

ASSESSING THE SUSTAINABILITY OF THE CREDIT GROWTH

Virginie Coudert, Cyril Pouvelle

NON-TECHNICAL SUMMARY

Credit growth rates as high as 30% or 50% a year were observed in some Central Eastern European countries (CEECs) in 2006-2007, such as the Baltic States, Bulgaria or Romania. This raises the question as to whether this strong credit growth could have been excessive and have paved the way to the credit crunch that followed the crisis in 2008-2009. However, we should not exclude the possibility that high credit growth can be explained by a catching-up process that is normal for countries with an initial low level of financial intermediation. To answer this question, we use two approaches, one based on deviations from long-term trends, the other on econometric regressions.

In the first approach, we compare observed credit growth to its long-term trend. We identify a “credit boom” if the credit/GDP ratio exceeds its long-term trend by above a confidence interval. Calculations show that there appears to have been a credit boom in a number of countries in 2006-2008 (the Baltic States, Hungary, Poland, Romania, Albania, Macedonia and Slovenia). This statistical approach is useful in that it compares recent and historical developments, but it does not take economic fundamentals into account

In the second approach, which seems to be more appropriate, we assess the “normal” level of credit with regard to fundamentals, based on a large sample of countries. The results show that the credit/GDP ratio was lying below estimated levels, for the majority of CEECs in 2006-2007. This suggests that a catching-up process was still underway. However, the credit ratio has already overcome its normal level in some countries such as Baltic States, and Bulgaria. We then estimate credit growth by taking into account its deviation from this “normal” level and other economic variables, such as GDP growth and the real interest rate. In this respect, results show that observed credit growth largely exceeded its estimated value in most CEECs in 2006-2007. It was also the case in early 2008, just before the Lehman Brothers’ bankruptcy spread the financial crisis to the whole world, including emerging countries.

JEL Classification: E30, E51, G21

Key Words: credit boom, transition, financial development