



## High-level conference of Banka Slovenije and the International Monetary Fund

**Main points from the joint high-level conference of Banka Slovenije and the International Monetary Fund on “Financial Systems in the Central, Eastern and Southeastern Europe (CESEE) Region” (May 17, 2024)**

*The regional BS-IMF conference discussed financial systems in the CESEE region and policies to adapt them to support growth. While financial resilience in the region has improved, scope exists to deepen financial systems and channel savings to more productive uses. Financial fragmentation was identified as a major challenge, with few easy fixes.*

### **CESEE banking: resilient but shallow**

**Participants noted improvements in the resilience of CESEE banking systems since the global financial crisis but considered that improved access to credit could help spur future growth:**

- CESEE banking systems were seen as resilient with strong capital, liquidity, and profitability across much of the region.
- The profitability is relatively high due to net interest margins and moderate cost-to income ratio, rather than high lending volumes. The structure of the regional banking systems seems to imply a reasonable degree of profitability going forward.
- Lending to the nonfinancial sector relative to GDP in the region remains much lower than in the euro area. Bank credit has room to grow and support growth of the real economy. External funding of corporates is dominated by non-bank funding, in contrast to the euro area where banks dominate. Corporates in the region generally have low, mainly short-term, debt.
- CESEE banks operate in fragmented markets, face policy uncertainty and are conservative, with low loan-to-deposit ratios. Foreign banks in the region tend to adjust and adopt to local practices. Banks have room to integrate new technologies and innovation. Participants also noted a lack of competition (e.g., higher margins than elsewhere).
- Strong regulation and supervision should be preserved, although some participants noted that regulations may be erring on the side of conservatism, hindering new bank entry and development.
- Adopting EU-wide supervision was seen as useful, as were other examples of international cooperation, e.g., the Vienna initiative, and participants emphasized the need to make further progress towards completing the banking union.
- Banks could face competition from rapidly growing non-bank lenders (e.g., private credit funds) in the future, although their lending levels are still very low. Surprisingly, Fintech did not appear to be having much impact on banking in the region.

## **CESEE capital markets: room for development**

**Capital markets in the EU, and especially in the CESEE are shallow, constrained by market fragmentation and structural obstacles.** The key requirements of efficient capital markets – breadth, depth, and competition – are challenging, given different regulations, bankruptcy and other financial laws, tax regimes, and central clearing counterparties. Cross-border business is, as a result, limited despite the technical interconnectedness of trading platforms.

- Firms rely more on foreign financing, banks and own profits than capital markets and the number of listed firms in the region has declined over time.
- The case for developing capital markets becomes even stronger as geopolitics may constrain the availability of FDI in the future, innovation becomes increasingly more important, and green transition projects are both capital intensive and require financing of long maturity.
- Meanwhile, households primarily store wealth in real estate, not financial assets. For markets to benefit from banks' excess liquidity, either directly or via mutual funds, a broader array of savings products is needed to cater to retail investors.

**Participants agreed that development of the local capital markets and building the capital markets union could bring substantial benefits such as facilitating innovation and building economic resilience, but would be a challenge.** Key issues discussed included:

- *Integration.* Integrating 27 different systems with different accounting, tax and legal standards would take a lot of determined action and time and require surrendering some national-level policy levers. It will be also key to continue developing local capital markets and related ecosystems that would facilitate future integration into the broader European market.
- *Venture capital.* Venture capital in CESEE is at the nascent state of development, although the three Baltic states showcased how a strong policy action, collaboration, and luck – major shocks can set back the best-laid plans by years – can result in significant progress. Participants shared experience of building a successful Baltic Innovation Fund created in 2014 – 15 through collaboration across all three governments and with the EIB.
- *Developing pension funds.* Private pension systems could be a key driver of a successful capital markets system, including venture funds, but the major challenges of such an approach, including the large fiscal costs of moving to second pillar pension systems was noted.
- *Financial literacy* is crucial for the overall development of capital markets and economic growth. Policymakers should prioritize financial education as part of broader economic strategies, including integrating financial literacy into educational curricula and public awareness campaigns.