

EMERGING EUROPE UPDATE

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Region's banking sector is not yet out of the woods

- This time last year, banking sectors across Emerging Europe were on the brink of collapse. Financial conditions have since stabilised, but how are the region's banks likely to fair in 2010? In order to better assess this we have constructed a 'Heat Map'. (See Table 1.) This grades key statistics on lending growth and banks' funding positions according to the conditions present in past financial crises. A red ranking suggests cause for concern, whereas green suggests that conditions are benign.
- Broadly speaking, the region's banking sector splits into three groups. The first contains those economies whose banking sectors are in reasonable shape. Unfortunately this consists of a fairly small number of countries (Poland, Slovakia, Turkey and the Czech Republic).** Here, FX lending is limited and banks' funding positions look reasonably secure – both short-term external debt and loan to deposit ratios are low. Likewise, although bad debt is increasing, the rise has been (and is likely to remain) comparatively moderate. Lending conditions in these countries are far from loose, but by the same token households and businesses will be able to access credit far more easily than elsewhere in the region. GDP growth is likely to be correspondingly faster.
- The outlook for banks in the second group (containing Hungary, Romania, Bulgaria and the Baltics) remains altogether more worrying.** Funding positions are weak and bad debt is rising quickly. What's more, the comparatively moderate pace of credit growth in these countries is a reflection of the ongoing deleveraging by households and businesses rather than a sign of prudent lending standards. Admittedly, capital ratios are high by international standards. But even so, credit conditions are at best likely to remain extremely tight as the excesses of the past decade are unwound. At worst, another significant deterioration in the global financing environment could trigger a fresh wave of banking troubles. **We expect all of the economies in this group to contract again this year.**
- The final group consists of just one country – Russia. On the face of it, Russia's banking sector looks in reasonably good shape. Bad debt is low, capital ratios are high and funding positions look fairly sound. But official data on non-performing loans are misleading – most independent estimates suggest that the true figure is closer to 20%. **What's more, the Russian banking sector is dominated by the big-four state-owned banks, all of whom are backed by the state's strong balance sheet. The country's remaining banks – which total over 1,100 in number – are in a much weaker position. If oil prices fall this year, as we expect, these smaller institutions will be hit hardest by the subsequent tightening in liquidity conditions.** We shall update our 'Heat Map' on a regular basis throughout the year, but for now at least, while the worst of the crisis has past, it is too soon to conclude that the region's banking sector is out of the woods.

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TABLE 1: BANKING HEAT MAP (ALL FIGS. LATEST OBS.)

	Non Performing Loans (% Total)	Private Sector Credit Growth (% y/y)	FX Lending (% Total)	Banks' Short-term External Debt (% GDP)	Bank Reg. Capital Ratio to Risk-Weighted Assets (%)	Loan/Deposit Ratio
Turkey	4.5	21.7	27.1	4.0	19.2	0.6
Poland	7.4	11.1	32.1	6.7	11.7	1.1
Czech Rep.		2.5	15.0	7.7	13.7	0.8
Slovakia	4.8	3.3	1.0	3.3	12.2	0.8
Hungary	9.5	0.6	63.0	13.5	12.3	1.5
Romania	11.2	3.5	60.2	6.7	12.3	1.2
Bulgaria	10.1	4.8	57.6	21.1	16.5	1.4
Estonia	12.0	-3.7	87.1	36.4	15.2	1.6
Latvia	14.5	-5.3	91.8	31.8	12.8	2.8
Lithuania	8.2	-6.7	71.8	11.7	13.9	1.8
Russia	6.0	1.4	30.2	2.4	18.5	1.6
Criteria	Green ≤5% Amber 5-7.5% Red >7.5%	Green ≤20% Amber 20-30% Red >30%	Green ≤25% Amber 25-50% Red >50%	Green ≤5% Amber 5-10% Red >10%	Green ≥15% Amber 10-15% Red <10%	Green ≤1.0 Amber 1.0-1.5 Red >1.5

Sources – National Central Banks, World Bank, IMF, Thomson Datastream, CEIC, Capital Economics