

Dimitar Bogov: Challenges of countries from South-Eastern Europe in the current economic and financial turbulence in the euro area

Opening speech by Mr Dimitar Bogov, Governor of the National Bank of the Republic of Macedonia, at the NBRM conference on the occasion of the 20th anniversary of the monetary independence of the Republic of Macedonia, Skopje, 27 April 2012.

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Dear Deputy Prime Minister, dear ministers, distinguished Governors, Your Excellences, dear guests, colleagues and friends

It is an honor to greet you and wish you welcome to this conference, which is a part of the activities for marking the 20th anniversary of the monetary independence of the Republic of Macedonia. The last two decades of monetary independence, the Republic of Macedonia has faced, and in our opinion, successfully addressed many challenges. Our twentieth anniversary takes place in exceptionally turbulent developments of global economy, particularly marked by events triggered by the euro area debt crisis. This means that as the other central banks from the region, we face a new challenge. Taking into account the timing of the conference, its topic came quite spontaneously, and therefore we consider that it will raise interesting discussion of current issues of the central banks of the South-Eastern Europe and beyond. On this occasion, I will briefly present my opinion on how the region has dealt with the crisis and the lessons learnt, leaving more time for panel discussion and for the presentations of the prominent representatives of international institutions and central banks in the region.

How has the region been dealing with the crisis so far?

In the recent five years of global economic crisis, generally we distinguish two subperiods. The first wave of crisis broke out in the US economy in the second half of 2007 and was primarily marked by the mortgage credit crisis and the collapse of large investment banks, destabilizing the international financial markets and deteriorating the expectations of economic entities. The second wave of crisis hit Europe in mid-2010 and was recognized as euro area debt crisis, causing new financial market disturbances, lower confidence among market participants, higher costs for financing and need of recapitalization of the banking sector. Apparently, the second wave of crisis broke out in the vicinity of our region. Yet, that the countries from the region get over this period relatively unwounded. One of the potential explanations is the fact that unlike the period of first wave of crisis, the countries from the region faced the second wave of crisis with fewer imbalances in their economies, i.e. better prepared to adjust to the external environment.

Facing the outbreak of crisis in the euro area was relatively painless. Yet, it does not mean that the risks have passed. The forecasts for 2012 are also marked by uncertainty and potential adverse effects of the events related to the euro area crisis. Given the generally unfavorable expectations for the European economy, the growth prospects of the countries in the region are also uncertain and accompanied by downward risks, considering the relatively close trade relations with the European Union. The lower external demand, along with the lower capital flows to the region, creates a need of proper adjustment of the domestic demand aimed to ensure sustainable external position. Therefore, some countries will need fiscal consolidation. The growing European debt crisis, the series of downward revisions of credit ratings of several international banks, the volatility of stock markets and the uncertainty clouding the future developments undermined the confidence of investors, in global terms, thus making the issue of deficit financing more pronounced and being treated more prudently.

Besides the macroeconomic performances, the attention has been and will be focused on the financial stability. The new risk to the financial sector triggered by the European debt crisis is either direct or indirect exposure to the Greek debt and the subsequent potential losses. The second risk is attributable to the reduced availability of funding from foreign parent banks, when some of them face the need of recapitalization that refers to additional risks to the intensity of credit activity in the countries from the South-Eastern Europe, particularly those where borrowings from foreign banks played a significant role in the establishment of credit potential. The third risk is induced rather by the effects of the global developments on the gradual deterioration of macroeconomic performances of the economies in the region, and resulted in impairment of the credit portfolio quality of the banking system, which has undoubtedly affected or will affect their future activities and performances.

Let me summarize the first point – the region has successfully dealt with the euro area crisis so far, but the risks remain. Many issues are still open and accordingly, the alertness of policy makers has to remain high.

What are the lessons learnt from the crisis?

The financial crisis shifted many traditional views in the economy, including the role and the objectives of monetary authority, where besides the conduct of monetary policy and the concern for the price stability, there is an obvious need for more active engagement of the central banks in the maintenance of financial stability in the economy. The period of crisis worldwide is full of many successful examples, probably the most so far in the world history, of application of wide range of prudential measures, modifications in the standard set of instruments and implementation of nonstandard measures of monetary policy. The need of comprehensive risks monitoring in the economy and greater flexibility concerning the intensity and the type of measures, taking into account the ultimate monetary objectives, is probably one of the major lessons from the crisis.

The economic theory clearly refers to the fact that the financial system is a relevant factor for economic growth, and the new message, clearly sent by the recent crisis, as the president of the Bundesbank, Weidmann, once said in one of his recent addresses,¹ is that there is a need of “well designed regulatory reform”. Otherwise, a financial system which is developed and widely globalized today could become an obstacle for the economic growth. Thus, even though the crisis is still present in our everyday life, the financial institutions have already been facing new banking standards, and the national regulators seek to incorporate them in the national regulation.

The debt crisis in the euro area resulted in establishment of new fiscal framework of the European Union and emphasized the need of fiscal consolidation. Fiscal imbalances are not sustainable on a long run, which is a postulate that also applies to the countries of the region, particularly countries where fiscal consolidation is crucial for maintaining macroeconomic equilibrium.

Besides the experiences above, during the crisis we also gained many other experiences related to the market sensitivity, the promptness of market response to the changes arising from the development of crisis, and the slow reversible process of regain of confidence among market participants. Lessons and experiences learnt from the crisis should help us face future challenges more successfully.

¹ Jens Weidmann, president of the Deutsche Bundesbank, Keynote speech at the Frankfurt Finance Summit, Frankfurt, March 2012.

Conclusion

Please allow me to ascertain that this crisis broadened our perspectives, imposed new aspects of policy making, and increased our interdependence in the global economy. The South-Eastern European countries which have been facing many challenges on their pathway to the European Union will probably face new future challenges arising from the current conceptual shifts in the Union. However, the countries from South-Eastern Europe should continue seeking to create sound macroeconomic policies, inevitably accompanied by structural reforms that need to ensure higher structural quality and structural flexibility of economies, which is a sine qua non not only for prompter integration to the European Union, but also for sound and sustainable development in a long run.

Distinguished guests,

Today, at this conference, we open up the discussion on issues that have been and will probably remain in the focus of interest of the central banks from the region for a long period of time. We tackle crucial issues which will absorb the attention, energy and available resources of many institutions in the region and beyond, in the period ahead. I would like invite you, through presentations and discussions, to make a modest contribution to the conceptualization and definition of the main approaches to face and deal with future challenges in the region.

Thank you for your attention and have a successful conference!