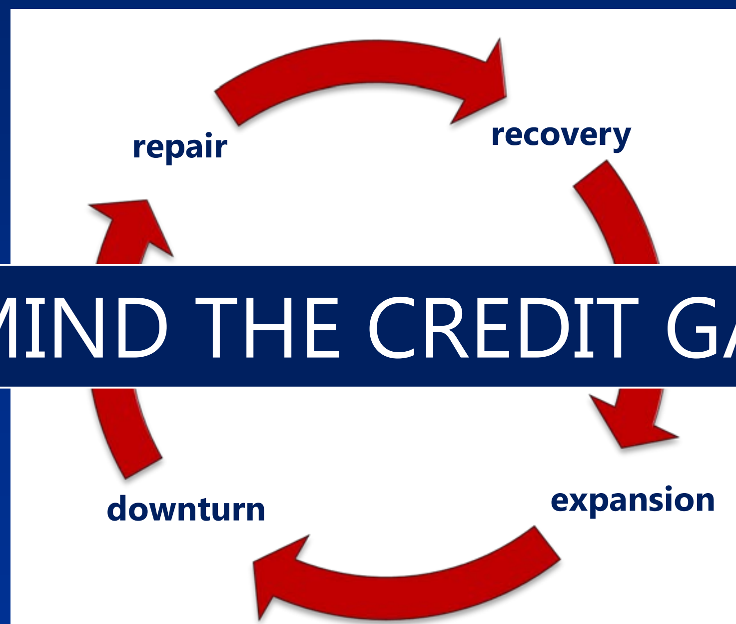
Spring 2015 Regional Economic Issues Report on Central, Eastern and Southeastern Europe (CESEE)

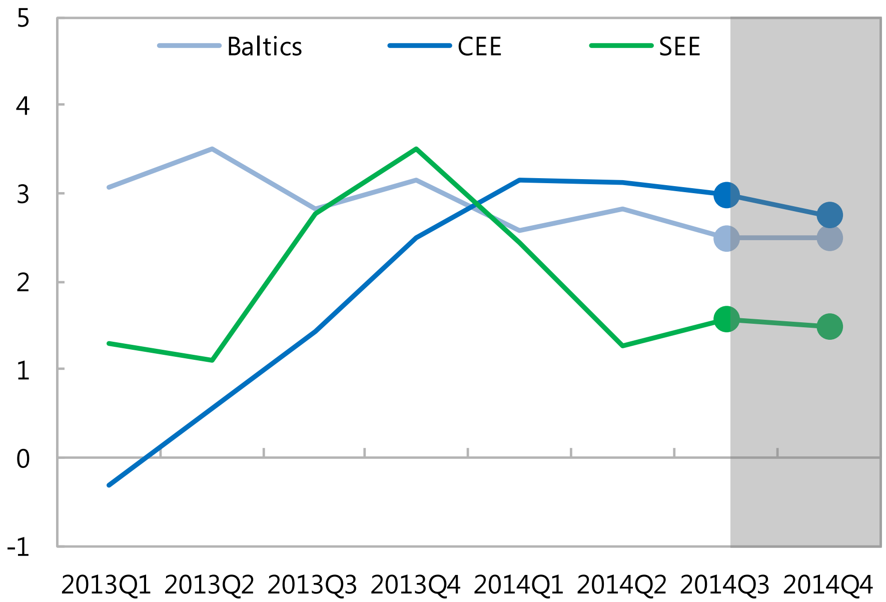
MIND THE CREDIT GAP

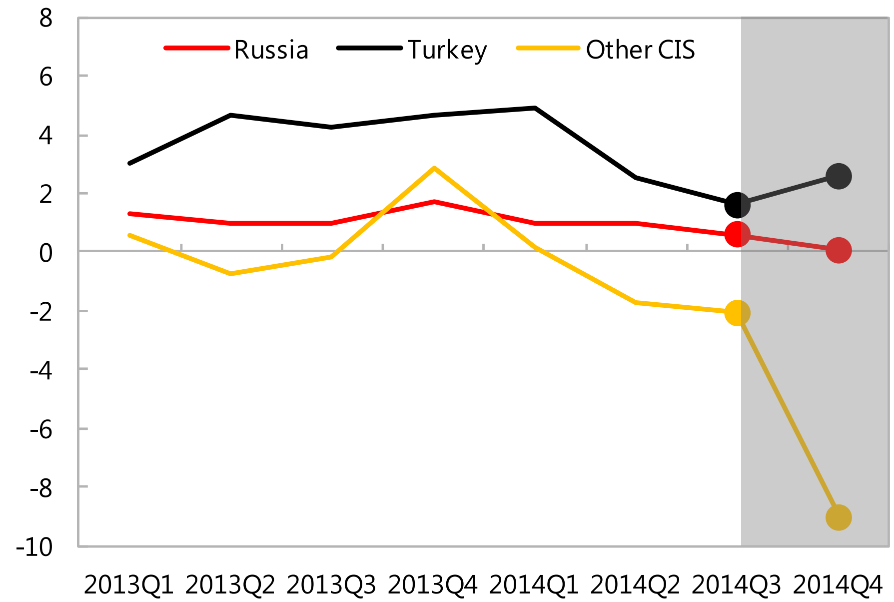


May, 2015

Growth Divergence in 2014

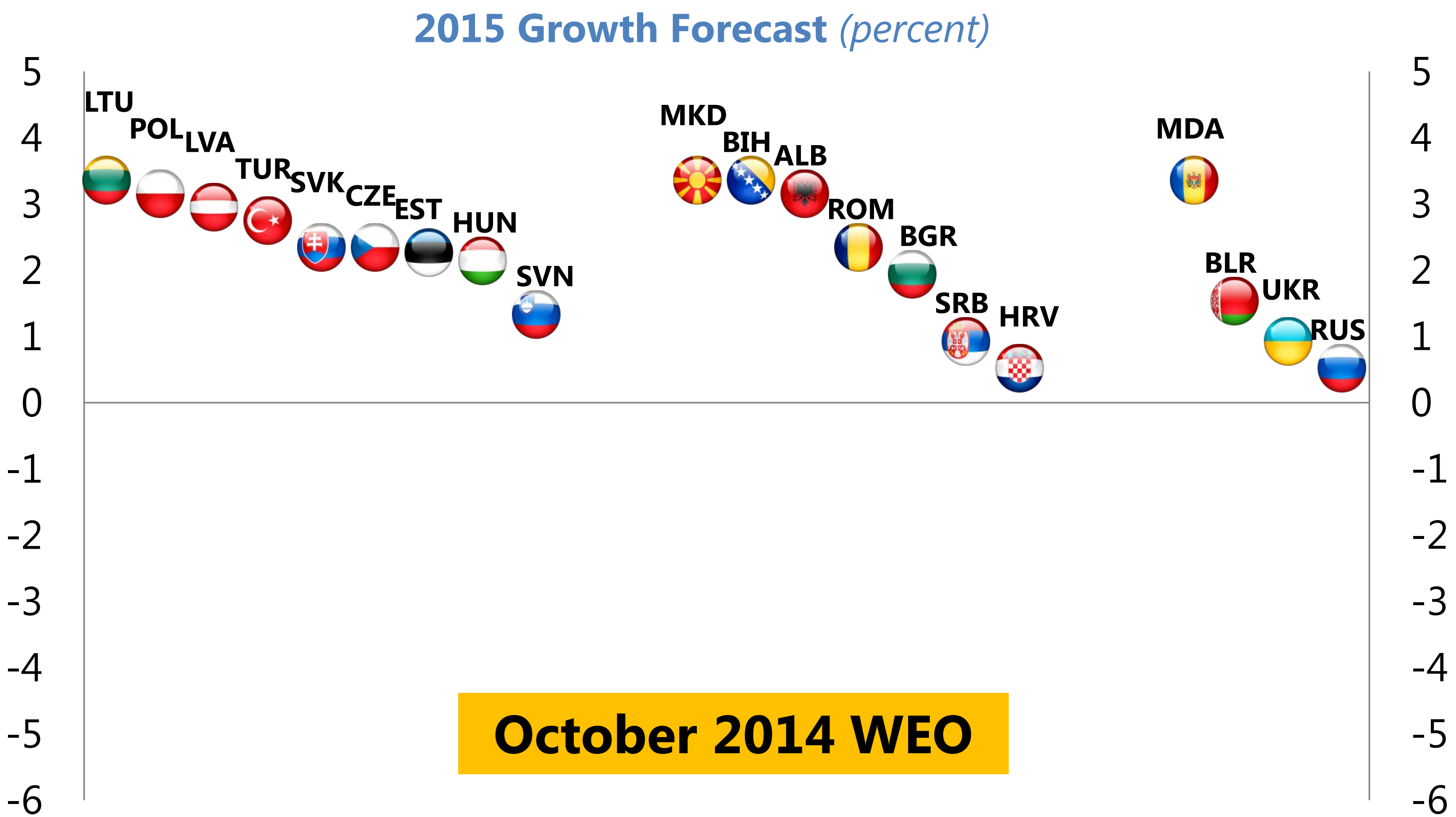
Quarterly GDP Growth, 2014 *(Percent, year-on-year)*





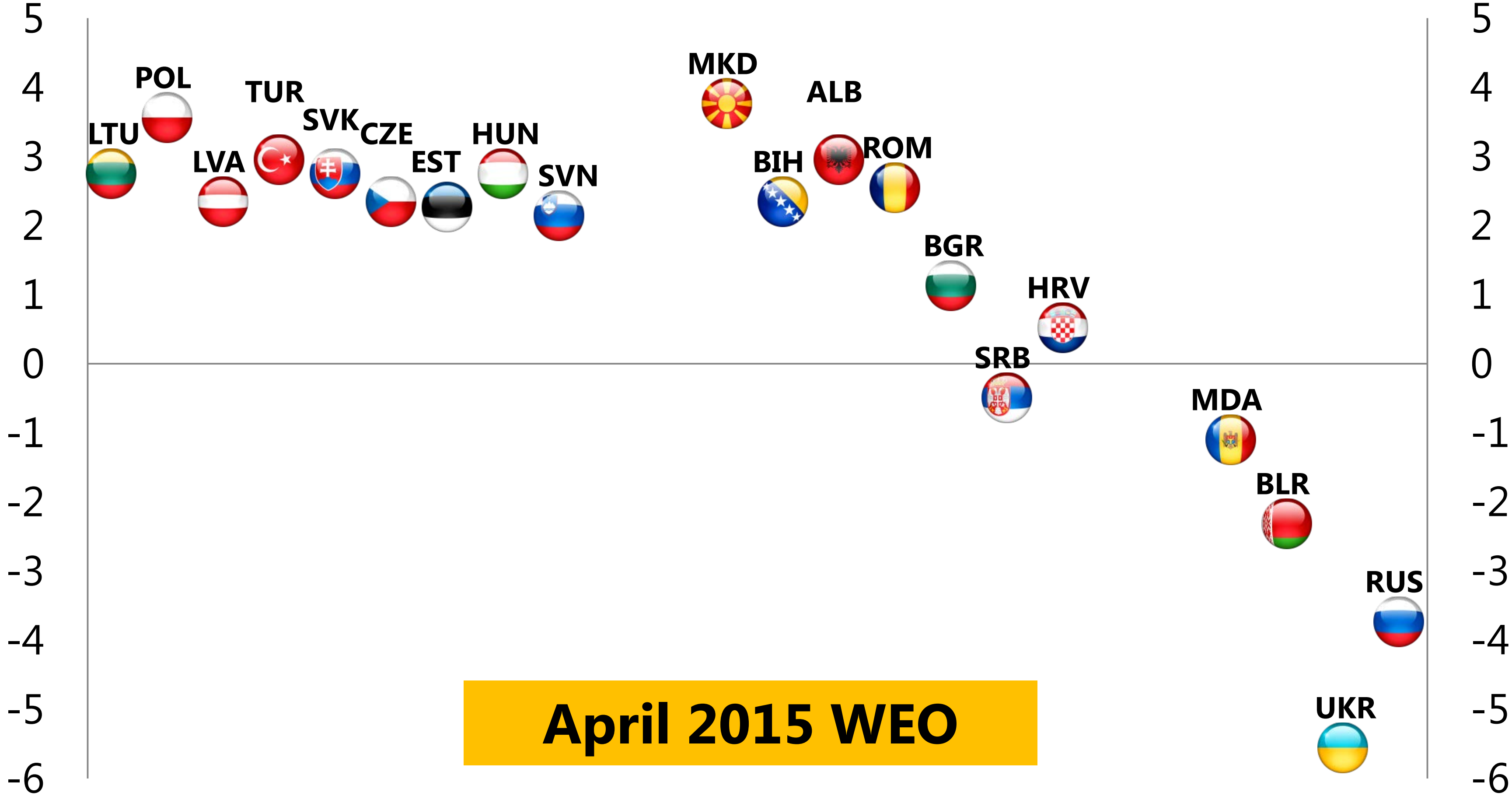
Note: The negative trend for Other CIS is mainly driven by Ukraine, which has a weight of close to two-thirds.

3-Speed Growth Outlook: CEE - solid, SEE - sluggish, CIS - recession



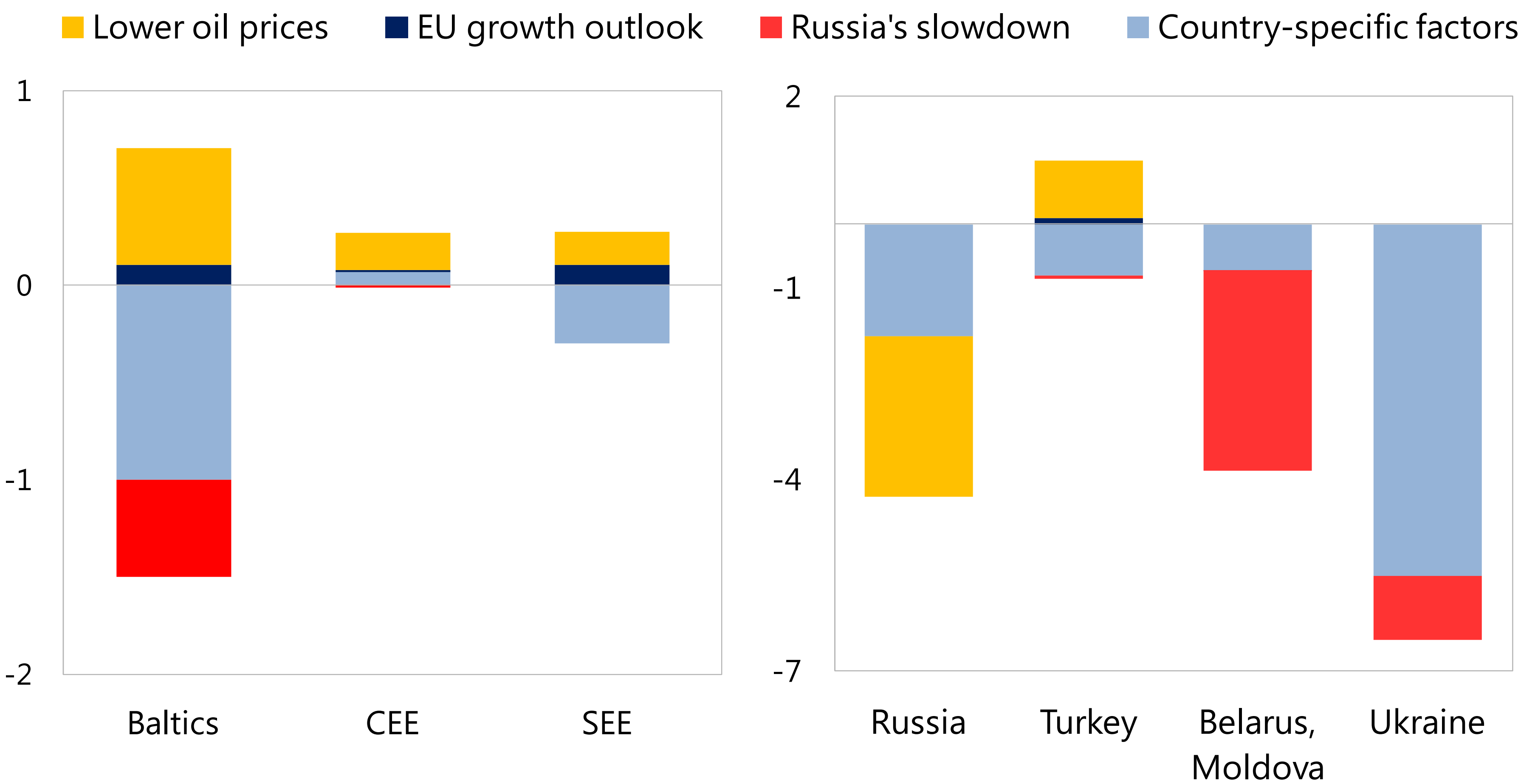
3-Speed Growth Outlook:
CEE - solid, SEE - sluggish, CIS - recession

2015 Growth Forecast *(percent)*



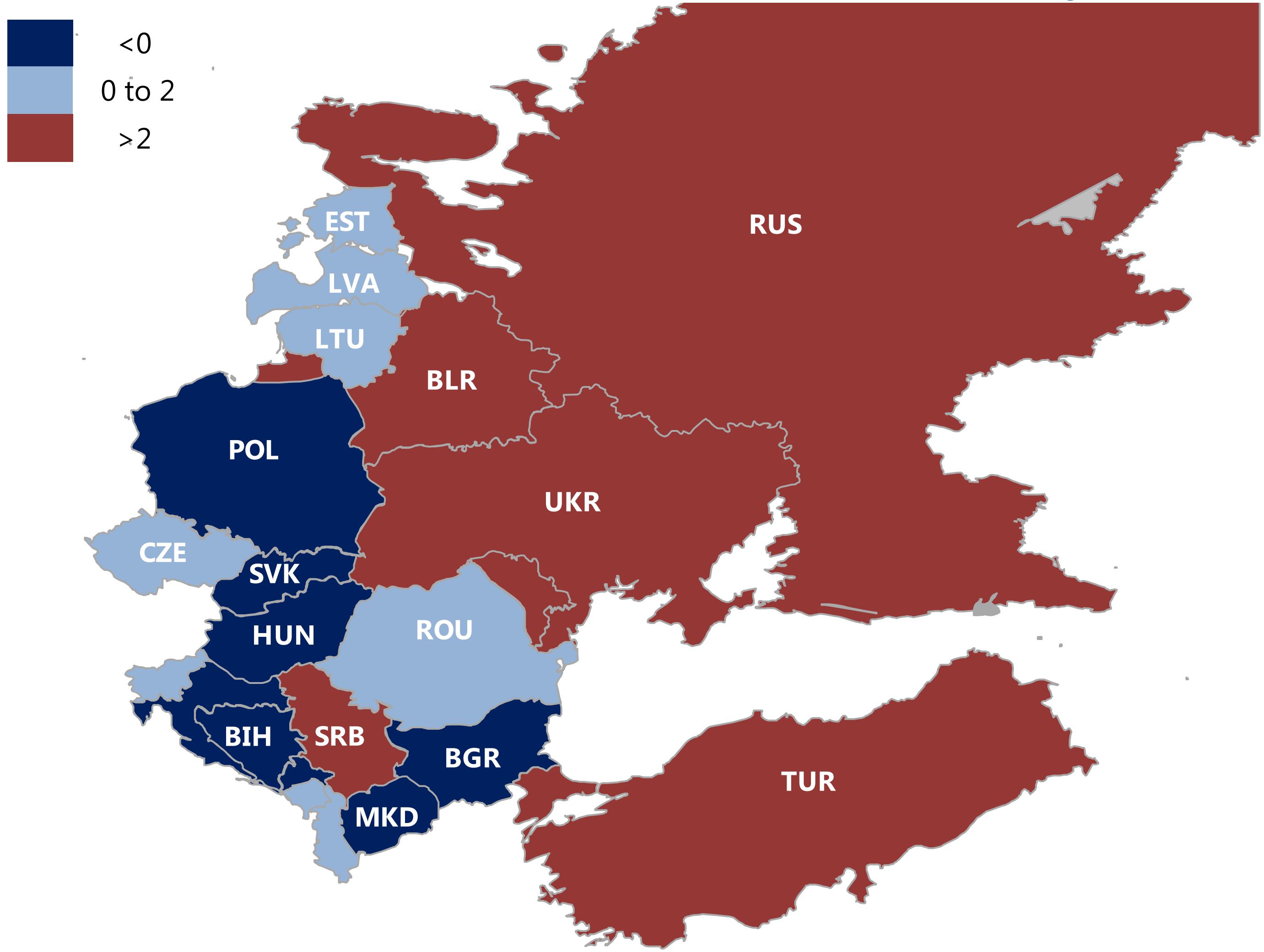
Growth Revision: Oil Price, Euro Area, and Geopolitical Tensions

2015 GDP Revisions – Apr 2015 WEO vs. Oct 2014 WEO *(Percentage points)*



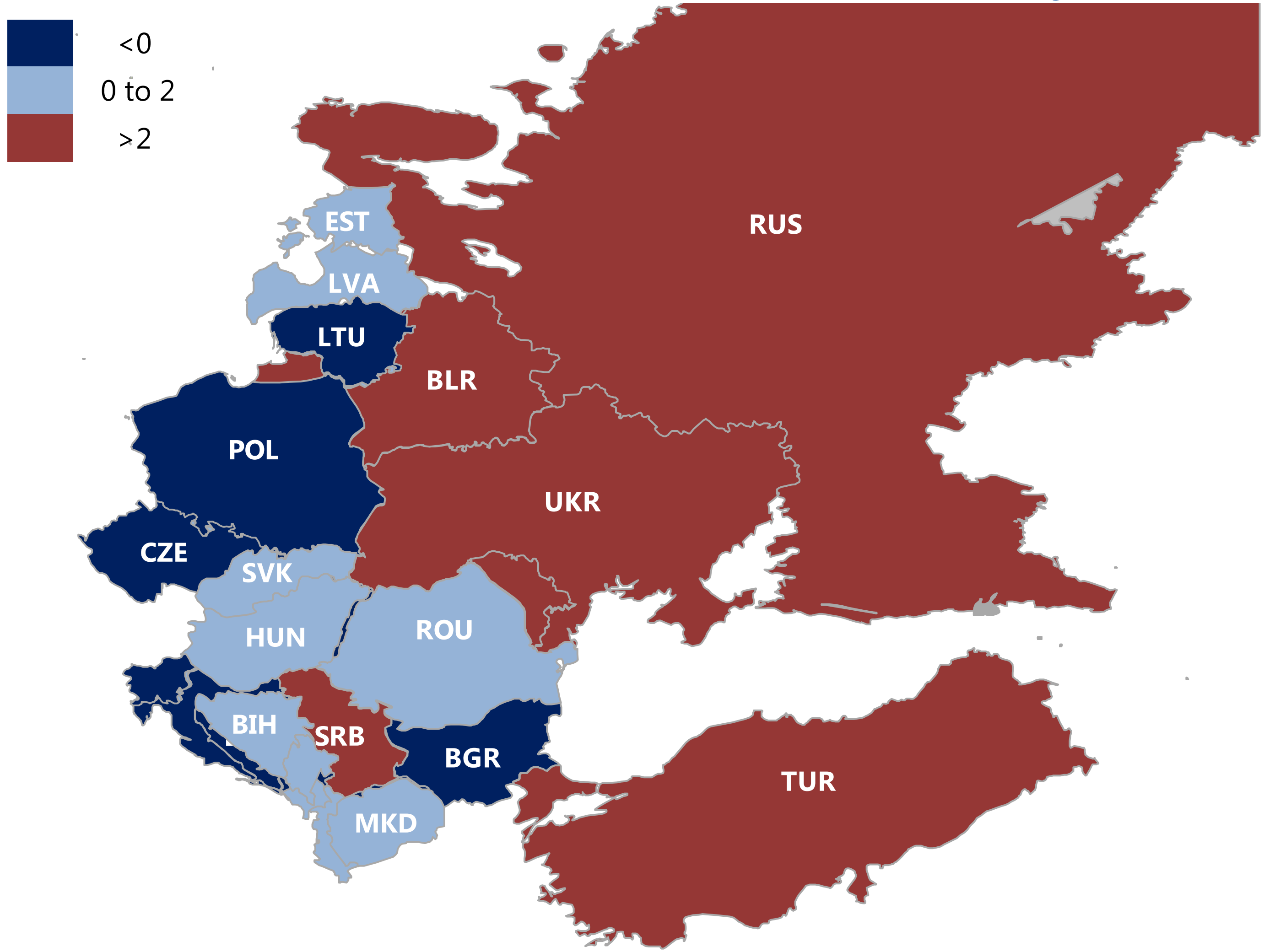
Inflation Outlook:
Many Sub-Zero Readings in 2014…

CESEE: Headline Inflation, 2014 (Percent, year-over-year)



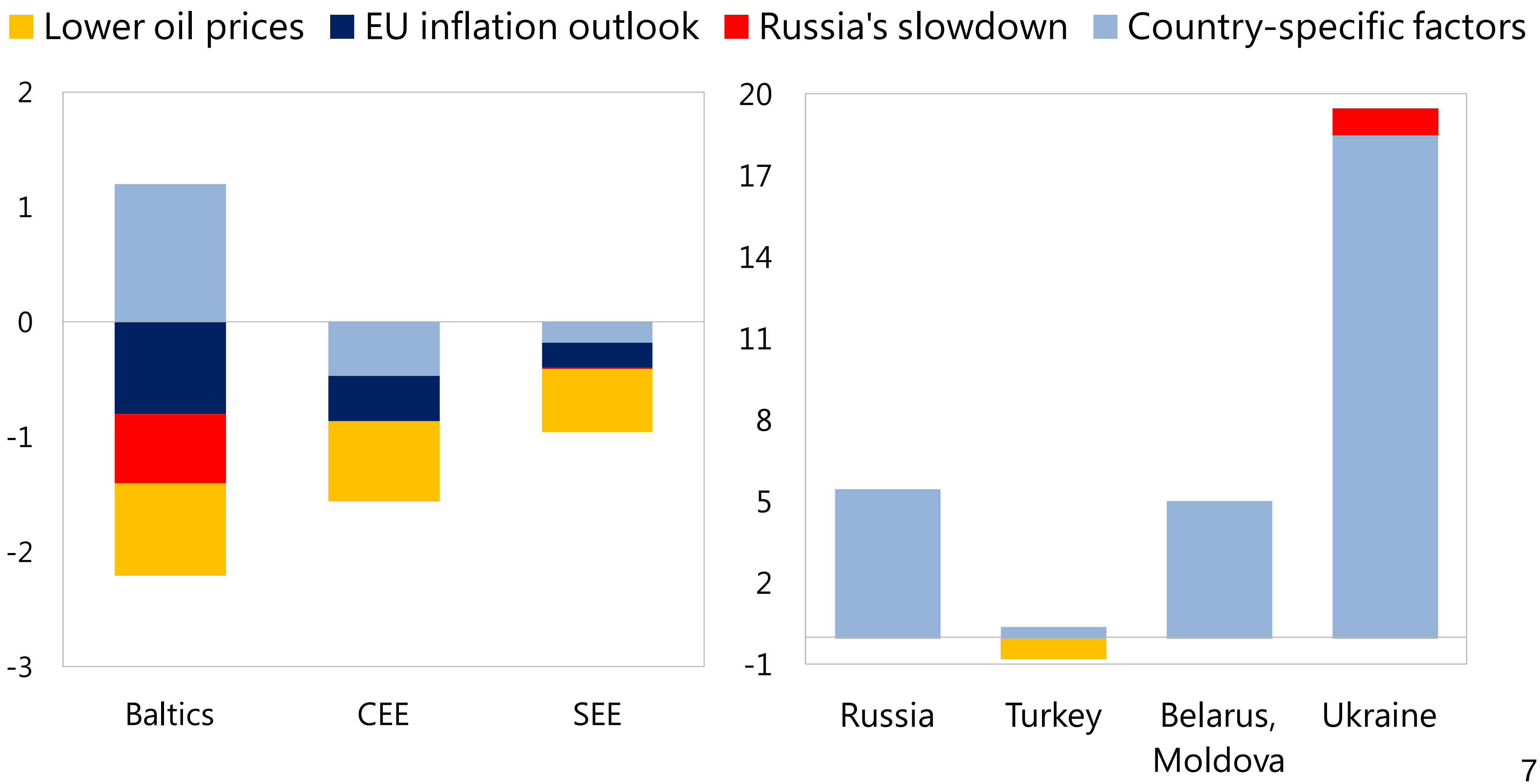
Inflation Outlook:
…but Started to Turn Positive in 2015

CESEE: Headline Inflation, 2015 (Percent, year-over-year)



Inflation Revision: Oil Price, Euro Area, and Geopolitical Tensions

2015 Inflation Revisions – Apr 2015 WEO vs. Oct 2014 WEO *(Percentage points)*



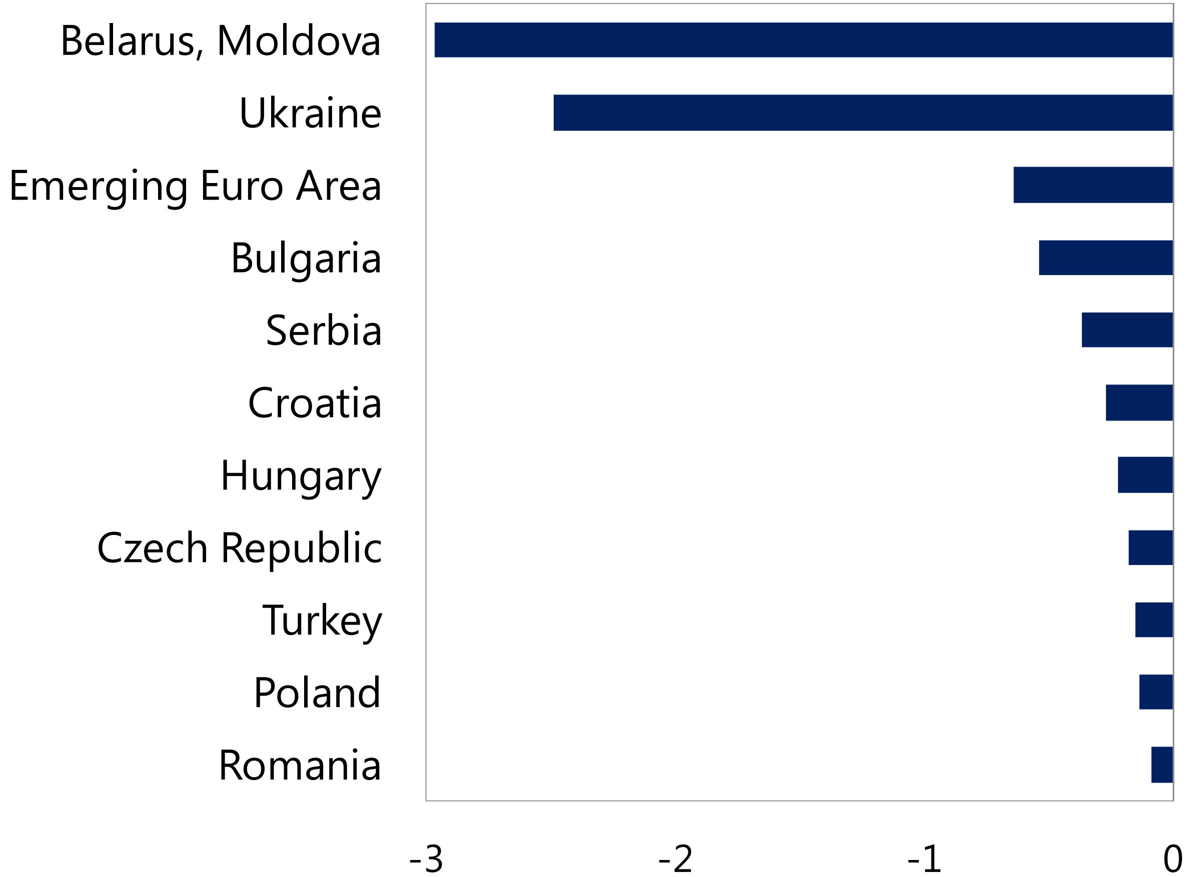
Risks More Balanced but Significant Downside Risks Remain

- Protracted slow growth in euro area
- Surge in financial volatility
- Persistent strength of US dollar
- Geopolitical tensions around Russia/Ukraine

- ↑ impact of ECB monetary easing on growth
- ↑ impact of low oil prices on growth in oil importers

Downside Risks: Spillovers from Deeper Recession in Russia

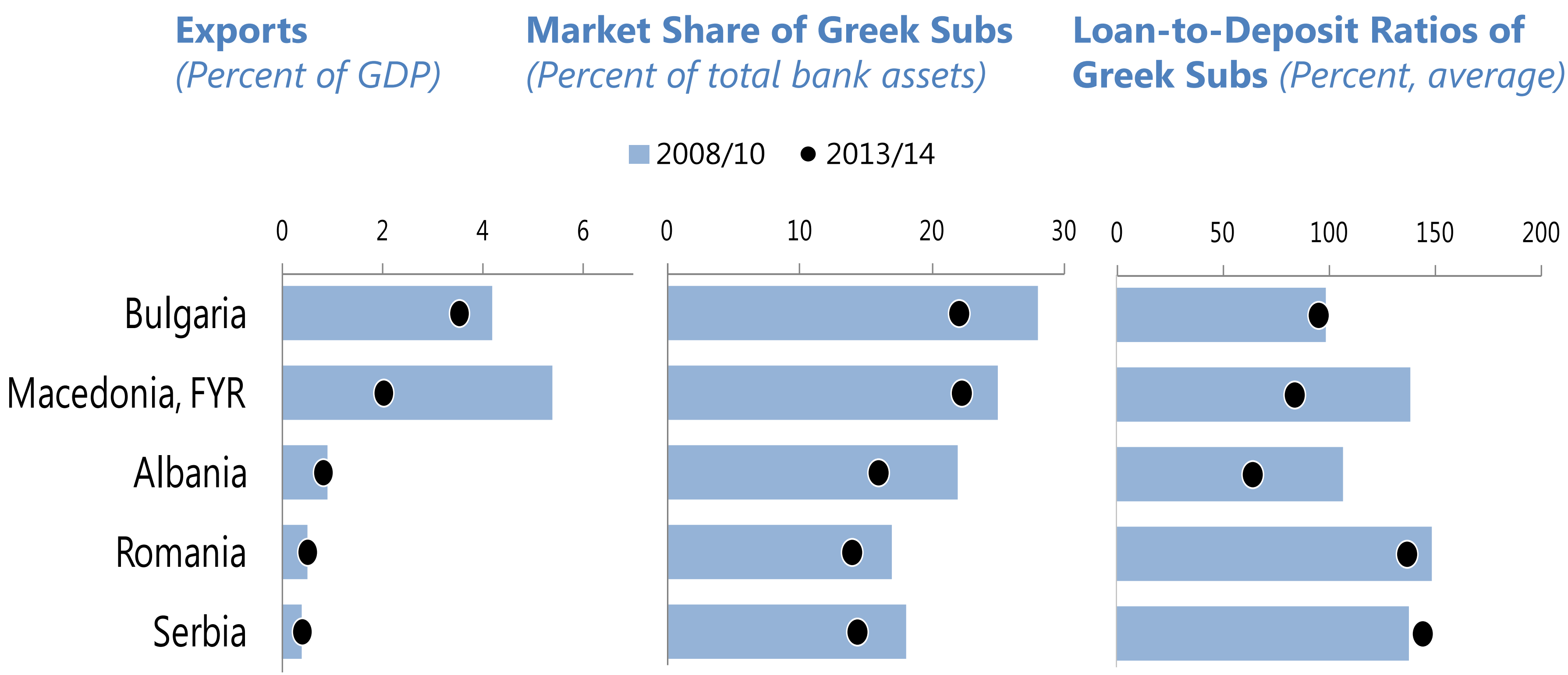
GDP Losses from Additional 4 Percent Fall in Russian GDP, 2015
(Relative to Baseline, in Percent)



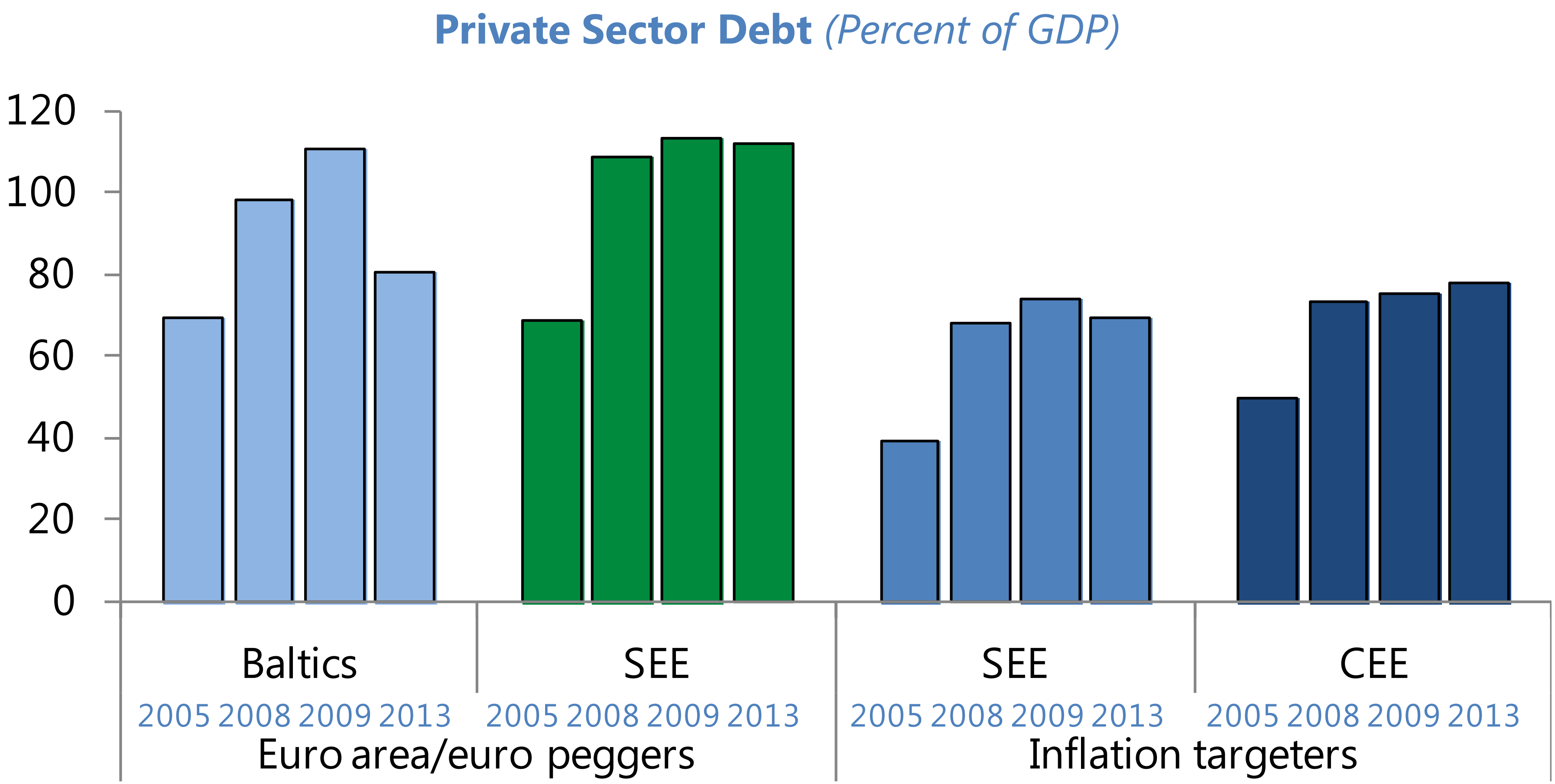
Note: Emerging euro area countries are Estonia, Latvia, Lithuania, Slovak Republic and Slovenia.

Downside Risks: Spillovers from Greece

Potential for Greece Spillovers through Real and Financial Channels

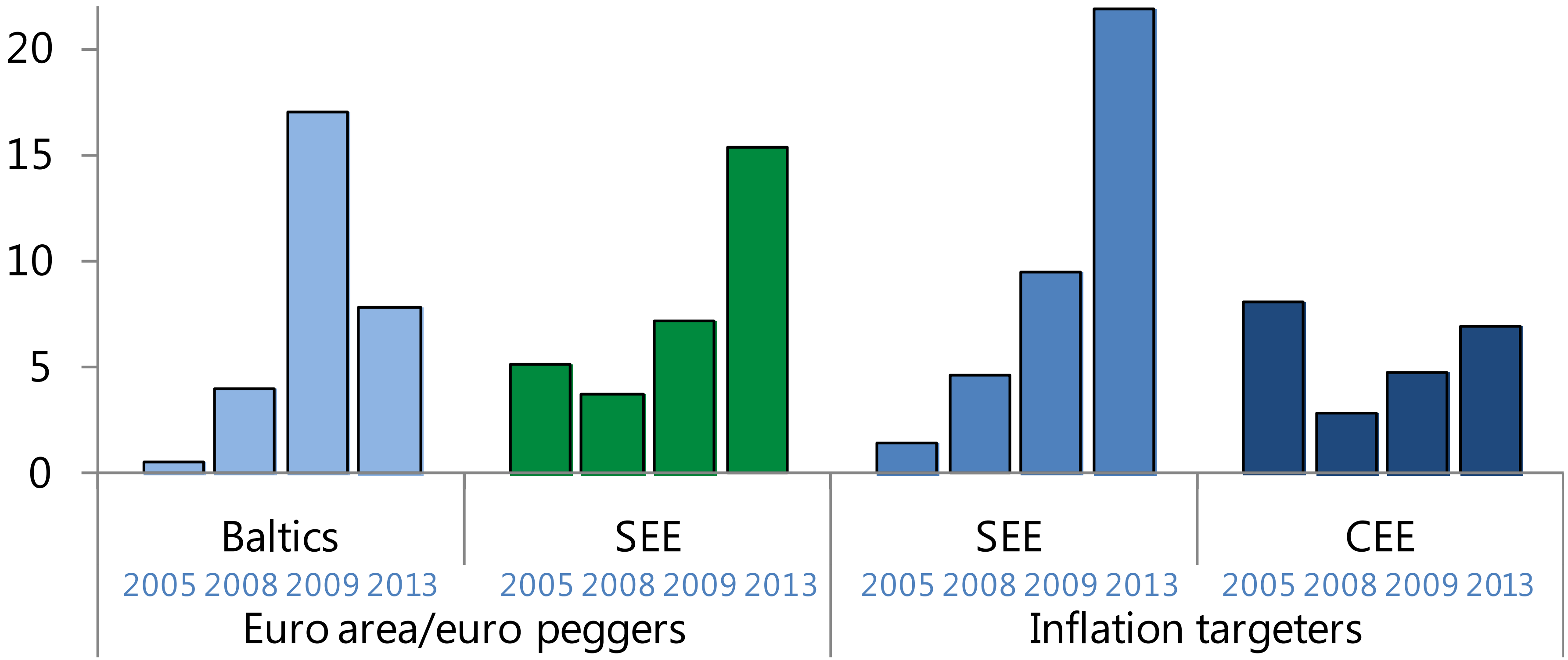


Incomplete Balance Sheet Repair in SEE – Persistently High Debt



Incomplete Balance Sheet Repair in SEE – High NPLs

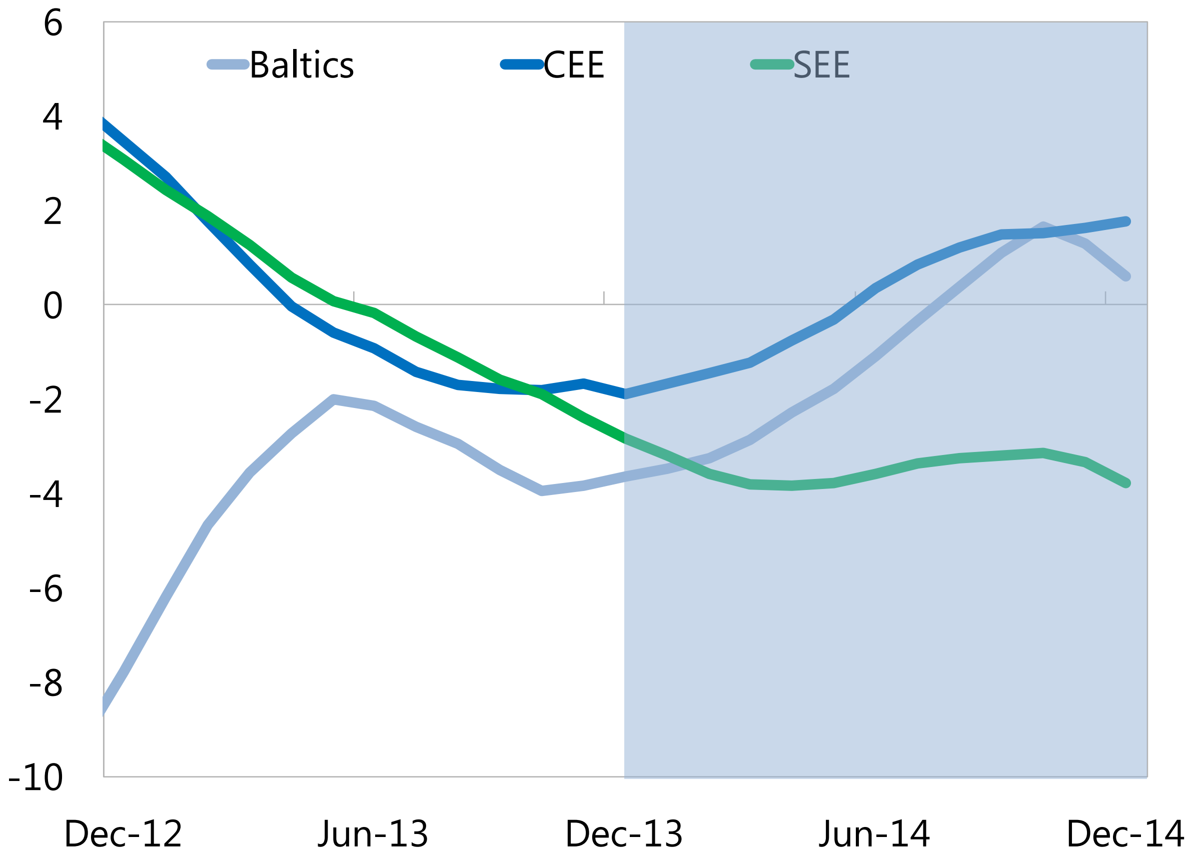
Nonperforming loans *(in percent of total loans)*



Incomplete Balance Sheet Repair in SEE – Negative Credit Growth

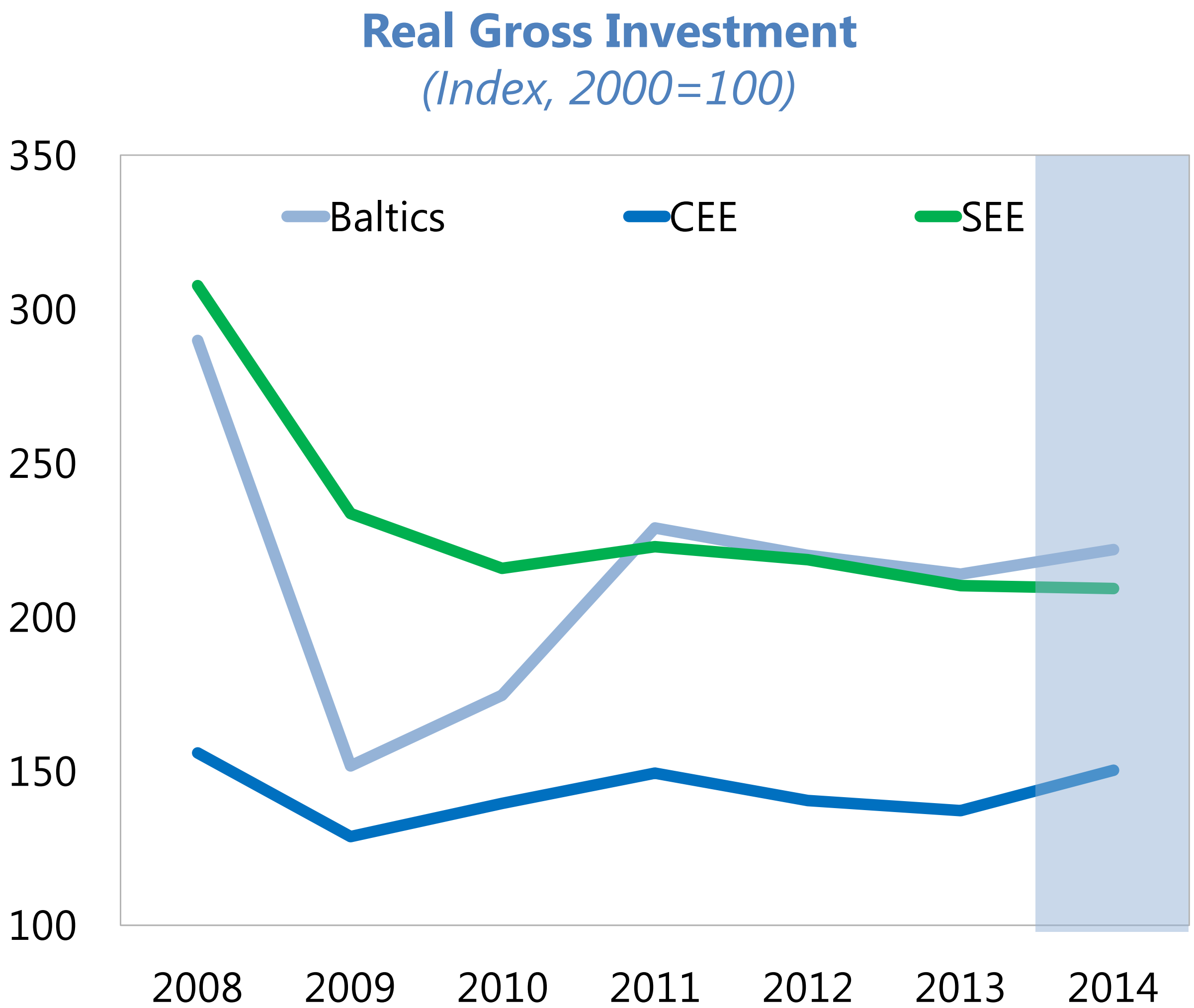
Corporate Bank Credit

(6-month moving average of y-o-y growth rates, percent)



Note: Adjusted for FX valuation effects.

Incomplete Balance Sheet Repair in SEE – No Investment Pick-up



Private Sector Balance-Sheet Repair

1. How much deleveraging?

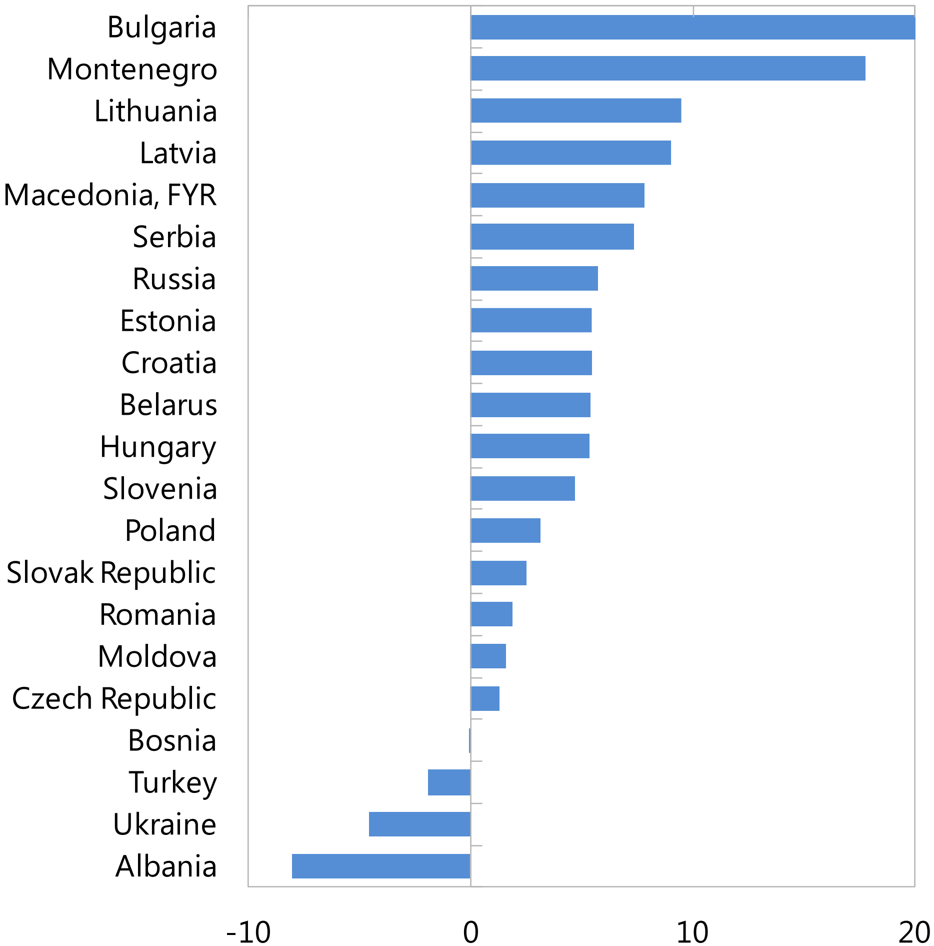
2. Real Impact of Deleveraging

3. Remaining weaknesses and credit gaps

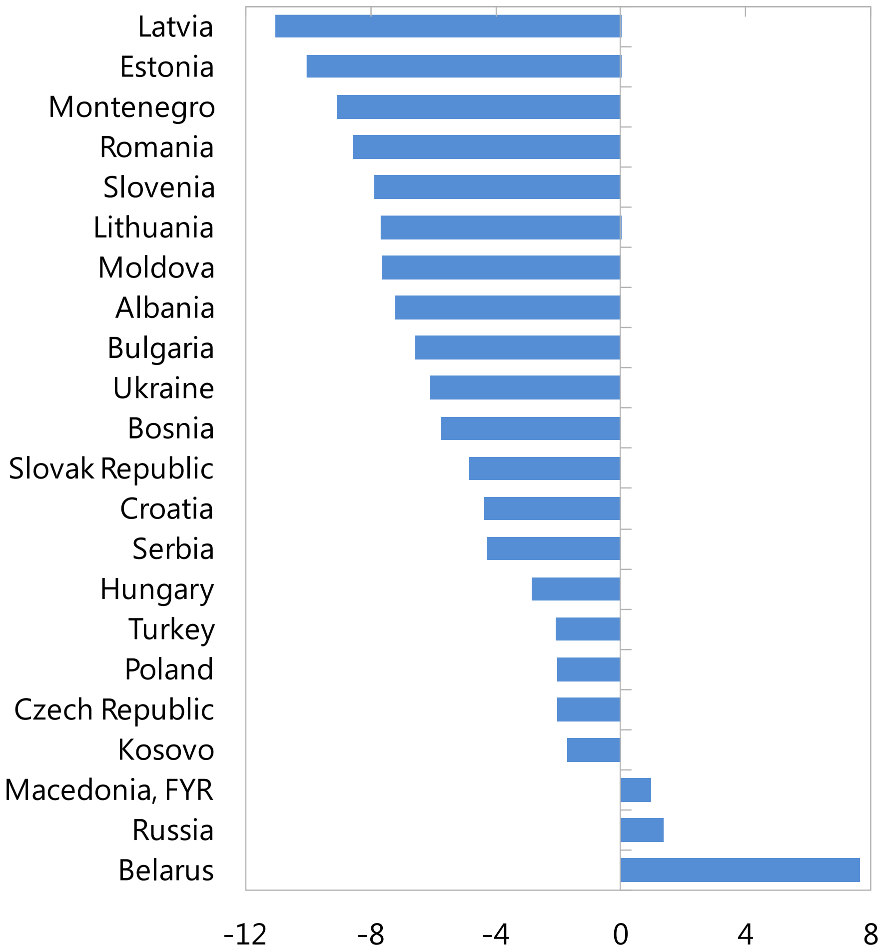
4. Policies to complete repair

1. How Much Deleveraging:
Sizable Deleveraging Efforts…

Post-Crisis Change in Private Savings Rate *(Percent of GDP)*

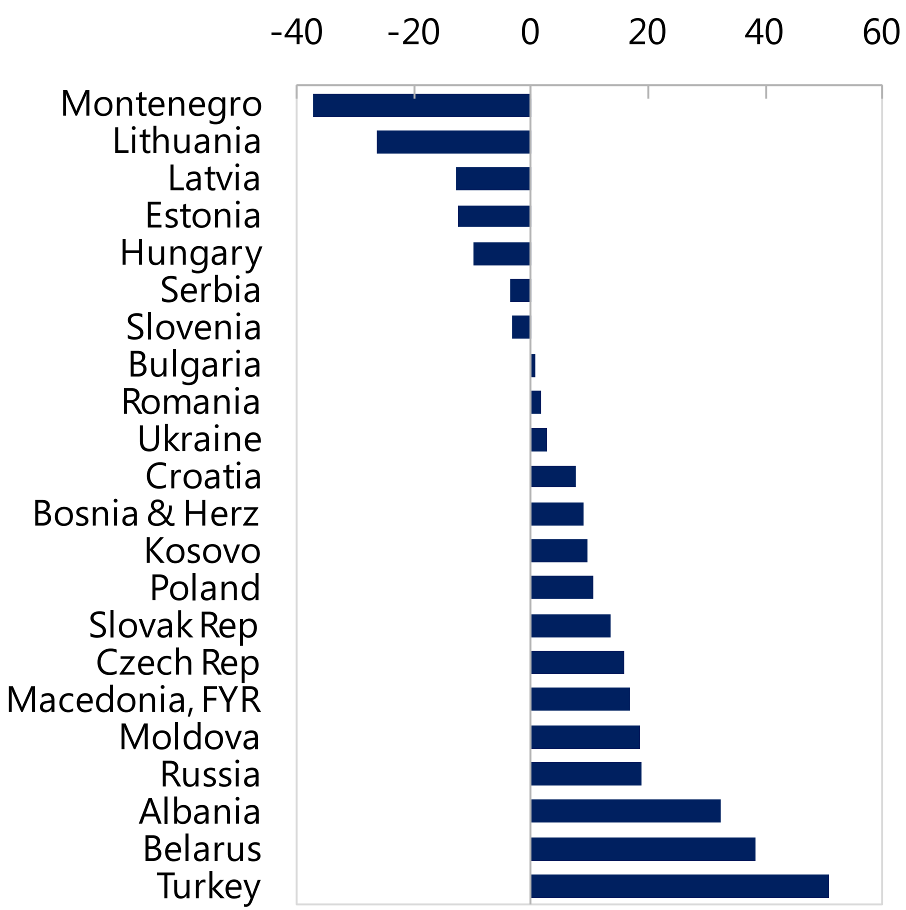


Post-Crisis Change in Private Investment Rate *(Percentage points of GDP)*

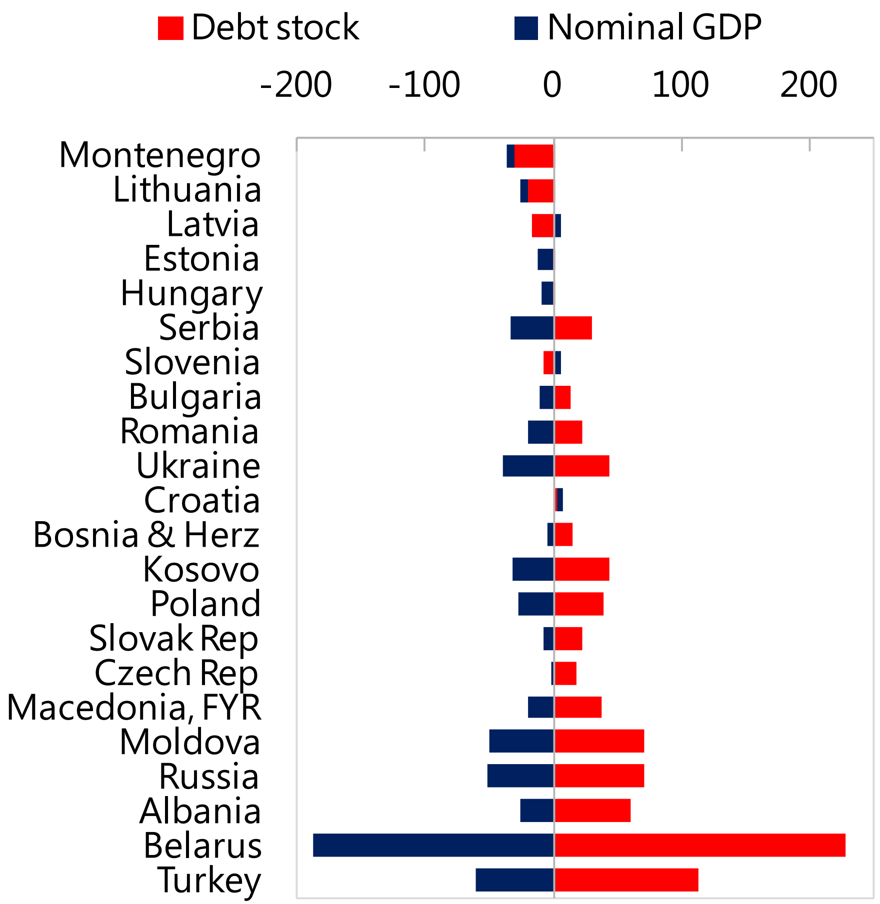


1. How Much Deleveraging: …but Modest Results

Growth of Private Debt-to-GDP Ratio over 2008–13 *(Percent)*

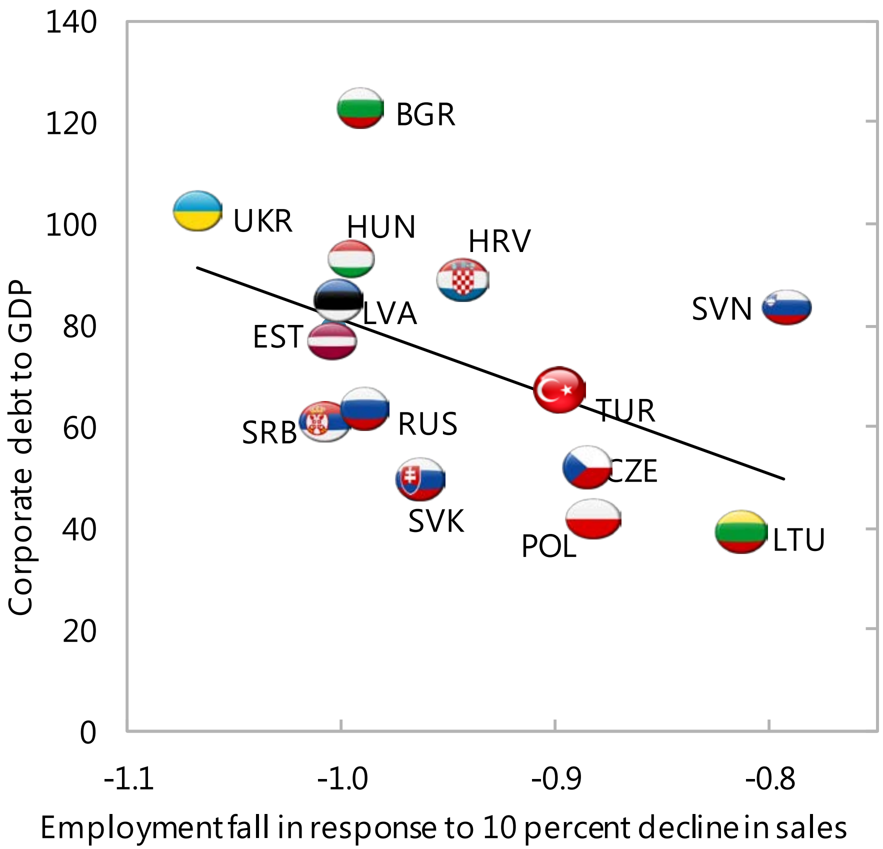


Contributions to Growth of Private Debt-to-GDP Ratio over 2008–13 *(Percent)*

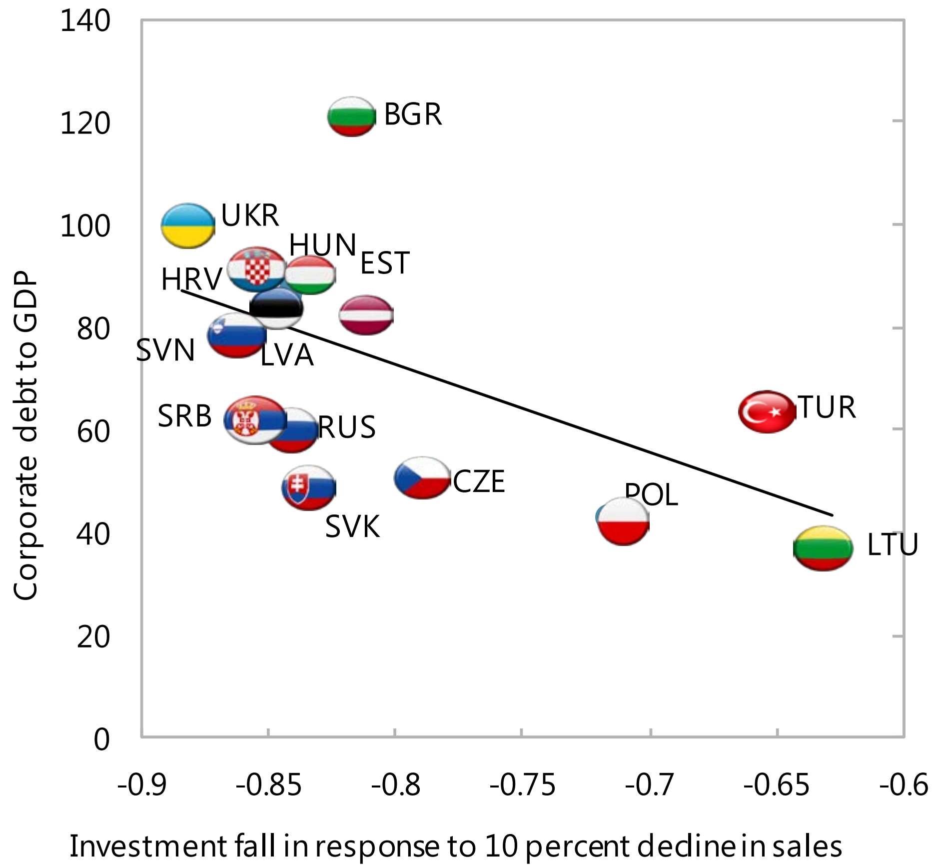


2. Real Impact of Deleveraging: Reduces Absorption of Leveraged Sectors

Employment and Leverage
(Percent)

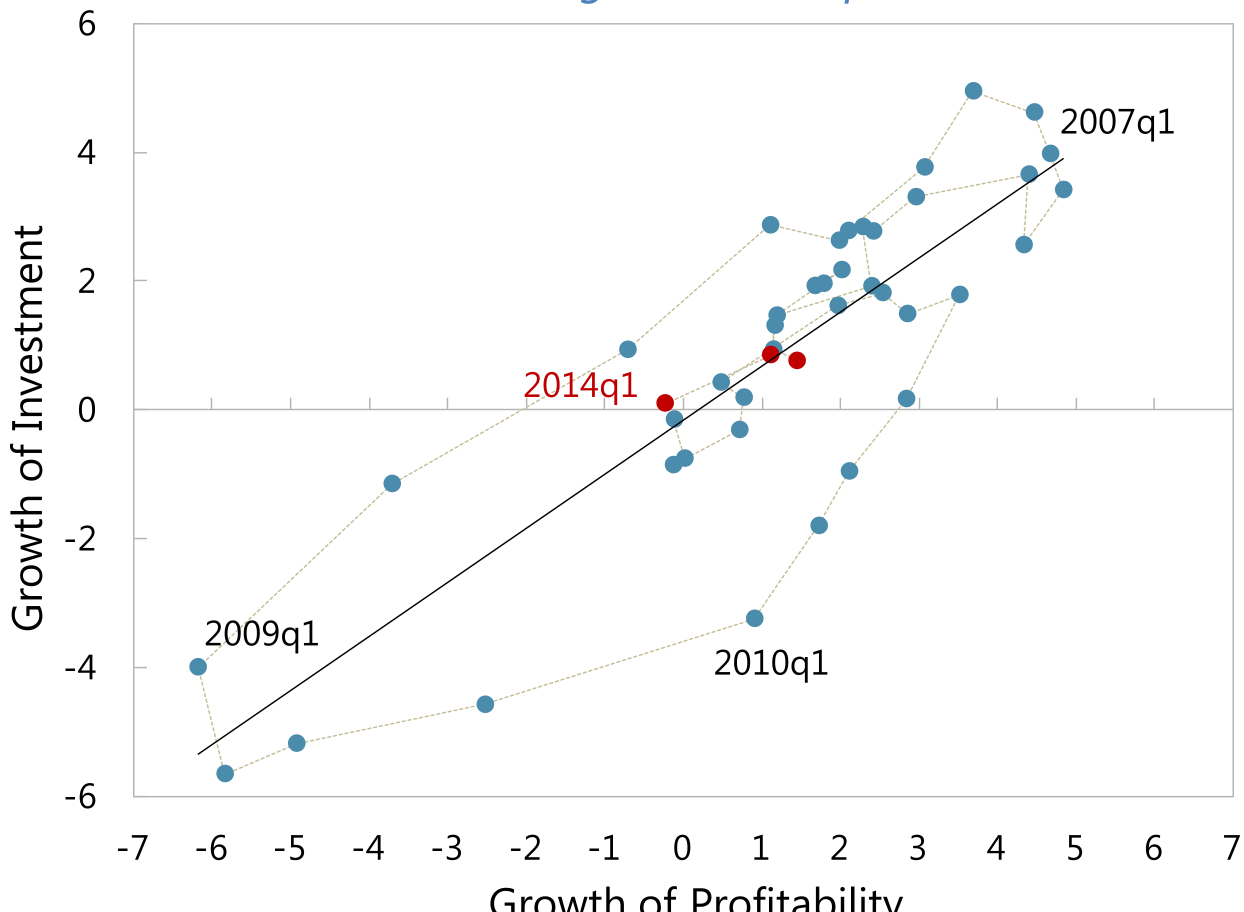


Investment and Leverage
(Percent)



2. Real Impact of Deleveraging:
…but Needed for Investment Recovery

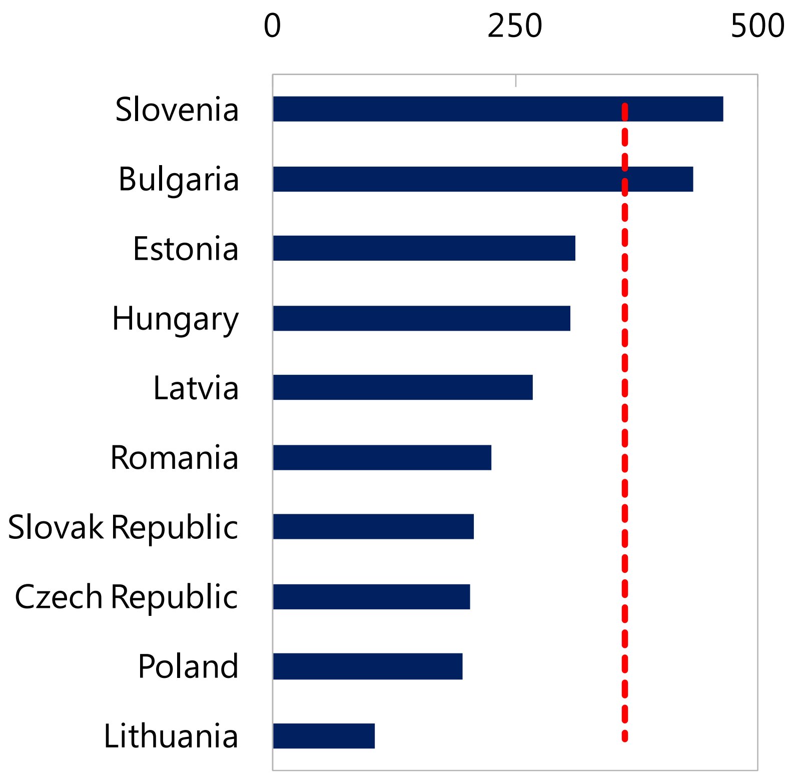
CEE: Profitability and Investment
(12-month growth rate, percent)



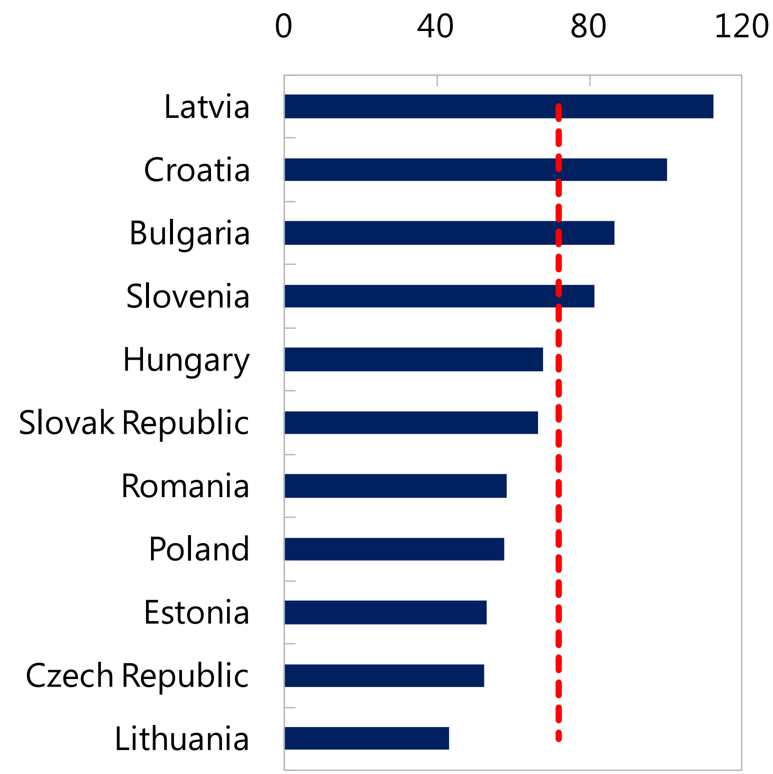
Note: Data points are quarterly, weighted-averages for CEE EU countries.

3. Remaining Weaknesses and Credit Gaps: Corporate Debt Risk Exposures

Liquidity Risk – *Debt-to-Income (Percent, aggregate sectoral accounts data)*



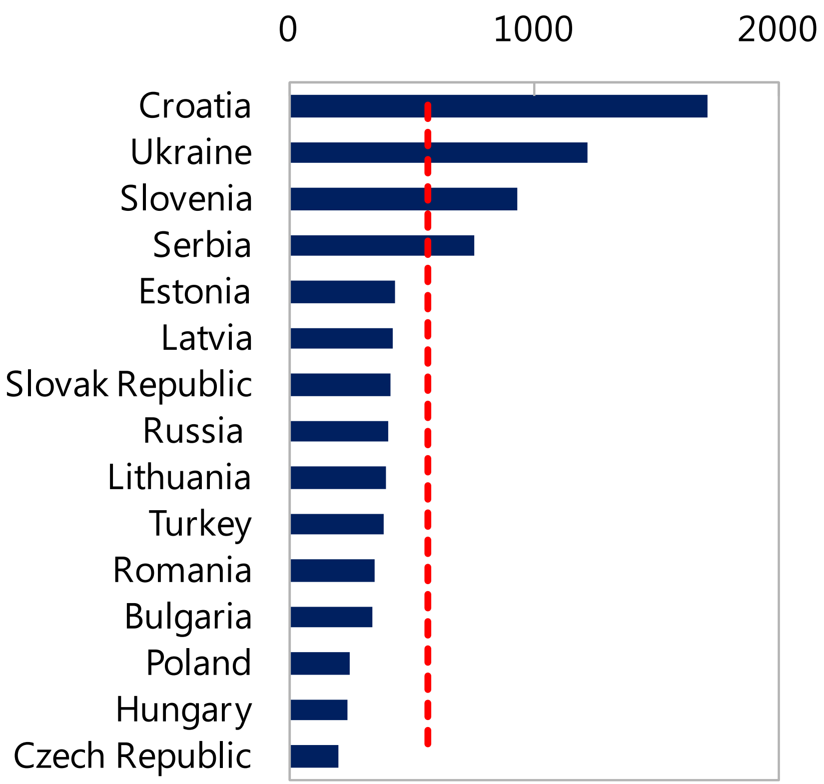
Solvency Risk – *Debt-to-Equity (Percent, aggregate sectoral accounts data)*



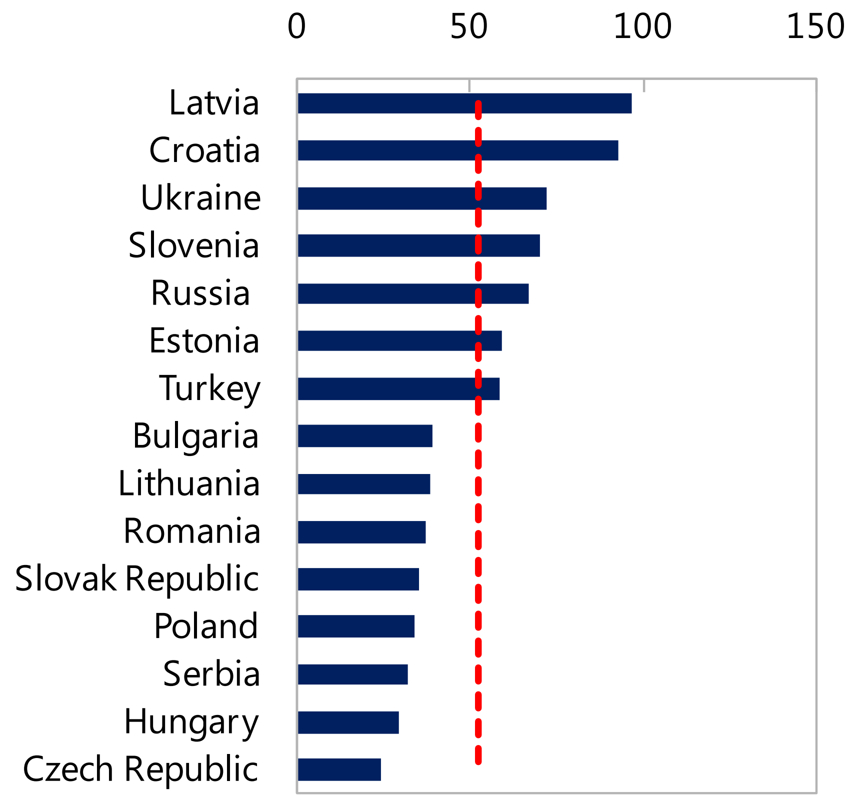
Note: Data are net of intercompany loans and cross-equity holdings among domestic firms. Thresholds are the cut-off points of the top quartile of the EU-wide distribution of the indicators over 1995-2007.

3. Remaining Weaknesses and Credit Gaps: Corporate Debt Risk Exposures (2)

Liquidity Risk – *Debt-to-Income (Percent, weighted-average of firm-level data)*

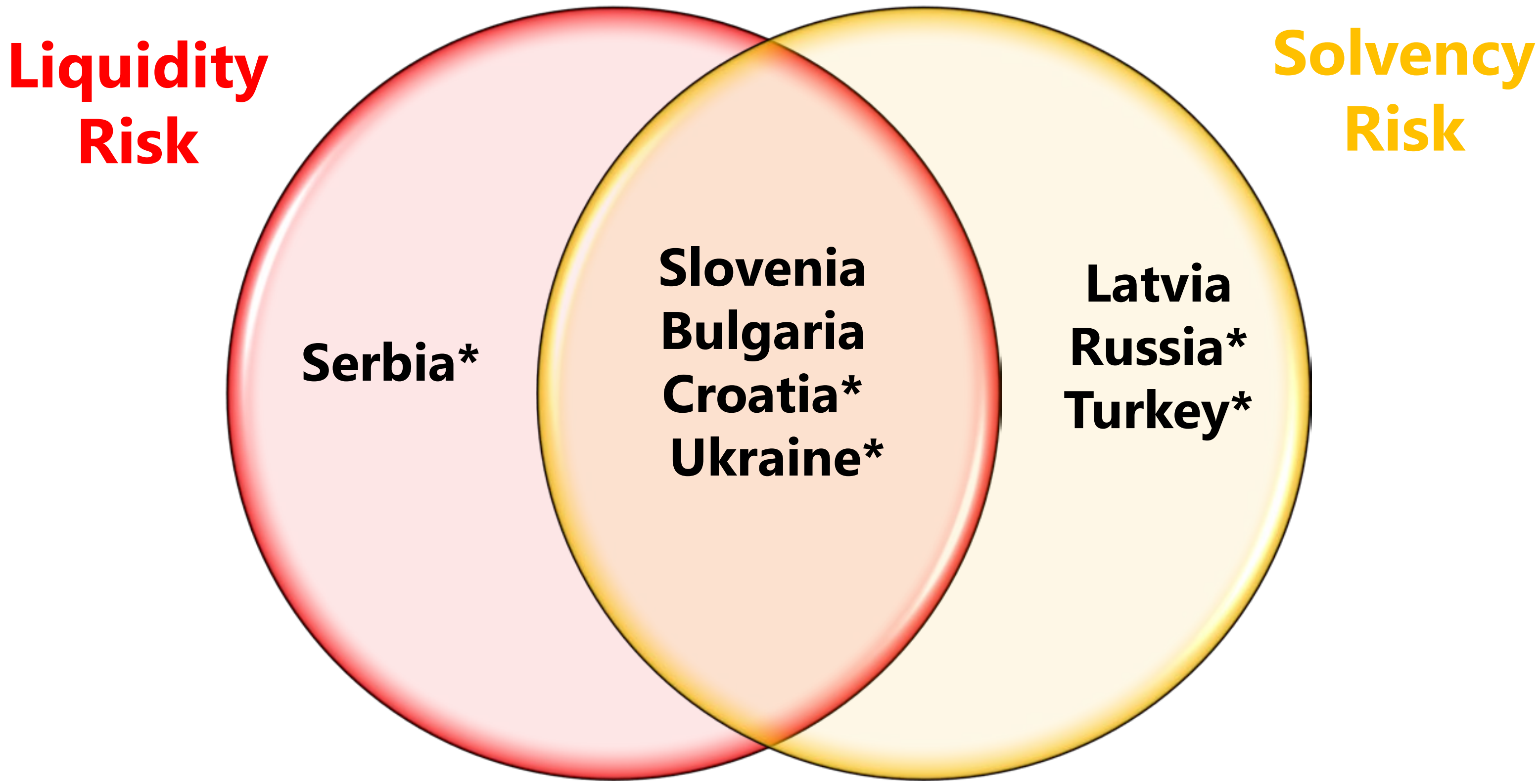


Solvency Risk – *Debt-to-Equity (Percent, weighted-average of firm-level data)*



Note: Data includes intercompany loans and cross-equity holdings among domestic firms. Thresholds are the average values of indicators across sample countries in 2013.

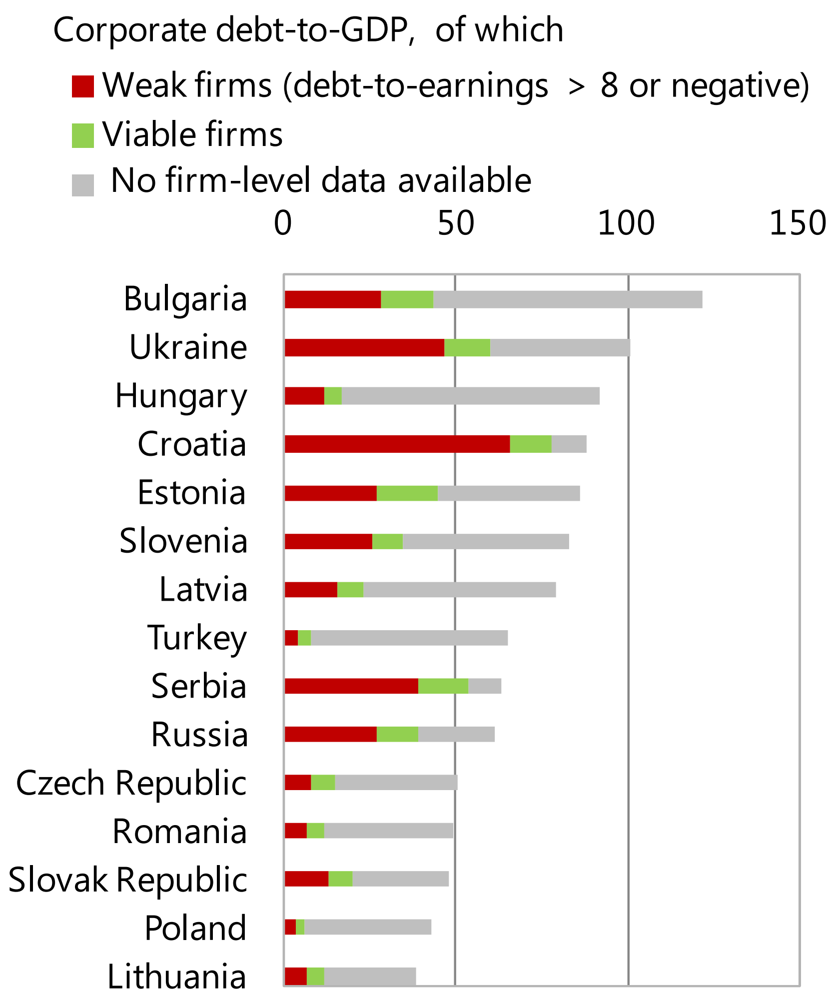
3. Remaining Weaknesses and Credit Gaps:
Corporate Debt Risk Exposures (3)



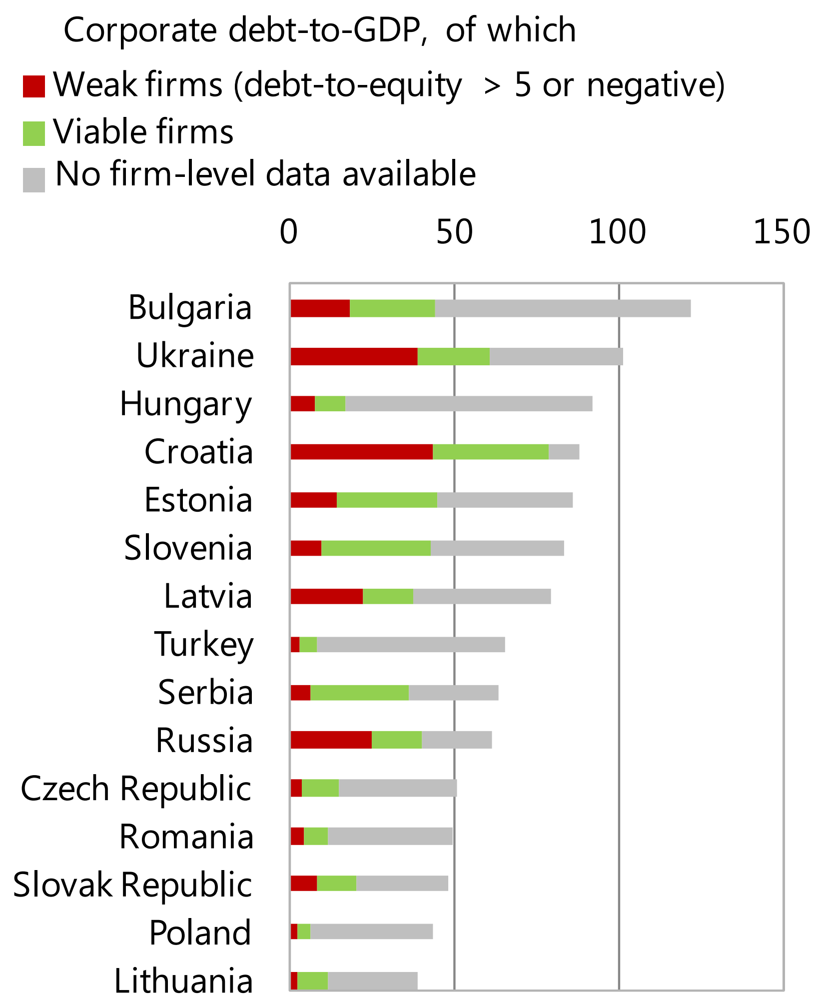
Note: (*) based fully or in part on firm-level data.

3. Remaining Weaknesses and Credit Gaps: Corporate Debt-at-Risk

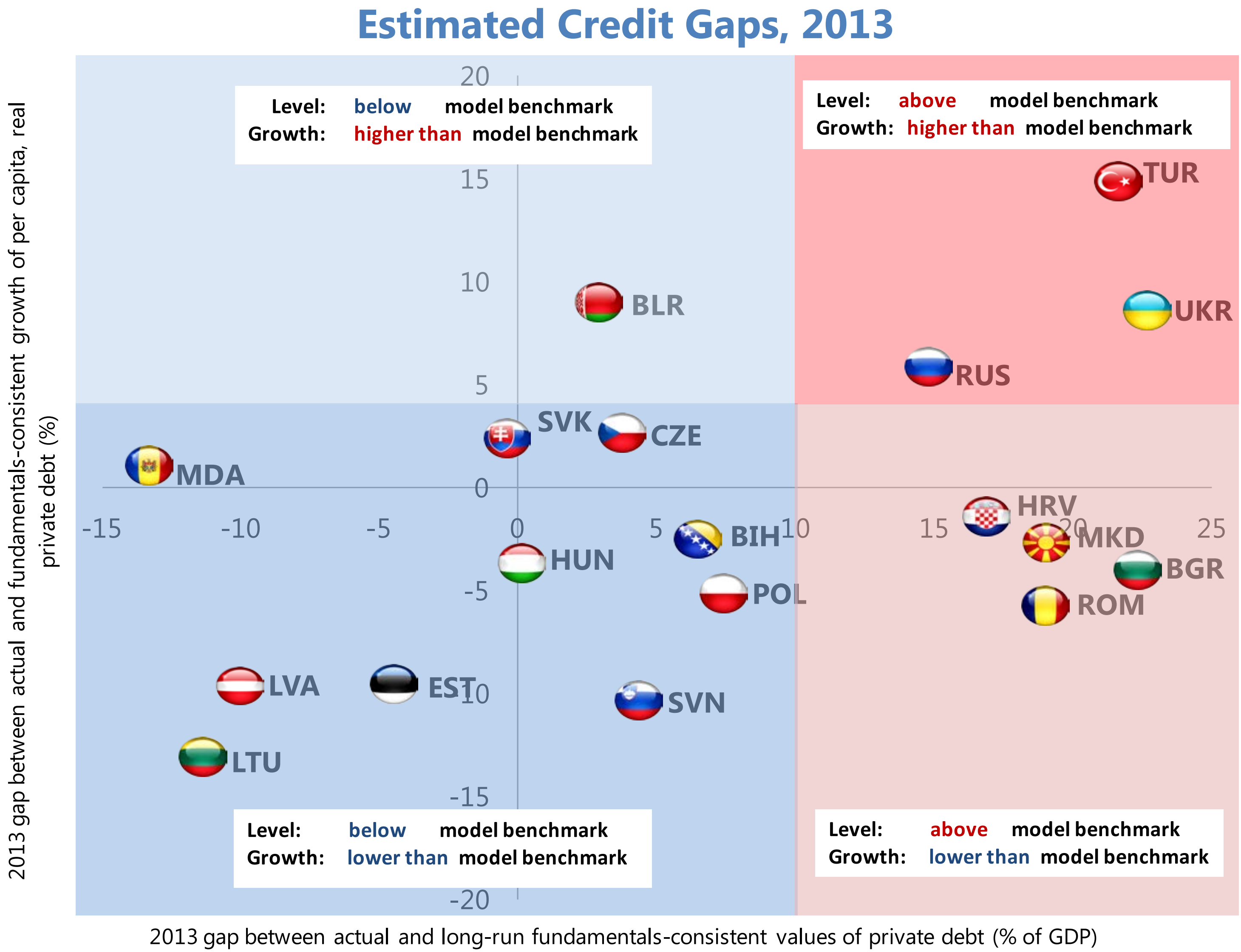
Liquidity Risk – *Debt-to-Income (Percent)*



Solvency Risk – *Debt-to-Equity (Percent)*

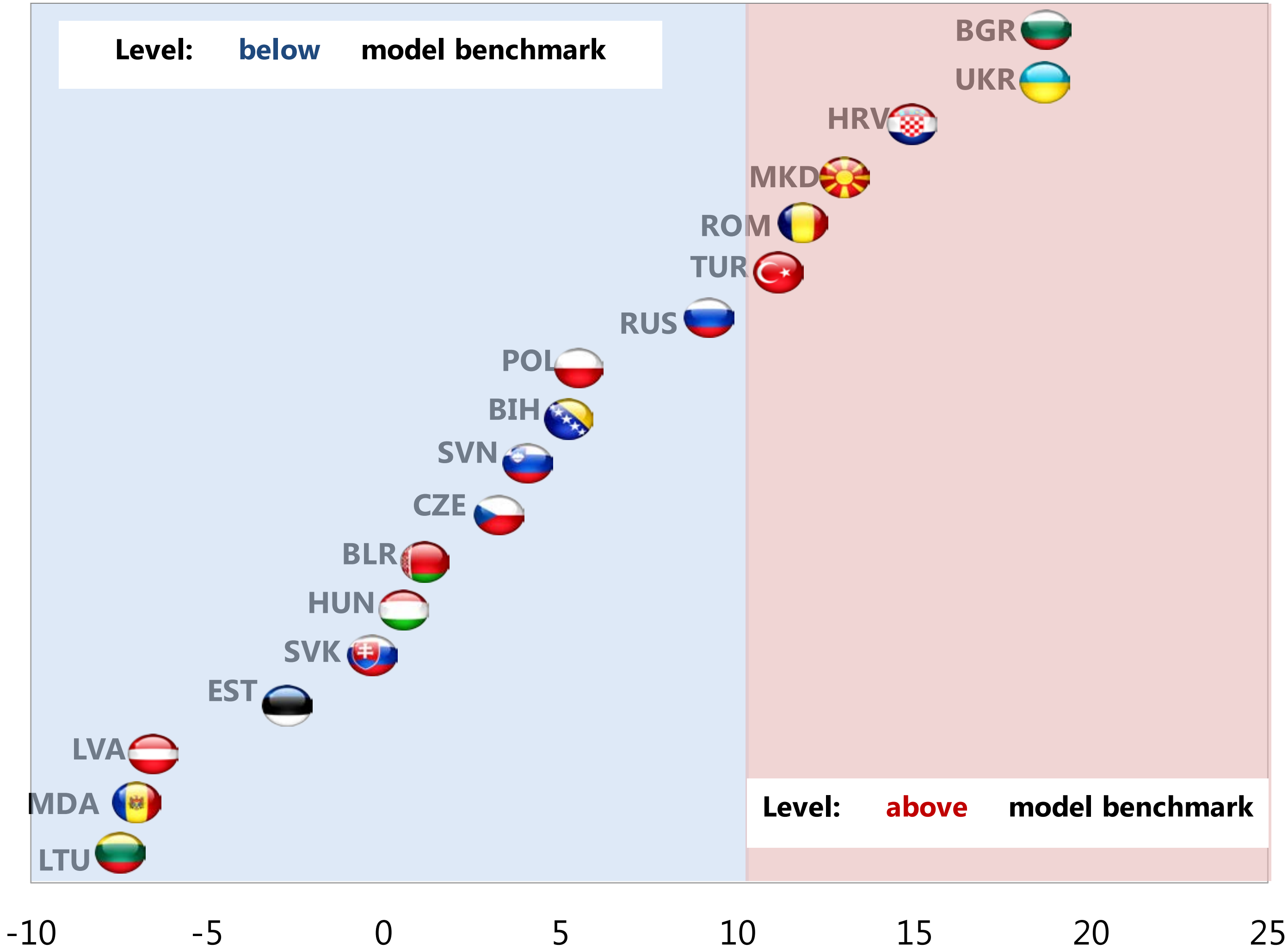


3. Remaining Weaknesses and Credit Gaps: Credit Gaps in 2013



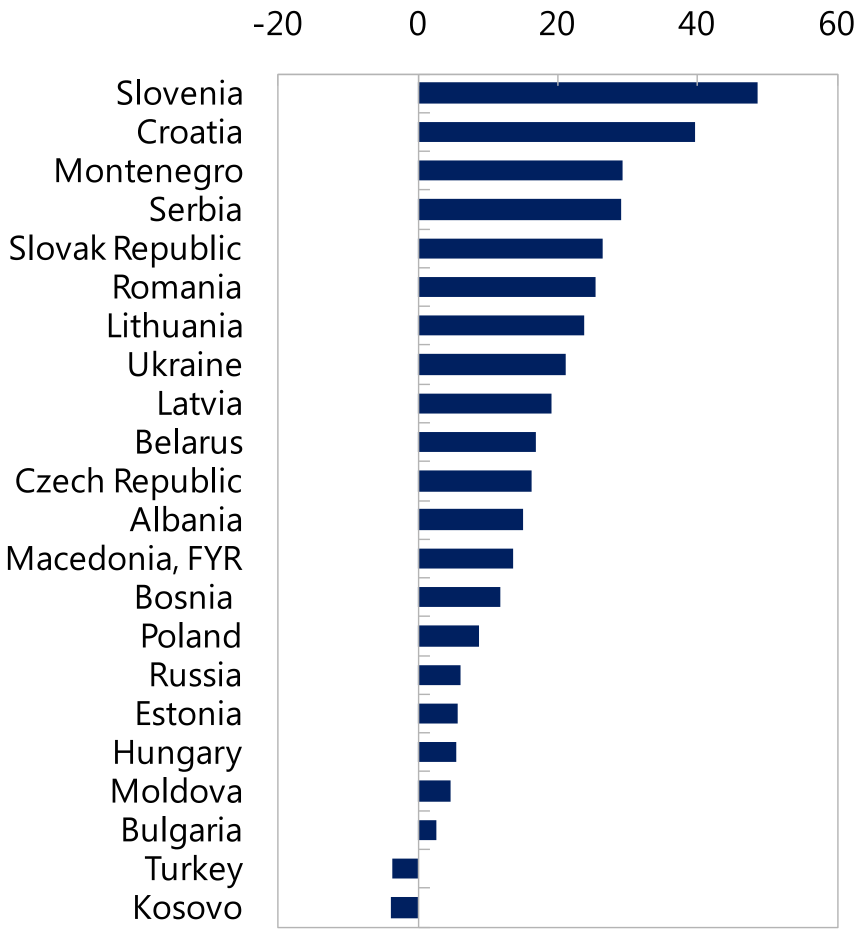
3. Remaining Weaknesses and Credit Gaps: Credit Gaps in 2020

2013 Credit Gap as Ratio to GDP in 2020 *(Percent)*



4. Policies to Complete Repair:
Fiscal Accommodation but Reduced Space

2008-13 Change in Public Debt
(Percentage points of GDP)



Gap between Debt-Stabilizing and Actual Primary Balance
(Percent of GDP)

Country	2008	2011	2013
Belarus	-4.8	-4	0.1
Bosnia	-1.7	1.1	-0.5
Bulgaria	-4.6	3.9	-0.1
Croatia	-1.1	3.5	2.8
Czech Republic	-0.8	2.2	-0.5
Hungary	-1	2.1	-0.8
Latvia	4.1	1.1	-0.5
Lithuania	2.7	3.1	-0.3
Macedonia	-0.1	1.3	1.7
Poland	0.6	1.4	0.8
Romania	2.5	2	-0.3
Russia	-0.2	-0.5	1
Serbia	0.3	1.5	3.8
Slovak Republic	1.2	2.3	0.3
Slovenia	-1.3	4.7	3.5
Turkey	-1.5	-2.2	-1.1
Ukraine	1.5	1.4	-1

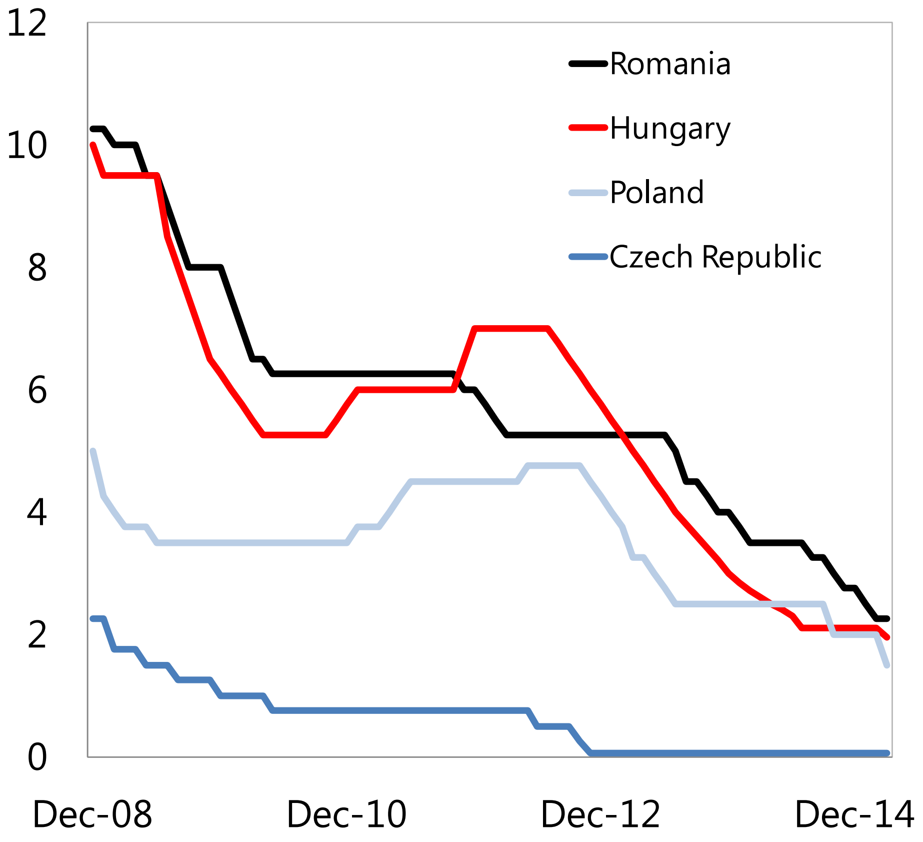
4. Policies to Complete Repair: Monetary Policy Key, but Options Limited

CESEE Exchange Rate Regimes

Euro peggers	Euro area members
Bosnia and Herzegovina	Latvia
Bulgaria	Lithuania
Croatia	Estonia
Kosovo	Slovak Republic
Macedonia, FYR	Slovenia
Montenegro, Rep. of	
Other exchange rate regimes	
Albania	Romania
Belarus	Serbia
Czech Republic	Ukraine
Hungary	Russia
Moldova	Turkey
Poland	

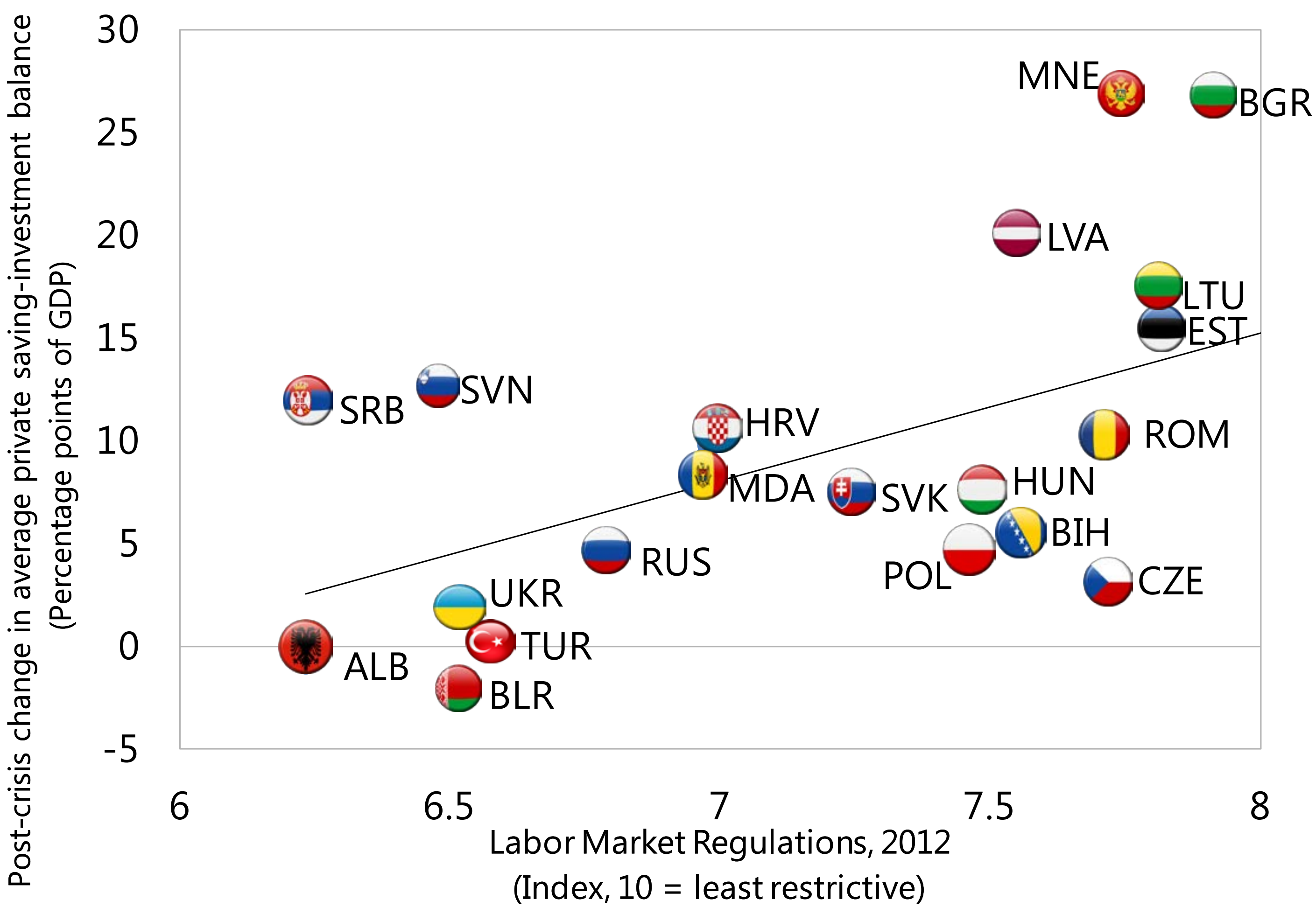
Central Bank Policy Rates, 2008–15

(Percent)

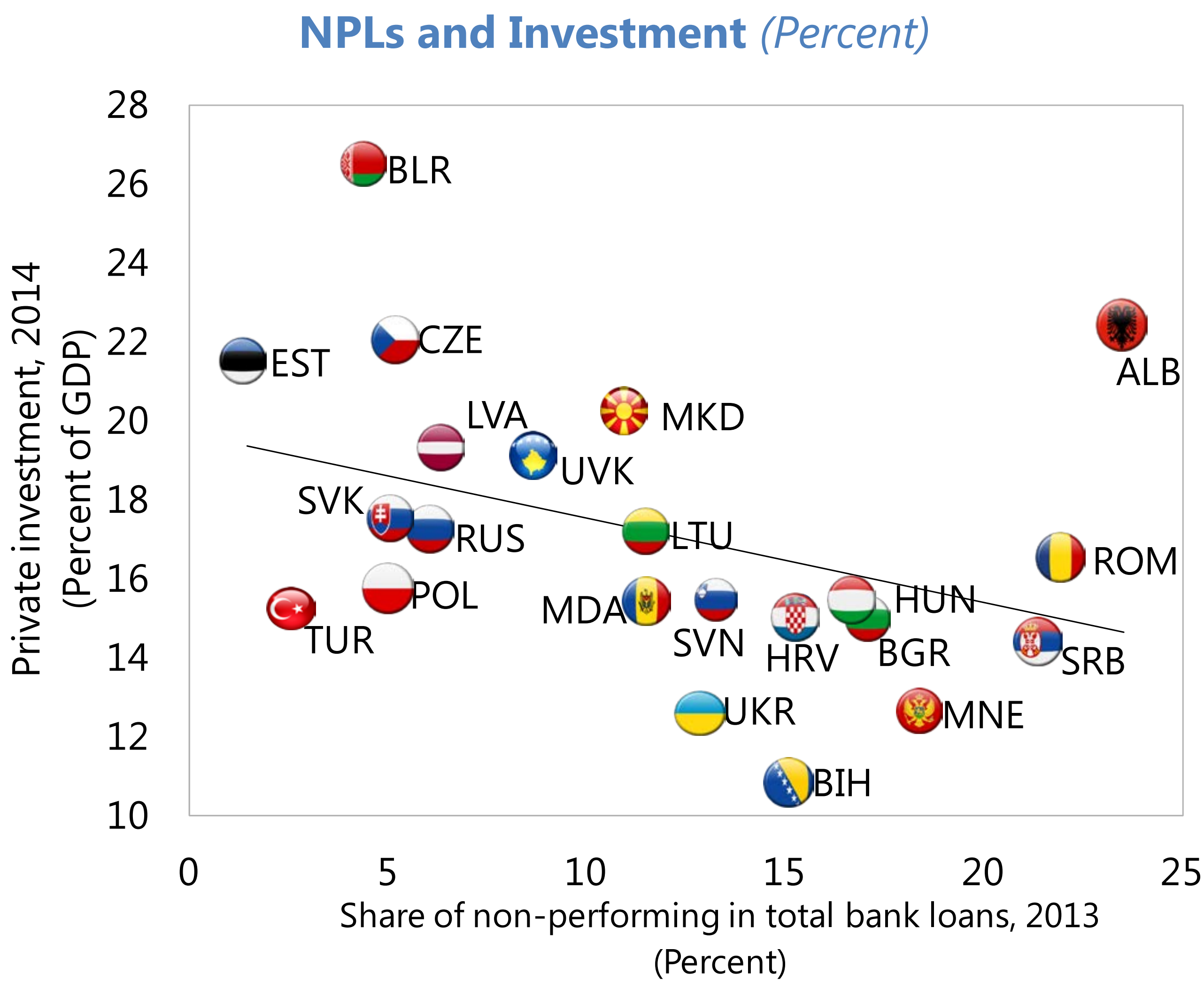


4. Policies to Complete Repair:
Need Flexible Adjustment Mechanisms

Post-Crisis Deleveraging and Labor Market Flexibility

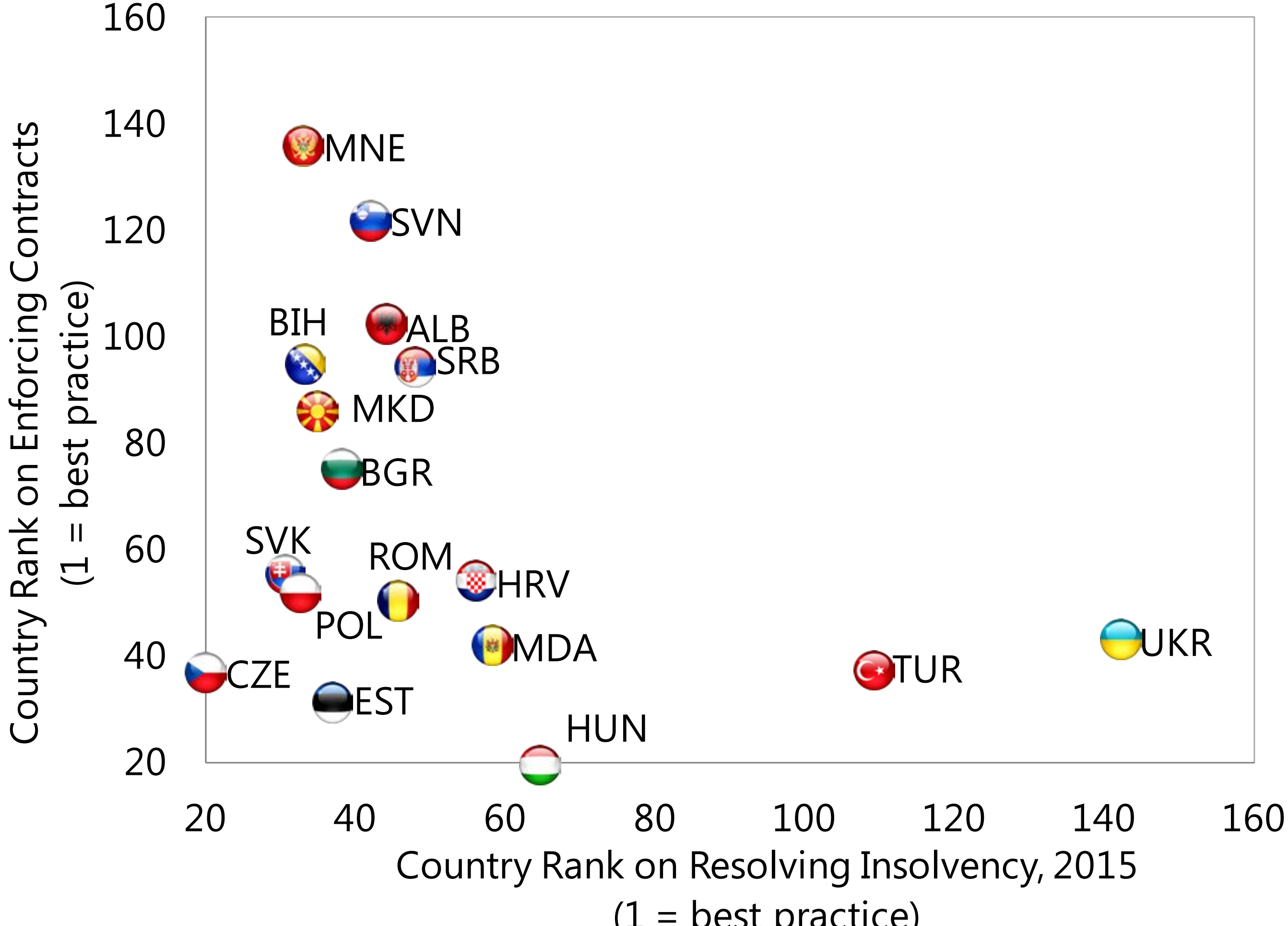


4. Policies to Complete Repair: Need to Clean up Bank Loan Portfolios



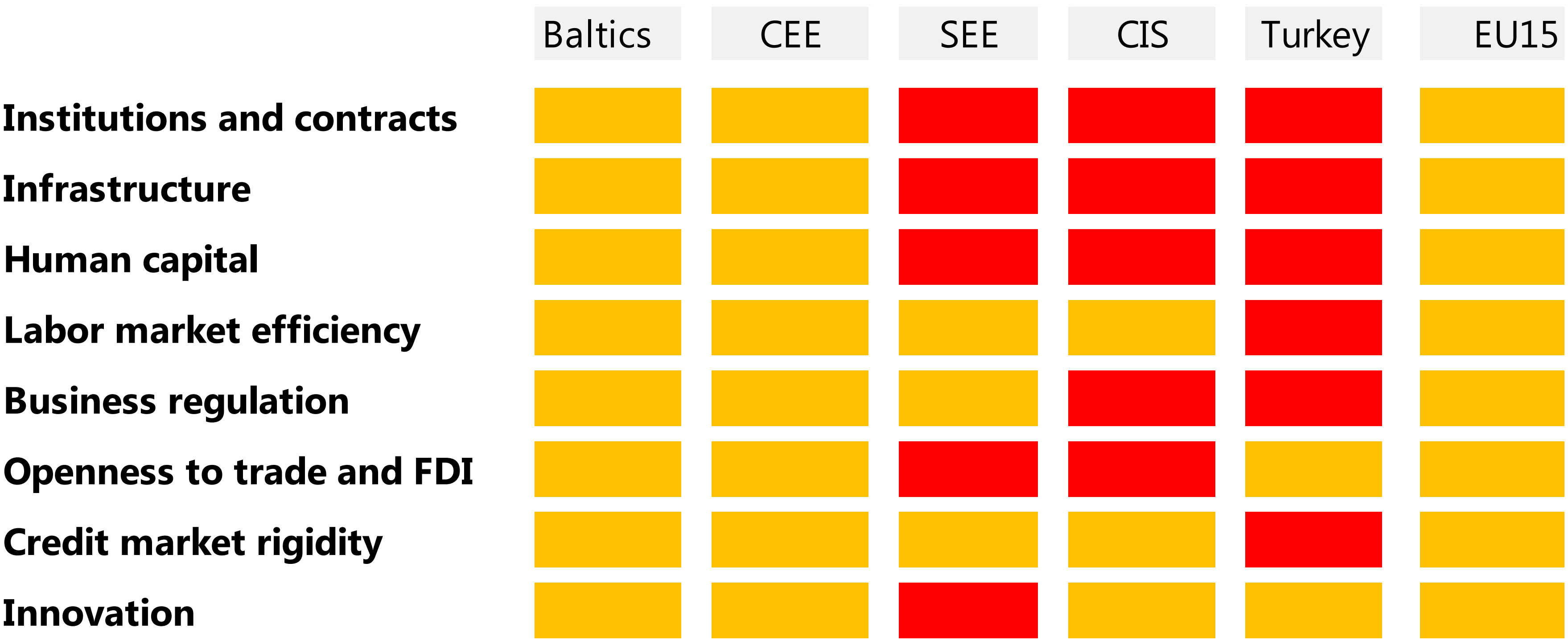
4. Policies to Complete Repair:
Need Effective Legal Frameworks

Country Ranks on Enforcing Contracts and Resolving Insolvency



4. Policies to Support Repair and Growth
Unfinished Structural Reform Agenda

CESEE: Structural Reforms Relative to OECD Countries



Note: Red - value in the 25th percentile; Yellow - value in the 50th and 75th percentile. The sample includes all OECD and CESEE countries.

Conclusions and Policy Messages

Growth disparities across CESEE due to

- Differential impact of external shocks
- Incomplete balance-sheet repair and structural weaknesses (in some SEE and CIS)

Policy response

- Mind the credit gaps and use monetary and fiscal space to support recovery and balance sheet repair
- Institutional reforms
  - Address high NPLs
  - Upgrade legal frameworks
  - Complete structural reform agenda

THANK YOU!

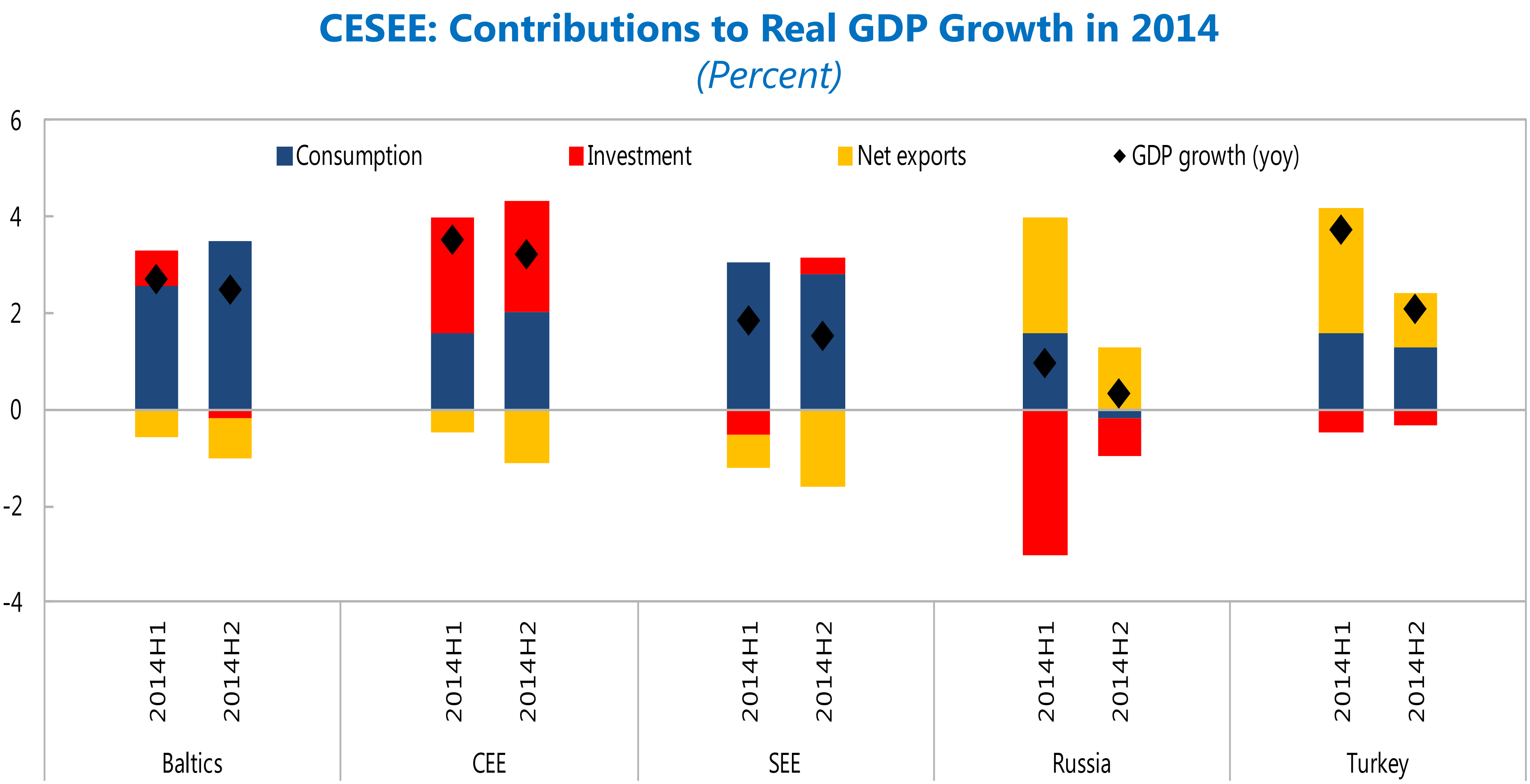
Growth divergent across the region

CESEE: Outlook for Real GDP Growth

		Projection	
	2014	**2015**	**2016**
CESEE[1]	1.4	**-0.4**	**1.3**
Baltics[1,2]	2.6	**2.6**	**3.3**
Central and Eastern Europe[1,3]	3.0	**3.1**	**3.1**
Southeastern Europe[1,4]	1.7	**1.9**	**2.4**
Other CIS[1,5]	-3.9	**-4.6**	**1.4**
Russia	0.6	**-3.8**	**-1.1**
Turkey	2.9	**3.1**	**3.6**

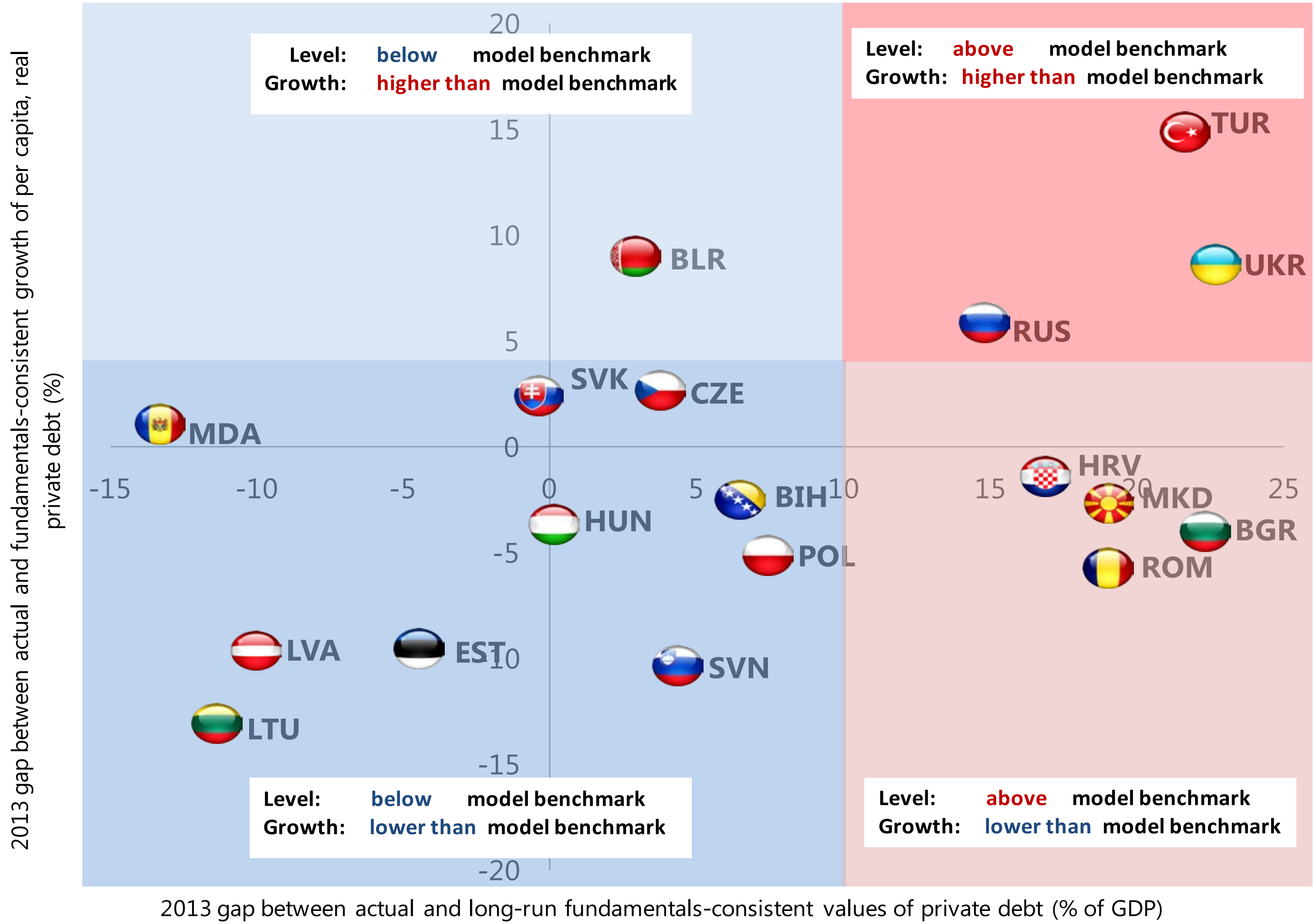
Note: [1] Weighted average. Weighted by GDP valued at purchasing power parity. [2] Estonia, Latvia, and Lithuania; [3] Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia; [4] Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Macedonia FYR, Montenegro, Romania, and Serbia; [5] Belarus, Moldova, and Ukraine.
Source: IMF World Economic Outlook database.

In 2014, investment made significant positive contribution to growth only in CEE



Sources: Haver Analytics; and IMF staff calculations.

Credit Gaps in 2013



Notes: Data for Bulgaria and Poland are for the 2012 gap and for Romania—for 2011, due to missing data.