The Euro Area: A Shelter? Estonian Perspectives.

Märten Ross, Bank of Estonia
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?

5 year CDS premia

Estonia  Slovakia  Slovenia

Märten Ross, Vienna  16 November 2009
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