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## **CEE: Policy lessons learned?**

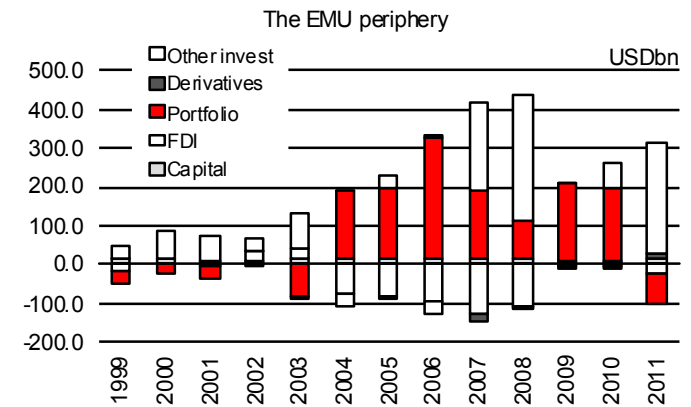
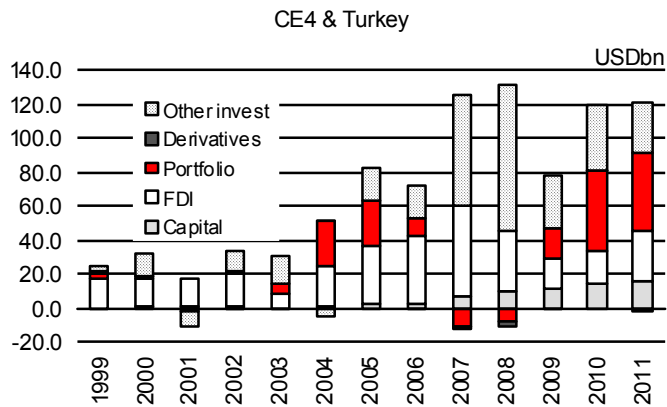
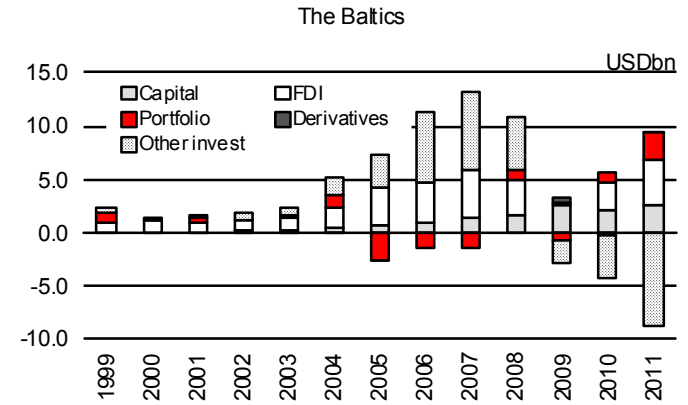
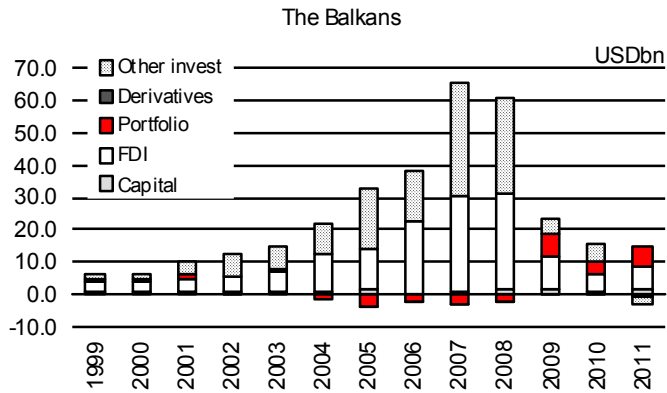
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**Gillian Edgeworth, Chief EEMEA economist**

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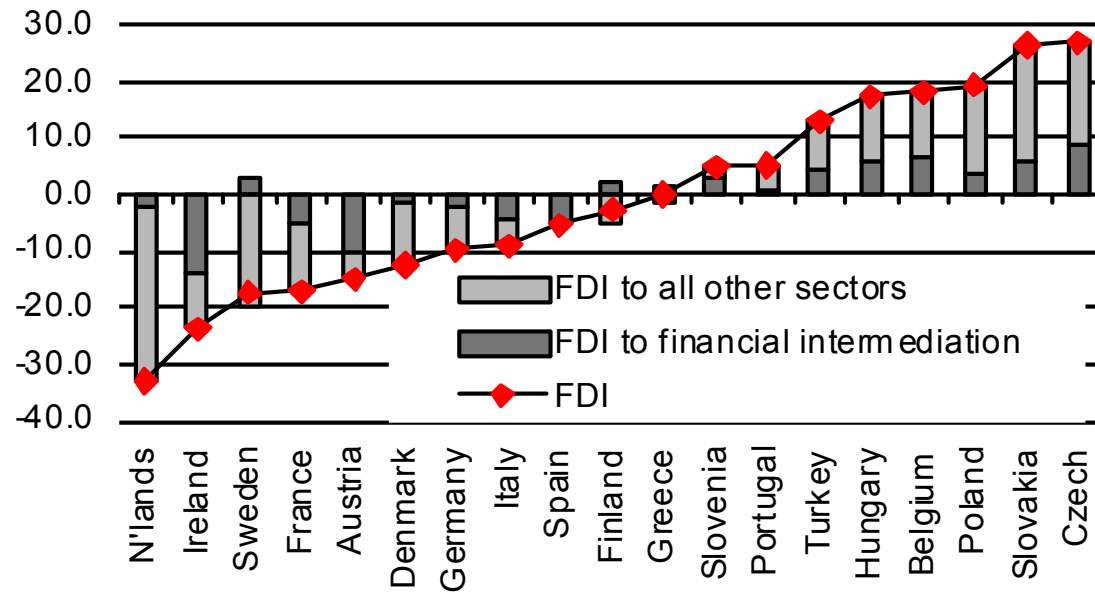
**February 2013**

# CEE took part in the boom in global capital flows (1)



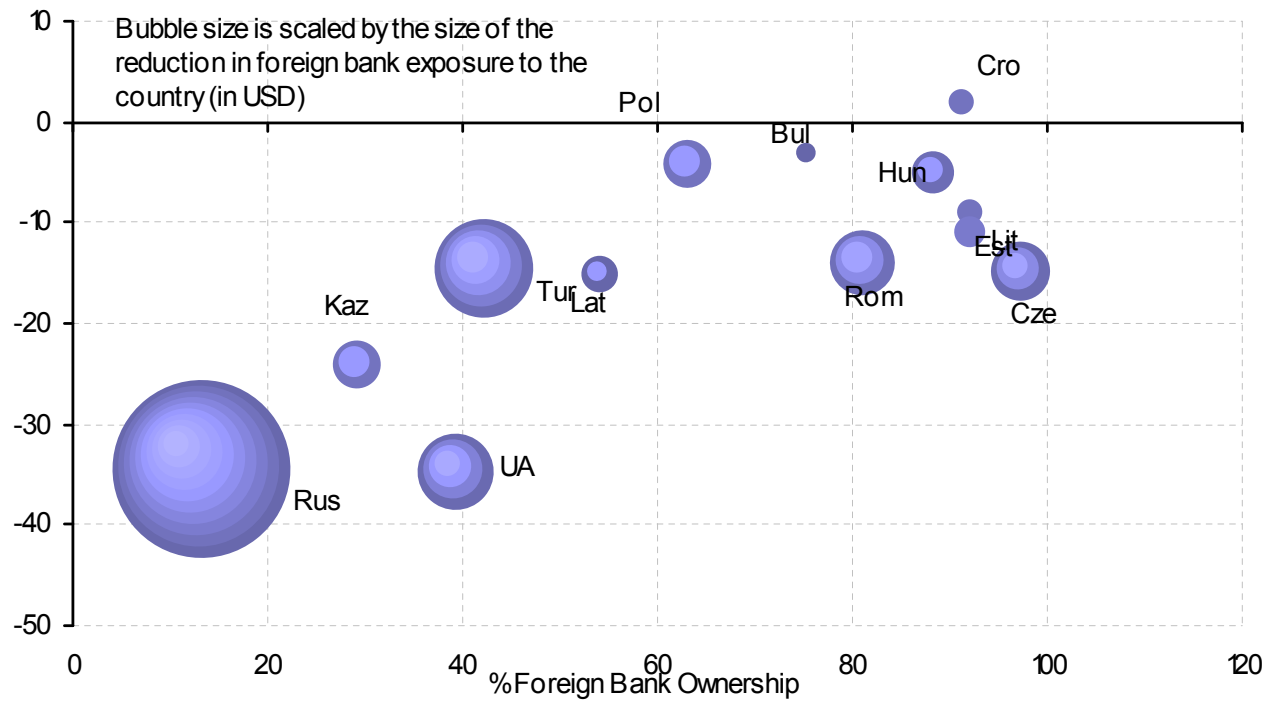
## CEE took part in the boom in global capital flows (2)

Strong net FDI inflows to the newer EU countries, much of which went to tradables (cumulative FDI 2001-11, % of 2011 GDP)

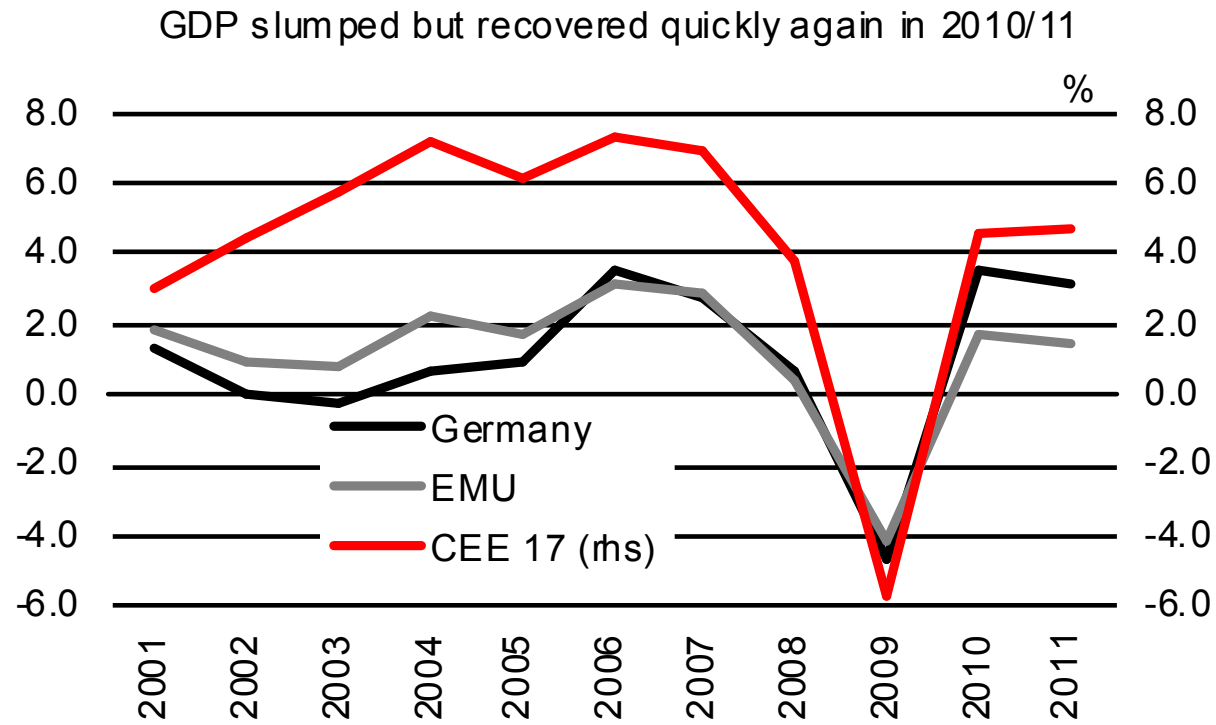


# Unique bank ownership structure helped smooth output

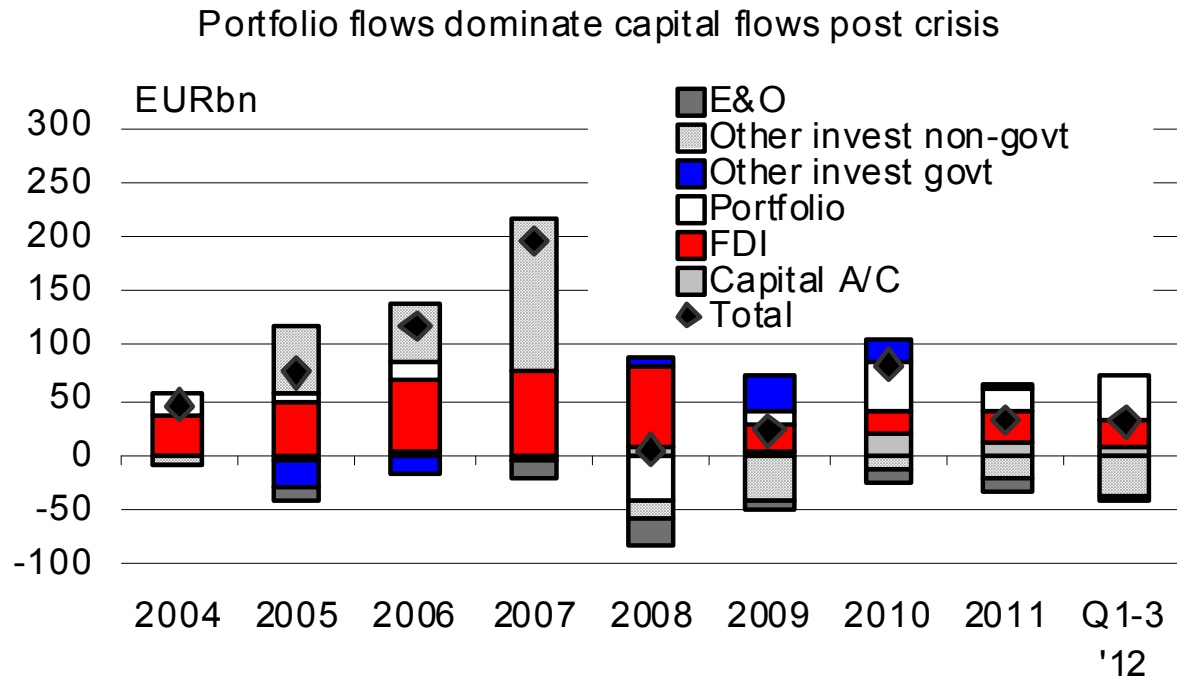
%Exposure reduction foreign banks vs pre-Lehman levels, Q4-08 to Q4-09



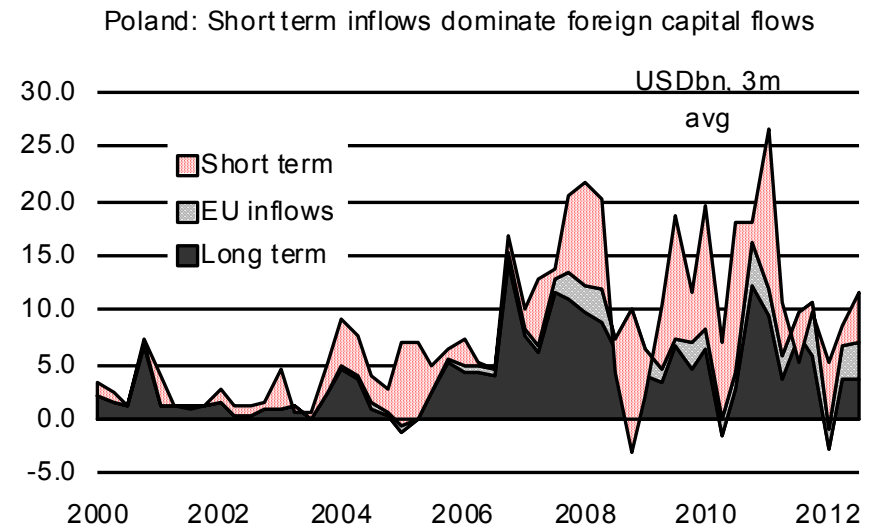
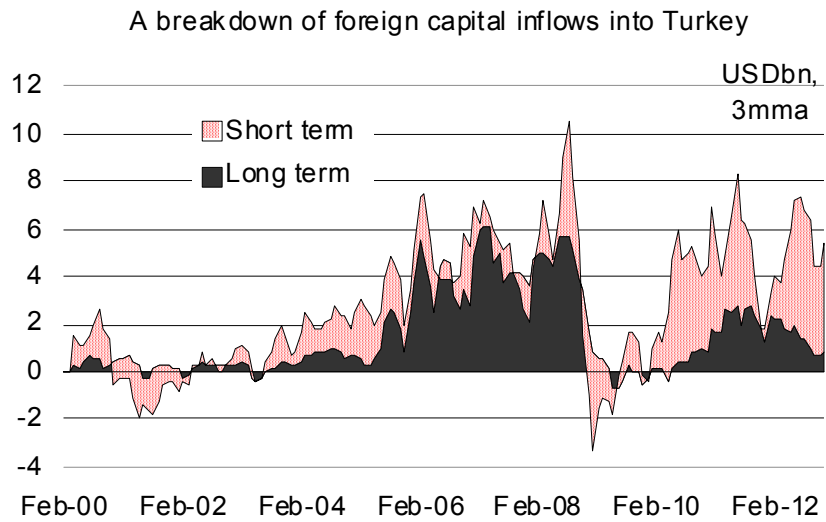
## The 2008/09 crisis was much shorter lived than feared



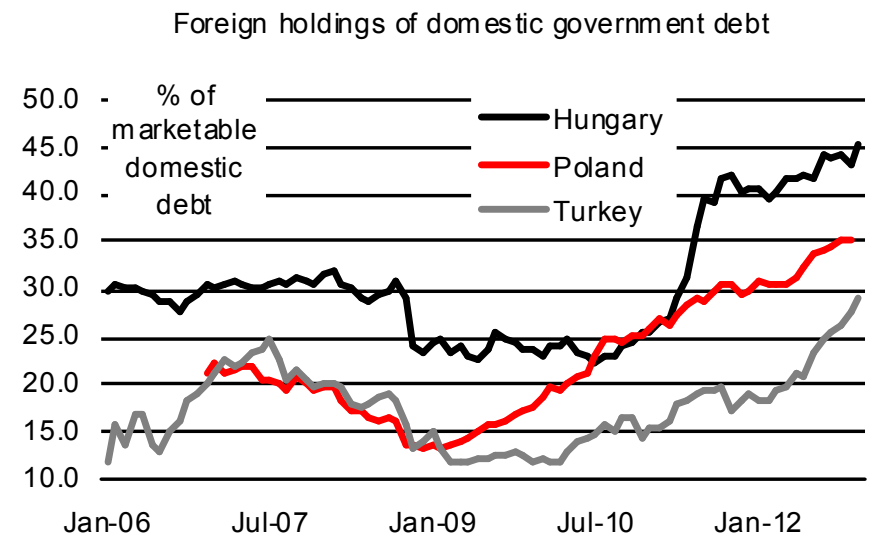
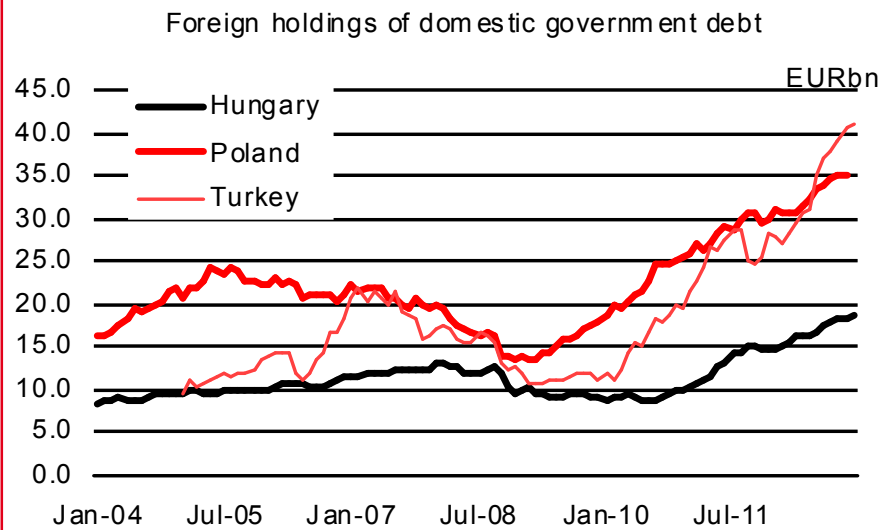
## The composition of capital flows post crisis is a concern (1)



## The composition of capital flows post crisis is a concern (2)



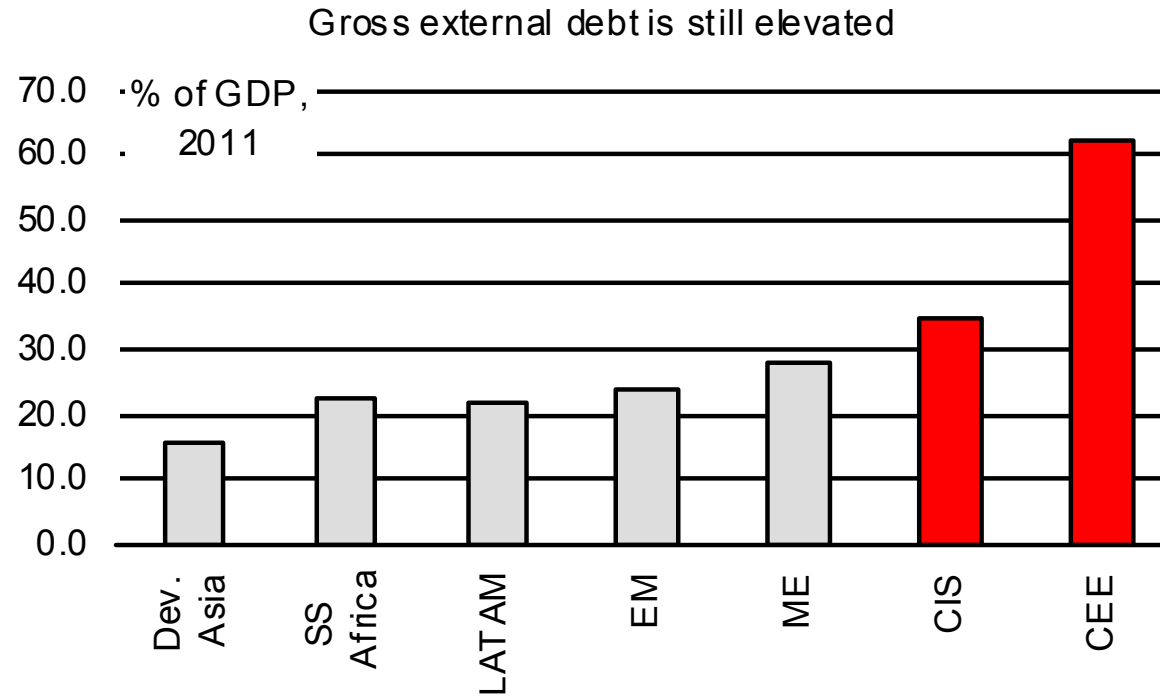
## The composition of capital flows post crisis is a concern (3)



Sources: Ministries of Finance, debt management agencies, UniCredit Research

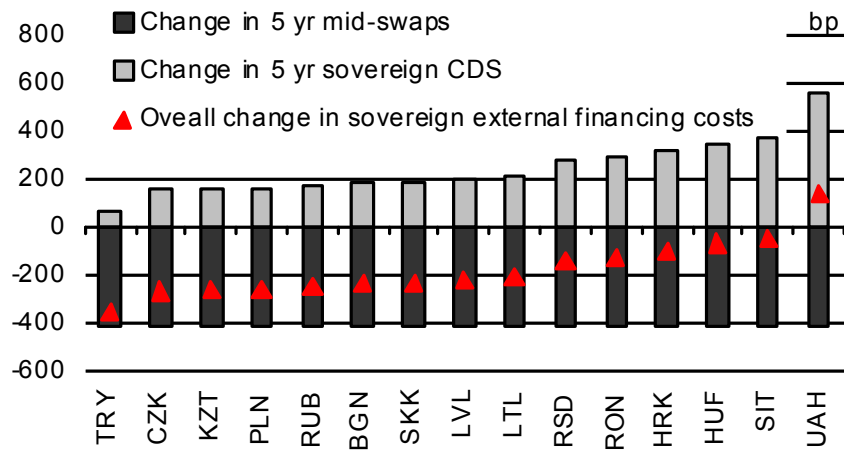


## Are we prepared for another shock? (1)

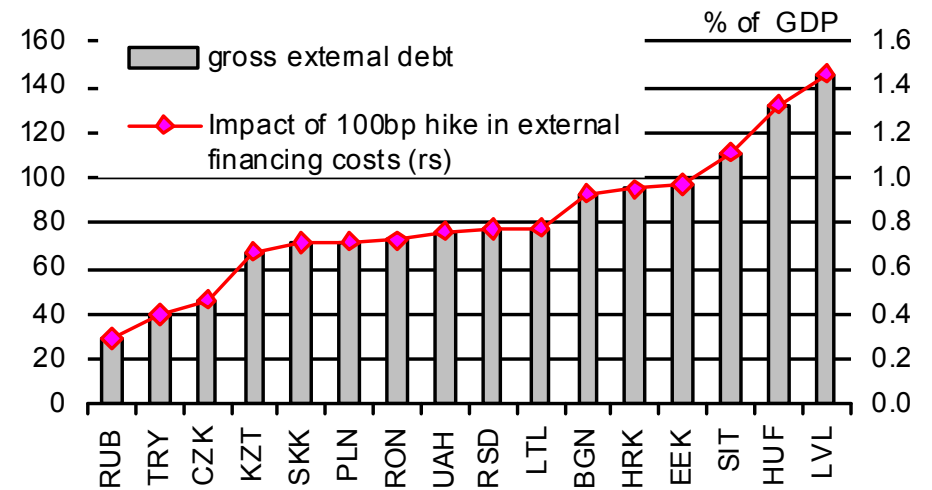


## Are we prepared for another shock? (2)

Change in external financing costs, as proxied by 5 yr sovereign CDS, 2007 compared with Q4-12 average

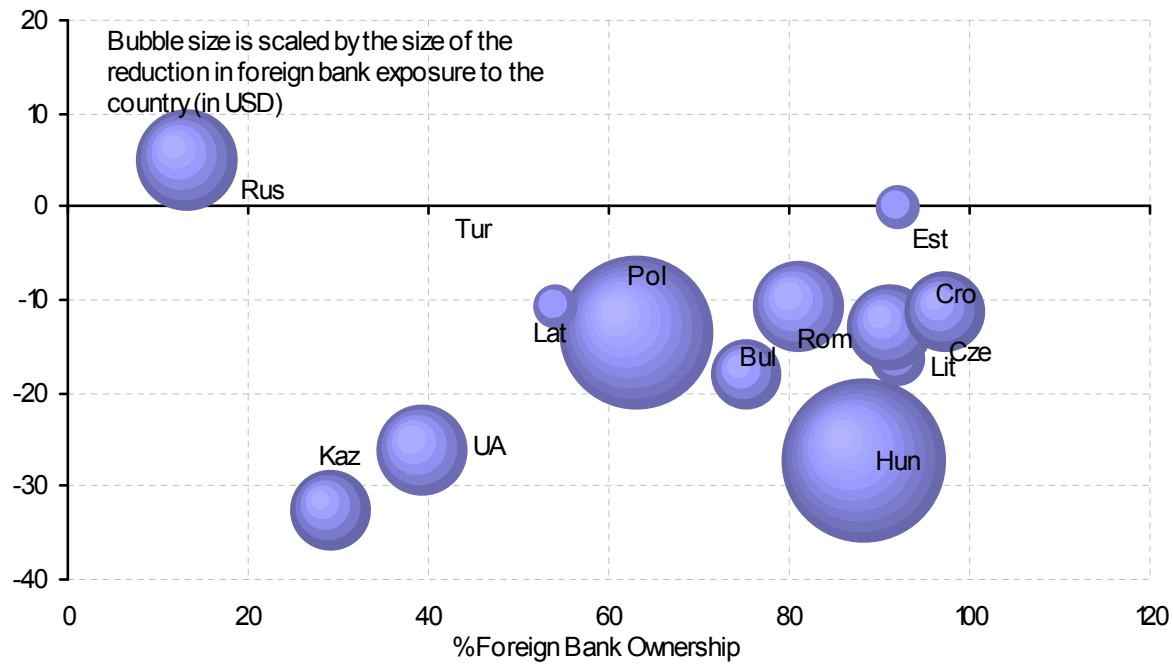


Higher external financing costs will weigh on BoP positions



## Are we prepared for another shock? (3)

%Exposure reduction foreign banks vs pre-EMU crisis, Q3-11to Q3-12



## Is banking union the solution?

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- The newer EU countries lack an anchor for policy. EMU entry has been pushed out considerably while growth can no longer be taken for granted. Fortunately to date authorities in most economies have acted responsibly but there are pockets of concern.
- The region is working through the collateral damage of the EMU crisis but would struggle to cope with yet another shock, were it to materialise, over the next couple of years.
- If faced with a sudden stop in short term capital flows, public and private sector financing across the region would once again become problematic, damaging growth performance. Most central banks do not have sufficient FX reserves to manage a withdrawal of short term capital.
- But this financial stress is not only a risk to the newer EU states. Given the ownership and funding structure of banking systems across the region, any financial stress in CEE carries implications for the EMU banking system.
- A more ambitious approach to the integration of the newer EU states into banking union could represent a turning point to counteract financial fragmentation and provide an anchor for policy.
- A scenario which sees the newer EU states become fully fledged members of banking union, exchanging common capital adequacy ratios, contributions to the ESM and some conditionality for an ECB swap line, needs consideration.