

EU ENLARGEMENT – 5 YEARS AFTER

Macro-financial stability 5 years after

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WORKSHOP

Macro-financial stability

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CZECH **CNB** NATIONAL BANK

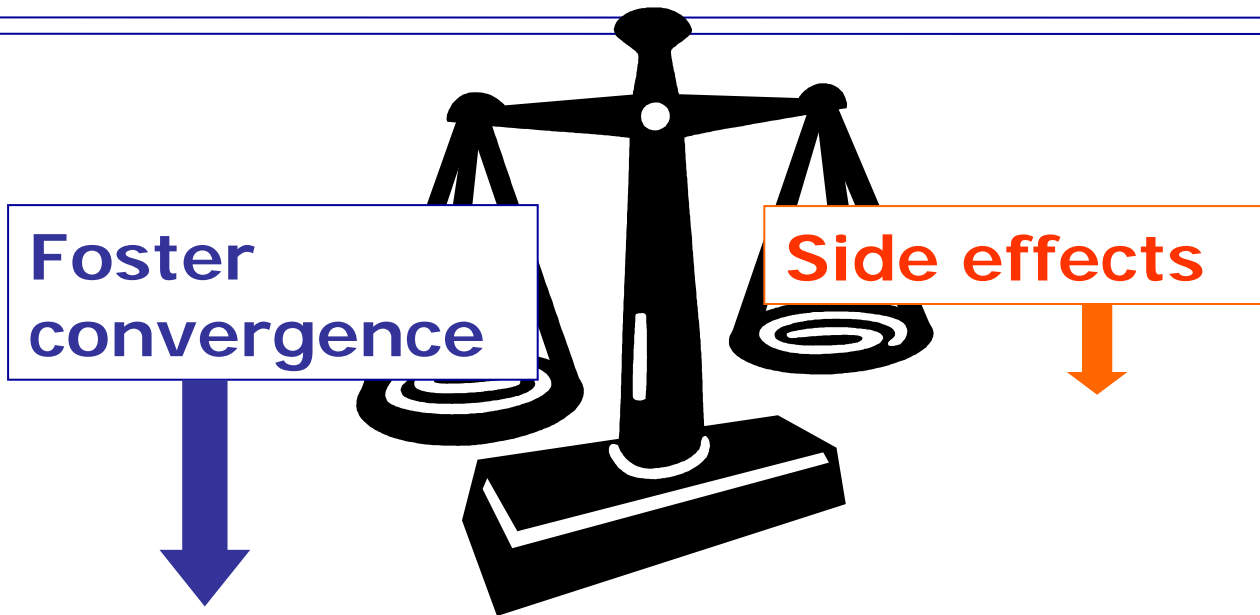
Enlargement as a medicine for the NMS



Foster
convergence

**It helped curing the
transformation symptoms
such as lack of capital and
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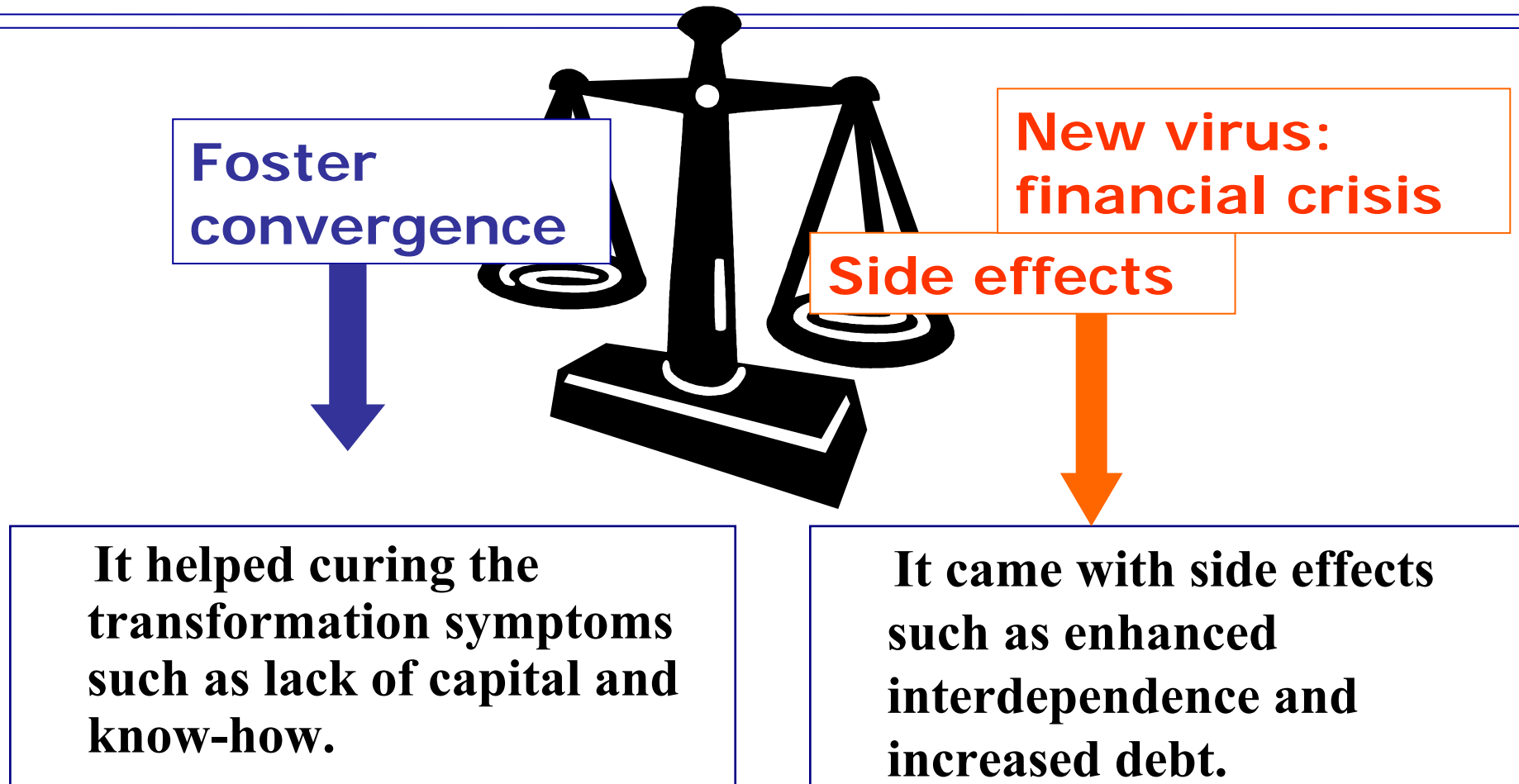
Enlargement as a medicine for the NMS



It helped curing the transformation symptoms such as lack of capital and know-how.

It came with side effects such as enhanced interdependence and increased debt.

Enlargement as a medicine for the NMS



Enlargement as a medicine for the NMS






The conference is an opportunity to discuss the complex task: cure symptoms and the fight virus

Focus of this workshop: stability

- **Two background documents provide us with an excellent collection of facts and analysis:**
 - ◆ **Enlargement has increased integration**
 - ◆ **Integration intensifies cross-country transmission of shocks, but it also makes risk sharing possible**
 - ◆ **Enlargement has put emphasis on nominal convergence (Maastricht)**
 - ◆ **Nominal convergence (according to Maastricht) contributes to macro-financial stability, but is not enough to secure it**
- **Background documents open various questions...**

About risk pricing

- **NMS do not have less efficient risk pricing than others**
 - ◆ **NMS are claimed to under-price risks (credit booms)**
 - ◆ **under-pricing observed in many countries**
- **Integration does not make countries similar**
 - ◆ **despite being integrated (trade openness, FDI), NMS are different according to financial stability indicators** 
 - ◆ **homogeneity (synchronization of cycles) and financial tools to trade and share risks are substitutes**
- **Markets seem to reflect country differences**
 - ◆ **country risk premia reflect differences in indicators** 
 - ◆ **policies (transparency) should focus on differentiating to reduce cross-country transmission of shocks** 


About macro-financial stability

- **NMS should go beyond Maastricht to ensure stability**
 - ◆ **3% deficit is no anchor, but the upper limit for bad times**
 - ◆ **easy to import instability, impossible to import stability**
 - ◆ **EMU entry is no panacea, domestic framework vital**
- **What are the guidelines for this framework ?**
 - ◆ **have medium-term fiscal plans, not just annual budget, do not encourage borrowed growth (fiscal authority)**
 - ◆ **internalize systemic risks into macro forecast, communicate actively (central bank)**
 - ◆ **conduct medium-term stress-tests and internalize systemic risks into risk models (supervision authority and also financial institutions)**

About financial stability

- **The new financial architecture should try to fight the virus, without forgetting the initial aim of the medicine (real convergence) :**
 - ◆ **No excessive regulation, if information available about risks, ensure that authorities will act (regulation versus incentives versus tools available) and households will consider (regulation versus financial education)**
- **Powers and responsibilities should be balanced:**
 - ◆ **either integration of supervision on national level (and national deposit insurance schemes) or EU supervisor (and the EU burden-sharing scheme)**
- **NMS has also something to offer:**
 - ◆ **1990's experience (privatization, bad bank assets, nationalization).**

Back to the growth effects

- **Do we underestimate enlargement bonus?**
 - ◆ improved consumer choice (welfare gains)
 - ◆ indirectly confirmed by voting by foot – NMS citizens did not go West (fears have not materialize)
- **Do we overestimate growth bonus?**
 - ◆ impossible to distinguish this bonus from transition and globalization factors
 - ◆ GNP indicates smaller gains (FDI) 
- **What are origins of growth bonus (integration or fiscal stimulus)?**
 - ◆ roughly 2% of GDP
 - ◆ estimated net inflow of structural funds 1.3% of GDP

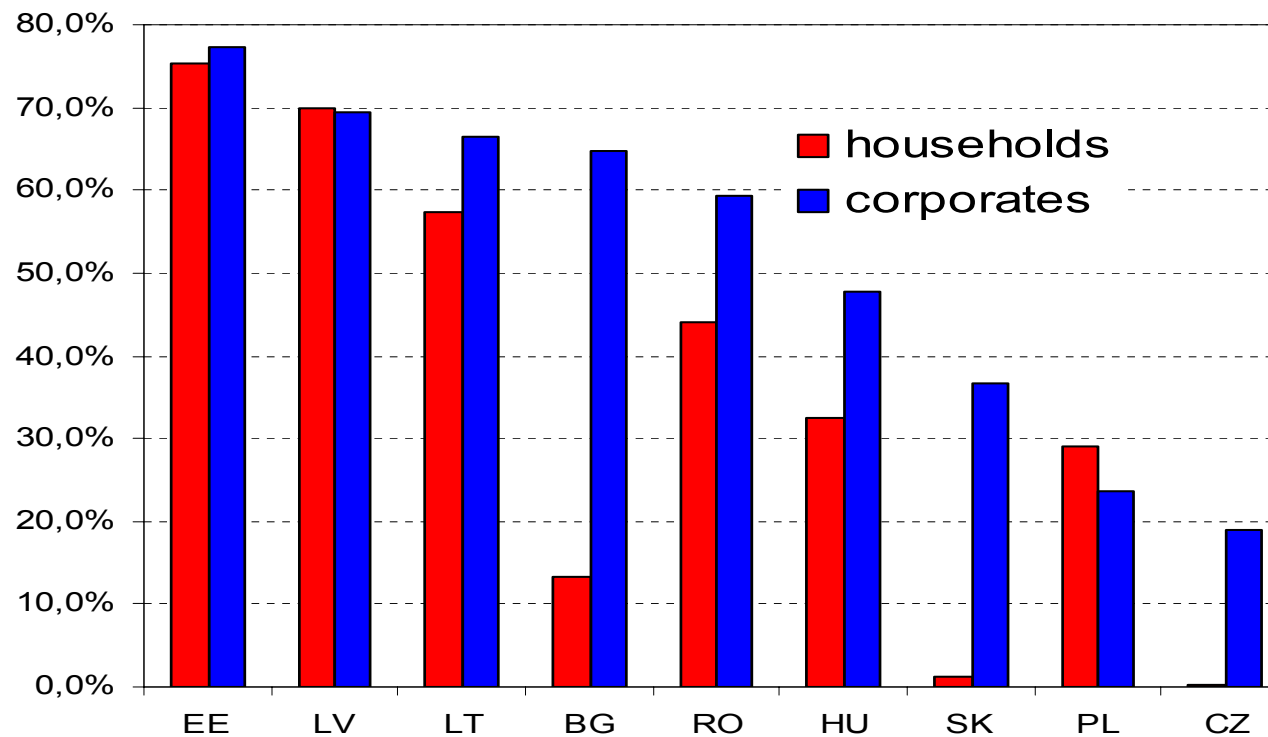
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Thank you for your attention

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About risk pricing

Chart: FX loans (in % of total, end-2007)

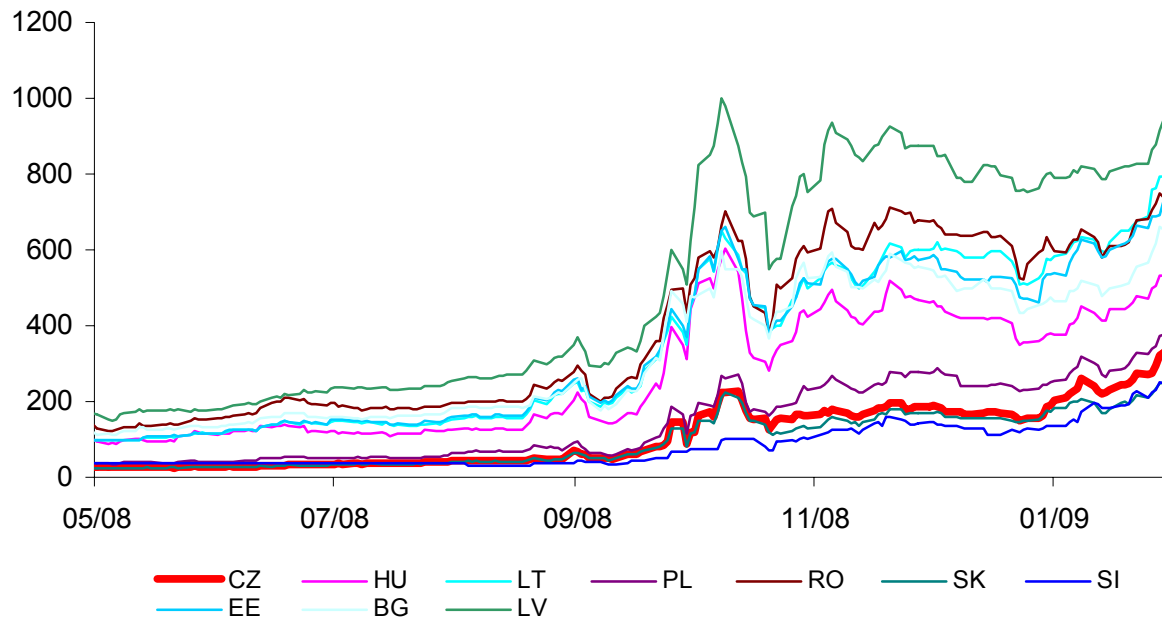


**Financial indicators point out to heterogeneity -
NMS should not be taken as a homogenous group**



About risk pricing

Credit Default Swap spreads
Chart: (5Y CDS, bps)



Source: Thomson Datastream

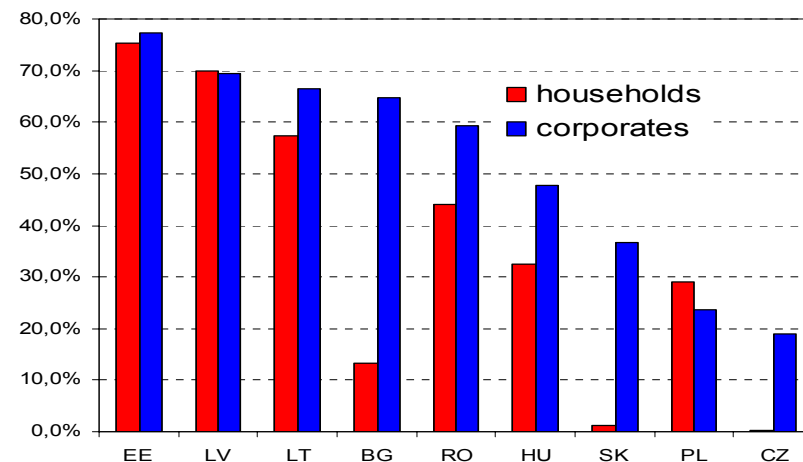
Markets seem to reflect this heterogeneity.



About risk pricing

**Example of ignoring heterogeneity:
„Argentina on Danube“
(Economist, February 21)–CR cut interest rates and households are in agony because of mortgages in euros.**

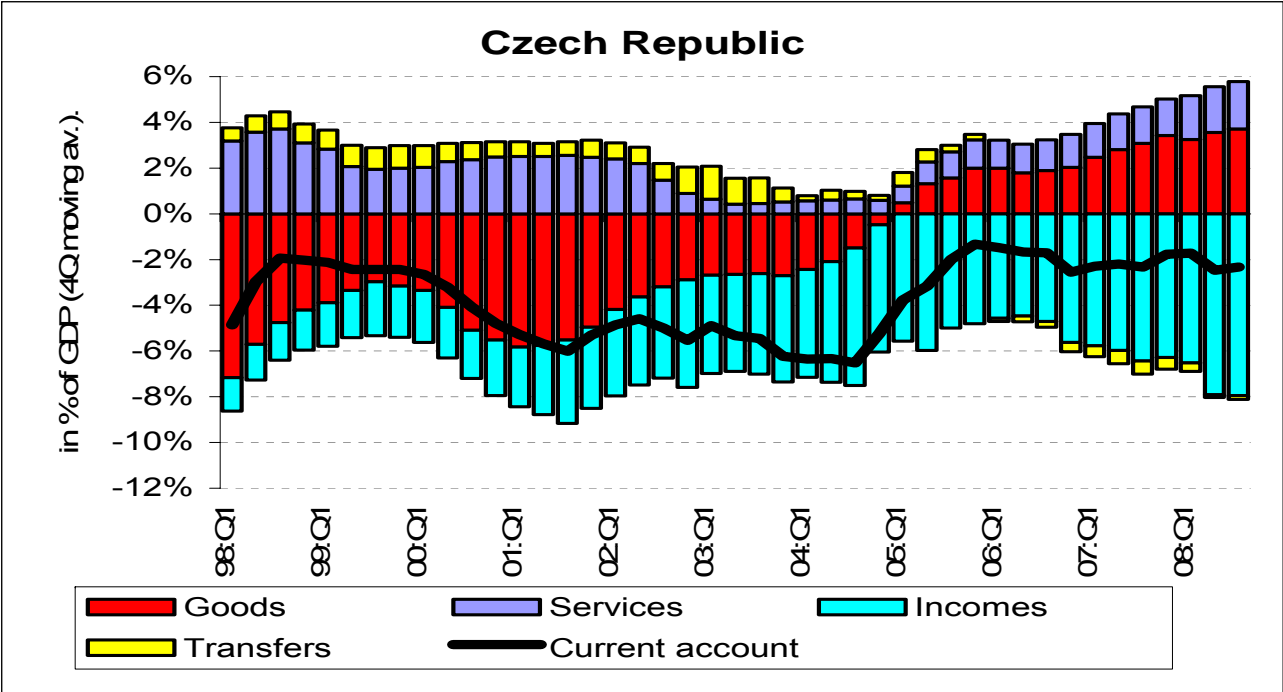
Chart: FX loans (in % of total, end-2007)



Media still view the NMS as a homogenous group sometimes. This view increases risks of cross-country transmission of shocks via contagion. See no mortgages in euros in the Czech case.

Back to the growth effects

Chart: Current account developments



Source: Eurostat

FDI improves trade balance, but negative income balance drives a wedge between the GNP and GDP.