THE WORLD AFTER THE CRISIS: S.E.E. CHALLENGES & PROSPECTS

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ABSTRACT

Two and a half years have passed since the beginning of the financial crisis in July 2007 but the economic crisis it caused is still with us. Regulators counteracted the crisis with drastic monetary and fiscal expansion and are currently designing a stricter and more stable future financial system that would ensure less wild economic fluctuations and, hopefully, no repetition of the adverse events we live today. Over the next decade, as economic and political power shifts to the developing world, global growth will slow down due to higher real interest rates, public and private deleveraging and a natural decline of global imbalances.

The SEE region imported the crisis at the end of 2008 through a sudden shrinkage of capital inflows and a concomitant collapse of export markets, which caused significant output losses and immense pressure in local asset and currency markets. The region was found overheating with rising current account deficits, inflation and huge credit growth, partly financed by foreign inflows. Yet, the SEE financial system proved stable and well capitalized and domestic regulators acted swiftly to avert a total collapse of output. While the recession is coming to an end, it is difficult to see a rapid future expansion without a simultaneous departure from the old demand-driven model of growth.

There is a crying need in SEE for a more balanced growth model and an emphasis on improving the domestic savings rate, shifting demand from consumption to investment, focusing more on export markets and fostering domestic competitiveness and total factor productivity via the rule of law, the quality of institutions, domestic infrastructure, as well as the matching of human capital development and job training with the modern needs of an increasingly globalized world economy. The current crisis can be turned into an opportunity for change.

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Dear Governors, distinguished guests, ladies & gentlemen:

It is my great pleasure to be here today and say a few words on weathering through the world economic crisis in our region. I will begin with the question of whether or not the international crisis is over. Then, I will give you my view on the evolution of world growth and the financial industry over the next decade, as it is important to know the external economic environment before we can make an educated assessment of where our region is going. I will subsequently focus on the South Eastern European region and the effects that the crisis has had so far. Lastly, given the changes that this international crisis has brought on the world economy and the region, I will make some detailed remarks on the required new model of economic development for the region.

1. Is the crisis over? The global view

The international financial crisis of 2007-2009 has been severe. It was caused by a combination of factors that reinforced each other, like the real estate bubbles in various countries, the global underestimation of risk, the proliferation of security products in the US and Western Europe, which were not understood very well by investors, the blind quest for profit at any risk by financial institutions, the remuneration packages of managers, the wrong incentives of the rating agencies, the enormous leverage ratios in the financial sector, or the lopsided use of short term borrowing for long tern investments. The crisis soon mutated into a real economic crisis as bank lending dried up and fear and risk aversion prevailed in all counterparty dealings. The financial crisis, especially after the collapse of Lehman Brothers in October 2008, mutated to the so called "Great Recession" globally. The collapse of international trade and the increased risk aversion of investors also affected the SEE region at the end of 2008.

In the last seven months, thanks to the previous drastic intervention of governments, central banks and international organizations, we have managed to escape a major collapse of the global financial system. The injection of ample liquidity by the monetary authorities resurrected the interbank market, which is almost back to normal. The private bond market is revived, Merger & Acquisition activity is up, and the international stock markets have already discounted a recovery of the global economy and future new profit opportunities.

A flavor of the near-collapse and revival is provided by the figure on how much more expensive it is for banks to borrow for three months relative to the government. Those spreads jumped up when the crisis began in August 2007, and skyrocketed after the collapse of the investment bank Lehman Brothers, but are now even smaller than the period before June 2007 (Figure 1).

A corresponding flavor of the collapse of the economies is provided by the figure describing the almost universal large negative growth of GDP in the second quarter of 2009 (Figure 2). And a flavor of how drastic was the response of the authorities is visible in the two major central banks' rapid increase of their own balance sheets (Figure 3), as well as the governments' new higher debt levels (Figure 4).

Yet, is the crisis over? And should we proceed with business as usual, rendering the crisis as a bad nightmare? The answer is a clear no. First, even though the collapse was avoided, the markets themselves are not convinced the crisis is completely over. For example, the credit default swap spreads for lending to major banks, although a lot lower than in March 2009, are not yet at their pre-crisis low levels (Figure 5). Second, the global recovery is sluggish and depends critically on governments and central banks maintaining their support. Third, the crisis has changed many fundamental parameters driving the world economies. It caused a big structural break on the evolution of the financial industry, on consumer behavior, on economic relations among nations, on the free market ideology and on government behavior. The next decade will be a period entirely different from the decade that preceded the crisis. I come to this point next.

2. The future of the global economy

We are facing a new world order ahead. Global economic growth will slow down, political power will shift towards Asia and the G-20, and the regulatory authorities will have the upper hand, with the Financial Stability Board and the IMF playing an important role. The G-20 regulatory decisions will affect banks in a fundamental way, raising the cost of capital. In my view, Wall Street will counter attack with plenty of money and political

influence. Yet, I am optimistic that we will end up with a more stable world financial system, which would help reduce the size of the global economic fluctuations.

The structural break on the evolution of the world economies comes from many sources. The first and major source is real interest rates. Credit risk will be higher in the future, implying higher required rates of return on all risky investments. The credit default swap spreads I showed you earlier will not decline to their June 2007 level. Financial markets will price risk in a more rational way. Bank intermediation will become more costly, which would naturally be passed on to bank customers in the form of higher lending rates. The higher government debt levels also imply bigger competition with the private sector for borrowed funds, pressuring interest rates up. And of course, over the next three years, as the economies gradually recover, the central bank intervention rates will go back up to more normal levels. All these will take place, in an environment of subdued inflationary pressures.[1] Hence, all factors point to permanently higher real interest rates, an economic force that goes against current consumption and, especially, investment.

A second force against global growth originates from the rapid rise in sovereign debt. It implies that in the future, say 2-3 years ahead, governments will start a process of de-leveraging, gradually generating fiscal surpluses to pay back for today's deficits. In a sense, we avoided a more permanent collapse in economic activity by trading off today's rapid fiscal expansion for tomorrow's lower but longer fiscal contraction.

A third force is the anticipated reduction of global imbalances. The American household is expected to increase its savings rate, thus reducing consumption. It follows that exports of third countries to the US will not follow the rapid growth path of previous years. The growth of global aggregate demand will decline, because – in my view - the American gap cannot be easily filled by the Chinese, Indian, or European consumer.

The global financial landscape is also expected to change in the future. The task for regulators is to increase global financial stability without hurting the good side of the

[1] Some economists are worried about the huge increase in central banks' balance sheets (Figure 3) and forecast high future rates of inflation, fearing an inability of the central banks to withdraw – when the time comes - the liquidity they provided. I do not share this fear, as deflation risks still outweigh the inflation dangers. Once world growth recovers, it would be straightforward to withdraw the excess liquidity.

banking business, which promotes healthy and needed financial intermediation. Yet, if onerous restrictions were to be imposed on banking, then a new wave of deregulation would be unfolding, which would appear optimal in the distant future as the memory of today's near-collapse fades.

In the process of re-regulating the global financial system, regulators ought to observe two main principles. First, it is important to establish a cross-country level playing field among financial institutions. This seems to be understood by the G-20, as they promote identical accounting standards and common restrictions on liquidity and leverage. Unilateral restrictive decisions by individual country regulators, which may appear to be working in the short-run, will hurt their banking systems in the long-run as financial capital is highly mobile.

Second, regulators ought to not lose sight of the fact that capital is costly, at least to banks if not to society. This is perhaps less appreciated by the floating initial rough proposals on countercyclical capital buffers or the need for quality capital, i.e. a larger stock component in capital adequacy rules. All these proposals are in the right direction but should not neglect the fact that often the same economic benefit could be accomplished with fewer regulatory restrictions. For example, instead of requiring banks to issue more equity during an expansion, regulators could force them to issue debt convertible to equity if a crisis were to occur. Alternatively, restrictions could be imposed on loan-to-value ratios (i.e. the size of collateral required) for extending loans to households and/or companies and on margin requirements on the loans used to buy stock, but surprisingly, I have not seen much discussion on these issues. Yet, the historical evidence suggests a strong procyclical behavior of the collateral demands of financial intermediaries, as they loosen their criteria in economic expansions and make them more stringent in economic contractions, thus amplifying the fluctuations of the business cycle (Figure 6).

3. Crisis arrival finds the SEE region in an unbalanced growth path

South Eastern European economies were growing fast at the time the crisis hit. The real estate market was booming. Foreign direct investment (FDI) was flowing into the

region at unprecedented rates. The countries were on a quick path to real convergence with the living standards of Western Europeans. Then, the region was hit hard by a sudden shrinkage of capital inflows and a concomitant collapse of export markets, which caused significant output losses and immense pressure in local asset and currency markets. Figure 7 shows the sudden stop in capital inflows and Figures 8a and 8b the huge decline in trade flows in 2008:Q4.

The economic climate in the region worsened abruptly as international investors woke up to the realization that the earlier fast growth of the region was unbalanced. The large current account deficits reveal that aggregate demand was rising faster than aggregate supply (Table 1), something that was known at the time but was ignored. Credit expansion prior to the crisis was huge too (Table 2). Financial activity with easy and low interest loans to households and corporations – and a lot of it in FX – had given a large push to economic activity prior to the crisis.

Yet, compared to the Baltic States, credit did not reach unprecedented levels and the region did not become as vulnerable to credit expansion (Figure 9). Actually, the crisis prevented further overheating. It stopped the credit bubble with a sharp knife relatively early. Had the crisis occurred with a delay of one or two years, the landscape would have been a lot more dramatic, as imbalances would have grown even larger. The debt burden would have been bigger, perhaps unmanageable. A collapse in financial and real activity would not have been avoided. Just observe today the unraveling economies of the Baltic region to get a sense of what could have happened.[2]

4. Stabilizing forces in the SEE region

In view of the sudden stop in capital inflows and the collapse of export markets, two forces prevented the complete collapse of output in the region. The first was the strength of the domestic financial systems. With the exception of Turkey, in most other SEE countries

[2] There, the credit bubble was bigger and it was stopped a year before the international crisis hit the SEE economies. It was the Scandinavian banks themselves, which were fearful of the bubble getting bigger and bigger and stopped providing more credit. They knew better from their own banking crisis in the early 1990s.

foreign banks have a dominant presence (Figure 10). The major foreign players are the four Greek banking groups (NBG, Alpha, Eurobank, Piraeus) plus seven additional banks, two Italian (Unicredit and Intesa San Paolo), three Austrian (Erste, Reiffeisen, Hypo Alpe Adria), one French (Societe Generale) and one Hungarian bank (OTP). Their asset exposures to the SEE economies vary from 31% for Hypo Alpe Adria to 1.7% for Societe Generale.

The foreign banks present in the SEE region turned out to be prudent banks. They had not invested in toxic assets. Twenty eight months after the eruption of the financial crisis in July 2007, this is transparent in the history of capital write-downs. Europeans banks wrote off €320 billion thus far[3], but very little of that amount originates from banking groups with a strong presence in the SEE region (Table 3). These losses were covered with capital increases. Also, very few banks involved in the SEE region suffered large overall losses from their global activities. From the previous 11 key player-banks in the SEE region, only Societe Generale had a global write-down of $8.8 bn and ranks 13th among the 59 European banks with losses. Unicredit suffered a $4.4 bn loss and ranks 22nd. Both banks have small asset exposure to the SEE region. A n additional point of strength is that banks in SEE enjoy adequate capitalization (Figure 11). The capital base in Serbia, in particular, is unusually strong. Simple capital-to-assets ratios are much stronger in SEE than in the EU-15 (Table 4).

The second force that prevented a bigger collapse of the real economies in the SEE region was the prudence of domestic regulators. Prior to the crisis, regulators had insisted that their banks be well capitalized, especially in Serbia and Turkey. And the response of regulators to the crisis was quick. The minimum deposit insurance was raised, the minimum reserve requirements were relaxed, central bank intervention rates declined, foreign banks were brought out of their cocoon to sign the Vienna initiative for Romania and Serbia, the IMF and other International organizations were brought in to support lending. Serbia, in particular, was the first country to quickly secure €3 billion of IMF funding.

[3] The losses came from a variety of sources, loan charge-offs and provisions (20%), non-mortgage asset backed securities (13%), monoline insurers (10%), CDOs (8%), subprime RMBSs (8%), and other.

5. Can the SEE region be pulled out of the recession soon?

Growth is expected to be sluggish in 2010. Since the middle of 2009, there is a ray of recovery hope in Europe and New Europe, in particular. Local currencies have recouped a significant part of their earlier losses and most economies in the region are now expected to record positive, yet substantially below-potential, rates of growth next year. The pace of steep output declines in SEE, which was experienced earlier this year, is now slowing down, and most economies in the region will likely see a return to positive growth in 2010 (Table 5). Nonetheless, the recovery will be slow and lagging behind other emerging economies in Asia and Latin America.

The road to recovery is likely to be accompanied with a forced correction of imbalances. Current account deficits are already correcting more rapidly than previous expected (Table 6). Inflation continues its downward trend without turning into deflation, unlike in the Baltic region, where deflation is expected in 2010 (Table 7). As economic activity is expected to remain below potential in the quarters ahead, inflationary pressures are likely to stay subdued.

In view of the present uncertain international economic environment, it is rather early to assert that a sustainable economic recovery is assured. Consumers continue to face plenty of headwinds with devaluation pressures threatening their cash obligations to banks (a lot of which is in foreign currency, see later Figure 17), while further increases in unemployment are expected as businesses continue to seek cost savings and maintain cautious hiring policies at a time when the road to a sustained economic recovery looks long and bumpy. Besides uncertain job prospects and slow income growth, tight credit conditions, higher oil prices and the expiration of the 'cash for clunkers' programs in a number of major economies all present serious headwinds to the global economic outlook.

Concerns today are focused on the fiscal front. Fiscal deficits are becoming a major source of vulnerability. As has been the case with many developed economies, public finances are deteriorating rapidly in many countries in SEE (Figure 12). The economic downturn is taking a heavy toll on tax revenues at a time when most governments are striving to pursue prudent fiscal policies in order to secure the disbursement of much

needed funds under the present loan arrangements with international monetary organizations. While Turkey and Bulgaria are still pondering on the necessity of financial assistance from the IMF, Hungary, Ukraine, Iceland, Latvia, Serbia and Romania are currently under the Fund's umbrella. Yet, government debt levels in the region remain low and in most countries recorded a decline from 2003 to 2008 (Figure13).

We should not expect the financial sector to pull the countries out of the current recession. Prior experience in the more developed western world shows that credit expansion lags the economic expansion. During a recession, it is the economy that drives credit, not the other way around. For example, in 9 out of 10 previous US post-war recessions, real personal consumption has rebounded three quarters earlier on average than consumer credit growth (Figure 14).

There are two major problems that constrain credit expansion in the SEE region. The first is liquidity. In the past, with the exception of Albania and Turkey, loans exceed deposits in the SEE countries (Figure 15). Lots of bank liquidity came from abroad as domestic deposits were unable to support by themselves the large expansion in credit growth. Nowadays, new liquidity is hard to come from abroad. Thus loan expansion requires domestic policy action, like reducing reserve requirements, utilizing the ample assistance of the IMF, capital increases in state-owned banks, increasing the minimum insurance on bank deposits, etc. Indeed, the SEE authorities took many of those measures in order to release new credit to households and enterprises.

The second constraint to loan expansion is the fear of borrower default. The experience with the business cycle in the West shows that non-performing loans (NPLs) rise as the recession progresses and peak after the end of the recession. NPLs are thus expected to reach very high levels in 2010. Indeed, NPLs keep rising, but they are still not as high as in the Baltic region (Figure 16). Note that the large FX exposure (Figure 17) increases the vulnerability to NPLs. And large devaluations are not out of the question. The currency board in the Baltic States may easily come under attack, as markets today consider it unsustainable. Bulgaria's currency board is also likely to come under pressure in 2010. In general, large devaluations increase the burden of households and companies that have borrowed in FX and can lead to bankruptcies. Along the same lines, a country's external debt can also turn problematic in the case of a large devaluation. Gross External

Debt is smaller than in the Baltic States (Figure 18), yet currency, interest rate and rollover risks are amplified in its presence.

Financial markets are recovering and stock markets have rebounded strongly from their March 2009 lows in line with world markets. Sovereign and credit spreads are significantly lower compared to March highs. Furthermore FX-volatility has subsided and the IMF has lately become more flexible with respect to country fiscal targets in their stand-by loan agreements. Today, sovereign spreads are almost at pre-Lehman levels but nowhere near the low levels that we witnessed prior to the outbreak of the crisis in June 2007 (Figure 19). In my view, SEE sovereign spreads still have room to decline towards a lower equilibrium level. However, this equilibrium, will remain higher in the future than it would have been had the crisis not occurred. In other words, the crisis is expected to leave its lasting mark on the risk premia of the SEE economies as well as the advanced economies, as I explained earlier in Section 2.

6. Looking ahead: A new economic model for the region

Over the last few years, citizens living in the SEE region saw their standard of living improve significantly relative to the average living standard in the Euro Area (Figure 20). Especially impressive is Serbia's performance, in view of its late start. Yet, this convergence may have now come to an end. The international financial crisis exposed the growth model's weaknesses: Too much emphasis on the non-tradable sector of the economy, on an over-leveraged private sector, on consumer demand and on real-estate development.

There is a crying need for a more balanced growth model in the years to come. Emphasis should be given on improving the domestic savings rate, shifting domestic demand from consumption towards investment, focusing more on export markets and fostering domestic competitiveness and total factor productivity (TFP). Numerous past academic studies have shown that TFP benefits from the rule of law, the quality of institutions and domestic infrastructure, as well as the matching of human capital

development and job training with the modern needs of an increasingly globalized world economy.

A critical point for the success of the long term recovery of the region is the additional emphasis that must be put on exports. In 2008, exports of goods and services as a percentage of GDP were around 30% for most economies of the SEE region, showing an increase since 2003. At the same time though, imports, whose share of GDP is higher than that of exports in every economy of the region, also increased in almost all countries. Imports seem to have expanded by more than exports (Figure 21).

Shifting domestic demand from consumption to investment (Figure 22) will help reduce external deficits in the long run and set solid foundations for future growth. The need to promote investment must be emphasised. Policy priorities must be set. For example, upgrading the infrastructure (ICT, Power, transportation, etc) is a top fiscal priority for SEE countries (Figure 23). Investment in infrastructure is also critical for improving productivity and boosting competitiveness.

Improving the quality of institutions is an important component of the effort to change the structure of the SEE economies. According to the various rankings (Table 8), SEE economies, when compared with Central Eastern European economies and the Baltic States, have made significant progress. According to the European Bank for Reconstruction and Development rankings for Financial Sector Reform, SEE economies have shown progress, even though still lagging behind. The same holds true for corruption and competitiveness rankings.

One of the most useful indexes gauging competitiveness performance is the "Ease of Doing Business" reports of the World Bank. In my view, their rankings are the most useful because they take pains to compare similar firms and households across countries. Also, instead of surveys, they use actual data that they get from insiders, e.g. how many days does it take to attain all necessary licenses to start a new business. SEE economies have shown an improvement in these rankings, which reflects their efforts to become more business friendly and attract FDI (Table 9). Some SEE economies, persistently every year, rank among the top ten reformers. Table 10 presents the sources of their improvement in the various categories of the Ease of Doing Business rankings.

Of course, the specific growth prescription can vary from country to country as the comparative advantages differ across the region. In the future, policy makers ought to be focusing more closely on the supply characteristics of their economies, while simultaneously ensuring macro-economic stability. Fiscal and monetary policy prudence should be accompanied by an environment of economic and financial stability and low rates of domestic inflation, factors which are closely watched by the IMF, rating agencies, fund managers and Greenfield investors. If achieved, they result in low real interest rates, low risk premia and significant FDI inflows.

A source of optimism on the future of SEE economies is the powerful policy anchor which a future EU/EMU entrance brings. Indeed, achieving EU and/or EMU membership implies a degree of discipline in economic policy making, which transcends the usual political business cycle and forces civilians and politicians to follow prudent macroeconomic and structural policies. In Serbia, for example, the EU Stabilization and Association Agreement was implemented unilaterally by Serbia and has served to modify the negative consequences of the international crisis in the country.

7. Conclusion: A new beginning ahead

The international financial crisis of 2007-2009 was severe and was caused by a combination of factors that reinforced each other. The crisis soon mutated into a real economic crisis and led to the so called "Great Recession" globally. The collapse of international trade and the increased risk aversion of investors affected the SEE region at the end of 2008. The crisis caused pain everywhere but also represents an opportunity for a new beginning.

Indeed, two and half years after July 2007, the crisis proves to have sparked the seeds of a new beginning. Regulators across the world are designing a regulatory framework, which promises to deliver future financial stability and thus a better environment for more stable economic growth. A new global financial architecture will trade off the benefits of long-run stability against a higher cost of financial intermediation.

Yet, global economic growth is bound to suffer from higher real interest rates, a process of deleveraging of the public and private sector, or a rebalancing need of the global consumer, with the Americans and the SEE citizens improving the savings ratio and reducing their consumption ratio.

The SEE economies were lucky not to host adventurous banks. Nevertheless, they imported the crisis through a sudden collapse of capital inflows and export markets. The crisis caught the region overheating and caused credit expansion to stall. Domestic deposits are insufficient to support credit growth and new liquidity was hard to come from abroad. Fears of borrower default are strong even today. The SEE economies avoided a bigger collapse only thanks to their strong financial systems and their strong capital cushion and thanks to the quick response by regulators, as governments and central banks took initiatives to strengthen lending. Of course, liquidity and NPLs are major concerns for banks that inhibit them from aggressively supplying new loans. The past business cycle experience shows that the recovery in lending will follow the recovery of the economies, as risks decline and loan demand by healthy borrowers returns.

The current SEE recession and the forced correction of external imbalances carry a hidden benefit. They persuade policy makers to abandon the old demand-driven growth model and switch to a more balanced approach. This new approach requires an increased emphasis on improving domestic savings, investment and exports. Fostering domestic competitiveness by setting policy priorities, such as upgrading the infrastructure and improving education and the quality of institutions, promises new future growth opportunities. Entrance into EU and/or EMU will play an important anchoring role to political and policy decisions, increasing discipline in economic policy making and forcing prudent macroeconomic and structural policies.

Ladies and gentlemen,

As we look ahead to the future, despite the evident risks, we can see new opportunities for healthy financial systems, a more balanced growth path and rising living standards for our citizens. It is time to turn the crisis into an opportunity for change. Thank you for your attention.

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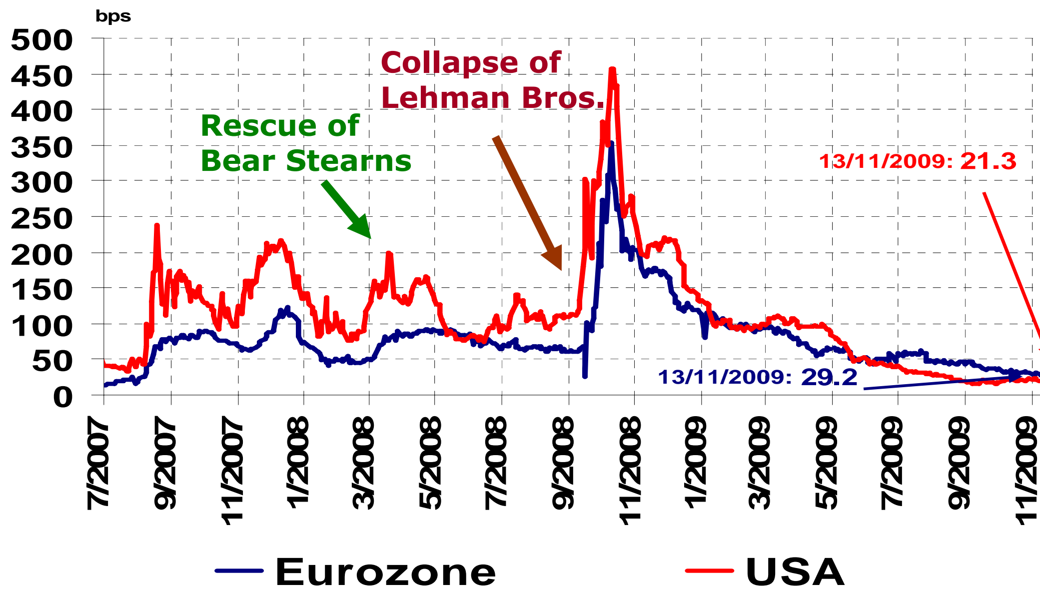
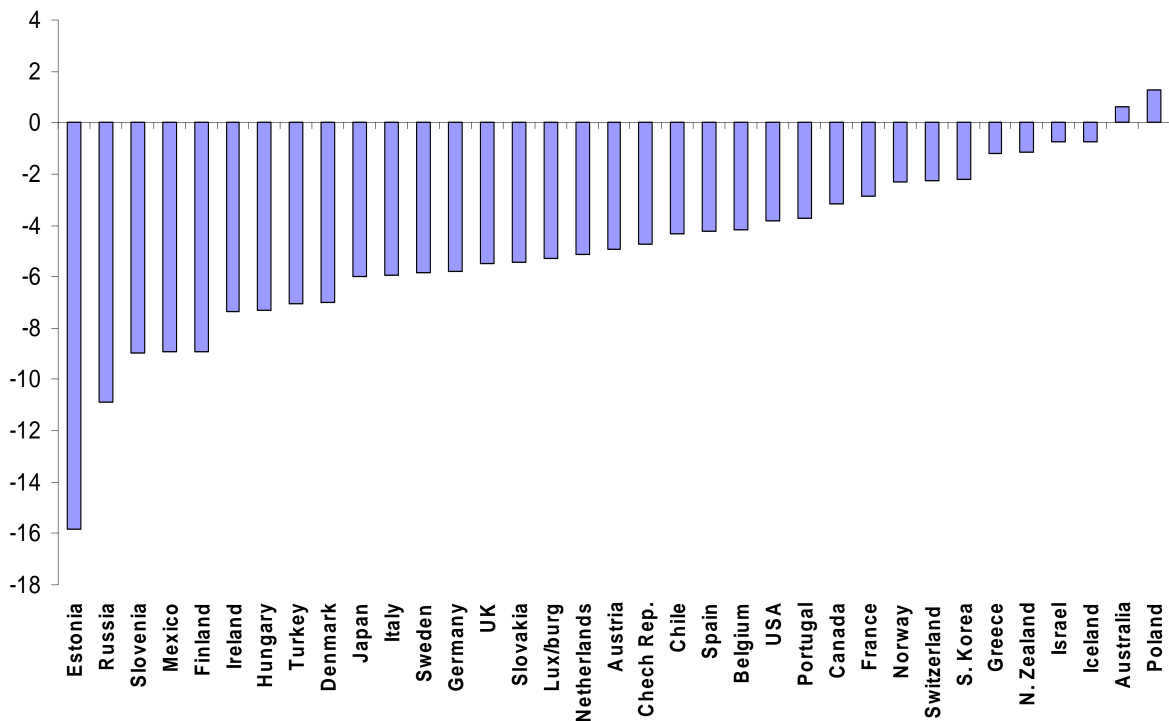
Figure 1.
TED spread & 3m Euribor – 3m Euro Area Tbills



Note: The spreads contain a risk premium plus a flight –to-quality premium in the US and the Euro Area. They are expressed in basis points
Source: Bloomberg

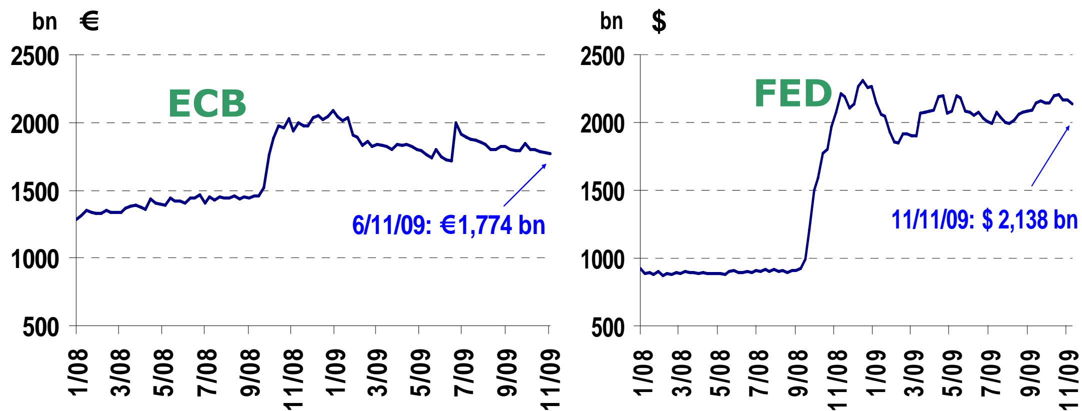
Figure 2.
Real Output growth, 2009:Q2



Note: Growth rate compared to the same quarter of previous year, seasonally adjusted.
Source: OECD

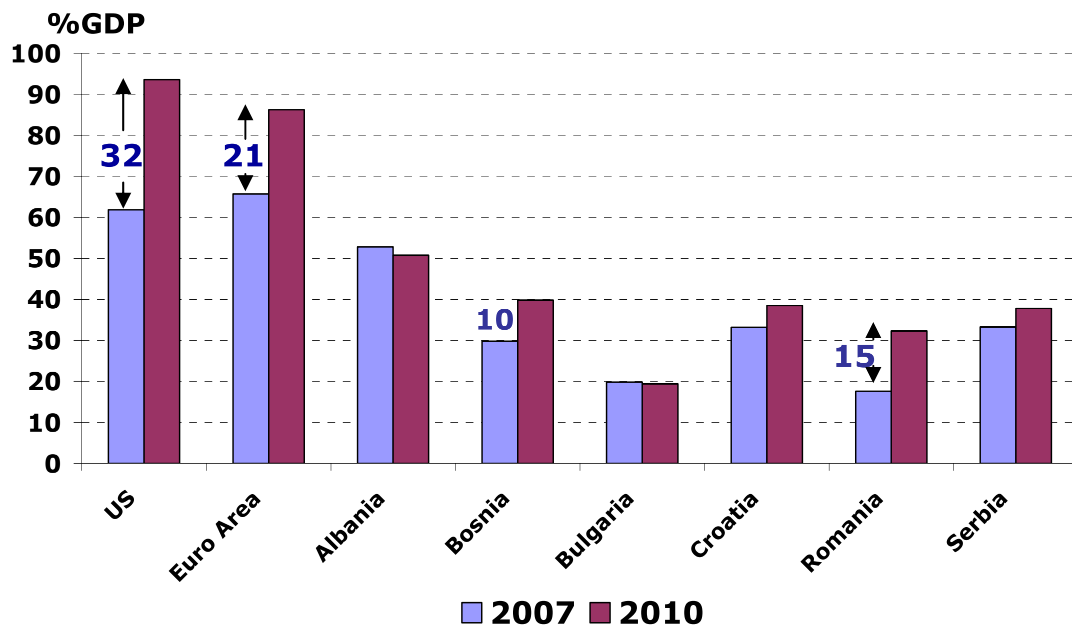
Figure 3.

Central bank balance sheets



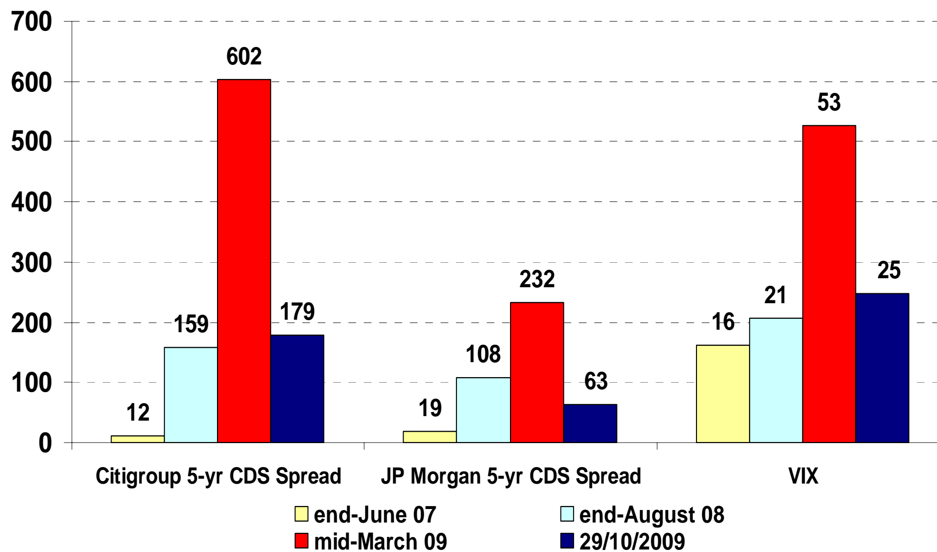
Note: The expansion a central bank's balance sheet implies it has bought (typically) securities by printing new money.
Source: ECB, Federal Reserve

Figure 4.
General Government Debt
(%GDP)



Note: The numbers inside the bar charts reflect the change in the ratio from end-2007 to end- 2010. The numbers for end-2010 are forecasts.
Source: IMF

Figure 5.
Is the crisis over?
Market perceptions of credit risk and stock market volatility

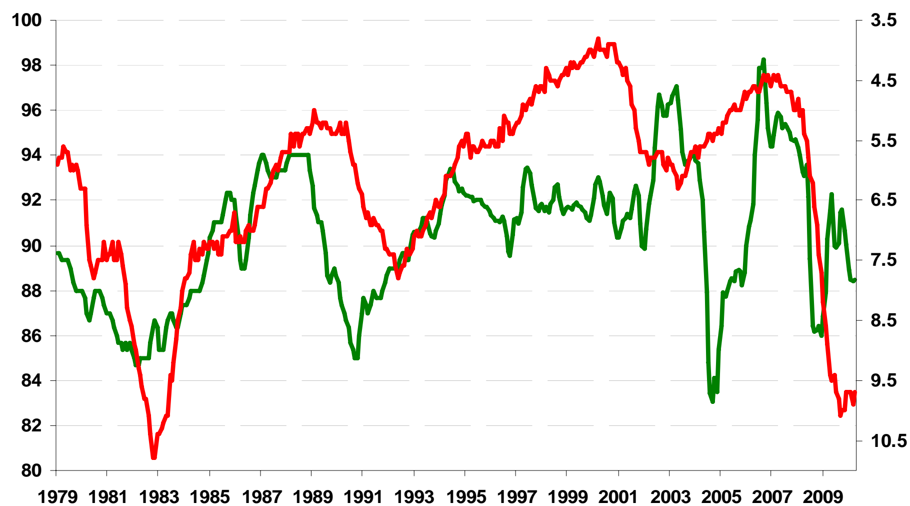


Note: The 5-year credit default swap rates are expressed in basis points. The number 179 for Citigroup at the end of October 2009 means that insurance protection for a $10 million 5-year loan to Citigroup costs 179 thousand dollars per year for 5 years. The VIX index is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. It is a weighted blend of prices for a range of options on the S&P 500 index. It is quoted in terms of percentage points and translates, roughly, to the expected movement in the S&P 500 index over the next 30-day period, on an annualized basis. For example, if the VIX is at 15, this represents an expected annualized change of 15% over the next 30 days.

Source: Bloomberg

Figure 6.

Loan to value ratio for new car loans & the Unemployment rate in the US



Note: The loan to value ratio is shown in percentage units on the left axis in red color: The higher the ratio, the bigger the size of the loan given the value of the underlying collateral. The unemployment rate is shown on the right axis, with units in reversed order. It is clear that collateral requirements loosen up (loan-to-value percentage rises) when the unemployment rate declines. The data are monthly.

Source: Federal Reserve, Bureau of Labor Statistics

Table 1.

Current Account, % GDP

	2006	2007	2008
Albania	-5.6	-9.1	-14.1
Bosnia & Herz/na	-8.4	-12.7	-14.9
Bulgaria	-18.5	-25.2	-25.5
Croatia	-6.7	-7.6	-9.4
FYROM	-0.9	-7.2	-13.1
Romania	-10.4	-13.5	-12.4
Serbia	-10.1	-15.6	-17.3
Turkey	-6.0	-5.8	-5.7
Estonia	-16.9	-17.8	-9.3
Latvia	-22.7	-21.6	-12.6
Lithuania	-10.7	-14.6	-11.6

Source: IMF

Table 2.

Credit Expansion

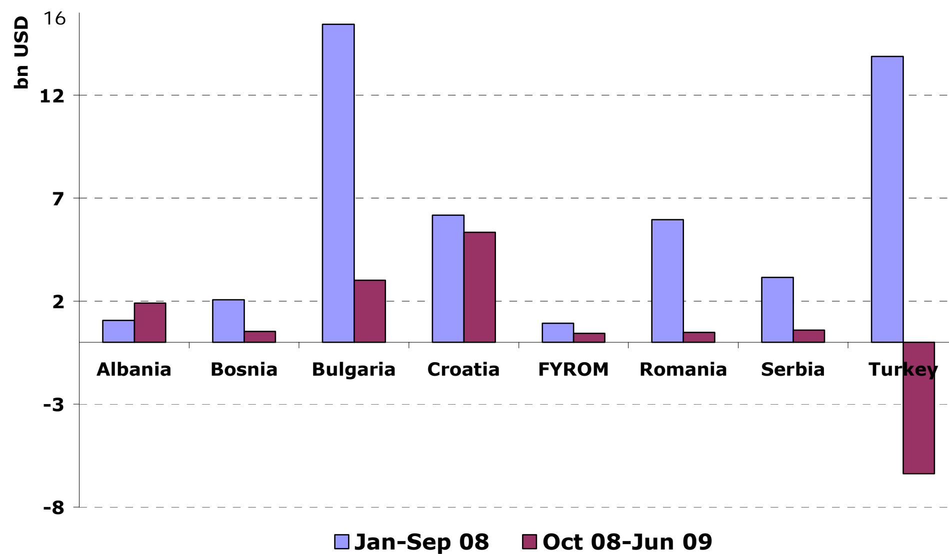
	Annual Credit Growth over 3 years Avg (2005-2007)	Δ(Credit/GDP) End 2004 - End 2007
Albania	60.5	20.3
Bosnia	26.3	17.4
Bulgaria	41.0	30.8
Croatia	18.8	16.1
FYROM	35.9	15.0
Romania	49.3	21.2
Serbia	36.0	13.0
Turkey	42.5	16.8
Estonia	37.4	39.0
Latvia	42.0	42.0
Lithuania	47.8	31.1

Note: Δ(Credit/ GDP) is the change from the end of 2004 to the end of 2007 in the ratio of credit-to-GDP.

Source: Central Banks, Eurobank Research

Figure 7.

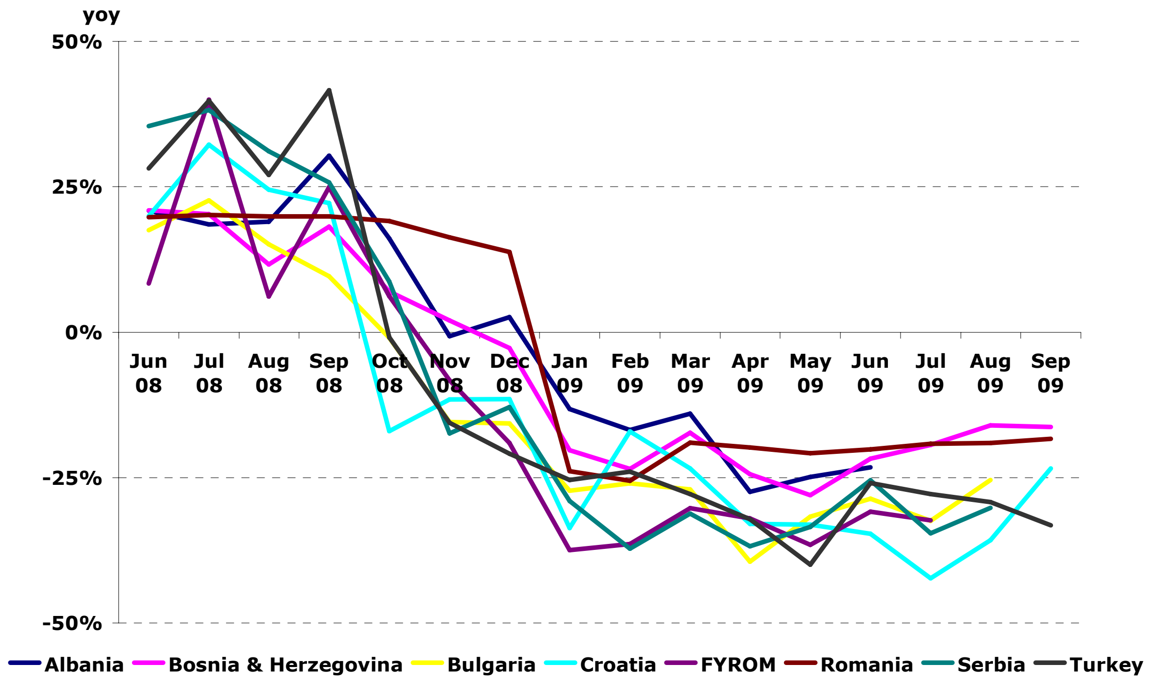
Financial Account Flows



Note: The financial account flows reflect transactions that involve financial assets and liabilities which take place between residents and nonresidents. The numbers are in billions current USDs and a positive number indicates net inflows in the economy for the specified time period.

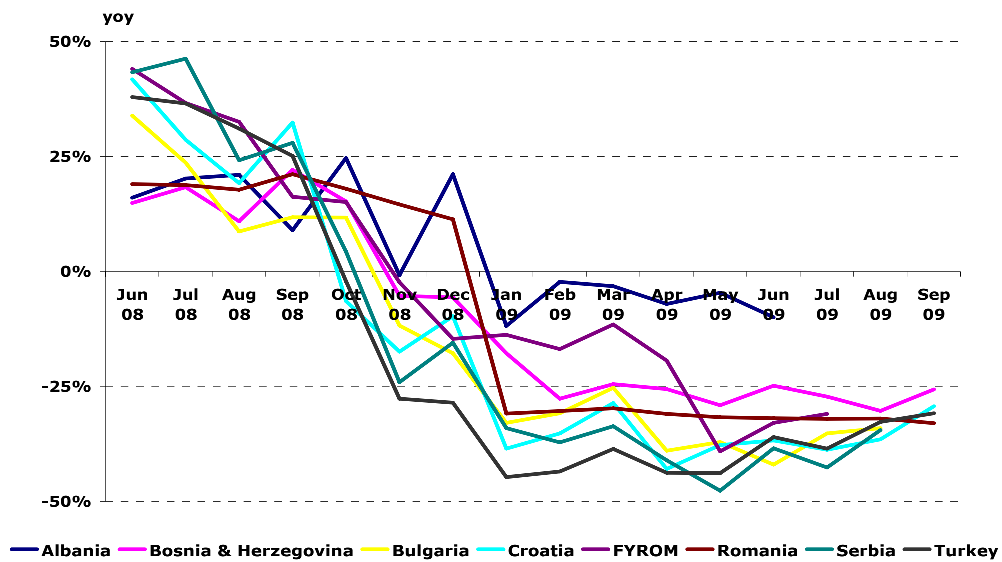
Source: Central Banks

Figure 8a.
Exports of SEE Countries



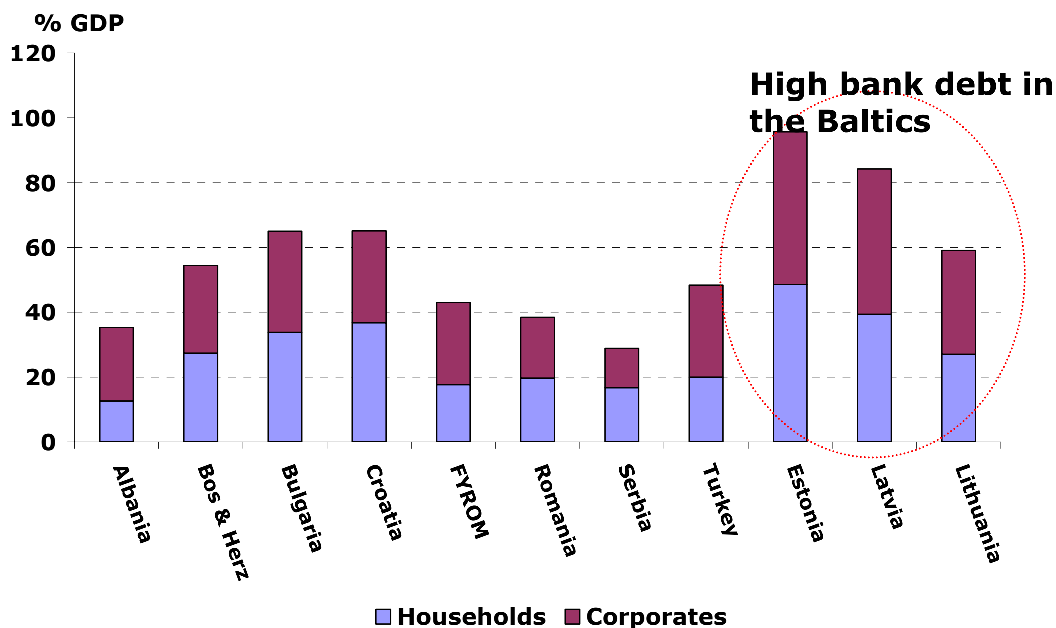
Note: Exports of Goods form the Balance of Payments Accounts, current prices, YoY change
Source: Central Banks

Figure 8b.
Imports of SEE Countries



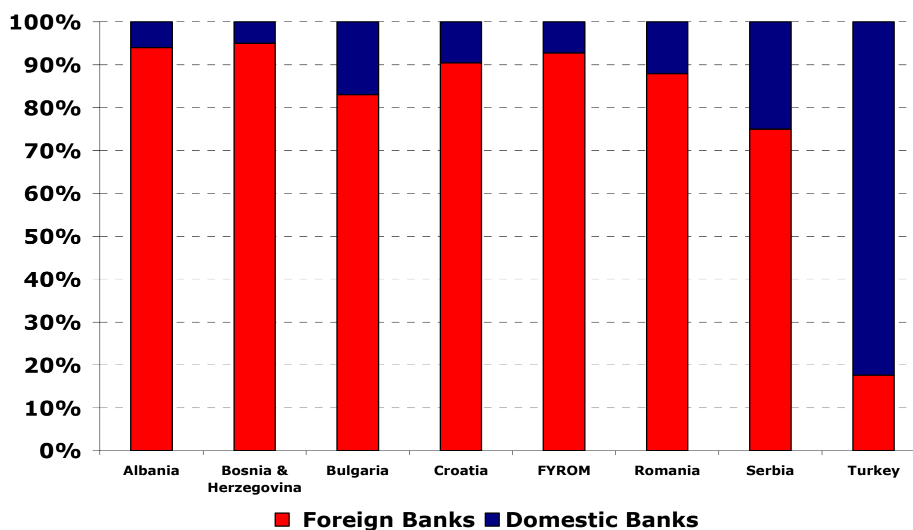
Note: Imports of Goods form the Balance of Payments Accounts, current prices, YoY change
Source: Central Banks

Figure 9.
Bank Credit Size and Distribution end-2008
(% GDP)



Note: Outstanding amounts of credit from domestic banks to the domestic private sector.
Source: Central Banks, Eurobank Research

Figure 10.
Foreign ownership of the banking sector
(% of ownership)



Note: Data for: Romania and Serbia Q2 2008, Bulgaria Q3 2008, Turkey October 2008, Croatia, FYROM, Albania and Bosnia 2008.
Source: Central Banks, Financial Supervision Authorities

Table 3.
European banks: Write-downs and capital increases
June 2007 – mid November 2009

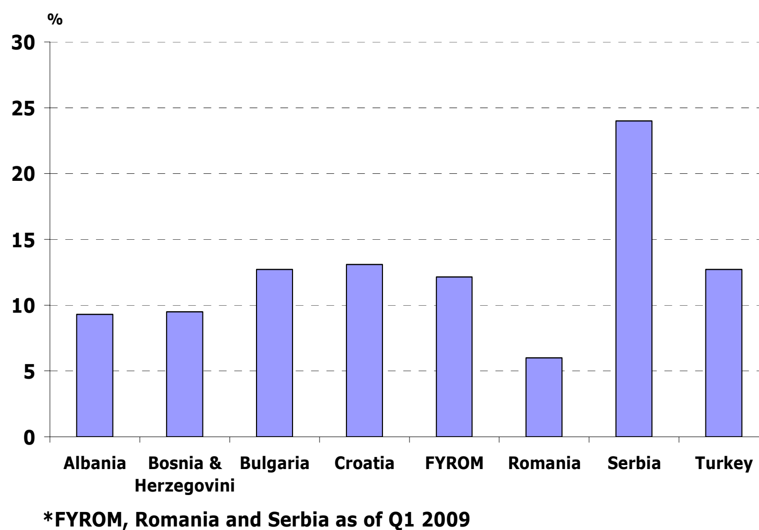
	Banks	Loss (€ bn)	Capital Raised (€ bn)	Presence in SEE country
1	UBS	34.9	27.0	
2	HSBC Holdings	33.3	19.3	TR
3	RBS	19.7	65.5	RO,TR
4	HBOS	19.7	17.2	
5	Barclays	15.8	20.5	
6	BNP Paribas	13.9	9.4	AL,BG,HR, RO,RS
7	Bayerische	13.4	14.8	HR,SI,BA, RS,ME
8	Credit Suisse	13.2	8.6	
9	Deutsche Bank	13.0	7.4	BG,HR,RO,RS,TR
10	ING Group	12.4	16.8	BG,TR,RO
11	IKB Deutsche	10.3	8.5	
12	B. Santander	9.4	19.7	
13	Soc. Gen.	8.8	15.7	TR
14	KBC Group	8.7	5.5	RS, BG
15	Fortis	6.5	16.0	
16	Credit Agricole	6.5	8.9	AL,BG,RO, RS,TR
17	Natixis	6.2	5.7	
18	DZ Bank	5.4	0.0	
19	Anglo Irish	5.2	3.1	
20	Hypo Real Estate	4.9	7.7	
21	Dexia	4.7	6.4	TR
22	Unicredit	4.4	10.3	RO,SI,BA, RS,HR, BG
23	Commerzbank	3.9	18.2	
24	Dresdner Bank	3.6	0.0	
25	Landesbank Baden Wurttemberg	3.3	0.0	
26	HSH Nordbank	2.9	1.3	
27	WestLB	2.7	5.0	
28	Lloyds Group	2.4	33.0	
29	Rabobank	2.4	1.0	
30	Northern Rock	2.2	3.8	
31	Bank of Ireland	1.9	3.5	
32	Allied Irish Banks	1.8	3.5	
33	Intesa Sanpaolo	1.8	4.0	AL,BA, HR, SI,RO,RS
34	Landesbank Sachsen	1.8	0.0	
35	Alliance & Leicester	1.8	0.0	
36	Deutsche Postbank	1.7	1.0	
37	BBVA	1.7	0.0	
38	Banco Popolare	1.7	0.0	HR,RO
39	ABN AMRO Holding	1.6	0.0	RO,TR
40	DNB NOR ASA	1.5	1.7	
41	Bradford & Bingley	1.4	2.0	
42	Banco Popular Esp	1.2	1.2	

43	Caisse d'Epargue	0.8	3.6	
44	EFG Eurobank	0.7	0.0	RO,BG,RS
45	Hessen-Thueringen	0.5	0.0	
46	HVB Group	0.5	0.0	
47	Standard Ch.	0.4	0.0	
48	Norddeutsche	0.4	0.0	
49	Danske Bank	0.4	0.0	
50	Piraeus Bank	0.4	0.0	AL,BG, RO,RS
51	Roskilde Bank	0.4	0.5	
52	Alpha Bank	0.3	0.0	RO,RS,MK,BG,AL
53	Land. Berlin	0.3	0.0	
54	NIBC Bank	0.3	0.0	
55	SEB	0.3	1.5	
56	Kommunalkredit	0.1	0.0	
57	Aareal Bank AG	0.0	0.0	
58	Kaupthing Bank	0.0	0.0	
59	Erste Group	0.0	2.1	HR,RS,RO
	Total	**320**	**401**	

Note: AL / Albania, BA / Bosnia and Herzegovina, BG / Bulgaria, HR / Croatia, ME / Montenegro, MK / Macedonia - Former Yugoslav Republic of, RO / Romania, RS / Serbia, SI / Slovenia, TR / Turkey

Source: Bloomberg

Figure 11.
Bank Capital to Assets ratio
(Q2 2009)



Note: Bank Capital refers to Total Equity.
Source: Central Banks, Eurobank Research

Table 4.
Bank Capital to Assets ratio

Austria	**6.3**	**Q1 09**
Belgium	**3.4**	**Q1 09**
Germany	**4.5**	**2008**
Greece	**4.5**	**2008**
Ireland	**5.1**	**Q1 09**
Norway	**4.2**	**2008**
Portugal	**6.1**	**2008**
Sweden	**4.7**	**2008**
UK	**4.4**	**2008**
Spain	**6.4**	**2008**
Estonia	**8.5**	**Q2 09**
Latvia	**7.4**	**Q2 09**
Lithuania	**10.4**	**Q2 09**

Note: Data on accounting basis. Data for: Austria and Greece are based on unconsolidated data for the whole banking system, Ireland and UK are regulatory capital to total assets, Portugal and Latvia are preliminary, Sweden are for the four large banking groups.
Source: IMF

Table 5.
Real GDP Growth (%)

	2008	2009f	2010f
Albania	6.8	0.7	2.2
Bosnia & Herzegovina	5.5	-3.0	0.5
Bulgaria	6.0	-6.5	-2.0
Croatia	2.4	-5.2	0.4
FYROM	4.9	-2.5	2.0
Romania	7.1	-7.5	-1.0
Serbia	5.4	-3.5	0.5
Turkey	0.9	-6.0	2.0
Estonia	-3.6	-14.0	-2.6
Latvia	-4.6	-18.0	-4.0
Lithuania	3.0	-18.5	-4.0

Source: Eurobank Research, IMF World Economic Outlook

Table 6.
Current Account Balance
(% GDP)

	2008	2009f	2010f
Albania	-14.1*	-11.5	-8.0
Bosnia & Herzegovina	-14.9	-8.8	-9.1
Bulgaria	-25.5	-12.0	-10.0
Croatia	-9.4	-6.1	-5.4
FYROM	-13.1	-10.6	-9.7
Romania	-12.4	-6.0	-5.5
Serbia	-17.3	-8.5	-9.5
Turkey	-5.7	-1.5	-2.5
Estonia	-9.3	1.9	-2.0
Latvia	-12.6	4.5	6.4
Lithuania	-11.6	1.0	0.5

*Estimate

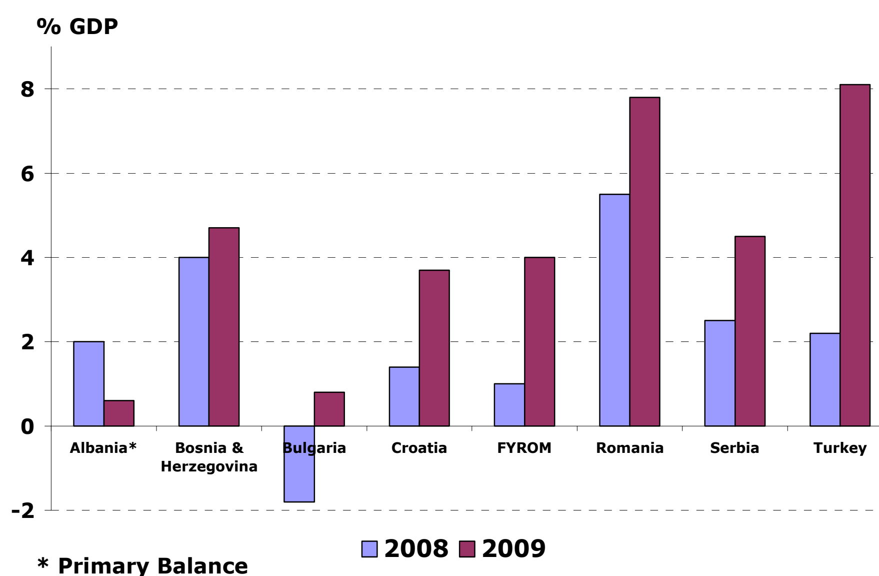
Source: Eurobank Research, IMF World Economic Outlook

Table 7.
Average CPI Inflation
(%)

	2008	2009f	2010f
Albania	3.4	1.7	2.0
Bosnia & Herzegovina	7.4	0.9	1.6
Bulgaria	12.0	2.7	1.6
Croatia	6.1	2.8	2.8
FYROM	8.3	-0.5	2.0
Romania	7.8	5.5	3.6
Serbia	11.7	8.0	7.0
Turkey	10.4	6.2	6.0
Estonia	10.4	0.0	-0.3
Latvia	15.3	3.1	-3.5
Lithuania	11.1	3.5	-2.9

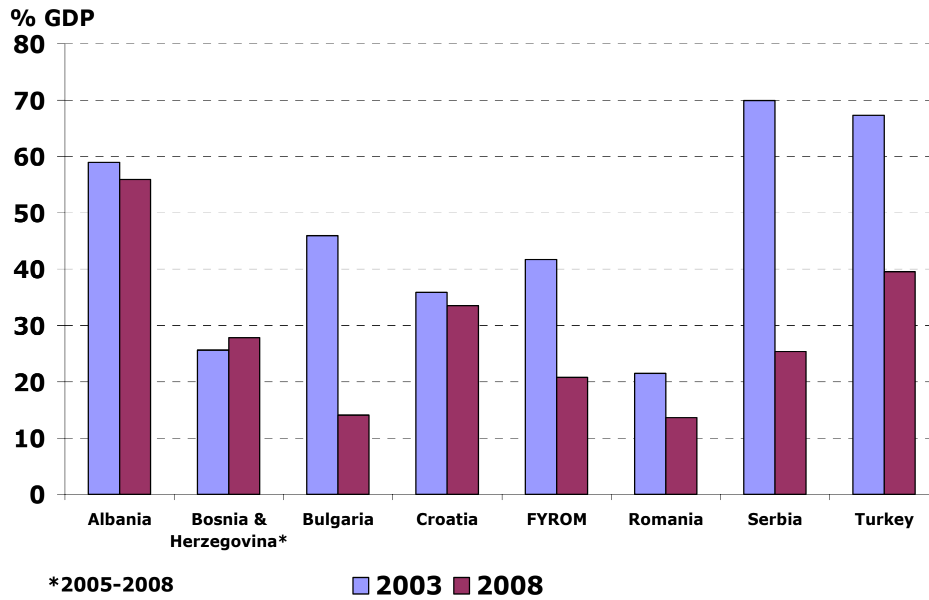
Note: Average of 12 monthly inflation rates
Source: Eurobank Research, IMF World Economic Outlook

Figure 12.
General Government Deficit
(% GDP)



Note: Primary Balance is the General Government Balance excluding interest payments.
Source: European Commission, Min. of Finance

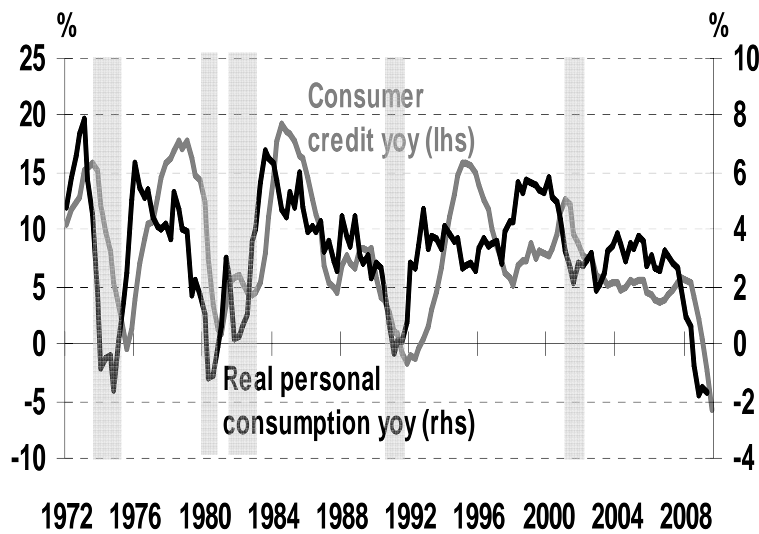
Figure 13.
General Government Debt
(% GDP)



Source: European Commission, Min. of Finance

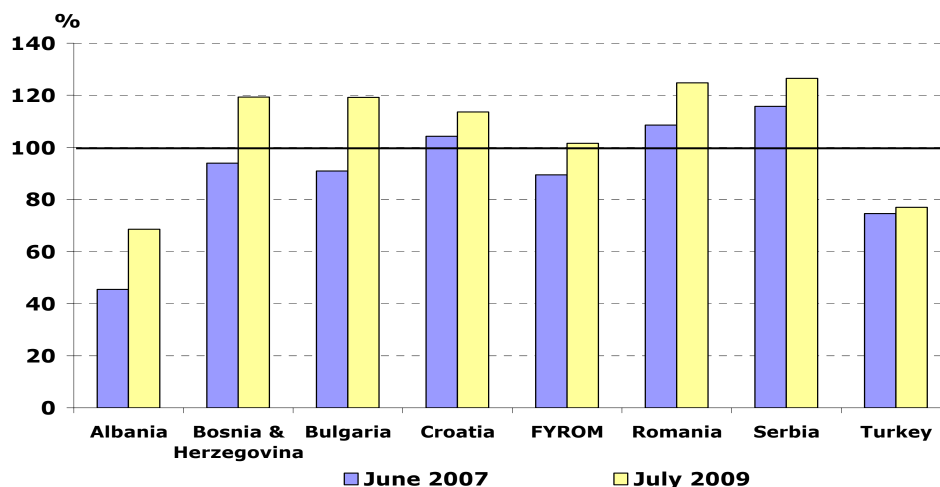
Figure 14.

Consumption and credit expansion in the USA



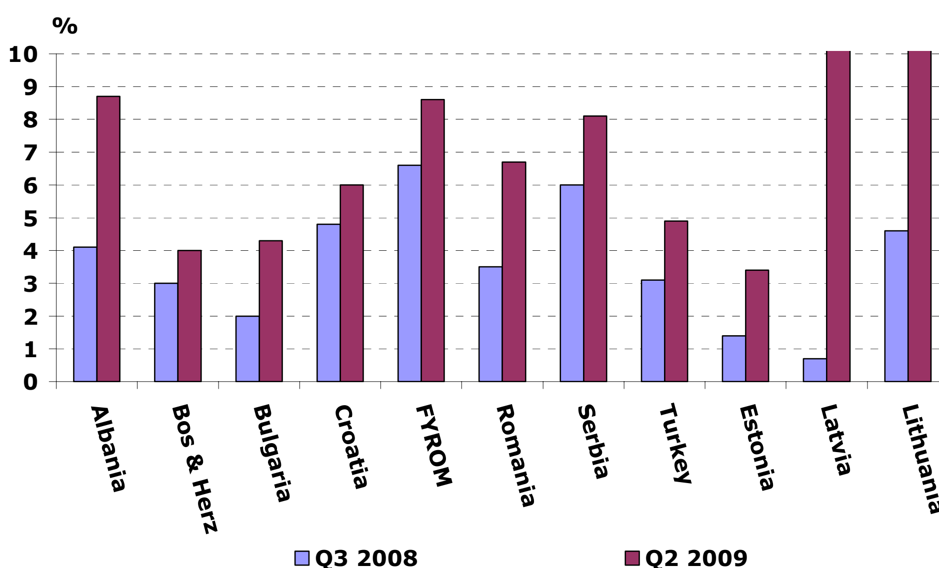
Note: Quarterly data, yoy growth rates.
Source: Federal Reserve, Eurobank EFG

Figure 15.
The ratio of Loans to Deposits



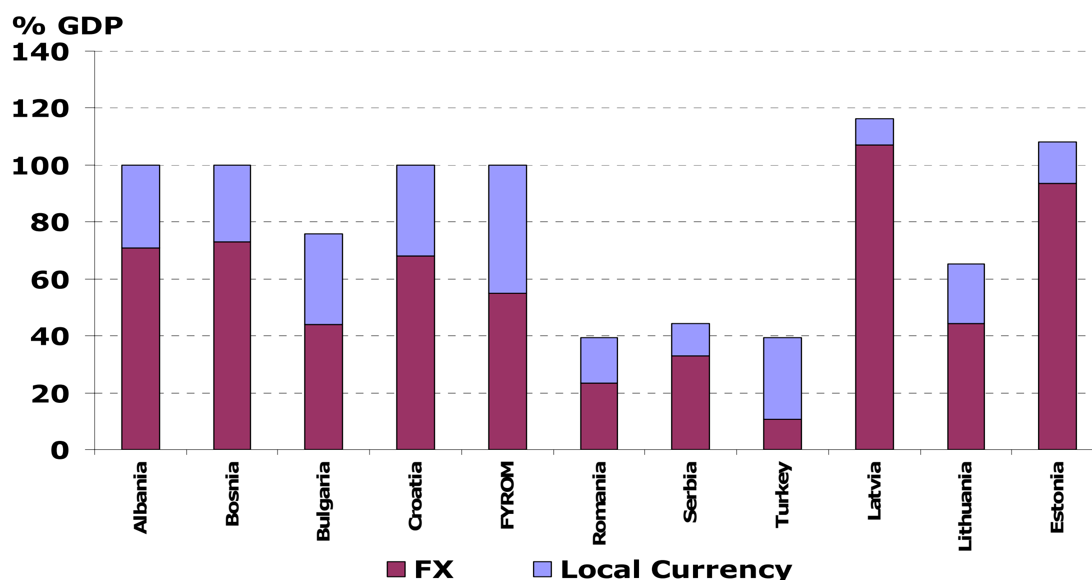
Note: Ratio of Loans to the domestic economy from domestic banks to Deposits in those banks.
Source: Central Banks, Eurobank Research

Figure 16.
NPLs overdue over 90 days



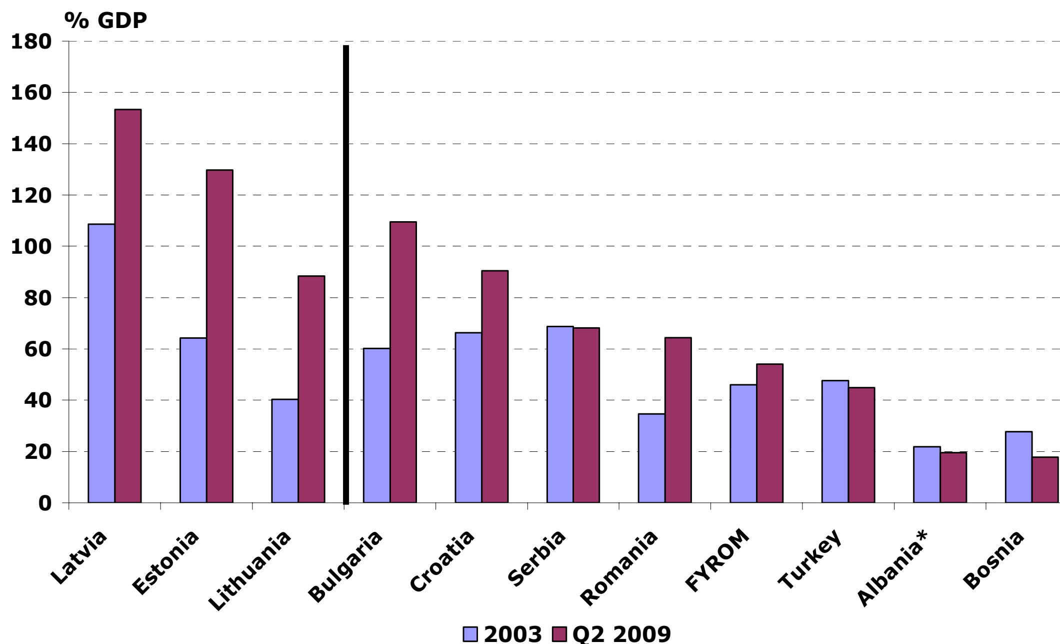
Note: Serbia as of Q1 2009, Lithuania Q4 2009
Source: Central Banks

Figure 17.
Total Bank Credit Decomposition
(Q2 2009)



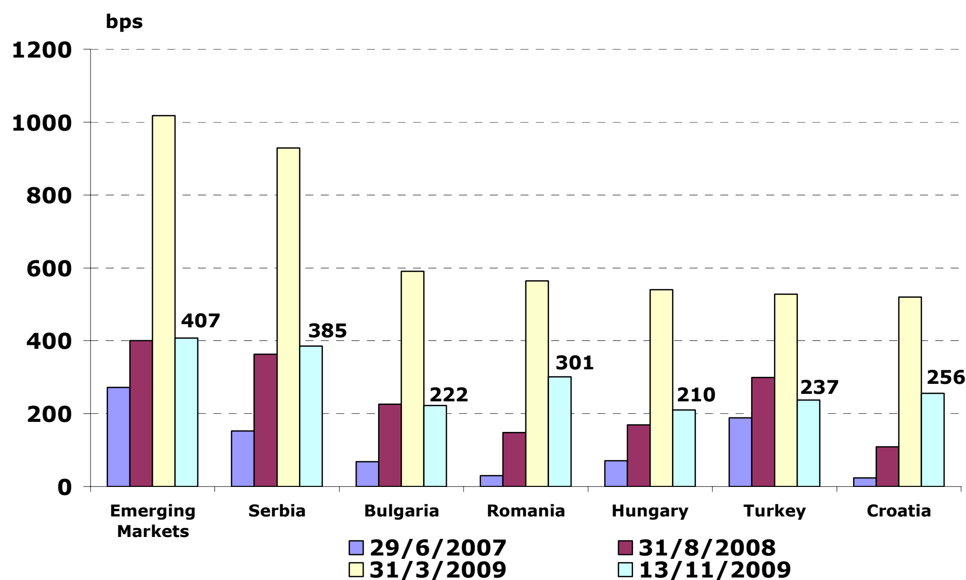
Note: Albania, Croatia as of Q1 2009
Source: Central Banks

Figure 18.
External Debt
(%GDP)



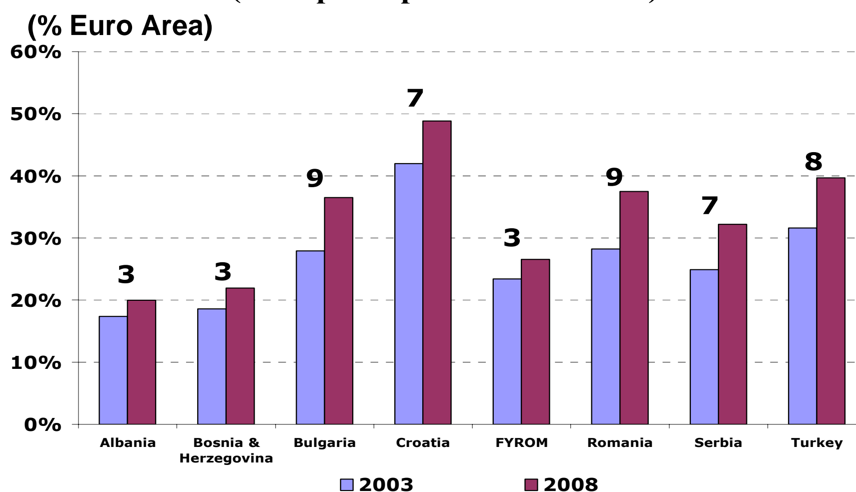
Note: Gross external debt, at any given time, is the outstanding amount of those actual current, and not contingent, liabilities that require payment(s) of principal and/or interest by the debtor at some point(s) in the future and that are owed to non-residents by residents of an economy.
Source: IMF

Figure 19.
Sovereign Spreads
(10-yr $ bonds over US bonds)



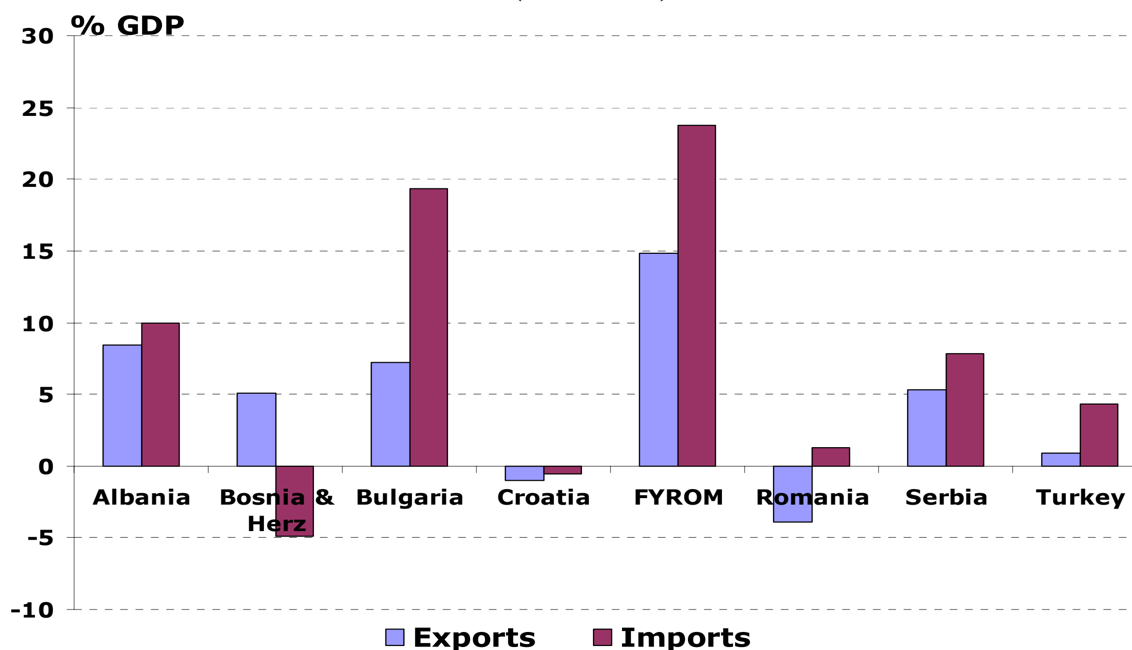
Note: The spread in basis points between the total required returns of 10-year bonds denominated in USD and the equivalent 10-year US bond.
Source: JP Morgan EMBIG

Figure 20.
Relative living standard
(GDP per capita based on PPP)



Note: The numbers in the figure present the improvement for each country between 2003 and 2008 in percentage points of EuroArea GDP in terms of purchasing power parity.
Source: IMF, Eurobank Research

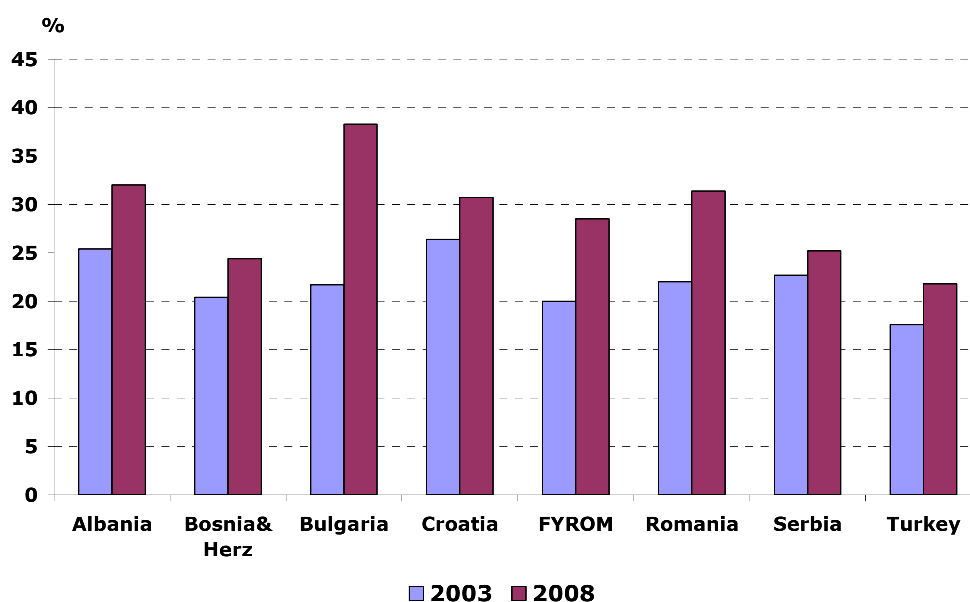
Figure 21.
Changes in Exports & Imports
Δ (2008-2003)



Note: Albania, Serbia Balance of Payments Account data. Bosnia: 2008-2004
Δ(2008-2003) = (2008 Exports or Imports to GDP) – (2003 Exports or Imports to GDP)

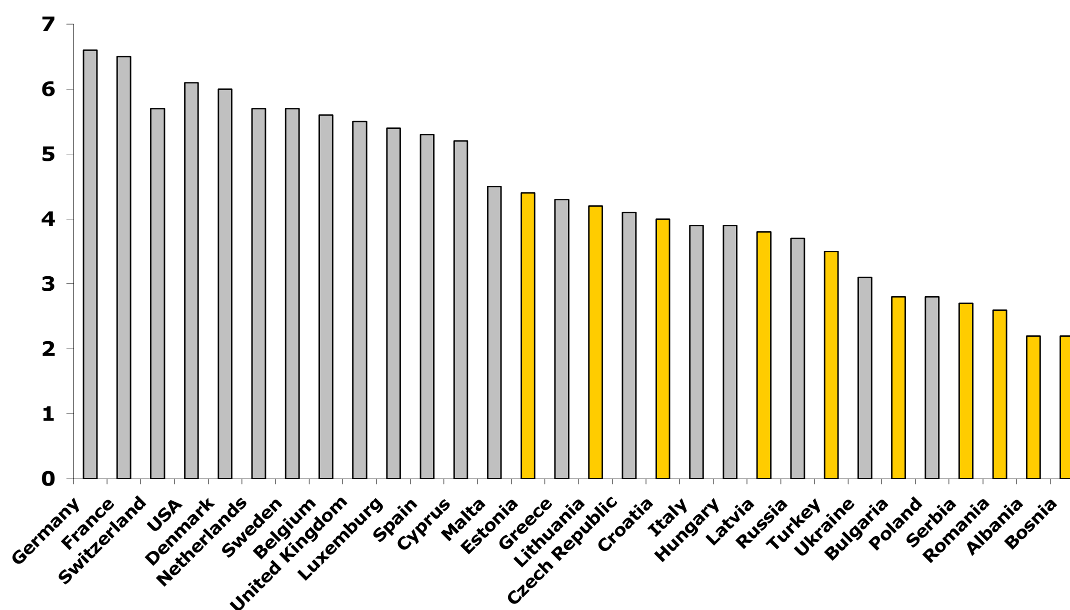
Source: Central Banks, National Statistical Authorities

Figure 22.
Total Investment
(% GDP)



Source: National Statistical Authorities

Figure 23.
Quality of Infrastructure Country Scores
(Average over 2001-2005)



Note: The answer to the question: How would you assess general infrastructure (e.g., transport, telephony, and energy) in your country? [1 = extremely underdeveloped; 7 = extensive and efficient by international standards]
Source: World Economic Forum

Table 8.
Quality of Institutions

	Financial Sector Reform*		Corruption Perceptions**		Ease of Doing Business†	
	2005	**2009**	**2005**	**2009**	**2005**	**2009**
SEE	2.57	2.86	87	71	90	78
Baltics	3.45	3.56	44	52	16	26
CEE5	3.46	3.54	47	49	52	53

Notes: * EBRD, mean of "Banking reform and interest rate liberalisation" and "Securities markets and non-bank financial institutions" indices, country group averages. SEE excluding Turkey, CEE5 excluding the Czech Republic. The transition indicators range from 1 to 4+, with 1 representing little or no change from a rigid centrally planned economy and 4+ representing the standards of an industrialised market economy.
** Transparency International, 2009, Median rank out of 159 and 180 counties in the years 2005 and 2009 respectively.
† Doing Business, 2006 and 2010 country reports. Please note that changes in methodology have been introduced between 2005 and 2009. Median rank out of 155 and 183 countries in years 2005 and 2009 respectively.

Table 9.

Improvement in the Ease of Doing Business rankings

	Rank 2005 among 155	Rank 2009 among 183	Cumulative Value Improvement (% 2009-2005)
Albania	117	82	13.5
Bosnia & Herzegovina	87	116	4.0
Bulgaria	62	44	16.8
Croatia	118	103	16.2
FYROM	81	32	22.5
Romania	78	55	13.9
Serbia	92	88	6.2
Turkey	93	73	13.5

Note: Bosnia & Herzegovina deteriorates in ranking, but shows slight overall improvement in values when examined in isolation

Source: Doing Business 2006 and 2010 Reports, processed data

Table 10.

Sources of improvement in Ease of Doing Business

% Improvement in values from 2005 to 2009	Albania	Bosnia	Bulgaria	Croatia	FYROM	Romania	Serbia	Turkey
AGGREGATE	**12.4**	**4.0**	**16.8**	**16.2**	**22.5**	**13.9**	**6.2**	**13.5**
Starting a Business	**71.2**	**24.0**	**71.9**	**41.3**	**84.8**	**4.1**	**21.7**	**41.0**
Construction Permits	**-9.1**	**46.4**	**0.0**	**27.6**	**-16.7**	**16.5**	**4.8**	**21.9**
Employing Workers	**17.8**	**7.5**	**47.5**	**2.2**	**38.3**	**52.4**	**-13.0**	**17.6**
Registering Property	**10.6**	**13.3**	**11.1**	**0.0**	**16.7**	**35.0**	**0.0**	**25.0**
Getting Credit	**5.0**	**11.6**	**20.6**	**43.3**	**13.3**	**22.9**	**56.7**	**13.2**
Protecting Investors	**46.0**	**3.0**	**7.0**	**10.0**	**7.0**	**3.0**	**-4.0**	**7.0**
Paying Taxes	**17.0**	**-37.6**	**18.7**	**31.0**	**25.9**	**-7.4**	**-61.0**	**12.9**
Trading Across Borders	**36.8**	**51.7**	**20.5**	**44.8**	**51.3**	**54.6**	**61.3**	**34.2**
Enforcing Contracts	**0.0**	**-80.3**	**-28.2**	**-38.0**	**-0.9**	**-52.8**	**-9.1**	**-50.4**
Closing a Business	**N/A**	**0.0**	**-1.4**	**0.0**	**5.5**	**11.0**	**5.1**	**13.0**

Note: Aggregate improvement is the average of the ten categories % improvement. Some adjustments have been made in some countries, depending on data availability.

Source: Doing Business 2006 and 2010 Reports, processed data