



# Non-Performing Loans in Asia and Europe— Causes, Impacts, and Resolution Strategies

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# Book Overview

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1

Summary of Nonperforming Loan Trends and Lessons from Three Decades of Crisis Resolution in Asia and Europe

2

Empirical Analyses of the Macrofinancial Implications of Nonperforming Loans in Asia and Europe

3

Country Case Studies on Nonperforming Loan Resolution in Asia and Europe

4

Policy Strategies for Nonperforming Loan Resolution and Market Development in Asia and Europe

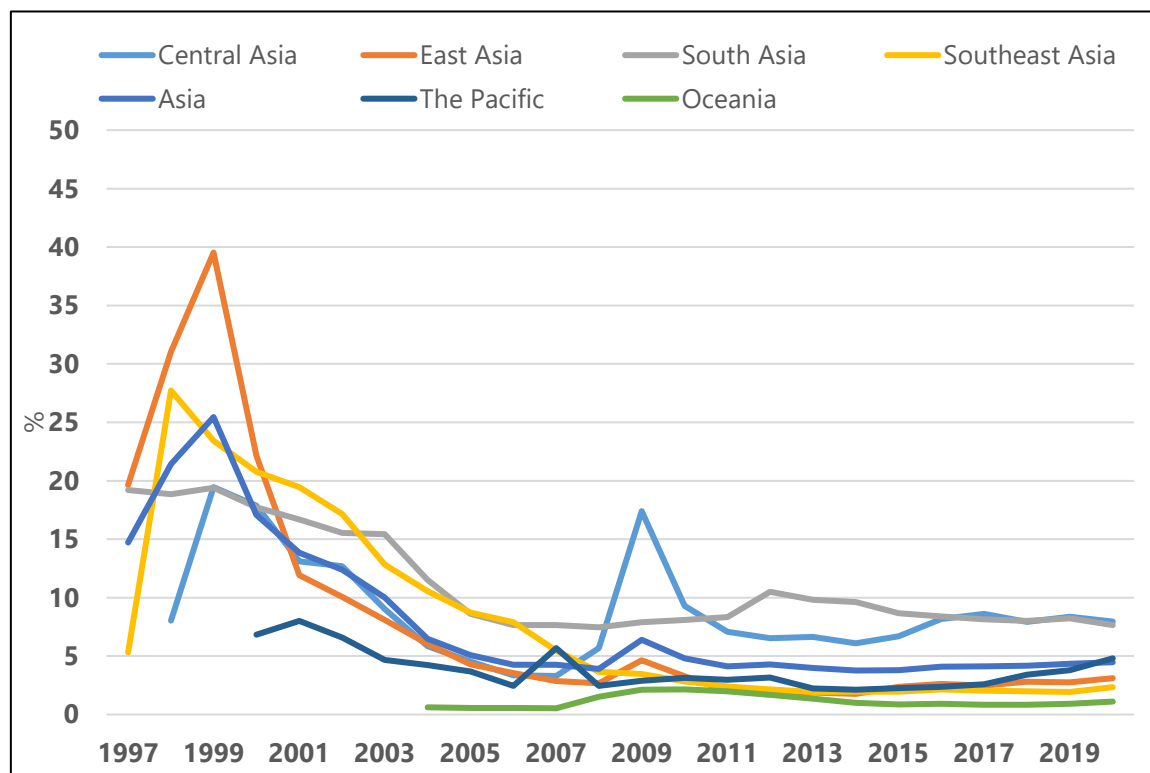


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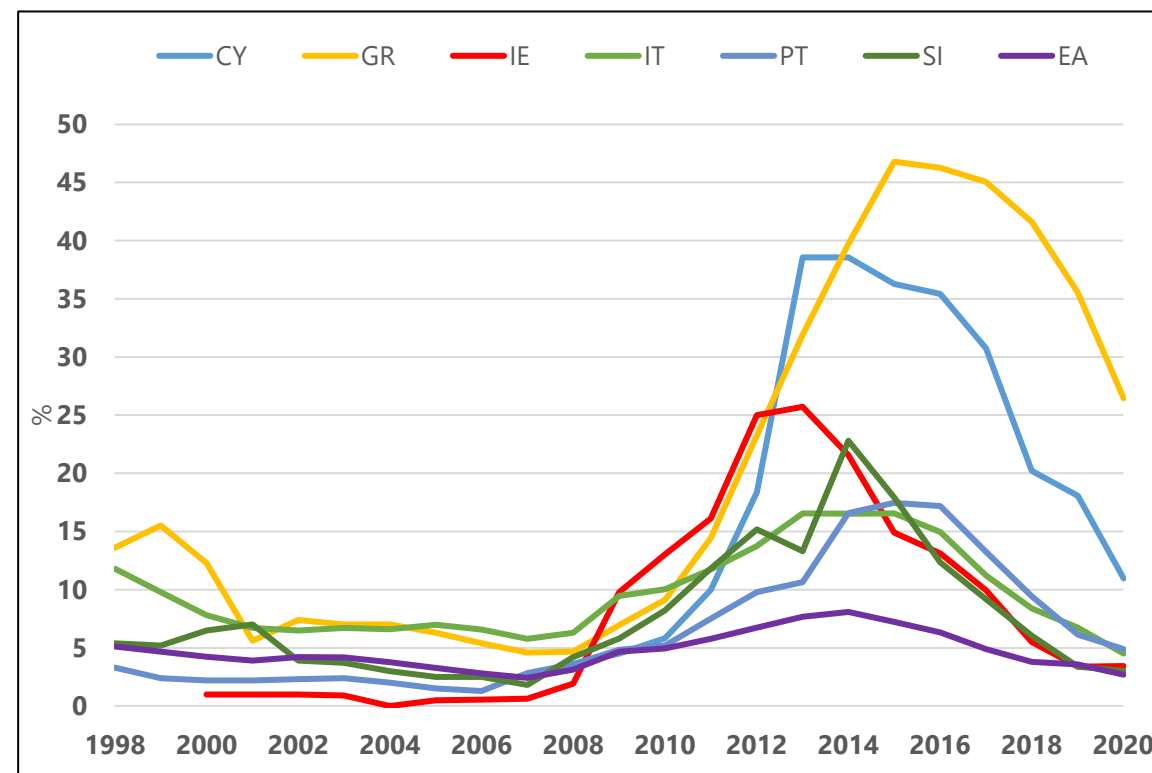
# Asia and Europe went through NPL surges in the last two decades

## NPL ratio in Asia, by subregion (1997-2020)



Note: Asian Development Bank calculations using data from Bank of Mongolia; CEIC Database; International Monetary Fund Financial Soundness Indicators.

## NPL ratio in the euro area and selected countries (1998-2020)

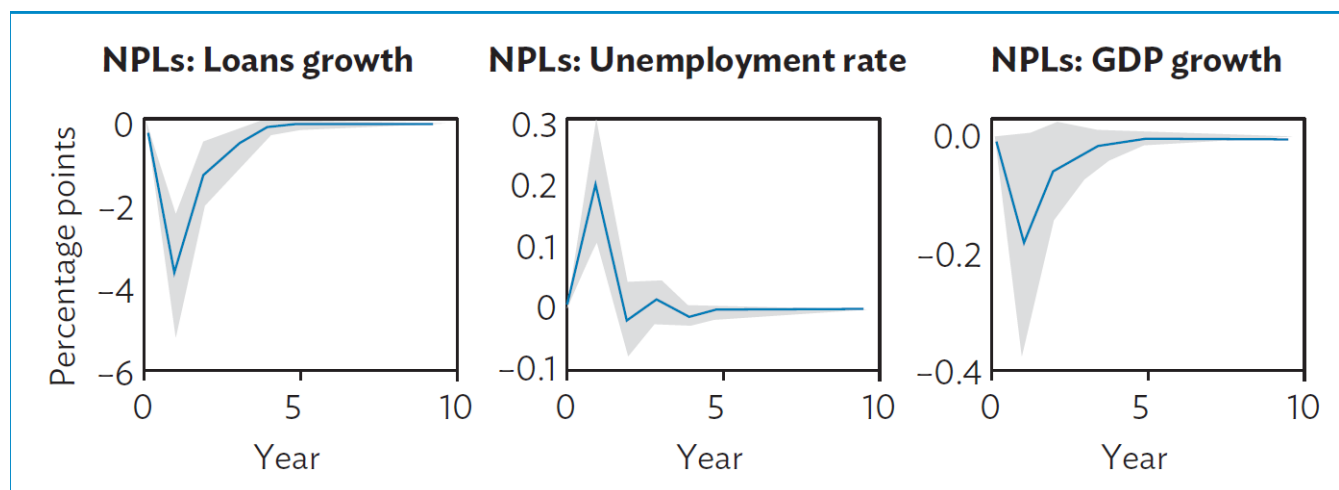


Note: data for Ireland and Cyprus available from 2000 and 2008 only. Source: IMF, ECB.

# Macrofinancial implications of nonperforming loans

- High NPLs can impair banking sector stability and its ability to financially intermediate
  - Chapter 3: Harmful macrofinancial implications of NPLs across Asian economies.
  - Chapter 4: Increases in NPL ratios depress bank lending in the euro area, widen bank lending spreads, and lead to a fall in GDP growth and residential real estate prices.
- Considerable economic benefits of dealing swiftly with elevated NPL levels, especially for bank-based financial systems such as in Asia and Europe

Estimated impulse response functions to a shock in the NPL ratio (Asia)



Source: Chapter 3.

# NPL resolution is often hampered by multiple impediments

## Supply Side

- ☐ First mover disadvantage
- ☐ Unwillingness to realize losses
- ☐ Accounting recognition of cost of recovery
- ☐ Bans/restrictions on loan sales
- ☐ Lack of expertise in asset management and asset valuation

## Demand Side

- ☐ Information asymmetries
- ☐ Barriers to investor entry
- ☐ Imperfect excludability: creditors compete with each other

## Structural & Legal Issues

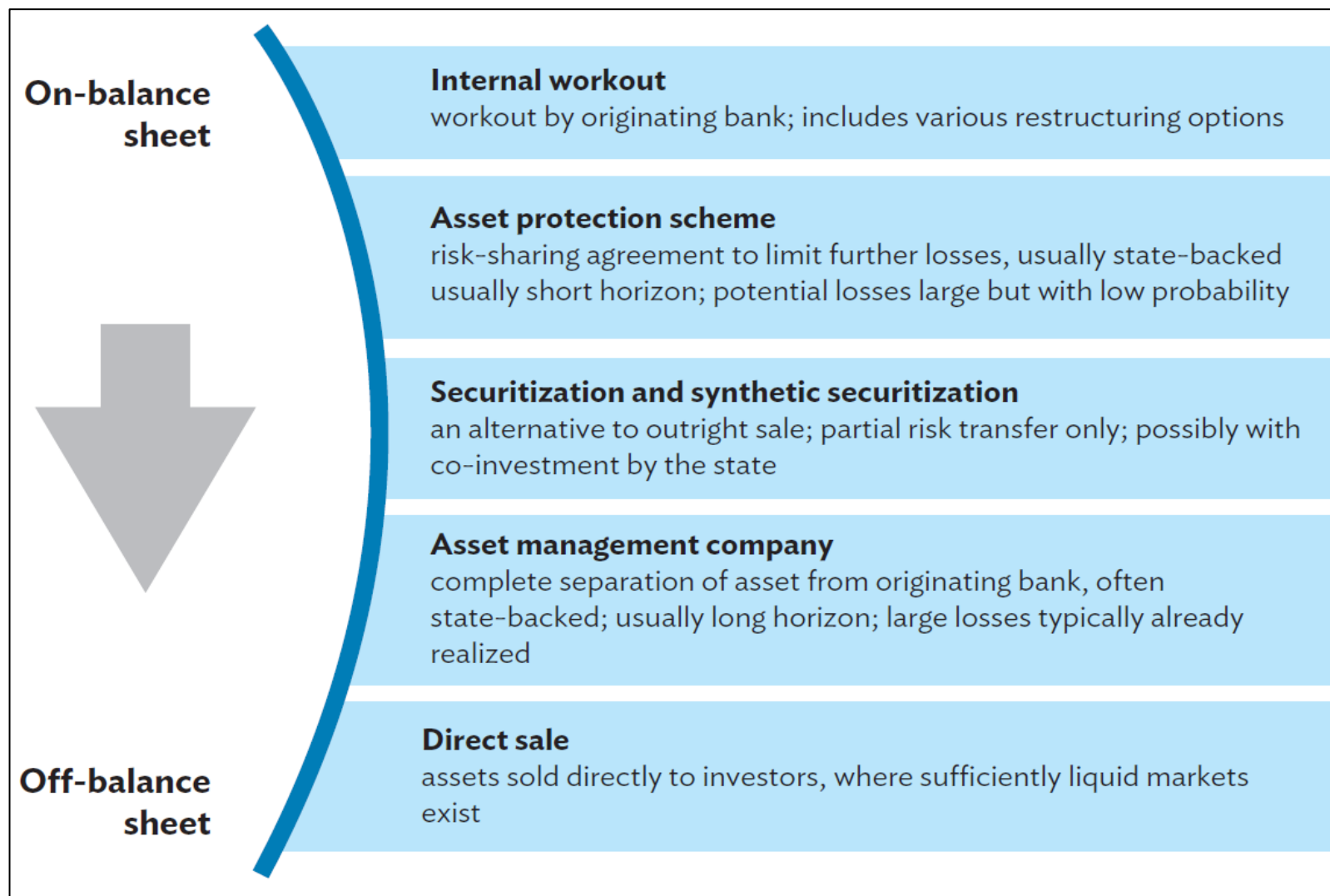
- ☐ Weak and unpredictable insolvency frameworks
- ☐ Opaque and lengthy collateral enforcement
- ☐ Lack of debt enforcement capacity



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# Elements of a comprehensive approach to NPL resolution



Source: Chapter 7.

# Different problems require different solutions

## Resolution methods and characteristics of NPL problems

- Country-specific conditions determine the right combination of NPL solutions
- Resolution by banks always part of the solution mix
- Market-based solutions are promising but often suffer from market failures

		APS	Public AMCs	Securitization	Direct Sales	Debt Restructure	Out-of-Court Workout
Nature of shock	Slow growth			✓		✓	✓
	Crisis	✓	✓	✓	✓	✓	✓
Asset types	Mortgages			✓		✓	
	SME loans		✓	✓	✓	✓	✓
	Large corp. loans		✓		✓		✓
	Unsecured loan		✓	✓	✓	✓	
Fiscal space	Limited	✓	✓	✓	✓	✓	
Legal constraint	Strong						✓

Note: AMC = asset management company, APS = asset protection scheme.  
Source: Chapter 8.

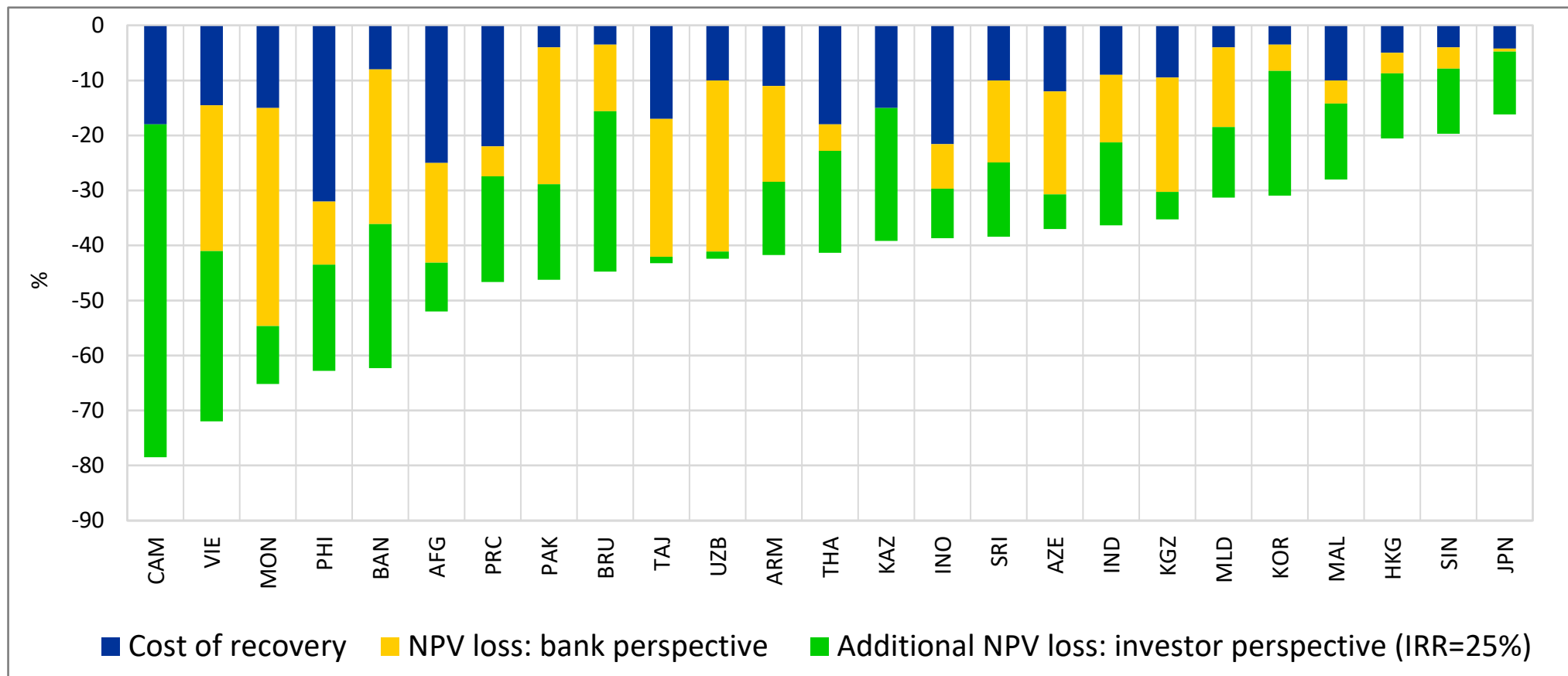
# Success factors for systemic AMCs

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- Strong track record for some asset classes – if properly designed and managed
- Normally don't require large start-up costs; publicly owned AMCs are, however, (contingent) liabilities for the public sector
- Asset transfers to AMCs should be informed by diagnostic exercises, ideally both an Asset Quality Review as well as a stress test.
- Such exercises are important to determine the appropriate transfer price and the scope of assets to be transferred
- Finding the optimal scale and scope of assets is important. Economies of scale to be weighed against complexity.
- Operational independence and professional management improve business results.
- Differing views between many Asian and European economies on whether AMCs should be permanent or temporary entities

# Bid-ask spreads can be significant

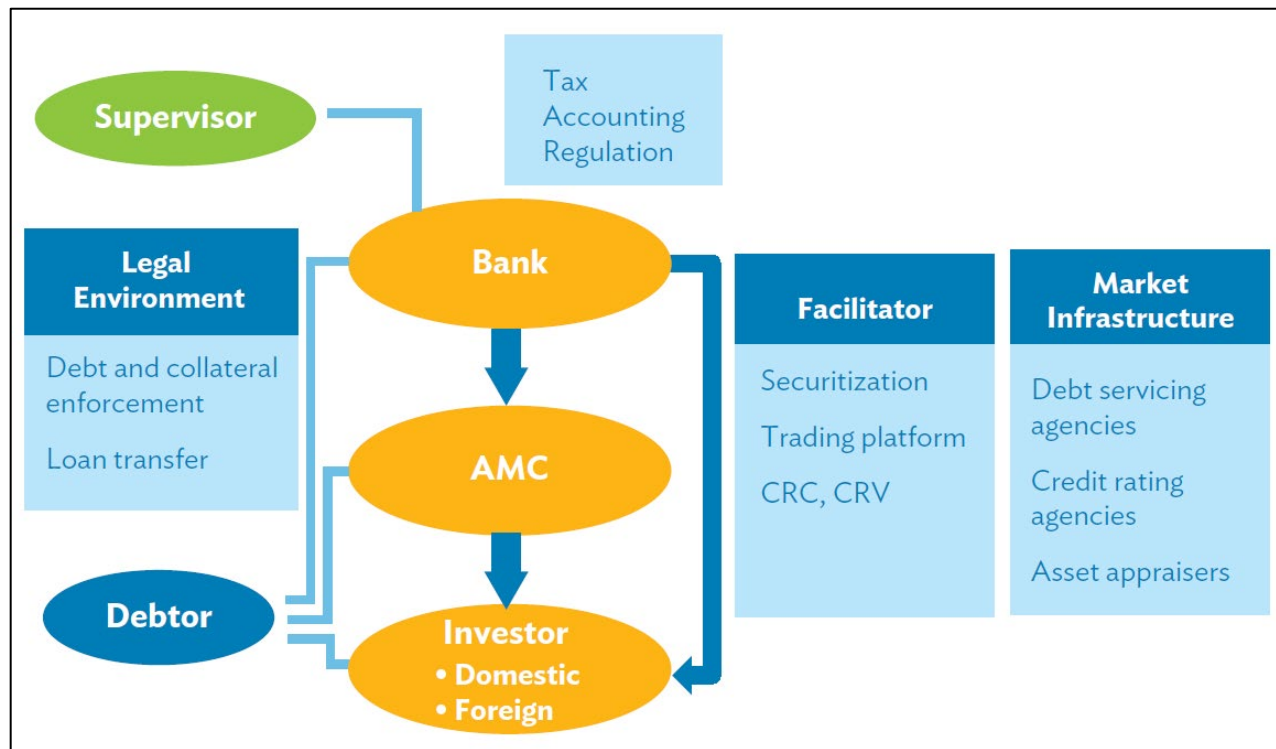
Difference between net book value and the estimated bid price (Asia)



Notes: For Cambodia and Kazakhstan, only the total NPV loss is reported.  
Source: Chapter 8.

# Multi-pronged strategy needed to unlock potential of NPL markets

A strategic framework to develop NPL markets



Note: AMC = asset management company, CRC=corporate restructuring company, CRV = corporate restructuring vehicle.

Source: Chapter 8.

- Supervisory efforts to recognize and resolve NPLs
- Reforms of the legal and judicial framework for debt enforcement
- Out-of-court work-outs
- Improving NPL data
- Public and private asset management companies
- Regional cooperation, such as 2017 EU Action Plan

# Key take-aways

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- ✓ Context-specific, bespoke combinations of resolution approaches are the best way forward
- ✓ Identify and realistically assess the NPL problem early on
- ✓ Boost capacity to deal with NPL problem
- ✓ Address obstacles to NPL market development
- ✓ Reform legal frameworks – ideally proactively before NPL problems build up



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