Banking Sector in Bosnia and Herzegovina

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Central Banks

• The most important monetary institution ("bank of banks")
• Main objective: price stability (for most of modern central banks), but also to assist other economic policies and growth
  – Other objectives: ER stability, money supply,...
• Full independence from government
• Conduct of monetary policy
• Maintain financial system stability
Central Banks

• Supervise and regulate depository institutions (not always, but very often)
• Provide financial services for government
• Issue new currency (monopoly on money issuing)
• Provide payment and other financial services to the government, the public, FIs, and foreign official institutions
• Perform economic research and financial sector analysis
CBBH – Currency Board

- Ruled-based monetary policy (very limited discretionary powers)
- Monetary and foreign exchange rate regime
- Exchange rate against anchor currency is set in the Law on the CBBH
  - can not be changed without parliamentary procedure
- Currency board arrangement in place since creation of the CBBH in 1997
CBBH – Currency Board

- Characteristics:
  - Fixed exchange rate (1Euro = 1.98553 KM)
  - Unlimited convertibility between domestic currency and the anchor currency
    * no restrictions on buying and selling KM and euro
  - Foreign exchange reserves to cover both money in circulation and deposits with the CBBH
  - No lending to any sector
    * especially important: government can’t finance fiscal deficit
  - Money supply is determined by selling and buying of foreign currency
Results after 15 years:

- Credibility of the CBBH and domestic currency
- Increasing trust in domestic currency
- Main pillar of macroeconomic stability and banking sector in the country
- Low and stable inflation
- Absence foreign exchange risk for foreign investors
CBBH – Balance Sheet

• Major assets
  – Deposits with other central banks and IFIs
  – Government bonds of the EMU countries
  – Cash in vaults
  – Gold

• Major liabilities
  – Reserves (deposits of commercial banks with the central bank)
  – Currency in circulation
CBBH – Foreign Reserves

millions KM

- 1997
- 1998
- 1999
- 2000
- 2001
- 2002
- 2003
- 2004
- 2005
- 2006
- 2007
- 2008
- 2009
- 2010
- 2011
CBBH – Cash Management

- Decisions about design and denominations
- Printing of notes and coins (realized in foreign countries)
- Supply of cash to the commercial banks (via the main units in Sarajevo, Mostar, Banja Luka)
- Cash processing and withdrawal of damaged notes
- Expert analysis and protection against counterfeits
CBBH – Fiscal Agent

• Banking and Fiscal Agent for the governments:
  – Transaction for new loans and donations
  – Transactions related to debt service
  – Investments on behalf Deposit Insurance Agency
  – Membership in the IMF and the WB (fiscal agent and depository)

• Single account for indirect taxes
  – Collecting funds from commercial banks
  – Allocation to the respective ministries’ accounts
CBBH – Payment System

- Credit Registry for enterprises and individuals
  - Data on all borrowers
  - Very important for credit risk assessment
- Central registry of transaction accounts
Increased need for statistical data (especially for financial sector and external position)

Statistical methodology should be in line with international standards (IMF, ECB,...)

Statistical data and objective economic analysis help general public and government to understand economic developments

Publications, web-site, press releases etc.
CBBH – Reserve requirement

- Single monetary policy instrument in currency board
- Banks need to keep certain share of their liabilities on central bank’s account (% of reserve base)
- Decrease of RR – fewer reserves, multiplied increase in deposits and thus the money supply ↑
- Increase of RR – higher reserves, multiplied decrease in deposits and thus the money supply ↓
CBBH – Reserve requirement

- CBBH used RR actively in recent years
- Before the crises – increase of RR to prevent excessive credit growth and its negative implications
- In the crises – lowering of RR in order to provide needed liquidity for the banks
- RR in Sept 2008: 18%;
- Currently 7% for long term and 14% for short term funds
- Liquidity crises was successfully averted
Monetary tool – Reserve requirement
Large excess reserves
• Two tier banking sector (central bank and commercial banks)

• Financial sector is dominated by commercial banks (over 85% of total assets)
  – Other financial institutions are much smaller
  – Capital markets still underdeveloped and do not attract investors
Financial sector in B&H

Financial Sector Assets (millions KM)

- Insurance: 1,115.4
- Leasing Co: 1,305.5
- Investment funds: 962.4
- Brokerage houses: 858.6
- Microcredit institutions: 7.7
- Stock Exchanges: 18.7
- Banks: 21,328.9
BH banking sector

- Successful reform and transformation (more advanced than other sectors of economy)
- Adequate regulation and improved supervision prevented major banking crises
- Large inflow of foreign direct investments before 2008
  - Transfer of know-how
  - Access to foreign funding
  - New products
- Consolidation since 2000 (smaller number of banks), but still no too large concentration
- Increase of local deposits (especially households), but also foreign funding
BH banking sector

- Currently 28 banks operating in BH (most of them operate in both entities or have two subsidiaries)
- Dominant control by foreign owners (over 90% of assets)
- Deposit Insurance covers all operating banks
  - Deposits are guaranteed by state funds in a case of bank bankruptcy
Commercial banks, Assets

- Rapid growth of banking assets till 2008, but stagnation since then
Loans to Companies

![Graph showing loans to companies from 2007 to 2011. The graph includes short-term and long-term loans, as well as the annual growth rate. The data for each year is as follows:

- 2007: Short-term loans = 1.90 billion KM, Long-term loans = 2.08 billion KM
- 2008: Short-term loans = 2.67 billion KM, Long-term loans = 4.68 billion KM
- 2009: Short-term loans = 2.55 billion KM, Long-term loans = 4.73 billion KM
- 2010: Short-term loans = 2.70 billion KM, Long-term loans = 4.97 billion KM
- 2011: Short-term loans = 3.02 billion KM, Long-term loans = 4.87 billion KM

The annual growth rate is indicated by a line graph over the years.]
Bad loans have been problematic after recession started. Companies and households have more problems in repaying their loans, so banks suffer losses.
Profitability of Banks

The graph shows the profitability of banks over the years, with ROAA (left-hand side) and ROAE (right-hand side) represented by different lines. The years 2007 to 2011 are marked on the x-axis, with values ranging from 0 to 10% on the y-axis. The graph indicates a downward trend from 2007 to 2009, followed by a recovery from 2010 to 2011.