

A RE-ASSESSMENT OF CREDIT DEVELOPMENT IN EUROPEAN TRANSITION ECONOMIES

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ABSTRACT. The aim of the paper is to assess the dynamics of credit development in the aftermath of the 2008 international crisis for a group of 11 European transition economies. Specifically, using filtering methods and dynamic panel estimations, the paper analyzes whether the expansion in banking credit before the recent financial crisis could be considered as “excessive” and whether its recent slowdown could be seen as a “credit crunch”. Our results suggest that the countries that had been characterized by a larger and more protracted excessive credit before the onset of 2008 crisis have experienced the largest credit contraction.

JEL Classification: C2; G21.

Keywords: Bank Credit; Dynamic Panel; CEECs.

RÉSUMÉ. L’objectif de cette étude est d’évaluer la dynamique de l’évolution du crédit après la crise internationale de 2008 pour un groupe de 11 pays européens en transition. Plus précisément, en utilisant des méthodes de filtrage et les estimations de panel dynamique, le document analyse si l’expansion du crédit bancaire avant la récente crise financière pourrait être considérée comme « excessive » et si son récent ralentissement pourrait être désigné comme « credit crunch ». Nos résultats suggèrent que dans les pays caractérisés par une croissance du crédit plus excessive et plus prolongée avant le début de la crise, le ralentissement des crédits bancaires a été le plus important.

Classification *JEL* : C2 ; G21.

Mots-clefs : Crédit bancaire ; estimations de panel dynamique ; PECO.

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1. INTRODUCTION

There exists a general agreement among economists that strong credit growth in the recent years has been "one of the majority pervasive developments" (Enoch and Ötör-Robe, 2007) in most of Central and Eastern European countries (CEECs hereafter). The strong speed of the process has raised fears about the "excessive" credit development and *per se* about financial and economic stability in a number of countries, in particular in Bulgaria, Croatia, Estonia, Latvia, and Romania.² The future of credit developments however, remains, relatively uncertain. On the one hand, the recent financial crisis has visibly deteriorated the liquidity and external financing of the CEECs banking sector, and may lead to a persistent deceleration in credit and in some cases to a "credit crunch".³ On the other hand, dynamics of credit can increase again with the world recovery and especially with the progress of the CEECs' economic and monetary integration with the euro area.⁴

This paper extends recent studies in the literature by assessing the dynamic of credit developments in the aftermath of the 2008 international crisis and analyzing credit development using several empirical methods. In particular, the main objective of this work is to shed some light on the private credit development in a group of 11 CEEC countries, analyzing whether the increase in credit before the 2008 international crisis could be considered as "excessive" as compared to its equilibrium level and whether its recent deceleration could be considered as a "credit crunch".

The analysis of credit development is rather difficult to perform in the case of transition economies where an "excessive" credit growth can be considered a result of the "catching-up" process. Given these difficulties, and in order to test the robustness of the results, two different approaches are implemented to analyze credit deviations. The first consists of estimating credit developments compared to a *trend* level of financial deepening (filtering method). The second method consists of estimating credit deviations from its long-term equilibrium, where to avoid the bias relative to the CEECs' adjustment process an out-of-sample equilibrium level is estimated for a panel of developed European countries (which can be considered a "natural" benchmark).

2. Traditionally, a rapid credit growth increases banking sector exposure deteriorating the quality of balance sheets that can lead to banking and financial crises (Demirgüç-Kunt and Detragiache, 1997; Bernanke *et al.*, 1999, Kaminski and Reinhart, 1999 and 2003). This channel is especially relevant in the case of emerging countries presenting important financial challenges such as dependence on external financing and currency and maturity mismatches that make them vulnerable to sudden stops in capital inflows (Chang and Velasco, 1998, 2000). Other important credit-crises channel works thought rapidly developing financial intermediaries (Goldstein, 2001), poor regulated and/or malfunctioning banking and financial sectors, and implicit or explicit public guarantees.

3. Ding *et al.* (1999) define credit slowdown as a general decline in credit growth due to either demand or supply factors while credit crunch is mostly due to supply ones and to the change in the relationship between credit availability and interest rates. A clear distinction between two concepts remains thus problematic. In this work, we partially follow their approach and define credit slowdown (interchangeably "soft landing") and "credit crunch" respectively as a general and more persistent decrease in banking credit as compared to the banking and financial sector development. See Section 3.2 for more details.

4. For a progress in the CEECs' monetary integration see Table A1 in the annex for a review of exchange rate arrangements.

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