Box 1

Financial Market Developments in CESEE: Markets Are in the Process of Stabilizing as Global Risk Appetite Rebounds

Following months of stressed financial markets in CESEE triggered by the collapse of Lehman Brothers in September 2008, market tensions started to ease in February and March 2009 (see box 1 in Focus on European Economic Integration 2/08 and Q2/09). Over the review period (April 10, 2009, to September 30, 2009), stabilization tendencies continued and some financial market segments even performed rather strongly. Global risk appetite and investor confidence in emerging markets increased further, also thanks to the global policy response to the crisis and its spillover effects on emerging markets (i.a. increase of IMF resources, formally agreed at the G-20 summit in April). Multilateral support programs for CESEE countries remained on track and presumably also had positive external effects on the countries of the region that have not been accorded such packages. Money market spreads against the euro area mostly declined, while local currency bond spreads remained broadly stable, with remarkable spread contractions in Turkey and Hungary. Eurobond as well as CDS spreads continued to retreat and came back close to the levels seen prior to the collapse of Lehman. Equity prices sustained their recovery, while exchange rates of currencies with free floats or managed floats either stabilized or continued to strengthen against the euro. In turn, the stabilization tendencies in foreign exchange markets gave central banks more room to cut interest rates in response to falling inflation and rising negative output gaps.

Over the review period, three-month money market spreads against the euro area mostly trended downwards. Spreads contracted most noticeably in Russia (−850 basis points), Romania (−400 basis points), Turkey (−240 basis points) and Hungary (−160 basis points). Money market spread contractions were largely associated with sizeable interest rate cuts (see introductory part of this report). In Russia and Romania, liquidity conditions have apparently improved considerably, as witnessed by money market rates moving towards policy rates (i.e. money market rates fell more strongly than policy rates). Also in Croatia (−75 basis points) and Bulgaria (−45 basis points), money market spreads decreased noticeably. By contrast, money market spreads remained broadly unchanged in the Czech Republic while they widened in Poland (+70 basis points).[1]

Spreads of government bonds denominated in local currency remained broadly stable over the review period with the exception of those in Turkey, Hungary and Bulgaria. Turkey performed best, with spreads tightening by 400 basis points, while in Hungary, spreads were down by 200 basis points. By contrast, spreads widened by 100 basis points in Bulgaria. On average, the CESEE region performed better in this market segment than other emerging market regions, thus reversing the poorer performance in the first few months after the Lehman crisis. The J.P. Morgan Government Bond Index spread for emerging Europe declined by 80 basis points, while the corresponding spreads for Asia, Latin America and Middle East/Africa increased by about 60 basis points.

Across the CESEE region, eurobond spreads retreated substantially from their highs seen in late 2008 and early 2009. However, despite the notable downward movements in recent months, eurobond spreads have so far not fully returned to the levels preceding the collapse of Lehman. Between April and September 2009, spreads on euro-denominated eurobonds tightened by more than 200 basis points in Croatia, Hungary and Romania, by about 150 basis points in Poland and Bulgaria and by 80 basis points in Turkey. Turkey's eurobond spread had already peaked in October 2008 and began to decline somewhat earlier than those of the other countries. In Croatia, Hungary and Romania, eurobond spreads fell more strongly than the average emerging market spread (J.P. Morgan Euro EMBI Global Index, −170 basis points) during the review period, after having recorded sharp increases following the collapse of Lehman. Spreads on Russian U.S. dollar-denominated eurobonds decreased by 230 basis points, which was broadly in line with developments seen for the overall market (J.P. Morgan EMBI Global Index).

[1] *The development in Poland may be explained inter alia by changing market expectations about future policy rate cuts.*

Similar to developments observed in the eurobond market, CDS spreads of CESEE countries tightened significantly in recent months (on CDS spreads, see also the report on a recent East Jour Fixe at the OeNB in the Highlights section of this report). The downward trend continued throughout the review period, interrupted only by temporary hikes in early summer. At end-September 2009, however, spreads were still trading slightly above the levels seen prior to the collapse of Lehman Brothers. CDS spreads of Slovakia and the Czech Republic returned closest to this level. Countries that recorded the largest widening of CDS spreads after the bankruptcy of Lehman Brothers (Hungary, Bulgaria, Romania, Russia and Turkey) also saw the most pronounced contractions in absolute terms (about 150 to 200 basis points). After these countries had been trading in a wide range in the first quarter of 2009 (the differential between Turkey at the lower end and Russia at the upper end reached about 400 basis points), spreads converged to about 200 basis points at end-September 2009. In the other countries, CDS spreads declined by between 60 basis points (Slovakia, Czech Republic) and 100 basis points (Poland, Croatia) over the review period.

Easing market tensions were also evident in equity markets, with most CESEE equity indices rising considerably in recent months. Over the review period, all equity indices except for Slovakia's (−10%) supported the recovery, which started in February and March 2009.[2] It is noteworthy that during the summer, Turkey's and Hungary's equity indices already surpassed levels reached before the collapse of Lehman Brothers, while most other indices moved closely towards this threshold. Equity price gains during the review period ranged from 20% in Poland to about 60% in Hungary, Bulgaria and Turkey. The Morgan Stanley Capital International Emerging Markets Eastern Europe Index (covering the Czech Republic, Hungary, Poland and Russia) performed only slightly better than mature stock markets, increasing by 30% while the EUROSTOXX 50 rose by 28% and the Dow Jones Industrial Average by 20%. However, its performance was slightly worse than the emerging markets' average (MSCI Emerging Markets index: +35%). A comparison among emerging markets reveals that emerging Asia, as represented by the MSCI EM Asia Index (+40%), outperformed all other emerging market regions.

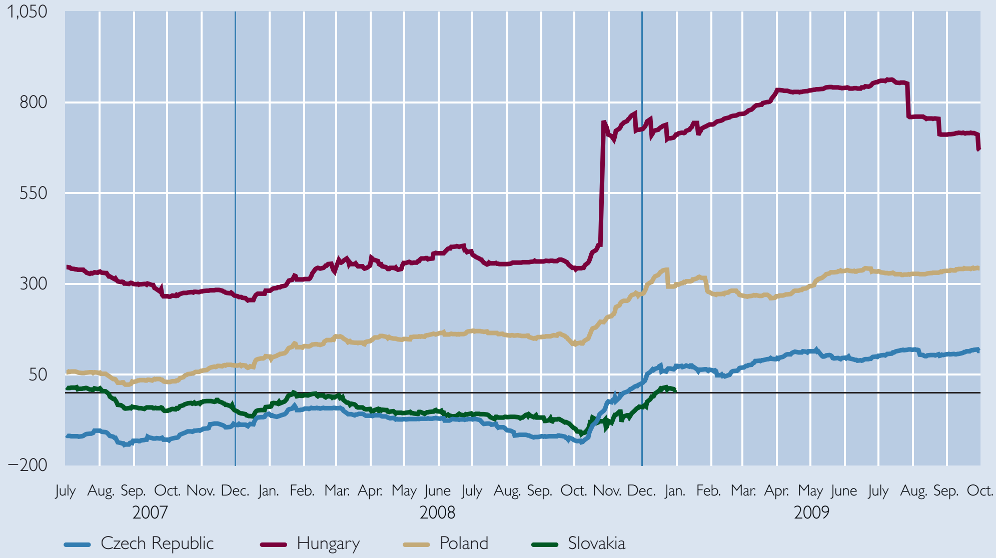
While equity indices rebounded, CESEE currencies either stabilized or continued to recover a part of their earlier losses. Over the review period, the Hungarian forint, the Czech koruna and the Polish złoty strengthened against the euro. After a notable recovery during the summer, the złoty lost some of its value more recently, while the other currencies stayed broadly stable. Still, at end-September 2009, all floating currencies, except for the Czech koruna, were traded way off the levels seen before the collapse of Lehman Brothers.

[2] However, Slovakia's equity market developed more strongly than those of other CESEE countries in the years 2007 and 2008, so that its medium-term performance compares well with that of other stock markets in the region.

Chart 1a

3-Month Money Market Rate Spreads against the Euro Area

Basis points *Cutoff date: Sep. 30, 2009*

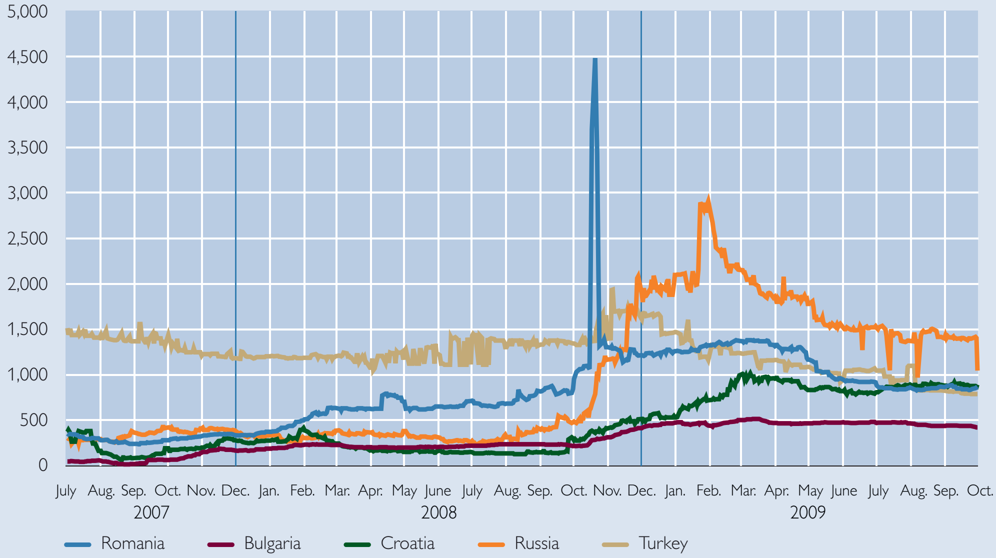


Source: Bloomberg.

Chart 1b

3-Month Money Market Rate Spreads against the Euro Area

Basis points *Cutoff date: Sep. 30, 2009*

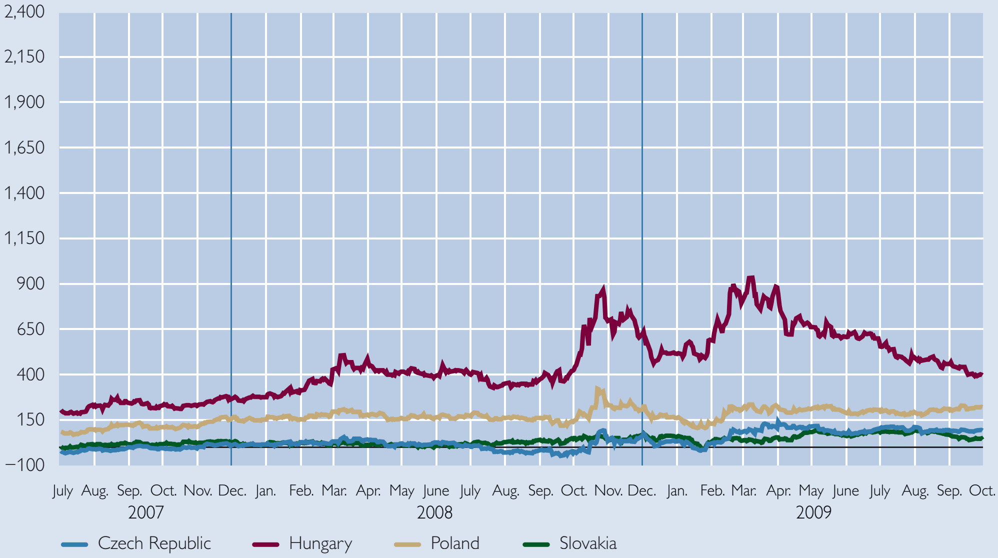


Source: Bloomberg.

Chart 2a

Local Currency Government Bond Yield Spreads against the Euro Area

Country subindices of JPM EM-GBI, basis points *Cutoff date: Sep. 30, 2009*

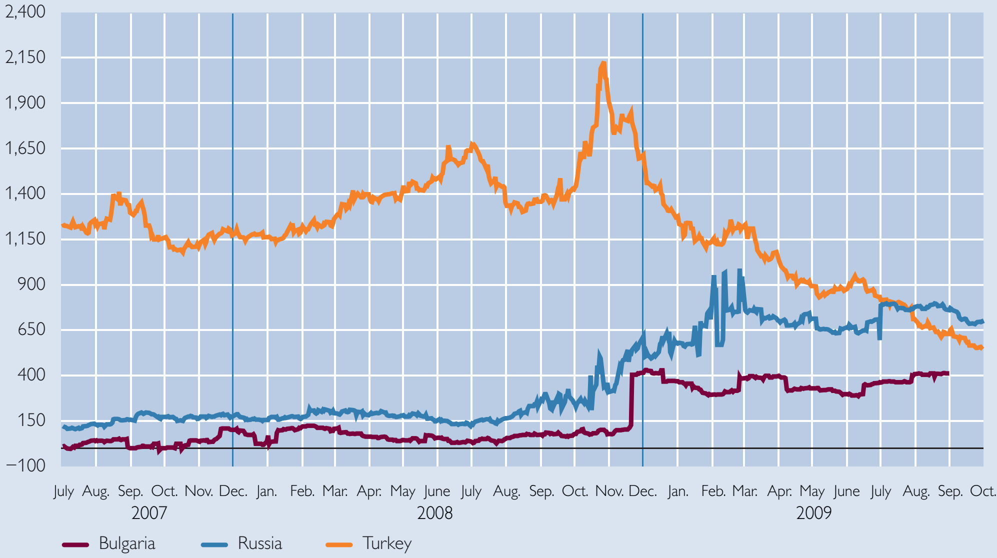


Source: Bloomberg, OeNB.

Chart 2b

Local Currency Government Bond Yield Spreads against the Euro Area

Country subindices of JPM EM-GBI for Russia and Turkey, Eurostat data for Bulgaria, basis points *Cutoff date: Sep. 30, 2009*



Source: Bloomberg, Eurostat, OeNB.

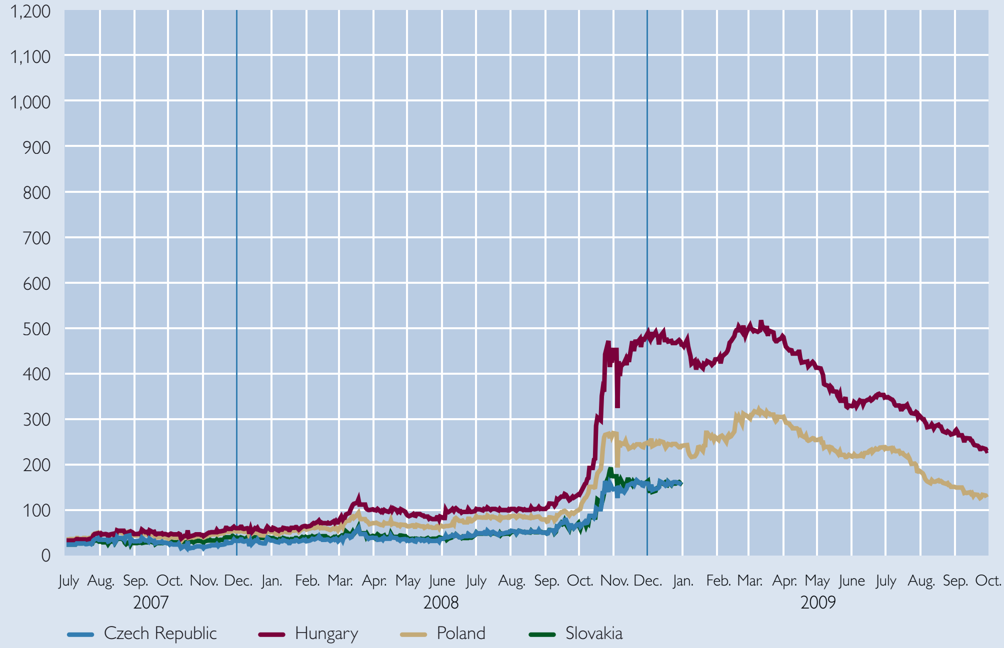
Note: The latest observation period for Bulgaria is Aug. 31, 2009.

Chart 3a

Euro-Denominated Eurobond Yield Spreads

JPM Euro-EMBI global index, basis points

Cutoff date: Sep. 30, 2009



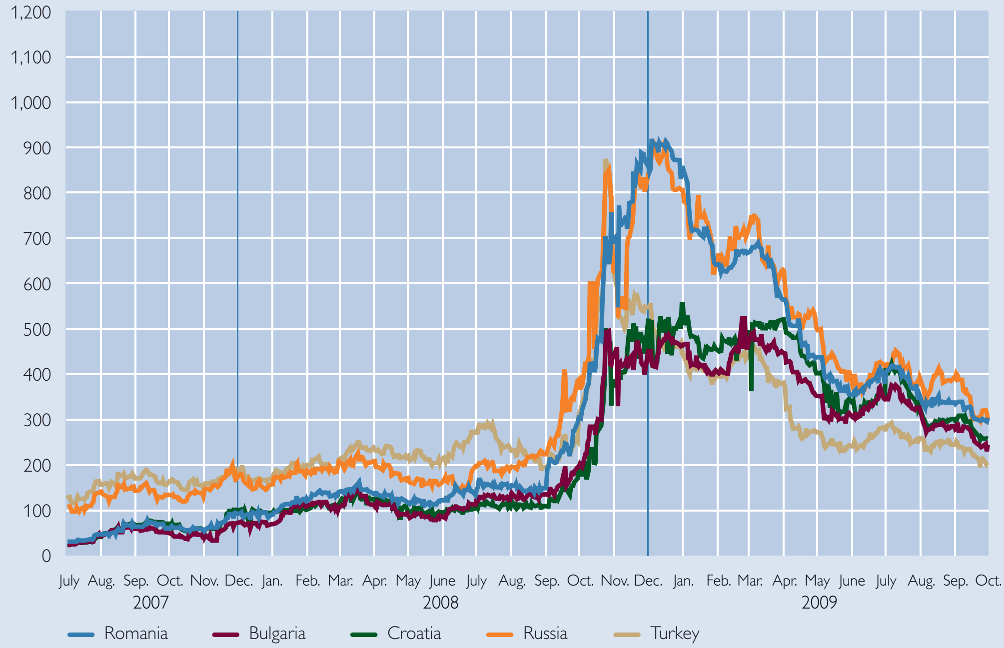
Source: Bloomberg, OeNB.

Chart 3b

Euro-Denominated Eurobond Yield Spreads

JPM Euro-EMBI global index, for Russia JPM EMBI global index, basis points

Cutoff date: Sep. 30, 2009

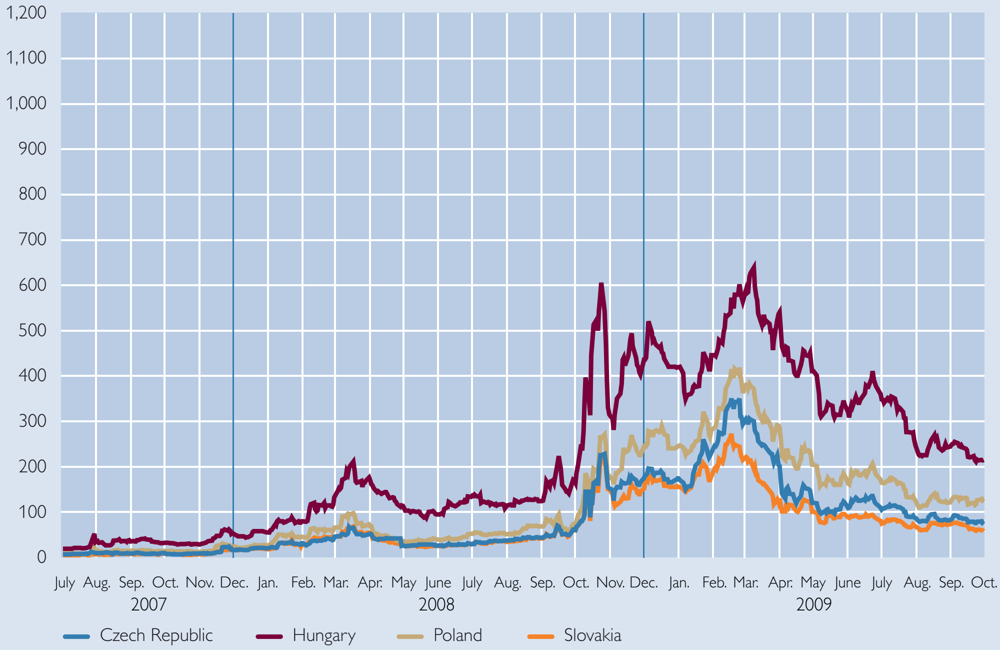


Source: Bloomberg, OeNB.

Chart 4a

Sovereign 5-Year Credit Default Swap Spreads

Basis points *Cutoff date: Sep. 30, 2009*

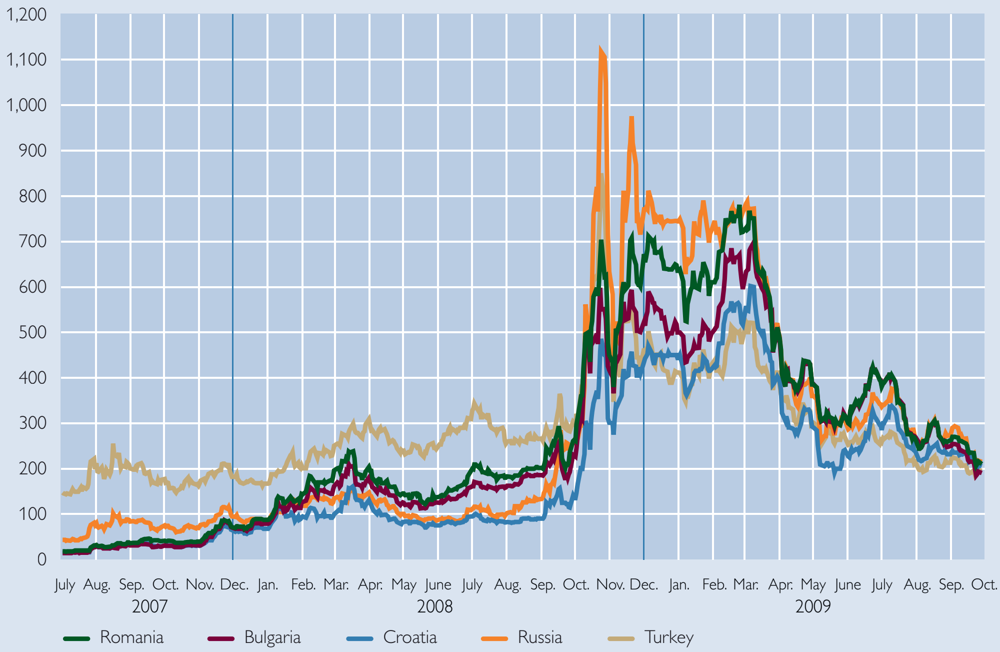


Source: Thomson Reuters, OeNB.

Chart 4b

Sovereign 5-Year Credit Default Swap Spreads

Basis points *Cutoff date: Sep. 30, 2009*



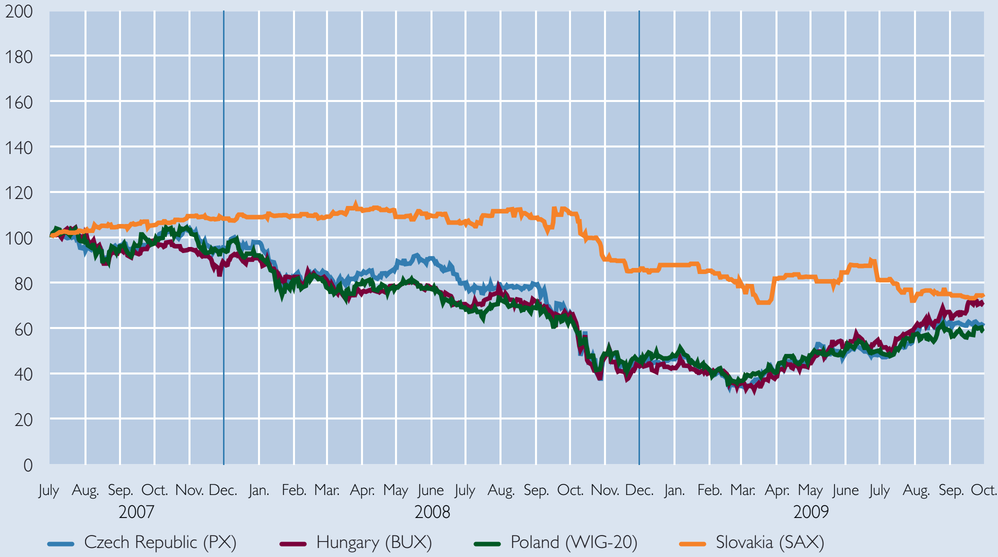
Source: Thomson Reuters, OeNB.

Note: Bulgaria and Russia USD-based.

Chart 5a

Stock Market Developments

June 29, 2007 = 100 *Cutoff date: Sep. 30, 2009*

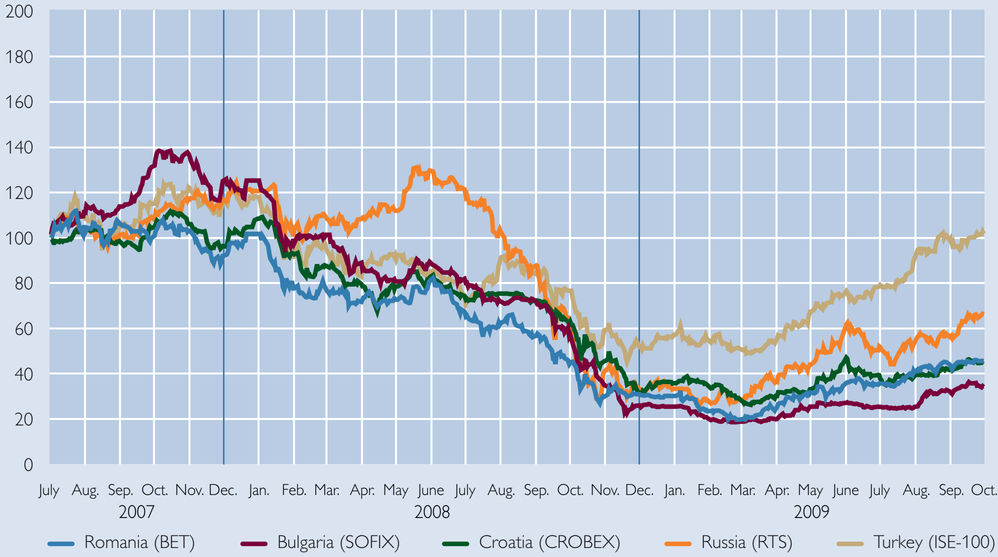


Source: Thomson Reuters, OeNB.

Chart 5b

Stock Market Developments

June 29, 2007 = 100 *Cutoff date: Sep. 30, 2009*

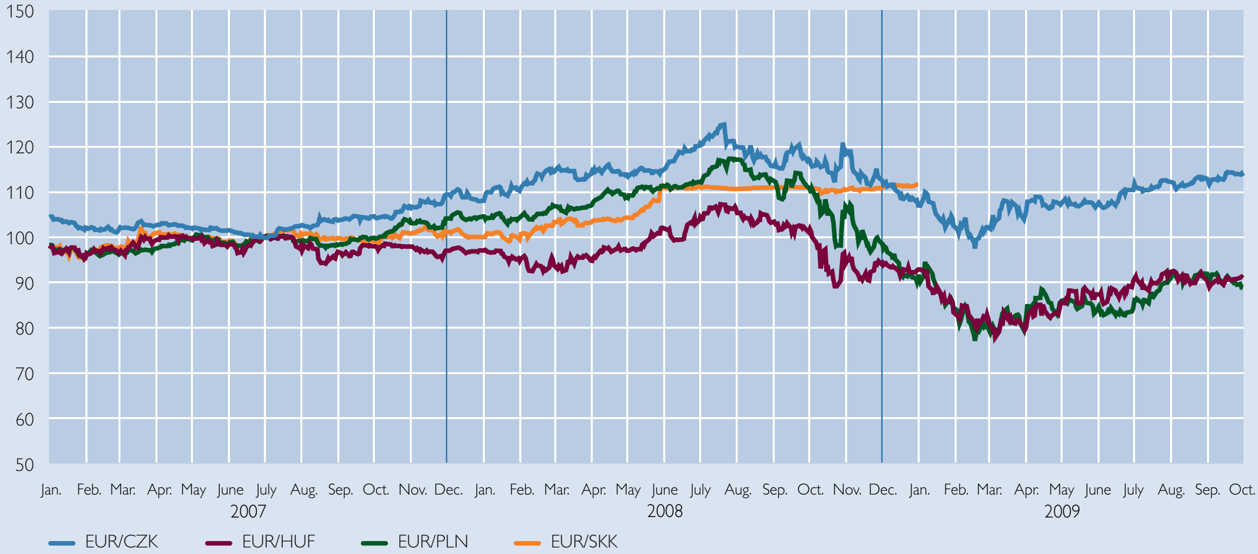


Source: Thomson Reuters, OeNB.

Chart 6a

Exchange Rate Developments

June 29, 2007 = 100 *Cutoff date: Sep. 30, 2009*



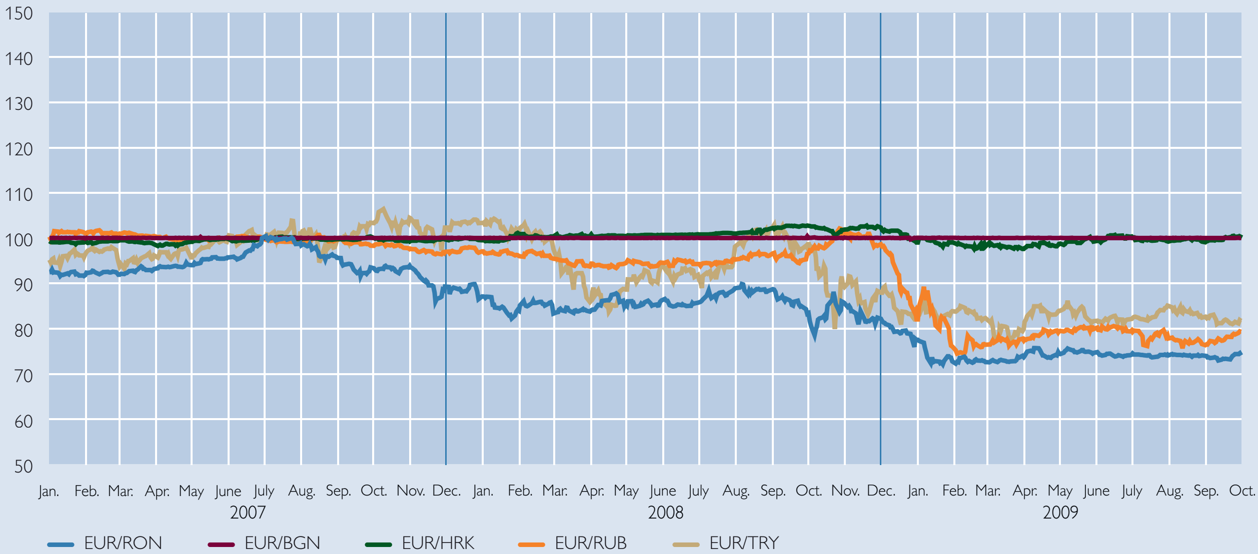
Source: Eurostat, OeNB.

Note: An increase in value means a nominal appreciation.

Chart 6b

Exchange Rate Developments

June 29, 2007 = 100 *Cutoff date: Sep. 30, 2009*



Source: Eurostat, OeNB.

Note: An increase in value means a nominal appreciation.