

Republic of Bulgaria May 2017	Nikoleta Koleva Lead economic analyst n.koleva@bcra-bg.com
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SOVEREIGN RATING	Initial rating	Review
Date of public disclosure:	12 Sept 2014	12 May 2017
Date of Rating Committee:	05 Sept 2014	10 May 2017
Long-term sovereign rating:	BBB- (ns)	BBB- (ns)
Outlook:	Negative	Stable
Short term sovereign rating:	A-3 (ns)	A-3 (ns)

• (ns) – not solicited rating

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“BCRA - CREDIT RATING AGENCY” AD rates Bulgaria with unsolicited sovereign long-term rating BBB- (ns) and short-term A-3 (ns) with stable outlook.

BCRA's officially adopted Sovereign Rating Methodology has been applied http://www.bcra-bg.com/files/file_330.pdf.

The report has been prepared and the rating – assigned, based on public information, made available by the National Statistical Institute, Bulgarian National Bank, Ministry of Finance, the World Bank, the International Monetary Fund, the European Commission, BCRA's database etc. BCRA uses sources of information, which it considers reliable, however it cannot guarantee the accuracy, adequacy and completeness of the information used.

The presidential elections held at the end of 2016 lead to conduction of pre-term parliamentary elections in early 2017. Despite the larger public support of the candidate for president nominated by the opposition party BSP, the parliamentary elections at the end of March 2017 confirmed the leading position of PP GERB. However, to have majority in the Parliament, the government should be built in a coalition partnership, as of the time of preparation of this report there is partnership established between the formations GERB and the United Patriots.

The deteriorating geopolitical situation on a regional and global scale threatens the international relations and economic development of the country. Additional insecurity with regard to the future perspectives for the economy stems from the results of the held and forthcoming elections (parliamentary and presidential) in a number of countries with key positions in international organizations and formations. The tension increases in connection with the refugee flow and the decisions for solving the problem within the EU which additionally strains the relations between the EU members and enhances the Euro-skeptical attitudes in some of them.

During 2015 and 2016, the economy reports the highest values for real growth over the years after the financial crisis – respectively, 3.6% and 3.4%, supported by strong consumption of the households and improvement in the trade balance of the country, while the formation of equity reports hesitations. The services continue to be a main category contribute for the growth in gross added value (GAV) of the country also in 2016. Among the production sectors, key sector remains Industry¹, which slows down compared to 2015, and in sector Construction there is reduction in the established GAV for 2016.

Despite the noticeable leap in direct foreign investments for 2015 (revised data), in 2016 it decreases to its lowest levels for the past five years – both in nominal terms and as a ratio to GDP. A reason for this is the smaller size of investment flows in share capital and reinvested profit, while the low-tide of debt instruments enhances.

From the second half of 2014, a quick euro devaluation is observed (and hence the national currency) compared to the US Dollar, as the rate remains at levels with higher values of US Dollar compared to the Bulgarian lev until March 2017. This

¹ Aggregate position of the sectors Mining industry; Processing industry; Production and distribution of electricity, heat and gaseous fuels; Water supply; Sewerage services, waste management and restoration.

development causes influence of the international trade of the country in the direction of decreasing the total value of the trade deficit and registration of a substantial surplus on the current account for 2016.

The major partners in the international trade in goods remain similar with those for the past five years. There are some changes in the shares of some of the partners resulting mainly from geopolitical processes over the past years. The structure in exports and imports of goods by ways of use remains similar with that of the previous year as changes continue to be observed in connection with the energy resources started in 2014. Bulgaria continues to be characterized as a net exporter, mainly of products with lower added value, while availability of products with a higher added value remains prevailing in net imports.

In 2016, the unemployment rate in the country reaches its lowest value after the financial crisis. The economically active population decreases (following the downward trend in 2013 in the active population) for the third consecutive year, as for 2014 and 2015 is due to a decline in the unemployed, that is higher in absolute value than the growth in the employed, and in 2016 a decrease is reported in both categories. The labor costs keep their upward trend as a result of the changes upwards in the country's minimum salary, supported by growth in labor productivity.

The overall price level continues for a third consecutive year to report a decline on an average annual base, measured through HICP. Among the main groups cooperating for that development, remain Transport and Communications. Since September 2016, there is a gradual slowdown in the decline of prices, but it continues to move in the negative range as of March 2017.

During 2016, the budget balance on a consolidated basis reports a surplus in a substantial size – 1.6% of GDP, entirely due to the account balance of EU funds (2.4% of GDP). The national budget balance (incl. state budget) reports a deficit in the size of 0.8% of GDP.

The balance of the state budget reports a deficit in the size of 1.2% of GDP with laid out 1.9% of GDP for 2016 in the law. The implementation of the state budget for the same year is characterized by full (over 100%) implementation of tax income and a substantially lower value of implementation of non-tax income. Nearly all costs groups are with about but slightly below 100% implementation as the costs for maintenance and transfers (by over 100%) and the capital costs (~79%) make an exception. The deficit set in the Law for the State Budget of the Republic of

Bulgaria for 2017 is determined to about 0.9% of the forecast GDP, formed by faster growing income compared to costs and transfers.

In 2014, the government debt increases substantially as a result of the issue Eurobonds, in 2015 and 2016 the ascending trend maintains, albeit at slower paces, again in relation to bonds issued in international capital markets (ICMs). A substantial increase at the end of 2016 is observed in the size of government guaranteed debt - from 0.6% of GDP for January-November to 1.8% of GDP of December 2016.

There is a change in the residual maturity of the debt in circulation - the share of the debt maturing in a year increases, also, the debt maturing over 5 years does. The funds on fiscal reserve provide the needed coverage of the pending payments as they are at their highest levels in the past 5 years.

The profitability of the Bulgarian 10-year bonds maintains its descending trend from 2015, as it continues to report values lower than those for Romania. The swap spreads against bankruptcy decreases gradually, after a substantial growth in the indicator at the end of 2014 in connection with the short banking panic and the bankruptcy of the fourth largest bank in size.

Gross foreign debt reduces substantially in 2015 in regard to the decline in the category of intercompany lending, and in 2016 remain at lower levels, with a slight growth in the debt of sector Government management with connection to the issue Eurobonds in March 2016.

In some of the main indicators Bulgaria reports an improvement in its position compared to the other state members of the EU. Compared to a year earlier the country ranks ahead in the ranking by growth of GDP (including per capita) and size of the debt of the sector Government management, while in regard to the changes in the price level shows the worst performance – it lags behind most of the EU average.

The assets in the banking system continue to grow for the second consecutive year after a drop in 2014 as a result of the exclusion of Corporate Commercial Bank's data from the banking system accounts. The non-performing loans reduce, and the liquidity in the banking system maintains its upward dynamics in the past 5 years. The capital adequacy on average for the system also remains at high levels for the past year. After a slowdown in the decline in lending in 2015, in 2016 there is a slight positive change in the amount of loans and payments in advance to the non-financial sector. The deposits remain a steady growth in 2016.

On August 13 2016, the published results from the Asset Quality Review (AQR) and conducted stress testing for ensuring stability of banks in Bulgaria show that the banking sector is stable, well capitalized and public support with state funds is not necessary.

Outlook

The stable outlook reflects BCRA's opinion that with the results of the pre-term parliamentary elections in March 2017 is ensured a certain level of security in the country in the background of increasing geopolitical conflicts in a global aspect. Preserving most of the positive trends in a number of economic and fiscal indicators has a positive influence on formation of the rating, as unfavourable changes in individual indicators are noticed, which are defined as factors causing a moderate risk.

The rating or outlook would be positively affected by a continuous improvement in economic performance of the country, an increase in formation of equity and restoration of investor's interest to the country. Positive influence in formation of the rating would affect more efficient management of debt and debt interests, decline of deficit and strive to balance the state budget and overcome the deflationary processes.

The rating and outlook would be negatively affected by deterioration of the above mentioned indicators (slowdown in economic growth, growth in unemployment rate and deterioration of the conditions in the labour market, continuous situation of deflation, and deterioration of fiscal indicators). As an unfavourable development would be assessed restoration and/or enhancement of the political instability in the country, as well as transfer of effects from geopolitical events and conflicts in the economy of Bulgaria. As potential risks would be assessed volatility in national currency rate, reduction in international trade in the country and deterioration in balance of payment status.

Regulatory announcements

Rating initiative

This is an unsolicited sovereign rating. Neither the rated entity, nor a related third party has participated in the credit rating process. BCRA did not have access to the accounts, management and other relevant internal documents for the rated entity or a related third party.

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Summary of the minutes of the Rating Committee:

The members of the Rating Committee discussed the grades of numerous credit rating factors included in the **Model for grading** and analysed in the **Credit Rating Report** according to the **Sovereign Rating Methodology**. Special attention was paid to the retention of the main trends in economic environment in the country – strong economic growth backed by domestic consumption and export, decline in unemployment rate and growth in income and productivity. The insecurity in the political environment of the past year decreases. The pre-term parliamentary elections in March 2017 confirm the position of PP GERB as a major political power which presuppose the lack of substantial changes in the conducted politics over the last years. As unfavorable factors were determined the reduction in foreign investment flow and continuous deflation in the country at indications for improvement in the EU. Discussed were the changes in the fiscal indicators of the country – the debt marks stabilization, with certain change in the maturity structure, while the budgetary balance marks improvement expressed in deficit reduction. Discussed was the change in the size of guarantees and government guaranteed debt at the end of 2016. The banking sector was defined as stable, according to the results of AQR, announced in August 2016.

The current sovereign rating and the related outlook have been determined based on the above discussion.

Table with general macroeconomic indicators:

Republic of Bulgaria		Developing economy ^[1] (Emerging and Developing Europe)						
Indicator		2016	2015	2014	2013	2012	2011	
Basic macroeconomic indicators	GDP (current prices, million BGN)	92 635	88 571	83 634	82 166	82 040	80 759	
	<i>GDP (annual real rate of change, %)</i>	3.4	3.6	1.3	0.9	0.0	1.9	
	Final consumption	70 991	69 672	66 496	64 969	66 642	63 116	
	Gross capital formation	18 812	18 768	17 928	17 534	18 001	17 339	
	Export of goods and services	58 884	56 781	54 373	53 122	49 882	47 704	
	Import of goods and services	56 051	56 650	55 161	53 459	52 485	47 400	
	GDP per capita (BGN)	12 967	12 001	11 561	11 275	11 162	10 673	
	GDP deflator (change, %)	1.1	2.2	0.5	-0.7	1.6	6.0	
	Average monthly salary (BGN)	962	878	822	775	731	686	
	Final consumption index (previous year = 100)	101.8	103.8	102.2	98.1	102.0	102.0	
	Inflation (Annual HICP change, %)	-1.3	-1.1	-1.6	0.4	2.4	3.4	
Unemployment rate (in %)	8.0	10.0	10.7	11.8	11.4	10.4		
Balance of payment	Current Account	1 989	-61	35	536	-358	136	
	Goods and services (net)	1 602	381	-262	-279	-1 403	71	
	<i>Trade balance</i>	-1 845	-2 622	-2 777	-2 933	-3 992	-2 690	
	<i>Services (net)</i>	3 447	3 004	2 514	2 653	2 589	2 761	
	Primary income (net)	-1 199	-2 082	-1 318	-1 581	-1 053	-1 597	
	Secondary income (net)	1 585	1 640	1 616	2 396	2 099	1 662	
	Capital account	1 067	1 422	960	469	546	504	
	Financial account	-51	-1 076	-2 090	1 419	-1 164	1 188	
	Direct investments (net)	-530	-2 388	-882	-1 243	-1 068	-1 189	
Reserve assets of BNB	3 467	3 730	1 807	-532	2 121	163		
Fiscal Indicators	<i>Million BGN</i>							
	Budgetary Balance (Maastricht Criteria)	30	-1 459	-4 561	-296	-263	-1 590	
	Consolidated budgetary balance	1 466	-2 485	-3 073	-1 441	-359	-1 489	
	State and state guaranteed debt	27 424	23 300	22 756	14 893	14 682	12 826	
	Fiscal Reserve	12 883	7 873	9 170	4 681	6 081	4 999	
	<i>% of GDP</i>							
	Budgetary balance (Maastricht Criteria)	0.0	-1.6	-5.5	-0.4	-0.3	-2.0	
	Consolidated budgetary balance	1.6	-2.8	-3.7	-1.8	-0.4	-1.8	
	State and state guaranteed debt	29.6	26.3	27.2	18.1	17.9	15.9	
	<i>Domestic state debt</i>	7.3	8.2	9.9	7.7	6.1	6.0	
	<i>Foreign state debt</i>	20.5	17.4	16.6	9.5	10.6	8.4	
	<i>State guaranteed debt</i>	1.8	0.7	0.8	0.9	1.2	1.5	
Debt of the Central Unit	29.9	26.3	-	-	-	-		

Republic of Bulgaria		Developing economy ^[1] (Emerging and Developing Europe)					
Indicator		2016	2015	2014	2013	2012	2011
	Domestic debt of the Central Unit	7.3	8.2	-	-	-	-
	Foreign debt of the Central Unit	20.8	17.4	-	-	-	-
	Gross foreign debt	73.1	75.0	92.0	87.9	89.9	87.9
	Short-term foreign debt	16.9	17.3	23.3	22.8	24.7	24.5
	Gross foreign debt of public sector	15.3	13.2	15.3	9.7	10.9	10.2
	Net international investment position	-75.2	-63.5	-75.2	-72.8	-77.9	-82.8
	<i>Million BGN</i>						
Banking sector	Assets of the banking system	92 095	87 524	85 135	85 747	82 416	76 811
	Loans and advance payments (regardless credit institutions)	54 467	54 121	55 590	58 489	57 841	56 044
	Classified loans	-	-	12 495	13 607	13 734	13 010
	Share of classified loans (%)	-	-	22.5	23.3	23.7	23.2
	Non-performing loans	9 956	11 021	-	-	-	-
	Share of non-performing loans (%)	18.3	20.4	-	-	-	-
	Deposits (regardless credit institutions)	74 129	69 276	63 710	62 230	57 256	52 808
	Total capital adequacy (%) ^[2]	22.2	22.2	21.9	16.9	16.7	17.5
Liquid asset ratio (%)	38.2	36.7	30.1	27.1	26.0	25.6	

[1] According to classification of IMF (World Economic Outlook)

[2] The new form of disclosure of information (on the middle of 2015) relating to the capital adequacy of banks is based on the reporting forms included in Commission Implementing Regulation (EU) No 680/2014 of 16.04.2014, laying down, according to Regulation (EC) No. 575/2013 of the European Parliament and of the Council, of technical standards with regard to supervisory reporting of institutions. The latest information is comparable, to a great extent, with that, published before the adoption of the Capital Requirements Directive / The Capital Requirements Regulation, as some of the distinctions are connected to:

- The sum of the two new positions "Base Tier 1 capital" and "Supplementary Tier 1 capital" comprises the term "Tier 1 capital";
- All positions related to the capital structure are presented after declines, deductions and after transitional treatment resulting from specific provisions of the Regulation;
- Capital requirements for most risk types can be obtained by direct multiplication of the risk-weighted exposures for the respective risk by ratio 0.08.
- Disclosure presents the most important positions forming the capital structure of the banks.

Source: BNB, NSI, Ministry of Finance, World Bank, International Monetary Fund, European Commission, Eurostat