EU Membership:
A Post-Accession Boom, but New Policy Challenges

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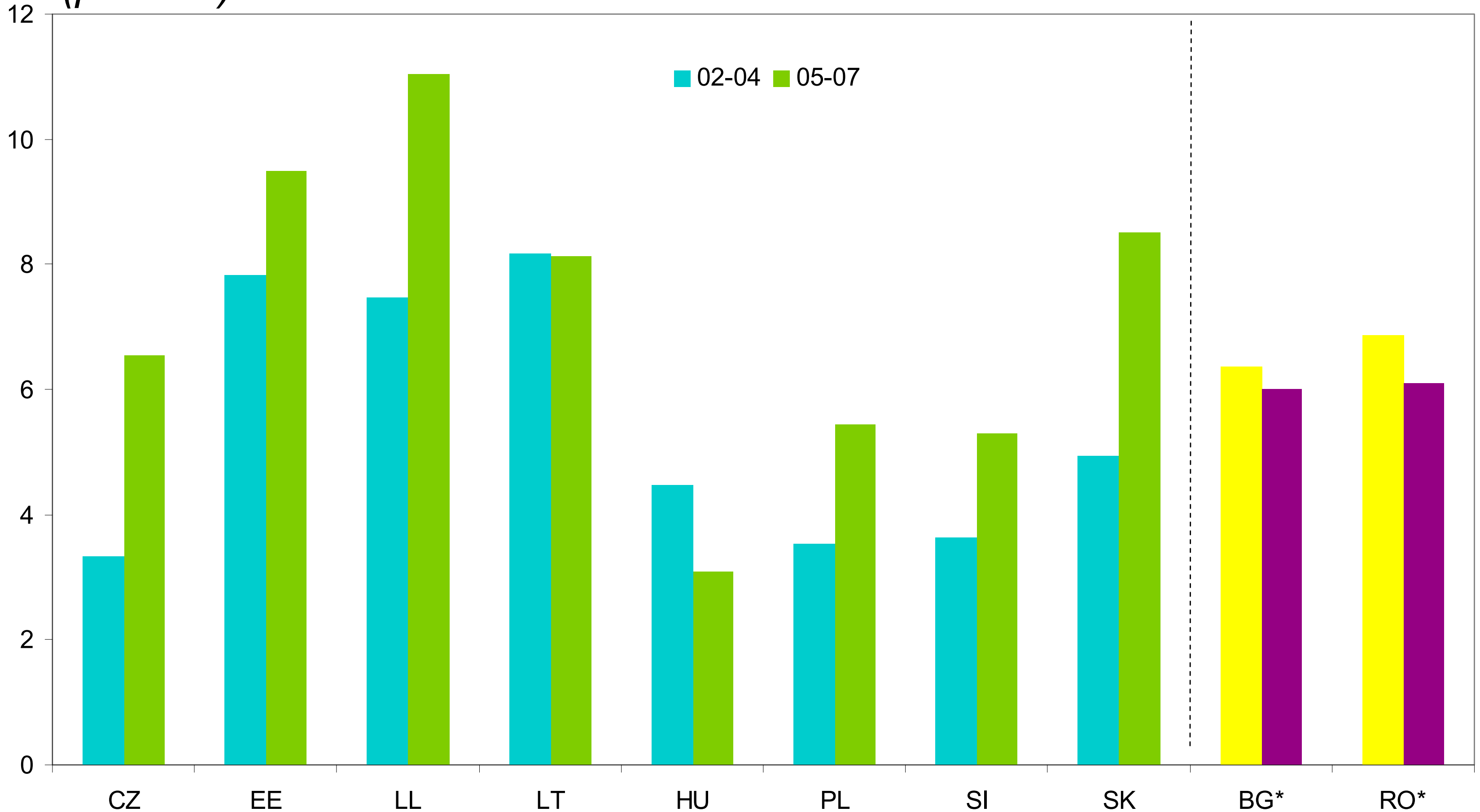
Most new member states have experienced an acceleration of growth after joining the EU

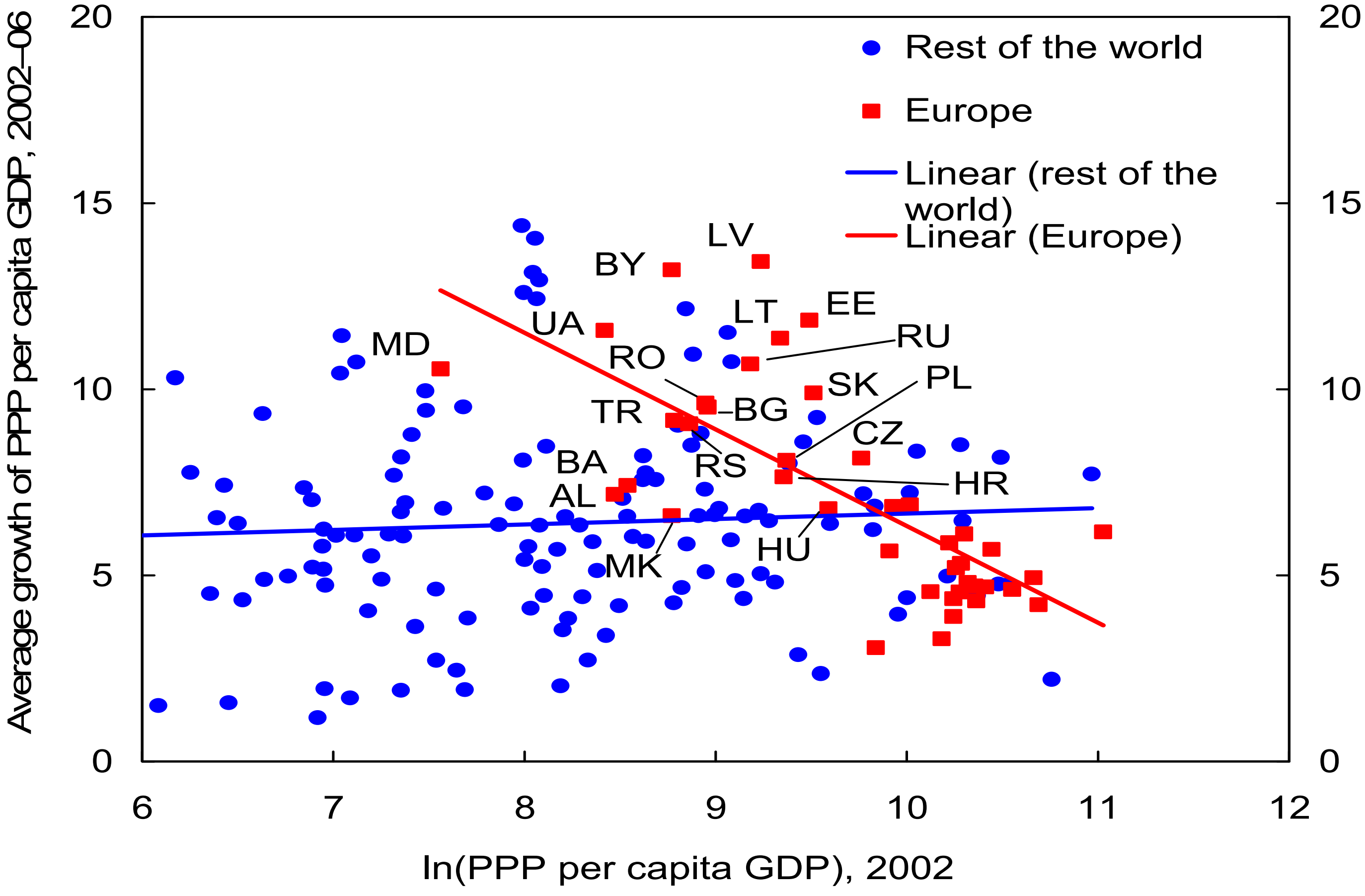
Average GDP growth
(percent)



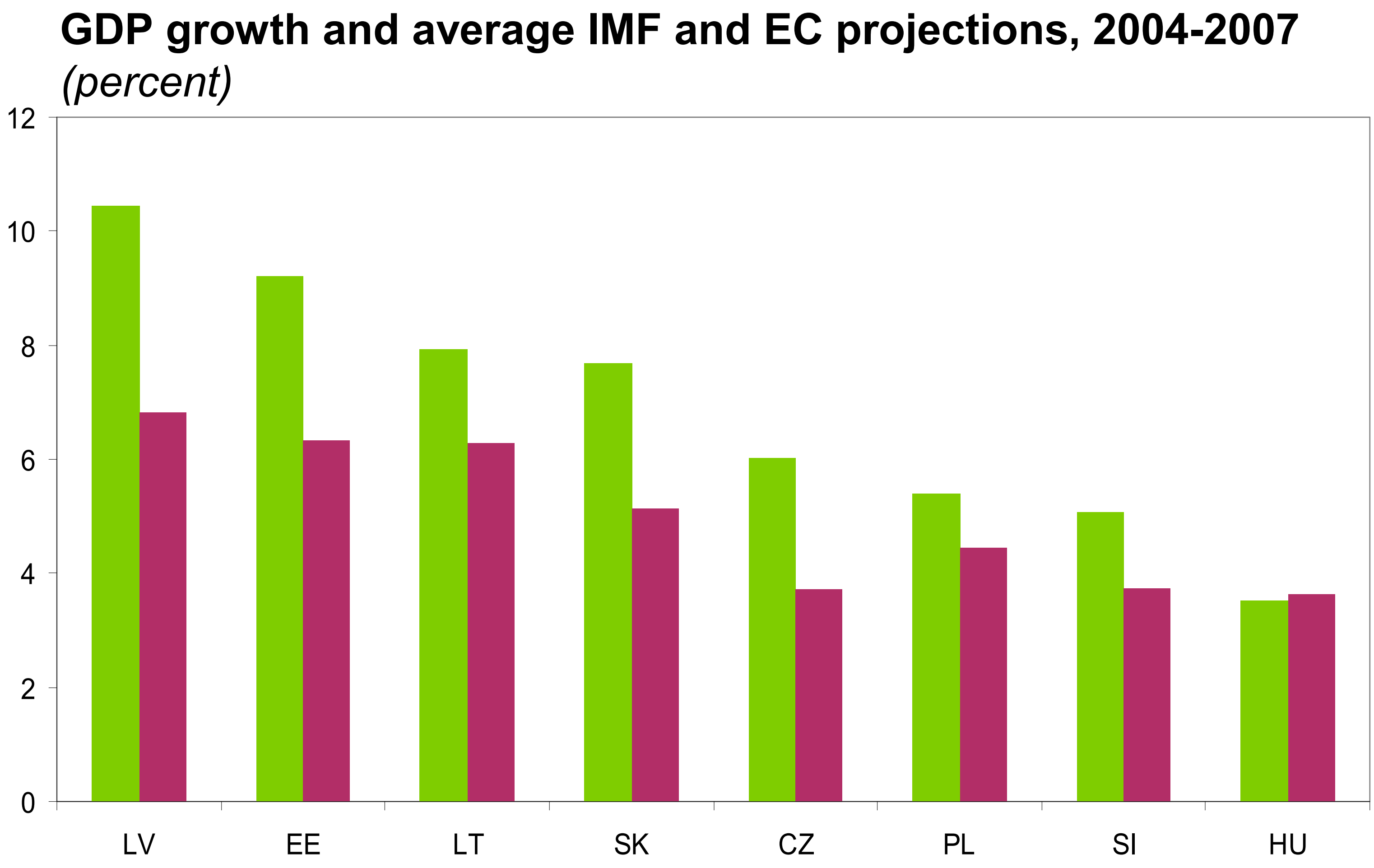
Source: Eurostat.
* 04-06 & 07-08 respectively

As a result the region has been converging very fast

Convergence in Emerging Europe and in the Rest of the World, 2002–06



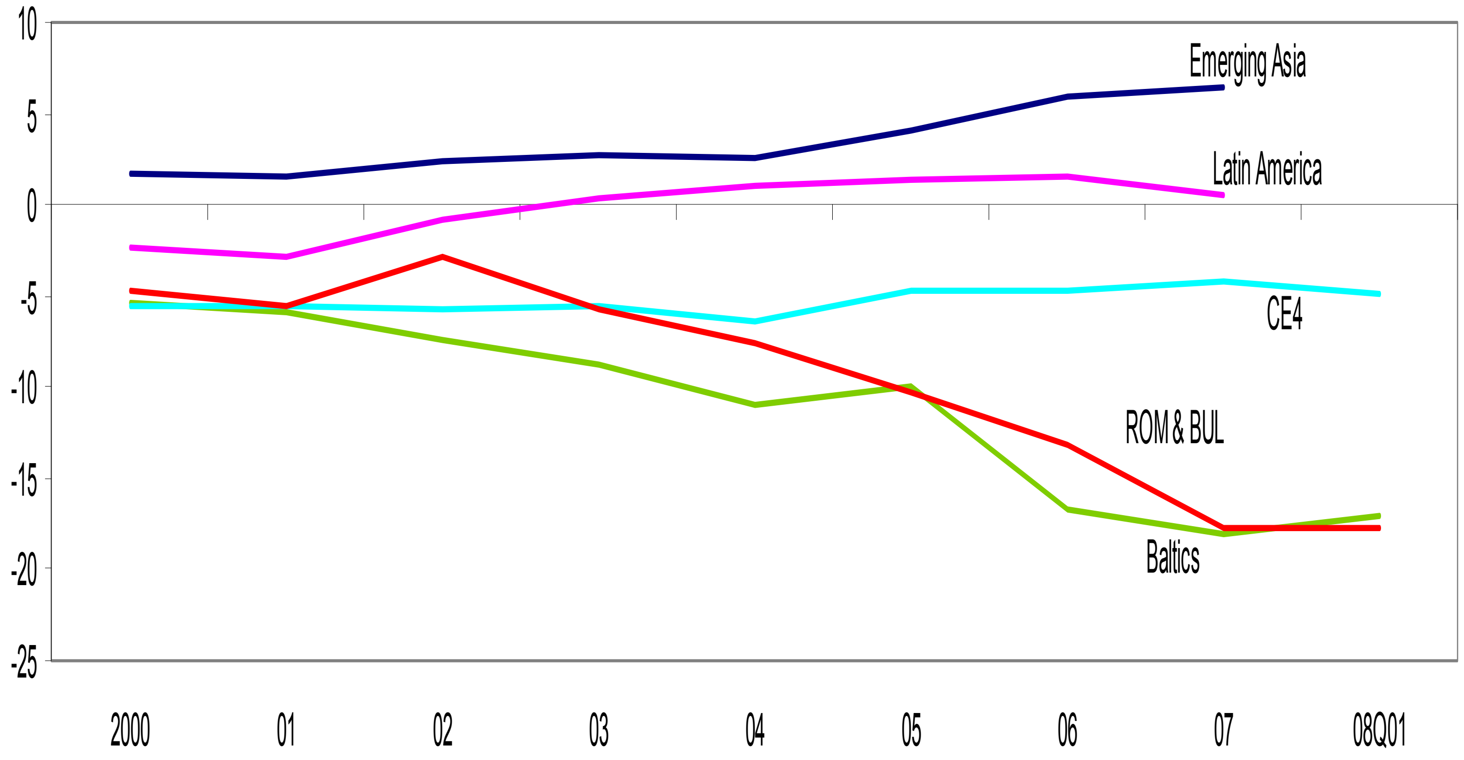
This exceeded expectations of most observers



Source: Eurostat, IMF, European Commission.

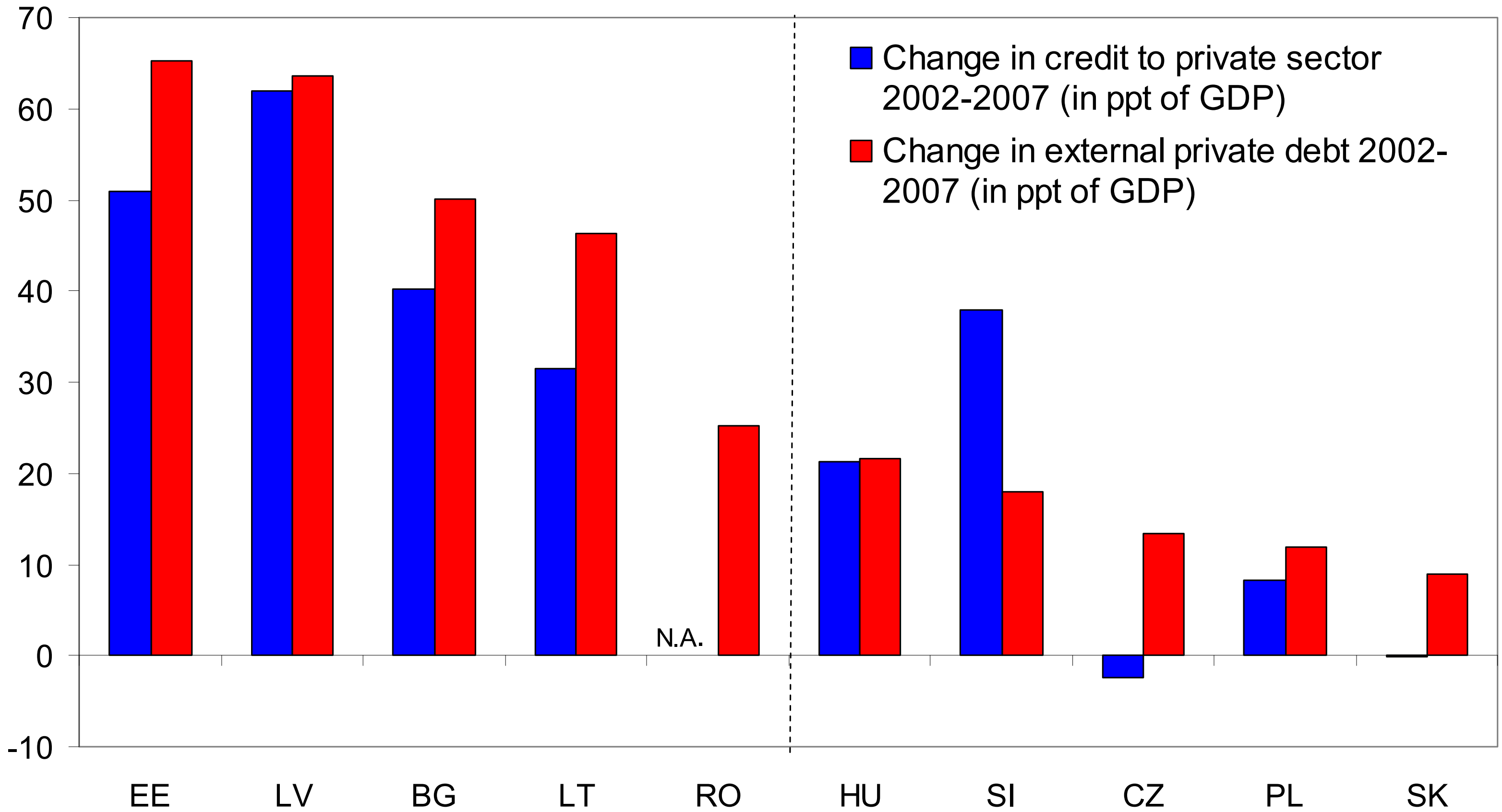
Increased access to foreign capital is believed to be a major contributor to the post-accession boom

Current account deficit
in percent of GDP



Source: National authorities.

And it is related to financial deepening



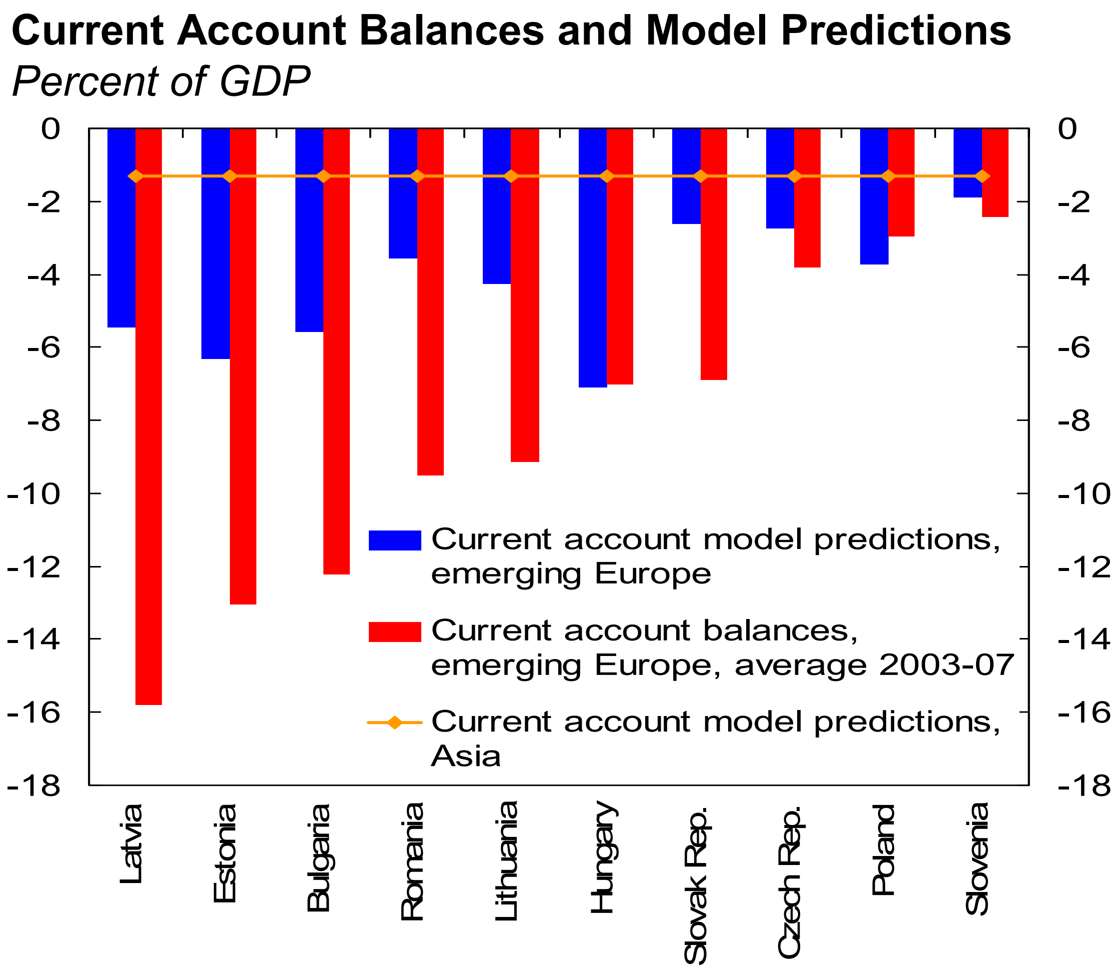
Sources: National authorities; and IMF staff calculations.

The credit-driven post-accession boom has created new vulnerabilities and policy challenges

Examples related to financial stability:

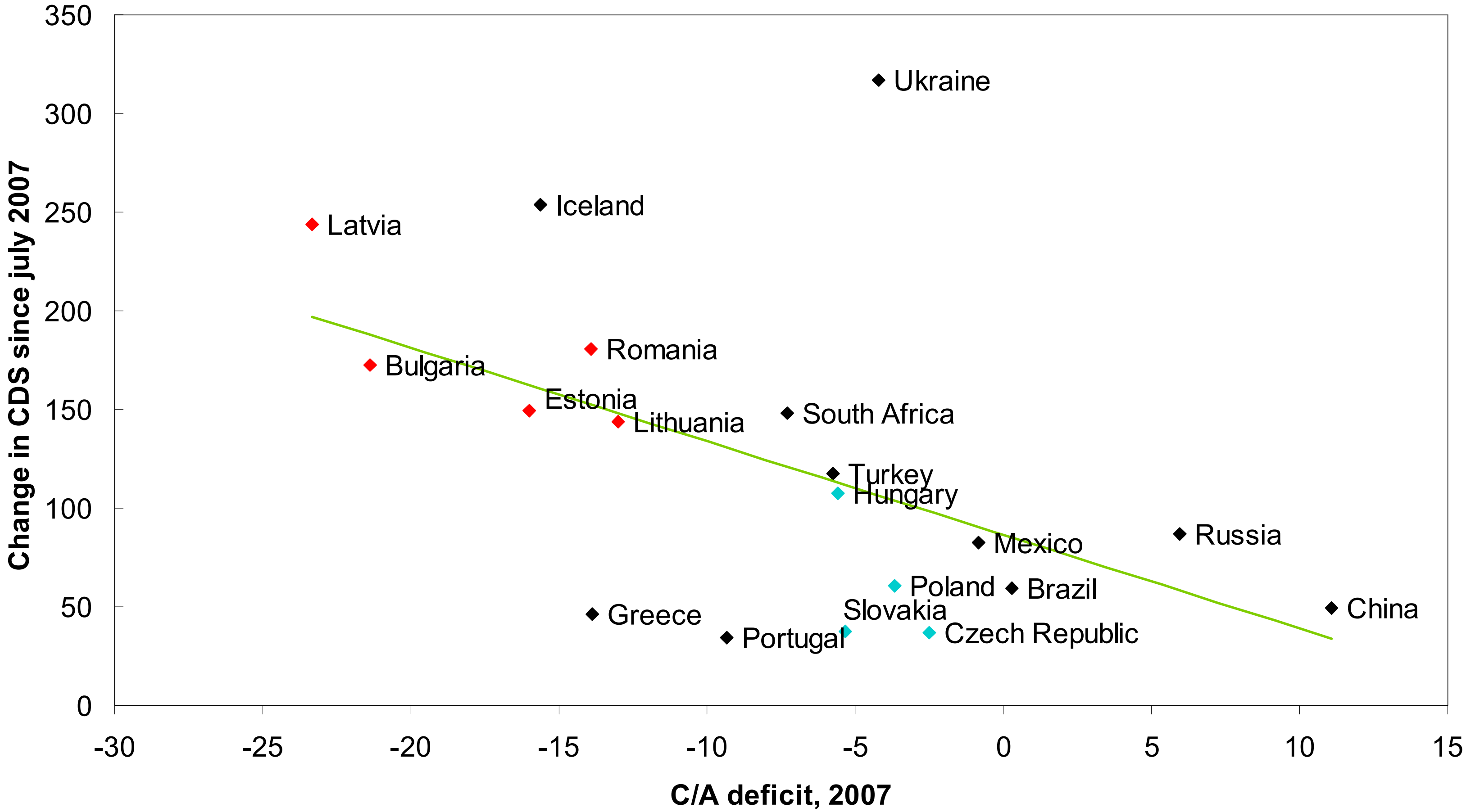
- Large current account deficits related to overheating
- Cross-border contagion risks
- Currency mismatches

C/A deficits in some countries exceed what would be consistent with macro fundamentals (Rahman, IMF WP 08/92)



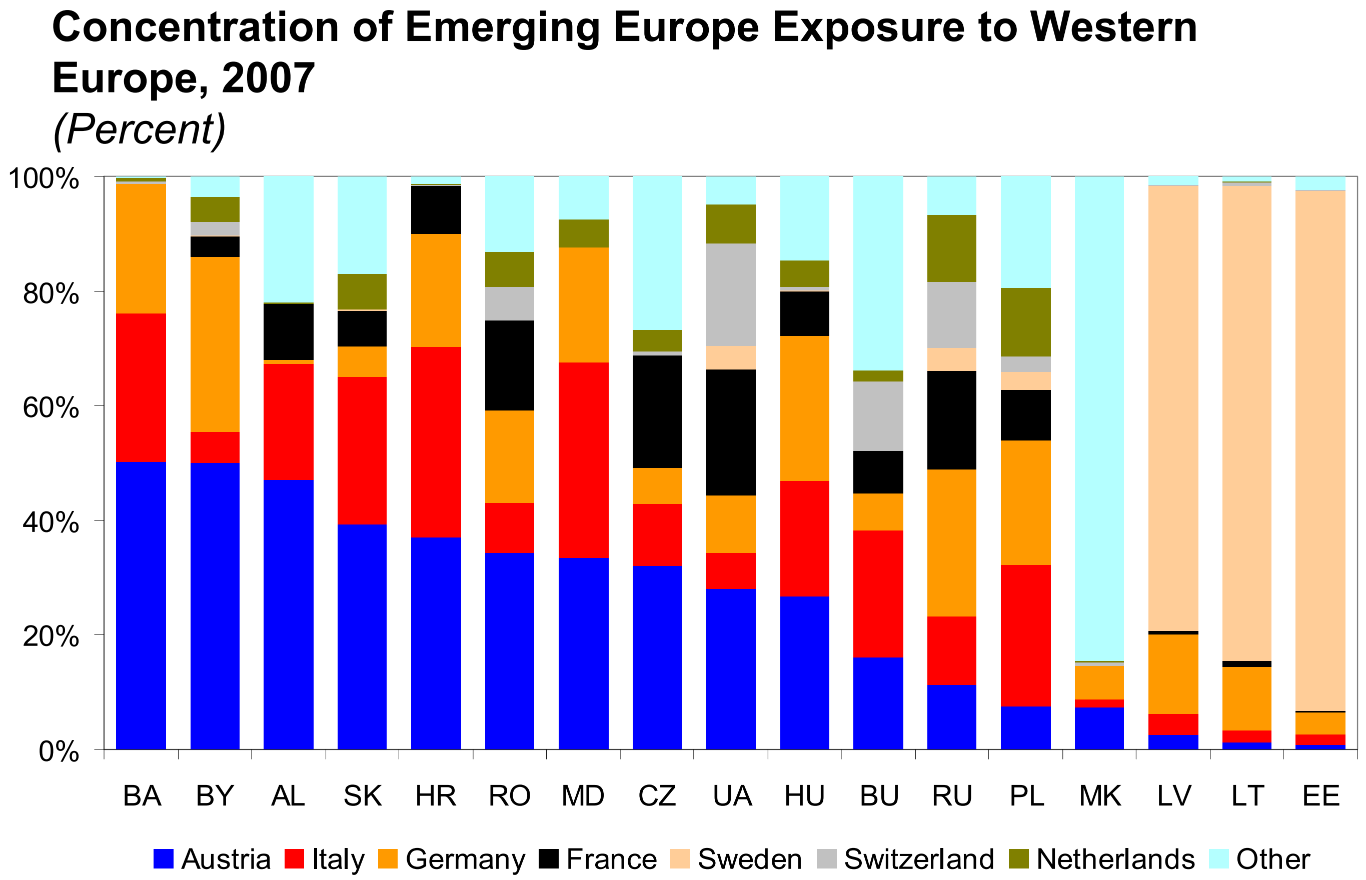
Source: Rahman 2008.

Since the onset of the 2007 financial crisis, these countries face higher financing cost



Source: Bloomberg, IMF.

Cross-border exposures by international banks (especially from Austria, Italy, Sweden, Germany) create new channels of contagion



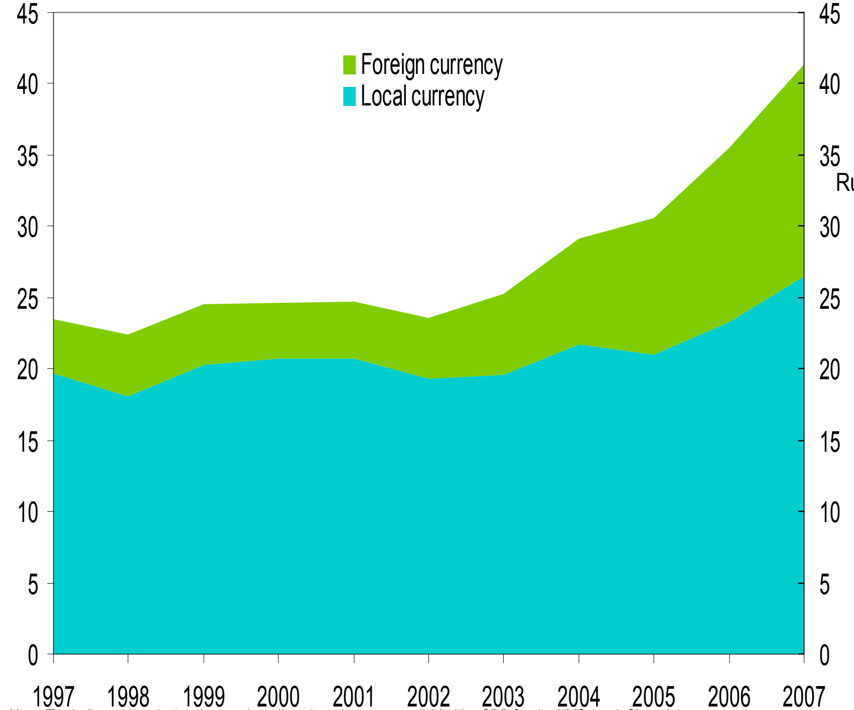
Source: Bank for International Settlements, Quarterly Review, June 2008.

Note: Country names are abbreviated according to the ISO standard codes.

1/ Emerging Europe exposure to western European banks is defined as the share of the reporting banks in each western European country in the total outstanding claims on a given emerging European country (both bank and nonbank sectors). For example, about 42 percent of Croatia's exposures to Western European reporting banks is owed to Austrian banks, 38 percent to Italian banks, 13 percent to French banks, etc. For the Baltic countries, 85 percent or more of exposures to the reporting banks is owed to Swedish banks.

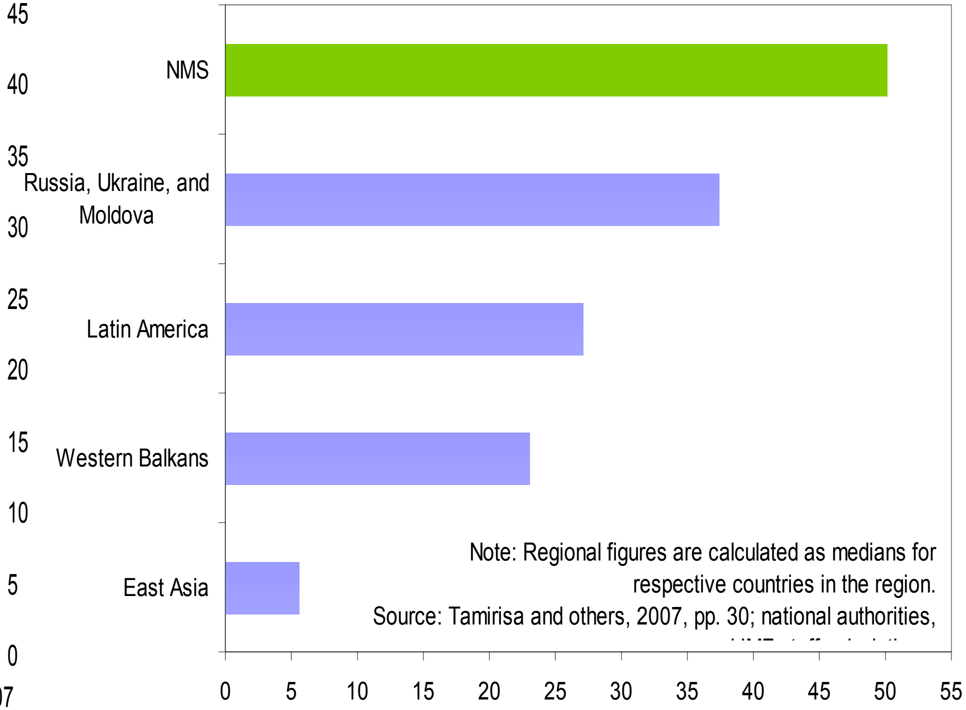
Rapid credit growth has been accompanied by a growing share loans denominated in foreign currencies (EUR and CHF)

NMS: Credit to the private sector
percent of GDP



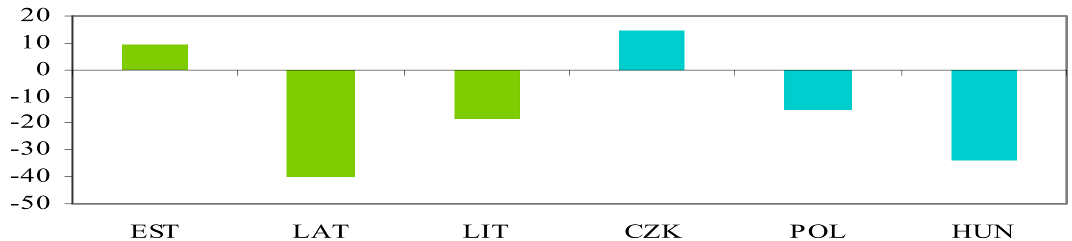
Note: The indicator is calculated as total credit to the private sector divided by GDP for the NMS (excl. Slovenia).
All figures were previously transformed to euros.
Source: national authorities, Eurostat, IMF staf calculations.

Emerging Markets: Foreign exchange borrowing
2005, as % of total loans to the private sector

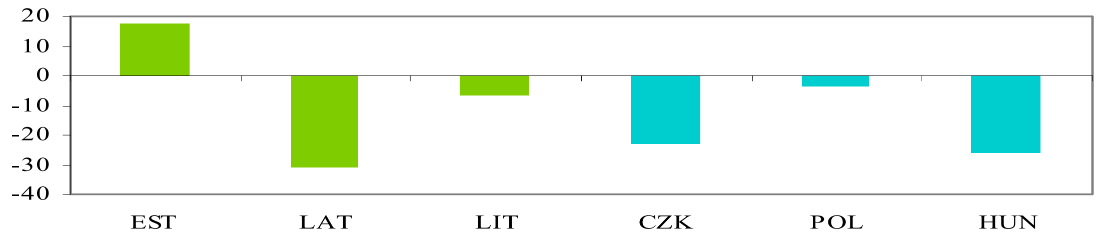


This has led to large currency mismatches in the non-financial private sector

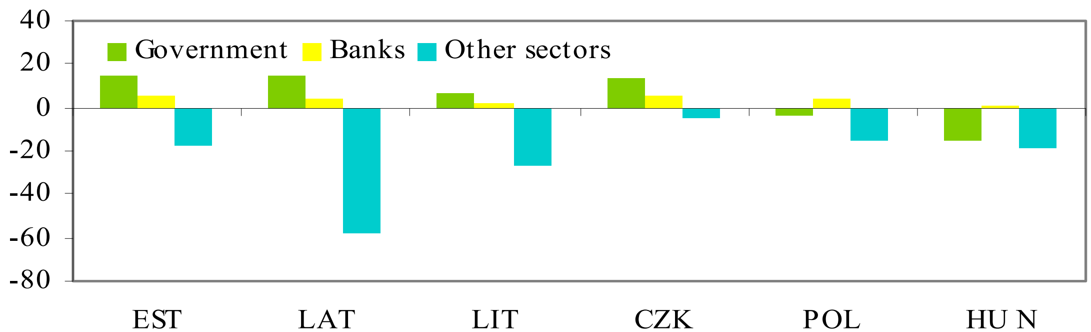
Net FX position, 2007 *percent of GDP*



Change in net FX position, 2002-2007, *percent of GDP*



Sectoral net FX position, 2007, *percent of GDP*



Source: National authorities, IMF staff calculations.

Empirical results
(Rosenberg and Tirpak, 2008):

- *Euroization* is a byproduct of convergence.

- EU membership boosts foreign exchange borrowing through multiple channels:
  - it offers better access to foreign funds in a fully liberalized environment of capital flows,
  - it provides natural hedging opportunities, through increasing trade openness,
  - it may boost private sector's confidence in exchange rate stability and imminent euro adoption.

- Regulatory measures have limited effectiveness due to opportunities to borrow directly from abroad (i.e., for corporations).

Conclusions

EU membership fundamentally changes the policy-making landscape, requiring more international cooperation

Examples in the area of financial stability:

- Emergency lines of credit for countries that are vulnerable to capital outflows (Iceland)
- Close cooperation of financial supervisors in home and host countries
- Euro adoption

Thank you!

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