Dimitar Bogov: Impact of international regulatory cooperation on the Republic of Macedonia

Opening speech by Mr Dimitar Bogov, Governor of the National Bank of the Republic of Macedonia, at the 36th meeting of the European Banking Federation, Skopje, 7 June 2013.

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Distinguished participants to the 36th European Banking Federation Associates' Meeting,

Dear Guests,

Ladies and Gentlemen,

Let me wish you a very warm welcome at today's meeting. The topic I want to dedicate my welcoming speech on is international regulatory cooperation. The banking system in the Republic of Macedonia is predominantly foreign-owned and consists mostly of either subsidiaries of foreign banks or of banks owned by foreign portfolio investors. Foreign ownership has assisted banks in their efforts to follow sound market practice, develop and maintain high credit standards and receive encouragement and advice from their larger and longer established parent institutions. The global financial crisis and Eurozone debt crisis have not fundamentally changed this relationship. Nevertheless, these exceptional crises do constitute a real challenge for international and global banking. The Vienna Initiative, the framework to safeguard the financial stability of emerging Europe, has been valuable in raising awareness that the deleveraging process in developed Europe should not unduly restrict operations of bank subsidiaries in emerging Europe.

In this context, it is important to note that even before the crises stroke, deposits raised in the Macedonian banking system by the predominantly foreign-owned domestic banks were lent by those same banks to borrowers in the Republic of Macedonia. As a rule, foreign funding, excluding equity and reserves, did not exceed 10% of all sources of financing of the banking sector. There has always been a difference amongst individual banks, a reflection of the different strategies for funding and acquiring sources, yet the overall importance of foreign funding is not in its percentage, but in its long-term nature. This is the premise on which the good business relations between parent banks and subsidiaries is based. When the crises stroke the relative importance of domestic deposits in financing the claims on Macedonian borrowers actually increased.

In the Republic of Macedonia the ratio of loans to domestic GDP is still 47–50%, while the ratio of deposits to domestic GDP is around 55%. These ratios in the developed world tend to be above 100%, which shows the potential for growth. Similarly, the ratio of household debt, including mortgages, to household disposable income, is around 25%, substantially lower than most countries at a similar level of development, also offering opportunities for the banking sector.

Regulatory capital allocation, on average, is 17%, more than two times the legal minimum of 8%. The high capitalisation of banks means they have the capacity to take losses and do not need to evergreen existing loans, but lend to new customers that are more likely to borrow. Strong capital ratios are one of the bright spots of the Macedonian economy.

The Macedonian banking sector comprises 16 banks. This is still a somewhat high number, given the country's population, and above all, the similarity of products banks are offering. Further mergers and acquisitions may have a positive impact on cost management, which will in turn make it easier for economies of scale to be achieved. On the other hand, domestic mergers and acquisitions are unlikely to involve a cutback in foreign ownership. Enhanced cooperation amongst regulators and supervisors from home and host supervisors is thus essential to the continuing stability of the system.

Yet there exists no precise definition what international regulatory cooperation is. Most of the time, it brings to mind the system of committees and working groups meeting in Basel, at the Bank for International Settlements. The international regulations which are the outcome of the Basel system, comprise among other documents, Basel III, the bold new guidelines at the core of which is the concept of risk-weight; some assets are riskier than others and this should be reflected in the percentage of capital that should be held against them. For credit risk, this riskiness is taken to depend on the obligor, i.e. it is taken that savers and investors are almost inherently more averse to obligations of some entities than to obligations of other entities. This approach is not new, but an enhancement of the existing Basel I and Basel II infrastructure.

Most of the criticism directed at Basel III is that higher capital ratios will have an adverse impact on lending because of the high opportunity cost of holding capital. In the economies of emerging Europe, including South East Europe, this criticism is heard less often, given that foreign ownership implies that decisions on capital increases are made at the group or parent level. More generally, the proposition that an increase in capital leads to a reduction in lending is often not validated by the facts. The cost of bank equity, the compensation an investor requires for a bank, falls as the bank's safety and soundness improve. As equity investors are last in the priority structure in case of a possible bankruptcy, higher capital allocation is likely to increase the confidence in the whole banking sector, which is also an aim of the Basel system.

To conclude, the Basel III document is an important milestone in development of international financial regulation. It has both a regulatory and constitutive dimension: on the one hand, it operates as a further development requiring central banks and other regulators to behave in accordance with its principles in order to strengthen financial stability; on the other hand it establishes even firmer the Basel Committee on Bank Supervision as the pivot of international regulatory cooperation centred on the concept of risk-weight. But Basel III also invites the question of a perhaps different representation of entities taking part in its consultative phases. In this context, it is a logical next step that supervisory colleges encompassing home and host central banks and regulators from this region cooperate in having a greater input in the Basel Committee's deliberations. Not only will this make everyone more aware of the variety of banking practices that exist in this region, but in conferring together at a senior level, during and between college meetings, central bankers and supervisors will secure a reasonable agreement between all parties as the best course on Basel III implementation.

The National Bank of the Republic of Macedonia continues to be committed to the adoption of the principles and frameworks contained in the Basel guidance papers. In adopting this commitment we take care that implementation is adjusted to our circumstances. In order for individual rules not to harm the bank business in hand specifically, and the economy in general, overall regulation should allow the wise exercise of judgement or discretion by the banks applying it and by the regulator overseeing that application.

I wish you, the European Banking Federation Associates', a successful Meeting today and a pleasant stay in the Republic of Macedonia.