INTESA SANPAOLO

International Research

Banks and Markets

Emerging Europe

The COVID-19 crisis has enlarged the deposit base which is expected to be absorbed only partly in 2021, opening up the possibility of a more dynamic funding strategy.

- **Deposits** accelerated in all countries of Emerging Europe (by around +14% in 2020 in the CEE and SEE regions), well above expectations, supported by precautionary motives and uncertainties among households and businesses. Interest rates did not play any role, as they remained very low (with decreasing trends) in the last few years in all CEE/SEE/CIS countries, but in particular, Poland and Czech Republic, in line with policy rate cuts to support economies.
- In **CEE countries**, deposits jumped by 13.5% (weighted average by nominal GDP) and by 14.4% without considering Poland. Hungary remained the best performer (23.3%), followed by Czech Republic, Poland and Slovenia, which showed similar yoy changes (around 12%). In **SEE countries,** the weighted average was somewhat higher (13.9% in 2020), with Romania and Serbia playing leading roles (+15.4% and +17.4%, respectively). The yoy increase was significant for **CIS countries** as well (11.7%), but this was partly due to exchange rates depreciation, which resulted in an increase in the outstanding amount (especially in Russia and Ukraine).
- Yoy changes have been overall higher for **corporates** vs **households**, but the share of corporate deposits in the total for the private sector was lower than 50% in all countries. Deposit volumes rose in general more in the household sector than for corporates, strengthening funding stability. The strong increase among corporates is connected to funds received from supportive measures and then temporarily deposited in banks. The discrepancy between the two sectors – relevant to evaluating deposit stability – was high in Hungary (28.6% vs 18% for households) in the CEE area; in Albania (18.7% and 5.9%, respectively) and Serbia (26.3% vs 12.4%) in SEE; and in both Moldova (26.9% vs 11.3%) and Ukraine (good performances for businesses at 46.5% vs 26.8%) among CIS countries.
- Following the implementation of lockdown policies worldwide in March 2020, governments and international organisations predicted a massive decline in remittances. Instead, registered remittances to several developing countries have since been growing at unprecedented rates. An explanation for SEE/CIS countries in particular is a **shift in flows from informal (unrecorded)** hand-carrying **to formal** (recorded) remittance channels.
- The **extra savings** accumulated because of the COVID crisis in bank accounts is seen to be partly used to pay down debt or to purchase houses, likely by higher-income earners, in the near future. Similarly, some deposits are expected to be used to purchase financial assets, particularly government bonds. Consumption and investment are expected to recover only gradually.
- Some excess involuntary accumulation of deposits with respect to the pre-pandemic scenario (which was quite strong in Hungary, Serbia and Romania) is expected to start being partially re-absorbed in 2021. Thus, we forecast **deposits** to rise by 4.3%, 4.1% and 4.3%, respectively, in CEE, SEE and CIS countries in 2021 and to accelerate slightly further in 2022.
- To improve their funding profiles, banks are being encouraged to offer a more diversified set of funding instruments by category and maturity. Most of the total deposits from the private sector are still **demand deposits**.
- **Debt securities issued** cover a very modest share of total liabilities in all countries, particularly in the SEE area and Slovenia, where they cover a very low percentage (from 0.2% in Croatia to 1% in Romania). In contrast, in CEE countries, the share of bonds was higher as of December 2020, particularly in Czech Republic (15.3%). Thus, ample room for growth remains in this market segment (particularly covered bonds and CDs) with the opportunity for banks to count on more stable deposits and for the customers to receive higher interest rates.

29 April 2021

Focus

Research Department

International Research Network

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Deposit growth offers the chance of a more dynamic funding strategy

Bank deposits saw a strong increase in 2020 in all CEE/SEE/CIS countries mainly due to precautionary behaviours and a fall in spending, despite low and decreasing interest rates. In the near future, part of the excess deposits is likely to be gradually spent. To improve their funding profiles, banks are now being encouraged to offer a more diversified set of tools by category and maturity (such as certificate of deposit [CDs] and covered bonds).

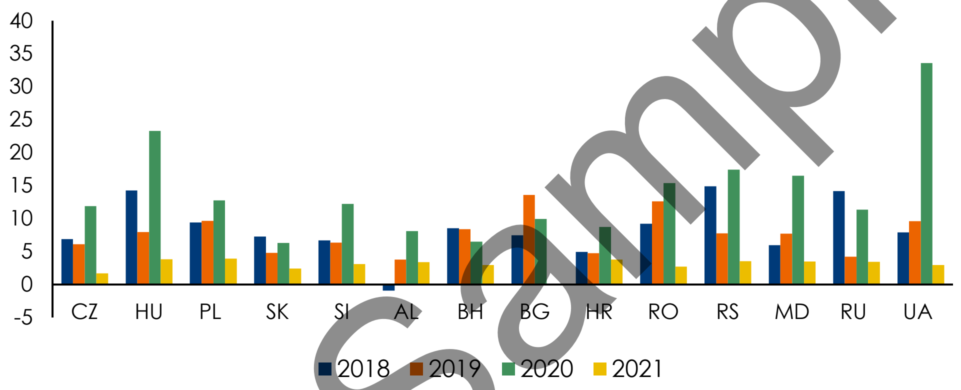
Bumper deposit growth

Bank deposits saw strong increases in 2020 in all CEE/SEE/CIS countries, as was the case in many Western European countries, well above our expectations[1], with this further confirmed by last available data, as of January.

The jump in deposits

In **CEE countries**, deposits rose by 13.5% (weighted average calculated using nominal GDP) and by 14.4% without considering Poland. Hungary continued to be the best performer (23.3%), followed by Czech Republic, Poland and Slovenia, with all three showing similar yoy changes (around 12%). The increase in Slovakia was a bit lower, though still significant (6.3%)[2]. In the **SEE countries,** the weighted average was somewhat higher (13.9% in 2020), with Romania and Serbia leading (+15.4% and +17.4%, respectively). The percentage annual increase has been relevant among the **CIS countries** as well (11.7%), though this was partly due to the accounting effects related to the depreciation of exchange rates.

Total deposits (yoy % changes)



Note: 2021 ISP forecasts. Forecast NA for Bulgaria. Source: ISP elaborations on central banks' data

Many drivers

Many drivers, which are analised in the following paragraph, can explain the current trend. As in Western Europe[3] and in the other advanced economies[4], the wide spread of the COVID-19 virus induced both households and corporates to save for precautionary motives, and to postpone consumption and investments, which have been limited by lockdowns (leading to **involuntary savings**).

Corporate vs household deposits

Yoy changes have overall been higher for **corporates** than **households**, but the share of corporate deposits in total deposits for the private sector is much lower than 50% in all countries, with Hungary the only exception (52%). In other words, the outstanding amount of deposits (volumes) increased in general more in the household sector than for corporates. It is important

[1] See IRN, *Economic and Banking Outlook*, June 2020 and September 2020.

[2] For an overview of the results and the macroeconomic context, see IRN, *Economic and Banking Outlook*, March 2021.

[3] See ECB, *Monthly Bulletin*, February 2021.

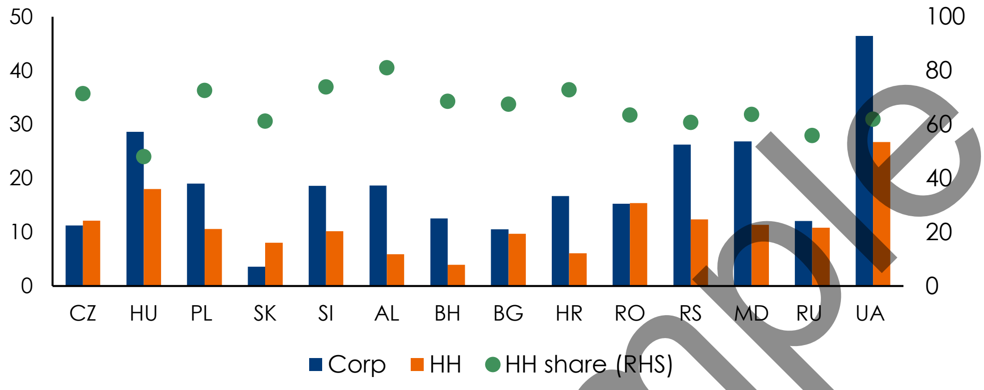
[4] See OECD, *Economic Outlook, Interim Report*, March 2021.

to distinguish between the two institutional sectors to evaluate deposit reliability for banks because traditionally core customer deposits are the most stable and granular funding source.

The strong increase among corporates is related to funds received from central authorities through supporting measures and then (temporarily) deposited in bank accounts. The macroeconomic recovery, with a rise in customer spending and investment, should mean an increase in withdrawals.

The discrepancy in the growth rates between the two institutional sectors was marked in Hungary (28.6% for corporates vs 18% for households) in the CEE area; in Albania (18.7% and 5.9%, respectively) and Serbia (26.3% vs 12.4%) in the SEE area; and in both Moldova (26.9% vs 11.3%) and Ukraine (with corporates performing well at 46.5% vs 26.8%) among CIS countries.

Corporate and household deposits (yoy % chgs in 2020, % share of household deposits in total deposits from the private sector)



Source: ISP elaborations on central banks' data

FX depreciation implied a strong revision in deposit growth in some countries

Exchange rates against both the euro and the USD played a relevant role in explaining such strong deposit increases in some countries – specifically, Hungary, Russia and Ukraine.

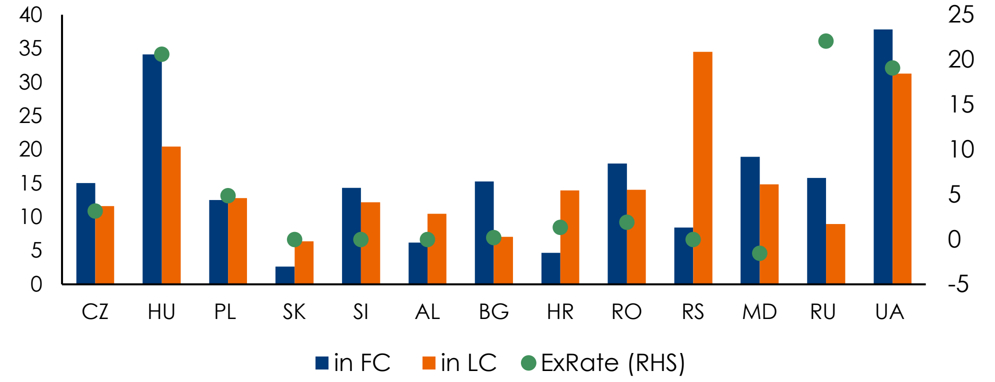
In Hungary, deposits denominated in foreign currency jumped by 34% in 2020, but the exchange rate suffered from strong depreciation at the same time (around 20%). Therefore, net of the FX effects, the yoy change is lower (11%). Total deposits increased by 17.7% yoy net and +23% not including accounting effects related to the FX depreciation.

In Russia as well, with a similar level of depreciation (around +20% in 2020, from 62 to 74 vs the USD), deposits denominated in foreign currency, mostly in USD, increased by 18% (-1% net of the depreciation), while the total outstanding amount of deposits increased by 4.4% net of FX depreciation (+9.6% comparing outstanding amounts).

Similarly, nominal changes were relevant in Ukraine. With an increase of deposits by 34% in 2020, the total deposit increase was significantly lower (+25%) net of FX depreciation (which was around 20% in 2020).

In contrast, in Serbia, as a consequence of the dinarisation policy adopted by the central bank in order to support the use of the national currency and therefore to increase the effectiveness of monetary policy[5], the increase in deposits denominated in foreign currency was limited to +8.4% yoy in 2020 (while deposits in local currency jumped by 34%).

Deposits in local and foreign currency (yoy % chgs in 2020 and exchange rate depreciation or appreciation)



Source: ISP elaborations on central banks' data

Remittances surprisingly bounced back

A strong decline was expected

Following the implementation of lockdown policies worldwide in March 2020, governments and international organisations predicted a massive decline in remittances[6]. By April 2020, remittance flows to developing countries were expected to fall by 20% during 2020, due to the unprecedented slowdown in economic activity in remittance-sending countries and the disproportionate increase in unemployment among migrants[7]. Instead, however, registered remittances to several developing countries grew at unprecedented rates.

Mounting job losses in Europe and the impact of the oil price collapse in Russia initially weighed on remittances, but they rebounded strongly as migrant workers benefited from host country macroeconomic support[8]. Increases in the number of unemployed were particularly pronounced in some European countries and Russia (from 4.6% in 2019 to 6% at year-end 2020)[9], from where most remittances flows to CEE/SEE/CIS countries are generated.

A recovery may be due to a shift from informal to formal channels

There could be several explanations for the observed **recovery of remittance** flows in the second half of 2020. Some studies indicate that migrants might have drawn on their savings to send money home during the pandemic, or that some migrants were able to access cash transfers offered by host country governments. Another relevant explanation for SEE/CIS countries in particular is a **shift in flows from informal (unrecorded)** hand-carrying **to formal (recorded)** remittance channels. Recent studies[10] indicate that the mobility constraints that prevented travelers from carrying cash across borders made electronic wire transfers the only option.

[5] See, National Bank of Serbia, *Report on Dinarisation of the Serbian Financial System*, December 2020.

[6] See, Davidia Zucchelli, *Remittances are expected to decrease in the current year and in 2021*, IRN Banks and Markets, September 2020.

[7] See World Bank-KNOMAD, *Migration and Development Brief 33*, October 2020.

[8] Quayyum, S. N., and R. K. Kpodar. 2020. "Supporting Migrants and Remittances as COVID-19 Rages On". IMFblog, 11 September 2020, https://blogs.imf.org/2020/09/11/supporting-migrants-and-remittances-as-covid-19-rages-on/

[9] ILO (International Labour Organization), *ILO Monitor: COVID-19 and the World of Work*, seventh edition. Geneva, 2021.

[10] Dinarte, L., E. Medina-Cortina, D. Jaume, and H. Winkler. 2021. "Not by Land nor by Sea: The Rise of Formal Remittances during COVID-19". World Bank, Washington, DC. https://devpolicy.org/Events/2021/Not-by-land-nor-by-sea-the-rise-of-formalremittances-during-COVID-19-Dinarte-13Apr/Full-paper.pdf.

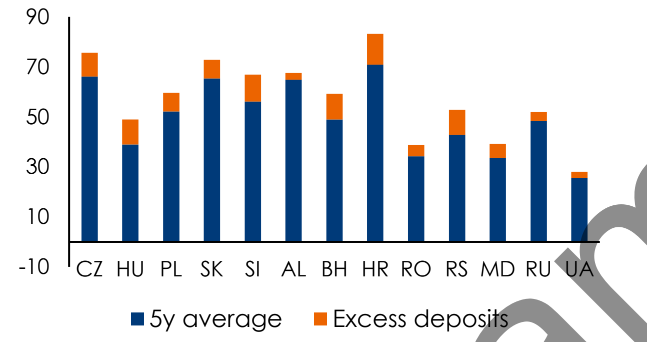
Because wire transfers are registered by central banks, many countries saw an increase in formal remittances in the past several months. Unfortunately, data on remittances updated as at end 2020 are not available for EE countries.

Estimating the size of informal remittances is challenging since they involve a substantial number of small-dollar transactions that are not registered in any system and easily go undetected. This process also has been driven by a reduction in the **cost to send remittances** through formal channels as well as by a crackdown on informal remittance providers in several destination countries. However, as the World Bank highlights, the impact of this compositional shift on the total amount of remittances remains unclear[11].

Excess deposits

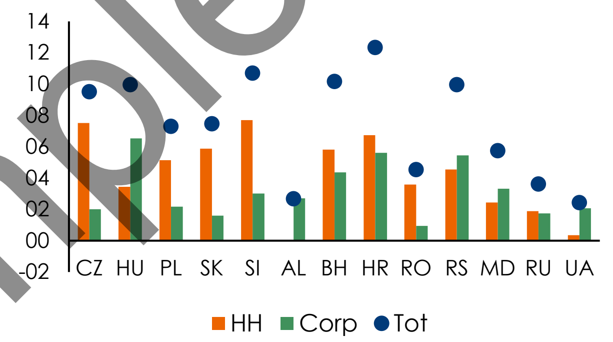
The excess deposits can be estimated as the gap between the actual deposit/GDP ratio and the average ratio of the last five years which could represent the 'normal' ratio in recent times. The decomposition of the total deposit/GDP ratio into the average increase in the last five years and the excess deposits shows that the latter was significant (over 10pp) in 2020, especially in Czech Republic, Hungary, Slovenia, Bosnia, Croatia and Serbia.

Decomposition of the deposit/GDP ratio in 2020 (avg and excess ratio, pp)



Source: ISP elaborations on central banks' data

Excess deposits in the household and the corporate sector (2020 deposit/GDP ratio, pp)



Source: ISP elaborations on central banks' data

Excess deposits mostly from households

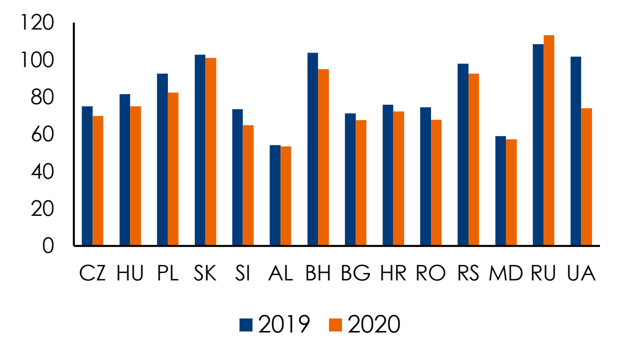
It is interesting also to note that excess deposits have been built up in particular by households. This is positive because corporate deposits are much more volatile than household deposits. In the CEE countries, especially in Czech Republic, Slovenia and Slovakia, households may count on higher income availability and therefore on higher excess deposits[12]. Among SEE countries, the two institutional sectors highlighted similar excess deposits ratios, which were somewhat diversified only in Romania (around 4pp).

Excess deposits were higher in the corporate sector only in Ukraine (equal to 2pp, covering almost the total excess), and Hungary (7pp), explained by several supporting measures adopted by central authorities in the latter (eg, Funding for Growth Scheme Go!) particularly towards SMEs.

[11] See World Bank, *ECA Economic Update Spring 2021, Data, Digitalization, and Governance*, March 2021.

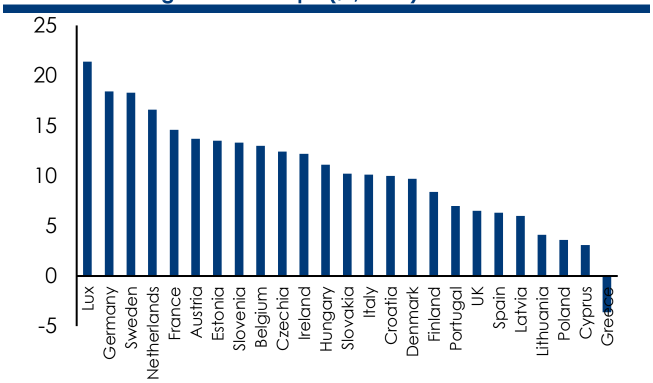
[12] The relationship between disposable income and the extra saving rate has been analysed in many advanced economies. In Canada, for instance, bank research suggests about 40% of the extra savings was accumulated by high-income households. Their incomes were less affected, and they typically spend relatively more on non-essential and hard-to-distance items. On the other hand, low-income households accumulated less than 10% of the savings. See Lawrence Schembri, *COVID-19, savings and household spending*, Bank of Canada, March 2021. With regard to Italy, see ISP, *Centro Einaudi, Indagine sul Risparmio e sulle scelte finanziarie degli italiani 2020*, October 2020.

LTD ratio (%)



Source: ISP elaborations on central banks' data

Household saving rates in Europe (%, 2019)



Source: Eurostat

The LTD ratio is at a very comfortable level

The excess deposit estimate is important also in order to evaluate the capability of banks to expand loans. Nevertheless, **liquidity** has not been a problem in CEE/SEE and only partially in CIS countries, as highlighted by the loan/deposit ratio, which declined further in 2020. This ratio shows some possible tensions (being over 100%) only in Russia and Slovakia. For comparison, the weighted average of the LTD ratio in the EA was 112.2% as of December 2020 (down from 114.9% as of end 2019)[13].

In Russia, if banks' loan growth continues to outpace deposit growth and the LTD ratio remains over 100%, banks could be pushed to start funding their loan books through CBR facilities, thus becoming net debtors to the CBR, with further pressure on net interest margins.

Furthermore, according to EBA elaborations, many EE countries show liquidity coverage ratios close to the European weighted average (173% as of December), with Slovenia and Romania occupying outlier positions (at over 300%). A cause for concern could be the potential increase in bank risk appetite to combat revenue pressures and manage excess liquidity.

Most lockdown savings were involuntary

Further clear evidence of confidence in banking sectors

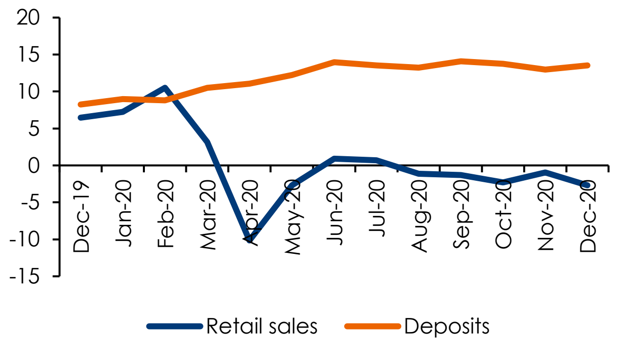
Many drivers can explain the deposit growth. The majority of savings was deposited in bank accounts, mainly as temporary measures while households and corporates tried to better evaluate the evolution of the pandemic. This is an important point, particularly in some countries – eg, Ukraine and Moldova – where the confidence in banks has been weak in the past, incentivising accumulation in alternative (and risky) informal saving channels (namely, under the mattress).

Deposits have been supported by **precautionary reasoning**, and by the **forced reduction in consumer spending**, generating involuntary savings[14]. In the household sector, retail sales showed a decline, which deteriorated gradually during 2020, in CEE countries (-2.7% yoy in December), while in the SEE area, they followed an increasing path, although this was very modest (+4.6% yoy in the same period) and at a lower level than before the crisis.

[13] See EBA, Risk dashboard, April 2021.

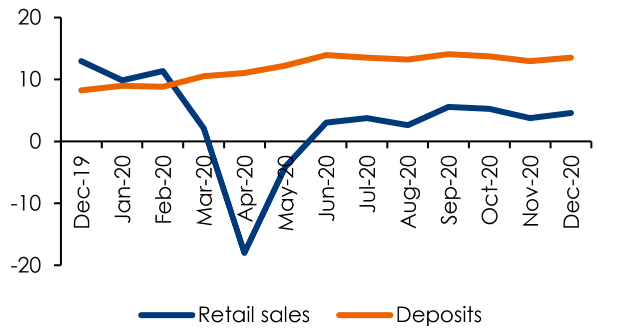
[14] Some estimations highlight that most lockdown savings were involuntary. See Oxford Economics, *Coronavirus Watch: Three key questions on savings*, March 2021, which refers to high-income countries and advanced economies.

Retail sales and deposits in the CEE area (% yoy chgs)



Note: weighted average, CEE countries ex Poland. Source: IRN elaborations on central banks' data

Retail sales and deposits in the SEE area (% yoy chgs)



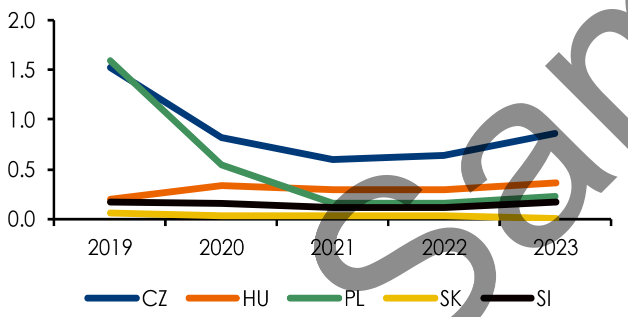
Note: weighted average, CEE countries ex Poland. Source: IRN elaborations on central banks' data

Deposit growth not supported by interest rates

Interest rates did not play any role in explaining the strong deposit growth for both the household and corporate sectors. **Interest rates** have in fact remained very low and continued to decrease in the last few years in all CEE/SEE/CIS countries, but particularly in Poland and Czech Republic, in line with policy rate cuts to support the economies.

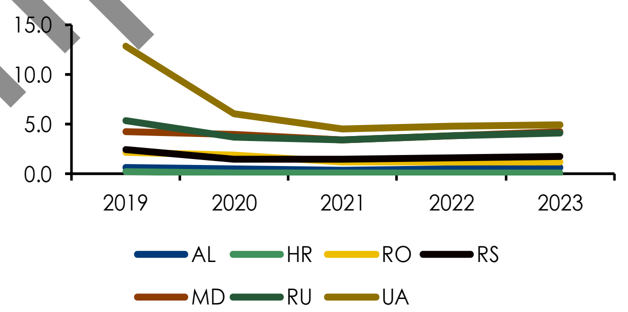
Deposit interest rates are still expected to decrease slightly overall in 2021, due to monetary easing, with some exceptions (ie, Russia and Ukraine) and start to rise from 2022 overall, following the expected reversals of policy rates. Therefore, they are estimated to play only a modest role in driving deposit in the near future.

Interest rates on deposits (CEE countries, 1Y, %)



Source: IRN forecasts

Interest rates on deposits (SEE/CIS countries, 1Y, %)



Source: IRN forecasts

Corporate deposits have been supported by postponed investments

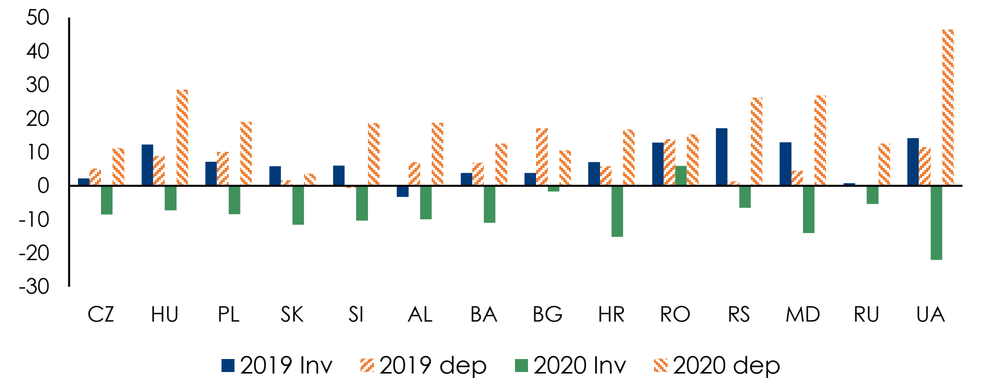
Temporary deposits

In the corporate sector, deposits have come from a decline in investments, which have been postponed amid a deteriorating pandemic situation, but at the same time, strongly fed by liquidity measures adopted by central banks (facilities, subsidies, among others).

While in 2019, investments and deposits increased in all CEE/SEE/CIS countries, with Albania the only exception (-3.3% yoy), in 2020, investments saw a decline in all countries, but this was particularly significant in Croatia (-15.2%), Moldova (-14%) and Ukraine (-22%).

The investment recovery expected in the coming years and to be boosted by EU-funded investment projects and the expected debt payback are forecast to lead back to normal deposit growth.

Investments and corporate deposits (yoy % chgs)



Note: % change in real gross fixed investment. Source: ISP elaborations on EIU data

Towards a gradual deceleration to 'normal' performances

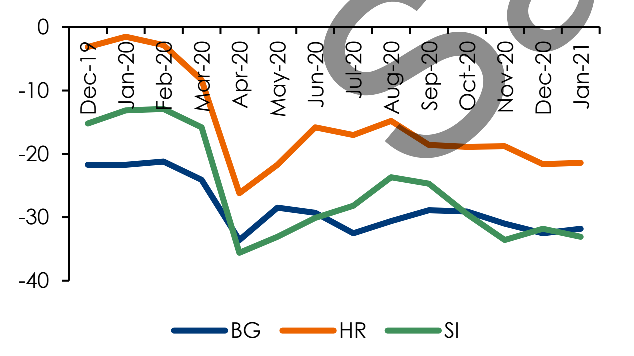
Evidence from survey responses[15] and credit data indicate that most of the **extra savings** accumulated because of the crisis is still sitting in bank accounts, mainly because of persistent high uncertainty due to new COVID waves.

Gradual deposit utilisation

Extra savings may be used for several **alternative purposes**. It can sustain the consumer spending rebound, but it can also be used to pay down debt or to purchase houses, likely by higher-income earners. Similarly, savings can be partly used to purchase financial assets, such as mutual funds or guaranteed investment certificates – again, of course, this would be more prevalent among higher-income earners and in countries offering special financial instruments, mainly CEE countries.

As far as future spending is concerned, **consumer confidence** has yet to recover in most countries[16]. Faster progress in vaccine deployment will be needed to help restore confidence, improve labour market conditions, and reduce precautionary savings rates. Consumption is expected to recover only gradually.

Consumer confidence (index)



Note: countries where data are available monthly. Source: IRN elaborations on central banks' data

Excess deposits/total loans (%, 2020)

Source: IRN elaborations

[15] See EIB, CESEE Bank Lending Survey, 2Q2020, and Capital Economics, *Households still accumulating excess savings*, April 2021.

[16] The extraordinary size and nature of these savings have sparked much debate about their potential impact if spent. The rebound in consumer spending could **support economic recovery** (see ISP/Centro Einaudi Report, 2020). This could be considered particularly true in EE, taking into consideration the potential GDP growth, which remains in the convergence process. For comparison, in the USA the deposit contribution to the recovery is expected to be modest, F. Bilbiie, G. Eggertsson, G. Primiceri, A. Tambalotti, in LaVoce, *Negli Usa i risparmi resteranno risparmi*, March 2021.

Excess deposits may result in a reduction in customer loan demand

It is reasonable to believe that part of the excess deposits can be used for future spending. In that case, it will likely reduce demand for loans, especially consumer loans. It is difficult, of course, to estimate such an effect because depositors are not the same people who are expected to borrow in the near future. Nevertheless, some depositors will spend some of the money that they could not use in 2020 – they will not apply for loans from banks. As shown in the chart above right, excess deposits represent a relevant share of loans – namely, around one-quarter of total loans in Hungary, Slovenia and Moldova and almost one-fifth of loans to the private sector in many SEE countries.

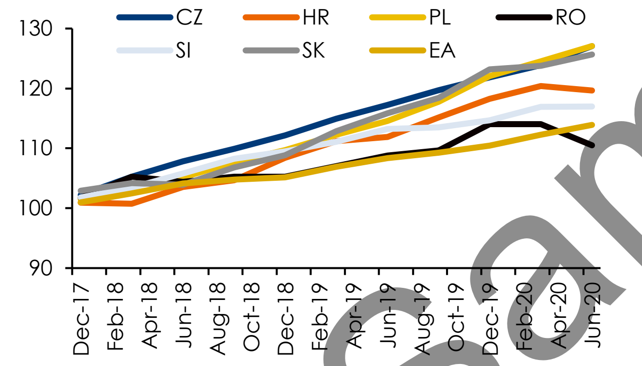
Not a residential bubble … yet

With regard to the housing market, BIS data on the most recent negotiations in some of the countries in our set show that no evident bubbles occurred in 2020. The index on **property prices** followed a gradually increasing path in the last few years. In some countries – eg, Croatia and Romania – data as of September highlighted a slight decline. In Hungary as well, where only data on prices per sqm are available, a fall of 5% occurred from December 2019 to September 2020[17].

In Czech Republic, Slovakia and Poland, where mortgages grew very fast before the pandemic, the central banks imposed some borrower-based measures (LTV, debt/income ratio limits) on lending growth, which were suspended when the extent of the crisis became clear.

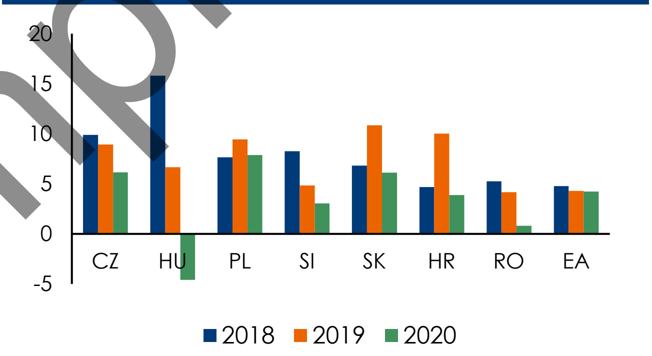
The demand for housing loans is expected to remain dynamic in the region, as residential property purchases continue to be considered a priority by families.

Residential property prices, all dwellings (BIS index)



Note: Index, 2017 = 100 (Units). Source: IRN elaborations on BIS data

Residential property prices, all dwellings (BIS data, % yoy chgs)



Source: IRN elaborations on BIS data

Furthermore, households may prefer to pay down debt and resume consumption, or to **buy assets**, while businesses may partly finance postponed investments with internal funding. The rise in **government bond issues** pushed by growing state financial needs due to the current crisis and offering positive interest rates could pressure competition (a crowding out effect).

With all these factors in mind, part of the excess involuntary accumulation of deposits with respect to the pre-pandemic scenario is expected to start being partially re-absorbed in 2021. In this context, in our latest *Outlook*[18], **deposits** are forecast to rise by 4.3%, 4.1% and 4.3%, respectively, in CEE, SEE and CIS countries in 2021 and to re-accelerate slightly in 2022.

In **Croatia**, an exceptional rebound is foreseen in 2022, before adoption of the euro, as occurred in other countries in similar circumstances (see ex Baltic countries), when people deposited money in local currency for conversion which had previously been set aside in informal tools.

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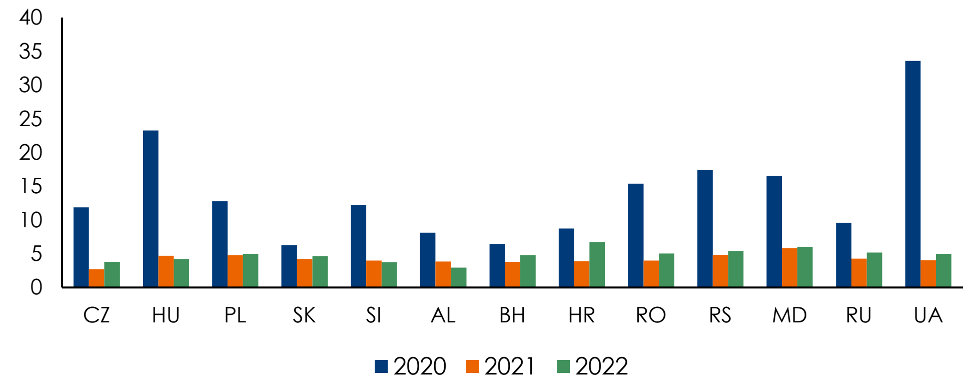
[17] For a deep analysis of the housing market, see IMF, *Global Housing Watch*.
[18] See IRN, *Economic and Banking Outlook*, March 2021.

Deposits from the private sector (yoy % chgs)



Source: IRN forecasts

A new funding strategy

Negative interest rates are unlikely now in EE

Even though interest rates did not play any role in 2020 with regard to driving saving and investment decisions (as in 2021, according to our forecast), in elaborating forecasts on banking aggregates, it is worth examining the possibility of the application of negative interest rates to bank deposits. This is a relevant point which has seen significant discussion, particularly in Western Europe, in the last few years.

Negative rates on bank accounts have already been applied in Western Europe[19]. Recently, also in Italy, the application of negative rates on deposits over €100,000 has been proposed and already applied by Unicredit[20]. In other words, customers are asked to compensate banks when they maintain cash in bank accounts.

Transmission from policy to deposit rates

As far as central banks are concerned, since 2015, the ECB[21] has charged commercial banks on their **deposits** as a form of non-traditional expansionary monetary policy – and therefore in Slovakia and Slovenia – rather than crediting interest to them (the current rate is -0.5%). It is part of a set of tools that are finally aimed at encouraging lending, spending and investment[22].

[19] In particular, interest rates on bank accounts have been negative for some years at some banks in Denmark, Switzerland and Germany, with different limits according to the deposit amount and the customer category (corporates vs households). See Alessandro Galiani, *Tassi negativi sui conti correnti, anche in Italia*. Cosa c'è da sapere, AGI, 10 ottobre 2019, and Christian Siedenbiedeln, *Die neuen Tricks mit den Negativzinsen*, Frankfurter Allgemeine, 24 April 2021.

[20] See, Morya Longo, "Perché il boom dei conti correnti è un costo per le banche, ma una risorsa per l'Italia", *Il Sole-24 ore*, 13 Aprile 2021.

[21] In recent years, central banks in other countries (such as Japan, Switzerland, Denmark, Sweden) have implemented negative interest rate policies on excess bank reserves in the financial system. Japan, which has been a pioneer, adopted a similar policy, with a mid-2020 target rate of -0.1%, but unsuccessfully because of deflation (economic stagnation). If people and businesses tend to hoard money, instead of spending money and investing, the result is a collapse in aggregate demand, which leads to prices falling even further, a slowdown or halt in real production and output, and an increase in unemployment (the economy enters a liquidity trap).

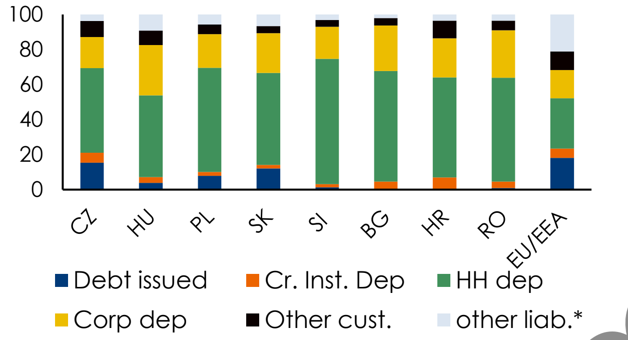
[22] The Eurosystem offers credit institutions two standing facilities: Marginal lending facility in order to obtain overnight liquidity from the central bank, against the presentation of sufficient eligible assets (rate at 0.25%); **Deposit facility** in order to make overnight deposits with the central bank (rate -0.5%). Furthermore, among **refinancing operations**, the Eurosystem's regular open market operations consist of one-week liquidity-providing operations in euros (main refinancing operations, or MROs) as well as three-month liquidity-providing operations in euros (longer-term refinancing operations, or LTROs). MROs serve to steer short-term interest rates, to manage the liquidity situation, and to signal the monetary policy stance in the euro area, while LTROs provide additional, longer-term refinancing to the financial sector. The targeted longer-term refinancing operations (TLTROs) provide financing to credit institutions.

Banks want to maintain a consistent deposit base

In EE in 2020, central banks in Hungary, Poland, Croatia and Moldova reduced the mandatory reserve requirement to support lending. At the same time, Poland revised *upwards* the interest rate on these reserves. Policy rates remain positive in the region. In commercial banks, individual depositors are not charged negative interest rates on their bank accounts. Banks have been reluctant to pass negative rates on to customers, and this could be a choice in the future only for deposits over an elevated total amount. But, this appears to be very unlikely now[23]. Banks would not be able to lower interest rates on deposits, which represent their main source of funding, below zero (a **zero lower bound**) because depositors would rather hoard cash[24]. Banks want to maintain a consistent deposit base so they can avoid using other, more expensive sources of capital to fund their activities[25].

Deposits are forecast to be further supported by the modest level of **financial deepening**, measured by the outstanding amount of deposits as a percentage of GDP. It has been gradually strengthening in the last decades, but there is still room for growth.

Liabilities composition (% of total liabilities, 2020)



Source: IRN elaborations on EBA data

Liabilities composition (% of total liabilities, 2020)

	Debt issued	Cr. Inst. dep	HH dep	Corp dep	Other cust.	Other liab.*	Total
CZ	15.3	5.8	48.2	17.9	9	3.8	100
HU	3.9	3.3	46.7	28.7	8.1	9.3	100
PL	7.8	2.2	59.6	19.2	5.4	5.8	100
SK	12	2.1	52.5	22.7	4.1	6.6	100
SI	1.3	1.8	71.6	18.3	3.9	3.1	100
BG	0.4	4.1	63.3	25.9	4.3	2	100
HR	0.2	6.7	57.1	22.3	10.1	3.6	100
RO	1	3.5	59.4	27	5.5	3.6	100
EU/EEA	18.1	5.3	28.8	16	10.6	21.2	100

Note: (*) Includes deposits from central banks. Source: IRN elaborations on EBA data

Furthermore, the still modest availability of alternative funding and investment products – such as certificates, bonds and covered bonds – can open new opportunities to realise a more appropriate ALM strategy. In order to improve their funding profiles, banks are encouraged to offer a set of tools that is more diversified by category and maturity. **Demand deposits** cover most of total deposits from the private sector. Data from central banks, even though they are not

By offering banks long-term funding at attractive conditions, they preserve favourable borrowing conditions for banks and stimulate bank lending to the real economy. Borrowing rates in these operations have been below the average interest rate on the deposit facility. In the EA, the rate on three-month euro deposits is assumed to average -0.5% in 2021 and 2022, and is expected to return to positive territory in 2025. See IRN, *Economic and Banking Outlook*, March 2021.

[23] In contrast, according to some research, banks can charge - in advanced economies - negative rates on a significant portion of their deposits, especially if they have sound balance sheets. Relatively sounder banks in the euro area are more likely to charge negative rates on corporate depositors. See *ECB Working Paper Series No 2289*, June 2019.

[24] We should also consider that **household deposits** are often subject to regulatory and political constraints that prevent rates from going below zero. More importantly, most household deposits are small and banks can **charge fees**, which are significantly more opaque, rather than varying interest rates. Therefore, the question of whether banks can transfer negative rates on to deposits is most relevant for large deposits, such as **corporate deposits**.

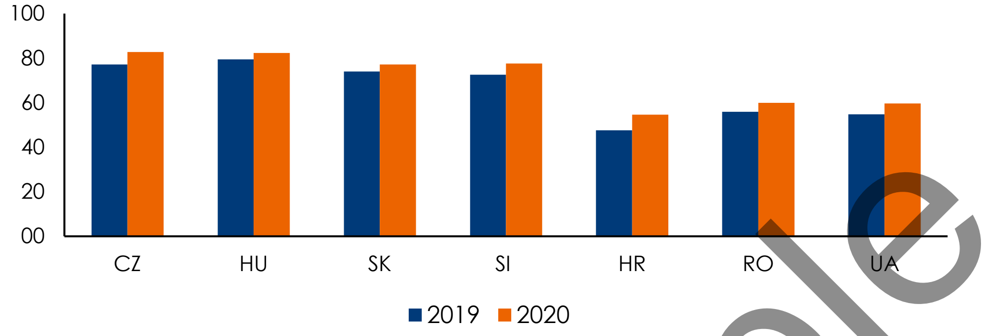
[25] The relation between short-term market rates and banks' margins also should be considered. This has been proved positive in the euro area, but the impact is increasingly non-linear with declining interest rates. The effect is not only statistically significant but also economically relevant. In particular, at negative market rates, a 1 percentage point decrease in the short-term interest rate would suggest a reduction in the monthly NIM of 3.2% relative to the sample mean compared with 1.2% at low-but-positive rates. See M. Klein, *Implications of negative interest rates for the net interest margin and lending of euro area banks*, BIS, March 2020.

perfectly comparable, highlight that the percentage share was close to 80% in many CEE countries, and close to 60% in the other three countries of our sample.

Debt securities issued cover a very modest share of total liabilities in all countries, particularly in the SEE area and Slovenia, where they cover a very low percentage (from 0.2% in Croatia to 1% in Romania). In contrast, in CEE countries, the share of bonds was higher as of December 2020, particularly in Czech Republic (15.3%).

Therefore, ample room for growth remains in this market segment, with the opportunity for banks to be able to count on more stable deposits and for customers to receive higher interest rates.

Demand deposits (% share of total deposits from the private sector)



Source: IRN elaborations on central banks' data

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