## THE EU, RUSSIA AND THE CRISIS

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This presentation does not necessarily reflects the views of DG ECFIN

## Main Points

- •*Global Crisis*: no region in the world is immune
- •Financial transmission channels powerful and near-immediate
- •Externally exposed countries (like RU) more vulnerable to first-order impact
- •Feed-back loops with the real economy
- •Impact and lag dependant on initial positions and adequacy of policy responses
- •Recent stabilisation, but risks remain

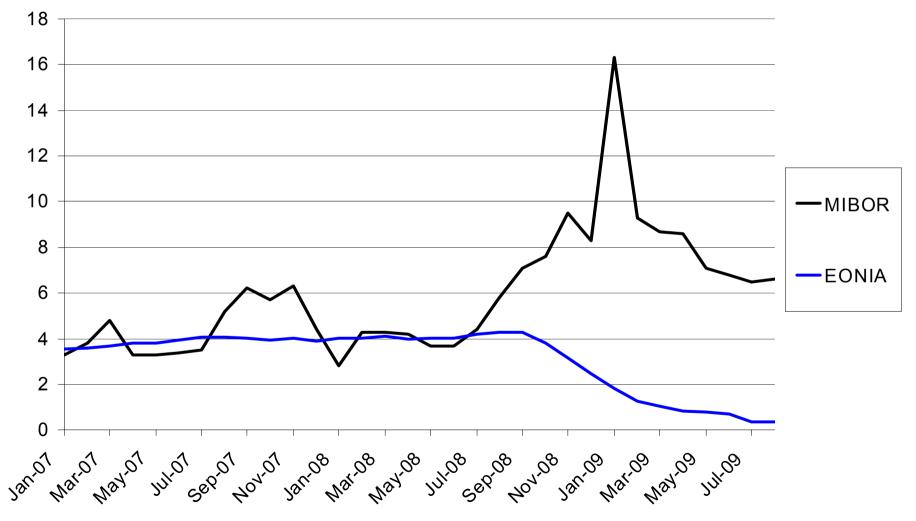
## Main Points

- •Cross-country variation in policy responses and instruments, depending on prior buffers and on the adequacy of policy actions
- •Fiscal policy: near-term versus long-term
- Priority to stabilisation, but long-term fiscal implications
- •Crisis response should not jeopardise implementing long-term reform agenda
- •Securing external financing
- •Global crisis global policy responses; devising global responses within the G20

### EU/RU stock markets affected...



### ...and interest rates too

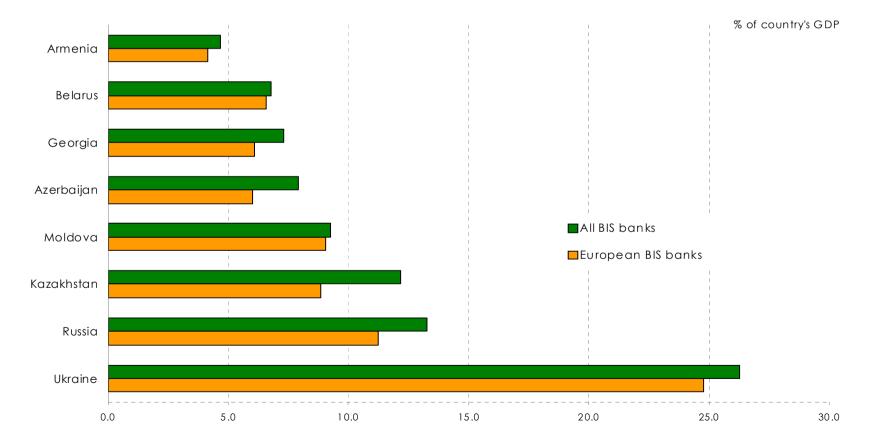


## Russia among the worst affected countries globally

- Several elements similar to *some* new MS
- Reliance on foreign funding
- Banking sectors under strain
- Forced adjustment of exchange rates in the face of capital outflows
- Commodities' reliance amplified the shock
- But large fiscal buffers/reserves as a cushion

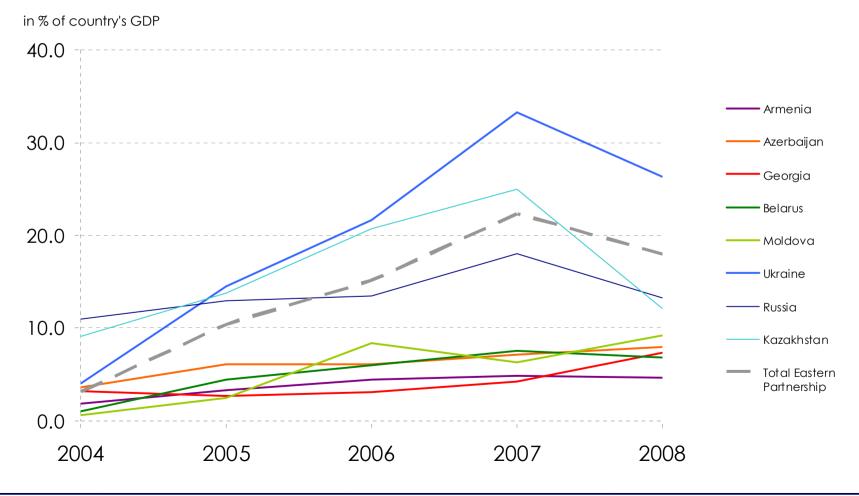
## Foreign bank claims in Russia/CIS: overwhelmingly EU

Foreign claims of the BIS reporting banks on the EU eastern neighbours in 2008

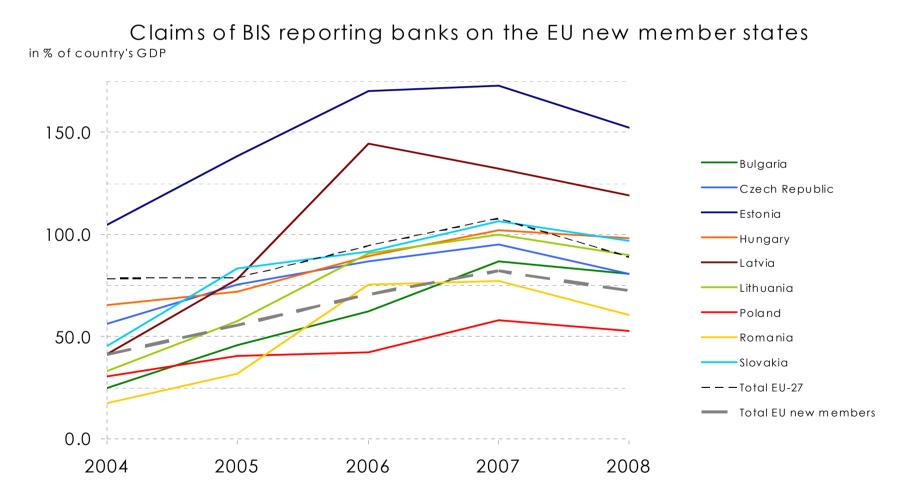


## Very rapid growth in bank claims during the years leading up to crisis...

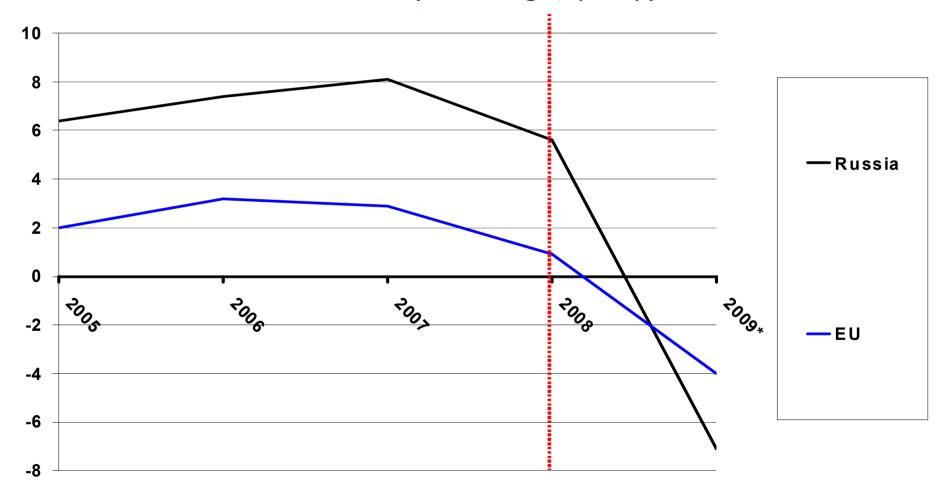
Claims of BIS reporting banks on the EU eastern neighbours



## ...yet ratios still well below NMS. Difficult to infer risk of balance sheet effects on real economy



## Real effects of the crisis: EU and Russia's GDP (% change, y-o-y)



## Policy responses to the crisis in the Russia and the EaP

Armenia*	Azerbaijan	Belaru s*	Georgia*	Moldova*	Russia	Jkraine*
* *			3,0		6,0 1,0	
			1,0		0,5 1,0 3,5	
			3,0		6,0	
	1200		550			
	! !	l	!		! !	! !
	ļ	ļ	ļ		! !	!
s	! 	USD	USD !		33% against basket !	37% against USD
	* * S	** 1200 ! ! !	** 1200 ! ! ! ! ! ! 25% against USD	** 3,0 ** 3,0 1,0 3,0 1200 550 !	1,0 3,0 1200 550 !!!!! !!!! !!!! !!!! 	*** 3,0 6,0 1,0 1,0 1,0 0,5 1,0 3,5 6,0 1200 550 1200 550 110 1 1200 550 110 1 1200 550 110 1 1200 550 110 1 120 1

Source: Central banks of the ENP-countries, EC.

## Russia's policy response

An extensive set of policy measures has been taken by Russia, which is rather similar to what the EU adopted:

- 1. Provision of domestic liquidity to the banking sector;
- 2. Provision of external liquidity (to banks and companies);
- 3. More flexible exchange rate policy;
- 4. Package of fiscal support measures;
- 4. Other measures (tax cuts, bank deposit insurance extended, increase in unemployment benefits, re-capitalisation of banks).

#### Main RU policy measures in 2008

#### • CBR

- Gradual rouble devaluation
- Increase in refinancing rate to prevent speculative attack on RUB
- A cut in the reserve requirements rate
- Increasing the amount of fund available through REPO
- CBR provides non-collateral loans to qualifying banks
- CBR and NWF provide subordinated loans
- Refinancing private external debt through CBR FX reserves

#### Government

- 100% guarantee for retail deposits up to RUB700,000
- Agency for Deposit Insurance was recapitalized
- VAT payment rules were changed
- A cut in the oil export duty

#### **Fiscal and Structural stimulus package for 2009**

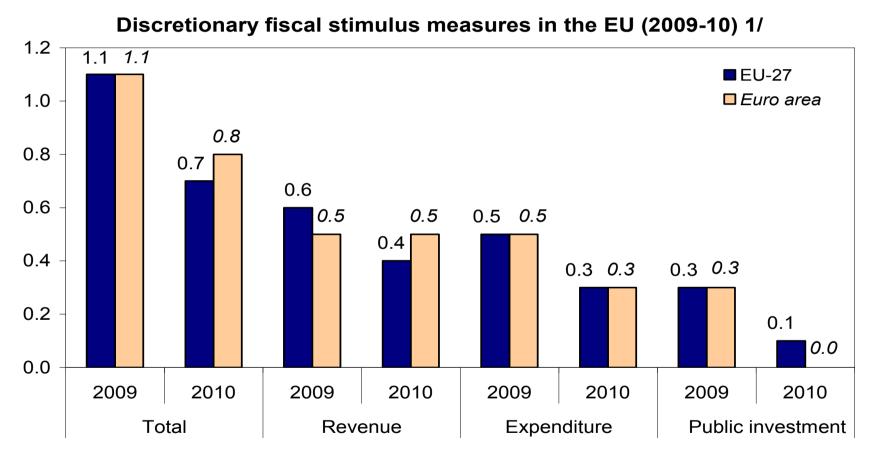
- Corporate Income tax rate cut from 24% to 20%
- Further financial support for banks RUB 555 billion (USD 15.8 billion)
- Social supporting RUB 628 billion (USD 17.9 billion)
- Regional level supporting RUB 300 billion (USD 8.5 billion)
- Supporting the real sector RUB 343 billion (USD 9.8 billion)
- Domestic demand supporting
- Additional government guarantees up to RUB 300 billion (USD 8.5 billion)

## EU's response: The European Economic Recovery Plan (EERP)

#### Main features:

- i. Timely, temporary, targeted, coordinated stimulus
- ii. Overall size: 1.8% of GDP
- iii. At Member State level: Size determined by fiscal space
- iv. Targeting: ST (stabilisation); LT: (growth; job creation; social protection; green economy)
- v. Credible commitment to medium-term fiscal adjustment and sustainability
- vi. Structural reforms to boost lon-run growth potential

#### EERP: 1.8% of GDP discretionary stimulus measures...



*Notes:* 1/ Figures for 2010 include permanent measures taking effect in 2009 plus measures taking effect in 2010.

Source: Commission services.

### ... in addition to large automatic stabiliser effects.

	of which:								
	N	Change in	Estimated	Budgetary	Change in the	of which:		Official	
% of GDP	Nominal balance	deficit with respect to 2008	impact automatic stabilisers	impact change in the interest expenditure	primary cyclically- adjusted balance	Budgetary impact expansionary measures	Residual	budgetary projections	
BE	-4.5	-3.3	-2.4	-0.2	-0.7	-0.4	-0.3	-3.4	
DE	-3.9	-3.8	-3.1	-0.2	-0.5	-1.4	0.9	-2.9	
IE	-12.0	-4.9	-3.2	-1.2	-0.5	-0.5	0.0	-10.7	
EL	-5.1	-0.1	-1.3	-0.3	1.5	0.0	1.5	-3.7	
ES	-8.6	-4.8	-1.5	-0.1	-3.2	-2.3	-0.9	-5.8	
FR	-6.6	-3.2	-1.9	0.0	-1.3	-1.0	-0.3	-5.6	
ΙТ	-4.5	-1.7	-2.3	0.5	0.1	0.0	0.1	-4.6	
CY	-1.9	-2.8	-0.7	0.6	-2.7	-0.1	-2.6	-0.8	
LU	-1.5	-4.1	-2.7	-0.3	-1.1	-1.2	0.1	-1.7	
МТ	-3.6	1.1	-0.7	-0.2	2.0	-1.6	3.6	-1.5	
NL	-3.4	-4.5	-2.6	-0.5	-1.4	-0.9	-0.5	-3.3	
AT	-4.2	-3.8	-2.4	-0.5	-0.9	-1.8	0.9	-3.5	
PT	-6.5	-3.9	-1.6	-0.1	-2.3	-0.9	-1.4	-3.9	
SI	-5.5	-4.6	-2.1	-0.4	-2.0	-0.6	-1.4	-5.1	
SK	-4.7	-2.5	-2.1	-0.1	-0.3	-0.1	-0.2	-3.0	
FI	-0.8	-4.9	-2.9	0.1	-2.1	-1.7	-0.5	-1.9	
EA	-5.3	-3.4	-2.3	-0.1	-1.0	-1.1	0.1	-	

Source : Commission services' Spring 2009 Forecast, Commission services.

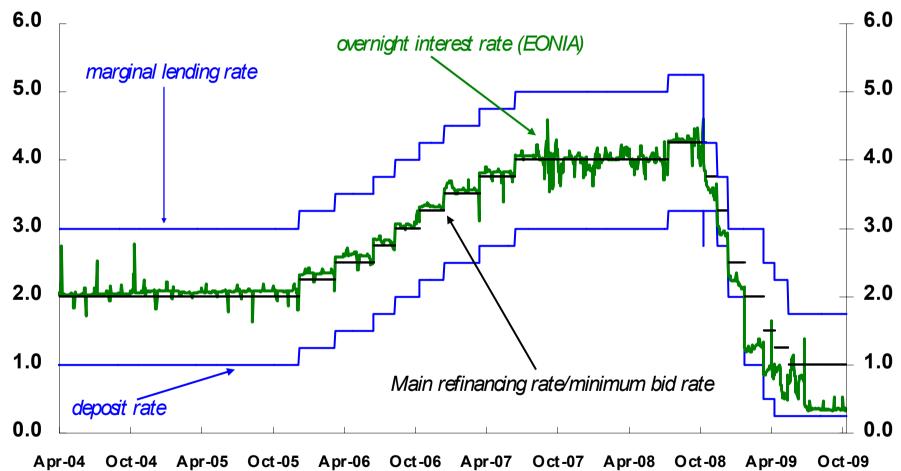
*Source official budgetary projections:* 2008 Stability Programmes or, where available, first 2009 notification and most recent official projections.

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## Monetary/Banking response

- ECB's massive liquidity provision and aggressive lowering of interest rates.
- Extension of guarantees on banks' liabilities.
- Capital injections and (in some cases) statecontrol.
- Treatment of impaired assets.
- Review of the regulatory and supervisory framework in the EU ("de Larosière" Report ).

### Monetary/Banking response



## Monetary/Banking response

(Central bank total assets as a share of respective GDP)

	EcB	Fed	BoE
Mid-2007	10%	6%	6%
Peak	19%	15%	20%
Peak reference date	02/01/09	17/12/08	22/10/08
Aug-09	17%	14%	16%

*Note: Total assets from the simplified balance sheets of the Bank of England, the Eurosystem and the Federal Reserve; annual GDP based on current prices and seasonally adjusted (forecast for 2009). Source: ECB calculations and Eurostat.* 

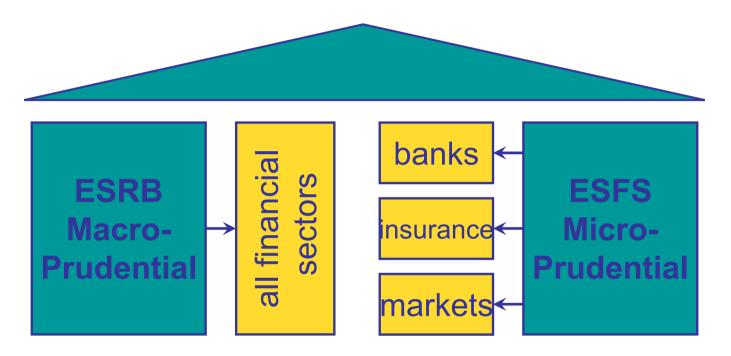
## Schemes for financial institutions

	<b>Total EU</b>		<b>Total EA</b>	
% of GDP	Approved	Effective	Approved	Effective
Guarantees on bank liabilities	24.8	8.1	20.7	8.7
Liquidity and bank funding support	2.9	2.6	1.0	0.8
Capital injections	2.6	1.5	2.7	1.4
Treatment of impaired assets	0.8	0.4	1.1	0.6
Total measures	31.2	12.6	25.4	11.5

#### Note: cut-off date 17 July 2009.

*Source: EU Commission - DG Competition's review of guarantee and recapitalisation schemes in the financial sector in the current crisis. 7 August 2009.* 

#### The new EU architecture is to be based on two pillars



Main objectives:

- *Macro*: better oversight of systemic risk
- *Micro*: enhanced supervisory convergence and coordination

## Why different effects from the crisis?

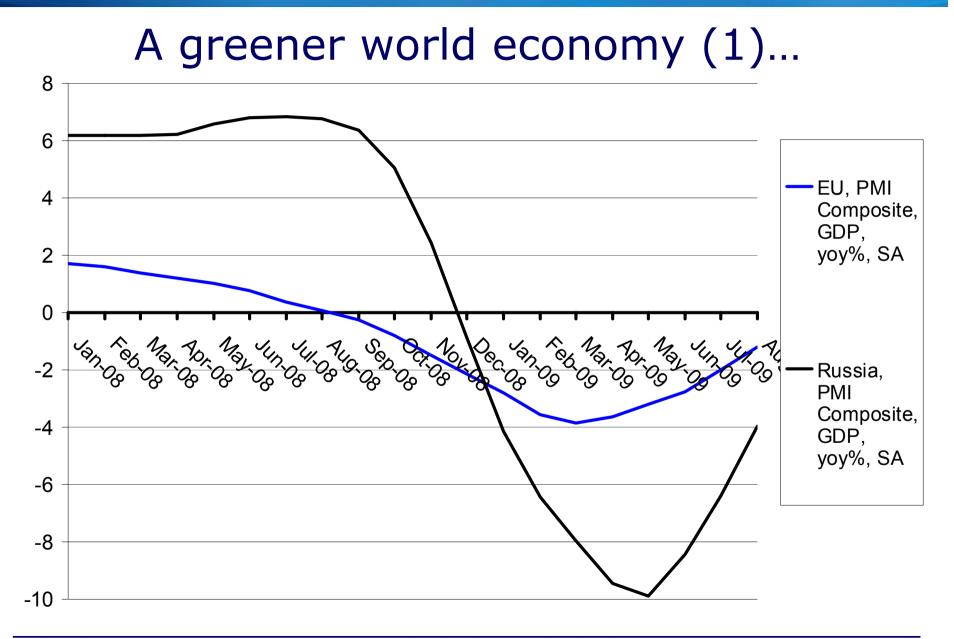
- Level of reliance on commodity exports
- Adequacy, consistency, speed and size of the policy response (especially in the fiscal side) and the external support programmes (which are also a part of the policy response)
- And, crucially, different amounts of financial distortions (smaller credit growth and external exposure of the banking sectors)

## Main Points (again)

- Economies most integrated into the world economy and most liberalised were the hardest hit. This does not imply protectionism and autarky but a need for policies designed to counterweigh the negative shocks arising from (beneficial) greater global integration.
- Macroeconomic stabilisation factors failed to insulate from the crisis but enabled the countries to implement policies that cushioned initial shocks. Well-designed fiscal policy tools and frameworks plus a consistent exchange rate policy are of particular importance.
- Growth models that relied more on *primary sectors* were seemingly more affected by the downturn, calling for intensified **efforts to diversify growth sources**.
- The financial component of the shock led the real one, so global in character and coordinated reforms of supervisory and regulatory financial frameworks are crucial.
- Exit Strategy also crucial.

## The Way Forward: Questions

- Some signs of recovery, but how green are those shoots?
- Exit strategy: (progressively...) unwinding of the stimulus and additional imbalances
- Longer term: what lessons to draw from the crisis?



## A greener world economy (2)...

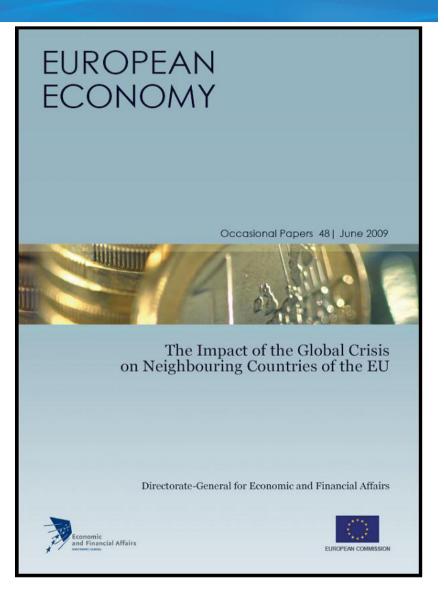
	Quarterly GDP forecast (%, quarter-on-quarter) 2009				Annual GDP forecast (%, year-on-year) 2009		
	2009/1	2009/2	2009/3	2009/4	Spring forecast May 2009	Interim forecast Sep. 2009	
Germany	-3.5	0.3	0.7	0.1	-5.4	-5.1	
Spain	-1.6	-1.1	-0.4	-0.2	-3.2	-3.7	
France	-1.3	0.3	0.4	0.3	-3.0	-2.1	
Italy	-2.7	-0.5	0.2	0.1	-4.4	-5.0	
Netherlands	-2.7	-0.9	-0.4	0.0	-3.5	-4.5	
Euro area	-2.5	-0.1	0.2	0.1	-4.0	-4.0	
Poland	0.3	0.5	0.1	0.0	-1.4	1.0	
United Kingdom	-2.4	-0.7	0.2	0.5	-3.8	-4.3	
EU27	-2.4	-0.2	0.2	0.1	-4.0	-4.0	

### No return to business as usual

- Reform of the international financial architecture (G20–Pittsburgh commitments– and FSB, two *fora* of major EU-Russia interaction), the recommendations from the De Larosiere report in the EU
- No additional creation of imbalances

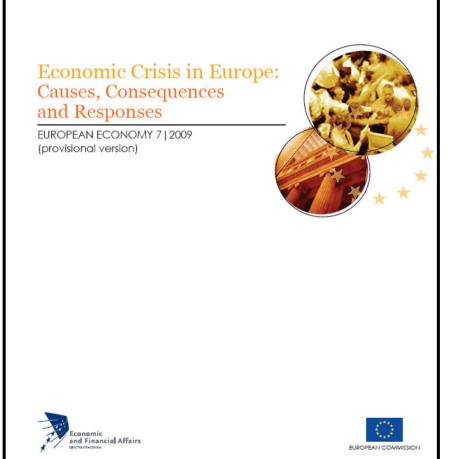
This presentation is largely based ontwoECFINrecentpapers:

1) the "Thematic article", the "Overview of Recent Economic Developments in the EU's Eastern neighbours" and on the "Russia Country Chapters" of the ECFIN Occasional Paper n° 40, "The Impact of the Global Crisis on Neighbouring Countries of the EU", European Commission, Brussels, 2009. The paper can be downloaded from the address below:



http://ec.europa.eu/economy\_finance/publications/publication15398\_en.pdf

•••and also on: 2) "Economic Crisis in Europe: Causes, Consequences and Responses", European Commission, Brussels, 2009. The paper can be downloaded from the address below:



http://ec.europa.eu/economy\_finance/publications/publication15887\_en.pdf



# Thank you for your attention!