



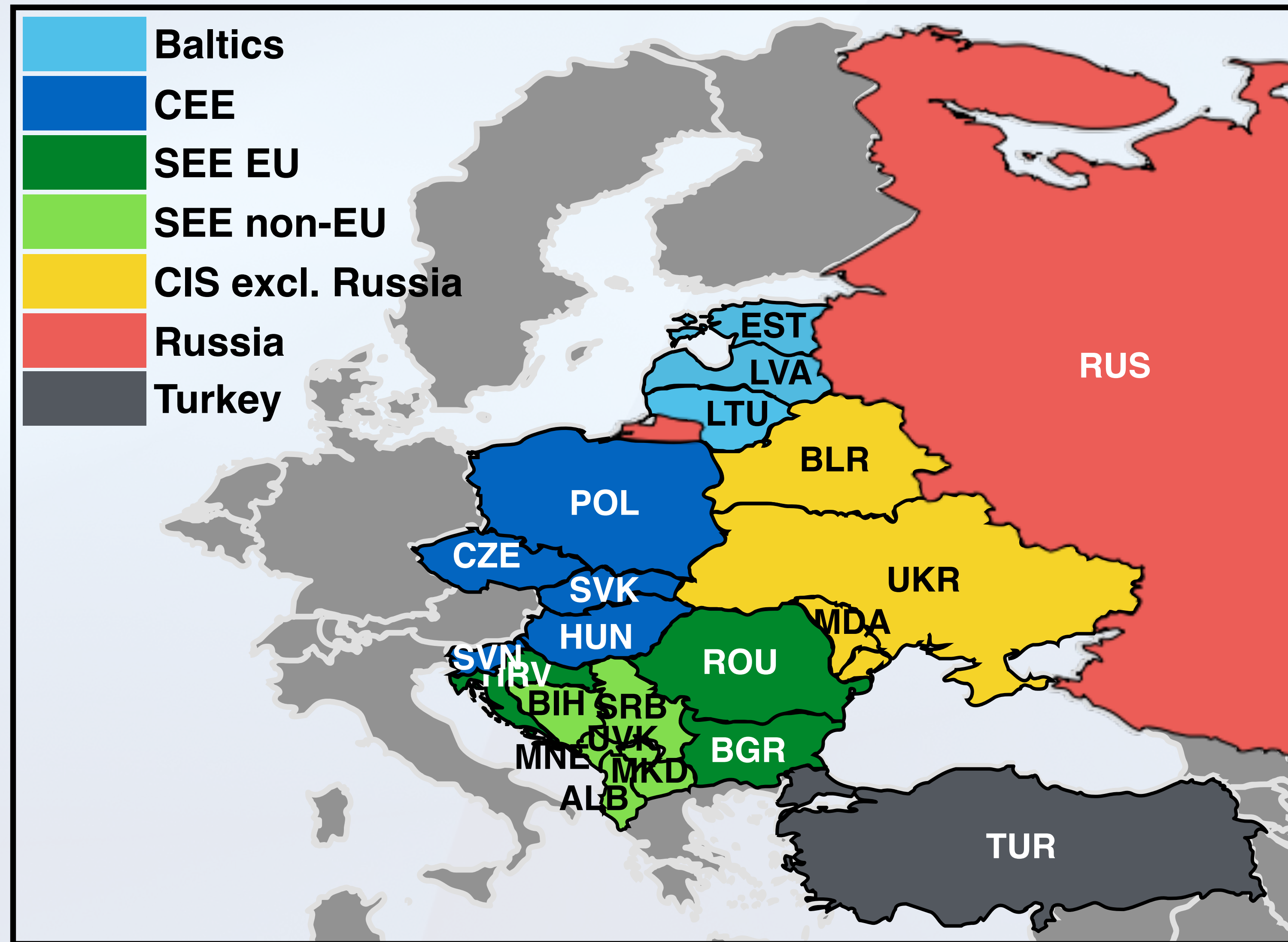
REGIONAL ECONOMIC ISSUES REPORT ON CENTRAL, EASTERN AND SOUTHEASTERN EUROPE

How to Get Back on the Fast Track?

MAY, 2016

EUROPEAN DEPARTMENT

Map of Central, Eastern, and South-Eastern Europe





REGIONAL ECONOMIC ISSUES REPORT ON CENTRAL, EASTERN AND SOUTHEASTERN EUROPE

**OUTLOOK
AND
RISKS**

**MEDIUM-TERM
GROWTH
CHALLENGES**

**POLICY
PRIORITIES**

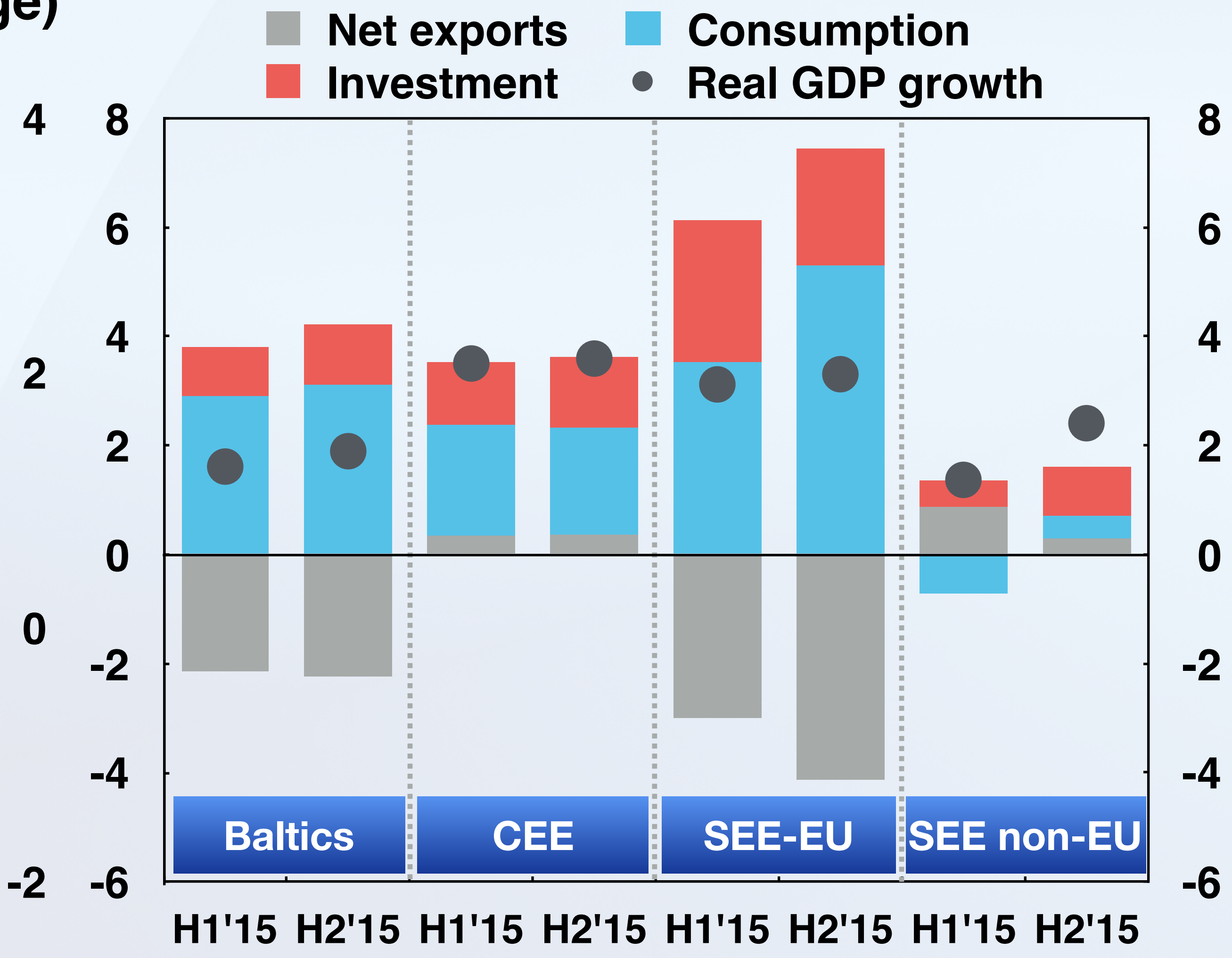
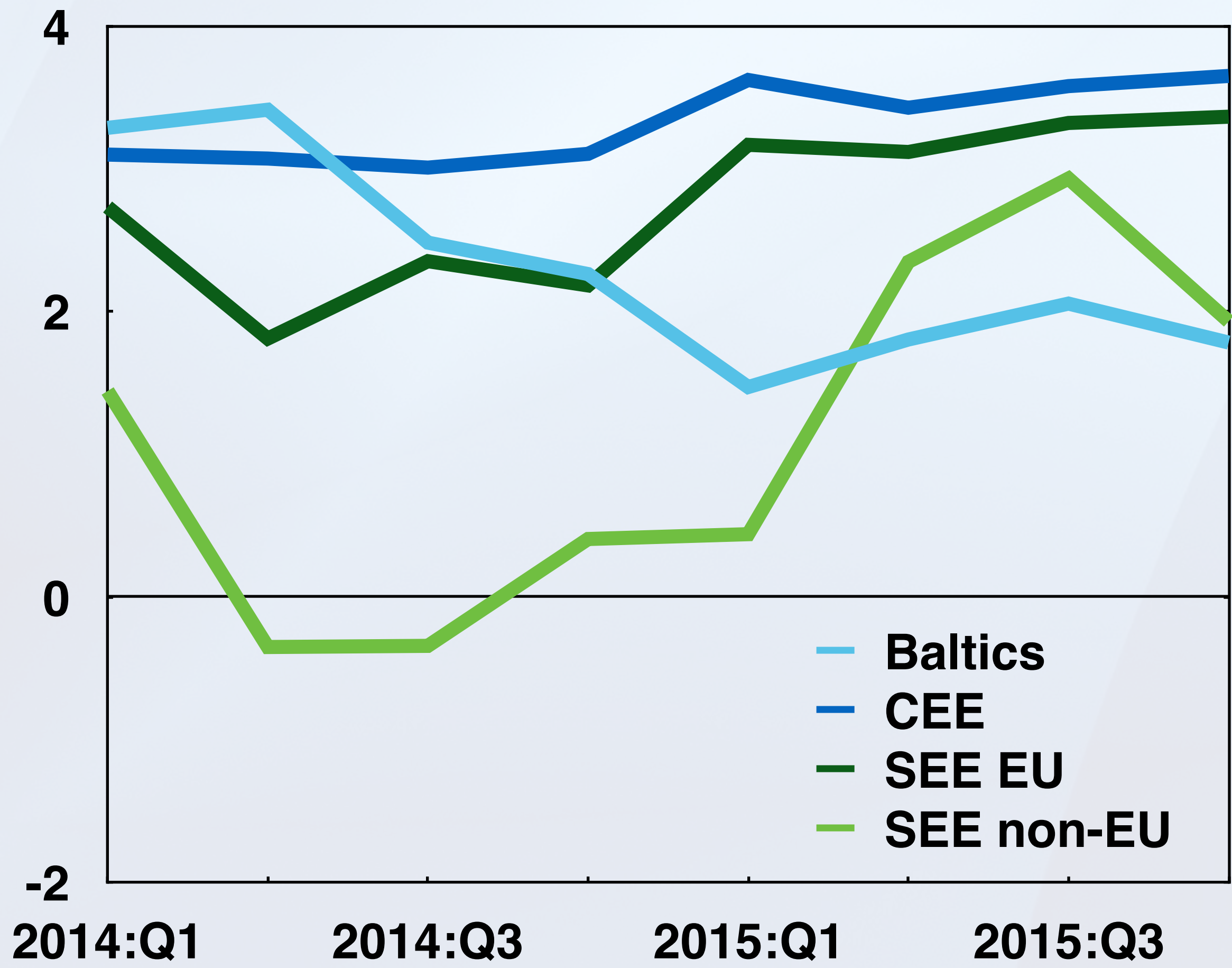


REGIONAL ECONOMIC ISSUES REPORT ON CENTRAL, EASTERN AND SOUTHEASTERN EUROPE

OUTLOOK AND RISKS

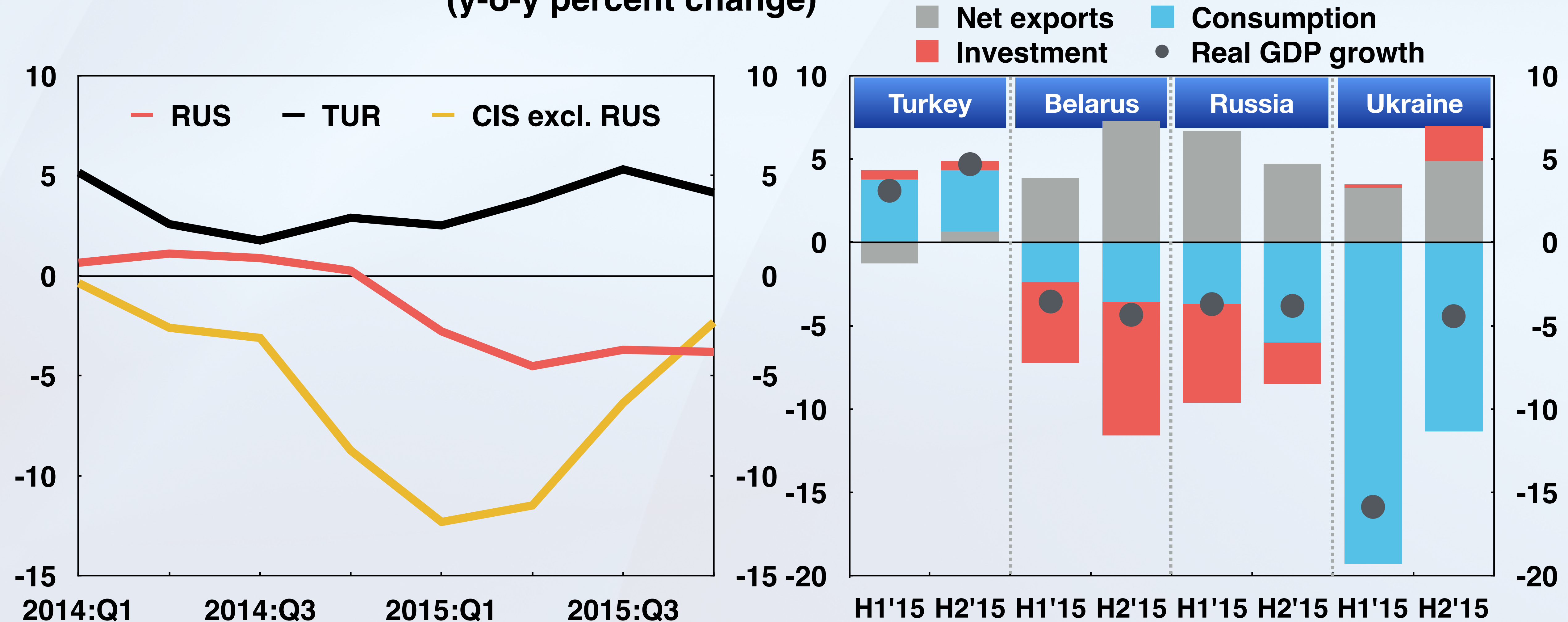
Solid growth in most CESEE countries

CESEE (excl. CIS and Turkey): Real GDP Growth and Decomposition
(y-o-y percent change)



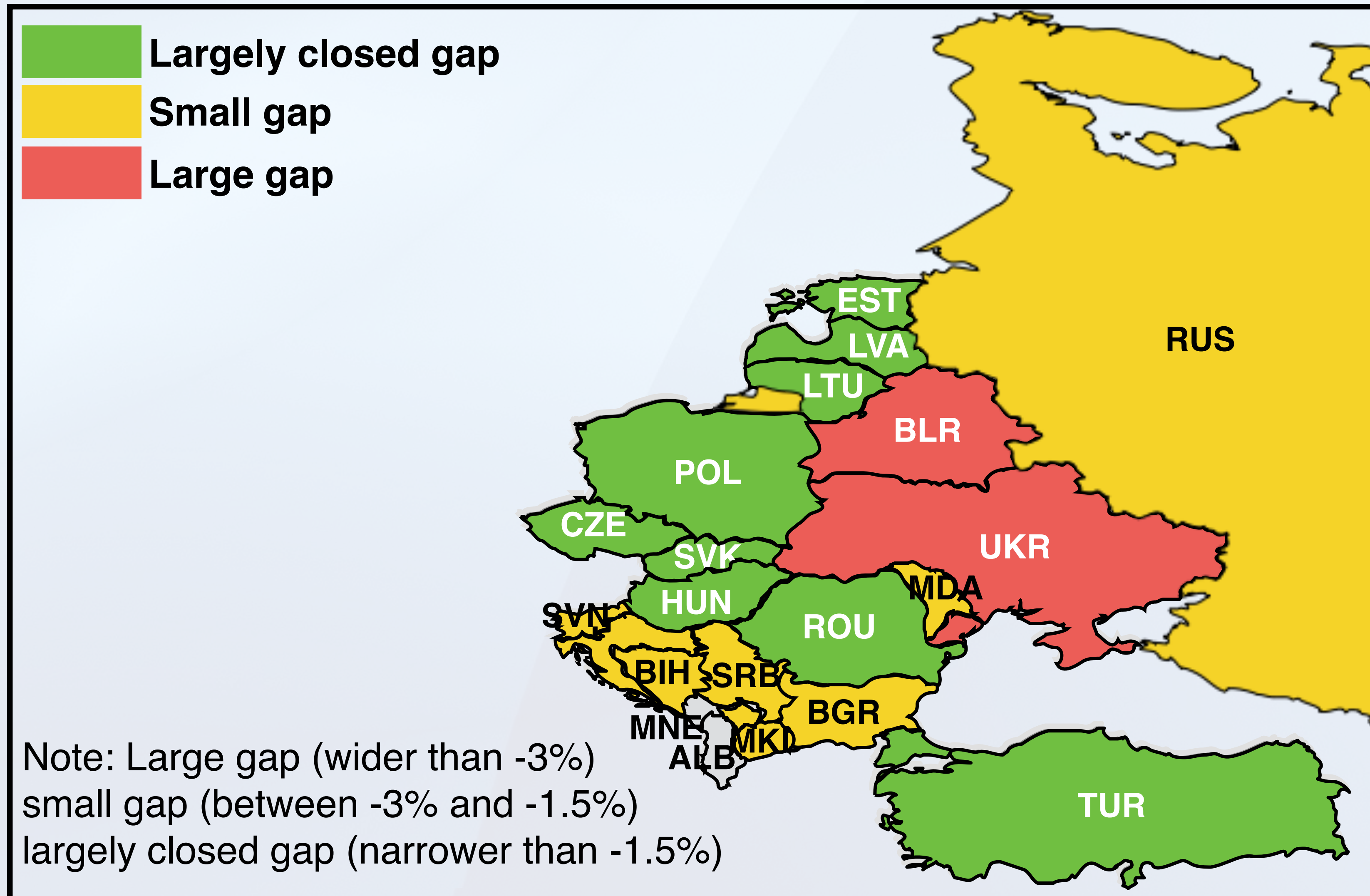
...incl. Turkey, but CIS still in recession

CIS and Turkey: Real GDP Growth and Decomposition (y-o-y percent change)



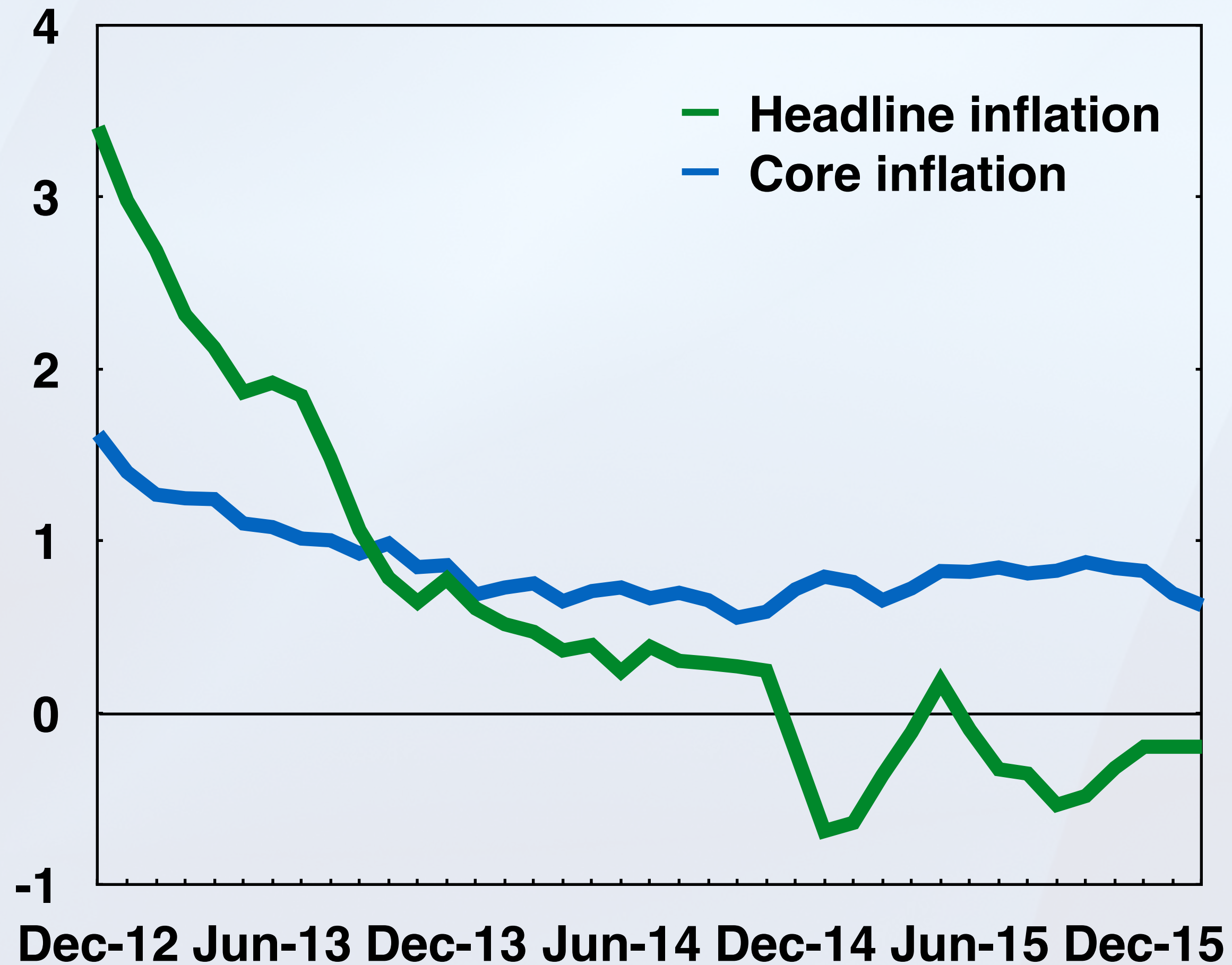
Cyclical recovery near completion?

CESEE: Estimated Output Gaps

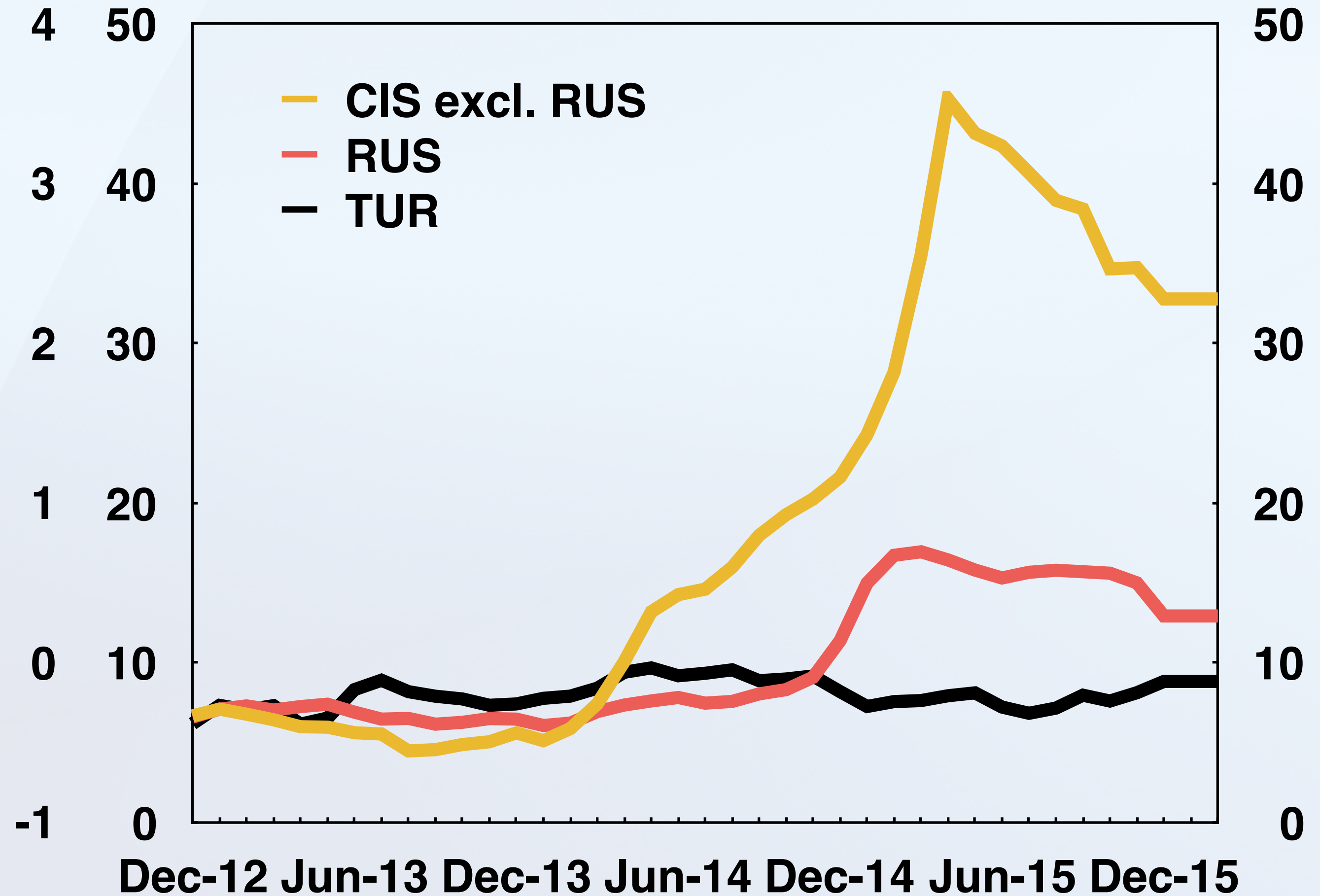


Low inflation outside CIS and Turkey

CESEE (excl. CIS and Turkey): Inflation (y-o-y percent change)

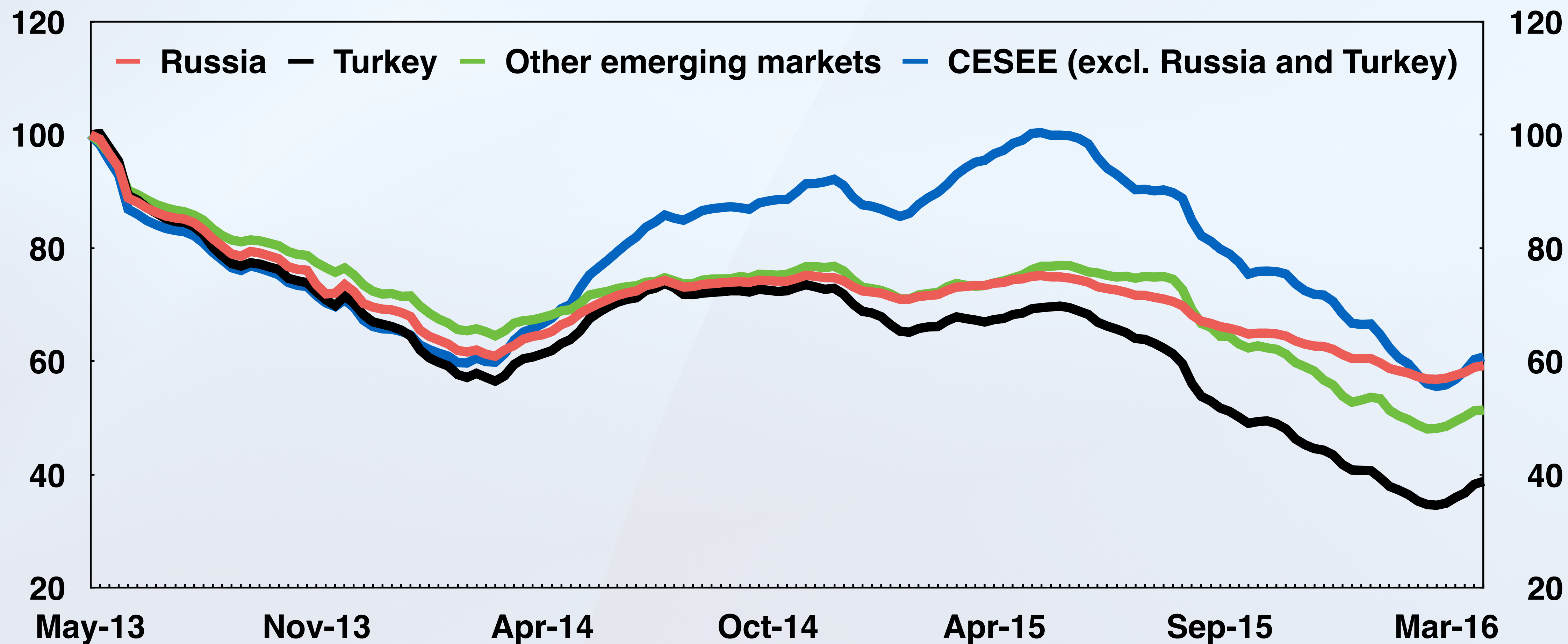


CIS and Turkey: Headline Inflation (y-o-y percent change)



Volatile capital flows...

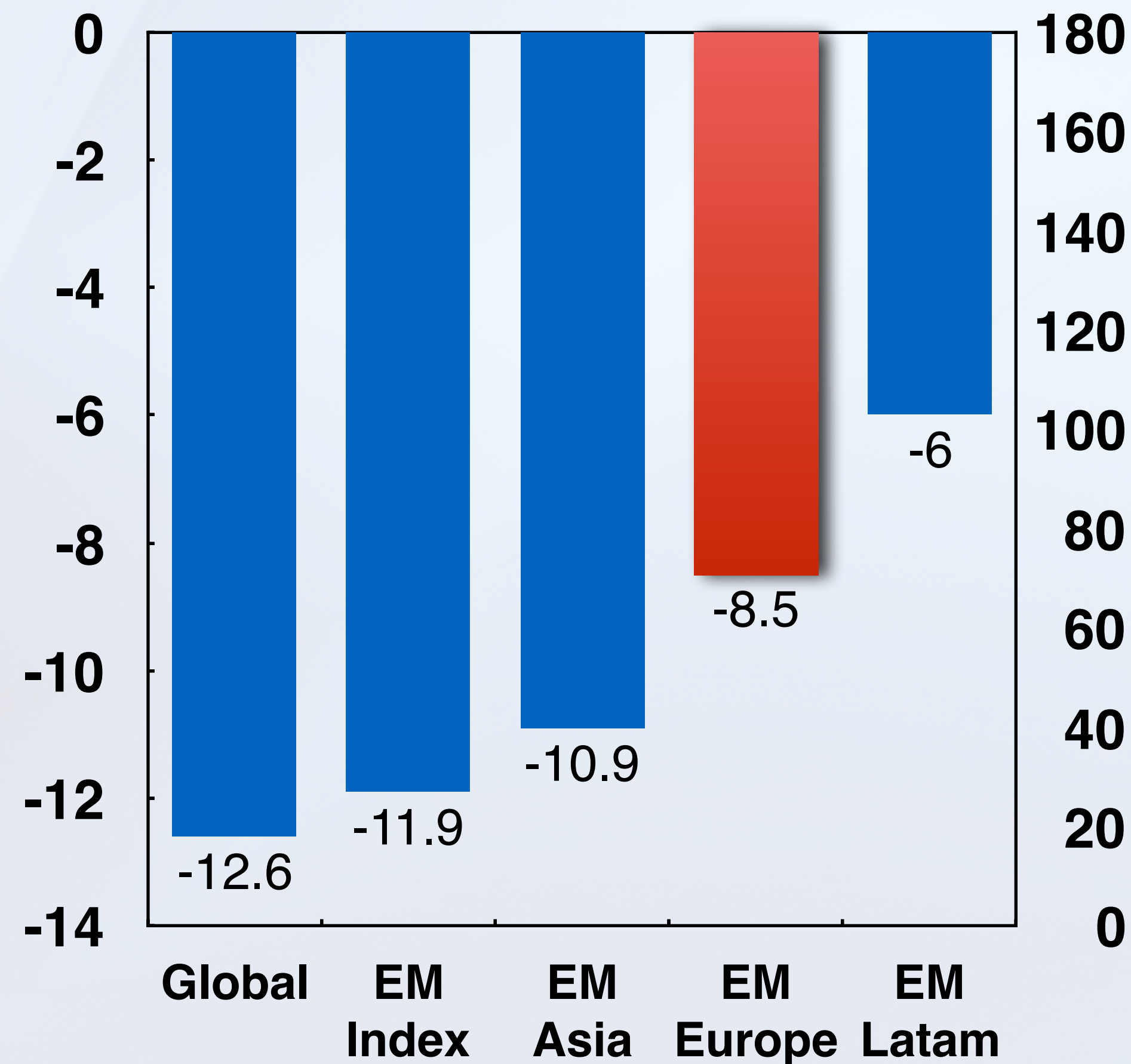
Cumulative Flows to Exchange-Traded and Mutual Funds Investing in Emerging Market Bonds (May 2013 = 100)



but asset price declines smaller than in other EMs

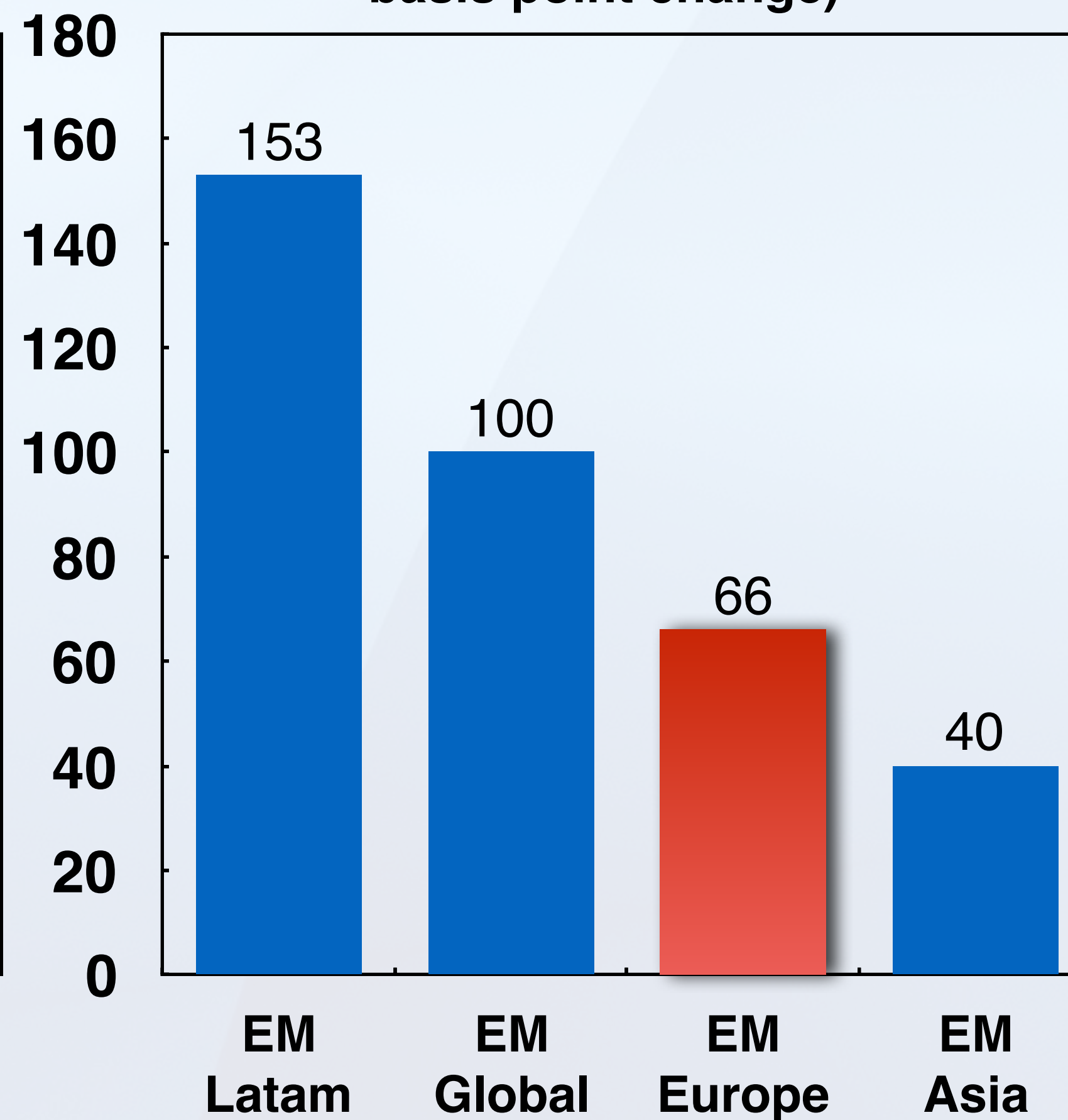
Equity Markets

(Dec. 1, 2015 to Feb. 16, 2016, percent change)



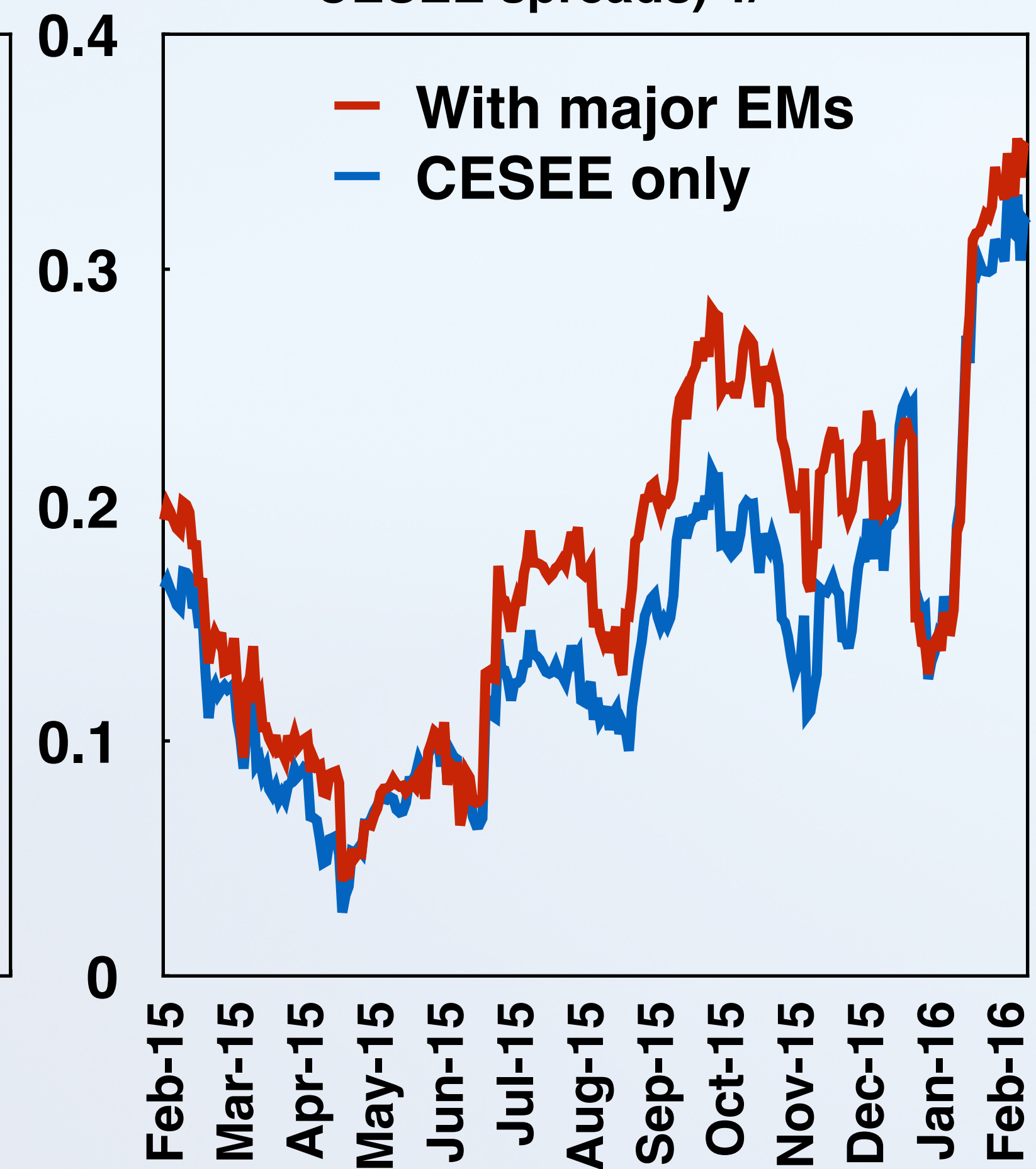
EMBIG Spreads

(Dec. 1, 2015 to Feb. 16, 2016, basis point change)



CDS Spreads

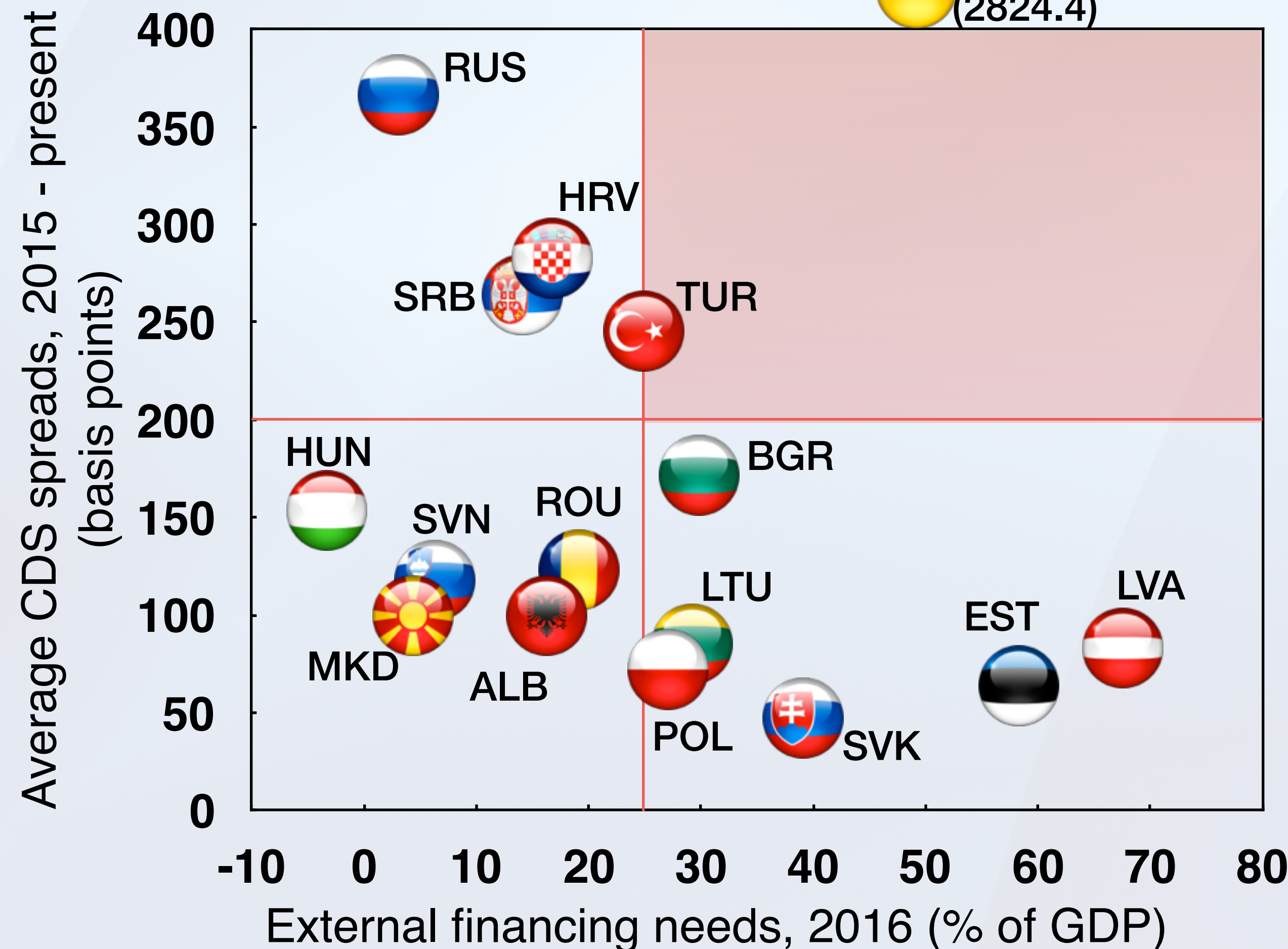
(Pair-wise correlations of CESEE spreads) 1/



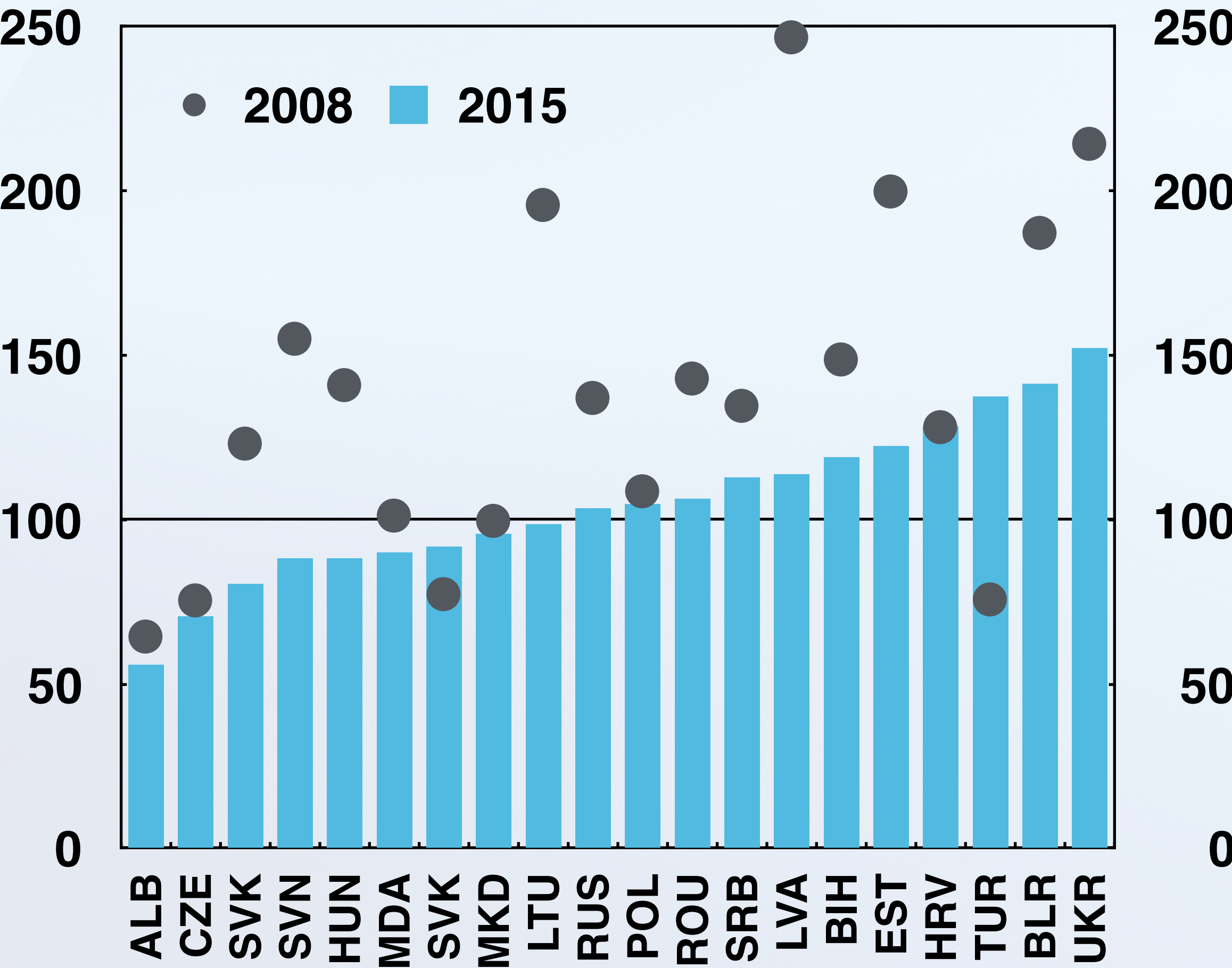
1/ Simple average of pair-wise correlations of daily changes in CDS spreads using a rolling 30-day window.

And exposures to external financial risks are lower

CESEE: External Financing Needs and CDS Spreads

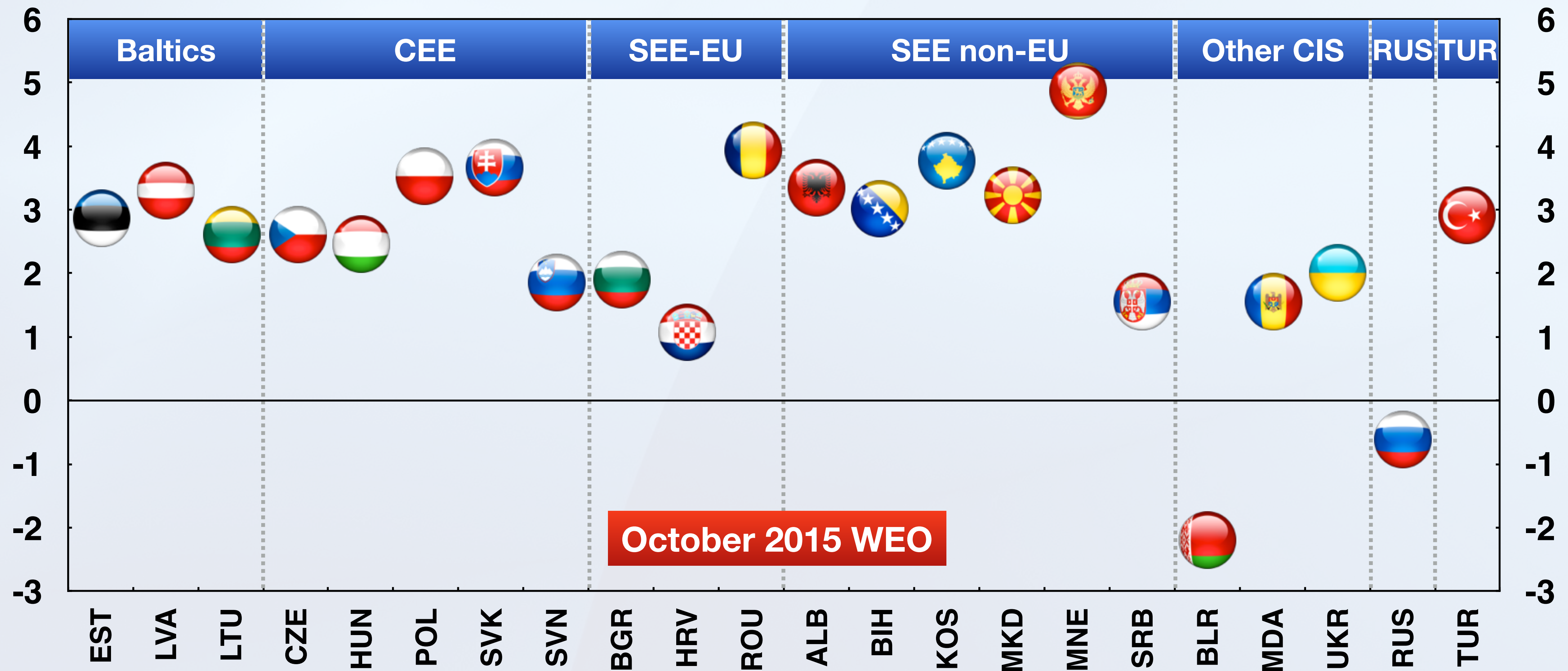


Pre-and Post-Crisis Loan-to-Deposit Ratios (percent)



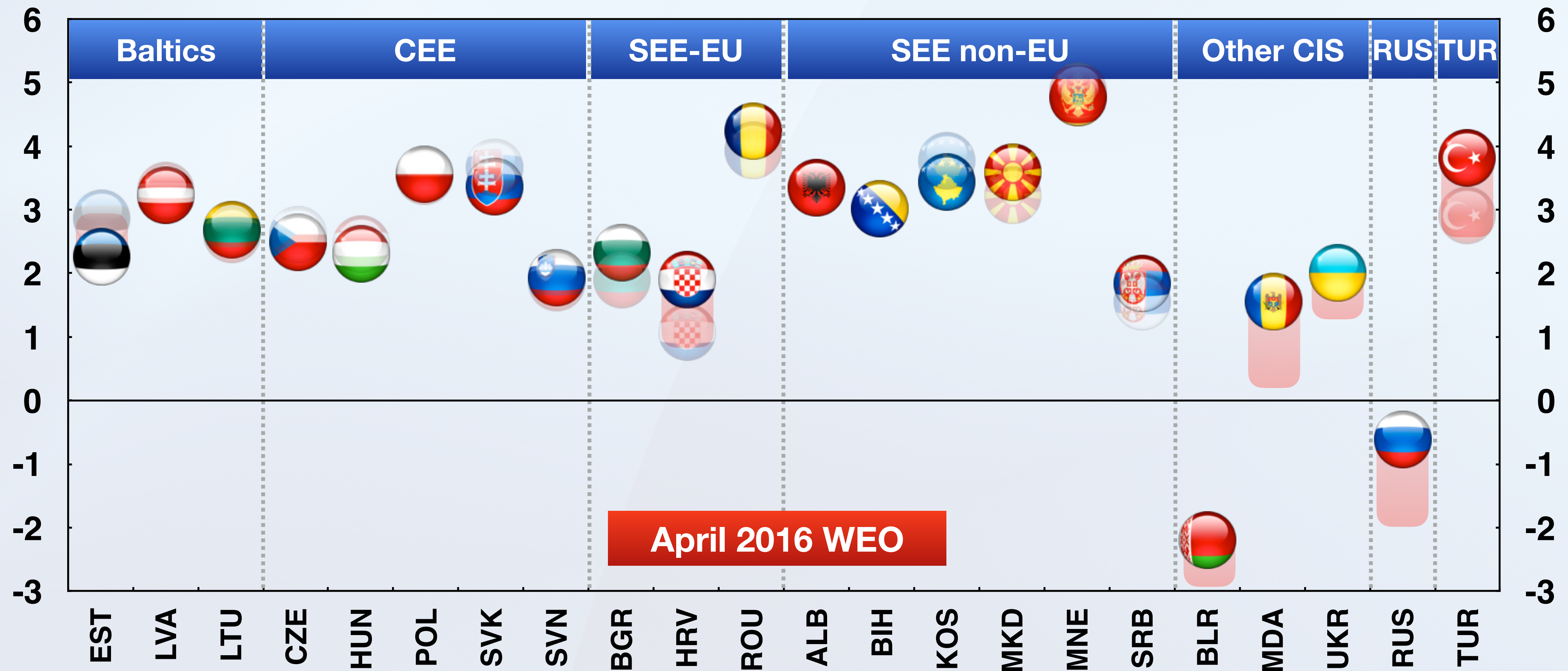
2016 forecasts broadly unchanged, except CIS

2016 Growth Forecast
(percent)



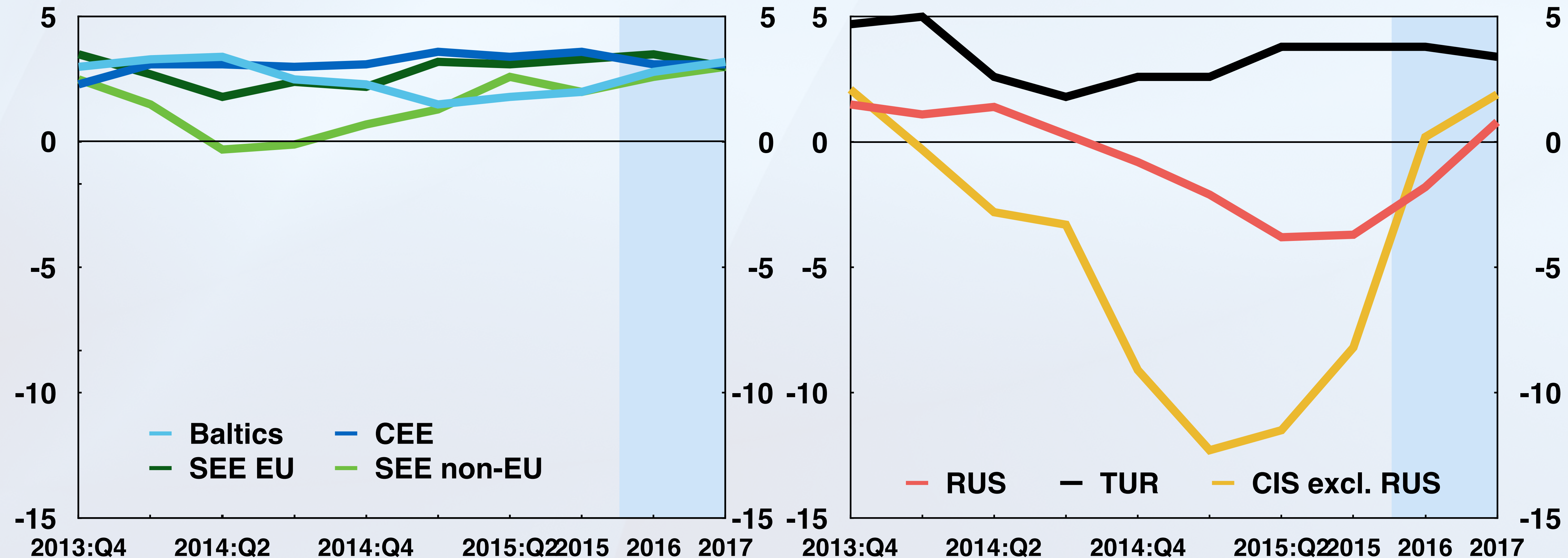
2016 forecasts broadly unchanged, except CIS

2016 Growth Forecast
(percent)



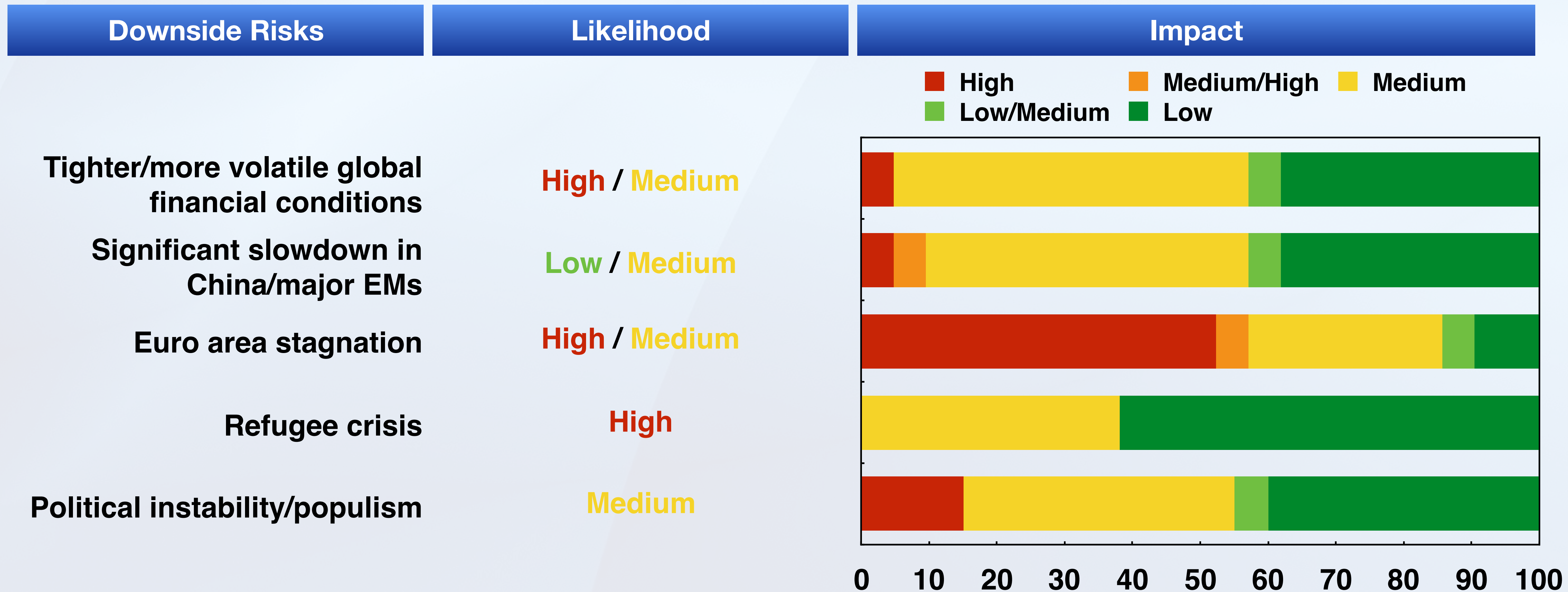
Overall, better growth outlook for 2016

CESEE: GDP Growth Forecasts
(y-o-y percent change)



But downside risks have increased...

CESEE: Desk Assessment of Risks to Outlook (percent of total responses)



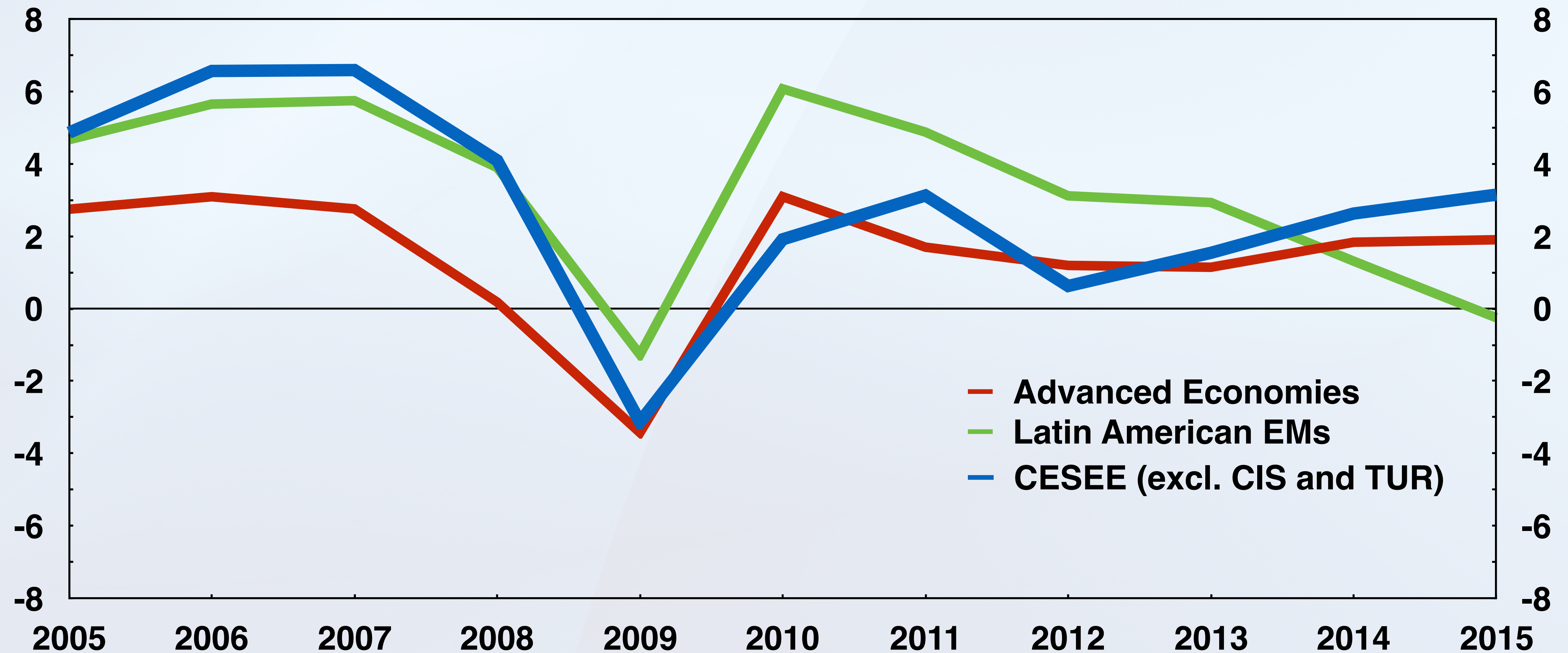


REGIONAL ECONOMIC ISSUES REPORT ON CENTRAL, EASTERN AND SOUTHEASTERN EUROPE

MEDIUM-TERM GROWTH CHALLENGES

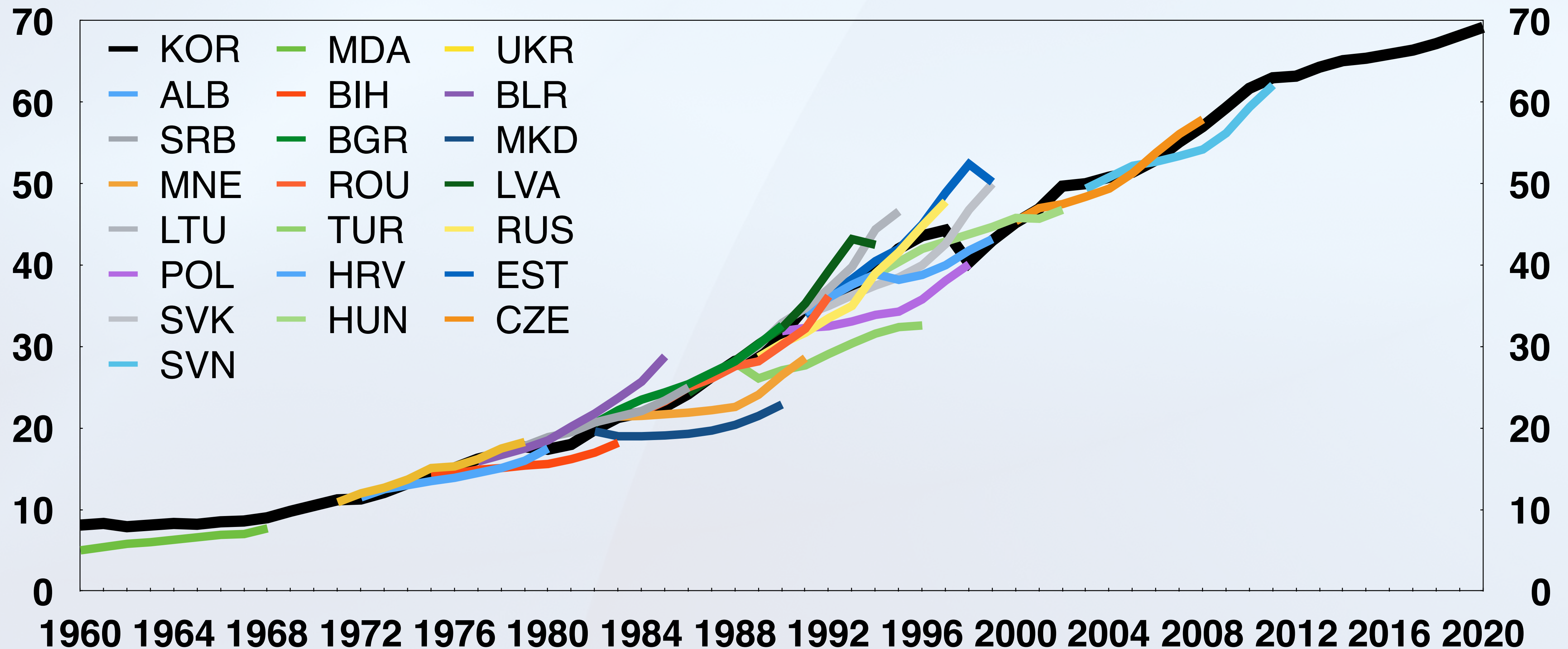
Post-crisis growth slowdown

**Real GDP Growth
(y-o-y percent change)**



Fast pace of convergence before crisis...

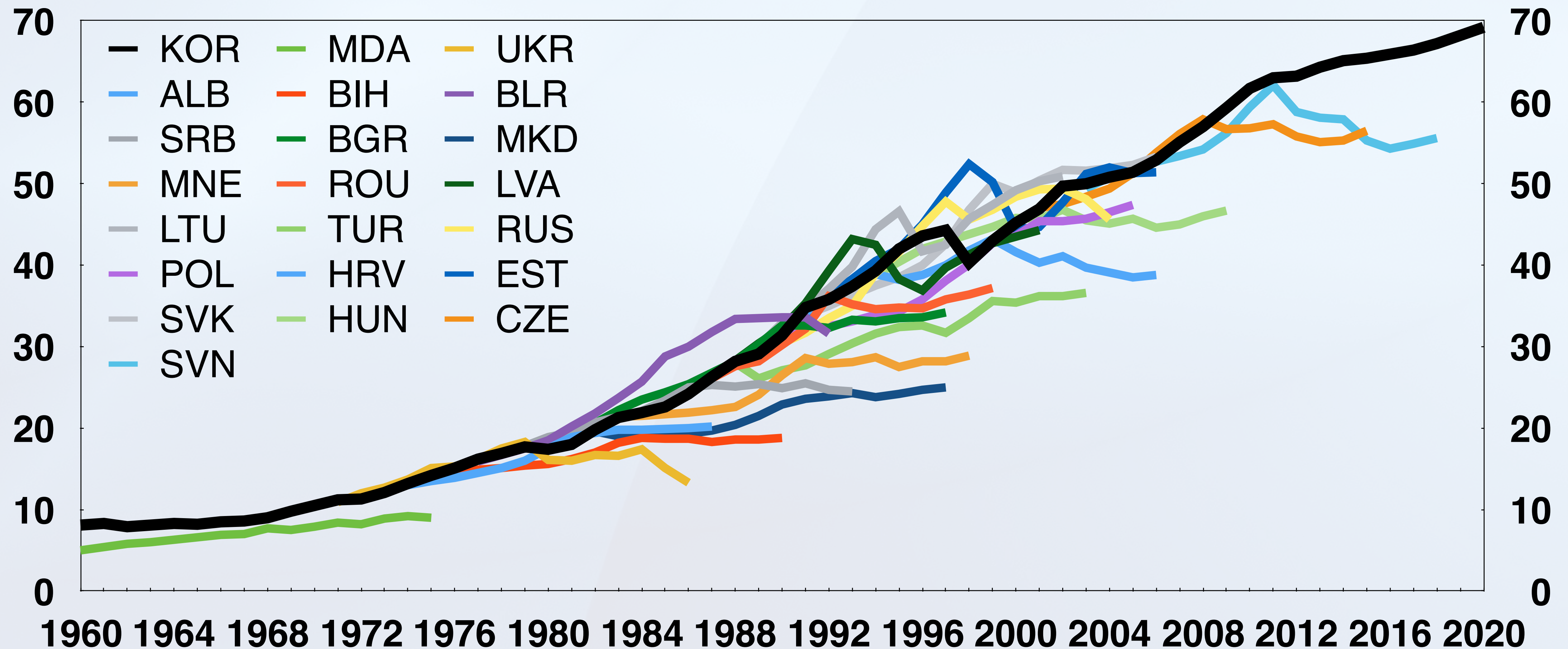
CESEE and Korea: GDP per Capita
(percent of per capita GDP of the U.S. at PPP)



Note: Data for CESEE countries are for 2000-2015 and are shifted back in time to comparable level of development of Korea.

...leveled off since 2009

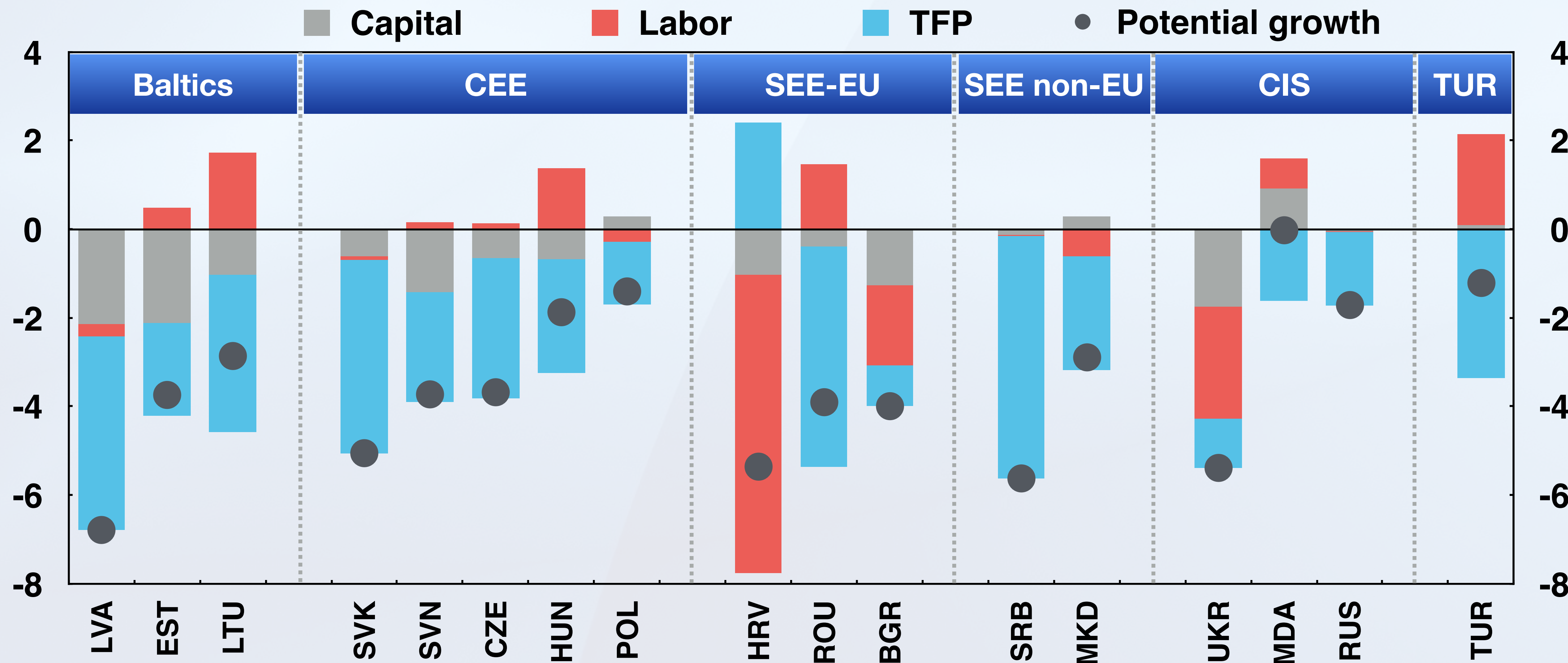
CESEE and Korea: GDP per Capita
(percent of per capita GDP of the U.S. at PPP)



Note: Data for CESEE countries are for 2000-2015 and are shifted back in time to comparable level of development of Korea.

Lower potential growth due to productivity and investment slowdown

Difference Between Average Potential Growth Before and After Crisis:
Factor Contributions (*percentage points*)



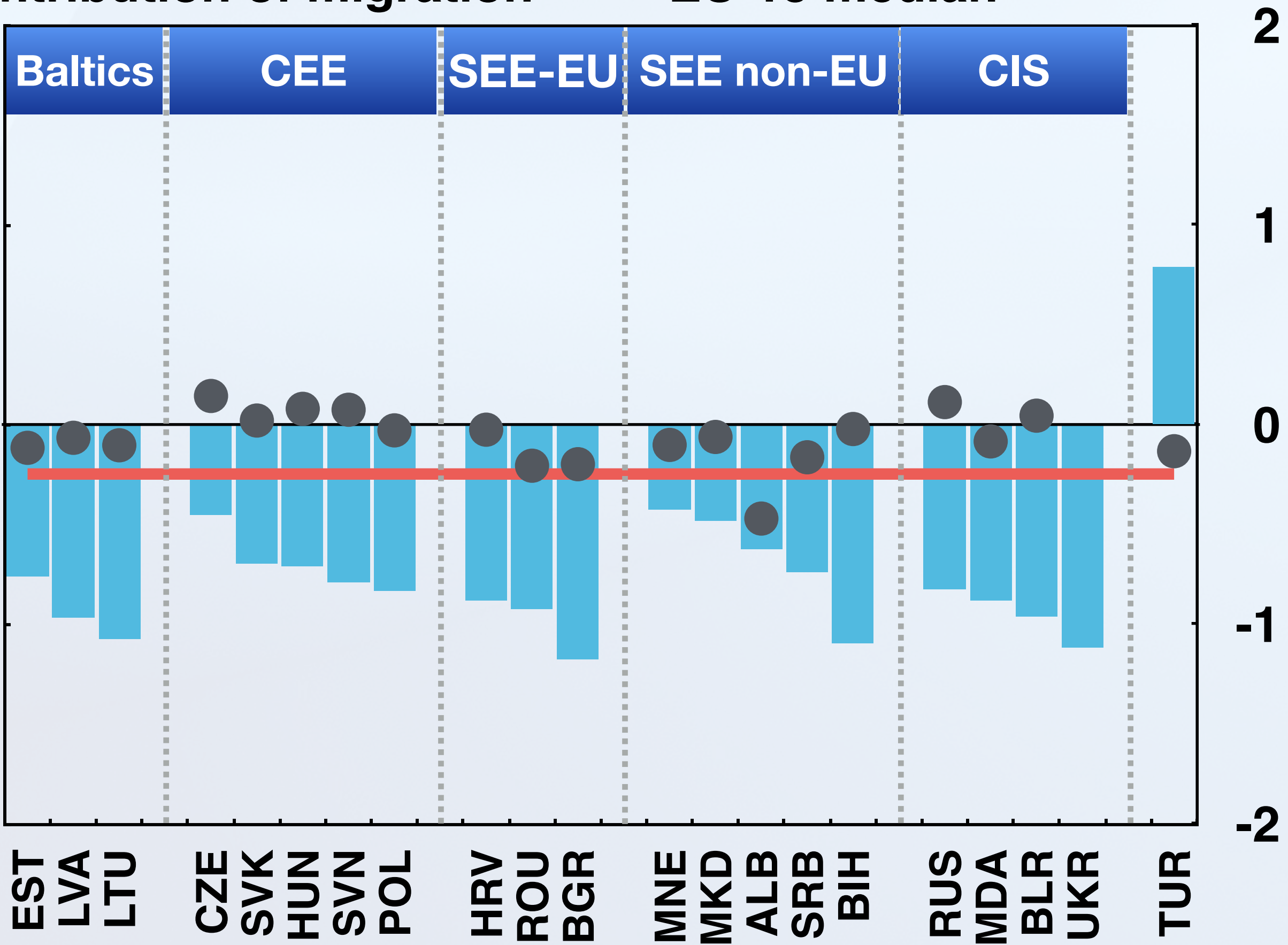
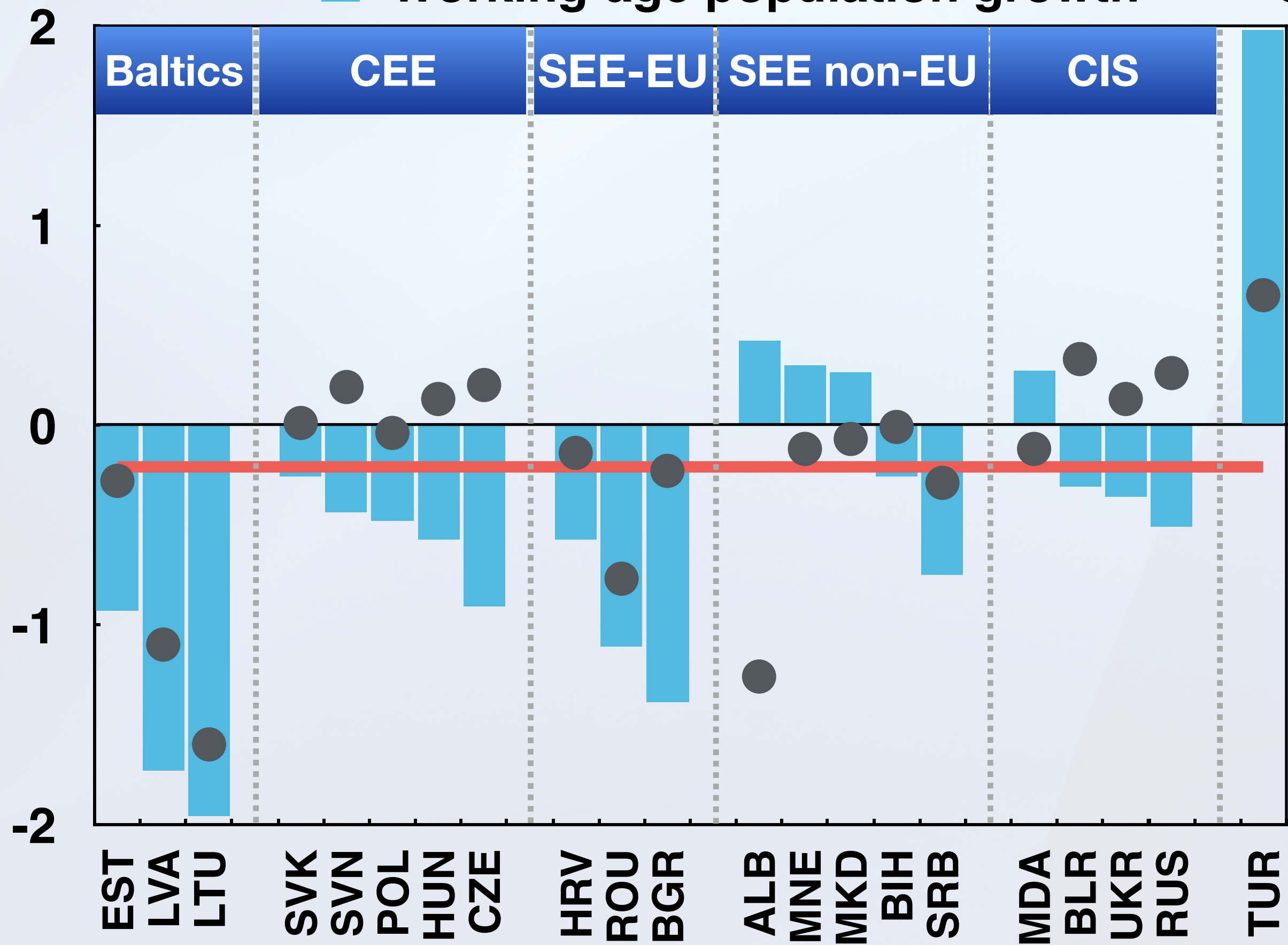
Note: TFP is the difference between potential growth and the contributions of capital and labor.

Decline in working age population

Working Age Population Growth, 2010-14
(y-o-y percent change, average)

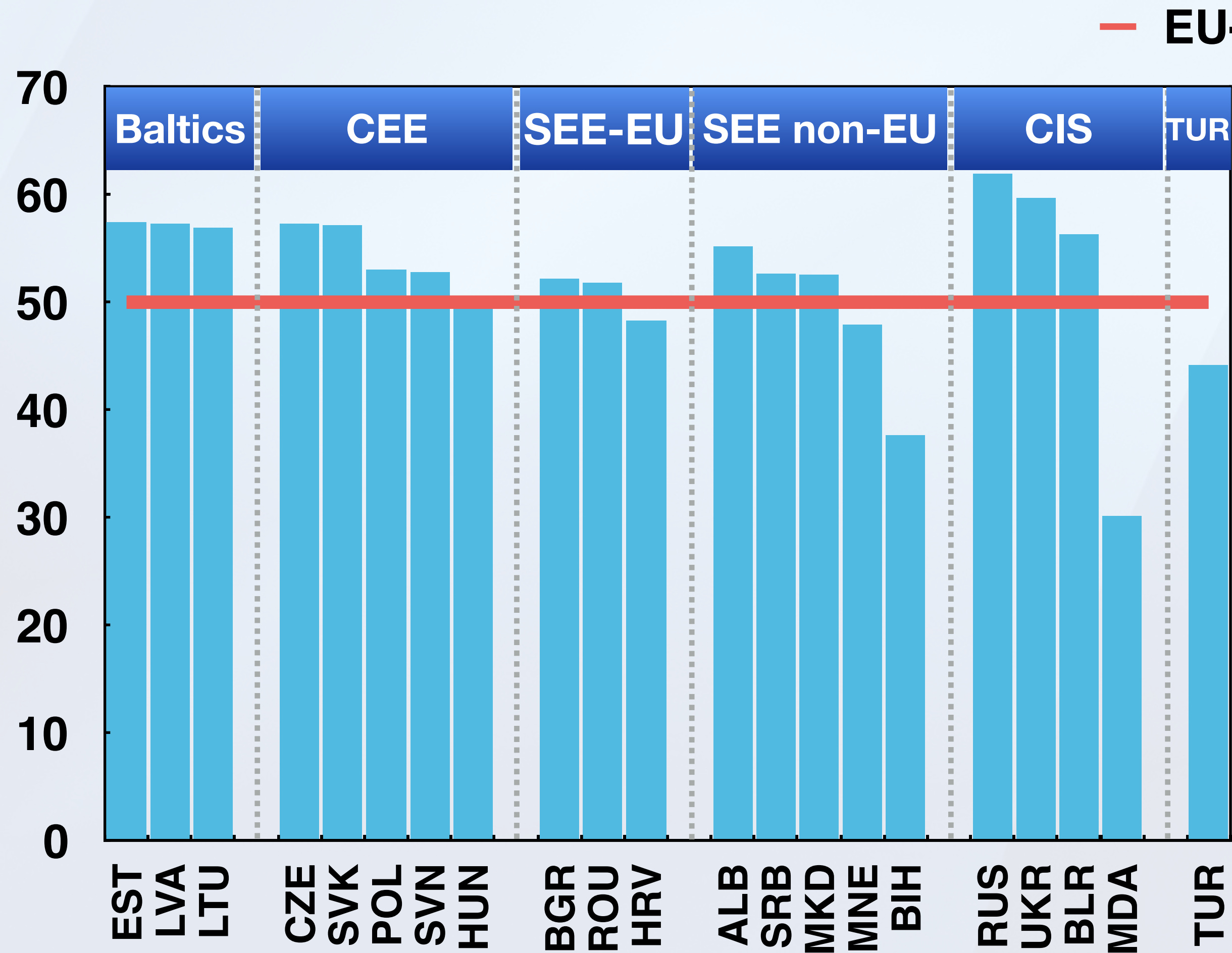
Working Age Population Growth, 2015-30
(y-o-y percent change, average)

■ Working-age population growth ● Contribution of migration — EU-15 median

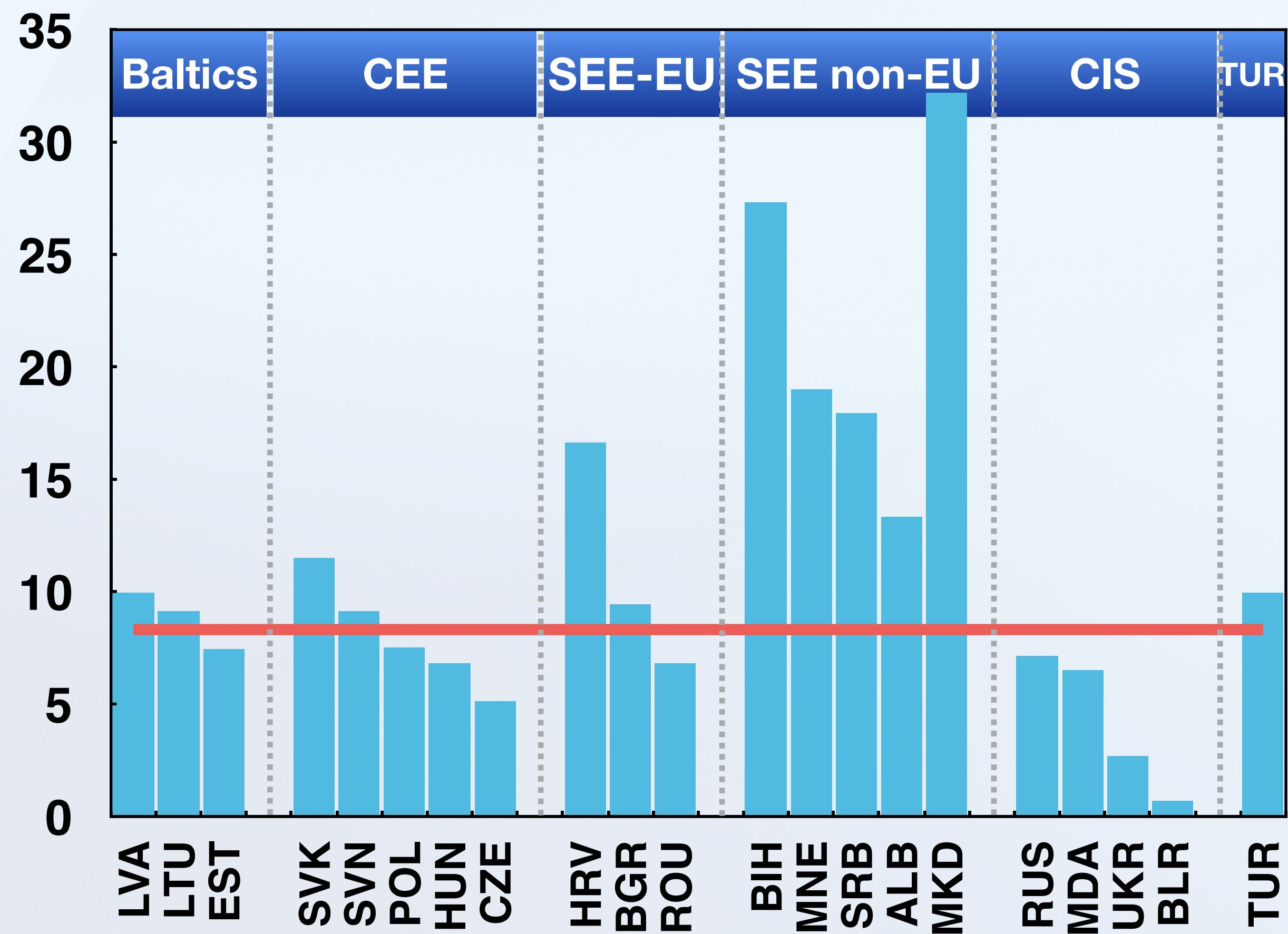


Room to increase labor supply

Full-Time-Equivalent Participation Rate
(percent, 2014)

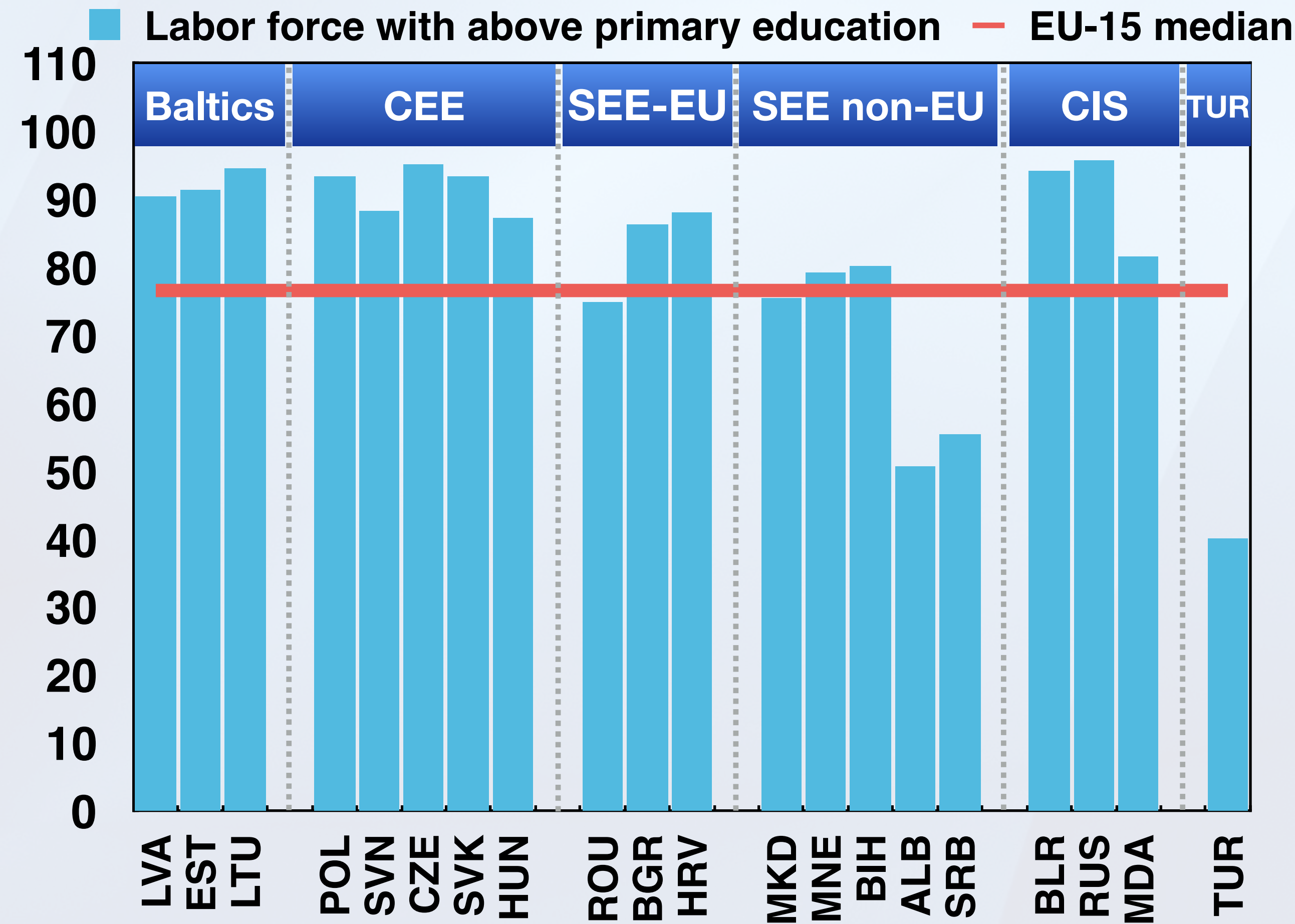


Average Unemployment Rate
(percent, 2000-15)

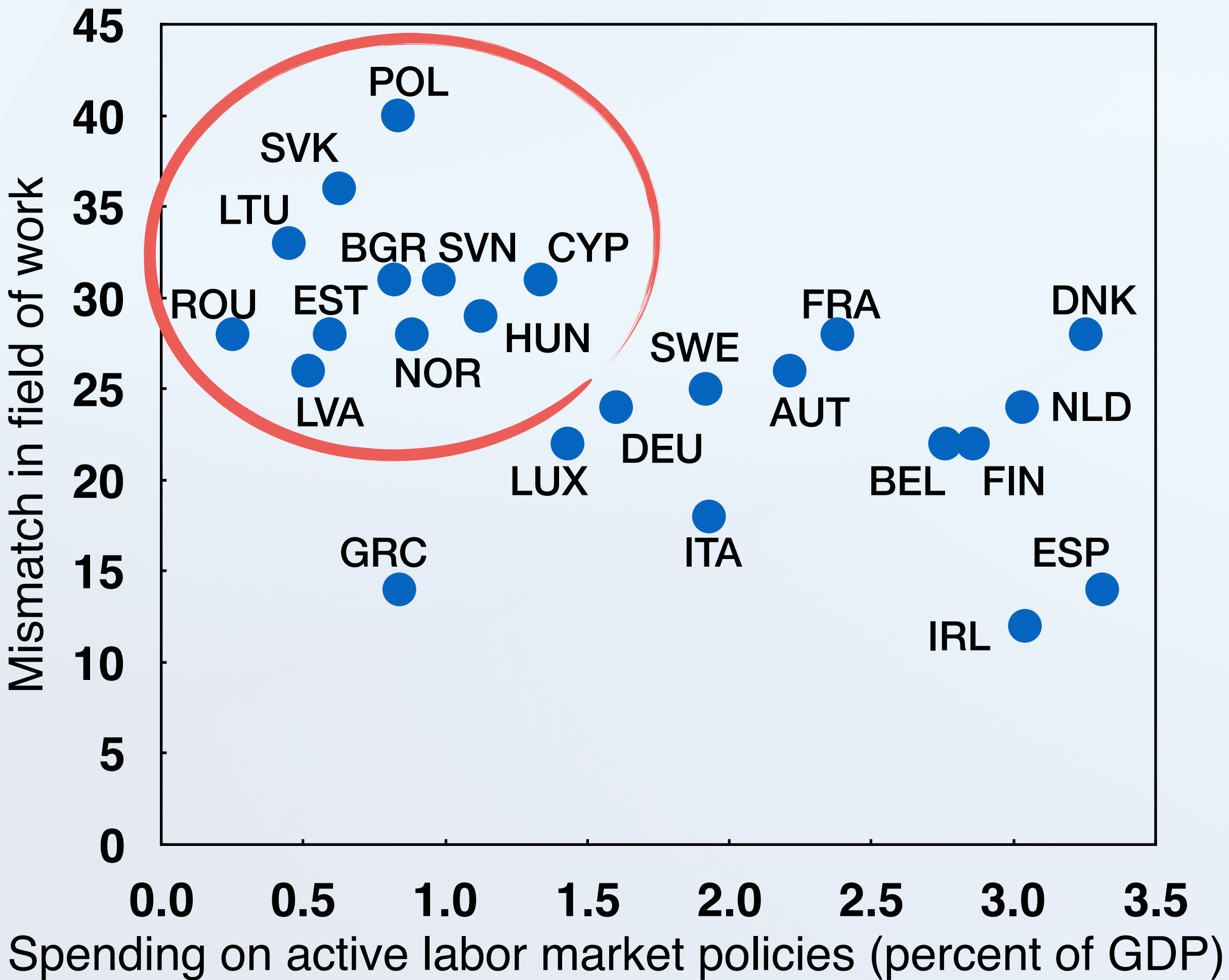


Room to increase labor quality and allocation

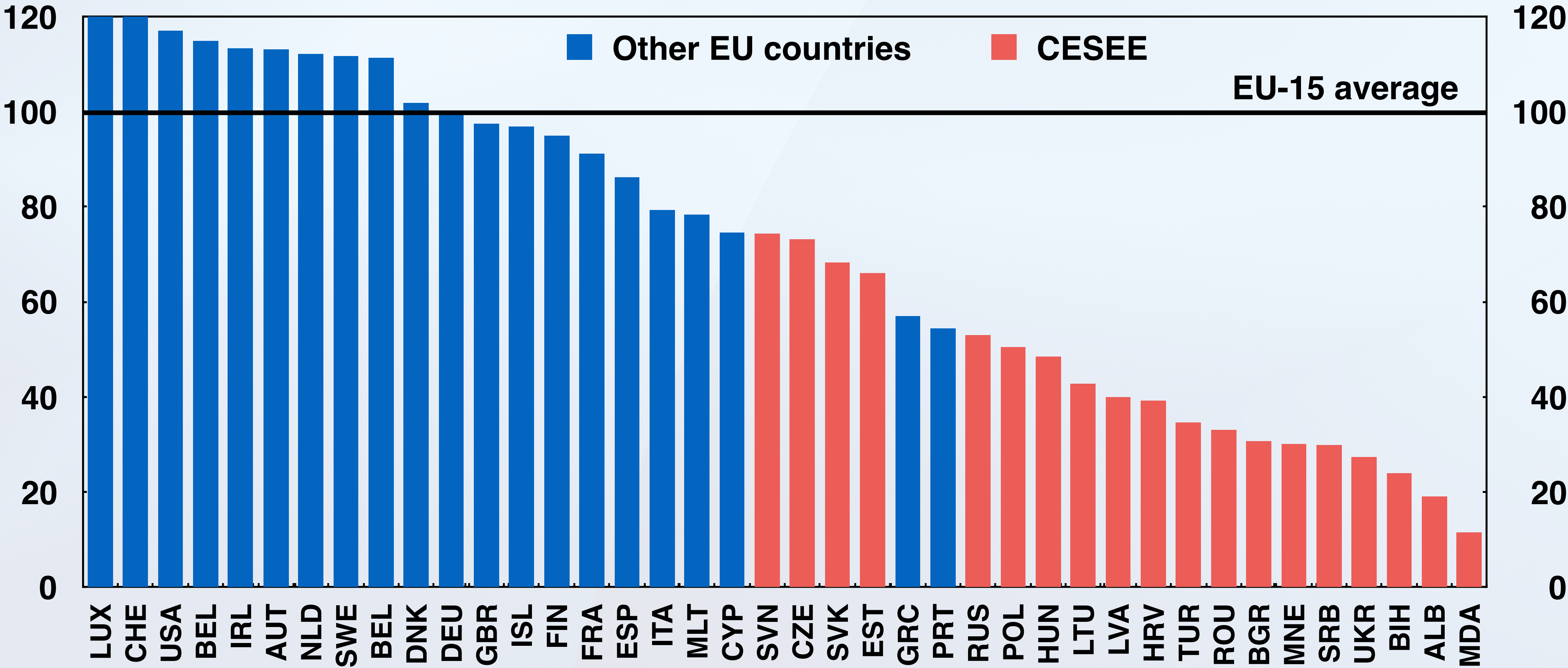
Labor Force with Above Primary Education
(percent of total, 2014)



Skill Mismatch and
Active Labor Market Policies

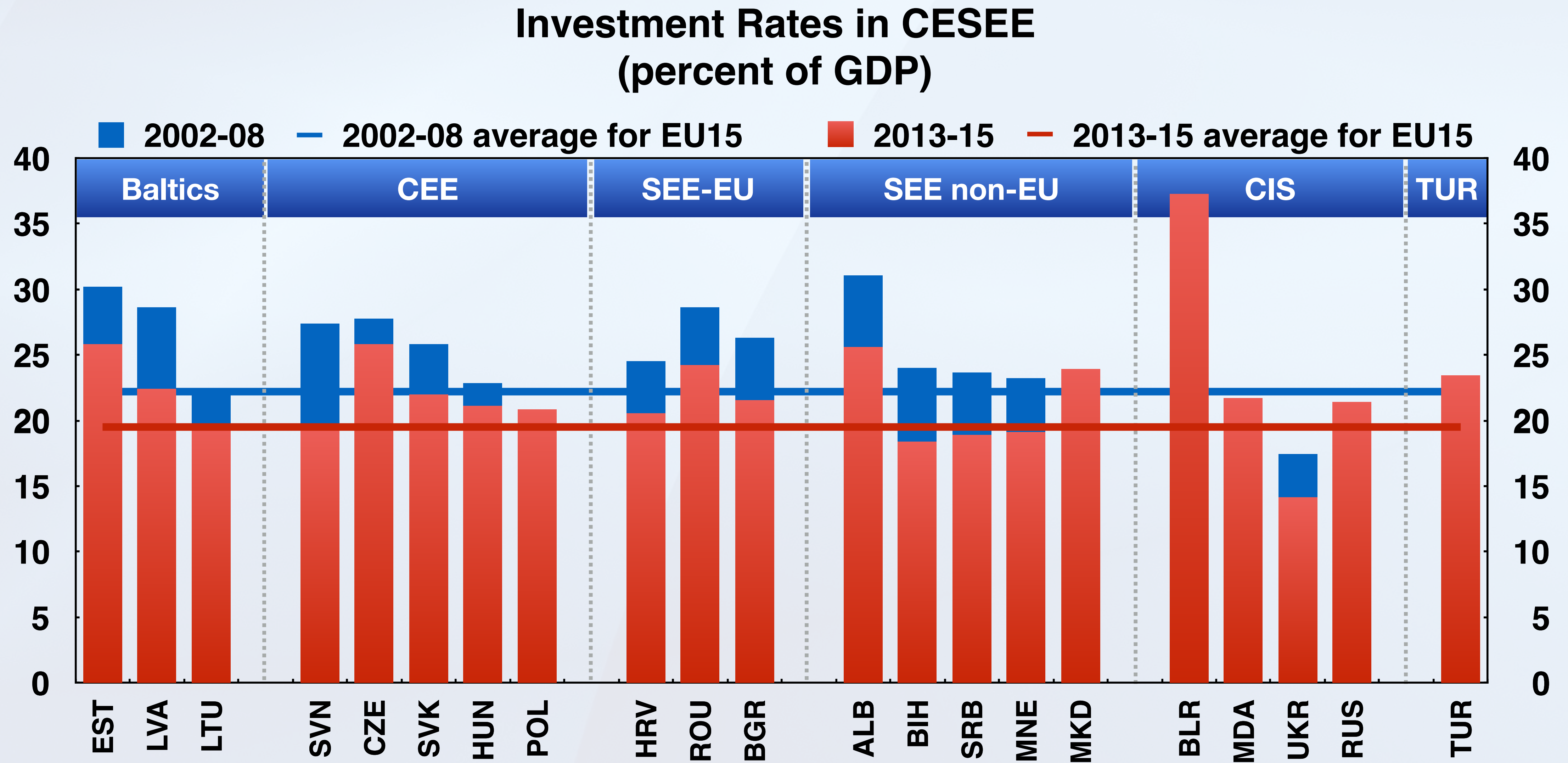


Capital Stock, Per Capita, 2014
(percent of EU-15 average)



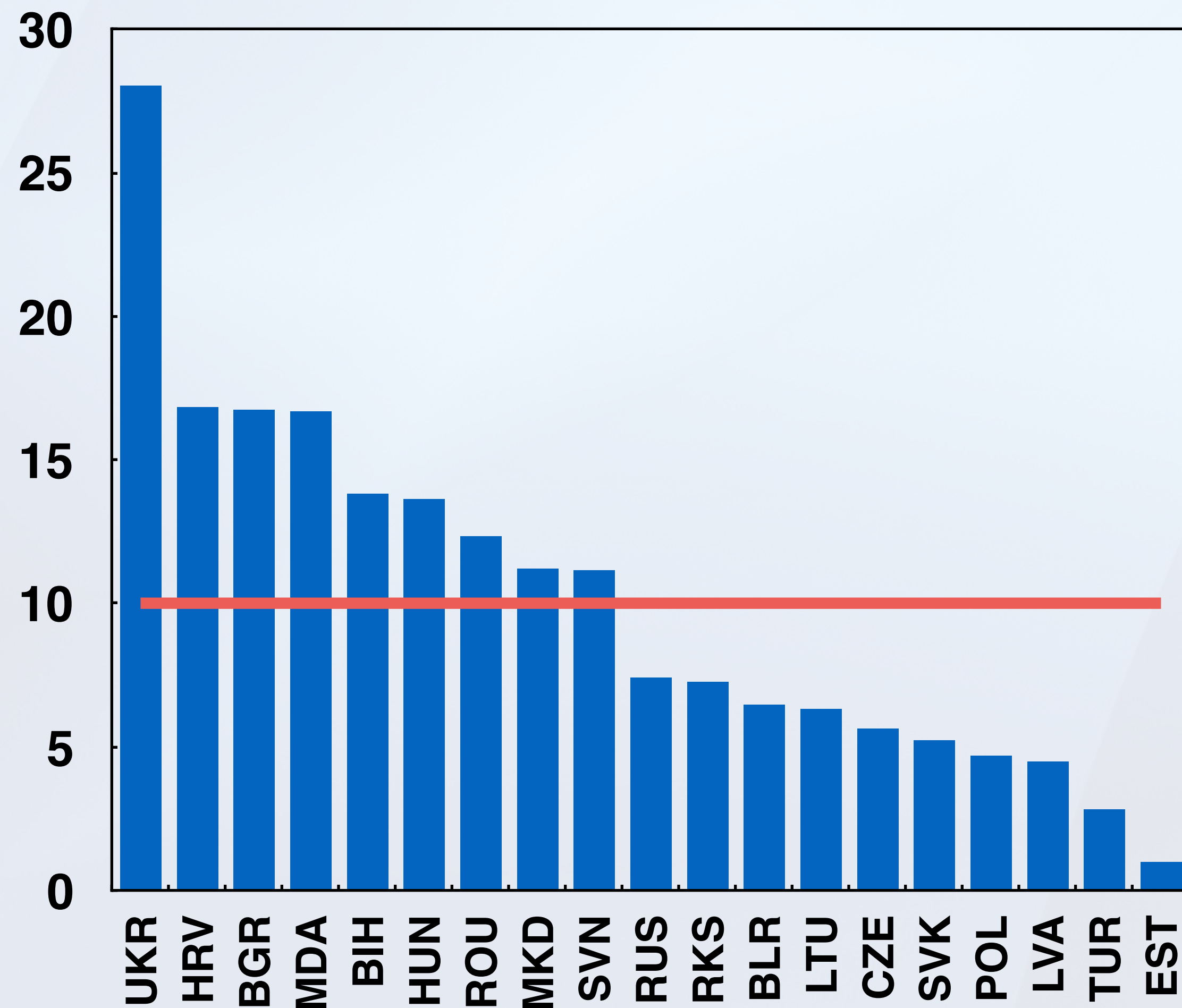
CAPITAL

But investment rates too low for fast catch-up



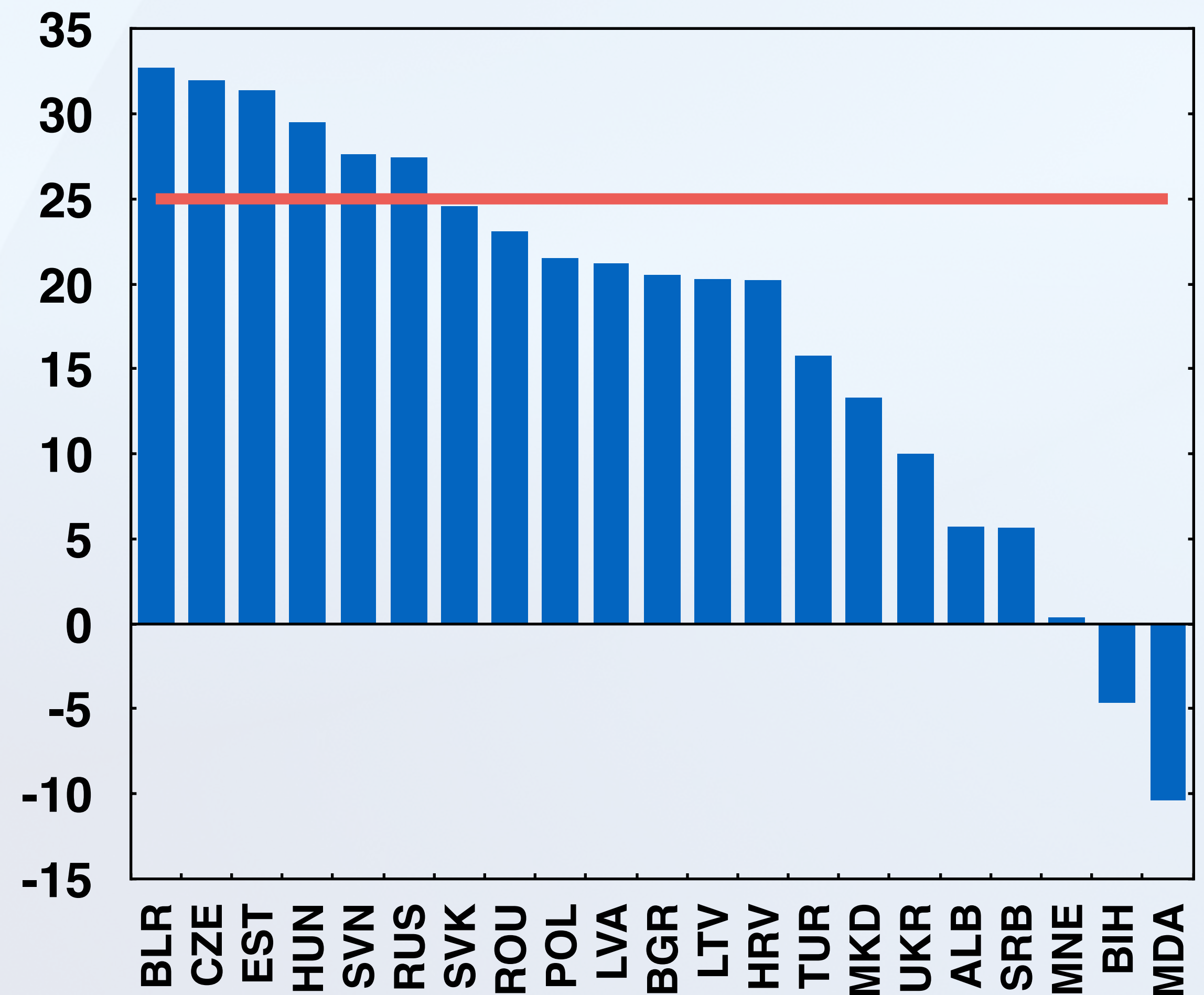
Non-Performing Loans

(percent of total loans, 2015Q3 or latest)



Gross Domestic Saving Rate, 2014

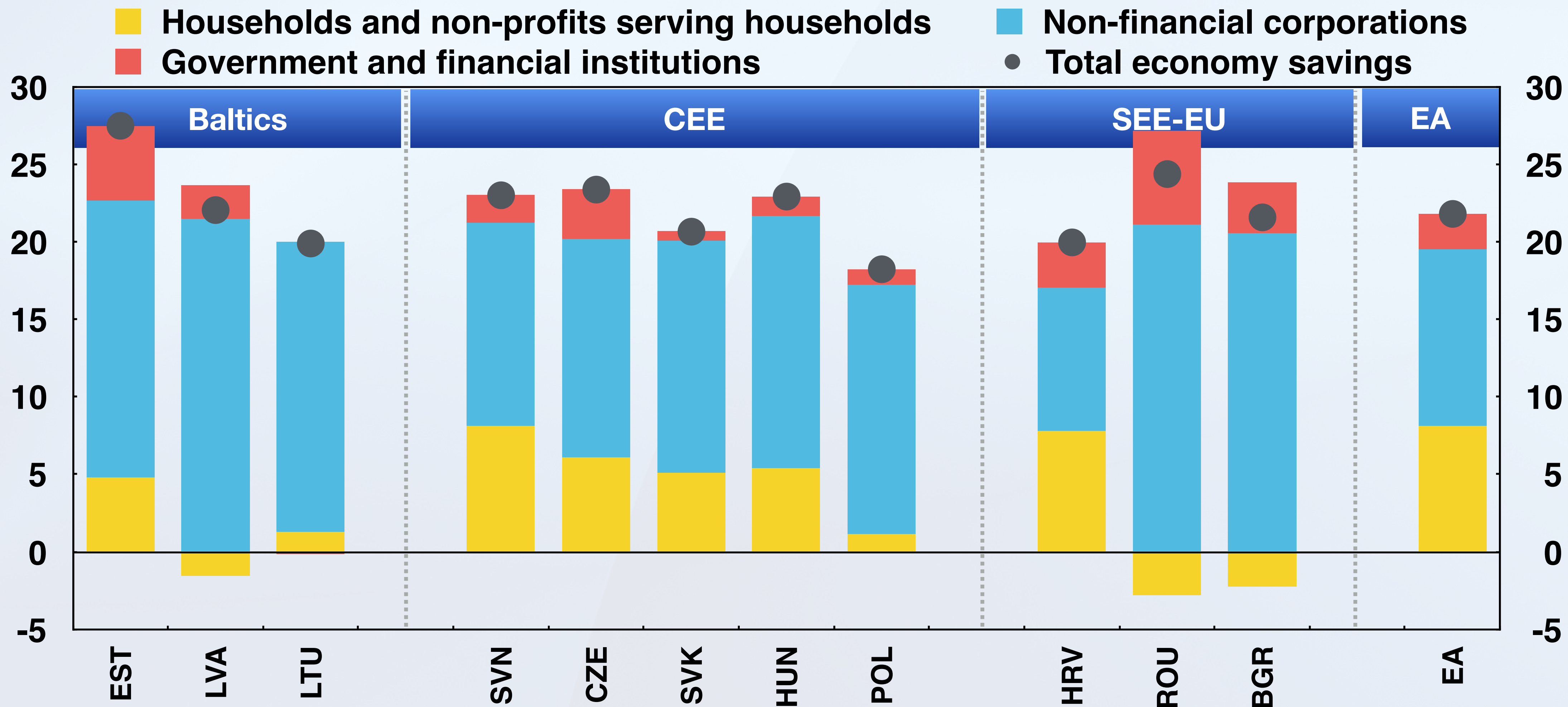
(percent of GDP)



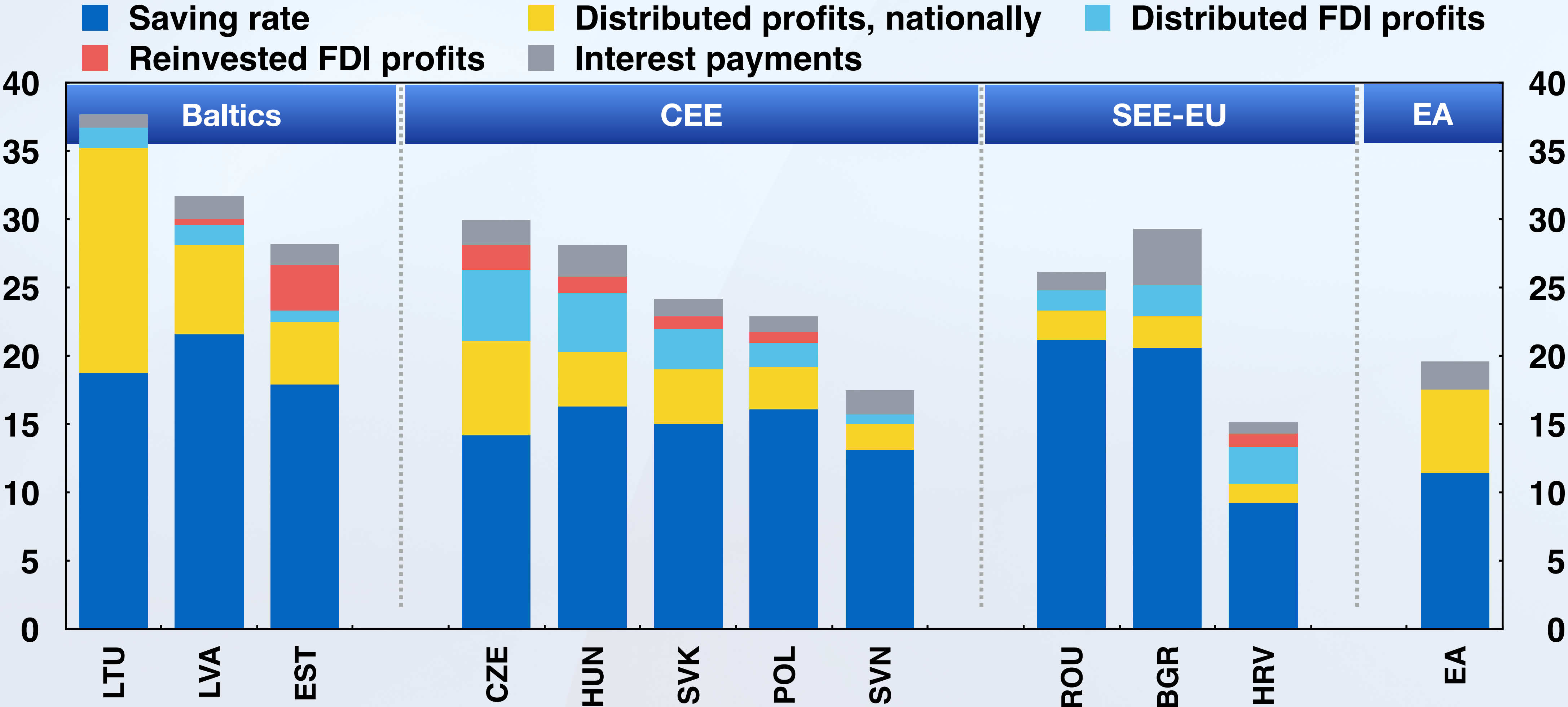
CAPITAL

Household savings are below advanced Europe

Economy-Wide Saving Rates: Composition
(average 2011-14, percent of GDP)

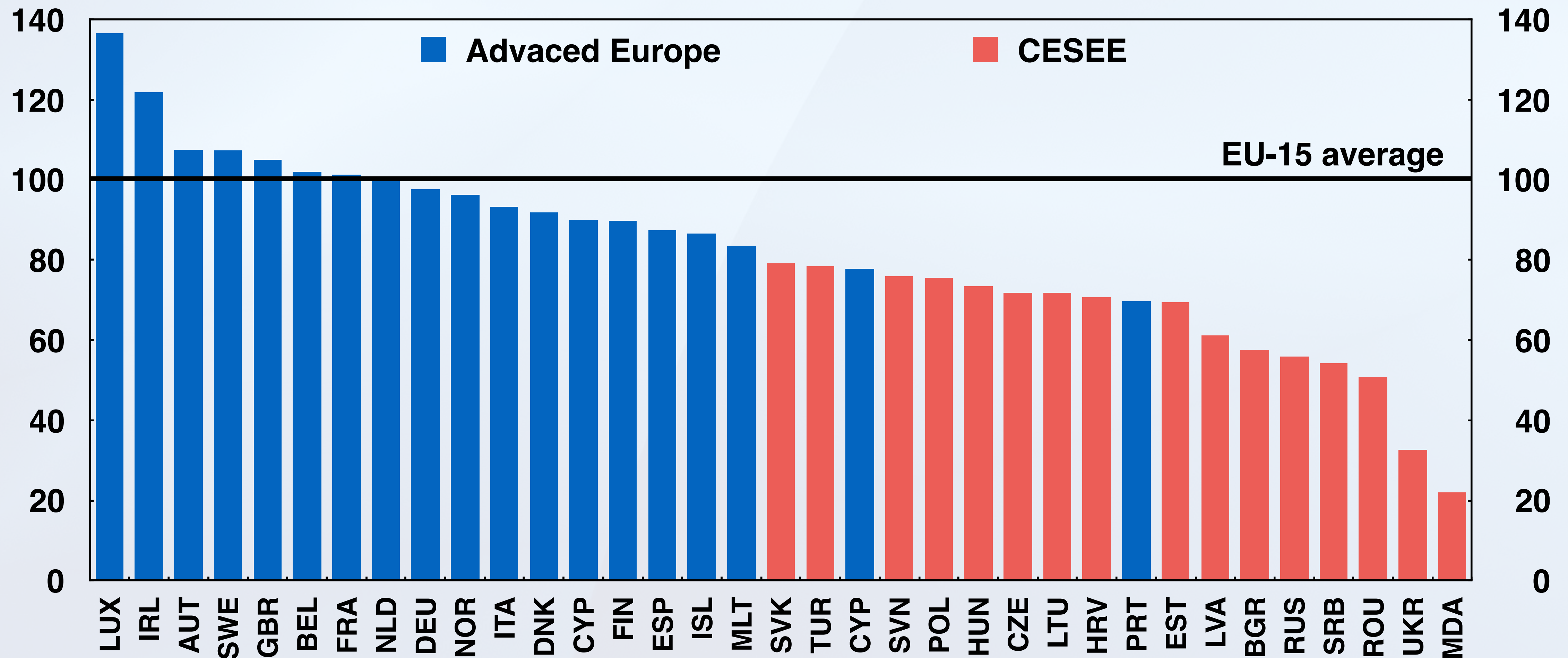


Corporate Sector Gross Operating Income
(average 2011-14, percent of GDP)



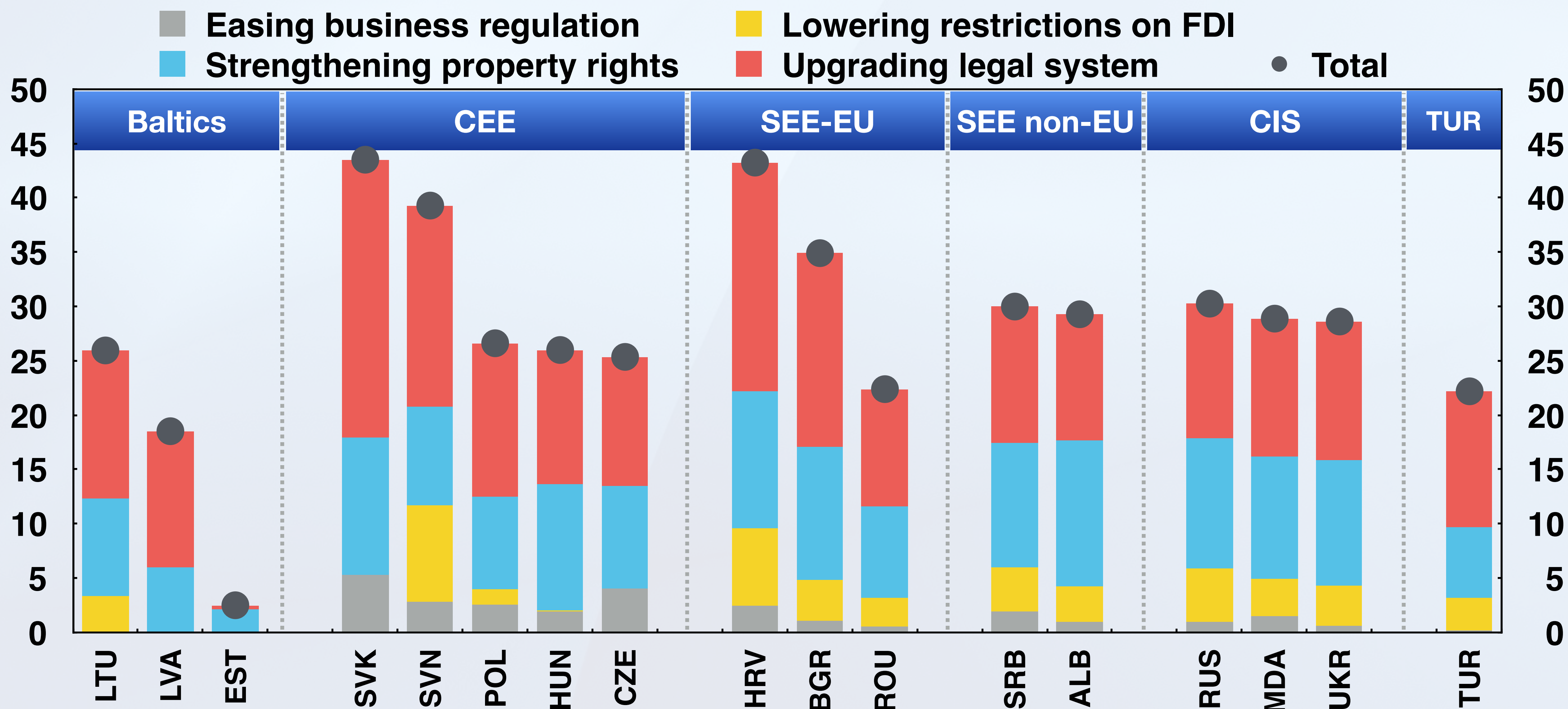
Productivity gaps relative to advanced Europe

Relative Total Factor Productivity Level
(2002-14 average)



Technical efficiency

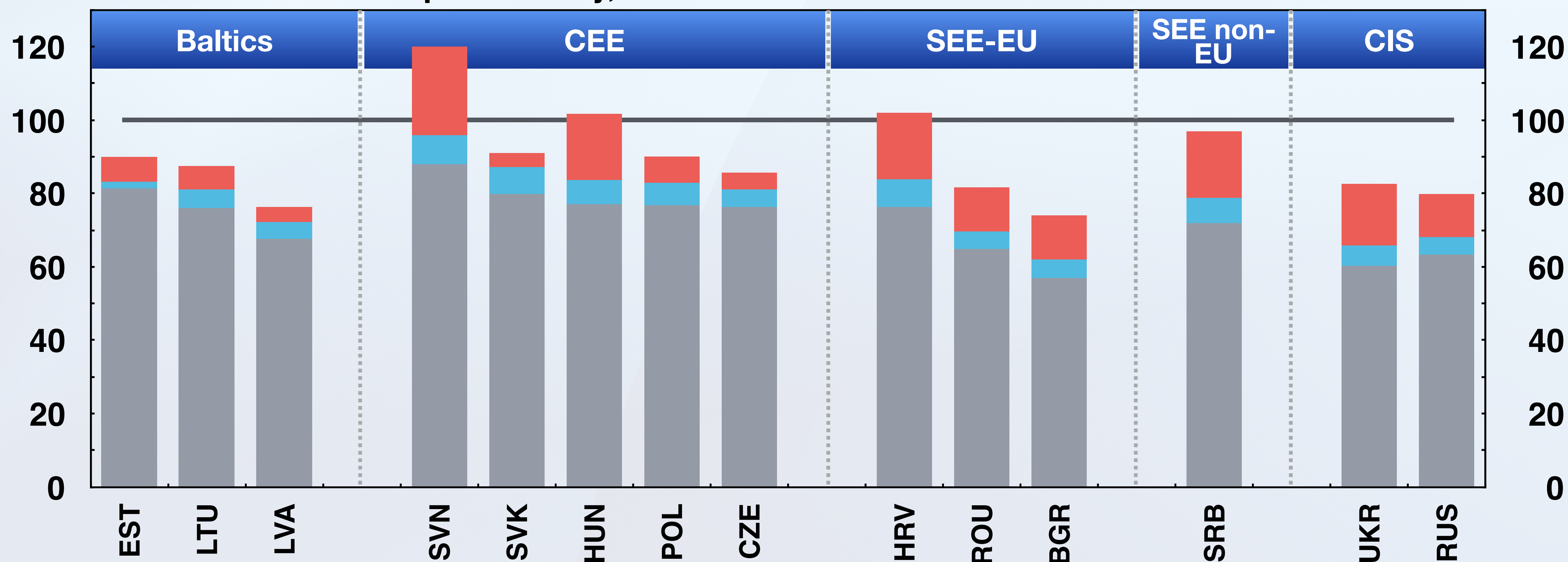
Potential Efficiency Gains From Structural Reforms (percent)



Allocative efficiency

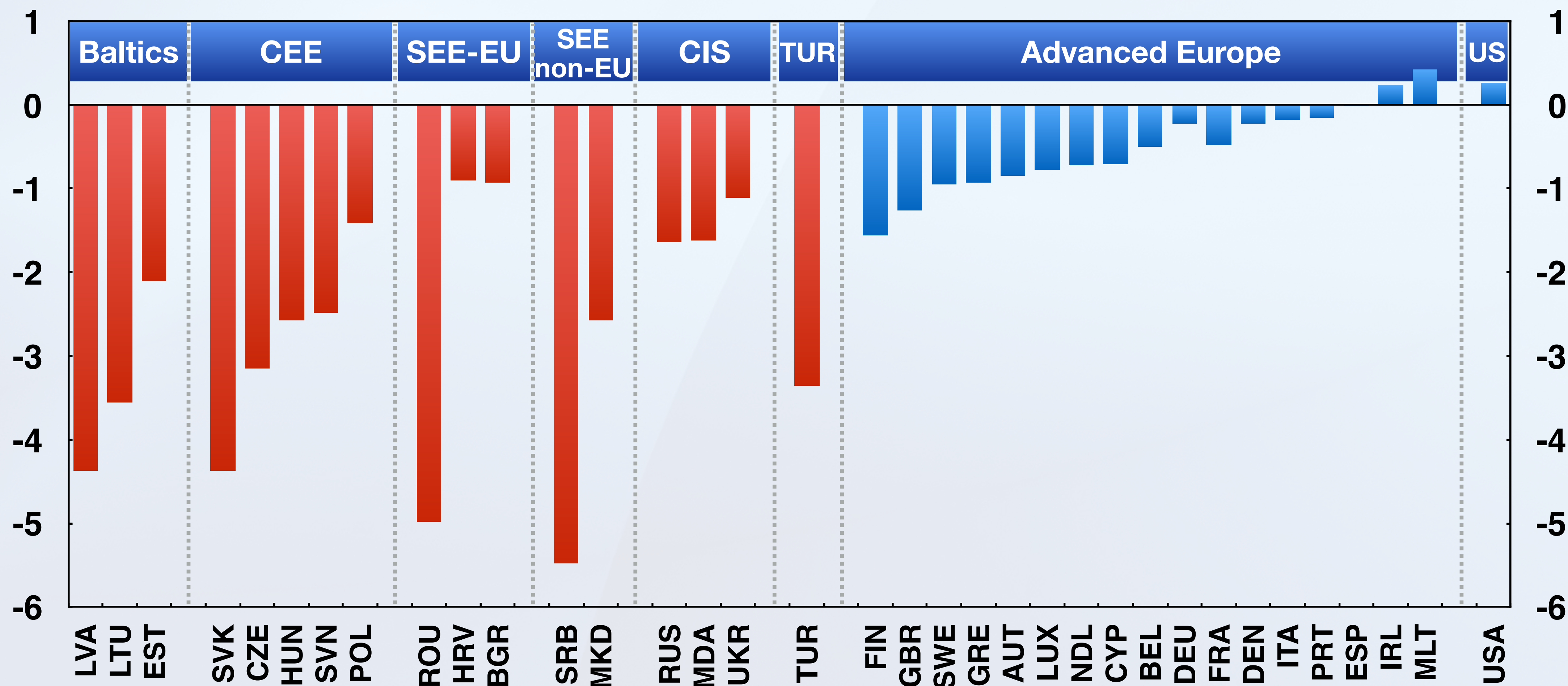
Potential Productivity Gains from Improved Allocative Efficiency (relative labor productivity, Sweden = 100)

- Potential gains from making financial services more affordable
- Potential gains from more efficient government
- Labor productivity, 2013



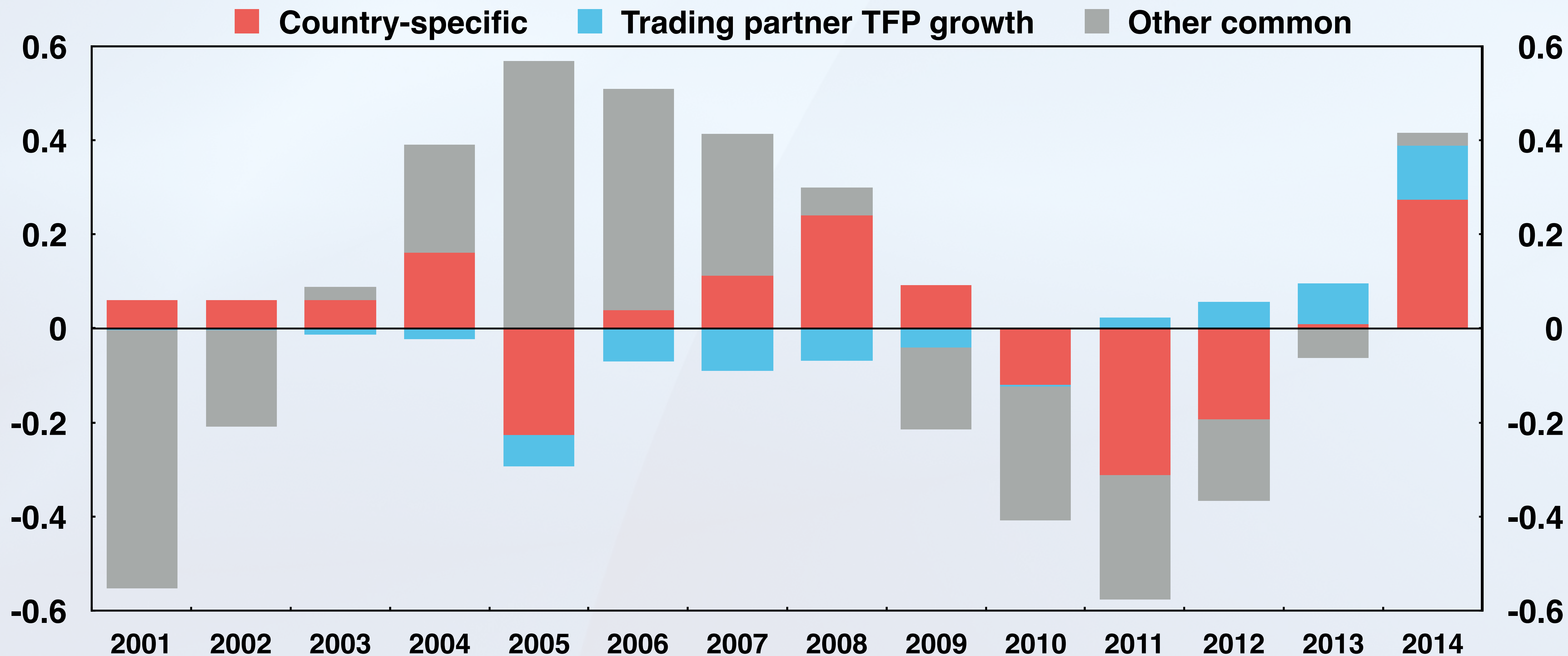
Post-crisis decline in TFP — global phenomenon

Difference Between Average TFP Growth before and after Crisis
(percentage points)



Importance of common factors

CESEE (excl. CIS and Turkey): Common and Country-Specific Components of the TFP Growth
(deviations from the mean, percentage points)



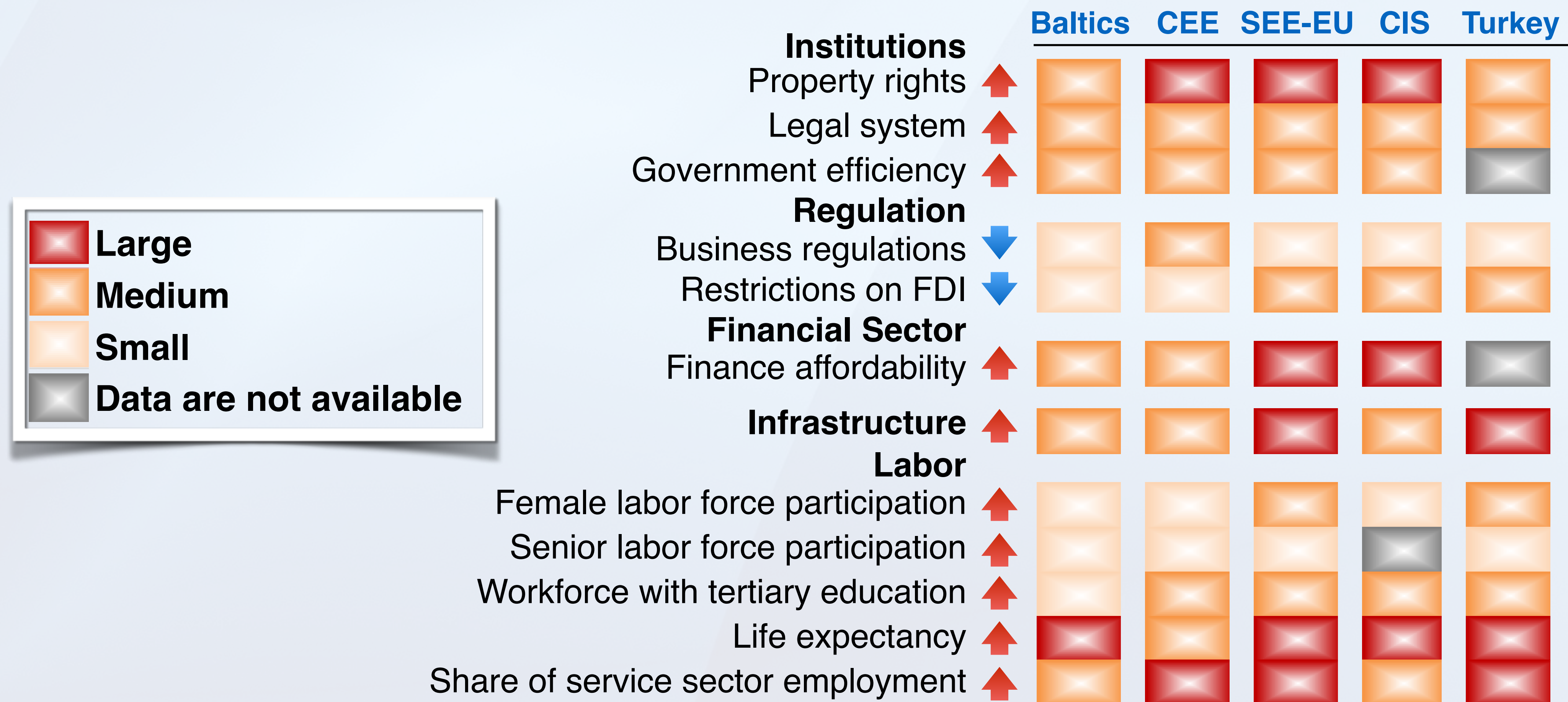


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POLICY PRIORITIES

Structural reform priorities

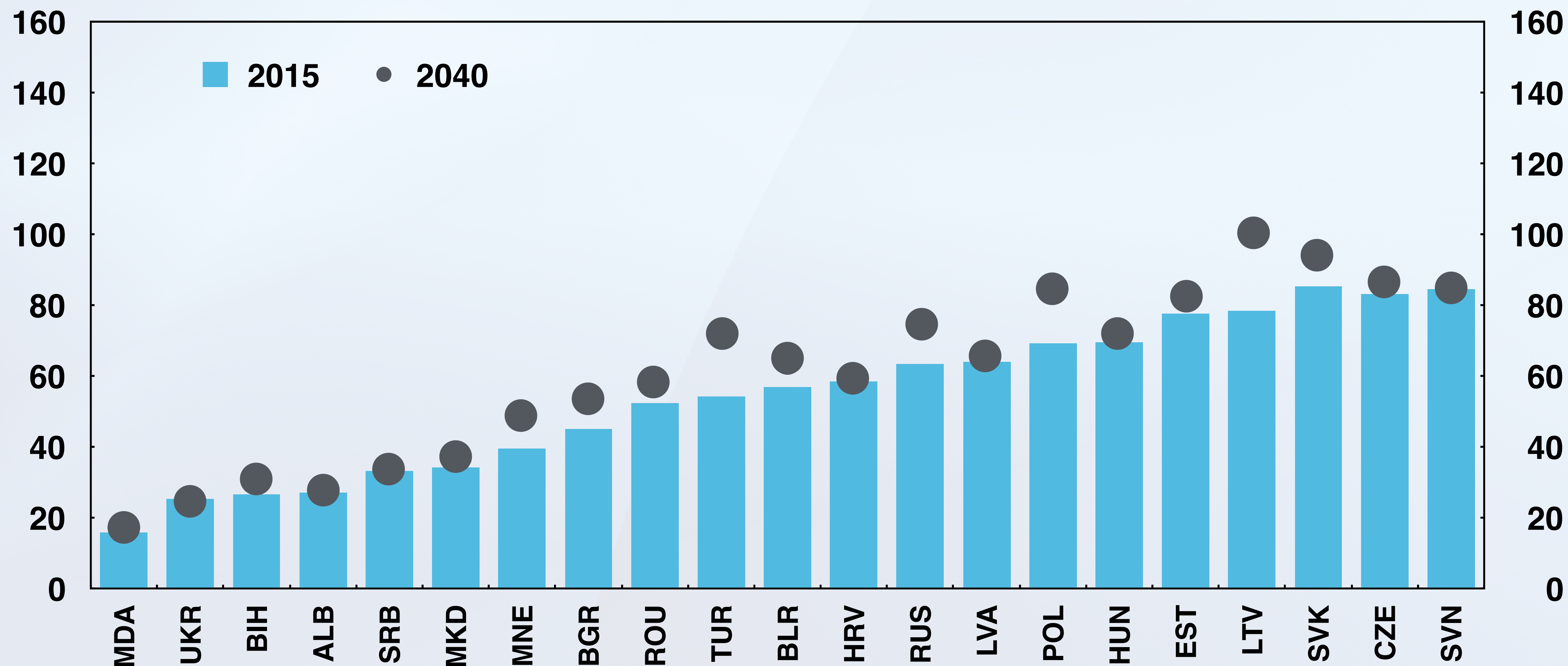
Potential Gains to Long-Term Growth from Policy Actions



Note: The thresholds are based on 25th (2.4 percentage points) and 75th (8.9 percentage points) percentiles of the distribution of growth impact of all policy measures across all CESEE countries. The growth impact of policy measures is calculated assuming that CESEE countries will improve their structural characteristics to the average level of EU-15.

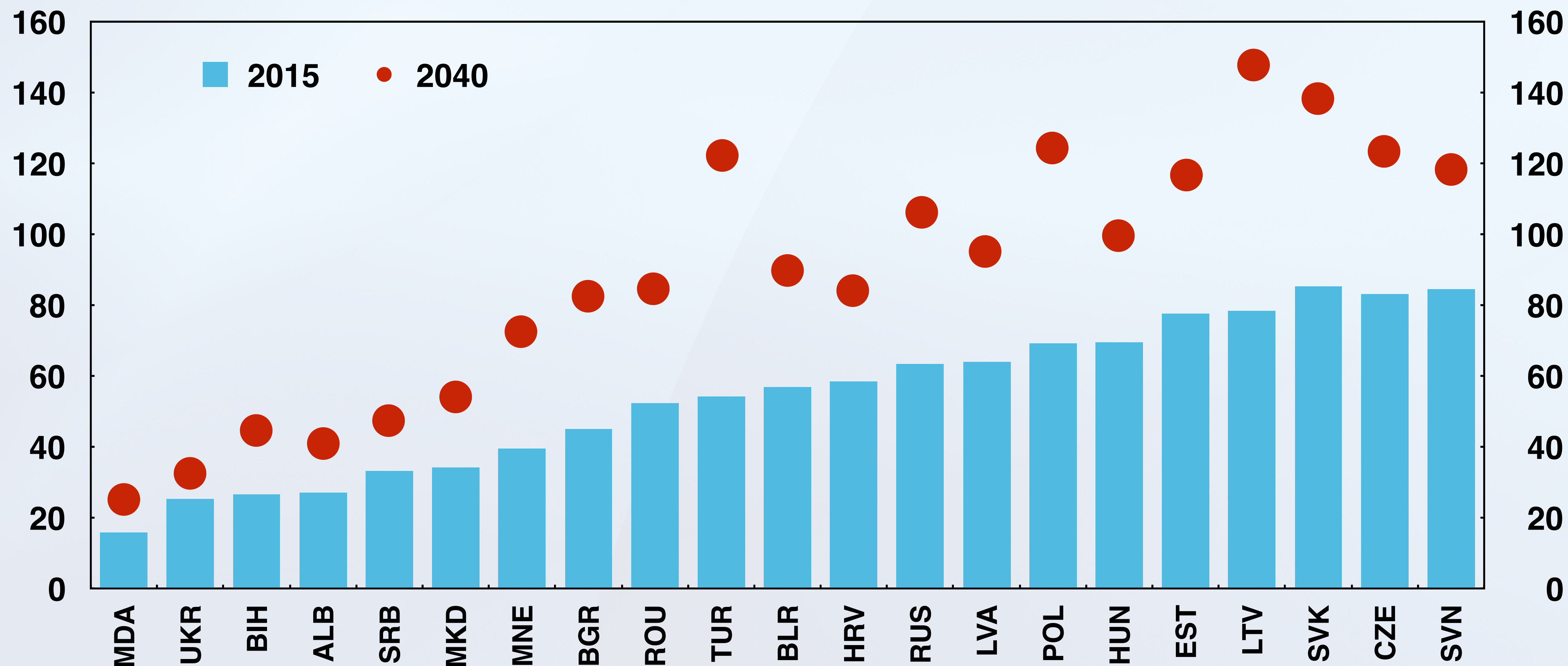
Need faster TFP growth to speed up convergence

TFP Growth Same as Euro Area
(percent of euro area income per capita)



Need faster TFP growth to speed up convergence

Constant Positive TFP Growth Differential relative to Euro Area
(percent of euro area income per capita)



Key Takeaways

Recovery amid headwinds

CESEE non-CIS: cyclical recovery near complete

CIS: gradual emergence from recession

...but more downside risks

Stalled convergence

Unfavorable demographics

Weak productivity growth

Weak investment growth

Reforms needed

Rebuilding fiscal buffers

Productivity enhancing structural reforms

Labor market policies