The IMF, CESEE and Banking

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The IMF has had close involvement with CESEE since early transition

- It supported the transition to market economies with
  - Financing
  - Technical Assistance
  - Training
- It provide financial help and TA during the 2008/09 crisis and beyond
Two waves of IMF programs: early transition and post-2008

Number of countries with active IMF arrangements in CESEE

Latest IMF arrangements by country

Note: Dashed pattern shows precautionary programs.

Note: Years indicate start date of arrangement.
Many of the IMF programs originated in banking sector problems

- Most countries had banking crisis in 1990s

**Banking crises**

In 1990s

In 2008
After banking crises in 1990s, banking systems were opened to foreign investors

- Much of the banking system in non-CIS CESEE is foreign owned

Note: for BLR and LTU data for 2014.
In pre-crisis boom years, CESEE was very profitable...

- Credit was growing rapidly
- Interest rate margins were relatively high
- Return on equity and capital was great
Between 2003 and 2008 there were large funding flows of Western European banks to CESEE...
...which fueled and financed a credit boom...

Credit-to-GDP ratio and its change (Percent of GDP)

Increase of credit-to-GDP ratio and increase of foreign funding to banks

$y = 0.6915x + 3.9528$

$R^2 = 0.5733$
...which led to high current account deficits and overheating economies.

Current Account Deficit in 2008
(Percent of GDP in USD)

Note: For EST, LVA and LTU: 2007.
After Lehman Brothers this suddenly stopped

- As parent banks got under pressure they could no longer send new funding to CESEE
- Credit booms suddenly stopped
- Domestic demand plunged just as exports dried up as well
- Result was deep recession
IMF provided financial assistance to many countries
Vienna Initiative helped prevent uncoordinated withdrawal of foreign banks

- Launched in January 2009, as a framework for safeguarding the financial stability of emerging Europe at the height of the global economic crisis;
- The main objectives were:
  - Prevent a large-scale and uncoordinated withdrawal of cross-border bank groups from the region;
  - Ensure that parent bank groups maintain their exposures and recapitalise their subsidiaries in emerging Europe;
- These objectives were achieved and a potentially region-wide systemic crisis in emerging Europe’s banking sector was avoided.
By 2010, crisis seemed over

- Risk premia had declined sharply
- Region started growing again
- Bank exposure to region stopped falling
Then euro area crisis broke
Bank deleveraging resumed

Bank’s external claims on all sectors
(billions of USD, FX change adjusted)
CESEE’s economy experienced another downturn
Many SEE countries asked for IMF assistance

SEE countries with IMF program, 2011-16
In 2014-16 CIS was hit by recession

- Collapse of commodity prices
- Sudden stop in capital flows to Russia, result of sanctions on Russia
- Conflict in Ukraine
Moldova and Ukraine got help from the IMF

Note: UKR had a Stand-By Arrangement program in 2014-15.
Banking problems played prominent role in programs

Non-performing loans to total loans (Percent)

Ukraine

Moldova

Number of Banks in Ukraine

In total 87 banks lost license; representing 30% of sector’s assets at end-2013
More recently, external position of BIS reporting banks in CESEE excl. Russia and Turkey appears to have stabilized...

External position of BIS-reporting banks on all sectors (billion of USD, FX change adjusted)
...as loan to deposit ratios in many countries have been reduced to much safer levels
CIS is now recovering; growth in non-CIS CESEE continues to be strong.
All regions are now showing positive growth.
Unemployment in New Member States coming down rapidly

Cumulative changes in unemployment rate
(2008Q1=0, seasonally adjusted)
Crisis legacies remain: high NPLs (especially in SEE and UKR)

Non-performing loans to total loans, end 2016
(Percent)

Note: for MNE data for 2012 and 2015.
High public debt

Public debt
(Percent of GDP)

In 2008

In 2016
Since early 1990s CESEE has made tremendous progress
Banking sector has played an important role in this convergence

- But banking sector has also contributed to problems
- Not enough risk aversion during booms; very risk averse during busts
- Foreign funding has exacerbated boom-busts
Thank you