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Deposit Market Development in Bulgaria – Before and During the Global Financial Crisis

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Abstract. The key objective of the paper is to analyze the deposit market development in Bulgaria before and during the global financial crisis. With this aim, the paper is focused on the major trends in the domestic deposit market development regarding the bank interest rate policy, bank liquidity management, bank accumulation of funds and the interbank competition.

Keywords: Deposit Market, Global Financial Crisis, Bulgaria.

1. Introduction

The global financial crisis had its origin in the United States in a relatively small segment of the lending market – the sub-prime mortgage market. It was rapidly spread across all economies, both advanced and emerging, as well as across economic sectors and the crisis grew into the deepest and fastest developing crisis in a century. Financial difficulties at leading transnational investment banks and funds completely eroded confidence among financial institutions, while the Lehman Brothers' failure in September 2008 practically paralysed international financial markets. Market malfunctions and tighter credit policy spilled over into the real sector. Over the last quarter of 2008 the global financial crisis grew into a global economic crisis whose severity in the advanced economies was defined as the severest in scope and scale since the 1930s' Great Depression. The global financial crisis affected equity markets worldwide, with many countries experiencing sharp equity market crashes [1].

Since the Q2/2008 the Bulgarian banking system has been subject to the negative impact of the global financial crisis. The major developments observed are the following: significant slowdown in the lending growth, sharp decline in the general economic activity, worsening credit portfolio with an increase in the proportion of non-performing loans, a rise in the bank impairment costs.

The main objective of the paper is to analyze the deposit market development in Bulgaria before and during the global financial crisis. The paper is organized as follows: Section 1 describes the impact of the crisis on the deposit market development. Section 2 is focused on the Bulgarian deposit market during the crisis and the central bank's recent measures to preserve the funds accumulated by banks and further strengthen their liquidity. In this rapidly changing environment, the Bulgarian National Bank (BNB)'s Banking Supervision promotes the ability of banks to overcome the financial crisis. The paper concludes with summarizing the results from the study.

2. Bulgarian Deposit Market Development Before the Crisis

The currency board arrangement (CBA) introduced in 1997 plays a key role in maintaining Bulgarian macroeconomic stability. Under the CBA, all BNB monetary liabilities are fully covered by full highly liquid foreign reserves, and the BNB has a duty to sell and purchase euro against Bulgarian levs (BGN) at a legally set fixed exchange rate. The benefits of the currency board as a specific monetary regime are evident during the current global crisis. The fixed lev/euro exchange rate is a strong nominal anchor guaranteeing exchange rate stability; the floating exchange rates of some EU currencies underwent significant devaluations in 2008, contributing to worsening internal environments. The stability of the CBA was supported by a prudent fiscal policy and stringent banking supervision that ensured the accumulation of significant financial reserves in the period of high economic growth. Preserving the currency board in Bulgaria and implementing available levers are the key measures adopted by the BNB to influence on the financial system and to mitigate the negative effects of the crisis. The deposit market development in Bulgaria before the crisis was characterized by a very strong competition between banks for attracting deposits. Before the crisis, banks did not increase the deposit interest rates in order to attract more and more customers. The tool they used was focus shifting to the quality of customer service. The external factors like the dynamics of interest levels of the European Central Bank (ECB) or the US Federal Reserve had an increasing influence on the competition for luring customer deposits before the crisis.

According to BNB data at the end of 2005 the annual interest rate on deposits for Bulgarian levs was 2.99%. The share of banks offering deposit rates in the range 2-5% was up to 75%. The deposit rate only in one bank was 6%. BNB statistics shows that the deposit portfolio of Bulgaria's 34 commercial banks expanded by 37% in 2005. Term deposits in the local currency increased their share in the overall deposit base to 45.7% on average for 2005. Euro deposits rose to 57% of the overall deposit base. The deposit base of the Bulgarian banks stood at 25,4 billion Bulgarian levs at end of December 2005, including 20.4 billion levs deposited by corporate and retail clients. Six banks managed 60% of all deposit accounts, or about 16 billion levs, by late 2005. HVB Bank Biochim (together with Hebros Bank, both owned by Bank Austria Credianstalt) controlled 12% of the deposit market in late 2005, followed by Bulbank (soon to have both Biochim and Hebros in its UniCredit Group) with 10.4%, and United Bulgarian Bank with 9.4% [2].

3. Deposit Market Development in Bulgaria During the Crisis

During the global financial crisis the Bulgarian deposit market exhausted its capacity to provide liquidity for local lenders as recession strengthened its grip on the economy. Continuing its counter-cyclic policy in a changed external environment, in 2008 the BNB Governing Council amended Ordinance No. 21 on minimum required reserves to recognize half of cash in vaults as reserve assets. In addition, the method of calculating penalty interest under this Ordinance changed to give banks easier access to their BNB reserves. From 1 December 2008 the minimum reserve rate was cut from 12% to 10% on all attracted funds and from 1 January 2009 it was cut to 5% on non-residents' funds and to zero on central and local government funds. Significant liquidity was released, with the total effect of the amendments reaching some BGN 3 billion. This helped banks manage liquidity amid world financial market turmoil. The liquidity release did not automatically boost lending, since it was dependent on household and corporate demand and on banks' risk assessments.

Deposits attracted from individuals in 2009 stood at 641, 6 million Bulgarian levs, compared to 1.3 billion levs in 2008. There was limited room for growth and it has been exhausted already. Competition between financial institutions heated in the middle of 2008, when funding from their foreign parent groups dried up and international markets were in the middle of the credit crunch. The all-out battle for customers' savings continued during the next year but interest rates have hardly risen over the year. As a result, banks have been inundated with resources that could prompt them to ease up internal lending restrictions [3].

According to BNB statistics, the total number of deposits of *non-financial corporations* and *households and non-profit institutions serving households (NPISHs)* reached BGN 13.149 million at the end of December 2008, reporting annual growth rate of 9.6%, and respectively BGN 13.241 million at the end of December 2009. The amount of deposits of households and NPISHs was BGN 21.956 billion in 2008 (i.e. the annual growth rate was 16.4%), and BGN 36.345 billion in 2009, growing by 2.7% on an annual basis.

The biggest contribution to the annual growth was that of deposits under the amount category *over BGN 50 thousand* which grew by 11.6% on annual basis during 2008. The volume of non-financial corporations deposits amounted to BGN 13,420 billion, while the annual growth rate was 0.3% in comparison. In 2009 their growth was 0.7%. In 2008, the biggest share (41.2%) of the number of deposits from non-financial corporations was held by the deposits from "Trade and repairs of motor vehicles and household goods". That economic activity also had the biggest share in the total amount of deposits of the sector – 31.5% [4]. In 2009, the number of deposits of non-financial corporations decreased by 4.9% annually, reaching 461.9 thousand. The amount of deposits of households and NPISHs was BGN 24.340 billion with annual growth rate of 10.9% in 2009. The non-financial corporations' deposits amounted to BGN 12,006 billion, decreasing by 10.5% on an annual basis. In fact, the lenders already had a wider range of options to attract funds from abroad, tapping not only parent companies but also credit lines from international financial institutions, such as the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank

(EIB). This was enough to meet the softened demand for credit in the domestic market. According to the bankers, the stale demand for funding was expected to force them to cut back deposit interest rates to offset the high interest paid on attracted resources. In addition, the analysts said that the turnaround would be slow but would help spur economic activity [3].

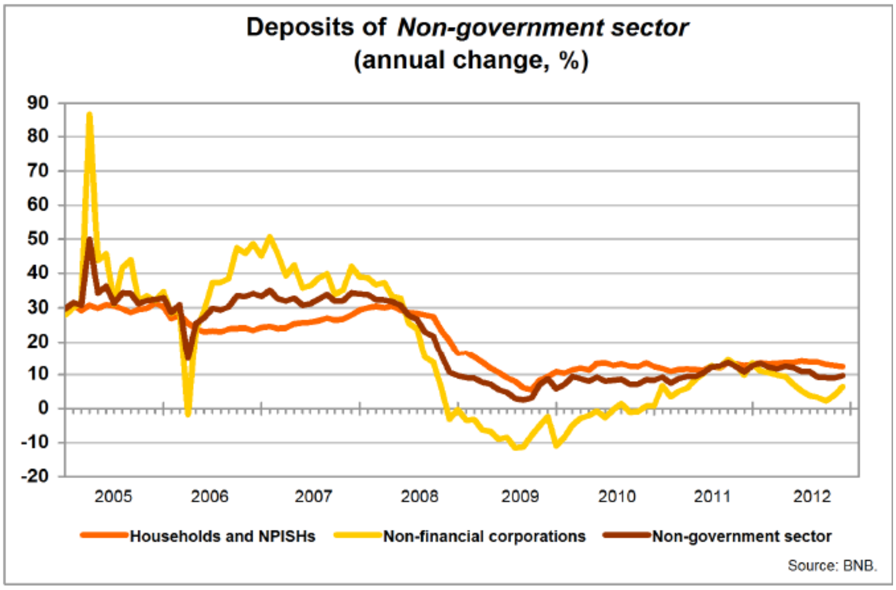

Fig. 1:

Banks' strategy over this period involved boosting deposits from residents wanting low-income low-risk investment, increasing non-interest revenue, and improving flexibility to cut administrative costs. This strategy helped Bulgarian banks to manage to increase their assets. Banks in Bulgaria have been recording consistent and significant growth in deposits throughout 2011, a trend that peaked in Q4/2011. The citizens' deposits with local banks increased by BGN 768 million only in December 2011. Thus the total amount of individual and household deposits rose by BGN 3.9 billion in 2011, marking an annual increase by 13.8%. Safeguarding banking stability is the BNB's priority that contributes to macroeconomic and financial stability and maintains confidence in banks. By the end of 2011 banking system assets reached BGN 76.7 billion: up BGN 3 billion or 4.1% on 2010, their growth matching that of attracted funds. Funds attracted domestically offered stable financing and fully offset declining non-resident funds. The share of individual and household deposits in total attracted funds reached 48.5% in 2011. The share of non-residents' funds fell 4.4 percentage points due to maturity of parent companies' funds during 2011. The share of residents' funds reached 80.8% [4].

There has been recently a noticeable trend among Greek and Romanian citizens and businesses that prefer to open deposit accounts with Bulgarian banks. The Bulgarian banks stability and their more attractive interest rate policy are the main reasons for the interest of Greek and Romanian citizens and companies. Meanwhile, a survey has shown that over the last five years only 45% of Bulgaria's population disposed of sufficient incomes to be able to put aside regular savings, predominantly small sums of BGN 100 per month. According to an analysis of Bulgaria's biggest bank UniCredit Bulbank there was an interesting trend – in times of crisis people with larger deposits tend to increase the amounts in the bank accounts, while those with smaller savings have them downloaded. Moreover, it appeared that over 2/3 of the money deposited in banks was in the hands of just 5% of the households in the country.

At the end of 2012, the Bulgarian government took the decision to levy tax on interest earned from bank time deposits since January 2013. Income on bank time deposits is taxed at a flat rate of 10%. This change is expected to raise an extra BGN 120 million for the public coffers. Initially, it was suggested that the cash could be used to fund increases in state pensions. The government's current line of argument is that the tax would bring Bulgaria into line with European norms, while helping rein in the deficit and promoting fairness. Bulgaria has been implementing a successful fiscal tightening program, and is targeting a deficit of 1.3% of GDP during 2013, and a balanced budget by 2015.

The most EU member states tax interest income. Bulgaria also has a flat 10% tax on personal income and corporate earnings, which the government has pledged not to raise. However, the critics suggest the plan is ill conceived. As well as the usual arguments about effectively taxing the same income twice over are that the new levy could actually discourage the tax paying and to shift activity into the grey economy – counteracting one of the main aims of the original flat rate. Moreover, the debate is also about why the government is proposing this tax at the last minute, why there has been no consistency, and why it’s being imposed at a time of crisis. There are a number of better options for reducing the government budget deficit, including axing questionable training programs for the unemployed.

According to UniCredit Bulbank, the deposits of the Bulgarians will continue to grow in 2013 though at a slower pace than in 2012 [5]. The statistics of the BNB shows that the residents’ deposits registered a new record in November 2012 when they grew with BGN 409 million to reach a total sum of BGN 35.3 billion. The introduction of the tax on deposit interests may have some negative effect on the time deposits but it will hardly lead to a serious loss of interest on behalf of the Bulgarians as bank deposits remain the safest and relatively profitable means of savings. In addition, in 2013, it is very likely that Bulgarian households will be very careful in their financial decisions. Interest rates on deposits are expected to continue declining in 2013, with the only notable exception being intermittent promotional rates offered by financial institutions. The credit crunch resulted in a brief period in Bulgaria, in 2009 and part of 2010, when banks offered high interest rates on deposits in an effort to shore up their liquidity. With their liquidity well above EU and local regulatory requirements, Bulgarian banks have since reduced interest rates, but that has not diminished household savings – with the economy still in the throes of slow recovery and double-digit unemployment, household consumption growth has been slow.

4. Conclusions

The financial crisis has focused the attention of investors, regulators, rating agencies and, not least, the banks themselves, on the need for stable sources of funding [6]. In fact, funds attracted from domestic sources provide stable financing, fully covering the decline of non-residents’ funds. Growing deposits of individuals and households lead to an increase in attracted funds. The outlook for the Bulgarian deposit market is that the residents’ deposits will continue to grow in 2013 though at a slower pace than in 2012 whereas an accelerating flight of deposits from banks in the four European countries – Greece, Spain, Portugal, and Ireland, is jeopardizing the renewal of economic growth and undermining a main tenet of the common currency: an integrated financial system [7].

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