Regaining Financial Market Stability in CESEE

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Outline

Global financial markets in 2009: back from the brink

CESEE markets: increasing differentiation and risks

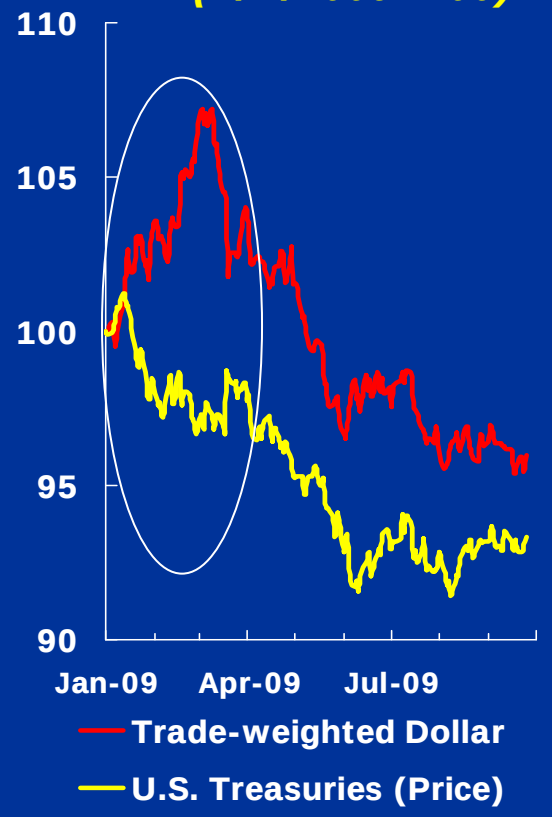
Policies to support financial market stabilization

- **Short-term actions in CESEE and Western Europe**
- **Long-term issues on changing the regulatory environment**

Globally, risk appetite has returned, and capital markets have re-opened since March 2009

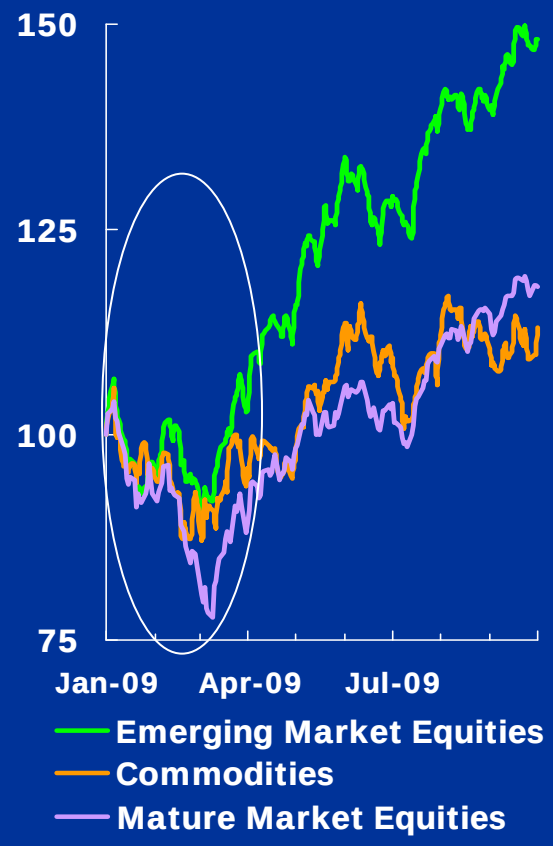
Traditional Safe Havens

(1/1/2009=100)



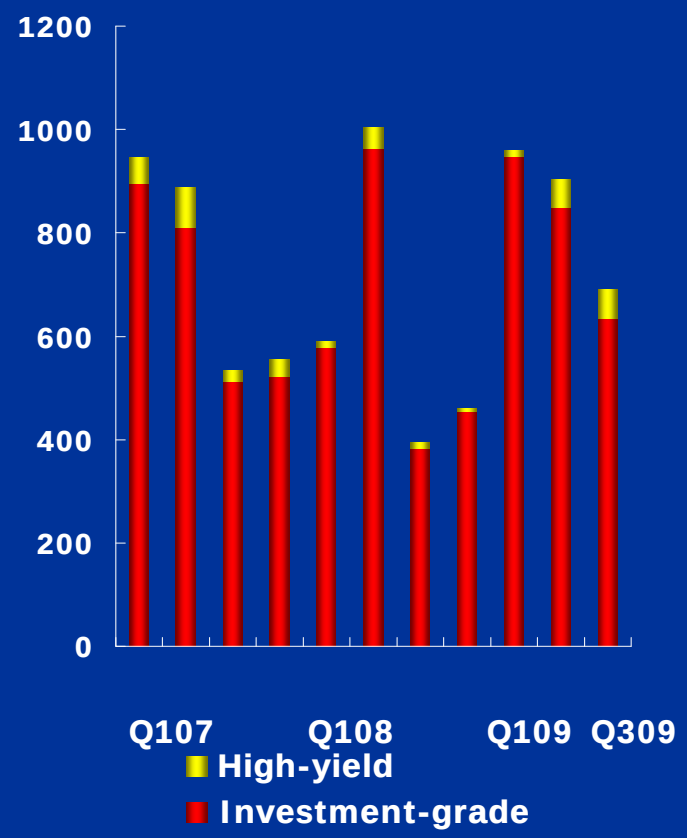
Cyclical Assets

(1/1/2009=100)



Corporate Bond Issuance in U.S. and Europe

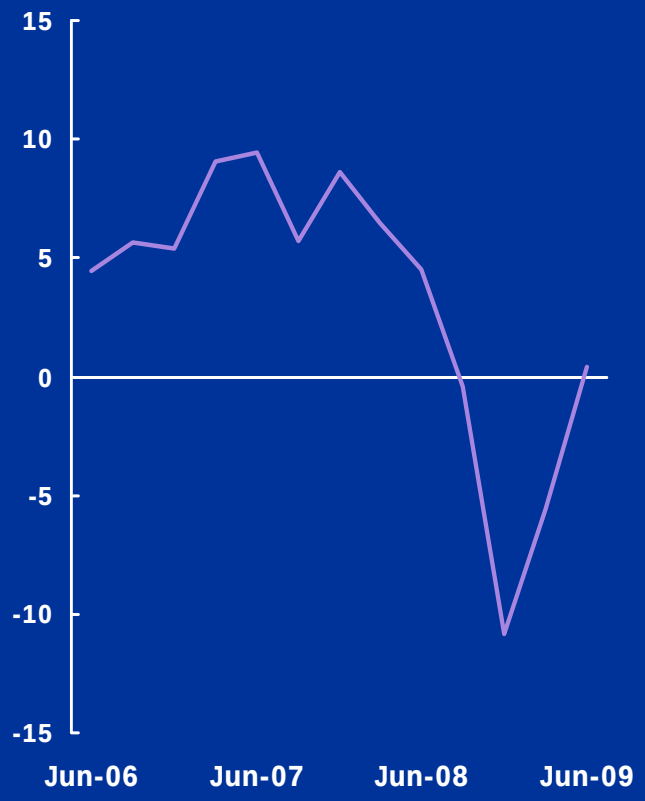
(billions of U.S. dollars)



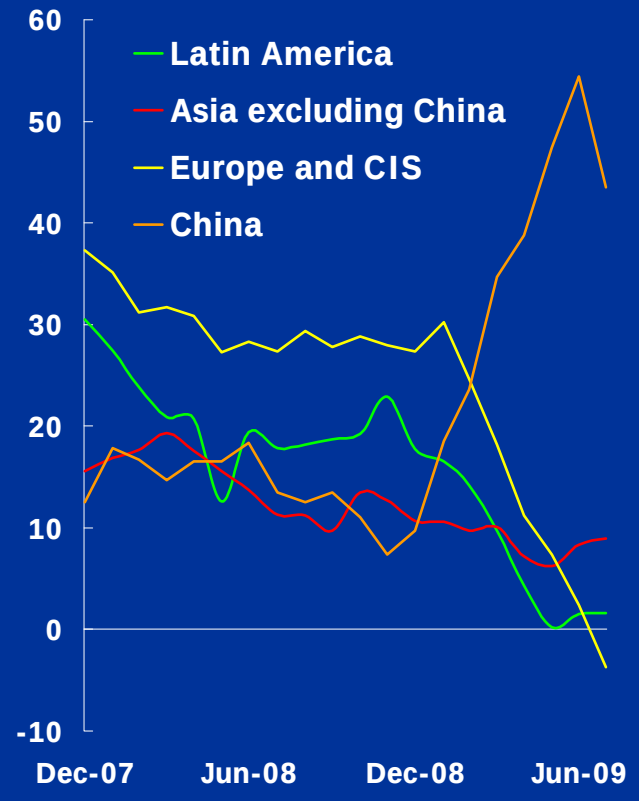
Source: GFSR.

In EMs, credit flows show signs of stabilizing, and equity inflows are rebounding

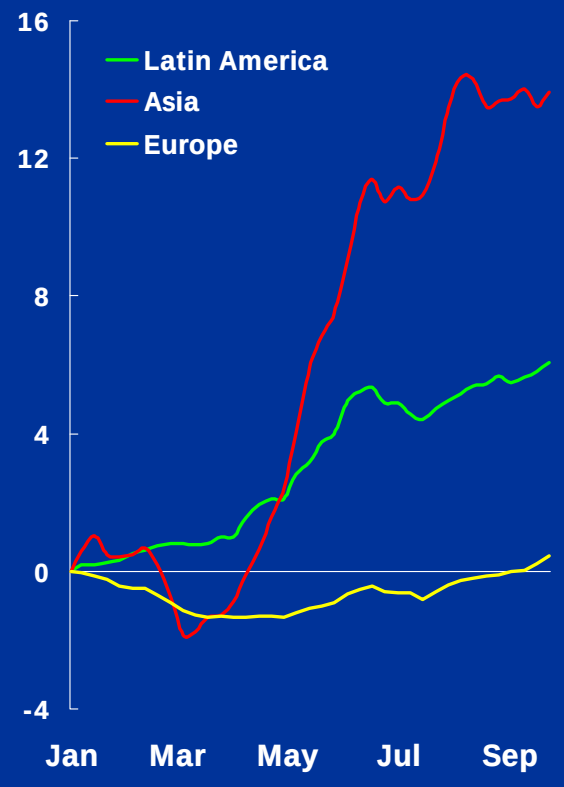
Cross-Border Bank Flows to EMs
(percent change)



Bank Credit to Private Sector
(6-month percent change, annualized rate)



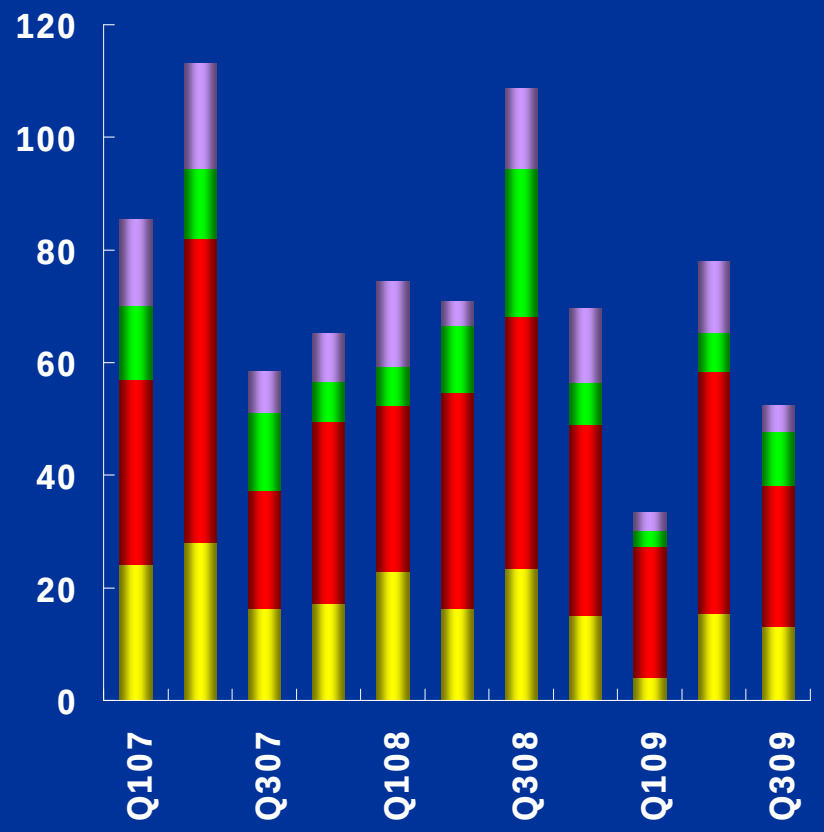
Inflows to EM Equity Funds
(2009, cumulative, billions of U.S. dollars)



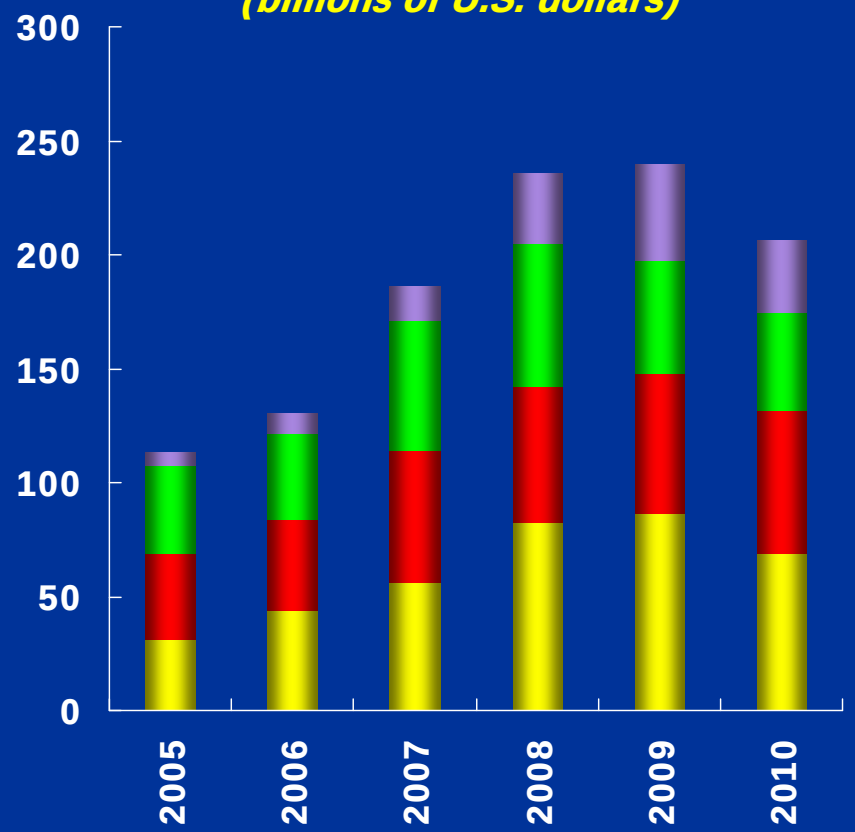
Source: GFSR.

Private bond issuance is recovering, but corporates still face significant external financing risks

EM Private Bond and Loan Issuance
(billions of U.S. dollars)



Refinancing Needs of EM Forex-Denominated Corporate Debt
(billions of U.S. dollars)

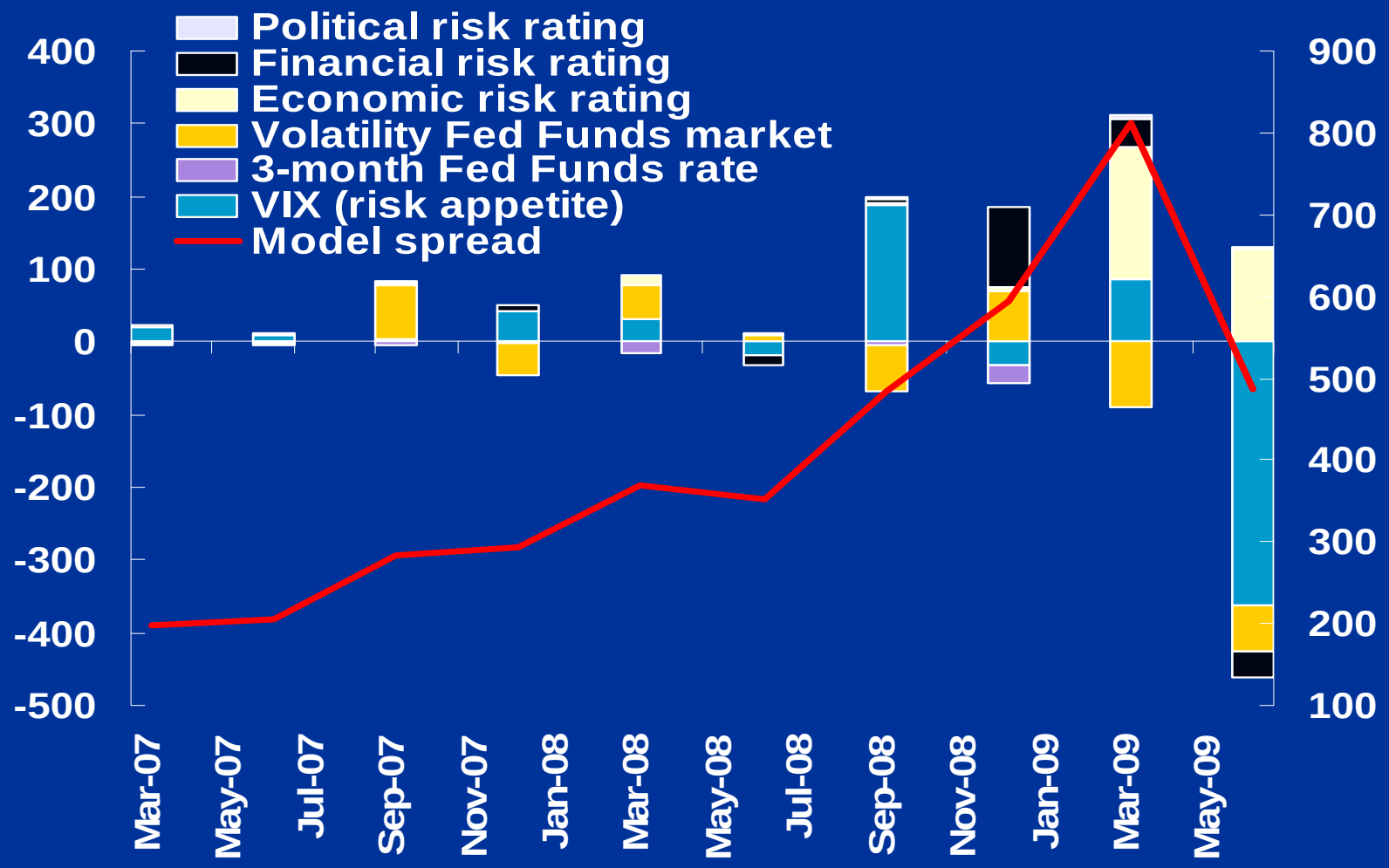


Europe | Asia | Latin America | Middle East / Africa

Source: GFSR.

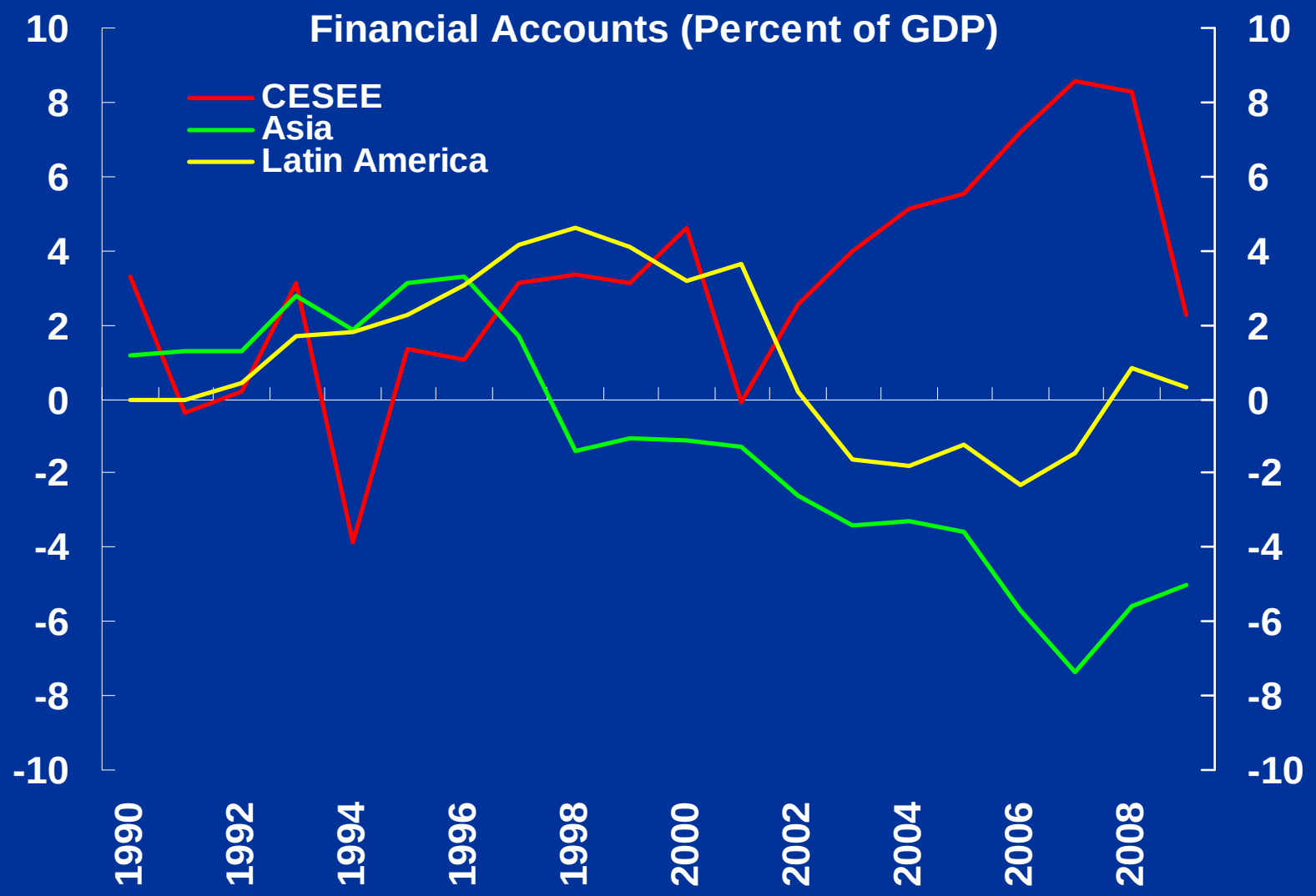
However, stabilization has been almost entirely driven by (volatile) improvements in global risk appetite

Contributions to Changes in Emerging Market Sovereign External Spreads (Basis points)



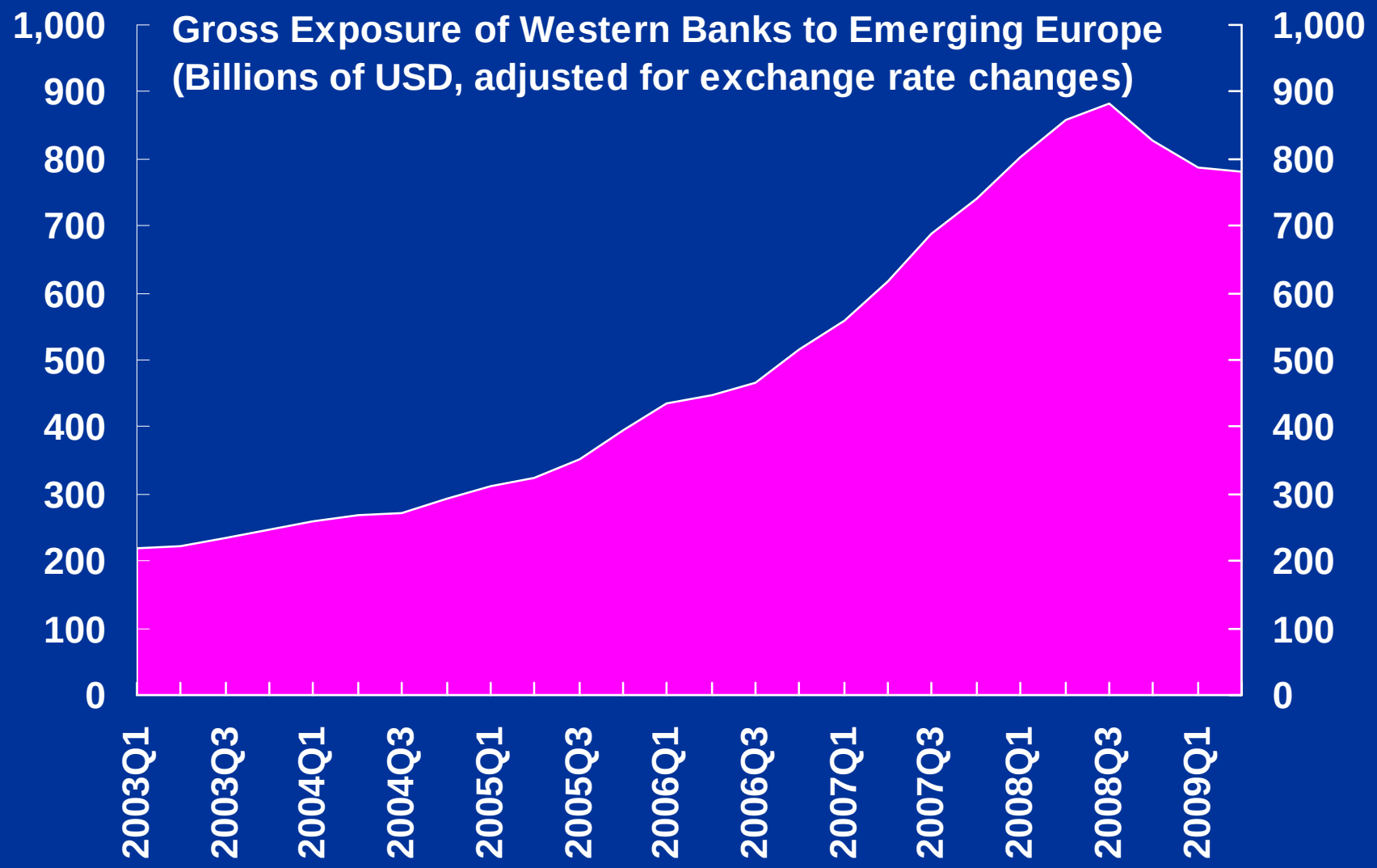
Sources: Bloomberg L.P.; and IMF staff estimates.
Note: For details of the model, see Box 1.5 of the April 2006 GFSR.

In CESEE, capital inflows have slowed more sharply than elsewhere (although they remain positive)...



Sources: WEO.

...although Western banks' exposure in the region is now stabilizing



Source: BIS.

Short-term market stabilization has been achieved through:

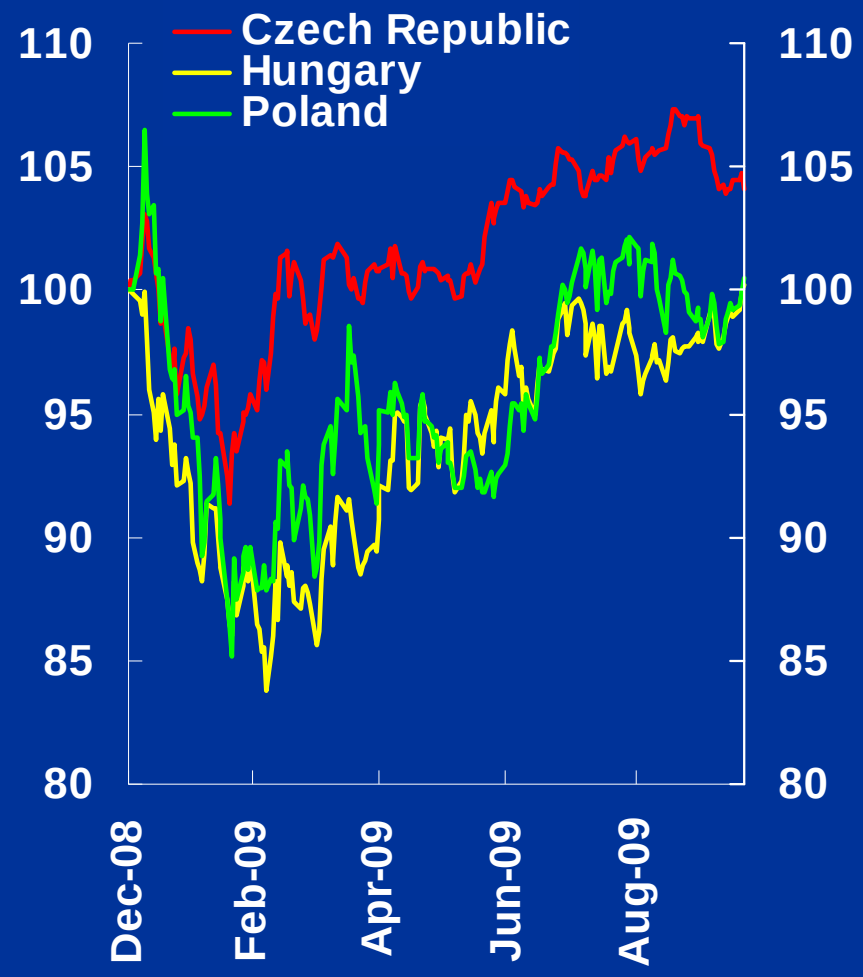
- Unprecedented policy interventions, notably monetary easing
- Bank support measures
- Continued exposure of parent banks
- ECB/SNB repo operations with selected CESEE central banks
- IMF/EU-led programs in the CESEE countries most affected

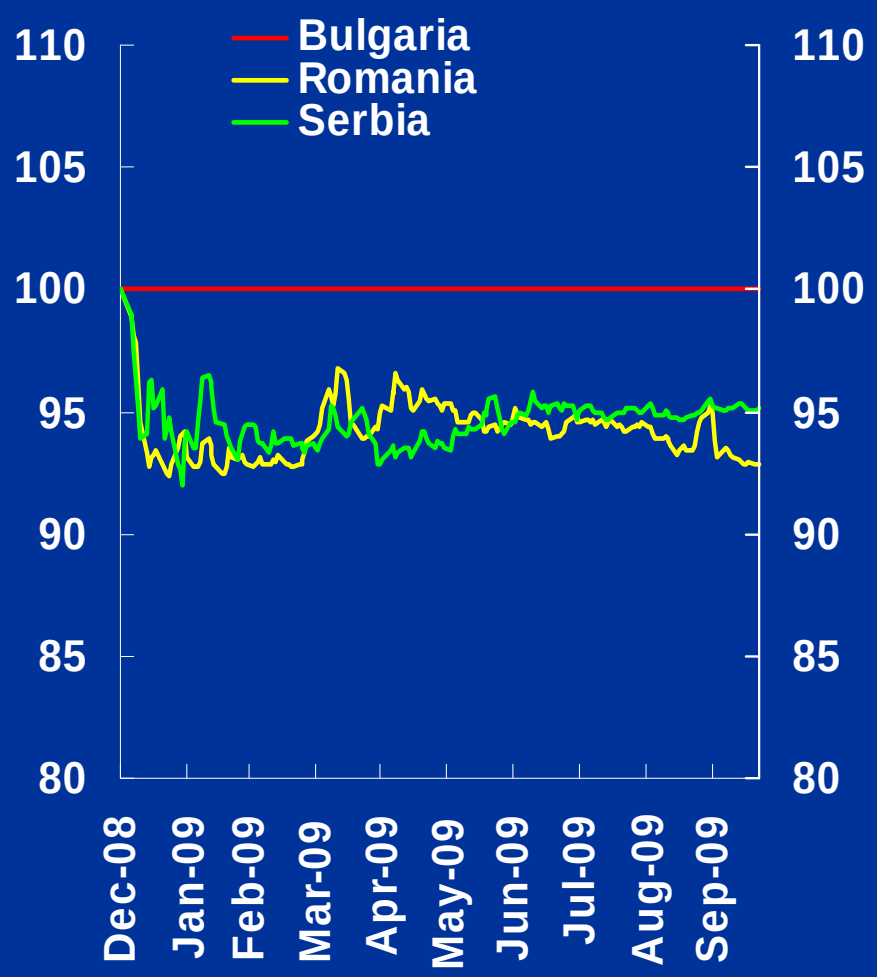
A number of countries have asked for support from the IMF and other IIFs

IMF Lending Arrangements as of September 30, 2009
(In millions of SDRs)

Member	Date of Arrangement	Date of Expiration	Amount Agreed	Of which drawn
SBA:				
Ukraine	5-Nov-08	4-Nov-10	11,000	7,000
Hungary	6-Nov-08	5-Apr-10	10,538	7,637
Latvia	23-Dec-08	22-Mar-11	1,522	714
Serbia	16-Jan-09	15-Apr-11	2,619	702
Romania	4-May-09	3-May-11	11,443	6,088
Bosnia and Herzegovina	8-Jul-09	30-Jun-12	1,015	183
Flexible Credit Line				
Poland	6-May-09	5-May-10	13,690	0

Foreign exchange markets have stabilized since earlier in 2009, but only CE3 currencies have recovered.





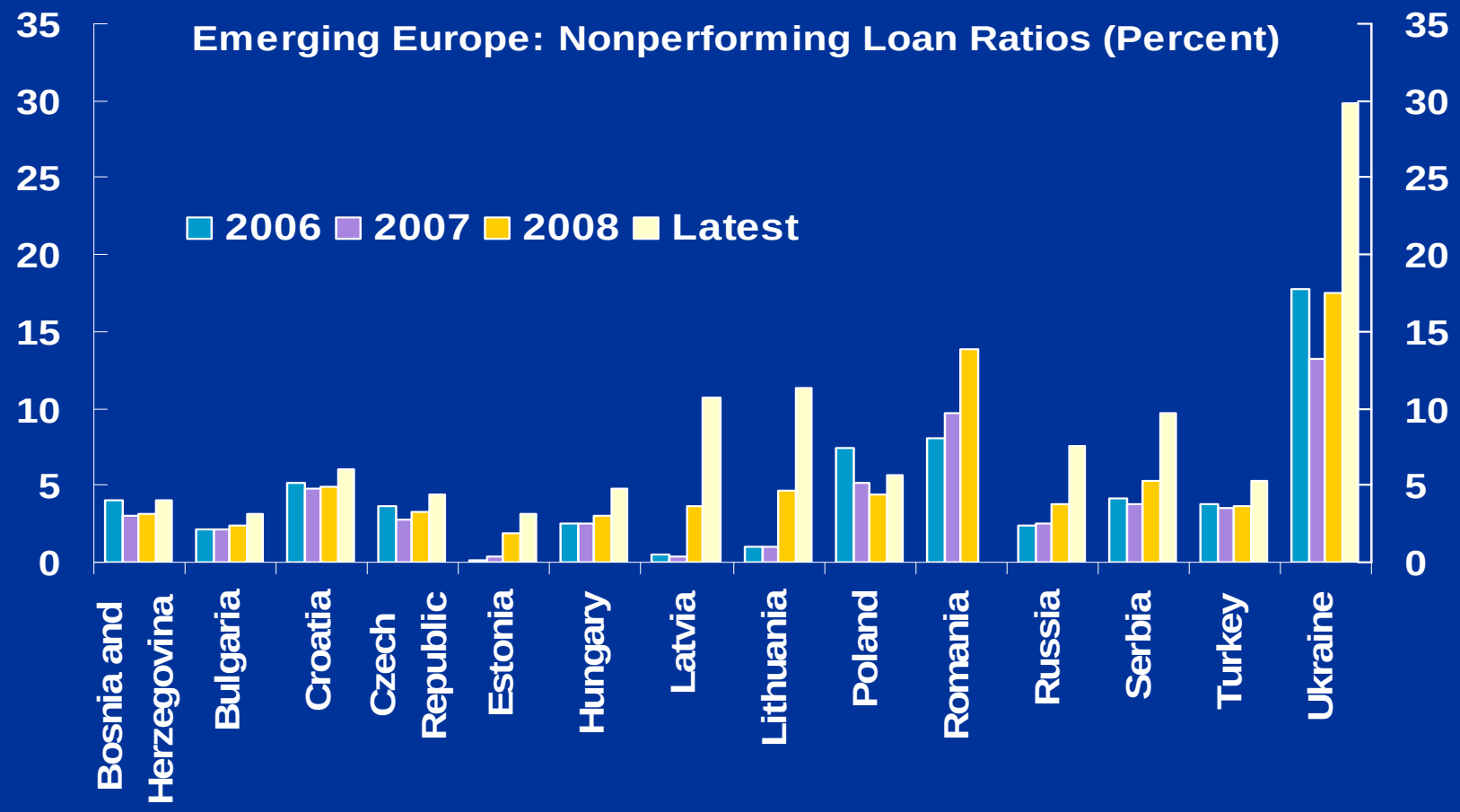
Sources: Bloomberg.

Risk premia show that the EU halo effect disappeared already in mid-2007 and markets are now differentiating

Source: DataStream.

Why are Markets Differentiating?

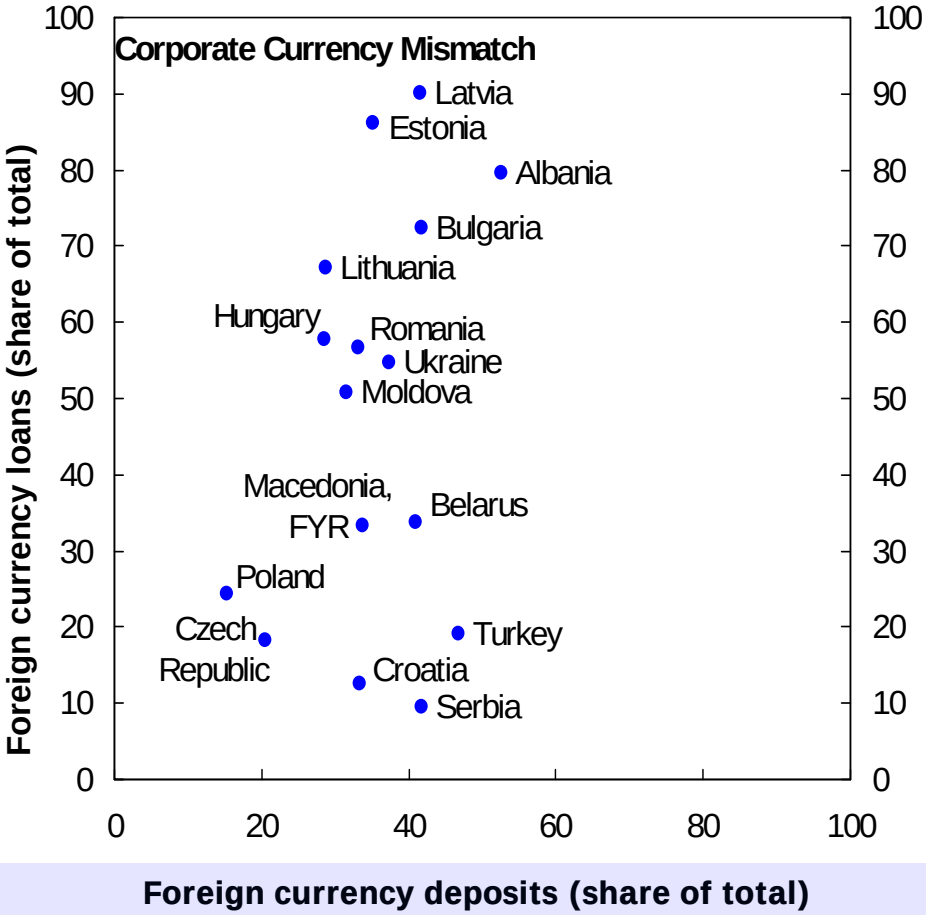
Growth prospects, debt overhang and NPLs differ widely...

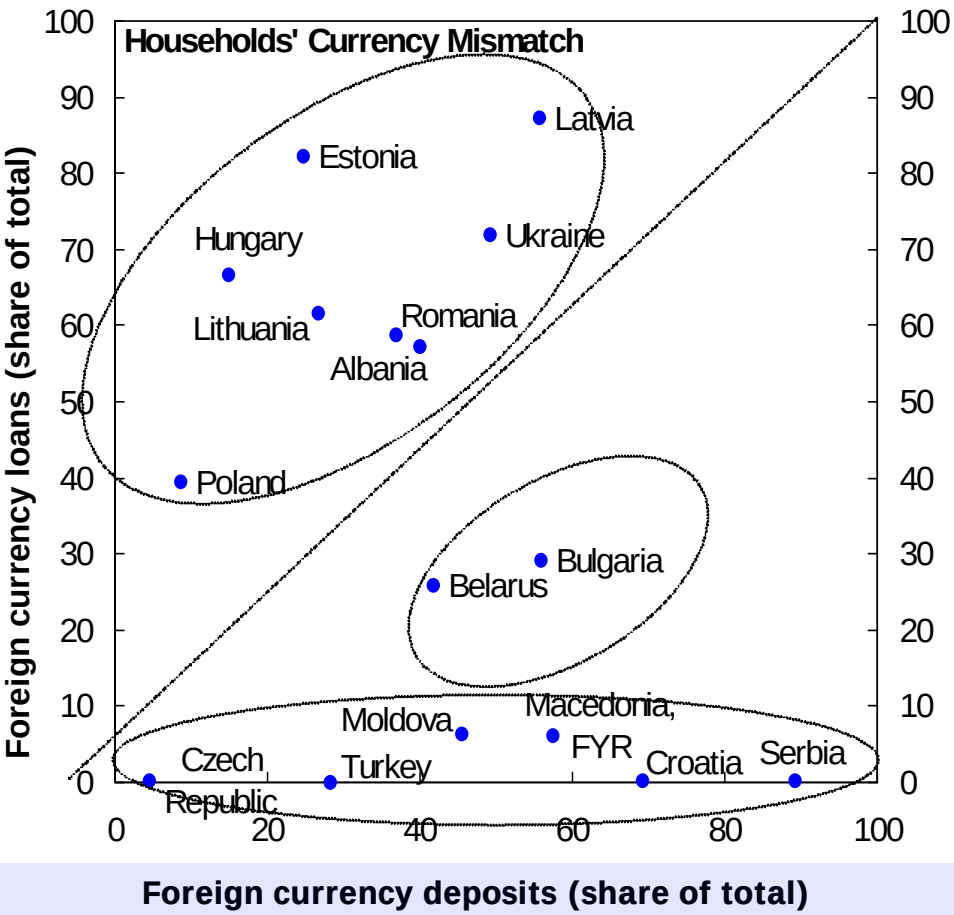


Source: National authorities.
Note: Due to differences in national accounting, taxation, and supervisory regimes, as well as changes in definition, nonperforming loans are not strictly comparable across countries or with historical data.

Why are Market Differentiating?

...as does the vulnerability to exchange rate movements.

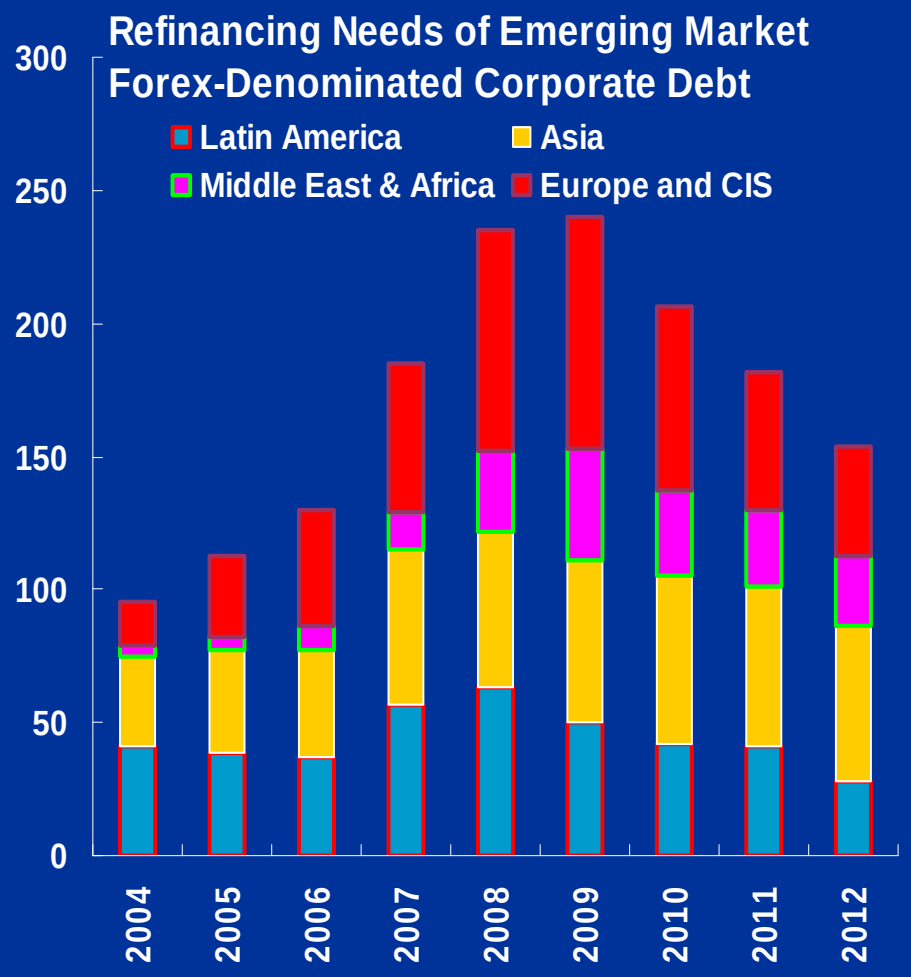


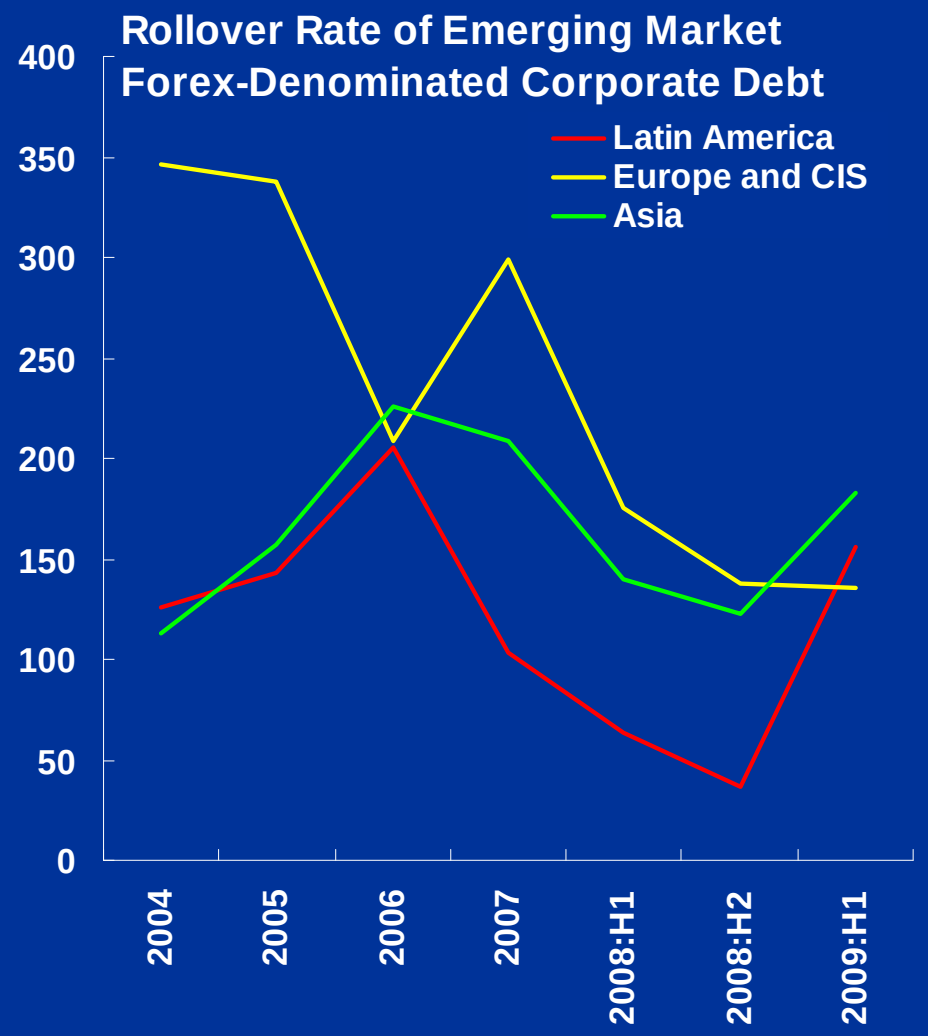


Source: IMF, Balance Sheet Approach.

Notes: Data refer to foreign currency denominated loans and deposits; including loans and deposits that are indexed to foreign currency would increase the ratios in some of the countries. The Czech Republic, included here among emerging Europe, was reclassified as an advanced economy in the Spring 2009 World Economic Outlook.

Corporate refinancing risks are particularly pronounced in CESEE countries





Sources: Bloomberg L.P.; and IMF staff estimates.

Policies to support CESEE financial market stability in the short term

CESEE Countries

- Deal with non-performing assets and troubled banks
- Support viable corporates facing rollover difficulties
- Continued IFI involvement in some countries (to prevent contagion)
- Ease interest rates as capital inflows resume (CE3)

Western Europe

- Measured exit from bank support schemes and liquidity injections (strategy for disengagement)
- Bank coordination (Vienna initiative)
- Recognize losses in Western parent banks

Long-term issues in securing financial market stability in CESEE countries

Challenges:

- Resurgence of capital flows to some countries: how to avoid a new bubble (healthy balance between tradables and non-tradables)
- A more innovative and competitive non-bank financial sector
- After the credit boom, high levels of private sector indebtedness in some countries
- Dealing with financial institutions that are too big to fail

Long-term issues in securing financial market stability

Some principles in the ongoing discussion:

- Restore market discipline, avoid moral hazard
- Remove procyclicality in the financial system
- Increase buffers against losses and liquidity dislocation
- Improve cross-border cooperation and coordination
- Establish macroprudential policy frameworks

Thank you!

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