Returning tremors in Emerging Markets.
Is this time different?

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1. Two major unsettling events and preliminary remarks (I)

- The Fed’s gradual withdrawal of its monetary stimulus and ensuing tremors worldwide: an unavoidable event (it was not unexpected/it is not a tail event)

- The Ukraine crisis: the return of geopolitics in Europe (it is an extreme event with knowns and unknowns)

- The big issue for policy-makers: how to make their economies more robust (less fragile)

1. Two major unsettling events and preliminary remarks (II)

- What may surprise is the intensity of tremors in some emerging markets bearing in mind: a/ lessons of crises in emerging markets (Asia, 97/98; Latin America, Russia, etc); b/ sounder macroeconomic fundamentals in numerous emerging economies and substantial build-up of reserves
- But, one should not underestimate the nature of the current “global financial cycle”: an ordinary global financial cycle (Borio) vs. one induced by policies aiming at averting a financial meltdown (the Great Recession)
- The fear of “sudden stops” and BoP crises has come back (in Europe too)
- Contagion at play, though there are clear differences among EMs
- A fall from grace: from “BRICS” to the “Fragile Five” (Brazil, India, Indonesia, South Africa, Turkey”; the list of vulnerable economies can be extended…
- EMs are hit both when there is massive injection of liquidity, and when the “vacuum cleaner” operates; the role of US, other major central banks’ policies
- A dysfunctional international policy regime

2. Stylized facts: The macro picture

- Macroeconomic fundamentals (external imbalances, gross external debt and short term debt, budget deficits, etc) matter much, but they do not provide insulation against a tidal wave of great scale
- Not least because of: a/ the size of liquidity that has been pouring into EMs during the past decade (EMs have attracted about $7 trillion since 2005 through a mix of FDI, mergers and acquisitions, and investment in stocks and bonds –according to the IIF; between 2010-2013, private capital flows jumped to 6% of EMs cumulated GDP); b/ much borrowing has take place primarily via bond markets (capital markets); c/ the emergence of index-tracking Exchange Traded Funds (ETFs), which has increased the indiscriminate nature of emerging market flows, and which leaves them vulnerable to across the board withdrawals
- Private indebtedness matters as much as public debt
- Sound fundamentals can make the difference between a recession and a balance of payments crisis (a "sudden stop")
- Macro-prudential measures strengthen macro fundamentals (they prevent large external imbalances)
- The importance of external indebtedness, of gross external financing requirements (GEFR) in explaining fragility of EMs to external shocks

2. Capital markets and fragility to external shocks

- The size of domestic saving and domestic investors' base help in making an economy less fragile (more robust)
- Deep financial markets entail pluses and minuses (non-resident investors' share of local currency denominated bond issues); in spite of improved economic policies in many EMs, investors tend to lump them together in times of sell off
- There are capital markets instruments which entail an indiscriminate impact on emerging economies (ETFs)
- Capital controls are not effective when massive outflows take place
- Political strains amplify economic instability and risk aversion

2. Policy responses

- Monetary policy rates rises do not seem to have a decisive impact (Turkey, India…); severe impact on economic activity

- The cost of funding goes up…

- CEEs are, arguably, better prepared now than during 2008-2009 (some of them had awful macroeconomic imbalances), but high external indebtedness and substantial GEFR make some of them vulnerable

- We are at the beginning of a bumpy ride, at a time when the crisis is not yet over (in Europe, the impact of the financial crisis blends with strains in the eurozone)

3. What next?(I)

- pieces of good news -

- Economic recovery in the US and a more upbeat, although with many caveats, IMF view on the economic outlook for the world economy
- The eurozone is, arguably, no longer menaced by a collapse (the ECB's role as a lender of last resort and large macro-imbalance corrections in its periphery)

- pieces of bad news -

- Specter of debt deflation in the eurozone; the link between sovereign debt and bank balance-sheets has not been severed; fragmentation of markets (although the periphery pays much less for issuing its debt…)
- China's bubbles
- Capital flows reversals (risk aversion)
- Trade protectionism
- Social and political implications of economic slowdown (economic recession) in some EMs --balance of payments crises
- Ineffective policy coordination (from G20 to G0…)
- Prospects of much lower growth much of the industrialized world (a *balance-sheet recession*, that is very time consuming in its healing)

3. What next? (II)

Scenarios

A

- a painful, but manageable correction in a baseline scenario (World Bank study);
- a modest retrenchment of capital inflows in EMs
- cost of long term funding goes up significantly, however

B

- a less likely scenario: a disorderly adjustment following massive capital outflows
- financial flows could decline by 80% quite rapidly
- ¼ of developing economies could experience “sudden stops” and BOP crises

C

- When examining GEFR one has to look at the structure/maturity of debt, which companies hold large debt, etc (India, Indonesia, Turkey look better when analysis is rounded up)

4. Europe (I)

- Major corrections have taken place in EMs which were threatened by “sudden stops” during 2008-2009 (Baltic countries, Hungary, Romania, etc); the current account imbalances went down quite dramatically (see Fig.1 and 2)
- GDP growth rates estimates for CEEs revised upwards (see Fig.3 and 4)
- But large GEFR can make some of them vulnerable (a high external debt to GDP ratio, which exposes countries to exchange rate and rollover risk, is an issue in several CEE countries – see Fig.5, 6 and 7)
- Capital flows reversals can put pressure on exchange rates (see Fig.8 and 9)
- High euroization cripples monetary and exchange rate policies (it poses a systemic risk – see Fig.10)
- Fed tapering counters attempts to relax monetary policies, especially where there is heavy pressure for depreciation of the local currency
- Is the level of the euro a problem?
- The Ukraine crisis is a major unsettling event

Fig.1 Current Account imbalances

Current Account (% GDP)	2005	2006	2007	2008	2009	2010	2011	2012	2013
Bulgaria	-11.6	-17.6	-25.2	-23.1	-8.9	-1.5	0.1	-0.8	1.9
Czech Republic	-1.0	-2.0	-4.3	-2.1	-2.4	-3.9	-2.7	-2.3	-1.4
Estonia	-10.0	-15.3	-15.9	-9.2	2.7	2.8	1.8	-1.8	-1.0
Croatia	-5.3	-6.6	-7.2	-8.8	-4.9	-0.9	-0.8	0.1	1.2
Latvia	-8.8	-15.8	-15.7	-9.2	6.1	3.0	-2.2	-2.5	-0.8
Lithuania	-7.1	-10.6	-14.4	-12.9	3.7	0.1	-3.7	-0.2	1.5
Hungary	-7.5	-7.4	-7.3	-7.3	-0.2	0.2	0.4	0.8	3.0
Poland	-2.4	-3.8	-6.2	-6.6	-3.9	-5.1	-5.0	-3.7	-1.3
Romania	-8.6	-10.4	-13.4	-11.6	-4.2	-4.4	-4.5	-4.4	-1.1
Slovakia	-8.5	-7.8	-5.3	-6.2	-2.6	-3.7	-3.8	2.2	2.1

Source: Eurostat, ECB

Fig.2 General Government imbalances

General Government Net lending (+)/Net borrowing (-) as % of GDP	2005	2006	2007	2008	2009	2010	2011	2012	2013E
Bulgaria	1.0	1.9	1.2	1.7	-4.3	-3.1	-2.0	-0.8	-1.9
Czech Republic	-3.2	-2.4	-0.7	-2.2	-5.8	-4.7	-3.2	-4.4	-2.7
Estonia	1.6	2.5	2.4	-2.9	-2.0	0.2	1.1	-0.2	-0.4
Croatia	:	:	:	:	-5.3	-6.4	-7.8	-5.0	-6.0
Latvia	-0.4	-0.5	-0.4	-4.2	-9.8	-8.1	-3.6	-1.3	1.3
Lithuania	-0.5	-0.4	-1.0	-3.3	-9.4	-7.2	-5.5	-3.2	-2.7
Hungary	-7.9	-9.4	-5.1	-3.7	-4.6	-4.3	4.3	-2.0	-2.4
Poland	-4.1	-3.6	-1.9	-3.7	-7.5	-7.9	-5.0	-3.9	-4.4
Romania	-1.2	-2.2	-2.9	-5.7	-9.0	-6.8	-5.5	-3.0	-2.6
Slovakia	-2.8	-3.2	-1.8	-2.1	-8.0	-7.7	-5.1	-4.5	-2.5

Source: Eurostat

Fig.3 EC growth forecast updates

	winter 2014			autumn 2013		
% GDP year on year	2013	2014	2015	2013	2014	2015
Euro Area	*-0.4*	*1.2*	*1.8*	*-0.4*	*1.1*	*1.7*
EU	*0.1*	*1.5*	*2.0*	*0.0*	*1.4*	*1.9*
Estonia	0.7	2.3	3.6	1.3	3.0	3.9
Latvia	4.0	4.2	4.3	4.0	4.1	4.2
Slovenia	-1.6	-0.1	1.3	-2.7	-1.0	0.7
Slovacia	0.8	2.3	3.2	0.9	2.1	2.9
Bulgaria	0.6	1.7	2.0	0.5	1.5	1.8
Czech Republic	-1.2	1.8	2.2	-1.0	1.8	2.2
Lithuania	3.2	3.5	3.9	3.4	3.6	3.9
Hungary	1.1	2.1	2.1	0.7	1.8	2.1
Poland	1.6	2.9	3.1	1.3	2.5	2.9
Romania	3.5	2.3	2.5	2.2	2.1	2.4

Fig.4 IMF growth forecast updates

International Monetary Fund - World Economic Outlook (WEO)

	WEO Oct. 2013		WEO update 21 Jan. 2014		
% GDP year on year	2013f	2014f	2013e	2014f	2015f
World Output	*2.9*	*3.6*	*3.0*	*3.7*	*3.9*
Advanced Economies	*1.2*	*2.0*	*1.3*	*2.2*	*2.3*
Euro Area	-0.4	1.0	-0.4	1.0	1.4
Emerging Market and Developing Economies	*4.5*	*5.1*	*4.7*	*5.1*	*5.4*
Central and Eastern Europe	2.3	2.7	2.5	2.8	3.1

Fig.5 Gross External Debt (% of GDP) (I)

Country	Indicator	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Argentina* *WB, ASF calculations*	Gross External Debt (% GDP)	111.7	62.1	50.8	47.5	38.1	37.9	35.0	31.5	29.8	27.6
	Short Term Debt (% GDP)	17.3	19.0	13.2	7.4	6.1	6.5	3.8	3.8	2.9	1.9
	Long Term Debt (% GDP)	94.4	43.1	37.6	40.1	32.0	31.4	31.2	27.7	26.9	25.7
Brazil* *WB, ASF calculations*	Gross External Debt (% GDP)	33.2	21.3	18.3	17.6	15.9	17.1	16.4	16.3	19.6	21.5
	Short Term Debt (% GDP)	3.8	2.7	1.9	2.9	2.2	2.5	3.1	1.7	1.4	1.4
	Long Term Debt (% GDP)	29.4	18.6	16.4	14.7	13.7	14.6	13.3	14.6	18.2	20.1
India* *WB, ASF calculations*	Gross External Debt (% GDP)			16.9	16.6	18.8	18.5	17.3	17.7	21.4	22.8
	Short Term Debt (% GDP)			2.6	2.9	3.6	3.4	3.3	4.2	5.1	5.4
	Long Term Debt (% GDP)			14.3	13.7	15.2	15.1	14.0	13.5	16.3	17.4
Indonesia* *WB, ASF calculations*	Gross External Debt (% GDP)		47.0	36.4	32.7	30.4	32.0	28.5	26.6	28.7	30.0
	Short Term Debt (% GDP)		3.9	3.3	4.3	4.0	4.5	4.7	4.5	5.1	5.5
	Long Term Debt (% GDP)		43.1	33.1	28.4	26.4	27.5	23.8	22.1	23.6	24.5
Korea, Rep.* *WB, ASF calculations*	Gross External Debt (% GDP)	20.9	19.1	23.7	31.8	34.1	41.4	35.4	35.8	36.2	34.3
	Short Term Debt (% GDP)	7.8	7.8	12.0	15.3	16.1	17.9	13.8	12.3	11.3	9.3
	Long Term Debt (% GDP)	13.1	11.3	11.7	16.5	18.0	23.5	21.6	23.5	24.9	25.0
Malaysia* *WB, ASF calculations*	Gross External Debt (% GDP)	45.9	39.1	34.7	32.2	32.6	37.8	33.3	31.7	32.3	
	Short Term Debt (% GDP)	9.2	9.2	7.3	11.9	9.9	11.7	14.2	15.1	15.4	
	Long Term Debt (% GDP)	36.7	29.9	27.4	20.3	22.7	26.0	19.1	16.6	16.9	
Mexico* *WB, ASF calculations*	Gross External Debt (% GDP)	21.5	19.9	17.7	18.9	18.7	22.3	24.1	24.7	29.8	28.2
	Short Term Debt (% GDP)	2.6	2.6	2.7	2.6	2.6	3.1	3.7	4.4	6.1	5.3
	Long Term Debt (% GDP)	18.9	17.3	15.0	16.3	16.1	19.2	20.4	20.3	23.7	22.9
Thailand * *WB, ASF calculations*	Gross External Debt (% GDP)	31.8	29.5	28.8	25.0	23.9	28.6	31.5	30.3	35.7	34.7
	Short Term Debt (% GDP)	7.1	9.1	8.6	7.4	7.5	11.3	14.7	13.0	15.6	14.9
	Long Term Debt (% GDP)	24.7	20.4	20.2	17.6	16.4	17.3	16.8	17.3	20.1	19.8
Turkey* *WB, ASF calculations*	Gross External Debt (% GDP)	41.1	35.3	39.2	38.7	38.5	43.8	39.9	39.3	42.9	45.3
	Short Term Debt (% GDP)	7.9	8.1	8.1	6.7	7.2	8.0	10.6	10.6	12.8	15.2
	Long Term Debt (% GDP)	33.2	27.2	31.2	32.0	31.3	35.8	29.3	28.7	30.1	30.1
Bulgaria* *WB, ASF calculations*	Gross External Debt (% GDP)	61.7	66.7	78.2	94.3	105.1	108.3	102.7	94.3	94.3	94.6
	Short Term Debt (% GDP)	12.0	16.9	23.3	30.5	36.5	34.7	31.1	26.3	26.1	24.4
	Long Term Debt (% GDP)	49.7	49.8	54.9	63.8	68.6	73.6	71.6	68.0	68.2	70.2

Fig.5 Gross External Debt (% of GDP) (II)

Country	Indicator	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Czech Rep.	Gross External Debt (% GDP)	36.2	40.1	39.9	43.1	48.5	51.4	56.3	59.7	62.0	71.0
ECB, ASF	Short Term Debt (% GDP)	12.3	11.8	9.9	11.6	12.6	11.7	11.8	13.4	11.9	14.3
calculations	Long Term Debt (% GDP)	23.9	28.3	30.0	31.4	35.9	39.7	44.5	46.3	50.1	56.7
Estonia	Gross External Debt (% GDP)	77.0	86.5	96.7	108.3	117.2	123.2	114.3	94.0	95.4	87.4
ECB, ASF	Short Term Debt (% GDP)	21.8	29.4	33.8	32.6	42.9	43.4	46.3	39.5	42.6	38.3
calculations	Long Term Debt (% GDP)	55.2	57.1	62.9	75.7	74.3	79.8	68.0	54.5	52.8	49.1
Croatia	Gross External Debt (% GDP)	69.3	72.0	74.6	77.3	85.1	100.7	103.7	103.4	102.2	104.9
ECB, ASF	Short Term Debt (% GDP)	8.0	9.4	11.1	7.7	12.9	11.3	13.9	15.4	11.3	12.1
calculations	Long Term Debt (% GDP)	61.3	62.6	63.5	69.6	72.2	89.4	89.8	88.0	90.9	92.8
Latvia	Gross External Debt (% GDP)	88.5	99.1	113.4	127.6	130.0	157.1	166.2	145.8	135.3	130.2
Calculations using	Short Term Debt (% GDP)	50.7	48.8	50.0	54.7	43.5	38.7	53.2	45.6	49.5	53.7
national data	Long Term Debt (% GDP)	37.8	50.3	63.4	72.9	86.5	118.4	113.0	100.2	85.8	76.6
Lithuania	Gross External Debt (% GDP)	42.1	50.5	59.9	71.5	71.0	83.9	82.9	77.4	75.4	67.2
ECB, ASF	Short Term Debt (% GDP)	15.2	19.6	17.9	18.4	17.8	15.6	15.2	13.8	14.4	12.8
calculations	Long Term Debt (% GDP)	26.9	30.9	42.0	53.1	53.2	68.3	67.7	63.7	61.0	54.4
Hungary	Gross External Debt (% GDP)	71.2	82.4	92.4	105.4	123.2	144.9	145.5	150.0	129.7	118.7
ECB, ASF	Short Term Debt (% GDP)	15.3	17.7	19.1	22.7	18.6	21.4	25.5	24.8	17.8	17.0
calculations	Long Term Debt (% GDP)	55.9	64.7	73.3	82.7	104.6	123.5	120.0	125.2	111.9	101.7
Poland	Gross External Debt (% GDP)	42.0	44.1	46.6	48.4	56.8	59.4	66.4	72.3	71.1	70.0
ECB, ASF	Short Term Debt (% GDP)	8.9	9.4	9.6	13.3	12.9	15.6	16.3	15.0	14.0	14.1
calculations	Long Term Debt (% GDP)	33.1	34.7	37.0	35.1	43.9	43.8	50.1	57.3	57.1	55.9
Romania	Gross External Debt (% GDP)	34.5	39.3	40.4	50.9	56.0	68.5	75.6	76.5	75.2	68.5
Calculations using	Short Term Debt (% GDP)	5.1	8.0	12.3	17.3	15.9	13.2	16.0	17.7	15.8	13.8
national data	Long Term Debt (% GDP)	29.4	31.3	28.1	33.6	40.1	55.3	59.6	58.8	59.4	54.7
Slovenia*	Gross External Debt (% GDP)	56.4	71.3	77.5	100.6	105.3	113.8	114.8	110.9	115.7	113.8
ECB, ASF	Short Term Debt (% GDP)	9.8	15.8	16.8	31.0	31.1	27.2	23.8	23.1	29.4	25.0
calculations	Long Term Debt (% GDP)	46.6	55.5	60.7	69.6	74.2	86.6	91.0	87.8	86.3	88.8
Slovak Republic	Gross External Debt (% GDP)	51.3	59.6	55.0	54.9	58.6	74.1	75.7	78.0	76.1	82.8
ECB, ASF	Short Term Debt (% GDP)	18.8	28.3	19.0	21.5	22.4	41.3	41.2	41.1	30.0	25.7
calculations	Long Term Debt (% GDP)	32.5	31.3	36.0	33.4	36.2	32.8	34.5	36.9	46.1	57.1

*Source: European Central Bank, World Bank, Eurostat, Central Banks, ASF calculations, *2013 Q3 data*

Fig.6 Bond yields

Country	Maturity	Nov-13	Dec-13	Jan-2014	Feb-14	Mar-14	Apr-14
Romania	1y	3.25	3.10	3.00	3.24	3.48	2.96
%Δ (month-to-month)		-14%	-5%	-3%	8%	7%	-16%
Poland	1y	2.64	2.43	2.73	2.86	2.82	2.74
%Δ (month-to-month)		-2%	-8%	11%	5%	-2%	-3%
Hungary	1y	3.41	3.25	3.14	3.50	3.36	3.14
%Δ (month-to-month)		-7%	-5%	-3%	11%	-4%	-7%
Czech Republic	2y	0.23	0.12	0.19	0.43	0.78	0.34
%Δ (month-to-month)		-29%	-67%	46%	85%	59%	-83%
Slovakia	2y	0.74	0.74	0.87	0.62	0.53	0.50
%Δ (month-to-month)		0%	0%	17%	-34%	-16%	-5%
Bulgaria	1y	0.46	0.57	0.70	0.90	0.80	0.68
%Δ (month-to-month)		-14%	20%	21%	25%	-12%	-16%
Latvia	1y	0.40	0.38	0.44	0.60	0.53	0.55
%Δ (month-to-month)		-5%	-5%	15%	31%	-13%	4%
Lithuania	1y	0.50	0.50	0.50	0.50	0.60	0.60
%Δ (month-to-month)		-18%	0%	0%	0%	18%	0%

Short-term (1-year and 2-year) government bonds: yield-to-redemption (%) and month-to-month change in yield-to-redemption, Datastream Bond Index. *Source: Thomson-Reuters Datastream, own calculations*

Fig.7 CDS

Country	Nov-13	Dec-13	Jan-2014	Feb-14	Mar-14	Apr-14
Romania	165.29	170.08	163.10	161.99	153.84	154.43
%Δ (month-to-month)	-1%	3%	-4%	-1%	-5%	0%
Czech Republic	54.00	54.79	53.88	53.47	53.14	52.56
%Δ (month-to-month)	-2%	2%	-2%	-1%	-1%	-1%
Poland	76.32	73.16	69.17	71.74	69.30	63.75
%Δ (month-to-month)	0%	-4%	-6%	4%	-4%	-8%
Slovenia	280.25	229.01	197.43	192.66	167.21	142.55
%Δ (month-to-month)	-8%	-20%	-15%	-2%	-14%	-16%
Lithuania	58.51	57.31	58.06	60.79	59.85	58.78
%Δ (month-to-month)	3%	-2%	1%	5%	-2%	-2%
Latvia	107.58	108.63	109.55	114.47	111.08	112.47
%Δ (month-to-month)	3%	1%	1%	4%	-3%	1%
Estonia	108.36	104.71	103.46	106.17	109.04	112.18
%Δ (month-to-month)	-3%	-3%	-1%	3%	3%	3%
Bulgaria	107.97	106.67	106.32	108.11	112.41	116.69
%Δ (month-to-month)	-3%	-1%	0%	2%	4%	4%

CDS Senior CR 5 year EURO: spread (mid, basis points) and month-to-month change in spread (mid), monthly data, Thomson Reuters Datastream. *Source: Thomson-Reuters Datastream, own calculations*

Fig.8 Equity index returns

	Bulgaria *)	Czech Republic *)	Hungary *)	Poland *)	Romania *)	Slovenia *)	Lithuania 1)	Latvia 2)	Estonia 3)
Currency	BL	CK	HF	PZ	RL	Euro	Euro	Euro	Euro
Jan-13	2.39%	3.49%	-0.76%	5.59%	4.72%	8.24%	1.51%	1.87%	7.19%
Feb-13	6.28%	-5.51%	6.43%	-1.16%	-0.74%	3.57%	5.05%	1.07%	5.31%
Mar-13	-1.85%	0.00%	-3.08%	-0.40%	0.78%	-4.16%	-1.66%	0.57%	-1.15%
Apr-13	0.16%	-2.26%	-4.59%	-1.76%	1.02%	-6.08%	6.92%	4.22%	9.08%
May-13	4.01%	-2.73%	2.33%	-1.87%	-1.69%	5.20%	0.63%	-3.10%	-0.99%
Jun-13	-0.92%	-0.23%	0.75%	7.31%	-2.04%	0.30%	0.91%	2.63%	-1.00%
Jul-13	5.10%	-7.64%	-0.15%	-5.47%	-1.86%	0.12%	1.58%	4.91%	-0.64%
Aug-13	1.81%	2.48%	-2.26%	5.24%	2.81%	4.80%	1.30%	6.34%	3.22%
Sep-13	-0.42%	-0.33%	-1.10%	3.48%	3.86%	-2.16%	0.38%	-3.56%	-0.95%
Oct-13	5.08%	7.25%	3.12%	2.55%	3.13%	-1.62%	1.91%	1.28%	0.13%
Nov-13	-0.46%	6.56%	0.62%	4.53%	1.91%	3.08%	-1.03%	-2.92%	1.03%
Dec-13	-5.15%	-0.24%	-0.44%	0.19%	4.38%	0.29%	-1.29%	2.10%	-0.47%
Jan-14	5.74%	-3.31%	-0.56%	-5.26%	1.49%	2.56%	2.47%	1.50%	-2.81%
Feb-14	6.49%	-0.53%	-0.14%	-0.19%	0.45%	6.05%	7.04%	4.26%	2.03%
Mar-14	6.02%	3.46%	-6.83%	0.99%	-5.57%	2.09%	-2.61%	-6.69%	-3.30%
Apr-14	0.72%	5.19%	2.39%	3.88%	0.89%	2.79%	2.69%	-6.46%	-1.13%

Equity index returns

*) Thomson Reuters Datastream 1) OMX Vilnius, 2) OMX Riga, 3) OMX Tallinn

Fig.9 Exchange rates

	Romania			Czech Republic			Hungary			Poland			Eurozone		
	EURRON		% change	EURCZK		% change	EURHUF		% change	EURPLN		% change	EURUSD		% change
Jan-13	4.45			25.10			291.21			4.08			1.32		
Feb-13	4.37	↓	-1.7%	25.68	↑	2.3%	291.52	↑	0.1%	4.17	↑	2.1%	1.37	↑	3.8%
Mar-13	4.36	↓	-0.2%	25.67	↓	0.0%	294.57	↑	1.0%	4.13	↓	-0.8%	1.30	↓	-5.3%
Apr-13	4.42	↑	1.3%	25.75	↑	0.3%	303.53	↑	3.0%	4.18	↑	1.1%	1.28	↓	-1.1%
May-13	4.32	↓	-2.2%	25.70	↓	-0.2%	298.80	↓	-1.6%	4.17	↓	-0.2%	1.32	↑	2.7%
Jun-13	4.42	↑	2.2%	25.76	↑	0.2%	293.39	↓	-1.8%	4.26	↑	2.1%	1.30	↓	-1.2%
Jul-13	4.45	↑	0.7%	26.02	↑	1.0%	294.26	↑	0.3%	4.33	↑	1.7%	1.30	→	0.0%
Aug-13	4.42	↓	-0.7%	25.97	↓	-0.2%	300.18	↑	2.0%	4.26	↓	-1.7%	1.32	↑	1.5%
Sep-13	4.42	→	0.0%	25.68	↓	-1.1%	300.54	↑	0.1%	4.25	↓	-0.1%	1.32	↓	-0.3%
Oct-13	4.45	↑	0.6%	25.65	↓	-0.1%	296.09	↓	-1.5%	4.22	↓	-0.9%	1.35	↑	2.5%
Nov-13	4.45	↓	0.0%	25.87	↑	0.8%	297.38	↑	0.4%	4.20	↓	-0.4%	1.35	↓	-0.3%
Dec-13	4.43	↓	-0.2%	27.44	↑	5.9%	303.67	↑	2.1%	4.20	→	0.1%	1.36	↑	0.5%
Jan-14	4.46	↑	0.7%	27.37	↓	-0.3%	297.08	↓	-2.2%	4.16	↓	-1.0%	1.38	↑	1.6%
Feb-14	4.49	↑	0.5%	27.58	↑	0.7%	312.03	↑	4.9%	4.24	↑	1.9%	1.35	↓	-1.9%
Mar-14	4.52	↑	0.6%	27.35	↓	-0.8%	313.09	↑	0.3%	4.20	↓	-0.9%	1.38	↑	1.9%
Apr-14	4.46	↓	-1.2%	27.48	↑	0.5%	307.42	↓	-1.8%	4.18	↓	-0.5%	1.38	↑	0.2%

Bulgaria EURBGN = 1.96
Lithuania EURLTL = 3.45

Fig.10 Systemic risk

Region/Country		Systemic risk (%)	Systemic risk due to CHF loans (%)	Systemic risk due to other FCY loans (%)
Non-Euro area	Latvia	44.3	NA	NA
	Croatia	36.7	4.4	32.3
	Serbia	31.8	1.9	29.8
	Romania	29.6	2.3	27.3
	Bulgaria	26.6	0.0	26.6
	Hungary	21.1	3.7	17.4
	Poland	14.3	NA	NA
	Czech Republic	3.5	-0.2	3.7
	UK	-0.1	0.0	0.0
Euro area	Slovenia	3.1	3.1	0.1
	Austria	2.2	0.8	1.3
	Greece	1.6	-0.4	2.0
	Slovakia	1.1	NA	NA
	Germany	0.6	-0.1	0.7
	Luxembourg	0.2	-0.7	1.0
	Italy	0.1	0.0	0.1
	France	-0.8	NA	NA

Source: Pinar Yeşin, Foreign-currency loans and systemic risk in Europe, 26 Nov 2013, www.voxeu.org

4. Europe: the return of geopolitics (II)

- The Ukraine crisis: it may dent economic growth prospects by 0.2-0.3% of GDP in CEEs (the cost of uncertainty, geographic proximity, resource reallocation, supply security, etc)
- The geopolitical relevance of the eurozone
- Being in the eurozone is a strategic choice in geopolitical terms too (Baltic countries)
- How to reconcile the economic rationale with geopolitical motives in joining the eurozone
- The Banking Union as a prelude to joining the eurozone
- Romania and Bulgaria need to get into the Schengen area and get their economies stronger

4. Europe: developments in the eurozone(III)

- The eurozone is no longer threatened by its collapse following the ECB's firm actions and correction of imbalances in member countries; but…
- There is threat of debt deflation in not a few economies (inflation has been coming down steadily at 0.5% currently)
- Huge unemployment against the backdrop of very low economic growth
- Hardly any break up of the link between sovereign debt and bank balance-sheets, while the Banking Union is lacking a solid financial underpinning
- Internal demand is very weak suffering from the negative loops between weak activity, weak banks, weak firms, diminished incomes, and the need for fiscal consolidation
- The elections for the EP will be a harbinger of what could happen in politics (populism, rejection of deeper integration, blocking of decision-making, etc)
- Political instability is a key issue in some countries; secessionist movements can bring about huge difficulties

5. What should EMs do? (I)

- Continue to improve macroeconomic fundamentals, although this is a tall order when the international environment is not favorable
- Create fiscal space and buffers; the *policy space* issue
- Structural reforms which should mobilize internal reserves and achieve efficiency gains, inclusive institutions (fairness as an issue) (Acemoglu and Robinson, Dani Rodrik)
- Pay attention to macro-prudential policies; but these are pretty untested…
- Linkages between financial markets and the international context from the perspective of undertaking effective macro-prudential policies ("having a large and liquid market can be a mixed blessing when a country is exposed to financial shocks coming from beyond its borders"/ B. Eichengreen and Poonam Gupta)
- The critical role an effective international policy regime plays in mitigating the destabilizing impact of capital flows (we need a new Bretton Woods!)
- Consider financial/monetary lifelines; the role of regional monetary arrangements (Asia, Europe)

5. What should EMs, CEEs do?(II)

- New institutional and policy arrangements in the EU, in the eurozone, are critical: the Banking Union/ the financial backstop; macroeconomic management at the eurozone (EU) level/a *fiscal capacity* –Europe needs its own Bretton Woods

- Combat debt deflation (lowflation)

- EU funds absorption as a modernization and a growth enhancing weapon

- A more robust economic growth model: more reliance on domestic savings; enhance tradables; mitigate the pains of bank lending retrenchment (the Vienna 2 Initiative; develop alternatives to bank lending)

6. We need a functional *international policy regime*

- Correct major currency misalignments
- Mitigate the impact of volatile capital flows
- Major central banks’ role in producing externalities
- The privileged status of economies that provide reserve currencies

A radical reform of finance is badly needed

(De Larosiere, Liikanen, Turner, Vickers, Tyrie reports)

- Glass Steagal, Volcker rule type measures
- Downsize finance
- Taming finance is a must for having financial stability