SAT-2G.404-2-EM-08

THE BULGARIAN BANKING SYSTEM IN 2016: A COSTLY SAFE BOX FOR THE SMALL DEPOSITOR

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Abstract: *The paper provides a quick glance at the developments of the Bulgarian banking sector in 2016, analyzing aggregated data to deduce conclusions regarding the behavior of mass increases in operational taxes that are, respectively, raising the overall prices of bank services for the retail customer, causing small deposits to no longer be viable*

Keywords: *Bulgarian banking sector 2016, bank operational taxes, bank operational taxes regulation*

JEL: *G21, E58*

INTRODUCTION

After the active phase of the latest financial crisis the banking system in Bulgaria went through a lot of turbulent developments – from the withdrawal of the banking license of Corporate Commercial Bank (CCB) and the following turmoil to the stress-tests performed by the Bulgarian National Bank (BNB) from June to September, 2016. During this time the system displayed relative stability in an environment of uncertainty and political indecision regarding the integration of the newly founded European Banking Union. On the other hand, for the current year of 2016 the Bulgarian monetary sector registers unconventional changes in the structure of its income and expenditures. The current dynamic is becoming a cause of disquietude in small depositors and concerns for the primary functions of the banking sector are raised among the general public. This leads to the necessity of a topical analysis of the indicators of the effectiveness of day-to-day operations and the general behavior of commercial banks during the specified period.

It is important to note that the character of banking activity has an integrated aspect of duality in It – on one hand – it serves a vital and fundamental purpose in an economic system; on the other hand – although not as obvious at first glance – it does have a certain "social" role to fulfil. Thus, keeping these points in mind, this paper treats the banking system in Bulgaria as its object of analysis, and more specifically – the dynamics of its income and expenditure accounts, whilst upholding a hypothesis that small depositors are overburdened with low interest rates on deposits coupled with relatively high operational fees. The individual approach that commercial banks have towards the formulation of their operational fees partially obstructs collecting and analyzing such data, making conclusions based on it unreliable. To avoid this problem we have turned to aggregated, statistical indicators that can be used as indirect measurements of the specified phenomena.

EXPOSE

Concerning the methodology of the practical analysis of the gathered data - the following indicators of efficiency have been calculated for the whole of the Bulgarian banking sector (Table 1).

Table 1. Indicators used

Indicators (Bulgarian banking system)	
Interest - based	**non-interest based**
income from interest operations	income from operational fees
expenditure on interest operations	expenditure on operational fees
net income from interest operations	net income from fees (income from fees - expenditure on fees)
Volume of deposits with an agreed maturity of up to 1 year, new business	
Ratio of net income from operational fees/net income from interest operations	
Net interest margin [(income from interest operations - expenditure on interest operations)/assets]	
Net interest rate spread towards non-financial enterprises	
Net interest rate spread towards households, consumer loans	
Net interest rate spread towards households, housing loans	

The distinction between interest-based and non-interest based indicators follows the theoretical identification of the two types of bank income [4]. The interest-based income and expenditures are a reflection of the primary functions of commercial banks – providing credit and deposit opportunities. The non-interest based income is realized through dividends, fees, commissions, deals with securities, currency trade, derivatives, etc. The focus of this paper is on the significant fragment of non-interest based income represented by income from operational fees; its other segments are omitted.

In its current state the environment of the banking sector remains tense. In preparation for the stress-test procedures (in mid-2016) commercial banks consolidated their portfolios, further limiting their rates of providing loans to private business and households, and this tendency for passive behavior was simultaneously accompanied by falling deposit interest rates, which have reached symbolical values as of late (Figure 1).

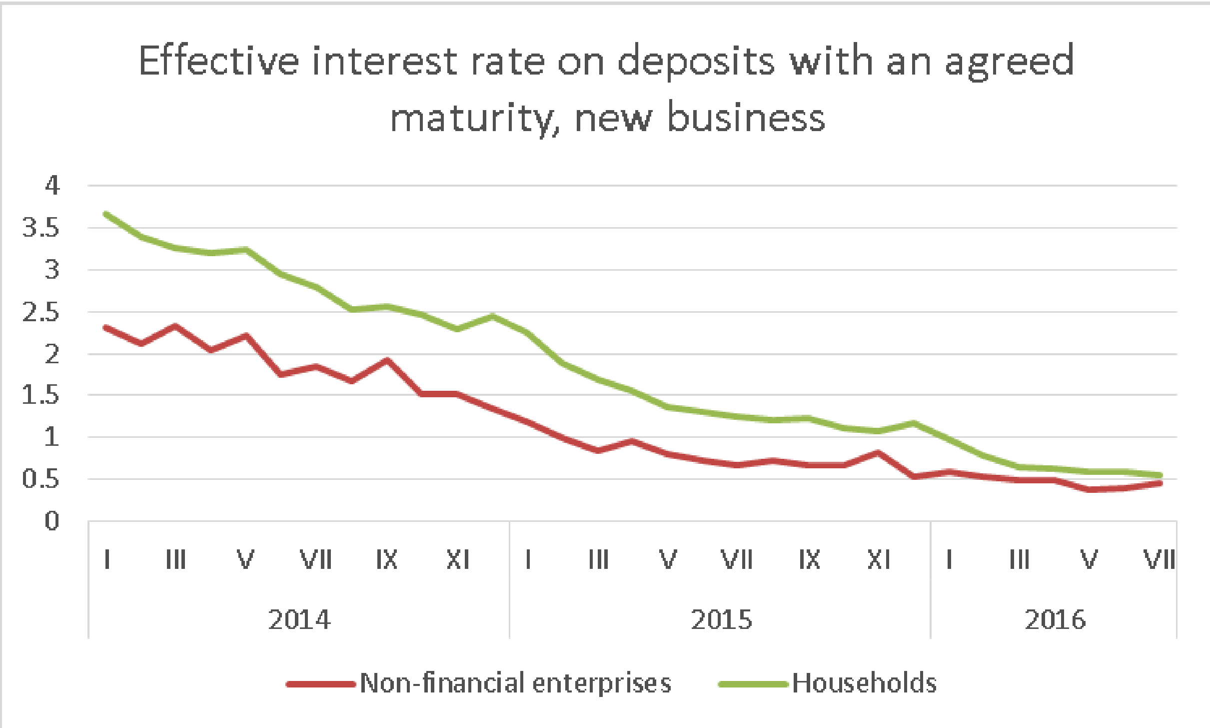


Figure 1. Effective interest rate on deposits with an agreed maturity of up to 1 year, in BGN; non-financial enterprises and households. Source: BNB, Monetary statistics [7]

As a result of the low income offered by banks on depositors' money, following the fundamental economic laws of supply and demand, the supply of new resources from the depositors is on a steep decline.

Excluding the last few months of 2014, the banking sector registers a declining trend in the volume of newly-attracted deposits (Figure 2). The sudden peak at the end of 2014 can be attributed to the technical exclusion of CCB's deposit base from the monetary and interest statistics of BNB that was performed in November, 2014. The peak itself is a visualization of the following repayment of the guaranteed deposits (all of those which, individually, amount to 100 000 euro or less) and their reintroduction back into the system's deposit base as newly created deposits in different commercial banks. From the start of 2014 up to July, 2016, the sector registers four times less in terms of the indicators for new deposits from non-financial enterprises (620 to 152 mln. BGN) and close to a two-time drop in new deposits from households (704 mln. BGN to 362 mln. BGN).

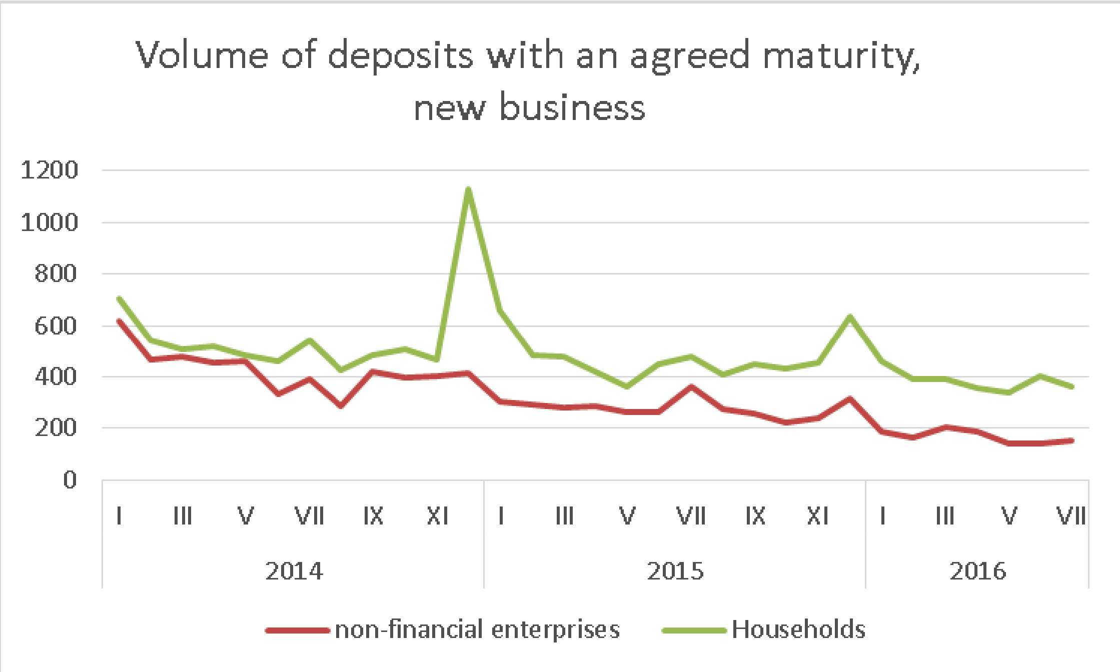
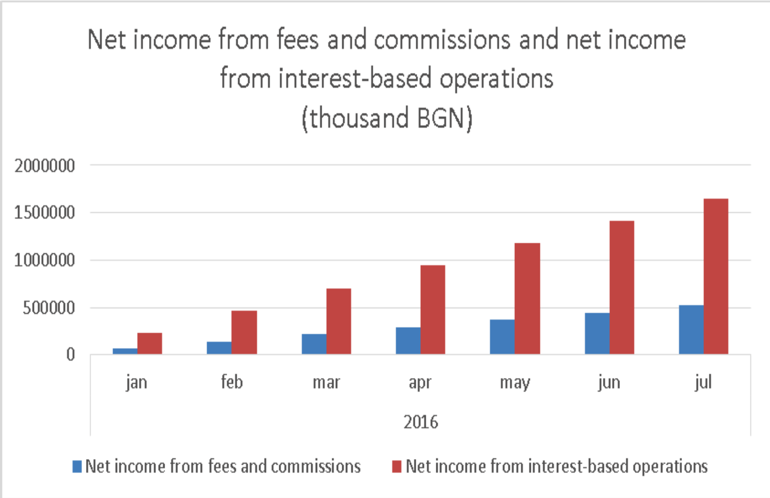


Figure 2. Volume of deposits with an agreed maturity of up to 1 year, new business; mln. BGN.Source: BNB, Monetary statistics [7]

Concerning the synchronization of the financial legislation with that of the European Union (directive 2014/92/EU), in the period leading up to October 1, 2016, commercial banks are obliged to present data regarding the level of their fees and commissions to the authorities at the National Bank. The newly-created register is supposed to go public on the BNB website after a period of initial data processing (estimated – around the end of October, 2016). The goal of the regulator is to not only provide a basis for comparison to the general public – new requirements for lower taxes for socially-vulnerable individuals are to be instated later on, too [2][8]. The availability of the reported data will allow for a more direct approach to the monitoring and regulation for the observation of the good practices of European banking. The BNB position is expressed on their website stating "Banks are supposed to apply acceptable fees on basic operations with payment accounts no later than February 1, 2017" [6]. Inevitably, the slowing down of credit activity and the anticipation of the newly-imposed regulations has led up to the desire of banks to compensate profit through various maneuvers, mostly concentrated in the increases of fees and commissions for their retail customers from the real economic sector – non-financial enterprises and households. Individual commercial banks approached this matter in different ways, but the overall tendency for 2015-2016 has been an overall increase in said fees [1]. Indirectly, this increase can be partially determined by an analysis of aggregate data containing the income from operational fees and commissions filed in the reports of the banking system (Figure 3).



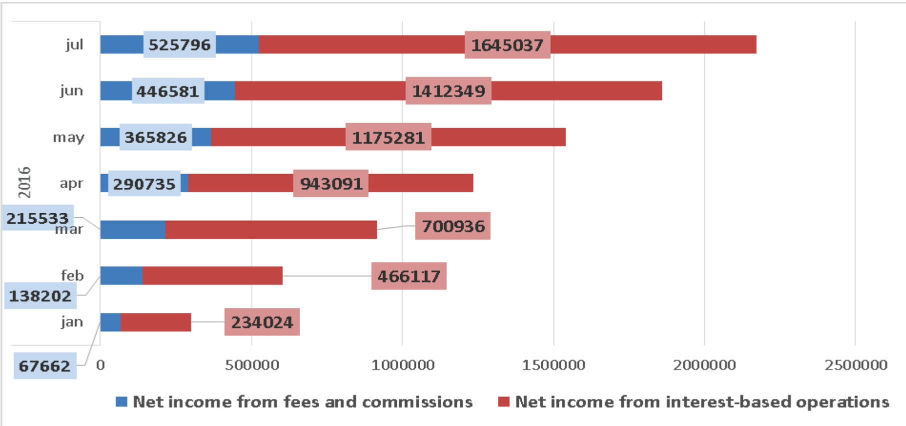


Figure 3. Net income from fees and commissions and net income from interest-based activities, in absolute values, in thousand BGN
Source: BNB, Monetary statistics, author's calculations [7][3]

Compared to the start of the year, in July 2016 the Bulgarian banking system has registered an increase of 458 mln. BGN in fee and commission income, which represented by its rate of growth for the period surpasses the rate of increase of income from interest-based operations. Compared to the same period of 2015 the increase in interest income is 36 mln. BGN more, and the increase in fee income – close to 15 mln. BGN. The percentage rate of the growth of income from interest-based assets has remained almost constant (603% → 602%; lower by 1%) while the percentage rate of income from fees and commissions has increased by 10% (667% → 677%) /on the basis of January, for the relevant year/. The juxtaposition in terms of a ratio between the two measurements paints a clear picture – for the relatively small period of January to July, 2016, the fee income has grown with over 3% of interest income and retains a faster rate of growth, especially considering that interest income is rising in absolute value at the same time.

Table 2 Relative shares of net income from fees and commissions and net income from interest-based operations to net total operational income, percent

month	jan	feb	mar	apr	may	jun	jul
Net total operational income	353428	645192	943243	1294280	1575777	2071487	2409915
Net income from fees and commissions/ net total operational income (%	19.14	21.42	22.85	22.46	23.22	21.56	21.82
Net interest income/net total operational income (%)	66.22	72.24	74.31	72.87	74.58	68.18	68.26

The trend of increasing operational fees and fees connected with the support of savings and payment accounts (respectively – the growth in income of said category in the banking sector reports) can be classified as “opportunistic” – a response to the upcoming regulatory changes[151]. Another explanation of the increase in income from fees and commissions[152] is a wider spread of banking services among the populace – a result of newer and better-targeted services that attract new clients. A notion against such claims is the widespread decline of the volume of newly created deposits. The belief that banks behaving in such a manner is a result of them operating in a state of low net interest margin is, also, unfounded (Figure 4).

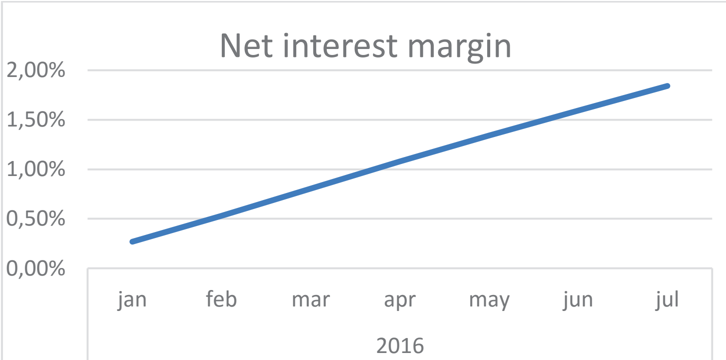


Figure 4. Net interest margin of the Bulgarian banking system, %
Source: BNB, Monetary statistics, author’s calculations [7][3]

The net interest spread towards household consumer loans mostly remains around the 10% marker for the observed period. In regards to non-financial enterprises the indicator is confined to a corridor between 2 and 4% marker, with a declining trend after May, 2016. The dynamics of the net interest spreads are calculated and presented in Figure 5.

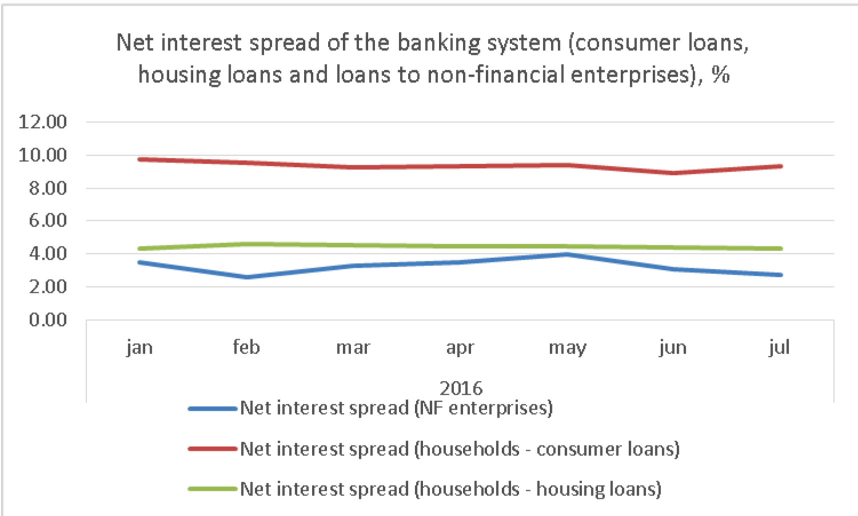


Figure 5. Net interest spreads of the banking system, loans to: non-financial enterprises, households – consumer loans and households – housing loans
Source: BNB, Interest rate statistics, author’s calculations [7][3]

Figure 5 clearly entails that the “razor” between the different interest rates is not highly volatile during the observed period when it comes to household loans, unlike the spread for private

[151] The BNB formulates the acceptable level that fees are supposed to have from February 2017 – onward based on a methodology that compiles an average of the current fee rates. Since they have been increased several times prior to the moment of calculation, their average (the one supposed to serve as a landmark from then on) will also be inflated, thus officially instating high fees as the norm

[152] One regularly quoted in Bulgarian media

business. As a whole the interest rate spreads remain relatively high for the real economic sector in Bulgaria, which partially constitutes the low investment activity in a macroeconomic sense.

CONCLUSION

Undoubtedly, the burden of fees and commissions for day-to-day operations falls directly upon the end-consumer (the retail customer) of banking services. Their raising reflects most negatively upon the vulnerable segments of the Bulgarian population (e.g. pensioners and elderly, who traditionally use saving accounts attached to a “savings book” – deposits redeemable after notice for holding smaller sums of money). Due to the current situation there is a real danger that small-time deposits, despite the generated interest, become a liability instead of an asset for their owners, as operational fees “eat up” the generated interest. Such instances contradict the fundamental functions of a banking system – to mediate the redistribution of money from points of surplus to points of deficit. An unofficial “deposit bar” appears to be forming at different levels at each commercial bank, causing deposits under a certain amount to no longer be viable as means to accumulate capital. Provided the newly instated regulations do not resolve this conflict, sooner or later the small depositors will be forced to relocate their savings into alternative options. At the moment though, a certain paradox is in play – the absolute amount of household savings keep on growing, albeit their rate of growth has slowed down significantly. On top of that, from 2014 up until now, the individual deposit count has lowered parallel to the falling interest rates, which constitutes that in the near future we can expect less, but larger deposits – ones that can still generate enough interest to be worth it. In this case the behaviour of non-financial enterprises and households, especially those who can be classified as small depositors, can be interpreted in different ways, not all of which are entirely related to rational economic and financial choices – for example, low general financial knowledge (thus – low commitment to personal finances, lack of knowledge), lack of available and accessible alternatives for small sums of money (underdeveloped financial markets), fear of keeping large sums of money on the territory of one’s home, work-related (or other kind of) commitment to a certain bank, etc.

Solving this issue in a positive way is reliant on addressing both aspects of the problem- in a macroeconomic and in a social sense. From the viewpoint of macroeconomics the excess of liquidity in the banking sector is best tackled with improving the stability of the political and economic environment, which should provide a long-term rise in demand for credit. The social aspect of the problem can be tackled through administrative regulation for transparency in banking activity practices, reductions in fees for socially-vulnerable groups of people and/or exemptions of fees and commissions for minor deposits (under a certain amount).

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