

# **Consequences of the Eurosystem's non –standard measures on the Western Balkan**

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НБРМ-NBRM

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# Eurosystem's non-standard measures and initial effects

- ▶ Announcement of 22 January 2015 – **Expanded Asset Purchase Programme**
- ▶ **Objectives:**
  - fulfill the ECB's price stability mandate (given historical low inflation)
  - provide monetary stimulus to the economy, in the context of policy interest rates being already at their lower bound.
- ▶ **The EAPP comprises:**
  - The Covered Bond Purchase Programme (CBPP3)
  - The Asset Backed Securities Purchase Programme (ABSPP)
  - The Public Sector Purchase Programme (PSPP)
- ▶ **Purchase pace and duration:** intended EUR 60bn/month until at least September 2016

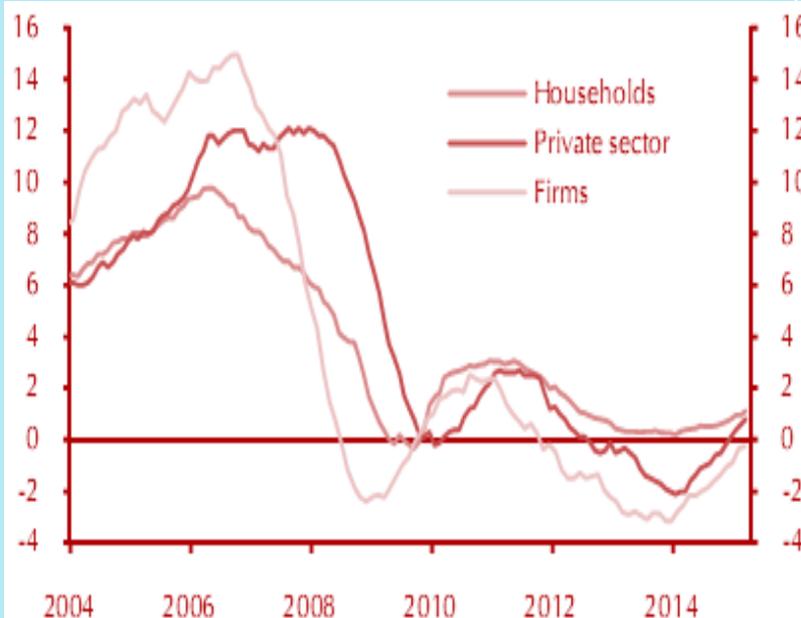
## Eurosystem holdings under the expanded asset purchase programme (bn. euros)

	ABSPP	CBPP3	PSPP	APP stock	Change
March 2015	4,624	63,606	47,356	115,586	
April 2015	5,785	75,070	95,056	175,911	60,325
as of 15th May 2015	6,131	80,759	122,405	209,295	33,384

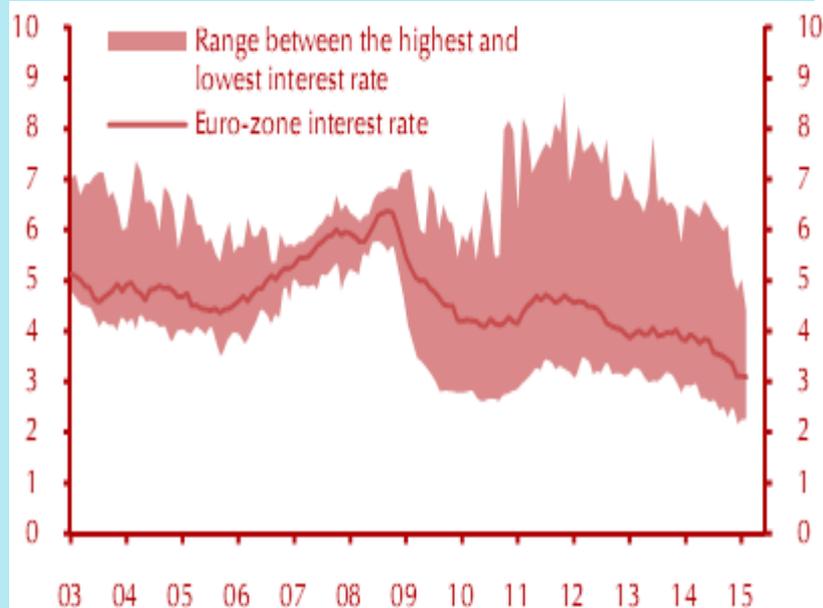
# Eurosystem's non-standard measures and initial effects

- ▶ **Early evidence shows measures have been effective**
  - lending activity accelerated (0,8% in March)
  - Bank Lending Survey suggests that lending growth might accelerate further
  - Narrowing interest rate spreads

Private sector lending (% , yoy)



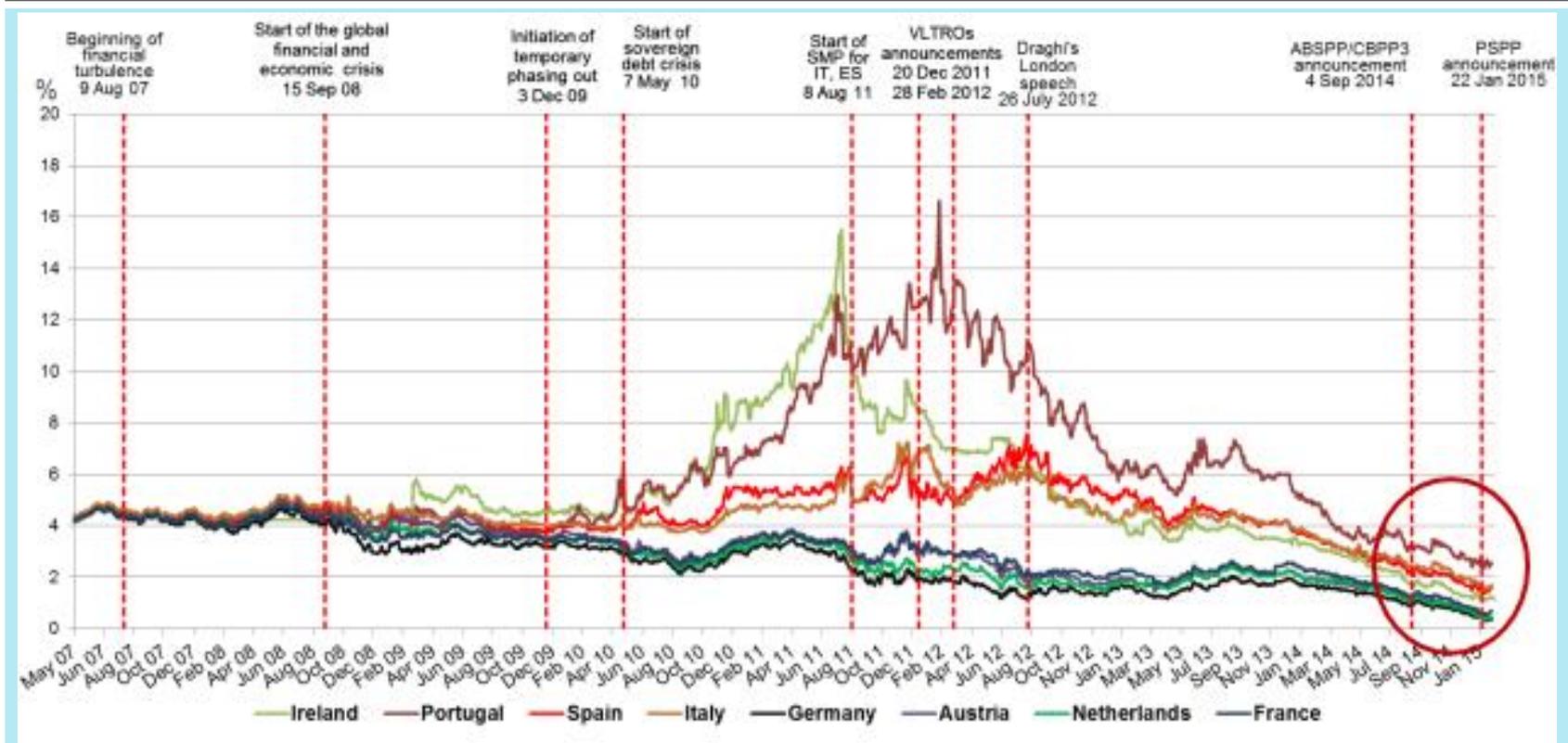
Interest rate on new loans to firms, 1-5 years (%)



# Eurosystem's non-standard measures and initial effects

- ▶ **Lowering yields of government securities** - before and in the aftermath of implementation of the PSPP

## 10 year euro area government bond yields



Source: NALM, What to expect the ECB's Expanded Asset Purchase Programme (EAPP), 12 March 2015

# Eurosystem's non-standard measures and initial effects

- ▶ **Inflation expectation improved after the announcement of the PSPP** - CPI of 0% in April (-0,1% March)
- ▶ **Improving economic activity in the Q1-2015** – economy expanded by 0,4% (0,3% in Q4-2014)

Euro area HICP inflation and 5y5y expectations

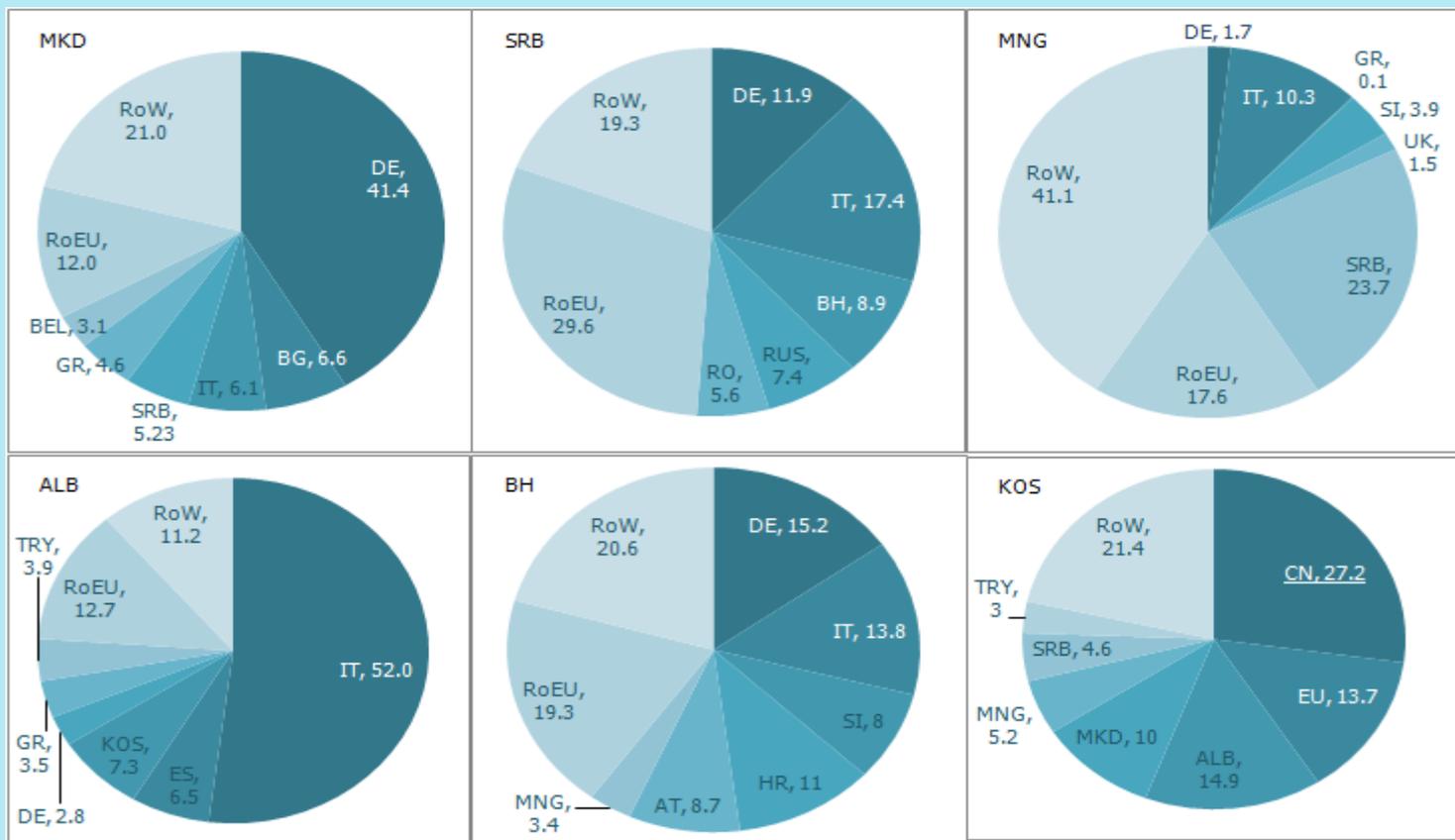


# Economic/financial linkages of Western Balkans to EU

- ▶ **Strongest channel of EU integration is foreign trade**
  - As of 2014, EU accounts between 70-80% of total exports in Macedonia, Albania and Bosnia
  - Strong bilateral connection to specific EU countries (Germany, Italy, Greece)
  - Somewhat strong regional trade interdependence as well.
- ▶ **EU has been most important source of financial flows to region**
  - In Serbia and Macedonia EU FDI account for more than 80% of total FDI
  - FDI directed to domestic banking sector –61% of presence of EU banks into regional banking system
- ▶ **Remittances from EU are also important financial flow**
  - connected to waves of emigration to EU member states, particularly from Albania, Bosnia and Kosovo.
  - remittances from EU are around 80% of total countries remittances on average
- ▶ **Euro is widely used in the majority of the Western Balkan countries**
  - Serbia around 70% of total deposits are euro denominated, Albania 30 are euro denominated
  - thus, euro is used as external anchor for foreign exchange policies.

# Economic/financial linkages of Western Balkans to EU

## Exports to EU, as of 2014 (% share in total exports)

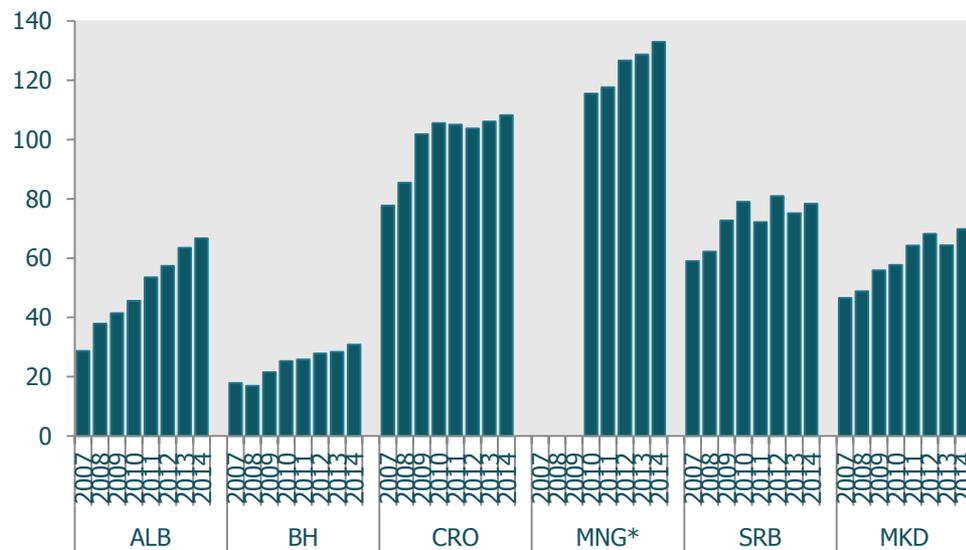


Source: countries statistical offices, Central Banks web sites

# Economic/financial linkages of Western Balkans to EU

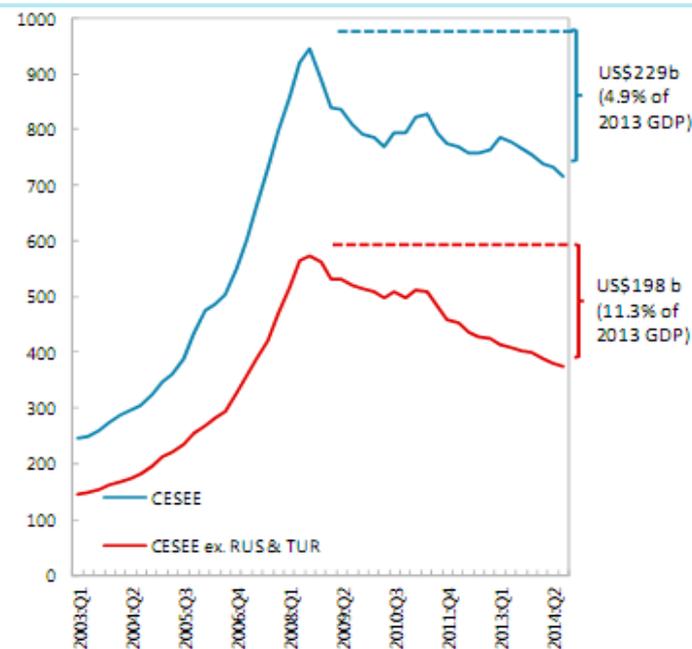
- **High reliance on foreign funding makes** the region sensitive to changes in external financial conditions, as well as to rollover and FX risks
- The countries are **highly financially opened**, with gross external debt between 20% (Bosnia) up to above 120% of GDP (Montenegro), Macedonian external debt is on average 60% for the period
- As capital flows fell in 2008, **decline in available financing particularly from parent banks** was registered and credit conditions tightened significantly

## Total External Debt to GDP (%)



\*Data for gross external debt of Montenegro are IMF estimates

## External position of BIS – reporting banks vis-à-vis CESEE (Billions of US dollars)

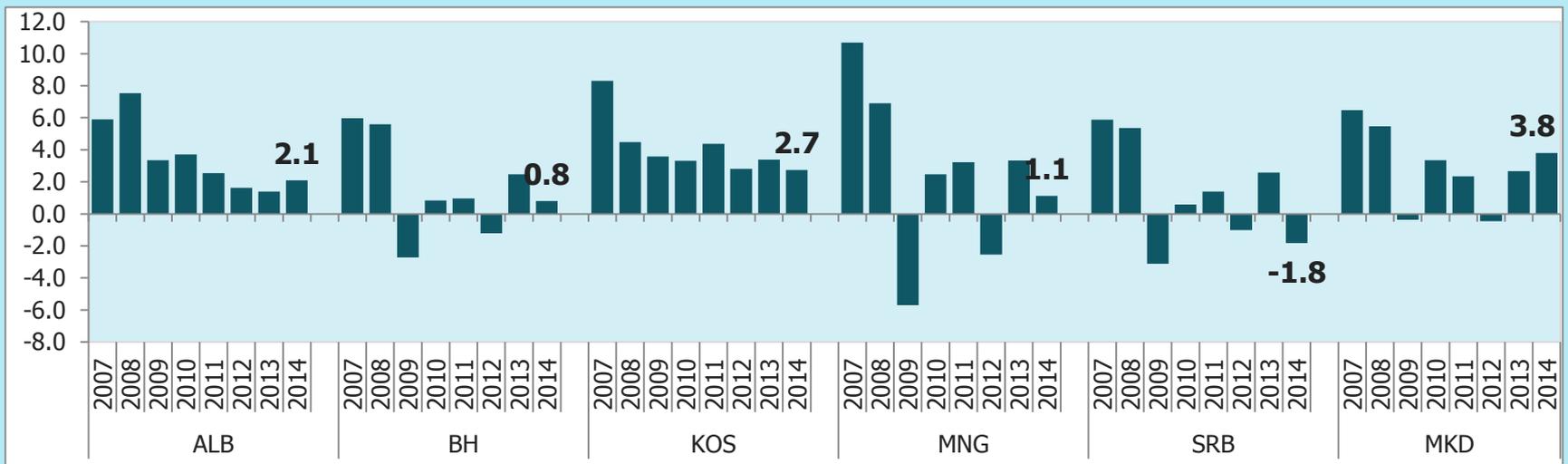


Source: Vienna Initiative, CESEE Deleveraging and credit monitor, Jan.2015

# Recent economic developments in Western Balkans

- **Region still coping with slow economic activity**
  - in 2014, economic activity was hit by weather shocks (Serbia), as well as by delayed public investment (Kosovo, Albania) and slowdown in advanced and emerging economies;
- **Macedonia is best performer among the WBs countries** - sustained recovery on the back of the increasing exports and investments
- **Improved near term outlook for EU economy and accelerating of EU consumption, might boost Western Balkan countries exports/GDP**

GDP (y-o-y, %)

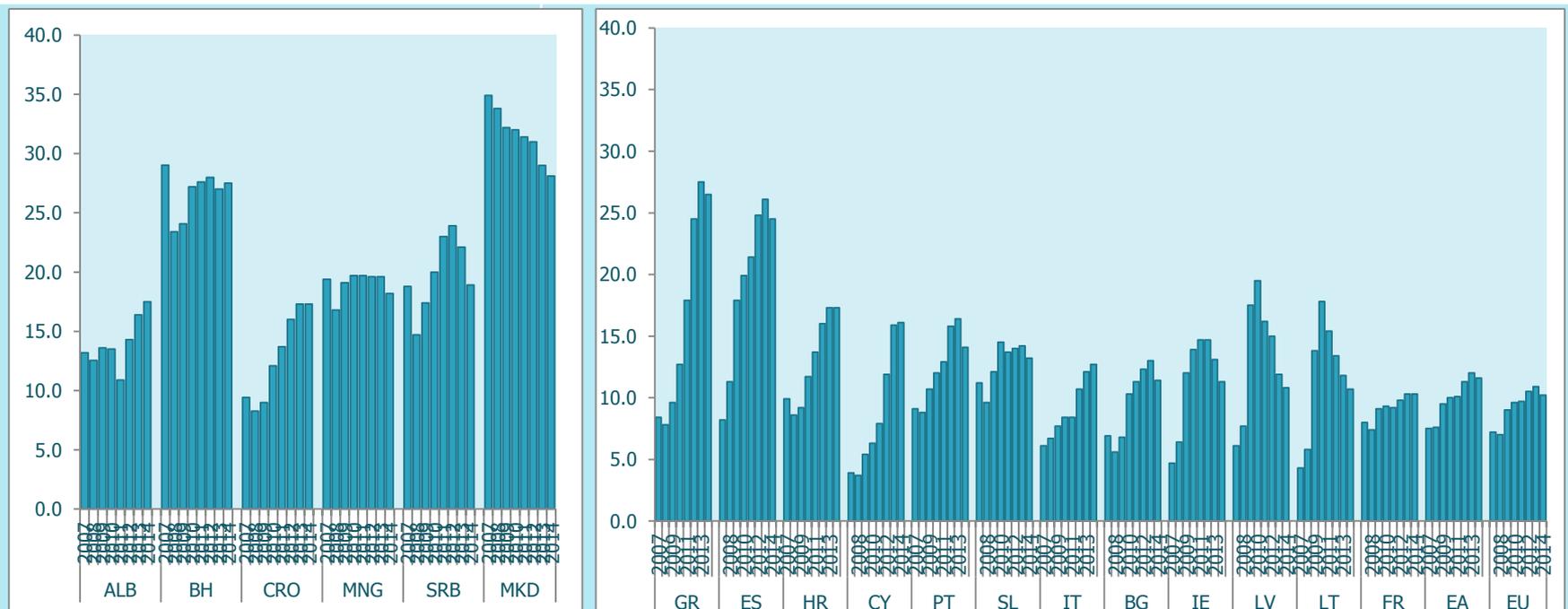


Source: IMF, countries statistical offices

# Recent economic developments in Western Balkans

- The economic recovery is having minor effects on labor market un the region
- However, Macedonia is experiencing improved labor market conditions since 2008
  - rise in potential - increased job creation;
  - implementation of ALMP

Unemployment rate (%)



Source: IMF, countries statistical offices, Eurostat

## Recent economic developments in Western Balkans - GDP projections

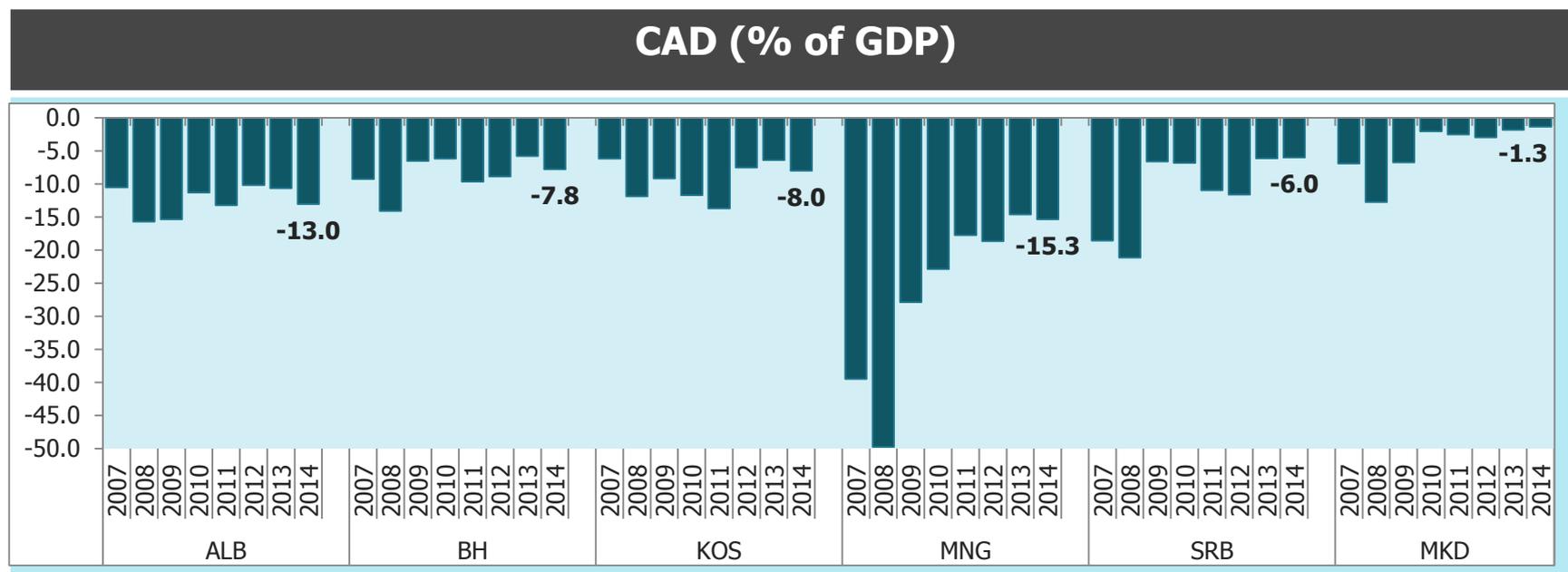
- For 2015, **region is expected to grow by 1,3%**, supported by recovering external demand, from EU and stabilization of international energy prices
- **Three major risks** to economic outlook for Western Balkans:
  - Failure of Greece and official creditors to reach agreement
  - Larger than expected impact of tightening of monetary policy in US
  - Geopolitical risk related to Ukraine/Russia

### GDP growth projections (%)

	European Commission, European Economic Forecast, Spring		IMF, World Economic Outlook, April 2015		World Bank, Global Economic Prospects, January 2015		EBRD, Regional Economic Prospects, May 2015		Bloomberg	
	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016
Macedonia	3.8	3.9	3.8	3.9	3.5	3.8	3.5	3.7		
Serbia	-0.1	1.2	-0.5	1.5	-0.5	1.5	0.3	1.8		
Montenegro	3.3	3.9	4.7	3.5	3.4	2.9	3.0	3.7		
Croatia	0.3	1.2	0.5	1.0	0.5	1.2	0.5	0.5	0.3	1.0
Albania	3.0	3.6	3.0	4.0	3.0	4.0	2.5	3.0		
Bosnia					1.5	2.5	2.5	3.0		
Turkey	3.2	3.7	3.1	3.6	3.5	3.7	3.0	3.0	3.2	3.7
Kosovo							2.5	3.5		

# QE consequences for Western Balkans – Trade channel

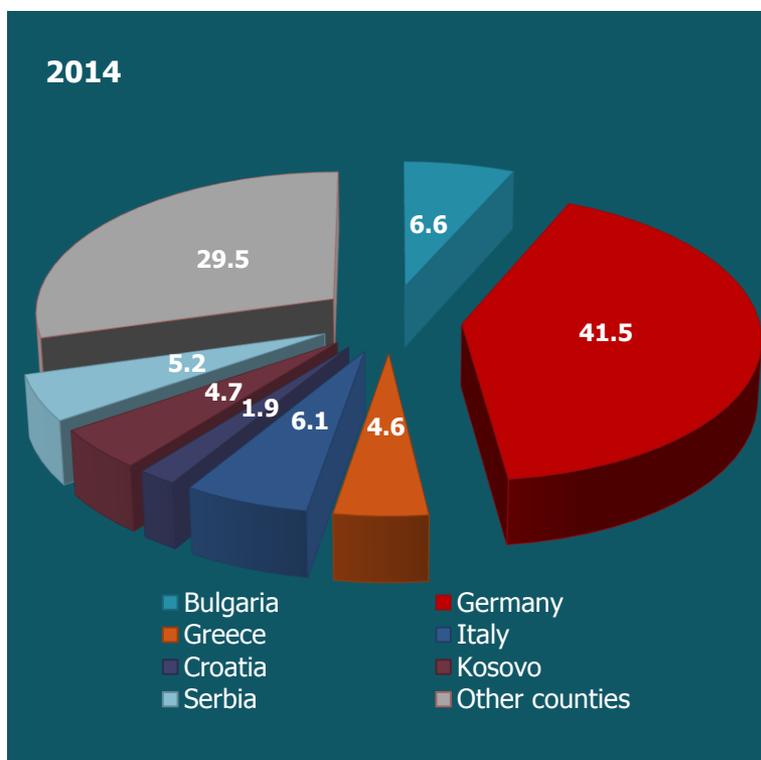
- **Current account deficits are improving in recent years**, but on a regional level CAD is still around 8% (as of 2014)
- **In Macedonia, the improved trade balance** due to FDI financed manufacturing exports (in TIDZ) contributed for CAD reduction
- **In Macedonia, there are some sights of traditional sectors recovery** -metal industry and textile



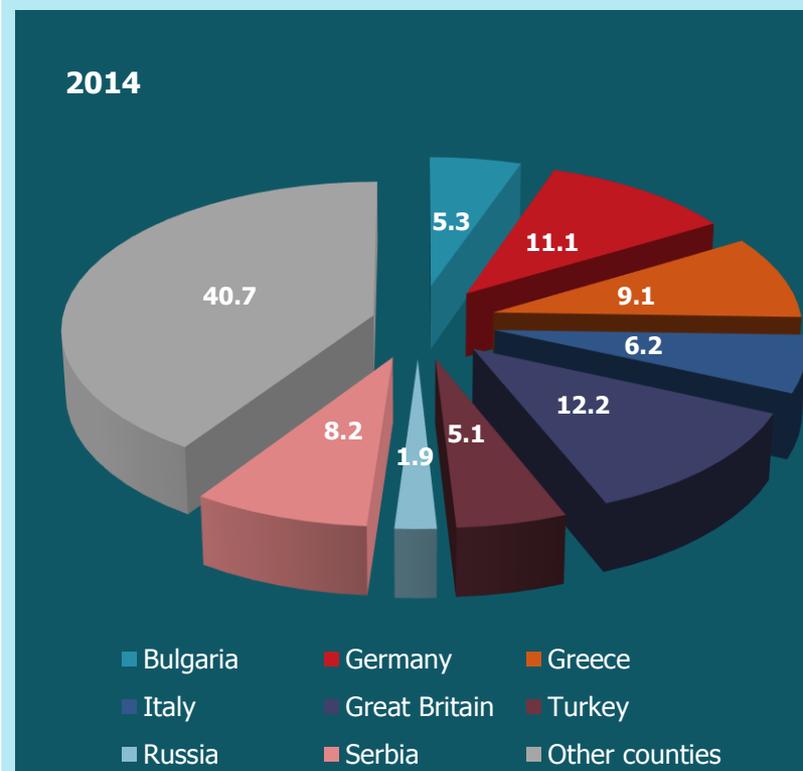
Source: IMF, countries statistical offices

# QE consequences for Western Balkans – Trade channel – Macedonian case

**Export of goods, by countries**  
(share, in %)



**Import of goods, by countries**  
(share, in %)

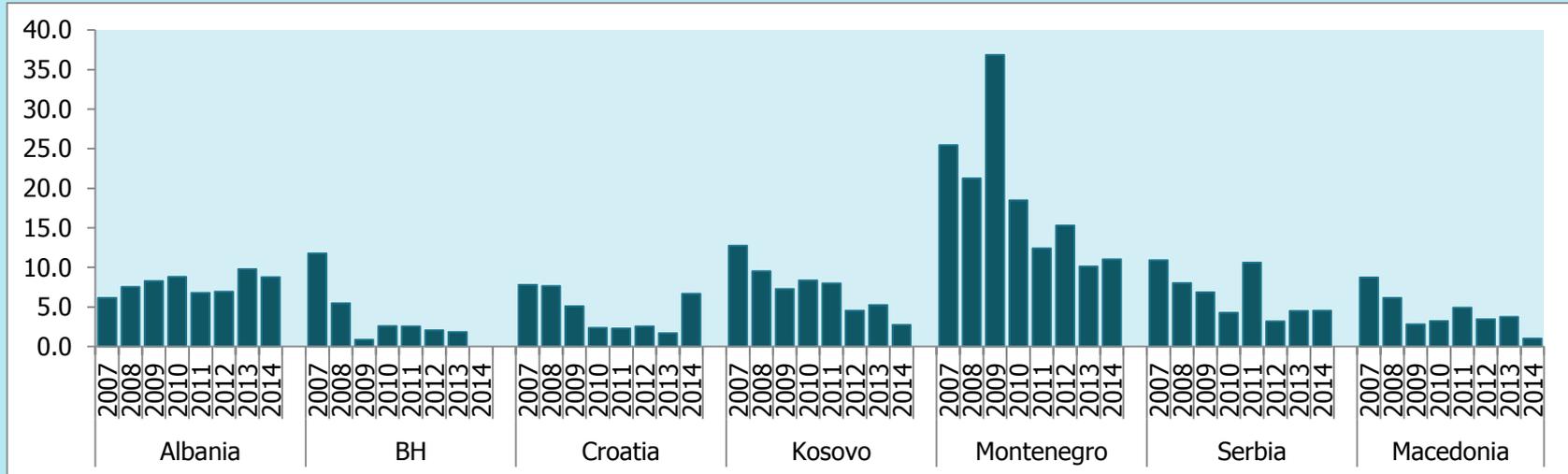


# QE consequences for Western Balkans – FDI channel

- **FDI inflows slowed after the crisis**, partly as result of the process of **deleveraging** by cross border bank groups

***Positive outlook for economic conditions in EU could boost foreign direct investments***

## FDI (% of GDP)



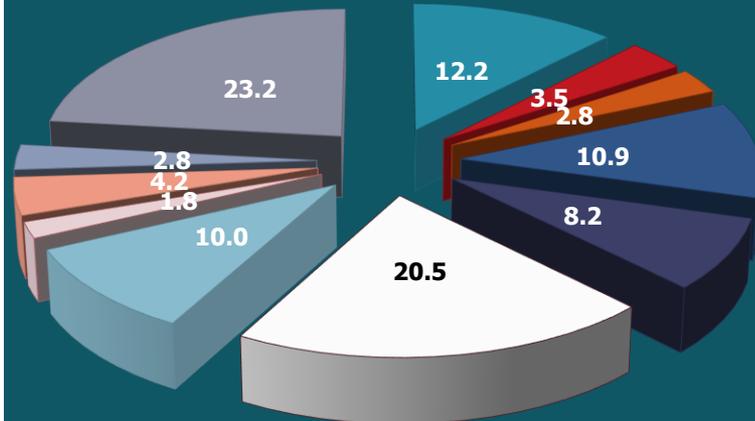
Source: IMF, countries statistical offices, Central bank web sites, NBRM calculations

# QE consequences for Western Balkans – FDI channel

## Macedonian case

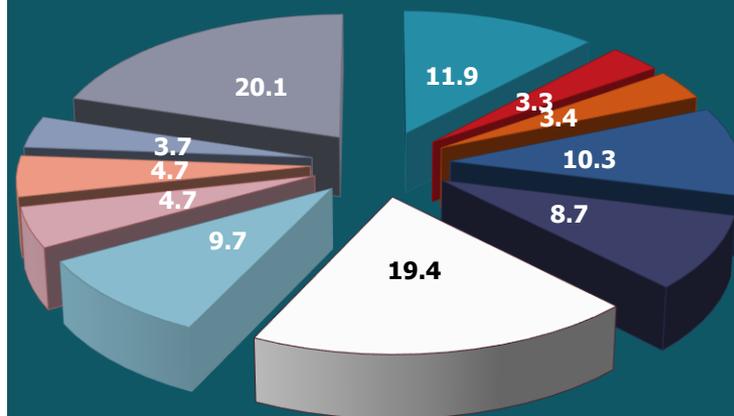
**Stock of FDI by countries**  
(share, in %)

2013



■ AUSTRIA      ■ BULGARIA      ■ GERMANY  
■ GREECE      ■ HUNGARY      ■ NETHERLANDS  
■ SLOVENIA      ■ SWITZERLAND      ■ TURKEY  
■ UNITED KINGDOM      ■ Other

2014



■ AUSTRIA      ■ BULGARIA      ■ GERMANY  
■ GREECE      ■ HUNGARY      ■ NETHERLANDS  
■ SLOVENIA      ■ SWITZERLAND      ■ TURKEY  
■ UNITED KINGDOM      ■ Other

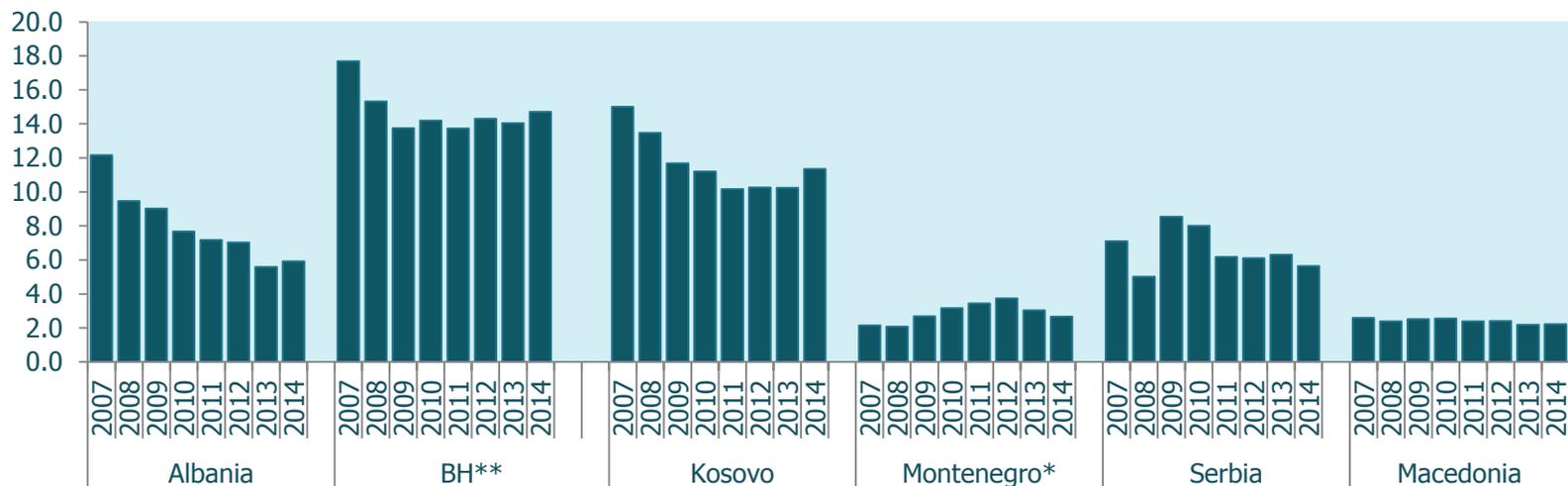
Source: NBRM

# QE consequences for Western Balkans – Remittances inflows

- **Remittances are particularly important** for Albania, Bosnia and Kosovo, with primary sources of inflows from Greece, Italy, Switzerland, Austria and Germany

***Improving growth performance of EU might preserve or stimulate remittances inflows***

## Remittances (% of GDP)



\* Refers to Secondary income, Other sectors.

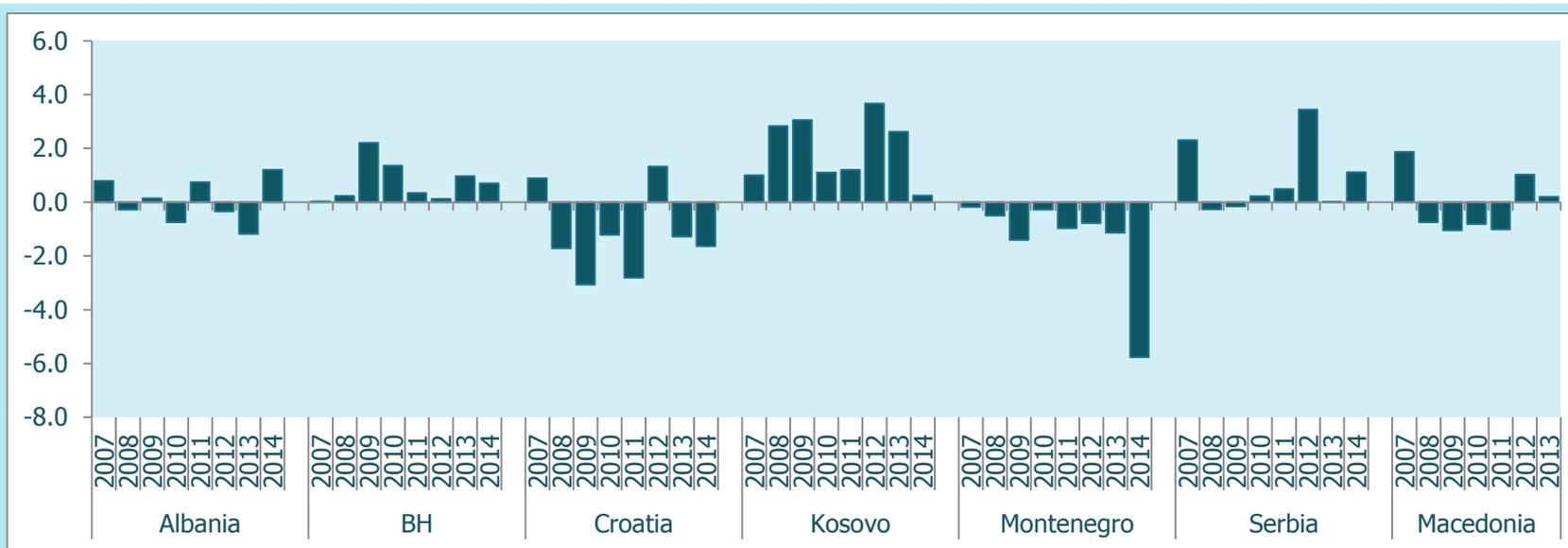
Source: IMF, countries statistical offices, Central bank web sites, NBRM calculations

# QE consequences for Western Balkans – Portfolio investments

- **Search for yield on EU markets** resulted in downward trend of prices of all financial instruments

*This is opportunity for WBs countries to attract portfolio inflows – but shallow domestic capital markets (in some cases there is developed local government securities market)*

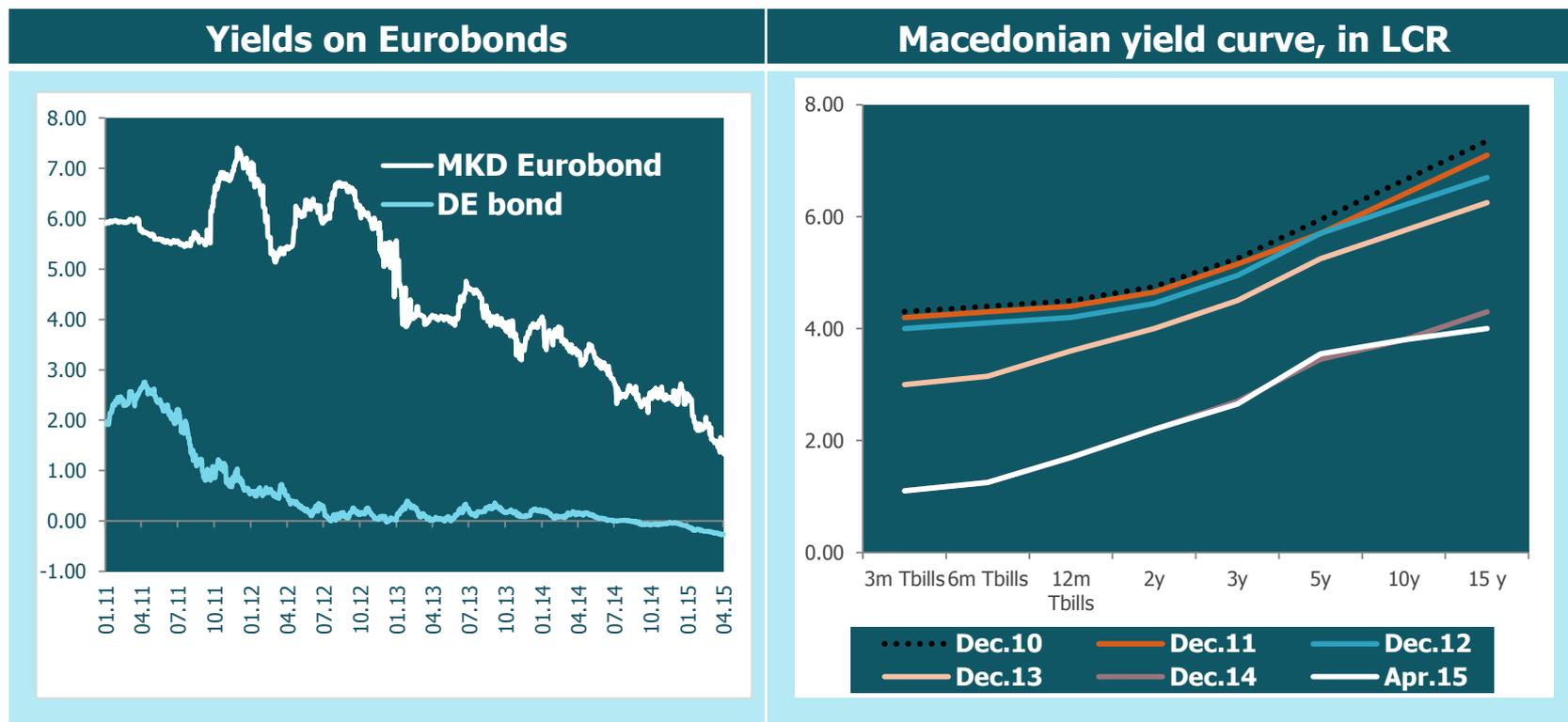
## Net Portfolio investment (% of GDP)



Source: IMF, countries statistical offices, Central bank web sites, NBRM calculations

# QE consequences for Western Balkans – Portfolio inflows

- **Falling yields even on regional Eurobonds, as well as on domestic markets** (lower financing costs), but still attractive for investors – case of Macedonia



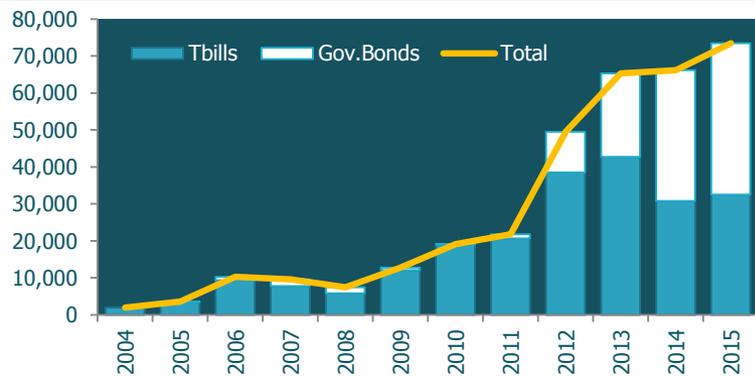
Source: NBRM

# QE consequences for Western Balkans – Portfolio inflows

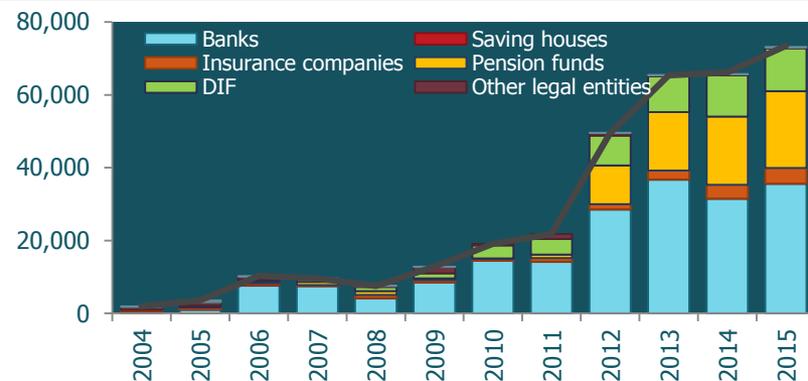
## Case of Macedonia – development of government primary market

### Increased bonds issues....

(Mil. MKD)



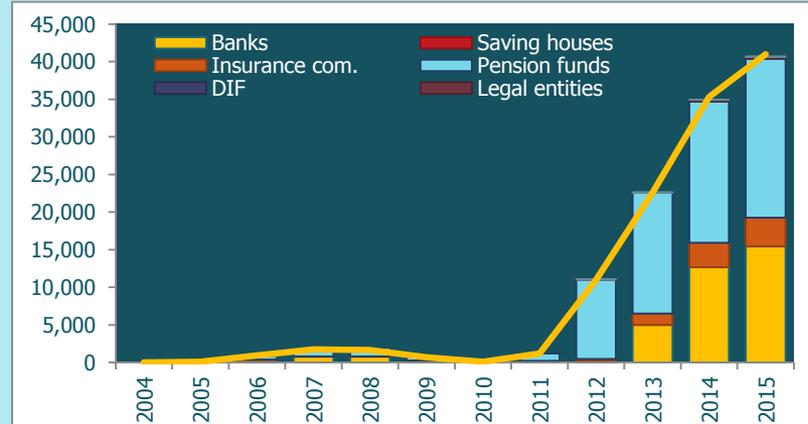
### .....substantial demand by domestic institutional investors



### ....while lengthening the maturity of the bonds up to 15 years....



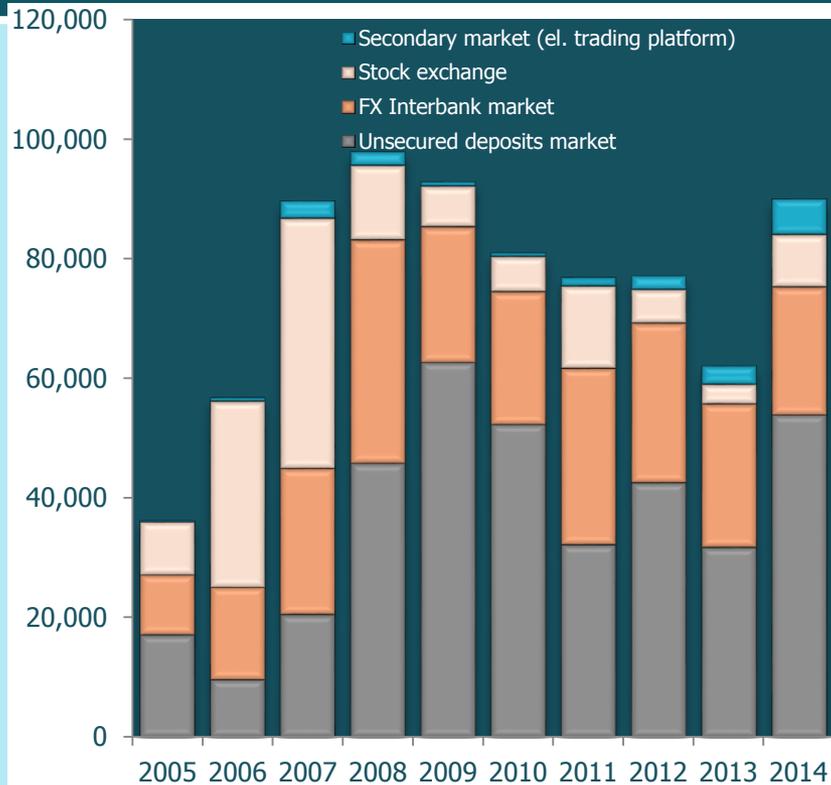
### .... bonds' investors are even domestic banks



# QE consequences for Western Balkans – Portfolio inflows

## Case of Macedonia – possibilities for development of secondary market

Trading on different market segments (Mil. MKD)



Improving trading on electronic trading platform –OTC (Mil. MKD)



# QE consequences for Western Balkans – Public finances

- ▶ Favorable market conditions for new issuances – **some countries in region exploited the opportunity**

Issuances of Eurobonds				Ratings							
Country	Eurobonds issued beginning from 2009	Maturity	Coupon								
Albania	2010 - 300 EUR mil.	_2015	7.500%								
	2011 - 2.000 USD mil.	_2021	7.250%								
Serbia	2012 - 750 USD mil.	_2017	5.250%								
	2013 - 1.500 USD mil. and 1.000 USD mil.	2020 and 2018, respectively	4.875% and 5.875%, respectively								
Croatia	2009 - 750 EUR mil. and 1.500 USD mil.	2015 and 2019, respectively	6.500% and 6.750%, respectively								
	2010 - 1.250 USD mil.	_2020	6.625%								
	2011 - 1.500 USD mil. and 750 EUR mil.	2021 and 2018, respectively	6.375% and 5.875%, respectively								
	2012 - 1.500 USD mil.	_2017	6.250%								
	2013 - 1.500 USD mil. and 1.750 USD mil.	2023 and 2024, respectively	5.500% and 6.000%, respectively								
	<b>2015 - 1500 EUR mil.</b>	<b>_2025</b>	<b>3.000%</b>								
Montenegro	2010 - 200 EUR mil.	_2015	7.875%								
	2011 - 180 EUR mil.	_2016	7.250%								
	2013 - 80 EUR mil.	_2016	float								
	2014 - 280 EUR mil.	_2019	5.375%								
	<b>2015 - 500 EUR mil.</b>	<b>_2020</b>	<b>3.875%</b>								
Macedonia	2009 - 175 EUR mil.	_2013	9.875%								
	<b>2014 - 500 EUR mil.</b>	<b>_2021</b>	<b>3.975%</b>								

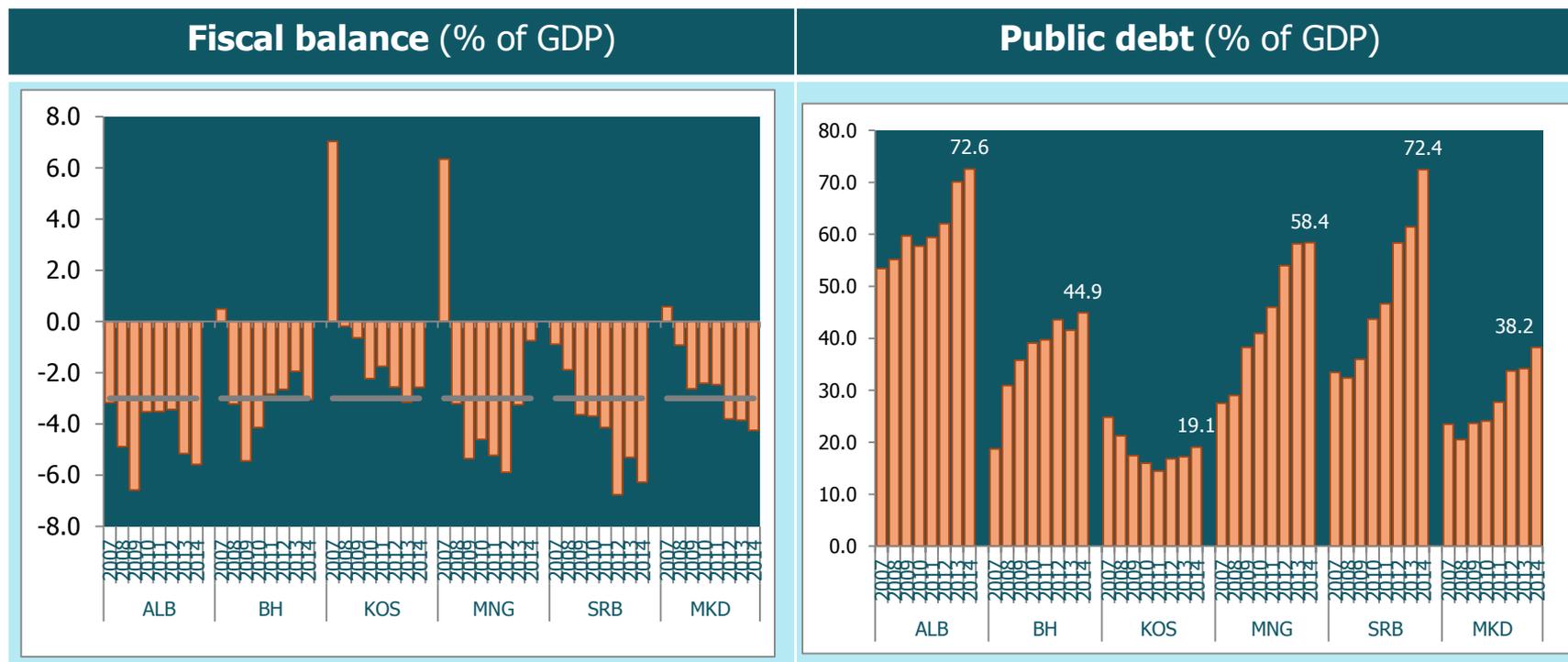
  

	2007	2009	2010	2011	2012	2013	2014	2015
Albania	B1	B1	B1	B1	B1	B1	B1	B1
			B+	B+	B+	B	B	B
Bosnia and Herzegovina	B2	B2	B2	B2	B3	B3	B3	B3
		B+	B+	B	B	B	B	B
Croatia	Baa3	Baa3	Baa3	Baa3	Baa3	Ba1	Ba1	Ba1
	BBB	BBB	BBB-	BBB-	BB+	BB+	BB	BB
	BBB-	BBB-	BBB-	BBB-	BBB-	BB+	BB	BB
Montenegro		Ba3	Ba3	Ba3	Ba3	Ba3	Ba3	Ba3
	BB+	BB+	BB	BB	BB-	BB-	B+	B+
Serbia						B1	B1	B1
	BB-	BB-	BB-	BB	BB-	BB-	BB-	BB-
	BB-	BB-	BB-	BB-	BB-	BB-	B+	B+
Macedonia	BBB-	BB	BB	BB	BB	BB-	BB-	BB-
	BB+	BB+	BB+	BB+	BB+	BB+	BB+	BB+
	Moody's		S&P			Fitch		

Source: Bloomberg

# QE consequences for Western Balkans – Public finances

- ▶ However, **fiscal space in region is limited** due to deficits and public debt levels
- ▶ **Macedonia and Kosovo have the lowest public debt levels**



Source: IMF, internet pages of CB

# QE consequences for Western Balkans – Monetary policy

- ▶ Activity of euro „peggers“ will **benefit** from the more **depreciated exchange rate**, while **floaters** have **room to ease monetary policy without risking capital flow reversals**

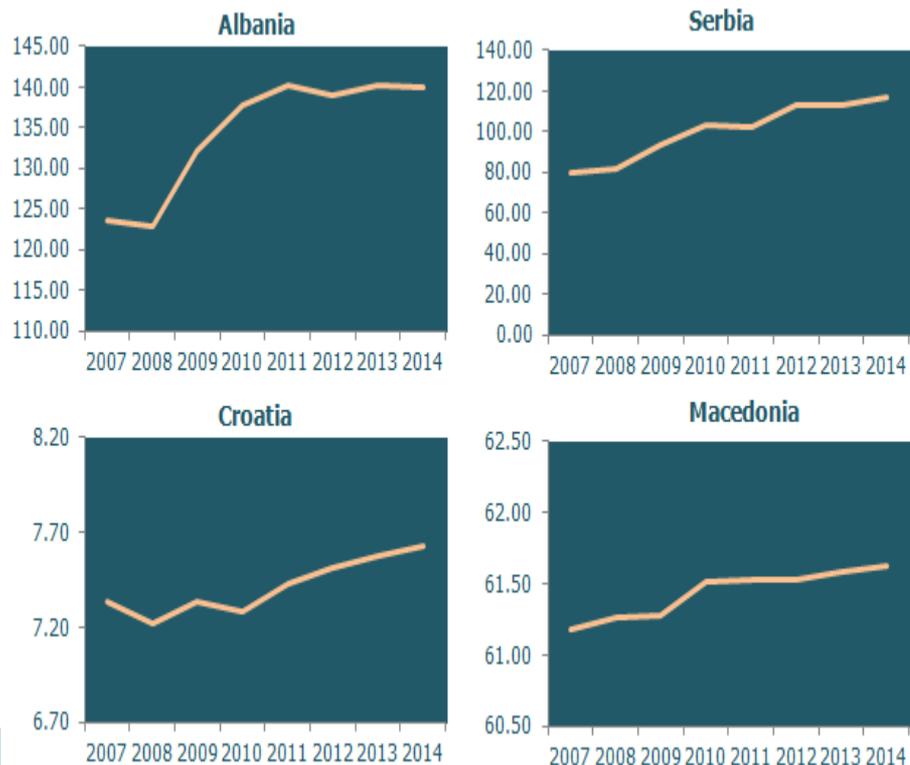
	Currency	Monetary policy framework	Exchange rate arrangement	
			de jure	de facto
Albania	Albanian lek	inflation targeting	free float	float
Bosnia and Herzegovina	Convertible marka	exchange rate anchor to EUR	currency board	currency board
Kosovo	Euro	exchange rate anchor to EUR	no separate legal tender	no separate legal tender
Montenegro	Euro	exchange rate anchor to EUR	no separate legal tender	no separate legal tender
Serbia	Serbian denar	inflation targeting	free float	float
Macedonia	Macedonian denar	exchange rate anchor to EUR	float	stabilised arrangement

Source: EU Enlargement –recent economic developments and challenges for EU membership

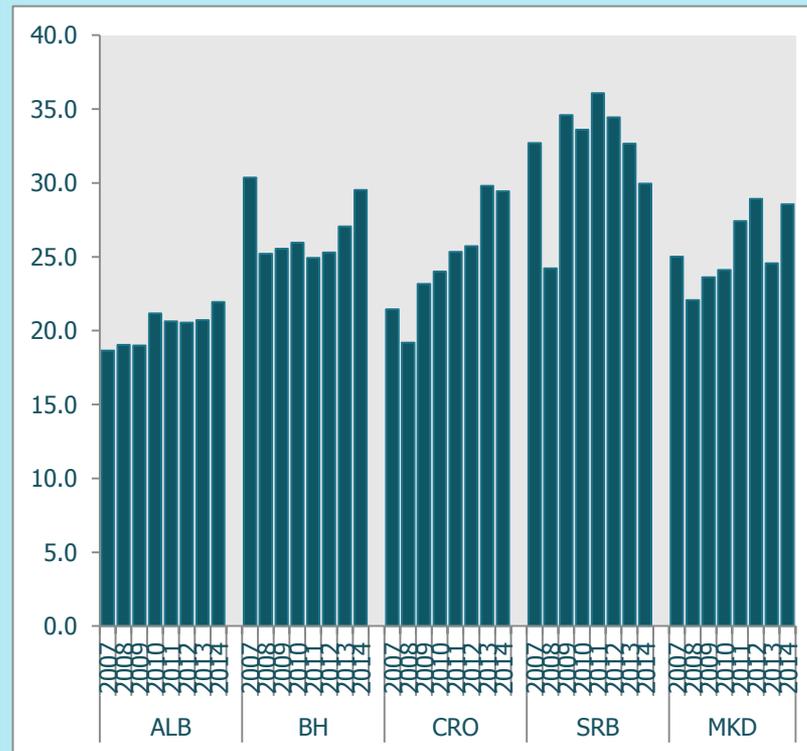
# QE consequences for Western Balkans – Monetary policy

- ▶ Different impacts on FX markets among regional countries

**Nominal exchange rates**  
(national currency per EUR)



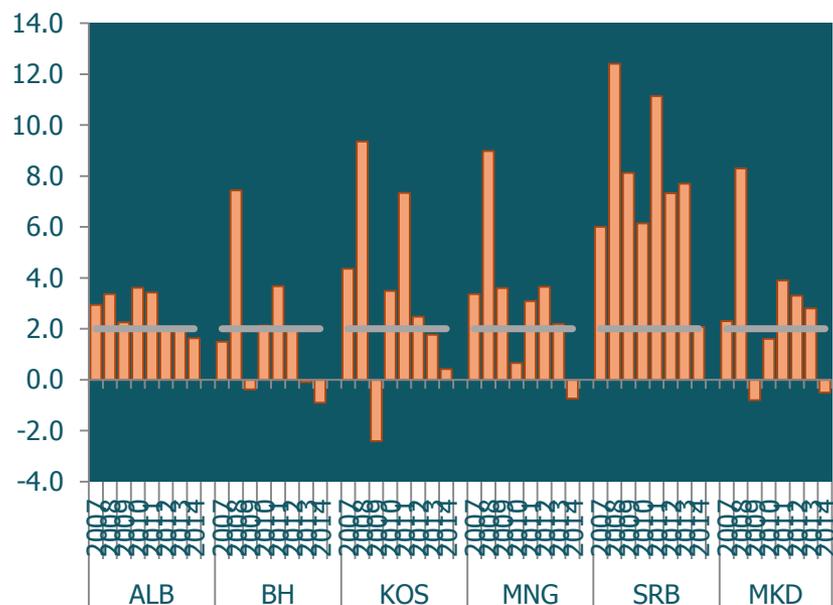
**FX reserves (% GDP)**



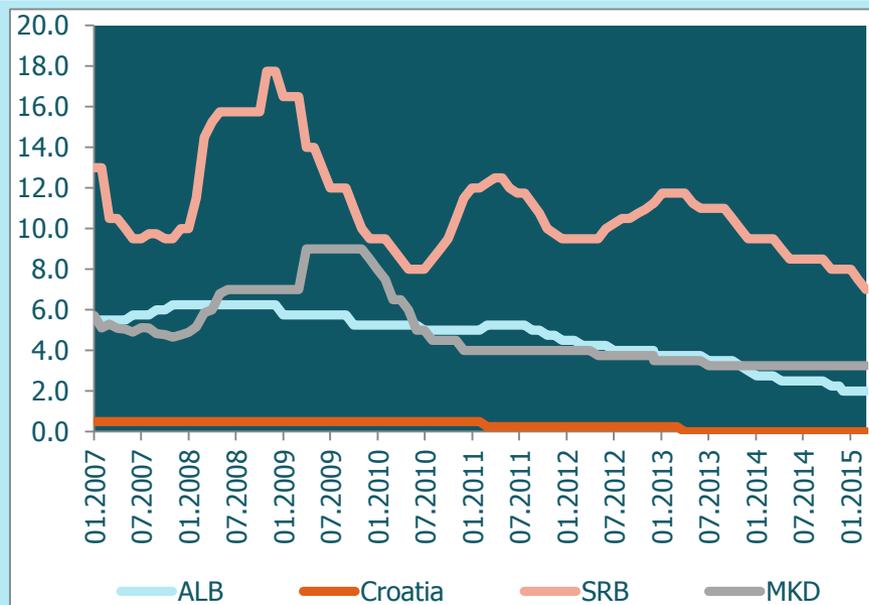
# QE consequences for Western Balkans – Monetary policy

- ▶ Western Balkans experiencing period of historically low inflation
- ▶ Monetary policy stance is eased to historically low levels
- ▶ **Thus, double effect of ECB QE thought monetary policy**

### Inflation (%)



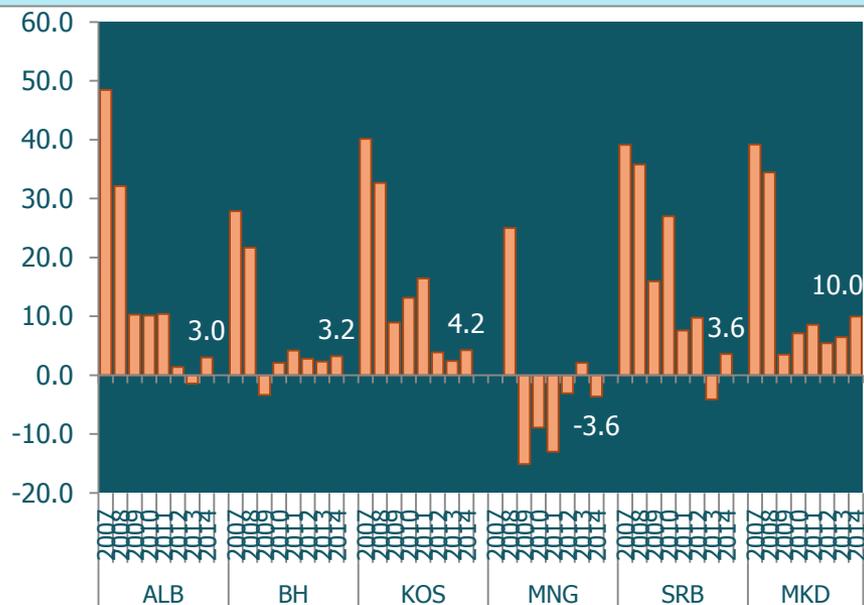
### Interest rates of Central banks (%)



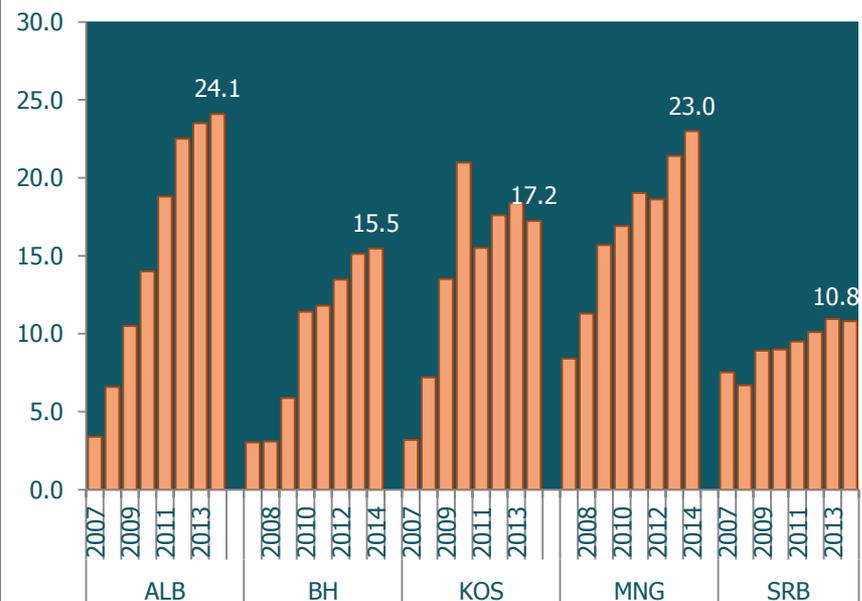
# QE consequences for Western Balkans – Banking system

- ▶ Possibility of „hot potato“ effect and intensification of credit activity
- ▶ Macedonia has the strongest credits growth and lowest NPLs level

Credit to private sector (%)

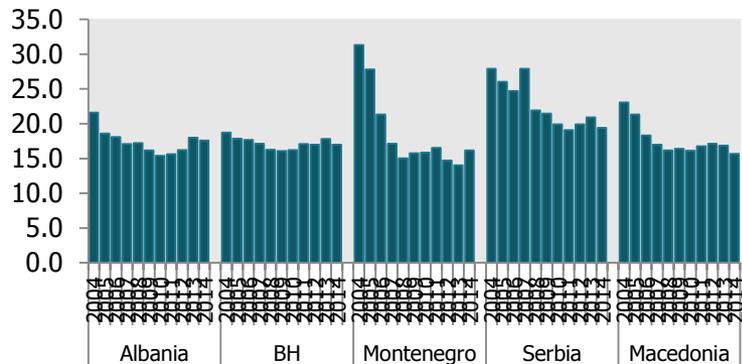


NPLs(%)

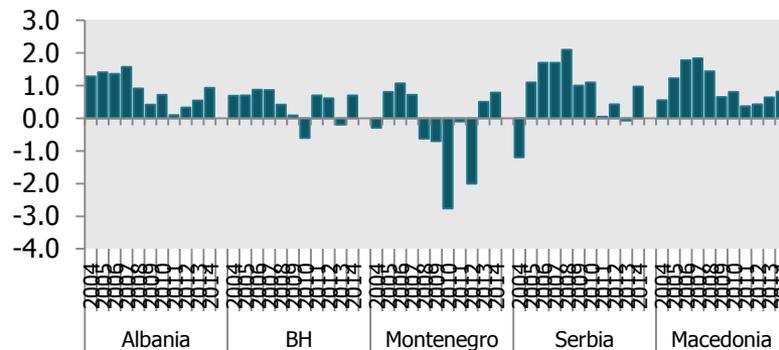


# QE consequences for Western Balkans – Banking system

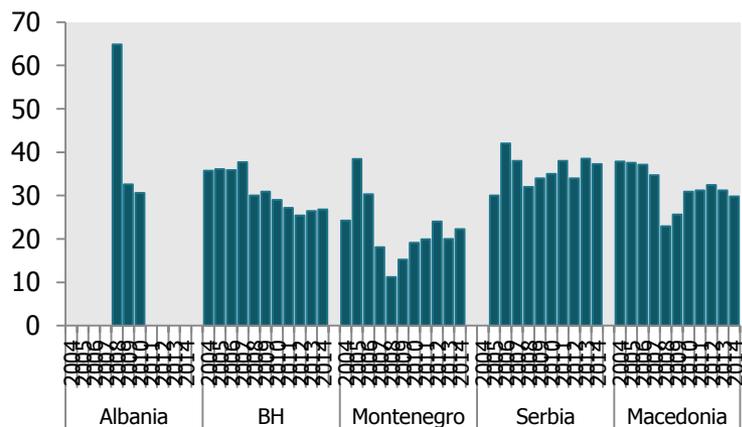
## Capital to risk-weighted assets (%) is high



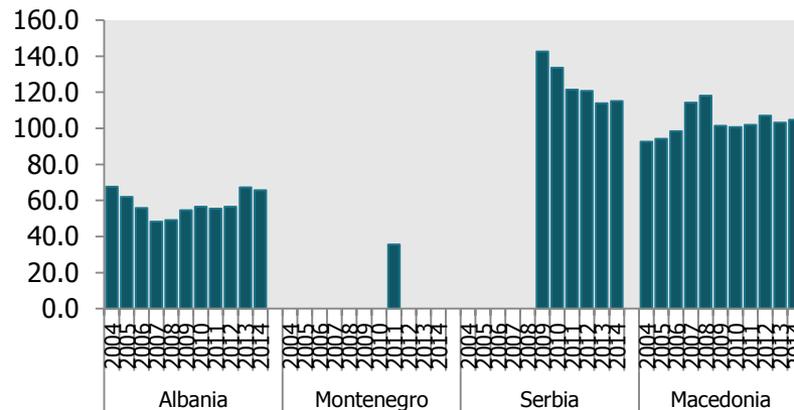
## Return on assets (ROA, %) is recovering



## Liquidity ratio (liquid assets to total assets) is high



## Coverage of NPLs with provisions - fully



# QE consequences for Western Balkans – Banking system

## Case of Macedonia

- ▶ **Relatively low share of external funding in total funding** (9,5%; Q4 2014) shielded our banks from broader deleveraging trends among European banks.;
- ▶ **The subsidiaries of European banks account for 52,76% of the banking system assets and some are systemically important for Macedonia**, but still account for a minor share of the overall group assets (parent banks are from Greece, Slovenia, Austria, and France)
- ▶ **Local subsidiaries are well capitalized, liquid and have limited exposure to parents;**
- ▶ **Their funding structure is mostly based on local deposits -** the funding liquidity risks remain low (loan-to-deposit ratio below 0.9, high share of time deposits 72,8% in total deposits, liquid assets to total assets ratio 29,8% which is higher than the pre-crisis level 2014) ).
- ▶ **The capital adequacy ratio is** 15.7 percent (with tier 1 capital at 13.7 percent)

# QE consequences for Western Balkans – Banking system

- ▶ Countries undertaking monetary and macro prudential measures to **boost credit activity – changes in RRs**

Country	Reserve requirements	Changes (beginning from 2008)
Albania	10%	
Serbia	5% - liabilities in dom. currency up to 2y 0% - liabilities in dom. currency over 2y 26% - liabilities in FX currency up to 2y 19% - liabilities in FX currency over 2y 50% - liabilities in FX currency – FX currency-indexed liabilities in dinars	The RR base has been reduced for certain loans approved in 2008-2014. In 2010, RR base in FX currency was extended by FX-indexed dinar liabilities. In 2011, maturity differentiation of dinar and FX currency RR ratios. Increase of foreign currency RR, which is allocated in dinars. At end of 2014 and at beginning of 2015, CB lowered the RR in FX currency.
Croatia	12%	Cummulative decrease of RR ratio by 5 p.p. In 2011, termination of the RR remuneration
Montenegro	9,5% - on part of the base comprised of demand deposits and deposits with the agreed maturity up to 1y 8,5% - on part of the base comprised of deposits with the agreed maturity over 1y	In 2011, decrease of RR ratio by 0,5 p.p.  In 2011, decrease of RR ratio by 1,5 p.p.  In 2014, decrease of the remuneration amount
Macedonia	8% - liabilities in domestic currency 20% - liabilities in domestic currency with FX clause 15% - liabilities in foreign currency	In 2013, decrease by 2 p.p.  Differentiation by currency from July 11, 2009 onwards.  Cummulative increase for 5 p.p.

Source: Central banks

## **QE consequences for Western Balkans – Banking system Macroprudential measures – Case of Macedonia**

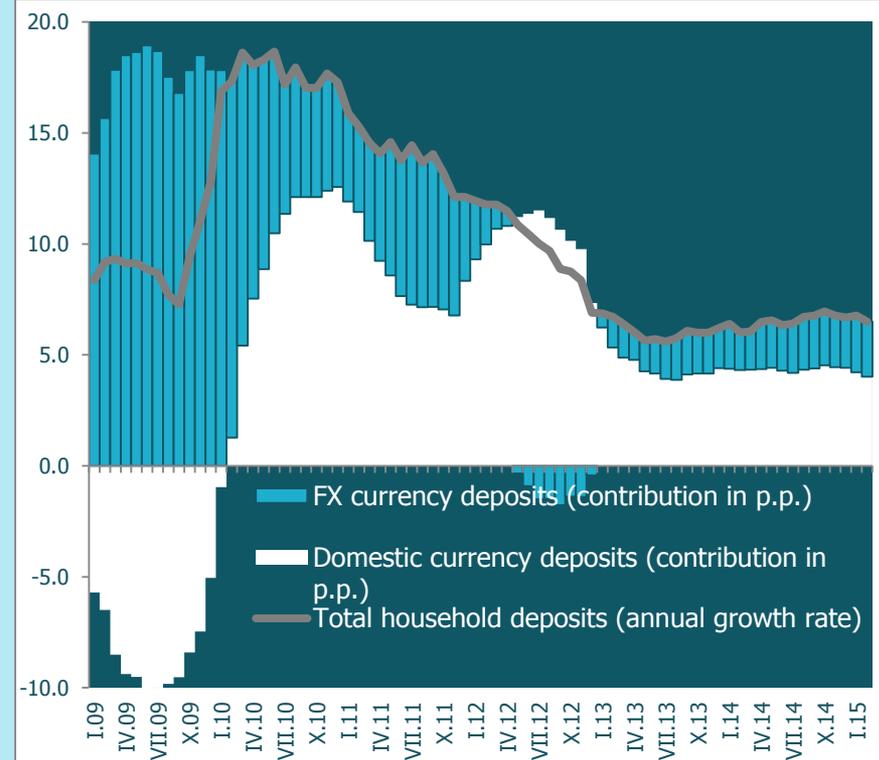
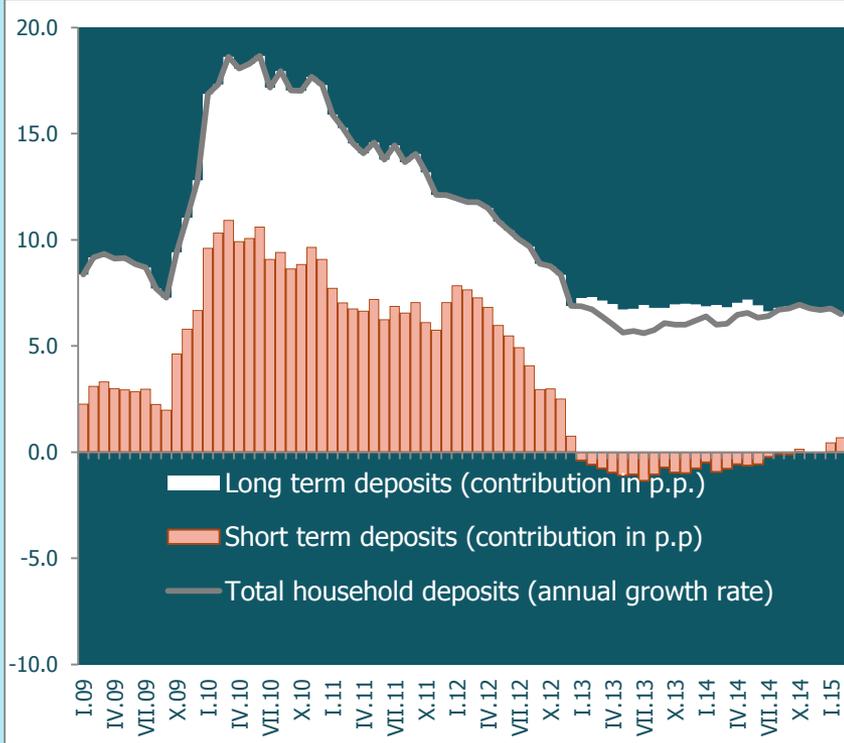
- In 2012 and 2013, NBRM undertook few **changes in the RR structure** in order **to address some structural issues** in the Macedonian economy and banking system:
  - ✓ **Lowering maturity mismatch in banks balance sheet**
  - ✓ **Boosting credit supply to systemically important sectors**
  - ✓ **Decreasing systemic risk in banking sector – decreasing euroization**
  - ✓ **Broadening of the scope of banks funding sources and establishing new market segments**

# QE consequences for Western Balkans – Banking system

## Macroprudential measures – Case of Macedonia

**Lowering maturity mismatch in banks balance sheet created from dominance of the short-term deposits** - sep.2011, introducing 0% for banks liabilities to private persons with contractual maturity of over 2 years

**Decreasing systemic risk in banking sector by lowering the share of FX deposits for efficient monetary transmission** -jul.2013, encouraging domestic currency savings by lowering the RR rate for liabilities in domestic currency (from 10% to 8%)

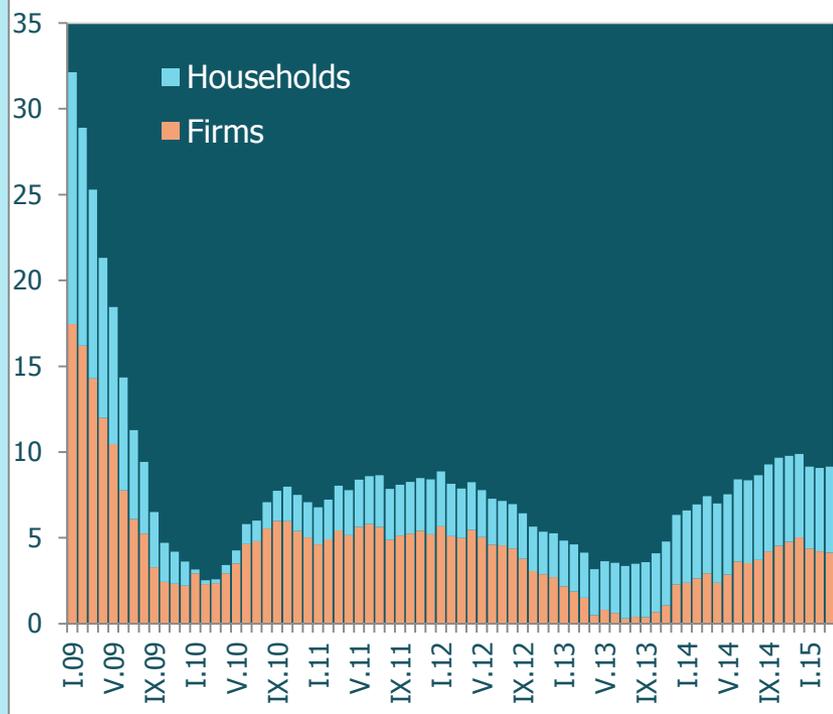


# QE consequences for Western Balkans – Banking system

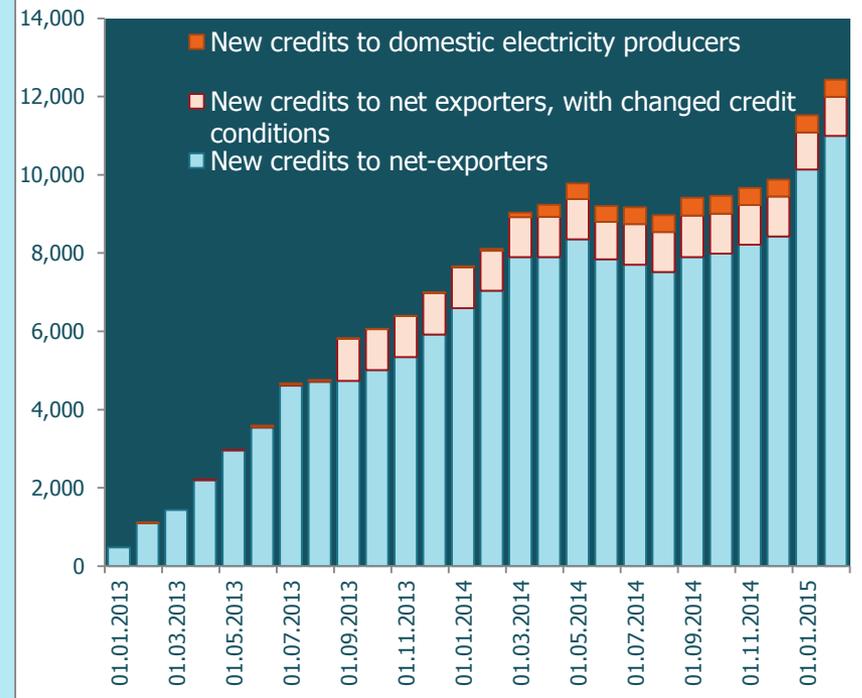
## Macroprudential measures – Case of Macedonia

### Credit to firms improved after the application of the measure

Contribution to annual credit growth rate (in p.p)



### Increased credits to systemically important sectors net exporters and domestic producers of electricity - nov.2012, possibility to decrease RR for the amount of newly granted credits to those sectors



# Transmission channels and challenges ahead

## ▶ **QE can work through a variety of channels**

- **Foreign trade and exchange rate channel**
- **Second-round real sector effects**
- **FDIs and remittances**
- **Interest rate channel**
  - however, still low demand and high NPLs in some countries with unstable cross-border flows from parent banks may limit effectiveness in Western Balkan countries
- **Portfolio re-balancing channel**
  - lowering yields of regional financial instruments –but still attractive
  - however, the level of development of domestic debt and equity markets is limiting factor
  - and poses risk of „unintended consequences“ – reduce incentives to pursue fiscal consolidation
- **Balance sheet effect**
  - influence in opposite direction as it rises cost of servicing of non-euro foreign currency denominated debt

## ▶ **Looking ahead – What needs to be done?**

- **Preserving macroeconomic stability** – optimal mix of monetary and macroeconomic policies is crucial
- **Undertaking significant structural reforms** to improve access, reduce inefficiencies and strengthen stability of the financial systems.

**THANK YOU FOR YOUR ATTENTION!**

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