EBCI Vienna Initiative

CESEE Deleveraging and Credit Monitor[1]

June 11, 2020

Key Developments in Portfolio Flows, BIS Banks' External Positions and Domestic Credit

The Covid-19 outbreak caused major portfolio outflows from CESEE countries. Earlier, in the second half of 2019, western banks kept stabilizing their positions in CESEE. Credit growth to both households and corporates picked up at the end of 2019 and kept growing until February 2020 when the pandemic hit.

As a result of the Covid-19 outbreak, Central, Eastern, and Southeastern Europe (CESEE) registered major portfolio outflows in March 2020, which later stabilized. This event overshadows the underlying trends during 2019. Data from the Emerging Portfolio Fund Research (EPFR) Global database show that between January and December last year, sizeable bond inflows ran in parallel with equity outflows (Figures 1 and 2). As the World Health Organization declared the Covid-19 as a global pandemic, CESEE suffered major portfolio outflows. For the first time in almost a year, bond and equity flows to the region stopped diverging and started following the same negative trend. For example, between the last week of February and the first week of April, cumulative bond flows went from US$6.5 billion to US$-1billion, and equity flows from US$-6.5 to US$-9.2 billion. After major policy interventions and with the prospects of reopening activity, portfolio flows started to stabilize since mid-April.

Before the pandemic, Western banks kept stabilizing their positions in CESEE and accelerated the reduction of their exposure to Turkey. External positions of BIS reporting

[1] Prepared by the staff of the international financial institutions participating in the Vienna Initiative's Steering Committee. It is based on the BIS Locational Banking Statistics and the latest results of the EIB Bank Lending Survey for the CESEE region.

banks[2] vis-à-vis CESEE fell sharply since mid-2018, and then stabilized the following year, reaching around US$578 billion in 2019H2, roughly similar to their levels at the beginning of 2019 (Figure 3 and Table 1). This exposure corresponded to 13.9 percent of the region's GDP, markedly down from a 15.3 percent a year earlier. Outflows from Turkey moderated significantly. While bank outflows from Turkey amounted to US$7.8 billion in 2019H1, in 2019H2 western banks accelerated the reduction of their exposure to Turkey by withdrawing US$16.5 billion.

At the end of 2019, Western banks were still mostly exposed to Turkey, Russia and the Poland. Foreign bank funding to Turkey stood at US$140 billion in 2019H2, or about 19 percent of the BIS-reporting banks' exposure to CESEE (Figure 4). After Turkey, BIS-reporting banks are mostly exposed to Russia (US$98 billion), Poland (US$90 billion) and Czech Republic (US$86 billion) among CESEE countries (Table 1). On a consolidated basis, countries with the largest exposure to Turkey are Spain (US$65 billion), France (US$28 billion), and the United Kingdom (US$14 billion) (Figure 5).

About 45 percent of CESEE countries experienced funding reductions in 2019H2 (Figure 6). In absolute terms (Table 1), outflows were the largest in Turkey (US$16.5 billion), Slovenia, Belarus (US$1.4 billion each), and Estonia (US$1 billion). Scaled by the size of the receiving economy, outflows exceeded 1 percent of GDP in only three cases: Croatia, Montenegro and Turkey. Funding reductions were driven by claims on banks, except in Slovenia and Turkey, where about 20 percent of the decline was due to corporates (Figure 7). In some CESEE countries, like Serbia and Montenegro, large losses of funding from banks were compensated by large increases in funding from corporates, which were large enough to leave slightly positive net funding position.

BIS data shows a small increase in external exposure. The average BoP deficit in 2019H2 was 0.2 percent of GDP (twice as much as in 2019H1). In addition, other investment flows in the BoP data, where cross-border bank financing is captured, increased in 2019Q4 for the CESEE region as a whole, (Figure 8). That said, for several countries, the difference between BoP flows and changes in BIS banks' external exposure is sizeable, suggesting additional capital flows from sources other than BIS reporting banks. For countries like Belarus, Czech Republic, Turkey, Slovenia and Lithuania, BoP data shows inflows, while BIS data suggest significant outflows.

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[2] The sample includes banks in Australia, Austria, Bahrain, Belgium, Bermuda, Canada, Cayman Islands, Chile, China, Cyprus, Denmark, Finland, France, Germany, Greece, Guernsey, Hong Kong SAR, India, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Luxembourg, Macao SAR, Malaysia, Mexico, Netherlands, Norway, Panama, Philippines, Portugal, Russia, Singapore, South Africa, Spain, Sweden, Switzerland, Taiwan Province of China, Turkey, the United Kingdom, and the United States. This note uses terms "BIS-reporting banks" and "Western banks" interchangeably, as CESEE financial linkages with non-European banks are negligible.

Credit growth picked up until the Covid-19 outbreak (Figure 9). Total credit to the private sector expanded by 7.9 percent year-on-year in February 2020, up from a growth rate of 5 percent growth in 3 months earlier. Lending to both households and nonfinancial corporations in CESEE countries accelerated in 2019H2 and early 2020, with household borrowing growing sharply in many countries. Except for Latvia and Ukraine, all CESEE countries recorded positive credit growth until February 2020 (Figure 10). In Hungary and Belarus total credit growth was at almost 15 percent. In Moldova, household credit growth remained very strong and recorded a 38 percent growth year-on-year (this phase had started in 2018 when temporary restrictions to credit were lifted by the supervisor and the new foreign bank owners resumed lending from a low base). Lending to households in Turkey and Russia also grew at above 15 percent year-on-year. Finally, corporate credit growth was the highest in Serbia, Ukraine and Hungary at nearly 10 percent year-on-year.

Overall, CESEE banks relied on domestic deposit growth to fund increased credit activity into 2019 (Figure 11). CESEE banks had tapped into foreign bank funding in 2017 after almost seven years of withdrawals. However, growth in domestic deposits became yet again the only source of higher bank funding in 2018 and 2019. In 2019H2, foreign funding decreased by about 0.7 percent of GDP (year-on-year) in CESEE, mostly driven by lower foreign funding in Turkey, Estonia and Belarus (Figure 12).

Key Messages - CESEE Bank Lending Survey: 2020H1[3]

The Spring 2020 edition of the CESEE Bank Lending Survey was conducted during the unfolding of the COVID-19 pandemic. This implies that some of the respondent banks formed their expectations before the impact of COVID-19 was fully unleashed and prior to the implementation of the containment measures, whilst others did so after that. The sample can be split into two groups - before (labelled pre-COVID-19 hereafter) and after (labelled post-COVID-19 hereafter) containment measures entered into force. This makes it possible to gauge the actual effect of COVID-19 on the revision of expectations. The survey finds that when the COVID-19 epidemic hit the region, banks revised sharply and negatively their expectations for the next six months (April to September 2020).

- **Banking groups reported over the recent past a generalized stability stance in their loan-to-deposit (LTD) ratio. Following the COVID-19 shock, expectations of re-leveraging disappeared whilst an increasing number of banking groups signaled the re-start of a deleveraging cycle.** Before the COVID-19 shock, deleveraging expectations at the group level (Figure 13) slowed significantly compared to 2013 and 2014. Also, a soft re-leveraging trend was detected. Nevertheless, the COVID-19 shock has changed significantly the attitude of banking groups operating in the CESEE region. Notably, expectations of re-leveraging disappeared whilst an increasing number of banking groups signaled the re-start of a deleveraging cycle. Specifically, almost 40% of the groups, reporting after the COVID-19 restrictions were imposed, expect a decrease in the loan-to-deposit ratio (LTD), bringing the indicator of a deleveraging attitude closer to levels recorded in 2013-2014.

- **CESEE subsidiaries and local banks entered the COVID-19 induced crisis supported by an increasing demand for credit. Nonetheless, expectations for the next six months reversed when COVID-19 started to dent the regional economies, thus pointing at contracting demand conditions.** Demand for loans and credit lines continued to increase in the last six months (Figure 14). These results mark the fifteenth consecutive increase in demand for credit, an improvement fully aligned with the expectations embedded in the Autumn 2019 release of the survey. Coming from this relatively benign environment, expectations for the next six months (April to September 2020) changed during the month of March 2020. Banks reporting before the COVID-19 restriction and containment measures were put in place expected an increase in demand in line with the past positive developments. Conversely, post-COVID-19 expectations are standing in a contractionary area. It should be noted that negative expectations of demand for loans have never been recorded over the past six years. Expected demand seems to be more contractionary for the household than the corporate segment, including SMEs. This suggests a still sustained need for finance in the corporate segment to meet liquidity and short-term needs even in the absence or subdued demand for firms' products and/or services.

[3] A full report with country chapters of the Spring H1 2020 survey release will be published in June 2020 on the EIB dedicated webpage http://www.eib.org/about/economic-research/surveys.htm as well as on the Vienna Initiative webpage.

- **Before COVID-19, CESEE subsidiaries and local banks had been mildly easing supply conditions. The COVID-19 shock is expected to determine a sharp tightening in supply across the client spectrum.** Supply conditions eased slightly over the past six months in line with the expectations recorded in the Autumn 2019 release of the survey. Against this backdrop, COVID-19 is expected to exert a significantly negative impact on aggregate supply conditions over the next six months (Figure 15). Supply conditions are expected to tighten sharply across the client spectrum, thus affecting the corporate segment, notably SMEs. The protracted inertia of supply-side conditions did not follow the robust demand conditions, leaving a noticeable perceived gap between demand and supply in the past. This is expected to become even more pronounced for enterprises – specifically SMEs – in the near future.

- **Many factors positively supporting supply conditions over the past are expected to enter into negative territory.** In late 2019 and early 2020, the number of domestic and international factors limiting supply was very limited (Figure 16). Against this backdrop, many factors positively supporting supply conditions in the past are expected to enter into negative territory. In addition to the local and international macroeconomic environment, NPLs (group and local level), local capital conditions, groups' funding and the regulatory environment are expected to exert significant negative pressure on supply conditions.

- **Credit quality continued to improve over the past six months. This positive trend is expected to reverse dramatically in the post-COVID-19 environment.** Over the past six months, aggregate regional NPL ratios showed another improvement in net balance terms (Figure 17). Nonetheless, the COVID-19 impact has determined a sharp and negative revision in expectations, whereby the vast majority of banks anticipate an increase in their NPL ratio over the next six months.

Figure 1. CESEE: Cumulative Portfolio Flows

(Billions of US$; cumulative weekly flows from April 1, 2018 until May 27, 2020)

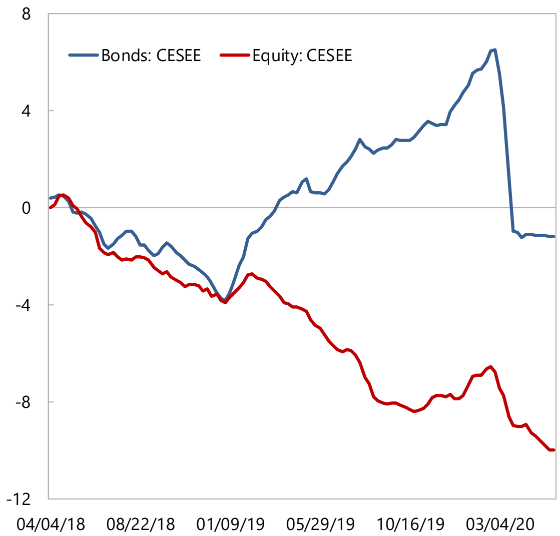


Figure 2. CESEE: Monthly Portfolio Flows, January 2015-May 2020

(Billions of US$)

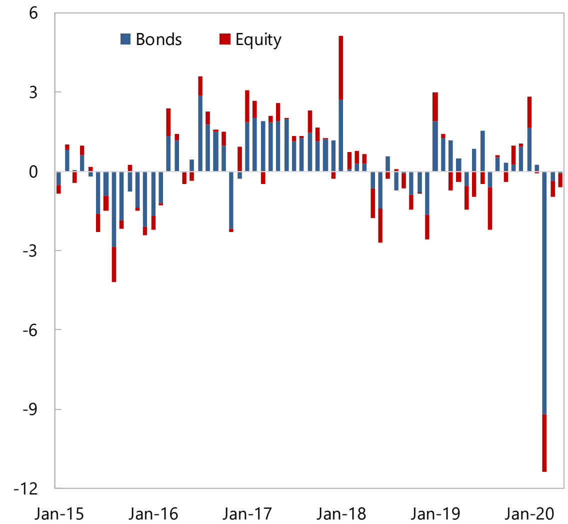


Figure 3. CESEE: External Positions of BIS-reporting Banks, 2009Q4-2019Q4

(Billions of US$, exchange-rate adjusted, vis-à-vis all sectors)

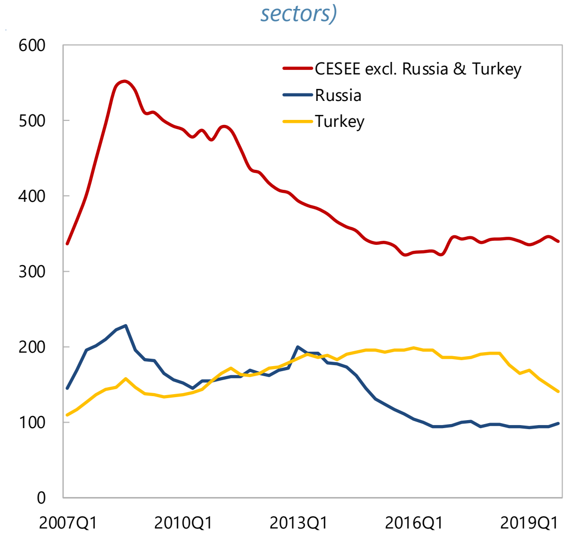
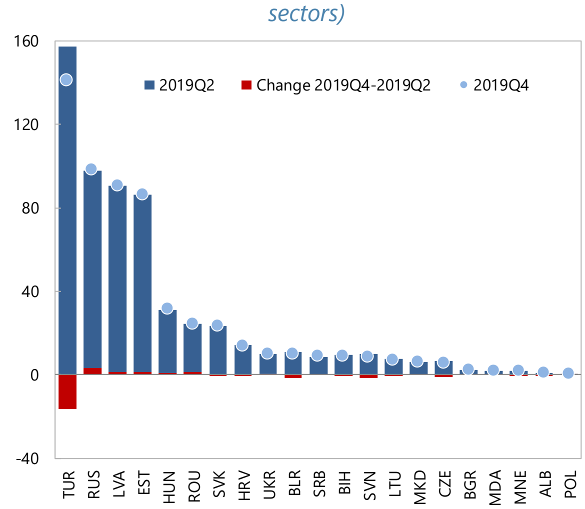


Figure 4. CESEE: External Positions of BIS-reporting Banks, 2019Q2–2019Q4

(Billions of US$; exchange-rate adjusted, vis-à-vis all sectors)



Sources: BIS, Locational and Consolidated Banking Statistics; EPFR Global; and IMF, World Economic Outlook, and IMF staff calculations.

Note: In Figure 1 and 2 fund flows are net inflows into EM-dedicated investment funds, including mutual funds and ETFs, as reported by EPFR Global. Data labels in the figures use International Organization for Standardization (ISO) country codes.

Figure 5. BIS Reporting Banks: Consolidated Exposure to Turkey, 2019Q4

(Total claims on intermediate counterparty basis, vis-à-vis all sectors; billions of US$)

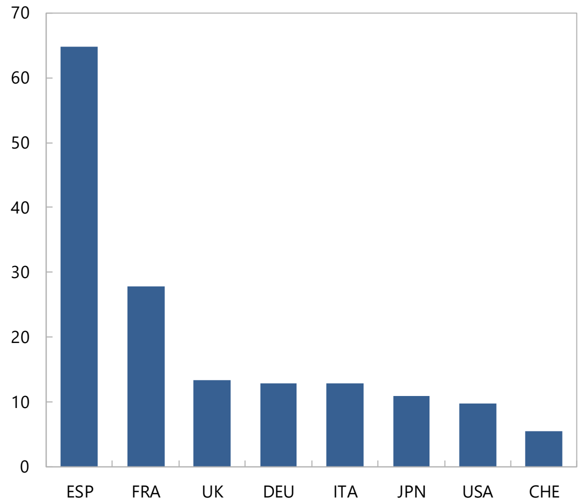


Figure 6. CESEE: External Positions of BIS-reporting Banks, 2019H2

(Cumulative change from previous quarter; percent of 2019 GDP)

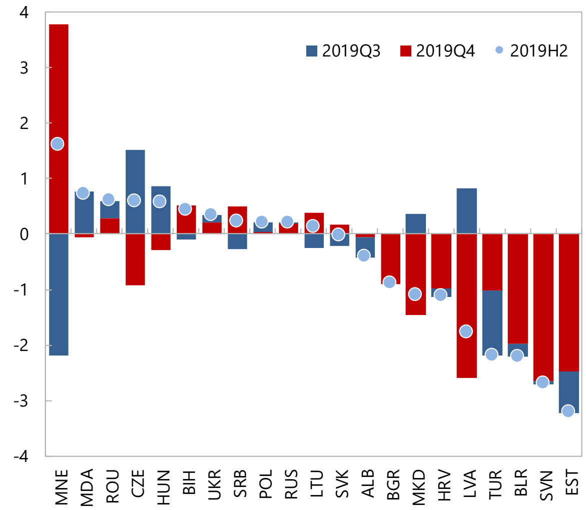


Figure 7. CESEE: External Positions of BIS-reporting Banks, 2019H2

(2019H2 flows as percent of 2019H1 stocks)

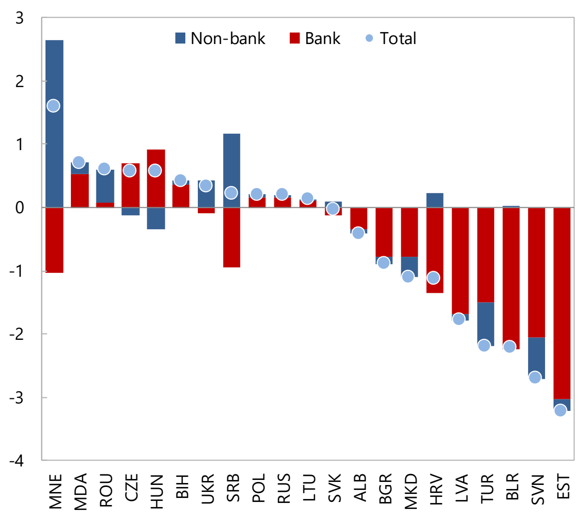
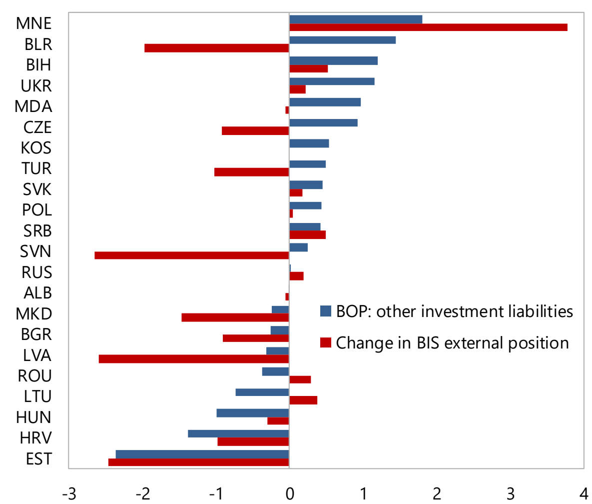


Figure 8. CESEE: Change in BIS External Positions and Other Investment Liabilities, 2019Q4

(percent of 2019 GDP)



Sources: BIS, Locational and Consolidated Banking Statistics; Haver Analytics; and IMF, World Economic Outlook, and IMF staff calculations.

Note: Data labels in the figures use International Organization for Standardization (ISO) country codes.

Figure 9. CESEE: Credit to Private Sector, January 2013–February 2020

(Percent change, year-over-year, nominal, exchange-rate adjusted, GDP-weighted)

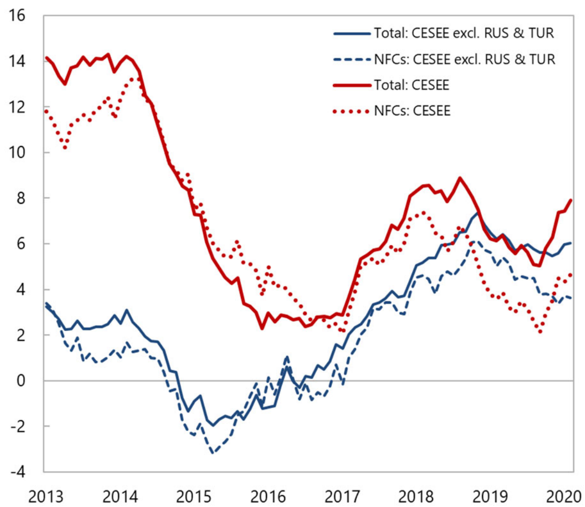


Figure 10. CESEE: Growth of Credit to Households and Corporations, Feb. 2020

(Percent, year-on-year, nominal, exchange-rate adjusted)

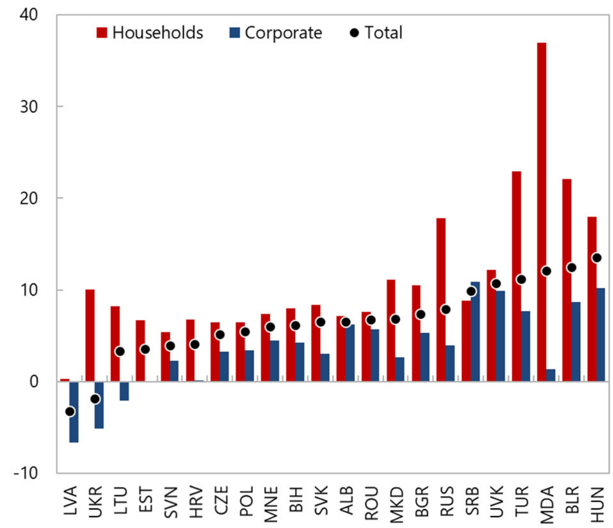


Figure 11. CESEE: Main Bank Funding Sources, 2007Q1–2019Q4

(Percent of GDP, year-on-year, exchange-rate adjusted)

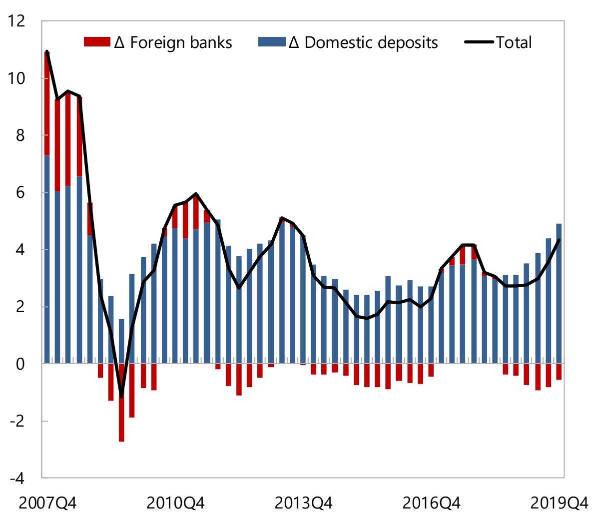
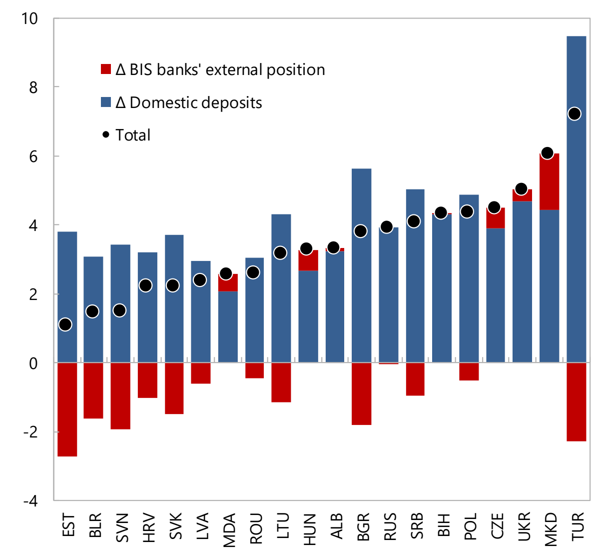


Figure 12. CESEE: Main Bank Funding Sources, 2019Q4

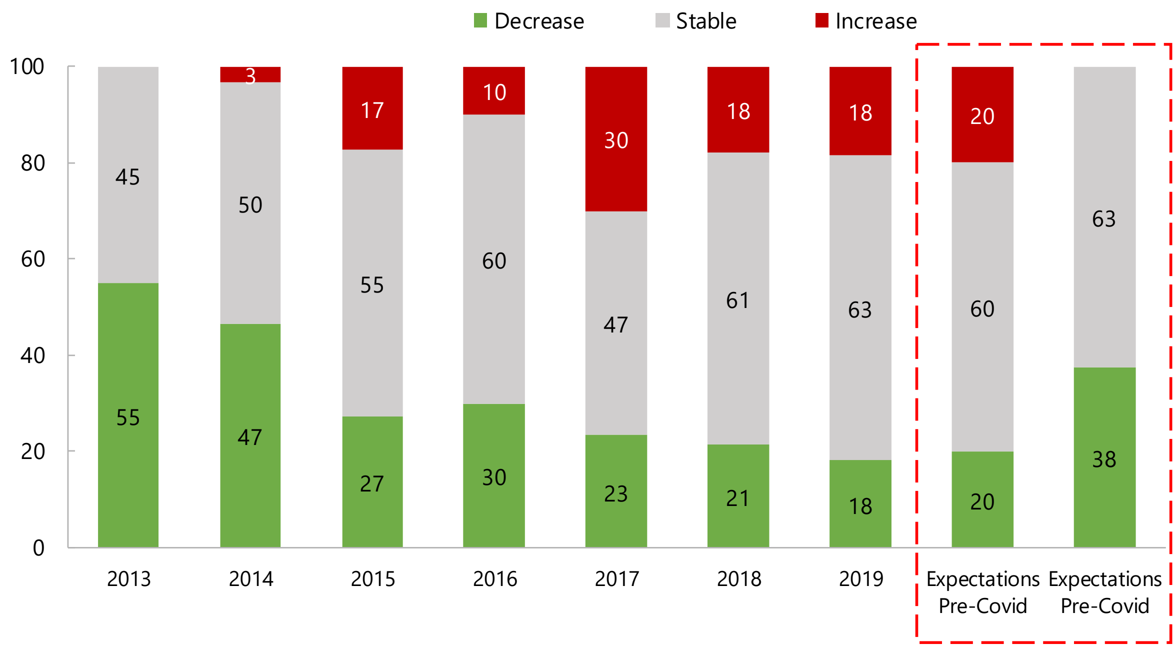
(Percent of GDP, year-over-year, exchange-rate adjusted)



Sources: National authorities; BIS; ECB; EBRD; and IMF, Monetary and Financial Statistics, and IMF staff calculations.
Note: Data labels in the figures use International Organization for Standardization (ISO) country codes.

Figure 13. Deleveraging: Loan-to-Deposit Ratio

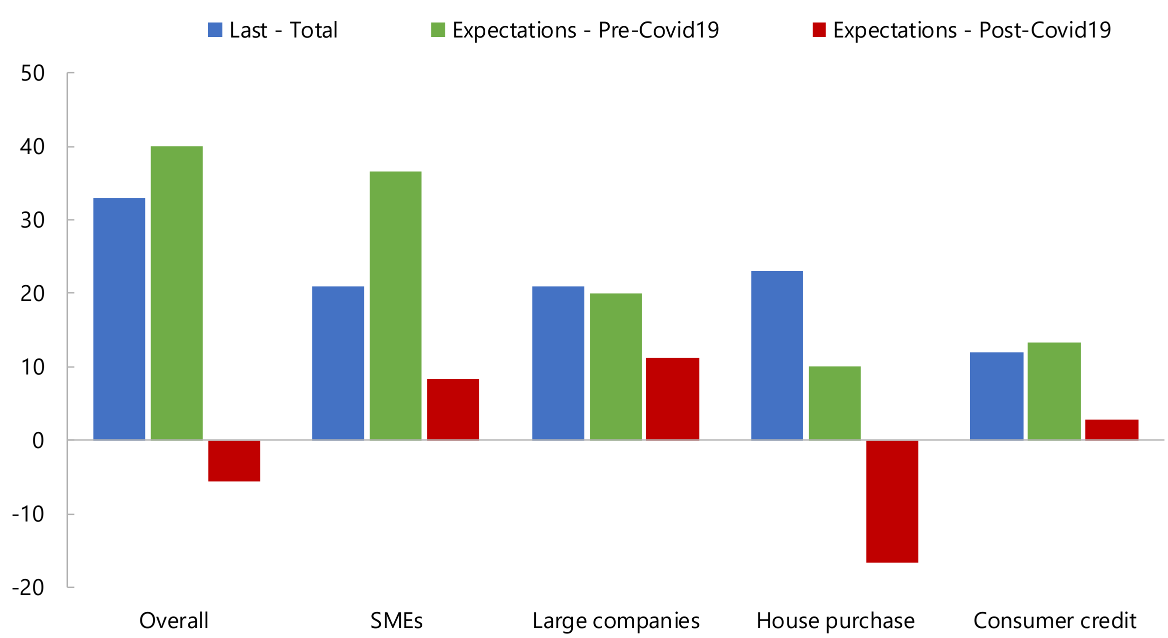
(Expectations over the next 6 months)



Source: EIB, CESEE Bank Lending Survey.

Figure 14. Demand, Past and Expected Development

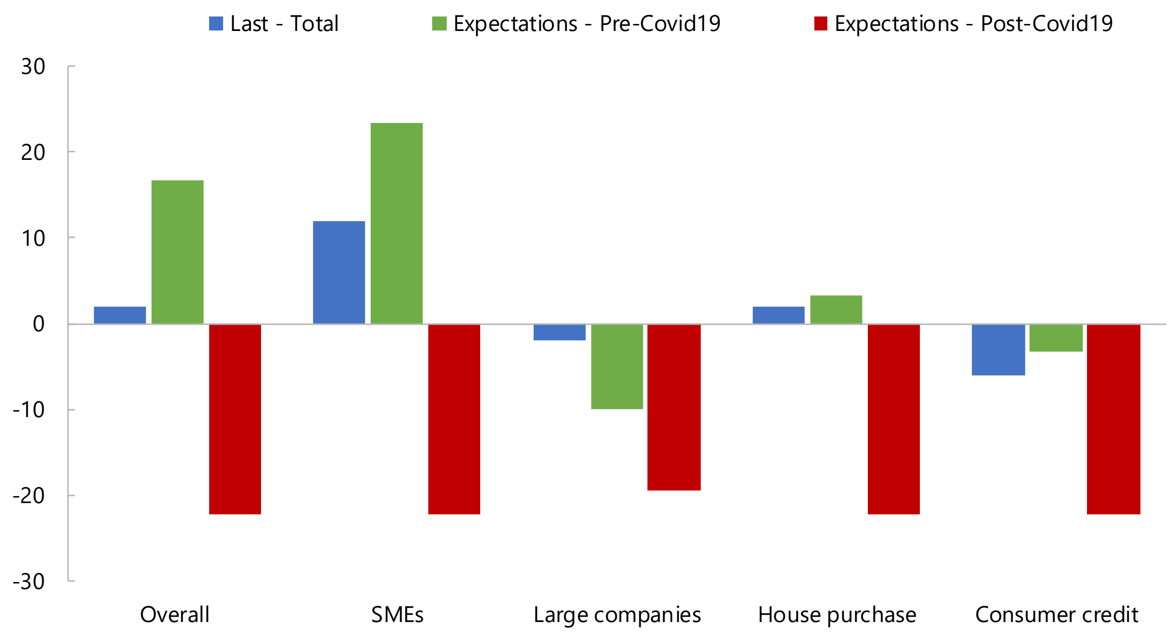
(Net percentages; positive (negative) figures refer to (decreasing) increasing demand)



Source: EIB, CESEE Bank Lending Survey.

Figure 15. Supply, Past and Expected Development

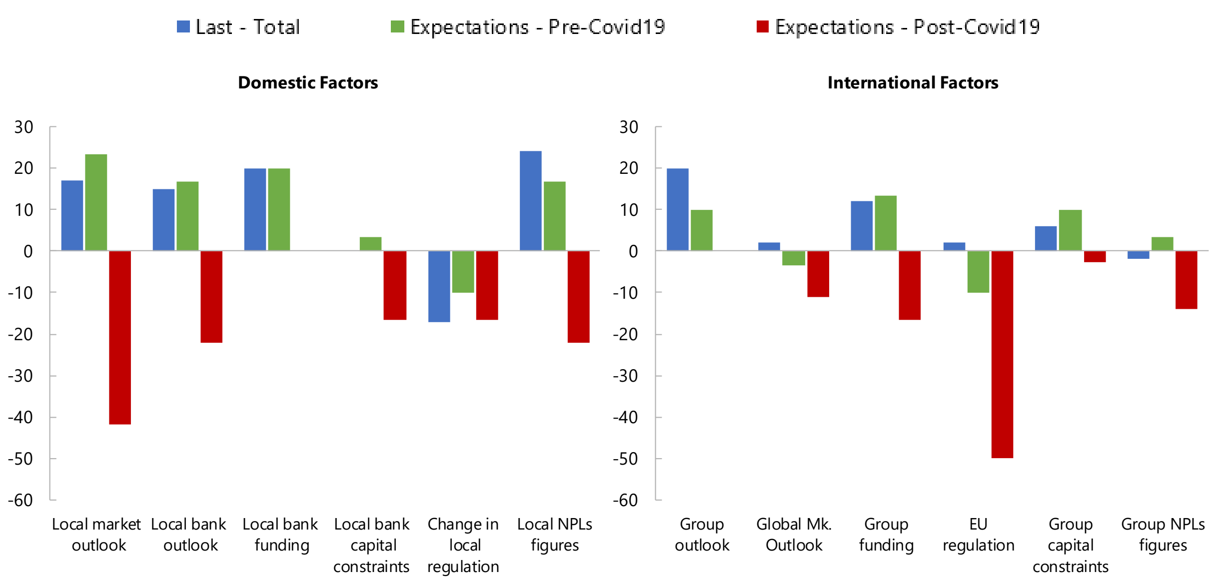
(Net percentages; positive (negative) figures refer to easing (tightening) supply)



Source: EIB, CESEE Bank Lending Survey.

Figure 16. Factors contributing to supply conditions (credit standards)

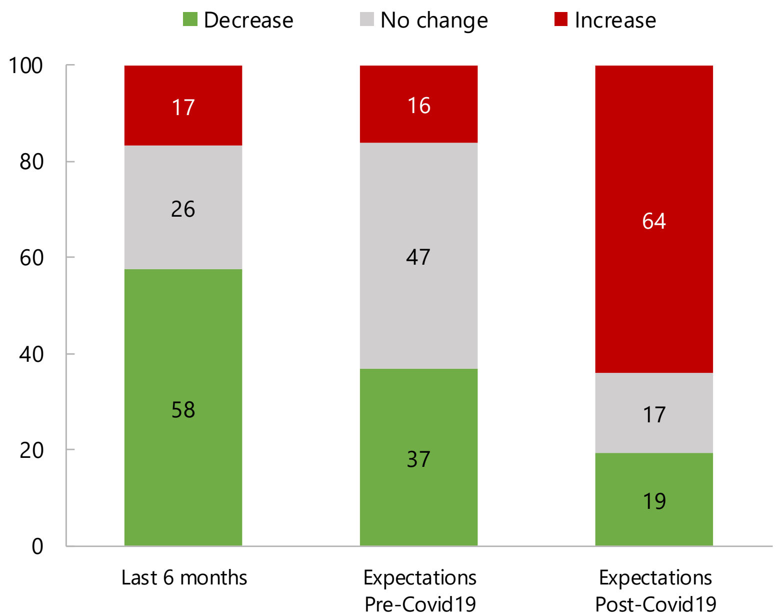
(Net percentage; positive figures refer to a positive contribution to supply)



Source: EIB, CESEE Bank Lending Survey.

Figure 17. Non-performing Loan Ratios

(Net percentage; negative figures indicate increasing NPL ratios)



Source: EIB, CESEE Bank Lending Survey.

Table 1. CESEE: External Position of BIS-reporting Banks, 2018H1 – 2019H2

(Vis-à-vis all sectors, based on the full sample of BIS-reporting banks, except for 2019Q3 which is based on the partial sample)

	2019H2 stocks		Exchange-rate adjusted flows (US$m)					Exchange-rate adjusted flows (% change)					Exchange-rate adjusted flows (% of GDP)				
	US$ m	% of GDP	2018H1	2018H2	2019H1	2019H2	Total	2018H1	2018H2	2019H1	2019H2	Total	2018H1	2018H2	2019H1	2019H2	Total
Albania	856	5.6	-64	-66	-169	-64	-363	-5.3	-5.7	-15.5	-7.0	-29.8	-0.4	-0.4	-1.1	0.1	-1.9
Belarus	9,630	15.3	-142	177	567	-1,394	-792	-1.4	1.7	5.4	-12.6	-7.6	-0.2	0.3	0.9	1.4	2.4
Bosnia-Herzegovina	2,337	11.8	96	140	-120	85	201	4.5	6.3	-5.1	3.8	9.4	0.5	0.7	-0.6	-0.1	0.4
Bulgaria	8,697	12.8	-50	138	-1,005	-606	-1,523	-0.5	1.4	-9.7	-6.5	-14.9	-0.1	0.2	-1.5	0.2	-1.1
Croatia	13,656	22.6	621	-1,448	-598	-679	-2,104	3.9	-8.8	-4.0	-4.7	-13.4	1.0	-2.4	-1.0	-2.0	-4.4
Czech Republic	86,207	35.0	7,850	-6,304	-206	1,426	2,766	9.4	-6.9	-0.2	1.7	3.3	3.2	-2.6	-0.1	0.7	1.3
Estonia	5,644	18.0	-641	260	162	-1,011	-1,230	-9.3	4.2	2.5	-15.2	-17.9	-2.1	0.8	0.5	0.1	-0.7
Hungary	31,124	17.7	257	-1,354	382	1,005	290	0.8	-4.4	1.3	3.3	0.9	0.2	-0.8	0.2	0.8	0.3
Latvia	6,815	20.0	-553	467	1,068	-607	375	-8.6	7.9	16.8	-8.2	5.8	-1.6	1.4	3.1	1.9	4.8
Lithuania	6,065	11.2	-564	-136	-195	69	-826	-8.2	-2.1	-3.1	1.2	-12.0	-1.1	-0.3	-0.4	0.7	-0.9
North Macedonia	1,575	12.4	431	-325	440	-140	406	36.9	-20.3	34.5	-8.2	34.7	3.4	-2.6	3.5	0.5	4.8
Moldova	280	2.3	-49	71	-23	85	84	-25.0	48.3	-10.6	43.6	42.9	-0.4	0.6	-0.2	0.7	0.7
Montenegro	1,748	31.8	342	191	44	88	665	31.6	13.4	2.7	5.3	61.4	6.2	3.5	0.8	-1.8	8.7
Poland	90,544	15.3	-4,235	1,816	-297	1,244	-1,472	-4.6	2.1	-0.3	1.4	-1.6	-0.7	0.3	-0.1	0.6	0.2
Romania	24,304	9.8	-888	-364	-1,306	1,493	-1,065	-3.5	-1.5	-5.4	6.5	-4.2	-0.4	-0.2	-0.5	0.7	-0.3
Russia	97,858	5.8	3,072	-2,771	396	3,380	4,077	3.3	-2.9	0.4	3.6	4.3	0.2	-0.2	0.0	0.1	0.1
Serbia	8,805	17.1	451	838	378	116	1,783	6.4	11.2	4.5	1.3	25.4	0.9	1.7	0.7	1.0	4.3
Slovakia	23,412	22.2	1,771	3,579	-827	-36	4,487	9.4	17.3	-3.4	-0.2	23.7	1.7	3.4	-0.8	-0.4	3.9
Slovenia	8,550	15.9	310	-784	982	-1,453	-945	3.3	-8.0	10.9	-14.5	-10.0	0.6	-1.5	1.8	0.4	1.3
Turkey	140,734	18.7	878	-25,571	-7,885	-16,498	-49,076	0.5	-13.4	-4.8	-10.5	-25.9	0.1	-3.3	-1.0	-2.7	-7.0
Ukraine	9,833	6.4	-425	85	554	524	738	-4.7	1.0	6.3	5.6	8.1	-0.3	0.1	0.4	0.5	0.6
CESEE	578,674	13.9	8,468	-31,361	-7,658	-12,973	-43,524	1.4	-5.0	-1.3	-2.2	-7.0	0.2	-0.8	-0.2	-0.2	-0.9
CESEE ex. RUS & TUR	340,082	19.7	4,518	-3,019	-169	145	1,475	1.3	-0.9	0.0	0.0	0.4	0.3	-0.2	0.0	0.6	0.7

Sources: BIS, Locational and Consolidated Banking Statistics; Haver Analytics; and IMF, World Economic Outlook, and IMF staff calculations.

Table 2. CESEE: External Position of BIS-reporting Banks, 2018H1 – 2019H2

(Exchange rate adjusted flows, based on the full sample of BIS-reporting banks, except for 2019Q3 data which is based on the partial sample)

	2019H2		Assets - Banks					Assets - Non-banks					Loans - Banks					Loans - Non-Banks				
	US$ m	% of GDP	2018H1	2018H2	2019H1	2019H2	Total	2018H1	2018H2	2019H1	2019H2	Total	2018H1	2018H2	2019H1	2019H2	Total	2018H1	2018H2	2019H1	2019H2	Total
Albania	-64	-0.4	30	-70	66	-52	-26	-94	4	-235	-12	-337	15	-75	-19	-51	-130	-88	-9	-250	-7	-354
Belarus	-1,394	-2.2	-9	487	391	-1,415	-546	-133	-310	176	21	-246	173	561	99	-1,011	-178	-115	-335	230	-34	-254
Bosnia-Herzegovina	85	0.4	141	118	-67	72	264	-45	22	-53	13	-63	82	117	-56	58	201	-46	22	-55	14	-65
Bulgaria	-606	-0.9	239	208	-711	-525	-789	-289	-70	-294	-81	-734	260	219	-13	-500	-34	-160	-159	-491	-83	-893
Croatia	-679	-1.1	343	-816	210	-819	-1,082	278	-632	-808	140	-1,022	355	-140	170	-753	-368	98	-609	-1,056	157	-1,410
Czech Republic	1,426	0.6	6,797	-6,101	-265	1,714	2,145	1,053	-203	59	-288	621	7,535	-8,228	-4,433	2,297	-2,829	2,169	224	-1,637	-341	415
Estonia	-1,011	-3.2	-463	224	97	-952	-1,094	-178	36	65	-59	-136	-439	264	64	-952	-1,063	-203	93	75	-104	-139
Hungary	1,005	0.6	1,048	-1,088	-521	1,600	1,039	-791	-266	903	-595	-749	908	-963	-906	1,185	224	-321	-59	517	-654	-517
Latvia	-607	-1.8	-735	256	371	-575	-683	182	211	697	-32	1,058	-732	265	403	-531	-595	151	120	446	-54	663
Lithuania	69	0.1	-224	-148	-681	61	-992	-340	12	486	8	166	-216	-128	-688	44	-988	145	96	-47	-56	138
North Macedonia	-140	-1.1	402	-320	307	-99	290	29	-5	133	-41	116	387	-330	288	-180	165	42	-27	73	-19	69
Moldova	85	0.7	-17	13	-6	63	53	-32	58	-17	22	31	-9	3	5	-2	-3	-32	57	-17	22	30
Montenegro	88	1.6	85	15	34	-57	77	257	176	10	145	588	16	20	34	-13	57	278	142	53	85	558
Poland	1,244	0.2	-4,345	2,960	-3,854	908	-4,331	110	-1,144	3,557	336	2,859	-4,168	1,554	-4,600	2,634	-4,580	1,595	-694	2,434	2,364	5,699
Romania	1,493	0.6	-1,967	-434	-1,330	190	-3,541	1,079	70	24	1,303	2,476	-1,936	-626	-1,440	-267	-4,269	929	-58	-365	299	805
Russia	3,380	0.2	4,513	-2,549	-2,828	2,753	1,889	-1,441	-222	3,224	627	2,188	3,413	-12	-3,533	3,166	3,034	-2,666	231	1,779	756	100
Serbia	116	0.2	226	385	-10	-487	114	225	453	388	603	1,669	229	400	-219	-282	128	189	619	-2	298	1,104
Slovakia	-36	0.0	1,376	3,495	-1,428	-137	3,306	395	84	601	101	1,181	1,384	3,082	-1,920	-298	2,248	-80	158	96	246	420
Slovenia	-1,453	-2.7	180	-37	64	-1,105	-898	130	-747	918	-348	-47	42	-87	-9	-279	-333	1	-388	-208	-171	-766
Turkey	-16,498	-2.2	-424	-21,679	-5,871	-11,291	-39,265	1,302	-3,892	-2,014	-5,207	-9,811	946	-18,422	-4,939	-8,364	-30,779	2,572	-2,988	-2,571	-3,838	-6,825
Ukraine	524	0.3	-404	6	647	-129	120	-21	79	-93	653	618	-387	66	104	-52	-269	-213	185	-366	248	-146
CESEE	-12,973	-0.3	6,792	-25,075	-15,385	-10,282	-43,950	1,676	-6,286	7,727	-2,691	426	7,858	-22,460	-21,608	-4,151	-40,361	4,245	-3,379	-1,362	-872	-1,368
CESEE ex. RUS & TUR	145	0.0	2,703	-847	-6,686	-1,744	-6,574	1,815	-2,172	6,517	1,889	8,049	3,499	-4,026	-13,136	1,047	-12,616	4,339	-622	-570	2,210	5,357

Sources: BIS, Locational and Consolidated Banking Statistics; Haver Analytics; and IMF, World Economic Outlook, and IMF staff calculations.