



REPUBLIC OF BULGARIA
MINISTER OF FINANCE

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MR. FRANCESCO MAZZAFERRO
HEAD OF THE ESRB SECRETARIAT
EUROPEAN CENTRAL BANK
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60314 FRANKFURT AM MAIN, GERMANY

Sofia, January 2022

Your ref: ESRB/2021/0113

RE: Warning of the European Systemic Risk Board of 2 December 2021 on medium-term vulnerabilities in the residential real estate sector of Bulgaria (ESRB/2021/12)/

Dear Mr Mazzaferro,

Thank you for your letter of 9 December 2021 notifying me of the European Systemic Risk Board (ESRB) Warning ESRB/2021/12 on medium-term vulnerabilities in the residential real estate sector of the Republic of Bulgaria. In this regard I appreciate the opportunity to submit comments to be published alongside the ESRB warning.

We welcome the extensive work of the ESRB to analyse and assess the residential real estate risks to financial stability in the European Economic Area. I would also like to note that we agree with the ESRB assessment of the medium-term vulnerabilities, stemming from the residential real estate sector, presented in the Warning to the Republic of Bulgaria.

The macroprudential policy mix of the Bulgarian National Bank (BNB) over the long-term has demonstrated its effectiveness to limit the negative spill-overs to the banking system from financial stability risks. In particular, the consistently applied conservative supervisory policy on capital, has proven to be efficient at national level and has been adequate for the banks operating in Bulgaria. It is worth mentioning that the conservative capital buffer policy results in one of the highest combined capital buffer requirements in the European Union. This approach contributed to the building up of substantial capital reserves and high absorption capacity of the banking system to withstand significant pressure stemming from the potential deterioration of the entire loan portfolio.

In terms of the cyclical risks' build-up, the BNB has been employing a proactive capital-based approach by using the countercyclical capital buffer (CCyB) since 2019. In response to the rising credit growth, and in particular to the elevated lending for house purchase, the BNB has further increased the CCyB to 1.0% in September 2021 with effect from 1 October 2022. The current practice of credit institutions to sustain high lending activity in the residential real estate segment, although justified in terms of individual credit decisions and covered by the existing liquidity and capital buffers of banks, has implications of systemic nature and creates necessity to continue the proactive policy strategy to build-

up buffer capacity against cyclical risks. In addition, on 16 December 2021, the BNB increased the countercyclical capital buffer rate applicable to credit risk exposures in Bulgaria from 1.0% to 1.5% in effect from 1 January 2023. The increase of the CCyB aims to strengthen the resilience of the banking system against the accumulation of cyclical risks and potential pressures from the residential real estate sector on the capital position of banks. The capital buffer framework is further enhanced by the predominant use of the standardized approach for credit risk exposures by Bulgarian banks.

The Bulgarian National Bank closely monitors the developments of the residential real estate sector. Based on this assessment the magnitude of potential residential real estate risks to financial stability is also mitigated by the economic factors. Housing prices in Bulgaria are assessed to be close to their equilibrium levels, while the extent of potential overvaluation is subject to uncertainty given the range of estimates provided by alternative methods of measurement and thus is difficult to justify as a source of increasing vulnerability. Despite the elevated credit growth, the household debt-to-GDP ratio in Bulgaria has stood at 25% as of mid-2021, which is among the lowest in the EU.

According to the BNB the structural risks from the banks' exposures to the residential real estate sector are currently a limited source of systemic vulnerability. The quantitative assessment on residential real estate lending and related risk indicators performed by the BNB reveals broadly unchanged structure and lending standards as of mid-2021. Despite the increasing exposure of the banking system to the residential real estate sector, the banks' risk appetite has not intensified further. There have been no significant changes related to the level of collateral coverage or the level of borrowers' repayment capacity.

In addition, in the course of 2022 the BNB plans to integrate the Pilot real estate survey, conducted in 2021, in the regular reporting for macroprudential purposes, with the aim to further enhance the assessment of real estate risks and to contribute to the quarterly financial stability analysis of the banking system

In conclusion, we consider the risks identified in the ESRB Warning to be broadly mitigated by the macroprudential measures of the BNB currently in place. At the same time the BNB will continue to closely monitor the developments and vulnerabilities for banks and financial stability, stemming from the residential real estate sector. We are confident, that in case that worsening of the real estate risks accompanied with significant relaxation of lending standards is observed, the BNB will consider additional measures, already available in the Law on Credit Institution in order to address potential financial stability vulnerabilities.

Yours sincerely,



Asen Vassilev

Deputy Prime Minister for EU Funds and Minister of Finance

**c.c.: Mr Dimitar Radev, Governor, Bulgarian National Bank
Mr Boyko Atanasov, Chair, Financial Supervision Commission**