Banks and Private Debt Restructuring During the Financial Crisis in the Emerging Countries

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Abstract:

The emerging countries experienced very rapid credit growth in recent years, which was generally viewed positively as supporting rapid convergence to the eurozone but at the same time it contributed to the emergence of sizable macroeconomic and financial vulnerabilities. The financial turmoil has undoubtedly reached Eastern Europe. As a result, currently there is extreme uncertainty in the New Member States regarding the future course of such fundamental things as financial intermediation, credit growth. The paper tries to present some financial measures regarding restructuring the banking sector for stimulating credit growth in the Eastern Europe and Central Asia and especially and some measures to restructure the private domestic debt.

Keywords: financial crisis, European emerging economies, private domestic credit, banking sector restructuring.

JEL Classification: E58, E61, G01, G12, G21, O23.

1. Introduction

The recent crisis began in the United States with the bursting of the sub-prime mortgage market and the unraveling of the securitization process in the summer of 2007, but it initially did not fully affect emerging markets (EM). In this context, EM stock markets peaked around November 2007, at a time when the repercussions of the crisis were already apparent in the U.S. with central banks injecting liquidity into the inter-banking markets and major financial institutions announcing massive write-downs from structured financial products.

The Lehman collapse on September 15, 2008 is seen as a key event, both in advanced economies but also EM countries, that unleashed a full-blown systemic crisis with global risk aversion dramatically increasing, asset markets across countries and regions plunging and the unwinding of carry trades that saw high-yielding EM currencies sharply depreciate within a short period of time. Even EM countries with sound macroeconomic and financial pre-conditions, built-up over the previous years, have been strongly affected by the financial contagion that in late 2008 spilled over to the real sector with export and GDP growth rates plunging and trade finance being contracting across the world (Frank and Hesse, 2009).

Within emerging markets, Eastern European and Central Asian economies have been the hardest hit. The linkages between Western Europe and emerging European banking systems make the region particularly

vulnerable. Western European banks may reduce the funding of their eastern European subsidiaries and losses from emerging Europe may damage western European balance sheets. Fortunately, there are promising regional initiatives in which some western banks have agreed to keep credit flowing to the subsidiaries (Cihák and Fonteyne, 2009a).

The financial turmoil has undoubtedly reached Eastern Europe. As a result, currently there is extreme uncertainty in the New Member States regarding the future course of such fundamental things as financial intermediation, credit growth, the exchange rate and real convergence in general.

The decline in bank lending activity may continue. On the demand side, there has been a fall in debtors' willingness to borrow in response to the continued deterioration in the outlook for business activity. On the supply side, banks' lower appetite to take risk has led to a decline in lending activity. In addition, the domestic financial sector has been forced to reduce its dependence on foreign funding, which may also lead to a curtailment of lending. The tightening of credit standards has been another factor contributing to a decline in lending. That, in turn, may result in reduced household consumption as well as in lower corporate investment and production.

Section 2 presents the banking sectors restructuring in the emerging countries, Section 3 shows the managing of the credit losses in the emerging countries, Section 4 presents the corporate and household debt restructuring in such countries and Section 5 concludes the paper.

2. Bank restructuring

The containment phase is intended to restore public confidence in the banking system and limit its adverse effects on the real sector. Numerous instruments are available to the authorities, most targeted at stabilizing the liability side of banks' balance sheets. These policy measures include:

1. Liquidity support in local currency. Liquidity support includes a reduction in reserve requirements, access to overdraft facilities, and the use of repos and reverse repos against broader types of collateral. But this needs to be done under closely monitored conditions to prevent recipient banks from shifting assets abroad. And liquidity support should not be extended to banks that are reportedly insolvent. Both have occurred in some middle-income CIS countries. For the poorer countries of the former Soviet Union, liquidity injections were put in place in Georgia and Tajikistan, reserve requirements were reduced in Georgia, and deposit insurance coverage was extended in the Kyrgyz Republic. Monetary policy will need to stand ready to sterilize excess liquidity where liquidity support put pressure on the exchange rate, though the risk of currency depreciation has been reduced with global monetary easing and associated declines in world interest rates.

2. Liquidity support in foreign currency. The ability of the central bank to provide liquidity support in foreign exchange is limited by the availability of reserves. Countries can benefit from temporary arrangements, such as a swap line to provide euro liquidity. For instance, this was made available to Estonia by the Swedish Riksbank,

and to Poland by the IMF's approval of a flexible credit line, which is extended only to countries with a track record of sound macroeconomic management. Countries without access to such swap lines have opted for high-access IMF arrangements that require policy reform.

3. Government guarantees. Some countries have introduced guarantees for third-party funding of banks. For example, guarantees have been extended for inter-bank credits in Hungary and Latvia, bank-issued securities used to roll over or refinance domestic banks' funding needs in Hungary, and new debt issuance by banks in Slovenia.

4. Deposit insurance. Countries have raised maximum limits on bank deposits covered by deposit insurance and increased deposit insurance premia — the uncoordinated increase in deposit insurance in the eurozone in 2008 and its effects on the new member states of the European Union that do not belong to the eurozone were addressed later. The provision of liquidity support and deposit and government guarantees should be accompanied by intervention in banks deemed insolvent. This was the case, for example, with the second largest domestically owned bank in Latvia, where liquidity support was not enough to stop a bank run—and with 17 banks in Ukraine, where temporary administrators imposed a freeze on household deposits and a moratorium on repayment of liabilities to allay concerns about the banking system's soundness.

The resolution phase of a systemic banking crisis seeks to restore the normal functioning of the credit system and calls for the restructuring of financial institutions. The response to a crisis requires that banks be recapitalized to protect depositors and taxpayers from losses arising from deteriorating asset quality. Bank supervisors must make a judgment about the viability of individual banks based on the best available, if typically incomplete, information and a view of its future prospects.

Solvent and undercapitalized banks need to be capitalized on a timetable agreed with regulators. Unless market players are prepared to absorb the assets of fragile banks prior to bankruptcy, nonviable and insolvent banks need to be taken over by regulators (or "intervened") and a decision taken on their future. If a bank is to be closed: Deposits need to be transferred to a healthy bank, • and creditors should share in the losses based on existing banking and bankruptcy laws. If a bank is to be kept open: The range of options includes recapitalizing • the bank with public funds, selling it, possibly with some government guarantee on asset values, and merging it with a healthy bank, possibly with some enhancement of the balance sheet.

While recapitalization of private banks should be done using private funds, crisis situations might call for public capital. In such cases, the government should acquire preferred shares in return for representation on the board, and existing shareholders should suffer a dilution. For undercapitalized subsidiaries of cross-border banks in ECA, the burden of recapitalization should rest with parent banks. For example, Romania has asked parent banks to preemptively recapitalize their subsidiaries (Cihák and Fonteyne, 2009b).

Countries have also used the crisis to give supervisors the broad authority to respond to systemic risks in the banking sector.

Kazakhstan now has a banking resolution framework that allows regulators to intervene, with appropriate powers, in cases of bank distress. Latvia has sought improvements in the legal framework for bank resolution, including intervention in troubled banks. Hungary has strengthened bank regulation and supervisory powers to allow forward-looking actions to preempt systemic distress. It also seeks to renew the focus on onsite verification of banks' safety and soundness and requires onsite inspections of the largest banks to evaluate asset quality, loan loss provisions and reserves, collateral values, capital solvency and governance; to calculate required adjustments to capital and provisions; and to recommend corrective action.

In Ukraine, legislation is being sought to allow revaluating shareholder capital; transferring the assets and liabilities of a bank, whether before or after revocation of its license without the prior approval of creditors, including depositors; simplifying the grounds for introducing temporary administrators in problem banks; and giving the central bank the authority to charter a bridge bank, tasked with administering the assets and liabilities of failed banks.

Similar actions are being taken in the low-income and lower middle-income countries of the former Soviet Union—with regular stress-testing of banks in Armenia and Georgia, increased provisioning in Georgia, requiring existing shareholders to inject capital in banks in the Kyrgyz Republic, with the authorities taking equity stakes when needed. Bank supervision is being strengthened in Armenia, the Kyrgyz Republic, and Tajikistan. All the low-income and lower middle-income countries of the former Soviet Union have made sure that the supervisory authorities have necessary powers of intervention.

Some previous episodes of systemic banking distress, such as Argentina 2001, Bulgaria 1996, Ecuador 1999, Indonesia 1997, Korea 1997, Malaysia 1997, Mexico 1994, the Russian Federation 1998, and Thailand 1997 have also seen regulatory forbearance. Specifically, to help banks recognize losses and allow corporate and household restructuring to go forward, the government might exercise forbearance either on loss recognition, which gives banks more time to reduce their capital to reflect losses, or on capital adequacy, which requires full provisioning but allows banks to operate for some time with less capital than prudential regulations require.

But regulatory forbearance has risks. First, a financial institution might use the period of forbearance to engage in risky lending in an effort to recover its capital position, increasing the costs of an eventual failure. It could also discourage loss-averse financial institutions from liquidating nonviable companies, selling to a strategic investor, or making forced sales of overvalued collateral. Third, forbearance on loss recognition may impede private recapitalization of banks since investors might be reluctant to invest in an institution with murky loan classifications and unclear provisioning rules. So, forbearance should focus on capital adequacy instead of loss recognition, be limited in applicability and duration, and be closely monitored.

More important, postponing bank restructuring has little to recommend it, since the global recession is expected to be more protracted than its recent predecessors. The likelihood of capital inflows recovering to pre-crisis levels is low, so there will be greater reliance on domestic savings. If problem loans are not recognized early and

addressed swiftly, this could discourage efficient financial intermediation and hold back the region’s growth recovery.

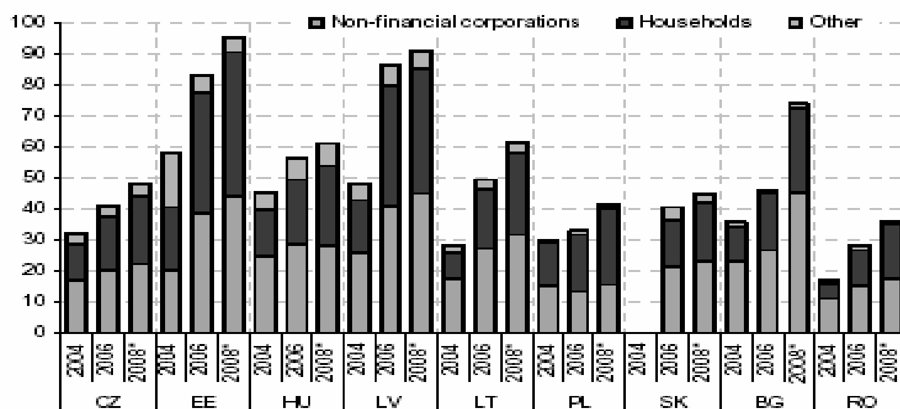
3. ECA’s credit losses: substantial but manageable

The sharp deceleration of credit growth to the private sector in the EU10 new member states and Croatia - EU10+1), after half a decade of exuberance, will inevitably squeeze households and enterprises and can only aggravate the worsening recession. The region experienced very rapid credit growth in recent years, which was generally viewed positively as supporting rapid convergence to eurozone the but at the same time it contributed to the emergence of sizable macroeconomic and financial vulnerabilities. Household indebtedness has grown rapidly across the region and across income groups, accounted for by an increasing proportion of mortgages. With a large proportion mortgages denominated in foreign currency or linked to the exchange rate and at floating interest rates, households have greatly increased their vulnerability to exchange rate and interest shocks. Lending to the corporate sector has been more subdued. By late 2008, loans in foreign currencies constituted the majority of bank loans in most countries in the region (except Czech Republic, the Slovak Republic, and Poland). As highlighted in the previous stresses in domestic inter-bank markets have affected local banks and depressed credit supply. Sectors most reliant on bank financing – construction and durable producers—as well as creditworthy market segments—small and medium enterprises – are likely to be the most affected by the tightened credit conditions.

Over the last 5 years, bank credit to the private sector had expanded rapidly in all countries in the region, with growth ranging from 14 percentage points of GDP in Croatia to 42 percentage points in Latvia. Starting from relatively low levels, it more than doubled in Lithuania, Bulgaria, and Romania. While credit expansion in the Baltic countries, Slovenia, and Croatia peaked during 2005-2006, in the remaining countries (in particular, Bulgaria and Romania), it accelerated in 2007 and through the first half of 2008 (Jickling, 2009).

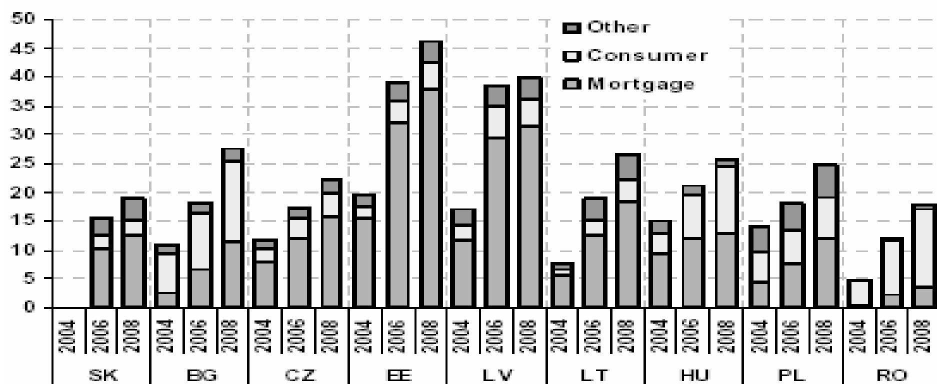
The credit expansion in 2004-2008 was largely a result of increased loans to households, including both consumer and mortgage loans, while growth in corporate sector loans has remained more modest in most countries. The credit expansion of 2004-2008 was driven mainly by the household sector (Figure 1), partly because this segment was underdeveloped across the region. Credit to non-financial corporations expanded more slowly or remained broadly stable as a percentage of GDP with the exception of Bulgaria. As a result, the share of household loans in bank portfolios has increased significantly in all countries. Among loans to households, mortgages have been growing particularly fast, especially in 2005-2006, while consumer credit accelerated strongly in 2007-2008 (Figure 2). In late 2008, the stock of households’ non-housing loans was much higher than the stock of housing loans in Bulgaria and Romania and more or less the same in Hungary and Poland. In the remaining countries, mortgage loans dominated the composition of bank loans to households (Isarescu, 2008).

Figure 1. Structure of Bank Loans to the Private Sector (% of GDP, 2004-2008)



Notes: 2008 refers to data from November 2008.*
Sources: Central Banks, World Bank Staff calculations.

Figure 2. Household Loans by Purpose (% of GDP, 2004-2008)



Sources: Central Banks, World Bank Staff calculations.

Given that the full impact of the crisis on asset quality is still unknown, past banking and currency crises offer a rough guide to assess underlying risks. The focus is on banking crises, accompanied by a currency crisis that had GDP declines exceeding 5 percent in the year following the onset of the crisis. In such cases, the nonperforming loans on average rise to 30 percent (Table 1). These are assumed to be a proxy for the probability of default. In addition, recovery rates are assumed to be roughly 40 percent on mortgages, in line with the marked declines in housing prices, and 15 percent on loans to firms, which broadly matches the average assumption by the Swedish Riksbank on the exposure of Swedish banks to the Baltic states. A preferable approach no doubt would be to calibrate the recovery rate by sector and country depending on country-specific bankruptcy resolution frameworks and other institutional characteristics that impact recovery rates, but such data are only available to banking supervision authorities of each country. The shares of households and firms in the total loan portfolio—a measure of exposure—are provided by a broad characterization of the consolidated banking sectors in ECA countries. Expected credit losses

are the product of exposure, the probability of default, and the recovery rate (Laeven and Valencia, 2008).

Table 1

Countries with banking and currency crises and nonperforming loans as a share of total loans

Country	Crisis year	Nonperforming loans (percent of total loans)
Banking and currency crisis		
Argentina	1980	9.0
Argentina	1989	27.0
Argentina	2001	20.1
Brazil	1994	16.0
Bulgaria	1996	75.0
Chile	1981	35.6
Dominican Republic	2003	9.0
Ecuador	1998	40.0
Estonia	1991	7.0
Indonesia	1997	32.5
Jamaica	1996	28.9
Korea, Rep.	1997	35.0
Malaysia	1997	30.0
Mexico	1994	18.9
Philippines	1997	20.0
Russian Federation	1998	40.0
Sweden	1991	13.0
Turkey	2000	27.6
Ukraine	1998	62.4
Uruguay	2002	36.3
Venezuela	1994	24.0
Average		28.9
Median		27.6

Country	Crisis year	Nonperforming loans (percent of total loans)
Banking crisis only		
Argentina	1995	17.0
Bolivia	1994	6.2
Colombia	1982	4.1
Colombia	1998	14.0
Croatia	1998	10.5
Czech Rep.	1996	18.0
Finland	1991	13.0
Japan	1997	35.0
Latvia	1995	20.0
Lithuania	1995	32.2
Nicaragua	2000	12.7
Norway	1991	16.4
Paraguay	1995	8.1
Sri Lanka	1989	35.0
Thailand	1997	33.0
Vietnam	1997	35.0
Average		19.4
Median		16.7

Source: Laeven and Valencia 2008.

The results of the analysis suggest that credit losses could, in a worsening scenario, be substantial but manageable. The variation across countries is largely accounted for by the size of the loan portfolio—that is, the share of credit in GDP. Note that despite sharp declines in real estate prices, this is somewhat compensated for by the better recovery rates for these loans given the collateral underlying mortgage lending—and indeed despite the sharp declines in real estate prices of the past year. Of course, the scenario could be more optimistic about recovery rates. For example, housing prices in many countries in the region have not declined as much, and banks might choose not to proceed immediately to sell these assets to avoid worsening the housing market (World Bank, 2008).

4. Corporate and household debt restructuring

With a few exceptions, non-financial corporate in ECA are only moderately indebted. Indirect evidence comes from these facts: Financial development (private credit to GDP) was still lagging economic development (GDP per capita) — but the gap has closed only recently relative to 1995.

Small and medium-size enterprises in ECA’s transition countries (excluding Turkey) relied more on retained earnings and informal finance than external finance to fund fixed investment, than did developing market economies, a gap that closed for the richer transition economies only in 2008, on the eve of the crisis. The growth of credit to non-financial corporates was considerably lower than that to households in many financially integrated ECA countries (see Figure 1).

Direct evidence comes from the evolution of corporate leverage — the ratio of total debt to total assets — for large non-financial corporates. Although leverage increased sharply in Hungary and, to less extent, in Turkey in 2008, it was still about half the elevated levels in East Asia during its crisis in 1997–98 and was also generally lower than in Argentina (2001), Brazil (1998), Mexico (1995), and Turkey (2001) in the years of their crisis. Corporate leverage is notably higher in Greece, Ireland, Portugal, and Spain (the EU cohesion countries), reflecting their deeper and more liquid financial markets.

Data for other countries in the region (taken from the Bloomberg database, which has a wider country coverage) confirm this view (Table 2).

Table 2

Median nonfinancial corporate leverage, by country, 2008 (percent)

Country	Number of firms	Corporate leverage
Europe and Central Asia countries		
Bulgaria	142	16.4
Croatia	201	26.5
Czech Rep.	13	10.8
Estonia	14	26.2
Hungary	24	19.5
Latvia	23	25.6
Lithuania	34	29.4
Macedonia, FYR	30	18.6
Poland	247	14.8
Romania	151	18.5
Russian Federation	713	23.5
Slovak Rep.	11	13.7
Slovenia	41	31.9
Turkey	219	20.6
Ukraine	193	17.5
Other countries		
Korea, Rep.	116	27.8
Thailand	364	24.9
Indonesia	244	30.2
Argentina	78	21.2
Brazil	313	28.0
Mexico	83	23.5
Portugal	53	41.1
Ireland	44	26.9
Greece	255	33.5
Spain	115	27.5

Source: Bloomberg database, 2008.

Corporate leverage in 2008 was among the lowest in Bulgaria, the Czech Republic, Poland, and the Slovak Republic; intermediate in Romania, Turkey, and Ukraine; and among the highest in Croatia, Estonia, Latvia, Lithuania, and Slovenia. But even the countries with the highest leverage have a total debt to total assets ratio broadly similar to those in East Asia and somewhat less than in the cohesion countries in 2008. In particular, corporate leverage in the ECA countries is much lower than that in East Asia during its crisis in 1997–98. The comparison, which focuses on the largest firms, is meant to be suggestive, and the small sample size in ECA’s smaller countries

in particular should be recognized. But it should be placed alongside the indirect evidence cited earlier about ECA's financial shallowness, the importance of households rather than non-financial corporates in rapid credit growth in many ECA countries, and the dominance of retained earnings as a source of financing for fixed investment giving way only recently to bank financing in a large sample of small and medium enterprises from across the region (IMF, 2009c).

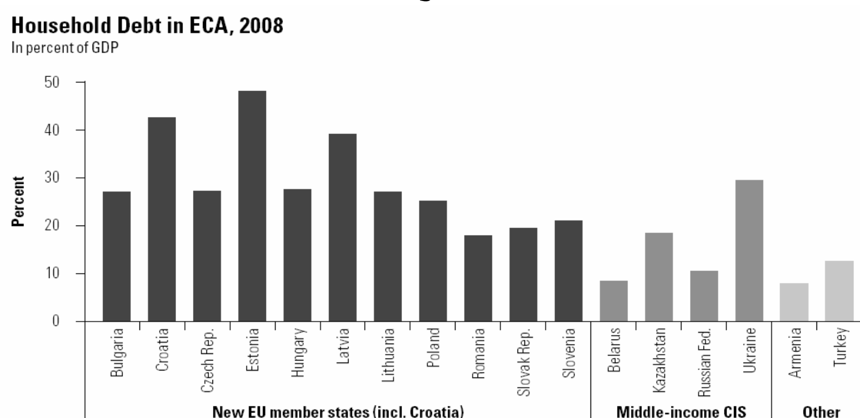
In countries where households are experiencing rising debt service burdens, governments may have to consider facilitating the restructuring of household debt in default. In many ECA countries where banks currently have limited capital buffers, bank responses to rising nonperforming loans have focused on extending grace periods. However, without the certainty of a rapid economic recovery, these restructuring strategies effectively postpone problems into the near future. This creates substantial risks of under provisioning and inadequate recognition of losses and thus of over-estimating bank solvency.

There is a role for governments to provide incentives for proper debt restructuring. Defining the right framework is challenging as it requires balancing competing pressures on banks, households, and the government in a way that is fiscally affordable, creates minimal market disruption, is socially acceptable, and allows banks to remain solvent and able to resume lending in the medium term.

A template for government-assisted household debt restructuring has been proposed recently. The authors advocate a restructuring program that reflects some essential features including simplicity and limited scope, as well as participation on a voluntary basis, among other features. They consider two general approaches, one involving the creation of a legal and institutional framework that can underpin case-by-case debt restructuring. The other approach is based on some form of financial assistance by the government (IMF, 2009b).

The risk exposure varies by type of household debt. In Hungary, in particular, we know from central bank data that the exchange rate exposure of consumer loans is much larger than the exchange rate exposure of housing loans (60 percent versus 84 percent at the end of 2008). The SILC and Ukraine data are for 2007 and our calculations are based on households reporting themselves as indebted. Between 2007 and 2008, the pool of indebted households may have expanded further.

Figure 3



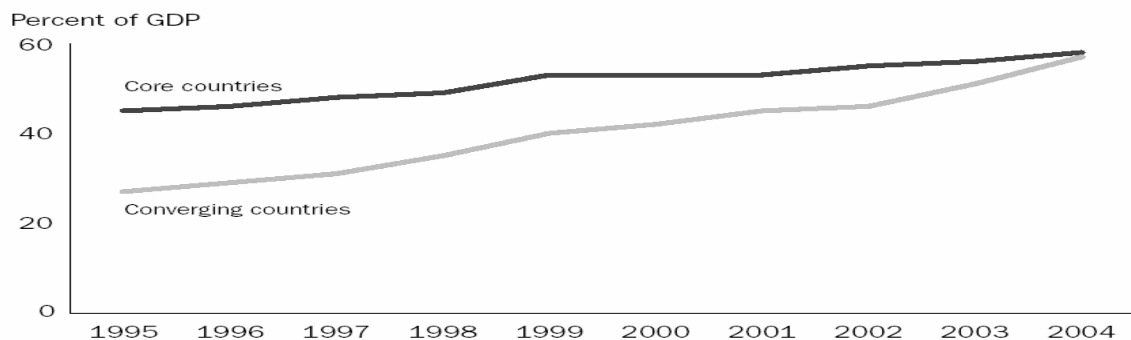
Source: IMF and Central Banks.

Much of the rapid expansion of credit in the years preceding the crisis was driven by the household sector. The ratio of household lending to corporations doubled in most countries between 2005 and 2008 (Figure 1). And mortgage lending as a share of lending to households increased sharply in some countries. Despite this growth, household indebtedness is still significantly lower than in the EU15 and reflected a pattern similar to that in the cohesion countries during their financial integration (Figure 2 and 3).

Household debt represents on average more than a quarter of GDP in the new member states of the European Union (EU10), but there is significant cross-country variation, with the number reaching more than 40 percent in some countries (Figure 3). These ratios are below the average of about 65 percent of GDP among EU15 countries, and closer to those for Ireland, Italy, Portugal, and Spain in the late 1990s (Figure 4).

Figure 4

Household debt, earlier EU members, 1995–2004

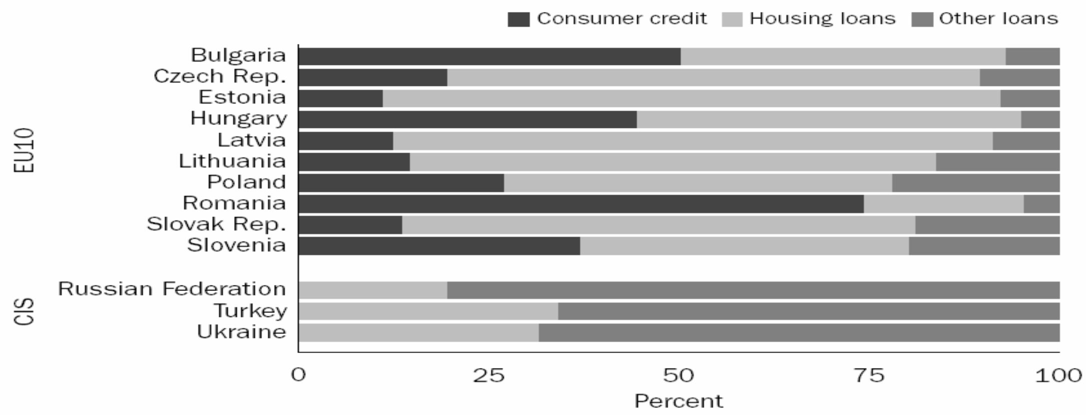


Note: The chart displays averages for each country group. Core countries includes Austria, Belgium, Finland, France, Germany, Luxembourg, and the Netherlands. Converging countries include Ireland, Italy, Portugal, and Spain.

Source: Gaspar and Fagan, 2006.

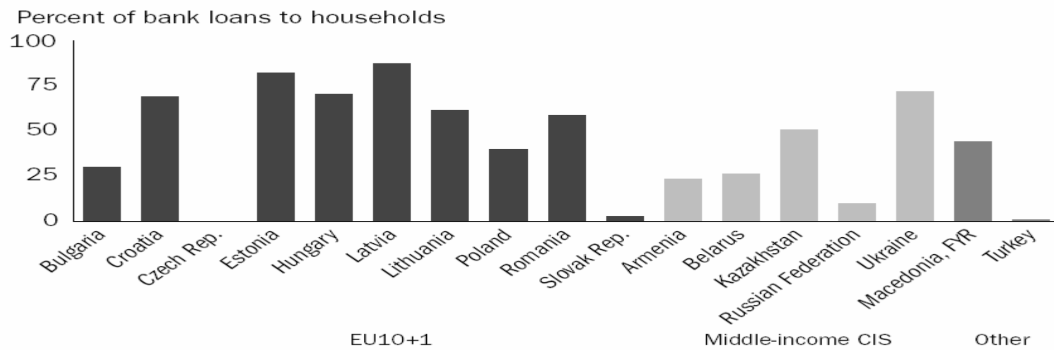
As household financial positions have grown, there has been a shift toward housing loans or mortgages on the liability side of the balance sheet and an increasing share of equities and pension and mutual funds on the asset side. Still there is much variability. Housing loans accounted for the bulk of household credit in the Baltic states, the Czech Republic, Hungary, and the Slovak Republic, while the opposite was the case in Romania, the Russian Federation, Turkey, and Ukraine (Figure 5).

Figure 5



Source: ECB and Central Banks

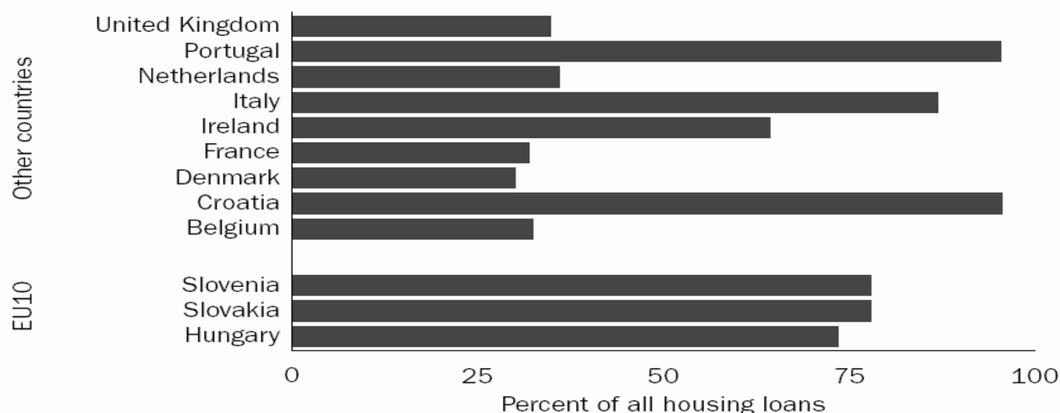
Figure 6



Source: Central Banks.

A large share of household debt is denominated or indexed to foreign currencies. This has exposed households to recent exchange rate depreciations to the extent that the currency composition of their assets, particularly labor income flows, leaves them un-hedged. But again, there is considerable variation across countries (Figure 6). In some EU10 countries, mortgages with variable (adjustable) interest rates account for the largest share of lending, thus exposing households to interest rate shocks (Figure 7).

Figure 7



Source: IMF and Central Banks.

The premise that all households should be compensated for the increase in debt service burden arising from economic shocks is not justified by the distribution of indebted households across quintiles. In fact, the evidence suggests that households have room to confront important economic shocks— with one caveat. It might be worth developing a simulation for simultaneous shocks to incomes and liabilities—such as sharper increases in unemployment and declines in nominal wages—to sharp depreciations of the exchange rate. Notwithstanding these caveats, it would be sensible to target eligibility of a government financial support program based on loan size and to households with incomes below a certain income threshold—and it would be best to keep income eligibility criteria simple and monitorable. Also, the cost of compensating households for their income losses is modest.

What have countries done to alleviate household debt distress? In Hungary, the authorities entered "gentlemen's agreements" with banks to convert foreign currency–denominated loans to households into local currency loans without penalty, capitalize the increase in mortgage payments arising from the conversion, and possibly extend the term of the loan for creditworthy borrowers. But the option has not been widely exercised because forint interest rates are substantially higher than euro interest rates. Hungary has introduced legislation to provide temporary state guarantees for mortgage payments of the unemployed and also to expand the mortgage debt servicing guarantee scheme for the unemployed to other debtors whose payment capacity has been impaired by the financial crisis because of either a reduction in income or an increase in debt service burden due to revaluation effects. In such cases, the lender would be asked to rephase the loan to temporarily lower the payment burden, and the government would guarantee the rephased portion of the loan, subject to restrictions. Romania has sought an agreement with commercial banks to facilitate the restructuring of debt contracted in foreign currency by adjusting the maturity and repayment schedule of the debt, including offering the option to voluntarily convert it into domestic currency (IMF, 2009a).

In Latvia, a partial state guarantee for restructured mortgage loans is being considered under guidelines intended to relieve borrowers' debt service to a level commensurate with their capacity to pay. And banks participating in Serbia's financial sector support program have been asked to facilitate the voluntary conversion of foreign currency

and foreign currency–linked loans into local currency loans and work with the central bank to develop loan workout programs.

5. Conclusions

Some deleveraging due to pressures in advanced country financial markets is likely. It is also to a degree needed as rollover gives way to restructuring of bank, household, and corporate debt. But collective action involving regional and international financial institutions, supranational authorities, parent banks and their subsidiaries, and home and host governments—and ECA's unique rollover determinants—can keep this process orderly. Although parent bank funding has for the most part continued, external financing is unlikely to recover its prominent role. Still, rollover in ECA is more probable than it was in previous capital account crises. These factors support this assessment.

The rollover of wholesale funding has been and continues to be difficult across the region. Two caveats should be noted, however. One is that while parent bank funding has proved to be stable so far, risks remain and whether it will continue to be stable depends on the health of Western European parent banks. Those banks could come under strain in the event of a prolonged recession and weak global recovery. In that case, collective action and generous official financing, both distinctive features of this crisis, will need to continue for some years.

The other caveat is that financial integration driven by a majority foreign owned banking sector and collective action under the aegis of the European Union and the International Monetary Fund to ensure continuation of exposure by parent banks may, however, be an aspect of European integration that is less of an option for ECA countries in the CIS that do not have European aspirations. For them, the pattern of integration may be more akin to that in the financially integrated East Asian countries.

Slow restructuring of banks could hold back the recovery of growth. Nonperforming loans are signaling systemic distress among borrowers: in Latvia and Ukraine, for example, they account for between 15 and 25 percent of all loans. The proportion is higher in sectors that were booming during the years of rapid credit growth, such as construction. In this context, regulators have begun to triage banks into those that are viable and meet regulatory requirements, nonviable and insolvent, and viable but undercapitalized. Based on such assessments, they are also taking actions appropriate to each case—from liquidation and recapitalization, to sale and merger. These efforts should proceed swiftly to avoid the earlier experience of transition countries in the 1990s: until banks were put on a strong footing, economic performance lagged.

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