

## **The Role of the Banking Sector in Selected EEC Countries in the Context of a Changing Economic Environment\***

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### **Abstract**

The specificity of the financial system in European countries remains based mainly on the banking sector, which constitutes the primary source of capital for enterprises. Nevertheless, differences in the level of development of financial systems, including the banking sector, persist across Europe. Among the Central European countries, Poland, Romania, Slovenia, and Ukraine exhibit the lowest levels of development. It should be emphasized that, in the case of Ukraine—currently at war—a significant disparity between deposit levels and loan amounts is not an extraordinary phenomenon. In the case of Poland, however, it indicates an underutilized credit potential that could significantly contribute to investment growth and further economic development.

**Keywords:** Financial system, Banking sector, Central and Eastern Europe

## Introduction

Financial intermediation plays a crucial role in the economy, as it transfers funds from entities with capital surpluses to those with capital deficits, thereby facilitating the investment process that directly impacts the level of economic development. This is one of the fundamental functions carried out through the financial system, both via the financial market and the banking sector. However, it should be noted that financing through the financial market appears to be a more flexible source of capital compared to the banking system, which is generally less inclined to take on higher levels of risk and to invest in innovative, high-risk industries.

The development of the banking system plays a key role in shaping the stability and growth potential of national economies. In Central and Eastern European (CEE) countries, the evolution of banking systems has been closely linked with the broader transformation processes that followed the transition from centrally planned to market economies. This study aims to assess the role of the banking sector in selected EEC countries and to compare its development to Western European financial systems, focusing on the dynamics of deposits, credit activity, and household financial assets.

## The Role of the Financial System in the Economy

The concept of the financial system is not interpreted uniformly in the literature. Undoubtedly, it constitutes a part of the economic system, which in turn forms part of the broader social system. Nevertheless, several theoretical approaches can be distinguished that define the essence and role of the financial system. The main ones include:

1. the institutional approach,
2. the monetary approach,
3. the intermediation and functional approach,
4. and the systemic approach.

In the institutional approach, various types of institutions that constitute the financial system are identified. In the monetary approach, the financial system functions as a mechanism for supplying money to the real sector of the economy. In this sense, it is a mechanism for the creation and circulation of purchasing power—i.e., money—between non-financial entities that are part of the real economy. Another group of definitions focuses on the key functions of the financial system, particularly financial intermediation and transformation. From this perspective, the financial system serves as a mechanism for transferring capital from surplus entities to those in deficit. This mechanism helps to reduce transaction costs, mitigate the adverse effects of information asymmetry, and perform transformations of capital, maturity, and currency. Additionally, it involves the transformation of risk and the creation of value for clients. The systemic approach, meanwhile, analyzes the financial system in terms of the interrelationships between its individual elements and the impact of these relationships on the system's overall functioning, in light of the concepts of complementarity and coherence.

Financial systems around the world adopt different models that reflect historical economic conditions, the level of development of financial markets, and the degree of bank involvement in financing enterprises and the public sector. Differences between these models concern primarily institutional structures, the scope of banking activities, sources of economic financing, and the relationship between the banking sector and the capital market. The two dominant models in economic practice are the market-oriented model and the bank-oriented model, also referred to as the continental model[1].

The market-oriented model is based on the dominance of financial markets as the main source of corporate financing, meaning that banks play a relatively limited role as intermediaries rather than primary capital providers. In this system, investment banks play a crucial role by engaging in securities issuance, financial advisory services, and asset management. Commercial banks, on the other hand, focus on core operational services for individual and business clients, such as account management, lending, and payment transactions [2]. A distinctive feature of this model is a highly developed and liquid capital market, which serves as an alternative source of financing for companies, thereby reducing their dependence on bank loans. Instead of relying on long-term bank financing, enterprises raise capital through the issuance of various securities. This structure fosters competitiveness and flexibility within the financial system but can also lead to greater economic instability, as financial markets are more susceptible to cyclical fluctuations. The Anglo-Saxon system dominates in countries such as the United States, the United Kingdom, Canada, and Australia, where well-developed capital markets and active investment funds ensure that corporate financing is not solely dependent on banks.

The bank-oriented model, or continental, model is characterized by the dominant role of banks as the main providers of capital to enterprises and the public sector. The foundation of this system is the universal bank, which performs a full range of banking operations, combining deposit and credit activities with investment banking functions. In contrast to the Anglo-Saxon model—where investment banks guarantee the issuance of securities and conduct trading on behalf of clients and on their own account—banks in the continental model perform both deposit-taking and investment activities. They directly transfer savings to the money and capital markets, offering financial services such as financial engineering, mergers and acquisitions, wealth management, and securities trading.

Unlike in the market-oriented model, where companies rely mainly on stock market financing, enterprises operating in the continental model obtain funds primarily through bank loans. This leads to stronger relationships between the banking sector and the real economy. Capital links often exist between banks and enterprises, enabling stable, long-term financing of investments. Banks in this model do not limit themselves to financing corporate activity; they also frequently participate in corporate governance by holding equity stakes or delegating representatives to supervisory boards. As a result, banks act as long-term business partners, reducing the risk of economic fluctuations and limiting speculative behavior in capital markets. The German-Japanese model prevails in countries such as Germany, Japan, France, and other continental European nations, where the traditionally strong role of the banking sector in financing the economy contributes to financial stability and sustainable economic growth.

The banking system thus remains one of the fundamental segments of the financial system in a market economy. It represents an organized set of banking institutions operating within a given economic area (most often within a country), functioning under specific legal frameworks and financial supervision regulations. The banking system comprises the central bank and commercial and investment banks, which perform a range of financial functions, including accepting deposits, extending credit, facilitating payments, issuing money, and providing financial intermediation. The banking system plays a crucial role in ensuring the efficient functioning of the financial market, mobilizing savings, and financing investment activities. Its key functions include:

1. Advisory and financial function, involving support for individual clients and the protection of their interests;
2. Settlement function, consisting of transferring funds from debtors to creditors via the banking system;
3. Deposit and credit function, enabling the transformation of deposits into loans;
4. Regulatory function, controlling the supply of money in response to demand;
5. Issuance function, involving the creation of currency and banknotes as legal tender;
6. Allocative function, allowing the flow of funds from less to more efficient areas of the economy;
7. Stimulative function, promoting the development of local entrepreneurship through bank financing [3].

In the literature, banks are typically attributed three fundamental roles:

1. the concentration of capital,
2. the transformation of money over time, and
3. the execution of financial settlements.

The capital concentration function refers to the transformation of small savings from households and businesses into large-scale investments that exceed the financial capacity of individual depositors. This enables the undertaking of economic projects of strategic importance. The transformation of money over time involves the use of short-term deposits and savings to finance long-term investments, especially credit operations, thereby influencing economic development. The settlement function, in turn, facilitates financial transactions between various economic entities, ensuring the smooth flow of funds within the economy.

Increasing competition and globalization, particularly in financial markets, have compelled banks to adopt risk management techniques and engage in off-balance-sheet operations, significantly expanding the scope of commercial banking activities. Consequently, the primary objectives of banking systems include maintaining the stability of their components, ensuring the proper functioning of essential financial functions, sustaining the confidence of investors, depositors, and creditors, as well as efficiently accumulating and allocating savings while safeguarding the stability of payment and settlement systems.

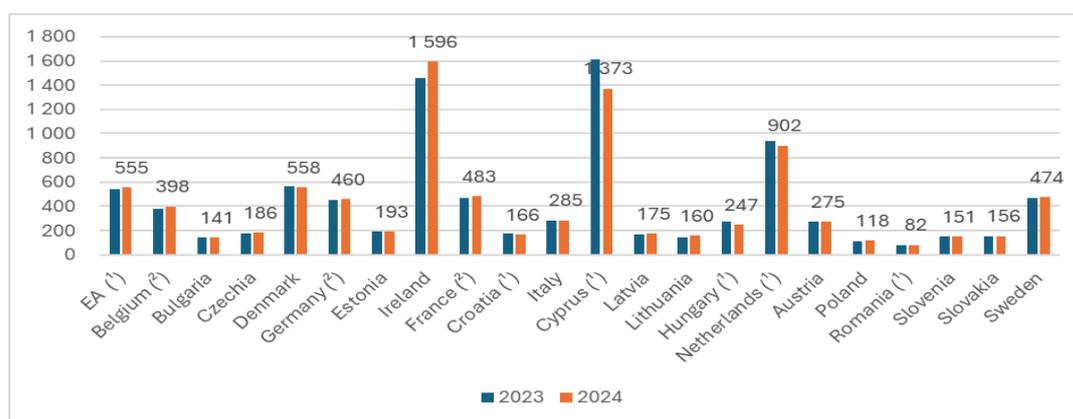
From the functions performed by banks in the market economy, it follows that they play a vital role in capital allocation, risk diversification, and overall economic growth. Notably, underdeveloped economies with low levels of financial intermediation and illiquid financial markets are unable to utilize savings effectively.

The analysis leads to the conclusion that the banking system constitutes an essential element of the financial system; however, its role depends on the adopted financial model. In the continental model—typical of Central

European countries—the banking system serves as the main source of capital, and banks function as universal institutions. Nonetheless, models based on securities markets represent an increasingly relevant alternative.

## The Role of the Banking System in the Financial System of Central and Eastern European Countries

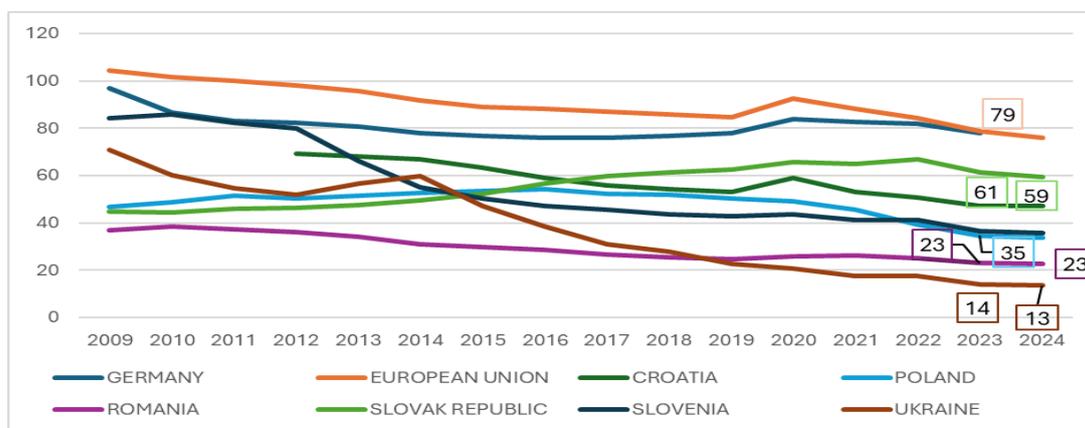
To assess the significance of the banking system within the financial framework, the study evaluated the level of financial system development in selected European countries. One of the key indicators assessed is the ratio of total assets of financial corporations to GDP for 2023–2024 (figure 1) [7,8]. All ECC countries display a lower level of financial system development compared to Western Europe. The lowest asset-to-GDP ratio was recorded in Romania, significantly below 100%, while the highest was in Hungary (247% of GDP). In euro area countries, this ratio averaged 555%, with Germany reaching 460% in 2024 [4]. Exceptionally high indicators in countries such as Ireland and Cyprus are largely due to their favourable tax policies towards the foreign sector, which attract capital inflows.



**Fig. 1. Total assets of financial corporations (as a percentage of GDP) in selected countries in Europe**

Source: authors' own calculations based on Eurostat data

It should be emphasized that the financial systems of Eastern European countries still have significant potential for further development, though the degree of advancement differs considerably between them. In Estonia, the Total Assets to GDP ratio reached 193% in 2024, while in Poland it stood at only 118%. To further assess the importance of the banking sector, the study also examined the ratio of Domestic Credit to the Private Sector (as a percentage of GDP) for the years 2004–2024. Data for selected countries are presented in Figure 2.

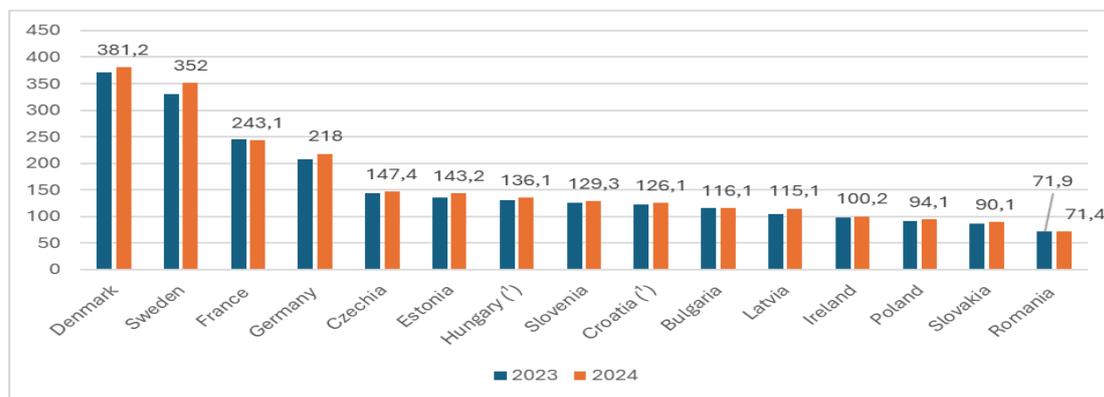


**Fig. 2 Domestic Credit to the Private Sector (as a percentage of GDP) for the years 2004–2024**

Source: authors' own calculations based on IMF data

The Analysis of the figure indicates that even among Western European countries, the role of credit to the non-financial sector is substantially higher than in Central and Eastern Europe [5,6]. In France, the ratio increased from 89% in 2007 to 108% in 2024, while in Germany it remained below 100% throughout the period [5]. Among Central European countries, the highest levels of this indicator were observed in Slovakia, Bulgaria, and Croatia. It is worth noting that Slovakia maintained an almost stable upward trend throughout the analyzed period, increasing from 39% of GDP in 2007 to 59% in 2024. The data also show that, apart from Romania and Slovakia, all countries recorded a decline in this indicator in 2020. This suggests that the overall credit volume in these economies decreased relative to the level of GDP. The reduction in lending activity was likely linked to the outbreak of the COVID-19 pandemic and the subsequent global economic lockdown. It is also worth emphasizing that all the examined countries experienced a decline in this indicator after 2022, reflecting the economic impact of the war on both Central and Western European economies.

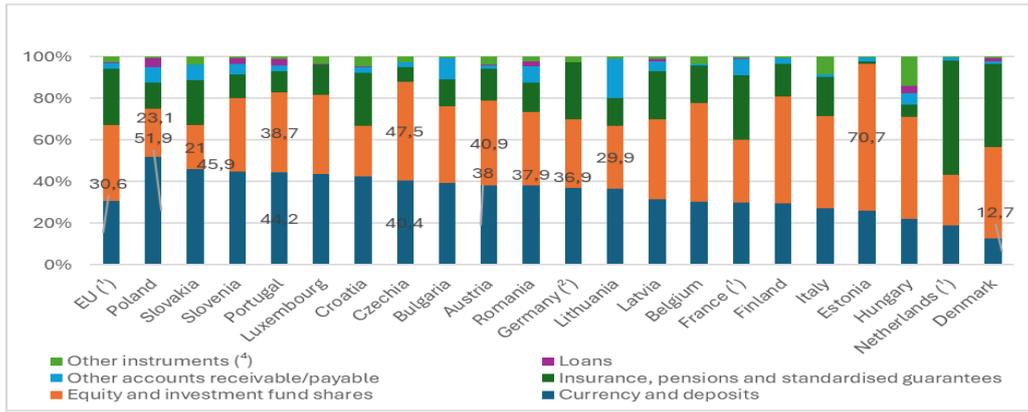
The countries with the lowest Credit-to-GDP ratios were Ukraine, Poland, and Romania. In 2024, this indicator reached only 23% in Romania and 34% in Poland. Among all Central European countries, Slovenia exhibited a persistent downward trend from 2010 to 2024, resulting in a significant decline from 86% to 36% of its GDP. A similar pattern can be observed in Ukraine: in 2008, the Credit to Non-Financial Sector to GDP ratio stood at 71%, whereas by 2020 it had dropped to just 21%. Following the full-scale invasion in 2022, the value of this indicator continued to decrease. Under wartime conditions, the decline in lending activity was steeper than the fall in GDP within the Ukrainian economy. Nevertheless, despite the ongoing war, the banking sector continued to supply capital to enterprises and households in 2024, at a level equivalent to 17% of GDP.



**Fig. 3. Total financial assets of households in relation to GDP**

Source: authors' own calculations based on Eurostat data

The development of the financial system can also be illustrated by the indicator representing Households' Financial Assets in relation to GDP, presented in Figure 3. The value of this indicator reveals apparent differences between Central and Eastern European countries and the highly developed economies of Western Europe. In Scandinavian countries such as Denmark and Sweden, household financial assets exceeded 350% of GDP in both 2023 and 2024. In the examined group of countries, the value of household financial assets increased slightly in 2024 compared to 2023, though the growth was not substantial. Only in Poland, Slovakia, and Romania did household financial assets remain below the level of national GDP, whereas in the Czech Republic and Estonia the ratio approached nearly 150%.



**Fig. 4 Structure of financial assets of households in selected countries in EU**

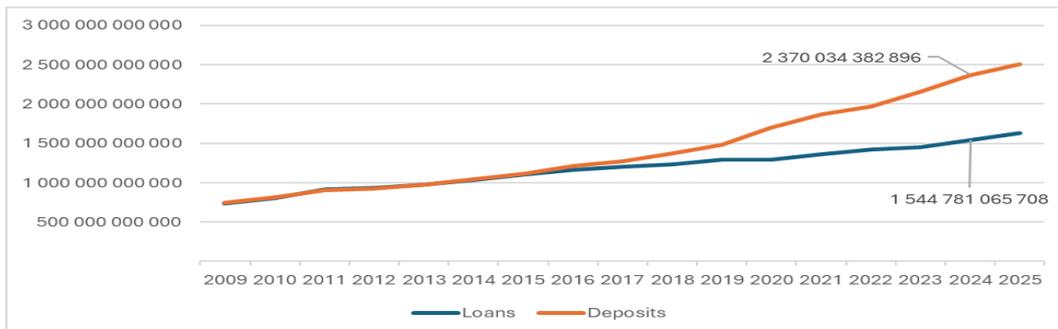
Source: authors' own calculations based on ECB data

It should be underlined that deposits and savings of the non-financial sector represent an essential source of capital for European banks. The analysis of the Structure of Financial Assets of Households presented in Figure 4 shows significant differences between individual countries. The largest components of household financial assets are Currency and Deposits and Equity and Investment Fund Shares.

An examination of household investment portfolios indicates that the traditional division between Western and Central-Eastern Europe is gradually diminishing. Nevertheless, cash and deposits continue to constitute a significant part of household portfolios. In Poland, this share is the highest, accounting for more than half of household financial assets in 2024. A similar situation can be observed in Slovakia, where the share reached nearly 46%. Conversely, Estonia shows the highest share of Equity and Investment Fund Shares—around 70% of total assets—with deposits representing only about 20%. This suggests that, apart from Poland, European households tend to allocate a greater proportion of their savings to financial markets than to the banking sector. However, the banking sector remains a major recipient of household financial surpluses. Given the large share of household savings held in bank deposits in Poland, the analysis also examined the Deposit-to-Credit Ratio in the Polish banking sector.

### Evaluation of Deposit and Credit Activities of the Banking Sector in Poland and Ukraine

The specific structure of household financial assets in selected European countries revealed that only in Poland do investments in the banking sector account for more than 50% of total household assets. Consequently, the banking sector is the primary recipient of household savings and a significant source of funding for credit activity. To assess the utilization of non-financial sector savings, a comparison was made between the lending and deposit activities of the Polish banking sector over the period 2009–2025. The data presented in Figure 5 indicate that between 2009 and 2015, deposits were almost entirely transformed into lending activities. However, since 2016, the growth rate of deposits has considerably exceeded that of loans granted by the banking sector. Although the total volume of loans continues to increase, their pace of growth remains substantially lower than that of deposits.



**Fig. 5 Total loans and deposits in Polish banking system (in PLN)**

Source: authors' own calculations based on National Bank of Poland data

It should be emphasized that, alongside Poland and Romania, Ukraine recorded the lowest ratio of total loans to GDP among European countries. Since 2014, when this ratio stood at 60%, it has declined significantly, reaching 23% in 2019. The total value of loans and deposits in the Ukrainian banking sector during 2007–2025 is illustrated in Figure 6. The data show that up to 2019, the value of loans slightly exceeded the level of deposits. However, a significant shift occurred in 2019, as the growth rate of deposits began to outpace credit expansion substantially. Despite the ongoing war, Ukrainian banks have continued to perform classical banking operations, including deposit-taking, lending, and payment services. During 2021–2025, credit financing of the economy was not interrupted, and the total loan volume even increased; nevertheless, the rise in deposits was more pronounced than that of loans [9].



**Fig. 6 Total amount of loans and deposits in Ukrainian banking system (in mln hryvnias)**

Source: authors' own calculations based on National Bank of Ukraine data

To compare the lending–deposit activity in Poland and Ukraine, the relationship between the total amount of deposits collected by the banking sector and their transformation into loans was analyzed. [9].

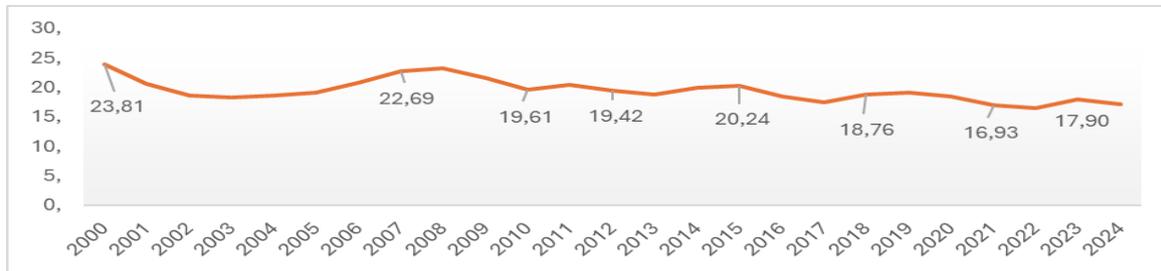


**Fig. 7. Total loans to total deposits in banking system (Ukraine and Poland)**

Source: authors' own calculations based on National Bank of Ukraine and National Bank of Poland data

The data presented in Figure 7 show that since 2020, both the Polish and Ukrainian banking systems have been characterized by high liquidity surpluses. Collected deposits significantly exceed the level of loans, indicating that only a portion of savings is transformed into credit. While such a situation is understandable in Ukraine, due to wartime conditions [9] and severe constraints on investment and credit activity, it is less justified in the case of Poland. This suggests that household savings only partially contribute to capital formation in the economy [10]. By conducting credit risk assessments, banks tend to transfer capital primarily to low-risk entities. As a result, enterprises operating in high-risk sectors face limited access to financing. Banks also generally prefer investments in low-risk securities, particularly government bonds. The high liquidity surplus in the Polish banking sector requires monetary policy interventions by the central bank, focused on liquidity absorption through the issuance of money bank central-bills and reverse repo operations. It seems necessary to undertake actions aimed at redirecting funds from the banking sector to the financial market to make capital access more flexible, especially for sectors and enterprises operating under elevated risk. This particularly concerns household savings, which are predominantly placed in the banking sector and show limited interest in capital market investments. The growing gap between the value of loans and deposits indicates that the level of investment in the economy is constrained by limited access to capital. It should be noted that in 2025, the

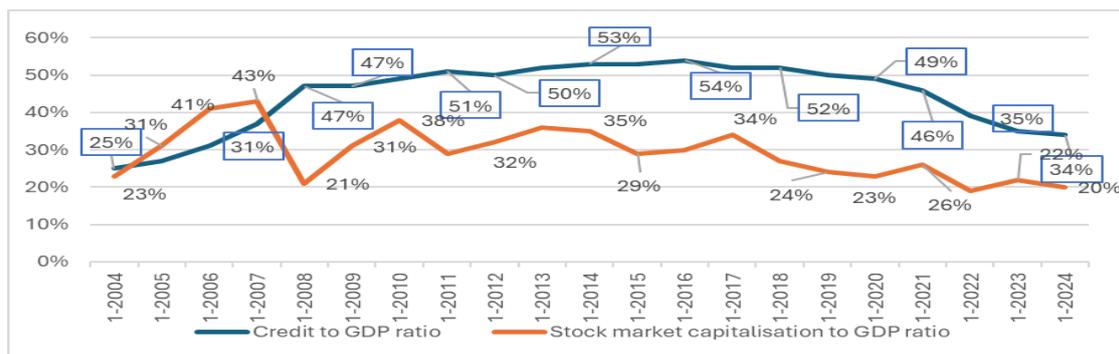
inflation target of the National Bank of Poland was achieved, implying that the cost of capital is no longer a major obstacle. Furthermore, Poland's economic growth rate remains among the highest in Europe, despite the relatively low investment-to-GDP ratio. This indicator, which measures the share of GDP devoted to investment activity across the government, business, and household sectors—defined as Gross Fixed Capital Formation (GFCF) as a percentage of GDP is presented in Figure 8.



**Fig. 8 Investments to GDP in Poland (in%)**

Source: authors' own calculations based on IMF data

The data indicate that the investment-to-GDP ratio reached its highest level in 2000. Since 2016, however, the ratio has remained unsatisfactory, falling below 18%. This period was marked by significant uncertainty in financial markets, first due to the COVID-19 pandemic and subsequently due to the war in Ukraine and the accompanying high inflation. Consequently, the central bank increased interest rates, raising the cost of capital and substantially reducing the pace of credit expansion.



**Fig. 9 Credit to GDP (in %) and stock market capitalization to GDP (in %) in Poland in 2004-2024.**

Source: authors' own calculations based on IMF data

This phenomenon is also reflected in the relationship between Credit-to-GDP and Stock Market Capitalization to GDP, illustrated in Figure 9. Between 2017 and 2024, the *Stock Market Capitalization to GDP* ratio declined to merely 20%, indicating that Poland's financial market remains underdeveloped, with slight improvement over time. Additionally, Polish households continue to prefer bank investments, which exacerbates the banking sector's excess liquidity and widens the gap between the value of loans and deposits.

## Conclusion

The analysis demonstrates that disparities in financial system development between Western and Central–Eastern European countries have been gradually narrowing. However, the degree of financial development remains uneven, and in countries such as Poland and Romania it continues to be relatively low. Across Europe, the banking system remains the core element of the financial system, regardless of its level of advancement. Similarly, within the banking sector, countries like Poland and Romania still exhibit a relatively low degree of development. Moreover, the global economic lockdown caused by the COVID-19 pandemic, followed by the war in Ukraine, significantly affected the relationship between banks' funding sources and their lending activity. The slowdown in credit growth, coupled with a rapid accumulation of deposits, has led to a substantial liquidity surplus in the banking sector—particularly in Poland. In addition, Polish households allocate more than 50% of their financial assets to bank deposits, indicating untapped potential for credit expansion. As inflation pressures have recently subsided across the EU—including in Poland (though not in Ukraine)—the cost of capital no

longer represents a critical barrier. Household savings could therefore serve as an important source of financing for domestic enterprises if a greater portion were redirected to the financial market. This is particularly important given the low investment-to-GDP ratio, which continues to restrain investment activity and compels the central bank to undertake liquidity-absorbing operations within the banking sector.

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