

# ***THE WORLD AFTER THE CRISIS: SEE CHALLENGES & PROSPECTS***

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# ***THE WORLD AFTER THE CRISIS: SEE CHALLENGES & PROSPECTS***

## **MAIN THEMES**

- I. THE GLOBAL VIEW ON THE CRISIS**
- II. THE FUTURE OF THE GLOBAL ECONOMY**
- III. THE REGIONAL VIEW ON THE CRISIS**
- IV. A MORE BALANCED-GROWTH MODEL  
FOR THE SEEs**
- V. CONCLUSION**

# I.

## THE GLOBAL VIEW ON THE CRISIS

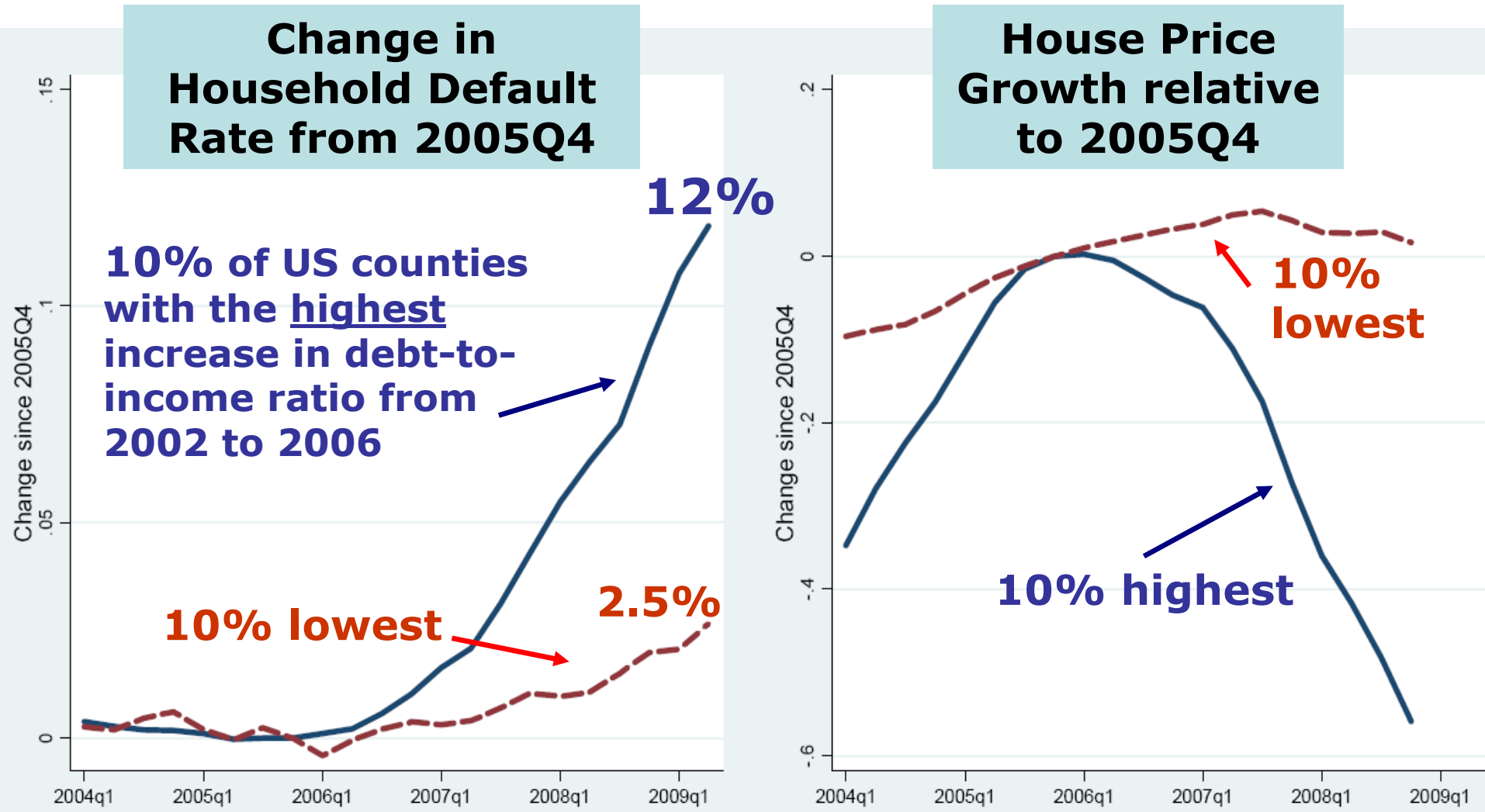
1. *Underlying causes*
2. *Effects on the global economy*
3. *The recovery*

✓ The crisis is already 28 months old

✓ Many underlying causes:

- 1) **Large global imbalances** ⇒ cheap money or liquidity from surplus countries channeled mainly to US
- 2) **Housing bubbles & the subprime explosion** without adequate bank controls on credit risk, e.g. interest rate only loans, etc.
- 3) **Securitization** and its new complicated and non-transparent layers in CDOs, CDOs squared, together with new private players outside the reach of Fannie Mae and Freddie Mac
- 4) “**Greed**,” i.e. the quest for yield with a simultaneous underestimation of risk, that is, the opposite of the “*Peso Problem*”. This is a recurrent feature of crises and endemic to capitalism
- 5) **Lax regulation** – Abolition of Glass-Steagall Act in 1999, new lenient SEC leverage ratios on investment banks, regulatory arbitrage and SPVs
- 6) **Perverted incentives** by Rating Agencies, corporate managers, etc.
- 7) **New equity culture** in traditional banking based on up-front fee generation
- 8) **Enormous Leverage** based on **short-term** borrowing by FI investing on their own account. This factor is very important in **spreading the crisis**.

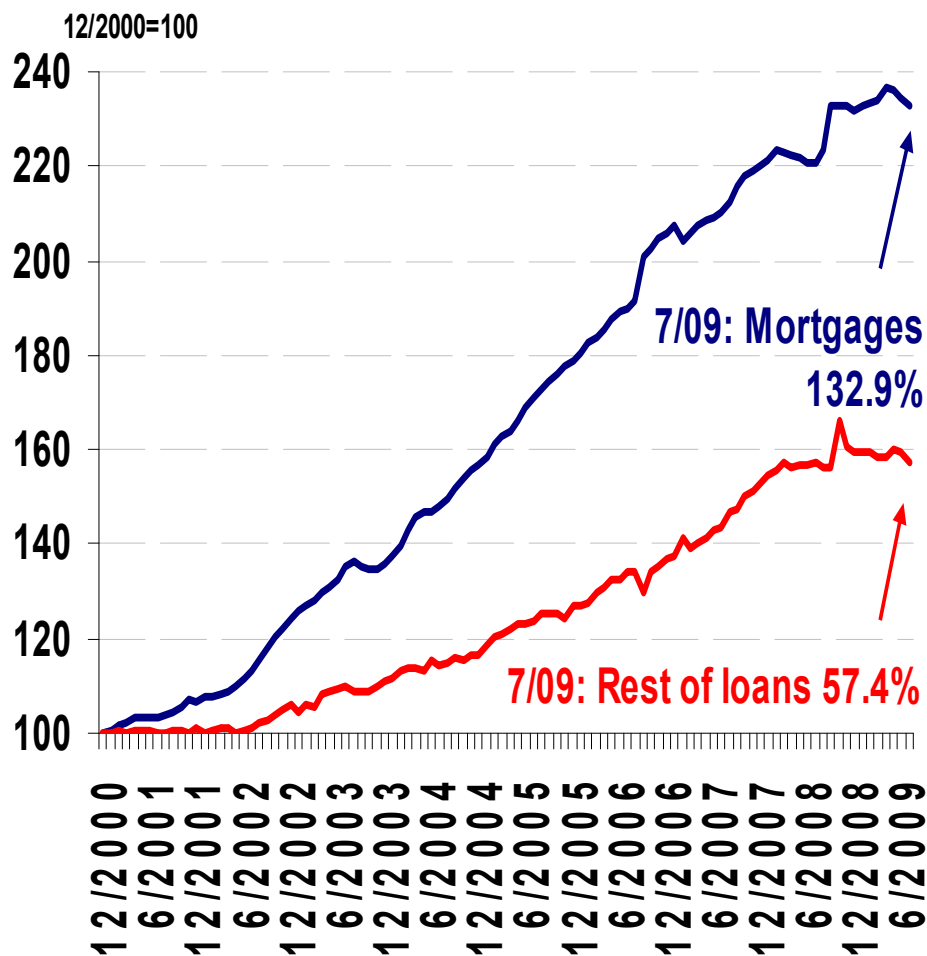
# I.1 The key role of household leverage: A cross-county analysis in the US



Source: *Mian & Soufi*, Un. of Chicago, August 2009

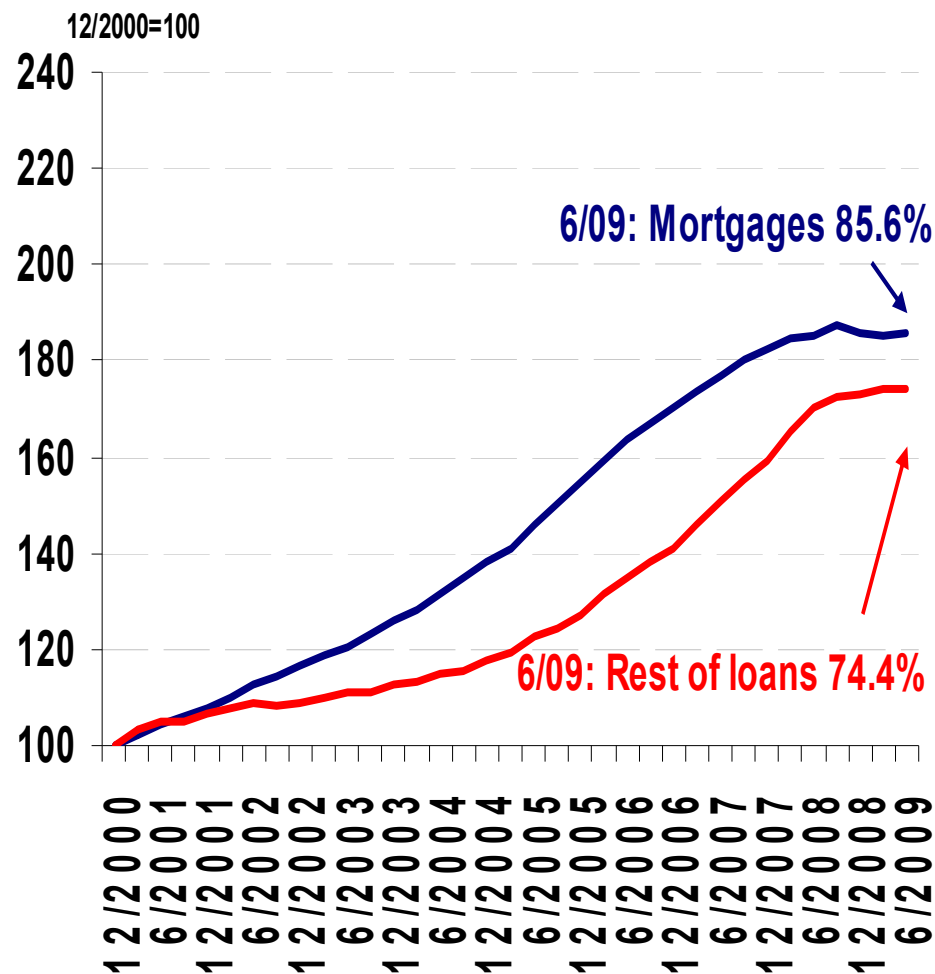
# I.1 Rapid rise in credit expansion

## USA



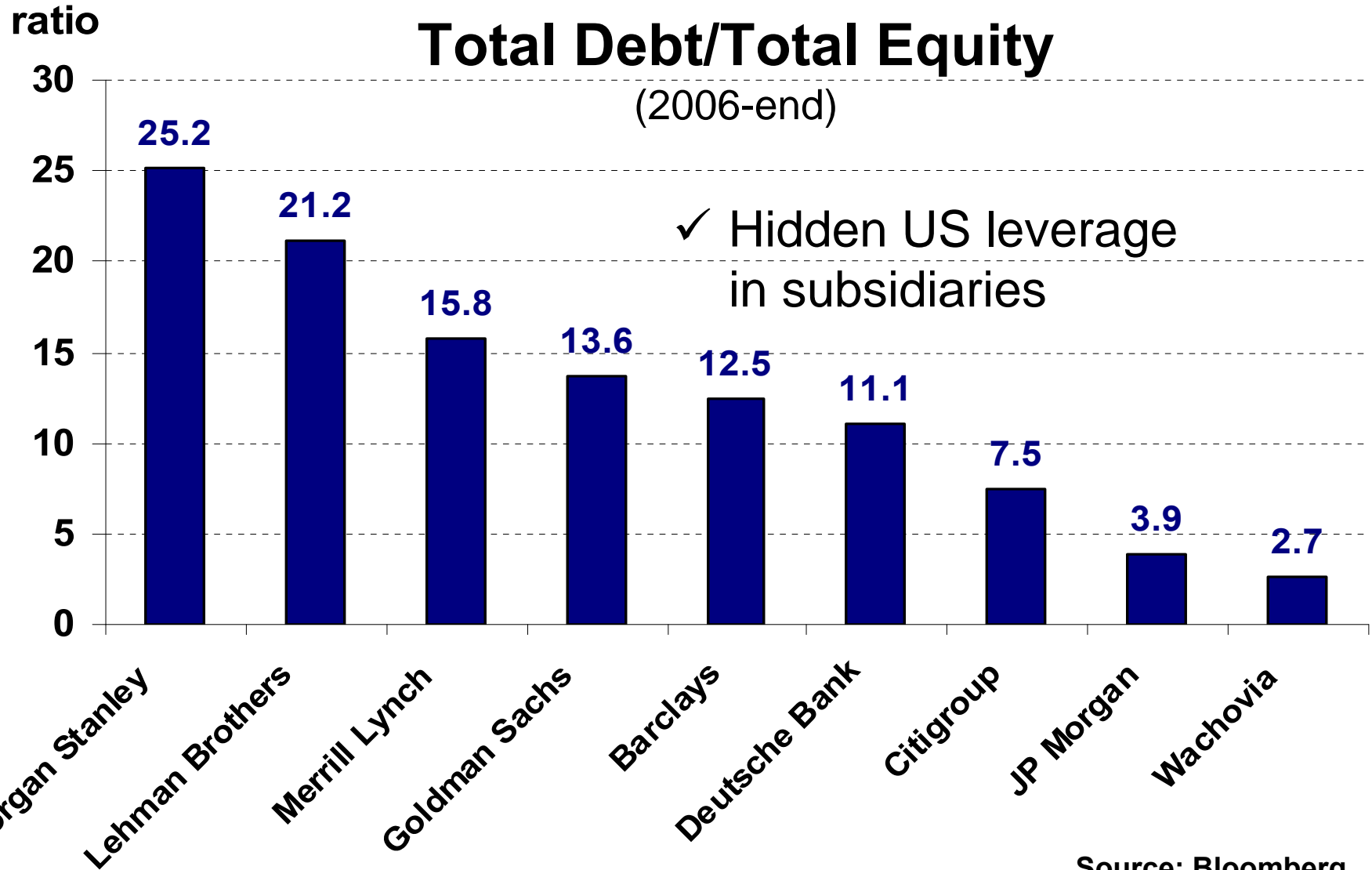
Source: Federal Reserve

## EURO AREA



Source: ECB

# I.1 Enormous gearing ratios by Financial intermediaries

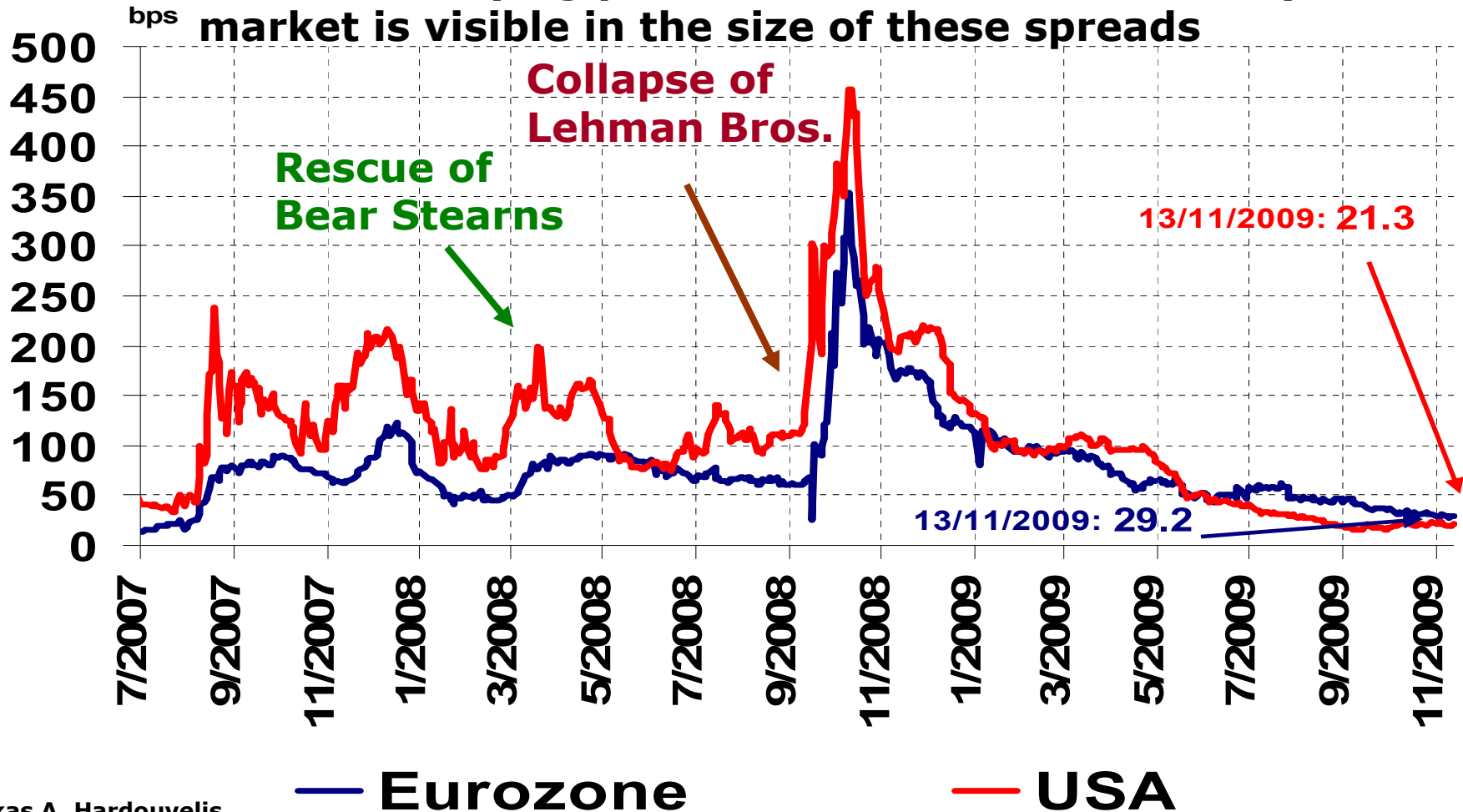


Source: Bloomberg

# I.2 It began as a financial crisis in July 2007 ...

- ✓ US TED spread, 3m Eurodollar - 3m Tbill, points to an increase in default premia and a flight to quality
- ✓ Same is true in the Euro Area (3m Euribor – 3m Euro Area Tbills)

**The time-varying pressure and fear in the money market is visible in the size of these spreads**

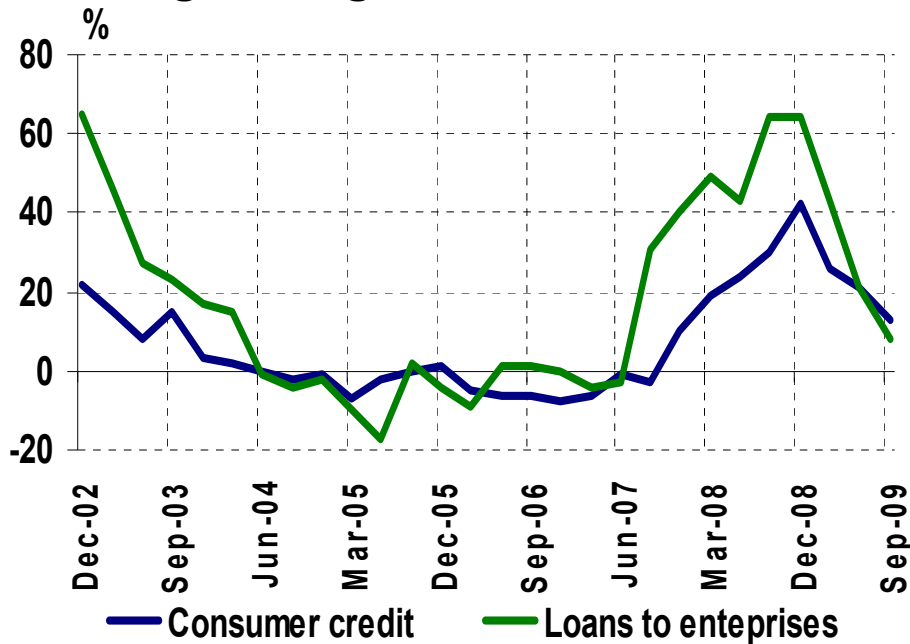




# I.2 Illiquidity & Insolvency ⇒ de-leveraging ⇒ tightening of credit standards

## Euro Area

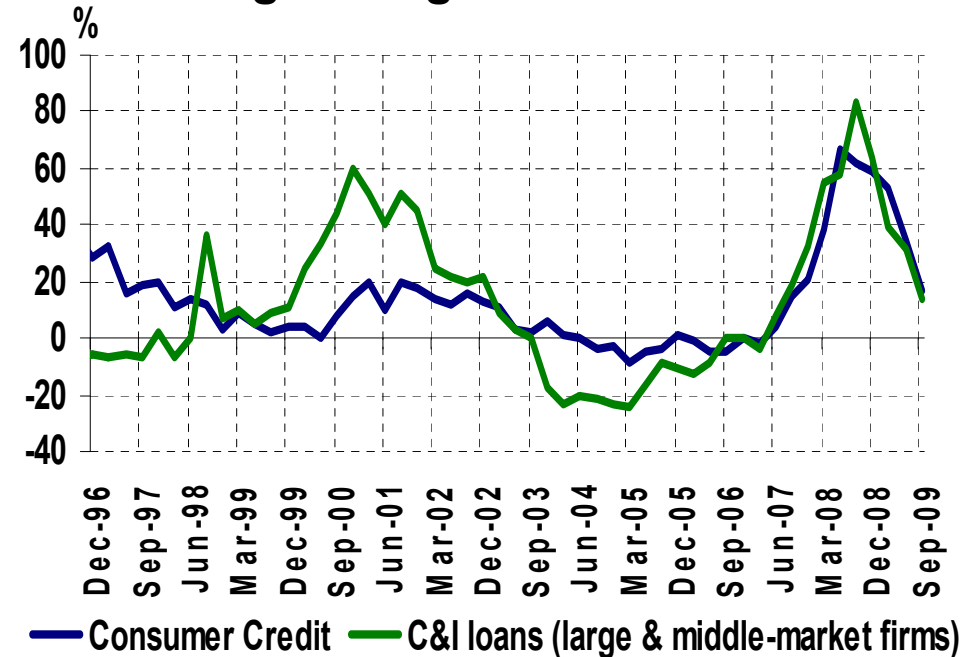
Net percentage of banks reporting a tightening of credit standards



Source: ECB, The Euro Area Bank Lending Survey, September 2009

## USA

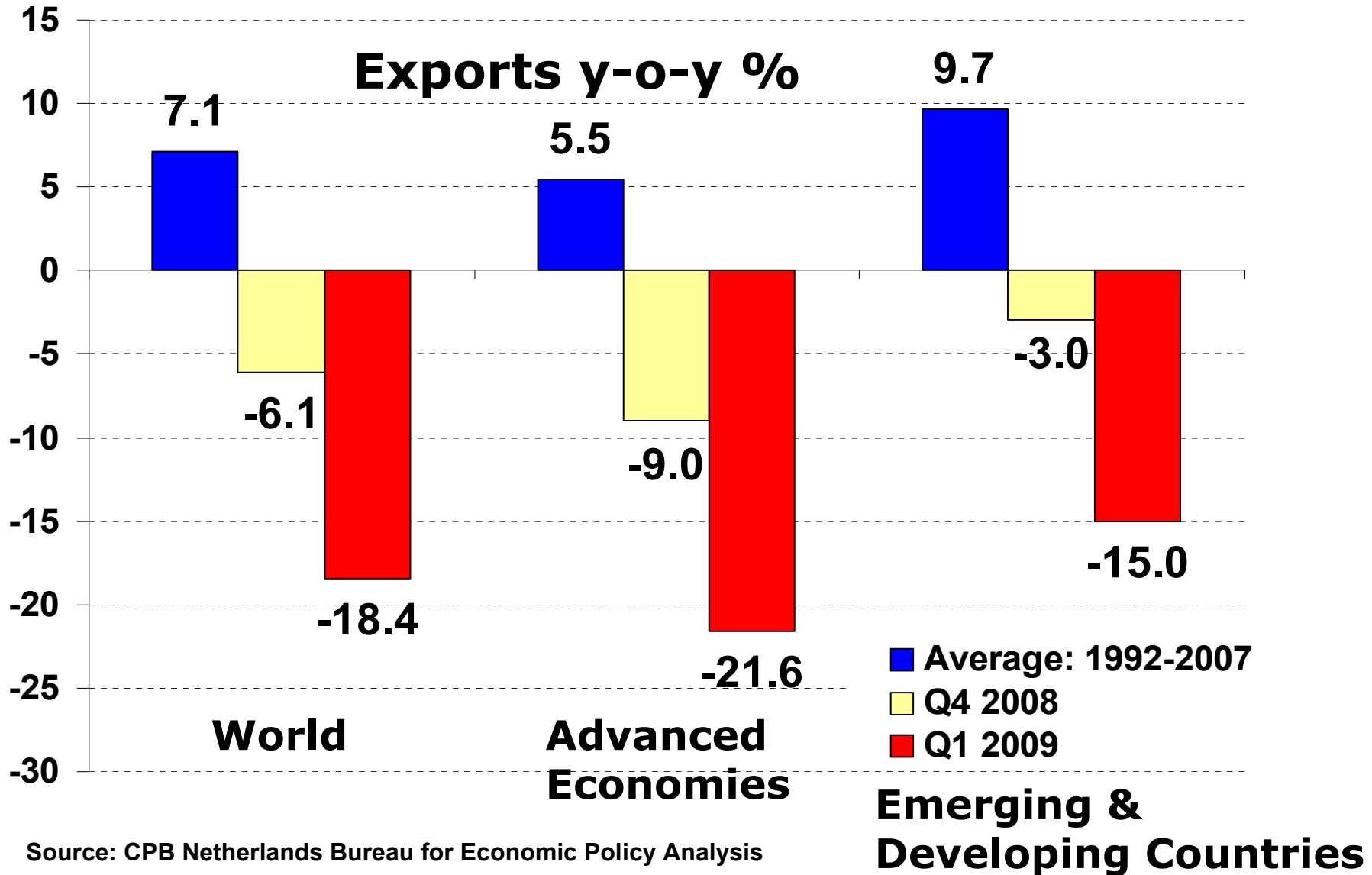
Net percentage of banks reporting a tightening of credit standards



Source: Federal Reserve, The Senior Loan Officer Opinion Survey on Bank Lending Practices, September 2009

- ✓ *The results of the September 2009 bank lending surveys in the US and the EA indicate a declining trend in the net tightening of credit standards for loans to enterprises in Q3 09 compared to the previous quarter.*

# I.2 Trade collapsed in 2008:Q4



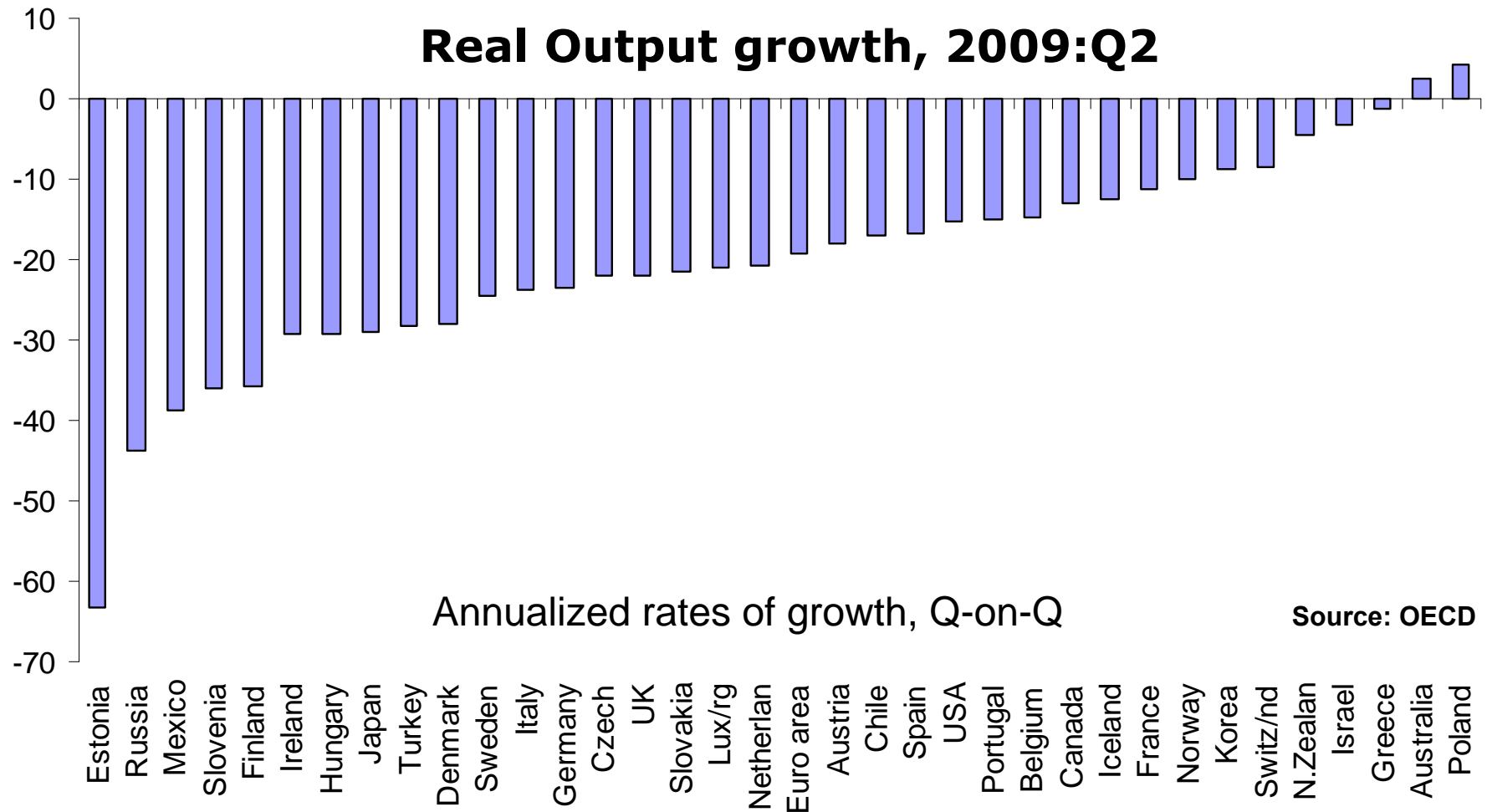
# I.2 ... and turned into the Great Global Recession in late 2008



Source: IMF, World Bank

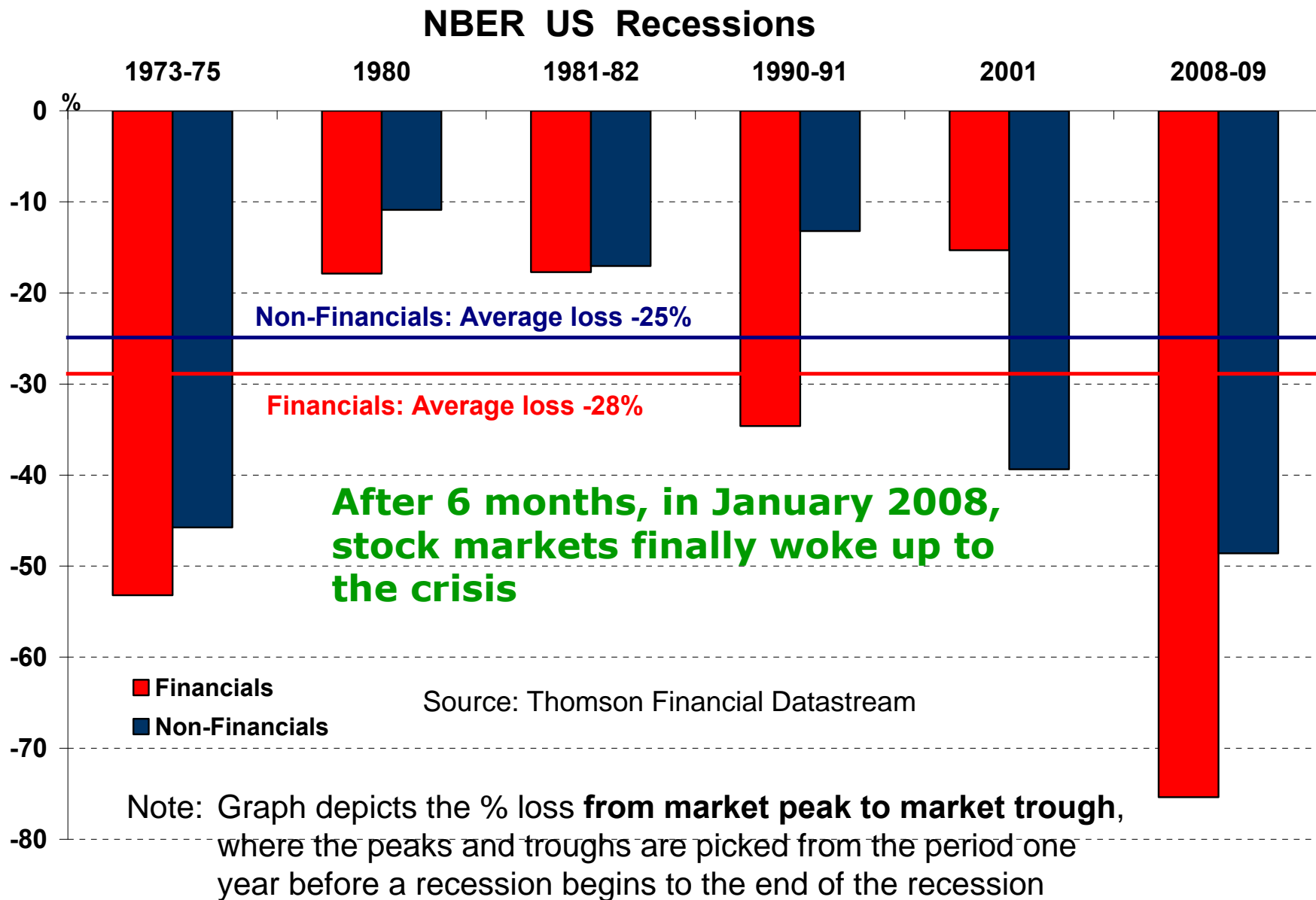
- ✓ Year 2009 is the first year of negative global economic growth since the Great Depression

# I.2 ... affecting all countries, as decoupling from the US proved to be a myth

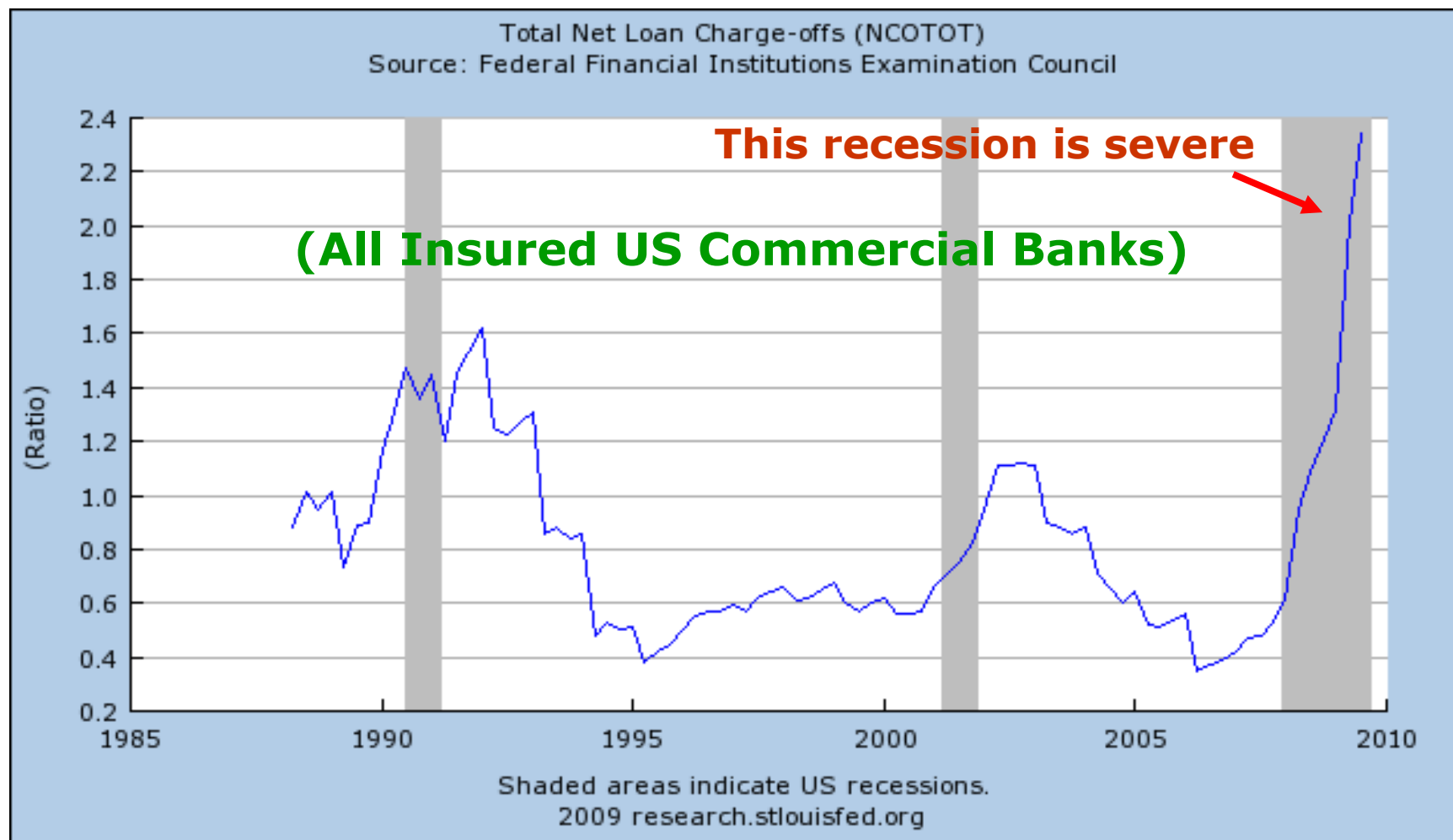


- ✓ The great fall in international trade & output began in 2008:Q4 and continued into 2009:Q2
- ✓ Rates of growth declined almost everywhere, even in China

# I.2 US: Financials vs. Non-Financials



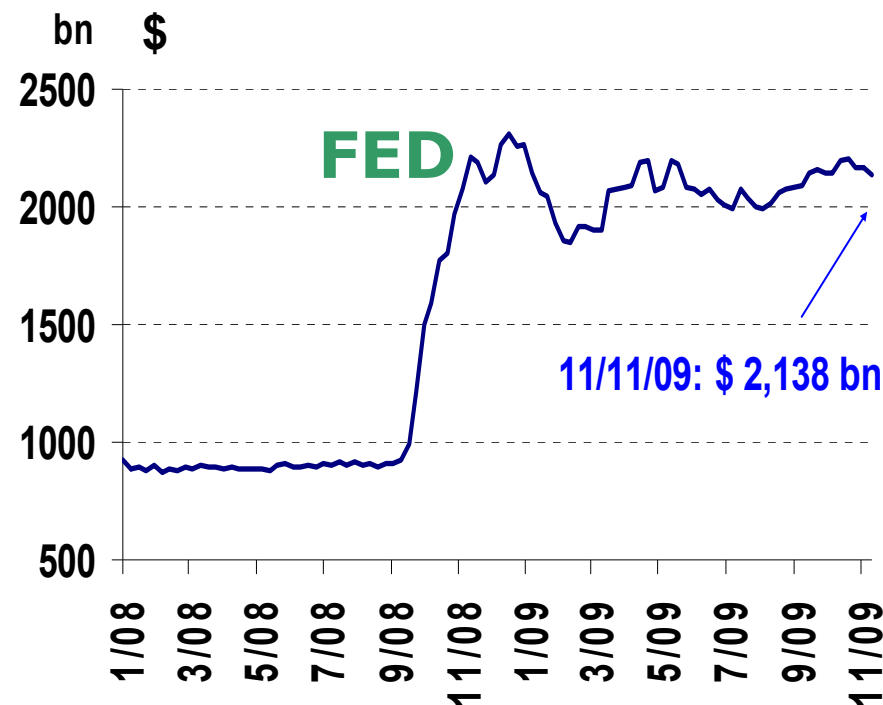
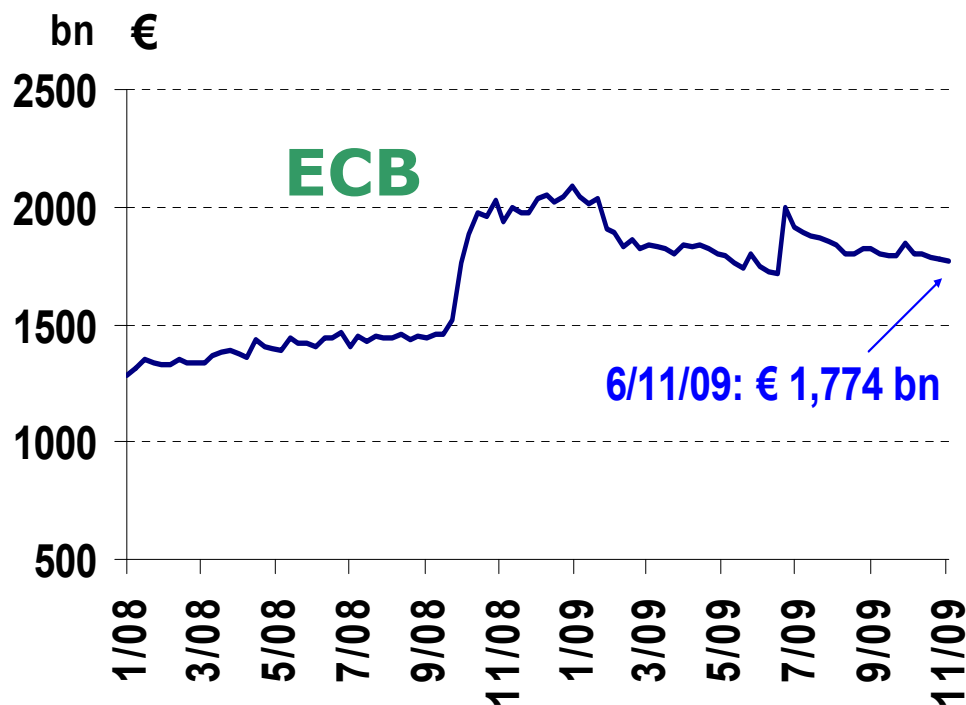
# I.2 US: Total Net Loan Charge-offs



Note: Graph depicts the loans charged off, defined as loan losses divided by total loans (annualized quarterly data for all US banks). Charge-offs are measured on a net basis, i.e. loan losses minus recoveries on loans previously charged off.

# I.2 Aggressive response by central banks

## Central bank balance sheets

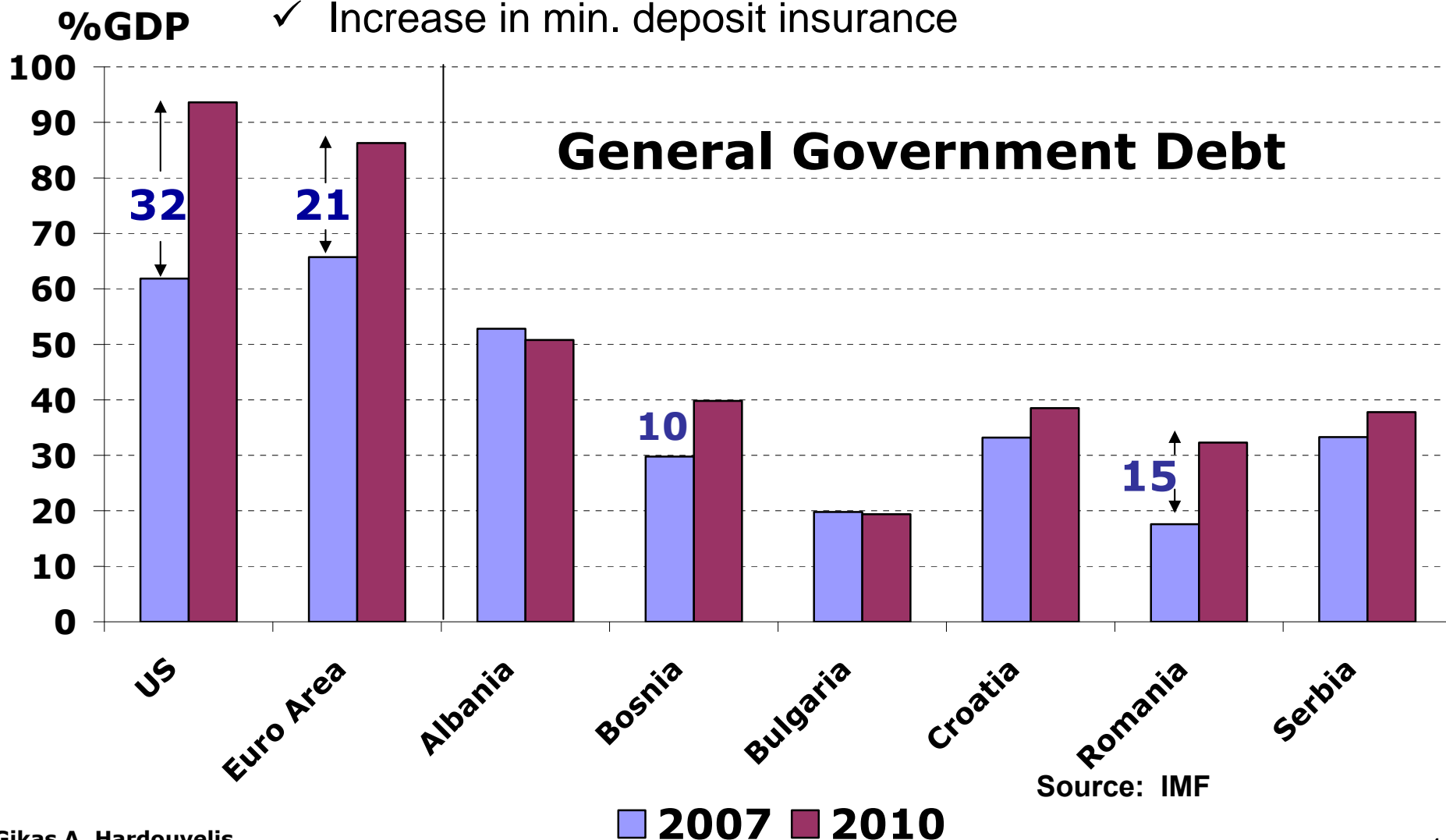


Source: ECB, Federal Reserve

- ✓ Central banks decreased their intervention rates, and pioneered new ways to provide liquidity, especially post-Lehman (quantitative & qualitative easing)
- ✓ Fed was the most aggressive of all, bringing interest rates to zero and more than doubling its own balance sheet

# I.2 Aggressive response by governments

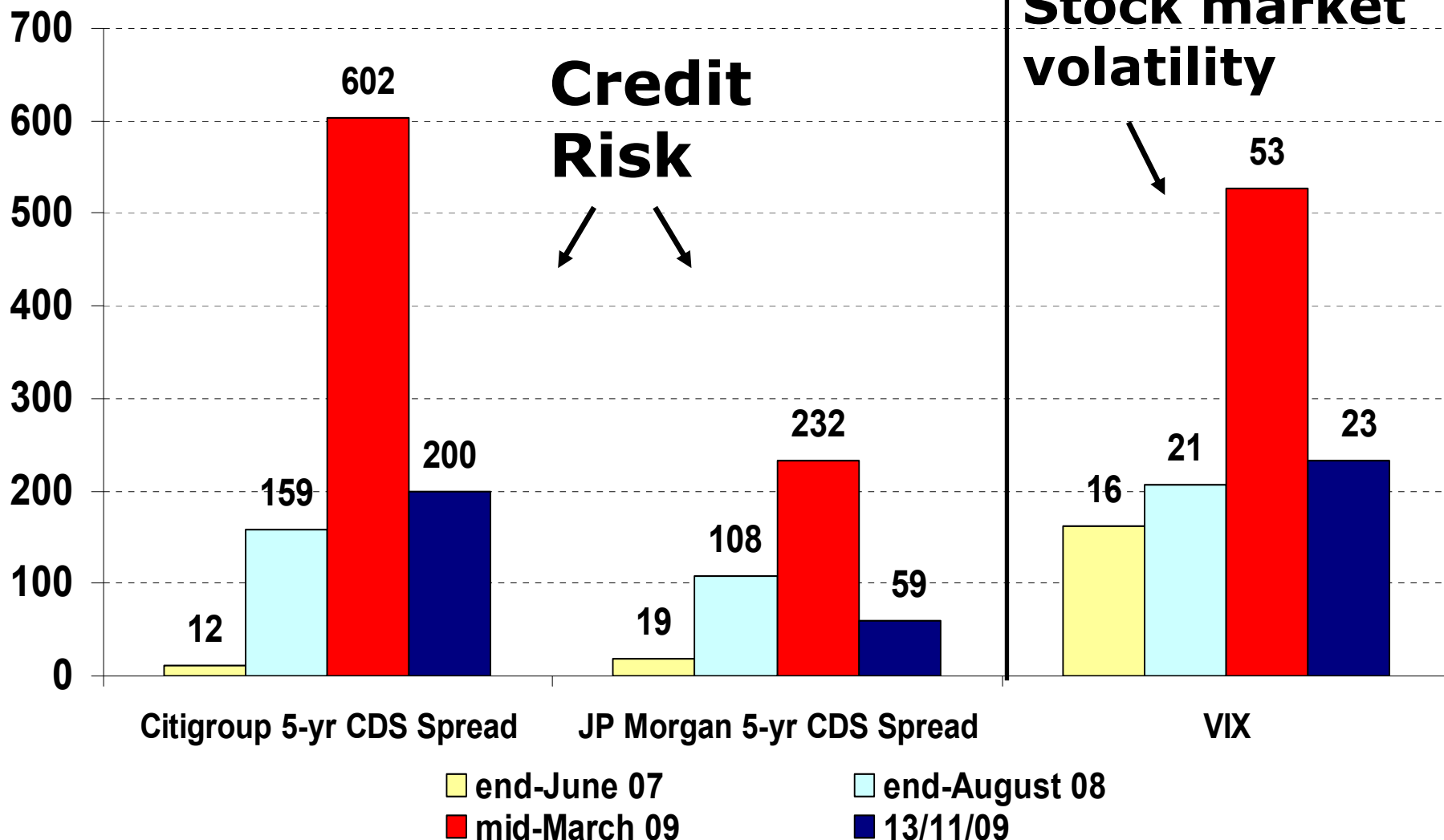
- ✓ Expansionary fiscal policies, especially in the US
- ✓ Rescue packages for banks
- ✓ Increase in min. deposit insurance





# I.3

## Is the crisis over? Risk aversion down but not at 2007 pre-crisis levels



## I.3 Recession is ending

- ✓ **Different views on the robustness of recovery, yet ...**
- ✓ **Worries of a W-shape recession seem to subside**

### OECD Real GDP Quarterly Projections (2009)

	Q1 09	Q2 09	Q3 09f	Q4 09f
<b>US</b>	-6.4	-0.7	1.6	2.4
<b>Eurozone</b>	-10.0	-0.4	0.3	2.0
<b>Germany</b>	-14.0	1.2	4.2	1.8
<b>France</b>	-5.6	1.2	1.6	1.9
<b>Japan</b>	-13.2	2.4	1.1	-0.9
<b>UK</b>	-9.6	-2.8	-1.0	0.0
<b>Canada</b>	-6.1	-3.2	-2.0	0.4

*Source: OECD quarter-on-quarter annualized GDP forecasts*

### Real GDP growth

	<b>2008</b>	<b>2009f</b>	<b>2010f</b>
<b>USA</b>	<b>0.4</b>	<b>-2.4</b>	<b>2.8</b>
<b>Euro Area</b>	<b>0.6</b>	<b>-3.8</b>	<b>1.5</b>
<b>Japan</b>	<b>-0.7</b>	<b>-5.5</b>	<b>1.4</b>
<b>China</b>	<b>9.0</b>	<b>8.5</b>	<b>9.5</b>
<b>Brazil</b>	<b>5.1</b>	<b>0.0</b>	<b>4.0</b>
<b>Russia</b>	<b>5.6</b>	<b>-7.5</b>	<b>3.0</b>
<b>India</b>	<b>7.5</b>	<b>5.8</b>	<b>7.5</b>

Source: EFG Research

- ✓ Recovery depends on central banks maintaining liquidity and governments maintaining fiscal stimulus
- ✓ Europe is lagging behind the US

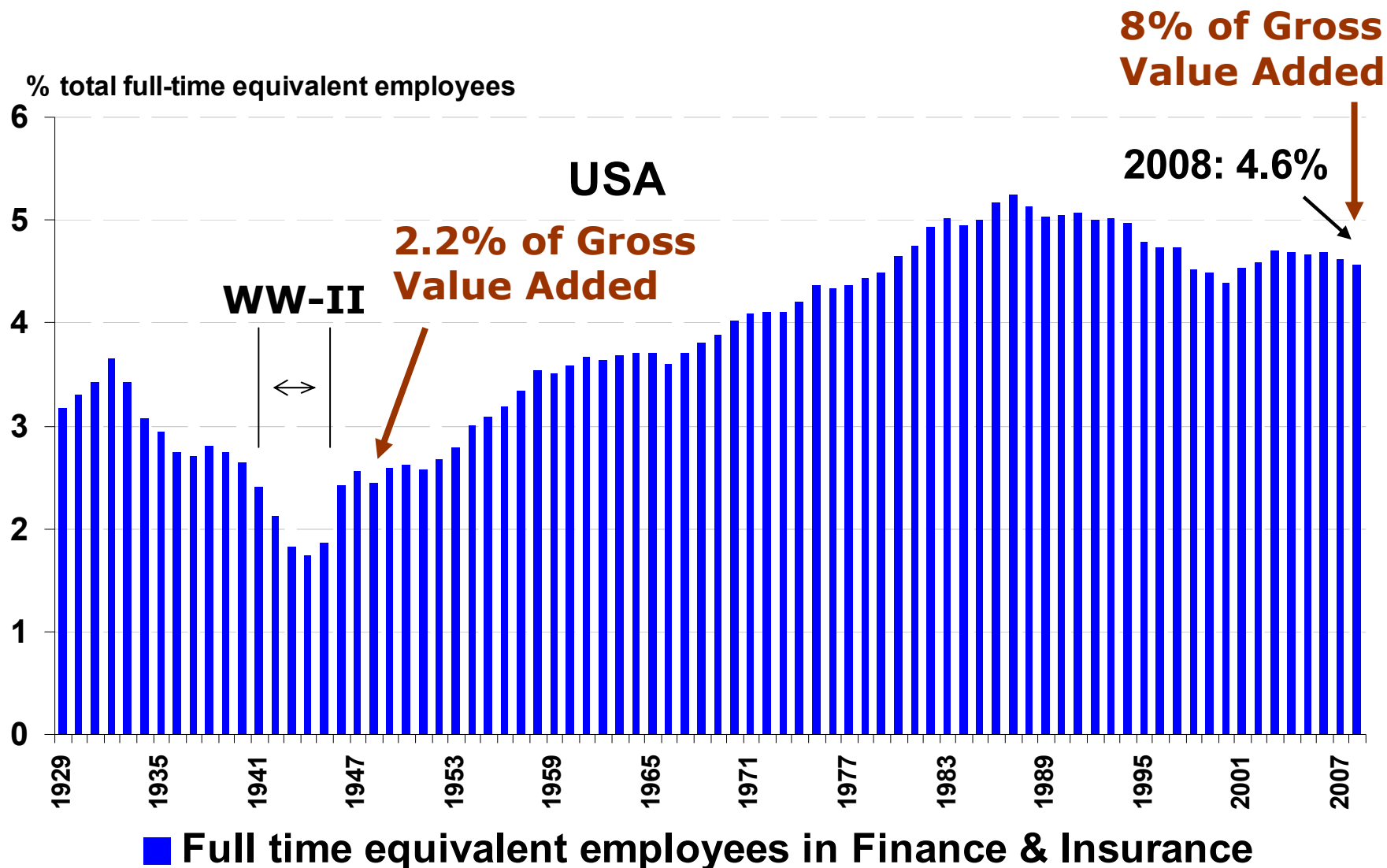
## II.

# THE FUTURE OF THE GLOBAL ECONOMY

*The crisis will leave its permanent imprints*

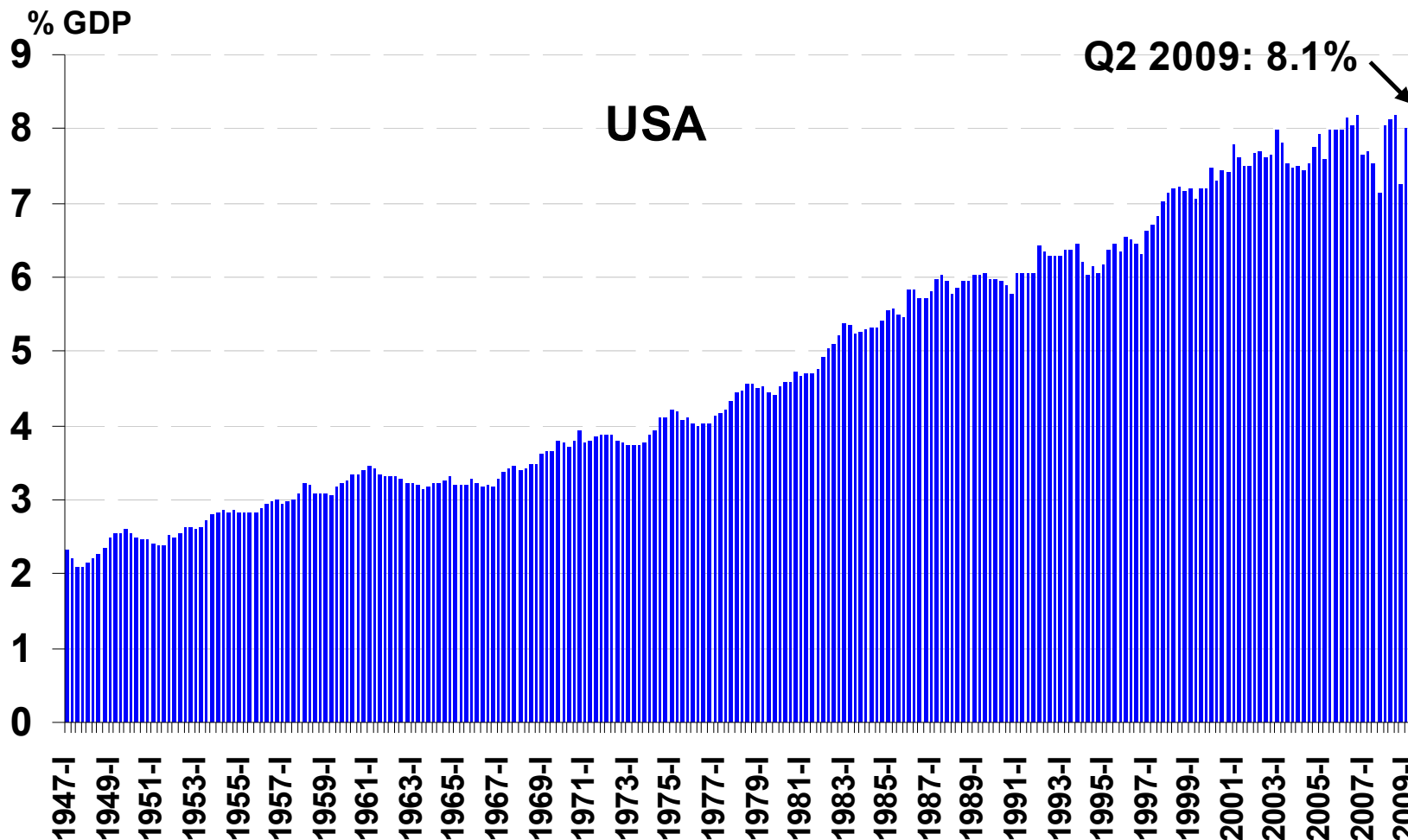
- ✓ Economics: **Slower global growth due to the crisis:** We are trading off current & future stability against future average growth
- ✓ Politics: Economic & political power → Asia and G-20, with the **crisis expediting the shift**
- ✓ Global Regulation: The Financial Stability Board gains power among IFIs
- ✓ **A different financial landscape**, as G-20 decisions will affect banks and increase the cost of financial intermediation
  - ★ Aim should be to avoid the excesses of the financial sector without imposing too much unnecessary cost
  - ★ Restrictions should be uniform across the globe and respect the **level-playing field**
  - ★ Onerous restrictions may cause a new wave of future de-regulatory fervor
  - ★ **Capital is costly.** Some smart proposals by academics that bear a minimum cost, e.g. *during economic expansions, instead of forcing banks to issue additional equity, which is costly, force them to issue debt convertible to equity during a crisis*
- ✓ **Wall Street** continues to hold considerable **political power against future regulatory restrictions**

# II. Will the expanding financial industry suffer?



Source: Bureau of Economic Analysis

# II. Will the expanding financial industry suffer?



■ Gross value added of financial corporate business

Source: Bureau of Economic Analysis

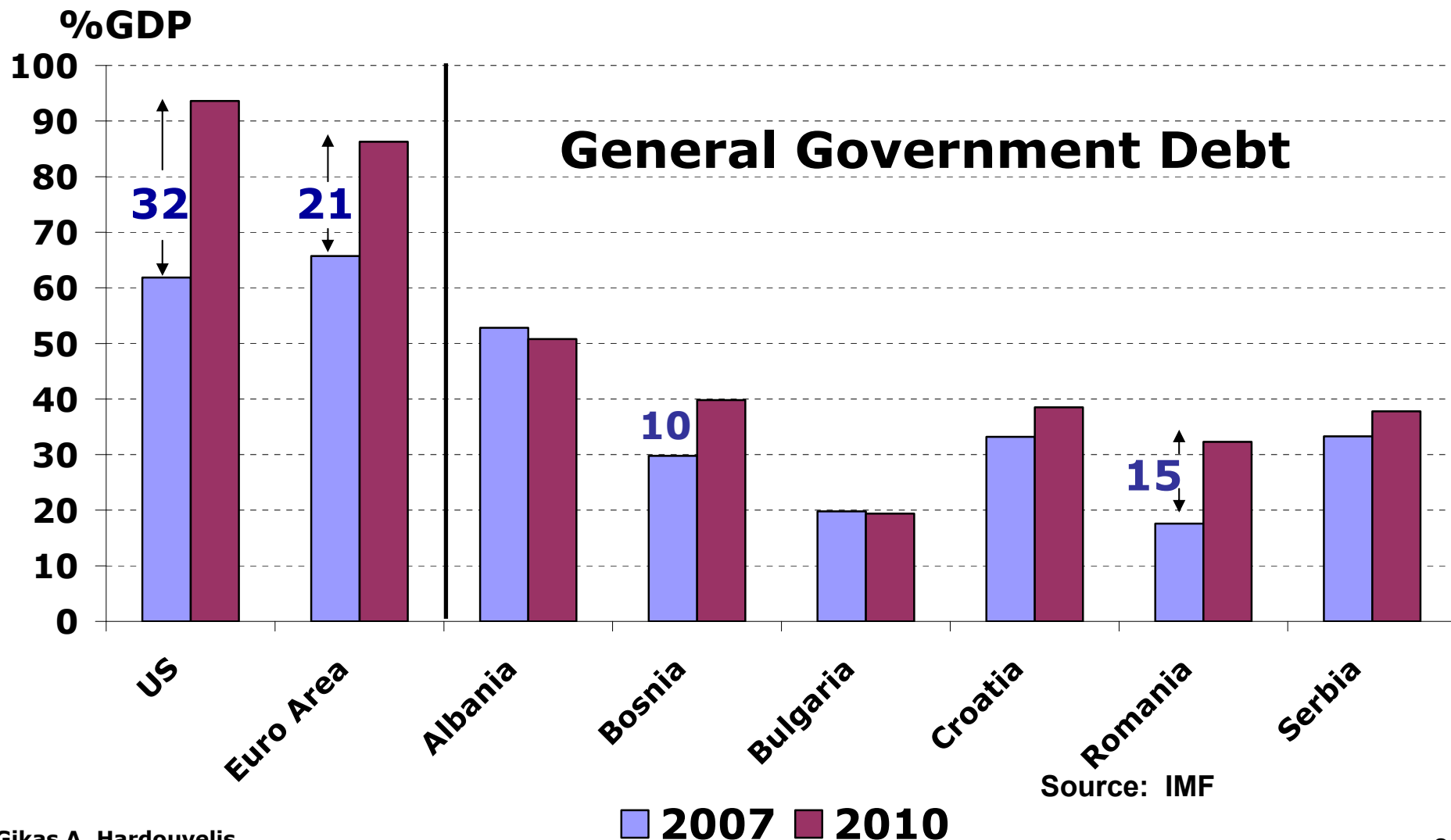
**It was not the Great Depression or Capitalism's 1989, but this Great Recession is likely to leave its permanent marks**

**My long-term view is for lower growth than the period leading up to the crisis**

- 1 Higher real interest rates ahead
  - ✓ Risk premia to stay high
  - ✓ Higher demand for new bank equity capital will increase the cost of intermediation
  - ✓ Fiscal debt will compete with private debt for funding
  - ✓ Central bank intervention interest rates expected to go back up
2. Future de-leveraging of the government sector, hence restrictive fiscal policy
3. Mediation of global imbalances: The US consumer is forced to reduce leverage and increase savings – hence lower exports by third countries to the US
  - ✓ The Chinese consumer is not ready to close the gap yet
  - ✓ India is still a closed economy
  - ✓ Europe depends on exports



## II. Current aggressive response by Western governments implies future restrictive fiscal policy



# III.

## THE REGIONAL VIEW ON THE CRISIS

1. *SEEs imported the crisis but were caught over-heating*
2. *Avoided a collapse due to strong financial systems and quick response by regulators*
3. *Sluggish growth in 2010*

# III.1 SEE economies were overheating when the financial crisis hit in 2007

<b>Current Account % GDP</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
<b>Albania</b>	<b>-5.6</b>	<b>-9.1</b>	<b>-14.1</b>
<b>Bosnia &amp; Herz/na</b>	<b>-8.4</b>	<b>-12.7</b>	<b>-14.9</b>
<b>Bulgaria</b>	<b>-18.5</b>	<b>-25.2</b>	<b>-25.5</b>
<b>Croatia</b>	<b>-6.7</b>	<b>-7.6</b>	<b>-9.4</b>
<b>FYROM</b>	<b>-0.9</b>	<b>-7.2</b>	<b>-13.1</b>
<b>Romania</b>	<b>-10.4</b>	<b>-13.5</b>	<b>-12.4</b>
<b>Serbia</b>	<b>-10.1</b>	<b>-15.6</b>	<b>-17.3</b>
<b>Turkey</b>	<b>-6.0</b>	<b>-5.8</b>	<b>-5.7</b>
<b>Estonia</b>	<b>-16.9</b>	<b>-17.8</b>	<b>-9.3</b>
<b>Latvia</b>	<b>-22.7</b>	<b>-21.6</b>	<b>-12.6</b>
<b>Lithuania</b>	<b>-10.7</b>	<b>-14.6</b>	<b>-11.6</b>

✓ Large external deficits carry sudden stop risks

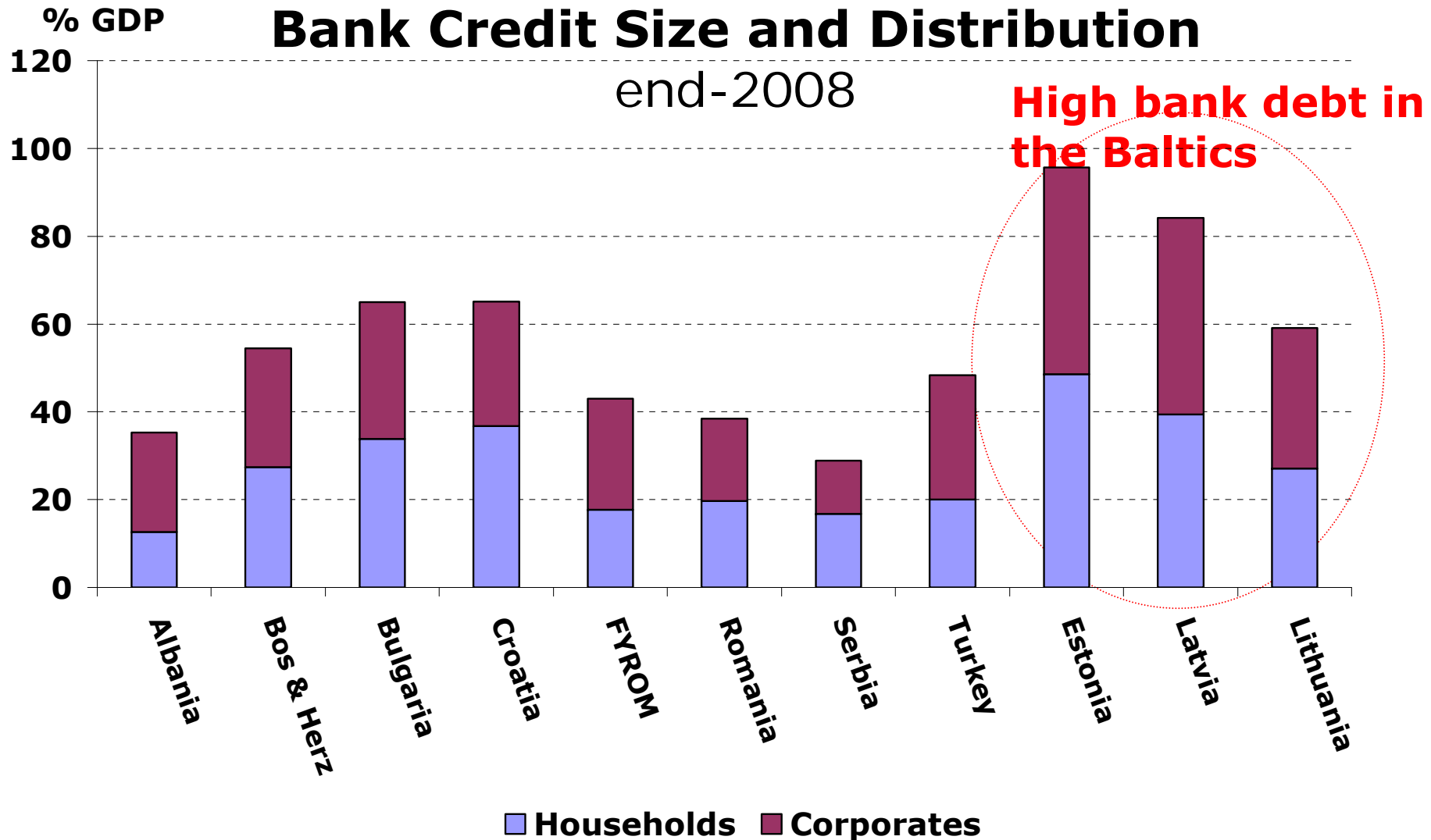
Source: IMF

# III.1 SEE economies were overheating when the financial crisis hit in 2007

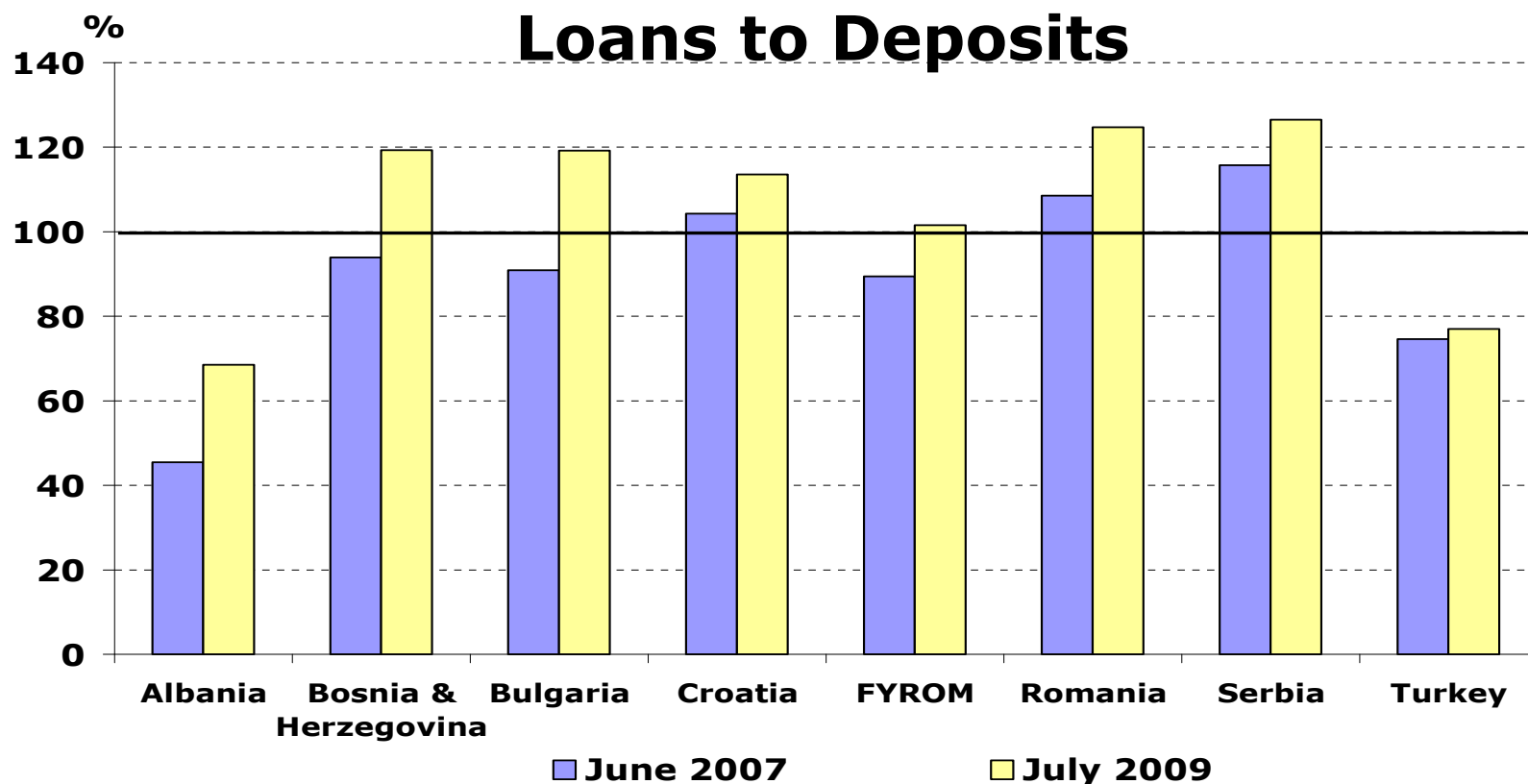
	<b>Annual Credit Growth over 3 years Avg (2005-2007)</b>	<b><math>\Delta</math>(Credit/GDP) End 2004 - End 2007</b>
<b>Albania</b>	<b>60.5</b>	<b>20.3</b>
<b>Bosnia</b>	<b>26.3</b>	<b>17.4</b>
<b>Bulgaria</b>	<b>41.0</b>	<b>30.8</b>
<b>Croatia</b>	<b>18.8</b>	<b>16.1</b>
<b>FYROM</b>	<b>35.9</b>	<b>15.0</b>
<b>Romania</b>	<b>49.3</b>	<b>21.2</b>
<b>Serbia</b>	<b>36.0</b>	<b>13.0</b>
<b>Turkey</b>	<b>42.5</b>	<b>16.8</b>
<b>Estonia</b>	<b>37.4</b>	<b>39.0</b>
<b>Latvia</b>	<b>42.0</b>	<b>42.0</b>
<b>Lithuania</b>	<b>47.8</b>	<b>31.1</b>

✓ Rapid credit growth leads to NPLs and credit risk

# III.1 Yet, compared to the Baltics, credit did not reach unprecedented levels



# III.1 Lots of bank liquidity came from abroad



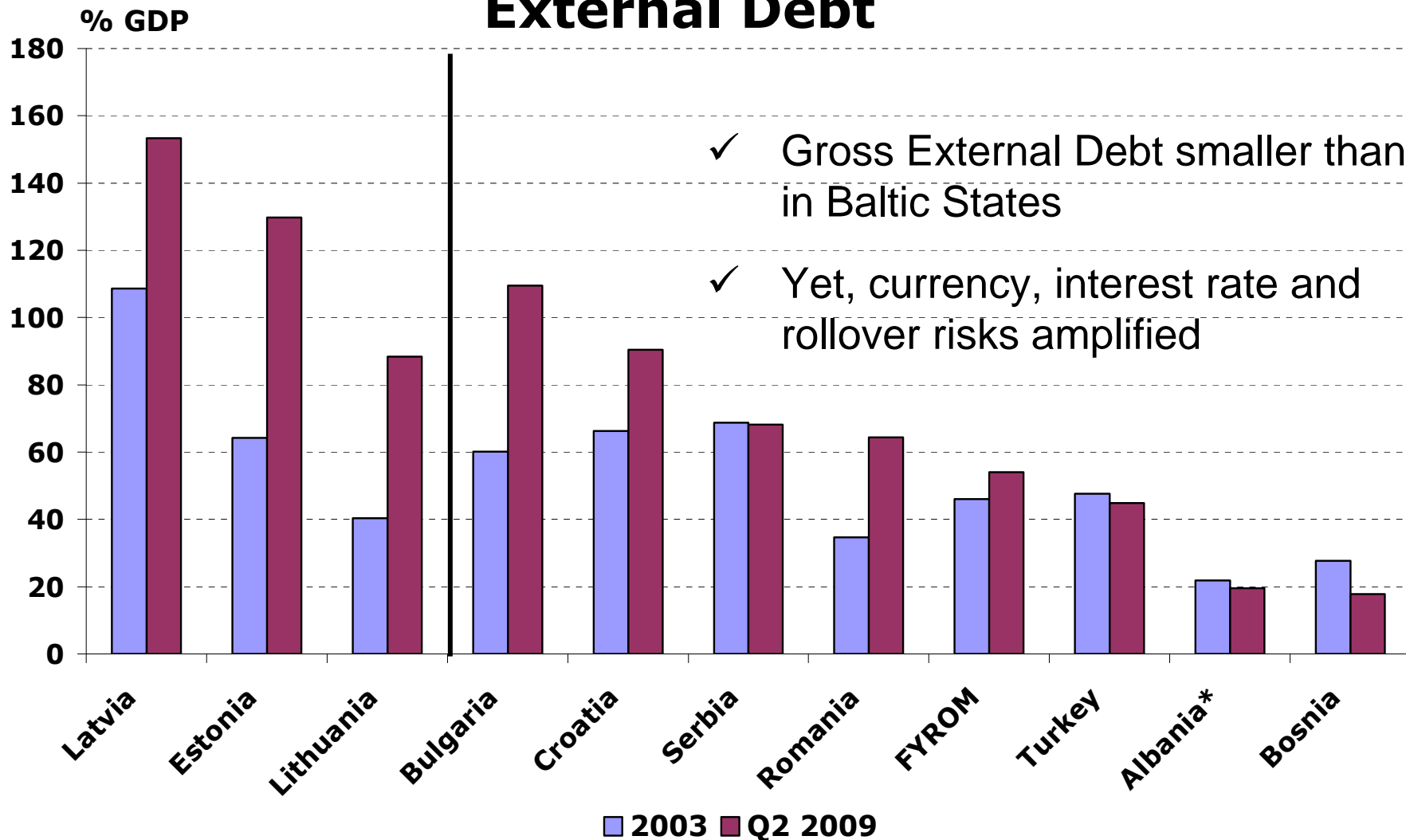
### Baltic States at July 2009

<b>Latvia</b>	<b>105.0</b>
<b>Lithuania</b>	<b>183.3</b>
<b>Estonia</b>	<b>167.9</b>

- ✓ Domestic deposits unable to support a large expansion in credit growth
- ✓ Difficult to bring liquidity from abroad

# III.1 High external debt is more serious: Euroization of domestic liabilities

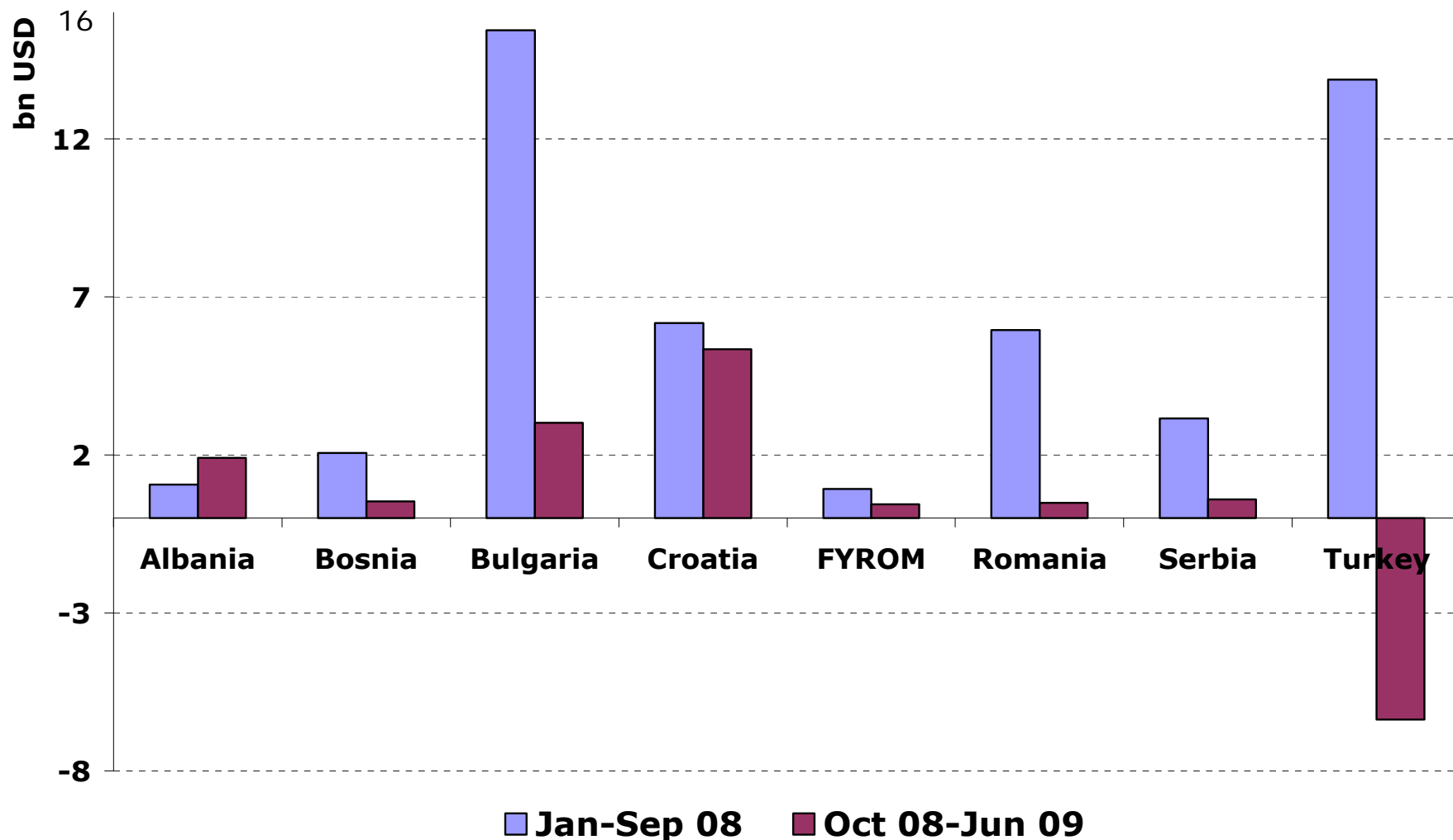
## External Debt



\* IMF projection for 2009

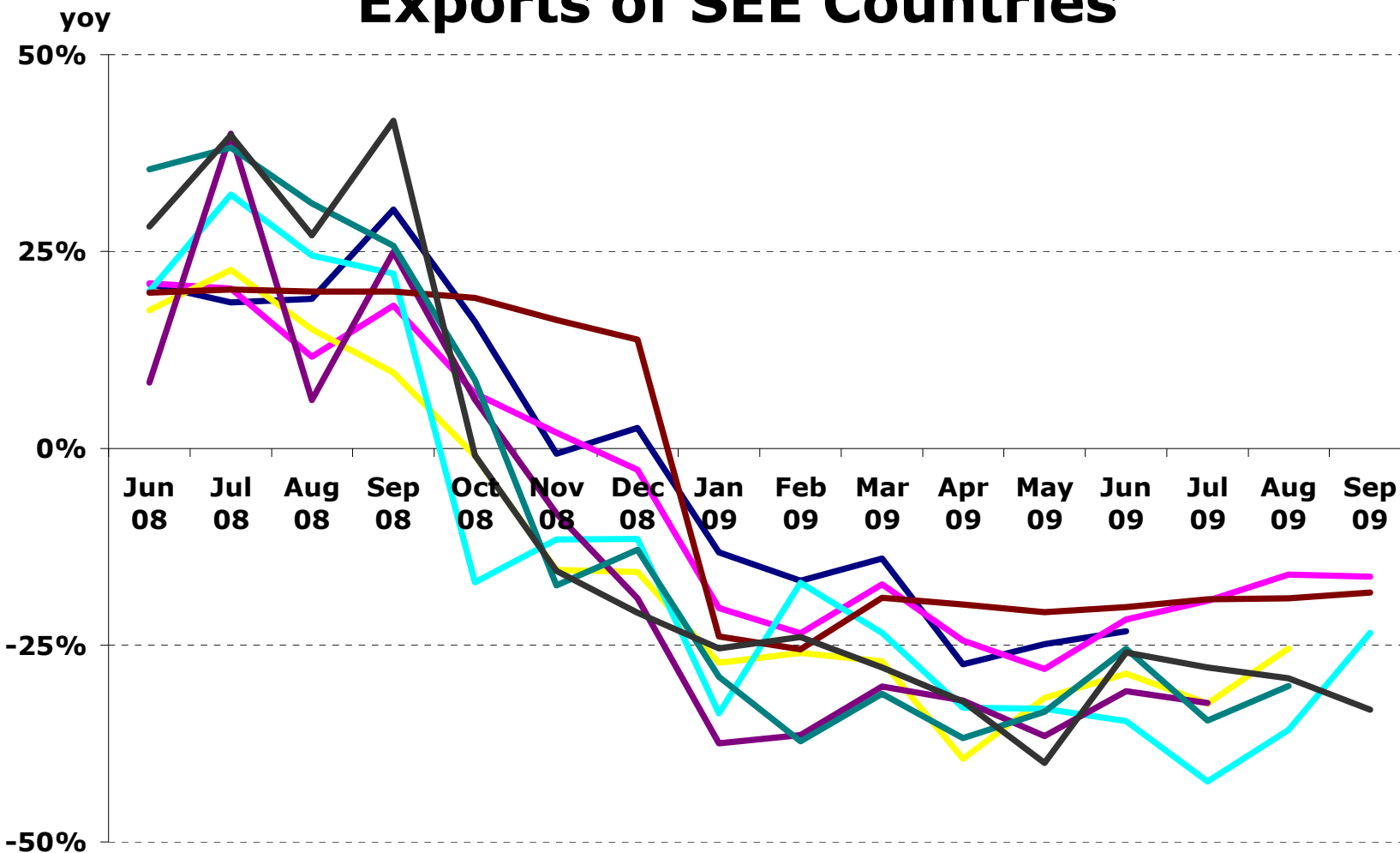
# III.1 Sudden stop in capital inflows in 2008:Q4

## Financial Account Flows





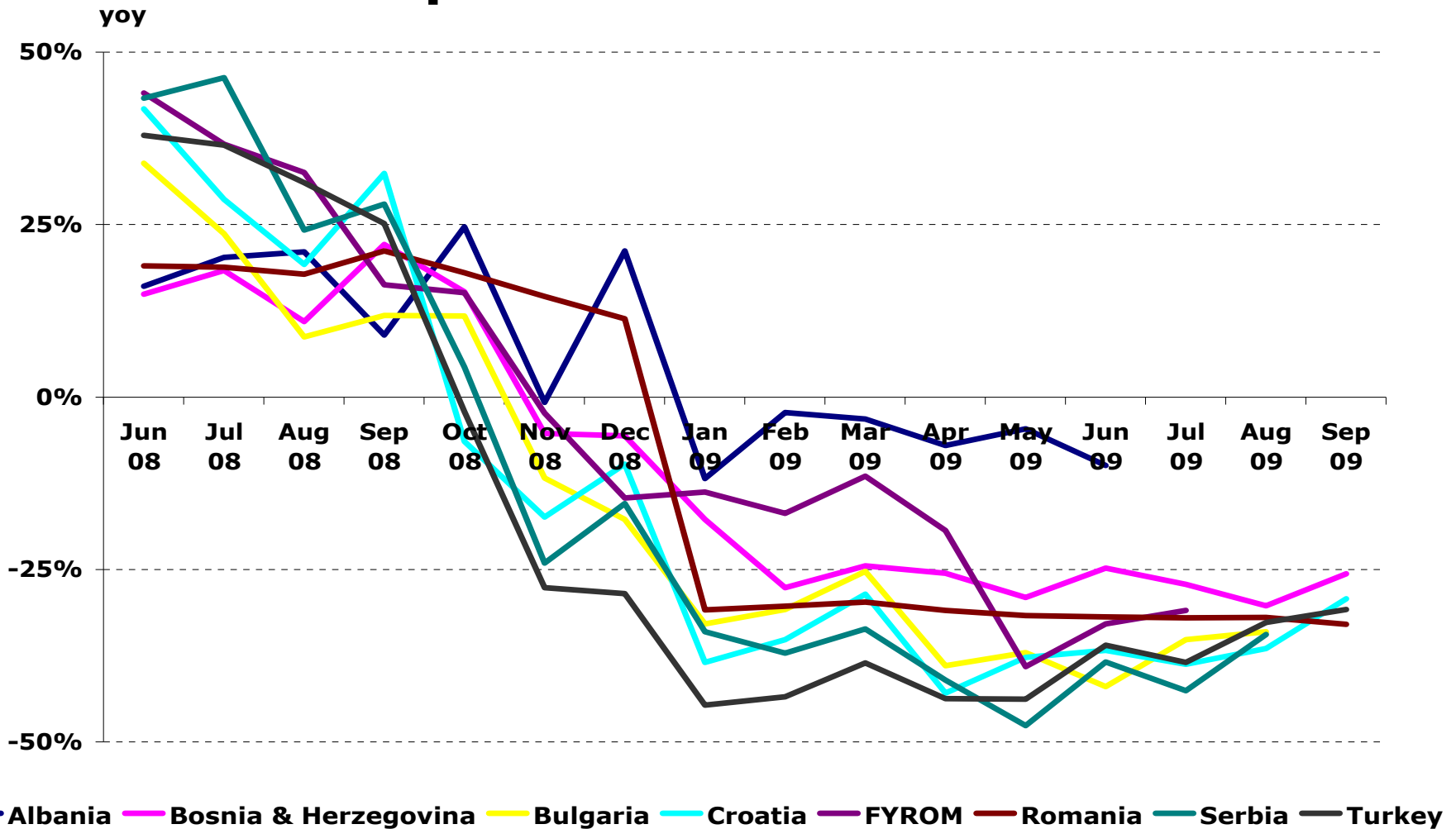
## Exports of SEE Countries



— Albania — Bosnia & Herzegovina — Bulgaria — Croatia — FYROM — Romania — Serbia — Turkey

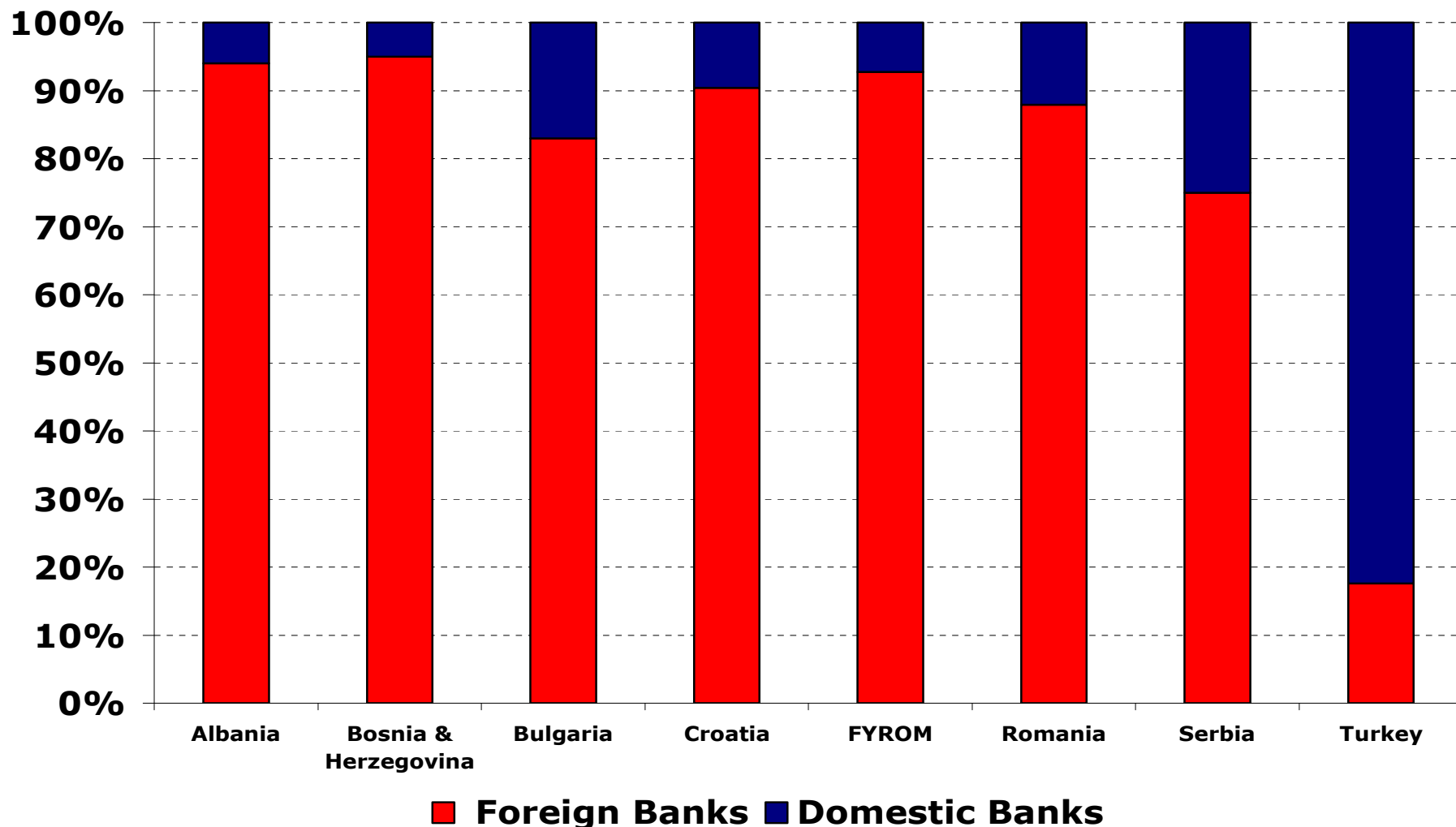
# III.1 Trade flows declined sharply in 2008:Q4

## Imports of SEE Countries



## III.2 Large foreign ownership of banking sector

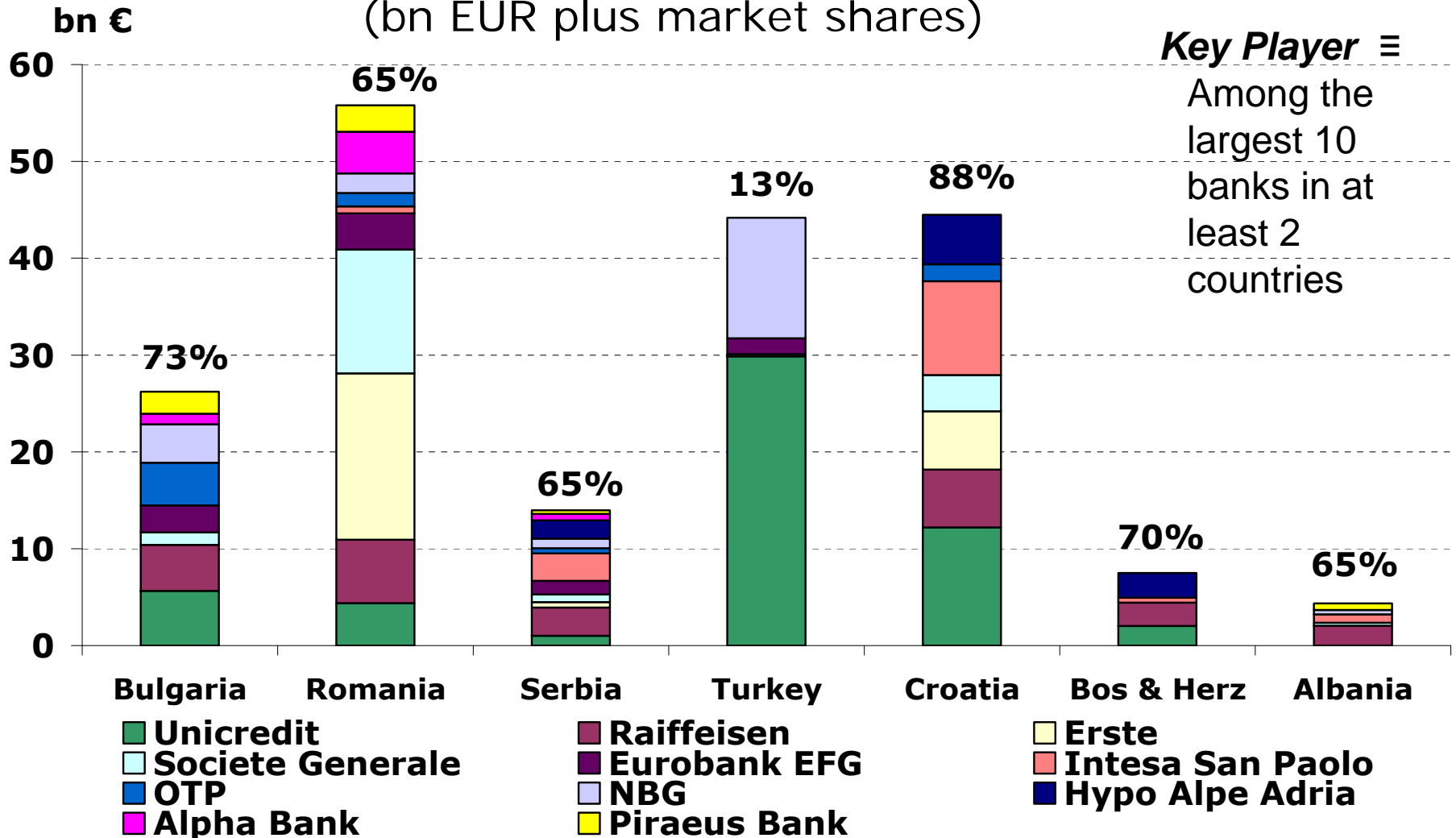
### % ownership



# III.2 Key "systemic" players

## Assets of key players in SEE countries

(bn EUR plus market shares)



## European banks: Write-downs and capital increases June 2007 – mid November 2009

	Banks	Loss	Capital Raised	Present in SEE
1	UBS	€ 34.9	€ 27.0	
2	HSBC Holdings	33.3	19.3	TR
3	RBS	19.7	65.5	RO,TR
4	HBOS	19.7	17.2	
5	Barclays	15.8	20.5	
6	BNP Paribas	13.9	9.4	AL,BG,HR,RO,RS
7	Bayerische	13.4	14.8	HR,SI,BA,RS,ME
8	Credit Suisse	13.2	8.6	
9	Deutsche Bank	13.0	7.4	BG,HR,RO,RS,TR
10	ING Group	12.4	16.8	BG,TR,RO
11	IKB Deutsche	10.3	8.5	
12	B. Santander	9.4	19.7	
13	Soc Gen	8.8	15.7	TR
14	KBC Group	8.7	5.5	RS, BG
15	Fortis	6.5	16.0	

	Banks	Loss	Capital Raised	Present in SEE
16	Credit Agricole	€ 6.5	€ 8.9	AL,BG,RO,RS,TR
17	Natixis	6.2	5.7	
18	DZ Bank	5.4	0.0	
19	Anglo Irish	5.2	3.1	
20	Hypo Real Estate	4.9	7.7	
21	Dexia	4.7	6.4	TR
22	Unicredit	4.4	10.3	RO,SI,BA,RS,HR, BG
23	Commerzbank	3.9	18.2	
24	Dresdner Bank	3.6	0.0	
25	Landesbank Baden Wurttemberg	3.3	0.0	
26	HSH Nordbank	2.9	1.3	
27	WestLB	2.7	5.0	
28	Lloyds Group	2.4	33.0	
29	Rabobank	2.4	1.0	
30	Northern Rock	2.2	3.8	

	Banks	Loss	Capital Raised	Present in SEE		Banks	Loss	Capital Raised	Present in SEE
31	Bank of Ireland	€ 1.9	€ 3.5		47	Standard Ch.	€ 0.4	€ 0.0	
32	Allied Irish Banks	1.8	3.5		48	Norddeutsche	0.4	0.0	
33	Intesa Sanpaolo	1.8	4.0	AL,BA, HR, SI,RO,RS	49	Danske Bank	0.4	0.0	
34	Landesbank Sachsen	1.8	0.0		50	Piraeus Bank	0.4	0.0	AL,BG, RO,RS
35	Alliance & Leicester	1.8	0.0		51	Roskilde Bank	0.4	0.5	
36	Deutsche Postbank	1.7	1.0		52	Alpha Bank	0.3	0.0	RO,RS,MK, BG,AL
37	BBVA	1.7	0.0		53	Land. Berlin	0.3	0.0	
38	Banco Popolare	1.7	0.0	HR,RO	54	NIBC Bank	0.3	0.0	
39	ABN AMRO Holding	1.6	0.0	RO,TR	55	SEB	0.3	1.5	
40	DNB NOR ASA	1.5	1.7		56	Kommunalkredit	0.1	0.0	
41	Bradford & Bingley	1.4	2.0		57	Aareal Bank AG	0.0	0.0	
42	Banco Popular Esp	1.2	1.2		58	Kaupthing Bank	0.0	0.0	
43	Caisse d'Epargue	0.8	3.6		59	Erste Group	0.0	2.1	HR,RS,RO
44	EFG Eurobank	0.7	0.0	RO,BG,RS		<b>Total</b>	<b>320</b>	<b>401</b>	
45	Hessen-Thuringen	0.5	0.0						
46	HVB Group	0.5	0.0						

AL / Albania, BA / Bosnia and Herzegovina, BG / Bulgaria, HR / Croatia, ME / Montenegro, MK / Macedonia - Former Yugoslav Republic of, RO / Romania, RS / Serbia, SI / Slovenia, TR / Turkey

## III.2 Adequate capitalization

### Bank Capital to Assets ratio (Q2 2009)



\*FYROM, Romania and Serbia as of Q1 2009

Source: Central Banks, Eurobank Research

Capital/Assets		
Austria	6.3	Q1 09
Belgium	3.4	Q1 09
Germany	4.5	2008
Greece	4.5	2008
Ireland	5.1	Q1 09
Norway	4.2	2008
Portugal	6.1	2008
Sweden	4.7	2008
UK	4.4	2008
Spain	6.4	2008
<b>Estonia</b>	<b>8.5</b>	<b>Q2 09</b>
<b>Latvia</b>	<b>7.4</b>	<b>Q2 09</b>
<b>Lithuania</b>	<b>10.4</b>	<b>Q2 09</b>

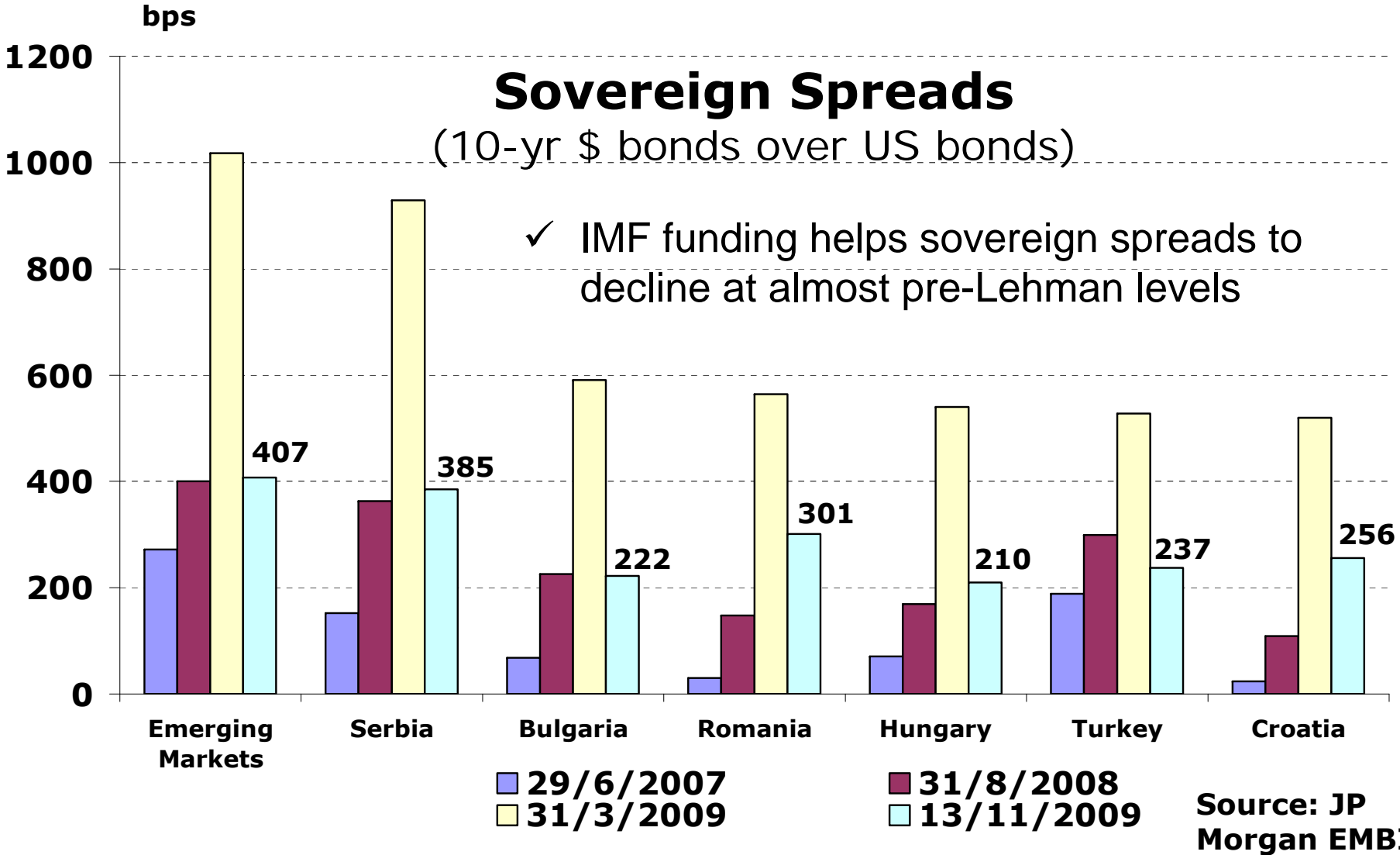
✓ Simple capital to assets ratio stronger in SEEES than in EU-15

## III.2 Government & Central Bank initiatives to strengthen lending

	Albania	Bosnia	Bulgaria	Croatia	FYROM	Romania	Serbia	Turkey
Deposits Guarantees	✓	✓	✓	✓		✓	✓	✓
Minimum Reserve Requirements		✓	✓	✓		✓	✓	✓
IMF Support		✓				✓	✓	
Special Lending Support	✓		✓	✓		✓	✓	
Monetary policy easing	✓			✓	✓	✓	✓	✓
Other (tax, regula- tory, etc)	✓				✓	✓	✓	✓



# III.3 Gone is the fear of financial collapse, yet concerns remain for the SEE region



## PROS

- ✓ Regional growth outlook improves in 2010
- ✓ Current account deficits correct more rapidly than previous expected
- ✓ Inflation continues its downward trend without deflation
- ✓ Financial market recovery:
  - Stock markets have rebounded strongly from March lows in line with world markets
  - Sovereign and Credit spreads significantly lower compared to March highs
- ✓ FX-volatility subsides
- ✓ IMF becomes flexible with respect to country fiscal targets in their stand-by loan agreements

## CONS

- ❖ Fiscal deterioration as Revenues are declining & Expenditures are exceeding targeted levels
- ❖ Rising NPLs & weak credit expansion, as credit follows an economic recovery, it does not lead it
- ❖ Monetary policy easing close to its end. Most likely we will see interest rates rising in 2010
- ❖ Subdued capital inflows as regional risk remains high

### III.3 Pros: Deep recession is out, yet stagnation continues in 2010

#### Real GDP Growth (%)

	2008	2009f	2010f
<b>Albania</b>	6.8	0.7	2.2
<b>Bosnia &amp; Herzegovina</b>	5.5	-3.0	0.5
<b>Bulgaria</b>	6.0	-6.5	-2.0
<b>Croatia</b>	2.4	-5.2	0.4
<b>FYROM</b>	4.9	-2.5	2.0
<b>Romania</b>	7.1	-7.5	-1.0
<b>Serbia</b>	5.4	-3.5	0.5
<b>Turkey</b>	0.9	-6.0	2.0
<b>Estonia</b>	-3.6	-14.0	-2.6
<b>Latvia</b>	-4.6	-18.0	-4.0
<b>Lithuania</b>	3.0	-18.5	-4.0

✓ Baltic recession is deeper, started earlier, will end later

Source: Eurobank Research, IMF World Economic Outlook

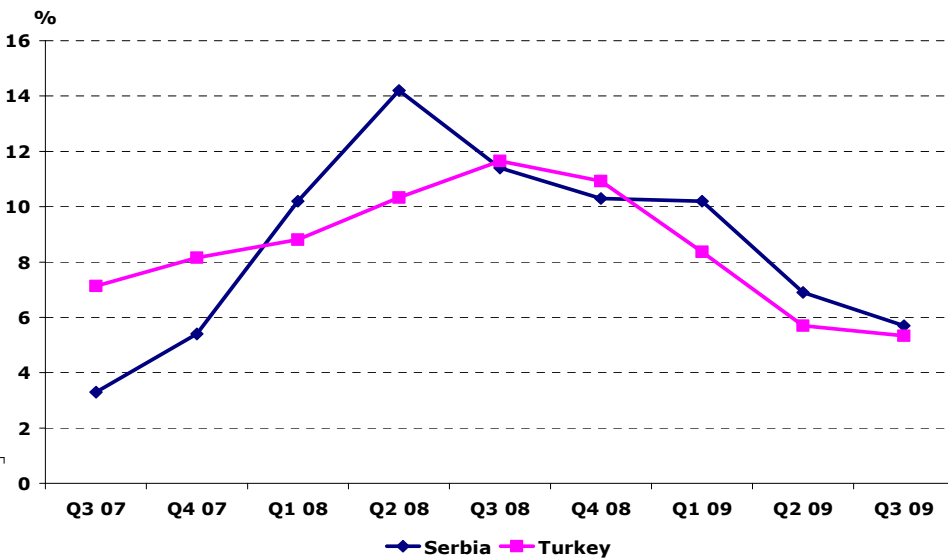
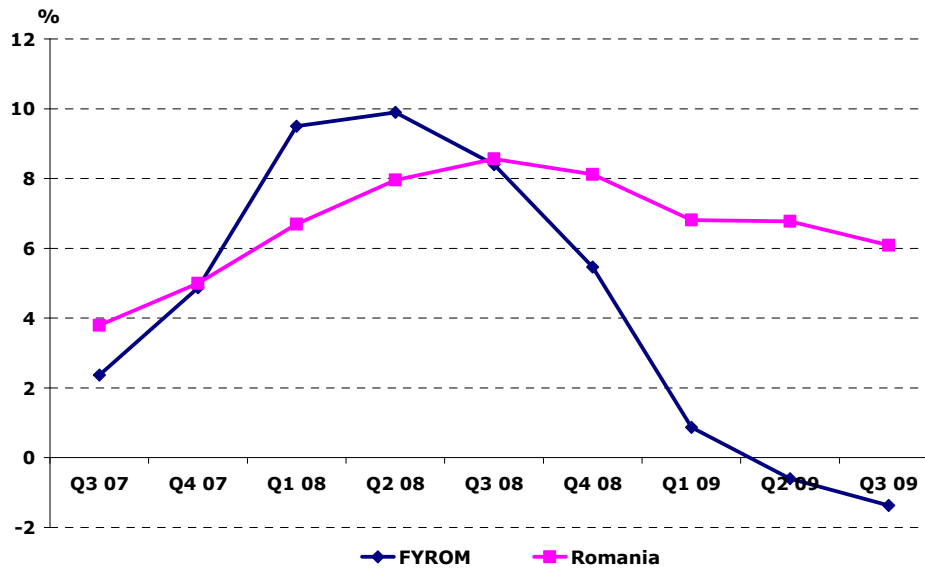
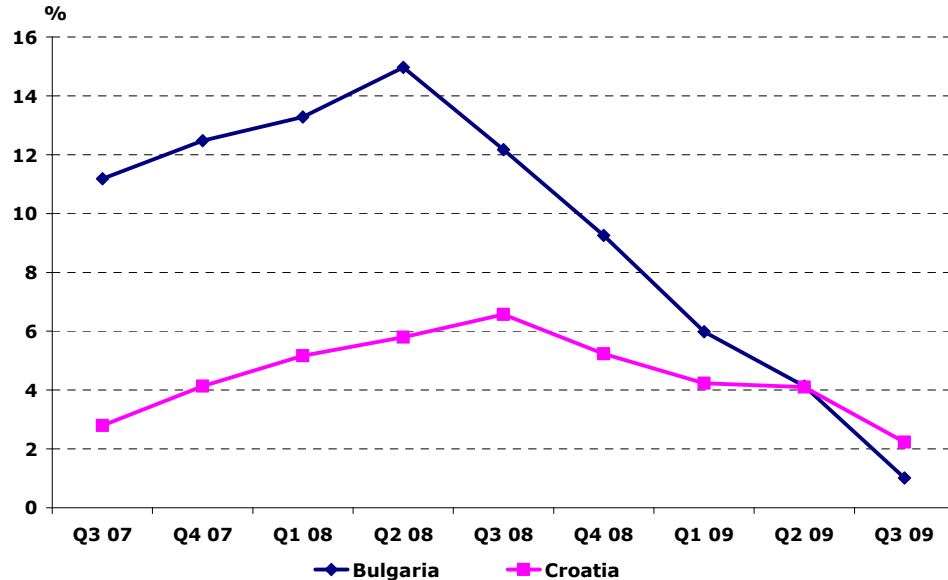
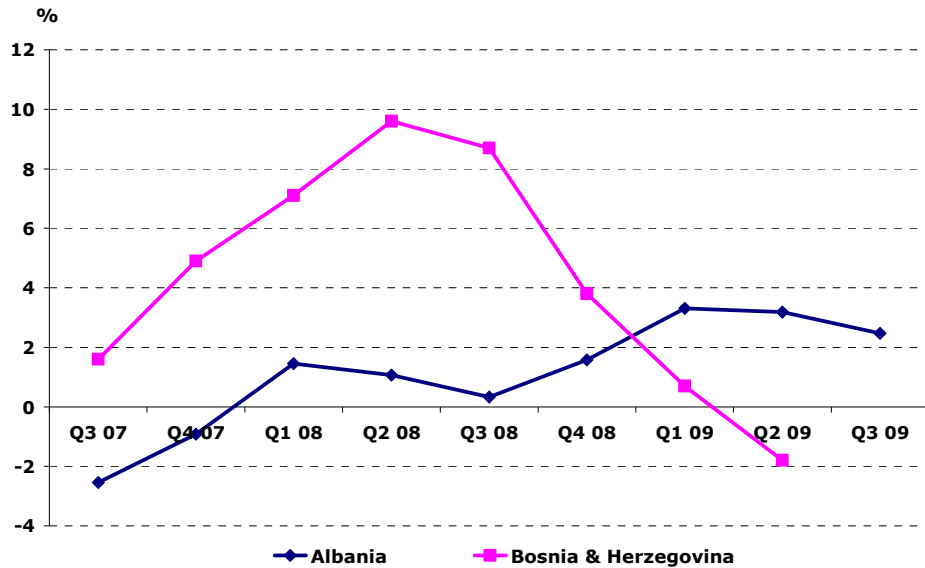
### III.3 Pros: Current account deficits decline

<b>Current Account Balance (% GDP)</b>			
	<b>2008</b>	<b>2009f</b>	<b>2010f</b>
<b>Albania</b>	<b>-14.1*</b>	<b>-11.5</b>	<b>-8.0</b>
<b>Bosnia &amp; Herzegovina</b>	<b>-14.9</b>	<b>-8.8</b>	<b>-9.1</b>
<b>Bulgaria</b>	<b>-25.5</b>	<b>-12.0</b>	<b>-10.0</b>
<b>Croatia</b>	<b>-9.4</b>	<b>-6.1</b>	<b>-5.4</b>
<b>FYROM</b>	<b>-13.1</b>	<b>-10.6</b>	<b>-9.7</b>
<b>Romania</b>	<b>-12.4</b>	<b>-6.0</b>	<b>-5.5</b>
<b>Serbia</b>	<b>-17.3</b>	<b>-8.5</b>	<b>-9.5</b>
<b>Turkey</b>	<b>-5.7</b>	<b>-1.5</b>	<b>-2.5</b>
<b>Estonia</b>	<b>-9.3</b>	<b>1.9</b>	<b>-2.0</b>
<b>Latvia</b>	<b>-12.6</b>	<b>4.5</b>	<b>6.4</b>
<b>Lithuania</b>	<b>-11.6</b>	<b>1.0</b>	<b>0.5</b>

Source: Eurobank Research, IMF World Economic Outlook

\*Estimate

# III.3 Pros: Inflation Rates on a downward path



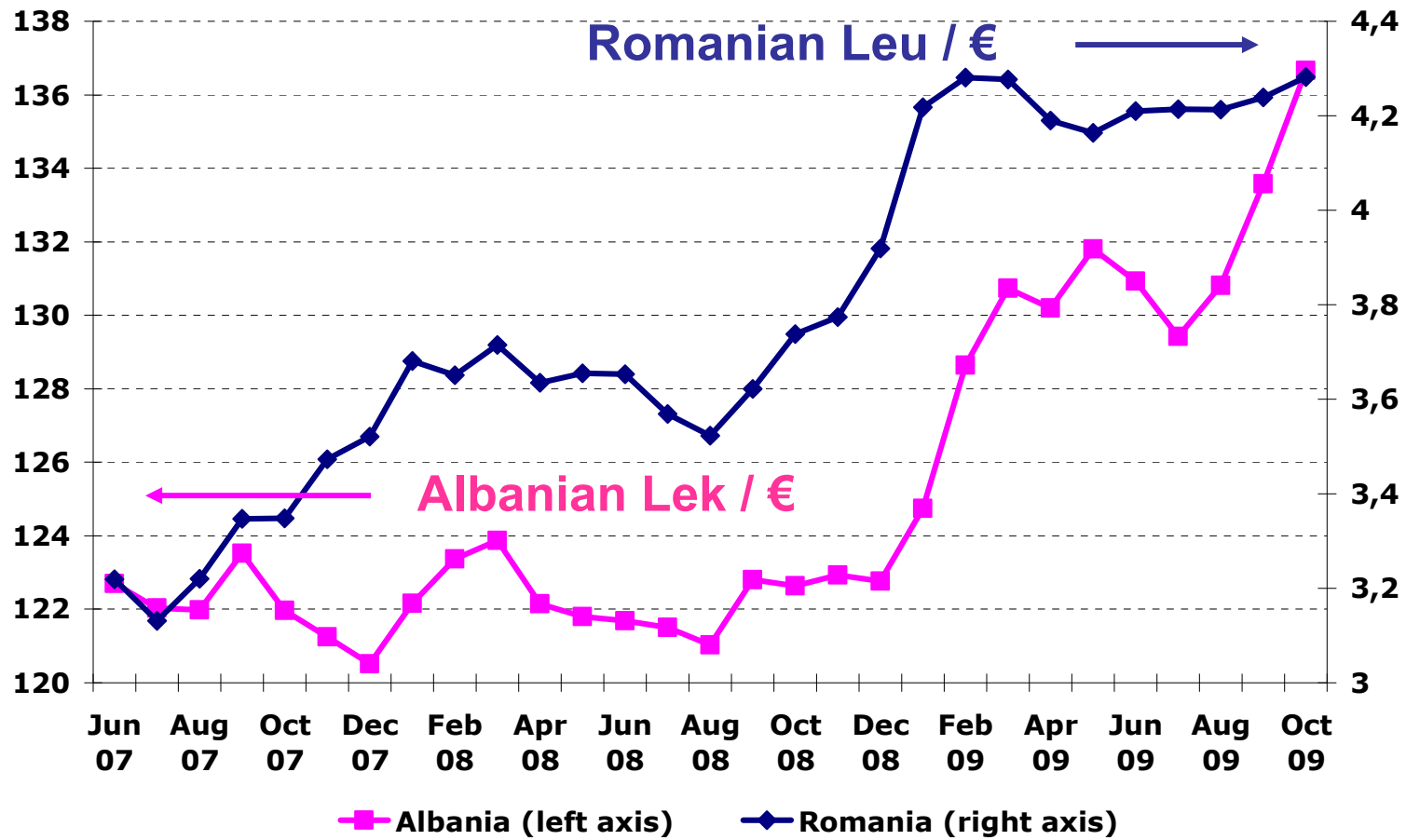
### III.3 Pros: Inflation on a downward trend in 2010, plus no deflation

<b>Average CPI Inflation (%)</b>			
	<b>2008</b>	<b>2009f</b>	<b>2010f</b>
<b>Albania</b>	<b>3.4</b>	<b>1.7</b>	<b>2.0</b>
<b>Bosnia &amp; Herzegovina</b>	<b>7.4</b>	<b>0.9</b>	<b>1.6</b>
<b>Bulgaria</b>	<b>12.0</b>	<b>2.7</b>	<b>1.6</b>
<b>Croatia</b>	<b>6.1</b>	<b>2.8</b>	<b>2.8</b>
<b>FYROM</b>	<b>8.3</b>	<b>-0.5</b>	<b>2.0</b>
<b>Romania</b>	<b>7.8</b>	<b>5.5</b>	<b>3.6</b>
<b>Serbia</b>	<b>11.7</b>	<b>8.0</b>	<b>7.0</b>
<b>Turkey</b>	<b>10.4</b>	<b>6.2</b>	<b>6.0</b>
<b>Estonia</b>	<b>10.4</b>	<b>0.0</b>	<b>-0.3</b>
<b>Latvia</b>	<b>15.3</b>	<b>3.1</b>	<b>-3.5</b>
<b>Lithuania</b>	<b>11.1</b>	<b>3.5</b>	<b>-2.9</b>

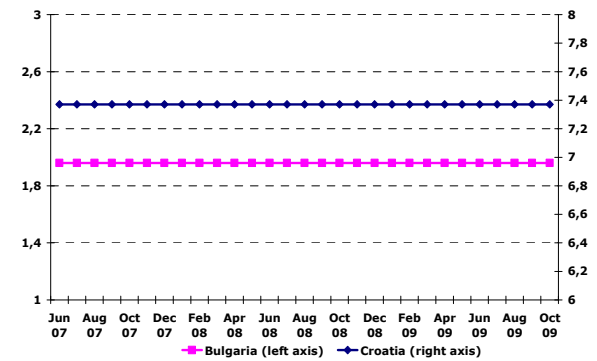
✓ Watch the Baltic expected deflation

Source: Eurobank Research, IMF World Economic Outlook

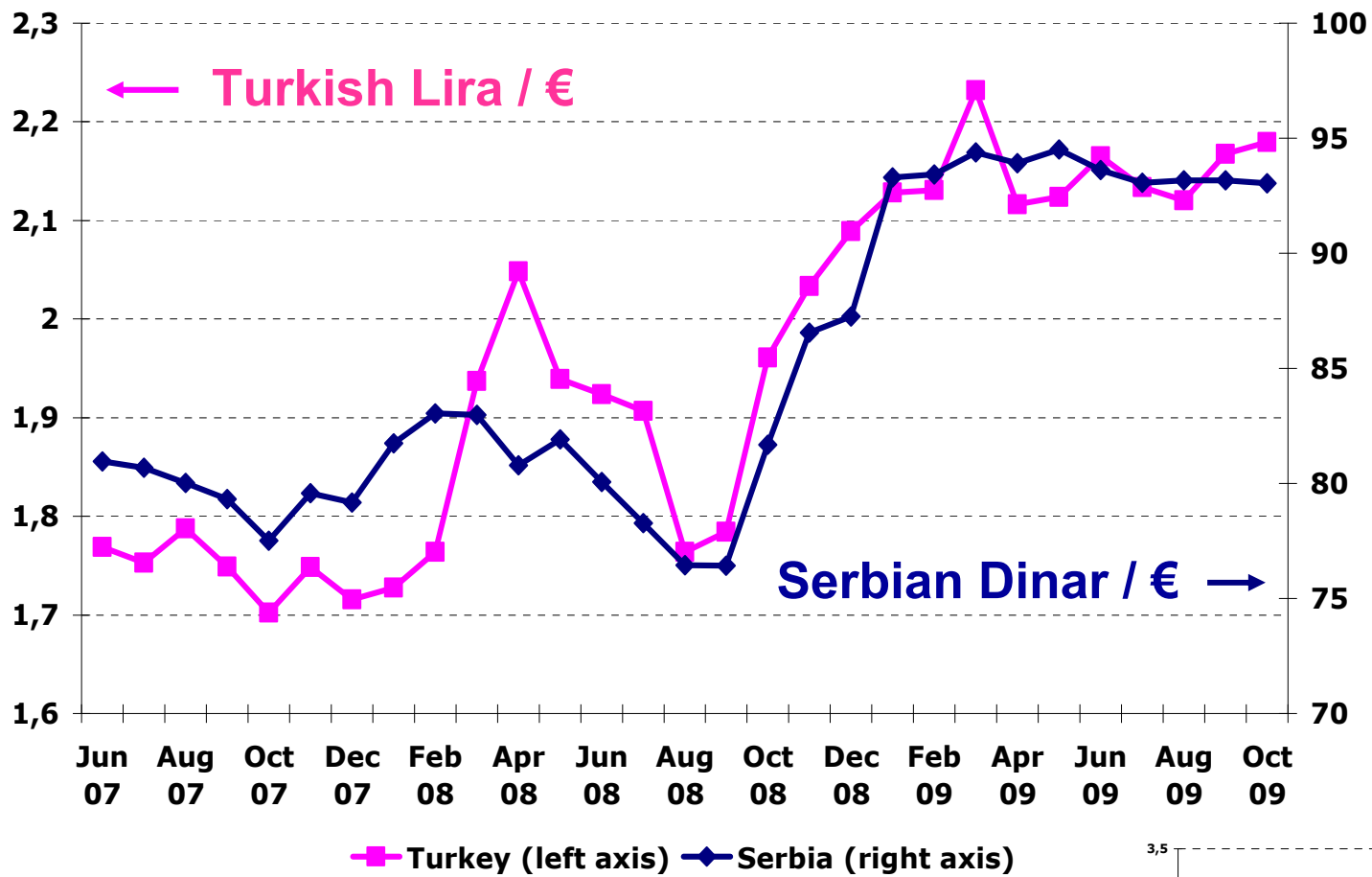
# III.3 Pros: Exchange Rates stabilize



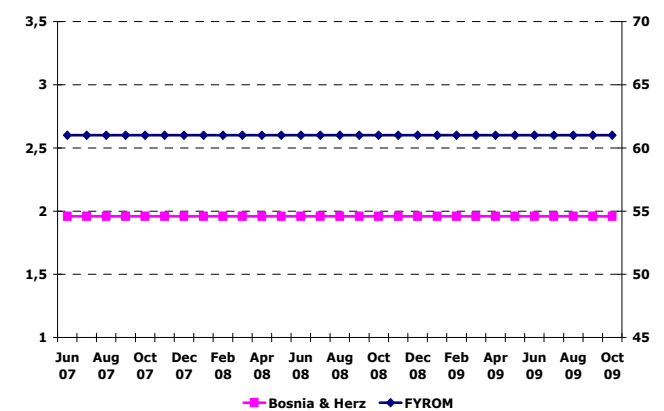
**FIXED EXCHANGE RATE:**  
**Bulgarian BGN (Lev) vs. EUR: 1.96**  
**Croatian HRK (Kuna ) vs. EUR: 7.37**



# III.3 Pros: Exchange Rates stabilize

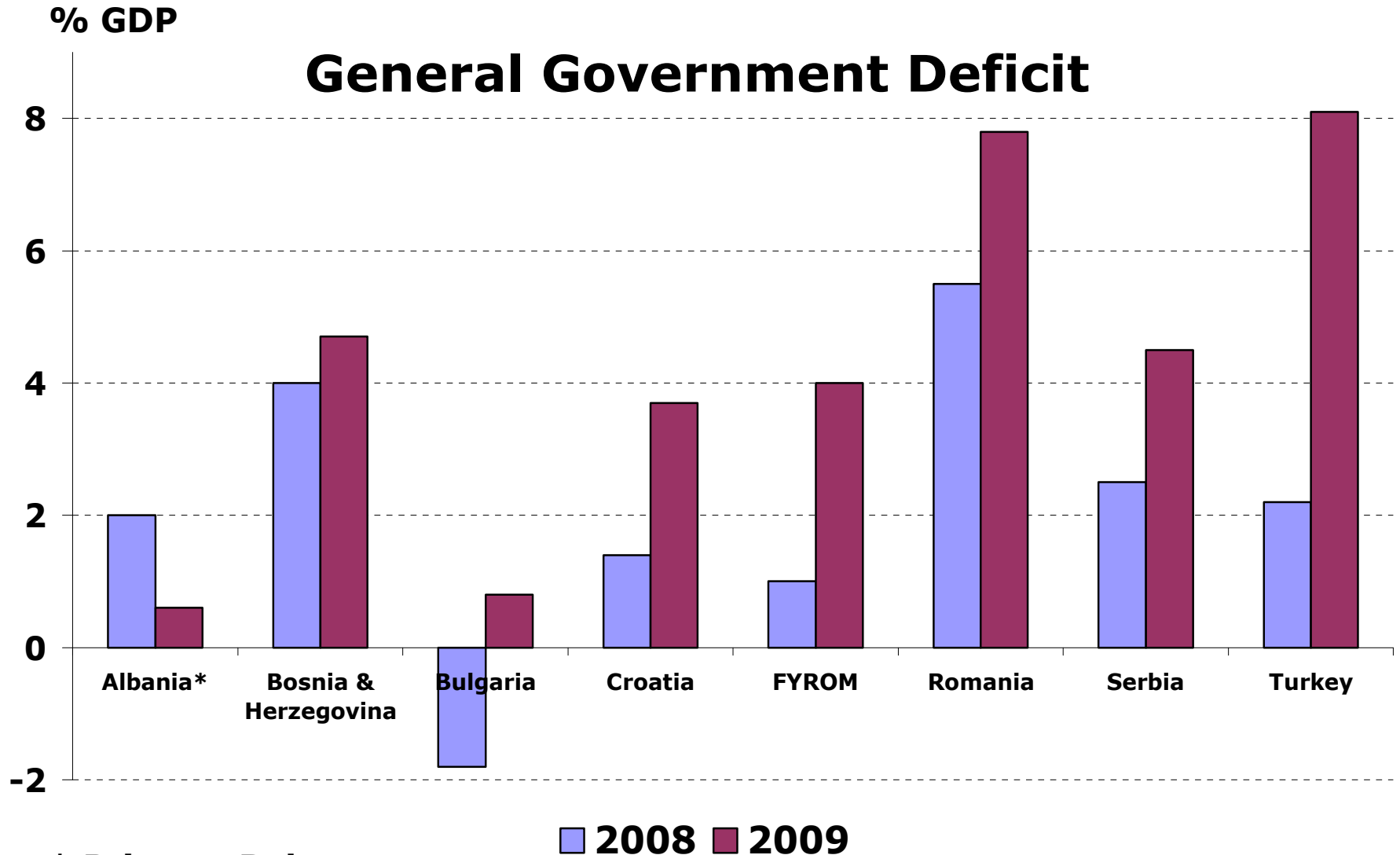


**FIXED EXCHANGE RATE:**  
**Bosnian BAM (Marka) vs. EUR: 1.96**  
**FYROM MKD (Denar) vs. EUR: 61**



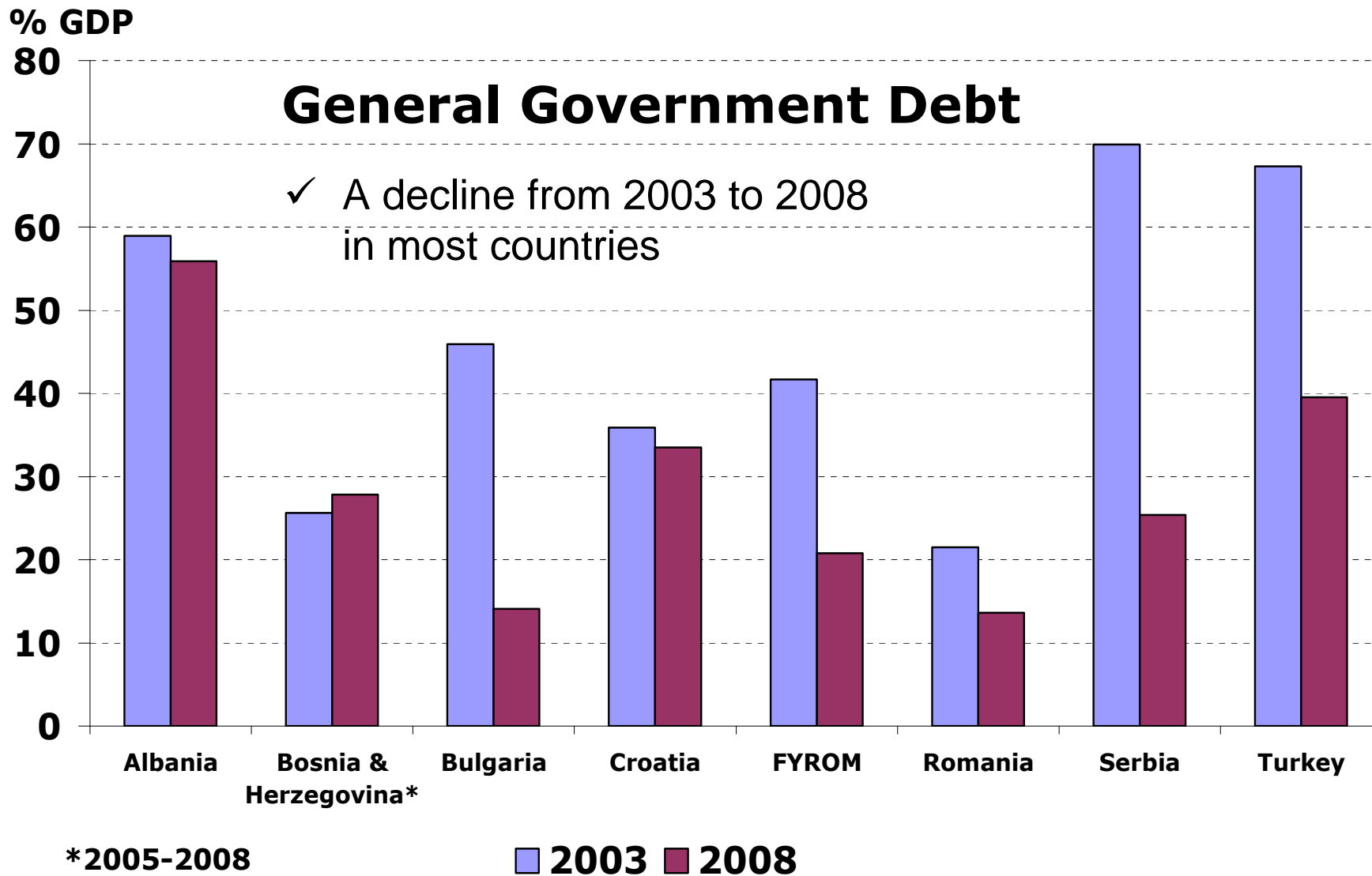


# III.3 Cons: Fiscal deficits, a major vulnerability

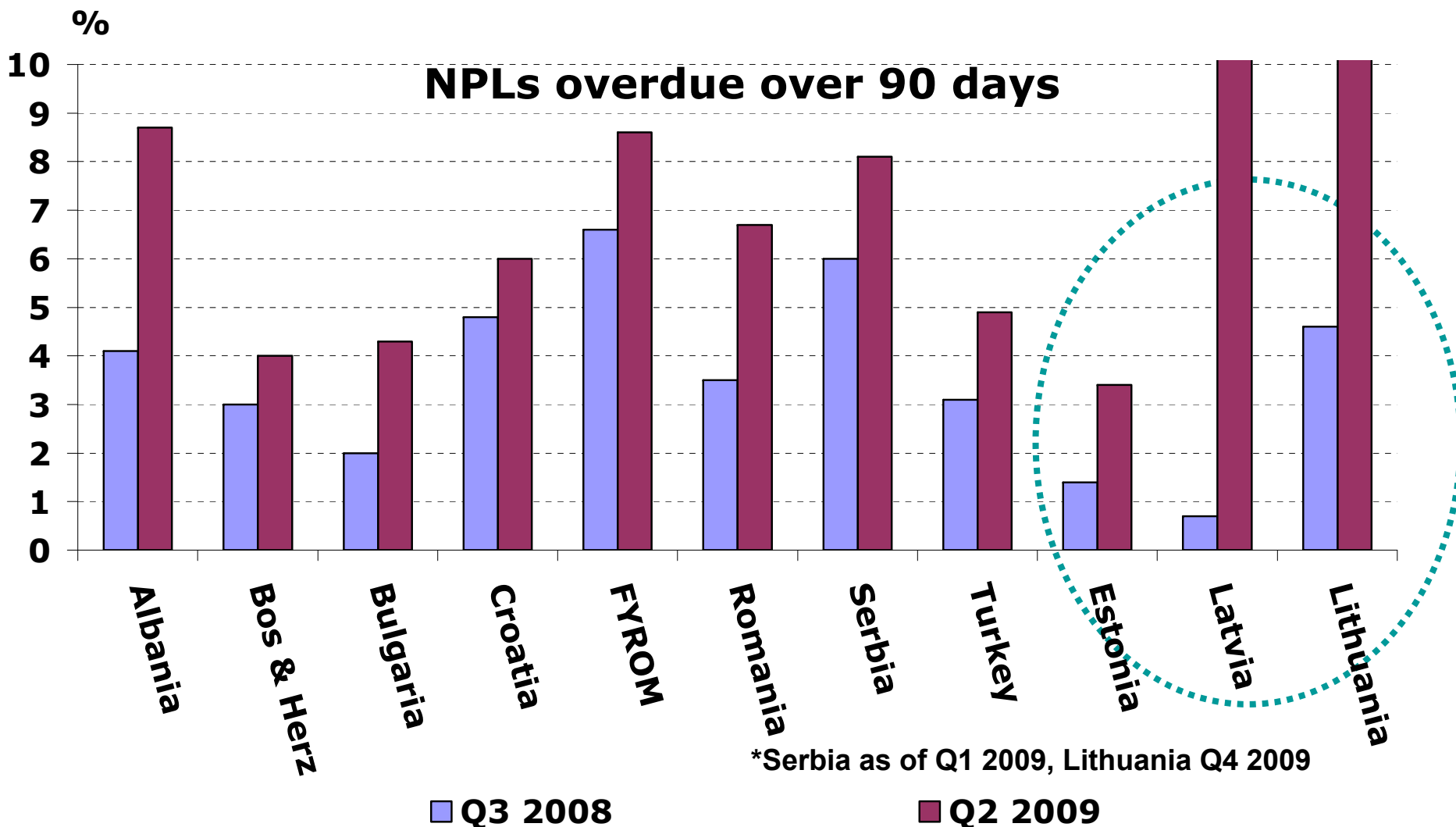


\* Primary Balance

# III.3 Yet, government debt remains low



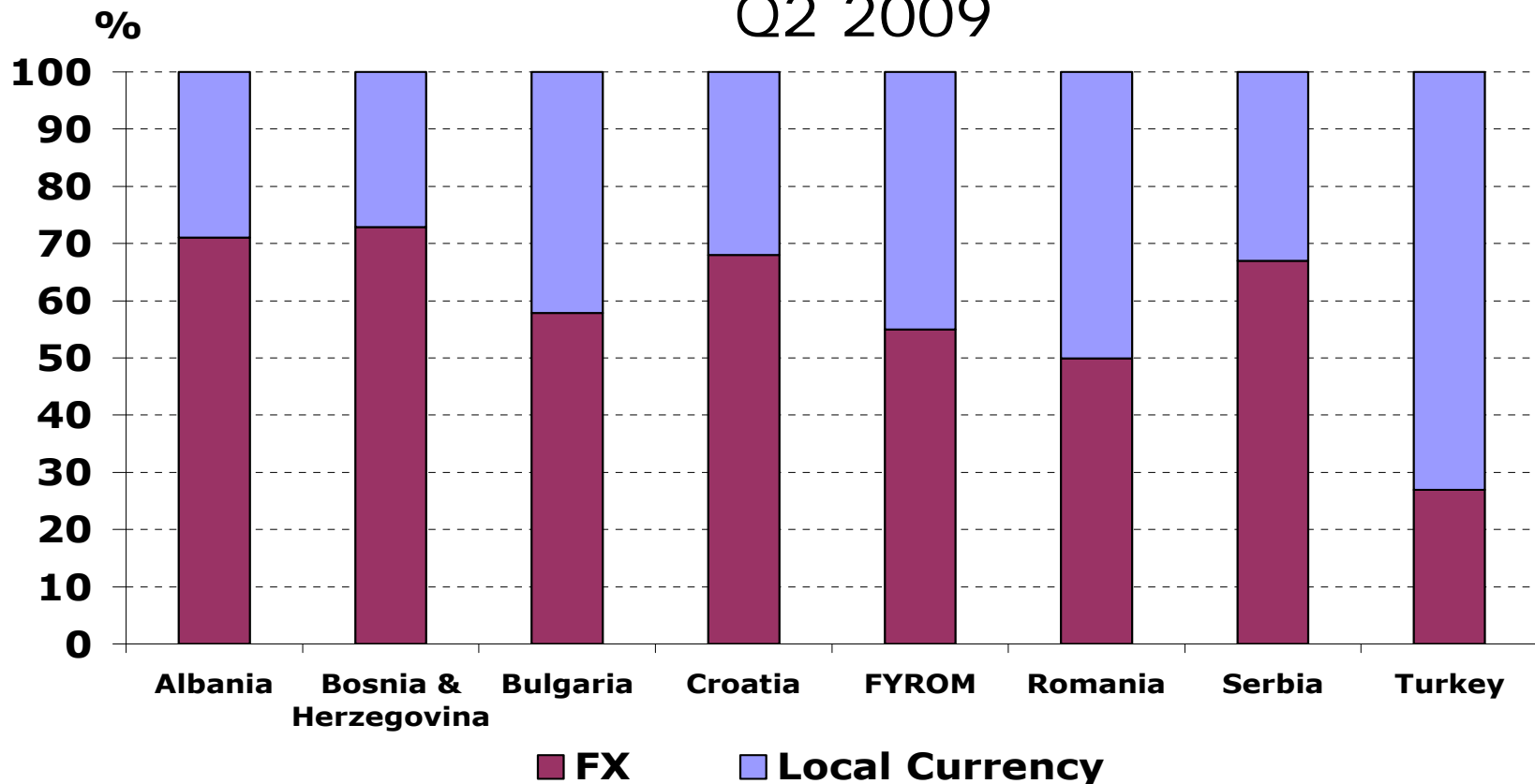
# III.3 Cons: NPLs keep rising



✓ Not as high as in the Baltic region

# III.3 Cons: Large FX exposure increases vulnerability to NPLs

## Total Bank Credit Decomposition Q2 2009



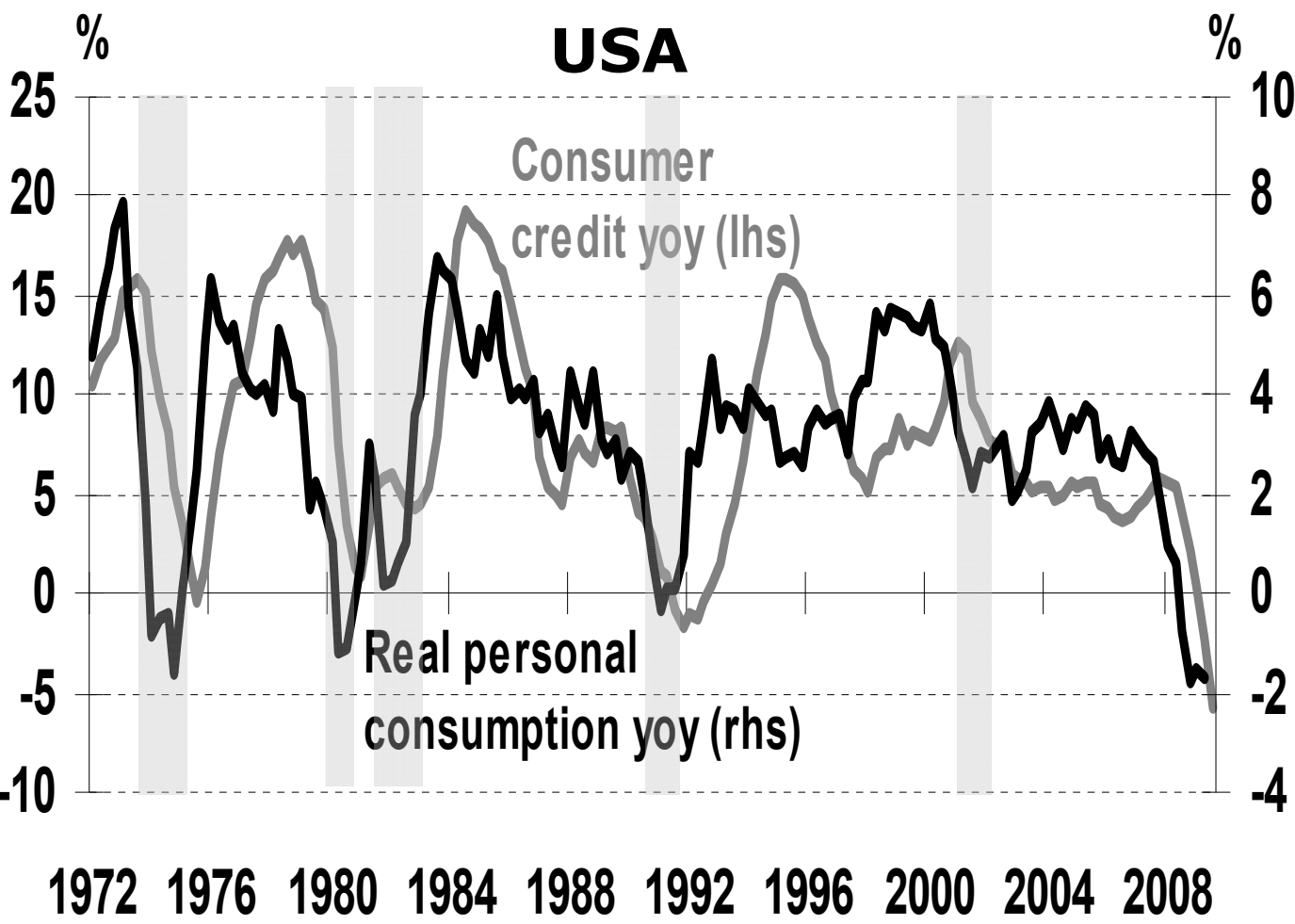
\* Albania, Croatia as of Q1 2009

\*\* Serbia as of Q2 2008

- ✓ Currency board would be attacked in Baltic States first, before migrating to Bulgaria

# III.3 Credit expansion follows a recovery

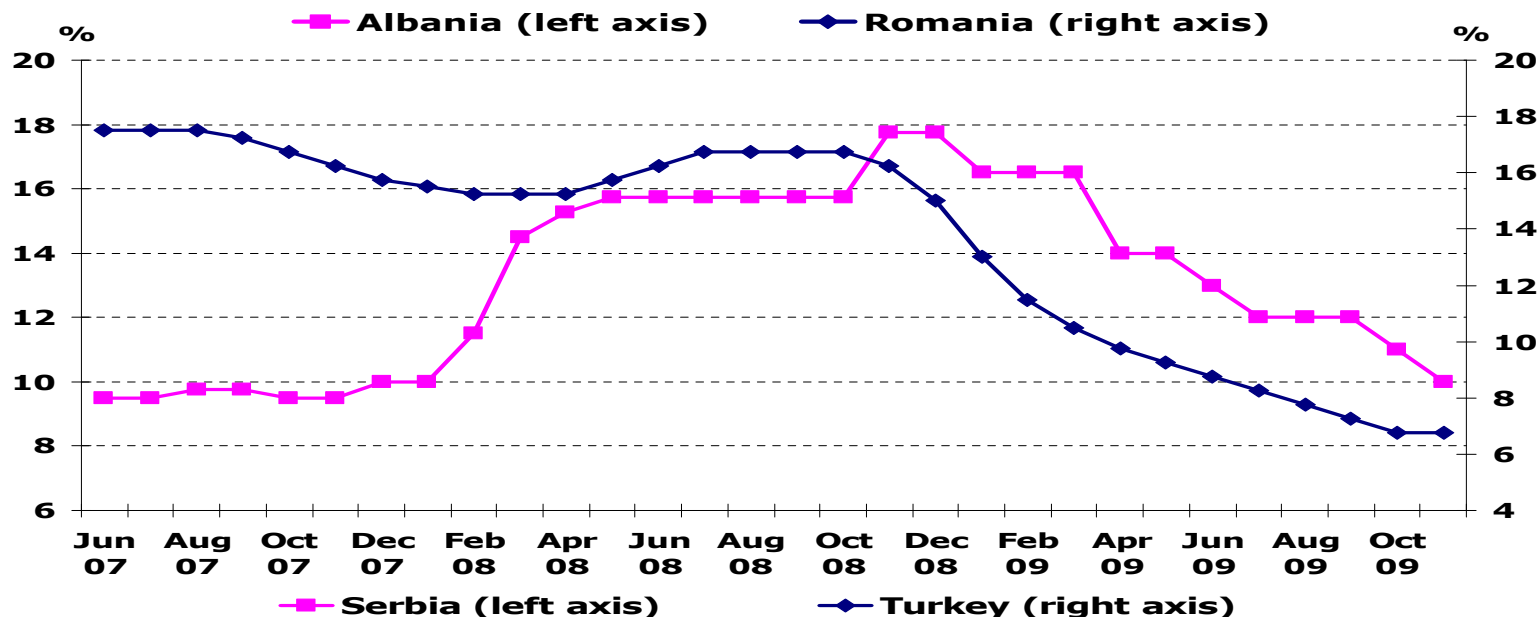
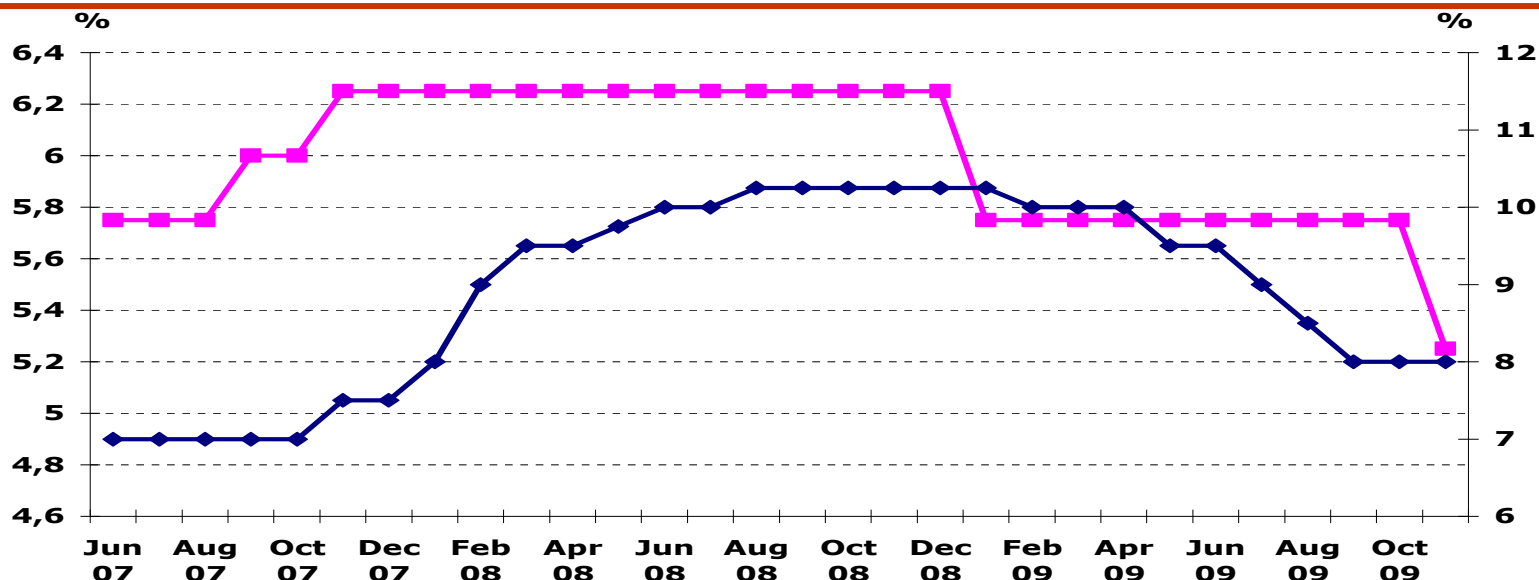
⇒ **SEEs cannot rely on banks to push them out of the recession**



- ✓ In 9 out of 10 previous US post-war recessions, real personal consumption has rebounded **3 quarters earlier** than consumer credit growth
- ✓ SEEs should therefore hope that good credit flows into their economies, **not any credit**

Source: Federal Reserve, Eurobank EFG

# III.3 Cons: Policy Rates may have bottomed

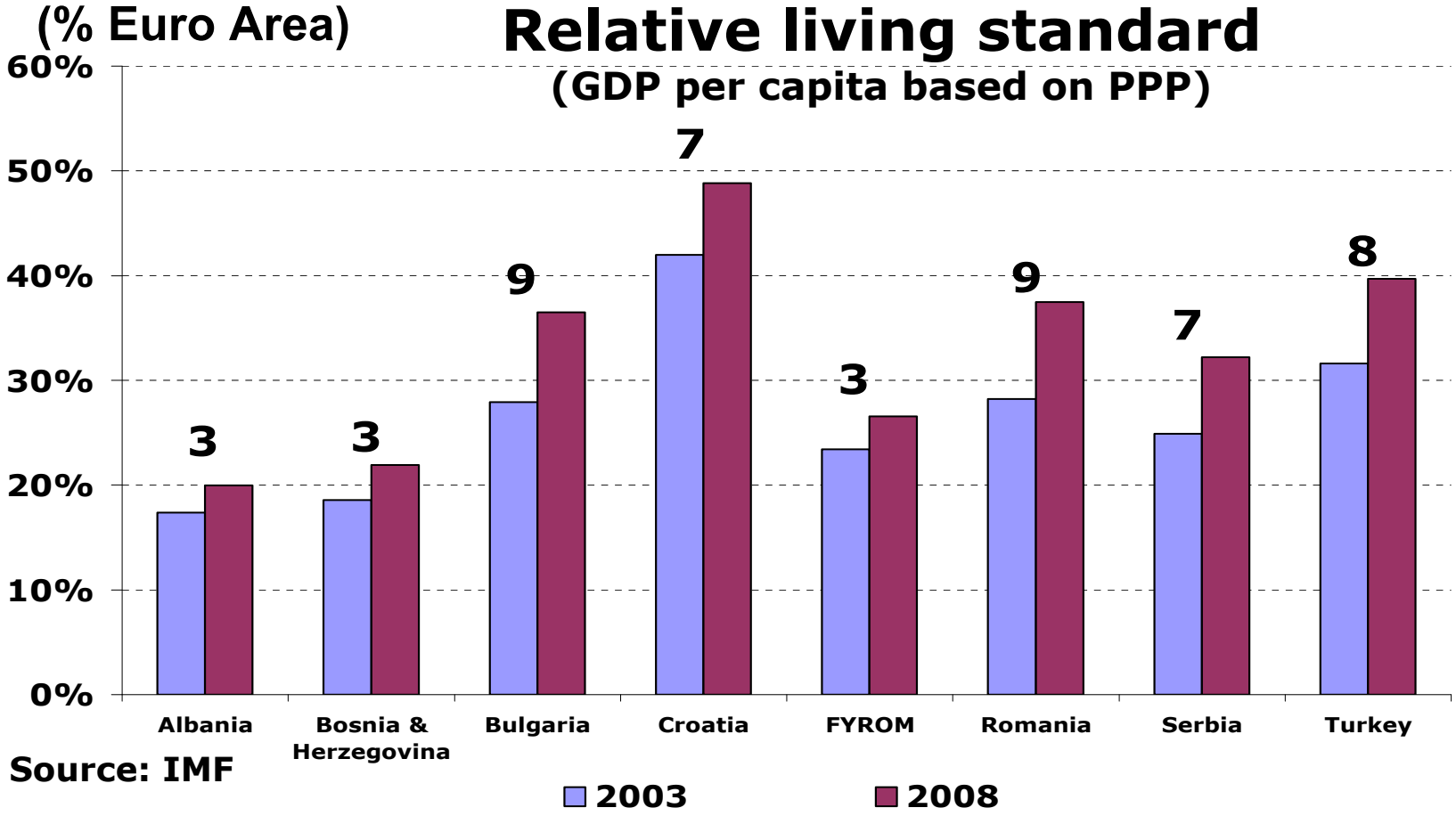


# IV.

## LOOKING AHEAD: A MORE BALANCED GROWTH MODEL FOR THE SEEEs

**From domestic consumption to  
investment and export driven growth**

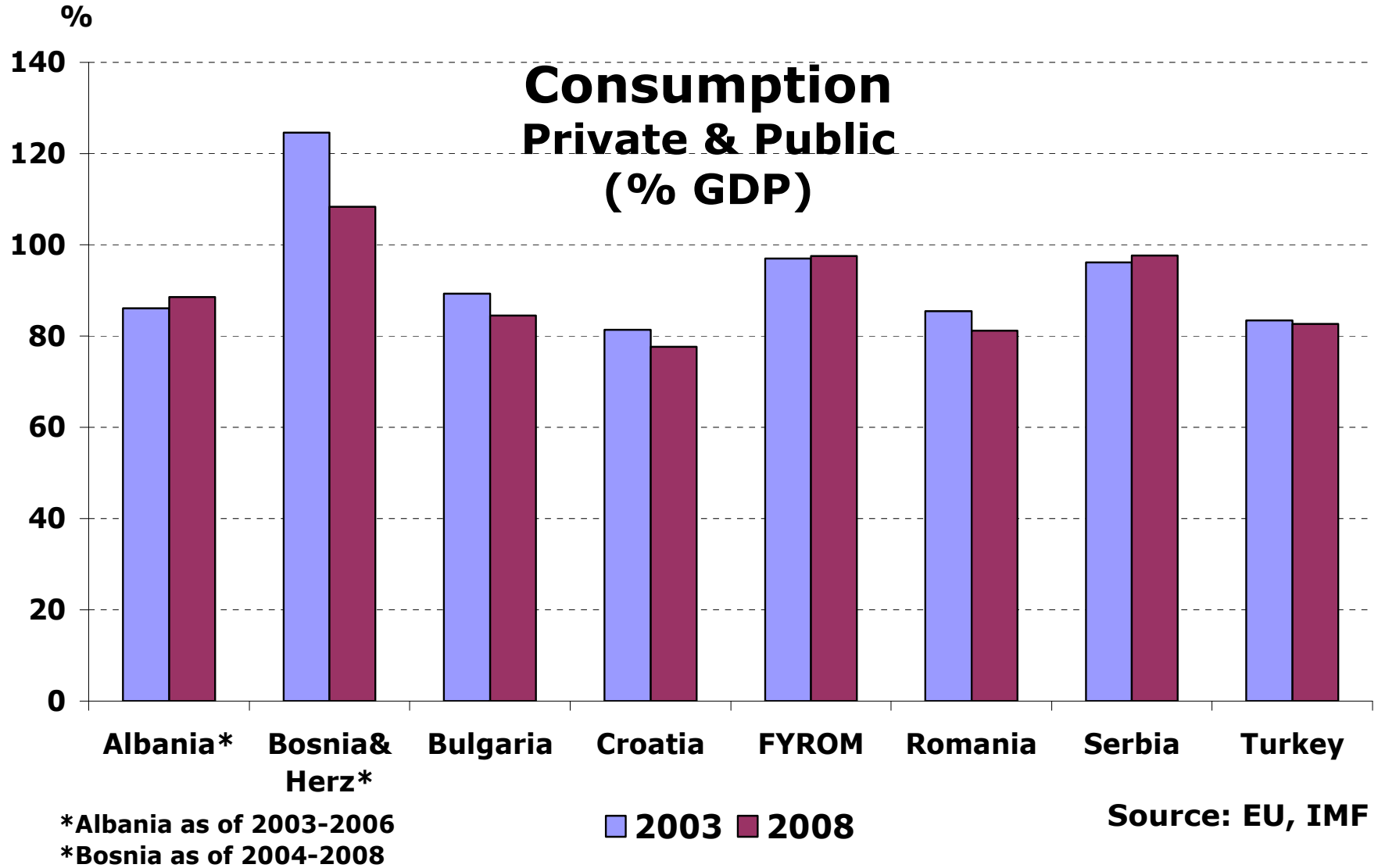
# IV.1 SEEs: Demand growth model improved living standards



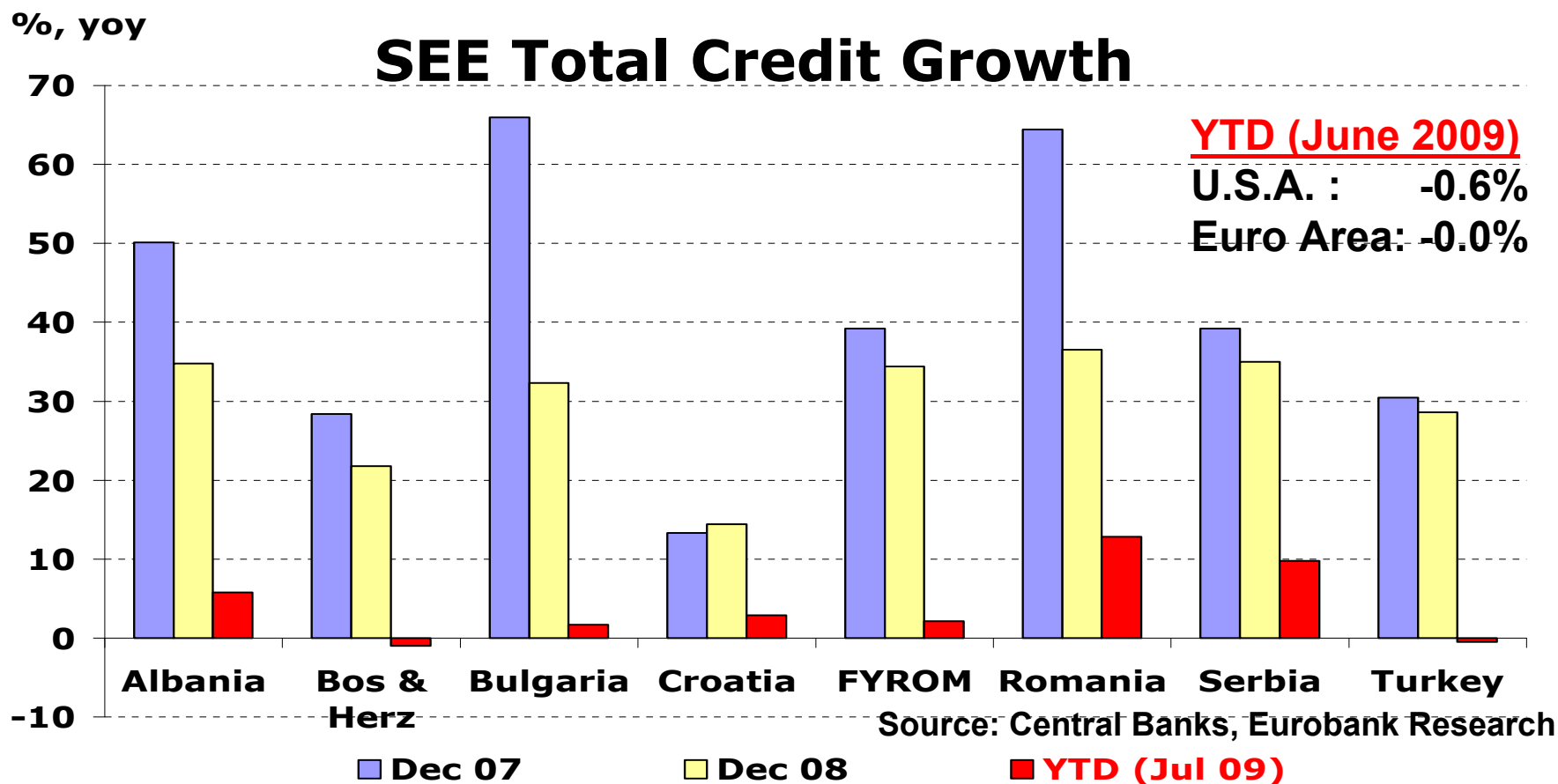
- ✓ SEEs improved their relative standard of living over the last 5 years
- ✓ Serbia's performance is impressive, given its late start



# IV.1 Consumption share too high



# IV.1 Yet now, demand-driven model outdated as credit bubble pops



- ✓ **Credit expansion will follow the recovery, it will not lead it**
  - “Economy recovers first and then lending unfreezes” is the Western experience with recessions
  - Loans exceed deposits
  - NPLs are rising and FX exposure is large

## IV.1 Foreign capital flew mainly into the non-tradables sector

### Share of FDI in Tradables & Non-tradables (%)\*

	Croatia	Bulgaria	Romania	Serbia	CEE5	Baltics
<b>Tradables</b>	<b>36</b>	<b>22</b>	<b>46</b>	<b>20</b>	<b>42</b>	<b>20</b>
<b>Non-tradables</b>	<b>64</b>	<b>78</b>	<b>54</b>	<b>80</b>	<b>58</b>	<b>80</b>
Trade	8	13	15	23	14	14
Transport	16	26	12	0	7	9
Banking	28	20	11	37	18	27
Real Estate	2	9	6	12	11	15
Other	10	10	10	8	8	15

\* FDI stock, 2005 or earlier

Source: IMF WP/07/236

**Tradable Sectors:** Industry, mining, agriculture, manufacturing, hunting, forestry, fishing, quarrying, processing industry

**Non-Tradable Sectors:** Wholesale & retail trade, transport, hotels & restaurants, construction, financial intermediation & insurance, real estate, post & telecommunications

## IV.2 A more-balanced growth model for future growth

Increased emphasis on:

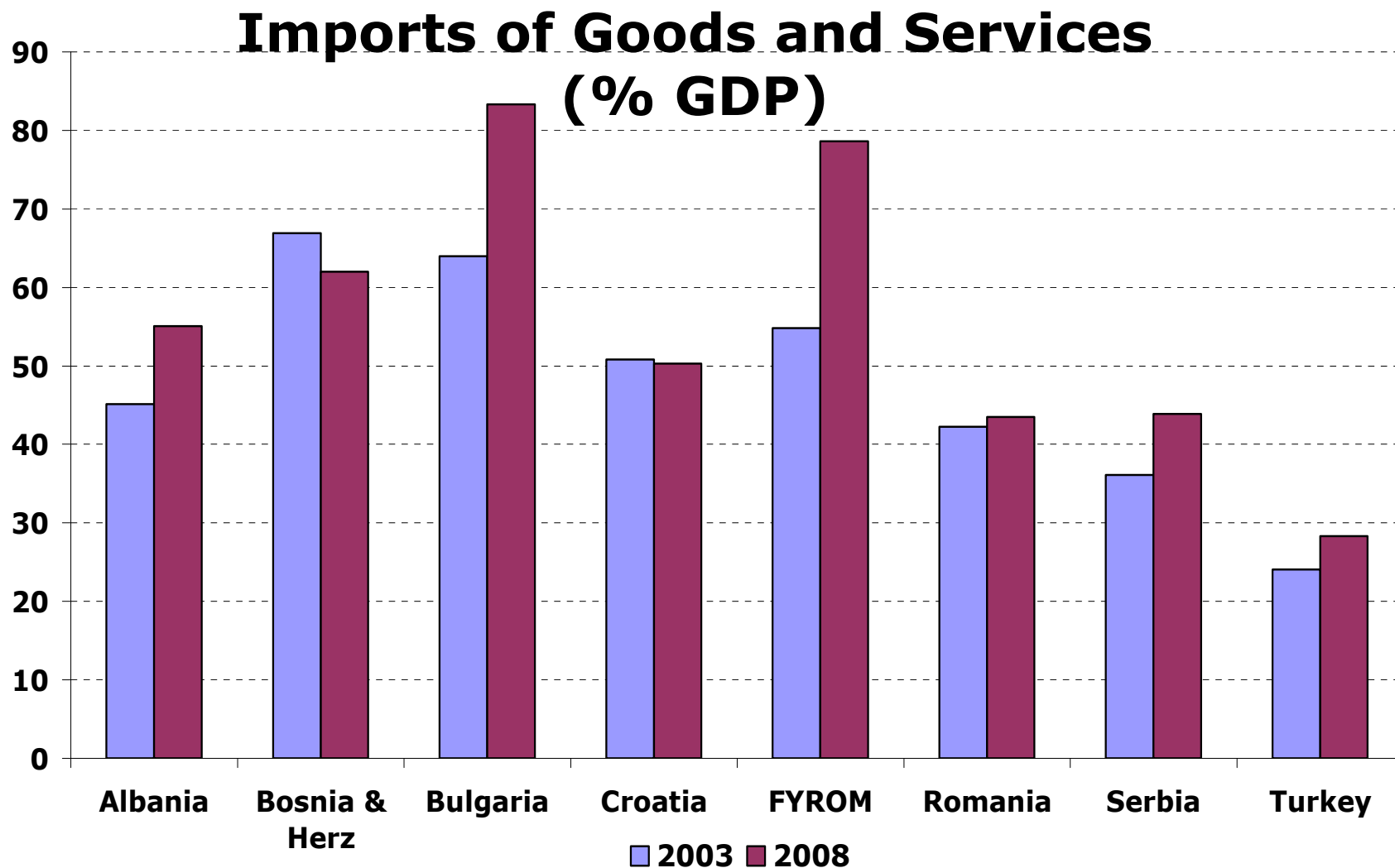
- ✓ Improving the domestic savings rate
- ✓ Shifting domestic demand from consumption to investment
- ✓ Focusing more on the export markets
- ✓ Fostering competitiveness and total factor productivity. Numerous studies have shown that TFP benefits from:
  - the rule of law,
  - the quality of institutions,
  - the quality of infrastructure,
  - or the matching of human capital development and job training with the modern needs of globalized market economies
- ✓ Of course, the specific growth prescription can vary from country to country as the comparative advantages differ across the region.
- ✓ Macroeconomic stability is an obvious prerequisite to the new growth model (IMF, Rating agencies, Greenfield investors watch inflation and fiscal deficits)
- ✓ EU/EMU entrance acts as a powerful anchor for policy decisions. In Serbia, EU Stabilization and Association Agreement unilaterally implemented

## IV.2 Additional emphasis on exports required



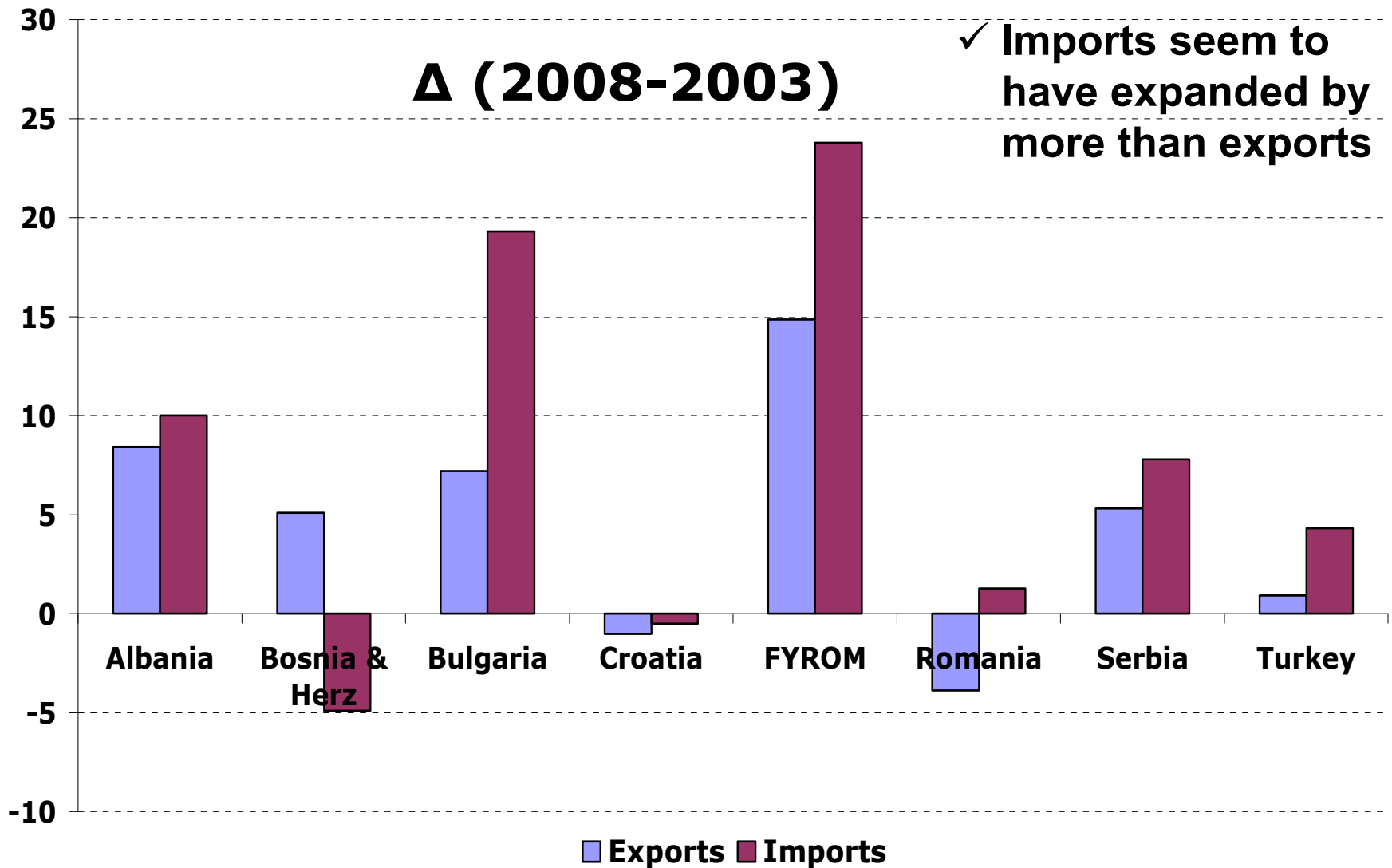
Serbia, Albania: Balance of Payments Accounts  
Bosnia: 2004-2008

# IV. Share of imports increased in almost all countries



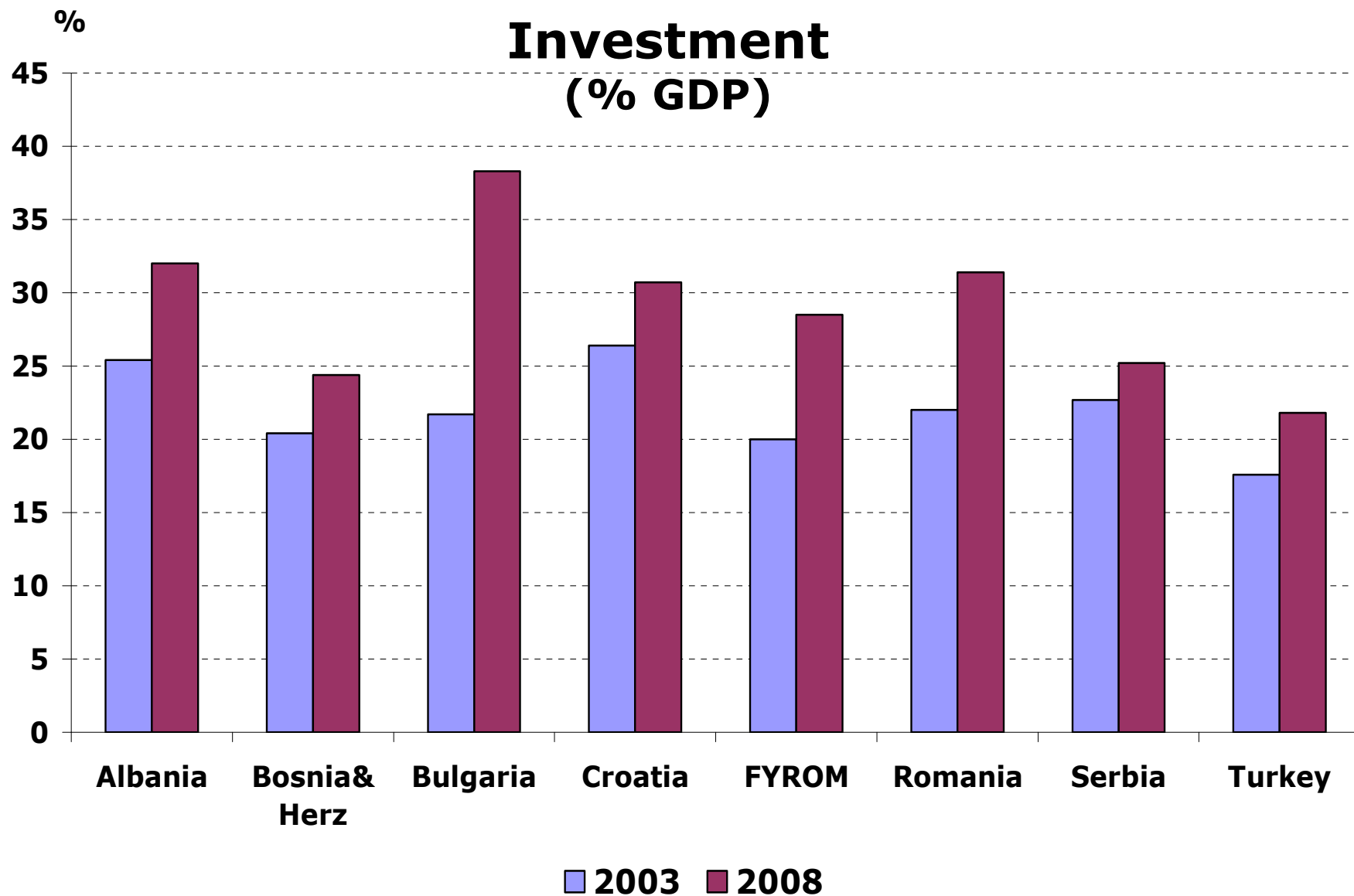
Albania, Serbia: Balance of Payments Accounts  
Bosnia : 2004-2008

## IV.2 Changes in Exports & Imports

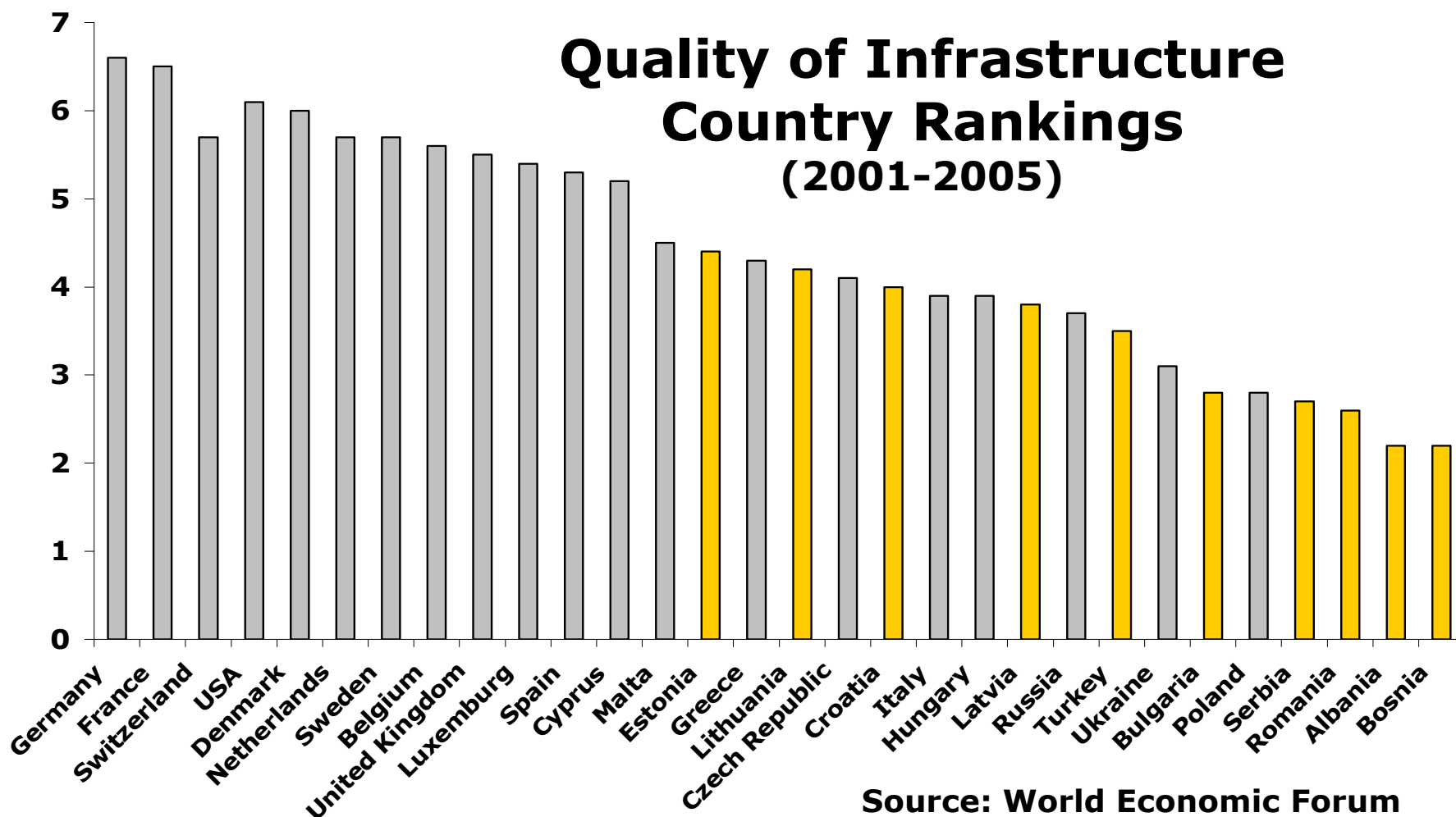


Albania, Serbia Balance of Payment Account  
Bosnia: 2008-2004

# IV.2 Need to promote investment







- ✓ Upgrading the infrastructure (ICT, Power, transportation, etc) is a top fiscal priority for SEE countries

## IV.2 Quality of Institutions

	Financial Sector Reform (0-5)*		Corruption Perceptions** (Median rank out of 159 and 180 countries)		Ease of Doing Business† (Median rank out of 155 and 183 countries)	
	2005	2009	2005	2009	2005	2009
SEE	<b>2.57</b>	<b>2.86</b>	<b>87</b>	<b>71</b>	<b>90</b>	<b>78</b>
Baltics	<b>3.45</b>	<b>3.56</b>	<b>44</b>	<b>52</b>	<b>16</b>	<b>26</b>
CEE5	<b>3.46</b>	<b>3.54</b>	<b>47</b>	<b>49</b>	<b>52</b>	<b>53</b>

\* EBRD, mean of "Banking reform and interest rate liberalisation" and "Securities markets and non-bank financial institutions" indices, country group averages. SEE excluding Turkey, CEE5 excluding the Czech Republic

\*\* Transparency International, 2009

† Doing Business, 2006 and 2010 country reports. Please note that changes in methodology have been introduced between 2005 and 2009

## IV.2 Improvement in the Ease of Doing Business rankings

	Rank 2005 among 155	Rank 2009 among 183	Cumulative Value Improvement (% 2009-2005)
Albania	<b>117</b>	<b>82</b>	<b>13.5</b>
Bosnia & Herzegovina	<b>87</b>	<b>116</b>	<b>4.0</b>
Bulgaria	<b>62</b>	<b>44</b>	<b>16.8</b>
Croatia	<b>118</b>	<b>103</b>	<b>16.2</b>
FYROM	<b>81</b>	<b>32</b>	<b>22.5</b>
Romania	<b>78</b>	<b>55</b>	<b>13.9</b>
Serbia	<b>92</b>	<b>88</b>	<b>6.2</b>
Turkey	<b>93</b>	<b>73</b>	<b>13.5</b>

Source: Doing Business 2006 and 2010 Reports, processed data

- ✓ Bosnia & Herzegovina deteriorates in ranking, but shows slight overall improvement in values when examined in isolation

## IV.2 Among the top ten reformers

*World Bank's Ease of Doing Business*

<b>COUNTRY</b>	<b>Among Top 10 Reformers</b>
<b>Albania</b>	<b>2007</b>
<b>Bosnia &amp; Herzegovina</b>	
<b>Bulgaria</b>	<b>2006</b>
<b>Croatia</b>	<b>2005 , 2006</b>
<b>FYROM</b>	<b>2006 , 2008</b>
<b>Romania</b>	<b>2004 , 2005</b>
<b>Serbia</b>	<b>2004</b>
<b>Turkey</b>	

Source: Doing Business Reports

## IV.2 Sources of improvement in Ease of Doing Business

<i>% Improvement in values from 2005 to 2009</i>	<b>Albania</b>	<b>Bosnia</b>	<b>Bulgaria</b>	<b>Croatia</b>	<b>FYROM</b>	<b>Romania</b>	<b>Serbia</b>	<b>Turkey</b>
<b>AGGREGATE</b>	<b>12.4</b>	<b>4.0</b>	<b>16.8</b>	<b>16.2</b>	<b>22.5</b>	<b>13.9</b>	<b>6.2</b>	<b>13.5</b>
<b>Starting a Business</b>	<b>71.2</b>	<b>24.0</b>	<b>71.9</b>	<b>41.3</b>	<b>84.8</b>	<b>4.1</b>	<b>21.7</b>	<b>41.0</b>
<b>Construction Permits</b>	<b>-9.1</b>	<b>46.4</b>	<b>0.0</b>	<b>27.6</b>	<b>-16.7</b>	<b>16.5</b>	<b>4.8</b>	<b>21.9</b>
<b>Employing Workers</b>	<b>17.8</b>	<b>7.5</b>	<b>47.5</b>	<b>2.2</b>	<b>38.3</b>	<b>52.4</b>	<b>-13.0</b>	<b>17.6</b>
<b>Registering Property</b>	<b>10.6</b>	<b>13.3</b>	<b>11.1</b>	<b>0.0</b>	<b>16.7</b>	<b>35.0</b>	<b>0.0</b>	<b>25.0</b>
<b>Getting Credit</b>	<b>5.0</b>	<b>11.6</b>	<b>20.6</b>	<b>43.3</b>	<b>13.3</b>	<b>22.9</b>	<b>56.7</b>	<b>13.2</b>
<b>Protecting Investors</b>	<b>46.0</b>	<b>3.0</b>	<b>7.0</b>	<b>10.0</b>	<b>7.0</b>	<b>3.0</b>	<b>-4.0</b>	<b>7.0</b>
<b>Paying Taxes</b>	<b>17.0</b>	<b>-37.6</b>	<b>18.7</b>	<b>31.0</b>	<b>25.9</b>	<b>-7.4</b>	<b>-61.0</b>	<b>12.9</b>
<b>Trading Across Borders</b>	<b>36.8</b>	<b>51.7</b>	<b>20.5</b>	<b>44.8</b>	<b>51.3</b>	<b>54.6</b>	<b>61.3</b>	<b>34.2</b>
<b>Enforcing Contracts</b>	<b>0.0</b>	<b>-80.3</b>	<b>-28.2</b>	<b>-38.0</b>	<b>-0.9</b>	<b>-52.8</b>	<b>-9.1</b>	<b>-50.4</b>
<b>Closing a Business</b>	<b>N/A</b>	<b>0.0</b>	<b>-1.4</b>	<b>0.0</b>	<b>5.5</b>	<b>11.0</b>	<b>5.1</b>	<b>13.0</b>

Source: Doing Business 2006 and 2010 Reports, processed data

## V. Conclusions

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- ✓ The international crisis will leave its permanent negative imprint on next decade's global growth
- ✓ A new global financial architecture will trade long-run stability against a higher cost of financial intermediation
- ✓ The SEE region was lucky not to host adventurous banks but imported the crisis through a sudden collapse of capital inflows and export markets
- ✓ The crisis caught the region overheating
- ✓ The crisis revealed the need for a new more balanced-growth model in the SEE region, with an increased emphasis on competitiveness, investment and exports
- ✓ Entrance into EU and/or EMU play important anchoring roles to political and policy decisions

# THANK YOU FOR YOUR ATTENTION!!

My thanks to the Research Department of Eurobank EFG for able research assistance and support

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