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Monetary Policy in a Non-euro EU Country. Challenges and Opportunities

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Agenda

- Non-euro EU countries are here to stay
- They have formal independence but limited autonomy (UK is an exception?) because of strong economic ties with the EA
- Recent experience - financial globalization and general economic interdependence – show limits to this autonomy. Imported financial and economic conditions limit the formal independence given by short-term interest rate and floating exchange rate
- Globalization and further stages of integration (banking union, capital market union etc.) as a challenge; national regulatory autonomy as an opportunity.

I

Non-euro EU countries are here to stay

Non-euro EU countries are here to stay

- Euro crisis as a game changer in our thinking about viability criteria of currency unions and pre-conditions for euro accession
 - Recent crisis as a major asymmetric shock – painful adjustment due to limited labor mobility and lack of fiscal transfer exacerbated by the sovereign-bank nexus and market perception of no (limited) lender of last resort for EA sovereigns
 - Serious needs of major institutional reforms in the EA: Strengthened fiscal coordination and banking union are most advanced but it is too early to say whether it will be enough (no serious tests thereof as yet)
 - Crisis as a definite proof that the Maastricht criteria are not enough to guarantee a success of euro accession as they seem not to have done for countries already in

II

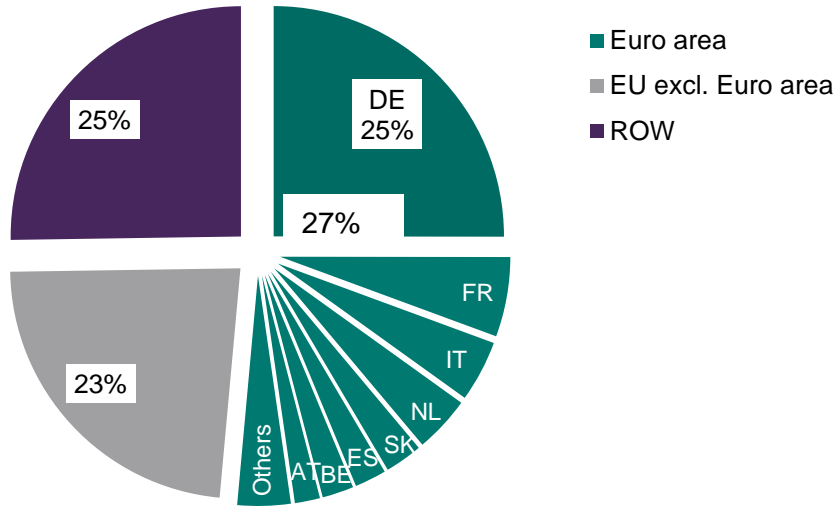
Limited independence: Strong Economic Ties with the Euro Area and Financial Globalization

(Limited) Independence

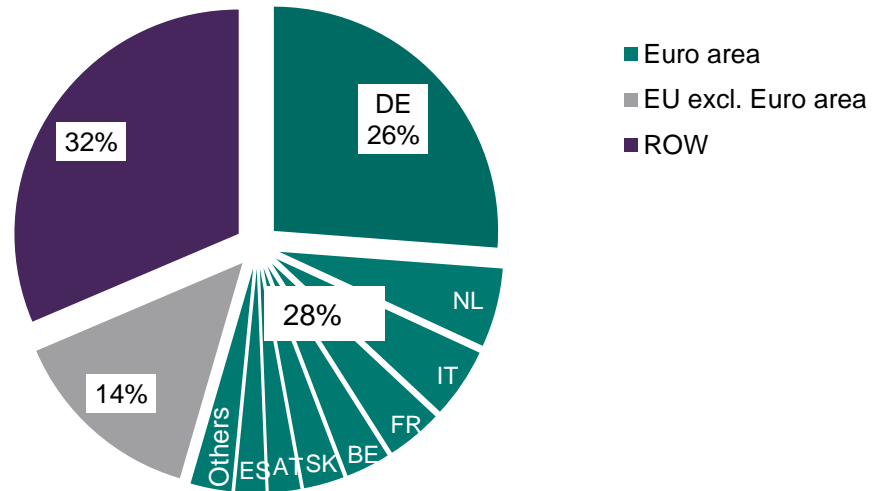
- Free choice of exchange rate regime
- Formally independent monetary policy (at least for those countries that have more flexible regimes) ...
- ... but liberalized capital flows
- and strong economic ties with the EA limit substantially this independence

The Polish economy has strong trade linkages with the euro area member states...

Export shares (2013)



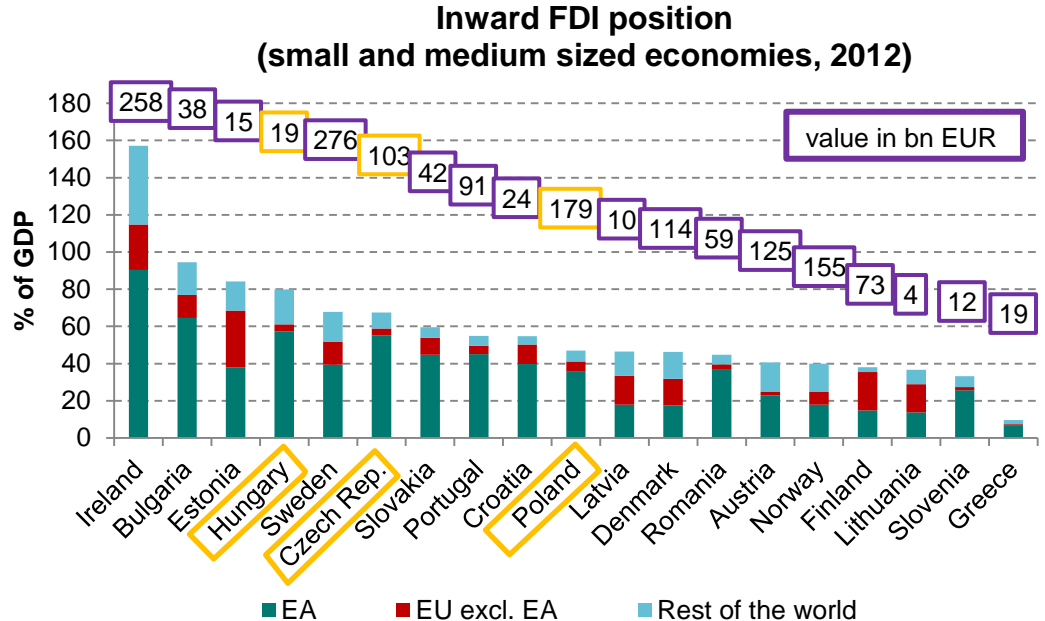
Import shares (2013)



Source: Eurostat, NBP calculations.

... supported by large inflows of FDI from the EA

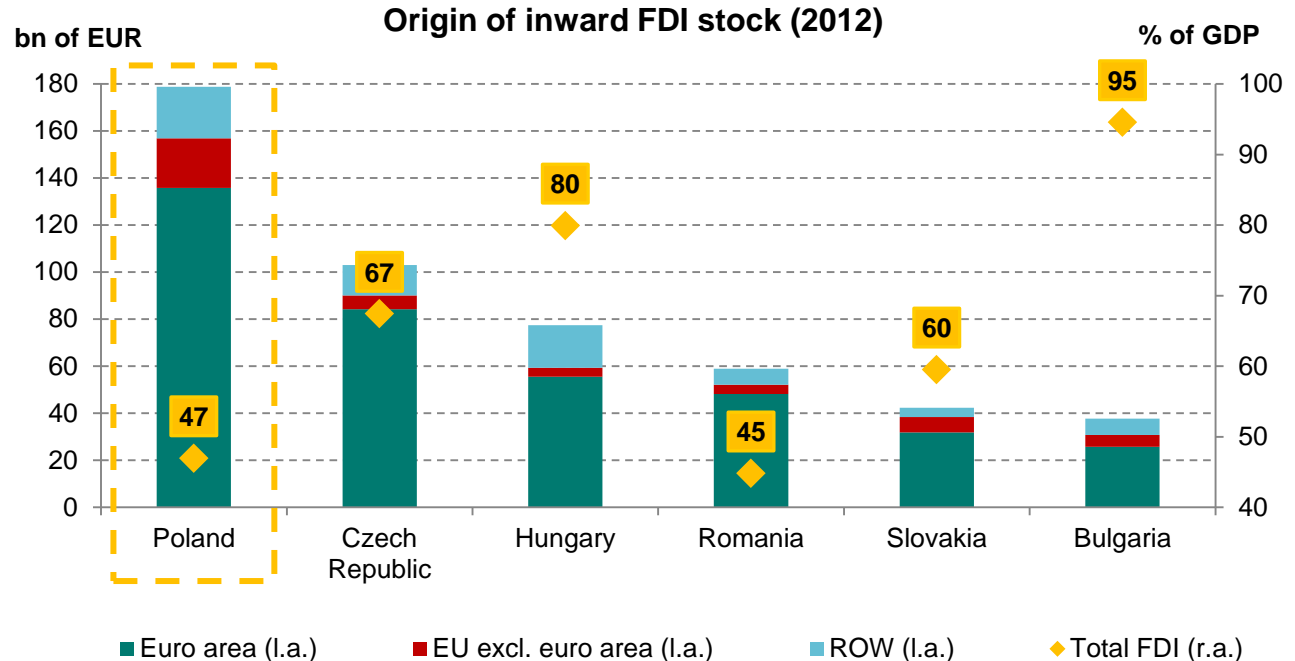
- Stock of inward FDI represents about 46% of GDP in PL, 67% in CZ and 80% in HU.
- Around 85% percent of this stock originates from Europe.



Source: Eurostat, NBP calculations.

...supported by large inflows of FDI...

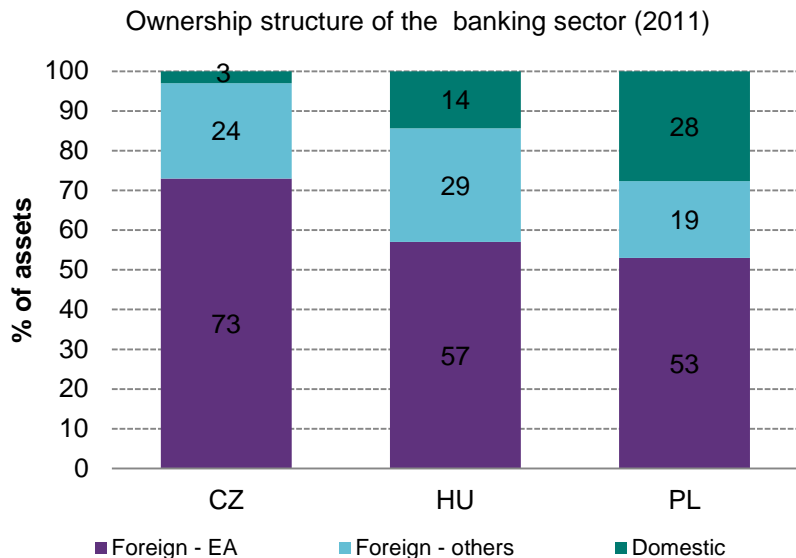
- More than **90% of FDI** stock originates from the European Union.
- Poland is ranked **14th in the top** prospective host destinations for 2013-15 in the UNCTAD survey (the highest position among NMS).



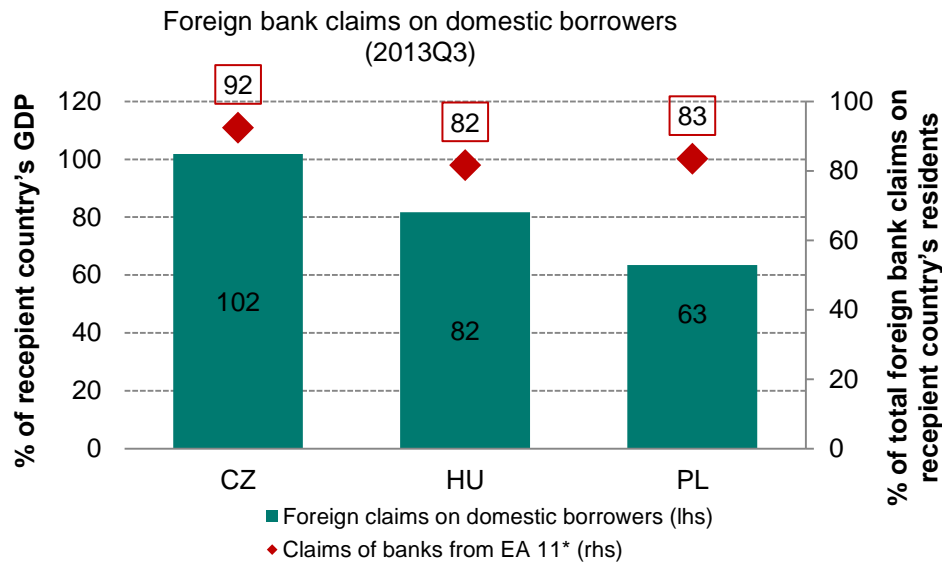
Source: Eurostat, NBP calculations.

Other financial linkages between the CEE-3 and the euro area are also very strong

Both due to the ownership structure of the banking sector...



...as well as due to the importance of bank funding from EA for CEE-3 public and private borrowers



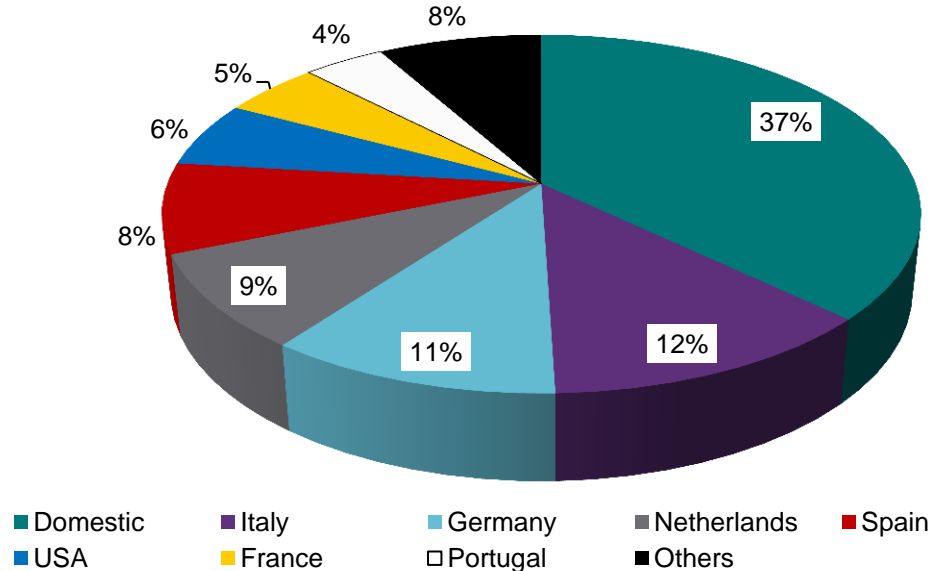
Source: BIS.

* EA 11: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Portugal, Spain

Apart from trade linkages, Poland is also strongly connected to the euro area through the banking sector.

- Polish banking system is **largely foreign-owned**.
- Foreign claims of BIS reporting banks in Poland amount to **63% of Polish GDP**:
 - **83% of these claims** consist of: assets of **foreign European banks'** subsidiaries and cross-border funding from European banks.

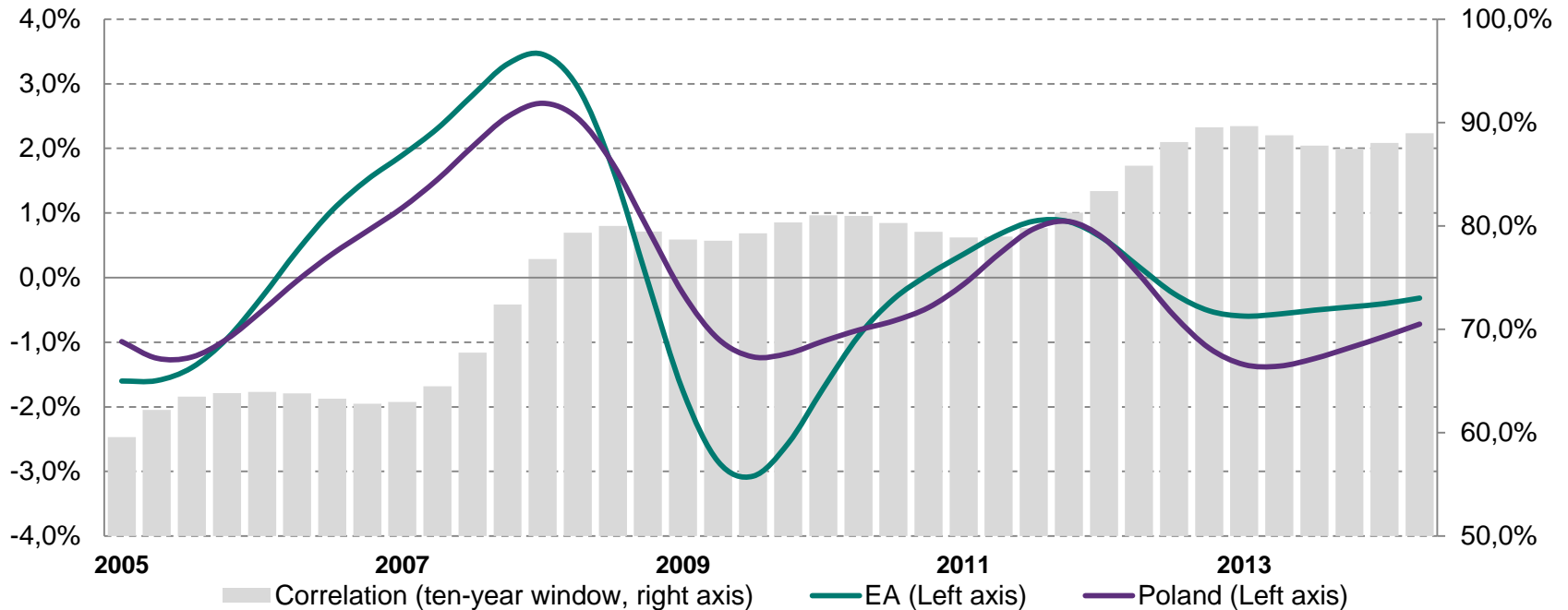
Ownership structure of the Polish banking sector in 2013 (per cent of assets)



Source: Polish Financial Supervision Authority.

Summary: Economic synchronization of Poland and EA is high

Cyclical Components of Real GDP and Their Correlation: EA and Poland



III

Financial Globalization

Liability	Equity						FDI						Debt						Credit									
Flows	N.Am.	LatAm	CE.EU	W.EU	Em.Ar.	Asia	Africa	N.Am.	LatAm	CE.EU	W.EU	Em.Ar.	Asia	Africa	N.Am.	LatAm	CE.EU	W.EU	Em.Ar.	Asia	Africa	N.Am.	LatAm	CE.EU	W.EU	Em.Ar.	Asia	Africa
Equity N.Am.	1.00																											
Equity LatAm	0.39	1.00																										
Equity CE.EU	0.52	0.49	1.00																									
Equity W.EU	0.63	0.35	0.50	1.00																								
Equity Em.Ar.	0.37	0.24	0.38	0.47	1.00																							
Equity Asia	0.24	0.31	0.38	0.40	0.31	1.00																						
Equity Africa	0.41	0.33	0.36	0.55	0.34	0.26	1.00																					
FDI N.Am.	0.54	0.06	0.07	0.45	0.53	-0.07	0.33	1.00																				
FDI LatAm	0.41	0.10	0.08	0.29	0.32	-0.07	0.04	0.68	1.00																			
FDI CE.EU	0.46	0.11	0.08	0.18	0.23	-0.12	0.09	0.61	0.65	1.00																		
FDI W.EU	0.57	0.21	0.19	0.38	0.35	0.21	0.16	0.61	0.79	0.75	1.00																	
FDI Em.Ar.	0.47	0.24	0.16	0.34	0.36	-0.04	0.04	0.65	0.77	0.69	0.64	1.00																
FDI Asia	0.36	0.16	0.08	0.29	0.30	-0.17	0.05	0.60	0.70	0.57	0.51	0.69	1.00															
FDI Africa	0.33	0.01	0.10	0.18	0.03	-0.16	-0.19	0.31	0.36	0.35	0.35	0.34	0.37	1.00														
Debt N.Am.	0.42	0.17	0.32	0.51	0.39	0.21	0.31	0.40	0.39	0.55	0.51	0.48	0.37	0.08	1.00													
Debt LatAm	0.30	0.40	0.33	0.16	0.13	0.00	-0.05	0.16	0.35	0.13	0.05	0.31	0.26	0.06	0.10	1.00												
Debt CE.EU	0.37	0.42	0.50	0.43	0.13	0.17	0.19	0.14	0.35	0.14	0.13	0.47	0.21	0.04	0.37	0.52	1.00											
Debt W.EU	0.49	0.05	0.33	0.50	0.23	0.27	0.47	0.29	0.30	0.44	0.37	0.25	0.02	0.10	0.58	-0.13	0.28	1.00										
Debt Em.Ar.	0.40	0.58	0.45	0.35	0.20	0.23	0.20	0.13	0.24	0.25	0.17	0.35	0.35	0.02	0.32	0.38	0.53	0.14	1.00									
Debt Asia	0.16	0.18	0.34	0.23	0.16	-0.04	0.16	0.35	0.31	0.30	0.30	0.45	0.36	0.14	0.45	0.37	0.42	0.19	0.39	1.00								
Debt Africa	0.26	0.27	0.39	0.18	0.07	0.14	0.09	0.13	0.21	0.10	0.01	0.41	0.21	0.07	0.21	0.46	0.61	0.15	0.44	0.32	1.00							
Credit N.Am.	0.29	-0.02	0.21	0.38	0.15	-0.05	0.32	0.20	0.02	0.19	0.20	0.12	0.09	0.04	0.37	0.14	0.23	0.25	0.23	0.25	0.03	1.00						
Credit LatAm	0.41	0.34	0.21	0.26	0.12	0.04	0.22	0.38	0.35	0.42	0.27	0.48	0.35	0.24	0.35	0.25	0.41	0.30	0.29	0.46	0.28	0.22	1.00					
Credit CE.EU	0.42	0.25	0.37	0.28	0.32	0.15	0.21	0.54	0.38	0.73	0.55	0.47	0.36	0.28	0.54	0.14	0.13	0.56	0.25	0.48	0.12	0.17	0.55	1.00				
Credit W.EU	0.19	-0.03	0.24	0.31	0.19	-0.05	0.26	0.27	0.08	0.20	0.30	0.19	0.13	0.15	0.45	0.20	0.25	0.33	0.26	0.45	0.16	0.63	0.30	0.34	1.00			
Credit Em.Ar.	0.25	0.54	0.39	0.21	0.10	0.16	0.05	0.33	0.16	0.30	0.29	0.38	0.34	0.00	0.40	0.31	0.33	0.15	0.56	0.51	0.27	0.24	0.45	0.48	0.28	1.00		
Credit Asia	0.08	-0.03	0.00	-0.01	0.00	-0.40	-0.12	0.33	0.23	0.33	0.24	0.31	0.23	0.25	0.33	0.18	0.17	-0.01	0.13	0.37	0.08	0.43	0.35	0.23	0.52	0.37	1.00	
Credit Africa	0.11	0.06	0.01	0.15	0.01	-0.20	0.12	0.40	0.30	0.35	0.33	0.24	0.37	0.18	0.32	0.11	0.06	0.13	0.03	0.34	-0.02	0.24	0.30	0.40	0.36	0.30	0.31	1.00

Figure: Gross inflows, all asset classes (FDI, debt, equity, bank credit), by geographical areas (North America, Western Europe, Latin America, Central and Eastern Europe, Asia, Emerging Asia, Africa). Green (Red) denote positive (negative) correlations. Source: Rey (Jackson Hole (2013))

Financial globalization

- Rey (2014) shows e.g. that the US monetary policy affects credit spreads and risk premia globally and affects leverage and credit flows internationally (including European banks)
- Obstfeld (2014) shows that exchange rates do not offset fully financial shocks
- Schoenmaker (2013) says bluntly that under any exchange rate regime the following three are not all mutually compatible:
 - 1. Financial stability.
 - 2. Nonintervention in cross-border financial flows.
 - 3. National control over financial supervision and regulation.

IV

Challenges and Opportunities

Challenges ...

- Maintaining both price and financial stability
- Continuing real convergence to the euro area
- Persuading large advanced economies to take into account spillovers effects of their policies

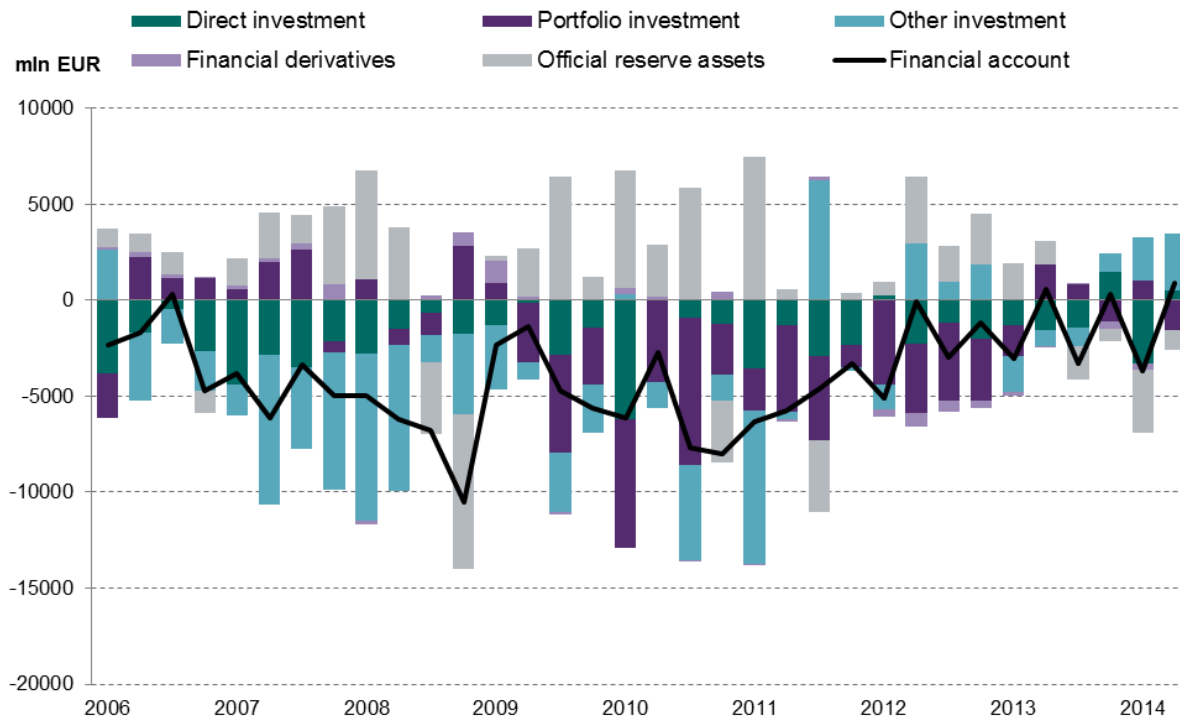
... and Opportunities

- Sound macroeconomic policies (both monetary and fiscal)
- Active macroprudential policy
- (Possible) enhancement of international liquidity support (extension of swap lines)

Poland as a successful case:

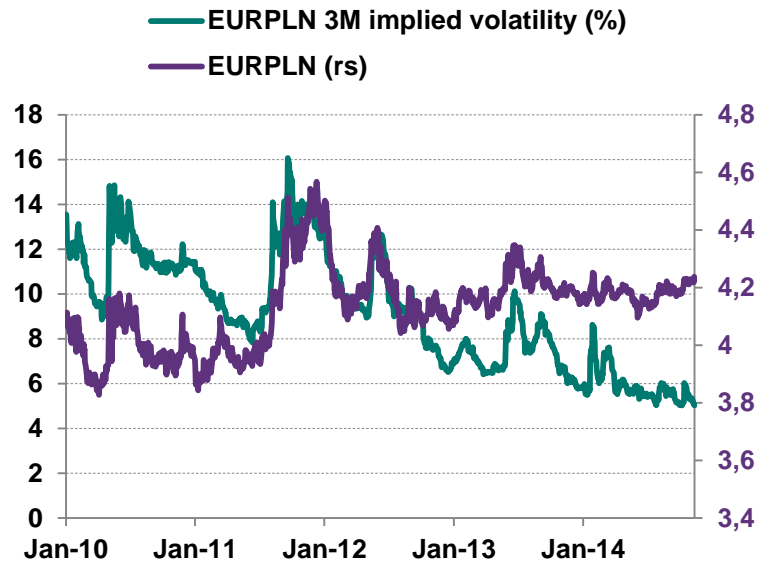
Substantial capital inflows with no asset price bubbles

Net capital flows to Poland

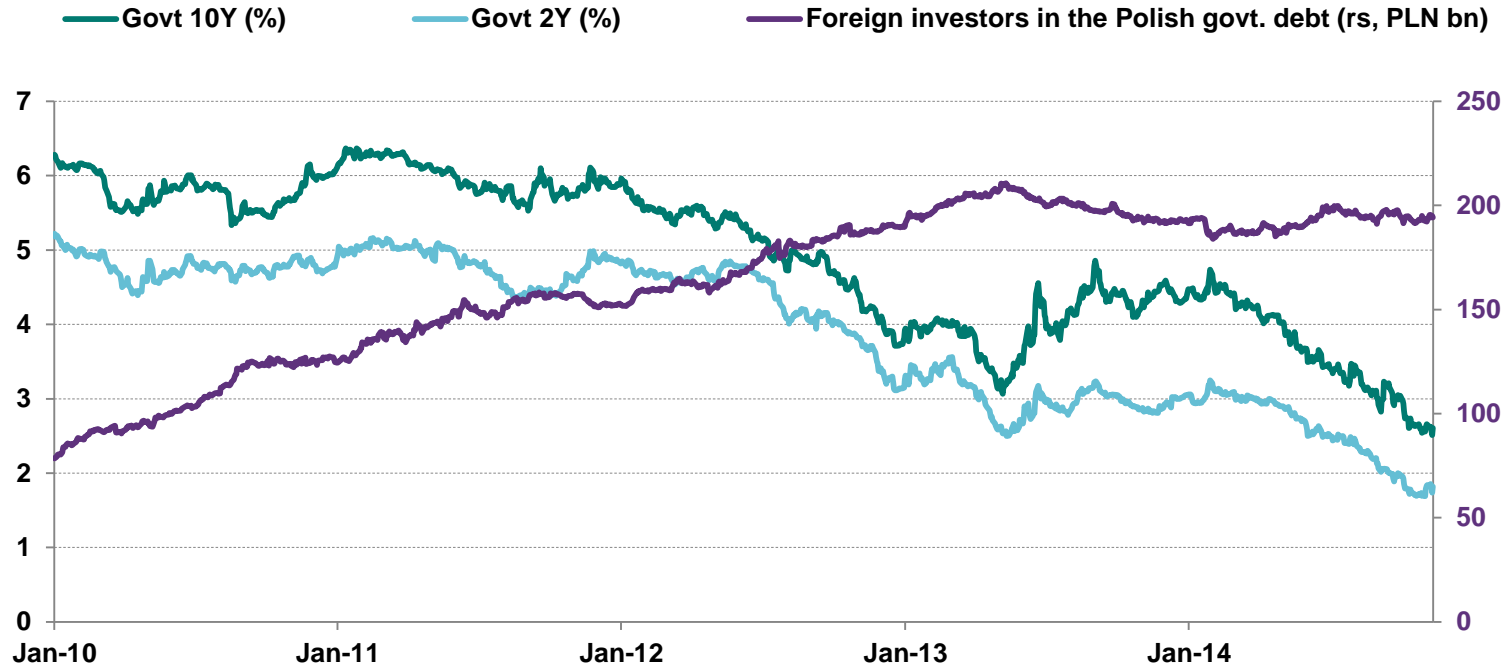


Source: NBP

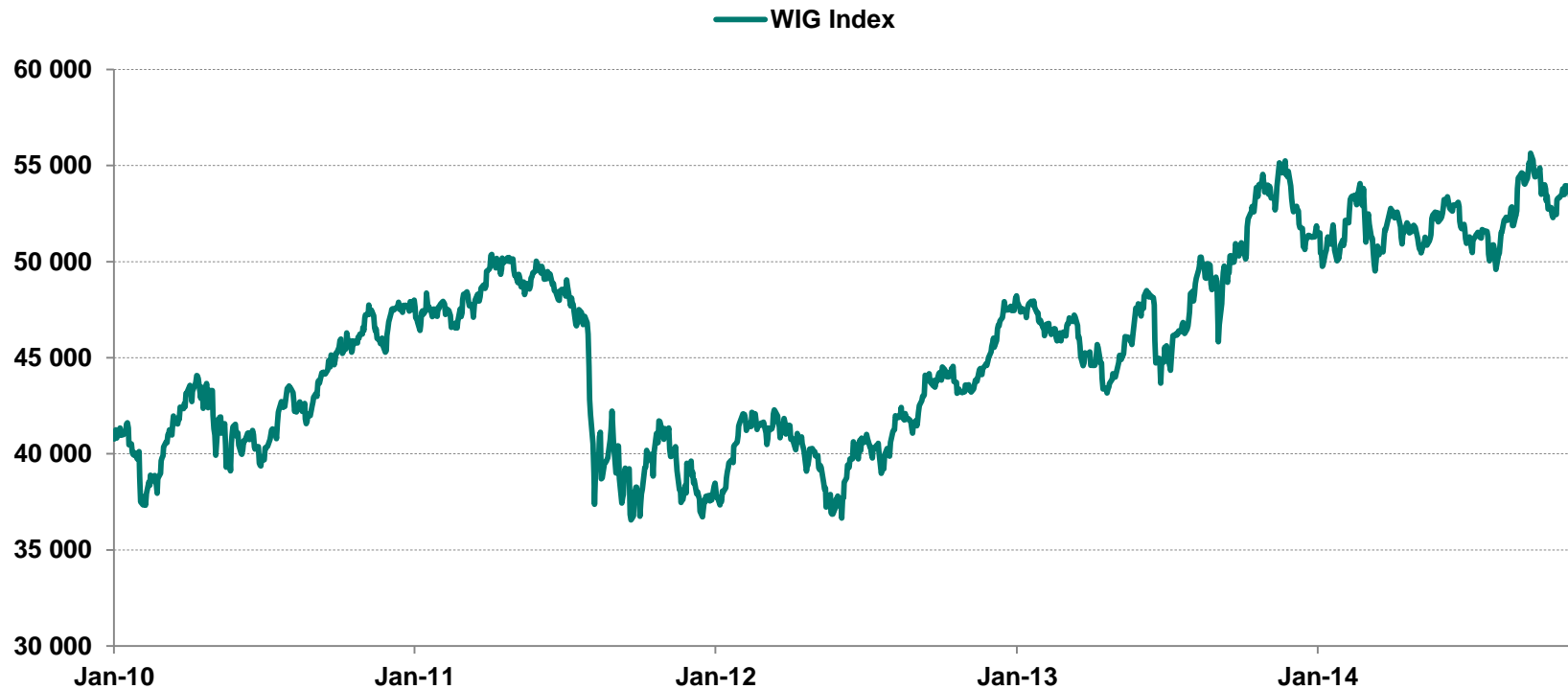
Exchange rate and its volatility



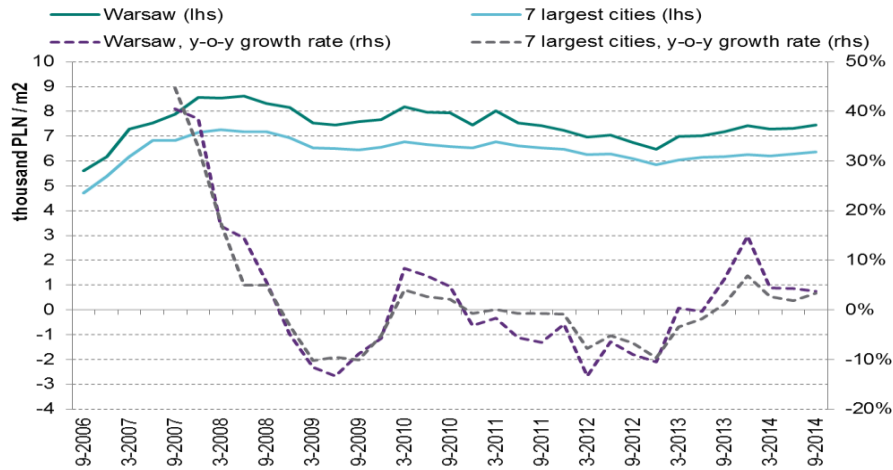
Treasury bonds' yield



Warsaw Stock Exchange Index



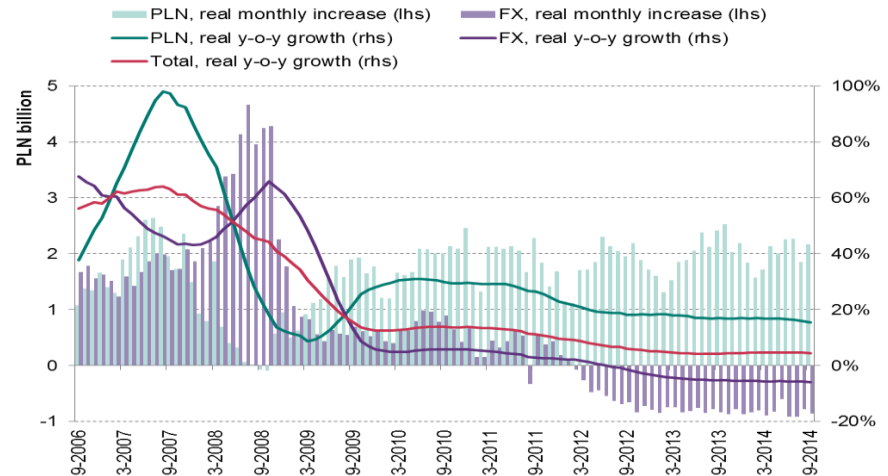
Transaction prices in the primary housing market in Poland



Note: The 7 largest cities index includes Gdańsk, Gdynia, Łódź, Kraków, Poznań, Warszawa and Wrocław.

Source: NBP

Housing loans monthly increases and annual growth rate



Note: Data after eliminating the impact of exchange rate changes.

Source: NBP

We protect the value of money