

Dimitar Bogov: We will need foreign loans also in the coming years

Interview with Mr Dimitar Bogov, Governor of the National Bank of the Republic of Macedonia, in Utrinski Vesnik, conducted by Ms Nina Nineska-Fidanoska and published on 22 August 2013.

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Mr. Bogov, in June, lending grew by only 3.7 percent, which is considered a very low rate. Few months ago, businessmen called for an annual credit growth rate of 8 to 10 percent. Is there a chance to reach that goal and when?

It is usually considered that credit growth should be two times the nominal growth of the gross domestic product. This means that if we want to achieve long-term real GDP growth of some four to five percent and inflation of two to three percent, then certainly I would say that credit growth of 10 to 15 percent is normal and desirable. But we were in a period of slower economic growth, so that the credit growth rate was relatively low in the last year. This year it continued, and in June we had an annual credit growth rate of 3.7 percent. It is low, but in line with our projections. For the entire year we expect credit growth of 7 percent and we believe we will achieve that rate. In June and July we already have a more intensive monthly credit growth compared to the previous months and we expect that trend to continue. For the next year, we are more optimistic, and in our projections we expect credit growth of up to 9 percent.

In July, the National Bank of the Republic of Macedonia made changes in the reserve requirement and also reduced the key interest rate to 3.25 percent, which is the historically lowest level. When do you expect the effects?

We made some changes, so that we reduced the reserve requirement ratio for denar deposits and we increased that for the foreign currency deposits. Our goal is to stimulate denar saving at the expense of the saving in foreign currency, which in this way will become more expensive, while saving in denars will become cheaper. Shortly after that, we reduced the key interest rate to 3.25 percent, thus sending a signal to the banks that there is room for greater lending activity.

Even that small amount of loans does not go to the companies, but mainly to the citizens. Why is that so and when will it change?

In 2009, soon after the outbreak of the global economic crisis, banks here immediately stopped lending to households, while they continued to lend to companies. It allowed banks to clean the loan portfolio of the households, i.e. to eliminate the bad loans in the meantime. Therefore, now they have room to re-start lending to the households, and they are doing it. The process of cleaning the credit portfolios of the companies, however, was left out at that point, so it began more intensively last year, and continued this year. Therefore, we have a small increase in bad loans, which reached about 12 percent. I think this process will slowly wind down. Then, together with the reduction of the risks that banks see in the real sector, and which will come to the surface now after the positive signals from the European economy, lending to companies will become a little more intensive.

In one of its reports NBRM has pointed out that one of the limiting factors for higher credit growth are some conservative strategies in the local banking groups. What specifically did you mean?

Yes, we pointed out the conservative strategies. And it is no secret that here we primarily think of the problems that some of the banks present in Macedonia have in their home countries. Banks in Slovenia and Greece are in serious problems, even though their banks in Macedonia are among the best, by both the quality of corporate governance and the credit risk management, and also the level of capital and liquidity they have is the highest in our

banking system. So, their banks in Macedonia have no impediment to normally work and grant loans.

But don't they grant loans normally?

Well, some of them are quite restrained. We constantly talk to them and they promise to be more active in the market.

Which of them are restrained?

Stopanska Banka has been quite restrained in recent years, but it always had positive rates of credit growth. It has never cut lending. But I must say that NLB Tutunska Banka registered a reduction in the credit growth last year, and this year it continues. I had serious discussions with the Supervisory Board from Ljubljana, where we claimed that such behavior is inappropriate and could adversely affect the reputation of the bank. They promised to reconsider their policy, particularly as there is no reason for NLB Tutunska Banka not to grant loans in Macedonia. The bank does not rely on funding from the parent bank, it is fully financed from its own resources here in the country, it has one of the best credit portfolios, it is profitable, it has excellent liquidity, outstanding quality systems of credit risk management, probably one of the best in the country.

Then why don't they grant loans?

This is the strategy of the parent bank, which must reduce its credit exposure for the entire group, and they impose those targets for all banks in the group proportionally, regardless of the situation in individual banks.

Can our monetary authority tell a foreign bank that it has to increase lending?

The bank should make rational decisions, and the decision they made is irrational because in that way they lose the profits they would make here. It would be more rational for the banks that have problems, to reduce their loan portfolio, while those that have no problems should expand it. And of course, NBRM is a regulator that constantly evaluates the shareholders, i.e. their eligibility to be shareholders in our banks. So there is a ground. We may assess that the shareholder in Slovenia is currently in unfavorable condition and is unable to financially support the bank in Macedonia. Not only financially, but also from a functional point of view. We have not yet made that assessment, but we could. It is an argument that we could use at any time if the shareholders from Slovenia do not perceive the situation here realistically and do not take the right decisions for their bank in Macedonia.

The Euro area is out of recession. You were the most optimistic, even more than the government, and projected growth of 2.2 percent for this year. Do you remain at this projection or will it go up?

The latest projection is still 2.2 percent, although we make a reassessment every month. Currently, developments are somewhat more favorable than those we have taken into account in our projection of 2.2 percent. It is true that at the very beginning we came out with the highest estimate for the economic growth this year. The data available so far suggest that we would be the closest to the actual development, which could be even better. In the beginning, in the first and second quarters, growth in the Macedonian economy was driven by some factors that were not very much related to the situation in the euro area, but our expectations for the second half of the year were that the European economy will recover, and that it will contribute positively to growth. It is true when the companies say that here the effects are felt with a time lag of one to two quarters. So, if in the European economy the second quarter is positive, here it is to give effect in the third and fourth quarters. Some industrial sectors in the country registered growth in the first half of the year, and those are mainly related to the new foreign facilities, while many sectors still have no growth. We expect these facilities to experience the benefits of the recovery in the European economy in the second half of the year.

Mr. Bogov, there are ongoing opinions that as long as we stand “glued” to the fixed exchange rate, the economy cannot get a meaningful flywheel. Have you been thinking about this issue, or you stay firmly at your position – the exchange rate will not be changed?

First, economic theory and practice have shown that economic growth does not depend on whether the exchange rate is fixed or floating. Economic growth depends on economic policies and factors of production. So, completely different factors, other than the exchange rate, affect economic growth. It is irrelevant whether the exchange rate will be fixed or floating, it is important that it is realistically determined. In Macedonia, the exchange rate is on an adequate level, all our analyses show that. Not just our analyses, but the IMF analyses show that, too. After we have determined this, then it is better for a small and open economy, such as the Macedonian, it to be fixed. Why? Because if we have a floating exchange rate, we will have higher inflation and higher interest rates for the real sector. So, I cannot understand those who stand for a floating exchange rate, though they are a minority, because the vast majority already agrees that the current exchange rate regime best suited our economy. And those who are most vocal about the floating exchange rate, are the same ones who claim that current interest rates are high. Well, then they would be even higher. Therefore, I do not see what would be the benefit, how it will contribute to higher growth.

There are opinions that it is easier to be Governor of a fixed rate, that it requires less managing of the monetary policy. Is that so?

It is true. It is easier to manage a fixed exchange rate than a floating one. However, regarding the advantage of a fixed exchange rate for the economy I would point out the experience of Serbia. Serbia has a floating exchange rate and since 2008 the exchange rate has depreciated some 50 percent. During the entire period, however, Serbia has had an inflation of over 10 percent, and the interest rates for the real sector have constantly been around 14 to 15 percent. Therefore, lately, the Serbian Central Bank stabilized the exchange rate, too. Large economies like Turkey or Poland can afford a floating exchange rate, but small economies cannot. It is much better to have a fixed exchange rate and disciplined policies.

A few weeks ago you said that a reduction of the budget deficit to the level that does not increase the public debt should be considered. What did you actually want to say?

I gave the same or similar statement a few times in the past. And it is not very different from what competent ministers think and say. In 2008, after the outbreak of the global economic crisis, we had a large room for fiscal support, because we had a low public debt, previously we had no budget deficit and the fiscal policy significantly supported the economic growth in the period when private consumption and external demand were shrinking. But in the past four years, the level of government debt increased to 34 percent of GDP. Although it is still a moderate level, a gradual reduction of the budget deficit to a level that will stabilize the level of public debt should be considered.

What is the level of budget deficit that is optimal for Macedonia?

There is no clear limit as to that level. Any limit we set might be a mistake. It depends on a number of factors – what is the economic growth in the country, at what interest rate we are borrowing, what is the creditors’ trust in our economy. Therefore, you cannot set a limit and say that if we exceed that level, then the situation is very bad. Generally, when economic growth is slower there is a room for fiscal stimulus and higher deficit, and when economic growth is faster, there is no need for fiscal stimulus and the deficit should be minimized.

Isn’t the Maastricht criterion that level?

The Maastricht criterion of three percent for the budget deficit is set as a criterion in the euro area. It does not mean that Macedonia should meet that level. Perhaps in periods when fiscal stimulus is needed. In the next period for Macedonia, perhaps the level of budget deficit, which would stabilize the public debt, is even lower.

What is the limit that the government debt must not exceed?

There is more room for the government, but that room will slowly be used up. Therefore fiscal consolidation should start to be considered, in order to avoid a situation of starting with the fiscal consolidation after this room is used up. As for the external borrowing, we will have it for a long period. And that is good, because even when we repay old liabilities, it is good to have a new loan that would compensate for that. It is not good to make repayment of the external liabilities overnight, and not to have a new inflow. Then the funds will have to be provided from home, which will adversely affect both the credit and the economic growth. So, we should gradually pay back our debt, but when an old debt falls due it is common to take a new loan to repay the old one, and if it can be reduced, it will be even better.

What will we do when in 2015 an installment of 500 million euros falls due?

The amount that will fall due in the public sector is around Euro 380 million. The rest is in the private sector. We have in mind those payments maturing in the next period. We have the potential, in both the foreign reserves and the economy, and certainly we expect that there will be new loans from abroad, which will repay part of the liabilities that will mature.