

DEVELOPMENT OF HOUSING LOANS IN BULGARIA

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Abstract: *Proper management of the loan portfolio by commercial banks is particularly important to avoid generating credit risks that threaten the stability of banks and the financial system as a whole. In Bulgaria, after the COVID crisis of 2020, there has been a significant acceleration in the growth rate of banks' loan portfolios, which are expanding mainly in the direction of housing loans. These accelerating rates require close monitoring and even administrative measures and requirements by the central bank to limit the build-up of risks. The analyses housing loans' dynamics, which are outpacing the growth of other types of loans such as consumer loans and loans to non-financial corporations, which are presumably drawn for productive purposes. The results of the analysis show that the growth rate of housing loans reached 25.9% in Q3 2024, a growth rate that has not been recorded in the last 15 years since the global crisis hit Bulgaria. Despite its acceleration, the share of housing loans in GDP is still at a much lower level in Bulgaria than in the euro area. Thanks to the BNB's stricter macroprudential requirements, risks in the banking system are being managed, but close analysis and monitoring of the housing loans market should continue.*

Keywords: *Banks, housing loans, Bulgaria, euro area*
JEL: *G21, E43, E51, E58*

1. Introduction

Proper management of the loan portfolio by commercial banks is particularly important to avoid generating credit risks that threaten the stability of the banking system and the financial system as a whole. To this end, commercial banks should be more responsible in the provision of credit and should adequately comply with the high standards set for lending in order to avoid reaching a point of over-indebtedness of economic agents that would discourage further regular servicing of existing loan exposures.

In Bulgaria, after the pandemic crisis of 2020, the growth rate of banks' loan portfolios has been accelerating, but this growth is set at around 13-14% on an annual basis in the first three quarters of 2024. For the first time in 2024, the growth rates that were inherent in the period before the financial crisis in 2008 manifested itself in Bulgaria are reached. By comparison, the banks' loan portfolio grew by 24.4% in Q1 2009 and by 11.1% in Q2 2009. The acceleration in the loan portfolio of banks in Bulgaria is largely driven by housing loans, which reached a growth rate of 25.9% in the third quarter of 2024 (32.8% in Q1 2009 and 19.1% in Q2 2009) and a share of 53.2% of total households' loans in Q3 2024 against a share of 43.7% in Q1 2009. The

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outlined trends in the growth of housing lending call for a more comprehensive analysis of the state of the housing loan market.

The aim of the study is to analyse what is happening with housing loans in Bulgaria and whether there are any prerequisites for generating risk factors for the banking system.

The thesis defended is that, despite the accelerating growth rates of housing loans, there are still no significant risks in the quality of these loans and, consequently, no problems with their servicing, since their growth is also linked to the rapid acceleration of the population's income. The timely measures taken by the BNB maintain the stability of the banking system and contribute to the regulation of its inherent risks.

The study is structured in an introduction, three parts and a conclusion. The introduction presents the relevance, the thesis and the aim of the study. The first part is devoted to the literature review on banks performance and banks' loan portfolios. The second part analyses housing loans' dynamics given by banking system to households in Bulgaria. In the next part, a comparative analysis of the dynamics of lending to the household sector in Bulgaria and the Euro area is made. In the conclusion, the main results are presented.

2. Research on the development of the banking sector and lending

In the economics literature, there are studies that cover the analysis of the development of the banking sector and lending in Bulgaria (Saryski (2011), Vachkov et al. (2017)), as well as studies that deal with a comparative analysis of lending in a number of countries (Peshev (2014), Kiss et al. (2006), Mihaylova-Borisova (2022), Mihaylova-Borisova (2023)).

Vachkov et al. (2017) analyse the development of the Bulgarian banking system by emphasizing a set of indicators typical for the banking system, including the indicators for the asset quality. The impact of the financial crisis on the development of the banking system in Bulgaria is made by Saryisky (2011), who concludes that the country's banks remained almost unaffected by the international crisis in 2008. Among the studies that analyses the bank efficiency in Bulgaria, one can point out (Borisov (2020), Nenovsky et al. (2008)).

Economic activity is pointed out as a factor for the demand for loans in several non-euro area countries in Peshev (2014). The period of analysis is 2008-2012 and the great importance of economic development for faster credit growth is proved.

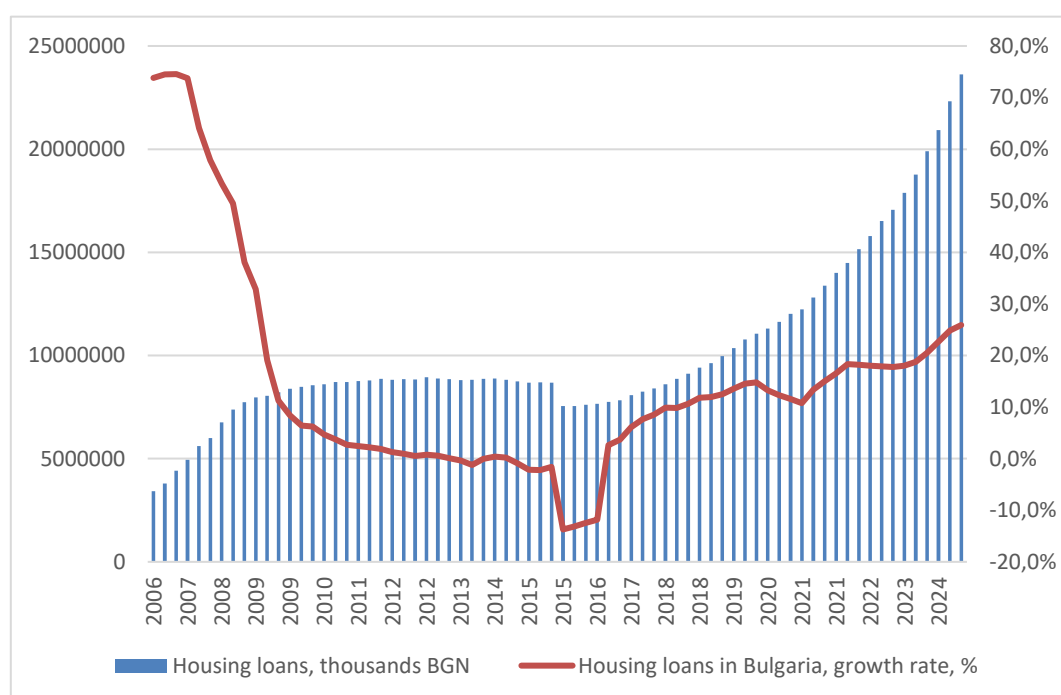
Kiss et al. (2006) also investigate growth of credits in the EU member states that joined the EU in 2004. They highlight that credits to GDP is at a very low level and conclude that there is no credit growth excess in three countries, Poland, Slovakia and the Czech Republic, while there is a generated risk associated with riskier credit growth in Estonia and Latvia.

Mihaylova-Borisova (2022) analyses the loan dynamics in CEE countries. She concludes that crises over the last two decades have led to a drop in the loans to GDP indicator for the countries studied. At the same time, the non-performing loans has been falling in recent years and after the pandemic crisis, posing no additional risks to the banking system. Mihaylova-Borisova (2023) uses a balanced panel model to demonstrate the positive relationship of private sector credit dynamics as a share of GDP with economic growth, the level of NPLs and deposits attracted in countries of the CEE.

3. Analysis of the dynamics of housing loans in Bulgaria

In Bulgaria, housing loans in 2024 continue to accelerate significantly, reaching an increase of 25.9% y-o-y at the end of Q3 (Figure 1). The acceleration in growth has been substantial over the last two years, with the growth rate becoming commensurate with that typical before the global financial crisis in Bulgaria (32.8% at end-Q1 2009).

Figure 1. Housing loans in Bulgaria



Source: BNB, own calculations

The acceleration in the growth of housing loans, especially in the last two years, is associated with a significant increase in wages in the Bulgarian economy. The average wage in Bulgaria in the third quarter of 2024 increased by 13.8% year-on-year. In the fourth quarter of 2022, gross wages grew by 16.2% y-o-y, compared with a 13% increase in the fourth quarter of 2023.

The growth in housing loans has been fuelled by a sustained downward trend in interest rates on housing loans (Figure 2). The volume-weighted interest rate on housing loans is holding at around 3% in 2022-2023, while interest rates globally are rising due to restrictive monetary

policies of leading central banks, including the ECB. The ECB starts to increase key interest rates from mid-2022 and this monetary policy has no impact on interest rates on housing loans in Bulgaria. This delayed transmission of ECB monetary policy can be explained by the fact that Bulgarian banks rely on a substantial inflow of deposits from economic agents in Bulgaria and banks are over-liquid. Household deposits are also growing at high rates. Total deposits in the banking system of households, financial and non-financial corporations amounted to BGN 134 billion at the end of September 2024, growing by 9.7% year-on-year. Deposit growth in 2022 and 2023 is 14.3% and 9.5%, respectively.

Figure 2. Interest rates on mortgage loans in Bulgaria

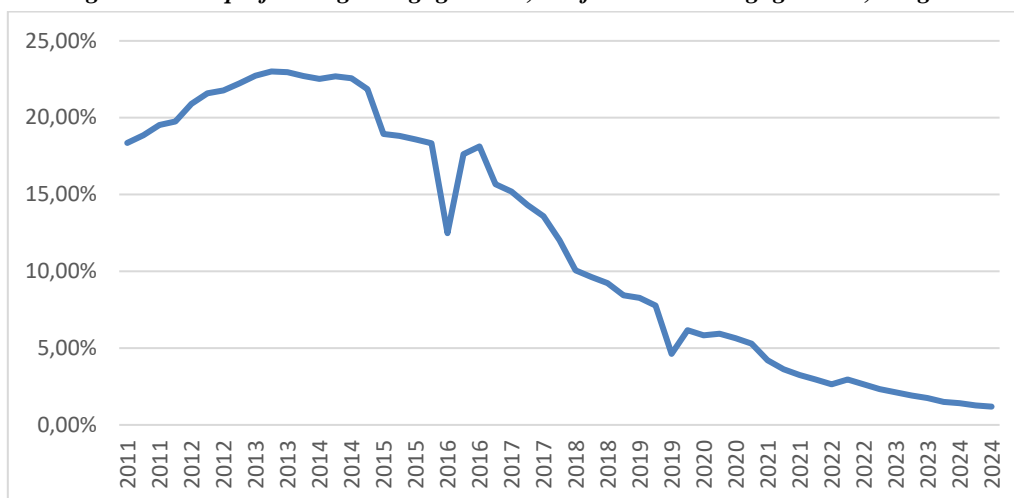


Source: BNB, own calculations

At the same time, accelerating inflation Bulgaria makes interest rates on housing loans even negative over the period 2022-2023 (Figure 2), when housing loan growth is seen accelerating. With negative lending rates, households are incentivized to borrow more resources, as they pay back less in real terms.

In analysing the dynamics of housing loans, it is important to track the level of non-performing loans and the share of regular exposures. Despite an acceleration in the growth rate of housing loans, there is a decline in the NPL ratio (Figure 3), which is favourable and does not create additional risks for households' servicing obligations.

Figure 3. Non-performing mortgage loans, % of the total mortgage loans, Bulgaria



Source: BNB, own calculations

The active role of the central bank (BNB) in monitoring and regulating the risk in the residential real estate market also contributes to the outlined trend of decreasing the share of non-performing loans in the total amount of granted housing loans. The central bank pursues a conservative policy and takes timely action to ensure sufficient capital buffers². In September 2022, the BNB took action to ensure that the Bank's policy is consistent with its policy of ensuring a prudent banking system. The BNB decided to increase the countercyclical buffer from 1.5% to 2% effective 1 October 2023 to ensure that banks have more capital in view of the continued high credit growth rates and uncertain economic environment. In addition, the BNB is introducing a number of indicators to be monitored by banks in lending to households as early as May 2024. In September 2024, the BNB further decided to apply specific indicators for credit standards to be followed in the granting of housing loans, which will come into force on 1 October 2024, such as: the ratio between the loan amount and the value of the collateral should be up to a maximum of 85%; the term of the loan granted should not exceed 30 years; the ratio between the monthly housing loan liabilities and the monthly income of the borrower should not be higher than 50%³.

On the basis of the analysis, it can be concluded that the pace of housing lending in Bulgaria is accelerating and reaching values that were typical for the housing lending market before the global crisis, which are also worrying. This also calls for a constant and careful monitoring of the banks' exposures to the household sector and the level of indebtedness of the sector in order to avoid generating internal risks in the system that could shake the stability of the banking system.

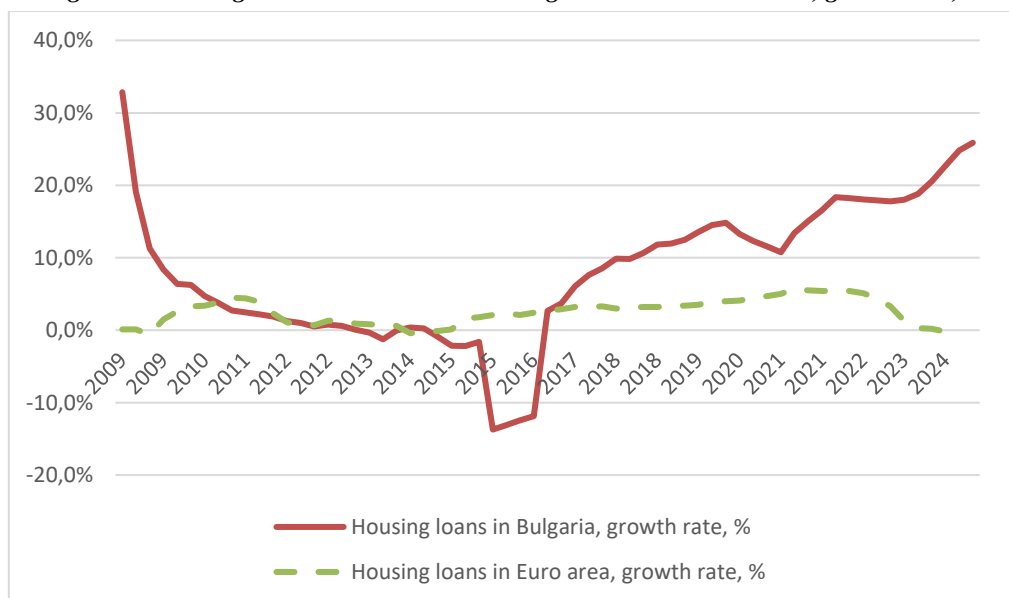
² BNB (2024a) Press release on the application of a minimum set of indicators for monitoring credit standards in the granting and renegotiation of loans secured by residential real estate: https://www.bnb.bg/AboutUs/PressOffice/POPressReleases/POPRDate/PR_20240520_4_BG

³ BNB (2024b) BNB press release on credit standard indicators requirements for the origination and renegotiation of loans secured by residential real estate: https://www.bnb.bg/AboutUs/PressOffice/POPressReleases/POPRDate/PR_20240911_1_BG

4. Comparative Analysis of Household Credit in Bulgaria and the Euro area

When comparing the trends in the development of housing loans in Bulgaria and the Euro area, divergent trends emerge. In the euro area, housing loans are starting to slow down and even reach a negative growth of 0.2% yoy in Q1 2024 against growth rates of 5-6% in 2021-2022 (Figure 4).

Figure 4. Housing loans to households in Bulgaria and the Euro area, growth rate, %

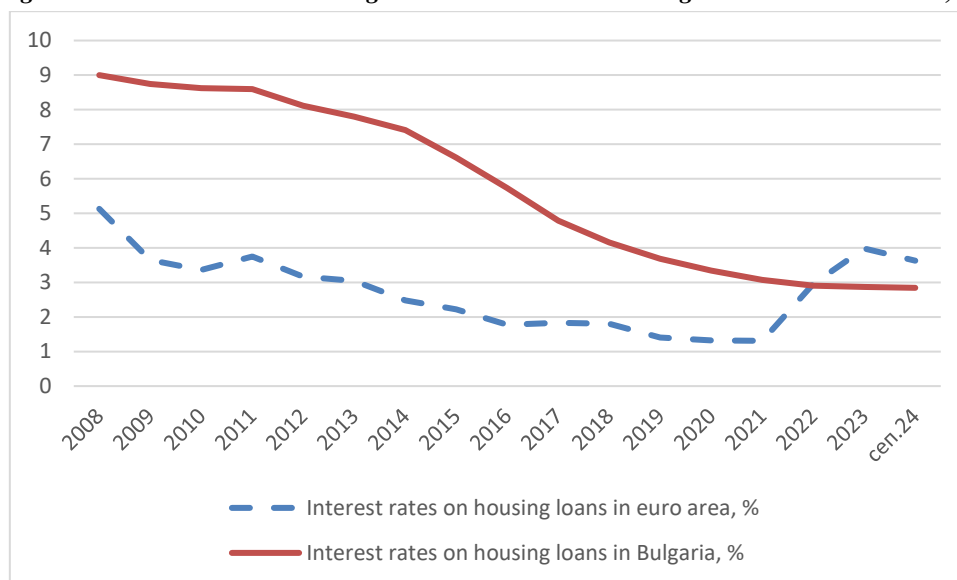


Source: ECB, BNB, own calculations

This downward trend in the growth of housing loans in the Euro area is due to the restrictive monetary policy of the ECB, which is rapidly being passed on to all interest rates, including interest rates on housing loans. The interest rate on housing loans in the euro area is 4% at end-

2023 and starts to decline slightly in 2024 (Figure 5) as ECB monetary policy loosens. At the same time, interest rates on housing loans remain at the same levels, unaffected by ECB policy.

Figure 5. Interest rates on housing loans to households in Bulgaria and the Euro area, %

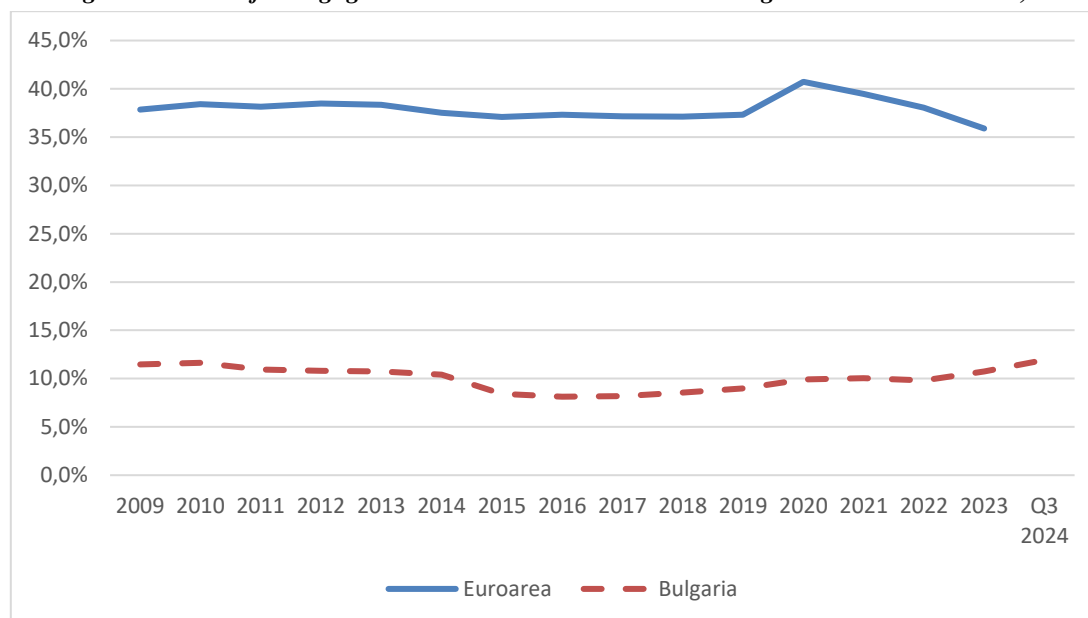


Source: ECB, BNB, own calculations

When tracking the dynamics of the growth of housing loans in Bulgaria and in the Euro area, we observe really worrying trends in the country related to the acceleration of credit growth. However, the level of housing loans as a share of GDP should also be monitored. In Bulgaria this share is only 12% at the end of Q3 2024 against 10.7% in 2023, while in the euro area it is at a much higher level of 36% in 2023. For the 2009-2024 period analysed, it is in the range of

35-40% of GDP, indicating much higher household indebtedness in the euro area compared to Bulgaria (Figure 6).

Figure 6. Share of mortgage loans to households in GDP in Bulgaria and the euro area, %



Source: ECB, BNB, own calculations

5. Conclusion

The study analyzed the dynamics of housing loans, highlighting a trend of accelerating growth rate of housing loans due to low interest rates on these loans granted by banks, high inflation in the last two years, which turns real interest rates into negative, as well as rising incomes. At the same time, the quality of housing loans is improving, as measured by the share of non-performing loans to the total level of housing loans in the country. This accelerating trend of housing loans deepening is also due to the still low share of housing loans in GDP in Bulgaria, which is around 12% against around 37% in the Euro area. This of course creates the potential for the housing loans market to develop and grow. Of course, this growth should also be closely monitored by the central bank, which is taking timely action at this time to preserve the stability of the financial system and to eliminate the build-up of material risks. Further monitoring of housing credit trends in Bulgaria will be of interest, and the guidelines for future research will be to assess with an econometric model the relationship between housing loans dynamics and a number of factors that have been identified as driving the behaviour of economic agents with respect to housing loans.

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