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Annex 2 Survey of banks' risk perceptions

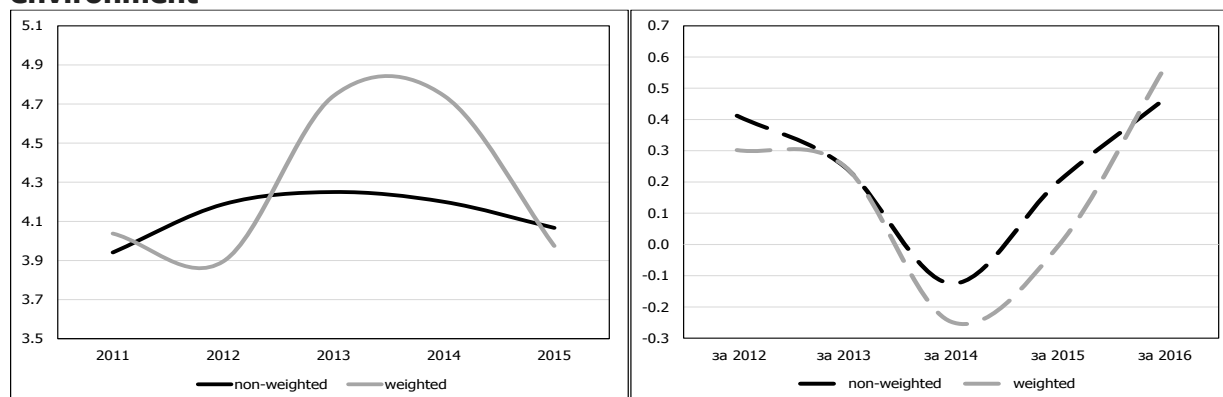
The Banks' Risk Perception Survey seeks to inform about the perceptions of banks operating in the Republic of Macedonia of the main sources of bank risks. The survey and processing of responses are performed annually by the National Bank of Macedonia.

The survey divides the risks in five groups as risks arising from: macroeconomic environment, financial markets, banking sector, strategy of the bank or the banking group, and amendments to regulations. Moreover, the survey asks banks to adequately rank risks by their significance and to express their expectations for the next calendar year. Banks assess the current level of each of the five groups of risks in the range from 1 to 5 (1 means that the risk group is of little significance for the bank, and 5 means that that risk group is extremely important for the bank at the time), while expectations are expressed by qualitative assessment of the risk direction (growing "+1", decreasing "-1", or unchanged "0").

Risks of the utmost significance in 2015 and the greatest impact on the banks' operations in 2016 include risks arising from the macroeconomic environment.

Chart 1

Current levels (left) and expectations (right) of risks arising from the **macroeconomic environment**



Banks' assets to total bank assets ratio is used as a weight for calculation of the weighted average grade.

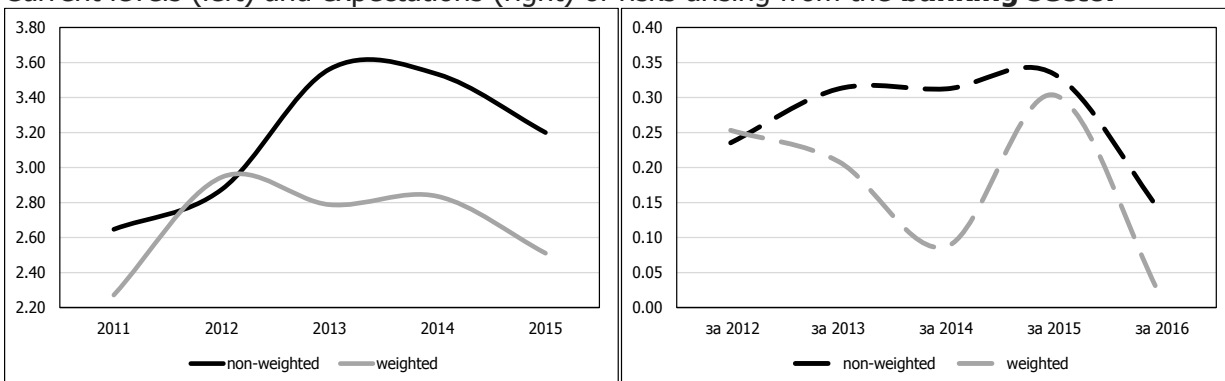
This risk group is marked by many uncertainties, so over the years back, one can observe differences between the banks' expectations for the future movements of these risks and estimates for their current level. Namely, although the assessments for the current level of risks arising from the macroeconomic environment were reduced by 0.1 compared to 2014, banks expect an increase in the impact of these risks in 2016, primarily due to external risks and political instability. Amid severe risks arising from the macro-economic nature, the banks in the survey conducted in 2015, rely most of their assessments on: uncertainty regarding the political crisis which contributes to restraint from greater economic activity, uncertainties on the pace of global recovery, reduced liquidity and indebtedness of the corporate sector, uncertainties about global prices of raw materials and the main export products, and on the movement of prices in the domestic economy and the public finances.



The second most important group of risks for the banks' operations are those arising from the banking sector.

Chart 2

Current levels (left) and expectations (right) of risks arising from the **banking sector**



Banks' assets to total bank assets ratio is used as a weight for calculation of the weighted average grade.

Banks with lower market share point to this group of risks as having a higher importance than banks with greater market share, which is the reason behind the significant difference between the weighted and non-weighted level of this group of risks. One of the main factors of such ranking of this risk group by the banks is the competitive pressure among banks, with special emphasis on interest rate policy and more liberal criteria for approving loans that may lead to a significant reduction in the quality of the loan portfolio, and therefore to increased future losses. Also, banks point to the fact that clients are fed up with the offered homogenous products, the lack of new versatile range of banking products and possible consolidations in the banking sector.

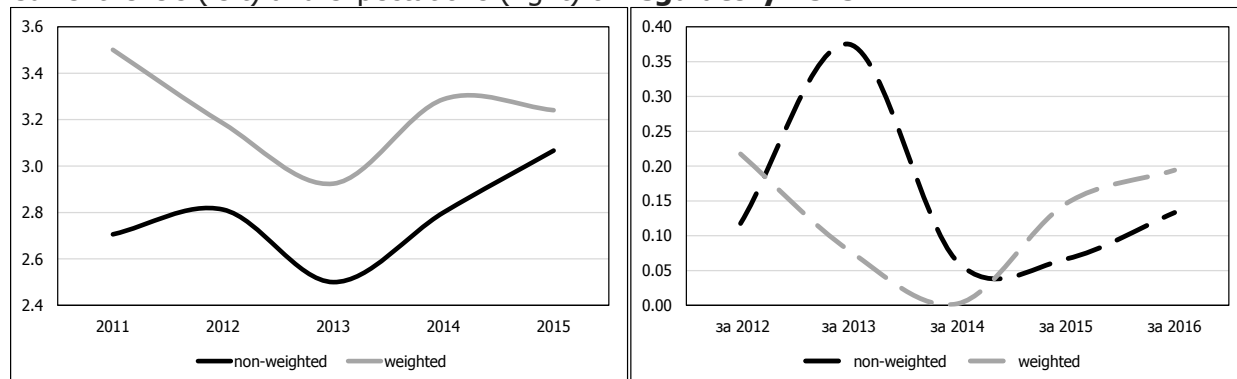
Banks, especially those with higher share in the total assets of the banking system, expect the importance of this group of risks to decrease during 2016.

Third most important group of risks for the banks is the risks arising from changes in the regulatory framework. Banks assessments indicate growth in the level of these risks in 2015, which is based on the following factors: negative impact on the banks' financial result of the enforcement of new legislation (e.g. regulations on accounting and regulatory treatment of foreclosed assets), amendments to regulation requiring modifications in software applications that impose additional investments in software solutions, risks of mutual incompatibility of certain regulations, lack of transparency and involvement of banks in the development of regulations that affect their operations. All this leads banks to expect higher regulatory risks.



Chart 3

Current levels (left) and expectations (right) of **regulatory risks**

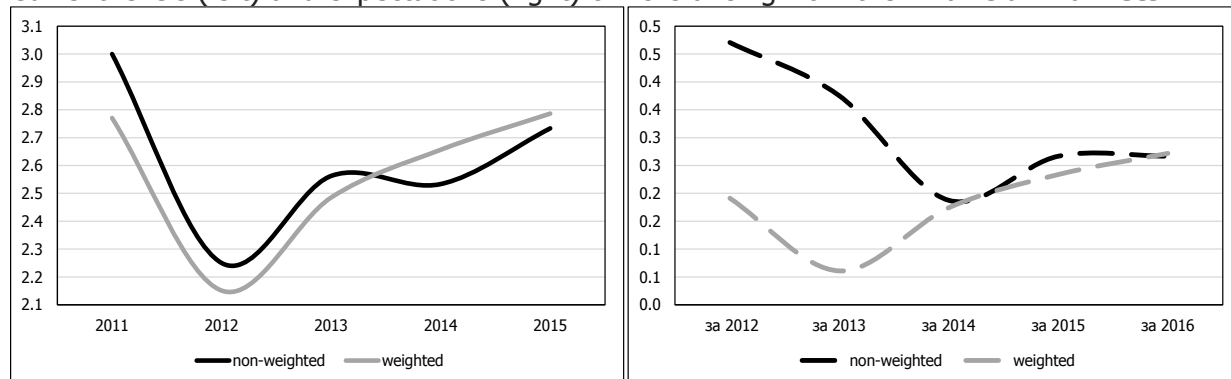


Banks' assets to total bank assets ratio is used as a weight for calculation of the weighted average grade.

The fourth most important group of risks for the banks' operations are the risks arising from developments in the financial markets. According to the banks, the level of group of risks arising from financial markets continue growing, and the expectations are that during 2016 the importance of this group of risks will remain the same. The banks indicated the following as risk factors in this group: volatility of financial markets in the euro area that increases the interest rate risk on the international financial markets and the domestic interest rate risk.

Chart 4

Current levels (left) and expectations (right) of risks arising from the **financial markets**



Banks' assets to total bank assets ratio is used as a weight for calculation of the weighted average grade.

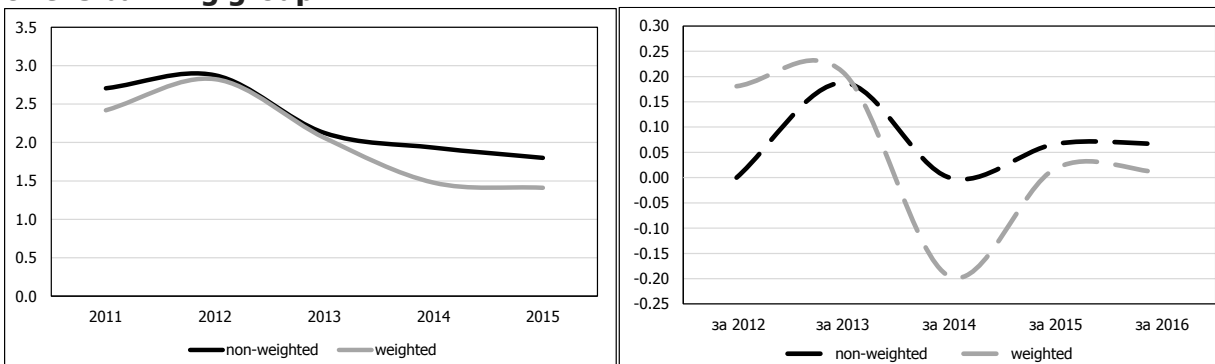
However, the lesser importance of this group of risks reflects the simple structure of the Macedonian financial system and the underdeveloped financial market, making banks to accept deposits in a traditional manner.

The banks assessed risks that arise from the strategy of the bank or the banking group as risks with the least importance.



Chart 5

Current levels (left) and expectations (right) of risks arising from the **strategy of the bank or the banking group**



Banks' assets to total bank assets ratio is used as a weight for calculation of the weighted average grade.

According to the banks, their market- and profit-oriented strategies include increasing number of activities, introducing new products, and therewith, increasing number of new and satisfied customers. Against this background, the group of risks arising from the strategy of the bank or the banking group has little influence. Also, the response analysis show differences in perceptions among banks. Banks with greater market share on average give lower grade for the impact of this group of risks on the operations compared to the banks with smaller market share. Banks do not expect the importance of this group of risks to change in 2016.

The Banks' Risk Perception Survey includes additional questions that banks answer descriptively. Answers to these additional questions from the survey conducted in late 2015 are given in the table below.

| | |
|---|--|
| <i>1. Does the bank have insight in the extent of exposure to interest rate risk in the banking book, if it applies only fixed and variable interest rates (without applying adjustable interest rates)?</i> | |
| number of banks that answered "YES" | number of banks that answered "NO" |
| 12 | 2 |
| <i>2. When applying interest rate adjustment option, do changes apply only to new or also to existing agreements, both for loans and for deposits?</i> | |
| number of banks that responded only with "NEW " | number of banks that responded with "NEW AND EXISTING" |
| 2 | 12 |
| <i>3. Does the Decision on accounting and regulatory treatment of foreclosed assets have an impact on the bank's approach/strategy in terms of (non)foreclosing of assets?</i> | |
| number of banks that answered "YES" | number of banks that answered "NO" |
| 6 | 8 |
| <i>4. Do you expect the initiated increase in the Fed's policy rate to affect your interest rates on deposits and loans denominated in US dollars, including those denominated in denars with US dollar clause?</i> | |
| number of banks that answered "YES" | number of banks that answered "NO" |
| 2 | 12 |