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ACRA affirms and withdraws **LT A-** and **ST S1** of **Bulgaria**, outlook **Stable**

ACRA has affirmed and withdrawn the following credit ratings of the Government of The Republic of Bulgaria (hereinafter, Bulgaria, or the country) under the international scale:

- **Long-term** foreign currency credit rating at **A-** and local currency credit rating at **A-**;
- **Short-term** foreign currency credit rating at **S1** and local currency credit rating at **S1**.

The outlook on the long-term foreign currency credit rating is **Stable** and local currency credit rating is **Stable**.

The credit ratings are unsolicited and ACRA has withdrawn them for a business reason.

Credit rating rationale

Bulgaria's A- sovereign credit rating is supported by a low government debt load, high fiscal reserves, modern fiscal rule framework, and a sustainable currency board arrangement.

ACRA estimates the country's GDP decline in 2020 to be between -5 and -12%, with the unemployment rate rising from 4.2% in 2019 to 6-12% in 2020. Deep GDP declines attributable to economic consequences of the COVID-19 crisis are expected in economies particularly dependent on tourist inflows and inherently offline services. ACRA estimates that Bulgaria's GDP share, which may be attributed directly or indirectly to external and internal tourism, is higher than 10%. Dependence on tourism is exacerbated by the fact that Bulgaria's loss in external tourism cannot be sufficiently replaced by internal consumption like in France or Italy; Bulgaria's net money flows from external tourism and transport are normally very positive at around 3.5-6% of GDP annually. These facts put Bulgaria alongside Croatia, Portugal, Greece and Spain as the top five EU countries most susceptible to the external tourism decline.

In ACRA's view, Bulgaria's strong fiscal position is likely to withstand the economic shock caused by the pandemic. The low level of general government debt, which was estimated to be less than 22% of GDP at the end of 2019, gives Bulgaria ample room to apply countercyclical fiscal policy. ACRA expects Bulgaria's general government deficit to reach at least 5% of GDP in 2020 (the latest public estimate from the Ministry of Finance was around 3%). The estimated deficit combined with 0.9-1.2% GDP of government debt maturing in 2020 will result in gross debt issuance needs of around 6-9% of GDP this year.

It is possible that the government meets part of its needs relying on EU funds and/or internal liquid assets. The considerable size of the country's fiscal reserve account (9% of GDP as of February 29, 2020) mitigates rollover risk and allows extraordinary expenses to be incurred with less debt buildup. Currently, the market for Bulgaria's government debt is not closed. On April 13, 2020, the Ministry of Finance reopened the issue of 10.5-year BGN-denominated securities maturing on December 21, 2029, which was originally placed on June 21, 2019. The auction resulted in a successful placement with an aggregate nominal value of BGN 200 mln, a weighted average yield of 0.55%, and a bid-to-cover ratio of 1.25.

ACRA does not expect the deficits in 2020 and in 2021 to pose particular risks to the long-term sustainability or the fiscal rule system of Bulgaria; the system will likely remain one of the most prudent among EU members. The fiscal rule system has a formal escape clause and special countercyclical options, which allow Bulgaria's government to boost expenses in a recession where GDP decline year-on-year is at least -3%. The system covers all the most important fiscal activities including the scope of government, public expenditures, and various budget balances. The current version came into force in 2014 and has not been violated since then. Since 2016, Bulgaria's fiscal legislation has incorporated EU laws related to fiscal policy. Historically, compliance with fiscal rules in Bulgaria has been very high and ACRA expects this to continue.

ACRA expects the country's currency board arrangement to withstand the shock caused by the pandemic. Firstly, it is supported by a sufficient volume of international reserves held by the Bulgarian National Bank (BNB). At the end of January 2020, these reserves fully covered the country's monetary base, as well as 27 months of pre-crisis net export of services, which may serve as the biggest shock to Bulgaria's balance of payments in 2020. Secondly, these reserves cover 72.6% of external debt. At the end of 2019, Bulgaria's external debt stood at 56.2% of GDP and was almost entirely denominated in foreign currency (EUR 85.4%, USD 10.3%). Despite the high share of foreign currency debt, ACRA notes that FX risk is reduced due to the sustainable currency board arrangement. Thirdly, the credibility of the policies maintaining Bulgaria's currency board arrangements is enforced by the government's strong will to comply with the ERM II and Banking Union processes, which could pave the way to inclusion into the Eurozone in 2022. Additionally, there has been a long history of strong commitment to the existing currency board arrangement, which started in 1997. ACRA estimates that the change in BNB assets (mostly international reserves) between the end of January and April 10, 2020, was positive and reached EUR +10%.

ACRA is concerned about the level of the government's financial sector contingent liabilities, which is somewhat elevated due to the relatively high pre-crisis level of NPLs in domestic banks and the adverse scenario shortfalls in the capital of two banks identified by the European Central Banks stress test in July 2019. The total NPL ratio in December 2019 was 6.5%, higher than the EU average of around 2.5%. However, over 20% of the system is domestically owned with NPL ratios that on average are significantly higher than that, which is important because domestic standalone banks cannot rely on extraordinary support from a parent bank. ACRA notes that on average provisioning levels were relatively high before the crisis, but the magnitude of the expected decline in incomes is capable of significantly worsening the asset quality of the system. Currently, the liabilities of households and companies affected by COVID-19 and the restrictions associated with it may be deferred for up to 6 months, but no later than December 31, 2020. On April 10, 2020, the Bulgarian National Bank approved the draft of the "Procedure for Deferral and Settlement of Liabilities Payable to Banks…" The approved moratorium provides opportunities for changes in the principal and/or interest payment schedule of liabilities without changing any key parameters of the loan agreement.

The overall quality of Bulgaria's institutional framework is comparable to that of other Central and Eastern European countries, but lags behind the EU average in all of the governance indicators. Nevertheless, positive dynamics exist. In a number of areas, the government is actively trying to comply with EU standards, which is a well-established institutional framework benchmark. Convergence with EU legislation is potentially very beneficial to the long-term creditworthiness of Bulgaria. For example, the BNB has strengthened its supervisory control while implementing the European Banking Authority's recommendations as it enters the EU's banking union.

ACRA notes that despite active opposition (in 2018-2020 Bulgaria's ruling party faced four votes of no confidence), adherence to key economic policies such as the currency board regime and fiscal rule framework is something on which both the ruling party and the opposition agree. Therefore, ACRA does not expect these policies to change in the event of a shift in the political climate.

Sovereign model application results

Bulgaria has been assigned an A+ Indicative credit rating in accordance with the core part of ACRA's sovereign model.

A number of modifiers in the modifiers part of the model allow the Indicative credit rating to be increased. These include the following, which are determined by the Methodology for Credit Rating Assignment to Sovereign Entities under the International Scale:

- Fiscal policy framework and fiscal flexibility;
- Debt sustainability.

Negative modifiers are the following:

- Potential economic growth;
- Sustainability of economic growth;
- Contingent liabilities and the risk of them materializing on the sovereign balance sheet;
- Market access and sources of funding;
- Balance of payment vulnerabilities;
- External debt sustainability.

In view of the abovementioned modifiers, Bulgaria's Indicative credit rating has been decreased by 2 notches. A Final credit rating of A- has been assigned. There are no extraordinary factors that could adjust the Final credit rating. In connection with this, the Assigned credit rating remains at A-.

Issue ratings

No outstanding issues have been rated.

Regulatory disclosure

The sovereign credit ratings have been affirmed to Bulgaria under the international scale based on the Methodology for Credit Rating Assignment to Sovereign Entities under the International Scale and the Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities.

The sovereign credit ratings of Bulgaria were published by ACRA for the first time on October 31, 2019.

The sovereign credit ratings were affirmed based on information from publicly available sources, as well as ACRA's own databases. The sovereign credit ratings are unsolicited. The Bulgarian government did not participate in the credit rating affirmation.

ACRA provided no additional services to the Bulgarian government. No conflicts of interest were discovered in the course of the sovereign credit rating affirmation.

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