

The banking sector will play a key role in the recovery of the economy in 2022, too, as it did in 2021



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At the beginning of the new year, the Ministry of Finance looks ahead with the viewpoint that our country's financial system will resist the COVID crisis as it did in the previous two difficult years. We hope to bring – thanks to the government's adequate and timely economic and social measures aimed at providing support and recovery, as well as with the support of the banking sector – hope and reassurance to people's real lives. Businesses can also take a long awaited breath, so that we can see the first good economic results.

The main priorities and challenges the Ministry of Finance will face during the year are in several directions. Our first task is to value and lay down in the draft budget law all policies of the new government. Of course, due to the time constraints and the need for a rapid adoption of the budget at the beginning of the year, the vast majority of these policies will be fully implemented within the budget revision at the end of June, as foreseen in the coalition agreement.

The other major challenge will be the ongoing preparations for the introduction of the euro. We intend to organise broad public discussions on the introduction of the single European currency, so as to make the transition from the lev to the euro as smooth as possible. Here, I have to point out that the preparations for our membership in the euro area are advancing well; the technical work is on track. We hope that this spring and summer we will manage to conduct this broad public discussion in order to make all citizens and businesses aware what exactly Bulgaria's membership in the euro area means and how it will affect their activities and their lives. They should also be confident that the adoption of the euro as a national currency will not cause financial shocks.

Last but not least, a government priority in the course of the year will be the structural reforms to be undertaken in the social and healthcare spheres, as well as some of the initiatives in the education system. They must be supported with sufficient financial resources, on the one hand, and must ensure sustainability over time, on the other.

Our debt policy is the other important point in the work of the Ministry of Finance. Our issue calendar for this year is ready. The public is interested whether our country will issue debt on the international financial markets, having in mind that last year it didn't have to. I believe that most probably there will be issues on the external markets because debt, both external and internal, of nearly

BGN 3 billion is maturing this year. I think that most of the debt repayments will take place in the first quarter of the year, and a smaller part – later in the year. At the very least, this debt must be refinanced and we will use all instruments the Ministry traditionally lays down in its debt policy.

In addition, we expect the budget deficit without COVID-related measures to be below 3% and with COVID-related measures – around 4%. This deficit will have to be financed through debt, so the state will participate in the debt markets in a very predictable way, the same way it did in previous years.

The Recovery Programme, which we started last summer with the Fund of Funds and the Bulgarian Development Bank, in partnership with several commercial banks for lending to businesses, is advancing extremely well. In the context of the ongoing COVID crisis, the Programme allows companies now to emerge from the heavy period of restrictions and lockdowns. The government intends to enhance this Programme towards broadening its accessibility and providing additional financial resources to help more companies to make use of these loans. The last lot of funds under the Programme is underway and the interest in it is higher than the amount of available funds. This is exactly our main argument to provide additional resources so that the Programme could continue operating this year, too.

In addition to expanding the Recovery Programme, we are also working to integrate the sectoral policies in it, to support individual industries with loans. The reason is that when EU funds are used, there are restrictions for certain sectors, while for national funds there are no such restrictions.

I am confident that 2022 can be a positive year for the development of the financial and banking sectors. Moreover, I believe that the banking sector will be of key importance for the recovery of the economy, like the role it played in 2021, too, and this would be good for both banks and Bulgarian firms.

I wish the representatives of the banking sector to see the beneficial aspects of the difficulties and to use them in the models for the recovery and sustainable development of our economy, as it is namely the crises that create the new models in society!



The Banking Sector – Opportunities and Challenges



Dimitar Radev
Governor of the BNB

It is a tradition to start a calendar year by reviewing the achievements of the banking sector in the previous year and outlining the opportunities and challenges in the new one.

In 2021 the Covid crisis continued to put the banking sector to a serious test. Unlike the stress tests in 2016 and 2019, the results of this test were not hypothetical, but provided a real assessment of the state of the sector and its capacity to operate under highly adverse conditions. This assessment can be summarised as follows: *not only were Bulgarian banks not weakened during the pandemic, but they enter 2022 with performance better than, or at worst consistent with, that at the start of the pandemic*, including in terms of capital, liquidity, asset quality and profitability. According to the latest data for 2021, the overall capital adequacy ratio is 22.4% and the liquidity coverage ratio is 325.4%, i.e. above the EU average. At the same time, the gross amount of non-performing loans and advances continued to decline, and profits approached their historically high levels of 2019.

The short explanation for these results is that *the banking sector was well prepared to operate in a complex and challenging macroeconomic environment*, as has been the environment over the past two years. This has allowed the banking sector to have a different focus from the one it had during the global financial crisis in 2008 or during the local problems in the sector in 2014. In these previous episodes, the banking sector was mainly engaged in solving problems within the sector. In the Covid crisis over the recent two years, the banking sector was not concerned with its own problems, but mainly with alleviating the effects of the crisis on businesses and households and subsequently with the recovery and speed-up of the economy.

In this sense, *the Covid crisis legitimised an important qualitative change in the position of the banking sector - from a source of problems in the past to an important factor in their resolution in recent years*. Significantly, the banking sector absorbed and implemented successfully and without shocks the anti-crisis package of measures approved by the BNB, amounting to about 9% of the GDP, as well as a private moratorium on loan repayments by businesses and households. At the same time, credit activity not only did not stagnate, but increased. According to the latest data from the 2021 monetary statistics, loans to businesses and households grew year-on-year by 4.1% and 12.5%, respectively.

Good operational performance was underpinned by progress on important strategic tasks. October 2021 marked the one-year anniversary of the country's accession as a full member to the European Banking Union. The assessment of this participation by both the ECB and the BNB is unequivocally positive. This assessment has to be seen outside the narrow context of the banking sector. *First*, it shows that *Bulgaria can be a successful and full participant in euro area institutions*, given that the Banking Union is the first such institution in which the country has participated; and *second*, it is *a good example of institutional development to be followed in an environment of still serious institutional deficits*.

In 2021, we also marked one year since the Bulgarian Lev joined the EU Exchange Rate Mechanism. *This participation confirms and further proves the currency stability of the country.*

Another important strategic aspect is the consolidation process continuing in our banking sector. This process follows global trends of seeking to streamline the structure and efficiency of the banking sector in the light of increasing competition and the pressure by new providers of financial services, as well as rising costs of complying with regulatory and legal norms.

In spite of the difficult and complicated environment created by the pandemic, in 2021 we saw the biggest acquisition, in terms of size and price, in the Bulgarian banking sector. A deal like this is *the most accurate market evaluation of the condition of the banking sector and its attractiveness to strategic investors.*

Therefore, the sector stayed in very good shape and so far, succeeded through the pandemic. Now our focus must shift onto meeting the challenges of the year 2022, keeping the strategic context, namely the process of Bulgaria's accession to the euro area, in which the banking sector will play a key role.

In general, *we expect that the macroeconomic environment in 2022 will be a little more favourable, but not less challenging.* Although we are at the peak of another wave of the Covid crisis, we suppose that the negative health effects would subside and lessen over the year and, consequently, measures restricting the economic activity would be eased and become more flexible. Such a development would promote the improvement in the economic environment.

On the other hand, banks will be faced with *greater dynamics of the risks associated with the balance-sheet value of assets and liabilities and of returns.* These dynamics will primarily depend on the development of the macroeconomic processes in Europe and, in a more global aspect, on the anticipated changes in the actions of the leading central banks. The withdrawal of the accommodative monetary policy, typical of recent years, will be visible in the reversal of the interest-rate cycle. These processes, which will be running globally with varying intensity and supported by different instruments of central banks, will largely determine the financial conditions in our country.

In the context of the ongoing global macroeconomic processes, inflation will continue to receive special attention. *We expect that the rate at which the prices in Bulgaria will be rising in 2022 will reach its peak, on an annual basis, within the first half of the year, and at the end of the year, again on an annual basis, it will fall below that reported as of December 2021.* The concrete nominal levels of the general price index will depend on the combined effect of the anti-inflationary and pro-inflationary factors, including on the dynamics of the energy prices in the international market and the prices of foodstuffs.

We believe that the coming discussions on the adoption of the 2022 budget will give additional indications of the development of the macroeconomic processes in Bulgaria. In this regard, the topics important for the banking sector are: the annual and medium-term macroeconomic framework; the level and management of the debt; the incomes policy; and the level and management of the so-called 'contingent liabilities' in the energy, transport and social security sectors.

In the context of the ongoing global and local macroeconomic processes and the still open issues, in 2022 the banking sector will have to find a balance between the possibilities of expanding the lending, as a result of the anticipated improvement in the economic environment, and the areas of economic uncertainty coming mainly from the evolution of inflation and the still unresolved risks caused by the pandemic. *A major criterion for reaching an optimum balance for each bank will be the preservation of, and even improvement in, the quality of assets.*

For its part, the BNB is ready, as it has been thus far, to implement the full range of measures, within its mandate, to mitigate and neutralise the manifestation of risks in relation to banks. The overarching objective of these measures is to *preserve and further strengthen the capital reserves and the high loss-absorbing capacity of banks* against potential deterioration in their loan portfolios and to ensure that the stability of the system is maintained, including in the event of less favourable than expected exogenous economic and financial developments.

In 2021, the BNB twice increased the level of the countercyclical capital buffer to reach 1.5% and confirmed the level of the systemic risk buffer at 3%. The BNB will continue to require banks to maintain adequate capital buffers against potential losses arising from the realisation of cyclical systemic risk. This risk currently arises mainly from active residential lending to households, as well as lending secured by commercial real estate. *At this stage, the focus will continue to be on the implementation of macroprudential measures targeting banks' capital, but the BNB stands ready to implement additional measures, if necessary, including borrower-based.*

More strategically, the BNB has already mobilised serious efforts in the project for the adoption of the euro in Bulgaria. The tasks on the way to achieving this goal go beyond the banking sector, but will also strongly involve the banks.

The dynamics of the political cycle in 2021 led to a pause in the institutions' work in the process in the country. All the factors are now in place for its resumption through *the continuation of the Coordination Council for Bulgaria's preparations for euro area membership; and the institutionalisation of the Euro Adoption Plan*. The draft of this plan, adopted by the Coordination Council on 30.06.2021, has already gone through the formal procedure of public consultation and inter-agency coordination, and has the support of our external partners.

In spite of the delay in the formal process, the BNB remained the institution that continued to work actively in all areas related to the euro area accession, falling within the scope of our responsibilities. To this end, we established the necessary internal organisation of work and good operational communication with the European Central Bank. Specific individuals and channels for partnership were identified on both sides. In this sense, the central bank is ready to carry out the huge amount of technical work related to the adoption of the euro in a timely manner, notwithstanding the emerging tighter work schedule.

In conclusion, 2022 is promising to be a year of challenges but also opportunities for the banking sector. The achievements of 2021 show that the sector is in a strong starting position to meet the challenges and make good use of the opportunities.



The digitalization and the contribution of banks to achieving an environmentally friendly and sustainable economy will continue to be leading for the banking system in 2022



Diana Miteva
Chairperson of the
Executive Board of the ABB
Executive Director of DSK Bank

The state of the Bulgarian economy and the recovery of the economic sectors from the pandemic of COVID-19 will predetermine the activity of the banking sector again in 2022. Although the forecasts of a number of European and international institutions are for potentially slower growth of the Bulgarian economy compared to the European and the global one, the expectations in 2022 for the Bulgarian economy are that it is going to return to the levels last observed in 2019 or before the coronavirus crisis.

This year will be marked by the decisions of the leading central banks to gradually withdraw the incentives given to economies to counter the negative effects of the COVID-19 pandemic, their response to inflation and the related debates on the interest rates. The monetary policy of the leading central banks, respectively, the interest rate environment is expected to continue to have a major impact on the performance of banks.

The Bulgarian banking system enters 2022 well capitalized, highly liquid and profitable. The gradual recovery of business activity last year had a positive effect on all key indicators of the financial performance of the banking sector. This is essential for economic development, not only for the banks but for the society as a whole.

Both deposits and loans in the banking system continue to grow – being a proof that the confidence in banks remains high and that they are successfully fulfilling their function in financing households and companies and contributing to financial stability. A positive trend we are witnessing is that citizens and companies are increasingly turning to alternative ways of managing their savings and investments, thanks to the wide range of products offered by the banks.

In recent years, regulations in the field of banking and financial services have increased tremendously, both in number and regarding the strength of the requirements. In this sense, the regulatory pressure on banks and related costs for banks will remain among the main challenges for the banking sector in 2022. Banks are looking for an effective way to deal with the growing number, complexity and fragmentation of new regulations introduced, not only by the European institutions, but also globally, such as the Basel IV agreement, the anti-money laundering framework, cybersecurity requirements, support for environmentally sustainable economic activities, part of the so-called “Green Deal” and related taxonomy, and others.

Digitalization, cybersecurity, credit risk management and the contribution of banks to achieving a green and sustainable economy will continue to be among the leading topics for the banking system in 2022.

Banks are already adapting their activities, their business models, internal rules, products and services in connection with the new realities, for which they intensively communicate and prepare their clients - both in terms of providing the necessary financing but also expertise, risk assessment and consultations.

In 2022, when the Association of Banks in Bulgaria /ABB/ will celebrate 30 years since its establishment, we will continue our consistent policy of openness and fair treatment, both to our members and to government agencies, institutions, other organizations, the media and society as a whole.

We take this opportunity to reiterate the ABB's readiness for fruitful and constructive cooperation with the Council of Ministers, the National Assembly, the Ministry of Finance, the Bulgarian National Bank, the Financial Supervision Commission and other state bodies and institutions in legislative proposals, various regulatory changes or other significant actions for the society this year.

It is also important for us that the work on the National Plan for the introduction of the euro in the Republic of Bulgaria is carried out in the presence of clear messages, timely actions and communication, so that it is possible to adequately plan the necessary activities in the banking sector in relation with the adoption of the euro in the country - in the short run and in medium term.

As usual, the ABB will rely on the European Banking Federation /EBF/, of which it is a member, to ensure the professionalism and efficiency of its activities. Participating in its work is extremely useful for the ABB's interaction with the European and national regulators, as well as for helping in finding the most effective solutions to various issues important for the development of the banking system.

We would like to express our appreciation and heartfelt gratitude to the representatives of the member banks of the Association, who actively participate in its work, united in 6 committees and 12 working groups at the ABB. We will continue to rely on you in 2022, in view of the emerging challenges the banking business is facing and the high social responsibility that the banking system has, as one of the key sectors for the development and stability of the national economy.



■ In November, the Financial Supervision Commission approved a proposal by the Executive Board of the ABB to elect Mrs. Irina Kazandjieva, Head of Banking Policy and Analysis at the ABB, as a member of the Management Board of the Investor Compensation Fund (FCI), for a new five-year term as a representative of the ABB.

■ In December, the ABB sent proposals for a substitute member of the ABB-nominated member of the Advisory Council to the Fund Manager of Financial Instruments in Bulgaria (FMFIB) - Mrs. Desislava Simeonova. The Executive Board of the ABB has appointed Mr. Kiril Velichkov from the UBB, who is a member of the Working Group on European programs and other funding at the Executive Board of the ABB as Mrs. Simeonova's Deputy. Mrs. Eleonora Hristoforova - Legal Adviser of the ABB has been appointed as a contact person. Expert working groups are expected to be formed as well, for which the ABB is also ready to nominate representatives.

■ In December, the ABB sent a letter to the State Fund for Agriculture (SFA) in relation with the establishment of three joint Working Groups, with representatives of the ABB and the SFA. Representatives of six banks and two representatives of the ABB Secretariat were nominated for participation in the expert Working Group for entries in the register of special pledges, administered by the SFA, of established pledges in favour of the bank in lending to applicants for support under schemes and measures for direct payments and rural development programme (RDP) measures, as well as for Working Group for exchange of electronic communications in issuing and confirming bank guarantees and for the Working Group for confirmation, sending and verification of documents submitted by banks in relation to RDP projects.

■ In December, the ABB sent a letter to the Ministry of Finance (MoF) regarding the Sustainable Finance Subgroup of the WF 26 Financial Services at the MoF, in which the ABB has two representatives. The ABB informed the MoF that it would like to nominate Mrs. Anna Madzhurova-Davri, Head of the UBB Sustainable Finance Programme and the KBC Group for Bulgaria, in the Subgroup, in place of one of its representatives - from the ABB Secretariat, taking into account that a Working group on Sustainable Finance has already been established at the ABB Executive Board, which includes representatives of the ABB members.

■ In December, the ABB and its members participated in the seventh consecutive information campaign European Money Mule Action (EMMA) organized by the Europol against the recruitment of "money mules". The campaign aims at informing the financial services customers about the most common ways of recruiting "money mules" as well as the risks and dangers they are facing by being involved in those activities and what steps to take in order not to become victims. More information about the campaign as well as the informational materials may be found [here](#).