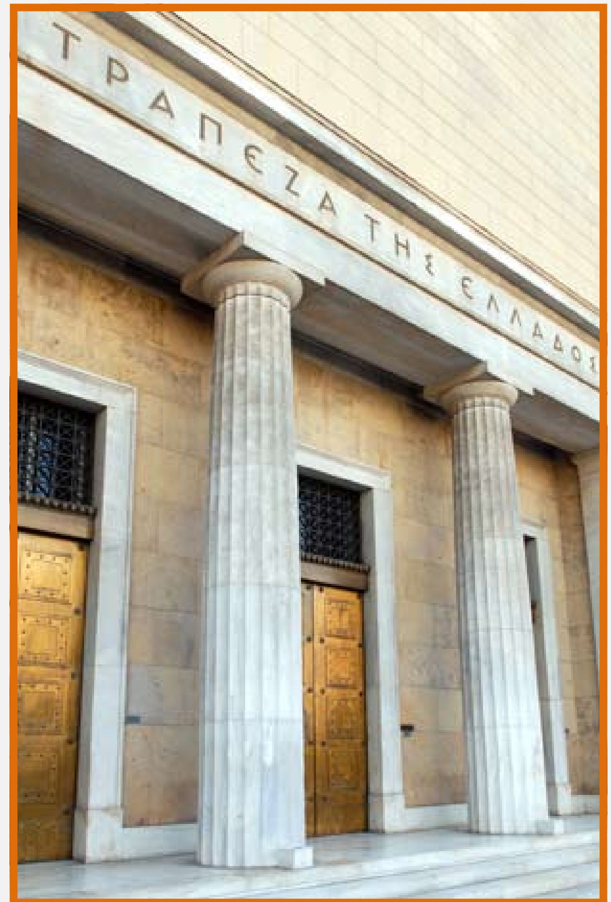
CHALLENGES AND PROSPECTS OF SOUTH EAST EUROPEAN ECONOMIES IN THE WAKE OF THE FINANCIAL CRISIS



Conference jointly organised by the Bank of Greece and the University of Oxford (SEESOX)

ATHENS
16 OCTOBER 2009

BANK OF GREECE
EUROSYSTEM

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Programme of the conference on "Challenges and prospects of South East European economies in the wake of the financial crisis"*

Welcome address by **George A. Provopoulos**, Governor, Bank of Greece

Keynote address by **Erik Berglöf**, Chief Economist, EBRD
"Sudden stop anno 2008: Why Emerging Europe was different"

First session: Impact of the crisis on the economic performance and prospects of the SEEEs

Chair: **Eleni Dendrinou-Louri**, Deputy Governor, Bank of Greece

Speakers (in alphabetical order):

Zbigniew Hockuba, Management Board Member, National Bank of Poland
"The impact of the recent crisis on the Polish economy and the response of the National Bank of Poland"

Paul Mylonas, Chief Economist, National Bank of Greece
"Resilience of SEEEs to the crisis"

Cristian Popa, Deputy Governor, National Bank of Romania
"Romania: Recent Macroeconomic and Banking System Developments"

Susan Schadler, Oxford University, former Deputy Director, IMF
"Three Post-Crisis Questions for Macroeconomic Policy in South East Europe"

Alexey V. Ulyukaev, First Deputy Chairman, Bank of Russia
"Global Crisis and its Impact on Russian Economy"

Discussant: **Max Watson**, Oxford University

* The speakers' presentations can be accessed at: http://www.bankofgreece.gr/Pages/en/Publications/seminars/SEESOX.aspx

Second session: Banking systems of SEEEs: Crisis effects, outlook and risks

Chair: **Yannis S. Costopoulos**, Chairman, Alpha Bank

Speakers (in alphabetical order):

Ardian Fullani, Governor, Bank of Albania
"Economic and financial challenges: prospects of Albania"

Gikas A. Hardouvelis, Chief Economist, Eurobank EFG Group
"Banking in the SEEEs: crisis effects, outlook and risks"

Radovan Jelašić, Governor, National Bank of Serbia
"Banking systems of SEEEs: crisis effects, outlook and risks"

Durmuş Yılmaz, Governor, Central Bank of the Republic of Turkey

Discussant: **Panayotis Thomopoulos**, Member of the Monetary Policy Council, Bank of Greece

Third session: Reform in the SEEEs, the role of the EU and other international institutions

Chair: **Ioannis Papadakis**, Deputy Governor, Bank of Greece

Speakers (in alphabetical order):

Dimitri G. Demekas, Assistant Director, IMF
"Lessons from the crisis for international financial surveillance"

Vladimir Gligorov, Economist, WIIW
"Neoclassicism in the Balkans"

Peter Grasmann, Head of Unit, DG ECFIN, European Commission
"Reform in the SEEEs: the role of the EU"

Orsalia Kalantzopoulos, Senior Advisor, Finance, World Bank Group
"Financial crisis in Central and Southern Europe: The World Bank's instruments and policies"

Discussant: **Peter Sanfey**, Lead Economist, EBRD

Fourth session: Panel discussion on the economic and financial challenges and prospects of SEEEs

Chair: **Max Watson**, Oxford University

Panelists (in alphabetical order):

Christopher Allsopp, Oxford University

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Radovan Jelašić, Governor, National Bank of Serbia

Laza Kekic, Regional Director, Economist Intelligence Unit

Panayotis Thomopoulos, Member of the Monetary Policy Council, Bank of Greece

Alexey V. Ulyukaev, First Deputy Chairman, Bank of Russia

Durmuş Yılmaz, Governor, Central Bank of the Republic of Turkey

I. Introduction: Overview of key themes*

The participants in the conference discussed the experience during the global crisis in South East Europe and neighbouring economies and considered what lessons policy-makers should draw for the future. The starting point of their analysis was the question what factors had helped to contain the regional impact of the crisis. The participants went on to explore the design of exit strategies from the period of crisis management; the question how far growth models in the region needed to change; and the scope for stronger risk mitigation strategies for the future.

The impact of the crisis on the region, while delayed, had proved to be serious – defying expectations of decoupling. The effects had varied considerably across countries, although in all cases a "financial meltdown" had been avoided. A key element limiting the impact of the crisis in all countries of the region had been the extent of prior banking reforms. Relative strengths and weaknesses in other policies explained some divergence in experience. The strength of fiscal policy, in particular, had varied considerably – although it had to be recognised that fiscal policy had tended to be pro-cyclical in most cases, especially when unusually high tax elasticities during the boom were taken into account.

External support had also been crucial, including unprecedented levels of actual and potential financing from the IMF. The ECB had provided huge indirect support to the region through its imaginative initiatives to ensure the liquidity of euro area financial markets, as well as direct support to some Eastern European non-euro area countries. More generally, the region had benefited from fiscal stimulus programmes in the advanced economies. The terms of the European Union's IPA support had also been made more flexible to allow budgetary financing. The World Bank had increased its lending in the region – and again had focused on budgetary support. The Vienna Initiative had played a very valuable role in buttressing the responsible approach of foreign-owned banks: this experience with the "soft power" of official external actors, as well as intensified cooperation between home and host supervisors deserved to be built on in the future.

As a result of sound banking systems and strong external support, the region had navigated the period of peak financial vulnerability without a steep tightening of either fiscal or monetary policy. Indeed, where fiscal credibility was strong, it had proved possible to ease interest rates as financial pressures abated and as inflation declined. Across the region, central banks had also responded

* The speakers' presentations can be accessed at: http://www.bankofgreece.gr/Pages/en/Publications/seminars/SEESOX.aspx

actively to the impact of financial stresses through a range of measures, especially in the field of liquidity provision.

The crisis had underscored that integration and interdependence inherently entail greater vulnerability to shocks, even given the special features of the EU Accession context. Nonetheless, outward-looking economic strategies, predicated on integration with EU and global markets, were seen to offer overwhelmingly the best chances for sustained real convergence. It was all the more important, therefore, to draw lessons from the crisis about the kinds of policies that could tap the full benefits of globalisation while tempering its risks.

This led participants to explore three key sets of issues for the future.

First, there was the design and timing of exit strategies. The ECB had clarified its broad strategy and was technically prepared to implement various options to normalise financing conditions in a measured manner. More challenging was the outlook for fiscal exit strategies in the advanced economies and also in the South East European region. In many cases, the crisis had both strained the public finances and underscored the need for more risk-averse medium-term targets. This meant preparing credible consolidation strategies, even if these needed to be implemented carefully to avoid an ill-timed withdrawal of stimulus. A number of participants also stressed the need for a macro-prudential exit strategy that would address gaps in this area that in part helped explain lending excesses during the boom period.

Second, there was a question to what extent the growth model in the region would need to evolve in order to assure sustainable growth in the wake of the global crisis. It seemed that foreign banks would take some time to rebalance their portfolios and, where needed, deleverage their balance sheets. Net capital inflows in the next few years would probably be lower and would be more dependent on direct investment (rather than banking) flows. The domestic sources of growth would need to evolve also. The traded goods sector would have to move to centre stage as a motor of growth. Domestic savings must be mobilised on a larger scale. And labour resources should play a more important role as a factor input. However, shifting growth models in this direction would typically require a further wave of targeted structural reforms. Greater integration within the South East European region could and should serve as a significant driver of a sustained economic recovery.

Third, participants explored what policy strategies could minimise countries' vulnerability in the future, including possible lessons from risk mitigation approaches in Asia (allowing for obvious differences with the context of EU integration under the *acquis communautaire*). A core conclusion was the case for more risk-averse budgetary policies, creating "fiscal space" to dampen economic shocks. Strong bank capital and liquidity and adequate foreign currency reserve requirements were essential financial buffers, which also protected the public finances. Measures were needed to avoid a renewed growth in unhedged foreign currency borrowing. Some participants highlighted the scope for floating exchange rates to dampen booms and restore competitiveness – albeit with potential balance sheet risks. A further issue, reflecting experience in Asia, was the scope for a more ambitious accumulation of foreign currency reserves to serve as a cushion against external risks. The need was stressed for more probing finan-

cial stability assessments and closer cross-border macro-prudential cooperation. The IMF's FSAP programme should be strengthened in some areas such as cross-border risk stress-tests – and there should be closer collaboration between the IMF and local regulators. As an anchor for continuing policy reforms in the region, it would be crucial to preserve the perspective of EU accession, notwithstanding evident enlargement fatigue in the Union.

There was wide agreement that these discussions had helped to highlight important issues arising from the experience of the crisis. This confirmed the value of such exchanges among policy makers and market participants in the region, as well as external actors. The organisers recalled that this was, indeed, the first in a series of initiatives to promote such exchanges within the framework of the cooperation agreement between the Bank of Greece and South East European Studies at Oxford (SEESOX). This aimed to stimulate debate among academics and policy makers on current issues and to promote a wider dialogue in the region.

II. Welcome address by George A. Provopoulos, Governor of the Bank of Greece

Dear fellow governors,

Dear friends,

Dear colleagues,

I am very pleased to welcome you to the Bank of Greece for this conference, co-sponsored by the Bank of Greece and the University of Oxford.

The focus of this conference is the policy responses to the most severe economic and financial crisis that the world has faced since the Great Depression and the key challenges that lie ahead for South East Europe in light of the crisis. This morning I would like to share with you some thoughts about policy responses to the crisis. I will also provide some observations on the challenges that lie ahead.

My remarks about policy will deal with three broad issues: first, the response of the Governing Council of the European Central Bank to the crisis; second, the pace at which the extraordinary monetary and fiscal stimuli now being provided should be withdrawn; and, third, the need to develop a macro-prudential approach to financial regulation.

The policy response of the ECB to the crisis has been, as we all know, rapid, bold and frequently unconventional. With the intensification and broadening of the crisis, beginning in October 2008, the ECB Governing Council reduced its key policy rate from 4.25% to 1.00% in a period of only seven months. This was an extraordinary response for a central bank that had, until that time, moved at a measured pace in changing rates, abiding by the principle that a certain degree of persistence in policy rate changes increases the effectiveness of rate adjustments.

Interest rate reductions may not be very effective, however, during times of extreme stress, when conventional channels of monetary policy transmission are blocked or impaired. In the aftermath of the collapse of Lehman Brothers, financial markets froze and credit intermediation collapsed. Uncertainty pervaded the markets, counterparties were viewed with suspicion, and the flow of credit all but halted. In these circumstances, the ECB undertook a number of non-standard measures to enhance the flow of credit and support the functioning of the money market. Our approach consists of five broad elements:

- first, the full accommodation of banks' liquidity needs at a fixed rate;
- second, the expansion of the list of assets used as collateral;
- third, the lengthening of the maturities of long-term refinancing operations;
- fourth, the provision of liquidity in foreign currencies;

- and fifth, purchases of covered bonds in order to stimulate a market that has been traditionally an important source of funding for banks.

In addition to this exceptional support to domestic financial markets, the ECB has also provided assistance to non-euro area financial markets. For example, we have entered into either swap or repo arrangements with Denmark, Sweden, Hungary and Poland. Moreover, EU countries have strongly supported recent measures to increase IMF resources through, among other vehicles, bilateral loans to the Fund, an SDR allocation, IMF gold sales and a quota increase. In turn, the Fund has responded to the crisis with a record lending commitment, which includes programmes to Belarus, Bosnia-Herzegovina, Hungary, Iceland, Latvia, Poland, Romania, Serbia and the Ukraine.

In addition to the foregoing actions by the ECB, euro area governments launched major fiscal stimulus programmes while supporting banks with guarantees and capital injections. Together, these measures reduced uncertainty and increased confidence, contributing to an improvement in economic and financial conditions.

Let me now say a few words about exit strategies. With the recovery in the euro area in its initial stages and with economic activity still far below pre-crisis levels, it is too soon to begin a withdrawal of the stimulus measures. Nevertheless, the development of a medium-term macroeconomic framework for the post-crisis period will be crucial. It will facilitate the achievement and maintenance of a sound fiscal position and the ability of the monetary authorities to deliver price stability. It will also help foster financial stability. The challenge will be to choose the correct timing of the withdrawal so as to avoid: first, a premature unwinding of public interventions; second, jeopardising the achievements in stabilising economic and financial conditions; third, letting these measures continue for too long, with risks of distorting incentives and damaging public balance sheets. Among the factors that will shape the ECB's approach to exiting the non-standard measures are the following:

First, we will act with the aim of securing price stability in the medium term. By implication, any non-standard measure that may pose a threat to price stability will be promptly withdrawn. If no such risk exists, a measure can be maintained in case of significant financial market tensions.

Second, we have built a degree of phasing out into the exit process through the design of our measures. In the absence of new policy decisions, several of these measures will unwind naturally, for example, through pre-determined termination rates.

Third, the ECB's operational framework comprises a broad set of instruments so that the exit strategy can be formulated in a very flexible way.

Let me turn to the issue of the exit from expansionary fiscal policies. In my view, an important medium-term risk to sustained recovery revolves around deteriorating fiscal positions. The large increases in fiscal deficits and public debt incurred to provide stimulus to the economy have already raised concerns in financial markets, as suggested by the widening sovereign spreads relative to pre-crisis levels, for economies with large fiscal burdens. If the recovery were to stall, followed by a prolonged period of very low growth, deficits and debt could swell to difficult-to-sustain levels. Governments will,

therefore, need to start addressing mounting long-run fiscal challenges by committing to large reductions in deficits once the recovery is on a solid footing and advancing reforms that will put public finances on a more sustainable path. I need to add here that Greece is among the euro area countries for which the challenge of medium-term fiscal viability is especially urgent.

Let me now turn to financial sector regulation. The best way of course to manage a crisis is to prevent it from happening. At the root of the market failure that led to the crisis were optimism bred by a long period of high growth, low real interest rates and policy failures. One such failure was that financial regulation was not equipped to address the risk concentrations and distorted incentives underlying the financial innovations.

This circumstance raises another medium-run challenge. The present crisis has revealed that macro-prudential factors play an important role in determining the size, nature and propagation of systemic risk. Therefore, it is essential to establish an effective framework for macro-prudential supervision that will ensure a systematic analysis of risks, as well as the formulation of policies to address such risks.

Let me say a few words about the framework for macro-prudential supervision envisaged for the EU. As you know, following the publication of the Report of the de Larosiére Group in February 2009, the Commission issued a package of draft legislation in late September with the aim of creating a European Systemic Risk Board – or ESRB. The main task of the ESRB will be to identify and assess risks to the stability of the EU financial system and issue, when or where necessary, risk warnings when the identified risks appear of course significant. Several features of the proposed framework are I think important and I am going to mention them.

- First, the European System of Central Banks will play a key role in the functioning of the ESRB. The voting members of the ESRB's General Board, some of which are present here in this room, will include the 27 governors of the EU's national central banks and the President and Vice-President of the ECB.
- Second, the ECB will be assigned the task of ensuring sufficient human and financial resources for the ESRB's Secretariat.
- Third, the ESRB will not be responsible for the implementation of macro-prudential policies. That responsibility will remain with national authorities and national supervisors.
- Fourth, since the ESRB will not implement macro-prudential policies, the effective monitoring of the follow-up to its warnings and recommendations and the consistent and timely implementation of the recommendations will be crucial for the performance and the credibility of the new macro-prudential supervisory framework.

The creation of the ESRB will, in my view, constitute a historic step forward, putting in place an important building block of an EU financial stability framework that is consistent with the objectives of creating a single market.

Some of the policy challenges facing the euro area also need to be addressed by the countries in South-Eastern Europe. Moreover, many of the countries in South-Eastern Europe are confronted by

additional challenges. Let me mention some of these challenges, as well as some questions that we may wish to consider during the course of this conference.

First, prior to the crisis many countries in the region ran large current account deficits underpinned by capital inflows. As the crisis demonstrated, however, capital flows can be subject to abrupt and sharp reversals. What policy measures can be used to deal with surges of capital inflows and their sudden reversals?

Second, much of lending in the economies concerned has been denominated in foreign currencies. This situation can lead to corrosive feedback loops between banking crises and foreign exchange crises, compounding the effects of each. What policies can be adopted to safeguard domestic banking systems from exposure to foreign currency borrowing?

Third, some banking systems of euro area countries have relatively high exposures in the countries of South East Europe. In addition to the measures that have already been taken, including bilateral MoUs among some national central banks, what other actions would help minimise the risks that may arise from strong financial linkages?

Fourth, many of the economies in South-Eastern Europe tend to be relatively closed. Moreover, the trade linkages among the countries of South-Eastern Europe themselves are quite limited. In other words, the shares of the exports of each country in South-Eastern Europe to the rest of the region tend to be relatively small, given the geographical proximity of our countries. These shares are typically in the range of between 15% and 30%. What then accounts for this circumstance and how can we boost both the level of trade in goods and services and intra-regional trade among our economies, thus helping to generate a virtuous circle of growth?

These I think are —indicatively, on a selective basis of course— some of the issues that perhaps can be addressed in today's meeting.

I look forward to a lively discussion and I am sure that there will be such a lively discussion. Once again, thank you very much for being with us, especially the guests, and I am sure that this meeting will be organised next year again and again. Now I give the floor to Erik Berglöf.

III. Keynote address by Erik Berglöf
Chief Economist, EBRD

Sudden stop anno 2008: Why emerging Europe was different

Thank you. It is very nice to be back in Athens, even though it is depressing to wake up in the morning and look at the weather map: outside you have rain, while you see the CNN weather map with a big sun over the United Kingdom where I normally live. I guess that is my life in a nutshell.

To be serious, the sun has not been shining this year on the region that we work in. It has been a very difficult year, and this is not a region that has avoided hardship in the past, most importantly of course the deep recession that took place throughout Central Europe, South-Eastern Europe and the Former Soviet Union at the outset of transition. A lot of what I have to say now will focus on Central and South-Eastern Europe, but not exclusively.

We have just released our growth forecasts for this year. When we look at this year we have five countries in our region that will have double-digit output declines this year. That is quite staggering. Moreover, we know that non-performing loans and unemployment are still rising in the region, further making a recovery difficult.

Having said this, what is more interesting to reflect upon is why, despite the size of the shock that hit the region, the effect has not been larger still. If you go back and look at emerging market crises in the past and at the size of the shock and the nature of emerging markets, you would have expected something much more severe. We could have seen a collapse of currencies and of banking systems; but in fact we do not see that – despite the very large exposure of the region to various vulnerabilities, such as large current account deficits and foreign exchange movements.

So the theme of my presentation is going to be what explains that. And I am going to start where the governor ended up and end up where the governor started.

The first point I want to make is that Europe is different in terms of its economic integration, its financial integration and —what is highly relevant— its political integration. The second point is that, exactly as the governor was describing, the policy response has been extraordinary. In this regard, emerging Europe is quite different from other regions. If you exclude Russia and Ukraine, then one can see that this region has not been affected as much in relative terms, relative to the scale of financial assets, as most other regions in the world. However, Russia and Ukraine have been affected by capital outflows in a way that is similar to emerging Asia and Latin America.

Why was the capital outflow so modest in relative terms? Why was there no sudden stop? Of course, there was also a very severe trade shock that hit the region and massive output declines, but no traditional emerging market twin crises – despite the magnitude of the shock. Why? The answer lies in the nature of the European financial integration, and more generally the broad range of European integration, as well as the policy response – which has been massive, comprehensive and coordinated.

I will first say a little bit about what elements I think are important for financial integration in Europe and what are the benefits. But I will also try to explain what role financial integration plays in the transmission of the crisis. Obviously, when an economy is integrated, you are vulnerable just by being integrated. Financial integration can generate macro-financial vulnerabilities and contribute to the vulnerabilities of foreign exchange exposures, credit bubbles and so on.

You are all familiar with the European transition and convergence model, the combination of political, legal-regulatory and broad cultural integration, trade integration and financial integration. EU banking groups have been a key part of this process. If you look at some of the new EU members or some of the South-Eastern European countries, you have countries where the shares of assets of the EU banking groups are above 90%. Financial integration has been rapid; and it was really taking off during the boom period. It was spearheaded by banks from Austria, Italy, Sweden and Greece —whose banks were very important in this part of the world— together with OTP from Hungary and other banks from Belgium, France, Denmark and the Netherlands. A very complex web has emerged in this period, but there has been no comparable evolution in the regulatory framework to parallel these developments.

What is the basic link between financial integration and economic growth? There are several ways and channels through which it works. One is to ease domestic savings constraints. It is clear indeed that much of the savings that were used for investment in this region came from outside the region. Financial development enables people to have access to credit. It also allows individuals to access entrepreneurial and educational opportunities. We know that it reduces macroeconomic volatility. It helps to transfer skills, technology and improved institutions and corporate governance through the banking system. There is no question that the foreign banks have played an important role in these regards in the region.

In the transition region, in contrast with other parts of the world, these very large capital imports have been associated with economic growth. What is important also, and again different from other parts of the world, is that these capital flows have been associated primarily with investment, rather than consumption. But the result has been rapidly increasing current account deficits in the region.

In light of global experience during the past decade, it is not at all clear that we should have expected this pattern. Because if you look at the rest of the world, the non-transition sample, capital account surpluses were negatively correlated with growth. In our region actually it is the reverse. So this already suggests that there is something different going on in our region compared with other parts of the world.

In our recent research, published in the EBRD Transition Report 2009, we find that there is robust evidence of very strong causal effects from financial integration to growth. A 1% of GDP rise in capital

inflows raised average annual growth by 0.15 to 0.4 percentage point per year. This is very significant. And when you look at the non-transition sample, we do not find these effects.

So there is something different about financial integration in Europe. Why is Europe different? There is a school of thought that says that there is a sort of level effect, so you need to get to a certain level of financial development to truly benefit from financial integration. That could be part of the explanation, and there is some evidence for that. If you look back at the history of financial integration and more generally financial development in Central and Eastern Europe, it took some time for these to really have an impact on growth.

Turning now to the crisis, by March 2008 very few parts of the region had actually been hit. The most seriously affected country was Kazakhstan, where the banking sector was extremely ambitious, did most of its operations outside of Kazakhstan and relied for its funding very heavily on wholesale markets. The Baltic States were also hit early, as some of the Swedish banks started to restrict credit as the signs of overheating were becoming overwhelming.

By December 2008 most of the region was in one way or another affected. Ukraine and the Baltic states stand out as being particularly hard hit. By March 2009 Russia was very severely hit: indeed I think most observers were surprised by the magnitude of the shock to Russia. We expect the Russian economy to decline by 8.5% in 2009, which will make it the G20 country with the largest decline this year.

If you look across the region, you can see that there were very large contractions in many countries. One cannot doubt that this was a severe shock for the region. But there is of course a lot of variation across countries, with some countries like Poland coming through the crisis with no recession, while other countries have a double-digit decline this year. What we have found is that, the higher share you have of foreign banks, the lower the outflow of capital was. So, despite these warnings at the start of the crisis, it seems that foreign banks helped mitigate the crisis, although they also played a very important role in contributing to external debt levels. And differences in external debt levels help to explain how severely a country was hit in the crisis.

The foreign bank presence, therefore, seems to have been a stabilising force during the crisis: somehow the foreign banks buffered the financing shock. If you look at which banks got into trouble —and there are quite a few banks that got into trouble— these are the ones that were domestic, at least domestic in the countries where they experienced problems.

But did the foreign banks actually fuel credit booms? If you had more credit booms, you also saw larger output declines. And did financial integration bias the currency composition towards foreign exchange? It seems reasonable that large foreign banks would push in that direction. And indeed capital inflows are very significantly correlated with credit growth in the boom period. Some countries basically had credit booms every year, or almost every year, in the run-up to the crisis.

So did financial integration generate macro-financial vulnerabilities? Yes, but what really mattered was these large inflows that generated credit booms and booms of foreign exchange lending. To the

extent that it was stocks that were a problem, it was debt levels, not foreign direct investment that mattered. On the whole, though, even if foreign banks appear to have been associated with unhedged foreign exchange exposures, the results are not very conclusive. In sum, the picture is complex, but I suggest that financial integration as it developed in Europe plays an important part in explaining why the crisis after all was not like a traditional emerging market crisis.

Let me now conclude with some reflections on the policy response.

When you look at the nature of the problem in Eastern Europe, what is also striking is the need for —and achievement of— adequate coordination in the policy responses. As the process of financial integration developed, I think it is fair to say that we were not prepared in any way in terms of platforms for coordination. There was a risk that government programmes to support banks in Western Europe would not be allowed to be used to support subsidiaries in Eastern Europe. There was a further risk that Eastern European countries would react to the prospect of a "sudden stop" by "ring-fencing" their subsidiaries and preventing funds from being transferred to the parents. There was also a risk that countries without credible deposit insurance schemes would see a big outflow to those that had such schemes.

And of course thinking about the private sector perspective —remember this was very much a private sector crisis— there was an obvious temptation for individual foreign banks to be the first to leave the country because you know that asset values are probably going to go down over time. But for the foreign banking sector as a whole, there was an interest in managing the deleveraging process. It is very much like a prisoner's dilemma problem. You wanted to find ways of coordinating. This was a core challenge.

When you look at the crisis response, it has clearly been massive and also well coordinated. The IMF's resources tripled. It was very important for the region. It gave us peace of mind. We know that at the beginning of the crisis the resources that the IMF had were not sufficient to deal with a full-blown crisis in Western Europe or in Eastern Europe. So we were concerned about that. And the things that came out of the G20 were very important. G20 signals that were sent, particularly about the replenishment of the MDBs, the multilateral development banks, were very important.

While the significance of the crisis response is obviously true for the IMF and for the investing international financial institutions like the EBRD, the World Bank and the EIB, even EU balance of payment support doubled twice during this period. But the ECB's role should not be forgotten. It has often been criticised, and in my view correctly so, for its limited support to the economies in Central and Eastern Europe, but its liquidity support to Western European banks active in the region was absolutely critical. The liquidity provision that was given to Western European banks was crucial for their ability to stay engaged in the region.

The response to the crisis also embraced private sector coordination. There were serious efforts to engage with the private sector. There was a new coordination platform, the Vienna Initiative, that filled this institutional vacuum in the banking sector.

But this is not the time to be complacent. These programmes are still absolutely critical for our region. A premature exit from liquidity support to Western European banks would be devastating for

Eastern Europe now. Leaving the bank support programmes in general would be very bad. Most of the countries in Eastern Europe came into the crisis with strong fiscal balance sheets with a few exceptions. They massively deteriorated. They do not have the resources for a fiscal stimulus. They rely on the fiscal stimulus in their export markets.

The premature introduction of capital requirements in the region could be very severe and it could severely impede recovery. Despite the recent progress, we have still some way to go in terms of getting the regulatory framework in place.

Let me summarise.

On the whole, when we look at the entire history of financial integration, including during this crisis, I think it is a success story. It does not mean that there are not things we need to try to address. We need to find a more balanced growth model, more domestic sources of investment and a more sustainable financial integration model – one which addresses the proclivity to promote local asset bubble credit booms and the tendency towards foreign exchange exposures.

I think that a changing and positive feature – not only in Europe, but maybe particularly in Europe – is a very close collaboration among the international financial institutions. The way we work together is very different, and I think it promises a lot in terms of what we can do to address some of the remaining issues. Maybe not so much in Central and South East Europe, but going further beyond. And we should remember that the European financial system now extends much beyond the EU area and the candidate countries and we need to acknowledge that also in our policy framework.

You could argue that European integration comes out stronger out of this crisis, but this is far from over: we need to make sure that we do not prematurely deconstruct or take away this very important policy support.

Thank you very much.

IV. First session: Impact of the crisis on the economic performance and prospects of the South East European economies

The first session of the conference was chaired by **Eleni Dendrinou-Louri**, Deputy Governor of the Bank of Greece. During this session, speakers focused on ways in which the global crisis had affected the South East European Economies and their neighbours. A number of recurring themes emerged. The region had not experienced a meltdown, including because of the advanced state of banking reforms and the availability of IMF support. Still, experience had been varied and in many ways it had reflected the robustness of domestic policies in the run-up to the crisis. Despite the impact of the crisis, there was a consensus that economic integration and interdependence were good for growth over the long run, but they inevitably increased vulnerability to shocks. A key theme for the future was therefore to reflect carefully on risk mitigation strategies, including a prudent fiscal policy that left room for manoeuvre in the face of shocks. Issues of reserve management, exchange rate regimes and possible constraints on capital flows were touched on. Several speakers also pointed to the need for renewed efforts with structural reforms to re-launch growth in the region on a strong and sustainable track in the wake of the crisis.

The first speaker was **Zbigniew Hockuba**, Management Board Member of the National Bank of Poland (NBP). Poland, he pointed out, represented something of a bright spot in the European economy. GDP had increased by 1.1% in the second quarter of 2009, and the growth rate was expected to remain in positive territory during the remainder of the year. Poland, indeed, was the only growing economy in Europe.

Several factors helped to explain this performance. For some years the current account deficit had been very moderate. The banking sector had entered the period of global turbulence in relatively good shape, with no toxic assets; and indeed banks, firms and the government had all retained access to European and global capital markets. The stock and bond markets had experienced a degree of shock after the Lehman Brothers failure, but the negative impact on debt markets had been less than in some other economies of the region.

At the policy level, the floating exchange rate had served as an important stabiliser for the economy – dampening exuberance in the upswing and helping to ensure competitiveness subsequently. This process had not been without risks, since there were significant levels of unhedged foreign currency

borrowing among firms and households – giving rise to liquidity and exchange rate exposures. However, foreign parent banks had continued to supply funding; the NBP had entered into swap transactions with banks; and serious credit risk effects from exchange rate fluctuations had not been evident so far. On the other hand, some deterioration in the budget deficit was expected, and fiscal retrenchment would be needed.

Paul Mylonas, Chief Economist of the National Bank of Greece (NBG), discussed the resilience of South East European economies. Ahead of the crisis, markets saw a region that was booming, with growth of 6-7% across the board. This reflected structural reforms and steep convergence prospects. At the same time, signs of overheating were present. Credit grew rapidly, including unhedged currency lending to households. External current accounts widened to striking levels, and external debt rose. Exchange rates appreciated. There were also liquidity issues, with loan-to-deposit ratios rising steeply. Real wages typically increased strongly. Following its far-reaching reforms, however, Turkey had been an exception to many of these trends.

As risk perceptions sharpened in global markets, spreads on credit default swaps went up from 200 to 800 basis points at the peak. Bank analysts foresaw a serious increase in non-performing loans (NPLs). At this point there was a risk of self-fulfilling expectations, even if institutions such as the NBG believed fundamentals to be sound. One factor accounting for worsening expectations was the sharp fall in growth. Behind this lay a major export shock. But there was also the impact of a drop-off in capital flows, which was massive in some cases. This led to a sharp slowdown —almost a standstill— in domestic credit. Still, FDI and non-bank private flows did not come to a halt; and there was not a sharp fall in external reserves, which were boosted in some cases by IMF agreements.

Looking to the future, leading indicators were showing some improvement, with consensus projections for positive growth in the third and fourth quarters of 2009. So the worst was over, and the damage has been less than pessimists expected. Several factors helped to explain this. To some extent there was the risk umbrella of EU Accession. In most cases, governments were also strong and inspired credibility. There was the actual and potential support from the IMF. Finally, one should not forget the trickle-down impact of domestic support programmes in advanced economies.

In this setting, it had been possible to avoid an across-the-board tightening of monetary policy; in some cases it was even possible to ease policy. In most cases, fiscal contraction was also avoided: automatic stabilisers were allowed to function. Moreover, the banking sector, a traditional Achilles' heel of emerging market economies, held up well. Foreign banks had proved loyal to these markets. Moreover, direct investors from the advanced EU economies were strongly committed to their modern and competitive facilities in the region. In terms of market share, these were economies on a rising trend of competitiveness.

The third speaker was **Cristian Popa**, Deputy Governor of the National Bank of Romania. The Romanian economy, he noted, had been a clear case of overheating prior to end-2008. A sharp contraction was now under way in output, taking place in direct correlation with a significant correction

in the external deficit and the latter reaching and being expected to remain at sustainable levels for the medium term could help lay the basis for a durable recovery. Modestly positive growth should resume in 2010, and the challenge was to ensure that this would be sustainable. That would require ongoing structural reforms, including in the public sector. Issues of wages, employment and pensions all needed to be tackled.

The sources of the downturn lay in a sharp slowdown in capital inflows, although not a "sudden stop" – FDI had dipped by roughly one half, for example. The construction sector (following a pronounced bubble) and an initial fall in inventories accounted for much of the very sharp decline in output, led by a sizeable drop in investment. Also, consumption had been driven, before the crisis, by unsustainable expectations of real wage growth and of domestic currency appreciation; and now there had been a correction, with a sharp rise in household saving, even as average income levels were dropping and unemployment was rising.

Expectations for 2010 showed a flattening out and modest pick-up – although this was more evident in external orders than in retail sales and the service sector generally. As the private sector began to expand again, it would be important that the structural deficit of the public sector decreased, to ensure a sustainable external current account position over longer-term horizons and also to prevent crowding out the private sector.

The depreciation of the exchange rate had been roughly in line with fundamentals, despite some political tensions. Competitiveness was also being corrected by a sharp rise in productivity. Inflation, meanwhile, had responded with quite a lag to the downturn, partly reflecting unusually favourable food prices in 2008. Headline inflation was moving towards the NBR target range; but monetary policy needed to stay vigilant, due to strong inflation persistence and the need to keep expectations credibly anchored.

External reserves were now at an all-time high, partly reflecting massive support from the IMF and the EU. In this connection, the commitment from parent banks, in the form of the Vienna Initiative (for which Romania was the pilot case) had been important. On the domestic money market, there was still a way to go in narrowing the margin of deposit interest rates over the policy rate and even further in terms of banks' lending rates. Loan growth had fallen sharply (turning negative around late 2009), although it was of course hard to disentangle the influences of supply and demand. As the situation normalised, one key concern was to avoid a resurgence of growth in unhedged foreign currency-denominated lending. The authorities had pressed banks to maintain or increase solvency, and all had complied, including with respect to a higher minimum CAR of 10%, with system-wide solvency reaching over 13%. Nonetheless, a pick-up in NPLs was of concern, with gross figures for the broad definition (substandard, doubtful and loss) reaching around 11%, but net figures (less provisioning and updated collateral) being under 2%. The stresses had become evident first in uncollateralised household loans and foreign currency loans. At present there was a pick-up in corporate NPLs, especially concerning SMEs.

Looking to the future, the focus now was turning to the strategy for euro adoption. This would be the key project of the new National Bank Board that had taken office that very day. The Bank now planned to prepare and implement all the steps leading to the adoption of the euro, which was foreseen for 2015, with a favourable decision on behalf of EU institutions hopefully being reached in the course of 2014.

Susan Schadler, a former Deputy Director of the IMF and an Oxford/SEESOX senior researcher, noted that economic performance across the region since the early 1990s had been modest by comparison with the Baltic States and Central Europe and other comparable emerging market economies. This implied that, following the crisis, countries had two priorities: to deal with the post-crisis world and post-crisis issues; and to improve on this somewhat disappointing track record. They had to run harder than many other countries to keep up.

A first major question was whether export orientation was important. Based on comparative data, export orientation indeed held the key to long-term growth – even in today's less hospitable global environment. Nonetheless, there were risks. The more integrated an economy, the more vulnerable it was to external shocks – particularly in the relatively low-income countries. The second question was whether the use of foreign savings has been favourable for growth. Indeed, higher current account deficits in countries of broadly this income level had been associated with higher domestic saving and investment. Nonetheless, high deficits in emerging Europe (unlike comparable regions) had also been associated with larger shocks to output. So, export orientation and the use of foreign savings were good for growth, but vulnerabilities came with both.

The third question was what policy makers could do to protect the economy from such vulnerabilities. One lesson was that leaving fiscal space for an expansionary policy in the time of a downturn in foreign demand was absolutely critical. Another conclusion concerned the extent to which countries need to "self-insure": it seemed that countries with higher reserve cushions had tended to experience higher long-term growth. However, it was not fully clear how this self-insurance helped, because in practice countries have not actually used their reserves a great deal. Earlier speakers had commended floating exchange rates – but their countries were nonetheless headed, over time, towards euro adoption. Indeed, over the longer run, many economists wondered whether in truth countries with very open capital accounts had any good alternative fixing in a relatively indelible manner. Finally, that led to the issue of taxes and constraints on speculative flows. A clear lesson from the crisis was that countries with large short-term exposures and big real estate bubbles had been the worst hit. Much more work should be put into the question of protecting countries – not just hoping for stronger cooperation on global financial regulation.

Alexey Ulyukaev, First Deputy Chairman of the Central Bank of Russia (CBR), pointed out that Russia —unlike some economies discussed earlier— had performed worse than expected. It had, so to speak, fallen from a high hill. A year previously it had a 6% budget surplus, an 8% trade surplus, a positive capital account and a reserve gain of some US$ 600 billion. Now, by contrast, there was a projected budget deficit in 2009 of 8.3% of GDP, a large capital outflow and a sharp fall in reserves. Russia was

thus one of the two economies in the G20 to experience a decline of more than 10% of GDP in the first half of the year. Russia, in his view, was too big an economy to be dependent on only one market, that for oil.

For the authorities, and especially the Central Bank of Russia, the most acute problem had been liquidity. The CBR had followed an easy quantitative approach, through its refinancing policy, while keeping a careful watch on interest rates in light of inflation. The limits and categories of refinancing had been enlarged, and the CBR even introduced uncollateralised credit – acquiring in the process balance sheet risks.

The economy had now passed the lowest point. It had entered a phase that was not exactly recovery, but a kind of "unstable stability". Bank credit was showing a modest positive growth rate. The condition of the banking system was not bad. Banks had moved from a negative to a positive net foreign asset position. Moreover, deposits of the private sector were on the rise. NPLs were rising, but banks had the resources to absorb these – the capital ratio being 19%. The trade balance was improving, following the depreciation of the ruble, and the capital account was close to balance. The fiscal deficit remained – although the projection of 7% in 2010 would probably be undershot. Economic growth next year would probably reach between 1.5% and 2.5% of GDP. A major positive element was that inflation had turned down – creating a possibility, since April, for cuts in the CBR policy rate.

The acute problem facing the CBR and the government now was the exit strategy. There was clear scope to reduce the budget deficit and also to cut the interest rate – although this would depend on progress with disinflation. Nonetheless, there was also a question how to address the vulnerability of growth over medium term, and this issue had moved to the centre of domestic debate. The key indications were to be more oriented towards local savings and local investments than before, while also enhancing the business environment to attract foreign investment of a durable and broadly-based nature.

The discussant for this session was **Max Watson** of Oxford University and formerly a Deputy Director of the IMF and an economic adviser to the European Commission. He pointed out that a first question arising from the session was what lessons policy makers should extract about real convergence with open capital accounts under the *acquis communautaire*. Recent imbalances in the region were now termed "unsustainable". But did this reflect just their size (in light of capital market imperfections) and the adjustment challenges implicit in their sector counterparts (with a strong bias towards residential investment)? Or did it result more from policy weaknesses or distortions in the deficit economies, which had triggered a misuse of foreign savings? He suggested that there had indeed been policy weaknesses, especially in fiscal and structural domains. On balance, however, convergence with open capital accounts —and a "manifest euro destiny"— emerged from this experience as inherently more risky than many anticipated.

There were clear lessons from this in terms of fiscal policy —including on revenue elasticities during credit booms— and also concerning the adequacy of external reserves. Risk mitigation techniques, such as those deployed in Croatia, had illustrated interesting potentialities in the monetary and pruden-

tial arsenal. Exchange rate regimes had been much discussed and the benefits of floating rightly flagged; however, one should not over-claim for these benefits in the case of small, open and relatively low-income economies. The avoidance of a meltdown in the region had highlighted the importance of banking reforms. In a deep sense, structural reforms could also be seen as a form of risk mitigation: if the business environment was weak, then too high a proportion of foreign savings could be attracted into the non-traded goods sector, with risky implications for imbalances and adjustment capacity.

The response to the crisis by international institutions had been formidable, including the Vienna Initiative. But the lessons of a somewhat comparable capital flow sequence in Latin America, in the 1980s, was that it takes time for "natural" banking flows to come back in the wake of such a crisis and of a necessary "concertation" of bank support. Regarding private sector capital, a key priority for countries was to undertake reforms that would stimulate non-bank flows and especially foreign direct investment. This meant reopening the analysis of structural policies to trigger an inflow of foreign investment in support of a new growth model – one more reliant on the traded goods sector, on domestic savings and on a much larger labour input.

If countries, over time, were to return to strong and sustained convergence, would they again be subject to waves of "feast and famine" in capital inflows? Capital controls could never be a first best, given the distortions and perverse incentives they cause. But risk mitigation by countries facing inflows might not be enough. Did one not need more market-related ways of diminishing the macro-prudential risk in capital flows, from the banking end? This suggested a harder look at cross-border macro-prudential issues by host and home supervisors alike, especially where banks were triggering systemic risk in terms of unhedged currency loans or excessive concentration of certain sectors.

Finally, one needed to return to the question of external and domestic anchors. It would be desirable to reinforce the role of EU Pre-Accession Economic Programmes and Economic and Fiscal Programmes as a commitment device for countries' policies – including through a more bilateral dialogue and through stronger emphasis on integrating structural reforms and the mitigation of macro-prudential risk. It could also be desirable to revisit the euro as an anchor. For many countries, it might be hard to have a well-anchored fiscal reform process without a vision of the euro down the line, although rushing into the euro was not the answer. A recent report by the European Commission stressed fiscal convergence, but it also highlighted a need to revisit structural policies, adjustment capacity and macro-financial analysis if countries were going to progress safely towards the euro.

V. Second session: Banking systems of South East European economies: crisis effects, outlook and risks

The second session which was chaired by **Yannis S. Costopoulos**, Chairman of Alpha Bank, was devoted to a review of the effects of the crisis on the financial sectors of countries in the region and the outlook and risks for banking in the future. With three Governors and a commercial banker speaking, several cross-cutting themes emerged.

First of all, the region had been hard hit since the Lehman collapse, defying earlier expectations of decoupling. Managing support for the economies and financial markets had thus been challenging for central banks. However, banking systems in the region had fortunately entered the crisis period in relatively strong positions, thanks to a steady strengthening of supervision and prudential oversight in preceding years and the generally responsible approach to banking on the part of (largely foreign-owned) banks.

Indeed, in the countries under discussion in this session, there had been no direct financial support to banks, though a number of measures to ease stresses facing banks had increased exposure of central bank balance sheets to commercial banks. Governors saw their adherence to exchange rate flexibility with minimal intervention as a major strength in curbing capital outflows, even though depreciations had in some cases pushed up non-performing loans (NPLs). The Vienna Initiative was welcomed as contributing strongly to stabilising foreign bank exposure and to establishing the need for banks to undertake stress tests.

Views on the appropriate future level for bank capital in emerging markets with conditions similar to those in this region spanned a wide range, reflecting the differences between the perspectives of the banking industry itself and those of concerned central bankers from countries with a history of instability. However, all participants in the session were cautiously optimistic about the future. Turnarounds in economic activity had started, though the strength of recoveries would depend critically on global economic and financial conditions, lagged effects of the shock in their own economies and banks' liquidity constraints.

The first speaker was **Gikas Hardouvelis**, Chief Economist at Eurobank EFG Group. In an overview of banking developments in the region during the crisis and current prospects, he painted a broadly positive picture, though sounding cautionary notes on the risk of over-regulation in the wake of

the crisis. In the last six months, thanks to the drastic intervention of governments, central banks and international organisations, we have managed to escape a major collapse of the global financial system. He saw the worst of the crisis for SEE as largely over. Interest rate spreads, which rose as high as 1,000 basis points, had mostly returned to pre-September 2008 levels. That said, spreads were still above 2007 levels, and he expected a 5-7 year period of relatively high risk premia the world over. In his view, SEE sovereign spreads still have room to decline towards a lower equilibrium level. He expected the crisis to leave its lasting mark on the risk premia of the SEEEs as well as the advanced economies. He expected global growth to pick up, but not to pre-2007 levels.

As far as banking in the SEE region is concerned, Mr Hardouvelis saw positives and negatives. On the positive side, he pointed to the fact that, except in Turkey, banks were almost entirely foreign-owned. The dominant 11 foreign banks in the region were well-capitalised, their lending in the region was small relative to their global portfolios, their write-downs were not among the largest of global banks and on the whole they had not been excessively adventurous in banking activities. Overall, the SEE countries could be relatively comfortable about the strength of the banks within their borders.

There were also, however, negatives. Though Mr Hardouvelis felt that the sharp slowdown in lending in 2008-09 was a blessing in disguise (insofar as it had pricked emerging bubbles at an early stage), he expected credit growth to recover slowly. In short, the experience of other countries following recessions indicated that credit growth, rather than leading the way out of recession, will lag the recovery. Two additional factors will hinder a resumption of lending growth: banks at present are highly liquidity-constrained and NPLs, which have risen rapidly especially under the weight of large FX lending, are likely to rise further through 2010. This means that both banks and potential borrowers are likely to be extremely cautious in returning to lending/borrowing activity. Prior experience in the more developed Western world shows that credit expansion lags the economic expansion. During a recession, it is the economy that drives credit, not the other way around.

In the meantime, central banks and regulators must do damage control in an effort to get lending going again. Mr Hardouvelis saw scope in this vein for expanding deposit guarantees, reducing reserve and liquidity requirements and using IMF and any other means of special lending support.

As for the future, Mr Hardouvelis was optimistic that real activity and credit growth would pick up, especially with the region's critical strength of having the EU anchor. However, he appealed strongly for avoiding what he saw as two potential mistakes: countries trying to outdo neighbours in tightening regulatory systems, which would result in regulatory arbitrage; and moving to very high capital requirements, which, in his view, would create governance issues and promote adverse selection. The task for regulators is to increase global financial stability without hurting the good side of the banking business. While acknowledging the merits of pro-cyclical capital buffers, he made a plea for devising "smarter" ways to insure banks than simply adding to capital requirements.

Ardian Fullani, Governor of the Bank of Albania, described pre-crisis conditions and policy challenges during the crisis in Albania. Even though the impact of the crisis on activity was among the

mildest in Europe, addressing volatility, slower growth and banking issues had proved quite complex.

The Governor called attention to pre-crisis vulnerabilities in Albania. Chief among these was rapid bank credit growth, which, in the governor's view, had led to high risk in banks' balance sheets, especially as foreign currency lending had increased. Also, credit growth had fed consumption, which, with a fiscal slippage in 2007, had raised the current account deficit.

For the Central Bank, responding to these signs of overheating had required striking a balance between monetary policy to secure low inflation and stronger bank supervision to secure stability. On the monetary side, interest rates were raised five times in the 1½ years before the crisis. On the supervision side, the Bank established a department of financial stability, modified the banking law, established a credit information bureau and pursued a dialogue with banks on governance, internal control, risk management and transparency. To counter risks from rising FX lending, the required provision for these loans had been raised to 150%. A two-day meeting with Bank of Greece officials had focused on these efforts.

Though some had expected Albania to decouple from the crisis sweeping Europe in late 2008, Albania, small, open, with close trade links to Greece and Italy and reliant on foreign banks, felt the effects quickly. Soon after the Lehman collapse, deposit withdrawals started, remittances slowed, and banks had liquidity problems. Credit growth stopped, consumption and investment slowed, and the NPL rate doubled. Despite a sharp depreciation, inflation stayed in the target range, helped by little pass-through to prices and commodity price drops.

These conditions had been challenging for policy, especially in January-February. Banks had pushed for stimulus, both fiscal and monetary. Though the Bank of Albania at first resisted, it eventually eased modestly, hoping to signal that, if the fiscal stance were held steady, the Bank would ease further. Facing high exchange rate volatility, the Bank vocally resisted targeting the exchange rate and merely intervened to smooth high volatility. Banks had remained well-capitalised, so deposit insurance was not extended as in some other countries, though the Governor felt the absence of coordination had fuelled outflows. Despite strong capital positions, banks had been pressed to raise capital and not pay dividends. Steps to ease market tensions (shifting repo auctions from fixed amounts to fixed prices, raising maturities on liquidity injections, reducing margins on overnight lending, raising limits on daily use of reserves and expanding the range of collateral) resembled those in other countries.

The Governor saw September as a turning point and expected growth over the next two years to remain about 2-2.5%, with low inflation. Financial market conditions, including the exchange rate, should stabilise. For the long run, the Governor saw structural reform, ideally synchronised in the region, as key to attracting needed FDI and fiscal stability along with better global conditions as critical to growth prospects.

Radovan Jelašić, Governor of the National Bank of Serbia, focused his remarks on the impact of the crisis and the resilience of banks in Serbia. He shared the view of others that developments, especially early in 2009, had been tense, but in Serbia sizeable pre-crisis cushions in banks had been invaluable.

The Governor emphasised the severity of the crisis in Serbia. On the financial side, he pointed to the 26% depreciation of the dinar/euro rate, a 16% drawdown of bank deposits over six weeks early in 2009, a drop in bank lending and a 500 basis point increase in sovereign debt spreads. The real impact was also dire: industrial production fell, the current account deficit contracted sharply and unemployment rose to over 20%.

Fortunately, banks' underlying position had been reasonably strong before the crisis owing to the large role of foreign banks and cautious prudential polices of the National Bank of Serbia (NBS). The average capital adequacy ratio was over 20%, a level the Governor defended given low credit agency ratings, a fully flexible exchange rate in the presence of large FX lending and a poor track record on bank soundness. Even with high capital ratios, it was fortunate that when deposit withdrawals occurred, banks had added cushions in the form of the 13% of bank assets held in NBS repos and high required reserves against FX deposits and foreign borrowing.

The Governor felt that the Vienna Initiative had played a critical role in sustaining banks' exposures to Serbia and securing the commitment of banks to stress testing. The tests had yielded reassuring results. Even with highly pessimistic assumptions on the output gap, rate of depreciation and change in interest rates, the average capital adequacy ratio would fall only to the range of 16-18%. The Governor noted, moreover, that over the summer the NPL ratio had shown signs of stabilising at about 8%. However, even if it rose to 22%, capital ratios would be above NBS floors.

The Governor pointed to several lessons from the crisis. First, bank shareholders had played a critical role. Strategic owners in particular deserved confidence. Some private owners had proved more difficult. Second, fiscal policy must have space, created through higher savings in good times, to play a counter-cyclical role in weak periods. Third, changes in legislation to deal with crises had to be rapid.

As for the future, the Governor pointed to five key developments. First, will Serbia shift to an export-oriented growth strategy? As growth rates of wages, foreign borrowing, domestic credit and privatisation revenues remain weak relative to pre-crisis rates, fiscal policy will not be able to pick up the slack. Exports must. Second, the scope for supportive monetary policy will depend on how well politicians rein in fiscal deficits in an environment of low revenue growth. Third, conditions in international capital markets will determine how close to pre-crisis levels international credit will be. Fourth, conditions in the home countries of banks operating in Serbia will be critical to foreign credit availability. Fifth, banks in Serbia need to address rising costs, especially from extensive branch networks.

Durmuş Yılmaz, Governor of the Central Bank of the Republic of Turkey, conveyed a rather upbeat message, stressing the significant challenges to the Turkish banking system during the crisis, but also the strong position of banks at the outset. In early 2008, many observers had expected the Turkish banking sector and general economy to remain decoupled from global setbacks. But Turkey, like most other emerging markets, proved unable to escape the turmoil after the Lehman collapse.

With good fundamentals, the Turkish banking system had not been badly damaged. Though the financial system had experienced exceptionally high volatility during the 1990s, the impact of the cur-

rent crisis had been “relatively limited,” and no bail-outs had been needed. In retrospect, the 2001 crisis had been a blessing, as it had prompted many key reforms. First, financial sector reforms had pushed banks into raising capital adequacy and deposit-to-loan ratios, while suppressing short foreign exchange positions and FX lending to consumers. Second, fiscal policy was constrained with ambitious primary surplus targets, allowing banks to resume their natural role of financing the corporate sector. Third, an inflation targeting (IT) monetary framework and central bank independence were put in place. Also, and critically, short-term central bank financing of the government was abolished.

Thanks to these policies, the economy and the financial sector had entered the crisis in strong positions. Thus, the rise in risk premia had been contained, Turkey had been more resistant to the crisis than its low credit ratings implied, and there had been space to ease policies.

What was done? First, relatively rapid cuts in policy rates have seen a total reduction of 1,000 basis points since September 2008 – more than in any other emerging market with an IT framework. Second, the gap between borrowing and lending rates was gradually narrowed in order to reduce fluctuations in the overnight interest rates. Third, to promote the flow of foreign exchange, the central bank acted as a blind broker in the interbank FX market, shouldering counterparty risk. Fourth, the maturity of banks’ foreign exchange borrowing from the central bank was extended, and the central bank took collateral in domestic currency. In fact, only two auctions of foreign deposits were completed, both for a small amount. Finally, foreign exchange liquidity was provided through a 200 basis point reduction in the FX reserve ratio.

Today, the average capital adequacy ratio is almost 20 percent, bank profits rose 35% in the year to Q1 2009, and the ratio of NPLs-to-total loans is only 5%. A sensitivity analysis carried out by the Central Bank indicated that even if the NPL ratio rose to 20%, the capital adequacy ratio would fall only to 12%. The Governor acknowledged Mr Hardouvelis’ concern about the costs of high capital ratios and emphasised the need to find the right balance between safety and efficiency. The Governor expected the strength of the financial sector to help extend the rebound in growth seen in Q2. Still, uncertainty about global and domestic economic prospects, excess capacity and unemployment would weigh on the recovery.

In closing, the Governor praised recent economic and financial cooperation between Greece and Turkey. Trade flows had quadrupled since 2000, and a large Greek bank now had an important presence in Turkey.

VI. Third session: Reform in the South East European economies and the role of the EU and of international institutions

This session brought together several people from international institutions and one independent academic to debate how the EU and other international institutions assess how the SEE region is coping with the crisis, how the international institutions have helped this process, and how they can continue to assist the region in the post-crisis period. The session was chaired by **Ioannis Papadakis**, Deputy Governor of the Bank of Greece.

Although the scope of the presentations was quite diverse, a number of interesting common themes emerged. Not surprisingly, most participants focused on the enhanced support available to the region from international financial institutions (IFIs). This is particularly true of the IMF, but also from the World Bank and others. But this extra support is evident not just in terms of money; there is also more flexibility in how the money is given. For example, Instrument of Pre-Accession (IPA) funds from the EU are now available for budgetary support, as part of the EU's crisis response. IFIs have also provided greater assistance for surveillance and technical support, especially in the area of banking regulation and stress-testing.

The participants proposed some explanations for the extent of the crisis in the region. There was a general consensus that credit growth in the run-up to the crisis had been too strong and that governments had often followed inappropriate pro-cyclical fiscal policies. Both of these factors had supported an unsustainable economic boom. But there was also a view that assessments of financial stability had been inadequate. The crisis has seen a significant increase in IFI soft power and in broad-based cooperation among regulatory authorities (both home and host), IFIs and the private sector. A prime example of the former is the moves towards visa liberalisation for the region adopted by the European Union during 2009. Regarding the latter, the Vienna Initiative (already discussed in other sessions) was highlighted as an important contributor to financial stability throughout the crisis.

Finally, the issue of exchange rate policy was brought up by several speakers. There was some discussion of whether a fixed or flexible exchange rate policy was more appropriate for the region's economies and whether exchange rates were sometimes overvalued.

Dimitri Demekas, Assistant Director at the IMF, gave the first presentation and discussed the lessons of the crisis for the region. He focused on four lessons in particular. First, he argued that there

had been significant pro-cyclicality, both of fiscal policy during the boom years and of financial regulation. The latter argument is based on the fact that banks' provisioning for losses during the pre-crisis period was negatively associated with profitability and GDP growth. In other words, banks implicitly believed that the good times would continue indefinitely and were therefore unprepared for the subsequent downturn. The second lesson is more positive: some countries had built strong liquidity buffers in the banking system during the crisis, and these had played an important role in preventing an even more serious crisis in the financial sector. The third lesson is that some banks had relied excessively on wholesale borrowing for financing their lending activities, rather than increasing the level of deposits, and thus were more vulnerable to the after-effects of the crisis. Finally, the fourth lesson concerns the importance of foreign-owned banks in the region and the implications for cross-border contagion.

Mr Demekas then focused his attention on how the IMF is carrying out and improving its financial surveillance programmes. The main existing surveillance instrument —the Financial Stability Assessment Programme (FSAP)— has significant drawbacks, he argued, not least the fact that it is voluntary and therefore occurs only if a country requests it. Another weakness is that stress-testing is often based on inadequate data and does not take sufficiently into account the cross-border aspects that are so important in South East Europe. Furthermore, the FSAP has been updated usually every 6-7 years; in the future, he said, there would be more frequent updates of the stability aspects of the programme.

Mr Demekas concluded by outlining some ways in which surveillance could and would be improved in the future. In general, this would involve a much greater degree of cooperation between the IMF and regulators, with the IMF focusing on "top-down" global risks and local regulators concentrating on "bottom-up" compliance with standards.

Vladimir Gligorov, Senior Economist of the Vienna Institute for International Economic Studies, focused his remarks primarily on the issue of competitiveness and the role of foreign direct investment. He pointed out that for a number of years the Central European countries enjoyed a growth model based on FDI into the tradable sectors. One of the results was high current account deficits, but this model of development was, up to a point, quite sustainable. However, in the Balkans, most FDI went instead either into services or into certain industries such as raw materials and metals. The result is a tradable sector that is quite weak and has difficulty competing in world markets. Even though the level of risk in the region has declined in recent years and even though the investment climate is not so bad, there may be stagnation ahead in the post-crisis period.

How can the international community help improve the situation? One problem that many countries have, in Mr Gligorov's view, is that they operate basically fixed exchange rates. He argued that countries in SEE should consider depreciating their real exchange rates through a nominal devaluation and that the IMF can help this process by providing the appropriate framework. But he also recognised that this would be a very difficult political decision, which may explain why some countries were reluctant to turn to the IMF. Other multilateral institutions can assist through investments in areas such as infrastructure and SMEs, while IPA funds from the EU can also play a role. In the end, however, and given

the extent of regional risks, it is going to be very difficult to shift the Balkan region towards a growth model based on export growth and higher levels of domestic saving.

Peter Grasmann, Head of Unit, DG ECFIN of the European Commission, outlined the EU's approach to SEE and the ways in which the EU tries to support SEE development. This support has three main parameters: finance, visa liberalisation and the accession anchor. He summarised the amount of financial support available for each country, acknowledging that the European Commission is not an international financial institution (although it sometimes acts like one) and that it was therefore not able to increase dramatically its funding as a crisis response. On visa liberalisation, he noted that Serbia, Montenegro and Former Yugoslavian Republic of Macedonia had satisfied the conditions (including new biometric passports) to be eligible for visa-free travel to the Schengen area, while Albania and Bosnia and Herzegovina still lagged behind. On enlargement, Mr Grasmann pointed to the worrying decline in support within the EU for taking on new members. Nevertheless, there has been progress recently in the two candidate countries from the region, Croatia (where negotiations could be concluded in 2010) and Former Yugoslavian Republic of Macedonia, with which the European Commission is now proposing the opening of negotiations.

Mr Grasmann then highlighted the massive build-up of foreign liquidity in the region, through the operations of foreign-owned, mostly EU, banks. As a result, many people have called for regulatory reform to prevent the build-up of excessive risks in the future. But there is a risk that the European Commission could overdo it. Indeed, although the risks of foreign currency mortgage lending are clear, so far there have not been large default rates on these loans. To some extent, he argued, we are operating in a "fog" and we have to hope to get it right.

The EU has stepped up its financial assistance to the region in a number of ways. First, the IPA has been beefed up, and the EU is showing more flexibility by allowing IPA funds to be used for direct budget support (in Serbia) and cooperating even more closely than before with the EBRD and EIB to create a wider investment framework in the Balkans. More generally, the EU has provided huge amounts of support in selected countries for the banking sector, including technical support for stress-testing exercises. However, the EU itself is facing major challenges in dealing with the global crisis. Therefore, Mr Grasmann concluded, if the EU wants to stabilise the region, it has to stabilise itself.

Orsalia Kalantzopoulos, Senior Advisor at the World Bank and until recently (July 2009) Director for Central Europe and the Baltic Countries, firstly summarised the World Bank's crisis-response efforts. She noted the extraordinary increase in World Bank lending to EU member states in Central Europe between 2008 and 2009 – from US$ 250 million in fiscal year 2008 to €3.3 billion in fiscal year 2009. This was mainly budget support to help mitigate the worst effects of the crisis. In particular, the World Bank has tried to help governments preserve spending on areas such as health, education and support to the unemployed. However, they have found this to be an extremely difficult task because of the large degree of decentralisation that has occurred in social services. This means that some of the World Bank's support to central governments is not trickling down to the local level.

Ms Kalantzopoulos commented extensively on the role of banks in the region and the importance of the Vienna Initiative in ensuring high rollover rates, which compare very favourably with those witnessed during the East Asian crisis in the late 1990s. However, many of the activities of these banks contributed to the risks, notably very high loan-to-deposit ratios, very high loan-to-value ratios and an over-reliance on borrowing in foreign currency. But the role of the parent banks must also be scrutinised; banks in Austria, Italy and Greece that have a significant exposure in Eastern Europe have not been properly supervised by their own central banks, according to Ms Kalantzopoulos.

The World Bank, in cooperation with other relevant institutions, is trying to address many of these problems in the financial sector. This includes finding appropriate mechanisms for winding up troubled banks, while keeping fiscal costs as low as possible, improving the supervisory powers of regulators, designing special purpose bank inspections and improving the stress-testing of banks' balance sheets. Other measures include work on improving loan accounting norms and standards, increasing the deposit-based funding of bank loans and encouraging more local currency lending, especially if the borrower's revenues are mainly in local currency. Ultimately, Ms Kalantzopoulos stressed, the crisis has shown that some people had been overly optimistic beforehand and that the glass should still perhaps be seen as half-empty rather than half-full.

Peter Sanfey, Lead Economist at the EBRD, summed up the discussion by picking out a few important themes that had arisen in one or more of the previous presentations and posing a series of questions for further debate. The most relevant ones were the following: First, how can countries put in place credible counter-cyclical policies when the good times return? Second, can the model of public-private cooperation exemplified by the Vienna Initiative be replicated in other areas? Third, how can local currency lending be encouraged? Fourth, have international institutions relaxed their policy conditionality in their lending programmes and, if so, is that a good thing? Fifth, how can EU enlargement for non-member SEE countries be kept on track, given all the problems internal to the EU? And sixth, how can the region regain the convergence path and what type of growth model will emerge in the region?

VII. Fourth session: Panel discussion on the economic and financial challenges facing South East European economies

The fourth and last session of the conference was in the form of a panel discussion moderated by **Max Watson** of Oxford University. Mr Watson opened the session by inviting the panelists to comment on those aspects of the crisis experience that they considered important and on the messages that policy makers should take away from this conference, including as regards the fiscal and monetary policy mix and broader questions about growth models.

During this session, a number of recurring themes emerged. The central bankers among the panelists generally stressed the immediate challenge of normalising conditions in the credit markets so as to reactivate the economy; and the need to proceed with an appropriate reform of banking regulation and supervision that would prevent the occurrence of another crisis while avoiding over-regulation.

Panelists generally underscored the need for structural reforms to attract FDI and support export-led growth, especially given that growth could no longer be based on domestic demand fuelled by foreign portfolio capital inflows. In light of the successful performance of the emerging economies in Asia, the suitability of the Asian model for the SEE region was an issue highlighted by one of the panelists.

There was some concern about how the correction of the fiscal imbalances and the return of interest rates to more normal levels would actually play out in the coming years. It was widely agreed that, given an uncertain outlook, risk mitigation strategies were called for, including prudent macroeconomic policies and ambitious structural reforms.

The first speaker was **Christopher Allsopp** of Oxford University. Mr Allsopp was sanguine about the prospects of a recovery in the region as well as the world economy, welcomed the fiscal policy response at the international level and thought that macro-prudential supervision/regulation could be a new and useful policy instrument.

Having come to South-Eastern Europe unprejudiced, he was struck by two things: that the situation in the region was not as bad as it had been thought just a few months ago; and that some of the policy responses had been intelligent and apparently quite effective. Developments in the region were broadly similar to developments in the rest of Europe and the rest of the world, and some of the problems were broadly similar.

The recession was likely to be V-shaped owing to the importance of the “trade shock” and the “financial stock cycle”, both of which had also been observed after the first oil crisis in the 1970s. In late 2008,

the world economy had simply fallen off a cliff in response to the trade shock, as had also been the case in late 1974, but a relatively rapid recovery was likely, as the trade cycle is linked to inventory behaviour. Also important had been the role of the budget deficits in stabilising the world economy and preparing the ground for a sustainable recovery in private spending. The sharp decline in economic activity —which entailed a massive increase in the private sector's net financial savings (savings minus investment)— had led to a large increase in public sector deficits. These deficits were the only way in which the private sector could improve its balance sheet position. Fiscal conservatives should realise that it is actually impossible to get private sectors around the world out of debt and the public sectors out of debt, simultaneously. In the Swedish crisis in the late '80s there had been a swing in the private sector financial balance of about 14-16% of GDP. Once the private sector got out of debt, it resumed spending.

As regards the balance between monetary and fiscal policy, it was very clear that fiscal authorities would want to get budget deficits under control and central banks would want to get interest rates back to more normal levels, and he was worried how that was actually going to play out. He saw no role for monetary policy in targeting asset prices, noting that monetary policy could do one job well, namely the trade-off between inflation and output stabilisation. One would hope that the new instrument of macro-prudential supervision and regulation could somehow square the circle. One of the important messages he would take from the conference was that there were serious outstanding issues about the assignment of instruments in the new environment.

Ardian Fullani, Governor of the Bank of Albania, focused his remarks on the challenges facing monetary policy in Albania, the reform of the system of bank regulation and supervision and the role of the European Commission.

For many countries in the region, this crisis meant a renewed need for balance-of-payments support from international institutions, which gave an uneasy feeling after 18 years of reforms. Nevertheless, the crisis was also providing the authorities and markets in the region, as in the rest of the world, a unique opportunity to identify problems and correct them with a view to preventing a similar crisis in the future.

The Bank of Albania has been vocal in voicing its concern regarding the impact of the international financial crisis on the Albanian economy. The risk to economic growth has increased owing mainly to a decline in bank lending. Exports had slowed down raising the trade deficit, while the inflow of remittances had declined. There was a strong need for a careful monetary policy and a responsible fiscal policy. His short-term concern was the possibility that the economic slowdown and the reduction in bank credit flows to the economy might develop into a vicious circle. The Bank of Albania would continue to inject liquidity in the interbank market and, should inflation expectations permit, might also lower the policy rate. Any decision on the policy rate would also take into account fiscal developments in the remainder of 2009 and the budget for next year.

The Bank of Albania would seek to improve the regulatory and supervisory framework —in general by aiming at enhancing clarity and simplicity through a more rules-based approach— taking into account the state of development of the banking sector, the nature of its activity and the associated risks,

as well as the international developments in this area. A more stringent supervisory approach might be adopted for some of the banks with systemic importance. To make the banking activity less pro-cyclical, the model of dynamic provisioning might be introduced, adapted to the business structure and level of technical sophistication of the banking sector. The Bank of Albania would continue to support a strong role for the domestic currency in bank lending, in part by raising the cost of foreign-currency lending that is not supported by retail saving in foreign currency. The Bank of Albania had been cooperating on issues of banking supervision with all central banks of the region over the past year and looked forward to further strengthening such cooperation.

He agreed with an earlier speaker that the European Commission should be involved more actively in the countries of the region. He added that the Commission should pay more attention to economic rather than political issues. In Albania at least, it was economics that had created problems for politics rather than vice versa.

The third speaker was **Radovan Jelašić**, Governor of the National Bank of Serbia. His remarks related mainly to the challenges facing fiscal policy, the need to reorient the policy focus from "fire-fighting" to promoting economic development and a loss of momentum in implementing banking regulatory reform.

The biggest challenge facing the countries in the region was how they would adjust to the new reality, especially from the fiscal standpoint. Serbia —much like Germany or Greece— hated to adjust, and its public debt-to-GDP ratio had risen during the first eight months of 2009 by 6.4 percentage points to 32% of GDP. It was not the level but the speed and direction of this change that was worrisome. The question was how quickly policy makers would realise that this was not sustainable and that tough decisions were called for.

Over the past year, the IMF (in cooperation with the EU, the World Bank and the EBRD) had concentrated on "fire-fighting" in the context of Serbia's precautionary arrangement with the IMF, approved in December 2008. The IMF had become "a bit timid" in applying its policy conditionality compared with earlier periods, as it had also adjusted in the meantime to the new reality. It was time to "roll up our sleeves" and focus instead on policies to foster medium- and long-term economic development. This would not be an easy task: the public was somewhat surprised that, after eight-nine years in transition, politicians were talking about restarting reforms.

Regulatory reform was lately losing momentum, definitely so in Serbia. People in Serbia had been frightened in late 2008 of the prospects for the financial sector and a pile of new laws had been drafted quickly, but these laws still waited to be passed by parliament. At the European level, he hoped that progress would be made in implementing the new ideas about cooperation between home and host banking supervisors and the new supervisory network. Time was passing fast and there was a risk that the opportunities offered by this crisis might be missed.

Max Watson (Chair), prompted by Governor Jelašić's reference to the recent weakening of the IMF's policy conditionality, recalled that in the mid-1970s the IMF had introduced the so-called

Witteveen facility (named after the then Managing Director of the IMF) and had been proud that the facility had virtually no policy conditionality. As it turned out, de Larosière —Witteveen's successor as the IMF's Managing Director in the late 1970s— found out painfully the need for programmes with strong conditionality, as the imbalances of the previous period had not really been corrected and had come home to haunt the IMF.

The fourth speaker was **Laza Kekic** of the Economist Intelligence Unit. Mr Kekic had a negative assessment of the region's economic performance and prospects and he considered that there could be lessons for the region from the successful Asian model.

South East Europe's recent economic performance was disappointing. It was worth bearing in mind that output in South East Europe was estimated to have contracted by about 5% in 2009, compared with about 6% for all the transition economies of Eastern Europe. This was a worse performance than recorded by any other emerging market region – worse not only than Asia, but also Latin America, Africa and the Middle East. The figure for South East Europe was influenced by the considerable weight of Romania, where real GDP had declined by some 7%; other countries in the Balkans had done better mainly because they were less integrated internationally and thus less exposed than the more advanced Central and East European countries to the impact of the recession in Western Europe.

Earlier speakers, he noted, had postulated a positive relationship between all forms of foreign capital inflows and growth for the specific case of Eastern Europe. This ran counter to the experience of most other emerging markets where the relationship with growth tended to be negative for portfolio and debt flows, apparently operating through the real exchange rate mechanism. He wondered why Eastern Europe should be different in this regard. He was sceptical whether the empirical evidence underpinning the thesis about an East European exception was particularly robust. For example, had the "bounceback" effect on growth after the deep transition recession of the early 1990s been properly accounted for? The answer might lie in the composition of capital inflows, as most studies in the general literature have shown a positive relationship between inflows of FDI (especially of the non-real estate type) and growth. He saw little reason why portfolio investment should have a positive impact on growth in Eastern Europe only, unlike in other regions.

As regards South East Europe's growth prospects, he agreed with Susan Schadler's "double whammy", namely the fact the economies in the region had to deal not only with a pre-crisis economic performance that had been mediocre compared to other emerging market economies, but also with the lasting negative impact from the crisis. The latter would partly reflect a weaker impulse from foreign trade in the coming years, which will have important implications given that export performance would be key to growth, irrespective of the model that was adopted in this region. There would also be a lasting negative influence from lower FDI inflows. South East Europe had suffered by far the biggest fall in FDI inflows of any emerging market region in 2009, by around 50% probably, albeit from a record high level in 2008. Whether and by how much FDI would recover was a big question mark, not least because a lot of empirical evidence had shown that FDI inflows followed, rather than initiated, growth

in an economy.

He was concerned that expenditure cuts to support fiscal adjustment could adversely affect the quality of the workforce by reducing government spending on education and health, especially since most of these countries were still low- or medium-income economies.

It had been suggested that the Asian model was irrelevant for this region and of course nobody could seriously suggest that it could be transplanted in a wholesale way. At the same time, it seemed almost absurd not to look more closely at the experience of countries that had grown by 7-8% a year for decades. Maybe economists in the region should spend some time reading Asian Development Bank reports rather than just European Commission papers.

The idea of relying on non-FDI forms of foreign savings is not a recipe for sustainable long-term growth. He could hardly think of many other statements in economics one could support with a higher degree of confidence. He was less certain, however, about what should be done about it, in particular whether the imposition of, say, particular types of capital controls or taxes on capital flows would be feasible or appropriate.

Russia's recent economic performance had been a negative surprise. An interesting lesson for South-Eastern Europe was that Russia had much smaller reliance on FDI: the share of foreign-owned companies in Russia was far lower than almost anywhere else in Eastern Europe. The oligarchs had proved to be poor capitalists. If the Balkans were run by domestic oligarchs, the region's performance would likely have resembled that of Russia's.

A key message for the economies in the region was that they needed to try to grow fast for prolonged periods. The key characteristic of these countries' identity, to be a little provocative, was not that they are European but that they are low- or medium-income economies that needed to grow fast.

Max Watson (Chair), prompted by Mr Kekic's discussion of the successful emerging economies in Asia, noted an interesting observation by an academic colleague of his: "Is it not strange that in the last decade they decided that the Feldstein-Horioka paradox could be relaxed, so that economies could run on surpluses and deficits, but it was actually the countries that exported savings that grew?" He agreed that the Asian model deserved more study.

Alexey Ulyukaev, First Deputy Chairman of the Central Bank of Russia, discussed the reform of banking regulation and supervision and the macroeconomic policy challenges facing the Russian economy:

In Russia, the financial industry was generally blamed for the crisis, and politicians were preoccupied with how to limit bankers' bonuses. However, the real problem was not the cost of the bonuses but rather the incentives that the bonuses created for taking excessive risks. It was, therefore, the structure of bankers' remuneration that mattered.

Central banks around the world shared responsibility for the crisis as they had printed too much money for 15-20 years. Regulation and supervision of financial institutions had also been relatively loose. For instance, the inclusion of so-called new innovative investment instruments into capital tier 2 and even

tier 1 had not contributed to financial stability. A good thing about the crisis was that it was now widely recognised that price stability and financial stability were just the two sides of one coin. Nobody was now talking about the need to remove the bank regulation/supervision functions from central banks.

A difficult economic environment would complicate policy implementation in the post-crisis period. The rapid growth rates of past years could not be repeated. To illustrate this, he noted that in some important respects —namely the prevailing levels of oil prices, interest rates and stock prices— the performance of the Russian economy in 2009 was quite similar to that in 2007, but the Russian economy had nevertheless grown by 7% in 2007 while it was declining by 8% in 2009. Politicians and the general public easily agreed on the need for counter-cyclical policies during the crisis because it was easy to accept fiscal deficits and a zero interest rate. But as the economy recovered, the politicians and the general public would turn against counter-cyclical policies that implied lower deficits and higher interest rates. In the case of the banks, it would be important to mandate larger capital and reserves in good times when risks were perceived to be low; otherwise, the same problems would return.

Durmuş Yılmaz, Governor of the Central Bank of Turkey, was the sixth speaker. Mr Yılmaz focused his remarks on the immediate policy challenge of supporting economic activity and employment, the medium- and long-term policy challenges of reforming the system of banking regulation and supervision and the future role of monetary policy:

An immediate policy challenge, which he considered to be the number one priority, was to stop the deterioration in the labour market and the loss of jobs. To this end, the financial industry and the policy makers (central banks and governments) needed to cooperate to help reactivate the growth process by normalising conditions in the credit markets. The governments, on their part, needed to return to fiscal discipline following the understandable and necessary fiscal expansion. The problem of high household indebtedness also had to be addressed.

The medium- or long-term challenges were related in part to theoretical issues about the market system. Up to now we had conducted our policies more or less on the assumption that the markets were perfect, implying that self-regulation was largely sufficient. The recent events proved this to be wrong, pointing to the need for strengthened regulation of financial institutions. Regulators were not smarter than the people running the private institutions, but had access to a much broader set of data and information on which to base their assessments and decisions. Regulations should be designed so as to limit excesses but without killing innovation and unduly curtailing private initiative.

Another medium-term challenge related to the change in the environment within which central banks had traditionally operated – in which only deposit money banks could have been the counterparties of central banks. The central bank of a major economy had done things which we could not have imagined. It was time to re-examine the issues of including non-bank financial institutions as counterparties and using new instruments to supply liquidity.

The central bank mandate also needed to be discussed. Price stability was the most important mandate for central banks, but recent events had demonstrated that financial stability should also be part of

their mandate. Most people agreed on this. However, there was still an outstanding question about whether central banks should have a responsibility for asset prices.

As regards the regulation/supervision of the financial system, there were two systems at present. In some countries, the central bank had the responsibility for financial stability as well as for bank regulation and supervision. In some other countries, including the UK and Turkey, the tasks of financial stability and banking regulation/supervision have been assigned to public bodies outside the central banks. In the UK such a system had been tested and it did not pass the exam. He could not predict what might happen were Turkey's arrangement also to be tested.

Panayotis Thomopoulos, Member of the Bank of Greece's Monetary Policy Council, was the last speaker. Mr Thomopoulos discussed a number of issues raised by earlier speakers in this conference, generally sounding an optimistic tone about the prospects of the SEE region:

There was a danger that the ongoing financial sector reform would result in over-regulation. As regards capital requirements, there was certainly room for raising the minimum overall capital adequacy ratios, as well as the proportion of core capital in total capital. In fact, the 6% core capital ratio had proven to be too low. However, this should be done within limits, to ensure that the return on equity in the financial sector remained high enough to attract investment, especially since cost-cutting was improving profitability in the non-financial sector. Otherwise, the end result could be a contraction of the balance sheet of the banking sector at a time when governments were asking banks to increase the flow of credit to the private sector.

Regulators should emphasise risk management —an issue that was not adequately discussed by earlier conference speakers— by, for instance, requiring banks to limit their exposure to risky products, improve internal control mechanisms and bring on their balance sheets items that were hidden off-balance sheet. These issues were being discussed at various international fora with a view to avoiding another crisis in the future. In this case too, over-regulation should be avoided.

The mood today was for over-regulation. This was in the interest of governments that needed to finance their large fiscal deficits and therefore wanted to encourage banks to buy "risk-free" government bonds, at the expense of credit to the private sector. As the excess liquidity was withdrawn from the world economy, loans to the private sector would be offered at higher real interest rates.

The prospects of the SEE economies generally seemed sound. These economies had been bottoming out after experiencing a steep decline. Moreover, inflation had fallen sharply, while the currency overvaluation had been corrected in some of these economies. Hence, these countries appeared still to have the initial advantages that had allowed them to grow fast, that is, low wages and geographical location; moreover, a few of them were already EU members, while the rest of them were under the EU umbrella, having started discussions for EU entry.

The banking sector in SEE economies should start reaping the benefits of healthier economies in the area, probably from 2011 or 2012 given certain lags. Greek banks should benefit from this. This did not mean that non-performing loans would not continue to rise for some time. However, stress tests that

were conducted in collaboration with the IMF confirmed that the Greek banking system had enough buffers to withstand even a very big rise in non-performing loans under a worst-case scenario. While no significant problems were expected, some vulnerabilities existed. For this reason, the Bank of Greece was looking at all Greek banks individually, focusing on their foreign as well as domestic operations. The big challenge for Greek banks was the Greek fiscal deficit which affected adversely their borrowing from international financial markets.

Max Watson concluded the session with remarks on the lessons from the current financial crisis and the need for the economies of South-Eastern Europe to implement risk mitigation strategies in light of an uncertain outlook:

Looking at the current global imbalances and monetary arrangements in the world – including the fact that most deficit countries still have fixed exchange rates, including the US vis-à-vis China, there was a certain déjà vu. Indeed, the variety of the panelists' projections, some of them worrying, as to where the world economy and financial markets would be in two years' time, should lead us to think that it was certainly time to implement some risk mitigation strategies.

As regards the emerging markets of South-Eastern Europe, it was pretty clear what needed to be done in the short term – especially as regards structural policies to improve the business environment. When one looked farther ahead, many of the big issues seemed to be open, including what would be done and needed to be done in policy assignment. But if we wanted to persist with transparent monetary policies —presumably with the corner solutions of inflation targeting or the adoption of the euro, a natural anchor for this region— then central bankers would have to emphasise that the fiscal, prudential and structural prerequisites for operating in that corner-solution world are more demanding than we had thought three years ago.

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He is a widely published and internationally respected specialist in the field of financial development and transition economics. His focus has been on policy-related issues in transition economies and he has regularly provided advice to national governments and international institutions, including the IMF and the World Bank.

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Mr Costopoulos is Chairman of the Board of Directors of Ionian Hotel Enterprises and a Member of the Board of the Institute of International Finance. He is also Chairman of the J. F. Costopoulos Foundation, a Member of the Board of Patrons of the European Association for Banking and Financial History, Vice-Chairman of the Benaki Museum, an Honorary Trustee of the Metropolitan Museum of Art and Chairman of the Board of Directors of the National Garden of Athens.

Dimitri G. Demekas, *Assistant Director, IMF*

Dimitri G. Demekas is Assistant Director of the Monetary & Capital Markets Department at the IMF. He is responsible for financial sector surveillance issues and helps manage the joint IMF-World Bank Financial Sector Assessment Program (FSAP). He was the principal author of the 10-year review of the FSAP, completed by the IMF Executive Board in September 2009. Prior to this assignment, he was Chief of the Southeastern Europe I Division at the IMF's European Department and the Fund's coordinator for regional issues in the Balkans. He has worked on financial sector issues in Asia and on macroeconomic issues in both Western and Eastern European countries. He has published extensively on transition economies, labour markets and the economics of post-conflict aid. In 2003, he was seconded from the IMF to work as Special Advisor to the Greek Presidency of the EU, where he covered, among other topics, EU relations with Russia and the Western Balkans. He was one of the main contributors to the Thessaloniki Agenda for the Western Balkans of June 2003. He holds a Ph.D. in Economics from Columbia University in New York and a B.A. from the University of Athens.

Eleni Dendrinou-Louri, *Deputy Governor, Bank of Greece*

Eleni Dendrinou-Louri was born in Athens. She studied at the Athens University of Economics (B.Sc. Econ., 1976), the London School of Economics (M.Sc. Econ., 1977) and the University of Oxford (D.Phil. Econ., 1986). Her research interests are in the areas of Industrial Organisation and Market Dynamics, Foreign Direct Investment and Globalisation Effects, Economics of Strategy and Sources of Growth and Structural Reform. She is Professor at the Department of Economics of the Athens University of Economics and Business since 2001.

She has worked as Assistant and Associate Professor at the same Department and as Visiting Fellow at Oxford University. She has taught, given seminars and lectures and participated at conferences in many European universities. She has worked for research projects of international organisations such as the OECD, the World Bank, CEPR, IES and the European Commission. She has published extensively

in international academic journals (such as Oxford Economic Papers, Journal of Industrial Economics, International Journal of Industrial Organization, Oxford Bulletin of Economics and Statistics, Weltwirtschaftliches Archiv, Review of Industrial Organization, Urban Studies, Regional Studies, Journal of Post Keynesian Economics) and acted as referee for many of them. She is a member of academic associations, such as the European Economic Association and the European Association for Research in Industrial Economics. She has served as deputy member of the Competition Commission.

In 2004-2008 she was the Director of the Prime Minister's Economic Office, member of the Council of Economic Experts, representative of Greece at the Economic Policy Committee of the European Commission and Deputy Coordinator of the Lisbon Strategy. Since June 2008 she is Deputy Governor of the Bank of Greece and member of the International Relations Committee (IRC) of the European Central Bank.

Ardian Fullani, *Governor, Bank of Albania*

Mr Ardian Fullani was sworn in on 28 October 2004 as Governor and Chairman of the Supervisory Council of the Bank of Albania. Before his appointment as Governor, Mr Fullani was General Manager of the Italian-Albanian Bank (2000-2004) and Deputy General Manager (1997-2000). Mr Fullani started working at the State Bank of Albania in 1985 and since 1987 served as Deputy Director of the Foreign Department. With the establishment of the Bank of Albania in 1992, he was appointed Deputy Governor and Director of the Foreign Department. He has also worked in the capacity of President of the Albanian Association of Banks, Chairman of the Institute of Banking Studies and Assistance, as well as Commissioner of the Albanian Securities Commission. On 7 June 2007, Mr Fullani was awarded by Mr Giorgio Napolitano, President of the Republic of Italy, the title "Commendatore dell'Ordine della Stella della Solidarietà Italiana" (Commander of the Star of Italian Solidarity). Mr Fullani was born on 15 January 1955 in Tirana, Albania. He holds two degrees, in Finance and Law, from the University of Tirana.

Vladimir Gligorov, *Senior Economist at the Vienna Institute for International Economic Studies (WIIW)*

Mr Gligorov, born in 1945, has been a Senior Economist at the WIIW since 1995. He holds degrees from Columbia University, New York (M.Ph., 1977) and Belgrade University (M.A., 1973). His academic interests include political economy, transformation economics and the economies of former Yugoslavia, and he has published many books and articles on related issues. Mr Gligorov was a Visiting Fellow at the Institut für die Wissenschaften von Menschen, Vienna, in 1994 (July-December); a Visiting Scholar at the Department of East European Studies, Uppsala University, Sweden, during 1992-1994; a Visiting Fellow, Centre for the Study of Public Choice, George Mason University, Fairfax, USA, during 1991-1992; a researcher at the Institute for Economic Sciences, Belgrade, during 1987-1991; a private scientist, Belgrade, during 1979-1987; an Assistant Professor, Belgrade University, during 1975-1979; and a Research Assistant, Bureau of Applied Social Research, Columbia University, New York, during 1972-1973. During 1971-1972, he held a Fulbright scholarship at the Columbia University, New York.

Peter Grasmann, *Head of Unit, DG ECFIN, European Commission*

Peter Grasmann studied economics, law and statistics at Munich University and the University of California at Berkeley. He holds a Ph.D. in Economics. Previously he worked as Lecturer at Munich University and CALTECH and later in financial services as an analyst and consultant. He joined the European Commission in 1991. He first worked on financial integration and capital movements, later on economic analysis and forecasting for the EU economy and subsequently as Head of Unit on the economic relationship with candidate and potential candidate countries. After a year of secondment to the International Civilian Office in Kosovo (UN1244), he returned to Brussels to lead a team on economic analysis of financial markets and financial stability.

Gikas A. Hardouvelis, *Chief Economist, Eurobank EFG Group*

Gikas A. Hardouvelis is Professor at the Department of Banking & Financial Management of the University of Piraeus, Greece, and Chief Group Economist and Head of Research at Eurobank EFG. He is also a Research Fellow at the Centre for Economic Policy Research in London and Head of the Academic Council of the Hellenic Bank Association. He holds a Ph.D. in Economics from the University of California, Berkeley (1983) and M.Sc. and B.A. degrees in Applied Mathematics from Harvard University (1978). He was Assistant Professor at Barnard College, Columbia University (1983-1989), Associate Professor and subsequently Full Professor at Rutgers University (1989-1993).

During 2000-2004, he served as Director of the Economic Office of the Greek Prime Minister Costas Simitis. Earlier, he was the Chief Group Economist at the National Bank of Greece (1996-2000), an Economic Adviser at the Bank of Greece (1994-1995) —where he also acted as Second Alternate to the Governor at the European Monetary Institute (precursor to the ECB)—, and Research Adviser and Economist at the Federal Reserve Bank of New York (1987-1993).

His academic work is published in several internationally renowned economic journals, including the American Economic Review, the Journal of Finance, the Review of Financial Studies, the Quarterly Journal of Economics, the Journal of Monetary Economics and the Review of Economic and Statistics. He was included in the Hall of Fame of the top-50 individual publishers worldwide in Applied Econometrics over the period 1989 to 1995. (See p. 432, in Badi H. Baltagi, "Applied Econometrics Rankings: 1989-1995", *Journal of Applied Econometrics* 1999, Vol. 14, pp. 423-441). His work on margin requirements had a crucial impact on shaping the reform of the legal framework governing US stock index futures markets.

Zbigniew Hockuba, *Management Board Member, National Bank of Poland*

Mr Hockuba, born in 1952, received his Ph.D. from the Foreign Trade Department of the Central School of Planning and Statistics in Warsaw (currently Warsaw School of Economics). He joined the Faculty of Economic Sciences, Warsaw University, in 1980, where he obtained his post-doctoral degree and became Professor of Economics in 1997. He has been teaching since then. He was a scholarship holder and visiting scholar at the Universities of Heidelberg, Konstanz (Germany), Oxford (UK) and

other universities. He has published widely, in both professional journals and more popular media.

Mr Hockuba was a Director of the Institute of Economic Sciences, Polish Academy of Sciences (1995-2005). He continued his cooperation with the Polish Academy of Sciences as Director of the Programme of Macroeconomic Monitoring of the Polish economy till 2007. He was a member of the Economic Sciences Committee of the Polish Academy of Sciences (1999-2007) and a member of the Macroeconomic Council to the Minister of Finance (2004-2005). He cooperated with various financial and industrial organisations as a member of boards of directors.

He has been awarded the Knight's Cross of the Order of Polonia Restituta. He is a winner of the Edward Lipinski prize and has been awarded a prize by the Minister of National Education for his post-doctoral thesis.

At the request of Sławomir S. Skrzypek, the President of the National Bank of Poland, Lech Kaczyński, the President of the Republic of Poland, appointed Zbigniew Hockuba to the post of the National Bank of Poland Management Board Member on 2 November 2007. Prior to that, he was an advisor to the President of the National Bank of Poland.

He is married and has one son.

Radovan Jelašić, *Governor, National Bank of Serbia*

Radovan Jelašić was born in 1968 in Baja, Hungary. In 1992 he graduated from the University of Belgrade's Faculty of Economics and went on to take an MBA at the University of Illinois, Chicago, USA.

Mr Jelašić began his banking career with Deutsche Bank in Frankfurt, where he worked for four years as a Regional Manager for Central and Eastern Europe. In 1999 he moved to McKinsey & Company Inc., working on banking projects in Germany, Poland and Bulgaria in the field of credit financing, privatisation, corporate takeover, organisational restructuring and mortgage financing.

From December 2000 to July 2003 Mr Jelašić held the position of Vice-Governor of the National Bank of Yugoslavia/Serbia, during which time he was in charge of the development and implementation of banking sector restructuring, reform of the banking supervision process, negotiations with the IMF, World Bank and EU on programmes related to the financial sector, as well as the reorganisation of the National Bank of Serbia IT Department.

On February 25, 2004, the Serbian Parliament appointed Mr Jelašić Governor of the National Bank of Serbia. He began his term of office on 1 March 2004.

Orsalia Kalantzopoulos, *Senior Advisor, Finance, World Bank Group*

Orsalia Kalantzopoulos, a Greek national, assumed her position as Senior Advisor to the World Bank's Vice-President for Financial and Private Sector Development in June 2009, during a critical period of the global financial and economic crisis. In her current role, she is supporting the Bank's overall strategy for responding to the financial crisis with a special focus on middle-income countries and the EU Member States.

From January 2008 to May 2009, Ms Kalantzopoulos served as Director for Central Europe and the Baltic Countries, where she spearheaded lending and technical cooperation programmes for eleven advanced middle-income economies — ten EU member countries and Croatia. During this period, she revived dialogue with countries with declining portfolios, delivered large reform-linked budget support operations in countries hit by the global financial crisis and strengthened the World Bank's partnership with European institutions. Most recently, she developed a multi-donor trust fund to finance technical cooperation activities for EU member countries.

Prior to that, Ms Kalantzopoulos was the Country Director and Regional Coordinator for South East Europe for five years, where she was in charge of the Bank's country relations and policy dialogue, programmes and projects in Albania, Bosnia and Herzegovina, FYROM, Montenegro, Serbia and Kosovo and coordinated the Bank's South East Europe regional agenda with the European Commission. During Ms Kalantzopoulos' five year tenure in South East Europe, the Bank developed effective programmes across countries and sectors and implemented regional programmes in environment, energy, communicable diseases, education, secondary roads, railroads and climate adaptation.

Ms Kalantzopoulos started her career at the World Bank in 1984 as an Economist in the Trade Policy Division of the Development Research Department and in 1985 was selected as a member of the 1986 World Development Report core team on Trade and Pricing in Agriculture. Between 1986 and 1993, Ms Kalantzopoulos had successive assignments as Sector Economist and Senior Country Economist for countries in Francophone Africa and South Asia Regions. In May 1993, Ms Kalantzopoulos was selected as Assistant to the Managing Directors in the Executive Offices and following the 1995 Presidential transition she was promoted to Advisor to the Managing Director for Operations and Strategy. In 1997, Ms Kalantzopoulos was selected as Country Director for the Caribbean, in the Latin America and Caribbean Region. During her five-year tenure in the Caribbean, Ms Kalantzopoulos re-established the country dialogue and lending with all Caribbean client countries and initiated the Caribbean Regional Disaster Mitigation Program supported by an innovative multi-country lending instrument – the horizontal Adjustable Program Loan, now used across the Bank.

Ms Kalantzopoulos holds a Ph.D. in Economics from the University of Pennsylvania, where under Nobel Laureate Professor Lawrence R. Klein she wrote a dissertation on International Trade and Econometrics applied to the multi-country Project Link. She also holds two Master's degrees in Regional Development as well as Economic Theory from the University of Pennsylvania. She graduated *magna cum laude* in Economics from the Athens School of Economics. Prior to joining the Bank, Ms Kalantzopoulos was a fellow in the Economics Research Unit at the University of Pennsylvania, an Economist at the United Nations Secretariat and a Senior Economist with General Motors Corporation. She is fluent in English, French, Greek and Spanish.

Ms Kalantzopoulos is married to Christos Mastroyannis MD, and they have two sons —Alexander and Philippe— both students at Yale University.

Laza Kekic, *Regional Director, Economist Intelligence Unit*

Laza Kekic heads the Economist Intelligence Unit's largest regional team of analysts who provide economic, political and business coverage for Eastern Europe, including the former Soviet Union. He also heads the Country Forecasting Services, which include the Economist Intelligence Unit's main traditional product, the Country Reports, as well as the Country Forecasts (medium and long-term forecasts for 82 countries aimed at direct investors). Areas of main specialisation and interest are: Russia, the Balkans and other transition economies, foreign direct investment, economic forecasting, growth economics. Mr Kekic has written extensively for the Economist Intelligence Unit and other outlets on these topics. He is also a frequent speaker at Economist and other conferences and seminars. Laza was educated at the London School of Economics (B.Sc. and M.Sc. Econ.) and joined the Economist Intelligence Unit in 1993.

Paul Mylonas, *Chief Economist, National Bank of Greece*

Paul Mylonas is currently Chief Economist of the Group, General Manager Strategy and Research, and Head of Investor Relations at the National Bank of Greece. He is Secretary of the Executive Committee and a member of the ALCO Committee of the Bank. From 1995-2000, he held the position of Senior Economist in the Economics Department of the OECD, where he worked in the Money and Finance Division, and was head of the Greek and Spanish desks. He also served as the OECD representative on the G10 Secretariat during 1999-2000. Prior to that, he worked at the International Monetary Fund (1987-1995). There, as a Senior Economist, he was the desk officer for Poland in the European Department. He also worked in the Fund's Policy Development and Review Department. From 1985-1987, he was Visiting Assistant Professor at the Department of Economics of Boston University. He holds a Ph.D. and M.A. in Economics (Princeton University) and a B.Sc. in Applied Mathematics – Economics (Brown University).

Ioannis Papadakis, *Deputy Governor, Bank of Greece*

Ioannis Papadakis was born in Alexandria, Egypt. He studied at the Athens University of Economics (B.A. Econ., 1970) and the Clark University of Massachusetts (Ph.D. Econ., 1973). His research interests are in the areas of Monetary Policy and Banking. He is Associate Professor at the Department of Economics of Athens University.

Professor Papadakis has served in several high-level positions in Greece and abroad. He started his career in Athens as Head of the Division of Monetary Policy (1975-1981) of the Foundation for Economic and Industrial Research (IOBE) and subsequently was IOBE's Deputy Director General (1981-1987). During 1989-1992 he served as Chairman of the Council of Economic Advisors of the Ministry of National Economy and was member of the Monetary Committee of the European Community. In 1992-1994 he served as Alternate Executive Director and member of the Executive Board of the International Monetary Fund (IMF) in Washington D.C. Upon his return to Greece, he

became member of the Scientific Board of the Hellenic Bank Association (1995-2001). He was subsequently appointed Economic Advisor of Geniki Bank (2001-2004) and Administrative Advisor of Emporiki Bank (2004-2007), in both cases contributing with his expertise to the restructuring effort and ultimately the privatisation of these banks. In 2007 he was appointed member of the Monetary Policy Committee of the Bank of Greece and in 2009 he became Deputy Governor of the Bank. At present, he is also member of the Economic and Financial Committee (EFC) of the European Union, Alternate Governor of the IMF and member of the Economic Policy Committee (EPC) of the OECD.

Cristian Popa, *Deputy Governor, National Bank of Romania*

Cristian Popa (born in 1964) is Deputy Governor of the National Bank of Romania (NBR). In this capacity, he coordinates monetary and exchange rate policy, research, publications, econometric modelling and forecasting, European integration and international relations. His responsibilities include advising government on behalf of the NBR on external sovereign debt issuance and the ratings agency dialogue. Dr Popa is also Vice-President of the NBR Monetary Policy and Supervision Committees and a member of its Board of Administration. He heads the NBR task force responsible for inflation targeting, and additionally serves as Alternate World Bank Governor for Romania, as well as representing the NBR International Relations Committee of the ECB/ESCB, in the Economic and Financial Committee and serving as accompanying person/alternate to the NBR Governor in the ECB General Council. Dr Popa is a member of the editorial boards of the Romanian Journal of European Affairs and Oeconomica, member of the Administrative Board of New Europe College Bucharest and an honorary member of the Board of Directors of the Romanian Academy's Institute for Economic Forecasting. Dr Popa joined the NBR in 1998, as Senior Advisor to the Governor and Chief Economist. He was previously active in research (between 1991 and 1998, he was Senior Research Fellow with the Institute of National Economy in Bucharest) and government (in 1993-4, Governmental Advisor to the Deputy Prime Minister in charge of Economic Reform; also, Director of Macroeconomic Policy Coordination within the Department of Economic Reform of the Romanian government). He completed a first mandate as NBR Deputy Governor in 1998-2004. Dr Popa has been Fulbright Fellow with Harvard University (1994-5), ACE-PHARE Visiting Fellow with the NIESR (London, 1997), and Visiting Scholar with the University of Michigan (Ann Arbor, MI, 1997). He has lectured at, among others, Harvard University, the London School of Economics, the London Business School, the Royal Institute of International Affairs (Chatham House), St. Mary's College of Maryland, the Oesterreichische Nationalbank, the Economic Planning Agency of Japan and the Global Forum (Tokyo), as well as the Basque Country University.

Dr Popa is the author of numerous papers focusing on monetary policy, international trade, inflation, exchange rates, financial indiscipline, privatisation, banking system reform and other issues pertaining to emerging and developed economies.

George A. Provopoulos, *Governor, Bank of Greece*

Mr Provopoulos holds a Bachelor's degree in Economics from the University of Athens, and an M.A. and a Ph.D. in Economics from the University of Essex. He was Associate Professor at the University of Athens from 1979 to 2007, Deputy Governor of the Bank of Greece from 1990 to 1993 and held various top executive positions in commercial banks from 1994 to 2008 (Economic Adviser at Alpha Bank, CEO at Emporiki Bank, Vice-Chairman and Managing Director at Piraeus Bank), before becoming Governor of the Bank of Greece in June 2008. In the latter capacity, he is currently also a member of the Governing Council of the ECB and Governor for Greece at the IMF.

Peter Sanfey, *Lead Economist, EBRD*

Peter Sanfey is a Lead Economist within the Office of the Chief Economist at the European Bank for Reconstruction and Development (EBRD) in London. His main responsibilities lie in the analysis of transition in Southeastern Europe (SEE), with a focus on the Western Balkans, and in research and publications on a range of topics covering the whole transition region. He also contributes to the Bank's economic analysis of selected EBRD investment projects in SEE. He was lead editor and co-author of Chapter 1 of the EBRD Transition Report 2008, published in November 2008, and he is the editor of the EBRD Working Paper series.

Dr Sanfey graduated from Trinity College, Dublin, in 1985 with a B.A. (first class honours) in Economics and received his Ph.D. in Economics from Yale University in 1992. He was a Lecturer in Economics at the University of Kent at Canterbury from 1992 to 1997, teaching courses mainly in the fields of macroeconomics and labour economics, before joining the EBRD in October 1997.

Dr Sanfey's main research interests are in the fields of transition economics, macroeconomics and labour economics. He was the lead author of a 2004 EBRD publication "Spotlight on Southeastern Europe: an Overview of Private Sector Activity and Investment". More recently, he co-authored another EBRD monograph "Life in Transition: an Overview of People's Experiences and Attitudes", published in 2007. He has published many articles in international refereed journals. His recent publications have covered the link between reforms and growth in transition countries, the interaction between subjective measures of individual well-being and progress in transition, and the causes and effects of informal activities.

Dr Sanfey has recently co-authored (with Christopher Cviić) a book entitled "Southeastern Europe: From Conflict to Cooperation". The book was published in 2008, in Croatian translation, by Novi Liber publishers in Zagreb, Croatia; a revised and updated version (in English), with the title "In Search of the Balkan Recovery: the Political and Economic Re-emergence of Southeastern Europe", will be published by C. Hurst & Co. Publishers.

Susan Schadler, *Oxford University, former Deputy Director, IMF*

Susan Schadler, currently a Senior Member of St Antony's College and Senior Research Fellow at Chatham House, is involved with a variety of projects on financial crises in Central and Eastern Europe

and issues of global economic governance. Until 2007, she was Deputy Director of the European Department of the IMF, guiding the IMF's work on Emerging Europe. Since leaving the IMF, she has consulted with a number of international organisations, governments and central banks. While at St. Antony's, she is writing a book on the history of financial crises in Turkey and the role of the global financial architecture in molding resolutions.

Panayotis Thomopoulos, *Member of the Monetary Policy Council, Bank of Greece*

Mr Thomopoulos has studied at the London School of Economics and Political Science (B.Sc. Econ., 1960; M.Sc. Econ., 1962) and at the Université de Paris-I (DEA, 1971). Since April 2009, he has been a member of the Monetary Policy Council of the Bank of Greece. During 1994-2009, he was Deputy Governor of the Bank of Greece. He was also a member of the Economic and Financial Committee (EFC) of the European Union (2002-2008); Alternate Governor of the International Monetary Fund (IMF) for Greece (2002-2008); a member of the International Relations Committee (IRC) of the European Central Bank (2000-2008); and a representative of the Bank of Greece in the Economic Policy Committee (EPC) of the OECD (1995-2008). Together with the Governor of the Bank of Greece, he participated in the meetings of the Governing Council (2000-2002), the General Council (1998-2002) of the ECB and, during 1994-1998, in the Council of the European Monetary Institute (EMI) and in the Committee of Alternates of the EMI.

During 1966-94, Mr Thomopoulos worked at the Economics Department (ECO) of the OECD, being responsible for the OECD's Annual Economic Surveys and for the forecasts published in the biannual OECD's Economic Outlook for selected European countries (United Kingdom, Belgium, Spain, Greece, Ireland, Luxembourg and Yugoslavia).

Mr Thomopoulos has been Chairman of the Board of Directors of the Interbanking Systems S.A. (DIAS) since February 1996; member of the Board of Governors of the Public Debt Management Agency since August 1998; and member of the Board of Directors of the Foundation for Economic and Industrial Research (IOBE) since 1995. He was also Chairman of the Committee assigned with the task of submitting recommendations for the restructuring and modernisation of the institutional framework regarding Social Security Funds' investment portfolios (August 2006-March 2007); member of the Board of Directors for the management of the Relief Account for Fire Victims (September 2007); Chairman of the Organising Committee for the Olympic Games Athens 2004 S.A. (July 1999-May 2000); member of the Board of Directors of the Athens International Airport El. Venizelos (1995-2000); member of the Board of Directors of the Alexander S. Onassis Public Benefit Foundation (1992-1995); and member (1995-1998) and Advisor to the Council of Economic Advisors of the Ministry of Economy and Finance (1998-2004). He has published books and articles on economic subjects.

Alexey V. Ulyukaev, *First Deputy Chairman, Bank of Russia*

Alexey Ulyukaev has had a distinguished administrative and academic career. Prior to his appointment as First Deputy Chairman of the Bank of Russia in April 2004, he was First Deputy Minister of Finance of the Russian Federation, head of the Group of Advisors to the Prime Minister of the Government of the Russian Federation, having held before that the posts of Economic Advisor to the Government of the Russian Federation and Assistant to the First Deputy Chairman of the Government of the Russian Federation.

Graduate of the Moscow State University in Economics, he earned his Doctor's degree in Economics in Moscow and his Ph.D. (Economics) at the University Pierre Mendes France in Grenoble. His academic career includes positions of Professor of Economics as well as Deputy Director of the Institute of Economy in Transition.

Max Watson, *Oxford University*

Max Watson is a Visiting Fellow at St. Antony's College and coordinator of the Political Economy at SEESOX programme. Prior to joining SEESOX he was a Senior Adviser on economic and financial affairs at the European Commission. He was formerly a Deputy Director of the IMF, where he was Mission Chief for Croatia, Hungary, Italy, Romania and Spain, among others, in the 1990s; Head of the International Capital Markets Division and the Debt Issues Unit in the 1980s; and, earlier, Personal Assistant to Managing Director de Larosière. His early career was spent in the Bank of England, where he worked on international economic issues and banking supervision, serving as Secretary of the International Conference of Bank Supervisors, and Secretary of the EU Supervisors Groupe de Contact. In the late 1970s he was a manager in the International Corporate Finance Department of S.G. Warburg & Co. He was educated at Cambridge and INSEAD, and is a Fellow of the UK Institute of Financial Services. Mr Watson has co-organised a number of workshops in Oxford on economic developments in the Balkans and on the Cyprus problem. His recent research and publications are mainly on these topics and also on the functioning of the euro area.

Durmuş Yılmaz, *Governor, Central Bank of the Republic of Turkey*

Born in Uşak in 1947, Mr Yılmaz obtained his B.A. in Economics from the City University of London and his M.A. degree from the University College, University of London. Mr Yılmaz started to work in the Foreign Exchange Department at the Central Bank of Turkey in 1980. He worked in the areas of Foreign Debt Rescheduling, Exchange Rates and Foreign Exchange Reserve Management. He became Deputy Director of the Foreign Exchange Transactions Division in 1993, Director of the Interbank Money Market Division in 1995 and Director of the Balance of Payments Division in 1996. Mr Yılmaz was promoted to Deputy Executive Director at Markets Department in 1996 to supervise Foreign Exchange Risk Management, Credits, Foreign Exchange and Foreign Banknotes Markets and Open Market Operations. He was appointed Executive Director of the Workers' Remittances (Non-

Residents FX Deposits) Department in 2002. Mr Yılmaz was elected member of the Board in the Shareholders Ordinary General Meeting held on 7 April 2003. Having served as Board member between May 2003 and April 2006, Mr Durmuş Yılmaz was appointed Governor of the Central Bank of the Republic of Turkey on 18 April 2006.

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