European Department

Capital Markets Union and the EU CEE New Member States

Eurofi High Level Seminar

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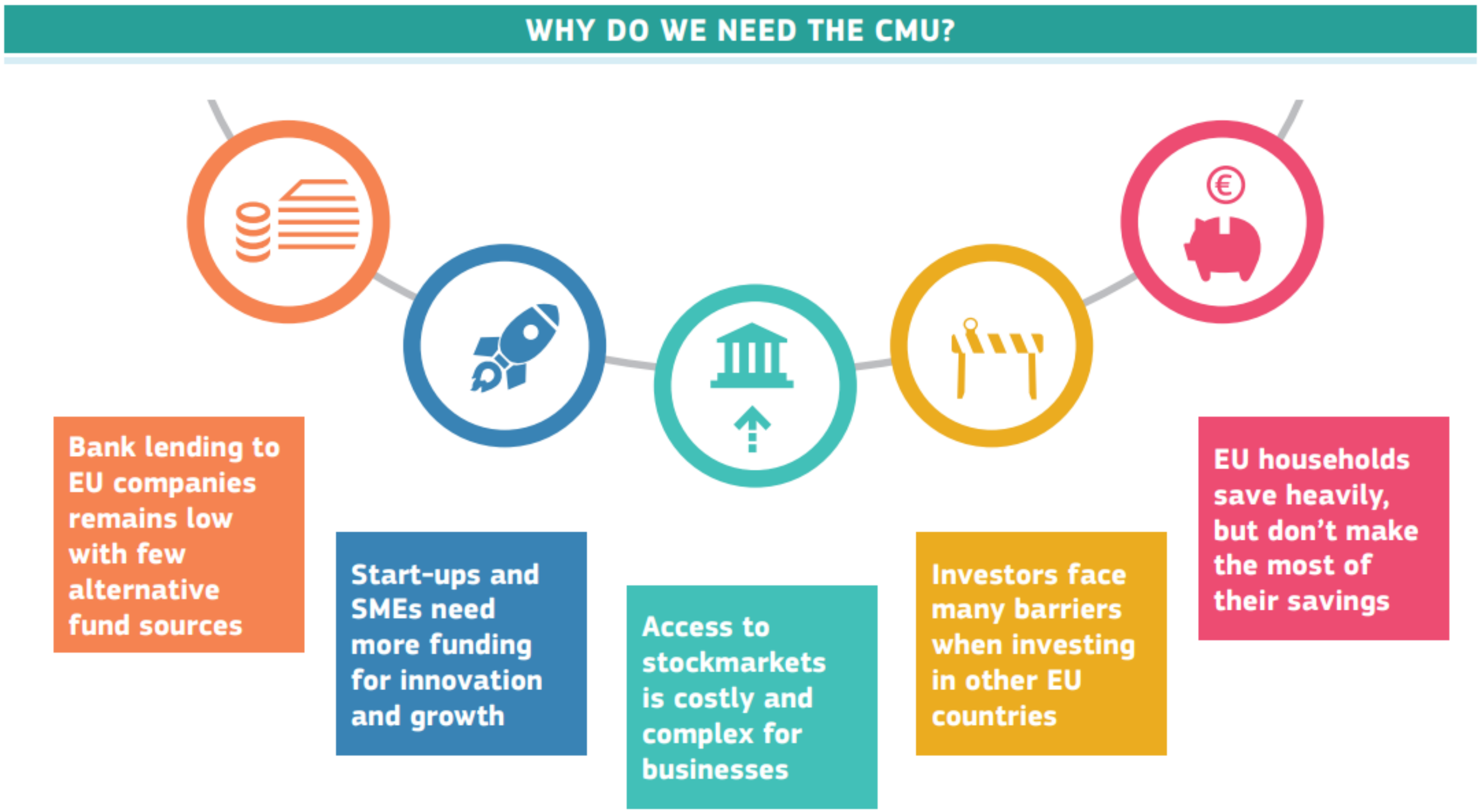
Why Capital Markets Union?



Source: European Commission.

Why Capital Markets Union?

Problems:

- Investment has been too low
- Companies are largely financed through banks
- Banks have been unwilling to lend
- Little stock market and corporate bond financing
- Little financing for startups/venture capital
- Household saving is largely in bank accounts
- Investors face hurdles investing in other countries

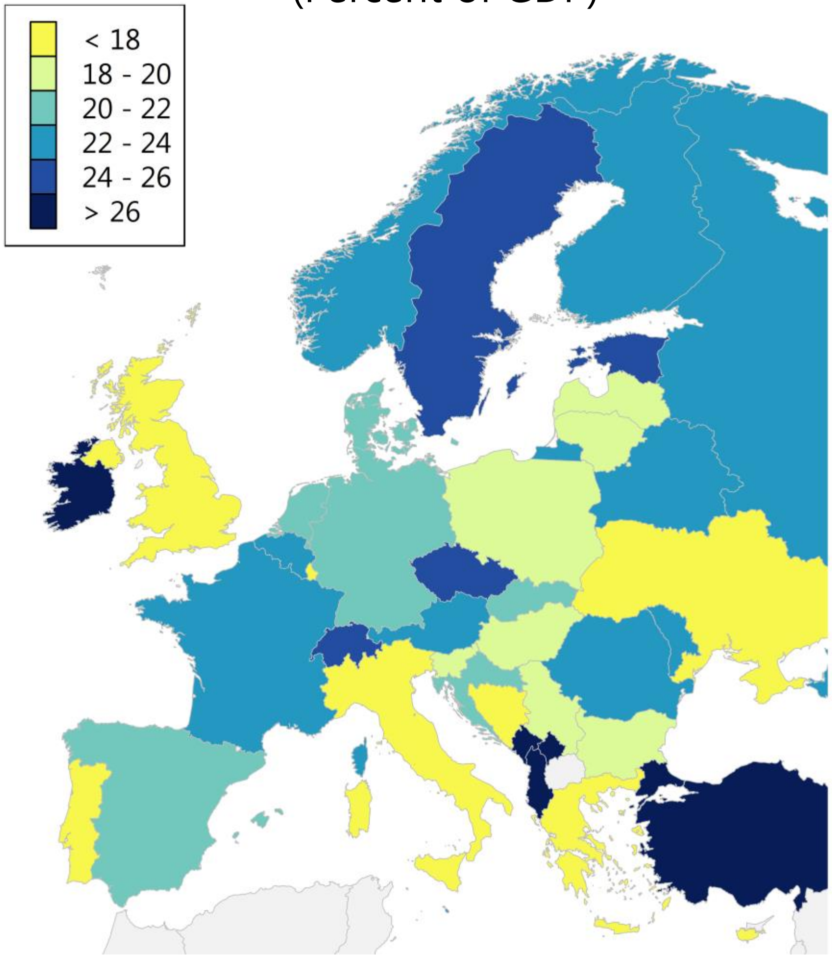
Many of these problems apply even more to EU New Member States than to Western Europe

- In addition:
  - Large scale deleveraging by Western parent banks
  - Capital markets are very small in absolute size

- Domestically owned SMEs may be even more constrained that in Western Europe

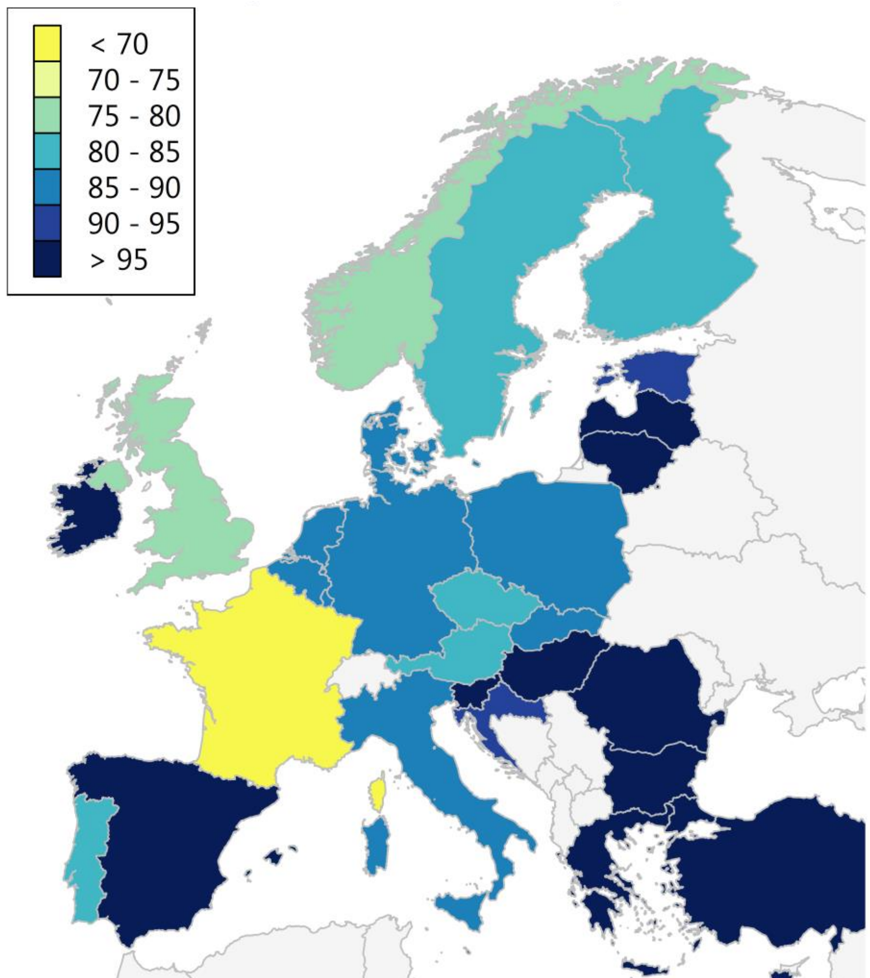
Investment in NMS is relatively low

Investment Rates in 2017
(Percent of GDP)



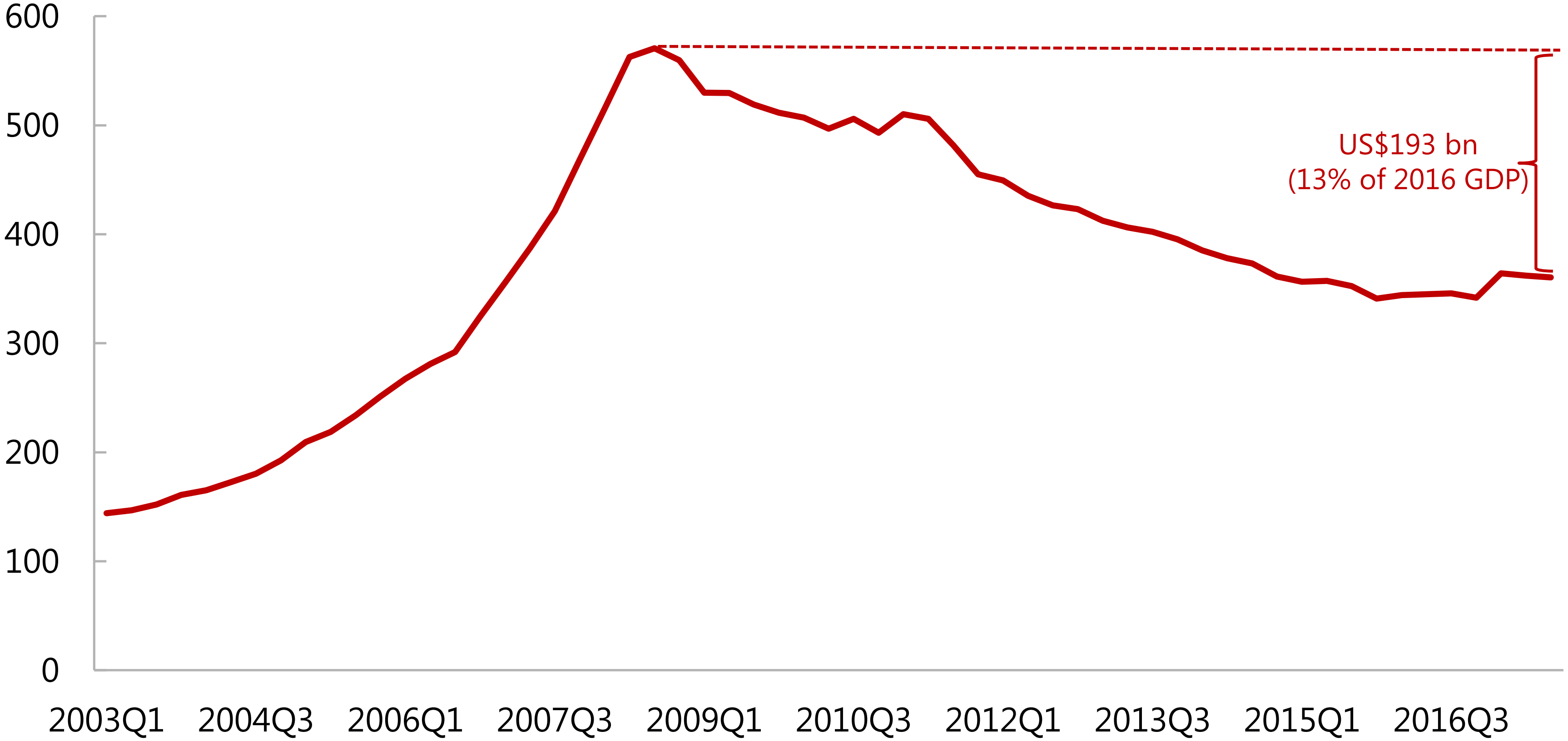
Most debt financing of firms is through banks

Non-Financial Corporations Loans as Share of Debt Instruments in 2016
(Percent)



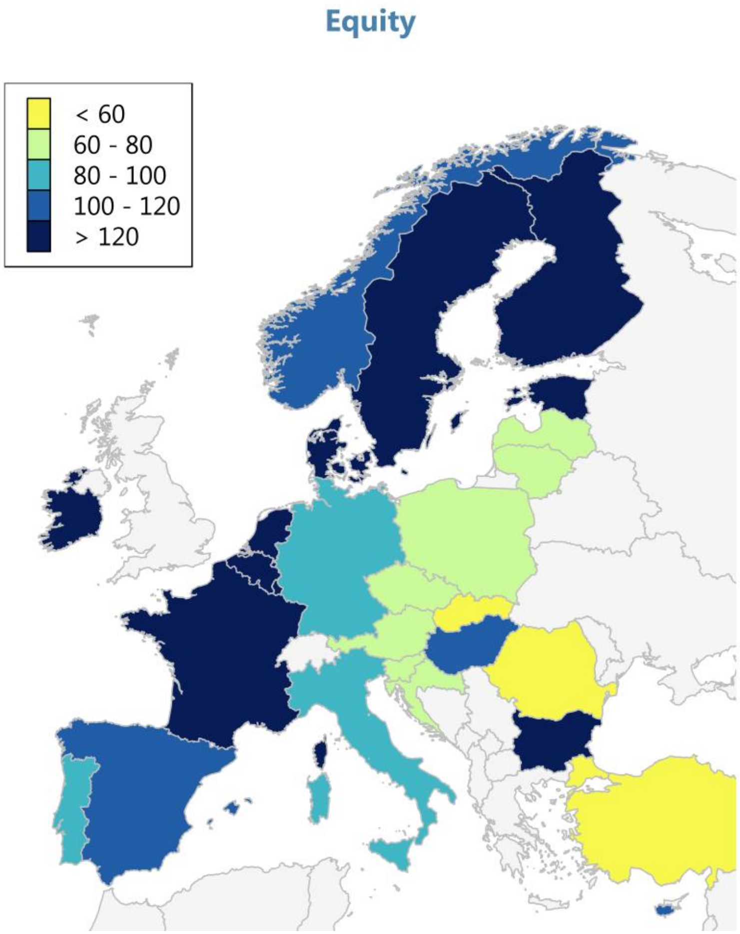
Large scale deleveraging by Western Banks in CESEE

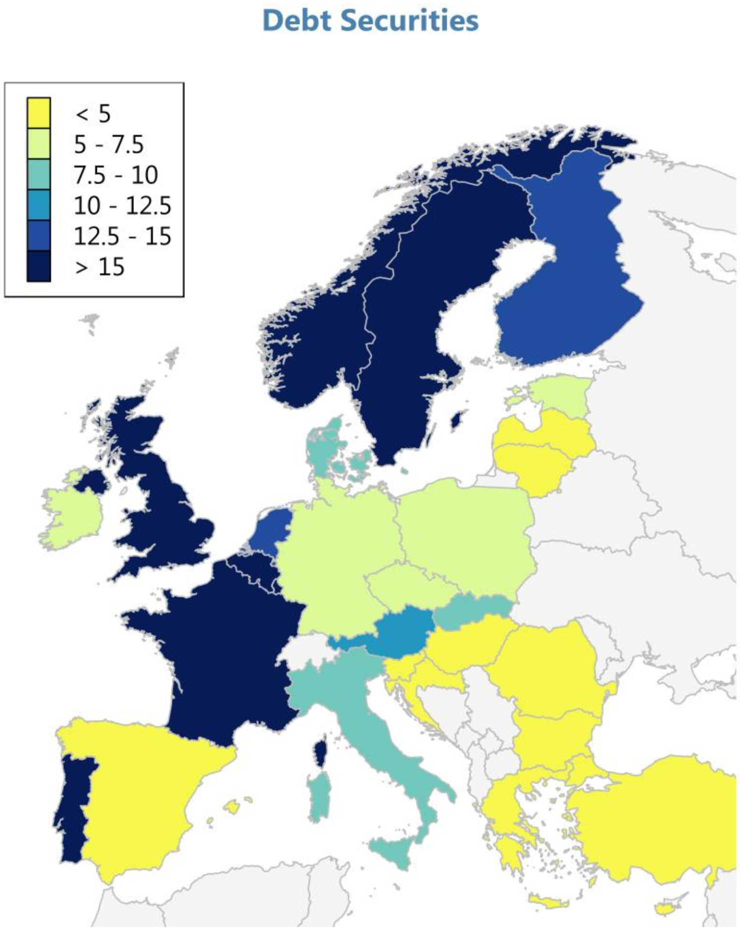
CESEE ex. RUS and TUR: External Position of BIS-reporting Banks
(USD billions, exchange-rate adjusted)



Equity and corporate bond financing very small

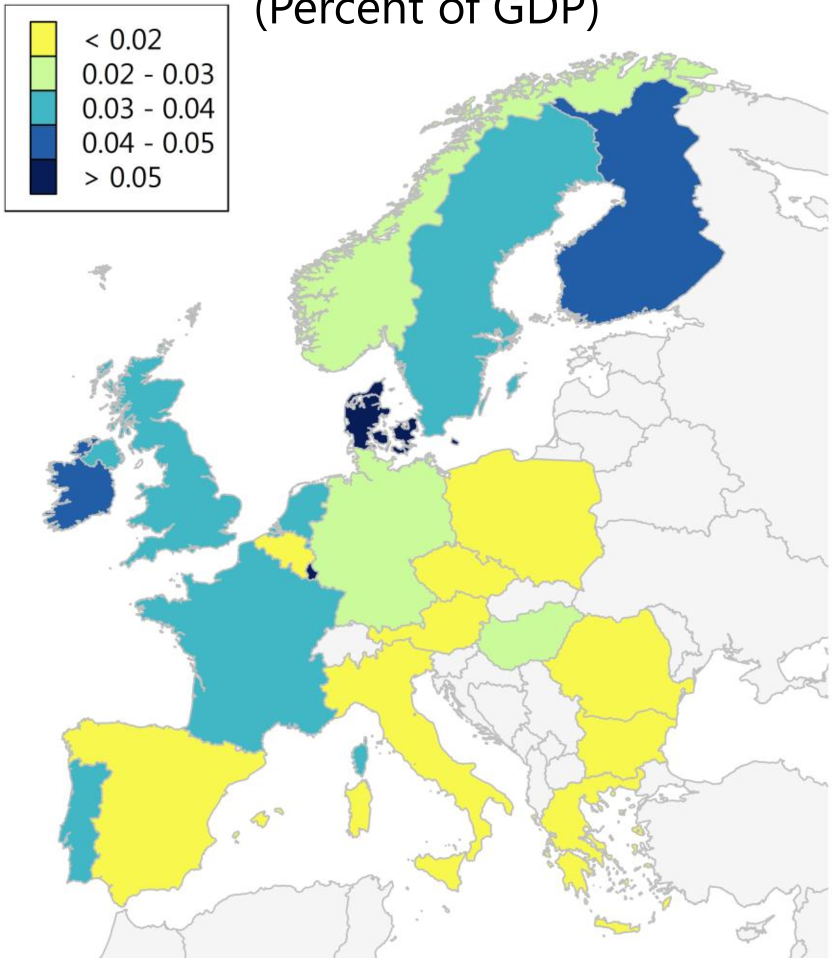
Non-Financial Corporations Equity and Debt Securities in 2016
(As Percent of GDP)





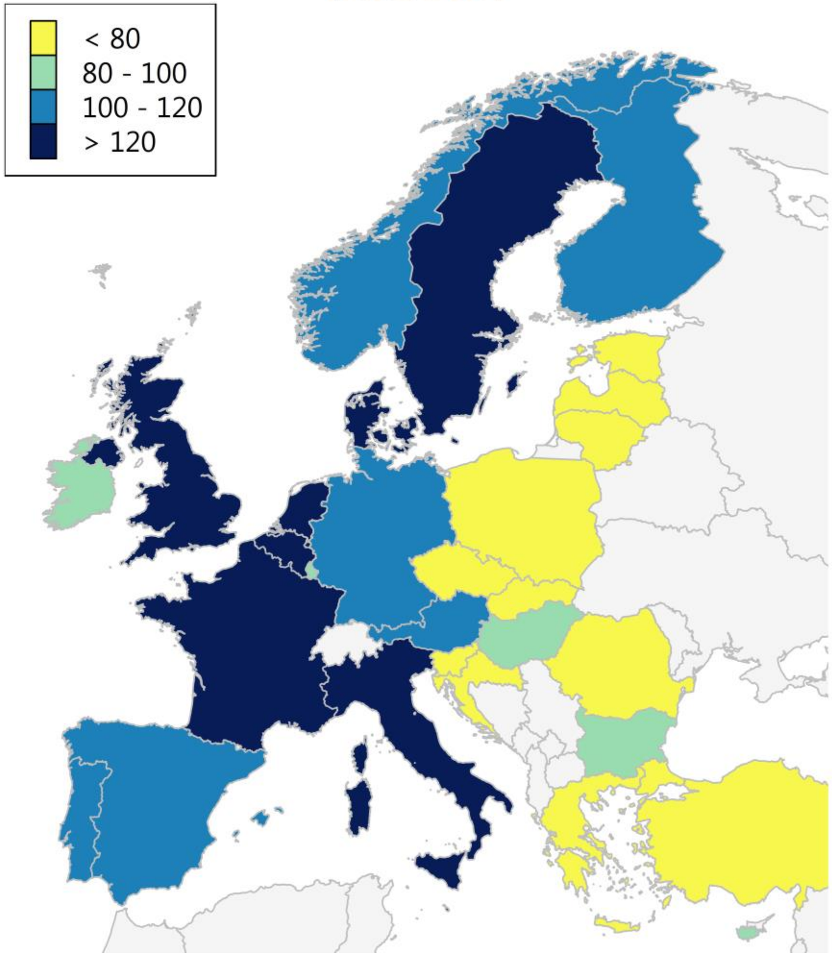
Venture capital is underdeveloped

Venture Capital in 2015
(Percent of GDP)

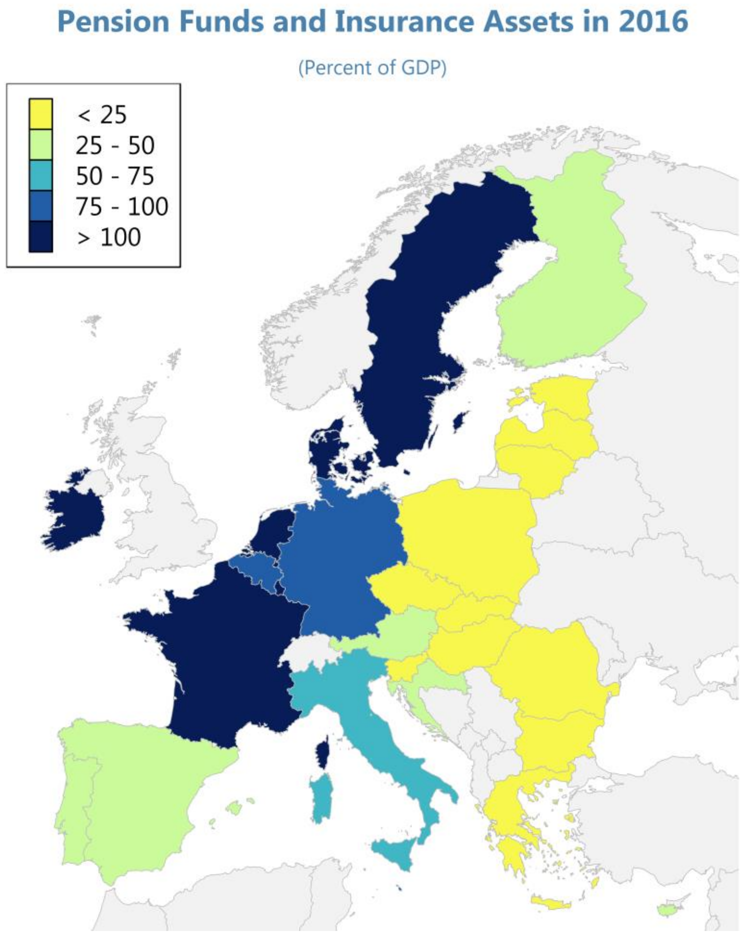


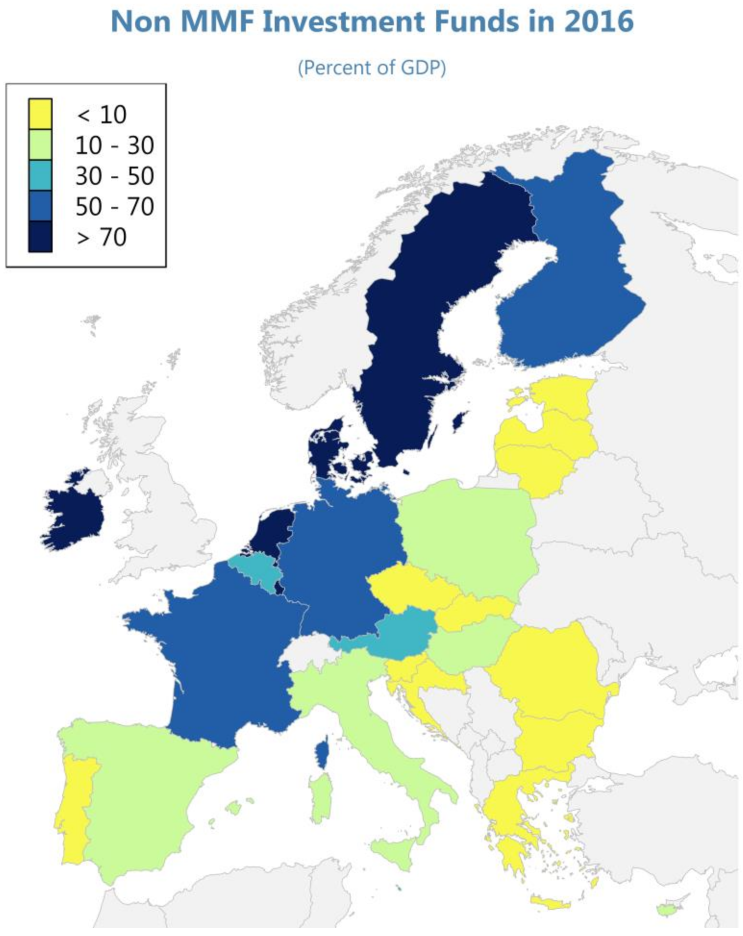
If we exclude bank deposits, household financial assets are limited

Households: Assets Excluding Currency and Deposits in 2016
(Percent of GDP)



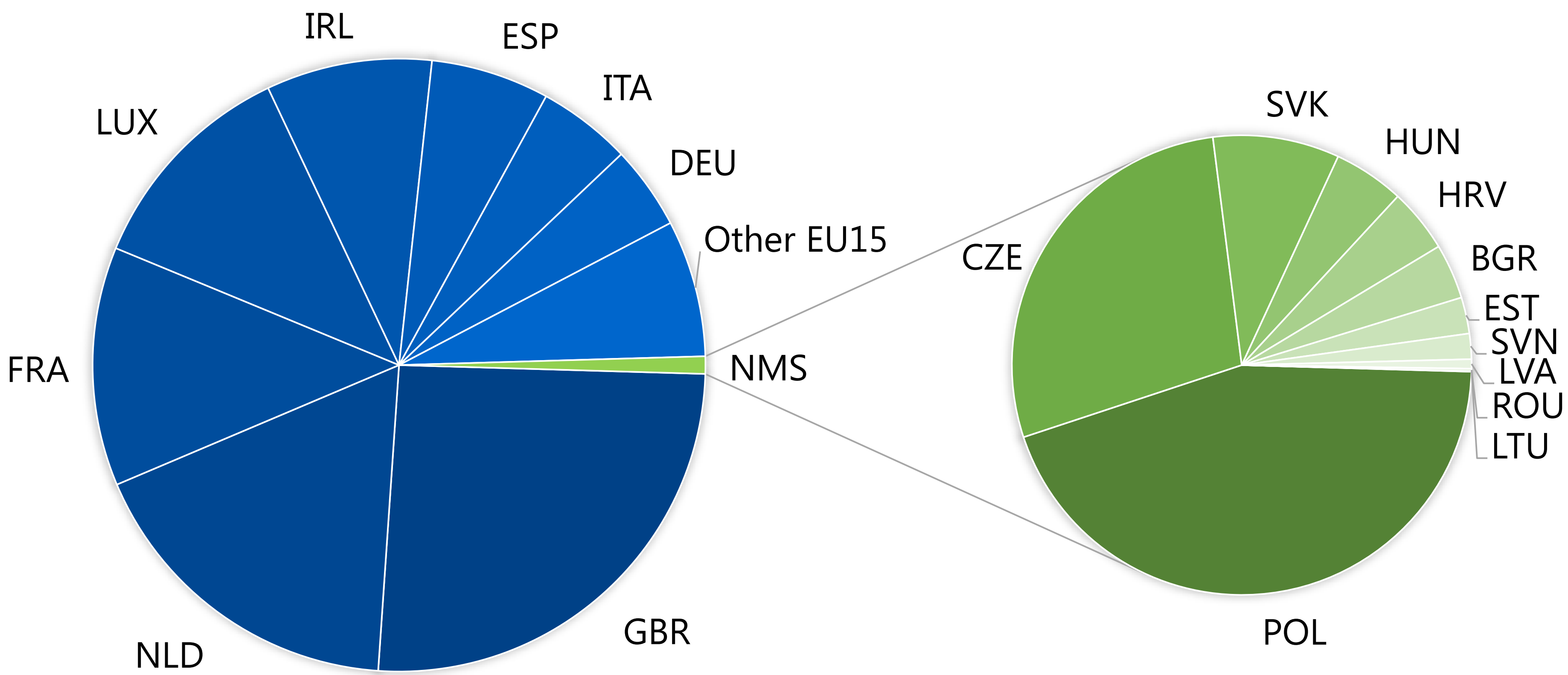
Institutional investors are much smaller than in Western Europe



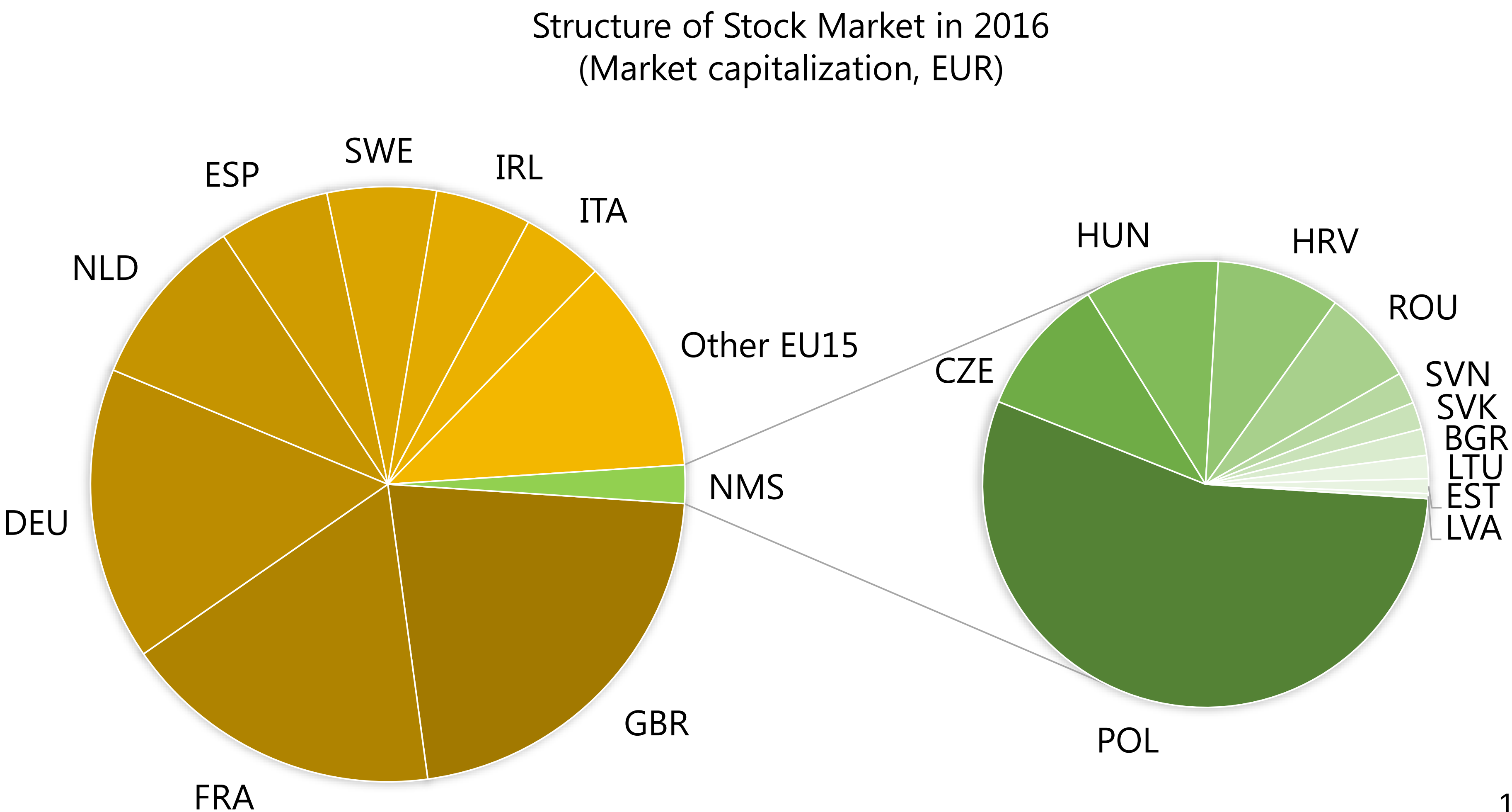


Capital markets are very small in absolute size—corporate bond markets…

Structure of Non-Bank Corporate Bond Market in 2016
(Value of outstanding debt securities, EUR)



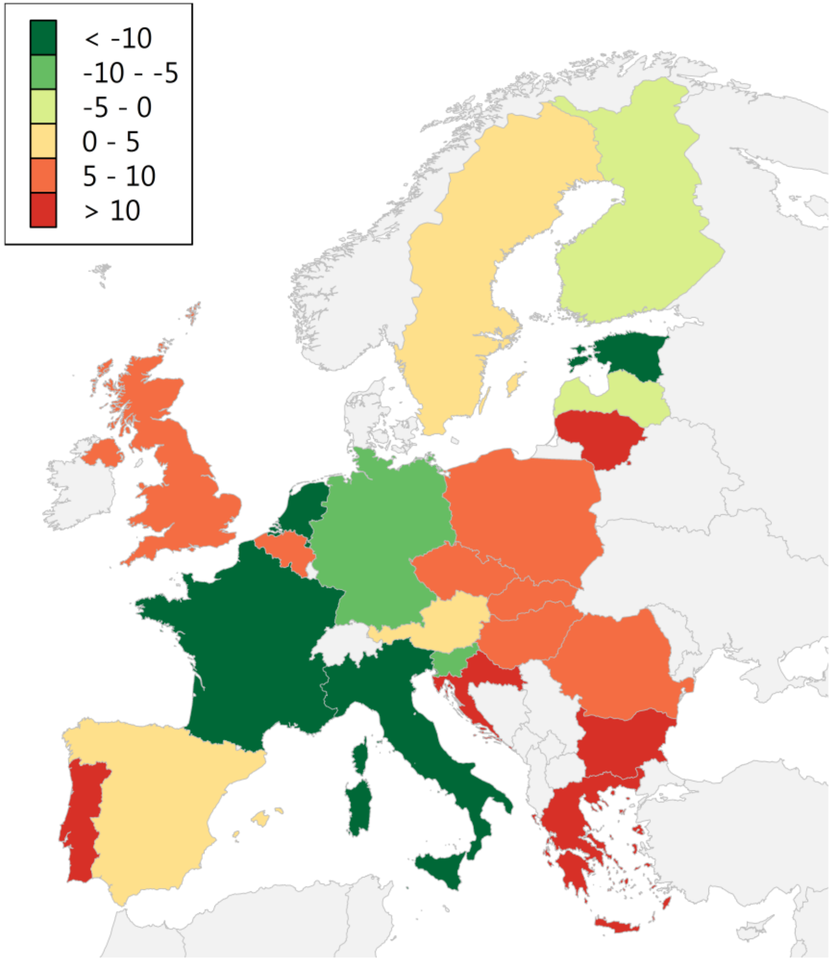
…as well as stock markets



In short, domestically owned SMEs may be *more* finance constrained relative to large firms than in Western Europe

Assessment of financial factors affecting investment: gap between SMEs and large firms, 2018

(Percentage Points)



Policy Recommendations (1)

- Need to have an optimal sequence of developing capital market union by matching investors with right issuers through the right instruments:
  - The CESEE government bond market is a good start
  - Large corporates will go offshore to finance anyway
  - Some covered bond and securitized SME/Household debt may be listed locally.

Policy Recommendations (2)

- Besides developing the domestic investor base (e.g. Pension and insurance), attracting foreign investors should be a key focus based on the experience of other EMs.
- Bond market finance may not be the best solution for family-owned SMEs based on international experience.
- We need consider the cost and size of funding and the flexibility to meet the SMEs’ funding needs.

Policy Recommendations (3)

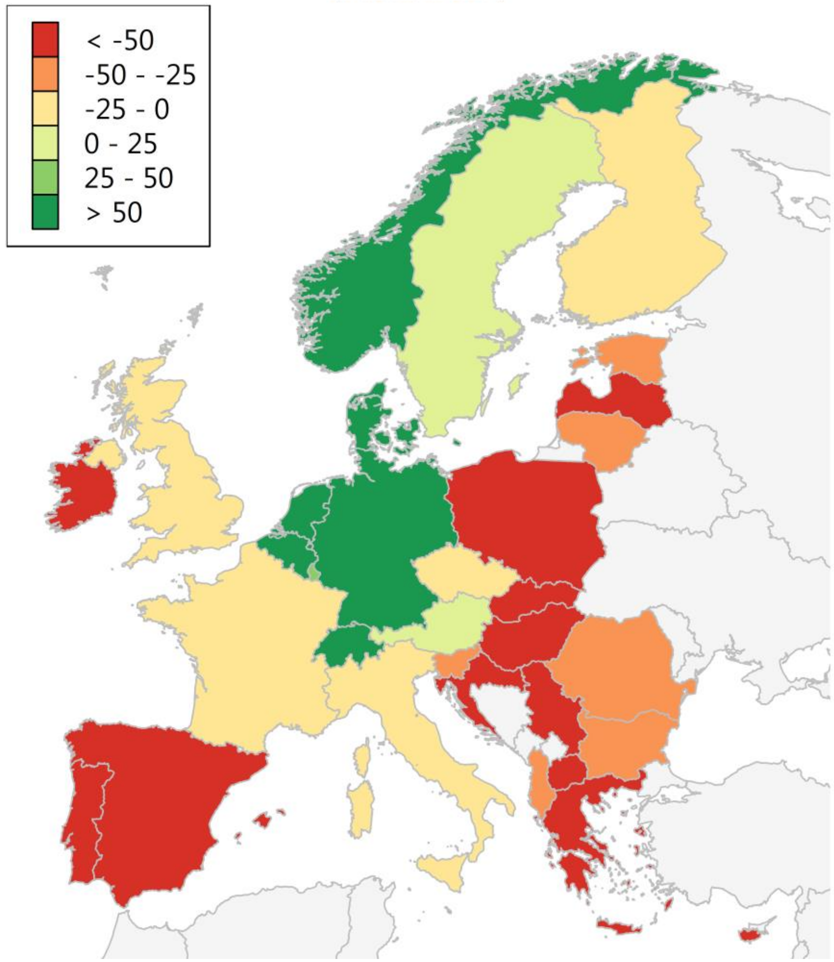
- Each country should have its own strategy based on the structure of the real sector (e.g. SME dominance, economic scale) and financial sector (banks, NBFI, debt composition) to choose the right instruments.
- Some countries might not have a critical mass to have their own full-fledged capital markets; a specialized version is more realistic.

Thank you

SUPPLEMENTARY SLIDES

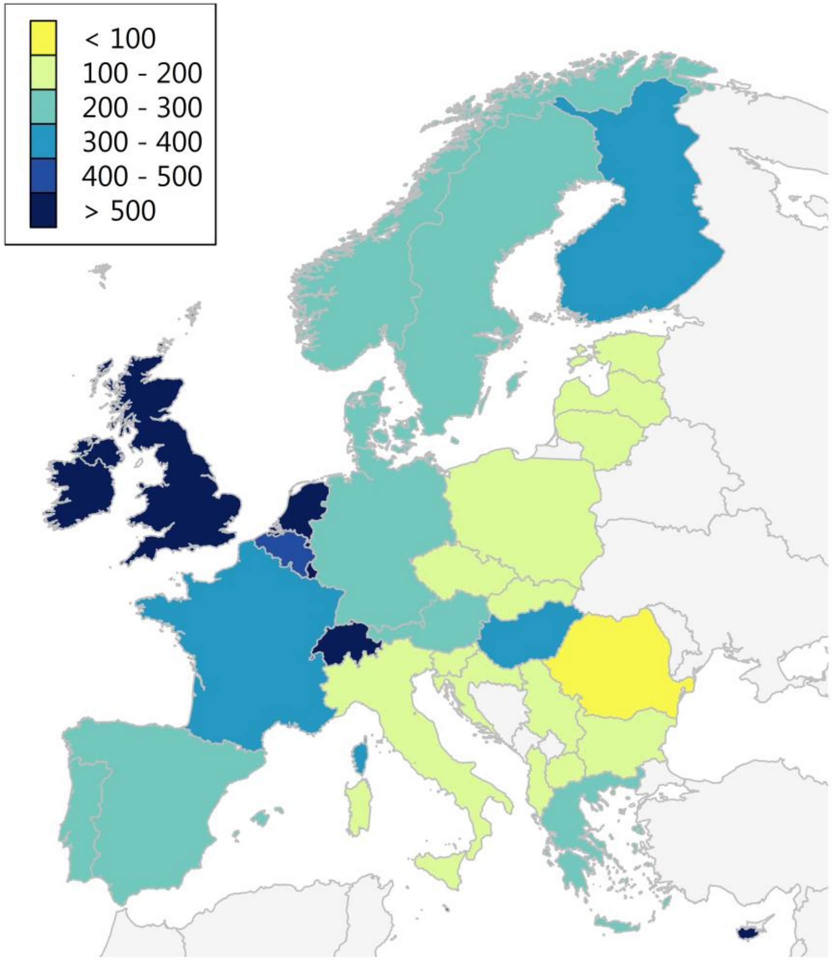
Capital flows have been one sided: IIP is very negative….

International Investment Position in 2016
(Percent of GDP)



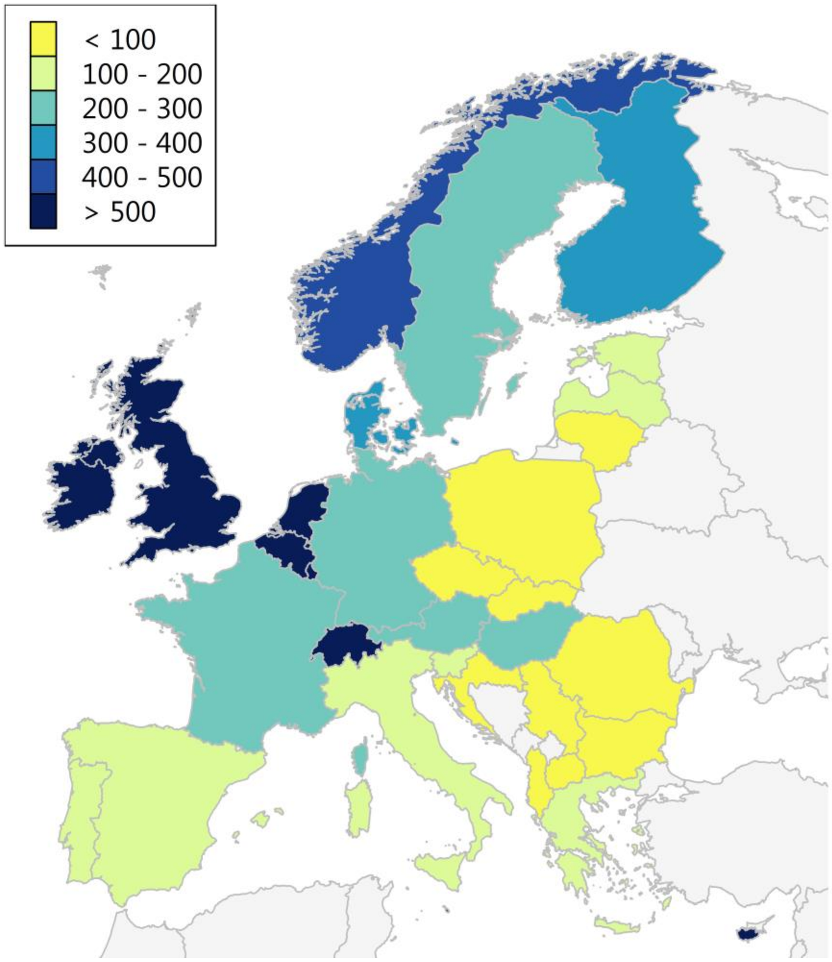
But this is not because stock of *inward* investment is so high….

International Investment Position - Liabilities in 2016
(Percent of GDP)



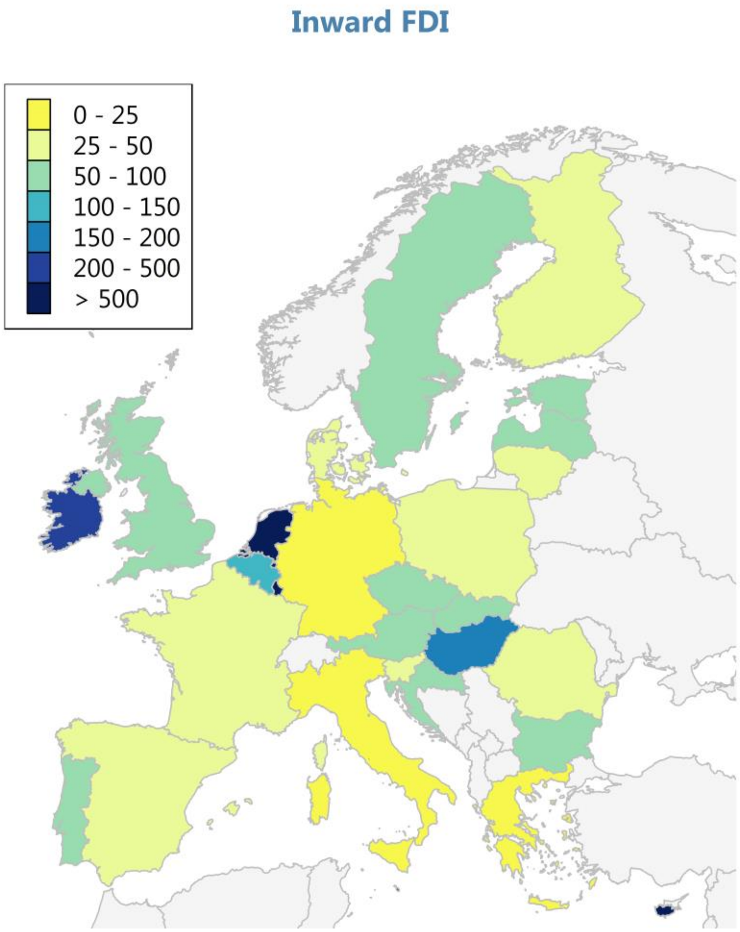
But because there has been so little outward investment

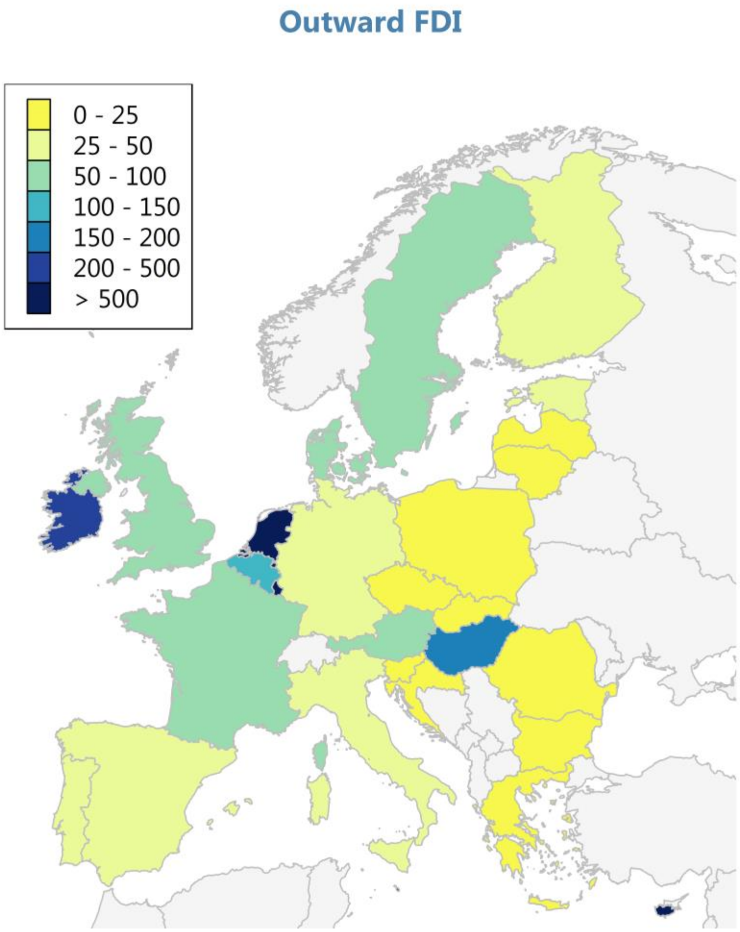
International Investment Position – Assets excl. Reserve Assets in 2016
(Percent of GDP)



This is clearly visible in FDI

Inward and Outward FDI in 2016
(As Percent of GDP)





Results is large *net* profit outflows

Difference between FDI profit inflow and outflow
(Minus reinvested earnings, percent of GDP)