CESEE Main Economic Issues

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Bas B. Bakker
Senior Regional Resident Representative for Central and Eastern Europe
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.
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)

Brazil
Russia
Turkey
China
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
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...

5-year CDS spreads (basis points)

Latin America
Developing Asia
CESEE
.. Interacting with rising political instability...

EIU Political Stability Risk Score
(0 = no risk)

May 2016

March 2015
Political instability in number of countries

- Kosovo
- Macedonia
- Moldova
- Ukraine
Adjustment fatigue and even reversal of fiscal policy stance

Estimates of 2016 Fiscal Deficit by WEO vintage (percent of GDP)

Estimates of 2016 deficit as in:
- Spring 2016
- Fall 2014
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 medium-term growth lower than expected.

TFP contribution to GDP growth
(pp, annual average)

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.
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