



Building Market Economies in Europe: Lessons and Challenges after 25 years of Transition

The Plumbing: Financial Sector Development

LAZARD

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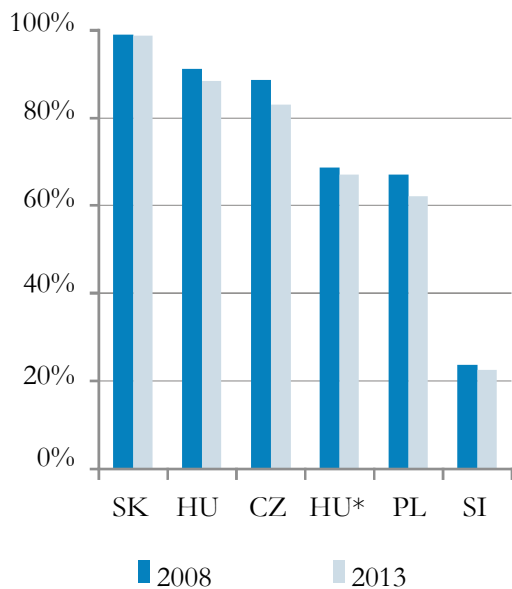
- A** The Western financial plumber was not sufficient after all
 - B** However, a national financial plumber will not be sufficient either
 - C** The best of both worlds: transparent plumbing serving a sustainable development model for the real economy
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- 1- Move beyond the traditional debate domestic vs. international
- 2- Strengthen domestic banks in order to serve countries' developmental objectives
- 3- Foster in a sound manner a more diverse foreign participation

A The Western financial plumber was not sufficient after all

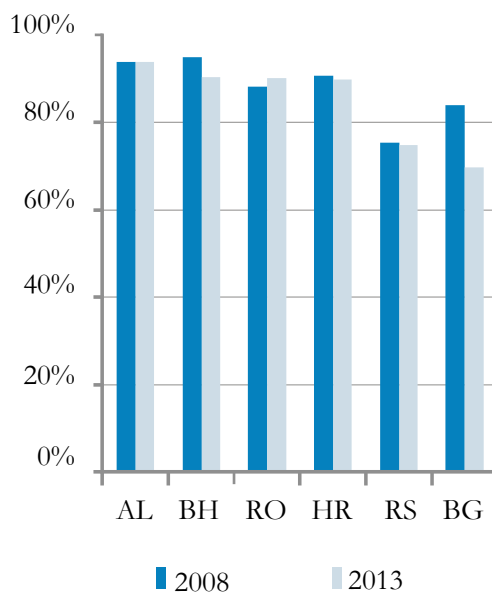
Foreign ownership of CESEE banks is on a slight decline but remains very high, with the exception of CIS

CE: FOREIGN OWNERSHIP*



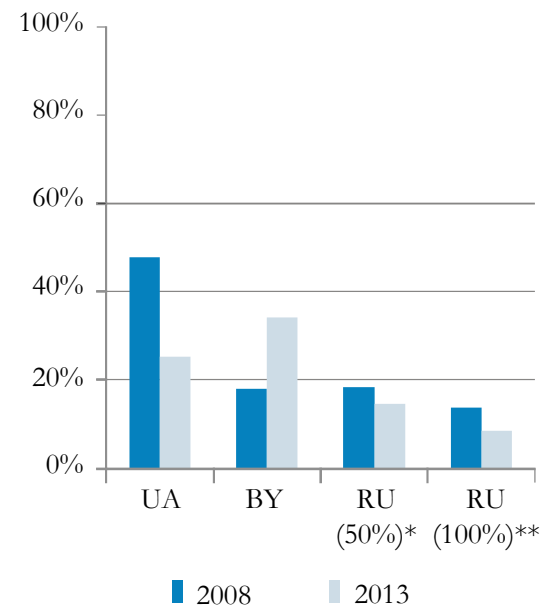
*excluding OTP, *% of total assets
Source: national sources, Raiffeisen RESEARCH*

SEE: FOREIGN OWNERSHIP**



***% of total assets
Source: national sources, Raiffeisen RESEARCH*

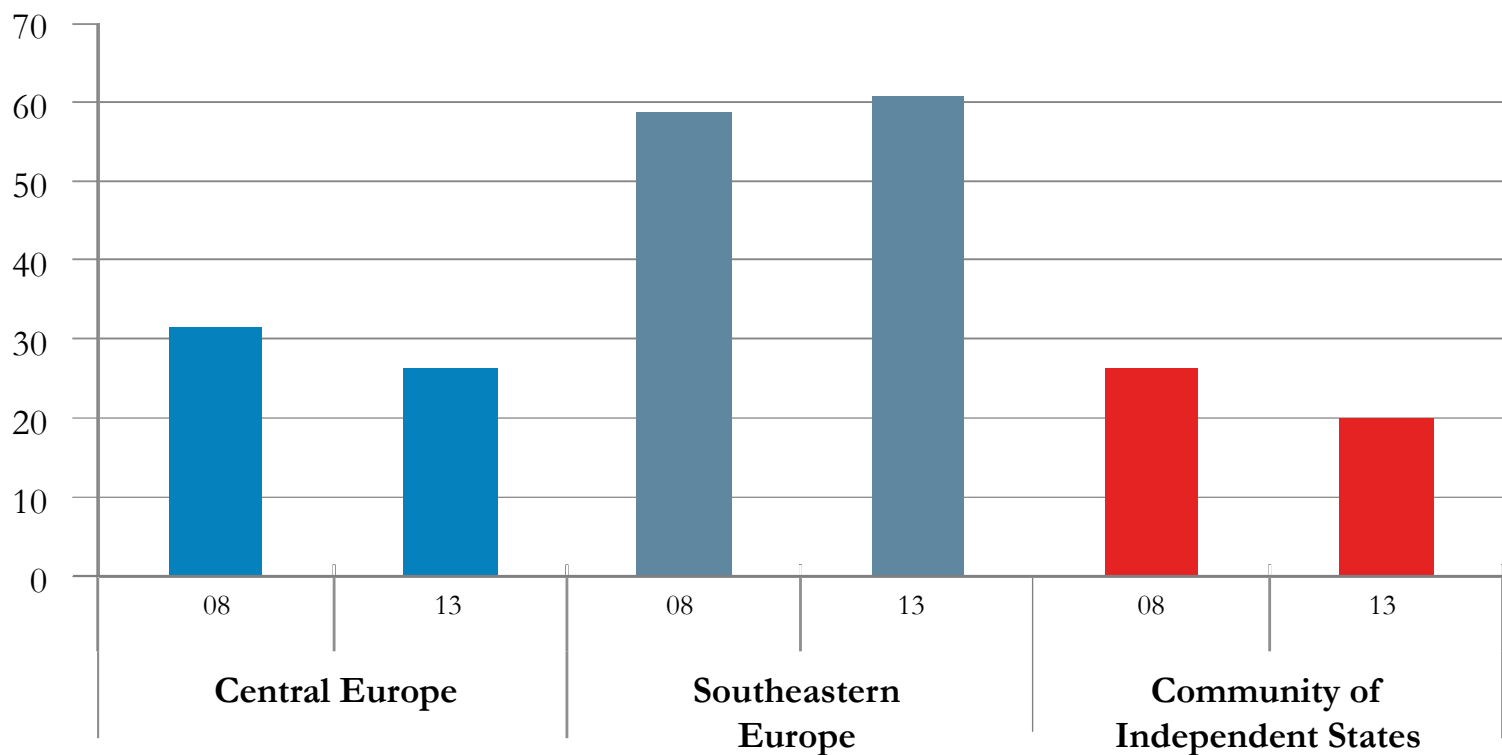
CIS: FOREIGN OWNERSHIP***



** Banks with over 50% foreign ownership
** 100% foreign-owned banks
***% of total assets
Source: national sources, Raiffeisen RESEARCH*

De-euroization is still a big challenge in SEE

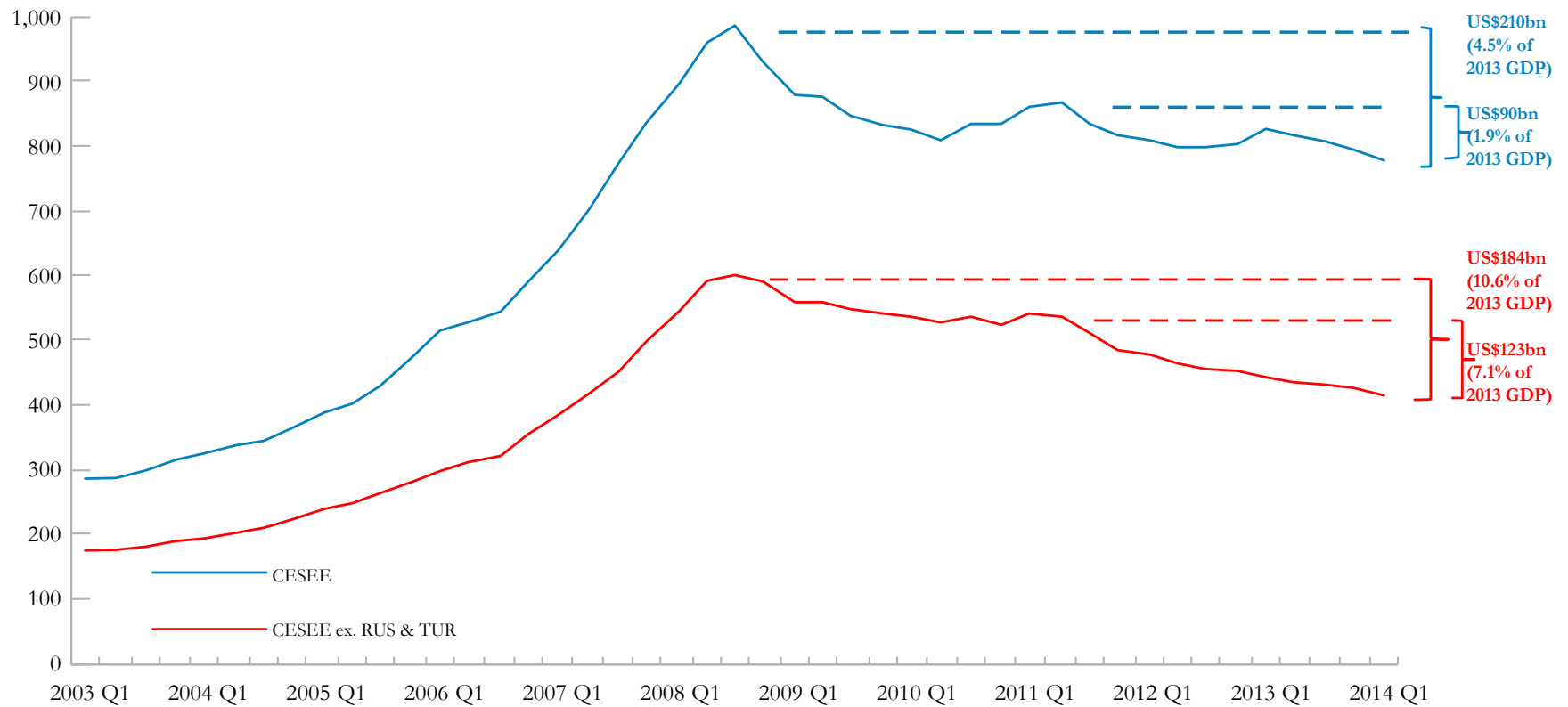
LOANS IN FOREIGN CURRENCY (AS A % OF TOTAL) RANGE BETWEEN 20% (FOR CIS COUNTRIES) AND 60% (FOR SEE COUNTRIES)



Source: national sources, Raiffeisen RESEARCH

Foreign banks have been disengaging...

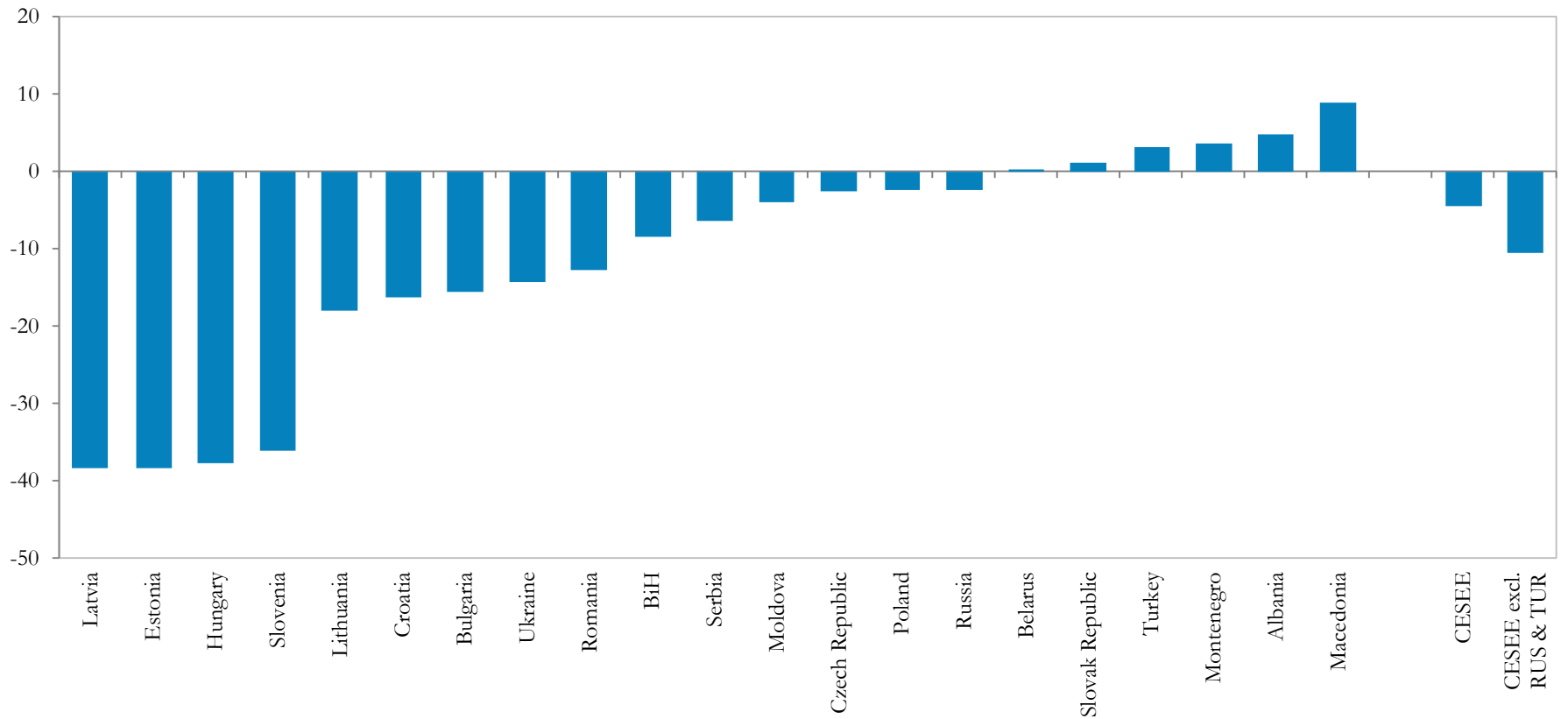
CESEE: EXTERNAL POSITIONS OF CESEE BIS-REPORTING BANKS (US\$BN)



Source: national central banks, Raiffeisen RESEARCH

... but deleveraging is much more acute in some countries than in others

EXTERNAL POSITIONS OF BIS-REPORTING BANKS (CHANGE IN 2008-2013, % OF 2013 GDP)

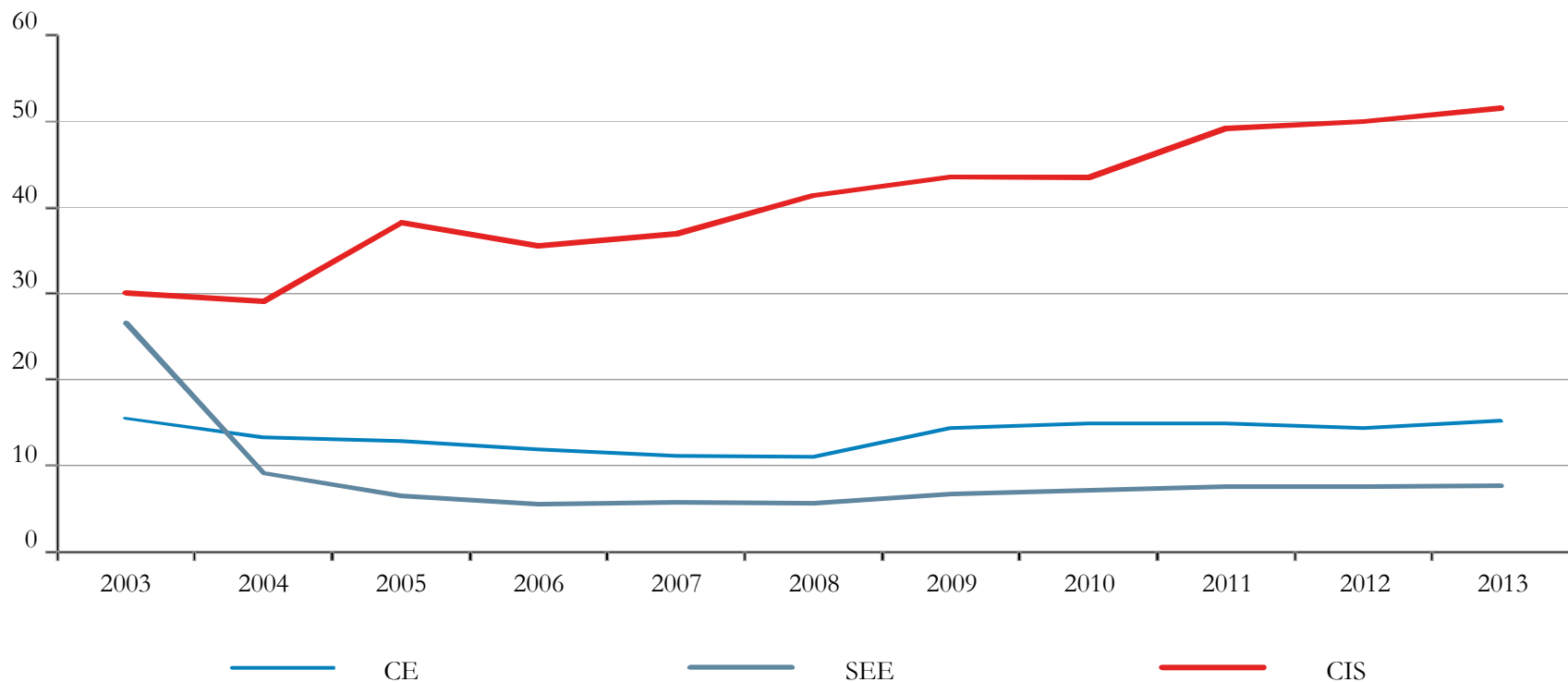


Source: IMF

B However, a national financial plumber will not be sufficient either

The presence of the State in the banking sector as of yet is on the rise only in CIS...

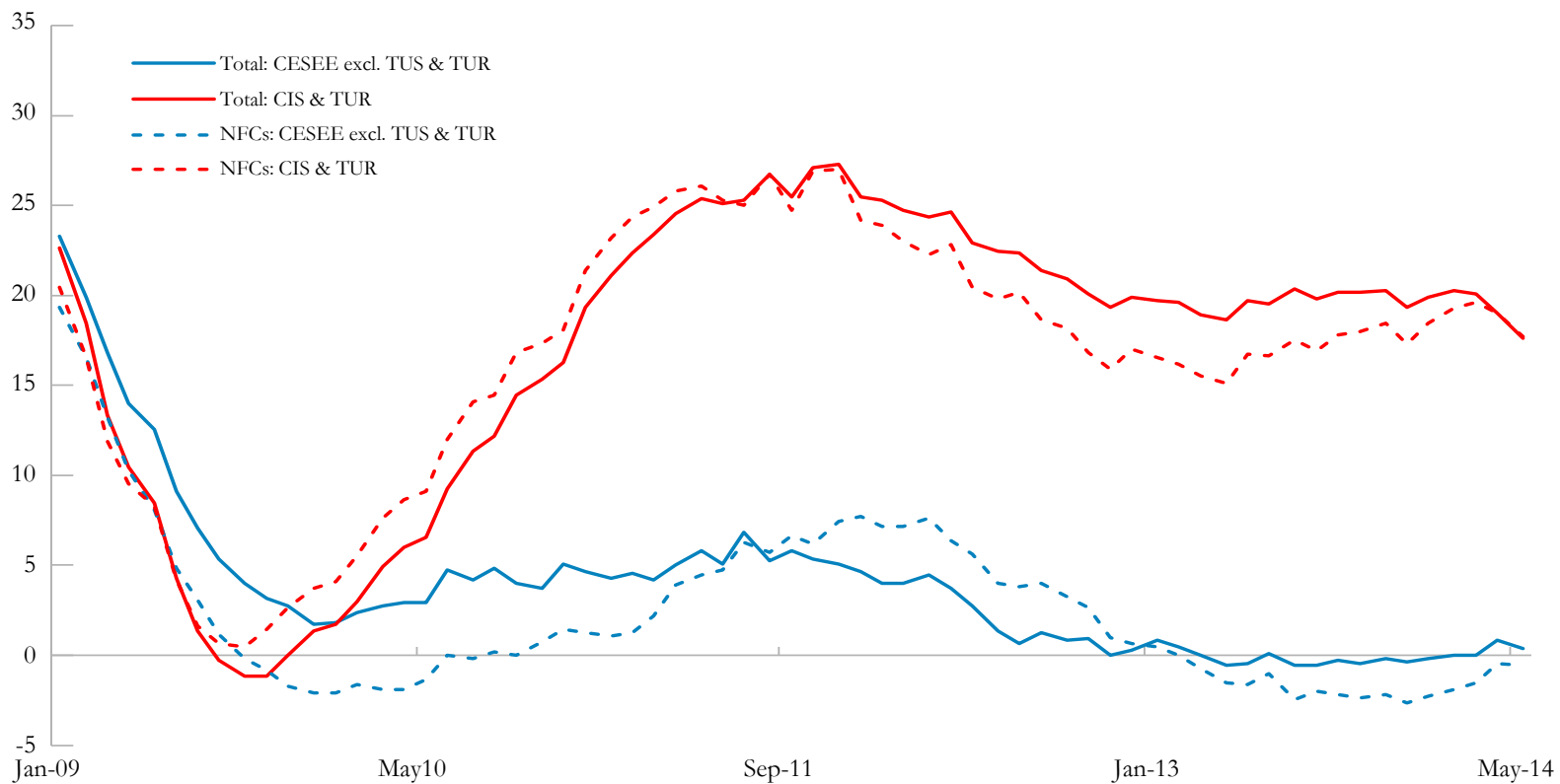
PRESENCE OF STATE-OWNED BANKS (% OF TOTAL ASSETS)



Source: national central banks, Raiffeisen RESEARCH

... amid a creditless recovery in CESEE...

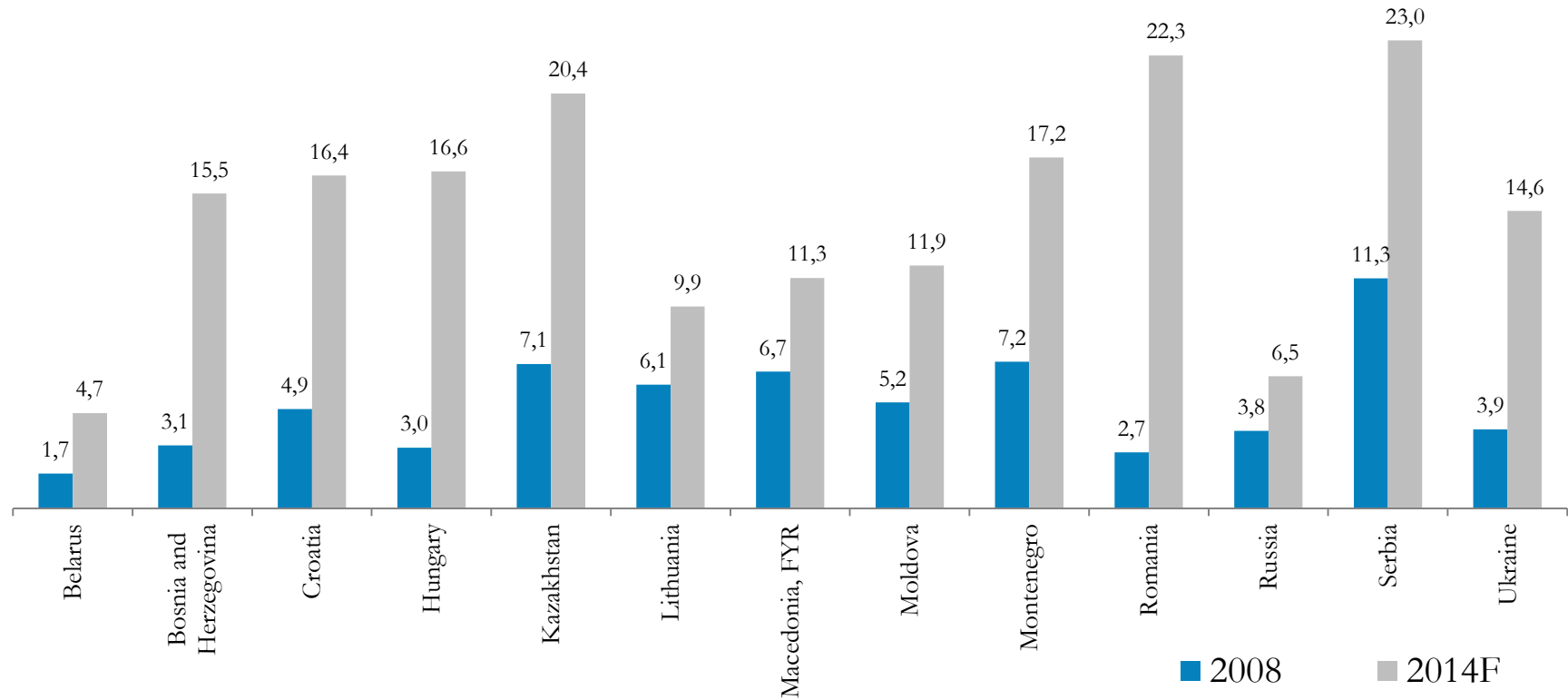
DECLINING LEVELS OF LENDING: CREDIT TO PRIVATE SECTOR (% CHANGE, YEAR-ON-YEAR)



Source: national central banks, Raiffeisen RESE/ARCH

... and lower credit quality

RISING LEVELS OF GROSS NPLS (AS A % OF TOTAL LOANS)



Source: IMF

C The best of both worlds: transparent plumbing serving a sustainable development model for the real economy

The best of both worlds: what kind of financial system do we want for the 25 years to come?

1

Move beyond the traditional debate domestic vs. international

2

Strengthen domestic banks in order to serve countries' developmental objectives

3

Foster in a sound manner a more diverse foreign participation

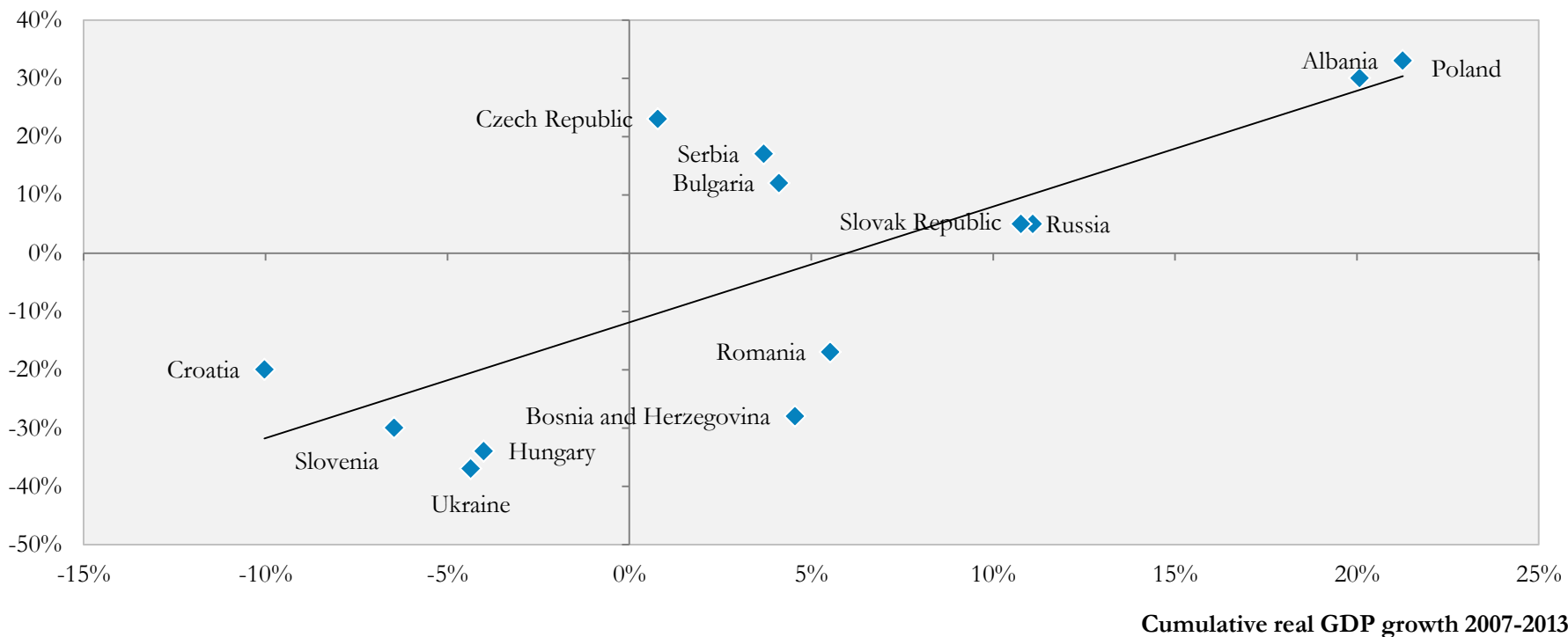
1

Move beyond the traditional debate domestic vs. international

Foreign banks are gaining experience, differentiating between countries and increasingly linking lending to country fundamentals

CHANGE IN CROSS-BORDER EXPOSURES BETWEEN 2007 AND 2013⁽¹⁾:

Change in banks' cross-border exposures 2007-2013

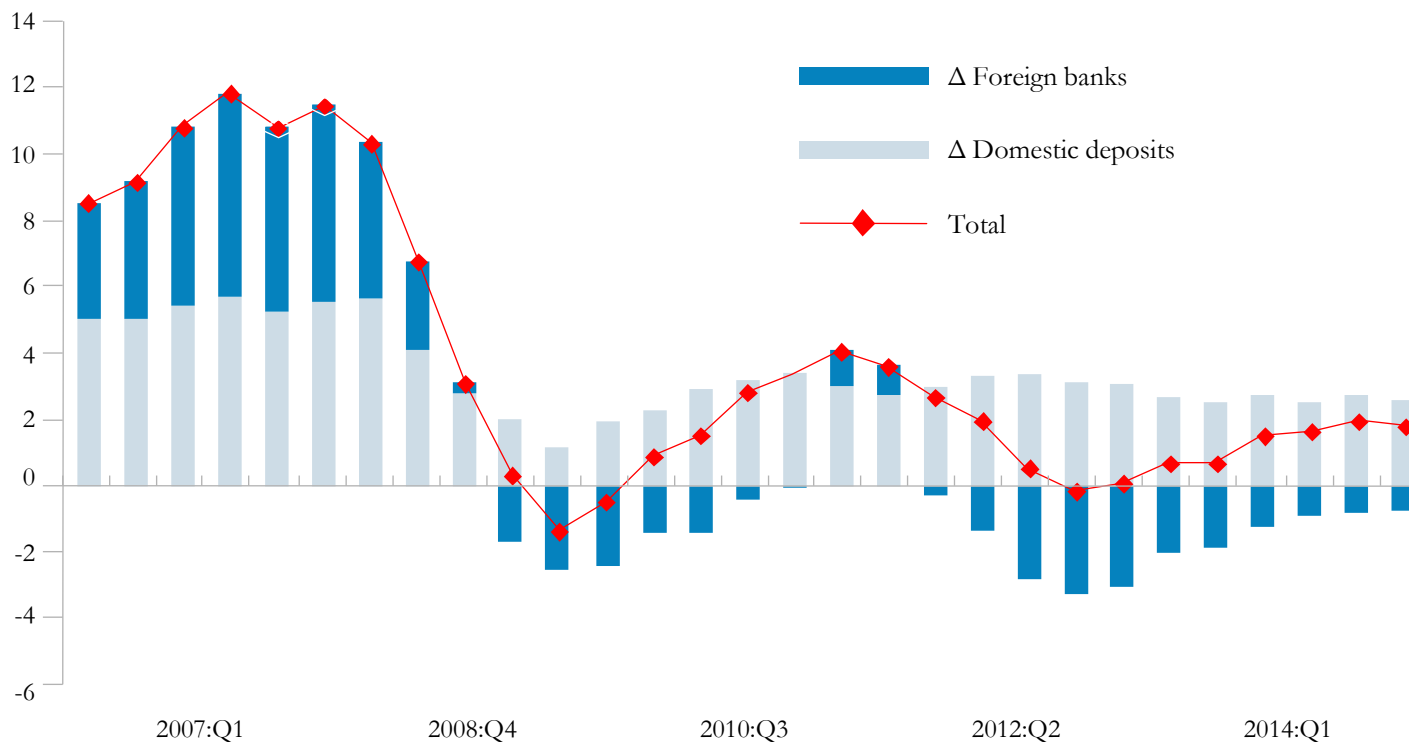


Note: (1) Relative change 2007-2013, BIS-reporting European banks, Source: BIS, Raiffeisen Research, IMF

Strengthen domestic banks in order to serve countries' developmental objectives

Domestic deposits have had a countercyclical effect, compensating for the decline in foreign funding

HIGHER RELIANCE ON DOMESTIC DEPOSITS VS. FOREIGN FUNDING – EVOLUTION OF BANKS' FUNDING SOURCES



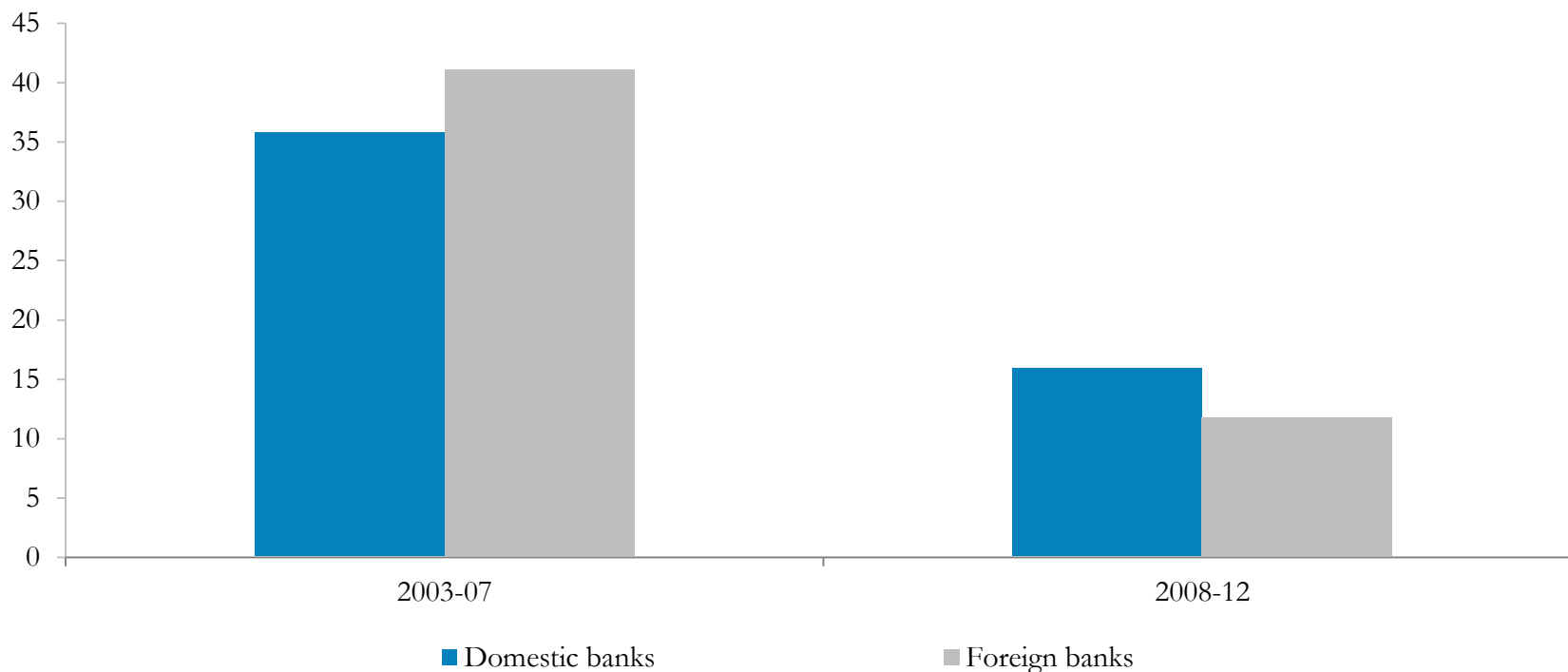
Notes: CESEE excl. Russia and Turkey; year-on-year change in the stock of BIS banks' exposure and domestic deposits in percent of GDP, exchange-rate adjusted. Excludes Latvia prior to 2011:Q3, Montenegro and Kosovo because of data unavailability

2

Strengthen domestic banks in order to serve countries' developmental objectives

Furthermore, domestic banks have played to some extent a countercyclical role and foreign banks a procyclical one in their lending activities

ANNUAL AVERAGE CREDIT GROWTH BY GROUP OF BANKS



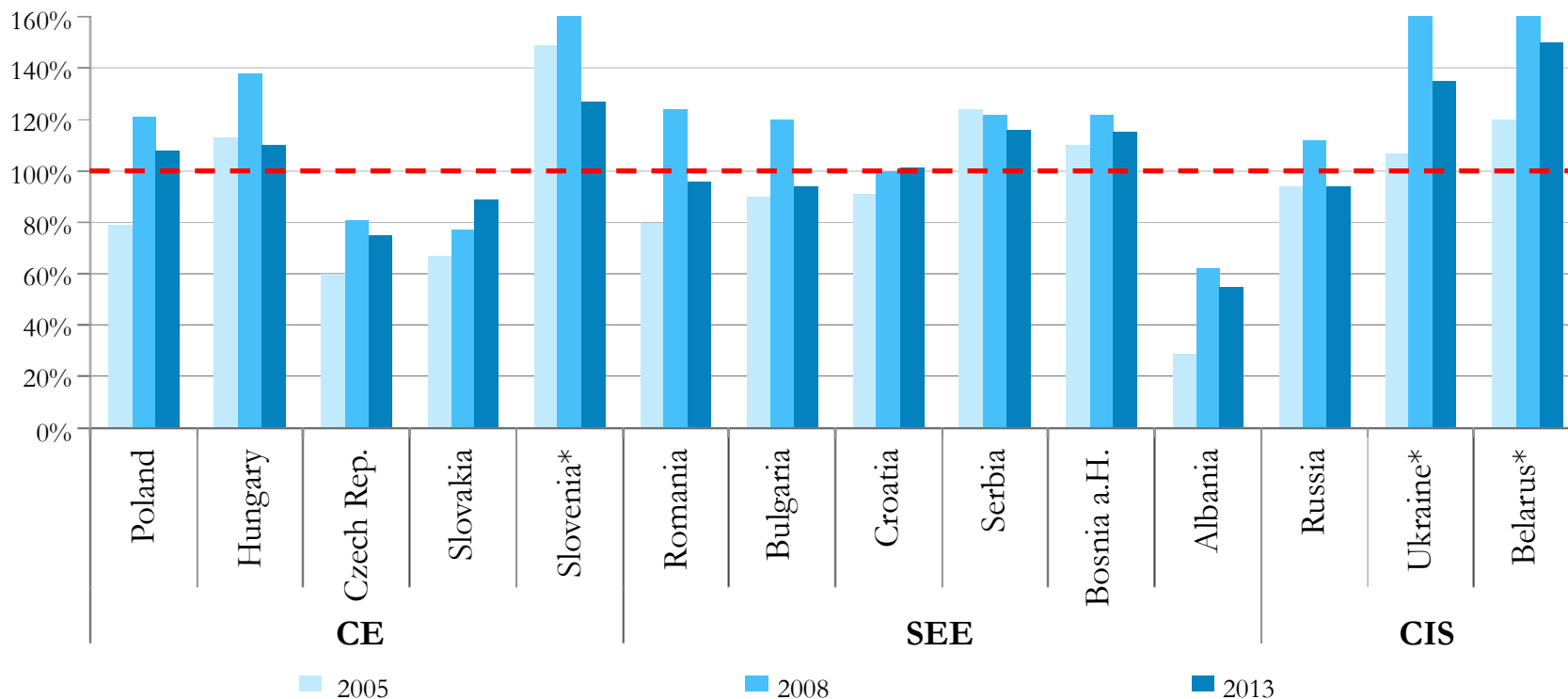
Source: Bankscope, IMF

2

Strengthen domestic banks in order to serve countries' developmental objectives

Lower Loan-To-Deposits ratios increase stability but also cap development opportunities, slowing down the pace of convergence and of transition as a whole

LOANS-TO-DEPOSITS ARE SLOWLY RECOVERING TO THEIR 2005 LEVELS IN MOST COUNTRIES

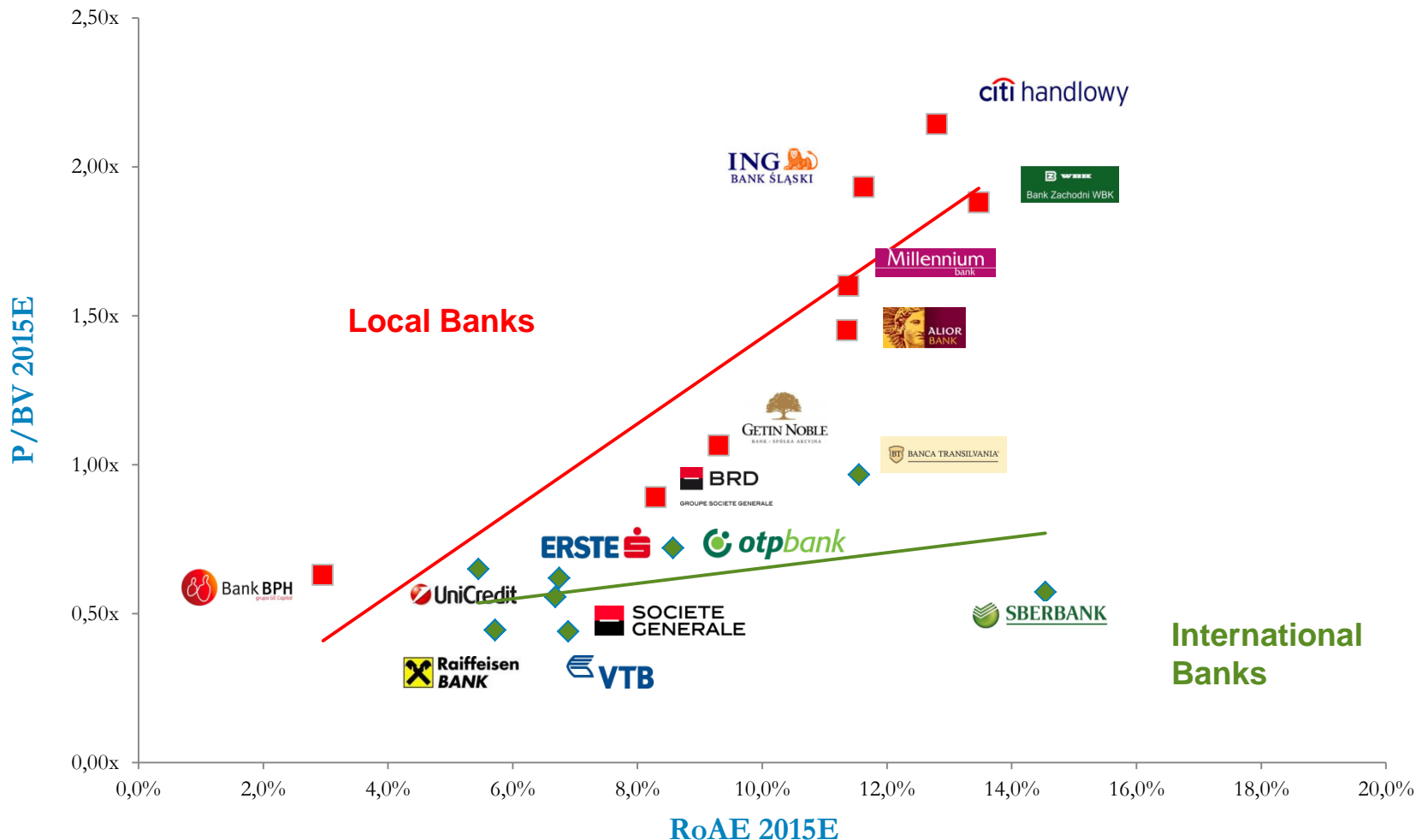


* Slovenia, Ukraine and Belarus in 2008 with L/D ratio values above 160%; SI: 166%, UA: 205%, BY: 171%
 Source: national central banks, Raiffeisen RESEARCH

Strengthen domestic banks in order to serve countries' developmental objectives

Markets seem to discount at this stage banks with international networks vs. local banks

P/BV VS. ROAE FOR LOCAL AND INTERNATIONAL BANKS

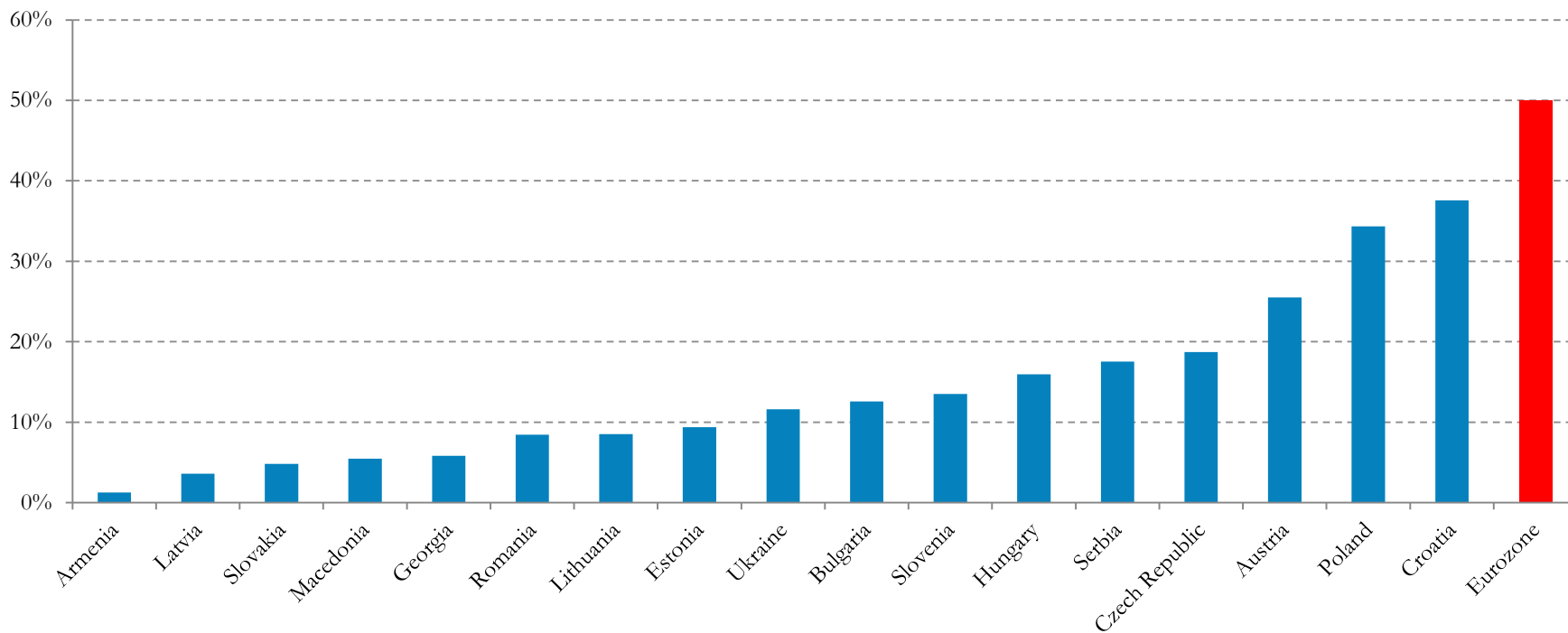


Foster in a sound manner a more diverse foreign participation

Local capital markets are still not large enough to compensate for the deleveraging

SIZE OF CAPITAL MARKETS

- Size of capital markets: c. US\$450bn (equivalent to Austrian GDP)
- Average of 20% of GDP in the region, as opposed to 50% in Eurozone



Source: Bloomberg, World Bank (as of end-2013)

Foster in a sound manner a more diverse foreign participation

With some Western banks retreating from CEE, new types of owners are emerging, calling for adequate regulation

■ Regional consolidators

- Sberbank acquired Volksbank Int'l and Denizbank in 2011/12
- OTP acquired Banco Popolare Croatia in 2014 and Banca Millenium Romania from BCP en 2014



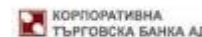
■ Domestic investors

- Otkritie acquired a 20% stake in Nomos Bank (Aug 2012) with the aim to consolidate 100% in the coming two years
- Ukrainian Smart Group acquired Bank Forum in Q3 2012
- MK Group in Serbia purchased a majority stake in AIK Banka



■ Sovereign Wealth Funds

- SWF of Oman bought a 30% stake in Bulgarian Corporate Commercial Bank
- QIA invested c.\$1bn in VTB as part of a c.\$3bn investment by a group of institutional investors



- **Private Equity:** PE funds are restricted as bank investors in some jurisdictions (e.g. Poland only allows minority stakes); though in some situations they have been allowed to buy smaller banks

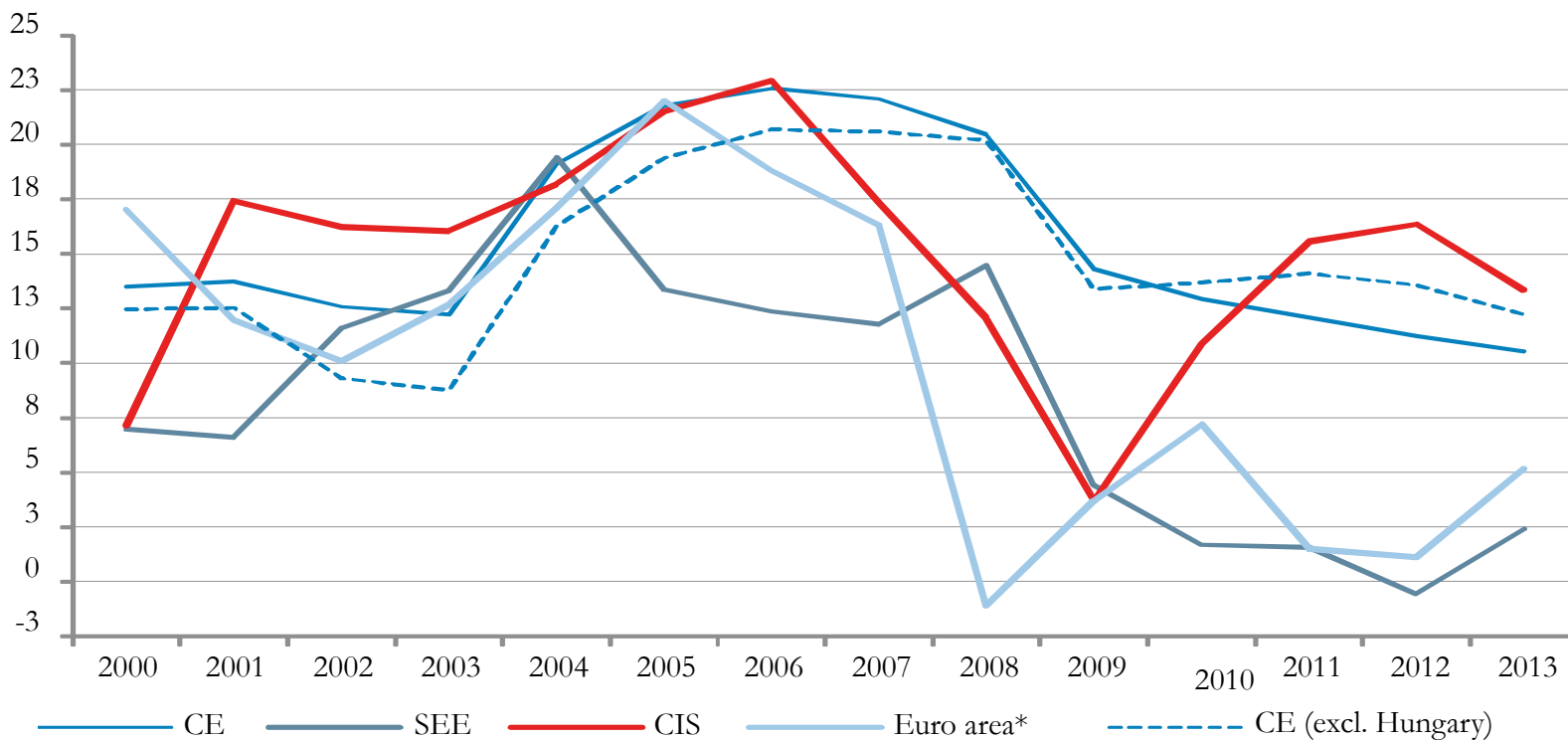
- Dexia Banka Slovensko was bought by Penta Investments in 2011



Foster in a sound manner a more diverse foreign participation

Bank profitability is still stronger in CE and CIS countries than in the Eurozone, thus providing interesting acquisition opportunities for focused players

LONG-TERM RETURNS ON EQUITY (%)



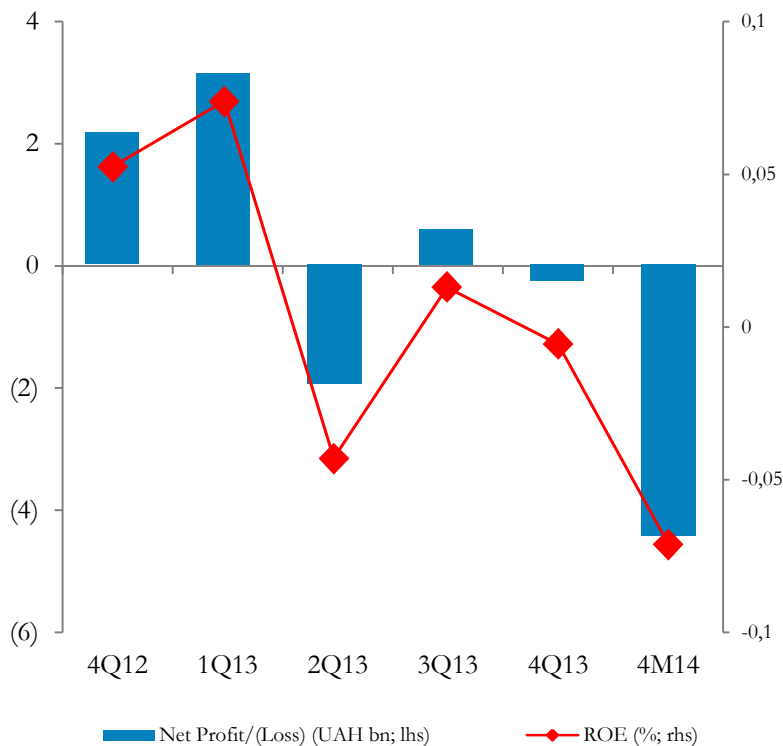
* H1 2013 data for euro area

Source: national central banks, Raiffeisen RESEARCH

The future starts today: Ukraine's banking sector shows most graphically the extent of what needs to be done in the near future

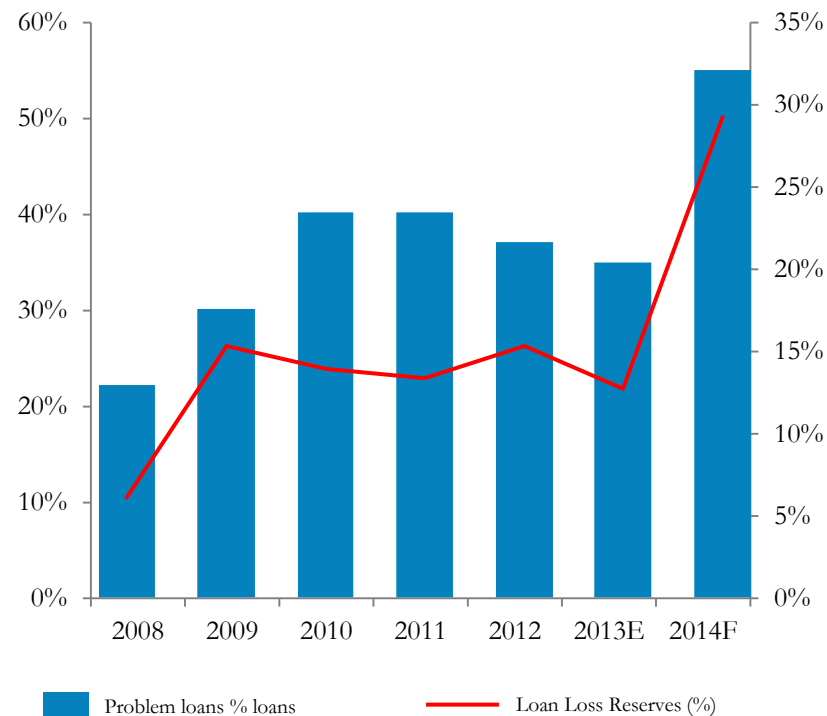
Declining profitability and soaring levels of low-quality loans are yet but the tip of the iceberg

NET PROFITABILITY OF BANKS



Source: Moody's Research

NPL'S REMAINED HIGH IN 2013, AND ARE EXPECTED TO FURTHER INCREASE IN 2014



Source: National Bank of Ukraine, Moody's estimates