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ANGELA ZAFIROVA*
BILJANA ANGELOVA**

IMPACT OF COVID-19 ON THE PERFORMANCE OF BANKING SECTOR AND THE SET OF MEASURES UNDERTAKEN IN THE REPUBLIC OF NORTH MACEDONIA

Abstract: The current crisis caused by Covid-19 pandemic has damaged the global economy, causing significant changes to every aspect of the global banking system, and Republic of North Macedonia is no exception. Since the banks are the main source of liquidity insurance for economies and they perform a very important intermediation role it is very important to study the impact of Covid-19 pandemic on the performance of the banking sector in the RNM. Because of that, the first aim of this paper is to analyze the defense function though a set of measures constructed in a direction of the support of the banking sector in the Republic of North Macedonia. The second aim of this paper is to analyze the impact on the banking sector in the Republic of North Macedonia caused by the Covid-19 pandemic. From the results obtained, we concluded that although the banks in the RNM faced a lot of challenges caused by the Covid-19 pandemic, they managed to maintain their profitability and stability and even to contribute in the process of mitigation of the consequences of the pandemic in the RNM.

Keywords: Covid-19, CAMEL, bank performance, banking sector

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* Assistant, MSc, Institute of Economics - Skopje, Ss. Cyril and Methodius University, Skopje, Republic of North Macedonia, E-mail: angela.zafirova@ek-inst.ukim.edu.mk

** Full-time Professor, PhD, Institute of Economics -Skopje, Ss. Cyril and Methodius University, Skopje, North Macedonia, E-mail: b.angelova@ukim.edu.mk

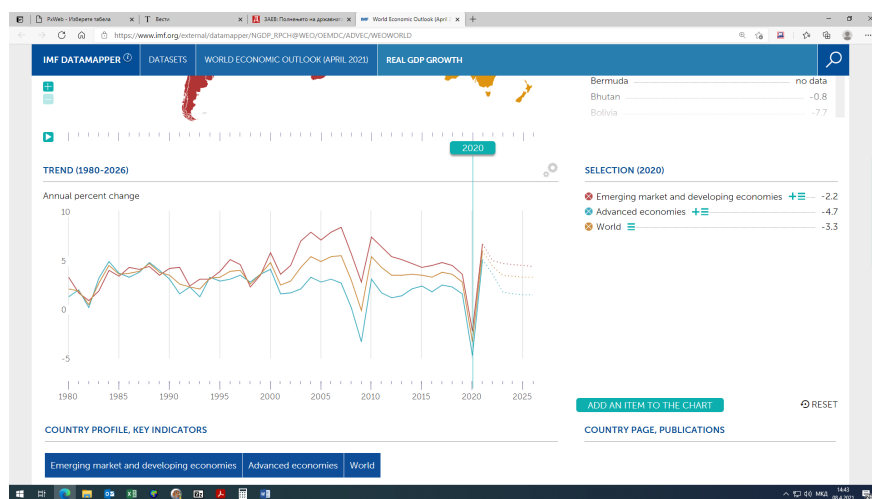
Introduction

The financial system is one of the pillars of statehood of Republic of North Macedonia. The stability of the financial system directly affects the stability of the state and all spheres of normal social functioning. During every crisis of an economic of financial nature in the country or abroad, the financial system, represented mainly by the commercial banks and the Central Banks, is under attack through various shocks. Since the country's monetary independence in 1991 and the package of laws passed in 1992 that provided an institutional framework for the monetary system, the banking system has been put through a number of challenges. With the maintenance of stable exchange rate of the denar, low level of inflation, continuous growth of foreign exchange reserves, the foundations of our statehood and independence were strengthened more and more. Throughout the years of North Macedonia's independence, the banking system has responded to a series of challenges, blockages, conflicts, financial crisis, thus standing out as one of the institutions with greatest trust among citizens. For the first time in recent history, the shocks caused by a health crisis have directly and indirectly caused disruptions in the economic and financial sectors in countries around the world. The health crisis that began with the emergence of the new type of corona virus "Covid19" spread across the globe with great speed at the level of pandemic and as expected, affected all social flows from the economy and finance to health, culture, art, that is the entire open system of connections and relationships in which individuals and groups function. The resulting pandemic presented a rare opportunity to activate the defense systems in direction of survival, reorganization and resetting of established habits, processes, trends and expectations. The "domino effect" which appeared caused consequences in our country as well, with an impact on citizens with controlled social behavior, with an impact of companies through disruption of international and domestic trade channels and investments, on domestic consumption with a further impact on the banking sector, budget implications etc. The first aim of this paper is to analyze the defense function though a set of measures constructed in a direction of the support of the banking sector in the Republic of North Macedonia. The second aim of this paper is to analyze the impact on the banking sector in the Republic of North Macedonia caused by the Covid-19 pandemic.

1. GENERAL OVERVIEW OF THE HEALTHCARE CRISIS AND ITS EFFECT ON THE ECONOMIC GROWTH

At the end of 2019 and the beginning of 2020, a small number of people adequately perceived the emerging epidemical situation in which the PRC is and what consequences it may have on individuals and companies around the world, the pandemic that slowly spread to all continents. The effects that resulted from the Covid-19 crisis left a deep mark in the normal functioning that we were used to until then. Today in the world there are over 400 million people who have been infected with the virus and over 5 million dead people by the end of 2021. In order to protect their citizens, the health authorities and the governments of the states have taken measures to reduce the spread of the infection by limited movement as well as through social and physical distance, which inevitably led to a decline in the world economy as a result of reduced consumer spending of the citizens, stopped investment cycle of the companies, delayed infrastructure and development projects of the governments etc.

Figure 1. Annual percentage change in GDP



Source: World Bank

As a result of the health crisis and the measures taken by the governments of the countries all over the world, in direction of protecting the health of their citizens and reducing the spread of infection through mass quarantines, the world economy during 2020 recorded the largest drop in GDP after the

Second World War by almost 3.3 percent. The decline of the world economy was in all sectors and almost all economies. The decline in the world economy was even higher than the decline in the world GDP during the international financial crisis in 2009. There was a decline in economic activity both in highly developed countries and in developing countries as well as in the fast-growing economies. The economies of highly developed countries in 2020 recorded a decline of 4.7 percent.

The activities undertaken by companies, individuals and state governments were aimed at mitigating the negative consequences of the corona virus. The labor market was seriously disturbed by the growth of the number of unemployed people. The number of directly lost jobs as a result of the negative impact of Covid19 crisis is estimated at 114 million jobs. Particularly affected were employees in the hospitality, transport and consumer goods stores. In conditions of general panic and fear, citizens opted for moderate consumption because as a result of mass quarantines they were limited in their options for personal consumption, while due to great uncertainty, they opted for delayed consumption of free cash resources for future and more stable periods that would follow.

The health crises have a profound negative impact on the economies of the countries around the world and the Republic of North Macedonia was no exception. In the Republic of North Macedonia, the health crises had a profound negative impact on the growth of the gross domestic product, international trade, labor market, foreign direct and domestic investments, reduced public spending, delayed private development and infrastructure projects, etc.

Table 1. Gross domestic product by production method for Republic of North Macedonia, at current prices for 2018, 2019, 2020 and 2021 (by sectors)

current prices (million denars)	2018	2019	2020	2021
A Agriculture, forestry and fishing	55979	56331	57351	52225
B, C, D and E Mining and quarrying; Manufacturing; Electricity, gas, steam and air conditioning supply; Water supply; sewerage, waste management and remediation activities	123187	125196	116703	121890
F Construction	35757	38994	35514	39157
G, H and I Wholesale and retail trade; repair of motor vehicles and motorcycles; Transportation and storage; Accommodation and food service activities; Wholesale and retail trade; repair of motor vehicles and motorcycles; Transportation and storage; Accommodation and food service activities	131737	140322	130471	138894
J Information and communication	22612	24365	26732	31249
K Financial and insurance activities	19276	19293	20636	21978
L Real estate activities	66152	68258	69940	75298
M and N Professional, scientific and technical activities; Administrative and support service activities	23822	26298	24251	28459
O, P and Q Public administration and defense; compulsory social security; Education; Human health and social work activities	76943	82218	88928	93220
R, S and T Arts, entertainment and recreation; Other service activities; Activities of households as employers; undifferentiated goods- and services-producing activities of households for own use	18458	20187	17555	20487
Value added	573922	601462	588081	622858
Net taxes on products	86956	91220	81199	97556
Gross domestic product	660878	692683	669280	720414
Real growth rates (in %)	2,90%	3,90%	-4,70%	3,90%

Source: State Statistical Office

According to Table number 1, the sectors G, H and I (Wholesale and retail trade; repair of motor vehicles and motorcycles; Transportation and storage; Accommodation and food service activities; Wholesale and retail trade; repair of motor vehicles and motorcycles; Transportation and storage; Accommodation and food service activities) and the sectors B, C, D and E (Mining and quarrying; Manufacturing; Electricity, gas, steam and air conditioning supply; Water), has the greatest impact on the on the amount of GDP of the North Macedonian industry. Those two sectors account for around 40% of the country's GDP value formulation. The drop in GDP in the North Macedonian industry amounts to almost 5 percent compared to 2019. It is interesting to be noted that the financial sector managed to increase its GDP despite of the Covid-19 crisis. But we can see that the economy in the Republic of North Macedonia in 2021, taking the GDP as measure is starting to recover from the Covid-19 pandemic.

2. IMPACT ON THE BANKING SECTOR IN THE REPUBLIC OF NORTH MACEDONIA CAUSED BY THE COVID-19 PANDEMIC THROUGH THE SET OF MEASURES IN THE COUNTRY

2.1 Measures adopted by the RNM government

Although there is no ideal set of measures that would completely nullify the negative impact of the COVID-19 crisis, the measures that were adopted in the RNM were aimed at preserving jobs, maintaining economic activity and stabilizing personal consumption. The first package of economic measures from the months of March and April 2020, until the most recent addition with the sixth package of economic measures in the amount of EUR 17.8 million to support the activities that were completely closed in order to prevent the spread of the coronavirus during the quarantine, as well as to improve the liquidity of the companies investing during the years 2020 and 2021. Total direct and indirect aid is estimated at around EUR 1.2 billion, though a set of 106 measured during the analyzed period.

2.2 Measures that affected the Banks and the Banks' customers

With all the measures adopted by NBRSM, their responsiveness, timeliness, far-reaching, in-depth analysis and their positive consequences, once again strengthened this institution and its management team as an entity with

greatest trust and reliability in the country. At the very beginning of the crisis, even though our country was faced with risks of that scale for the first time, a series of measures were developed by the National Bank, which were fully understood and used by the banks in the direction of protecting citizens and companies as well as the entire financial sector.

The most significant measures since the beginning of the crisis adopted by NBRSM will be elaborated briefly in the following part of this paper.

Based on the analyzes at the beginning of the crisis, it was decided to keep the level of the interest rate for treasury bills at 2% at the same offered amount of EUR 405 million. The analysis of the crisis was through the prism of comparison with the financial crisis of 2008, where the rate of capital adequacy, the gains from past years in the direction of recapitalization and the liquidity of the banking sector increased, the level of non-performing loans decreased, with the conclusion that the banking system has absorption capacity of the impending crisis.

In a situation where it became clear that the effects of the corona crisis will not be localized and is gaining an international character in countries all over the world, the National Bank reduced the reference interest rate on treasury bills, thereby giving a signal for monetary easing in conditions of low inflation, high foreign exchange reserves and potential risks that were in sight. The NBRNM made a decision to reduce the basic interest rate by 0.25 percentage points to 1.75 percent.

The National Bank re-introduced the non-standard measure regarding the mandatory reserve, which enables the reduction of the basis for the obligation of the mandatory reserve in denars of the commercial banks for the amount of the newly approved and restructured loans approved to the enterprises in activities that according to the information from the Government of the Republic of North Macedonia will be the most affected by the spread of covid-19. This measure will encourage uninterrupted credit support on favorable terms by the banks for the most affected sectors.

The Council of the National Bank held an extraordinary electronic session at which it adopted regulatory changes aimed at temporarily easing the financial burden of citizens and companies that are beneficiaries of loans. Mainly the changes were as following:

- Banks should reprogram the debts of their clients without a parallel increase in the provisions for those placements
- Banks should be able to postpone customer maturities for 6 months without a parallel increase in reservations for those placements

- Instead of the current approach, according to which banks and savings banks are obliged to record loans that are overdue for more than 90 days as non-performing, now the criterion for transitioning into a non-performing claim has been moved to 150 days
- Flexibility of banks and savings houses when changing the contractual conditions for repayment of loans in favor of customers, depending on the need and financial ability of each creditor-beneficiary. More favorable conditions may be a temporary postponement of the obligation for payment (grace period), extension of the due date, lower interest rate, approval of a new more favorable loan to close the existing one, etc., which enables the reduction of the current burden on citizens and companies in dealing with the negative pressures of the pandemic.

With the IMF decision, our country received financial support of around EUR 176 million. The financial support from the IMF was extremely important for us, both for the implementation of fiscal measures and for ensuring further growth of the foreign exchange potential of our economy, that is, for increasing the foreign exchange reserves. In this way, more space is created for implementing a loose monetary policy and for providing easier financial conditions for crediting the affected companies and citizens.

At the session of the Committee for Operational Monetary Policy of the National Bank it was decided to reduce the amount of treasury bills that banks can register with the Central Bank. At this session, it was decided that the offer of treasury bills will be reduced by MKD 8,000 million. The funds released by the reduced supply of treasury bills would provide further support to the Macedonian economy through the maintenance of credit flows and the credit cycle by the banking system. Shortly after this session another session was held where they agreed on Reduction of the basic interest rate by an additional 0.25 percentage points and an additional decrease of 7 billion MKD in the offer of treasury bills at the auction held by NBRSM.

The NBRNM recommended payment of pensions in coordination with the Banks in the direction of protecting the most elderly and also the most vulnerable categories in conditions of a pandemic.

With the regulatory changes adopted by the Council of the National Bank, it is foreseen that banks can offer their clients a second favorable change in the contractual conditions for credit products. The goal was to help those customers who are negatively affected by the covid-19 pandemic and despite all the measures feel a prolonged negative impact from the recession.

3. IMPACT ON THE BANKING SECTOR IN THE REPUBLIC OF NORTH MACEDONIA CAUSED BY THE COVID-19 PANDEMIC

In the first part of the analysis in this paper, in order to get conclusions about the credit activity, the growth of deposits and the effect on the banking sector in the Republic of North Macedonia, we will take the available data from NBRM. The analysis will take the credit exposure of the banking sector from the end of 2016 to the end of 2020 in order to see how and does the Covid-19 pandemic influenced the financial position and the performance of the banking sector in the Republic of North Macedonia. Additionally, in the analysis we will include the year 2021 (the last available data) in order to see their performance after Covid-19.

Table 2. Loans and deposits for all banks in the RNM for the period 2018-2021 (in million denars)

No.	Description	2018	2019	2020	2021
2	Gross loans to non-financial entities	320.085	339.699	353.502	383.627
	non-financial entities	162.775	166.723	168.420	183.639
	Households	153.229	169.510	181.166	196.167
3	Deposits of non-financial entities	371.333	405.587	430.870	468.844
	non-financial entities	100.948	114.853	127.385	142.478
	Households	257.036	276.671	288.992	309.051

Source: The National Bank of the RNM

From the information presented in Table 2, we come to a conclusion about the distribution of the loans and the deposits in the banks in the Republic of North Macedonia for the period 2018-2020. The growth of lending in 2019 and 2020 came to the greatest extent from lending to the households, while in

the section of loans to legal entities the growth was much smaller till the year 2021. The net deposit base in the analyzed period is divided in deposits of individuals and legal entities. The growth of domestic deposits in 2020 had almost identical growth of residential deposits and deposits of legal entities. Deposits of the state, non-profit institutions that serve households and non-residents entered with a small share that is not presented in the previous table.

From the perspective of the Income statement, i.e. financial result, the year 2020 was a successful year with a total profit MKD 7.252 million (Table number 3) and almost maintains the profit of 2019, which is mainly a result of the protection of the banking sector and the customers who use loans with the measure of deferment of obligations, increases in the value correction item on financial assets and a special reserve for potential client losses.

Table 3. Income statement for the banking sector in the RNM for the period 2018-2021 (million denars)

INCOME STATEMENT	2018	2019	2020	2021
	INTEREST INCOME	19.605	19.247	18.525
INTEREST EXPENSE	-4.225	-4.232	-3.451	-3.067
NET INTEREST INCOME	15.380	15.015	15.074	15.660
NET INCOME FROM COMMISSIONS AND FEES	4.639	5.075	4.844	5.594
NET INCOME FROM INSTRUMENTS MEASURED AT FAIR VALUE THROUGH INCOME STATEMENT (INCLUDING TRADING)	8	43	-45	28
NET INCOME FROM OTHER FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE THROUGH INCOME STATEMENT, DETERMINED AS SUCH AT INITIAL RECOGNITION	13	11	10	12
NET INCOME FROM EXCHANGE DIFFERENCES	858	922	1.020	1.144
OTHER INCOME	3.561	2.170	3.175	3.959
IMPAIRMENT LOSSES - CORRECTION OF VALUE OF FINANCIAL ASSETS AND SPECIAL PROVISION FOR POTENTIAL CREDIT LOSSES	-3.362	-4.206	-4.486	-3.853
LOSSES DUE TO DAMAGE TO NON-FINANCIAL ASSETS	-440	124	-46	5
EXPENSES FOR THE EMPLOYEES	-5.018	-5.188	-5.162	-5.401
AMORTIZATION	-1.078	-1.050	-1.084	-1.185
OTHER EXPENSES	-5.219	-5.401	-5.375	-5.928
PROFIT/LOSS BEFORE TAX	9.341	7.514	7.925	10.035
PROFIT TAX	-988	-829	-673	-885
PROFIT/LOSS AFTER TAX	8.353	6.685	7.252	9.150

Source: The National Bank of the RNM

In the second part of the analysis in this paper, as to whether the performance of the banking sector in the Republic of North Macedonia is influenced by the Covid-19 pandemic, the CAMEL model for evaluation of the performance of the banks was used. The sample used was consisted of all commercial banks in the Republic of North Macedonia. The period of study was divided into two segments, pre-pandemic period (years 2015-2019) and pandemic period (years 2020 and 2021) of Covid-19. Using the CAMEL model, we calculated the most important ratios for capital adequacy, assets quality, management efficiency, earnings quality and liquidity position for each bank and for each year and then we compute the composite CAMEL rating for each period (pre-pandemic and pandemic period) for each category and for each bank in order to get to a conclusion whether the performance of each commercial bank in the Republic of North Macedonia was influenced by the Covid-19 pandemic.

In the table number 4, you can see the ratios and the criteria for evaluating each CAMEL component.

Table 4. CAMEL components

CAMEL components	Indicator	Formula	Criteria
Capital	Capital adequacy ratio		$\geq 8\%$
Assets	NLP ratio Loan loss rate		$\leq 1\%$ $< 2\%$
Management	Profit per employee		Depends on the level of income
Earnings	ROA ROE		$\geq 1\% - 1.5\%$ ≥ 11
Liquidity	Current ratio		> 1

Source: Author's calculations

Table 5. Composite CAMEL rating

Name of the Bank	RANKING										COMPOSITE RANKING	
	2015 – 2019					2020-2021					2015-2019	2020-2021
	C	A	M	E	L	C	A	M	E	L		
BANK	C	A	M	E	L	C	A	M	E	L		
CKB	1	1	5	5	3	1	1	5	5	3	3	3
HALK	1	1	2	4	3	1	1	3	2	4	2	2
CAPITAL	1	5	3	5	2	1	3	5	5	3	3	3
KOMERCIJALNA	1	4	1	2	2	1	3	1	1	3	2	2
NLB	1	1	1	1	2	1	1	1	1	3	1	1
PROCREDIT	1	1	1	3	2	1	1	2	2	2	2	2
DEVELOPMENT BANK	1	1	3	5	1	1	1	2	4	1	2	2
SHARKASSE	1	1	4	4	3	1	1	3	3	2	3	2
SILK ROAD	1	2	3	3	3	1	1	3	2	3	2	2
STOPANSKA BANKA BITOLA	1	1	4	3	2	1	1	1	3	2	2	2
STOPANSKA BANKA SKOPJE	1	1	1	1	3	1	1	1	1	3	1	1
TTK	1	2	4	3	3	1	1	3	2	3	3	2
UNI	1	1	3	3	3	1	1	3	1	3	2	2

Source: Author's calculations

From the results obtained and presented in Table 5, we concluded that although the banks in the RNM faced a lot of challenges caused by the Covid-19 pandemic, they managed to maintain their profitability and stability and even to contribute in the process of mitigation of the consequences of the pandemic in the RNM. Some of the banks made a higher profit during the pandemic period compared to the years before the Covid-19, whereas almost all the banks had solid and stable liquidity position after the year 2019.

Conclusion

The emergence of a new health crisis, caused by Covid-19, with an unprecedented scale of spread in the world across all countries and continents brought new challenges during the years 2019, 2020 and 2021. As a result

of the health crisis, the economic activity at the conscious level experienced a great reduction. In a situation of reduced economic activity and a trend of decreasing employment, the financial sector collided with a potential risk that needed to be reacted to immediately. Withdrawal of deposits from banks as well as fear of job losses and thus problems in servicing credit obligations in banks and the loss of international and domestic markets, reduced sales and investments, i.e. closure of entities in the business sphere was something that was expected and in sight. The financial sector, which consists mostly of Banks and the Central Bank at the head of the system, was faced with the challenge of maintaining its stability. From the analysis in this paper, it can be seen that the answer was timely, direct and comprehensive. The Central Bank in coordination with the government and the banks adopted and implemented a set of measures that managed to maintain stability. The conclusion of the analysis is that the banking sector, with its capacity and the knowledge of the members of the supervisory and management boards, as well as with its mechanisms in the structure of the banks, responded quickly and efficiently to the new challenges. The central bank, as a pillar of the stability of the banking sector, once again demonstrated its professionalism and independence. As a result of the measures, the banking sector maintained and increased liquidity, the credit activity of banks was maintained, the existence of customers was not threatened under the pressure of their credit obligations. During the analyzed period, interest rates decreased, both on the side of the liabilities and the assets of the banks, the rate of non-performing loans of the banks was reduced, the profits, which are a source of stability, were largely maintained, and thus the adequacy of the capital in the segment of large and medium-sized banks, an increase was observed. Everyone was up to an unknown challenge and responded well.

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