



THE EU'S EASTERN NEIGHBOURING COUNTRIES AND THE CRISIS

by

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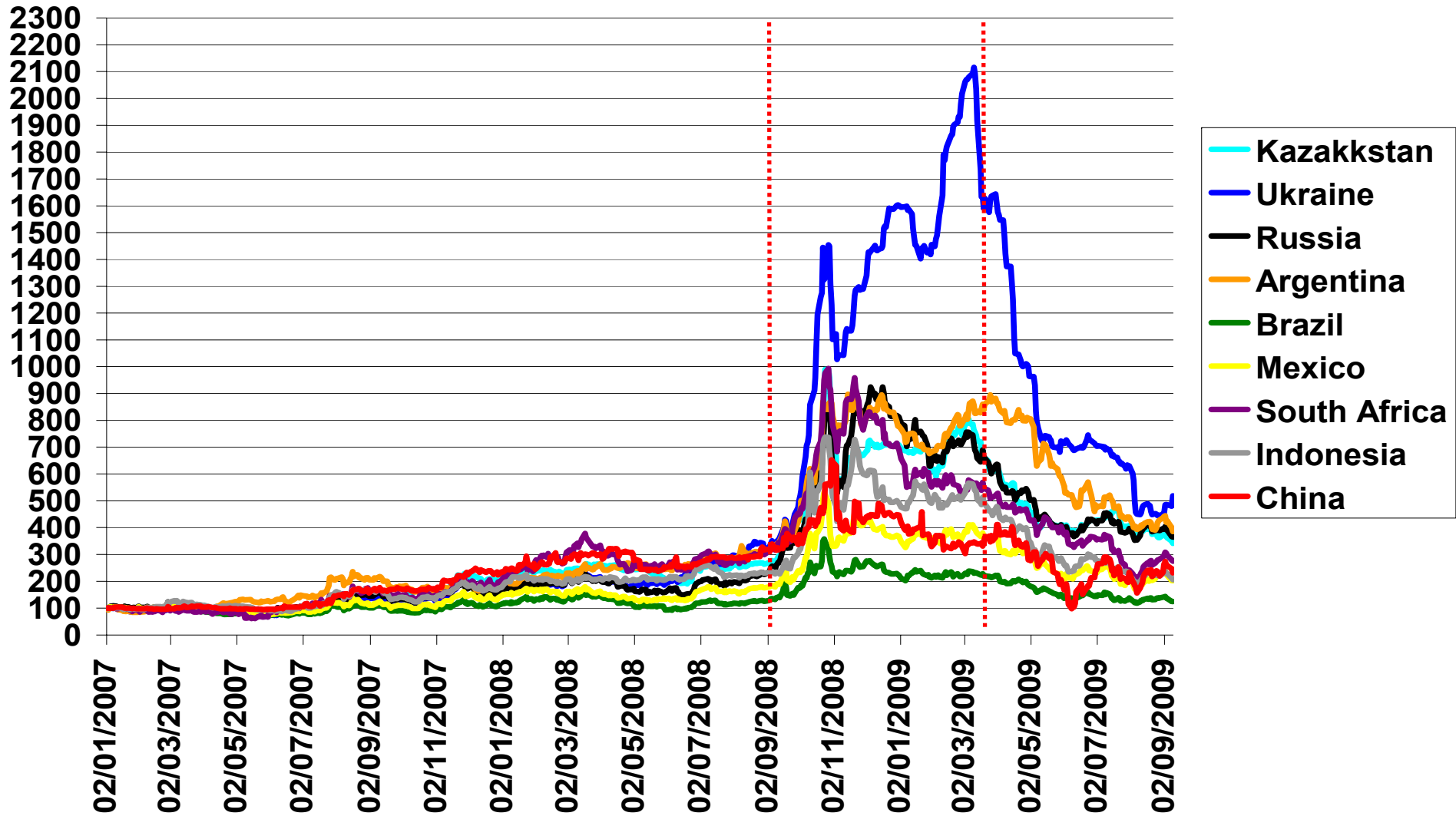
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DG Economic and Financial Affairs



Three Quarters that Shook the World...





Overview of Presentation

- Yearly DG ECFIN Occasional paper on EU neighbourhood
- This year special topic on the global impact of the crisis
- Crisis impact and recent developments in Russia and Eastern Partnership countries
- Policy responses and challenges
- Discussion



Main Points

- No region in the world immune
- Financial transmission channels powerful and near-immediate
- Externally exposed countries more vulnerable to first-order impact
- Feed-back loops with the real economy
- Impact and lag dependant on prior buffers and adequacy of policy responses
- Recent stabilisation, but risks remain

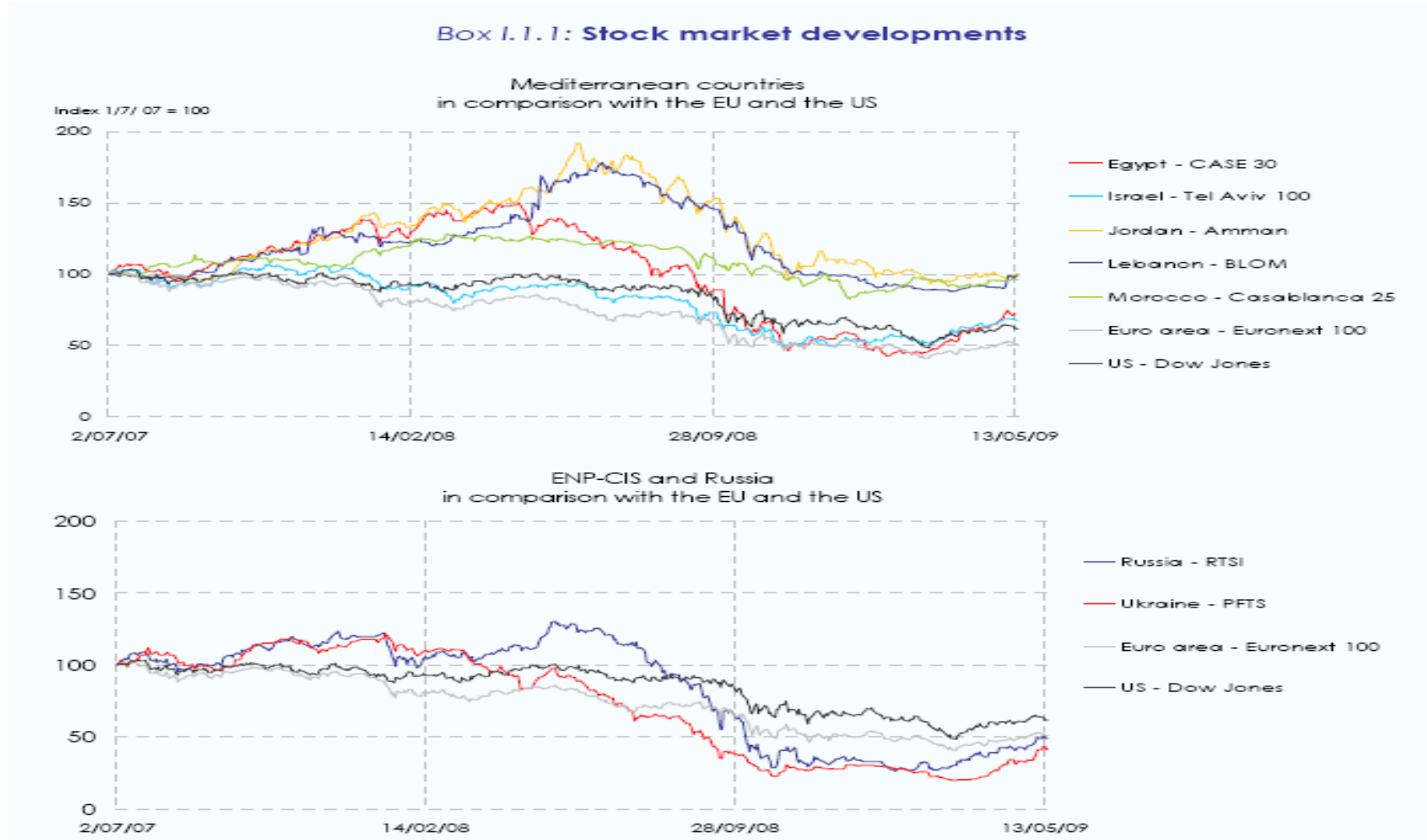


Main Points

- Large cross country variation in policy responses and instruments, depending on prior buffers and adequacy of policy actions
- Near term versus long term fiscal policy
- Securing external financing
- Crisis response in relation to implementing long-term reform agenda (including at international level, e.g., G 20)

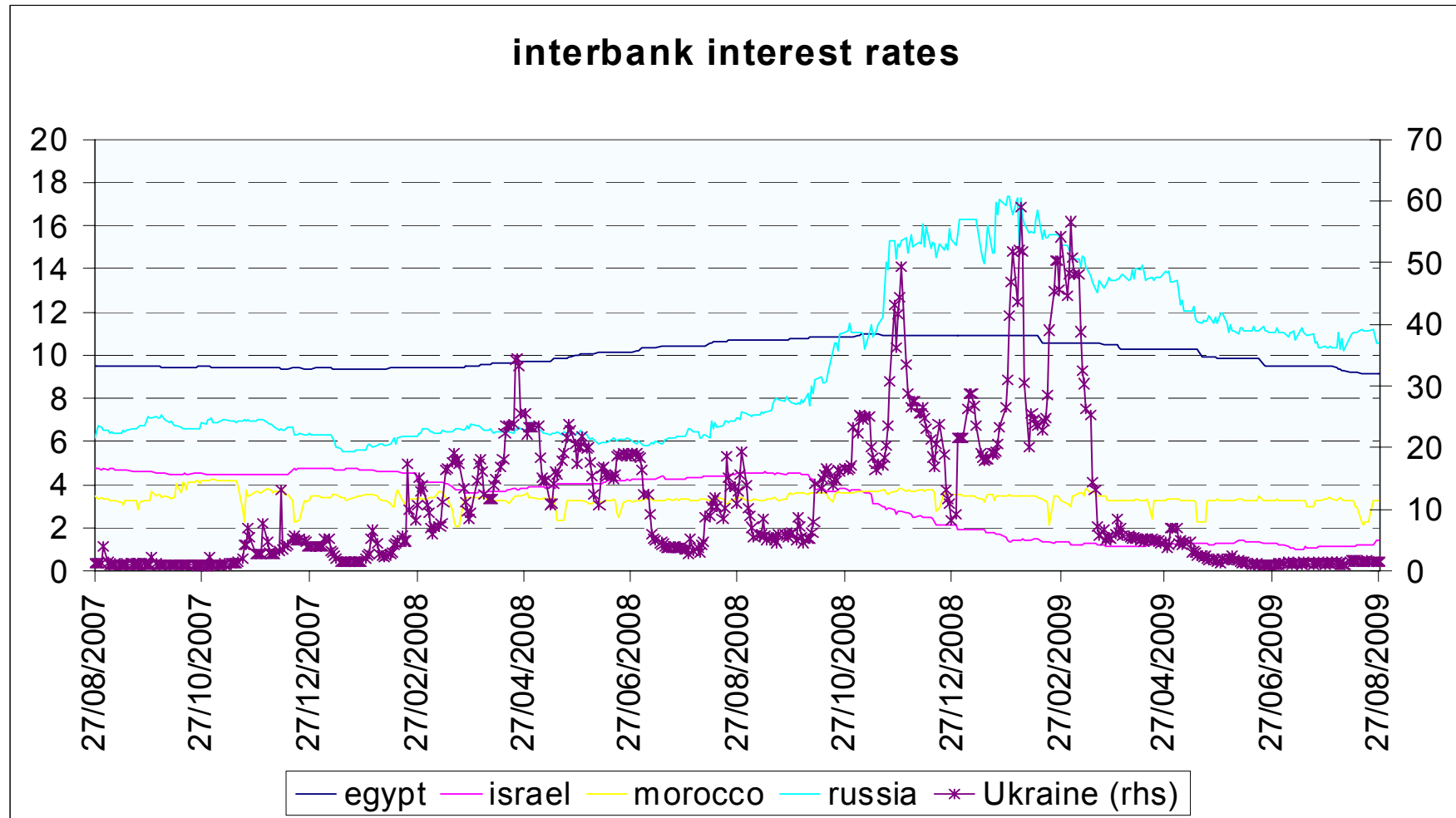


EU neighbourhood affected, but differentially across regions, as, for instance, with share prices....





...and interest rates





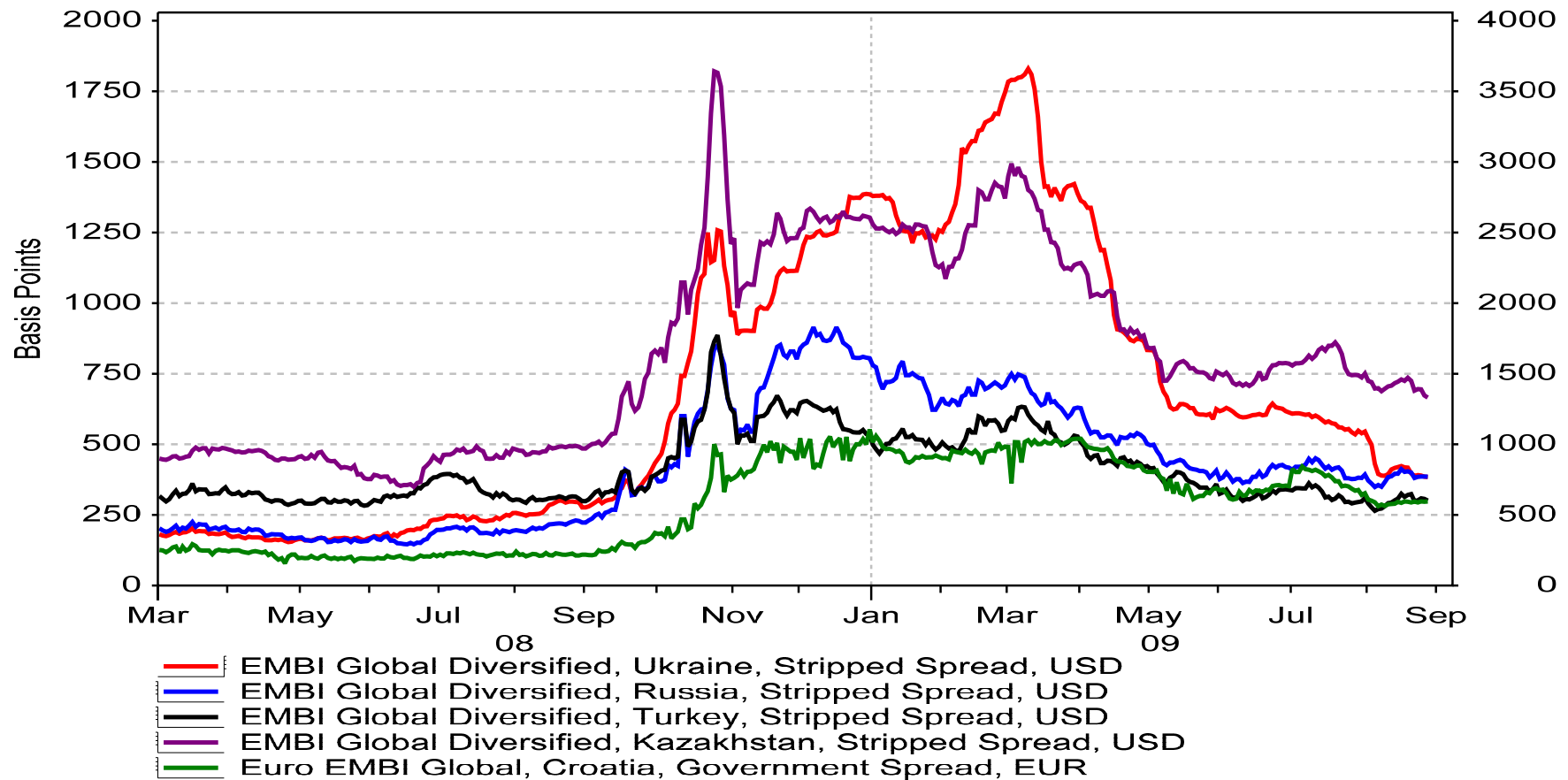
Eastern neighbourhood among the worst affected regions globally

- Several elements similar to *some* new MS
- Reliance on foreign funding
- Banking sectors under strain
- Forced adjustment of exchange rates in the face of capital outflows
- For some, commodities' reliance amplified the shock
- Fiscal buffers and/or foreign assistance as a cushion
- Quite direct feed-through of the crisis crucial difference with Mediterranean neighbourhood – but not only for the worse



Tensions led to sharp increase in yields in emerging Europe bonds, but spreads narrowing

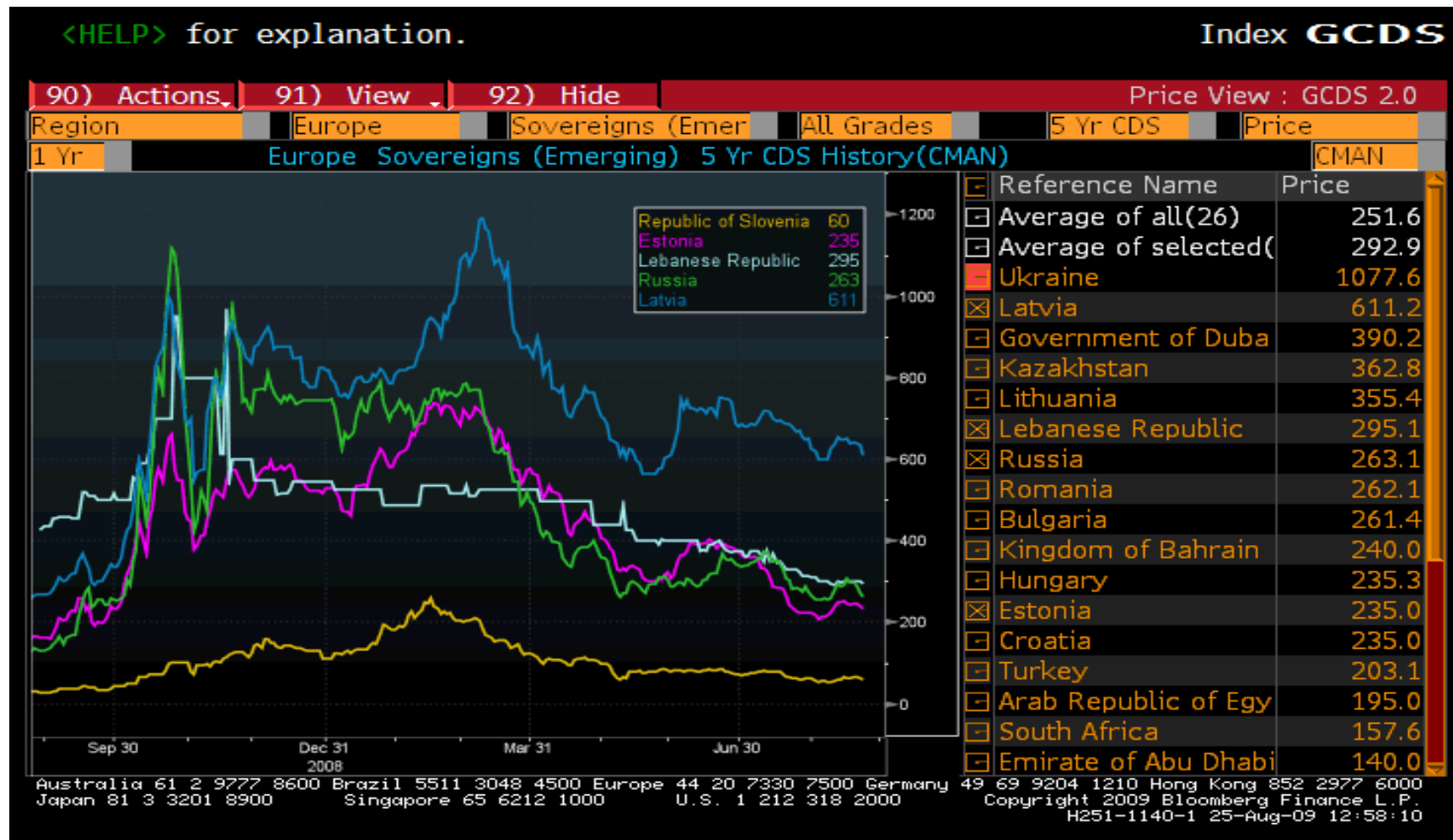
J.P. Morgan, Index, All Maturities



Source: Reuters EcoWin

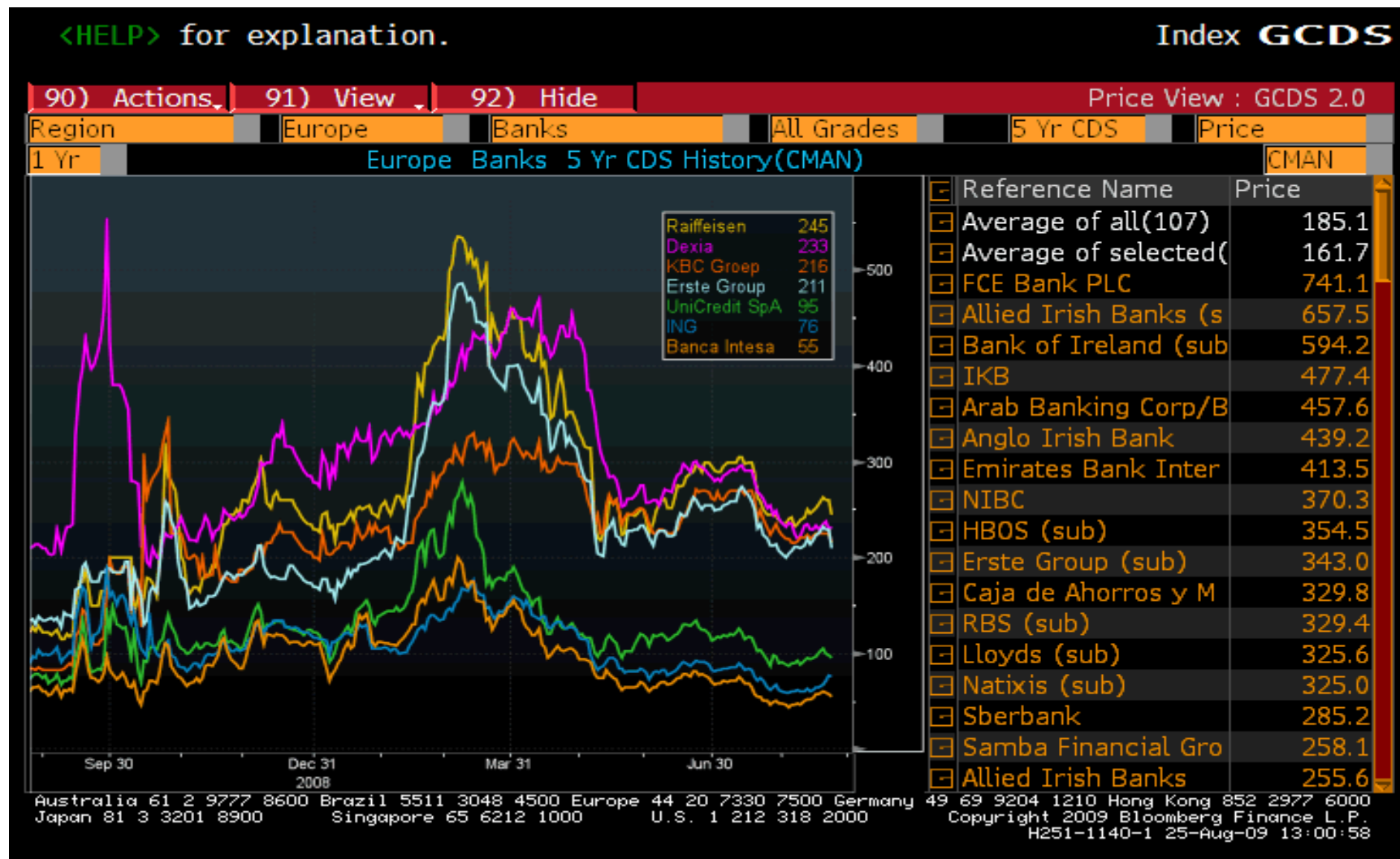


CDS spreads (incomplete) measure of financial stress and risk aversion for sovereigns...





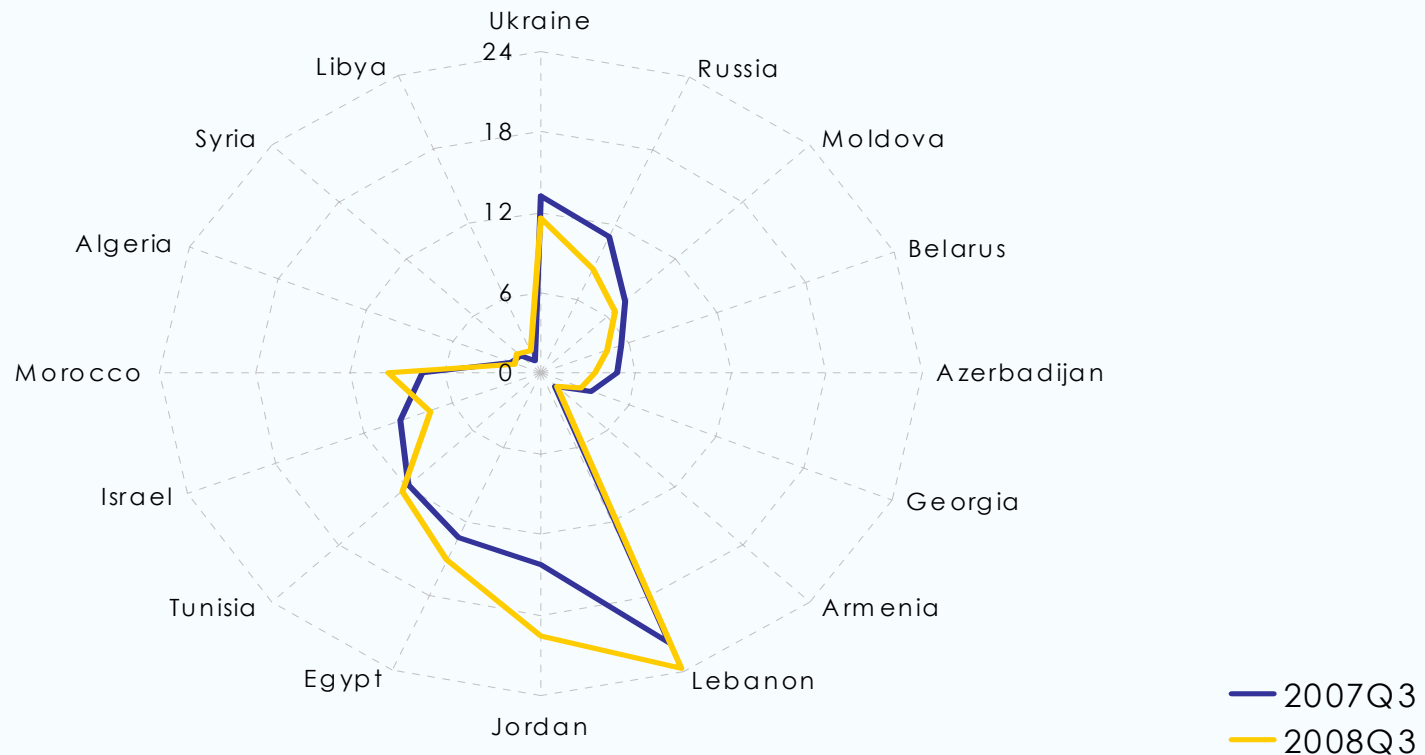
...and commercial banks active in the region





Cross-border exposures an issue, but not uniformly across either countries or regions

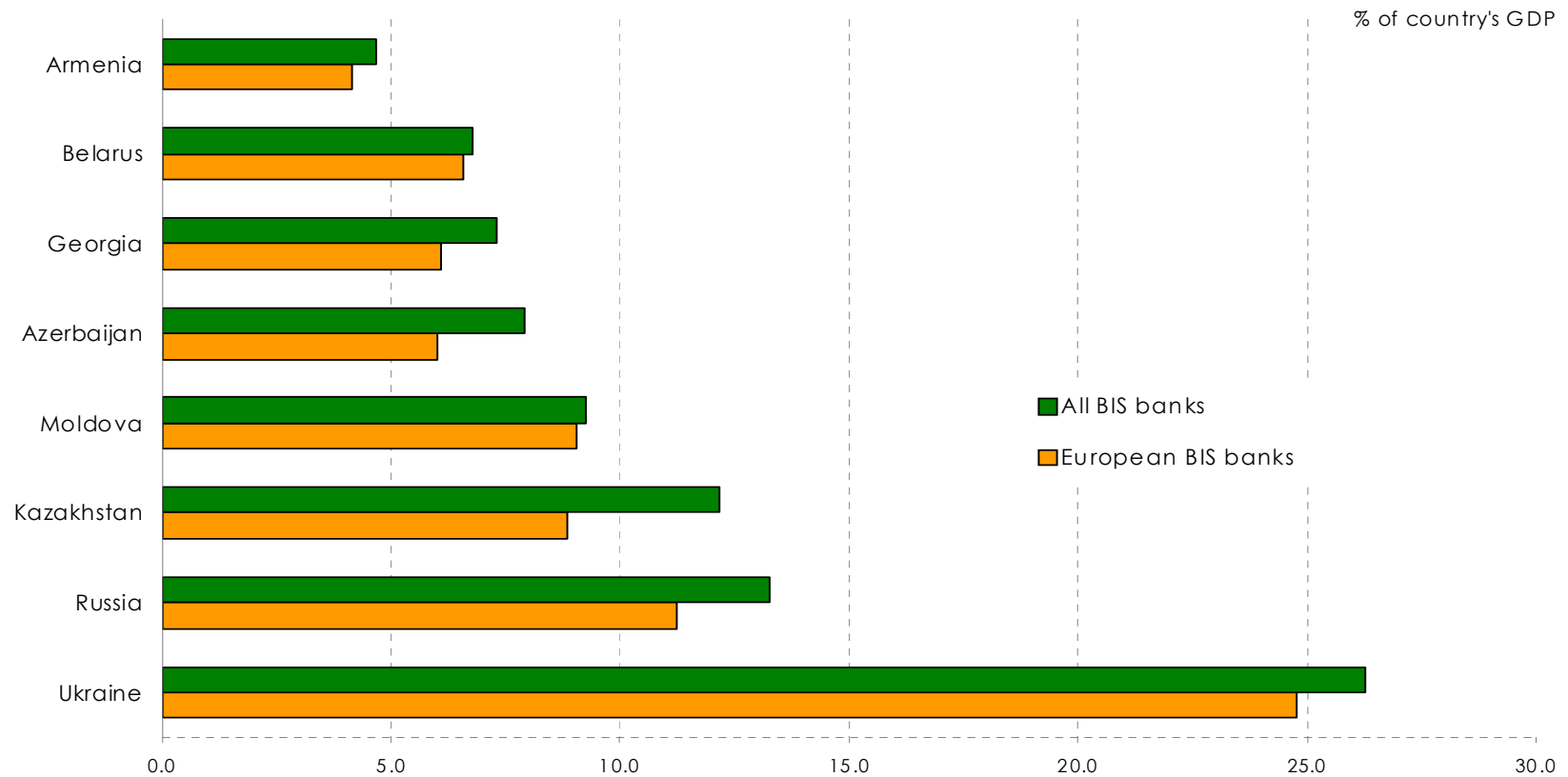
Graph: Cross border loans from BIS reporting banks (% GDP)





Foreign bank claims in the eastern neighbourhood overwhelmingly European/EU

Foreign claims of the BIS reporting banks on the EU eastern neighbours in 2008

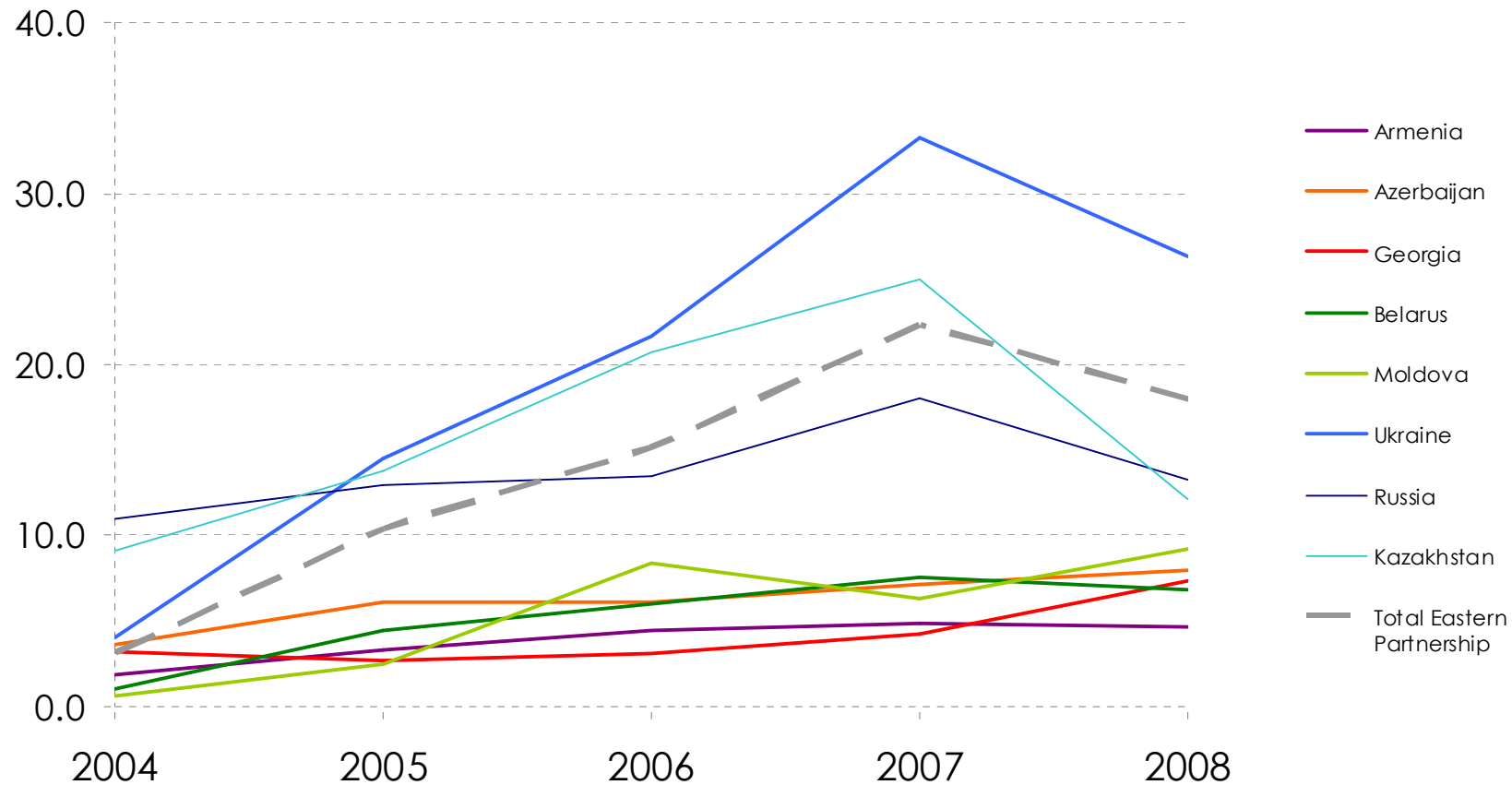




Very rapid growth in bank claims during the years leading up to crisis...

Claims of BIS reporting banks on the EU eastern neighbours

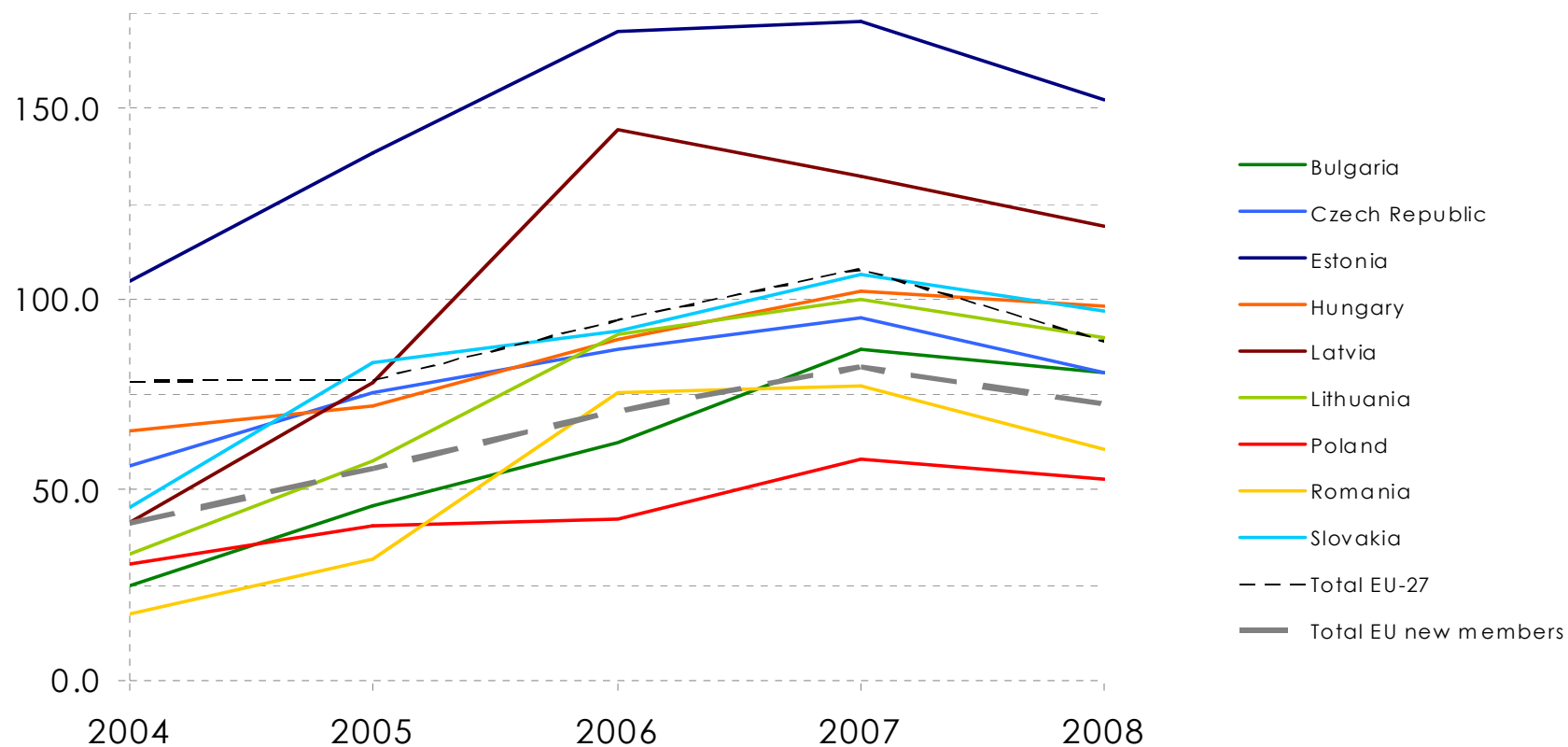
in % of country's GDP





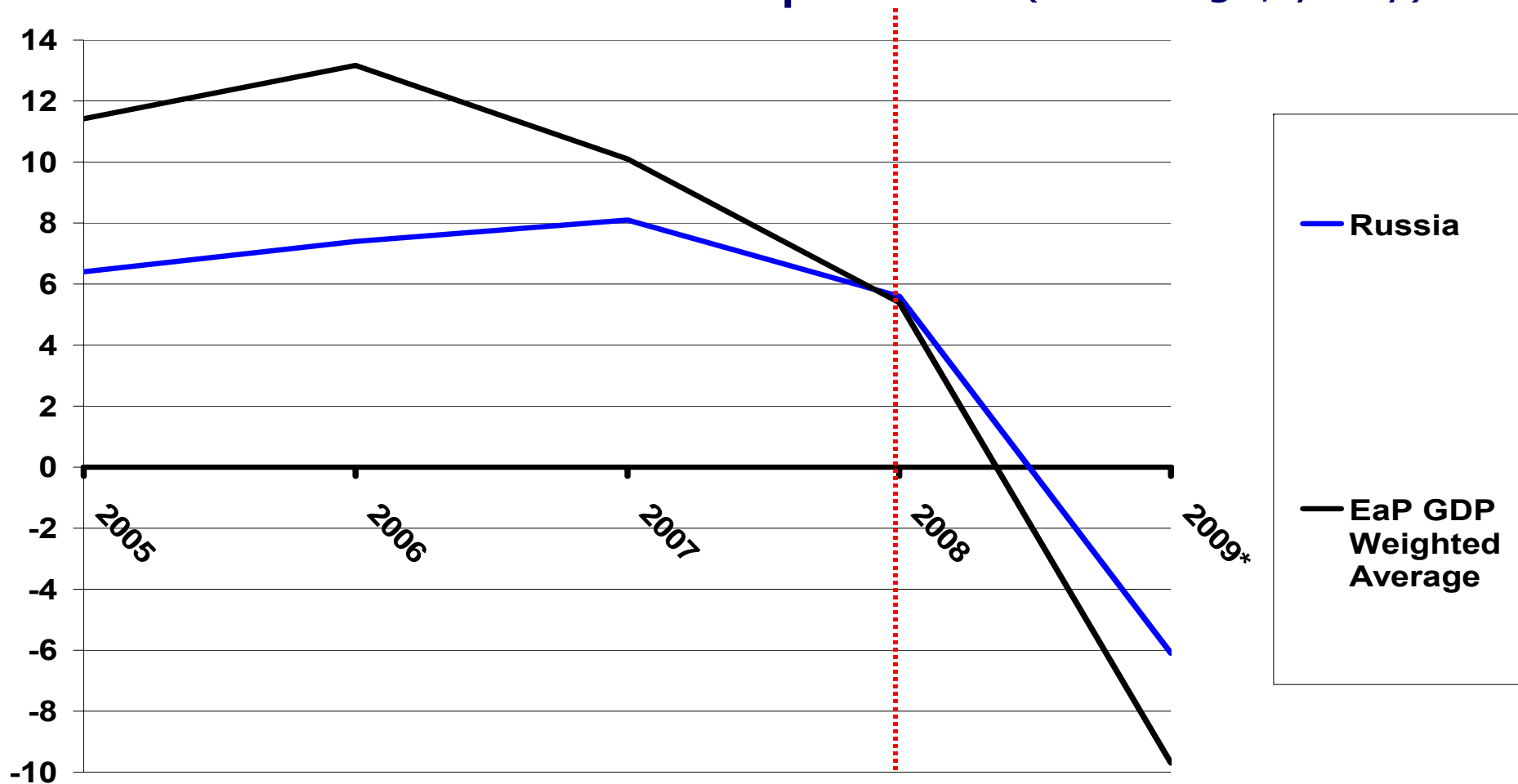
...yet ratios still well below NMS. Difficult to infer risk of balance sheet effects on real economy

Claims of BIS reporting banks on the EU new member states
in % of country's GDP



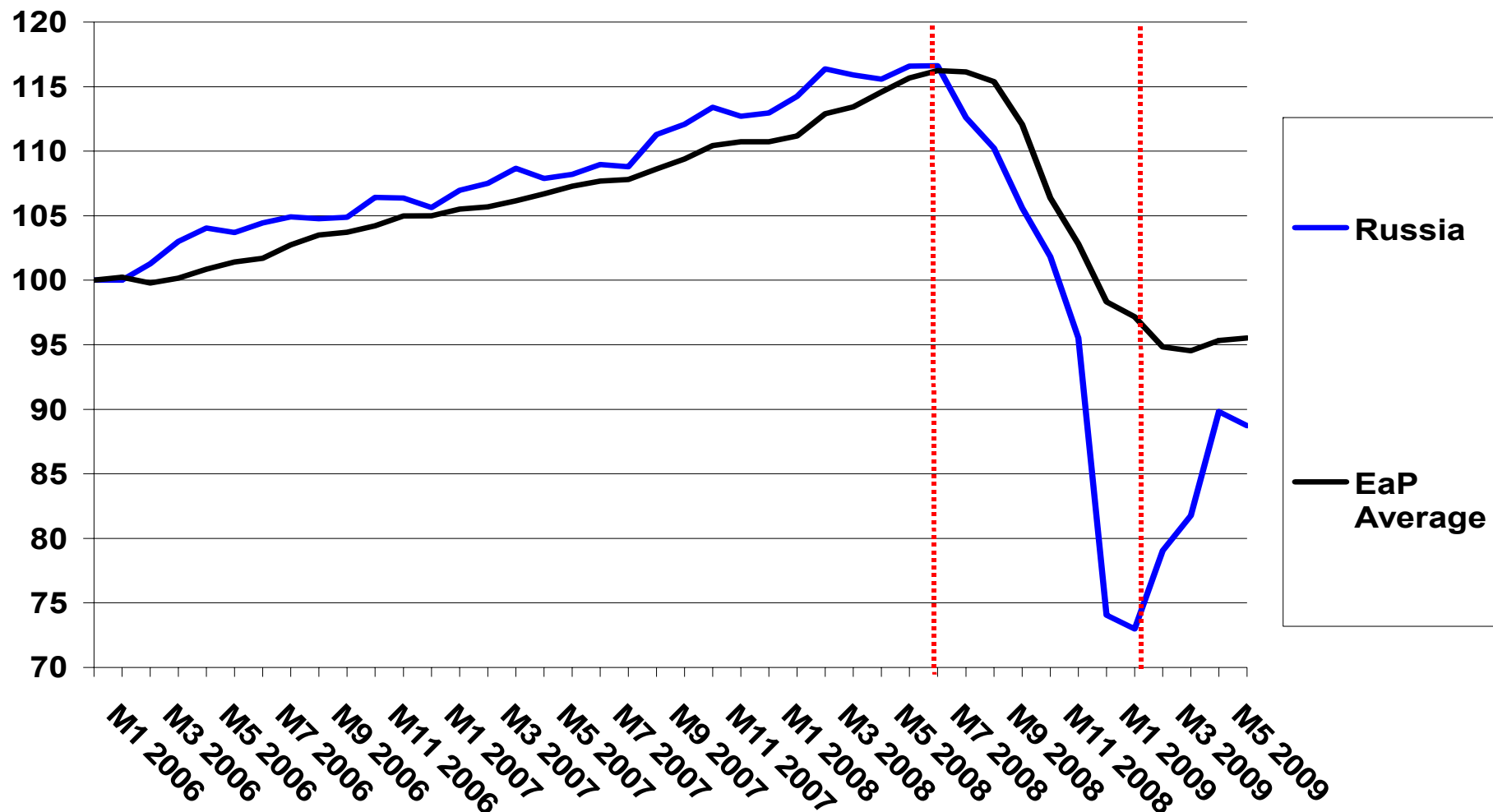


Real effects of the crisis: Russia and Eastern Partnership GDP (% change, y-o-y)



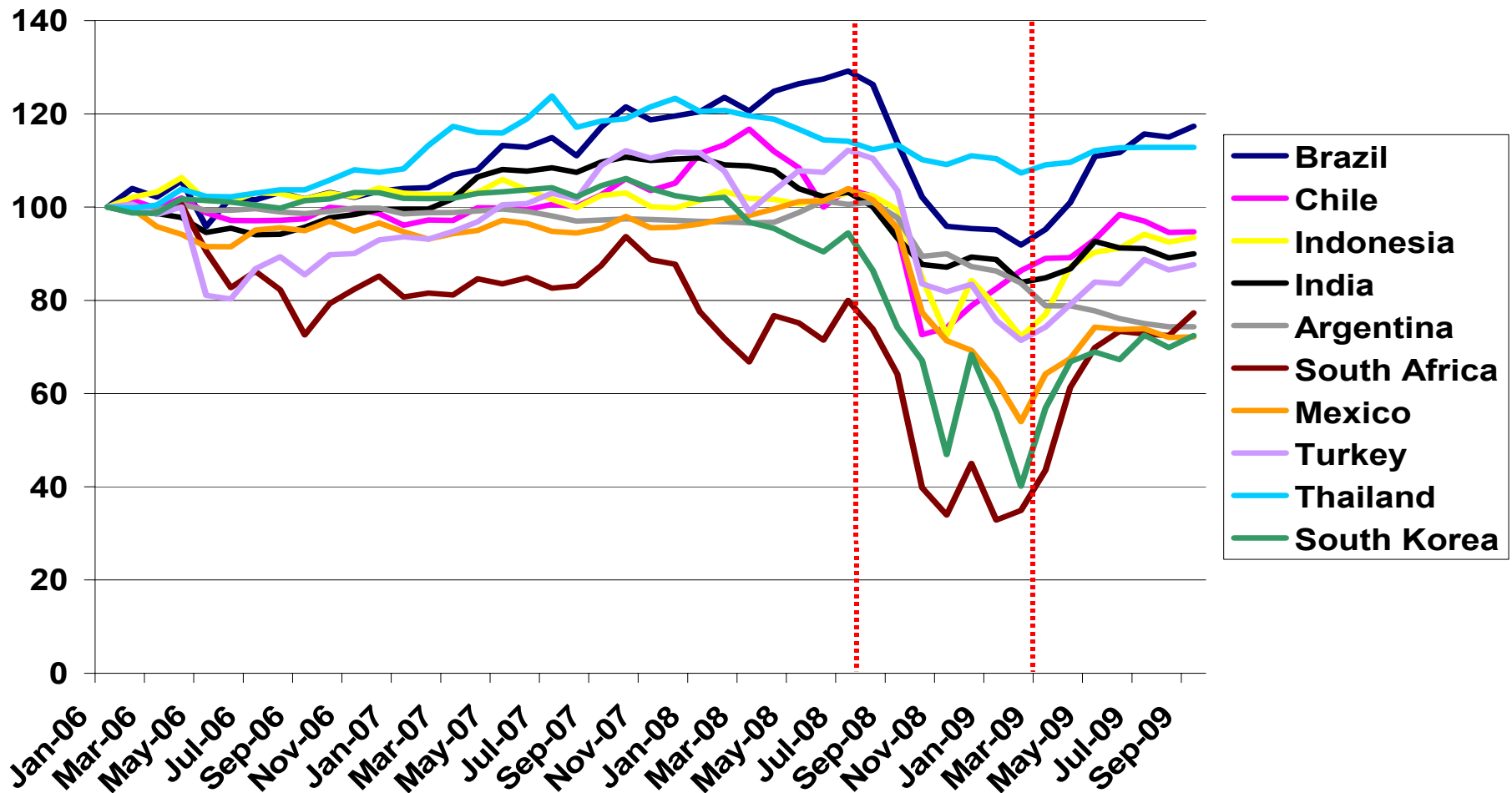


Effects of the crisis: Russia and EaP exchange rates (index: 2006=100)



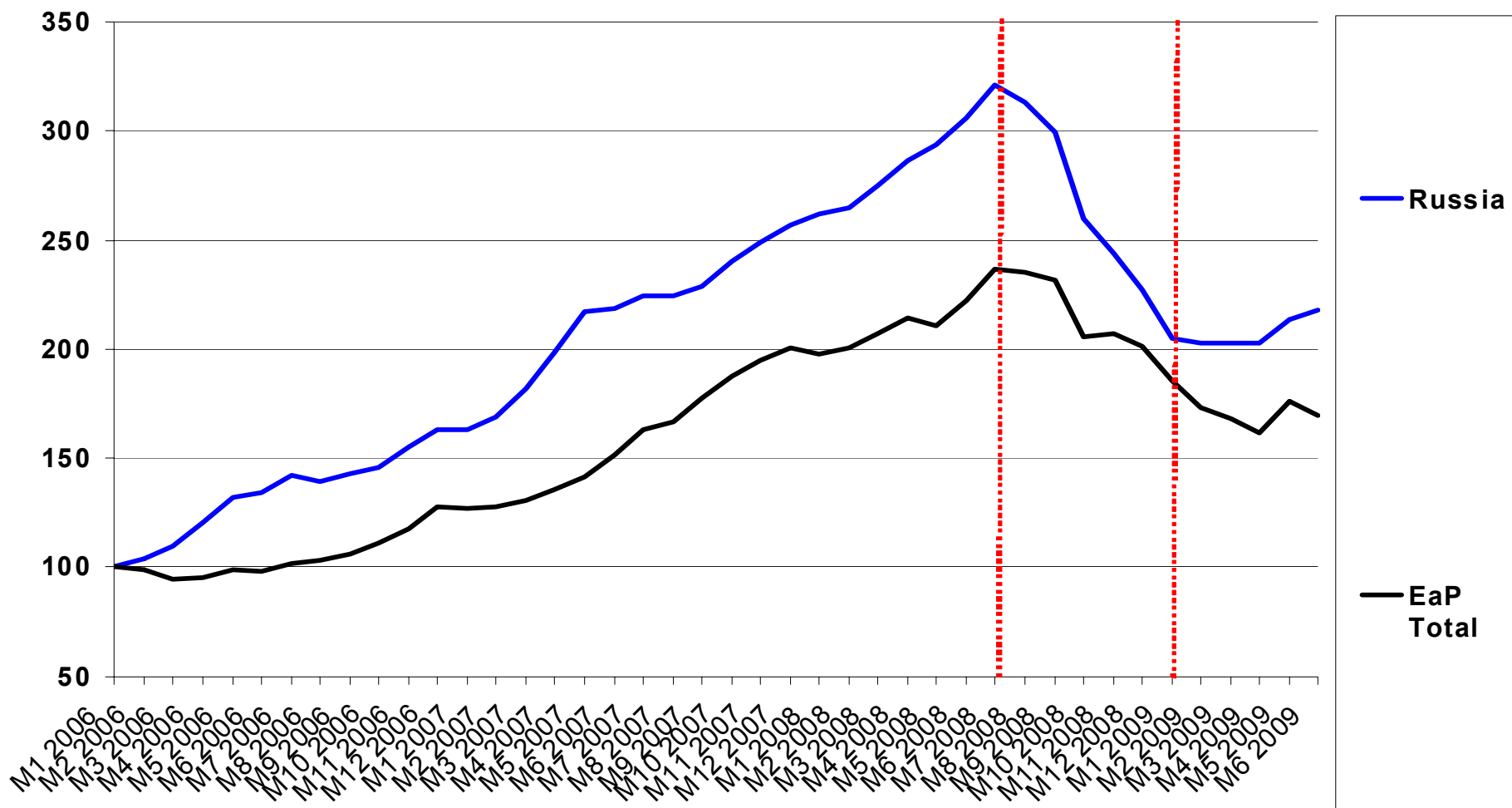


Effects of the crisis: Other emerging markets (index: 2006=100)



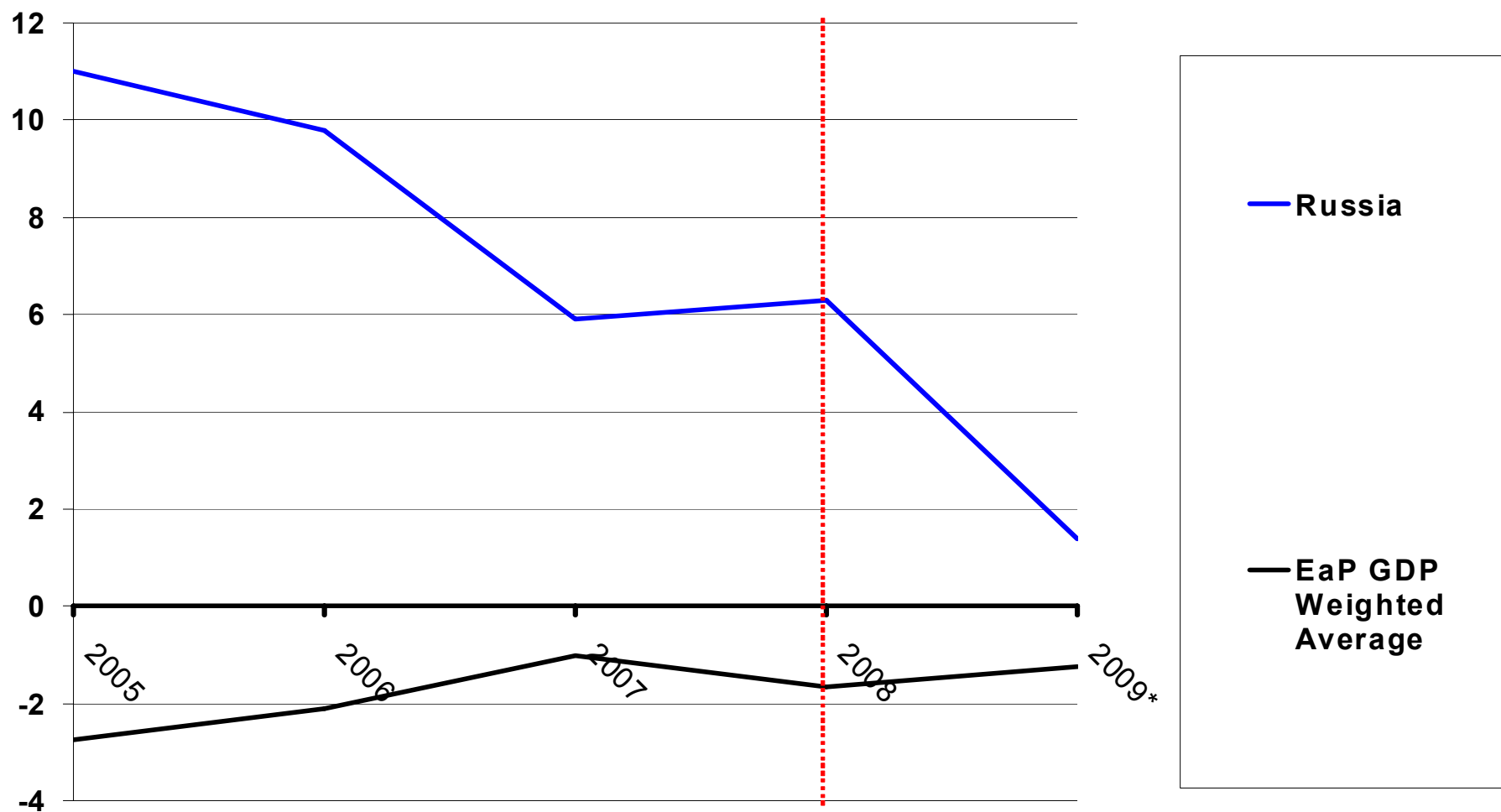


Real effects of the crisis: Russia and EaP Reserves (index, 2006=100)



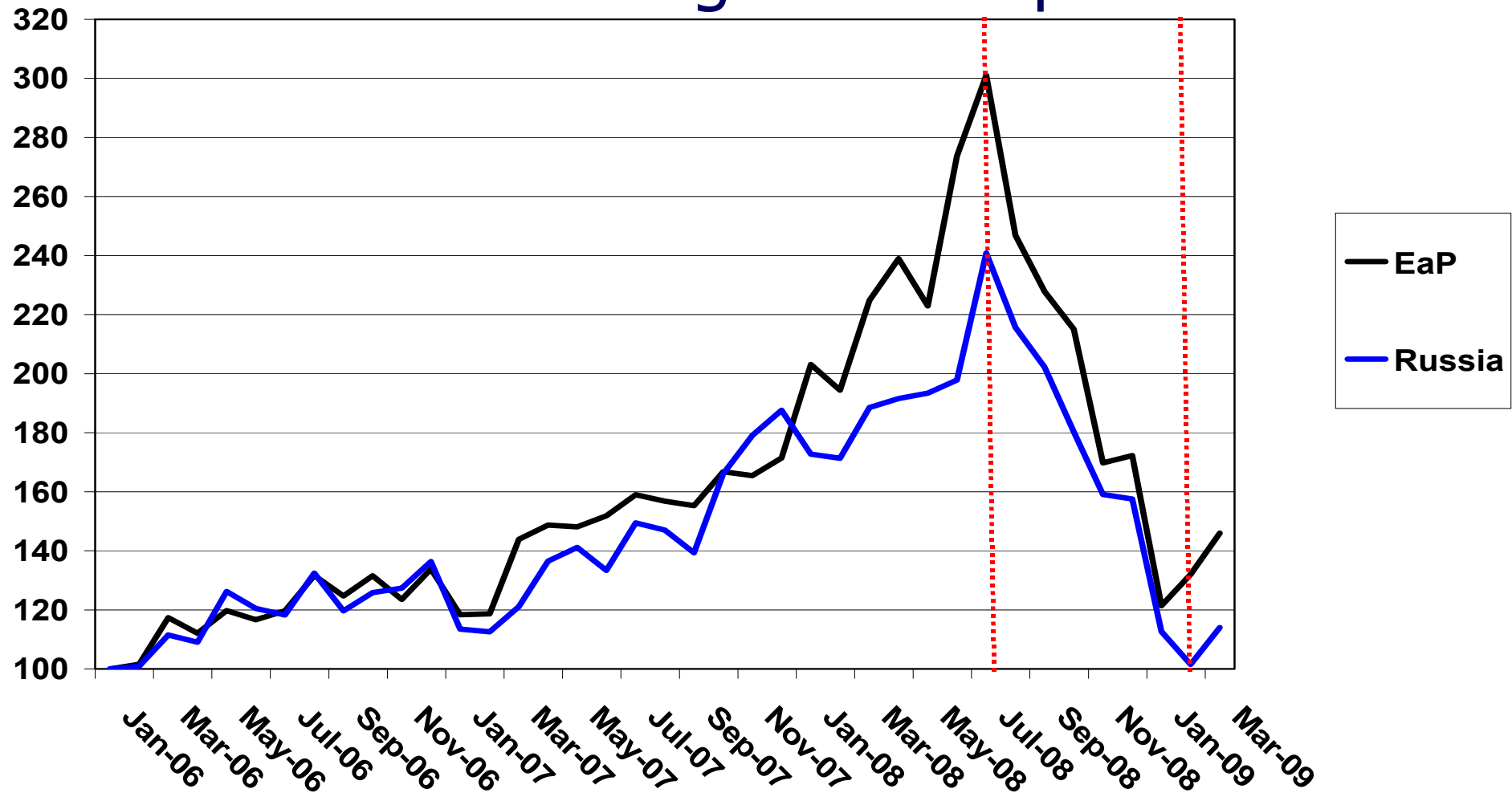


Real effects of the crisis: Russia and EaP current account balance (% of GDP)



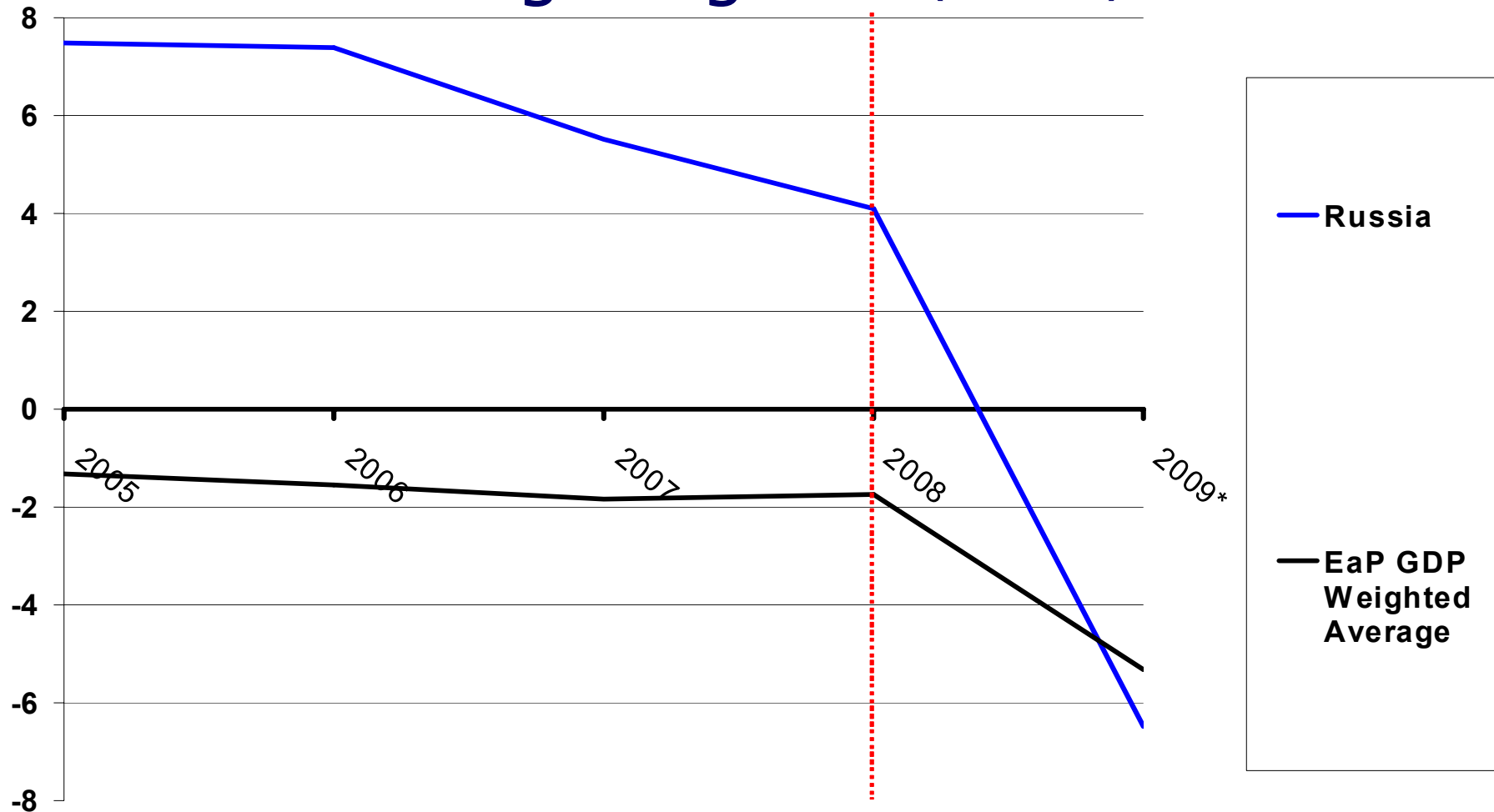


Real effects of the crisis: Eastern neighbors exports



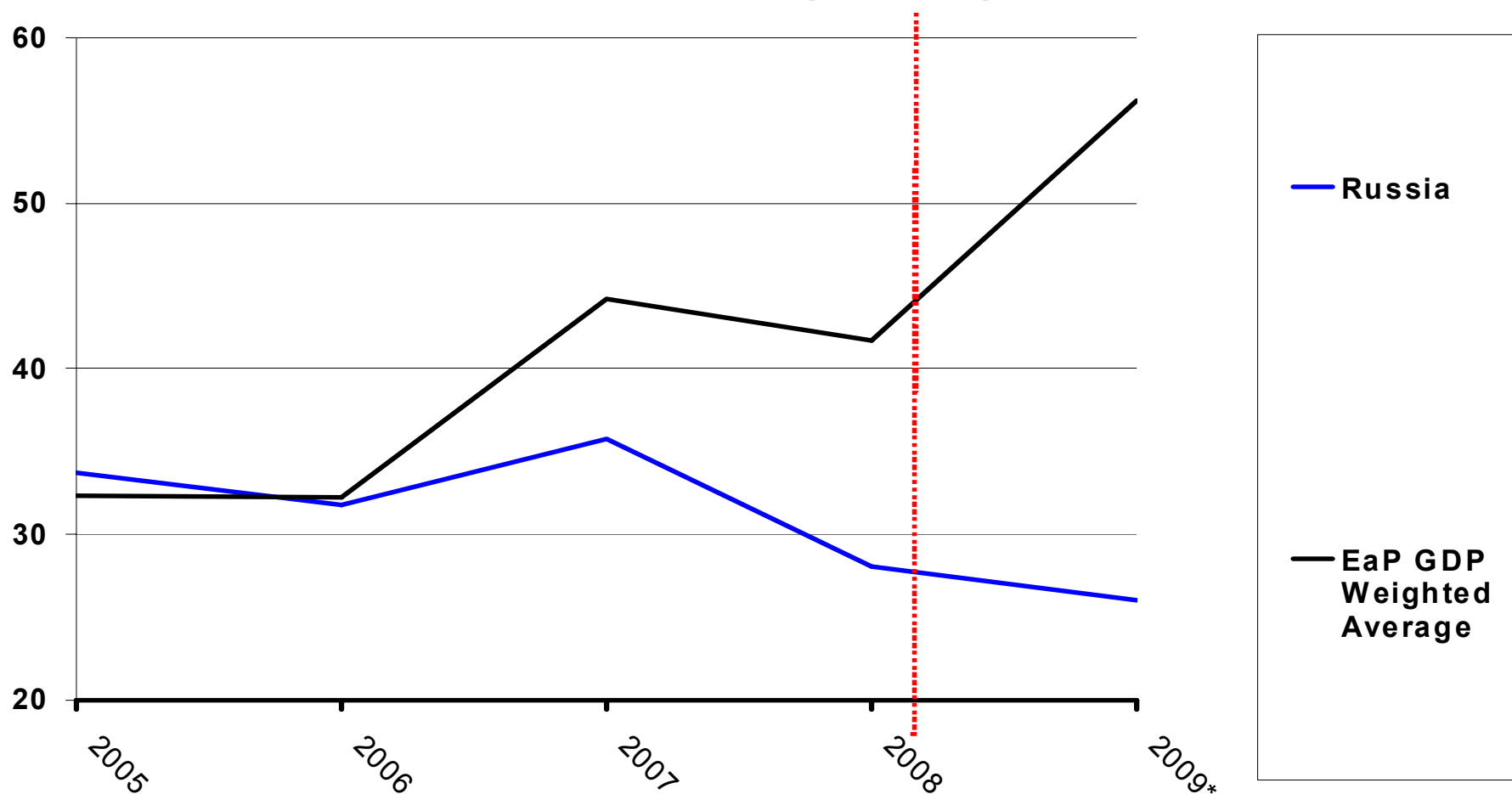


Real effects of the crisis: Russia and EaP budget figures (% GDP)





Real effects of the crisis: Russia and EaP Debt (% GDP)





Policy responses to the crisis in the EU's Eastern neighbors

	Armenia*	Azerbaijan	Belarus*	Georgia*	Moldova*	Russia	Ukraine*
Fiscal support							
Fiscal stimulus (% of GDP) ***				3,0		6,0	
Nature of stimulus							
* Infrastructure						1,0	
* Export							
* Tax cuts				1,0		0,5	
* Non-bank bail-outs						1,0	
* Other						3,5	
Fiscal stimulus (% of GDP) †				3,0		6,0	
Monetary support							
Monetary easing (basis points, decrease from peak)		1200		550			
Quantitative easing							
Financial support							
Deposit guarantees	!		!			!	!
Liquidity provision	!			!		!	!
Loan guarantees						!	!
Capital injection	!		!	!		!	!
Asset purchase						!	
Nationalisation							
Depreciation of pegged currencies				25% against USD	17% against USD	33% against basket	37% against USD
Drop in reserve requirements	!			!		!	

Legend: * Country under IMF programme, *** Announced, † Effective, ! yes

Source: Central banks of the ENP-countries, EC.

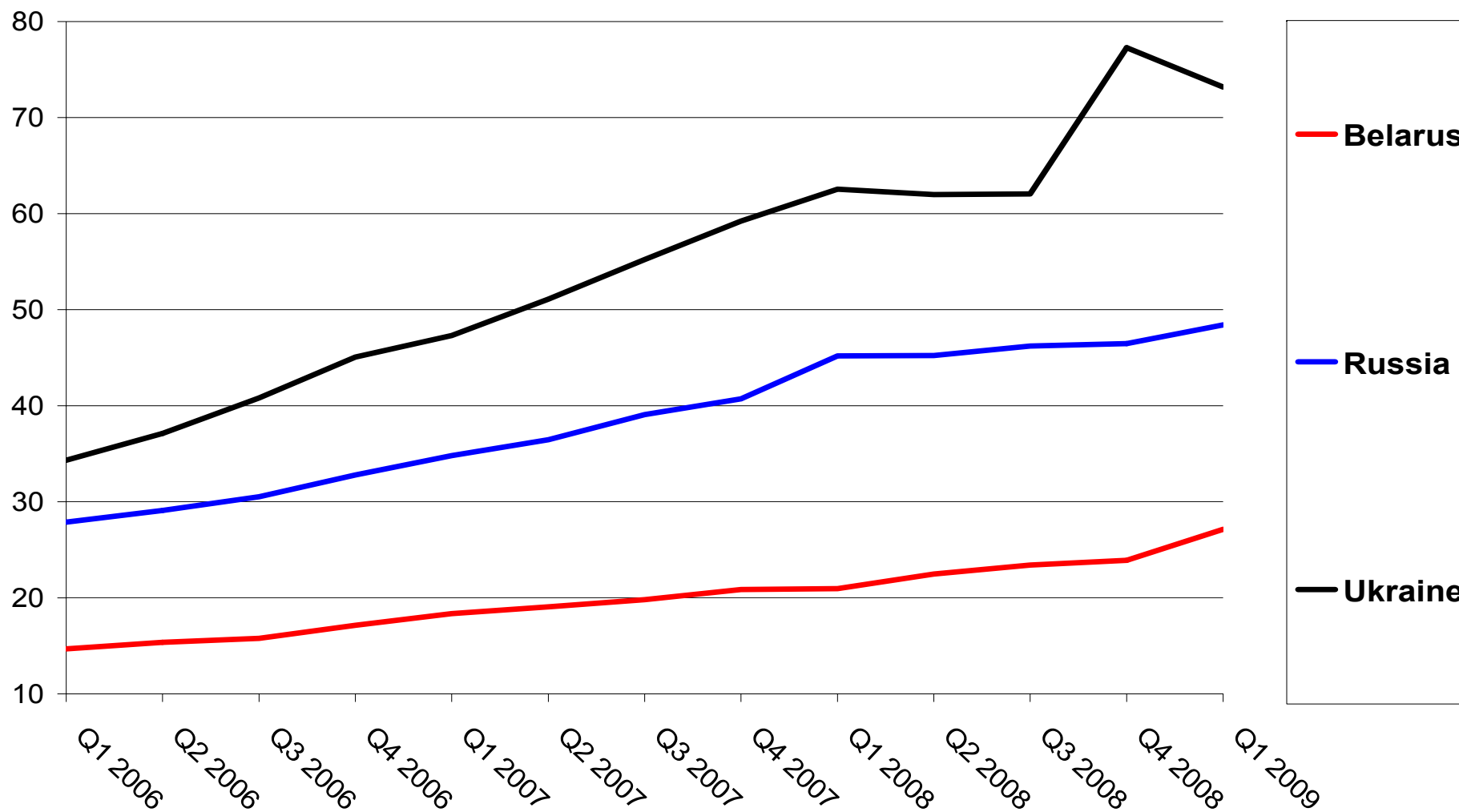


Why different effects from the crisis?

- Level of reliance on commodity exports
- Adequacy, consistency, speed and size of the policy response (especially in the fiscal side) and the external support programmes (which are also a part of the policy response)
- **And, crucially, different amounts of financial distortions (smaller credit growth and external exposure of -largely state-owned-banking sector)**

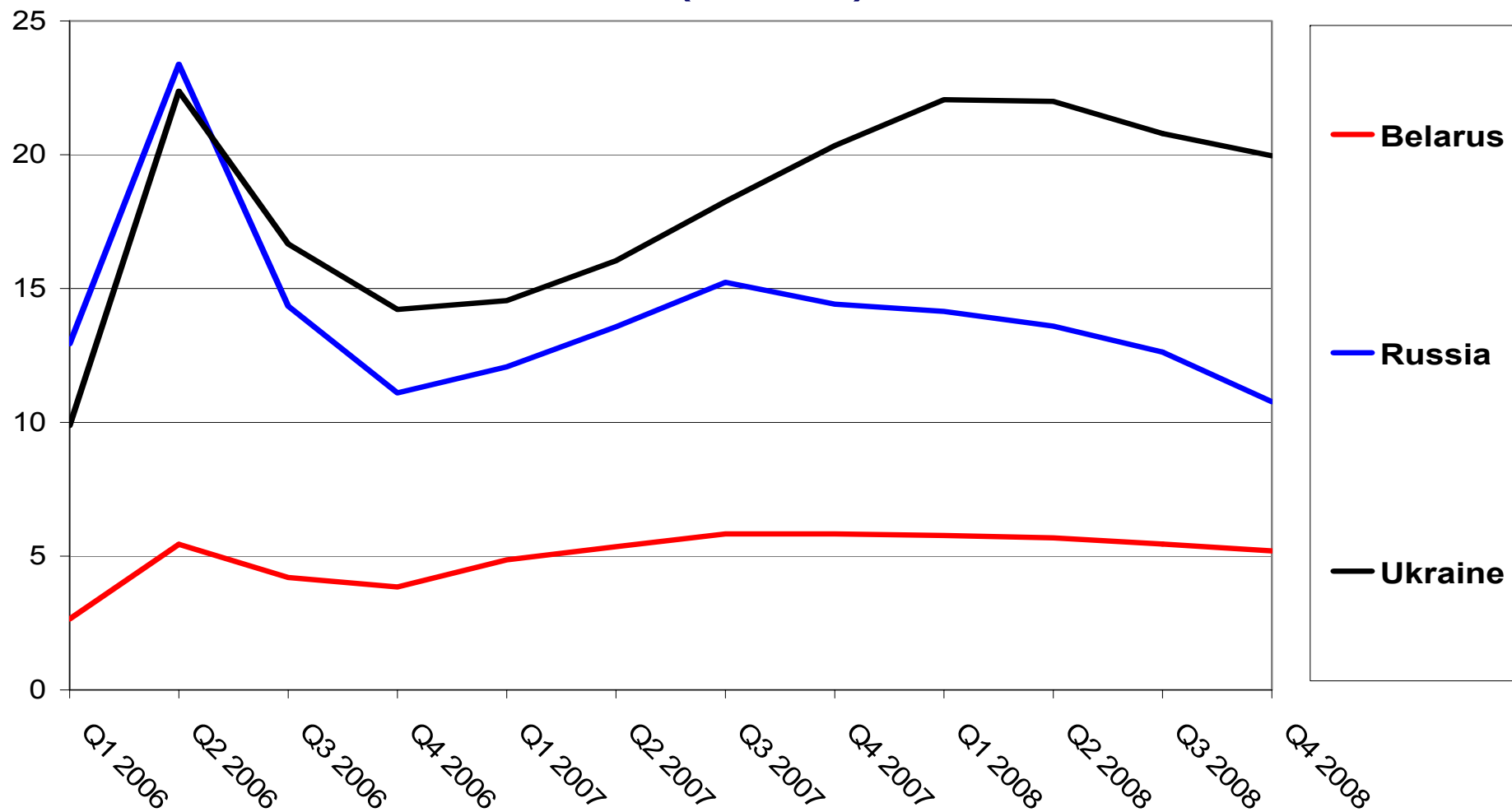


Credit to GDP: BY, RU and UA





External Bank Assets: BY, RU and UA (% GDP)





Main Points (again)

- The EU's Eastern neighbouring economies most integrated into the world economy and most liberalised were the hardest hit. *This does not imply protectionism and autarky* but a need for **policies designed to counterweigh** the negative shocks arising from (beneficial) greater global integration.
- Macroeconomic stabilisation factors failed to insulate from the crisis but enabled the countries to implement policies that cushioned initial shocks. **Well-designed fiscal policy tools and frameworks** plus a consistent exchange rate policy are of particular importance.
- Growth models that relied more on primary sectors were seemingly more affected by the downturn, calling for intensified **efforts to diversify growth sources**.
- The financial component of the shock led the real one, so **global in character and coordinated reforms of supervisory and regulatory financial frameworks** are crucial.
- **Exit Strategy** also crucial.

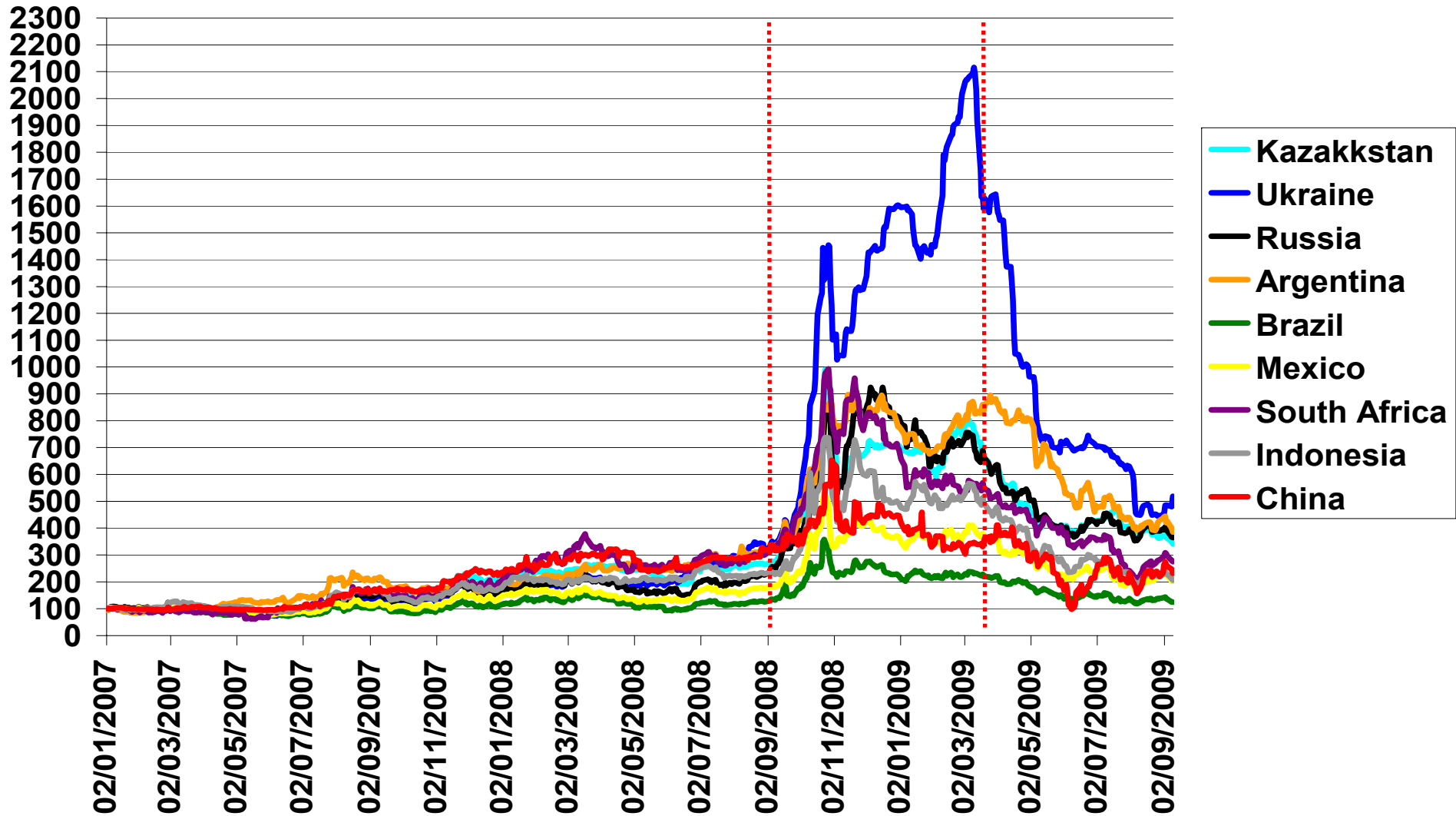


The Way Forward: Questions

- Some initial signs of recovery, but how green are those shoots?
- Exit strategy: (progressively...) unwinding of the stimulus and additional imbalances
- Longer term: what lessons to draw from the crisis?



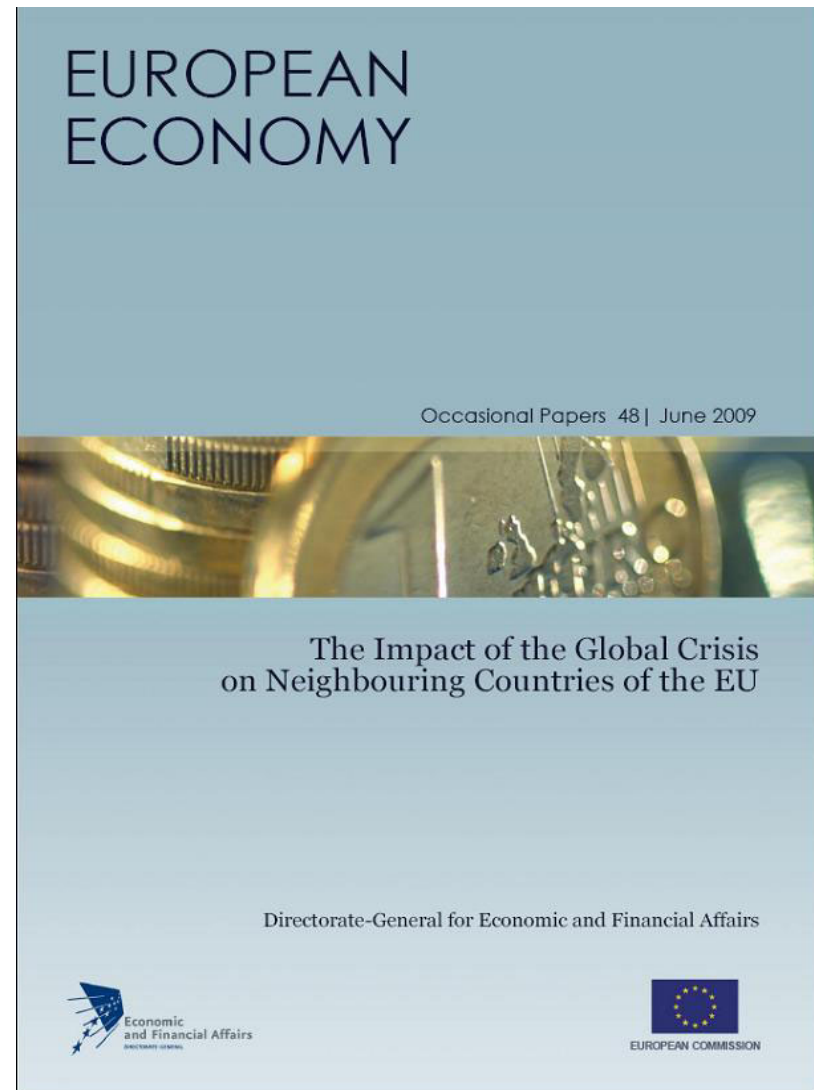
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Thank you for your attention!

This presentation is based on the "Thematic article", the "Overview of Recent Economic Developments in the EU's Eastern neighbours" and on the "Eastern Country Chapters" of the ECFIN Occasional Paper n° 40, "The Impact of the Global Crisis on Neighbouring Countries of the EU", European Commission, Brussels, 2009. The paper can be downloaded from the address below:



http://ec.europa.eu/economy_finance/publications/publication15398_en.pdf