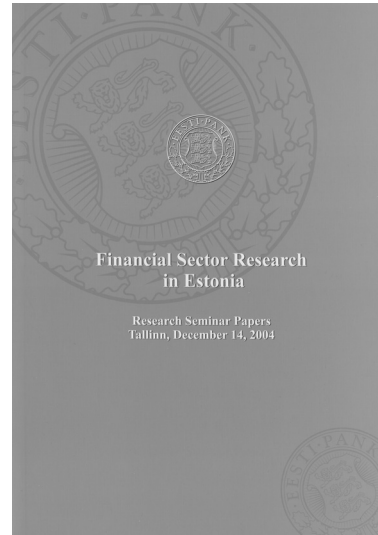


SEMINAR INTRODUCING RESEARCHES ON FINANCIAL MARKETS

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On 14 December 2004, Eesti Pank organised a seminar on financial markets research in Estonia in co-operation with the University of Tartu and Tallinn University of Technology. This was a continuation to the seminar on labour-related studies, which was held on 9 May 2003. Analogously to the compilation containing papers presented at the seminar on labour market, a compendium of the researches introduced at the financial markets seminar was published recently, and it is now available at libraries and on the web site of Eesti Pank.



The compendium comprises five researches on the operation of financial markets. The range of topics is relatively broad, including an analysis on the productivity of the banking sector, financial stability analyses both on the state and the banking sector level, as well as issues on economic and lending cycles.

The compendium is useful reading for anybody interested in the development of financial markets in Estonia, as well as in the Central and Eastern Europe. Hopefully this concise summary will excite greater interest in the studies and enable better understanding of all the technical details in the articles.

The article by **Märten Kress** treats business and credit growth cycles. The author enquires into issues related to the possibility of distinguishing between periods of high growth and low (and negative) growth, and to the connections between business cycles and credit growth cycles. The results of the econometric analysis reveal that the economic crisis of Russia in 1998 resulted in the so-called low-growth period in the business and credit growth. At this point it is important to note that whereas the credit growth regime of the private sector followed the regimes of business growth with a three-month lag in both entering and exiting the low-growth stage, the business sector credit growth slowed down not until five months after the halt in business growth and accelerated remarkably not before eight months after the end of the recession period.

The role of debt burden and credit growth as a cause of financial crises has been subject to discussion in several academic researches. **Jana Kask**, **Peeter Luikmel** and **Lenno Uusküla** have touched upon the same topic. Using data from the 25 Member States of the

EU and three candidate countries – Bulgaria, Romania and Turkey – from 1970 onwards, the authors study the impact of debt burden on the occurrence of financial crises. With the help of a comparative analysis and the econometric model, it was concluded that although there has occurred a remarkable growth in the debt burden before a financial crisis in several countries, and crises have occurred in countries with a high level of debt, there are still plenty of examples, where countries that have had high credit growth rates have not experienced a subsequent crisis, which is why the direct statistical link between the level and growth of indebtedness and financial crisis is weak. At the same time, the authors observed that there is some evidence revealing that if the level of indebtedness in a country is relatively high, the crisis may last longer and be more costly than in countries with a low debt burden.

Forecasting problems in the banking sector is essential from the point of view of timely implementation of measures in order to avert a crisis or reduce its negative results. **Kadri Männasoo's** paper is about searching for early warning signals of a banking crisis in the Central and Eastern European countries. The descriptive section of the research points out that the high loan-to-assets ratio is usually associated with problem banks in the EU Member States and with sound banks in countries outside the EU. Another observation is that non-EU banks are more sensitive to inflationary instabilities and exchange rate fluctuations. The econometric analysis showed that in the longer term, macroeconomic and structural indicators are the best early signs of a crisis. Although bank-specific factors (liquidity, credit and market risk, efficiency and profitability) are irrelevant independently, it cannot be claimed that they would be insignificant signs of a crisis when taken together. Bank-specific variables describe the crisis process much better than the macroeconomic ones.

Over the last years, foreign ownership in the banking sector has increased considerably in many Central and Eastern European countries. **Janek Uiboupin** analyses the impact of foreign banks' entry into the banking market on the stability of the local banking sector. The two objects under study are volatility of credit supply growth and quality of the loan portfolio. The descriptive statistics shows that compared with local banks, the credit supply of foreign banks is considerably more stable. The loan portfolio of foreign banks increased at a slower pace until 1998 and picked up speed from 1999, whereas it must be pointed out that credit supply has not been notably dependant on the local economic environment. The results of the econometric analysis reveal that the countries with a bigger share of foreign capital suffer from smaller loan loss provisions. Therefore it can be concluded that the entry of foreign banks has a stabilising effect on the loan market and reduces loan loss provisions.

Ly Kirikal approaches the productivity of banks from a different angle by presenting the Malmquist productivity change index. The advantage of the index is that it enables to differentiate between better utilisation of the technology at hand and the technological progress. The Estonian banking market has efficiently introduced innovative, new technology-based products and services. The efficiency analysis of the banking sector shows that productivity growth is mainly related to implementation of new technologies, and better utilisation of technology plays only a secondary role.