CESEE economies: Outlook and challenges

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Outline

- **Outlook**
- Risks
  - Weak growth in Euro Area
  - External funding conditions
  - Geopolitical risk
- Challenges
  - Fiscal consolidation
  - Monetary policy
  - High NPLs
  - Labour market
  - Business environment
  - Policy priorities summary
Recovery in prospect...

Real GDP growth (percent)

EU
BRIC
USA
Japan
…but weak convergence…
...but weak convergence
More balanced growth

Real GDP growth composition

- Investments
- Consumption
- Foreign demand
Inflation back on the radar - negatively

Inflation rate (percent)

2012

2013

latest

BiH

Serbia

Albania

Romania

Latvia

Slovenia

Poland

Kosovo

Estonia

Lithuania

Czech Rep.

Slovak Rep.

Hungary

Croatia

Montenegro

Macedonia

Bulgaria

Inflation rate (percent)
Euro under appreciation pressure

Central banks balance sheets
(index, Jan-2011=100)

Exchange rate and commodity prices

Euro Area NEER (2000=100)

Commodity price (y/y percent changes)
Inflation expected to rise (we hope)...

[Graph showing inflation trends in the USA, UK, Euro area, and Japan from 2011 to 2016.]
...including in CESEE

Inflation rate (percent)
CEE fiscal mostly under control
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High dependence on external funding...

Gross External Liabilities
(Percent of GDP)

2008

Baltics
CEE
SEE
East3
RUS
TUR
CESEE
...increased further in recent years.

Gross External Liabilities (Percent of GDP)

2012

Average of other EMs
FDIs are a significant part of the economy in various regions. The chart shows the gross external liabilities (as a percent of GDP) for different regions in 2012. The FDI stock is particularly high in the Baltics and CEE regions, while the SEE and East3 regions have moderate levels. The RUS, TUR, and CESEE regions have lower gross external liabilities.
Private sector accounts for most of the external debt

External Debt
(Percent of GDP)

Baltics  CEE  SEE  East3  RUS  TUR  CESEE

2012

Public
Private

Average of other EMs
Funding structure matters

Private External Debt Structures
(Percent of GDP, 2012)

- Debt securities
- Direct cross-border lending
- Parent bank lending
- Inter-company lending
# Sources of external funding risks

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<th>Stock vulnerabilities</th>
<th>Flow vulnerabilities</th>
<th>External fundamentals</th>
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Countries susceptible to external funding risks

External Fundamentals

Stock Vulnerability
- EST
- SVN

Flow Vulnerability
- HRV
- HUN
- SRB

Countries susceptible to external funding risks:
- BLR
- TUR
Deleveraging continues

External Position of BIS-reporting Banks
(Billions of US$, exchange-rate adjusted, vis-à-vis all sectors)

- Baltics, -49 percent
- SEE EU, -31 percent
- SEE non-EU, -18 percent
- CE4, -21 percent from peak
Uncertainty on geopolitical situation

Russia and Ukraine share of exports (percent)

Share of gas consumption provided by Russia (percent)
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Fiscal buffers need to be rebuilt
Montary policy challenge

Y/Y change in interest rates, April 2014

Change in:
- Policy rate
- Real interest rate*

*backward looking real interest rate
Bank legacy issues

\[ y = -0.594x + 6.9088 \]
\[ R^2 = 0.305 \]

Average real credit growth (percent y/y), Q1-Q3 2013

Non-performing loans ratio, latest available
Weak labour markets

2005-2007 average
Weak labour markets

2011-2013 average
2005-2007 average
Business environments need work

Doing Business 2014 rank

Denmark
UK
Finland
Sweden
Ireland
Lithuania
Germany
Estonia
Latvia
Macedonia
Netherlands
Austria
Portugal
Slovenia
Belgium
France
Cyprus
Montenegro
Poland
Slovakia
Spain
Hungary
Bulgaria
Luxembourg
Italy
Turkey
Greece
Romania
Czech Rep.
Kosovo
Croatia
Albania
Serbia
Malta
Bosnia

0 20 40 60 80 100 120 140
## IMF policy priorities in the region

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<th>Policy area</th>
<th>Priority*</th>
<th>Common policy recommendations</th>
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| Fiscal              |           | • Composition of fiscal consolidation should be more balanced  
|                     |           | • Improve tax compliance                                                                   |
| Monetary            |           | • Monetary policy should remain supportive, while being alert to  
|                     |           | inflation and exchange rate pressures                                                    |
| Financial system    |           | • Address high NPLs problem  
|                     |           | • Strengthen financial sector supervision and regulation                                   |
| Labor market        |           | • Improve labor market participation and reduce skill mismatches  
|                     |           | • Consider active labor market policies                                                  |
| Business environment|           | • Improve contracts enforcement  
|                     |           | • Strengthen insolvency framework                                                          |
| Social security     |           | • Consider parametric reform of pension system  
|                     |           | • Ensure fairness and counter abuses of the system                                         |

* Prevalence of calls for policy action in latest IMF Article IV staff appraisals
Thank you