Ivan Iskrov: Conflicts and complementarities between monetary and macroprudential policies

Opening speech by Mr Ivan Iskrov, Governor of the Bulgarian National Bank, before the International Conference on the Occasion of the 15th Anniversary of the Introduction of the Currency Board Arrangements in Bulgaria "Conflicts and Complementarities between Monetary and Macroprudential Policies", organised by the Bulgarian National Bank, Sofia, 5–6 July 2012.

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Dear ladies and gentlemen,

It is my pleasure to be here today with you and to open this conference under the topic "Conflicts and complementarities between monetary and macroprudential policies". These issues have been discussed extensively in recent years by policymakers, financial market players and academicians alike. The ongoing financial and sovereign debt crisis has sparked a need to reassess the existing economic governance structure and to come up with options for better policies. And one of the key aspects of this debate is about the optimal mix of policies, which is precisely the topic of our conference.

The BNB has decided to organise this conference because there is a big interest nowadays in the way monetary and macroprudential policies interact or, according to some, could be even in conflict.

Since these issues to a great extent relate to the role and responsibilities of the central banks, the timing of this conference conveniently coincides with the 15th anniversary of the introduction of the currency board arrangements in Bulgaria. This is an opportunity for us to discuss the success of Bulgaria's monetary policy regime in the broader context of the lessons from the current crisis. The speakers and discussants from the BNB today and tomorrow will share the knowledge we have acquired, based on our rich institutional experience.

The experience of the Bulgarian central bank is unique. We are one of very few central banks in the world which have both practiced "conventional" monetary policy (involving setting of policy rates and conducting open market operations) and then operated a currency board after that. We have had a track record, during the last two decades, of monetary policy under two remarkably contrasting regimes. Thus our legacy is very different from that of the other similar monetary policy regimes in Europe (such as Estonia, Lithuania, or Bosnia and Herzegovina), where the currency boards were adopted by newly-established central banks in newly-independent states as a means of bringing confidence in a new national currency, promoting political emancipation and national identity. That was not our case, however.

The currency board arrangements were introduced in Bulgaria exactly 15 years ago with the very same motivation that stays behind the current reform agenda in the euro area. We did it in order to achieve a much more efficient macroeconomic management and to bring in credibility in the whole policymaking process. Furthermore, the case of Bulgaria demonstrates the importance of maintaining wide consensus among politicians and the society at large, on the key principles of economic policy.

The currency board arrangements are not just another monetary policy regime. They are a "frame of mind", a way to view and tackle the economic, political and social processes. Some Western analysts and researchers fail to understand this. But I am sure the contributions by my colleagues from the BNB will clearly illustrate during this conference that the currency board is something more than just a monetary policy regime.

Following a dramatic banking and financial crisis in 1996–1997, the economy was stabilised by the introduction of the currency board arrangements, in combination with the strong fiscal discipline, the liberalisation and privatisation of the Bulgarian economy, and the use of a broad range of macroprudential instruments.

The current global crisis is not the first one successfully weathered by the Bulgarian economy. In only two decades we have endured the Asian crisis, the Russian Crisis, the "dotcom bubble" burst, the U.S. subprime crisis and the failure of Lehman Brothers, before the euro area financial and sovereign debt crisis came in. But the recent crisis has served as perhaps the biggest "litmus test" for the optimality of our monetary policy regime.

We believe that a small open economy, which is not rich in certain commodities or natural resources, cannot succeed in pursuing the so-called independent monetary policy. All these issues will be elaborated today by deputy governor Hristov who will share our experience with you during the afternoon session of this conference.

Dear colleagues,

No monetary policy regime *per se* is universally superior, however. This is where the need for an optimal policy mix, which relates to the topic of this conference, can be illustrated by the case of Bulgaria again.

Fiscal policy must play a vital buffer and corrective role in a small open economy. The same is valid for an economy with a fixed exchange rate. While the importance of fiscal discipline is only now being acknowledged in some parts of the euro area, the philosophy of constant fiscal vigilance has been guiding the policymakers in Bulgaria since 1997. But even fiscal discipline is not enough for the overall macroeconomic stability. The reason for this is the fact that there has always been, and there will always be, a strong interconnection between the state of the public finances and the quality of the banks' balance sheets.

Because of that, following a deep financial and banking crisis in the mid-1990s, Bulgaria adopted one of the most conservative supervisory standards and practices in Europe. What is more, they have been persistently implemented in a countercyclical fashion, both before and during the crisis.

As deputy governor Simeonov will detail later at this conference, the BNB has mastered and tested successfully a long list of both "macro" and "micro" bank supervision instruments. In the "good" times, the BNB insisted on the build-up of capital and liquidity buffers, discouraging banks from excessive asset growth and risk-taking. But since the end of 2008, the BNB focused on the capital and liquidity relief for banks while also allowing them to ease lending.

As a result of these conservative and countercyclical policies of the BNB, and the rather prudent behaviour of the banks themselves, today Bulgaria manifests a very stable banking sector, with outstanding capital adequacy and liquidity ratios. Four years after the Lehman Brothers collapse, the banking system of Bulgaria remains one of the few in the EU where no single bank needed to be rescued or supported with taxpayers' or central bank money.

Merging the monetary and macropdudential mandates (including banking supervision) under the auspices of the central banks is currently being implemented in some of the "older" EU Member States. The macroprudential oversight of the financial system is being introduced only recently at the EU level. While these new concepts are now being embraced by central bankers and politicians worldwide, the simultaneous pursuit of both monetary and banking stability, from a true macroprudential perspective, has been the order of the day for the BNB for more than a decade now.

Through our own painful experience with a crisis in 1996–1997, we became fully aware of the systemic importance of the financial system. Thus a key element behind the success of the overall policy mix in Bulgaria is that our central bank is entrusted with the tasks and responsibilities to regulate and supervise the banks in the country, with the goal of ensuring the stability of the banking system.

Only three days ago, the capital markets provided the latest proof of the efficiency of the macroeconomic policies in Bulgaria and the resilience of our economy in the face of such a severe global crisis. Bulgaria's global issue of 5-year euro-denominated bonds, marking our country's return to the international bond markets after a decade, was a great success. The international investors' orders oversubscribed the offered amount more than 6 times. Their strong interest has resulted in a very low annual yield of 4.436%. At present, only the highest-rated EU Member States can afford to pay a lower price for borrowing on the private capital markets.

To conclude, we have achieved monetary and banking stability in Bulgaria during the last 15 years. They have been bolstered by the synergies of monetary and macroprudential mandates (including banking supervision) within the central bank, complemented by the prudent fiscal policies of several consecutive governments since 1997. The BNB representatives will be eager to discuss our knowledge today and tomorrow, while also looking forward to learning about the experiences of the other countries represented at this conference.

I wish you a most fruitful exchange of views and ideas.

Thank you very much for your attention.