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Dynamics of Bank Credits to Private Sector in the Central and Eastern European Countries

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Abstract

Objective: The purpose of the research is to analyze credits dynamics, provided by banking sectors in the CEE countries from the international financial crisis to present.
Methodology: The study examines the data for domestic credits, provided by banks of the ten Central and Eastern European countries in particular Bulgaria, Romania, Poland, Hungary, Czech Republic, Estonia, Lithuania, Latvia, Slovenia, Slovak Republic. The used methods are descriptive analyses and synthesis.
Results: It is found that the bank credits were negatively affected by the observed crises in the last twenties years: international financial crisis, European debt crisis and pandemic crisis. After the COVID-19 crisis the credit growth has started to recover, together with the economies. In 2021, all banking systems in CEE countries reported a recovery of their loan portfolios, recording positive growth rates. However, rising and accelerated inflation since mid-2021 and the subsequent reaction by central banks to curb it faces new challenges for banks and countries.
Implication: The study's results are important for policy makers, aiming to recover the economic development of countries, as well as to the bank managers, aiming to improve the activity of the managed banking institutions.

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INTRODUCTION

The dynamics of credit provided by banks to the private sector is of particular importance for an economy, since it is through the credit channel that central banks ensure the action of their monetary policy on the economy through the so-called transmission mechanism. This mechanism is disrupted in times of crisis, leading central banks to turn to non-conventional monetary policy instruments such as asset purchases, aiming to intervene directly in certain markets and providing the necessary liquidity for the purposes of economic recovery. In these processes, the role of banks, which are the main intermediaries in an economy, is also very important. This is particularly true for the financial sector of the CEE countries. Their non-bank financial intermediaries account for only about 10% of total assets in the financial system.

The main activities of banks are related to the attraction of deposits and their provision of credit to economic agents experiencing a shortage of financial resources. Lending by banks leads to a rise in demand for commodities in the economy and to an increase in investment. The study of the dynamics of bank credits to the firms and households is therefore a particularly topical issue.

The objective of the research is to trace the dynamics of credit provided by the banking sector to the firms and households (private sector) in the CEE countries. The study period is from the global financial crisis to the latest available data on banking sector lending in the countries analysed.

The study uses data on credit extended by the banking systems of ten CEE countries, namely Bulgaria, Romania, the Czech Republic, Poland, Hungary, Slovakia, Slovenia, Estonia, Lithuania and Latvia. The methods used are descriptive analysis and synthesis. The statistical information used in the study is from the databases of the IMF and the World Bank.

The study argues that the banking systems of CEE countries are facing many challenges related to the observed crisis processes, new regulations and supervisory requirements of central banks, the level of non-performing loans and economic development.

The study has several parts. The next part reviews the literature from the perspective of studies on the analysis of credit dynamics in CEE countries. The third part analyses the data on credit extended by the banking systems of the CEE countries. The last section presents the main findings of the study and future research directions.

LITERATURE REVIEW

There are a lot of studies in the economic literature dealing with the dynamics of credit provided by banks to the private sector, as well as dealing with the development of banking systems.

Two groups can be distinguished among the studies in respect to the analised countries. On the one hand, these are studies concerning the development of credit and the banking sector in an individual country (Vachkov, Georgiev, Valkanov and Yambolov 2017; Dimitrov 2018; Mihaylova-Borisova 2021a; Sariiski 2011), and on the other hand, these are studies related to the dynamics of credit in several countries with similar development (Kiss et al. 2006; Aydin 2008; Enoch and Otker-Robe 2007).

Studies on the performance of the banking system in Bulgaria use a number of indicators characterizing banks. Vachkov, Georgiev, Valkanov, and Yambolov (2017) analyze the banking system stability by focusing on the asset quality, liquidity position of banks and their solvency.

In analysing the development of the banks, the researchers also considered the crises impact in the last years - the international financial crisis in 2008 and the COVID-19 crisis. In this regard, Dimitrov (2018) examines the influence of the international crisis in 2008 on the stability of Bulgarian banks, concluding that they are highly liquid and maintain their high capital adequacy. Sariiski (2011) also analyses the impact of the crisis on the banking system in Bulgaria. The study concluded that Bulgarian banks were not largely influenced by the crisis. Mihaylova-Borisova (2021a) examines the impact of the COVID-19 crisis on the Bulgarian banking sector. It concludes that banks are more stable than during the international financial crisis in 2008. In addition to studies on the stability of the banking system in Bulgaria, there are those that calculate and analyze the bank efficiency dynamics (Borisov 2017; Borisov 2020; Nenovsky, Mihaylova, Chobanov and Koleva 2008).

Tsanevska (2017), Vasileva (2017), Peshev (2014) analyze the lending activity of Bulgarian banks. Peshev (2014) examines the factors that affect the demand for credit in several EU countries but outside the euro area. The period of analysis is from 2008 to 2012. The result showed that the significant impact of economic activity on credit demand is proved.

Among the group of comparative studies on banking systems is that of Kiss et al. (2006). The authors investigate whether the CEE countries are experiencing a more serious increase in lending due to convergence towards the euro area countries, or whether this increase in lending is more related to a credit boom that poses a risk to the financial stability of the countries. For this purpose, the researchers use data for the new EU member states including (Estonia, Lithuania, Latvia, Czech Republic, Slovakia, Slovenia, Hungary, Poland) applying a panel econometric model for the purpose of separating the equilibrium trend and the excess (boom) component. The results pointed out that for most countries the credit-to-GDP ratio appears to be below the level justified by macroeconomic fundamentals. For two countries, Latvia and Estonia, the increase in this ratio is found to be beyond the equilibrium level in the years 2004-2005. For this reason, credit growth in Estonia and Latvia is considered to be riskier, while there are no signs of excess credit growth for the Czech Republic, Slovakia and Poland (Kiss et al. (2006), p. 23).

Aydin (2008) examines the importance of foreign banks in the credit boom in Central and Eastern European countries. The results show that they are essential for credit growth in these countries. Banking sector credit activity in the countries analysed depends on foreign banks, for which economic activity and interest margin are determinants.

Emoch and Otker-Robe (2007) also investigate the concept of excessive growth of credit in Central and Eastern European countries. The credit dynamics for each country over a longer period, before the international financial crisis in 2008 is also analysed. Overall, for the period 1996-2004, this indicator was at a much lower level than the European Union average (Emoch and Otker-Robe 2007, p. 54). By 1998, the countries of Central and Eastern Europe (Bulgaria, Croatia Latvia, Lithuania,, Estonia, Slovenia, Hungary, Romania) had levels of this indicator below 40%, with the largest value in Croatia at 40%, while Bulgaria, Romania, Lithuania and Latvia had levels below 20%. Until 1997, the majority of these countries' loans were denominated in national currency, with the exception of Latvia and Romania. In 2004, only Croatia and Slovenia remained with loans predominantly denominated in local currency - around 70-80% of total credits, while for most countries the part of loans in local currency was below 50% in the same year.

As a result of the literature review, it worth to be concluded that there are numerous studies on both the development of banking systems for individual countries and groups of countries and the development of credit in individual countries and groups of countries. It is noteworthy, however, that the time period is very short and covers several years, i.e. they concentrate on periods of rapid credit growth, periods of global financial crisis or pandemic crisis. For this reason, a study of the dynamics of credit in the Central and Eastern European countries for the period from 2008 to the present would be particularly important.

Analyses of credit dynamics in the Central and Eastern European Countries

When analysing the loan portfolios of banks in Central and Eastern European countries, loans to the private sector have shown a steady downward trend in the years following the 2008 global financial crisis. In 2008, the countries, having the highest share of credit in GDP were Estonia, Latvia, Slovenia, Bulgaria (Figure 1). The high levels of loans as a present of GDP are due to high growth rates in the years before the financial crisis. In Bulgaria, for example, the credit growth was 63.3% in 2007. The minimum reserve ratio was used to limit credit growth, despite the action of the Currency Board. It was increased from 8% to 12% in September 2007, and additional reserves were introduced if a certain credit growth rate was exceeded. All these administrative restrictions introduced by the central bank aim to limit credit growth.

Estonia also recorded a credit growth rate of over 60% in 2004 and 2005. The high growth of banks' loan portfolios in Estonia is associated with sound public finances and a favourable business environment, low real interest rates, high GDP growth, EU accession (OECD 2011). The expansion of the credit portfolio of banks in Estonia is also due to the low level of lending in the years before the country's accession to the EU i.e. the low level of financial intermediation. The share of loans in GDP in 2004 was only 40.3% and reached 101.4% in 2009. At the same time, high credit growth is dangerous as it also reveals the presence of macroeconomic imbalances (Fitch 2005).

The only CEE country that has seen an increase in the share of credit as a share of GDP over the period analysed is Slovakia. In 2008, private sector claims as a share of GDP amounted to 40.7% and rose to 68.3% in 2021, reaching the highest level of credit as a share of GDP among all CEE countries. Following the country's accession to the European Union, an accelerated increase in the banking sector's lending to the non-financial sector began (Harvan et al. 2015, p. 3). In the loan portfolio structure of banks in Slovakia, it can be observed that until the 2008 international financial crisis, loans granted to non-financial enterprises increased, while after that the increase stopped. At the same time, loans granted to households continued to grow at double-digit rates as they were used to finance the purchase of a house. Housing loans accounted for 77% of total credits extended to households at the end of 2014 (Harvan et al., 2015, p. 3).

With the accelerated growth of the banks' loan portfolio, the level of non-performing loans is also important, as it is possible that at some point a larger part of these loans will become non-performing with a more substantial increase in borrowers' indebtedness. Countries with higher levels of credit as a share of GDP, such as Latvia and Estonia, experienced a more substantial deterioration in the quality of their banking systems' loan portfolios within a year of the global financial crisis (Figure 2). After this increase, there was an improvement in their loan portfolios. For most countries, an improvement in the quality of banks' loan portfolios is observed several years after the 2008 financial crisis until 2013-2014. These are several countries such as Bulgaria, Hungary, Romania, whose non-performing loans reached 16.7%, 15.6% and 13.9% in 2014, respectively. Due to the financial crisis and the slowdown in credit growth, a gradual stabilisation and improvement in the quality of banks' loan portfolios in CEE countries has also been seen. In 2021, non-performing loans account for less than 5% of the loan portfolios of banks in the countries analysed. An additional factor for banks' loan quality improvement is the pandemic crisis, which has a restraining effect onthe new loans due to business closures, job cuts, and income restrictions.

In some countries, moratoriums are being introduced on payments on loans already received by households and businesses to deal with the negative effects of the pandemic crisis, while in other countries moratoriums are being introduced on loan payments to deal with inflation. For example, Bulgaria is introducing a private moratorium from 13 March 2021 for the purpose of easing the difficulties faced by households and businesses in servicing their obligations. On December 2, 2020, a decision of the Bulgarian National Bank's Managing Board extended the deadline for deferring loans to households and firms (Mihaylova-Borisova 2021a). This has a favourable impact on the quality of Bulgarian banks' loan portfolios. In 2020, the deterioration was by 0.82 percentage points to 5.8% by year-end. There is an improvement in Bulgarian banks' credit portfolios' quality (4.6% non-performing loans (NPLs) as a share of total loans at end-2021), despite some increase in NPLs to 6.4% at end-September 2021.

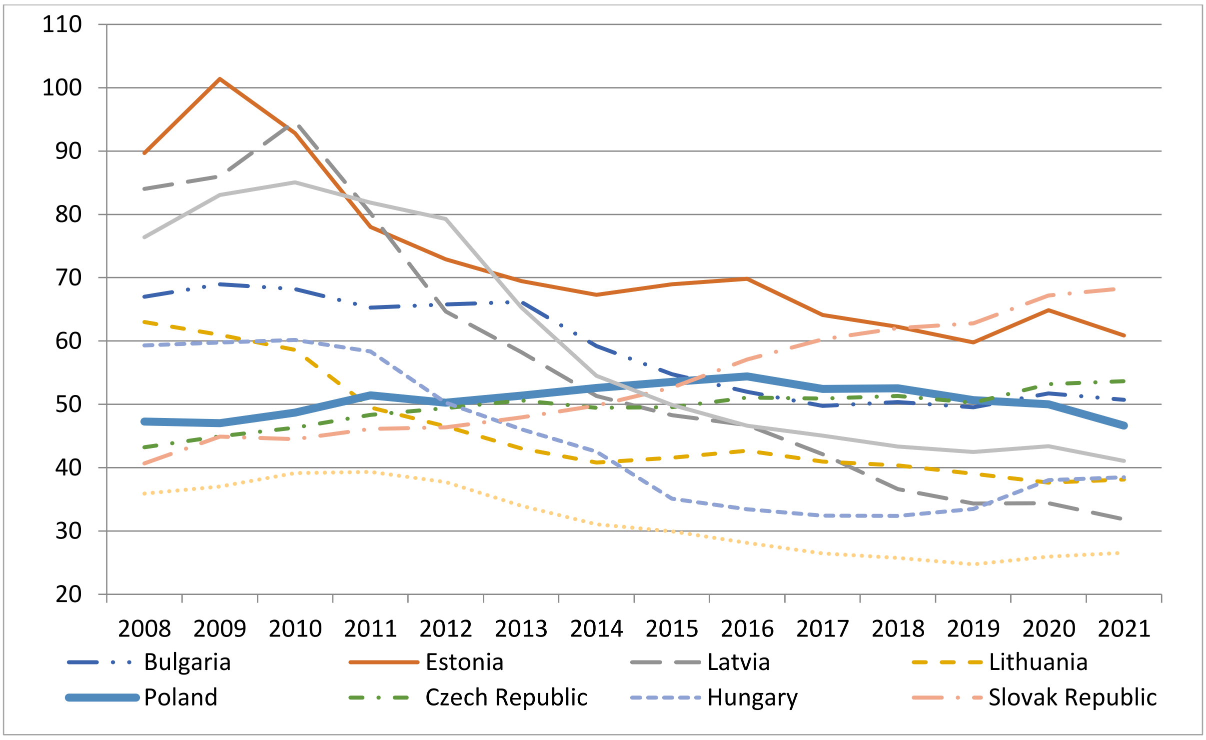


Figure 1. Claims to private sector as a share of GDP, %
Sources: World Bank Database

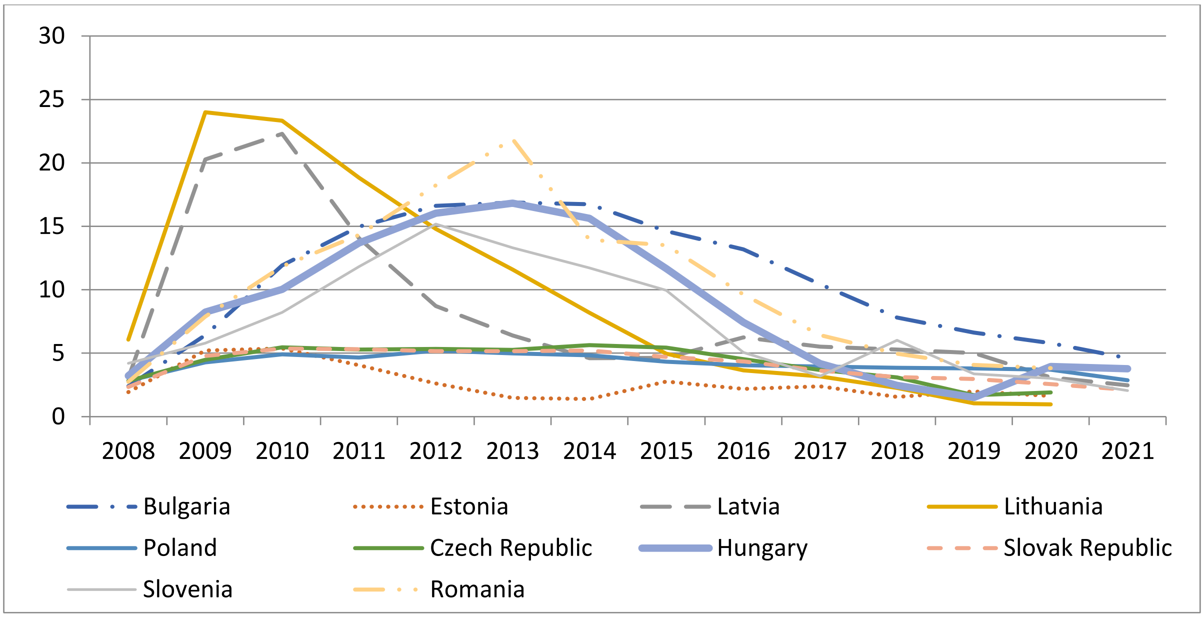


Figure 2. Bank non-performing loans (% of total gross loans)
Sources: World Bank Database

From the beginning of July 2022 Romania introduces a temporary moratorium on the servicing of bank loans by households and companies. The measure is part of an overall EUR 1.1 billion package aimed at reducing the impact of accelerating inflation. Households eligible for the temporary moratorium must have demonstrated that their monthly expenditure has increased by 25% year-on-year over the past three months. Businesses are required to prove that their annual revenues have fallen by 25% year-on-year over a three-month period.

Credit dynamics depend on credit interest rate levels. Since the global financial crisis, there has been a steady downward trend in lending rates in most countries. This is the result of the expansionary policy of the European Central Bank (ECB) and other non-euro area central banks, which initially moved to lower key interest rates to support constrained lending after the 2008 global financial crisis. After interest rates reached zero levels, even after introducing negative interest rates in mid-2014, the ECB moved to directly inject liquidity into specific markets (Mihaylova-Borisova 2021b). In 2022, the ECB starts to increase interest rates and tighten monetary policy because of rising inflation, which will affect future lending and deposit rates upwards.

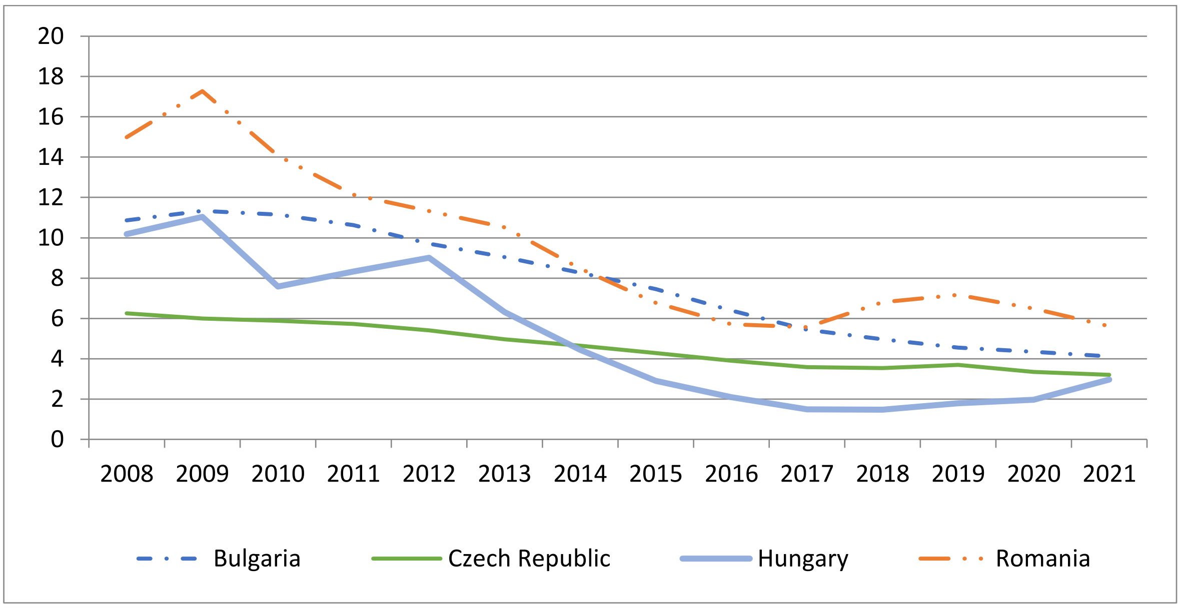
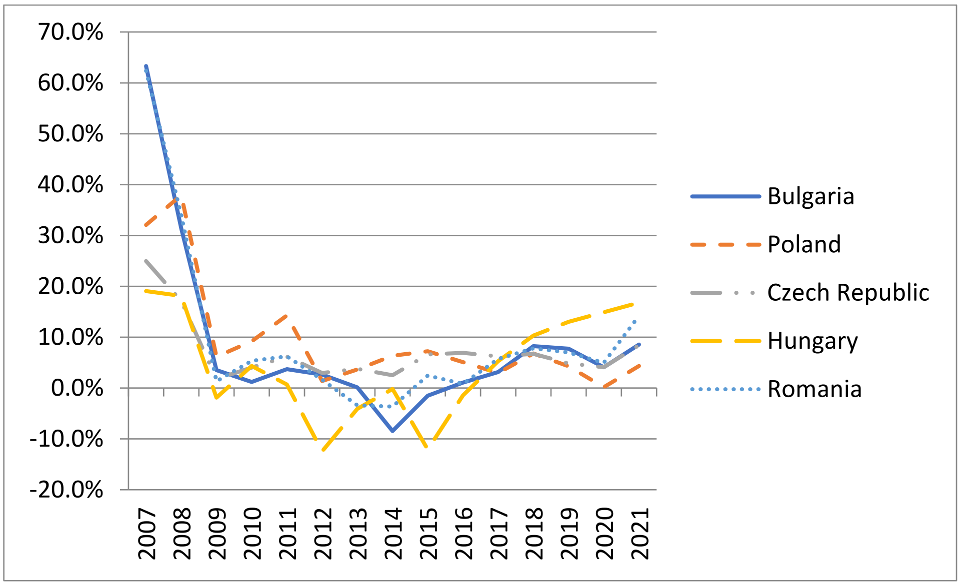


Figure 3. Lending interest rates (%)
Sources: World Bank Database

Over the period analysed in the countries covered, the most significant decline in lending rates was recorded in Romania, which went from 17.3% in 2009 to 5.6% in 2021 (Figure 3) . In 2018 and 2019, a slight increase in lending rates was observed in Romania, but it was also associated with a slight increase in deposit rates in these two years, from 0.89% in 2017 to 1.3% in 2018 and 1.9% in 2018, respectively. At the same time, the real interest rate in Romania fell below 1%, the lowest since the financial crisis, which is reflected in the slowdown in the country's credit growth rate in 2018-2019.

In Hungary, lending rates are the lowest compared to Romania, the Czech Republic and Bulgaria since 2014. Over the period 2015-2021, lending rates in the country range from 1.36% to 1.95%. These low interest rates on loans granted by the banking system have a favourable impact on economic agents in terms of loan withdrawals. The growth rate also reached double-digit levels in this period, accelerating rapidly from 5.3% in 2017 to 16.8% in 2021 (Figure 4).

The crises have had a negative impact on credit dynamics in Central and Eastern Europe. The global financial crisis has had a significant impact on the growth rate of credit extended by banks to the private sector. In 2009, there was a significant slowdown in the growth rate of credit in all countries compared to the previous year, due to the loss of jobs, the slowdown in economic activity, the decline in the incomes of economic agents. In Estonia and Hungary, there was even a fall in lending of 3.9% and 1.9% respectively in 2009. Over the period 2012-2013, there was also a drop in bank private loans in almost all countries except Bulgaria, Estonia, Poland, Slovakia and the Czech Republic. The most significant decline was recorded in Slovenia, with a 17.1% year-on-year decline in 2013. Following the gradual recovery of economies from the debt crisis in Europe in 2012-2013, positive credit growth rates were also observed. However, the pandemic crisis again had a negative impact on their growth rate. The dynamics of lending in the countries analysed show that banks are facing the challenge of coping with the crisis developments, economic instability, stricter regulations related to high capital adequacy and liquidity requirements after the global financial crisis. However, thanks to the stricter regulatory requirements after the global financial crisis, banks are better prepared for the next two crises, and therefore their recovery is faster. In 2021, all banking systems in Central and Eastern European countries reported a recovery of their loan portfolios, recording positive growth rates.



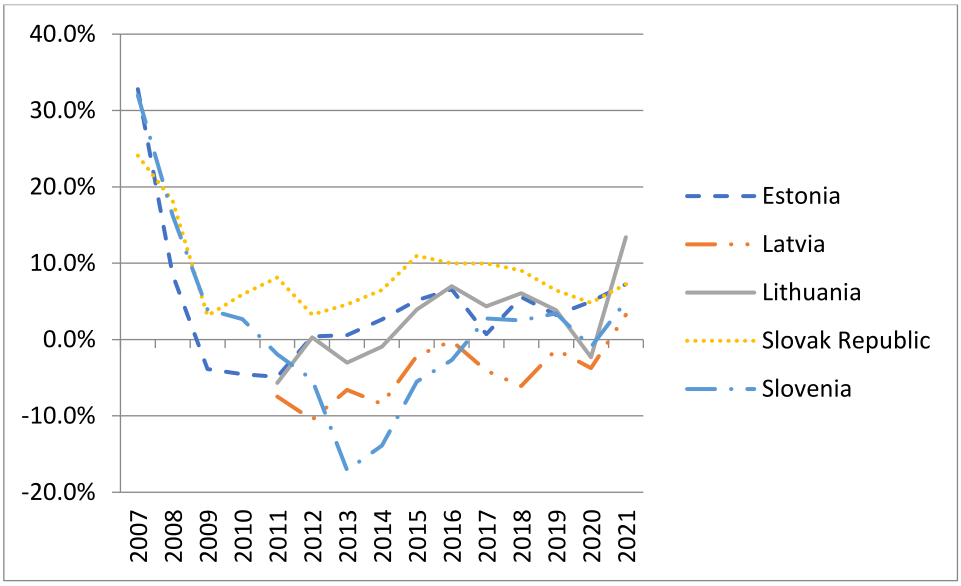


Figure 4. Private sector claims growth rate (%)
Sources: World Bank Database, own calculations

DISCUSSION AND CONCLUSIONS

The study analyses the dynamics of credit provided by banks to the private sector in Central and Eastern European countries. Data for the ten Central and Eastern European countries Bulgaria, Romania, Czech Republic, Poland, Hungary, Slovakia, Slovenia, Estonia, Lithuania and Latvia are used. It is found that most countries have seen a decline in the level of credit extended to the private sector as a share of GDP due to the impact of a series of crises: the global financial crisis, the European Union debt crisis and the pandemic crisis. The only country in Central and Eastern Europe that has seen an increase in the credits as a share of GDP over the period analysed is Slovakia. In 2008, private sector claims as a share of GDP amounted to 40.7% and rose to 68.3% in 2021, reaching the highest level of credit as a share of GDP among all countries in the region.

The level of non-performing loans is also of concern to banks, as accelerated growth in banks' loan portfolios could lead to deterioration in the quality of loan portfolios. Countries such as Latvia and Estonia, which had higher levels of loans as a share of GDP before the global financial crisis, also experienced a more significant deterioration in the quality of loan portfolios in the year after the crisis. For most countries, there was an improvement in the quality of banks' loan portfolios several years after the 2008 financial crisis until 2013-2014. These are several countries such as Bulgaria, Hungary, and Romania, whose bad loans reached 16.7%, 15.6% and 13.9% in 2014, respectively. Due to the financial crisis and the slowdown in credit growth, a gradual stabilization and improvement in the quality of the loan portfolios of banks in Central and Eastern European countries is also reported, reaching levels below 5% of the loan portfolios of banks in the countries analyzed in 2021.

Taking the importance of credit for countries' economic development, future work will focus on identifying the determinants of credit dynamics in Central and Eastern European countries. This is also important for economic policy makers, as expectations of recession in the countries and rising inflation, they will face new challenges.

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