Event Wrap-Ups

EBRD Transition Report 2011: The Crisis from the Household Perspective

Compiled by
Markus Eller and
Mariya Hake

On January 31, 2012, the Oesterreichische Nationalbank (OeNB) hosted the presentation of the 2011 EBRD Transition Report and the January 2012 update of the EBRD's growth forecasts for Central, Eastern and Southeastern Europe (CESEE).

At the press conference (which was chaired by *Doris Ritzberger-Grünwald,* Head of the OeNB's Foreign Research Division), *Jeromin Zettelmeyer,* the EBRD's Deputy Chief Economist and Director of Research, summarized the EBRD's new growth forecasts for the countries in which it operates (the EBRD region[1]) and outlined the most important findings of the EBRD Transition Report 2011 "Crisis and Transition: The People's Perspective."[2] The main contribution of the 2011 Transition Report lies in delivering a better understanding of both the financial crisis (2008–2010) and its longer-term implications from the household perspective, based on the findings of the second round of the *Life in Transition Survey (LiTS II),* a household survey that was conducted jointly by the EBRD and the World Bank[3].

Part I: Economic Prospects in the EBRD Region – Emerging Europe under Threat from the Euro Area Sovereign Debt Crisis

The EBRD expects that GDP growth in the transition countries will slow substantially from about 4.8% in 2011 to 3.1% in 2012. This can largely be attributed to significantly reduced growth in CESEE, where a few countries (Hungary and Slovenia) are expected to fall back into recession in 2012. Next to contractive fiscal consolidation measures in this region, the financial transmission of the sovereign debt crisis experienced in some euro area partner countries is seen as the main reason for the projected economic slowdown. Related spillovers have recently become evident in net capital outflows (observed for the first time since 2009 owing to the outflow of non-FDI capital), tightened lending conditions, sluggish or negative real private sector credit growth, and an overall deterioration of stock market indices. The EBRD's projections are subject to various downside risks, most notably a further aggravation of the sovereign debt crisis in the euro area and/or uncoordinated policy responses by individual countries.

However, the EBRD's economic outlook also cites the following encouraging prospects: First, Russia and other CIS countries which are not very integrated with Western Europe will most likely continue to post respectable GDP growth rates, assuming that commodity prices remain high. Second, compared to 2008, economic fundamentals in the EBRD region have largely strengthened: The region is less dependent on external financing, and bank balance sheets are generally stronger as a result of recapitalization and deleveraging. Third, during the current crisis, negative spillovers are expected to be mostly limited to financial channels transmitting euro area stress via strongly integrated banking systems, whereas the role of trade channels should not be as significant as during the 2008–2009 crisis, given the less global scale of the external shock.

1 *Covering 29 countries, the EBRD region stretches from Central and Eastern Europe to Central Asia, including Turkey. Effective from 2008, the Czech Republic was the first country to graduate from the EBRD.*

2 *See http://www.ebrd.com/pages/research/publications/flagships/transition.shtml for the full report.*

3 *In addition to the countries of the EBRD region, the second round of the LiTS household survey also comprised five Western European countries, i.e. Germany, France, Italy, Sweden and the United Kingdom.*

Part II: Understanding the Impact of the Crisis from the Household Perspective

In the second part of his presentation, Zettelmeyer elaborated on the impact of the financial and economic crisis on household consumption in the EBRD region as compared to a benchmark group of Western European countries (Germany, France, Italy, Sweden and the United Kingdom). Based on an index comprising a variety of crisis events (e.g. job losses, reduction of wages or working hours, reduction of remittances), the EBRD analysis showed that households in the transition countries suffered more crisis-related "shocks" and reduced their consumption (in particular for essentials such as staple foods and health care) much more strongly than their Western European counterparts. The decline in consumption can partly be attributed to the fact that most of the transition countries have by far less effective formal safety nets (e.g. safety benefits, access to finance) in place than the countries in the Western European benchmark group. On the positive side, informal borrowing channels (i.e. borrowing from relatives and friends) lessened the decline in base consumption, particularly in the less advanced and harder-hit countries. Furthermore, the Transition Report revealed that the role of formal borrowing in shaping a transition region's response to the crisis was ambiguous. On the one hand, those respondents who were successful in obtaining a loan during the crisis were able to cushion the impact of the crisis. On the other hand, pre-crisis borrowing exacerbated the decline in household consumption during the crisis. Moreover, households that were affected more strongly by the crisis were more likely to be in arrears on their mortgage. Interestingly, the EBRD's analysis also reveals that foreign currency mortgage borrowers have continued to service their debts more satisfactorily than local currency borrowers, though at the expense of reduced consumption. This may suggest that banks granted foreign currency loans to borrowers with increased risk-bearing capacities.

Besides the impact of the crisis on household consumption, the EBRD Transition Report 2011 also studied the effects of the crisis on the public's support of market economies and democracy. Compared to LiTS I (conducted in 2006), the crisis has led to a strong shift in public opinion, turning public sentiment against democracy and free markets in most of the more advanced transition countries, while the opposite has been the case in many of the less developed CIS countries. Apparently, the crisis experience has led people to turn against the political and economic status quo they are faced with in their country.

The discussion that ensued after the presentation reiterated that the repayment of debt in foreign currency is apparently still manageable at the micro-level, but is associated with negative consequences at the macro-level given that household consumption has been cut back in order to continue servicing foreign currency loans. In addition, Zettelmeyer pointed out that mortgage holders in the five Western European comparator countries fared better than their counterparts in Eastern Europe, who were presumably subject to stronger over-borrowing before the crisis and a stronger decline of asset (in particular housing) prices during the crisis. Moreover, the importance of the financial integration model for economic development in the CESEE region was underlined. This model, however, still requires some modifications. Especially, the development of local currency capital markets and enhanced cross-border supervisory integration were stressed as crucial reform steps required to sustain this model.