



THE EU, RUSSIA AND THE CRISIS

by

*Dr. Lúcio VINHAS DE SOUZA**

European Commission

DG Economic and Financial Affairs

*Lucio-Mauro.VINHAS-DE-SOUZA@ec.europa.eu.

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Main Points

- *Global Crisis*: no region in the world is immune
- Financial transmission channels powerful and near-immediate
- Externally exposed countries (like RU) more vulnerable to first-order impact
- Feed-back loops with the real economy
- Impact and lag dependant on initial positions and adequacy of policy responses
- Recent stabilisation, but risks remain

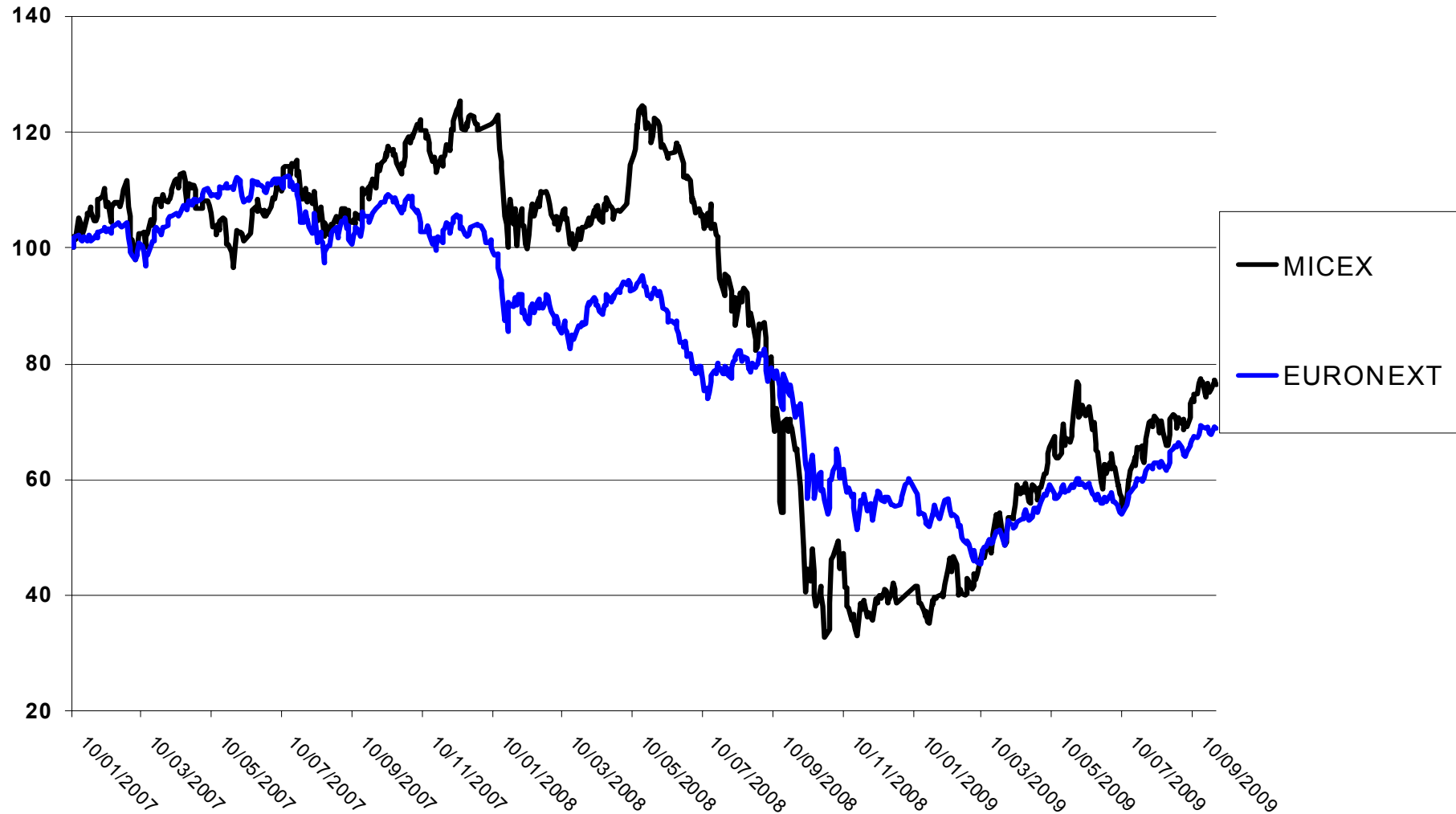


Main Points

- Cross-country variation in policy responses and instruments, depending on prior buffers and on the adequacy of policy actions
- Fiscal policy: near-term versus long-term
- Priority to stabilisation, but long-term fiscal implications
- Crisis response should not jeopardise implementing long-term reform agenda
- Securing external financing
- Global crisis – global policy responses; devising global responses within the G20

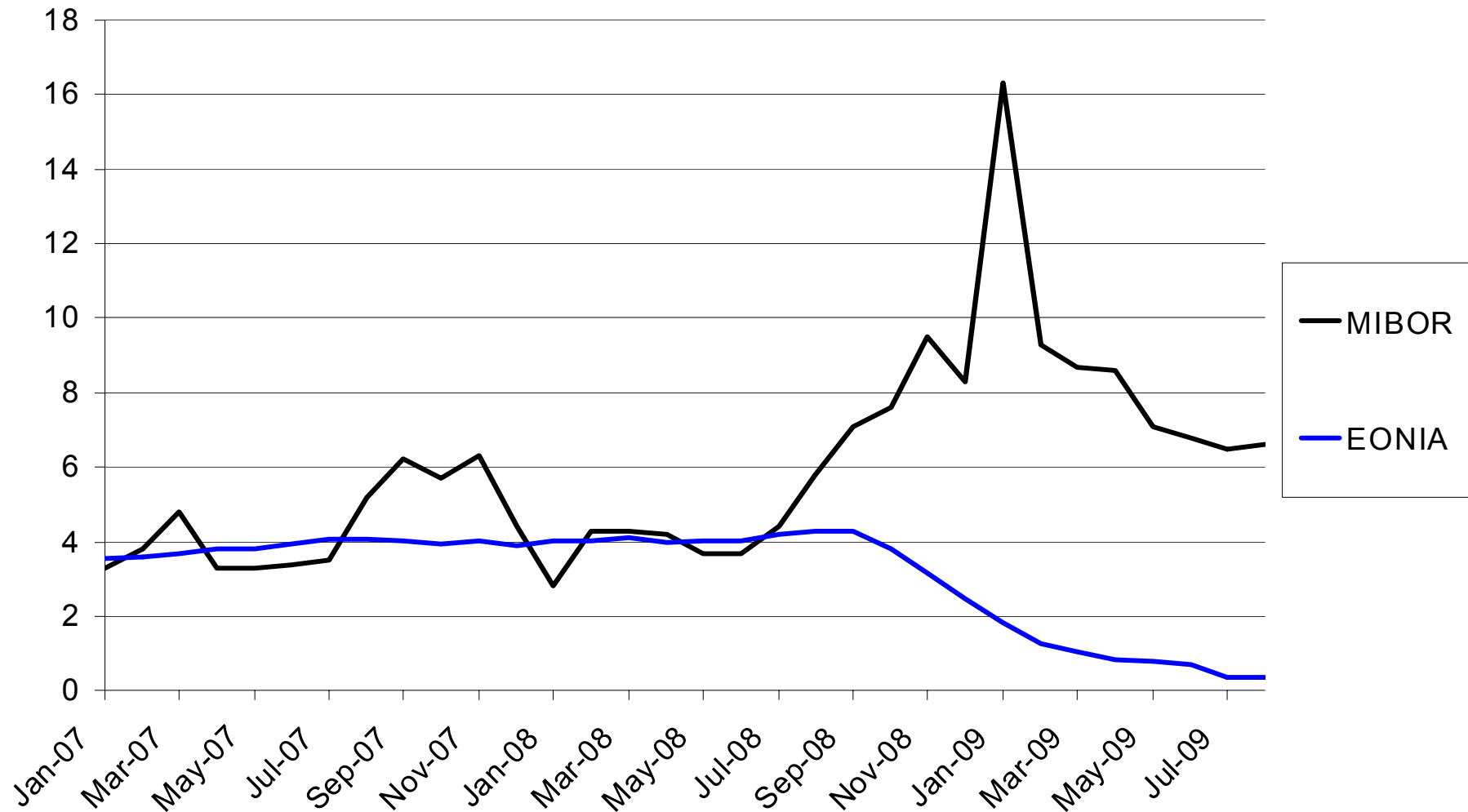


EU/RU stock markets affected...





...and interest rates too





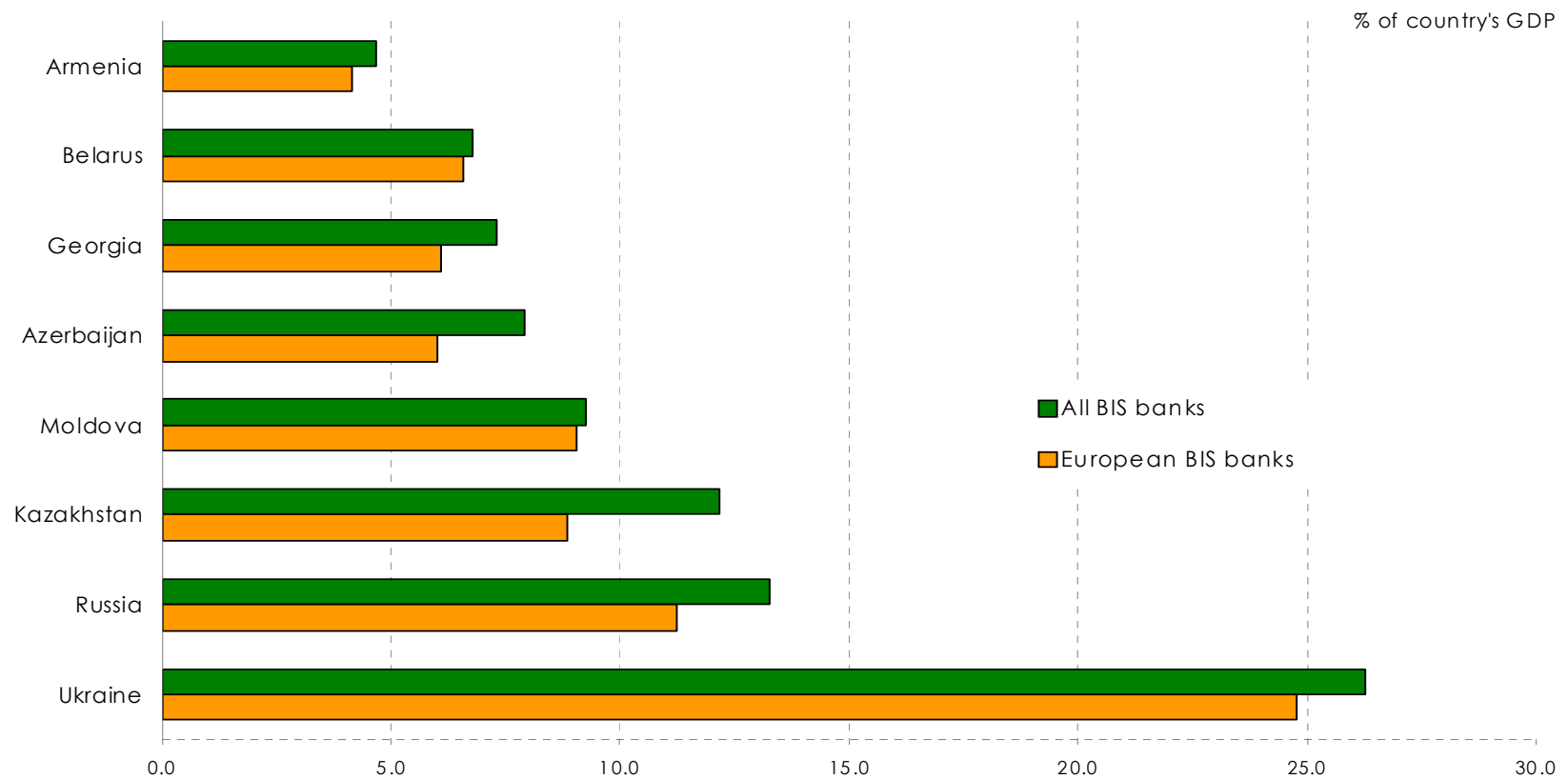
Russia among the worst affected countries globally

- 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
- Commodities' reliance amplified the shock
- But large fiscal buffers/reserves as a cushion



Foreign bank claims in Russia/CIS: overwhelmingly EU

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

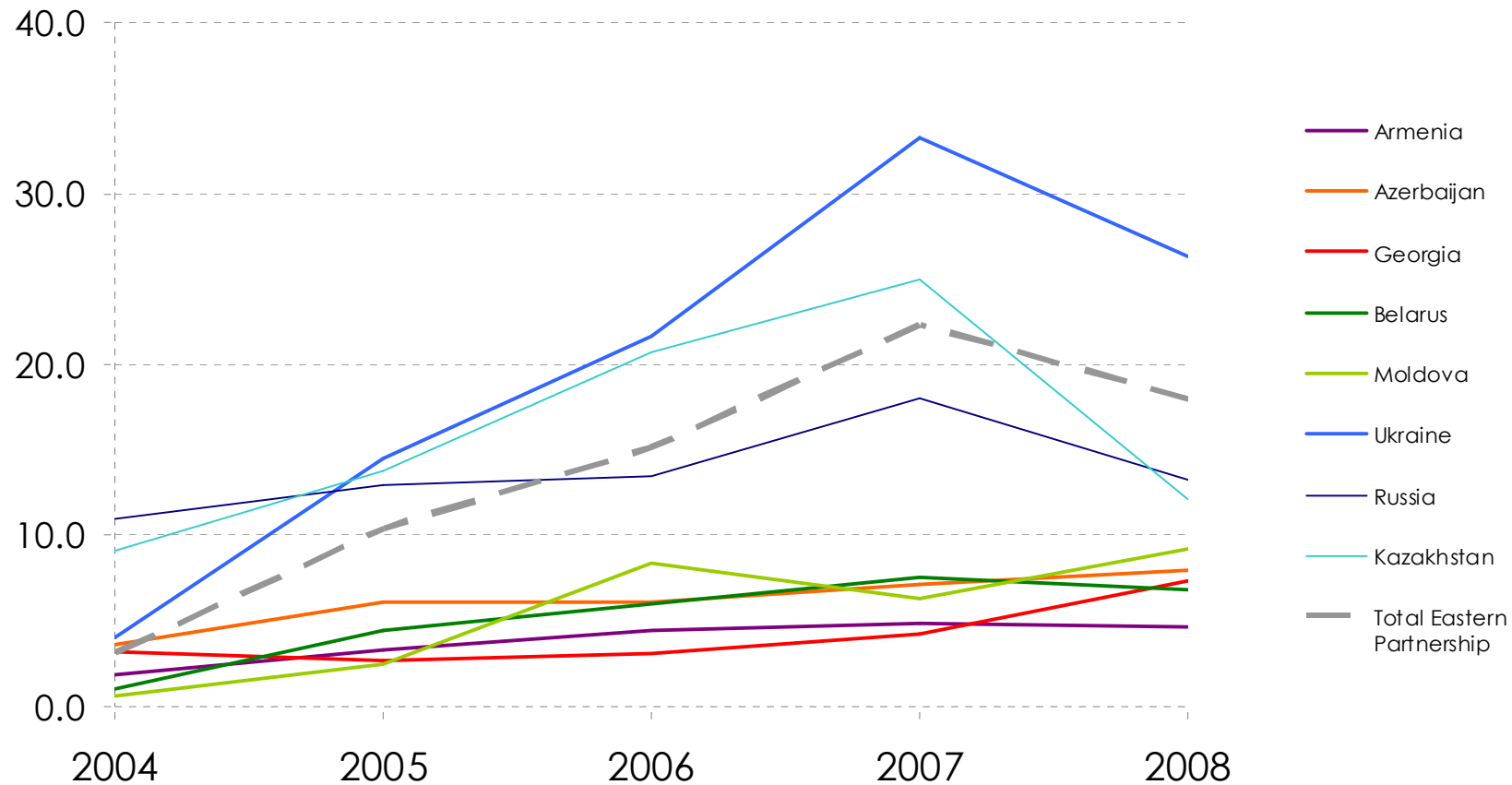




Very rapid growth in bank claims during the years leading up to crisis...

Claims of BIS reporting banks on the EU eastern neighbours

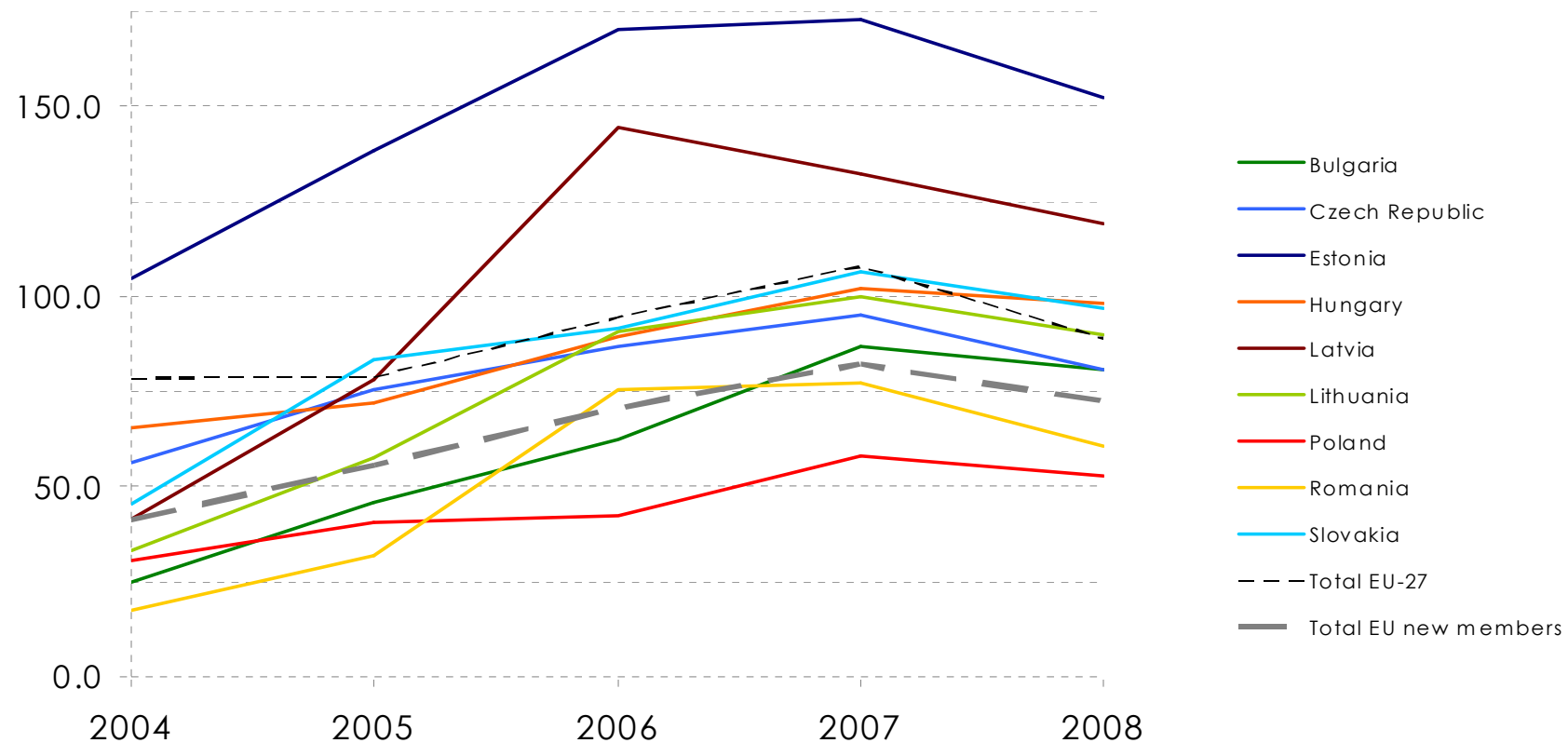
in % of country's GDP





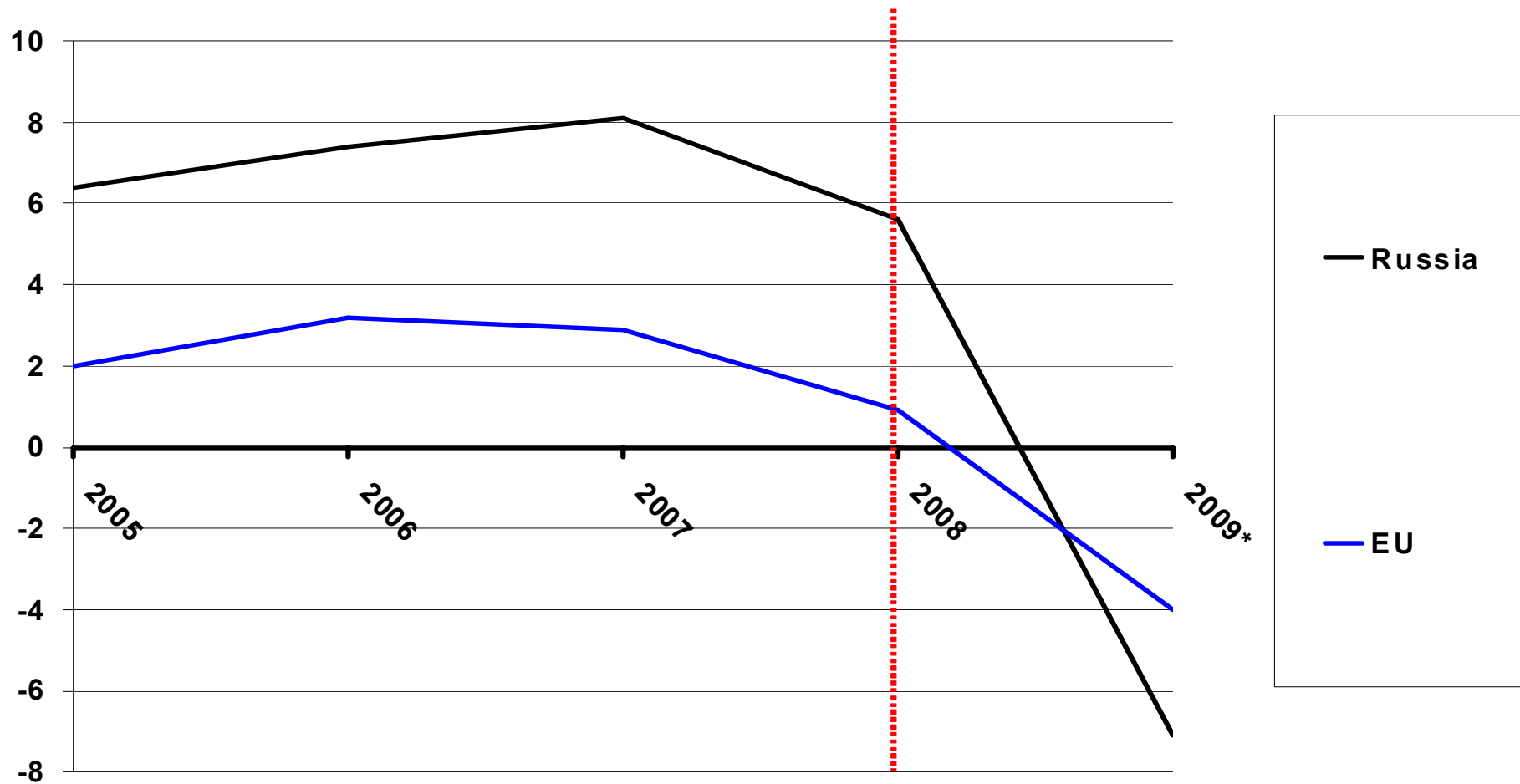
...yet ratios still well below NMS. Difficult to infer risk of balance sheet effects on real economy

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





Real effects of the crisis: EU and Russia's GDP (% change, y-o-y)





Policy responses to the crisis in the Russia and the EaP

	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.



Russia's policy response

An extensive set of policy measures has been taken by Russia, which is rather similar to what the EU adopted:

- 1. Provision of domestic liquidity to the banking sector;*
- 2. Provision of external liquidity (to banks and companies);*
- 3. More flexible exchange rate policy;*
- 4. Package of fiscal support measures;*
- 4. Other measures (tax cuts, bank deposit insurance extended, increase in unemployment benefits, re-capitalisation of banks).*



Main RU policy measures in 2008

- **CBR**
 - Gradual rouble devaluation
 - Increase in refinancing rate to prevent speculative attack on RUB
 - A cut in the reserve requirements rate
 - Increasing the amount of fund available through REPO
 - CBR provides non-collateral loans to qualifying banks
 - CBR and NWF provide subordinated loans
 - Refinancing private external debt through CBR FX reserves
- **Government**
 - 100% guarantee for retail deposits up to RUB700,000
 - Agency for Deposit Insurance was recapitalized
 - VAT payment rules were changed
 - A cut in the oil export duty



Fiscal and Structural stimulus package for 2009

- Corporate Income tax rate cut from 24% to 20%
- Further financial support for banks – RUB 555 billion (USD 15.8 billion)
- Social supporting – RUB 628 billion (USD 17.9 billion)
- Regional level supporting – RUB 300 billion (USD 8.5 billion)
- Supporting the real sector – RUB 343 billion (USD 9.8 billion)
- Domestic demand supporting
- Additional government guarantees – up to RUB 300 billion (USD 8.5 billion)



EU's response: The European Economic Recovery Plan (EERP)

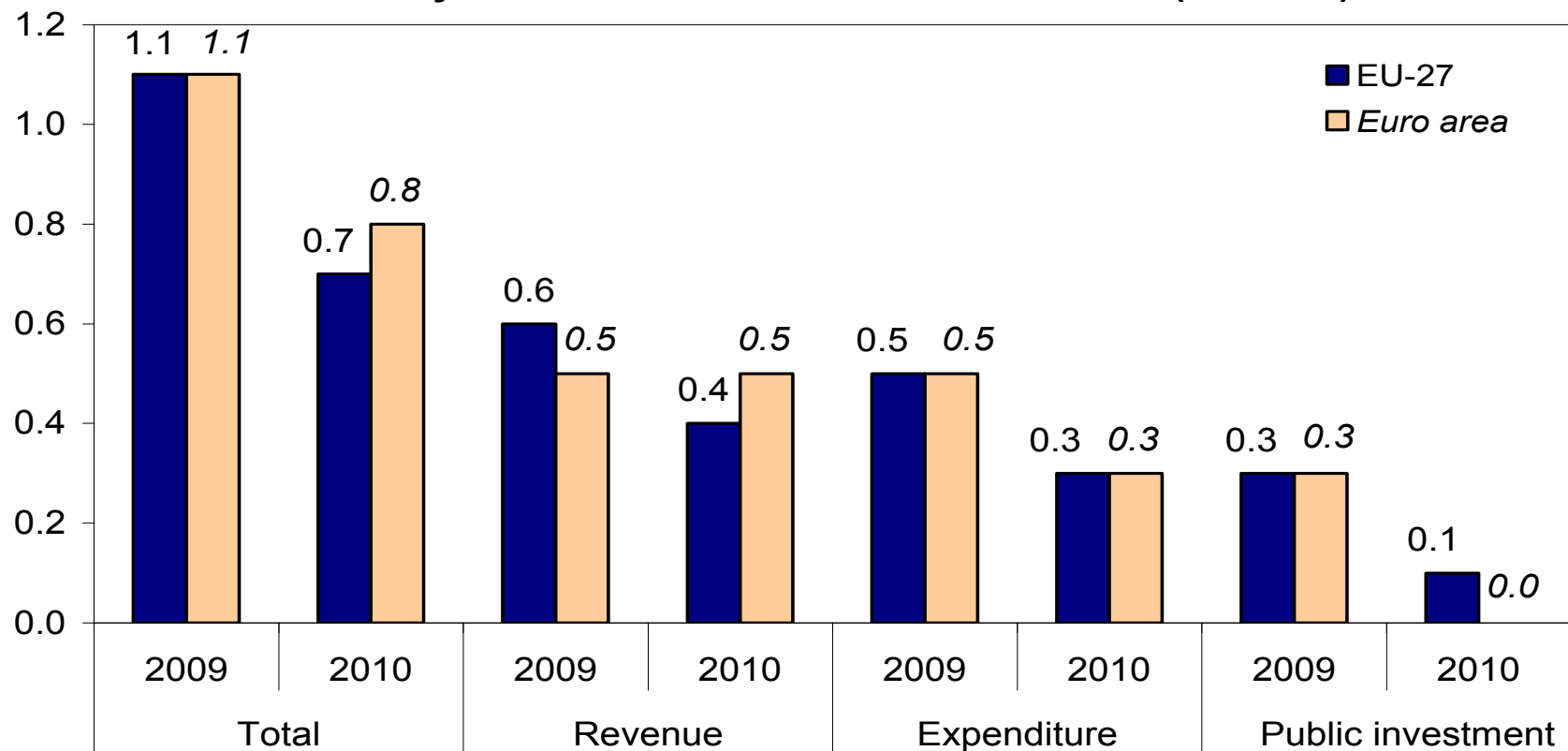
Main features:

- i. Timely, temporary, targeted, coordinated stimulus
- ii. Overall size: 1.8% of GDP
- iii. At Member State level: Size determined by fiscal space
- iv. Targeting: ST (stabilisation); LT: (growth; job creation; social protection; green economy)
- v. Credible commitment to medium-term fiscal adjustment and sustainability
- vi. Structural reforms to boost long-run growth potential



EERP: 1.8% of GDP discretionary stimulus measures...

Discretionary fiscal stimulus measures in the EU (2009-10) 1/



Notes: 1/ Figures for 2010 include permanent measures taking effect in 2009 plus measures taking effect in 2010.

Source: Commission services.



...in addition to large automatic stabiliser effects.

% of GDP	Nominal balance	Change in deficit with respect to 2008	of which:		Change in the primary cyclically-adjusted balance	of which:		Official budgetary projections
			Estimated impact automatic stabilisers	Budgetary impact change in the interest expenditure		Budgetary impact expansionary measures	Residual	
DE	-3.9	-3.8	-3.1	-0.2	-0.5	-1.4	0.9	-2.9
IE	-12.0	-4.9	-3.2	-1.2	-0.5	-0.5	0.0	-10.7
EL	-5.1	-0.1	-1.3	-0.3	1.5	0.0	1.5	-3.7
ES	-8.6	-4.8	-1.5	-0.1	-3.2	-2.3	-0.9	-5.8
FR	-6.6	-3.2	-1.9	0.0	-1.3	-1.0	-0.3	-5.6
IT	-4.5	-1.7	-2.3	0.5	0.1	0.0	0.1	-4.6
CY	-1.9	-2.8	-0.7	0.6	-2.7	-0.1	-2.6	-0.8
LU	-1.5	-4.1	-2.7	-0.3	-1.1	-1.2	0.1	-1.7
MT	-3.6	1.1	-0.7	-0.2	2.0	-1.6	3.6	-1.5
NL	-3.4	-4.5	-2.6	-0.5	-1.4	-0.9	-0.5	-3.3
AT	-4.2	-3.8	-2.4	-0.5	-0.9	-1.8	0.9	-3.5
PT	-6.5	-3.9	-1.6	-0.1	-2.3	-0.9	-1.4	-3.9
SI	-5.5	-4.6	-2.1	-0.4	-2.0	-0.6	-1.4	-5.1
SK	-4.7	-2.5	-2.1	-0.1	-0.3	-0.1	-0.2	-3.0
FI	-0.8	-4.9	-2.9	0.1	-2.1	-1.7	-0.5	-1.9
EA	-5.3	-3.4	-2.3	-0.1	-1.0	-1.1	0.1	-

Source: Commission services' Spring 2009 Forecast, Commission services.

Source official budgetary projections: 2008 Stability Programmes or, where available, first 2009 notification and most recent official projections.

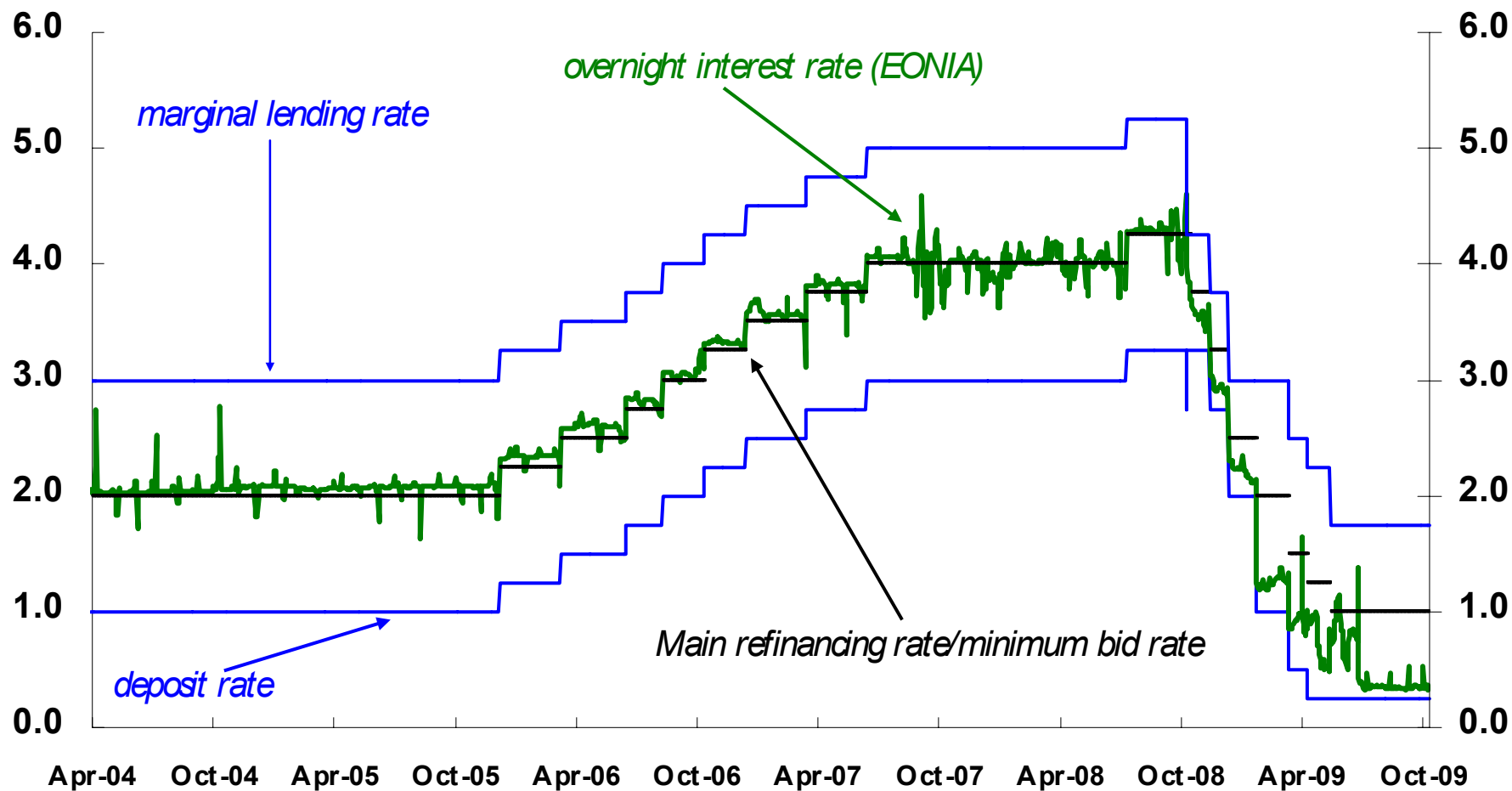


Monetary/Banking response

- ECB's massive liquidity provision and aggressive lowering of interest rates.
- Extension of guarantees on banks' liabilities.
- Capital injections and (in some cases) state-control.
- Treatment of impaired assets.
- Review of the regulatory and supervisory framework in the EU ("de Larosière" Report).



Monetary/Banking response





Monetary/Banking response

(Central bank total assets as a share of respective GDP)

	EcB	Fed	BoE
Mid-2007	10%	6%	6%
Peak	19%	15%	20%
<i>Peak reference date</i>	<i>02/01/09</i>	<i>17/12/08</i>	<i>22/10/08</i>
Aug-09	17%	14%	16%

Note: Total assets from the simplified balance sheets of the Bank of England, the Eurosystem and the Federal Reserve; annual GDP based on current prices and seasonally adjusted (forecast for 2009).

Source: ECB calculations and Eurostat.



Schemes for financial institutions

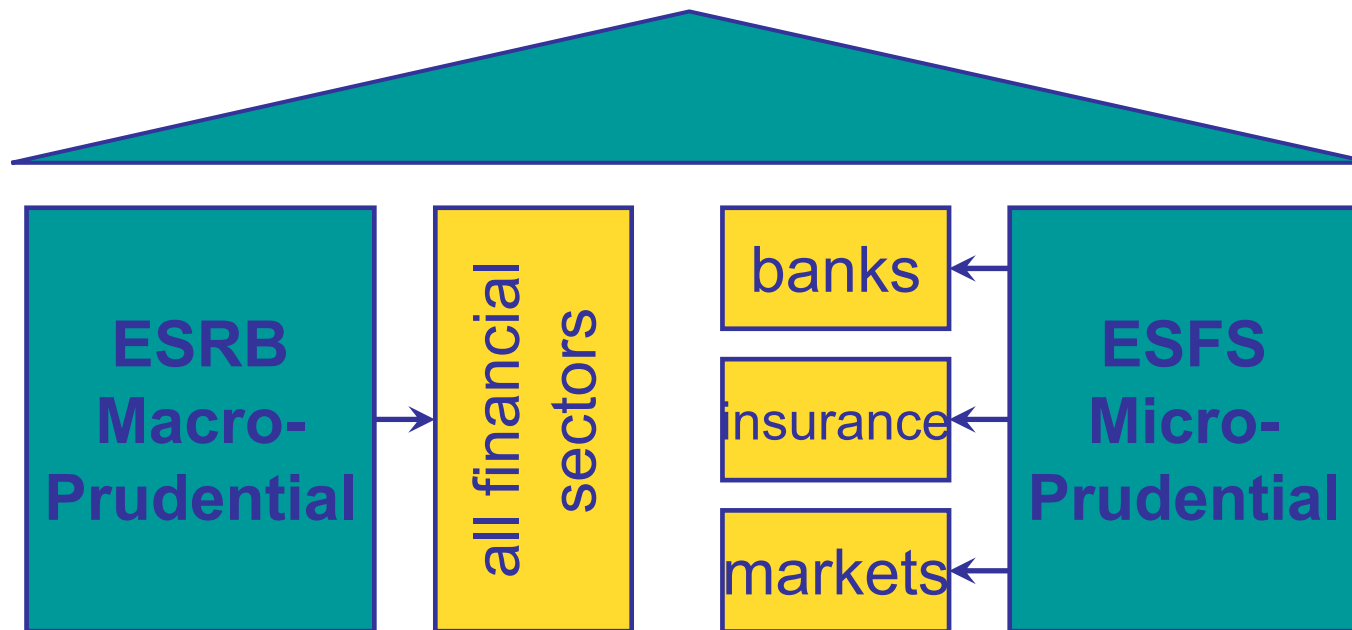
% of GDP	Total EU		Total EA	
	Approved	Effective	Approved	Effective
Guarantees on bank liabilities	24.8	8.1	20.7	8.7
Liquidity and bank funding support	2.9	2.6	1.0	0.8
Capital injections	2.6	1.5	2.7	1.4
Treatment of impaired assets	0.8	0.4	1.1	0.6
Total measures	31.2	12.6	25.4	11.5

Note: cut-off date 17 July 2009.

Source: EU Commission - DG Competition's review of guarantee and recapitalisation schemes in the financial sector in the current crisis. 7 August 2009.



The new EU architecture is to be based on two pillars



- Main objectives:
- *Macro*: better oversight of systemic risk
 - *Micro*: enhanced supervisory convergence and coordination



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 the banking sectors)**



Main Points (again)

- 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.

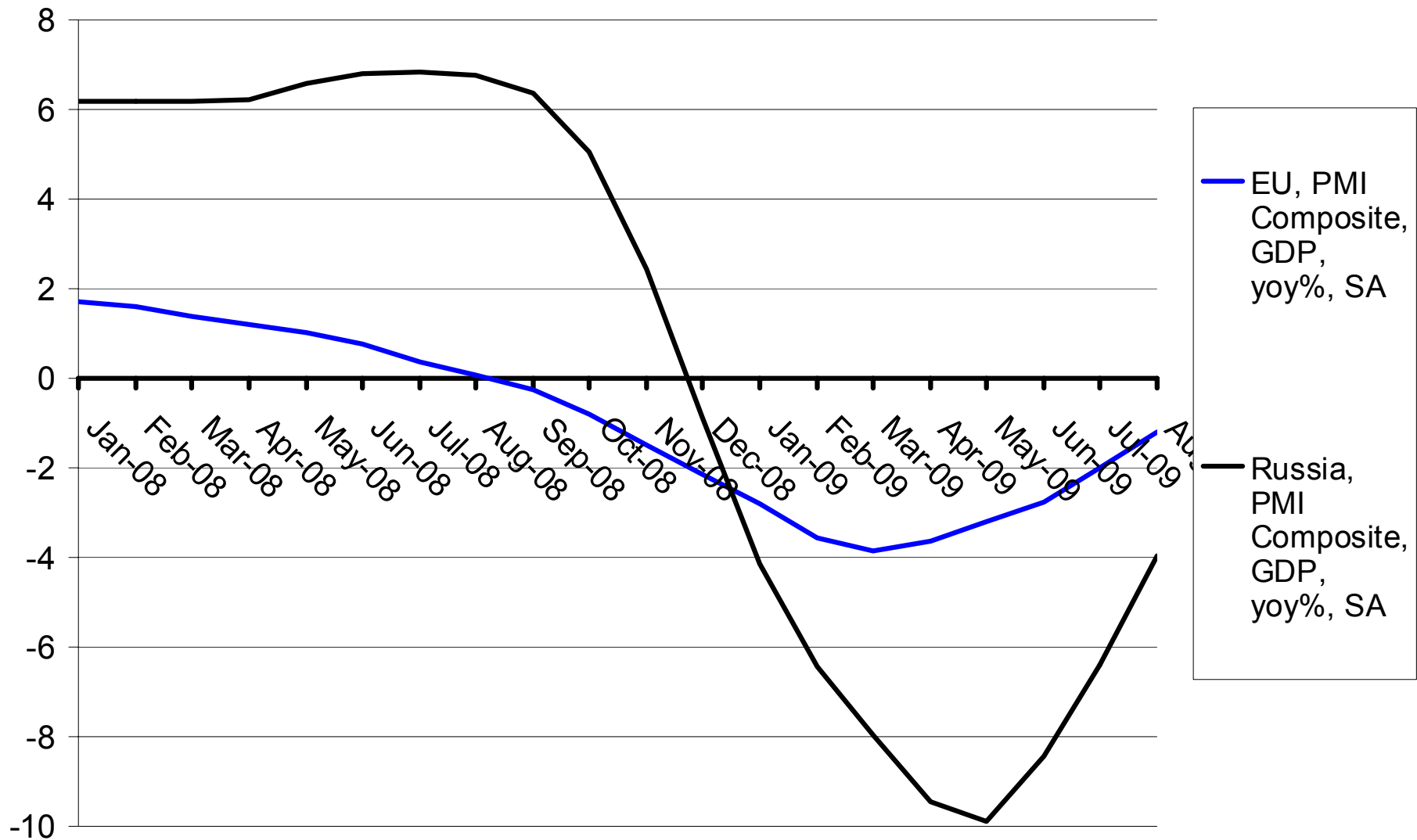


The Way Forward: Questions

- Some 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?



A greener world economy (1)...





A greener world economy (2)...

	Quarterly GDP forecast (% quarter-on-quarter) 2009				Annual GDP forecast (% year-on-year) 2009	
	2009/1	2009/2	2009/3	2009/4	<i>Spring forecast May 2009</i>	<i>Interim forecast Sep. 2009</i>
Germany	-3.5	0.3	0.7	0.1	-5.4	-5.1
Spain	-1.6	-1.1	-0.4	-0.2	-3.2	-3.7
France	-1.3	0.3	0.4	0.3	-3.0	-2.1
Italy	-2.7	-0.5	0.2	0.1	-4.4	-5.0
Netherlands	-2.7	-0.9	-0.4	0.0	-3.5	-4.5
Euro area	-2.5	-0.1	0.2	0.1	-4.0	-4.0
Poland	0.3	0.5	0.1	0.0	-1.4	1.0
United Kingdom	-2.4	-0.7	0.2	0.5	-3.8	-4.3
EU27	-2.4	-0.2	0.2	0.1	-4.0	-4.0



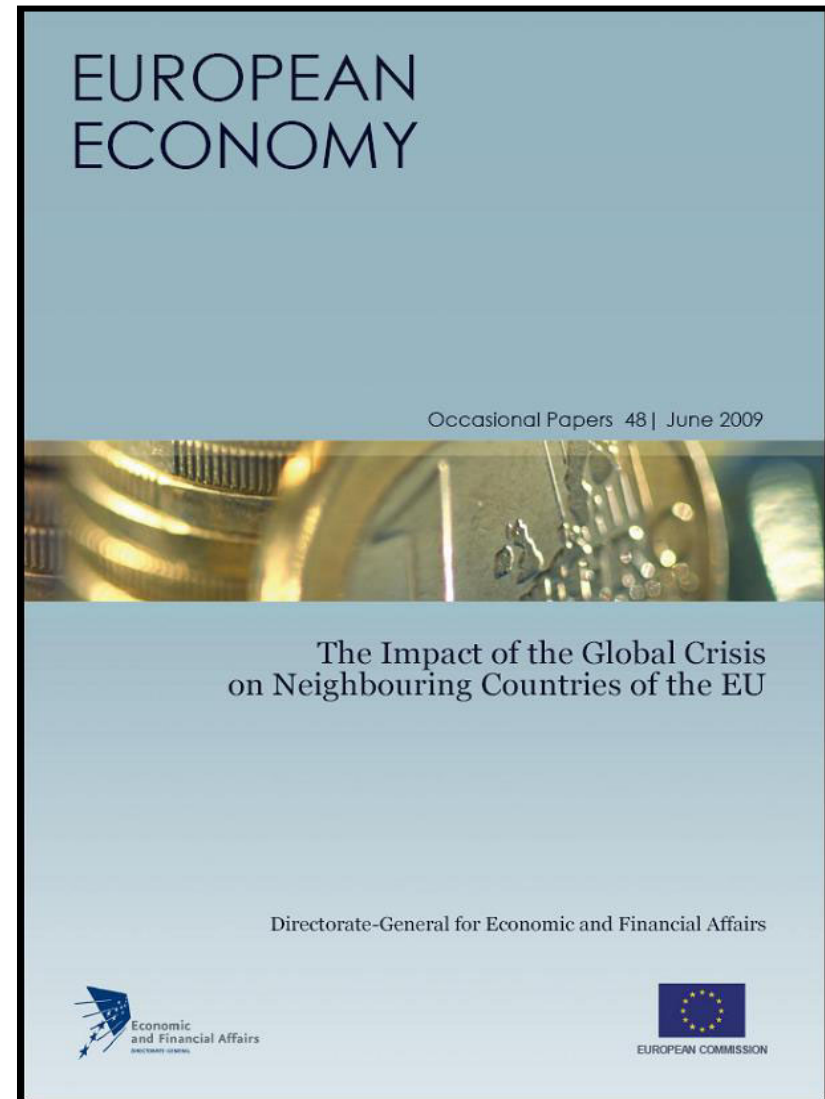
No return to business as usual

- Reform of the international financial architecture (G20–Pittsburgh commitments– and FSB, two *fora* of major EU-Russia interaction), the recommendations from the De Larosiere report in the EU
- No additional creation of imbalances



This presentation is largely based on two ECFIN recent papers:

1) the "Thematic article", the "Overview of Recent Economic Developments in the EU's Eastern neighbours" and on the "Russia 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



...and also on: 2) "Economic Crisis in Europe: Causes, Consequences and Responses", European Commission, Brussels, 2009. The paper can be downloaded from the address below:

Economic Crisis in Europe: Causes, Consequences and Responses

EUROPEAN ECONOMY 7 | 2009
(provisional version)



http://ec.europa.eu/economy_finance/publications/publication15887_en.pdf



Thank you for your
attention!