# Macroprudential policy in the Western Balkans: the last five years and COVID-19 crisis response[1]

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*This study takes stock of macroprudential policy instruments and their recent development (since 2015) in Western Balkan[3] economies. Banks in the region, which are dominated by institutions headquartered in the EU, tend to be in good shape, profitable and well capitalized. All countries under review are oriented toward EU macroprudential policies, given that they strive to join the European Union. However, the pace at which the required policy frameworks are being put into place differs across countries. Preparatory work for the creation of large parts or entire macroprudential and prudential toolkits is still ongoing in Kosovo and Montenegro, while Serbia and North Macedonia have already accumulated some experience in using related instruments (including capital buffers, reserve requirements, risk weights, etc.). Albania and Bosnia and Herzegovina are situated somewhere in between these two groups of economies in terms of the range and the timing of measures put in place. The biggest remaining challenges include elevated growth rates of partly unsecured consumer loans, and still high shares of foreign currency loans in total loans – notwithstanding de-euroization measures. The COVID-19 crisis triggered the immediate relaxation of some macroprudential measures and regulatory standards. Yet, the bulk of COVID-19 response steps is situated outside the macroprudential realm and includes moratoria on loan repayments, adjustments in loan classification and provisioning rules, which in turn, may (temporarily) undermine the economic substance of capital buffers.*

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*Keywords: banking sector, financial stability, macroprudential policy, Western Balkans*

This study constitutes a stocktaking exercise addressing macroprudential instruments and toolkits in a European region that unfortunately often tends to receive less attention: the Western Balkans (Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, Serbia). As far as the authors are aware, no such comparative inventory of regulatory measures aimed at safeguarding financial stability, countering systemic risks and enhancing financial system resilience[4] has been done in recent years for this region. Our chosen delimitation of macroprudential

[1] *Cutoff date for data: September 15, 2020.*

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[3] *The Western Balkan economies comprise: Albania, Bosnia and Herzegovina, Kosovo (this designation is without prejudice to positions on the status of this territory and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence), Montenegro, North Macedonia and Serbia.*

[4] *For more detailed indications of aims of macroprudential policies, see International Monetary Fund (2014, pp. 4–5).*

instruments largely corresponds to the compilation established in chart 1 of Eller et al. (2020, p. 67).[5]

A brief snapshot of financial sectors in the Western Balkans (section 1) leads to the core of the study, a detailed comparative table of macroprudential policy toolkits (including information on legal bases, goals, institutions and actual implementation of measures). The table provides country-by-country information for the period from 2015 leading up to the recent COVID-19 crisis period (which started in March 2020 for the countries under review). Information provided is discussed in sections 2 (2015 to early 2020) and 3 (coronavirus response). Section 4 wraps up and summarizes the article and provides some conclusions.

## 1 The financial sectors of the Western Balkans – a snapshot

The financial sectors of the Western Balkan[6] countries are primarily bank based while nonbank financial institutions only play a minor role. The banking landscape is dominated by foreign-owned banks mainly headquartered in the EU. As of June 2020, the number of banks ranged between 10 in Kosovo and 26 in Serbia. The concentration of banks is higher in Albania, Kosovo and North Macedonia, with around 60% of assets being held by the three biggest banks; in the larger Western Balkan countries, around 40% of assets are held by the three largest banks.[7]

The overall situation of the banking sectors in the region is assessed to be good (also refer to footnote 6). Banks generally are in a good shape, profitable and well capitalized. The capitalization of banks (tier 1 ratio) surpasses regulatory requirements by far. The banking sectors in the Western Balkans are overall profitable (see table 1). Furthermore, the liquidity of banking sectors is high and loan-to-deposit ratios have remained well below 100% in most countries.

Financial intermediation in the Western Balkan economies is rather moderate, with ratios of private sector credit to GDP ranging between around 34% in Albania and 50% in Montenegro. Generally, financial intermediation has not changed significantly since 2015 and has, on average, not expanded more strongly than GDP. Overall, from 2015 to the first quarter of 2020, growth of credit to the private sector (households and nonfinancial corporations) was strongest in Kosovo with annual average growth rates of around 10%. It was weakest in Albania (around 1%), where credit initially slumped and only recovered in 2019. In all countries under review, credit to households recorded higher growth rates from 2015 in the light of better income prospects and more favorable lending conditions. It is noteworthy that lending to households for nonhousing purposes – so-called consumer loans – has become a key driver of credit dynamics in many Western Balkan economies, particularly in Montenegro and Serbia. These nonhousing-purpose loans

[5] *Thus, without pretense to exhaustiveness, we consider as (macro)prudential measures (if adopted): (1) Capital-based measures (minimum capital requirements, risk weights for banks' exposures, countercyclical capital buffer, capital conservation buffer, systemic risk buffer, capital buffer for systemically important banks, leverage ratio, other systemically important institutions (O-SII) buffer), (2) borrower-based measures (limits on loan-to-value, debt service-to-income and debt-to-income ratios; foreign currency lending bans, mandatory write-offs of fully provisioned/long-term impaired exposures), (3) liquidity-based measures (minimum reserve requirements, liquidity requirements, loan-to-deposit limits, single client exposure limits, sectoral and market segment exposure limits, intragroup exposure limits, foreign currency exposure limits, foreign currency mismatch limits).*

[6] *For a detailed overview of the banking sectors in the Western Balkans, see Comunale et al. (2019).*

[7] *According to latest data provided by S&P Global Market Intelligence. For Kosovo, we use data published by the central bank of Kosovo: https://bqk-kos.org/repository/docs/2018/Final_Financial%20System_April%202020.pdf*

Table 1

**Banking sector indicators**

| | 2015 | 2016 | 2017 | 2018 | 2019 | Q1 20 | Q2 20 |
|---|---|---|---|---|---|---|---|
| **Tier 1 capital ratio** | % | | | | | | |
| Albania | 13.5 | 13.8 | 15.1 | 17.0 | 17.1 | 17.9 | 17.0 |
| Bosnia and Herzegovina | 13.8 | 15.0 | 14.8 | 16.5 | 17.5 | 16.7 | 17.3 |
| Kosovo | 19.0 | 17.9 | 18.0 | 17.0 | 15.9 | 15.1 | 16.7 |
| Montenegro | 14.2 | 14.7 | 15.0 | 14.4 | 18.1 | 17.4 | 19.6 |
| North Macedonia | 13.9 | 13.9 | 14.2 | 15.0 | 14.8 | 15.0 | 15.5 |
| Serbia | 18.8 | 20.0 | 21.6 | 21.1 | 22.4 | 21.9 | 21.8 |
| **Return on equity** | *% of average equity* | | | | | | |
| Albania | 13.2 | 7.2 | 15.7 | 12.4 | 13.3 | 3.5 | 9.1 |
| Bosnia and Herzegovina | 0.9 | 6.2 | 9.0 | 8.5 | 9.1 | 9.4 | 7.1 |
| Kosovo | 26.8 | 18.6 | 19.0 | 18.2 | 16.9 | 16.3 | 14.5 |
| Montenegro | –0.7 | 1.5 | 7.0 | 5.3 | 9.0 | 8.9 | 5.3 |
| North Macedonia | 10.4 | 13.3 | 13.3 | 15.7 | 11.4 | 7.5 | 8.6 |
| Serbia | 1.2 | 2.9 | 9.8 | 10.5 | 9.3 | 10.5 | 8.4 |
| **Bank loans to the domestic nonbank private sector** | *%, as a share of GDP* | | | | | | |
| Albania | 38.1 | 37.1 | 35.4 | 32.5 | 34.0 | 35.8 | 35.4 |
| Bosnia and Herzegovina | 52.8 | 52.3 | 54.0 | 54.2 | 55.1 | 53.8 | 53.6 |
| Kosovo | 34.8 | 36.7 | 38.7 | 41.0 | 42.8 | 43.5 | 44.1 |
| Montenegro | 50.6 | 49.4 | 48.8 | 49.3 | 50.1 | 51.0 | .. |
| North Macedonia | 50.8 | 47.8 | 48.5 | 48.8 | 48.9 | 49.0 | 51.8 |
| Serbia | 45.1 | 44.1 | 42.9 | 44.1 | 45.0 | 45.5 | 48.0 |
| **Bank loans to the domestic nonbank private sector** | *Annual change in %* | | | | | | |
| Albania[1] | –4.0 | 1.0 | 2.1 | 1.3 | 4.6 | 6.2 | 4.9 |
| Bosnia and Herzegovina[1] | 1.0 | 2.8 | 6.5 | 6.6 | 6.0 | 3.6 | 0.4 |
| Kosovo | 7.3 | 10.4 | 11.5 | 10.9 | 10.0 | 9.2 | 6.4 |
| Montenegro | 2.4 | 5.7 | 7.5 | 9.6 | 6.8 | 5.6 | 7.1 |
| North Macedonia[1] | 5.8 | 3.6 | 3.8 | 7.4 | 6.2 | 4.6 | 5.7 |
| Serbia[1] | –2.3 | 3.0 | 4.9 | 7.8 | 8.1 | 9.6 | 12.4 |
| **Foreign currency loans to the private sectors** | *% of total laons* | | | | | | |
| Albania[1] | 52.2 | 47.9 | 47.2 | 47.9 | 45.9 | 45.8 | 46.0 |
| Bosnia and Herzegovina[1] | 71.0 | 64.5 | 62.9 | 59.0 | 52.6 | 52.2 | 52.2 |
| Kosovo | 0.3 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 |
| Montenegro | .. | .. | .. | .. | .. | .. | .. |
| North Macedonia[1] | 43.5 | 40.5 | 39.5 | 37.8 | 38.4 | 38.0 | 38.1 |
| Serbia[1] | 60.6 | 59.7 | 59.8 | 59.5 | 59.1 | 59.0 | 58.3 |
| **NPL ratio** | *% of total loans* | | | | | | |
| Albania | 18.2 | 18.3 | 13.2 | 11.1 | 8.4 | 8.2 | 8.1 |
| Bosnia and Herzegovina | 13.7 | 11.8 | 10.0 | 8.8 | 7.4 | 6.6 | 6.7 |
| Kosovo | 6.2 | 4.9 | 3.1 | 2.7 | 2.0 | 2.5 | 2.6 |
| Montenegro | 12.6 | 10.3 | 7.3 | 6.7 | 4.7 | 5.1 | 5.3 |
| North Macedonia | 10.8 | 6.6 | 6.3 | 5.2 | 4.8 | 5.0 | 4.7 |
| Serbia | 21.6 | 17.0 | 9.8 | 5.7 | 4.1 | 4.0 | 3.7 |

*Source: National central banks, OeNB caculations, statistical offices.*

[1] *Foreign currency component at constant exchange rates.*

are often relatively large, long term and uncollateralized.[8] Due to heightened uncertainty and income losses, the annual growth of loans to the private sector, as is to be expected, has decelerated in most economies of the region since the start of the COVID-19 crisis, particularly in Bosnia and Herzegovina as well as in Kosovo. By contrast, Serbia has registered stronger credit growth, especially to corporates.

[8] *For details see: Box 2: Western Balkans: strong domestic demand fuels economic growth. In: Focus on European Economic Integration Q2/19. OeNB. 18–23.*

Credit quality clearly improved in all Western Balkan economies during the second half of the 2010s. In 2015, Albania and Serbia had reported nonperforming loan (NPL) ratios close to 20%; the best performers, Kosovo and North Macedonia, had recorded around 6% to 8%. At the end of the first quarter of 2020, NPL ratios stood between 2.5% in Kosovo and 8.2% in Albania.

A special feature of those Western Balkan economies that are not unilaterally euroized[9] is the high degree of de facto euroization. Despite some decline, the share of foreign currency lending to the private sector is still at elevated levels. At the end of the first quarter of 2020, Serbia featured the highest share of foreign currency lending to the private sector, with 66% of total lending. The ratio of private sector foreign currency loans to private sector foreign currency deposits was below 100% in all countries of the region save Bosnia and Herzegovina, and even below 50% in Albania, North Macedonia and Serbia.

## 2 Stocktaking of macroprudential policies before COVID-19

The global financial crisis of 2008–2009 was the starting point for launching macroprudential policy strategies. In the Western Balkans, Serbia can be seen as a pioneer in implementing a macroprudential framework in reaction to the boom-bust cycle that preceded the global financial crisis[10], especially considering that a supranational macroprudential framework was not established until the year 2011 (European Systemic Risk Board, 2011). Also, North Macedonia applied macroprudential policies relatively early on.[11] In the Western Balkans, determining factors have been Basel III[12] as well as EU policies. The latter are especially important for two reasons: the progressive integration of financial markets of Western Balkan countries into the European system against the background of these countries' aspirations to join the EU in the future, as well as the importance of EU-headquartered banks in the region.

As table 2 shows, the Western Balkan central banks and policymakers have shown different speeds in creating and refining toolkits of macroprudential instruments and preparing them for implementation in recent years.[13] Indeed, preparatory work is still ongoing with respect to large parts or entire toolkits in three countries (Albania, Kosovo and Montenegro). The sudden onset of the COVID-19 crisis has further extended the maturing phase of toolkits prior to their effective application (see section 3). As can be expected, the institutional framework is dominated by national central banks that have the mandate to conduct macroprudential policies. In the case of Bosnia and Herzegovina, the banking agencies of the two entities are in charge of applying most available instruments. The official goals

[9] *The euro is used as the legal tender in Kosovo and Montenegro.*

[10] *During the boom years (pre-2008), Serbia introduced a variety of measures to curb lending and particularly foreign currency lending; during the ensuing bust, several measures were loosened (for more details see Dimova et al., 2016).*

[11] *For instance, for an overview of macroprudential measures implemented from 2004 to 2010 by the National Bank of the Republic of North Macedonia refer to Celeska et al. (2011).*

[12] *Basel III constitutes a global regulatory framework for more resilient banks and banking systems (Bank for International Settlements, 2011).*

[13] *In the table, measures are taken into account insofar as they are mentioned in the respective national central banks' financial stability reports and/or in IMF staff reports, financial system stability assessments or program monitoring reports from 2015. This implies that all measures cited in the above sources and valid in or from 2015 are included in the table, even if some of these measures were adopted before that year.*

of macroprudential policies pertain to general aims (mitigation of systemic risks), on the one hand, and to de-euroization objectives (alleviation of foreign exchange risks in countries that are not officially euroized or administered by a currency board), on the other. Intermediate objectives often include preventing excessive credit growth, excessive leverage, maturity mismatches and illiquidity, supporting credit growth and promoting use of the local currency.

Looking at the various instruments actually used, one can argue that only Serbia and North Macedonia have accumulated some years of experience in applying a variety of measures. To a clearly minor degree, this applies to Albania as well as to Bosnia and Herzegovina. At the same time, there appears to be some reticence in activating capital buffers, typically a core element of the macroprudential toolkit: Albania had scheduled to implement its capital buffers only in March 2020; while their formal coming into force was not deferred due to the coronavirus crisis, the buffers' planned ratios were immediately set at zero and thus do not have any economic impact for the time being (see table 2); Montenegro is still taking preparatory steps for implementing its capital buffers; Bosnia and Herzegovina has only introduced the capital conservation buffer and is still considering the introduction of other buffers; Kosovo for the moment is not planning the introduction of any capital buffers. Again, only Serbia and North Macedonia have gathered some experience in using capital buffers (both from 2017).

Given that many of these measures have only been applied for a comparatively short time (if at all) in the Western Balkans, it would seem too early to try to econometrically establish a track record of their effectiveness.[14] In any case, since their inception and until the COVID-19 crisis, most measures have not been decisively altered. At least at first sight (without any econometric analysis, which is not the object of this study), the measures appear to have been successful. Previously high credit growth slowed down on average and even fell below GDP growth in 2015 to 2019, although notably in Serbia, Montenegro and Kosovo expansion rates of household loans, and here, particularly general purpose consumer loans as well as real estate loans, have continued to raise concern and merit close monitoring.[15] Credit quality has increased across the board, even if NPLs still remain rather elevated in Albania and Bosnia and Herzegovina. Perhaps most problematic, shares of foreign currency loans in total loans, while slightly declining, continue to be at relatively high double digits – notwithstanding de-euroization strategies[16] (see also related assessments in European Commission, 2019).

[14] *Accordingly, to the best of our knowledge, authorities in the Western Balkans do not yet have at their disposal econometric impact analyses of macroprudential instruments, but only the information that the situation in the banking sectors has largely improved since the very recent introduction of macroprudential tools (where they were introduced) at least until early 2020.*

[15] *In reaction, Serbia raised capital requirements regarding general purpose consumer loans in 2019 (as shown in table 2). In contrast, Montenegro and Kosovo – for lack of readily available toolkits – have not yet taken macroprudential action in this respect.*

[16] *Thus, Serbia remains committed to its dinarization strategy, North Macedonia continues to differentiate reserve requirement rates between dinar and foreign currency deposits, and Albania resorted to various measures in 2018 to strengthen use of the lek (for more details see table 2).*

Table 2

## Macroprudential policy in the Western Balkans[1]

**Albania**

| Legal and regulatory basis | Objectives and involved institutions | Instruments | Actual application |
|---|---|---|---|
| 2015: Regulatory framework of the Bank of Albania (BoA) "On the capital adequacy ratio"<br><br>2017: "Macro-prudential Policy Strategy" (approved on August 2 by BoA Supervisory Council, decision no. 38)<br><br>March 2019: "On the Liquidity Coverage Ratio" (regulation no. 27)<br><br>June 2019: "On macro-prudential capital buffers" (adopted on 5 June by BoA Supervisory Council, regulation no. 41); followed by decision no. 3368 issued by the Governor of the BoA on June 28, 2019: "On determining macro-prudential capital buffers"<br><br>September 2019: "On determination of countercyclical capital buffer" (decision no. 4913, September 30, 2019); December 2019: "On determination of countercyclical capital buffer" (decision no. 6476, December 24, 2019)<br><br>March 2020: "For the determination of the macroprudential capital buffers and of the systemically important banks" (decision no. 1714, issued March 25, 2020)<br><br>June 2020: "On determination of countercyclical capital buffer" (decision no. 3044, June 30, 2020) | 2015: assessment, prevention and mitigation of systemic risk (that threatens financial stability): shielding the rest of the system from negative consequences in case of failure of systemically important bank, strengthening the financial system's capacities to avoid or cope with these risks with as little loss as possible<br><br>De-euroization: reducing exposure of financial system to unfavorable developments in the exchange rate and to stress situations of FX liquidity<br><br>2017: ultimate objective: preventing systemic risks and strengthening resilience of the financial system in order to safeguard financial stability<br><br>Intermediate objectives: mitigating and preventing excessive credit growth and leverage, excessive maturity mismatch and market illiquidity; limiting direct and indirect exposure concentrations; limiting excessive risk-taking by systemically important financial institutions<br><br>Institutions: BoA (Financial Stability Department, Financial Stability Advisory Committee, Governor (deciding authority), Supervisory Council)<br>De-euroization: cooperation: BoA, Ministry of Finance and Economy, Financial Supervision Authority | 2013/2015: minimum capitalization levels, countercyclical requirements; stress tests (aimed at improving the banking sector's ability to cope with losses resulting from the materialization of adverse, but possible, events in the real and financial sector)<br><br>2017/2019: **capital buffers** (originally planned to be implemented in phases from end-March 2020 to end-December 2023, but due to COVID-19 crisis initial application with 0% ratios and with zero economic impact; increase of ratios deferred for a year; buffers will comprise common equity tier 1 (CET1) capital: capital conservation buffer (CCoB): 0.5% to 2.5% of risk-weighted exposures; countercyclical capital buffer (CCyB): 0% to 2.5% of risk-weighted exposures; systemic risk buffer (SyRB): 1% to 3% of risk-weighted exposures; capital buffer for systemically important banks: at least 0.5% | Stress tests carried out quarterly (top-down) and annually (bottom-up) for capitalization as well as annually for liquidity risks<br><br>2013: countercyclical requirements for bank capital for investments in nonresident financial institutions (but no longer in force since beginning of 2019)<br><br>2015: minimum capitalization levels, capital requirements for market and operational risk<br><br>March 2017: Countercyclical requirements (of May 2013) refined in that higher capital is required for extent of change regarding placements with nonresidents, while base period of comparison is adjusted based on a two-year rolling period (but no longer in force since beginning of 2019)<br><br>February 2018: measures taken to strengthen use of lek in banking activity: (1) change in reserve requirement rates for Albanian lek as well as for FX, (2) higher minimum requirement of ratio of liquid assets to short-term liabilities in FX, (3) banks requested to carry out moral suasion measures among potential unhedged FX borrowers<br><br>Liquidity coverage ratio (LCR): On a solo basis, banks have to comply with the minimum level of LCR starting from March 1, 2020; on a consolidated basis, from January 1, 2022<br><br>**Exceptional measures due to the COVID-19 crisis:**<br>– Loan repayment moratorium: relaxation of requirements for loan classification and provisioning to allow banks to defer loan installments of households and corporates without penalties (expired), extended to three important sectors: tourism (until end-2020), clothing and manufacturing sector (until autumn)<br>– Making it possible for banks to restructure current loans considering the solvency of borrowers without additional costs and without downgrading the status of borrowers (unitl end-2020)<br>– Suspension of dividend distribution for banks until end-2020<br>– Suspension of the creation of reserve funds for real estate obtained versus the payment of loans until end of 2020 |

*Source: National central banks, IMF.*

[1] *The list is not exhaustive.*

Table 2.1

## Macroprudential policy in the Western Balkans[1]

**Bosnia and Herzegovina**

| Legal and regulatory basis | Objectives and involved institutions | Instruments | Actual application |
|---|---|---|---|
| Law on the Central Bank of Bosnia and Herzegovina (CBBH) (Official Gazette of Bosnia and Herzegovina (FBiH), no. 1/1997)<br><br>2014: Banking Agency of the FBiH (FBA): "Decision of Minimum Standards for Capital Management in Banks and Capital Hedge" (Official Gazette of FBiH, no. 48/14)<br><br>2014: Banking Agency of Republika Srpska: "Decision of Minimum Standards for Capital Management in Banks and Capital Hedge" (Official Gazette of Republika Srpska, no. 57/14)<br><br>2017: Law on Banks of FBiH (Official Gazette of FBiH, no. 27/17)<br><br>2017–2019: Law on Banks of Republika Srpska (Official Gazette of Republika Srpska, no. 41/17, 19/18 and 54/19)<br><br>Decision on calculation of capital in banks, Official Gazette of FBiH, no. 81/17 and Decision on calculation of capital in banks, Official Gazette of Republika Srpska, no. 74/17<br><br>Decision on Liquidity Risk management, Official Gazette of FBiH, no. 81/17 and Decision on Liquidity Risk management, Official Gazette of Republika Srpska, no. 04/18 | CBBH: monitoring systemic risks and actively cooperating with all institutional stakeholders<br><br>CBBH: active role in maintaining financial stability through coordinating the activities of the two entities' banking agencies; cooperating with relevant international and domestic institutions to ensure continuity of systemic risk monitoring. CBBH contributes to the preservation of financial stability within its membership in the Standing Committee for Financial Stability of Bosnia and Herzegovina<br><br>2014: FBA: strengthening the resilience of banks in the face of potentially severe crisis situations<br><br>2014: Banking Agency of Republika Srpska: strengthening the resilience of banks in the face of potentially severe crisis situations<br><br>**Institutions:** mandate for macroprudential policy not explicitly delegated to any specific institution; CBBH, banking agencies of the two entities | CBBH: minimum reserve requirements, systemic liquidity managment<br><br>FBA: end-2015: capital leverage ratio, end-2016: capital conservation buffer<br><br>Banking Agency of Republika Srpska: end-2015: capital leverage ratio, end-2016: capital conservation buffer<br><br>From 2017: FBA, Banking Agency of Republika Srpska (see actual application)<br><br>Agencies are considering introduction of countercyclical capital buffer and systemic risk buffer | CBBH: recently (up to 2020): minimum required reserve ratio: 10%<br><br>FBA, Banking Agency of Republika Srpska: from January 2017 (in both entities): minimum CET1 ratio: 6.75% , minimum CET1 ratio: 9%, minimum total regulatory capital ratio: 12%, capital conservation buffer: 2.5% of total amount of risk-weighted exposure, minimum leverage ratio: 6%, minimum liquidity coverage ratio: 100%, limits on net open FX exposures for EUR: 30% of capital, for all other currencies: 20%, and for total FX position: 30%<br><br>FBA introduces liquidity coverage ratio (LCR) from Q2 2018, and Banking Agency of Republika Srpska from Q2 2019<br><br>**Exceptional measures due to the COVID-19 crisis:**<br>– 2020: During the state of "natural or other disaster in the territory of Bosnia and Herzegovina" banks are allowed to use the capital conservation buffer if they retained earnings from 2019 and postponed the payout of dividends and bonuses<br>– Banking Agencies instructed banks to support customers in case of repayment difficulties, e.g. by offering a loan moratorium of a maximum of six month and the revision of fees; extended until end-2020; a one-year moratorium on loans for hotel investments was agreed between the Federal Ministry for Environment and Tourism and the FBA<br>– Approval of an additional exposure amount for overcoming client liquidity problems<br>– Relaxation of loan settlement requirements for customers, extension of regulatory forbearance measures, in combination with easing of reclassificaiton and provisioning |

*Source: National central banks, IMF.*

[1] *The list is not exhaustive.*

Table 2.2

## Macroprudential policy in the Western Balkans[1]

**Kosovo**

| Legal and regulatory basis | Objectives and involved institutions | Instruments | Actual application |
|---|---|---|---|
| 2016: Executive Board of the Central Bank of the Republic of Kosovo adopts "Macroprudential Policy" (August 10) | Helping safeguard the stability of the Kosovo financial system by strengthening the latter's resilience and decreasing the buildup of systemic risk<br><br>Intermediate objectives:<br>–Mitigating and preventing excessive credit growth and leverage as well as excessive maturity mismatch and illiquidity<br>–Limiting direct and indirect exposure concentrations as well as systemic impact of misaligned incentives aimed at reducing moral hazard<br>–Strengthening the resilience of financial infrastructures<br><br>**Institutions:** Executive Board of the Central Bank of the Republic of Kosovo, supported by Macroprudential Advisory Committee | –To mitigate and prevent excessive credit growth: reserve requirements, aggregate lending limits, lending limits on specific sectors, leverage ratio, countercyclical capital requirements, capital adequacy ratio, loan-to-value ratio, loan-to-borrower's income ratios, loan-to-deposit cap<br>–To counter maturity mismatch: maturity mismatch limits<br>–To counter illiquidity: reserve requirements, liquidity ratios, emergency liquidity facility<br>–To limit exposure concentrations: large exposure restrictions, related party lending limits, large exposure limits on funding, FX exposure limits<br>–To limit systemic impact of misaligned incentives: limits on dividend payments, limits on remuneration levels and systems, SIFI capital surcharge<br>–To strengthen resilience of financial infrastructures: increased disclosure, limits on external funding, limits on wholesale market funding | Continuation of work for operationalizing macroprudential policy and instruments<br><br>**Exceptional measures due to the COVID-19 crisis:**<br>–Loan repayment moratorium for corporates and households, expired; extension of the deadline for the submission of applications for loan restructuring until September 30, 2020<br>–Revision of requests for the suspension of credit repayments and the freezing of individual credit ratings |

*Source: National central banks, IMF.*

[1] *The list is not exhaustive.*

Table 2.3

## Macroprudential policy in the Western Balkans[1]

**Montenegro**

| Legal and regulatory basis | Objectives and involved institutions | Instruments | Actual application |
|---|---|---|---|
| Law on Credit Institutions (Official Gazette of Montenegro, no. 72/2019) – planned implementation from January 1, 2021 | Preventing financial crisis of systemic proportions, combating credit risks, liquidity risks and other sector risks<br>**Institution:** Central Bank of Montenegro | Large exposure limits (liquidity-based measure, see actual application)<br>**Capital buffers** (comprising CET1 capital): capital conservation buffer: 2.5% of total risk exposure, countercyclical capital buffer: 0% to 2.5% of total risk exposure, structural systemic risk buffer: at least 1% of exposure, G-SII buffer: 1% to 3.5% of total risk exposure, O-SII buffer: up to 2% of total risk exposure | **Large exposure limits:** exposure to one person or group of connected persons may not exceed 25% of CET1 capital<br>Application of capital buffers planned from January 1, 2021<br>**Exceptional measures due to the COVID-19 crisis:**<br>–Permission to increase exposures to a person or group of related parties beyond the prescribed exposure limits (25% of the bank's own funds) without prior central bank approval<br>–Reduction of the fee that banks have to pay for withdrawing reserve requirement liquidity and of the mandatory reserve requirement for deposits with a maturity of up to one year from 7.5% to 5.5% and for deposits with a maturity of more than one year from 6.5% to 4.5%<br>–Banks may treat the restructured loan as a newly approved loan, provided that the loan beneficiary documents to the bank that financial position has or will deteriorate in the near future due to the adverse impact of COVID-19 on its operations and that the bank estimates that the loan beneficiary's creditworthiness will improve upon restructuring<br>–Banks can restructure and classify loans under certain conditions<br>–Loan repayment moratorium for households and corporates up to 90 days, expired; new moratorium for up to 90 days to creditors whose financial situation was negatively affected by the COVID-19 crisis; moratorium on loan repayment from priority sectors (tourism) from September 1, 2020, to August 31, 2021<br>–Tempory prohibition for banks of paying dividends to shareholders, except in the form of bank shares |

*Source: National central banks, IMF.*

[1] *The list is not exhaustive.*

Table 2.4

## Macroprudential policy in the Western Balkans[1]

North Macedonia

| Legal and regulatory basis | Objectives and involved institutions | Instruments | Actual application |
|---|---|---|---|
| Absence of explicit macroprudential legal framework<br>Amendments to Banking Law from October 2016 (Official Gazette of the Republic of Macedonia 190/16) | Curbing financial vulnerabilities, containing buildup of systemic risk over time, and adjusting the resilience of the banking sector; and, more generally, preventing and reducing risks that affect financial stability<br>**De-euroization** in order to rein in currency risk<br>**Institutions:** National Bank of Republic of North Macedonia (NBRNM; de facto assumption of role of macroprudential authority), assisted by Financial Stability Unit (within NBRNM Financial Stability, Banking Regulations and Bank Resolution Department)<br>Moreover, signing of MoU in Q1/2020 reconstituting the Financial Stability Committee (comprising all regulatory and supervisory authorities of the republic including the NBRNM, the Ministry of Finance, the Agency for Insurance Supervision and others) to serve as principal domestic coordination body for macroprudential policy and crisis management, by i.a. monitoring systemic risks and recommending macroprudential measures | Risk weights (with respect to capital requirements) for banks' exposures<br>Mandatory write-offs of credit exposures that are fully provisioned/impaired<br>From 2016: capital conservation buffer, capital buffer for systemically important banks, countercyclical capital buffer, systemic risk buffer; reserve requirements (for de-euroization, differentiated) | 2015: **increase of risk weights** to curb excessive credit growth in various types of exposures (e.g. consumer loans)<br>**Mandatory write-offs** of credit exposures fully provisioned/impaired for two years (since July 2019: for one year)<br>Extension (from 2013) until end-2017 of nonstandard **reduction of reserve requirement** base for banks for amount of newly approved loans to net exporters and domestic producers of electricity<br>From March 2017: **capital conservation buffer:** 2.5% of risk-weighted assets (minimum)<br>From March 2018: **banks identified as systemically important** as of April 2017 are required to fulfill adequate level of respective **capital buffers** (ranging from 1% to 2.5%)<br>**Reserve requirements:** differentiation of rates on denar and FX deposits, from 2016 increase on FX-linked deposits<br>**Exceptional measures due to the COVID-19 crisis:**<br>–Banks are not allowed to implement higher risk weights for consumer loans with maturities that were prolonged in the period from March to September 2020, which resulted in contractual maturity of more than 8 years<br>–Postponement of the deadline for submitting ILAAP (internal liquidity adequacy assessment process) forms (from May 30 to September 20, 2020)<br>–Banks can initiate changes in loans' contractual terms without client request, which clients can accept/decline within 10 days; extended: banks can allow a second period of deferred payment of loan liabilities (with clearly defined criteria by banks for approval of a second period of deferred payment up to six months; in addition, in the period from March to September 2020, banks' clients can also request changes in their loans' contractual terms (only for loans with performing status before the pandemic), without considering such change as restructuring (forbearance)<br>–Relaxation of classification of nonperforming loans, but only until September 2020. Banks will be required to comply with the rules existing prior to March 2020 in terms of identification of NPLs and their adequate provisioning no later than December 2020. |

*Source: National central banks, IMF.*

[1] *The list is not exhaustive.*

Table 2.5

## Macroprudential policy in the Western Balkans[1]

**Serbia**

| Legal and regulatory basis | Objectives and involved institutions | Instruments | Actual application |
|---|---|---|---|
| 2010: assignment of legal mandate for macroprudential policy to the National Bank of Serbia (NBS): Article 4, Item 3 of the Law on the National Bank of Serbia (RS Official Gazette, nos. 72/2003, 55/2004, 85/2005, 44/2010, 76/2012, 106/2012, 14/2015, 40/2015, 44/2018); 2011/17: NBS Decision on measures for safeguarding and strengthening stability of the financial system<br><br>March 2015: adoption of Macroprudential Framework by NBS<br>December 2016: adoption of secondary legislation on capital adequacy, liquidity risk management, reporting requirements and other items applicable as of June 30, 2017 | Reducing financial system vulnerability and increasing resilience to financial and economic shocks; mitigating cyclical as well as structural dimensions of systemic risk<br><br>**Dinarization strategy:** limiting euroization risk and promoting the use of domestic currency<br><br>Intermediate macroprudential objectives:<br>–Mitigating and preventing excessive credit growth and leverage<br>–Preventing excessive maturity mismatch between funding sources and placements of financial institutions<br>–Limiting systemic impact of misaligned incentives in terms of favoring certain financial institutions, strengthening resilience of financial infrastructure<br>**Institution:** NBS | Stress tests to assess sector solvency risks (related to excessive credit expansion) and liquidity risks (related to rapid outflow of deposits) in case of unfavorable macroeconomic conditions or loss of depositor confidence<br><br>Increase of capital requirements: see actual application<br>Dinarization: see actual application<br>–To counter excessive credit growth and leverage: countercyclical capital buffer, sectoral capital buffer, limit on leverage ratio, loan-to-value limit (mortgage), loan-to-income limit<br>–To counter excessive maturity mismatch: liquidity coverage ratio, net stable funding ratio, loan-to-deposit ratio<br>–To check exposure concentrations: cap on exposure to particular sector or asset class<br>–To limit systemic impact of misaligned incentives: capital buffer for systemically important financial institutions<br>–To strengthen resilience of financial infrastructure: systemic risk buffer | **Stress tests** (solvency and liquidity) carried out quarterly<br><br>–Dinarization measures: **80% loan-to-value limit** (for FX or FX-indexed housing loans); permission of banks to provide FX or FX-indexed loans to natural persons subject to a down-payment or placement of deposit of no less than 30% of the loan amount (no such restriction for euro-indexed loans); loosening through reduction of reserve requirements on FX deposits<br>–From mid-2017: capital buffers: **capital conservation buffer** (2.5% of risk-weighted assets), countercyclical capital buffer (0%), systemic risk buffer (3% of FX and FX-indexed domestic bank exposures), **capital buffer for a systemically** important bank (1% to 2% of risk-weighted assets)<br>–January 2019: increase of capital requirements regarding general-purpose consumer loans<br><br>**Exceptional measures due to the COVID-19 crisis:**<br>–March 2020: relaxation of loan-to-value limit for mortgages of first-home buyers from 80% to 90%<br>–90-day loan repayment moratorium for all bank loans and financing leasing agreements with opt-out clause; extended until end-September<br>–Regulation encourages banks to offer debtors options for refinancing consumer, cash and other loans for up to two years. The relief can be offered to debtors even if, after refinancing, the credit burden to a debtor's income is higher than 60%<br>–July 2020: NBS regulations adopted in order to facilitate repayment of household loans granted by March 18, 2020 |

*Source: National central banks, IMF.*

[1] *The list is not exhaustive.*

## 3 Macroprudential policies since COVID-19: What has changed?

The COVID-19 crisis has significant implications for financial stability and hence for macroprudential policies in the Western Balkans. Overall, the authorities in the region reacted swiftly and forcefully at the onset of the crisis in all policy spheres, and central banks have implemented measures to combat the negative impact of the crisis, taking into consideration country-specific factors. But also international institutions providing guidance with respect to prudential regulations (e.g. the Bank for International Settlements and the European Banking Authority) have given some direction how to address financial stability challenges arising from COVID-19 from a macroprudential viewpoint.[17] Generally, measures have tended to focus on the relaxation of regulatory standards to cushion the negative impact on households, corporates and banks (see table 2).

While the relaxation of macroprudential measures has played a role, the Western Balkan economies' policy response to COVID-19 was largely beyond the macroprudential realm as understood above. In the following, we therefore provide a somewhat more comprehensive overview of measures implemented by central banks in response to the COVID-19 crisis.[18] The bulk of measures comprises some form of moratoria on loan repayment for households and corporates that were implemented in all Western Balkan economies at the onset of the crisis. Loan moratoria differ in length of the postponement (up to six months in Bosnia and Herzegovina) and in terms of opt-in or opt-out options (the latter in Serbia, where a loan moratorium is applied to all bank loans and financing leasing agreements unless the client declines the moratorium). Furthermore, there have been several changes to, or relaxations of, loan classification and provisioning rules to prevent loans from being classified as nonperforming.

Regarding the use of capital buffers, no changes occurred that can be directly linked to the COVID-19 crisis – apart from the postponement of planned ratio hikes in the case of Albania.[19] At the same time, crisis-triggered temporary lenience in the assessment of credit quality and, more generally, in the calculation of capital, may have undermined the economic substance of capital buffers and thus may have made it easier for banks to observe them – in a purely formal way. In its June 2020 quarterly assessment of the countercyclical capital buffer, the National Bank of Serbia (2020) however argued that the buffer remains at zero to support the credit activity of banks and to mitigate the adverse effects of the crisis on the financing of corporates and households.

[17] *For instance, the Bank for International Settlements announced the postponement of Basel III implementation to support banks and supervisors in coping with the current entirely unexpected challenges to financial stability (press release March 27, 2020: https://www.bis.org/press/p200327.htm) and the European Banking Authority put up several guidelines on the implementation of prudential policies in the context of COVID-19 (e.g. press release March 25, 2020: https://eba.europa.eu/eba-provides-clarity-banks-consumers-application-prudential-framep work-light-covid-19-measures).*

[18] *That said, explicit monetary policy measures such as changes of key policy rates or liquidity support to the banking sector are outside the scope of our study. For an overview, refer to the IMF policy tracker: https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19.*

[19] *While this development appears to differ from reactions in EU countries, where particularly countercyclical capital buffers were loosened in a number of cases, one has to add of course that in the majority of Western Balkan economies (including Albania), capital buffers do not yet play a meaningful economic role. For more information on macroprudential and policy measures taken in response to the coronavirus crisis in EU member and euro area countries, see European Systemic Risk Board (2020) and European Central Bank (2020).*

We only found one easing measure that can be clearly related to a borrower-based instrument, simply because not so many borrower-based instruments are in use in the Western Balkans: Serbia relaxed the loan-to-value limit for first-time home buyers from 80% to 90%, but without explicitly stating that the relaxation was related to the COVID-19 crisis.

Central banks in the Western Balkans introduced several measures with the aim of facilitating lending activity by banks. In Montenegro, the limit on exposures vis-à-vis an individual (or a group of related parties) was relaxed. Now the exposure limit of 25% of a bank's own funds can be exceeded with the approval of the Central Bank of Montenegro. Furthermore, the central banks of Montenegro and North Macedonia relaxed reserve requirements.

As the region is in the midst of the pandemic, further measures to support the financial sector are likely to be put in place. Overall, for the time being and based on information available, financial stability seems to be preserved in the Western Balkan economies despite strong headwinds as the COVID-19 crisis unfolds. So far, there is only scarce evidence on the actual impact of crisis-related measures, for instance, how many households and corporates have used a loan moratorium. Furthermore, the share of loans now under a temporary moratorium that will eventually turn nonperforming is currently incalculable.[20] This is certainly not only the case for the Western Balkan countries but also true for more advanced economies, such as the euro area. The effectiveness of measures to mitigate the adverse impact of the crisis as well as its medium- to long-term impact on macro-financial stability will only be assessable with a certain lag of time.

## 4 Summary and conclusions

This short study tries to take stock of macroprudential policy instruments and their recent development in Western Balkan economies. As far as the authors are aware, no such comparative stocktaking has been done in recent years for this region. We cover the last five years (since 2015), and of course, take a particular look at developments since the outbreak of the COVID-19 crisis in March 2020. Our delimitation of macroprudential instruments largely corresponds to that applied by Eller et al. (2020).[21] The banking landscape in the region is dominated by foreign-owned credit institutions domiciled in the EU, and banks tend to be generally in good shape, profitable and well capitalized. Credit growth has been relatively weak in most countries, if fueled by partly uncollateralized general purpose household loans. Shares of foreign currency loans in total loans – disregarding unilaterally euroized Kosovo and Montenegro – continue to hover at rather high double digits, and deposit euroization also remains stubbornly at elevated levels.

In recent years, the Western Balkan economies have shown different speeds in creating and refining toolkits of (macro)prudential instruments and in preparing

[20] *According to the NPL monitor for the CESEE region (Vienna Initiative, 2020) different waves of new flows of nonperforming loans can be expected: an immediate spike in the fourth quarter of 2020, a slower but more widespread wave in the first half of 2021 and a third wave toward the end of 2021 related to sectoral spillovers.*

[21] *Based on the findings of this study, it might be possible to carry out further research. For instance, the CESEE macroprudential policy index (MPPI) established by Eller et al. (2020) might be enlarged to include the Western Balkan economies, which would make it possible to analytically discuss the intensity of measures in the respective economies. While a full econometric impact analysis covering the entire Western Balkan region will still have to wait some years owing to the, on average, still short data series, countries like Serbia and North Macedonia, which have more extended track records, might merit a closer look.*

them for implementation. Indeed, preparatory work is still ongoing with respect to large parts or entire toolkits in three countries (Albania, Kosovo and Montenegro). All countries of the region are generally oriented toward Basel III-related harmonization, e.g. concerning minimum capital requirements, and toward EU macroprudential policies, given that they strive to (eventually) join the European Union. Apart from combating systemic risks, macroprudential goals notably include de-euroization or promotion of national currencies in those countries that possess their own legal tender. Serbia and North Macedonia have clearly gathered the most experience in the region when it comes to using macroprudential instruments (including capital buffers, reserve requirements, single client exposure limits, risk weights and loan-to-value limits), followed at a distance by Albania and Bosnia-Herzegovina. The biggest challenges (at least prior to the COVID-19 crisis) have included (1) the elevated growth rates of partly unsecured consumer loans – to which Serbia has responded by increasing related capital requirements; (2) the (to different extents) still high shares of foreign currency loans in total loans in the individual countries – notwithstanding various de-euroization measures and (3) elevated ratios of nonperforming loans.

The COVID-19 crisis quickly triggered the relaxation of some measures and regulatory standards to cushion short-term negative impacts on households, corporates and banks. However, the bulk of crisis containment measures being applied is situated outside the macroprudential realm and includes e.g. moratoria on loan repayments, adjustments in loan classification and provisioning rules. While the COVID-19 crisis has hardly changed official capital buffer policies (except in Albania, which has effectively relaxed its stance), temporary lenience in the assessment of credit quality and the calculation of capital may have undermined the economic substance of the buffers and thus made it easier for banks to formally observe them.

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