

Vladušić Ljubiša: Recent developments in the Central Bank of Bosnia and Herzegovina

Speech by Mr Vladušić Ljubiša, Vice Governor of the Central Bank of Bosnia and Herzegovina, at the 9th Meeting of the Governors' Club in the Region of Black Sea, Balkans and Central Asia, Bucharest, 23 May 2003.

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Thank you Mr. Chairman, Your Excellency, Ladies and Gentlemen,

I wish to pay my respect to you all on behalf of the CBBH.

I will speak about several key development components which have represented current issues in the CBBH since the last meeting.

Currency Board Arrangement

In the period since its establishment to date, the Central Bank of Bosnia and Herzegovina has developed according to the Basic Principle of Monetary Policy, this being the Currency Board Arrangement.

The Currency Board in BiH has been set up on very clear principles:

- stability of the local currency and its issue and withdrawal from circulation;
- fixed exchange rate with full coverage in free convertible foreign exchange funds;
- management of foreign exchange reserves in a safe and profitable way;
- setting up and maintaining payment and settlement systems;
- coordination of activities of banking supervision agencies;
- provision of the required reserve maintenance.

By conducting such monetary policy, we have achieved the following results:

- confidence in the local currency;
- stable exchange rate;
- growth of foreign exchange reserves which have now stabilized at around EURO 1,1 billion, which is a four-month imports coverage;
- price stability;
- decrease of inflation, which is now slightly above zero;
- improvement of the country's payment foreign exchange position;
- stability of public sector.

During the previous months, there has been a discussion in BiH whether we should keep such strict Currency Board rules. The International Conference was organized in April on the Role of the Currency Board in Monetary Policy - History and Practice. Some of the participants were representatives of East European countries which have their monetary policy based on Currency Board. The basic opinion expressed during this Conference was that Currency Board was successful in all these countries, but also that Currency Board in those countries was more flexible.

As a result, the opinion expressed at this conference, and also that of the Central Bank and BiH authorities is that BiH should keep the Currency Board set up as presently, with the aim to provide global financial stability, searching additional possibilities to make the Currency Board serve development and to enable the Central Bank to participate more actively in the financial sector and to issue short-term securities.

The additional reason is that the Currency Board Arrangement is important for BiH economy and it is a base for continuation of maintaining and improving financial stability, through which the development of other sectors of economy is influenced.

Required reserves

The required reserve is the only instrument of monetary policy available in BiH, within the Currency Board Arrangement. The purpose of the required reserve is to provide appropriate liquidity of the banking sector and accomplish the global financial stability in the country.

One of the most significant changes in monetary policy which is related to required reserve will start as of 01 June.

The goals to be achieved by the suggested measures are the following:

- efficiency and stability of monetary policy within the Currency Board arrangement. The aim is to give more flexibility to the CBBH so that it can react to prompt changes in the surrounding;
- harmonization aimed at adjusting the regulations on the required reserve to the European standards; and
- financial stability, meaning that global financial stability should be increased by means of banks' required reserves.

In order to achieve the mentioned goals, the CBBH has made four changes in the implementation of banks' required reserves:

1. The base for required reserve is expanded to include also foreign exchange deposits, in addition to KM deposits.

The defined required reserve in the previous period (10% on deposits and borrowed funds in KM) fulfilled its function and did not endanger the liquidity. However, as only local currency KM was included in the base for required reserve settlement, it resulted in unequal position of the local currency compared to deposits in foreign currency.

2. Cash held by banks in their vaults will no longer be eligible for maintenance of required reserves. It will be possible to meet the requirement only with deposits held by banks in the reserve accounts with the CBBH.

3. Now, the CBBH can determine the rate at any level within the scope of 0-20%. This change will provide more flexibility to our Governing Board.

The required reserve rate has already been defined. From 01 June, it will be 5% on the expanded base, instead of the previous 10% on KM deposits.

4. The Central Bank has more flexibility to determine compensation to be paid to banks on reserve deposits.

Results of monetary policy

The successful monetary policy has influenced the improvement of situation in the banking sector. The consolidation of the global banking sector has taken place, as it follows:

- privatization of banks has been completed;
- minimum capital requirement was increased to KM 15 million;
- merger of banks;
- considerable increase of assets and capital;
- increase of credit potential;
- introduction of new products and services;
- deposit insurance;
- increase of the volume of payment transactions.

The privatization of the banking sector is in its final stage. The share of the state capital in the banking sector is around 10%.

Consolidation of banking sector is obvious. Out of 55 banks in 2000, 40 banks are currently operating in BiH. Share capital in 2002 amounted to KM 745 million and was higher by 19% compared to 2001.

The balance sheet assets of banks reached KM 5.535 billion in the end of 2002, and compared to the end of 2001, they were higher by 22% or by KM 995 million. Within the structure of assets, the most important is the share of loans amounting to 55%.

In the total liabilities, deposits take 75%, and capital takes 15%.

Financial sector in BiH is estimated to have accomplished satisfactory results and that the situation in this sector is much healthier than in the previous period.

New initiatives

Initiative has been started in BiH for the establishment of capital market, as one of the segments of the total financial system. In this respect, guidelines for work have been set up. Accordingly, Capital Market Council has been recently established and its work scope defined. The Council will have an advisory role and discuss the issues related to securities and capital market, guided by the international standards and principles in this field.

Finally, the independent monetary policy in BiH, legislation and supervision of the banking sector represent a good base for further improvements in this field and the base for preparations for joining the European Union. Adherence to the international standards, principles of the Basle Committee and the norms of the European Union are necessary for further progress and strengthening of financial stability.

Thank you for your attention.