# Capital markets development in other EU countries. Has Estonia missed the train?

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# Estonia – is there a problem?

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## Inherited long term issues

- Estonia is a small and distant market
- The working population of Estonia is declining due to aging and migration
- GDP per capital in Estonia lags behind the EU average

## Self-made issues

- Estonia had the lowest growth rate among the EU-13 in both 2015 and 2016
- Estonia has a concentrated banking market which dominates the financial sector of the country
- EUR 3bn of Estonian pension assets are invested abroad

# Capital markets facilitate the growth of the economy…

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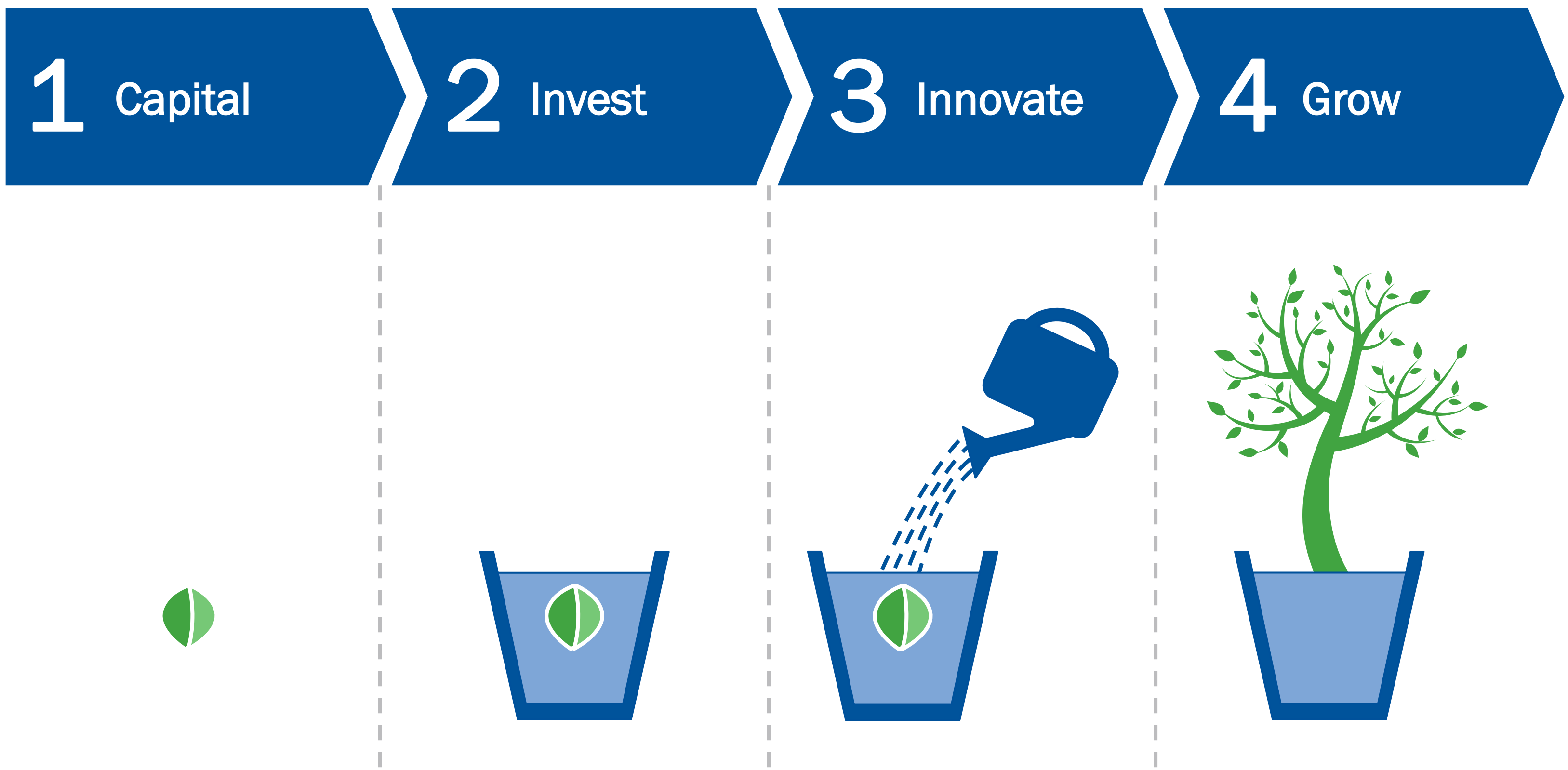

# …They do this by matching providers capital with users of capital

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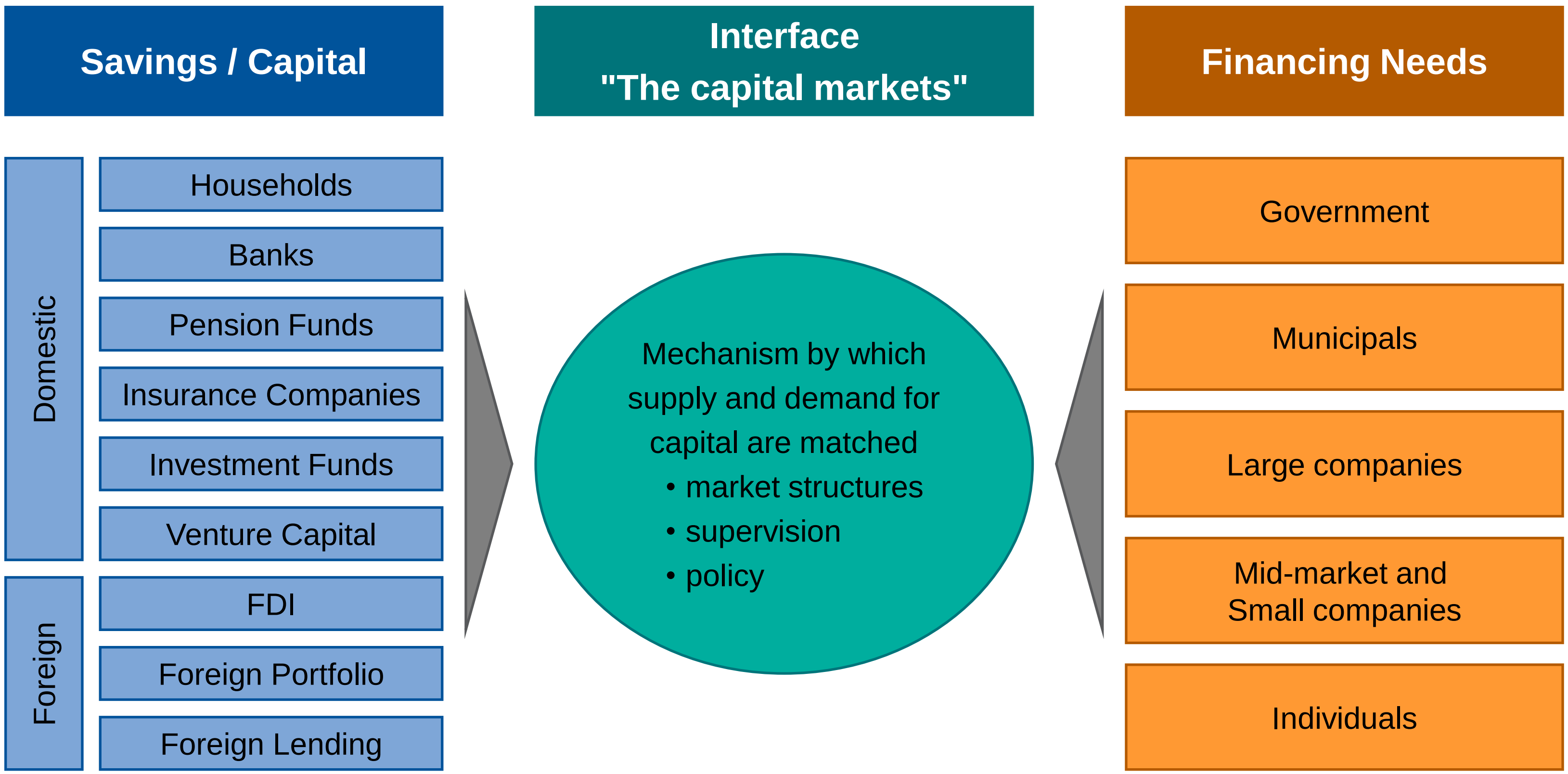




Source: BCG Analysis

# Deep pools of non-bank capital help to insulate economies from shocks

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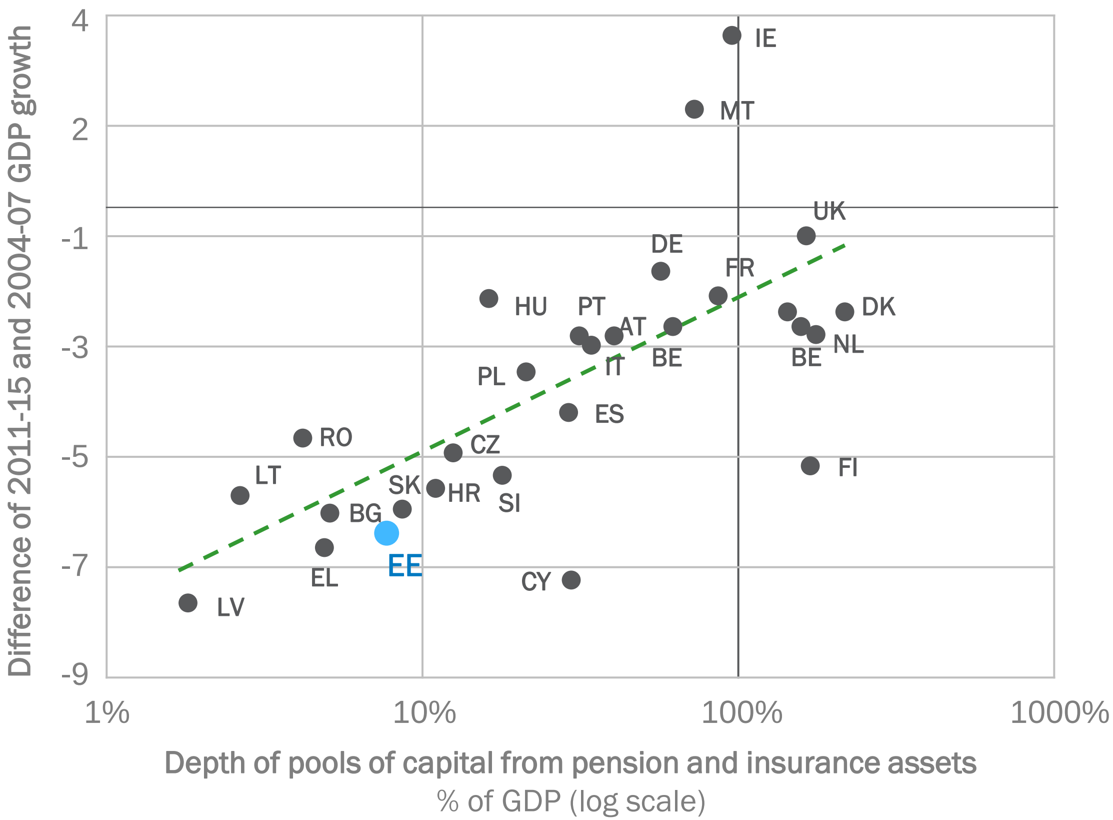
Value of pensions and insurance assets as % of GDP vs. change in GDP growth rates since the crisis




Countries with deeper pools of non-bank capital have seen less contraction in economic growth since the 2008 crisis

This can be linked to the lower dependence that their economies have on financing from banks

Banks have limited the amount of credit that they provide to the real sector due to tighter capital requirements and tighter risk controls



Source: The Benefits of Capital Markets to High Potential EU Economies; New Financial and AFME

# Baltic states lag behind European averages for both the availability of non-bank capital, and the demand for non-bank finance

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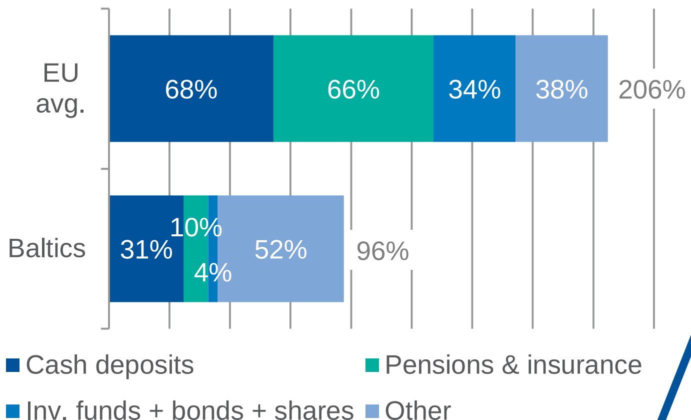
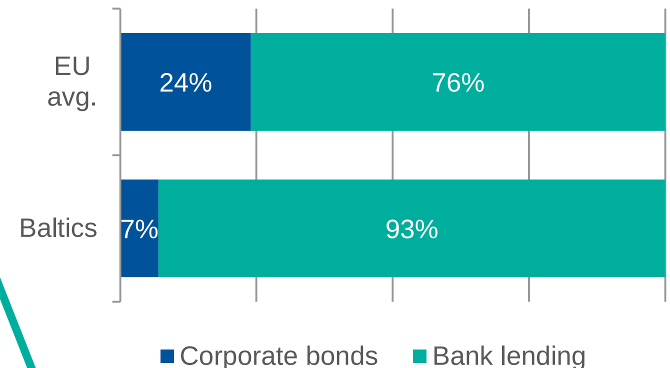
## Savings / Capital

**Value of household financial assets**
% of GDP in 2015




## Financing Needs

**Value of bank lending & corporate debt**
3 years to 2015




Pools of capital in Baltic states are considerably smaller than the average across the EU

This is especially true for pensions and insurance assets, and direct investments by households in funds, bonds and shares

The Baltic banking sector provides a much larger share of capital to businesses than the EU average

This is driven by the dominance of the banks, and by the lower number of large, private companies seeking non-bank capital

**Efforts to develop capital markets in the Baltics will need to focus on both the supply of capital and the demand for capital to increase investment opportunities**



Source: The Benefits of Capital Markets to High Potential EU Economies; New Financial and AFME

# Growth in Polish capital markets has historically been supported by institutional reform

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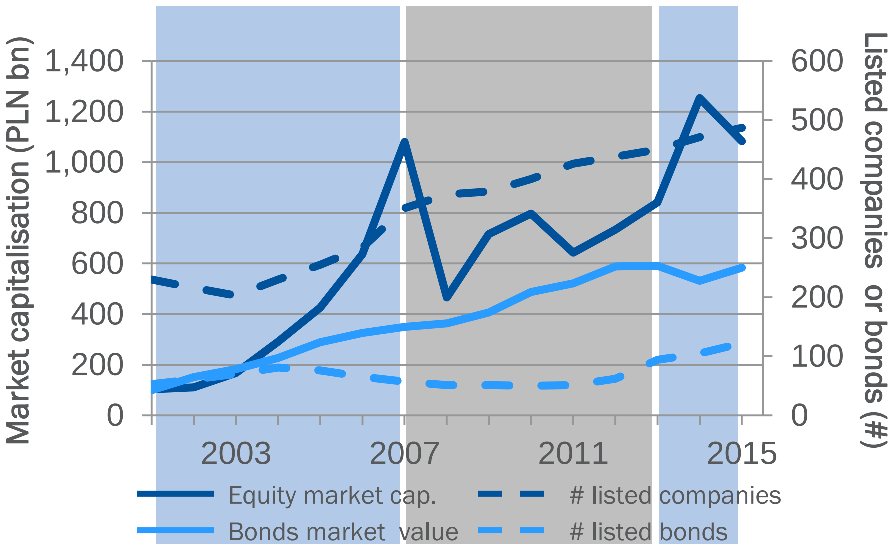


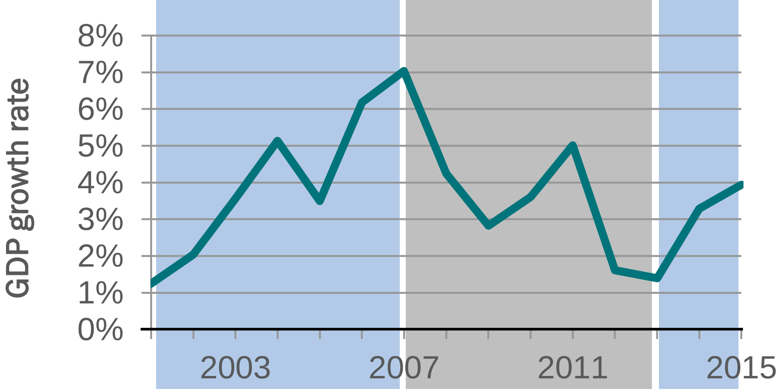


- Poland's early growth was driven by broadening access to finance and developing the non-bank financial sector
- Poland came to be regarded as the financial centre of CEE/SEE
- Institutional reforms helped the market to grow: e.g. Poland was a regional pioneer of clearing and settlement infrastructure reform, including CCP
- The financial crisis affected Poland less severely than more bank dominated states in CEE/SEE – Poland was the only CEE/SEE country with positive growth in GDP throughout the financial crisis
- Poland's capital markets are currently under pressure from political sources, such as the ongoing pension reforms

# Capital markets in Ireland and Luxembourg are highly specialised and have tailored their evolution towards leading in niche parts of the European market

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Markets in Ireland and Luxembourg have been helped to develop by social and policy factors, such as highly educated staff, strong geographic ties, linguistic advantages and low taxation on holding companies

| Luxembourg | | Ireland |
|---|---|---|
| LuxSE lists the first ever Eurobond | 1970 | |
| LuxSE lists the first bond denominated in ECU | 1982 | |
| EEC UCITS Directive approved – Luxembourg one of the first states to adopt the legislation | 1985 | EEC UCITS Directive approved – Ireland one of the first states to adopt the legislation |
| | 1990 | Funds start listing on the ISE |
| | 2000 | ISE starts international debt listing business |
| LuxSE lists the first Sharia bonds in Europe | 2002 | |
| LuxSE lists the world's first green bond | 2007 | |
| LuxSE is the first dim sum bonds in Europe | 2011 | |
| | 2012 | ISE opens the European Wholesale Securities Market in a JV with the Malta Stock Exchange |
| LuxSE launches the Luxembourg Green Exchange for green securities | 2016 | |

**Luxembourg**

| | # (foreign %) | Rank[1] |
|---|---|---|
| Listed companies | 180 (84%) | 14th of 28 |
| Bond issuers | 2,079 (100%) | 3rd of 28 |
| Funds & ETFs | 5,971 | 2nd of 28 |

**Ireland**

| | # (foreign %) | Rank[1] |
|---|---|---|
| Listed companies | 51 (22%) | 24th of 28 |
| Bond issuers | 4,467 (86%) | 1st of 28 |
| Funds & ETFs | 5,980 | 1st of 28 |

1: Rankings out of the 28 EMEA members of the World Federation of Exchanges



Source: World Federation of Exchanges, 2016 statistics

# Estonia should follow the Irish and Luxembourgish approach and develop its capital market through specialisation

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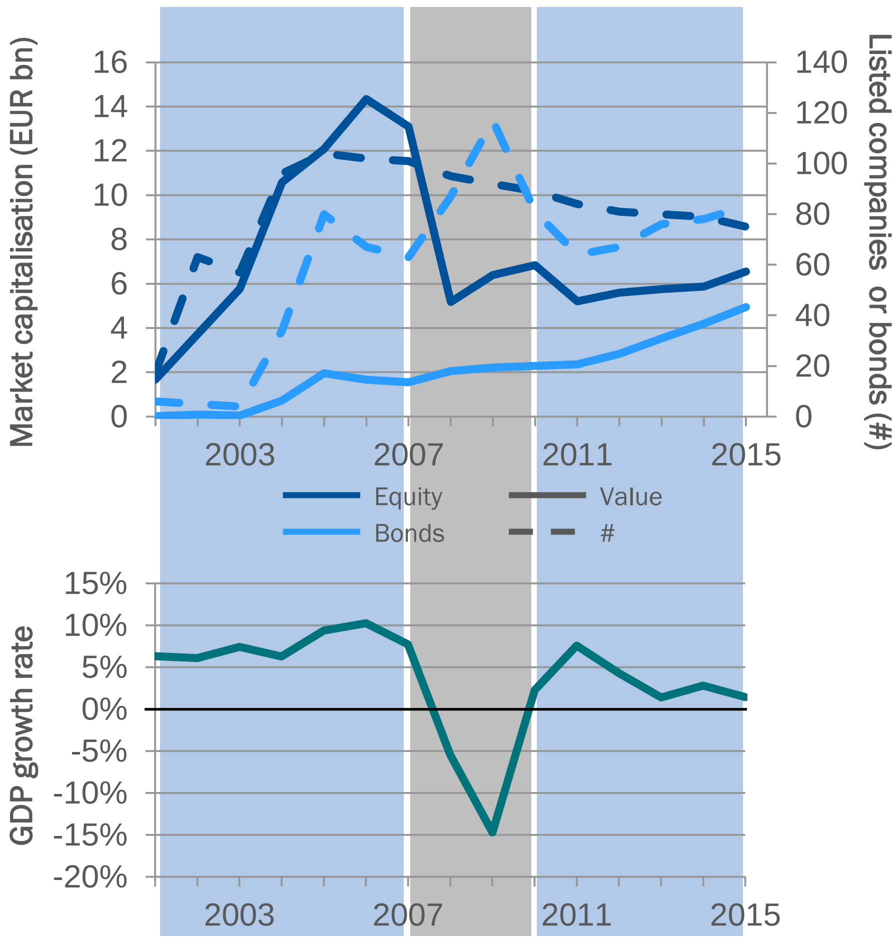


- Estonia has returned to economic growth, but proceeds are flowing into areas other than the capital market:
  - Savings are often held in bank deposits
  - Surplus capital is often invested in property rather than capital market instruments

**Has Estonia missed the train?**

- Estonia is constrained by demographic issues such as its small population
- There is headroom for development of the capital market, but Estonia should focus on becoming a specialised leader in niche areas, such as Fin Tech, or Venture Capital
- Estonia should also look to develop on a regional level – it should promote a Baltic view with homogenous regulations, and lead creation of regional instruments such as covered bonds

# Capital markets are the engine room of modern economies – they help to mobilise and price capital, and to hedge financial risks

# Thank you

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