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The Euro Area: A Shelter? Estonian Perspectives.

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Estonian context

- Fully fixed exchange rate for 17 years
- Exports of trade and services is ca 75% of GDP, no capital controls since 1992
- Government debt 5% in 2008, net debt positive
- Banking sector fully integrated into Nordic banking
- The capital is Tallinn, closest capital Helsinki (not …!)
- Labour and product markets considered flexible

- Neither Asian-Russian nor Post-Lehman crises induced public discussion about these principles

Estonia and post-Lehman crisis

- NB. Adjustment from post-EU boom started well before Lehman
- Foreign trade was hit hard
- Cost of capital went up initially, later the development has been more ambiguous
- Elevated level of emotions in financial markets

- But by now situation has stabilised without major qualitative damage
  - Government debt is still less than 8%

- So the life is still possible also outside the euro area
  - How much the shelter would have made a difference?

Shelters could be different -- we are not talking about this shelter (probably)

Shelter helps outsiders already!

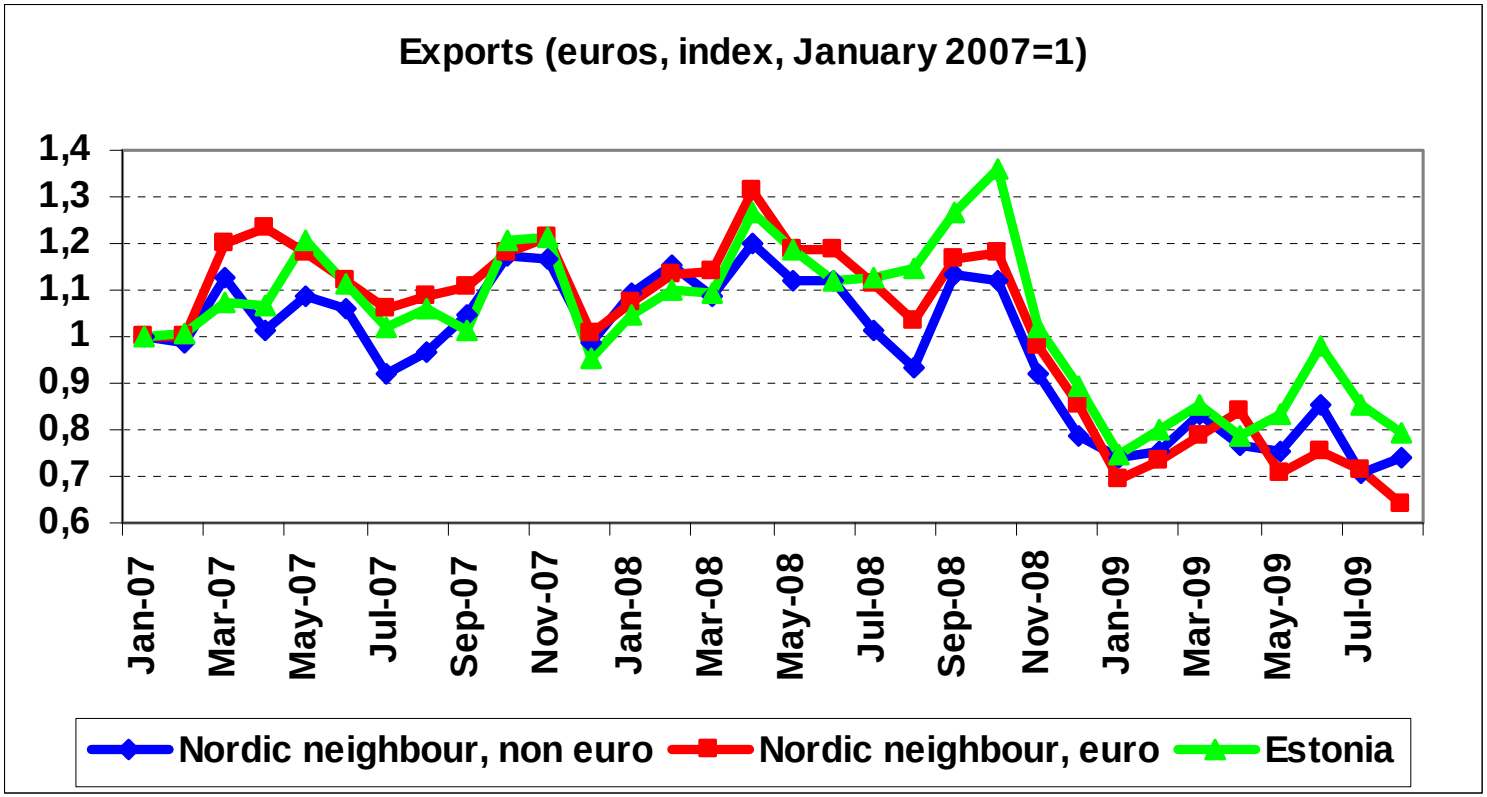
- Existence of Euro area has stabilised a situation already
  - Stable neighbour has been a blessing
  - Chaos in Europe could have been considerably larger and relatively high degree of freedom in policy choices would have not been probably here at all
  - Low euro interest rates were passed through

- Outsiders are as interested in strong euroland as insiders!

Euro and trade shock?

- Being in or out would have not made much difference to the trade decline
  - With marginal exceptions, where trade financing was specific issue (not widespread specific problem)
- More strategically being under the shelter could have been probably beneficial
  - Bigger integration, less “non-core producer” effect (maybe)

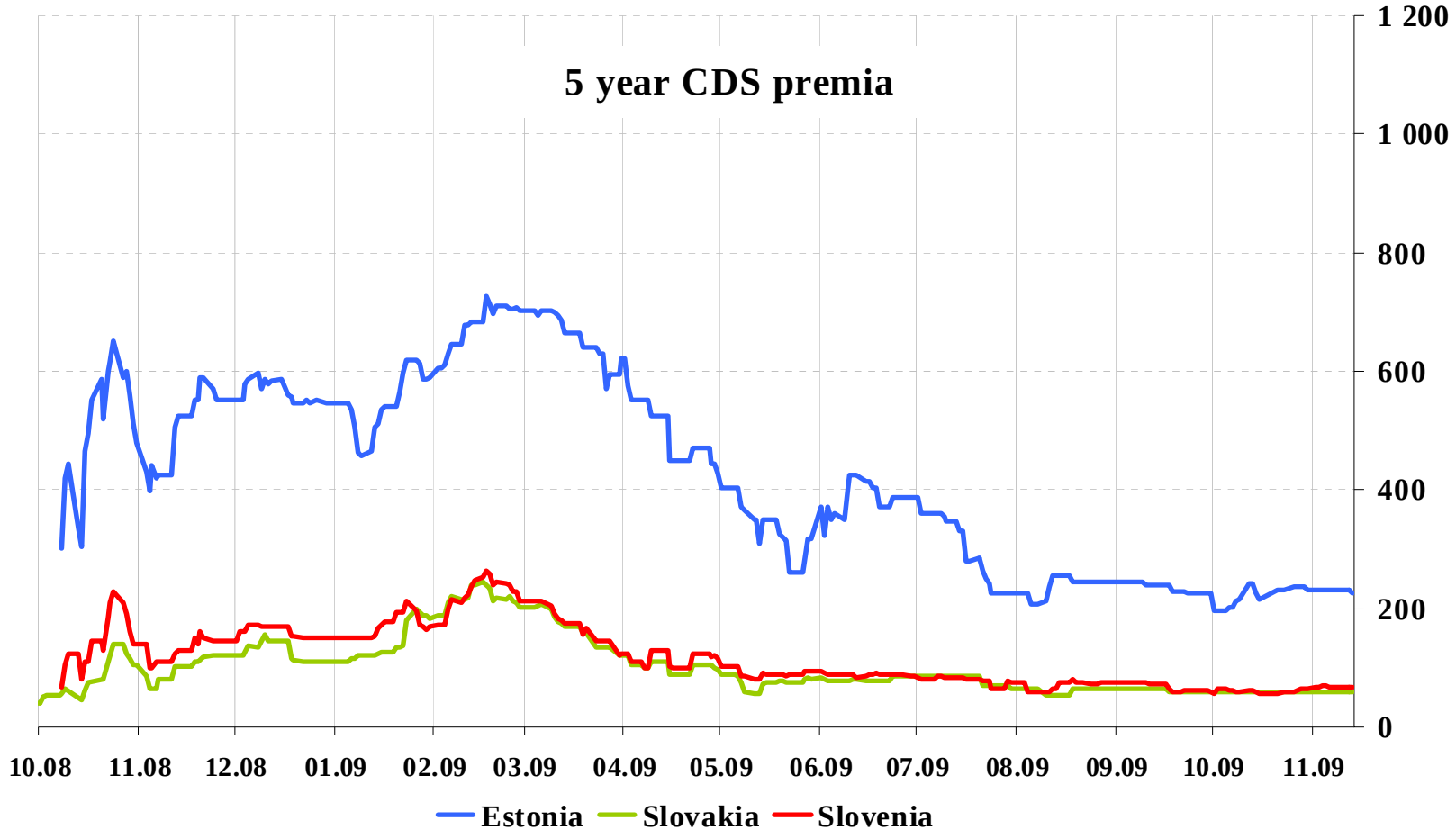
If there was any shelter then it was not seemingly functioning for trade



Euro and finances?

- Crisis elevated outsiders' problems in financial markets
  - Small open economy is "even smaller" in global crisis
  - Foreign (currency) positions under special scrutiny
    - Strange how debt and debt can really be different for some…
- All in all staying out was more costly

Is this a proof of a shelter?



At least from distance the shelter definitely looks like this!

Conclusions

- Estonia does not need an exit for the sake of an exit itself
  - Currency board, conservative fiscal policy and flexible markets is a viable policy combination on its own
- However, crisis has only proven the case for euro-shelter for us
  - Ability to withstand shocks is again been tested and test is passed