

Central and Eastern Europe facing deleveraging

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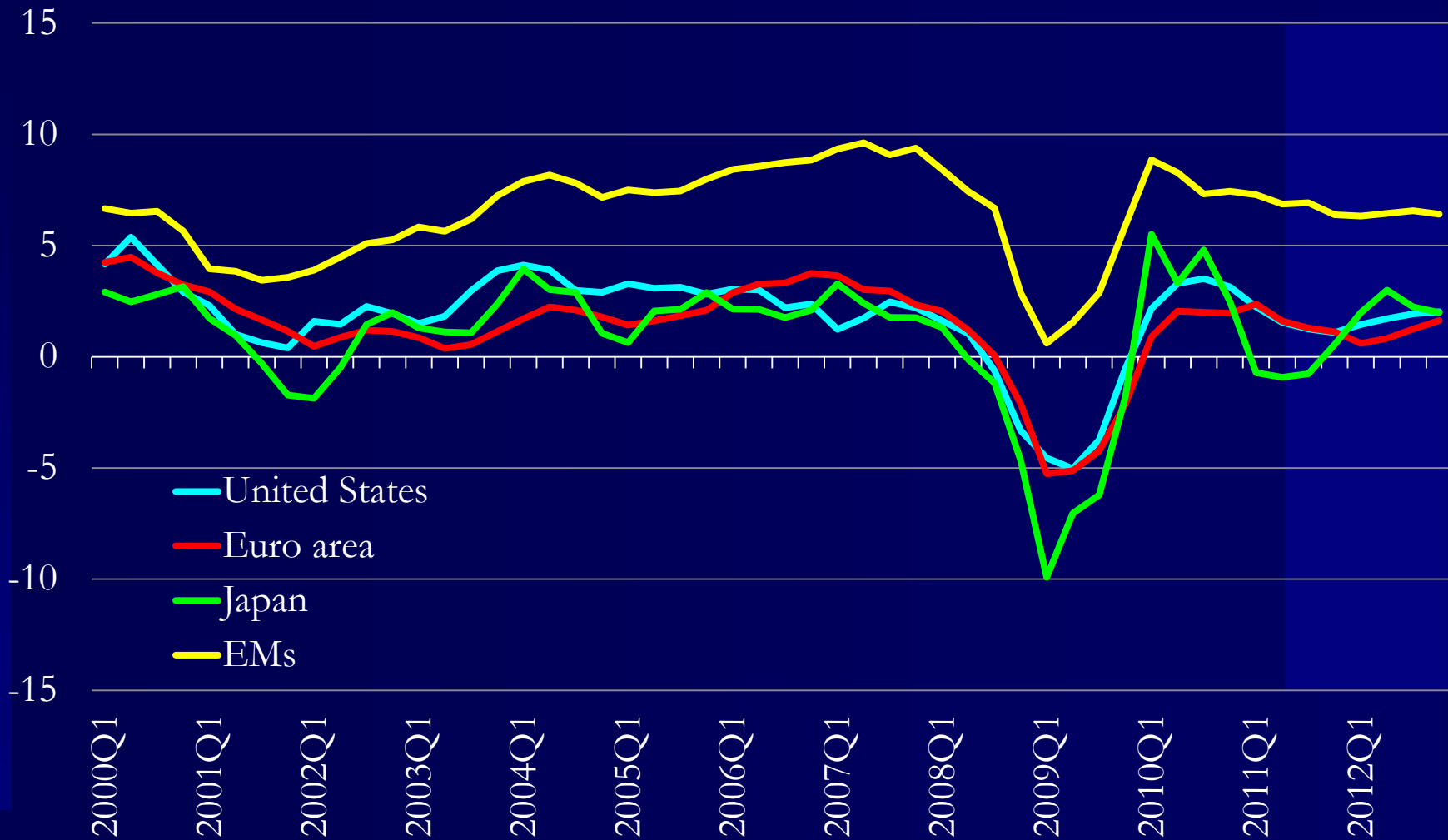
Structure of Presentation

- Economic and financial background
- Prospects for CESEE countries
- Whys and hows of deleveraging
- How vulnerable is CESEE
- Can the adverse effects be avoided?



The recovery from recession is slowing...

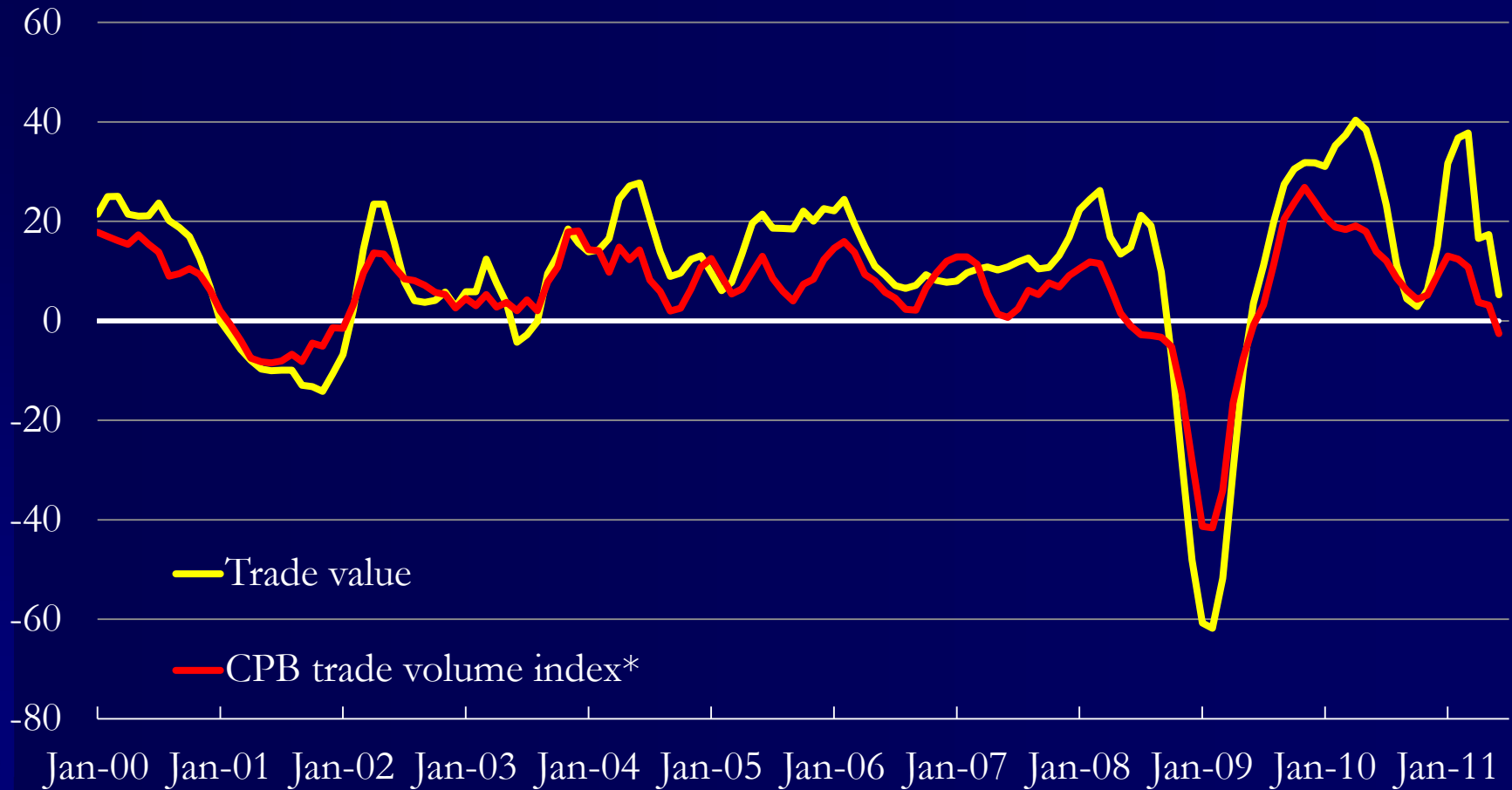
GDP Growth
(percent)



Source: IMF, WEO October 2011.

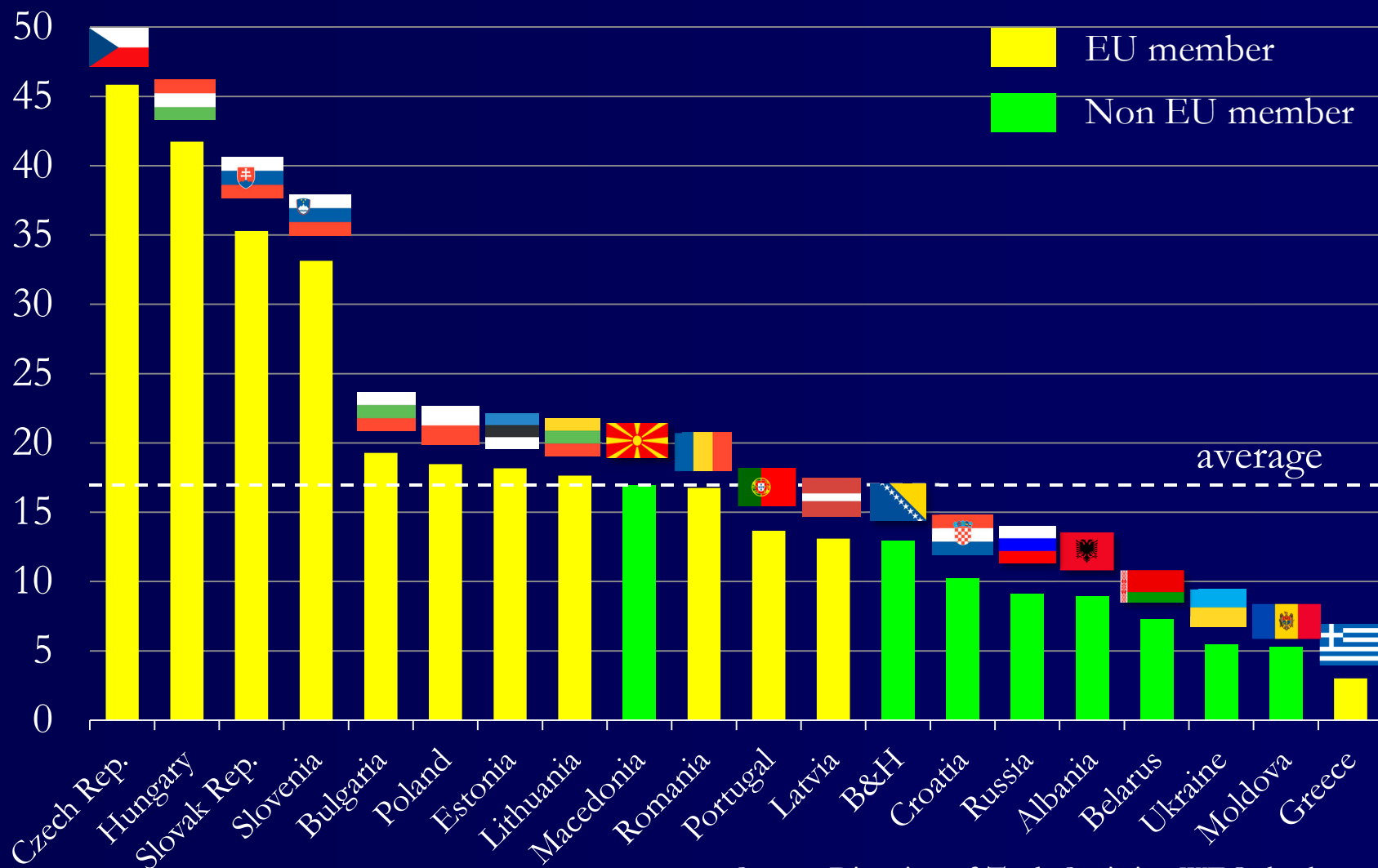
...and world trade is not looking healthy.

Growth of Trade
(percent)



Eurozone recession will badly affect some of CESEE

Exports to Eurozone
(percent of GDP)



Source: Direction of Trade Statistics; WEO database.

In October IMF predicted moderate growth for 2012

GDP Growth
(percent)

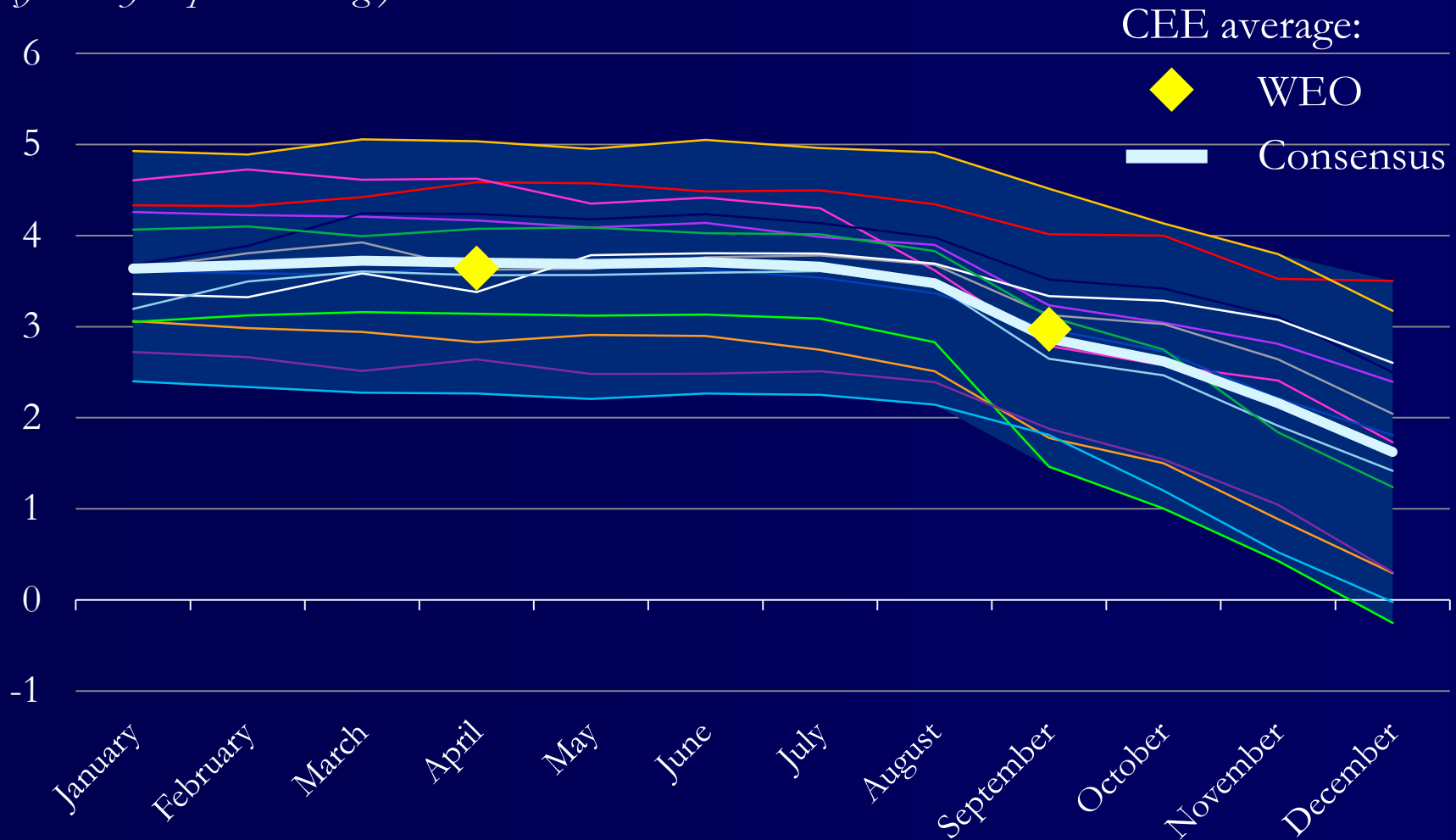


Source: IMF, WEO October 2011.



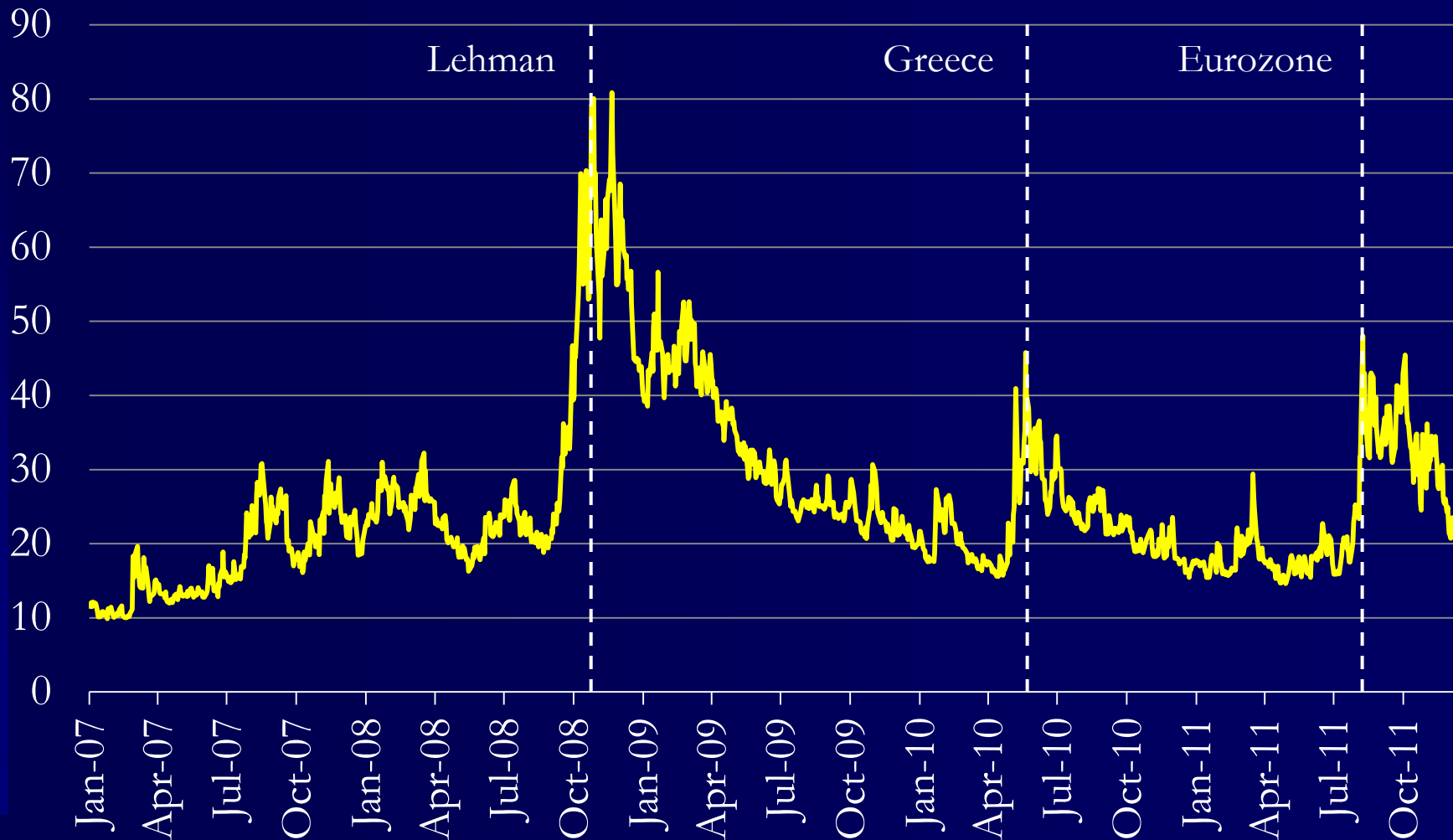
But consensus forecasts are being reduced

2012 GDP growth forecasts
(year on year percent change)



A third wave of fear has hit the markets...

Market Volatility Index
(VIX S&P 500)



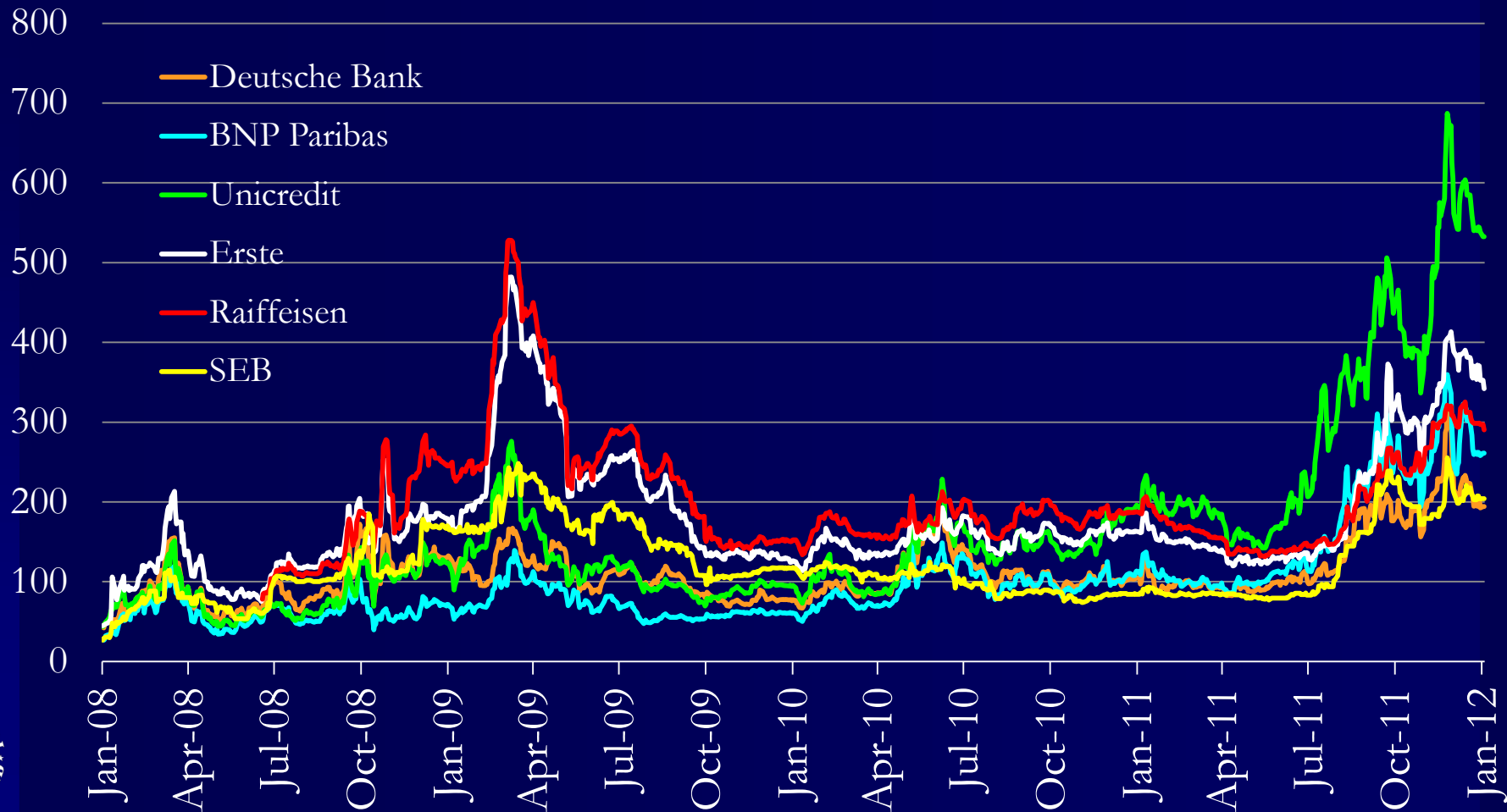
...wholesale funding has become expensive again...

3M Euribor-OIS spread



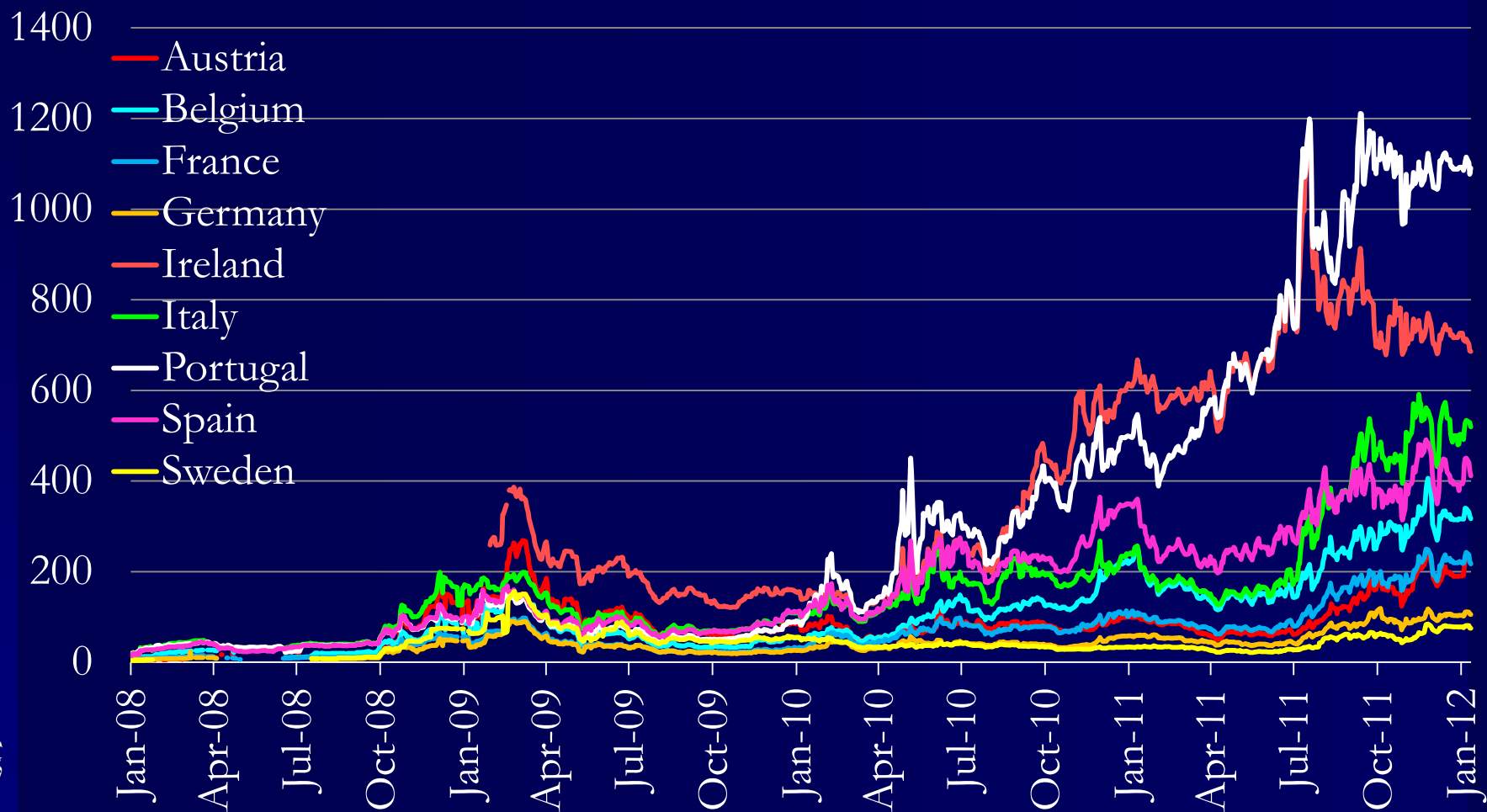
...and European banks are under pressure...

Banks' 5yr CDS Spreads
(basis points)



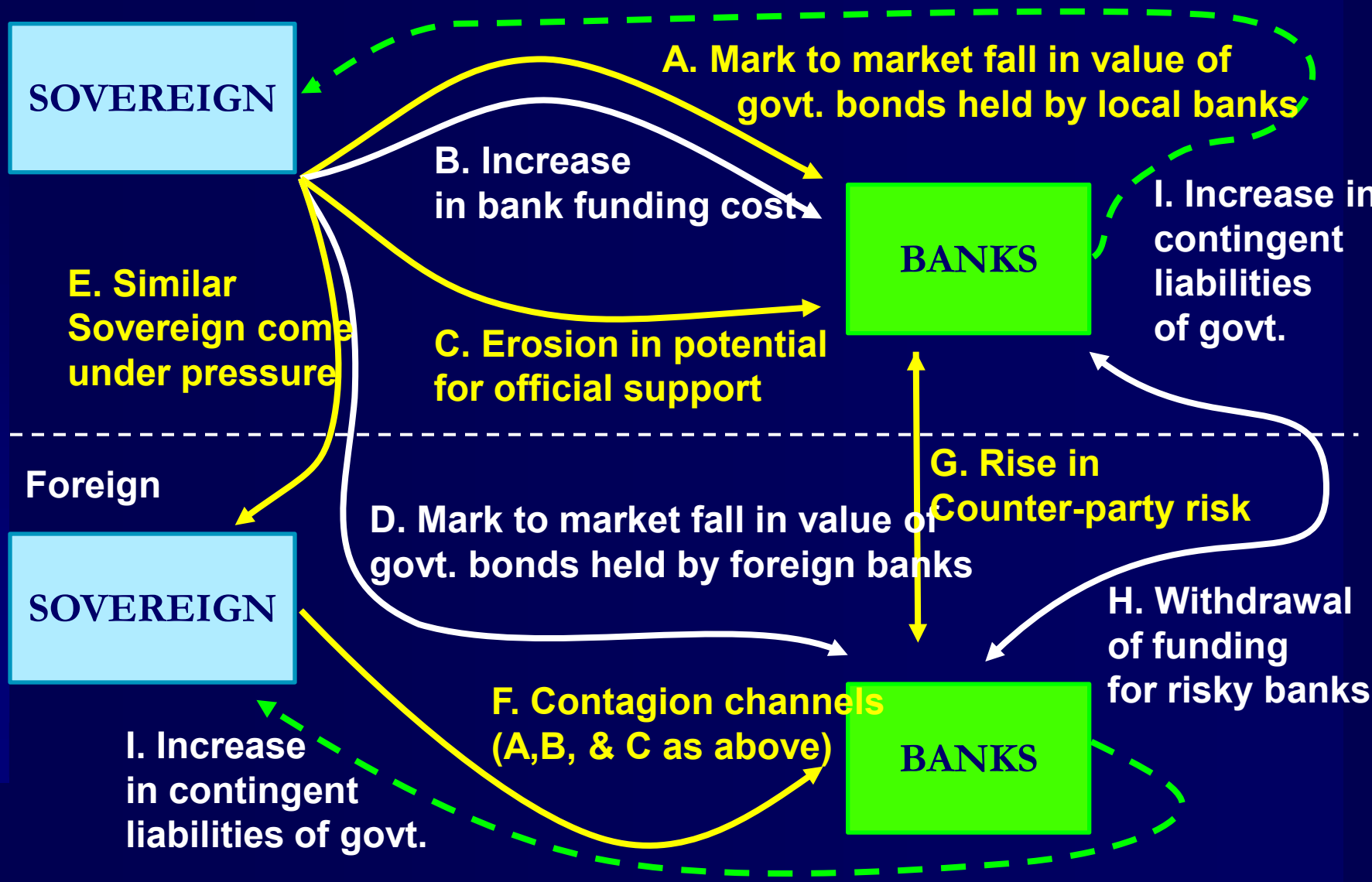
...as are West European sovereigns.

Sovereign 5yr CDS Spreads
(basis points)



Feedback loops tie sovereign strains to the banking system

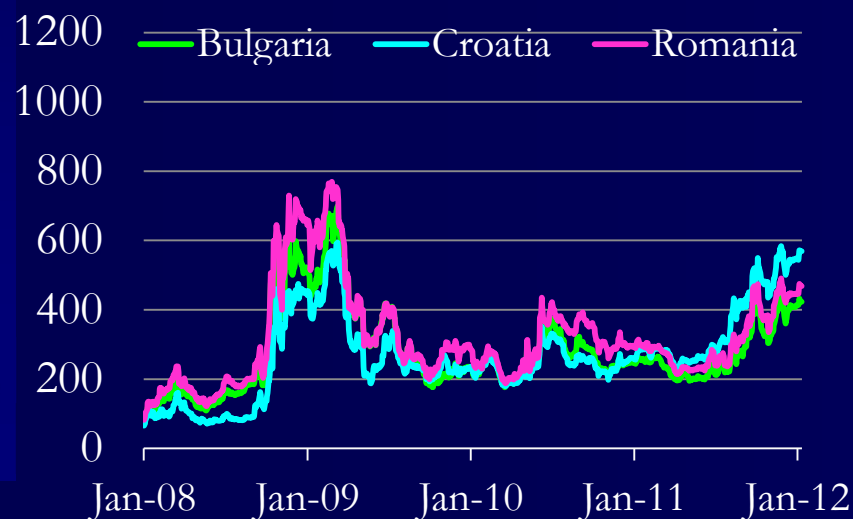
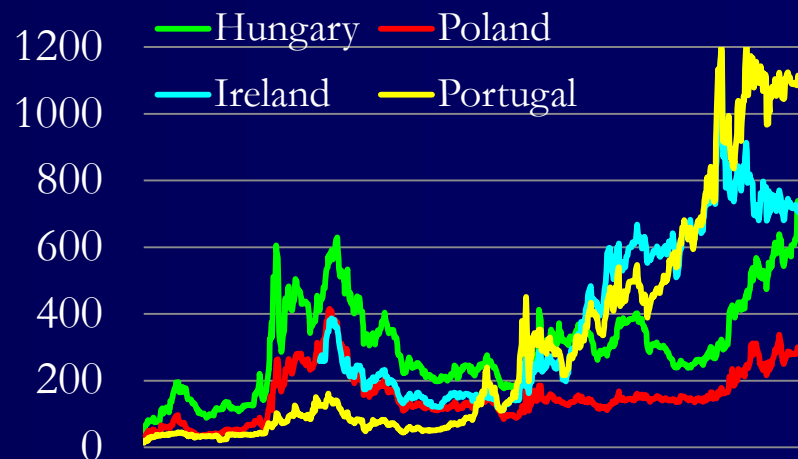
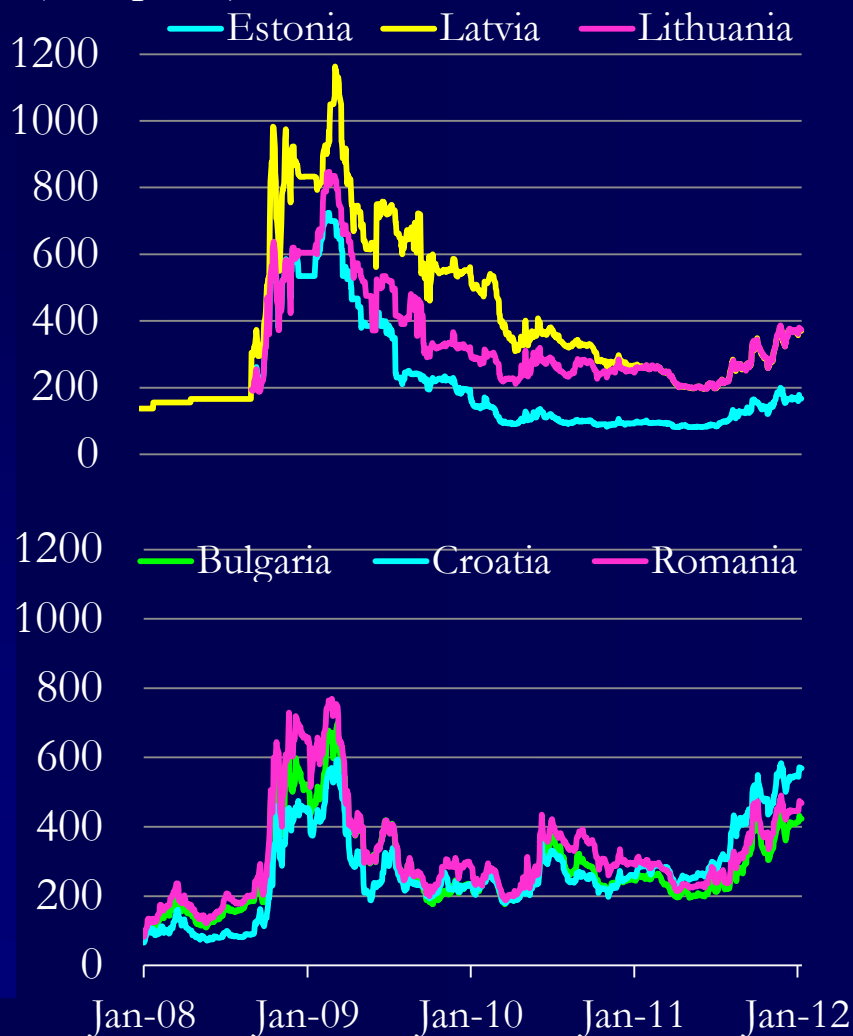
Domestic



CESEE is not behaving like eurozone periphery...

Sovereign 5-yr CDS Spreads

(basis points)



Source: Bloomberg.



...but may be decoupling from other EMs.

EMBI Sovereign Spreads

(basis points)

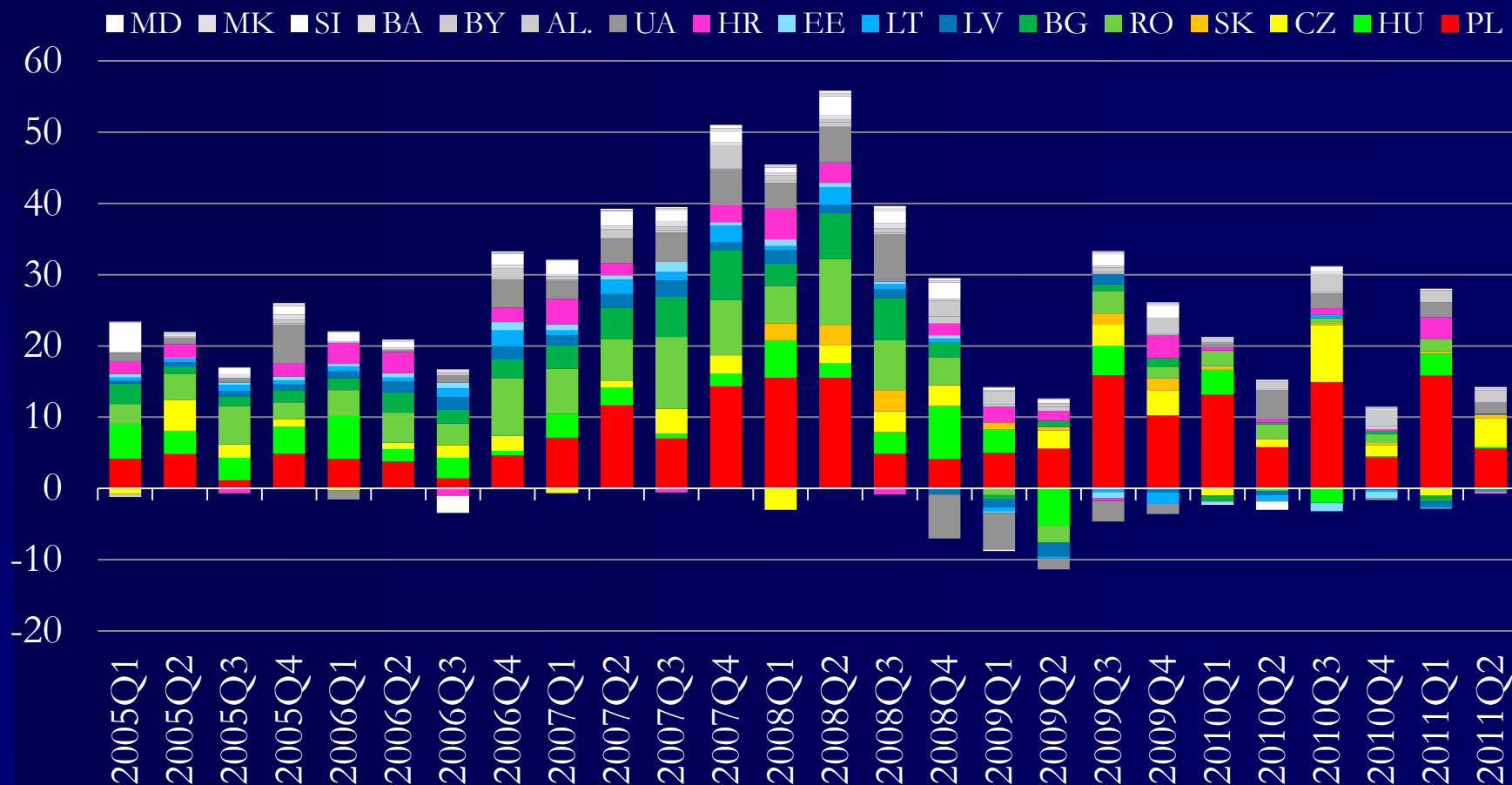


Source: Bloomberg.



Capital inflows are now well below boom levels

Inflows to Emerging Europe
(billions USD)



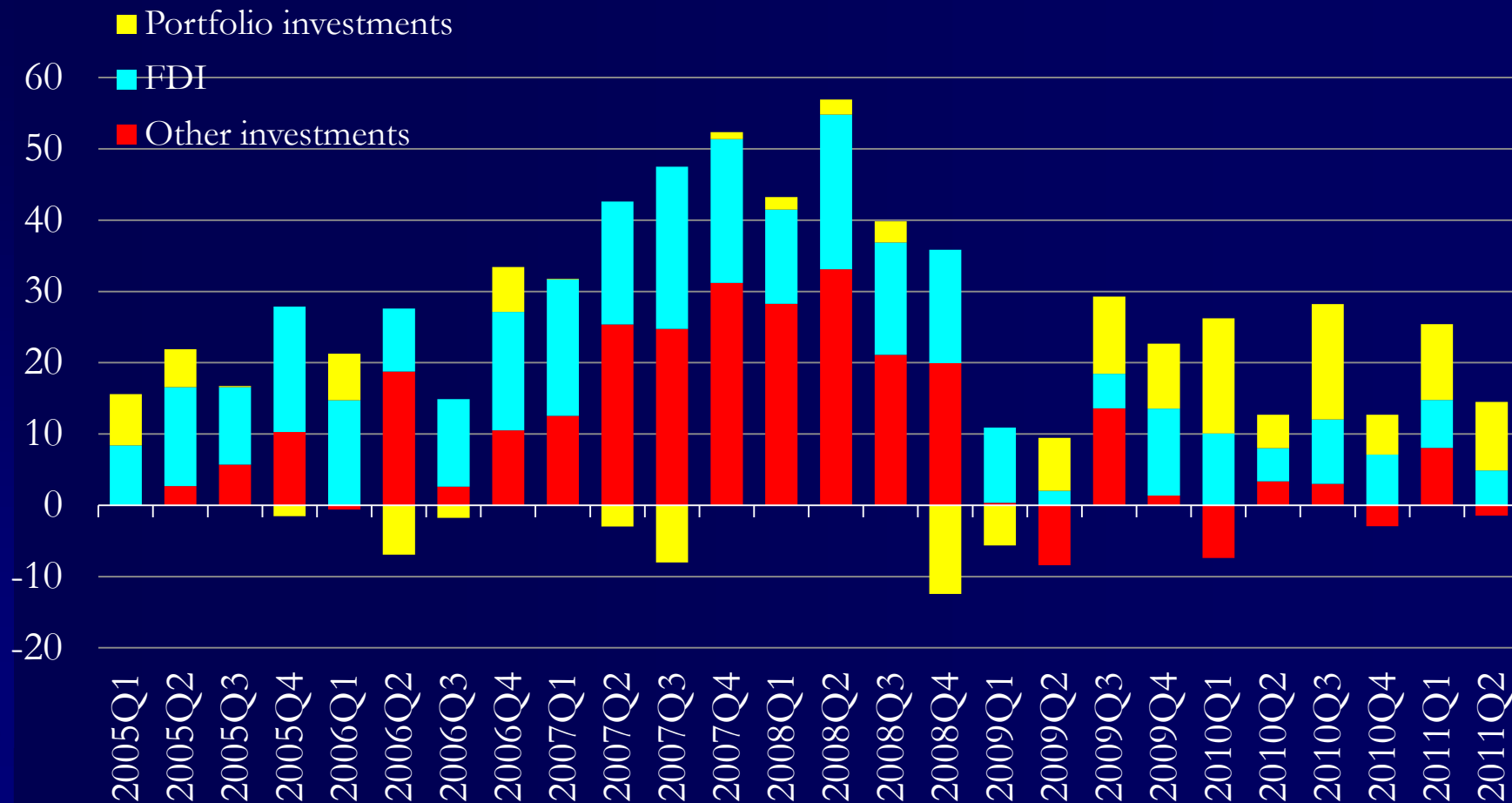
Note: Russia and Turkey excluded

Source: International Financial Statistics



Portfolio and FDI inflows have recovered, but not bank flows.

Inflows to Emerging Europe
(billions USD)



Why delever?

- Markets say so

Stock prices have fallen

Funding model is precarious

- Regulators say so

Capital raising has been under way since 2008

Stress tests used to identify capital needs

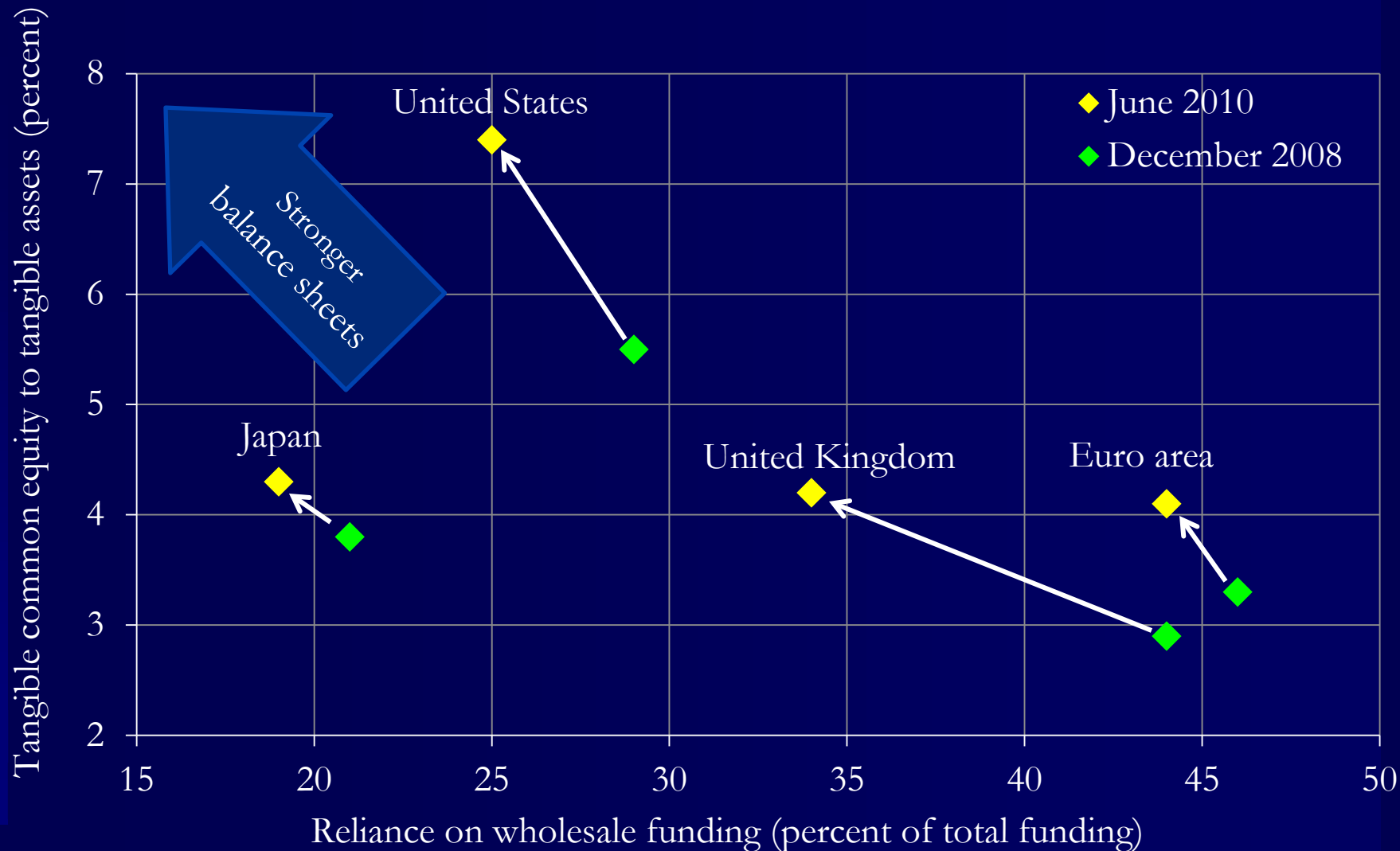
Basel III guidelines need more and better capital

EBA directive for temporary Tier 1 buffer of 9 percent
by June 30



Eurozone banks delayed correcting balance sheets

Banking System Capital and Reliance on Wholesale Funding



How to delever?

- Liability side

 - Raise capital from shareholders, market (or government)

 - Retain earnings

 - Convert bonds and low quality capital into equity

- Asset side

 - "Manage the hell out of the assets" (Jamie Dimon)

 - Let loans run off

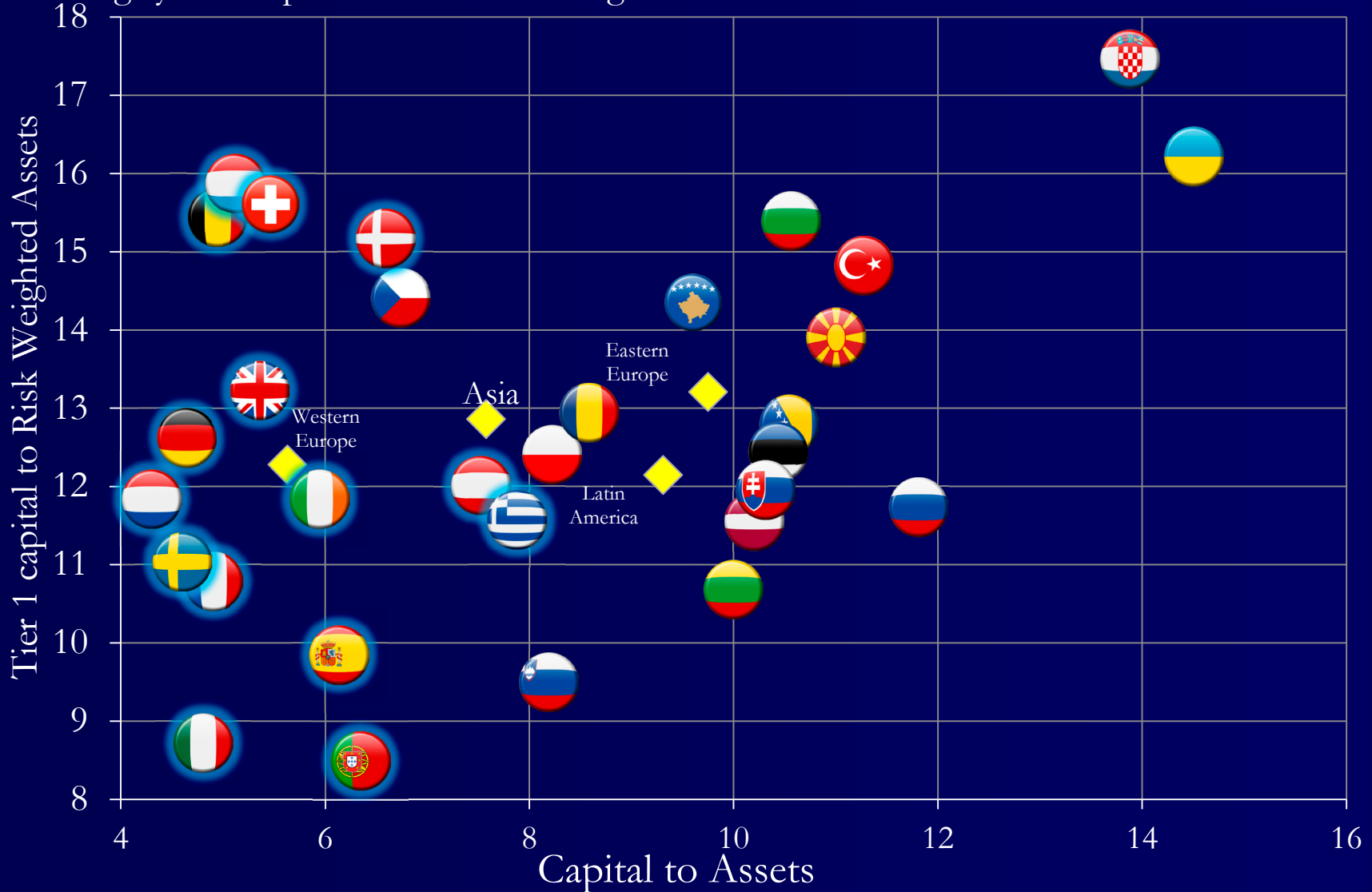
 - Sell loans

 - Sell non-core and subsidiary units



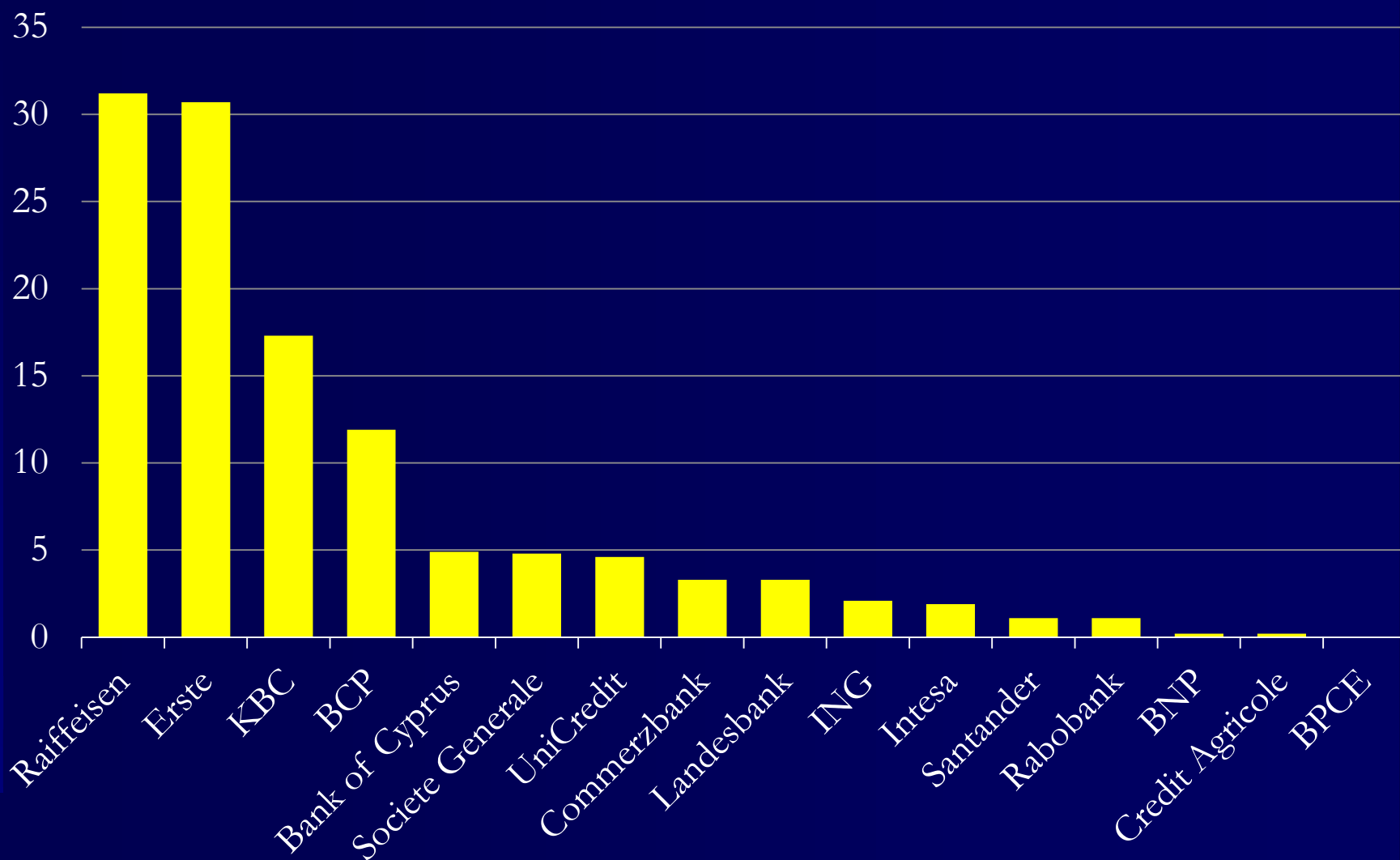
CESEE banks are less leveraged than parents

Banking system capitalization and leverage:



CESEE subsidiaries are a minor part of most groups

Major Euro area Banking Groups With Rated Subsidiaries in Eastern Europe
(Assets of Rated EE Subsidiaries in percent of total group assets)



Source: Moody's Investors Service

But groups dominate CESEE banking systems,...

Banking system concentration and ownership:

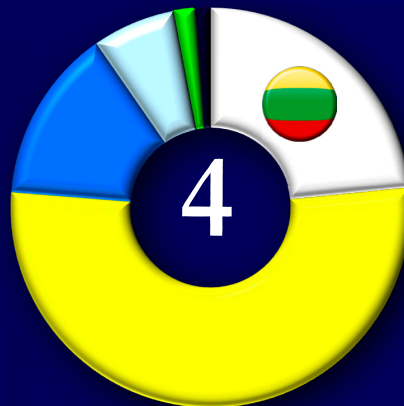
Estonia



Latvia



Lithuania



Poland



Czech Republic



Slovak Republic



Number of banks jointly controlling over 80 percent of system assets

Source: Bankscope.

... especially in EU members ...

Banking system concentration and ownership:

Hungary



Romania



Bulgaria



Belarus



Moldova



Ukraine



... and smaller economies.

Banking system concentration and ownership:

Croatia



Bosnia & Herzegovina



Slovenia



Serbia



Albania

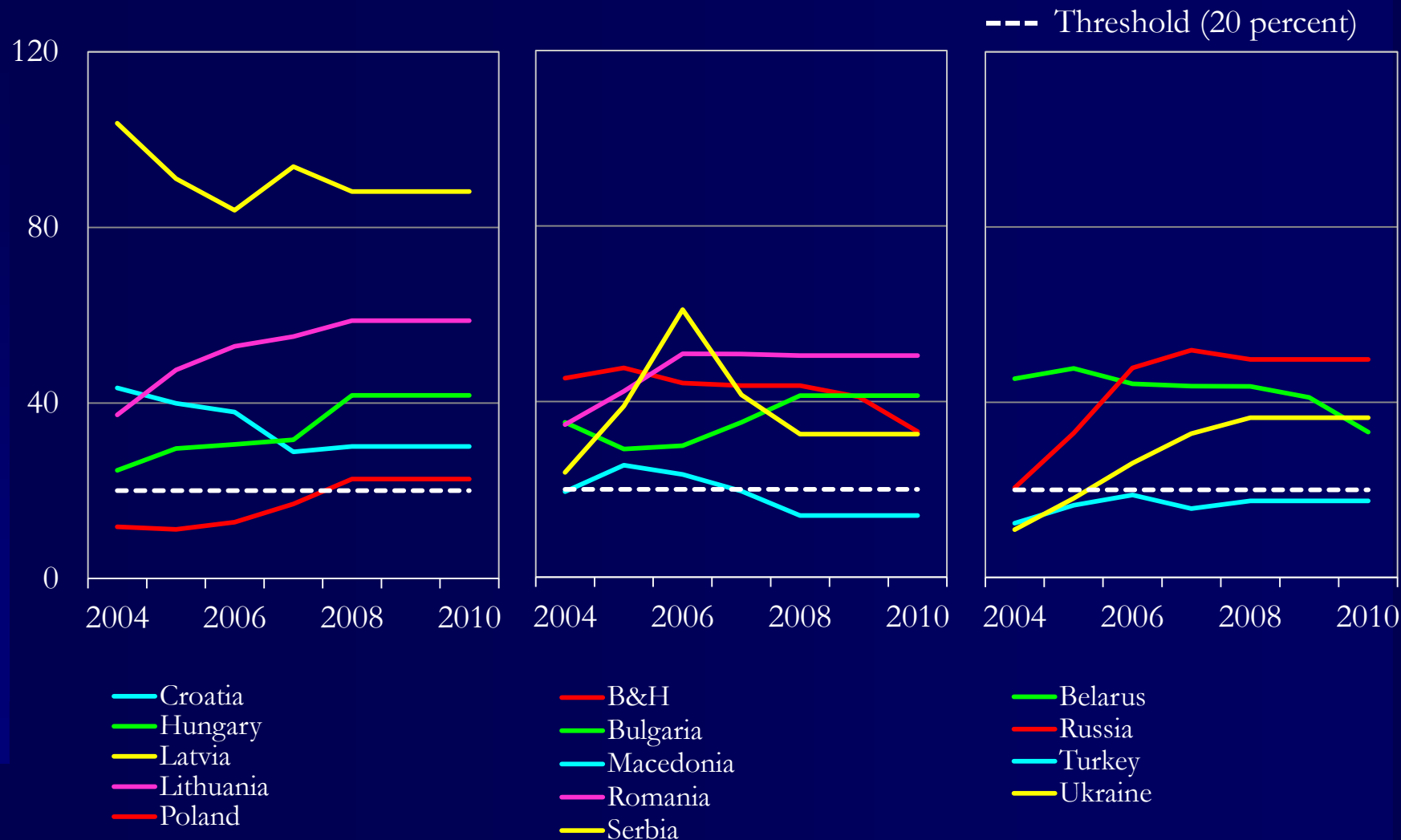


Macedonia



Much credit remains financed from abroad...

Foreign liabilities in percent of domestic credit
(percent)

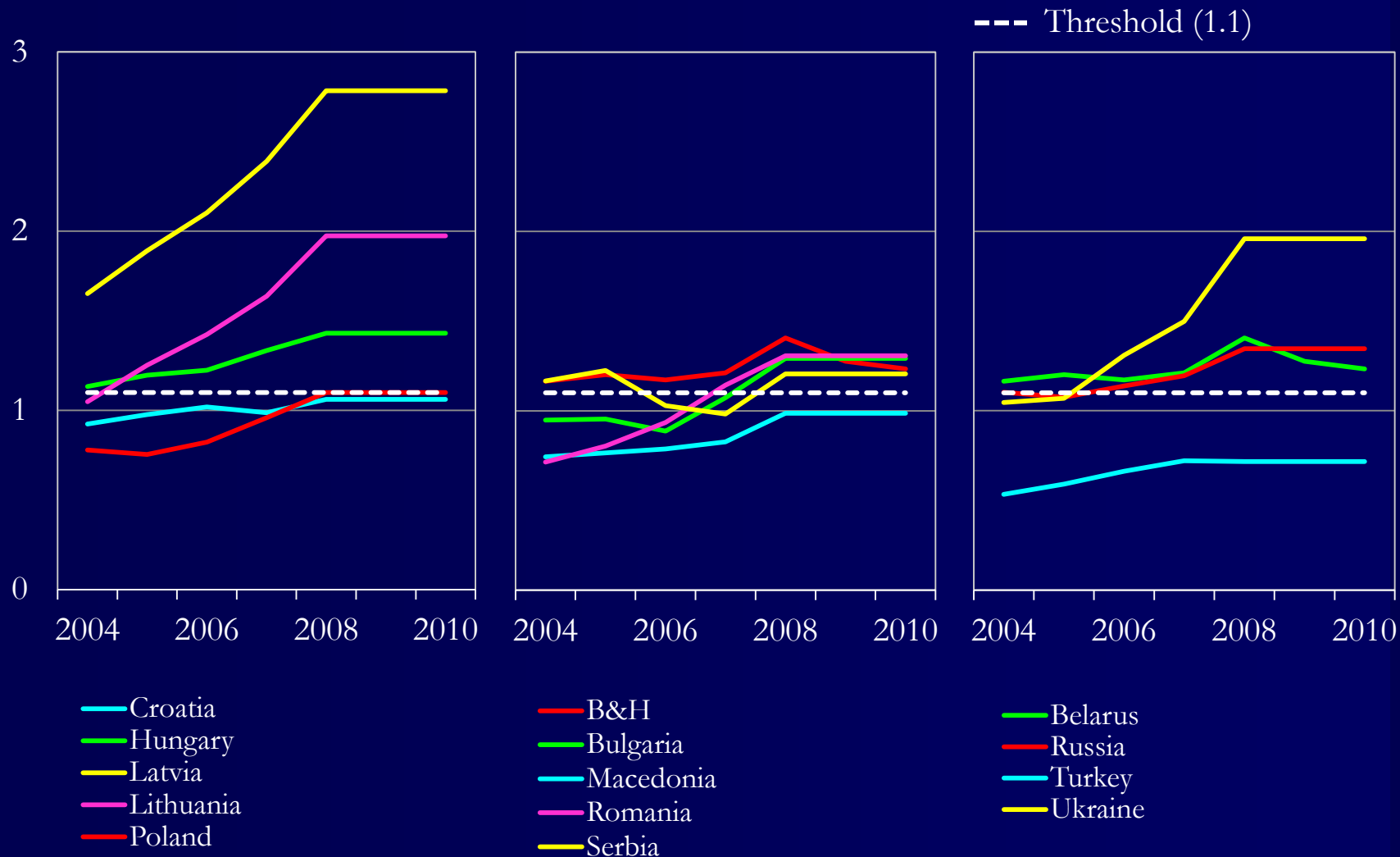


Source: IMF staff



...and loan-to-deposit ratios are still high.

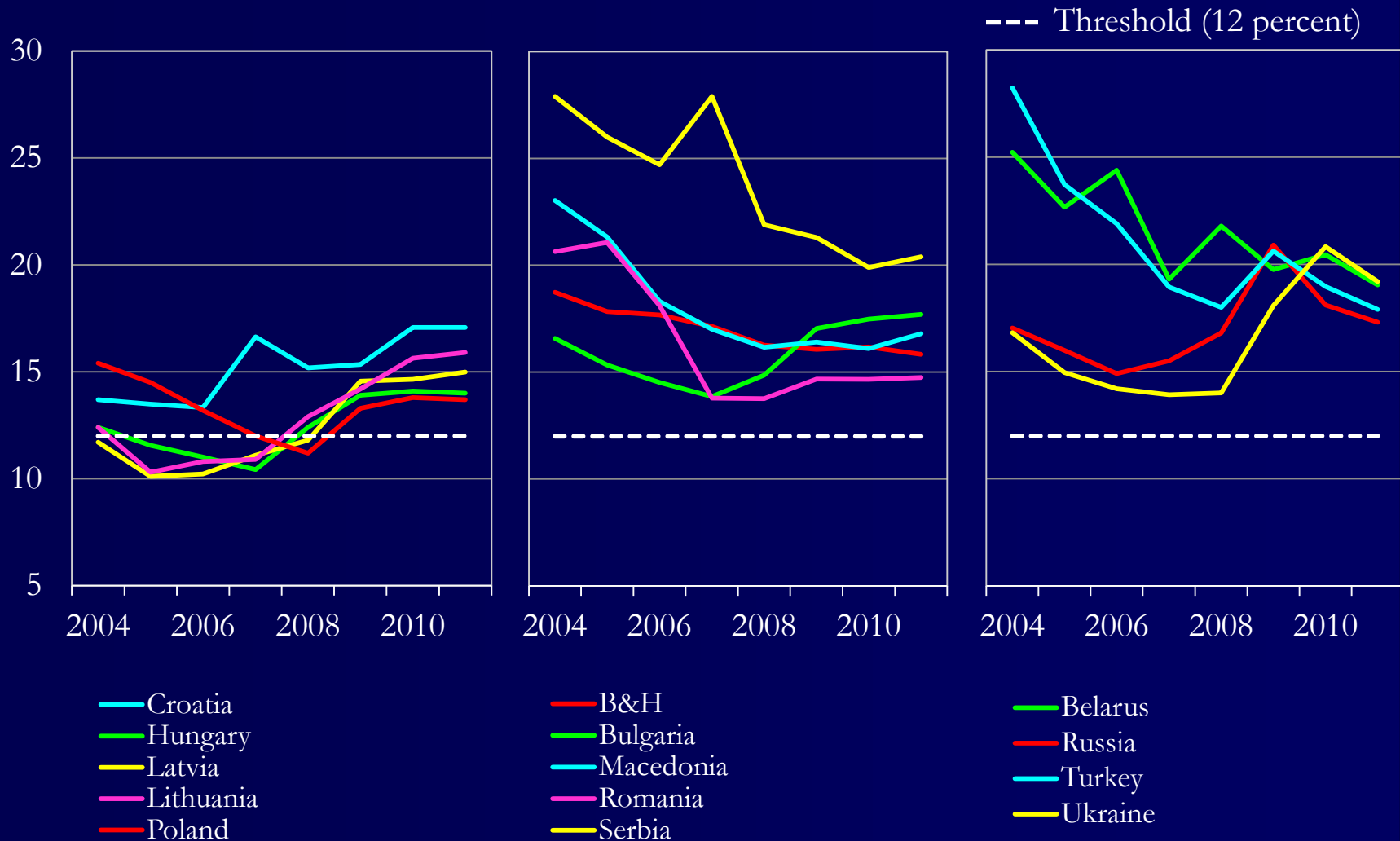
Loan-to-Deposit Ratio



Source: IMF staff

Bank capital ratios are fairly strong...

Capital Adequacy Ratio
(percent)

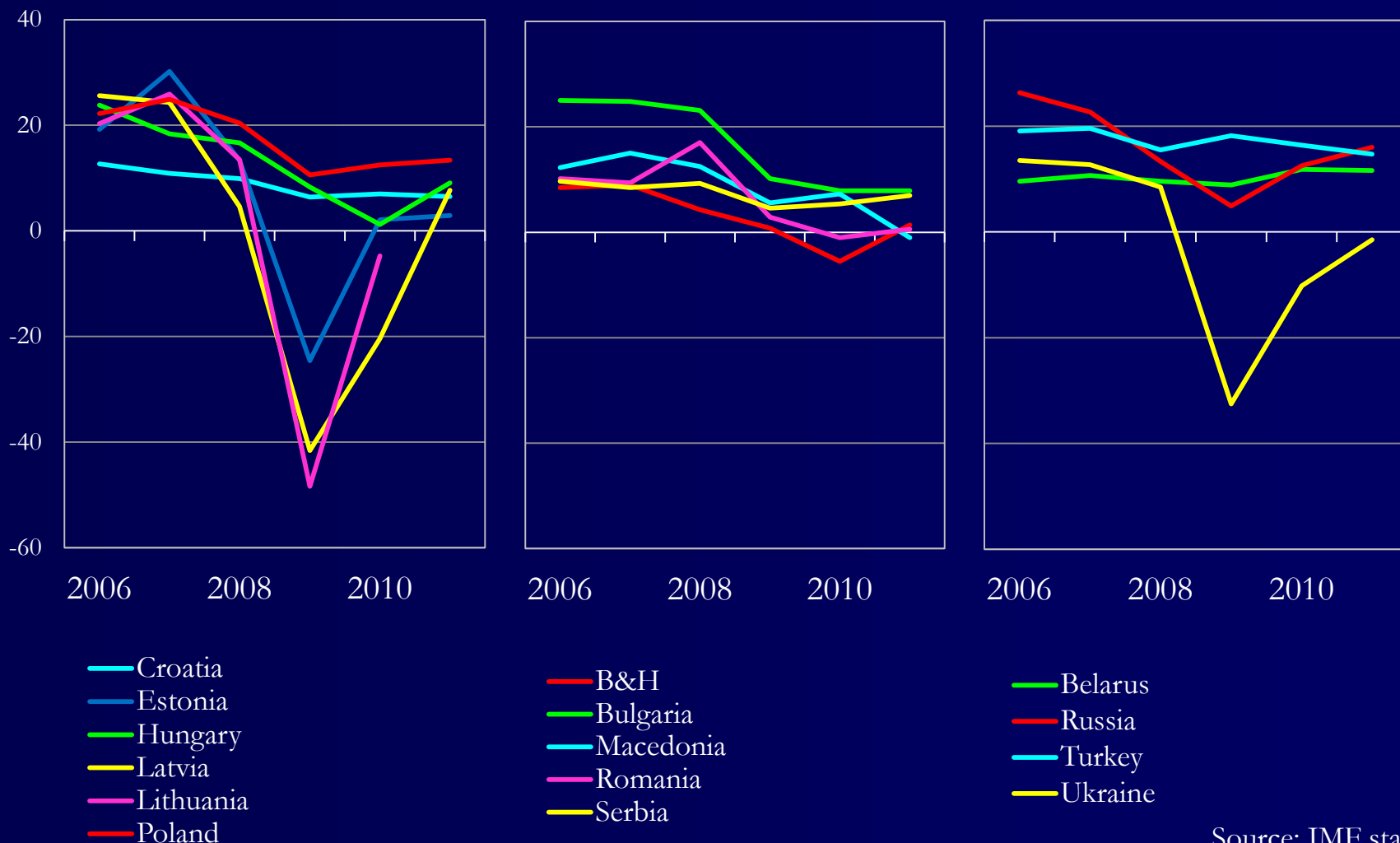


Source: IMF staff



... and return on equity is again positive.

Return on Equity
(percent)

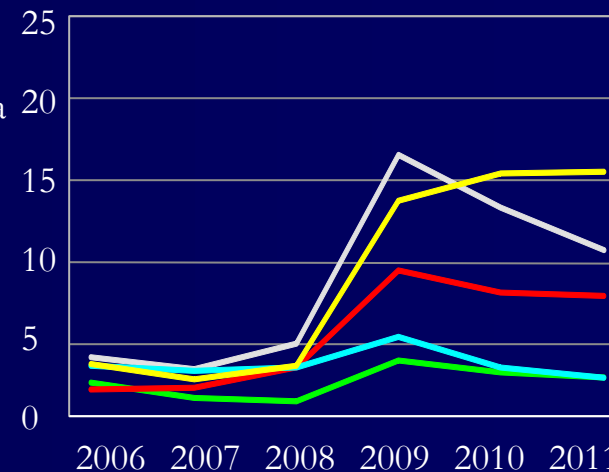
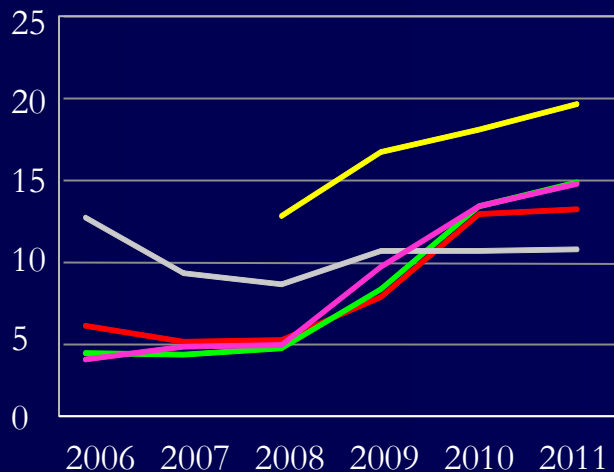
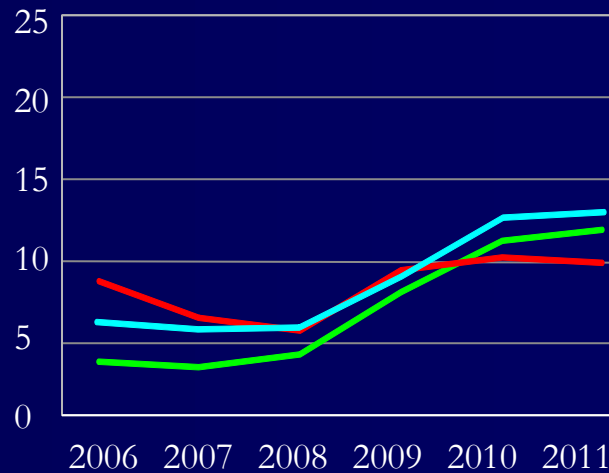
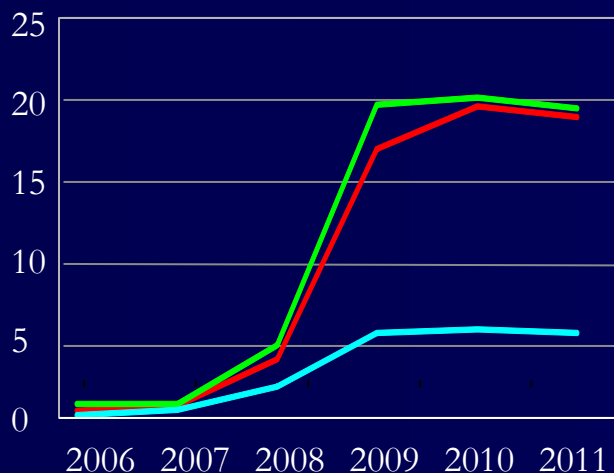


Source: IMF staff



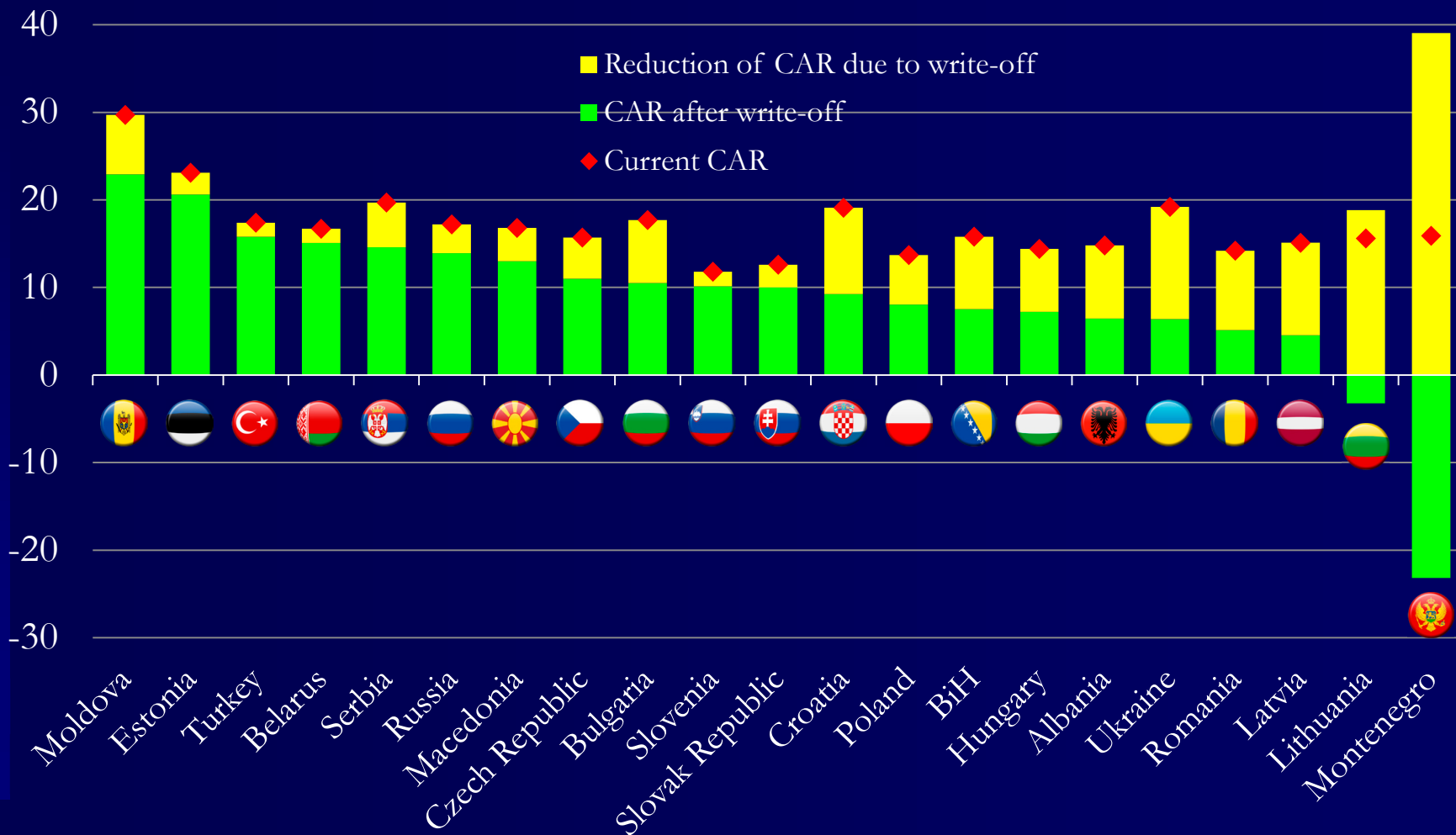
NPLs may have peaked...

Bank nonperforming loans
(percent of total loans)



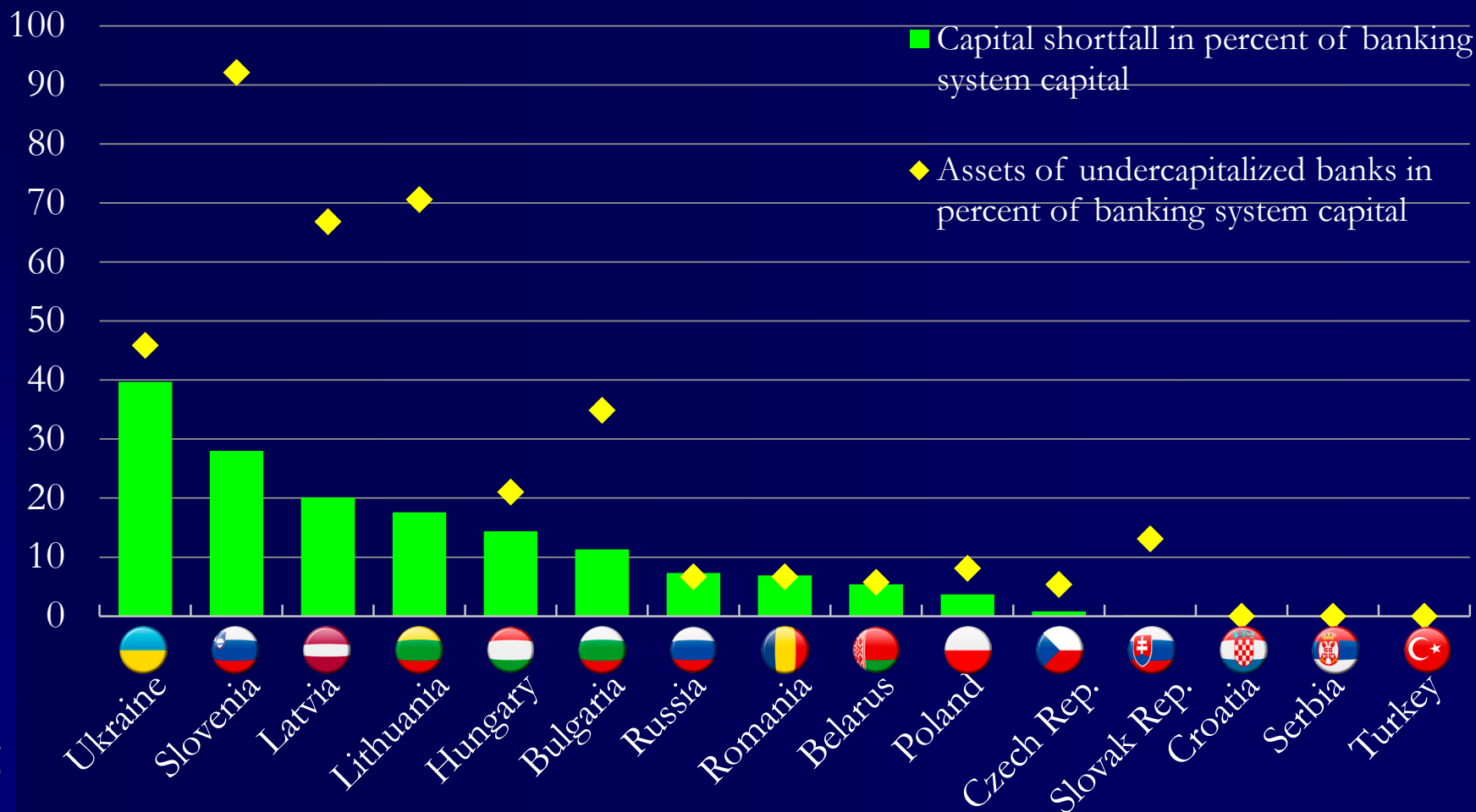
... and capital would allow almost all to be written off ...

CAR Under Complete Write-off of Existing NPLs
(percent of RWA)



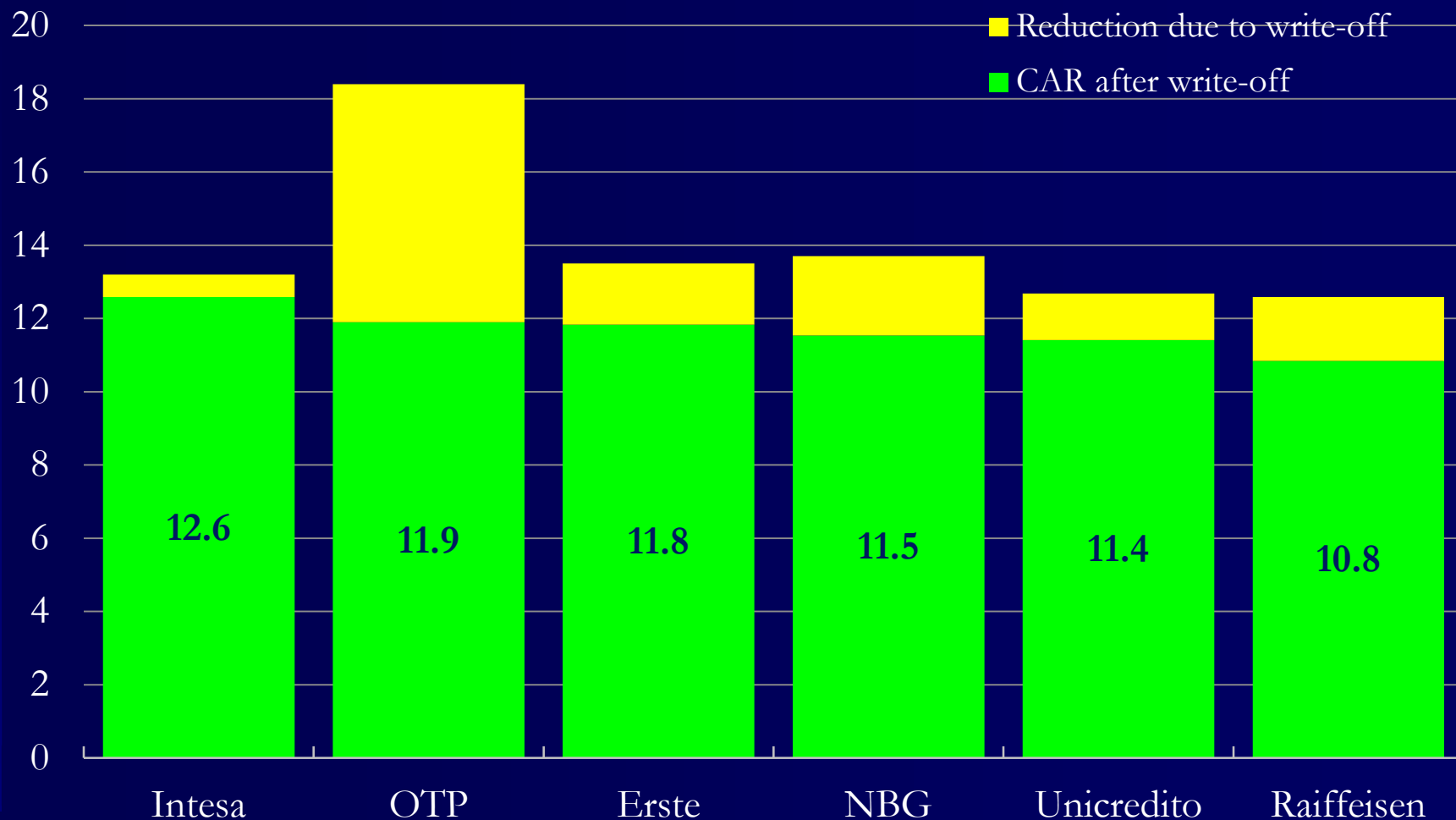
... without impairing most banking systems...

Banks with CAR below 8 Percent after Complete NPLs Write-off
(percent of RWA)



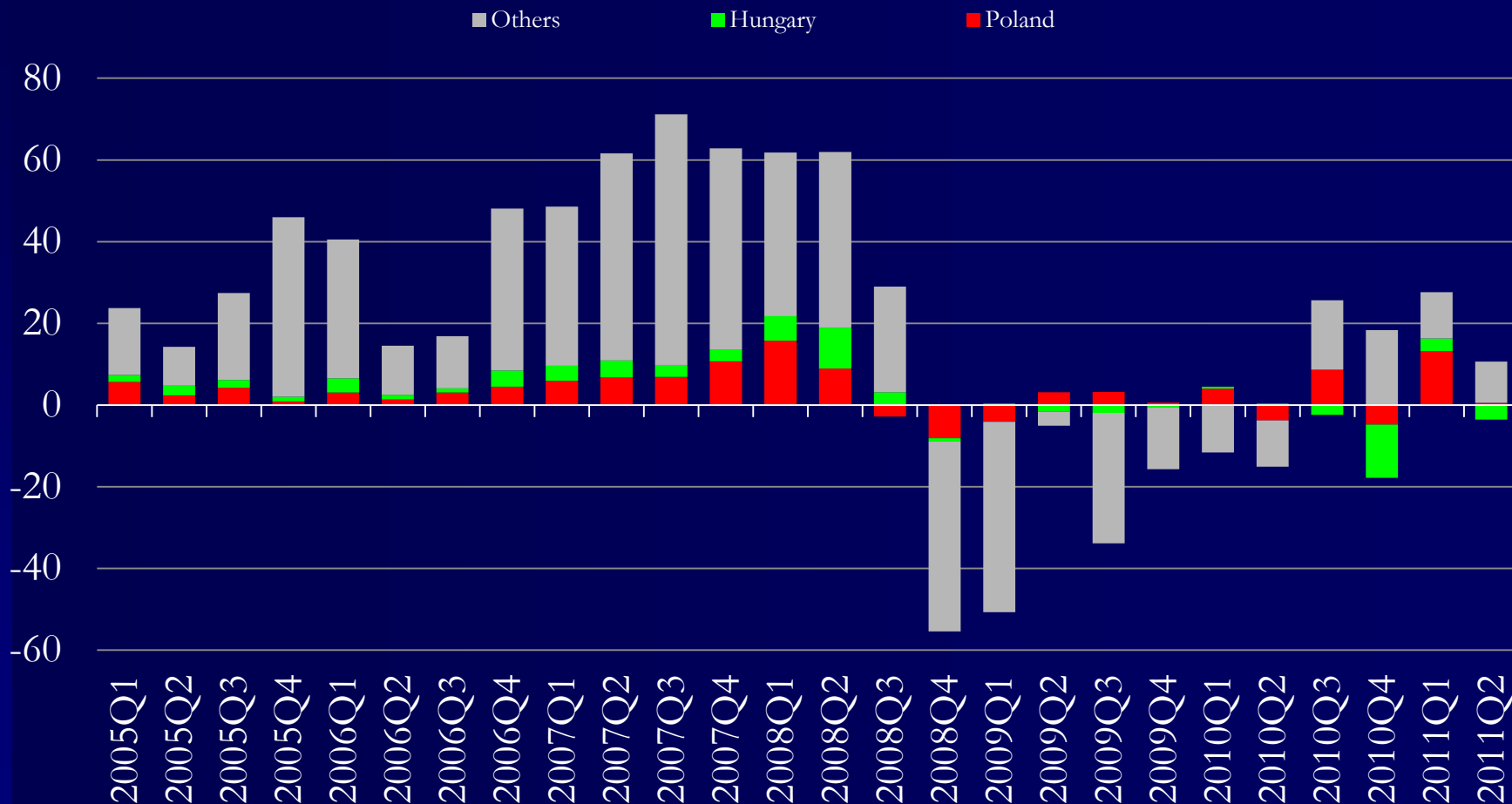
.. or the viability of most local groups.

Selected Banking Groups: Reduction of CARs under Complete NPL Write-off in CESEE (*percent of RWA*)



Bank inflows are already barely positive...

Change in external positions of reporting banks
(billions USD, estimated exchange rate adjusted changes)



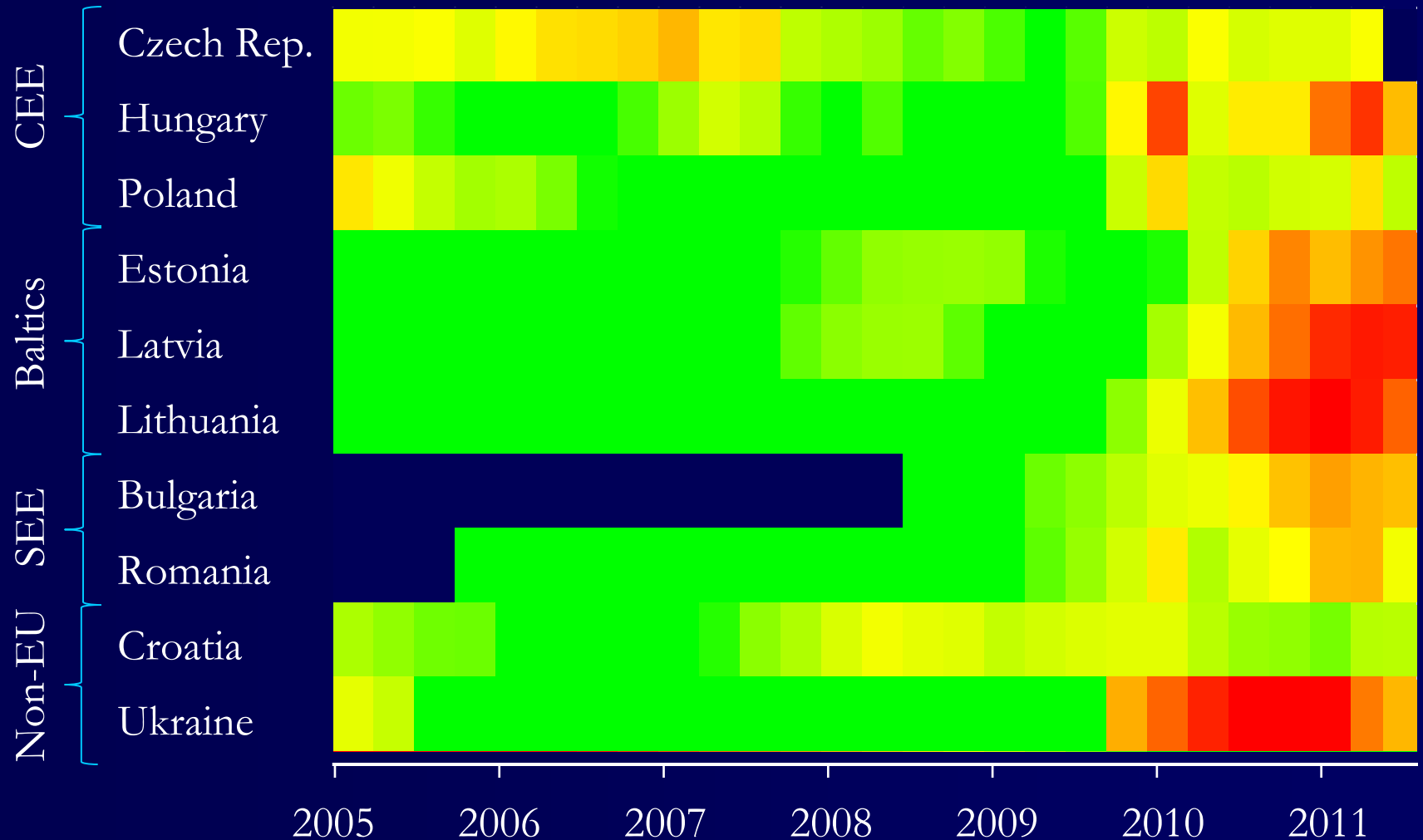
... and this is keeping credit expansion subdued.

Domestic Credit to GDP
(year on year percent change)

< -15%

0%

> 15%



Deleveraging is a containable threat.

- Parent banks are under pressure to delever.
- But CESEE subsidiaries are well capitalized, quite strong, and small
- Deleveraging through loan sales and branch sales is difficult
- Already signs that credit growth is constrained and may not support growth.
- Enhanced supervisory cooperation may allow group deleveraging to take into account host country interests.



Thank you

