CESEE Main Economic Issues

Commerzbank CEEMEA Day

Coworth Park, May 20, 2016

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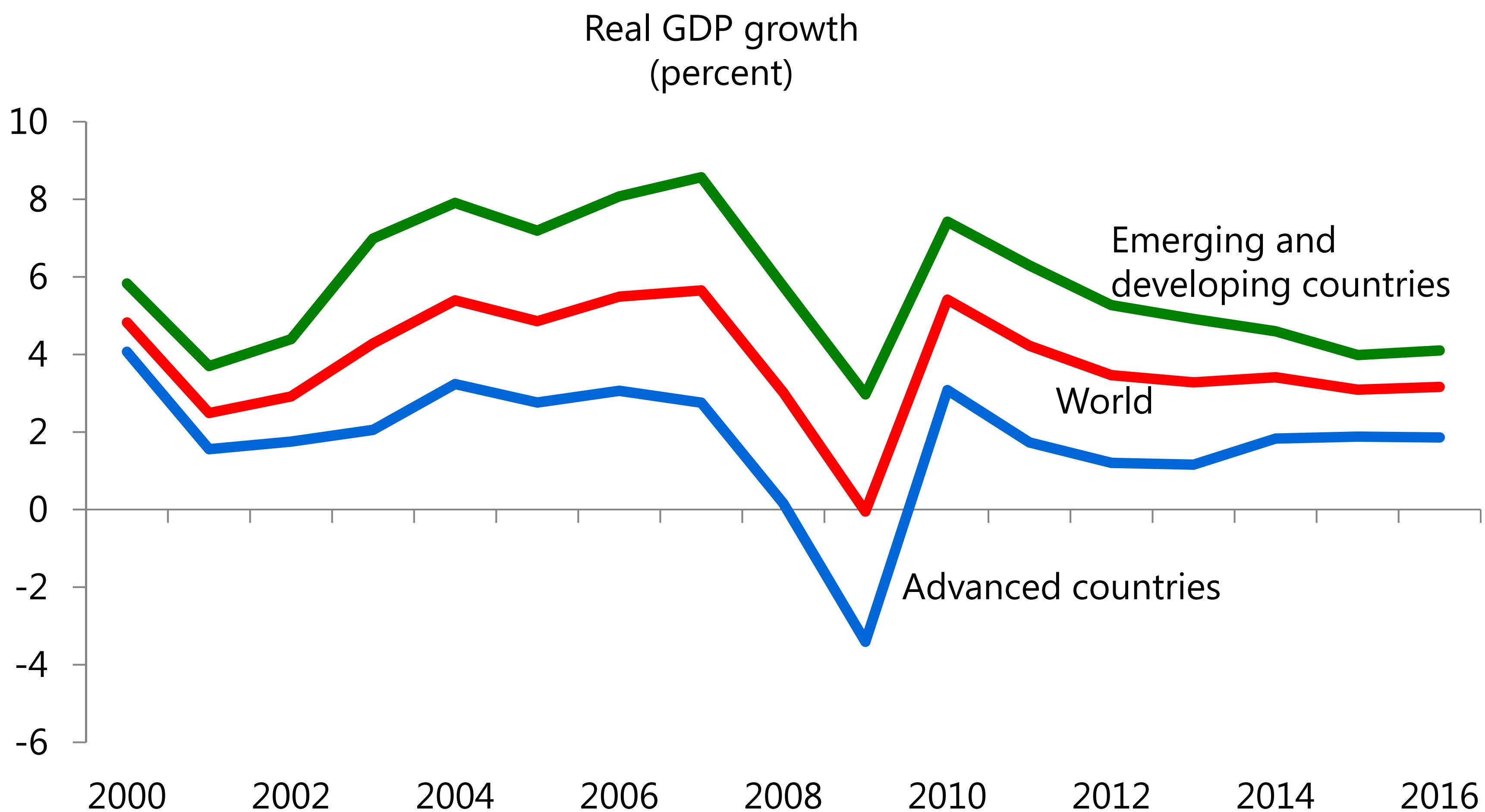
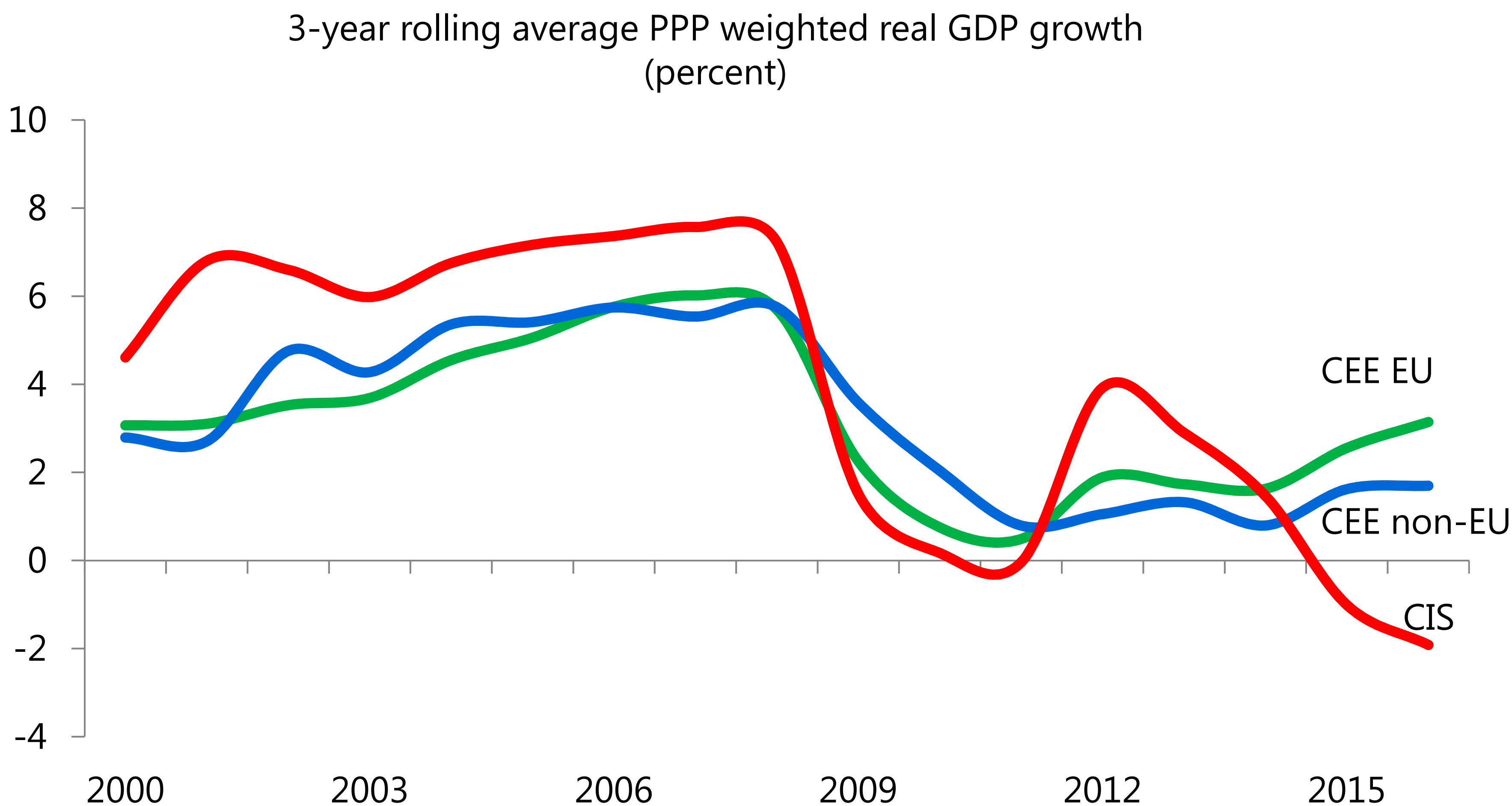
Global growth has *decelerated* since 2010



Why has global growth disappointed?

- Advanced countries remain mired in low growth
- Large emerging market countries have slowed down
  - Argentina, Brazil, Russia and Venezuela in recession
  - Growth in China has slowed down

CESEE more complicated: CIS in recession; non CIS doing much better



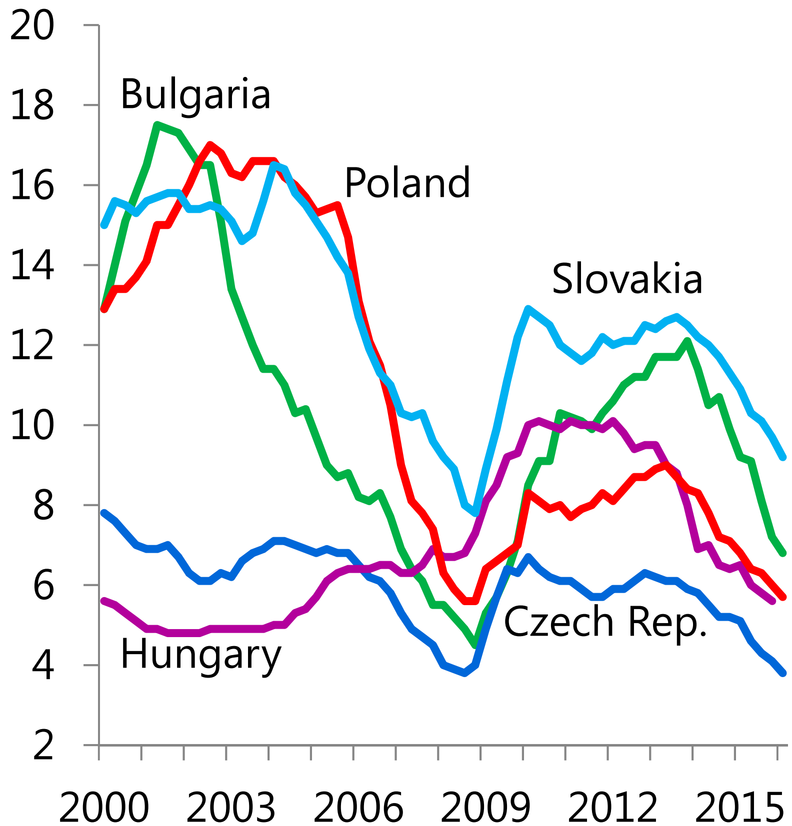
CESEE is more complicated

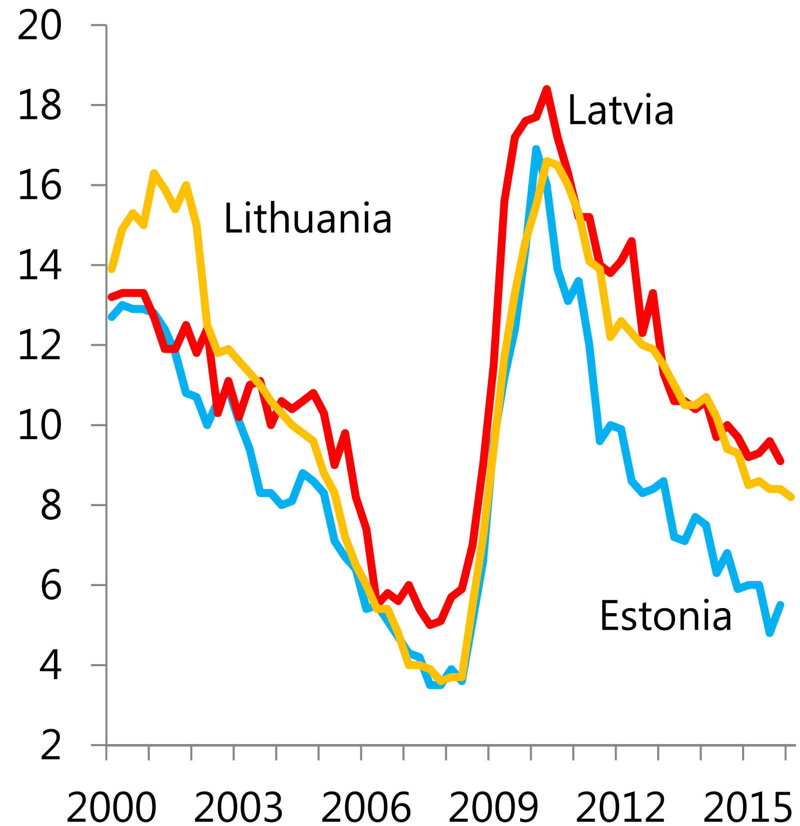
- Much of CIS was in recession in 2015
  - Russia was hit by fall in oil prices and sanctions
  - Ukraine and Belarus also in recession

- But outside CIS, region is doing much better
- Particularly EU new member states

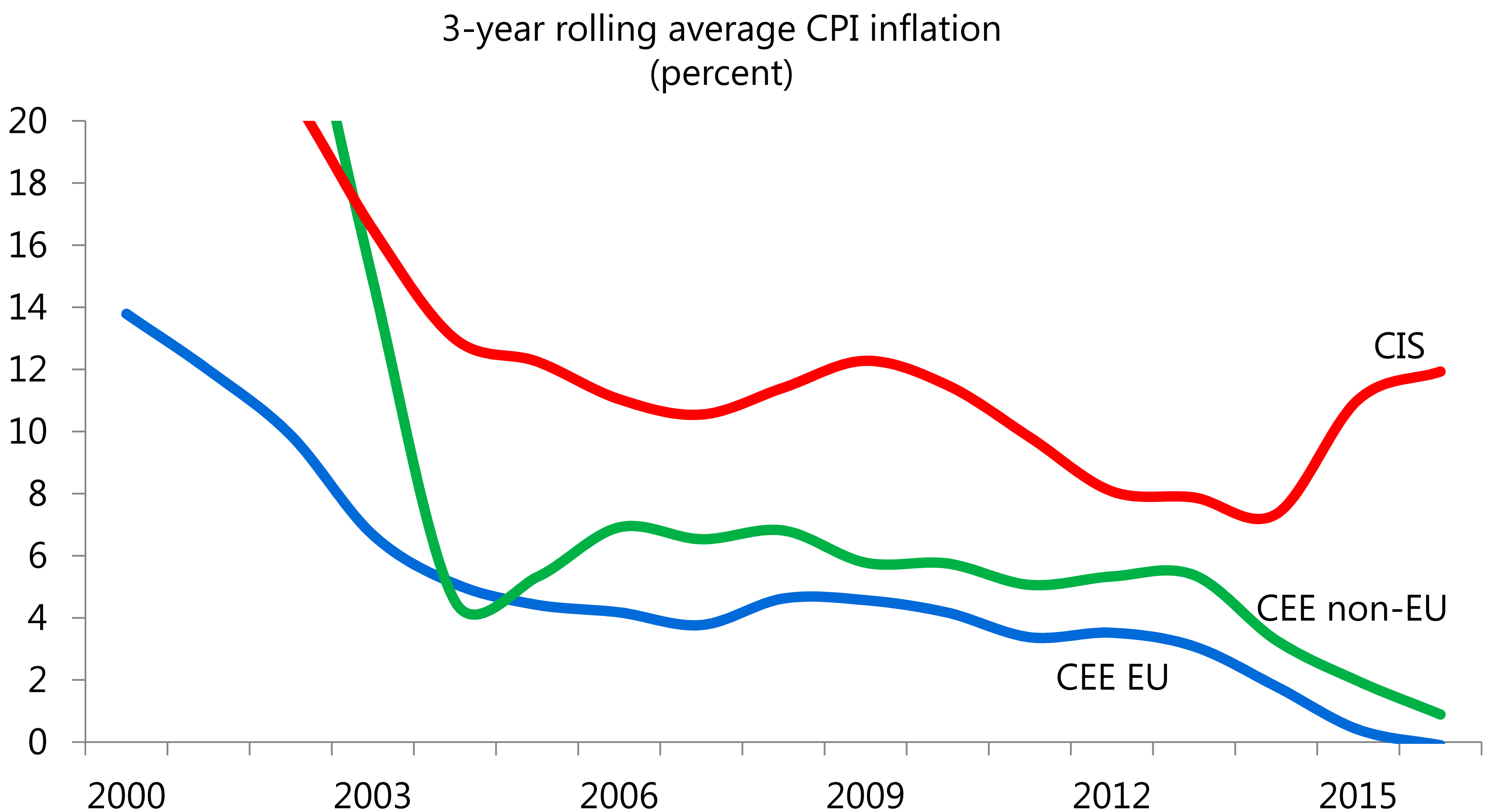
In many EU New Member States unemployment is coming down fast and is now near pre-crisis lows

Unemployement rates
(percent)





Similar dichotomy in inflation: relatively high in CIS, low elsewhere

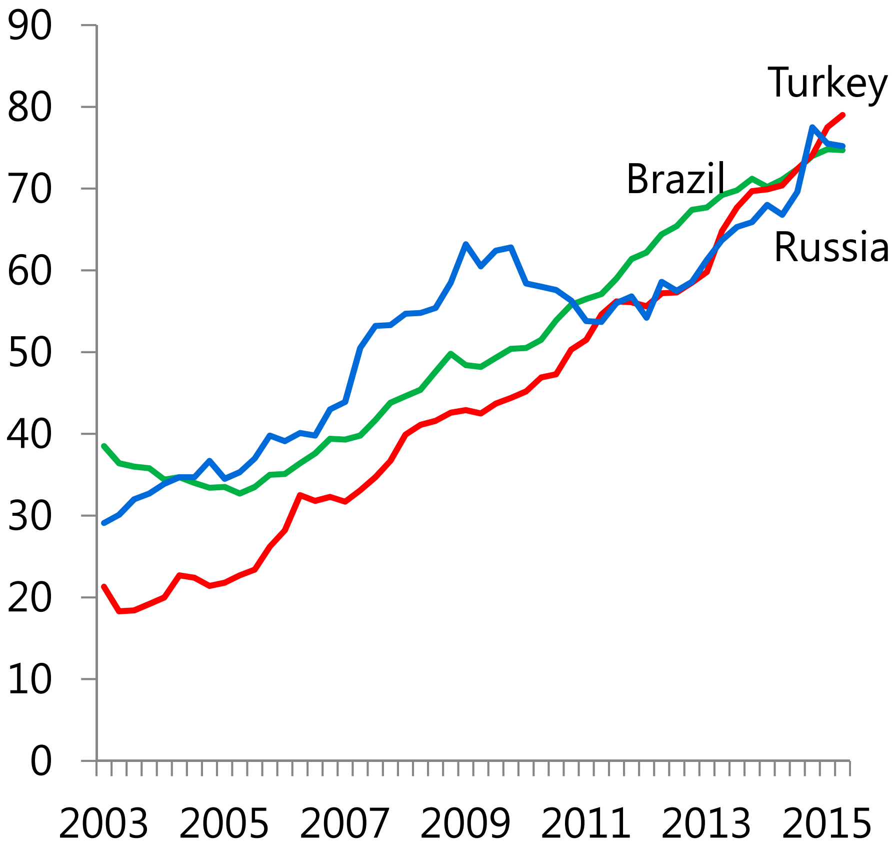


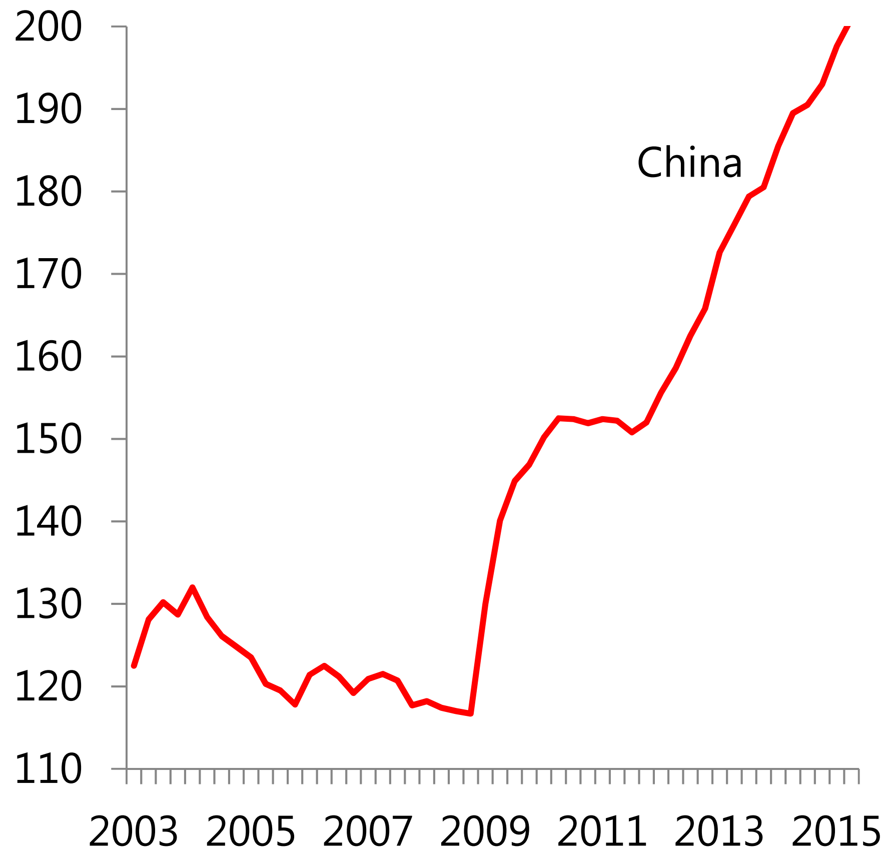
Why the difference between non-CIS CESEE and large EMCs?

- Commodity price declines hurt some large EMCs; most of non-CIS CESEE commodity importer
- Different stages of credit cycle
  - Post 2009, growth in CESEE was held back by overhang of credit boom and deleveraging
  - By contrast, large EMCs saw *acceleration* of credit
  - Currently, large EMCs may be at the end of credit boom
  - In CESEE impact of deleveraging is diminishing

Large EMCs had credit boom

Credit to private non-financial sector
(percent of GDP)

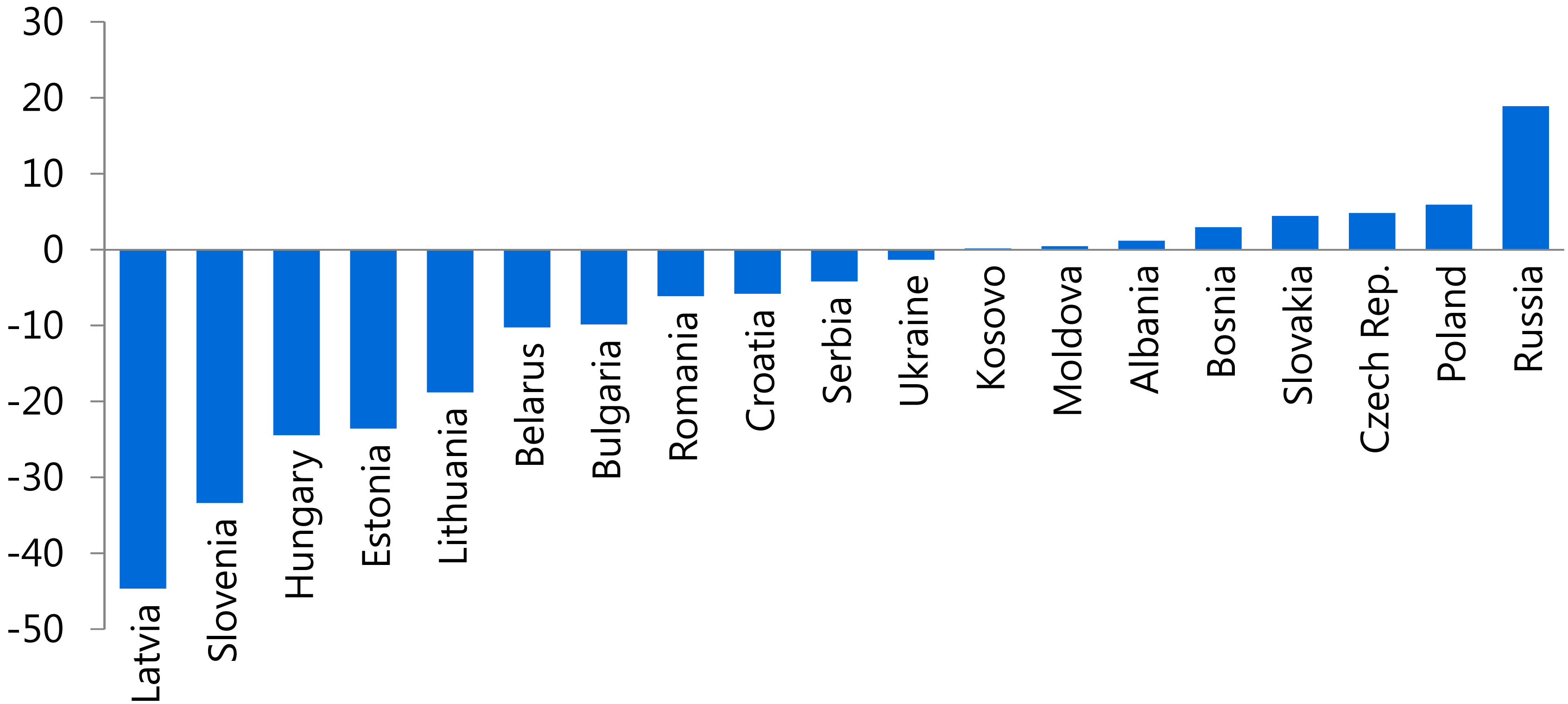




In non-CIS CESEE there has been deleveraging

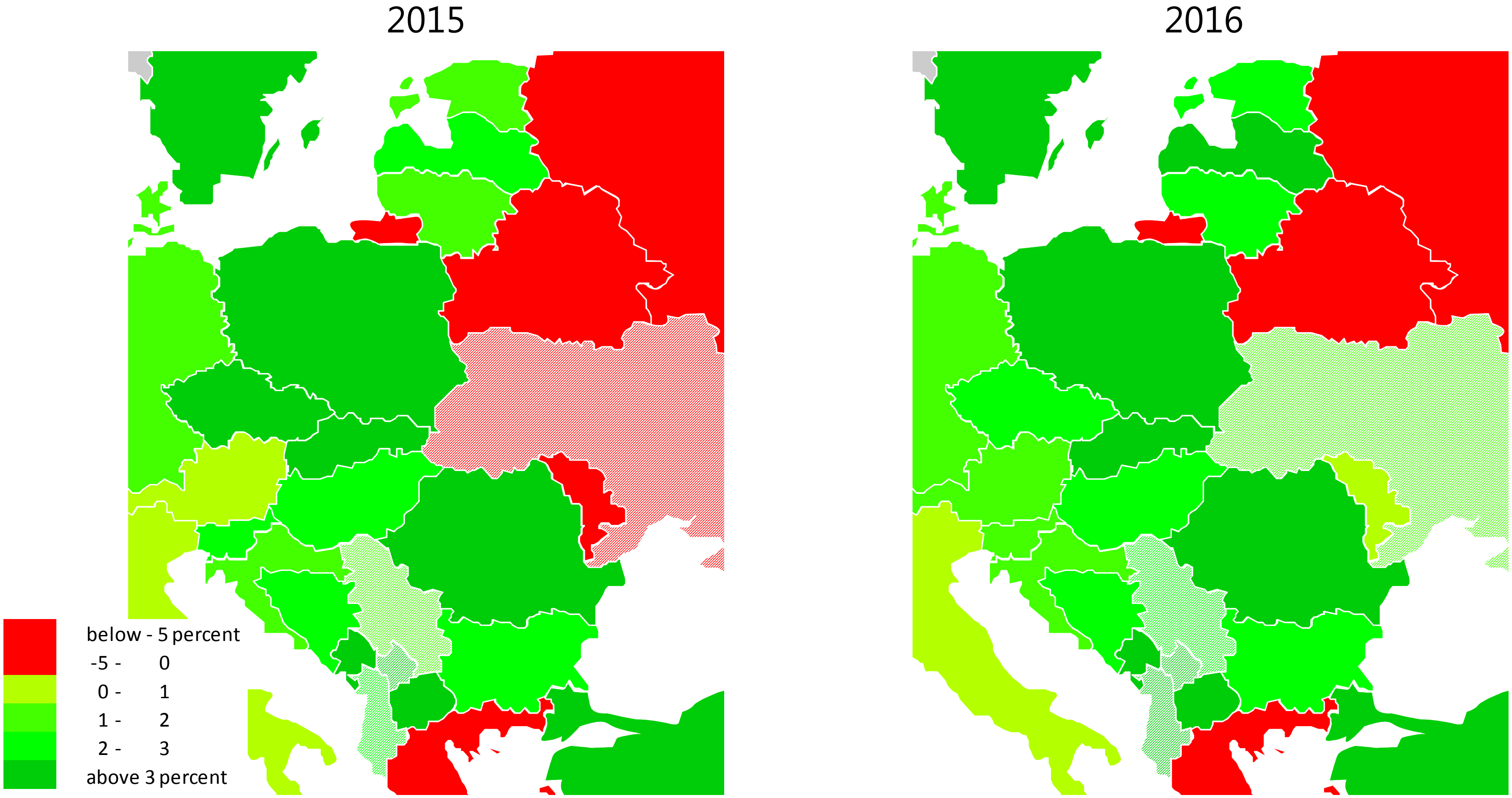
It had a credit boom pre-2009; and has been working off the overhang

Change in claims on non-financial private sector to GDP ratio, 2010-2014 (percentage points)



Growth in CESEE is projected to accelerate this year

Real GDP growth
(WEO Spring 2016 , percent y/y)



Note: Striped fill denotes CESEE country under IMF programs.

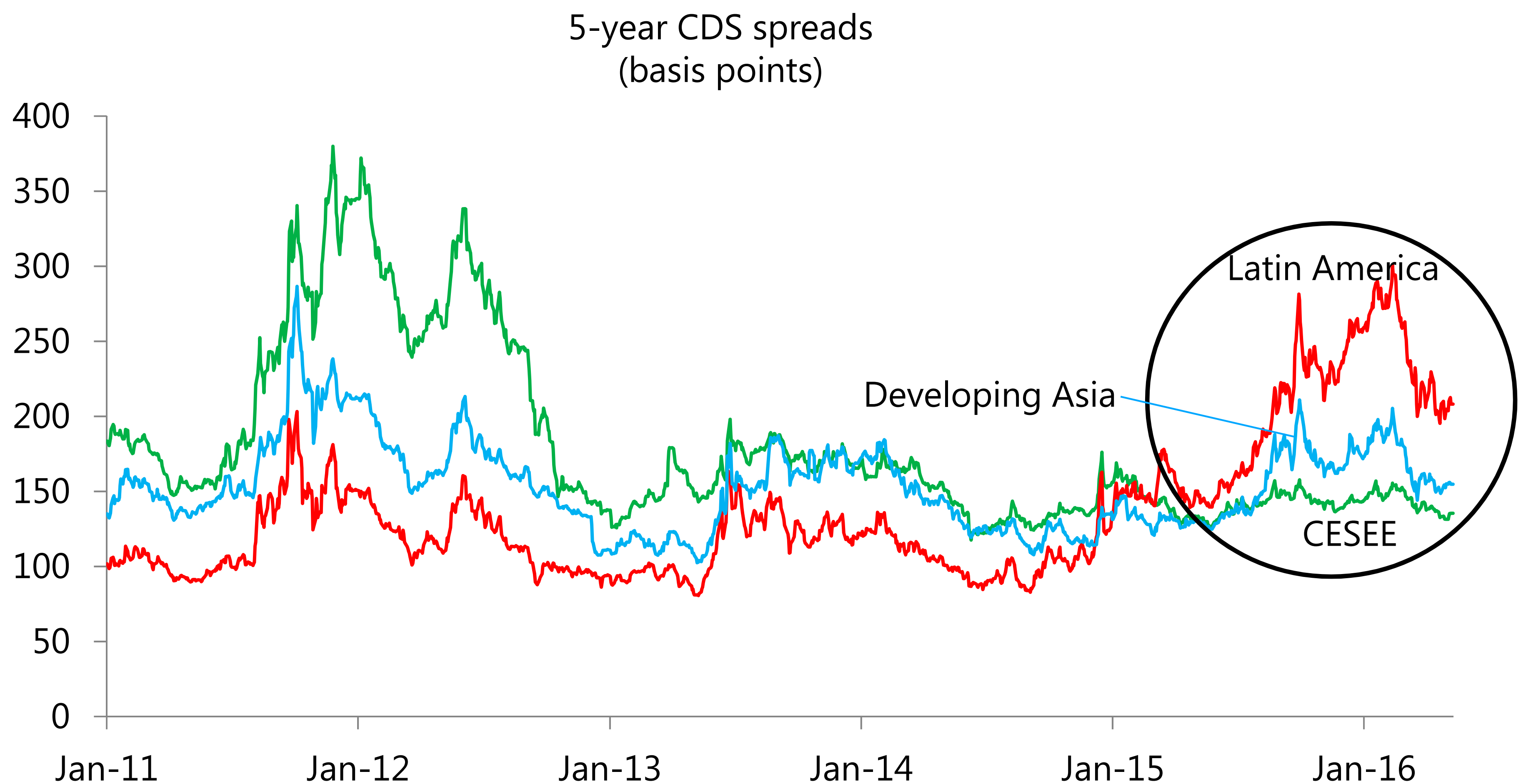
Although there are many downside risks

- Disappointing Euro Area growth
- Geopolitical tensions
- Refugee crisis
- Hard landing in China
- Slowing growth in large emerging markets

Brexit

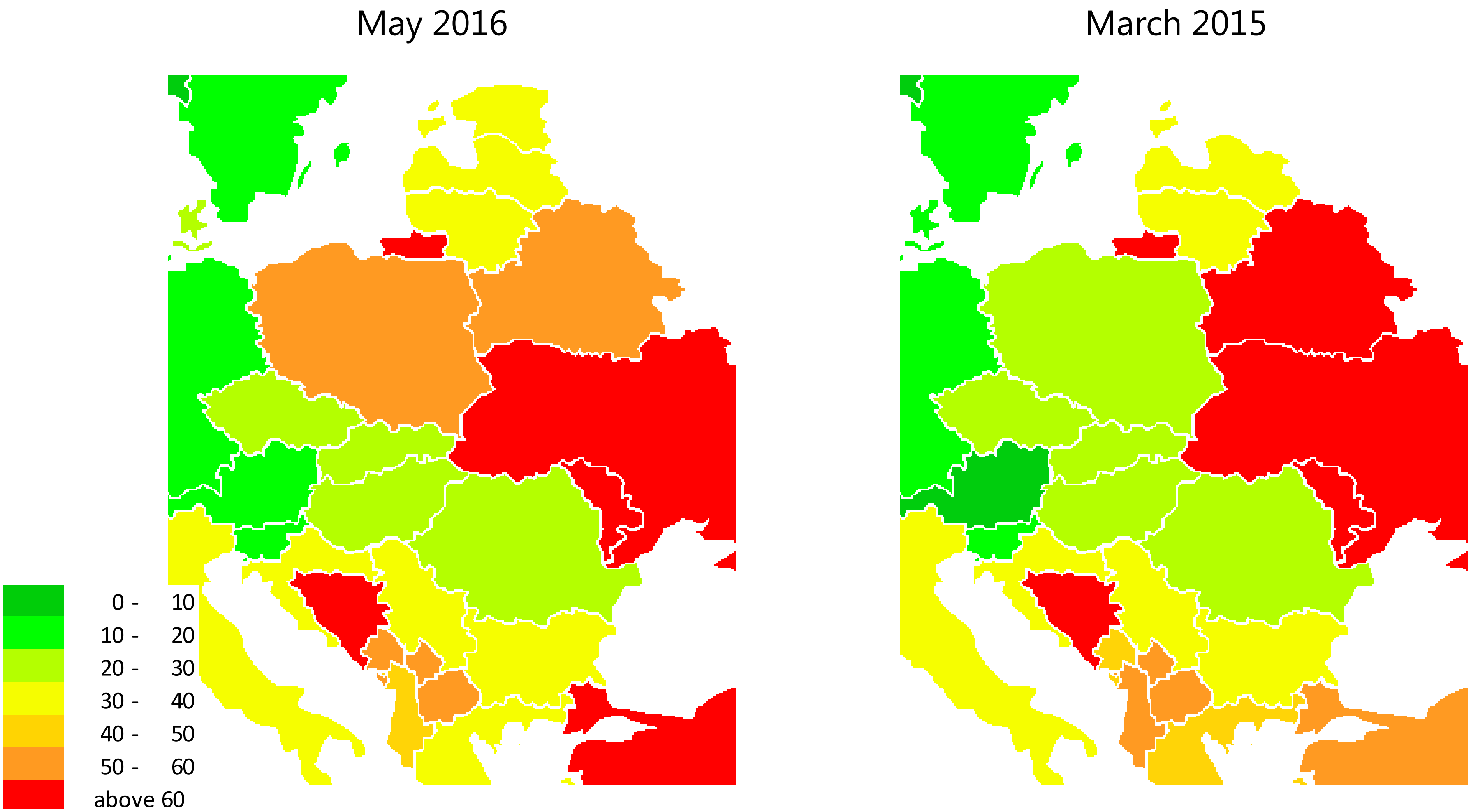
- Direct trade and financial links with CESEE are not large for most countries
- Germany is an important trading partner for the CESEE, with large direct links to the UK
- Risk that Brexit could trigger renewed market turmoil, and long period of uncertainty.

Renewed financial market turmoil...



.. Interacting with rising political instability…

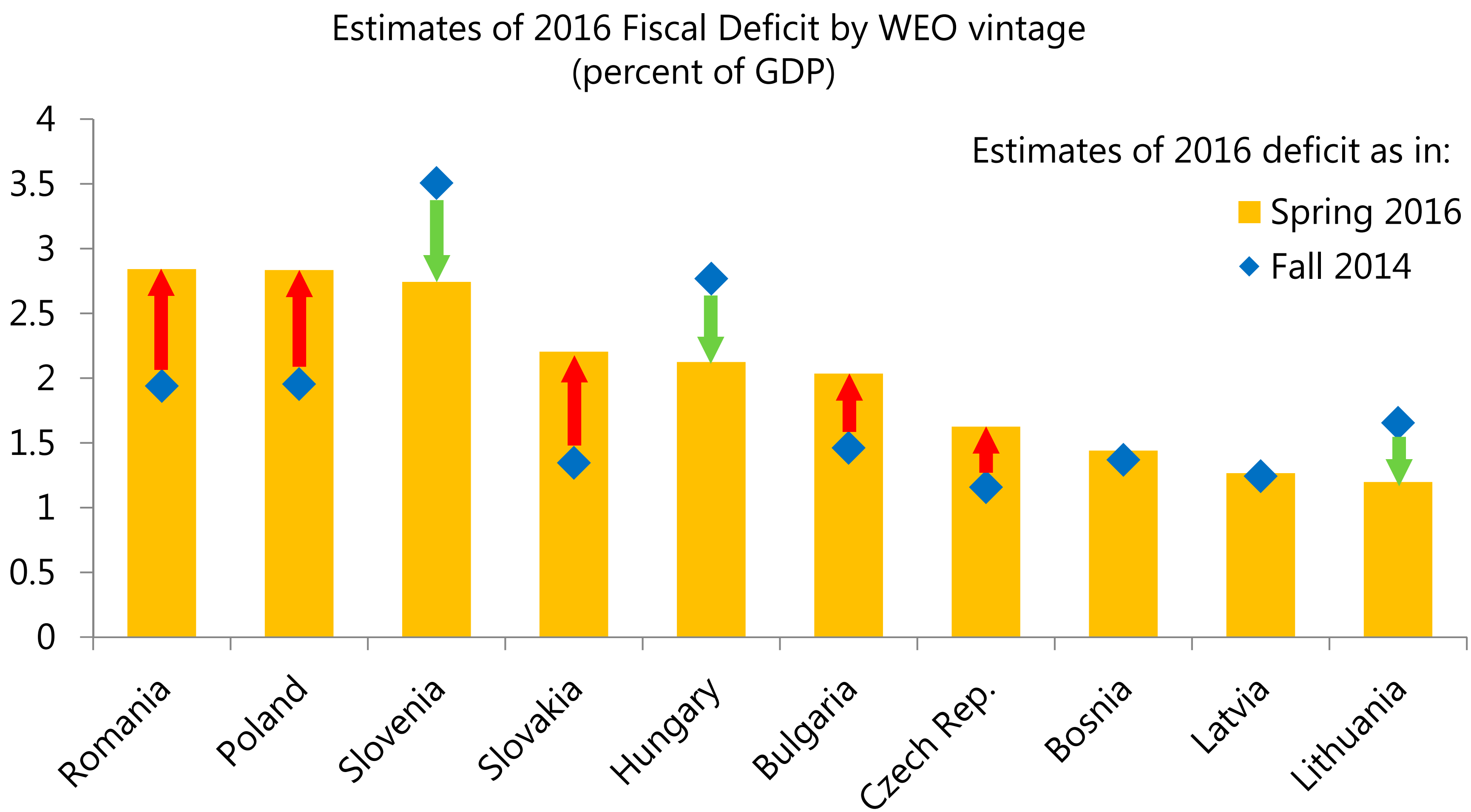
EIU Political Stability Risk Score
(0 = no risk)



Political instability in number of countries

- Kosovo
- Macedonia
- Moldova
- Ukraine

Adjustment fatigue and even reversal of fiscal policy stance



Even without downside materializing growth is too low in many countries

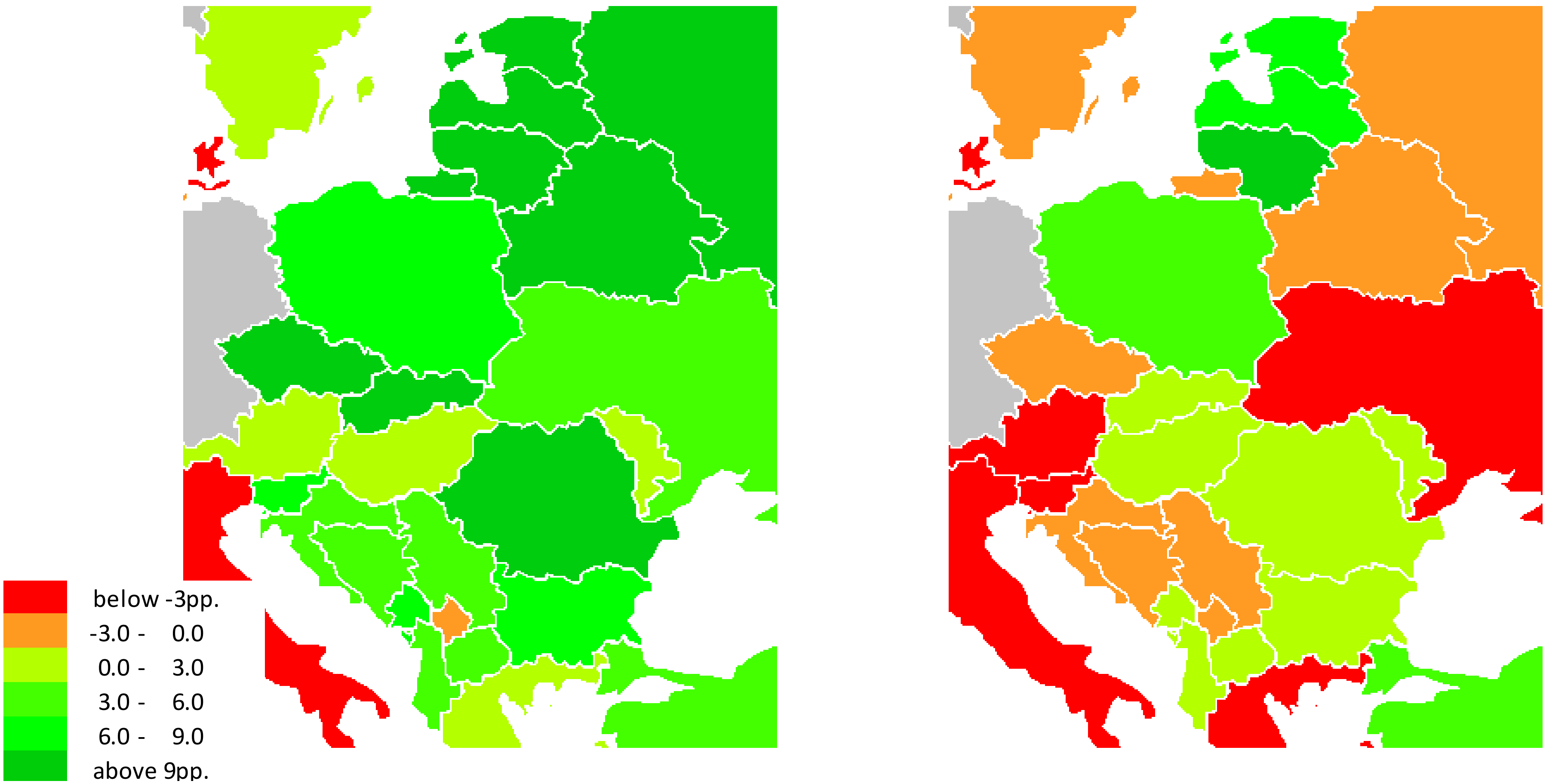
- Catch-up has stalled, and in some countries even reversed
- Countries need to get back to rapid convergence

Catch-up has continued post-2008 in Central Europe and Baltics, but stalled in many SEE and CIS countries.

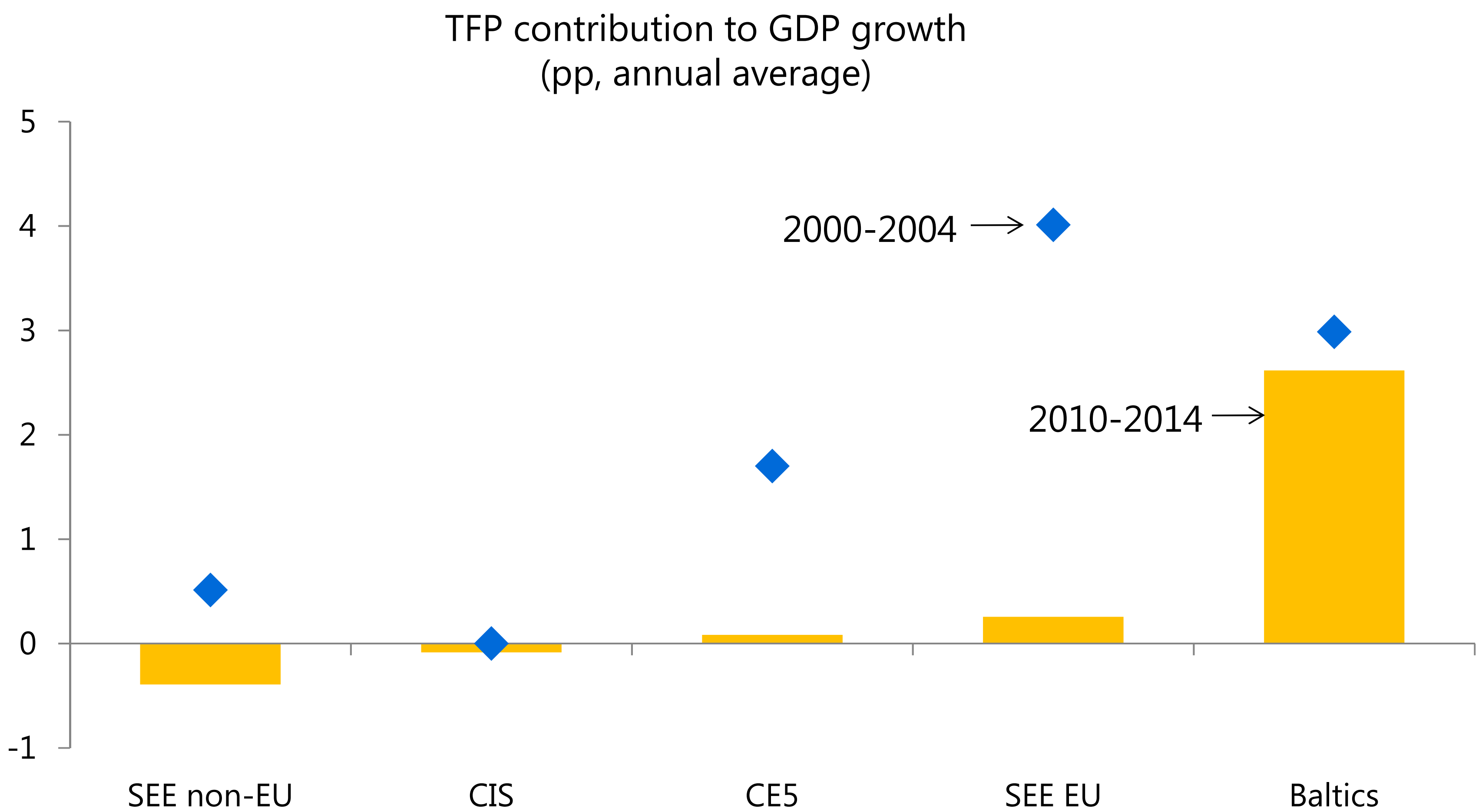
Change in income per capita gap to Germany
(percentage points, PPP-adjusted)

2003-08

2010-2015



Demographics and much reduced productivity growth may make mediun-term growth lower than expected

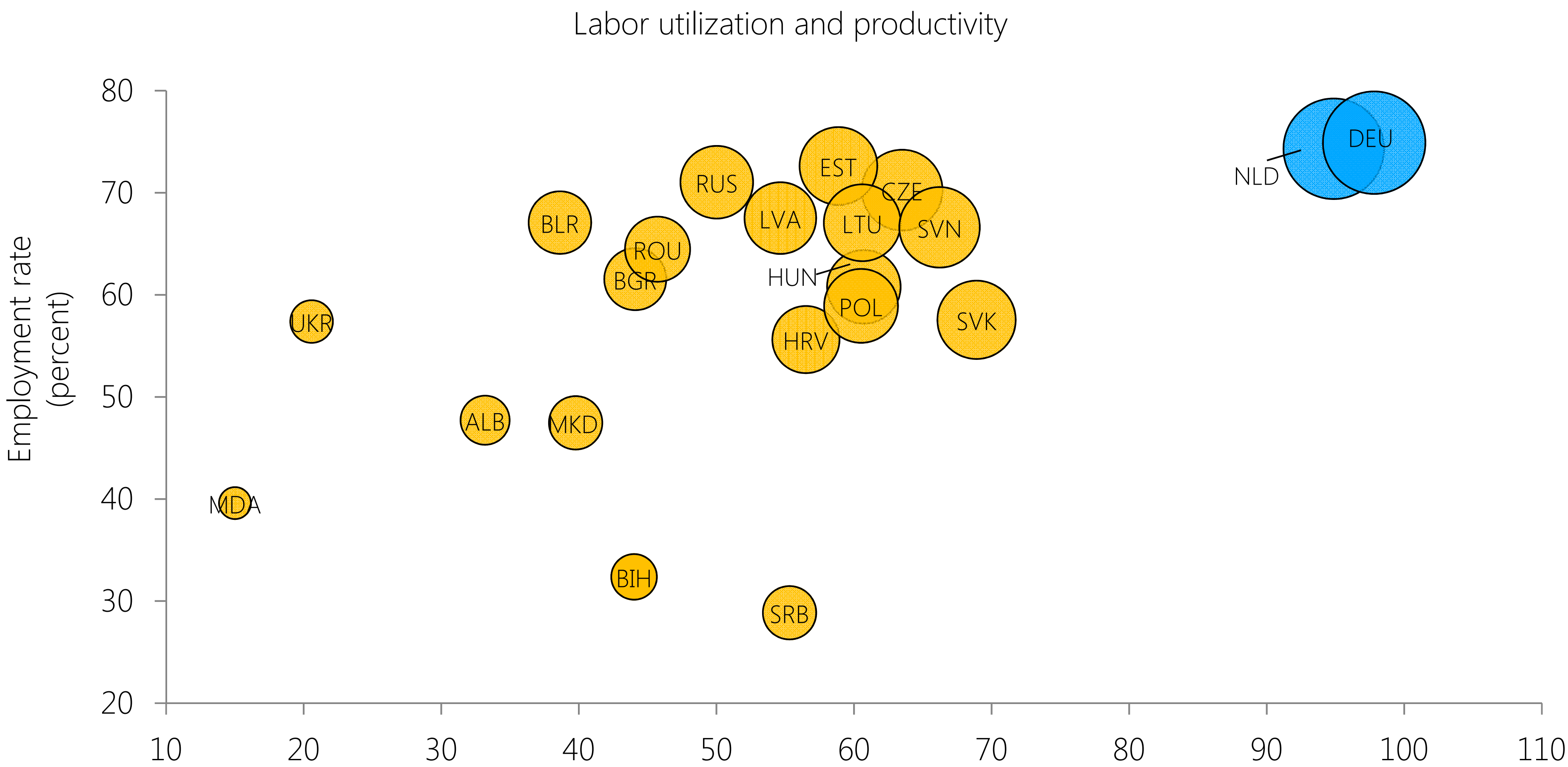


Note: SEE non-EU excludes Serbia and Montenegro.

How can we boost convergence going forward?

- Question we addressed in depth in our just-published Spring 2016 issue of "CESEE Regional Economic Issues."

Further raising employment rates is needed, as is higher labor productivity



Note: bubble size reflects GDP per capita (PPP)

To raise labor productivity more investment needed

- The capital stock per capita in a typical CESEE economy only about a third of that in advanced Europe.
- Investment gaps are particularly wide in infrastructure
- In most of the region, domestic savings rates are too low
- Policies should therefore focus on institutional reforms that reduce inefficiencies and increase returns on private investment and savings.

Boosting Total Factor Productivity (TFP) is important as well

- CESEE countries may have to address structural and institutional obstacles that prevent efficient use of available technologies, or lead to inefficient allocation of resources.
- Our recent CESEE report suggests the largest efficiency gains are likely to come from
  - Improving the quality of institutions (protection of property rights, legal systems, and healthcare)
  - Increasing the affordability of financial services (especially for small but productive firms)
  - Improving government efficiency.

Thank you