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CEE capital markets in the post-crisis environment

The earlier global financial crisis of 2007 hit the economies of Central and Eastern Europe (CEE) hard, exacerbated by over-reliance on foreign currency lending, a highly Eurorised economy and low levels of domestic savings. The actions agreed at the Vienna Initiative stemmed the immediate financial stability risks and established that a move away from an over-reliance on traditional banking services was an absolute priority. A lot of constructive policy reform has occurred since then- including the launch of the EBRD's "Local Currency and Capital Markets Development Initiative" in Zagreb in May 2010- but the latest crisis, precipitated by the COVID-19 pandemic, and the capital outflows from the region, show that there is some way to go

We recognise the CEE as a dynamic region, which has the potential to grow at a faster rate than the EU as a whole. Integrated capital markets must remain an essential part of this formula, and a constructive and innovative approach is required to shift these economies in the right direction.

The CEE countries face specific challenges in developing their financial sectors due to the limited size of their individual markets. Any policy interventions, including post-crisis response, should consider these when arriving at solutions:

- Recent events suggest that an on-going priority is to develop secondary market liquidity in order to build investor confidence – volatility in markets was exacerbated by the inability to execute trades and hedge currency and interest rate risks. Facilitating access to local markets for all investors is key, as well as developing connectivity, and reducing transaction costs.
- Linked to this, single country solutions for developing capital market infrastructure tend to be uneconomic and do not pique investor interest. Regional solutions that highlight the CEE as a "region within a region" are preferred.
- Local capital markets in CEE countries do not attract investors nor support larger issuers because of their limited scale. Under-developed money markets, domestic government and corporate bond markets undermine strong, market-oriented economic development.
- Banks still finance 90% of the economy in CEE (the EU average is 75%) and focus on traditional business, resulting in a relatively limited range of financial products available. The rise of innovative products, such as covered bonds, is recent and limited.
- EU funds have been valuable in targeting public sector and infrastructure development, but there are huge gaps in access to finance for the private sector, particularly SMEs. SMEs will also be hardest hit by the adverse effects of the current crisis.

The EU Capital Markets Union is a hugely beneficial initiative, which will remain integral in post-crisis actions to reopen financing channels. It needs to remain an agile framework that takes into account the distinctive challenges of the CEE countries.

So, where do we go from here? Regardless of whether we are undertaking crisis response or post-crisis rebuilding, 'regional initiatives', something that the EBRD has championed for many years, must remain a priority. Short-term Central Bank securities purchase programs and IFI support facilities to boost liquidity are valuable but we also need to address the core issues of instrument supply, secondary market liquidity and regulation on an on-going and multi-asset basis.

In the Baltic States, expansion of products through uniform Covered Bond and Real Estate Investment Trust (REIT) regimes, championing a regional index, and promoting their green credentials, are tangible steps in supporting our broader effort to obtain a single Frontier market classification for these combined markets. Equally, the SEE link project currently connecting the stock exchanges of seven countries in a virtual trading hub – should boost secondary market liquidity when the clearing and settlement infrastructure is connected in Stage II. Harmonisation of regulation both facilitates investments and enhances private sector competitiveness.

Capital markets in the CEE region will only flourish if we continue promoting collaborative innovative solutions and strategic priorities.

Going alone is not an option: through collaboration, CEE countries can tackle the unique challenges they face. Should they grab it, they will show that unity makes strength. ●