Dimitar Radev: Decision about the euro is strategic, not conjunctural

Interview by Mr Dimitar Radev, Governor of the Bulgarian National Bank, for Investor Digest, October 2019.

* * *

Mr. Radev, how would you assess the results of the asset quality review that the European Central Bank (ECB) conducted on six Bulgarian banks? How is the subsequent communication with Frankfurt in view of the goal of entering ERM II?

The results are not surprising. They correspond to our own assessments. The communication with the ECB was and remains excellent both when it comes to the work related to the asset quality review and stress test, and when it comes to the overall process of preparing to join ERM II, the Single Supervisory Mechanism and the Single Resolution Mechanism.

By definition, the parameters of such stress tests are markedly conservative. The ECB's approach, however, included some quite unlikely scenarios, such as increasing corporate tax to 30% in the next three years. This could be a negative development for countries like Greece with its 28% tax, or Spain with its 25%, but it seems unrealistic for Bulgaria with its 10%. Wasn't it logical for the European Banking Authority's methodology, which was developed for the stress tests on the largest Western European banks a year ago, to be adapted to the conditions in Bulgaria?

The technical parameters in the methodology of the stress test's baseline and adverse scenario are the same as those applied across all the member states by the European Banking Authority. The effect of this specific scenario you are referring to on the balance of banks turned out to be negligible, which is why we did not have to seek corrective actions during our talks with the ECB.

The new IFRS 9 accounting standard was applied in this review. According to experts like Assoc. Prof. Sariyski, this standard allows for more subjective models and does not provide for any arbitration that could resolve disputes between appraisers and those evaluated. Are such criticisms founded?

We are talking about a new international standard that is mandatory for banks. Bulgarian banks were well-prepared for its introduction. This was also one of the main recommendations we made after the asset quality review in 2016. There are established platforms for discussing and amending existing, as well as adopting new international accounting standards.

BNB will have to start applying the measures and recommendations of the Single Supervisory Mechanism with the eventual entry into a "close cooperation" mechanism. What practical changes would this bring to the work of banking supervision?

The changes are of a regulatory and administrative nature. A large part of them have been prepared already and we are ready for their introduction on the date of our effective accession. Under the close cooperation mechanism the ECB exercises direct supervision over the largest banks and there the BNB will be involved with the participation of BNB's experts in the supervisory teams. An ongoing active exchange of supervisory information will be established between us and the ECB concerning the other banks that will remain under BNB's direct supervision.

Countries like Hungary, Poland and especially the Czech Republic are markedly against joining the eurozone at this point. Is the currency board the main difference between them and Bulgaria which explains this discrepancy between policies, or are there other factors at play?

This is a political decision, above all. What's positive in our case is that this decision is based on strategic and not conjunctural considerations. Practically, there isn't a serious political factor in our country that does not support this decision. On the technical level, the monetary regime in Bulgaria allows for its implementation to happen quicker and seamlessly.

You said in an interview for Market News this spring that the downturn in Europe could turn out to be temporary, but that would remain to be seen. How would you comment the developments in recent months?

Uncertainty is on the rise and a lot of current data indicates a continuing economic downturn in the eurozone. This motivates the ECB to make decisions for an even more stimulating monetary policy. The technical details and the degree to which the ECB decided to step up its policy are a subject of debate, but the basic macroeconomic motivation behind these decisions is clear, in principle.

Responding to a question by Investor.bg, BNB says that given the lev's fixed exchange rate, delaying the entry into ERM II cannot create direct financial and macroeconomic risks for the Bulgarian economy. Could the opposite happen, however? Is it possible for ERM II membership to be negative for Bulgaria if it comes during unfavourable times for the European economy? To put it in different words, should we be in a hurry for the eurozone or should this goal be consistent with the conditions and trends for the time being?

We should follow our strategic plan with a focus on the quality of the process. Due to the nature of our monetary regime, based on a fixed exchange rate, as well as our firm commitment to not change it until country's eurozone accession, our currency being part of ERM II will not lead to any changes in our macroeconomic position. The direct effects will be rather positive, such as increasing Bulgaria's credit rating and improving the overall investment environment.

Spanish economist Daniel Lacalle told Bloomberg TV Bulgaria in an interview that he believes the ECB's policy of stimulation has long exhausted its efficiency and the only thing it is currently doing is to transfer funds from productive to non-productive sectors of the economy. Lacalle also recalls that negative interest rates have played a significant role in Japan's difficulties with inflation and growth. What's your opinion? Is there a risk for the eurozone to get into the Japanese scenario?

The global economic environment is far from being conventional. In that sense, the ECB's response with unconventional measures is completely logical. When unconventional measures are applied, it is normal to have different views about their effect, including the possibility of a "Japanese" scenario. It would be wrong, however, to put the focus solely on monetary policy without taking into account what is being or not being done to address the global economic uncertainty, and also in the areas of structural reforms and fiscal policy.

You have said many times that in order to be effective, the politicians' attempts to stimulate the economy must be aimed at structural areas, like the labour market, pension reforms and education. What room for action do Bulgarian politicians have when these three areas are concerned? Do you believe that there are unused opportunities?

Such opportunities exist, but they are associated with complex and sometimes time-consuming measures. They are not limited only to the labour market, pension reforms and education, but also extend to areas like health care, defence, the modernization of the technical and social infrastructure. Some steps in these fields require serious public resources. It is a good sign that they are implemented within an overall disciplined fiscal framework.

Quite a few economists say that the 2% inflation goal, set by the ECB, is a thing of the past given the ageing population and structurally transforming technologies. Do you believe there are grounds to correct this goal?

There are grounds to conduct a strategic review of the monetary policy's goals. The last time this was done was back in 2003. There are expectations that the new ECB leadership will initiate such a review.

What effect do the low interest rates have on the Bulgarian economy?

The immediate effect is positive. The increased credit activity is one of the indicators for this. Such a development, however, is connected with some serious challenges, for Instance the profitability of the banks as a result of the diminishing interest margins. I should say that so far the Bulgarian banks manage to deal with this challenge. Cyclical risks are also accumulating, due to which BNB activated and subsequently increased the level of the countercyclical capital buffer for banks.

In recent years we have seen a few large deals in the Bulgarian banking system. Do you expect the consolidation to continue in the future? Is it a completely positive phenomenon?

Consolidation is one of the possible responses to the challenges facing the banks. I expect this process to continue.