Regional Economic Issues in CESEE

JVI Lecture,

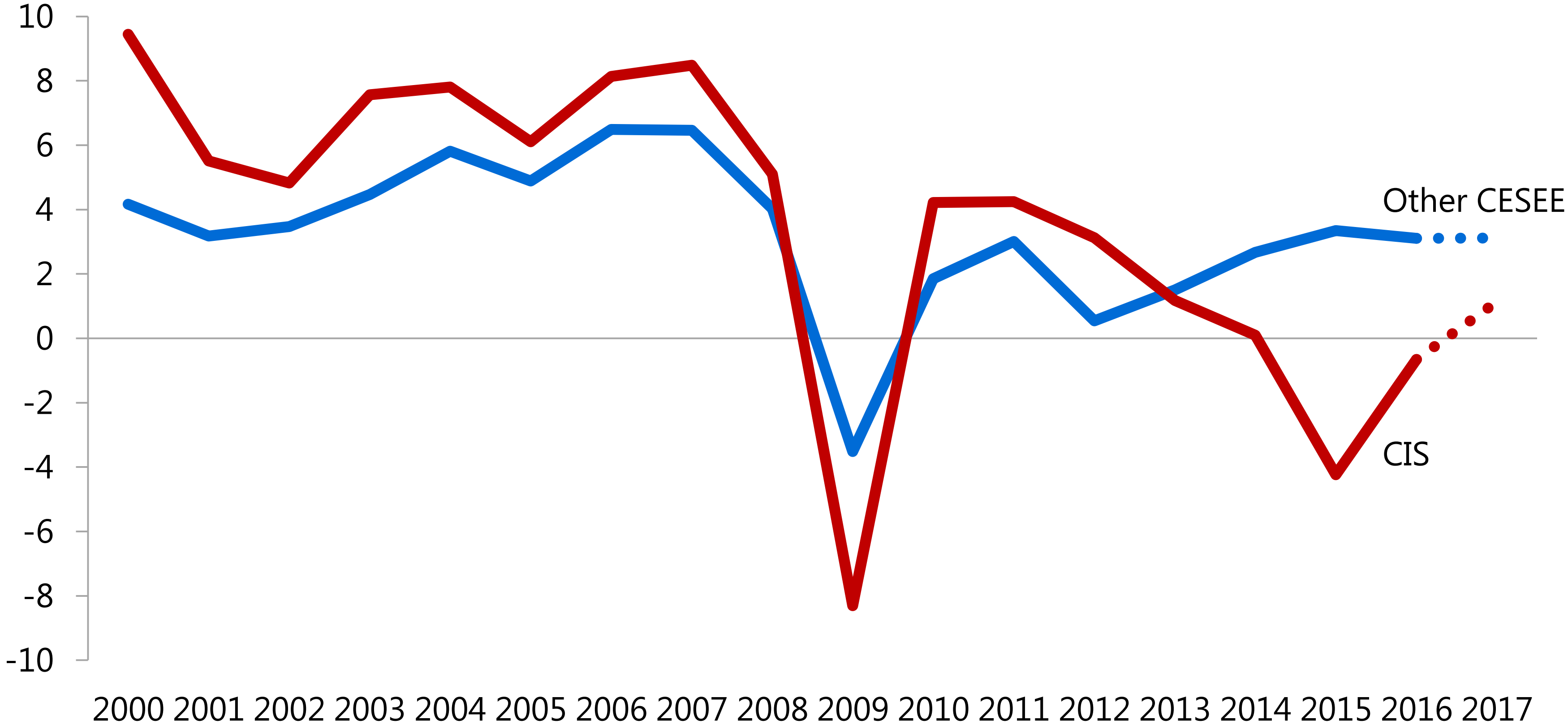
Vienna, February 8, 2017

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

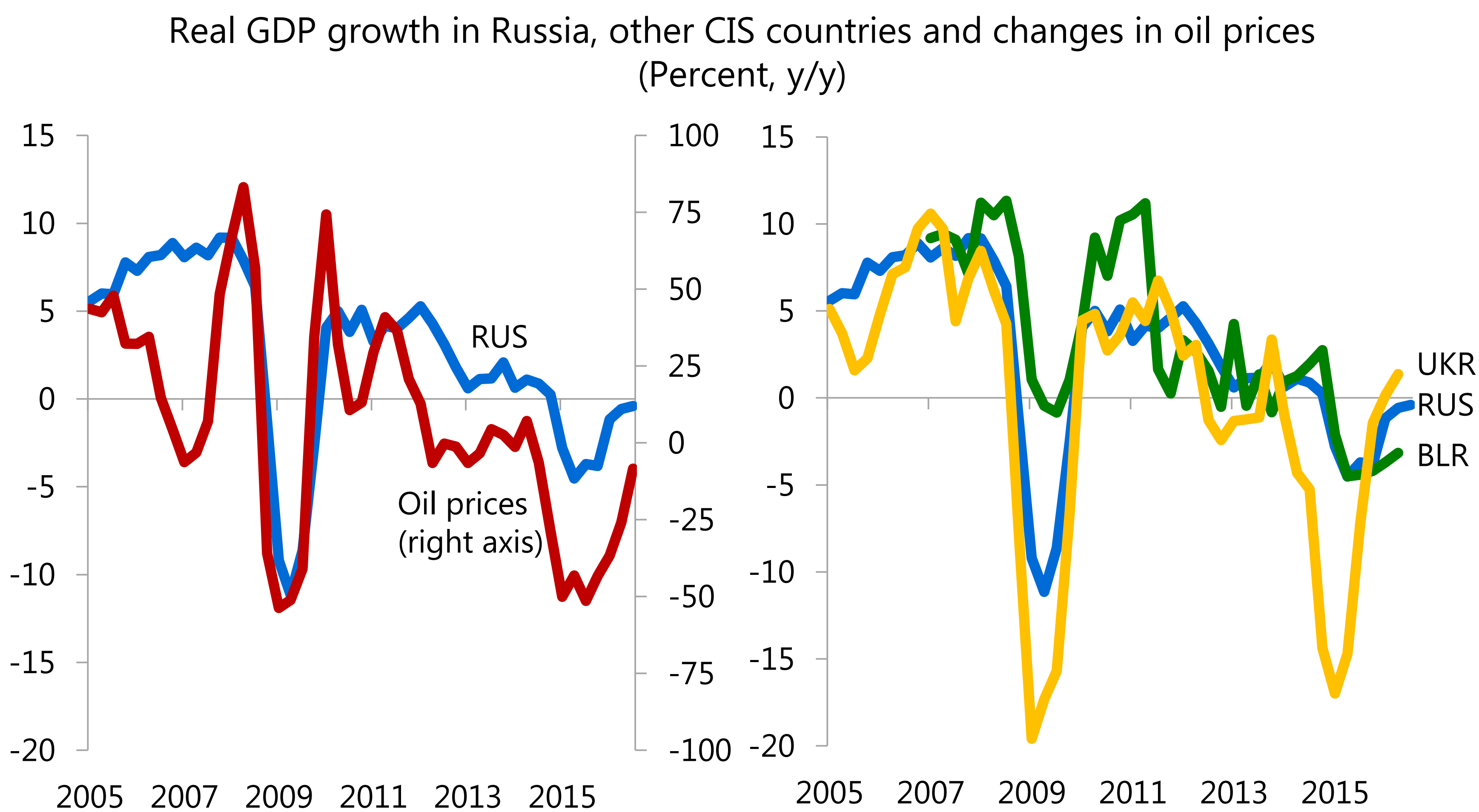
Outlook for CESEE

Within CESEE dichotomy: CIS was in recession, but non-CIS fairly strong

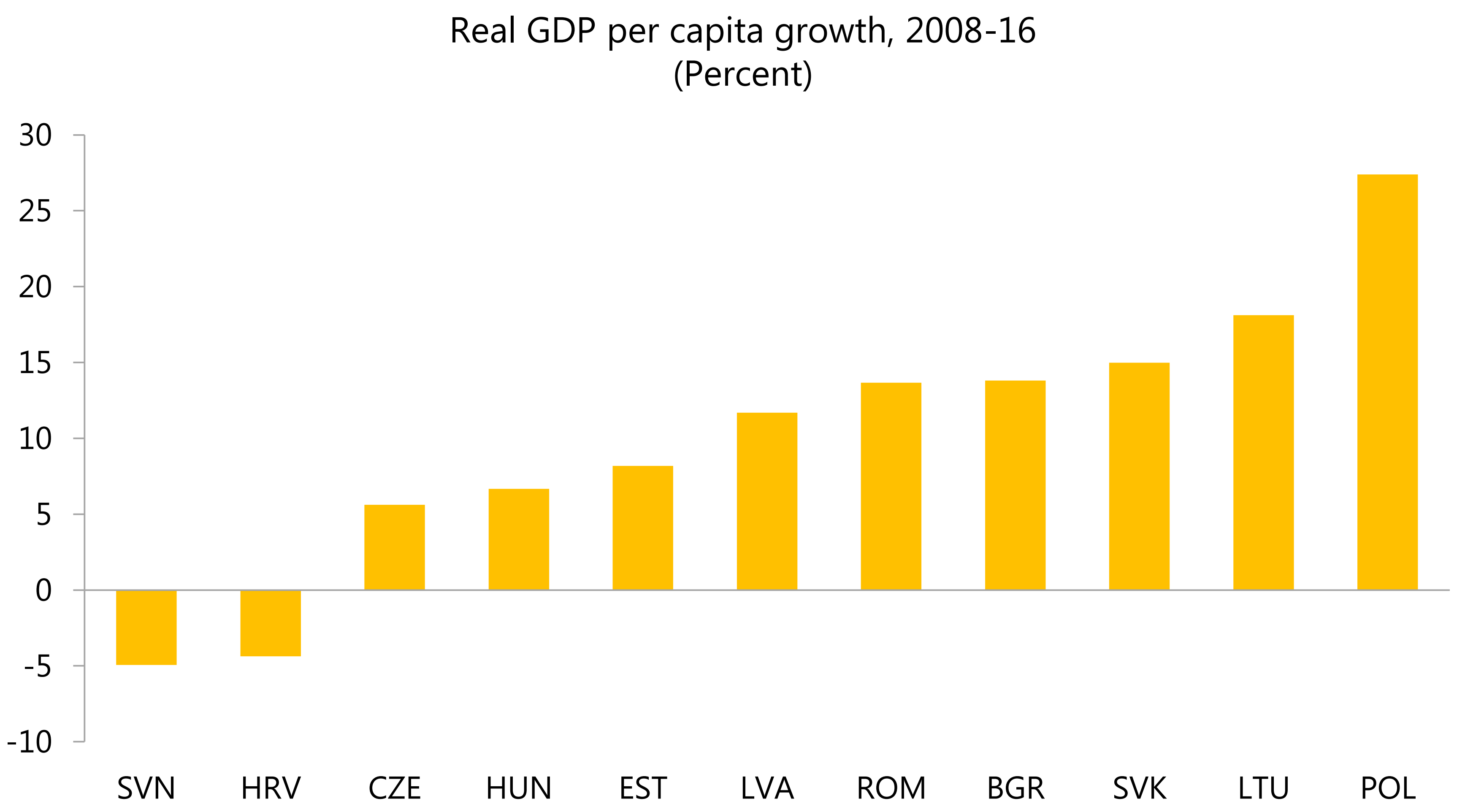
PPP weighted real GDP growth
(Percent)



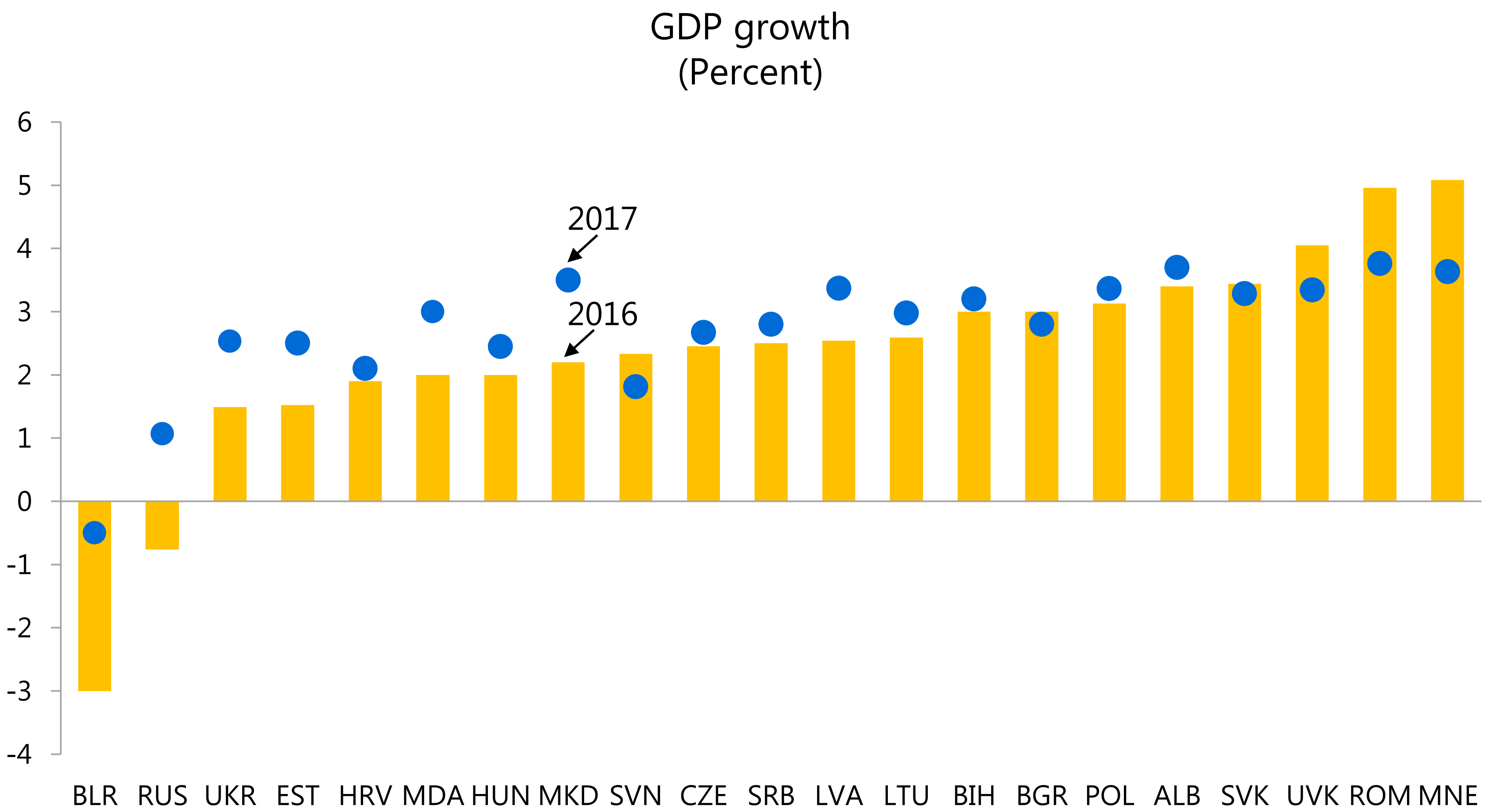
CIS was hit by oil price decline, sanctions and conflict in Ukraine, but is now recovering



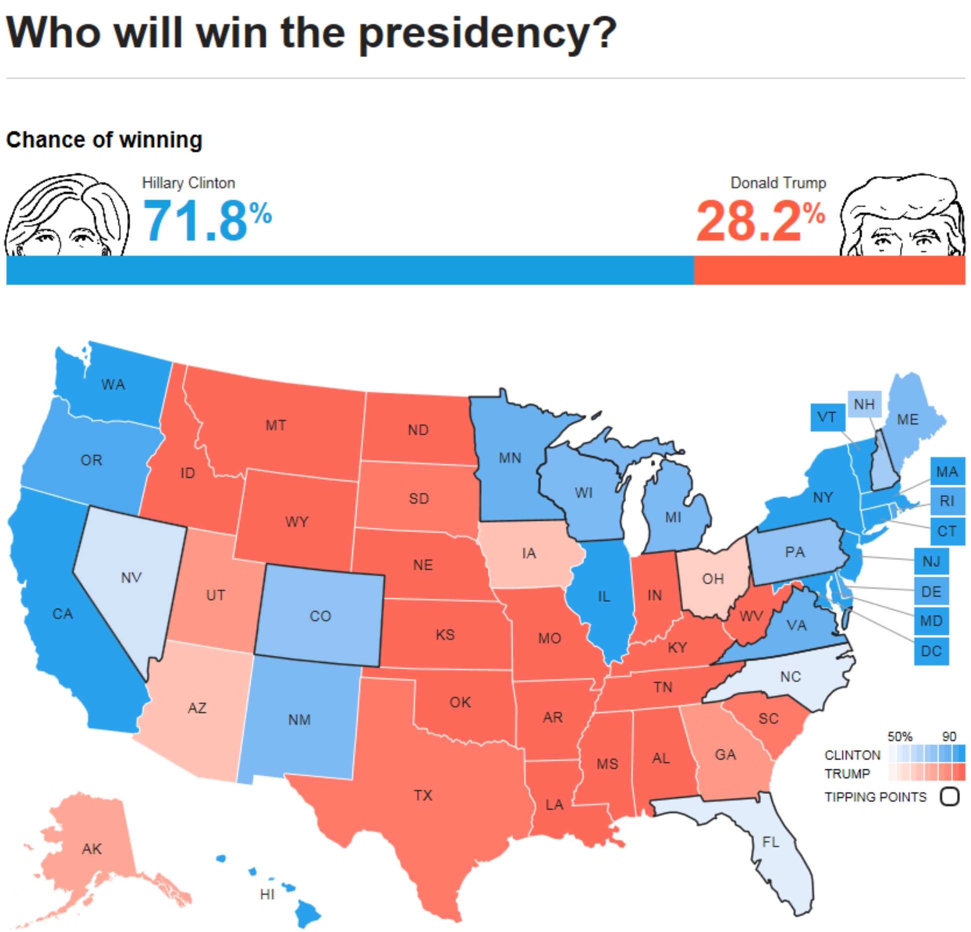
By contrast, EU new member states continue to recover from 2009 crisis



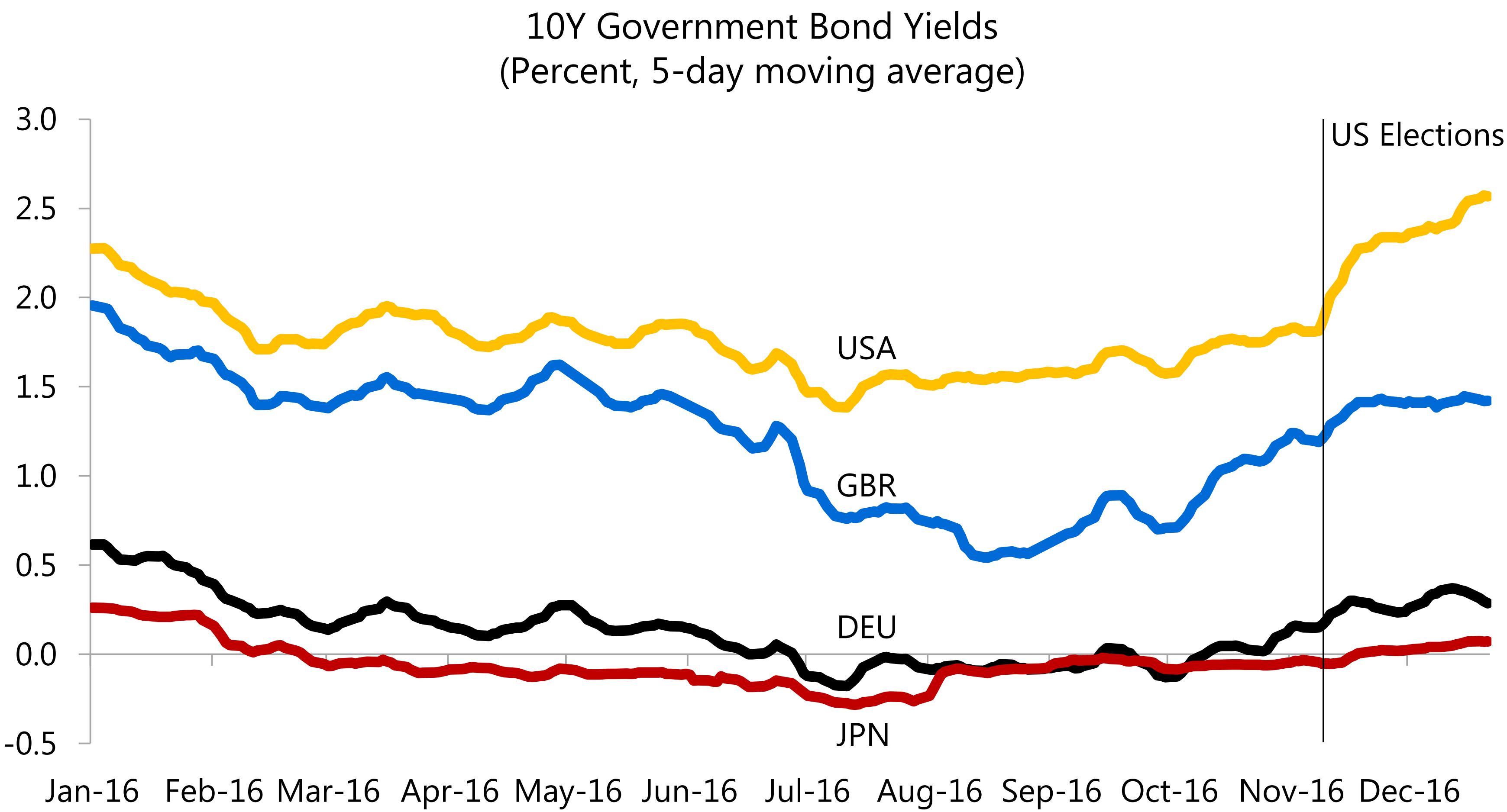
October 2016 WEO projections: pick-up in CIS in 2017, and continued strong growth in rest of CESEE



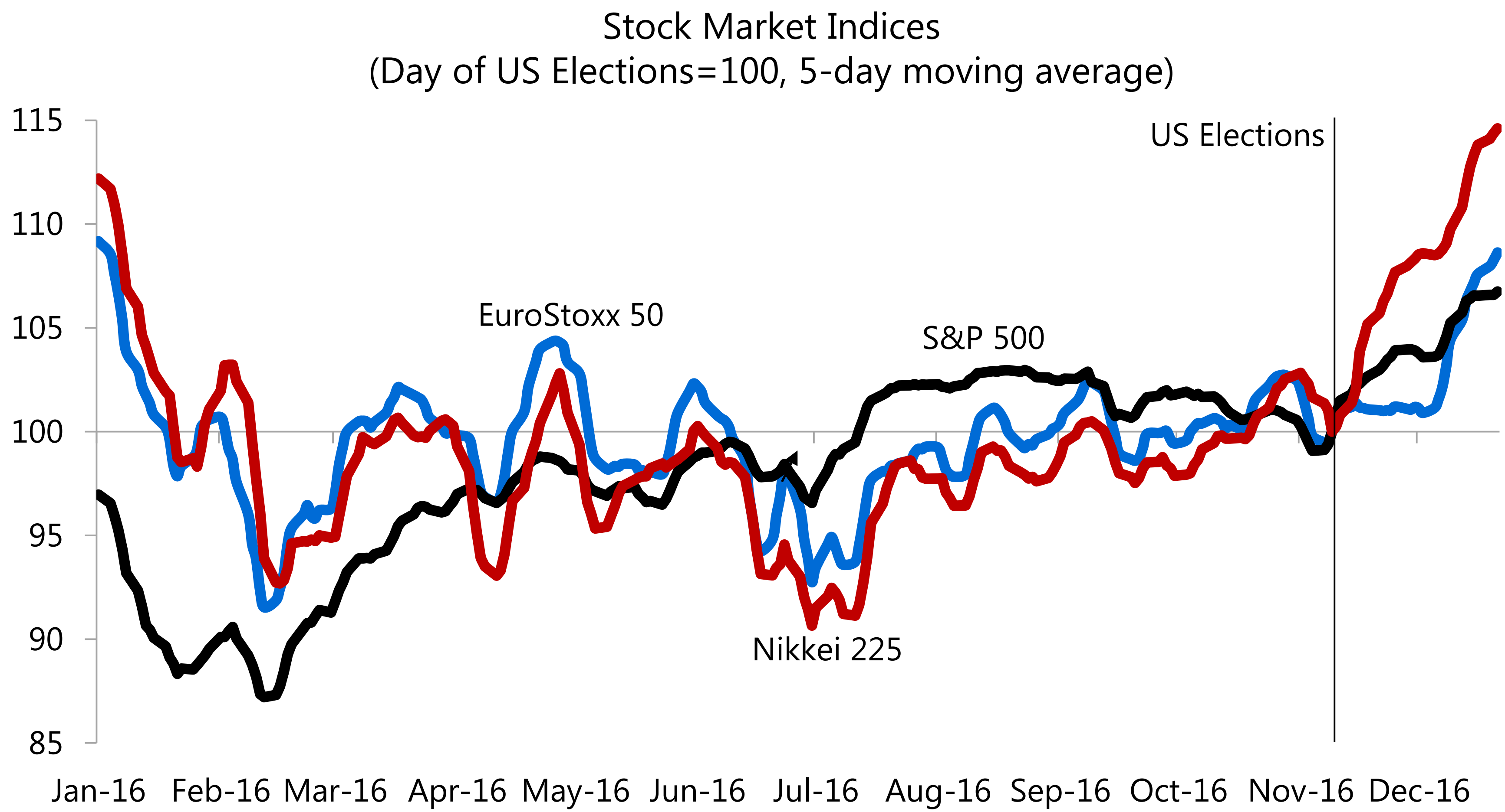
After projections were made Donald Trump was elected, which was not quite expected by markets



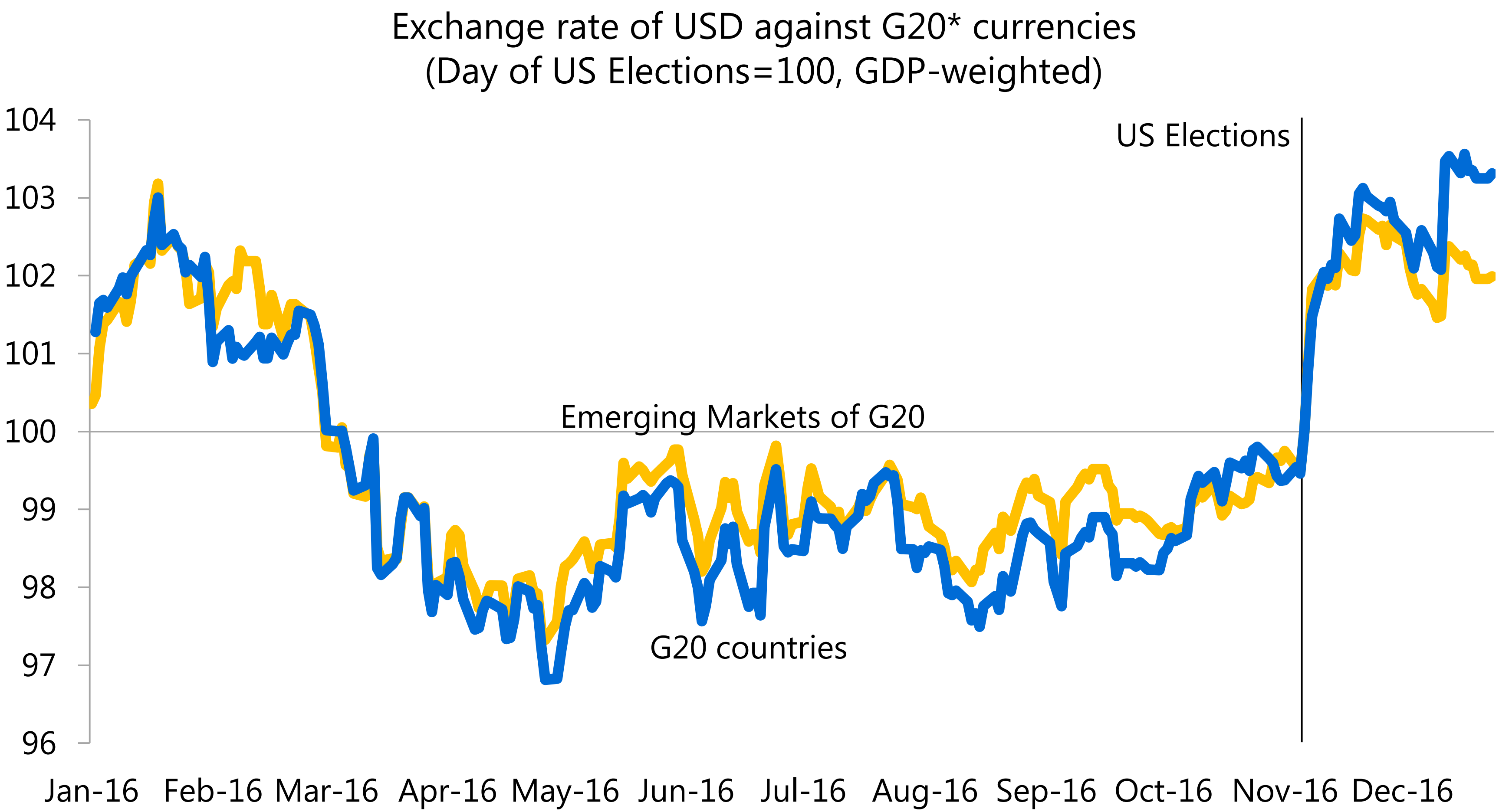
Since the election there has been a sharp increase in US long-term interest rates



…as financial markets have become more optimistic…



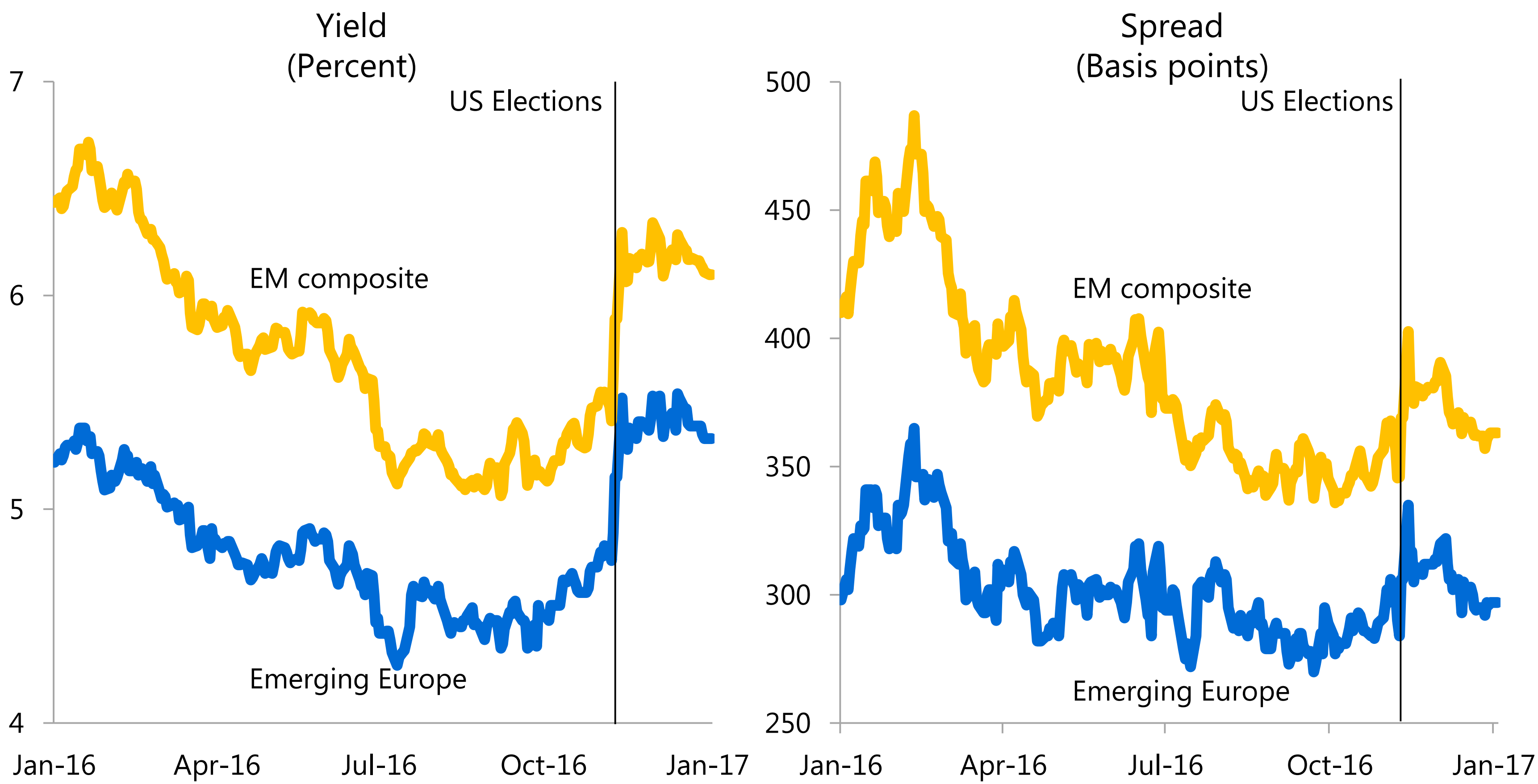
Dollar appreciated strongly



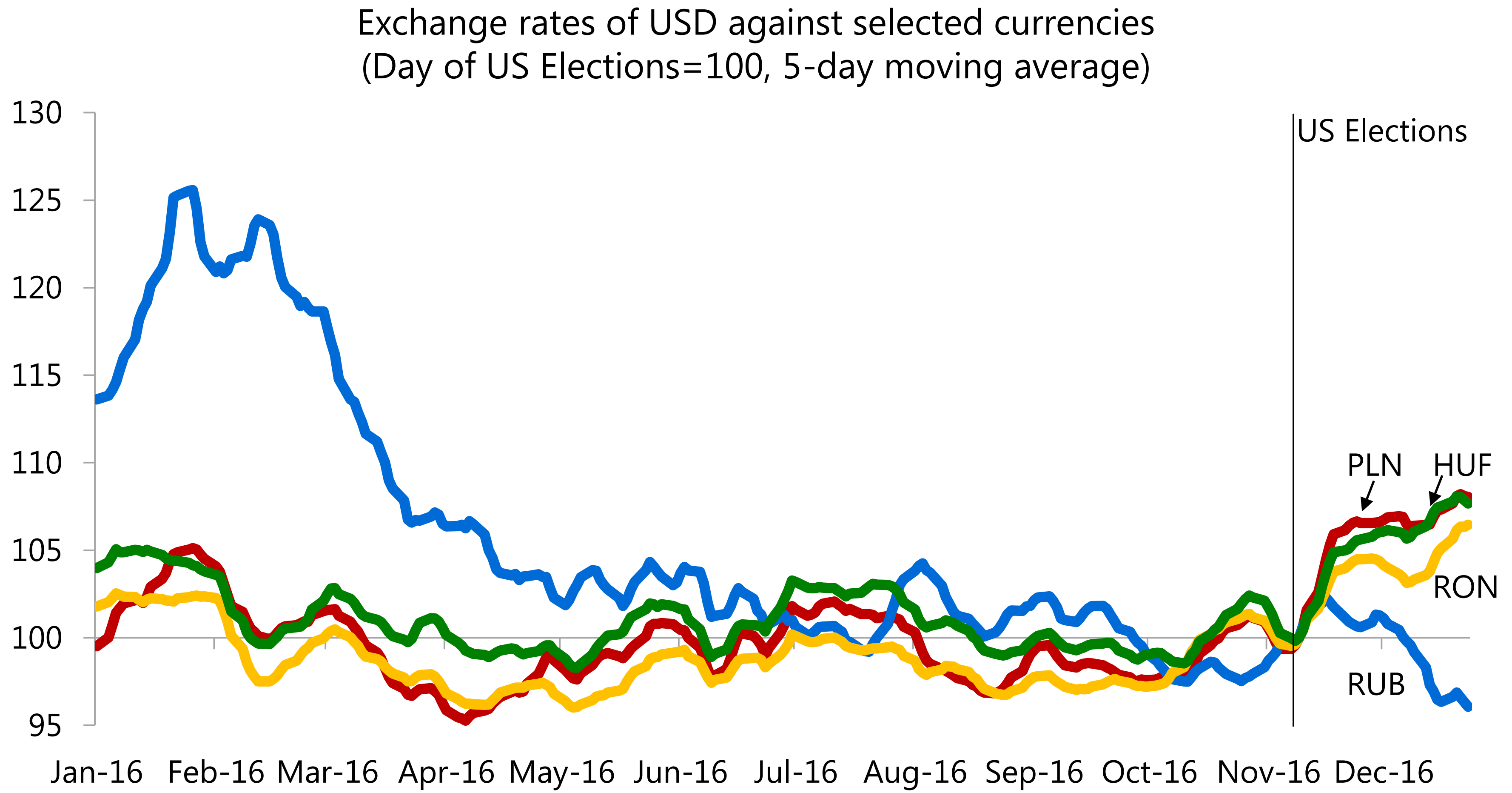
*DEU, FRA, ITA and EU are replaced by EA.

Financial conditions for EMs have tightened, but spreads broadly unchanged

Emerging Market Bond Index Plus



In CESEE, exchange rates have depreciated vis-à-vis dollar, except RUB (oil prices up)



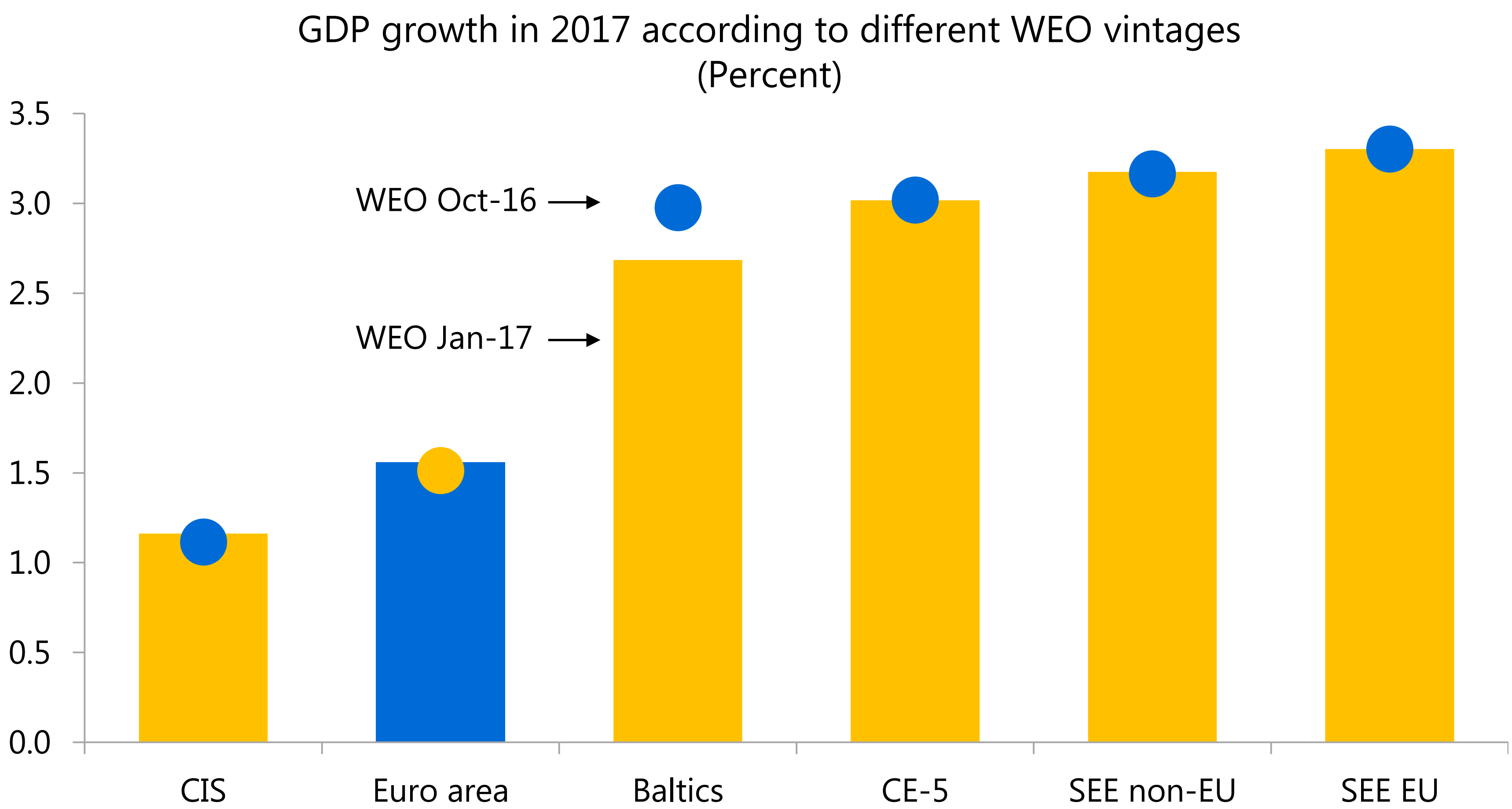
Markets seem to anticipate US fiscal stimulus and higher US growth. What does this mean for CESEE?

- Stronger US growth
  - Will boost exports, but at risk of more protectionism
  - May boost commodity prices
- Stronger dollar
  - Helps exporters ✓
  - Negative balance sheet effects for dollar-indebted ✗
- Higher financing costs
  - Hurts countries with weak growth ✗
  - May help countries that are advanced in the cycle ✓

For CESEE overall impact likely to be modest

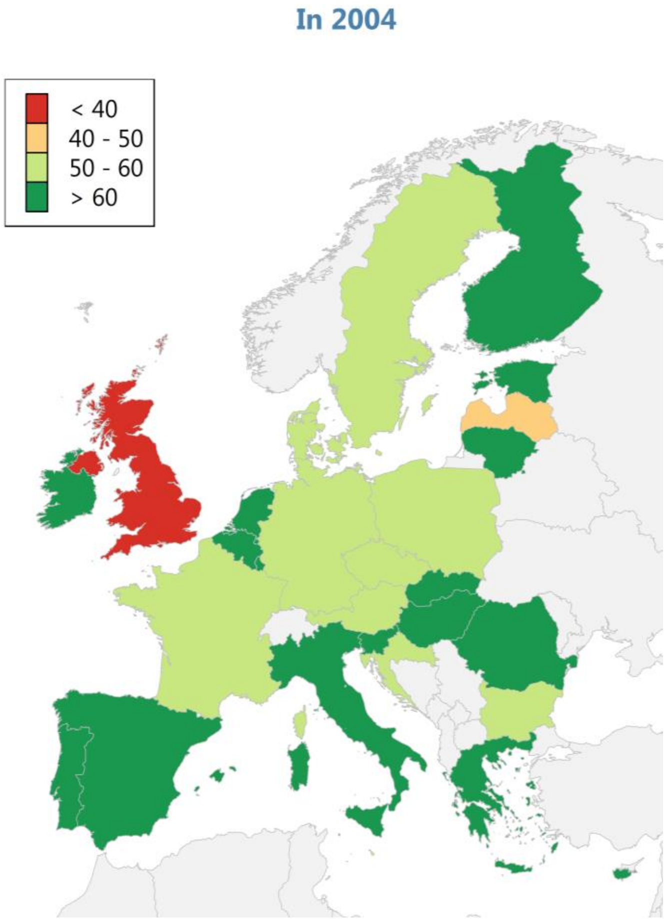
- But this will depend on US policies, which are not quite clear at this stage.
- There are also risks:
  - Increase in US protectionism, which could lead to trade war
  - With already low unemployment, large fiscal stimulus could lead to much faster than expected monetary tightening.

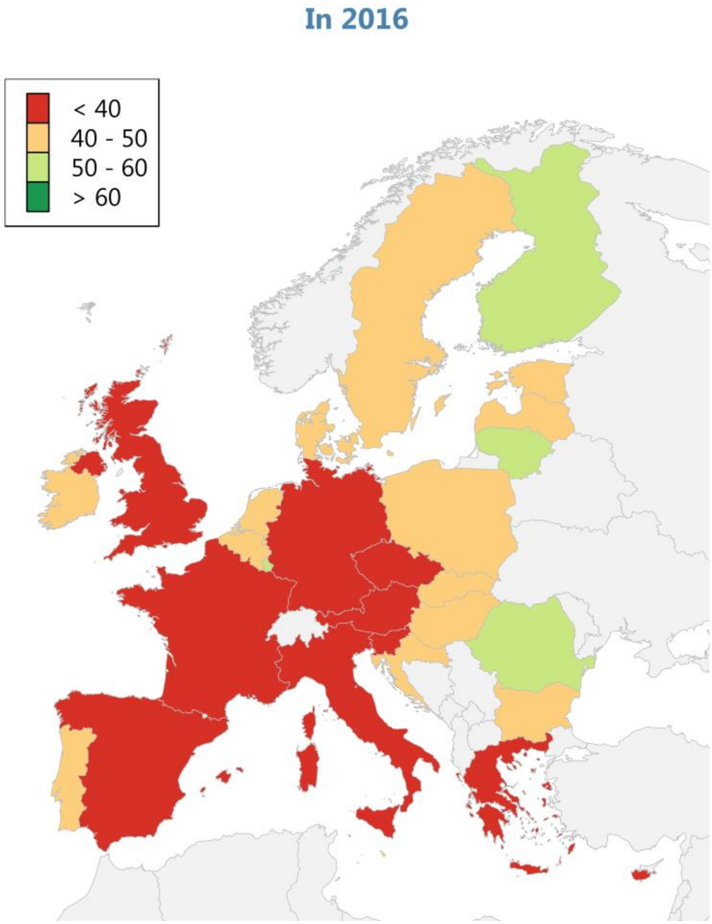
Indeed, projections for CESEE roughly unchanged



Bigger risk may be Europe. Unhappiness with EU has increased sharply in past decade…

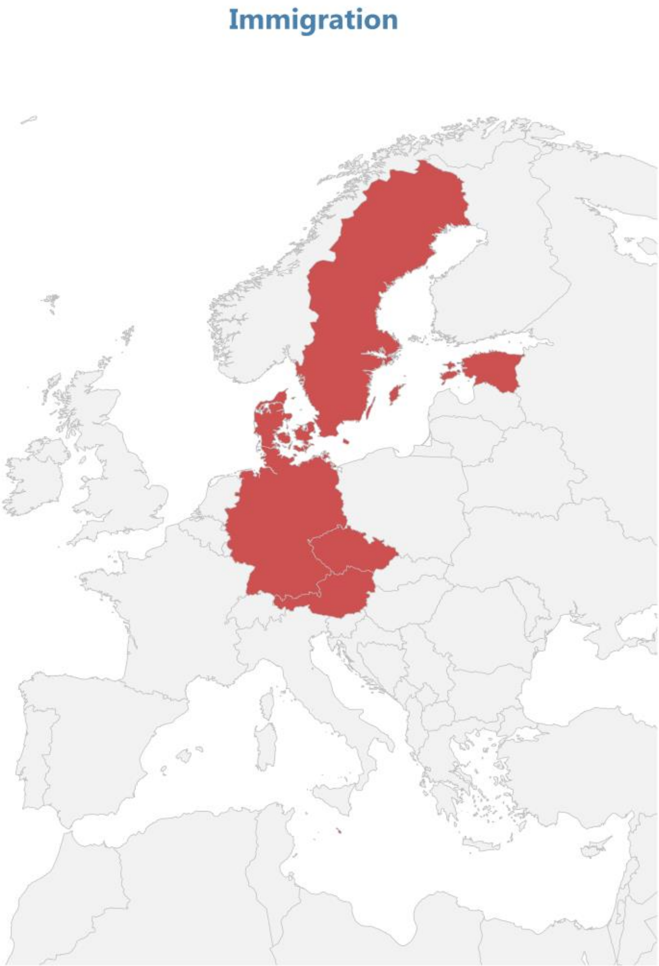
Level of confidence in the European Union
(Percent of population surveyed by Eurobarometer)

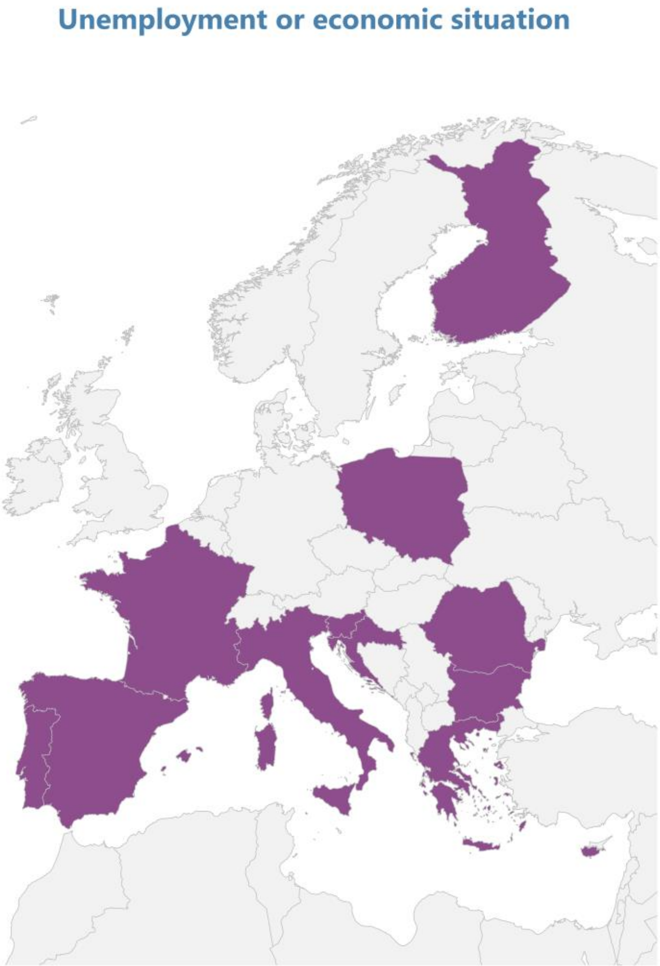




Further fueled by concerns about migrations and economy

Most important issues facing the EU countries in 2016
(According to Eurobarometer)

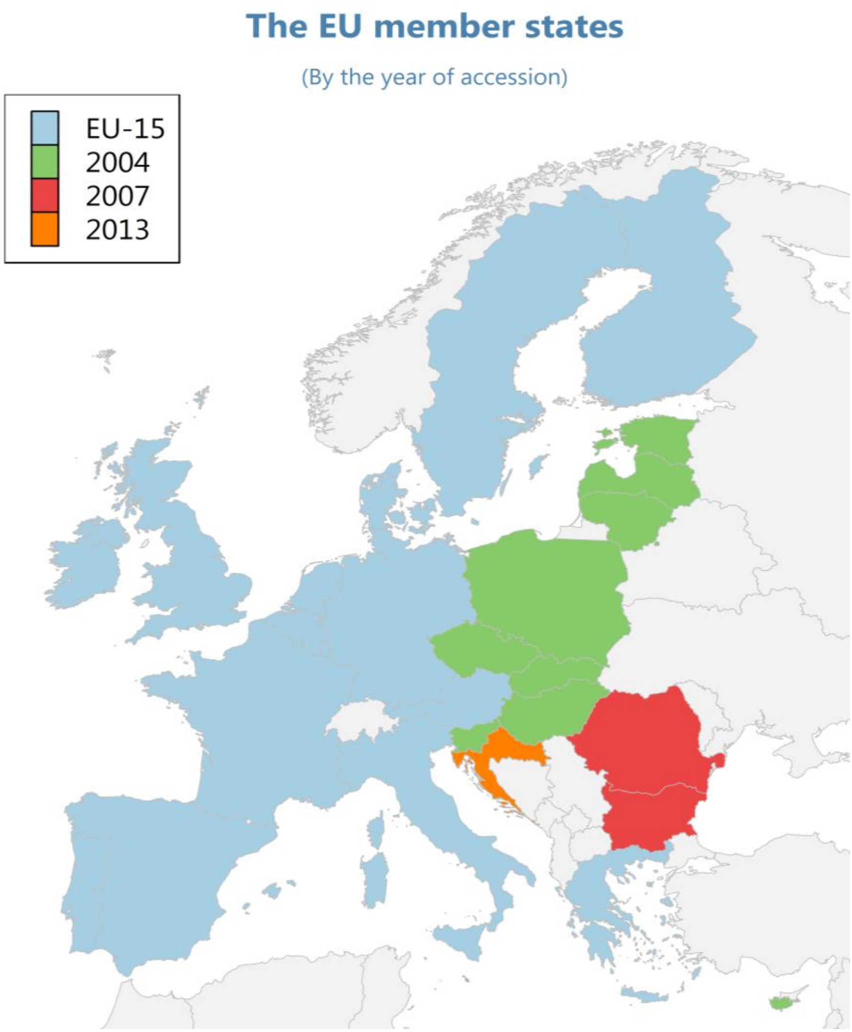




There are a number of important elections in 2017

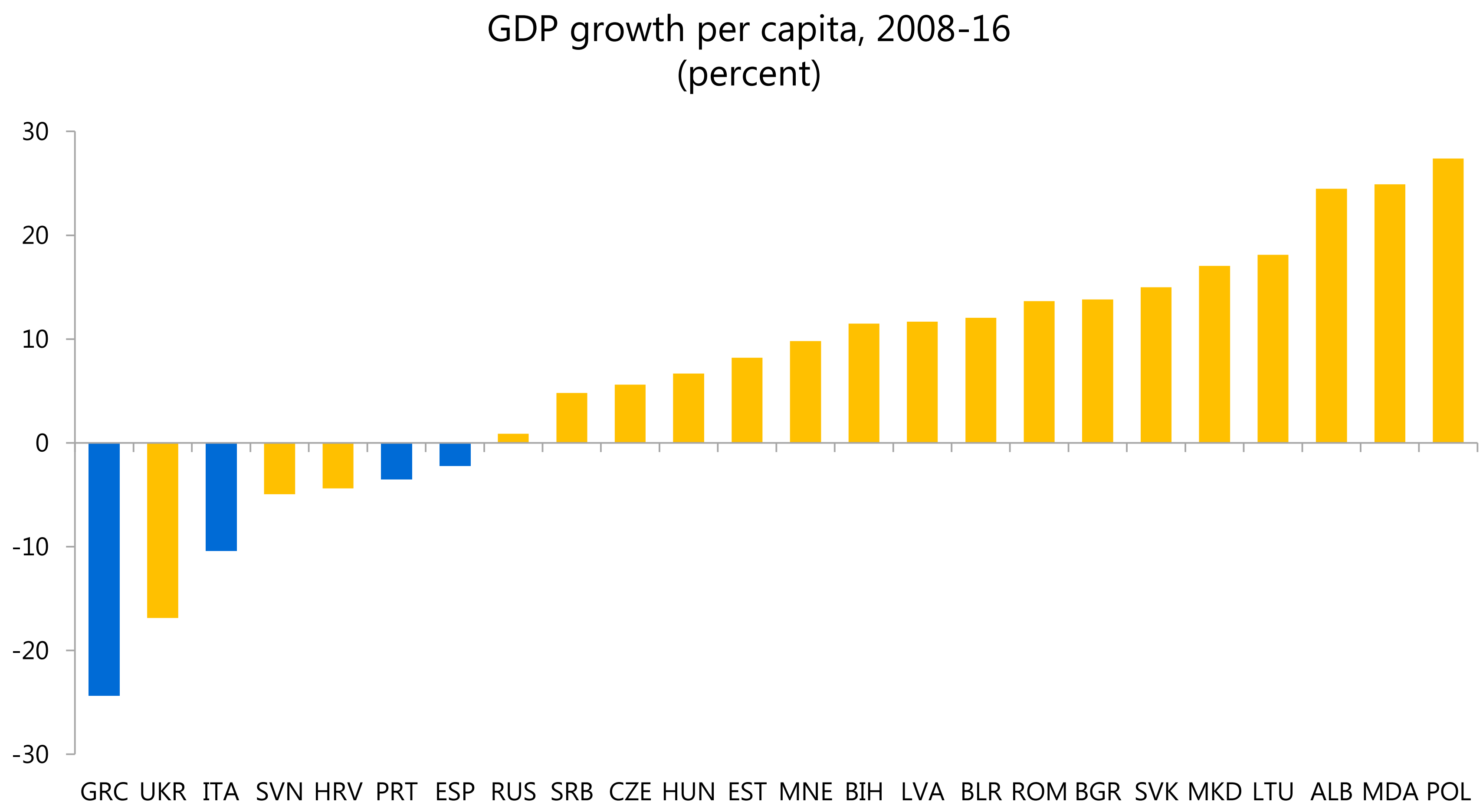
- French presidential elections
- German federal elections
- Dutch general elections
- (Possibly) Italian general elections

How will this affect further expansion to Western Balkans?



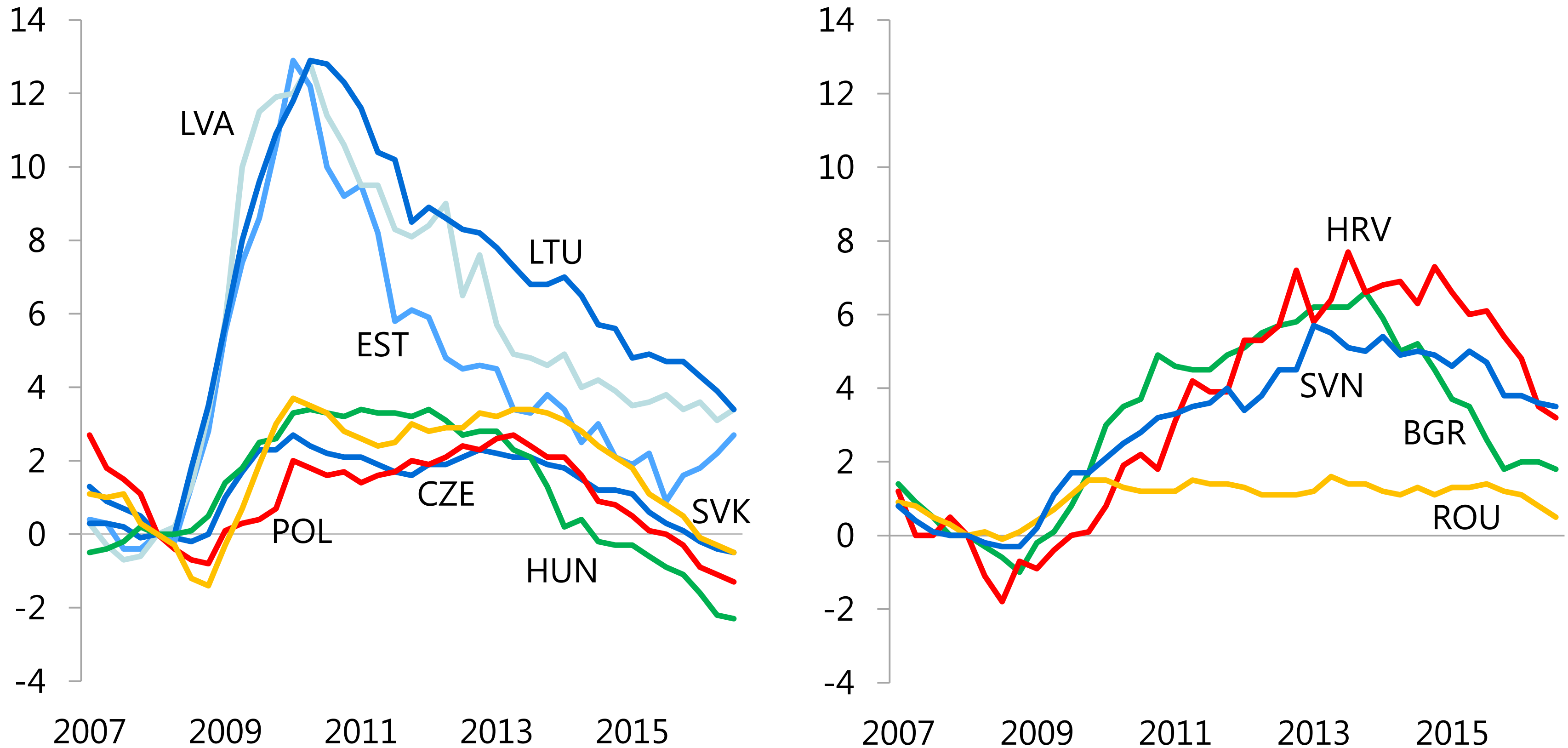
Remaining and future challenges

The 2009 crisis was deep, but most CESEE countries have recovered to above pre-crisis levels



Unemployment in the EU New Member states is coming down rapidly

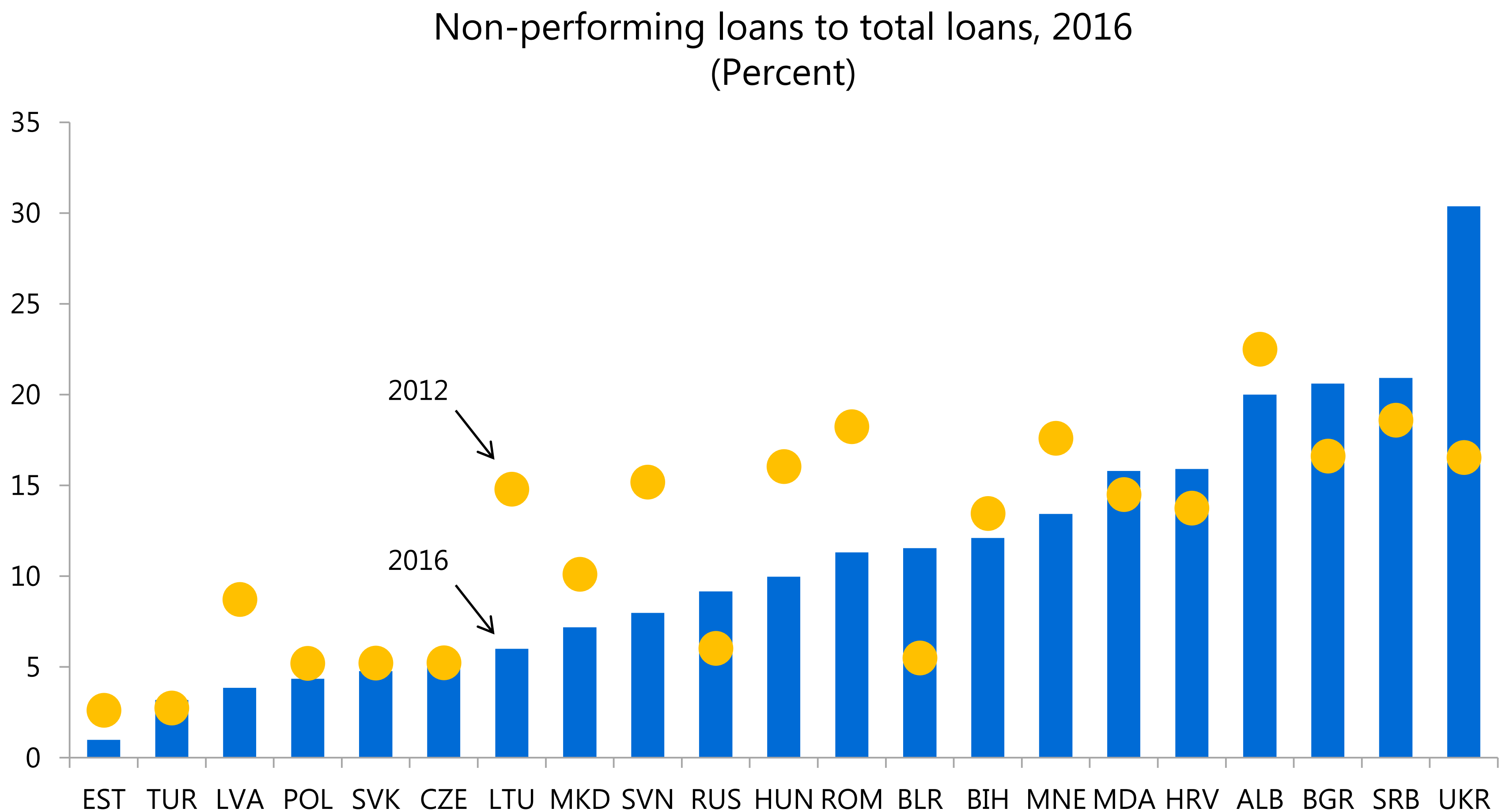
Cumulative changes in unemployment rate
(2008Q1=0, seasonally adjusted)



However, there are crisis legacies

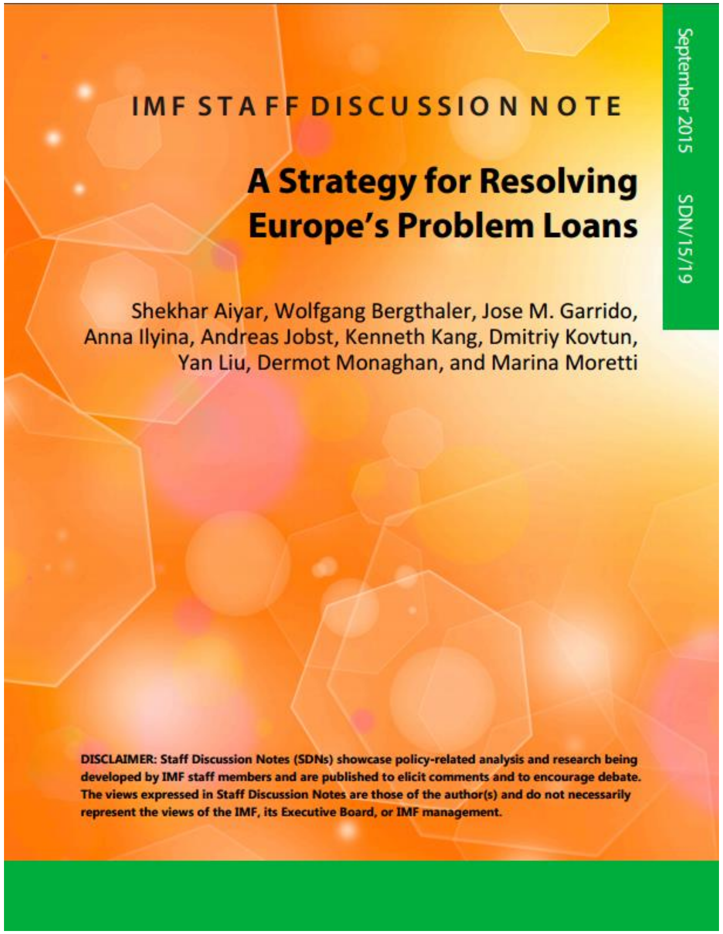
- Financial sector:
  - High share of non-performing loans
- Government sector:
  - Rebuild fiscal buffers

Clean up banks' balance sheets: NPLs have come down (although they are still high in SEE and Ukraine)



Note: for MNE and BGR data for 2012 and 2015.

How to deal with high NPLs?


September 2015 SDN/15/19

IMF STAFF DISCUSSION NOTE

A Strategy for Resolving Europe's Problem Loans

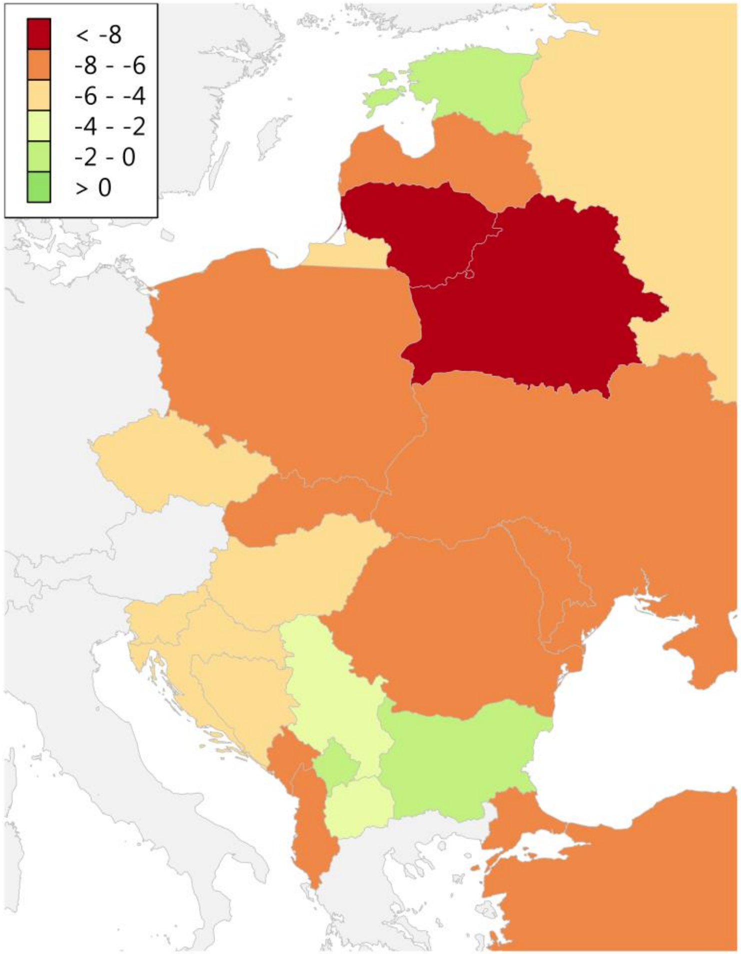
Shekhar Aiyar, Wolfgang Bergthaler, Jose M. Garrido, Anna Ilyina, Andreas Jobst, Kenneth Kang, Dmitriy Kovtun, Yan Liu, Dermot Monaghan, and Marina Moretti

DISCLAIMER: Staff Discussion Notes (SDNs) showcase policy-related analysis and research being developed by IMF staff members and are published to elicit comments and to encourage debate. The views expressed in Staff Discussion Notes are those of the author(s) and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

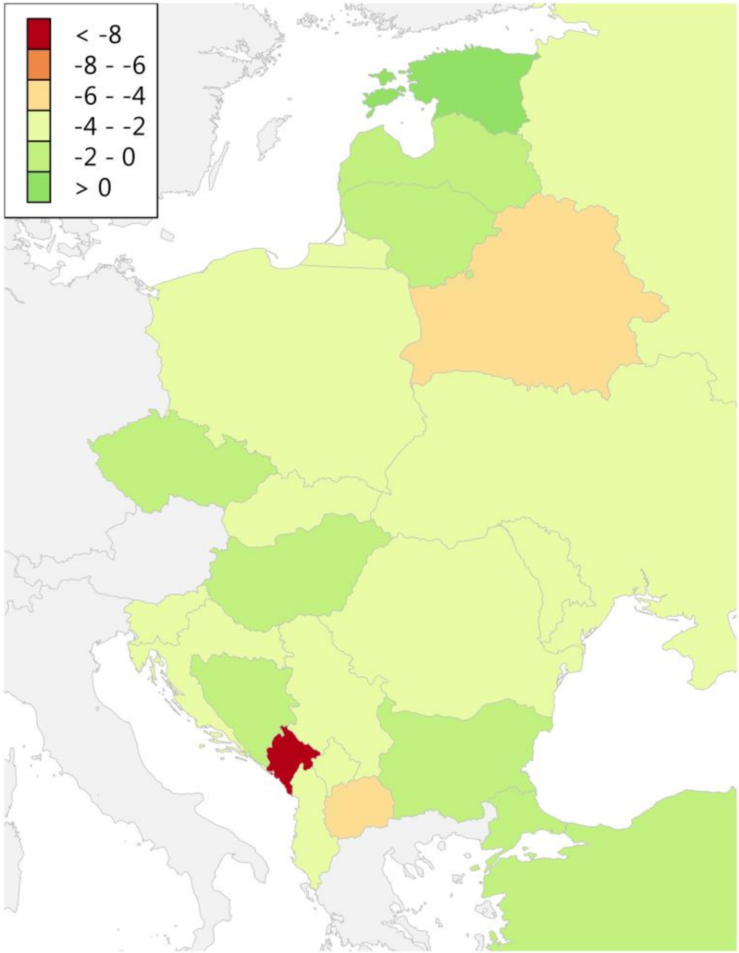
Fiscal deficits have declined to more modest levels…

Fiscal balance
(Percent of GDP)

In 2009



In 2016

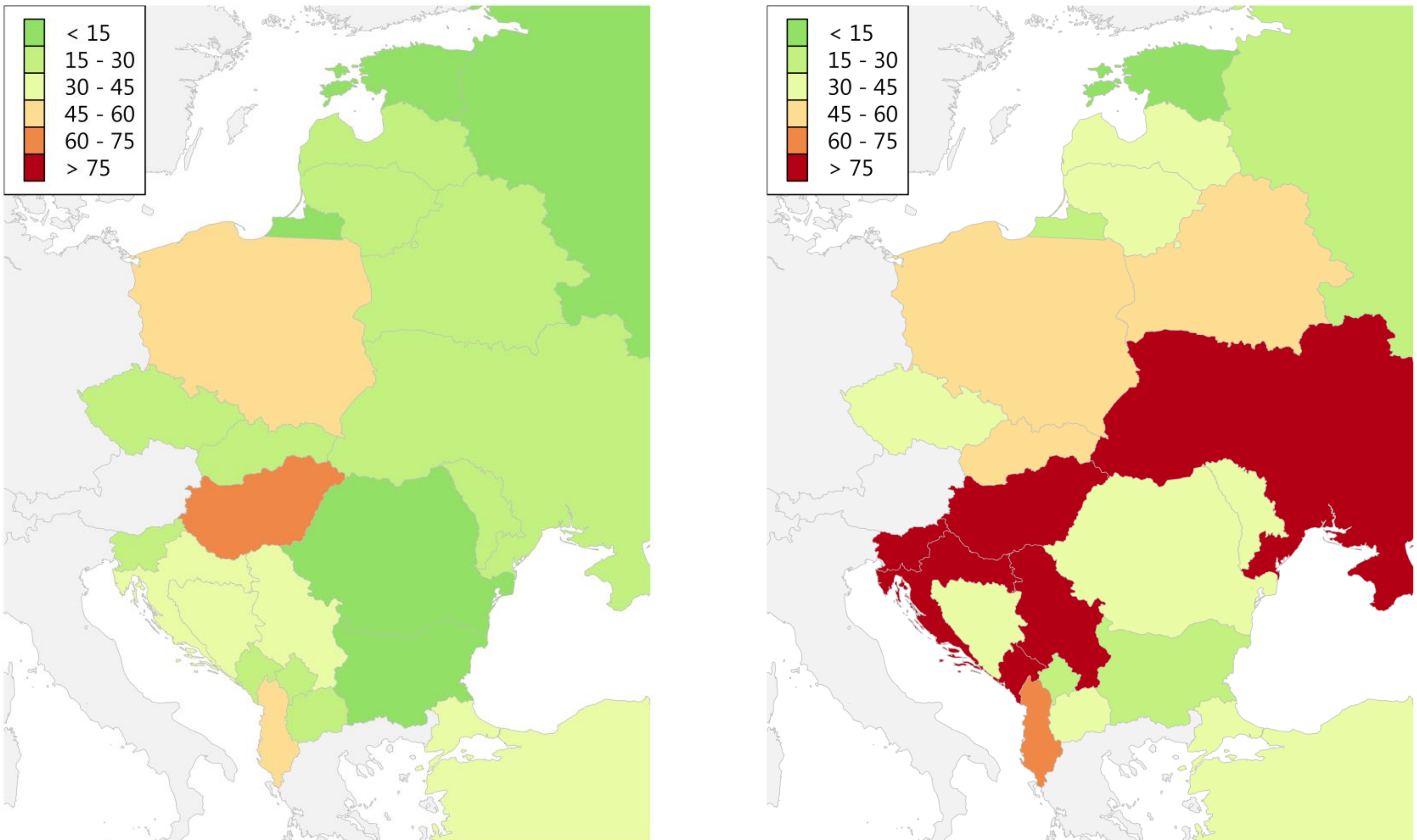


But public debt is no longer low

Public debt
(Percent of GDP)

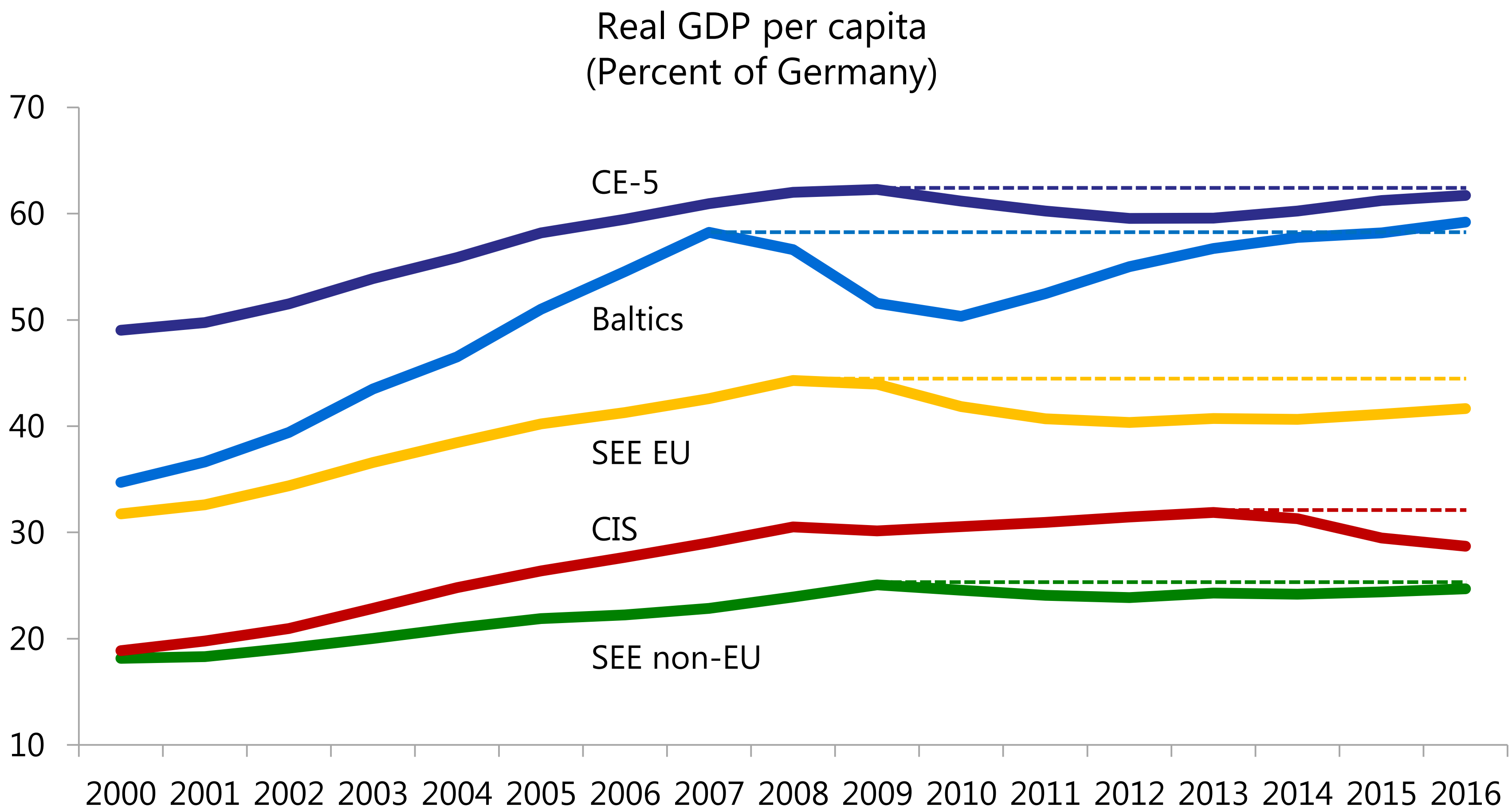
In 2008

In 2016

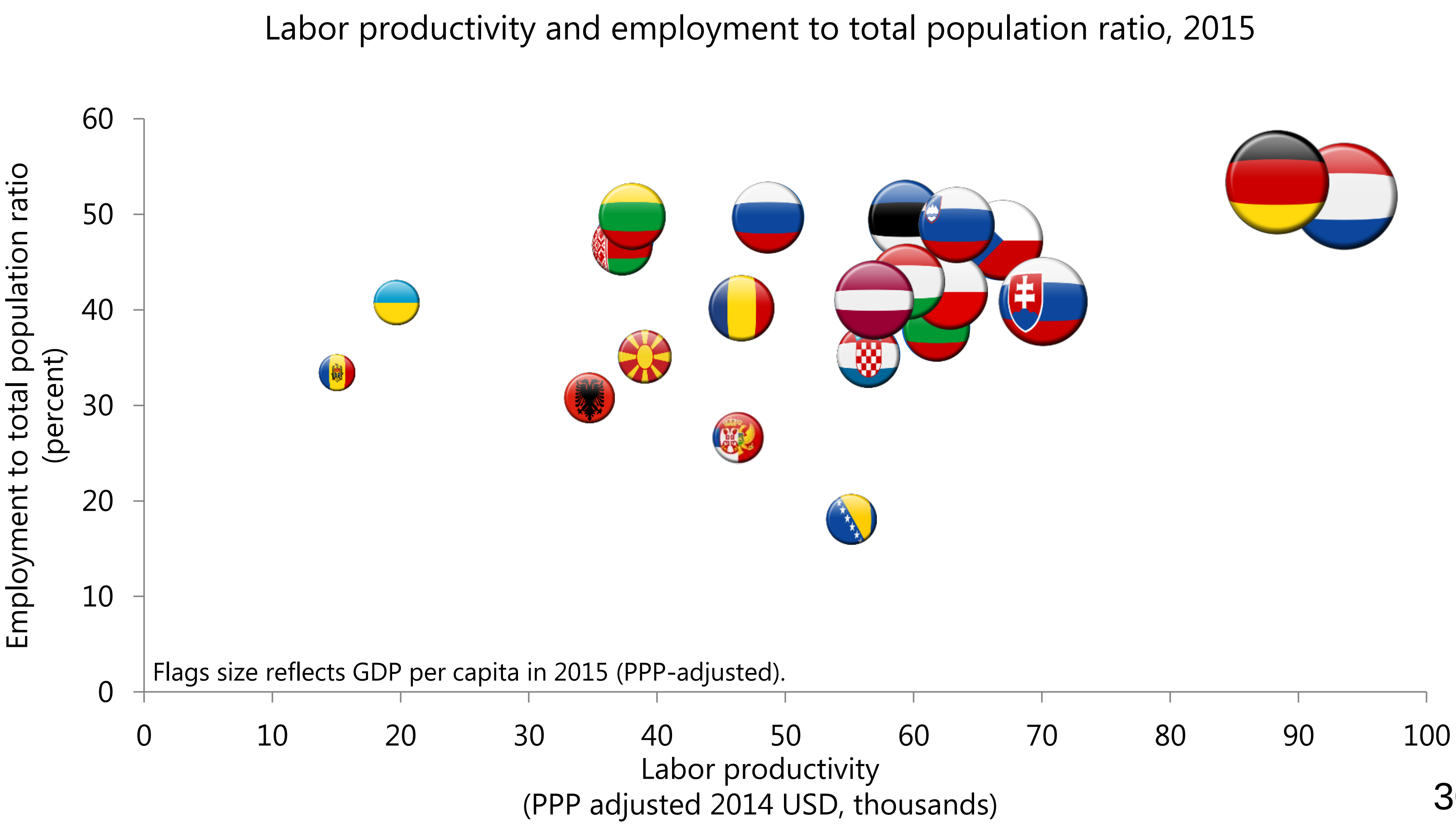


In past 25 years, region has made tremendous progress

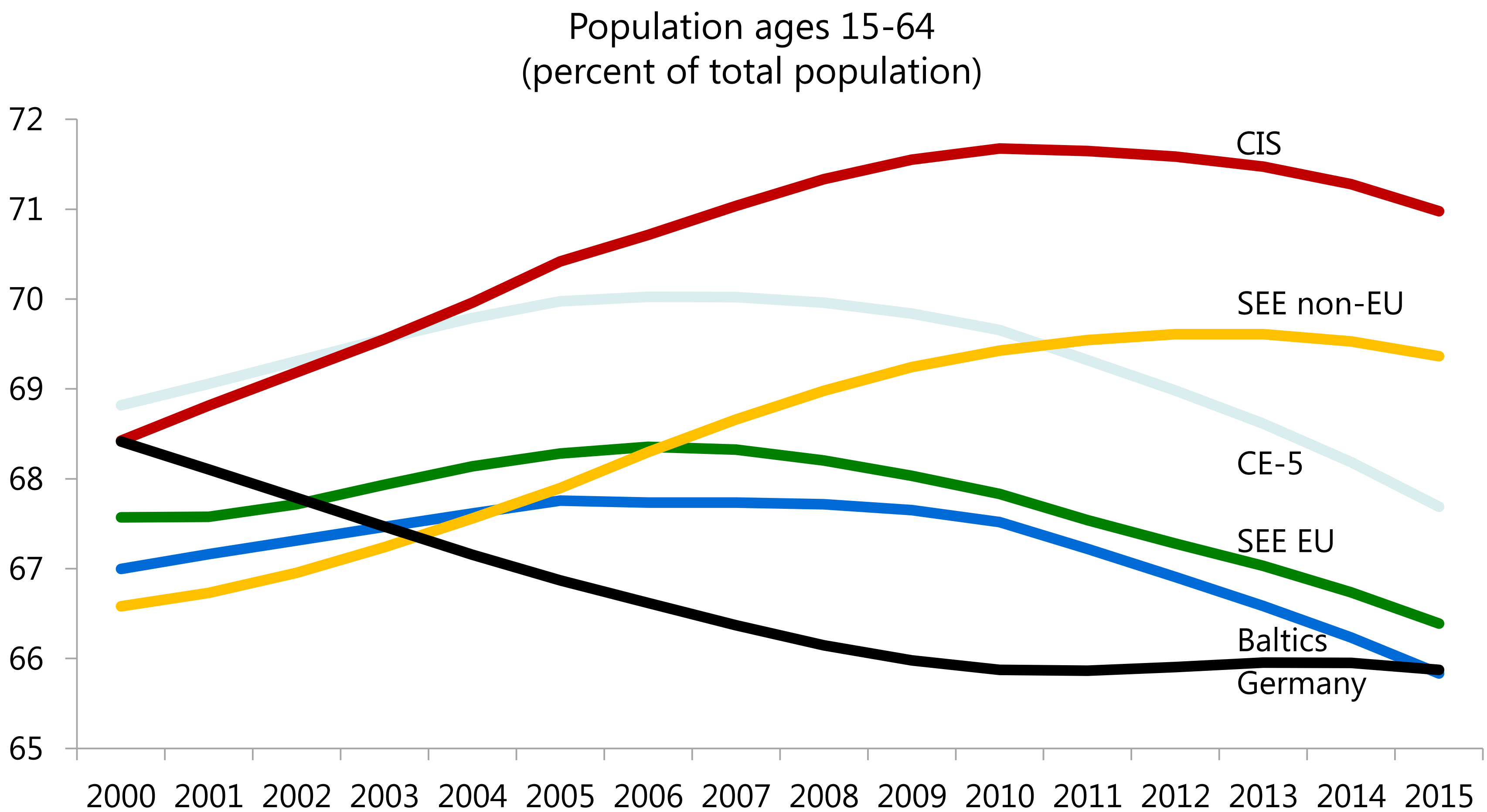
But more recently, convergence has slowed



Further convergence will require both higher labor *input* and labor *productivity*

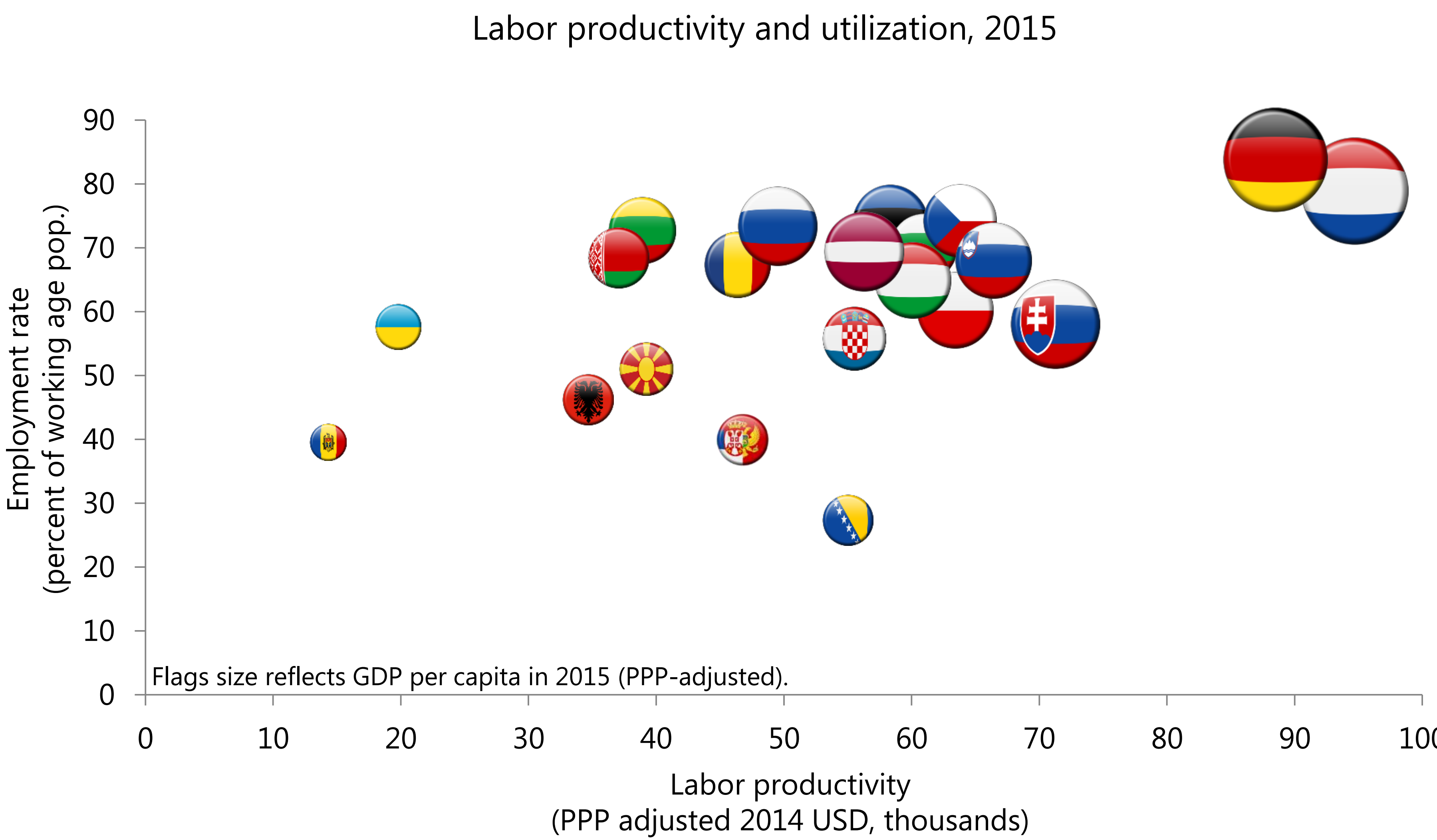


Labor input looks relatively high, but this is partly because a large share of the population is between 15 and 64 (working age)

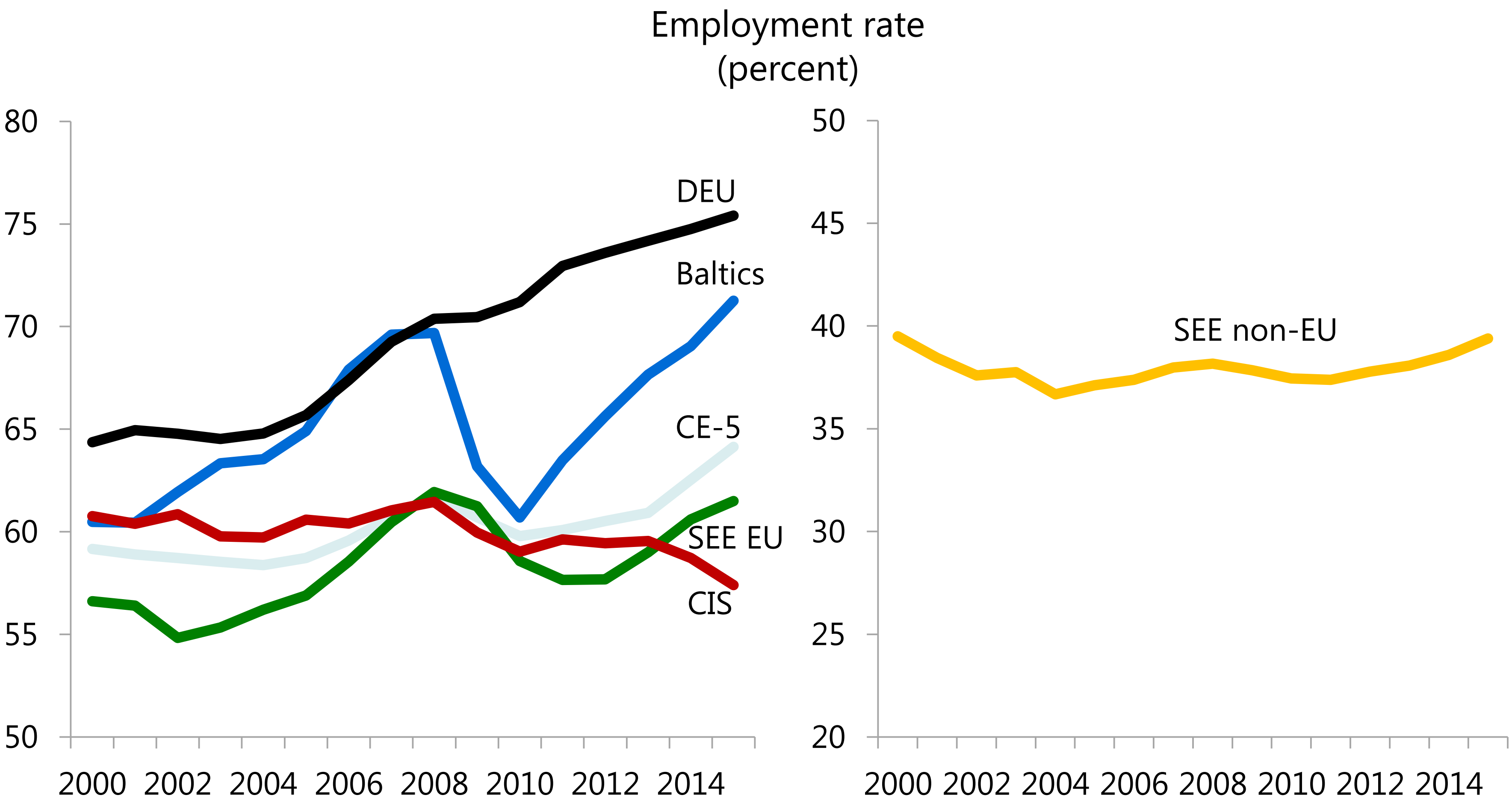


Note: Simple average of given countries.

If we compare employment to working age population rate differences in labor input with Germany are more pronounced



Indeed, employment rates are still well below Germany—with the exception of Baltics

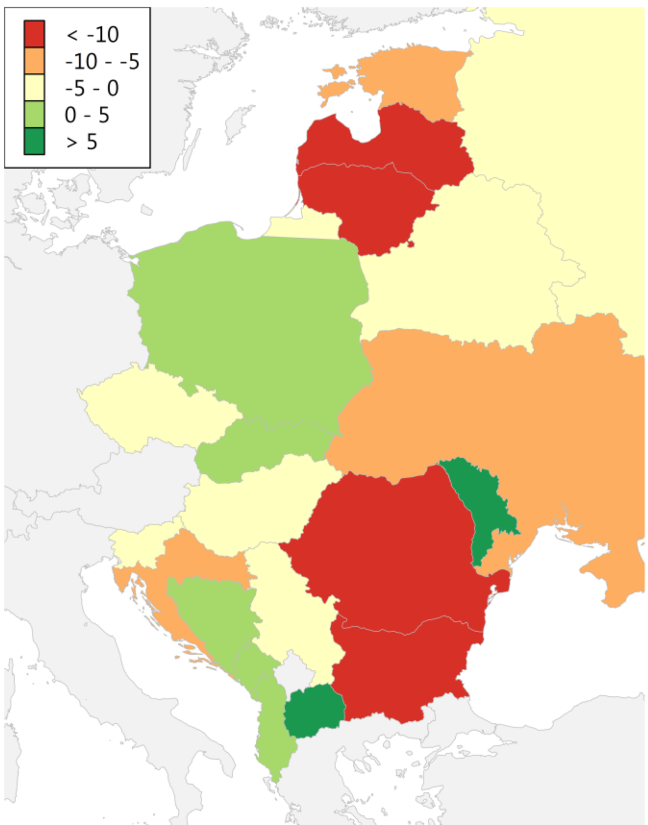


Note: Simple average of given countries.

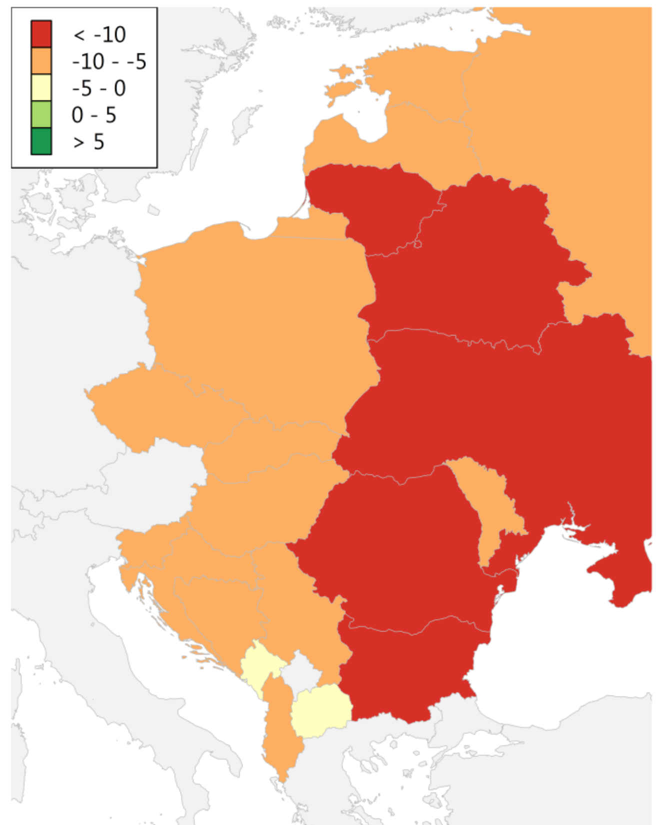
Aging will accelerate in the next decade

Working age (15-64) population growth
(percent)

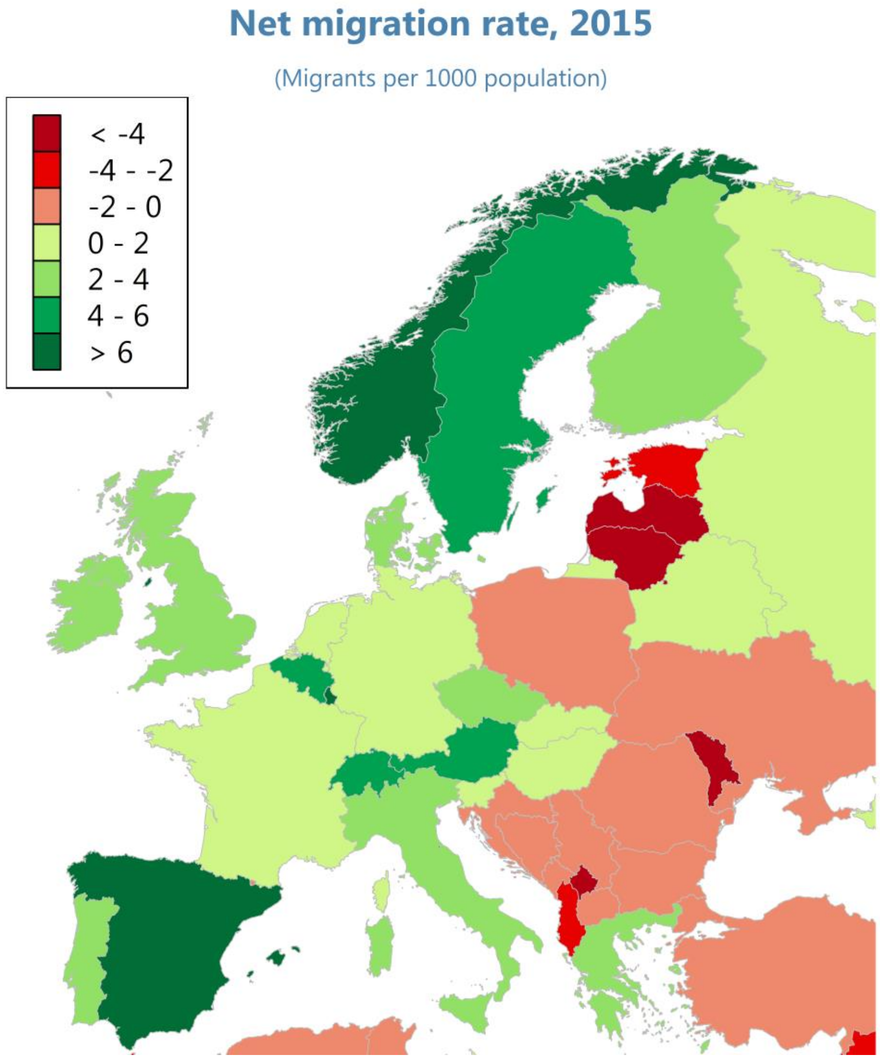
2000-2015



2015-2025

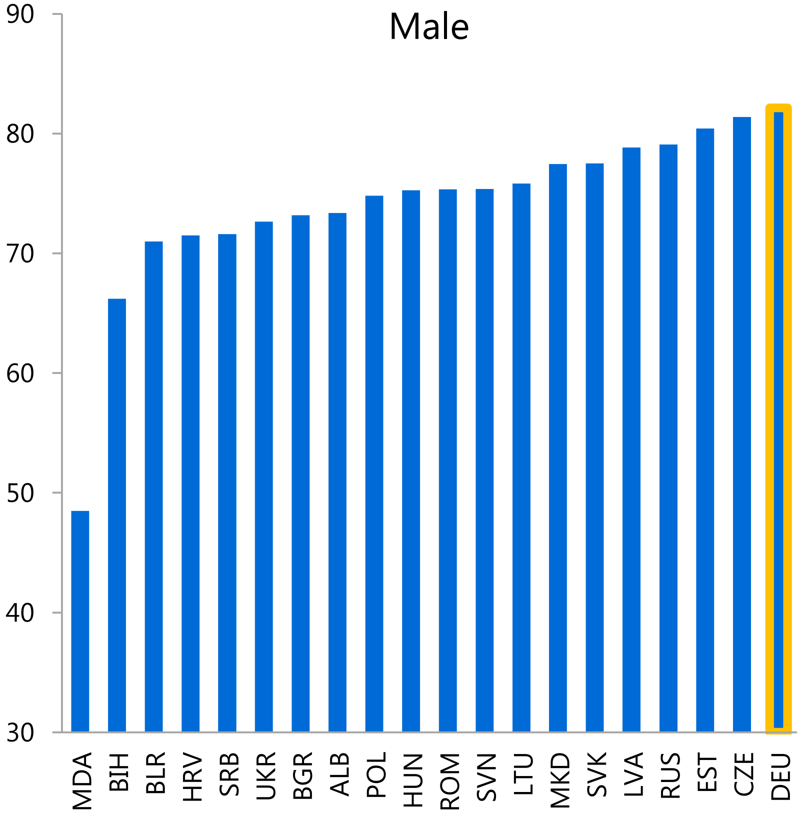


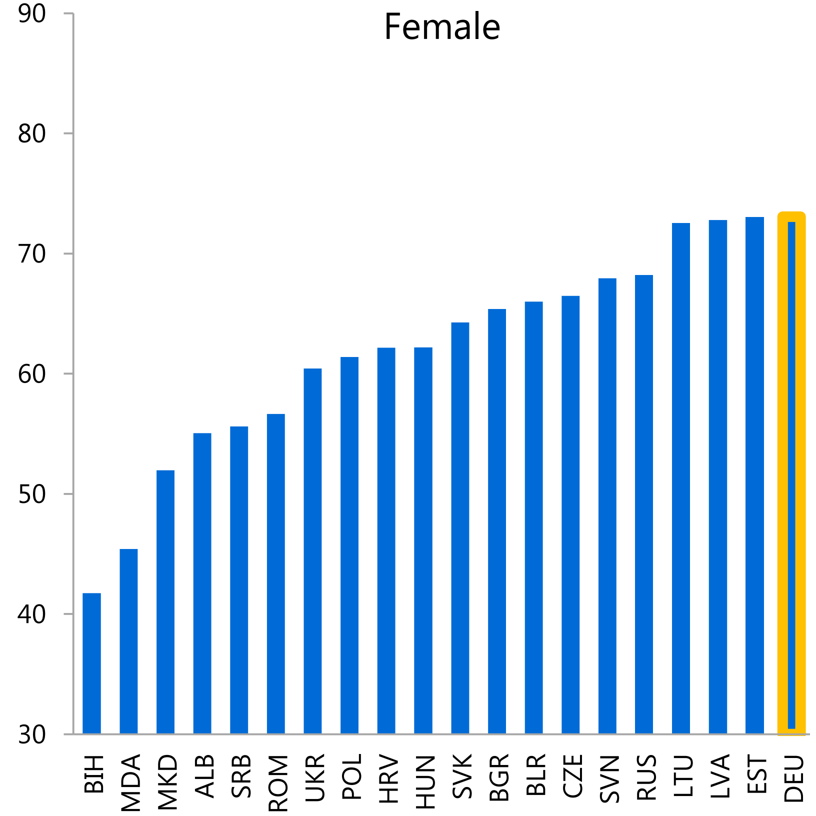
Emigration exacerbates the labor supply problem



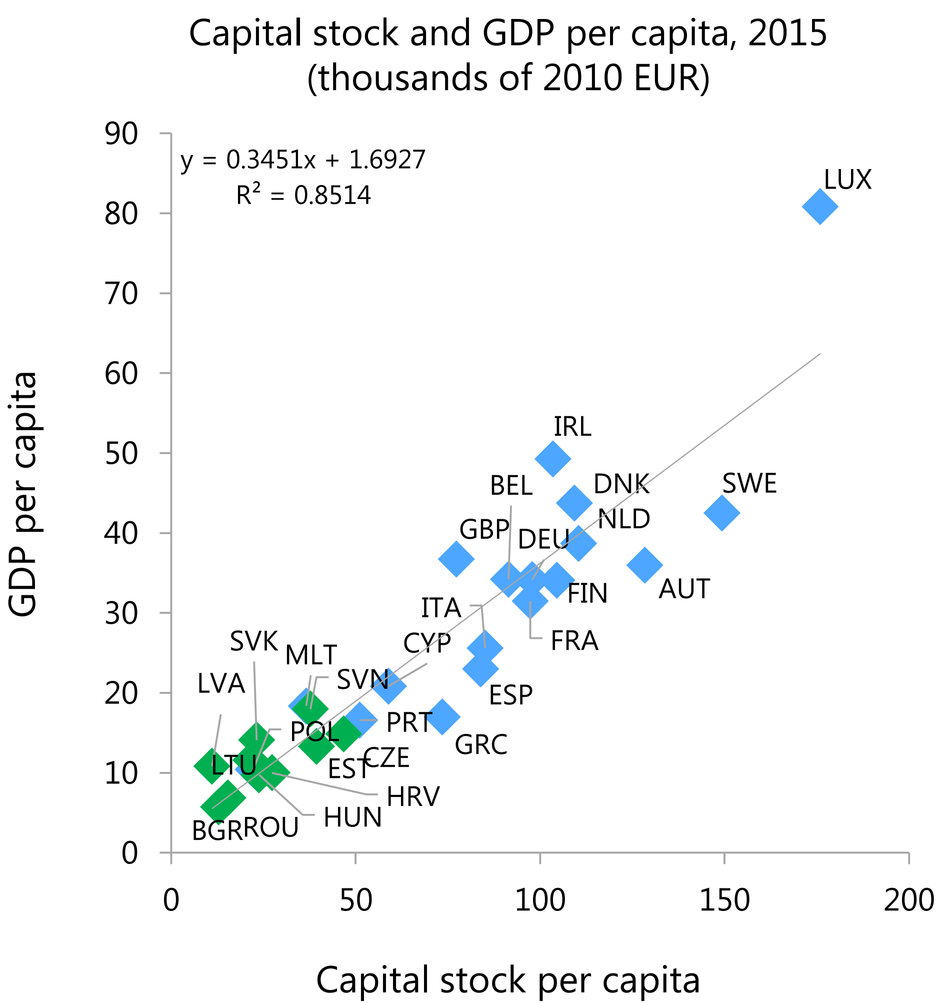
It will be important to increase labor force participation, including of women

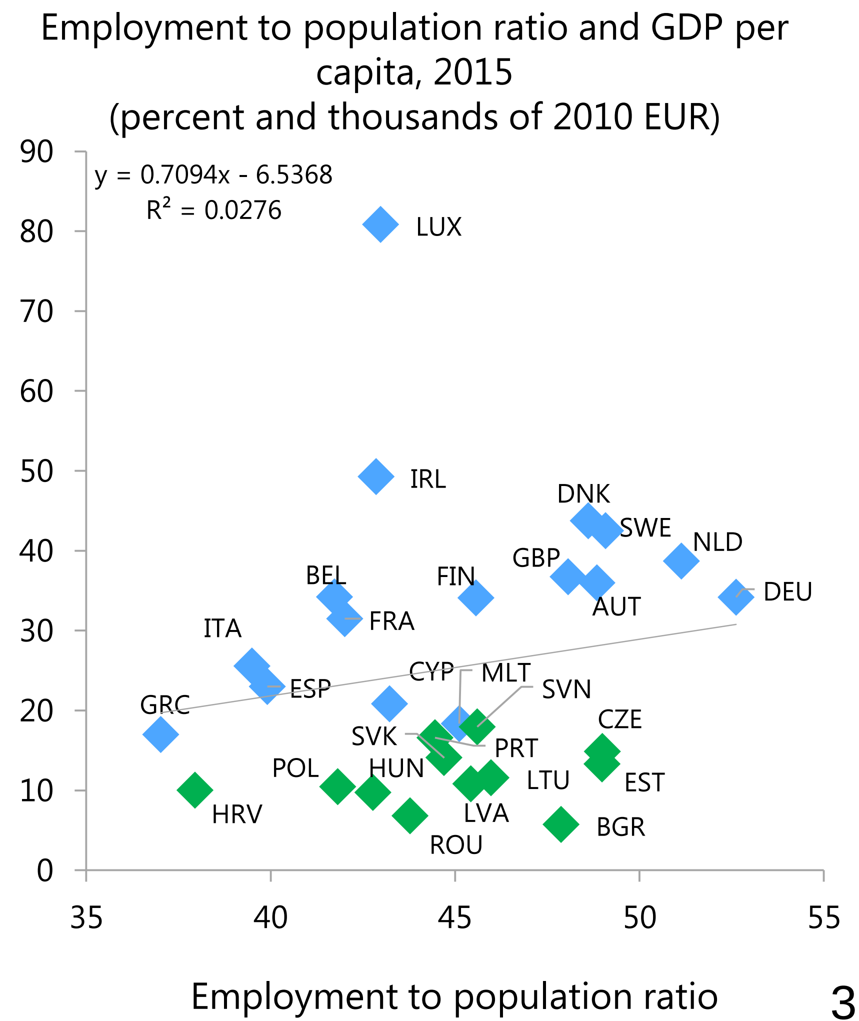
Labor force participation rate, 2015
(percent of either male or female population ages 15-64)



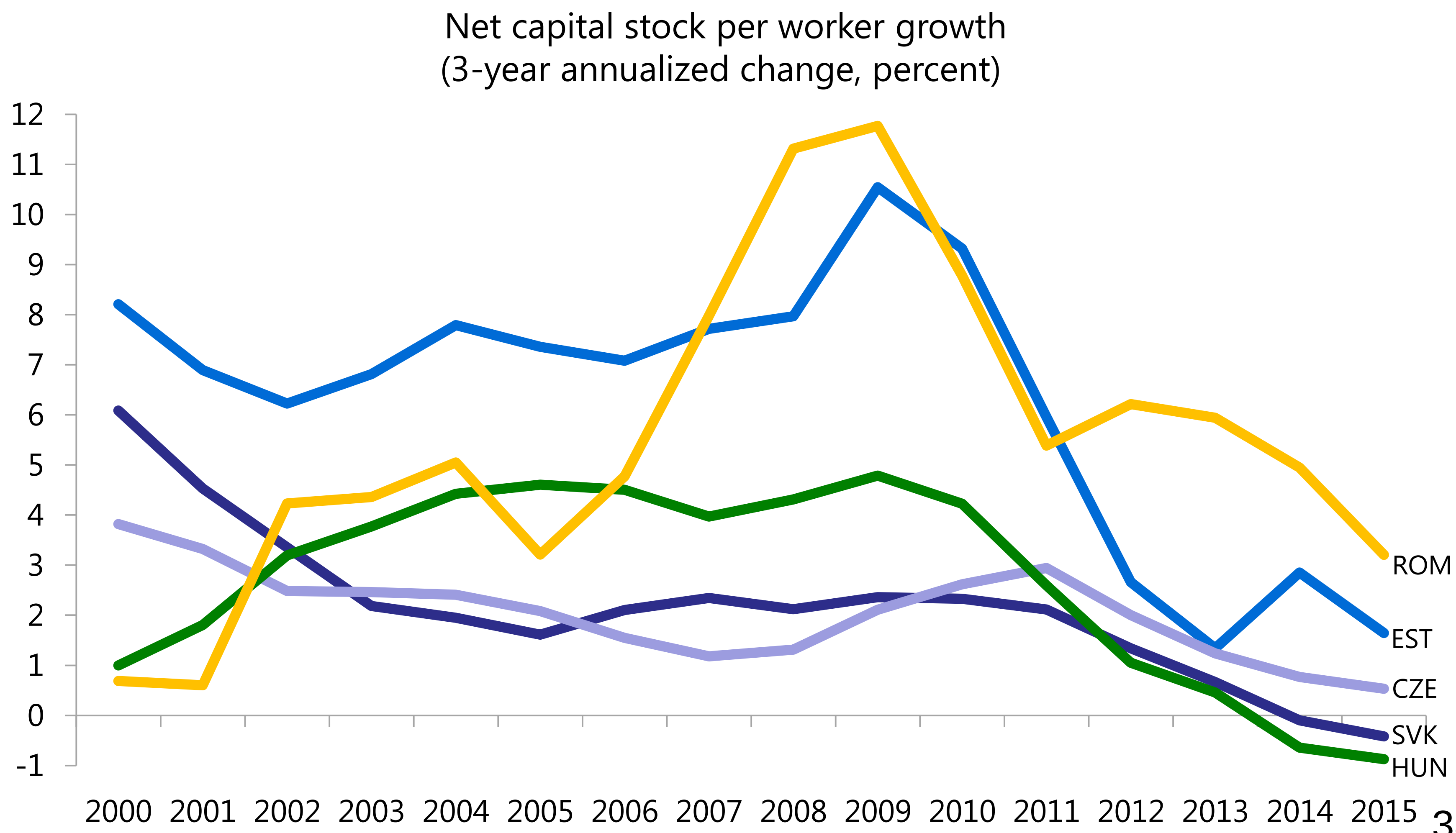


While higher labor input will help, higher capital stock and thereby labor productivity may be even more important



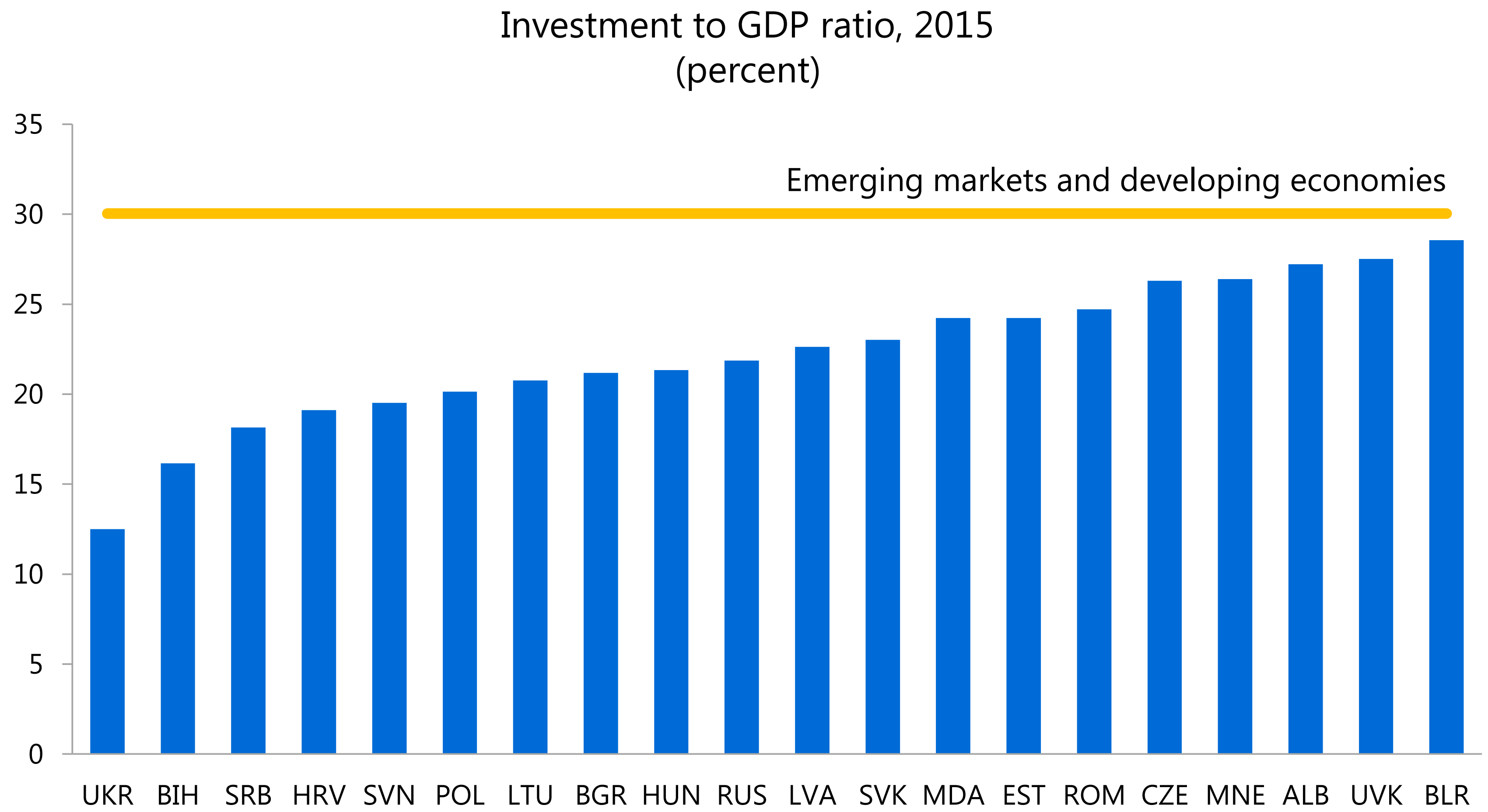


However, growth of capital stock has slowed…



…as investment rates post-crisis are (too) low.

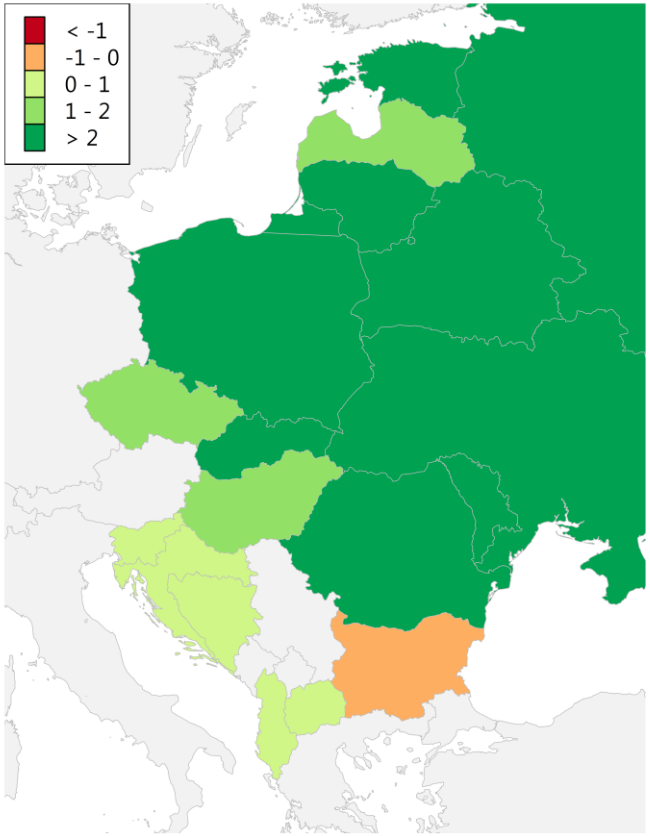
EUR



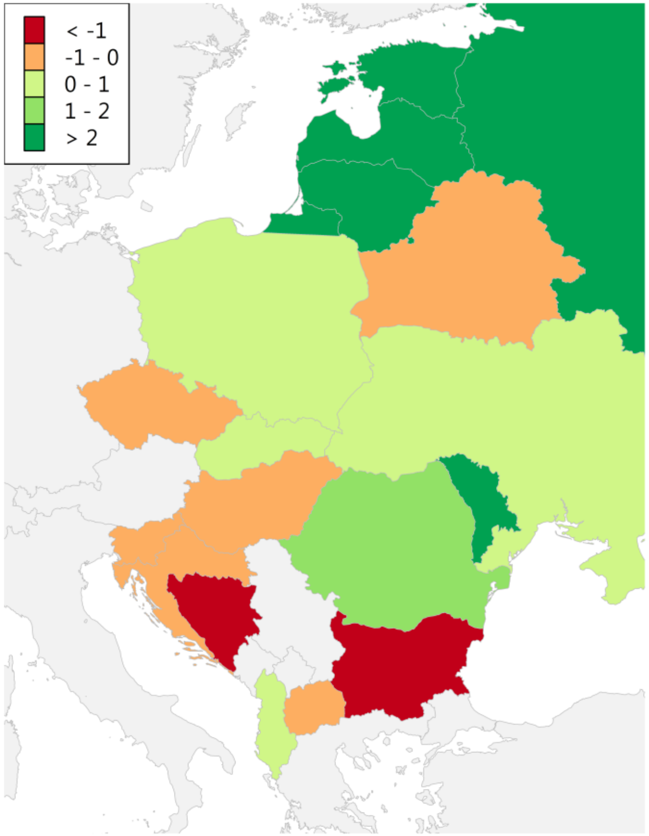
Low investment not only problem: TFP growth has slowed as well…

Average total factor productivity growth
(percent)

2000-04



2010-14



So what should be done?

Address factors that might constrain productivity (REI May-16)

- Insufficient protection of property rights and
- Inefficient legal systems and other government services
- Limited access to financial services (e.g. for SMEs)
- Infrastructural gaps

Improve public investment management and tax administration (REI Nov-16)

- Closing efficiency gaps in public investment and tax collection could bring sizable benefits.
- Further upgrades of public investment management should focus on improving allocation and implementation frameworks and procedures.
- Improvements in tax administration should aim at reducing compliance gaps.
- Design of reforms should include elements that help reduce resistance to reforms and build the support base for their successful completion.

Thank you