BENEFITS OF THE INCOMING FOREIGN BANKS OF THE COUNTRIES OF CENTRAL AND EASTERN EUROPE

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Abstract

The aim at this paper is to analyze the incomings of foreign banks of CEE to determine the effects of the penetration of foreign-owned banks of host countries. With the transition to the banking system mono bank of two levels, early transition extraordinary efforts were made for the privatization and restructuring of banks of the CEE countries. A review of the empirical evidence and general researches will analyze the benefits of these banks, as well as the recent crisis has affected financial business activity of foreign-owned banks in the financial and economic stability in the host countries. The findings of the survey, estimated that foreign banks have a significant impact on the consolidation of the banking system, the recent financial crisis also affected the restriction of credit placements. However, based on the findings it is recommended having the reinforcement of the regulatory framework of these countries, increased activity of foreign banks in order to impact on their economy to be on a higher level.

Key Words: *Foreign banks, the banking system, the financial crisis, Central and Eastern Europe, South-Eastern Europe.*

Introduction

Various studies on evaluation reports confirmed the view that in the beginning of the transition the financial sector was faintly, underdeveloped and shallow. During the second half of the 1990 banking reform efforts are hampered by internal obstacles or from external causes. After a decade of efforts by the banking system in varying degrees for each country, some countries still face with number of problems. Yet, there is a consensus as an economic performance, macroeconomic stability period while growing in different period of time depends on the extent in which financial institutions and markets efficient conduct their activities within an appropriate infrastructure (Stubos, Tsikripis, 2004).

In the early stages of transition, were made attempts to privatization and restructure the banking system inherited from socialism. However, the transition countries were fenced by financial crisis bank recapitalization and fiscal burden to the failed banks quickly became problematic in many countries. In addition, it was difficult to find the owners of private banks who were not the main client who possession any experience in banking. Foreign banks had brought rapid improvements in many areas of the banking business. The expertise of foreign banks in marketing and in the risk management was evident (Kraft, 2004).

Lending boom is further enhanced by capita from parent banks located in member states of the European Union l. The main business leaders behind the expansion of credit by foreign banks raises the profit orientation of these banks associated with a tendency to increase their risk. Structural changes in the banking sector from EU build a background for increasing banks from EU profit orientation. These structural changes have occurred since the 1990s (Cetkovic, 2011).

The economies of Central and South-Eastern Europe (CESEE) were also affected by the financial crisis by tightening global credit conditions resulting in a deceleration (or transitional reversal) of the input capital in the region. Banking sectors of the CESEE has been quite resilient to the autumn of 2008 with the introduction of the global economic and financial crisis. In the second half of 2008, however, a number of offers and demand side factors negatively affected to the lending banks across the region (Gardon, Martin, 2010).

Banking system reforms in the region

The so far story of the banking transition can be characterized into four stages that take the banking sector by the privation of banking institutions in the 1990s, modern competitive banking industry with a large presence of foreign-owned banks. The first phase of banking development in economic transition has included the establishment of banking institutions in the early 1990. The second phase is the phase of bank failures involved in transition and systemic crises at one time or another has touched every economy in transition in the mid-1990s (see Bonin and Wachtel 2005). The third phase of the banking transition has involved a long process of restructuring through privatization and the entry of foreign banks. By the end of the century, most of the banks have returned to private ownership and in almost all countries in transition, foreign banks have dominated. The fourth phase, brings the present time. In transition economies most banks are generally sound, appropriate, regulated and competitive institutions (Haselman, Wachtel, 2006).

The financial system dominated of commercial banks. The role of financial intermediation and other financial institutions is weak. The insurance industry in the most of the region is diminutive and underdeveloped. A feeble of traditional government with the inadequate practices risk management and a lack of consumer confidence has restricted total assets held by these institutions, limiting at the same time somewhat the opportunity to present a source of systemic risk to the financial sector (Mustafa).

World Bank and International Monetary Fund had numerous initiatives introduced and implemented that affect in all aspects of banking and financial market development. The legal framework, institutional, the regulatory and supervision of financial institutions is continuously improved and strengthened. Through the implementation of economic regulation, supervising and stability programs, these organizations provide the broader context for the restructuring of the economy of each country, which is a prerequisite for effective banking reform. In a more specific context, through monetary policy, management programs and they have helped greatly in the promotion and implementation of specific policies leading to the reforms of the banking system (Stubos, Tsikripis, 2004).

Banks with foreign ownership can urge benefit, diversification of risk for both trans-boundary banking groups. For banks that have more diverting operations distributed in several countries can reduce their overall profile of risk. For the host countries, the presence of foreign banks can help to mitigate the impact of internal shocks in the economies of the host country. However, the presence of foreign banks increases exposure to external thrusts and foreign banks have difficult Oversight (IMF, 2013).

Investments in information technology were evident in many cases by the banks with foreign ownership. Foreign banks were engaged in significant technology transfer. These transfers would not be so significant if the banks had remained in the hands of the indigent owners, primarily because the bulk of knowledge was at the owners of foreign banks and secondly because the large investments needed in some areas such as IT. Thirdly, the arrival of foreign banks brought fresh capital into transition countries, in the form of capital investment and later in the form of lending (Kraft, 2004).

The western banks entrance in the CESEE first was initially closed for capital investments in local subsidiaries, but over time the Western Banks provided financing increasingly. Total funds given to the region grew by about 200 million dollars in 2002 and 10000000000000 US $ in 2008, or 25% of regional GDP. During 2003-2008, most of the CESEE countries experienced a credit boom. During this period, foreign banks competing for market share and less indebted borrowers initial optimistic were eager to take credit for consumption and investment. Credit booms were associated with an increase in foreign currency loans in most countries. The increase was reflected in the demand and supply factors: on one side, demand for borrowing in foreign currency increased from differences in interest rates (IMF, 2013).

Ownership of foreign banks can facilitate an orderly evolution of funding models of banks in CESEE. By pushing forward with the plan envisaged the creation of an integrated European financial that will remove many of the shortcomings of banks "centralized", reducing t the need for a major change in the composition of financing. Improved cooperation in general to better manage trans-boundary banks, through the use of a more coordinated policy (IMF, 2013).

SEE countries have achieved a great deal in the banking reform area. The entry of reputable foreign banks together with the supervision of the improved and macroeconomic stability, has produced major advances in banking. At the same time development of financial institutions, banks and capital markets continue to lag behind, as well as anti-trust rules and regulation of securities. Weaknesses in the legal framework still weak governance, inadequate accounting and entry and exit barriers hamper the business environment and growth prospects. The banking sector cannot sit too far to the rest of the economy. Just a continuation of the extensive reforms undertaken so far could lead to balance sustainable growth. Banking sectors could contribute to such growth, but cannot be the only catalysts (Kraft, 2004).

The banking sector of CESEE (Central and Eastern Europe) was fairly resilient to the global economic and financial crisis of 2008. The profit rate remained high due to development (though falling), increases in credit and loans in total loans amounted to stabilize the historically low level. In second half of 2008. However, a number of offers and demand side factors

negatively affected the lending banks across the region. These factors involved more closely in global terms of liquidity (more than before September 2008.), the slowdown in capital flows in CESEE increased risk of banks and decrease of loan applications in the background of development, falling investment and increased consumption (Gardon, Martin, 2010).

The CESEE economies have strong financial relation to the Western Europe and directly and indirectly affected by regulatory reforms in the western. There are direct effects deriving from the local implementation of international regulatory reforms and indirect effects arising from changes in business models. The direct impact of regulatory reform is negligible. Banks in CESEE countries need to maintain capital levels, higher level than they have agreed internationally to a minimum because of reports of the minimal higher determined by local regulators and also because of the high degree of macroeconomic volatility and overall risk in these jurisdictions. For this reason, the adoption of high level and quality of regulatory capital is not seen as a necessary inconvenience. However, indirectly impact is likely to be more important. Precisely for this reason the presence of foreign banks in the region are likely to be affected by implementation of regulatory reforms of internationally active banks. Debate on the undesirable indirect consequences so far has been strictly supervised quality and focused on specific aspects of the agenda (Impavido Rudolph, Ruggerone, 2013).

The financial crisis and the potential effects on the global economy

Regarding the crisis that began in 2007, Bhaduri (2010) shows that every financial crisis has features that are similar repetitive; but historical perspective make each different crisis. He suggests that the purpose of any theory regarding the recession is the identification of specific characteristics, even if is not enough adequately address a particular crisis. Although formal model is not always historically accurate, at least gives some knowledge about the central mechanism that accelerates multiple financial crisis, as cited in (Kazi, Leonard, 2011).

The effects of the crisis in early 2008 did not seem affected developing countries. This is because financial and economic indicators had not their significant changes. The evolution of the crisis, its entry into a new phase, characterized by the loss of confidence of major market agents, the tensions in money and capital markets accompanied these significant losses in stock markets, changed the global economic landscape. In particular, the situation up to that point relatively stable at developing countries. More specifically, the financial crisis has reduced demand for investments in these countries, particularly in those that present significant deficits of balance of payments indicators and macroeconomic imbalances. World Bank as one of the international organizations for the recommended policies and ways to overcome the crisis, suggests three different interventions, tailored to the economic development of a country: First, the growth of social assistance, secondly, measures short-term administrative and thirdly, measures to promote growth in the supply of food products (Mustafa).

Since the beginning of the global financial crisis, the regions of CESEE has felt a significant cash in capital inflows. In most countries, current account deficits are low or very low. The economies are developing rapidly and a rebalancing of growth occurred from domestic demand towards net exports. In addition, global regulatory agenda and the need to strengthen balance sheets are being made to reduce the western bank of the risk weight of their assets,

resulting in lower exposures to the east. For this reason, higher domestic savings in East and higher capital and liquidity needs of the highest in the Western are reduced availability and the need for capital inflows. Despite the sharp decline in foreign financing, local banks have managed largely to compensate for the lack of liquidity in domestic deposits. Foreign groups continue to be systemically important for carrying jurisdictions. A small group of actors, systematically control the three biggest banks in any given country (Impavido Rudolph, Ruggerone, 2013).

A string of banks failures can reduce credit and money supply and result in a recession due to supply the collapse of credit which may force companies and individuals to reduce investment and consumption, which could result in a decrease production short and may have an adverse effect on the economy in the banking sector which could exacerbate the effects of asymmetric information, and bank failures can cause loss of collected information in relation to banks and customers and create difficulties for borrowers obtain credit elsewhere, and increase the costs of economic activity. Banking crises may also cause an increase in uncertainty, leading companies to delay investment and borrowing decisions. Banking crises have a negative impact on the level of confidence in the financial system, depositors and other creditors may lose confidence in banks and the banks may lose confidence in other banks, which may result in a malfunction of the financial systems and payment. Banking crises can be associated with other financial crises, as public debt crisis, currency crisis, etc. (Deltuvaité, 2011).

Also, the second string of funding reductions began in mid-2011 when western European banks came under renewed pressure. That changed when the Eurozone crisis escalated and swallowing the major economies of Europe and banks came under pressure, even in the "main countries" pressures were accompanied by tightening regulatory Basel III recommendations of UAE which were needed to take a more flexible and stronger banking over time but carry the risk that banks choose to reduce lending rather than capital increases. In the second half of 2011, the UAE had issued a recommendation to raise significant capital requirements for banks. More stringent requirements under Basel III should be phased in over more years, but market pressures had caused banks to try to comply with the future requirements ahead of schedule. Western Banks reduced their funding for CESEE-in, with the exception of Russia and Turkey (IMF, 2013).

Banking crises can impose costs on the economy as a whole or in its parts. (Hoggarth et al. 2002) argue that the banking crisis may affect banks failed, shareholders, depositors, other creditors of banks and borrowers, directly. The string of bank failures can create difficulties in finding alternative sources of funding.

The main policy challenges after financial Crisis

It was a challenge for the Western Balkan authorities to design the appropriate policy responses to the financial and economic crisis. Significant restrictions on both the monetary and fiscal spheres leave limited space for active policy responses. The burden of adjustment can therefore fall on domestic demand and relative prices in most countries. The response of monetary policy is limited by the frequent use of the exchange rate as a nominal anchor and a high degree of euroisation, which affects two sectors, financial and non-financial. Widespread use of the euro as

a currency financial (credit transactions and saving) is further reduced to a political purpose "independent" monetary. Central banks continue to make use of instruments such as reserve requirements of mandatory and administrative measures that affect the volume and quality of lending, but adjustments more stable money supply in the short term through instruments normal, as interest rates are hampered by monetary frameworks in place. Monetary authorities in countries with few solid pillars may be in a better position in order to accommodate the shocks caused by out of the money supply, such as reduced inflows or outflows possible capitals that can be caused crisis. But even in these countries, the space for' manoeuvre' of the transmission mechanism of monetary policy is limited by excessive euroisation (EC).

According to Tropeano (2011), the state should turn back to the financial system in order to change the governance practices of financial firms that favor speculation and maximizing short-term profits and bonuses. The state must order, provide liquidity and insolvency provisions only for those institutions to follow strict rules. The current form of financial regulative reforms in Europe, however, made the presentation of the new capital requirements as set by the Basel Committee. However, according to the author, these requests can be sent easily to the expansion of the background banking and wealth in Europe. A substantial reform of the banking and non-banking institutions is necessary. Revenues must be controlled and reduced in all institutions. Debt from active banks in international markets could be increased, too rapid and concentrating in declining financial limits. The new capital rules process of debt burden internationally active banks which disrupted risk and unfairly compared with advanced countries to make the first application. For example, the package of the new Basel 2.5 increases the cost of internationally active banks to keep trading exposures in countries of CESEE's. Those banks act as market maker and are the greatest providers of liquidity in some countries CESEE, and this could have negative consequences and may ultimately affect the development of domestic financial markets in these countries.

Similarly, the need for internationally active banks to raise new capital with high quality or to reduce risk exposure can reduce debt in the countries of CESEE's to be considered "healthy".

Finally, the race of several advanced countries to adopt the new requirements, debt speed while making it potentially messy and too focused on countries CESEE's where branches are present. Decision of Sweden in 2011 he pronounced Tier 1 equivalents equity for 10% of assets at risk in 2013 and 12% of assets at risk up in 2015 was seen by observers as an example regulator (Impavido, Rudoloph, Ruggerone, 2013)

Conclusions

- The second level banks in the region should except implementation of the principle of profitability, the focus that the level of credit supply is in harmony with the level of demand for loans, due to the restriction of credit in recent years banks with foreign ownership.
- Because the money markets and capital markets are underdeveloped in the region, foreign ownership banks due to their domination in these countries should placement of their loans extended to me too well to loans with maturities long, in order to meet the

needs of the economy to finance investment projects which will help the economic development of the region.

- Regulatory policies also in these countries should prove to be cautious regarding in the application of Basel II and Basel III, because of the excessive increase in liquidity reserves can mitigate credit placement.
- As regards, capital ratios for banks in the region, regulatory authorities need to implement selective policies to banks and not to apply standard models for all banks in terms of capital requirements
- Regulatory authorities should improve the design of policies aimed at changing the forms of financing to the second level banks, and commercial banks manage to do a multiplication of loans in the highest possible level.
- In the region countries is required, increasing competition in the banking sector with the aim of providing different products and services, and lower prices, which are considered very high.
- Banks with the foreign ownership also have to make changes in the management of operational policies in order to reduce the cost, which is considered very high in the host countries.
- In order to maintain the overall financial stability and economic growth, banks need to find solutions to reduce the level of non-performing loans, where the level of non-performing loans in some countries in the region has achieved double digit growth.

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