Article

Financial markets

Financing in Swiss francs in emerging Europe: a limited risk

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The decision taken on 14 January by Switzerland's central bank to no longer peg the Swiss franc to the euro immediately led to the Swiss currency appreciating significantly against the main currencies, including those of Central Europe. Since that date, the Croatian kuna has lost 14% of its value against the Swiss franc; the Bulgarian lev, 13%; the Polish zloti and the Romanian leu, 12%; and the Hungarian forint, 10%. This depreciation has reminded us of a practice that is sometimes overlooked: certain countries in emerging Europe have tended to make extensive use of loans in foreign currency (including the Swiss franc), both individuals and firms. The most extreme case is Croatia, where close to 75% of all credit is via loans in foreign currencies, while Bulgaria, Romania, Hungary and Poland have shares of between 40% and 60% of all credit. Given this situation, there have been

warnings that the appreciation of the Swiss franc could lead to difficulty in paying back these loans.

Fortunately this diagnosis becomes less alarming when we broaden our focus of analysis to include more data. The most frequent error has been to believe that all countries have taken advantage of cheap financing in Swiss francs to the same degree. Although the data provided by national banks are not always exhaustive, the most widely used currency for financing in Croatia, Bulgaria and Romania, and also for corporate credit in Hungary,[1] has actually been the euro and not the Swiss franc. Given that the currencies of these countries have appreciated against the euro, the threat posed by exchange rates has shrunk considerably. The risk remains, however, for loans to households in Hungary and Poland, whose debt is largely in Swiss francs.[2]

In both cases, certain factors mitigate the effect of the depreciation of national currencies. In order to reduce the high exposure to exchange rate risk of household loans, Hungary introduced a rule, highly controversial due to its adverse effect on banks, which states that the exchange rate applied between the forint and the Swiss franc must be the one on November 2014. At the time, Hungarian banks also hedged for exchange rate risk, so the impact of the forint's depreciation has been covered. With regard to Poland, the key factor reducing the effect of the Swiss franc's appreciation is contractual in nature as most loans have revision clauses that establish the mortgage exchange rate paid in Swiss francs must be close to the interbank rate for the Swiss currency. As the latter's value has fallen since the franc was floated (specifically the mortgage rate could drop from 2% to 1%, approximately, if the current spread continues), this lower financial cost would partly offset the increase in the nominal value of debts resulting from the zloti's depreciation.

To conclude, one additional element that should reduce fears of the effect of the Swiss franc's appreciation is the fact that the banks in these five countries are reasonably solvent (see the second graph). Nonetheless, we should not become complacent as it would not be the first time that episodes of high exchange rate volatility ended up causing problems for the banking system.

1. In Bulgaria, almost all credit in foreign currency is in euros while, in Croatia and Romania, the share is approximately 90%. In Hungary, 83% of corporate loans in foreign currency are in euros. No detailed figures are available for Poland but it would be reasonable to assume that its pattern does not vary greatly from other Central European economies, so most foreign currency loans to companies would be in euros.

2. In Hungary, 90% of loans to households in foreign currency are in Swiss francs while, in Poland, the share of mortgage loans in Swiss francs is 80% of foreign currency mortgages (there are no data for other types of loan to households).

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