



CESEE Deleveraging and Credit Monitor¹

June 15, 2022

Key Developments in Portfolio Flows, BIS Banks' External Positions, and Domestic Credit

Portfolio flows to CESEE countries have come under pressure but remained largely resilient so far amid geopolitical uncertainty and rising global yields. BIS banks have maintained their cross-border exposures to the region and international banking groups continue to see market potential in most CESEE countries but the war in Ukraine is worsening expectations. Credit growth to the private sector has remained stable over the last six months but banks are signaling a turning point with credit tightening expectations gradually emerging.

Portfolio flows to Central, Eastern, and Southeastern Europe (CESEE) have come under pressure amid geopolitical risks and rises in global yields but have remained largely resilient.² Following the Russian invasion of Ukraine, flows became highly volatile and reversed for some economies. After a continued period of sustained bond inflows since June 2020, CESEE bond funds experienced monthly redemptions over the last six months reflecting flight-to-quality dynamics amid expectations of global policy normalization. However, monthly average bond outflows through the end of April 2022 at US\$ 0.6 billion were far smaller than the US\$ 9 billion outflow recorded in March 2020 (Figure 1). After some bouts of volatility in the wake of the war in Ukraine, CESEE equity funds have seen positive equity inflows on net over the last six months at an average pace of US\$ 0.2 billion monthly (Figure 2). The resilience of portfolio flows in the CESEE has defied expectations of a market turmoil supported by hiking cycles in the region which have created attractive risk compensation and by a more stable investor base. Looking ahead, tighter external financial conditions on the back of monetary normalization in advanced countries and heightened geopolitical uncertainty is likely to increase downside risks for portfolio flows to the CESEE region. The IMF estimates that capital flows at risk in emerging markets have

¹ Prepared by the staff of the international financial institutions participating in the Vienna Initiative's Steering Committee. It is based on the BIS Locational Banking Statistics and the latest results of the EIB Bank Lending Survey for the CESEE region.

² Data is sourced from the Emerging Portfolio Fund Research (EPFR) Global database which contains fund data for publicly available open-end funds, closed-end funds and exchange-traded products (ETPs).

increased over the last six months with potential headwinds from a possible sharp rise in US term premia or further rise in risk aversion.³

The gradual pace of BIS banks' deleveraging in the CESEE region has reversed in the last quarter of 2021 despite geopolitical uncertainties, the Omicron variant, and concerns over inflation risk. Overall foreign claims of BIS banks⁴ in the region stood at US\$581 billion in 2021Q4, 1.3 percent higher than a year earlier (Figure 3 and Table 1), reversing the trend of moderate deleveraging that started in 2018Q3. This exposure corresponded to 11.9 percent of the region's GDP, which stood somewhat below pre-pandemic levels of 13.2 percent, and markedly down from the 18.8 percent peak reached in 2015 before the latest deleveraging cycle started. While the significant retrenchment of BIS banks' exposure to Turkey that started in 2018Q3 had slowed down during the first three quarters of 2021, it accentuated during the last quarter with cross-border claims decreasing by 7.3 percent year-on-year. During 2021H2, the largest increase in BIS banks' exposure was observed in the Czech Republic where cross-border claims rose by US\$14.1 billion (5.0 percent of GDP) driven by a surge in bank assets (Table 2).

As of December 2021, BIS banks continued to be mostly exposed to Turkey, Poland, Czech Republic, and Russia. Foreign bank funding to Turkey stood at US\$123 billion, or about a fifth of the BIS-reporting banks' exposure to CESEE (Figure 4). After Turkey, BIS-reporting banks are mostly exposed to Poland (US\$102 billion), Czech Republic (US\$95 billion), and Russia (US\$89 billion), among CESEE countries (Table 1). On a consolidated basis, the country with the largest exposure to Turkey is Spain (US\$53 billion), followed by France (US\$23 billion), Germany (US\$13 billion), and the United States and the United Kingdom (US\$11 billion each) (Figure 5).

Around half of CESEE countries experienced funding reductions from BIS banks in 2021H2. BIS banks reduced their exposure most notably to Turkey by -US\$5.6 billion (-0.7 percent of GDP), Estonia by -US\$2.5 billion (-6.9 percent of GDP), Slovenia by -US\$2.3 billion (-3.8 percent of GDP), and Croatia by -US\$2.2 billion (-3.3 percent of GDP) (Table 2). Scaled by the size of the receiving economy, outflows exceeded 1 percent of GDP in six countries: Estonia, Slovenia, Croatia, North Macedonia, Lithuania, and Belarus (Figure 6). In these countries, funding reductions on claims on banks reinforced credit reduction to non-banks (Figure 7). Among the largest funding reductions, negative flows were driven by decreased claims on banks in most

³ Global Financial Stability Report (2022), "The Financial Stability Implications of the War in Ukraine", Chapter 1, April.

⁴ The sample includes banks in Australia, Austria, Bahrain, Belgium, Bermuda, Canada, Cayman Islands, Chile, China, Cyprus, Denmark, Finland, France, Germany, Greece, Guernsey, Hong Kong SAR, India, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Luxembourg, Macao SAR, Malaysia, Mexico, Netherlands, Norway, Panama, Philippines, Portugal, Russia, Singapore, South Africa, Spain, Sweden, Switzerland, Taiwan Province of China, Turkey, the United Kingdom, and the United States. This note uses terms "BIS-reporting banks" and "Western banks" interchangeably, as CESEE financial linkages with non-European banks are negligible.

countries whereas, in Slovenia, the reduction in cross-border claims on non-banks (-2.3 percent of GDP) exceeded the decrease in claims on banks (-1.5 percent of GDP).

Looking at the evolution of foreign claims as a share of GDP of the recipient economy, BIS banks stabilized their exposure to the region in 2021Q4, while balance of payment (BoP) data suggests positive cross-border inflows. During the last quarter of 2021, BIS external funding to all sectors remained broadly stable across the region with increased cross-border funding in some countries offsetting funding reductions in other countries. BOP data paints a slightly different picture with movements in 'other investment flows', which include cross-border bank financing, showing an increase in liabilities at an average growth rate of 1.5 percent of GDP (Figure 8). The largest increase in BoP liabilities was registered in Slovakia (15.6 percent of GDP) followed by Lithuania (5.0 percent of GDP). For several countries (Slovak Republic, Montenegro, and Lithuania), the difference between BoP flows and changes in BIS banks' external exposure is sizeable, suggesting additional inflows from sources other than BIS reporting banks (e.g., deposits from non-residents, trade credit, other loans). For countries like North Macedonia and Croatia, both BoP data and BIS data point at cross-border outflows.

Bank lending continued to increase in the first months of 2022 supported by the economic recovery and fueled by inflationary pressures but the war in Ukraine may ease credit growth going forward. (Figure 9). Overall credit growth in the region, excluding Russia and Turkey, remained stable over the last six months at around 8.4 percent year-on-year. However, this trend masks significant cross-country variation partly reflecting differences in inflation spikes across the region. In Turkey, credit growth to the private sector doubled from 11 percent in November 2021 to 24 percent in April 2022 on the back of accelerated inflation which jumped to a two-decade high in April exceeding 60 percent. In Russia, credit growth remained stable at around 17 percent during the six months preceding the invasion of Ukraine in March 2022. Focusing on credit developments in April, lending to households and corporates remained resilient in most CESEE countries but Latvia experienced a contraction in lending to enterprises, and the rate of household credit growth significantly outpaced corporate credit in Ukraine and Moldova (Figure 10).

Key Messages – EIB CESEE Bank Lending Survey: Spring 2022⁷

The EIB CESEE Bank Lending Survey (BLS), covering the period October 2021 to March 2022 and expectations for the period April 2022 to September 2022, analyses the lending activity trends in the CESEE region and the attitude of cross-border banking groups towards the region. It finds that cross-border banking groups operating in CESEE continue to see high or medium market potential in most of the region's banking markets, but the war in Ukraine is worsening expectations. Banks are signaling a potential tightening of credit supply in the next months — with small to medium-sized firms (SMEs) and corporates hit the hardest — and a possible deterioration of credit quality.

Following a positive trend in credit supply, credit demand, funding and credit quality during the last months, **local subsidiary banks in the region** are signaling a turning point (see Figure 13) in which the geopolitical uncertainty is negatively influencing banks' expectations.

- **Demand** from banks' clients is expected to remain resilient, but it is expected to be more tilted towards firms' liquidity needs (in other words, higher working capital) and less towards longer-term fixed investments.
- So far, the ample policy response to COVID-19 has prevented harsh deleveraging. Nonetheless, a credit tightening on the **supply** side is gradually emerging as a prevailing approach. Such deterioration of credit supply expectations is widespread across segments but appears more relevant for small and medium-sized enterprises (SMEs) and large corporates.
- **Funding conditions**, which were supported by strong corporate and retail funding, are expected to be less favorable.

The results of the CESEE Bank Lending Survey help to anticipate the possible impact of the war in Ukraine on the region's banking market and on the availability of credit for companies and households.⁸ The information was collected at the end of March 2022, and hence incorporates expectations related to the war (but does not account for potential policy responses across the region that may cushion the war's impact).

Credit quality remained stable during the last months, with no significant spike in non-performing loans (NPLs) due to COVID-19 (Figure 15). The new shock related to war revived negative expectations, possibly taking into account second-round effects on companies (for example, higher costs, supply disruptions, withdrawal of COVID-19 support, etc.).

Regarding the **international banking group strategies**, the exposure to CESEE countries has been maintained or increased during the last six months (Figure 17). This is also due to the higher profitability of CESEE subsidiaries: Return on Assets (RoA), after temporary reduction aftermath of Covid-19 shock, were above Group for vast majority of Banking Groups. Cross-border banking

⁷ A full report with regional and country chapters of the EIB Spring 2022 CESEE Bank Lending Survey will be published in June 2022 on the EIB dedicated webpage <http://www.eib.org/about/economic-research/surveys.htm>.

⁸ Russia and Ukraine are not covered by the current run of the survey.

groups continue to see high or medium market potential in most of the region's banking markets, albeit some erosion in expectations due to the war, with the highest potential seen in Poland, the Czech Republic, Hungary, and Romania. Despite some top banking groups in the region are also having a direct presence in Russia, Belarus or Ukraine, no reduction of operations in CESEE is envisaged at this stage. They rather signal positive strategic intentions towards their regional operations: two-thirds of banking groups intend to maintain operations in the region, while one-third expect to selectively expand operations in certain countries.

Figure 1. CESEE: Monthly Portfolio Flows, January 2015-April 2022
(Billions of US\$)

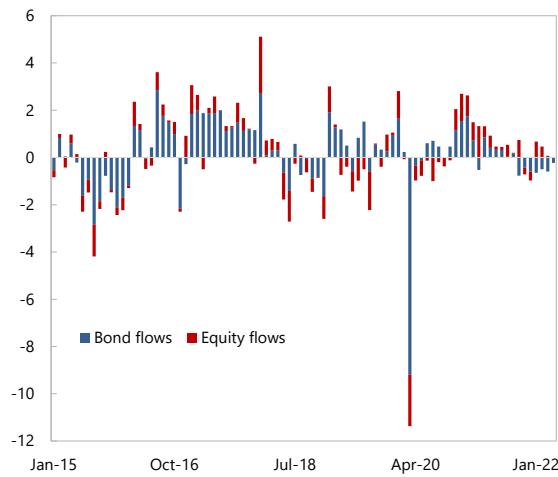


Figure 2. CESEE: Cumulative Portfolio Flows
(Billions of US\$; cumulative weekly flows from April 4, 2018 until June 8, 2022)

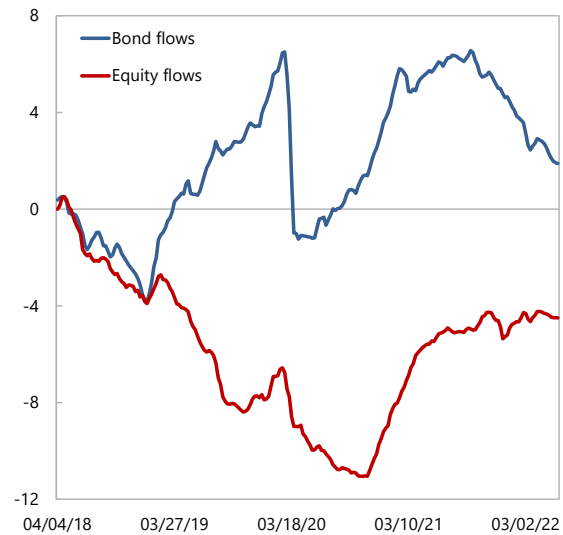


Figure 3. CESEE: External Positions of BIS-reporting Banks, 2007Q1-2021Q4
(Billions of US\$, exchange-rate adjusted, vis-à-vis all sectors)

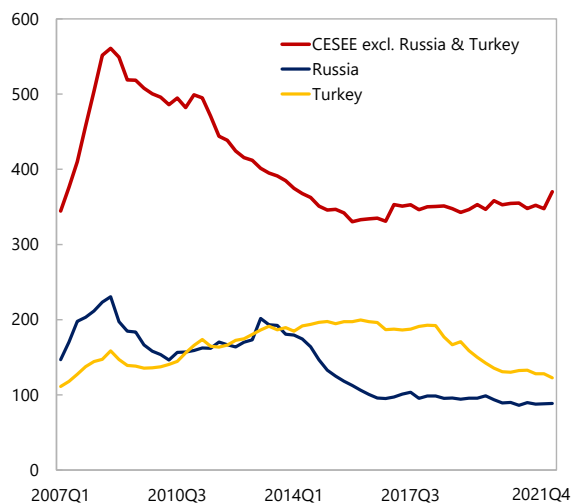
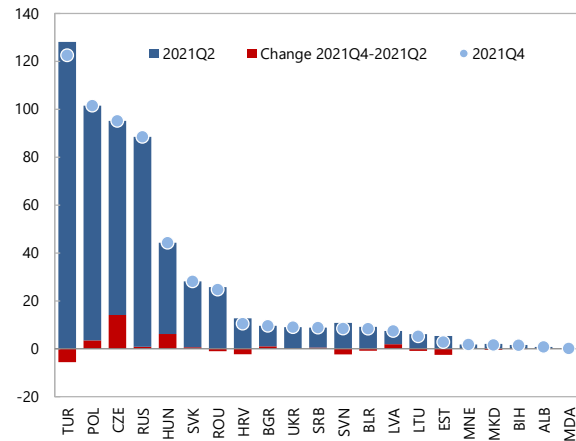


Figure 4. CESEE: External Positions of BIS-reporting Banks, 2021Q2-2021Q4
(Billions of US\$; exchange-rate adjusted, vis-à-vis all sectors)



Sources: BIS, Locational Banking Statistics; EPFR Global; and IMF, World Economic Outlook, and IMF staff calculations.

Note: In Figure 1 and 2 fund flows are net inflows into EM-dedicated investment funds, including mutual funds and ETFs, as reported by EPFR Global. Data labels in the figures use International Organization for Standardization (ISO) country codes.

Figure 5. BIS Reporting Banks: Consolidated Exposure to Turkey, 2021Q4

(Total claims on intermediate counterparty basis, vis-à-vis all sectors; billions of US\$)

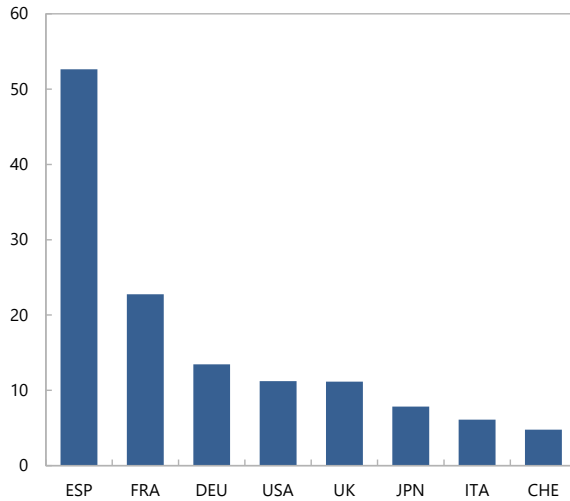


Figure 7. CESEE: External Positions of BIS-reporting Banks, 2021H2

(2021H1 flows as percent of 2020 GDP)

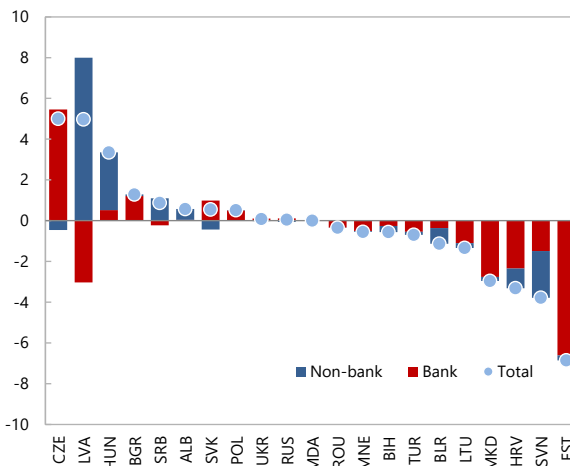


Figure 6. CESEE: External Positions of BIS-reporting Banks, 2021Q3-2021Q4

(Cumulative change from previous quarter; percent of GDP)

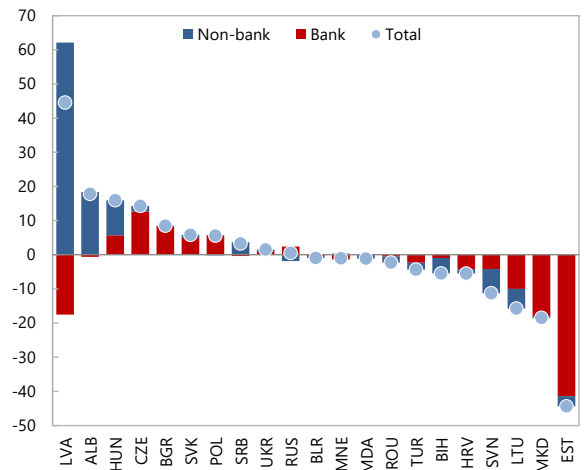
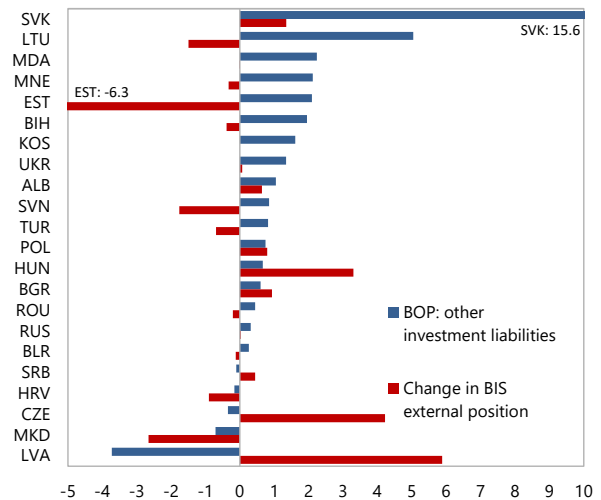


Figure 8. CESEE: Change in BIS External Positions and Other Investment Liabilities, 2021Q4

(Percent of GDP)



Sources: BIS, Locational and Consolidated Banking Statistics; Haver Analytics; and IMF, World Economic Outlook, and IMF staff calculations.

Note: Data labels in the figures use International Organization for Standardization (ISO) country codes.

Figure 9. CESEE: Credit to Private Sector, January 2013–April 2022

(Percent change, year-over-year, nominal, exchange-rate adjusted, GDP-weighted)

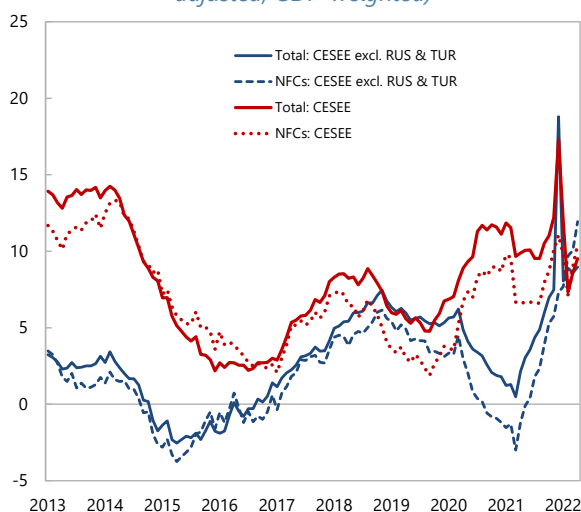


Figure 11. CESEE: Main Bank Funding Sources, 2007Q1–2021Q4

(Percent of GDP, year-on-year, exchange-rate adjusted)

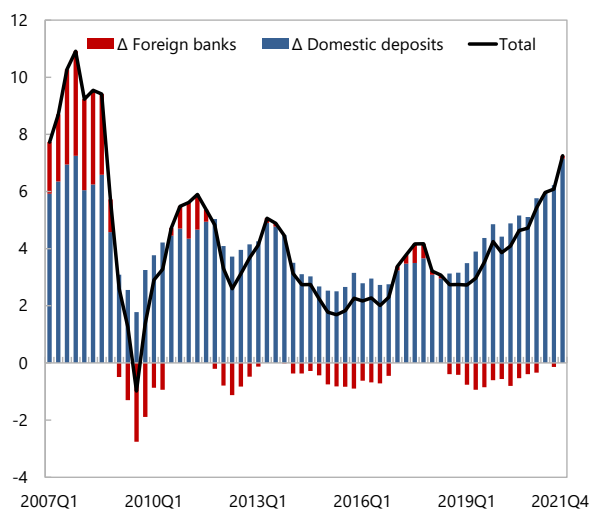


Figure 10. CESEE: Growth of Credit to Households and Corporations, April 2022

(Percent, year-on-year, nominal, exchange-rate adjusted)

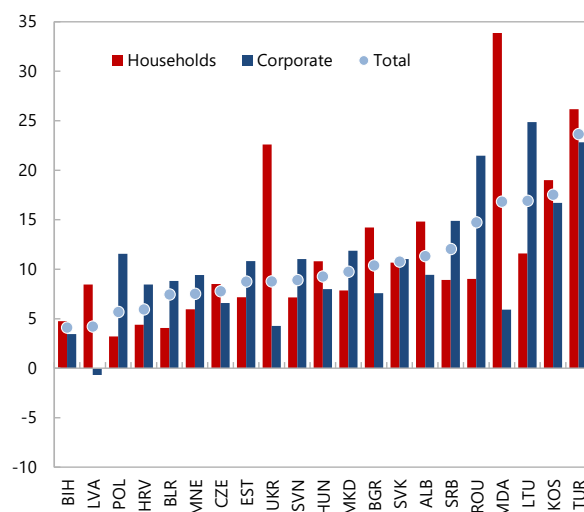
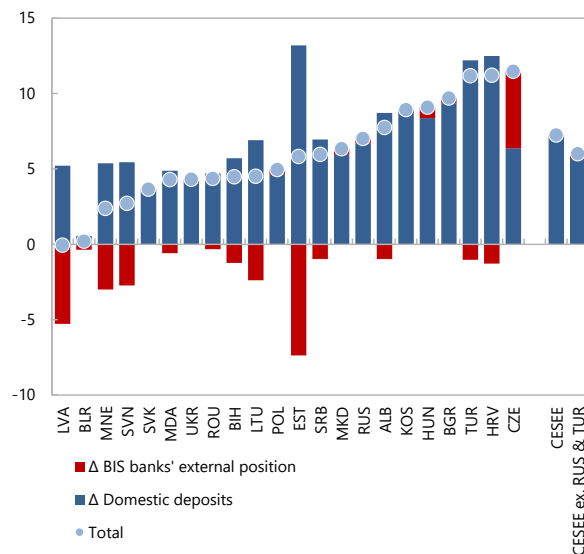


Figure 12. CESEE: Main Bank Funding Sources, 2021Q4

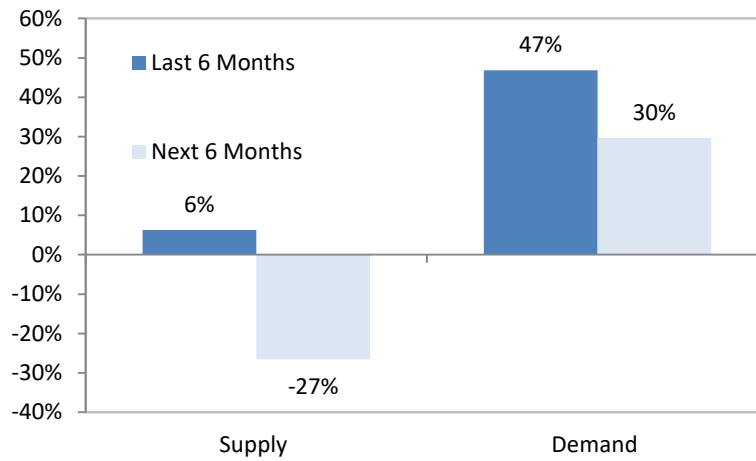
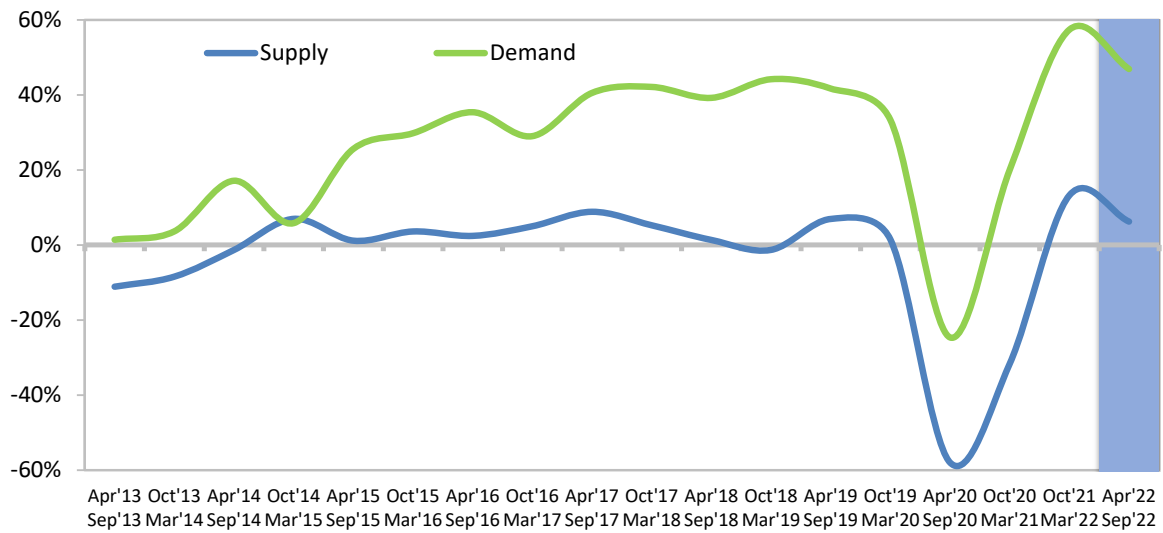
(Percent of GDP, year-over-year, exchange-rate adjusted)



Sources: National authorities; BIS; ECB; EBRD; and IMF, Monetary and Financial Statistics, and IMF staff calculations.

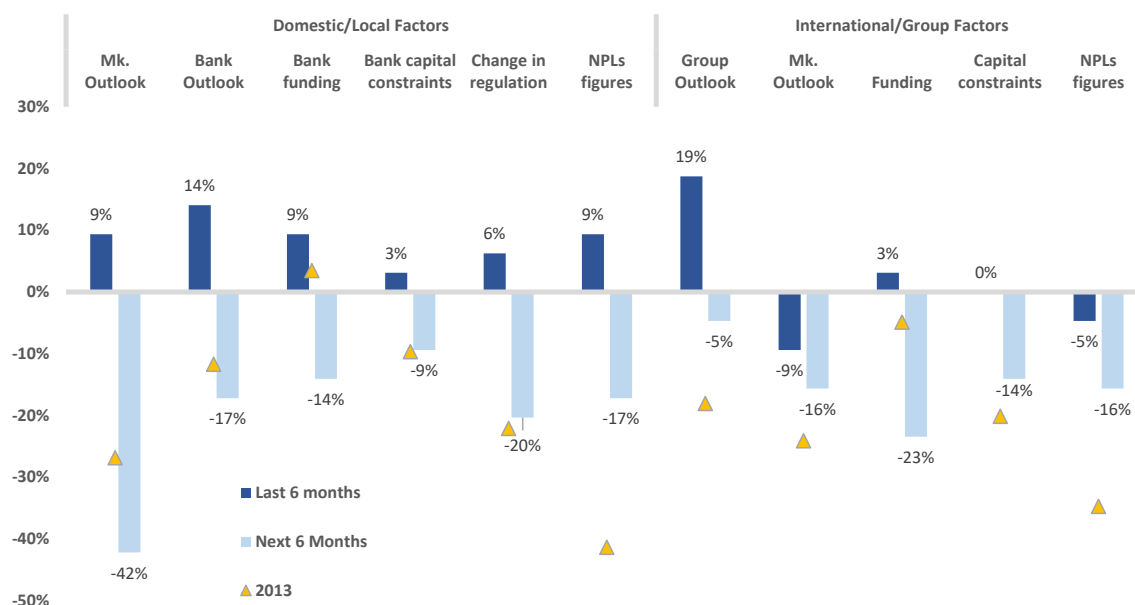
Note: Data labels in the figures use International Organization for Standardization (ISO) country codes. For Panels 1 and 2, Data for Russia is unavailable starting February 2022.

Figure 13. Total Supply and Demand, Past and Expected Development
(Net percentages; positive figures refer to increasing (easing) demand (supply))



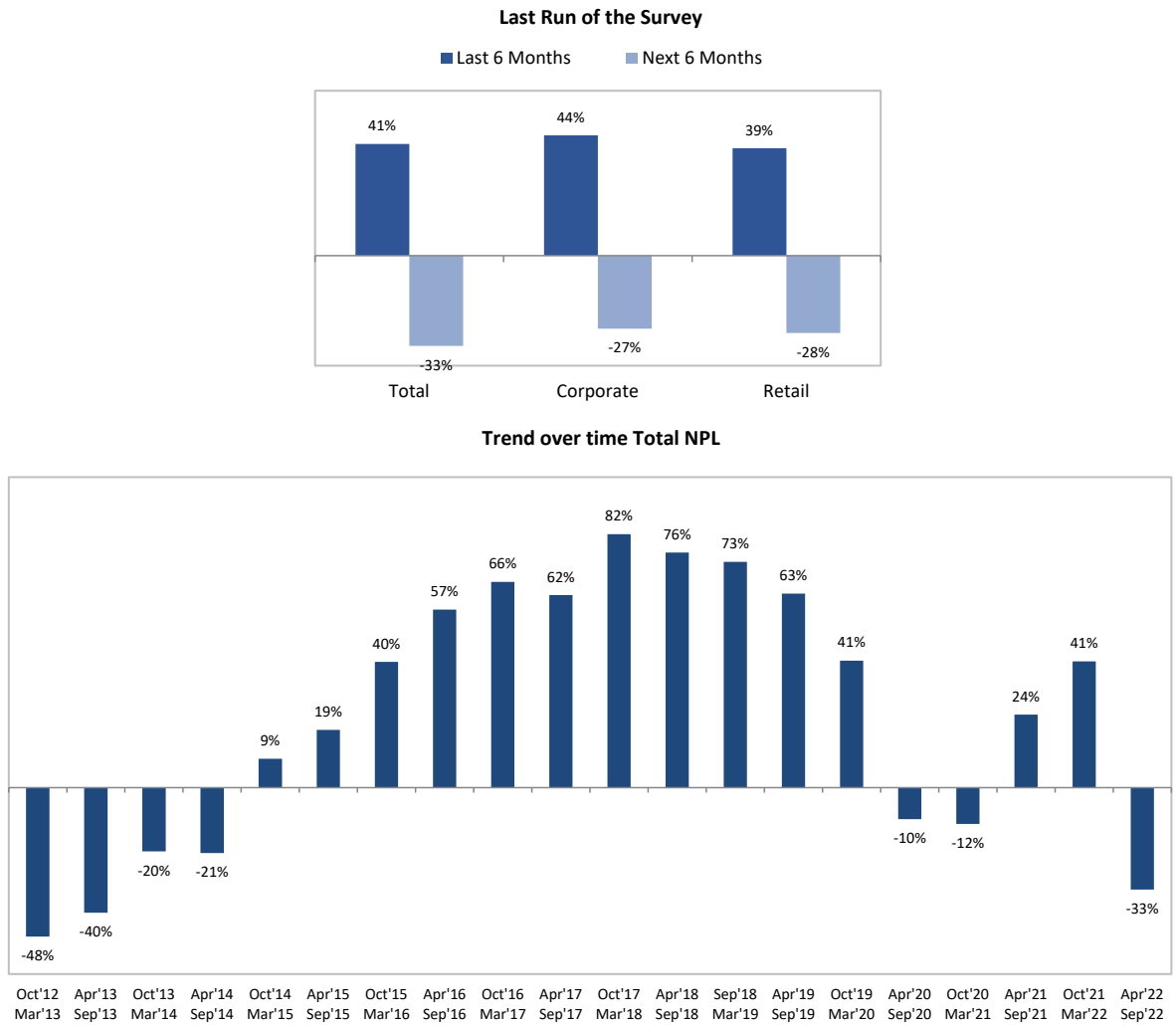
Source: EIB, CESEE Bank Lending Survey.

Figure 14. Factors Contributing to Supply Conditions (Credit Standards)
(Net percentage; positive figures refer to a positive contribution to supply)



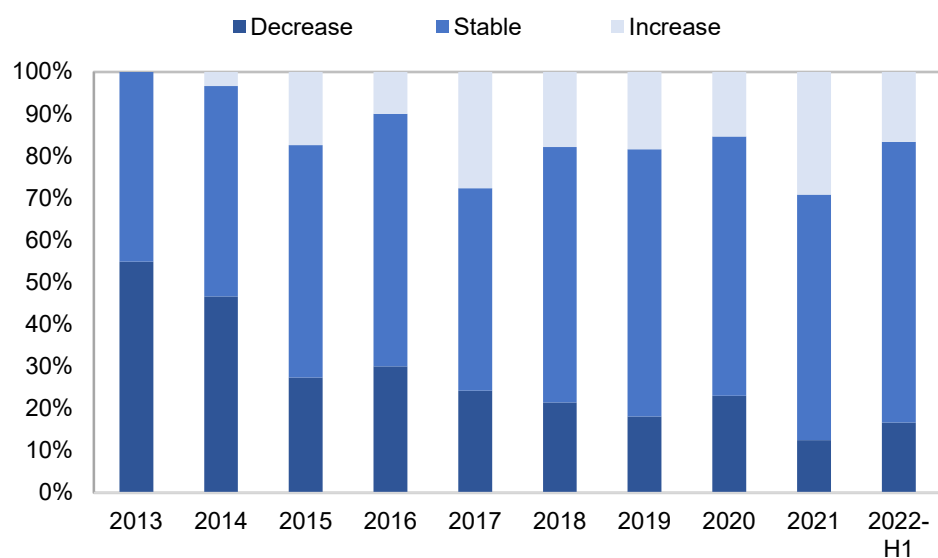
Source: EIB, CESEE Bank Lending Survey.

Figure 15. Non-performing Loan Ratios
(Net percentage; negative figures indicate increasing NPL ratios)



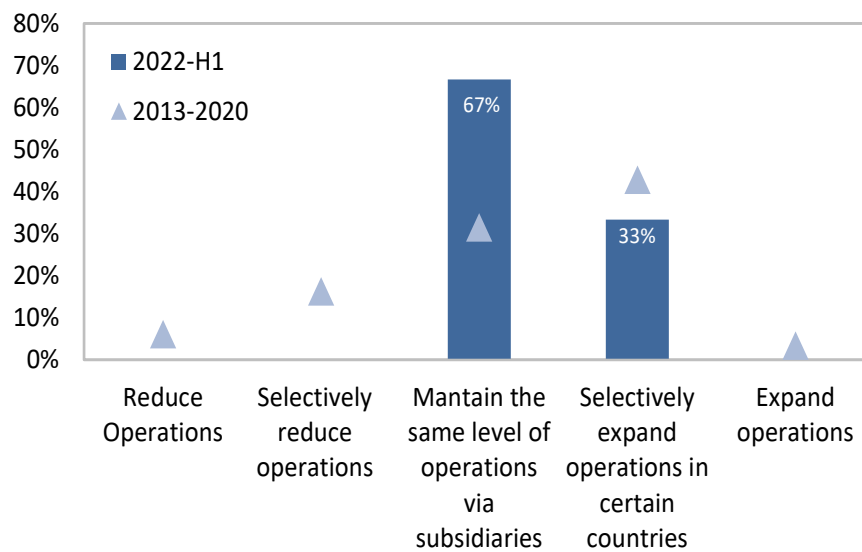
Source: EIB, CESEE Bank Lending Survey.

Figure 16. Deleveraging: Loan-to-deposit Ratio
(Expectations over the next 6 months)



Source: EIB, CESEE Bank Lending Survey.

Figure 17. Group-level Long-term Strategies in CESEE: Beyond 12 Months
(Triangles refer to average outcomes between 2013 and 2020)



Source: EIB, CESEE Bank Lending Survey.

Table 1. CESEE: External Position of BIS-reporting Banks, 2020H1 – 2021H2

(Vis-à-vis all sectors, based on the full sample of BIS-reporting banks)

	2021H2 stocks		Exchange-rate adjusted flows (US\$m)					Exchange-rate adjusted flows (% change)					Exchange-rate adjusted flows (% of GDP)				
	US\$ m	% of GDP	2020H1	2020H2	2021H1	2021H2	Total	2020H1	2020H2	2021H1	2021H2	Total	2020H1	2020H2	2021H1	2021H2	Total
Albania	781	4.3	134	-128	-208	105	-97	15.3	-12.6	-23.5	15.5	-11.0	0.9	-0.8	-1.1	0.6	-0.5
Belarus	8,412	12.3	-254	-354	135	-773	-1,246	-2.6	-3.8	1.5	-8.4	-12.9	-0.4	-0.6	0.2	-1.1	-1.9
Bosnia-Herzegovina	1,499	6.7	-401	-82	-230	-126	-839	-17.2	-4.2	-12.4	-7.8	-35.9	-2.0	-0.4	-1.0	-0.6	-4.0
Bulgaria	9,622	12.0	111	595	-917	1,034	823	1.3	6.7	-9.6	12.0	9.4	0.2	0.9	-1.1	1.3	1.2
Croatia	10,476	15.4	-867	-1,344	1,032	-2,249	-3,428	-6.2	-10.3	8.8	-17.7	-24.7	-1.5	-2.3	1.5	-3.3	-5.7
Czech Republic	95,199	33.7	-1,365	-4,441	-409	14,116	7,901	-1.6	-5.2	-0.5	17.4	9.1	-0.6	-1.8	-0.1	5.0	2.5
Estonia	2,842	7.8	293	-543	-174	-2,487	-2,911	5.1	-9.0	-3.2	-46.7	-50.6	1.0	-1.8	-0.5	-6.9	-8.1
Hungary	44,269	24.0	6,843	-3,901	3,793	6,194	12,929	21.8	-10.2	11.1	16.3	41.3	4.4	-2.5	2.1	3.4	7.3
Latvia	7,435	19.1	106	183	-1,766	1,937	460	1.5	2.6	-24.3	35.2	6.6	0.3	0.5	-4.5	5.0	1.3
Lithuania	5,228	8.0	95	727	-869	-876	-923	1.5	11.6	-12.5	-14.4	-15.0	0.2	1.3	-1.3	-1.3	-1.2
North Macedonia	1,626	11.7	32	-30	469	-411	60	2.0	-1.9	29.9	-20.2	3.8	0.3	-0.2	3.4	-3.0	0.4
Moldova	174	1.3	-5	-3	-101	0	-109	-1.8	-1.1	-36.7	0.0	-38.5	0.0	0.0	-0.7	0.0	-0.8
Montenegro	1,778	30.6	196	20	-185	-32	-1	11.0	1.0	-9.3	-1.8	-0.1	4.1	0.4	-3.2	-0.6	0.8
Poland	101,501	15.1	-5,782	10,828	-288	3,501	8,259	-6.2	12.4	-0.3	3.6	8.9	-1.0	1.8	0.0	0.5	1.3
Romania	24,736	8.7	-216	3,080	-1,637	-993	234	-0.9	12.7	-6.0	-3.9	1.0	-0.1	1.2	-0.6	-0.4	0.2
Russia	88,476	5.0	-9,543	-3,138	1,440	876	-10,365	-9.7	-3.5	1.7	1.0	-10.5	-0.6	-0.2	0.1	0.0	-0.7
Serbia	8,864	14.1	270	-401	-493	550	-74	3.0	-4.4	-5.6	6.6	-0.8	0.5	-0.8	-0.8	0.9	-0.2
Slovakia	28,153	24.5	6,422	-1,987	-871	635	4,199	26.8	-6.5	-3.1	2.3	17.5	6.1	-1.9	-0.8	0.6	4.0
Slovenia	8,495	13.8	1,642	-74	-320	-2,329	-1,081	17.1	-0.7	-2.9	-21.5	-11.3	3.1	-0.1	-0.5	-3.8	-1.4
Turkey	122,554	15.2	-11,520	1,566	-4,106	-5,592	-19,652	-8.1	1.2	-3.1	-4.4	-13.8	-1.6	0.2	-0.5	-0.7	-2.6
Ukraine	9,029	4.6	-1,041	28	120	168	-725	-10.7	0.3	1.4	1.9	-7.4	-0.7	0.0	0.1	0.1	-0.5
CESEE	581,149	11.9	-14,850	601	-5,585	13,248	-6,586	-2.5	0.1	-1.0	2.3	-1.1	-0.4	0.0	-0.1	0.3	-0.2
CESEE ex. RUS & TUR	370,119	16.1	6,213	2,173	-2,919	17,964	23,431	1.8	0.6	-0.8	5.1	6.8	0.4	0.1	-0.2	1.0	1.4

Sources: BIS, Locational and Consolidated Banking Statistics; Haver Analytics; and IMF, World Economic Outlook, and IMF staff calculations.

Table 2. CESEE: External Position of BIS-reporting Banks, 2020H1 – 2021H2*(Exchange rate adjusted flows, based on the full sample of BIS-reporting banks)*

	2021H2		Assets - Banks					Assets - Non-banks					Loans - Banks					Loans - Non-Banks				
	US\$ m	% of GDP	2020H1	2020H2	2021H1	2021H2	Total	2020H1	2020H2	2021H1	2021H2	Total	2020H1	2020H2	2021H1	2021H2	Total	2020H1	2020H2	2021H1	2021H2	Total
Albania	105	0.6	-8	2	-172	8	-170	142	-130	-36	97	73	0	-11	-2	7	-6	142	-128	-25	84	73
Belarus	-773	-1.1	-90	-17	9	-246	-344	-164	-337	126	-527	-902	0	2	-41	-255	-294	-217	-243	110	-519	-869
Bosnia-Herzegovina	-126	-0.6	-400	-89	-209	-59	-757	-1	7	-21	-67	-82	-324	-112	-204	2	-638	-1	7	-24	-64	-82
Bulgaria	1,034	1.3	410	475	-697	969	1,157	-299	120	-220	65	-334	397	359	-77	847	1,526	-262	-168	-327	-75	-832
Croatia	-2,249	-3.3	-458	-39	784	-1,594	-1,307	-409	-1,305	248	-655	-2,121	-399	-95	772	-1,365	-1,087	-402	-1,458	-81	-578	-2,519
Czech Republic	14,116	5.0	-5,220	-1,635	-1,211	15,403	7,337	3,855	-2,806	802	-1,287	564	-3,203	-12,226	4,128	4,384	-6,917	888	-989	-19	-758	-878
Estonia	-2,487	-6.9	133	-234	-258	-2,399	-2,758	160	-309	84	-88	-153	16	-371	-296	-197	-848	-88	-88	13	-103	-266
Hungary	6,194	3.4	1,372	-3,635	376	950	-937	5,471	-266	3,417	5,244	13,866	1,248	-3,169	181	-489	-2,229	5,590	-771	4,307	3,062	12,188
Latvia	1,937	5.0	-239	340	-782	-1,180	-1,861	345	-157	-984	3,117	2,321	-234	332	-842	-630	-1,374	15	-68	-1,082	-146	-1,281
Lithuania	-876	-1.3	-217	599	-779	-719	-1,116	312	128	-90	-157	193	-190	575	-802	98	-319	-35	-153	127	-279	-340
North Macedonia	-411	-3.0	45	-7	437	-383	92	-13	-23	32	-28	-32	15	-28	496	-445	38	-11	21	9	-34	-15
Moldova	0	0.0	-7	3	-74	1	-77	2	-6	-27	-1	-32	-2	9	-6	-1	0	2	-6	-26	-1	-31
Montenegro	-32	-0.6	19	20	-135	-30	-126	177	0	-50	-2	125	25	13	-63	-27	-52	227	-49	7	27	212
Poland	3,501	0.5	-5,138	8,201	-1,179	3,370	5,254	-644	2,627	891	131	3,005	-4,399	8,965	-3,649	1,609	2,526	324	747	1,681	2,029	4,781
Romania	-993	-0.4	-342	2,202	32	-967	925	126	878	-1,669	-26	-691	-212	1,853	-39	-1,193	409	-391	570	-1,384	-423	-1,628
Russia	876	0.0	-10,721	-746	3,365	2,038	-6,064	1,178	-2,392	-1,925	-1,162	-4,301	-10,243	-676	3,001	3,067	-4,851	1,358	-2,216	-1,435	-394	-2,687
Serbia	550	0.9	237	-536	-455	-144	-898	33	135	-38	694	824	233	-666	-139	-142	-714	186	-53	198	915	1,246
Slovakia	635	0.6	2,364	-1,208	-974	1,136	1,318	4,058	-779	103	-501	2,881	1,612	-1,107	-958	1,212	759	1,696	17	120	-213	1,620
Slovenia	-2,329	-3.8	141	380	-746	-920	-1,145	1,501	-454	426	-1,409	64	-215	324	69	-925	-747	-225	-74	63	82	-154
Turkey	-5,592	-0.7	-4,640	2,829	-3,805	-4,382	-9,998	-6,880	-1,263	-301	-1,210	-9,654	-4,339	3,358	-2,995	-2,458	-6,434	-4,495	-2,099	2,033	-874	-5,435
Ukraine	168	0.1	-354	-248	309	211	-82	-687	276	-189	-43	-643	-143	-90	86	123	-24	-536	351	-362	401	-146
CESEE	13,248	0.3	-23,113	6,657	-6,164	11,063	-11,557	8,263	-6,056	579	2,185	4,971	-20,357	-2,761	-1,380	3,222	-21,276	3,765	-6,850	3,903	2,139	2,957
CESEE ex. RUS & TUR	17,964	0.8	-7,752	4,574	-5,724	13,407	4,505	13,965	-2,401	2,805	4,557	18,926	-5,775	-5,443	-1,386	2,613	-9,991	6,902	-2,535	3,305	3,407	11,079

Sources: BIS, Locational and Consolidated Banking Statistics; Haver Analytics; and IMF, World Economic Outlook, and IMF staff calculations.