

Transition report 2006

Finance in transition

EBRD

**Transition
Report 2006**

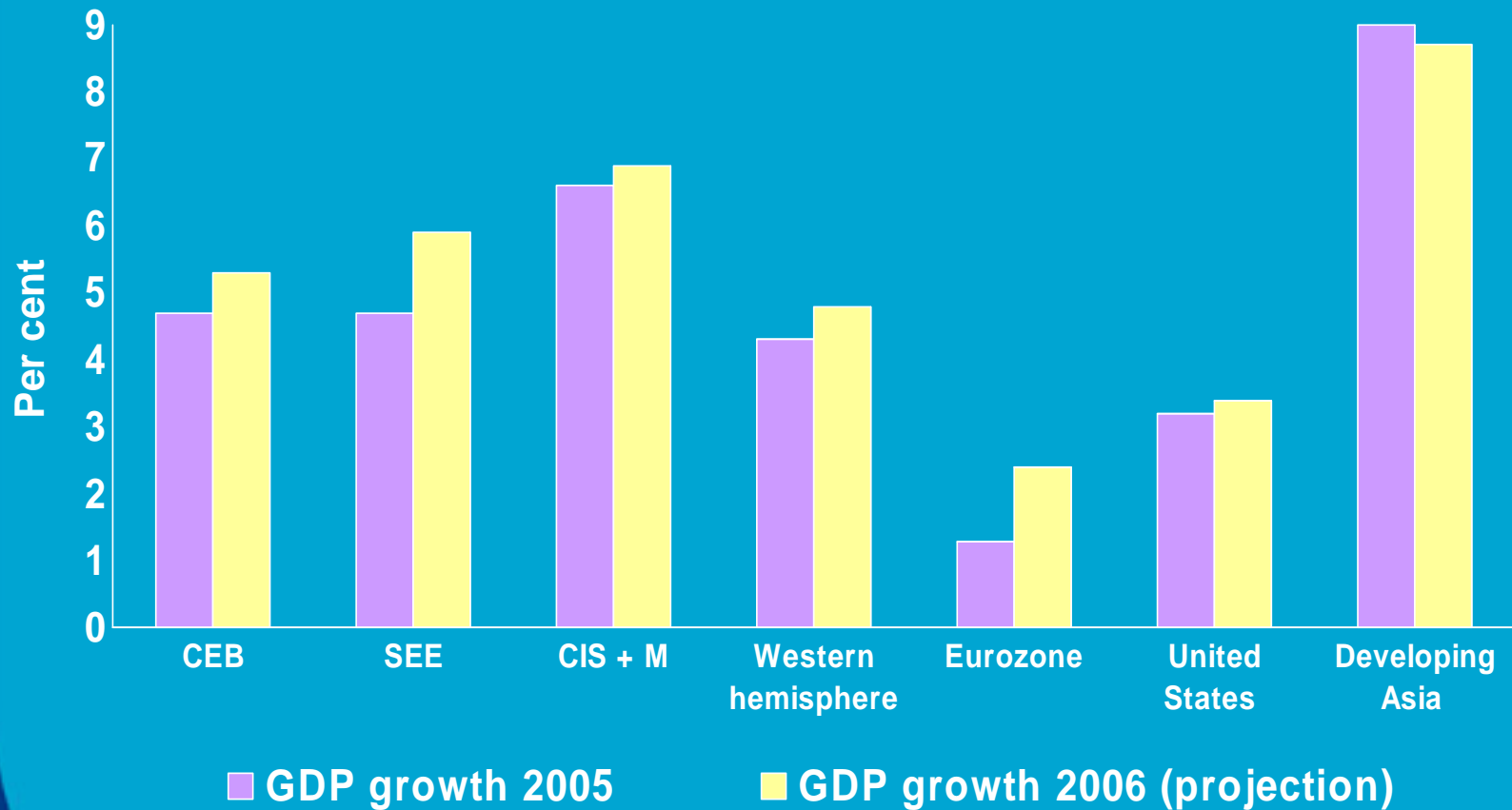
**Office of the Chief
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The big story: continued strong growth in 2005/06



Source: EBRD and IMF estimates

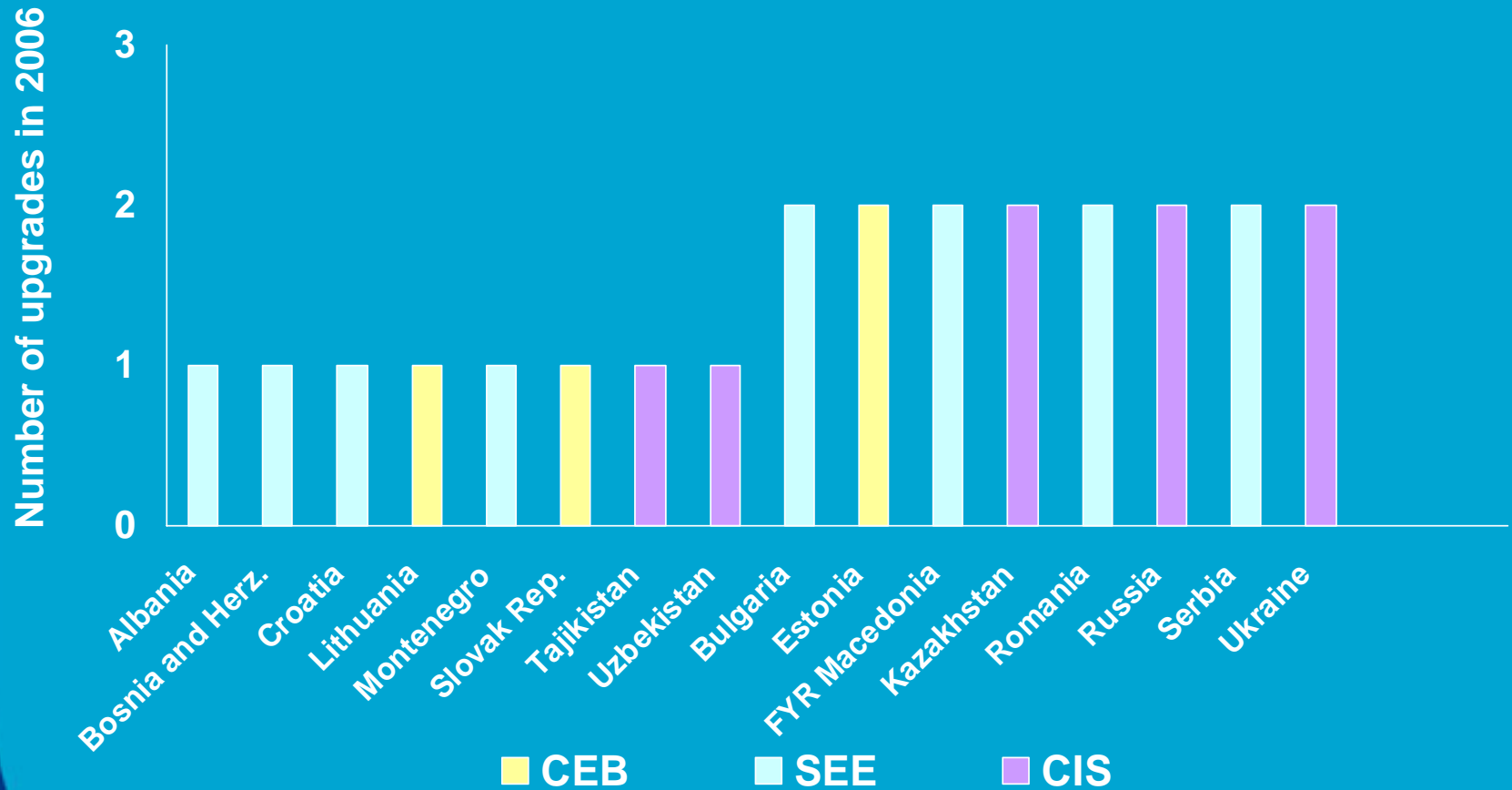


Growth and progress in reform

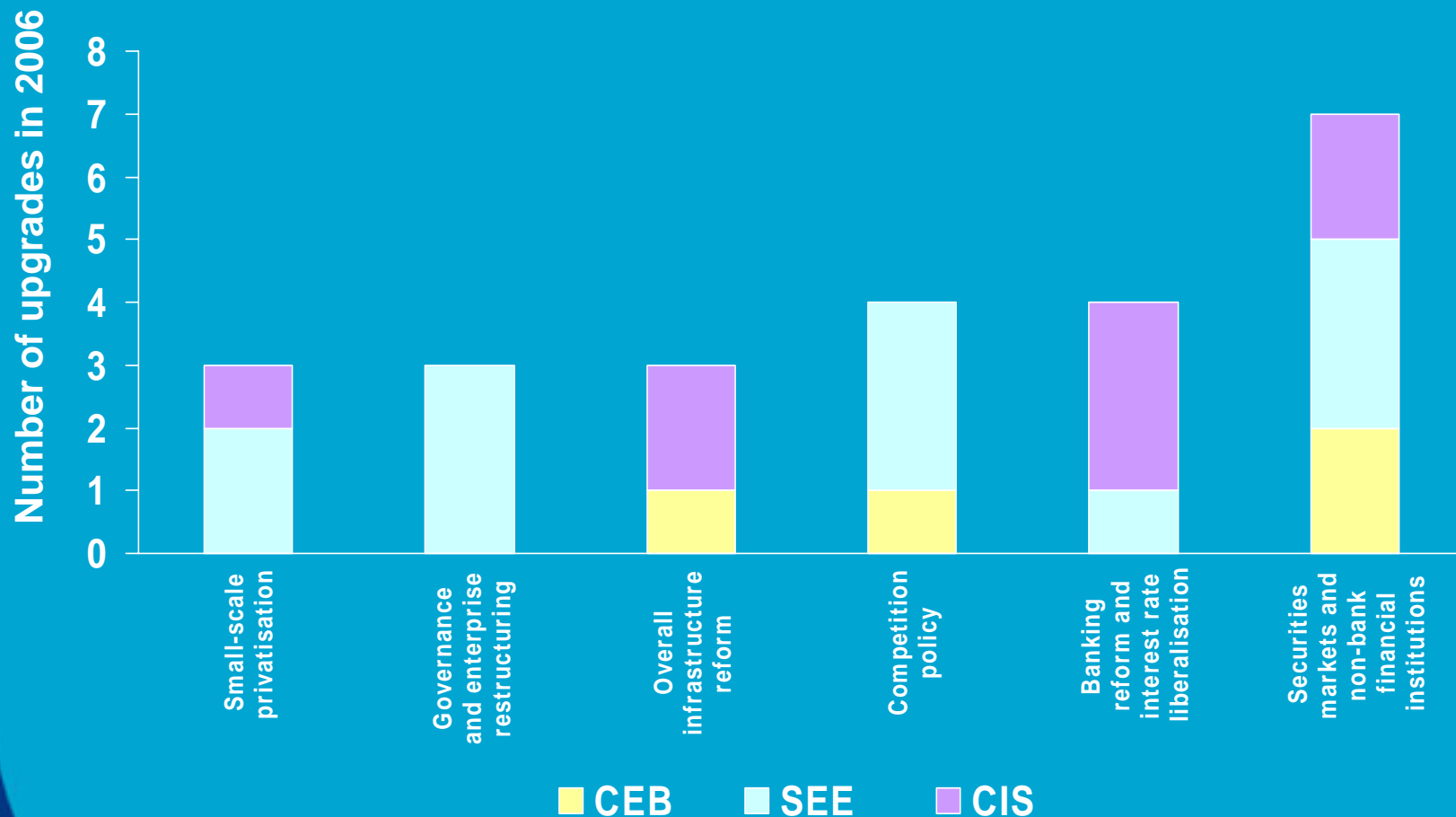
- Economic growth projected to exceed 6 per cent in 2006, driven largely by private consumption
- High commodity prices benefited parts of CIS
- Continuing progress in reform, particularly in SEE
- Reforms on hold in CEB after EU accession
- Markets responding to institutional strengthening in some CIS countries



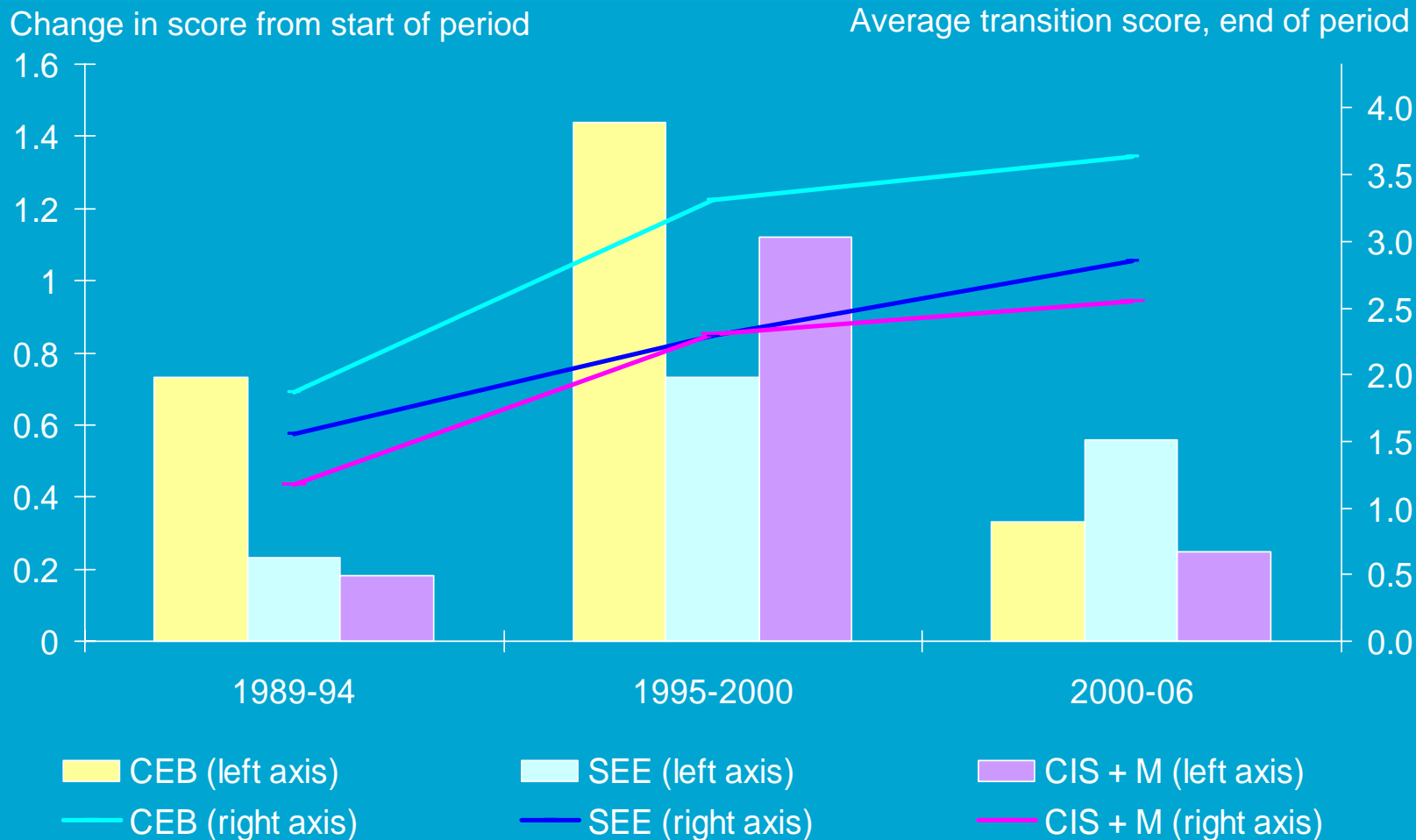
Progress in transition by country



Progress in transition by sector

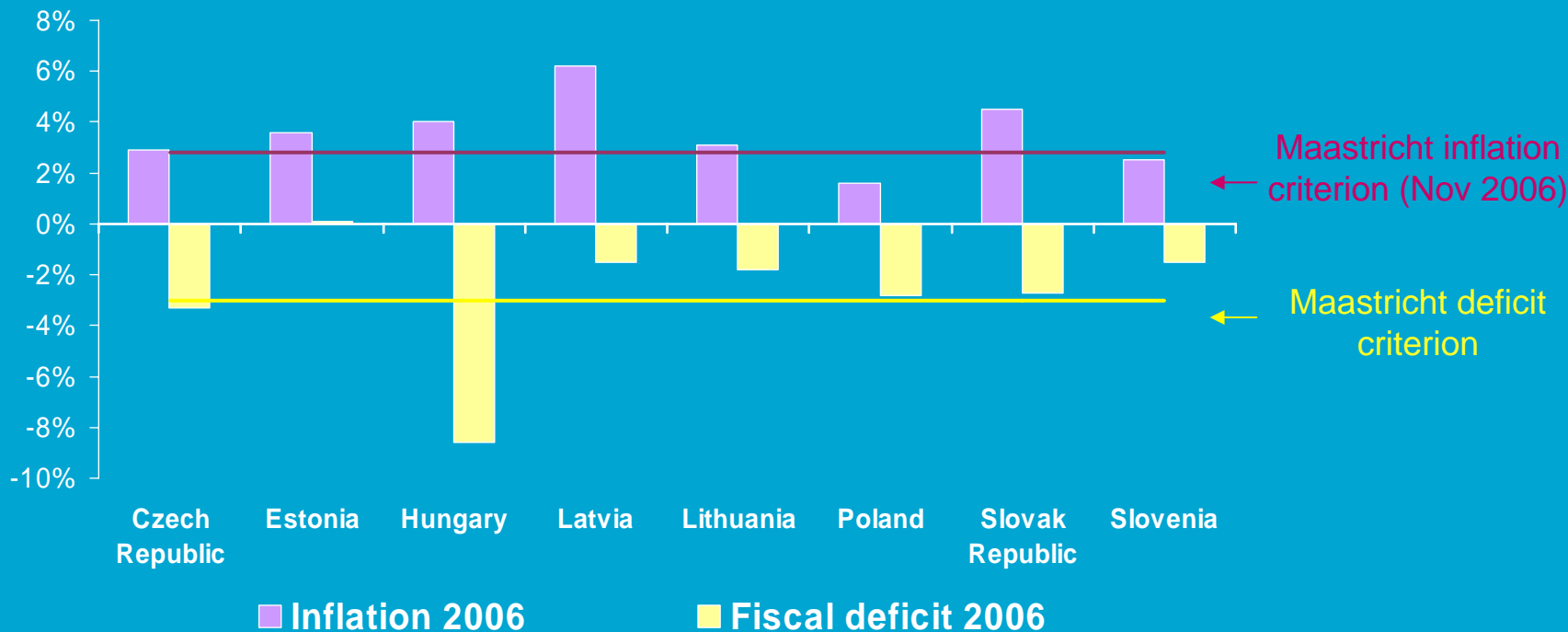


Trends in transition: 1989-2006



CEB: some imbalances remain

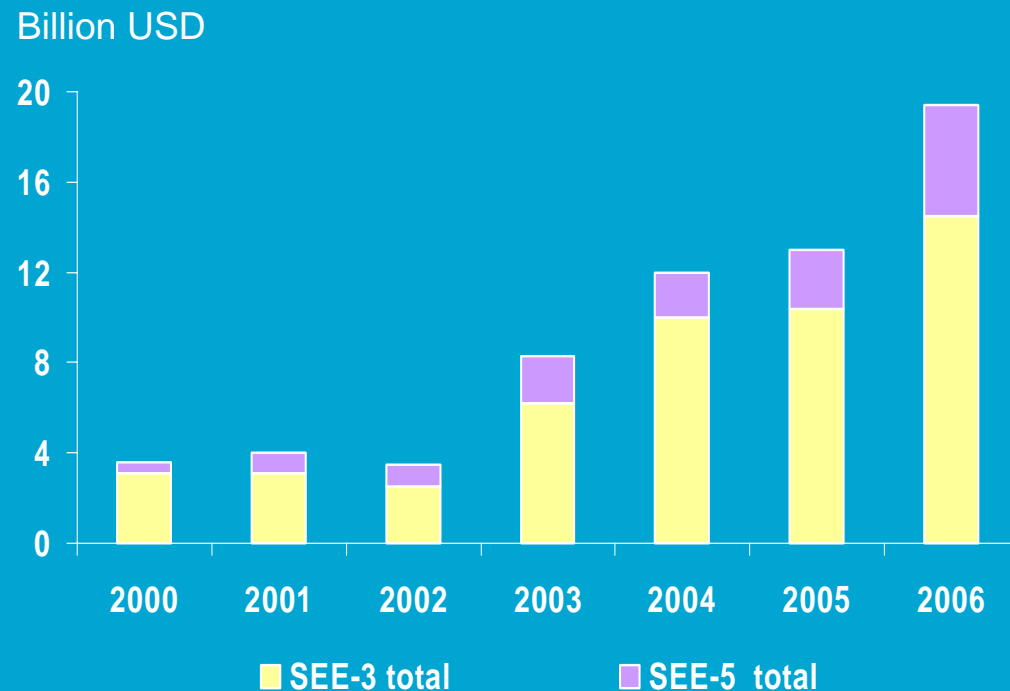
- Strong growth in 2005-06, driven largely by domestic demand
- Demand and high energy prices fuel inflation and external imbalances
- Euro entry dates have been pushed back, except Slovenia and Slovak Rep.



SEE: fresh wave of FDI

- Strong growth in 2005-06
- Prospects of EU accession attracting record inflows of FDI, mainly due to privatisations and bank acquisitions
- No deterioration in fiscal position and inflation is generally under control, but government spending is large relative to GDP
- Large current account deficits could pose a problem if remittances or FDI slow down

Net Foreign Direct Investment



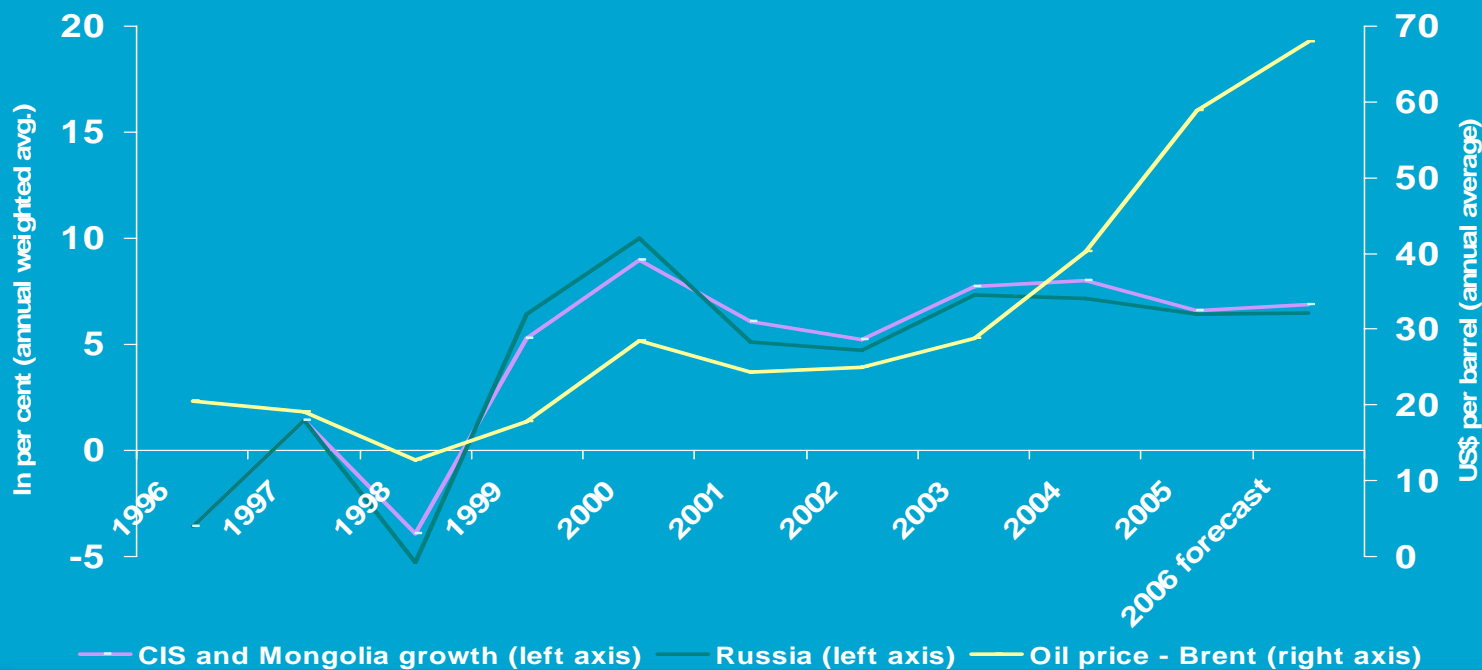
SEE-3 = Bulgaria, Croatia, Romania

SEE-5 = Albania, Bosnia-Herzegovina, FYR Macedonia, Montenegro, Serbia



CIS: domestic consumption rising

- Strong growth fuelled by high energy/commodity prices and domestic consumption
- High energy prices have been associated with strong growth, but capacity constraints are now imposing limits
- Resource rich countries managing windfalls with restraint

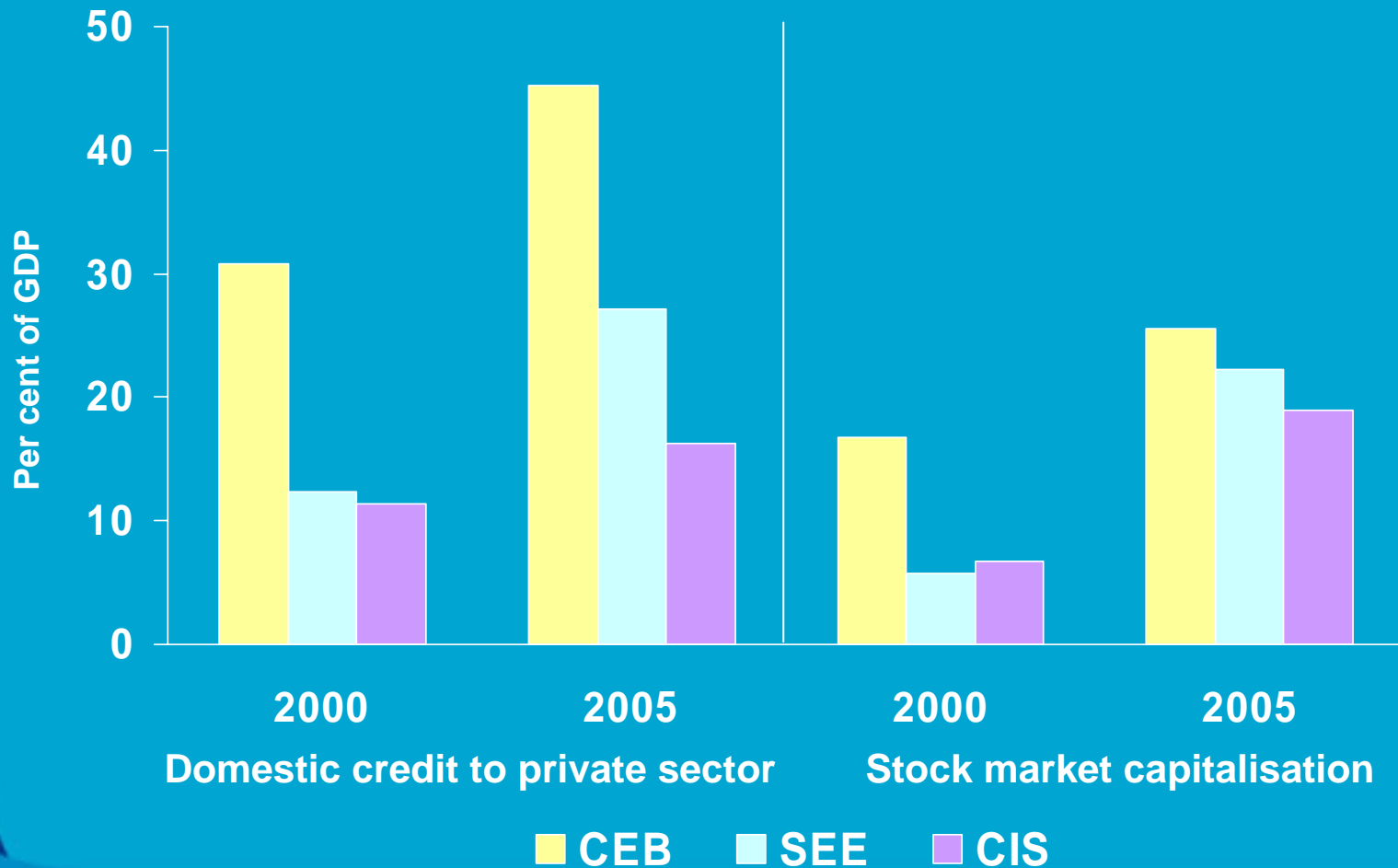


Special theme - Finance in Transition

- Financial sectors have grown in size and complexity but remain underdeveloped; further institutional reforms still needed
- Financial sector development is linked to growth
- Entry of foreign banks has had a positive impact on efficiency and stability of banking systems
- Access to bank finance remains problematic for many firms, particularly SMEs
- Non-bank sector is now growing, including private equity. Private equity funds can play a positive role in restructuring firms



Financial markets are growing

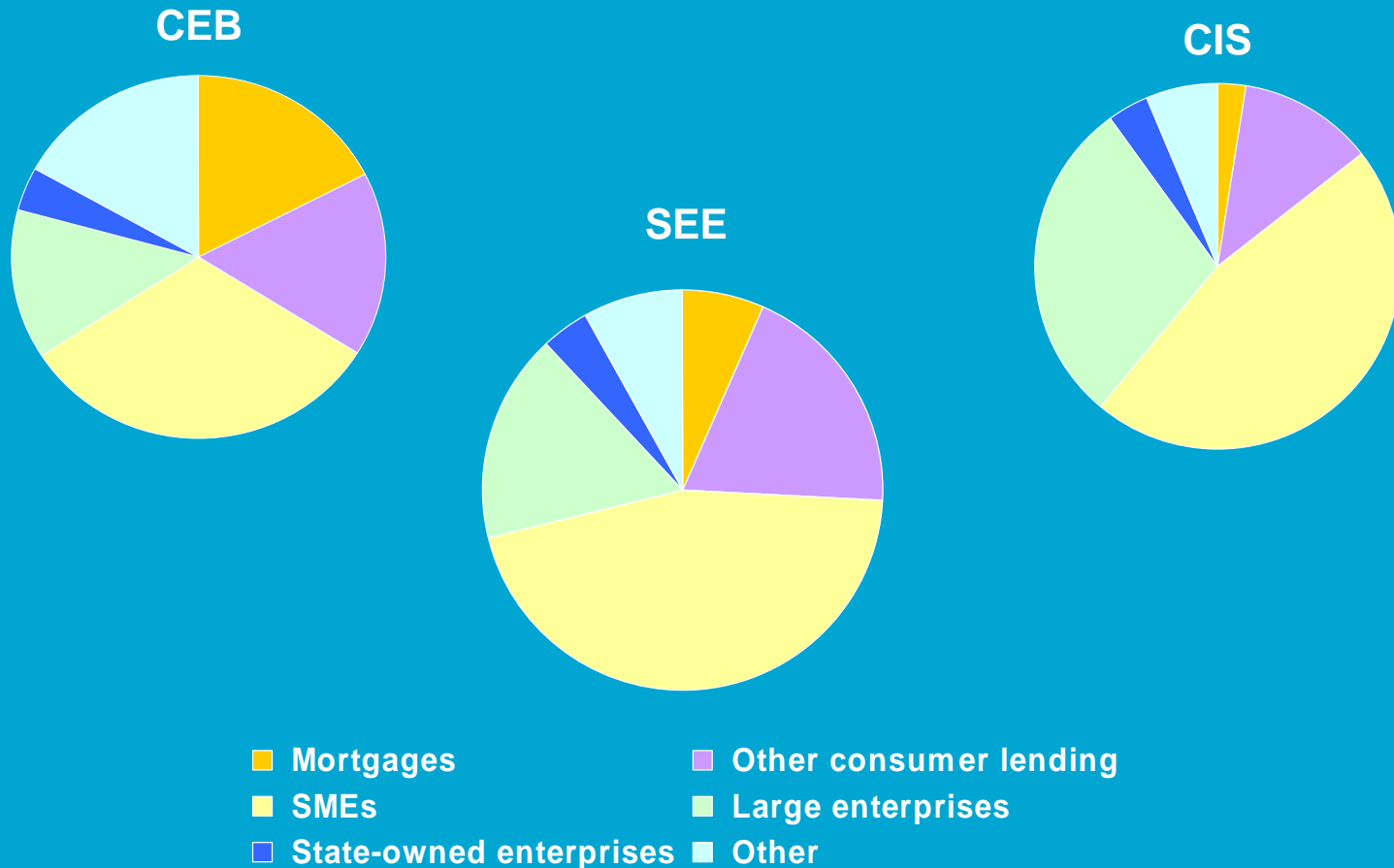


Finance and growth

- Evidence from large number of countries for 1994-2003 suggests significant gains for transition countries from advancing financial development
- Transition countries could increase growth in industrial output by up to 1.4% per year by raising financial development
- Largest gains likely in countries with low initial levels of financial depth



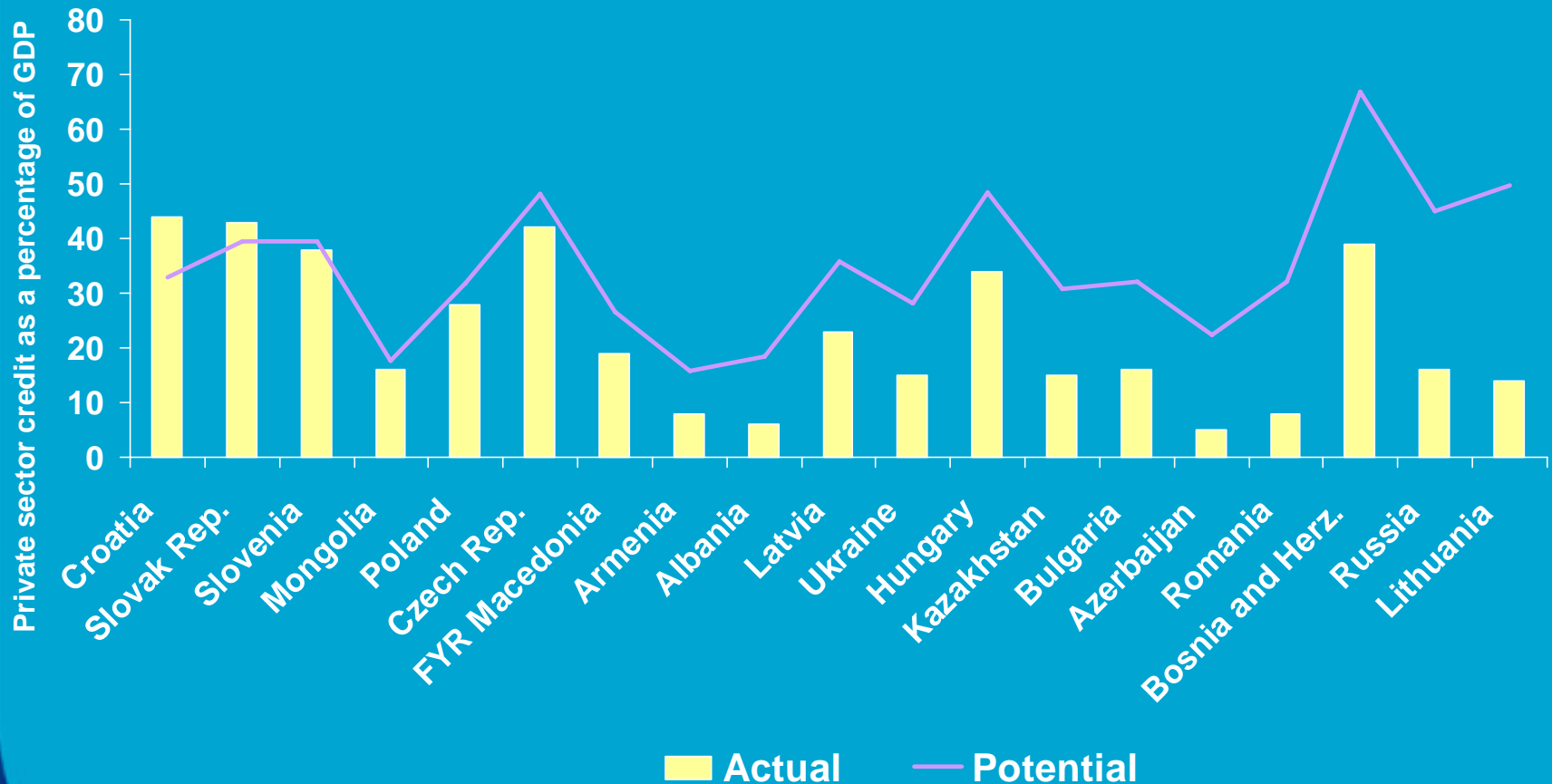
Banks are lending to a diverse range of borrowers, including households



Source: Banking environment and performance survey (EBRD)



Institutional reforms can boost lending



Note: The chart shows the potential impact that reforms, such as protection of creditor rights and the creation of credit registries, could have on financial development.



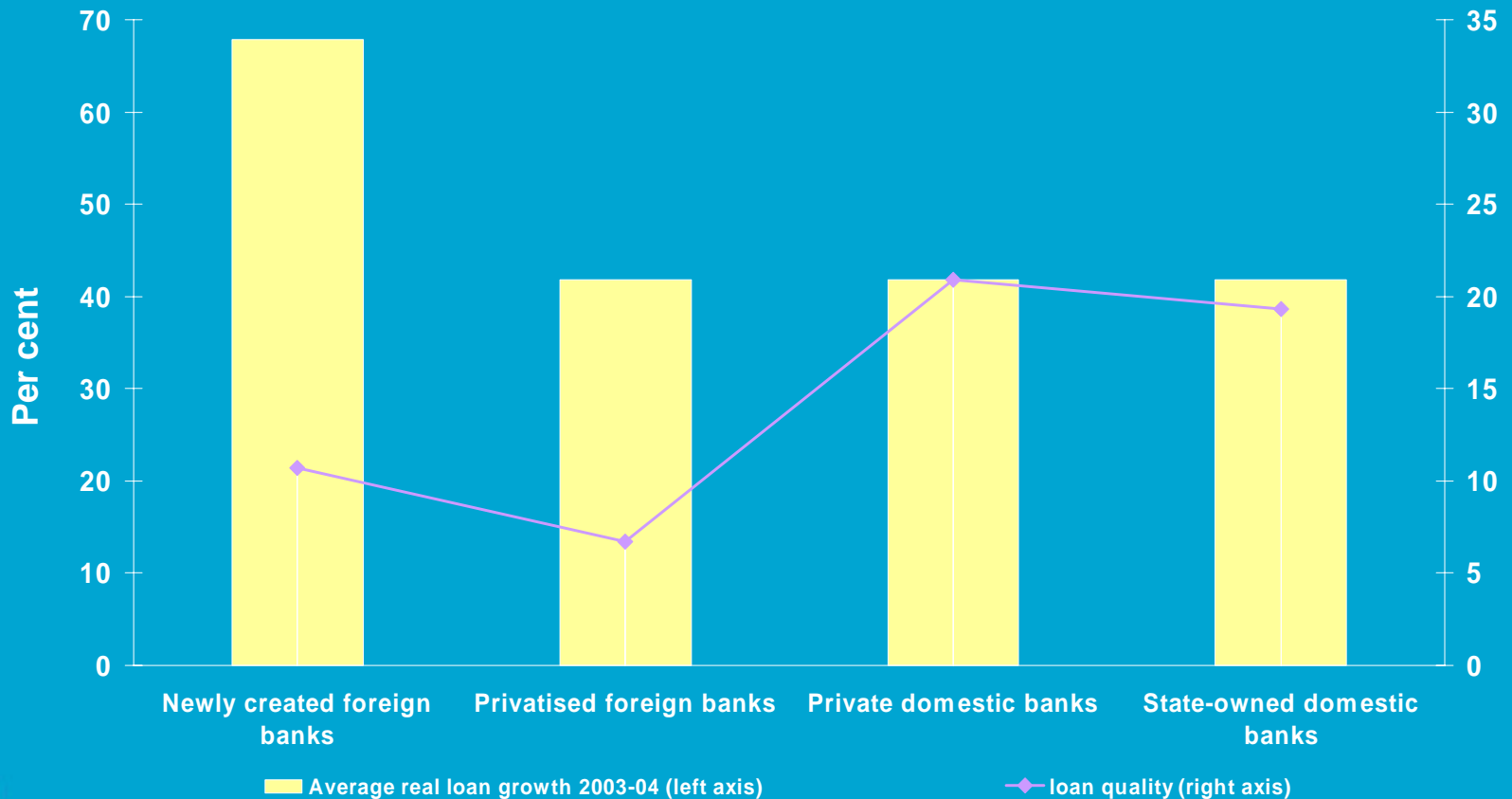
Bank performance

- Foreign owned banks have become increasingly important players
- Institutional factors have also been important in explaining performance
- Insights from EBRD's Banking Environment and Performance Survey (BEPS) conducted in 2005 with a sample of 220 banks in 20 countries



New foreign banks grow faster

Foreign banks have better portfolios than domestic banks

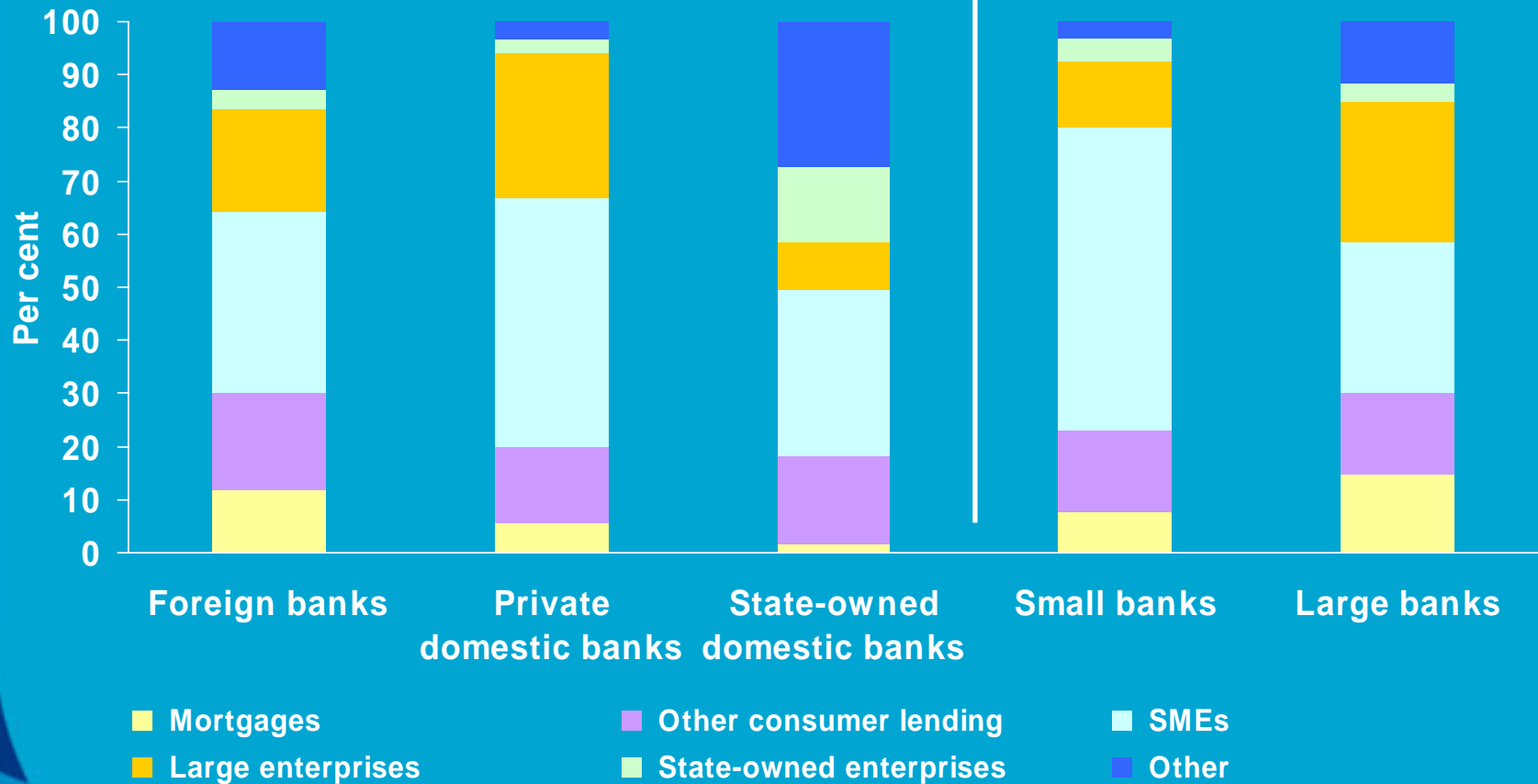


Source: Banking environment and performance survey (EBRD) and Bankscope

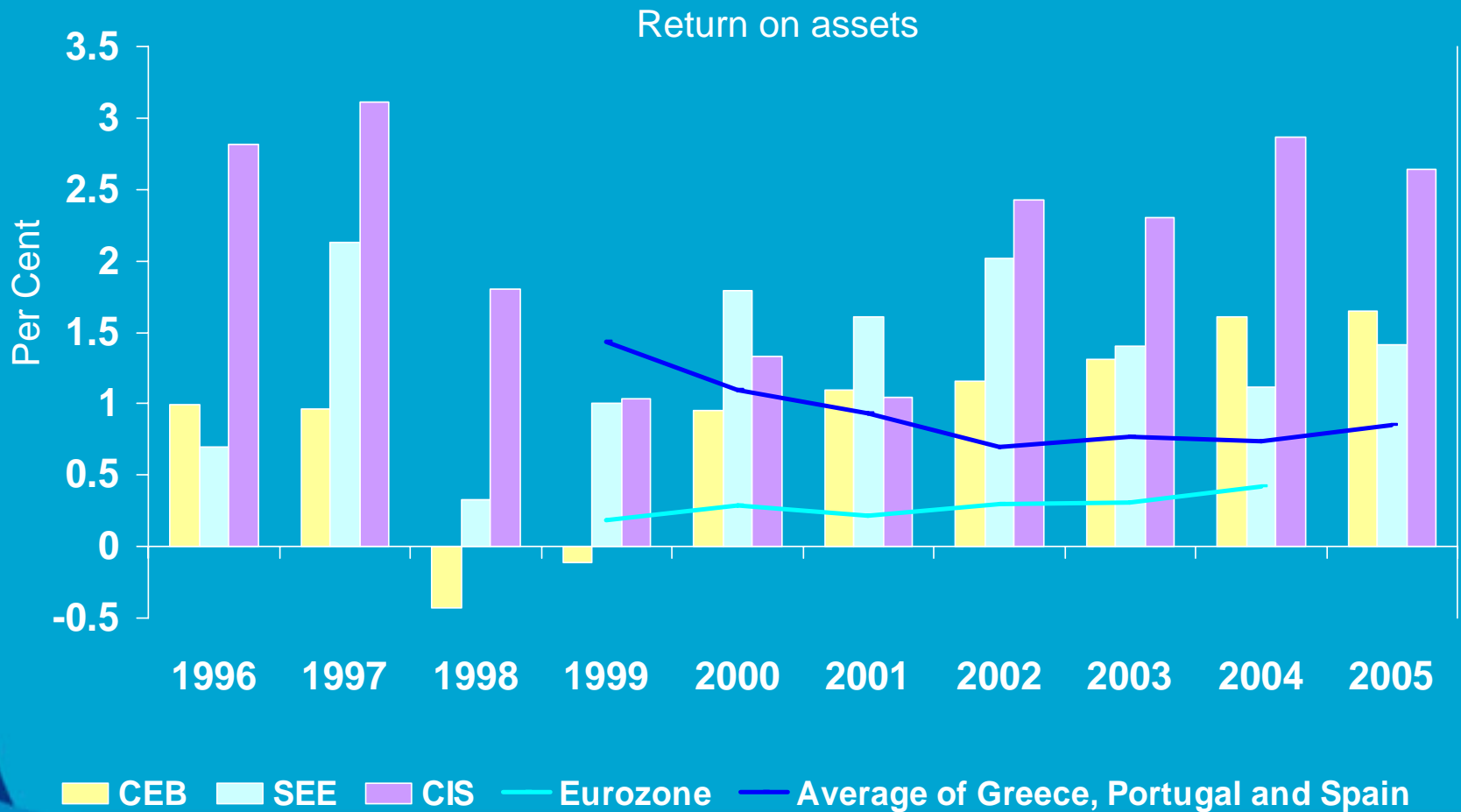


Foreign, large banks focus on consumer credit

While domestic, small banks focus on SMEs

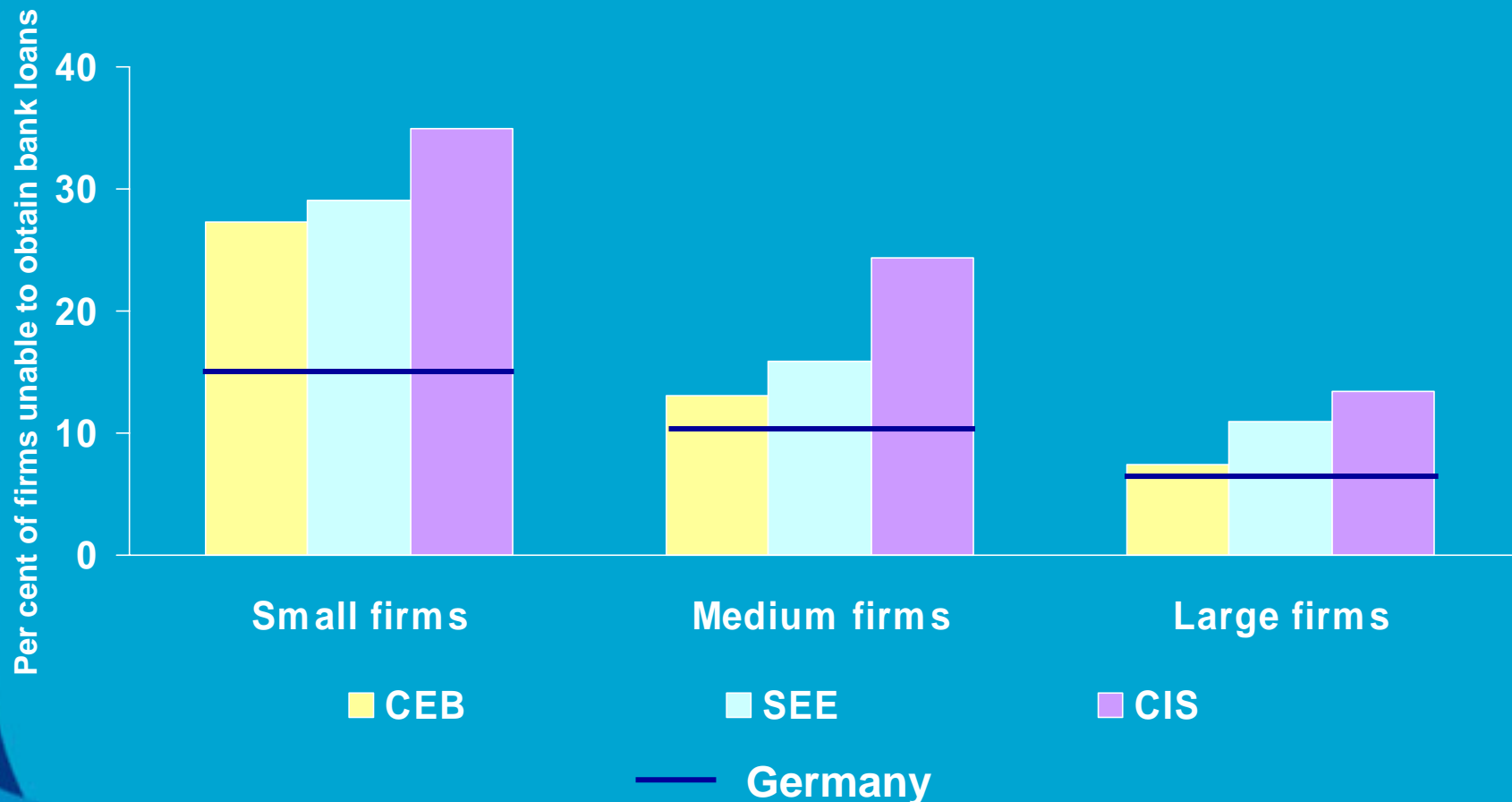


Banks' performance has improved



But firms still lack access to credit

Small enterprises and CIS firms are especially constrained

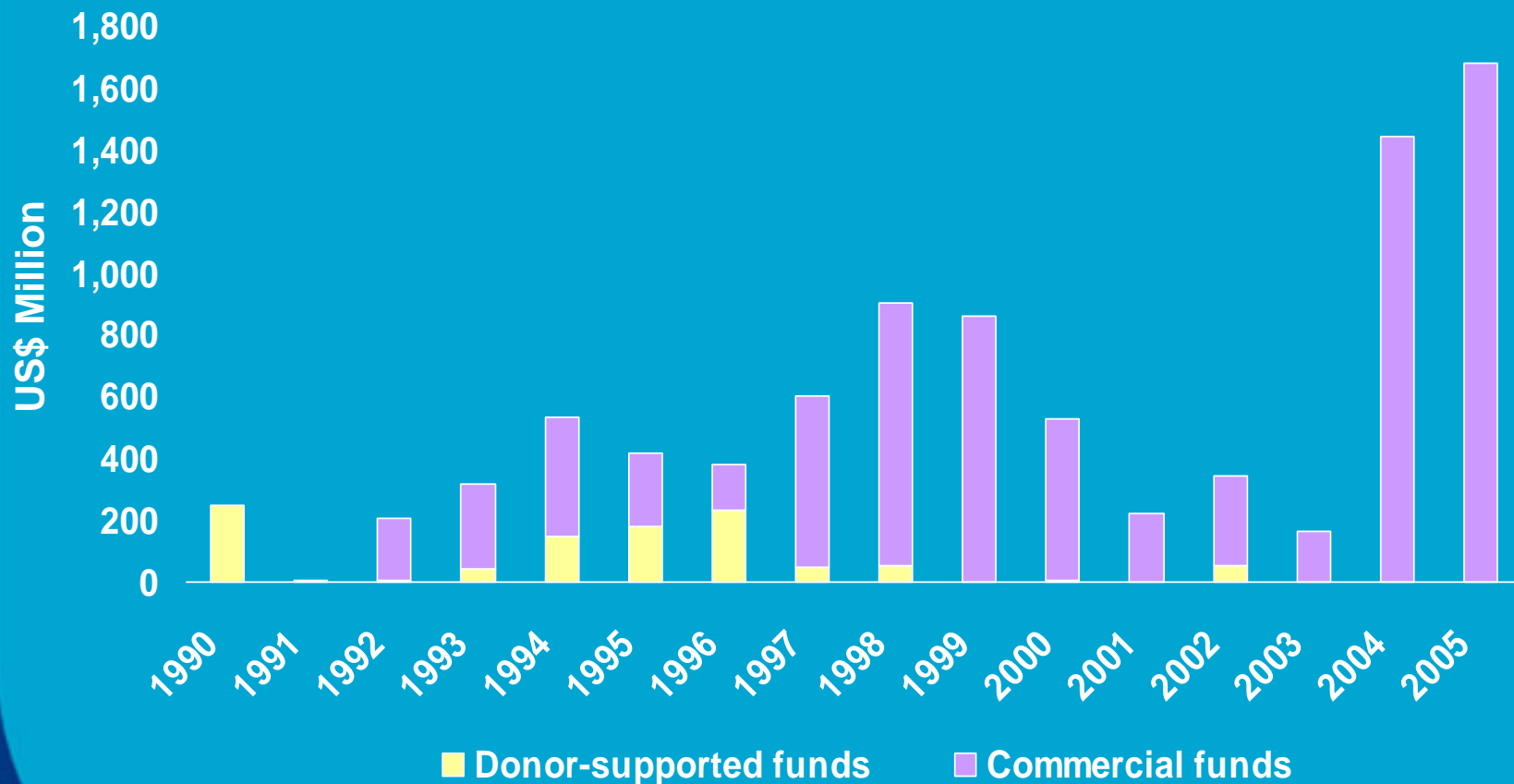


The emergence of non-bank finance

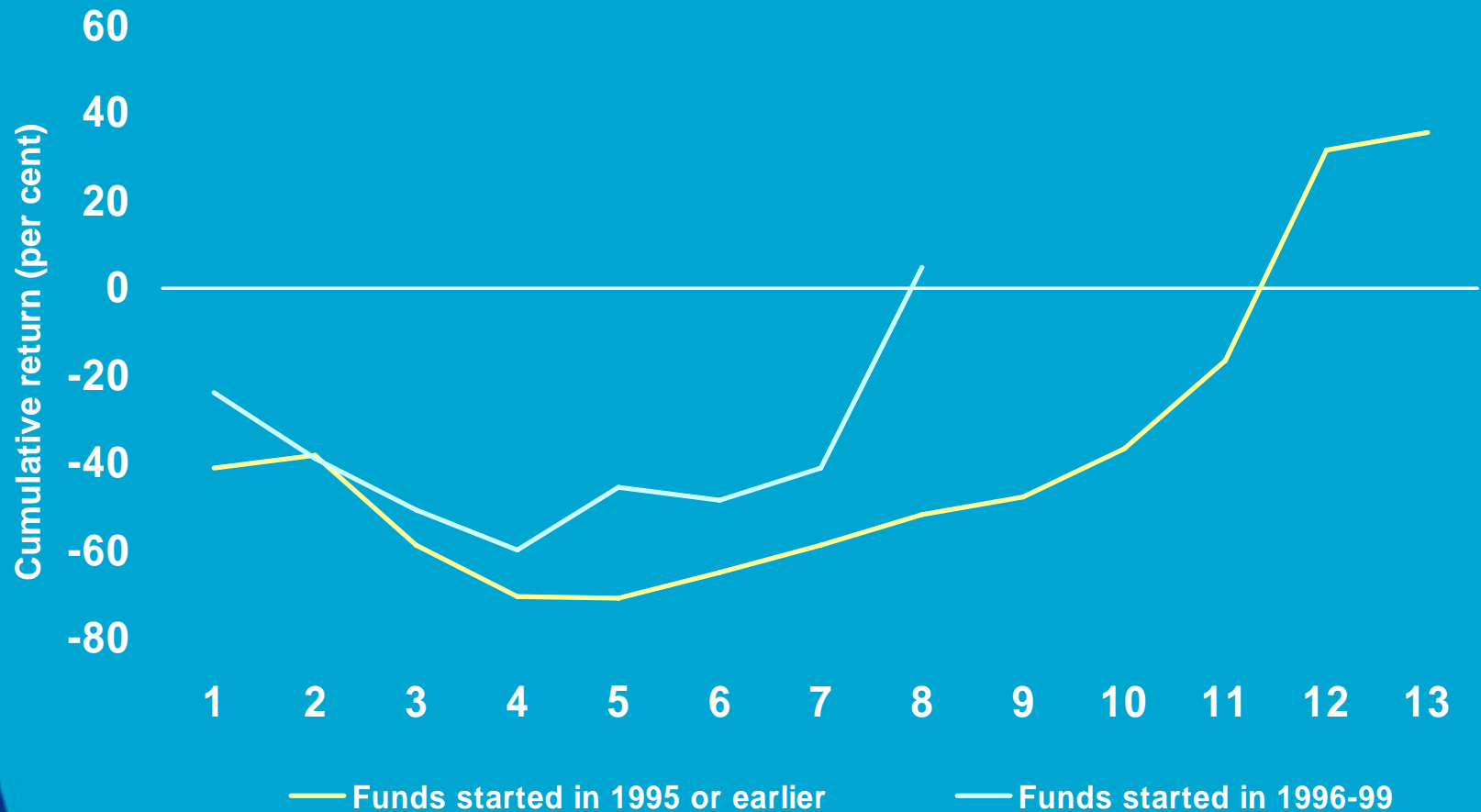
- Public equity markets have grown significantly, although they still remain quite small and often illiquid
- Unique EBRD data relating to 44 funds with 450 investments show that private equity has also begun to emerge from the shadows
- Private equity can play an important role in restructuring firms and improving performance
- Private equity can also support the development of know-how and expertise



The emergence of private equity



Fund performance improving



Performance of private equity funds

- Returns have increased rapidly in recent years due to better exit and investment opportunities
- Large funds, diversified funds provide better returns
- Returns comparable to private equity funds in EU
- Most funding comes from abroad; limited domestic interest thus far in providing private equity finance
- Restructuring of firms by private equity funds – particularly changes in management - has been associated with improved returns



Conclusion

- Progress in reform has been maintained
- Strong growth throughout the region in 2006
- Financial markets have also grown in size, complexity and stability
- Public and private equity markets have emerged but bank-based systems dominate
- Continuing scope for improving the quality of institutions and the operating environment
- Potentially large growth dividend from further financial deepening



KAZAN

Republic of Tatarstan



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We look forward to welcoming you in the **Russian Federation**
next year at the **EBRD Annual Meeting and Business Forum**
20 and 21 May 2007

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