EUROPEAN CENTRAL BANK

BANKING STRUCTURES IN THE NEW EU MEMBER STATES

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LIST OF COUNTRY ABBREVIATIONS

AT	Austria
BE	Belgium
CY	Cyprus*
CZ	Czech Republic*
DE	Germany
DK	Denmark
EE	Estonia*
ES	Spain
FI	Finland
FR	France
GR	Greece
HU	Hungary*
IE	Ireland
IT	Italy
LT	Lithuania*
LU	Luxembourg
LV	Latvia*
MT	Malta*
NL	Netherlands
PL	Poland*
PT	Portugal
SE	Sweden
SI	Slovenia*
SK	Slovakia*
UK	United Kingdom
EU	European Union (25 countries, after enlargement)
EU-15	European Union (15 countries, before enlargement)
NMS	new Member State (ten countries, marked with *)

EXECUTIVE SUMMARY

This report, prepared by the ESCB Banking Supervision Committee, aims to provide an extensive and in-depth analysis of banking structures in the new Member States (NMSs) of the EU. This special focus is justified by the fact that most of the NMSs' banking sectors have been through similar structural changes in a relatively short period of time and, consequently, share some common structural characteristics. A detailed analysis of the banking structures in the NMSs is therefore needed to identify those financial stability implications which relate to their specific structural characteristics.

OPERATING ENVIRONMENT

In recent years banking sectors in the NMSs have operated under favourable macroeconomic conditions owing to considerable progress in real and nominal convergence in most countries. GDP growth in the NMSs has outstripped that of the EU-15 countries, whereas average inflation has fallen from double-digit figures in 1998 to euro area levels in 2003. While the macroeconomic environment has generally been conducive to banking sector stability, some problem areas remain where further improvements are needed. These mainly concern the large current account and fiscal imbalances in some countries as well as the reversal of the disinflation process in several countries in 2004.

In terms of the regulatory and supervisory environment, a capacity for effective prudential regulation and supervision has been developed. Financial supervision tends to be organised on a sectoral basis in six NMSs whereas in the other four NMSs, a single supervisory authority oversees the whole financial sector. In all NMSs, a single supervisory authority (central bank or a separate body) is responsible for the supervision of commercial banks, as is the case in the EU-15 countries.

MAIN STRUCTURAL FEATURES OF NMS BANKING SECTORS

As most new Member States followed similar development paths during the transition period, most NMS banking sectors share common structural characteristics. Despite an upward trend in many countries, the level of financial intermediation is still low in the former transition NMSs, compared with the EU-15 countries. In terms of financial structure, the NMSs rely more heavily on bank finance than on direct market finance, as is the case in most EU-15 countries. The structure of the banking systems is dominated by commercial banks, with an around 90% share of total banking sector assets. In some countries there is also a significant number of small cooperative banks. Furthermore, some countries have specialised financial service providers, such as mortgage banks, building societies or international banking units.

Foreign presence is very large in most NMSs, mainly in the form of subsidiaries of foreign banks. On average, 72% of bank assets are foreign-owned. In general, NMS banks have a limited presence abroad which more often occurs via branches in neighbouring regions, but some banks also have equity participations in foreign banks. The market structure of NMS banking sectors is generally characterised by relatively high concentration. On average, the largest five banks hold 72% of total banking sector assets in the NMSs. Given the high concentration in most of the NMSs, potential concerns may arise as regards the degree of competition. However, concentration and margins are negatively related, i.e. margins are among the lowest in highly concentrated markets and are the highest in markets with lower concentration. This suggests that high concentration may not necessarily lead to anti-competitive behaviour in the NMSs.

BALANCE SHEET STRUCTURE AND PERFORMANCE

On the assets side of NMS banks' balance sheets, the loan-to-asset ratio is catching up rapidly with that of EU-15 banks; largely as a result of rapid lending growth in many countries. Household lending – in particular, mortgage lending – has been the fastest growing area in most of the NMSs in the past few years. However, it only represented 24% of banks' loan books in 2003, whereas loans to non-financial corporations made up 52% of the total loan portfolio. Looking at the liabilities side, customer deposits are the most important funding source for banks in the NMSs, with 66% of total assets. The proportion of debt securities on the liabilities side, however, remains insignificant in most NMSs. Regarding the currency structure of banks' assets and liabilities, a large diversity could be observed across the NMSs. The share of foreign currency balance sheet items tended to be the highest in countries with full and quasi-currency boards or basket pegs.

Benefiting from favourable macroeconomic conditions and high lending growth, banks in the NMSs generally improved their performance in 2003. Despite an improving trend in the quality of the NMS banks' assets, their ratio of non-performing and other doubtful loans was still considerably higher than that of EU-15 countries. A large dispersion of asset quality indicators can be observed across the NMSs which is mainly due to differences in the pace of bad loan restructuring, macroeconomic conditions and loan classification rules. Despite recent high lending growth, banks maintained adequate solvency buffers in the NMSs, reflected by an average solvency ratio of 13.6% in 2003.

POLICY ISSUES AND IMPLICATIONS FOR FINANCIAL STABILITY

One of the potential concerns related to high foreign ownership is that foreign banks may react differently than domestic banks to adverse changes in business cycle conditions – either at home or in a host country –, or in the case of a host country banking crisis. Empirical evidence, however, suggests that high foreign ownership in the NMSs may have a stabilising effect on credit supply although caution may be needed when drawing conclusions from experiences during the transition period.

Strong ownership links between the "old" and "new" Member States may give rise to a risk transmission channel within the EU. As regards potential negative impacts, it is important to note that adverse effects resulting from ownership links could be quite asymmetric for home and host countries. Whereas the impact for EU-15 banks should be limited, the transmission of shocks from EU-15 countries is more likely to have an impact on systemic risk in the NMSs. Regarding EU-15 banks, positive effects from an increased presence in the NMSs may have so far outweighed the negative effects. In particular, NMS banks have contributed strongly in recent years to the profitability of EU-15 banks. Looking at the host countries, NMS banks have benefited from their close links with EU-15 banks through knowledge-transfer, including improvements in risk management systems. Over the medium to long-term, this will have a stabilising effect on banking systems in the NMSs.

Competition in NMS banking markets is expected to intensify further, partly owing to the increasing EU integration of banking sectors. This will have positive welfare implications, but may also present challenges for the nascent banking sectors. A higher degree of competition may put pressure on margins, and therefore also on banks' profitability. Without corresponding restructuring on the cost side, banks' ability to withstand shocks may be hampered by decreasing capital buffers. It is worth noting, however, that some of the pressure to restructure will be offset by the rapidly growing lending volumes and an expected increase in non-interest income.

A recent acceleration of financial deepening in a number of NMSs is a natural part of the real convergence process. Despite the positive effects of this on economic development, additional risks may also arise due to the rapid lending growth. Thus, prudential regulation and supervision may be challenged when addressing the issue of high credit growth. Although it may be very difficult for authorities to distinguish empirically between excessive credit growth and financial deepening related to catch-up. Policy responses may differ in each case: whereas increased risks from high lending growth may justify the introduction of counter-cyclical or tighter prudential requirements, policy responses of this type may hamper financial deepening and thereby slow down the real convergence process.

One of the most important regulatory challenges in the NMSs may stem from the specific ownership structure and the potential shift of banking structures in the future towards branching. After EU enlargement, the new entry of foreign branches or transformation of subsidiaries into branches may give rise to regulatory challenges similar to those related to the Nordea case. A foreign branch in the NMSs may have systemic importance in the host country even though it only represents a relatively modest share of the group's total operations. In this case, a potential conflict may emerge between home country control in micro-prudential supervision and host country responsibility in safeguarding financial stability. This highlights the need for enhanced coordination and information-sharing between host and home supervisory authorities. Bilateral agreements between national authorities can alleviate the information asymmetry problem and the increasing number of Memoranda of Understanding between NMS and EU-15 authorities in recent years may be seen as an encouraging sign in this respect.

1 INTRODUCTION

With the recent accession of ten new Member States to the European Union, there is clearly a need for detailed analysis of their banking structures and developments, especially in light of the significant structural changes that have taken place in a relatively short period of time. It is also important to know, how and to what extent the NMS banking sectors are integrated with the rest of the EU and the rest of the world and how the accession process has had an impact on their banking sectors.

The purpose of this report, prepared by the ESCB Banking Supervision Committee (BSC), is therefore to present findings on the structure of the banking sector in the NMSs, to describe recent changes and present a brief outlook, and to show how the NMS banking sectors have become integrated with the rest of the EU. The main findings of this report have been summarised in the 2004 *Report on EU banking structure*. The virtue of this study, however, is that it provides a more in-depth analysis and includes a statistical annex for each of the NMSs.

Although extensive information is already available about NMS countries' banking structures, it is hoped that this comprehensive overview of structural factors and recent changes will provide added value and complement existing studies. The report is therefore based on both existing literature on the banking systems in the NMSs[1] and a questionnaire answered by the representatives of the new Member States in the (BSC).

The report is structured as follows:

– Section 2 describes developments in the external macroeconomic, regulatory and supervisory environment.

– Section 3 focuses on the main structural characteristics of the banking sectors in the NMSs, such as the organisation and functioning of the banking sector, the influence of foreign ownership in the banking sector, and the issue of concentration and competition.

– Section 4 discusses recent developments in balance sheet structure and the performance of NMS banks.

– Section 5 describes some topical policy issues and challenges.

– Section 6 concludes.

1 See, for instance, ECB (2002), *Financial Sectors in EU Accession Countries*, July.

2 THE MACROECONOMIC AND REGULATORY ENVIRONMENT

2.1 MACROECONOMIC ENVIRONMENT[2]

Over the past five years the NMSs have made considerable progress in real convergence. Between 1999 and 2003 they recorded an average GDP growth rate of 3.2%, compared with 2.0% for the EU-15 countries. The gap between the growth rates was particularly significant in 2003, as real GDP grew by 3.8% in the NMSs, compared with 0.75% in the EU-15 countries. The Baltic States stood out in particular with average growth of 7.8%. Looking at the structure of output growth, increasing domestic demand also played a prominent role in several countries since net exports were negatively affected by sluggish economic activity in Europe. Despite continuing convergence, GDP per capita levels still lag far behind that of the old Member States, accounting for only 51% of the EU-15 average in 2003 (in PPP terms).

From similar levels in 1999, unemployment rates have been diverging in the NMSs and EU-15 countries for the past five years. Despite robust economic growth, average unemployment rate in the NMSs increased by almost 2 percentage points, to 13% in 2003. Contrary to developments in the new Member States, the average unemployment rate declined by 0.6 percentage point in the EU-15 countries during the same period, to 8.1% in 2003.

The NMSs have made great progress in terms of nominal convergence as average inflation fell from 10.5% in 1998 to 2.1% in 2003. Dispersion by the level of inflation is substantial across the NMSs: in five countries, the inflation rate – as measured by the Harmonised Index of Consumer Prices (HICP) – was below the EU-15 average, whereas it remained relatively high in HU, SI and SK. As already observed in the first half of 2004, the disinflation process came to a halt or even reversed in several NMSs.[3]

As regards fiscal performance, a large variation can be observed among the NMSs in recent years. Fiscal policies have been sound in the Baltic States and SI, with general government deficits being kept below 3% of GDP (EE even recorded a surplus). The fiscal positions in other countries have diverged from the convergence criteria recently, with fiscal deficits ranging from 3.7% to 12.6% in 2003. Fiscal consolidation is of primary importance in these countries, but concerns may still remain for a few countries about the pace of the process in the next few years.

Increasing general government deficits have not so far caused concern for most of the NMSs in terms of public debt levels. Despite an upward trend in public indebtedness, government debt-to-GDP ratios have stayed well below the 60% threshold in most NMSs, on average reaching 44% in 2003. Cross-country differences are quite substantial, however, with debt ratios ranging from 5.3% in EE to 70.9% in CY.

Regarding the external position, developments have been quite diverse across the NMSs for the past few years. The Baltic States, CZ and HU recorded large current account deficits in 2003, in the range of 6.2%-12.7% of GDP. At the same time, the structure of capital inflows has shifted towards portfolio investments from FDI inflows. Whereas in recent years current account deficits have been covered by net FDI inflows for the NMSs as a whole, a considerable gap opened up in 2003.

Vulnerability to foreign exchange shocks varies quite significantly across the NMSs. In this context, an important distinction must be made between groups of countries according to their exchange rate regimes. Broadly speaking, countries can be classified into two main groups:

2 In line with the aim of this report, this section focuses on longer-term changes in macroeconomic conditions rather than the latest developments.

3 Rising inflation can be explained by increases in indirect tax and regulated prices, higher oil prices, and stronger domestic demand. The relative importance of these factors, of course, may differ according to country.

– The first group contains the Baltic States – which either operate a full (EE and LT) or quasi-currency board (LV) – MT, with a basket peg, and SI, with a de facto tightly managed exchange rate regime.

– The second group includes countries where larger swings in exchange rates have higher probability due to more flexible regimes. This group comprises countries with floating or managed floating regimes (CZ, PL and SK) or a peg with wide bands (CY and HU).

According to the three major rating agencies (see the country annex), ratings on long-term foreign currency denominated sovereign debt for the NMSs are still considerably lower than for the EU-15 countries. In the group of the NMSs, only SI has AA ratings, while most of the countries have A ratings. PL has the lowest ratings on average, with two of the large rating agencies giving it a BBB rating. Within the EU-15 group, ten countries have AAA ratings, four countries have AA ratings and only one country has an A rating.

2.2 REGULATORY ENVIRONMENT AND SUPERVISION

2.2.1 PRUDENTIAL REGULATION

Financial Sector Assessment Programmes (FSAPs) undertaken by the IMF show that significant progress has been made in reforming of the banking sector. The same trend can be observed from EBRD indicators of banking reform (see Table 1), which show that the capacity for effective prudential regulation and supervision has been developed (including procedures for the resolution of bank insolvencies) and that budget constraints on banks have been hardened by eliminating preferential access to concessionary refinancing by the central bank.[4]

In terms of policy restrictiveness, according to the Heritage Foundation, the NMSs have improved their relative position in the world ranking. Between 1997 and 2003, many NMSs

4 Some countries apply even more stringent capital adequacy norms than in the EU-15 countries or the United States, as prescribed under the Basel framework.

Table 1 Indicators of policy restrictiveness (Heritage Foundation) and banking reform (EBRD)

	Heritage Foundation				EBRD			
	World rank (overall)		Restrictions in banking and finance		Index of banking sector reform		Index of reform of non-bank financial institutions	
	1997	2003	1997	2003	1997	2003	1997	2003
CY	38	14	2	2	-	-	-	-
CZ	18	32	1	1	3.0	3.7	2.7	3.0
EE	32	6	2	1	3.3	3.7	3.0	3.3
HU	68	42	2	2	4.0	4.0	3.3	3.7
LV	65	29	2	2	3.0	3.7	2.3	3.0
LT	73	22	3	1	3.0	3.0	2.3	3.0
MT	78	37	3	2	-	-	-	-
PL	73	56	3	2	3.0	3.3	3.3	3.7
SK	70	35	3	1	2.7	3.3	2.3	2.7
SI	89	52	2	3	3.0	3.3	2.7	2.7
NMSs*	60	33	2	2	3.1	3.5	2.7	3.1

Sources: Heritage Foundation, *Index of Economic Freedom 2004*; and EBRD, *Transition Report 2003*.
Note: For the Heritage Foundation indicators, scores range from 1 to 5. A score of 1 means very low barriers or restrictions, a score of 2 low and 3 moderate barriers or restrictions. The EBRD indicator for banking reform is measured on a scale from 1 to 4+. A score of 2 means that a country has established internal currency convertibility and liberalised significantly interest rates and credit allocation. A score of 3 means that a country has achieved substantial progress in establishing a prudential regulation and supervision framework. A score of 4 represents a level of reform that approximates the BIS institutional standards. ±0.3 indicates top and bottom of the categories.

reduced restrictions in banking and finance or maintained low levels of restrictions already in place in 1997 (see Table 1).[5] This evolution was underpinned by the increasing competitiveness of the banking industry, the removal of barriers to entry for foreign banks, sound and prudent regulations, the possibility for banks to engage in a wider range of financial activities and the minimal role of the state in commercial banking in 2003.

The most important European banking directives have been implemented in the NMSs. Table 2 gives an overview of some remaining issues, as identified by the European Commission in its 2003 progress reports towards accession. According to the progress reports, in all countries, except LV and SI, the Electronic Money Institutions Directive[6] still needed to be transposed into national law or has only been partially transposed.[7] In four countries (EE, LT, LV and SI), transitional arrangements are in place with regard to deposit guarantee schemes, while in three other countries (CY, PL and SK), some aspects of the coverage has to be expanded. Also countries with a large number of cooperative or savings and loans institutions (CY, HU and PL) need to bring certain aspects of their legislation into line with the body of EU law (*acquis communautaire*). Finally, in up to three countries, some progress is still needed towards adopting the capital adequacy legislation, the rules of winding up and the rules related to the operations of branches and subsidiaries.

5 The Heritage Foundation keeps track of ten indicators of policy restrictiveness. Other indicators include trade policy, fiscal burden, government intervention, monetary policy, foreign investment, wages and prices, property rights, regulation and informal markets. Concerning *barriers to capital flows and foreign investment*, in some cases, these are higher than in *banking and finance*, due to the fact that authorisation is required for issuance of debt and money market securities, limitations on open foreign exchange positions, maximum ownership restrictions, or approval processes (e.g. for real estate purchases).

6 Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions (OJ L 275, 27.10.2000, p. 39).

7 In several countries, however, progress has been made or the Directive has been transposed into national legislation in the mean time.

Table 2 Legislative and supervisory alignment of the NMSs (end-2003)

	CY	CZ	EE	HU	LT	LV	MT	PL	SI	SK
Legislative alignment with the acquis communautaire in the banking sector, except for:										
Electronic Money Institutions Directive	(*)	*	*	(*)[1]	(*)[1]		(*)	*		(*)[1]
Deposit guarantee schemes			T		T	T		*	T	*
Cooperative credit institutions	T			T				*		
Savings and loans institutions' annual accounts									*	
Capital adequacy rules		*					(*)	*		
Winding up, liquidation procedures			*				(*)	*		
Branches' and subsidiaries' annual accounts/EU passport				*			(*)	*		
Acquis-related tasks as a supervisory authority in the field of banking are performed satisfactory, except for:										
Legal protection of supervisors/enforcement powers								*	*	
Enhancing cross-border supervisory cooperation								*		
Strengthening cooperative banks' supervisor	*									
Improving cooperation between sectoral supervisors	(*)				*			*		(*)
Financial independence		*								
Operational and political independence				*				*		
Out-of-court redress schemes									*	

Source: European Commission, *Comprehensive monitoring report on preparations for membership*, 2003.
Note: T means transition arrangements are in place (ending at the latest by end-2007); * denotes certain issues need to be resolved in the field under consideration, as inferred from the mentioned reports; (*) means progress has been made or the issue resolved in the mean time; blank means the issue was not mentioned.
1) Directive transposed into national legislation in 2004.

2.2.2 SUPERVISORY STRUCTURE

In six NMSs (CY, CZ, LT, PL, SI and SK) supervision tends to be organised on a sectoral basis; a distinction is usually made between the oversight of banks, insurance companies, pension funds and firms providing investment services. In EE (EFSA), HU (PSZÁF), LV (FKTK) and MT (MFSA), a single supervisory authority oversees the whole financial sector – as is also the case in seven EU-15 countries.[8]

In all NMSs, a single supervisory authority is responsible for the supervision of commercial banks, as is the case in the EU-15. In five countries, the central bank is entrusted with bank supervision (CY, CZ, LT, SI and SK), whereas in the other five countries (EE, HU, LV, MT and PL), a single supervisory authority has been established outside the central bank, also as a result of recent changes.[9] In addition, in CY and CZ, cooperative banks are supervised by a separate authority.

Regarding the performance of tasks by supervisory authorities, the EU progress reports have indicated some areas where improvements could be made (see Table 2). In particular, the reports noted that cooperation between different sectoral supervisory authorities could be improved – as has been the case in CY with the signing of a Memorandum of Understanding – and that full financial and operational independence should be granted to supervisory authorities.

2.2.3 SAFETY NET ARRANGEMENTS

As indicated in Nenovsky and Dimitrova (2003)[10], deposit protection in the NMSs is mostly arranged as an explicit and compulsory scheme. Deposit insurance schemes were implemented between 1993 and 2003, generally covering deposits in both local and foreign currencies. In most NMSs, there is an element of co-insurance in that the cover is restricted to the lower of the maximum cover or a percentage (usually 90%) of the actual deposit amount. The level of the protection ranges between €6,400 (EE) and €25,000 (CZ). Three countries (EE, LT and LV) have cover below the EU minimum level of €20,000, but transitional arrangements are in place so that they will reach the EU minimum by 2008. In CZ, HU, PL and SI, the coverage exceeds the EU minimum.

In most countries a special body is responsible for the management of the deposit insurance fund; the exceptions being CY and SI, where the central bank is involved in the management of, respectively runs, the deposit insurance fund, and LV, where the supervisory authority manages the deposit insurance fund. Annual premiums range from 0.1% (CZ) to 0.75% (SK) of insured deposits and are not risk-adjusted in most NMSs. Funding is either completely private (CY, CZ, LT, MT and SI) or jointly private and official (EE, HU, LV, PL and SK).

2.2.4 ACCOUNTING STANDARDS

Under EU reporting requirements, banks are required to publish financial statements and reports for the shareholders at least once a year. In five countries (CZ, EE, LT, LV and SK), banks are required to report on a quarterly basis; in four other countries (HU, MT, PL and SI), banks only have to report quarterly (MT: semi-annually) if they are listed on the stock exchange. The timeliness of the reporting varies from 35 days (LT) to 45 days (CZ and

8 In the EU-15, there is an integrated supervision of the whole financial sector in AT (FMA), BE (BFIC), DE (Bafin), IE (FSA), LU (CSSF), NL (DNB) and UK (FSA). In the remaining eight countries, there is a sectoral supervision. *Banks* are supervised by a single supervisor in all EU-15 countries. In five countries (ES, GR, IT, NL and PT), the central bank is the relevant authority, while in the remaining ten countries, a separate supervisory authority is entrusted with bank supervision. See ECB, *Developments in national supervisory structures*, June 2003.

9 In PL, the Commission for Banking Supervision (KNB) is responsible for supervising banks. It is chaired by the President of the National Bank of Poland, but is autonomous in decision making. The executive agency of the Commission is the General Inspectorate of Banking Supervision, which is organisationally autonomous within the structure of the National Bank of Poland.

10 Nenovsky and Dimitrova, *Deposit Insurance during EU Accession*, William Davidson Institute Working Paper No. 617, Michigan Business School, October 2003.

HU) and 60 days (EE, LV, SI and SK) for quarterly reporting. The annual reporting time-frame in the NMSs ranges from four to six months.

Financial statistics and ratios are believed to be less valuable as a means of comparing banks with each other than is the case with banks in the EU-15. This is due to important revenue and asset distortions that can exist, evolving local accounting standards, and frequent changes in accounting treatments made by certain banks.[11] However, some NMSs (CY, LT, LV and MT) have already implemented the international accounting standards (IASs), which make a comparison of financial ratios easier and more meaningful. Moreover, in other countries (CZ and EE), accounting rules for banks are almost fully harmonised with the IASs.

2.2.5 BANKS' CORPORATE GOVERNANCE

In some countries, banks are subject to additional corporate governance rules besides those that apply for other listed firms. In CY and MT, banks may comply voluntarily with a code of conduct that aims to strengthen monitoring by the board, protect small shareholders, improve transparency, ensure an effective internal control system and agree on reasonable remuneration of chief executives. Some countries also refer to the OECD principles of corporate governance and the BCBS framework for internal control systems with which their banks have to comply.

In most countries, the banking law includes additional principles of corporate governance. These additional principles often relate to adequacy of risk management and internal control systems, and fit and proper tests of board members. Independent audit committees serve as another corporate governance mechanism. In a few countries these are mandatory; in others they exist de facto in large financial institutions, although not explicitly required by law. In HU the supervisory board performs the audit function. In LV, in addition to the regular company laws, a specific recommendation has been issued on internal control systems and the audit function applicable to banks.

In all NMSs except CY and MT, a two-tier governance structure – distinguishing between the daily management and the supervision of management in terms of legal set-up – is common in the banking and corporate sector.

11 Moody's (2004), *Mutual benefits of foreign ownership of Central and East European banks*, Special Comment.

3 STRUCTURAL CHARACTERISTICS OF BANKING SECTORS IN THE NMSs

3.1 INTERMEDIATION AND ORGANISATION OF THE BANKING SECTOR

3.1.1 FINANCIAL INTERMEDIATION

The level of bank intermediation in terms of lending to the private sector is generally increasing in most NMSs. A distinction should be made, however, between CY and MT and the other NMSs, i.e. the central and eastern European countries (CEECs) and the Baltic States.[12] In 2003 the respective ratios of domestic credit to the private sector, as a percentage of GDP, stood at 118% in MT and 122% in CY, which were higher than the EU-15 average of 117%. In the former transition countries, the level of bank intermediation is much lower. On average, the ratio of domestic credit to the private sector as a percentage of GDP in the former transition NMSs increased from 29% in 1995 to 35% in 2003. The noticeable increase in several countries coincided with both a rapid increase in economic and financial development and significant progress in the privatisation process. In some countries (CZ and SK), however, the ratio of domestic credit to GDP has shown a decreasing trend for the past five or six years. This can mainly be explained by the protracted restructuring of bad loans accumulated earlier.

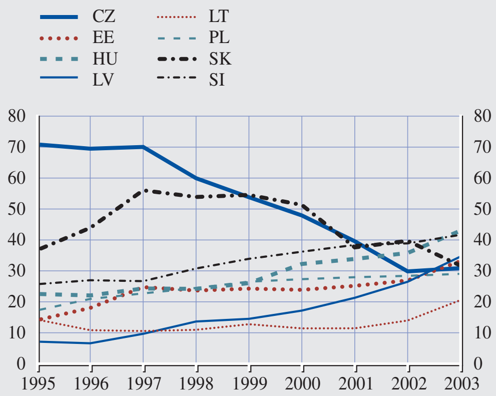
Several factors can explain the relatively low financial depth in the former transition NMSs:

– First and foremost, these countries have moved from centrally planned economies to market economies in a very short period of time. Hence, they all started with low levels of intermediation, given the absence of know-how and experience in their early years of capitalism.

– There may also be the effect of initially inadequate enforcement of creditor rights or regulation, prohibiting foreign borrowing, imposing ceilings on interest rates, or limiting the amount of financial services that banks could offer.[13]

Chart 1 Evolution of domestic credit to the private sector in the NMSs

(% of GDP)



Source: International Financial Statistics.

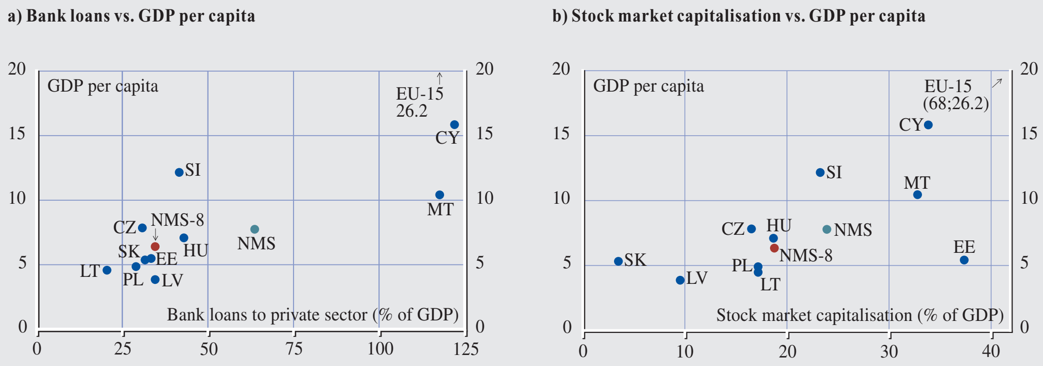
– Another important factor is that, due to the large presence of multinational companies, foreign bank lending and inter-company loans play a significant role in the financing of non-financial enterprises in most NMSs. In several countries the proportion of foreign debt is close to or even higher than 50% of total corporate debt.[14]

Many empirical studies have found that financial development increases with economic development.[15] As already noted above, some CEECs and the Baltic States are catching up rapidly with the rest of the EU, as reflected not only in their high economic growth rates, but also in an increase in their intermediation levels. This is also borne out in

12 In Charts 1, 2, 3 and 5, the group of these countries is referred to as NMS-8.
13 Over time, however, changes in regulation have contributed to an increase of bank intermediation.
14 Foreign debt includes foreign bank loans, intercompany loans and trade credit. For the CEECs, see Report on Financial Stability, Magyar Nemzeti Bank, June 2004.
15 See, Levine (1997), *Financial development and economic growth: Views and agenda*, Journal of Economic Literature, pp. 688-726; Levine, Loayza and Beck (2000), *Financial intermediation and growth: Causality and causes*, Journal of Monetary Economics, pp. 31-77; Khan and Senhadji (2000), *Financial development and economic growth: an overview*, IMF Working Paper No. 209.

Chart 2 Financial depth and economic development

(2003; GDP per capita in thousands)



Sources: BSC, European Commission, Eurostat, International Financial Statistics, World Federation of Stock Exchanges.

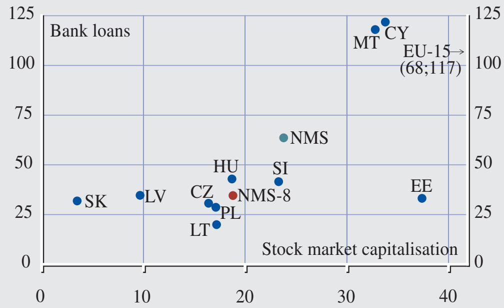
the relations for the NMSs in Chart 2 for the year 2003. The charts suggest that NMS countries with a higher GDP per capita have more developed financial markets and a greater role for the banking sector in financial intermediation.

3.1.2 FINANCIAL STRUCTURE

In terms of financial structure, the NMSs are more heavily relying on bank finance than on direct market finance, as is the case in most EU-15 countries. Chart 3 shows that, on average, the private sector in the NMSs relies 2.5 times more on bank finance than on stock market financing. In any case, stock markets in these countries are relatively small, as a percentage of GDP, compared with developed countries. For example, the ratio of stock market to GDP for the EU-15 countries is 68% and for the United States 150%, against 24% for the NMSs (19% for the former transition NMSs). The ratio for the NMSs is close to the average ratio in other emerging markets (e.g. Brazil, Mexico and Turkey).

Chart 3 Loans to the private sector versus stock market capitalisation

(2003, % of GDP)



Sources: BSC, Eurostat, International Financial Statistics, World Federation of Stock Exchanges.

3.1.3 STRUCTURE OF THE BANKING SECTOR

The largest part of the NMS banking sector is comprised of commercial banks (see Table 3): they employ 88% of all staff, cover 90% of total assets and have the widest branch network penetration, amounting to 86% of the whole banking sector. In some countries (CY, HU and PL), there is also a significant number of small cooperative banks. Furthermore, in some countries, specialised financial service providers are present.[16]

16 In CY it concerns international banking units; in CZ and SK building societies; in HU building societies and mortgage banks.

Table 3 Banking sector structure in the NMSs and financial ratios (2003)

		Number of banks	Number of branches	Number of staff	Total assets (€m)	Market share	Tier 1 ratio	Total capital ratio	ROE	ROA	Cost-income ratio
CY	Commercial banks	11	459	7,744	23,765	87.4	9.7	14.0	7.4	0.70	76.9
	Cooperative banks [1]	1	5	201	2,497	9.2	59.1	64.9	-27.9	0.50	52.5
	Special purpose	2	7	111	920	3.4	16.5	16.8	19.8	1.30	22.1
CZ	Commercial banks	20	1,636	36,392	63,462	79.9	5.8	14.5	23.6	1.3	52.3
	Foreign branches	9	19	857	7,610	9.6	n.a.	n.a.	n.a.	0.85	58.8
	Building societies	6	15	1,755	8,344	10.5	3.7	13.3	13.3	0.49	57.2
EE	Commercial banks [2]	7	194	4,204	6,302	100.0	9.9	14.5	12.6	1.50	54.0
HU	Commercial banks	31	1,147	26,549	50,730	85.0	8.4	11.6	19.8	1.65	60.6
	Cooperative banks	182	n.a.	n.a.	3,640	6.5	n.a.	n.a.	17.9	1.18	74.0
	Mortgage banks	3	8	316	4,131	7.6	4.1	10.8	32.4	1.36	58.3
	Building societies	2	7	302	471	0.9	4.7	38.3	-15.6	-0.79	116.6
LT	Commercial banks [2]	13	117	n.a.	6,381	100.0	7.8	13.2	13.4	1.26	77.7
LV	Commercial banks	22	206	8,112	8,459	100.0	11.7	11.7	16.3	1.47	56.1
MT	Commercial banks	16	103	3,411	17,800	100.0	16.9	19.1	11.0	1.00	66.3
PL	Commercial banks	60	3,119	124,096	98,272	94.7	8.3	13.6	5.9	0.95	68.0
	Cooperative banks	600	1,275	27,161	5,446	5.3	9.5	14.2	12.3	1.66	75.2
SI	Commercial banks [3]	20	1,176	11,397	21,367	98.7	9.8	11.5	12.6	1.03	62.5
	Savings banks	2	16	58	83	0.4	7.1	8.8	15.4	1.04	76.4
	Cooperative banks [4]	8	16	26	192	0.9	17.2	2.6	11.8	0.7	76.6
SK	Commercial banks [5]	18	553	19,147	22,380	94.2	21.2	20.7	13.8	1.08	70.7
	Building societies	3	0	650	1,371	5.8	29.4	30.9	12.1	1.90	55.9

Source: BSC.
1) Refers to the Cooperative Central Bank which provides banking and ancillary services to the 361 cooperative credit institutions in CY.
2) Foreign branches included.
3) Branches include post office counters, which are part of Post Office Bank of Slovenia.
4) Savings and loans undertakings – until February 2004 S&L undertakings operated under a transitional regime, which allowed the capital ratio to be below 8%.
5) Commercial banks include three foreign bank branches and ten banks which have authorisation for mortgage activities.

In terms of profitability and cost efficiency, commercial banks do not always perform better than specialised financial service providers. It should be noted, however, that accounting measures are sensitive to the strategies used to write off, and provide for, bad loans (see Section 2.2.4). Furthermore, Table 3 shows that the NMS banking sectors seem to be adequately capitalised; and, with a few exceptions, the total capital ratio is well above 10%.

3.1.4 PRIVATISATION AND STOCK LISTING

OWNERSHIP AND PRIVATISATION

The privatisation programmes in most NMSs have been fully completed by 2003. In PL, SI and SK, privatisation has been largely completed. In CY there are only two small state-owned credit institutions representing 4.6% of total banking sector assets. In EE and LT, no banks are owned by the public sector. Furthermore, state ownership is negligible in CZ (two small banks focusing on export, small businesses and municipalities), HU (0.9% of banking sector capital), LV (6.5% of capital), MT (one bank in which the state seeks to dispose of its minority stake), PL (six are state-owned, four of which are scheduled for privatisation) and SK (one bank is left for privatisation).

BANK LISTINGS ON THE STOCK EXCHANGE

The number of banks listed on the stock exchange ranges from one or two (EE, LV and SI) to 14 in SK. In general the number of banks

Table 4 Bank ownership structure and total banking sector assets

	Number of banks		Number of state-owned banks		Number of foreign-owned banks		Asset share of state-owned banks		Asset share of foreign-owned banks		Total banking sector assets (€bn)
	1997	2003	1997	2003	1997	2003	1997	2003	1997	2003	2003
CY [1]	12	14	2	2	4	6	3.9	4.6	11.6	12.3	27.2
CZ	50	35	n.a.	2	24	27	17.5	3.0	n.a.	96.0	79.5
EE	12	6	n.a.	0	4	3	0.0	0.0	n.a.	97.3	5.8
HU [1]	45	36	n.a.	1	30	29	3.5	2.3	n.a.	83.3	54.4
LT	12	13	3	0	5	10 [2]	48.8	0	40.6	95.6	6.4
LV	32	22	n.a.	1	15	9	6.8	4.1	n.a.	47.2	8.5
MT	n.a.	16	n.a.	0	n.a.	10	0.0	0.0	n.a.	67.6	16.8
PL [1]	83	60	n.a.	6	29	46	51.6	24.4	n.a.	67.8	103.7
SI	34	22	n.a.	2	4	6	40.1	36.0	n.a.	36.0	21.6
SK	29	21	4	2	13	19	48.7	3.7	29.6	96.3	23.8

Sources: EBRD for 1997, BSC for 2003.
1) Excludes cooperative banks and international banking units, but includes the Cooperative Central Bank (for CY).
2) Includes foreign bank branches.

in the local market is very small and hence, even if there are only a few banks listed, they usually represent a significant share of the banking sector assets (56% in EE and 20% in LV). Only in SI, one small bank out of the 20 banks is listed and has an asset share of 2%.

In HU the three listed banks account for 24% of assets. In some other countries (CZ, MT and PL) listed banks account for nearly 50% or even more (90% in SK and 74% in CY) of banking sector assets.

In most countries the listing of banks on the stock market is stable. In CZ the listing of bank stocks, bonds and mortgage bonds on the stock exchange is increasing. The number of stock listings is (slightly) decreasing in two countries: namely LT, after the removal of one bank from the market due to privatisation to a single owner, and PL, due to merger and acquisition (M&A) activity.

LINKS BETWEEN BANKS AND NON-FINANCIAL COMPANIES

Banks do not have significant stakes in non-financial companies in most NMSs. In some countries (CY, LT and MT), there are explicit rules that a bank may not acquire major stakes, while in other countries (CZ, PL and SK), there are no specific limits; although major stakeholdings are sometimes discouraged. In most cases, however, shareholding of banks is related to auxiliary services, such as consulting and advisory functions, export, securities sector or property management (CZ, HU, MT and SK).

Non-financial institutions rarely have significant participating interests in banks in most countries: in HU one bank is owned by an industrial concern; in LT two of the smallest banks are owned by non-financial companies; and in LV one bank out of 22 is indirectly owned by a non-financial firm. In line with Article 16 of the Consolidated Banking Directive (Directive No. 2000/12/EC), authorisation is required if a non-financial firm reaches a significant threshold in a bank's capital.

3.2 FOREIGN PRESENCE

3.2.1 DIFFERENT MODES OF FOREIGN PRESENCE

As indicated by Table 4, foreign banks have expanded their presence in the NMSs quite significantly during the last decade. Table 5

Table 5 Foreign credit institutions in the NMSs (2003)

	CY	CZ	EE	HU	LT	LV	MT	PL	SI	SK	Total
Number of foreign branches	2	9	1	0	3	1	2	1	1	3	23
Total assets (€ million)	408	7,610	537	0	555	405	4,753	693	205	3,034	18,200
% of total banking assets	2	10	9	0	9	5	27	1	1	13	6
Number of foreign subsidiaries	4	18	3	28	5	7	8	45	5	16	139
Total assets (€ million)	2,921	62,315	5,622	33,708	4,876	3,701	6,662	74,716	3,879	19,834	218,234
% of total banking assets	11	79	97	62	76	44	38	67	18	84	62
Foreign-owned bank assets [1] as % of total banking assets	12	96	97	83	96	47	68	68	36	96	72
Number of top-5 foreign banks	1	5	4	4	5	2	4	4	1	5	34
Nationality of top-5 foreign banks	7 AT, 3 BE, 3 DE, 2 FI, 1 FR, 1 GR, 1 NL, 6 SE, 1 UK, 4 IT, 2 TK, 1 US										

Source: BSC.
1) The percentage share of foreign branches and subsidiaries do not necessarily sum up to foreign-owned bank assets because the latter may also include indirect or minority foreign ownership.

shows that most foreign presence is now in the form of subsidiaries of foreign banks.

A large part of the foreign ownership of NMS banks stems from privatisation of former state-owned banks, at least in the CEECs. Usually, foreign banks initially bought a small equity share in the bank and over time increased their shareholding. In addition, a number of banks entered these markets via greenfield operations, which has the advantage that they avoid inheriting bad loans from the past.

Foreign banks have chosen to become active in the NMSs as part of either a global or regional expansion strategy. An example of a global expansion strategy is where US banks and, to a lesser extent, Belgian banks have developed financial services activities in the CEECs. Examples of regional expansion strategies include Nordic banks becoming active in the Baltic States, and Austrian and Italian banks operating in neighbouring central European countries (CZ, SK and HU). In general, the presence of non-EU banks in the NMSs is rather limited.

Foreign presence is very large in most NMSs. On average, more than 70% of bank assets are foreign-owned. Foreign presence is notably high in CZ (96%), EE (97%), HU (83%), LT (96%) and SK (96%). At the other end of the scale are CY and SI, with respectively 12% and 36% of assets held by foreign banks. With few exceptions, the four or five largest banks are all foreign-controlled (see Table 5).

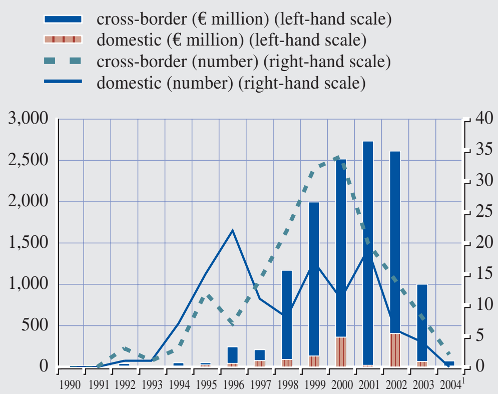
Most of the banks involved in the NMSs are viewed as strategic investors with a strong commitment to the local economy, rather than financial investors.[17] Strategic ownership has the advantage of providing both stability and expertise in retail banking and risk management. The motives for foreign banks' presence in the NMSs range from increasing profitability and diversification to more long-term strategic goals.

3.2.2 M&A ACTIVITY INVOLVING MAINLY FOREIGN BANKS

Figures on mergers and acquisitions (M&A) clearly show that foreign banks became very active in the NMSs in the latter half of the 1990s (see Chart 4). Privatisation was the main driver of M&A activity. In the last two years, there have been very few M&As, reflecting the fact that most banking markets might have reached a near-equilibrium foreign-dominated shareholder structure. In the near future, only a few M&As are expected, since most banks are now privatised and enjoy stable

17 See Moody's (2004).

Chart 4 Domestic and cross-border M&As



Source: Thomson Financial (SDC Platinum).
Note: Information only available for the first half of 2004; except for cross-border deals, NMS countries are viewed only as target. Value of M&As is on the left-hand scale; number of deals on the right-hand scale. Note: Not all deals may be reported.

shareholdership, and concentration in the domestic banking sectors is generally very high in most NMSs, leaving little scope for further significant mergers in the NMSs. In some countries with relatively moderate concentration levels, however, an equilibrium market structure may not have been reached yet. Further consolidation in relatively less concentrated banking markets will also hinge upon potential mergers between parent institutions.

Looking at the distribution of M&A activity across the different NMS banking sectors, it is apparent that CZ, HU and PL have been the most popular M&A targets over the period under examination, mainly because these countries had the largest number of banks. These countries also have the most diversified M&A structure across, mainly EU-15, countries. In the Baltic States, however, foreign M&As are much more concentrated (SE and FI). Banks from AT, BE, FR and DE were the most active acquirers and have built up positions in five NMSs.

Table 6 gives an overview of the largest banks involved in M&A deals in the NMSs according to the size of the deals. The largest banks, acquiring banks in different NMS countries, are from AT, BE, SE and FR. Also one large US banking group, Citigroup, made targeted large-value acquisitions in the NMSs (PL).

3.2.3 IMPACT OF FOREIGN OWNERSHIP ON PERFORMANCE AND FINANCIAL DEEPENING

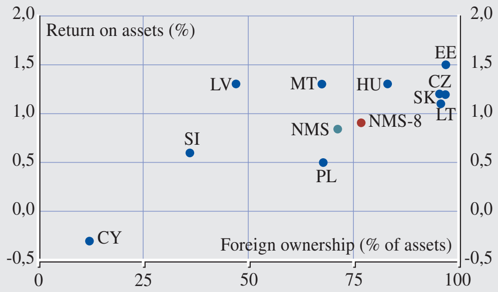
It has been argued that financial statement measures provide mixed signals about banks' performance in transition countries, due to the less developed and evolving nature of their banking sector. Consequently, an association between accounting information, performance and institutional characteristics of banking sectors may be fraught with difficulties. Despite this, however, most empirical evidence seems to point toward a positive association between foreign ownership and banking sector

Table 6 Largest acquirers according to deal values (1990-June 2004)

Rank	Acquirer	Target nations	Number of deals	Deal value (€ million)
1.	Erste Bank (AT)	CZ, SK, HU	8	2,141
2.	KBC (BE)	CZ, PL, HU, SI	16	1,983
3.	Société Générale (FR)	CZ, SI	2	1,329
4.	Citigroup (US)	PL	3	1,038
5.	Bayerische HypoVereinsbank (DE)	CZ, PL	7	932
6.	SEB (SE)	LT, EE, LV, PL	14	568
7.	IntesaBci (IT)	SK	1	440
8.	Bank Przemyslowo-Handlowy (PL)	PL	2	400

Source: Thomson Financial (SDC Platinum).
Note: The table also includes deals where domestic banks engaged in M&As were later taken over by foreign banks and incorporates a number of M&As related to the same acquirers that have gradually increased their shareholding in the target bank.

Chart 5 Foreign ownership and banking sector performance in 2003



Source: BSC.
Note: Correlation between foreign ownership and ROA is 0.78; country averages are asset-weighted figures. For CY, the figure on foreign ownership does not take international banking units into account.

performance in transition countries.[18] This is also borne out by the, albeit possibly biased, evidence in Chart 5 for the banking sectors of the NMSs. The chart suggests a positive relation between foreign ownership and ROA for the year 2003. It should be acknowledged, however, that banks' performance may vary substantially within the different NMSs, depending not only on ownership, but also on the specialisation and strategy of the individual banks.

Some empirical literature has documented the effect of foreign ownership on aggregate lending growth and on the extension of credit to specific market segments in transition countries. In particular, foreign banks were initially believed to focus their activities on large enterprises and underservice the retail and SME segment. This is due to the fact that large enterprises are easier to monitor or more profitable, allowing foreign banks to "cherry pick" the most profitable activities in the economy. Alternatively, foreign banks often follow their customers abroad and hence, when the latter set up operations in the NMSs, foreign banks also establish a local presence.[19] However, this holds perhaps more for other transition countries which made relatively little progress in reform – and not for the NMSs – or applies only to the early period of transition in which mainly greenfield operations were carried out.[20] Furthermore, there is counterevidence to indicate that foreign banks in fact lend more to local customers through co-financing with local banks because of the latter's strength in seizing enterprise assets of firms in liquidation.[21]

Foreign ownership is beneficial for the banking systems of (former) transition countries since it involves a transfer of technology and human capital which increases the operational capacity of local banks. In particular, foreign ownership is widely believed to have contributed to an improvement of the risk profile, reputation and risk management of local banks and hence to financial stability in NMSs and a convergence with western standards.[22]

3.2.4 ROLE OF CROSS-BORDER LENDING FROM EU-15

By more than doubling in nominal value, cross-border lending by EU-15 banks to the NMSs has gained importance in recent years, rising from 31% to 42% of NMS countries' GDP between 2000 and 2003. In particular, the

18 See Yildirim and Philippatos (2002), *Efficiency of banks: Recent evidence from the Transition Economies of Europe 1993-2000*, unpublished paper; Bonin, Hasan, Wachter (2004), *Bank performance, efficiency and ownership in Transition Countries*, Bank of Finland BOFIT Discussion Paper 7; Hasan and Marton (2003), *Development and efficiency of the banking sector in a transitional economy: Hungarian experience*, Journal of Banking and Finance, pp. 2249-2271; Weill (2003), *Banking efficiency in Transition Economies*: *The role of foreign ownership*, Economics of Transition, pp. 569-592.

19 See Wezel (2004), *Foreign Bank entry into Emerging Economies: An empirical assessment of the determinants and risks predicated on German FDI data*, Deutsche Bundesbank Discussion Paper 1; Williams (2002), *The defensive approach to multinational banking: evidence to date*, Financial Markets, Institutions, and Instruments, pp. 127-203; Berger, Clapper, Udell (2001), *The ability of banks to lend to informationally opaque small businesses*, Journal of Banking and Finance, pp. 2127-2167.

20 Fries and Taci (2002), *Banking reform and development in Transition* Economies, EBRD Working Paper No. 71.

21 Du (2003), *Why do multinational enterprises borrow from local banks?*, Economics Letters, pp. 287-291; Fries and Taci (2002).

22 See Moody's (2004).

growth of cross-border lending accelerated in 2003, showing an overall increase of 41% compared with a year earlier. In some countries, the strong expansion of cross-border borrowing may also indicate the increased role of foreign liabilities in financing the high level of domestic lending growth.[23] However, from the point of view of the EU-15 banking sectors, loan exposures to the NMSs still accounted for only a limited share of EU-15 banks' global exposures, comprising 2.6% of total foreign claims and 4.5% of claims on EU-25 countries in 2003.

The cross-border exposures of EU-15 banks to the NMSs are characterised by a high level of concentration at both the creditor and borrower country levels. At the end of 2003, three countries (BE, DE and IT) accounted for nearly two-thirds of cross-border lending from the EU-15 countries to the NMSs. On the borrowers' side, the three largest CEECs (CZ, HU and PL) made up 74% of total claims on the NMSs. Looking at the relative importance of the NMSs in foreign exposures by country, at the end of 2003, the proportion of cross-border loans to the NMSs totalled at least 10% of total claims on EU-25 countries in four of the EU-15 (AT, GR, IT and SE).

3.2.5 PRESENCE OF NMS BANKS ABROAD

In general, NMS banks have a limited presence abroad which usually occurs via branches in neighbouring regions (EE has presence in the other Baltic States; CY in Greek ethnic communities abroad; CZ banks in SK and vice versa; SI banks in other former Yugoslav republics and Italy). In addition, some banks in HU, PL and SI have equity participations in foreign banks. Furthermore, banks from four NMSs have a limited representation abroad via representative offices (LT, MT, PL and SI).

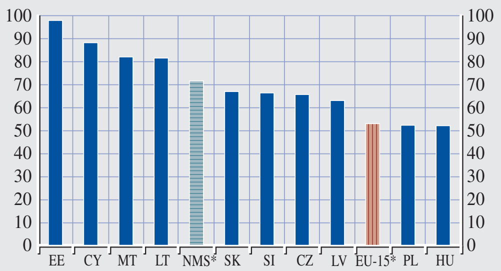
3.3 CONCENTRATION AND COMPETITION

In general, concentration of banking markets is relatively high in the NMSs. The aggregated market share of the five largest banks (CR5 ratio) varied between 52% and 98% in 2003, averaging at 72% (see Chart 6). Countries with a smaller market size generally have the highest concentration among the NMSs. In particular, more than 80% of the banking sector assets is held by the five largest players in CY, EE, LT and MT. But even in countries with the lowest CR5

23 Parent bank funding played a dominant role in this process. See also section 4.1.

Chart 6 Market share of the five largest banks (CR5) in the NMSs

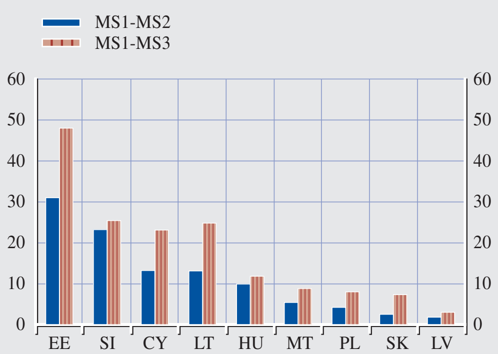
(2003, %)



Source: BSC.
1) Unweighted average.

Chart 7 Differences between the market shares of leading banks

(2003, %)



Source: BSC.
Notes: MS1-MS2: difference between the market shares of the largest and second largest banks; MS1-MS3: difference between the market shares of the largest and third largest banks; Individual market shares are not available for CZ.

ratios (HU and PL) market concentration is only around the average level of EU-15 countries.

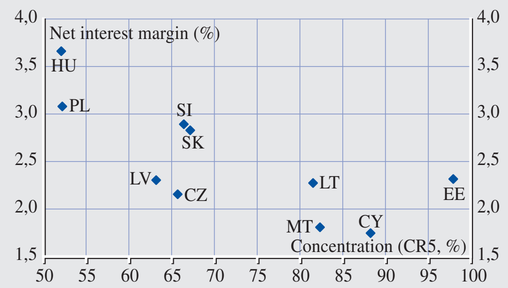
Given the small size of the NMSs, it may be more relevant to benchmark them against the smaller EU-15 countries. In this comparison, concentration cannot be considered too high in the NMSs since the average CR5 is only 7 percentage points higher than the average of smaller EU-15 countries.[24] Within the group of the NMSs, a negative relationship between market size (measured by total banking sector assets) and concentration can also be observed (the cross-country correlation between market size and market concentration is -0.64).

Using the difference between market shares of leading banks as an alternative measure for assessing competitive conditions, some countries' relative positions within the group of the NMSs are quite different to those based on CR5 ratios (see Chart 7). The market share advantage of the largest bank over its closest rival is at least 10% in five countries (EE, SI, CY, LT and HU). Compared with rankings based on CR5 ratios, the banking markets in HU and SI may seem less competitive, whereas the picture looks more favourable for MT, LV and SK.

Given the high concentration in most of the NMSs, potential concerns may arise as regards the degree of competition. The traditional structure-conduct-performance (SCP) hypothesis assumes that high concentration enables banks to collude, which may in turn provide for the possibility of charging higher prices and realising extra profits in a given market. Looking at a simple cross-country correlation in 2003, such a relationship may not hold for the NMSs. In fact, concentration and margins are negatively related, i.e. margins are among the lowest in highly concentrated markets (CY, EE, LT and MT) and are the highest in markets with lower concentration (HU and PL), as is clear from Chart 8. This may suggest that concentration ratios do not necessarily reflect competitive conditions within the region.

Chart 8 Relationship between market concentration (CR5) and the net interest margin

(2003)



Source: BSC.
Note: The correlation coefficient is -0.74. For CY, the net interest margin is computed for commercial banks (i.e., excluding international banking units and cooperative credit institutions).

As regards the assessment of competitive conditions by central banks, six countries (CY, EE, LT, LV, SI and SK) characterised their banking markets as having strong competition. The four remaining NMSs (CZ, HU, MT and PL) characterised their banking markets as having a medium level of competition. Some countries indicated that the degree of competition may differ according to sub-markets. Most of the central banks based their evaluation on both interest rate or interest margin developments and concentration indices.[25]

Looking ahead, some countries mentioned that their membership of the EU and their subsequent adoption of the euro would have a positive impact on the level of bank competition. As a potential consequence, the pressure from narrowing margins would increase the need to improve cost efficiency. This may give a further impetus to the M&A process and thus lead to a renewed wave of consolidation in some countries with relatively less concentrated banking markets. Foreign banks may also have an impact on the degree of competition in the banking sector since foreign-owned banks may have access to comparably cheaper funding from their parent bank.

24 Sample: countries with a population of less than 20 million (excluding LU).
25 In PL the degree of competition is measured by the Panzar-Rosse method.

4 BALANCE SHEET STRUCTURE AND PERFORMANCE OF NMS BANKS[26]

4.1 BALANCE SHEET STRUCTURE

Despite high lending growth in recent times, the proportion of customer loans in total assets has still remained below the EU-15 average. For the NMSs as a whole, the loan-to-asset ratio was 49% in 2003, compared with 51% in the EU-15 countries. Household lending, and mortgage lending in particular, has been the fastest growing area in most of the NMS in the past few years; but it only represented 24% of banks' loan book in 2003, while loans to non-financial corporations made up for 52% of the total loan portfolio.[27]

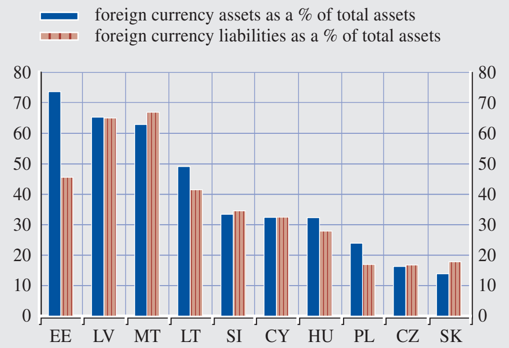
Despite strong credit growth recently, the ratio of liquid assets remained relatively high in the NMSs. On average, the liquid asset ratio was 37% in 2003, compared with 26% in EU-15 countries.[28] Cross-country variation was quite large in this respect, as the ratio ranges from 19% in EE and SK to 47% in CZ. Treasury bills and government bonds accounted for almost 17% of total assets on average. Non-debt type securities, including shares and participating interests, have only a 2% share in total assets.

Looking at the liabilities side, customer deposits are the most important funding source for banks in the NMSs, with 66% of total assets. Growth of deposits lagged behind the rapid increase in lending volumes in 2003, thus the overall loan-to-deposit ratio rose by 6 percentage points, to 74%. The proportion of debt securities on the liabilities side is non-significant in most of the NMS, making up only 4% of total assets. The share of securities type liabilities is the most significant in EE (14%), CZ and HU (8%), partly due to the increasing role of mortgage bonds.

Interbank liabilities also represent a substantial part of funding sources, with an average share of 14% of total assets. Funds raised from the money market have grown in importance in 2003, especially in those countries where domestic funding sources proved to be insufficient for financing the high lending growth. Group funding via parent banks may have played a substantial role in this development.

Chart 9 Share of foreign currency denominated assets and liabilities in the NMSs

(2003, %)



Source: BSC.
Note: For CY, the figures exclude international banking units.

4.2 CURRENCY STRUCTURE OF ASSETS AND LIABILITIES

Regarding the currency structure of banks' assets and liabilities, a large diversity can be observed across the NMSs. The proportion of foreign currency denominated assets ranges from 14% to 74% and that of the foreign currency denominated liabilities from 17% to 67% (see Chart 9). The share of foreign currency balance sheet items tends to be the highest in countries with full and quasi-currency boards or basket pegs (the Baltic States and MT). Euro-denominated assets and liabilities, in general, constitute the largest part

26 The analysis in this section is mostly based on banking data collected by the BSC for 2002 and 2003. Calculation of indicators is based on the methodology used in the "EU banking sector stability" report (ECB, November 2004). Note that due to the revision of underlying data by one country, asset quality indicators differ from those published in the "EU banking sector stability" report.

27 Note: Figures for lending breakdown are unweighted averages; CY is not included.

28 Liquid assets include cash, balances with the central bank, treasury bills, loans to credit institutions and debt securities by public bodies.

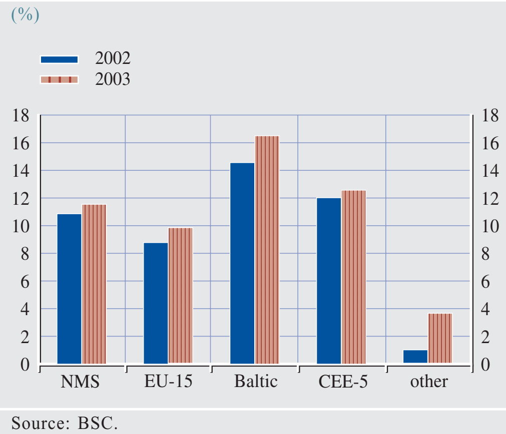
of foreign currency items, except in two countries (LV and MT).[29]

The proportion of foreign currency denominated loans as a percentage of total loans is substantial in most of the NMSs, reaching at least 20% in seven countries. Cross-country differences are significant in this respect as well, with the ratio of foreign currency loans ranging from 4% to 81%. Borrowing in foreign currencies is more typical for the non-financial corporations. Foreign currency loans make up at least one-third of total bank loans to domestic enterprises in six countries. The proportion of foreign currency denominated household loans is negligible (0-5%) in six countries, but rather high in the Baltic States and PL, varying between 30% and 67%.

4.3 PROFITABILITY

Benefiting from favourable macroeconomic conditions and high lending growth, banks in the NMSs generally improved their performance in 2003, but cross-country differences remained significant. The overall ROE in the NMSs increased only moderately, from 10.9% in 2002 to 11.6% in 2003. Looking at differences between country groups, the

Chart 10 Return on equity in the NMSs by country groups



Source: BSC.
Note: ROE is measured as a percentage of Tier 1 capital.

Baltic States outperformed CEE-5 countries with an average ROE of 16.5% (see Chart 10). As regards profitability differences by ownership, on average, domestic banks outperformed foreign controlled banks by a margin of 0.5 percentage point.[30]

Despite a substantial decline in 2003, the average net interest rate margin in the NMSs, at 2.7%, is much higher than in the EU-15 countries (1.4%). Cross-country variations are substantial, as the gap between the highest (HU) and lowest (CY) margin was 2 percentage points. As reflected by the significant difference in the net interest margin, the relative importance of net interest income is still larger in the NMSs compared to the "old" Member States. Net interest income represented 62% of total income in 2003 in the NMSs, compared with 58% for the EU-15 countries. Regarding the most important sources of non-interest income, net fee and commission income accounted for 26% of total income, whereas the share of net trading and foreign exchange profits reached 10.5% in the NMSs.

Owing to the deterioration in 2003, the average cost-to-income ratio (65%) exceeded that of the EU-15 countries (60.4%). Moreover, the ratio of costs to total assets in the NMSs was much higher than in the "old" Member States suggesting considerable scale inefficiencies in the banking sectors of the NMSs. Regarding cost efficiency, significant differences could not be observed between domestic and foreign

29 Data on the proportion of euro denominated assets and liabilities are only available for six countries. The share of euro denominated assets and liabilities, as a percentage of foreign currency assets and liabilities, ranges from 25% to 91% and from 24% to 92%, respectively.

30 This might seem to be in contradiction with the positive cross-country correlation between foreign ownership and bank performance suggested by Chart 5. It should be borne in mind, however, that the treatment of foreign owners is different in the two cases (ownership vs. control). Owing to the highly profitable operation of one domestically controlled but foreign owned large NMS bank, the relationship between the profitability of foreign and domestic banks is different, depending on which concept is used. Thus, on the basis of *ownership* foreign banks have outperformed domestic ones, in line with the findings of Chart 5.

banks in 2003. However, dissimilarities in cost efficiency were substantial between small and medium-sized domestic banks since the cost-to-income ratio for medium-sized banks was 11 percentage points lower.

4.4 ASSET QUALITY

For the NMSs as a whole, the ratio of non-performing and other doubtful loans as a percentage of total loans, at 10.4%, is still high compared with the EU-15 countries (3.1%). A large dispersion can be observed across the NMSs as regards asset quality. Banking sectors in the Baltic States, supported by very favourable macroeconomic conditions, recorded the lowest share of nonperforming loans. For this country group, the average ratio of non-performing and other doubtful loans was only 1.5 %, as opposed to 11.1% in the CEE-5 countries. The latter group showed large diversity, as the ratio of non-performing and other doubtful loans ranged from 3.5% to 21.9%. It is important to note, however, that cross-country variation in asset quality indicators can also be explained by differences in loan classification rules.[31] A positive impact of foreign ownership on asset quality is suggested by the comparison between domestic and foreign banks, since the non-performing loans ratio was 1.9 percentage points lower for the latter.

4.5 SOLVENCY

Despite high lending growth recently, capital ratios have still remained at a relatively high level in the NMSs. The overall solvency ratio declined by 0.5 percentage point, to 13.6%, for the NMSs as a whole in 2003. The decrease in the solvency ratio was most significant in the Baltic States (0.6-1.7 percentage points) and CY (2.1 percentage points) due to dynamic growth in risk-weighted assets and an overall loss in the banking system, respectively. The aggregated market share of banks with a solvency ratio below 9% was very small, making up only 3% of total assets in the NMSs.

As regards banks' capital structure, the picture is rather reassuring, as reflected by high Tier 1 capital ratios. For the NMSs as a whole, the Tier 1 ratio, at 13.4%, remained just slightly below the overall solvency ratio. Moreover, the Tier 1 ratio of the NMSs was 4.6 percentage points higher than in the EU-15 countries. Accordingly, the share of Tier 2 capital accounted for only 10% of own funds, as opposed to 29% in the EU-15 countries.

31 In PL, for example, loans on which payment was overdue for more than 30 days belonged to the category of non-performing loans until the end of 2003. Loan classification rules changed in January 2004. The new regulations adopted the "standard" 90-day criterion. Moreover, the definition of other doubtful loans can also differ substantially across the NMSs.

5 POLICY ISSUES AND CHALLENGES

This section outlines some policy issues related to financial stability and supervision emanating from the above analysis. The issues pertaining to financial stability concern the implications of foreign ownership for the extension of local credit, the transmission of shocks from the EU-15 countries to the NMSs, and issues related to concentration and competition. The high lending growth and branching are policy issues with supervisory implications. Whereas high foreign ownership may be peculiar for the group of NMSs, it should also be stressed that some of the structural features and developments discussed – e.g. high concentration or quick financial deepening – are not necessarily unique to the NMSs.[32] However, a separate discussion of relevant issues seems justified by the many structural characteristics shared by the NMSs.

5.1 FINANCIAL STABILITY

5.1.1 HIGH FOREIGN OWNERSHIP AND BANK CREDIT STABILITY

One of the potential concerns related to high foreign ownership is that foreign banks may react differently than domestic banks to adverse changes in business cycle conditions – either at home or in a host country –, or in the case of a host country banking crisis. There may be various explanations for such a destabilising behaviour. Parent banks may reallocate their capital across regions or countries on the basis of expected risks and returns. Owing to differences in business cycle conditions, activities of subsidiaries in low-growth countries may be scaled down substantially in favour of other countries. Similarly, deteriorating economic conditions in the home country may force parent banks to downsize their operations abroad. On the other hand, parent banks may provide financial support for their subsidiaries during crisis times in host countries, thereby ensuring a smoothing effect on the subsidiaries' credit supply.

Empirical evidence suggests that, similarly to Latin American experiences, the potentially destabilising behaviour does not hold for CEECs.[33] Foreign banks actually contributed to a stable development of bank lending in the CEECs, especially in the case of greenfield banks with a relatively long presence. Moreover, there is also some evidence of a negative relationship between home country economic growth and host country bank credit by foreign bank subsidiaries. To sum up, past experiences suggest that high foreign ownership in the NMSs may have a stabilising effect on credit supply.

However, care must be taken when drawing conclusions on foreign bank behaviour from experiences in the transition period:

– Significant differences in customer base between foreign and domestic banks may have played a role in defining their response to adverse changes in business conditions. More specifically, state-owned enterprises – which have been severely hit by the transformation crisis – may have formed a larger part of the loan portfolio of domestic banks than that of the foreign-owned banks. On the other hand, foreign banks may have focused their lending activities on better quality customer groups (e.g. large multinational corporations), which have been less affected by the transformation crisis.

– The transition period may have been too short to capture several lending and business cycles; thus, conclusions drawn on the basis of a relatively short period may not be robust enough.

32 See for instance the relatively high concentration in several smaller EU-15 countries or the episodes of rapid lending growth preceding euro adoption in some EMU-12 countries.

33 For an empirical analysis on CEEC, see de Haas and van Lelyveld (2002), *Foreign banks and credit stability in Central and Eastern Europe: Friends or foes?*, De Nederlandsche Bank, Research Series Supervision No. 58. It should be noted that the sample also included Croatia and Romania.

5.1.2 RISK TRANSMISSION BETWEEN EU-15 COUNTRIES AND THE NMSs

Strong ownership links between the "old" and "new" Member States may give rise to a risk transmission channel within the EU. As regards potential negative impacts, it is important to note that adverse effects resulting from ownership links could be quite asymmetric for home and host countries. Whereas the impact for EU-15 banks should be limited, the transmission of shocks from EU-15 countries is more likely to have an impact on systemic risk in the NMSs.

Regarding EU-15 banks, positive effects from an increased presence in the NMSs may have outweighed negative ones so far. In particular, NMS banks have contributed strongly to the profitability of EU-15 banks in recent years.[34] Despite the clear benefits of income diversification, it is important to stress that, in some cases, expansion in the CEE region was a source of increased earnings volatility due to higher risk-taking. This highlights the fact that the transfer of know-how and risk management practices to subsidiaries has to be effective in order for them to operate successfully in the new markets. Besides mostly positive experiences of EU-15 banks in the NMSs, there are also examples of foreign banks retreating from the NMSs either due to failed expansion strategies or problems at home.

Looking at the host countries, NMS banks have benefited from the close links with EU-15 banks through knowledge-transfer, including improvements in risk management systems. Over the medium to long-term, this will have a stabilising effect on banking systems in the NMSs. It is important to stress that positive impacts on performance are related to both the duration of the presence and the mode of entry. In particular, greenfield banks – especially those with a longer presence – seemed to outperform other foreign banks.[35]

Despite mostly positive stability implications, potential problems at EU-15 banks may affect banking sector stability in the NMSs negatively. Moreover, due to the regional expansion strategy of some foreign investors, problems at parent banks may affect not just a single country but several NMSs simultaneously. Risk transmission from EU-15 countries to the NMSs is mitigated, however, by the fact that the majority of foreign owners in the NMSs are sound and have high credit ratings. Although financial support at times of distress has largely been untested so far, strategic investors from EU-15 countries are generally trusted to provide adequate liquidity support or capital injection, if needed. In this respect, too, there were only a few instances when foreign banks did not provide support for their subsidiaries and opted to withdraw from the market. Another potential risk factor – already observed in some countries – may lie in with the shift in the structure of foreign interbank financing towards shorter maturities, since this makes banks' funding more sensitive to shocks.

5.1.3 HIGH CONCENTRATION AND STABILITY

Another concern may relate to the relatively high concentration of the banking markets in the NMSs.[36] Economic theory provides contrasting views on the relationship between bank concentration and stability.[37] The proponents of the concentration-stability view claim that a concentrated banking sector with a few large banks is less prone to crisis than a less concentrated banking system. It is argued that large banks can diversify risk better; and high concentration can enhance profits, which in turn provides a buffer against adverse shocks and reduces incentives to engage in excessive

34 Most notably, Austrian banks earn an increasing share of their consolidated profits in CEECs. CEEC subsidiaries accounted for 38% of their ten parent banks' operating profits in 2003. Source: OeNB FSR.

35 See Majnoni, Shankar and Varhegyi (2003), *The Dynamics of Foreign Bank Ownership: Evidence from Hungary*, World Bank Policy Research Working Paper 3114.

36 It is important to stress that, as suggested in Section 3.3, these potential concerns may be different to those related to the lack of competition.

37 For an overview of the theoretical considerations, see Beck, Demirguc-Kunt and Levine (2003), *Bank Concentration and Crises*, World Bank Policy Research Working Paper No. 3041.

risk-taking. Moreover, large banks are easier to monitor; thus, corporate control may be more effective, thereby lowering the risk of contagion in concentrated banking systems.

Others, however, argue that a more concentrated structure increases banking sector fragility. Proponents of the concentration-fragility view claim that greater subsidies for large banks through "too-big-to-fail" policies increase moral hazard in a concentrated banking system, compared with a less concentrated one. Moreover, large banks may be more opaque than small banks and are therefore more difficult to monitor. Finally, large banks with greater market power may charge higher interest rates and thereby provide incentives for firms to take more risks.

Despite these conflicting theoretical predictions, evidence from empirical investigations on a large country sample suggests that the probability of a banking crisis is lower in a more concentrated banking system.[38] Thus, to a certain extent, these results support the view that a high concentration of banking sectors in the NMSs may not per se be a cause for serious concern from a financial stability point of view.

5.1.4 IMPLICATIONS OF PROSPECTIVE CHANGES IN COMPETITION

Marked changes in competitive conditions as a result of EU accession are generally not expected in the NMSs. In the longer term, however, competition in the banking market is expected to intensify further, partly owing to the increasing EU integration of banking sectors. This will have positive welfare implications, but also embody potential challenges to the nascent banking sectors.[39] A higher degree of competition may put pressure on margins, and therefore banks' profitability. Without corresponding restructuring on the cost side, banks' ability to withstand shocks may be hampered by decreasing capital buffers. Empirical evidence indicates that the efficiency gap between the old and new EU Member States has been narrowing recently, suggesting that some restructuring is taking place.[40]

Strengthening competition has led to some narrowing of margins. But despite the narrowing of interest rate margins, the net interest margin has, on average, remained relatively high in the NMSs compared with the EU-15 countries. Nevertheless, the comparatively high overall margins may conceal the fact that increasing competitive pressures might lead to a substantial decrease in lending margins in some market segments. In some countries, a high degree of competition in household lending has led to low lending margins, close to euro area levels. It cannot be ruled out that narrower margins may encourage some banks to raise lending volumes. Should credit risks be higher in these countries than in the euro area as a result, banks may find that risks were not adequately priced. However, it is also worth noting that at least some of the pressure on banks' profitability will be offset by an expected increase in non-interest income.

5.2 FINANCIAL SUPERVISION

5.2.1 HIGH LENDING GROWTH AND PRUDENTIAL REGULATION [41]

The recent acceleration in financial deepening in a number of NMSs is a natural part of the real convergence process. Despite the positive effects of this on economic development, additional risks may also arise due to the rapid

38 See Beck, Demirguc-Kunt and Levine (2003), *Bank Concentration and Crises*, World Bank Policy Research Working Paper No. 3041.

39 The potential trade-off between competition and stability is surveyed, for example, in Carletti and Hartmann (2002), *Competition and Stability: What's Special About Banking?*, Working Paper No. 146, European Central Bank.

40 See Kosak and Zajc (2004), *The East-West Efficiency Gap in European Banking*, paper presented at the 25th SUERF Colloquium held in Madrid.

41 Note that authorities have several other policy instruments, e.g. monetary policy or fiscal policy tools, at their disposal to contain credit growth. Since the focus here is on the supervisory challenges, the discussion of other policy implications would go beyond the scope of this report.

lending growth. Thus, prudential regulation and supervision may be challenged when addressing the issue of high credit growth. Although it may be very difficult for authorities to distinguish empirically between excessive credit growth and catch-up related financial deepening, policy responses may differ in each case. Whereas increased risks from high lending growth may justify the introduction of counter-cyclical or tighter prudential requirements, policy responses of this type may hamper financial deepening and thereby slow down the real convergence process.

In some countries, high lending growth has already triggered responses recently from national authorities. Most commonly, these include central bank communication on the risks related to high lending growth (moral suasion), recommendations made by supervisors aimed at increasing banks' risk awareness and the use of monetary policy instruments (reserve requirements, interest rate policy). Concerns remain, though, in some countries over whether these measures will prove adequate.

On the other hand, a potential use of prudential requirements to moderate credit growth is not without caveats. For instance, it may be very difficult to implement dynamic provisioning in most NMSs as historical time series are too short for developing reliable estimates of expected future losses. Moreover, the tightening of prudential regulations might induce a shift in the banking structure towards branching, which in turn may create new supervisory challenges in the NMSs (see Section 5.2.2).[42]

5.2.2 REGULATORY AND SUPERVISORY CHALLENGES RELATED TO BRANCHING [43]

One of the most important regulatory challenges in the NMSs may stem from the specific ownership structure and a potential future shift of banking structures towards branching. Since EU accession, new entry of foreign branches or transformation of subsidiaries into branches may give rise to regulatory challenges similar to those related to the Nordea case. A foreign branch in the NMSs may therefore have systemic importance in the host country even though it only represents a relatively modest share of the group's total operations. In this case, a potential conflict may emerge between home country control in micro-prudential supervision and host country responsibility in safeguarding financial stability. This highlights the need for enhanced coordination and information-sharing between host and home supervisory authorities. Bilateral agreements between national authorities can alleviate the information asymmetry problem, and the increasing number of Memoranda of Understanding between NMS and EU-15 authorities in recent years may be seen as an encouraging sign in this respect.[44]

As regards expected developments in banking structures, there are indications that the role of foreign branches might increase in the banking sectors of the NMSs. Several countries reported that some subsidiaries may be transformed into branches or that there may be increased interest from EU-15 banks to establish new branches using the possibility of the single "passport". In most countries there is great uncertainty about the speed and scale of these potential structural changes. But, generally, a large wave of branching may not be expected in the NMSs, at least not in the short term. Some countries, however, have mentioned that the long-term possibility of large market participants transforming themselves into branches cannot be excluded. In particular, a widespread use of the institutional form of the European Company may have implications on systemic risk.

42 See IMF Country Report No. 04/358.

43 It is to be noted that regulatory and supervisory challenges related to branching can be extended to the case of subsidiaries as well, insofar as decision and strategy-making processes are centralised in the parent institution. The special focus here, however, is on policy implications related to branching since the information asymmetry problems faced by host supervisors are more pronounced than in case of subsidiaries.

44 Note that branching may have not only a bearing on supervisory challenges but also in respect of safety net arrangements (deposit insurance schemes, lender of last resort).

6 CONCLUSION

The economic environment in which NMS banks operate has been characterised by favourable conditions. This has contributed to the positive developments observed in most NMS banking sectors in the last couple of years. Although price competition has intensified over the past few years, profitability has improved due to high lending growth, relatively high interest margins and lower provisioning costs. At the same time, the regulatory and supervisory framework is converging towards that of the EU-15 countries.

Bank intermediation is low in the former transition NMSs but increasing steadily. As is the case in most EU-15 countries, bank financing is the most important source of funding for firms and households. Furthermore, it has been found that foreign (mainly EU-15) banks dominate the banking sectors of the NMSs. Indeed, some EU-15 banks nowadays report increasing dependence on earnings from the NMSs in their total operating profits, especially because of high competition/low margins in their home markets. Whether it may be possible for newcomers to successfully enter the NMS banking markets is questionable since:

i) markets seem to be saturated and margins are on a downward trend;

ii) it is difficult to make customers switch;

iii) privatisation or takeover opportunities of local banks seem to have vanished.

From the perspective of the NMSs, foreign banks may have a beneficial role because they help to improve risk standards and human capital. Furthermore, concentration is relatively high, especially among the smaller countries; although this does not seem to have led to anti-competitive behaviour.

NMS banks now face several challenges:

– First, many NMSs are still undergoing rapid (technological) changes, which may have an impact on risk measurement and management systems.

– Second, foreign ownership is having a large influence on banks' operations and activities in many NMSs. While generally positive, it may raise several issues with implications for financial stability and supervision, such as those related to the stability of credit growth, transmission of shocks from EU-15 to NMS banks or a possible restructuring of foreign banks' presence.

– Third, NMS banks will have to keep a firm control on balance sheet structure and asset growth, as they may reach limits on the funding side or face with (negative) shocks on the asset side: for example, if the exchange rate depreciates and causes a deterioration in foreign-currency denominated loans.

ANNEX

COUNTRY TEMPLATES

CYPRUS

Macroeconomic environment and financial markets

	2001	2002	2003
Real GDP growth	4.0	2.1	1.9
GDP per capita (in PPP terms, in €)	18,294	18,390	18,839
Inflation (HICP)	2.0	2.8	4.0
Standardised unemployment rate (as a % of labour force)	2.9	3.9	4.5
Population (in millions)	0.7	0.7	0.7
General government deficit(-)/surplus(+) (as a % of GDP)	-2.4	-4.6	-6.4
General government gross debt (as a % of GDP)	64.3	67.4	70.9
Current and capital accounts balance (as a % of GDP)		-4.5	-3.3
Openness (export + import of goods and services, % of GDP)	99.0	112.2	104.0
Stock market annual return in %	-47.2	-29.2	-14.7
Stock market capitalisation (as a % of GDP)	68.0	41.9	33.8
Corporate sector debt securities (outstanding as a % of GDP)		0.5	0.4
Country ratings (December 2004)	Fitch	Moody's	Standard and Poor's
Country rating: foreign currency (long-term)	A+	A2	A
Country rating: domestic currency (long-term)	AA	A2	A
Exchange rate regime	Peg to the euro with wide bands (± 15%)		

Regulatory environment

Supervision	
Supervisory authority of banks	Central Bank of Cyprus
Single financial supervisory authority	No. Separate supervisory bodies for insurance companies, investment firms and cooperative credit institutions.
Deposit insurance scheme	
Administration	Joint public/private
Coverage limit	€20,000
Co-insurance	No co-insurance
Minimum capital to establish CI	€5.1 million

Structural features of the banking sector

	2001	2002	2003
Financial structure and financial depth			
Openness of the financial sector			
(export plus import of financial services as a % of GDP)	0.7	2.7	2.4
Domestic credit to private sector as % of GDP	121.4	124.8	122.1
Banks and other CI [1]			
Number of credit institutions	12	14	14
o/w number of banks	9	11	11
Number of bank branches [2]	484 (496)	473 (485)	459 (471)
Number of bank employees [2]	7,524 (7,822)	7,668 (7,967)	7,744 (8,056)
Market share of banks (%)	89.0	87.3	86.2
Number of other credit institutions (CI)	3	3	3
Market share of other CI (%)	11.0	12.7	13.8
Concentration index (CR5) for CI (%)	89.2	88.7	88.4
Number of ATMs (per 1,000,000 inhabitants)	448	507	534
Number of POS terminals (per 1,000,000 inhabitants)	11,285	12,571	14,857
Number of cards with a cash function (per 1,000 inhabitants)	802	841	896
Ownership structure (market share by total assets, %)			
– Domestic public banks	4.2	4.5	4.6
– Domestic private banks	83.0	82.8	83.1
– Foreign banks (branches and subsidiaries)	12.8	12.7	12.3

1) Domestically-controlled and foreign-controlled banks, excluding cooperative credit institutions and international banking units.
2) Figures in brackets refer to the total banking sector, excluding cooperative credit institutions and international banking units, whereas those outside brackets refer to commercial banks only.

CZECH REPUBLIC

Macroeconomic environment and financial markets

	2001	2002	2003
Real GDP growth	2.6	1.5	3.7
GDP per capita (in PPP terms, in €)	14,149	14,883	15,506
Inflation (HICP)	4.5	1.4	-0.1
Standardised unemployment rate (as a % of labour force)	8.0	7.3	7.8
Population (in millions)	10.3	10.2	10.2
General government deficit(-)/surplus(+) (as a % of GDP)	-5.9	-6.8	-12.6
General government gross debt (as a % of GDP)	25.3	28.8	37.8
Current and capital accounts balance (as a % of GDP)	-5.4	-5.7	-6.2
Openness (export + import of goods and services, % of GDP)	144.2	133.4	134.4
Stock market annual return in %	-17.5	17.9	43.1
Stock market capitalisation (as a % of GDP)	12.5	12.8	16.5
Corporate sector debt securities (outstanding as a % of GDP)		3.2	3.8
Country ratings (December 2004)	Fitch	Moody's	Standard and Poor's
Country rating: foreign currency (long-term)	A-	A1	A-
Country rating: domestic currency (long-term)	A	A1	A
Exchange rate regime		Managed float.	

Regulatory environment

Supervision	
Supervisory authority of banks	Czech National Bank (CNB)
Single financial supervisory authority	No. Separate supervisory bodies for insurance companies/pension funds, investment firms and co-operative credit institutions. The separate supervisory body for credit institutions will be incorporated into CNB by the middle of 2005.
Deposit insurance scheme	
Administration	Joint public/private
Coverage limit	Equivalent of €25,000
Co-insurance	10% co-insurance
Minimum capital to establish CI	CZK 500 million (€15.7 million)

Structural features of the banking sector

	2001	2002	2003
Financial structure and financial depth			
Openness of the financial sector (export plus import of financial services as a % of GDP)	1.0	1.4	1.0
Domestic credit to private sector as % of GDP	39.6	29.8	30.9
Banks and other CI			
Number of credit institutions [1]	172	83	77
o/w: number of banks	38	37	35
Number of bank branches	1,751	1,722	1,670
Number of bank employees	40,871	40,625	39,004
Market share of banks (%)	99.9	100.0	99.9
Number of other credit institutions (CI)	134	46	42
Market share of other CI (%)	0.1	0.0	0.1
Concentration index (CR5) for CI (%)	68.4	65.8	65.8
Number of ATMs (per 1,000,000 inhabitants)	188	221	250
Number of POS terminals (per 1,000,000 inhabitants)	1,754	2,486	3,018
Number of cards with a cash function (per 1,000 inhabitants)	445	566	651
Ownership structure (market share by total assets, %)			
– Domestic public banks	4	5	3
– Domestic private banks	1	2	1
– Foreign banks (branches and subsidiaries)	95	93	96

1) Banks and credit unions.

ESTONIA

Macroeconomic environment and financial markets

	2001	2002	2003
Real GDP growth	6.4	7.2	5.1
GDP per capita (in PPP terms, in €)	9,016	9,658	10,010
Inflation (HICP)	5.6	3.6	1.4
Standardised unemployment rate (as a % of labour force)	11.8	9.5	10.2
Population (in millions)	1.4	1.4	1.4
General government deficit(-)/surplus(+) (as a % of GDP)	0.3	1.4	3.1
General government gross debt (as a % of GDP)	4.4	5.3	5.3
Current and capital accounts balance (as a % of GDP)	-5.5	-9.9	-12.7
Openness (export + import of goods and services, % of GDP)	182.7	169.4	170.7
Stock market annual return in %	2.4	44.2	34.4
Stock market capitalisation (as a % of GDP)	25.0	31.0	37.4
Corporate sector debt securities (outstanding as a % of GDP)		0.6	0.8
Country ratings (December 2004)	Fitch	Moody's	Standard and Poor's
Country rating: foreign currency (long-term)	A	A1	A
Country rating: domestic currency (long-term)	A+	A1	A
Exchange rate regime	Currency board (pegged to the euro). Entered ERM II in 2004.		

Regulatory environment

Supervision	
Supervisory authority of banks	Estonian Financial Supervision Authority (EFSA)
Single financial supervisory authority	Yes.
Deposit insurance scheme	
Administration	Joint public/private
Coverage limit	From Dec. 31, 2003: EEK 100,000 (€6,391) From Dec. 31, 2005: EEK 200,000 (€12,782) From Dec. 31, 2007: EEK 313,000 (€20,000)
Co-insurance	10% co-insurance
Minimum capital to establish CI	€5 million

Structural features of the banking sector

	2001	2002	2003
Financial structure and financial depth			
Openness of the financial sector (export plus import of financial services as a % of GDP)	0.6	0.5	0.6
Domestic credit to private sector as % of GDP	25.2	26.9	33.1
Banks and other CI			
Number of credit institutions	7 (6 [1])	7 (6 [1])	7 (6 [1])
o/w: number of banks	7	7	7
Number of bank branches	211	198	197
Number of bank employees	3,949	3,934	4,280
Market share of banks (%)	100	100	100
Number of other credit institutions (CI)	-	-	-
Market share of other CI (%)	-	-	-
Concentration index (CR5) for CI (%)	99	99	99
Number of ATMs (per 1,000,000 inhabitants)	439	468	476
Number of POS terminals (per 1,000,000 inhabitants)	3,848	5,395	6,773
Number of cards with a cash function (per 1,000 inhabitants)	722	822	883
Ownership structure (market share by total assets, %)			
– Domestic public banks	-	-	-
– Domestic private banks	2.4	2.5	2.5
– Foreign banks (branches and subsidiaries)	97.6	97.5	97.5

1) Excluding the Nordea branch.

HUNGARY

Macroeconomic environment and financial markets

	2001	2002	2003
Real GDP growth	3.8	3.5	2.9
GDP per capita (in PPP terms, in €)	12,032	12,841	13,535
Inflation (HICP)	9.1	5.2	4.7
Standardised unemployment rate (as a % of labour force)	5.6	5.6	5.8
Population (in millions)	10.2	10.2	10.1
General government deficit(-)/surplus(+) (as a % of GDP)	-4.4	-9.2	-6.2
General government gross debt (as a % of GDP)	52.0	57.1	59.1
Current and capital accounts balance (as a % of GDP)	-6.2	-6.9	-9.0
Openness (export + import of goods and services, % of GDP)	147.2	130.6	128.8
Stock market annual return in % (BUX)	-9	9.4	20.3
Stock market capitalisation (as a % of GDP; equities only)	19.4	19.5	18.7
Corporate sector debt securities (outstanding as a % of GDP)		1.1	0.9
Country ratings (December 2004)	Fitch	Moody's	Standard and Poor's
Country rating: foreign currency (long-term)	A-	A1	A-
Country rating: domestic currency (long-term)	A+	A1	A
Exchange rate regime	Pegged to the euro with wide bands (± 15%)		

Regulatory environment

Supervision	
Supervisory authority of banks	Hungarian Financial Supervisory Authority (HFSA)
Single financial supervisory authority	Yes.
Deposit insurance scheme	
Administration	Joint public/private
Coverage limit [1]	HUF 6 million (€24,300)
Co-insurance [1]	10% co-insurance for amounts over HUF 1m (€4,050)
Minimum capital to establish CI [1]	Commercial bank/building soc.: HUF 2,000m (€8.1m) Mortgage bank: HUF 3,000m (€12.1m) Cooperative bank: HUF 250m (€1.0m)

1) Calculated with HUF/EUR rate on 22 October 2004.

Structural features of the banking sector

	2001	2002	2003
Financial structure and financial depth			
Openness of the financial sector (export plus import of financial services as a % of GDP)	0.9	0.7	0.9
Domestic credit to private sector as % of GDP	33.8	35.8	43.0
Banks and other credit institutions (CI)			
Number of credit institutions (cooperatives included) [1]	230	225	218
o/w: number of banks [2]	33	30	31
Number of bank branches [2]	1,014	1,117	1,147
Number of bank employees [2]	23,549	25,965	26,549
Market share of banks (%) [2]	91.8	88.7	85.0
Number of other CI [3]	197	195	187
Market share of other CI (%) [3]	8.2	11.3	15.0
Concentration index (CR5) for CI (total assets) (%)	56.4	54.5	52.3
Number of ATMs (per 1,000,000 inhabitants)	255	266	287
Number of POS terminals (per 1,000,000 inhabitants) [4]	1,875	2,241	2,405
Number of cards with a cash function (per 1,000 inhabitants) [5]	501	534	614
Ownership structure (market share by total assets, %)			
– Domestic public banks	4.2	4.7	2.3
– Domestic private banks	30.6	11.3	15.7
– Foreign banks (branches and subsidiaries) [6]	65.2	84.0	83.3

1) Excludes two specialized credit institutions (MFB – Hungarian Development Bank – and Eximbank).
2) Excludes mortgage banks and building societies.
3) Mortgage banks, building societies and cooperatives.
4) POS terminals at commercial points (excluding ones at banks and post offices).
5) Cards applicable for buying and cash withdrawal (ex cards with no cash withdrawal function).
6) The biggest Hungarian bank (OTP) is listed on BSE (stock exchange) and is included in foreign ownership.

LATVIA

Macroeconomic environment and financial markets

	2001	2002	2003
Real GDP growth	8.0	6.4	7.5
GDP per capita (in PPP terms, in €)	8,000	8,810	9,610
Inflation (HICP)	2.5	2.0	2.9
Standardised unemployment rate (as a % of labour force)	12.9	12.6	10.4
Population (in millions)	2.3	2.3	2.3
General government deficit(-)/surplus(+) (as a % of GDP)	-2.1	-2.7	-1.5
General government gross debt (as a % of GDP)	14.9	14.1	14.4
Current and capital accounts balance (as a % of GDP)	-7.1	-6.5	-7.6
Openness (export + import of goods and services, % of GDP)	93.3	92.3	97.4
Stock market annual return in %	-6.6	27.4	133.3
Stock market capitalisation (as a % of GDP)	8.5	7.4	9.6
Corporate sector debt securities (outstanding as a % of GDP)			0.4
Country ratings (December 2004)	Fitch	Moody's	Standard and Poor's
Country rating: foreign currency (long-term)	A-	A2	A-
Country rating: domestic currency (long-term)	A	A2	A-
Exchange rate regime	Pegged to SDR, fluctuation band ± 1%.		

Regulatory environment

Supervision	
Supervisory authority of banks	Finance and Capital Market Commission (FKTK)
Single financial supervisory authority	Yes.
Deposit insurance scheme	
Administration	Government (no central bank)
Coverage limit	– until end 2005: 6,000 lats (€9,000) – from begin 2006 to end 2007: 9,000 lats (€14,000) – from begin 2008: 13,000 lats (€20,000).
Co-insurance	No co-insurance
Minimum capital to establish CI	€5 million

Structural features of the banking sector

	2001	2002	2003
Financial structure and financial depth			
Openness of the financial sector (export plus import of financial services as a % of GDP)	1.8	1.5	1.9
Domestic credit to private sector as % of GDP	21.3	26.5	34.6
Banks and other CI			
Number of credit institutions	23 (22 [1])	23 (22 [1])	23 (22 [1])
o/w: number of banks	23 (22 [1])	23 (22 [1])	23 (22 [1])
Number of bank branches	193	199	206
Number of bank employees	7,943	8,240	8,895
Market share of banks (%)	100	100	100
Number of other credit institutions (CI)	-	-	-
Market share of other CI (%)	-	-	-
Concentration index (CR5) for CI (%)	66.2	65.3	63.1
Number of ATMs (per 1,000,000 inhabitants)	336	360	373
Number of POS terminals (per 1,000,000 inhabitants)	2,933	3,560	4,416
Number of cards with a cash function (per 1,000 inhabitants)	379	437	506
Ownership structure (market share by total assets, %)			
– Domestic public banks	3.2	4.0	4.1
– Domestic private banks	54.7	54.2	49.5
– Foreign banks (branches and subsidiaries)	42.2	41.8	46.3

1) Excluding the Nordea branch.

LITHUANIA

Macroeconomic environment and financial markets

	2001	2002	2003
Real GDP growth	6.4	6.8	9.7
GDP per capita (in PPP terms, in €)	8,690	9,412	10,371
Inflation (HICP)	1.3	0.4	-1.1
Standardised unemployment rate (as a % of labour force)	16.4	13.5	12.7
Population (in millions)	3.5	3.5	3.5
General government deficit(-)/surplus(+) (as a % of GDP)	-2.0	-1.5	-1.9
General government gross debt (as a % of GDP)	22.9	22.4	21.4
Current and capital accounts balance (as a % of GDP)	-4.7	-4.8	-6.5
Openness (export + import of goods and services, % of GDP)	105.4	111.7	109.5
Stock market annual return in %	4.9	2.9	6.9
Stock market capitalisation (as a % of GDP)	9.9	9.3	17.2
Corporate sector debt securities (outstanding as a % of GDP)	0.8	0.7	0.4
Country ratings (December 2004)	Fitch	Moody's	Standard and Poor's
Country rating: foreign currency (long-term)	A-	A3	A-
Country rating: domestic currency (long-term)	A	A3	A-
Exchange rate regime	Peg to the euro with zero fluctuation band under Currency Board arrangement.		

Regulatory environment

Supervision	
Supervisory authority of banks	Central bank.
Single financial supervisory authority	No. Separate supervisory bodies for securities firms and insurance companies.
Deposit insurance scheme	
Administration	Public
Coverage limit	Equivalent of €14,481; from 2008 – €20,000
Co-insurance	Yes.
Minimum capital to establish CI	€5 million

Structural features of the banking sector

	2001	2002	2003
Financial structure and financial depth			
Openness of the financial sector (export plus import of financial services as a % of GDP)	0.4	0.3	0.1
Domestic credit to private sector as % of GDP	11.4	14.0	20.6
Banks and other CI			
Number of credit institutions	13	14	13
o/w: number of banks	13	14	13
Number of branches	156	119	117
Number of employees	n.a.	n.a.	n.a.
Market share of banks (%)	100	100	100
Number of other credit institutions (CI)	-	-	-
Market share of other CI (%)	-	-	-
Concentration index (CR5) for CI (%)	87.9	84.5	81.6
Number of ATMs (per 1,000,000 inhabitants)	198	257	285
Number of POS terminals (per 1,000,000 inhabitants)	2,659	2,985	3,771
Number of cards with a cash function (per 1,000 inhabitants)	233	462	668
Ownership structure (market share by total assets, %)			
– Domestic public banks	12.2	-	-
– Domestic private banks	2.8	4.0	4.4
– Foreign banks (branches and subsidiaries)	85.0	96.0	95.6

MALTA

Macroeconomic environment and financial markets

	2001	2002	2003
Real GDP growth	-2.2	2.6	-0.3
GDP per capita (in PPP terms, in €)	15,124	15,479	15,605
Inflation (HICP)	2.5	2.6	1.9
Standardised unemployment rate (as a % of labour force)	7.7	7.7	8.0
Population (in millions)	0.39	0.39	0.39
General government deficit(-)/surplus(+) (as a % of GDP)	-6.4	-5.8	-9.6
General government gross debt (as a % of GDP)	62.0	62.3	70.4
Current and capital accounts balance (as a % of GDP)	-4.5	0.5	-5.5
Openness (export + import of goods and services, % of GDP)	187	186	190
Stock market annual return in %	-34.8	-14.4	13.6
Stock market capitalisation (as a % of GDP)	34.9	30.5	32.8
Corporate sector debt securities (outstanding as a % of GDP)		5.4	6.2
Country ratings (December 2004)	Fitch	Moody's	Standard and Poor's
Country rating: foreign currency (long-term)	A	A3	A
Country rating: domestic currency (long-term)	AA-	A3	A+
Exchange rate regime	Basket peg. Composition of the basket: EUR (70%), GBP (20%), USD (10%).		

Regulatory environment

Supervision	
Supervisory authority of banks	Malta Financial Services Authority (MFSA)
Single financial supervisory authority	Yes.
Deposit insurance scheme	
Administration	Joint public/private
Coverage limit	The total amount of compensation to private individuals shall be the lesser of 90% in respect of that depositor's eligible deposits, or up to the Maltese Lira equivalent of €20,000.
Co-insurance	10% co-insurance.
Minimum capital to establish CI	€5 million

Structural features of the banking sector

	2001	2002	2003
Financial structure and financial depth			
Openness of the financial sector (export plus import of financial services as a % of GDP)	..	..	..
Domestic credit to private sector as % of GDP	121.2	119.6	117.7
Banks and other CI			
Number of banks	*17*	14	16
o/w: number of banks	17	14	16
Number of bank branches	96	98	100
Number of bank employees	3,583	3,462	3,403
Market share of banks (%)	100	100	100
Number of other credit institutions (CI)	-	-	-
Market share of other CI (%)	-	-	-
Concentration index (CR5) for CI (%)			82
Number of ATMs (per 1,000,000 inhabitants)	352	347	370
Number of POS terminals (per 1,000,000 inhabitants)	15,287	16,368	16,185
Number of cards with a cash function (per 1,000 inhabitants)	874	938	980
Ownership structure (market share by total assets, %)			
– Domestic public banks	-	-	-
– Domestic private banks	38.4	35.4	32.4
– Foreign banks (branches and subsidiaries)	61.1	64.6	67.6

POLAND

Macroeconomic environment and financial markets

	2001	2002	2003
Real GDP growth	1.0	1.3	3.8
GDP per capita (in PPP terms, in €)	9,771	10,021	10,376
Inflation (HICP)	5.3	1.9	0.7
Standardised unemployment rate (as a % of labour force)	18.5	19.8	19.2
Population (in millions)	38.6	38.2	38.2
General government deficit(-)/surplus(+) (as a % of GDP)	-3.8	-3.6	-3.9
General government gross debt (as a % of GDP)	36.7	41.1	45.4
Current and capital accounts balance (as a % of GDP)	-2.9	-2.6	-2.2
Openness (export + import of goods and services, % of GDP)	59.0	62.7	71.4
Stock market annual return in %	-33.5	-7.7	33.9
Stock market capitalisation (as a % of GDP)	13.6	14.2	17.2
Corporate sector debt securities (outstanding as a % of GDP)		3.7	3.3
Country ratings (December 2004)	Fitch	Moody's	Standard and Poor's
Country rating: foreign currency (long-term)	BBB+	A2	BBB+
Country rating: domestic currency (long-term)	A	A2	A-
Exchange rate regime	Free float.		

Regulatory environment

Supervision	
Supervisory authority of banks	Commission of Banking Supervision (KNB)
Single financial supervisory authority	No. Separate supervisory bodies for securities firms and insurance companies/pension funds.
Deposit insurance scheme	
Administration	Joint public/private
Coverage limit	€22,500
Co-insurance	Yes.
Minimum capital to establish CI	Commercial bank: €5 million Cooperative bank: €1 million

Structural features of the banking sector

	2001	2002	2003
Financial structure and financial depth			
Openness of the financial sector (export plus import of financial services as a % of GDP)	0.6	0.5	0.5
Domestic credit to private sector as % of GDP	27.9	28.4	29.0
Banks and other CI			
Number of credit institutions	713	667	660
o/w: number of commercial banks	71	62	60
Number of commercial bank branches (total banking sector)	2,879 (4,080)	3,040 (4,302)	3,119 (4,394)
Number of commercial bank employees (total banking sector)	138,822 (165,225)	131,878 (158,697)	124,096 (151,257)
Market share of commercial banks	95.4	95.0	94.7
Number of other credit institutions (CI) (cooperative banks)	642	605	600
Market share of other CI (cooperative banks)	4.6	5.0	5.3
Concentration index (CR5) for CI	54.7	53.4	52.3
Number of ATMs (per 1,000,000 inhabitants)	168	185	196
Number of POS terminals (per 1,000,000 inhabitants)	1,698	1,750	1,930
Number of cards with a cash function (per 1,000 inhabitants)	371	436	388
Ownership structure (market share by total assets, %)			
– Domestic public banks	23.5	25.1	24.4
– Domestic private banks	7.8	7.5	7.8
– Foreign banks (branches and subsidiaries)	68.7	67.4	67.8

SLOVAKIA

Macroeconomic environment and financial markets

	2001	2002	2003
Real GDP growth	3.8	4.6	4.5
GDP per capita (in PPP terms, in €)	10,433	11,328	11,743
Inflation (HICP)	7.2	3.5	8.5
Standardised unemployment rate (as a % of labour force)	19.4	18.7	17.5
Population (in millions)	5.4	5.4	5.4
General government deficit(-)/surplus(+) (as a % of GDP)	-6.0	-5.7	-3.7
General government gross debt (as a % of GDP)	48.7	43.3	42.6
Current and capital accounts balance (as a % of GDP)	-8.0	-7.5	-0.5
Openness (export + import of goods and services, % of GDP)	152.8	148.7	155.7
Stock market annual return in %	31.4	15.9	26.9
Stock market capitalisation (as a % of GDP)	2.6	3.3	3.5
Corporate sector debt securities (outstanding as a % of GDP)		0.5	2.4
Country ratings (December 2004)	Fitch	Moody's	Standard and Poor's
Country rating: foreign currency (long term)	A-	A3	A-
Country rating: domestic currency (long term)	A+	A3	A-
Exchange rate regime	Managed float.		

Regulatory environment

Supervision	
Supervisory authority of banks	Central bank.
Single financial supervisory authority	No. Financial Market Authority is supervisory body for financial market, insurance companies and pension funds
Deposit insurance scheme	
Administration	Joint public/private
Coverage limit	€20,000
Co-insurance	10% co-insurance
Minimum capital to establish CI	Credit institution: €12.14 million – with mortgage transactions: €24.3 million

Structural features of the banking sector

	2001	2002	2003
Financial structure and financial depth			
Openness of the financial sector (export plus import of financial services as a % of GDP)	0.4	0.8	n.a.
Domestic credit to private sector as % of GDP	37.6	39.7	31.7
Banks and other CI			
Number of credit institutions	20	20	21
o/w: number of banks	20	21	21
Number of bank branches	1,008	1,020	1,057
Number of bank employees	21,158	19,717	19,797
Market share of banks (%)			94.2
Number of other credit institutions (CI)			3
Market share of other CI (%)			5.8
Concentration index (CR5) for CI (%)	66.8	66.9	67.5
Number of ATMs (per 1,000,000 inhabitants)	219	254	279
Number of POS terminals (per 1,000,000 inhabitants)	1,778	2,269	2,563
Number of cards with a cash function (per 1,000 inhabitants)	366	442	559
Ownership structure (market share by total assets, %)			
– Domestic public banks	26.5	4.4	3.7
– Domestic private banks			-
– Foreign banks (branches and subsidiaries)	73.5	95.6	96.3

SLOVENIA

Macroeconomic environment and financial markets

	2001	2002	2003
Real GDP growth	2.7	3.3	2.5
GDP per capita (in PPP terms, in €)	15,300	16,100	16,500
Inflation (HICP)	8.6	7.5	5.7
Standardised unemployment rate (as a % of labour force)	5.6	6.1	6.5
Population (in millions)	2.0	2.0	2.0
General government deficit(-)/surplus(+) (as a % of GDP)	-2.8	-2.4	-2.0
General government gross debt (as a % of GDP)	28.1	29.5	29.4
Current and capital accounts balance (as a % of GDP)	0.1	0.7	-1.0
Openness (export + import of goods and services, % of GDP)	120.1	113.7	113.4
Stock market annual return in %	19.0	55.2	17.7
Stock market capitalisation (as a % of GDP)	17.9	23.3	23.3
Corporate sector debt securities (outstanding as a % of GDP)		0.7	0.8
Country ratings (December 2004)	Fitch	Moody's	Standard and Poor's
Country rating: foreign currency (long-term)	AA-	Aa3	AA-
Country rating: domestic currency (long-term)	AA	Aa3	AA
Exchange rate regime	Entered ERM II in 2004/Managed float		

Regulatory environment

Supervision	
Supervisory authority of banks	Central bank.
Single financial supervisory authority	No. Separate supervisory bodies for securities firms and insurance companies.
Deposit insurance scheme	
Administration	Central bank
Coverage limit	SIT 5.1 million (€21,267)
Co-insurance	No co-insurance.
Minimum capital to establish CI	Bank: €5 million; savings bank: €1 million

Structural features of the banking sector

	2001	2002	2003
Financial structure and financial depth			
Openness of the financial sector (export plus import of financial services as a % of GDP)	0.2	0.3	0.2
Domestic credit to private sector as % of GDP	38.4	38.9	41.7
Banks and other CI			
Number of credit institutions	69	47	30
o/w: number of banks	21	20	20
Number of bank branches 1)	1,182	1,179	1,176
Number of bank employees	11,258	11,543	11,397
Market share of banks (%)	98.0	98.6	98.7
Number of other credit institutions (CI)	48	27	10
Market share of other CI (%)	2.0	1.4	1.3
Concentration index (CR5) for CI (%)	69.1	69.5	67.4
Number of ATMs (per 1,000,000 inhabitants)	516	549	621
Number of POS terminals (per 1,000,000 inhabitants)	13,145	14,758	16,046
Number of cards with a cash function (per 1,000 inhabitants)	922	1,040	1,437
Ownership structure (market share by total assets, %)			
– Domestic public banks	41.6	24.9	23.8
– Domestic private banks	42.0	40.4	40.2
– Foreign banks (branches and subsidiaries)	16.4	34.6	36.0

1) Including post office counters, which are part of Post Office Bank of Slovenia.

Banking sector performance and balance sheet structure in all NMSs

		CY	CZ	EE	HU	LT	LV	MT	PL	SI	SK
Profitability and efficiency											
ROE (% of Tier 1 capital)	2002	-4.5	24.8	13.6	14.1	12.1	17.5	12.2	5.8	11.0	18.9
	2003	-4.3	22.5	15.6	16.7	11.1	18.9	13.6	5.7	10.2	15.0
ROA	2002	-0.3	1.1	1.4	1.2	0.9	1.3	0.8	0.5	0.6	1.3
	2003	-0.3	1.2	1.5	1.3	1.3	1.3	1.3	0.5	0.6	1.2
Cost-income ratio	2002	73.3	58.6	63.6	67.0	79.2	65.2	45.9	63.7	59.8	46.4
	2003	68.5	63.6	61.0	62.2	77.7	62.5	32.9	68.1	63.4	68.7
Asset quality 1)											
NPL as % of total loans	2002	8.8	9.0	1.3	3.7	5.8	1.9	8.2	16.0	22.2	20.6
	2003	12.7	6.4	0.7	3.5	2.6	1.7	7.5	16.2	21.9	18.5
Provisions in % of total loans	2002	5.3	4.4	0.9	2.0	1.1	1.2	1.6	7.0	8.8	11.1
	2003	6.8	2.4	0.7	1.8	0.6	1.0	1.8	7.1	8.4	7.2
Provisions in % of NPL	2002	59.9	49.3	68.7	53.8	18.7	61.8	19.7	43.7	39.6	54.0
	2003	53.7	38.2	93.0	52.5	21.3	60.3	23.7	43.8	38.5	38.7
Capital adequacy											
Solvency ratio	2002	12.8	14.1	15.0	13.3	14.7	12.0	20.3	13.8	11.9	21.3
	2003	10.6	14.5	14.3	11.9	13.2	10.3	20.9	13.8	11.6	21.6
Balance sheet structure (million €)											
Total assets	2002	26,454	79,509	5,221	46,281	4,988	7,125	15,769	116,044	19,783	21,527
	2003	27,249	77,632	6,314	52,463	6,381	8,410	17,444	103,633	21,361	20,883
Customer loans	2002	13,662	28,730	3,161	25,859	2,584	3,399	7,364	56,240	9,477	6,879
	2003	13,625	30,596	4,386	30,772	3,924	4,384	7,690	52,457	10,723	8,047
– lending to public sector (%)	2002	..	18.9	2.7	6.6	8.3	..	11.0	6.1	9.9	2.0
	2003	..	16.9	3.9	3.2	5.3	3.7	7.9	7.5	5.6	1.9
– lending to NFC (%)	2002	..	48.4	33.2	52.5	66.9	..	58.7	51.8	58.8	43.1
	2003	..	45.5	33.7	51.2	66.2	59.4	61.9	48.6	62.9	41.8
– lending to households (%)	2002	..	16.7	28.1	21.4	13.7	..	16.9	37.4	25.8	10.9
	2003	..	21.1	27.8	26.3	17.8	26.2	16.0	38.9	24.8	13.9
– lending to FIs (%)	2002	..	11.2	35.9	13.9	11.1	..	13.4	4.8	3.4	42.9
	2003	..	12.0	34.6	16.7	10.7	10.7	14.2	4.9	4.0	40.3
Customer deposits	2002	19,289	51,696	3,134	31,614	3,382	5,019	8,366	80,438	13,677	14,917
	2003	18,784	51,164	3,433	31,803	3,931	5,545	8,171	71,798	13,919	15,704
Loans to total assets (%)	2002	51.6	36.1	60.5	55.9	51.8	47.7	46.7	48.5	47.9	32.0
	2003	50.0	39.4	69.5	58.7	61.5	52.1	44.1	50.6	50.2	38.5
Loans to deposits (%)	2002	70.8	55.6	100.8	81.8	76.4	67.7	88.0	69.9	69.3	46.1
	2003	72.5	59.8	127.7	96.8	99.8	79.1	94.1	73.1	77.0	51.2

Source: BSC. Information of foreign-controlled subsidiaries and branches is reported if their share of total assets over total national banking sector assets is larger than 2% for each reporting entity. For lending breakdown, percentages may not add up to 100% because of the presence of a residual lending category (not reported).

1) Definitions of non-performing and other doubtful loans differ between countries. Consequently, these data should be interpreted with caution.

DATA SOURCES FOR COUNTRY TEMPLATES

Macroeconomic environment and financial markets

BSC, Eurostat, ECB, European Commission, International Monetary Fund (World Economic Outlook), Bloomberg, World Federation of Stock Exchanges, "Bond markets and long-term interest rates in EU accession countries (ECB, October 2003)", "Bond markets and long-term interest rates in non-euro area Member States of the European Union and in accession countries" (ECB, November, 2004), Fitch Ratings, Moody's, Standard and Poor's

Regulatory environment

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Structural features of the banking sector

BSC, ECB, Eurostat, IMF (International Financial Statistics, Balance of Payment Statistics), "Payment and securities settlement systems in the accession countries" (ECB, April 2004)