

Credit cycle in Bulgaria

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Abstract The banks play a special role in the financial system. Some economic subjects have less access to other forms of funding than to banks. By the special bank's role for part of the borrowers, credit growth changes the investment and the consumption and stimulates economic growth in the country. During the crisis in 2008 in Bulgaria characterizes with: a gradual decline of the lending rate in 2008 from 24.38% in the first quarter to 2.27% in the fourth quarter for business and lower for household loan to 5.79% at the end of 2009. For the period 2010-2015, households' trends are also descending, but with lower fluctuations - from - 0.81% at the end of 2010 to - 1.79% at the end of June 2015.

Different factors related to the supply and demand of credit influence of their amount. Higher domestic consumption and investment depends on the lending and therefore it could be actively used as an instrument for stimulating of economic growth.

Keywords: Banking; credit; supply and demand of credit.

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The banks play a special role in the financial system. Some economic subjects have less access to other forms of funding than to banks. The increase of money supply leads to higher bank reserves and expanding the bank lending. By the special bank's role for part of the borrowers, credit growth changes the investment and the consumption and stimulates economic growth in the country.

The expansion of lending in Bulgaria could be explained in different aspects - as a positive phenomenon at the macroeconomic level, affecting economic growth and negatively at the macro and microeconomic level. On macroeconomic level, it is expressed by: increasing the negative current account balance and creating conditions for the development of inflationary processes. At the micro level, the negative impact due to increasing risk. It effects the stability of the banking system.

1. Data analysis for the period 2003 - 2008

For the period 2003 - 2008 lending constantly increases. The reasons for the credit

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expansion in this period in Bulgaria are directly related to some specific conditions: higher domestic demand due to the economic situation after the introduction of the Currency Board in Bulgaria in July 1997. In general, it is characterized with continued increasing of GDP, sustained macroeconomic stability and low inflation. At the same time, financial stability was achieved and bank confidence in the monetary institution - the Bulgarian National Bank (BNB). Other reasons for post-crisis financial stability are:

- restored confidence in a banking system due to restructuring of most banks. They become private, with foreign owners. Although the banking market is relatively small (with a large number of banks), bank assets dynamically growth;
- government interference in the financial sector is adequate. Overall, the regulation and financial supervision exercised has been positive for the period.

The credit growth for period 2003-2008 depends on additional factors. Together with the macroeconomic stability and the privatization of the banking sector can be mentioned:

- access to international capital markets;
- the decrease of the cost of the resource - as a consequence of the repeated increase of the country's credit rating;
- low interest rates on world markets;
- struggle to increase the market share of Commercial banks;
- higher savings;
- reducing of risk in the real economy due to the improved information environment;
- needs for investment in new technology and equipment due to the strong competition on European market;
- increasing demand for consumer goods - as a result of higher wages and formation of middle class in the country;
- reduced need for public sector loans - if the budget needs to borrow, it would lead to increased interest rates of loans in the country.

Overall economic and financial stability leads to strong increasing of lending. The crisis in the second half of the 1990s led to the suspension of any financial intermediation for some time. The policy followed, has aimed to reducing inflation, high GDP and rapidly growing incomes and profits, exacerbated the need for credit, and changed banks 'views on borrowers' requirements. The foreign banks on the market, as well as the strengthening of Commercial banks audit in the sector, led to a return the confidence of the public to the banks and an increasing of deposits. On the other hand, improved economic conditions predetermined the growth of foreign cash flows, mainly coming from foreign banks in Bulgaria. All factors have led to strong need to find ways for investment of accumulated funds of Commercial banks. Following tendencies have observed:

- continued and very dynamic growth of lending by commercial banks, which in the fourth quarter of 2001 exceeded 32 % (at the end of the period compared to the end of the previous year) and at the end of the fourth quarter of 2004 was 48.58 % and reach in the first quarter of 2005 to 73.09%, restriction of loans in

- 2006 and 2007, a new peak in the first quarter of 2008 and a rapid decrease in the growth rate in 2009 to 3.59 % at the end of the second quarter;
- Change in the structure of the borrowers in the period 2000 - 2001 due to the change of ownership and the greater efficiency of the private companies;
 - Commercial banks investment in foreign assets in 2000-2001 and follows decreasing of them in 2002-2003, related to the increase of lending on the local market;
 - Loan expansion, which started in 2003, and reflects the need for long-term capital to upgrade technology and to buy household goods for long-term use. The increased share of long-term loans, could be explained by the increased confidence between creditors and borrowers and the reduction of risk;
 - Collapse of foreign liabilities of local banks, which started in 2004 and peaked in 2006, slowing growth in lending;
 - Lending in services is highest share compared with all other sectors of economy.

Table 1. Annual growth rate of bank credit for the period 2003 - 2008 quarterly

	I 2003	II 2003	III 2003	IV 2003
Credit for non- government sector, including, %	45.68	52.05	47.05	48.31
- for non- financial institutions, %	42.88	47.90	38.32	37.74
- for households, %	54.30	68.44	73.02	80.65
	I 2004	II 2004	III 2004	IV 2004
Credit for non- government sector, including, %	52.32	47.79	49.27	48.58
- 3a - for non- financial institutions, %	41.73	35.05	38.64	38.00
- for households, %	84.55	79.60	76.41	74.82
	I 2005	II 2005	III 2005	IV 2005
Credit for non- government sector, including, %	73.09	41.80	35.93	32.39
- for non- financial institutions, %	69.62	32.91	25.93	22.26
- for households, %	81.83	72.18	63.51	58.39

	I 2006	II 2006	III 2006	IV 2006
Credit for non- government sector, including, %	5.59	24.22	23.63	24.61
- for non- financial institutions, %	- 7.49	14.21	17.31	19.42
- for households, %	39.65	38.65	32.58	30.55
	I 2007	II 2007	III 2007	IV 2007
Credit for non- government sector, including, %	36.6	47.8	55.9	62.5
- for non- financial institutions, %-	30.1	47.5	57.8	67.1
- for households, %	37.6	38.6	48.3	52.4
	I 2008	II 2008	III 2008	IV 2008
Credit for non- government sector, including,	59.61	54.63	49.81	38.45
-- for non- financial institutions, %	64.65	58.07	52.89	39.87
- for households, %	51.96	49.18	44.85	36.14

Source: BNB and own calculations

2. Data analysis for the period 2009 - 2015

The conditions of the crisis in 2008 include: a strong decline in the lending rate in 2008 from 38.45. % in the first quarter to 2.27% in the fourth quarter for business and lower household loan contraction to 5.79% at the end of 2009. It is due to two types of bank operations. Concerning liabilities: The lower deposit base and the parent banks withdraw of the non-deposit attracted funds due to liquidity problems in all countries. According assets the reasons are following:

- For businesses - increasing risk in the economy makes banks more cautious considering credit projects. Additionally, increasing of the share of “bad” credits is contributing to it;

- For business - within a bank channel, the period of crisis makes firms less vulnerable to risk. Moreover, the crisis has deteriorated their cash inflows, increased their indebtedness, and the short-term cash flow balancing requires usage of different forms of credit;
- For business, on the other hand, the market conditions and level of aggregate demand is reduced the need for new investments in real assets and the use of loans to finance them;
- For business - the waiting economic results also shrinks demand for credit;
- For households - the rise in unemployment immediately after the 2008 crisis and the keeping of income on the same level led to a decline in demand for credit.

For the 2010-2015 period, lending shows the following trends:

- For businesses - there is a low increase of the loan to 2.42% at the end of 2010, 5.43% - in 2011, approximately the same (4.99%) - in 2012. In 2013 there is a strong contraction of corporate lending, with an increase of 0.07% at the end of the year. It is due to the slow and difficult recovery from the crisis and the still shrunken markets of the Bulgarian exports. The risk is kept at high level, which makes both companies and banks cautious. In 2014, as a result of problems in the banking system and in particular in one of the largest banks in the middle of the year, business lending sharply declined by 11.62% at the end of the year compared to the same moment of the previous year. This trend has preserved in 2015.
- For households - decreasing of the loan for the period 2010-2015, but with lower fluctuations - from minus 0.81% at the end of 2010 to minus 1.79% at the end of June 2015.

Table 2. Annual growth rate of bank credit for the period 2009-2015 quarterly

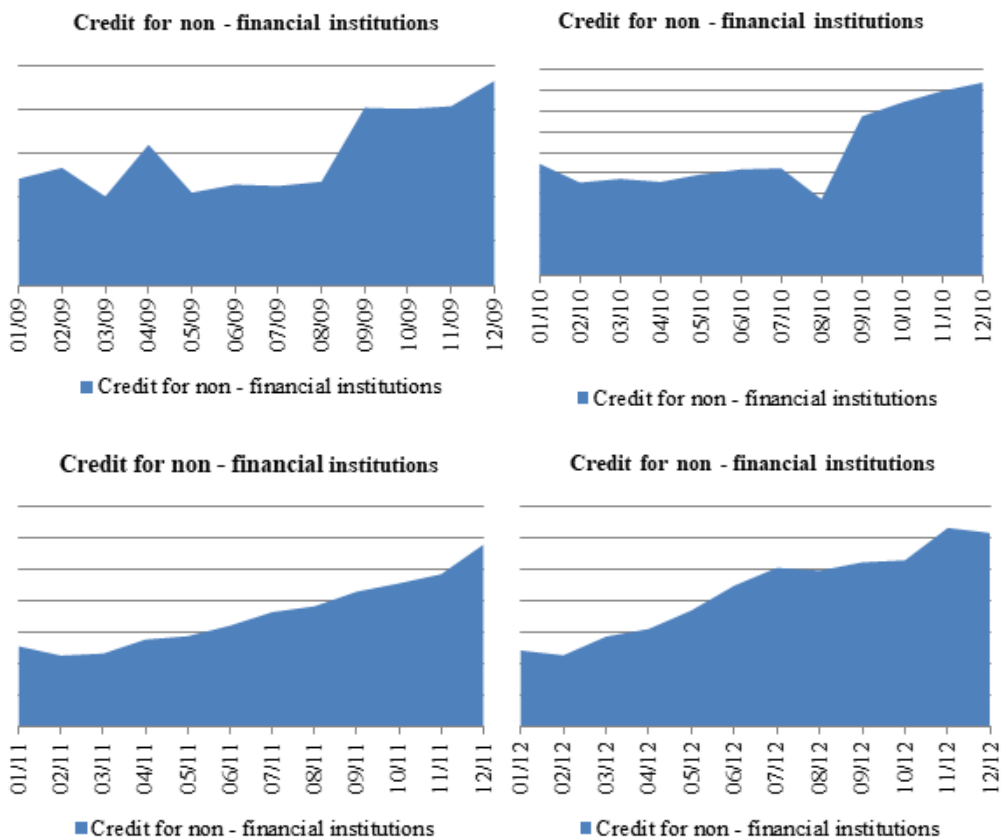
	I 2009	II 2009	III 2009	IV 2009
Credit for non- government sector, including,	24.53	11.19	5.05	3.59
-- for non- financial institutions, %	24.38	10.09	3.70	2.27
- for households, %	24.79	13.05	7.32	5.79
	I 2010	II 2010	III 2010	IV 2010
Credit for non- government sector, including,	2.34	2.16	1.38	1.19
-- for non- financial institutions, %	1.12	1.24	1.77	2.42
- for households, %	4.36	3.66	0.76	-0.81

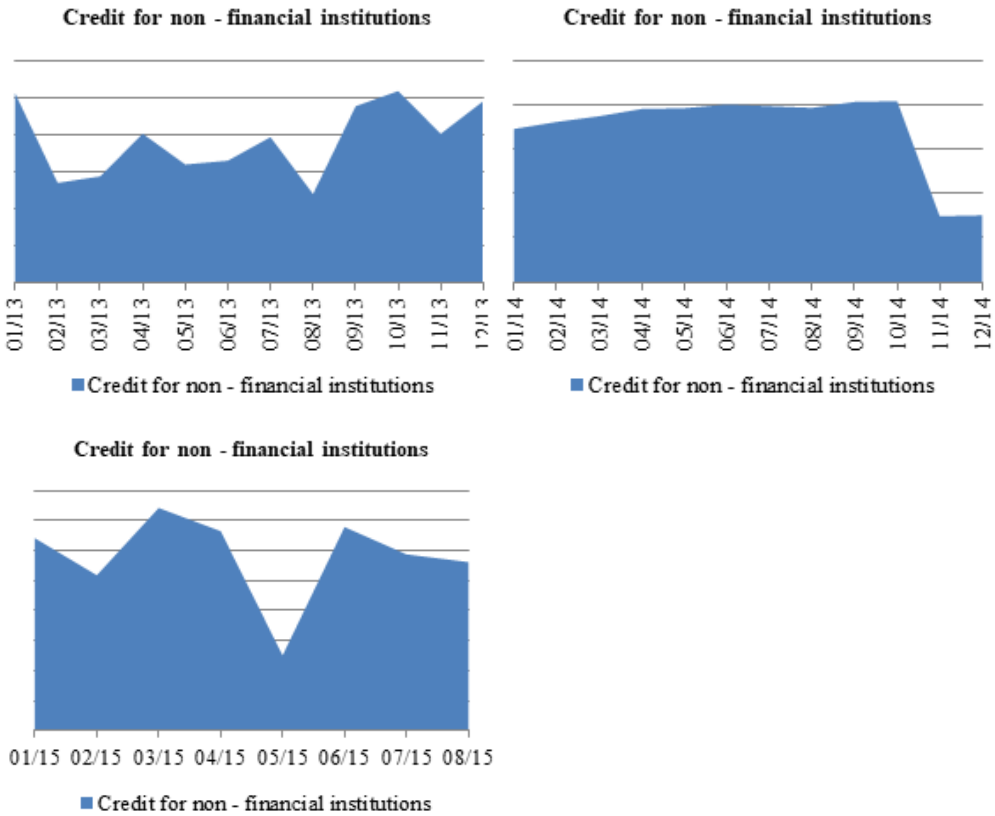
	I 2011	II 2011	III 2011	IV 2011
Credit for non- government sector, including,	1.56	2.32	2.49	3.23
-- for non- financial institutions, %	2.98	4.11	4.14	5.43
- for households, %	-0.71	-0.57	-0.22	-0.44
	I 2012	II 2012	III 2012	IV 2012
Credit for non- government sector, including,	3.11	3.76	3.23	2.84
-- for non- financial institutions, %	5.56	6.62	5.98	4.99
- for households, %	-1.00	-1.09	-1.52	-0.97
	I 2013	II 2013	III 2013	IV 2013
Credit for non- government sector, including,	2.34	0.99	0.68	-0.01
-- for non- financial institutions, %	4.38	2.04	1.37	0.07
- for households, %	-1.30	-0.91	-0.60	-0.16
	I 2014	II 2014	III 2014	IV 2014
Credit for non- government sector, including,	1.22	2.10	1.98	- 8.15
-- for non- financial institutions, %	1.70	3.07	2.97	-11.62
- for households, %	0.33	0.28	0.10	-1.64

	I 2015	II 2015
Credit for non- government sector, including,	- 9.20	-10.17
-- for non- financial institutions, %	-13.07	-14.51
- for households, %	-1.79	-1.79

Source: BNB and own calculation

3. Graphical presentation of the data for the period 2009-2015





4. Demand and supply of credit

Positive or negative changes related to the supply and demand of credit determine their amount. The changes in the credit cycle could be divided into several stages over the research period: The first stage is before the country's accession to EU in 2007. At this stage, the following factors have a strong influence on demand:

- expected earnings growth, higher permanent income (according to Friedman's monetary theory) encourages increased consumer lending;
- the rise of real estate prices increases the demand for mortgage loans;
- future participation in the European common market implies new investments in real assets to improve the competitiveness of local economy;
- the higher regulatory European requirements (for example - environmental) requires additional investments to be financed with credit.

The second stage is after accession and before the crisis in 2008. At this stage the demand depends on following factors:

- economic growth. Large numbers of projects with high returns are available, which allows to be financed at a higher price of the borrowed capital;
- rising property prices due to increased demand. The part of it is local, driven by

the level of savings in the country. Another reason is the rate of return by real estate investment. The part of the demand is formed by non-residents attracted to the local market by the high return on their investments;

- sharp increasing of earnings;
- low real interest rate.

The factors affect the supply of credit during the second stage is:

- inflow from parent banks;
- increasing local savings due to good economic activity;
- low “price” of attracted funds;
- low level of debt in different sectors;
- positive economic results.

The third stage of the credit cycle is after the 2008 crisis. During this period, the factors affecting demand are:

- income falls or keeps on the same level in real terms;
- real estate prices have fallen;
- increasing of BGN equivalence in foreign currency loans.

The factors influencing the supply are:

- recovering part of the deposits lost by banks during the crisis;
- reducing risk in the economy;
- economic activity slowly recovers. The return of projects is increased and therefore companies tend to be financed at a higher cost of the loan;
- positive outlook for income growth and a propensity for consumption, which leads to increased willingness to use the loan.

Credit data show certain risks for changes of supply and of demand, as reflected in:

- Problem with “bad” credits as well as solvency of borrowers. This risk can be minimized by upgrading the credit risk assessment system and methods. It has been achieved by introducing a centralized risk assessment system with issuing credit score for each borrower. At the same time risk assessment methods have to become much more objective and unified.
- An accounting of lost and the separation of sustainable legal provisions requires a more accurate assessment of the liquidity of the collateral offered and the creditworthiness of borrowers before a credit decision is taken.
- Increased number of partially secured loans. Often, by the lack of first-class collateral by borrowers, banks create a special pledge of commodities, output and uncompleted production, as well as customer receivables, which in most cases are low-liquid assets. These losses for the bank by collateral due to the poorly developed secondary market for more specific types of production and the uncompleted production, as well as the large amount of non-performing receivables whose quality is not always analyzed and taken into account when assessing the collateral offered. The bank lending to risky customers, due to the existence of “good” collateral, as well as lending to solvent customers with “bad” collateral, may worsen the bank loan portfolio. Each bank must ensure that the creditworthiness of the client is consistent with the quality of collateral offered to

- minimize the risk of default on repayment of the loan.
- A number of banks increase the growth rate of lending to firms with negative development trends. It needs to be taken into account when assessing the credit policy. The payment of commissions and interest by the borrower provides bank income. In some cases, in order to alleviate the monthly repayment, long-term loans are granted for small monthly amounts and additionally they use to cover operating costs, for short-term purposes.
 - With a relatively small number of high profitable companies, the commercial banks can be increased the share of overdraft to finance the working capital. It will considerably reduce the credit risk and will help to improve the financial situation of the companies. By overdraft do not imply a high profitability for banks because the funds finance purchased of goods and materials do not bring the income. The payments of the principal and the interest come after the sales of goods and production.
 - Investment projects - relatively few qualitative investment projects high rate of return applies for bank investment credits.
 - Own funds by lending - the next problem for obtaining loans in Bulgaria is very low amount of own funds (an essential condition for granting an investment bank loan). The companies have a low capital base. The attracted funds include the obligations to banks and the same towards: suppliers, staff, budget, National Social Security Institute, National Health Insurance Fund, etc. If they invest more own funds in their projects, more trust will gain in their creditors.
 - Lending and capital adequacy. Many companies as borrowers for promising investment projects and at the same time reported a loss for the previous year and uncovered losses from the previous few years. With the exception of several single cases, Bulgarian entrepreneurs do not agree to recapitalize their company by attracting new partners or new major shareholders, who would have contributed additional capital.
 - The reasons for the insufficient number and size of loans servicing the Bulgarian economy is the relatively unsatisfactory bank management and the insufficient knowledge of the bank credit officers and senior bank managers of the competitiveness in the different sectors and sub-branches of small and medium-sized companies.
 - Export activity of Bulgarian companies - as a further problem for obtaining the credit of small and medium-sized companies is relatively weak exports of these enterprises. This problem is possible be resolved by setting up specialized banks and funds that they grant credits and issue guarantees or cover differences between market and preferential interest rates of loans to Bulgarian producers, which have an export orientation. Priority should be given to the possibility of obtaining financial resources from international financial markets by the support of providing state guarantees or by issuing government guaranteed bonds. In the same time, Bulgarian banks for stimulating the export need to accumulate enough resources.

- Capital market and credit level - underdeveloped capital market in Bulgaria. The relationship between bank and bond lending and the absence of the latter (with a few exceptions) is one of the most significant reasons for the credit restrictions of banks on the real economy. In order to satisfy the needs of a mortgage loan in Bulgaria and the greater implementation of the Mortgage Bonds Act, adopted in 2000, should be created with public sources at least one mortgage bank. With the establishment of a mortgage bank could use with long-term cash resources through the issue of mortgage-backed real estate bonds.
- Rapid credit growth in the banking system may also trigger shocks by worsening macroeconomic stability and loan quality. The rising of the current account deficit (directly related to the credit boom) along with inflationary pressures make the economy vulnerable to macroeconomic shocks. For example, a sudden turnaround in the direction of foreign capital or some other “shock” would lead to severe consequences - a rise in interest rates, a slowdown in growth, a decline in asset prices.

Conclusion

The banks play a special role in the financial system. Some economic actors have less access to other forms of funding than to banks. For the period 2003-2008 the lending constantly increases. The conditions of the crisis in 2008 include: a gradual decline in the lending rate in 2008 from 38.45. % in the first quarter to 2.27% in the fourth quarter for business and lower for household loan to 5.79% at the end of 2009. For the period 2010-2015, households' trends are also descending, but with lower fluctuations - from minus 0.81% at the end of 2010 to minus 1.79% at the end of June 2015.

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