

## **Ivan Iskrov: Global and regional challenges to the economy and the financial system. Do we have working solutions?**

Opening address by Mr Ivan Iskrov, Governor of the Bulgarian National Bank, before the International Scientific Forum “Global and Regional Challenges to the Economy and the Financial System: Do We Have Working Solutions?” organised by the VUZF University, Sofia, 10 May 2012.

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Dear Mr. Rector,

Dear Participants and guests of the conference,

Ladies and gentlemen,

It is an honour and a pleasure for me to take part in the opening of this International Scientific Forum organized by the VUZF University. I would like to thank its Rector, Prof. Vazov for inviting me, and through him to congratulate the University on the occasion of its remarkable 10<sup>th</sup> Anniversary.

The academia are famous for their conservatism but here, only a decade after its foundation, your University established itself as one of the leading universities in Bulgaria in the area of finance and insurance. An example of the high European standards to which the VUZF University aspires, are the joint bachelor’s and master’s degree programmes with the University of Sheffield. In addition, the Extended “Erasmus” University Charter awarded by the European Commission provides opportunities to VUZF University students to train and have internships at EU universities and companies.

It was announced lately that in the recent five years 55 thousand people have graduated economy in Bulgaria. Against the background of this interest to higher education in economics, the VUZF University gained a reputation as one of the most attractive higher education establishments for young people seeking the optimum combination between theoretical knowledge and practical training. One of the reasons is that VUZF University is known for its policy of attracting as priority professors of great experience, acclaimed as practiced professionals in their area of expertise.

This is very gratifying for me, because as an employer in large financial institutions since 1997 I have been aware that the discrepancy between theoretical knowledge and practice is a serious issue facing newly-minted economists upon their graduation. And practical experience gives a great momentum at the beginning of any young person’s career – because it not only teaches them specific professional skills, but also develops their comprehensive qualities, such as team work skills, efficient time management, motivation to seek alternative solutions in a competitive environment, etc.

VUZF University however is not just a place of education, it is a centre of research, discussions and generation of ideas. Today’s forum is another proof of this.

A year ago, again before the audience of a scientific conference organized by VUZF University, I expressed my purely professional dissatisfaction with the fact that we rarely hear the prudent voice of the Bulgarian academia. While the world has been analyzing and discoursing for years on the causes, manifestations, and lessons learned from the global crisis, our academic community rarely expresses any views on these issues and seems to be still encapsulated in its own circle, engaged in its internal management or even day-to-day problems.

Therefore I am glad now to admit that in this also VUZF University is an exception. I have been following with interest the public appearances of your rector, vice rector, and other professors and academics of your university. VUZF University representatives have often

come up with authoritative public comments on topical economic subjects of great public significance.

Today I congratulate VUZF University for outpacing “the older” universities of economics by organizing this timely discussion. The announced topic – “Global and Regional Challenges to the Economy and the Financial System: Do We Have Working Solutions?” – speaks for itself and is an eloquent testimony to the importance of today’s forum.

Because external environment is of special significance for the dynamics of such an open economy as that of Bulgaria. It is a known fact that the original causes of the global financial and subsequently economic crisis did not stem from our region or from Europe’s emerging markets. Still, we should in no way take comfort in the external origin of the crisis because no matter what the origins of the crisis might be, we, here in Bulgaria, must deal with its consequences.

This is the right place to stress that the BNB is aware of its huge responsibility for the financial stability of this country and consistently works in fulfilment of the functions and tasks assigned to it by law.

In its work, the Central Bank collaborates with many other international and national institutions, and whenever a need arises, it steps into the role of a constructive opponent. Because, as I have stressed on various occasions, it should not surprise us, nor should we show intolerance to the fact that the political institutions in the democratic countries are very sensitive especially with regard to quick achievements within the context of the electoral cycle. Whereas the tasks of central banks go beyond the horizon of the next parliamentary or presidential elections. We are guided by the understanding that we have to keep our reputation as institutions with national responsibility, holding as our priority the long-term economic interests of the people and of the state. Hence, the fundamental logic of the so very important (and very strictly adhered to throughout the EU) principle of national central bank independence and the need to provide independent analyses and information to the general public.

In this sense, we, at the BNB, just as we have done so far, will always support an economic policy in Bulgaria that does not threaten long-term economic interests at the cost of achieving quick economic effects – such as the policy of continuing structural reforms, enhancing the efficiency of institutions and improving the general environment for doing business in this country. The BNB traditionally supports conservative fiscal policy owing to which Bulgaria today demonstrates excellent fiscal indicators and given the stable banking system we have reasons to expect that our new issue of euro-denominated Bulgarian global bonds will be well received. We would also welcome efforts at speeding up privatization and active concessioning – inasmuch as they would not only strengthen our country’s fiscal position, but would also improve the long-term competitiveness of the Bulgarian economy. We, however, cannot be indifferent to any ungrounded economic experiments whatsoever.

At the same time, the range of working solutions for Bulgaria’s economic prosperity must also take into account the analysis of the comparative advantages of the Bulgarian economy in a global context.

In fact, it is exactly the current crisis that has highlighted and provided empirical evidence of the resilience of Bulgaria’s economy. Allow me to recall that before the crisis many argued that the currency board in Bulgaria was restraining the economy’s flexibility and that the high current account deficit (above 1/4 of GDP in 2007) was a dreadful “imbalance” that could in no way be funded in the event of capital flight from the country. To the surprise of many institutions and experts, a great part of them of proven experience and repute, BNB’s gross international foreign exchange reserves increased from BGN 24.9 billion as at the end of 2008 to BGN 26.1 billion at the end of 2011. Presently the lev is more than 150% covered with BNB’s international foreign exchange reserves of the highest quality (not even taking into account the government’s deposit). In short, for fifteen years now businesses and citizens have benefited from the predictability and stability resulting from the fixed exchange

rate and the stable Bulgarian banking system. Not lastly, in the past year the current account turned positive after an impressive growth of Bulgaria's exports for two years in a row (by over 30% annually in each year), and at a growing share in total EU imports. All this offers interesting matter for discussion at a forum like this one. How do adjustments and counteracting "imbalances" in a small and open economy with a currency board fit into orthodox economic theories and explanations from popular textbooks, which are as a rule written about economies quite different from that of Bulgaria, and by authors of a radically different economic background? I am curious as to what conclusion today's scientific forum will reach.

Another big myth about Bulgaria was the imminent "collapse" of our banking system (because of the "avalanche" of bad loans and the "dependence" on foreign banks which would have run away in panic and withdrawn their capital from Bulgaria). None of all these apocalyptic prophecies has happened. Our banking system kept sizable buffers and demonstrated impressive for the whole EU ratios of capital adequacy and liquidity. Given the high level of domestic depositors' trust (only in one year, until March, total deposits increased by over BGN 5 billion), the dependence on foreign sources of funding diminished considerably – at end-March less than 13% of total attracted resources comes from parent banks abroad, as opposed to nearly 1/4 at end-2008. Ultimately, unlike some of the more advanced economies, no bank in Bulgaria needed to be rescued.

And the very frequent headlines about "bad" loans do not reveal the true picture in Bulgaria as compared with the other economies in the EU. The reason is that the legal framework, financial reporting standards and regulatory practices in the various countries are rarely the same, and this seriously hampers any comparisons across countries (as an example, some countries directly write off and keep off-balance sheet a large part of their non-performing loans). For instance, focusing solely on 'bad' loans may be misleading if it is not accompanied by the clarification that the assets in the banking system balance sheet are very little exposed to the risk of mark-to-market revaluations (and exactly the manifestation of that risk became the biggest problem in many of the "advanced" banking systems). Furthermore, it is very common in Bulgaria to comment on the *gross* non-performing (over 90 days past-due) loans ratio, whereas the economically more significant ratio is the "*net* non-performing (over 90 days past-due) loans/*net* loans" ratio – it correctly reflects the fact that the risk has already been taken into consideration in the income statement through the impairment costs that banks have actually made. Also, as a rule, net non-performing loans represent the part of the loan portfolio covered by highly liquid (and acceptable under the BNB's high standards) collateral. Net non-performing loans in Bulgaria hold a share of 10.71% at end-March 2012. What I mean to say is that the analyses and conclusions about non-performing loans across countries are useful only when they are based on comparable values.

Despite the objective indicators, all the resilience and adaptability of the economy and banking system in Bulgaria remain unnoticed by many international observers and the leading world media. Even the analyses made by European and international organisations, known for their high expertise, still lack understanding of the economic specifics in the different countries. Instead, they often use the easier approach (which has proved wrong) to group countries and entire regions by meaningless geographical characteristics, and these are simply "labelled" along with superficial and clichéd conclusions. Such geographical approach that fails to take into account the very diverse economic structures, institutional environment, or even political and historical traditions, may well be appropriate in meteorology, but definitely not in economic analyses! I believe that today's conference will touch on this range of issues too.

That is why I expect to have some of the above-mentioned issues analysed today at your forum. Seeking useful ideas and working solutions for exiting the crisis would continue, as the crisis itself is not over yet. We are far from having ensured that lasting recovery of the economy back to the rates of growth that correspond to its potential. In Bulgaria and in

Europe as a whole the risks to economic development remain, as can be seen from the continuing flows of negative data – limited consumption, weak investment interest, subdued labour market, volatile financial markets.

I wish you fruitful discussions and success to your forum!