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Partners for Financial Stability 2010 – 2013

Financial Sector Progress, Gaps and Challenges in SEE & EURASIA

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Purpose

- Provide data and analysis for USAID/others to better understand weaknesses and gaps in financial sector development in Southeast Europe (SEE) and Eurasia
- Assess the consequences of the global financial crisis on the financial sectors in the region
- Evaluate and compare financial sector disparities across regions and countries
- Propose initiatives to USAID/others to promote financial sector stability and economic growth to the countries of the region

Themes

- Financial and Macroeconomic Stability
- Financial Sector Size
- Financial Sector Sophistication
- Access to Financial Services
- Financial Sector Enabling Environment



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EUROZONE
KOREA
OTHER ADVANCED

CEE NORTHERN TIER
o/w EU from May 2004

OTHER CEE SOUTHERN TIER
o/w Bulgaria, Romania (EU
2007) and Croatia (2012?)

OTHER EURASIA
o/w Russia, Central Asia

Turkey

SEE

- Albania
- Bosnia
- Kosovo
- Macedonia
- Montenegro
- Serbia

EURASIA

- Armenia
- Azerbaijan
- Belarus
- Georgia
- Moldova
- Ukraine



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Fundamental Findings

Compared with global benchmarks for advanced economies, the financial sectors in the PFS Beneficiary countries are very small, unsophisticated, and do not provide broad access to financial services.

The PFS Beneficiary countries have financial systems and economies that are less stable than those of advanced economies, notwithstanding the recent turbulence experienced in Eurozone and other advanced economies.

The presence in many of the PFS countries of EU-based banks can help significantly with the effort to stabilize the financial sector. However, some EU-based banks that have expanded into these emerging markets over the last two decades have also faced their own challenges of solvency and liquidity.

With size, sophistication and access being serious weaknesses in their financial systems, key challenges for these countries are how to (1) encourage more sustainable levels of credit to creditworthy borrowers in the private sector, and (2) develop the non-bank financial sector.

While the financial sectors in these countries have made progress over the last two decades, there is a limit to how far they can advance if the real sector does not reform and develop.



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EURASIA is the weakest region of the three USAID/E&E Bureau regions, followed by CEE SOUTHERN TIER and then CEE NORTHERN TIER.

The PFS Beneficiary countries in EURASIA and CEE SOUTHERN TIER generally rank lower than or equal to their respective regions as a whole. Exceptions are EURASIA PFS Beneficiary countries which scored higher than the regional average for Financial Sector and Macroeconomic Stability, and slightly higher in terms of Enabling Environment indicators.

CEE SOUTHERN TIER scores are lower than in the CEE NORTHERN TIER countries for Financial Sector and Macroeconomic Stability, Size and Sophistication. However, CEE SOUTHERN TIER countries, including PFS Beneficiary countries in the region, score higher than CEE NORTHERN TIER countries in Access to Financial Services.

EURASIA is the weakest region in most cases, reflecting lower levels of financial and macroeconomic stability, financial sector size and sophistication, and access to financial services



Reasons for Regional Differences

Soundness of banks, with banks experiencing rising levels of non-performing loans. EURASIA banks in particular have high levels of non-performing loans and have responded with very high capital adequacy ratios.

Confidence in the currency and monetary (anti-inflation) policy—EURASIA and CEE SOUTHERN TIER depositors show a strong preference for foreign exchange-denominated deposit instruments vs. CEE NORTHERN TIER countries.

Macroeconomic policies, with all three regions showing differing patterns and results, including instability in key areas—high inflation rates, deep current account deficits, low levels of gross foreign exchange reserves...

General development of the financial sector, as reflected in the size and sophistication of financial markets.

Access to financial services, where patterns have differed in all three regions.

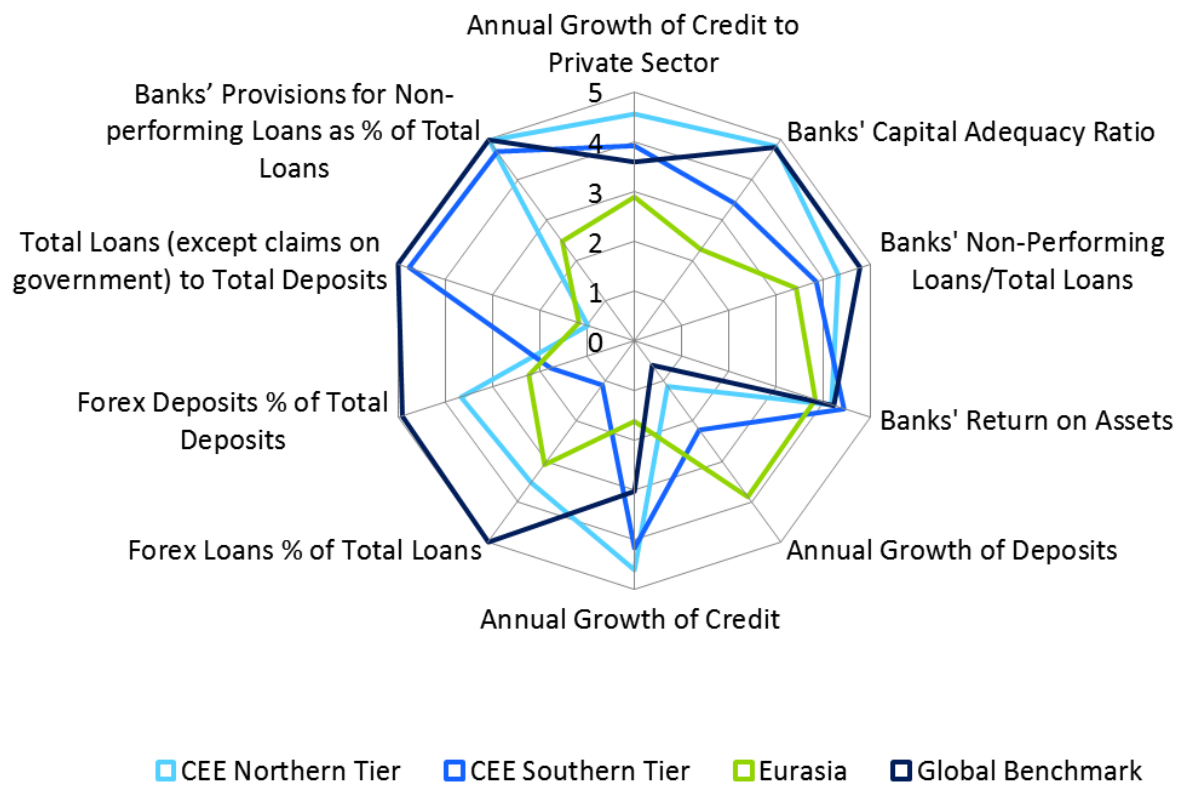
The financial sector enabling environment—property registration, contract enforcement, credit information, investor protection, accounting/auditing/disclosure....



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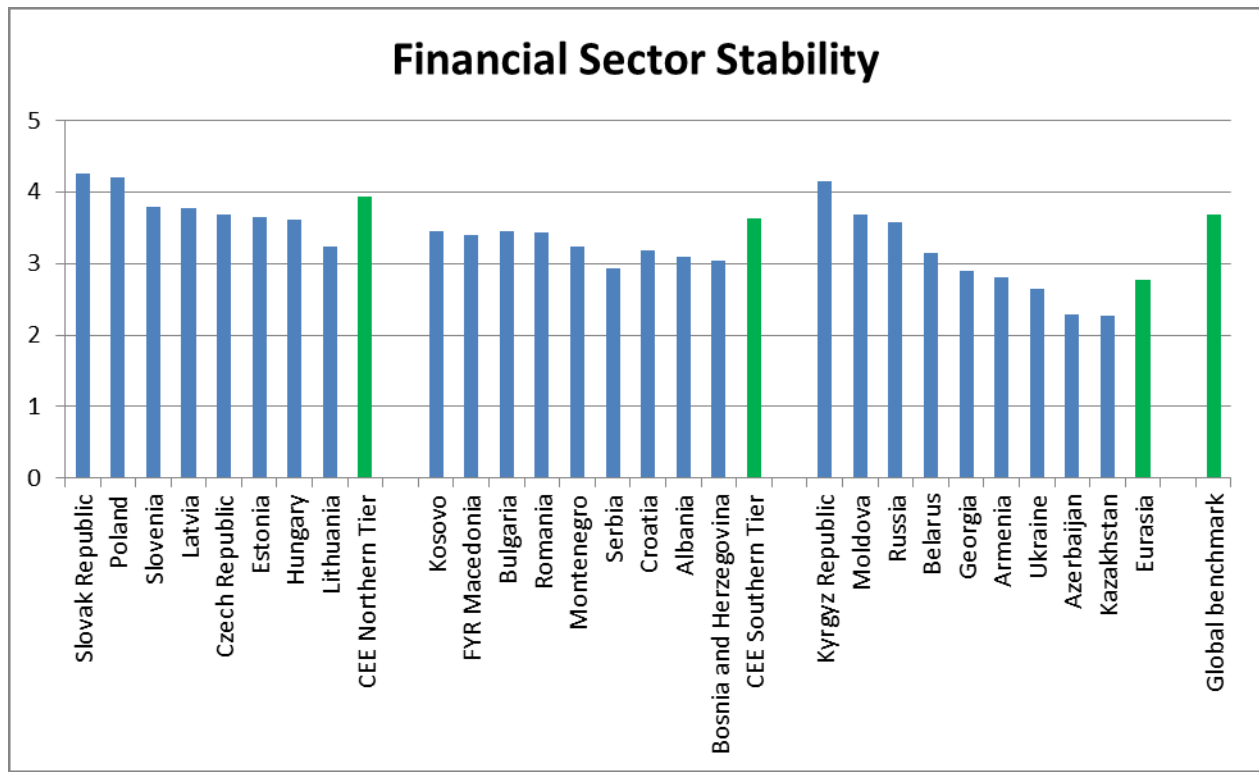


Financial Sector Stability





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Macro-Financial Stability...



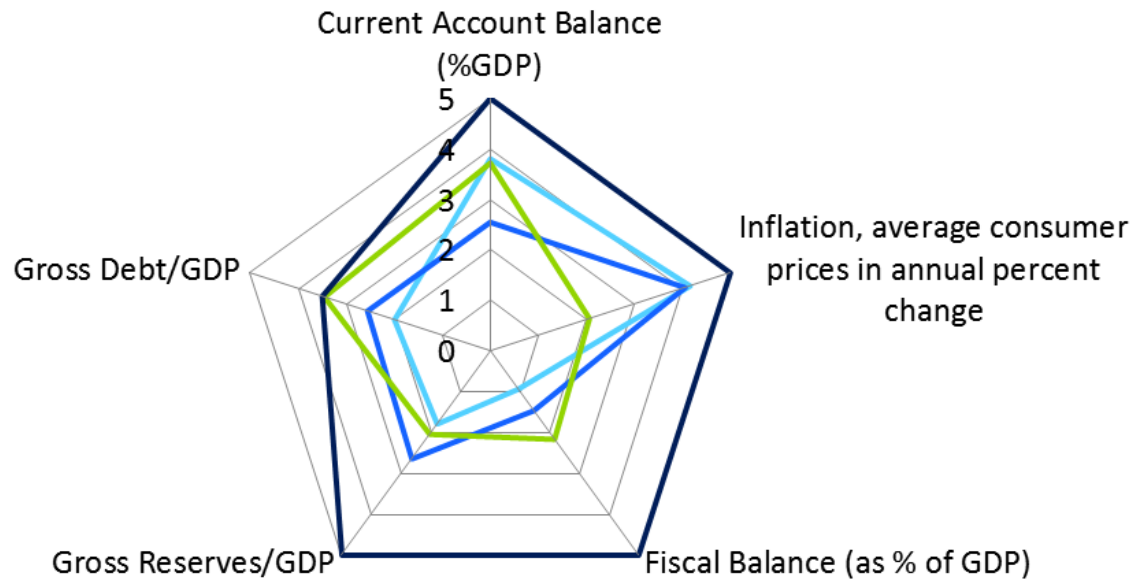
	Global	CEE NORTH	PFS-SEE	PFS-EURASIA
Financial Stability Score	3.69	3.94	3.51	2.89
<i>Capital Adequacy</i>	Rising, reasonably stable since 2008; 13.1% average	Rising since 2008; 12.9% average	High and reasonably stable; 17.6% average	Very high; 24.6% average
<i>Non-performing Loans</i>	Rising since 2008 from low and stable levels; 3.3% average	Very high since 2009; 5.7% average	Very high since 2009; 8.6% average	Very high since 2009; 10.2% average
<i>Provisions for Loan Losses</i>	Reasonable coverage; 69.6% average	Reasonable coverage; 69.5% average	Reasonable coverage; 79.0% average	Reasonable coverage; 83.8% average
<i>Return on Assets</i>	Low but positive; 0.5% average	Negative in 2009 and flat in 2010; 0.4% average	Low since 2009, but higher before; 0.9% average	Reasonable except for losses in 2009; 1.0% average
<i>Credit Growth</i>	Slow since 2008 and almost flat in 2009; 7.4% average; PFS uses 15-25% as a best practices standard	Negative in 2009; 17.7% average	Slow in 2009; 28.2% average	Reasonable growth; 41.3% growth
<i>Private Sector Credit Growth</i>	Slow since 2008 and almost flat in 2009; 7.4% average	Negative in 2009; 15.2% average	Slow but still positive in 2009; 31.5% average	Reasonable growth; 41.1% average
<i>Deposit Growth</i>	Flat in 2009; 8.4% average	Slowdown in growth in 2009; 11.2% average	Significantly lower growth since 2008; 18.2% average	High growth; 25.9% average
<i>Foreign Exchange Loan Exposure</i>	About half, therefore fairly high; 53.4% average	Relatively low; 21.2% average	About one third; 35.7% average	One third; 33.5% average
<i>Foreign Exchange Deposit Share</i>	Low; 9.1% average	Stable share; 25.9% average	High share; 59.1% average	Very high; 55.3% average
<i>Loans-to-Deposits</i>	Very high (1.7x)	Very high (1.6x)	Balanced (1.1x)	Very high (1.6x)



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Macro Stability



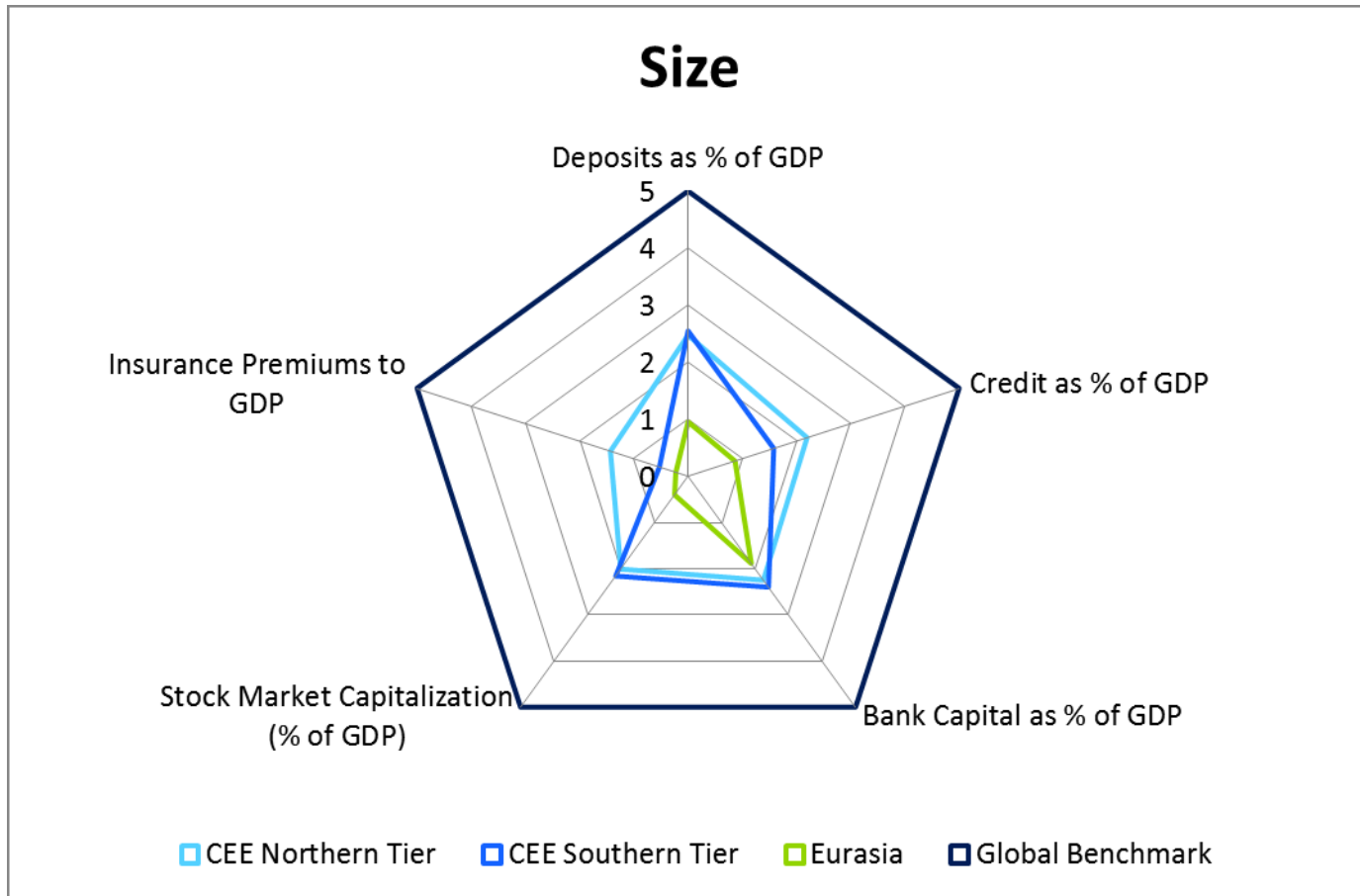
□ CEE Northern Tier □ CEE Southern Tier □ Eurasia □ Global Benchmark

Macro-Financial Stability...

	Global	CEE NORTH	PFS-SEE	PFS-EURASIA
<i>Macro Stability Score</i>	2.79	2.43	2.55	2.58
<i>Inflation</i>	Low and stable; 2% average	Low since 2009, but fairly high before then; >4% average	Low and stable in 2007 and since 2009; >4% average	High in 2007-08, lower since; 10% average
<i>Fiscal Balances</i>	Fairly high deficits; 3.9% average	Fairly high deficits; 4.2% average	Reasonable deficits; 2.9% average	Reasonable deficits; 2.9% average
<i>Current Account</i>	Low deficits; 2.5% average	Surpluses since 2009 after deep deficits in 2007-08; <4% average	Very high deficits, although some improvement since 2009; 15.5% average	High deficits, although some improvement since 2009; nearly 11% average
<i>Gross Debt</i>	Very high; 180.3% average; PFS uses 60% as a best practices standard	High; 131.4% average	Moderately high; 93.6% average	Reasonably low; 71.9% average
<i>Gross Reserves</i>	High; 26.3% average	Low to medium levels; 18.3% avg.	Medium levels; 21.3% average	Low; 17.0% average

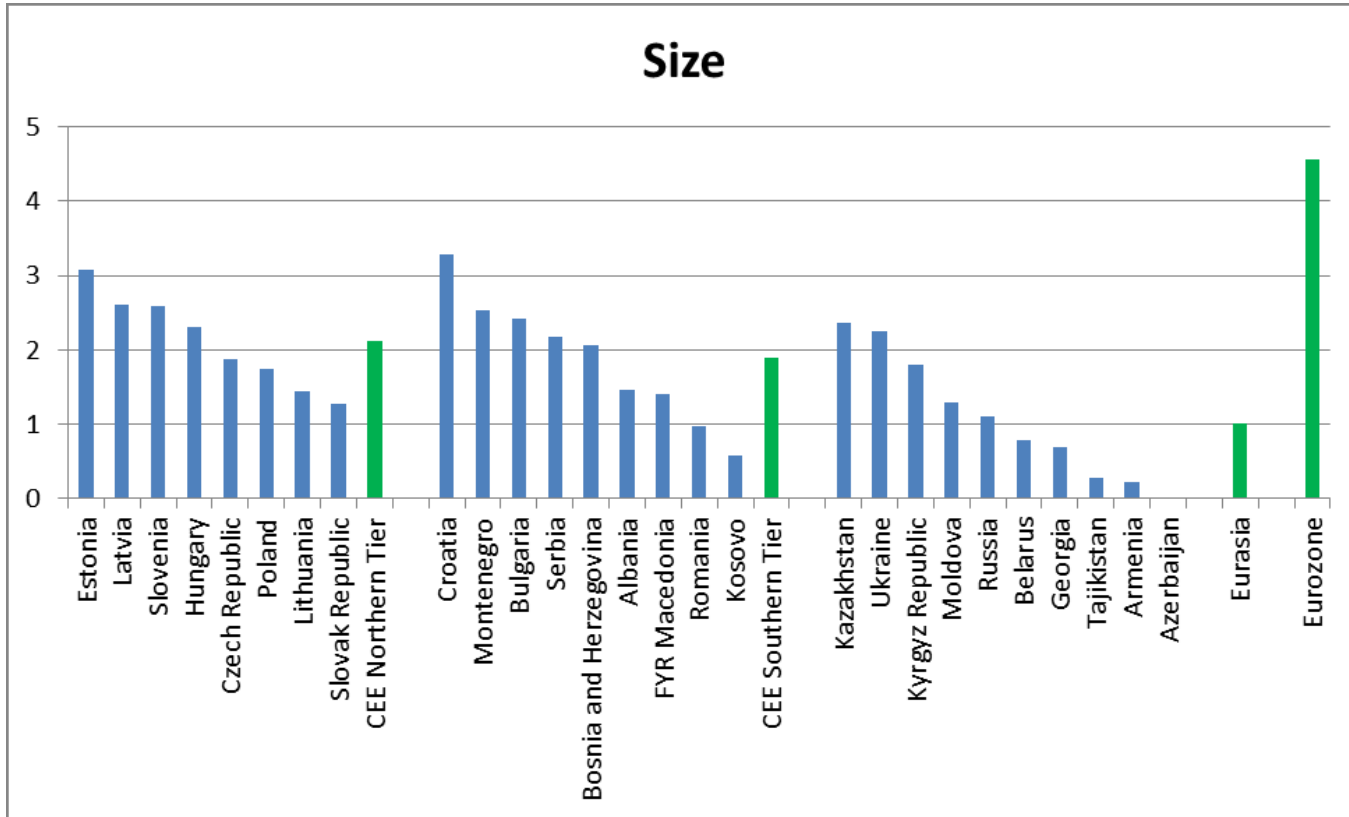


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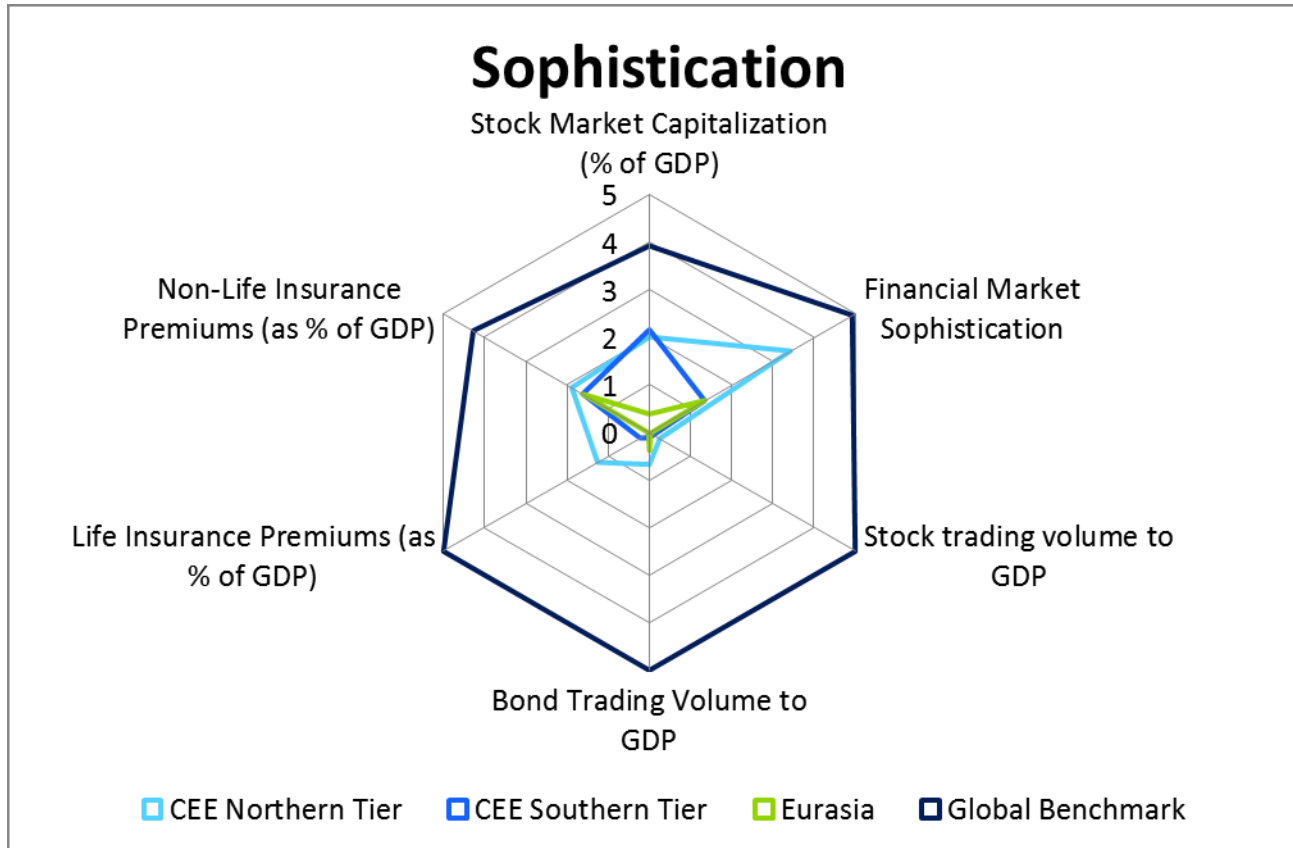


Financial Sector Size

	Global	CEE NORTH	PFS-SEE	PFS-EURASIA
Score	4.56	2.11	1.70	0.83
<i>Deposits to GDP</i>	High levels; 82.9% average	Moderate levels; 46.7% average	Moderate levels; 46.0% average	Low levels; 23.4% average
<i>Credit to GDP</i>	High levels; 139.8% average	Moderately high levels; 72.4% average	Moderate levels; 54.4% average	Relatively low levels; 37.1% average
<i>Bank Capital to GDP</i>	High levels; 16.6% average	Moderate levels; 11.1% average	Moderate levels; 11.3% average	Low levels; 9.0% average
<i>Stock Market Capitalization to GDP</i>	High levels; 53.4% average	Moderately low levels; 27.3% average	Moderately low levels; 24.5% average	Very low levels; 1.5% average
<i>Insurance Premiums to GDP</i>	Very high levels; 19.6% average	Low levels; 3.2% average	Low levels; 3.1% average	Low levels; 2.5% average

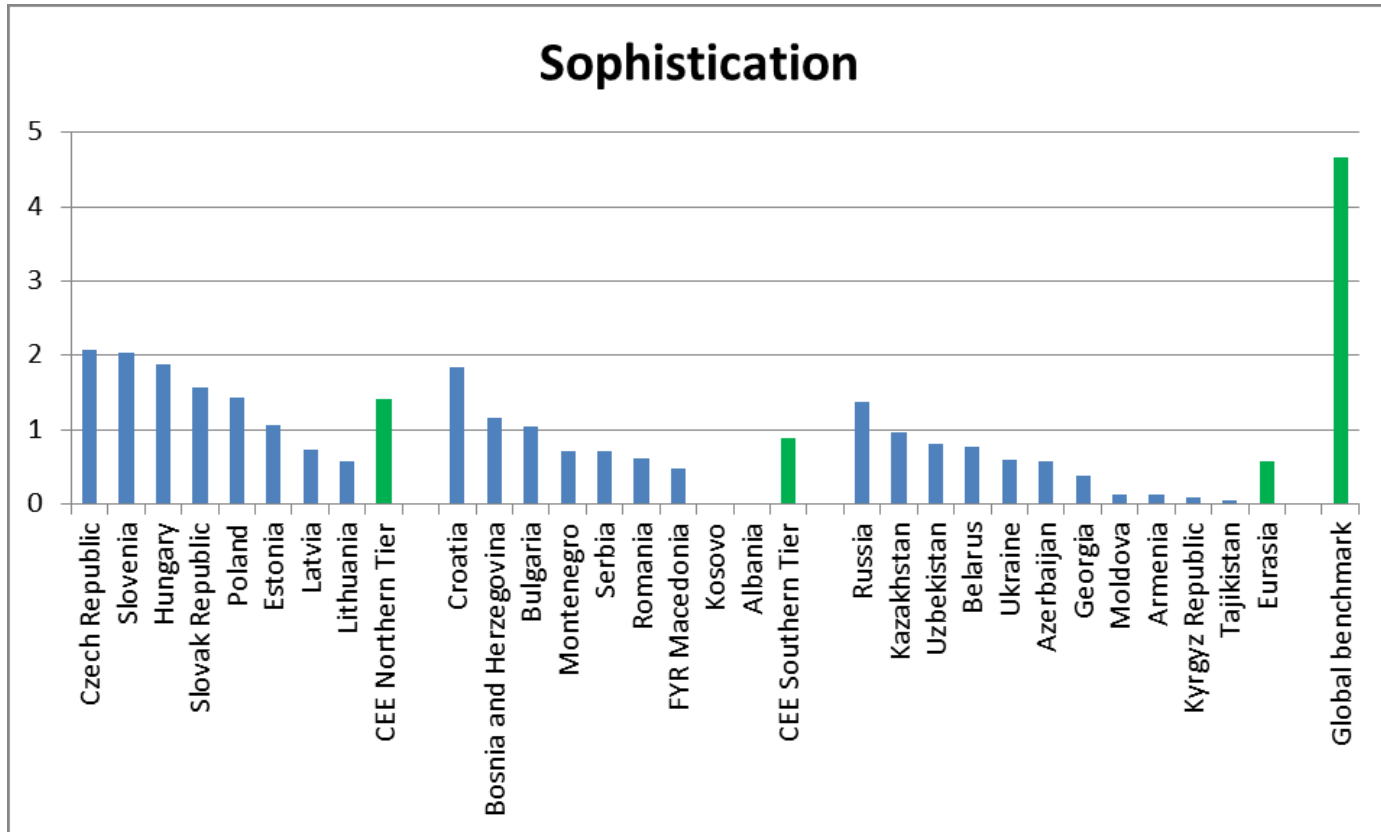


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Financial Sector Sophistication

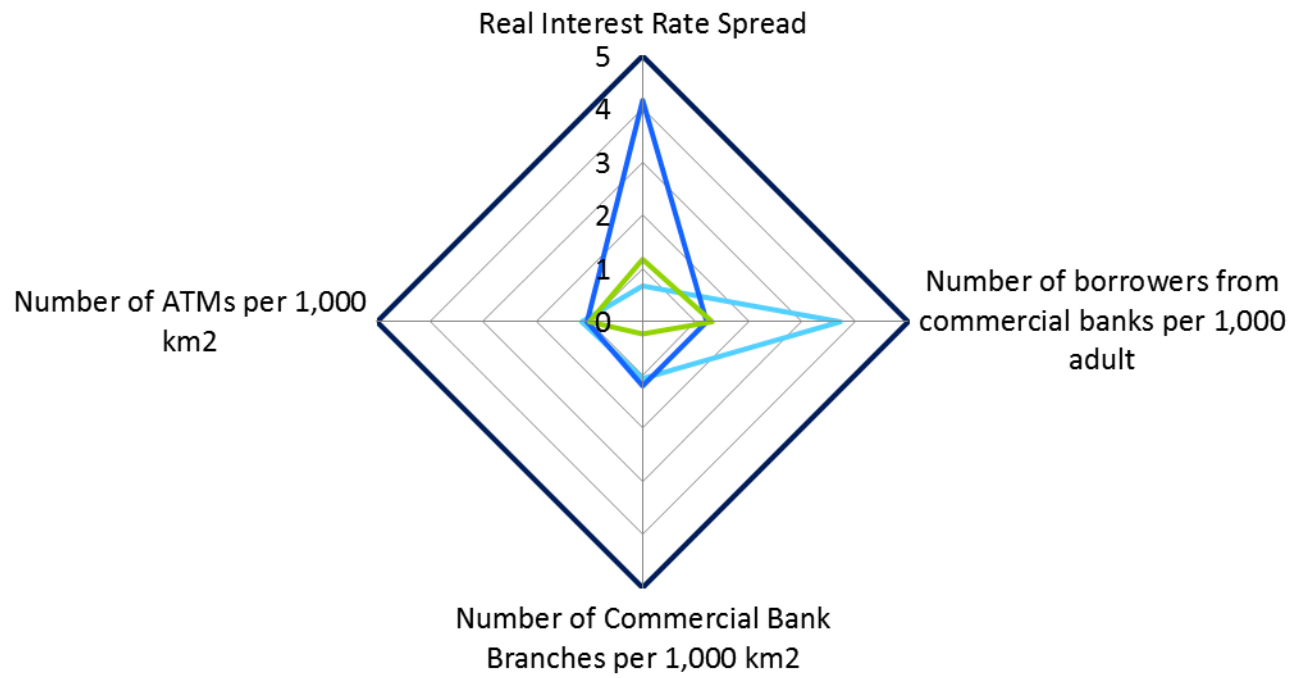
	Global	CEE NORTH	PFS-SEE	PFS-EURASIA
Score	4.67	1.42	0.54	0.56
<i>Bond Trading Volume to GDP</i>	Moderately high levels; 40.2% average	Very low levels; 5.4% average	Very low levels; 0.2% average	Very low levels; 4.9% average
<i>Stock Market Capitalization to GDP</i>	High levels; 53.4% average	Moderately low levels; 27.3% average	Moderately low levels; 24.5% average	Very low levels; 1.5% average
<i>Stock Trading Volume to GDP</i>	High levels; 177.4% average	Very low levels; 9.0% average	Very low levels; 3.0% average	Very low levels; 0.5% average
<i>Life Insurance Premiums to GDP</i>	Reasonably high levels; 4.6% average	Moderately low levels; 1.2% average	No real market	No real market; 0.02% average
<i>Non-Life Insurance Premiums to GDP</i>	Reasonably high levels; 3.4% average	Moderate levels; 2.0% average	No real market	Moderate levels; 2.3% average
<i>Financial Market Sophistication Index</i>	Very high levels; 5.5 average on a scale of 7	Reasonably high levels; 4.6 average on a scale of 7	Moderate to low levels; 3.1 average on a scale of 7	Moderate to low levels; 3.4 average on a scale of 7



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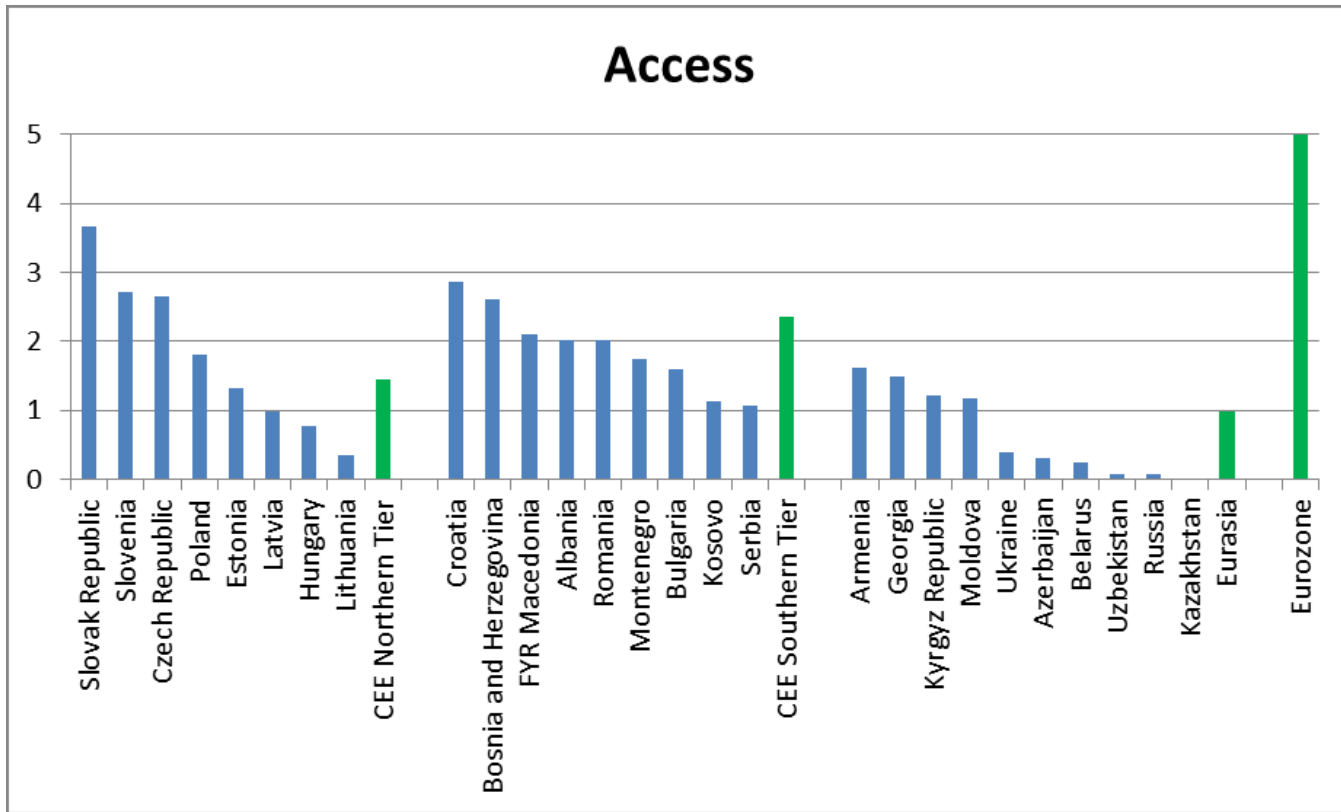
Access



□ CEE Northern Tier □ CEE Southern Tier □ Eurasia □ Global Benchmark



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Access to Financial Services

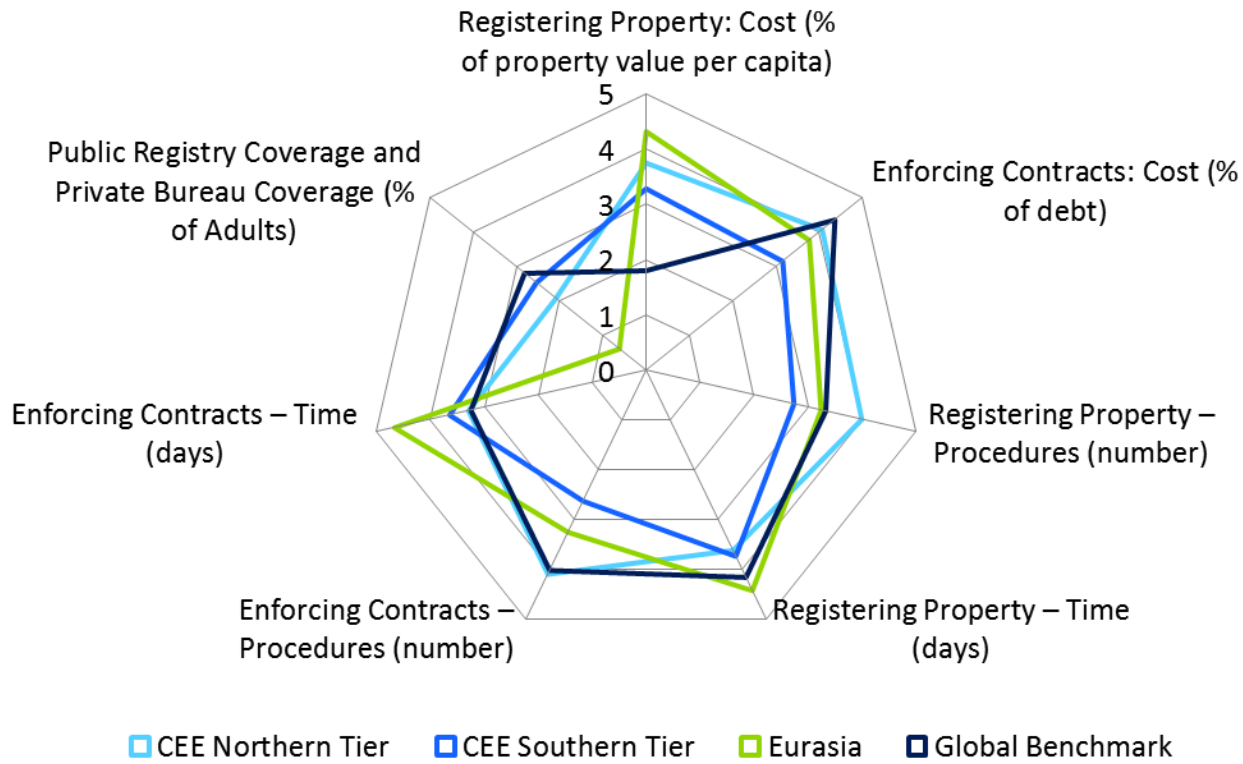
	Global	CEE NORTH	PFS-SEE	PFS-EURASIA
Score	5.00	1.46	2.32	0.97
<i>Real Interest Rate Spreads</i>	Narrow spreads that were negative in 2008; 0.4% average; PFS uses 2.5% as a best practices standard	Negative net spreads, although positive in 2009; negative 2.2% average	Positive and reasonable spreads; 1.7% average	Negative net spreads, although positive in 2009; negative 2.1% average
<i>Borrower Density</i>	High levels; 572 on average	Reasonably high levels; 430 on average	Low levels; 153 on average	Low levels; 177 on average
<i>Bank Branch Density</i>	High levels; 92 on average	Moderate to low levels; 20 on average	Moderate to low levels; 16 on average	Low levels; 6 on average
<i>ATM Density</i>	High levels; 155 on average	Moderate to low levels; 36 on average	Moderate to low levels; 24 on average	Moderate levels; 46 on average



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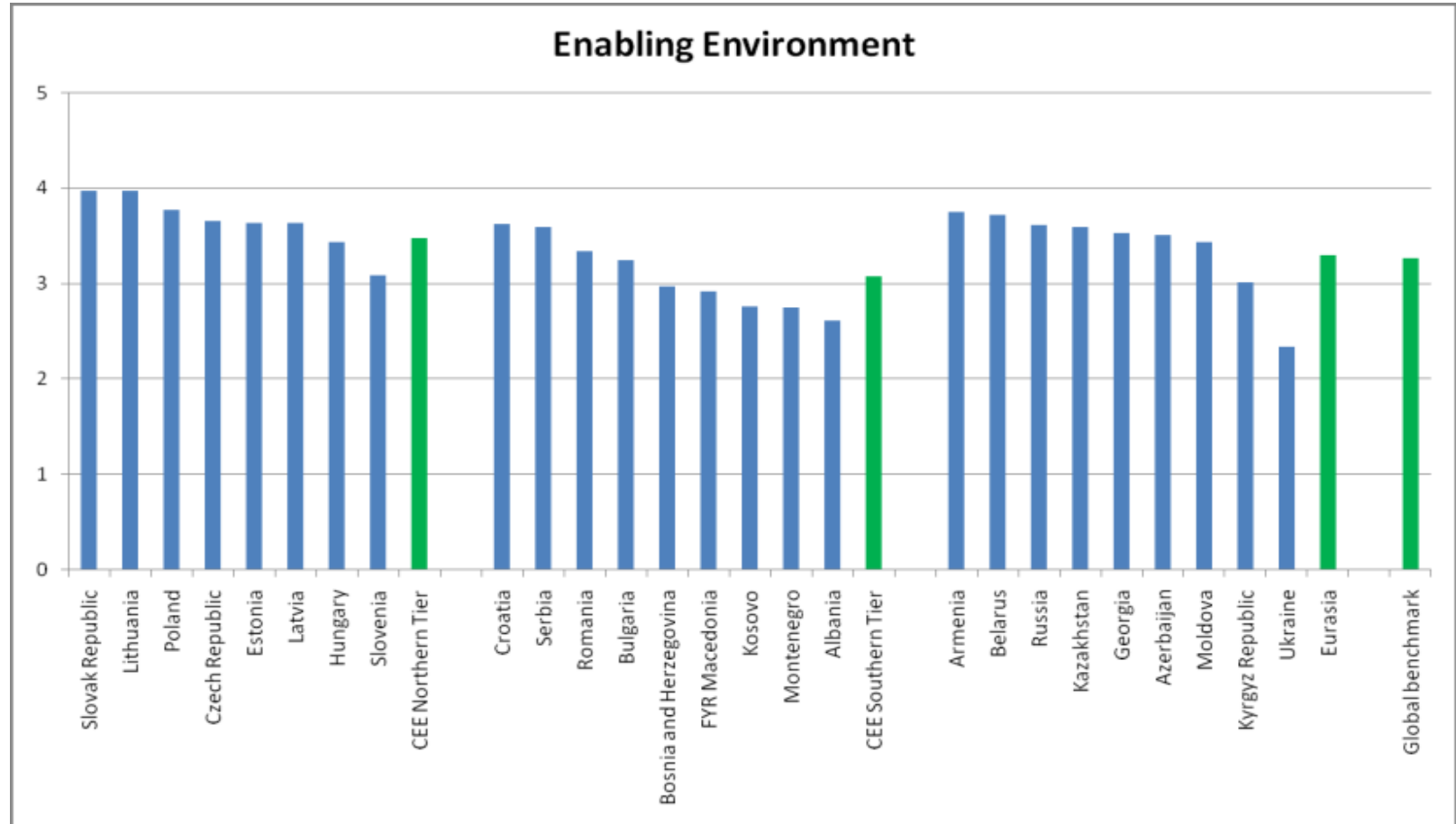


Enabling Environment





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Financial Sector Enabling Environment

	Global	CEE NORTH	PFS-SEE	PFS-EURASIA
<i>Score</i>	3.27	3.48	2.89	3.38
<i>Property Registration Procedures</i>	Moderate number of procedures; 5.4 in 2010	Low number of procedures; 4.4 in 2010	High number of procedures; 6.5 in 2010	Low number of procedures; 4.3 in 2010
<i>Property Registration Time</i>	Relatively fast; 34 days in 2010	Relatively slow; 51 days in 2010	Relatively slow; 55 days in 2010	Relatively fast; 26 days in 2010
<i>Property Registration Cost</i>	Relatively high cost; 6.6% of property value per capita	Relatively low cost; 1.9% of property value per capita	Moderate cost; 3.1% of property value per capita	Low cost; 0.9% of property value per capita
<i>Contract Enforcement Procedures</i>	Low number of procedures; 32 in 2010	Low number of procedures; 32 in 2010	High number of procedures; 42 in 2010	Moderate number of procedures; 36 in 2010
<i>Contract Enforcement Time</i>	Relatively slow; 608 days in 2010	Relatively slow; 588 days in 2010	Moderately slow; 493 days in 2010	Relatively fast; 290 days in 2010
<i>Contract Enforcement Cost</i>	Relatively low cost; 18.3% of debt in 2010	Relatively low cost; 22.0% of debt in 2010	High cost; 37.7% of debt in 2010	Relatively low cost; 25.5% of debt in 2010
<i>Public Credit Registry Coverage</i>	High coverage; 16.8% of adults in 2010	Moderate coverage; 10.9% of adults in 2010	High coverage; 15.8% of adults in 2010	Moderately low coverage; 9.6% of adults in 2010
<i>Private Credit Bureau Coverage</i>	Reasonably high coverage; 33.8% of adults in 2010	High coverage; 38.9% of adults in 2010	Moderate coverage; 24.5% of adults in 2010	Low coverage; 10.8% of adults in 2010



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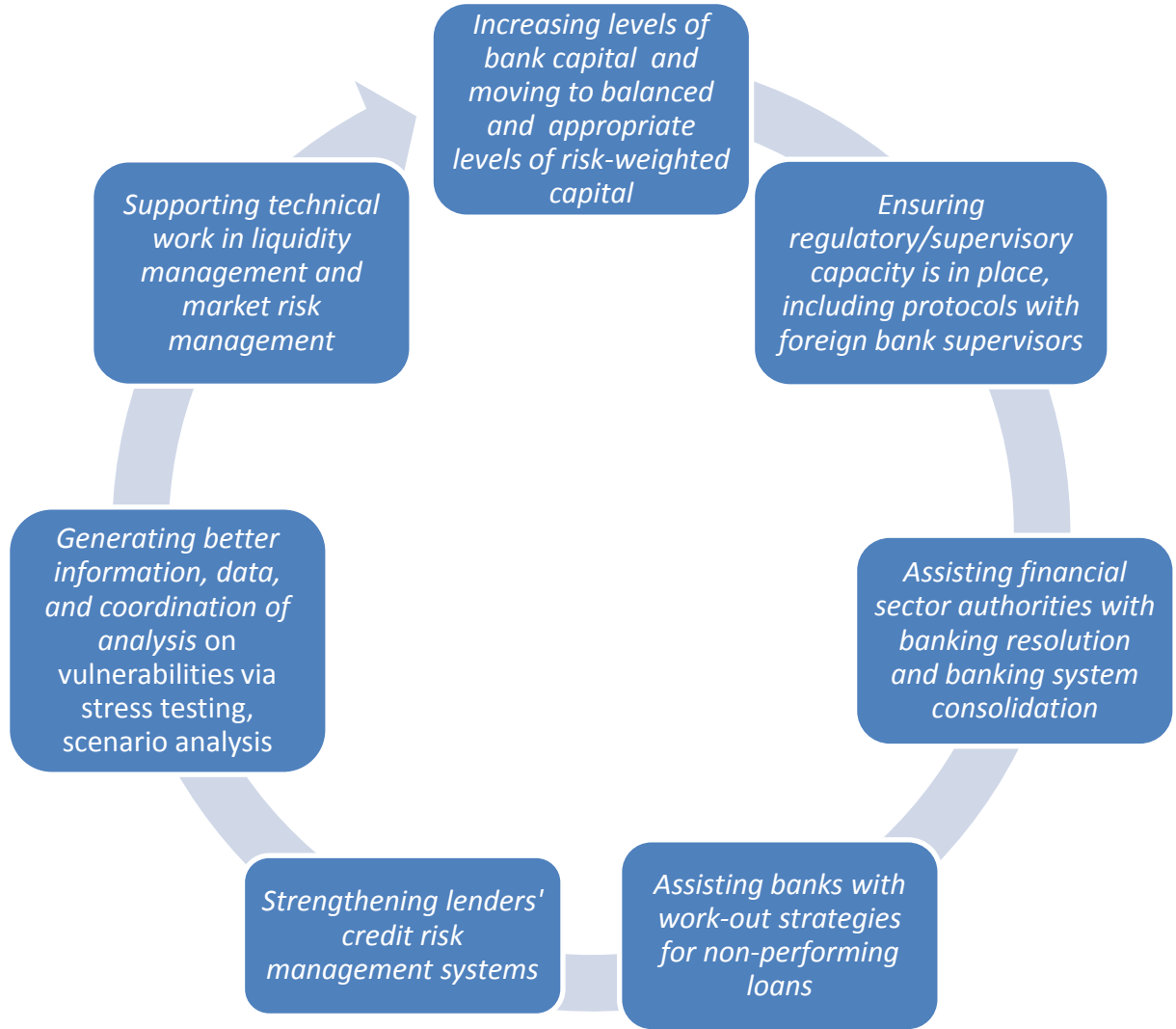
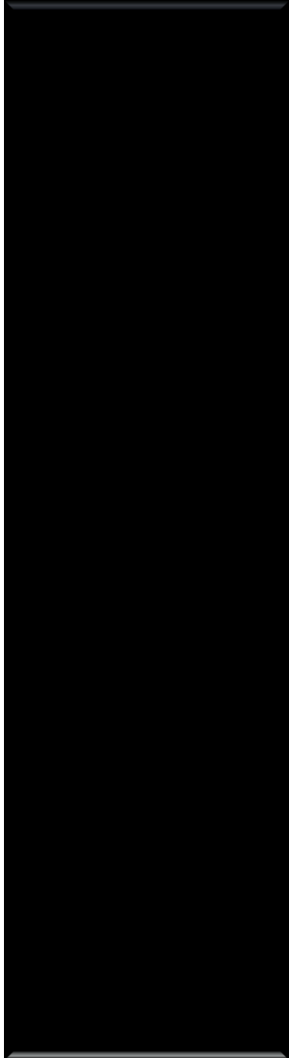


Why is the Financial Sector Important for Economic Growth Programming?

1. The private sector needs financing and sources of investment to grow, create jobs, and reduce poverty.
2. A stable macroeconomic environment is also needed for businesses to thrive – but macro stability is linked to financial sector stability.
3. Weak or unstable financial sectors can disrupt other reforms – witness the global financial crisis.



Macro-Financial Stability Initiatives





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To Promote Financial Sector Growth...

As PFS financial systems are small, it will take time for their banking systems and non-bank financial institutions to grow. To do so, measures will need to be taken to instil confidence over the long term so that (1) depositors, creditors, investors and consumers feel safe, (2) their resources are well managed and protected, and (3) contractual obligations are understood and consistently enforced.

Strengthening the court system to ensure that contractual rights and responsibilities are observed and consistently enforced .

Promoting joint listings on larger (regional/global) exchanges, and encouraging more listings and more freely floated shares for purchase on the open market.

Developing risk management capacity to ensure credit quality and foster conditions for sustained growth and confidence.

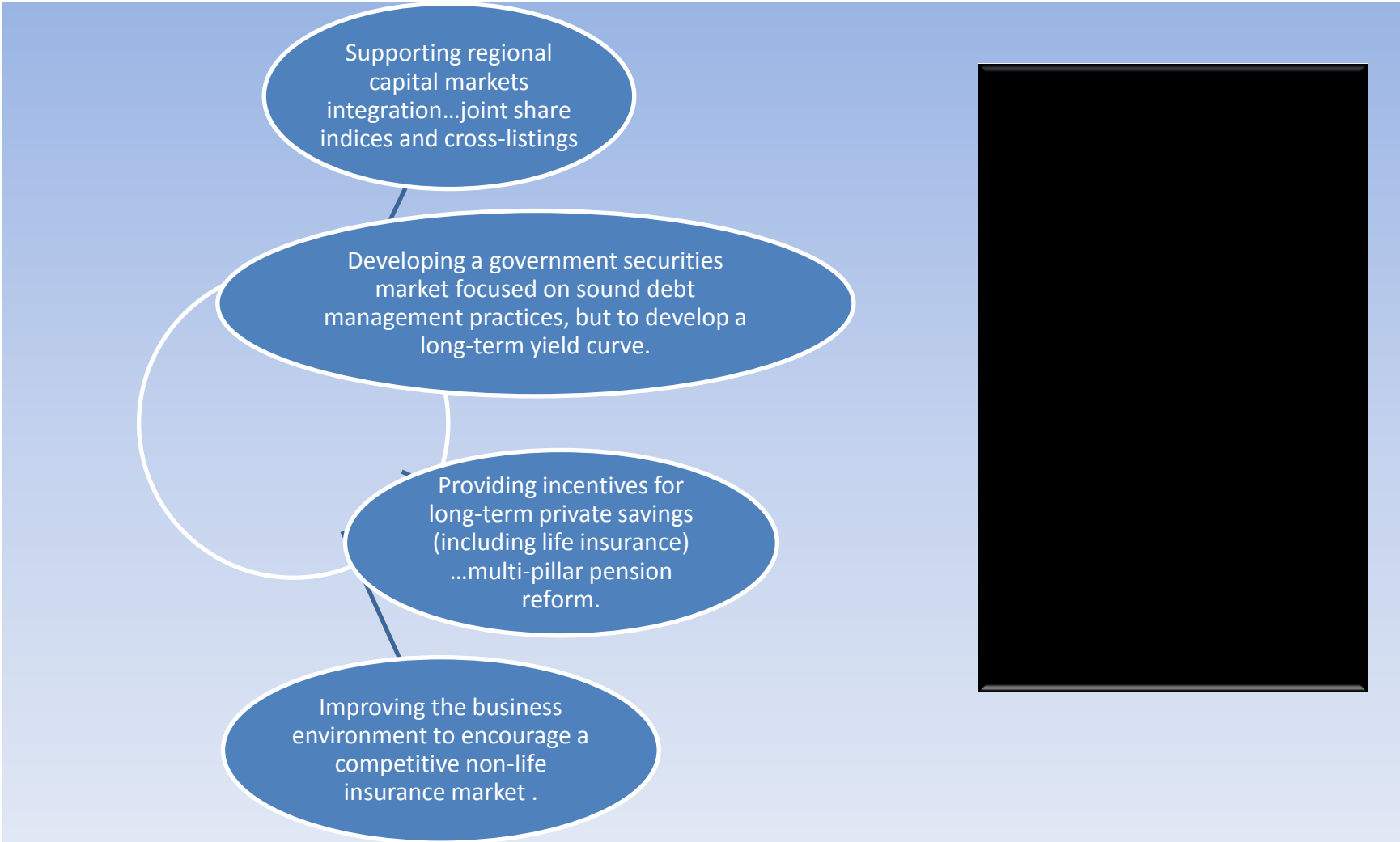
Developing strategies to diversify financial services, with specific targets set for achievement over a period of 10 or so years.



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For Greater Sophistication...





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To Increase Access....

Increasing the use of internet-based banking and postal service outlets.

Linking company payroll systems with loan payment system infrastructure to make debt payments regularly and electronically.

Expanding coverage of credit transactions and histories with positive and negative information.

Via pledge and collateral registries, faster and more efficient enforcement of collateral and guarantees securing loans.

Financial literacy training and consumer protection in financial services.



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A Better Environment...

Professional development and certification through distance learning for financial sector professionals



Translating international accounting, auditing and financial reporting standards into local languages



Establishing policy reform committees to work for a sound regulatory framework and improved business environment.



Better Financial Sector Enabling Environment



Expanding use of specialized commercial courts to reduce legal logjams



Expanding use of user-friendly technologies to facilitate property registration