NEW BANKING REGULATIONS AND THEIR EFFECT ON ECONOMIC ACTIVITIES IN GEORGIA

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Abstract: The functioning of the commercial banking system plays an important role in the development of the state under the transformed economy. Also, the economic growth rate of the country stands for the stability of the banking sector. The problems of commercial banks and other subjects of financial sector are instantaneously affecting other areas of economy.

The modern Georgian banking system was founded after the collapse of the USSR and the independence of the country. By 1995 the number of banks was more than 100 that was reduced to 16 in 2017. At present, the National Bank of Georgia is supervising the financial sector, which is obliged to analyze and elaborate policies to reduce risks and stability to the minimum.

The purpose of the work is to study new banking regulations in Georgia, which entered into force from January 1, 2019 and radically changed the existing lending policy. The article analyzes the regulatory situation as a bank, as well as for business sector and consumers.

The work is based on both qualitative as well as quantitative methods of research, in particular analyzing official documents and legal documents and statistical data to make clear the distinction between before and after the regulation period.

The recommendations developed based on the results of the research have a practical purpose that can be used when developing various state documents for the regulation of the financial sector.

Key words: Banking system, banking regulations, economic activities, Georgia

Introduction

Excessive credit is one of the most serious problems of the population. According to the International Monetary Fund, Georgia has the leading position among the world's countries with the debt in commercial banks [20]. According to the International Monetary Fund's data of 2013, every third borrower in Georgia has been paying more than 50% of its income on bank liabilities [28]. In order to regulate this problem, significant changes have been made in the lending policy of 2017-2019. Namely:

- Approved in 2017 and already enacted on the Basel 3 framework, "Rules for Disclosure of Information by Commercial Banks", according to which banks are obliged to publish quantitative and qualitative information about capital, risk-weighted assets, management compensation and other important issues.
- Amendments were made to the Organic Law on "National Bank of Georgia", according to which the National Bank has been given full authority to supervise the entire financial sector (banks, microfinance organizations, non-bank institutions, etc.) From May 2018, NBG has restricted unsecured consumer loans to more than 25% of the bank's capital.
- Effective interest rate up to 50% [14].

And since January 1, 2019, the "Framework for Responsible Credit" of the National Bank has been elaborated, in which the borrower is obliged to assess the user's income, the cost of securing the loan, which aims to protect the borrowers and the financial system from risks caused by the fluctuation of the foreign currency exchange rate [15].

These changes have caused a number of reactions. According to one part of the specialists, the amendments will strengthen the sustainability of the financial sector. In the short term this will bring down the retail lending, increase in expenditure in the sector, increase demand on capital and decrease profitability, and in the long term the qualitative improvement of the Georgian financial system [14]. Others (Kipiani, 2019 [29]; Zambakhidze, 2019 [30]; Kepuladze, 2019 [31]) believe that is expected to increase the credit rating, which will further increase the financial burden of consumers and cause a systemic problem.

The goal of the research is to analyze existing data before the change of lending policy and after it and to review

- Commercial Banks' Income
- Small Business

- Building and Real Estate Sector
- Customers' Perspective;

The research has the greatest practical and theoretical significance, since the analysis of the changes in the short term as a result of the above regulations creates a clear representation of the impact of changes and allows us to get the most objective prognosis of the long term and work out relevant recommendations.

A theoretical framework of the thesis is based on traditional and non-traditional monetary policy.

Literature review

At the modern stage, radical transformation of monetary policy has been made and new methods of interaction between money and credit and fiscal policy have been developed.

Using monetary policy when using traditional monetary credit methods stimulates the economy through two channels:

- Interest rate channel. It is a mechanism of monetary policy, whereby a policy-induced change in the short-term nominal **interest rate** by the central bank affects the price level, and subsequently output and employment [16].
- Bank lending channel. It represents the credit view of this mechanism. According to this view, monetary policy works by affecting bank assets (loans) as well as banks' liabilities (deposits). The key point is that monetary policy besides shifting the supply of deposits also shifts the supply of bank loans [17].

The most traditional approach to identify and estimate the effects of monetary policy shocks remains the timing assumption that a current innovation to the instrument used by monetary policymakers [7]. The traditional approach, which identifies changes in monetary policy with changes in the stock of money, is not adequate, since in practice the growth rates of monetary aggregates depend on a variety of variables [1].

The forms of monetary policy, particularly used when interest rates are at or near 0% and there are concerns about deflation or deflation is occurring, are referred to as unconventional monetary policy. These include credit easing, quantitative easing, forward guidance, and signaling [18].

There is a widespread notion that unconventional monetary policy actions undertaken by central banks over the past years have helped to alleviate some of the immediate downside risks to financial markets and the global economy [13].

John Maynard Keynes pointed to an increase in the role of the state to eradicate the crisis and suggested that the increase of money in circulation would improve the investment environment and stimulate consumption, but ignored the risk of rising inflation [9].

The instrument of non-traditional monetary policy implies support of the state when financial institutions cannot afford the crisis using only standard market methods.

Unconventional financial methods include:

- Negative interest rate policy stimulates bank net worth. Significant capital gains and a more favourable economic environment, that induces banks to increase credit supply to the real economy, outweigh the costs of negative rates. A simple welfare analysis yields that under reasonable conditions, negative interest rates might constitute an optimal crisis response [2].
- Zero interest rate policy is a macroeconomic concept describing conditions with a very low nominal interest rate. Can be associated with slow economic growth, deflation, and deleverage.
- Forward guidance is when the Central Bank announces to markets that it intends to keep interest rates at a certain level until a fixed point in the future. The aim of forward guidance is to influence long-term interest rates and market expectations [19].

However unconventional monetary policy takes many forms. In some cases (for instance Denmark), it involves the use of negative interest rates. Some commentators advocate suspension or changes to inflation targets. The more common forms of unconventional monetary policy involve massive expansion of central banks' balance sheets and attempts at influencing interest rates other than the usual short-term official rates [12]. So, unconventional monetary policy helped to stabilize some sectors and provoked modest additional risk taking in others [6].

In sum, we can say that the main difference between traditional and non-traditional monetary policy is that through existing instruments. In the case of traditional monetary policy, the central bank sells or buys state bonds to maintain the current interest rate.

While qauantative easing during non-traditional monetary policy, the Central Bank buys or provides financial assets to maximize the money on the market and to stimulate the economy [16].

The main difference between the traditional non-standard monetary policy is the traditional (standard) monetary policy of how the neoconservative principle of non-interference of the state of the market in

the market changes, how does the central bank change its policy and sanitizing measures to overcome the crisis (Borio & Disyatat [3]; Furceri, Loungani & Zdzienicka [8]; Kuroda [10]; Ueda [11]; Carpenter & Demiralp [4]; Cecioni, Ferrero & Secchi [5]; etc.).

Therefore, the main driving mechanism in monetary policy is to operate the money. This was the old debate between the neo keynesians and monetarists. More important is the combination of Keynesianism and monetarism and non-traditional cash-credit methods in the modern economy. The International Monetary Fund economists created the term MP-plus ("Monetary Policy Plus"), which means a very large set of financial instruments, including traditional cash-credit methods and non-traditional methods. Using monetary policy when using traditional monetary credit methods stimulates the economy through two channels. These include: interest rate channel (interest rate channel) and bank lending channel (bank lending channel).

Methods survey and results

According to the National Bank of Georgia, the purpose of the Framework for responsible credit is to support stable functioning of the financial system and encourage healthy lending, which in turn will contribute to sustainable development of the country's economy. According to the basic principle of regulation, the financial institution should not impose a loan or other obligation without studying the person's solvency. This principle is one of the requirements of European Union.

The regulation applies to all loan issuing entities under the supervision of the National Bank. The loan issuer shall be obliged to assess the user's income, the cost of the loan and the loan, whose monthly payments (LTV) and the collateral value (LTV) do not exceed the limits set by this regulation. The provision for loan to all organizations simultaneously came into effect on 1 January 2019 [15].

The reform was based on two goals:

1) Gradual reduction in the level of felicity, which will enable us to get some type of economic advantage in Georgia. This will enable us to macroeconomic policy and macroeconomic status in Georgia to become more stable and predictable in the long term.

2) The rights of users in the financial sector are protected [20].

The subsequent sections of the paper examines the results of changes in the Framework for responsible credit enacted on 1 January 2019, in the short term of time, as well as the prospect of different segment

of the financial market. Analysis gives an opportunity to assess the current situation, to identify the advantages, risks and predictions.

Responsible Credit Framework

Within the framework of Framework for responsible credit the National Bank regulates the average weighted interest rate that aims to estimate average annual weighted interest rates on loans issued in different national / foreign currencies issued by commercial banks. Namely:

• Different maturities loans

• Loans to various categories of debaters

• Consumer loans

• Loans provided by real estate.

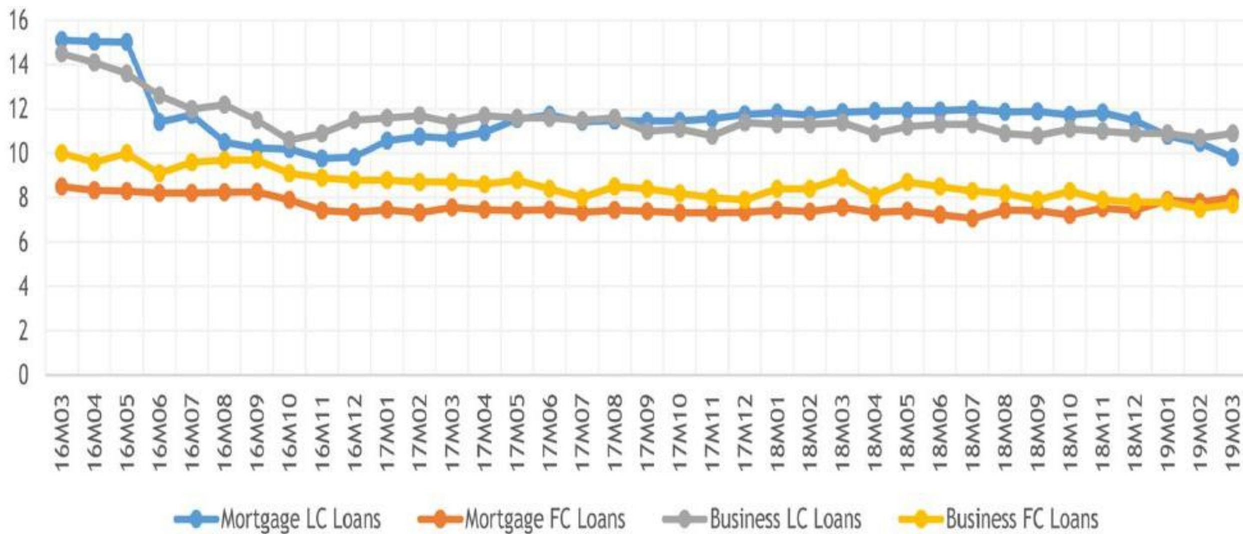
Also, average annual weighted interest rates are determined by the flow of loans and balances (National Bank, 2019).

The average annual weighted interest rate can be calculated using the formula:

$$\overline{P} = \frac{\sum PV}{\sum V},$$

The average annual weighted interest rate for loans is P, the nominal annual interest rate, the V - loan volume according to the Agreement.

Based on the monthly statistical reporting of commercial banks operating in the territory of Georgia (including non-resident banks on the territory of Georgia), we get the following picture (diagram)



Source: National Bank of Georgia, 2019

The results of banking regulations from the perspective of commercial banks

The net profit of 15 commercial banks operating in Georgia in January 2019 amounted to 67,755 million GEL, which is 792 thousand less compared to the same period of the previous year [21].

After enabling bank regulation, the volume of loans issued to banks in January decreased by 170.2 million lari compared to December. According to the National Bank statement, the volume of loans issued in national currency decreased by 118,7 million lari (1%) and the volume of loans in foreign currency decreased by 51.5 million lari (3%). The volume of lending to resident individuals decreased by 1% or 265.8 million lari in January of the year 2019 and amounted to 13,9 billion lari [22].

Building sector and real estate market

The tightening of the loan for the banking sector has had a direct impact on the building and real estate sector, whose share of the country's economy exceeded 9% in 2017-2018. Some of the developers say that after the regulation, their sales were halved, and some were stopped at all. According to them, business in such conditions ceases to develop. In January 2019, the sale of real estate companies decreased by 50% compared with the same period last year [21].

Small Business

Enactment of new regulations has significantly reduced trade equipment stores. It was complicated and in many cases it was impossible to use the installment service, which inflicts damages to the share of installments. According to local media, "Regions, where citizens are self-employed, cannot afford the revenues and they are practically prohibited from using new banking regulations." In some cases, there is the risk of closing the business, after which a lot of unemployed people will be found [24].

Conclusion

In conclusion, it can be said that for a large part of the population who bought household techniques with the installment and real estate secured bank loans, availability on consumer loans as well.

In addition, the research, based on the data of the National Statistics Office of Georgia, "World Experience for Georgia", considering that 40% of the population pay communal taxes with borrowed money and 50% for loan for food [25].

If we agree that the population will be limited to access to finance for basic living conditions, it is likely to reduce the demand for the loan but not the amount of money that the National Bank and Regulation do not restrict. It should be noted that private creditors have a radically high interest rate than commercial banks. Therefore, the necessity of putting the segment into the legal framework is not the result of a longer period of impairment than before the regulation.

It is important that the Borrower's Payment Assessment Requirement is also defined by the EU Directive (Directive 2008/48 / EC of Customer Credit Agreements), which, in agreement with the Association Agreement, must adopt until September 2019 [26].

Also, the Central Bank's attempt to protect consumers' rights and gradually regulate the financial market may be assessed positively. However, the scope of lending to lower income levels of population may be more stimulating and promoting economic growth.

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