Opportunities and Risks for Western Balkans

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Life in Western Balkans has become brighter

Nightlights intensity

2002

2013

Change 2002-2013

- Green: Lights much brighter in 2013
- Light green: Lights brighter in 2013
- Light grey: No change in 2013
- Light red: Lights dimmer or missing in 2013
After recessions in 2009 and 2012, the region is growing again, supported by activity in main trading partners.
And unemployment is finally coming down—although it remains too high.
Immediate outlook is good
What are the remaining challenges and vulnerabilities?

- Address overhang of the 2009-12 crisis, including in:
  - The banking system
  - The public finances
- Complete transition
- Speed up convergence
The Banking System

(This is discussed in depth in upcoming REO)
In run up to global financial crisis large inflows of foreign bank funding fueled and financed a credit boom.

**Foreign Banks’ Funding to all Sectors, to Peak** (Foreign bank funding per GDP)

**GDP Growth**
(Percent)

Sources: BIS, IFS, and IMF staff estimates.
Bank funding dropped in the global crisis

**Capital Inflows to Western Balkans 1/**  
(Percent of GDP)

**External Bank Claims on Western Balkans 1/**  
(Percent of GDP, all sectors)

1/ Does not include Kosovo; includes Serbia and Montenegro from 2007.

1/ Does not include Kosovo. 2016 uses GDP projections. Sources: BIS, IMF IFS, and IMF staff estimates.
The result was a sharp drop in credit growth, in large part supply driven.

**Decline in Real Credit Growth to the Domestic Private Sector, 2007-08 to 2010-11** (pps, SA smoothed growth rate against average of previous 12 months)

**WB EU-Owned Banks: Demand vs. Supply Determinants of Credit Growth** (Percentage points, relative to 2007-08)

1/ Smoothed growth rates measure the growth against previous 12 months average.
Sources: HAVER, IMF IFS, and IMF staff calculations.
NPLs rose and profits plunged

**NPLs: Trough-to-Peak Change**

(pps)

**ROE: 2007-to-Trough Change**

(pps)

Sources: Country Authorities, IMF FSI, and IMF staff estimates.
NPLs have come down, but remain high
Banking sector challenges

- Banks need to address NPLs
- Banks need to manage deleveraging and expand funding sources
- Address non-bank obstacles to credit
Dealing with NPLs require multipronged approach

Summary of Key Policy Actions and Recommendations Fostering Bank Balance Sheet Repair

- Loan classification and provisioning
- Write-offs
- Sale/Transfer of NPLs
- Bankruptcy Law
- Private bailiffs law
- Taxation
- Cadastral information

Source: Regional Economic Outlook, CESEE, November 2017
Banks need to manage deleveraging and expand funding sources

- Deleveraging:
  - Monitor banks; ensure that bank maintain contingency plans
  - Remain in close communication with parent banks and home supervisors

- New funding:
  - Tackling overbanking to attracting fresh foreign capital
  - Develop local capital markets
Governments need to address non-bank obstacles to credit

- Improve land and property titling
- Accelerate slow court procedures
- Upgrade insolvency frameworks:
  - Personal bankruptcy
  - Limit power of minority holdouts in corporate restructuring
Public finances
Fiscal deficits have come down, particularly in countries with IMF Programs

General Government Balance (Percent of GDP)

Countries with ongoing or recently completed IMF programs
However, public debt is far above pre-crisis levels.
Much of which is financed externally

External Public Debt (Percent of GDP)

External Public Debt in Western Balkans (Percent of GDP)
Unfortunately, little further consolidation is planned.
External vulnerabilities
Current account deficits have come down and are now almost fully financed by FDI.
External debt remains relatively high as lower bank funding has been offset by higher public debt.
Completing transition
In past two decades Western Balkans have not done as well as the NMS: at similar income levels they have grown less.

GDP PPP per capita in 1996 vs. its change in 1996-14

Note: Data for UVK not available.
Source: Penn World Tables.
Western Balkans are poor because relatively few people work and capital stock per worker is low (TFP is low as well)

Capital per Worker vs. Employment to Population Ratio

Employment to population ratio in 2016 (Percent) vs. Capital per worker in 2014 (Thousands of PPP dollars)

Source: ILO and Penn World Table. Note: Data for UVK not available.
EU accession process should lead to improved institutions / completion of transition

Average of Six EBRD Transition Indicators in 2014

Note: 2007 for Czech Republic.
Better policies would help, whether or not WB become EU members

- What can be done to boost investment and create jobs so people stay?
- Improve investment climate
  - Better protection of property rights
  - Improve legal systems and other government services
  - Address infrastructural gaps
- Address efficiency gaps in public investments and tax collection
Boosting government effectiveness would also help

Government Effectiveness vs. GDP per capita in PPP dollars, 2015

Ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance

Note: Data for UVK not available.
Thank you