Banking Sector Trends and Challenges in Slovenia

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Note: These are the author’s own views, not necessarily those of the IMF. This presentation is based on the 2007 IMF Article IV report for the Republic of Slovenia – Selected Issues (by R. Bems and J. Andritzky), IMF Country Report No. 07/182, available at www.imf.org/cee
European integration poses new challenges for the Slovene banking system

- Competition from small foreign-owned banks (vs. large Slovene state-dominated banks)
- Deepening integration with West and East European financial markets, accelerated by euro adoption
- Declining interest margins, loss of some exchange rate revenues
- Vulnerabilities from cross border exposure
How efficient is the Slovene banking system?

- Study by IMF Article IV team, May 2007 - low efficiency and profits in the EU context
- Comparison with commercial banks in smaller EMU and NMS markets
- Based on bank-level balance sheet and income statement data from BankScope
How efficient is the Slovene banking system?

Cost and Profit Indicators

Cost-to-Income Ratios (percent)

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<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
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<tbody>
<tr>
<td>SVN</td>
<td>60</td>
<td>65</td>
<td>70</td>
</tr>
<tr>
<td>SVN (three biggest)</td>
<td>75</td>
<td>80</td>
<td></td>
</tr>
<tr>
<td>NMS</td>
<td>80</td>
<td>85</td>
<td></td>
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<tr>
<td>EMU</td>
<td>90</td>
<td>95</td>
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Source: Bankscope.

Return on Average Equity

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<tr>
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<th>2003</th>
<th>2004</th>
<th>2005</th>
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<tbody>
<tr>
<td>SI</td>
<td>4</td>
<td>8</td>
<td>12</td>
</tr>
<tr>
<td>SI (three biggest)</td>
<td>16</td>
<td>20</td>
<td></td>
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<tr>
<td>NMS</td>
<td>12</td>
<td>16</td>
<td>20</td>
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<tr>
<td>EMU</td>
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Source: Bankscope.
Profits in Slovenia have been affected by declining net interest margin.

**Net Interest Margins**

- **SI**
- **NMS**
- **EMU**
- **SI (three biggest)**

Source: Bankscope.

**Average Net Interest Margin, 2005**

EMU average = 1.51

Source: Bankscope.
Estimates of the Distance from the Cost Efficiency Frontier

Average Bank Efficiency Scores by Country, 2005
(Distance from cost frontier, frontier=1)

Source: Staff calculations.
Fast-growing NMS have made efforts to make their banking systems more efficient

Source: EBRD.
Market contestability is analyzed using an index that measures the extent of the pass-through of changes in input prices to revenues in banks (Panzar & Rose 1987).

Under perfect competition, bank revenues increase by the same amount as input prices, with output quantity staying constant and output prices increasing proportionally (index=1).

Source: Staff calculations.
Efficiency and contestability – Summary

- There is a correlation between contestability index and cost efficiency.
- Larger cross-country studies show that concentration, state ownership, market entry and activity restrictions reduce contestability and hence efficiency.
- Banking concentration and state ownership are high in Slovenia, financial sector reform has been slow.
- A more efficient banking system in Slovenia would enhance growth and financial stability.
Policy conclusions

- Deeper EU integration and capital markets development will add to competitive pressures and force Slovene banks to improve efficiency.

- Policy support:
  - Privatization,
  - Implementation of EU integration laws
  - Listing in the stock exchange (transparency and accountability of managers)
  - Developing a long-term growth strategy for the sector
  - Strong bank supervision to monitor bank performance and risks (including due to cross-border exposures)