

EFFECTS OF COVID-19 ON THE BANKING SECTOR – EVIDENCE FOR BULGARIA

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Abstract: *The COVID 19 pandemic influences seriously all people around the world and disrupts the daily life. It is having the impact on the global economy. The pandemic affects on every sectors of economy. As a result of this virus, the world economy is weakening and it is also in Bulgaria.*

The banks have a fundamental role to play as provider of payment services, liquidity and funding to the business and individuals in the time of COVID- 19 crises. From one side, most of the governments realized schemes for recovery, based on easy access to the credit for business and households, state guarantees of them, low interest. It has made to be easy passed through the crises. From other side, banking sector will play important role by the recovery of economy. It is tough more for small and open economy as Bulgarian.

This paper aims to evaluate the monetary measures during the crises and counteracts the economic losses after this period.

During the crises the Bulgarian banks lose the part of their disposal funds due to withdraw of businessdeposits. At the same time, they implemented relief measures such as suspension of loan repayments for affected customers or some other forms of moratorium on payment of credit obligations as well as actions to ensure companies continue to have access to credit in exceptional circumstances. The firms need the usage of lending to cover inequity between in- and outflows, decide their liquidity problems and ensure the working capital for restarting of business.

The main goal of economic policy after pandemic of COVID 2019 aims the recovery of economy. It requires to be found all instruments for influencing on the aggregate supply. This purpose could be realized with monetary and fiscal instruments. By the Currency Board, Bulgarian National Bank keeps only one monetary instrument. The current research investigates the changes in banking sector. For the first months of lockdown in Bulgaria the credit has used actively for the quick recovery of economy to pre-crisis level.

Keywords: *COVID-19, monetary policy, banking sector, credit, deposits*

JEL Codes: *G2*

INTRODUCTION

The COVID 19 pandemic influences seriously all people around the world and disrupts the daily life. It is having the impact on the global economy. The pandemic affects on every sectors of economy. As a result of this virus, the world economy is weakening and it is also in Bulgaria.

The extensive spread of COVID 19 has become catastrophic to the global economy, inflicting severe damage to the global production and supply chain (Acemoglu D., V. Chernozhukov, I. Werning, M. Whinston, 2020). The last changes are impacting in countries as Bulgaria because:

- demand for manufacturing goods and raw materials from high-income countries is decreasing;
- delays in the delivery of necessary components and supplies from more technologically advanced countries are disrupting the value chains;
- Other factors, restriction of movement of goods and people, inability to reach workstation or the financial limitations, which affect the normal production process.

The quarantining measures necessary to contain the virus have triggered an economic downturn affecting not only global production and supply, as well as international trade, foreign direct investments, international financial markets, and international tourism and travels and on national level – on monetary supply, budget spending and government debt.

1. Theoretical approach

The banks play important role for main part of business in Bulgaria. Due to it they must accumulate disposal resources. Mainly they come from deposits and credit lines from other parent's banks abroad.

More of these funds go to the business through the credit. The credit transmission channel includes bank and balance sheet types. The bank credit channel is based on the understanding that banks play a special role in the financial system. The large companies can attract resources by selling commercial papers and other forms of credit by increasing their debt. The small and middle businesses have limited access to financial markets. They are not able to attract funds from there. The gap between large and small firms widens mainly during a recession. Less access to other forms of credit markets than to banks makes small businesses extremely dependent on the actions of the banks and monetary institution.

The balance sheet channel focuses on the potential impact of changes in monetary policy on borrowers' balance sheets and their incomes, including their net wealth, liquid assets and cashflows. The firms often finance investments and current expenses by borrow and sometimes increasing their loans earlier in the economic cycle. The consumers also want to borrow at a time when their income is declining and when credit conditions are poor, and then the volume of credit increases. Such an inverse relationship is not contained in the credit channel theory, which requires firms and households to reduce their loans during the recession and after it.

2. Banks' liabilities and assets before the pandemic

2.1 Deposits before the pandemic

The dynamic of deposits for investigated period depends on the current account balances and term deposits. The corporate deposits during the whole period change with positive trend exclude 2014. It due to bank panic connected with one main bank at this moment in the system. The level of deposits in banking system ensures sustainable disposal resources for the active operation.

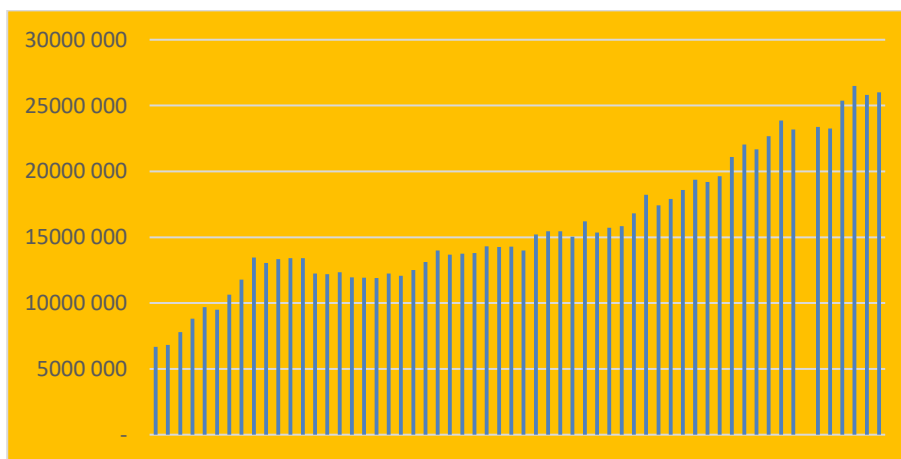


Fig. 1. Business deposits for the period 2005-2019 (thousand BGN)

Source: Bulgarian National Bank

2.2 Credit before pandemic

Before the health crises, overall economic and financial stability in Bulgaria leads to strong increasing of lending (Assenova, 2019).

The crisis in the second half of the 1990s led to the suspension of any financial intermediation for some time. The policy followed, aimed at reducing inflation, high GDP and rapidly growing incomes and profits, exacerbated the need for credit, and changed banks' views on borrowers' requirements. The entry of foreign banks to the market, as well as the strengthening of Commercial banks audit in the sector, led to a return the confidence of the public in banks, and

hence an increasing of deposits. On the other hand, improved economic conditions predetermined the growth of foreign cash flows, mainly coming from foreign banks in Bulgaria. All factors have led to strong need to find ways to invest accumulated funds to bring income (Assenova K. 2009, 2018).The business loans increase during the investigated period 2005-2019.

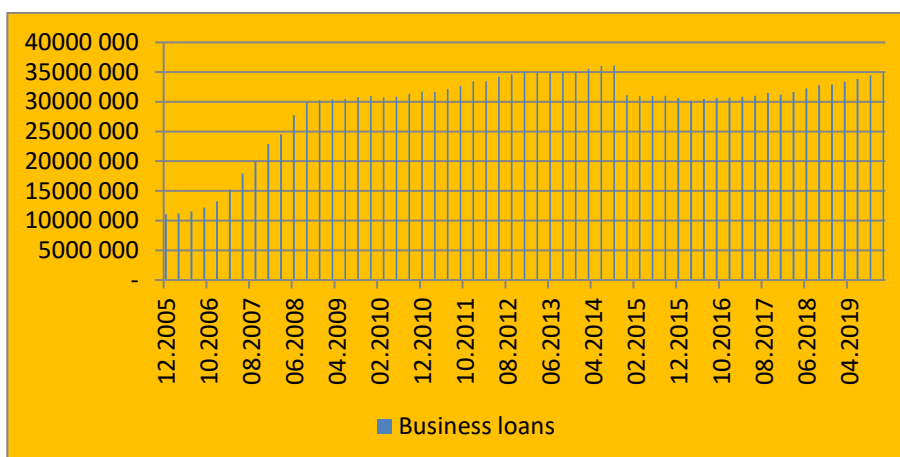


Fig. 2a. Business loans for period 2005-2019 (thousand BGN)
Source: Bulgarian National Bank

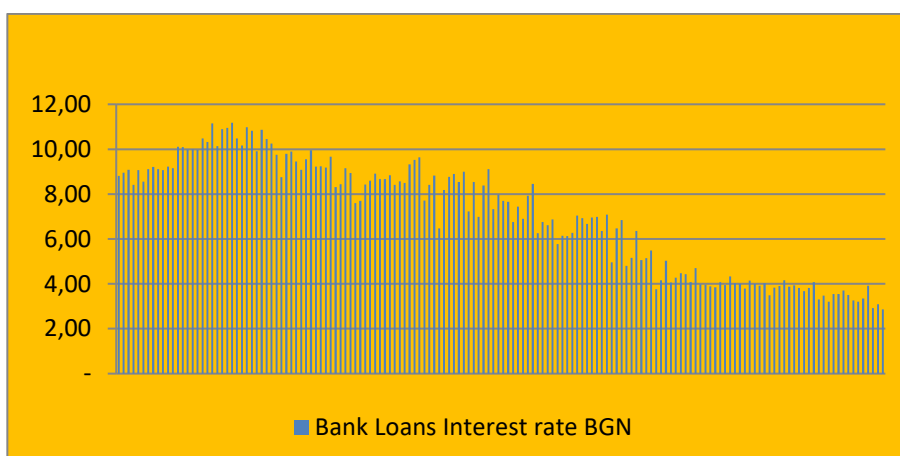


Fig. 2b. Bank Loans Interest rate BGN for period 2007-2019 (%)
Source: Bulgarian National Bank

3. Banks' liabilities and assets after the pandemic

After the start of health crises in China before the coronavirus crisis became evident, GDP sharply decline on the first stage of world pandemic (Farboodi, M., Gr.Jarosch, R. Shimer, 2020, Alfani, G., 2020). It made difficult functioning of supply chain to other parts of world. As it known, the world economy depends on the China delivery. As results it is declined produced supply in other part of world. On second stage, after the lockdown in more of countries, many sectors of economy were closed and it additionally reduces produced GDP in these countries. The Bulgarian economy as small and open economy is very sensitive to outside conditions. The lockdown in the many countries in the world impacts on Bulgarian Net export, orientated mainly to the countries of EU. Their GDP declines and it directly reduce Bulgarian GDP. During the pandemic the investments in Bulgaria collapsed due to expected recession all over the world. Third part of GDP – consumption also reduces. More consumers have temporarily or sure unemployed, on other places the incomes were reduces due to insecure situation. All efforts forced sharp reduction of consumption. Last part of GDP – public spending does not compensate the lost by other three components of GDP.

The Bulgarian National Bank has introduced several measures, including following:

- “temporary moratorium on bank loans repayment, following the EBA Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (EBA/GL/2020/02)

- The state Fund Manager for Financial Instruments in Bulgaria announced a new package of measures to support various business and public groups through financial instruments. The Fund will provide bank guarantees in of BGN 170 million (EUR 87 million), which should serve to secure a loan portfolio of up to BGN 850million. Loans under the scheme will have a term of up to 10 years and the possibility of interest-free loans....”²

The changes of deposits during the period of lockdown are insignificant.

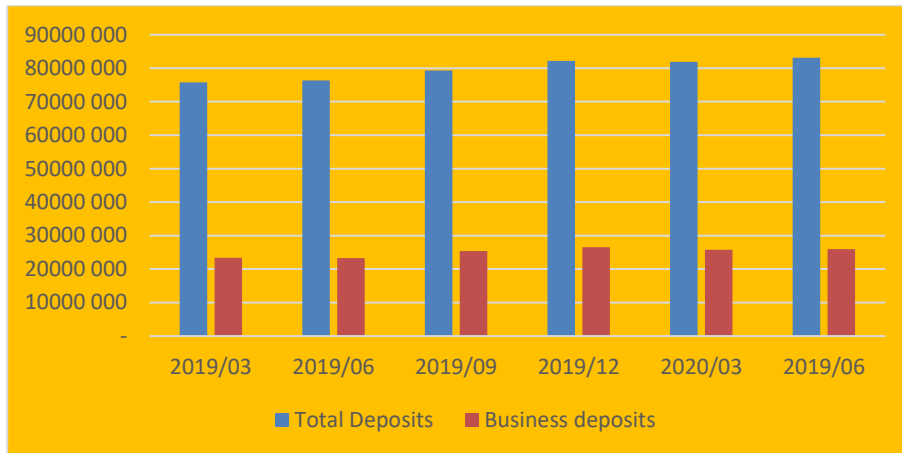


Fig. 3. Total and business deposits for period 01/2019-05/2020(%)
Source: Bulgarian National Bank

From other side, when businesses that have had to lay off workers need to start operating again and to see the demand for their products and services rebound quickly, if indeed they survive the downturn. The new stimulus package from the Government perhaps the catalyst for a change of the credit cycle. The companies may redirect payment installments for later period after lockdown and take new loans to cover differences between in- and out- flows. They could take the credit to recovery the business (Beck, T. ,2020).

Table 1. Total and Corporate loans’ changes during the lockdown (on monthly base) %

Total and Corporate loans’ changes during the lockdown (on monthly base) %	April 2020	May 2020	June 2020
Loans total	-1.14	0.23	0.49
Business loans	-1.79	0.45	0.19

²EUROPEAN COMMISSION, DIRECTORATE GENERAL ECONOMIC AND FINANCIAL AFFAIRS(2020), Policy measures taken against the spread and impact of the coronavirus – 17 July 2020

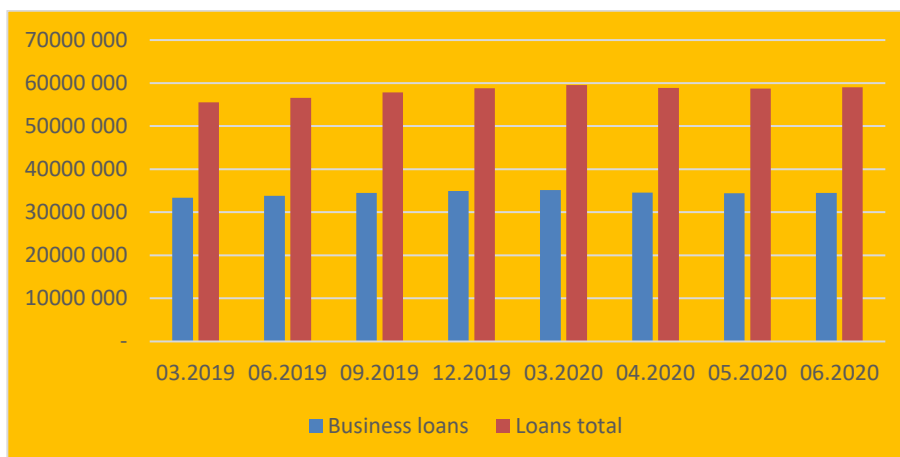


Fig. 4. Total and business loans for the period 01/2019 - 06/2020(thousand BGN)
Source: Bulgarian National Bank

The credit cycle goes to new stage after the lockdown. During this period, the factors affecting demand are:

- Income fall or keep on the same level;
- Unemployment;
- The companies reduce their investments due to the stage of market;
- Negative tendency in Net Bulgarian export;
- Financing of negative cash flows.

The factors influencing the supply are:

- Reducing of part of business deposits by banks during the crisis;
- Increasing risk in the economy;
- Economic activity freezes for several months. The return of projects is reduced.

Therefore companies to be financed negative cash flow.

The interest rate of bank loans is with high volatility in the begging of 2020. After the pandemic of COVID 19 rate decreases sharply.

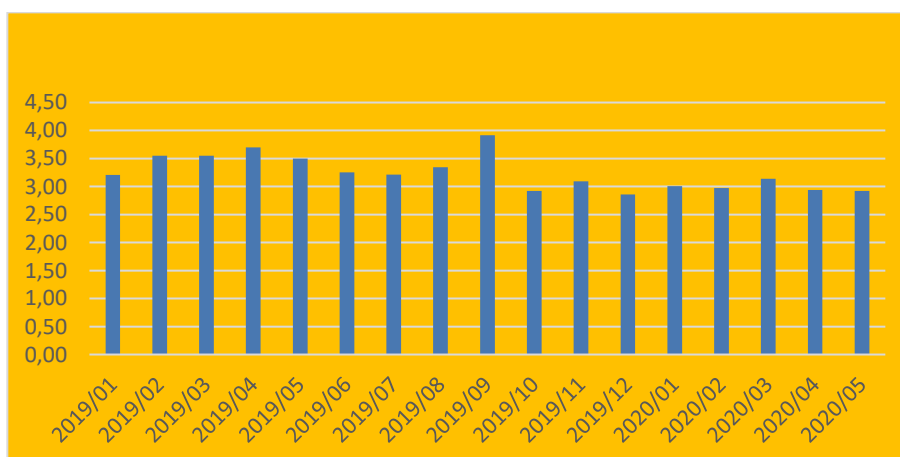


Fig. 5. Bank Loans Interest rate BGN for period 01/2019-06/2020(%)
Source: Bulgarian National bank

CONCLUSION

The pandemic of COVID-19 has dramatically affected just about every aspect of the economy. The credit cycle transforms from the record long benign to a stressed one. This paper seeks the accumulated deposits and access to credit from before the unexpected global health crisis

to its immediate and extended impact and the performance of several key indicators of deposits and credits. The focus is on the corporate deposits and credits to non-financial institutions.

The Bulgarian economy as small and open economy is very sensitive to outside conditions. After the pandemic of COVID 19 the national economy depends on them. They impact on all sectors. The new stimulus package from the Government perhaps the catalyst for a change in the credit conditions. The deposits in banking system have not changed during the lockdown. The credit cycle after the pandemic goes to new state with reducing the loans for a business for two months by the starting of the pandemic of COVID 19 and slowly recovery economic activities and raise the corporate credit by covering the liquidity gap and recovery the business.

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