Regional Economic Outlook and Regional Economic Issues – Focus on CESEE

IMF Macroeconomic Policy Seminar

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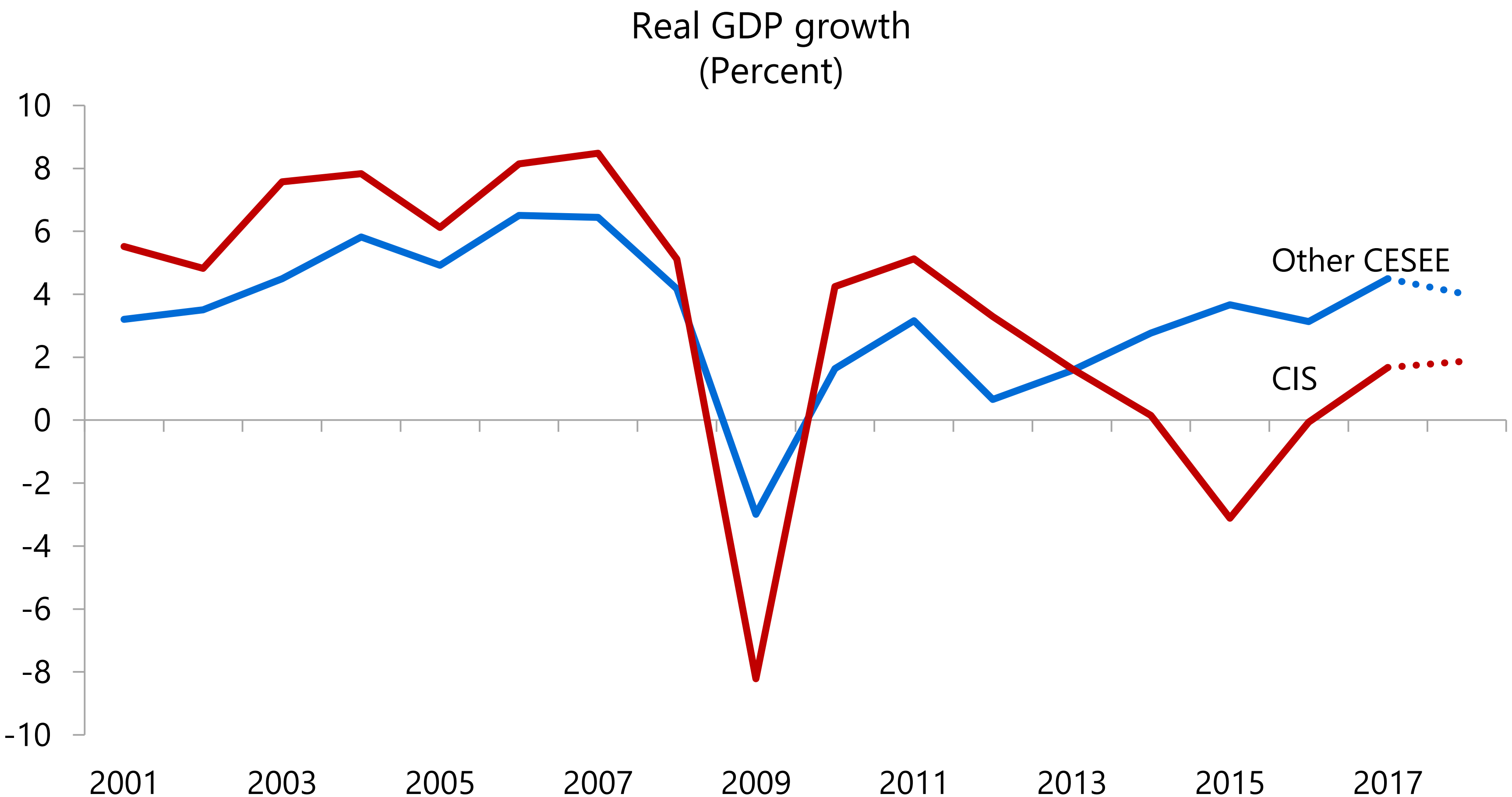
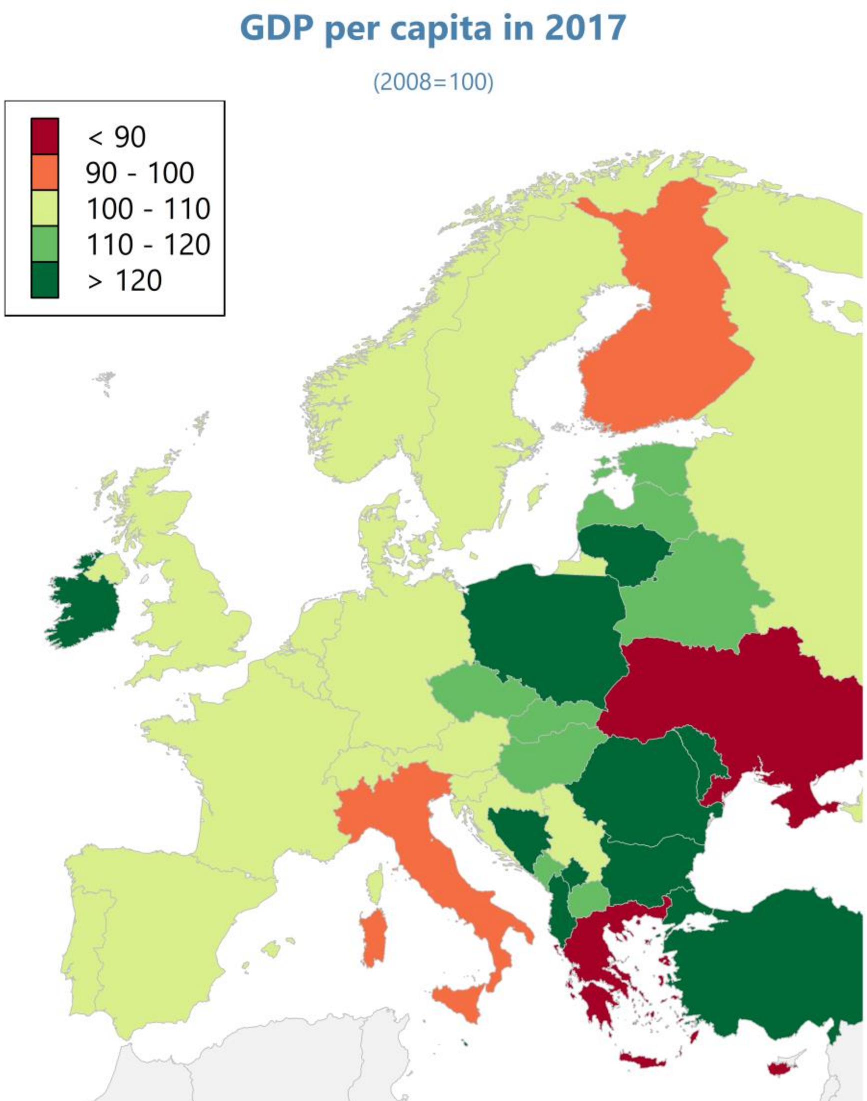
THE WORLD ACCORDING TO THE APRIL 2018 WEO

In CESEE, CIS recovering and non-CIS growing strongly

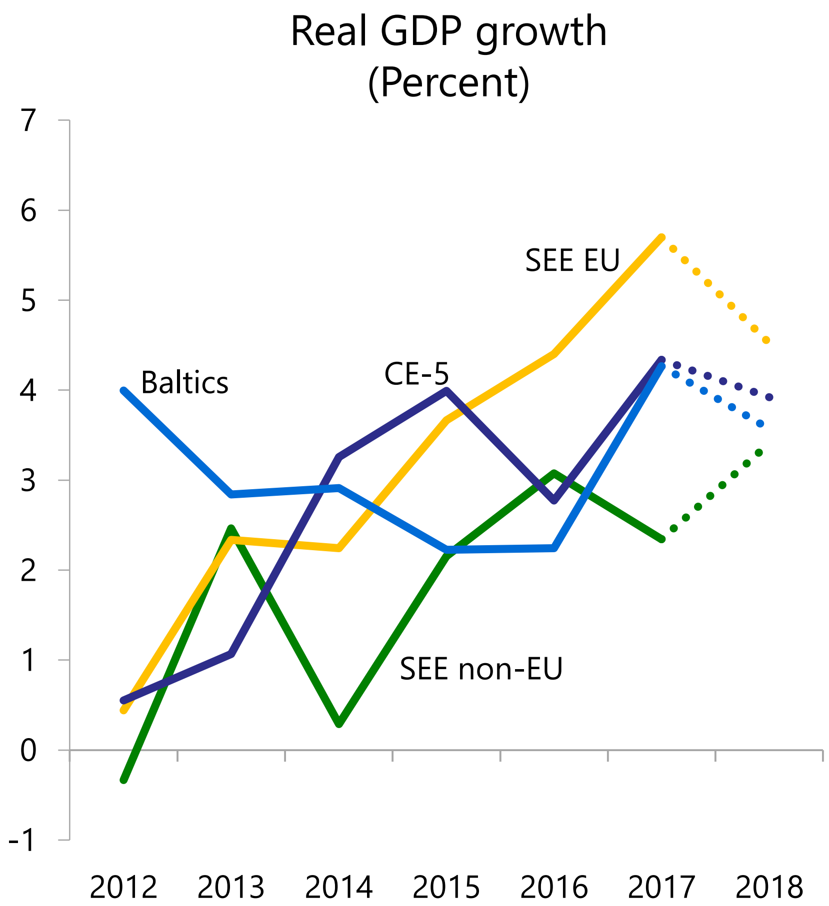


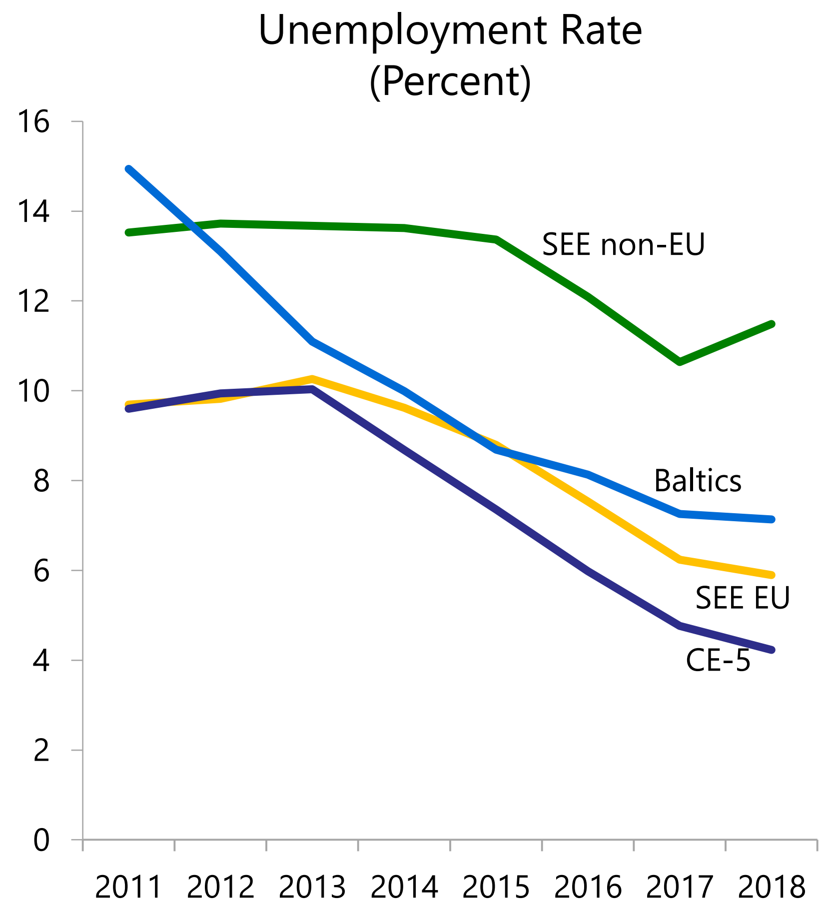
GDP per capita is well above pre-crisis level (except Ukraine)



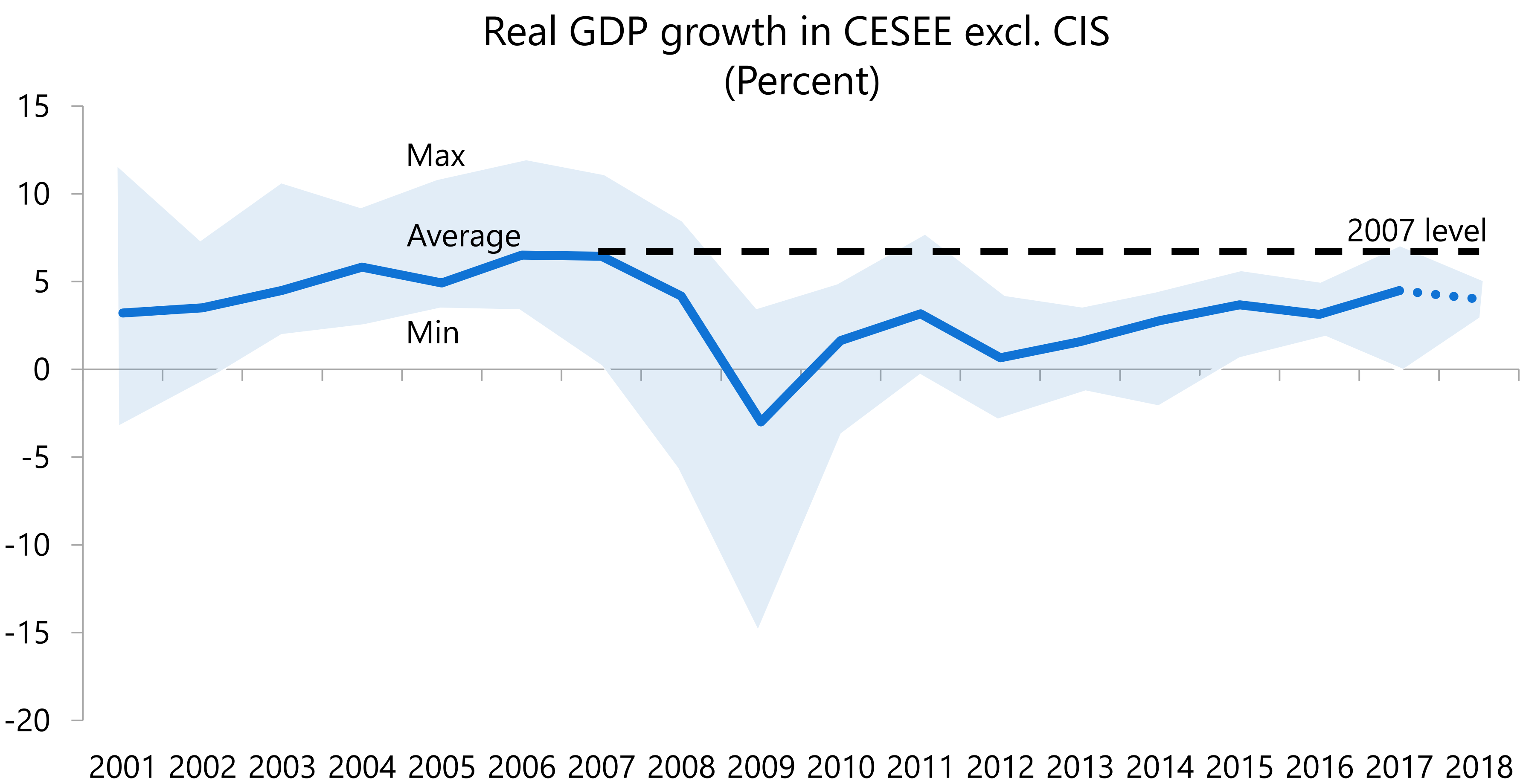
NON-CIS CESEE

Growth is rapid, and unemployment is falling sharply



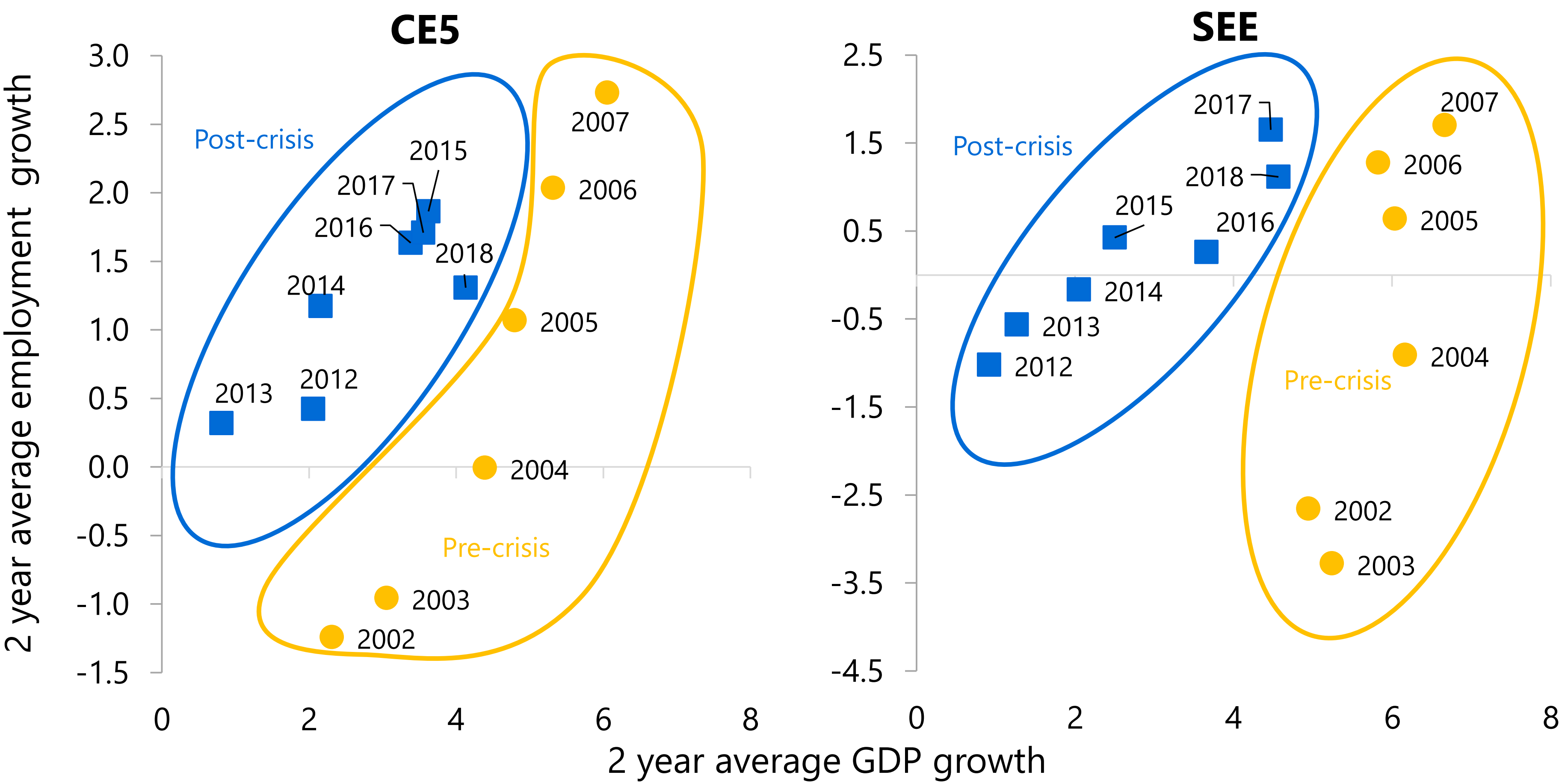


Growth in the region is not as high as in the pre-crisis years



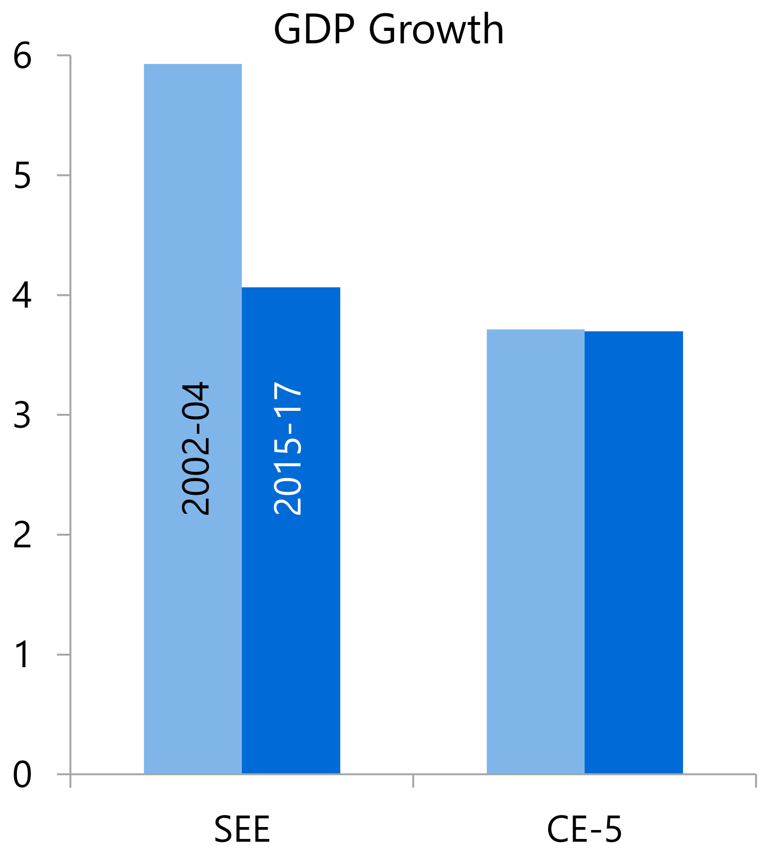
But employment growth in many countries is as high as during pre-crisis peaks.

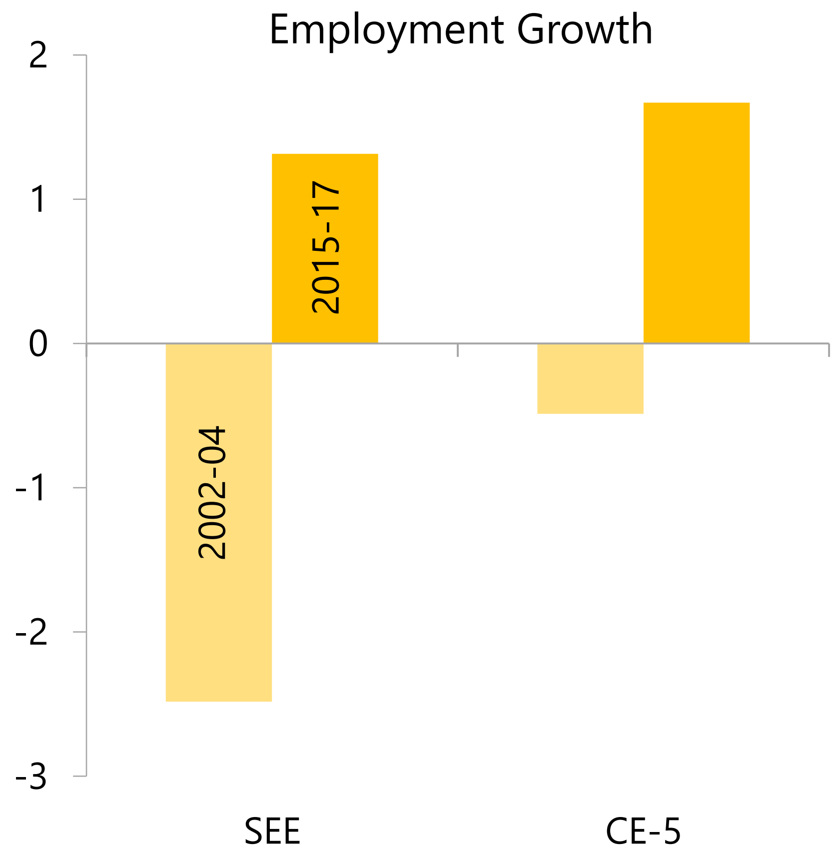
GDP growth vs. employment growth
(Percent, 2 year average)



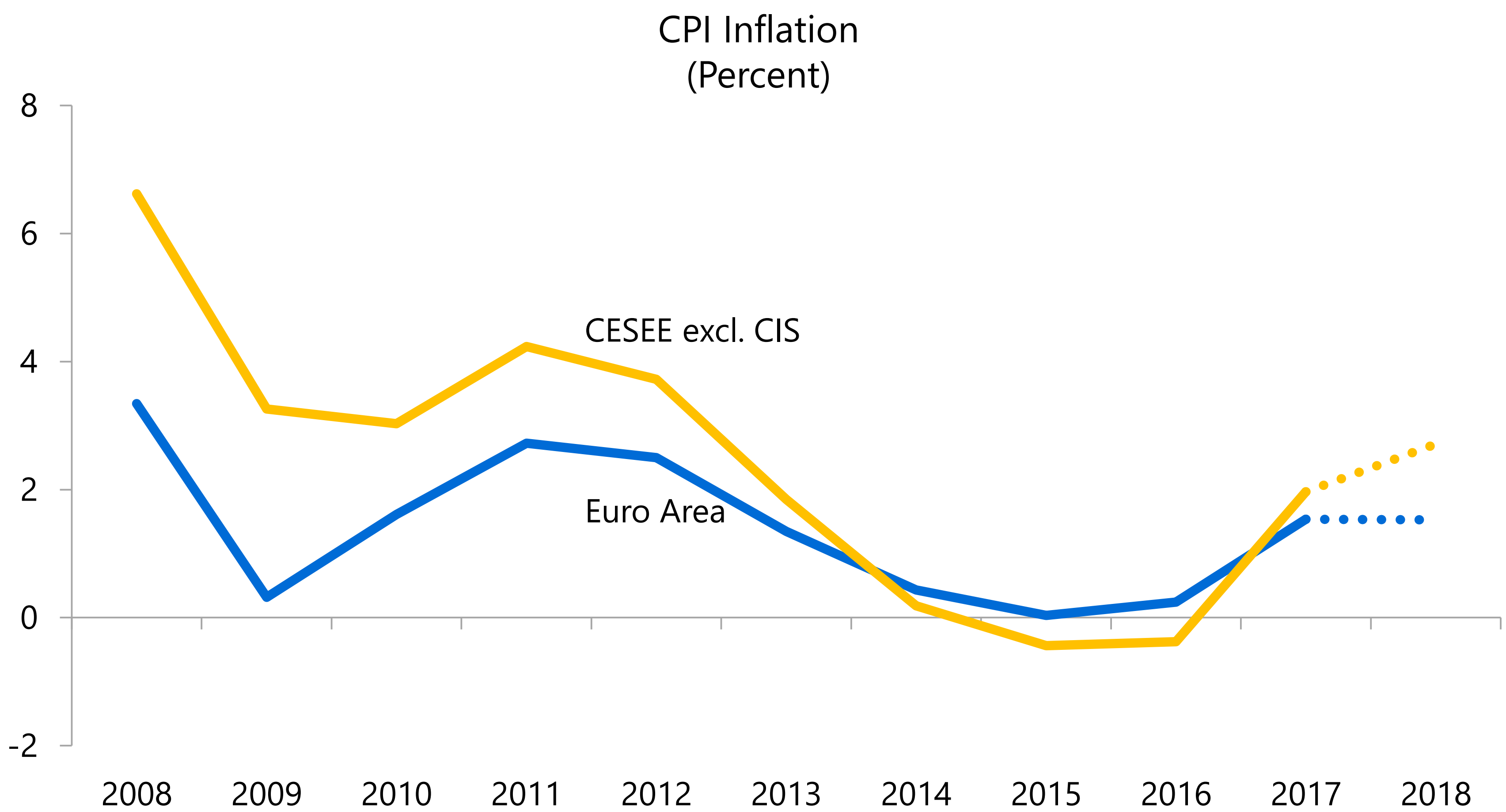
Even if we exclude peak pre-crisis years: current growth is lower but employment growth higher than pre-crisis

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

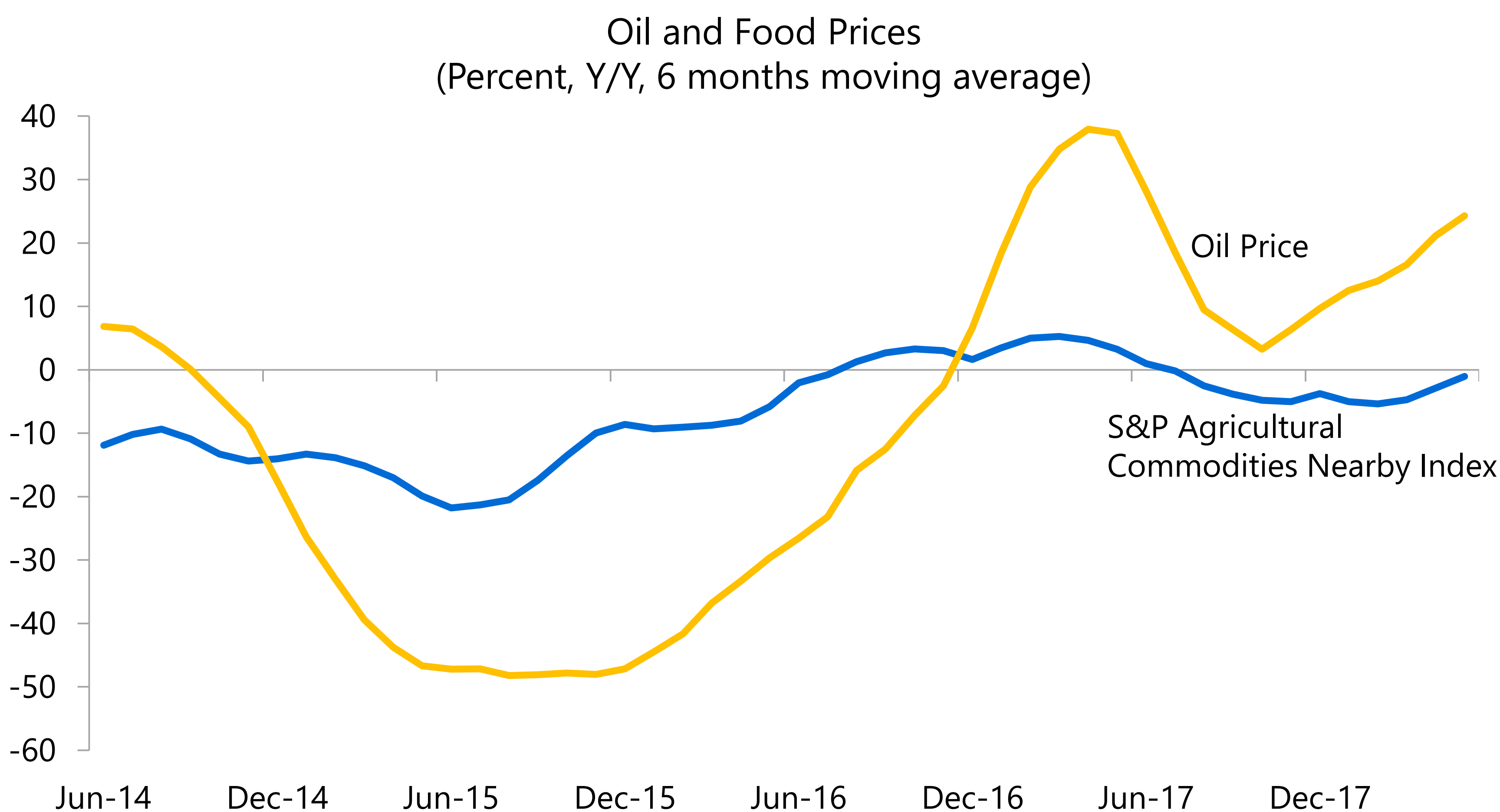




Inflation, which was very low in 2015-16 has picked up recently



Energy and food prices played key role in pick-up of inflation



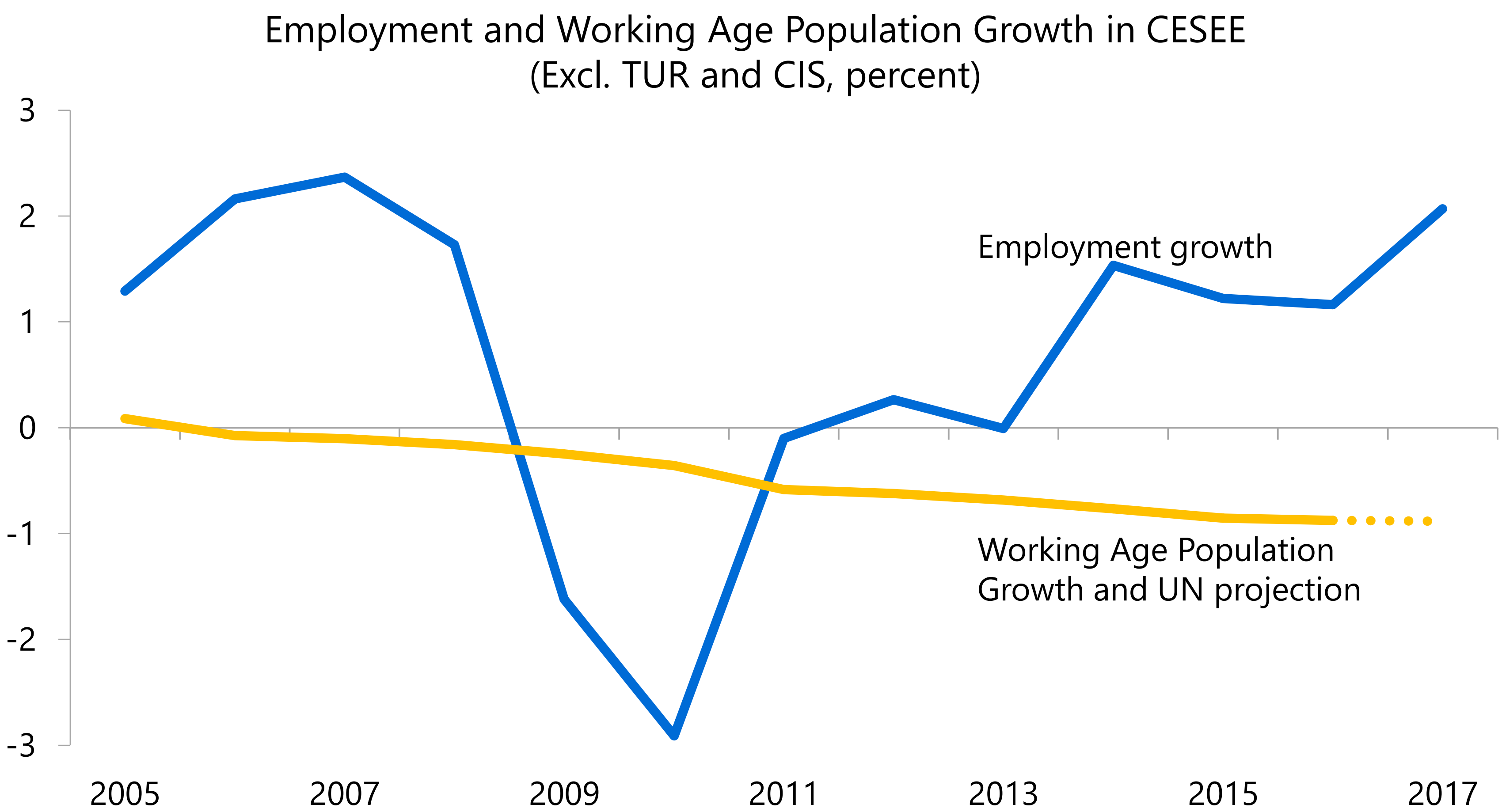
Growth in 2018 will continue to be strong

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

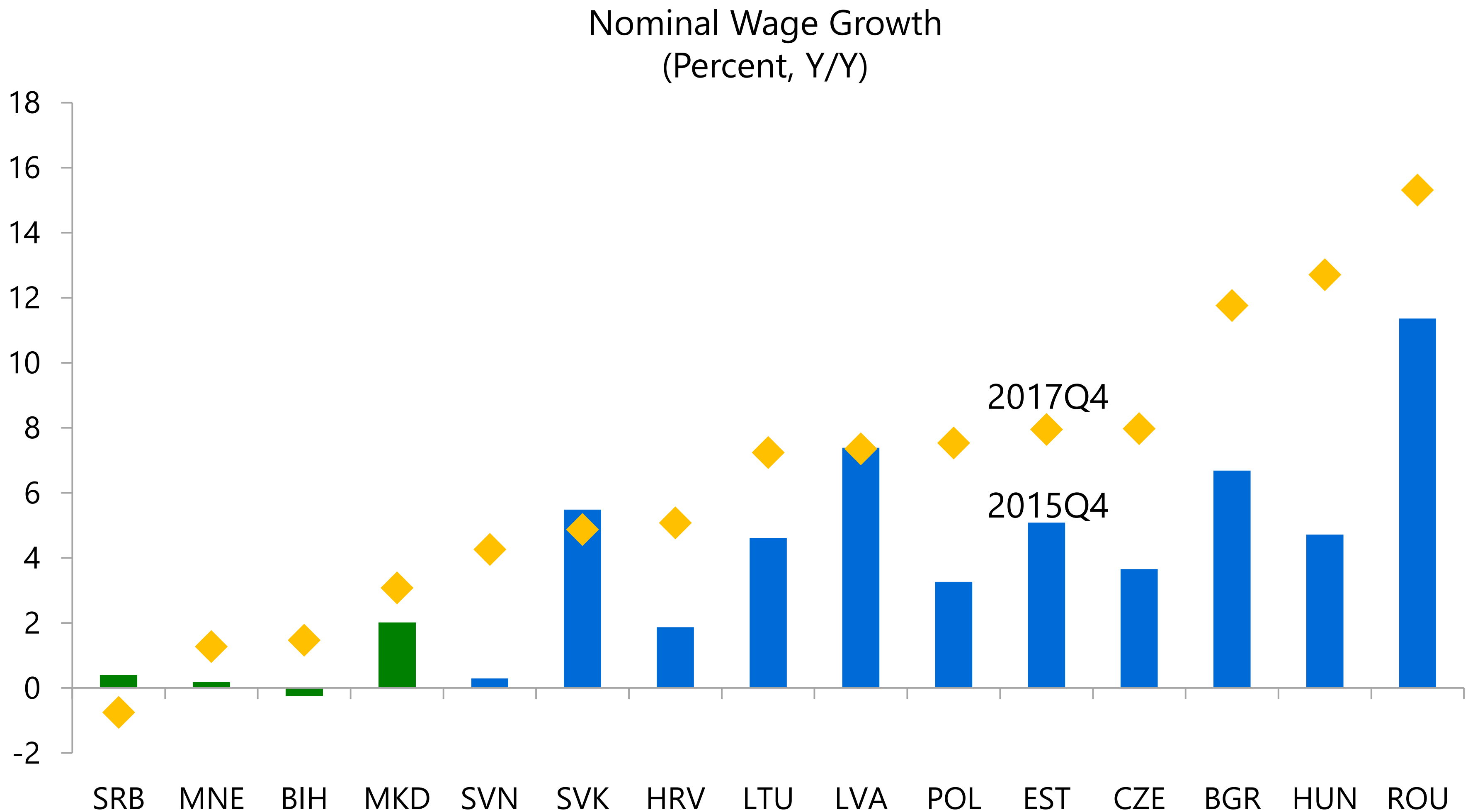
- Consumption is solid as employment is growing rapidly and wages are accelerating

- Investment further boosted by pick-up of EU funds

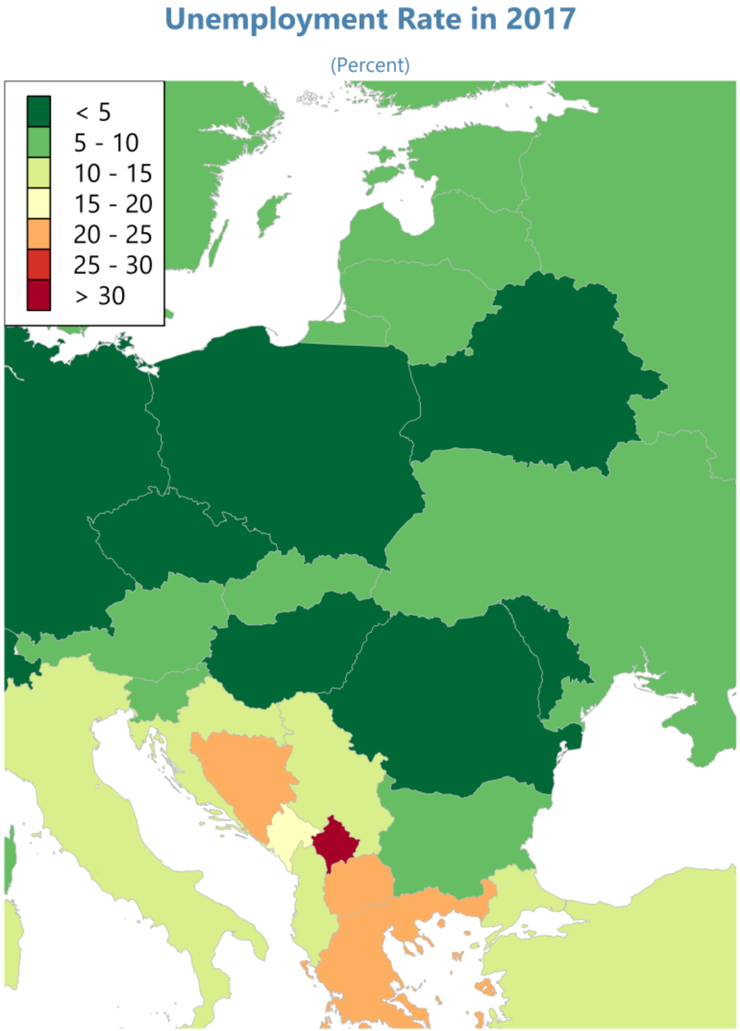
What will this imply for labor markets?

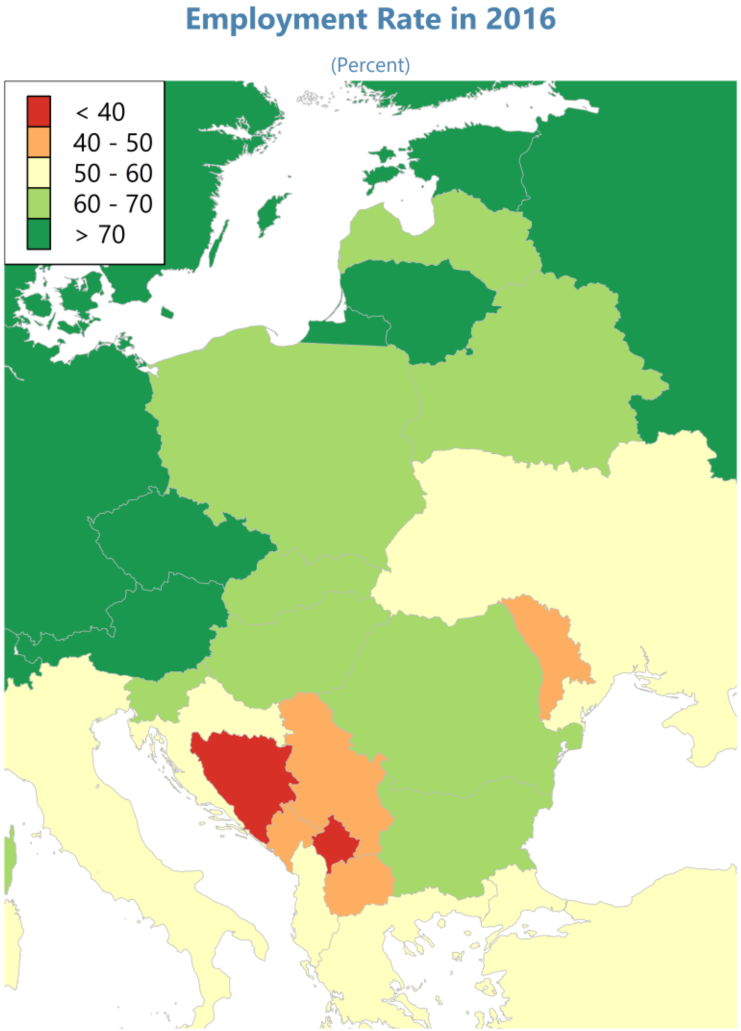


In the EU NMS wage growth has accelerated, while it has remained more modest in the Western Balkans



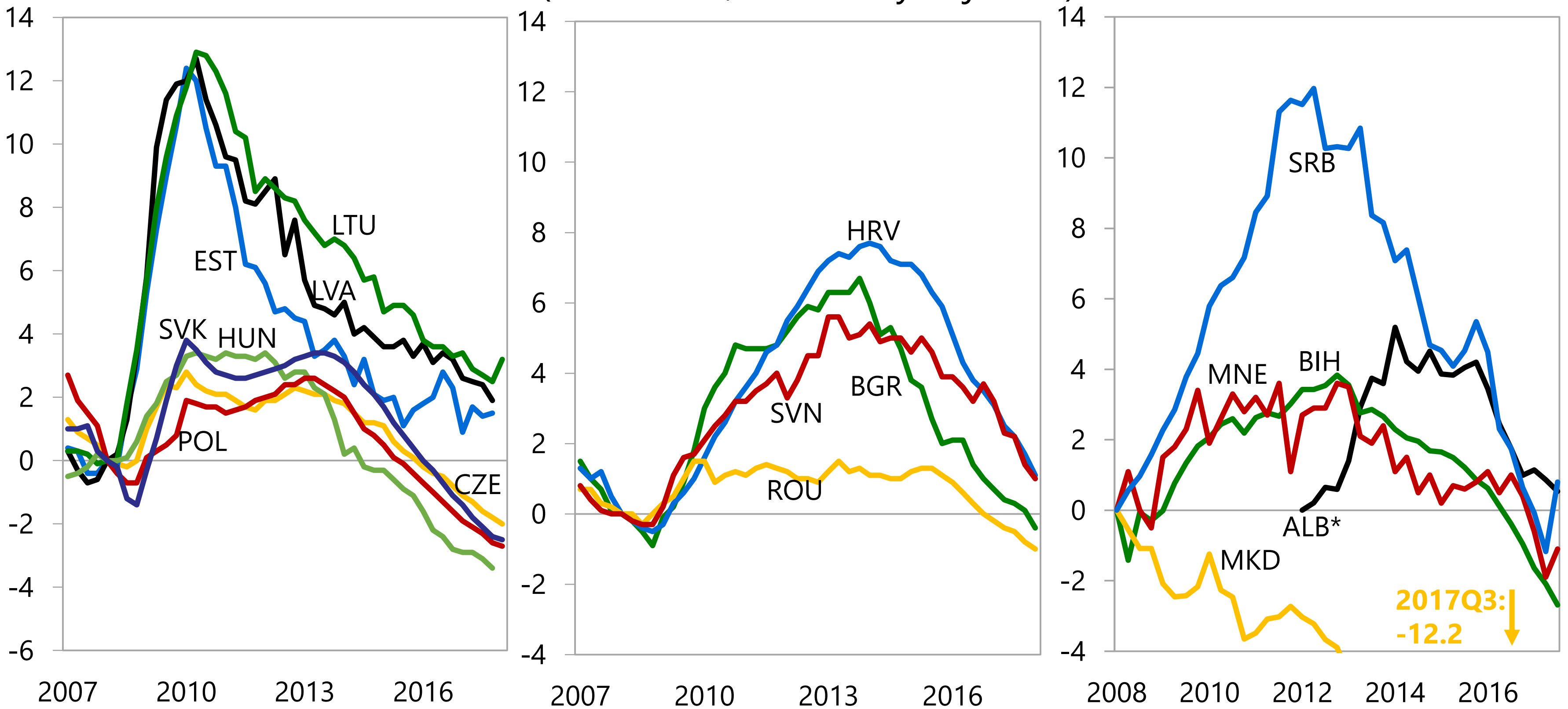
In Western Balkans unemployment rates are still very high and employment rates low





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

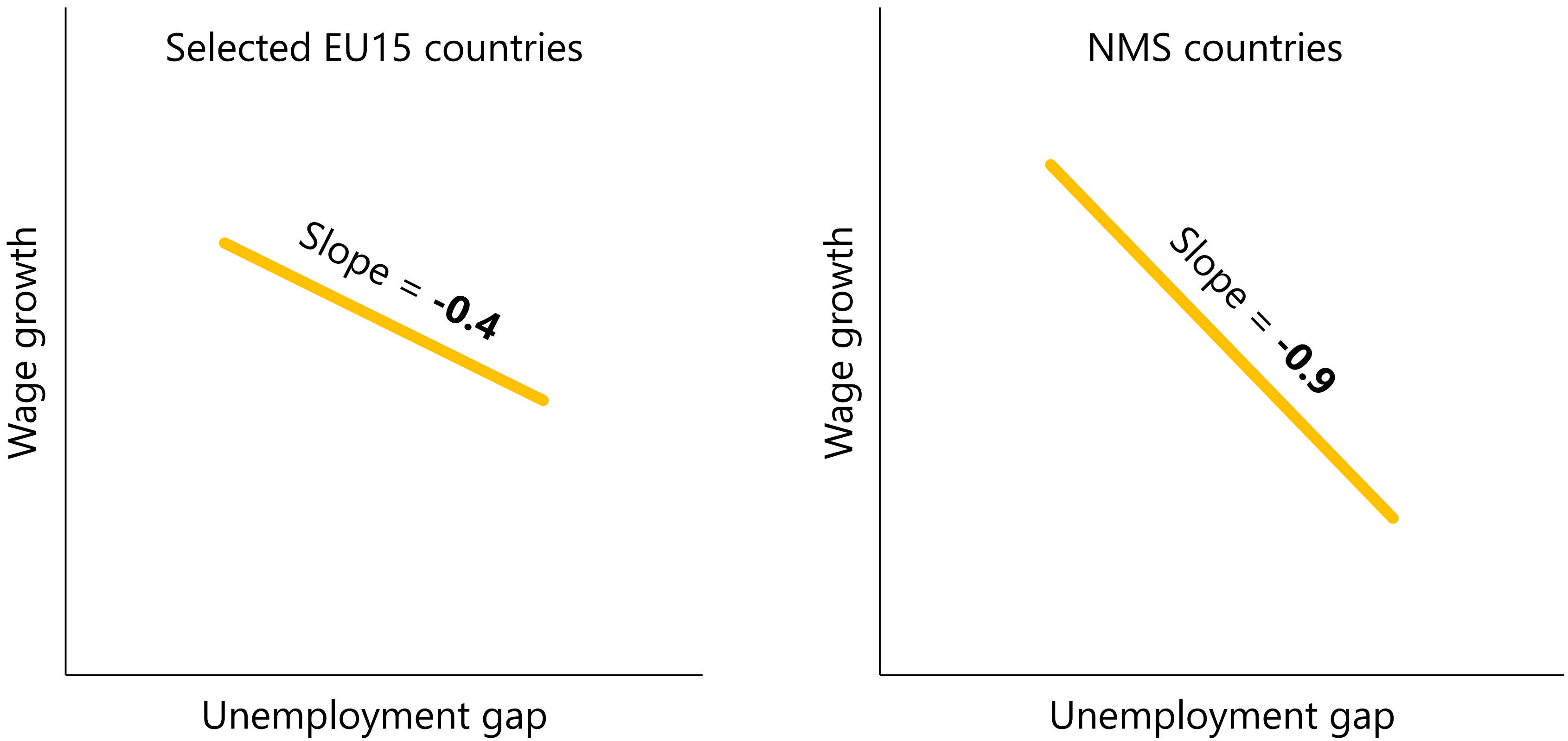
Cumulative Changes in Unemployment Rate
(2008Q1=0, seasonally adjusted)



*For ALB 2012Q1=0

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

Wage Phillips Curve
(based on panel regression)



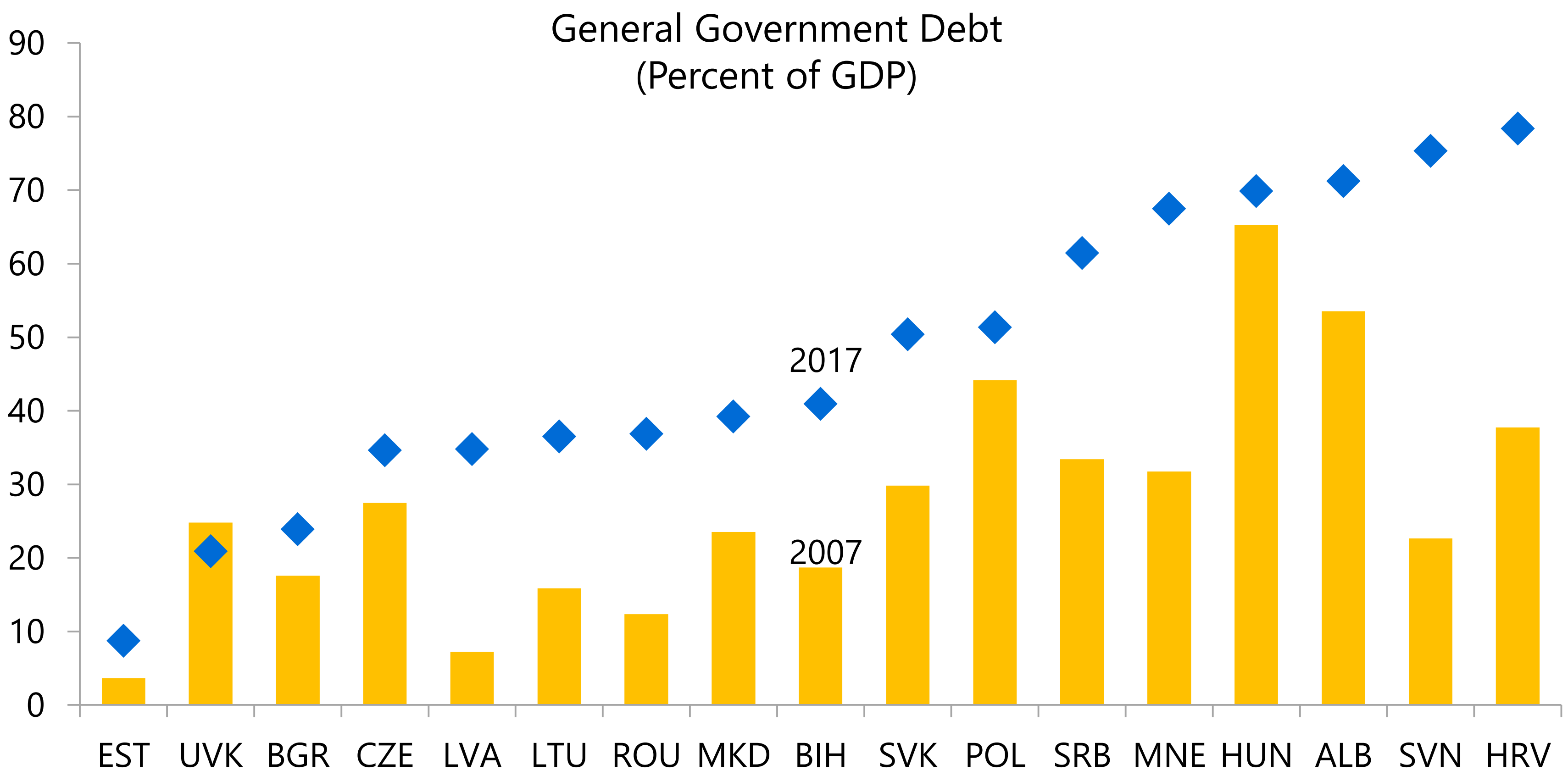
Source: Spring 2018 Regional Economic Outlook for Europe

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

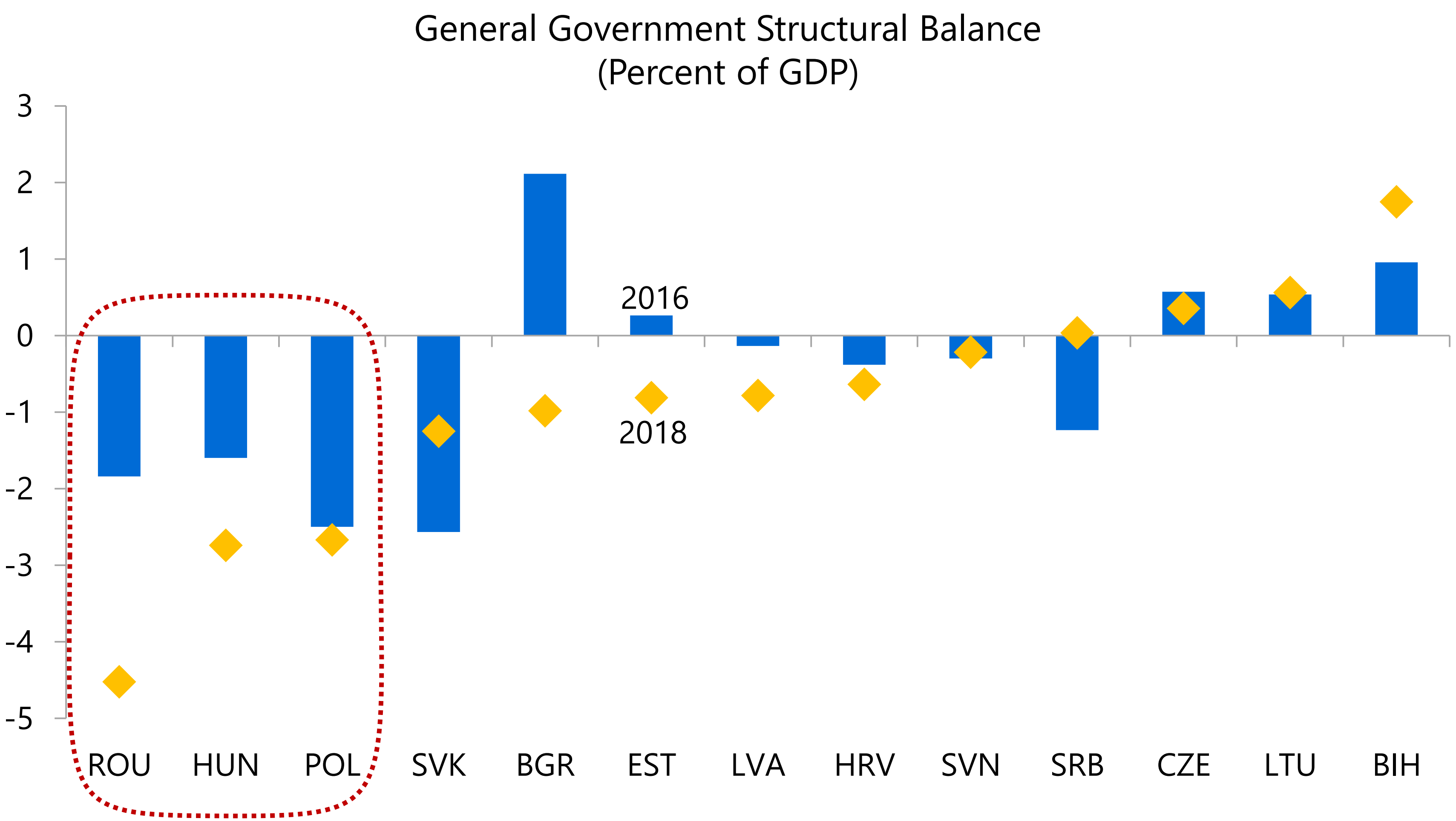
- At some stage, labor market shortages will become constraint on growth
- Growth can only continue at this pace if productivity picks up

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.



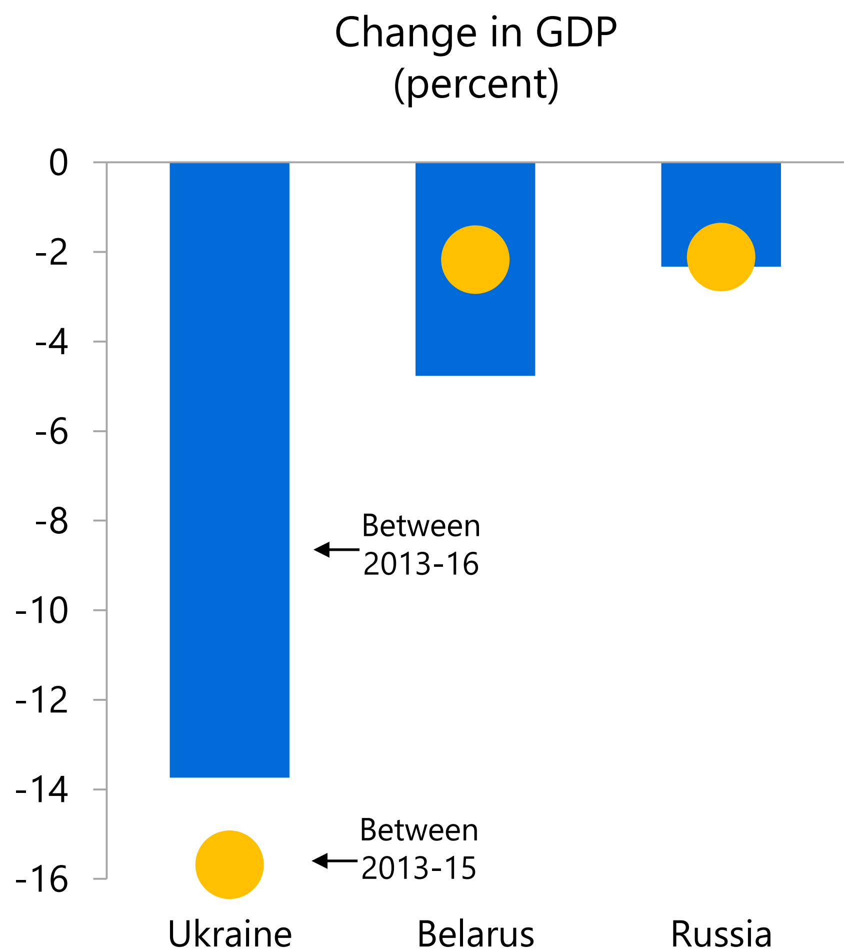
Unfortunately, many countries with too high structural deficits are reverting to pro-cyclical loosening



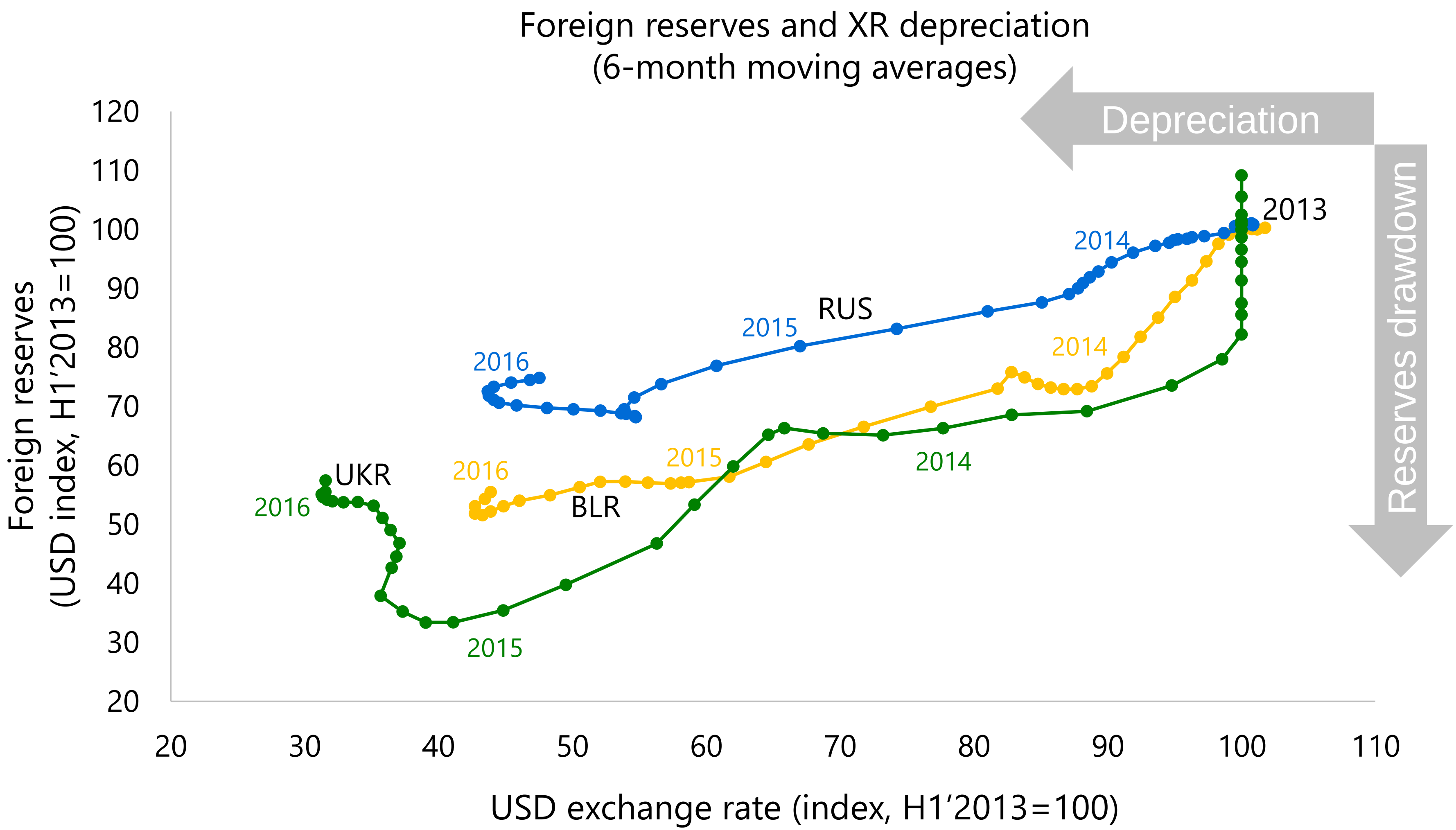
CIS

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

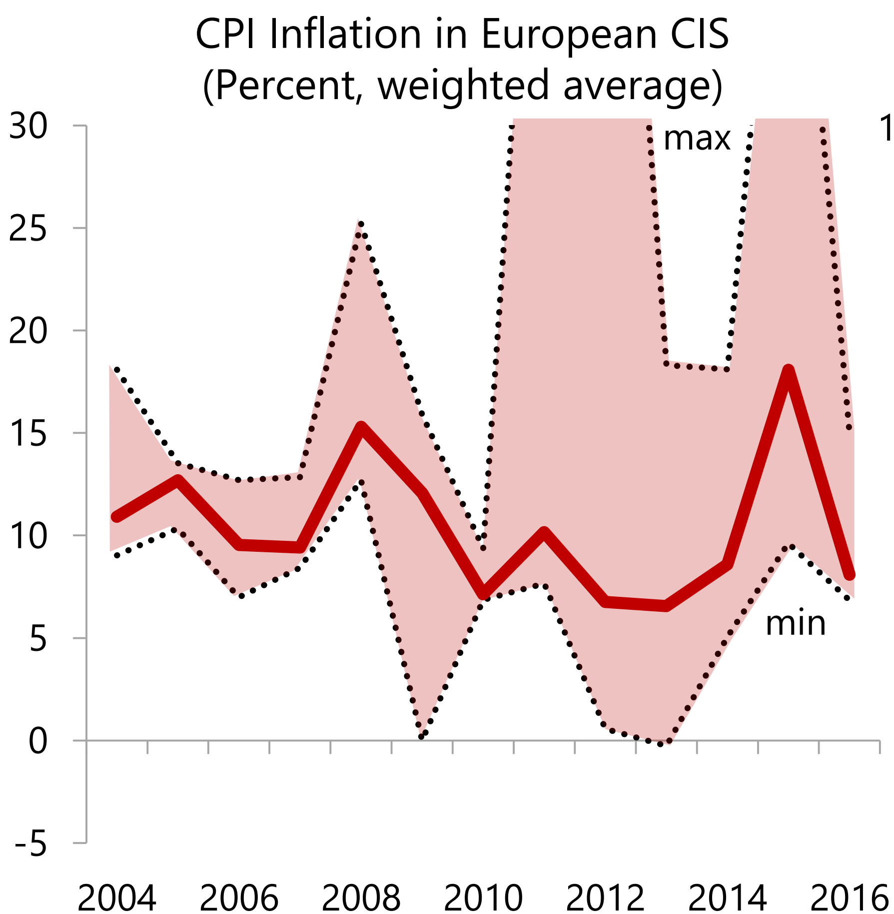
- Collapse of commodity prices
- Sudden stop in capital flows to Russia, result of sanctions on Russia
- Conflict in Ukraine

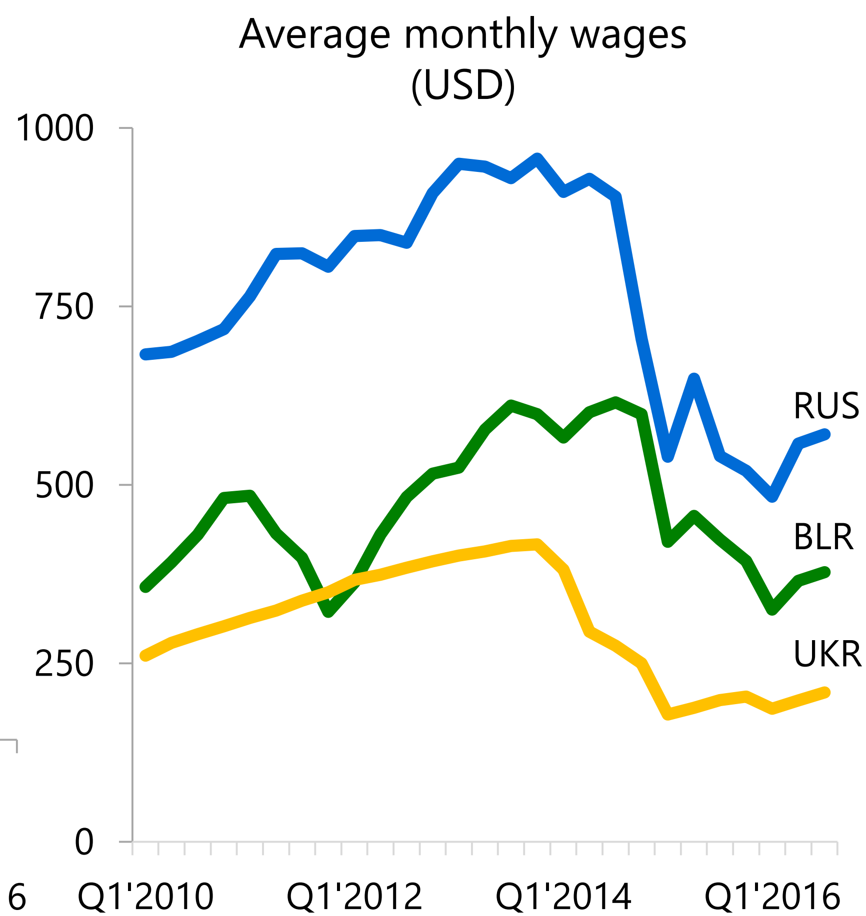


Exchange rate flexibility was unavoidable given the limited buffers…



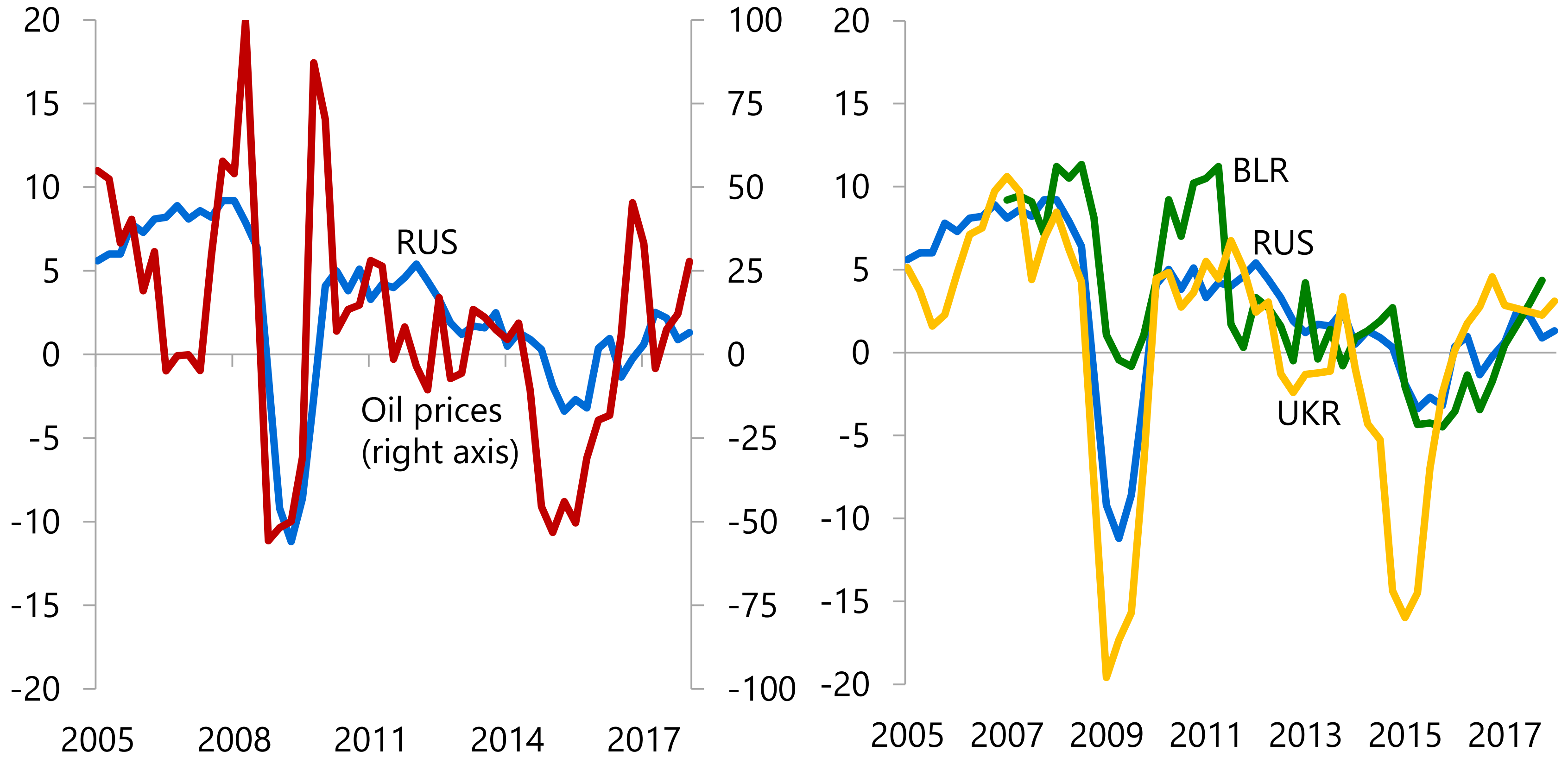
...but increased inflation and reduced real wages





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

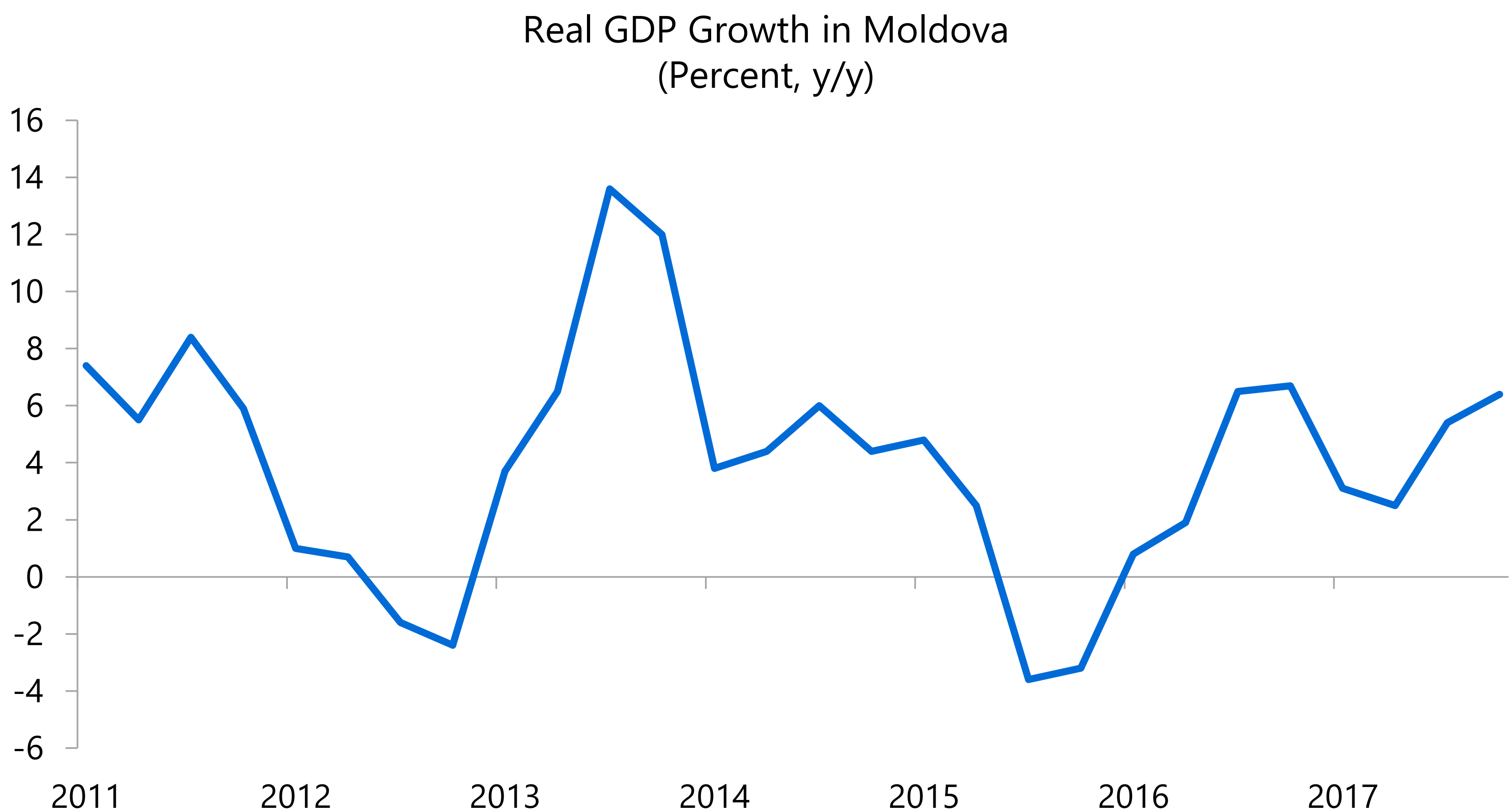
Real GDP growth in Russia, other CIS countries and changes in oil prices
(Percent, y/y)



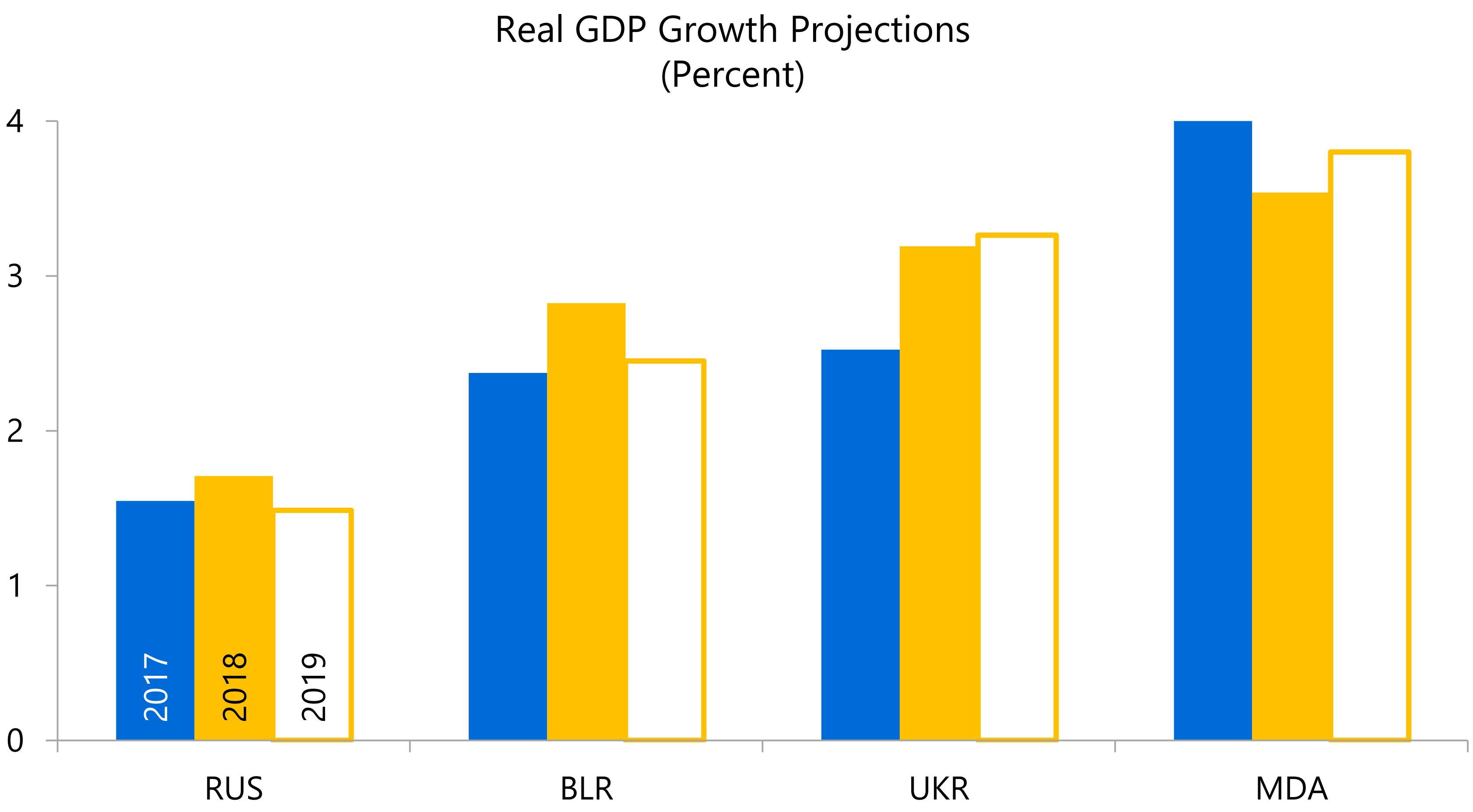
Moldova had a banking crisis in 2014

- 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

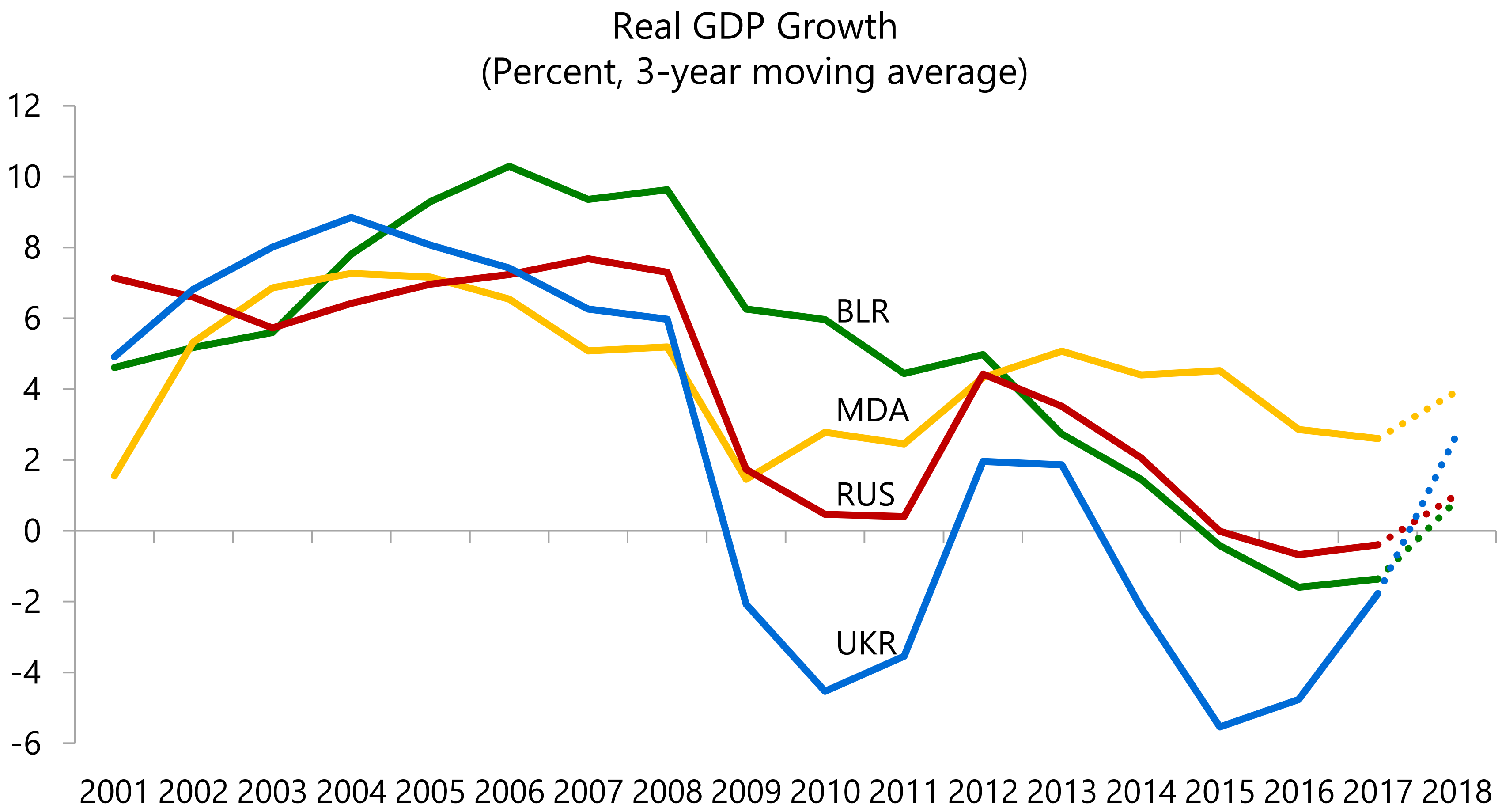
But is now also recovering



Near-term prospects show solid growth



But growth is low in comparison to pre-crisis period



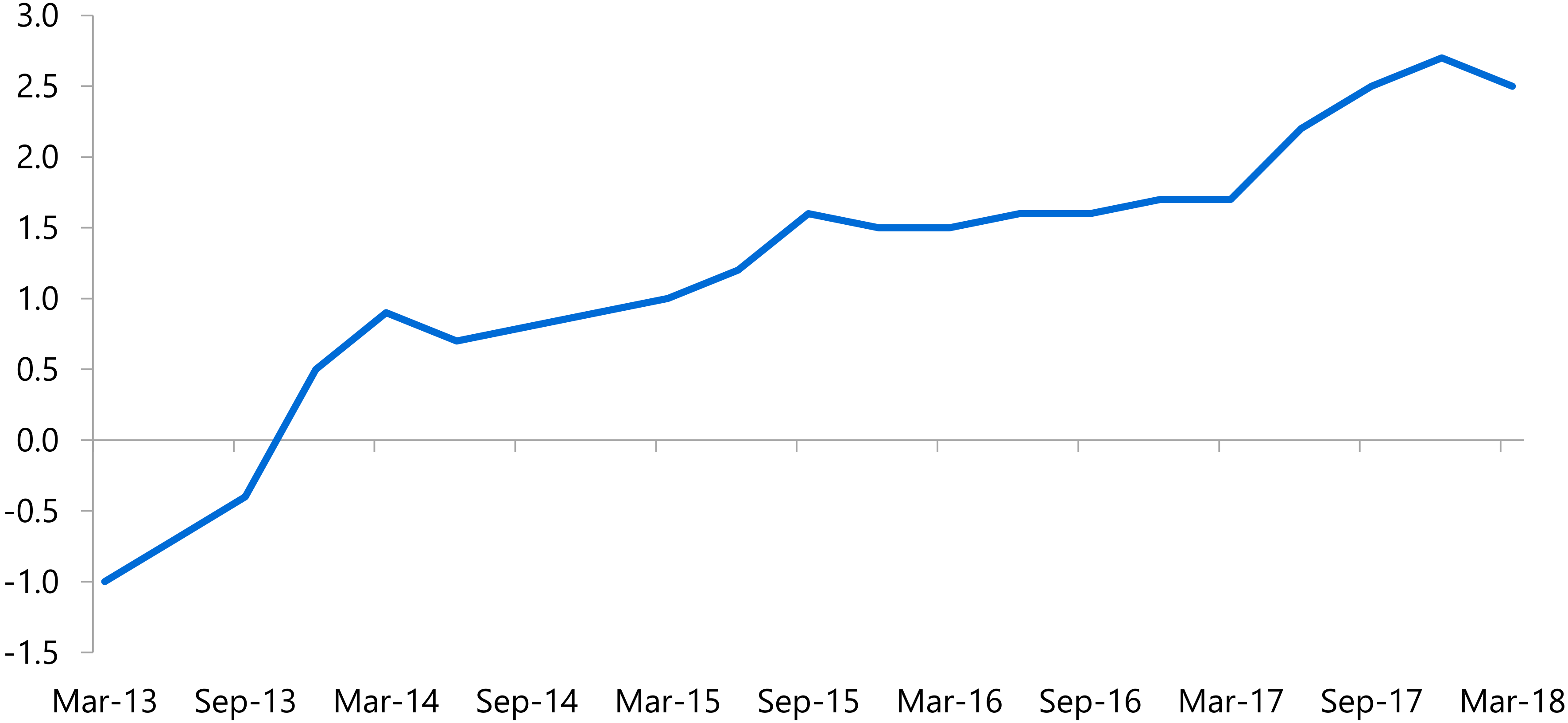
RISKS TO THE OUTLOOK

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

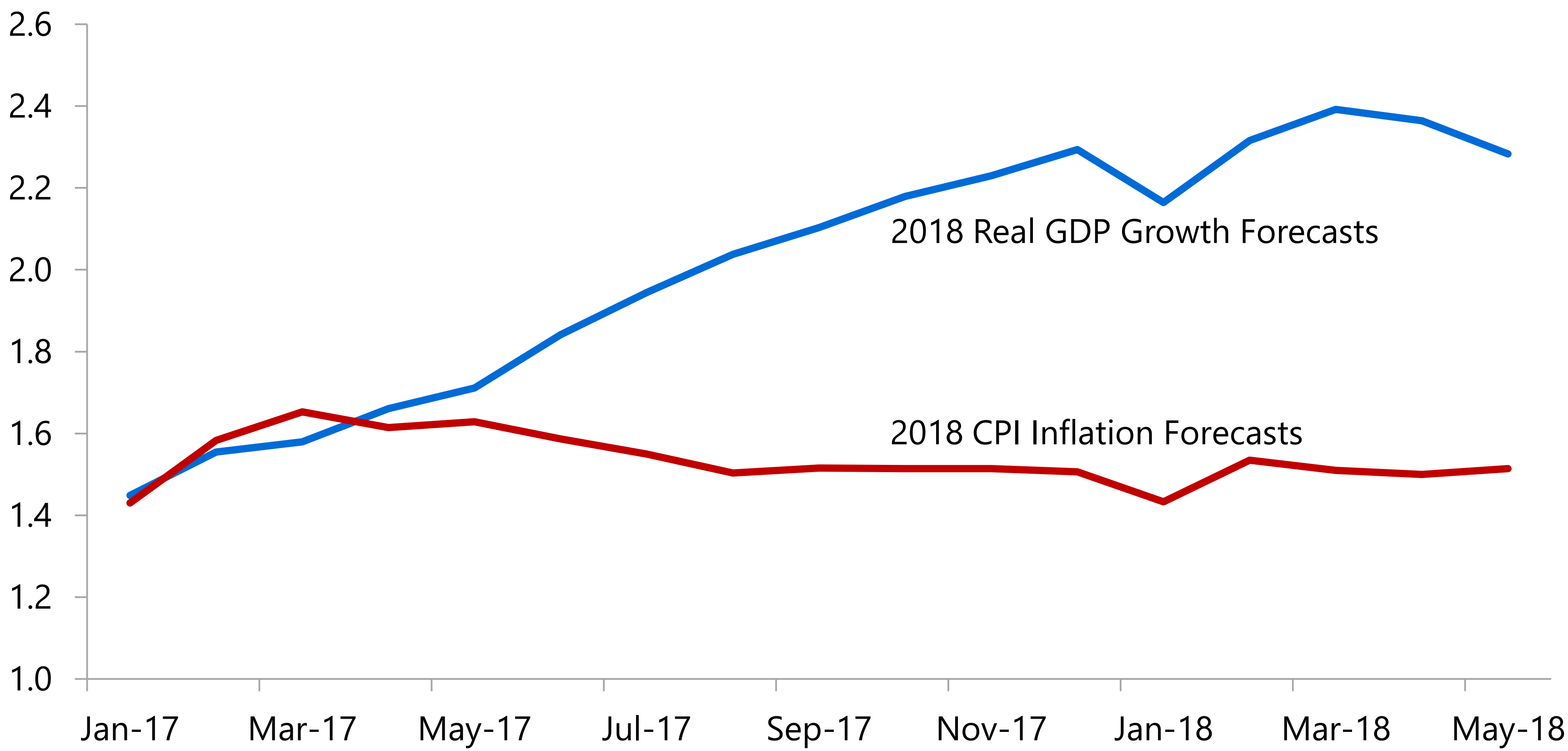
Since the WEO was published, growth in the EA in Q1 came in lower than expected

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



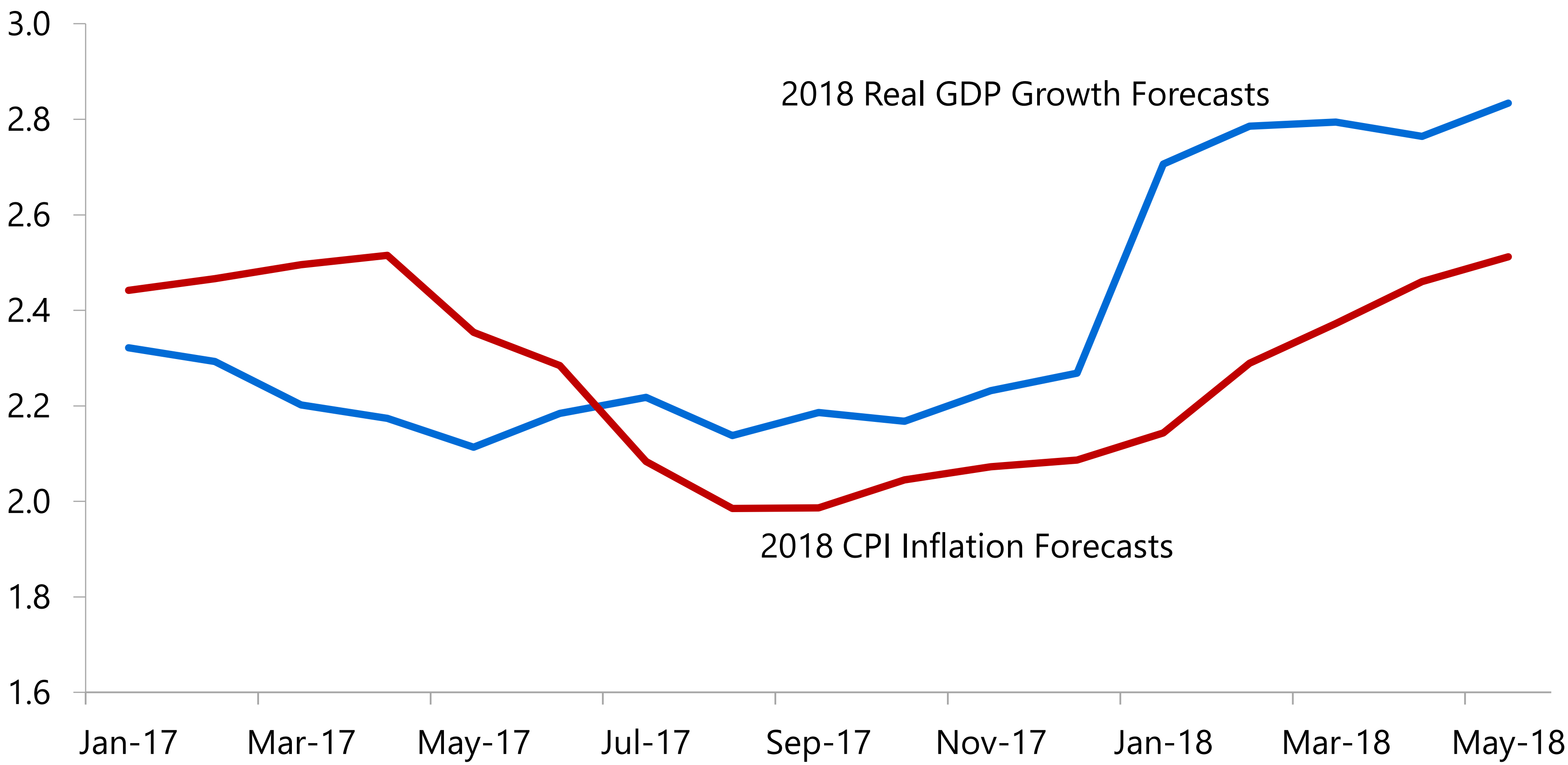
So far, consensus forecast for this year has not changed much

Consensus Forecasts of Real GDP and CPI Inflation for Euro Area

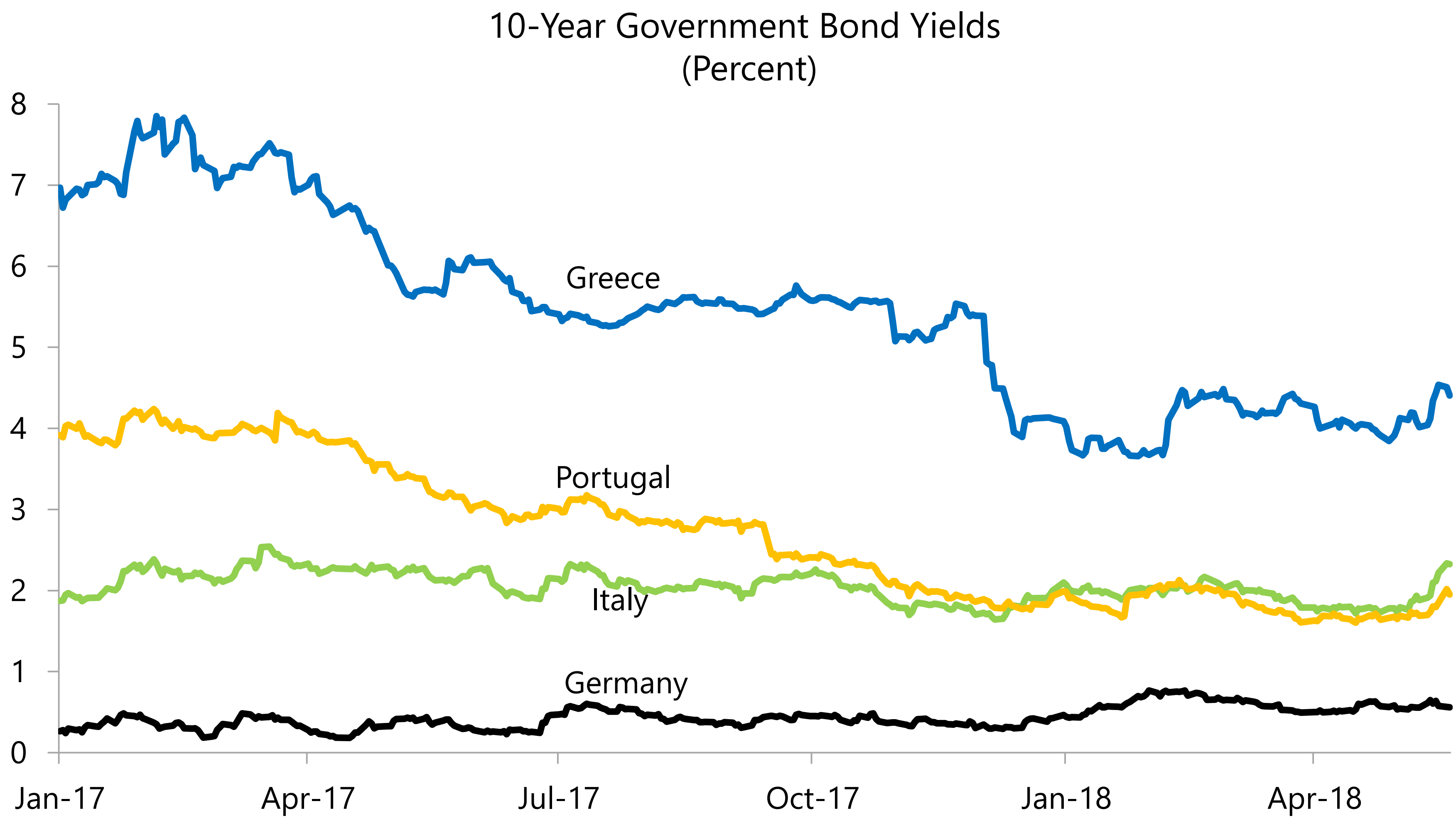


For the USA, forecasts of growth and inflation have been increasing

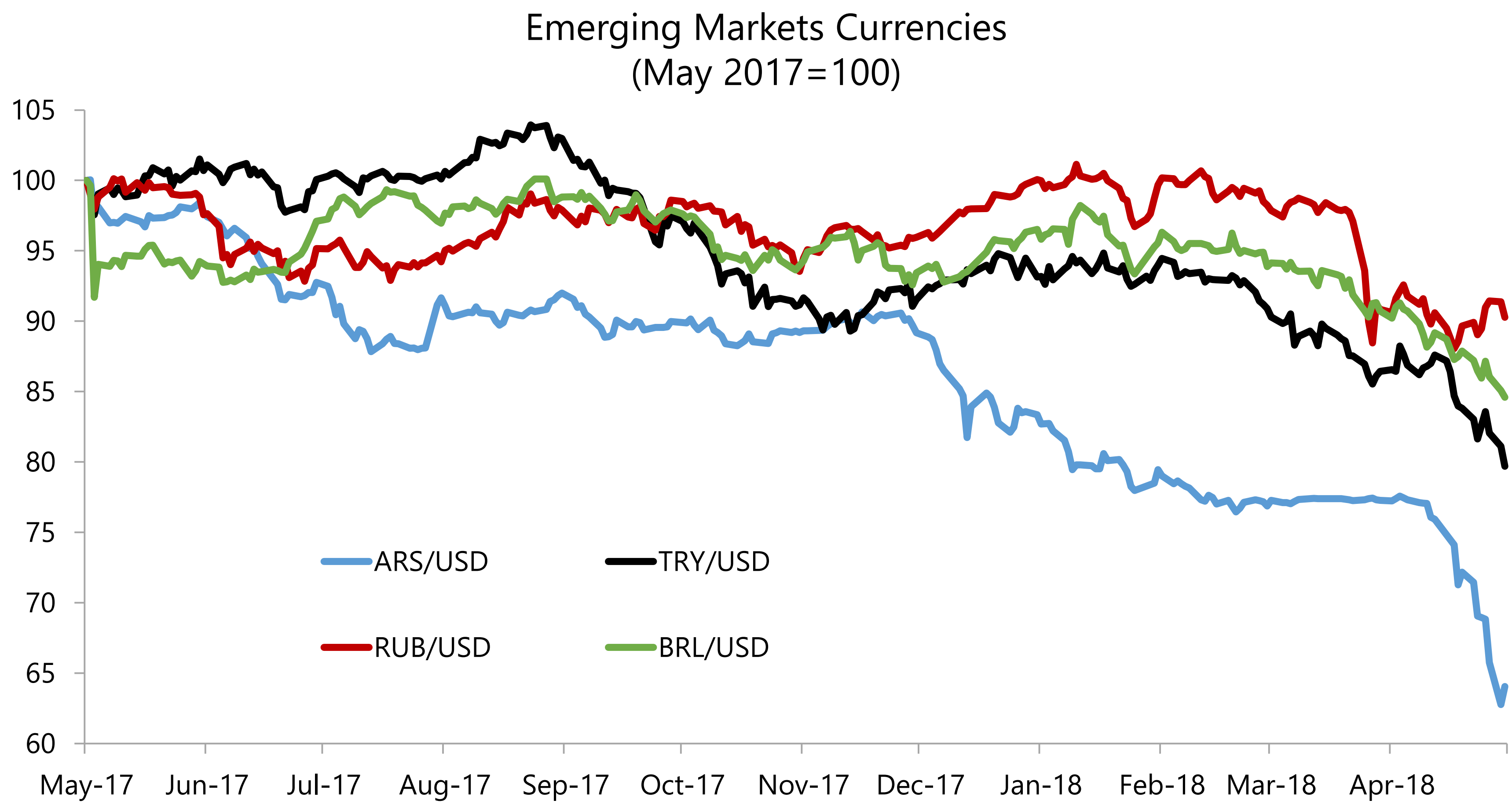
Consensus Forecasts of Real GDP and CPI Inflation for USA



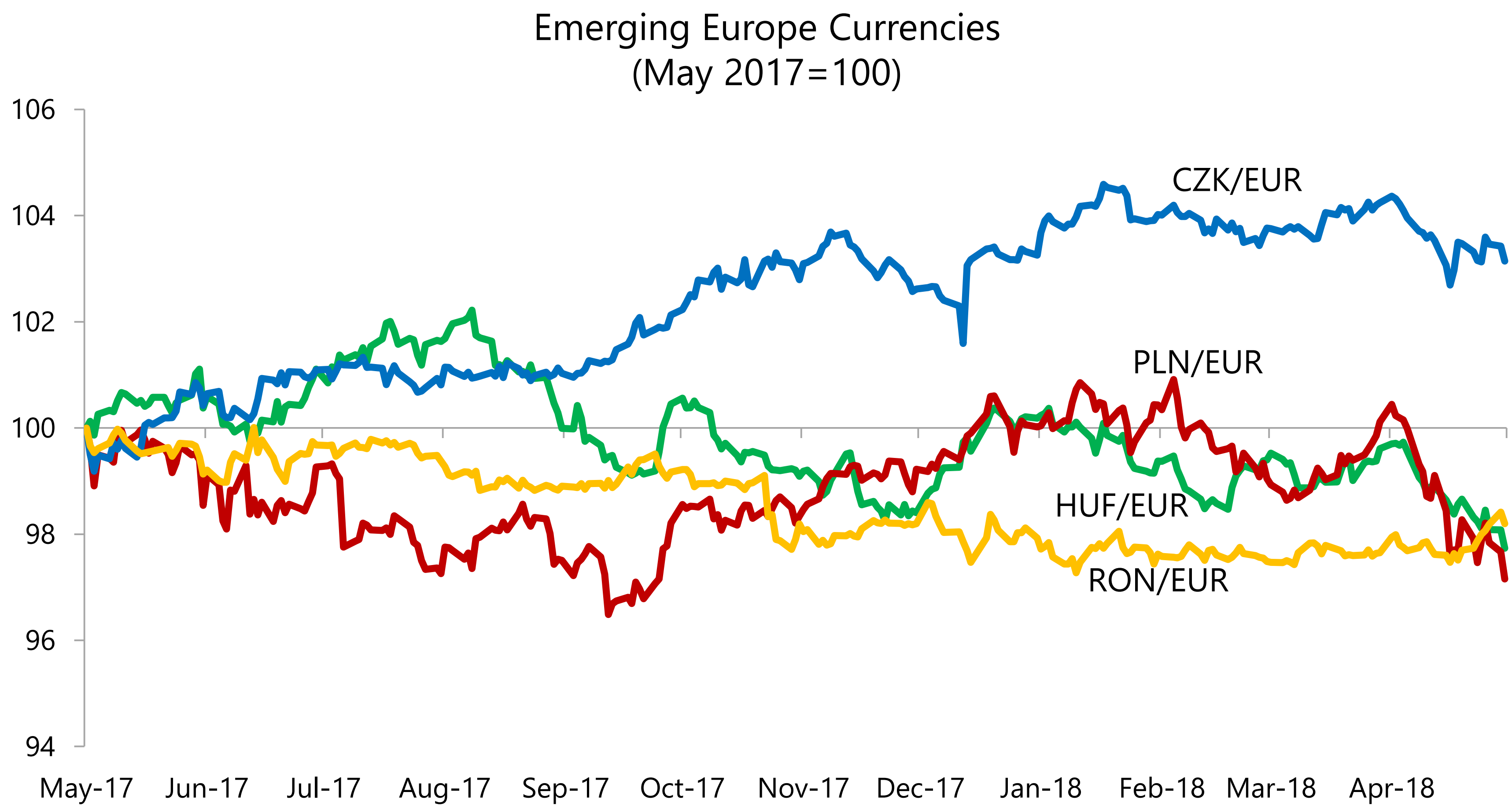
With a new government in Italy, interest rates in euro area periphery have been rising



Currencies of large EM have been under pressure

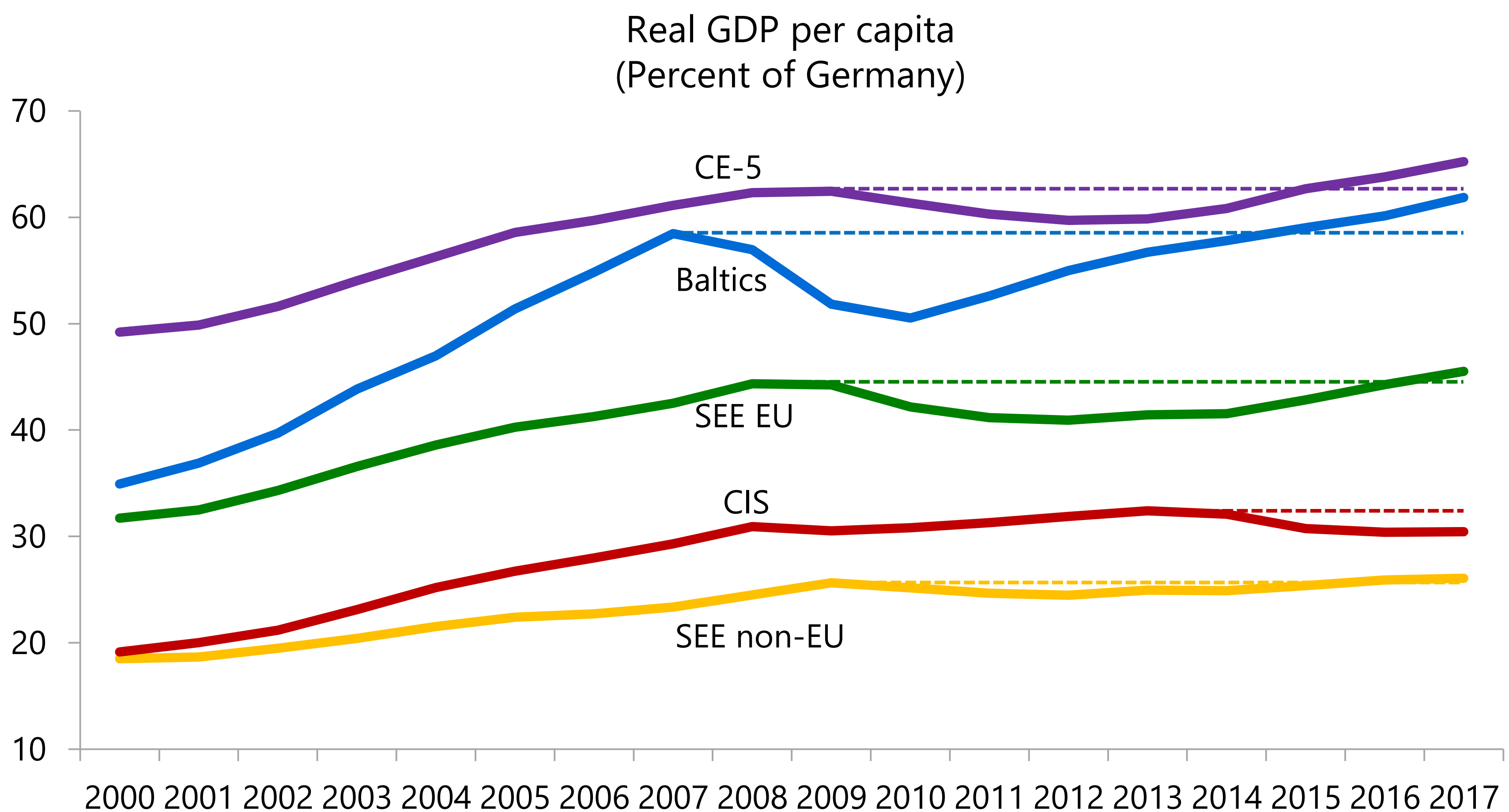


Outside Russia and Turkey, currencies in CESEE have remained stable

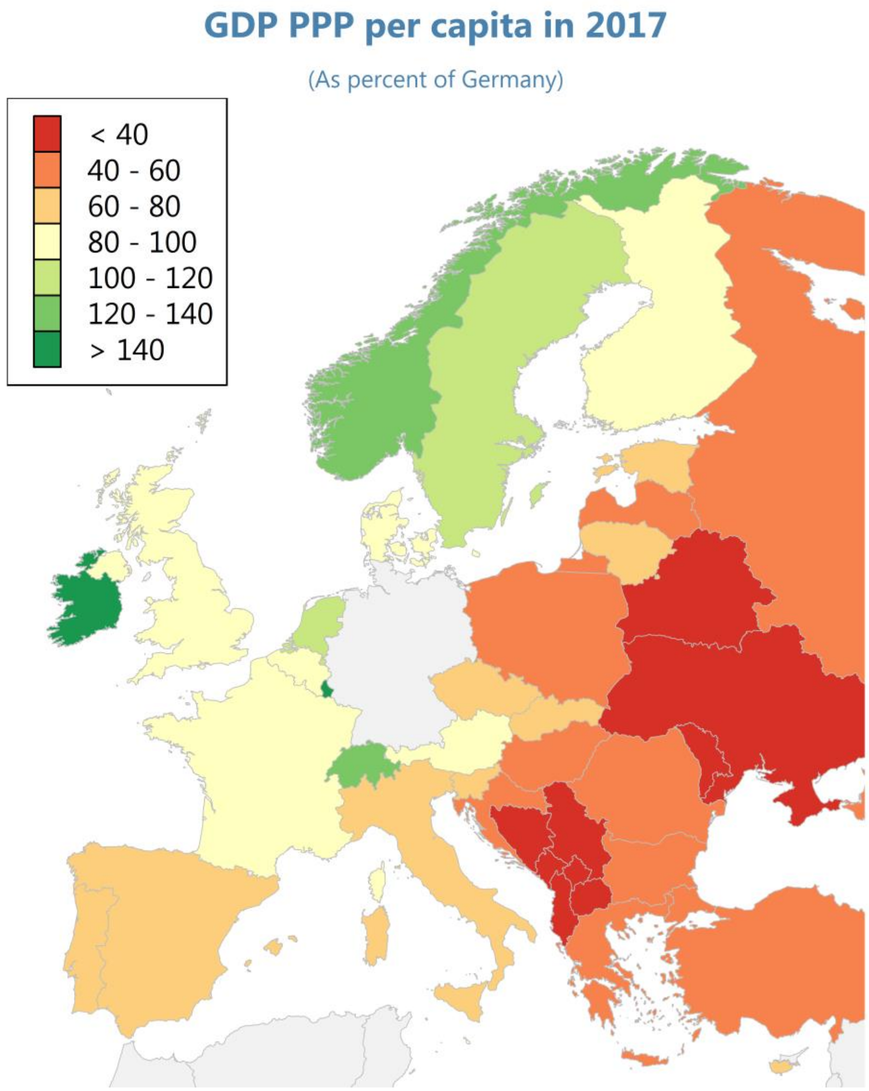


THE FUTURE OF CONVERGENCE

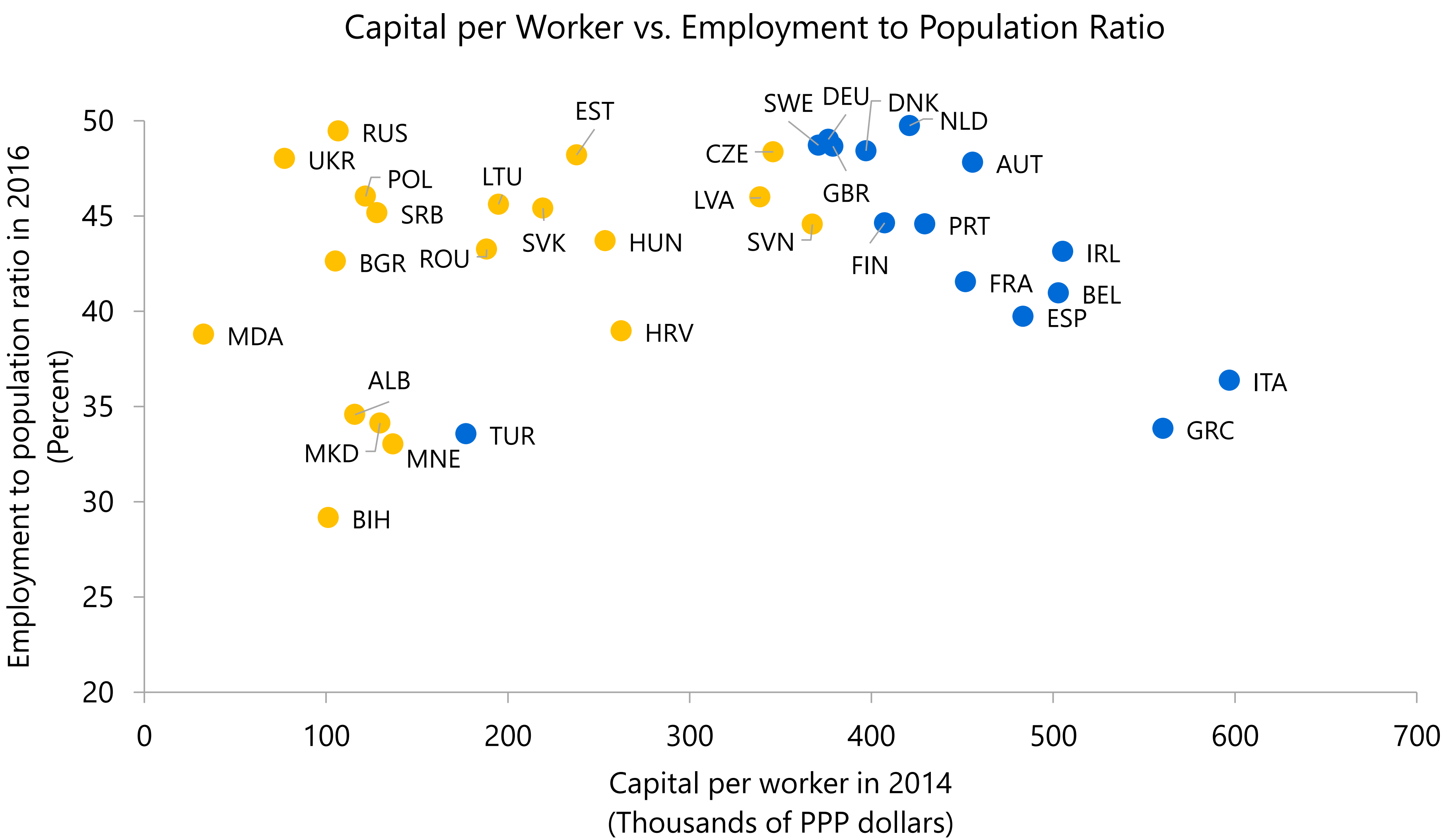
Convergence has resumed (except in CIS)



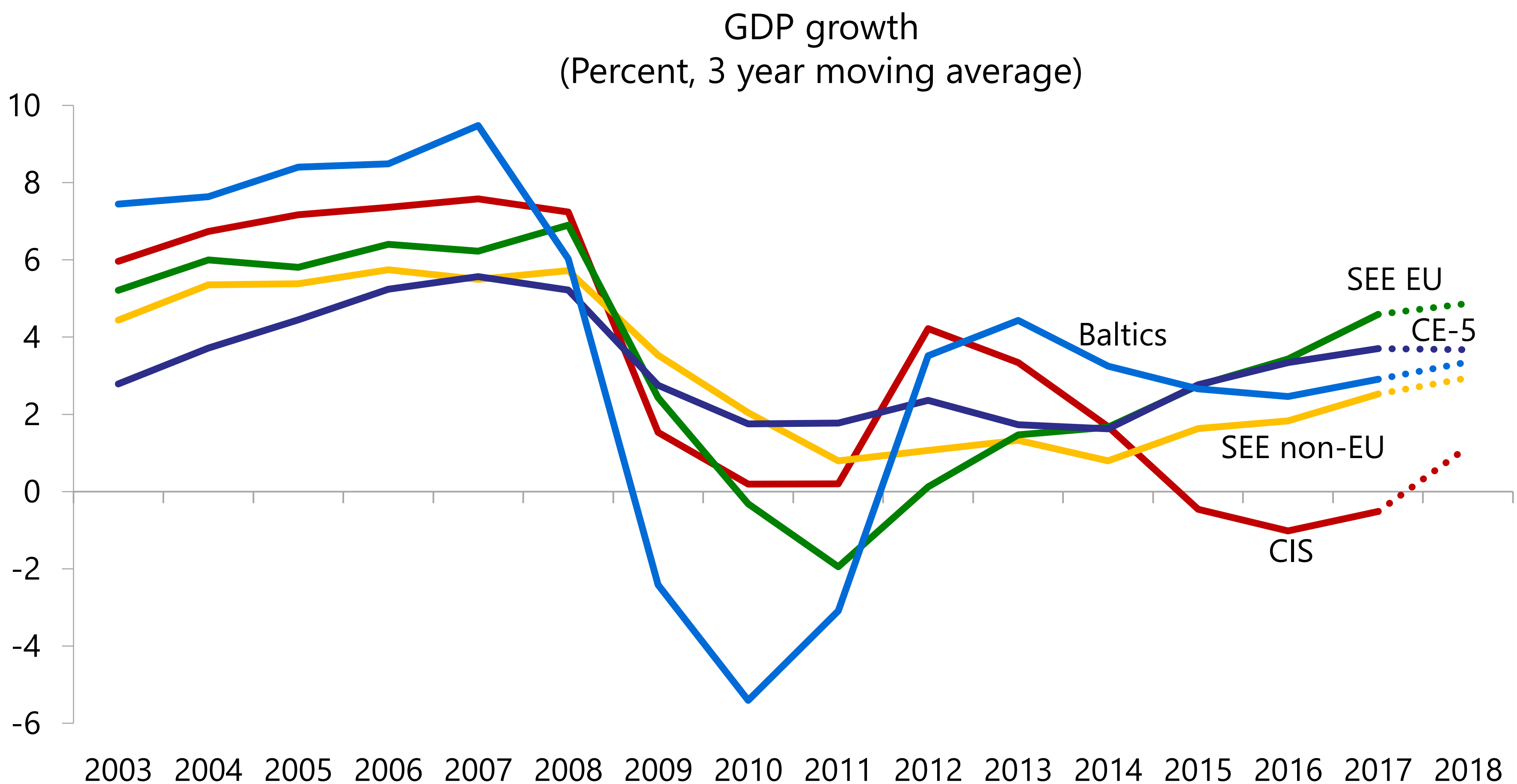
But CESEE is still much poorer than Western Europe



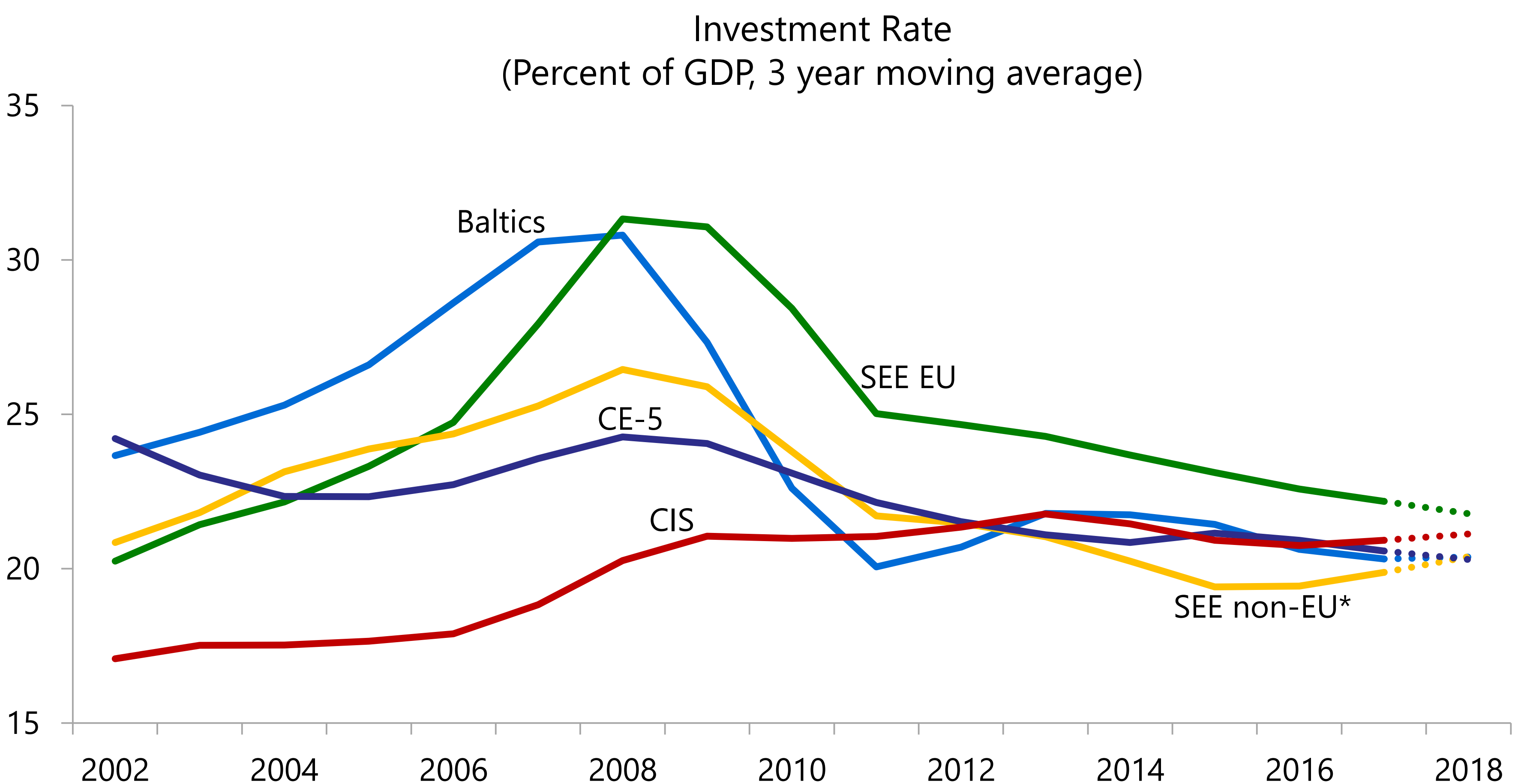
As fewer people work and there is less capital per worker



Growth is slower than pre-crisis…

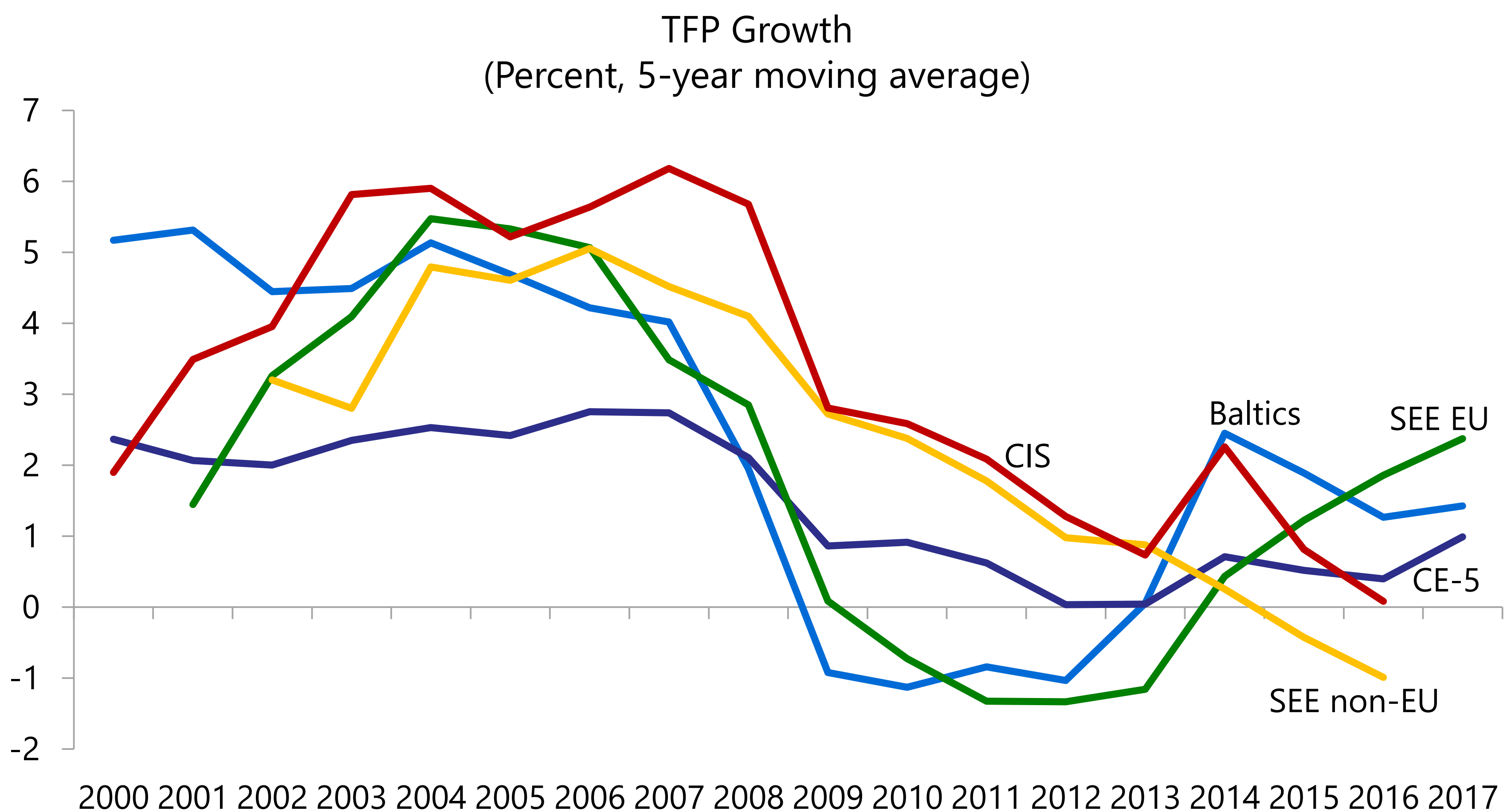


As investment rates are lower (except CIS)

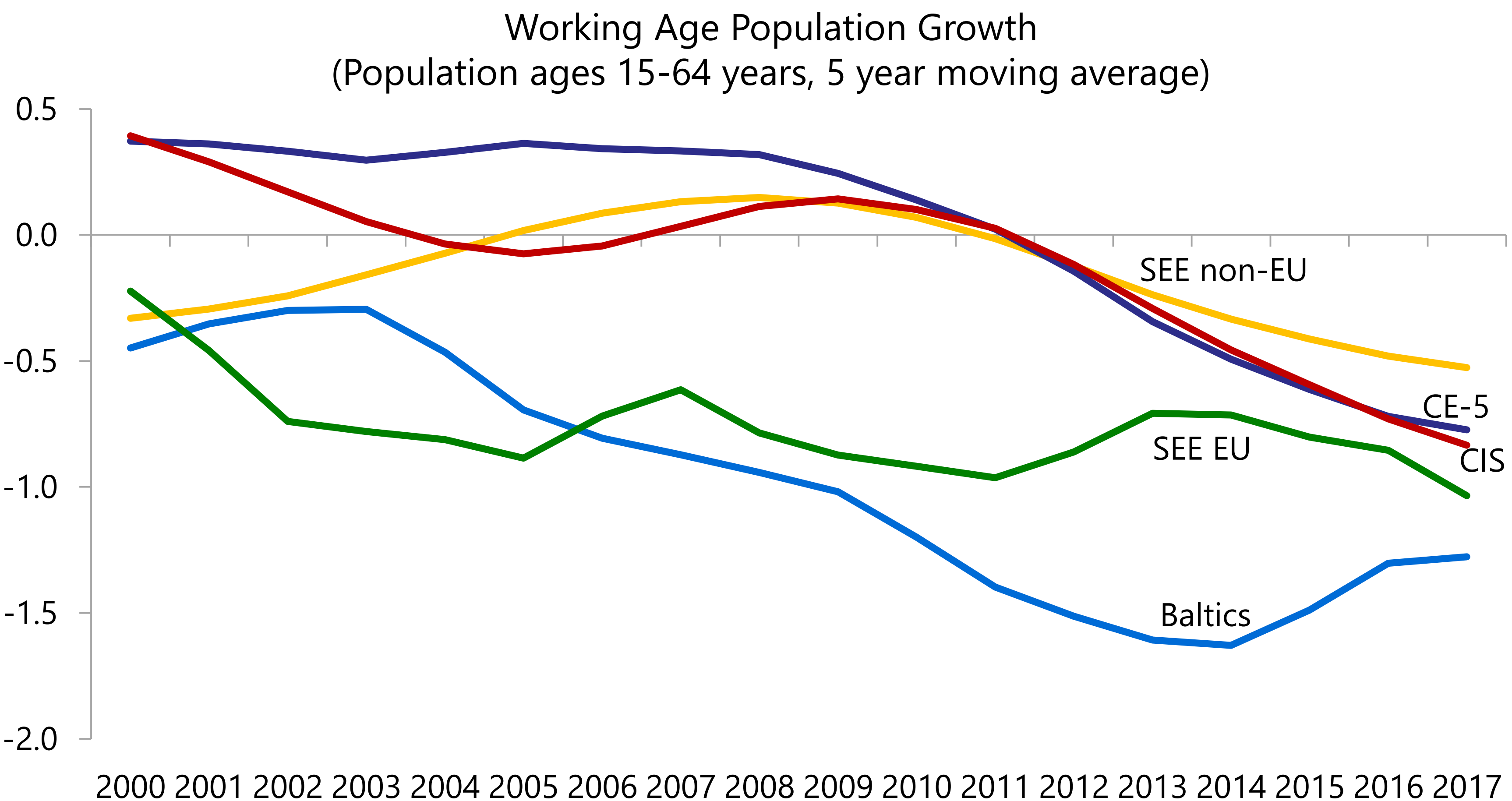


*Excl. MKD

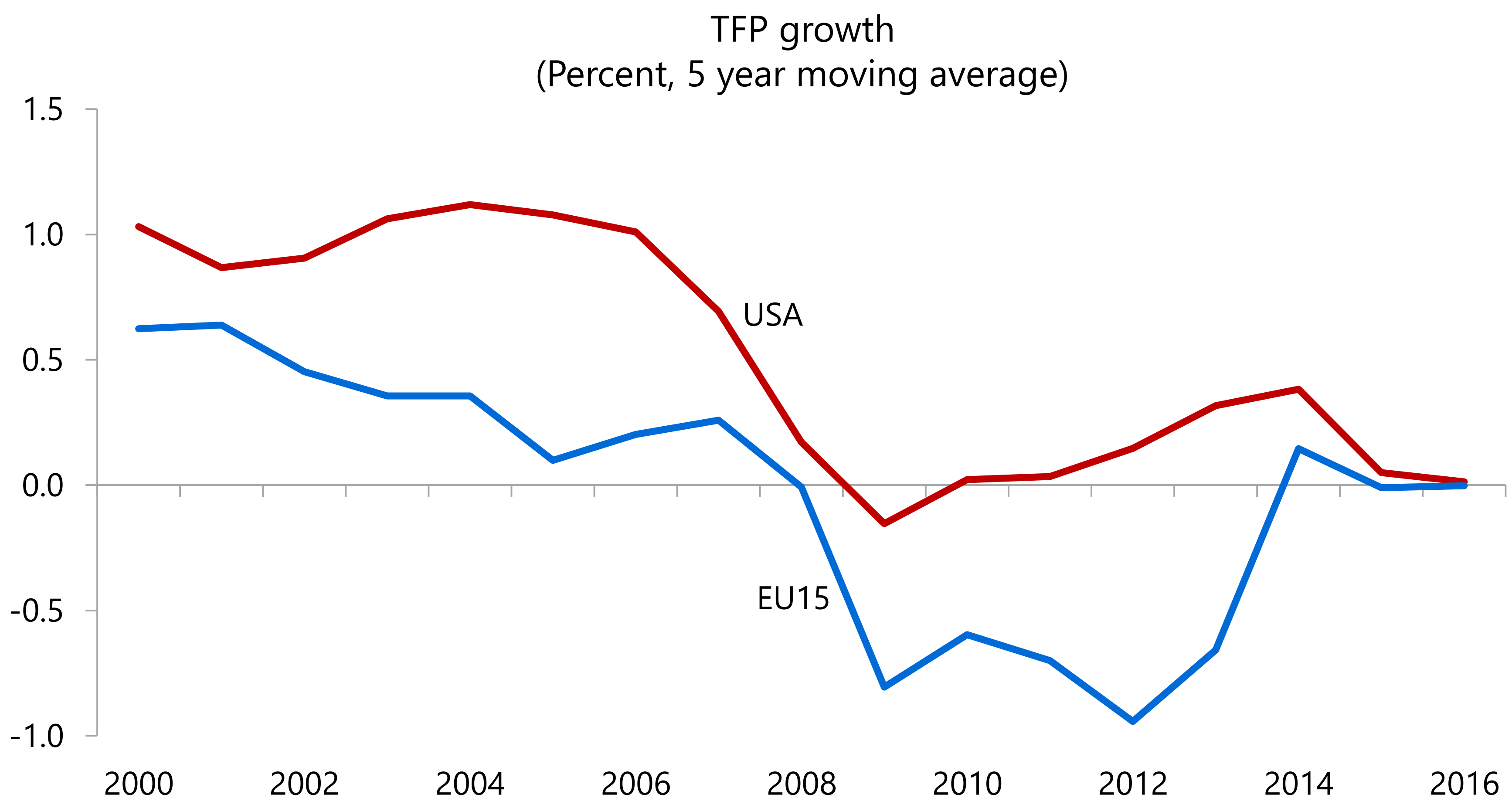
Technological progress and efficiency advance much more slowly



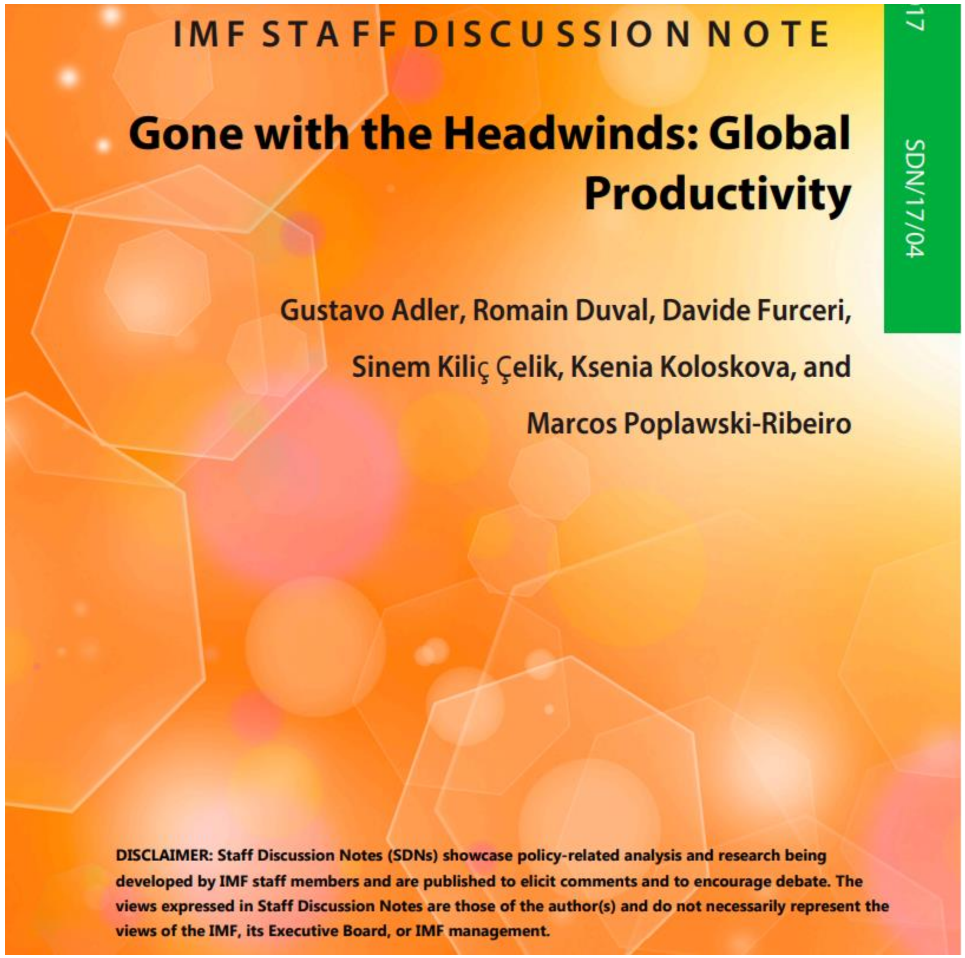
Further exacerbated by the decline of the working age population



Fall in TFP is a global problem



Why has global TFP growth slowed?



IMF STAFF DISCUSSION NOTE

SDN/17/04

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

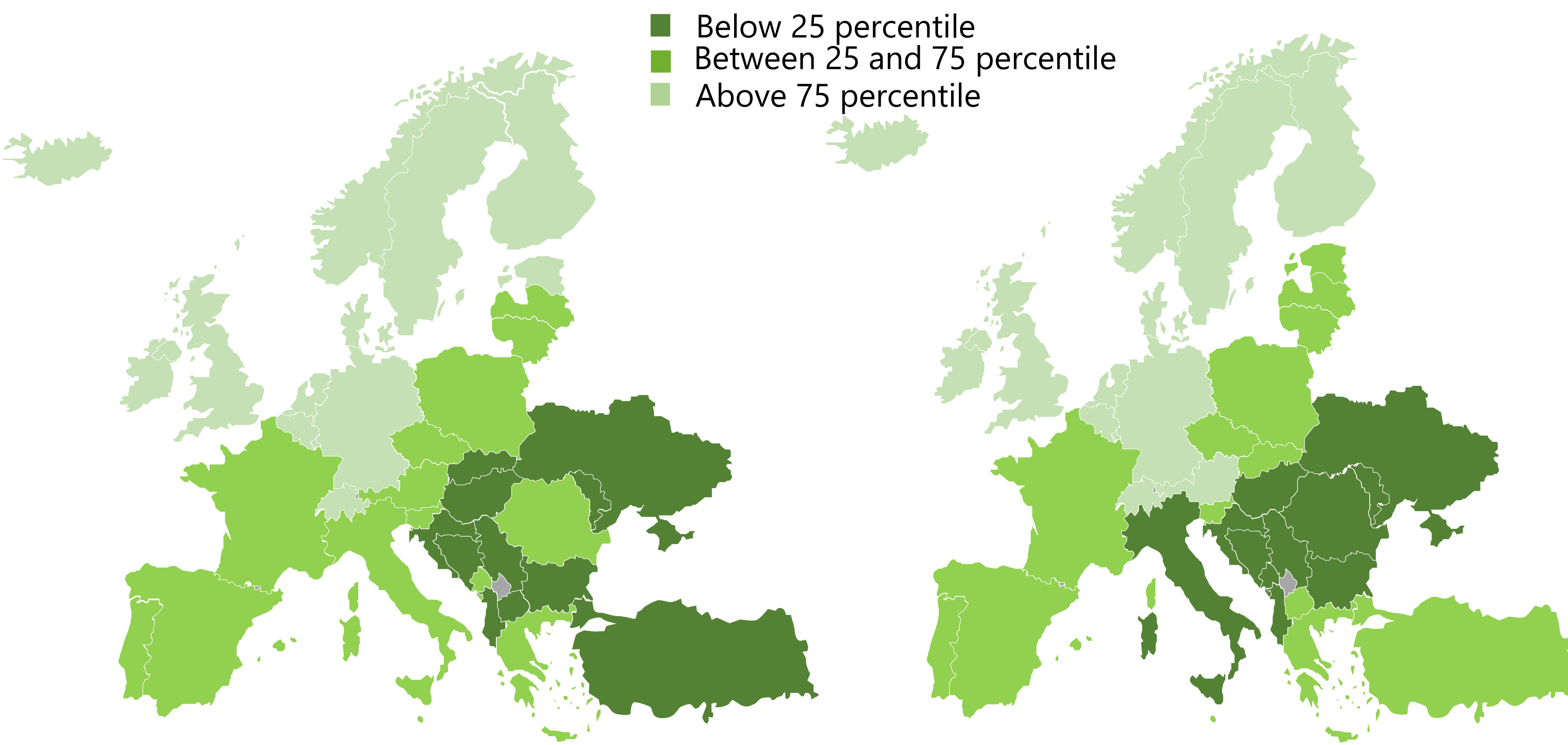
Address several problems

- 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

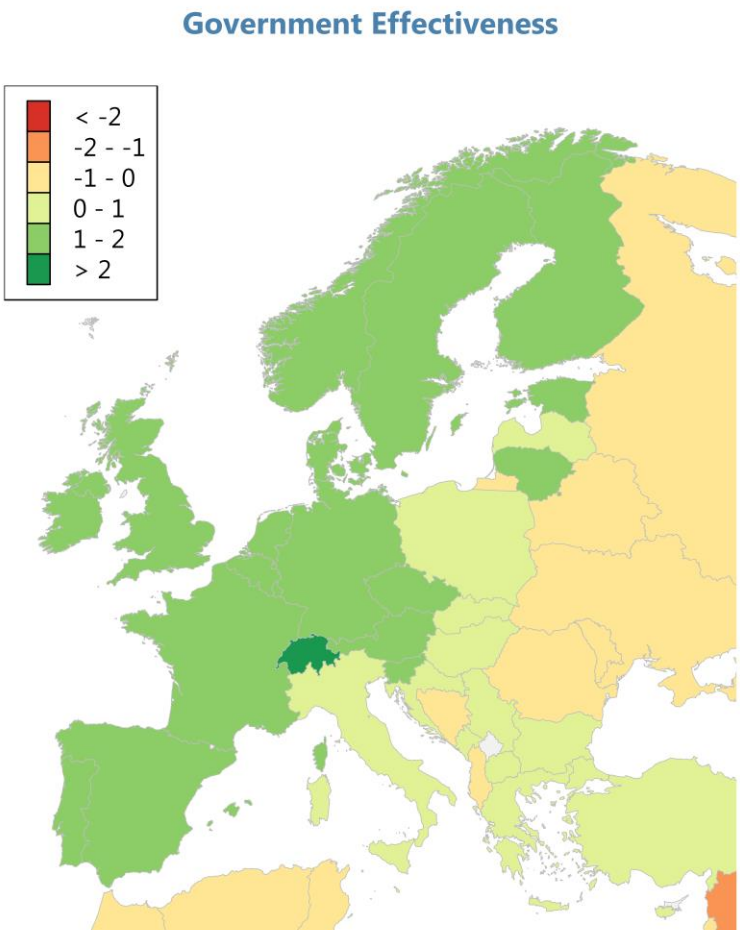
Impartial Courts, 2015

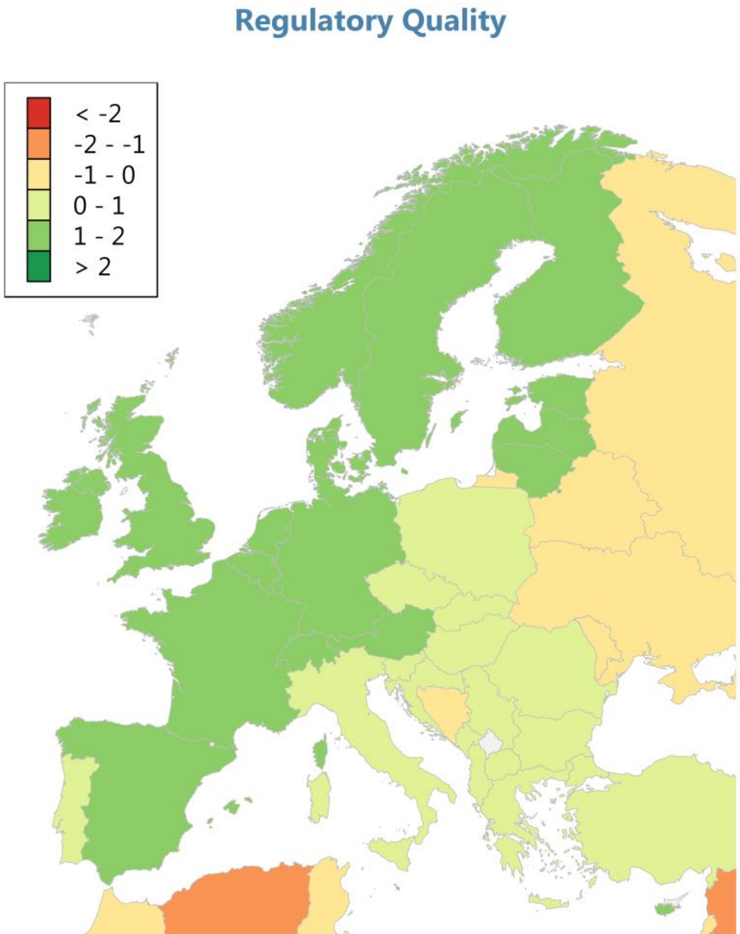


Source: World Economic Forum. Note: Worldwide distribution excluding LICs

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

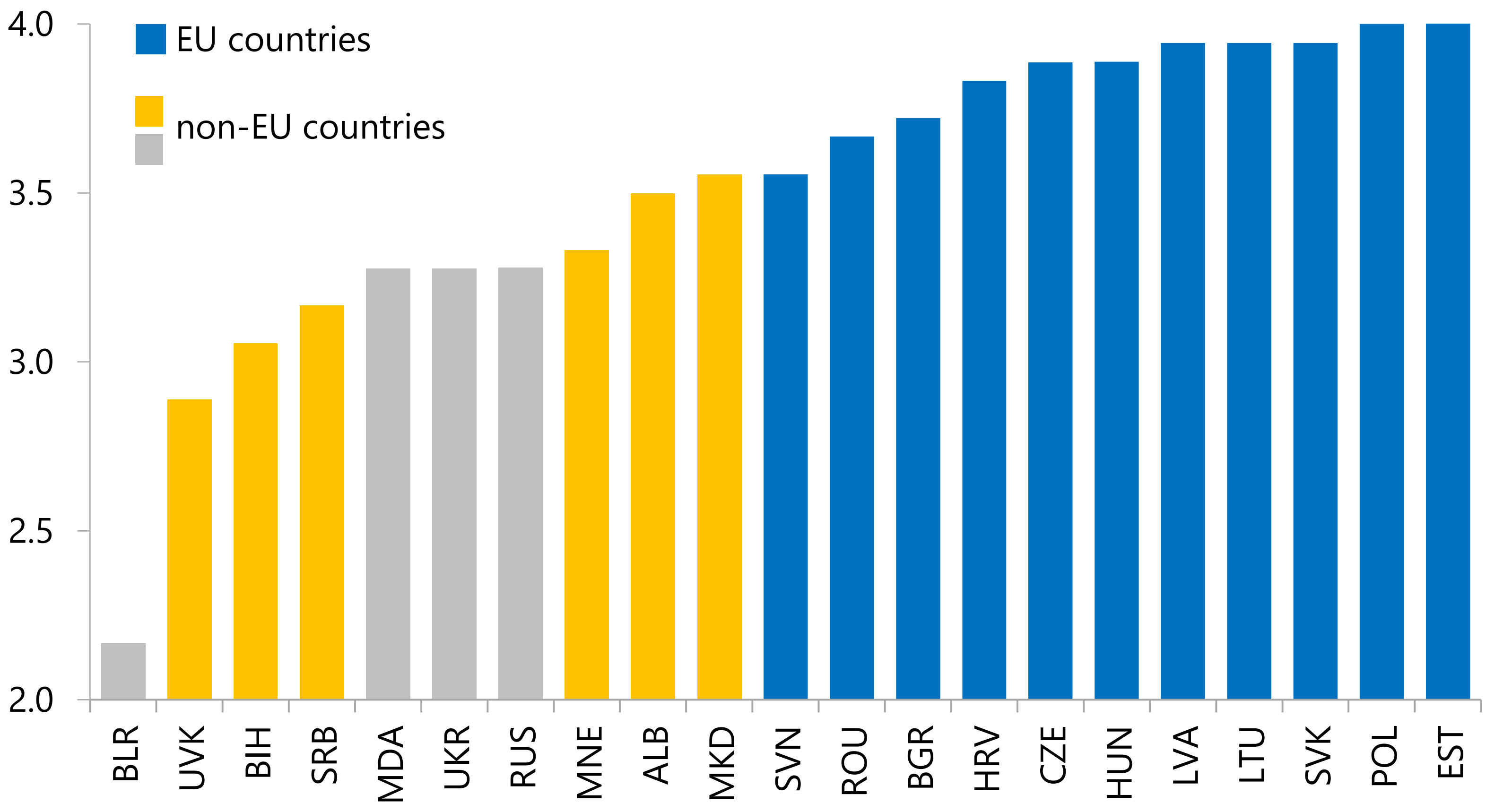
World Governance Indicators, 2016
(Ranges from -2.5 (weak) to 2.5 (strong) governance performance)





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