

THE PROCESS OF DE-EUROISATION IN THE MACEDONIAN BANKING SECTOR IN THE PERIOD OF SOVEREIGN DEBT CRISIS

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ABSTRACT

Like in other Balkans countries, euroisation in Republic of Macedonia, was a process which started with the introduction of euro in EU, first by setting the euro as official anchor towards Denar as Macedonian national currency, and later on by increasing use of euro in deposit and credit activities of Macedonian banks.

However due to the shocks created in the period of the post financial crisis and sovereign debt crisis in the countries of Eurozone, the process of de-euroisation has started-first in the Macedonian banking sector and later in other sectors of the Macedonian economy.

This paper aims to present the effects of the process of de-euroisation in Macedonian banks, analyzing this phenomenon in three different items of banking sector balance sheets: liquid assets, credit portfolio and deposit base, through the methods of comparative and trend analysis.

Key words: euroisation, de-euroisation, macro-prudential measures, FX-component

Introduction

Euroisation is voluntary, market forces driven use of the euro in the domestic monetary system alongside the national currency.¹ Moderate euroisation is an inevitable process accompanying the globalization of the world economy, and predominantly reflects the growth of efficiency in the country's financial sector.

The euroisation of the EU countries outside the euro area and candidate countries is encouraged by the progress in financial markets integration, harmonisation of legislation and increasing free movement of capital and labor.

However, the recent sovereign debt crisis and negative impact which was made on the EMU members put forward a question of euro survival and many countries in Europe outside the euro-zone, started the process of so called de-euroisation.

Was the process of de- euroisation necessary in the Macedonian banking sector?

By maintaining a fixed exchange rate of Denar against the Euro, as a central pillar of monetary strategy, the relevance of Euro in the Macedonian banking sector was even more emphasized. Namely, Euro became the most common currency of the assets and liabilities with a currency component, which was one of the contributors to reduce the currency risk as a factor to the stability of the Macedonian banking system.

However, the Macedonian economy, as a small and open economy, is inevitably sensitive to developments in the international environment. Therefore, the turbulent external environment and the high degree of uncertainty regarding the future development of the debt crisis in the Euro area, and survival of euro currency, forced the banks in the Republic of Macedonia to manage and maintain their security and stability. Namely, after some years of moderate to extensive use of euros in banking activities, as of 2011 year, Macedonian banks started the process of de-euroisation, decreasing the level of liquid assets, deposits and placing loans in FX currency mostly in euro.

¹ Sandrine Levasseur “Why not Euroisation” Economist at the OFCE Economic Research Department, Special issue, April 2004, pg 125

Macedonian banks and national banking authorities have realized that more extensive use of foreign currency would not bring along additional monetary policy stability, but on the contrary, it might create an unjustified increase of social costs and risks to the financial system. It was also realized that the extensive cash substitution would decrease seigniorage and add costs of organizing the co-circulation of foreign cash and will also increase the likelihood of a systemic financial crisis. Even more, the assumptions were that the widespread growth of foreign currency denominated deposits would increase the vulnerability of the banking sector to market risks or costs of risk covering. There was also a threat, that the greater imbalance of the financial sector's net foreign currency position would reduce the possibilities of the central bank to grant last resort loans, which would increase the vulnerability of the banking system. And finally, the growth of systemic risk in financial intermediation in turn could affect the overall risk margin and increases domestic interest rates, which could be prevent with the increased use of national currency, and thus decreased participation of FX currency, in particular euro, in banking sector's balance sheets.

The effect of the de-euroisation process on Macedonian banking sector

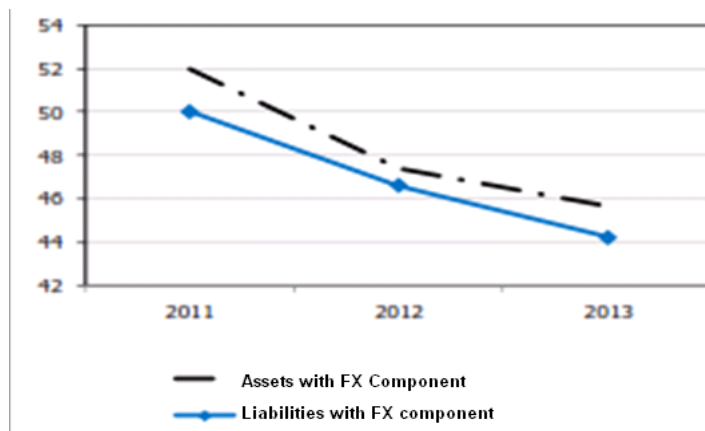
The process of de-euroisation in Macedonian banks is the period of sovereign debt crisis is evident through:

- Decreasing participation of the banks' assets and liabilities with FX component in total assets and liabilities of the Macedonian banking sector
- Decreasing the share of liquid assets kept in foreign currency in favor of increased share of liquid assets in national currency (Denars) kept in the Macedonian banking sector balance sheets.
- The intensive growth of the loans and deposits with domestic currency (Denars) vis-a-vis decreasing trend of the loans and deposits with FX components (foreign currency or Denars with FX clause)

Namely, the process of de-euroisation in Macedonian banks' balance sheets, which accelerated in late 2011, continued in 2012 and 2013, but a little slower on the assets, rather than the liabilities.

The share of assets with a currency component to total assets fell by 4, 5 % in 2012 and by additional 1.7 % in 2013, while the share of liabilities with a currency component in total liabilities decreased by 3, 4 % in 2012 and additional 2.4 % in 2013. (Picture 1).

Picture 1 Participation of the banks' assets and liabilities with FX component in total assets and liabilities



Source: NBRM Annual Banking report

Beside the uncertainty of the euro surviving, the monetary authorities measures which led to increasing the difference between yields of Denar and of foreign currency liquid financial assets, also affected the currency structure of the banks' liquid assets. Namely, by the end of 2011, the liquid assets augmented by 8.8% which is mostly due to the rise in the Denar liquid assets by 12.5%.

Furthermore, in 2012, the share of Denar assets in the structure of liquid assets increased by 4.1 %, reaching 70.0%, while foreign currency liquid assets at the end of 2012 registered an annual decline of 2.6%. The decrease of foreign currency liquid assets was even more significant in 2013, when it was registered the decline of 6% compared to the previous year.

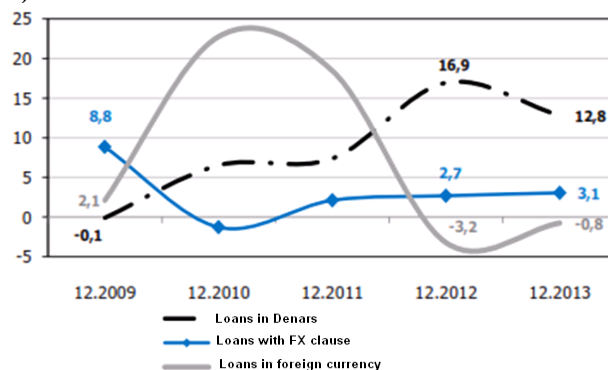
The lower preference of banks to place new sources of funding in foreign currency liquid assets can be seen from the ratio between the annual change in foreign currency liquid assets and total sources of funding, which for the most part of 2012 and 2013 was negative reaching -9%, at the end of 2013.

Banks' preference to convert foreign currency liquidity in Denar financial assets was particularly notable in the first quarter of 2012, which corresponds with the period of greater turbulence on international financial markets due to the developments in the euro area. In contrast, the ratio between the changes of Denars liquid assets to total funding sources during 2012 was significantly higher, compared to 2011, reaching 11% at the end of 2013 comparing with the previous year.

Analyzing the level of de-euroisation of the Macedonian banking sector by currency aspect of its credit and deposit structure, it can be said that it much more visible at deposits rather than credit portfolio side.

The de-euroisation related to credit portfolio, was perceived through the reduction of foreign currency loans and slower growth of loans with FX clause, (in both cases dominantly pronounced by households) , experiencing in the same time , significant increase of the loans in national currency over the whole analyzed period . (Picture 2)

Picture 2: The trend of growth of loan portfolio in the Macedonian banking sector (2009-2013) (analyzed by currency aspect)



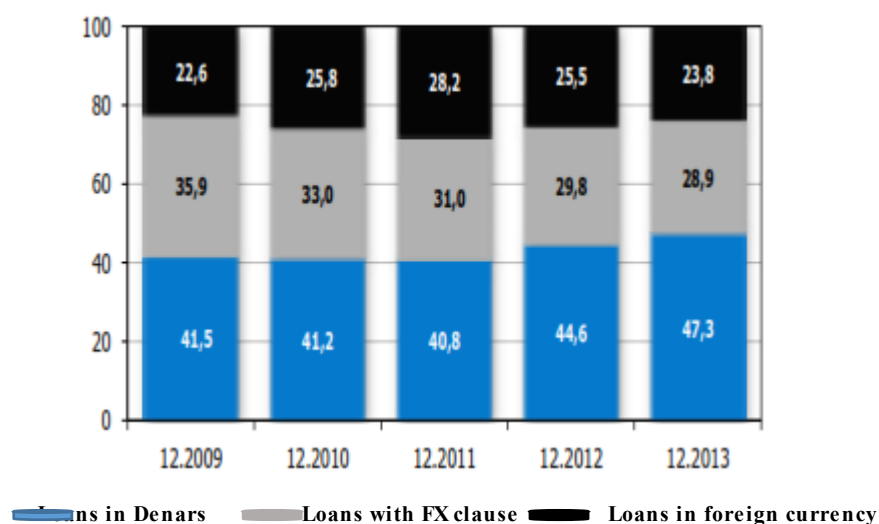
Source: NBRM Annual Banking Reports

More precisely, the trend of growth of loans in Denars, vis-a-vis loans in foreign currency (over 90 % in Denars) have reversible path. Namely in 2010 , the growth of the loans in foreign currency reached its pick, increasing by 22,7% comparing with the previous year, the next 2011 their growth was 18,2% , while in 2012 and 2013 they marked negative growth of -3,2% and -0,8 % respectively.

On the other side, in 2010 and 2011, the loans in Denars were continuously growing by 6-7% each year , reaching its pick in 2012 registering double-digit growth (of 17%) for the first time after 2008. The next 2013 the double-digit growth continued, with the rate of 12, 8%. Thus, Denar loans fully determined the overall annual credit growth, unlike previous years when loans with currency component caused most of the growth.

Analyzing the Credit structure by currency, the situation is little different. Namely in 2010 and 2011 the credits with currency component (foreign currency credits and Denar credits with FX clause) remains dominant making up 57%- 59% of total credits. In 2012, accelerated growth of Denar loans increased their share in the currency structure of loans, which equaled 44.6%, while the loans with a currency component constitute 55.4%, thus dominating the structure of total loans. The FX component loans were still dominant in 2013, but their contribution decreased at the level of 52,7%, while the Denars loans participated with 47,3% in total credit portfolio. (Picture 3)

Picture 3: Currency credit structure of Macedonian banking sector (2009-2013)



Source: NBRM Annual Banking Reports

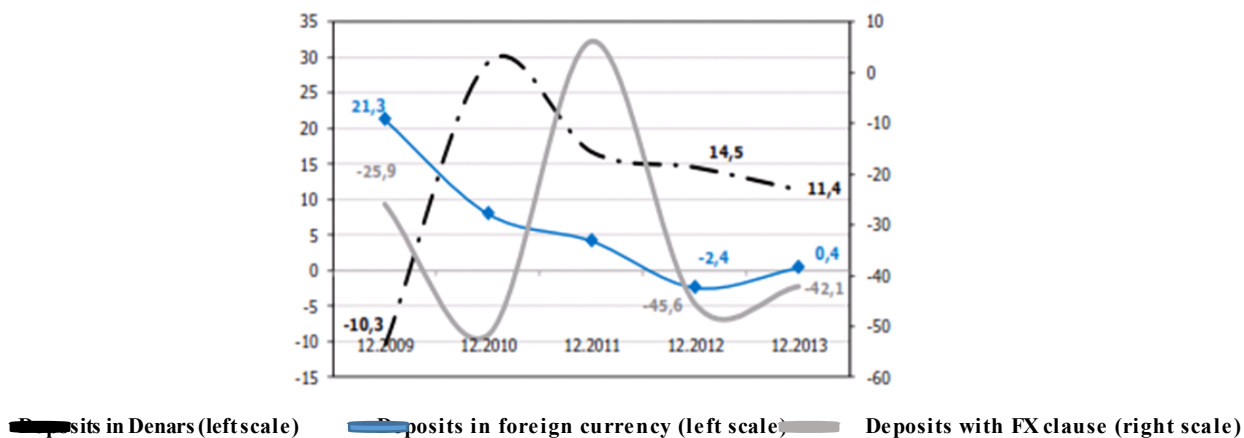
The process of de-euroisation at the banks' deposits are even more evident since their currency structure was driven by the uncertainty about the euro area debt crisis, the attractiveness of the deposit interest rates on Denars savings, with parallel lowering the interest rate on euro savings, as well as the introduced measures regarding differentiating the rates of reserve requirements. Namely, during the period 2011-2013, the National bank of Republic of Macedonia introduced different rates of reserve requirements regarding the currency aspect of the banks' deposits which are amounting as follows: 10% of deposits in domestic currency and then decreased at the level of 8% as of 08.01.2013 year; 20% of deposits in domestic currency with foreign currency clause; 13% for deposits in foreign currency which was changed to 15% from 01.08.2013 year with exception for deposits of non-residents - financial institutions in foreign currency with contractual maturity of one year, for which the reserve requirement rate remained 13%. This measure stimulates the banks to increase the deposits interest rate gap in favor of Denars deposits, since the reserve requirements rate for deposits in foreign currency is almost twice higher than the same rate for Denars deposits.

Thus, the process of de-euroisation became more evident in Macedonian banks deposit base, which can be seen if we analyze either the trend of growth, or the deposits currency structure.

Thus, the key feature of the deposit base of the Macedonian banking system is the switch in the depositors' preference to save in domestic currency, which started in 2010 (as an influence of the turbulences in Eurozone and then continued in the next years), making Denars deposits increased faster compared to deposits with FX component. Namely, the faster growth of Denar deposits comparing the one to foreign currency which was started in 2010 (registering growth rate of almost 30%, continued in 2011 with growth of 16,7, and 14,5 and 11,4% for 2012 and 2013 respectively. Foreign currency deposits on the other hand which increased by 21% in 2009, couldn't keep the same trend, and registered growth rate of only 8% and 4,2% for 2010 and 2011, while in

2012 registered negative growth of 2,4% and kept the foreign deposit base almost at the same level for 2013 . (Picture 4)

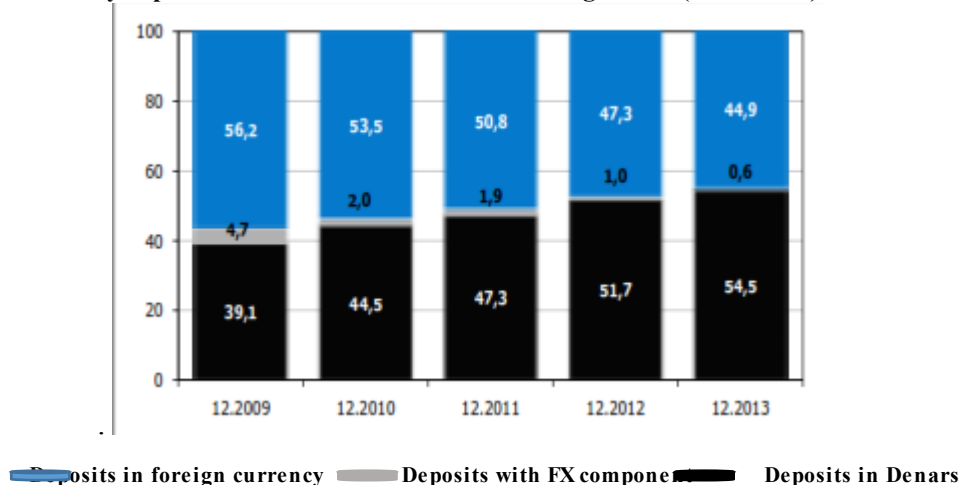
Picture 4: The trend of growth of deposits in the Macedonian banking sector (2009-2013)
(Analyzed by currency aspect)



Source: NBRM Annual Banking Reports

Analyzing deposit base structure by currency aspect, the deposits with FX component were continuously decreasing their participation in the total deposit base, participating with 61% in 2009, and registering only 45, 5% contribution in 2013. Thus , as of 2012 the Denars deposits have the largest share in the total deposit base contributing with 51,7% , while in 2013 , they registered relative figure of 54,5% in total deposit base, mostly due to the increased household savings .(picture 5)

Picture 5: Currency deposit structure of Macedonian banking sector (2009-2013)



Source: NBRM Annual Banking Reports

CONCLUSION

The process of euroisation in Republic of Macedonia practically started by accepting the Euro as the exchange rate anchor(2002), and later on by obtaining the status as EU candidate country at the end of 2005. The geographical proximity of the euro area and having close trade, and financial relationship with several EU countries, accelerated the wide acceptance of Euro parallel with domestic national currency. Therefore most of the loans, deposits and liquid assets of Macedonian banking sector balance sheets were kept in euros.

However, analyzing the euroisation's side effects, as well as the turbulences in the Eurozone, which created uncertainty about Euro survival, Macedonian authorities were forced to create some macro-prudential measures (differentiation of reserve requirements rate depending on currency of

the banks' deposits, tightening the limits of the banks' net open foreign exchange positions) which initiated the process of de-euroisation . As the result of these measures, as of 2011, the share of foreign currency component in loan portfolio, deposit base as well as liquid assets continuously declines, keeping the same trend in the current year.

However, having a status of EU candidate country, it can be expected that some level of moderate euroisation in Republic of Macedonia is likely to continue, but still with increasing participation of denar deposits and credits activities among financial intermediaries.

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