

## Bulgaria: Two rating upgrades in one day

S&P's one notch upgrade to BBB- was long overdue for Bulgaria, but the one notch upgrade from Fitch to BBB, a similar rating to Moody's, came as a surprise

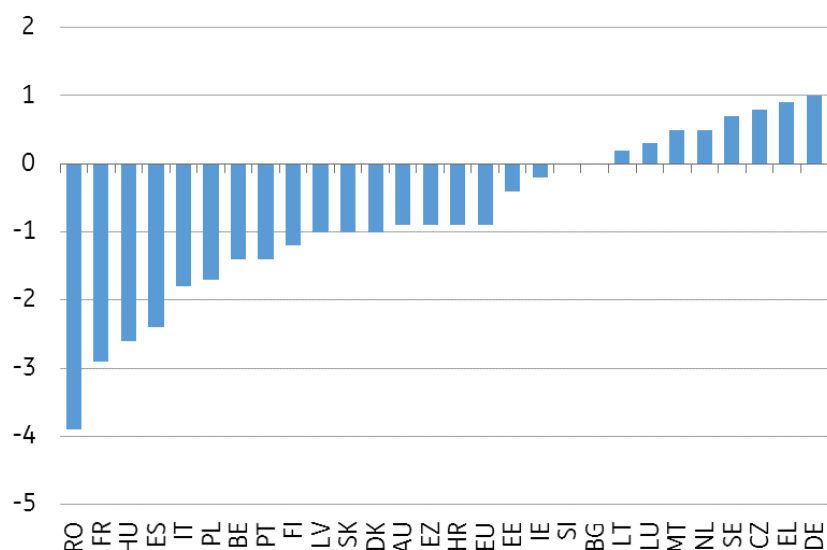


Source: Shutterstock

Bulgaria received two upgrades on Friday with both agencies citing the improvement in government and external positions on conservative fiscal policy, unlike elsewhere in CEE, strengthening economic growth and gains in export competitiveness resilient to rising labour costs. Relatively high NPL ratios, weak institutional set-up, low GDP per capita and fiscal contingent liabilities are cited as weaknesses. Both agencies assume a stable government over the next year constrained by the presidency of the EU council. ERM-II entry, though viewed as a difficult task in getting support from every Eurozone member, is viewed as credit supportive by boosting credibility.

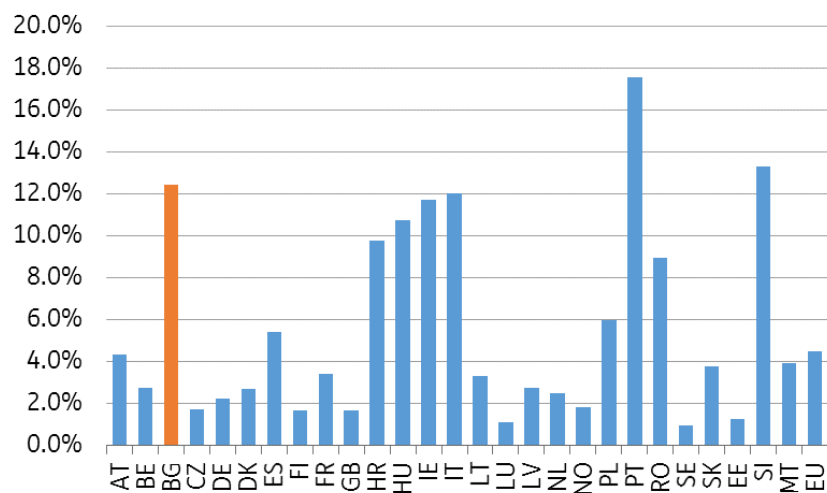
## Currency board requires fiscal discipline

European Commission, Autumn 2017 forecasts



## NPL ratio still at relatively high levels

European Banking Authority, Greece and Cyprus not included



Easily fulfilling the nominal Maastricht criteria, the Prime Minister, Boyko Borisov, has searched and found support for the country ERM-II bid from most influential decision-makers in Europe, at least on a declarative level. This could be part of a diplomatic show-off in favour of more European integration in contrast to Brexit. However, we feel that Bulgaria would likely avoid applying for ERM-2 unless it receives guarantees that would stay within the mechanism for the minimum time.

With low real convergence (the lowest GDP per capita in the EU), low institutional integration (still under EC supervision on justice with little progress and outside the Schengen space), such

guarantees are hard to get, in our view. The ERM-II bid looks a natural choice, but adopting the euro without achieving higher total factor productivity growth (via structural reforms) might limit the convergence process and leave the country vulnerable to shocks in the future, similar to countries exposed by the European debt crisis. That could potentially trigger large and painful internal devaluation in the future. The currency board exchange rate regime has forced Bulgaria into fiscal discipline, but history tells us that institutional weakness could lead to large public burdens.