

# **The Eurozone in Crisis. A View from Poland.**

Marek Belka

President of the National Bank of Poland

Banco Central de Reserva del Perú

Lima, 28 May 2012

**1.**

# **The lessons from the euro crisis**

# **The euro crisis puts an end to the convictions that**

- **competition on the Common Market was sufficient to secure the coordination of euro zone member countries economic (e.g. wage) policies**
- **the Stability and Growth Pact was sufficient precaution against disequilibria in the economies of the member states**

# The euro crisis illustrated a necessity of:

- **a reconfiguration of institutional structure of the euro zone**

## GOVERNANCE

- *Excessive Imbalances Procedure, European Semester, strengthening the Stability and Growth Pact, Fiscal Compact, new supervisory architecture (ESRB, European supervisory authorities for banking, insurance and securities markets)*

## EMERGENCY FINANCING AND CRISIS RESOLUTION

- *European Financial Stability Facility and European Stability Mechanism*

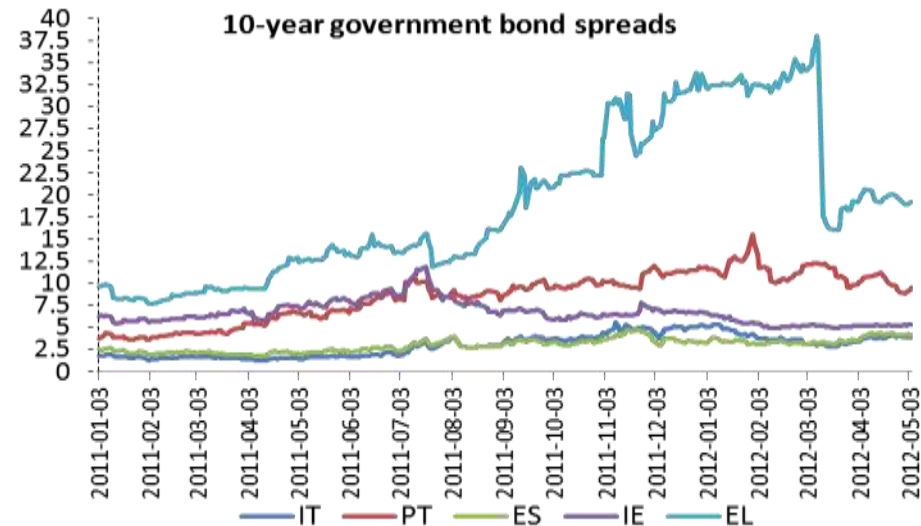
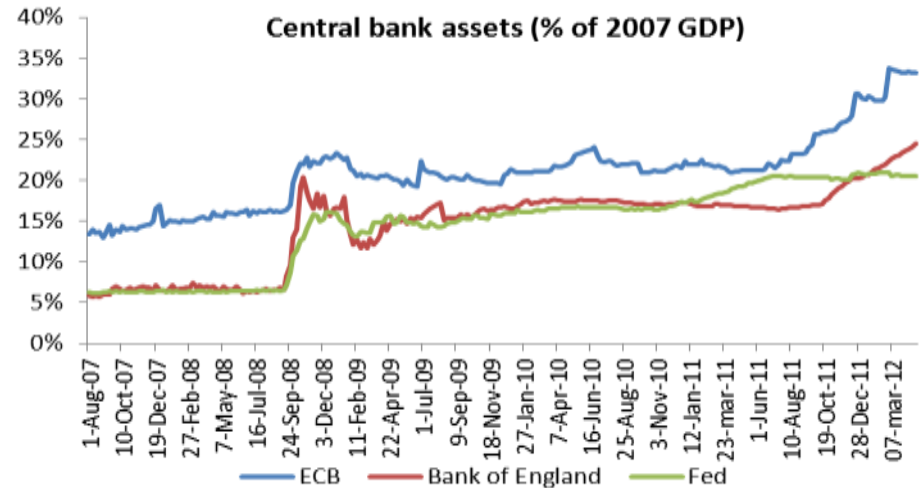
- **making macro-prudential policy an additional weapon of central banks**

2.

**Euro area on the „way out of the woods”**

# Policy efforts to contain the crisis accelerated since 2011q4

- **Policy actions taken since December 2011:**
  - Significant expansion of the ECB's balance sheet (3-year LTROs)
  - Fiscal Compact
  - Temporary strengthening of the firewall by combining the ESM and EFSF
  - Publication of bank recapitalisation plans by EBA
  - Progress with second Greek package
  - Progress with fiscal adjustment and structural reforms at national levels



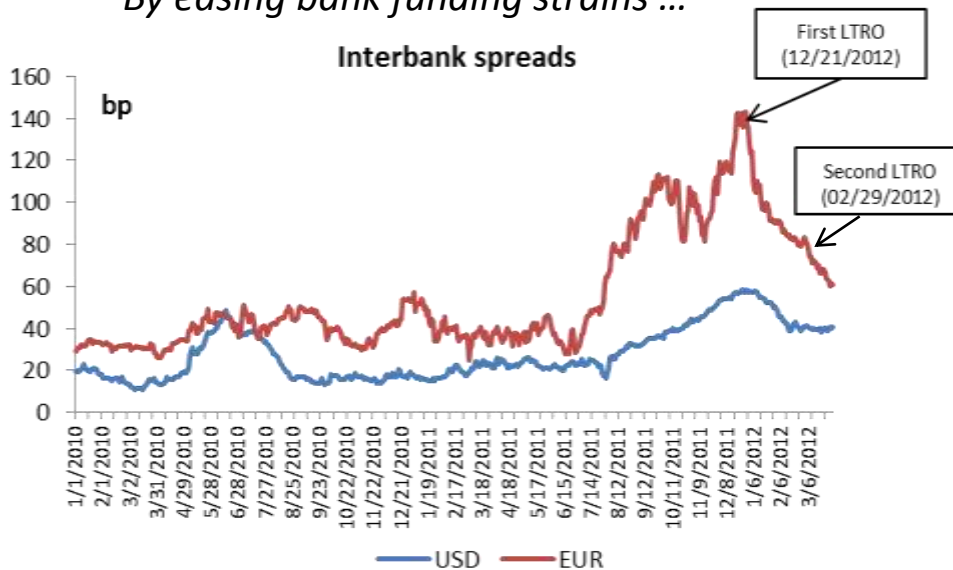
# Emergency liquidity support by the ECB played an important role in stabilising financial markets

Central bank providing emergency liquidity support is „like a goalkeeper in a football team. The goalkeeper’s job is to be the last line of defence, and to prevent goals that the defenders have failed to prevent. A team with perfect defenders might not need a goalkeeper. In practice, though, no defenders are perfect, and even the best teams want to have the best goalkeepers.”

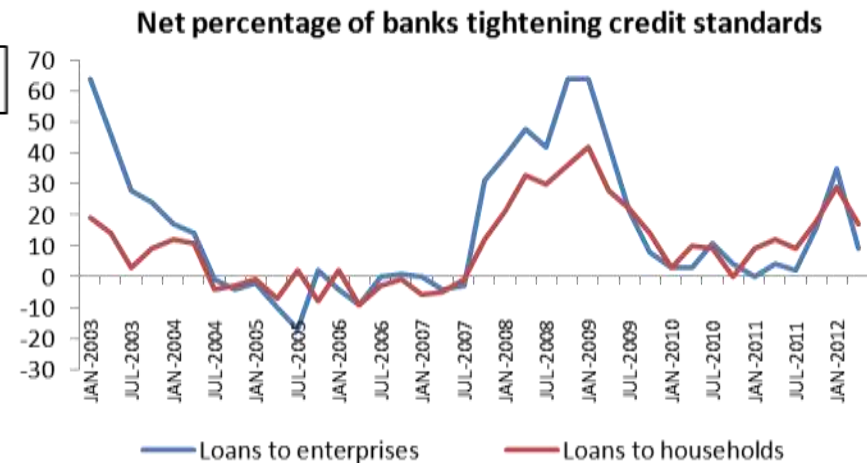


# LTROs have contained the risk of liquidity-driven bank failures and disorderly deleveraging

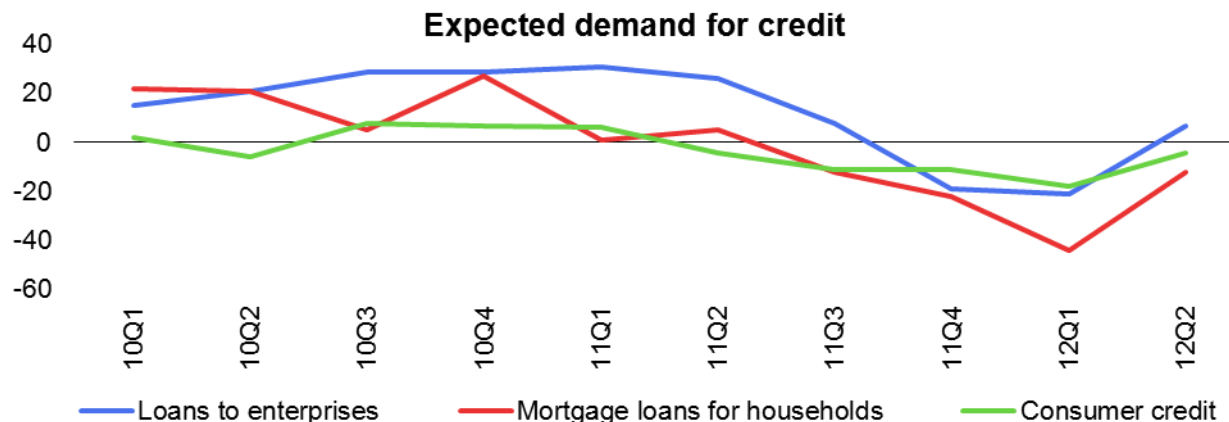
*By easing bank funding strains ...*



*...LTRO helped to prevent disorderly deleveraging*

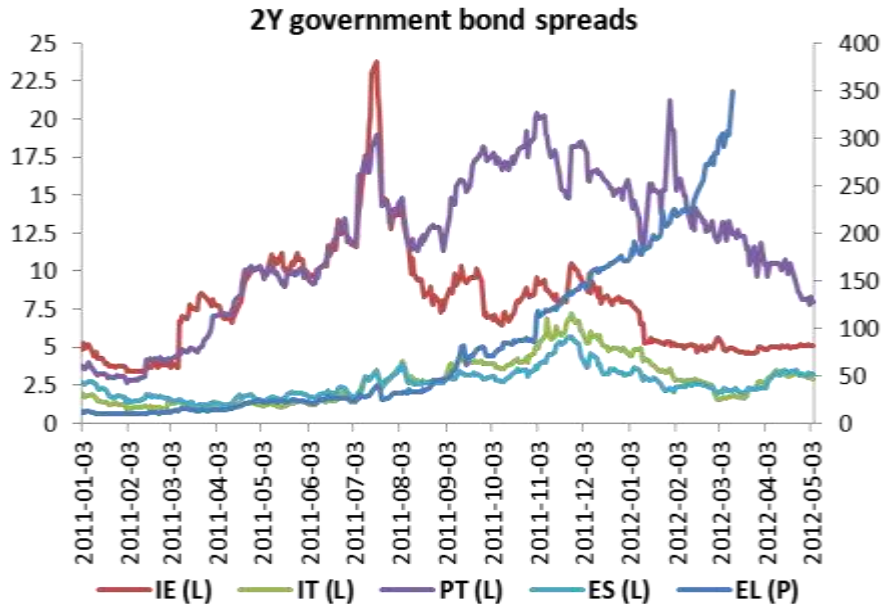


*In the context of weak demand for credit, LTROs are however unlikely to spur private sector credit growth*





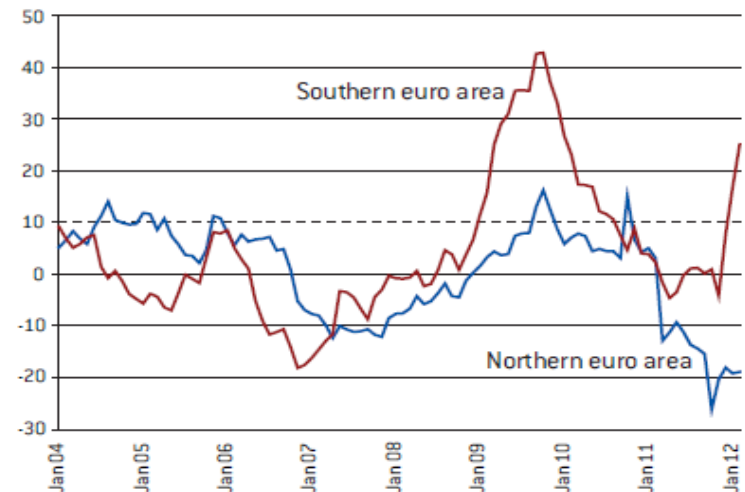
# LTRO has temporarily broken negative sovereign-bank feedback loops



- However, LTROs might also have strengthened sovereign-bank nexus in some fragile euro area economies over the medium term

- LTROs temporarily supported easing of tensions in the government bond markets (although mainly at the short end of the yield curve)

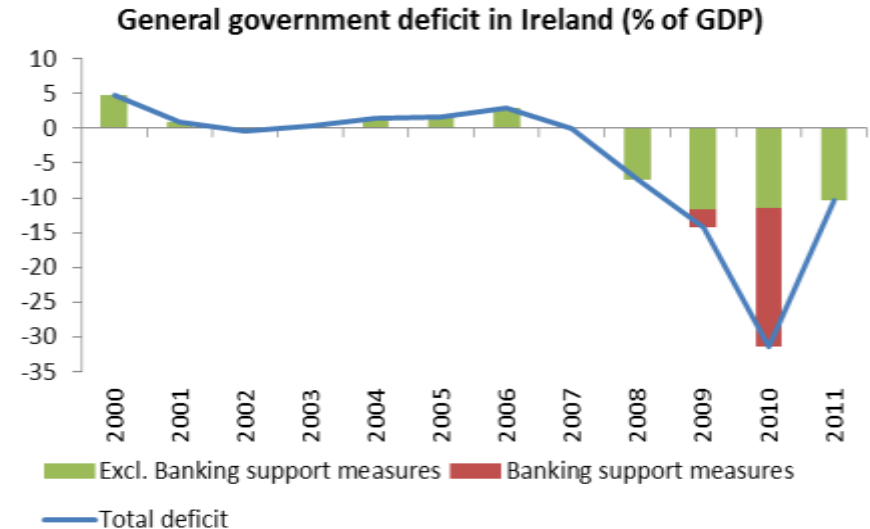
*Banks of southern euro area countries increased their holdings of general government securities after the launch of LTROs*



Source: J. Pisani-Ferry, G. Wolf (2012)

# More lasting decoupling of sovereign and banking risks requires changes to banking resolution framework

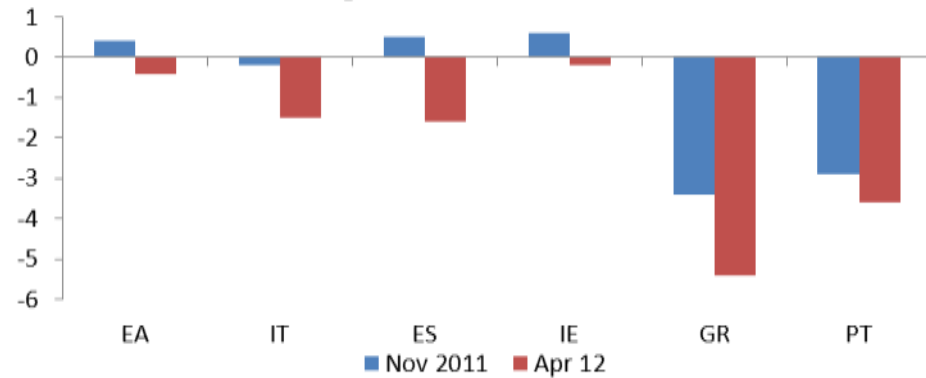
- Bank bailouts and financial sector assistance or market fears of thereof have put significant strains on public finance in selected euro area countries (e.g. Ireland, Spain)
- In mid-2012 European Commission will put forward legislative proposal on EU-wide bank recovery and resolution framework
- The establishment of euro-area bank resolution fund could further boost the effectiveness of new resolution framework
  - *Politically feasible?*



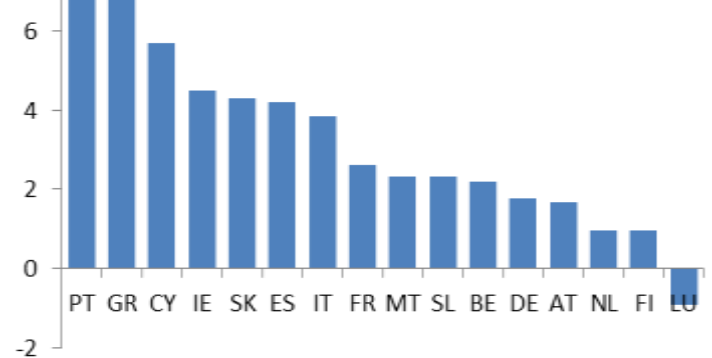
# Weak growth prospects may put strains on the adopted crisis resolution strategy

- Current forecasts scenarios point to mild recession in the euro area in 2012; Fiscal austerity acts as a drag on near-term growth prospects

GDP growth forecasts for 2012

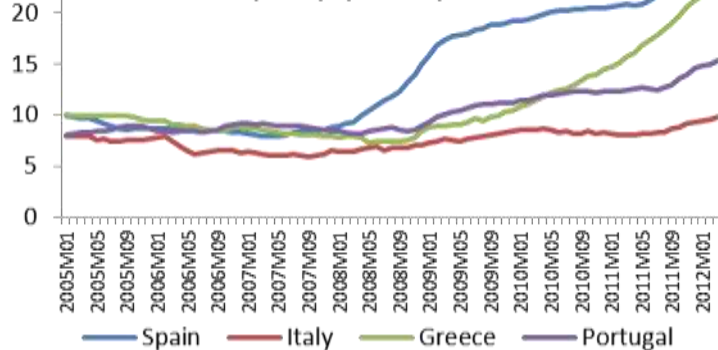


Projected change in structural fiscal balance over 2011-2013

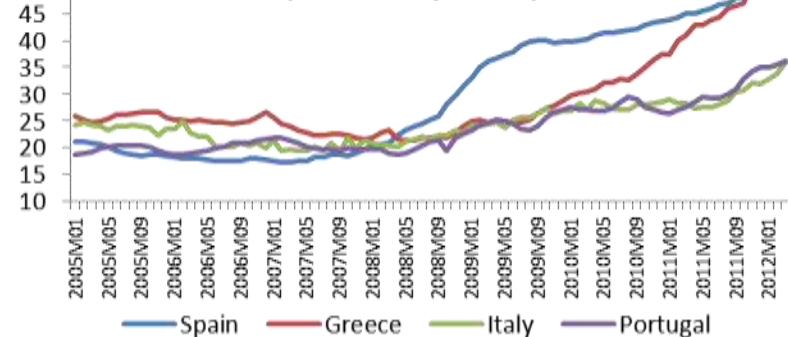


- High social costs of crisis have negative impact on democratic legitimacy of adopted crisis resolution measures (which implies political risks to the regions' economic outlook)

Unemployment rate (total population)



Unemployment rate (less than 25 years old)



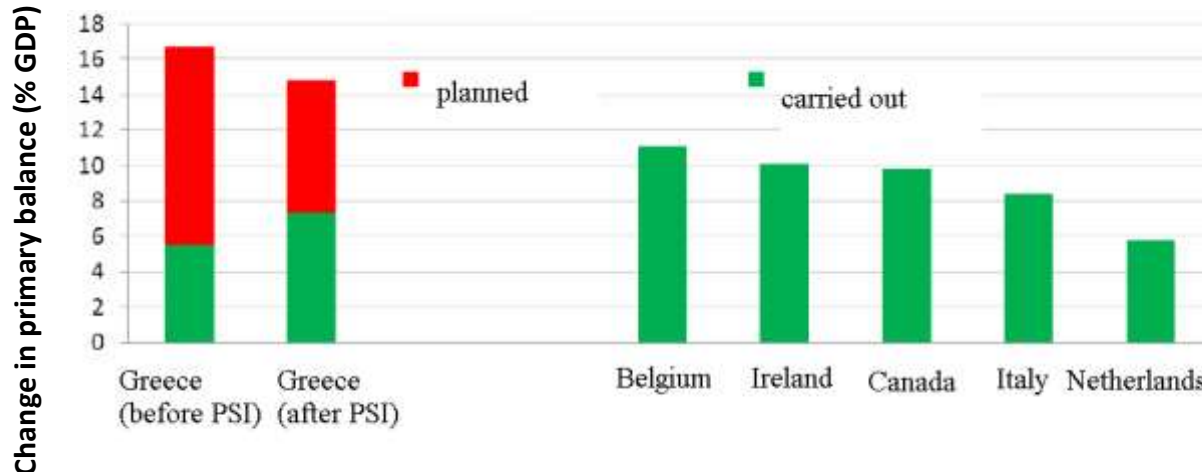
# The scale of assistance to Greek economy is unprecedented by historical standards but significant effort is still required to ensure the stability of its public finance

<u>Various forms of EU and international support ≈ € 380 bn</u>	<u>The equivalent of: (2011 data)</u>	<u>By comparison:</u>
Financial assistance (loans): € 240 bn	<ul style="list-style-type: none"> <li>• 3% of EU GDP</li> <li>• 177% of Greek GDP</li> <li>• € 33 600 per Greek inhabitant</li> </ul>	<ul style="list-style-type: none"> <li>• Total US Marshall plan 1948-1951:               <ul style="list-style-type: none"> <li>– ≈ USD 13 bn (85% grants, 15% loans)</li> <li>– ≈ 5% of US GDP</li> </ul> </li> </ul>
Private sector involvement (debt write-downs): € 100 bn		<ul style="list-style-type: none"> <li>– ≈ 2.1% of GDP of recipient countries</li> </ul>
EU funding for the period 2007-2013 (grants): > € 40 bn (including € 20 bn from EU structural and cohesion funds and € 20 bn under the Common Agricultural Policy)		

Source: European Commission (April 2012).

Fiscal adjustment in Greece:


Fiscal adjustments carried out in OECD countries with debt/GDP ratio exceeding 90%:



Source: OECD, IMF data, NBP calculations.

## **The tradeoff related to the Fiscal Compact**

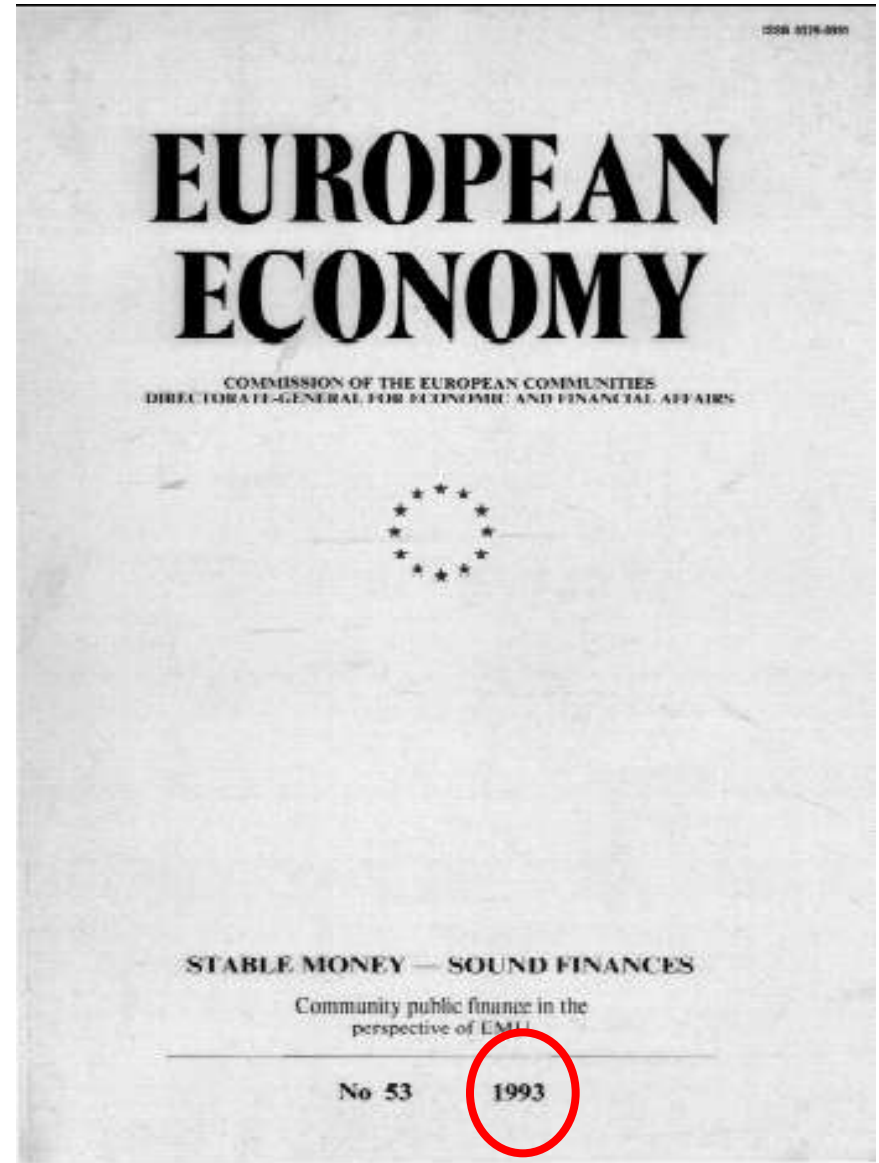
- **The Northern euro zone countries can afford to reduce relatively quickly their budget deficits, increasing the volume of the domestic savings, because the overall demand will be supplemented by the external demand for their exports.**
- **Is it possible for the less open and less competitive countries of the Southern cone of the euro zone, especially those going through a balance sheet recession?**

A photograph of the Golden Gate Bridge in San Francisco, California, shrouded in a thick, white fog. The bridge's iconic red-orange towers and suspension cables are visible, extending into the distance where they disappear into the mist. The water of the bay is also obscured by the fog, creating a serene and somewhat mysterious atmosphere.

**A return of the old questions  
regarding the future of the euro zone**

- **„There would be many fewer economic problems if the EU**
- **either moved on to full federal system,**
- **or was to revert to just being a common market of national systems, including national monetary systems.”**

- The last proposal to create a federal budget in the European Union was put forward in 1993.





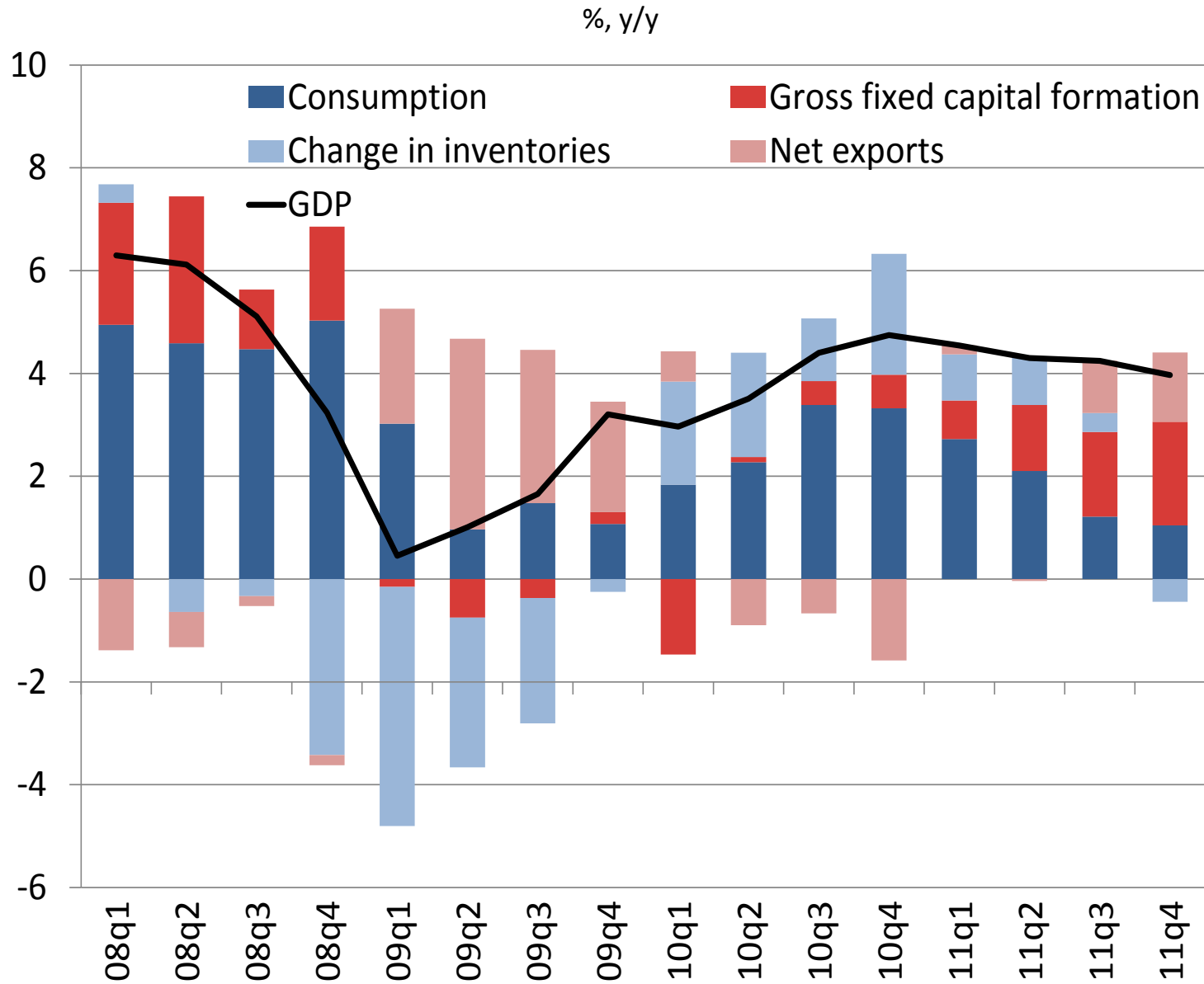
- **„The United States in the 19th century had a common currency, but it did not have a large, centralized fiscal authority. The federal government was much smaller than it is today. In some ways, the U.S. then looks like Europe today. Yet the common currency among the states worked out fine.**
- **Americans in the 19th century were willing to move among the states, whereas Greeks have to stay in Greece because they don't speak German.”**

# **3. The impact of the euro crisis on the Polish economy**

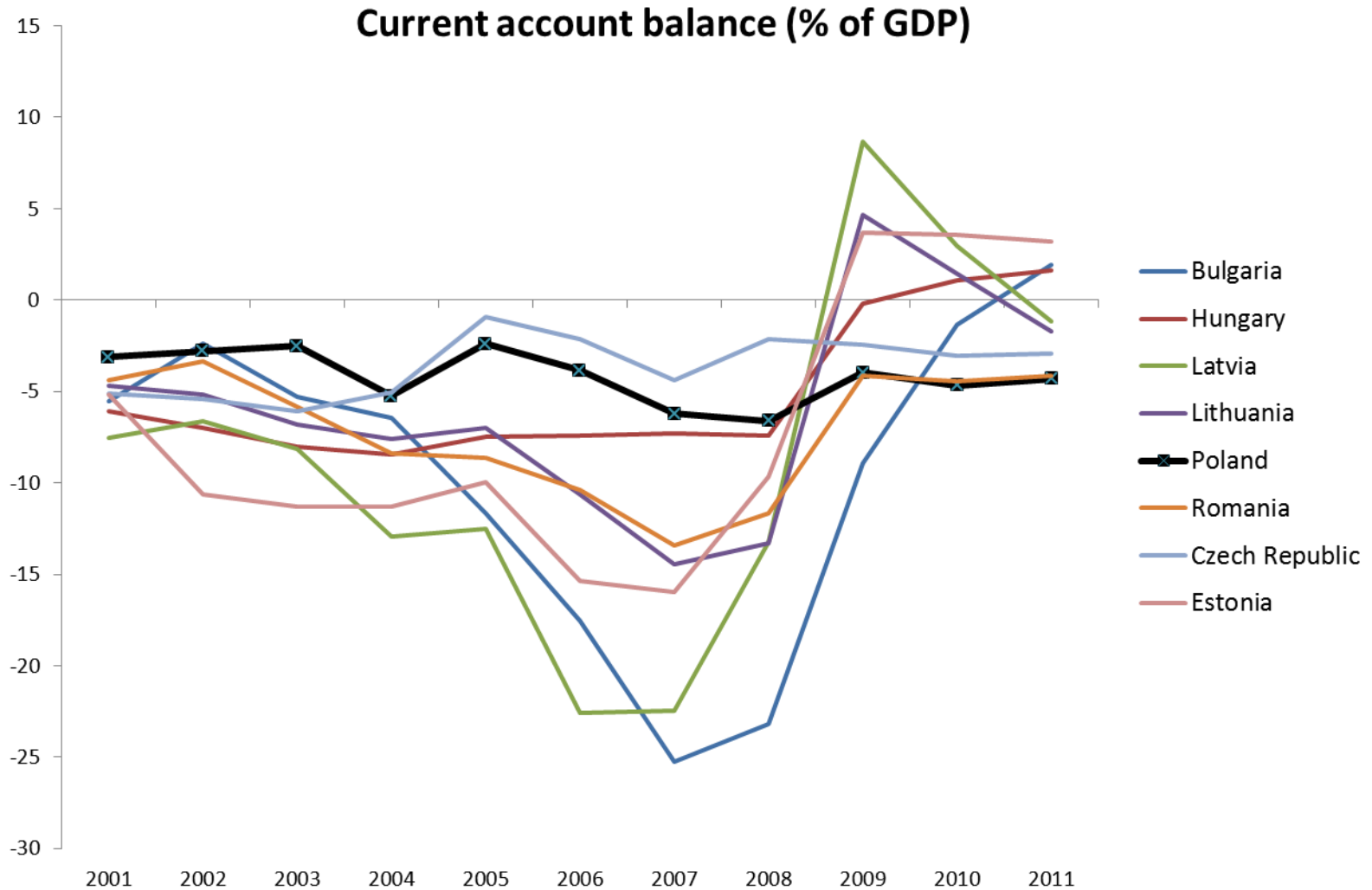
# **Poland's economy weathered relatively smoothly through the global banking crisis and the resulting euro zone debt crisis**

- **Balanced economic growth makes the Polish economy relatively resistant to external shocks**
- **The important shock absorbers are the floating exchange and the growing flexibility of the Polish labor market**
- **Economic growth is supported by the boom in public investments**

# The GDP rate of growth stays close to the potential of the Polish economy

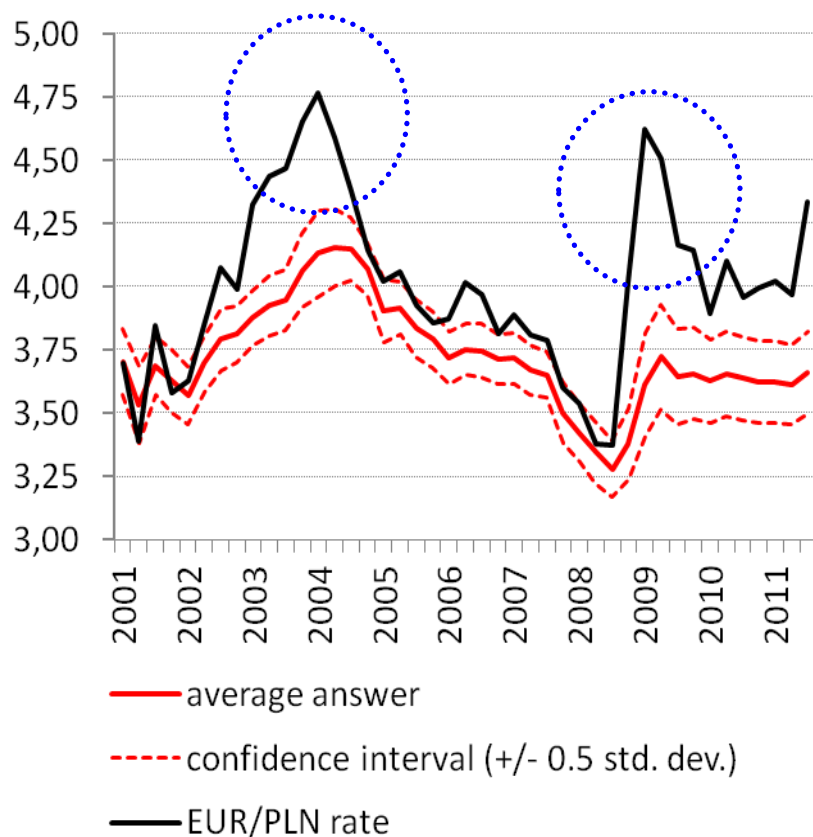


# One of the symptoms of the balanced growth in Poland is the relatively stable current account balance

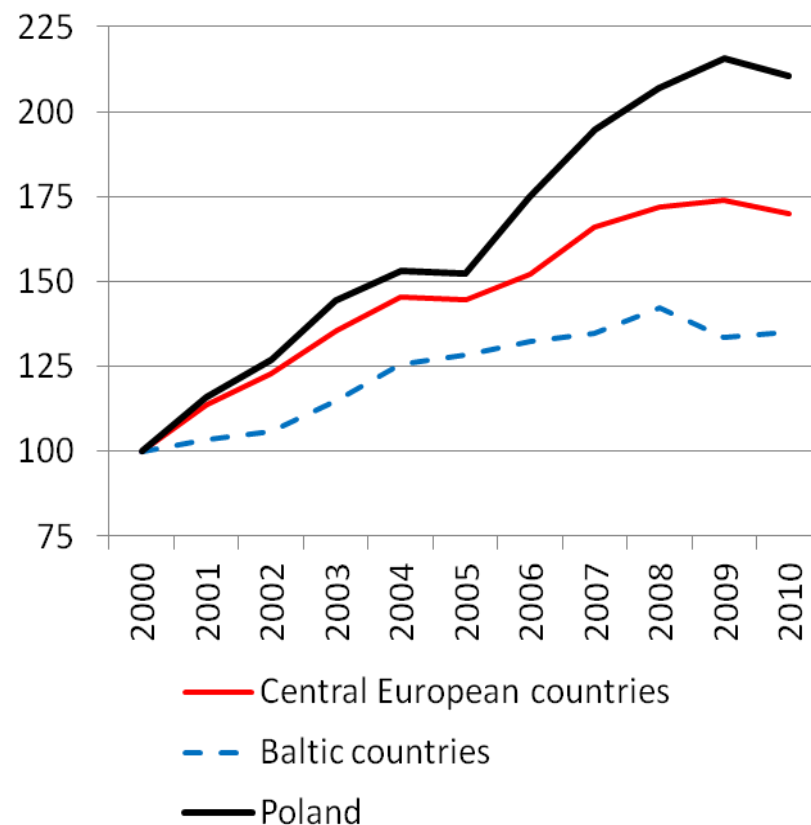


# Flexible exchange rate of the Polish zloty amortizes effectively external shocks

## Exchange EUR/PLN rate at which exports is no longer profitable

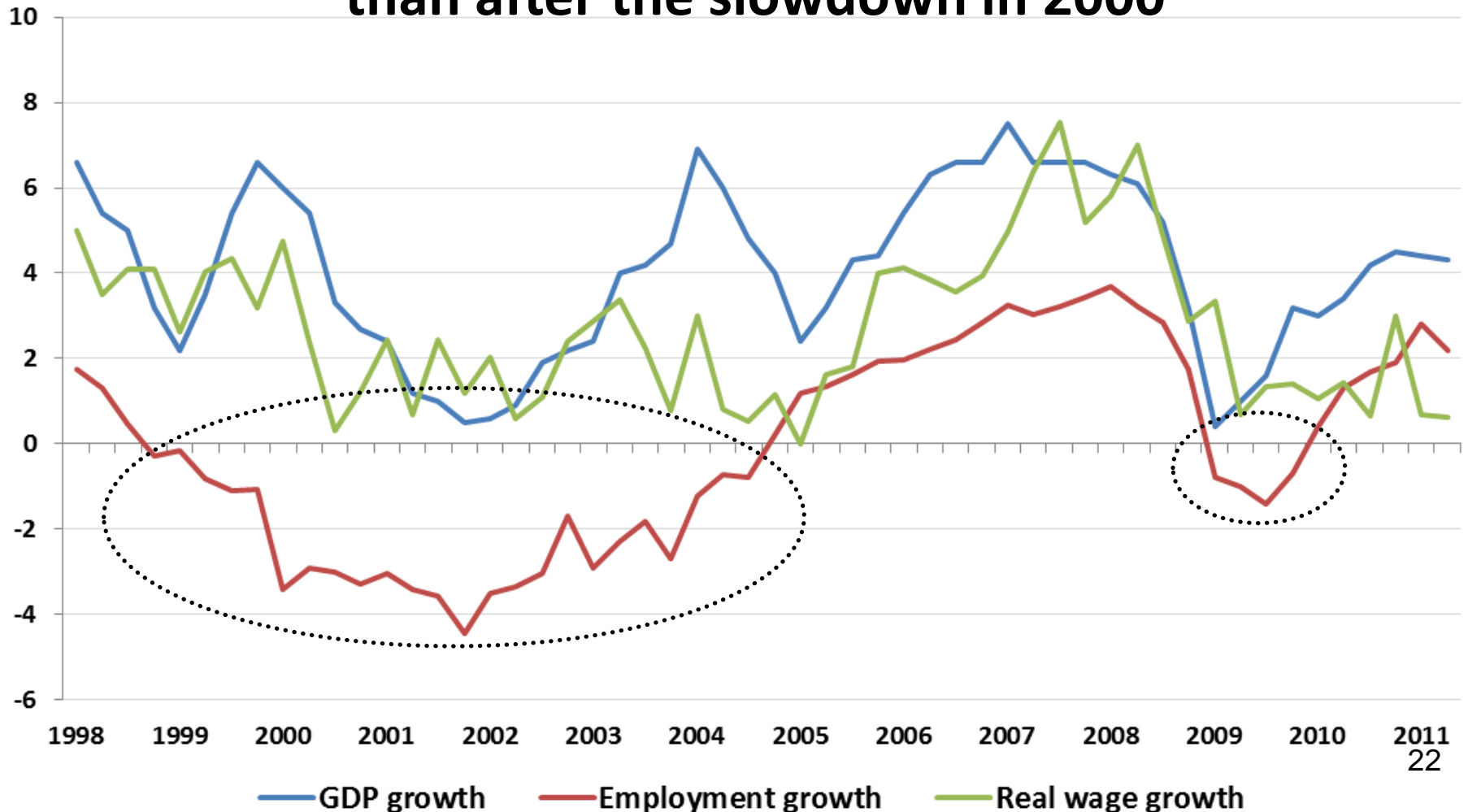


## The share of exports in global trade (scaled so that 2000=100)



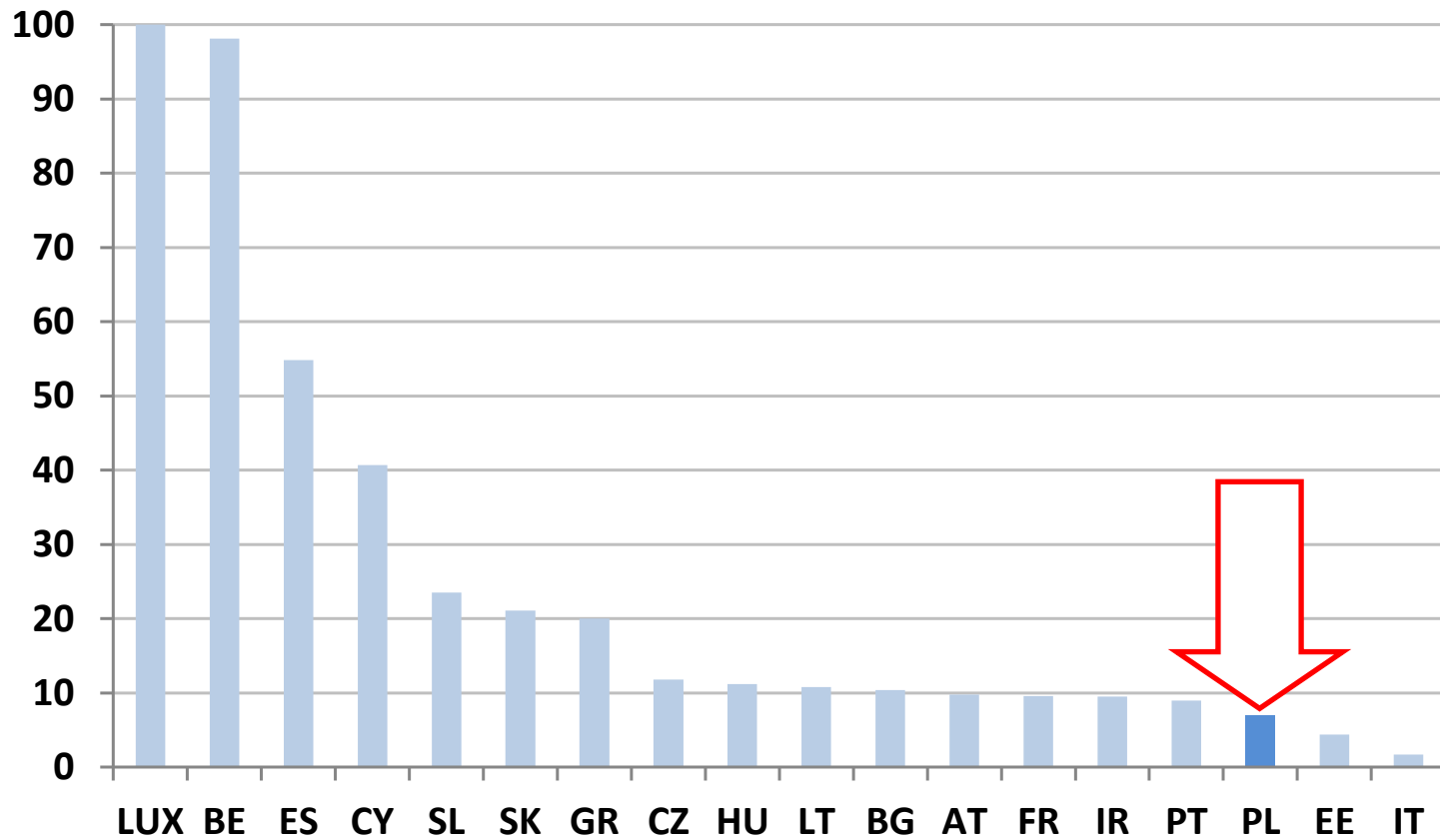
# The important shock absorber was the growing flexibility of the Polish labor market

The rise in unemployment in 2009 was shorter and milder than after the slowdown in 2000



# Factors behind the increased flexibility of labor market in Poland

## Low coverage of automatic wage indexation (%)

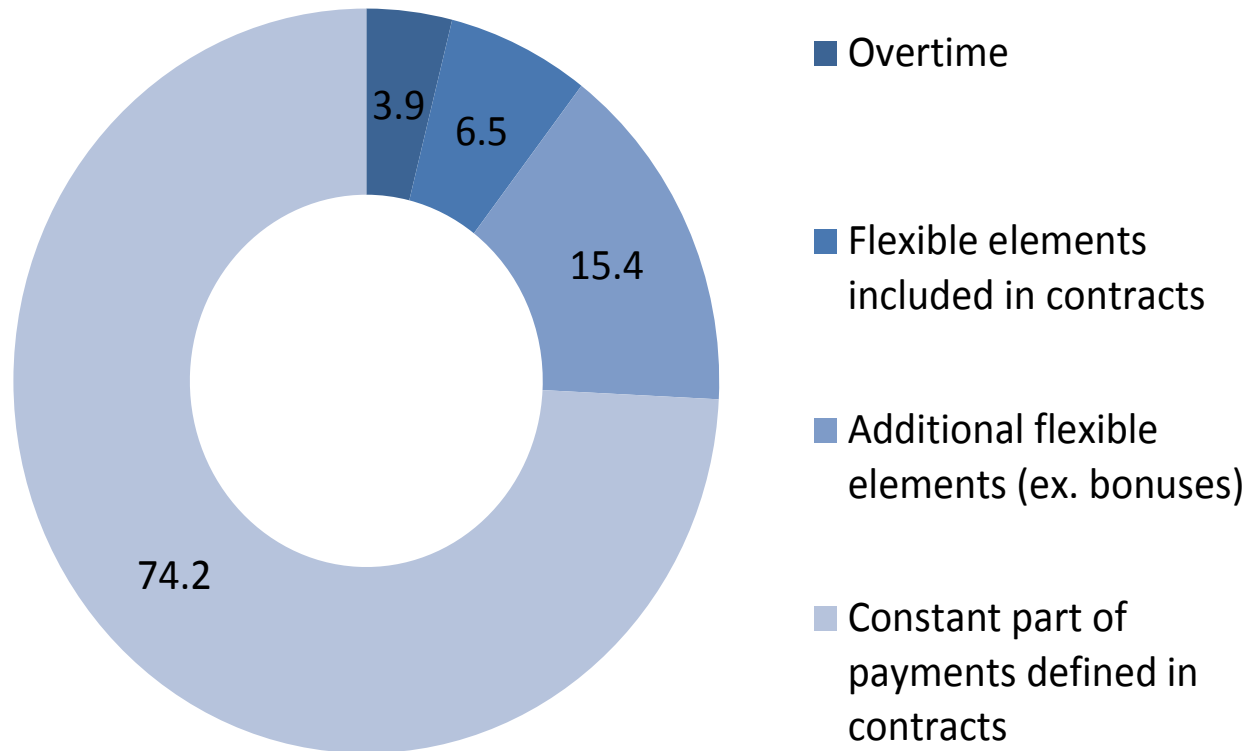


Source: ECB Wage Dynamics Network Survey Report (2009)



# Factors behind increased flexibility of labor market in Poland

## Flexible wage components as a cushion against adverse shocks (%)



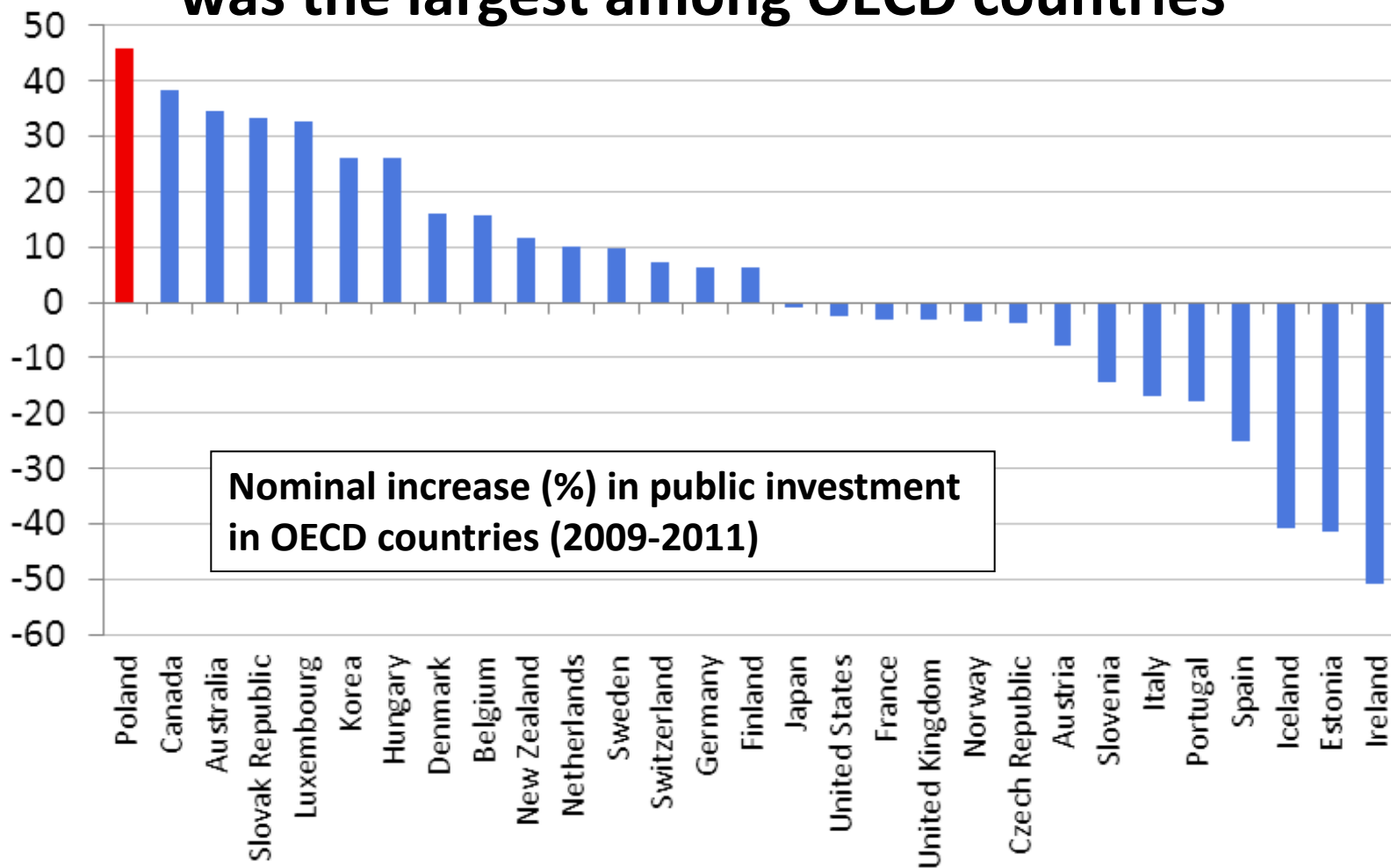
# Poland did not implement a fiscal stimulus during the crisis.

- Instead a boom in public investment took place, partly related to absorption of EU structural funds

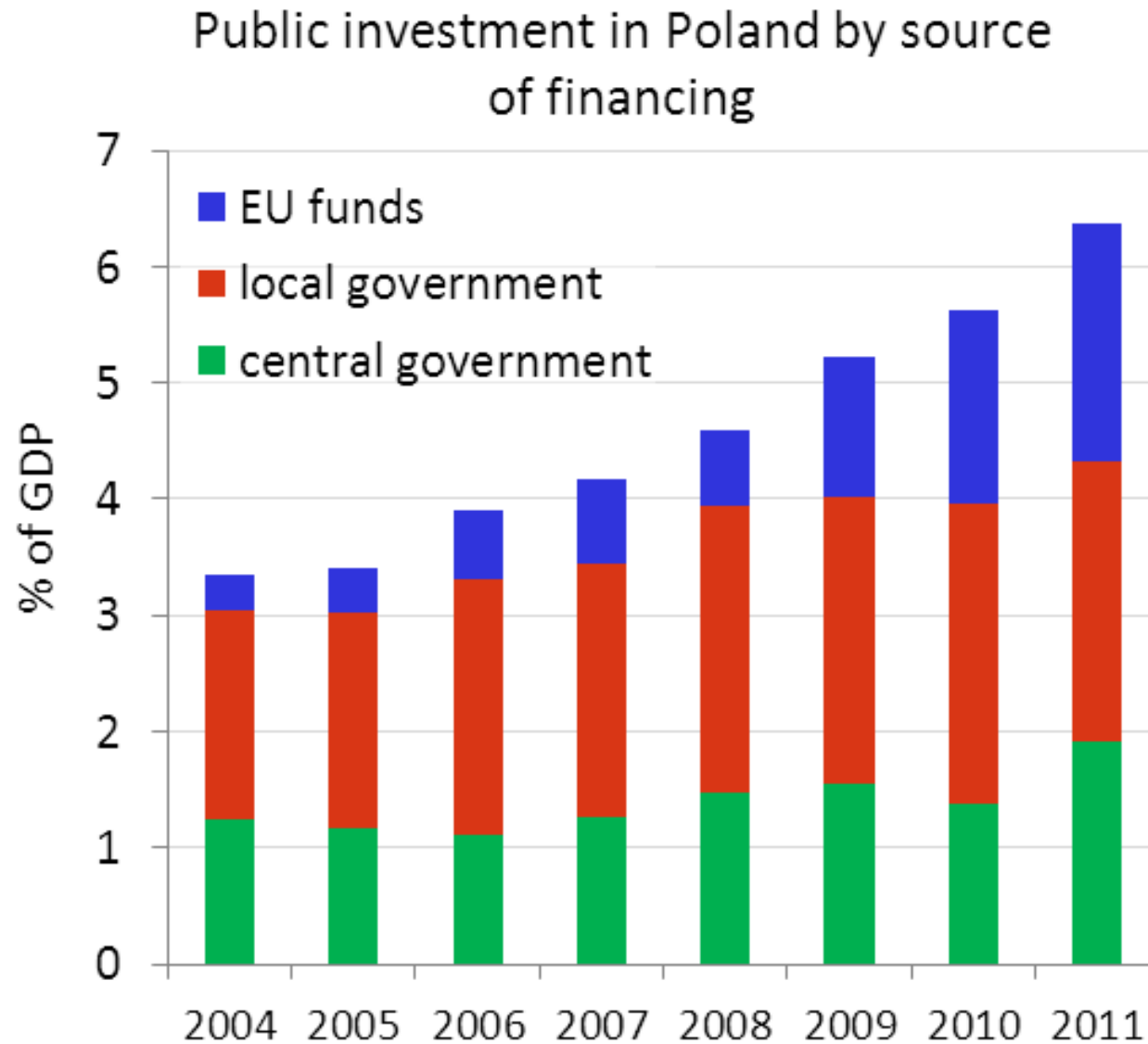


# Public investment „stimulus” in Poland

The increase in public investment during the crisis was the largest among OECD countries



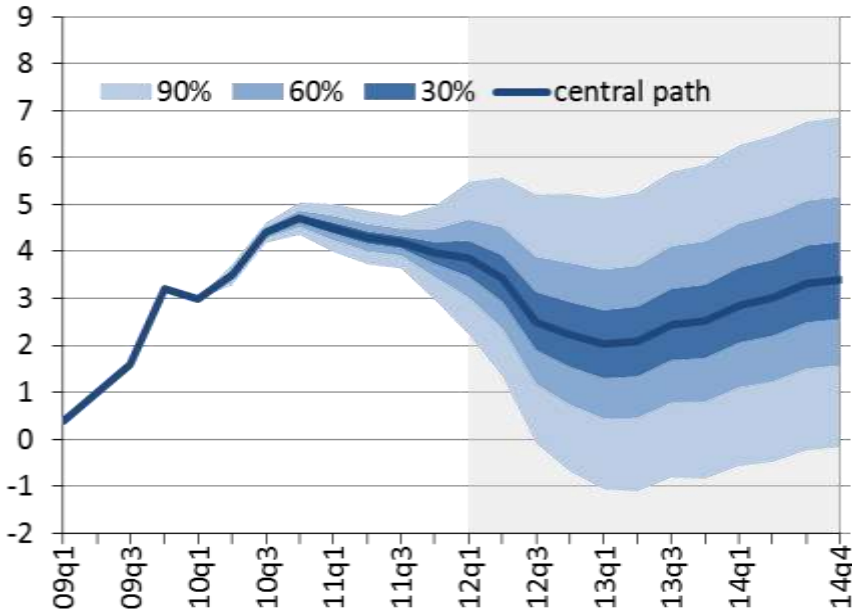
# Public investment „stimulus” in Poland



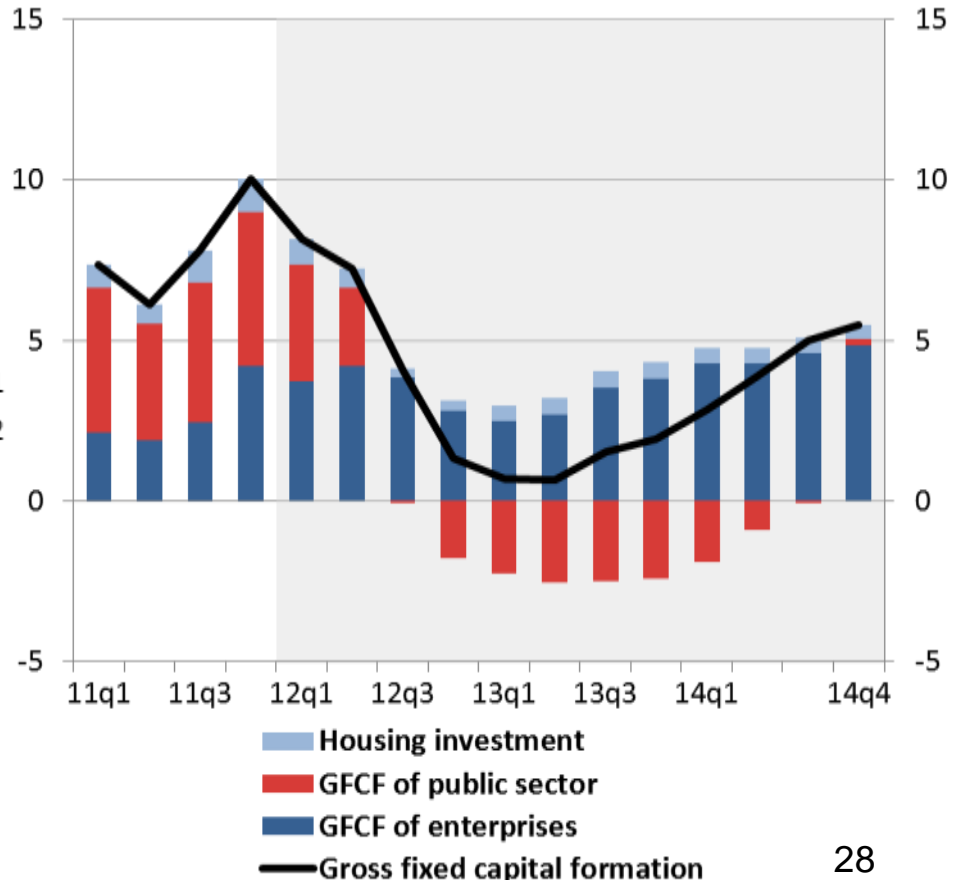
Source: NBP calculations

# In 2012-2013 economic slowdown is expected in Poland

GDP growth (y/y)

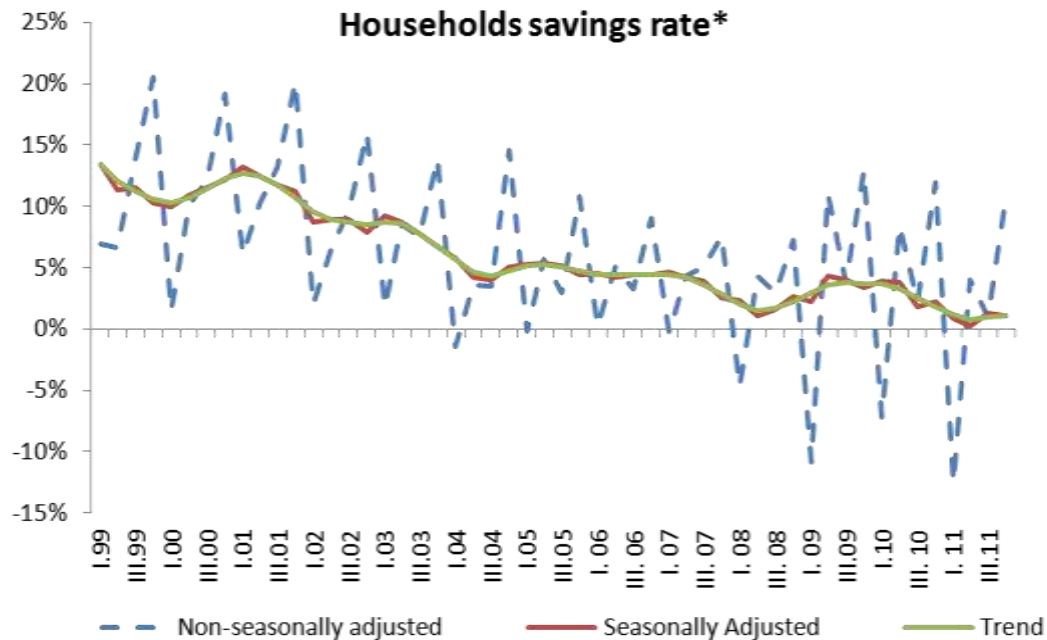


Projected decline in public investment spending indicates that the weakness of external demand will not be offset by robust domestic demand growth to the same extent as in previous years



# Low households savings rate may limit domestic demand's resilience to external shocks

Since beginning of 2000 a marked downward tendency of savings rate of households has been visible



\*Excl. transfers to obligatory pension funds

**Low savings rate weakens households' shock-absorption capacity and may bode ill for robustness of domestic demand in the context of external demand weakness**

**4.**

**Lessons from the euro crisis  
for the catching up economies**

- **Floating exchange rate helps to resolve the conflict between nominal and real convergence and may help to stabilize the REER (real effective exchange rate)**
- **Joining a monetary union by catching-up economies poses additional challenges resulting from the higher level of the natural rate of interest than in developed countries**



# Macro-prudential policy: the necessary second tool of central bank countercyclical policy



# The probability of conflicts between monetary policy and macro-prudential policy is very low

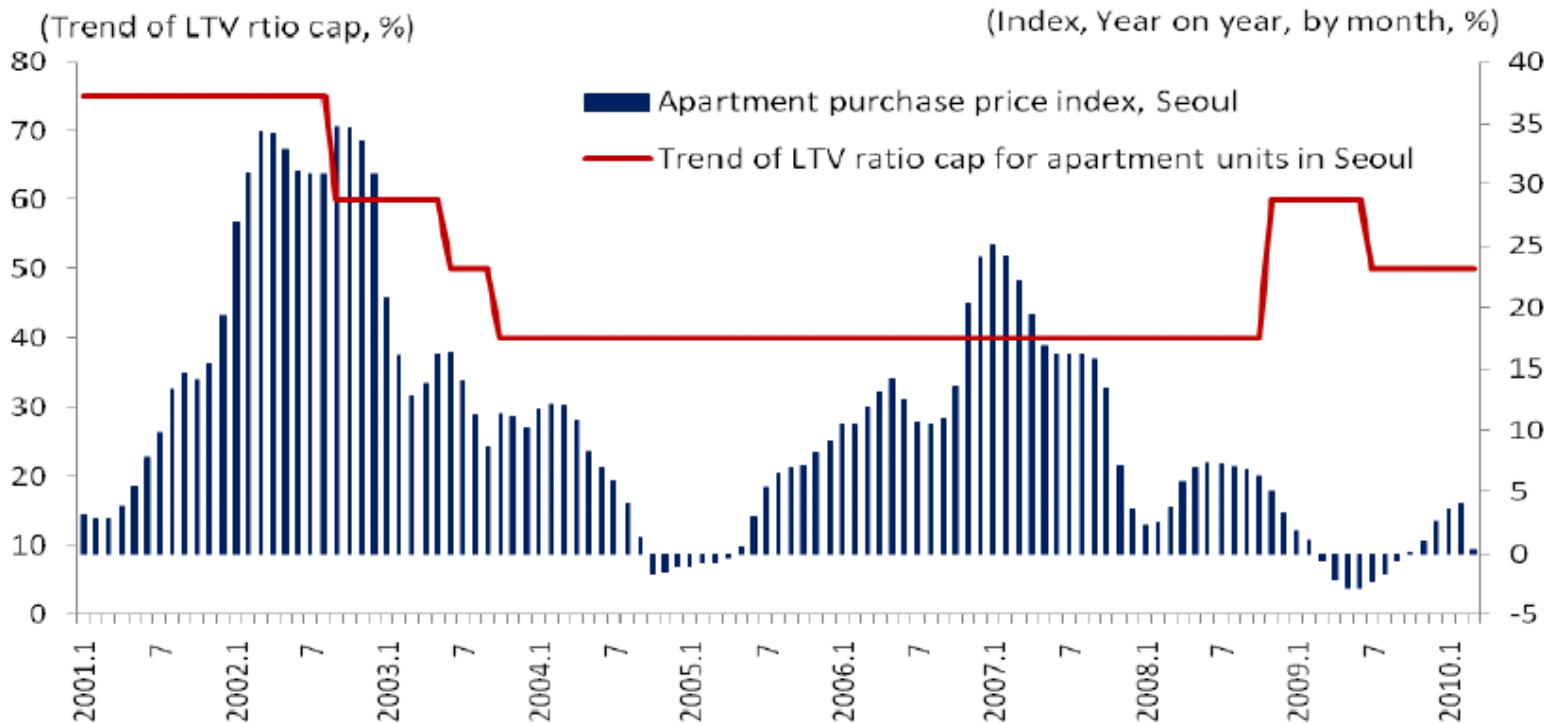
Table 2 Likely instances of conflicts between monetary and macro-prudential policies

	Inflation above target	Inflation close to target	Inflation below target
Financial exuberance (boom)	Complementary	Independent	Conflicting
No imbalance	Independent	Independent	Independent
Financial deflation (bust)	Conflicting	Independent	Complementary

Source: Beau D., Clerk L., Mojon B. (2011). “Macro-prudential policy and the conduct of monetary policy”, *Occasional Paper* no. 8, Bank of France.

# In South Korea macro-prudential policy has been successfully used for macroeconomic stabilization purposes

Figure 9: Trend of LTV Ratio Cap<sup>a</sup> for Apartment Units in Seoul, and Apartment Purchase Price Index of Seoul



Source: „Soon-taek Chang, Mortgage Lending in Korea. An Example of a Countercyclical Macro-prudential Approach”, *Policy Research Working Paper* no. 5505, December 2010, p. 18

- **CRD IV: Maximum harmonization:**
- **Level playing field?**
- **For whom?**

