Dimitar Radev: Spillovers from the ECB's monetary policy decisions are fast and strong

Statement by Mr Dimitar Radev, Governor of the Bulgarian National Bank, for the IFLR Yearbook: Global Banking & Financial Policy Review 2019/2020, published on 24 September 2019.

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There is much discussion these days about the course of monetary policy in the euro area. What global headlines rarely catch, however, is how such policy affects the European economies outside the euro area.

Bulgaria is an example where, due to the high openness of our economy and the strong financial links with the euro area, spillovers from the ECB's monetary policy decisions are fast and strong.

Around 50% of Bulgaria's exports go to the euro area. Investors from the euro area account for 67% of our FDI stock. Our banking system is dominated by the presence of euro area owned banks, which hold around 55% of the sector's assets. The monetary policy regime in Bulgaria (a currency board with the national currency fixed to the euro) is another factor enhancing the direct transmission of ECB's monetary policy. Therefore, even though Bulgaria is not a member of the euro area yet, it is important to consider how our economy is affected by the ECB's continued accommodative stance.

Financial stability and its implications are issues to be potentially concerned about. The ECB's monetary policy in recent years has succeeded in sustaining the economic recovery in the EU following the great financial crisis. In the EU countries that are not using the euro, the effects from monetary conditions in the euro area led to improving macroeconomic environment, loosening financing conditions, and high bank liquidity. That stimulated lending and, in turn, the increase in residential property prices. However, these developments also increased cyclical risks.

The Bulgarian National Bank conducted research into Bulgaria's financial cycle. Our findings showed that we are currently in an upward phase of cyclical risk accumulation. Hence, we activated and then raised the rate of the countercyclical capital buffer.

We have so far taken two decisions. In 2018, we set the countercyclical capital buffer rate applicable to credit risk exposures in Bulgaria at 0.5%, with effect from October 1 2019. In early 2019 we raised the rate to 1.0%, with effect from April 1 2020. The rate is applied to the overall credit stock of banks and not to the volume of newly issued loans. We announced that we could increase the rate to a higher level earlier if credit growth significantly accelerates.

Our decisions were taken despite the fact that the standard metric of how the credit-to-GDP ratio deviates from its long-term trend remained deep in negative territory.

Furthermore, we strengthened the macroprudential powers of the Bulgarian National Bank. The key element here was the introduction into Bulgarian law of a framework of borrower-based measures – requirements such as loan-to-value (LTV) and loan-to-income (LTI) – in addition to the existing capital-based measures.

As monetary easing in the euro area is likely to stay for quite some time, policymaking in the non-euro area countries affected by the ECB's monetary policy needs to remain attentive. From a regulatory and a supervisory perspective, both positive and negative externalities from the euro area to our economies will need to be properly managed.

The original text is published in English and can be read ***here***.