Post-crisis bank business models in Central and Southeastern Europe

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The region at the peak of the crisis: Strong impact, but considerable variation

Criteria:
(1) > 25% depreciation of currency;
(2) > 20% house price decline;
(3) > 2 (out of 6) months of industrial production decline;
(4) > 2 consecutive months net credit decline
Could have been a lot worse

- No uncontrolled currency collapses
- No system wide bank runs; payments systems intact
- No populist or coercive policy responses
- No reform reversals

On all these dimensions, this crisis contrasts with previous emerging market crises
Capital outflows relatively modest in most countries in Central and Eastern Europe

Percentage changes in external assets of BIS-reporting banks

<table>
<thead>
<tr>
<th>Region</th>
<th>Avg 2007Q4/2008Q1</th>
<th>Avg 2008Q4/2009Q1</th>
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<tbody>
<tr>
<td>Emerging Europe</td>
<td>-3.4</td>
<td>-11.1</td>
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<tr>
<td>Russia &amp; Ukraine</td>
<td>-4.4</td>
<td>-7.8</td>
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<td>Cent Asia &amp; Caucasus</td>
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<td>Latin America</td>
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<td>Emerging Asia</td>
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<td>-11.9</td>
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Crisis challenge:
Systemic problem – systemic response
Forceful crisis response

- Massive domestic support in western Europe
- Mature responses in central and eastern Europe
- Forceful, coordinated international support
  - IMF resources tripled to US$ 750 billion
  - EU BoP support quadrupled to €50 billion
  - G20: capital to multilateral development banks
  - ECB liquidity support to Western banks
- Parent banks stayed in the game
The crisis response included large international support packages ...

External balance of payments support (Percent of GDP)
... and an unusual mechanism for public-private coordination: the “Vienna Initiative”

- Coordination among banks to maintain exposures
- Joint IFI (EBRD/EIB/WB) support to bank groups
- Home country authorities allow parent bank support of subsidiaries
- Host country authorities to provide liquidity equally to foreign and domestic owned banks
Financial integration – a double-edged sword

- Capital inflows and financial integration key drivers of growth and convergence
- Foreign banks were a stabilising factor in the crisis
- However, foreign financing also contributed to credit booms, excess leverage, and foreign currency debt that made the crisis worse
Capital inflows were a driver of growth in transition countries

... in contrast with other emerging markets

- Analysis suggests a causal relationship
However, foreign finance led to FX lending, credit booms, and external (over-)indebtedness.

Cross-border debt inflows and domestic credit growth, 2005-08

Foreign bank share and FX lending share, end-2007

Median growth of BIS lending between mid-2005 and mid-2007, %

Average credit growth between mid-2005 and mid-2007, %

Share of foreign currency lending in total domestic lending, %

Asset share of foreign-owned banks, %
... which made the crisis worse

External debt and cumulative output decline in crisis

Pre-crisis credit boom and cumulative output decline in crisis
Cross-border banking requires supporting regulatory framework

• Home country model not sufficient
  – Requires check at the European level
  – Host country authorities need assurances
  – How to deal with non-EU countries

• Higher capital requirements

• Too complex to fail (to manage)?
  – “Living wills”
  – How to cut?

• Return of securitisation?
Vienna Plus: Addressing the FX exposures

Together with the other IFIs:
- Ensure conducive macroeconomic policies
- Establish supporting regulatory framework

EBRD:
- Actively use own funding activities
- Work with partner banks to reduce FX exposures
Thank you!