

POST- CRISIS BUSINESS MODEL OF BANKS IN THE REGION

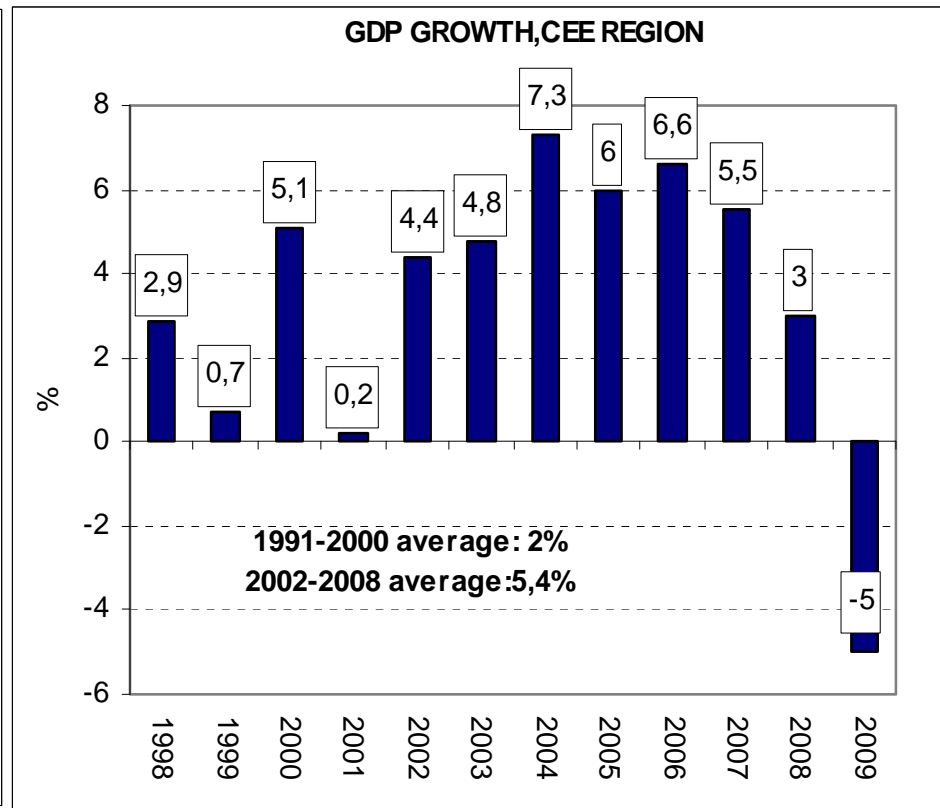
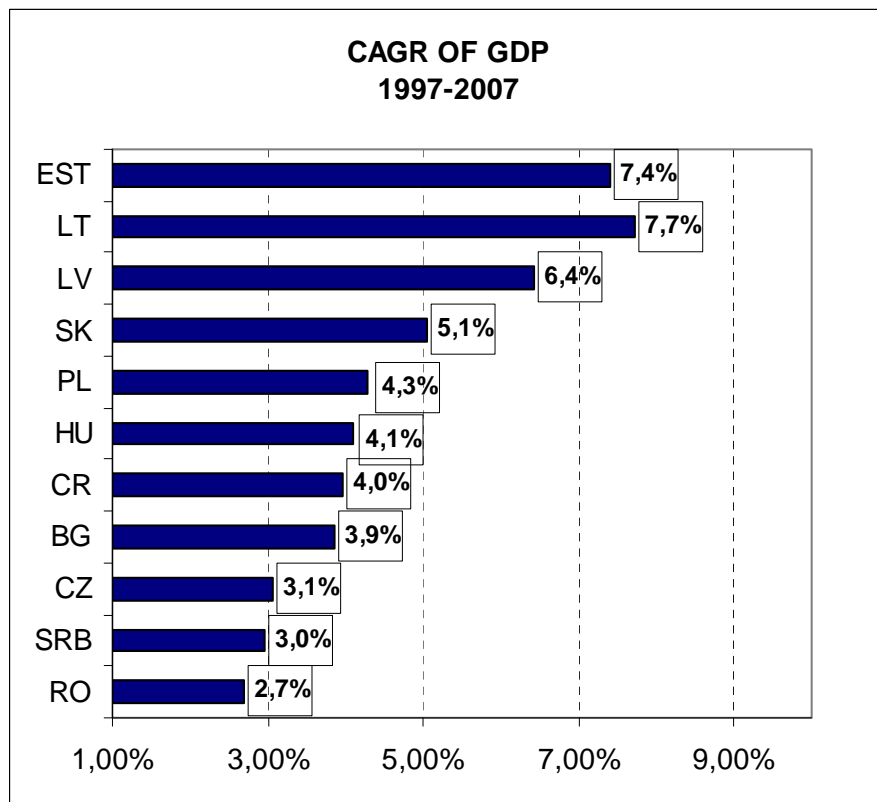
Dr. György Surányi

Resident Regional Head

INTESA  SANPAOLO

**BEFORE THE CRISIS:
A MACROECONOMIC OVERVIEW**

GDP GROWTH RATES WELL ABOVE THE EMU AVERAGE...

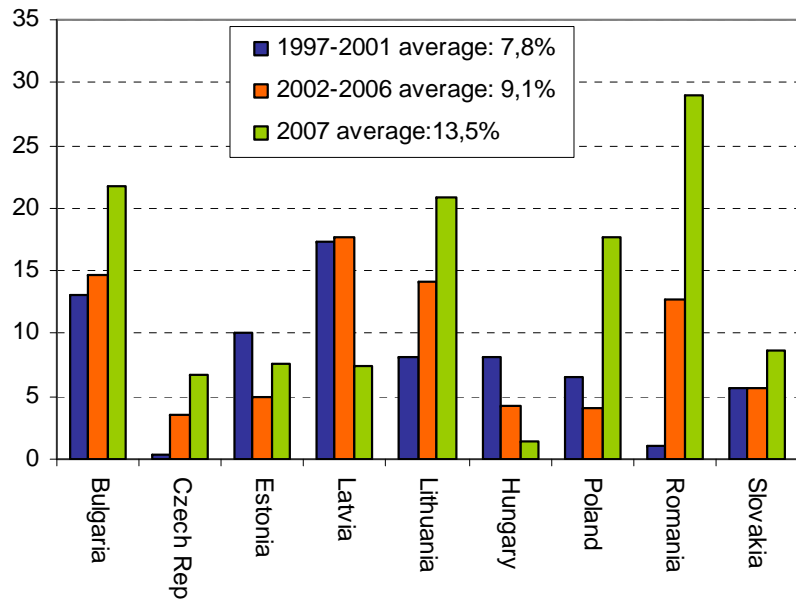


Before the crisis the consensus view was that in case of small, open, converging economies the sustainable growth strategies are export and investment-driven growth strategies –actively supported by capital inflows (both debt- and non-debt type financing) (C/A deficits!)

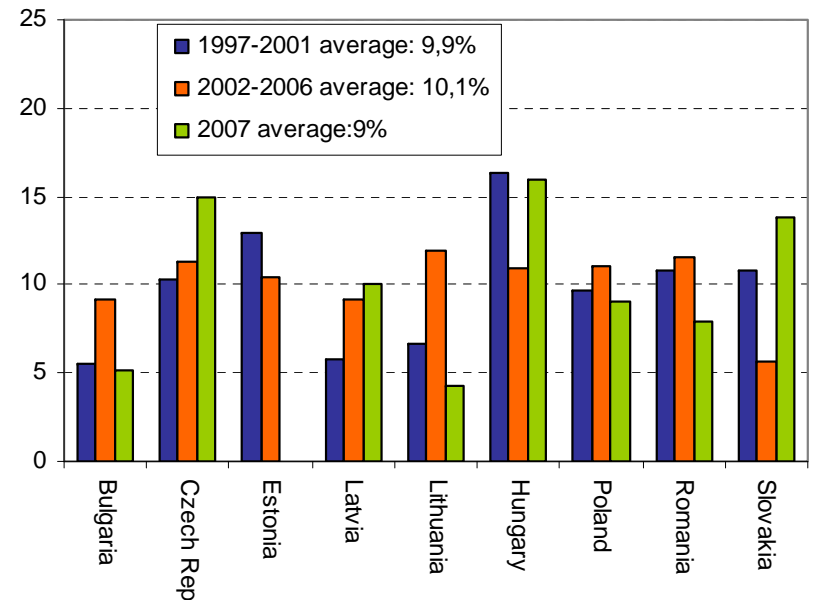
Source: Eurostat, IMF

EXPORT AND INVESTMENT DRIVEN GROWTH STRATEGIES

TOTAL INVESTMENTS (yearly growth rates%)

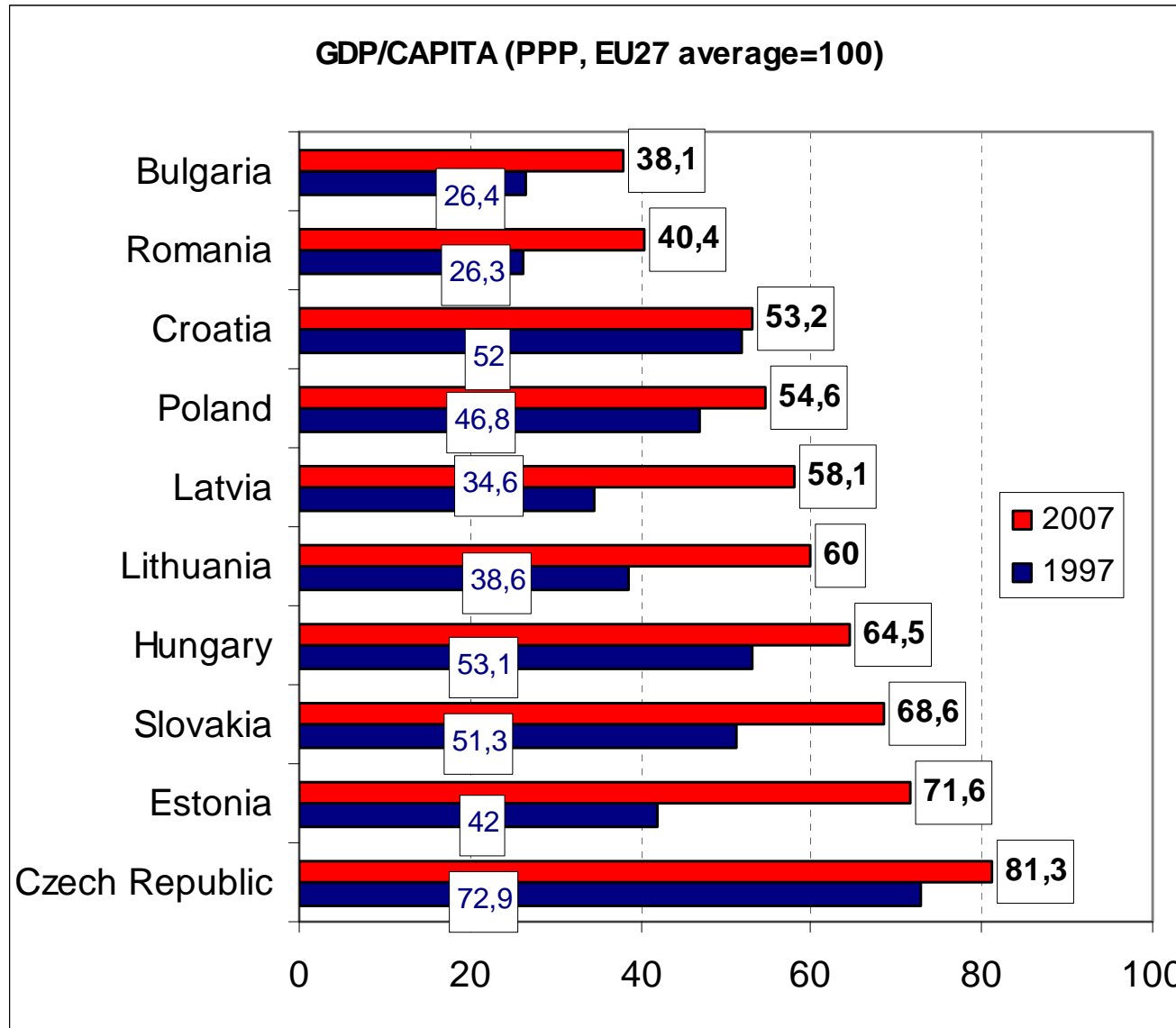


EXPORTS (yearly growth rates%)



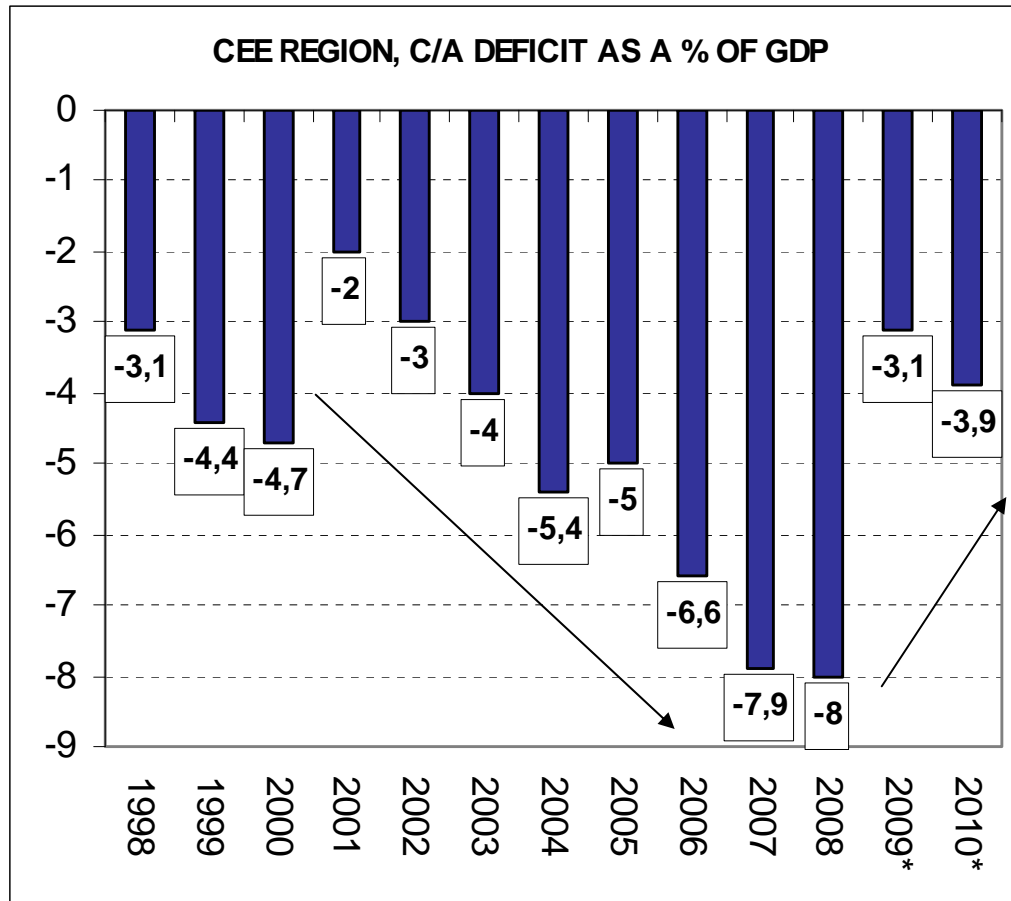
Source: Eurostat

STRONG GROWTH RATES PUSHED AHEAD REAL CONVERGENCE



Source: Eurostat

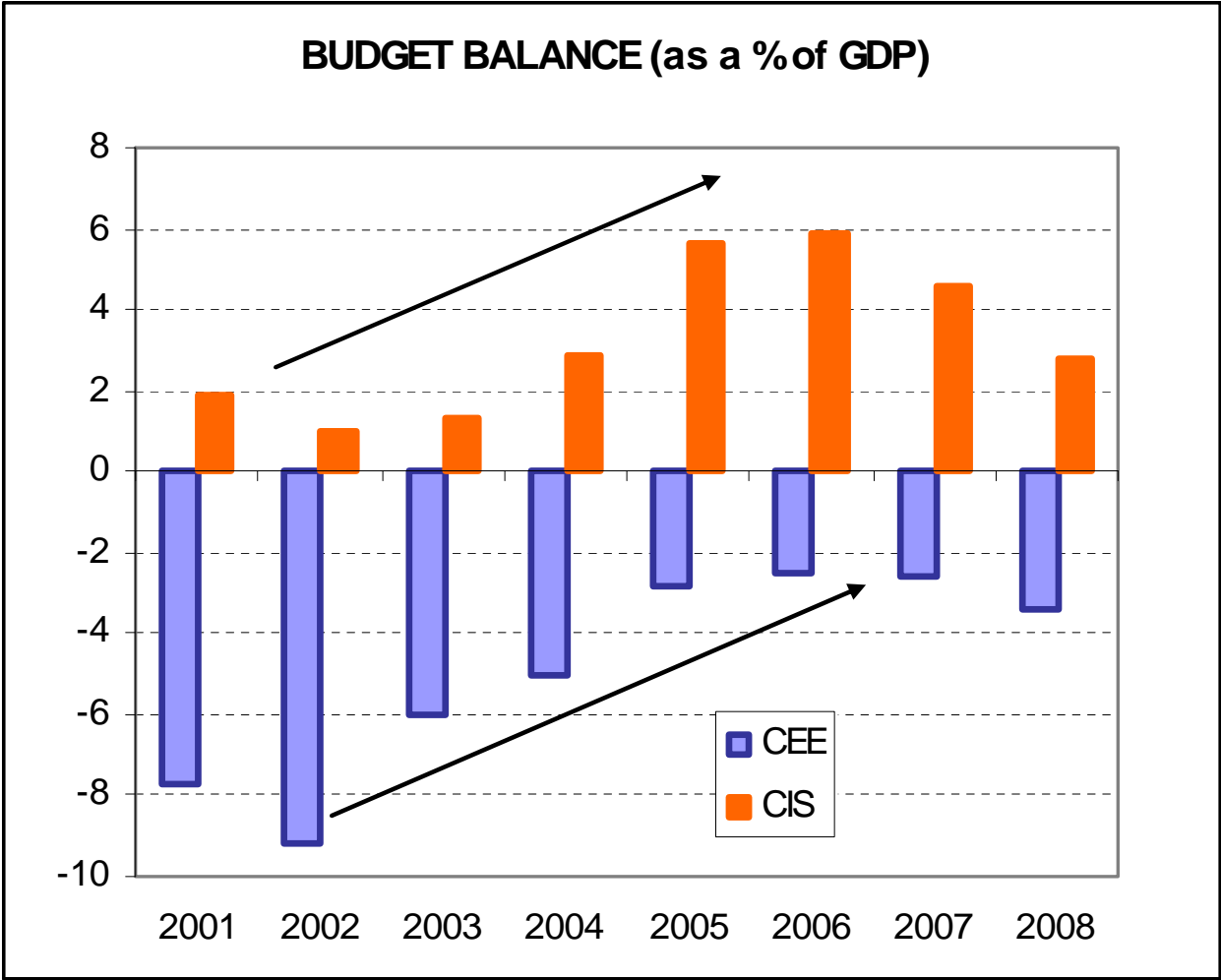
C/A DEFICIT A REGIONAL PHENOMENON



In the CEE region almost all countries run external deficits or to put it another way: net domestic savings were negative

**Before the current crisis it was considered sustainable
A natural „side effect” of the catching up process**

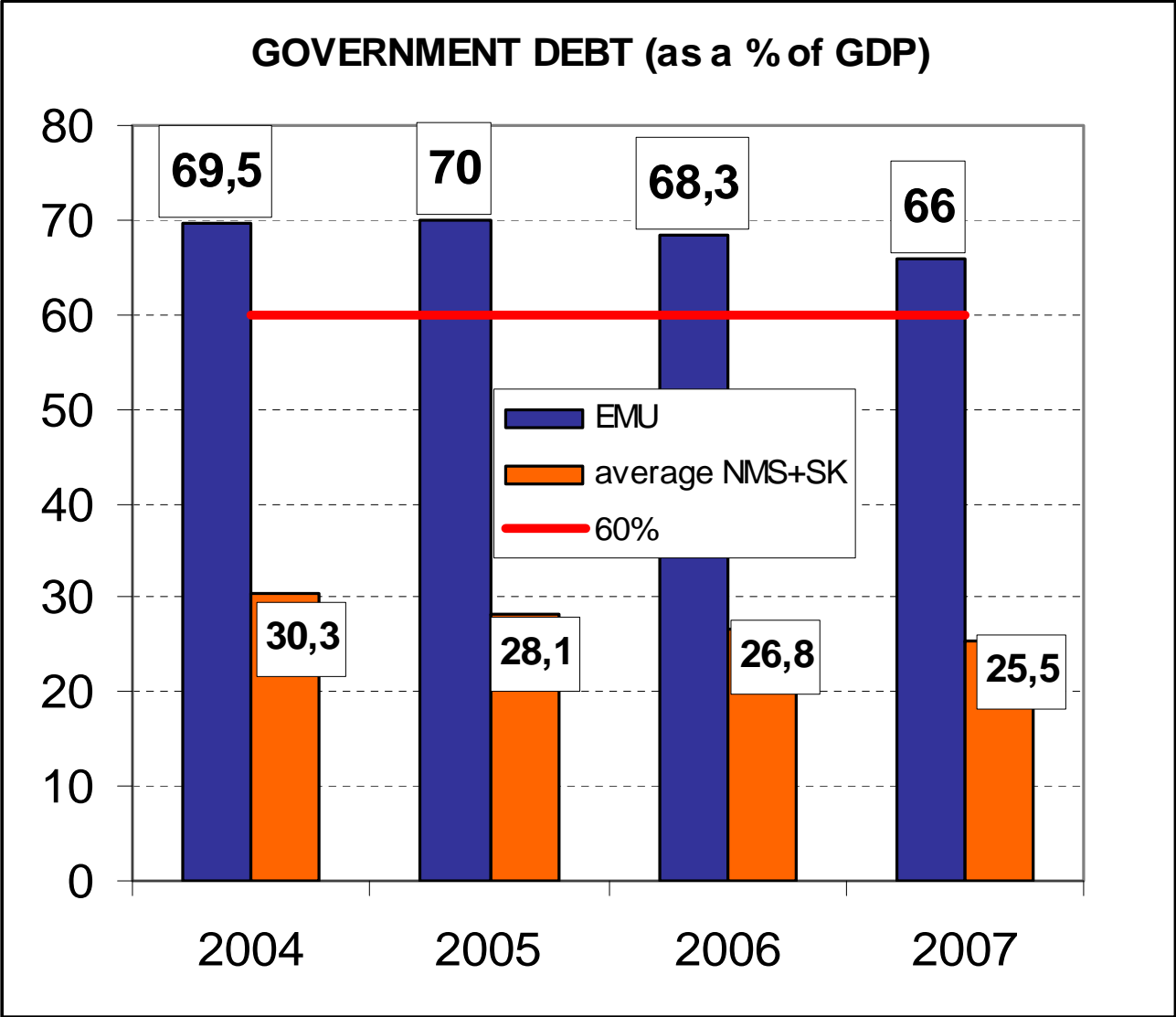
DISCIPLINED FISCAL POLICIES



The external deficit was not the result of loose fiscal policies (SGP, Maastricht!)

Source: IMF

LOW DEBT LEVELS



Source: Eurostat

BUT THERE WERE DIFFERENCIES ACROSS THE REGION

**STABLE GROWTH, SUSTAINABLE
INTERNAL AND EXTERNAL
BALANCES**



Hungary

Serbia

Croatia

SERIOUS IMBALANCES

Romania
Bulgaria
The Baltic states
Ukraine

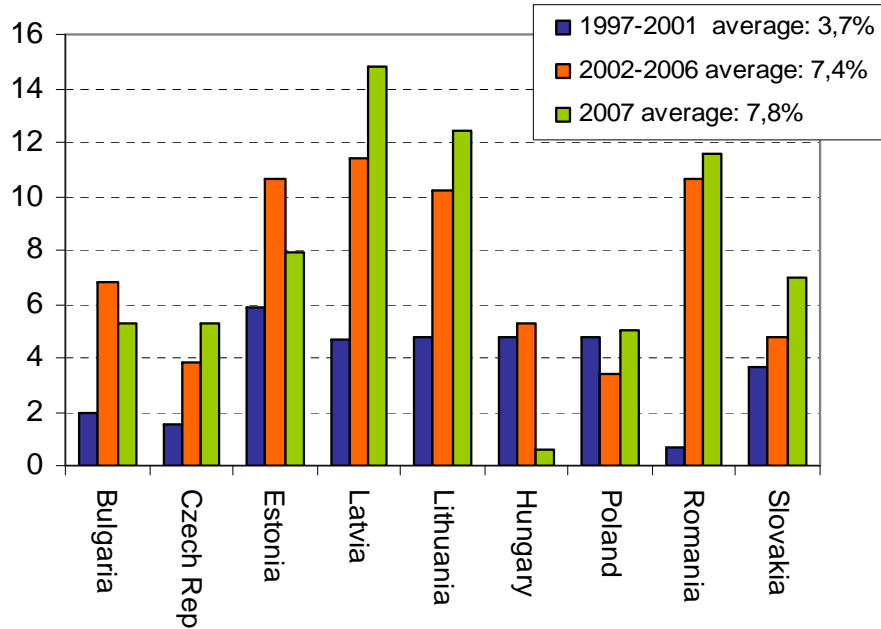
The first group: low inflation, healthy fiscal balances, acceptable external position, no asset price bubble

The second group: high inflation, huge external imbalances, asset price bubbles, consumption driven growth financed by cheap external funding

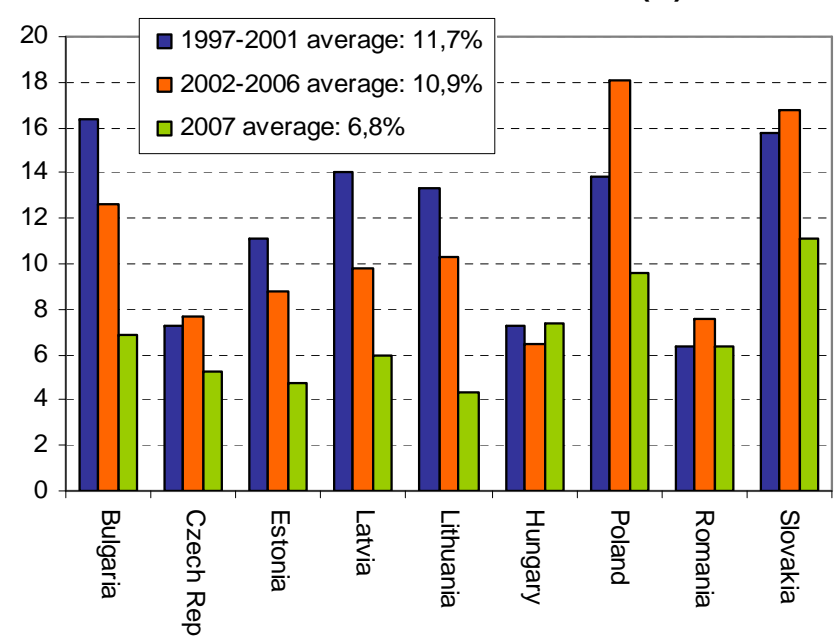
BUT DUE TO THE GLOBAL CRISIS ALL COUNTRIES FACE ALMOST SIMILAR CHALLENGES

BUT THERE WERE DIFFERENCIES ACROSS THE REGION

HOUSEHOLDS' CONSUMPTION (%)



NUMBER OF UNEMPLOYED (%)

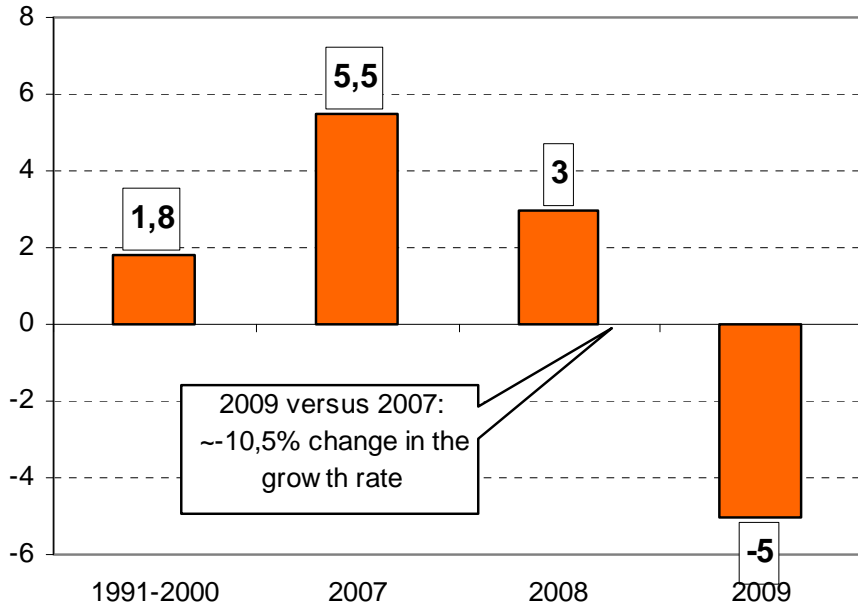


In some countries domestic demand rose strongly in spite of disciplined fiscal policies

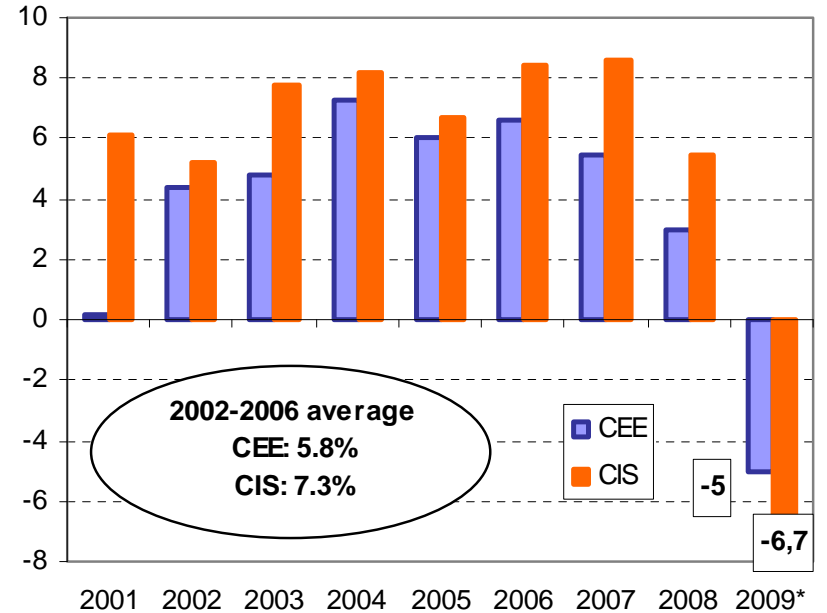
THE CRISIS: THE REGION ENTERED A DEEP RECESSION

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GDP GROWTH RATES, CEE (%)



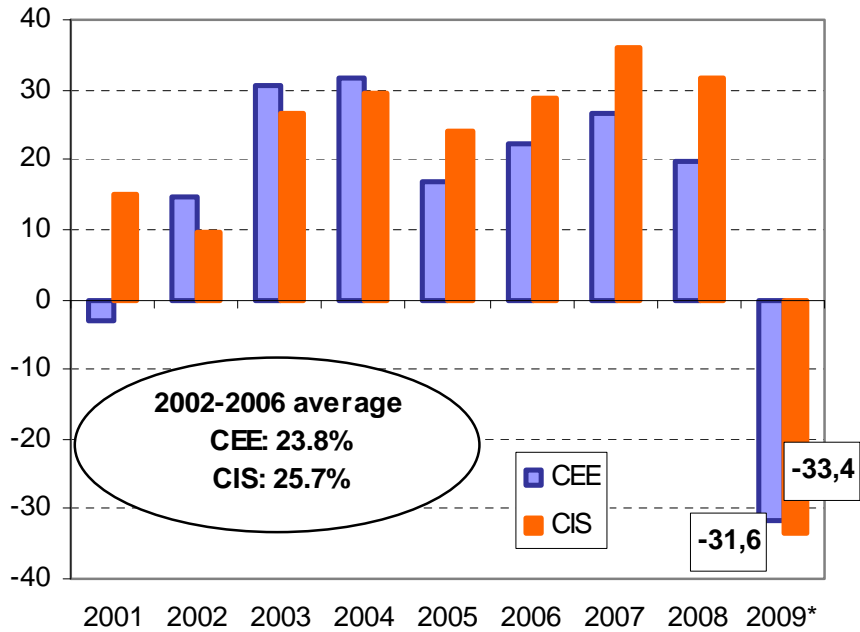
GDP GROWTH RATES (%) CEE AND CIS



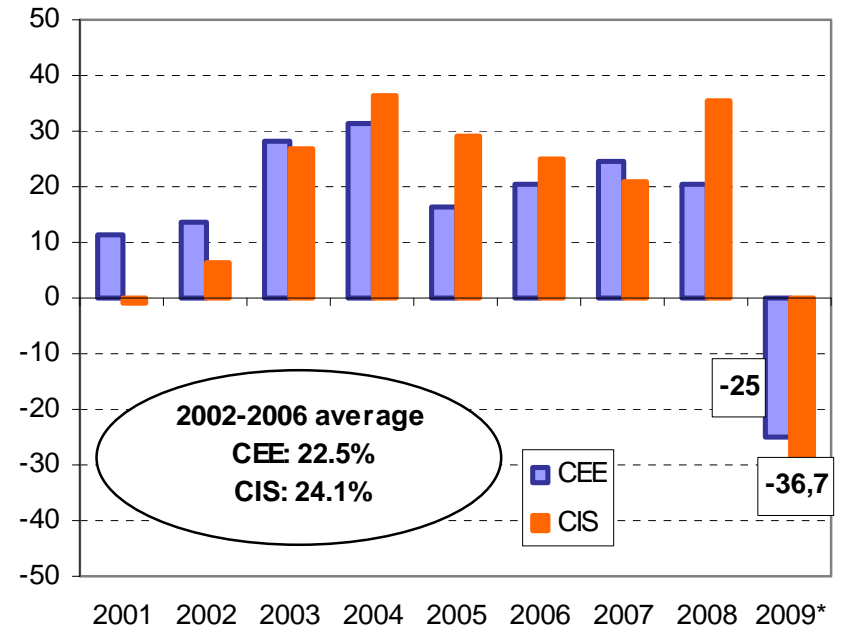
Source: IMF

EXPORT MARKETS COLLAPSED

IMPORT VALUE (change, %)

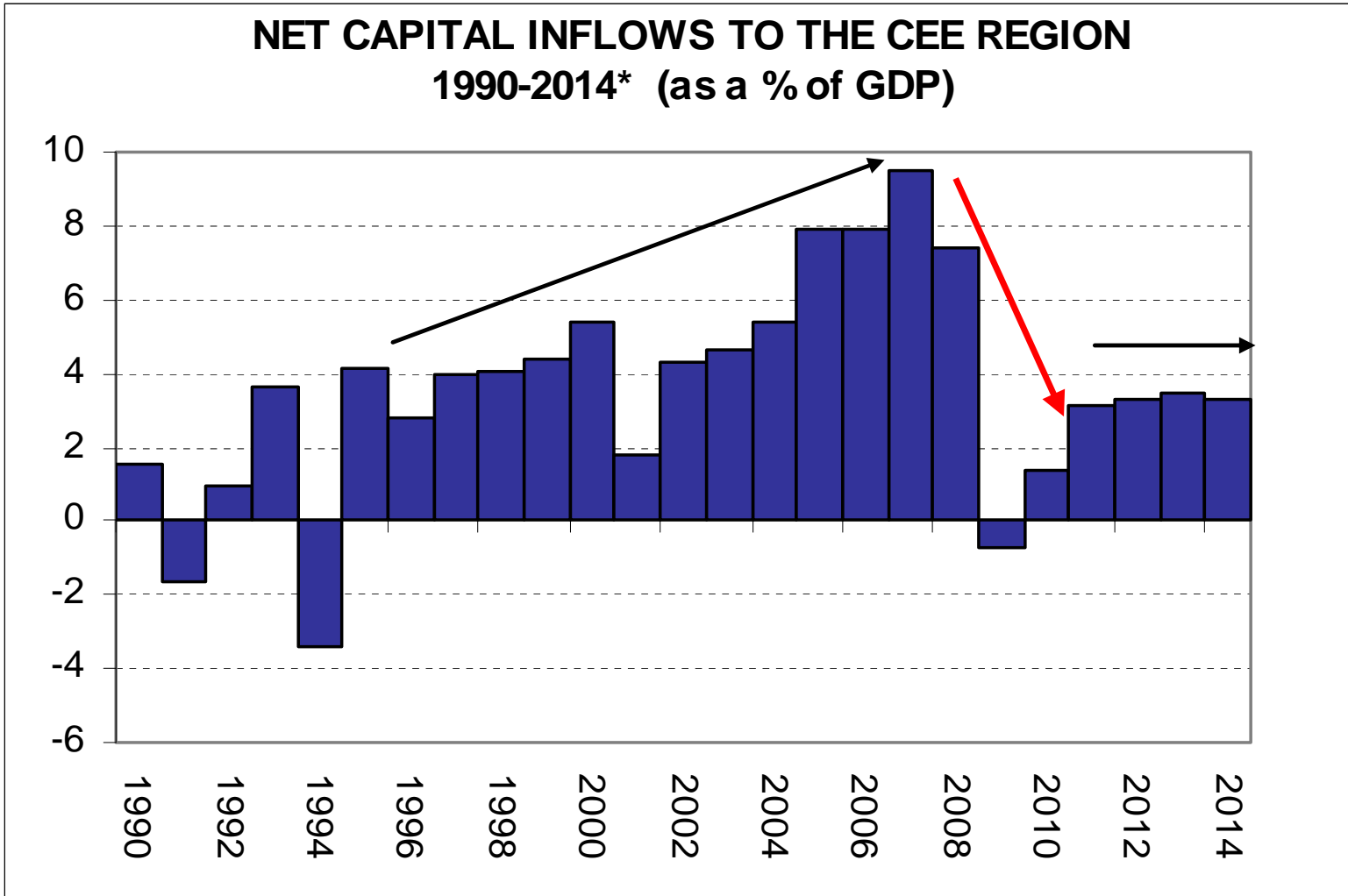


EXPORT VALUE (change, %)



Exports are down ~25-35% y-o-y

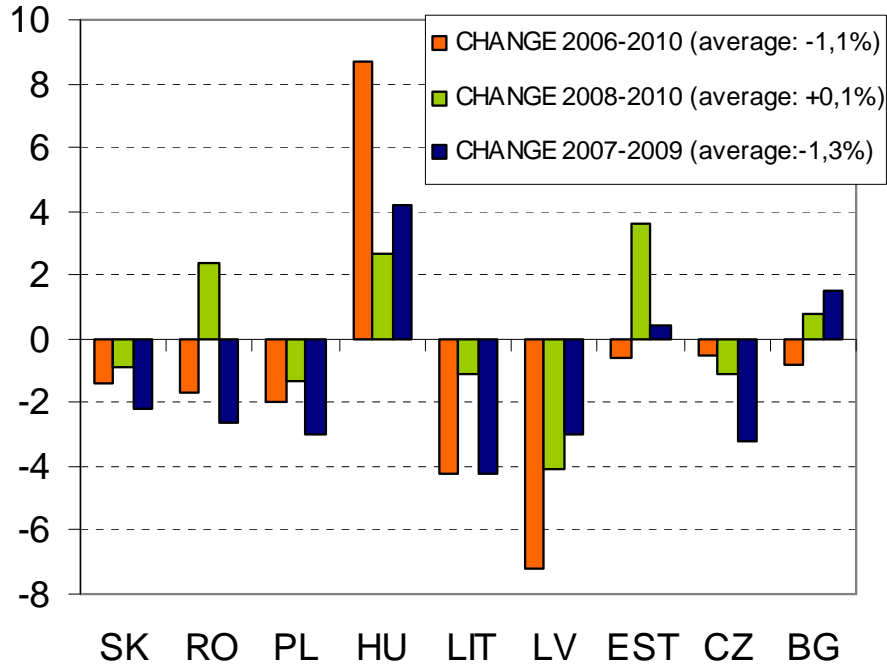
SUDDEN STOP OF CAPITAL INFLOWS



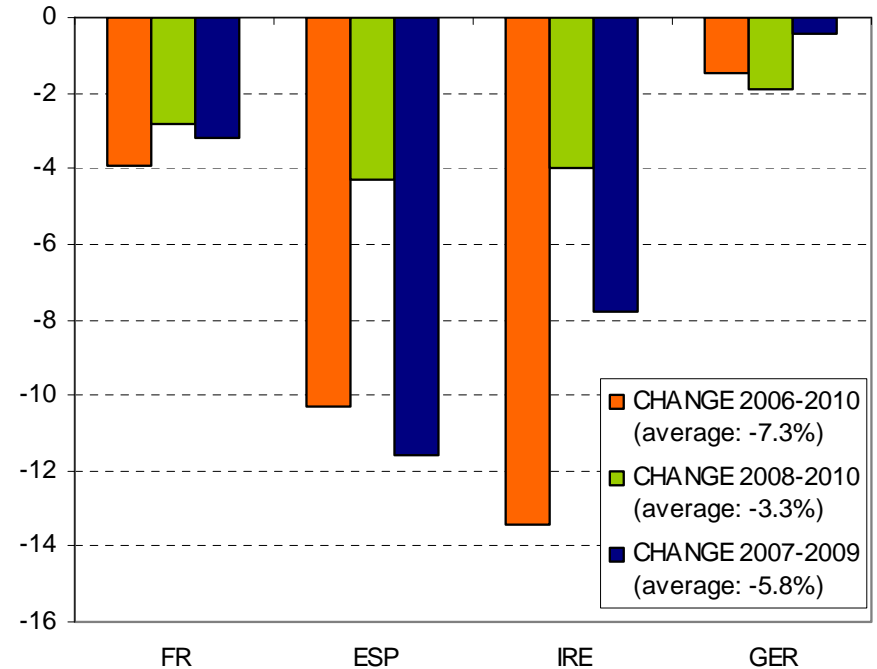
Source: IMF, IMF staff estimates

FISCAL POLICIES ARE NOT ABLE TO PROVIDE A SHELTER

CHANGE IN THE CYCLICALLY ADJUSTED BUDGET BALANCE (% of GDP)



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EMU 2008-2010: -2.5%

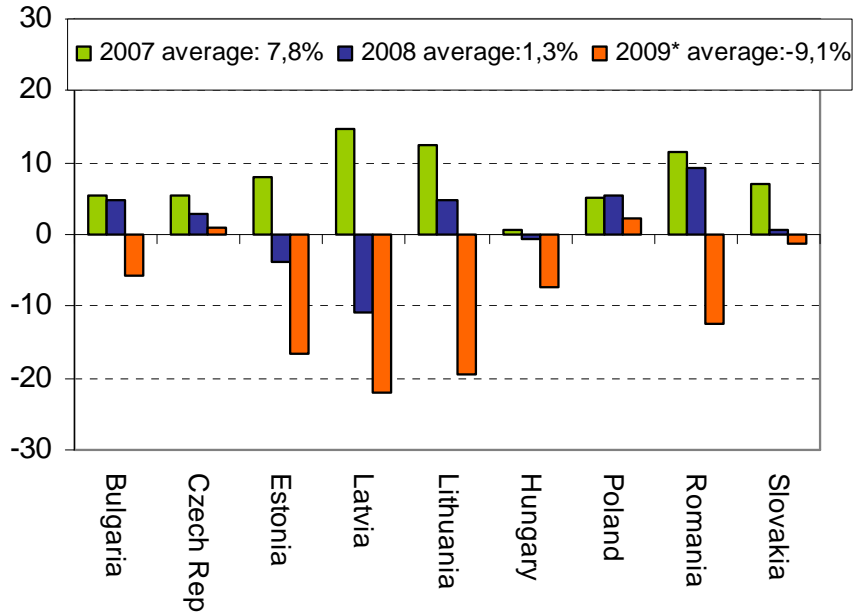
Sustainability fears (even in case of low debt countries), the appearance of roll-over risks!

Fiscal policies are not in a position to give a countercyclical boost to the economy

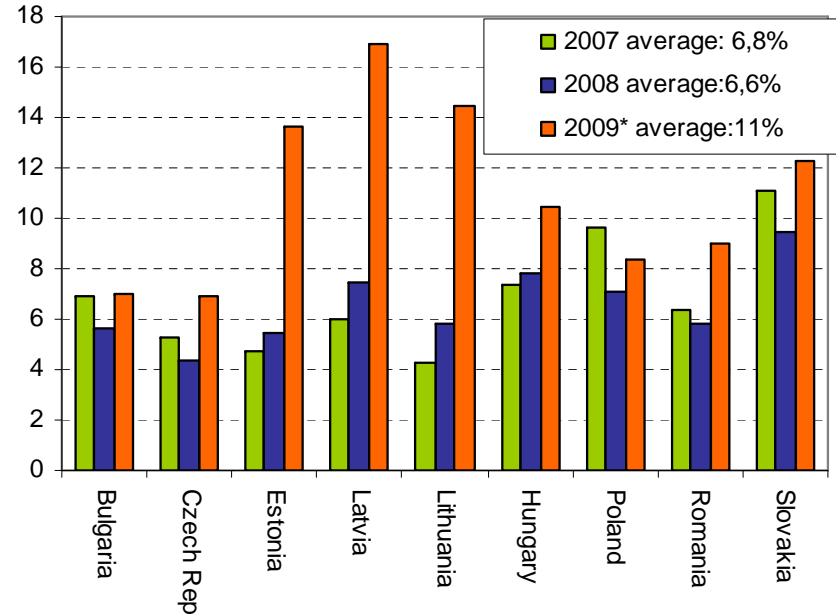
Source: Eurostat, Brussel Commission

RIISING UNEMPLOYMENT, FALLING CONSUMPTION

HOUSEHOLDS' CONSUMPTION (%)

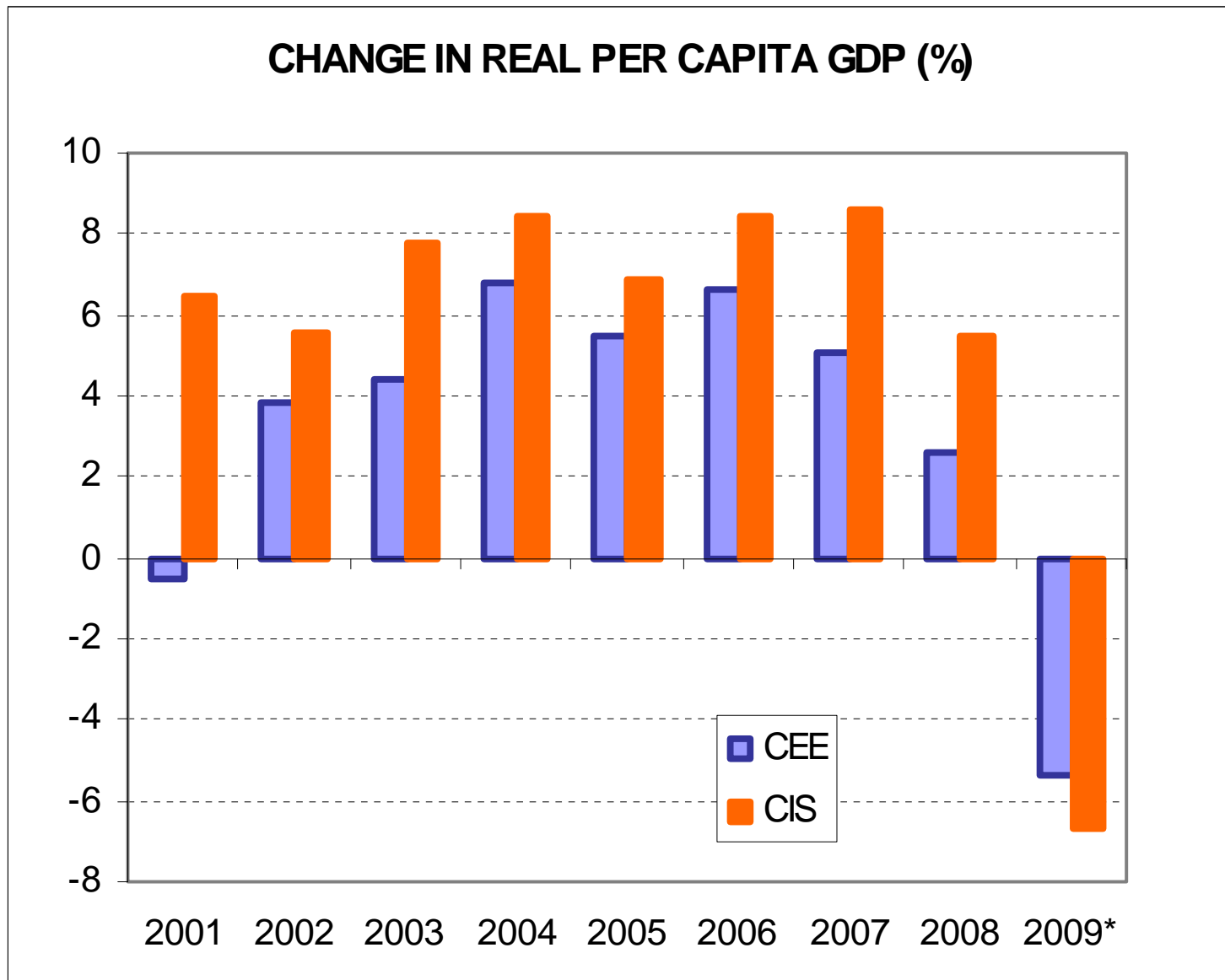


NUMBER OF UNEMPLOYED (%)



Source: Eurostat, Brussel Commission

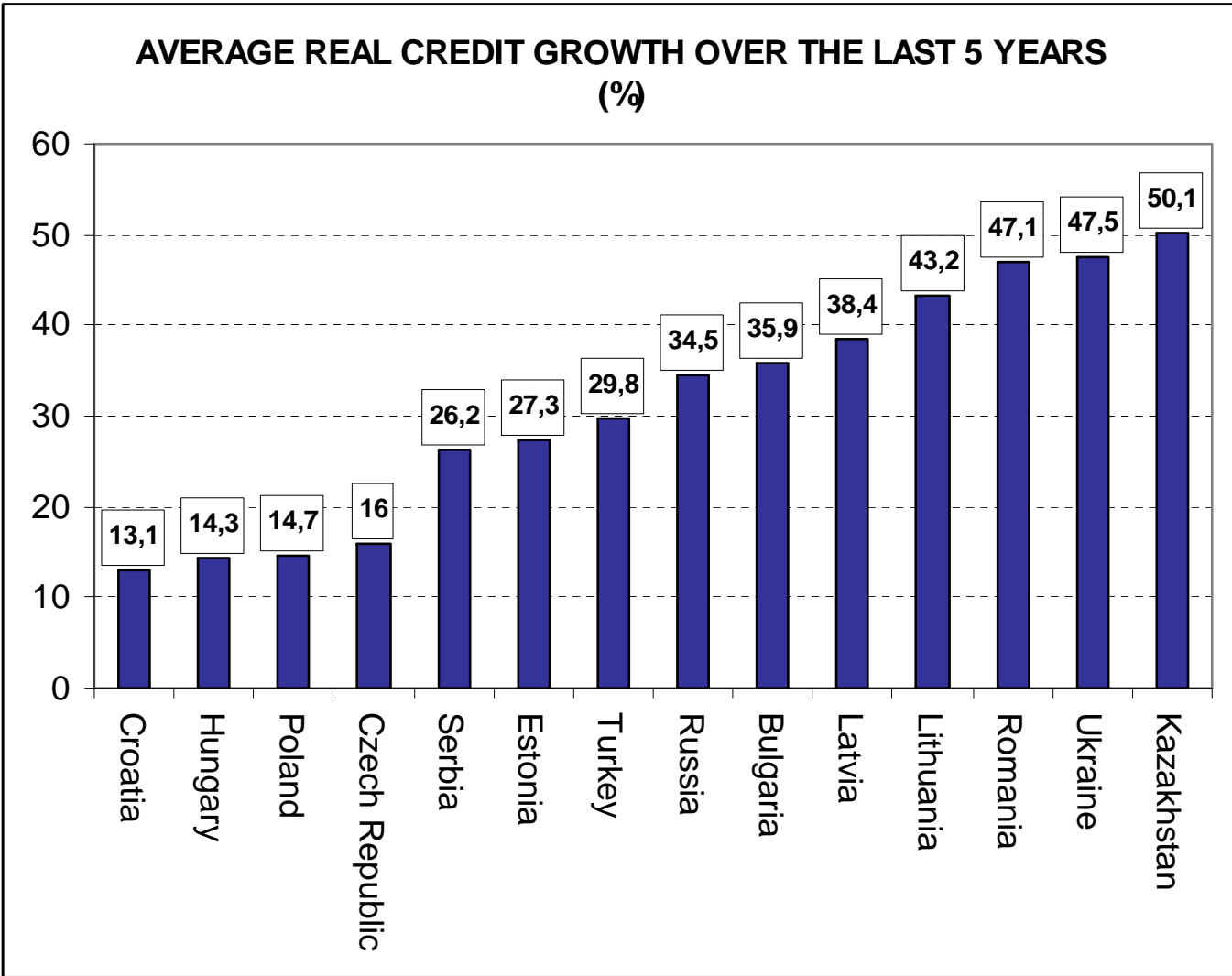
REAL CONVERGENCE CAME TO A HALT



Source: IMF

THE BANKING SECTOR

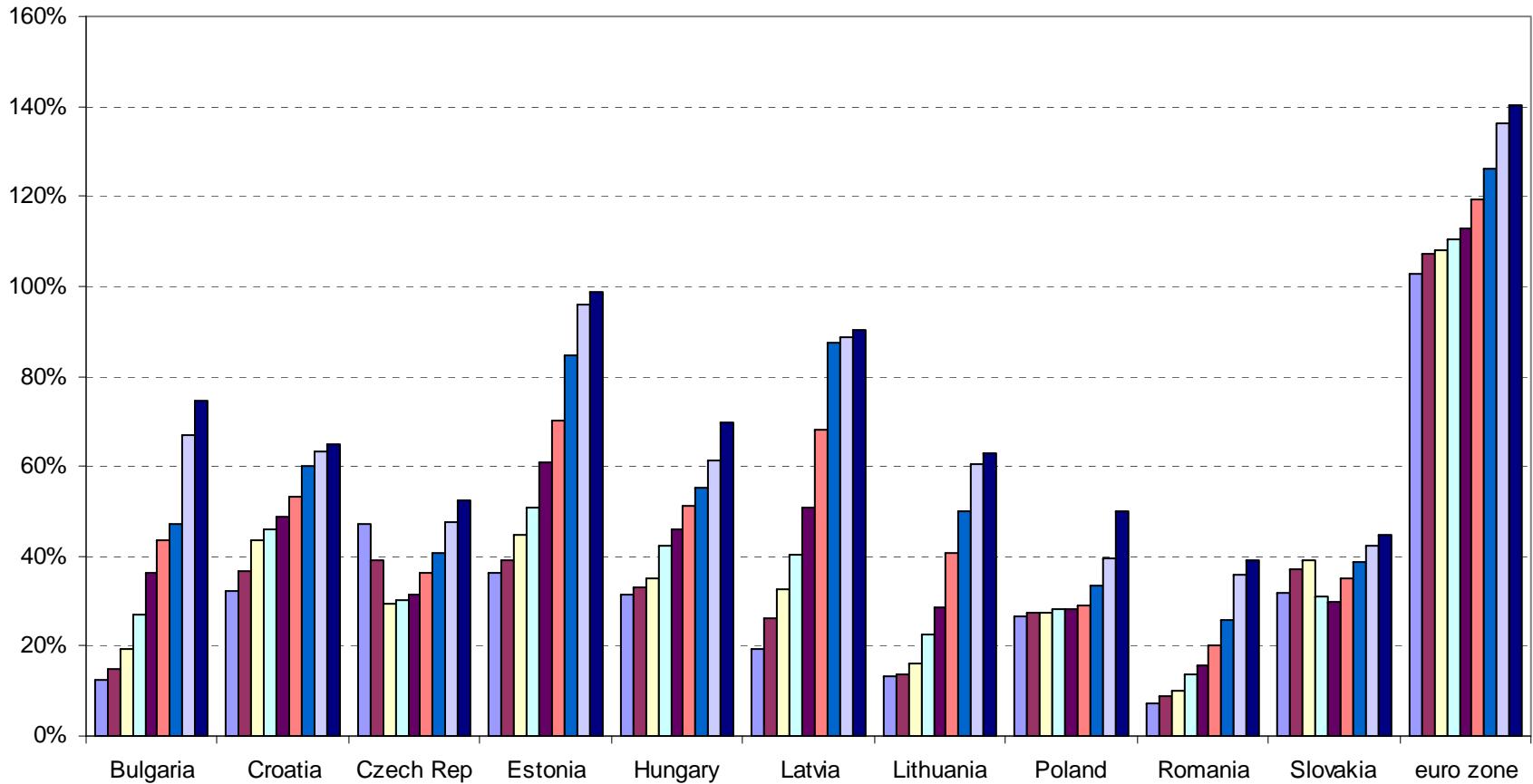
BEFORE THE CRISIS: STRONG CREDIT GROWTH ACROSS THE REGION



Source: IMF, 2004-2008

STILL RELATIVELY LOW LEVEL OF FINANCIAL INTERMEDIATION

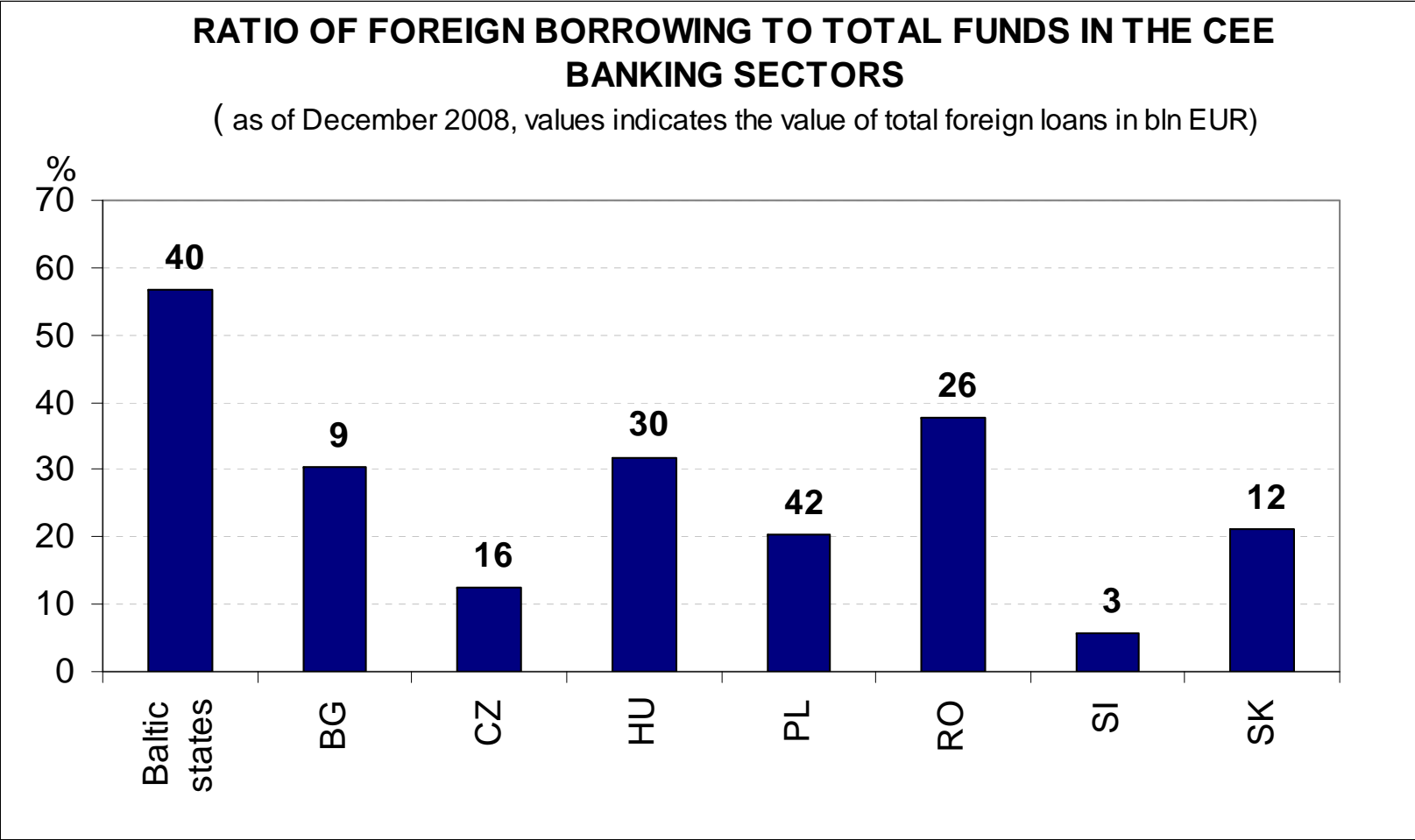
PRIVATE SECTOR CREDIT TO GDP IN SELECTED COUNTRIES (eop,%)



2000 2001 2002 2003 2004 2005 2006 2007 2008

Source:IMF

THE CREDIT GROWTH WAS FINANCED BY CHEAP EXTERNAL FUNDING

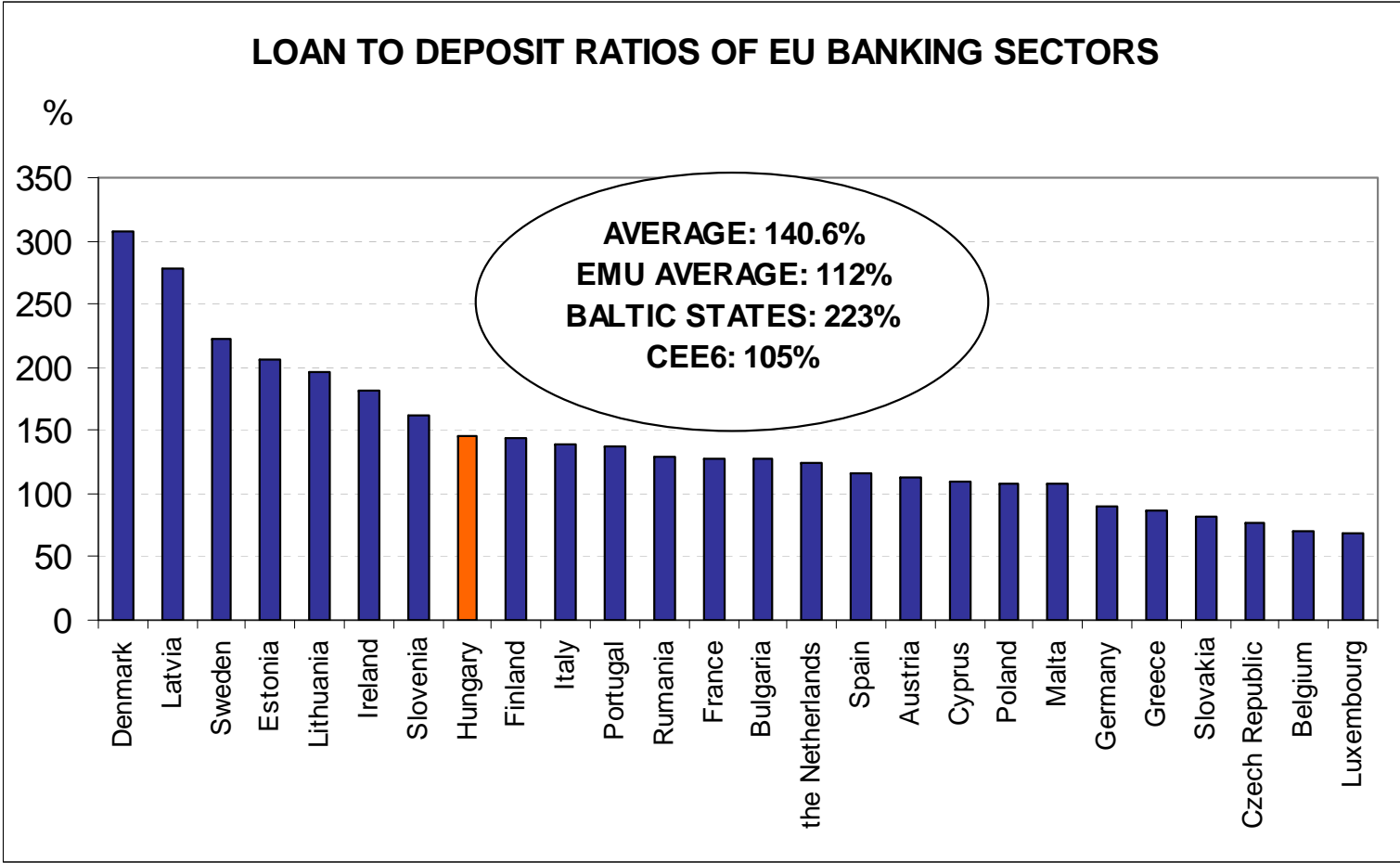


Foreign banks play a leading role in the region

Foreign-controlled equity/total equity: ~70-90%

Source: NBH

THE CRISIS: SUDDEN STOP OF CREDIT



The growth strategies built on cheap external financing are not sustainable any more

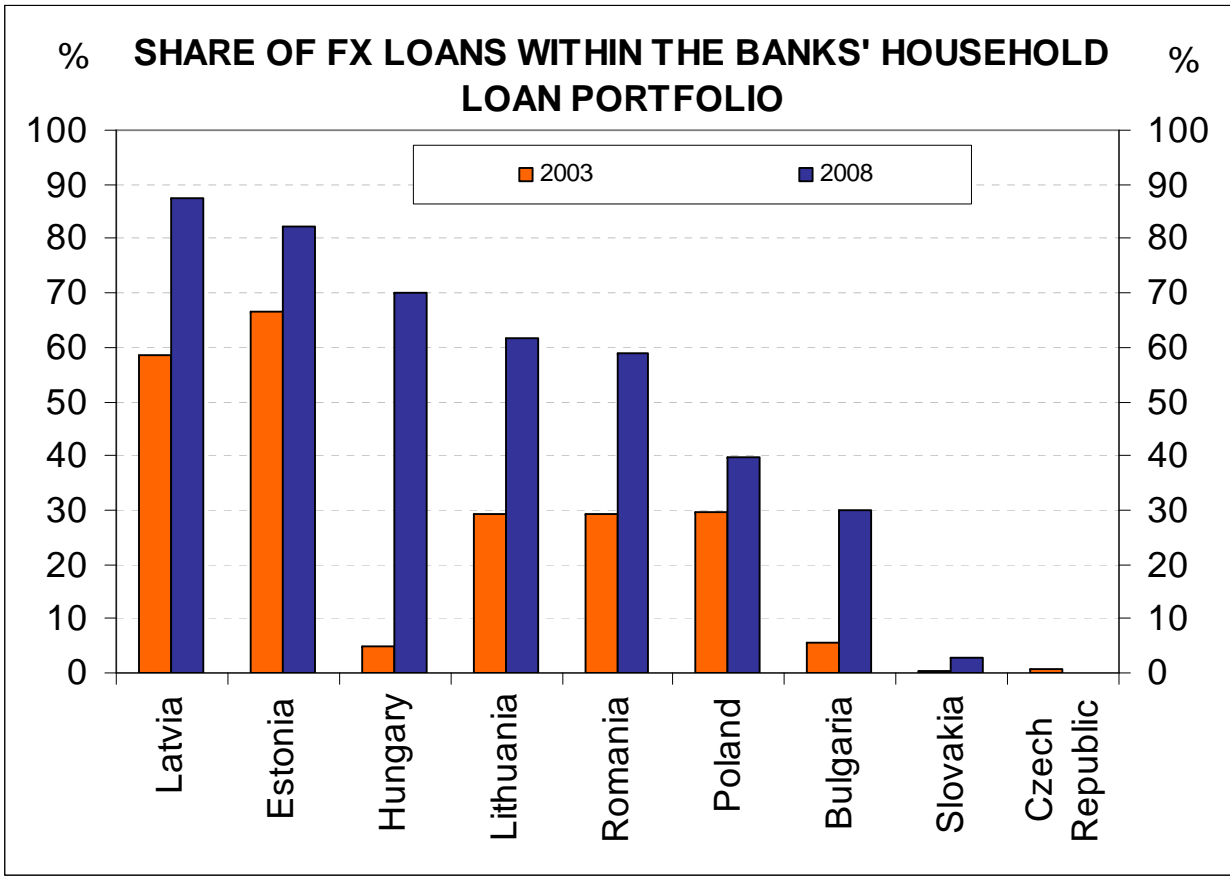
Domestic savings will not be sufficient to substitute external funding

Source: ECB, NBH, data as of end-2008

THE RISING RATIO OF FX TRANSACTIONS AND BOOMING FX LENDING IS A REGIONAL PHENOMENON

Small, open, export-driven economies, liberalized FX transaction among residents, and/or currency board or spontaneous euroization or the voluntary interpretation of IT (high interest rate differential)

NO LENDER OF LAST RESORT



Source: NBH

UNHEDGED FX POSITIONS

A natural consequence of the permanent external deficits in the region

Net domestic savings were insufficient to finance investments and exports, hence external capital inflows were needed to finance the deficit.

The debt-generating part of the capital inflows necessarily resulted in the formation of an unhedged FX position at one or more domestic agents.

The balance sheet of the banking sector purely mirrors the macro imbalances.

THE CRISIS: IS THERE A WAY OUT?

The region imported the financial crisis

Collapsing export markets: a huge shock to the real economy

Sudden-stop of capital inflows: financial sector shock

The room for fiscal maneuver is limited

The central banks are unable to provide the system with foreign currency liquidity

If –in the midst of the crisis–

- **governments** intend to improve external balances, to keep budget deficits under control,
 - **the banking sector** aims for lower L/D rates,
 - **authorities**, financial watchdogs demand higher capital adequacy ratios, impose limitations to FX lending
- simultaneously, the result would be an even deeper recession

THE CRISIS: IS THERE A WAY OUT?

Due to the cross –border dependencies coordinated actions are needed

The problems can not be solved on a national basis

Governments, central banks in the region should act jointly with the ECB, the European authorities, international organizations and foreign owners of the banking sector

Not to fund a credit boom, but

to create the conditions for a moderate 5-8% yearly growth rate in credit and avoid a long-lasting depression

DID THE EURO PROVIDE A SHELTER?

The EUR on its own was not able to provide a shelter

The ECB could have helped by providing EUR liquidity to the region

The main issue was:

Whether the given banking sector had a liquidity buffer?

Slovakia versus Czech Republic

The Czech Republic managed the crisis well and so did Slovakia.

The pace of GDP contraction is similar in both countries.

Macroeconomic policies

The external deficits that had been considered sustainable before the crisis are no longer sustainable

The region will not be able to return to the growth levels seen before the crisis, economies should adjust to a lower path.

Germany: should take over as the „final consumer” of Europe instead of pushing ahead with a purely export-driven growth strategy.

FUTURE CHALLENGES

Banking sector

L/D ratios should adjust, but it would be a mistake to target L/D at or even below 100%, as it would kill growth and convergence

Limiting FX based lending is acceptable only if medium and long-term domestic currency- based financing is available at a reasonable price

Killing FX-based lending and at the same time not providing domestic currency based financing would result in a prolonged economic stagnation

In an economy that is heading towards the euro, the dynamic expansion of CHF or JPY denominated loans in the household sector is clearly not a welcome development (especially if these loans are short-term instruments), but there are serious arguments supporting EUR-based lending in case of mortgages and investments

If the economy as a whole is on a sustainable path –primarily the external position is sustainable- the risk of the open, unhedged FX position is manageable, both on a macro and on a micro level.