

## Central/Eastern Europe: EU will avoid its failure!



## Microscope

The global credit crisis has left banks with more than \$2 trillion in losses and writedowns, according to Bloomberg. The crisis is also taking its toll on emerging economies, especially Central and Eastern European countries. Hungary, Ukraine and Latvia needed international bailouts to avert defaults as they struggle to refinance short-term debt. For western banks involved in Eastern Europe, the financial risk has been surfaced. Credit-default swaps on sovereign debt in the region, which measure the risk of default, have risen, generally to more alarming levels. When governments are at risk of default, banking systems typically get into deep trouble. Western countries, like Austria, which hosts Raiffeisen and Erste Bank, has loans to the wider region of €230 billion (\$293.5 billion), equivalent to about 80% of Austrian GDP. Austria's government-bond yields have risen close to the levels of Italy, the euro zone's habitual miscreant. Worries that the euro zone will have to bail out its eastern cousins have hit Euro. In a simplified scenario, a western bank facing life-threatening losses could just walk away, limiting the hit to a write-off of the equity it had invested in the subsidiary. **E**

Eastern European economies have been battered by the global financial crisis, which has cut demand for exports while shutting off credit and investment. Those currencies led declines across emerging markets since Lehman Brothers Holdings Inc.'s collapse in September roiled global credit markets, as investors avoided the region because of higher foreign-debt costs and dwindling exports. In fact, exports of manufactured goods to Western Europe have plummeted; remittances from migrant workers employed there will also surely fall. Poland, by far the largest economy of the new EU members, is nowhere near collapse. Unlike its central European neighbours, it is big enough not to depend chiefly on exports to the rest of the EU. By European standards, its public finances are in fairly good shape. Its debt-to-GDP ratio is below 50%. Growth will be slightly negative, but nobody is forecasting a big decline. Some

Polish firms and households have taken out foreign-currency loans. But the figure is around 30% of all private-sector lending, compared with twice that in Hungary. Conventional wisdom usually suggested the stimulus by government expenditure could act as buffer for this economic downturn. The policy, however, seems not to be working here. Countries such as Poland and the Czech Republic have cut interest rates to help ease the pain. But this has sent their currencies tumbling, increasing the agony for households that have mortgages in euros. In Hungary, the gross figure of debt is near 100% of GDP. Even those that could perhaps afford to run a counter-cyclical policy to offset the effects of the downturn are squeezing public finances — in part because they think that

cutting deficits will help them reach the safety of the euro zone. In fact, many of them now members of the EU. One consequence is that older EU countries will find themselves footing the bill for clearing it up. In addition, the financial sector interaction between East and West is so deep to afford to let Eastern Europe go down. For example, Hungary recently secured 20 billion euros in loans from the IMF, the EU and the World Bank in the first bailout for an EU member nation last year. The World Bank, the European Bank for Reconstruction and Development and the European Investment Bank said they would provide 24.5 billion euros for the region. Eastern European currencies strengthened against the euro last week as world governments prepared aid packages to prevent an economic crisis in the region from spreading. **E**

### MARKET BRIEFING

YTD % (local curr)

<b>US DJ</b>	7,062 (-19.5%)
<b>Nasdaq</b>	1,377 (-12.6%)
<b>Euro Stoxx 50</b>	1,976 (-19.4%)
<b>HSI</b>	12,811 (-11%)
<b>Japan NK225</b>	7,568 (-14.6%)
<b>China Shanghai Composite</b>	2,082 (14.4%)
<b>Singapore</b>	1,594 (-9.5%)
<b>India BSE30</b>	8,891 (-7.8%)
<b>Brazil BOVESPA</b>	38,183 (1.7%)
<b>Aus All Ord</b>	3,296 (-9.9%)
<b>US-10yr Bond</b>	Yield 3.01%

As at 27/02/09

## Insight: “Hedge Fund”

Hedge funds are investment funds that undertake a wider range of activities than other investment funds and also pay performance fees to investment managers. Each fund will have its own strategy which determines the type of investments and the methods of investment it undertakes. Hedge funds as a class invest in a broad range of investments extending over shares, debt, commodities and so on. As the name implies, hedge funds often seek to offset potential losses in the principal markets they invest in by hedging their investments using a variety of methods, most notably short selling. However, the term “hedge fund” has come

to be applied to many funds that do not actually hedge their investments, and in particular to funds using short selling and other “hedging” methods to increase rather than reduce risk, with the expectation of increasing return. The net asset value of a hedge fund can run into many billions of dollars, and this will usually be multiplied by leverage. Hedge funds dominate certain specialty markets such as trading within derivatives with high-yield ratings and distressed debt. Some hedge fund managers specify a hurdle rate, signifying that they will not charge a performance fee until the fund's annualized performance exceeds a benchmark rate, such as T-bill yield, or LIBOR. This links performance fees to the ability of the manager to provide a higher return than an alternative, usually lower risk, investment. **E**

## A-Z Financial Tools

**Mark-to-market** is the accounting act of recording the price or value of a security, portfolio or account to reflect its current market value rather than its book value. This is done most often in futures accounts to make sure that margin requirements are being met. If the current market value causes the margin account to fall below its required level, the trader will be faced with a margin call. **E**



**IBC Group**

Comprehensive Financial Planning  
Wealth Management Advisory  
International Business Advisory  
Call 2268 6308  
Email: [insider@ibccapital.com](mailto:insider@ibccapital.com)

**Next Insight**

“Indicators of Economic Recovery”