World Economic Situation and Prospects
Weekly Highlights

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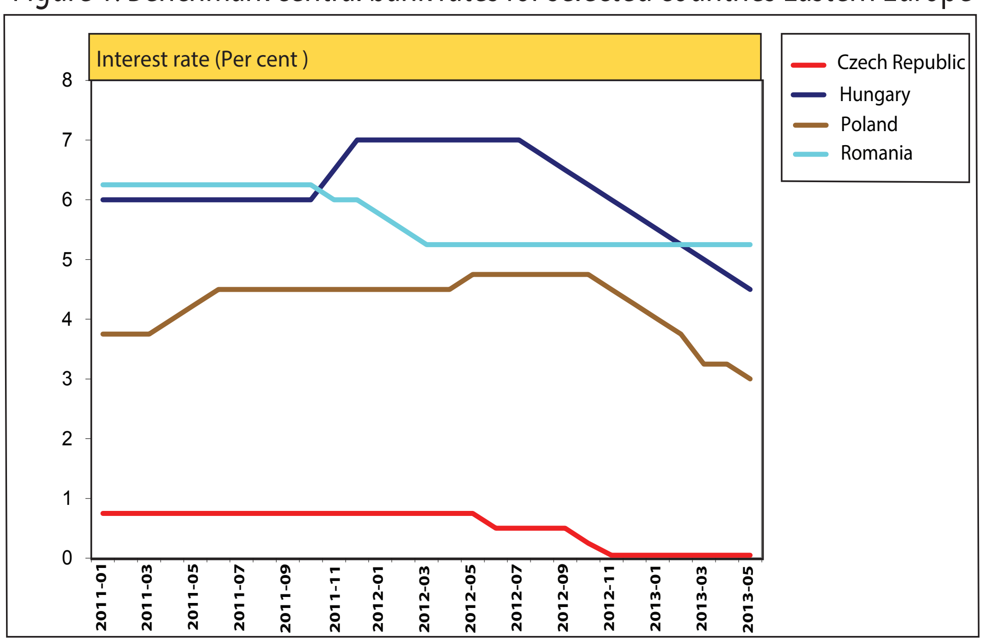
Limited impact of monetary policy on domestic credit in Eastern Europe

Since mid-2012, most of the central banks of the countries with flexible currencies in Eastern Europe have relaxed their monetary policy stances by cutting their benchmark policy rates, aiming to revitalize growth. As last year's inflationary pressures—which were caused by higher food and fuel prices—subsided in early 2013, there was more room for monetary relaxation and, as a result, interest rate cuts continued, the latest one implemented by the Hungarian National Bank in May. Currently, the central bank policy rates are at record low levels in the Czech Republic, Hungary, Poland and Romania (figure 1). In Hungary, the central bank also resorted to unconventional policy measures to boost domestic credit. A "Funding for Growth Scheme" was announced in April, offering funds at a zero interest rate for commercial lenders, in order to channel the funds into loans for small- and medium-sized enterprises (SMEs) at low interest rates, and to help SMEs convert their foreign currency loans into loans in the domestic currency.

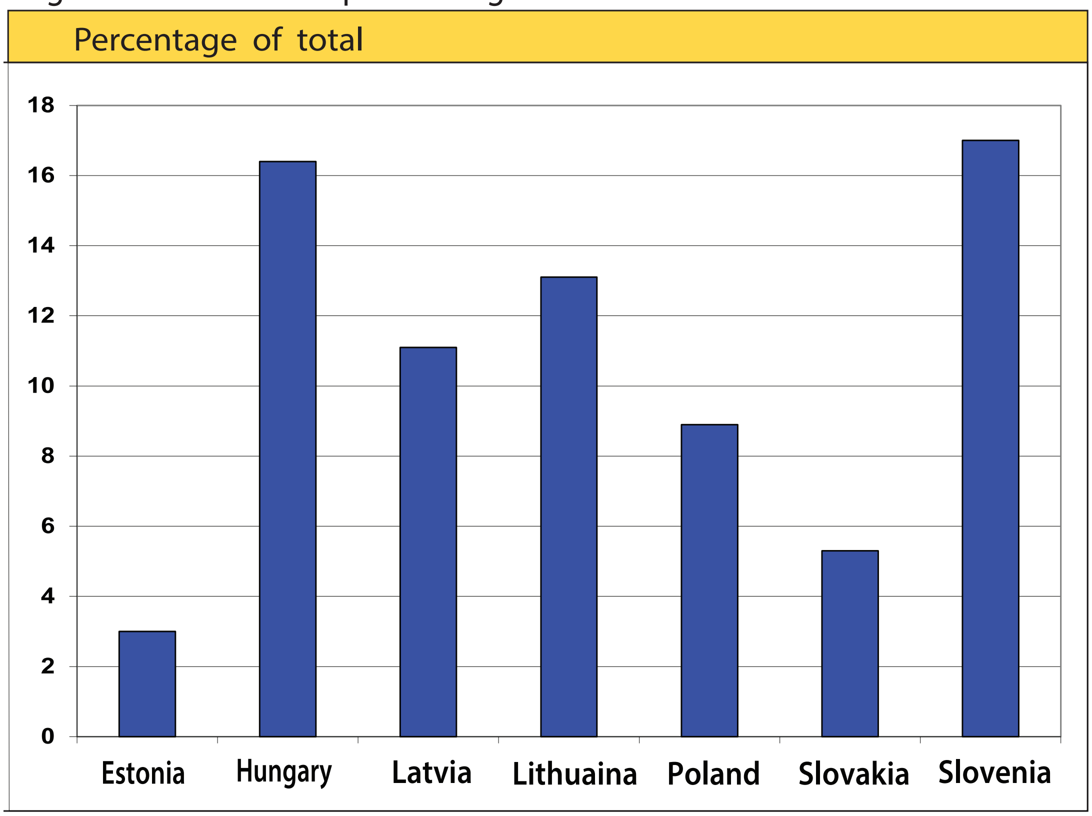
Figure 1: Benchmark central bank rates for selected countries Eastern Europe



Sources: Czech National Bank, Hungarian National Bank, National Bank of Poland, National Bank of Romania.

However, despite accommodative monetary policy, credit growth in the region remains either anaemic or even negative, and credit standards remain tight, as the share of non-performing loans remains high (figure 2). In the first quarter of 2013, credit to the private sector contracted in some countries, particularly in Hungary and in Slovenia. As cross-border deleveraging by the parent EU-15 banks is currently of a smaller magnitude than in the previous years, and the banks increasingly rely on domestic funding sources, supply constraints are gradually becoming less prevalent.

Figure 2: Share of non-performing loans in selected new EU member States



Source: European Bank for Reconstruction and Development.

Apparently, the recovery in private credit in Eastern Europe is being held back by low demand for loans. Households and businesses still continue to repair their balance sheets. Businesses are reluctant to invest and undertake risks as long as the output gap is negative and both domestic and external demand remain feeble. Although demand for short-term corporate loans is strengthening, firms are unwilling to take long-term loans. The ongoing fiscal austerity weakens households' purchasing power and their ability to repay credit. Although consumer sentiment indicators in recent months improved somewhat in some East European countries, they remain far below the pre-crisis levels.