



Banking Sector & Capital Flows

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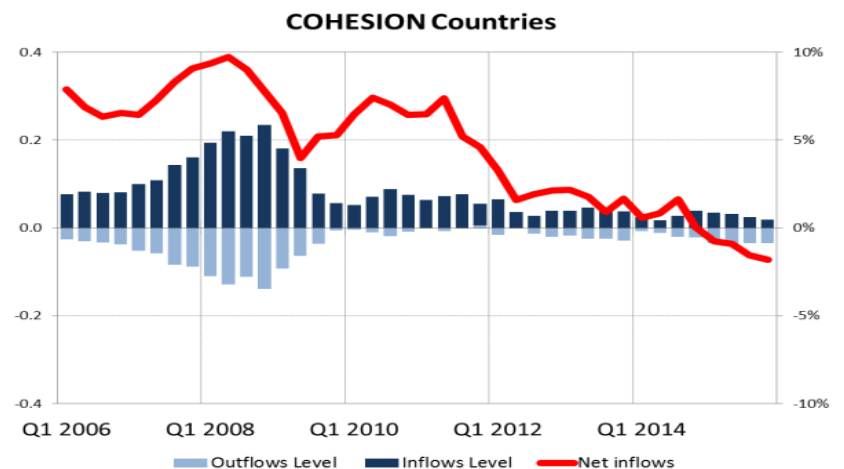
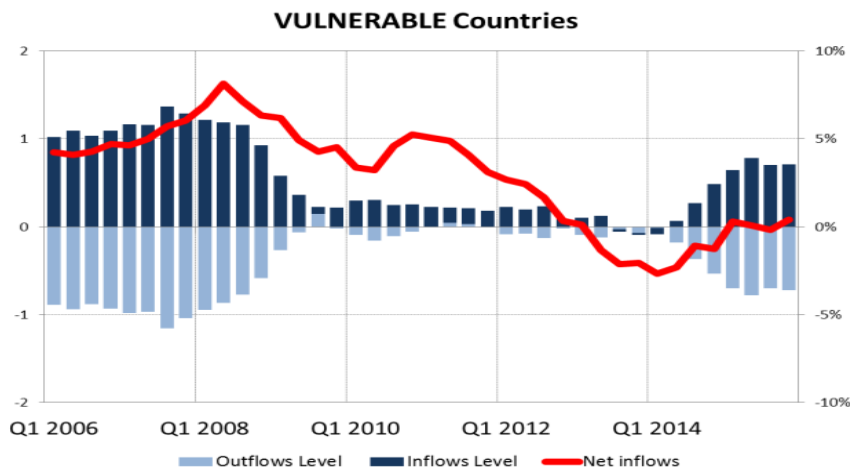
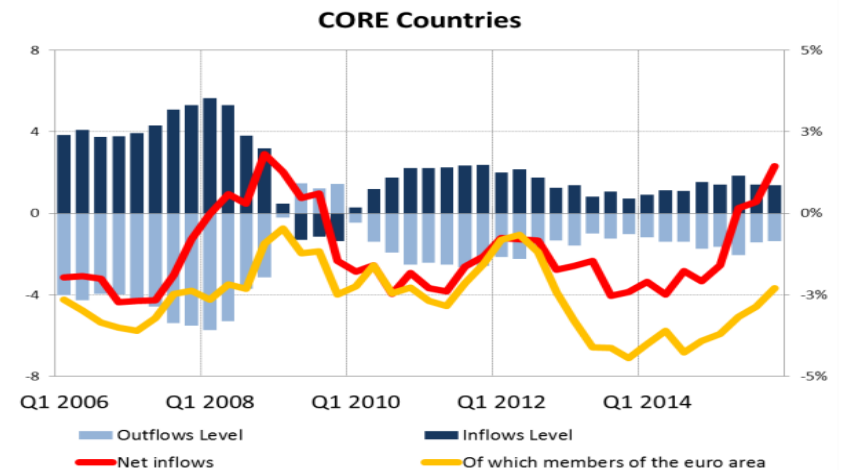
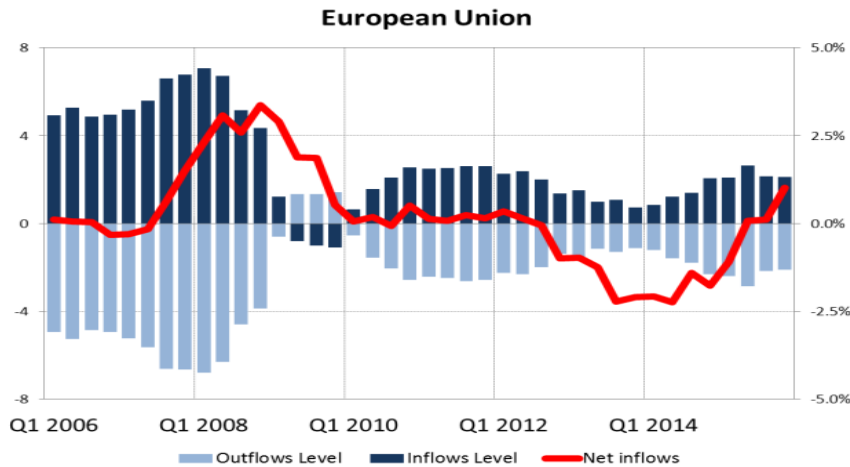
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Evolution of capital outflows and inflows in the EU

(level, USD trillions, lhs, and net flows in % GDP, rhs, 4-qtr moving average)

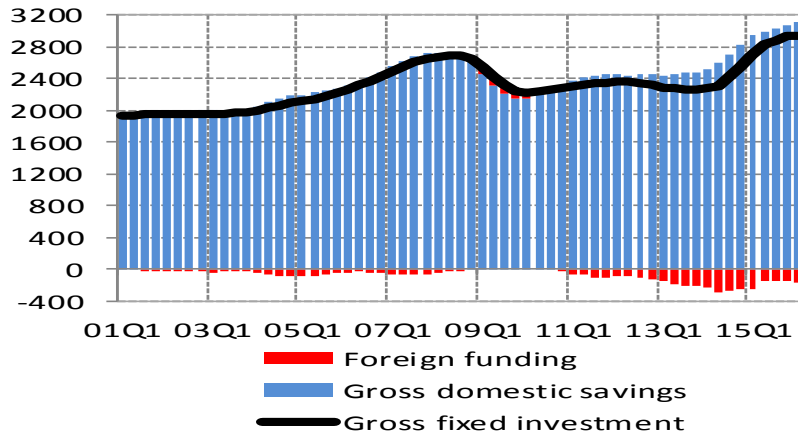




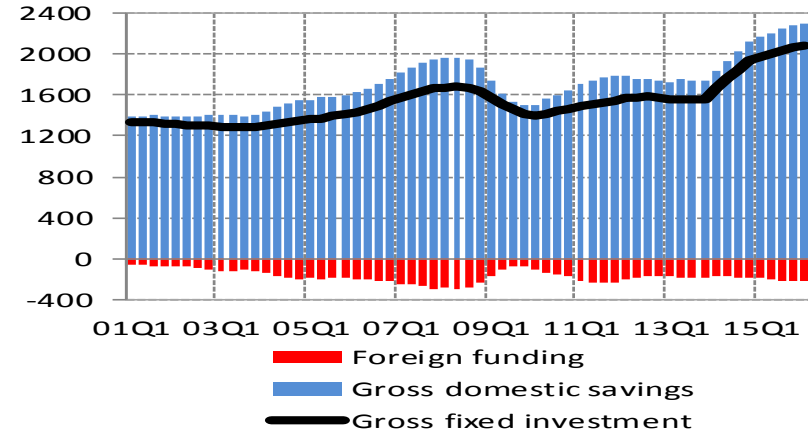
External sources of finance (2) – investment financing

Domestic vs external source of finance for domestic investment
(EUR billions, annual flows)

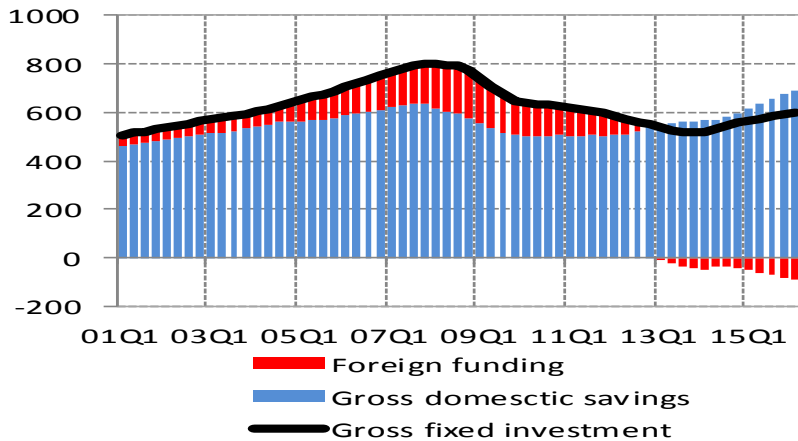
EU



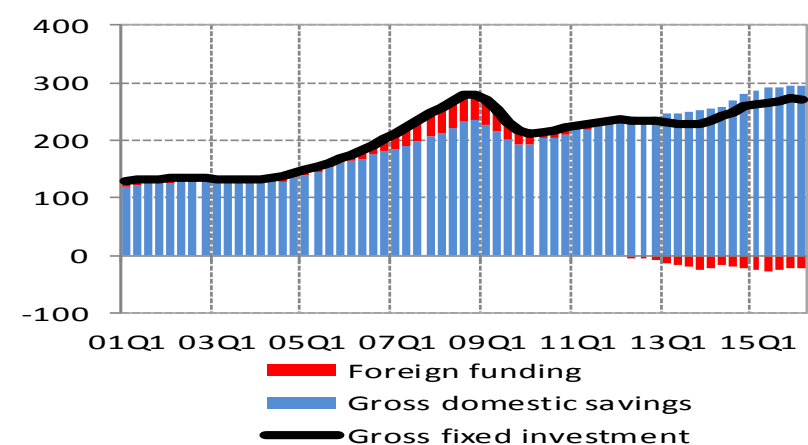
Core countries



Vulnerable countries



Cohesion countries



External sources of Finance by asset type (3)

Evolution of capital inflows and outflows in the EU - (% GDP)

	Outflows					Inflows				
	Portfolio Equity	Portfolio Debt	Direct Investment	Other investment	Total	Portfolio Equity	Portfolio Debt	Direct Investment	Other investment	Total
CORE	-1.0	-5.3	-4.0	-19.8	-30.1	-0.7	-6.6	-2.0	-21.1	-30.4
VUL	0.8	-6.2	-2.9	-10.9	-19.2	1.4	-14.1	0.1	-12.2	-24.8
COH	-0.4	-0.1	-2.0	-0.7	-3.2	0.5	-0.2	-3.4	-4.2	-7.3
EU	-0.5	-5.6	-3.9	-17.6	-27.5	-0.2	-8.3	-1.5	-18.8	-28.7

Note: Difference between average annual flows prior to the crisis (2005Q1-2007Q2), and after (2012Q1-2014Q4)

Source: IMF balance of payments statistics



- Traditional banking model :
 - relatively high capitalized subsidiaries (due to retained earnings to finance future growth)
 - fast lending growth financed through intra-group funding from the parent country

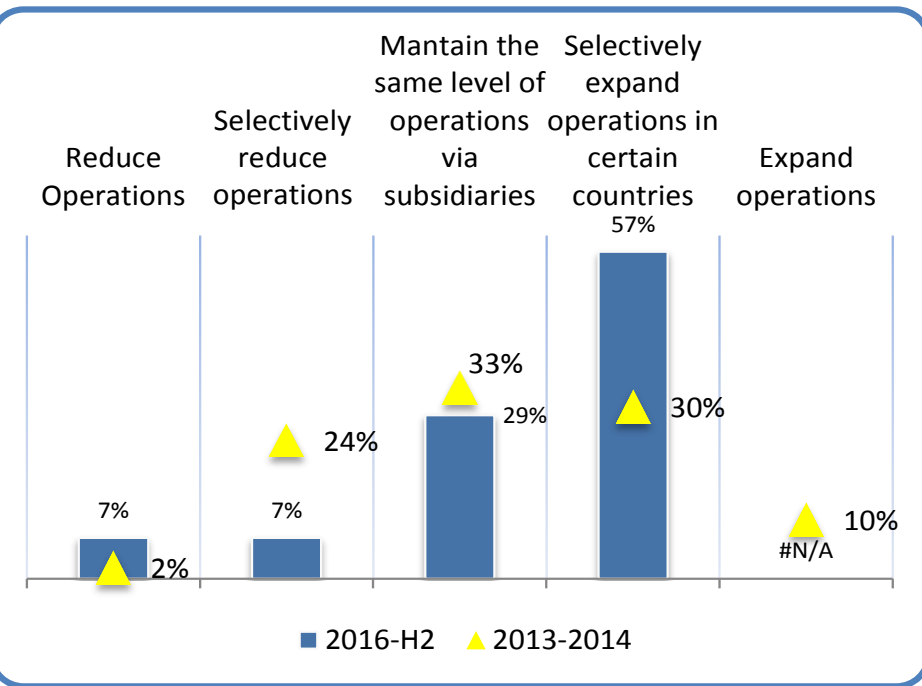
- The crisis has led to a transformation of the banking model:
 - capital in the subsidiaries preserved, but more repatriation of profits
 - transformation of the funding model towards domestic funding sources
 - local NPLs first, as well as parents NPLs and capital position lately emerging as a constraint

- The EIB Bank Lending survey, developed in the context of the Vienna Initiative, an useful instrument to assess dynamics

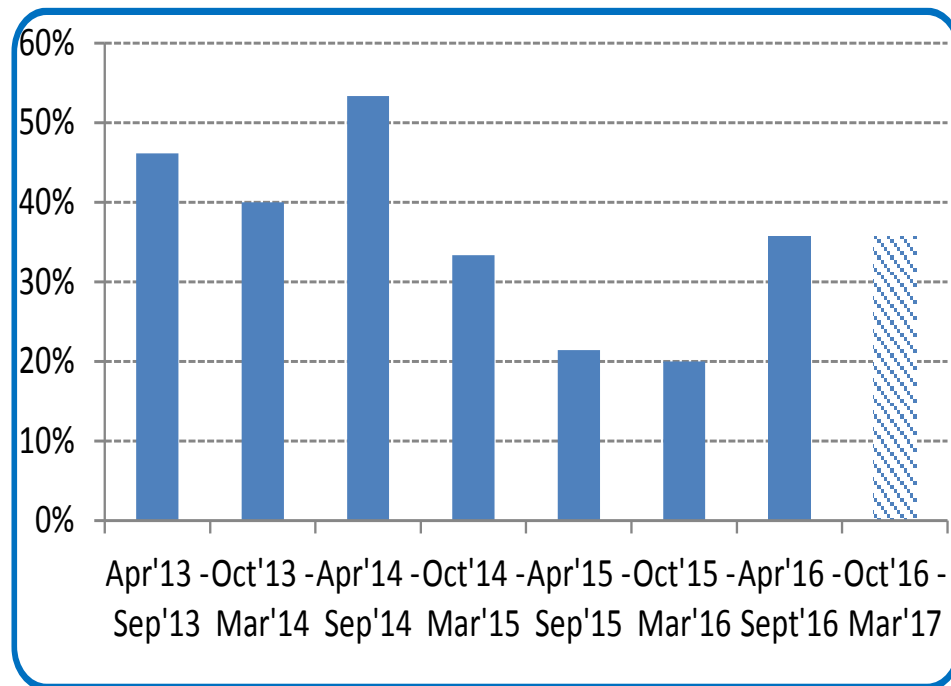


Groups: Commitment to the region

Groups' intentions on aggregate operations in CESEE



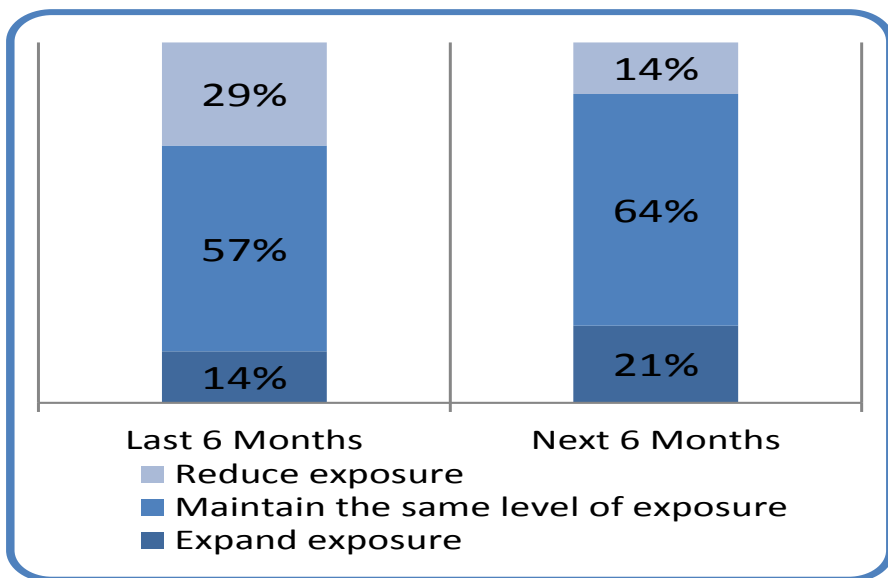
ROA of your CESEE operations - % of responses with ROA lower of overall group ROA





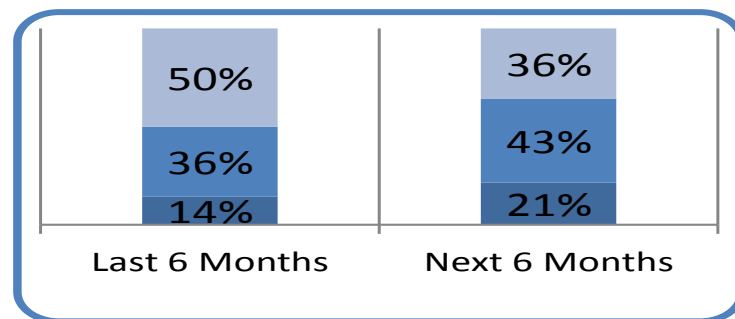
Groups: Exposure to CESEE - by instrument

Groups' total exposure to CESEE

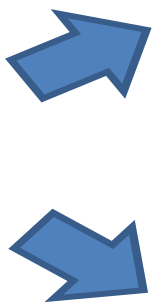
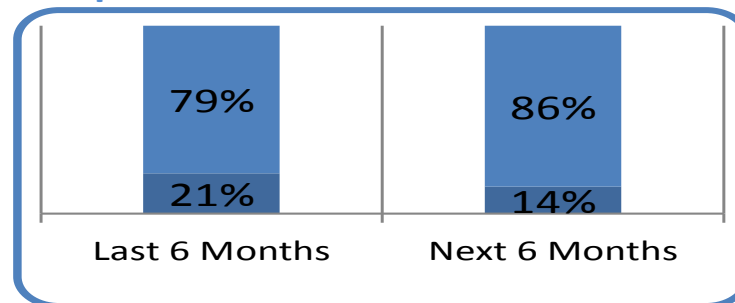


Exposure to subsidiaries

Intra-group funding

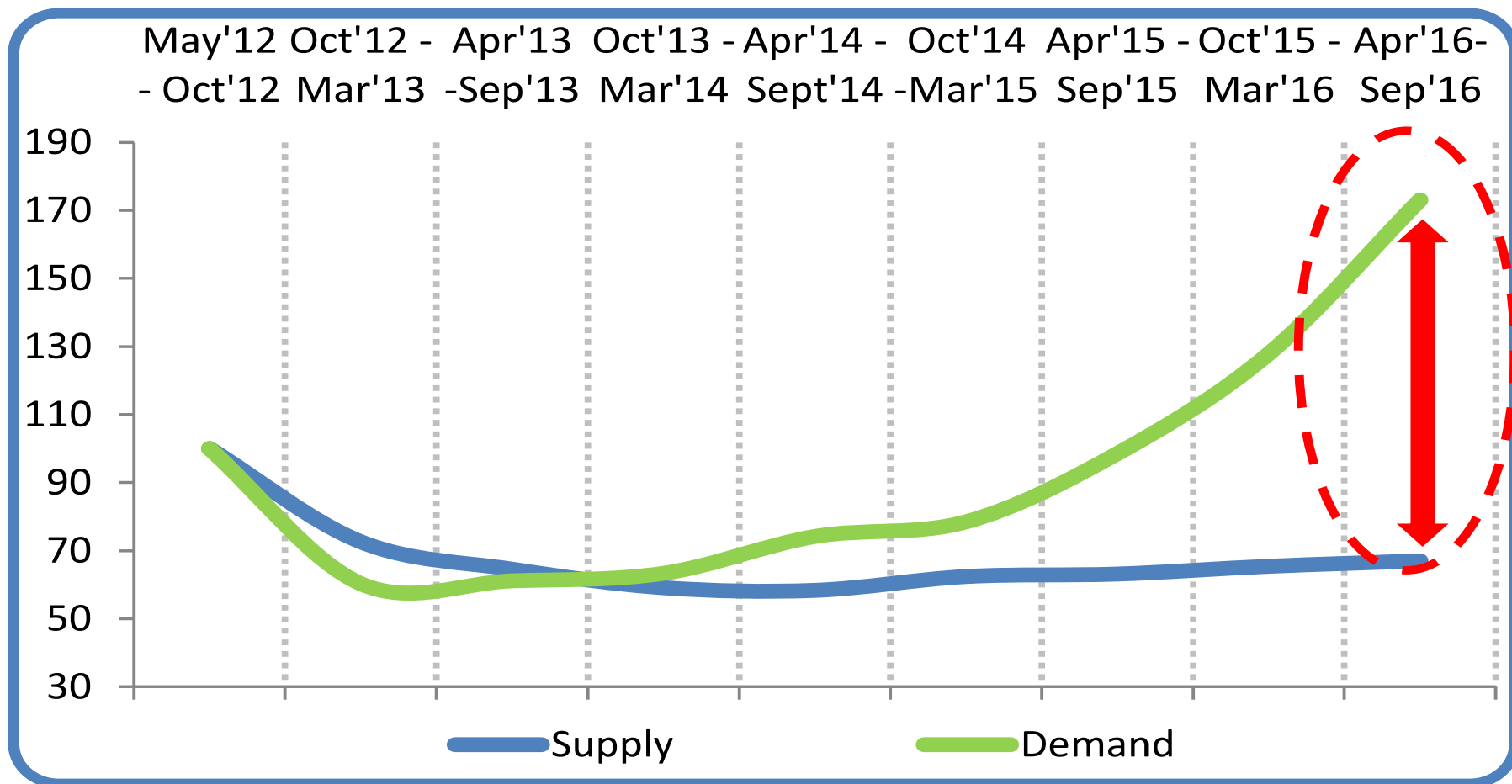


Capital



Subsidiaries: Cumulated demand and supply dynamics – an increasing perceived gap

Cumulated net percentages - supply and demand

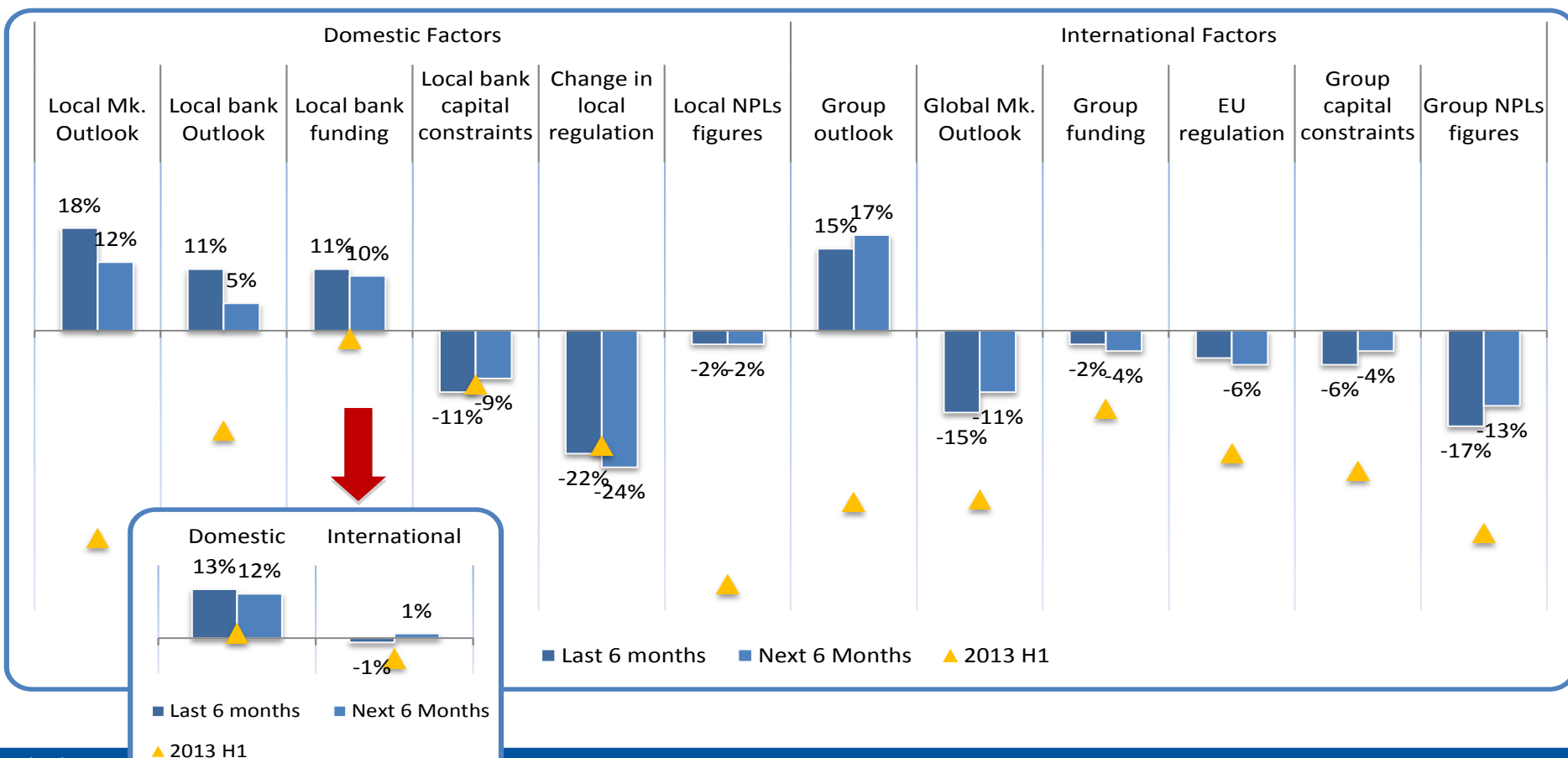


Determinants of supply (constraints)



- Domestic factors: capital and regulation, only marginally NPLs
- International factors: mostly negative, with more pronounced negative contributions from Group NPLs and global outlook

Net percentages; positive figures indicate a positive contribution to supply conditions



Recent research findings on cross border banking

- Subsidiaries' lending behavior is strongly influenced by parents' financial conditions, particularly in Central and Eastern Europe (Jeon et al., 2013)
- Existence of internal capital markets within international banking groups - spur growth and transmit cross border financial weaknesses (Houston and James, 1998; De Haas and Van Lelyveld, 2010)
- Recent research - Gattini and Zagorisiou (2016)
 - Subsidiary banks provide an extra boost to credit growth at the domestic level; whilst domestic and subsidiary banks contracted credit similarly after the financial crisis
 - Funding costs are transmitted from home to host markets
 - Parents' asset quality predictor of credit growth at subsidiary level
 - Parents' economic capital position matters - suggesting a rather centralized management of capital levels
 - Parents' excessive risk taking matters: excessive credit expansion coupled with a reduction of economic capital ratios jeopardizes subsidiaries' lending capacity

Summing up....

- The region benefited from capital inflows as a driver of stronger growth than the one allowed by the limited domestic savings
- Structural funds, FDIs and cross-border banks have been key drivers
- What could be the model for the future?
 - FDI (?)
 - Capital Market Union, as a means for real integration into the European single financial market (?)
 - Equity investment (private equity and venture capital) (?)
 - Bond Market (?)
 - Cross-border banking (?)

Vienna Initiative future work

- Continuous monitoring: Deleveraging and Credit Monitor, Bank lending Survey and NPL Monitor

New work plan / enhanced focus for Vienna Initiative 2.0 – future work streams:

- Future financial sector development in CESEE and the role of cross-border banking
 - Capital Markets Union and new model for capital flows
 - Investment in CESEE
 - Specific regulatory issues, country and regional basis
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- Full Forum in Luxembourg Q1 2017



Thank you