INTERNATIONAL
Herald Tribune

Bank crisis is bypassing central and East Europe

By Judy Dempsey
Thursday, October 9, 2008

BERLIN: New members of the European Union in Central and Eastern Europe have – so far – avoided much of the upheaval caused by the crisis of confidence in the global financial system.

Although consumer spending is falling and growth rates are declining in the Czech Republic, Poland, Slovakia, Slovenia and particularly in Estonia, analysts said the trends were not related to the banking turmoil spreading across the Continent.

"It is remarkable how little impact the crisis has had on the region as a whole," Eric Berglöf, the chief economist of the European Bank for Reconstruction and Development, said in an interview. The bank was established in 1991 after the collapse of the communist system to help countries in Eastern and Central Europe make the transition to market economies.

"The interesting question to ask is why the region has not been hit more than it has," Berglöf said.

One reason is that while most countries in the region opened their banking sector to foreign banks when they were preparing to join the European Union in 2004, they also strengthened their regulatory and supervisory processes.

"The presence of foreign banks in the banking system has managed to smooth the liquidity impact of the crisis," Berglöf said.

"What many of the banks in Western Europe did," he said, "they went for lending to Eastern Europe." He continued, "In general, they had very little exposure to the subprime lending instruments that have been so disastrous for U.S. banks."

The share of credit that comes from these banks has been high. "Between 60 and 80 percent of the banking sector assets are controlled by foreign banks," Berglöf said. These domestic banks were initially run as independent subsidiaries. Now they have become much more integrated with their parent banks.

"In which case, if there was any kind of spillover, if the foreign banks in these countries were in some kind of difficulties, that would be a serious concern," he cautioned.

Some foreign banks that did buy into banks in Eastern Europe, like UniCredit of Italy, are now facing serious liquidity problems at home. So far, UniCredit's problems have not spilled over into Poland, said Maciej Krzak, macroeconomic specialist at the Center for Social and Economic Research in Warsaw.

"The banks in Poland have been extremely profitable because they focused on lending and had strict credit standards," Krzak said. "These banks were not dabbling in the subprime mess."

The small and immature stock markets in Eastern Europe have been an advantage, too.

"Exposure by these stock markets to the world economy is relatively small," said Vasily Astrov, East European specialist at the Vienna Institute for International Economic Studies.

And yet, growth rates and consumer spending are declining across the region for reasons that Astrov said were domestically driven and, depending on the country, included higher interest rates, inflation or efforts to curb the budget deficit.

In Poland, inflation and high interest rates have made the national currency, the zloty, stronger against the euro and the dollar. As a result, exports, which are the driving engine of Poland's economy, are slowing. Growth this year will fall to 6 percent, from 7 percent in 2007.

The European Bank for Reconstruction and Development has estimated that growth across Central and Eastern Europe this year will average 4.7 percent, in contrast to 5.9 percent last year. The bank said the slowdown reflects anti-inflationary tightening of monetary policies and the expected decline in exports.

In Slovakia, the central bank revalued the currency in May by 17 percent to achieve parity with the euro, which Slovakia will adopt next year. That has fed inflation and slowed exports.

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