



THE CURRENT STATE AND FUTURE PROSPECTS  
FOR THE CEE FINANCIAL SECTOR

# CEEC Financial Sector Issues and Macroeconomic Policy

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# Summary

- Identifying financial sector commonalities between CEECs
- Dimensions of the appropriate policy response
- Challenges in financial sector development





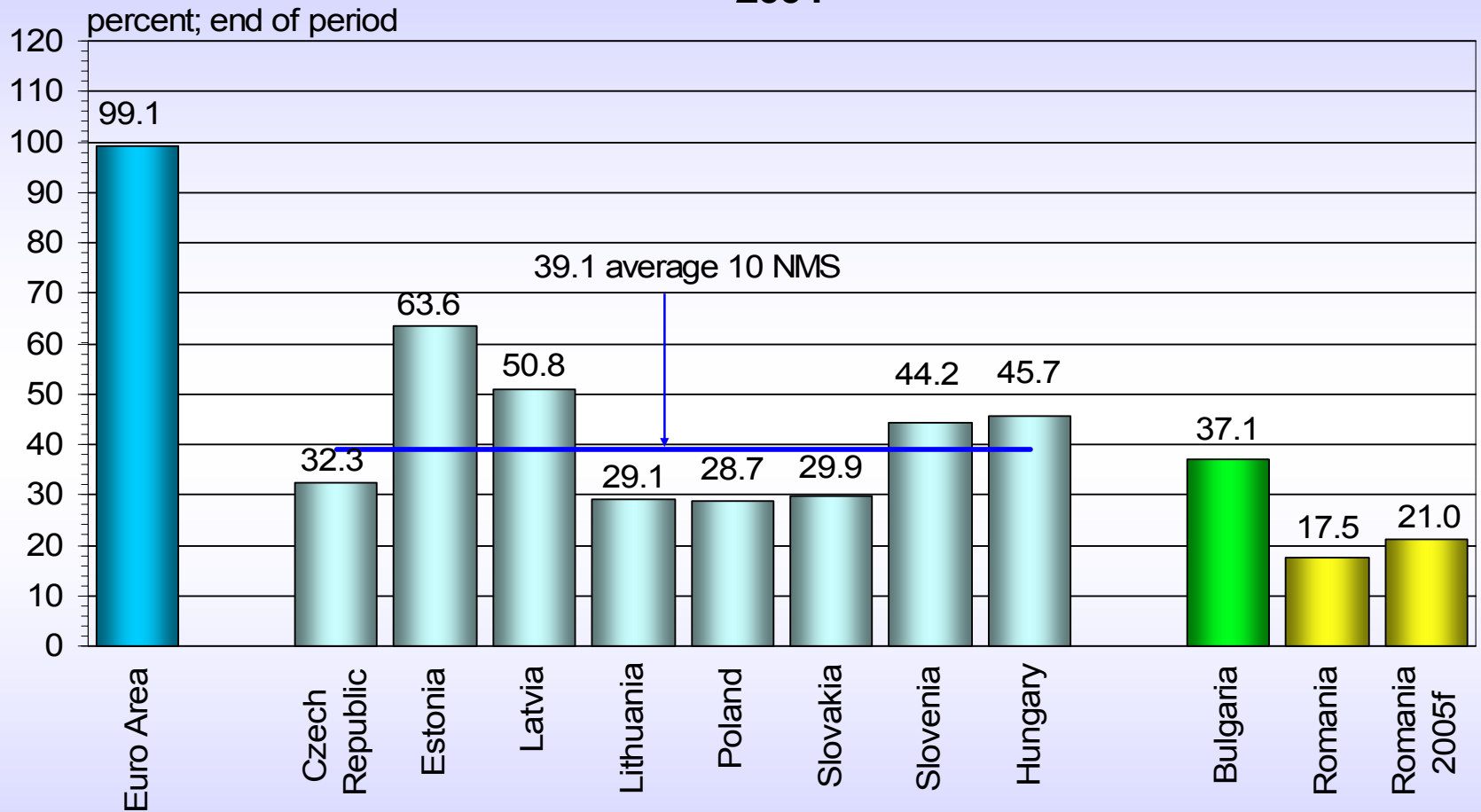
# 1. CEEC Financial Sector Salient Features

- Relatively small financial sector size/depth, rapid growth of intermediation
  - previous crises, clean-ups
  - household credit boom, in some cases also forex credit
- Small open economies in increasingly globalized environment: substantial role of foreign capital
  - as domestic market players/suppliers of financing for domestic credit expansion
  - regional market perspective
  - lack of obvious stable niches for domestic players
- Important asymmetries persist:
  - between financial sector components (underdevelopment of capital markets, insurance)
  - later development of longer-term credit
  - degree of euroization (attendant prudential problems, short horizon of risk perception)
- Incompletely exploited efficiency gains & niches
  - high transaction costs (spreads, etc.)
  - limited diversification (products as well as risks)
- Similarities with other EMs; EU/EMU integration endpoint & likelihood of appropriate policy adoption (regulatory convergence, policy anchor)





# Financial Intermediation\* 2004



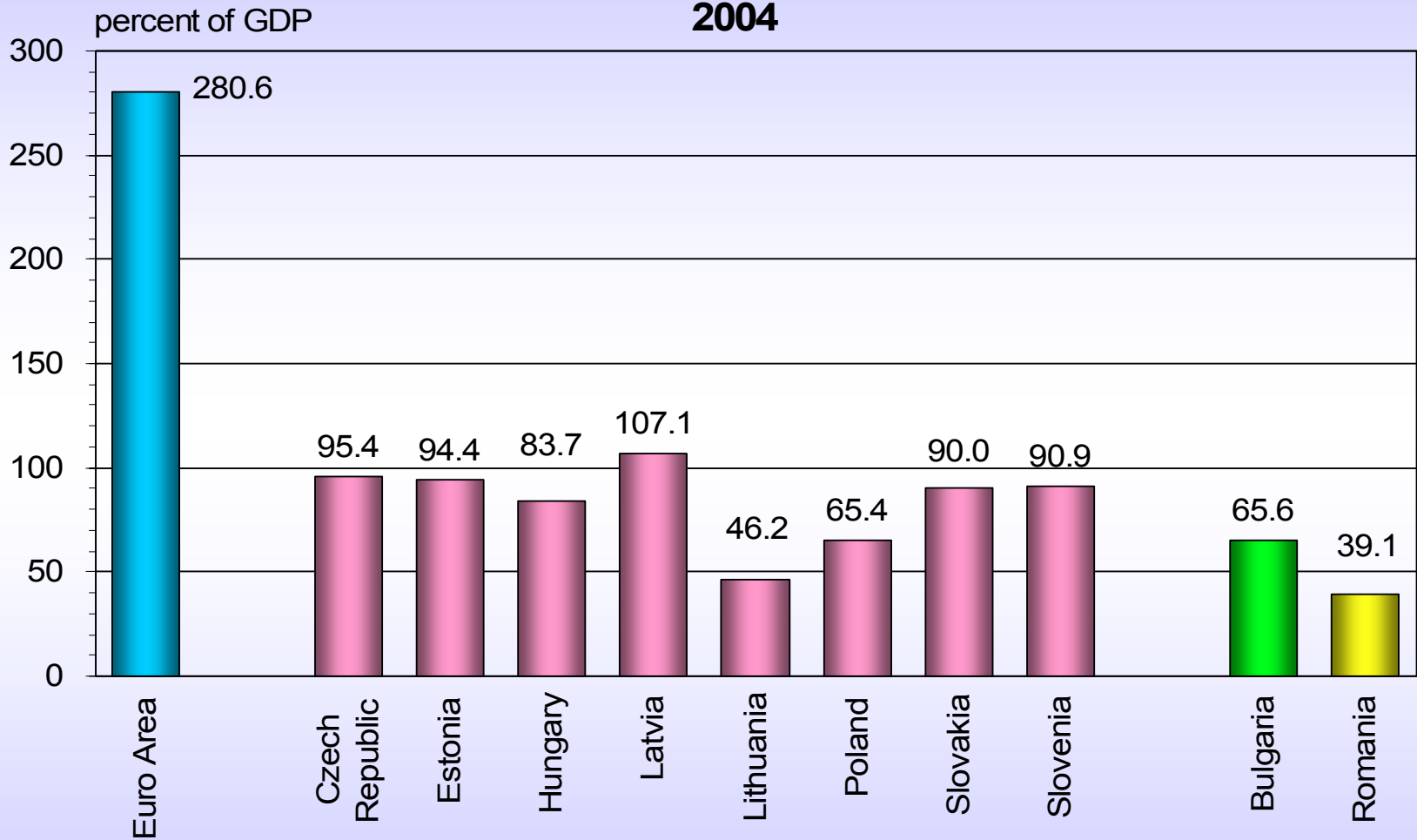
Source: EUROSTAT;  
for Romania: National Bank of Romania, National Institute of Statistics

\*) non-government credit/GDP





# Bank Assets 2004

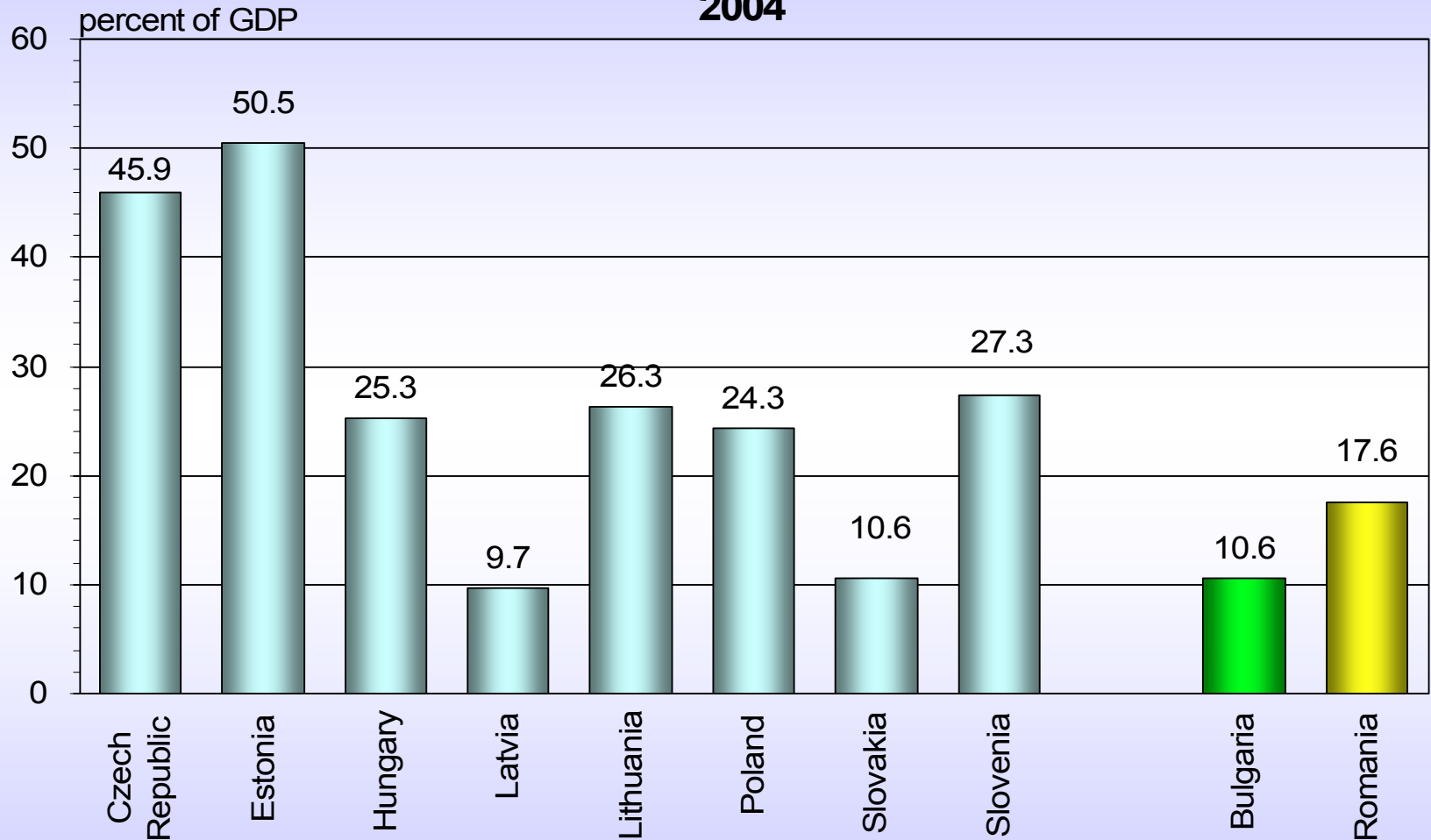


Source: Websites of central banks and EUROSTAT





## Stock Market Capitalisation 2004

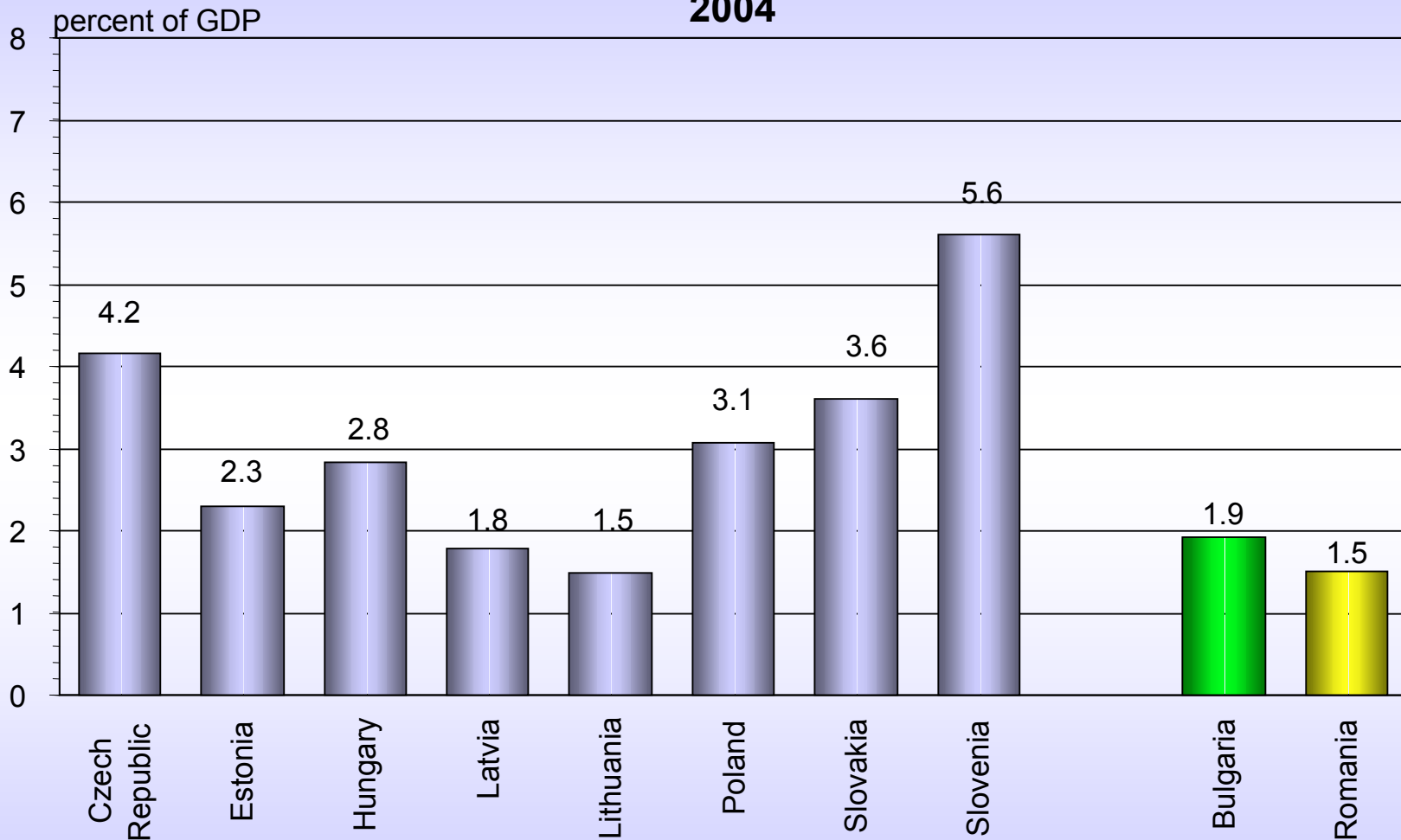


Source: Websites of stock exchanges, EUROSTAT, NIS, BSE, RASDAQ





# Insurance Premia 2004



Source: Swiss Re





## 2. The Appropriate Policy Response

- Baseline: managing dynamics of intermediation with view to maintaining main macroeconomic equilibria (given high procyclicality)
- Limits to use of traditional monetary/exchange rate policy instruments
- Complementarity between price stability and financial stability objectives: need for support for traditional monetary policy instruments from prudential and administrative measures (though 2<sup>nd</sup> best)
- Importance of other components: fiscal, wage, structural







# 3. Challenges in Financial Sector Development

- Measures to slow credit growth may have negative impact on the real convergence process, possible perverse effects (stimulation of potentially volatile capital inflows)
- Effectiveness of market-based policy instruments is dependent upon deeper financial intermediation and increasing sophistication of financial sector
- Efficiency of administrative measures may prove short-lived as capital mobility allows banks to circumvent them, incl. by direct borrowing abroad
- Need for diversification vs. organic development of capital markets & insurance components

