Slovakia, given that over the last few months the euro has appreciated substantially against a number of CESEE currencies.

Some further progress in EU accession negotiations

The accession negotiations with the EU candidate countries Croatia and Turkey have been proceeding. In the case of Croatia, negotiations are now ongoing in 22 out of 35 chapters and seven chapters have already been closed provisionally. The provisional closing of another eleven chapters is blocked, however, due to an unresolved border dispute with Slovenia. As this issue lingers on, time is running out to conclude negotiations by the end of this year, as originally envisaged.

Of the eight opened negotiation chapters, Turkey and the European Union have managed to provisionally close only one chapter. As Turkey does not, as yet, meet all of its statutory obligations – specifically with regard to extending the existing customs union with the EU to Cyprus – opening chapters on these matters has been delayed. Moreover, the EU will not close any other chapter provisionally unless Turkey has met all of its statutory obligations.

To sum up, the ongoing global crisis has put the growth process in the CESEE countries to the test. At the current juncture, challenges are manifold, and the dependence of the region on global financial and economic developments remains high. The crisis has exposed some of the macrofinancial vulnerabilities in the region, while also confirming the diversity across CESEE countries in terms of performance and also, at least to some extent, in terms of crisis-response measures.

In recent months, Europe as a whole has begun to pay greater attention to economic and financial developments in CESEE countries, and in particular also to the need to be prepared to actively support individual CESEE countries. This is a reflection of Europe's increasing recognition of the fact that the intense trade, FDI and financial sector links between many Western European countries and the CESEE region are too important to take a laissez faire approach to adverse developments in individual member countries. As for policy action, the doubling of EU macrofinancial assistance for Member States in need, to a total of EUR 50 billion, is a case in point. Moreover, the additional funds Europe is providing to beef up IMF resources will also help deal with adverse developments in individual CESEE countries.

Box 1

Financial Market Developments in Central, Eastern and Southeastern Europe: Spillovers from the Global Financial Crisis

This box reviews financial market developments in CESEE in a cross-country perspective and in comparison with developments in the euro area and in non-European emerging markets. The macroeconomic implications of financial market developments are analyzed and discussed in the main part of Recent Economic Developments in this issue.

After CESEE countries had been hit hard by the wave of market corrections from mid-September until end-October 2008 (see box 1 in Focus on European Economic Integration 2/08), financial market conditions remained tense over the review period (October 28, 2008, to April 10, 2009). Developments across the countries were rather divergent in most financial market segments. Among the different financial market segments, exchange rates seem to have been affected most, hitting record lows against the euro and prompting central bank interventions in many countries (see main part of the report). While money market developments differed considerably, local currency government spreads declined in the majority of countries. Eurobond spreads and credit default swap (CDS) premiums stayed at elevated levels, while becom-

ing more volatile. However, both segments started to show some downward tendencies in late February/early March 2009. Similarly, stock markets managed to recover somewhat in that time period, after the downward trend had decelerated the months before.

Over the review period, money market spreads against the euro area moved in quite different directions across the CESEE region, ranging from –360 basis points in Turkey to +660 basis points in Russia. The sharp contraction in Turkey is largely associated with sizeable policy interest rate cuts (–625 basis points), which by far exceeded the rate cuts of the ECB (–225 basis points). In contrast, spreads widened significantly in Russia, reflecting a liquidity squeeze on the interbank market as well as the central bank's monetary tightening aimed at supporting the ruble. Due to tightened liquidity conditions, Croatian spreads recorded an increase of 540 basis points, while spreads in Bulgaria increased by some 160 basis points. In the Czech Republic, the interest rate differential toward the euro area became positive in terms of 3-month money market rates by mid-November 2008 (after having been negative since March 2005), as the differential in key policy rates turned positive as well. In comparison with the countries already mentioned, spreads remained broadly unchanged in Poland, Hungary and – albeit at a much higher level – in Romania.

In most of the CESEE countries, local currency government bond spreads declined over the review period. Turkey's local currency bond market performed best, as spreads were down by 1,000 basis points. Spreads widened significantly only in Russia (+330 basis points) and marginally also in the Czech Republic (+20 basis points). All countries except for Turkey underperformed global developments, since spreads declined by less than the 100 basis points recorded by the JPM GBI-EM spread.

Eurobond spreads have remained at elevated levels since October 2008. Despite high volatility in some countries, most of the CESEE countries' eurobond spreads stayed almost unchanged (with changes ranging from –20 basis points in Bulgaria to +30 basis points in Hungary), while the average emerging market spread (JPM Euro EMBI Global Index) declined somewhat more noticeably (–40 basis points) over the review period. Again, Turkey represents an exception, with spreads having contracted substantially (–500 basis points). Having ranked among the countries with the highest euro-denominated eurobond spreads at end-October 2008, Turkey's spreads stood below those of Romania, Bulgaria, Croatia and Hungary at the cutoff date. Romania's spreads declined markedly as the agreement on an IMF-led multilateral financial support package was coming into reach and was then eventually announced in March 2009 (–150 basis points since end-October 2008). Finally, spreads on Russian U.S. dollar-denominated eurobonds decreased by 240 basis points, which was roughly in line with the decline observed for the overall market (JPM EMI Global Index).

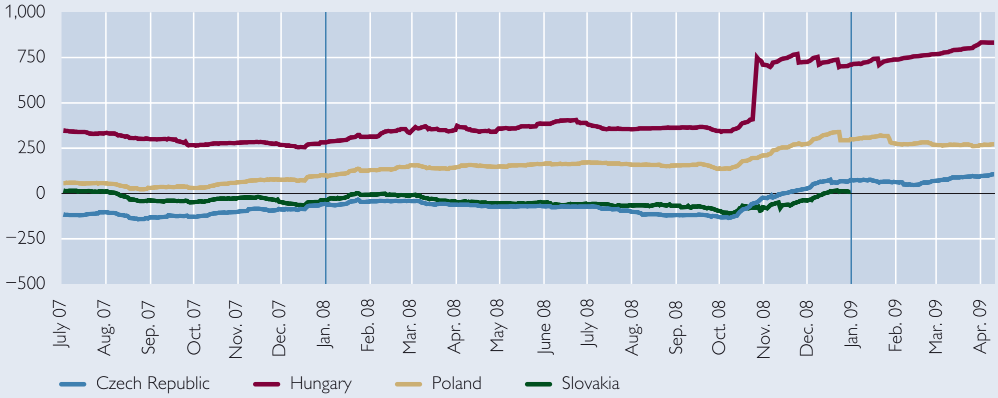
Developments in CDS markets were characterized by much higher volatility over the review period (partly due to decreasing liquidity). For example, Russia's 5-year CDS (representing the most volatile in our country selection) was traded between 400 and 1,000 basis points, whereas Slovakia's 5-year CDS (being the least volatile in our sample) moved in a range from 100 to 280 basis points. While CDS premiums still trade well above pre-September 2008 levels, some downward tendencies were recently seen in all countries (since late February 2009 in the Czech Republic, Poland and Slovakia, since March in the rest of the countries). With the exception of Hungary, CDS premiums of those countries which had initially recorded the strongest increases also showed the most pronounced downward corrections in absolute terms in March and early April 2009 (Bulgaria, Croatia, Romania, Russia and Turkey). Similar to developments in the eurobond market, Romania's CDS spreads decreased notably due to the international financial support package. Russia and Turkey performed best, with CDS premiums declining by some 650 and 370 basis points from their record highs at end-October 2008. CDS of the three countries considered to be least risky (the Czech Republic, Poland and Slovakia) had been trading in a rather close range up to end-October. Since then, however, Polish CDS premiums went up markedly and Czech CDS premiums followed suit at the beginning of 2009. The Czech Republic's differential to Slovakia narrowed again in recent weeks, but Poland's CDS premiums were 100 basis points higher than Slovakia's at the cutoff date (compared with 50 basis points at end-October 2008).

From end-October 2008 to end-February 2009, CESEE stock markets recorded further losses, though on average the downward trend decelerated somewhat. In March, however, a recovery set in. When taking the whole review period into consideration, only Bulgaria (–40%), Croatia (–30%) and Slovakia (–10%) recorded equity price losses. In contrast, the most pronounced equity price gains were seen in Russia (+40%) and the Czech Republic (+20%). Hence, developments within the CESEE region diverged considerably. A global comparison reveals that, over the review period, Eastern Europe performed in line with other emerging market regions, while outperforming mature stock markets. Similarly to the MSCI EM Index, the MSCI EMEE Index (covering the Czech Republic, Hungary, Poland and Russia) increased by about 30%, whereas the DJ Industrial Average and the EURO STOXX decreased by about 5%.

Chart 1a

3-Month Money Market Spreads against the Euro Area

Basis points *Cutoff date: April 10, 2009*

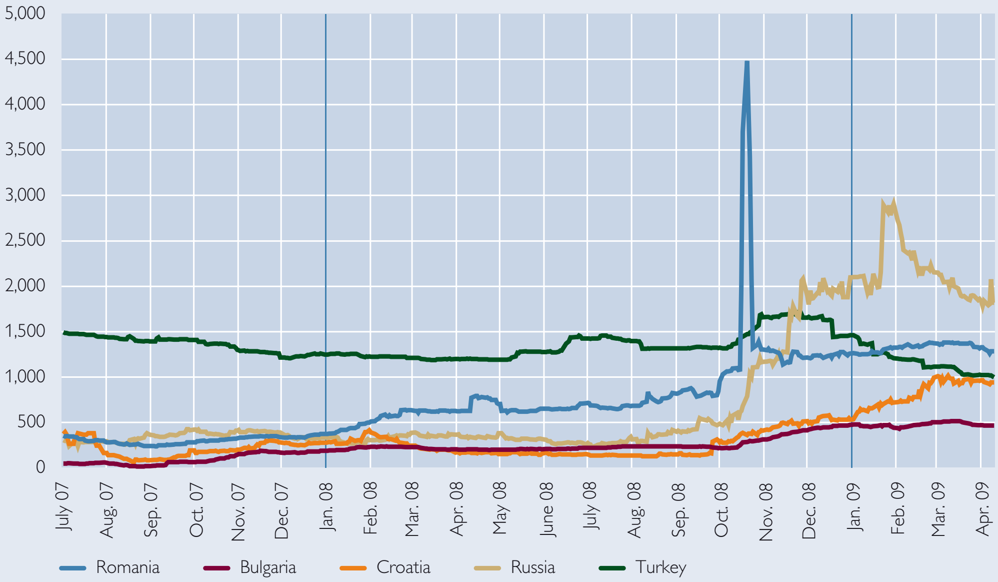


Source: Bloomberg.

Chart 1b

3-Month Money Market Rate Spreads against the Euro Area

Basis points *Cutoff date: April 10, 2009*

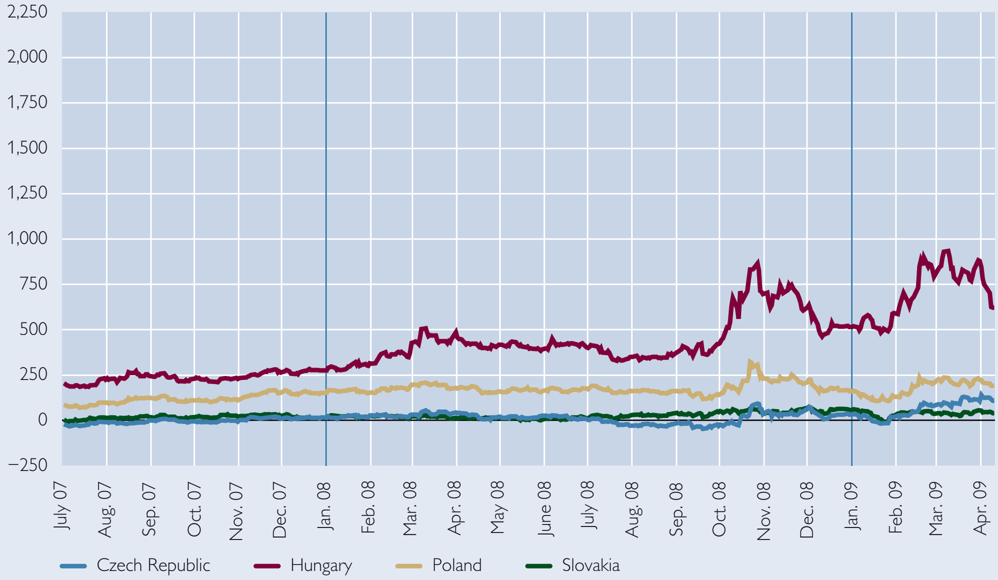


Source: Bloomberg.

Chart 2a

Local Currency Government Bond Yield Spreads against the Euro Area

Country subindices of JPM EM-GBI, basis points *Cutoff date: April 10, 2009*

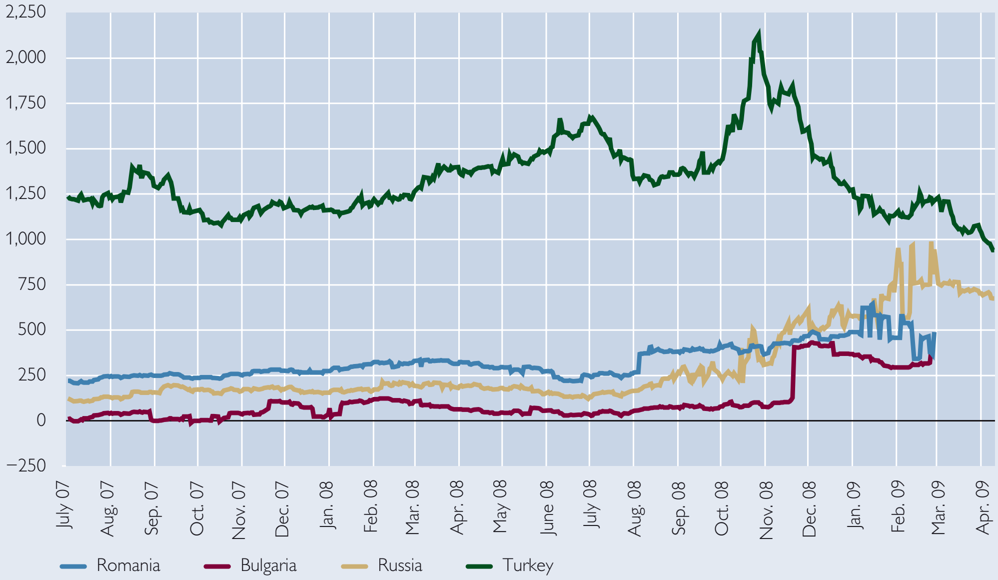


Source: Thomson Reuters.

Chart 2b

Local Currency Government Bond Yield Spreads against the Euro Area

Country subindices of JPM GBI-EM for Russia and Turkey, Eurostat data for Bulgaria and Romania, basis points[1] *Cutoff date: April 10, 2009*



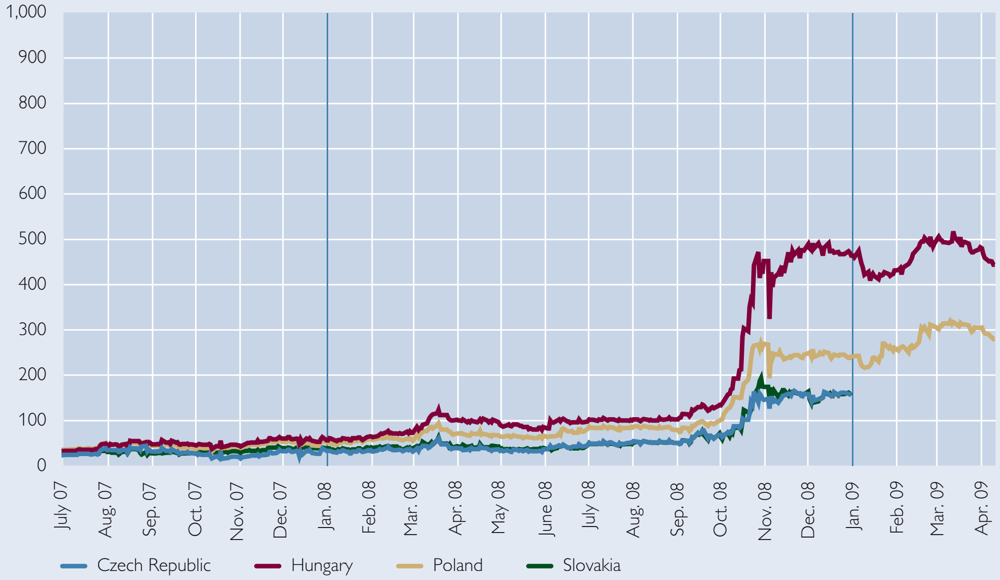
Source: Thomson Reuters, Eurostat.

[1] The last observation for Bulgaria and Romania is February 27, 2009.

Chart 3a

Euro-Denominated Eurobond Yield Spreads

JPM Euro EMBI Global, basis points *Cutoff date: April 10, 2009*

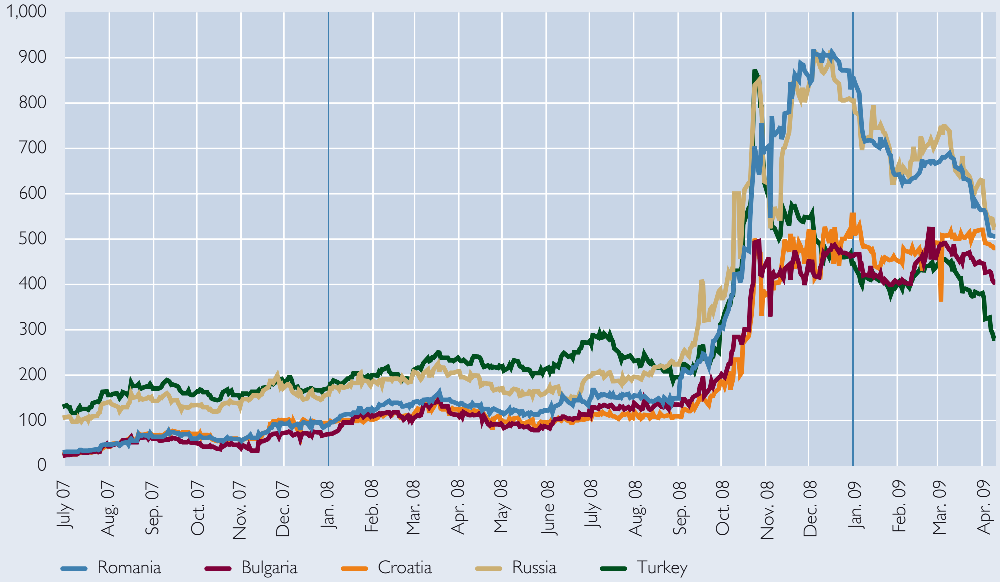


Source: Thomson Reuters.

Chart 3b

Euro-Denominated Eurobond Yield Spreads

JPM Euro EMBI Global, for Russia JPM EMBI Global, basis points *Cutoff date: April 10, 2009*

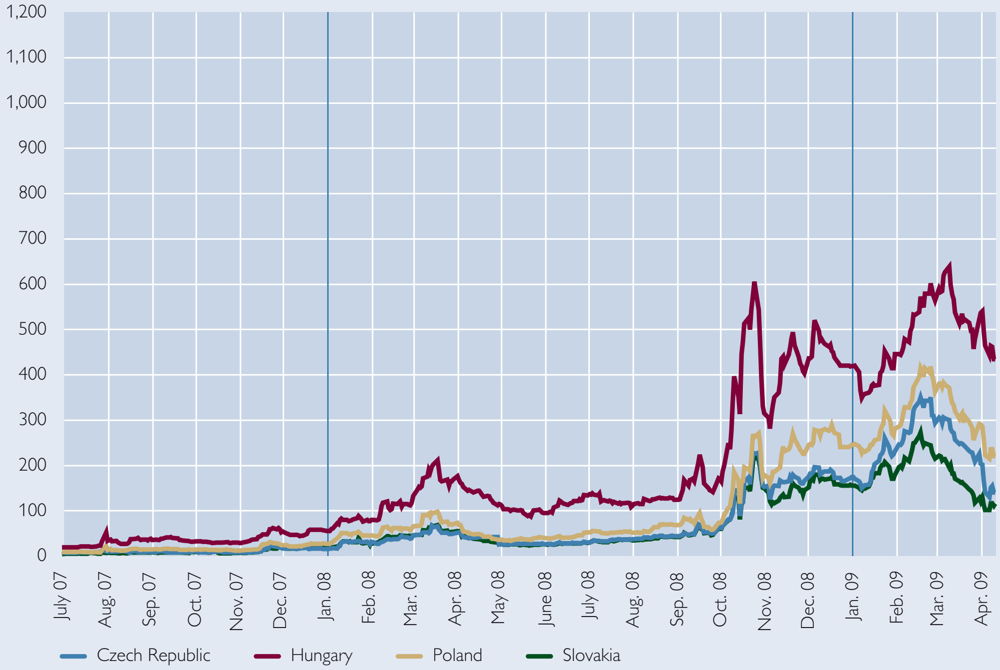


Source: Thomson Reuters.

Chart 4a

Sovereign 5-Year Credit Default Swap Premiums

Basis points *Cutoff date: April 10, 2009*

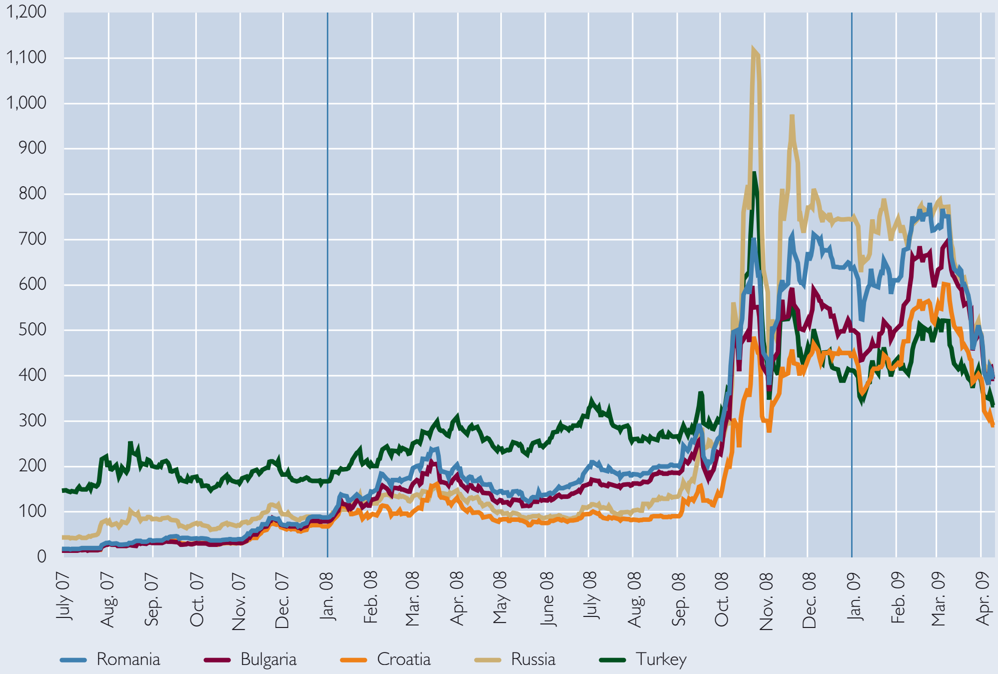


Source: Thomson Reuters.

Chart 4b

Sovereign 5-Year Credit Default Swap Premiums

Basis points *Cutoff date: April 10, 2009*

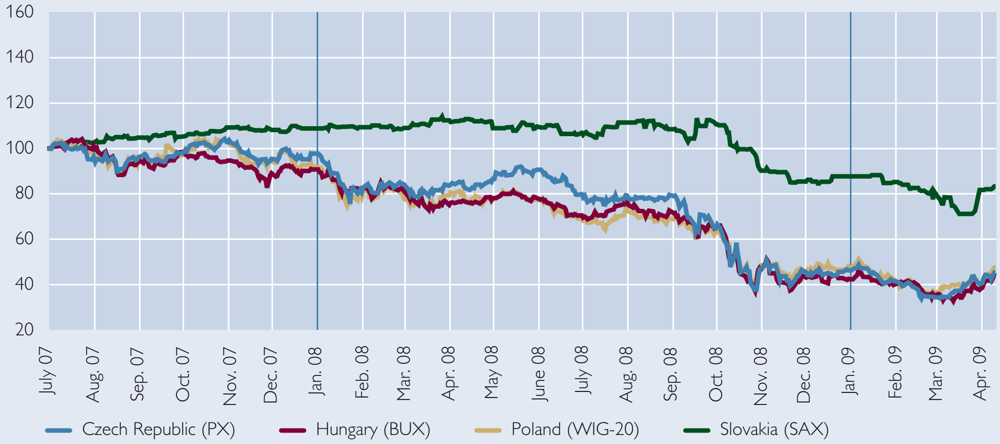


Source: Thomson Reuters.

Chart 5a

Stock Market Developments

June 29, 2007 = 100 *Cutoff date: April 10, 2009*

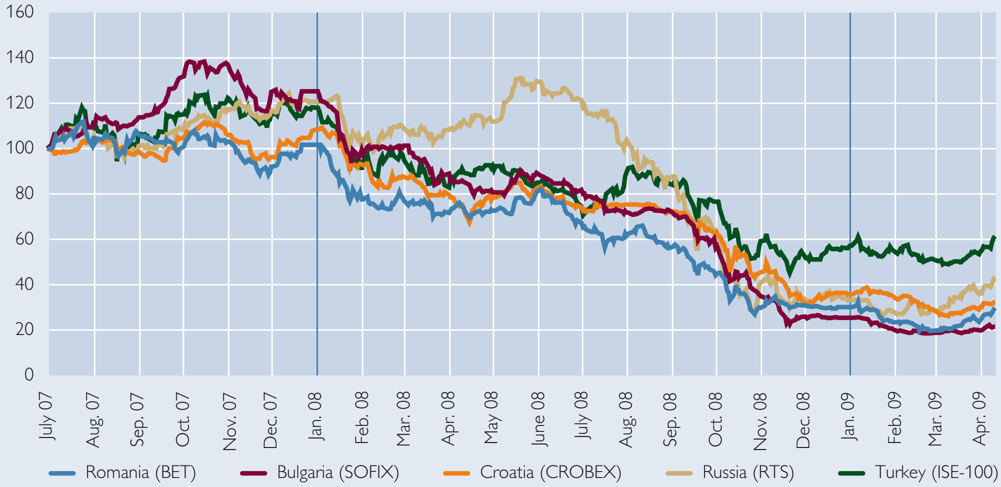


Source: Thomson Reuters.

Chart 5b

Stock Market Developments

June 29, 2007 = 100 *Cutoff date: April 10, 2009*

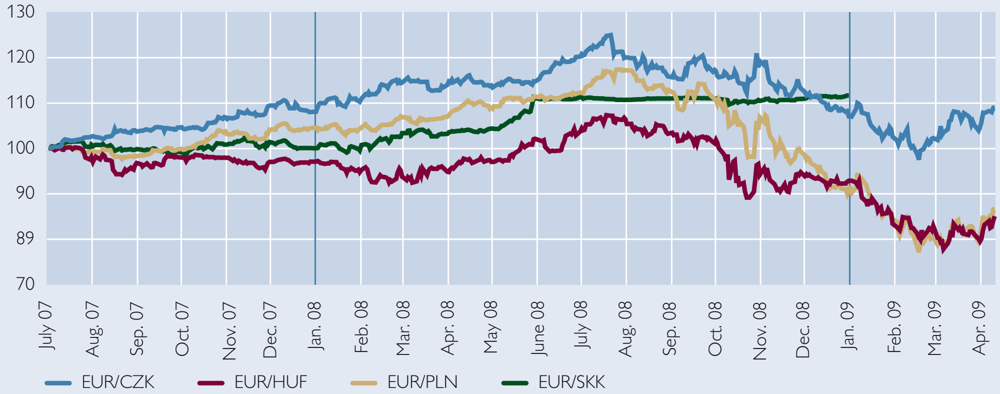


Source: Thomson Reuters.

Chart 6a

Exchange Rate Developments against the Euro[1]

June 29, 2007 = 100 *Cutoff date: April 10, 2009*



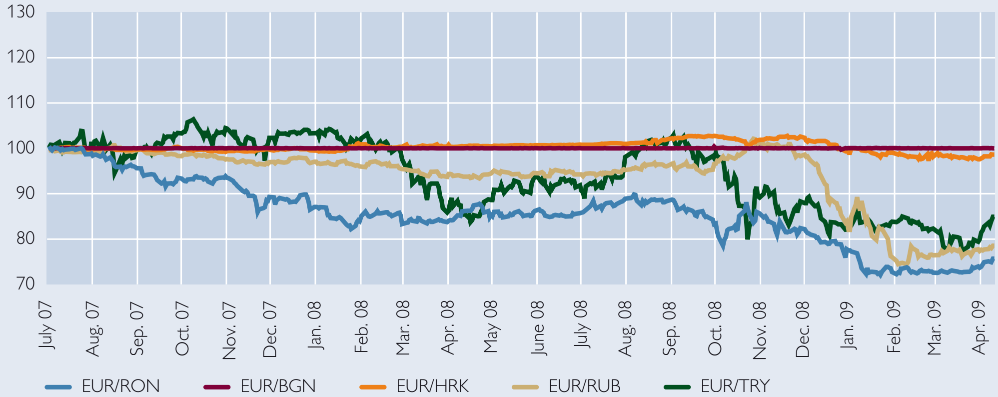
Source: Thomson Reuters.

[1] An increase in value means a nominal appreciation.

Chart 6b

Exchange Rate Developments against the Euro[1]

June 29, 2007 = 100 *Cutoff date: April 10, 2009*



Source: Thomson Reuters.

[1] An increase in value means a nominal appreciation.