

BACKGROUND INFORMATION

LOAN GROWTH FOLLOWING ASIAN/RUSSIAN CRISIS IN 1999–2000: CAN THE 1997 BOOM RECUR?

In the second half of 1990ies one of the most essential issues of Estonia's economic policy was imbalance of the external sector resulting from the preferential growth of demand over domestic supply. The problem culminated in 1997 when rapidly worsening external environment made financing of the quickly growing current account deficit difficult. One of the main causes of the 1997 boom was rapid growth in loans, mainly sustained by foreign loans. The annual credit growth rate reached about 100 per cent. In later periods that indicator dropped quickly down to negative values because of overall decline in domestic demand. Since the second half of 1999 there have been signs of recovery in domestic demand as well as in domestic credits. Inevitably a question arises whether the problems of 1997 could recur? Hereinafter we try to give a brief survey of the current situation comparing it with the situation in 1997, and to take a look at possible medium-term developments.

Current Situation

This summer the annual growth of banks' loan portfolio exceeded 26% (at the beginning of the year the growth was 10%). The loan growth is concentrated into non-banking financial sector, mainly in leasing business,

the annual growth being here 66%. Leasing companies used money for three purposes: redemption of debt, increasing credit portfolio in other Baltic States and increasing credit portfolio in Estonia. In case of the latter the annual estimated growth was 30%. The annual growth of loans extended to private persons by the end-quarter was 32%. As to the corporate credits the growth has been contained at a modest level – 6% in June – nevertheless showing a rising trend. As of the end of the quarter, the total growth in loans to private sector (credits extended to enterprises and private persons by banks and leasing companies) was almost 12% a year (see Table 1b).

In addition to the loan growth concentration into financing institutions there is another essential difference in comparison with the year 1997, namely, the importance of direct external lending has grown in corporate financing. In the middle of the year the growth of foreign debt was about 11%, about 2 million kroons in volume (see Figure 9b).

Loan Structure by Sectors

As it was pointed out above, the growth of banks' loan portfolios accelerated by the end of the second half of

Table 1b. Total residential leasing and loan portfolio (EEK mn)

	12.98	03.99	06.99	09.99	12.99	03.00	06.00 ¹
Private individuals loan and lease total	4,666	4,753	4,823	5,310	5,748	5,883	6,166
o/w real estate loan and lease of private individuals	3,105	3,147	3,249	3,301	3,573	3,743	4,035
other loan and lease of private individuals	1,561	1,606	1,574	2,009	2,175	2,139	2,132
Corporate credit and lease total	22,682	21,977	21,982	21,916	22,279	22,560	23,837
o/w corporate settlement credits	2,183	2,132	1,999	1,757	1,774	1,835	2,019
corporate real estate loans and lease	2,079	2,476	3,738	3,930	4,222	4,488	5,033
other corporate loans	15,071	14,627	13,251	13,324	13,621	13,832	14,715
corporate bonds owned by banks	3,349	2,743	2,996	2,904	2,661	2,405	2,070
Loan and lease total	27,347	26,730	26,806	27,226	28,026	28,443	30,003
o/w cars and other traditional leasing property	4,760	4,986	4,913	4,820	4,866	5,124	5,786
Loan and lease of non-residents	1,198	1,038	823	996	1,091	1,186	1,248

¹ Leasing data for June 2000 are preliminary.

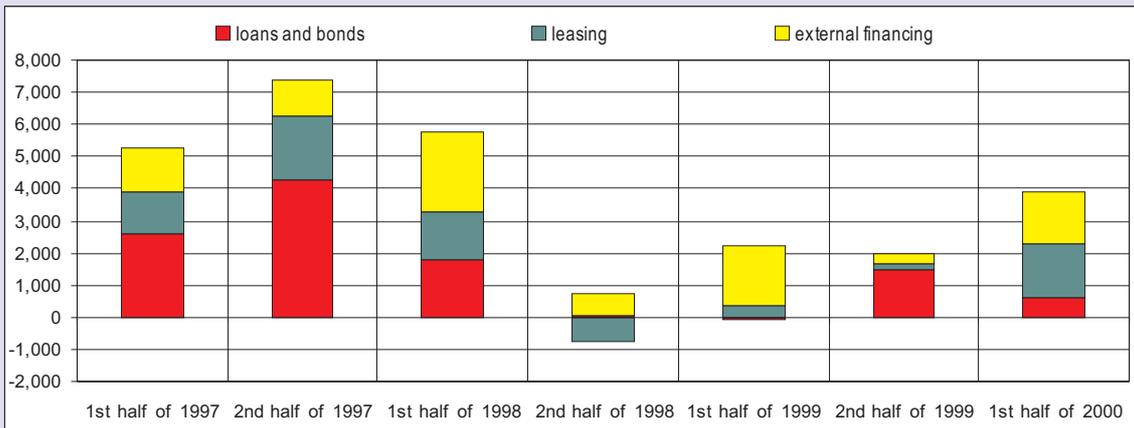


Figure 9b. Absolute growth of the real sector's external financing (EEK mn)¹

the year (26% against the first half of 1999), whereas there are no indicators to reverse that trend. The threshold issue is to identify a growth rate not endangering the external balance of macro-economy, ie not facilitating too fast growth of domestic demand. Firstly, it is worth to consider how the credit channelled to business sector is distributed between domestic-market oriented branches of economy, ie sheltered sector and west-oriented branches of economy, ie open sector (another issue would be the more accurate definition of those sectors). Knowingly, the open sector enterprises do not generally depend on the cyclic nature of domestic demand in Estonia (eg quite extensive shrinking of domestic investments and consumption during 1998 and the first half of 1999). In recent years the share of the sheltered sector in credit portfolios of banks and leasing companies has grown. Among other factors the latter is also due to most of the exporting enterprises having found favourable financing sources from abroad (for example, parent companies) and do not need credit from domestic market. The estimated share of the sheltered sector in loan portfolios of banks and leasing companies is close to 80%.

The most preferable branch of economy is real estate and business service and its share in loan portfolios

of banks and leasing companies has increased to 30% against 26% last year (annual growth 30%). At the same time during the last year there has been a fast growth in corporate real estate loans and leasing – 35%. In near future one should take into account that a number of new real estate projects has been launched recently. The growth in real estate loans for private persons is gaining pace.

In addition to real estate and business service also trade is significant and here the growth has been much faster during last months than in the industry. Sectors with small loan volumes (outstanding loans below 1 billion kroons) such as energy (targeted loans to municipal enterprises) and public administration (local governments) demonstrate clear-cut growth trends. In recent periods there has been no loan growth in construction and hotel business. **Hence the growth in volume and quality of loan portfolios of banks depends increasingly on domestic demand.**

An essential consumption indicator is the growth of **consumption loans** to private persons. Thus far there have been no signs indicating an essential growth of consumption loans in banks' loan portfolios. The banks have channelled most of consumption

¹ The growth of external liabilities reflects the growth of corporate external loans, trade credits and other liabilities attracted by direct loans and as loans from direct investors. The growth of the first half of 2000 is estimated.

loans through leasing companies. New leasing products to facilitate purchasing of consumer goods have come or are about to come to the market. **Currently the volume of such products does not have noticeable effect on macroeconomic stability.**

Conclusions

What is the current monetary policy message? It can be said that currently the space of loan growth does not endanger macroeconomic equilibrium. The 11–12% credit growth is close to that of the eurozone and does not exceed too much the nominal speed of economic growth. At the same time we have to bear in mind that monetary policy viewpoints should not be based only on static indicators. In order to make decisions and create viewpoints it is necessary to look forward for a year or more. Many new risk factors can appear in near future.

During the last half a year the loan growth has significantly accelerated and there has been no sign of any factors that could substantially slow down that pace. An opinion poll made by the Estonian Institute of Economic Research proves that the future expectations of both private persons and enterprises keep improving, therefore, the credit demand is expected to grow. In such a situation the tightening of monetary conditions in Europe would be welcome. Nevertheless, most probably the European Central

Bank is in the final cycle of raising interest rates, leaving no significant space for further interest rate increase in Estonia. Currently there are no restrictions as regards credit supply. The banks are liquid and capable to increase their loan portfolio fast in near future.

Nevertheless, the current situation differs in many respects from the situation in 1997. Unlike in 1997 at present and also in near future the loan growth is mainly fed by growing domestic deposits, which makes the banks less dependant on the external changes. In addition, the price level at securities market reflects fundamental indicators of enterprises more adequately than in 1997. Nevertheless, those two development trends can change swiftly. It should be noted that since the end of 1999 unlike crediting the deposit growth has not essentially accelerated. It could mean that in medium term the banks have to rely increasingly on external borrowing. If the economic growth continues at high speed and the expectations of economic agents continue to improve, it could bring along an increase in the value of assets. This in its turn would trigger overoptimistic expectations. Still it should be noted that meanwhile the banking system has gathered strength. The change in the structure of ownership has contributed to reshaping of strategy and upgrading of management procedures. Therefore, as a conclusion it can be said that though in short-term perspective the loan growth would not endanger the macroeconomic equilibrium, such a threat could manifest itself in medium term.