

The future of Central Europe's financial system

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A financial system that supports real convergence by being sufficiently large, diversified, well regulated and understood.

This requires four (interrelated) developments:

- Sustainable(!) banking sector growth; avoiding financial bubbles and overbanking
- Development of the non-bank financial sector; satisfying unmet demand for financial services
- 'Widening' of financial supervision and regulation; covering also non-bank financial institutions
- Improving financial literacy; enabling people to take appropriate financial decisions

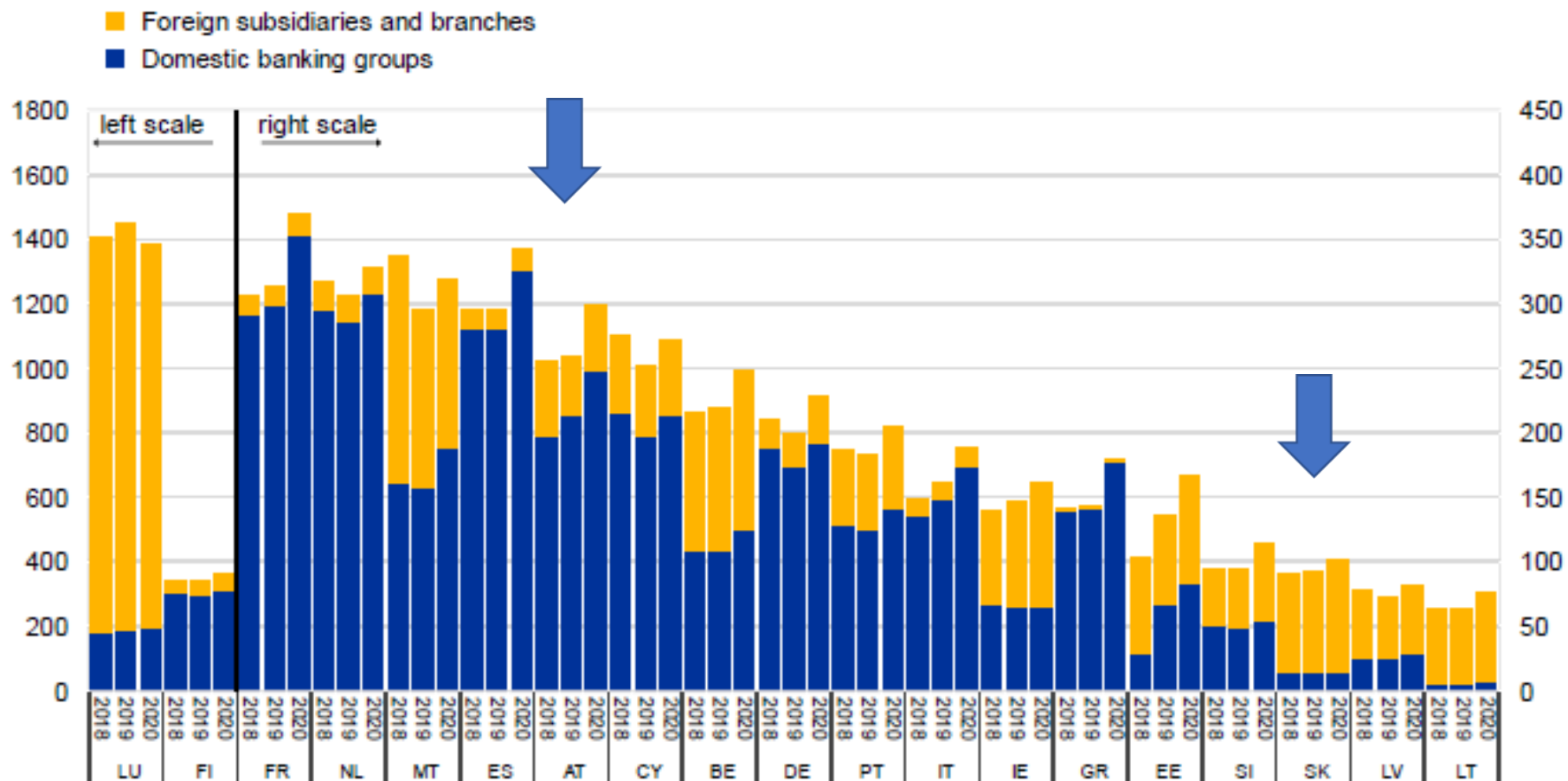
What is the evidence on finance and growth?

Key takeaways from a recent survey paper (Popov 2017):

- On average, financial development has a positive, monotonic effect on economic growth. Pretty robust finding across many types of studies and methodologies.
- The positive effect of finance on growth weakens and at times even reverses once private sector credit to GDP grows beyond 70-100% (e.g. due to increased financial fragility and relatively less productive lending)
- Recent papers show that the marginal contribution of banks to economic growth declines, while that of capital markets increases with economic development.
- Financial development can have social impacts, e.g. on income and gender inequality. Findings on these effects tend to be more heterogenous.

Financial structure in the euro area

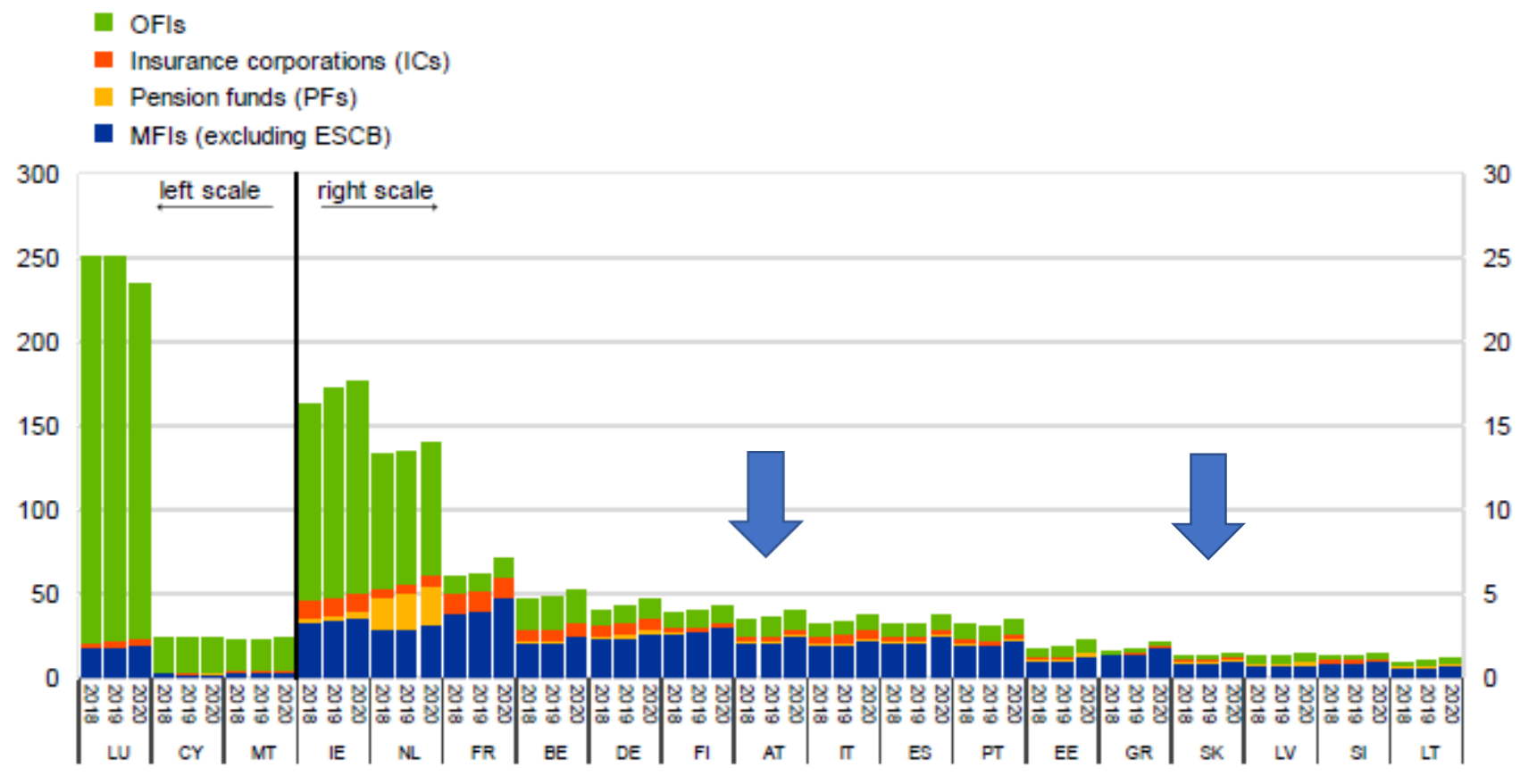
Figure 2: Total Banking Sector Assets in euro area countries (% to GDP)



Source: ECB Financial Integration and Structure in the euro area 2022, Statistical Annex

Financial structure in the euro area

Figure 1: The Size of the euro area Financial Sector (assets to GDP)



Source: ECB Financial Integration and Structure in the euro area 2022, Statistical Annex

The 'financing gap'

Identifying financing gaps is challenging; no commonly accepted methodology.

A large part of the gap is unobservable, resulting in a likely underestimation of the real needs.

There is, however, some (pre-Covid) evidence:

- 'The Eurozone SME bank financing gap fell from 6% of GDP in 2015 to 3% of GDP in 2019, or EUR400bn, [...] remaining higher than the 2% of GDP in the US' (Allianz 2019)
- 'SME financing gaps (for debt or equity) remain high, despite the provision of support from national [and European] instruments' (ERDF 2019)
- 'Firm-level data suggests that the use of external equity is still relatively exceptional [and] private equity activity in the EU still shows a strong home bias' (Raposo and Lehmann 2019)

Studies were conducted during times of highly accommodative monetary policy, which, however, also reduced banking sector profitability!

The 'regulation gap'

Post-GFC period brought major advancements in financial regulation

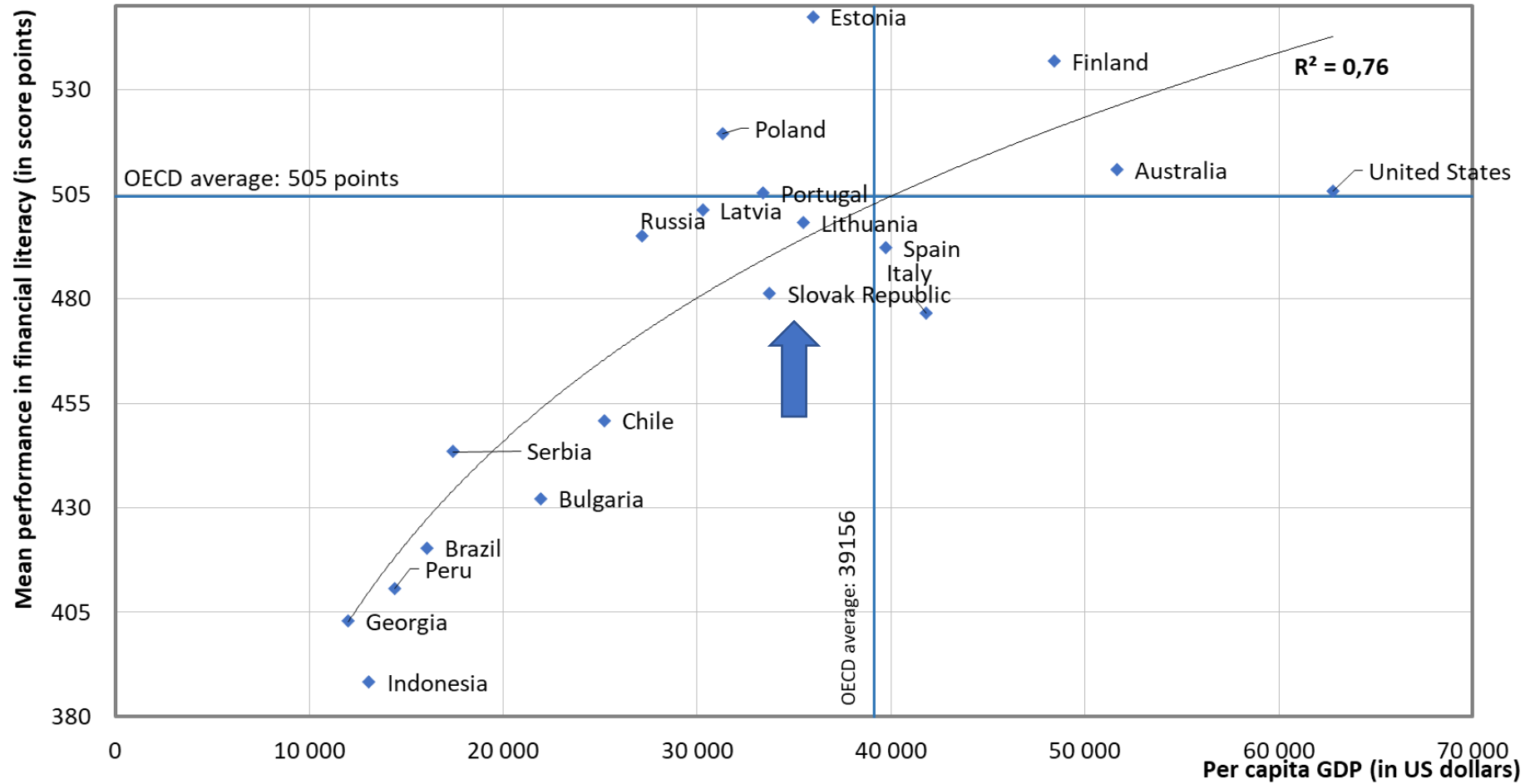
- Banking system now generally better capitalized with more liquid assets
- Risk management practices improved and many banks successfully 'de-risked'
- Macroprudential policy added an important, systemic oversight dimension

There are, however, important gaps and financial market development will increase their importance:

- Non-bank and systemic financial sector risks still less understood than banking sector risks, data transparency and analytical tools to be improved
- Microprudential regulation of non-banks relatively lighter and macroprudential regulation largely non-existent
- Fintech as major regulatory challenge

Financial literacy

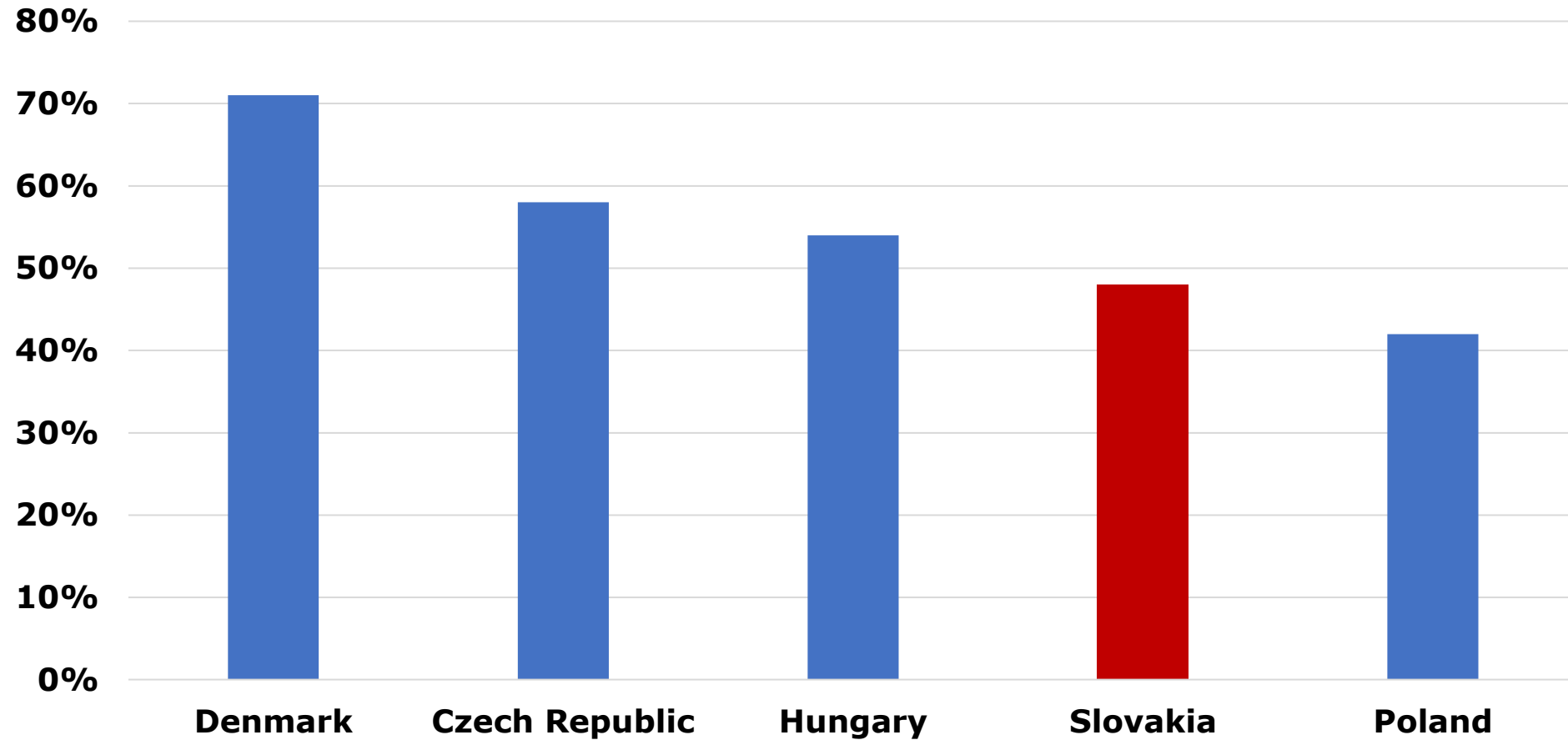
Figure 1: Financial Literacy and Income



Sources: World Bank and OECD (PISA Study), Data refer to 2018

Financial literacy

Figure 2: Global Financial Literacy Survey (2015)
(% of population answering all questions correctly)



Sources: S&P Global FinLit Survey Data refer to 2015

Table 1: Questions on Financial Literacy in the HFCS
(Results for SK)

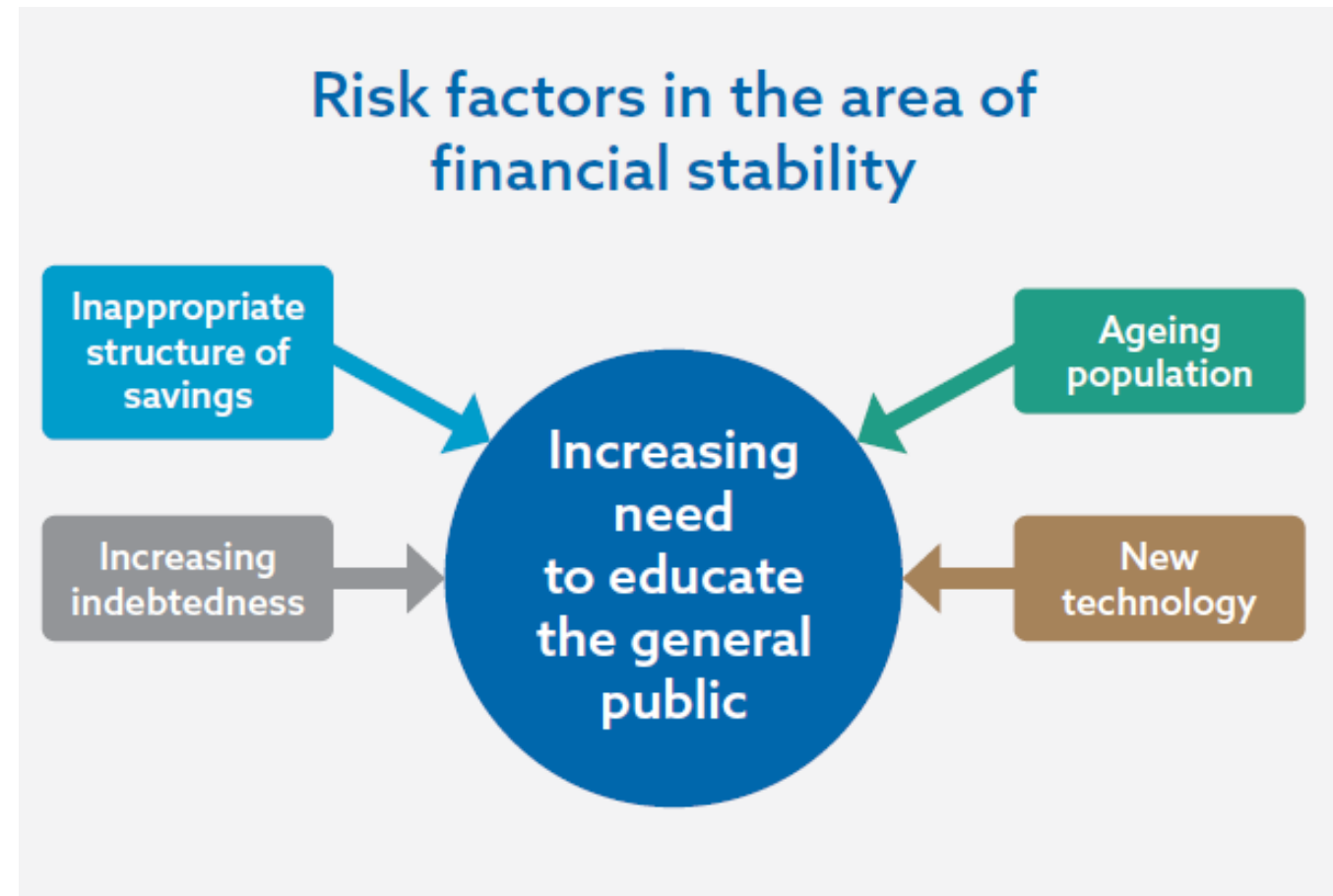
	HFCS 2014	HFCS 2017	HFCS 2021 *
Question 1 - which of the following mortgages allows you to set the amount and number of payments necessary to repay the loan?			
1 Mortgage with variable interest rate	13,7%	12,8%	8,8%
2 Mortgage with fixed interest rate	57,2%	55,6%	59,1%
-1 I don't know	29,1%	31,6%	32,1%
Question 4 - A company can have access to funds via issuing equities or bonds. Which of these securities poses a higher risk of losing money?			
1 Equities	18,4%	19,5%	21,6%
2 Bonds	5,0%	7,1%	5,8%
3 Equally risky	33,2%	28,0%	27,7%
4 Don't know what the difference between equities and bonds is	27,2%	17,5%	16,4%
-1 I don't know	16,2%	27,9%	28,5%
Correct answers on all four financial literacy questions	10,6%	10,7%	12,2%

Source: Household Finance and Consumption Survey (HFCS)

NBP Flagship Conference, October 2022

Financial literacy should be improved in most countries – but there is additional need for financial literacy convergence in the CEE region!

Failure to do so creates financial stability risks and may slow down economic convergence.



Source: NBS – Financial Literacy Support Strategy (2019)
www.nbs.sk/img/documents/ts/191107/final_nbs_strategiafingram_en.pdf

A financial system that supports real convergence by being sufficiently large, diversified, well regulated and understood.

'To do list' for central banks:

- Avoid excessive banking sector risks while enabling the sector to develop further
- Create the framework for non-bank financial sector development
- Close existing gaps in financial supervision and regulation
- Help to improve financial literacy

Thank you for your attention

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www.allianz-trade.com/en_global/news-insights/economic-insights/European-SMEs-Filling-the-bank-financing-gap.html

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