.8	35.2	36.2	36.8	37.5	37.3	36.8	36.4

Table 1

Bulgaria--Selected Indicators (cont.)	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Expenditures/GDP	37.7	43.2	40.5	35.1	35.0	34.8	37.7	37.5	37.0	36.7
Interest/revenues	2.0	2.3	2.4	2.5	2.2	1.8	1.6	1.6	1.6	1.6
Debt/GDP	17.1	27.1	26.2	29.6	25.6	22.6	21.5	20.4	19.5	18.7
Debt/revenues	45.7	71.9	67.5	84.0	70.8	61.6	57.2	54.6	52.9	51.3
Net debt/GDP	11.0	17.5	18.2	17.1	14.8	12.8	12.2	11.7	11.2	10.9
Liquid assets/GDP	6.1	9.7	8.0	12.5	10.8	9.8	9.2	8.7	8.2	7.8
Monetary indicators (%)										
CPI growth	0.4	(1.6)	(1.1)	(1.3)	1.2	2.6	2.5	2.2	2.2	2.2
GDP deflator growth	(0.7)	0.5	2.2	2.2	3.4	3.6	3.1	3.0	2.8	2.7
Exchange rate, year-end (LC/$)	1.4	1.6	1.8	1.9	1.6	1.7	1.7	1.6	1.6	1.6
Banks' claims on resident non-gov't sector growth	0.2	(7.6)	(1.6)	1.8	4.5	8.9	6.0	5.4	5.2	5.2
Banks' claims on resident non-gov't sector/GDP	68.3	61.7	57.5	55.0	53.5	54.6	54.4	53.9	53.5	53.3
Foreign currency share of claims by banks on residents	47.6	42.1	33.1	29.0	25.3	23.6	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	41.2	40.9	40.3	38.7	36.9	35.9	N/A	N/A	N/A	N/A
Real effective exchange rate growth	0.9	(0.8)	(3.3)	0.2	1.1	3.3	N/A	N/A	N/A	N/A

Sources: Eurostat (Economic Indicators), Bulgarian National Bank (External Indicators), Eurostat (Fiscal Indicators), and Bulgarian National Bank, International Monetary Fund (Monetary Indicators).
Adjustments: Usable reserves adjusted by subtracting monetary base from reported international reserves.
Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. e--Estimate. f--Forecast. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Bulgaria Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	4	Reduced predictability of future policy responses, for example in episodes of heightened political volatility. Transparency and checks and balances can at times be hampered.
Economic assessment	4	Based on GDP per capita (US$) and growth trends as per Selected Indicators in Table 1.
External assessment	2	Based on narrow net external debt and gross external financing needs/(CAR + useable reserves) as per Selected Indicators in Table 1.
Fiscal assessment: flexibility and performance	2	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1.

Table 2

Bulgaria Ratings Score Snapshot (cont.)

Key rating factors	Score	Explanation
Fiscal assessment: debt burden	1	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in Table 1.
		Over 80% of gross government debt is denominated in foreign currency.
Monetary assessment	5	The lev has been pegged to the euro via a currency board.
		The Bulgarian National Bank has been successful in maintaining a currency board, supported by political commitment to prudent fiscal policies. As per its charter --and according to the currency board regime under which it operates-- the Bulgarian National Bank's (BNB's) ability to act as a lender of last resort is limited.
Indicative rating	bbb-	As per Table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	0	
Final rating		
Foreign currency	BBB-	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt.
Local currency	BBB-	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings History, May 6, 2019
- Sovereign Ratings List, May 6, 2019
- Sovereign Risk Indicators, April 11, 2019, An interactive version is also available at http://www.spratings.com/sri
- Default, Transition, and Recovery: 2018 Annual Sovereign Default And Rating Transition Study, March 15, 2019
- Sovereign Debt 2019: Global Borrowing To Increase By 3.2% To US$7.8 Trillion, Feb. 21, 2019
- Global Sovereign Rating Trends: First-Quarter 2019, April 4, 2019
- Banking Industry Country Risk Assessment Update: May 2019, May 10, 2019

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