EBRD RESPONSE TO THE GLOBAL CRISIS

Lecture 9

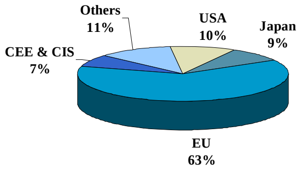
LIUC 2009

Source: EBRD materials and Transition Report 2009

What is EBRD?

- The European Bank for Reconstruction and Development is an international financial institution that promotes transition to market economies in **30 countries** from central Europe to central Asia.
- EBRD is the largest single investor in Central and Eastern Europe

Shareholding of the EBRD



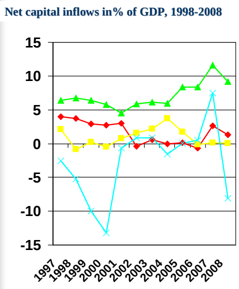
EBRD mandate and objectives

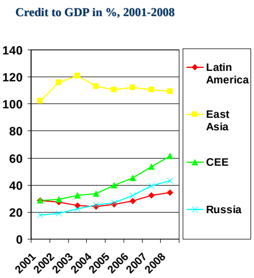
- EBRD has a unique mandate, both political and economic, to promote transition to market-based economies by investing mainly in the private sector
- The main objective is to mobilise significant foreign direct investment and support the privatisation process in transition economies
- EBRD encourages environmentally sound and sustainable development

The crisis in EBRD region: 4 propositions

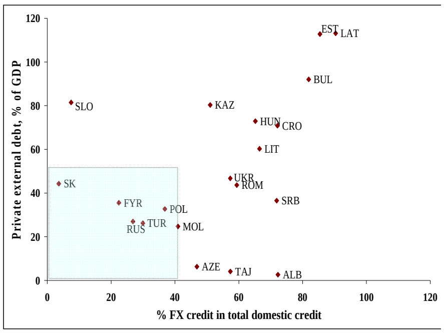
- 1: Emerging markets and Emerging Europe extraordinarily resilient in first phase
- 2: Large differences in output declines in Emerging Europe are associated to pre-crisis vilnerability
- 3: European cross-border banking system has held up relatively well
- 4: National and international policy response has played an important positive role

Prologue: Capital flowed in and credit bubble grew…



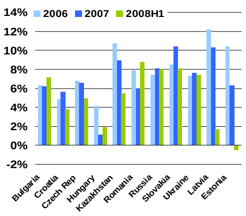


…leading to high levels of private debt, much of it in foreign currency

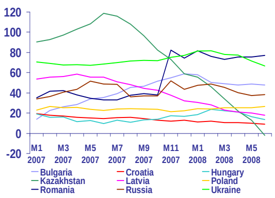


Vulnerabilities notwithstanding, the region initially decoupled from the global crisis

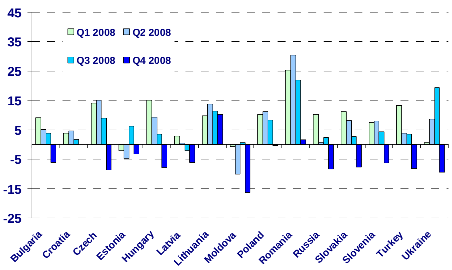
GDP growth



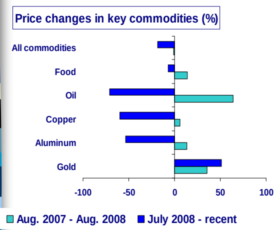
Credit growth

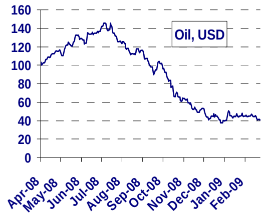


Then came the massive trade shock... Export volumes, y-o-y, %



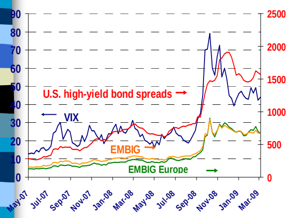
Commodity prices dropped sharply

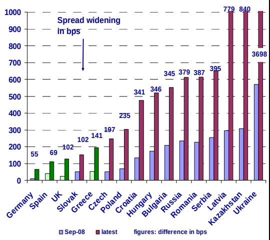




Much tighter financial conditions since Sept-Oct 2008

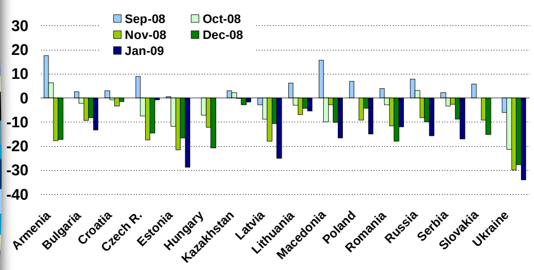
Cost of capital and risk indicators



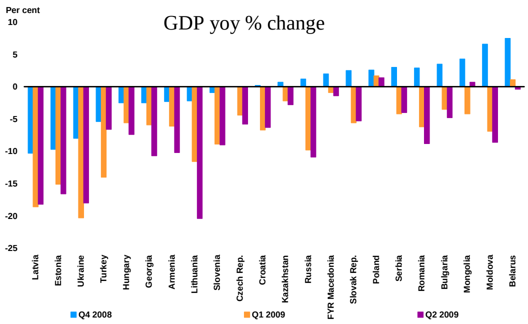


Crisis finally hit hard in Q4 2008 all across Emerging Europe…

Industrial production growth, y-o-y %



Crisis finally hit hard in Q4 2008 all across Emerging Europe…but with substantial differences



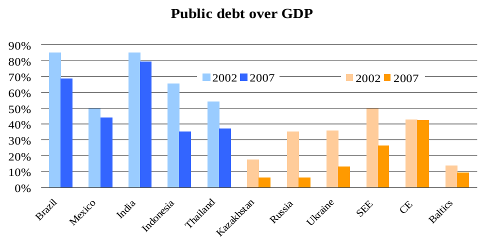
Some recent positive signs ...

- In line with the general recovery in international financial markets, regional financial indicators began to point upward beginning in March 2009.
- At the same time, the effects of the financial and real shocks began to be felt in the corporate, household, and banking sectors, with rises in unemployment, corporate insolvencies and non-performing loans.
- IMF outlook (Sept 09): "The risks to the outlook for the region are tilted downward, with greater risks for economies that are in deeper recessions and face difficult financing conditions. …..A protracted global downturn would also delay the recovery in Russia, with negative repercussions for economies closely tied to its fortune.…"

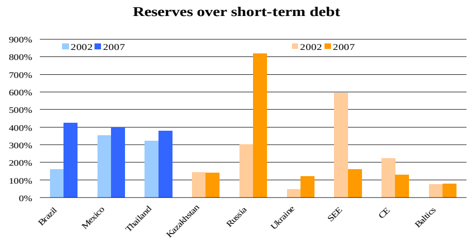
What explains the resilience of emerging markets, including emerging europe in the first phase of the crisis?

- Improvements in fundamentals: policies and institutions.
  - ➢In most countries: lower public debt, better fiscal policies; better monetary frameworks; more stable external capital structures
  - ➢In some countries (but not in Emerging Europe): lower foreign currency external debt

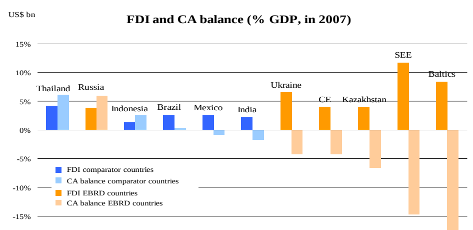
Public debt ratios had declined – and were especially low in transition countries



Liquidity improved in many emerging markets, but not in CEE and SEE



Unlike other emerging markets, Emerging Europe ran large current account deficits

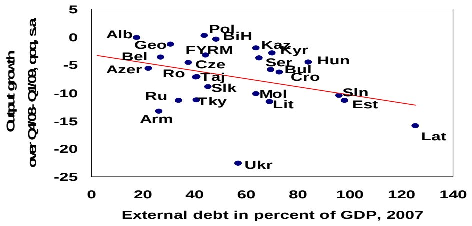


…though they have largely been financed by FDI

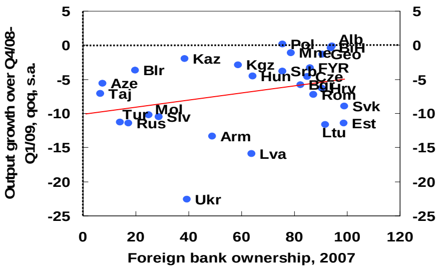
What caused the large *differences* in output declines in Emerging Europe?

- Strong association between pre-crisis vulnerabilities and output declines
- Pre-crisis external debt and size of pre-crisis credit boom associated with higher output collapses
- Foreign bank presence had stabilising effect

Output decline correlations: External debt

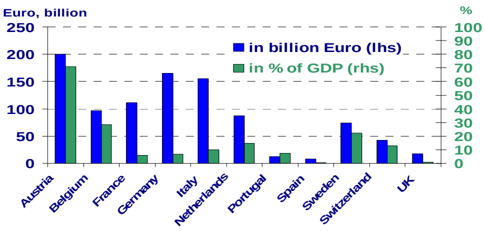


Output decline correlations: foreign banks presence



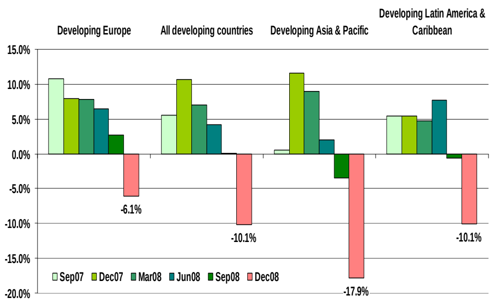
European commercial banks are deeply invested in the CEE region

Eight West European countries have banking system exposures to the CEE region in the order of 6-70 percent of GDP



Emerging Europe relatively less affected

(Cross-border flows of BIS-reporting banks: relative terms)



Crisis response to EBRD region

Domestic policy challenges are many …

- Monetary and fiscal policies: no one-size-fits-all.
- Right policies depend on: strength of public balance sheet, credibility of monetary and fiscal institutions, currency composition of debt, domestic inflation dynamics, external and public financing constraints.
- The overriding challenge (almost everywhere): to protect the core banking system and SME lending.
- Another key challenge: maintaining SME financing

… but the room for domestic policy action is shrinking rapidly

***Problem**:* External financing constraints and exchange rate pressures limit scope for domestic policy response

- Monetary policy is becoming constrained by the exchange rate (even in countries without currency mismatches)
- In several countries, significant banking sector problems could not be addressed without outside help

An *international* and *coordinated* policy response is critical

- *International* dimension is critical because Eastern Europe cannot do it on its own (given lack of private sector financing)
- *Coordination* is critical because of massive cross-country externalities:
  - Trade and financial integration carry the effect of both the crisis and the crisis response across borders
  - Competition for a common pool of private resources (global savings and liquidity). Played a role both in the propagation of the crisis and in the response.

The Joint IFI Action Plan for Eastern European Banking Systems

- Common initiative of EBRD, EIB and World Bank Group (IFC), announced end-February
- Core elements:
  - Common needs assessment both at the level of Eastern European banking systems and at the bank group level
  - A coordinated approach to refinancing and recapitalization, with burden sharing across IFIs, home and host countries, and parent banks.
- IFI contribution: about € 25 bn during 2009-10

EBRD response to the crisis in the region

- Increasing business volume from €5.1 bln in 2008 to €8 bln in 2009
- Recapitalising sound banks
- Stepping in support for small and medium-sized enterprises
- Expanding trade facilitation programme to maintain vital trade flows to and from the region
- Working more closely in coordination with other IFIs