

Part Five

ANALYZING OF CENTRAL BANK'S ASSET STRUCTURE AND OF ASSET RISK MANAGEMENT

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Introduction

A major characteristic of the currency board system in Bulgaria (which was introduced on the 1st of July, 1997) is the restructuring of the central bank of the country (The Bulgarian National Bank - BNB), which resulted in the establishment of two main departments of the bank with separate balance sheets - the Issue Department, carrying out the functions of the Currency Board and the Banking Department, which can act as lender of last resort in case of a systemic risk for the national banking system.

The assets of the Issue Department (the Currency Board) include the foreign exchange and the monetary gold reserves of the Central Bank, whereas its Liabilities consist of national currency in circulation, reserve requirements and deposits of commercial banks with the Central Bank (which comprise the monetary base - M_0) and also-deposits of the Government and of organizations, fully financed by the state budget. One of the specific characteristics of the Currency Board functioning mechanism in Bulgaria is the fact that an additional item - Deposit of the Banking Department - is included in the Liabilities side of the Issue Department's balance sheet.

Practically, this means, that the sum of the monetary base (M_0) and the government's deposit with the Central Bank are backed to the full extent by a part of the foreign exchange reserves of the Issue Department; the remaining part of the forex reserves' sum (the 'surplus' reserves) form the backing for the Banking Department's deposit with the Issue Department. The Banking Department can dispose of this kind of asset to refinance commercial banks, in cases, when it is considered that a systemic risk for the banking system can arise.

The assets of the Banking Department include, also, part of the foreign assets of the Central Bank (other than the foreign exchange, which form the assets of the Issue Department) and all the domestic assets of the Bank.

The Liabilities of the Banking department include liabilities of the Central Bank, other than liabilities of the Issue Department, i.e. liabilities to foreign (mainly) and domestic creditors, as well as, the capital (net worth) of the Bank.

As a whole the Banking Department's Balance is constituted on the residual principle.

A precise assessment of risk, associated with the asset structure and hence, detailed considerations, concerning asset risk management can be done only on the basis of adequate information on the structure of assets of the Issue and the Banking departments in respect to:

- form of investment (nature of financial instruments);
- terms (maturity) and liquidity;

- currency of denomination;
- nominal and current yield, etc.

As long as such information is not officially published by the Bank, the analytical work has been done on the basis of the available (officially and regularly published) data on the total sum and structure of the assets and liabilities of the Issue department and the Banking department of the BNB¹.

Relatively more attention is paid to risk asset management of the Issue department, because of the fact that it fulfills the functions of the Currency Board.

An attempt is made to analyze (as far as possible, having in mind the information, which is available) the asset structure in respect to its correspondence to liabilities structure, of both the Issue department and the Banking departments of the Bank.

1. Issue Department's Assets

1.1. Legal Framework

The basic principles of functioning of the Currency board system in Bulgaria are stipulated in the Law of the Bulgarian National Bank (The Bulgarian National Bank Act), which was passed through Parliament on 05.06. 1997.²

According to it (article 20) the basic function of the Issue department is to keep full backing in foreign exchange of the total sum of the money liabilities of the BNB; for this purpose the Issue department disposes with the possibility of effective management of the international foreign exchange assets of the Bank.

As stipulated in the above-mentioned Act (article 28), the total sum of the money liabilities of the Bank (the Issue department) consists of:

- notes and coins (denominated in BGL) in circulation;
- balances on accounts of other persons (except those of the IMF and other international financial institutions) with the BNB.

The total sum of the gross (total) international foreign exchange assets (reserves) of the Bank, which constitute the asset side of the Issue department's balance sheet, is equal to the current market price of the following bank's assets :

- notes and coins (cash balances), denominated in freely convertible foreign currencies;

¹ Data on assets of the Issue Department are officially published weekly and on assets of the Banking department - monthly.

² "Durjaven vestnik" ("Official gazette"), 1997, N 46, June, 10, 1997.

- balances on accounts in convertible currencies of the BNB with foreign central banks or with other financial institutions, granted one of the two highest credit ratings by two internationally accepted rating agencies;

- the sum of the special drawing rights (SDRs) of the BNB with the IMF;

- holdings of debt instruments (of a high level of liquidity), issued by foreign governments, central banks, international financial institutions other foreign financial institutions responding to the above- mentioned criterion (of high credit ratings).

- the monetary gold of the Bank, valued at DM 500/troy ounce, or at the current market price, whichever is lower;

- balance on forwards and repo (repurchase) deals of the BNB with (or guaranteed by) foreign central banks or public international financial institutions, as well as futures and options, in foreign currencies, held by the BNB, on which the counterparty is a foreign person.

1.2 Risk Assessment Of the Assets Initial Structure

The first officially published balance sheet of the Issue Department (as of 01.07.97 - i.e. the very start of the Currency Board system in Bulgaria) showed, that the total sum of its assets amounted to 2,819.96 bln. BGL, of which more than half

(52.0%) represented holdings of foreign negotiable securities, 24.9% - holdings of foreign exchange and 22.7% - monetary gold - the prevailing part - nearly 90%, of the total gold reserves of the Central Bank - (see Tables 1 and 2 of the Appendix).

By that time the sum total of the Issue Department's assets exceeded the monetary base (M_0) more than twice, since it represented about 40% of the liabilities of the Issue Department; the rest of it represented mainly deposits of the Government (about 21.2 %), the state fund for reconstruction and development (SFRD - about 19.7%) and the deposit of the Banking Department, amounting to about 493.82 bln. BGL - 17.5% of the Issue Department's liabilities.

If we try to analyze this broad initial Issue Department's asset structure from the point of view of risk, yield and liquidity, we could make the following basic observations.

As a whole, the asset structure is favorable, first of all from the point of view of yield - securing, since we could assume, that the yield (interest) on negotiable foreign securities (predominantly - short-term government debt instruments) is, naturally higher than the yield, secured by the other two forms instruments), in which the Issue Department holds its assets.³

³ We are unable to give a more concrete and judgment, because of the lack of officially published data on the yield (profitability) of the different kinds of assets.

As far as liquidity is concerned, the initial structure of the Issue Department's assets, can be considered, to some extent, relatively less favorable. Undoubtedly, the most liquid part of the assets, are the holdings of the board in foreign exchange, in the form of cash balances (which, naturally, represent quite a small part) and of balances on accounts, held with first-class foreign banks.

Of course, holdings of negotiable foreign securities can also be classified as "liquid" (having in mind, that, first of all, they are predominantly short-term debt instruments, and also, the fact, that they can easily be sold at any time), but nevertheless, they are somewhat "less liquid" in comparison with forex holdings, especially - cash balances⁴.

The assessment of risk in relation to the structure of the department's assets, requires an analysis of different kinds of possible risk.

First of all, it can be assumed, that political risk is practically equal to zero, having in mind that the prevailing part of the Issue Department's reserves are held in financial institutions in the most developed countries (such as the USA, Germany, Great Britain, etc.), which are (traditionally) economically, socially and (most of all) politically stable.

Political risk can rather arise as a result of eventual dramatic political and/or economic changes in Bulgaria, which could lead to such events, as, for instance. failure in the regular servicing of the external debt (even a new moratorium on it), sharp deterioration of the relations with the IMF and other international financial institutions, etc., but, this also, can be considered as a purely theoretical possibility.

Credit risk, connected with the level of creditworthiness of foreign banks, in which the Issue Department holds its forex reserves, and that of issuers of the negotiable securities, held by the Department, can also be considered as practically equal to zero. The foundations on which this judgment is based, result from the fact, that foreign exchange reserves are held with solid, first-class financial institutions, with the highest possible credit ratings (one of the two highest grades, by at least two internationally accepted credit agencies, as stipulated by Law) and that the assets, invested in securities, are held in government debt instruments (predominantly - US and German) which are (practically) riskless.

The risk, connected with possible unfavorable (downward) changes in the current market price of the Department's assets, exists both in respect to gold reserves and (to some extent) to holdings of negotiable securities. In both cases, however, this kind of risk can be

⁴ Again, the lack of more precise and detailed information on the structure of each of these two forms of assets makes a more concrete and definite judgment on liquidity status of the assets impossible.

considered as minimal, having in mind the low level of price volatility of these kinds of assets during the period from the establishment of the Currency Board system in Bulgaria until nowadays⁵.

Movements in the market price of the Issue Department's assets also result in respective changes in the total sum of the Department's assets; in this respect, an upward price change has an additional favorable effect, because it creates possibilities to increase the monetary base (M_0) in BGL and/or - the amount of Banking Department's deposit, i.e. its possibilities to provide refinancing for the banking sector, in case of systemic risk. Naturally, eventual downward price movements would have the respective negative effects.

As far as interest-rate risk is concerned, it should be noted, that risk on forex reserves and on securities (debt instruments) with floating (market-linked) interest rates is connected with possible downward change in market interest-rate levels, whereas risk on fixed-income securities can arise in cases of upward changes in interest-rate levels.

Having in mind the nature of the Issue Department' holdings of foreign exchange and negotiable securities, as well as, the relative stability in market interest rates in the basic key currencies, we could make an assessment, that during the period under review there have not been any significant changes, respectively any significant losses, or profits for the Issue Department, arising from them.

The currency risk can arise in cases of unfavorable changes in the exchange rate of different components of assets. A precise judgment on this kind of risk can be done only on the basis of a detailed information on currencies of denomination of each of the forms, in which the Issue Department's assets are held. Such information, unfortunately, is not available.

Nevertheless, some considerations, in regard to currency risk assessment can be made on the basis of the fact, that, at the moment of introduction of the Currency Board system in Bulgaria, the prevailing part of the forex reserves of the Central Bank was denominated in USD, and the predominant part of the rest - in DM.

From this point of view, the upward trend in the exchange rate of the USD, which prevailed in the past months after the establishment of the Currency Board in Bulgaria, can be estimated as favorable; on the other hand, it should be noted, that because of the fact, that the DM was chosen as reserve currency of the board, a considerable part of the USD -denominated

⁵ Although it is impossible to make precise calculations of price movements (and hence-of the size of eventual profits or losses for the Issue Department), we can suppose, that price changes during the period under review have been quite limited; most probably, their possible net result is positive (or at

assets have been converted into DM-denominated instruments. This conversion process, probably, has resulted in a loss for the Issue Department, but a more definite and precise assessment cannot be done, since data on the rate of exchange, at which such conversion operations have been effected, are not available.

Possible future exchange rate movements could have some effect, which will depend to a great extent on the currency structure of the Issue Department's assets. Assuming that an increasing (most probably- prevailing) part of the non-gold assets will be held in DM-denominated instruments, obviously an eventual continuation of the upward trend of the USD exchange rate will have a negative effect and vice versa.

The exchange rate BGL/DM being fixed, any movement in the USD/DM rate results ("automatically") in a respective change of the rate of exchange of the BGL *vis-a-vis* the USD. Any rise in the USD exchange rate leads to respective increase in the BGL equivalent of all USD-denominated assets of the Issue Department, and hence - of the total sum of assets; this means that either the monetary base (M_0) or the amount of the Banking Department's deposit will be increased. If the result is an increase in the monetary base, it will lead to an increase in the money supply in the national economy, and consequently - to expansion of credit, investment and probably - growth of GDP on the other hand, this process may result in stimulating the inflation process⁶.

Adversely, any downward movement of USD rate of exchange will inevitably result in a decrease of the BGL equivalent of USD-denominated and (to a less extent), total assets of the Issue Department, which will negatively affect the monetary base and/or the sum of the Banking Department's deposit.

As a whole, the total sum of the assets of the Issue Department, translated into BGL, will be less sensitive to possible changes in exchange-rate movements if a greater part of the assets are DM-denominated.

Theoretically, if all the Department's assets are denominated in DM, the BGL equivalent of their total sum will not be affected by any changes in the exchange rate of the USD, or any other currency *vis a vis* the DM (resp. - *vis-a-vis* the BGL).

least - neutral), rather than negative. The market price of gold during this period was, also, more or less, stable, with a prevailing (as a whole) tendency of slight upward movements.)

⁶ The rising USD exchange rate can also have some stimulating effect on exports (respectively - destimulating effect on imports), thus positively affecting the trade balance of the country; those possible effects of exchange-rate movements, however, are not so closely connected with the main concrete problems, analyzed in this work.

Theoretically, some liquidity problems in the functioning mechanism of the Currency Board system can arise as a result of a considerable structural mismatch between assets and liabilities of the Issue Department.

At the start of the Currency Board system in Bulgaria, the most liquid part of the Issue Department's liabilities (coins and notes in circulation) was more than 100% (117.5%) backed by the most liquid part of the Department's assets (reserves in foreign exchange); the monetary base (M_0) was almost twice (up to 192.2%) covered by forex reserves and holdings of securities of the Issue Department ; at the same time these two

“items” of the Department's assets backed almost fully the total amount of the monetary base plus claims of the Government. (95.1%).

In other words, the initial liquidity structure of assets can be considered as corresponding as a whole to the initial liquidity structure of liabilities.

1.3. Analysis Of Changes in the Amount and Structure Of the Issue Department's Assets From the Point Of View Of Risk Assessment and Risk Management

The officially published by the BNB data reveal a permanent tendency of increasing of the total sum of the Issue Department's assets.

Naturally, the fastest rate of growth was recorded during the first month of the functioning of the Currency Board system - by the end of July 97 the total sum of the assets stood at 3,460.73 bln. BGL, which meant an increase by 22.7%, as compared with 01.07. 1997. This upward tendency continued (albeit, with somewhat slower pace) until the end of the year (1997); as a result, the total sum of the Issue Department's assets as of 31.12.1997 amounted to 4,411.91 bln. BGL, which represented an increase of 56.5% in comparison with 01.07. 97 (the date of the start of the Currency Board in Bulgaria), respectively - an increase of 27.5%, as compared with 31.07. 1997.

The upward tendency was (most probably - only temporarily) interrupted in the beginning of 1998, but, nevertheless, by the end of January 1998, the sum total of assets amounted to 4,17205 bln. BGL, which was by 47.9% more than that on 01.07. 97, respectively - 20.6% more than that on 31.07. 1997.

As a whole, during the period under review the most liquid part of the Issue Department's assets (forex reserves) experienced the highest rate of increase; by the end of the first month of functioning of the Currency Board their amount was increased by 148.9% (from 700.98 bln. BGL on 01.07.1997 to 1,745.22 bln. BGL on 31 .07. 1997).

During the remaining months till the end of the year their amount continued growing with moderate rates, as a result of which the sum total stood at 2,263.68 bln. BGL as of 31.12.1997 (an increase of 222.9% and of 29.7% as compared with 01.07. and 31.07.1997 respectively).

Of course, it should be noted, that the increase of the BGL equivalent of the forex holdings of the Issue Department can be attributed partly to the upward change of the exchange rate of the USD; although it is impossible to make a precise judgment (because of lack of information on the currency structure of forex reserves), we can assume, that only quite a small (practically negligible) portion of the increase in the BGL value of assets is due to changes in the USD exchange rate, having in mind that during the second half of 1997 the USD/BGL exchange rate went up by approximately 5%.

A tendency of moderate decrease of the amount of forex reserves was observed in the very beginning of 1998; as of 30.01.98 it was equal to 2,114.89 bln. BGL, which is still by 201.7% more, as compared with the start of the Currency Board system and by 21.2% more in comparison with 31.07.1997.

At the same time, the rate of increase of the Issue Department's holdings of foreign securities was considerably lower; they amounted to 1,446.41 bln. BGL (01.07.1997), 1,495.42 bln. BGL (31.12.1997 - an increase by 3.4%); during the first month of 1998 their sum total fell to 1,405.13 bln. BGL - a decrease by 2.8%, as compared with the date of the start of the Currency Board system.

As a result, the relative share of security holdings in total assets of the Department was considerably lowered (from 52.0% on the 01.07. to 33.9% on 31.12. 1997 and 33.7% on 30.01. 1998). Respectively, the relative share of forex reserves recorded a sharp rise-from 24.9% (01.07.97) to 51.3% (31.12.1997) and 50.7 % (30.01.98).

These major changes in the structure of assets can be estimated as normal and leading to a higher liquidity level, but at the same time - to a relatively lower yield⁷; from the point of view of risk assessment the structural changes can be considered neutral, since all kinds of assets of the Department are (as required by Law) practically riskless, the only exception (to some extent) being the currency risk.

The amount of monetary gold reserves of the Department demonstrated quite a low level of volatility; at the start of the Currency Board it stood at 640.70 bln. BGL, by the end of

⁷ A more precise judgment (as stated above) is impossible, because of lack of information on the detailed structure, liquidity status and yield of different kinds of assets of the Issue Department

the year (1997) - it was equivalent to 644.11 bln. BGL, as well as 644.12 bln. BGL on 30.01.1998, i.e. it increased by 0.5%. It can be assumed that changes in the BGL value of the Issue Department's gold reserves are due to changes in the USD price of gold and/or changes in the USD/BGL rate, since the volume of gold reserves (in physical terms) did not change.

Logically, the relative share of gold reserves as part of the total assets of the Issue Department was (practically) constantly diminishing (from 22.7% as of 01.07.97 to 14.6 % and 15.4%, as of 31.12.97 and 30.01.98 respectively).

The amount and relative share of the fourth "item" of assets on the Issue Department's balance ("interest due in") - were always quite insignificant - they ranged between 5 and 15 bln. BGL, respectively - between 0.1% and 0.4%.

As a whole, during the period under review the changes in the structure of assets have been in correspondence with the changes in the structure of the Issue Department's liabilities. Roughly speaking, the latter consists mainly of the monetary base (reserve, or "high powered" money - M_0)⁸, claims of the Government (including the State Fund for Reconstruction and Development - SFRD) and the Banking Department's deposit.

Of those three major broad components of liabilities, for the period from 01.07.97 to 31.12.97 (resp. - to 30.01.98) the monetary base (M_0 - consisting of notes and coins in circulation and reserve requirements and other deposits of commercial banks) grew by 101.96% (resp.- by 74.5%), claims of the Government - by 39.1%, resp. - by 41.7 %, and the amount of the Banking Department - by 2.4%, resp. - by 10.8%.

Within the monetary base (M_0), the total sum of notes and coins in circulation grew by 137.1%, resp. - by 115.4% (from 598.99 bln. BGL as of 01.07.97 to 1,419.81 bln. BGL as of 31.12.97 and 1,290.76 bln. BGL as of 30.01.98), whereas the total amount of bank deposits grew by 62.2 % and 28,2 % respectively (from 529.37 bln. BGL on 01.07.97 to 857.85 bln. BGL on 31.12.97 and 678.82 bln. BGL on 30.01.98).

On the basis of this information we can conclude that the most liquid (short-term)part of the Issue Department 's liabilities has grown with the fastest rate; as a result, its relative share in the total sum of liabilities has increased from 21.1% as of 01.07.97 to 32.2 % as of 31.12.97 and 30.9% as of 30.01.98; the relative share of Government's assets (claims) has stayed, more or less, stable (40,9%, 36.3% and 39.2% respectively), whereas the share of the Banking Department's deposit with the Issue Department has fallen from 17.5% on 01.07. 97 to

11.5% on 31.12. 97 and 13.1 % on 30.01. 98. This means, that a bigger proportion of the assets increase serves as backing for the increased money circulation and/or increased claims of Government, rather than as a source of increasing the Central Bank's possibilities to refinance commercial banks, in cases of systemic risk . The high rate of M_0 growth can increase the risk of renewing the inflation processes in the national economy.

Nevertheless, the even higher rate of growth of the most liquid part of the Issue Department's assets (foreign exchange reserves) has led to increasing of the percentage of covering (backing) of the total amount of BGL notes in circulation to 159.3% on 31.12.97 and 164.1% on 30.01.98 from 117,5% on 01.07.97; the percentage of backing of the amount of reserve money (M_0) by forex holdings of the Department increased to 99.4 % and 107.4% from 62.2% respectively, and by forex reserves plus holdings of foreign securities - decreased to 165.5% and 178.8% from 192.2% respectively.

The percentage of covering of the sum total of reserve money (M_0) plus Government's claims on the Issue Department by forex reserves and holdings of foreign securities also increased (though moderately) - from 95.1% on 01.07. 1997 to 97.2% on 31.12. 1997 and 97.7% on 30.01. 1998.

Most probably the tendency of increasing of the total sum of assets of the Issue department will continue, at least for the near future, though with considerably lower rates. Under a Currency Board system this is essential not only for the normal functioning of the financial system, but also for the economy as a whole and specifically for growth in the real sector. In these circumstances, the main source of growth of money supply (subsequently - of investment and economic growth) is the increase of foreign exchange assets of the Board (The Issue Department), which will allow a corresponding increase of monetary base and hence - of money supply; of course, money supply can be increased even if the monetary base remains unchanged, by adequate changes in the structure of monetary base by lowering the reserve requirements of the Central Bank, which will result in increasing the amount of BGL notes and coins in circulation, and also - of the value of the money multiplier, and hence - the money supply.

The possibilities for increasing money supply in this way are quite limited, since a sharp lowering of the reserve requirements of the Central Bank can lead to increased risk in the banking system, although it could bring to improving liquidity of commercial banks.

⁸ See Alberto F. Ades, *Currency Board and its Implications for Argentina*, N.Y, 1995, and also, Balyosov, Zdr., *Equilibrium Levels of Exchange rate and Foreign Reserves under Currency Board* (in

Another way of increasing of monetary base (and money supply) without an adequate increase in foreign exchange assets of the Board is to lower the percentage of its covering (backing) but under the present circumstances it is not desirable, because it can negatively affect the level of public credit and subsequently - the stability of the financial system.

Still another possible way (at least - theoretically) is the devaluing of the national currency - the BGL - *vis-a-vis* the reserve currency of the Board - the DM; for the present, this is also practically impossible, although in a relatively longer term perspective it is not quite improbable⁹.

Consequently, having in mind the present situation and the near future (at least until the end of the year), practically the only possible way to increase money supply is to secure a process of (moderate) growth of foreign exchange assets as a result of a surplus in the balance of payments of the country.

Further dramatic changes in asset structure should not be expected. Most probably the relative share of foreign exchange reserves (cash and balances on accounts) will fluctuate around the present level, i.e. over 40% up to 50% or slightly higher. It can be assumed, that this part of assets of the Issue Department will continue to back (at around 100% degree of coverage) the monetary base (reserve money), that is - BGL notes and coins in circulation plus deposits of commercial banks with the Department¹⁰.

Evidently, changes in the currency structure of assets will continue, as gradually a greater proportion of USD-denominated assets will be converted into DM-denominated ones; unfortunately, as far as this aspect of asset structure is concerned, a more precise forecast is impossible, first of all, because of lack of any official information on the present currency structure of assets¹¹.

2. Banking Department's Assets

The analysis of the available officially published by the BNB information shows, that both the amount (sum total) and the structure of the Banking Department's assets have been considerably more stable, during the period under review, as compared with those of the Issue Department (See Table 4 of the Appendix).

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⁹ Such a measure may prove favorable for the development of exports (hence, for the trade balance and the balance of payments, as a whole), but at the same time it will inevitably stimulate the inflation process.

¹⁰ The relative share of holdings of foreign securities also can be expected to be relatively stable (most probably within the limits of 33 to 40% respectively).

This circumstance can be attributed to the fact, that, with the start of the Currency Board mechanism, in the asset side of the Banking Department's balance sheet were included mainly such kinds of Central Bank's asset, which are less "volatile" (less vulnerable to changes), as well as to the "residual" principle, on which the balance sheet of the Banking Department is being formed.

During the period from 31.07.1997¹² to 28.11.1997 (more recent data have not yet been officially published) the total sum of Banking Department's assets has increased by 0,4% (from 3,560.26 bln. BGL to 3,574.72 bln. BGL), i.e. it has been practically stable for these four consecutive months.

As a whole, changes in asset structure have also been insignificant. The major "item" of the Department's assets constitute claims on the Government, participation (quotas) of Bulgaria in the IMF and other international financial institutions and the Banking Department's deposit with the Issue Department (altogether they represent more than 85% of the sum total of the Department's assets).

For the period under review, the most dynamic part of assets have been claims of the Banking Department on the Government - they increased in value by 26.3 % (from 1,194.45 bln. BGL to 1,508.64 bln. BGL); as a result, their relative share in the sum total of the Department's assets rose from 33.5% to 42.2%.

At the same time, the amount of the Banking Department's deposit with the Issue Department declined by 30.1% (from 792.02 bln. BGL to 553.86 bln. BGL), as a result of which its relative share in total assets fell from 22.2% to 15.5%.

For the same period, the amount, as well as the relative share of Bulgaria's quotas in the IMF and other international financial institutions have stayed practically stable (1,087.12 bln. BGL and 1,039.96 bln. BGL, 30.5% and 29.1%, respectively).

The relative share of other "items" of the Banking Department's assets (which is, more or less, negligible, except, to some extent, for that of investments in securities), has fluctuated within quite narrow limits: the share of holdings of BGL-denominated securities - about 8% (between 7.7% and 8.2%), that of gold and other precious metals - within the range from 2.0% to 2.2%, and the relative share of fixed assets - between 2.2% and 2.6%.

¹¹ This process of further changes in the currency structure of assets will depend also on the eventual movement of the USD/DM exchange rate.

¹² The first officially published balance sheet of the Banking Department was as of 31.07.1997.

In a most concise form, this structure of the Banking Department's assets can be estimated as relatively favorable from the point of view of risk (as a whole, practically all kinds of assets are riskless, or, at least- very low-risk), not so favorable, as far as liquidity is concerned (most of the assets represent claims arising from long-term credits and/or investments) and "neutral" in regard to yield ¹³.

An important characteristic of the Banking Department's asset structure is the very high (and also - increasing) relative share of claims on the Government, which is an indicator for the too high (and potentially-destabilizing for the national financial system) amount of the official "internal" (predominantly denominated in BGL) debt of the Government. As a whole, the two items - "claims on the Government and budget -financed organizations" and "investment in securities" (which, assumable, consist mainly, if not - exclusively - of holdings of Government securities) represent about a half (41.7% as of 31.07.97 and 50.1% as of 28.11.97) of total assets of the Banking Department.

For the whole period under review the structure (in broad lines) of liabilities side of the Banking Department's balance sheet has also remained stable. Liabilities of the Department (mainly - credits from the IMF and other international financial institutions) have accounted for about 72.5% -73.0% of the sum total, whereas the share of capital (net worth) has been about 27.0% - 27.5%.

Any dramatic changes in the asset, as well as in the liabilities structure are not probable, at least for the near future - up to the end of 1998 and, maybe - throughout 1999. The only change of some significance, which is sure enough, will be the increasing of Bulgaria's quota in the IMF (according to the decision for general increase of member-countries' quotas), as a result of which the relative share of the respective "item" in the sum total of the Banking Department's assets will be correspondingly increased.

Considerable changes are also possible in regard to the amount and the relative share of the deposit of the Banking Department with the Currency Board (The Issue Department). In this respect movements are possible in both directions, but in case the process of stabilization of the banking system continues and at the same time the amount of the Issue Department's assets continues to increase, most probably the long-term tendency will be towards moderate growth.

¹³ It should be noted, here, that the present value of interest-rates in Bulgaria is too low, with real interest close to (or even - below) zero; so the yield on most of the assets of the Banking Department (those, denominated in BGL) is low, but the asset structure is not among the reasons for it.

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TABLE 1. ISSUE DEPARTMENT - BALANCE SHEET - BLN. BGL

	01.07.97	31.07.97	29.08.97	30.09.97	31.10.97	28.11.97	31.12.97	30.01.98
Assets	2,819.96	3,460.73	3,751.50	3,936.24	4,078.82	4,217.15	4,411.91	4,172.05
1. Cash and balances on accounts in forex	700.98	1,745.22	1,653.40	1,642.74	2,031.76	2,061.68	2,263.68	2,114.89
2. Monetary gold	640.70	640.73	640.78	643.97	644.02	646.22	644.11	644.12
3. Negotiable foreign securities	1,446.41	1,066.57	1,444.27	1,639.84	1,392.66	1,497.00	1,495.42	1,405.13
4. Interest due in	11.87	8.22	13.05	9.70	10.38	12.26	8.70	7.91
Liabilities	2,819.96	3,460.73	3,751.50	3,936.24	4,078.82	4,217.15	4,411.91	4,172.05
1. Notes and coins in circulation	598.99	834.02	976.14	1,032.50	1,082.82	1,145.33	1,419.81	1,290.26
2. Accounts and deposits of commercial banks	529.37	655.71	624.81	591.29	559.68	604.14	857.85	678.82
3. Deposits of the Government and budget-financed organizations	597.96	556.21	609.12	784.49	1,153.00	1,293.20	1,277.35	1,634.64
4. Other deposits	33.72	12.69	21.14	15.44	19.02	19.11	24.93	20.77
5. State Fund for reconstruction and Development	555.87	609.90	579.44	589.20	575.77	598.79	323.93	-
6. Interest due out	10.24	0.19	0.06	0.35	2.38	2.72	1.93	0.64
7. Deposits of the Banking Department	493.82	792.02	940.82	922.97	686.16	553.86	506.13	546.93

TABLE 2. ISSUE DEPARTMENT- STRUCTURE OF ASSETS AND LIABILITIES (in % OF TOTAL SUM)

	01.07.97	31.07.97	29.08.97	30.09.97	31.10.97	28.11.98	31.12.98	30.01.98
Assets	100	100	100	100	100	100	100	100
1. Cash and balances on accounts in forex	24.9	50.4	44.1	41.7	49.8	48.9	51.3	50.7
2. Monetary gold	22.7	18.5	17.1	16.4	15.8	15.3	14.6	15.4
3. Negotiable foreign securities	52.0	30.8	38.5	41.7	34.1	35.5	33.9	33.7
4. Interest due in	0.4	0.3	0.3	0.2	0.3	0.3	0.2	0.2
Liabilities	100	100	100	100	100	100	100	100
1. Notes and coins in circulation	21.2	24.1	26.0	26.2	26.5	27.2	32.2	30.9
2. Accounts and deposits of commercial banks	18.8	18.9	16.7	15.0	13.7	14.3	19.4	16.3
3. Deposits of the Government and budget-financed organizations	21.2	16.1	16.2	19.9	28.3	30.7	29.0	39.2
4. Other deposits	1.2	0.4	0.6	0.5	0.5	0.4	0.6	0.5
5. State Fund for reconstruction and Development	19.7	17.6	15.4	15.0	14.1	14.2	7.3	-
6. Interest due out	0.4	0	0	0	0.1	0.1	0	0
7. Deposits of the Banking Department	17.5	22.9	25.1	23.4	1.8	13.1	11.5	13.1

TABLE 3. ISSUE DEPARTMENT - CHANGE IN ASSETS AND LIABILITIES (IN %)

	28. 11. compared to 01.07.97	1997 compared to 31.07.97	31.12. compared to 01.07.97	1997 compared to 31.07.97	30.01 compared to 01.07.97	1998 compared to 31.07.97
Assets	+49.5	+21.9	+56.5	+27.5	+47.9	+20.6
Cash and balances on accounts in forex	+ 194.5	+18.1	+223.0	+29.7	+201.7	+21.2
Monetary gold	+0.9	+0.9	+0.5	+0.5	+0.5	+0.5
Negotiable foreign securities	+3.5	+40.4	+3.4	+40.2	- 2.8	+31.7
Liabilities	+49.5	+21.9	+56.5	+27.5	+47.9	+20.6
Notes and coins in circulation	+91.2	+37.3	+137.1	+70.2	+115.4	+54.7
Accounts and deposits of commercial banks	+14.2	- 7.9	+62.2	+30.8	+28.2	+3.5
Deposits of the Government and other budget-financed organizations	+116.2	+132.5	+113.6	+129.7	+173.4	+193.9
State Fund for Reconstruction and Development	+1.1	- 1.8	- 41.7	- 46.9	-	-
Deposit of the Banking Department	+12.1	- 30.1	+ 2.4	-36.1	+10.8	-30.9

TABLE 4. BANKING DEPARTMENT - BALANCE SHEET BLN. BGL (ABSTRACT)

	31.07.1997 relative share - %		29.08.1997 relative share - %		30.09.1997 relative share - %		31.10.1997 relative share - %		28.11.1997 relative share - %		Change in % 31.07.97 - 28.11.97
Assets	3560,26	100	3,661.90	100	3,593.14	100	3,543.14	100	3,574.72	100	+0.4
1. Gold and other precious metals	74.22	2.1	75.57	2.1	77,50	2.2	72.55	2.0	74.30	2.1	+0.1
2. Securities	293.33	8.2	287.79	8.2	280.44	7.8	273.47	7.7	281.11	7.9	- 4.2
4. Credits for the Government	1,194.45	33.5	1,166.63	31.9	1,138.19	31.7	1,349.67	38.1	1,508.64	42,2	+26.3
5. Participation on IMF and other international financial organizations	1,087.12	30.5	1,070.55	29.2	1,044.56	29.1	1,032.39	29.1	1,039.96	29.1	-4.3
8. Fixed assets	79.01	2.2	83.27	2.3	85.42	2,4	90.00	2.6	91.68	2.6	16.0
10. Deposits in Issue Department	792.02	22.2	940.82	25.7	922.97	25.7	686.16	19.4	553.86	15.5	-30.1
Liabilities and capital	3,560.26	100	3,661.90	100	3,593.14	100	3,543.14	100	3,574.72	100	+0.4
Liabilities	2,576.29	72.4	2,680.67	73.2	2,618.41	72.9	2,580.60	72.8	2,593.40	72.5	+0.7
1. Credits from IMF	1,489.51		1,610.60		1,571.34		1,539.91		1,551,25		+4.1
2. Liabilities to other international financial organizations	1,078.98		1,062.44		1,036.54		1,024.42		1,032.11		- 4.3
Capital	983.98	27.6	981.23	26.8	974.73	27.1	962.53	27.2	981.32	27.5	-0.3