

European Department

Central, Eastern and Southeastern Europe (CESEE)

Recovery at risk? - CEE external vulnerability and Poland Article IV preliminary conclusions



CASE, Warsaw - May 27, 2014

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Outline



Outlook for the region

External funding patterns and risks

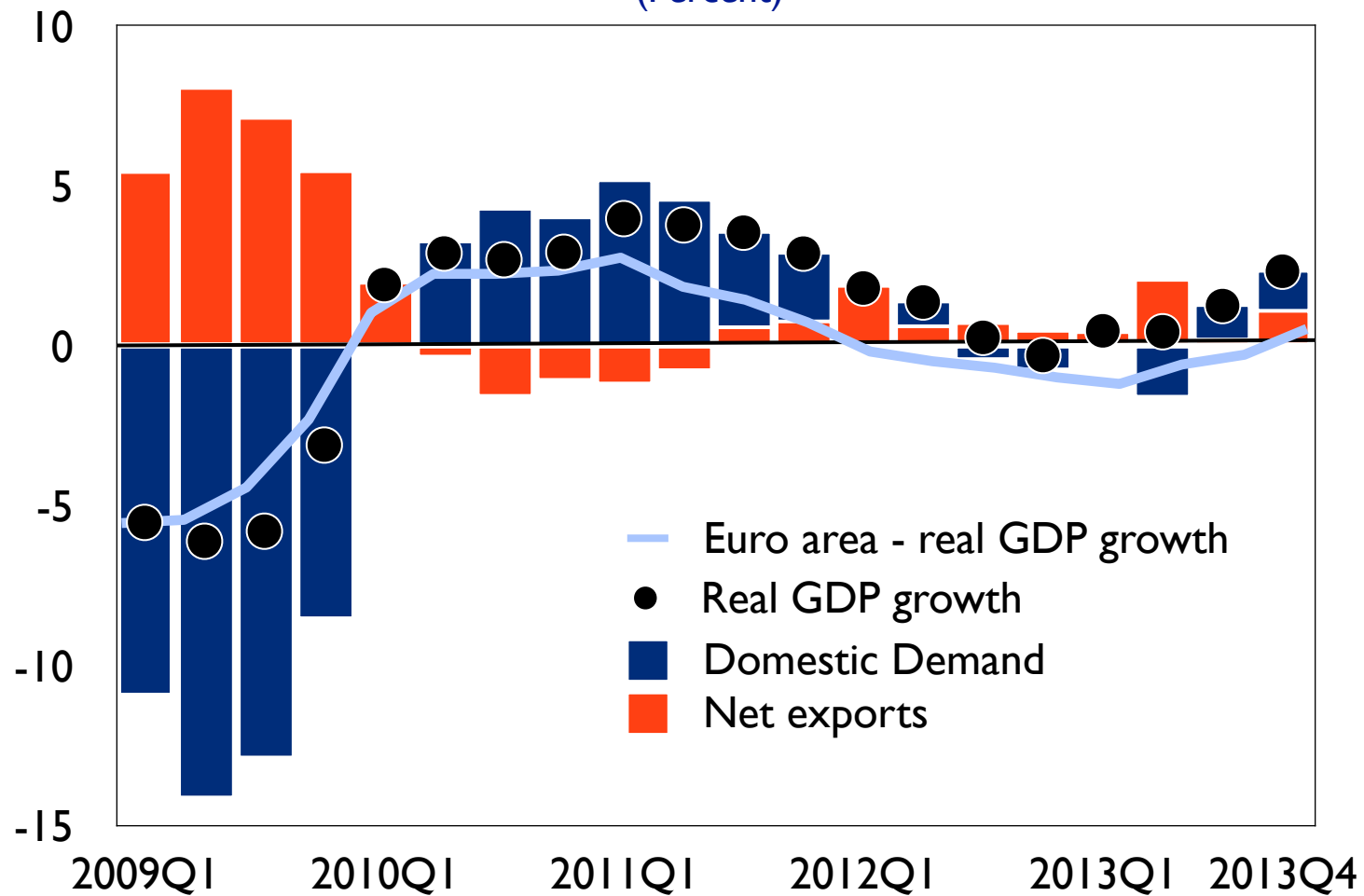
Policy priorities

Poland Article IV

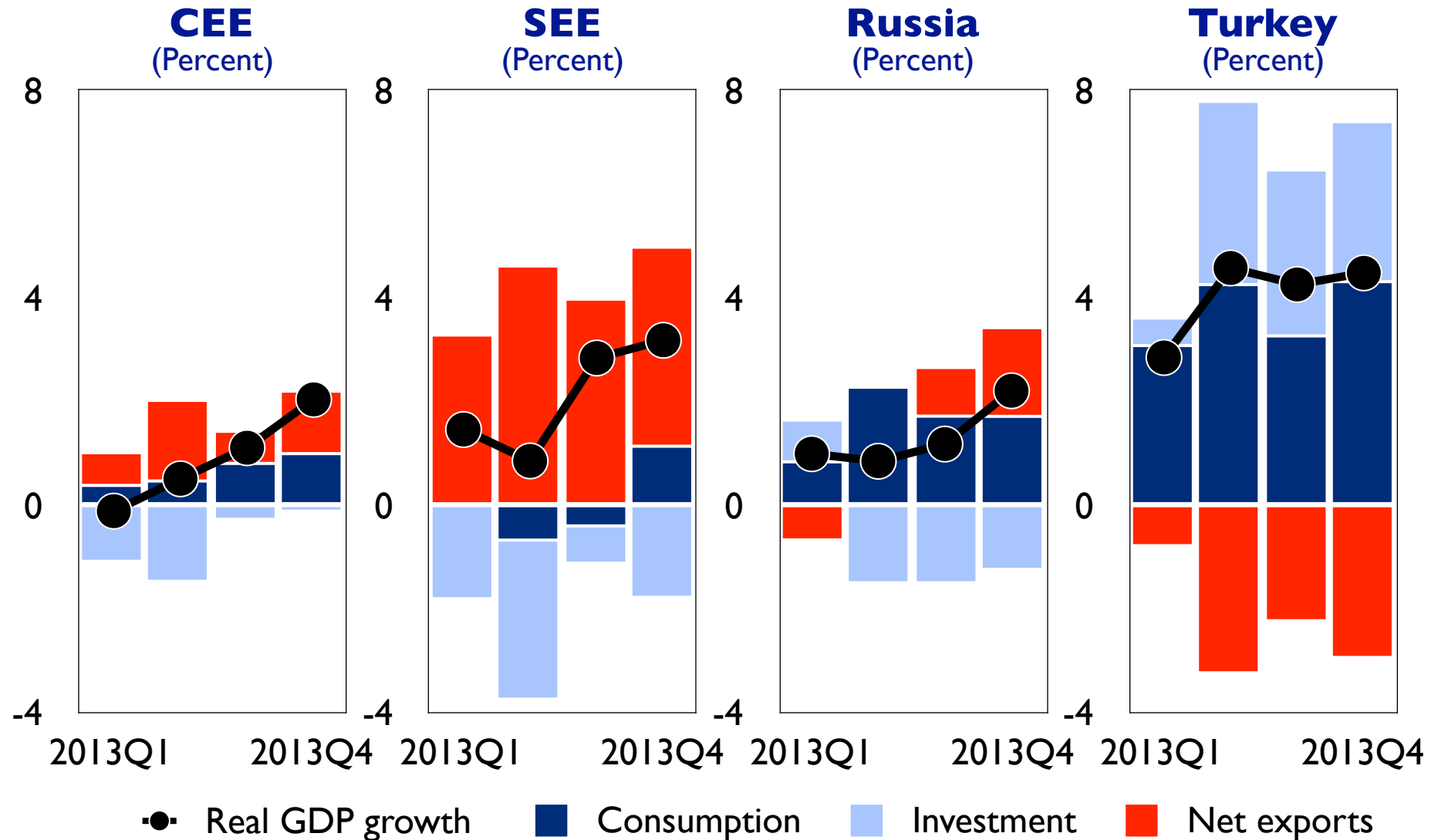
Growth picked up in 2013H2...



CESEE excl. RUS & TUR: Contributions to Real GDP Growth (Percent)



Drivers of growth different across region...

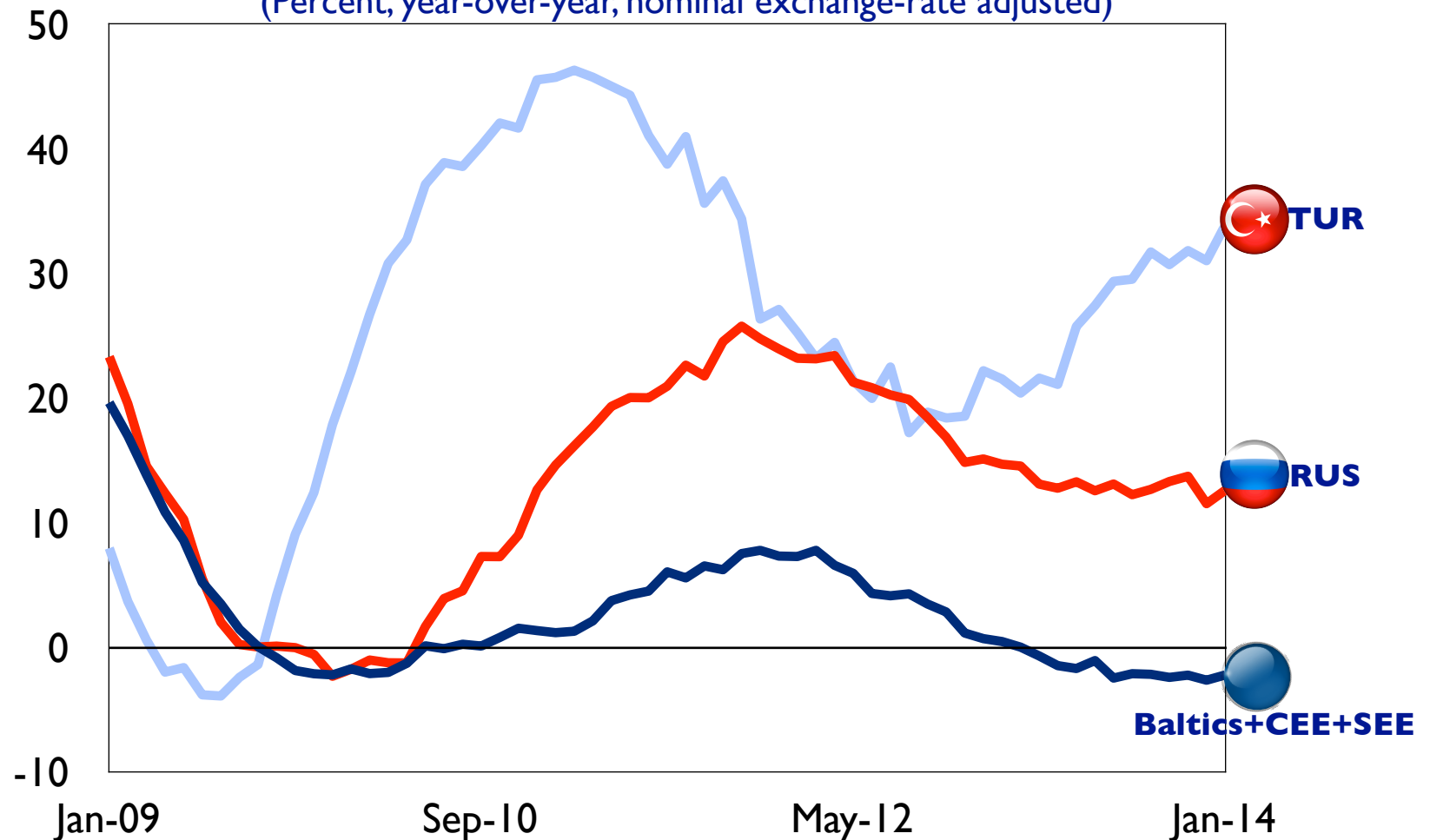


... but recovery is mostly “creditless” ...



Credit to Nonfinancial Corporations

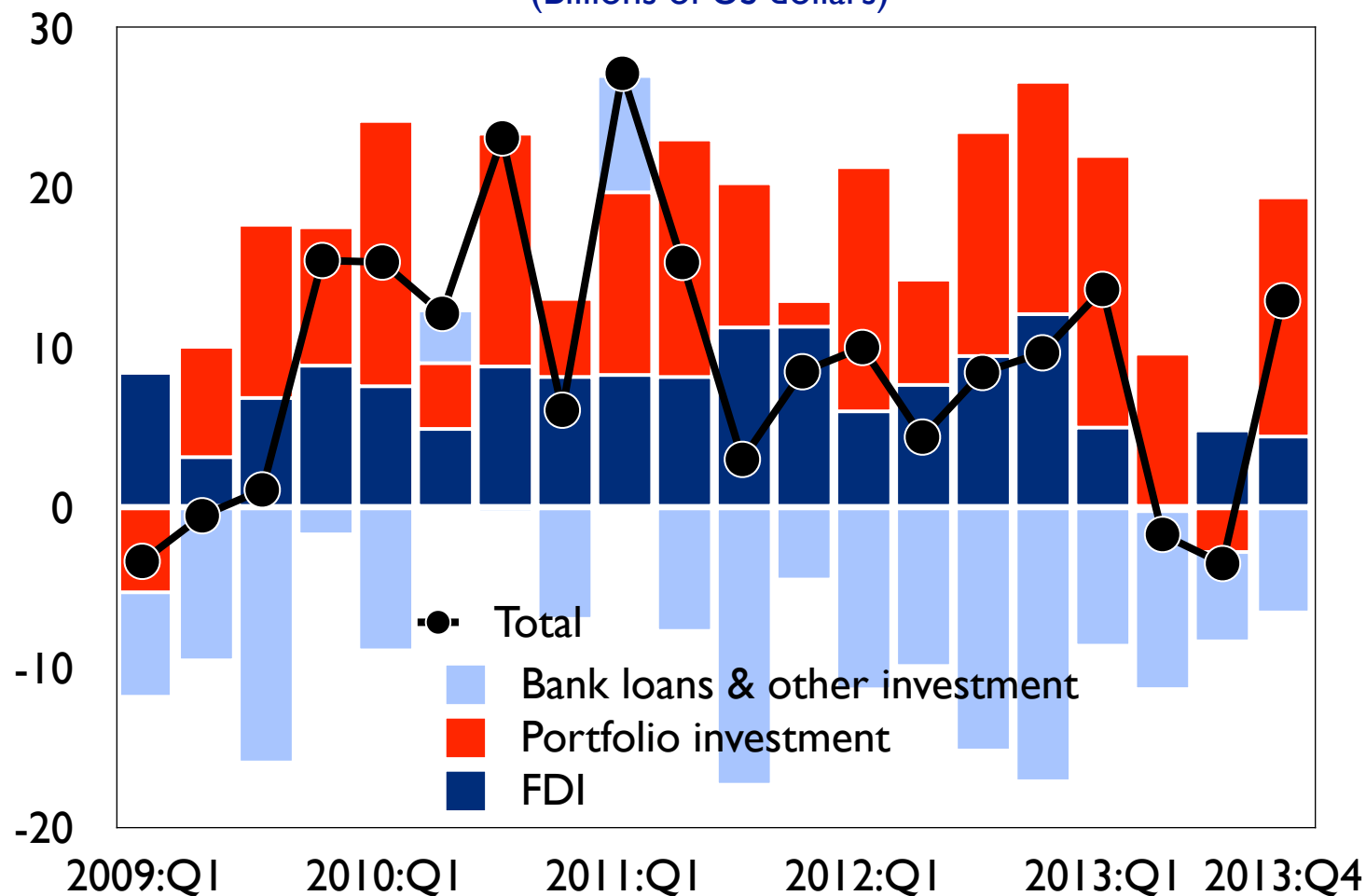
(Percent, year-over-year, nominal exchange-rate adjusted)



... while external funding flows became more volatile post-taper talk



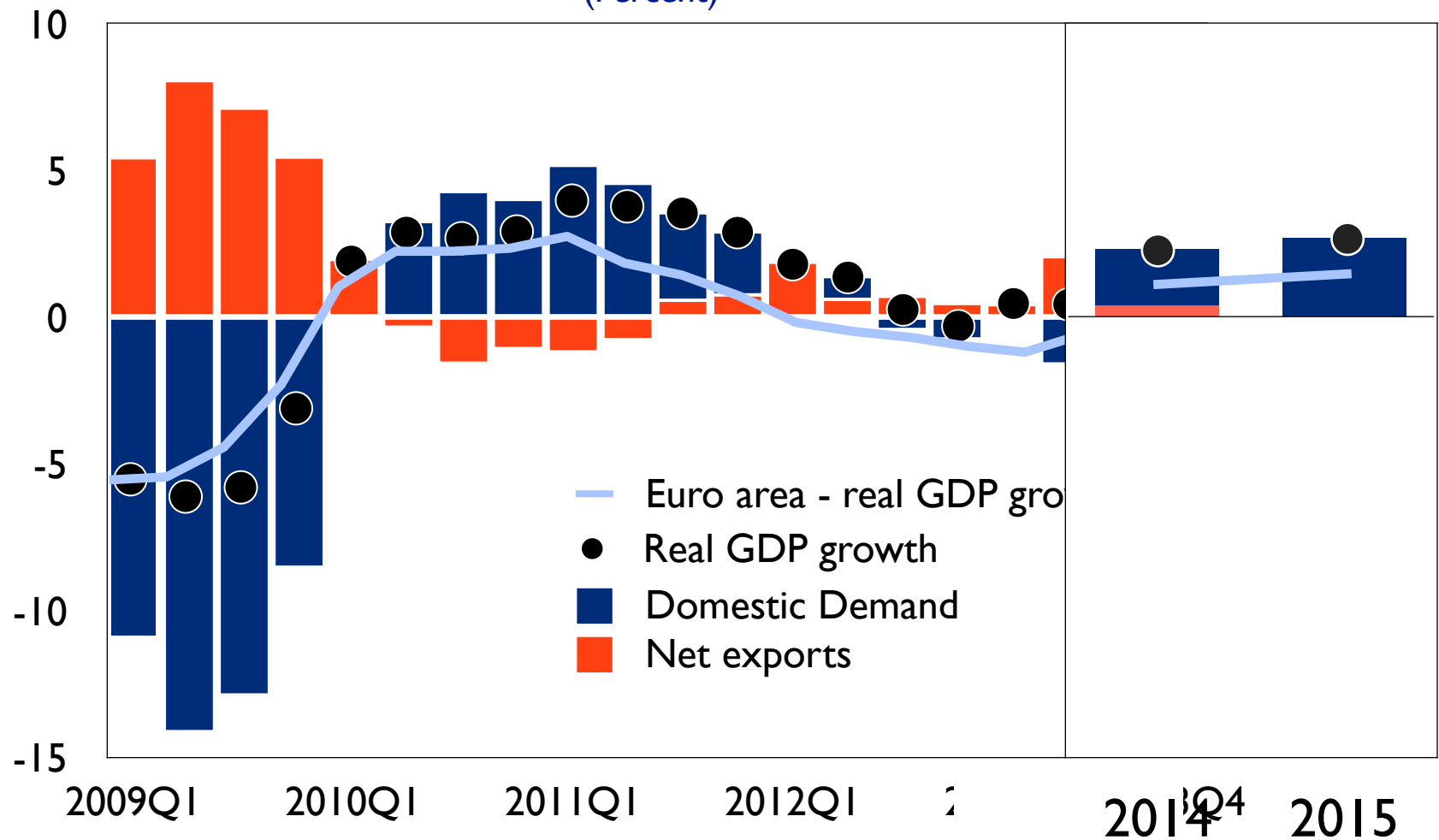
CESEE excl. RUS & TUR: Capital Flows
(Billions of US dollars)



Growth is expected to accelerate...



CESEE excl. RUS & TUR: Contributions to Real GDP Growth (Percent)



...but projections have been revised downwards.



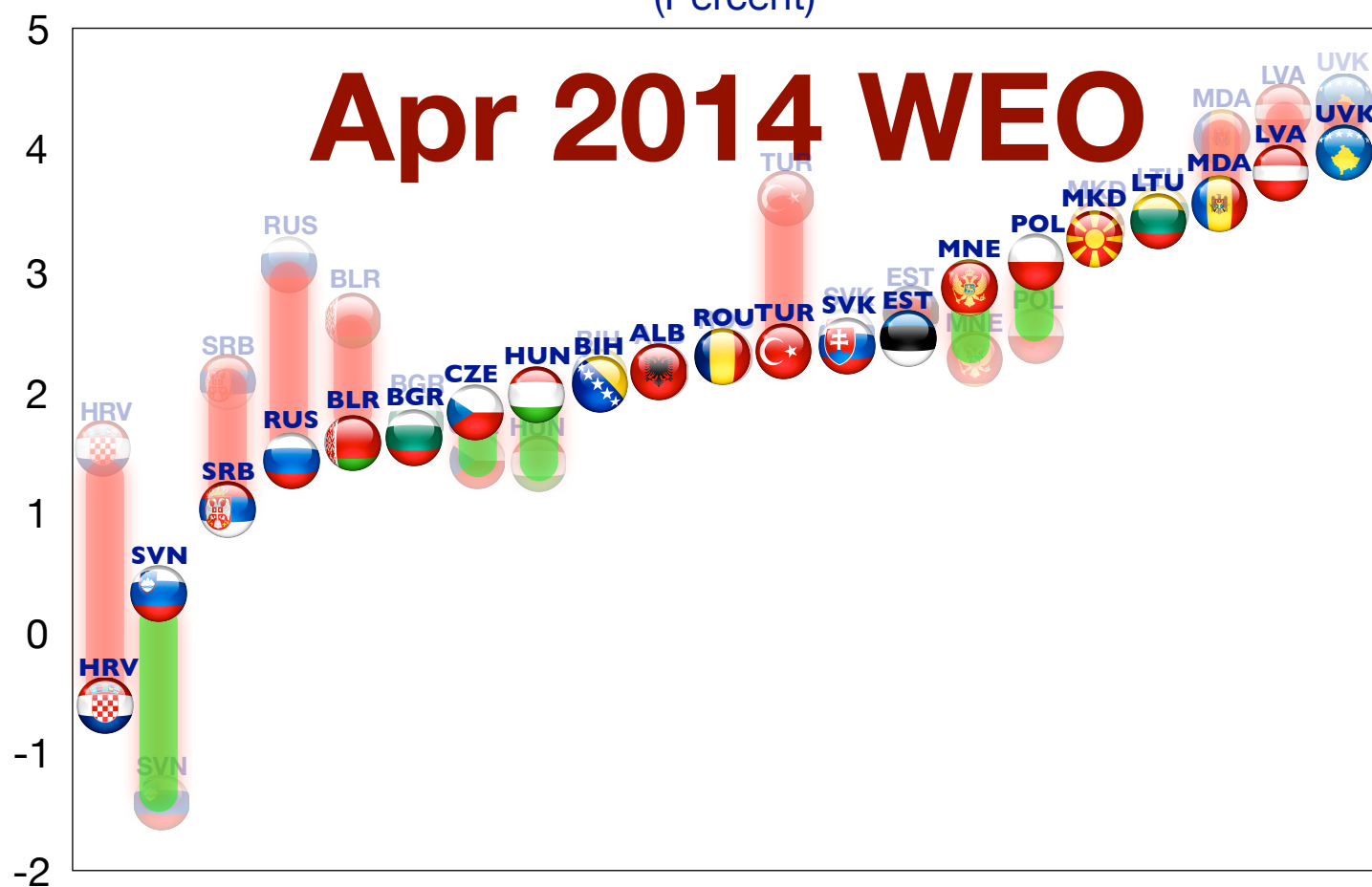
Real GDP Growth, 2014 (Percent)



...but projections have been revised downwards.



Real GDP Growth, 2014 (Percent)



Key Risks



Protracted weak growth in euro area

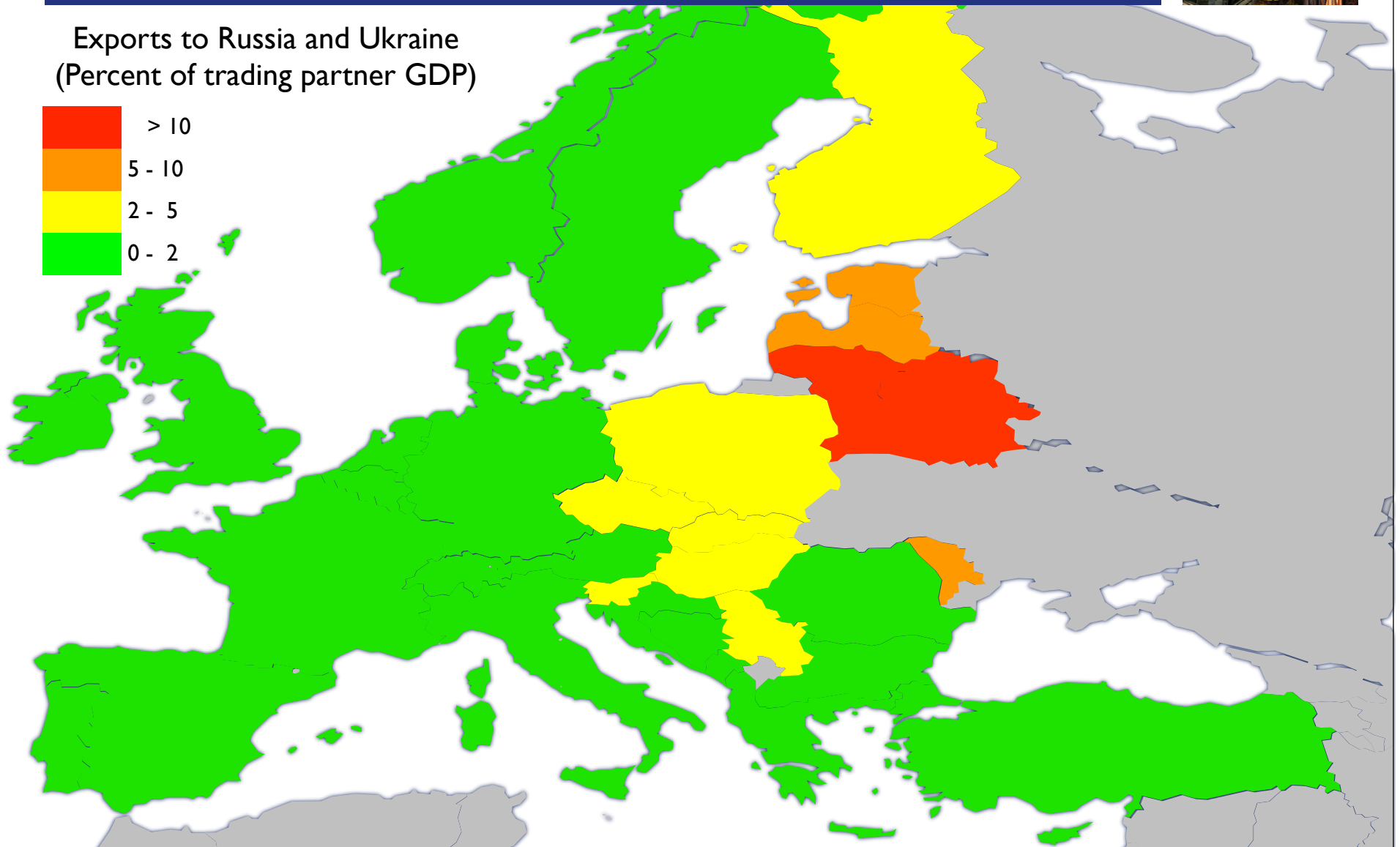
Increasing geopolitical tensions

Global financial market volatility

Risks from geopolitical tensions: trade linkages with Russia and Ukraine



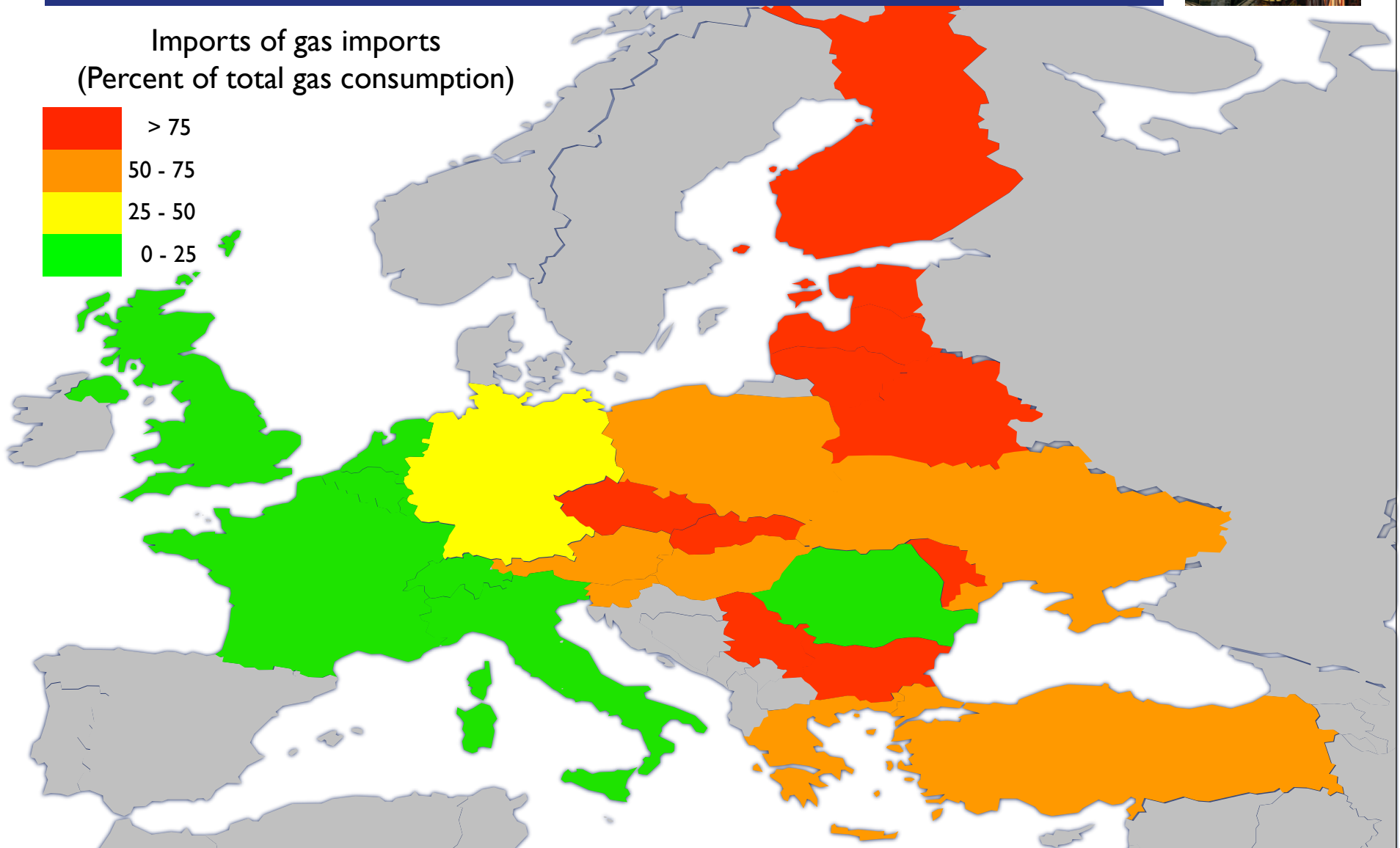
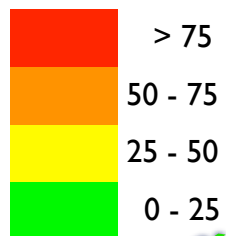
Exports to Russia and Ukraine
(Percent of trading partner GDP)



Risks from geopolitical tensions: Dependence on Russian gas



Imports of gas imports
(Percent of total gas consumption)



CESEE External Funding Patterns and Risks



1 External Funding Structures

2 External Funding Conditions

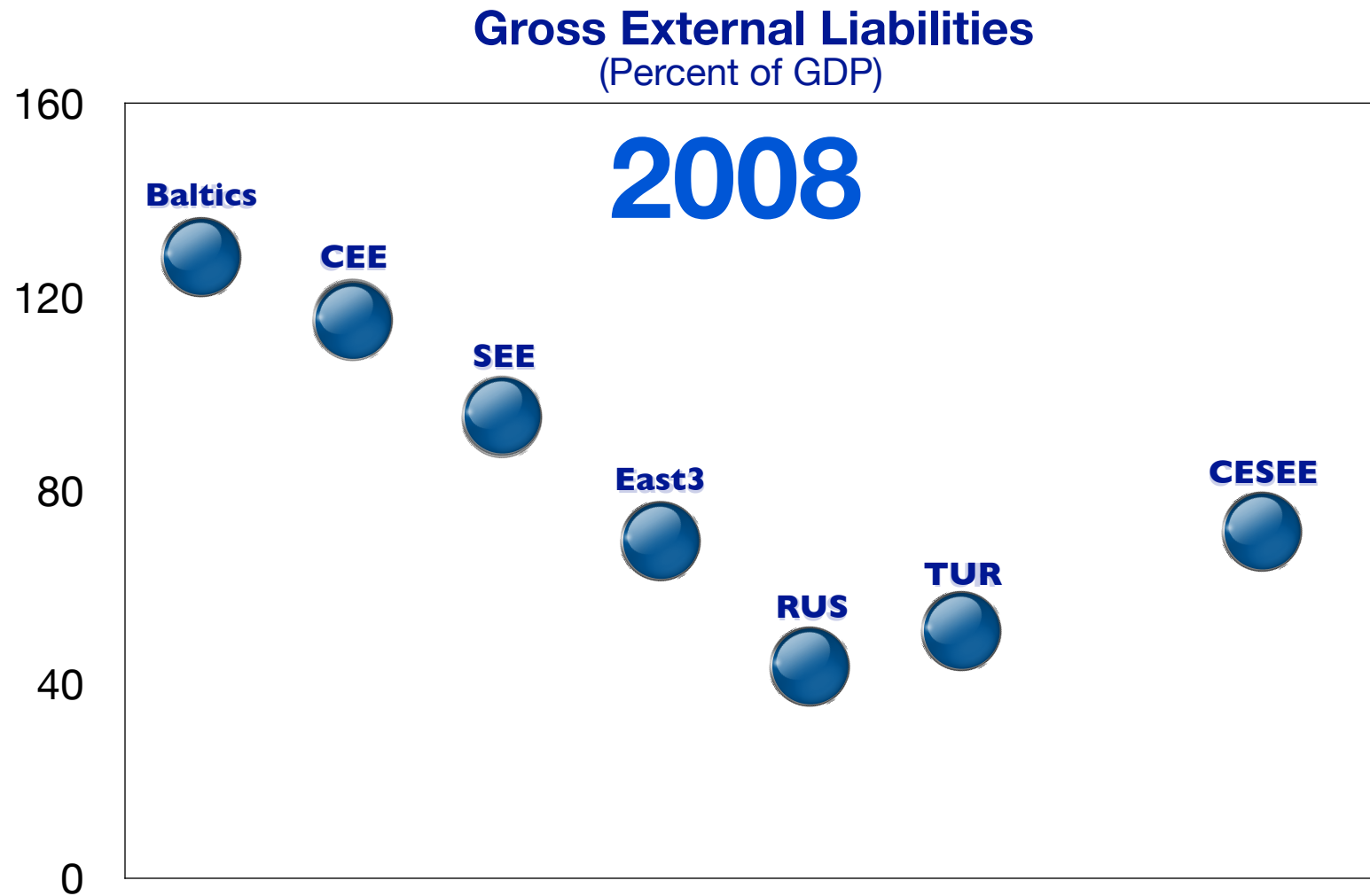
CESEE External Funding Patterns and Risks



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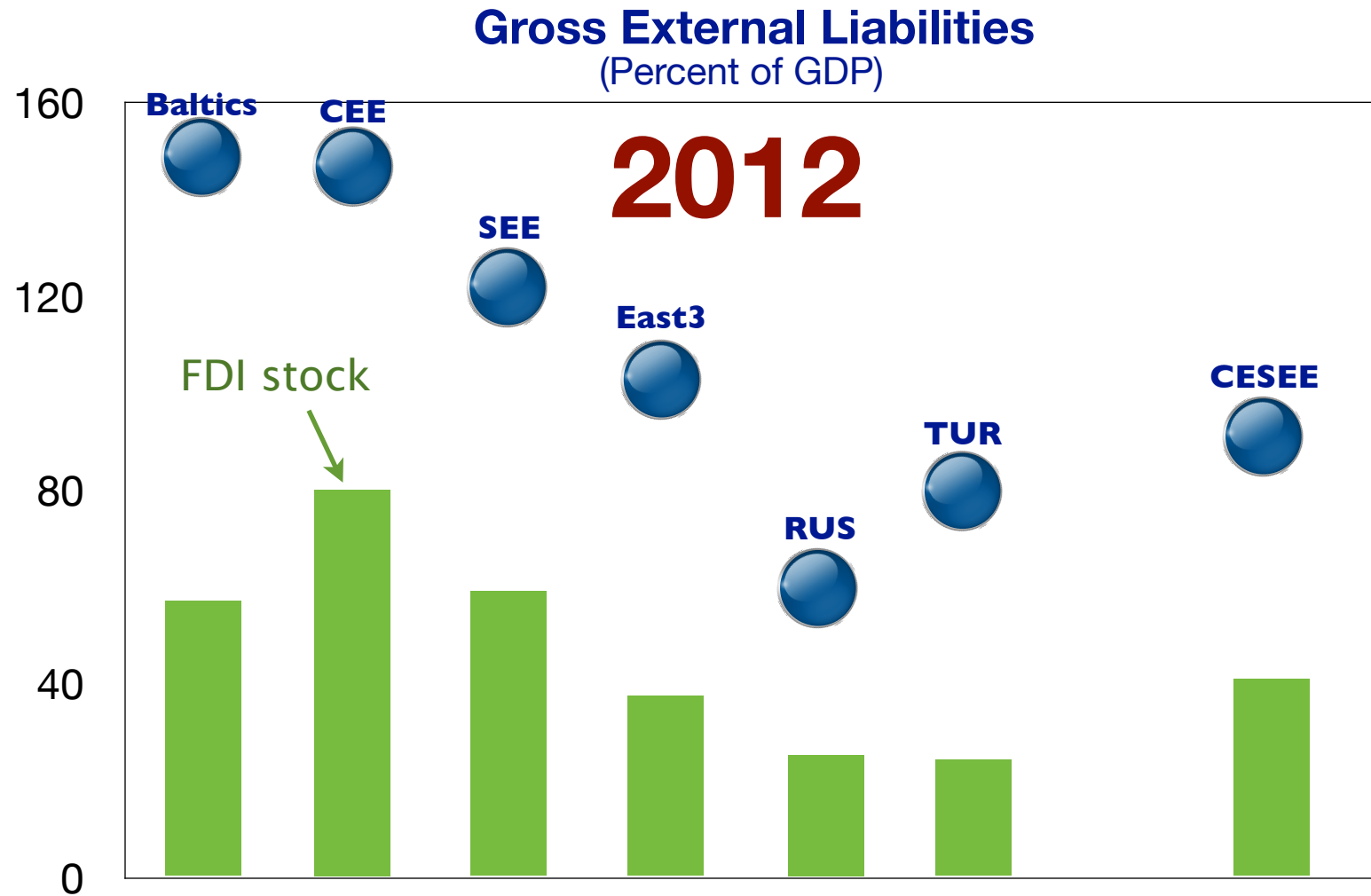
High dependence on external funding



High dependence on external funding



Significant share is FDIs



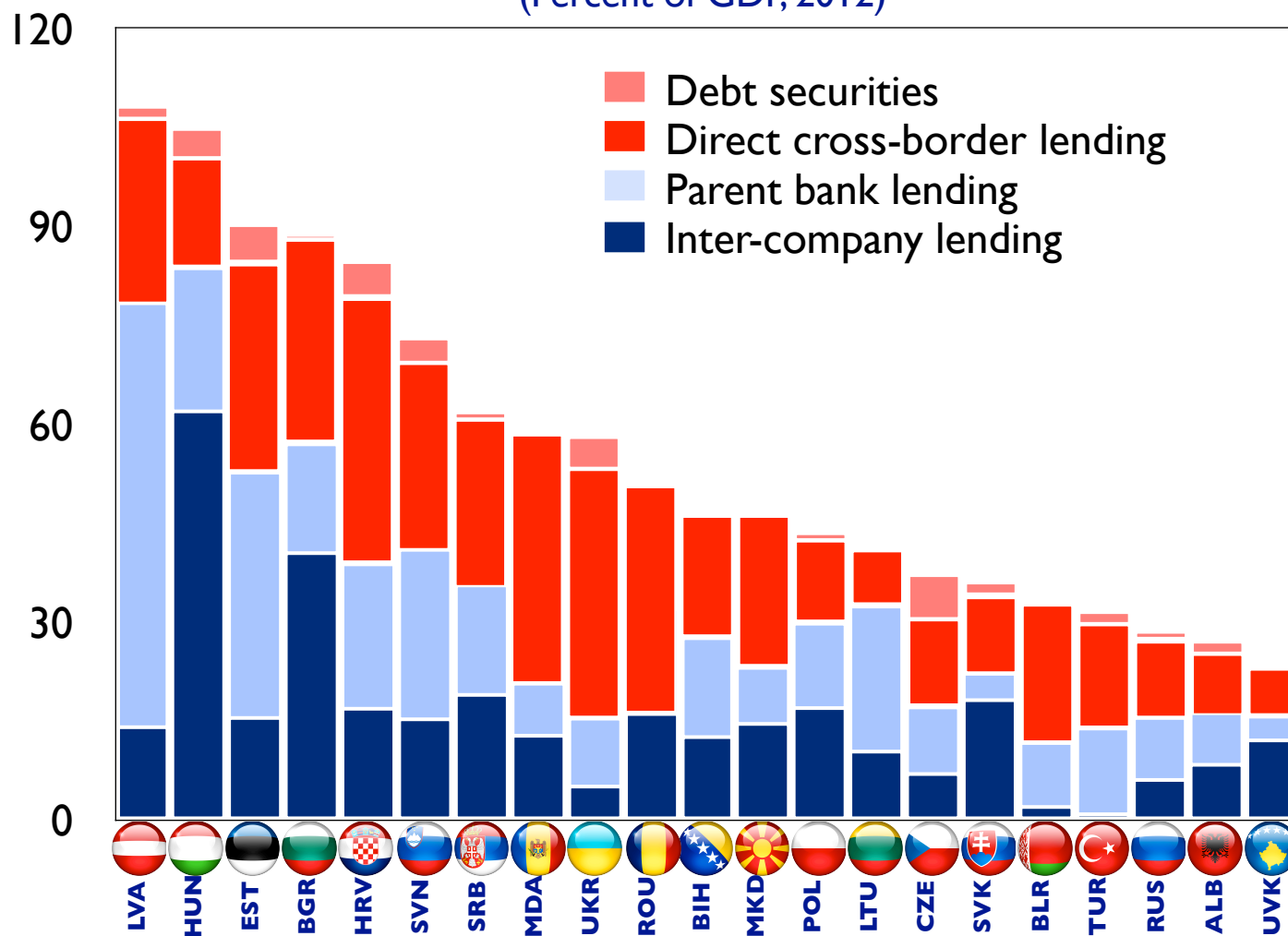
Private sector accounts for most of the external debt



Funding structure matters



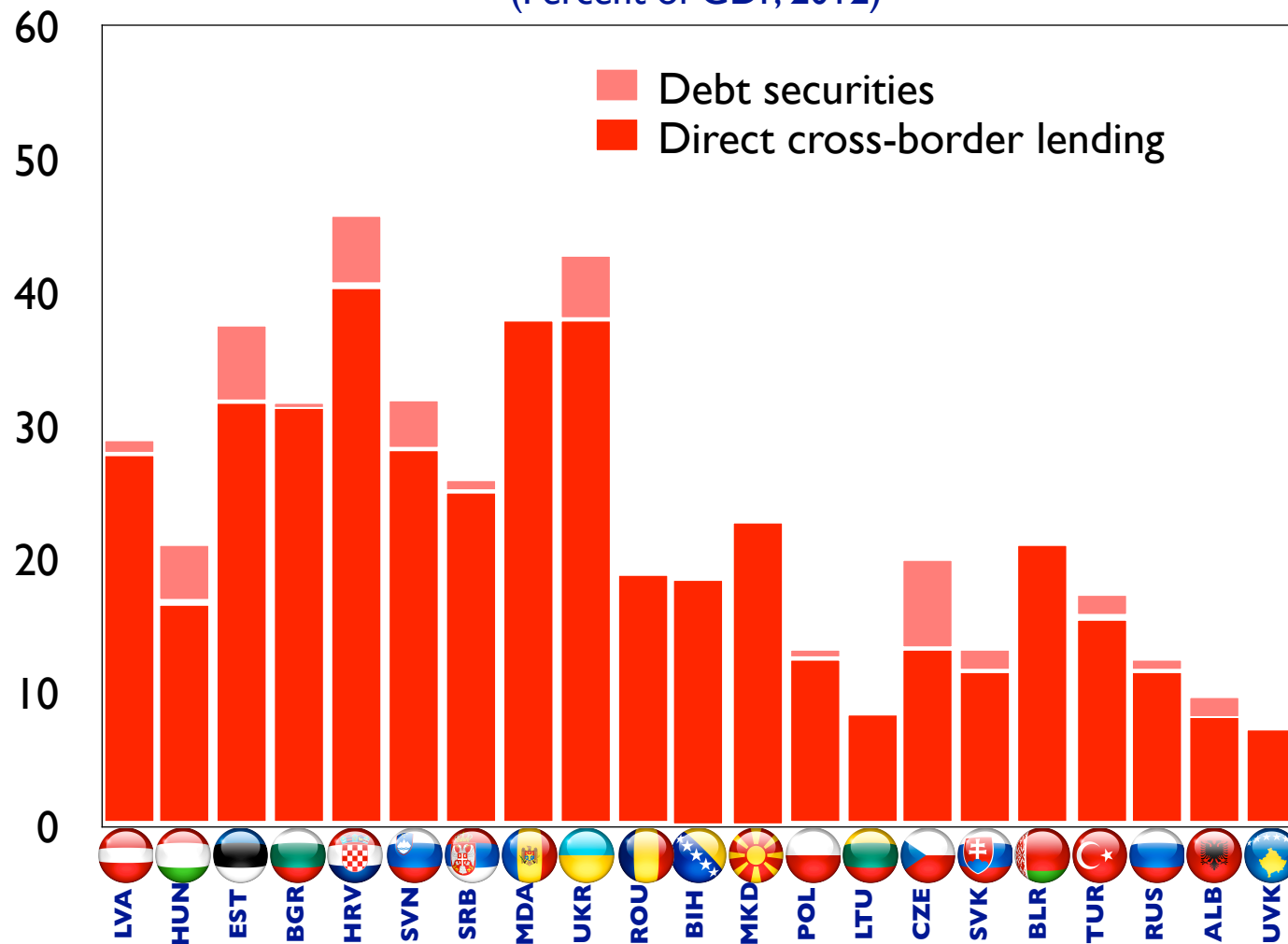
Private External Debt Structures (Percent of GDP, 2012)



Taking out funding from affiliated entities gives a different picture



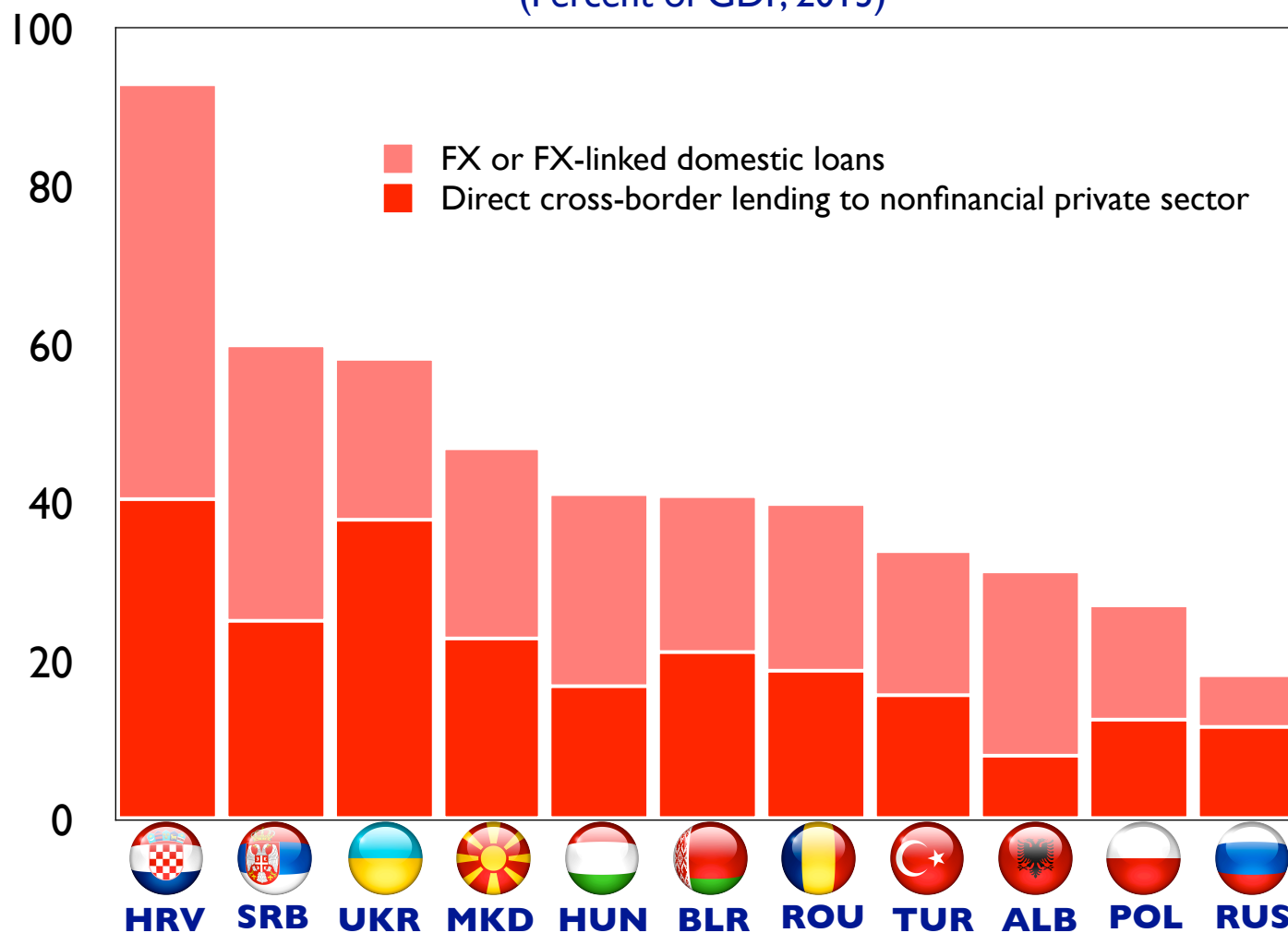
Private External Funding from Non-Affiliated Sources (Percent of GDP, 2012)



FX risks arise from external borrowing, but also from FX or FX-linked domestic loans



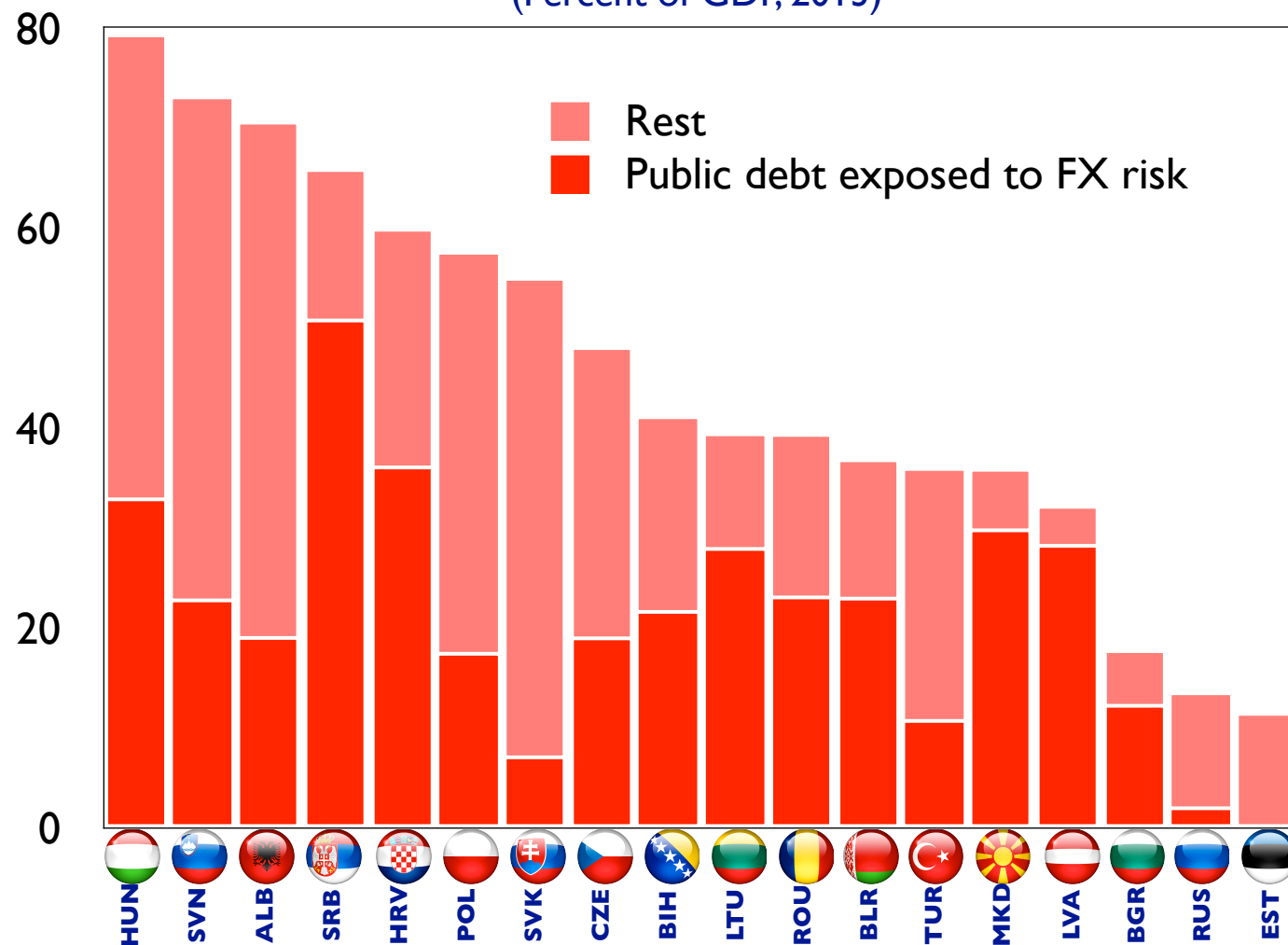
FX or FX-Linked Loans to Nonfinancial Private Sector (Percent of GDP, 2013)



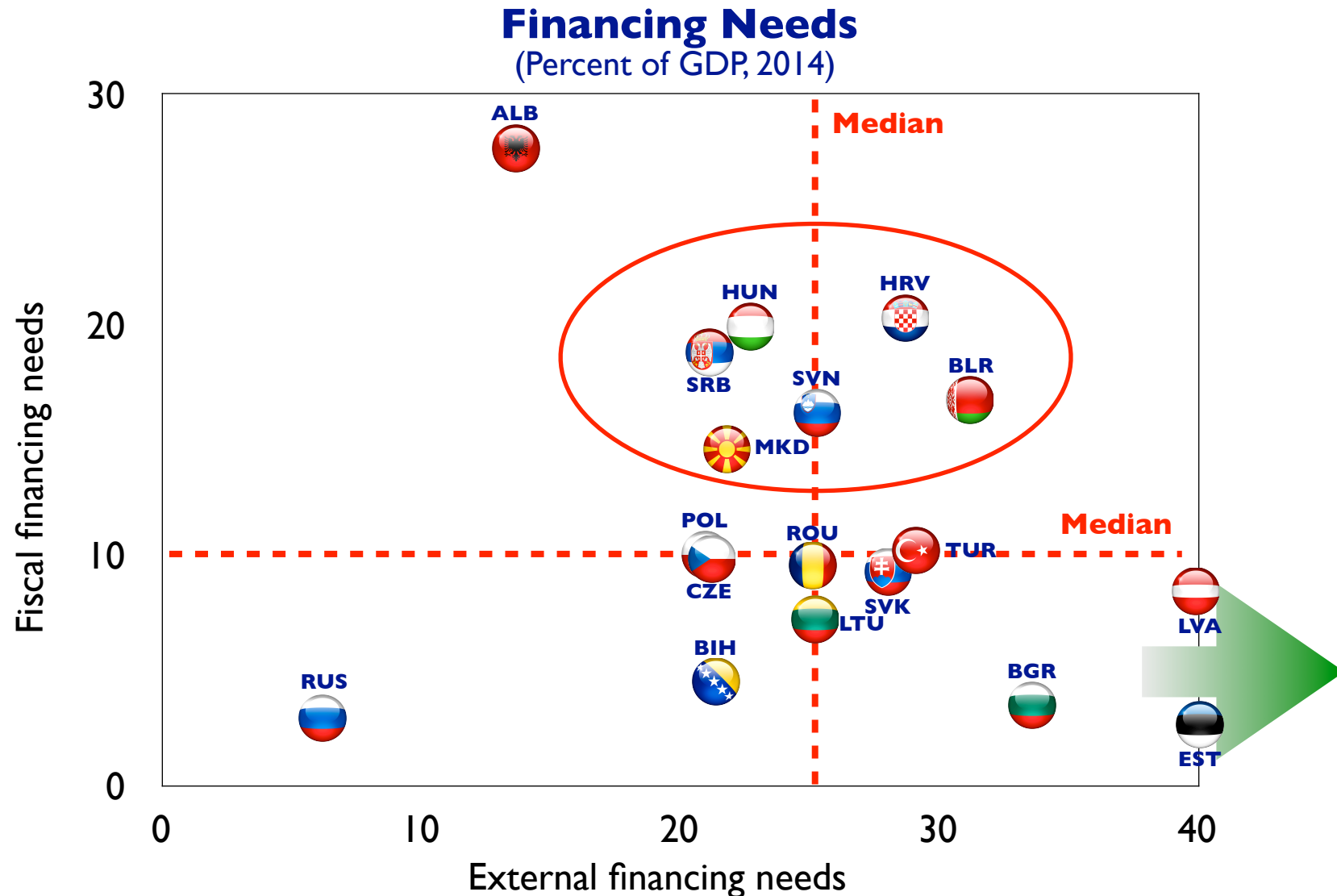
Public sector is exposed to foreign funding and exchange rate risks as well...



Public Debt and Foreign Exchange Risks (Percent of GDP, 2013)



Some countries have both high external and fiscal financing needs

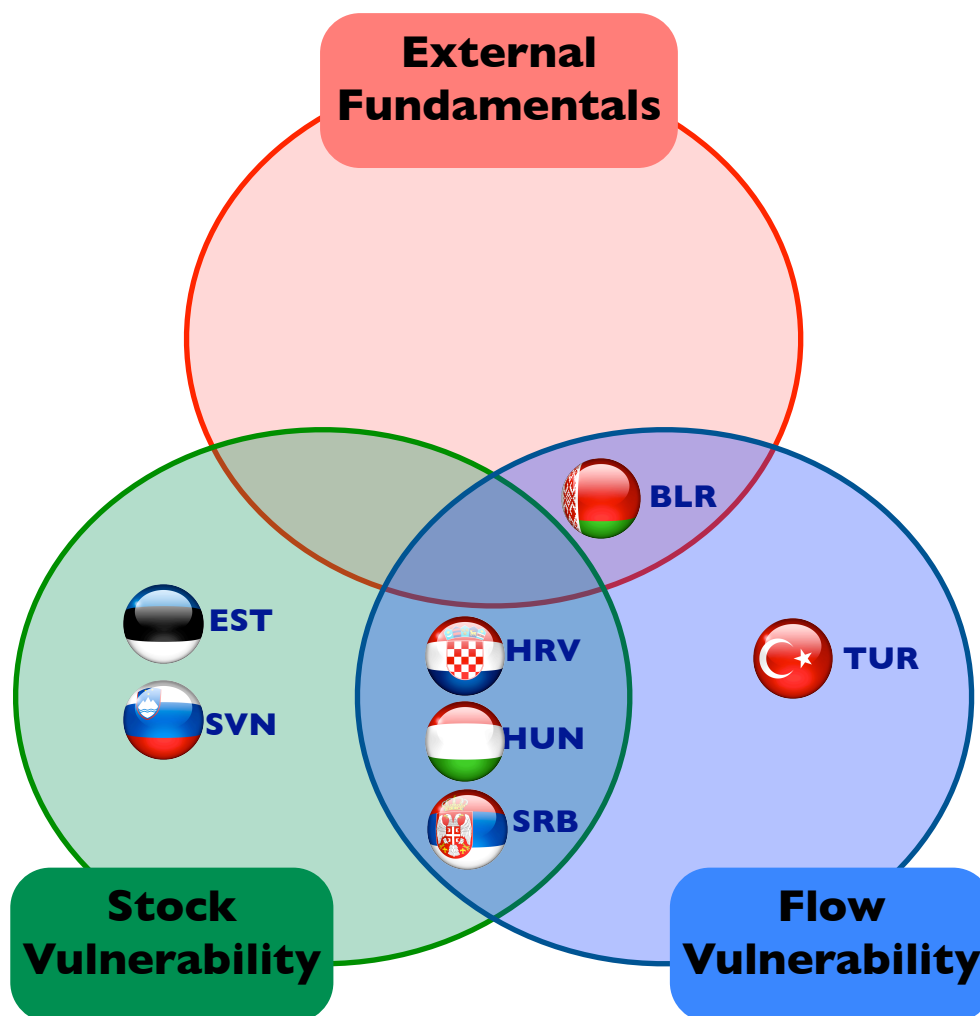


To sum up: sources of external funding risks



Stock vulnerabilities	Flow vulnerabilities	External fundamentals
Stock of debt	External financing needs	Exchange rate misalignment
External funding from non-affiliated sources	Fiscal financing needs	Reserve buffers
Debt denominated or linked to FX	Funding costs	

Countries susceptible to external funding risks



CESEE External Funding Patterns and Risks



1 External Funding Structures

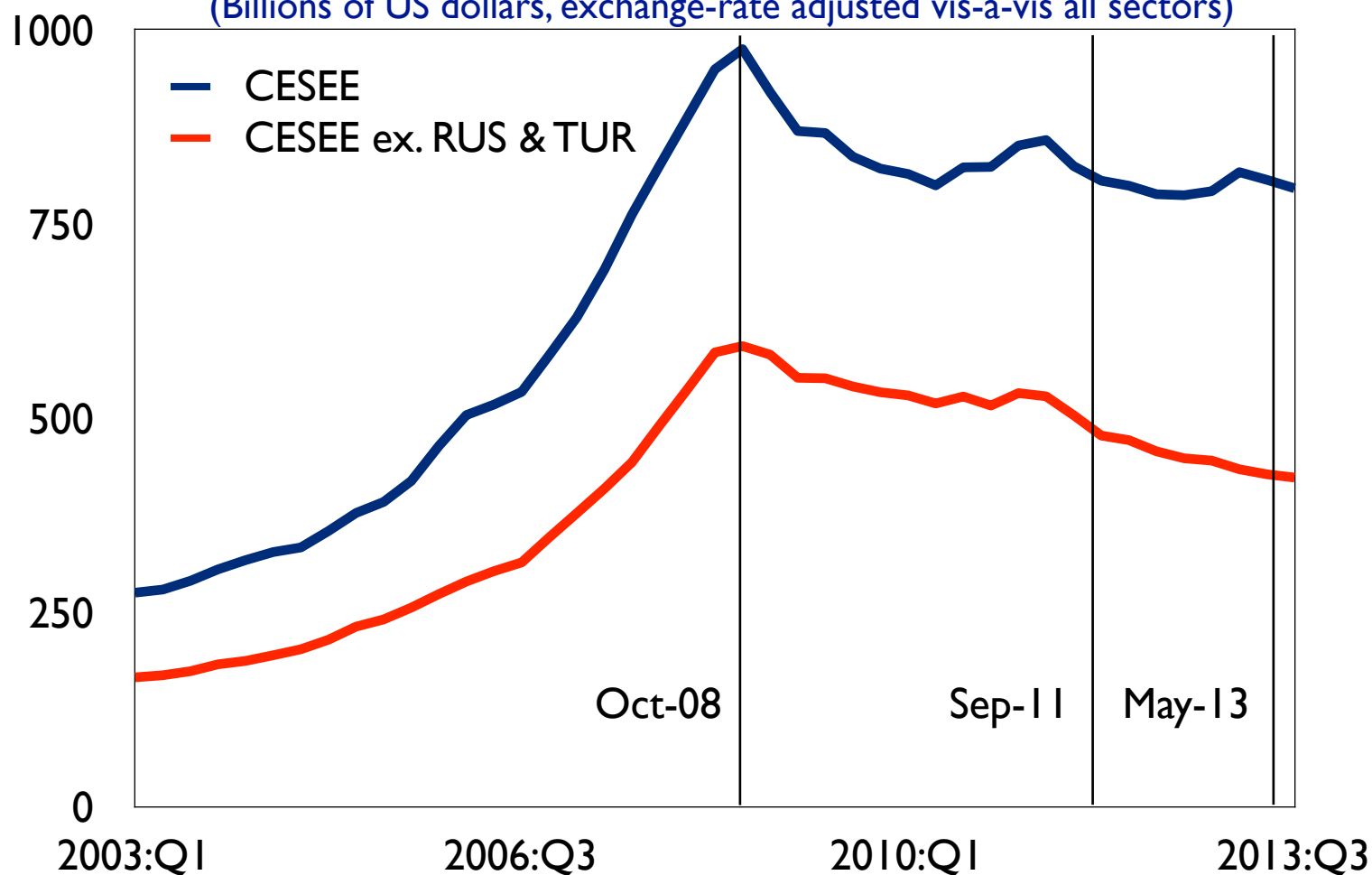
2 External Funding Conditions

CESEE region has undergone large scale foreign bank funding reduction since the crisis ...



External Position of BIS-Reporting Banks, 2003:Q1-2013:Q3

(Billions of US dollars, exchange-rate adjusted vis-à-vis all sectors)

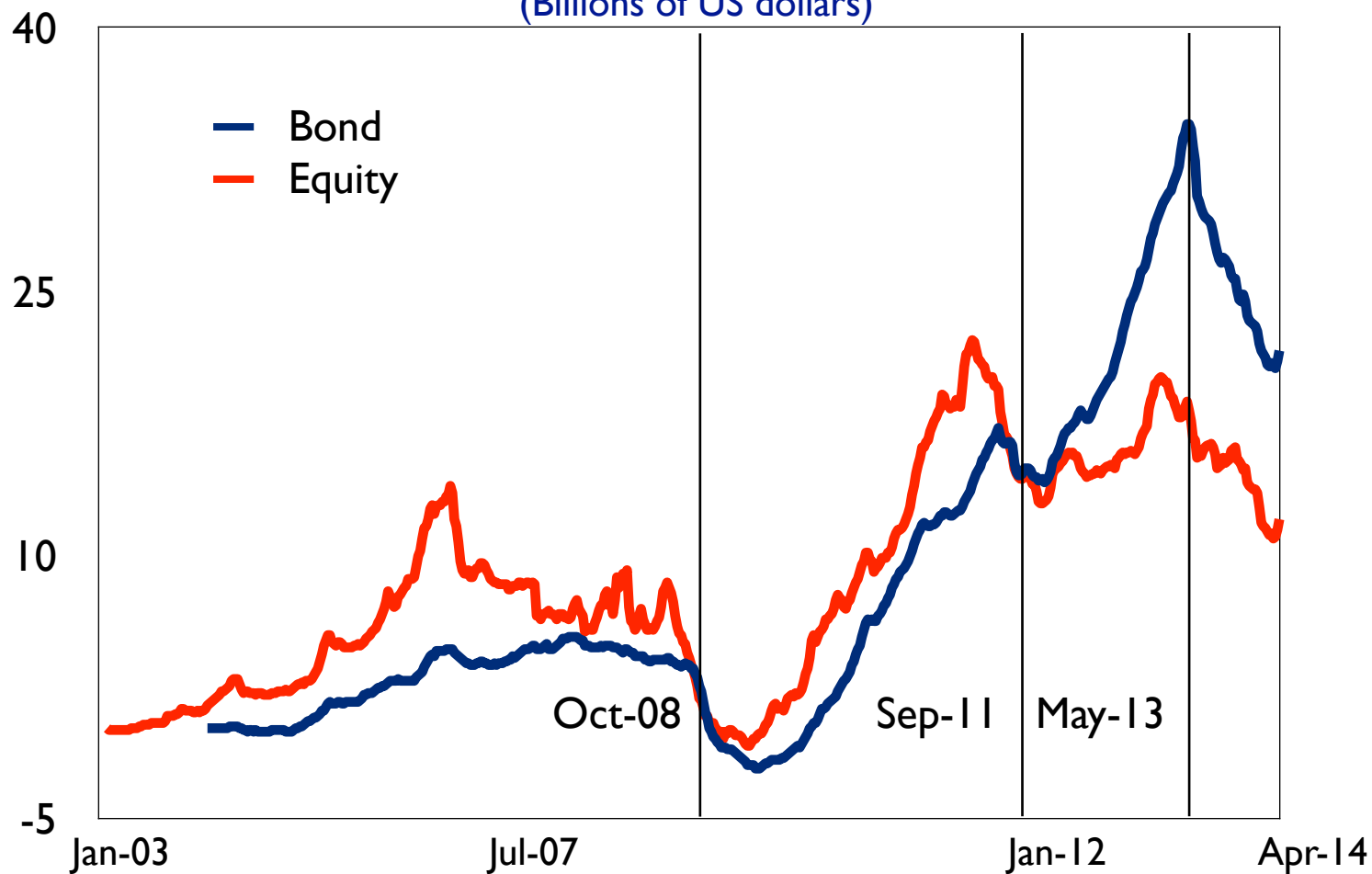


Reversal of portfolio inflows since taper talk



Cumulative EPFR Flows into CESEE ETFs and Mutual Funds

(Billions of US dollars)

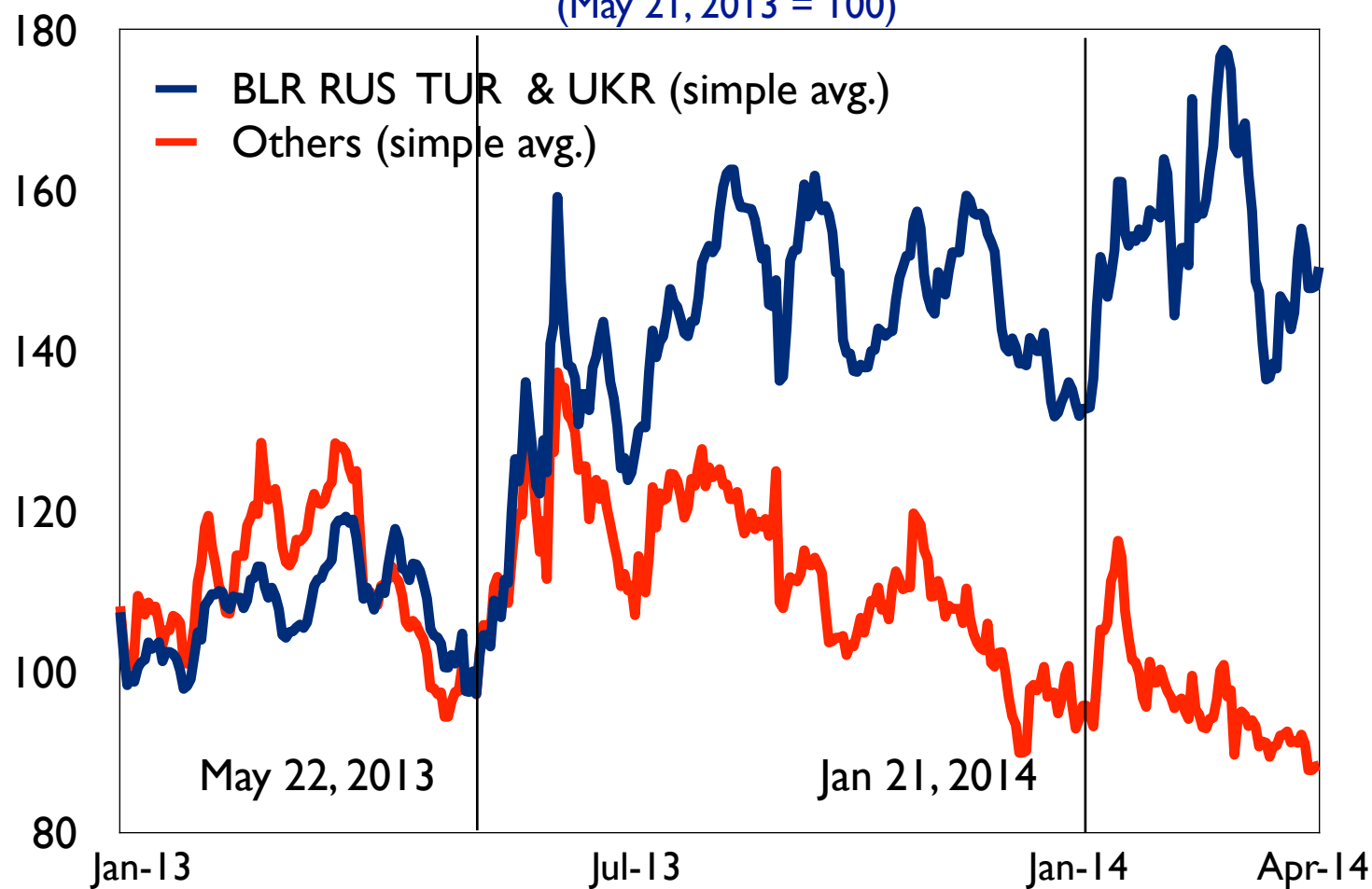


... accompanied by a divergence in bond market spreads



EMBIG Spreads Indices, Jan 2013 - Apr 2014

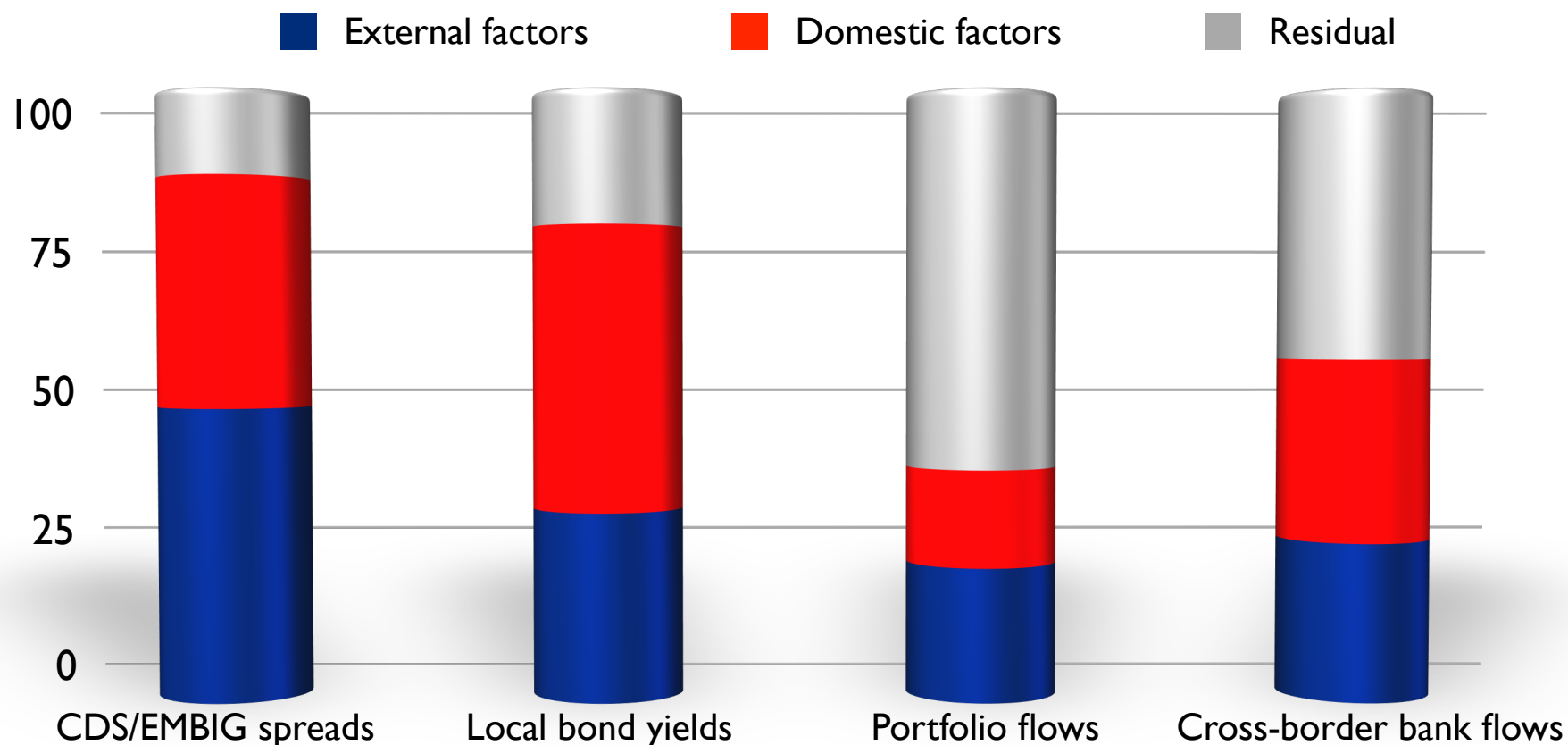
(May 21, 2013 = 100)



While external factors are important, domestic fundamentals also matter



External and Domestic Drivers
(Percent of variance)



Near term policy priorities



Monetary & Exchange Rate Flexibility

Targeted Liquidity Provision

Active Debt Management

International Cooperation

Medium term policy priorities



Rebuild Fiscal Buffers

Address Crisis Legacies

Address Structural Weaknesses

Diversify Funding Sources

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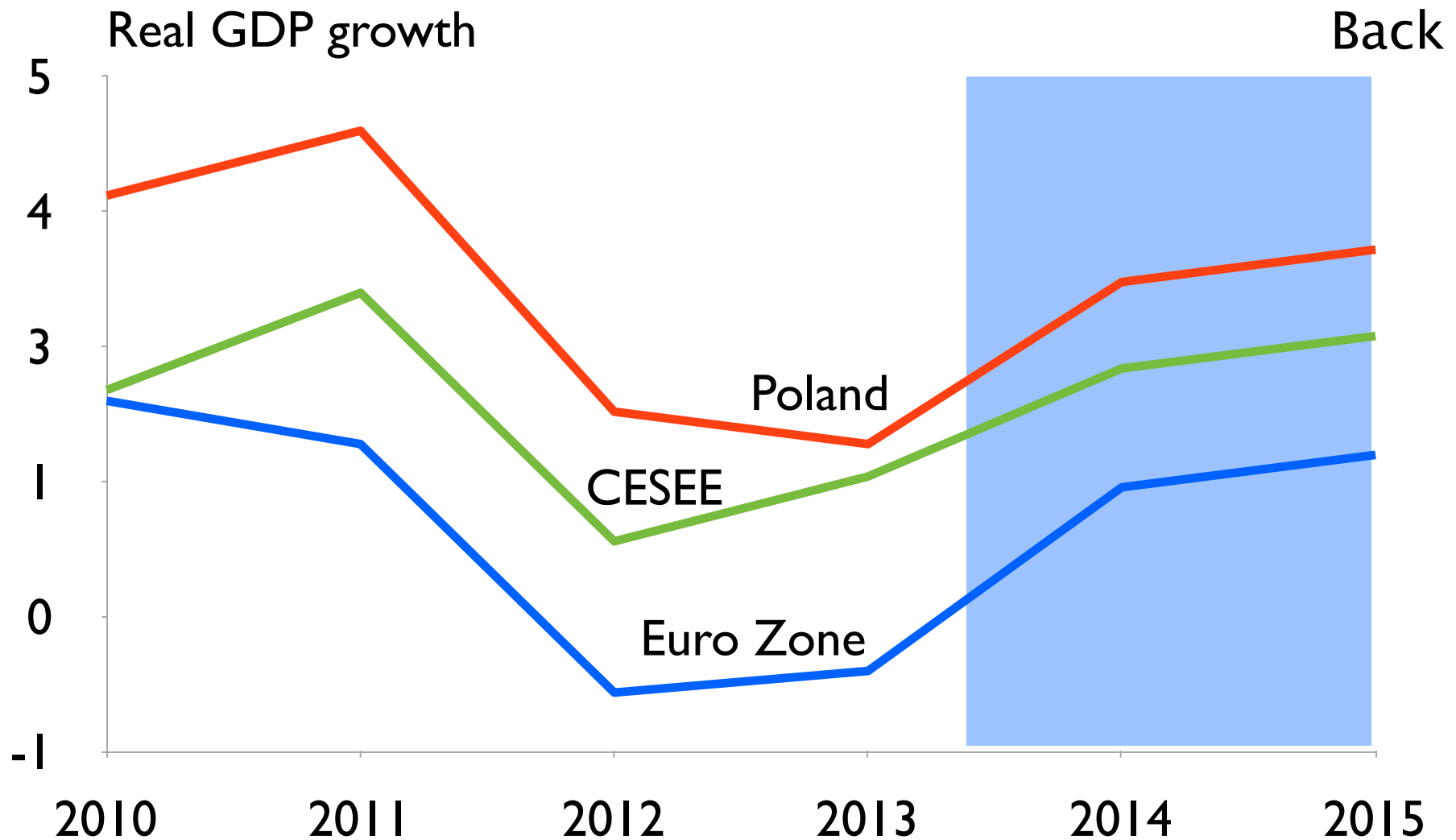
Poland Article IV

Main messages from annual consultation



- Steady recovery from 2012-13 slowdown
- External risks remain, FCL helps
- Inflation low, challenge for monetary policy
- Fiscal consolidation at appropriate pace
- Pension system changes don't address legacy issues
- Financial sector resilient, but supervisory framework needs further work
- Labor market and business climate reforms needed

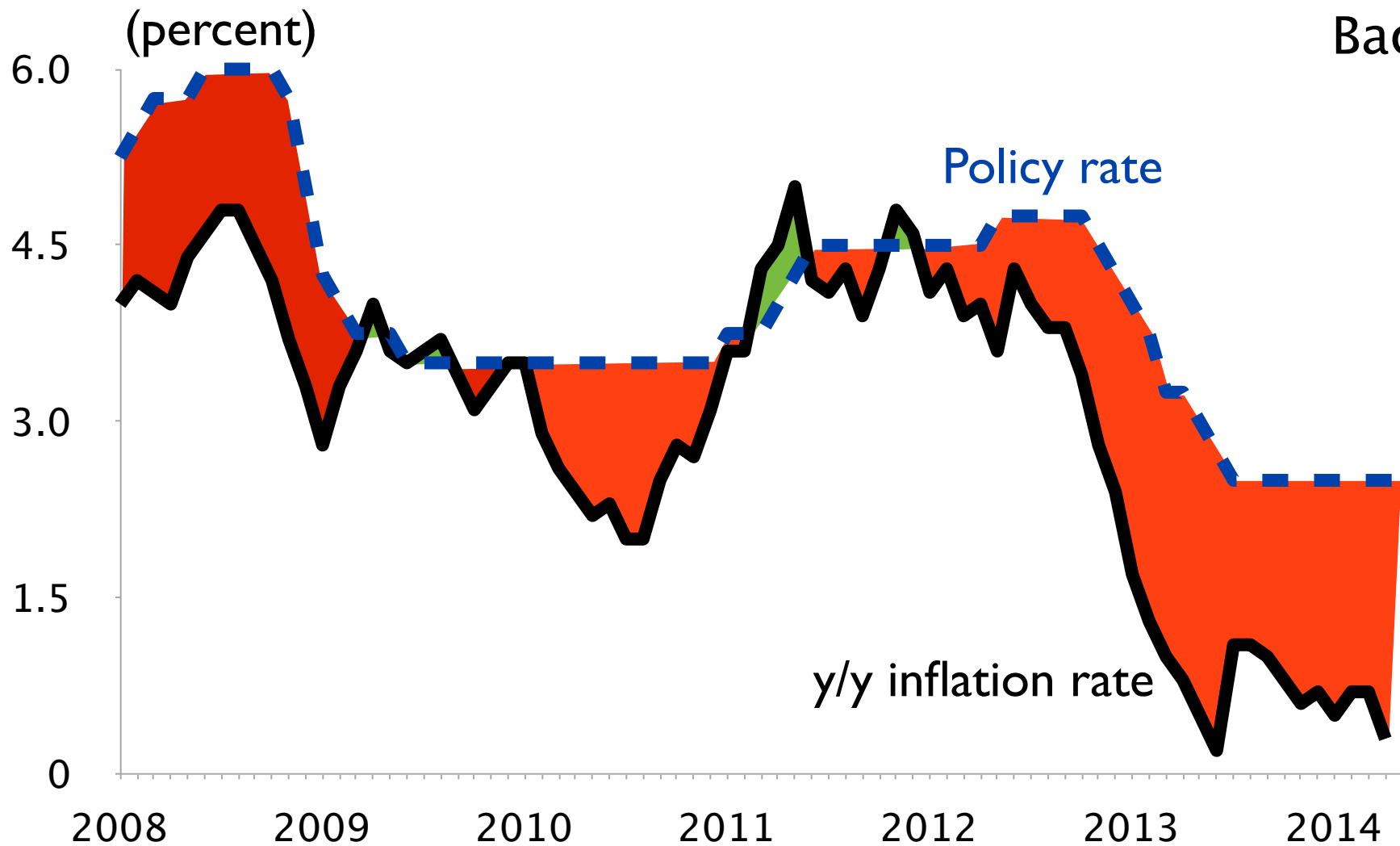
Recovery picking up momentum



Real rates rising as inflation falls



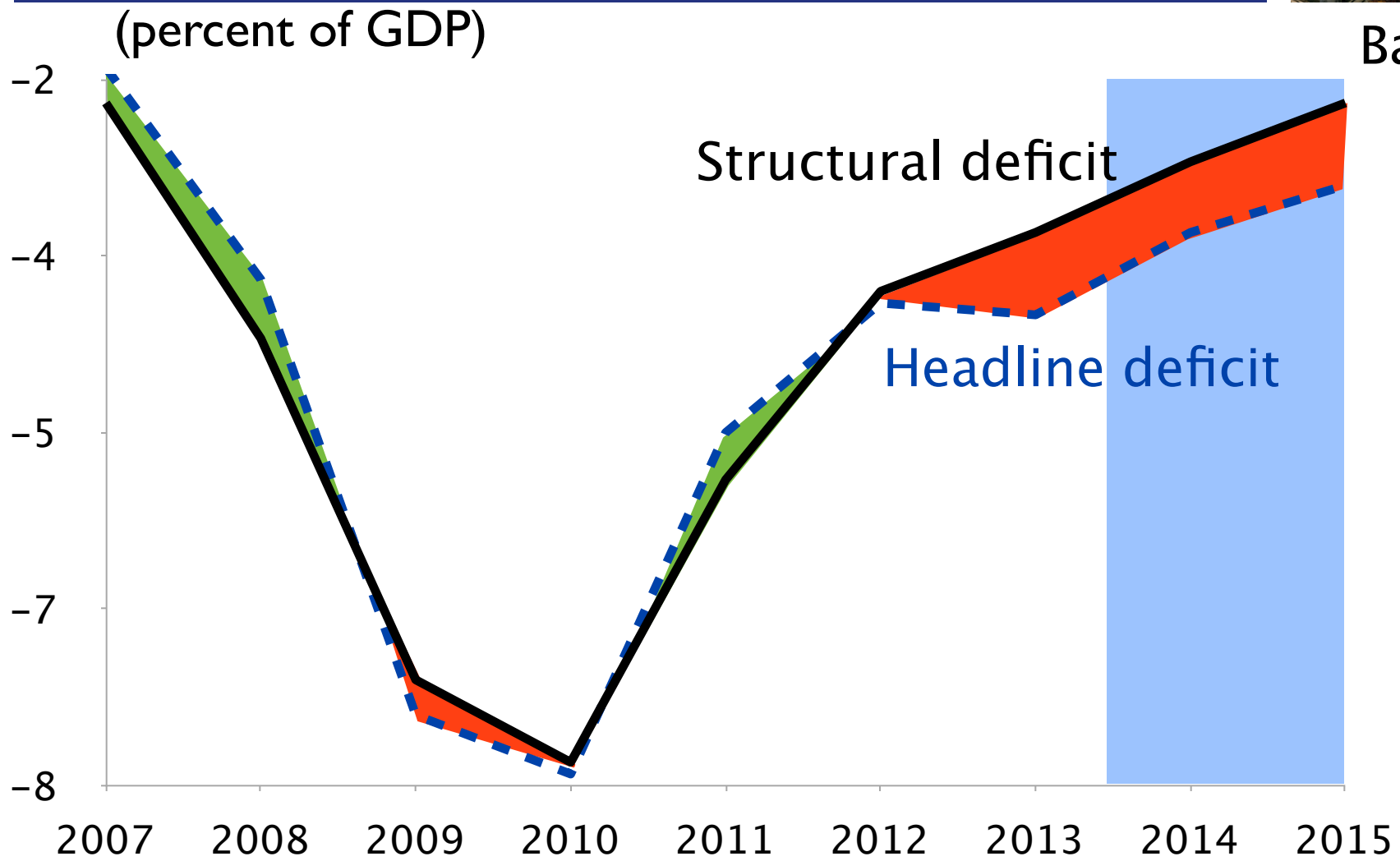
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Calibrated fiscal policy



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Pension changes



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- Improve fiscal aggregates by about 30 percent of GDP in present value terms
- But implicit liabilities rise in turn
- Liquidity in bond and equity markets could fall
- Legacy flaws pose long-term risks
 - fix zero floor in indexation mechanism
 - align disability pension formula with regular benefits
 - address imbalances in special occupational schemes
 - low replacement rates threaten old-age poverty and fiscal pressures

Main messages from annual consultation



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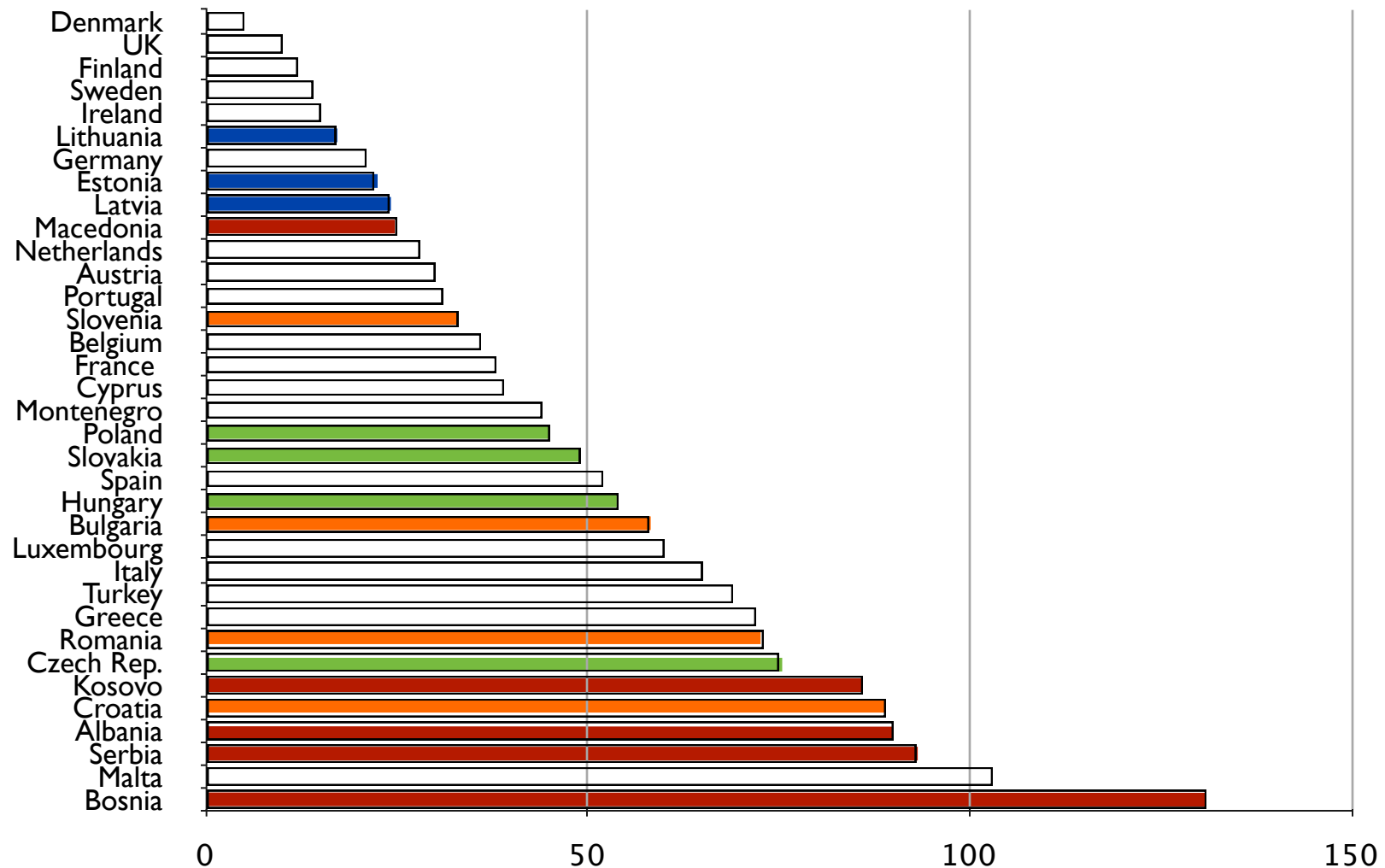
- Steady recovery from 2012-13 slowdown
- External risks remain, FCL helps
- Inflation low, challenge for monetary policy
- Fiscal consolidation at appropriate pace
- Pension system changes don't address legacy issues
- Financial sector resilient, but supervisory framework needs further work
 - fix legal and tax obstacles to NPL resolution
 - restructure credit unions
 - finalize Systemic Risk Board legislation

Business climate



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Doing Business 2014 rank



European Department



Thank you!