Post-crisis bank business models in Central and Southeastern Europe

Erik Berglof
Chief Economist
European Bank for Reconstruction and Development

European Bank
for Reconstruction and Development

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

European Bank
for Reconstruction and Development

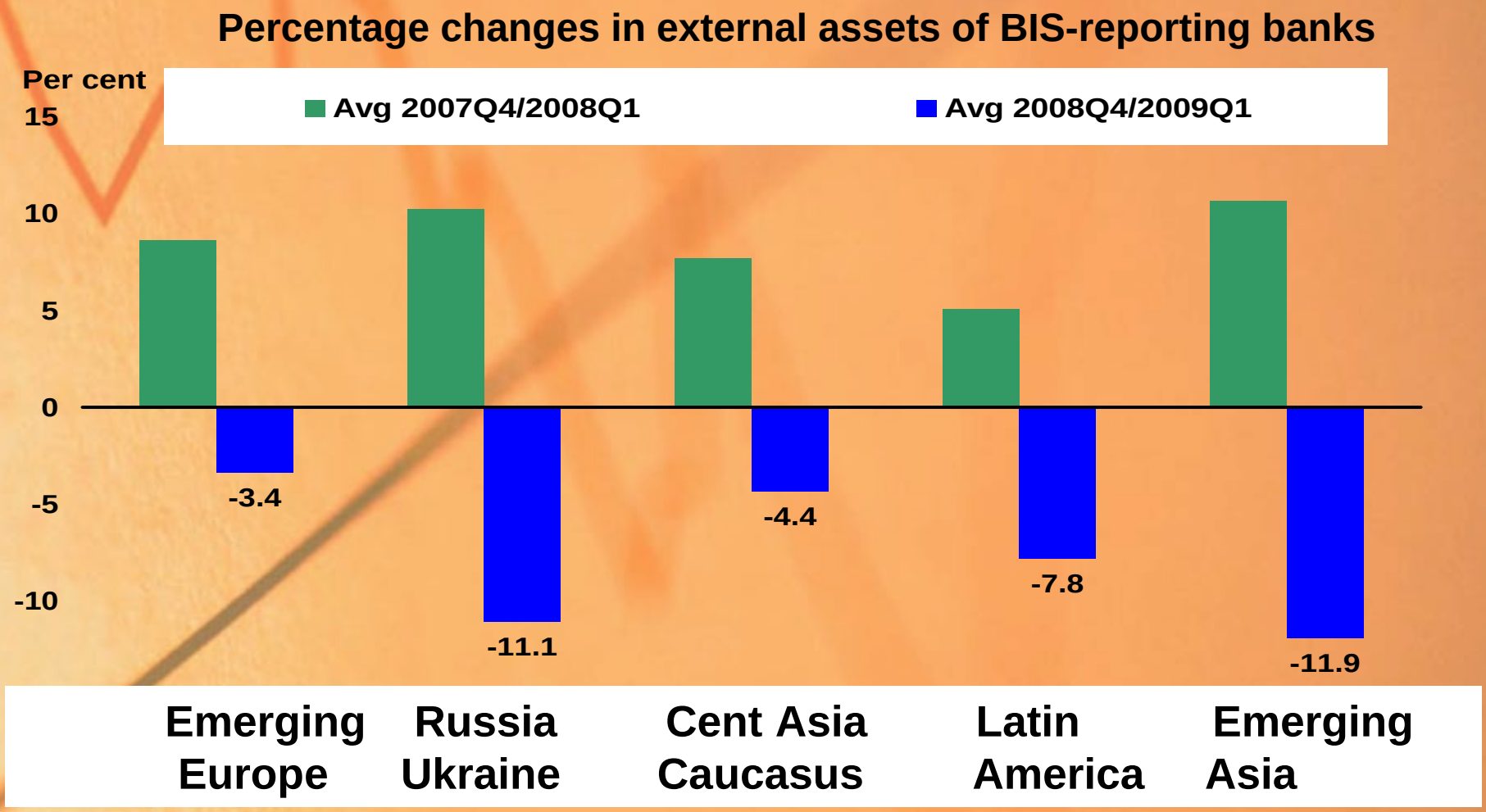
Could have been a lot worse

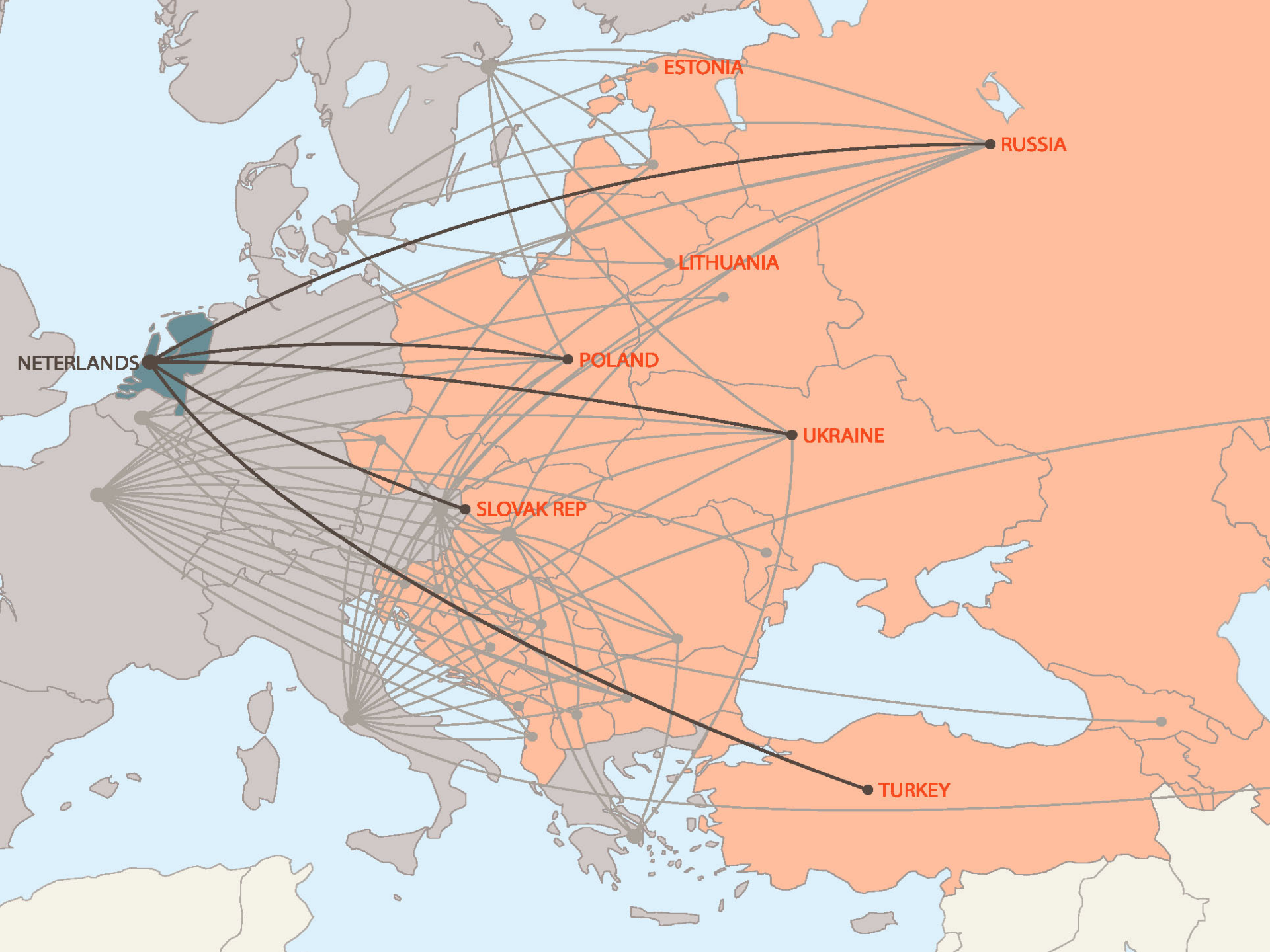
- No uncontrolled currency collapses
- No system wide bank runs; payments systems intact
- No populist or coercive policy responses
- No reform reversals

On all these dimensions, this crisis contrasts with previous emerging market crises

European Bank
for Reconstruction and Development

Capital outflows relatively modest in most countries in Central and Eastern Europe




ESTONIA
RUSSIA
LITHUANIA
NETERLANDS
POLAND
UKRAINE
SLOVAK REP
TURKEY

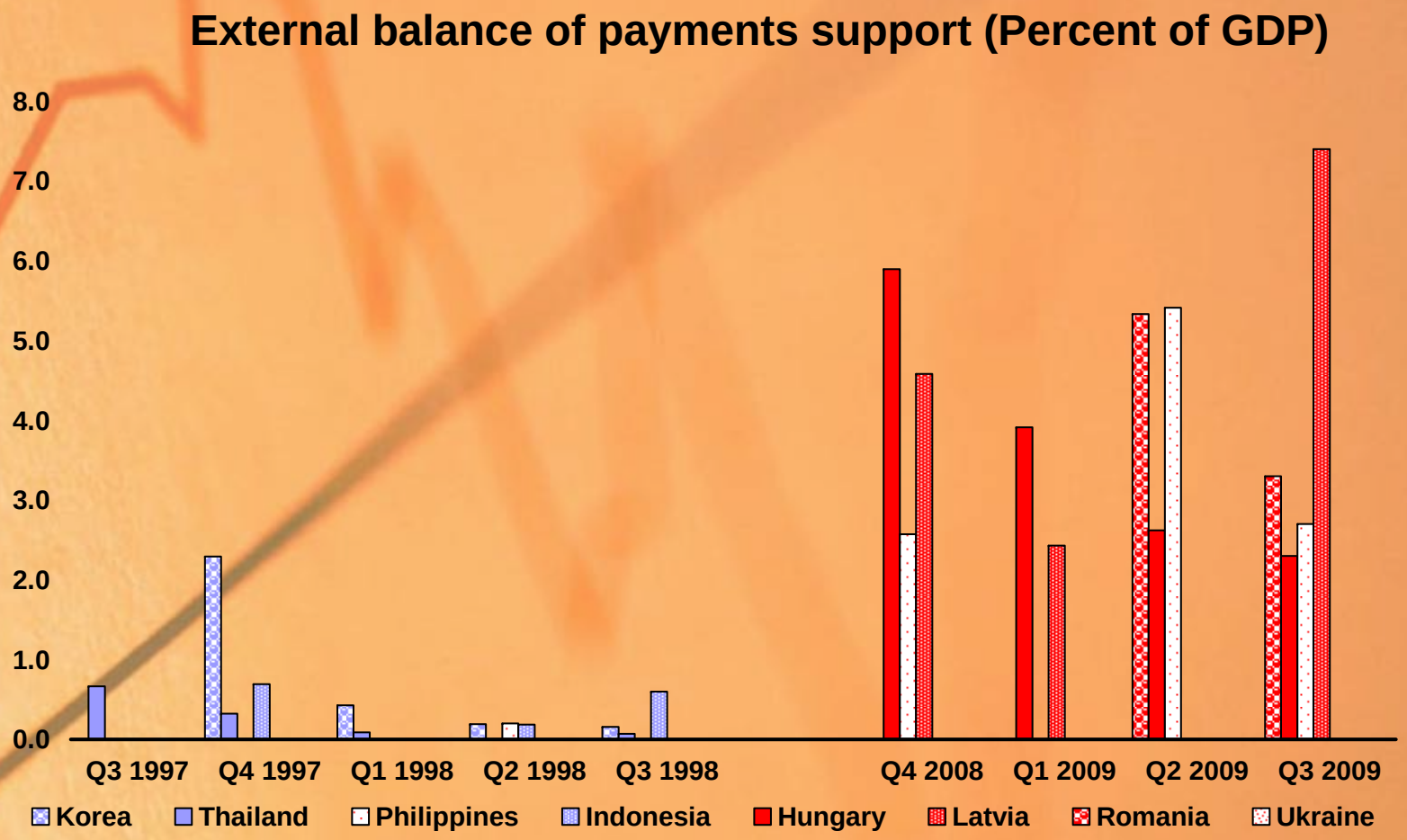
Crisis challenge:
Systemic problem – systemic response

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

European Bank
for Reconstruction and Development

The crisis response included large international support packages …



… 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

European Bank
for Reconstruction and Development

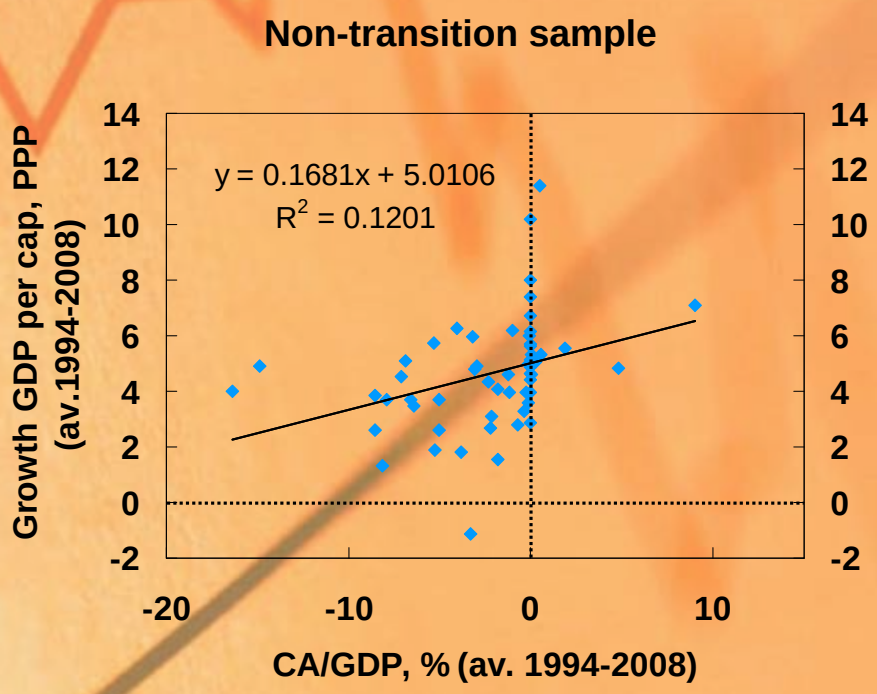
Financial integration – a double-edged sword

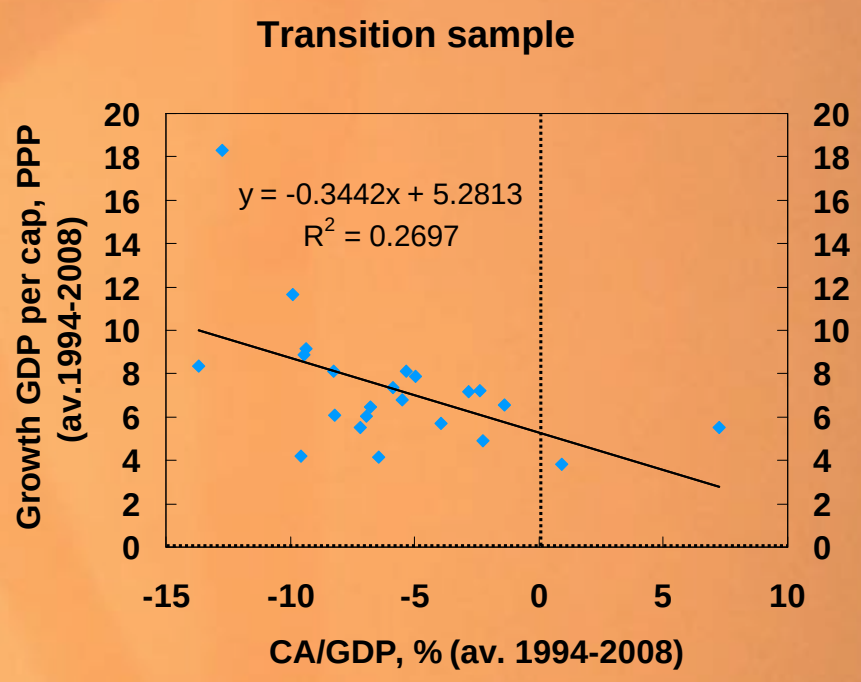
- Capital inflows and financial integration key drivers of growth and convergence
- Foreign banks were a stabilising factor in the crisis
- However, foreign financing also contributed to credit booms, excess leverage, and foreign currency debt that made the crisis worse

European Bank
for Reconstruction and Development

Capital inflows were a driver of growth in transition countries

… in contrast with other emerging markets



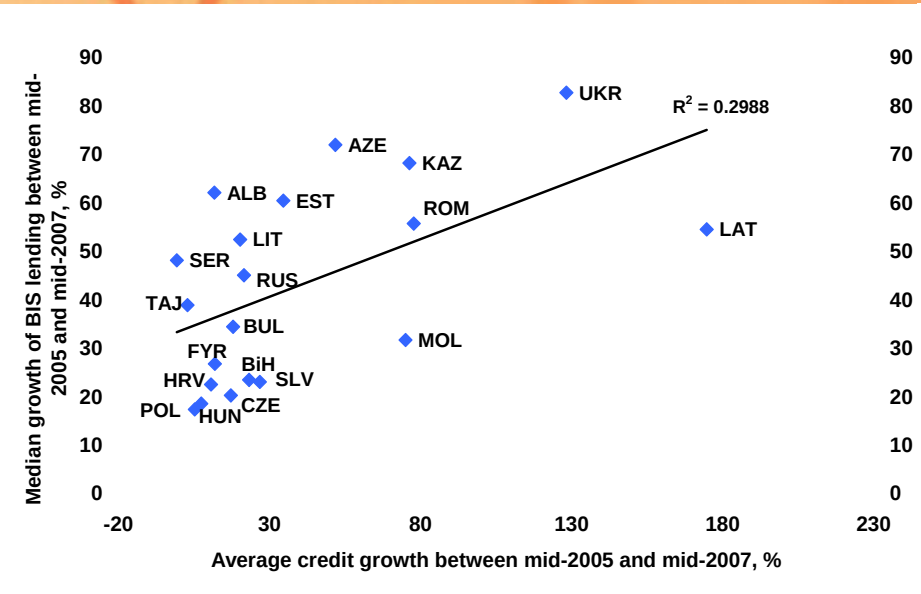


- **Analysis suggests a causal relationship**

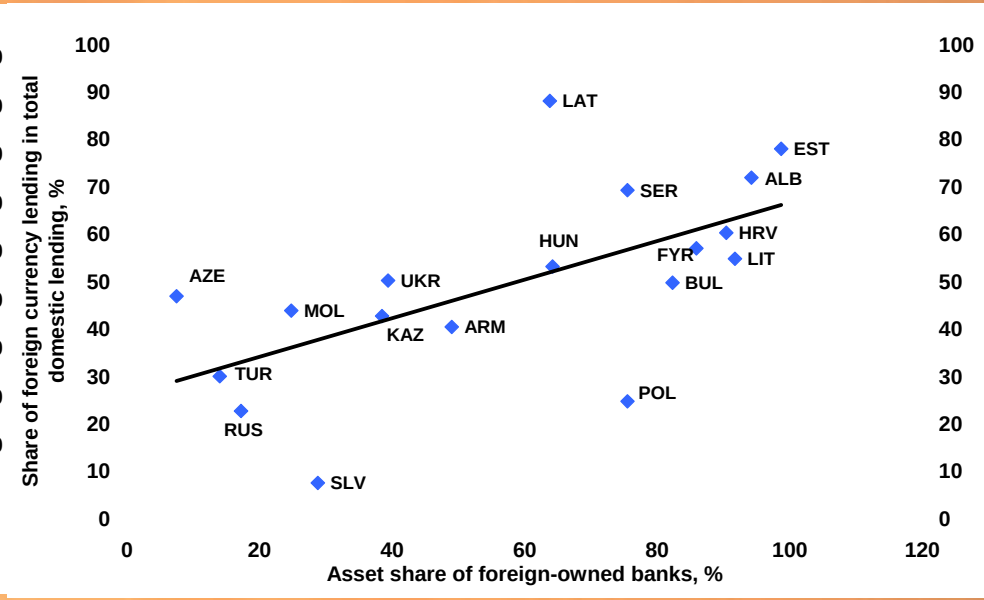
European Bank for Reconstruction and Development

However, foreign finance led to FX lending, credit booms, and external (over-)indebtedness

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



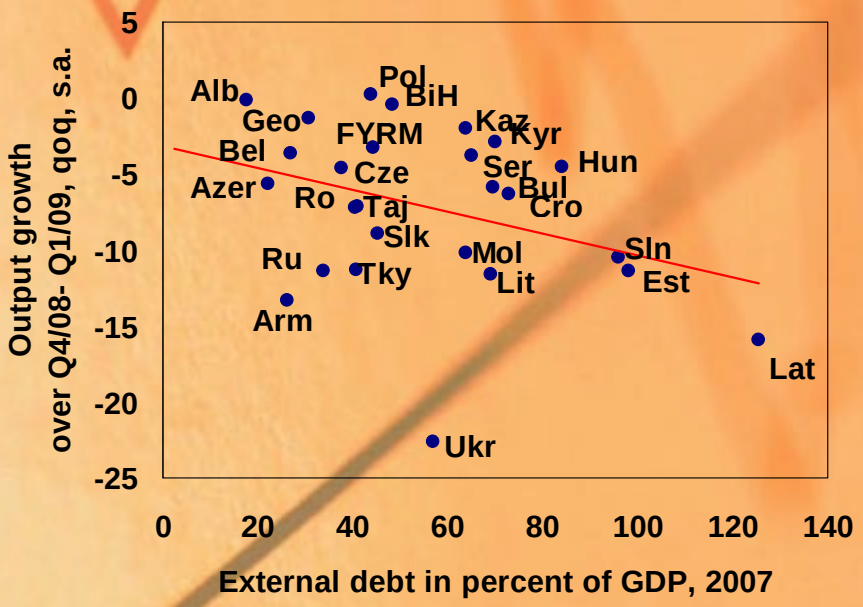
Foreign bank share and FX lending share, end-2007



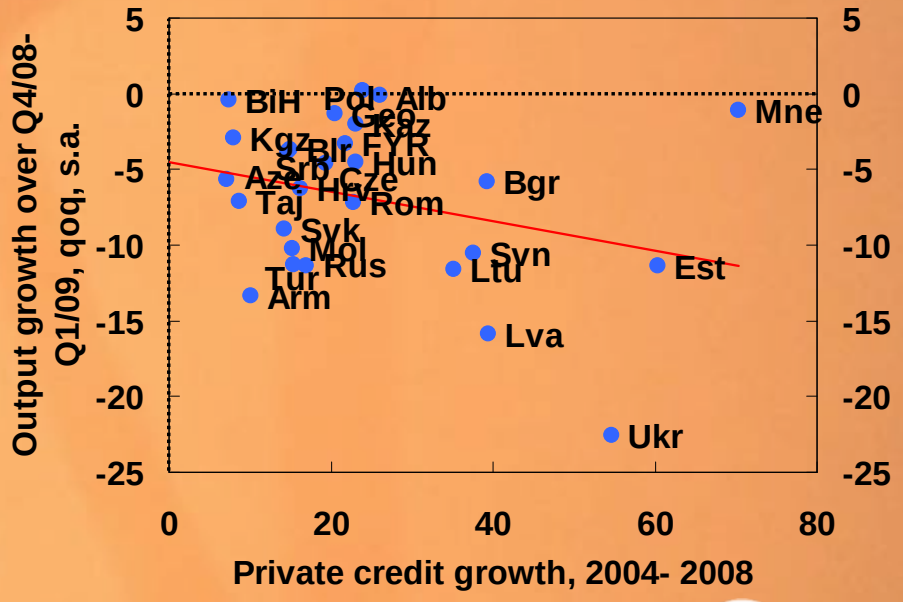
European Bank
for Reconstruction and Development

… which made the crisis worse

External debt and cumulative output decline in crisis



Pre-crisis credit boom and cumulative output decline in crisis



European Bank
for Reconstruction and Development

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?

European Bank
for Reconstruction and Development

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

European Bank
for Reconstruction and Development

Thank you!

European Bank
for Reconstruction and Development