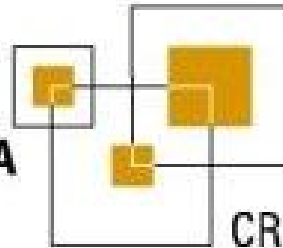


HRVATSKA UDRUGA BANAKA



CROATIAN BANKING ASSOCIATION

Banks in Croatia and the SEE/CEE region in the crisis and the post-crisis period

Zoran Bohaček

EBF Associates' meeting

December 9th, 2010

Agenda

- Introduction
- Causing the crisis
- Questioning the role of banks in the region during the crisis
- Bank profitability and capital adequacy



CBA Analysis no. 24, June 2010 - **Sustainable Fiscal Policy And Public Debt: Never Again As It Used To Be**

CBA Analysis no. 22, March 2010 - **Small and Medium Size Enterprises Funding In Crisis: Between Wishes And Possibilities**

CBA Analysis no. 20, October 2009 - **Development of Banking in Croatia: Years of Maturing Through International Integration 1999-2009**

CBA Analysis no. 19, September 2009 - **Bank Profitability in Croatia: How to Estimate the Fall?**

CBA Analysis no. 18, May 2009 - **Interest Rates in The Time of Crisis: Where is Croatia Compared to Eurozone?**

CBA Analysis no. 17, March 2009 - **Monetary Transmission: It All Starts and Ends With Banks**

CBA Analysis no. 16, February 2009 - **Advisers were Right: Fiscal Adjustment May Mitigate the Crisis**

CBA Analysis no. 15, December 2008 - **Regulatory Cost (IRO) and Cost of Funds Index (COFI): What Does the Crisis Bring**

CBA Analysis no. 14, October 2008 - **"Big" and "Small" Permanent Effects of Problems in European Banks on Small European Periphery Countries**

CBA Analysis no. 13, September 2008 - **Banking Profitability in Croatia: The Fall Continues**

CBA Analysis no. 12, July 2008 - **"Subprime" Crisis and Financial Regulation Doubts: Where is The Difference Between Global and Local Effects?**

CBA Analysis no. 11, June 2008 - **Interest Rate Growth: Where is Croatia Compared to Europe in Times of Crisis?**

CBA Analysis no. 10, March 2008 - **Why Interest Rates Grow: What Does Costs of Funds Index (COFI) Show?**

CBA Analysis no. 9, February 2008 - **Loans and Economic Growth: From Theory to Reality**

CBA Analysis no. 8, December 2007 - **Croatian Banking System stability: Where Does the Risk Hide?**

CBA Analysis no. 7, November 2007 - **External Debt: Where Caution Ends Fear Begins**

CBA Analysis no. 6, October 2007 - **Value Creation in Banking**

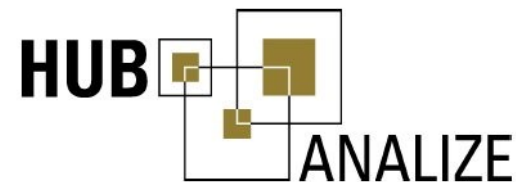
CBA Analysis no. 5, September 2007 - **Capital Inflows, Credit Growth and Restrictions: Regulatory Costs and Regulatory Distortions**

CBA Analysis no. 4, August 2007 - **Deposit Rates and Deposit Insurance: Who is Paying the Cost of Regulations?**

CBA Analysis no. 3, July 2007 - **Bank Profitability in Croatia: Between Myth and Reality**

CBA Analysis no. 2, June 2007 - **Concentration in Banking: On the Complexity of the Relationship between Concentration and Competition in Europe**

CBA Analysis no. 1, May 2007 - **Interest Rates Entering Europe: A Comparison of Lending Interest Rates in Croatia and the Eurozone**



Dvobroj 25-26

rujan 2010.

PROFITABILNOST BANAKA I KREDITI KAKO SU BANKE UBLAŽILE KRIZU 2008.-2010.

How did banks mitigate the crisis 2008-10

Presented at a briefing on Sep. 15th

What caused the crisis?

“greedy” bankers and careless regulators
or

regulators who influenced relaxation of credit
granting in the name of short-term political
interests

- *In any case, we'll end up with stricter
regulation*



Starting point: a widespread narrative

„Although the extent and depth of the impact on CESEE remain unclear at this point, increased integration by CESEE countries into international financial markets and the high share of foreign ownership in their banking systems may increase their susceptibility to the risk of cross border contagion.“ (Maechler and Ong, 2009).

So how did (international) banks actually behave in this crisis in this region and what are the implications for financial stability?



Role of banks - Main messages

- The crisis showed that the banking system in Croatia and several other CESEE countries had stabilising effect, not accelerating as believed at the outset
- Maintained stability of banks resulted in smaller “credit shock” than in most other countries



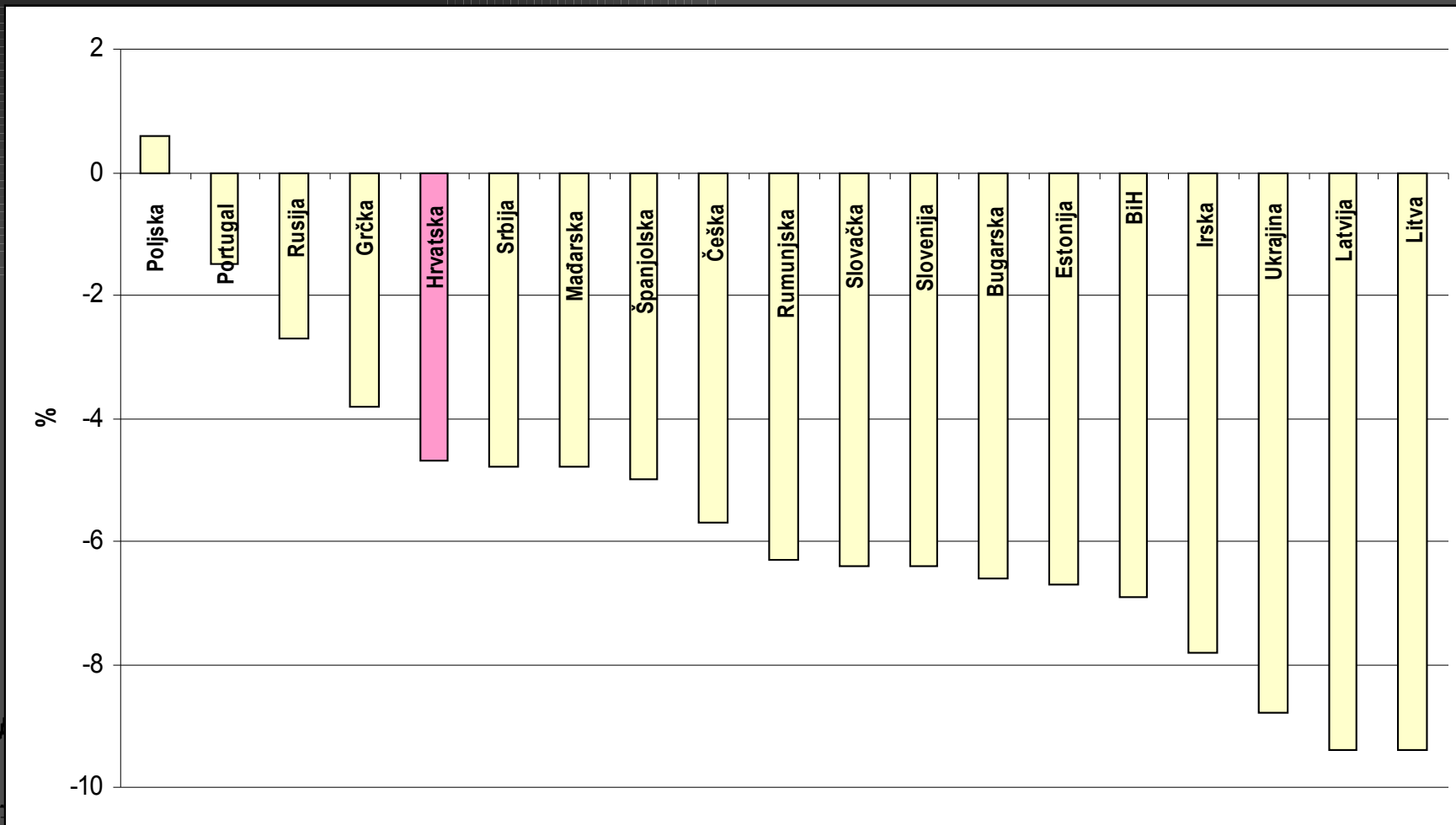
Some definitions

- Shock - departures from the long-run trend
- Foreign liabilities - banks' liabilities to nonresidents (in SDR)
- Relative importance of banks' foreign liabilities - ratio of banks' foreign liabilities to banks' domestic credit to other sectors
→ international financial integration of the banking system

(CESEE 15 + GIPS)



“Credit shock” – deviation from longterm trend - 1Q2010

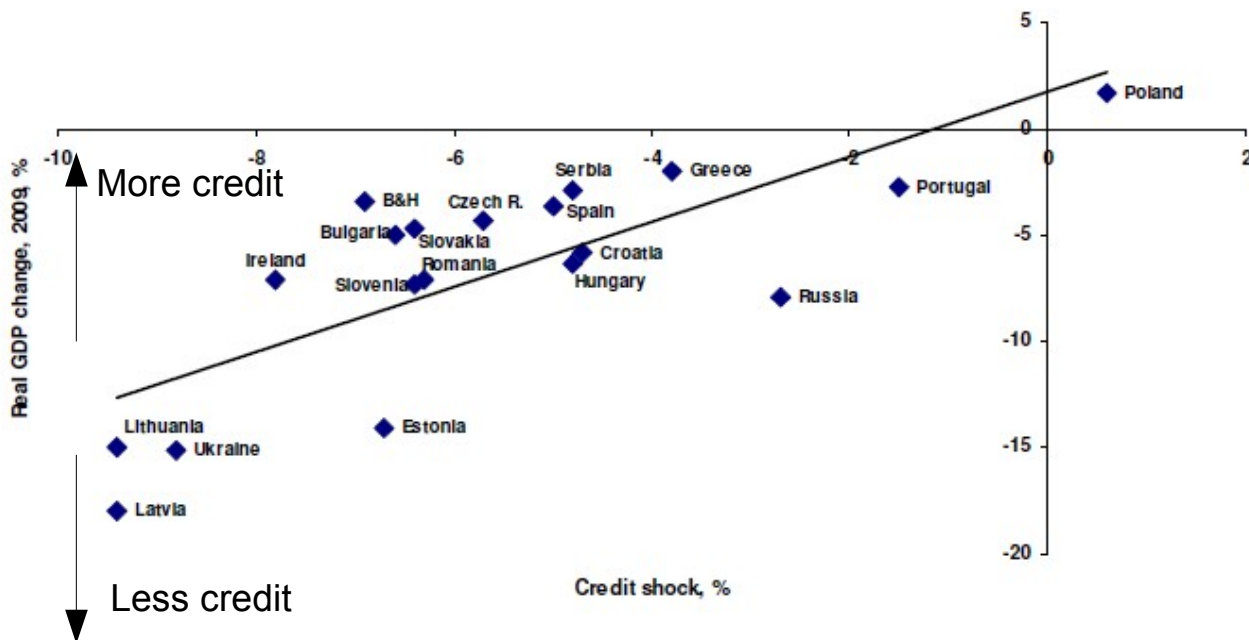


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Credit shock Q1:2010 vs. real GDP growth 2009

Anticyclical role of credits in the crisis:



Source: IMF World Economic Outlook, April 2010 for GDP growth, IMF IFS for credit.

In Croatia

- No government support
- Finance budget deficits
- Foreign capital inflows (2+bln€)



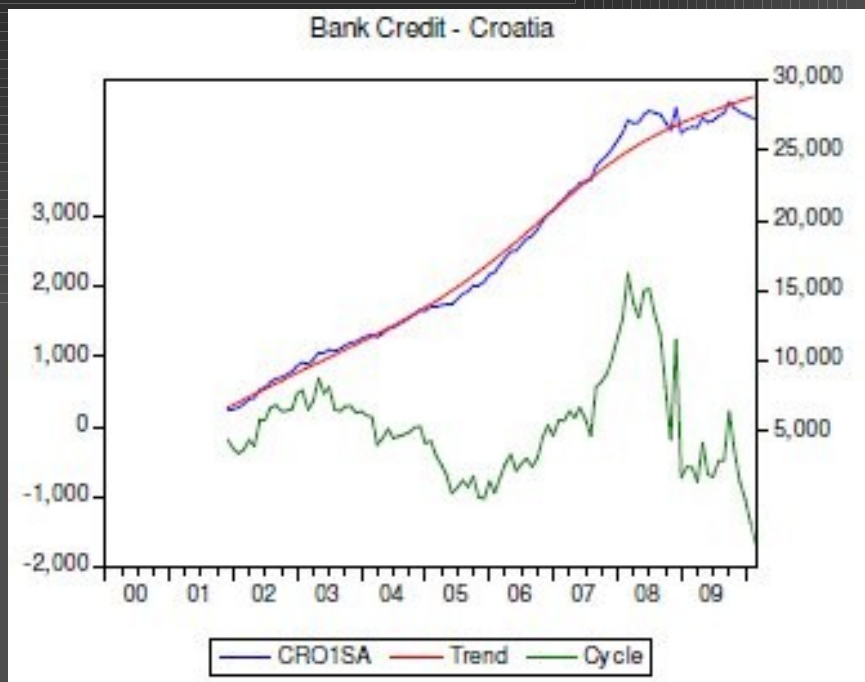
linear correlation coefficient 76.4%

Finding the answer

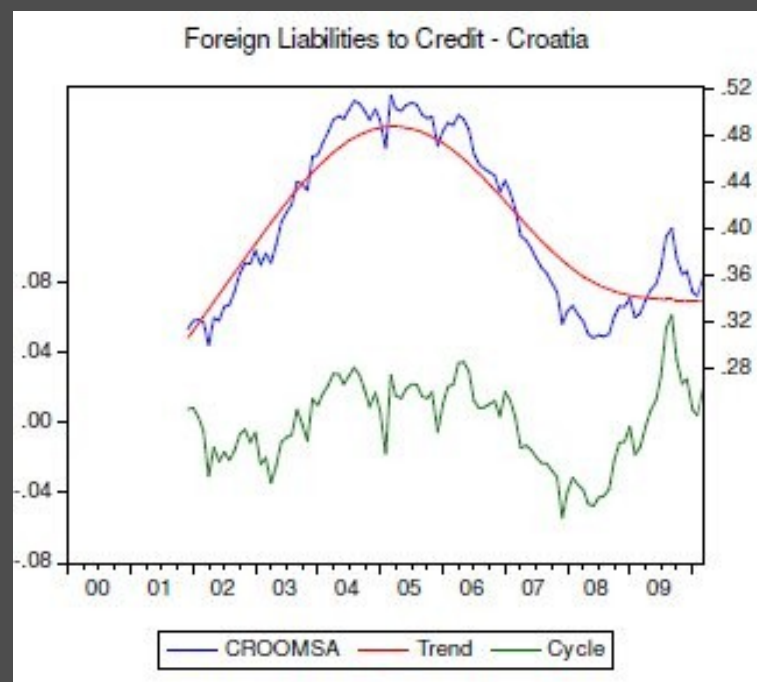
- Estimate trend in banks' credit and departures from the trend at the time of crisis
- Estimate trend in ratio of banks' foreign liabilities to domestic credit to private sector and departures from the trend at the time of crisis.
- If shocks identified in (1) are positively related to shocks identified in (2), banks' integration with international markets plays procyclical role and vice versa.



Case of Croatia



- 4.7%



+ 3.1%

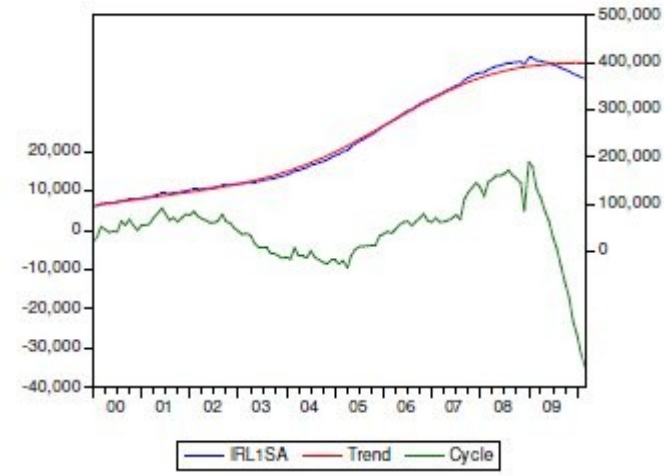
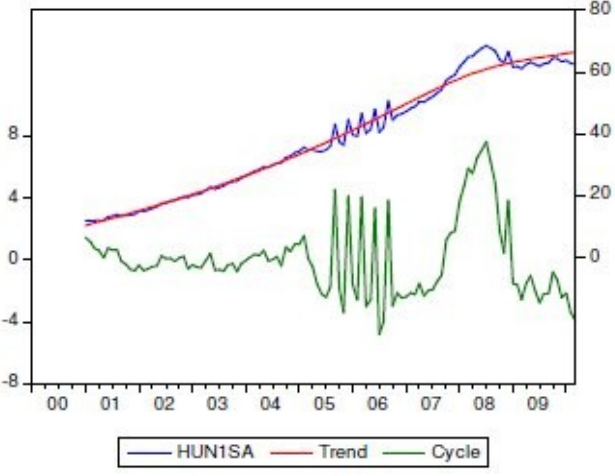
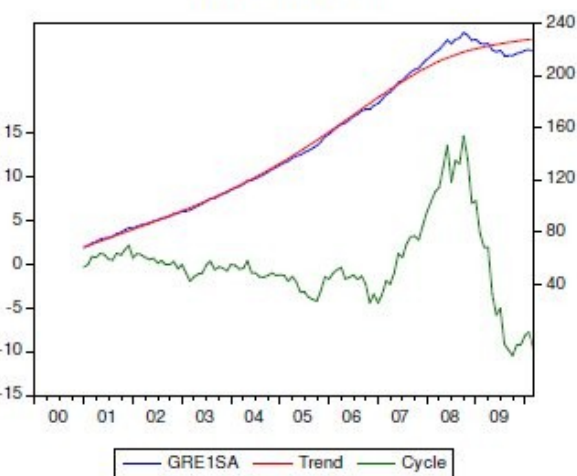


Some other countries

Bank Credit - Greece

Bank Credit - Hungary

Bank Credit - Ireland



-3,8%

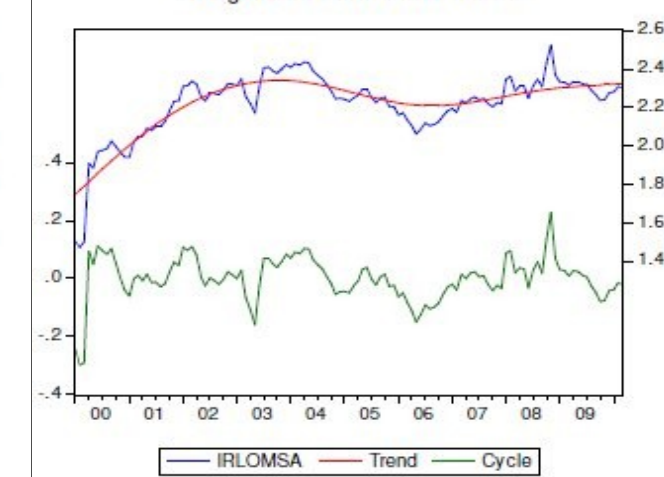
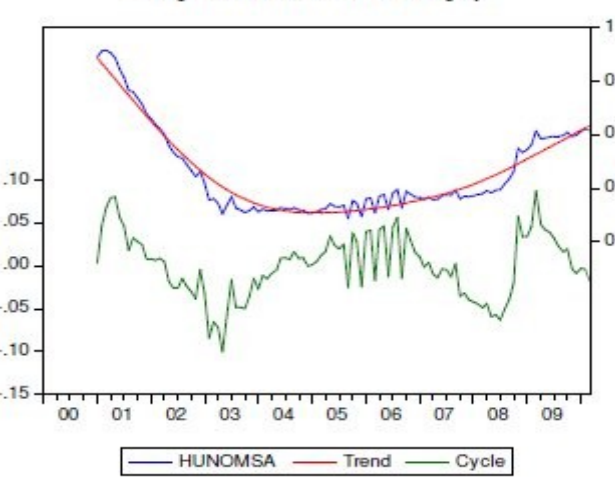
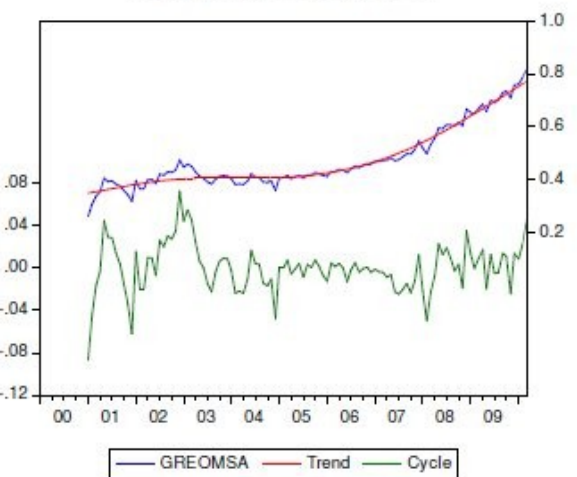
-4,8%

-7,8%

Foreign Liabilities to Credit - Greece

Foreign Liabilities to Credit - Hungary

Foreign Liabilities to Credit - Ireland

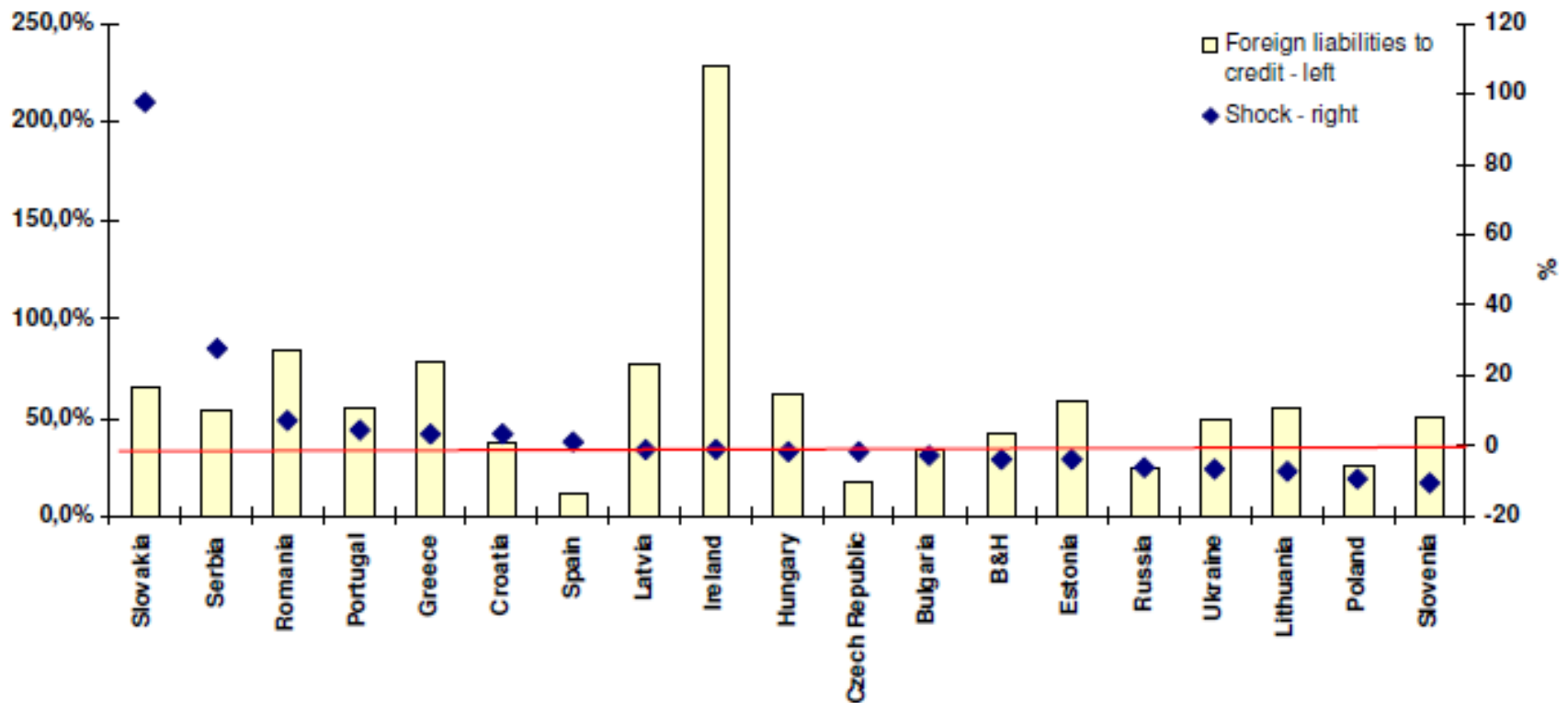


+3,2%

-1,4%

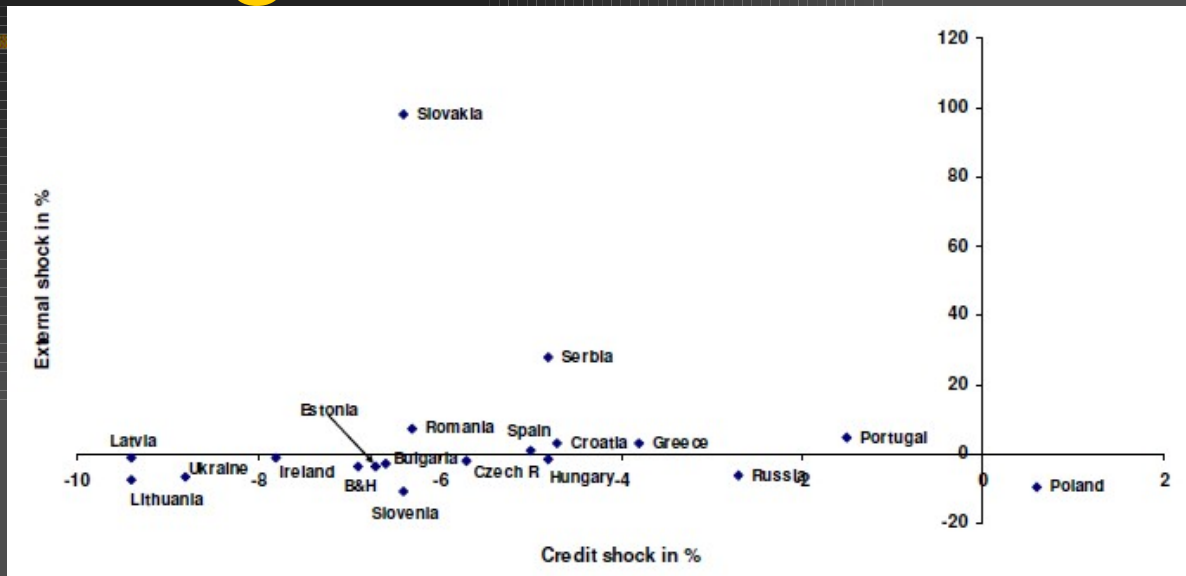
-1,1%

Banks' foreign liabilities to private sector credit and size of external shock 1Q2010



Source: IMF International Financial Statistics, author's calculations.

Credit shock vs. shock to banks' foreign liabilities as of 1Q2010



linear correlation coefficient ~ 0

Procyclicality
(association between adverse credit shock and an adverse shock to banks' foreign liabilities)

Neutrality

Countercyclicality
(association between adverse credit shock and a positive shock to banks' foreign liabilities)

Lithuania, Russia, Slovenia, Ukraine

Bosnia and Herzegovina, Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Poland*, (Ireland); positive external shock in the initial stage of the crisis was detected in Bosnia and Herzegovina, Czech Republic, Estonia and Hungary

Croatia, Romania, Slovakia, Serbia (Greece, Portugal, Spain)



Conclusions (partial)

- Very country specific
- At least four countries with countercyclical behavior of banks and many with neutral role
- Small number of procyclical countries

To be seen: Implications for financial stability



Financial stability elements

- Lender of the last resort
- Deposit insurance
- Banking (financial) regulation & supervision

+ Macroprudential (systemic risk considerations)

Post crisis initiatives and reforms (none specifically designed for New Emerging European Economies)



What is so specific in CESEE?

- Relative size problem and asymmetric integration
- Strength and volatility of capital inflows
- Idleness of countercyclical monetary policy - not necessarily linked with exchange rate regime
- Size distribution of banks
- Internationalization of banks
- Practically no mechanism for smoothing out capital flows
 - EC for inner circle
 - IMF for outer circle



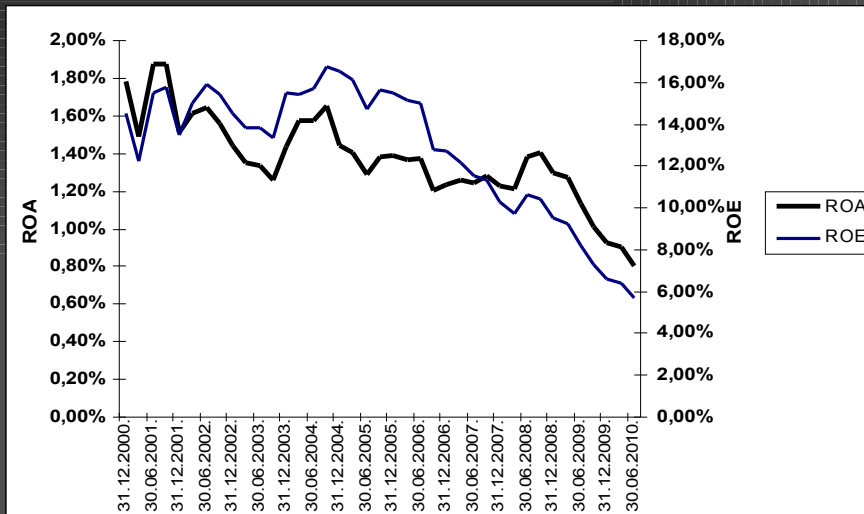
Remedies

- Fiscal restraint
- Adoption of Euro as soon as possible
 - problem of declining motive from both sides
- Strengthening financial regulation and supervision
- Reduction in country risk improves risk-return profile and helps capital inflows

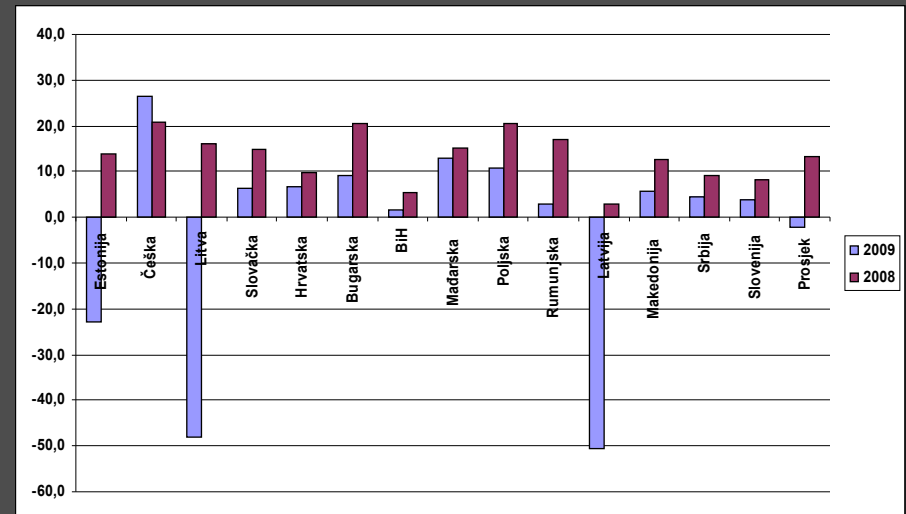


Bank profitability

ROE, ROA - Croatia



ROE Comparison

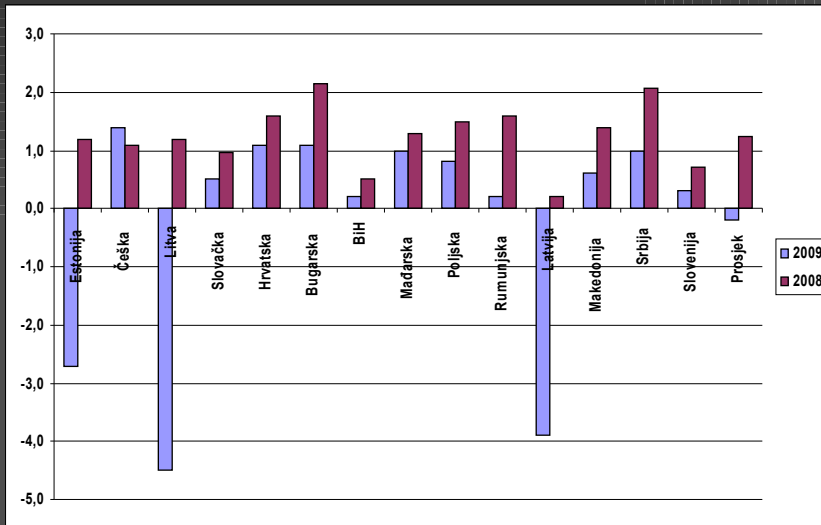


Return on equity in Croatia falls below the long-term return on government bonds, and below average for a comparable group of countries

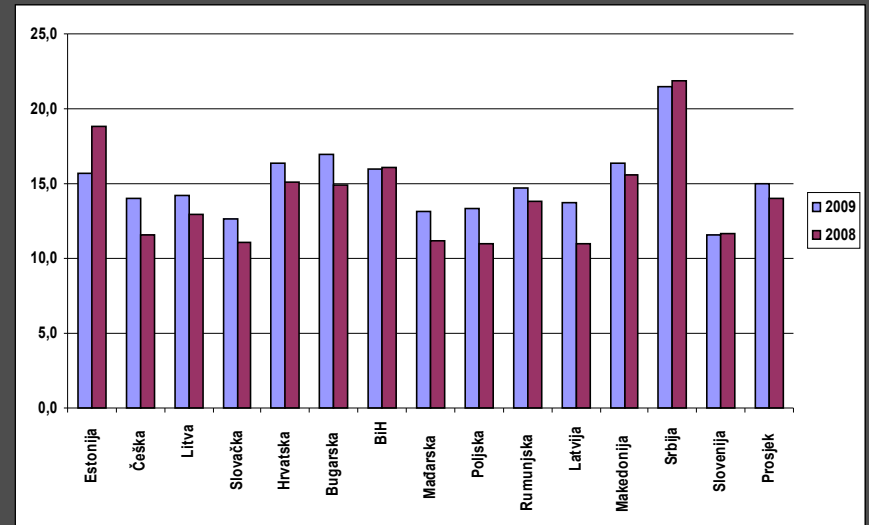


Bank capital

ROA



Capital adequacy ratio



Banks are highly capitalized and still offer a solid return on assets

Parent banks promise long-term support

