# European Response to the Global Financial Crisis

**Marek Belka**
President
National Bank of Poland

# Global crisis revealed euro area weaknesses

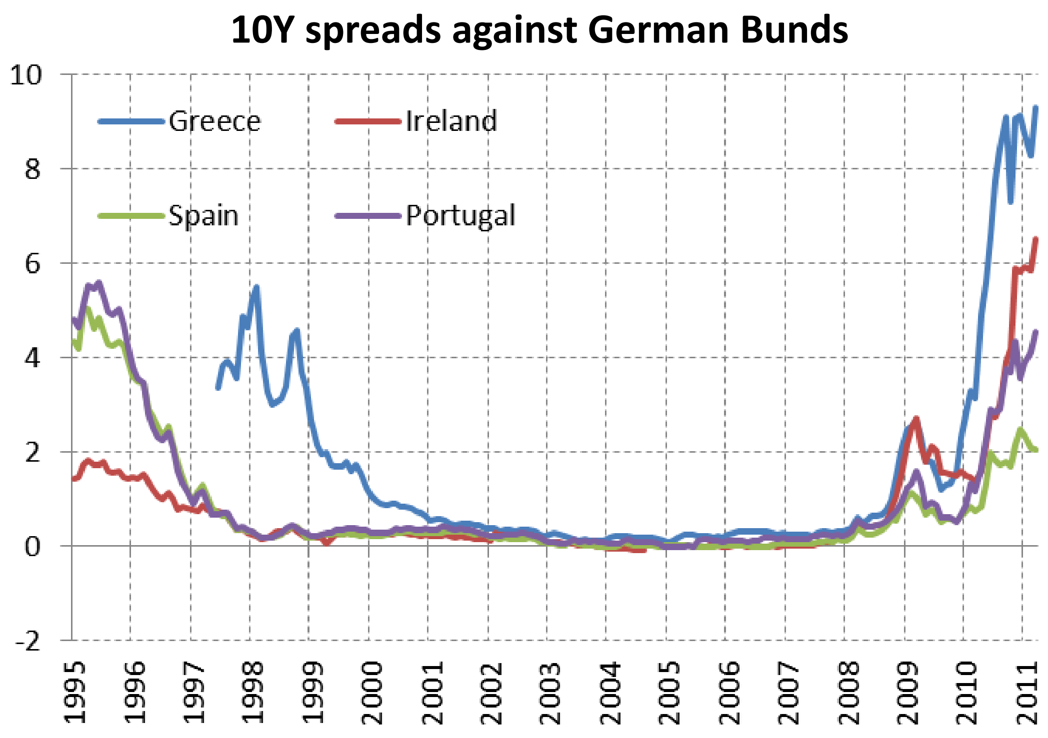
**Euro as an unfinished project:**

+ common monetary policy;
+ financial market integration.

- multiple fiscal and structural policies;
- weak and fragmented supervision, lack of cross-border bank resolution regime.

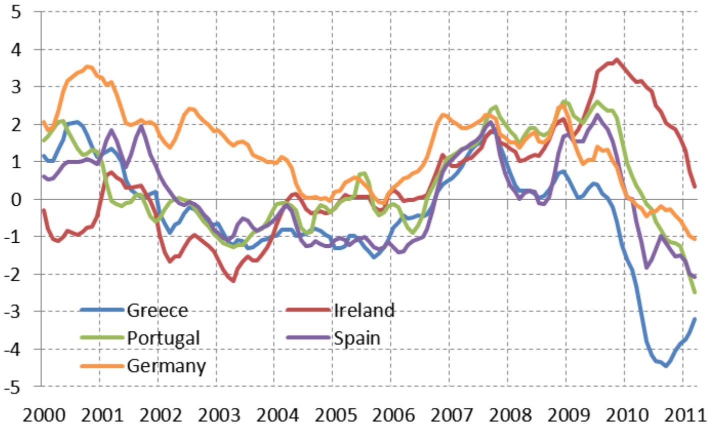
# The Euro – good project for good times

## Credibility shelter for the periphery.



# Increased creditworthness induced high capital inflow

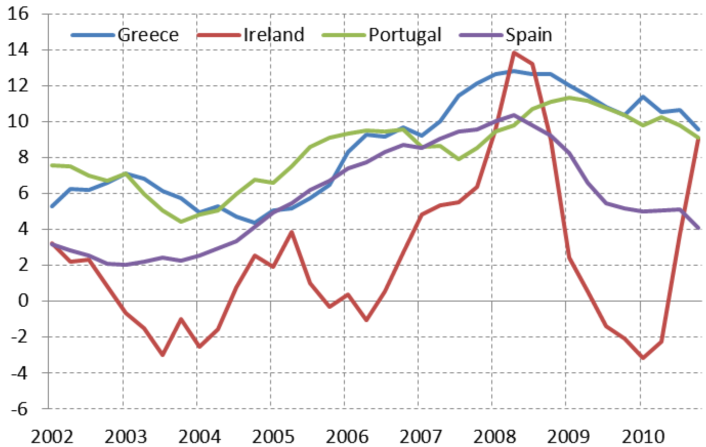
Real 3m interbank rates, in %



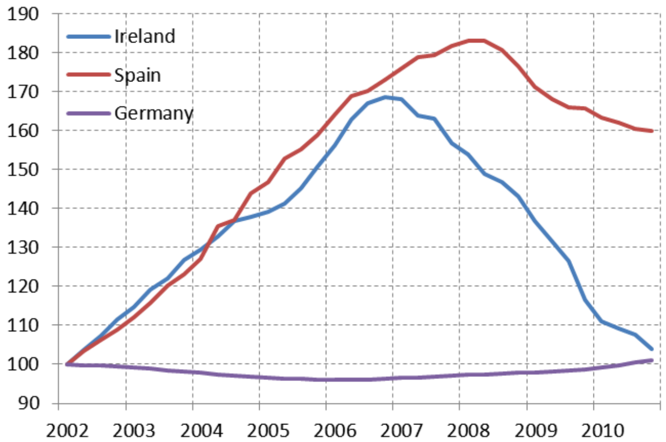

**<u>Effects of euro area membership for the peripheral countries:</u>**

- **Significant decrease in nominal and real interest rates.**
- **Incresed foreign capital inflow, mainy into non-tradeables sectors (inter alia construction).**
- **Large investment in housing started a boom-bust cycle in the periphery.**

Foreign capital inflow, in % of GDP



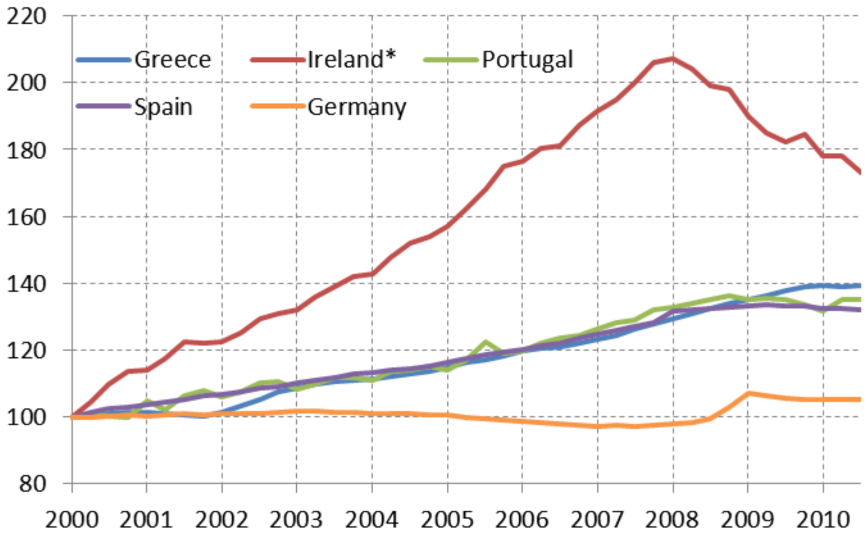

House prices, Q1 2002=100



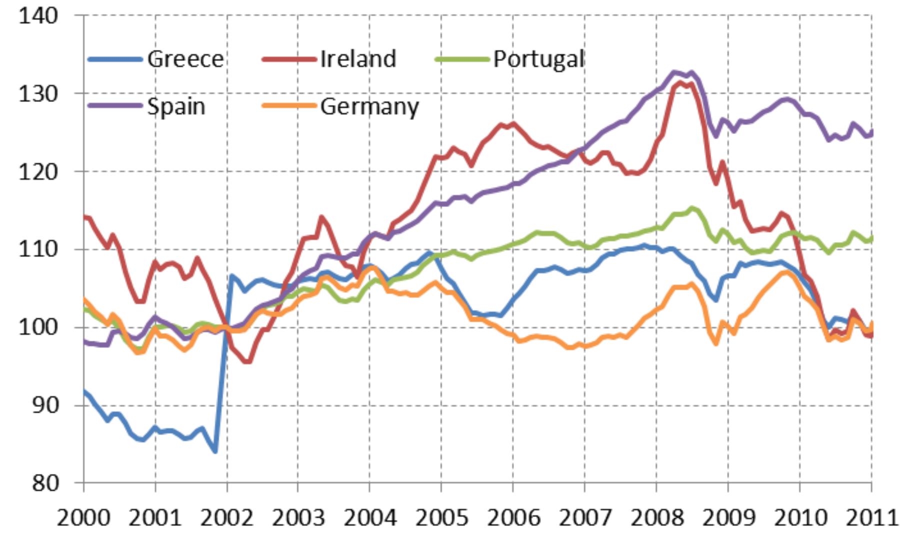
# Eroding competitiveness

**A bulk of capital inflow did not strenghten the competiveness.**

**Unit labour costs, Q1 2000=100**



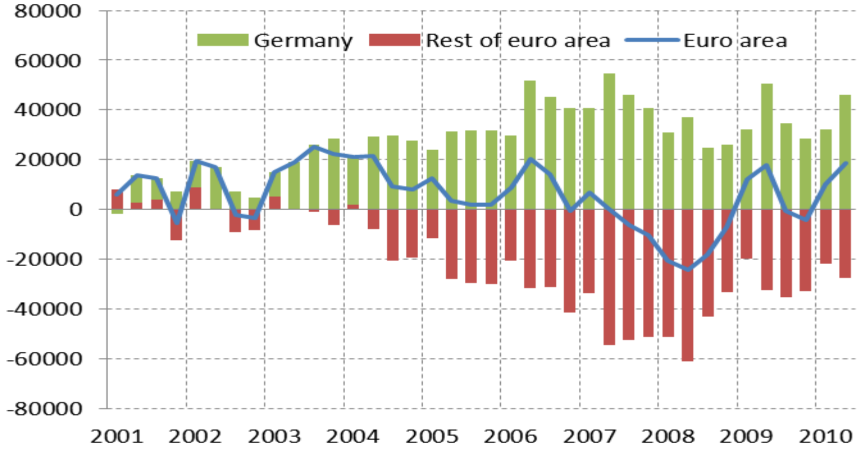

**ULC deflated REER, Jan. 2002=100**



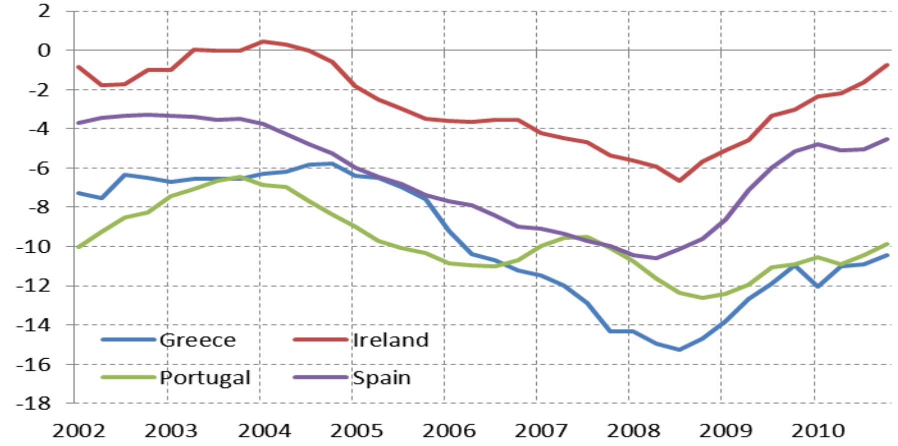

* Ireland – business sector, rest – total economy

# Faster convergence but at a cost of growing external imbalances

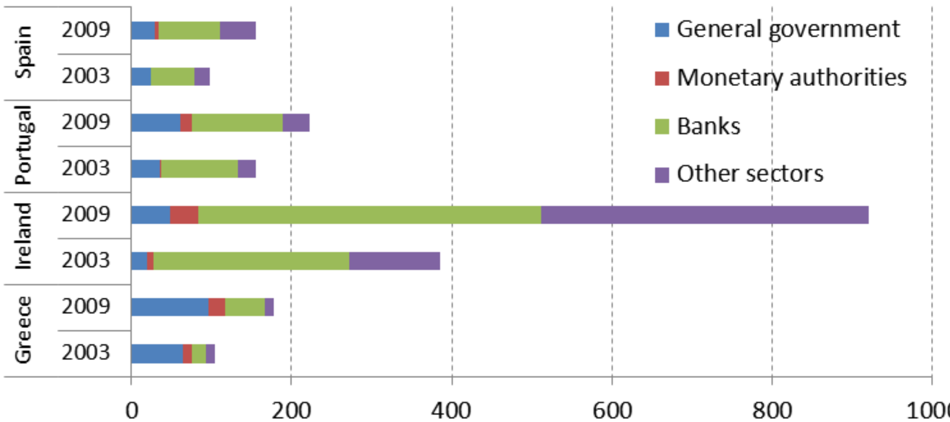
**Current account balance, Germany vs. rest of the euro area, EUR mn**




**Current account balance in the peripheral countries, in % of GDP**

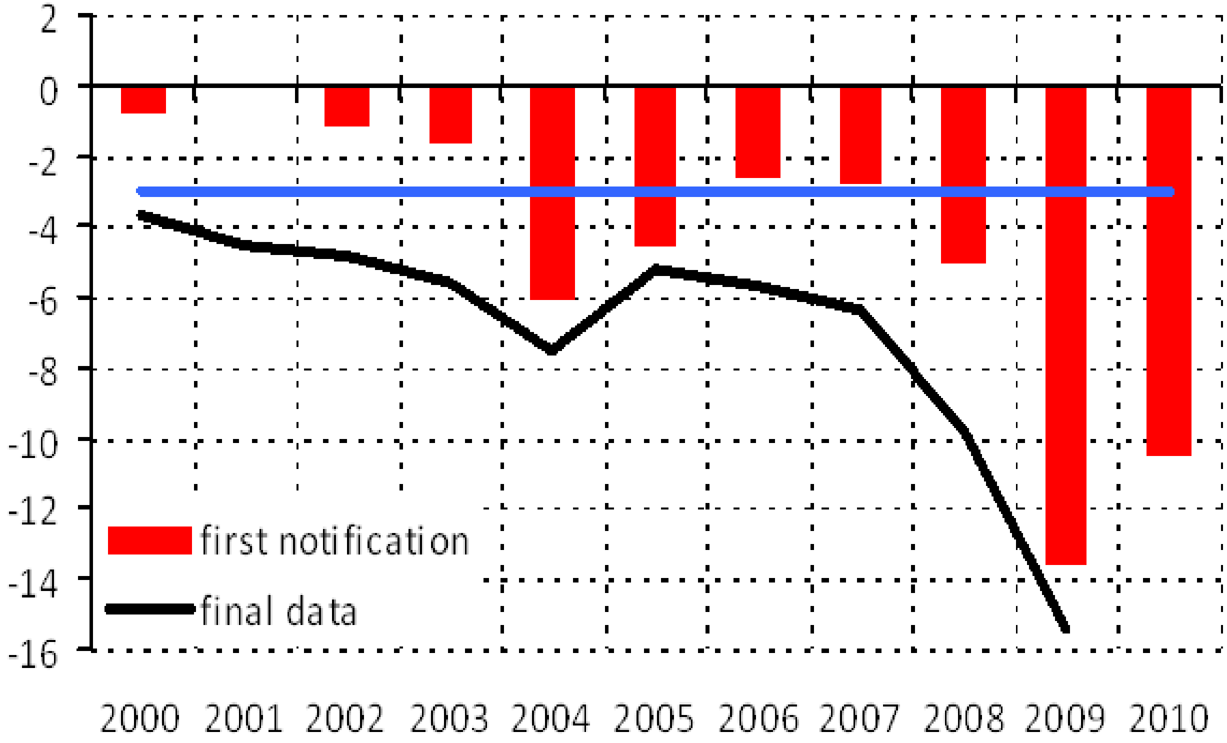



**External debt, in % of GDP**



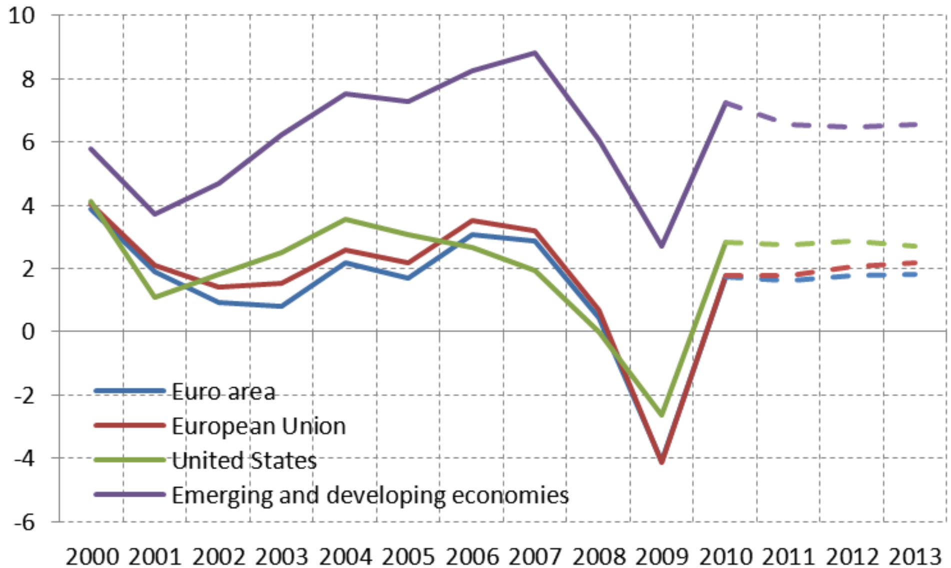
# Greece – an example of weak supervision over national fiscal policies in the euro area

**General government balance in Greece, in % of GDP**

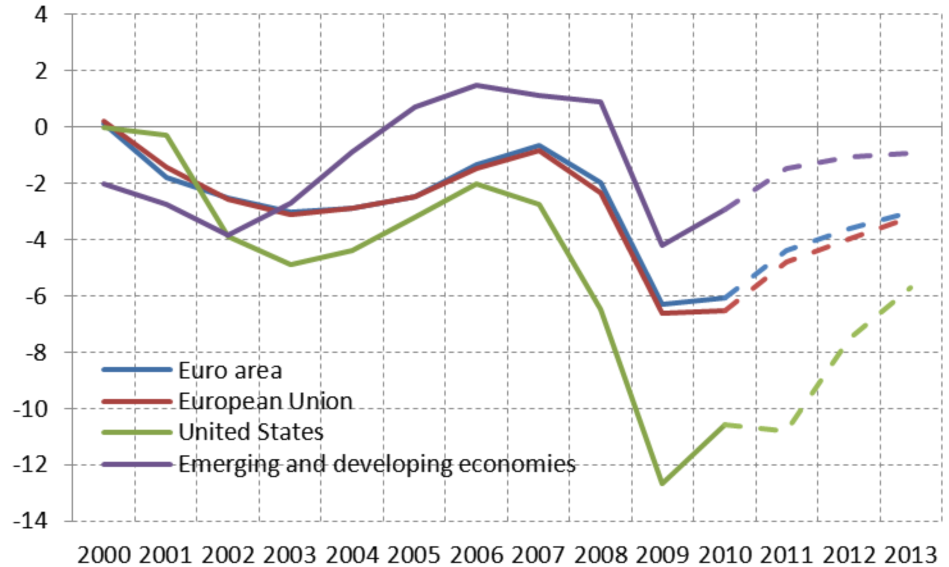


# Global crisis effects on European economy

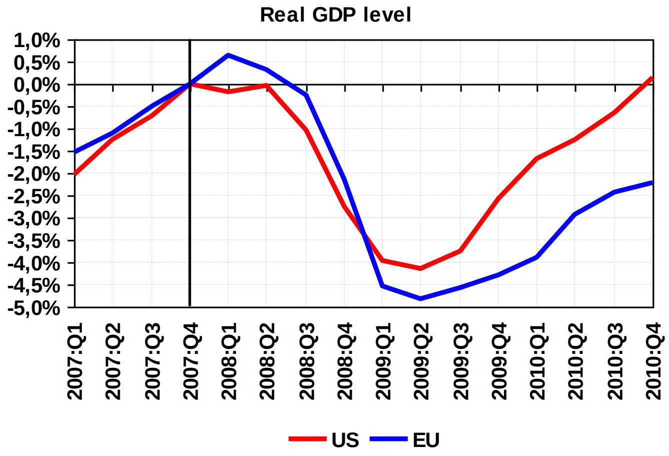
## GDP growth rate, in %, y-o-y

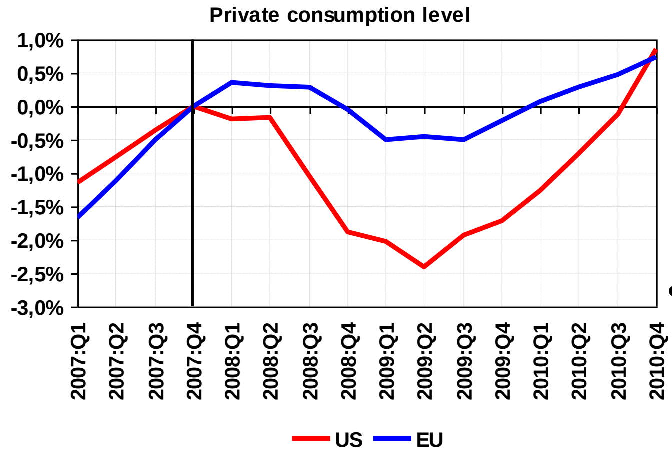


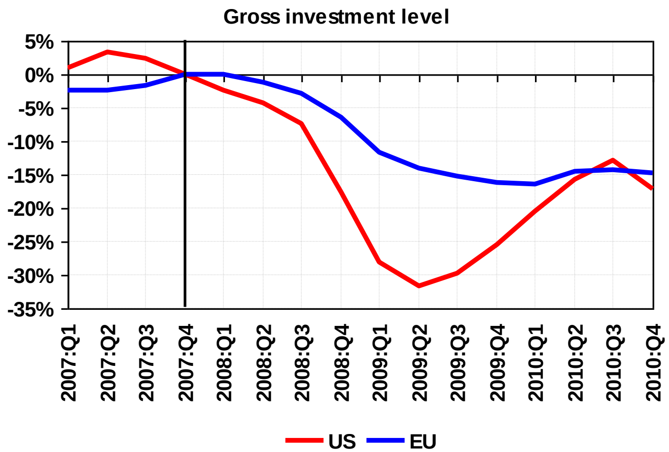

## General government balance, in % of GDP

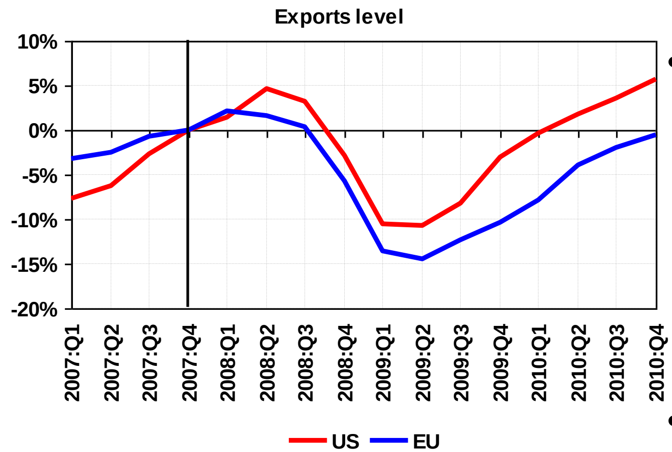


# EU vs. US – the national accounts perspective



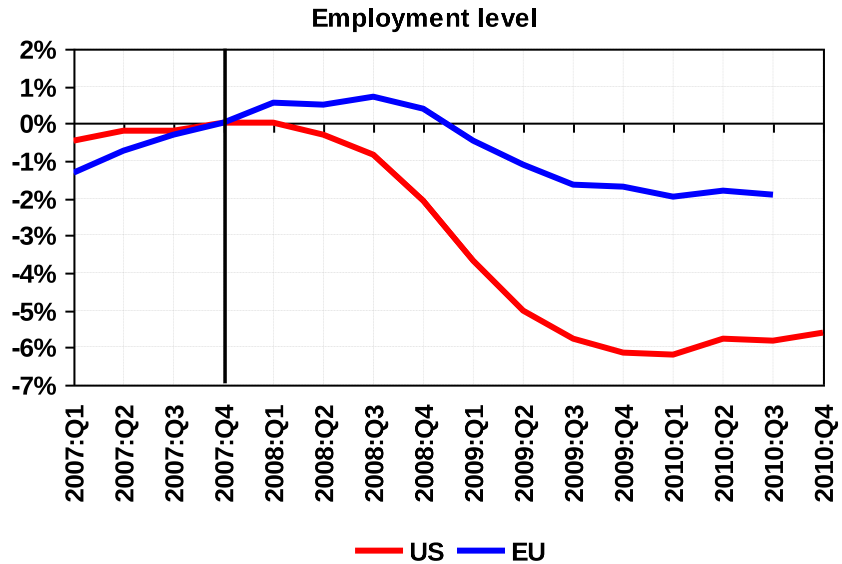



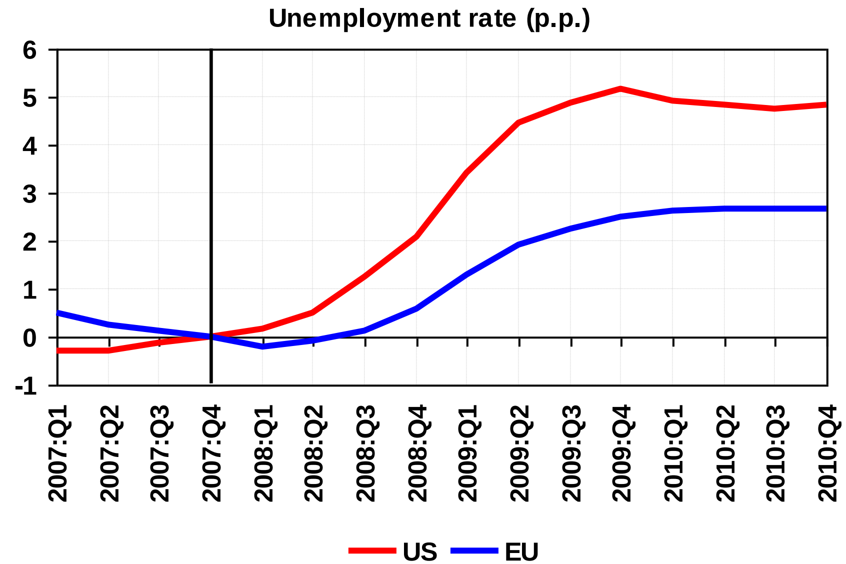




- **Generally synchronous slowdown and recovery in economic activity.**
- **Similar output loss of up to 4-5% in terms of real GDP level in both regions.**
- **Sharper drop in consumption and investment in the US but shallower contraction of exports.**
- **More rapid recovery in the US.**

# EU vs. US - labour markets developments



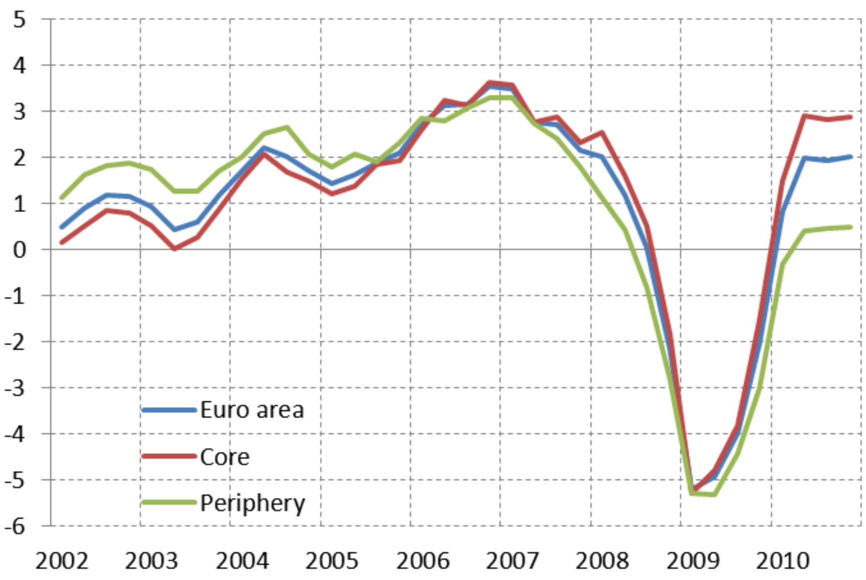




*Note: 2007:Q4 treated as the business cycle peak.*
*Source: BLS, Eurostat, NBP calculations.*

- **Generally synchronous worsening of labour market conditions.**
- **Sharper deterioration of labour market conditions in the US.**
- **Both regions stuck at present with high unemployment: EU – 9.5%, US – 8.8%.**

# Periphery slows down euro area recovery

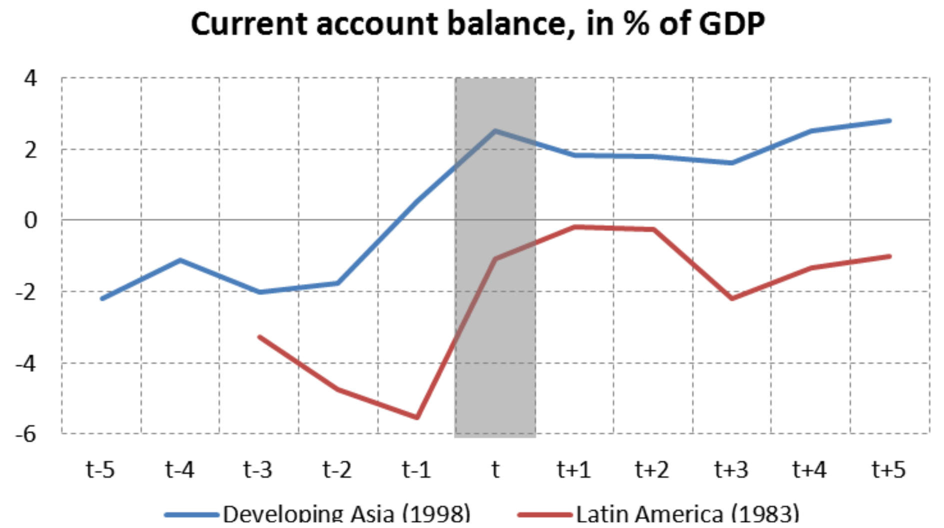
## GDP growth rate, in %, y-o-y

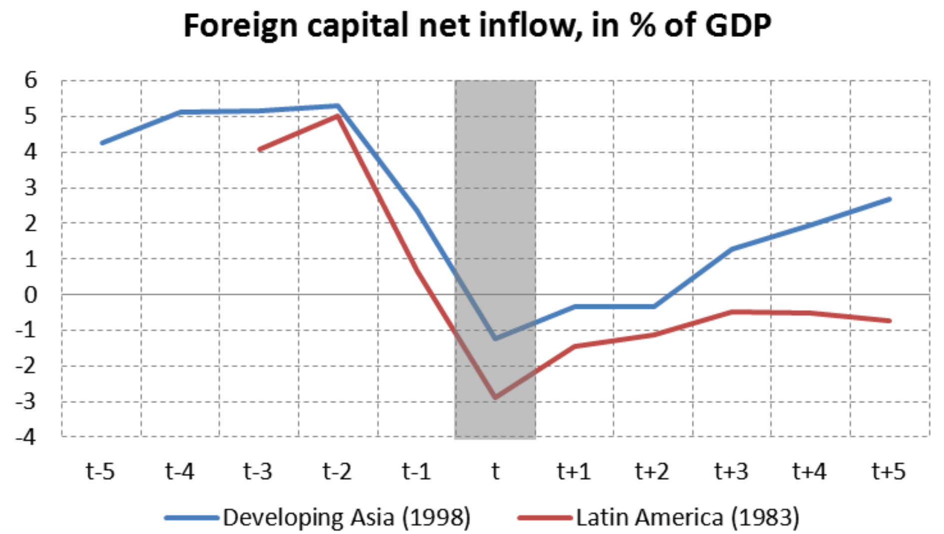



## GDP forecasts by the IMF, in %, y-o-y

| | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|
| **Euro area** | -4,1 | 1,7 | 1,6 | 1,8 | 1,8 |
| **United States** | -2,6 | 2,8 | 2,8 | 2,9 | 2,7 |
| **Emerging economies** | 2,7 | 7,3 | 6,5 | 6,5 | 6,5 |
| | | | | | |
| **Germany** | -4,7 | 3,5 | 2,5 | 2,1 | 1,9 |
| **France** | -2,5 | 1,5 | 1,6 | 1,8 | 2,0 |
| **Netherlands** | -3,9 | 1,7 | 1,5 | 1,5 | 1,6 |
| **Austria** | -3,9 | 2,0 | 2,4 | 2,3 | 2,2 |
| **Belgium** | -2,7 | 2,0 | 1,7 | 1,9 | 1,9 |
| **Finland** | -8,2 | 3,1 | 3,1 | 2,5 | 2,2 |
| **Luxembourg** | -3,7 | 3,4 | 3,0 | 3,1 | 3,2 |
| | | | | | |
| **Greece** | -2,0 | -4,5 | -3,0 | 1,1 | 2,1 |
| **Ireland** | -7,6 | -1,0 | 0,5 | 1,9 | 2,4 |
| **Italy** | -5,2 | 1,3 | 1,1 | 1,3 | 1,4 |
| **Portugal** | -2,5 | 1,4 | -1,5 | -0,5 | 0,9 |
| **Spain** | -3,7 | -0,1 | 0,8 | 1,6 | 1,8 |

# First Europaean experience of a serious financial crisis




**Previous financial crises in Latin America (1980's) and Asia (1990's) resulted in a number of social, political and economic reforms that changed its growth models.**

# European response to the crisis – success of common policy

- Temporary measures aimed at stimulating domestic demand and  restoring financial stability (stimuli plans).
- Common response to the debt crises in the peripheral countries.
- Reforms of the European institutional framework

# Response to the debt crises in the euro area

**Financial aid to the troubled countries (mutual EU and IMF deals):**

- **Greece – EUR 110 bn – aimed at restoring public finance stability and regaining competitiveness.**
- **Ireland – EUR 85 bn – aimed at restoring financial system and public finance stability.**
- **Portugal – EUR 78 bn – aimed at restoring the public finance stability.**

# Reforms - restoring competitiveness in the euro area

**Pact for the Euro:**

- **Fostering competitiveness.**
- **Fostering employment.**
- **Contributing further to the sustainability of public finances.**
- **Reinforcing financial stability.**

# Reforms - strenghtening of European institutional framework

**<u>New euro area crisis management framework:</u>**

- **Strenghtened discipline of the Stability and Growth Pact.**
- **Macro-prudential supervision – European Systemic Risk Board.**
- **Micro-prudential supervision – European Supervisory Authorities.**
- **Support for the euro area countries in financial difficulty - European Financial Stability Facility (EFSF) to become permanent European Stability Mechanism (ESM) from mid-2013 onwards.**

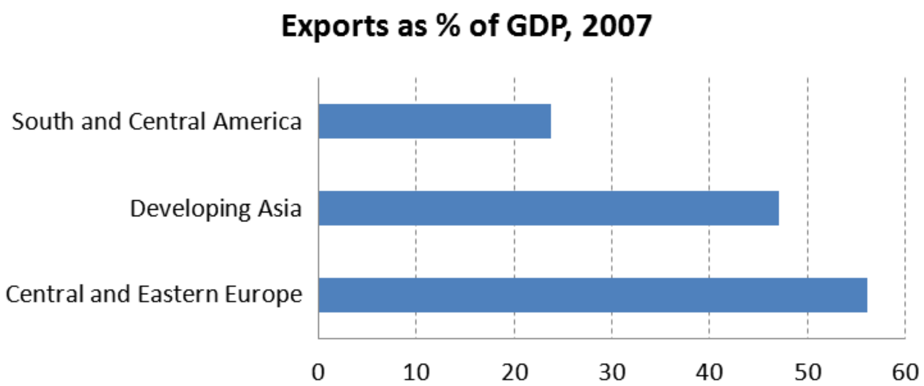
# Challenges ahead

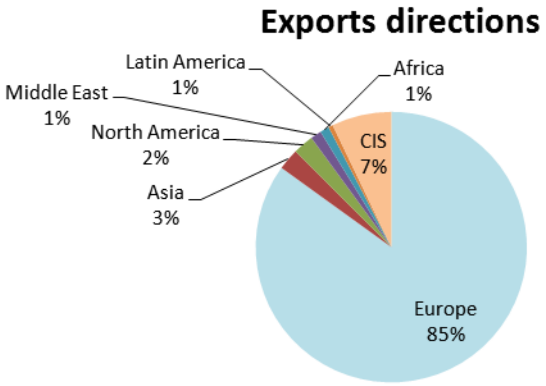
- **Public debt restucturing.**

- **Succesfull implementation of undertaken reforms.**

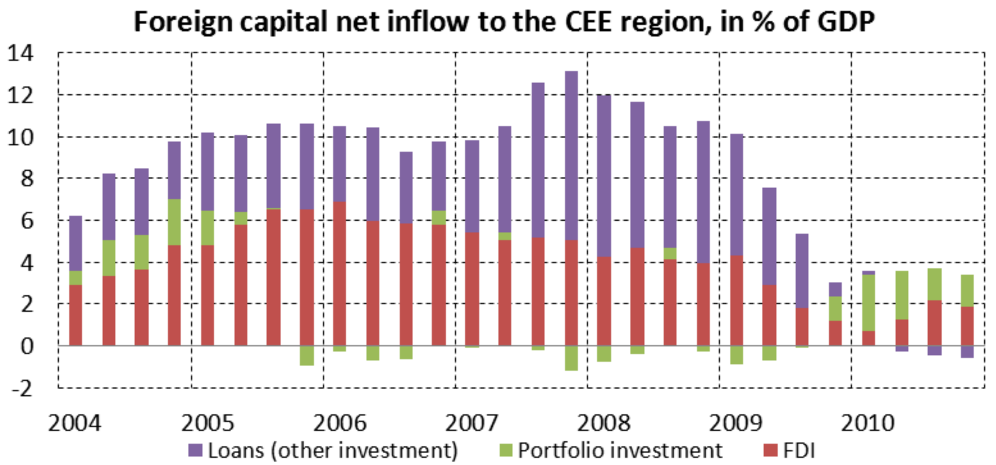
# Central and Eastern Europe – response to the crisis

- **<u>High trade openess and integrity with the rest of Europe.</u>**

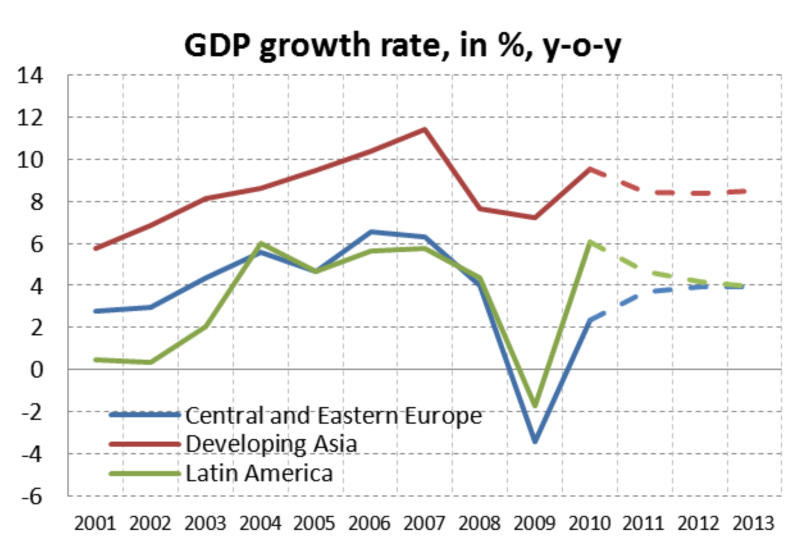



- **<u>Dependence on foreign capital inflow.</u>**



# CEE weathered the crisis better than expected




- **CEE countries suffered more severely from the crisis than other emerging markets.**

- **The worst, however, had been avoided:**

  ✓ **no massive foreign capital outflow (especially from the banking sector);**
  ✓ **no currency crises;**
  ✓ **no bailouts.**

# EU solidarity and willngness to reform helped fighting the crisis effects

**Mutual IMF & EU finacial aid for the CEE countries:**

- **Hungary – EUR 20 bn;**
- **Latvia – EUR 7.5 bn;**
- **Romania – EUR 20 bn;**
- **non-EU countries:**
    - **Bosnia, Kosovo, Moldova, Serbia, Ukraine.**

**Vienna Innitiative – preventing a large-scale and unco-ordinated withdrawal of cross-border bank groups from the region.**

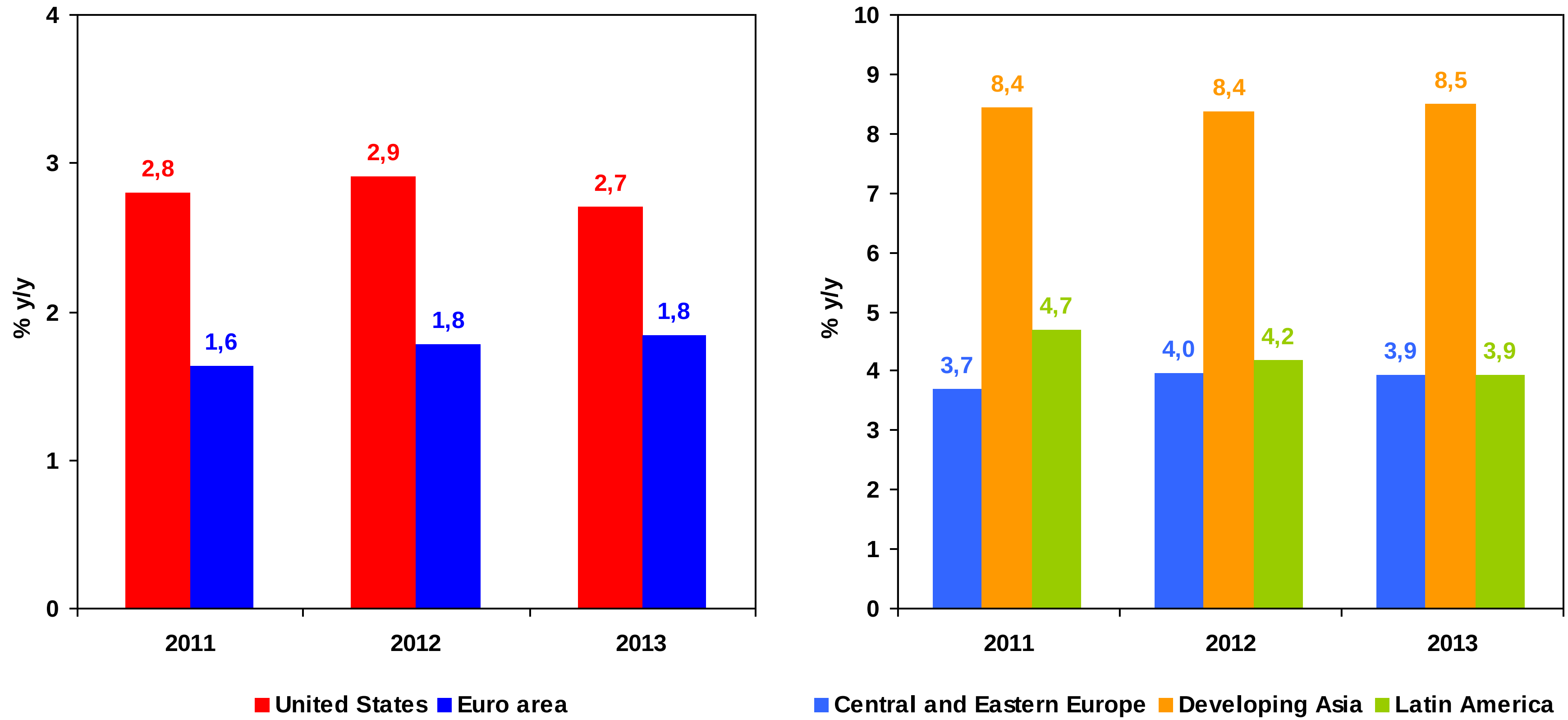
**Poor economic, financial and fiscal performance.**

**Fiscal austerity plans – tax hikes and expenditure cuts (especially severe in the Baltic states).**

**Improved financial markets supervision.**

# The road ahead

## GDP growth forecasts, in % y-o-y




*Source: IMF WEO, April 2011.*

# Thank you!