Editorial

Dear reader,

The economic links between East and West have been strengthening continuously since the borders have been opened up. Although we may identify links in numerous economic fields – the trade of goods and services, foreign direct investment (FDI) and the labor market – from a central banker's view, financial links may well be the most interesting and important ones.

Austria's banking sector is a frontrunner in reinforcing financial ties with the East. Building on high trade shares and FDI, this sector has invested quite heavily in the region. As a result, Austria's banks are not only represented in nearly every country in Eastern Europe, very often they are main shareholders, owners or investors. The developments of recent months have shown that this process is still well underway. In fact, Austrian banks made several key investments during the summer months, e.g. in Ukraine. Hence, the financial analysis of the region is highly interesting not just from an economic but also from a financial stability perspective.

Such analyses benefit not only the Oesterreichische Nationalbank (OeNB). Closely monitoring financial markets in Eastern Europe is also crucial from a European perspective. Convergence issues, the identification of the factors driving real growth, the significance of foreign ownership and the possible risks of high credit growth rates all have a broad impact on European developments. These considerations lie at the heart of the choice of the topic of this year's OeNB Conference on European Economic Integration, which will be organized jointly with the European Central Bank (ECB) and the Center for Financial Studies, namely financial development, integration and stability in Central, Eastern and Southeastern Europe. In the runup to this event, the OeNB has intensified the relevant research, culminating in this special issue of Focus on European Economic Integration, which takes a close look at financial developments and integration and which will be available for the conference.

In his study on banking in ten countries in Central and Eastern Europe since 2000, Stephan Barisitz analyzes recent structural changes and modernization in an environment of generally strong growth. He draws the following conclusions: Selling banks to foreign strategic investors has paid off in most cases. The continued swift dissemination of IT and e-banking may help reconcile the seeming paradox of simultaneous "overbanking" and "underbanking" in the region. The near-ubiquitous credit boom, while embodying a welcome structural catching-up process, is not without risks, cautions the author, and has not yet been fully brought under control.

The study written jointly by Peter Backé and Tina Zumer (ECB) sheds more light on this credit boom. The authors review private sector credit developments in Central and Eastern European EU Member States. The analysis shows that lending to the private sector has grown dynamically in most but not all countries under review, that loans to households have risen dynamically in all countries, and that foreign currency lending has been sizeable. Macroeconomic stabilization, comprehensive reforms and privatization in the financial sector as well as the introduction of market institutions and legal reforms have promoted credit growth. The authors point out that fast and persistent private sector credit growth frequently goes hand in hand with high current account deficits, necessitating action to keep macroeconomic vulnerabilities in check.

Tamás Mágel provides insights into the role of Austrian credit institutions in banking sector developments in Bosnia and Herzegovina. The author describes the institutional and macroeconomic background, ownership structures and concentration in the banking sector, the degree of financial intermediation, the structure of the aggregated balance sheet, the role of foreign exchange and the development of capital adequacy and profitability. The author finds that macroeconomic stabilization and the market entry of foreign banks has supported the reform process in the banking sector and has helped deepen financial intermediation while leading to a relatively high concentration of banking sector assets.

The contribution by Markus Arpa, Thomas Reininger and Zoltan Walko examines whether Central and Eastern Europe will ever catch up with the euro area in terms of banking intermediation. The authors use the private credit flow-to-GDP ratio, a flow-flow measure that complements the widely used stock-flow measure, to gauge and compare the degree of banking intermediation. The authors ascertain that, based on the flow-flow measure, the current degree of banking intermediation in most Central and Eastern European countries is significantly closer to the euro area average than suggested by the traditional stock-flow measure. Furthermore, the authors analyze the implications of the different concepts of convergence for the degree of banking intermediation. Drawing on the experience of major catching-up economies in the past 50 years worldwide, the authors tend to take a rather skeptical view on the possibility of realizing a flow-flow ratio that would be high enough to produce simultaneous convergence in the stock-flow ratio and in per capita income levels while not ruling out this possibility completely.

In the last special focus study, Ingrid Ettl and Alexandra Schober-Rhomberg take a closer look at the implementation of the Basel Core Principles in selected countries from the perspective of the International Monetary Fund (IMF). They base their analysis on the Financial System Stability Assessments (FSSAs) of the IMF in Bulgaria, the Czech Republic, Germany, Croatia, Hungary, Austria, Poland, Romania, Russia, Slovenia, Slovakia and Ukraine, covering a range of key supervisory areas. Comparing the implementation of the core principles across countries allows identifying the strengths and weaknesses of financial regulation and banking supervision. This in turn suggests in which areas there is a need for action to strengthen the supervisory regime.

All in all, these studies take a closer look at some of the topics which will be presented at the forthcoming Conference on European Economic Integration entitled "Financial Development, Integration and Stability in Central, Eastern and South-Eastern Europe." We hope that the findings pique your interest, and are looking forward to stimulating presentations and fruitful discussions at the conference and at subsequent OeNB events on financial sector issues.

If you have further comments or are looking to exchange ideas, please do not hesitate to contact us at

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