

# Regional Economic Outlook and Regional Economic Issues – Focus on CESEE



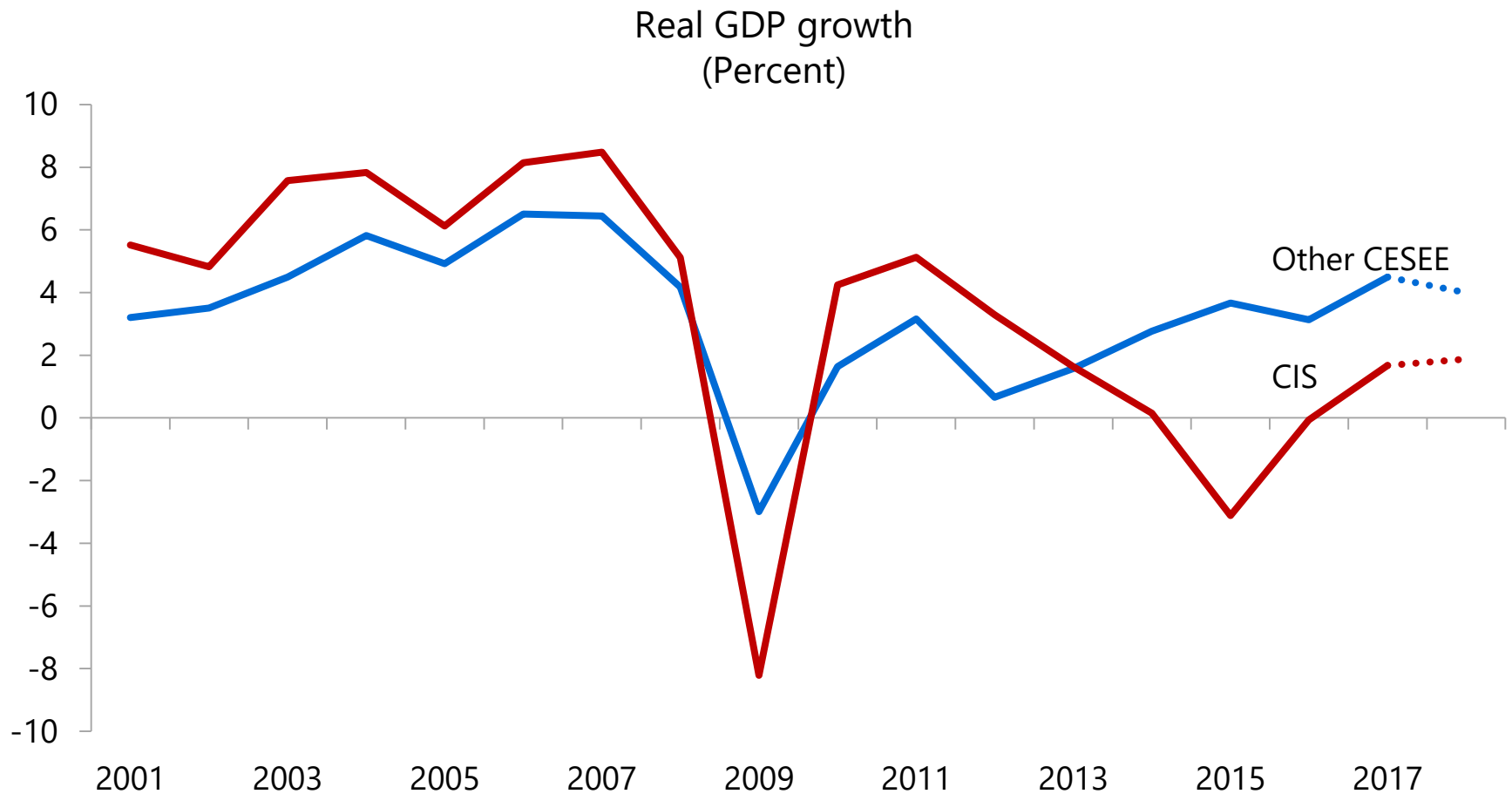
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# THE WORLD ACCORDING TO THE APRIL 2018 WEO

# In CESEE, CIS recovering and non-CIS growing strongly

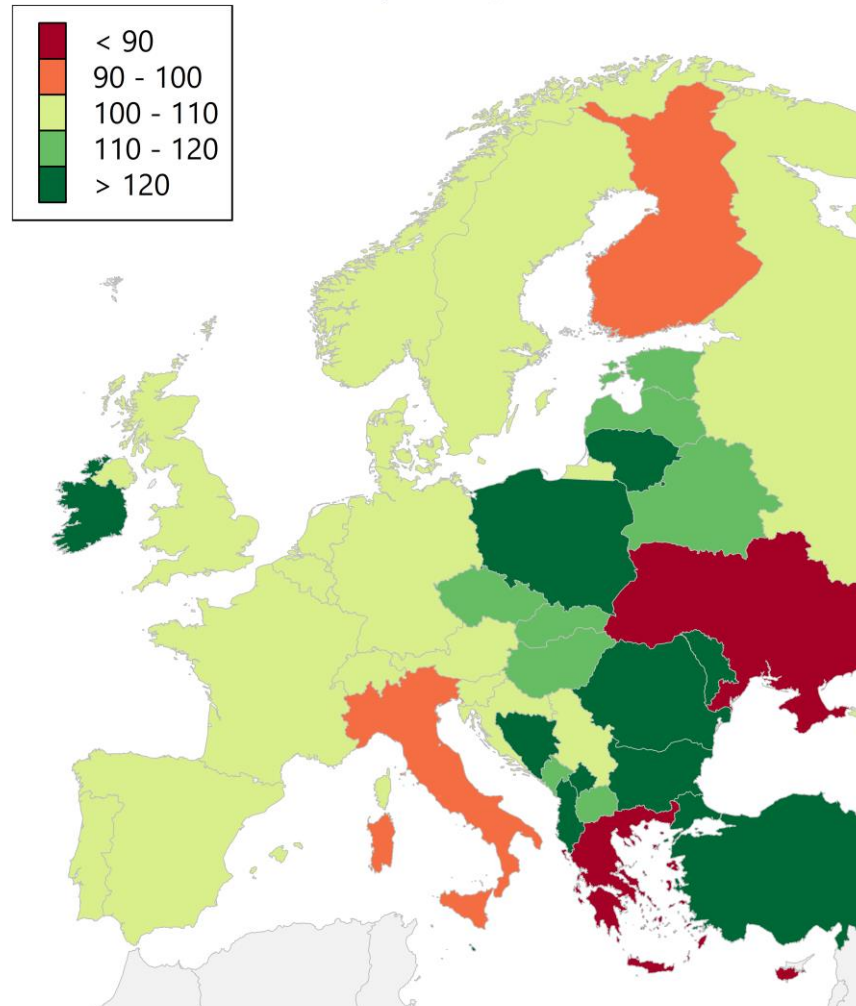


# GDP per capita is well above pre-crisis level (except Ukraine)



## GDP per capita in 2017

(2008=100)



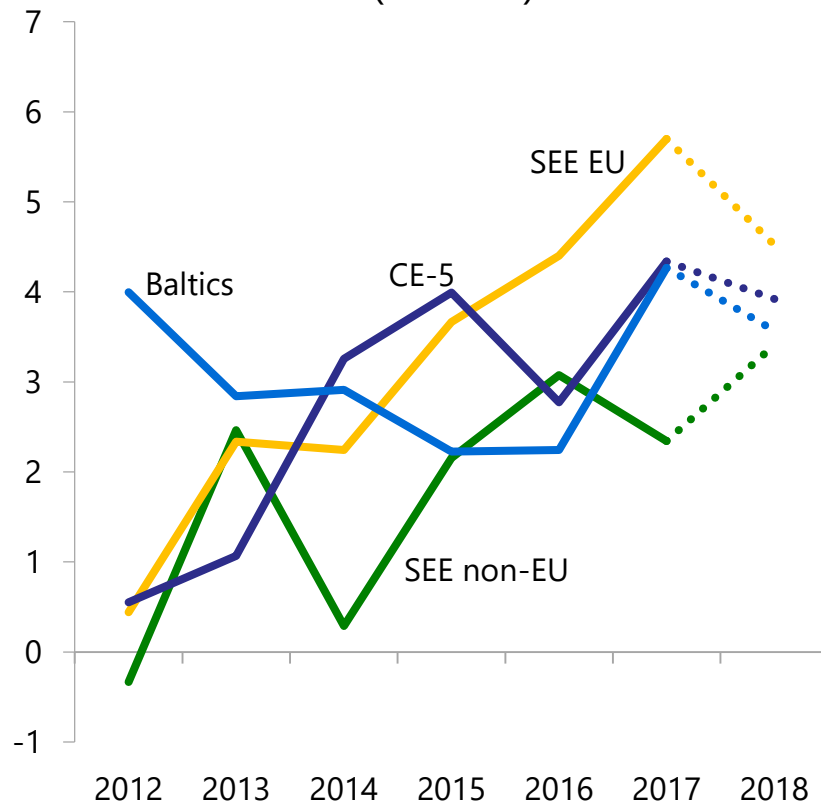


NON-CIS CESEE

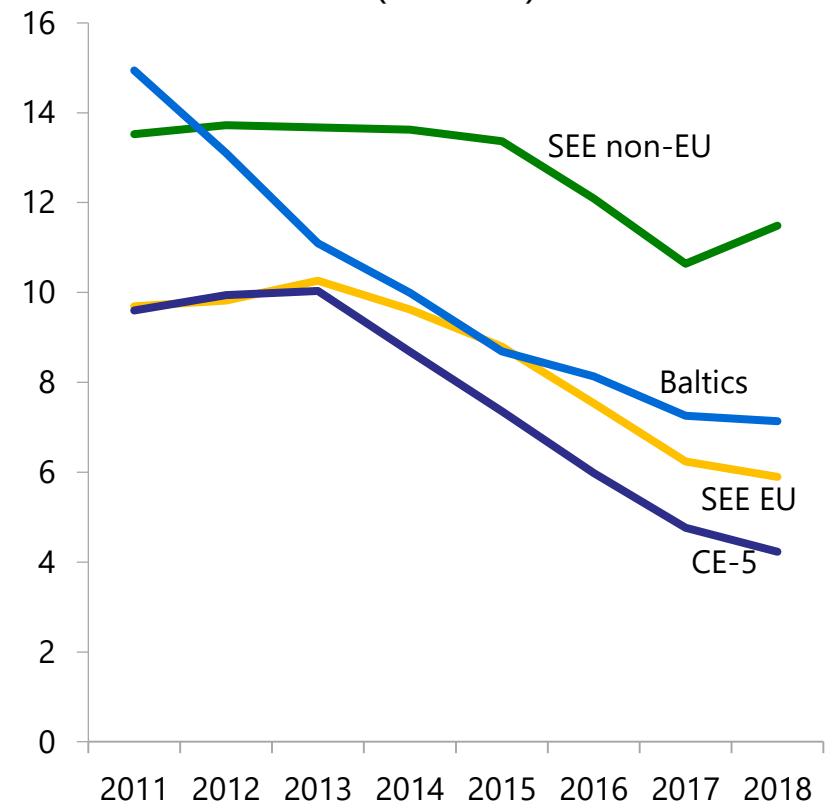
# Growth is rapid, and unemployment is falling sharply



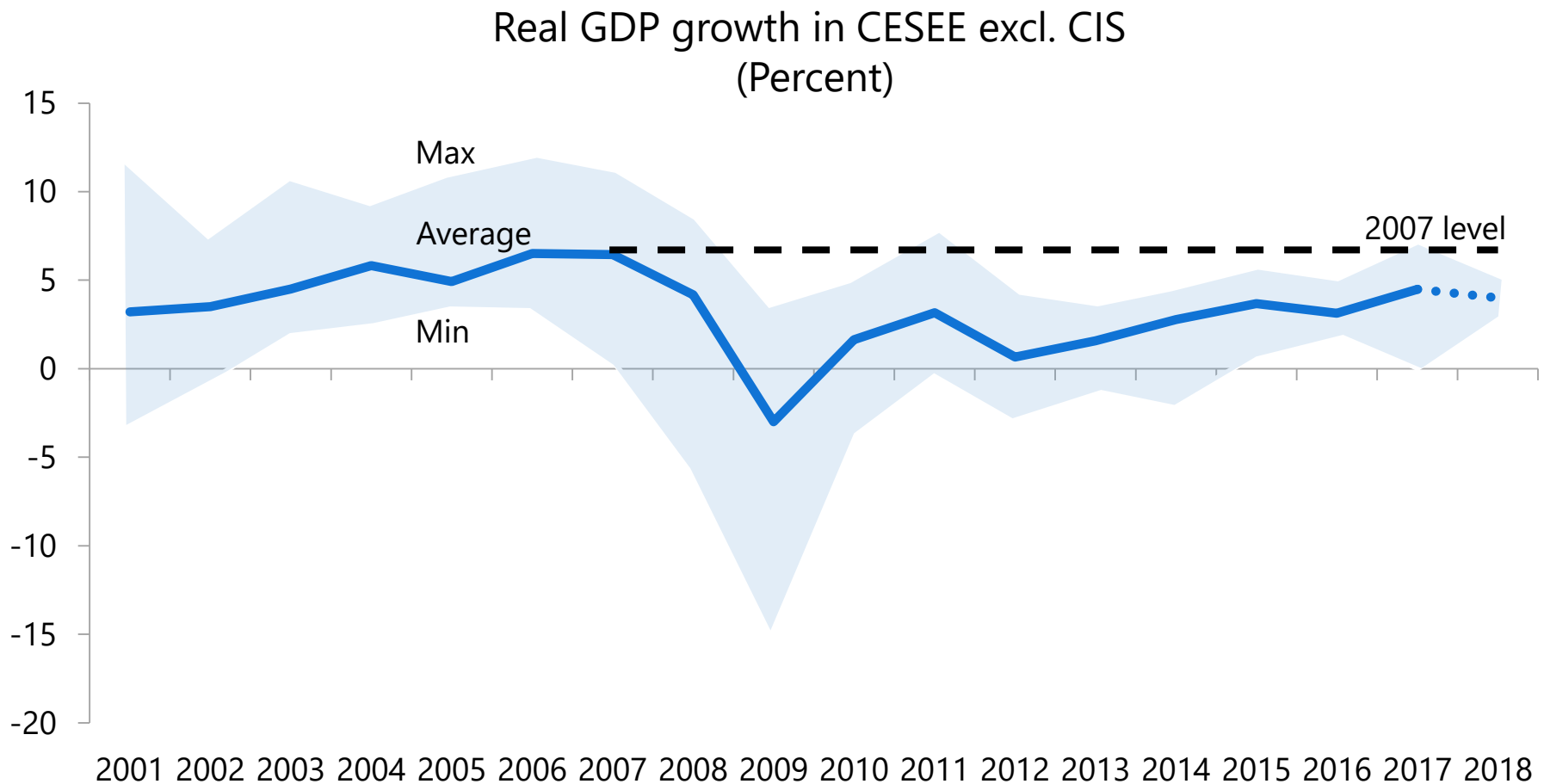
Real GDP growth  
(Percent)



Unemployment Rate  
(Percent)



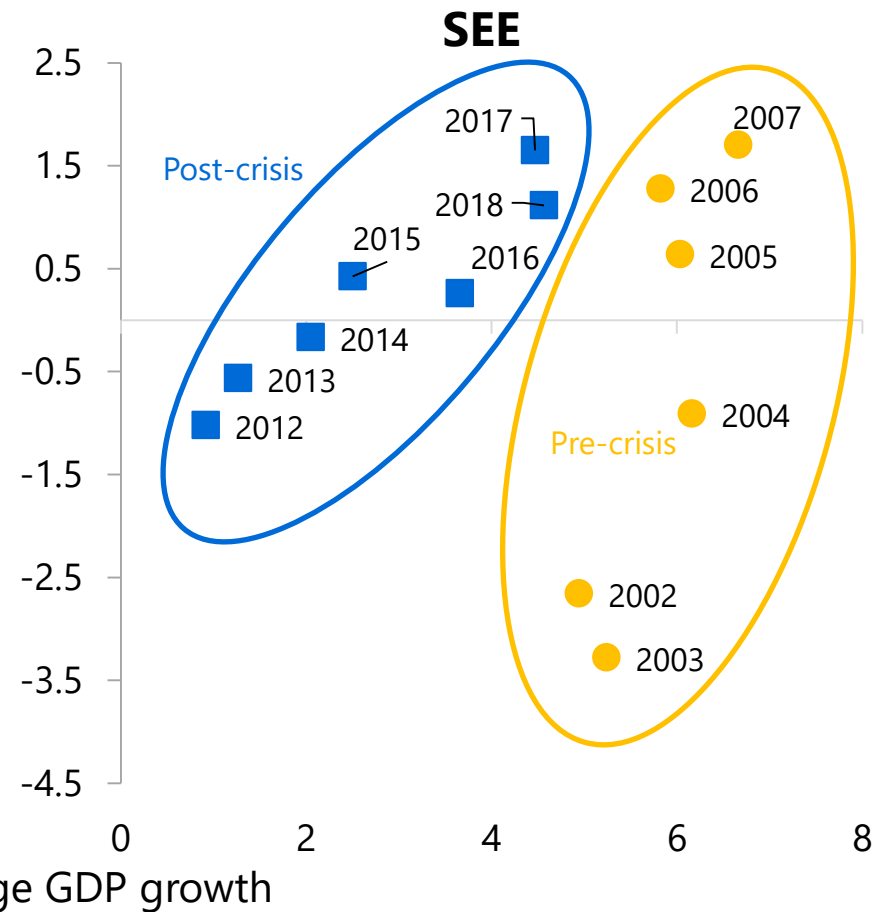
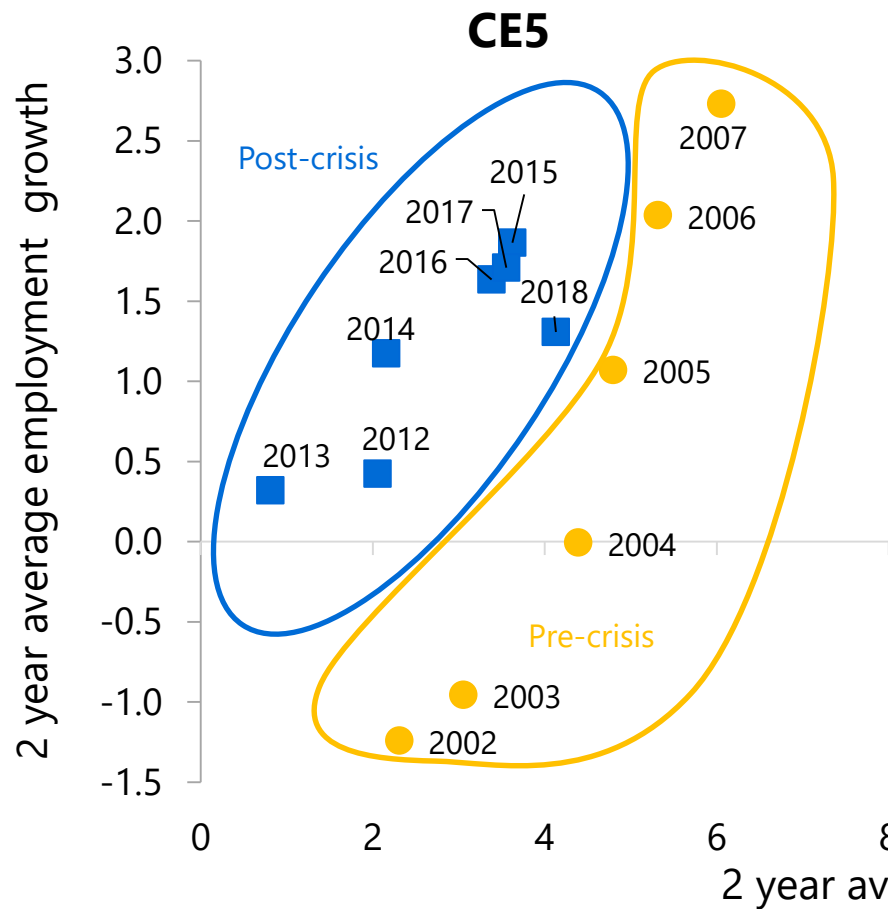
# Growth in the region is not as high as in the pre-crisis years



But employment growth in many countries is as high as during pre-crisis peaks.



GDP growth vs. employment growth  
(Percent, 2 year average)

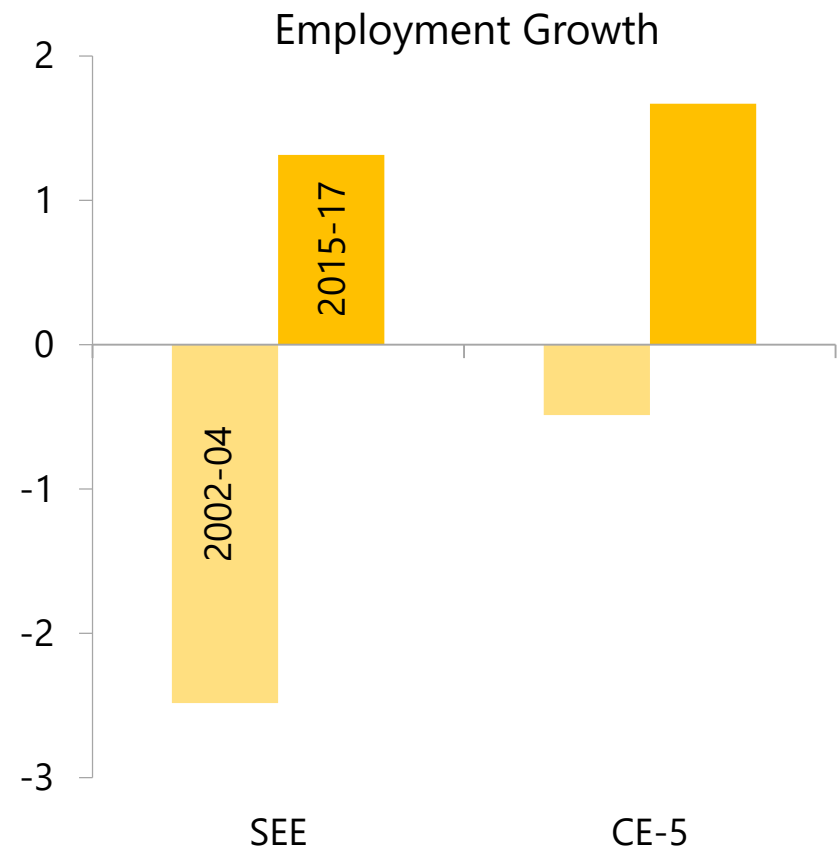
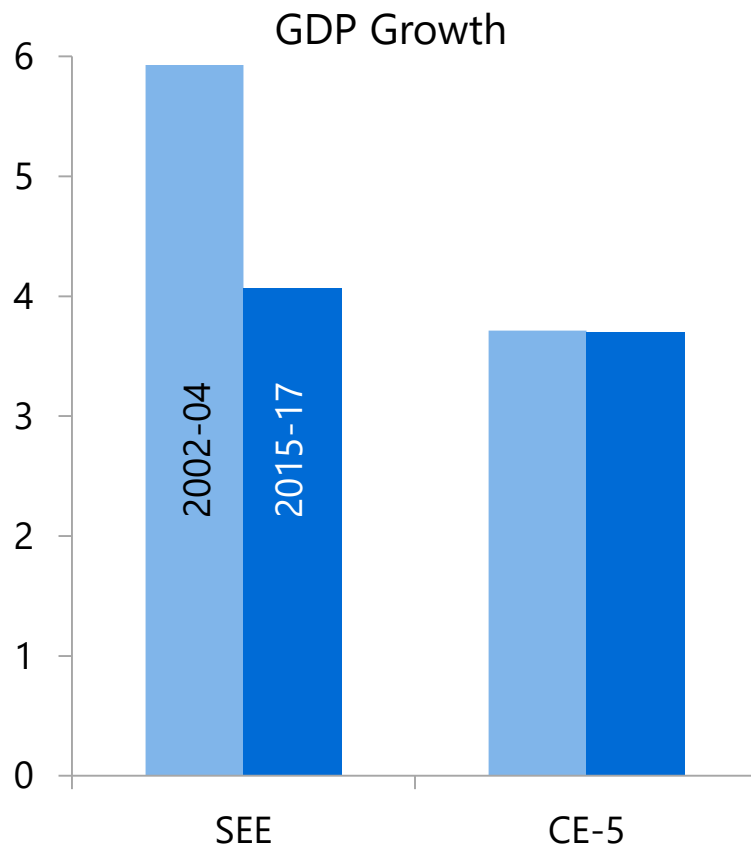




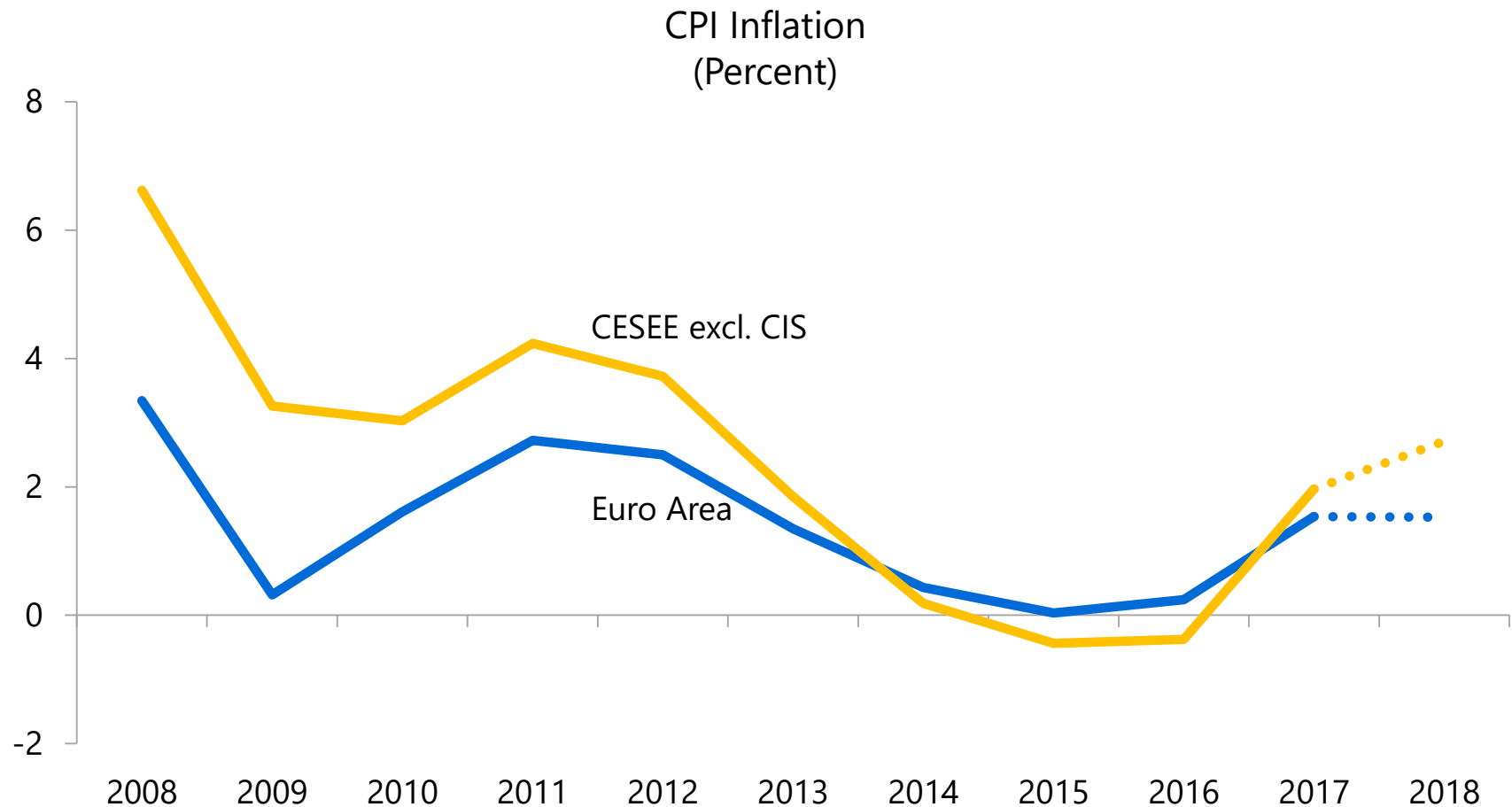
Even if we exclude peak pre-crisis years:  
current growth is lower but employment growth  
higher than pre-crisis



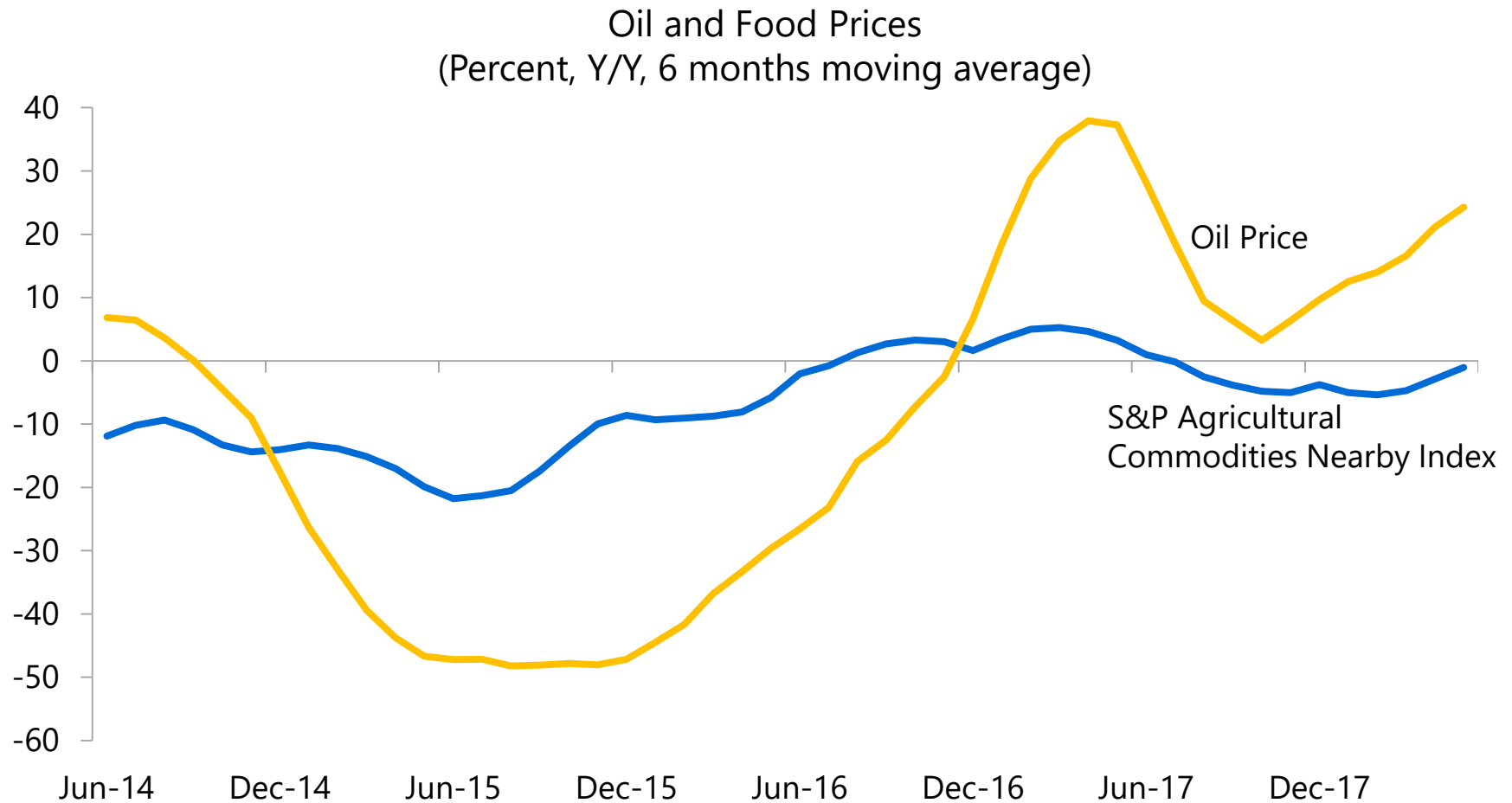
GDP and Employment Growth in 2002-04 and 2015-17  
(Average, percent)



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

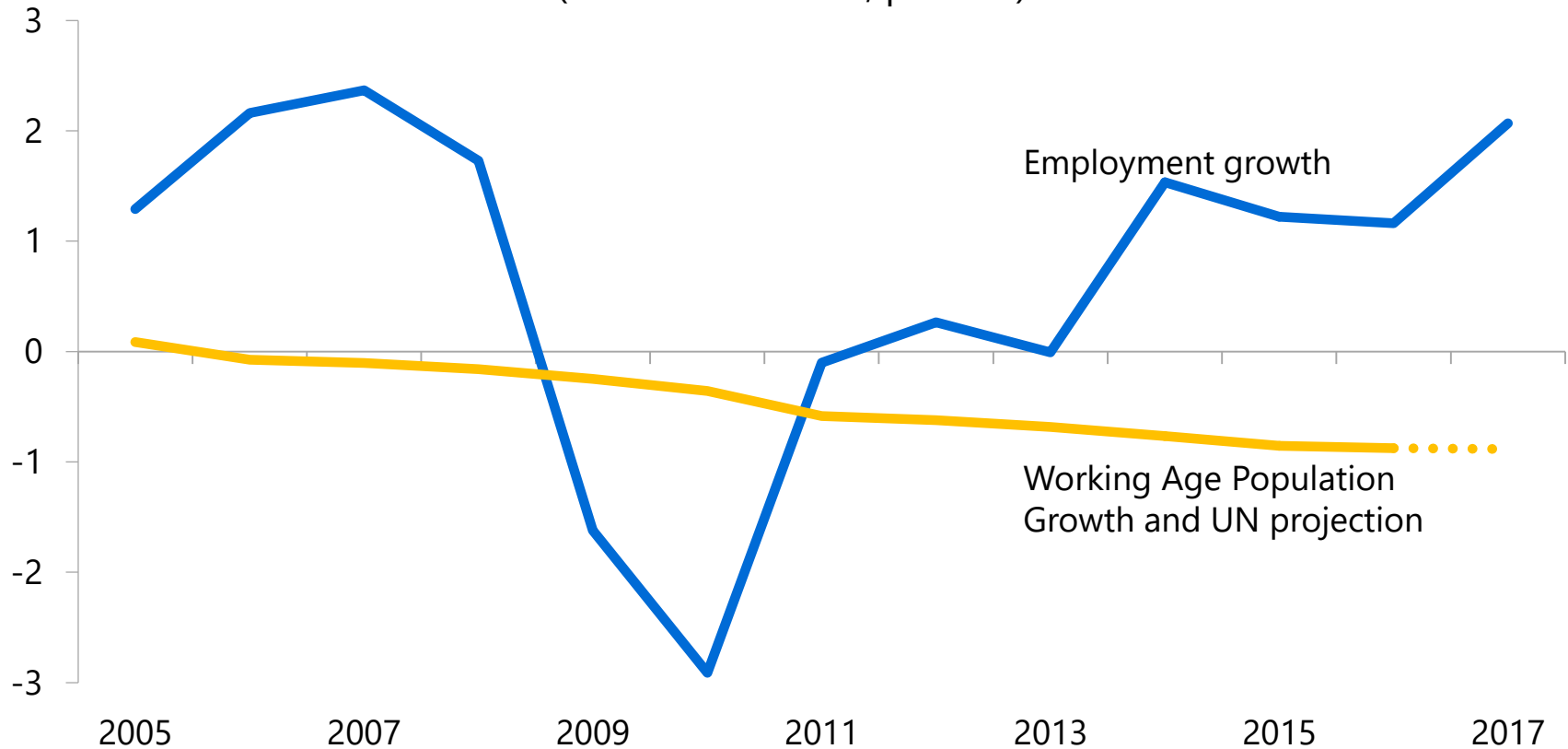


- External demand expected to remain strong in the next quarters...
- Consumption is solid as employment is growing rapidly and wages are accelerating
- Investment further boosted by pick-up of EU funds

# What will this imply for labor markets?



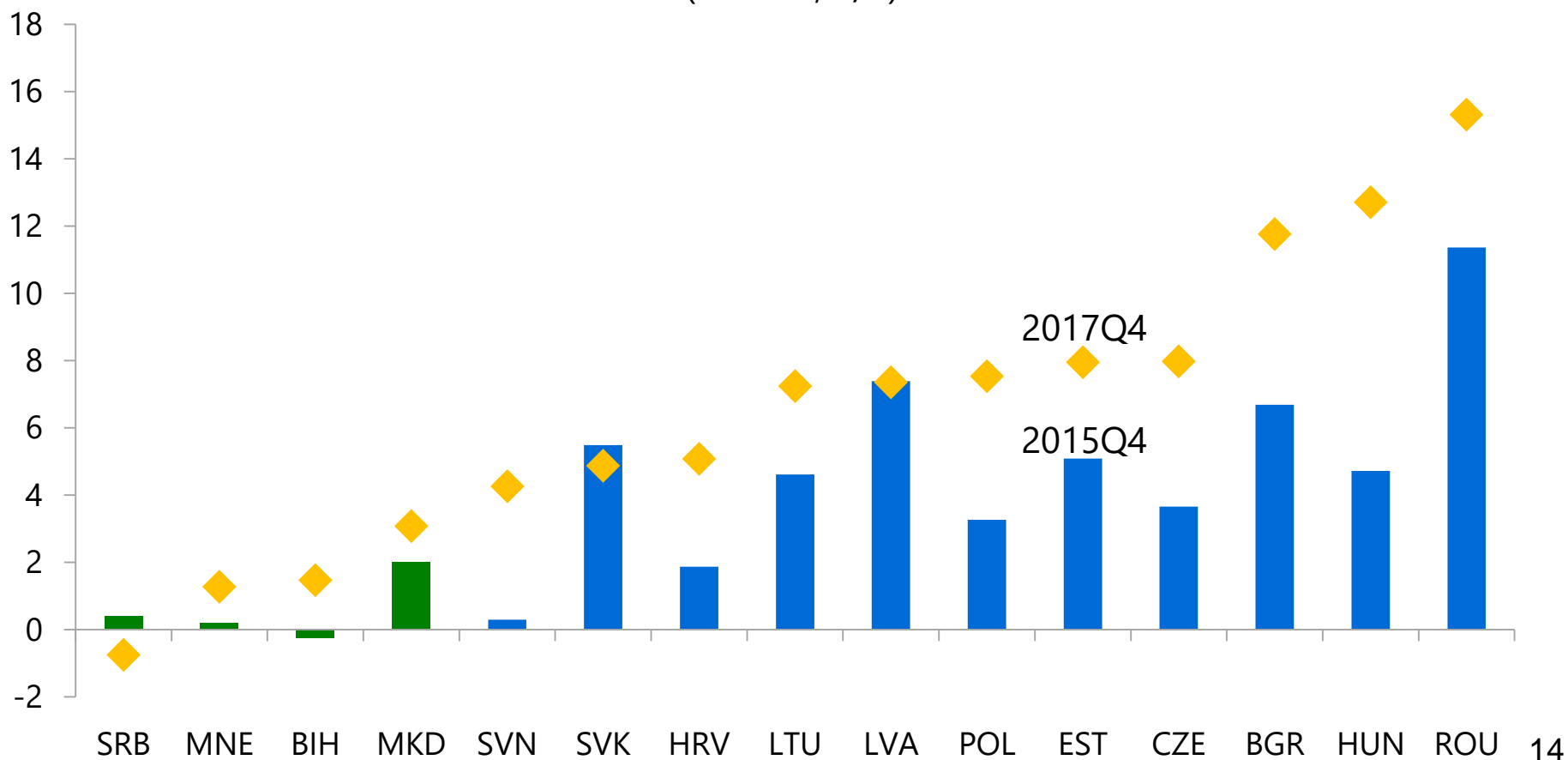
Employment and Working Age Population Growth in CESEE  
(Excl. TUR and CIS, percent)



In the EU NMS wage growth has accelerated, while it has remained more modest in the Western Balkans



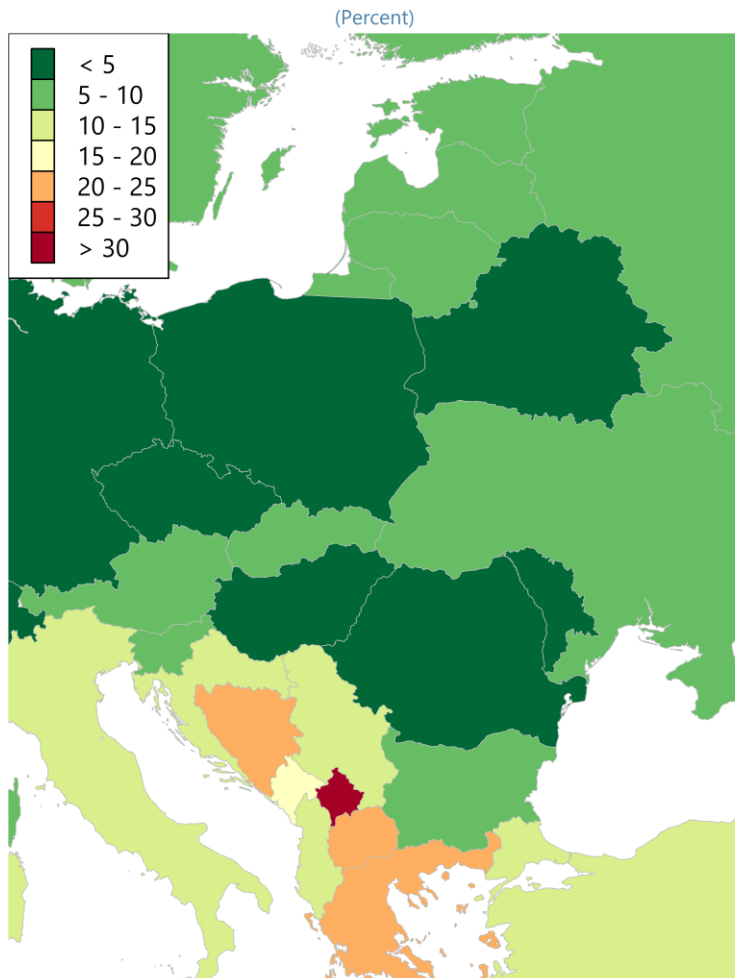
Nominal Wage Growth  
(Percent, Y/Y)



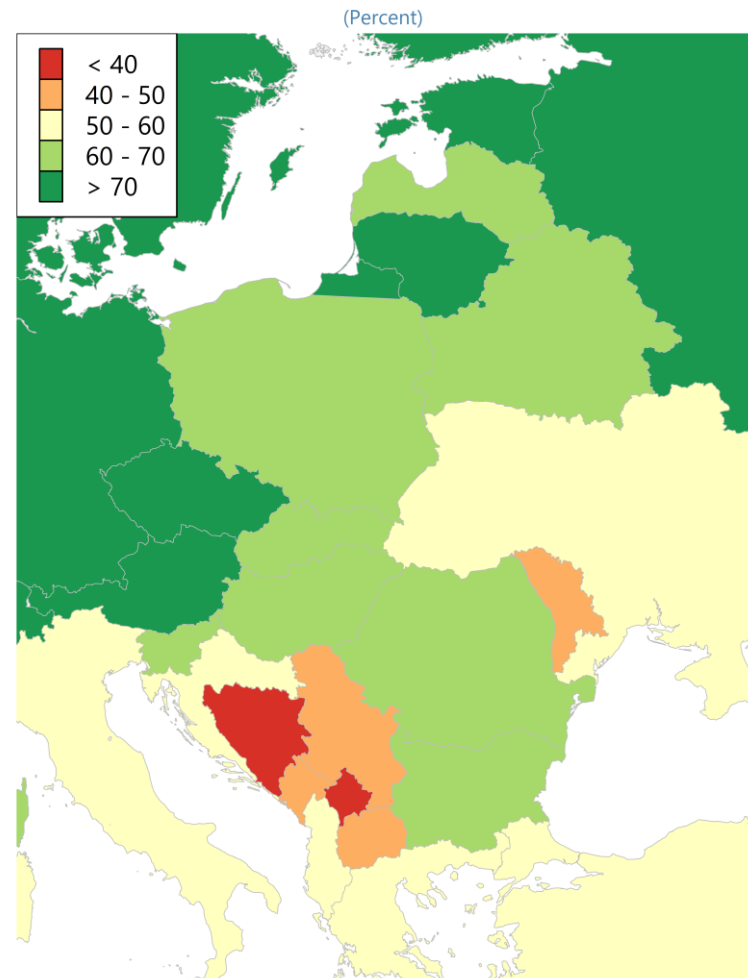
# In Western Balkans unemployment rates are still very high and employment rates low



Unemployment Rate in 2017



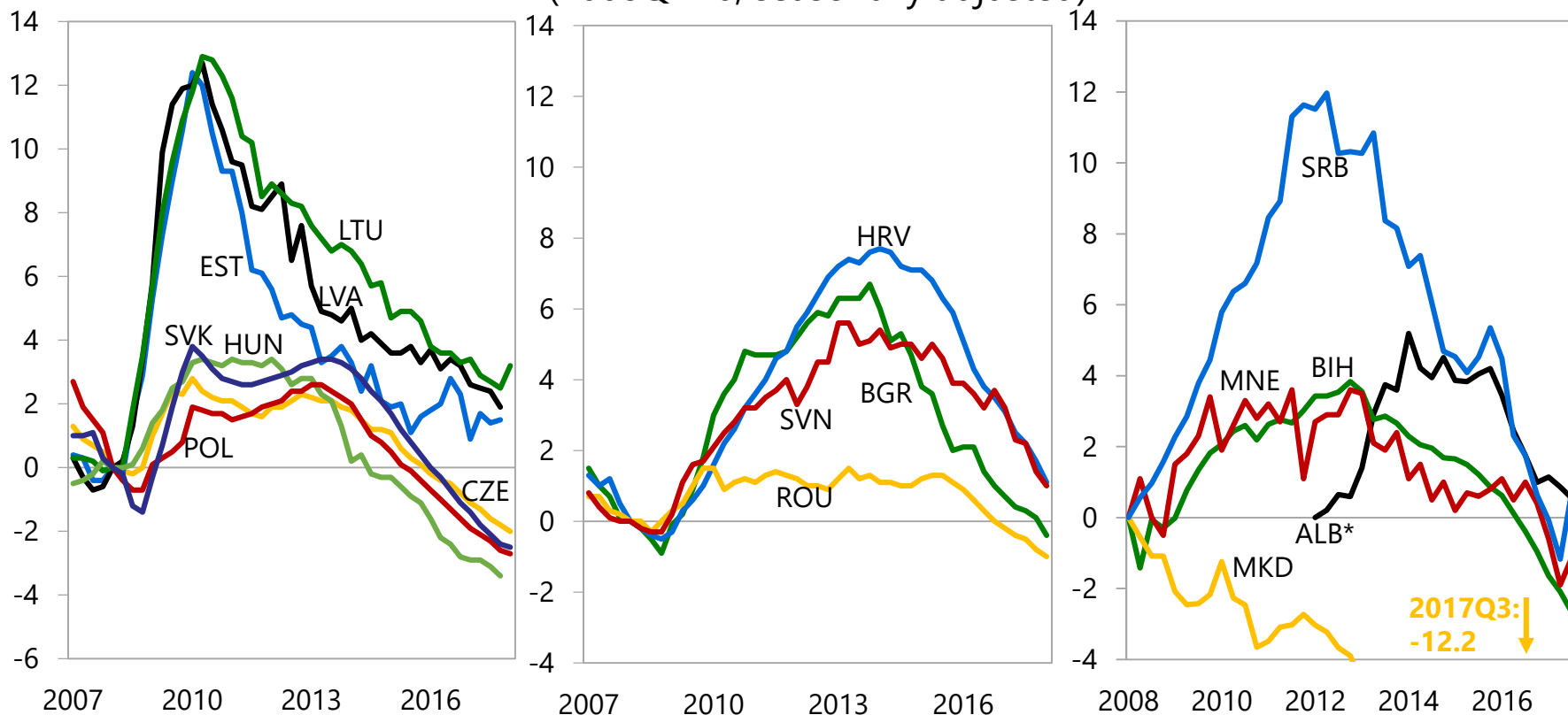
Employment Rate in 2016



# Unemployment is coming down rapidly and is now below pre-crisis levels in many countries



Cumulative Changes in Unemployment Rate  
(2008Q1=0, seasonally adjusted)

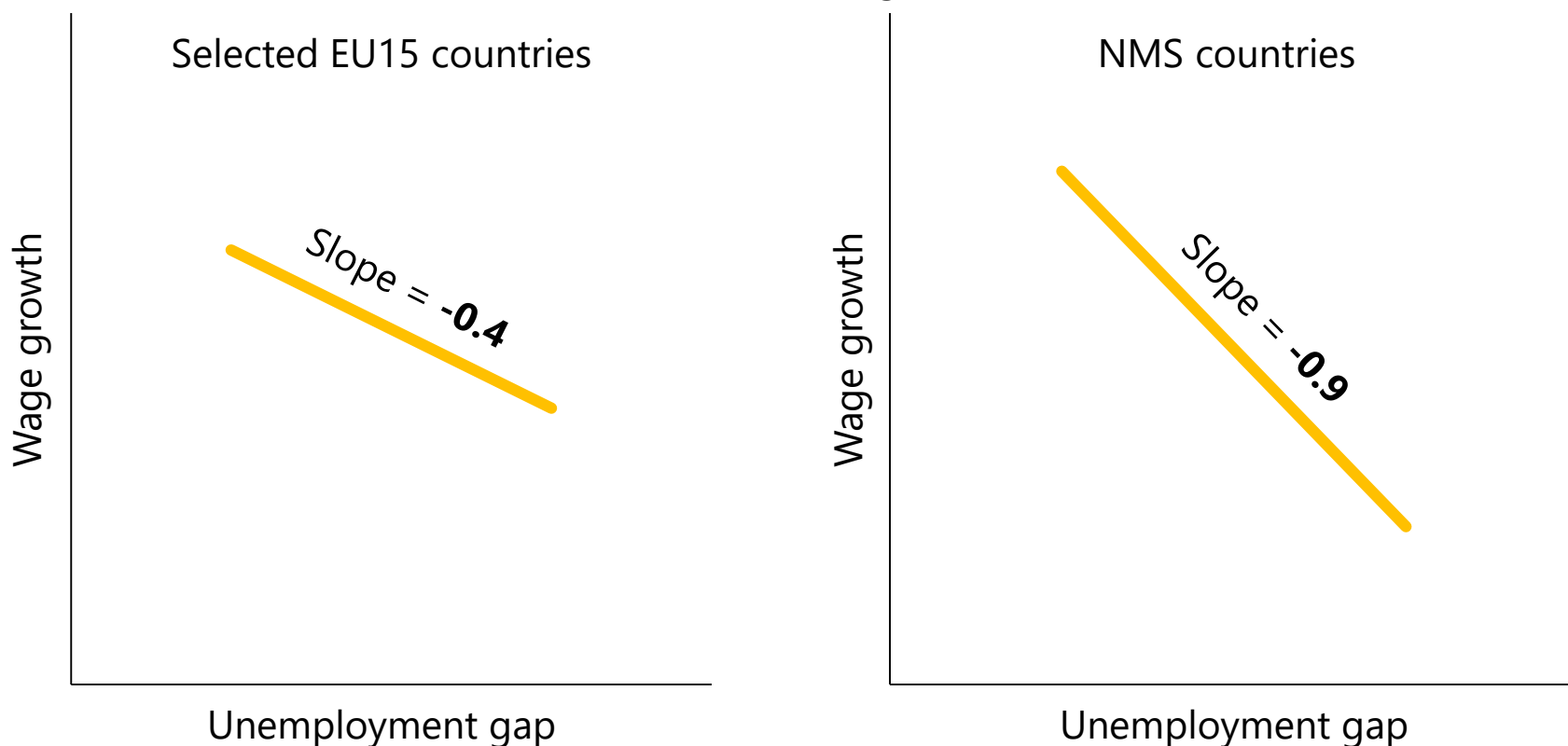




# The wage Phillips curve is flat in Western Europe and steep in NMS countries



Wage Phillips Curve  
(based on panel regression)



Rapid decline of unemployment suggests that GDP is growing faster than potential

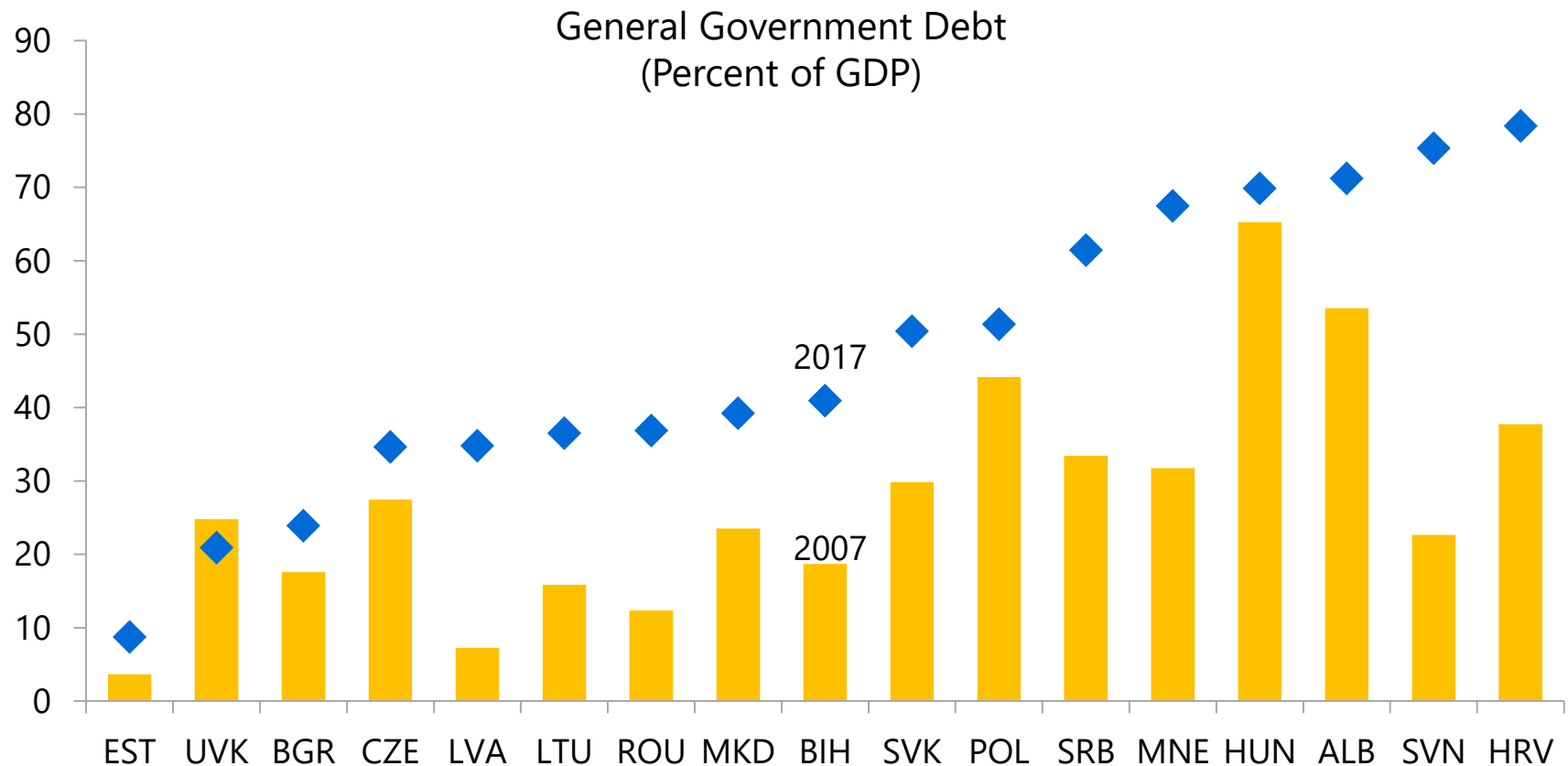


- At some stage, labor market shortages will become constraint on growth
- Growth can only continue at this pace if productivity picks up

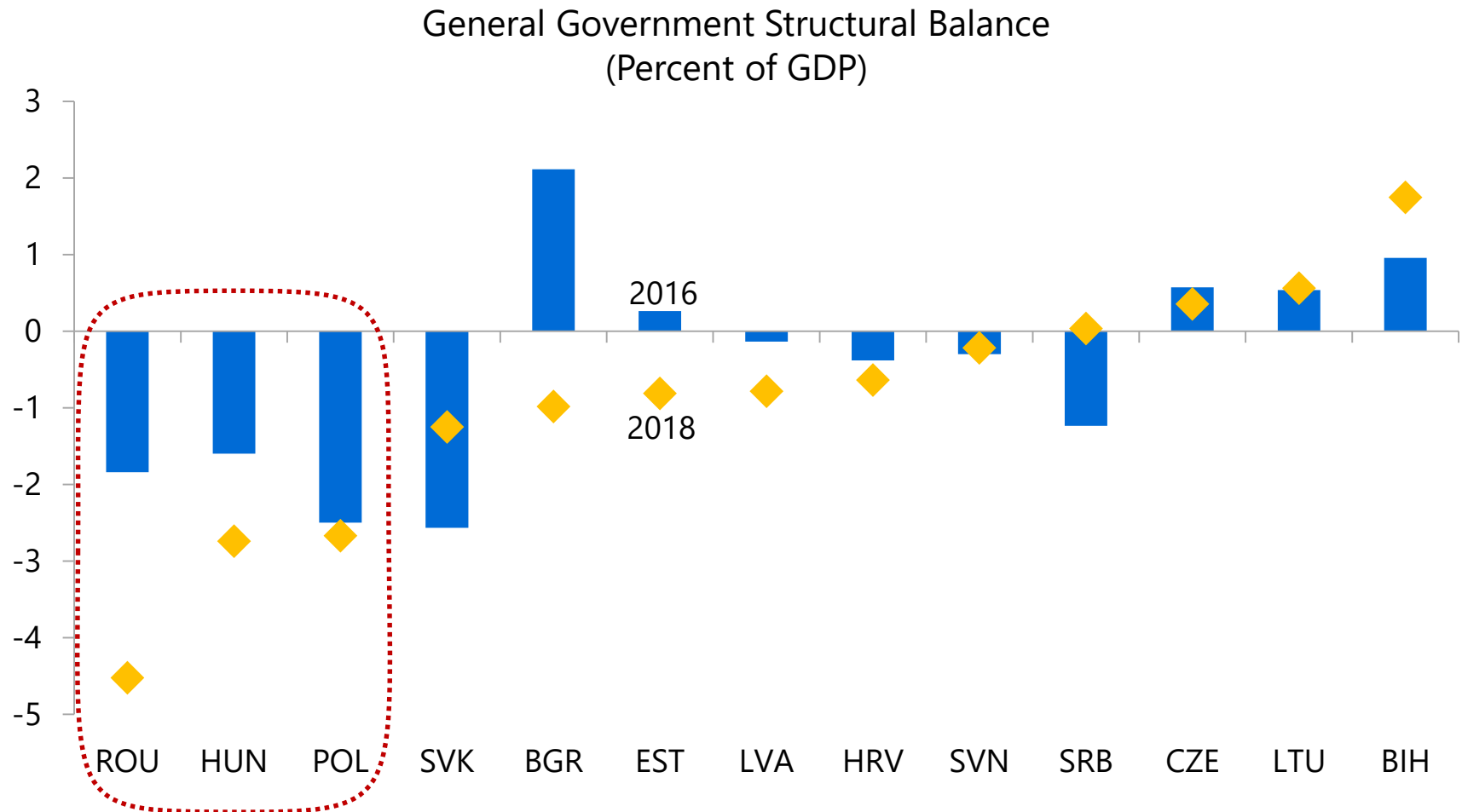
# This would be the good time to create fiscal space and reduce structural deficits



- Particularly given that debt is much higher than pre-crisis levels.



Unfortunately, many countries with too high structural deficits are reverting to pro-cyclical loosening



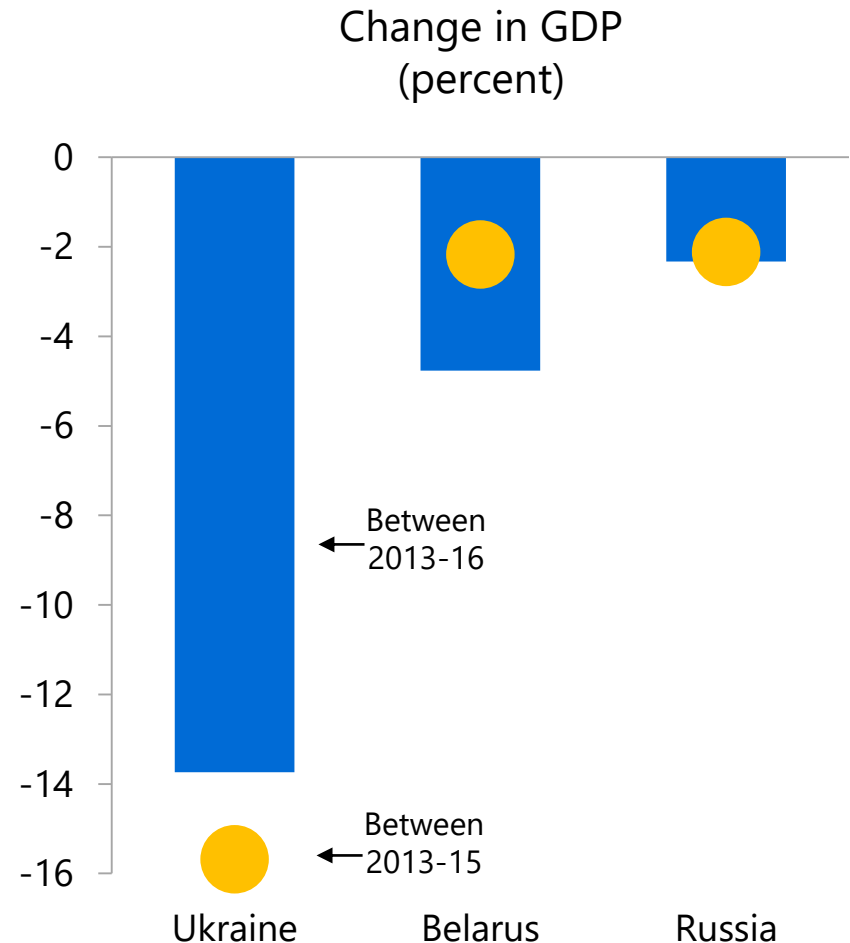


CIS

In 2014-15, Russia and Ukraine suffered from shocks, and Belarus from spillovers



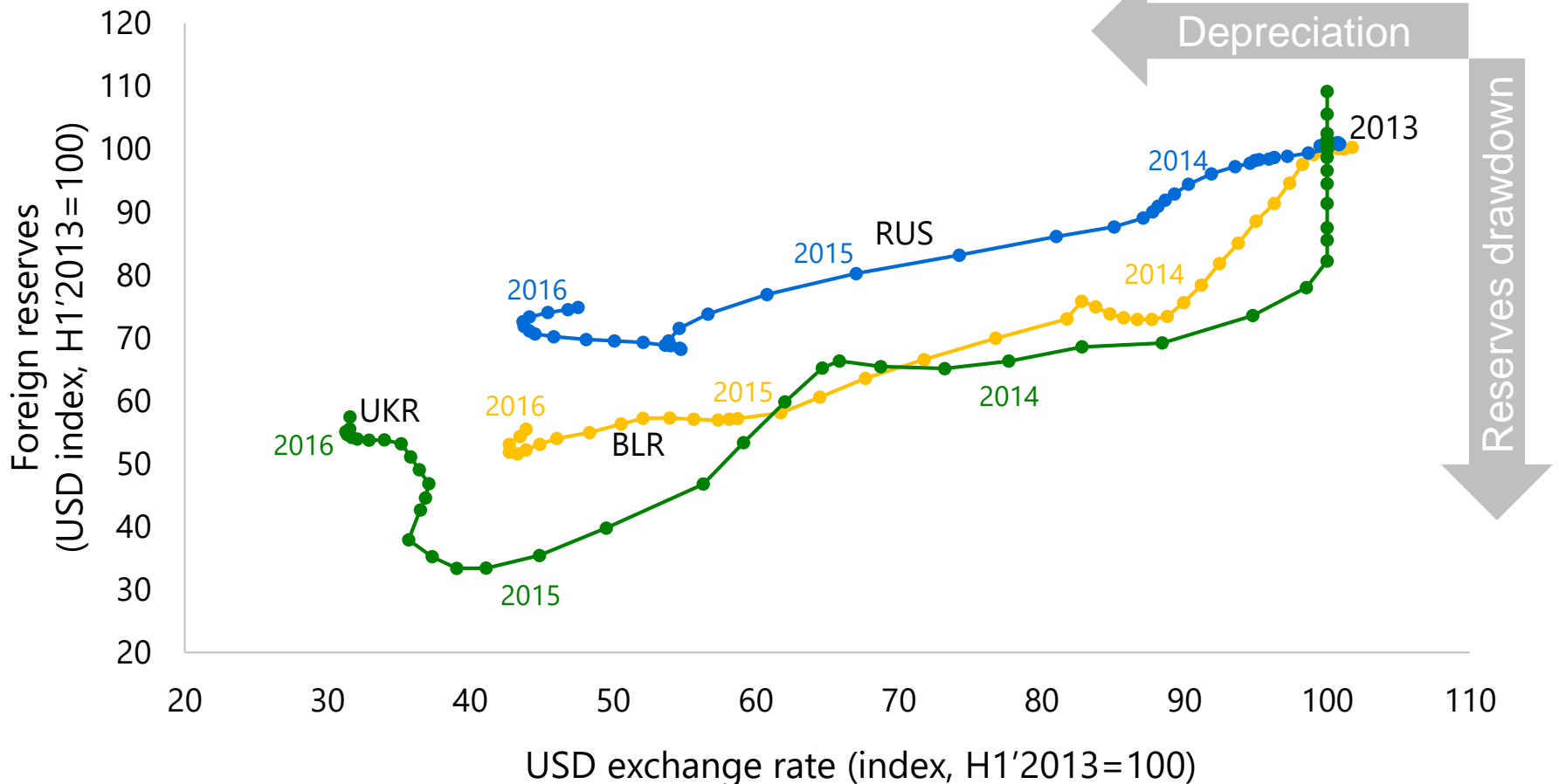
- Collapse of commodity prices
- Sudden stop in capital flows to Russia, result of sanctions on Russia
- Conflict in Ukraine



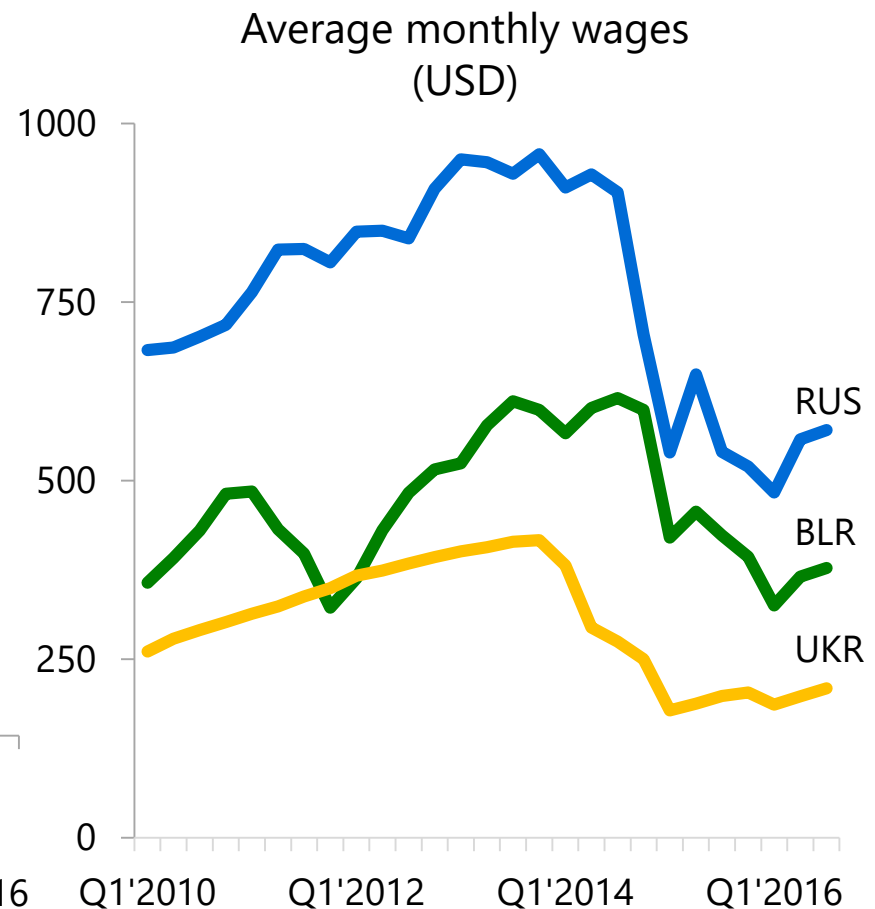
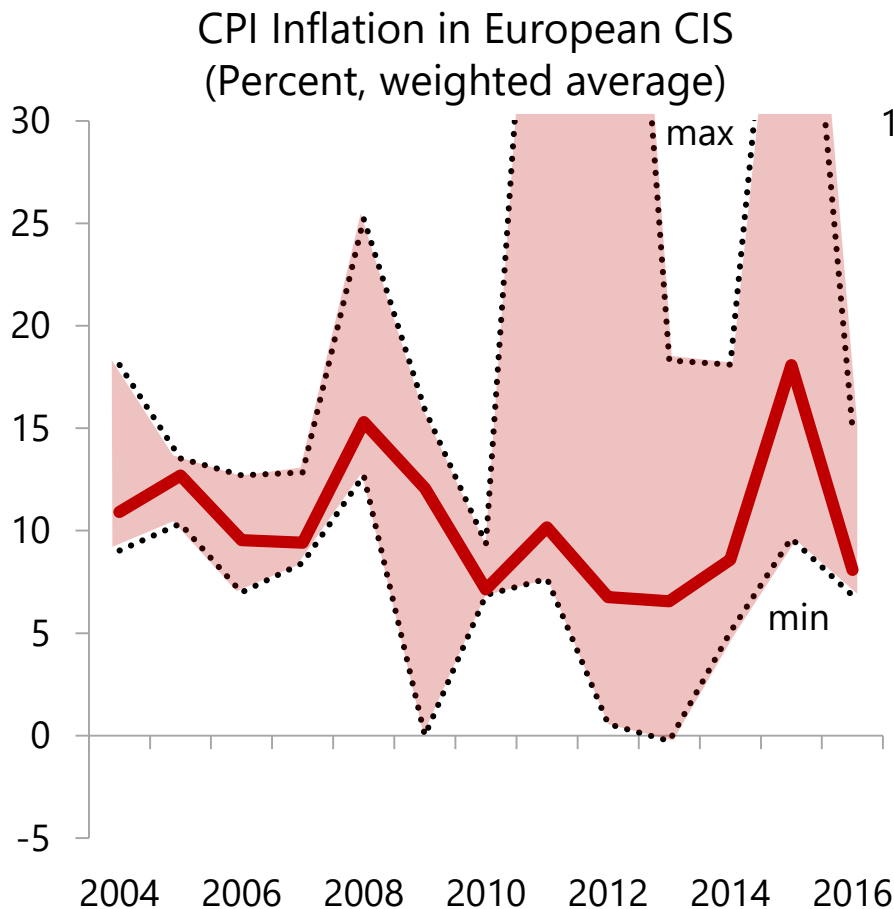
# Exchange rate flexibility was unavoidable given the limited buffers...



Foreign reserves and XR depreciation  
(6-month moving averages)



# ...but increased inflation and reduced real wages

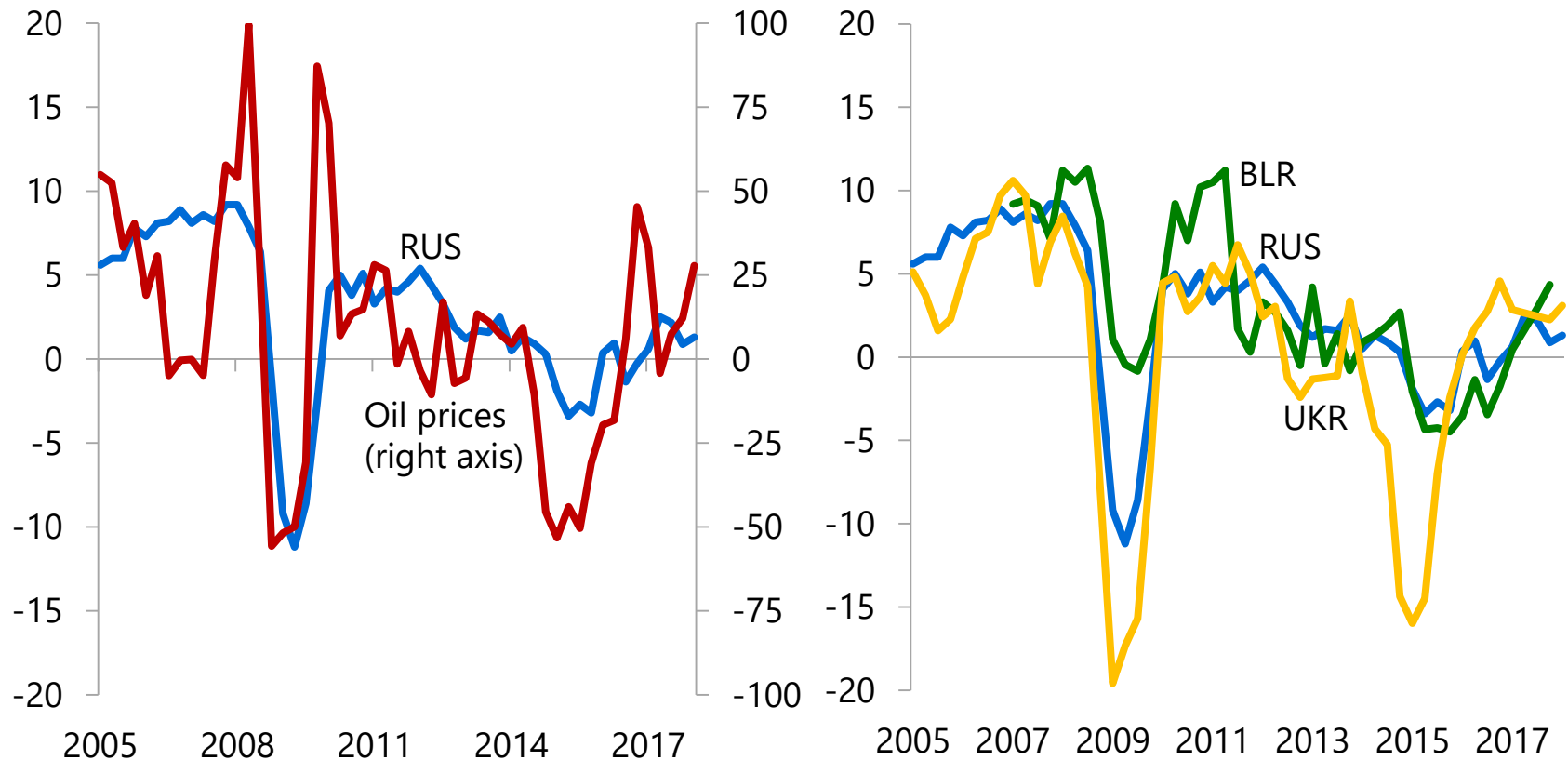




# Ukraine and Russia are now recovering (helped by rising oil prices)



Real GDP growth in Russia, other CIS countries and changes in oil prices  
(Percent, y/y)



# Moldova had a banking crisis in 2014

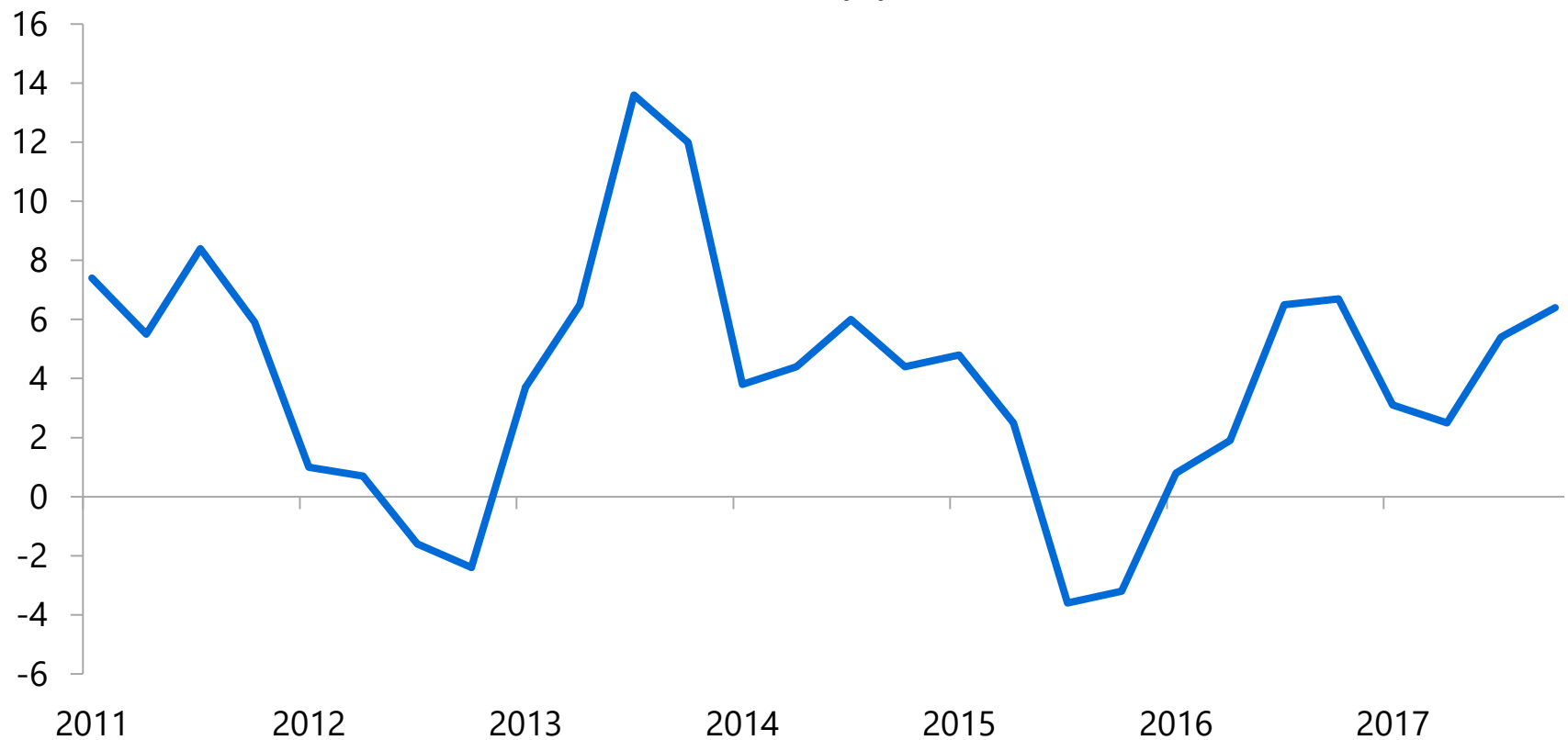


- Three large banks collapsed as a result of their long-lasting abuse by the shareholder(s)
- Supervisory action was slow to come
- Supervisory forbearance increased the ultimate resolution costs to the budget

# But is now also recovering



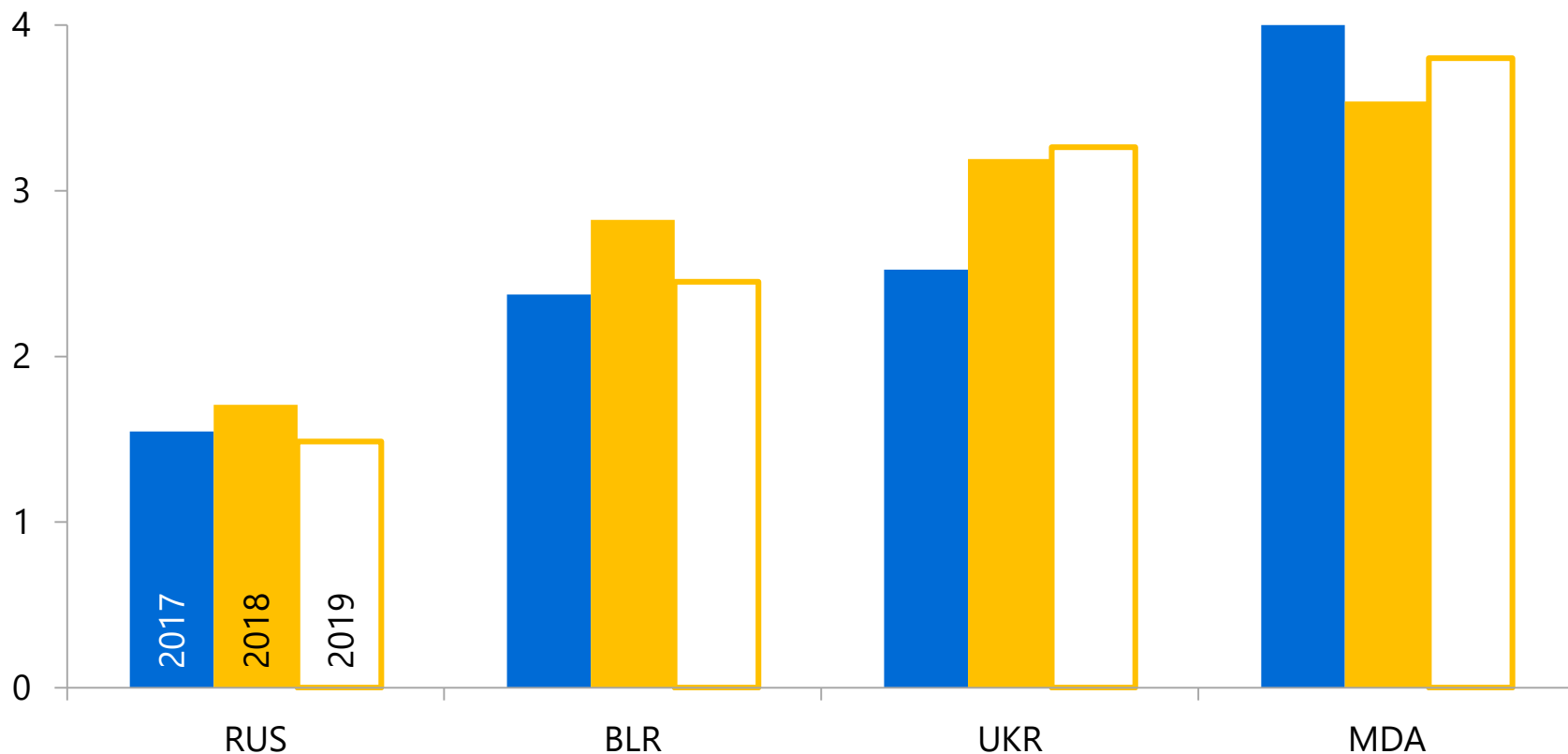
Real GDP Growth in Moldova  
(Percent, y/y)



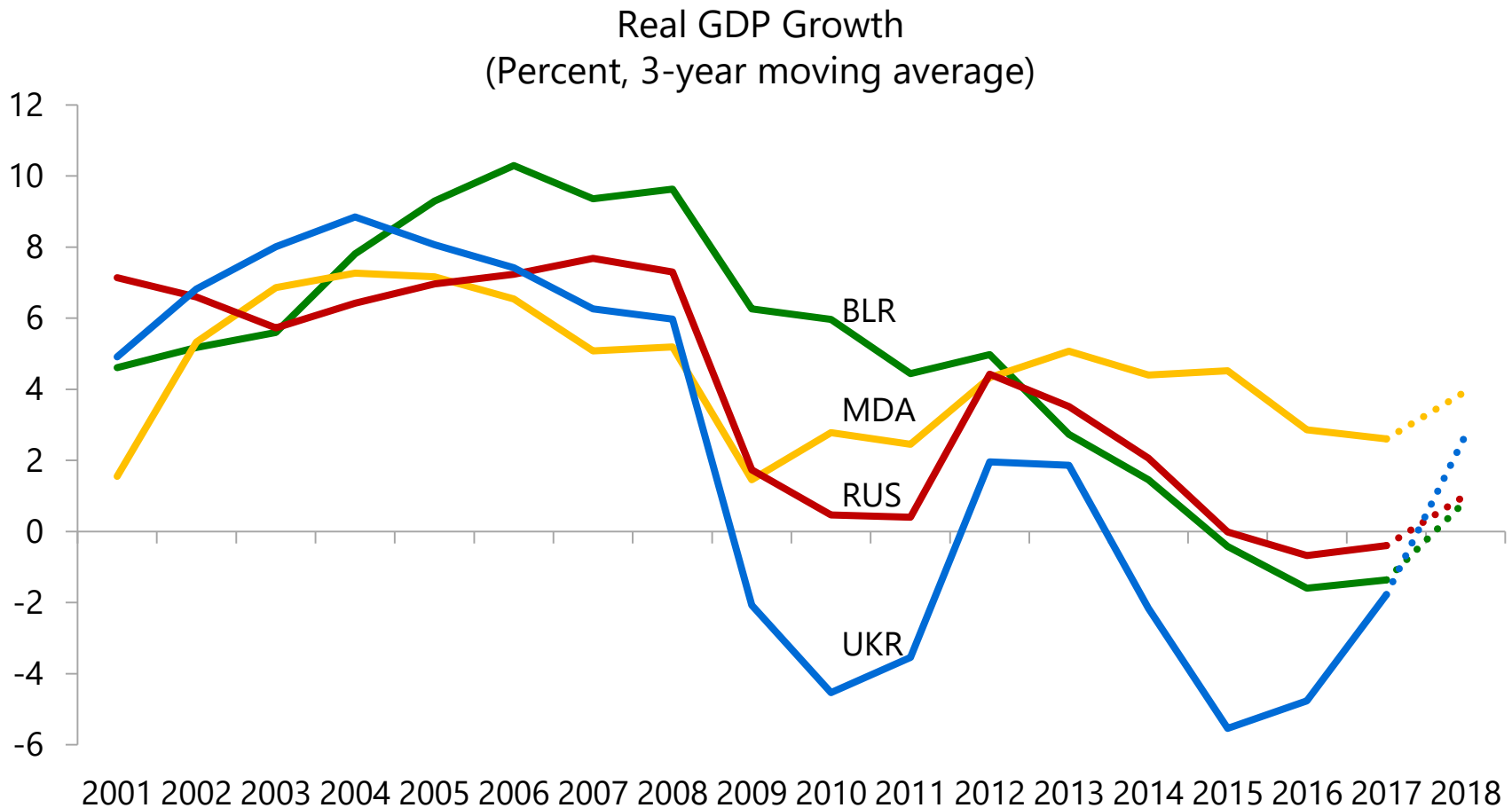
# Near-term prospects show solid growth



Real GDP Growth Projections  
(Percent)



# But growth is low in comparison to pre-crisis period





# RISKS TO THE OUTLOOK

# Since WEO was published we have seen

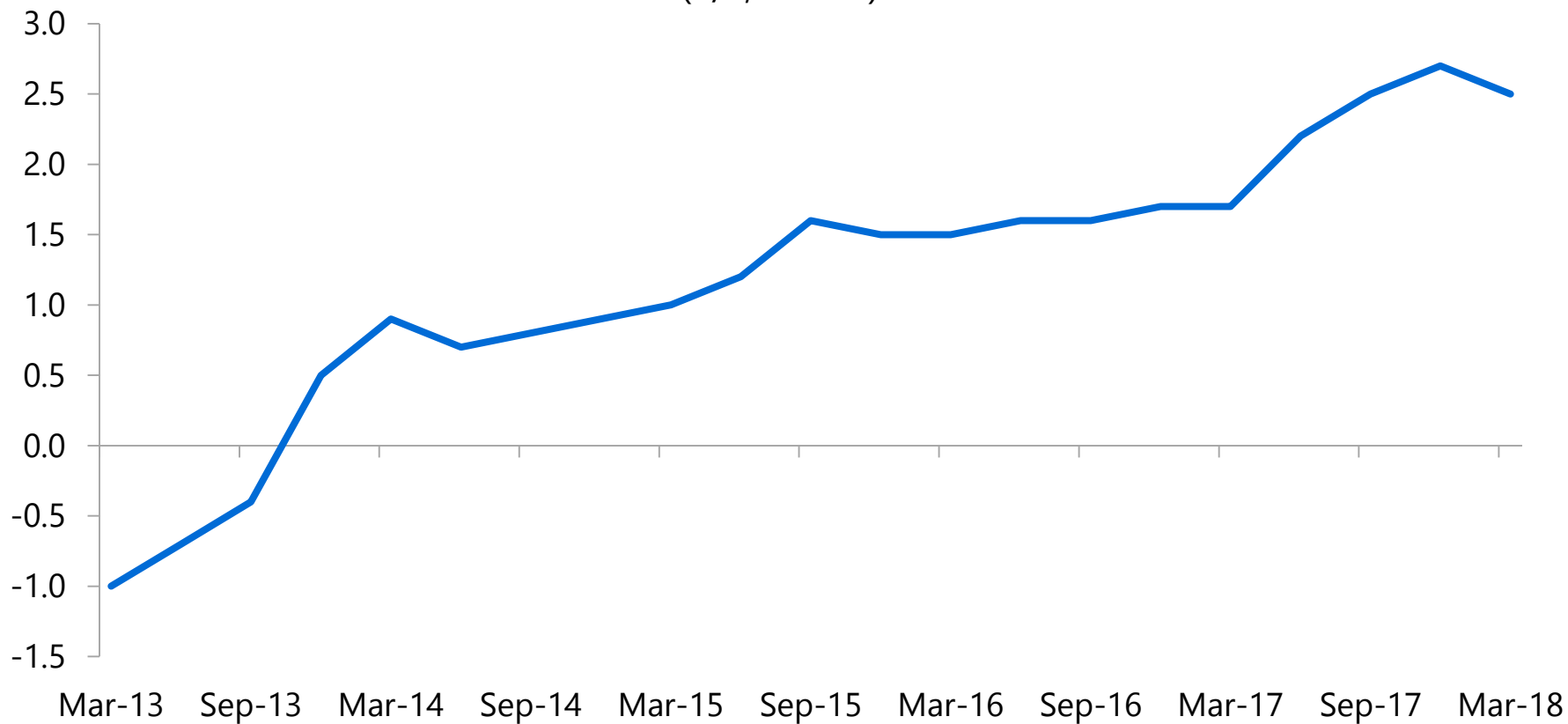


- Weaker than expected growth in euro area
- Increased market turmoil, both in
  - Euro area periphery
  - Emerging market countries

Since the WEO was published, growth in the EA in Q1 came in lower than expected



Real GDP Growth in Euro Area  
(Y/Y, SWDA)

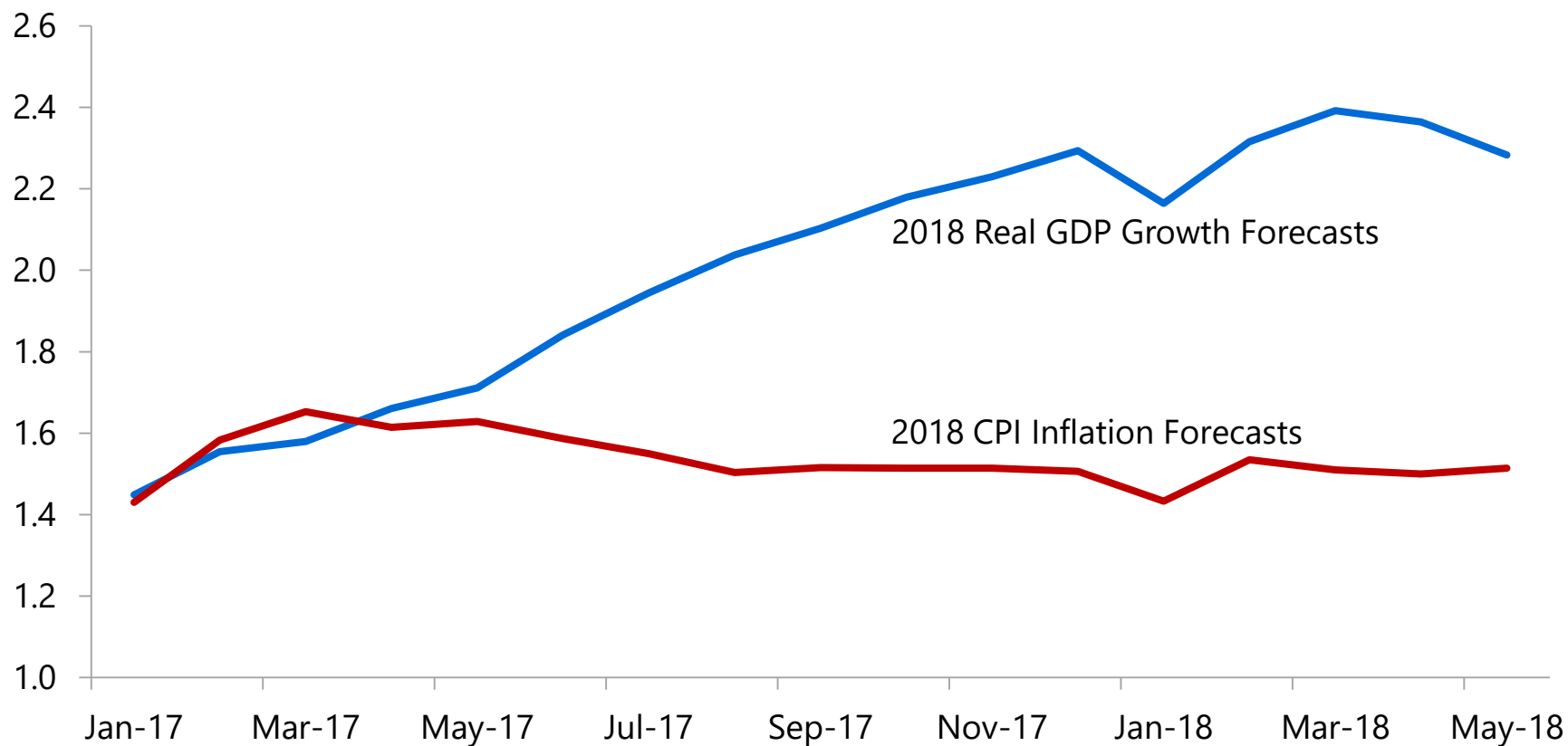




# So far, consensus forecast for this year has not changed much



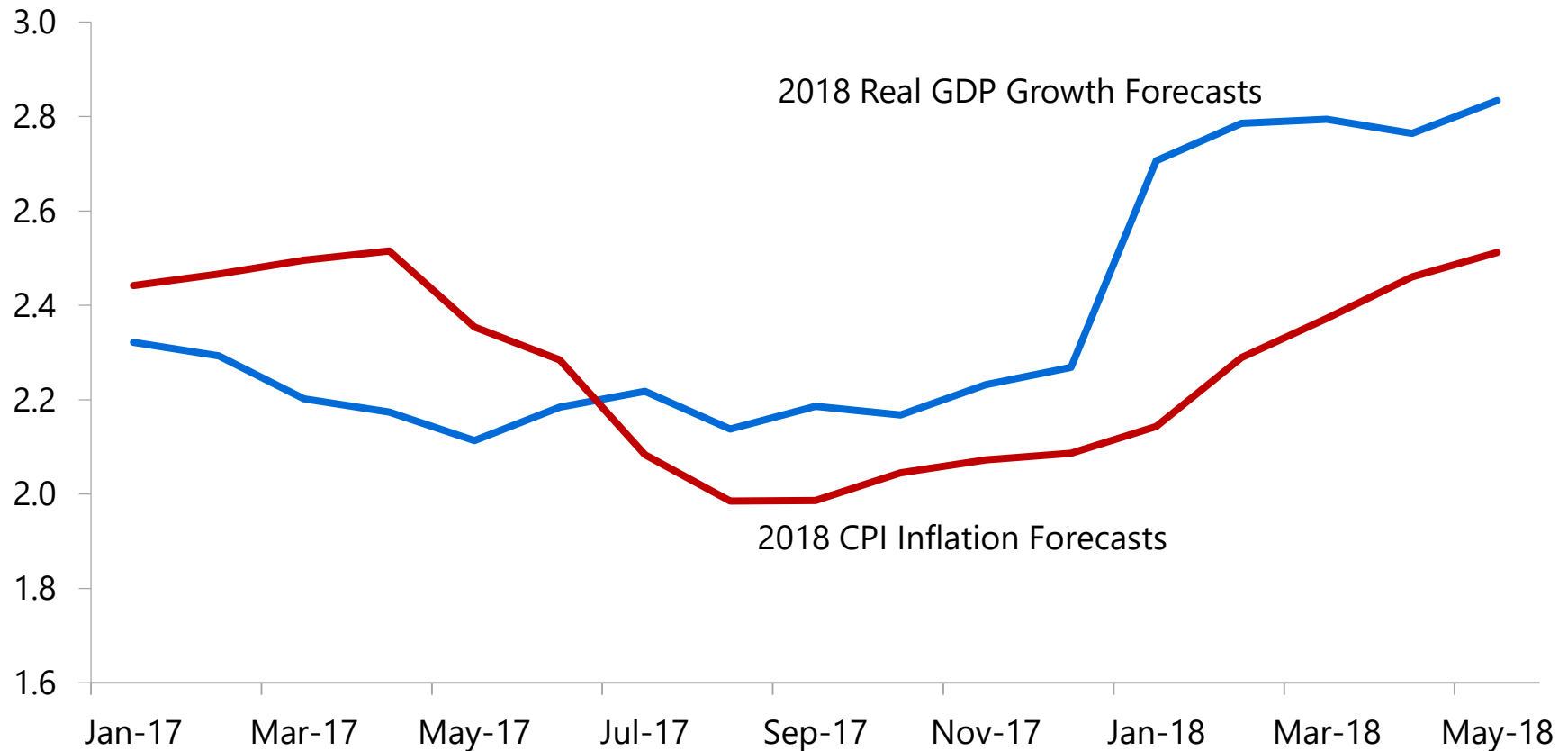
Consensus Forecasts of Real GDP and CPI Inflation for Euro Area



# For the USA, forecasts of growth and inflation have been increasing



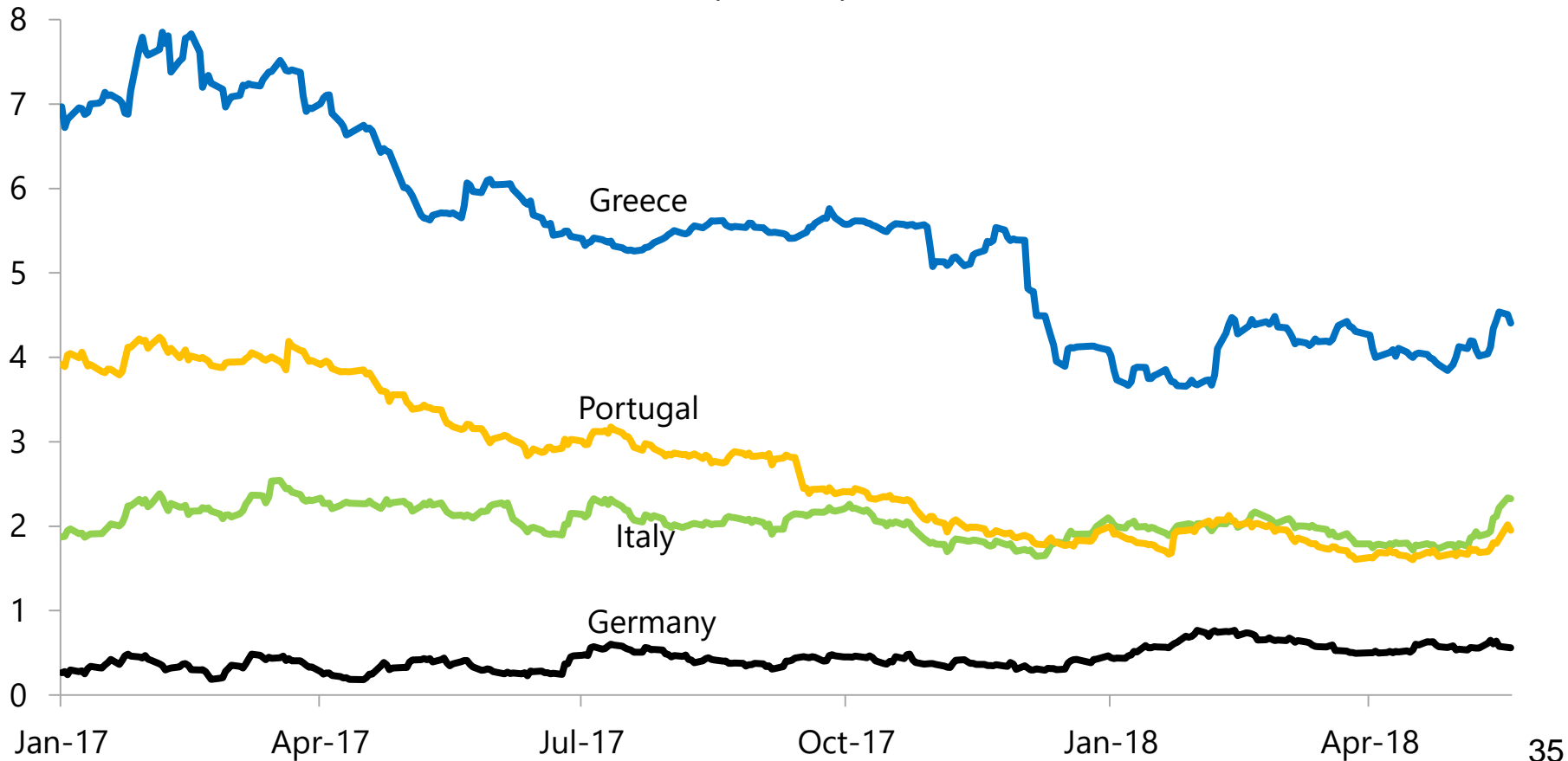
Consensus Forecasts of Real GDP and CPI Inflation for USA



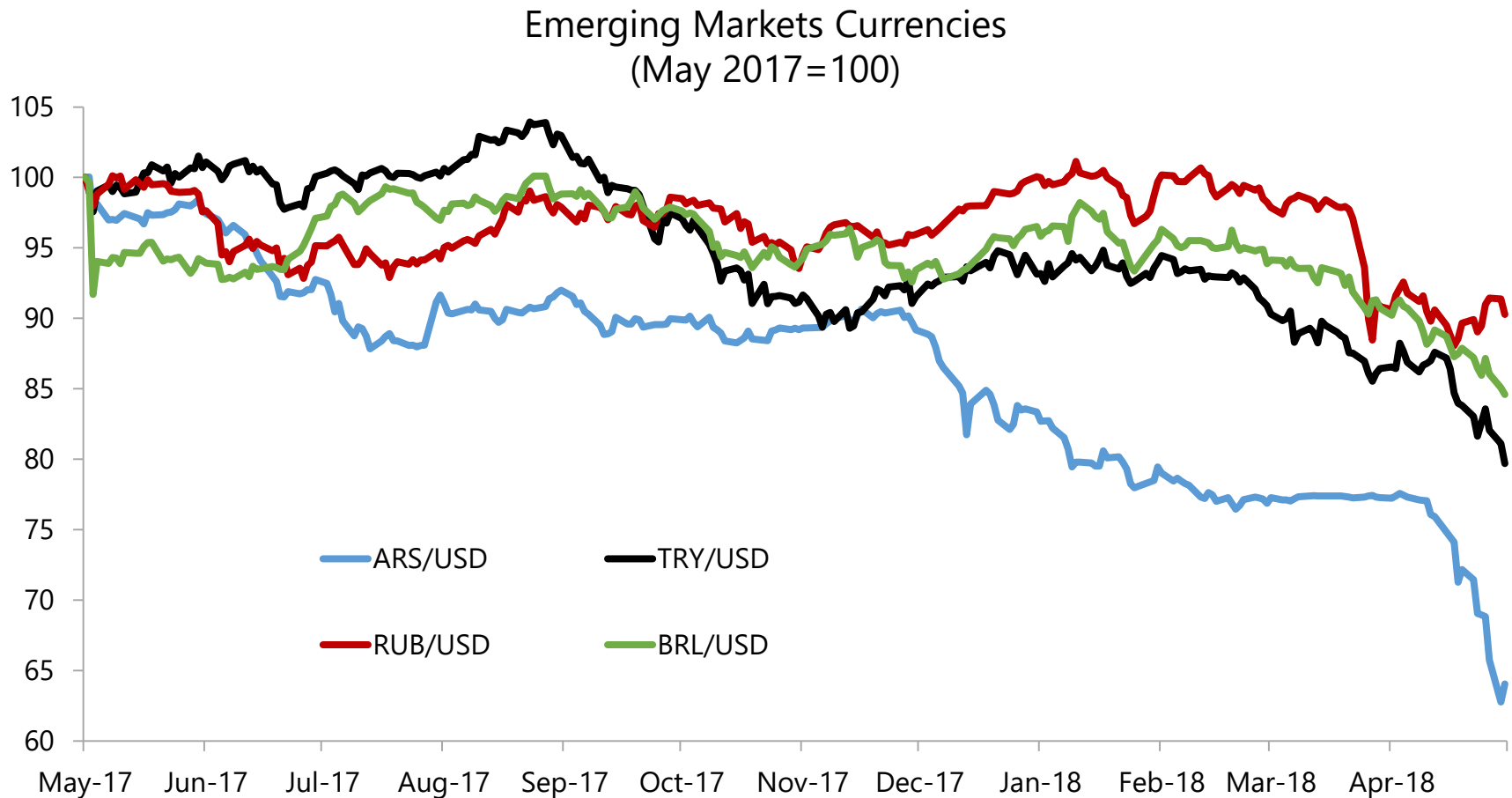
With a new government in Italy, interest rates in euro area periphery have been rising



10-Year Government Bond Yields  
(Percent)



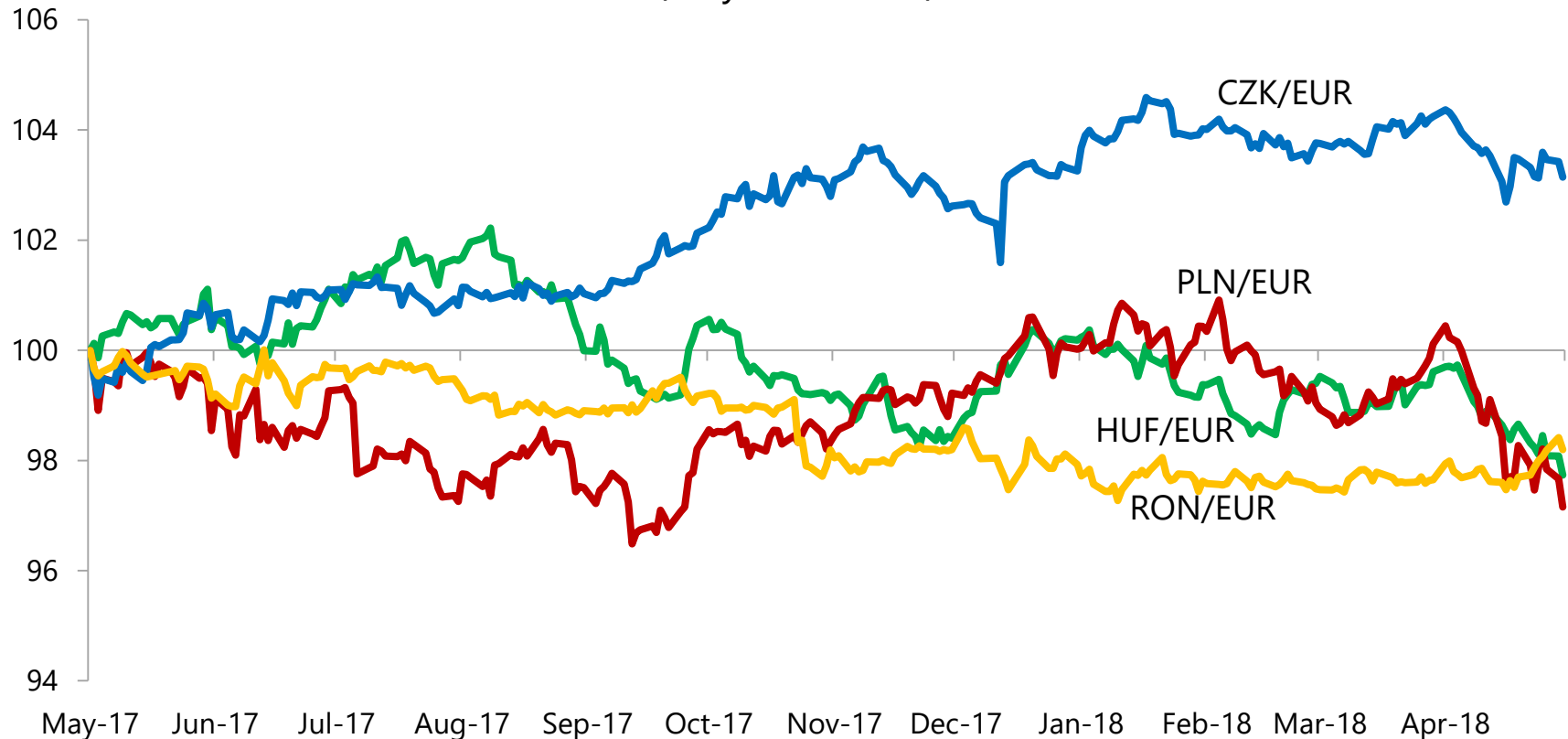
# Currencies of large EM have been under pressure



# Outside Russia and Turkey, currencies in CESEE have remained stable



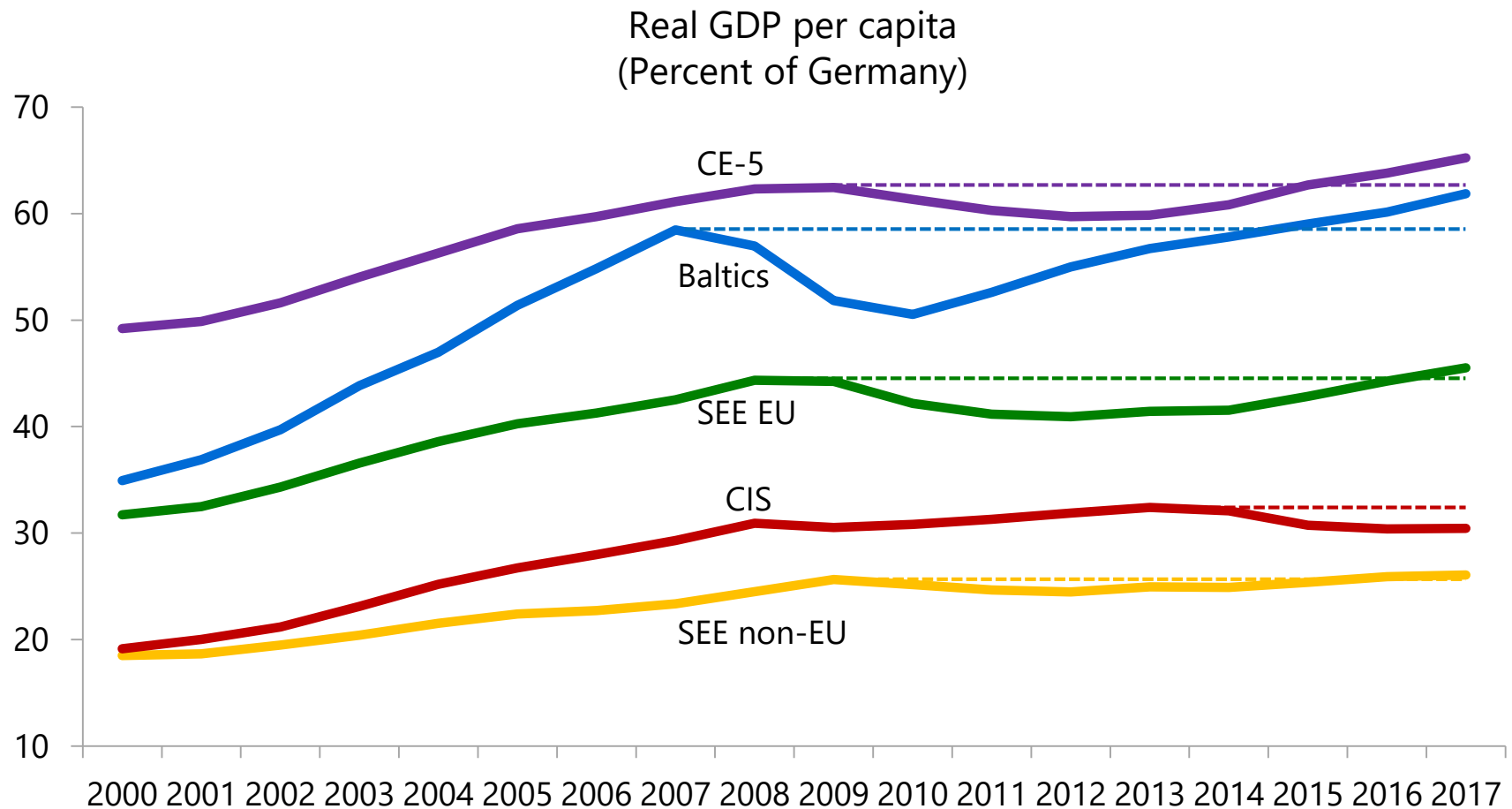
Emerging Europe Currencies  
(May 2017=100)





# THE FUTURE OF CONVERGENCE

# Convergence has resumed (except in CIS)

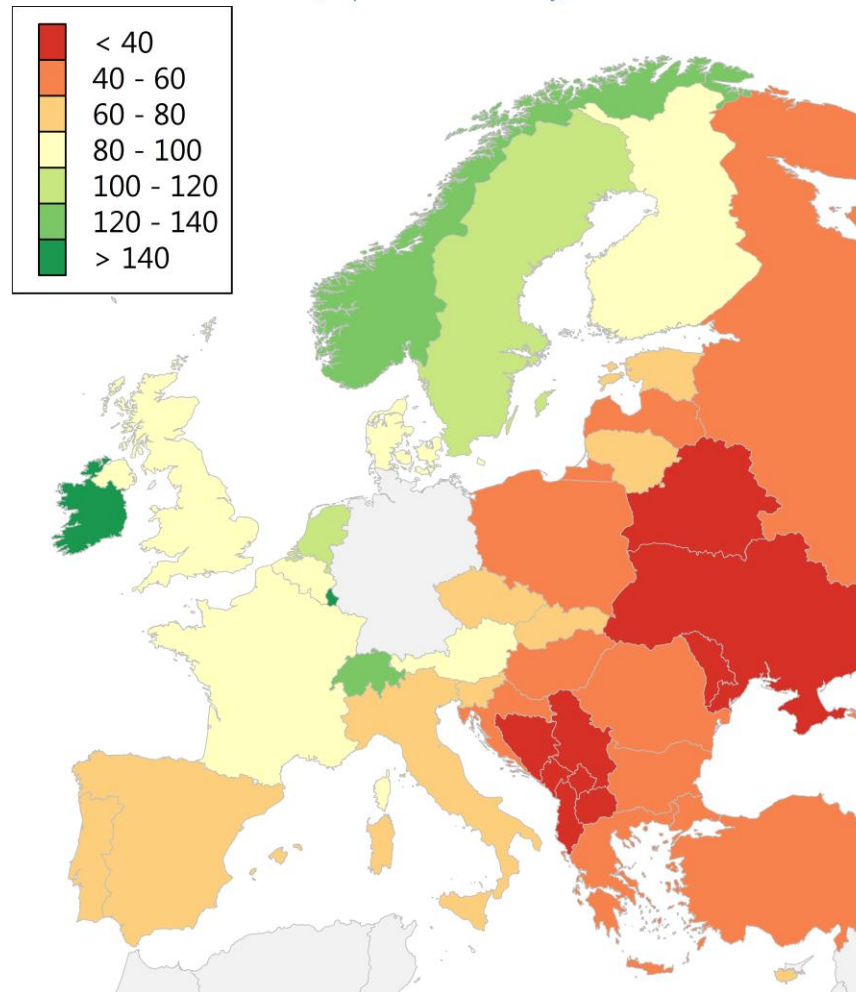


# But CESEE is still much poorer than Western Europe



## GDP PPP per capita in 2017

(As percent of Germany)

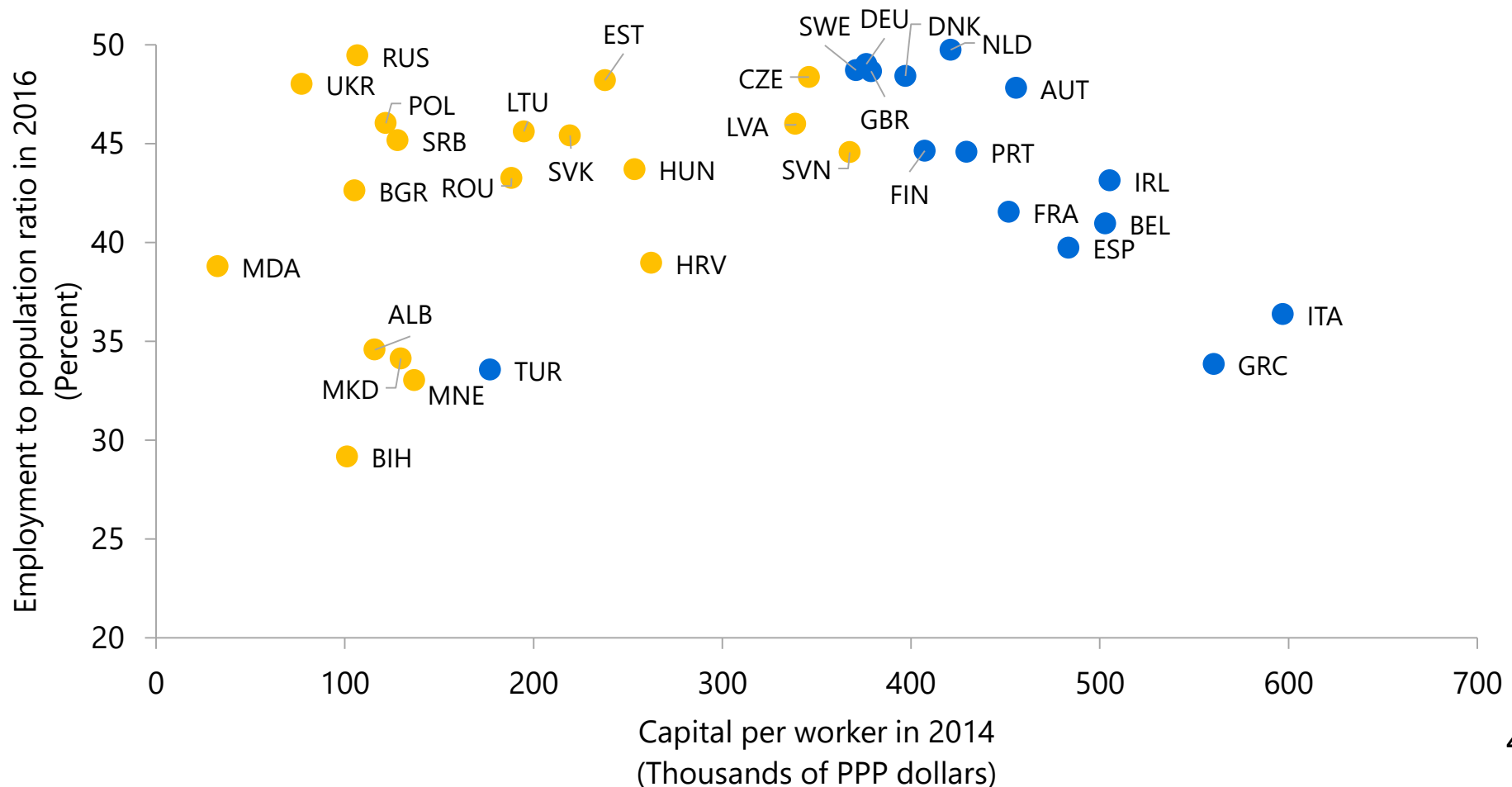




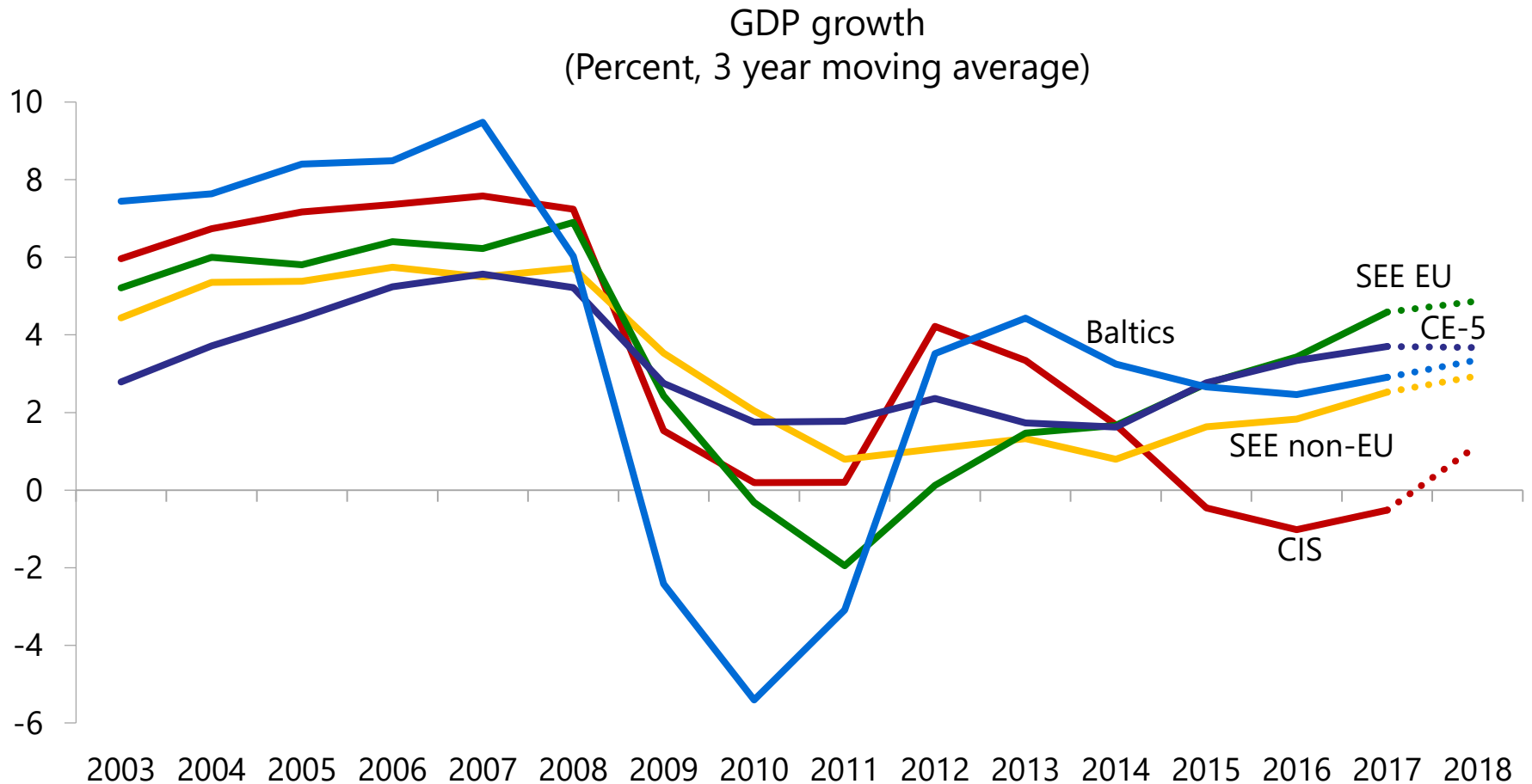
# As fewer people work and there is less capital per worker



Capital per Worker vs. Employment to Population Ratio



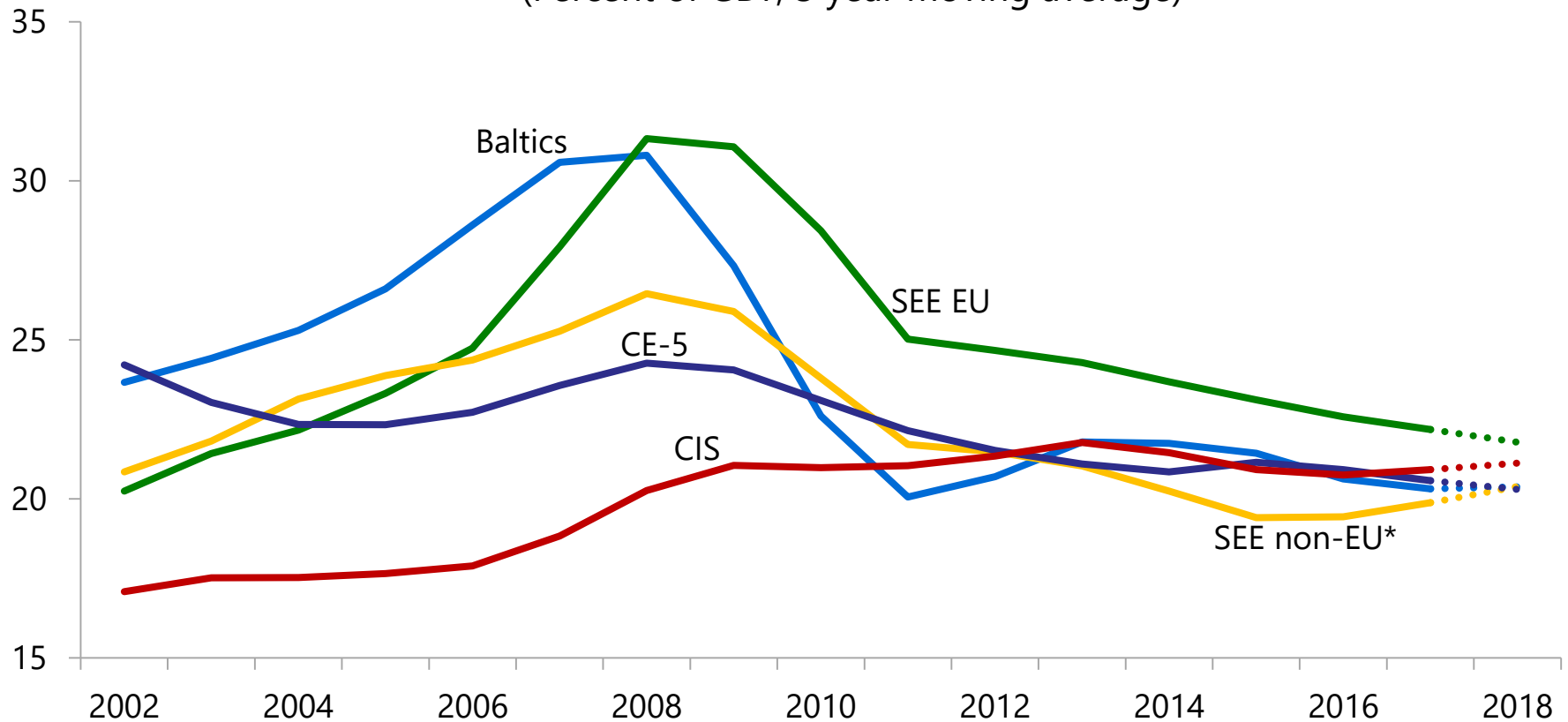
# Growth is slower than pre-crisis...



As investment rates are lower (except CIS)

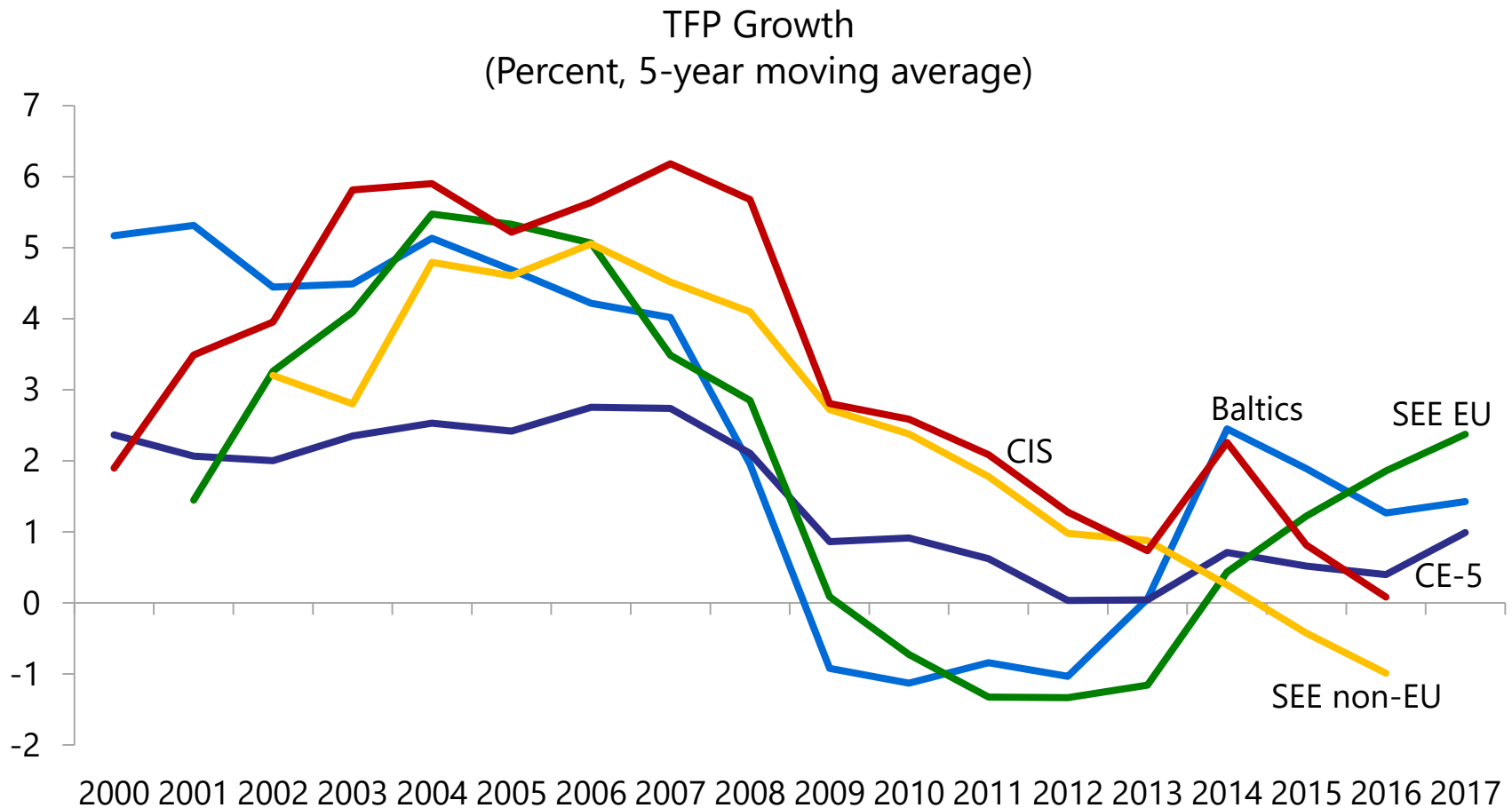


Investment Rate  
(Percent of GDP, 3 year moving average)

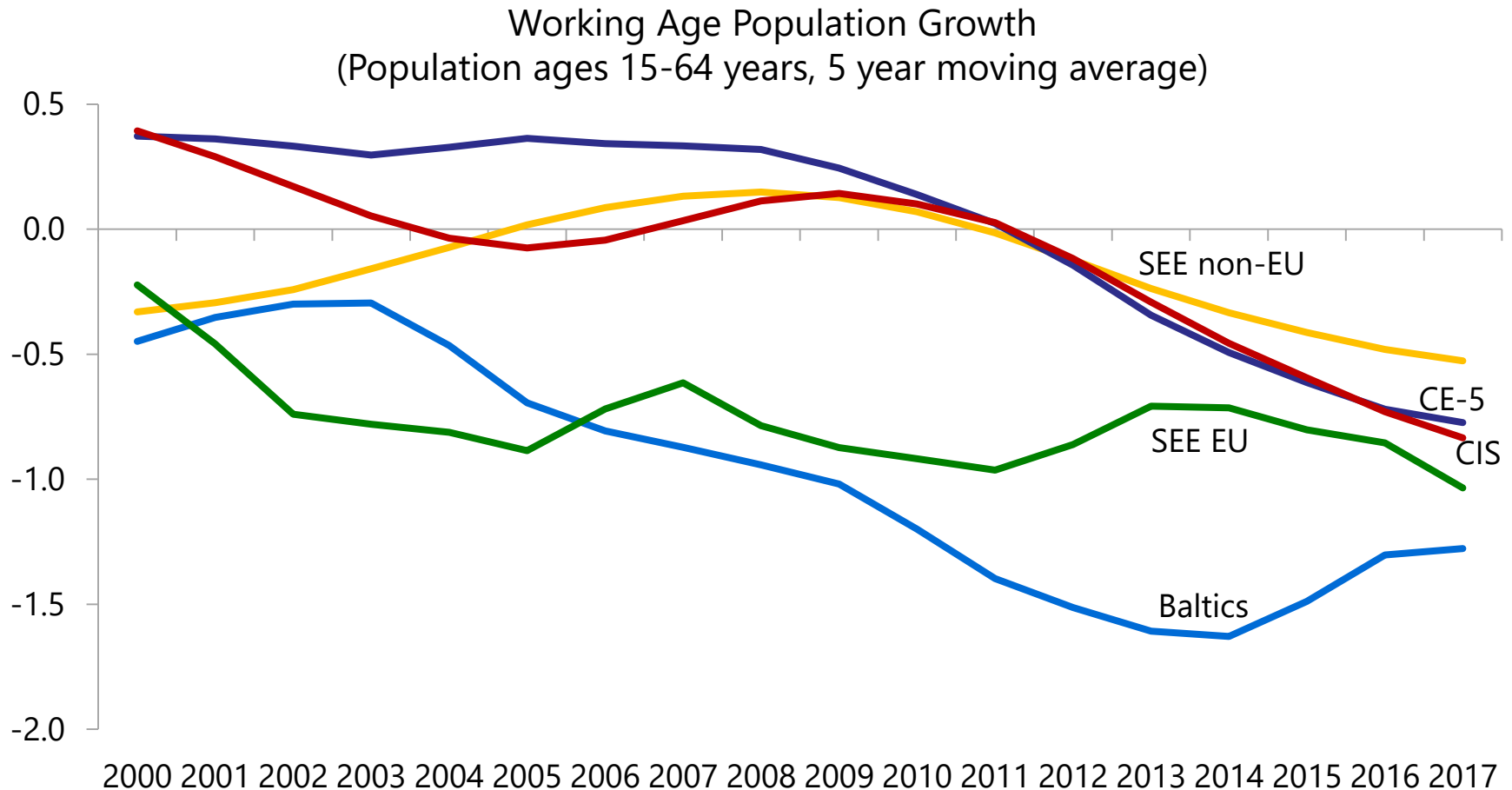


\*Excl. MKD

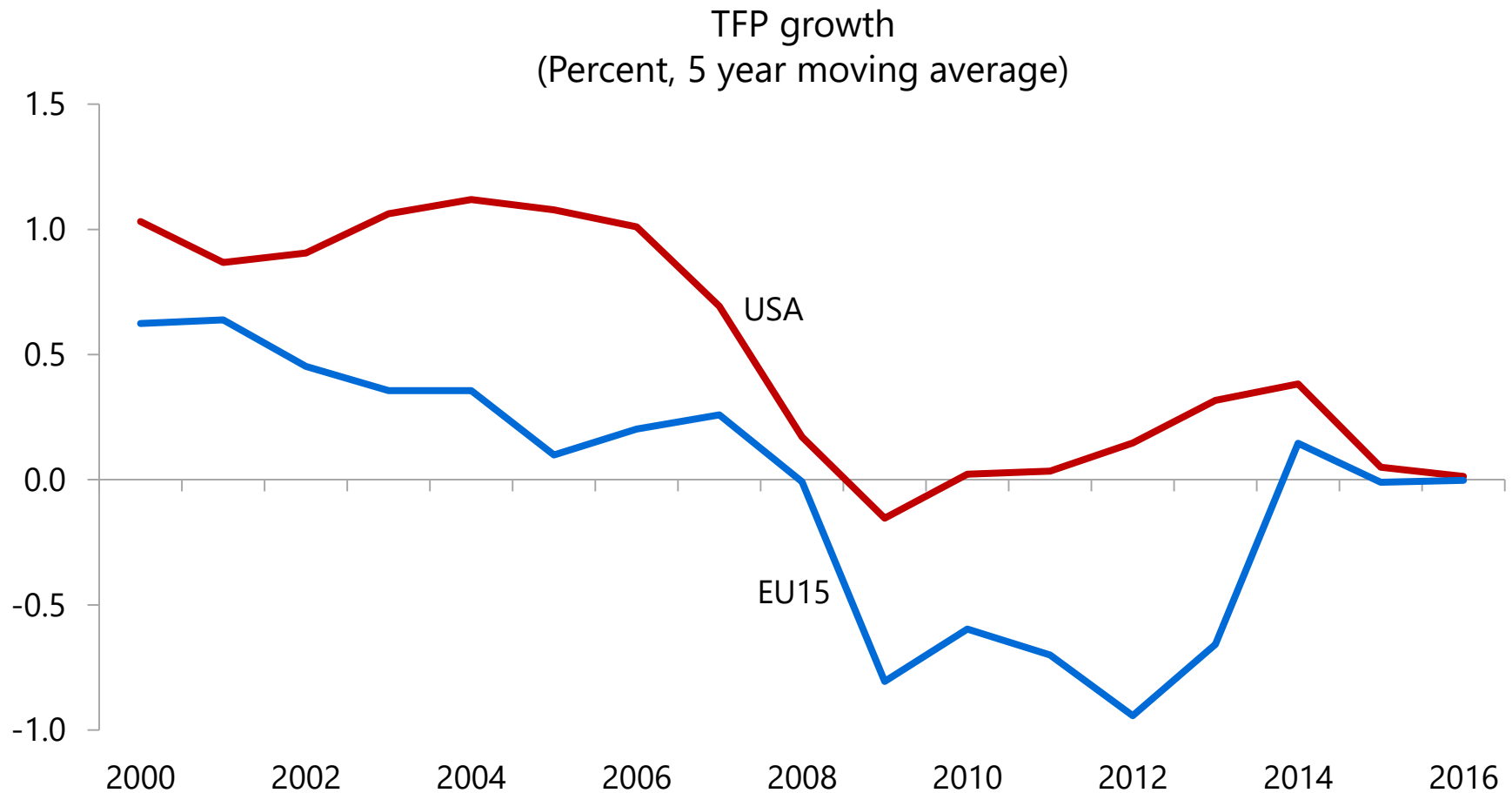
# Technological progress and efficiency advance much more slowly



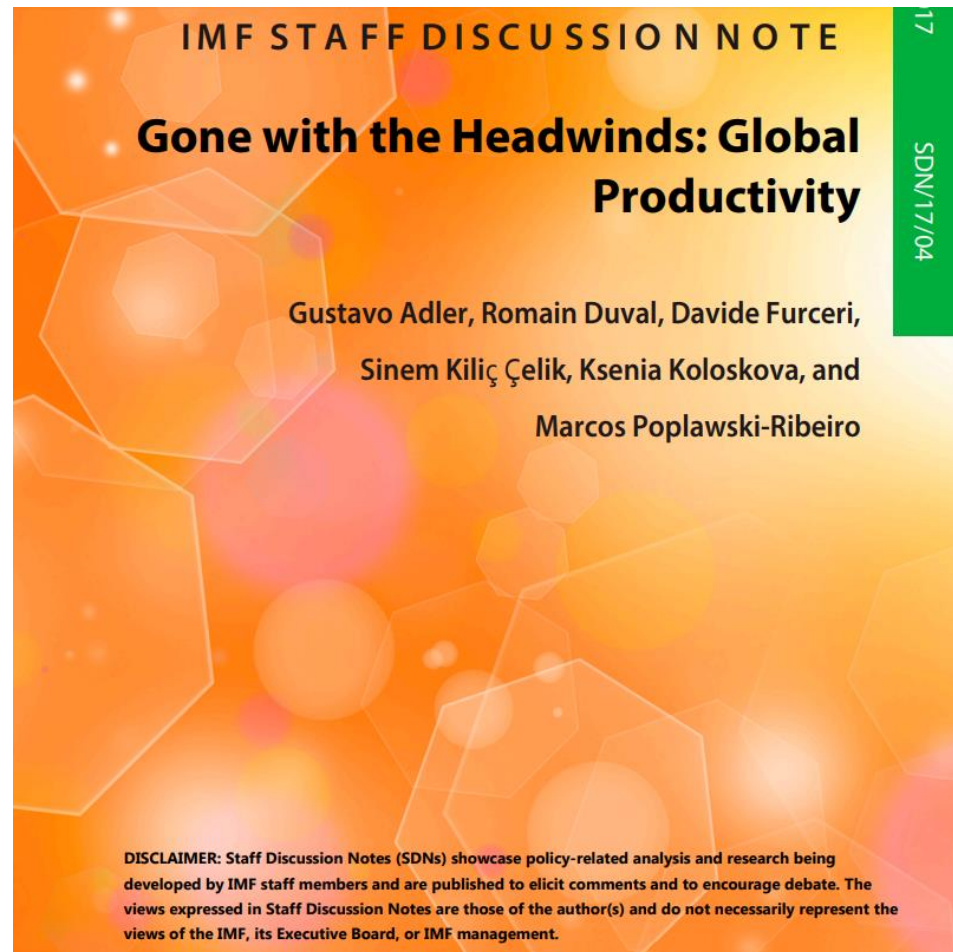
# Further exacerbated by the decline of the working age population



# Fall in TFP is a global problem



# Why has global TFP growth slowed?



# 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

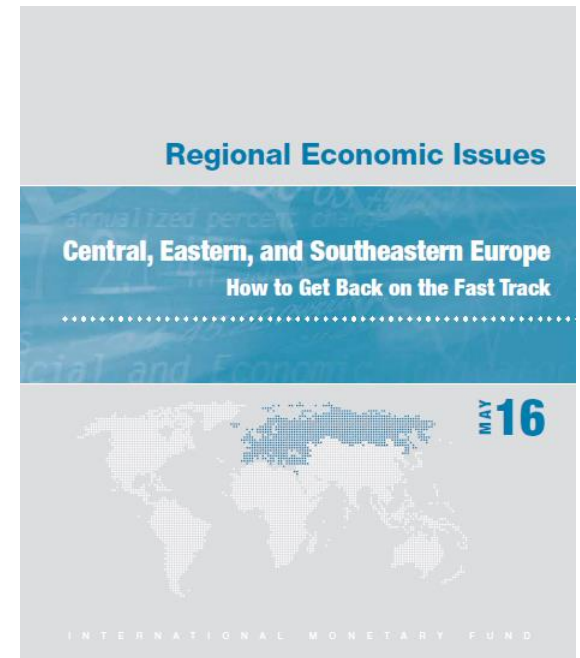


# What can be done to boost TFP growth



Address several problems

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



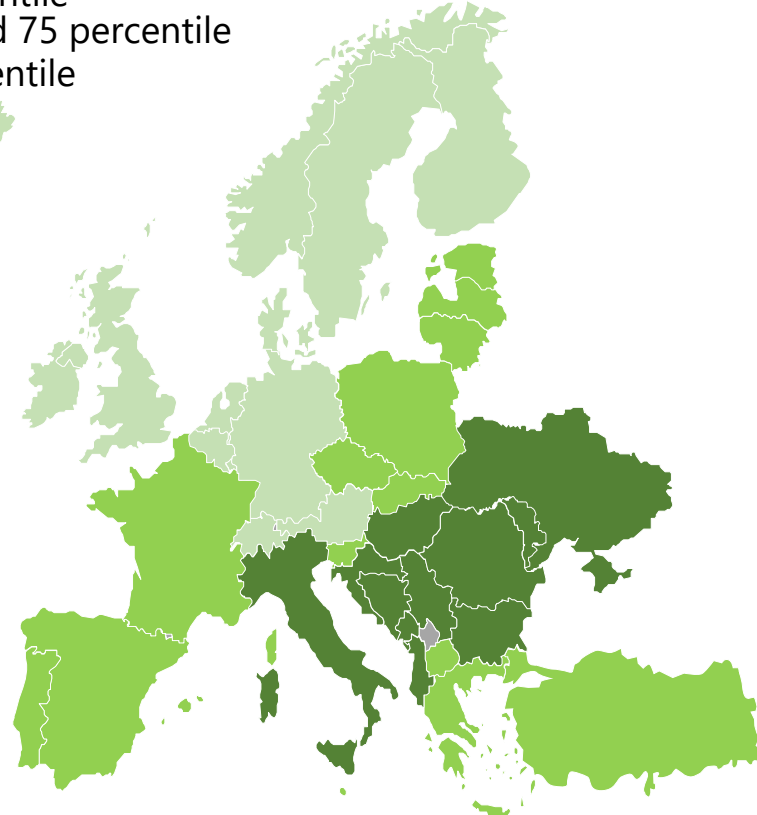
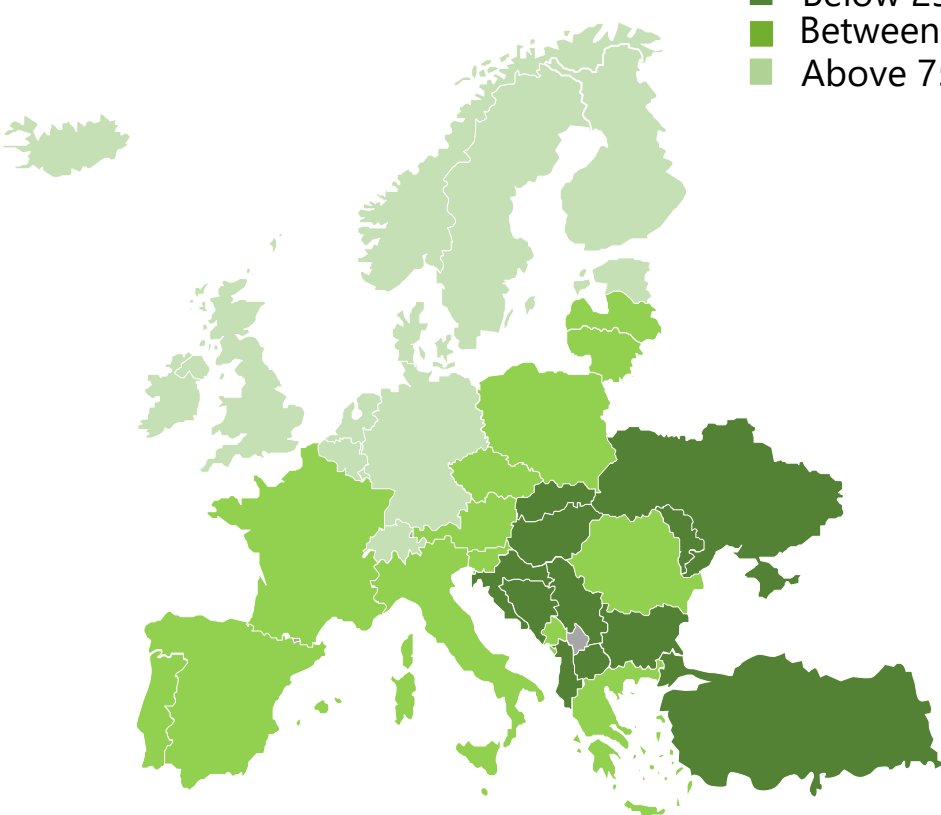
# Improve institutions, especially judiciary



Judicial Independence, 2015

Impartial Courts, 2015

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



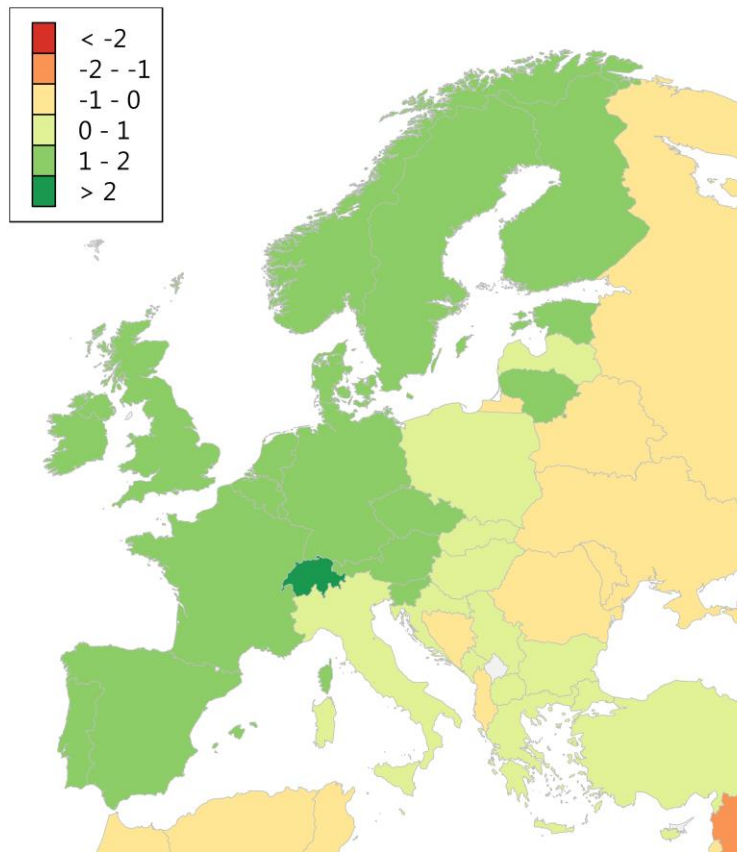
Source: World Economic Forum. Note: Worldwide distribution excluding LICs

# Other institutional indicators also show a room to catch up to Western Europe

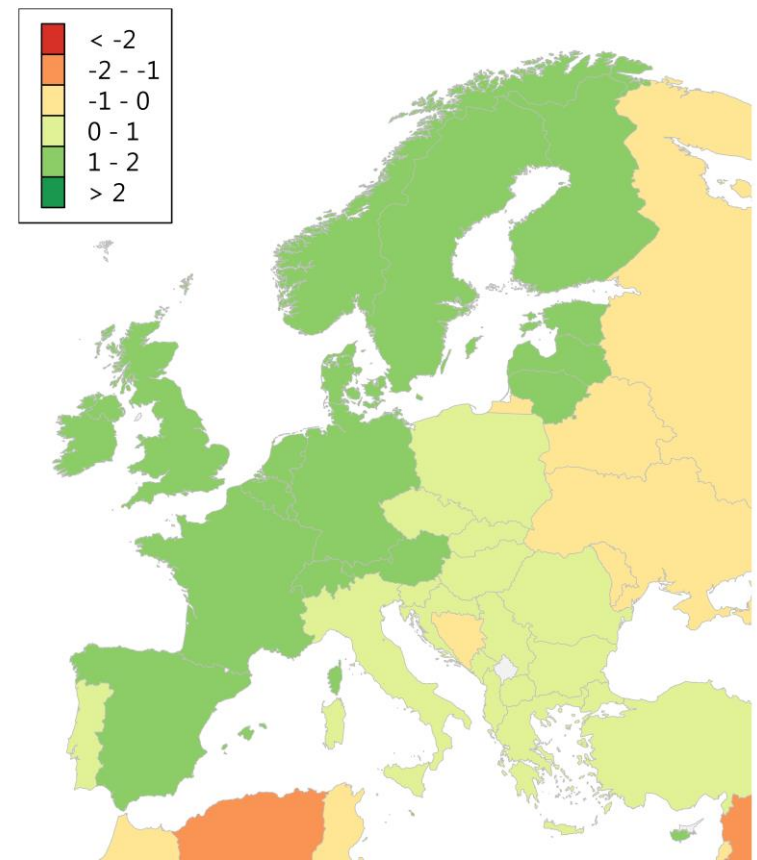


World Governance Indicators, 2016  
(Ranges from -2.5 (weak) to 2.5 (strong) governance performance)

Government Effectiveness



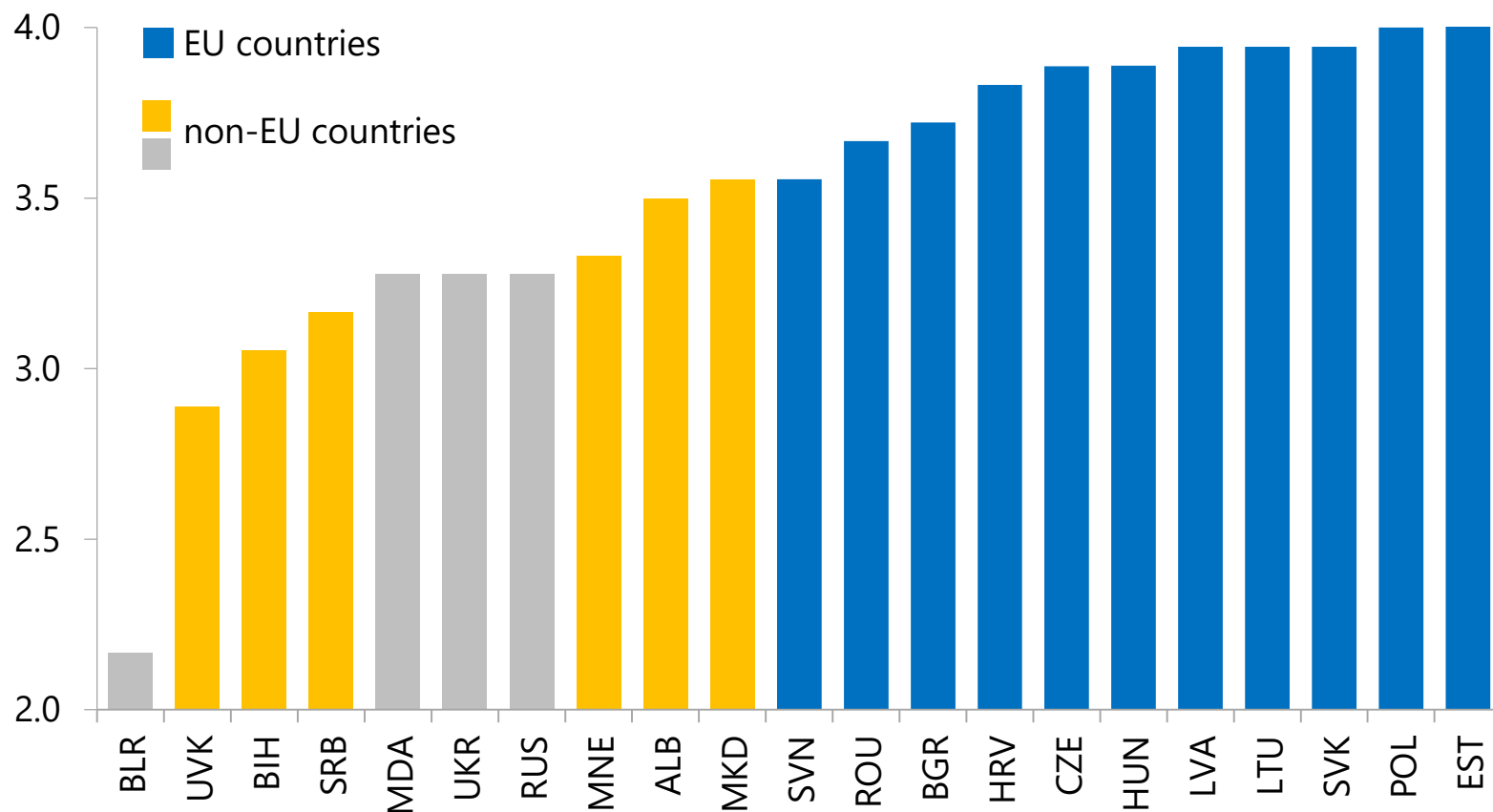
Regulatory Quality



# 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