Fifteen years have passed since eight Central European (CE) and Baltic countries joined the EU, followed at later dates by three Southeastern European (SEE) countries. The anniversary is a good opportunity to take stock of the road travelled by the banking sector in the new member states and its achievements and challenges.

As a practicing banker at the time of EU expansion and following the “Big Bang” in 2004, I have been asked to share my personal experience in the countries I dealt with during the mid-nineties until now. Mine is more a testimonial and a subjective account of the evolution in the banking sectors of various CE (Poland, Czech Republic, Slovakia, Hungary, Slovenia) and SE countries (Romania, Bulgaria, Croatia) than a rigorous analysis of those countries’ banking systems.

A quick look back at the period before the fall of the Berlin Wall and collapse of communism reveals that, even in centrally planned one-party countries, banking sectors evolved in somewhat different directions. On the one hand, there was a model that was emulating the Soviet banking framework from the USSR (examples being Romania, Bulgaria, to a certain extent the former Czechoslovakia) and a more decentralised system which was following the (timid) market reforms in other Eastern countries (Poland, Hungary, the former Yugoslavia). These nuances in the role and organisation of the banking systems to a certain degree stemmed from the socioeconomic systems in the region which had evolved over decades. The so-called reformers (Poland, Hungary, ex-Yugoslavia) allowed for a somewhat bigger role of the market than in the other countries. The international trade patterns also reflected these differences, with reformers trading more with the “hard currency” areas of the world. All of this forced the banks in those countries to also be more attuned to market forces.

The political and economic reforms following the fall of communism had a dramatic impact on the banks in the region where two groups of countries evolved: one group embarked on a fast liberalisation of their economies and financial systems (Czech Republic, Hungary, to a lesser degree Poland). The other group that was still relying on the dominant role of the state in the banking system (Slovenia, Croatia, Bulgaria, Slovakia, to some extent Romania).
The above mentioned different starting positions and the initial attitude toward market reforms was also reflected in the role of direct foreign investments (DFI) in the region’s banking system. The faster reformers saw the penetration of foreign strategic owners into their banking institutions much faster than the laggards. Many Western European financial groups (to a lesser extent the US investors) sensed the historic opportunity to enter a promising market, one with significant potential for economic growth and largely underbanked. The most active ones came from mid-sized Western European countries (Austria, Belgium, Greece, the Netherlands, Ireland, Portugal) although there emerged some strong players from the larger EU member states as well (Italy, France, Spain, to a lesser degree Germany). The larger the market in CE and SEE (e.g., Poland) the bigger the interest and willingness to pay a higher price for an existing banking asset.

The late 1990s already saw a robust penetration of foreign strategic investors into Czech Republic, Poland, Hungary, followed a few years later by Romania, Croatia, Bulgaria and Slovakia. Slovenia was a special case to which I will turn later.

Thanks to this aggressive arrival of Western European banking and insurance groups into the region, financial intermediation in CE and SEE experienced its first “leapfrogging”, narrowing the gap with the Western part of the continent even prior to the official EU membership which started in 2004. The opening up of trade and investment flows, the arrival of hundreds of experienced Western bank executives and various financial experts had a profound impact on the banking landscape of CE and SE Europe already in the early 2000s.

Most of the foreign groups came to the region with the idea to stay for a long time (“forever”, as my Western European boss would mention quite often!). That had an impact on their attitudes and behaviour, since many saw CE and SEE and their second home market (this could certainly be said for the Austrian, Italian, French Greek, Portuguese and Belgian groups, perhaps at one point for the Irish as well) and wanted to be fully integrated in the community and expanding their stakeholder base.

Complementing the political and market reforms, and the growing presence of foreign capital in the banks of the region was also the financial policy and regulatory framework that most of the countries started to shape along the Western European models as part of the multi-year EU accession negotiations. This process was another manifestation of the “soft power” EU exerted on the aspiring member states!

When the “Big Bang” finally came on May 1, 2004, when ten new member states joined the EU (of which 8 from Central Europe and the Baltics!), the banking systems in the
new CE countries where already humming along full speed. By that date, roughly two-thirds of the banking assets in the Czech Republic, Slovakia, and Hungary were already foreign owned. Poland kept several large banks under state control, whereas in Slovenia the political and public opinions were not favouring foreign ownership in general and in banking in particular. Even in other countries in the region which had not yet joined the EU (Romania, Bulgaria, Croatia), foreign ownership of banks exceeded 50% by mid-2000s.

The leading role of foreign strategic ownership in CE also resulted in a somewhat more pronounced market concentration than before. While the largest banks in Poland and Hungary, respectively, were not owned by strategic foreign investors, in all four Visegrad countries (Poland, Czech Republic, Slovakia, Hungary), the top four - five banks accounted for more than 60% of the market. A similar pattern of market concentration was soon followed by the banking sectors in Rumania, Bulgaria and Croatia.

The period following the membership of the first eight post-communist countries in 2004 saw a deep financial deepening of this economies where the banks played a key role - stock markets and non-bank financial intermediaries were rather incipient as was the regulatory framework governing them. During the years 2004-2008, we witnessed an extremely fast growth in bank lending in the region, coupled with strong external borrowing by the countries and companies from the new member states. What was particularly noticeable was intense household borrowing in Euros and Swiss francs which later on, with the currency corrections and strengthening of the Swiss currency, caused serious distress in many banking system in the region.

Generally speaking, the years leading to the Great Recession saw a growing sophistication in the product and distribution channels of CE and SEE banks, thus making banks in the region increasingly similar to their counterparts in the Western part of the continent.

What was not yet up to date to the fast development of the banking systems were the regulatory and supervisory frameworks, both in the “old” as well as “new” member states. This made the crisis of 2008-2009 even deeper. In the CE and SE countries where banks were predominantly owned by foreign strategic investors (Poland, Hungary, Czech Republic, Slovakia, Romania, Bulgaria and Croatia) the burden of capital increase and enhanced risk management techniques was borne by the Western parents, thus not putting any pressure on public finances in the host countries. Only in Slovenia, with more than 50% of the banking assets in state hands, was the post-crisis restructuring of the banks financed by public money and increased domestic debt.

The coping with the Great Recession in the region also depended, to a large extent, on the macro politics and institutional capabilities in individual countries. For example,
Poland with its sizeable domestic market and prudent macro policies at the time the crisis broke out, never experienced a real recession during the time when all other member states (and many other European countries) had negative economic growth for a couple of years (2008, 2009). Other more advanced new member states (Czech republic, Slovakia, Hungary) had an institutional framework in place which enabled a relatively smooth transition from the overheating of the pre-crisis period to a more sustainable, prudent banking policies with improved supervision and risk management know-how. In the less advanced financial policy environments in SE Europe (Romania, Bulgaria, Croatia plus Slovenia with its slow reaction to the deepening economic crisis), the process of banking adjustment to the post-crisis conditions and standards was somewhat more time consuming and costlier.

After the crisis, the banking system in the region with the strong support of the parent groups from Western Europe, became better equipped to cope with the changing market conditions, to an extent becoming safer and better managed than in some of the Southern European countries (Greece, Cyprus, Portugal, Spain, Italy). One could say that, following the years after 2009, CE and SE European banks have converged with their counterparts in the West, in many areas (digitalization, distribution channels, marketing) surpassing the more established banks in the “old” Europe.

The restructuring, increased capital requirements, ever more demanding prudential regulations and increased risk awareness over the past ten years have significantly lowered the appetite of the traditional strategic investors from the West. Many of those banking groups which came to the CE and SEE region in the 1990s with the intention to “stay forever” have either exited or significantly reduced their presence in the region (Portugal, Greece, Ireland, France, Austria, Belgium, Italy). As a result of these developments, we are witnessing the dominance of a few foreign strategic investor in more mature and still lucrative markets (Poland, Czech Republic, Slovakia) and the resultant further market concentration. Also, we are now seeing the entrance of large (mostly US based) Private Equity firms entering (at least temporarily) the CE and SEE banking institutions, buying banking assets either from the state or from the exiting Western banking groups (Slovenia, Croatia, Bulgaria). Finally, we are seeing some attempts by the country governments to increase their ownership of banks with the intention to keep some of the banking sector in government and/or domestic private sector hands (Hungary, Poland, Croatia).

In sum, the past two decades have seen some dramatic developments in CE and SEE region - if say, in the mid- to late 1990s, banking in the region was a world apart from the one in Western Europe, this difference has largely disappeared. The level of knowledge, sophistication in banking in the regions has by now reached the level not too different form the one in the mature Europe. The same could be said of the supervisory and regulatory frameworks and the level of knowledge and relative independence of the financial authorities from the political interference. The
convergence with Western Europe banking and in some instances the leapfrogging continues to this day. The challenges facing banks and bankers on both sides of the EU are becoming increasingly similar.

I feel fortunate and privileged to have been an active participant in this exciting journey!

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