Global Crisis Impact in Banking System for Western Balkan Countries

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The current global economic crisis has affected in banking system for Western Balkan countries. This concern is expressed with the contraction of lending, fallen of the volume of remittances, fallen of international trade, and fallen of foreign direct investments.

The aim of this paper is to present an overview of the credit risk that the banking system function for Western Balkan Countries faces. For all these countries will be presented the trend of NPLs for all these countries for a time series of 2008-2012. After, from data taken from international monetary fund we will give some conclusions for the main problems that increased credit risk.

Introduction

According to IIBF (2010) the definitions of NPLs, ROE, ROA, EM and Regulatory capital as a percent of risk-weighted assets is as below:

Definition of Nonperforming Loan – NPLs: A sum of borrowed money upon which the debtor has not made his or her scheduled payments for at least 90 days.

Definition of Return on Assets – ROA: An indicator of how profitable a company is relative to its total assets. ROA gives an idea as to how efficient management is at using its assets to generate earnings.

The formula for return on assets is**:** ROA = Net Income/Total assets.

Definition of Return on Equity – ROE: The amount of net income returned as a percentage of shareholders equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

ROE is expressed as percentage and calculated as: ROE=Net Income/Shareholder's Equity

Definition of Equity Multiplier-EM: it's average assets divided by average equity, the reciprocal of the capital to asset ratio. It provide a gauge of a bank's leverage or the dollar amount of assets pyramided on tyhe bank"s base of equity capital.

The formula for equity multiplier is**:** EM = Assets/Equity and the formula EM=ROE/ROA.

Definition of Regulatory capital as a percent of risk-weighted asset: Regulatory capital (or Capital adequacy) is the amount of capital of a bank or other financial institutions has to hold as required by its financial regulator. This is in the context of fractional reserve banking and is usually expressed as a capital adequacy ratio of liquid assets that must be held compared to the amount of money that is lent out.

The formula for regulatory capital as a percent of risk-weighted asset is: Regulatory Capital as a Percent of Risk-Weighted Asset = Regulatory Capital / Risk-Weighted Asset.

An overview of Banking system in Western Balkan countries

The actual banking system for the Western Balkan Countries according to IMF reports is as below.

Albania: Albania did not experience a big bombast credit cycle, in large part because of prudent limits on external borrowing prior to the crisis. Today banks exhibit high liquidity and solvency ratios supported by continued stringent liquidity and capital requirements. Nonetheless, nonperforming loans have risen sharply, over the last two years. Provisioning has been adequate, but bank profitability has suffered and some banks are shrinking their loan portfolios to meet capital requirements.
The preponderance of foreign subsidiaries in Albania and banking troubles in Europe raise the specter of potential spillovers to the country's banking system. However, the low reliance on external funding and greater dependence on local deposits prior to the crisis has helped to mitigate the risks.

Bosnia and Herzegovina: The banking system is relatively stable, but lending remains muted and NPLs are creeping up. Financial sector indicators through end 2012 suggest that the banking system which is predominantly owned by Austrian and Italian banks remains profitable and adequately capitalized at the aggregate level. Non-performing loans have edged up further and could rise even more in the near future although provisioning stands at 67 % of non performing assets. While, the latest stress tests did not reveal major weaknesses in the system the banking agencies have been quick to engage some smaller banks that presented tighter capital positions under severe shock scenarios. Parent banks' exposure to their subsidiaries declined only moderately over the last several quarters. The loan to deposit ratio remains relatively high at around 125 %. Credit growth remains subdued, however at 3 % in 2012, reflecting banks applying tighter credit standards and the weak economy.

Bulgaria: The banking system wide capital adequacy ratio is high with all banks meeting the 12 % regulatory minimum. Strong deposit growth and subdued credit demand boosted liquidity and allowed external funding to decline, although the stock of parent funding in some banks remains sizeable. The difficult economic environment has taken a toll on asset quality and profitability. Weak growth of NPLs high corporate indebtedness and a depressed real estate market continue to pressure asset quality. A large stock of NPLs may constrain credit availability once the recovery gains traction and savings and related deposit growth ease and it may also undermine the efficiency of credit intermediation by locking in resources. The Bulgarian National Bank is closely monitoring banks, including through frequent onsite inspections high frequency reporting, and enforcing higher capital and liquidity buffers in the relatively weaker pockets of the system that could be potentially exposed to spillovers from the on-going euro area crisis and where NPLs are higher.

Croatia: The Croatian banking system proved highly resilient throughout both the United States subprime crisis and the euro area crisis, mainly thanks to sound fundamentals and macro prudential measures implemented in the pre crisis period. The banking system remains highly liquid, despite increasing provisioning needs against the growth of NPLs. The high capital adequacy of the banking sector sufficiently ensures its resilience to potential shocks. The deleveraging process in the euro area banks has so far affected the banking system only modestly, thanks to the solid profitability of domestic banks and the strict macro prudential policy which created substantial foreign liquidity reserves in banks. In addition, steady growth of domestic deposits has so far been sufficient to finance the subdued credit demand. For the steady recovery of the economy it will be critical that banks bolster their credit activity. One has to be aware however, of the risks to such a credit recovery posed by the introduction of formal and informal macro prudential measures by home countries targeting the overall exposure of their banks and their subsidiaries.

FRY Macedonia: The banking system in FRY Macedonia remains stable, liquid, and well-capitalized. While NPLs continued to increase somewhat, they remain more than fully covered by provisions. The authorities expect the level of NPLs to stabilize given that the recent rise can be entirely attributed to a few weak clients. The Macedonian banks, including subsidiaries of parent banks from the euro zone are mostly financed by domestic resident deposits, do not depend on external wholesale funding, and have very limited credit exposure to countries or clients from the euro zone. By adopting amendments to the Banking Law, in accordance with past Fund advice, the authorities have strengthened the crisis management framework. In particular, these changes ensure that the National Bank of Republic of Macedonia can impose fit and proper requirements on bank management and owners, and create scope for widening the class of collateral that banks may use to access liquidity support from the National Bank of Republic of Macedonia.

Montenegro: Important progress was made in stabilizing the banking system but continued progress in financial regulation and supervision is required. Policy actions should focus on liquidity and raising capital buffers of banks. The new resolution framework should be applied if owners fail to meet capital calls, onsite control of NPLs identification and disposal be tightened, and legal and administrative obstacles to collateral execution be tackled. Moreover, foreign parent bank support has recently been reduced. By the later stages of the lending boom banks had increasingly relied on foreign borrowing to finance credit expansion. This reliance rose further, as foreign parents stepped up their support to offset the large deposit outflows in order to avoid an immediate disorderly adjustment to banks' balance sheets. As deposits began to stabilize however, flows from parents began to reverse and funding from parents declined steadily during 2010 and 2011 as credit lines were repaid. On the asset side, the deleveraging reflects a combination of bad loan disposal and slow new lending**.** Reflecting a sharp reassessment of collection prospects and stepped up Central Bank monitoring and provisioning requirements, banks aggressively sold bad loans to parents or factoring companies, and in this way there was a reduction of NPLs.

Republic of Kosovo: The banking system is generally resilient to a wide range of shocks including a possible further deterioration in the euro area. However there are pockets of vulnerability among small and medium sized banks and in one large foreign subsidiary. These vulnerabilities stem primarily from loan and deposit concentration and from possible risks to banks' external assets. The banking system has remained well capitalized and liquid, despite a recent increase in NPLs. NPLs have continued to increase and this increase has being concentrated in the corporate sector. The central bank has stepped up data collection on loans' terms and conditions to improve its ability to discover misreported problem loans. Also, the central bank is reassessing risks to banks' external assets including deposits held with other entities of a banks' consolidated financial group.

Romania: The Romanian banking system has a history of structural excess liquidity and deviations of money market rates from policy rates prompting some observers to question, the effectiveness of monetary policy. The Romanian banking system has kept solid capital buffers throughout the financial crisis but NPLs are sizable and have continued to rise in recent months. The diversification of the banking sector in recent years is a welcome development, but the authorities should remain watchful to improve banking sector health and act forcefully to clean up deteriorating balance sheets should NPLs ratios continue to increase.

Serbia: Serbia's banking sector has not been as impacted by deleveraging pressures as other European peers. Capitalization and liquidity indicators are high and NPLs are well provisioned. However, recent resolution cases are suggestive of weaknesses in some state owned banks. Credit growth is low despite abundant liquidity in the banking system due to perceived lending risks, and high NPLs.

Slovenia: The Slovenian banking system has been significantly affected by global crisis.

Most banks in the system were affected adversely by the economic downturn. The performance of banks deteriorated markedly as a result of higher levels of NPLs in the corporate and real estate sector, particularly construction industry. As a result the banking system reported operating losses in 2010 and 2011. Since a significant amount of asset growth prior to the economic crisis, was fuelled by wholesale funding from abroad, both capital adequacy and liquidity came under some strain. Leasing companies, several of which are owned by banks, have been affected by economic conditions as well. As a group, they reported operating losses attributable to high NPLs and lower levels of activity. Insurance companies have remained profitable.

The key indicators of performance of Banks in Western Balkan Countries

For this comparison the data used are based on an average of data's for 2008-2012. The key indicators in which will be based the comparison: NPLs, ROE, ROA, EM, Regulatory capital as a percent of risk-weighted assets.

Fig.1.NPLs as a percent of total loans

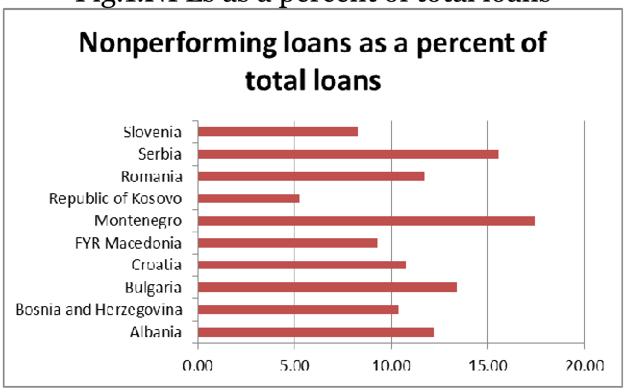


Fig.2. Return of equity (ROE)

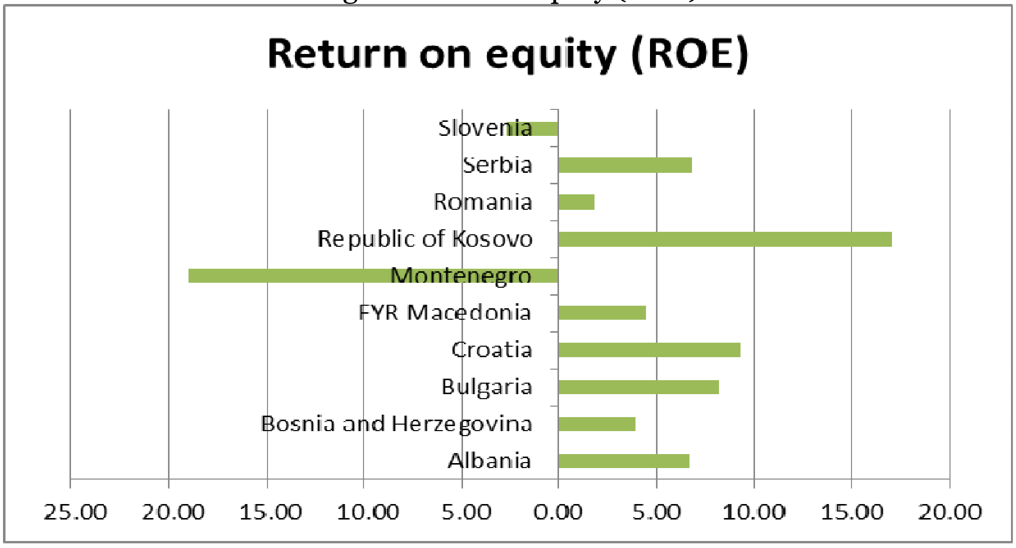


Fig.3. Return of assets (ROA)

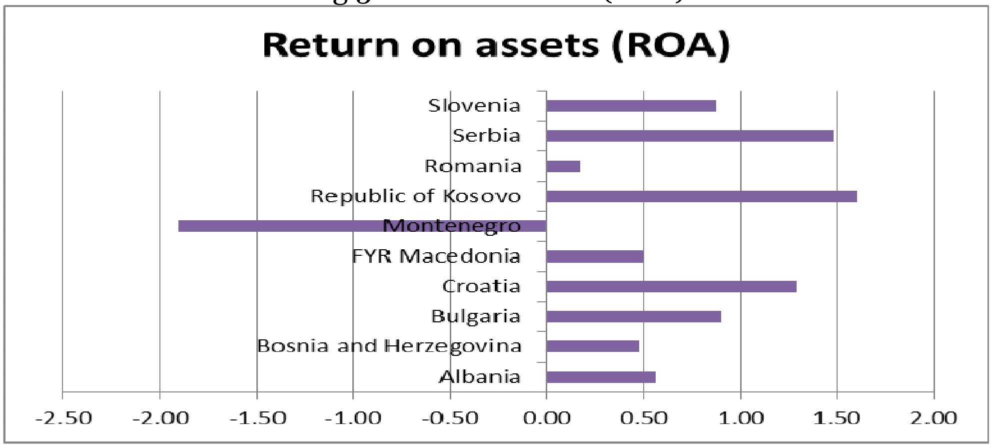


Fig.4. Equity multiplier (EM)

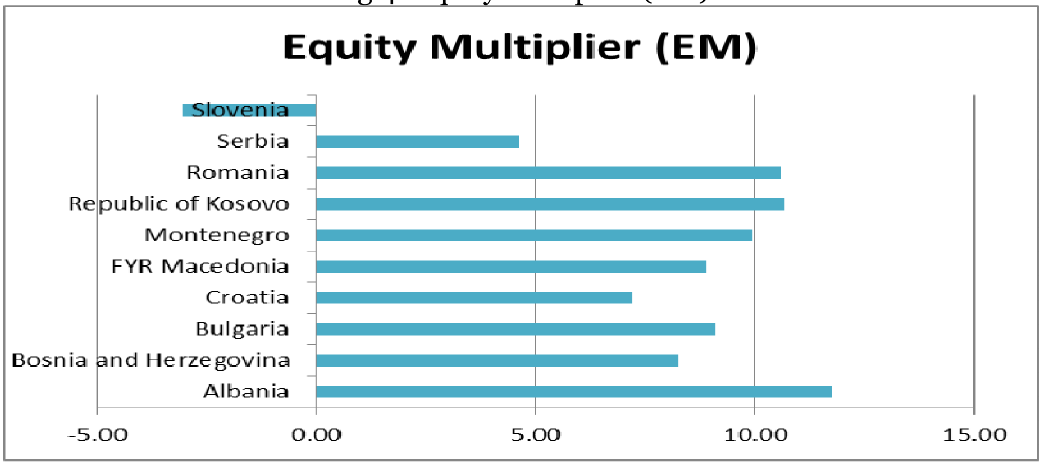


Fig.5. Regulatory capital as a percent of RWA

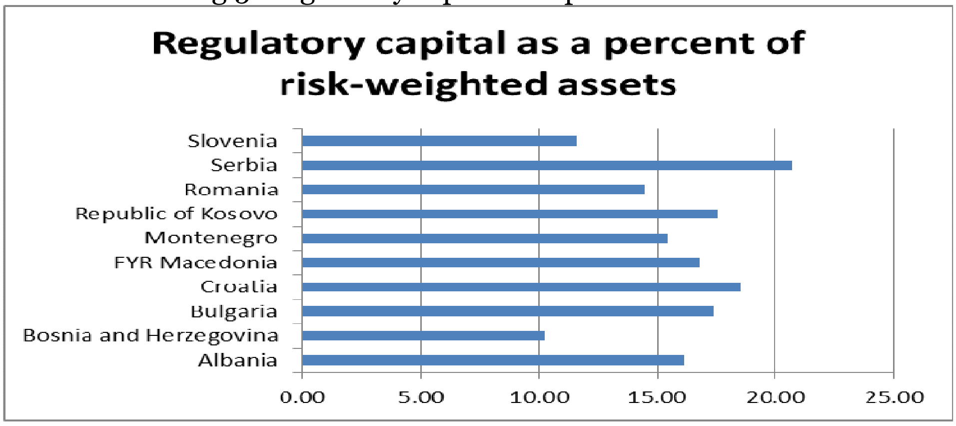
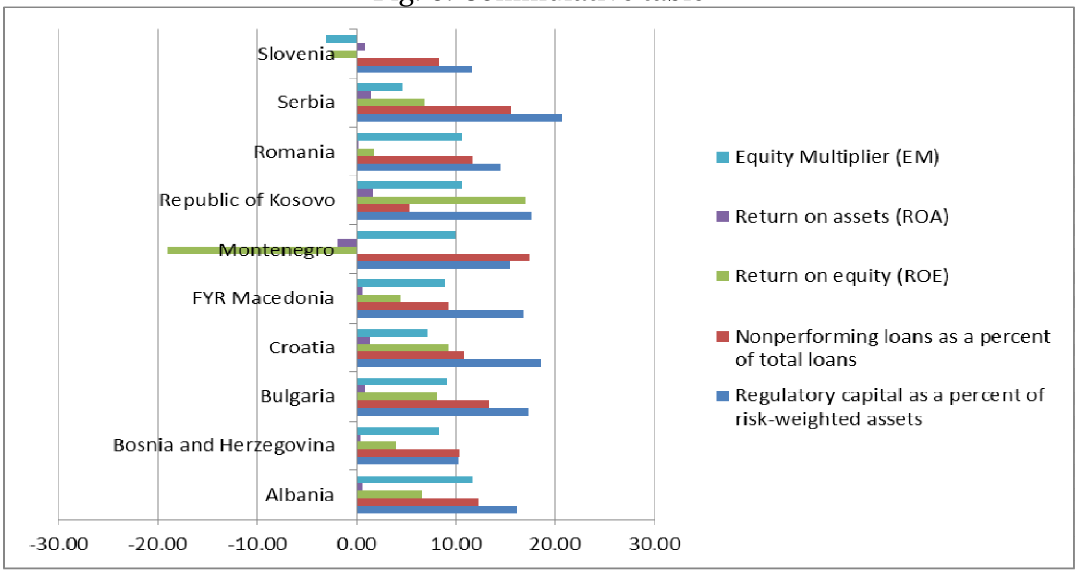


Fig. 6. Commulative table



According to the figures we see that Montenegro to 17.47 %, maintains the highest level of NPLs in comparison with other countries. Montenegro is followed by Bulgaria with 13.4 %, Albania with 12.25% and Romania with 11.74 %. States as with as Croatia with 10.78 %, Bosnia and Herzegovina with 10.4 % and FYR Macedonia with 9.3 %, shows a stable level in the region. Republic of Kosovo appears with the lowest level of NPLs which maintains a level of 5.27 %.

According to data, we notice that Republic of Kosovo holds the highest level of return on equity, 17.07%, in comparison with other countries. Republic of Kosovo, is followed by Bulgaria 8.19%, Serbia with 6.85%, Albania with 6.67%, FYR Macedonia with 4.45%, Bosnia and Herzegovina with 3.96%, Croatia with 1.29% and Romania with 1.8%. The state that has the lowest level of this indicator is Montenegro with -19%.

According to data, we notice that Republic of Kosovo with 1.6% holds the highest level of return on assets compared to other countries. After Republic of Kosovo, Serbia also maintains a high level, with 1.48%, followed by Croatia with 1.29%. Below level 1%, is Bulgaria with 0.9%, Albania with 0.57%, FYR Macedonia with 0.5%, Bosnia and Herzegovina with 0.48% and Romania with 0.17%. The state that has the lowest level is Montenegro with -1.88%.

According to data, we notice that Albania with 11.76% holds the highest level of equity multiplier compared to other countries. Albania is followed by Republic of

Kosovo with 10.67, Romania with 10.59 and Bulgaria with 9.1%. The state that has the lowest level of this indicator is Slovenia with -3.06%.

According to data, we see that Serbia with 20.7% holds the highest level of indicator regulatory capital as a percent of risk-weighted asset compared to other countries. Serbia is followed by Croatia with a level 18.54%, followed from Republic of Kosovo with 17.58%, Bulgaria with 17.41%, FYR Macedonia with 16.83%, Albania with 16.15% and Montenegro with 15.43%. The state that has the lowest level of this indicator is Slovenia with 11.59%.

Conclusions

Assessment of the financial condition of a bank cannot be measured only in numbers, which means that the fact that an institution was contained bank regulatory capital minimum rates, liquidity and other regulatory requirements does not guarantee that the financial situation is stable. Thus regulators should use their professional judgment and to consider qualitative factors as well as quantitative ones during such an analysis.

Based on these data, we can give some thoughts on the state of the banking system in the western Balkan Countries from the perspective of several key indicators:

Albania: Taking an average of the last five years we see that the level of NPLs is 12.25%, the rate Regulatory capital as a percent of risk-weighted assets is 16.15%, ROE is 6.67%, ROA is 0.57% and EM is 11.76%. The main problems are the prolonged legal proceedings for execution of collateral, high informality that cause difficulty in the analyses of the revenues of clients and delays in collections from the government contracts. There are many construction companies that have finished their contracts with state and still haven't been paid. Unlike many countries in the region the global crisis didn't affect Albania as did with other countries.

Bosnia and Herzegovina: Taking an average of the last five years we see that the level of NPLs is 10.4%, the rate of Regulatory capital as a percent of risk-weighted assets is 13.4%, ROE is 3.96%, ROA is 0.48% and EM is 8.25%. The main problems are lower lending, decline in remittances, execution of collateral. The banking system is relatively stable but lending remains muted and nonperforming loans are increasing.

Bulgaria: Taking an average of the last five years we see that the level of NPLs is 13.4%, the rate of Regulatory capital as a percent of risk-weighted assets is 17.41%, ROE is 8.19%, ROA is 0.9% and EM is 9.1%. The main problems are difficult economic environment, valuation of collateral and debt restructuring procedures. The banking system is stable and liquid, but nonperforming loans are rising.

Croatia: Taking an average of the last five years we see that the level of NPLs is 10.78%, the rate of Regulatory capital as a percent of risk-weighted assets is 18.54%, ROE is 1.29%, ROA is 1.29% and EM is 7.19%. The main problems are large exposure of borrowers to currency and interest rate risk, legal procedures and execution of collateral. The largely foreign-owned banking system remains stable and well capitalized, although growing NPLs, indirect credit risk stemming from vulnerable borrowers and sizeable dependence on parent banks for funding require careful monitoring.

FYR Macedonia: Taking an average of the last five years we see that the level of NPLs is 9.3%, the rate Regulatory capital as a percent of risk-weighted assets is 16.83%, ROE is 4.45%, ROA is 0.5% and EM is 8.9%. The main problems are lower lending, high level of concentration of banking sector (only in 3 banks out of a total of

16 banks) and slower development of the mortgage. The banking sector remains well-capitalized and highly liquid, with a stable domestic financing base but non-performing loans are increasing.

Montenegro: Taking an average of the last five years we see that the level of NPLs is 17.47%, the rate of Regulatory capital as a percent of risk-weighted assets is 15.43%, ROE is -19% , ROA is –1.88% and EM is 9.95%. The main problems are the use the euro currency which cannot be injected by central banks and execution of collateral. Banks sold bad loans to parents or factoring companies and this contributed to a sharp decline of NPLs, however NPLs remain high.

Republic of Kosovo: Taking an average of the last five years we see that the level of NPLs is 5.27%, the rate Regulatory capital as a percent of risk-weighted assets is 17.58%, ROE is 17.07%, ROA is 1.6% and EM is 10.67%. The main problems are the use of euro currency which cannot be injected by central banks, decline in remittances. Two-thirds of remittances come from Germany and Switzerland. The banking system has remained well-capitalized and liquid, despite the increase in non-performing loans. Republic of Kosovo has the lower level of NPLs than the other countries in region.

Romania: Taking an average of the last five years we see that the level of NPLs is 11.74%, the rate of Regulatory capital as a percent of risk-weighted assets is 14.48%, ROE is 1.8%, ROA is 0.17% and EM is 10.59%. The main problems are un-hedged borrowers of foreign currency loan, the weak economic activity and around 80% of banking system is foreign owned. The banking sector is vulnerable to spill over from the euro area and the weak economic recovery.

Serbia: Taking an average of the last five years we see that the level of NPLs is 15.58%, the rate of Regulatory capital as a percent of risk-weighted assets is 20.7%, ROE is 6.85%, ROA is 1.48% and EM is 4.63%. The main problems are debt restructuring procedures, the judicial system, and execution of collateral. Serbia has large capital cover relative to other countries in the region but the high capital cover weigh down on its banking sector's profitability.

Slovenia: Taking an average of the last five years we see that the level of NPLs is 8.32%, the rate of Regulatory capital as a percent of risk-weighted assets is 11.59%, ROE is -2.66%, ROA is 0.87% and EM is -3.06%. The main problems are: weak governance in public banks, a credit boom financed externally and directed in significant part towards construction companies. The corporate sector is over indebted and suffers from the double dip recession. The Slovenian financial system has been hard hit by crisis.

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