Regional Economic Outlook and Regional Economic Issues

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In the last decade, world has experienced a lot of shocks

- 2008/09 global economic and financial crisis
- 2010/12 Euro area crisis
- 2014/15 oil price collapse and recession in large EMCs
Until a year ago growth continued to disappoint
The good news is that more recently we have been upgrading growth forecast.
This year, advanced economies are growing around 2 ¼ percent, China and India, 7, other EMCs, 3 ½
USA will grow by 2.7 percent, euro area by 2.2, and Japan by 1.2
Unemployment rate in advanced countries is near pre-crisis low.
But wage growth remains subdued
With recovering oil prices, inflation in advanced countries has picked up, but remains below target.
But stock markets are surging, net worth in the US is above pre-crisis peak.
Fed has started to tighten, ECB rates are expected to remain low for longer
In CESEE, CIS recovering and non-CIS growing strongly

Real GDP growth (Percent)

Other CESEE

CIS
GDP per capita is well above pre-crisis level (except Ukraine)
NON-CIS CESEE
Growth is rapid, and unemployment is falling sharply

Real GDP growth (Percent)

Unemployment Rate (Percent)
Growth in the region is not as high as in the pre-crisis years.
But employment growth in many countries is as high as during pre-crisis peaks.
Even if we exclude peak pre-crisis years: current growth is lower but employment growth higher than pre-crisis.
Inflation, which was very low in 2015-16 has picked up recently.
Energy and food prices played key role in pick-up of inflation
Growth in 2018 will continue to be strong

- External demand expected to remain strong in the next quarters...

- Consumption is solid as employment is growing rapidly and wages are accelerating

- Investment further boosted by pick-up of EU funds
What will this imply for labor markets?

Employment and Working Age Population Growth in CESEE
(Excl. TUR and CIS, percent)
In the EU NMS wage growth has accelerated, while it has remained more modest in the Western Balkans.
In Western Balkans unemployment rates are still very high and employment rates low.
Unemployment is coming down rapidly and is now below pre-crisis levels in many countries.
In both regions, rapid decline of unemployment suggests that GDP is growing faster than potential.

- At some stage, labor market shortages will become constraint on growth.
- Growth can only continue at this pace if productivity picks up.
This would be the good time to create fiscal space and reduce structural deficits

- Particularly given that debt is much higher than pre-crisis levels.
Unfortunately, many countries with too high structural deficits are revert to pro-cyclical loosening.
In 2014–15, Russia and Ukraine suffered from shocks, and Belarus from spillovers

- Collapse of commodity prices
- Sudden stop in capital flows to Russia, result of sanctions on Russia
- Conflict in Ukraine
Exchange rate flexibility was unavoidable given the limited buffers...
...but increased inflation and reduced real wages

CPI Inflation in European CIS (Percent, weighted average)

Average monthly wages (USD)

- RUS
- BLR
- UKR
Ukraine and Russia are now recovering (helped by rising oil prices)
Moldova had a banking crisis in 2014

- Three large banks collapsed as a result of their long-lasting abuse by the shareholder(s)
- Supervisory action was slow to come
- Supervisory forbearance increased the ultimate resolution costs to the budget
But is now also recovering

Real GDP Growth in Moldova
(Percent, y/y)
Near-term prospects show solid growth
But growth is low in comparison to pre-crisis period

Real GDP Growth
(Percent, 3-year moving average)
THE FUTURE OF CONVERGENCE
Convergence has resumed (except in CIS)
But CESEE is still much poorer than Western Europe
As fewer people work and there is less capital per worker
Growth is slower than pre-crisis...
As investment rates are lower (except CIS)
Technological progress and efficiency advance much more slowly
Further exacerbated by the decline of the working age population
Fall in TFP is a global problem

TFP growth
(Percent, 5 year moving average)
Why has global TFP growth slowed?

Gone with the Headwinds: Global Productivity

Gustavo Adler, Romain Duval, Davide Furceri, Sinem Kiliç Çelik, Ksenia Koloskova, and Marcos Poplawski-Ribeiro

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Several interrelated factors have played a role

- To some extent measurement issues

- Weak corporate balance sheets, tight credit conditions which constrain investment in intangible assets

- An adverse feedback loop of weak aggregate demand, investment, and capital-embodied technological change

- Elevated economic and policy uncertainty
What can be done to boost TFP growth

Address several problems

- Limited access to financial services (e.g. for SMEs)
- Infrastructural gaps
- Inefficient legal systems and other government services
Improve institutions, especially judiciary

Judicial Independence, 2015

Impartial Courts, 2015

- Below 25 percentile
- Between 25 and 75 percentile
- Above 75 percentile

Source: World Economic Forum. Note: Worldwide distribution excluding LICs
Other institutional indicators also show a room to catch up to Western Europe.

World Governance Indicators, 2016
(Ranges from -2.5 (weak) to 2.5 (strong) governance performance)
EU accession process should lead to improved institutions / completion of transition

Average of Six EBRD Transition Indicators in 2014

Note: 2007 for Czech Republic.
Institutional reforms provide large efficiency gains

- Better institutions hold the promise of retaining emigration of skilled workers

- Effective protection of property rights provides stronger incentives for investment

- Institutions affect innovation and productivity through enhanced trust, cooperation, commitment, and contract enforcement
CONCLUSION
Concluding thoughts

- CESEE has done nicely in recent years with strong growth and rapidly declining unemployment.
- Growth is not as high as pre-crisis.
- The challenge will be to continue current growth rates.
- Productivity growth will need to pick up; at some stage labor market will become constraint.
- Reforms and improvements of institutions will help.
Thank you