Banking Sector Trends and Challenges in Selected Central and Eastern European Countries

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Abstract
The aim of the paper is to analyse the main features of the banking systems of five countries from Central and Eastern Europe (Czech Republic, Poland and Hungary, which adhered at the European Union in 2004, Bulgaria and Romania, which became member of the European Union at first January of 2007). In the study we took into consideration the Republic of Slovenia and Slovakia – new member states of the Monetary Union – to highlight the discrepancies between countries and the efforts necessary on the way to convergence.
The analyses undertaken in the paper show some common features of the banking systems from these countries, such as: the dominant position of the banks in the national financial systems, even if in the last years we can observe the increased role played by other financial intermediaries (insurance companies, investments funds, leasing companies); the little role of capital markets in financing the companies; the prevalence of foreign-owned banks, with positive influence on the development and consolidation of banking system, the rapid increase of non-government credit (especially, credits denominated in foreign currencies).
Even if these banking systems have achieved important progresses, their development and efficiency is different from one country to another. While in some countries, the banking sector development is similar to the Euro Zone, in other countries there are significant disparities. In the context of the current financial crisis, we intend to show the latest transformations of the banking systems from these countries.
The current financial crisis has determined the decrease of the rate of growth of credits and even halting lending in some countries, which entailed significant intensification of the concerns of national and international authorities in adopting urgent measures in order to restore the stability of the economies and to resume the credit activity.

Keywords: *financial system, banking sector, financial intermediation, banking credits, lending structure.*
Keywords: *credit institutions, banking intermediation, lending structure, loans granted households, financial stability, the current financial crisis*

JEL classification codes: E44, E51, G21.

Introduction

Due to the restructuring and privatization process, the alignment of banking legislation to European legislation requirements, diversification of products and services portfolio offered by the banks, the banking sector of the Central and Eastern European countries registered in the last decade a significant consolidation. Today, the banking sector represents the most important component of the financial system.

The dominant position of the banking sector within the financial system of the Central and Eastern European countries is illustrated by the banking assets that hold, on an average, 70% of the total assets of the financial system. As a matter of fact, the financial system of all the European Union member states is centered on banking financial intermediaries. In this respect, it is estimated that the stability and the efficiency of banking sector is an essential precondition for sustainable economic development of the states and, at the same time, for providing a good running of the nominal and real convergence process. Likewise, a solid and competitive banking sector allows the efficient transmission of monetary policy signs towards the real economy and, thus, contributing to achieve the basic objective of the central banks of the surveyed countries and namely, the provision and maintenance of price stability.

The structure of the financial system in the case of the considered countries can be followed based on figure 1. The data illustrated in figure 1 shows, on one hand, the dominant position of the banking sector within the financial system and, on the other hand, the fact that although the non-banking financial institutions hold a reduced share of the total assets of the financial system, in recent years they recorded a fast increase (mainly, the insurance companies, the investment funds and leasing companies). Such an evolution is due to the macroeconomic stabilization, structural changes within the non-banking sector, as well as to the measures taken by monetary authorities, mainly in Romania and Bulgaria in order to limit the increase of bank credits that engaged the increase of the credits given by non-banking financial institutions, especially by the leasing companies.

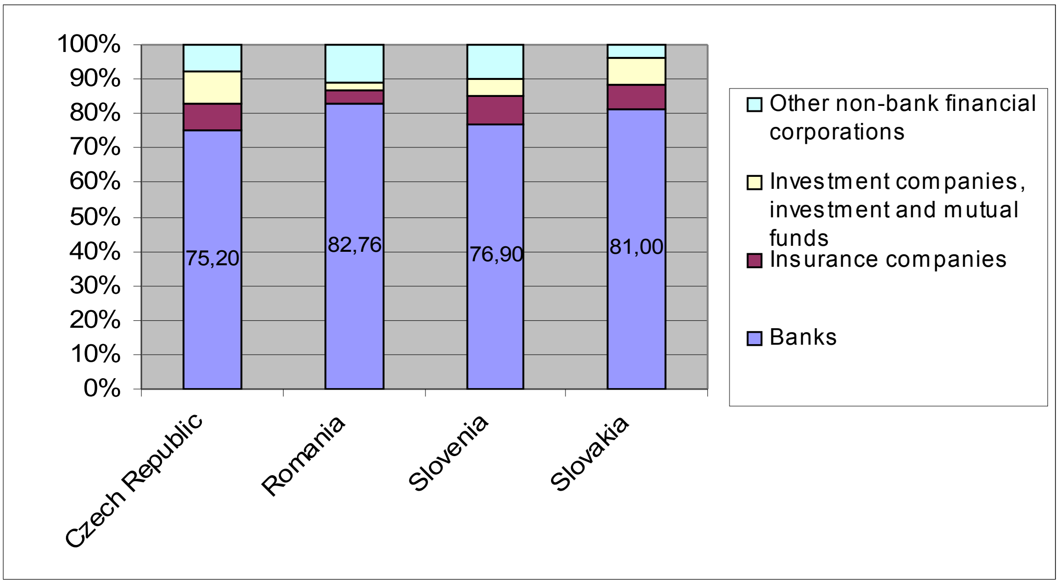

Figure 1: The structure of financial system in selective countries from Central, Eastern and South-Eastern Europe in 2008 (in % of total assets of financial systems)

Source: restructured data after national central banks.

Our paper is structured as following: the second section highlights the changes produced in the banking sector from some countries of Central and Eastern Europe, emphasized through the EBRD indicator, the presence of foreign banks, and the process of banking consolidation.
The third section analyses the transformations registered in the credit activity of the credit institutions through the dynamics and the structure of the loans granted to nonfinancial corporations and to households. Also, in this section, we intend to highlight the factors that have determined the accelerated dynamics of credit, especially the one granted to households, but also the implications in terms of macroeconomic stability. The study ends with conclusions.

Changes in the structure of banking sectors in the countries of Central and Eastern Europe

Transformations in the banking systems of the countries of Central and Eastern Europe taken in the analysis may be evidenced by a synthetic indicator calculated by the European Bank for Reconstruction and Development (EBRD), the assessment of banking reform and liberalization of interest rates. This indicator measures the degree of reform of the banking sector by liberalizing interest rates and the allocation of credit, the lending to the private sector, private ownership of the banking sector, the level of competition between banks, banks' solvency, the implementation of a regulatory framework and prudential supervision. The indicator values are between 1 and 4+ and have the following meaning: the value of 1 signifies reduced progress in the reform process, and the 4+ reflects a full convergence with international standards and performance of advanced industrial economies, a full convergence of banking laws and regulations with BIS standards, and a full range of banking services (EBRD, 2006).The reform of the banking systems of the countries taken in the analysis, revealed the EBRD indicator, may be pursued based on data in Table 1.

Table 1: Assessment reform the banking system based on the EBRD index, in some countries of Central and Eastern Europe in the period 1990-2008

Country	1990	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008
Bulgaria	1.00	2.00	3.00	3.00	3.30	3.30	3.67	3.67	3.67	3.67	3.67
Czech Republic	1.00	3.00	3.30	3.67	3.67	3.67	3.67	4.00	4.00	4.00	NA
Hungary	1.00	3.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Poland	2.00	3.00	3.30	3.30	3.30	3.30	3.30	3.67	3.67	3.67	3.67
Romania	1.00	3.00	2.67	2.67	2.67	2.67	3.00	3.00	3.00	3.30	3.30
Slovenia	1.00	3.00	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30
Slovak Republic	1.00	2.70	3.00	3.30	3.30	3.30	3.70	3.70	3.70	3.70	3.70

Source: EBRD, 2008.

The transition indicator's values, computed by EBRD, highlight, on one hand the fact that all analyzed countries have registered significant progresses in the banking sector reform, and, on the other hand, for all countries (except Hungary, where the transition indicator has the maximum value of 4+) there are still improvement possibilities. The lower score obtained by Slovenia and Romania (3,3% for the year 2008 by comparison with 3,67% in the case of Bulgaria and Poland) is due to the slowly rhythm of the reform process.

A fundamental characteristic of reform in the analyzed countries is privatization, which was completed in a large number of countries and which has deeply affected the structure of bank ownership. Bank privatization sectors was considered the most important way through which foreign banks could step into the bank markets of Central and Eastern European countries. In this context, it is to be mentioned the most important privatization made until now in Central and Eastern Europe, that is the selling of the Commercial Bank of Romania at the end of 2005 to Erste Bank AG, which has determined in Romania the significant increase of the percentage of assets held by the banks with foreign majority capital out of the total assets of the banks, from 59.2% at the end of 2005 to 87.3 % at the end of 2007.

Foreign banks prevail mostly in the Slovak Republic, Romania, the Czech Republic and Bulgaria (see data in figure 2). In these countries, foreign banks are the leading actors on the domestic bank markets, hence their behavior influences greatly the bank crediting operations and generally the level of financial mediation. In comparison to the mentioned countries, the percentage of the foreign capital is much lower especially in Slovenia (only of 28.7% at the end of 2008), where the private capital which is mostly domestic.

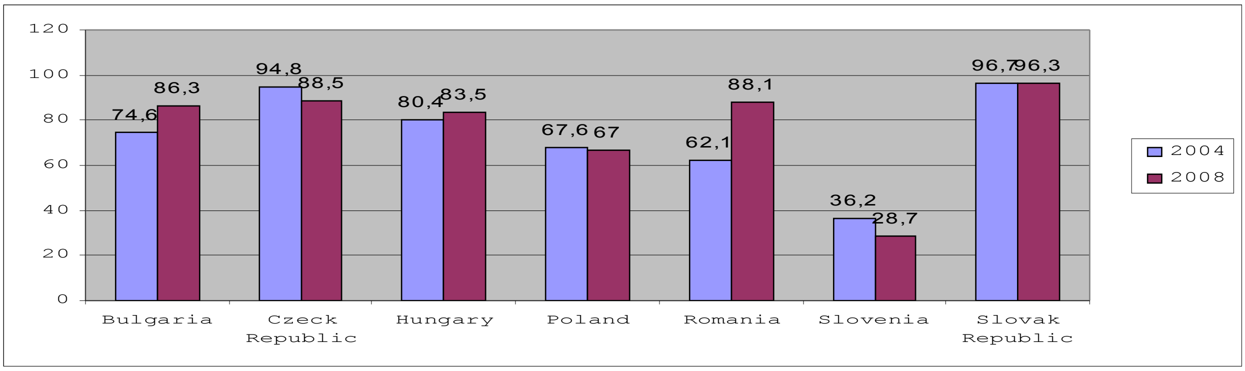

Figure 2: Asset shares of foreign-owned banks (in %) in some countries in Central and Eastern Europe in the period 2004 – 2008
Source: Raiffeisen Research, 2009.

Banking sector in the countries of Central and Eastern Europe is dominated by banks from Western Europe, especially the Austrian banks (Erste, Raiffeissen), French (Société Générale), Italian (UniCredit, Intesa), German (Commerzbank, BayernLB) and Dutch (ING), which is shown in table 2.

Table 2: Involvement of Western Banks in the Countries of Centra and Eastern Europe in 2008

Country	Main foreign banks
Bulgaria	UniCredit, OTP, Raiffeisen
Czech Republic	KBC, Erste, Société Générale
Hungary	KBC, BayernLB, Intesa
Poland	UniCredit ING Commerzbank
Romania	Erste Société Générale Raiffeisen
Slovenia	Société Générale Intesa UniCredit

Slovak Republic	Erste Intesa Raiffeisen

Source: Centre for Eastern Studies, 2009.

In specialized literature (Hryckiewicz, 2008) tackling the banks with international operations, there are several factors which are very important for the selection of the location, such as: the potential of bank market from the host country, the legislation of the country of origin, economic growth rates of the origin and host country and the headquarters of the foreign bank. In the case of the Central and Eastern Europe countries which were taken into account for our study project, foreign banks were interested to extend their operations especially because of the high economic growth of bank markets in those countries , the low financial mediation and the high level of interest rate.

From the point of view of the host country, this is interested in attracting the interest of foreign banks as they may contribute to the enhancement of stability, reliability and competitiveness of the banking sector, to the significant improvement of the banking practices further to the numerous advantages created, such as: better bank-risk management, bank product quality, range and price improvement, the enhancement of the efficiency of the banking operations further to the know-how added, technology and liquidities included, the facilitation of the access to foreign financing for the companies and the individuals of the host country.

Furthermore, foreign banks may contribute to the enhancement of the private sector crediting in the host country, on the one hand, because they are not restricted by the conditions on the domestic market, and on the other hand because of the easy access to financing on the international financial markets, based on the reputation of the mother bank (Burcu, 2008).

Besides these advantages, the presence of the foreign banks also presents certain limitations, the most important being the exposure of the host country to a high contagion risk. This is because the financial difficulties of the mother bank that take place when the origin country is in recession may affect their branches abroad. On the other hand, significant macroeconomic unbalances in the host country may determine the withdrawal of the foreign bank capitals or the renunciation of the mother banks to the financial support of their branches, with serious consequences, particularly in the financial stability of that country.

Another mutation that occurs in the structure of the bank sectors in all Central and Eastern European countries is the intensification of bank reinforcement, seen in the increase of the number of banks (see the data in table 3). If in the case of some countries, mostly the Czech Republic, Bulgaria and Hungary, we see a significant diminishing of the number of banks, in the case of other countries such as Poland, Romania and Slovakia we witness a divergent tendency, the number of banks increasing. Against the background of banking reinforcement, it is worth noting that the decrease of the number of credit institutions was the result of numerous mergers and purchases and less the effect of bank going bankrupt.

Table 3: The evolution of number of credit institutions in different countries in the period 2003 - April 2009

Country	Number of credit institutions						
	2003	2004	2005	2006	2007	2008	2009 April
Bulgaria	35	35	34	32	29	30	30
Czech Republic	77	70	56	57	56	54	54
Hungary	222	217	214	212	206	204	192
Poland	660	744	730	723	718	712	715
Romania	39	40	40	39	42	45	44
Slovenia	33	24	25	25	27	25	26
Slovak Republic	22	21	23	24	26	26	27
MU	6.623	6.427	6.271	6.157	6.128	6.570	6.550
EU	9.054	8.908	8.689	8.514	8.348	8.525	8.465

Note: PL data for the number of credit institutions include credit unions since 2004, whereas previously it included only commercial and cooperative banks.
Source: ECB, 2008 and Bank of Slovenia.

The enhancement of bank reinforcement in the Central and Eastern European countries also has effects on the bank market concentration, measured by the ratios Herfindahl – Hirschmann and the market share of the first 5 crediting institutions (see the data in table 4). In the case of all the studied countries, we can see a tendency of decreasing the bank market concentration that, next to the increase of the number of banks with foreign-owned majority capital may be perceived as signs of enhancement of bank competitiveness. Furthermore, it is worth mentioning the situation in Poland where the concentration degree is much lower (in the case of both indices) in comparison to other countries, which means a higher competitiveness on the banking market. In all countries (except for Poland) including in EU27 and the Monetary Union, the first 5 credit institutions hold more than 50% of all banking assets.

Table 4: The evolution of the concentration index of banking market in different countries in the period 2003 - 2007

Country	Herfindahl* Index					Weight of the 5 leading credit institutions in the total assets				
	2003	2004	2005	2006	2007	2003	2004	2005	2006	2007
Bulgaria	NA	721	698	707	833	NA	52.30	50.80	50.30	56.70
Czech Republic	1.187	1.103	1.155	1.104	1.100	65.80	64.00	65.50	64.10	65.70
Hungary	783	798	795	823	839	52.10	52.70	53.20	53.50	54.10
Polonia	754	692	650	599	640	52.00	50.00	48.50	46.10	46.60
Romania	1.251	1.111	1.115	1.165	1041	55.20	59.50	59.40	60.10	56.30
Slovenia	1.496	1.425	1.369	1.300	1.282	66.40	64.60	63.00	62.00	59.50
Slovak Republic	1.191	1.154	1.076	1.131	1.082	67.50	66.50	67.70	66.90	68.20
MU13 unweighted avg.	579 983	599 997	642 1029	630 996	654 1.006	40.50 54.20	41.60 54.20	42.60 54.90	42.80 54.40	44.10 54.70
EU 27 unweighted avg.	545 1.145	567 1.114	600 1.135	588 1.104	628 1.102	39.70 58.80	40.90 58.50	42.10 59.30	42.10 58.90	44.40 59.40

**** calculated as the sum of the square of the market shares for all credit institutions in a Member State***

Source: ECB, 2008.

Financial intermediation, lending structure and profitability of the banking system

A significant sign of progress recorded by the banking sectors of Central and Eastern European countries is represented by the increase of financial intermediation degree expressed both in the light of banking assets share of GDP and in the light of banking credits share of GDP (see the data of figure 3). Such an evolution reflects the significant orientation of credit institutions to the real economy and their return to the financial intermediation function.

The significant remaking of the financial intermediation process, mainly in Bulgaria and Romania (see the data of figure 3) was determined by the changes occurred at the offer level and at banking credits demand.

The increase of banking credits offer was determined by the decrease of crediting risk of the real economy based on the improvement of macroeconomic conditions (the decrease of inflation rate, of interest rate, national currency appreciation), the existence of a liquidity excess in the banking sector and also by the competition increase on the banking market following foreign capital entries). Likewise, the increase of banking credits offer was sustained by the creation of credit offices, by improving the credit guarantee regulations, by improving the banking legislation, of audit and accounting practices.

Regarding the credit demand, it increased as a consequence of improving the macroeconomic conditions (decrease of inflation rate, of interest rates, economic growth acceleration), the initial lowered indebting degree of population and increasing of its income (Sirtaine, 2007).

Based on the data shown in figure 3, we may find out that of the surveyed countries, Slovenia is the country with the highest degree of financial intermediation, and, at the opposite side, there is Romania that, although recorded remarkable progresses on the financial intermediation level, is under the level of the other countries and well below euro zone average. At the end of 2008, the financial intermediation degree measured by the share of banking assets of GDP was of 262.3% of euro zone (Raiffeisen Research, 2009). Such a situation shows that the Romanian banking market features a great growth potential. The significant difference between the financial intermediation degree in Romania and EU25, for example, is considered as normal if we take into account the GDP per capita that is much below the average of EU 25. In this respect, it is worth mentioning that, in Romania, at the end of 2008, the GDP per capita expressed at the purchasing power parity was at only 43.5% of EU25 average (National Bank of Romania, 2008b).

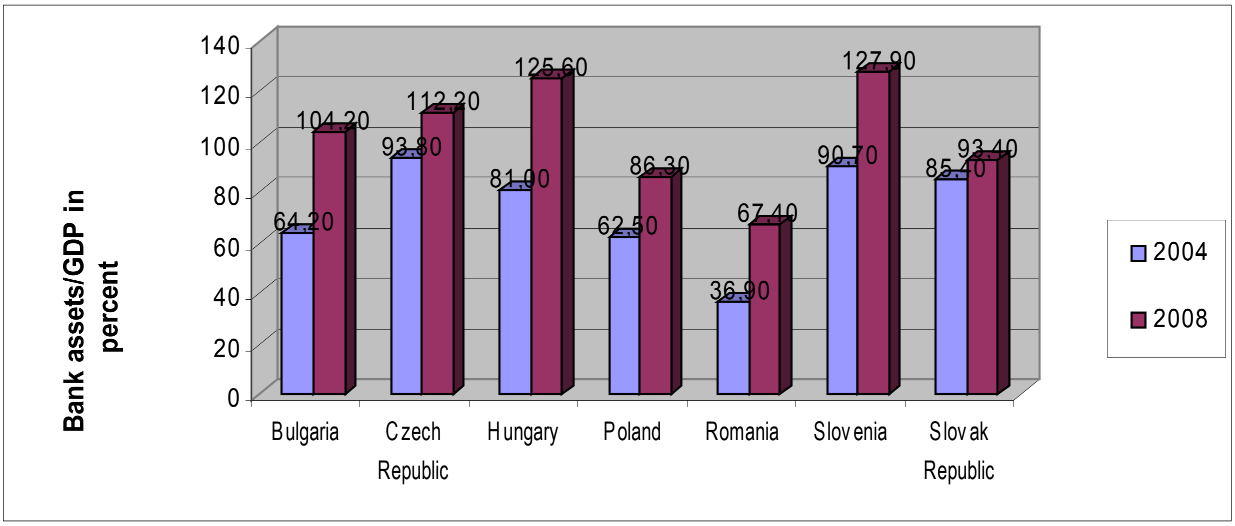

Figure 3: Evolution of financial intermediation in different countries in the period 2004-2008
Source: Raiffeisen Research, 2009; national central banks.

The banking credits given to the economy recorded an enhanced growth, mainly in Romania and Bulgaria (see the data of table 5), evolution justified by the initial very low levels of financial intermediation and by its convergence process towards the levels of EU developed countries.

The fast increase of banking credits in the Central, Eastern and South-Eastern European countries was financed by the significant entries of foreign capital in the banking sectors, stimulated by the high differential of positive interest and by the anticipation of a real appreciation on the long run of the currencies of the respective countries (Isărescu, 2008).

Analyzing the dynamics of the banking credits depending on the beneficiaries (non-financial corporations and households) it is found out a faster increase of the credits given to households in all the surveyed countries, except Bulgaria where the increase of credits given to the corporate sector surpassed, at the 2007 level, the credits given to households (see the data of table 5).

Table 5: Evolution of loans granted to the economy of credit institutions in the period 2005 - 2008 (growth in % year on year in domestic currency terms)

Country	Growth in loans granted to non-financial corporations				Growth in loans granted to households[1]			
	2005	2006	2007	2008	2005	2006	2007	2008
Bulgaria	22.34	19.40	72.43	32.32	58.39	30.55	52.35	31.30
Czech Republic	14.33	20.08	17.09	14.08	32.27	29.28	34.40	21.15
Hungary	11.40	12.68	14.00	4.50	31.07	31.29	31.00	20.97
Poland[2]	2.72	14.19	23.37	28.80	21.92	33.02	37.72	44.30
Romania	32.30	43.22	46.81	29.68	79.98	83.76	82.09	38.74
Slovenia	22.50	24.80	35.90	18.30	28.00	24.10	27.10	14.80

Slovak Republic	22.00	21.50	24.10	13.10	42.10	32.50	28.50	25.50

[1] ***including non-profit institutions serving households***
[2] ***loans granted of monetary financial institutions***
Sources: national central banks.

The significant expansion of credits given to households points out the large increase of credit demand for houses, consumer credits but also the strategies of the credit institutions acquiring new market quotas by attractiveness and diversity of credit offers. Such an evolution was determined by interest rate reduction, the increase of population incomes, need of improving the endowment degree of the houses and consumer durables, as well as significant orientation of the credit institutions to crediting the households and competition increase between banks on the retail segment.

The share of loans granted to households in relation to GDP, for some countries, can be observed in the figure 4. From the analyzed countries, Romania holds the last place, which reflects the existence of a growth potential for the household credit.

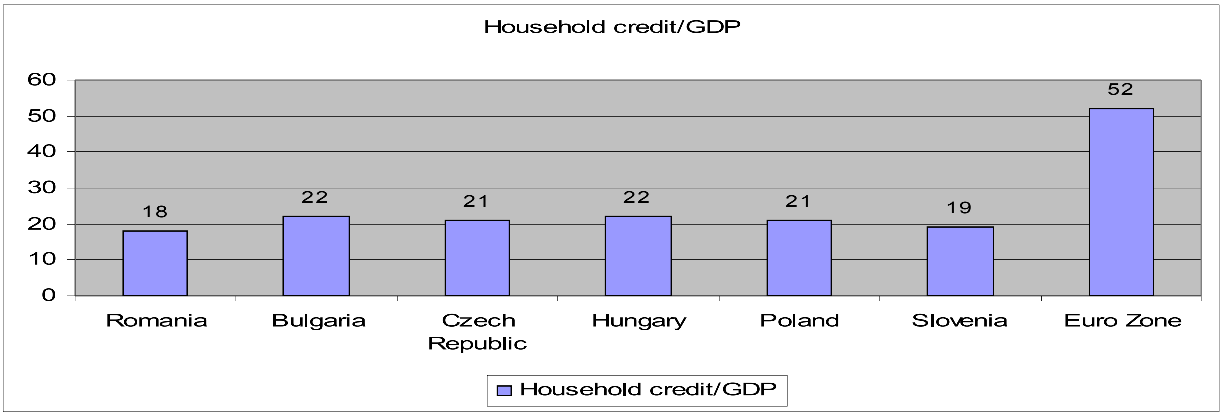

Figure 4: Household credit in selective countries from Central and Eastern Europe in 2007 (as % of GDP)
Source: National Bank of Romania, 2008(c).

The dynamics of banking credits given to households are significantly sustained by the house credits that, in some countries, especially in Romania, Bulgaria and Poland, at the 2007 level, recorded a more important increase compared to consumer credits (see the data of table 6). In these countries, the housing loans have become the most important banking products from the retail segment.

Table 6: Evolution of the loans granted to households by the credit institutions in the period 2006 - 2008 (in % year on year)

Country	Growth in loans for housing purchase			Growth in loans for consumer credit			Other loans to households		
	2006	2007	2008	2006	2007	2008	2006	2007	2008
Bulgaria	74.06	64.25	38.05	50.03	49.00	29.85	31.08	26.83	5.86
Czech Republic	40.07	42.06	20.14	37.71	30.22	22.85	30.20	33.64	25.53
Hungary	18.82	15.68	24.58	61.23	39.82	40.73	17.37	1.38	12.04
Poland	55.57	59.88	64.88	24.15	35.98	17.95	14.87	41.35	35.76

Romania	184.00	81.00	47.25	85.70	65.36	33.74	70.13	200.00	109
Slovenia	42.98	36.50	27.25	7.07	19.94	5.14	19.75	23.73	10.02
Slovak Republic	45.27	33.33	26.1	27.54	18.71	23.91	83.64	33.13	22.30
MU 13	12.51	6.93	1.62	7.49	4.93	2.29	2.89	1.87	2.27

Source: national central banks and data processed based on ECB,2008.

The significant dynamics of the housing loans was determined by the ratio between supply and demand. Regarding the credits demand for housing, its increase has been determined especially by the increasing of the population's income, and also of housing price.

The structure analysis on destinations of credits given to households (see the data of table 7) illustrates the existence of some discrepancies between the countries. In this respect, it is worth mentioning the situation of Romania, where, at the 2007 level, although house credits recorded the most important increase, they hold a more reduced share, the consumer credits are prevailing. Comparatively, in EU27 and euro zone, the situation is reversed where the housing credits hold a share of over 70%. Such a difference shows the low purchasing power of Romanian population and its prevailing orientation to consumption and the low degree of endowment with consumer durable (National Bank of Romania, 2006). Consequently, the banking crediting of Romanian population should align to European standards regarding the relation between house credits and consumer credits.

Table 7: Evolution of structure the loans granted to households (according to destination) by the credit institutions in the period 2005 – 2008 (in %)

Country	2005			2008		
	Loans for housing purchase	Loans for consumer credit	Other loans	Loans for housing purchase	Loans for consumer credit	other loans
Bulgaria	28.41	60.63	10.96	42.81	51.16	6.03
Czech Republic	67.54	21.43	11.03	70.26	19.36	10.38
Hungary	59.97	31.66	8.37	50.75	44.52	4.73
Poland	35.76	37.64	26.60	52.53	19.61	27.86
Romania	13.19	84.55	2.26	21.06	74.29	4.65
Slovenia	31.95	45.96	22.09	43.38	36.85	19.78
Slovak Republic	65.66	13.67	20.67	67.60	13.54	18.86
MU 13	69.52	13.26	17.22	71.37	12.88	15.75

Source: national central banks and data processed based on ECB, 2008.

The extremely fast increase of credits given to population households and,within them, mainly of the ones expressed in foreign currency (stimulated by the lower interest rates compared to the ones related to loans in national currency and by the appreciation of national currencies), has determined significant increase of the domestic demand, pressure on inflation and increase, at high levels, even at alarming levels, of current account deficits, mainly in Bulgaria and Romania (see the figures 5 and 6).

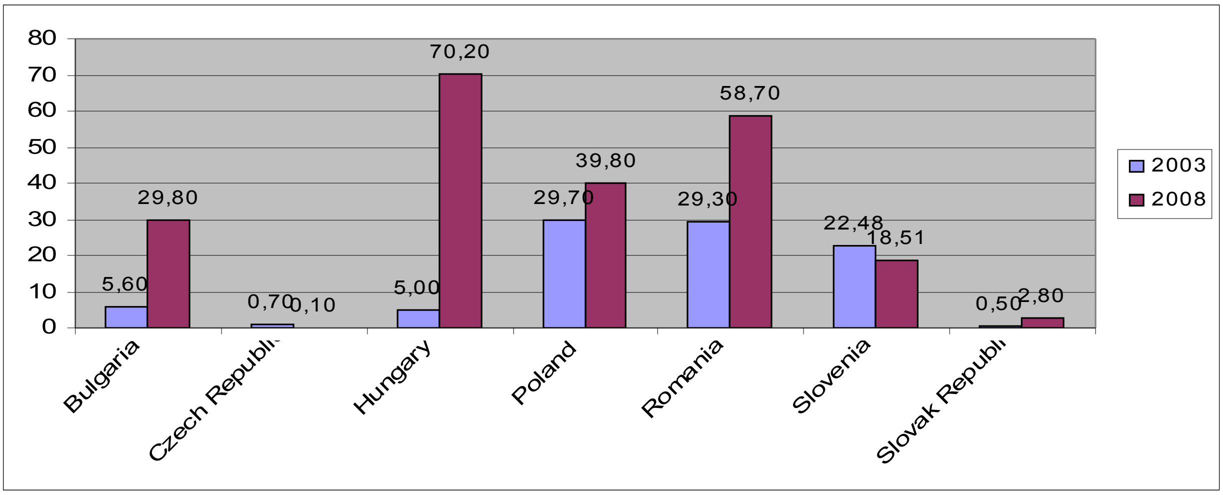

Figure 5: Evolution of loan denominated in foreign currency (in per cent of total loans)granted to households by the credit institutions in the period 2003-2008
Sources: IMF,2009(b) and National Bank of Hungary, 2009.

In this context, the monetary authorities, being concerned by providing price stability, including provision of financial stability, adopted a set of measures in order to slow down the credits given to the population, mainly the foreign currency credits and mortgage credits. Within the measures adopted by the monetary authorities in various countries, mainly in Bulgaria and Romania, there are included both handling of indirect tools of monetary policy (especially, minimum banking reserve requirements, interest rate of monetary policy) and also measure of management nature, such as introducing some crediting limits and limits to loans expressed in foreign currencies.

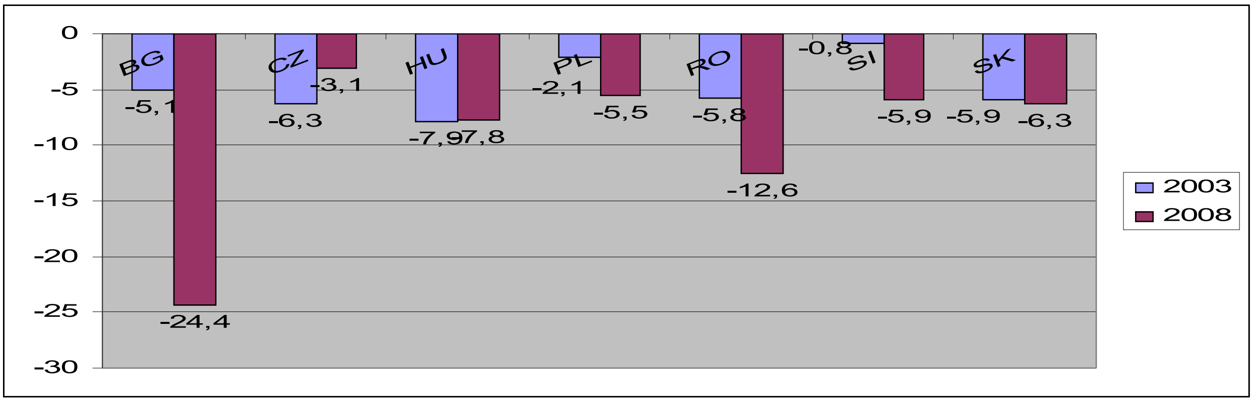

Figure 6: Evolution of current account balance(in per cent of GBP)in the period 2003-2008
Sources: IMF, 2009(b) and National Bank of Hungary, 2009.

In the context of significant mutations recorded in East and Central European countries at the level of financial intermediation, naturally a question arises: at what level are placed the banking performances and, generally, the indexes of financial stability?. In the context of the restructuring and privatization process, of the significant expansion of credit and competitiveness enhancement, the bank sectors of the Central and Eastern European countries improved profitability and efficiency. Although interest margins decreased as competition increased, banks witnessed a rise in income as the volume of operations boomed and the range of bank products and services diversified. In 2008, the bank sectors of most countries witnessed a deterioration of the profitability and efficiency ratios in the condition of the considerable reduction of the volume of operations in this period of international crisis. Exceptions from this evolution are Romania, where profitability indicators improved, and Poland, where RoE and RoA remained stable (see figure 7).

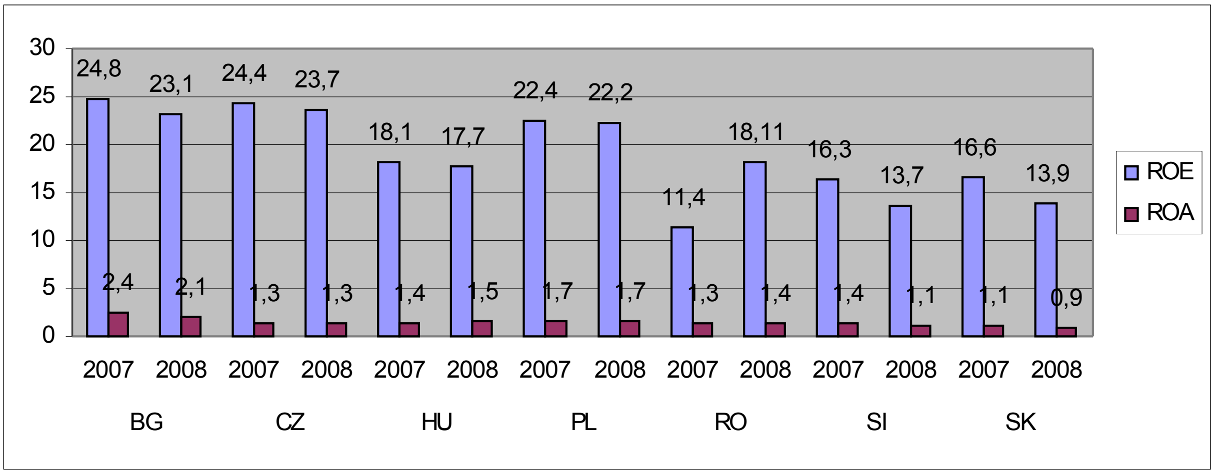

Figure 7: Comparative situation of profitability and efficiency of the banking sector in the period 2007-2008* (%)
BG-December; CZ-September; HU-December; PL-September; RO-December; SI-September; SK-September.
Source: IMF, 2009(a) and National Bank of Romania, 2008(a).

As a result of the global financial crisis, the banks from Central, Eastern and South-Eastern Europe face sharply slowing economic growth, tough external financing conditions, higher risk aversion and a tense liquidity situation (Deutsche Bank Research, 2008). Due to the high ratio of FX-denominated credits (e.g. in the Hungary and Romania), the *strong* FX depreciation represents an important challenge for the Central, Eastern and South-Eastern European banks. As can be observed in the figure 8, after the collapse of Lehman Brothers in September 2008, the Polish zloty, the Czech koruna, the Hungarian forint and the Romanian leu depreciated sharply against the euro until mid-February 2009. This evolution can be explained by the overall rise in risk aversion, the deleveraging of risky assets by financial institutions and the deterioration of the (export) growth outlook.

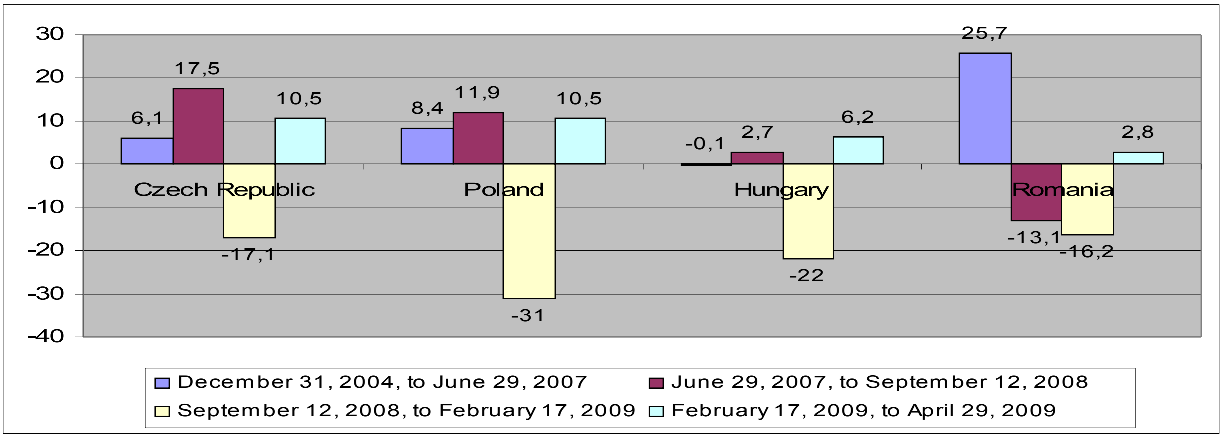

Figure 8: Evolution of exchange rate between national currencies and euro
Source: Oesterreichische Nationalbank, 2009.

From the viewpoint of financial stability, an important part is played by the ratio "capital adequacy" (see the data of table 8), that although in certain countries had a descending trend is still in all countries above the minimal level provided by European and international regulations (8%).

Table 8: Comparative bank regulatory capital to risk-weighted assets in the period 2005-2008 (%)

Country	2005	2006	2007	2008
Bulgaria	15.30	14.50	13.90	14.90
Czech Republic	11.90	11.50	11.50	12.90
Hungary	11.60	11.00	10.40	11.10
Poland	14.50	13.20	12.10	11.60
Romania	21.10	18.10	12.70	11.90
Slovenia	10.60	11.10	11.20	11.20
Slovak Republic	14.80	13.00	12.40	11.30

Source: IMF, 2009(a), http://www.imf.org/external/index.htm

The intensification of the banking crediting has implications also on the share of nonperforming credits in the total portfolio of credits. In the year 2008, the highest share of nonperforming credits was registered in Romania. This situation is due to the significant expansion of the credits granted to households and especially of the credits in foreign currencies based on the significant appreciation of the Romanian currency in the first part of 2007 and on the renouncement of the National Bank of Romania to the measures of banking prudency concerning the limitation of credits in foreign currencies. But, the significant depreciation of the Romanian currency from the beginning of 2008 and especially from October 2008, in the context of the current international financial crisis, has negative implications for the debtors exposed to the currency risk and for the quality of the credits portfolio of the credit institutions. In the present conditions, the share of nonperforming credits is still high, being also determined by the fall of the population income and of the price of real estate assets as a consequence of the international financial crisis.

As a result of currency depreciation and of the deepen recession, the credit risk has increased (sharply) in the CEE banking sector. At the end of 2008, with one exception (Poland), the share of nonperforming loans was higher that in the previous year. Non-performing loans include sub-standard, doubtful and loss classification categories. Based on the data presented in figure 9, it can be concluded that, in the year 2008, the highest share of nonperforming credits was registered in Romania.

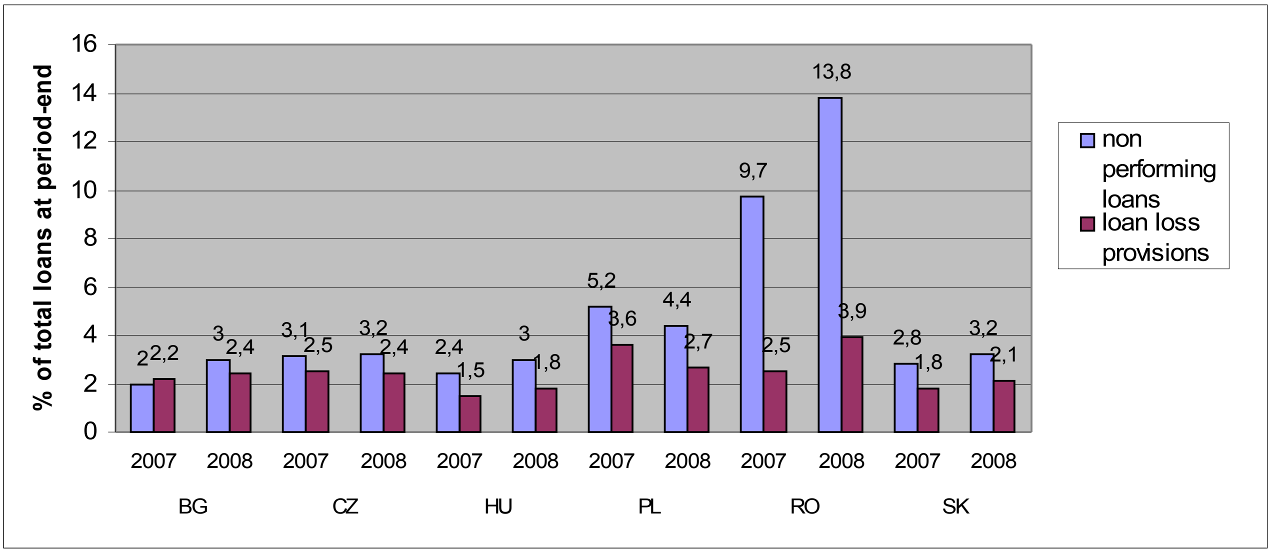

Figure 9: Credit Quality in selective Central and Eastern European Countries
Source: Oesterreichische Nationalbank, 2009, ***http://www.oenb.at/en/presse_pub/period_pub/finanzmarkt/finanzmarktstabilita/financial_stability_report.jsp***

This evolution can be explained by the significant expansion of the credits granted to households and especially of the credits in foreign currencies based on the significant appreciation of the Romanian currency in the first part of 2007 and on the renouncement of the National Bank of Romania to the measures of banking prudency concerning the limitation of credits in foreign currencies. But, the significant depreciation of the Romanian currency from the beginning of 2008 and especially from October 2008, in the context of the current international financial crisis, has negative implications for the debtors exposed to the currency risk and for the quality of the credits portfolio of the credit institutions. In the present conditions, the share of nonperforming credits is still high, being also determined by the fall of the population income and of the price of real estate assets as a consequence of the international financial crisis.

Conclusions

The bank sectors of Central and Eastern European countries faced significant qualitative transformations in the past decade, being dominated by private banks, respectively by foreign banks, which brought numerous advantages for internal bank markets and new challenges for the monetary authorities.

A significant index for the progresses made by the bank sectors of Central and Eastern European countries is the increase of the financial mediation degree that shows the significant orientation of the credit institutions to the real economy.

The accelerated dynamics of loans granted by the credit institutions, especially households loans, particularly in the Romania and Bulgaria has been driven by changes in the supply and demand of credits, which have improved significantly in the last years. These changes are due to improved macroeconomic conditions (lowering the inflation rate and interest rates, accelerating economic growth), intensifying competition in national banking markets, improvement schemes to guarantee loans, improving banking legislation, accounting practices and auditing, initial low debt level and growth of population' revenues.

The accelerated growth of households loan has been significantly sustained by the housing loans, which in some countries was the most important product on the retail banking segment. Such development has both positive effects through increasing the level of living of the population, significant development of the real estate sector, but it implied risks to macroeconomic stability.

In the context of current international financial crisis, lending activities of credit institutions recorded a significant decrease in the beginning of 2009.

The banking sector from the countries analyzed in the paper was not directly affected by the current crisis as it has been exposed to toxic assets. Starting with October 2008, the effects of international crisis were felt indirectly by the banking sector from the countries considered for the study by reducing external financing, increasing their cost and damage the international economic environment, which decreased the supply of and demand for loans, respectively the restriction in the activity of bank loans.

In some countries, the banking sector is faced with deteriorating loan portfolio quality, lower performance indicators and instability. The banking sector profitability in terms of return on equity and return on assets decreased in all countries, except Romania.

The economic recession and the worsening of macroeconomic imbalances all over the world have intensified the concerns of national and international authorities in order to adopt urgent measures, aimed at restoring macroeconomic stability and resuming the credit activity.

In the period before the current crisis amplification (amplification produced by Lehman Brothers bankruptcy in September 2008 and after the taking over, in the same month, of the bank Merrill Lynch by Bank of America), the central banks of the countries reviewed have implemented restrictive monetary policy measures (in particular, higher reserve requirements, higher interest rate, the introduction of limits on loans denominated in foreign currency) in order to counter inflationary pressures caused by rapid dynamics of bank loans, especially those granted to the households.

Starting with September 2008, when turmoil in international financial markets have turned into a deep financial crisis worldwide, the central banks in the countries reviewed have relaxed restrictions on monetary policy (in particular, by reducing reserve requirements and in early 2009, by lowering the interest rates of monetary policy) to ensure normal operation of the banking sector and to support the bank lending of real economy.

In elaborating the measures to implement, the national authorities took into account the particularities of national financial systems (bank-oriented systems), and the extremely serious effects of restricting lending on national economies.

Currently, the bank lending activity is facing a slight recovery, but we can say that its reviving depends on the real economy, because the economic agents are the main customers of banks.

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