

Monetary Policy and the Stability of the Banking Systems in the Countries of the Region - A Decade After the Lehman Brothers' Bankruptcy



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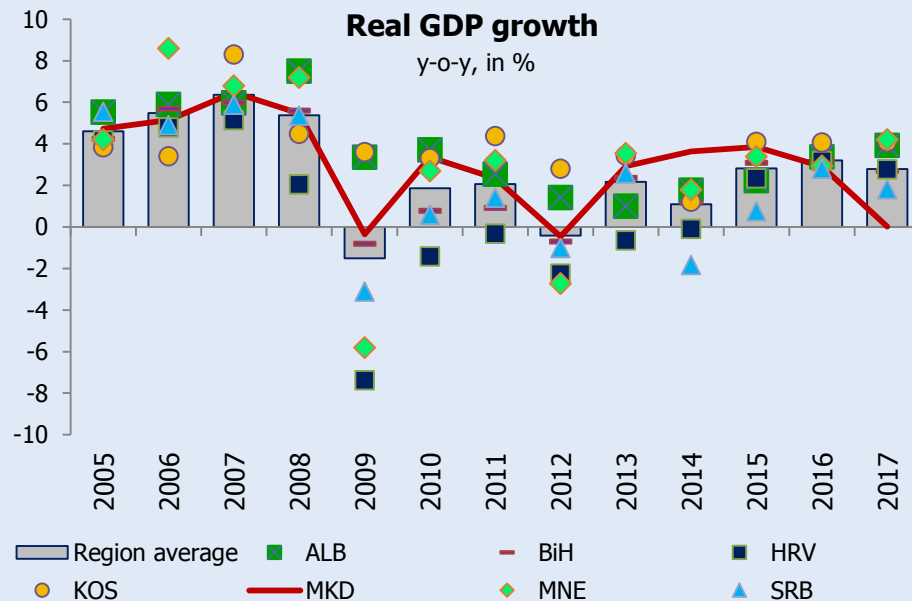
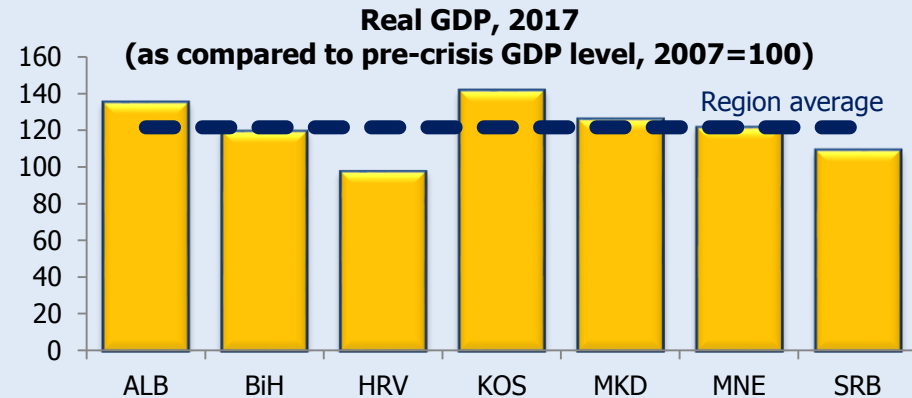
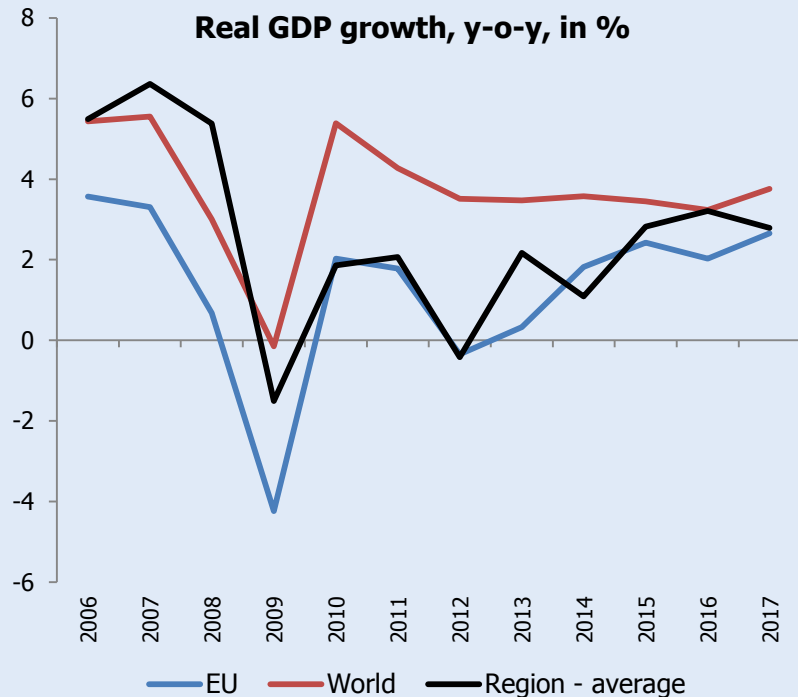
Economic developments

Growth is strengthening and broadening across Europe

2017 marked by widest dispersed growth between countries since 2010

Region is following gradual recovery after the crisis

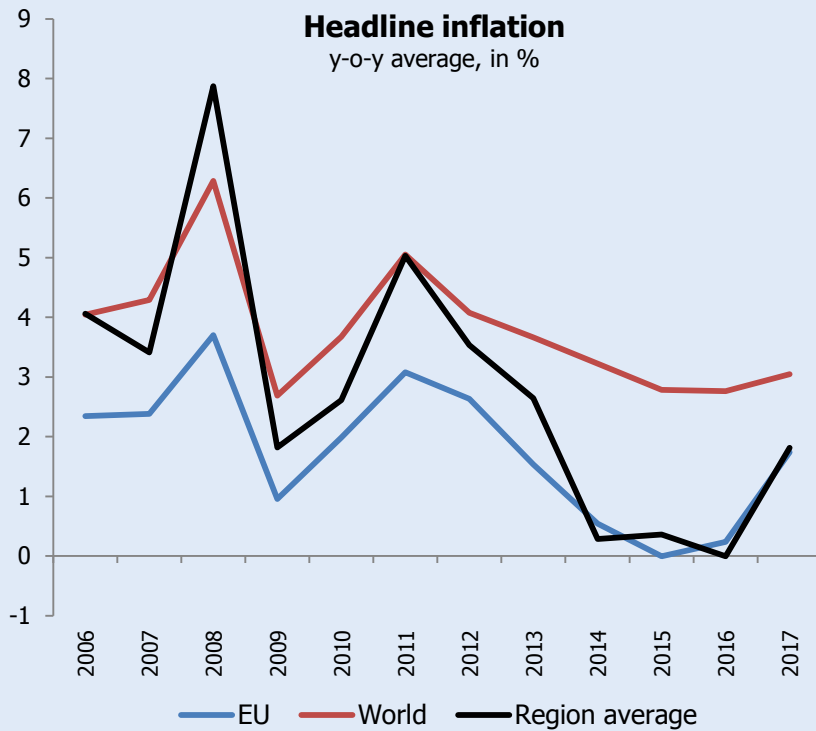
Slowdown in growth in 2017 due to weaker growth in Macedonia (prolonged political crisis) and Serbia (extreme weather conditions – severe winter and summer drought)



Monetary policy and inflation

Headline inflation has picked up, reflecting stronger fuel prices, but core inflation remains soft

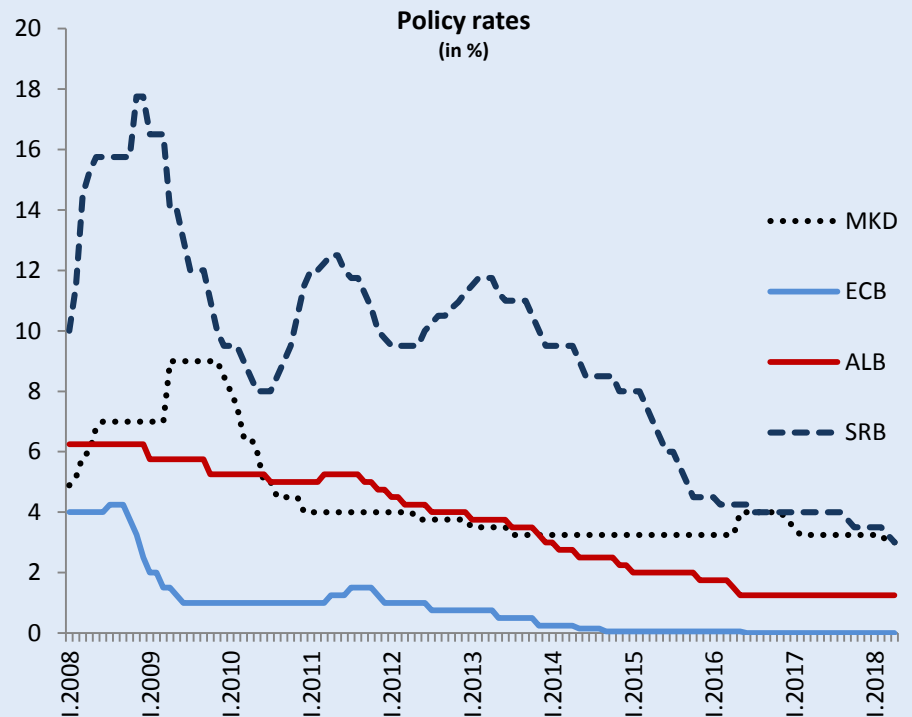
Inflation rose in most of the region led by food and energy prices



Source: IMF WEO, April 2018

Monetary policy remains accommodative in support to economic growth...

...as currencies appreciate in inflation targeting countries



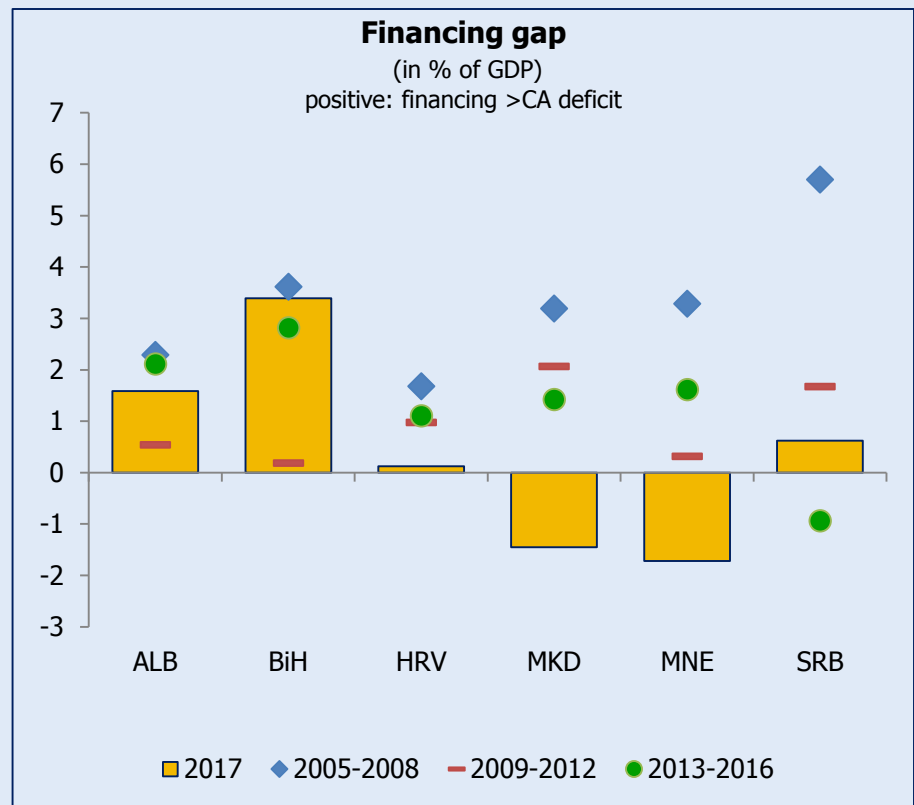
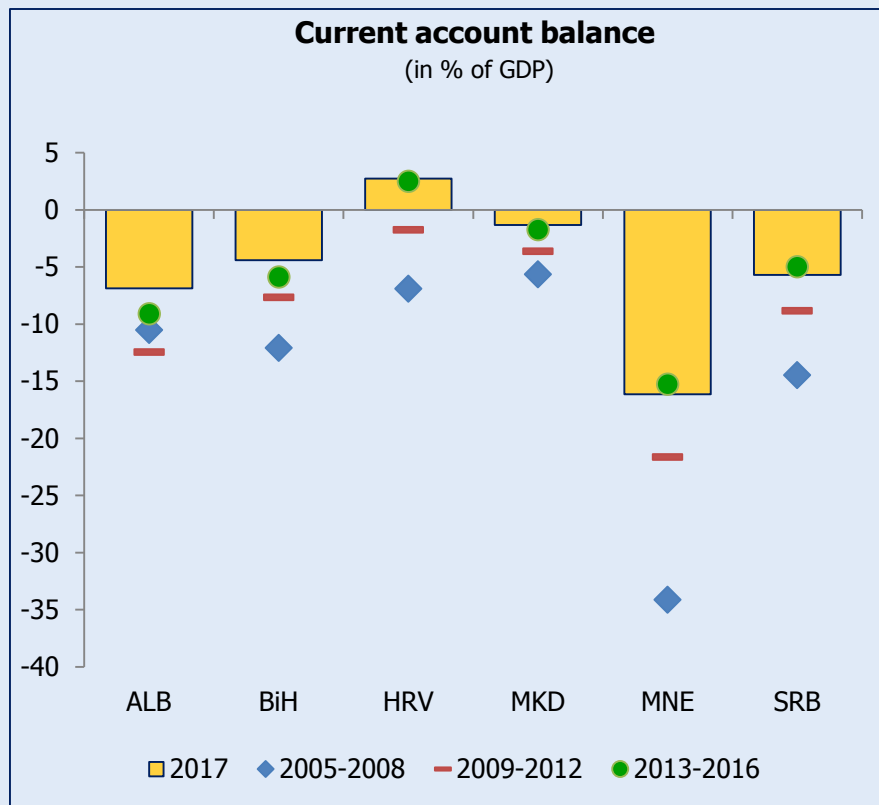
Source: central banks web sites.

External sector developments

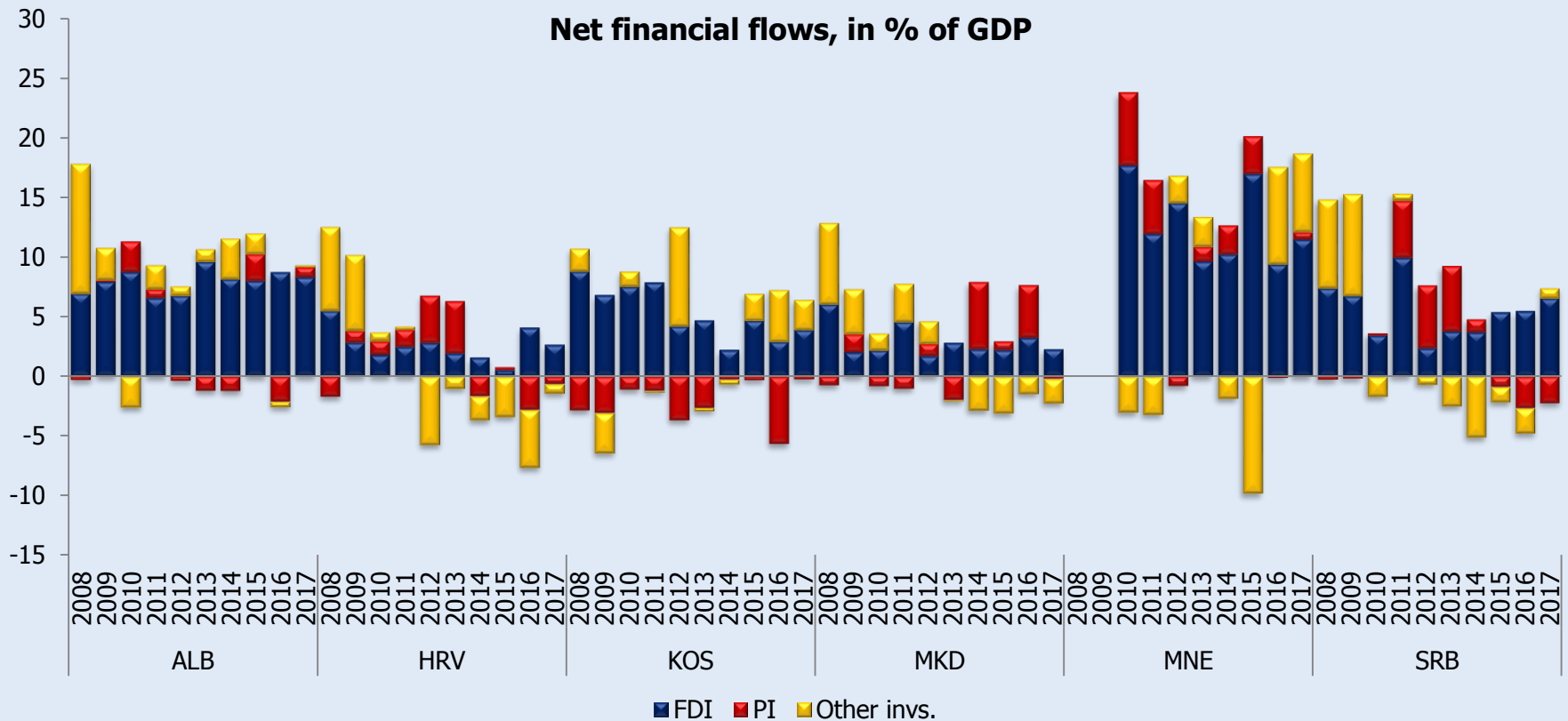
...Supported by shrinking external imbalances following GFC, with some economies replacing large CA deficit with small surpluses

Capital inflows continued, albeit at decelerated pace across the region

Low yields in EA enable capital inflows in 2016-2017



Financial inflows mainly in the form of FDIs as more stable component Incurrence of portfolio liabilities supported by Government financing abroad

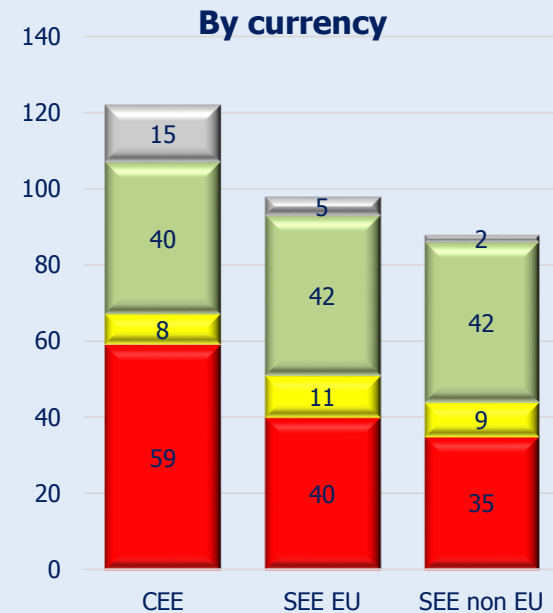
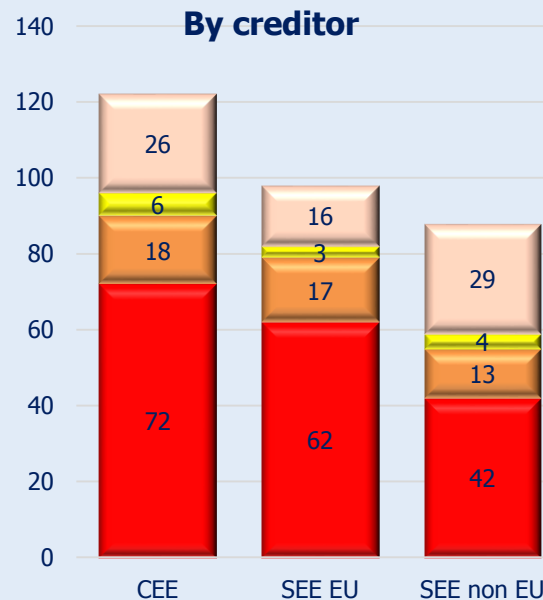
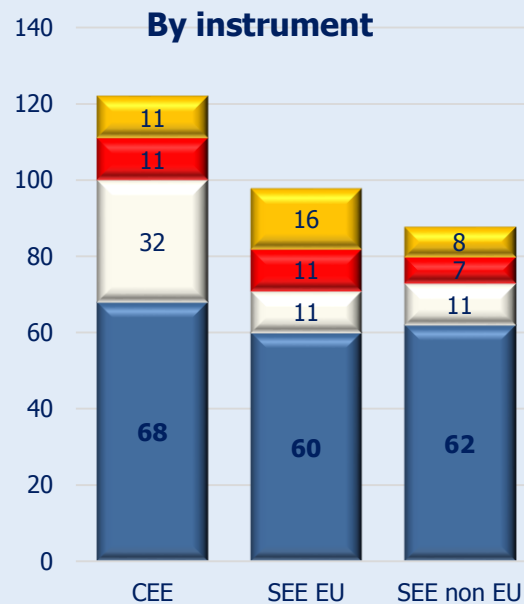


Capital flows

By creditor, significant reliance on EU developments, as EU creditors are largest

Significant share of external liabilities denominated in euros, which poses risk when ECB starts to reduce the extent of monetary accommodation

Composition of external liabilities
(% of GDP, end 2015)



- Cross border lending to non-banks
- Cross border interbank funding
- Portfolio investment
- FDI and intercompany lending

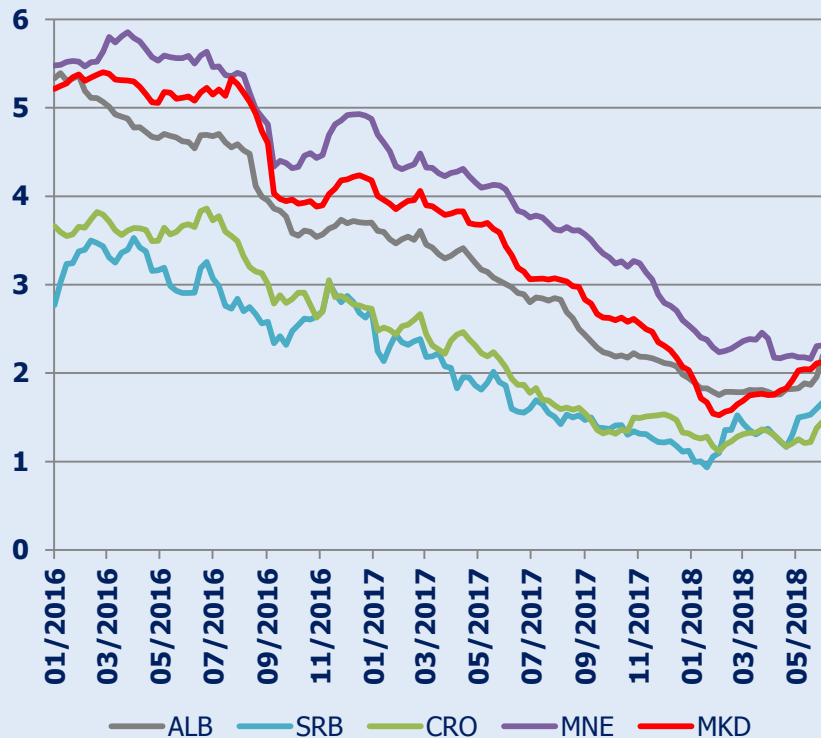
- Euro area
- other EU
- US
- RoW

- Euro
- US dollar
- domestic
- Other

Fiscal sector developments

Ultra loose monetary policy of major central banks enabled favorable conditions for Government borrowing on international markets

**Yield spreads on Eurobonds*
(in p.p.)**



Country	Eurobonds issued beginning from 2009	Maturity	Coupon
Albania	2015 - 450 EUR mil.	2020	5.750%
Serbia	2011 - 2.000 USD mil.	2021	7.250%
	2013 - 1.000 USD mil. and 1.500 USD mil.	2018 and 2020, respectively	5.875% and 4.875%, respectively
Croatia	2009 - 1.500 USD mil.	2019	6.750%
	2010 - 1.250 USD mil.	2020	6.625%
	2011 - 750 EUR mil. and 1.150 USD mil.	2018 and 2021, respectively	5.875% and 6.375%, respectively
	2013 - 1.500 USD mil. and 1.750 USD mil.	2023 and 2024, respectively	5.5% and 6.0%, respectively
	2014 - 1.250 EUR mil.	2022	3.875%
	2015 - 1.150 EUR mil.	2025	3.000%
	2017 - 1.250 EUR mil. and 1.275 EUR mil.	2027 and 2030, respectively	3.00% and 2.75%, respectively
	2018 - 750 EUR mil.	2028	2.700%
Montenegro	2014 - 280 EUR mil.	2019	5.375%
	2015 - 500 EUR mil.	2020	3.875%
	2016 - 300 EUR mil.	2021	5.750%
	2018 - 500 EUR mil.	2025	3.375%
Macedonia	2014 - 500 EUR mil.	2021	3.975%
	2015 - 270 EUR mil.	2020	4.875%
	2016 - 450 EUR mil.	2023	5.625%
	2018 - 500 EUR mil.	2025	2.750%

Source: Bloomberg

* Spreads are calculated in regard to German government bonds with similar maturity, except for Serbia that issues securities in US dollar, so spread is made in regard to US government securities

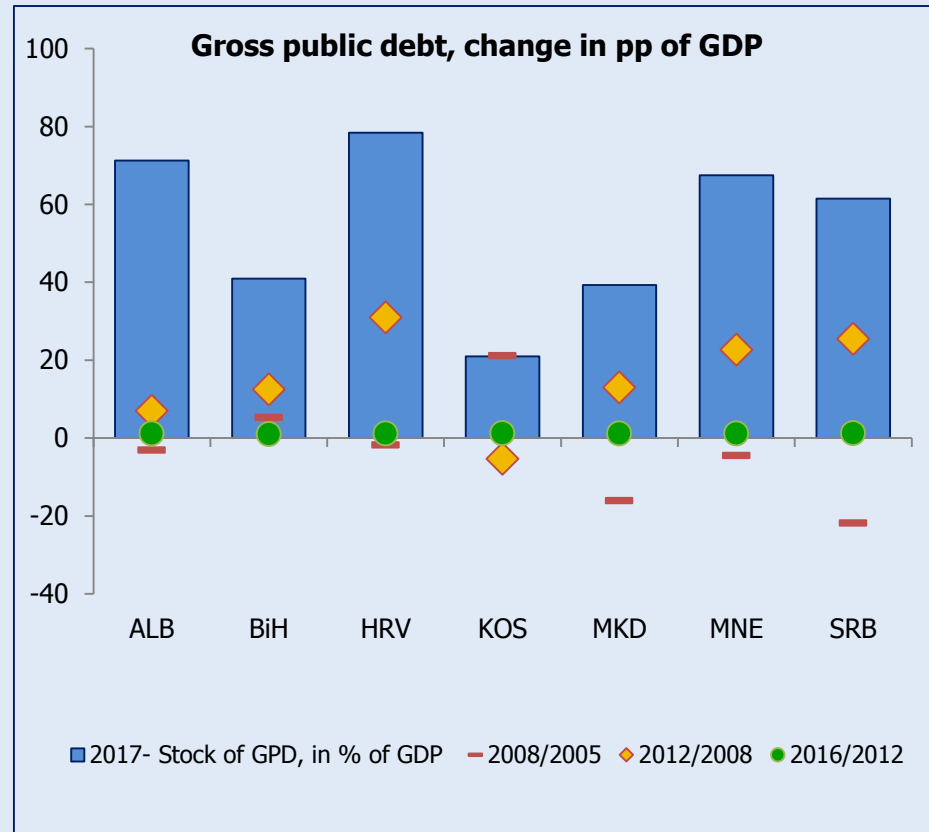
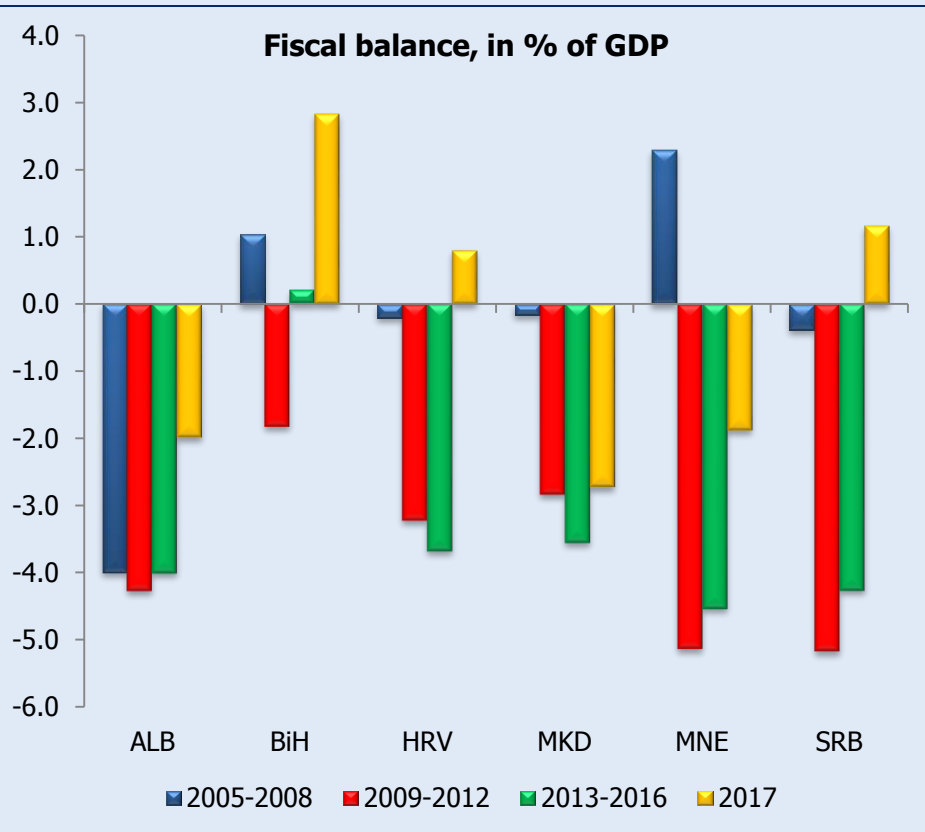
Fiscal sector developments

Fiscal consolidation is broadly on the way across the region

Gradual winding down of fiscal stimulus as economies recover

Public debt growth sustained at a slower pace in recent period

Still, the level of public debt remains elevated in some countries



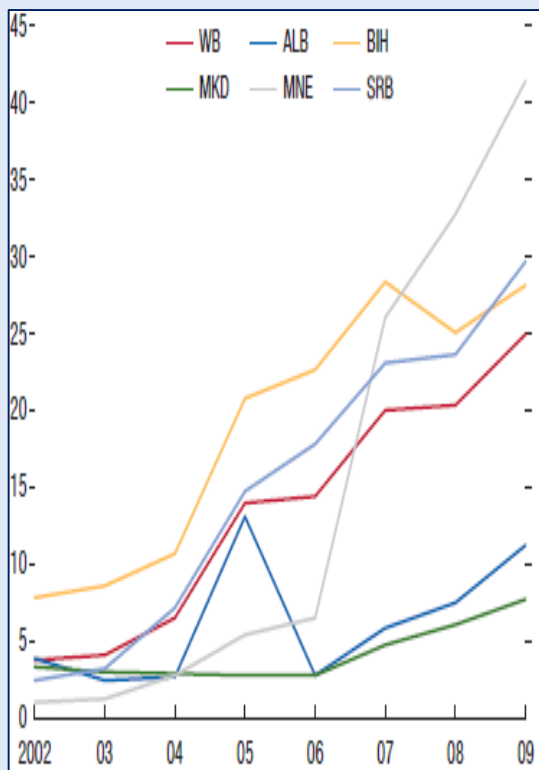
Banking sector developments

Banking systems broadly stable across the region, but still reeling from the boom-bust cycle

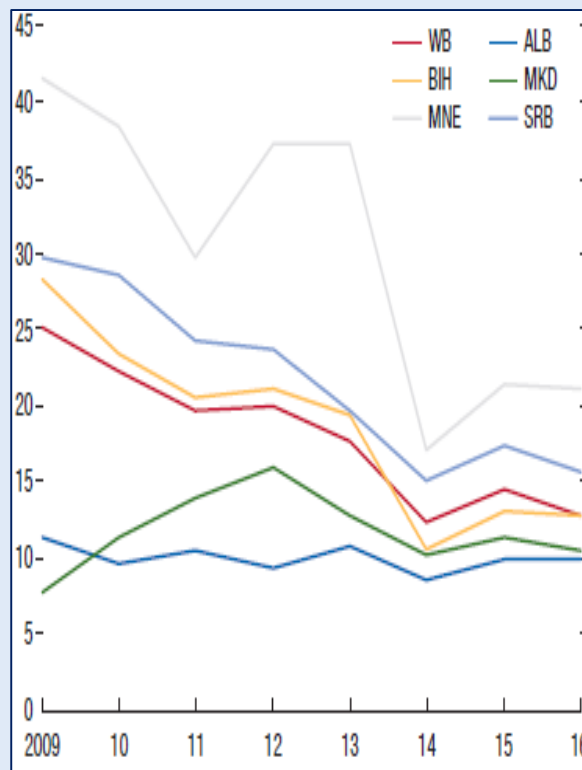
- Ample foreign parent banks financing pre crisis that fueled credit boom
- Sudden stop in foreign financing post crisis with credit entering a bust cycle

Foreign bank funding to all sectors (% of GDP)

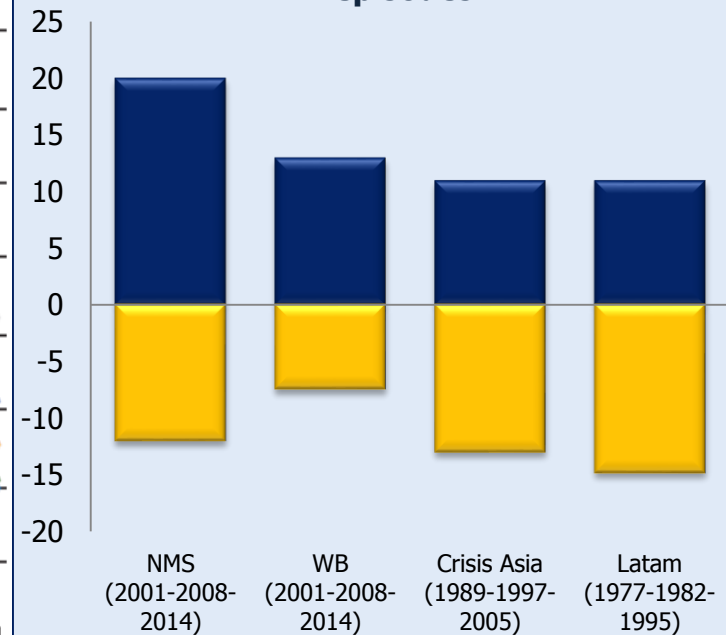
To Peak



Post crisis



Leveraging and Deleveraging episodes



■ Decrease in foreign bank funding, all sectors, % of GDP

■ Increase in foreign bank funding, all sectors, % of GDP

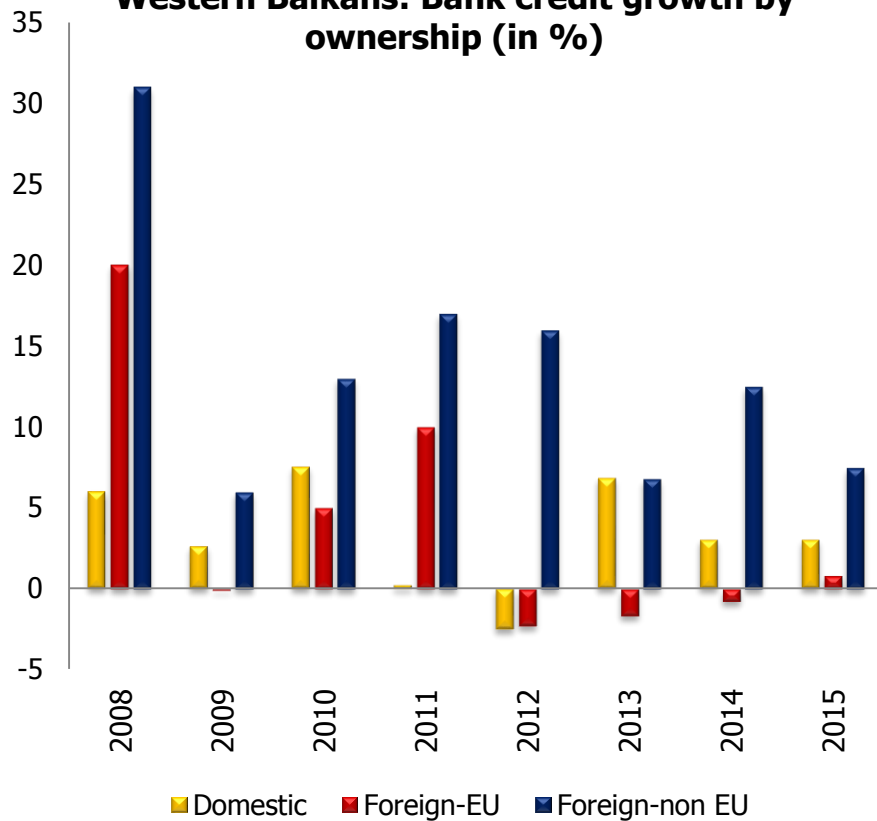
Source: IMF, Regional Economic Outlook: Europe, Nov. 2017

*Western Balkans refers to: Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro and Serbia.

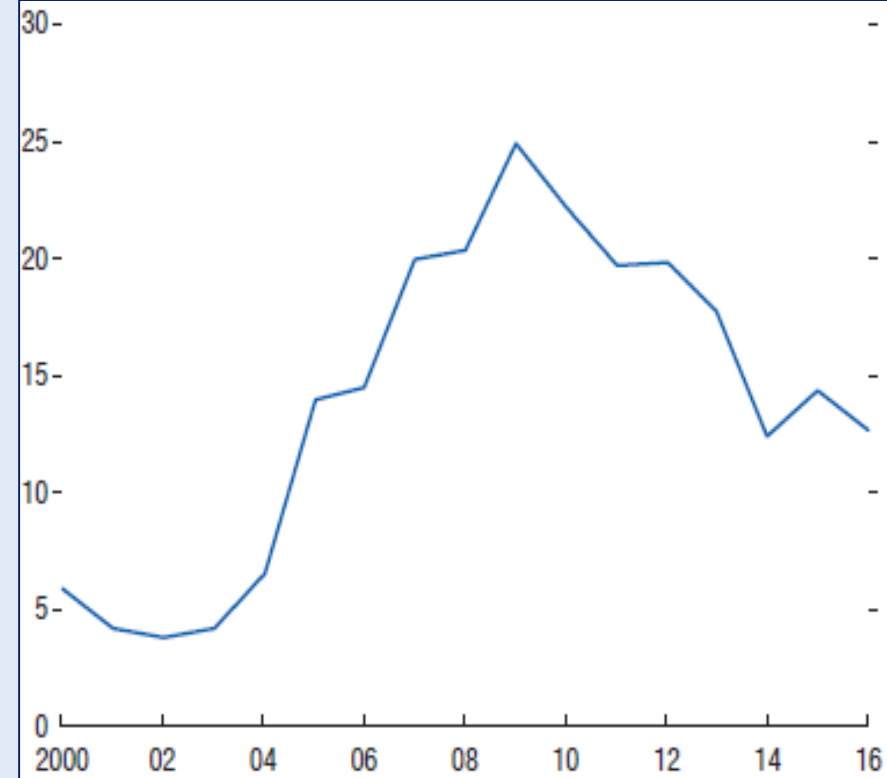
Banking sector developments

- **EU-owned banks experienced the sharpest falls**
- Gradual stabilization in foreign funding flows in recent years, but still far below pre-crisis levels

Western Balkans: Bank credit growth by ownership (in %)



External bank claims on WB
(% of GDP, all sectors)

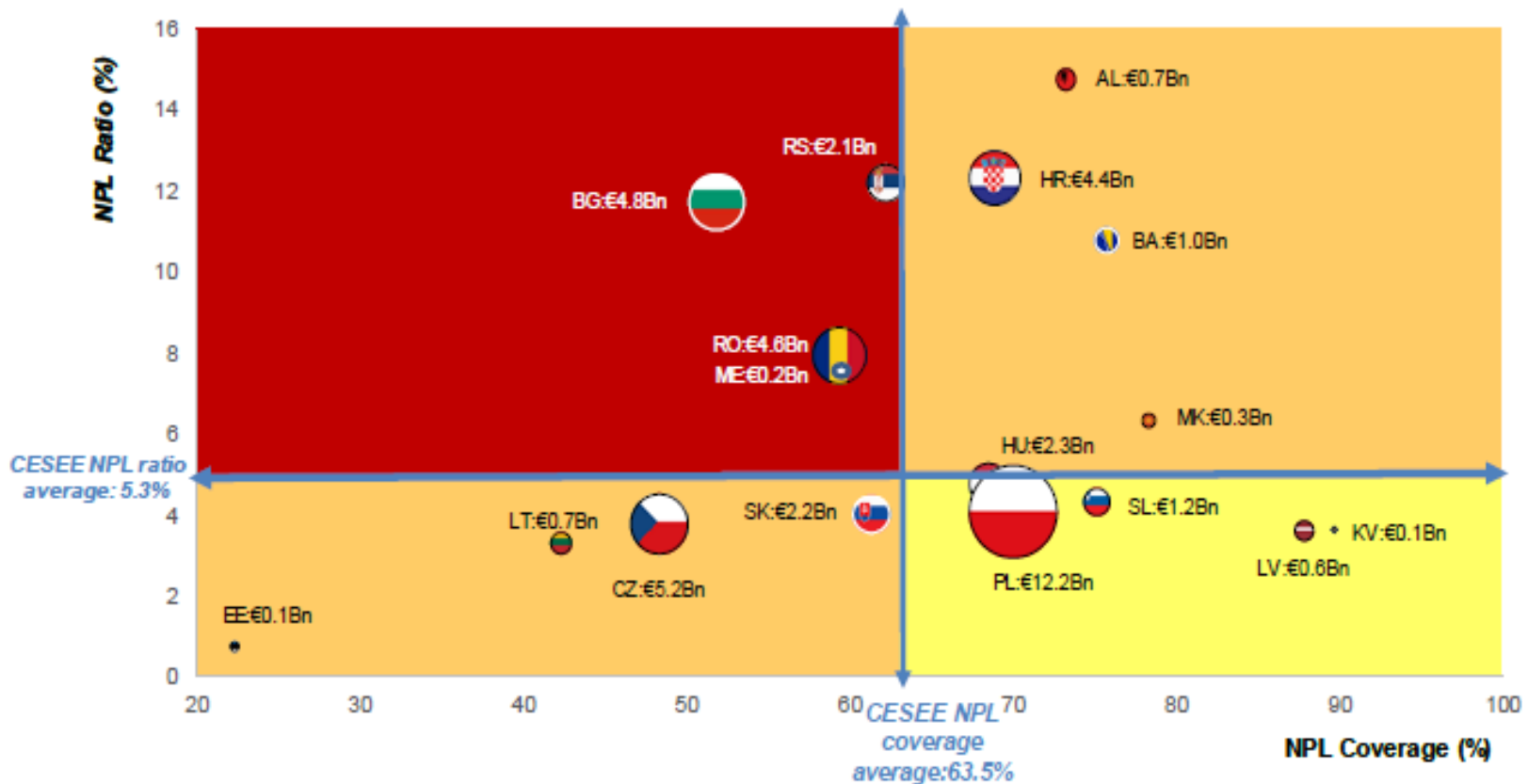


Banking sector developments

NPL ratios are declining and NPL coverage ratios are improving

- All countries in the region are witnessing drop in NPL in recent years
- In 2017 no country recorded NPL ratio above 15%

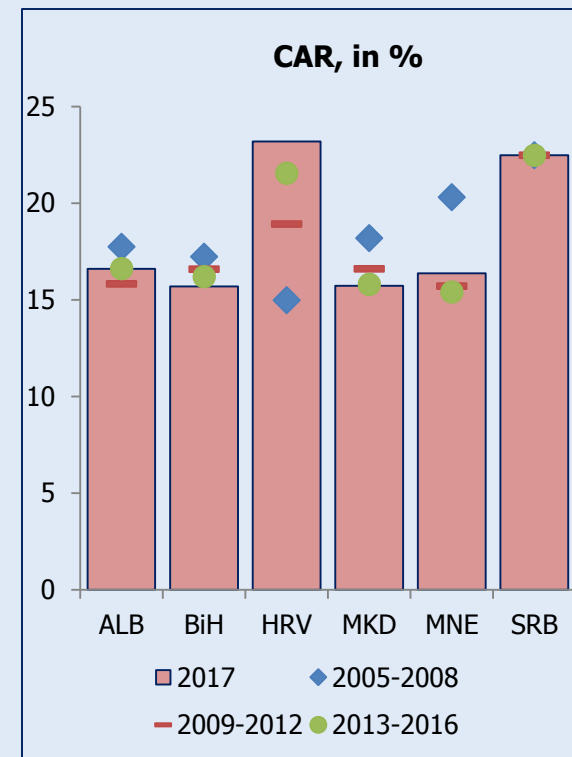
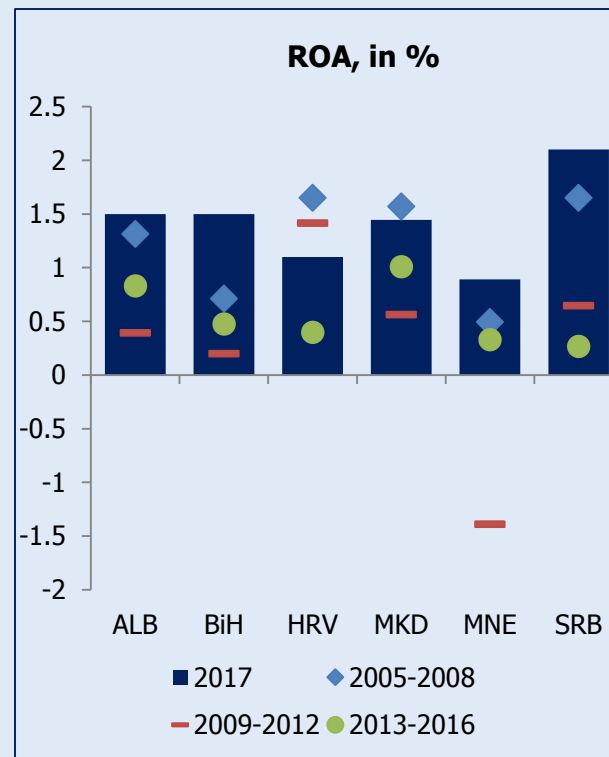
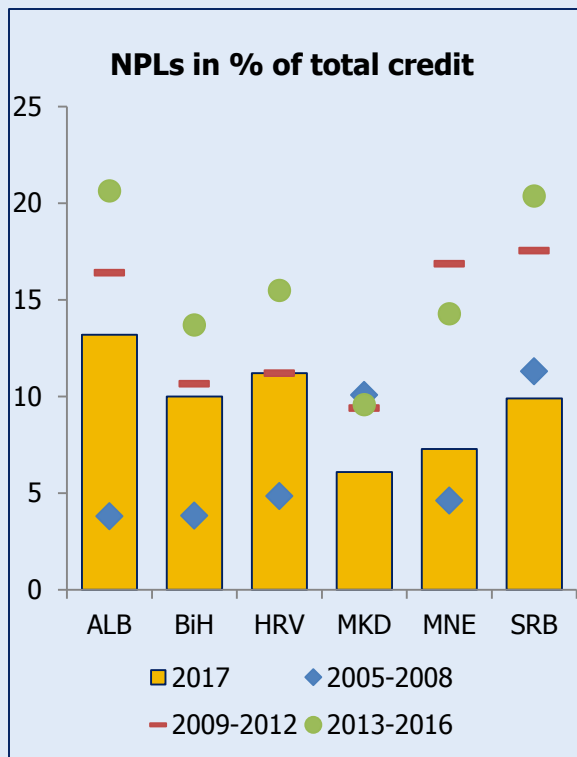
NPL ratio, coverage ratio and volume (% , EUR bn, September 2017)



Banking sector developments

NPLs improvement comes after the peak in the burst of the crisis

- GFC resulted in drop in **profitability**, which is also improving in recent times
- **Capital positions** remained sound and broadly stable

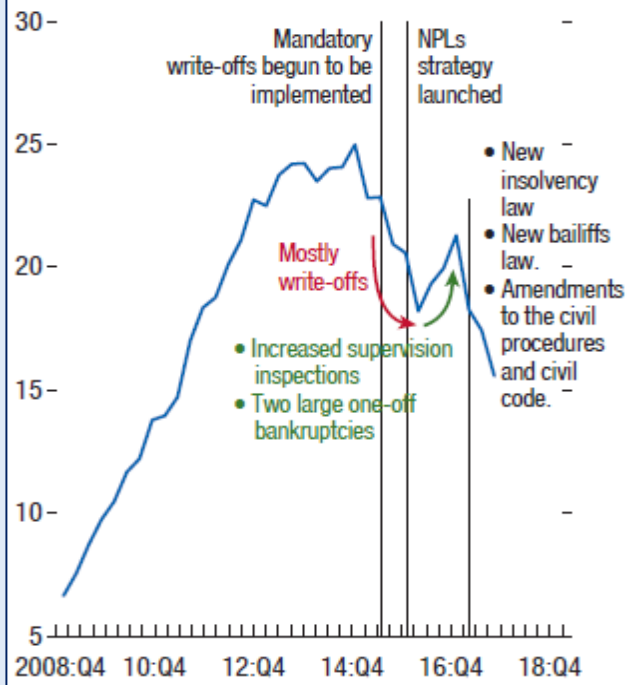


Banking sector developments

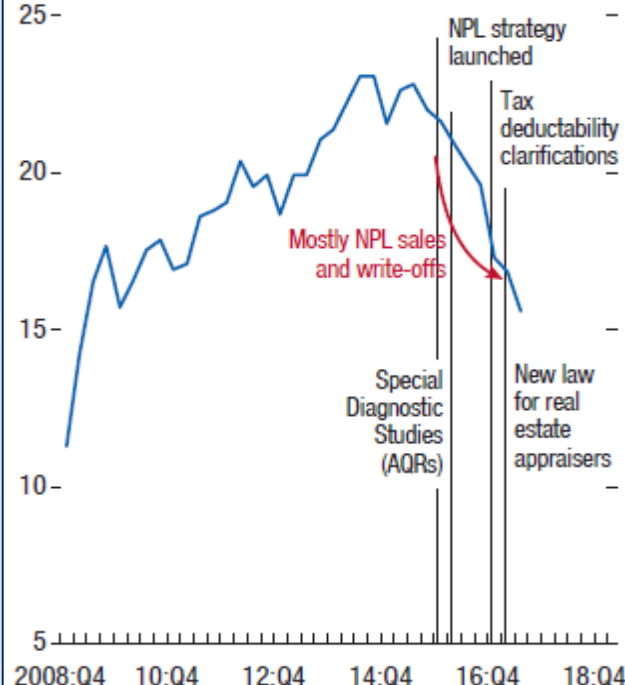
Reduction in NPLs was supported by NPL resolution measures and strategies implemented in the region

- Albania and Serbia implemented comprehensive strategies covering banking supervision, tax issues, court procedures and legal aspects
- Macedonia with relatively lower NPLs in regional comparison – measure for mandatory write-off of loans that were fully provisioned for more than 2 years; Draft NPL resolution strategy

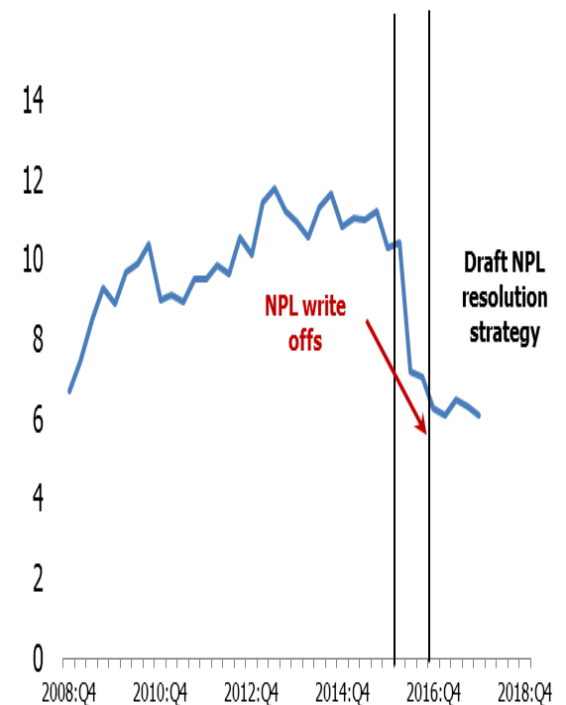
Albania- NPL, in % of total loans



Serbia- NPL, in % of total loans

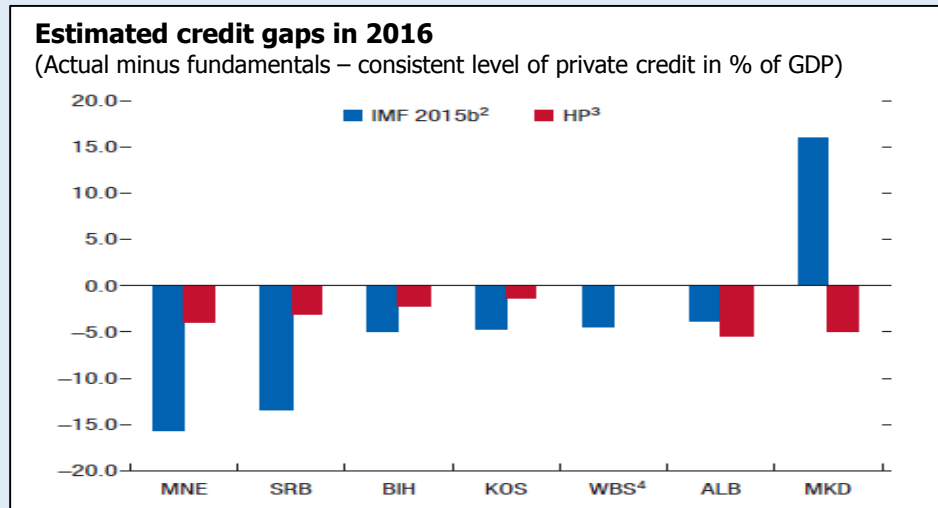
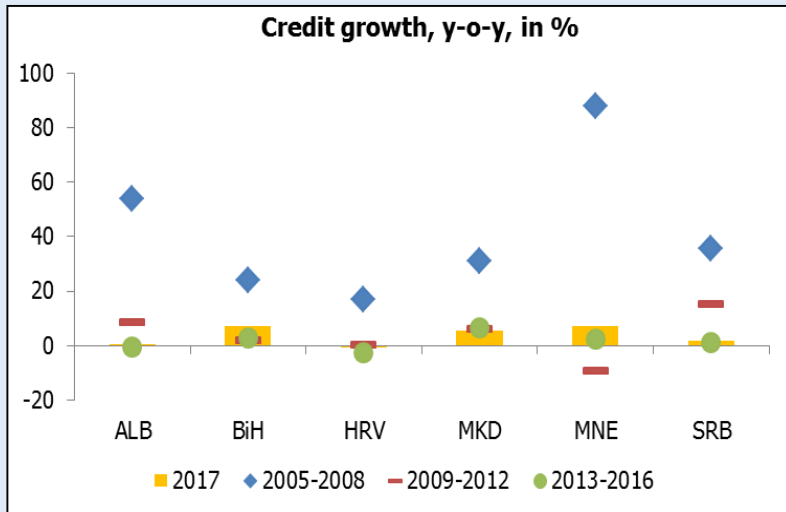


Macedonia - NPL, in % of total loans



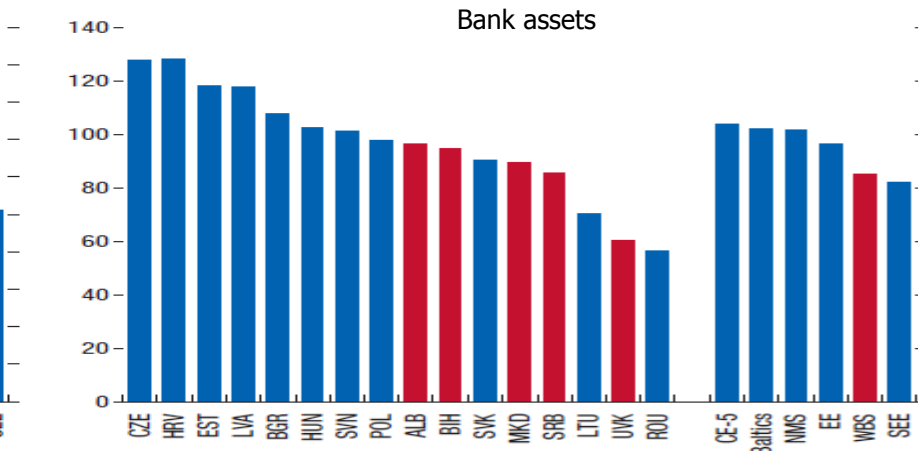
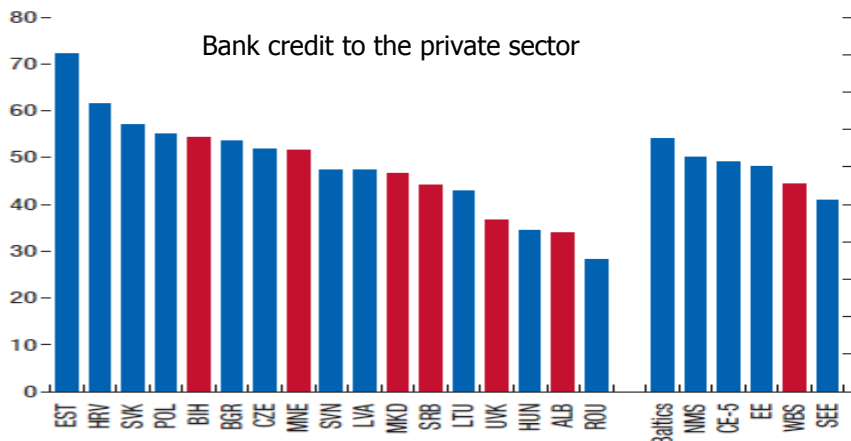
Banking sector developments

- Credit growth has improved in recent years, but still remains timid across the region
- Credit to GDP ratios still below levels predicted by fundamentals
- Financial intermediation levels in the region are relatively low compared to other CESEE countries



Source: IMF, Regional Economic Outlook: Europe, Nov. 2017 and central bank web sites.

Emerging Europe: Financial Depth, in % of GDP, 2016

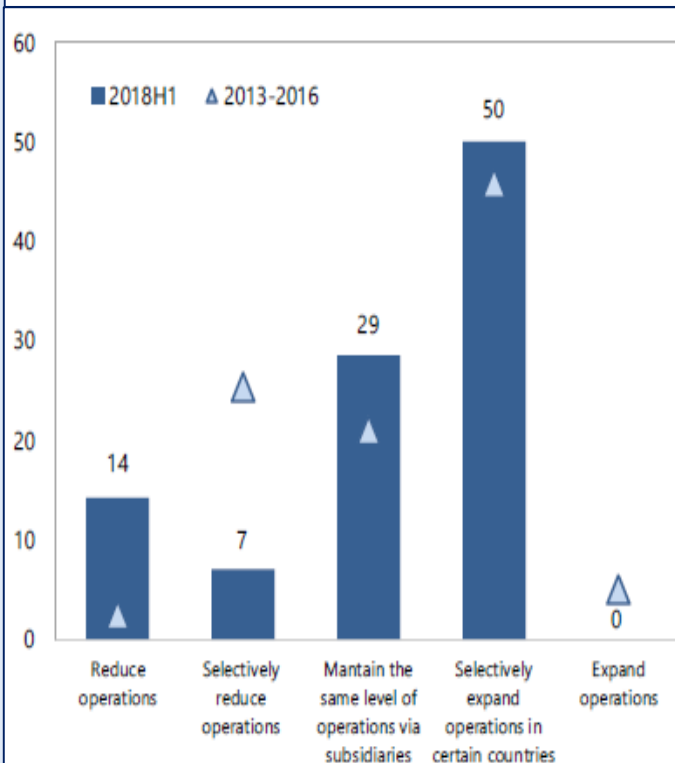


Banking sector developments

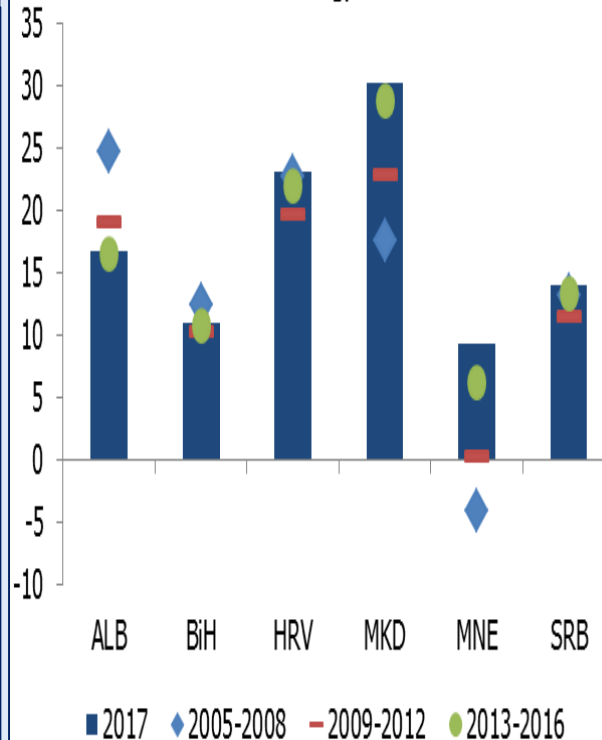
Going forward, expanding the funding base is important factor for bolstering credit intermediation

- Foreign banks see limited prospects in the region
- Region is under significant indirect effects from EU regulatory changes via dominance of foreign subsidiaries
- Stable deposit growth has mitigated decline in foreign funding post crisis – however, further growth is constrained by region's low savings level and low interest rates

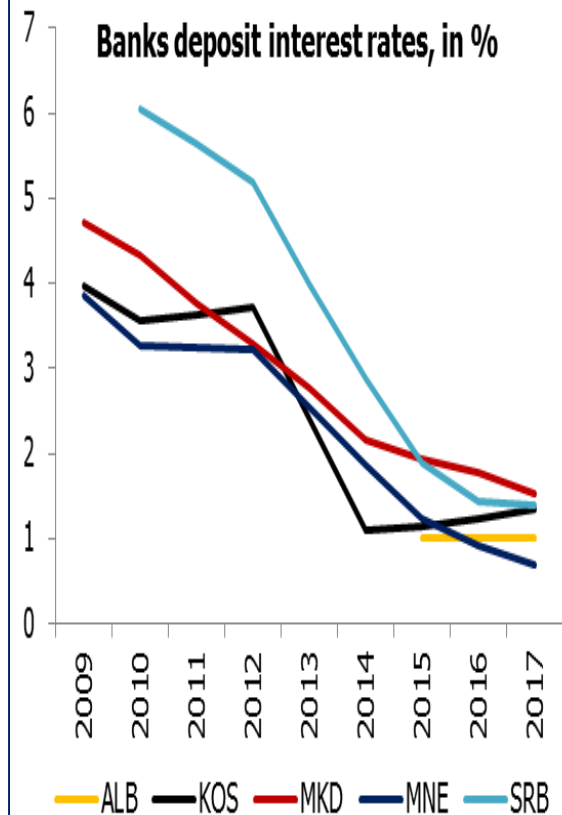
Group level response of long term strategies in CESEE (in %)



Gross national saving, in % of GDP



Banks deposit interest rates, in %

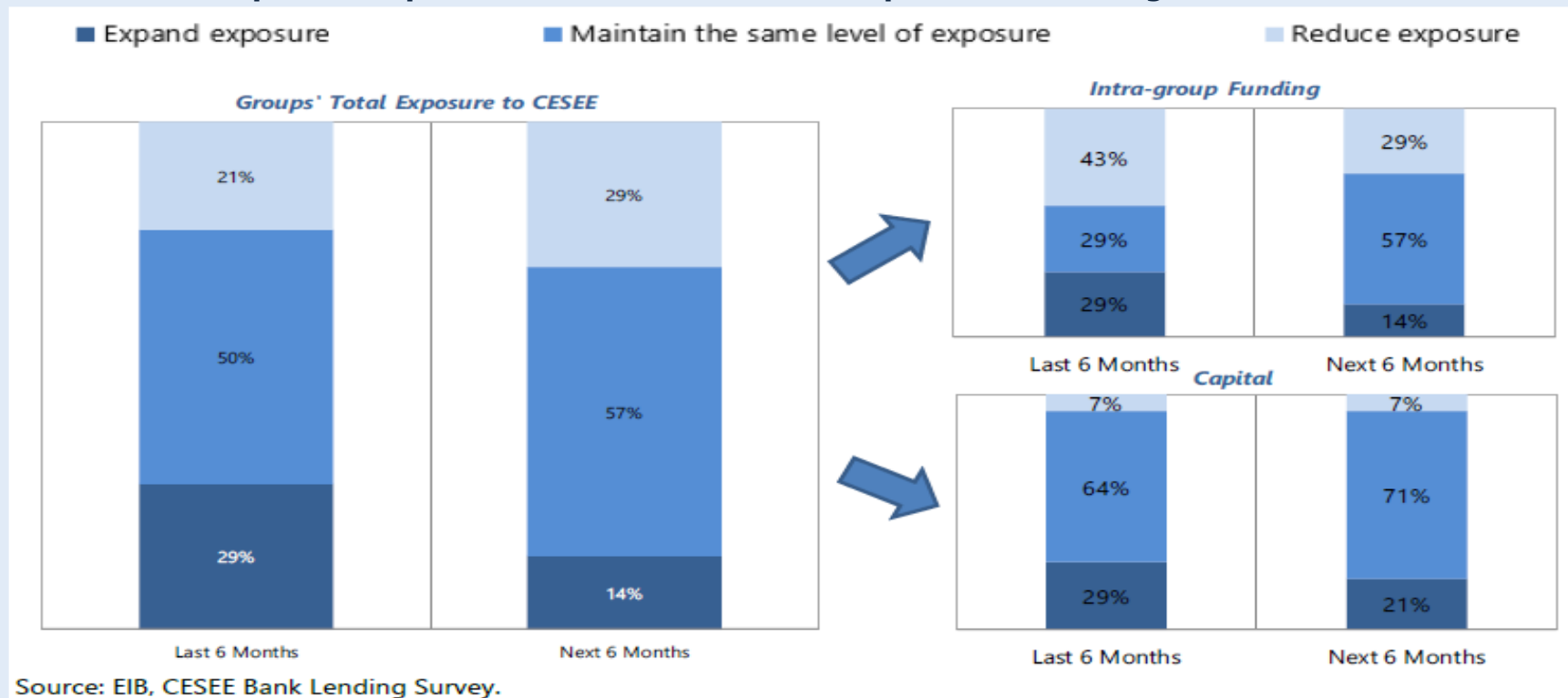


Banking sector developments

The latest EIB Survey points to some positive developments

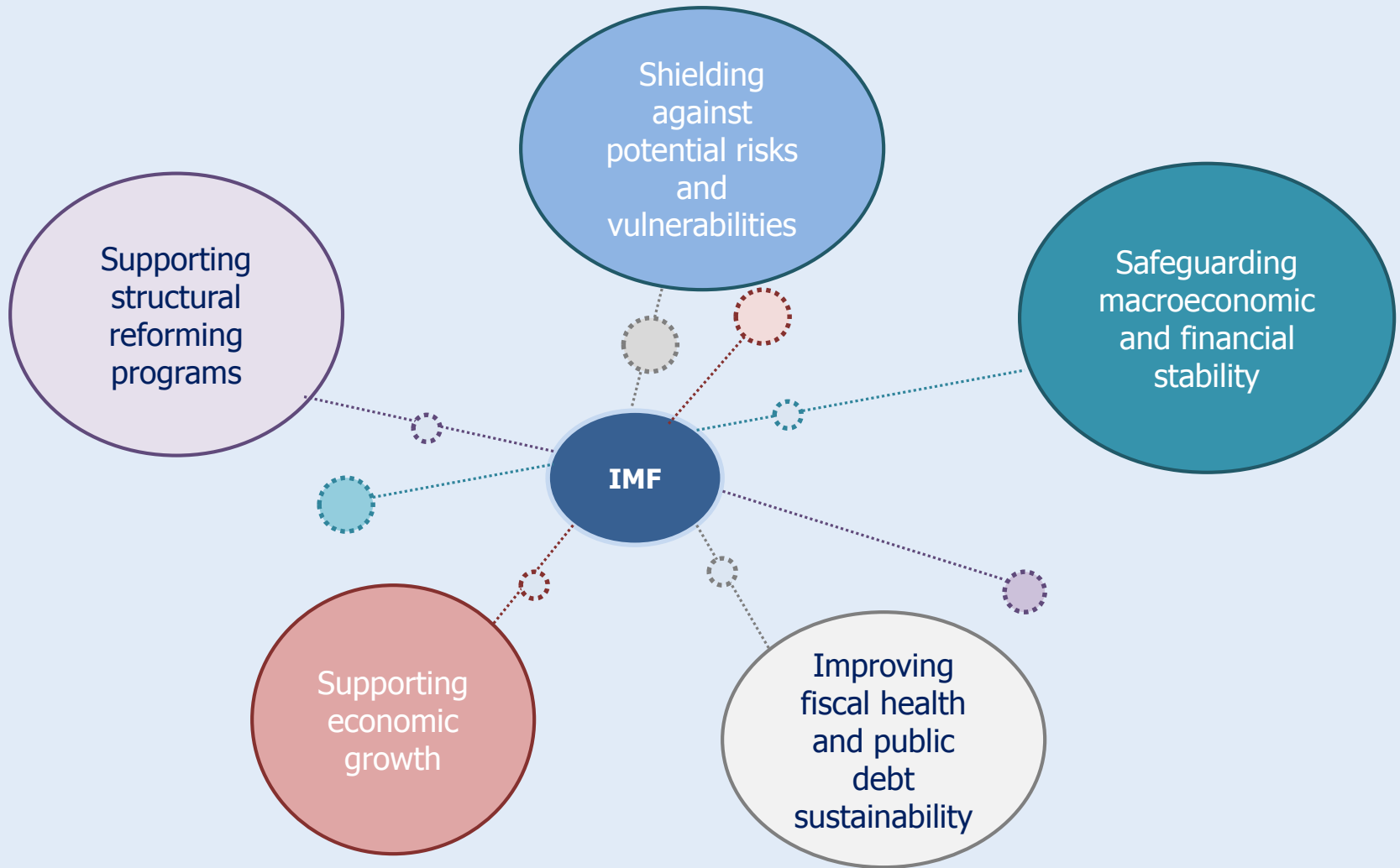
- Total exposure to the region is trending positively over the past six months, for the first time since starting the survey (2013) - fifth of banking groups have reduced their exposure and 30% have increased their exposure to CESEE resulting in positive aggregate net balance

Groups total exposure to CESEE : Cross border operations involving CESEE countries



Comprehensive NPL strategies in countries with still high NPL levels and structural reforms (sound bankruptcy and insolvency regimes, strengthening property rights protection and judiciary systems) could also support faster recovery in credit growth in the period ahead

IMF role in the region

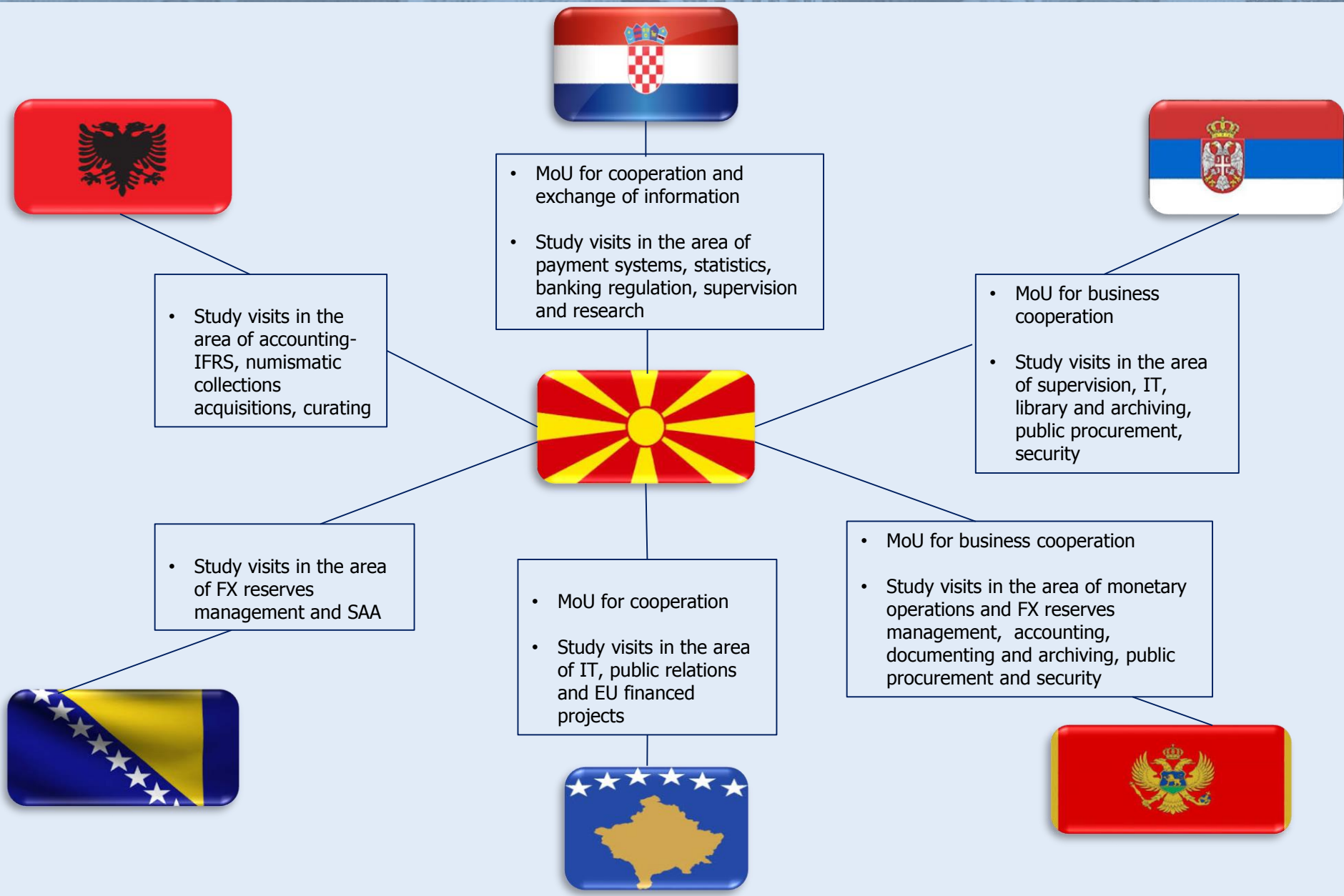


IMF role in the region

IMF arrangements in the region following GFC

	Year of approval	Type of arrangement	Access approved	Goal
Albania	2014	Extended Fund Facility	EUR 330.9 million	Restore economic growth and control rapidly rising public debt
Bosnia and Herzegovina	2016	Extended Fund Facility	EUR 553.3 million	Support country's reform agenda
	2012	Stand -By Arrangement	EUR 631.6 million	Support Government economic program
	2009	Stand-By Arrangement	USD 1.57 billion	Support Government economic program to mitigate negative effects from GFC
Kosovo	2015	Stand By Arrangement	EUR 184 million	Preserve low public debt; lifting economic potential by removing key structural impediments to growth; catalyzing support from other multilateral and bilateral creditors
	2012	Stand By Arrangement	EUR 106.6 million	Support Government's economic program
	2010	Stand By Arrangement	EUR 108.9 million	Restore fiscal sustainability and safeguard financial sector stability
Macedonia	2011	Precautionary Credit Line Arrangement	EUR 475.6 million	Mitigate against potential risks that may rise needs of financing
Serbia	2015	Stand By Arrangement	EUR 1.2 billion	Restoring public finances' health; increasing the stability and resilience of the financial sector; and implementing comprehensive structural reforms, to form a solid foundation for job creation and return to sustained high growth.
	2009	Stand By Arrangement	EUR 402.5 million	Safeguarding macroeconomic and financial stability in view of the global financial turmoil

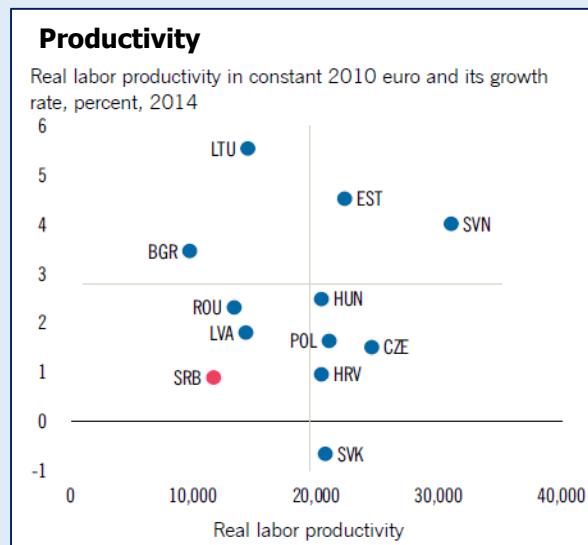
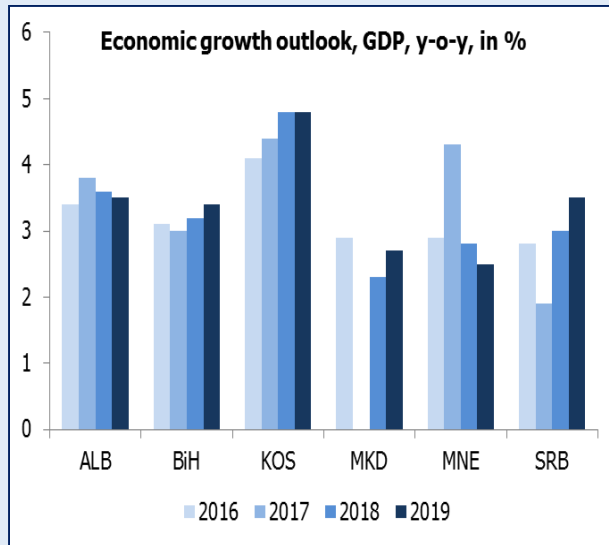
Regional cooperation among central banks



Going forward – Regional Outlook

Generally positive growth outlook

- Externally, main risks related to EU recovery and developments with rising protectionism
- Domestically, political uncertainty may cloud growth prospects if upcoming elections in several countries lead to a slower pace of structural reforms
- Low and stagnant productivity may hamper region's growth potential



Source: World Bank Western Balkans RER, Spring 2018.

- Fiscal consolidations will reduce fiscal risks and ensure fiscal space to support growth enhancing reforms and investments
- Advancement in structural reforms to reduce labor market rigidities and promote private sector development

Going forward – main challenges and uncertainties

GEO-POLITICAL ECONOMICS

Geo-political development

Economic growth path

Centers of gravity for the global economy

Trade patterns and rising protectionism

Energy commodity markets/prices

GLOBAL FINANCIAL MARKETS

Global banking landscape and FDI

Capital markets

Banking regulation

Monetary dynamics – ECB MP normalization

Sovereign debt markets

FINTECH ADOPTION

Payment systems evolution

Financial service innovation

EU AND EURO AREA

EU enlargement appetite

EU and EA consolidation



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