



The World Bank

**EU10**  
**Regular Economic Report**

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**October 30, 2008**

# What Has Happened?

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- The correction of housing prices in the U.S. is at the root of the problem ...
- ... in the context of ongoing globalization and increasingly sophisticated financial innovation, ...
- ... large current account deficits in the U.S., U.K., Spain, Australia, Eastern Europe, and ...
- ... large surpluses in Asia and the middle East.
- Frozen credit and interbank markets, extraordinary volatility, dramatic policy responses.

# International financial crisis has intensified in early October

## Resulting in:

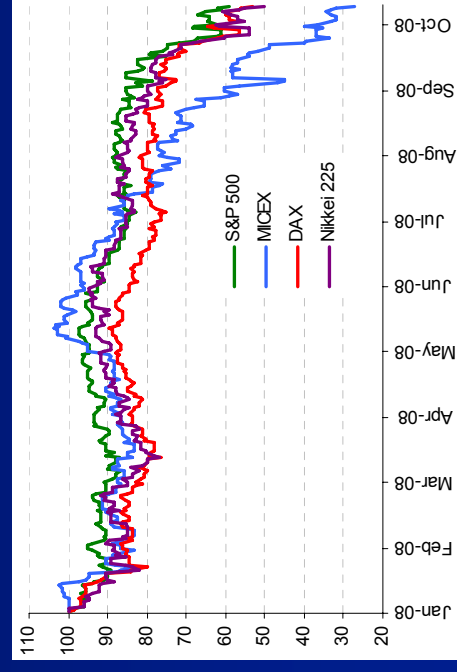
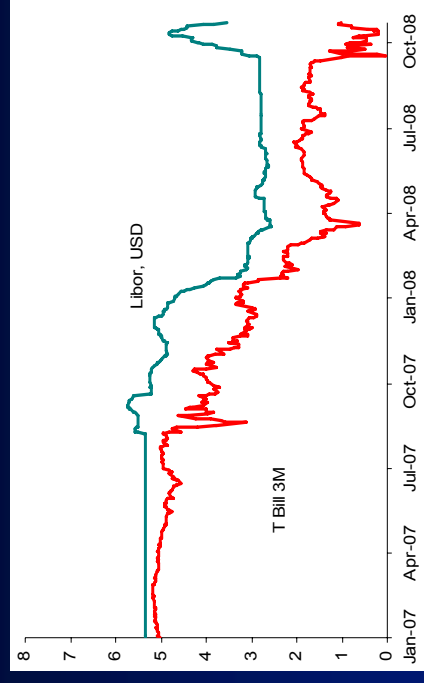
- tightening of interbank markets
- numerous bank failures and takeovers in developed economies
- sharp drop in equity prices in both developed and developing countries
- dramatic increase in volatility for equities, commodities and currencies. ...

## Financial turmoil will hit real economy...

	2007	2008f	2009f	2010f
World	3.7	2.8	1.3	3.2
U.S.	2.0	1.7	0.2	2.1
Eurozone	2.6	1.3	-0.4	1.7
Japan	2.0	1.0	-0.1	1.9
Central and Eastern Europe	6.6	5.7	3.3	4.9

Source: WB Global Economic Prospects 2009 (forthcoming)

Spread 3-month US Treasury Bill and 3-month LIBOR, in %





# Financial turmoil will affect the growth in the region....

- Growth is likely to slow in almost all countries due to weak external demand and tight financial conditions, **with projections subject to substantial uncertainty.**
- Further moderate slowdown appears likely in Bulgaria, Czech Republic, Poland, and Slovenia; Romania and Slovakia are expected to face a more substantial slowdown but from higher growth rates in the past. Estonia, Latvia and Hungary may face more prolonged contraction.

IMF WEO Forecasts, October 2008

GDP growth	2007	2008	2009
Bulgaria	6.2	6.3	4.3
Czech Republic	6.6	4.0	3.4
Estonia	6.3	-1.5	0.5
Hungary	1.3	1.9	2.3
Latvia	10.3	-0.9	-2.2
Lithuania	8.9	3.9	0.7
<u>Poland</u>	<u>6.6</u>	<u>5.2</u>	<u>3.8</u>
Romania	6.0	8.6	4.8
Slovak Republic	10.4	7.4	5.6

*Note: Subject to ongoing revision*

# Policy responses

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- Stabilize financial system
  - ensuring appropriate liquidity conditions for financial institutions
    - (Czech R.: liquidity-supplying repo operations)
    - (Hungary: secured loans to banks and primary dealers, overnight facility for two-way foreign exchange swap tenders, supported by a €5 billion repo line with the ECB.
    - (Poland: “trust package”)
  - providing financial institutions with additional capital resources (Hungary, Croatia)
  - enhancing cooperation procedures among European countries (Bulgaria, Poland)
- Restore/maintain macro stability
  - begin reversing the pro-cyclical tendencies in fiscal policies, but be careful not to widen fiscal deficits by more than investors will be ready to finance and deem sustainable at a time of more negative investor sentiment
  - there may be some scope for monetary easing in some countries when market conditions stabilize
- Accelerate reforms (by continuing public finance reforms; increasing labor force participation rates, improving productivity by modernizing education; reducing red tape and improving governance and investment climate)

# Poland is not immune but well positioned against the crisis: **Overview**

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- Sound macroeconomic fundamentals and policies; strong financial system
- Roadmap to **EUR 2012** is ready
- Government starting ambitious reform program
- Poland has to follow-through on plans; no scope for complacency

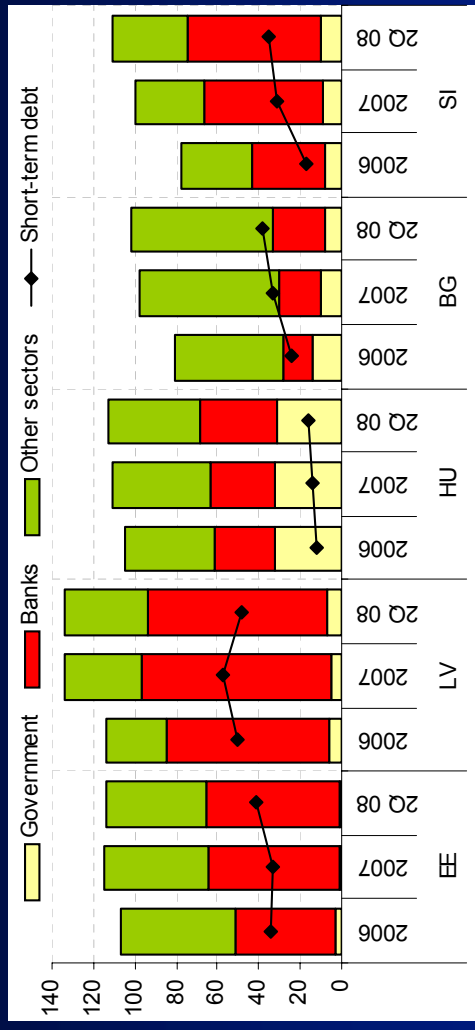
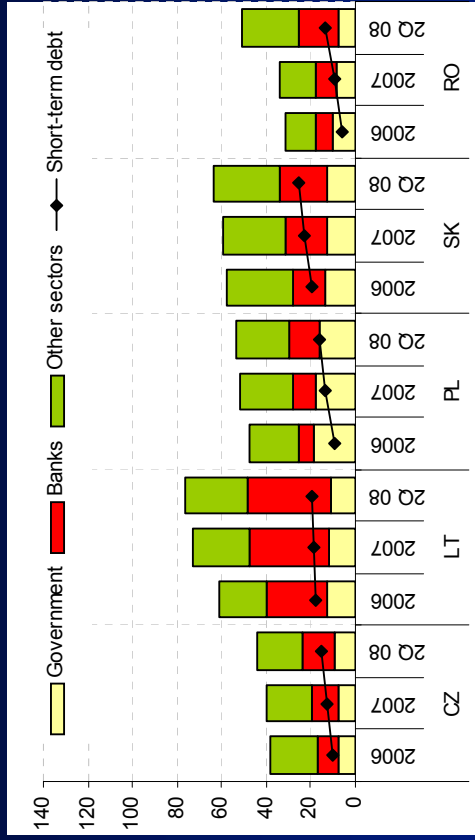
## Poland is not immune but well positioned against the crisis: **1) Fundamentals are sound**

	2007	2008	2009
Real GDP (% change)			
Government September 2008	6.6	5.5	4.8
IMF WEO October 2008	6.6	5.2	3.8
World Bank October 2008	6.7	5.4	4.0
Consumer prices (% change)			
Government September 2008	2.5	4.4	2.9
IMF WEO October 2008	2.5	4.0	3.3
World Bank October 2008	2.5	4.2	3.4
Current Account Deficit (% of GDP)			
Government September 2008	-3.8	-5.2	-5.8
IMF WEO October 2008	-3.8	-4.7	-5.7
World Bank October 2008	-4.7	-4.7	-5.4
Fiscal balance (% of GDP)			
Government September 2008	-2.0	-2.5	-2.0
General government debt (% of GDP)			
Government September 2008	45.2	44.3	43.9

- At present forecasting is more an art than a science. The baseline growth scenario is subject to downside risks
- Downside risks for growth forecast, depending on the scale of the slowdown in Western Europe and credit slowdown
- Flexible exchange rate regime is credible and operates well as self-regulatory mechanism in the economy

# Poland is not immune but well positioned against the crisis: 2) Banks are sound

Foreign debt by sector, as percent of GDP

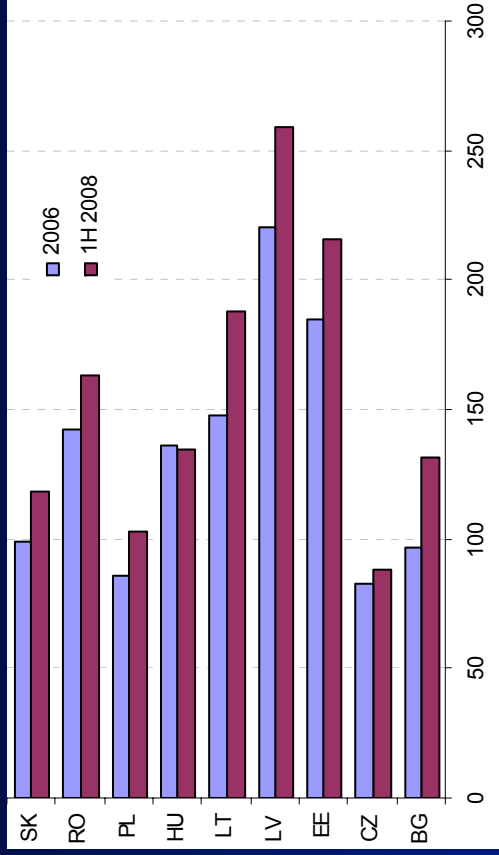


Source: Central Banks, staff calculations.

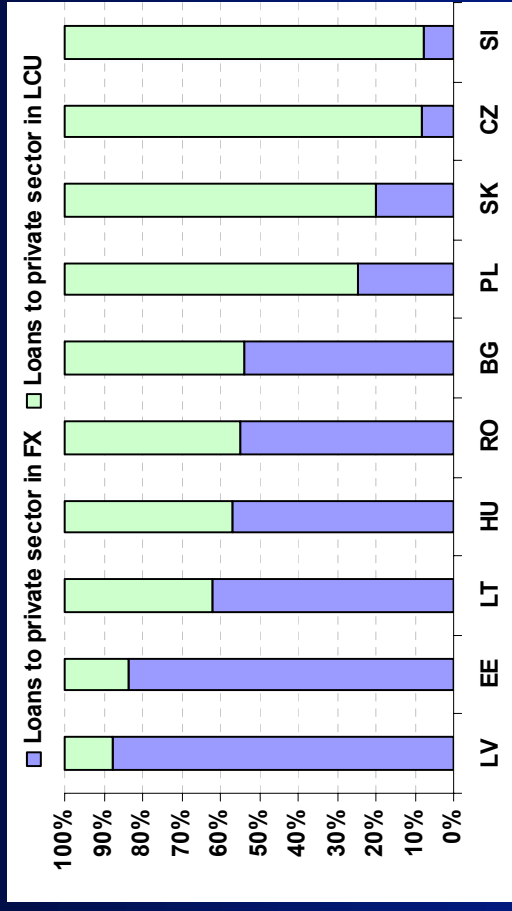
- High profitability of banks [data until 1H 2008] related to good macro performance and booming markets
- Banks' foreign debt increased over last years but the level is relatively low. Banks in Poland are not as much dependent on foreign financing as in other countries in the region

# Poland is not immune but well positioned against the crisis: 3) Banks' FX risk is moderate

Loan-to-deposit ratio



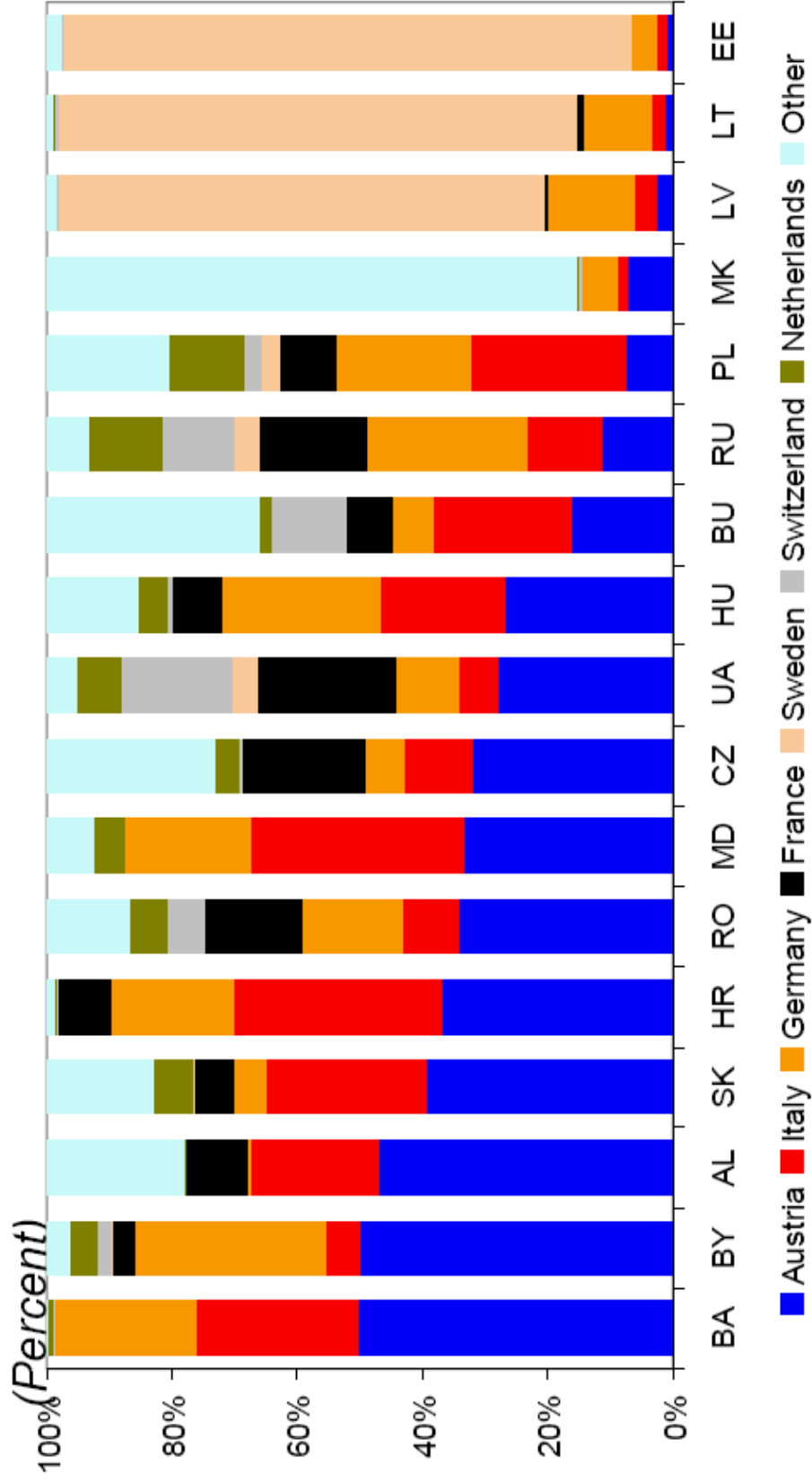
Currency structure of bank loans to the private sector in the EU10 in 2Q 2008



- Loan to deposit ratio is around 100%, much lower than in most other countries in the region; credit expansion is mainly financed from domestic deposits.
- FX loans constitute around 1/4 of total loans to the private sector which can be regarded as low as measured by regional standards [Moreover, last Friday, CHF was only 3% stronger against the Zloty than the 2002-24Oct2008 average]

# Poland is not immune but well positioned against the crisis: 4) Bank ownership is well diversified

Concentration of Emerging Europe Exposure to Western Europe, 2007



Source: Bank for International Settlements, Quarterly Review, June 2008.

## World Bank in NMS – supporting reforms in Poland

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- Reforming labor markets, pensions and delivery of social services
- Strengthening the business environment
- Infrastructure development
- Regional development
- Public finance and administrative reform
- Climate change agenda

# World Bank in NMS – supporting long-term structural issues

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## Regional themes for structural support

- **Regional and global public goods**
  - Climate change (strategic planning, investments in energy, low-carbon transport options and industrial adaptation, structuring of carbon finance projects, development of green investment schemes)
  - Financial market stability (financing where the client cannot borrow on reasonable terms in the market to support development goals)
- **Growth and competitiveness**
  - Education, skills and labor markets (tertiary education and skills, challenges of life-long learning and second chance education)
  - Business environment, entrepreneurship and infrastructure (training in the design, structuring, legislative and regulatory environment required for successful Public Private Partnership; 'Doing business' environment; second-generation financial sector reforms and the assessment of countries' corporate governance, accounting and auditing standards under the international Report on Standards and Codes (ROSC) program)
- **Spatial and social inclusion**
  - Social inclusion (Roma Inclusion initiative; pension reform and managing requirements for long-term care in the context of population aging)
  - Spatial inclusion (intellectual framework in WDR 2009; support better planning and infrastructure investment at the municipal level)
- **Public sector**
  - Established products (regional fiscal studies and country-specific diagnostics, such as Public Expenditure and Institutional Review, Regional Economic Report)
  - New products (efficiency and effectiveness reforms, such as the integration of revenue systems or development of e-governance systems; assistance for countries preparing for Euro adoption with planning measures and evaluations of other countries' experiences; support in shaping new development assistance budgets).

# World Bank in NMS – Examples

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- **Lending**
  - Bulgaria (Development Policy Loan)
  - Poland (Odra river basin flood protection, road maintenance and rehabilitation, Post Accession Rural Support, Programmatic Policy loan under discussion: employment, entrepreneurship, and social service delivery)
  - Hungary: exceptional!
- **Analytical and Advisory Activities**
  - EU8+2 Regular Economic Report
  - Cross-country fiscal studies: Vocational Education, Administrative Capacity, Public-Private Partnerships, Social Assistance, Health Care Spending, Higher Education Financing, Intergovernmental Fiscal Relations, Public Transport Investment Management
  - Doing Business Report (global dimension)
- **Fee-for-Service technical assistance**
  - Latvia (Green Investment Scheme - establishing regulatory and institutional framework for participation in international emissions trading)
  - Czech Republic (integrated revenue administration)
  - Poland (cooperation with Mazowieckie voivodship)



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Thank you for your  
attention