



Governance Structure

-The Macedonian experience in FX reserves management-

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Workshop on Governance Framework for Reserve
Managers

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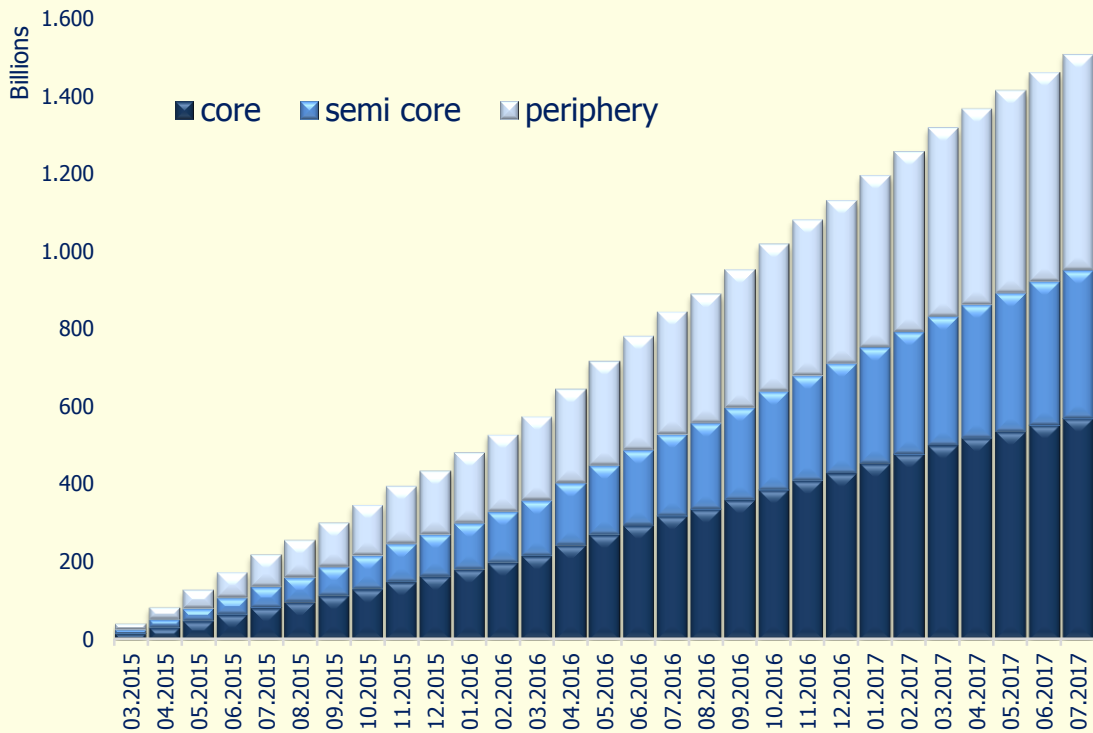
**FX reserves management under
unfavorable market environment**

Market environment Eurozone

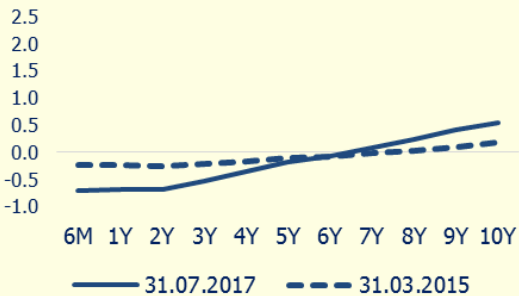
ECB's PSPP objectives:

- Improving broader financing conditions by reducing sovereign yields – negative till 5y!!!
- Rebalancing into private-sector assets

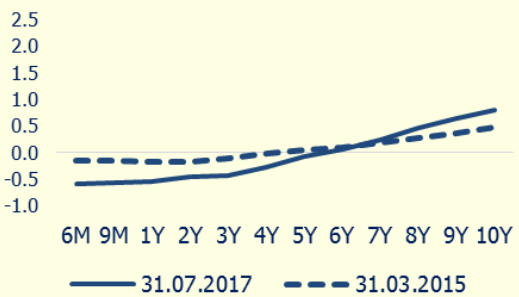
ECB PSPP breakdown



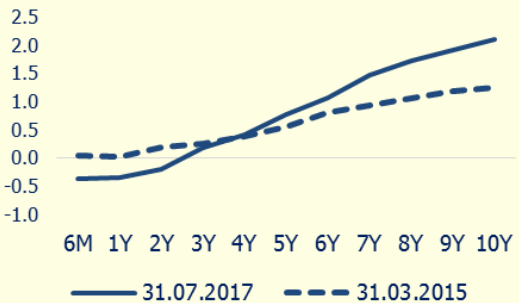
Germany Sovereign Curve



France Sovereign Curve

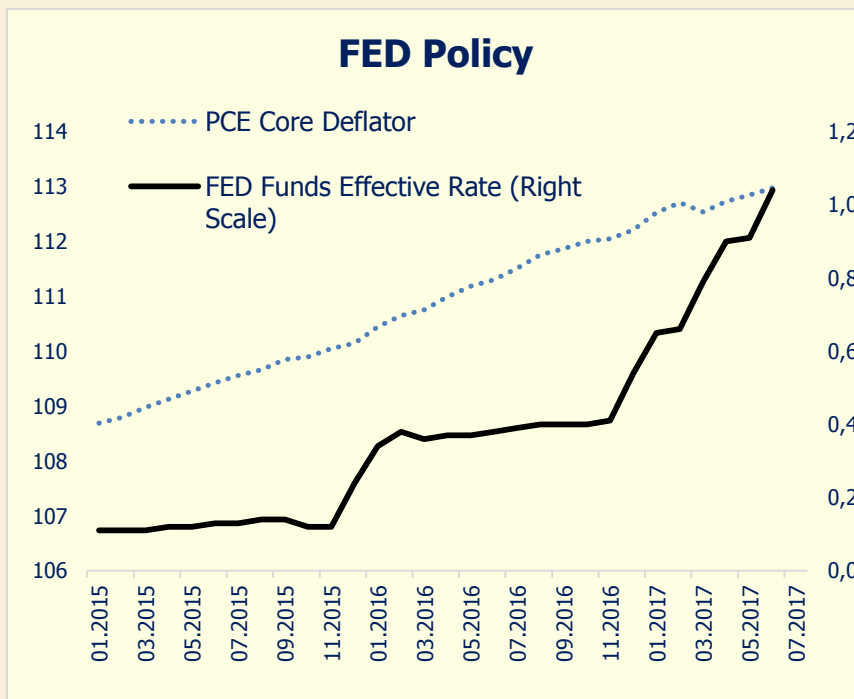


Italy Sovereign Curve

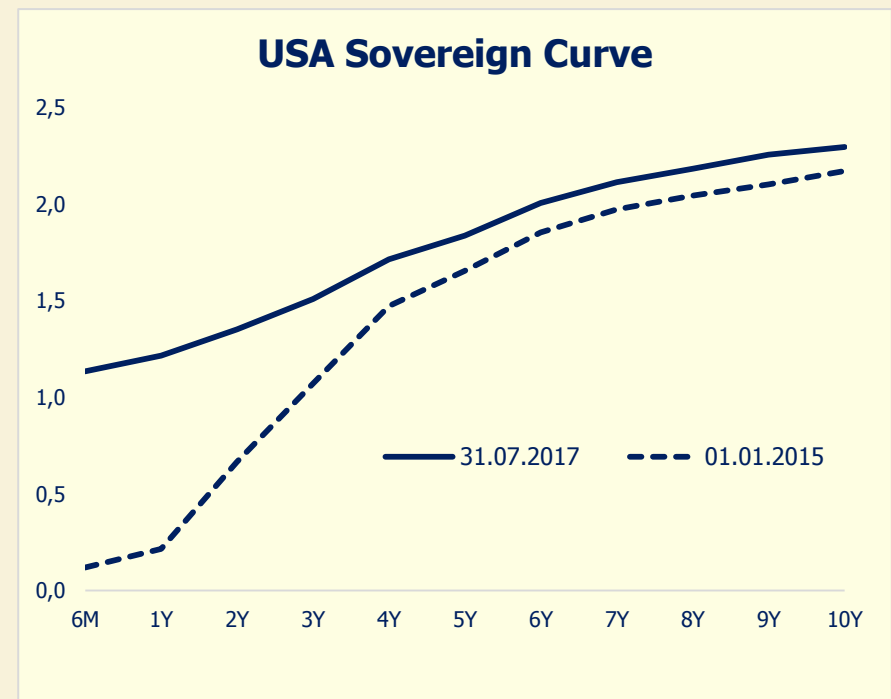


Market environment USA

FED policy rate in line with the upward trend of the PCE core deflator



US sovereign yield curve shift predominantly affected by the FED monetary policy



FX reserves management

In current market environment, CBs face two issues:

- internal -changing rationale for holding reserves as they grow and
- external issues - the state of markets and the level of yields

Combination of this issues determines the CB's profile in reserves management

Market position

Blocked

Market-mover

Price-taker

Small

In this area CBs largely act as **LIQUIDITY** managers

In this area CBs have to behave as **MARKET** managers

In this area CBs are predominantly **INVESTMENT** managers

This area is probably more suited to **SWFs**

Inadequate

Sufficient

Comfortable

Surplus

Significant

Size of reserves

NBRM in the group of **Price Takers** and with a role of **combined Liquidity and Investment manager**

FX reserves management Macedonia

Changing environment, low and negative yields in long period urge for strategic orientation towards changes in portfolio management



Markets

- Insufficient compensation of risk
- Low and negative rates (EUR)
- Compressed spreads
- Diverging monetary policies
- Market disturbances due to political risk

Investment Behavior

- Search for yield and preservation of capital
- Increase in market risk tolerance (currency risk and duration)
- Increase in credit risk tolerance
- Extending the scope of eligible assets (predominantly into money market, covered bonds, corporate bonds)

Portfolio changes

- Currency diversification (USD, AUD, CAD, other)
- Extended duration for EUR
- Added new instruments and new issuers (larger exposure to financial institutions and non-core EZ)
- Increased HTM portfolios
- Increased active portfolio management (RVT, derivatives, futures)

FX reserves management Macedonia

Purposes of FX reserves holdings

- ❖ **Monetary policy purpose:**
 - Exchange rate targeting strategy – peg to EUR
 - CB intervenes in the FX market
- ❖ **Precautionary objectives (insurance against shocks):**
 - Buffer against balance of payments shocks
 - Investor confidence in the country's ability to meet FX obligations, and to reduce cost of external funding
 - Emergency liquidity assistance to banking sector - in case of market disruptions
 - Funds in case of national disasters and emergencies
- ❖ **Other objectives**
 - Generate income to cover operational costs (protect Central Bank independence)
 - Preserve wealth for future generations

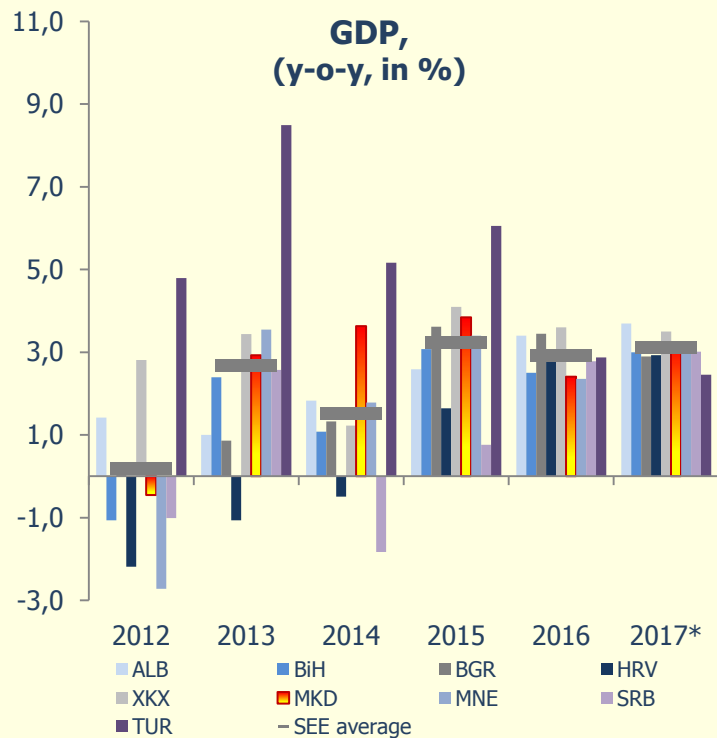
Investment principles/objectives

- ❖ **Safety** - Capital preservation
- ❖ **Liquidity** - Liquidity provision
- ❖ **Profitability** – Income generation

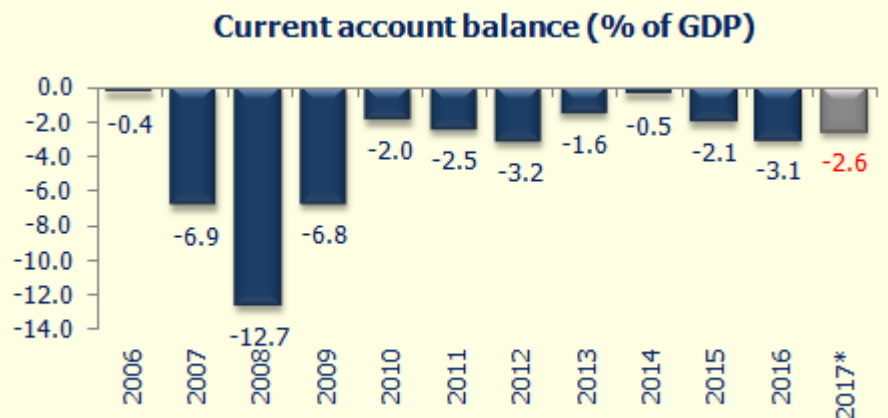
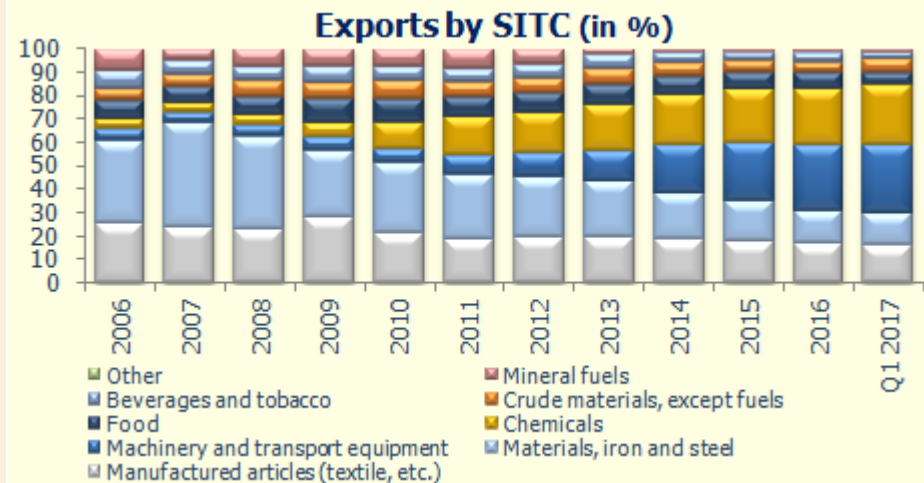
FX reserves management Macedonia

Country's profile – small and open economy with exchange rate commitment to EUR;
GDP has grown over the last couple of years - despite several external and internal shocks...

...supported by **structural changes** in the economy that encouraged FDI entrants with effect on export diversification and CA deficit lowering



Source: IMF data, *2017 projections.

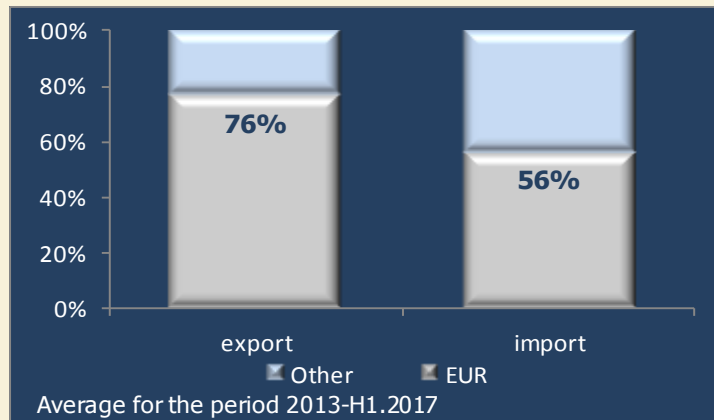


FX reserves management Macedonia

- Exchange rate regime / currency of intervention
- Currency structure of trade
- Currency composition of external debt



important factors of FX reserves
currency composition and tranching

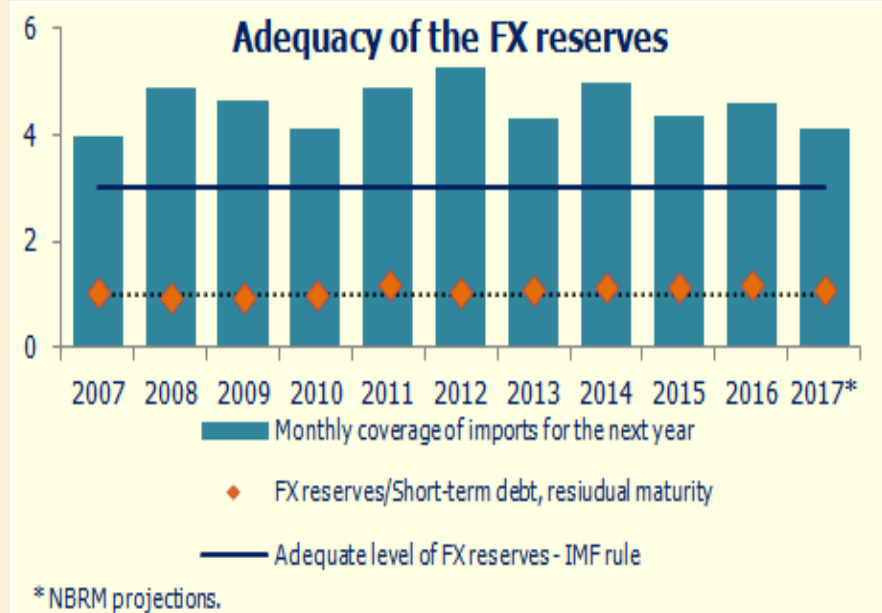
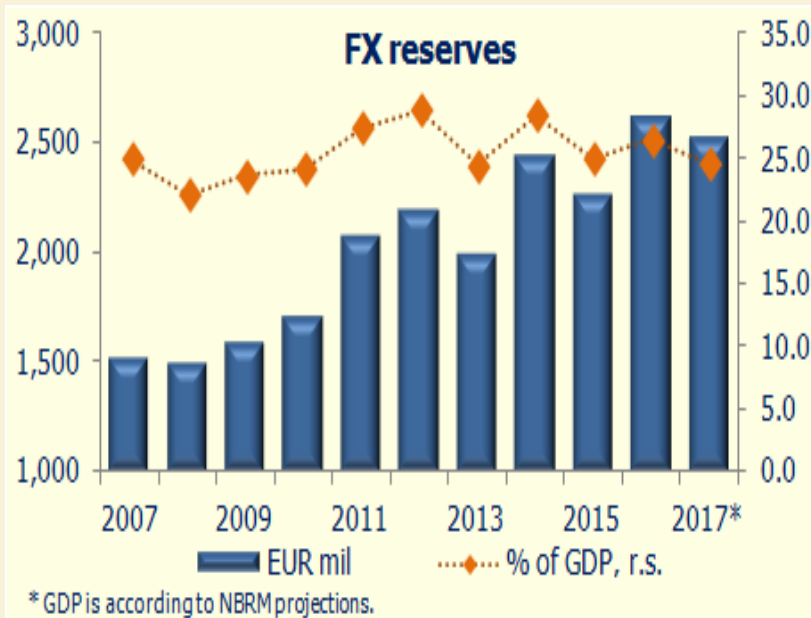


Tranche	Before 2016	Present
Operational portfolio	/	EUR
Liquidity portfolio	EUR/ some USD/ other	EUR
Investment portfolio (Trading/HTM)	EUR USD diversification currencies	EUR (trading/HTM) USD (at the moment only HTM)

FX reserves management Macedonia

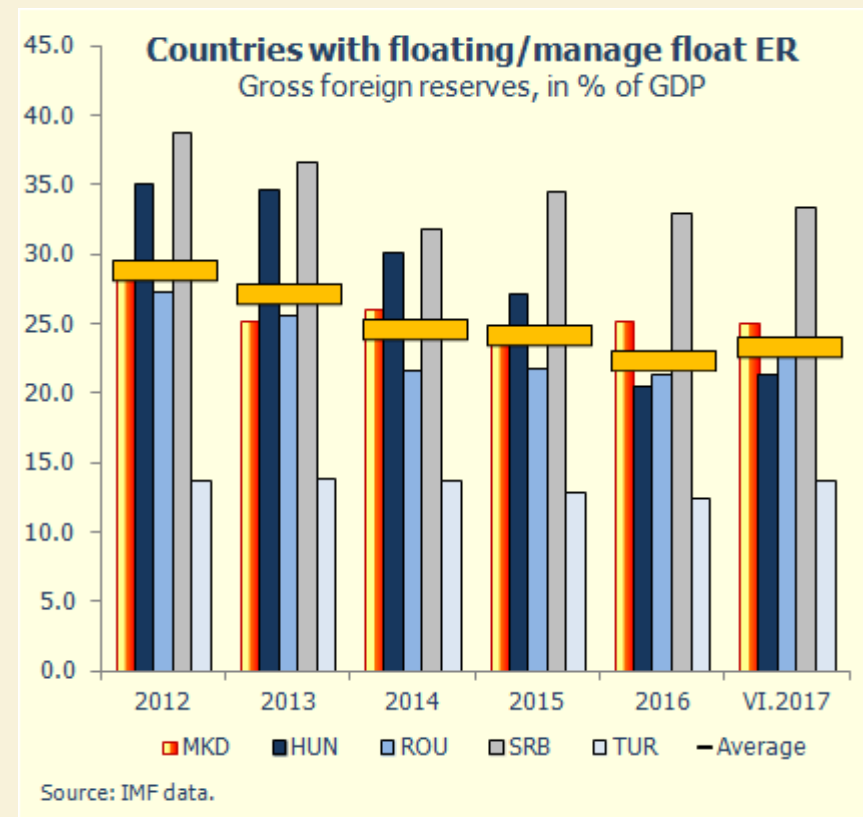
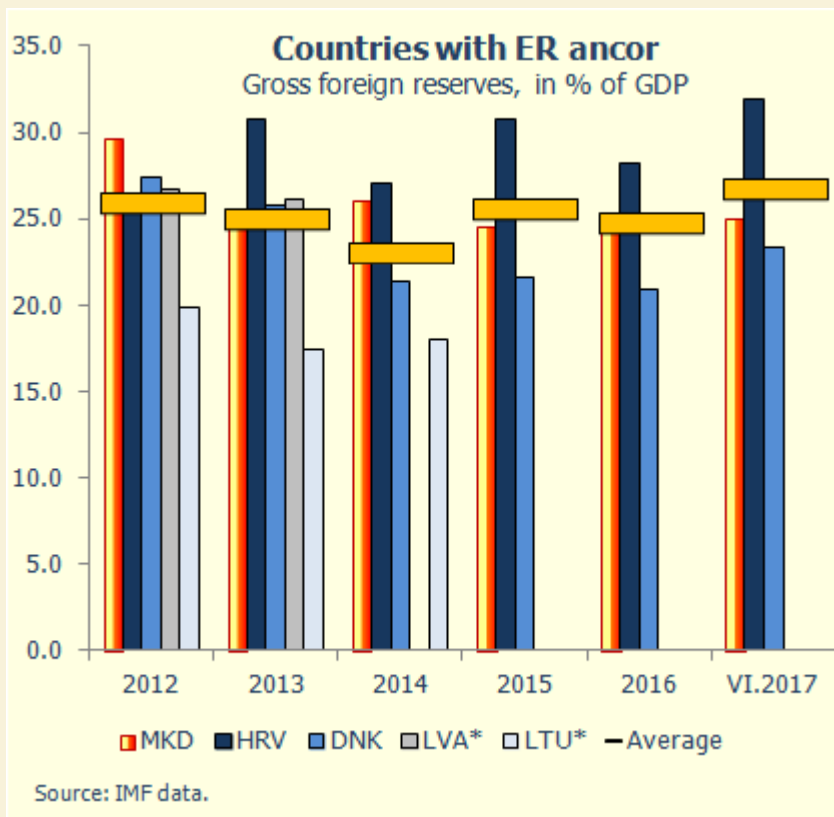
FX reserves on a generally growing path

- Increased by 1.6 times in absolute terms as compared to the pre crisis-level (2008) and are constantly maintained at adequate level



FX reserves management Macedonia

Macedonian FX reserves around the average of the countries with ER commitment



*Latvia joined the Euro in 2014; Lithuania in 2015.



Governance, Accountability and Oversight



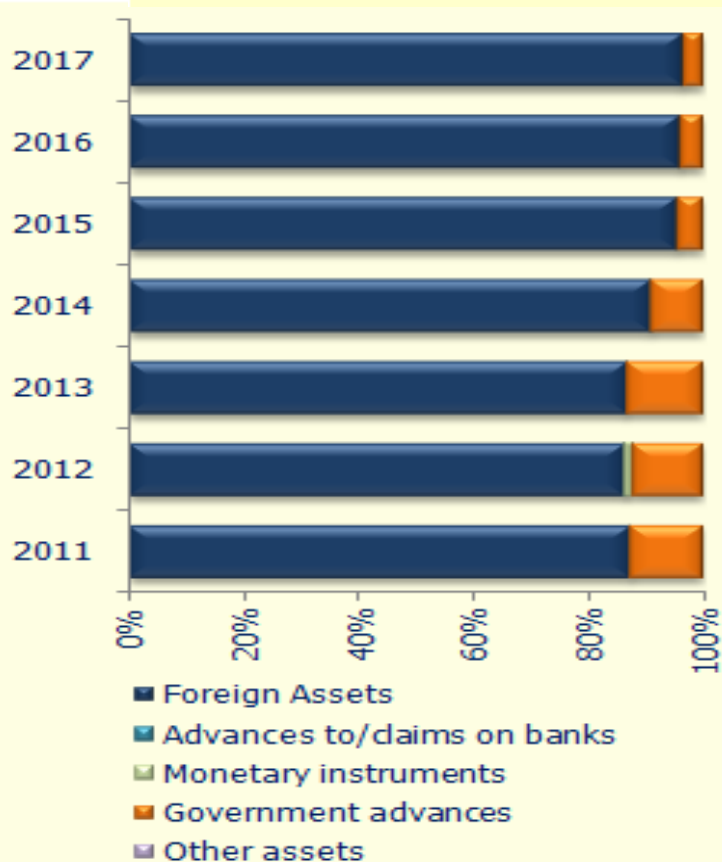
Governance, accountability and oversight

For NBRM - FX reserves management is important function set by the law

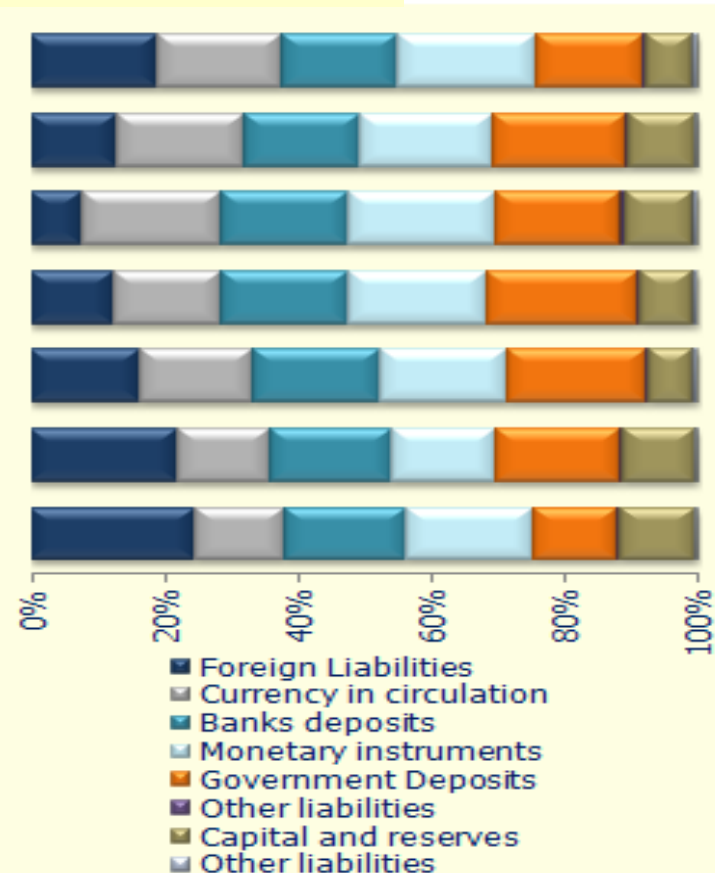
- FX reserves - predominant item on the asset side of the Balance Sheet
- On liability side - monetary liabilities, and government deposits

NBRM strives to maintain sound financial position – does to protect financial and policy independence

Assets



Liabilities



Governance, accountability and oversight

Clear segregation of responsibilities on strategic, tactical and operational level – **VERTICAL GOVERNANCE**
 Separated portfolio management activities from - performance measurement, risk control and compliance, accounting and settlement – **HORIZONTAL GOVERNANCE**

NBRM Board

Adopts Policy for FX reserves management in which sets/approves:

- objectives and investment horizon
- risk/return preferences
- criteria for portfolio tranching and for determination of strategic currency structure
- eligible asset classes
- acceptable credit rating for investments

Governor

Adopts Guidelines for FX reserves management in which approves/sets:

- strategic benchmark portfolios
- strategic currency composition
- additional criteria for eligible asset classes and issuers
- risk budget in accordance to Board risk/return preferences

Governor makes the decision on the members of Investment Committee

Investment Committee

Works under the Policy set by the Board and Guidelines defined by the Governor

- Adopts annual portfolio allocation, tactical currency composition and tactical duration
- Review and decides on taking tactical positions
- Conducts oversight on the implementation of the Policy, Guidelines and on all operational processes for reserves management

Financial Markets Operations Department

FX management Division	Risk management Division	Division for market analysis
portfolio management activities (yield curve exposure, sector allocation, security selection)	limit compliance performance reporting	macroeconomic and market developments

Payment Systems Department

Back office division
settlement and cash management activities, accounting of transactions

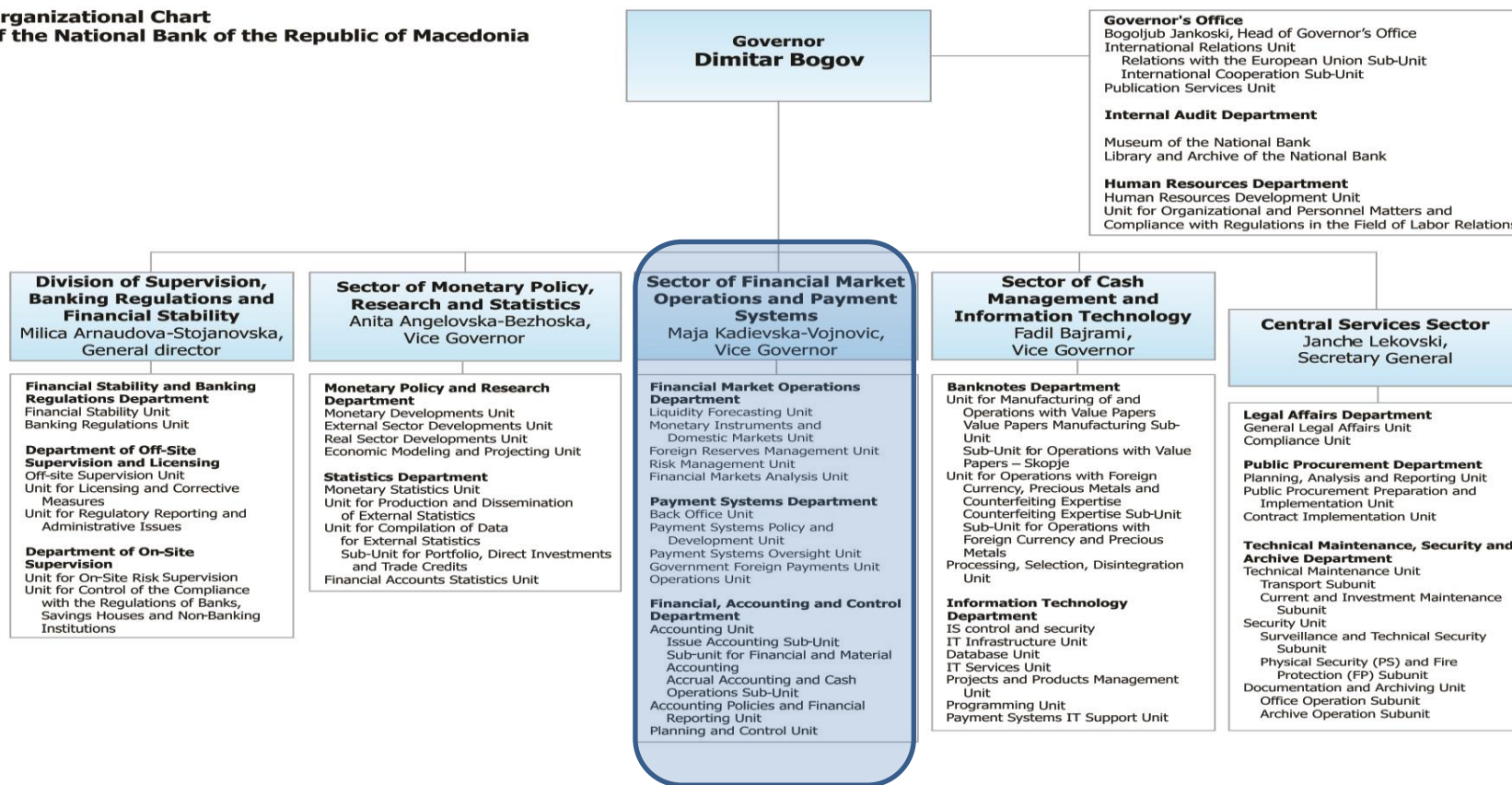
Accounting Department

control over accounting of transactions and reconciliation in GL
analysis and effects over PL

Governance, accountability and oversight

Investment Committee - Chairperson: **Vice Governor** – Sector for Financial Market Operations and Payment System, member DFMO (5), PSD (1), FACD (1)
 IC meets on regular monthly basis. More frequent meetings if needed as well

Organizational Chart of the National Bank of the Republic of Macedonia



Governance, accountability and oversight

Reserves management continuously is supported by

Legal Department

- reviews and gives opinion on agreements with counterparties
- reviews compliance of Policy and Internal Guidelines to NBRM Law
- discussions for assigning dedicated lawyer

IT Department

- internally developed IT systems for risk management

OVERSIGHT

Internal Audit Department reports to the NBRM Board about the adequacy of internal policies, procedures and processes

External Audit control – NBRM performance, and within it, to FX reserves management process - findings are submitted to Board and published on web site of NBRM

TRANSPARENCY

On monthly basis - Statistics Department publishes data on FX reserves

On quarterly basis - regular reports for the reserves management are submitted by the IC to the NBRM Board and to Minister of Finance

On annually basis - as part of NBRM report, FX reserves management report is prepared

- **RAMP client from July 2014 till now**
- **Beneficial decision for FX Reserve Management process - better institutional and operational set up**
- **Full revision of the processes towards more active portfolio management, strengthened risk procedures and back office function**
- **Gained skills have led to augmented overall confidence in FX Reserve Management— as one of the core CB's functions**

Challenges – summing up

- **Impossible Trinity in time of low and negative yields' environment within the given country specific factors: Safety, liquidity, return....Which is the first?**
- **The pressing need for good governance and oversight in reserves management has been emphasised in recent years**
- **Fundamental decision in FX reserve management is proper asset allocation**
 - but, this is constrained by country specific factors (FX rate regime, reserves volume, countries liabilities)
- **Low yielding environment forced to employ diversification**
 - NBRM undertook currency as well as asset diversification, but limited in scope
 - In expectation of rising yields environment on global markets, shortening durations and orientation to money market instruments
- **Given the rising challenges - the investment process must remain guided by sound investment principles and solid risk management policies - Impossible Trinity should be reached**

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