

May 5 2021

wiiw Spring Seminar online presentation

Darkest before the dawn?

wiiw Spring Forecast and medium-term outlook for CESEE

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Overview

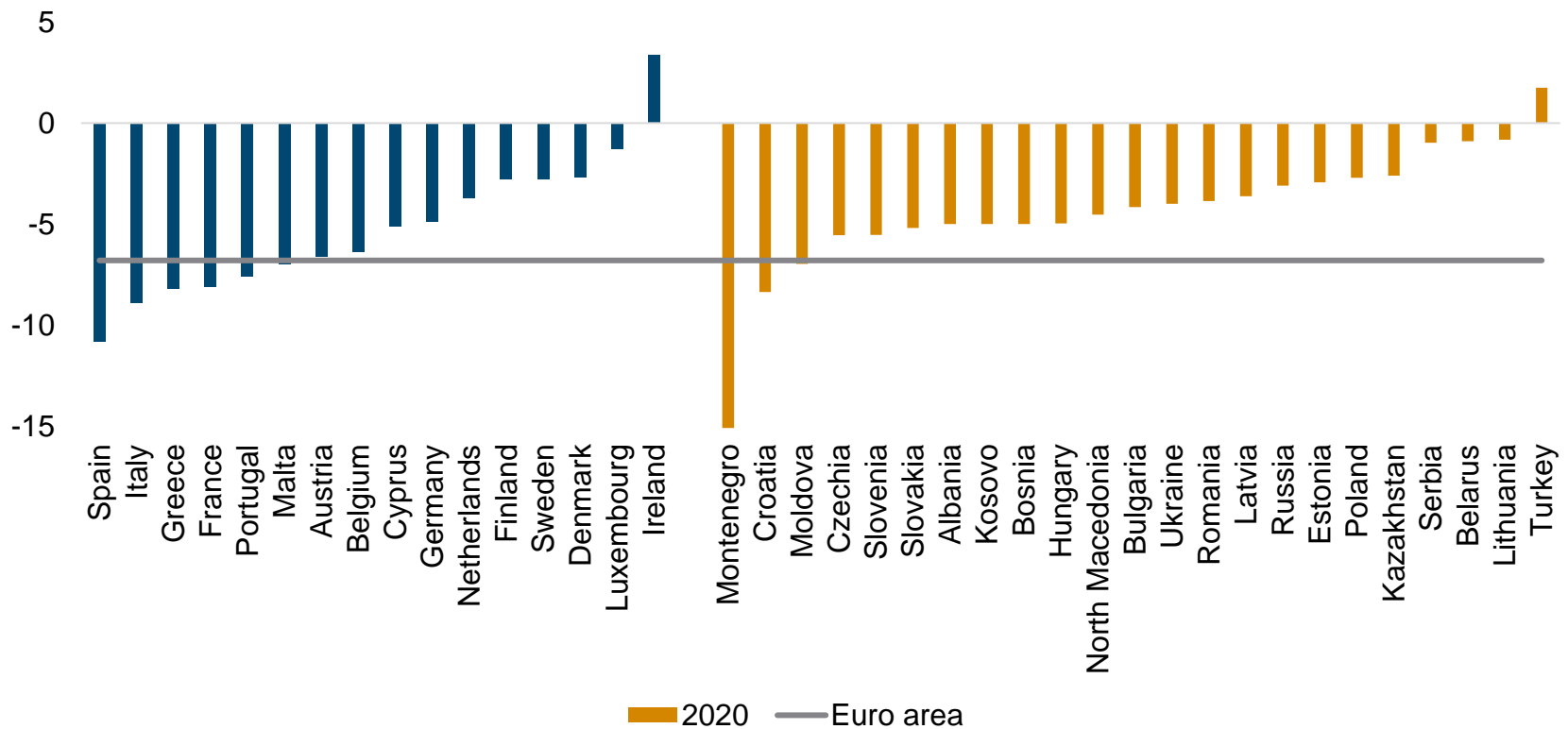
1. New forecasts for CESEE: Recovery delayed
2. Why has the second wave been so bad in CESEE?
3. Drivers of growth in 2021-23: Waiting for vaccines
4. Financial sector: This is not 2008, but watch for asset bubbles
5. Other risks: Rising US rates, inflation, labour markets
6. CESEE in the 2020s

1. New CESEE forecasts:

Outperformance over, recovery delayed

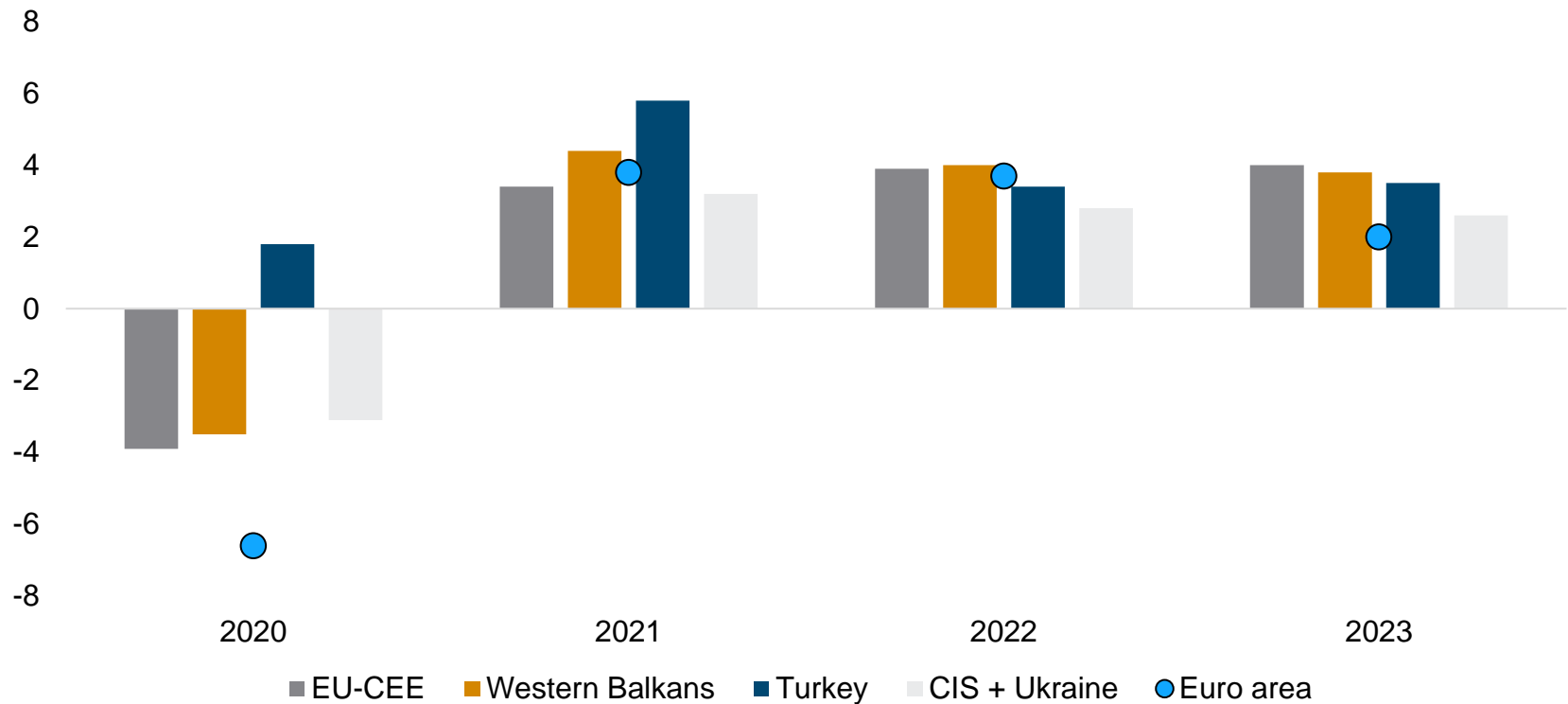
In 2020 CESEE mostly did better than Western Europe and especially the big euro area countries (ex. Germany)

Real GDP, 2020, % change versus previous year



New forecasts: Most of CESEE will not outperform euro area again this year

Real GDP, % change versus previous year



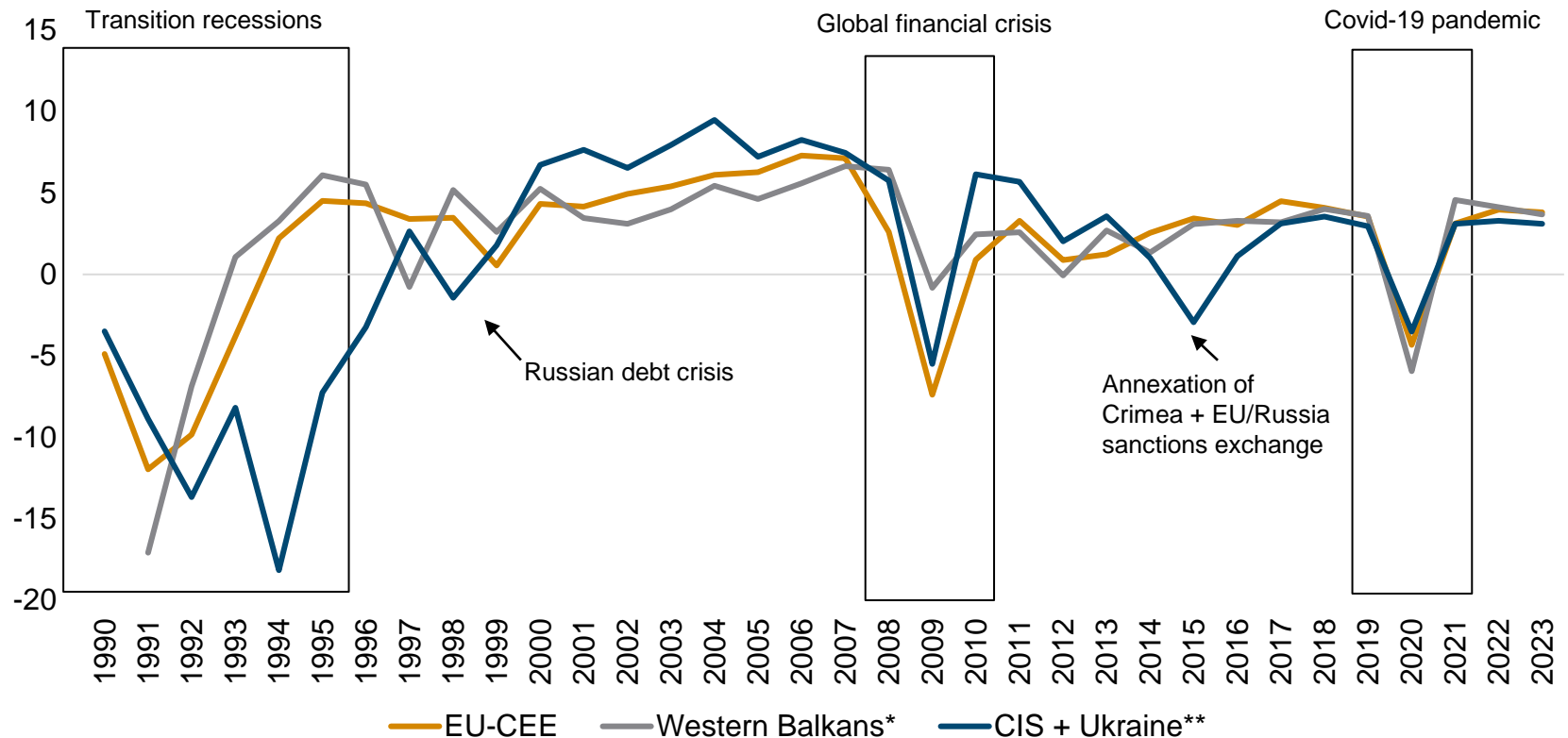
New forecasts: 2021 strongest in Southeast Europe

Revisions: Mostly downwards in EU-CEE this year

		Forecast, %			Revisions, pp	
		2021	2022	2023	2021	2022
EU-CEE	BG	2.5	3.1	3.4	↑ 0.8	↑ 0.5
	CZ	2.9	3.2	3.9	↓ -1.0	↓ -0.3
	EE	1.2	3.8	4.3	↓ -2.7	↑ 0.8
	HR	4.5	4.6	3.7	↓ -0.5	↑ 0.6
	HU	3.9	4.5	4.0	↑ 0.9	↓ -0.1
	LT	2.1	3.8	3.5	↓ -2.4	↑ 0.6
	LV	2.8	4.2	3.8	↓ -1.6	↑ 1.4
	PL	3.4	3.6	4.4	↓ -0.1	↑ 0.2
	RO	3.8	4.5	4.0	↑ 0.1	⇒ 0.0
	SI	3.6	4.0	3.3	↓ -0.9	↑ 1.0
	SK	3.6	4.4	3.5	↓ -0.5	↑ 0.5
Western Balkans	AL	4.5	4.4	3.8	↓ -0.1	↑ 0.4
	BA	2.5	2.9	3.3	↓ -0.7	↓ -0.2
	ME	6.5	5.0	3.7	↑ 1.5	↑ 0.9
	MK	4.1	3.4	3.2	↓ -0.4	↓ -0.6
	RS	5.0	4.4	4.2	↑ 0.5	↑ 0.3
	XK	4.8	4.6	3.9	⇒ 0.0	↑ 0.3
Turkey	TR	5.8	3.4	3.5	↑ 1.7	↓ -1.2
CIS+UA	BY	1.5	1.9	2.2	↑ 2.7	↑ 0.6
	KZ	3.2	4.1	4.4	↑ 0.7	↑ 0.1
	MD	4.0	4.5	3.5	⇒ 0.0	↑ 0.5
	RU	3.2	2.7	2.3	↑ 0.7	↑ 0.6
	UA	3.5	3.2	3.0	↑ 1.5	↓ -0.4

The region has seen much worse in fairly recent times

Real GDP growth, % per year, regional (simple) averages

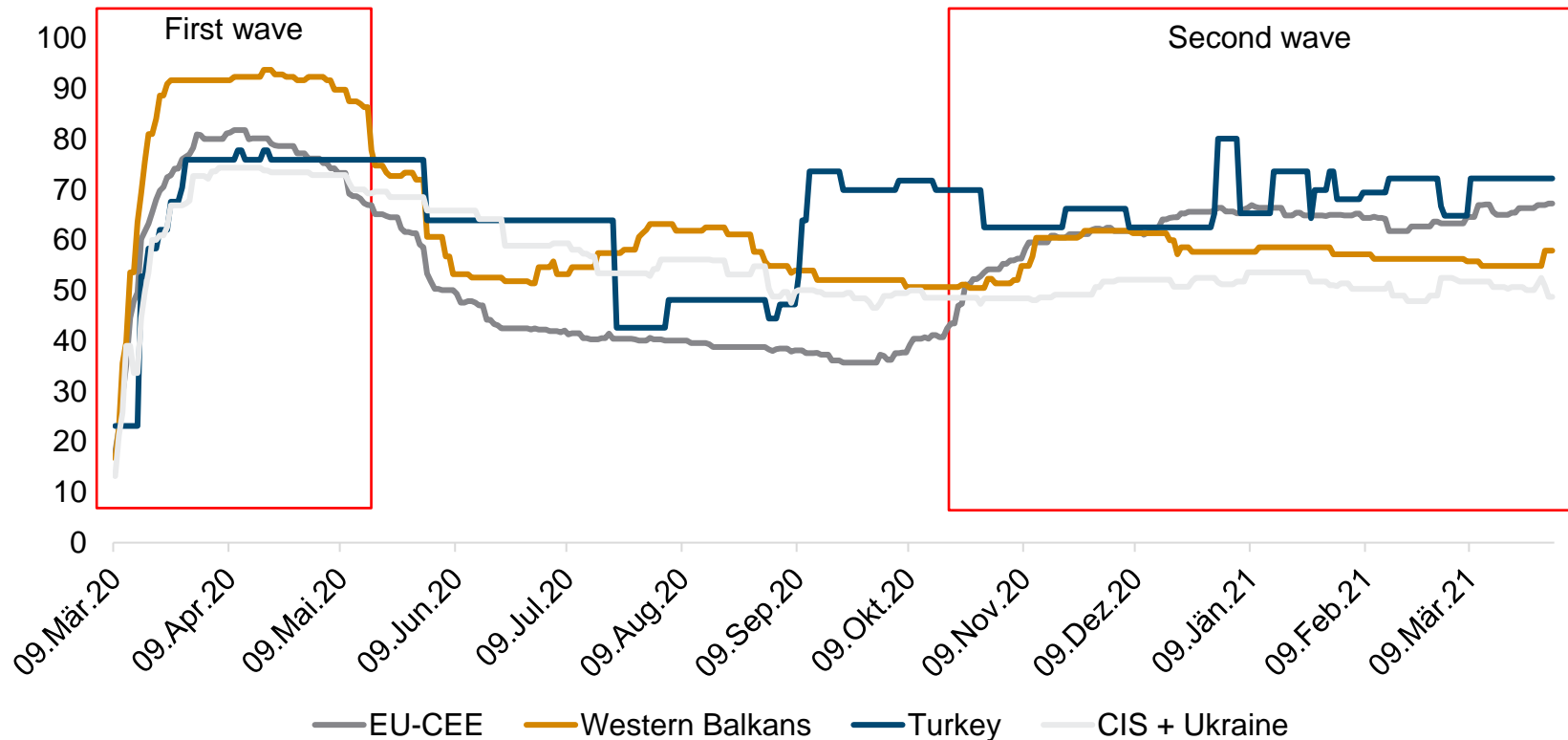


Source: National sources, wiiw. *Average includes Albania and North Macedonia from 1991, Serbia from 1996, Bosnia and Herzegovina and Montenegro from 2000, and Kosovo from 2001. **Average includes Russia and Ukraine from 1990, and Belarus, Kazakhstan and Moldova from 1991.

2. Why was the second wave so bad in CESEE?

In the second wave, CESEE has sacrificed public health for the economy, in terms of restrictions...

Stringency index (0 = min; 100 = max)

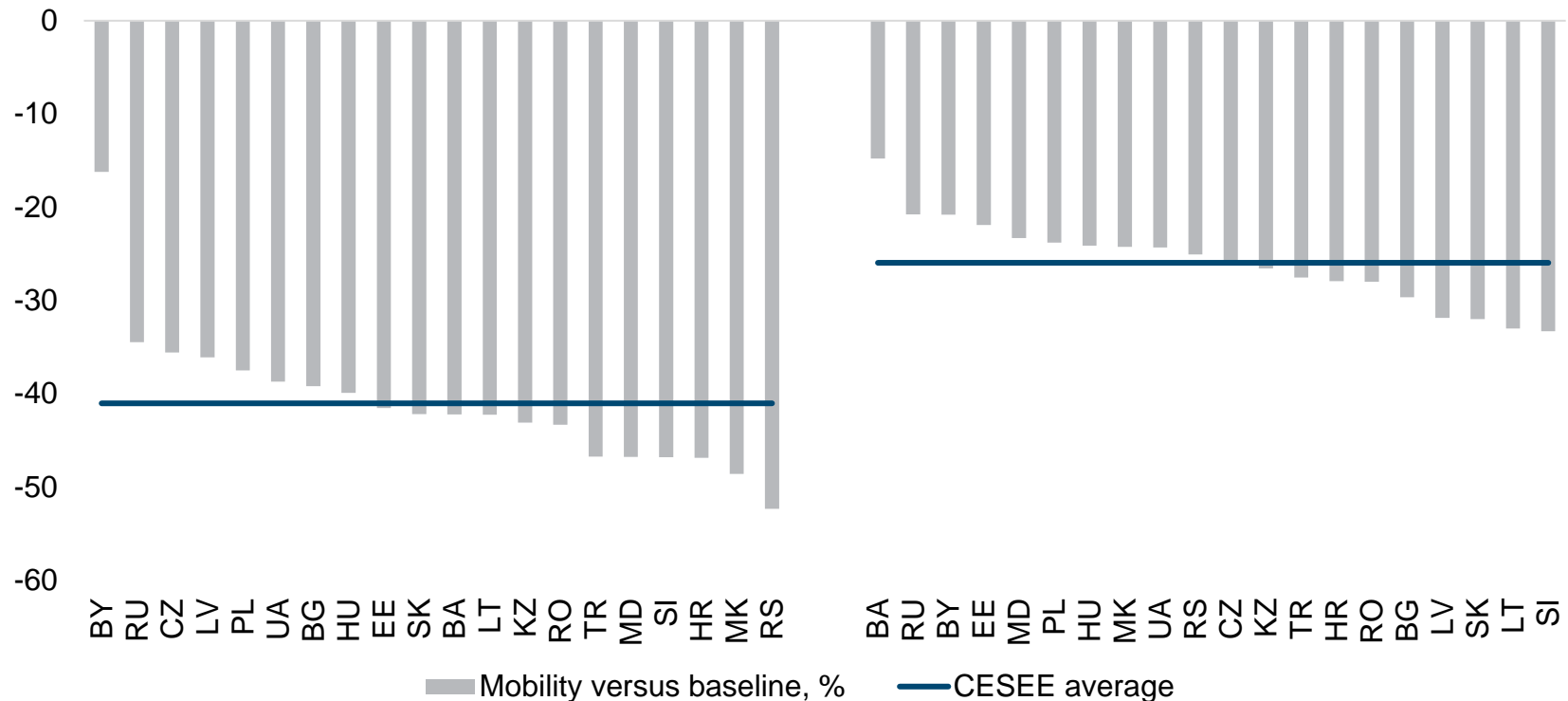


...and mobility

Google mobility workplace data, % change versus baseline, period averages

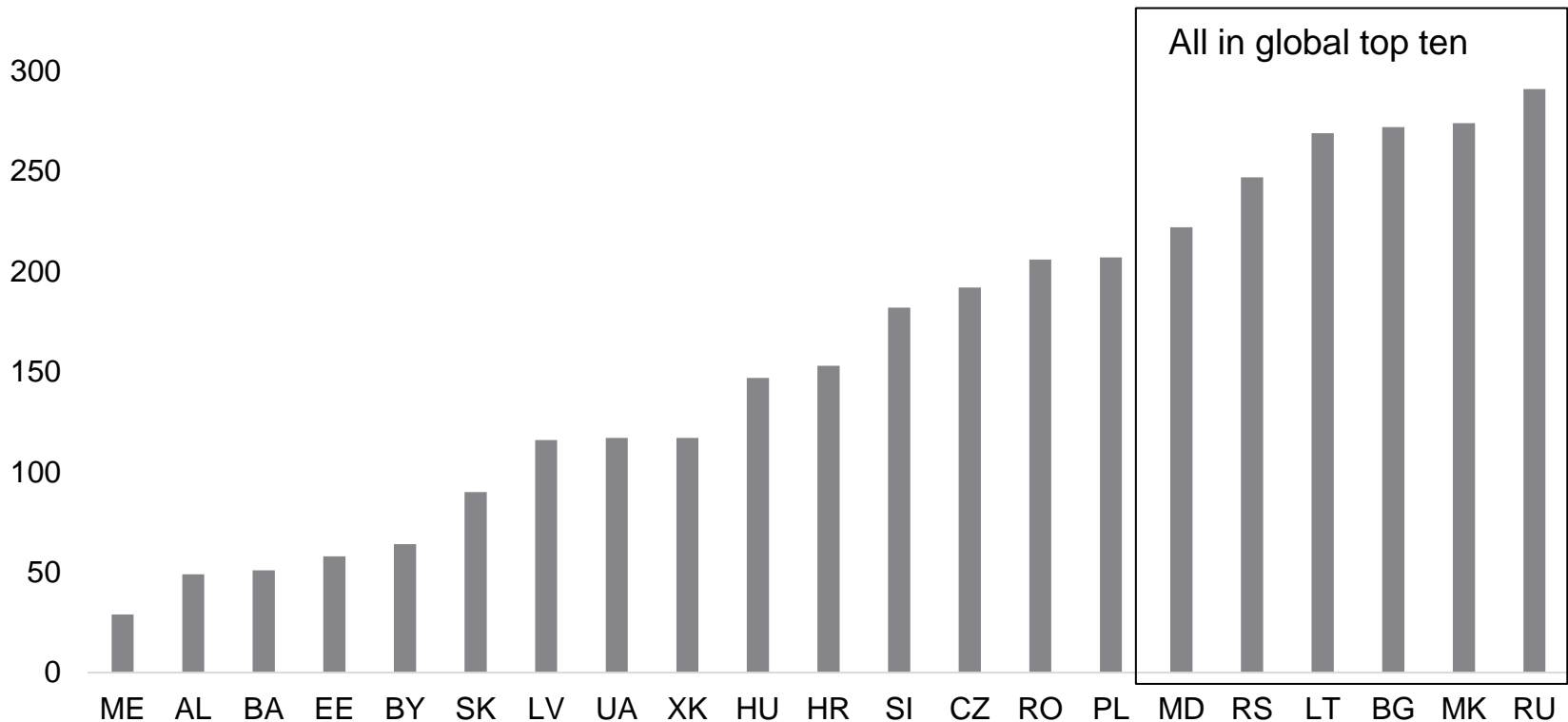
15 March – 15 May 2020

1 November – 28 February 2021



Impact: Six of world's ten highest levels of 'excess deaths' are in CESEE

Excess deaths per 100,000 people, since country's first 50 COVID deaths

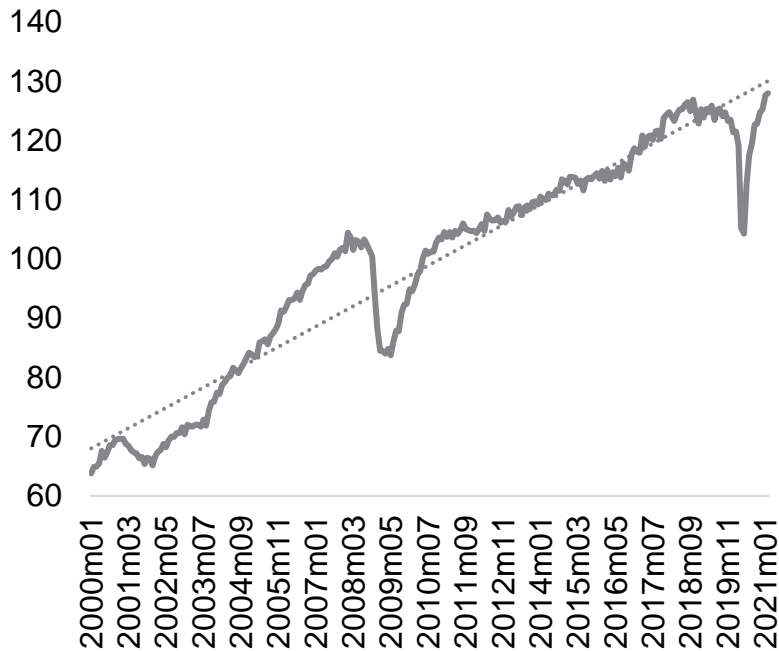


3. Drivers of growth in 2021-23:

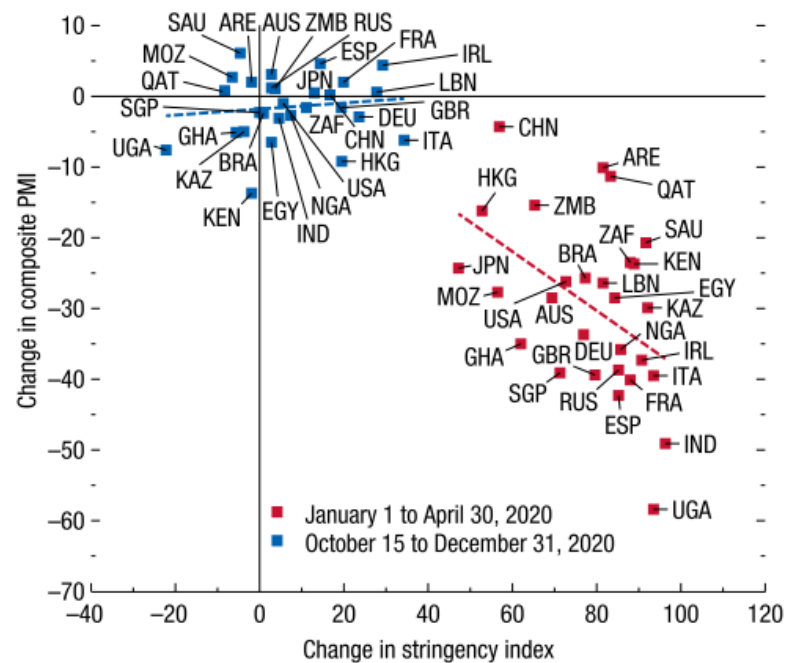
Economies have adapted; waiting for the vaccines

Adaptation: Current and future lockdowns will not have same negative economic impact as first wave

Global merchandise trade volume, 2010 = 100, seasonally adjusted

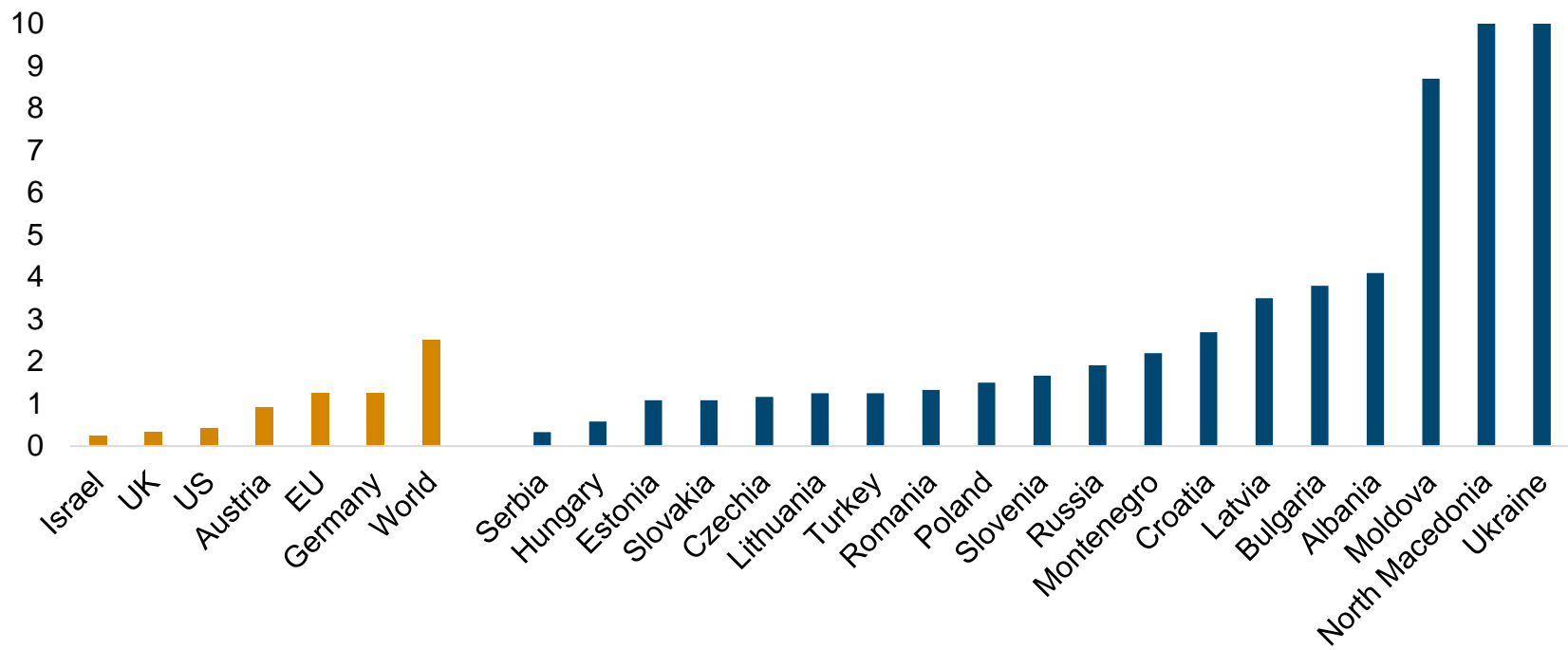


Economic activity and mobility in first versus second wave



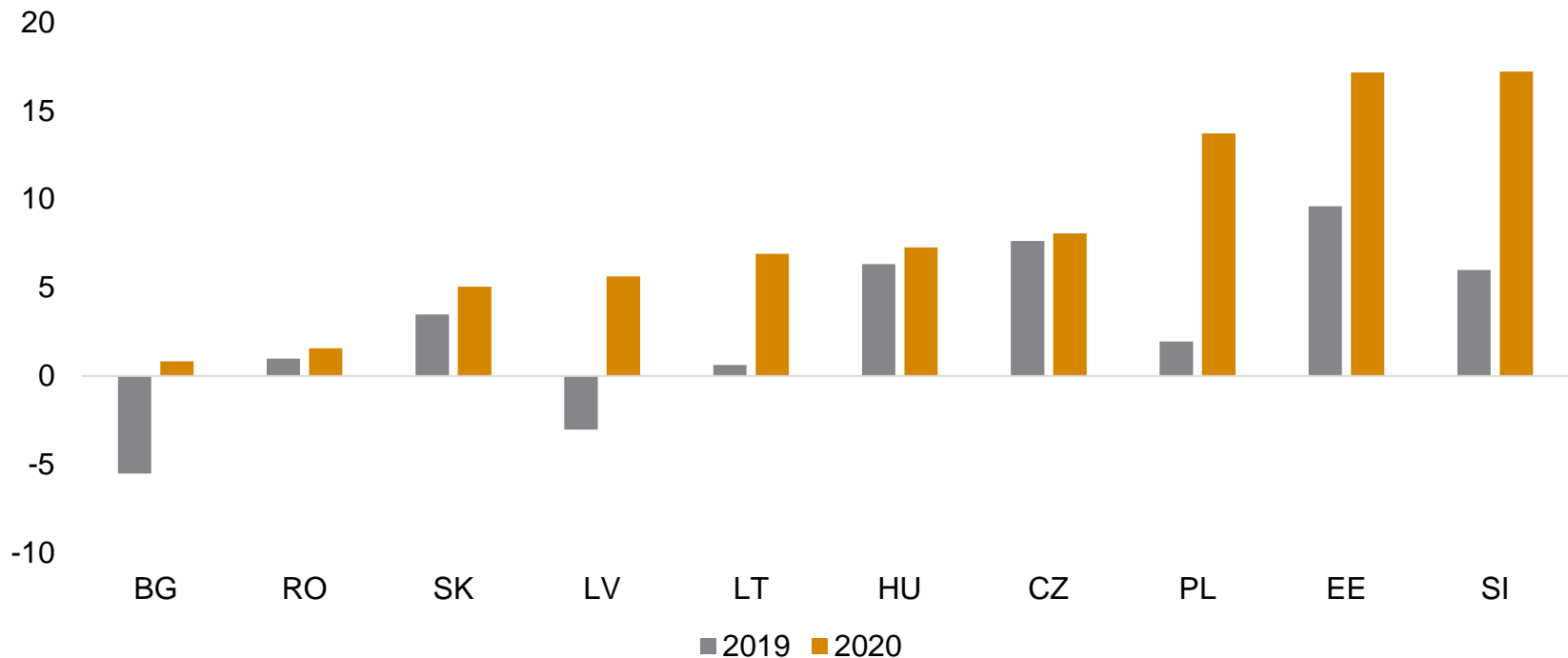
The central question: How quickly can vaccination rates increase? Huge divergence within CESEE.

Years until 75% of population are vaccinated, based on current vaccination rates



Once vaccination rates increase and weather improves, consumption should swing into gear

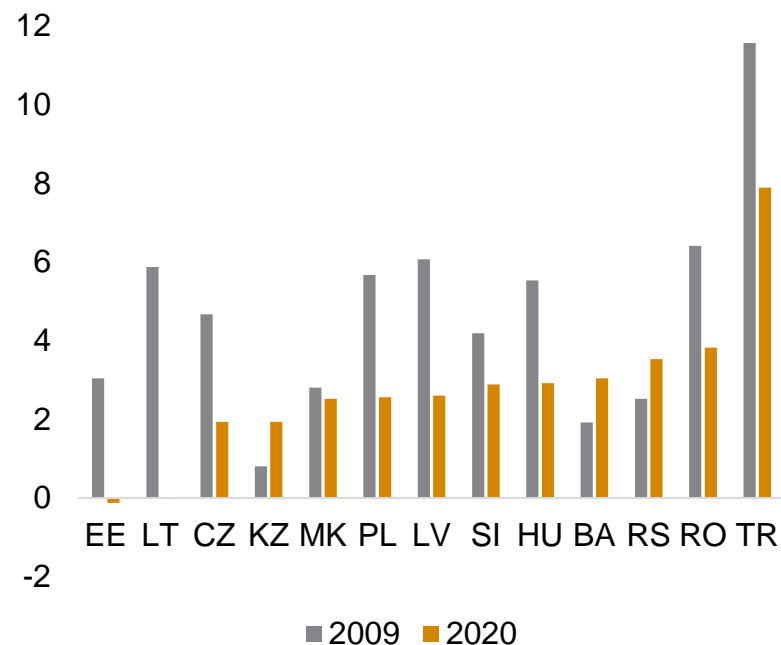
Net savings rates of households, %



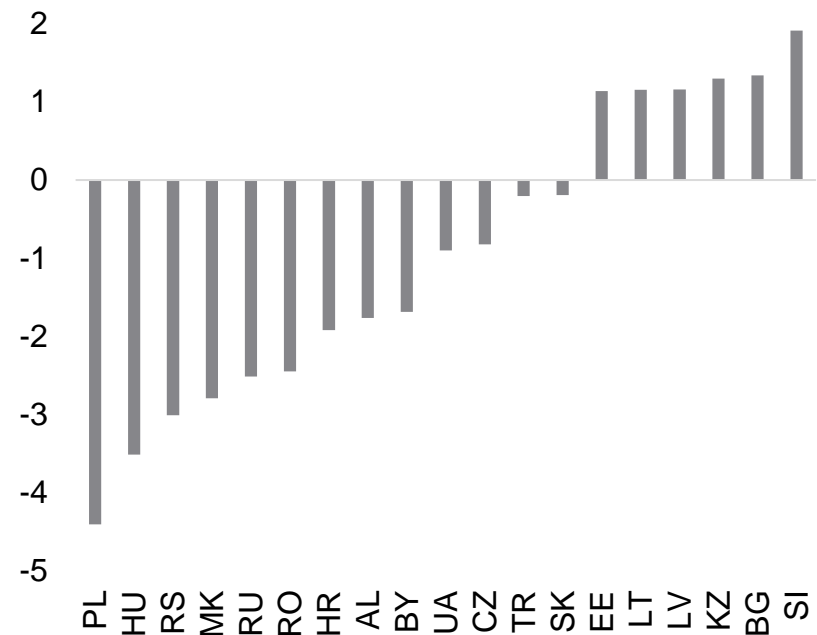
Source: OECD. Note: Net household saving = household net disposable income, adjusted for changes in pension entitlements, minus household final consumption expenditure.

Policy is likely to remain supportive, both at the EU and local levels: cheap debt and room to keep rates low

Effective interest rate on public debt, %



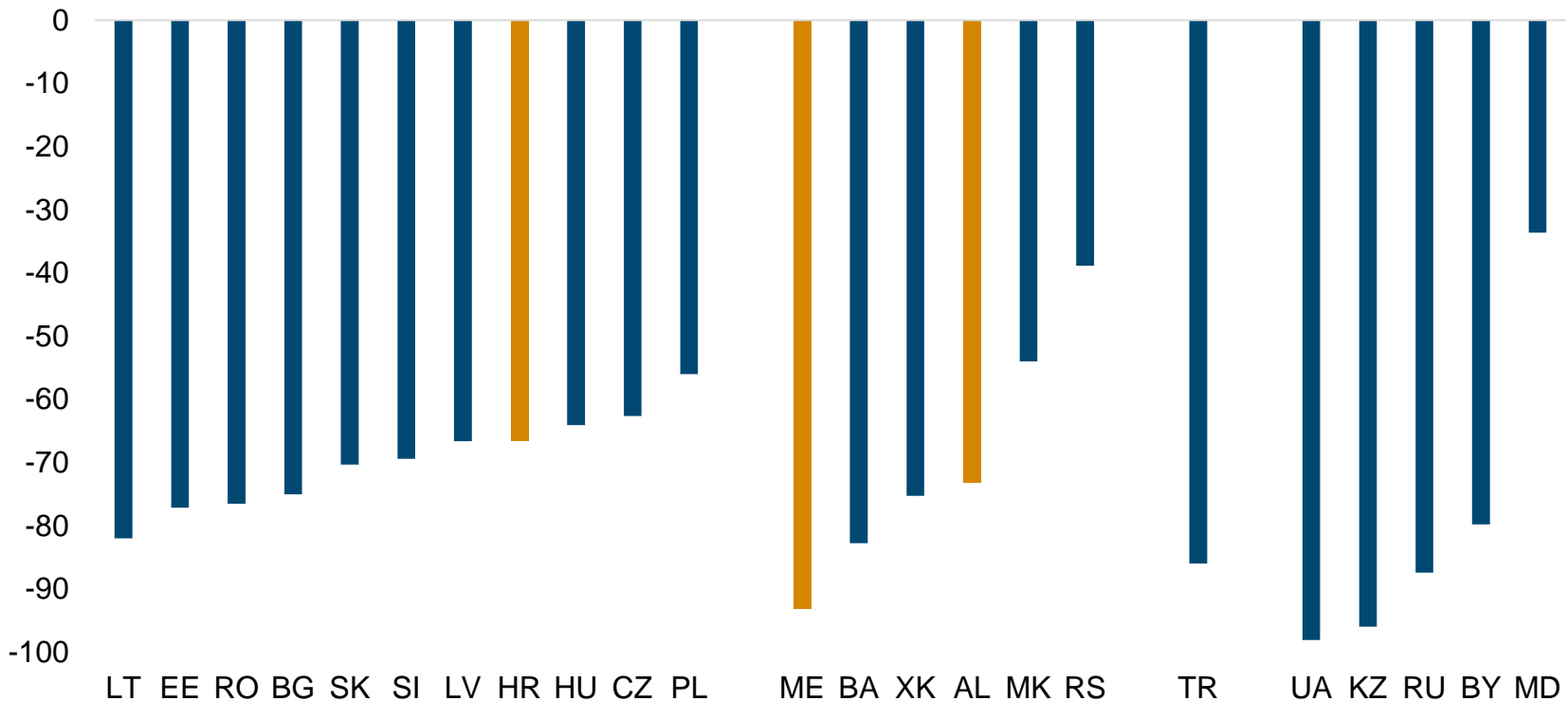
Real interest rates, CPI-adjusted, Feb 2021 vs 2007-19 average, pp



Sources: IMF, national sources, wiiw. Note: Effective interest rate on public debt calculated as interest payments (primary budget balance - overall budget balance) divided by net public debt.

External factors: Room to grow as global recovery gains momentum

Travel services credit (BoP), euro based, % change year on year, April-September 2020

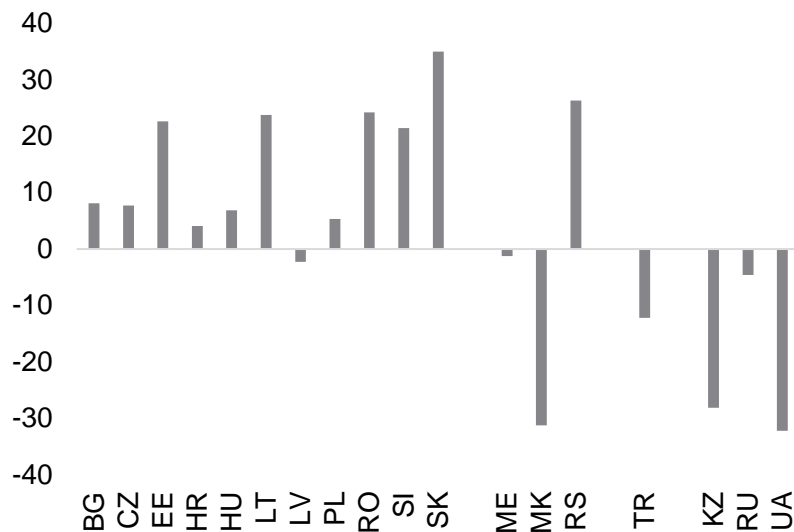


4. Financial sector:

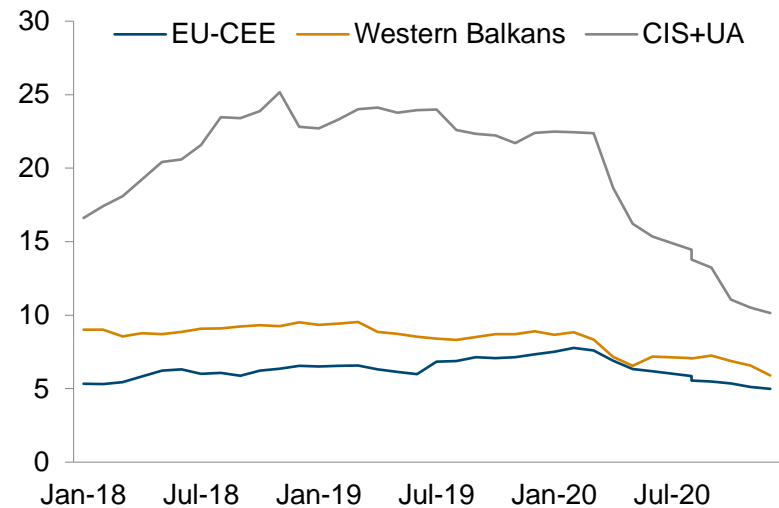
This is not 2008, but watch for asset bubbles

This time is different (vs GFC): ample monetary stimulus, but credit performance remains weak ...

Change in cross-border consolidated bank claims in Q3 2020, % y-o-y



Credit growth of households, % y-o-y



Source: BIS, wiiw calculations

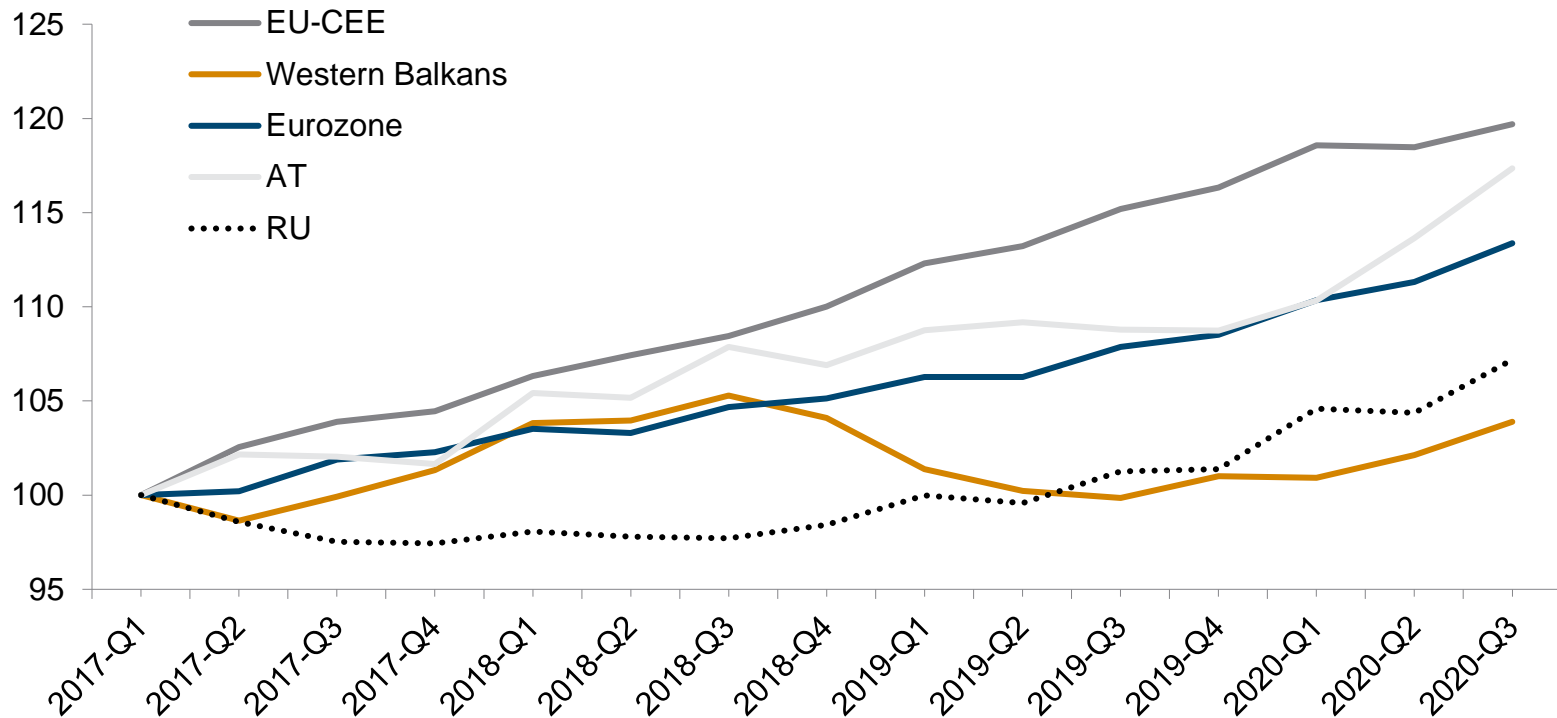
Note: Ultimate risk basis by counterparty, in USD terms

Source: wiiw Monthly Database incorporating national statistics.

Note: Simple averages for country aggregates.

... as liquidity pours into housing market, and risks of price correction are increasing

Index of real residential property prices, Q1 2017=100



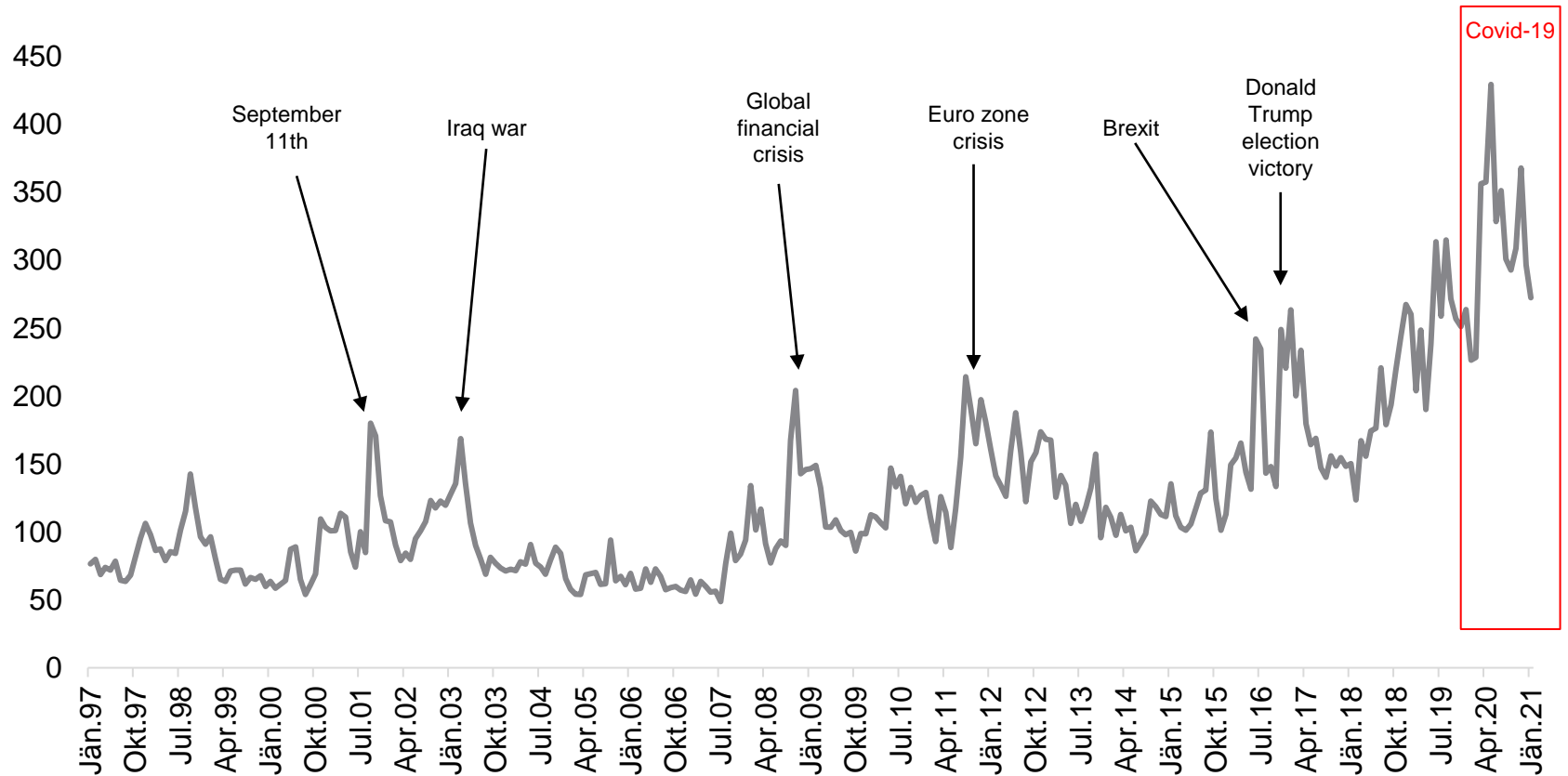
Source: BIS, wiiw calculations.

Note: Simple averages for country aggregates.

5. Risks to the outlook

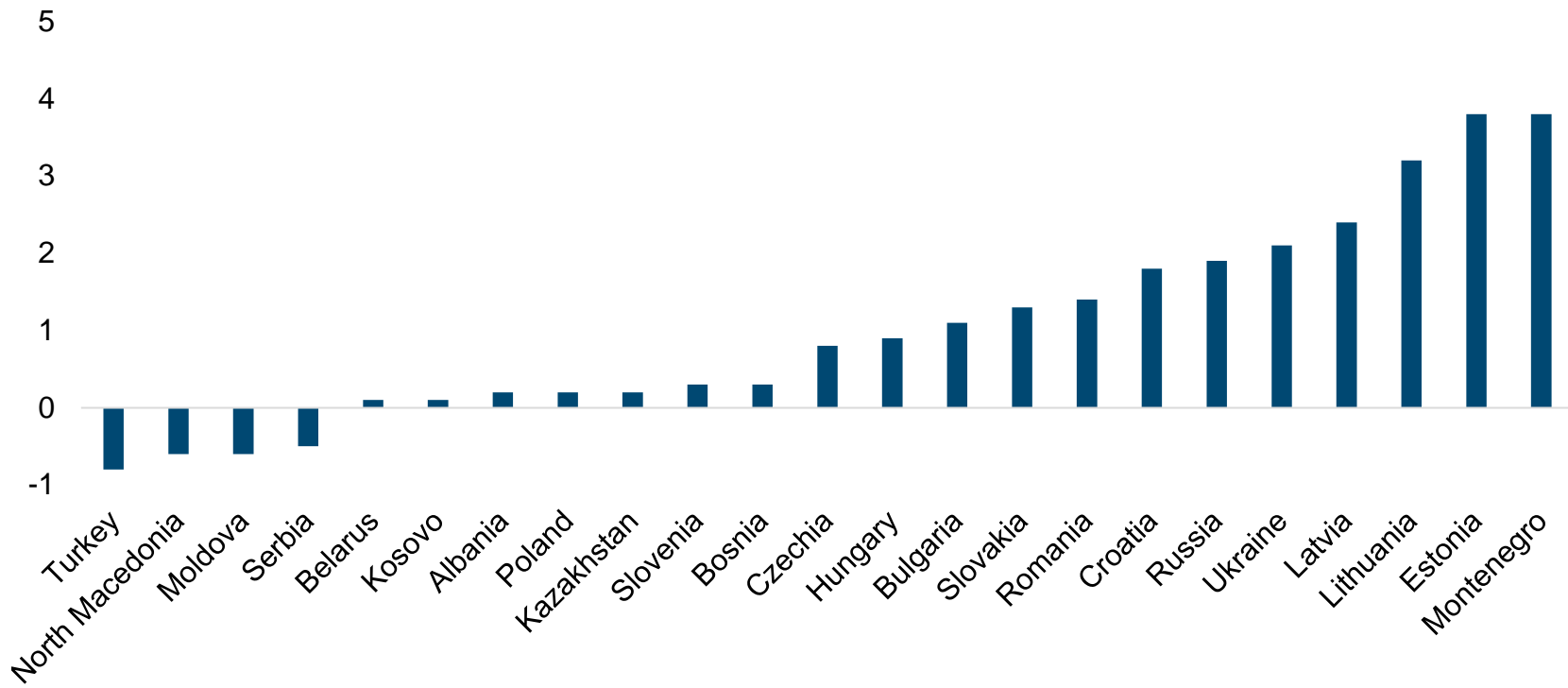
Global uncertainty: Unprecedented levels

Global economic policy uncertainty index



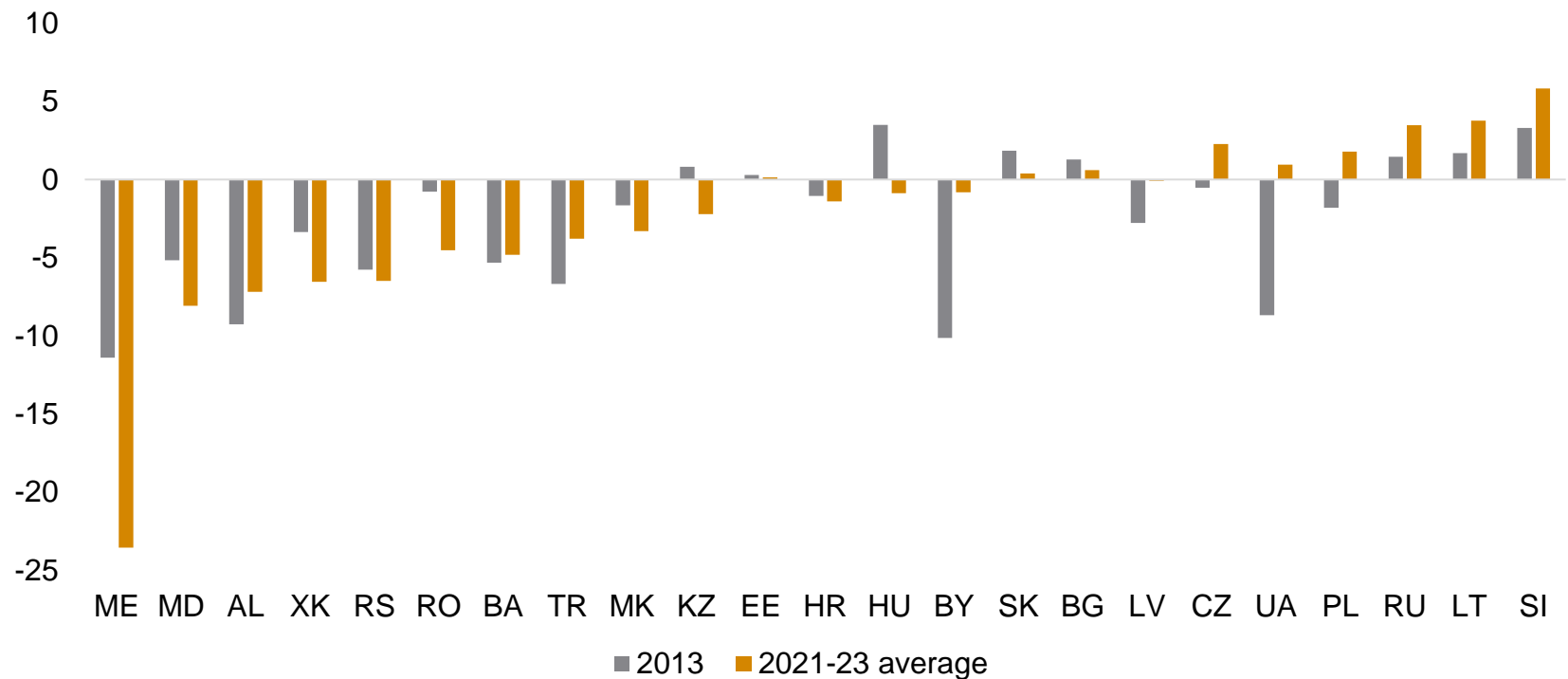
The fallout in the labour market: Mostly limited so far, but headline numbers unlikely to reflect underlying reality

Unemployment rate, pp change between Q3 2019 and Q3 2020



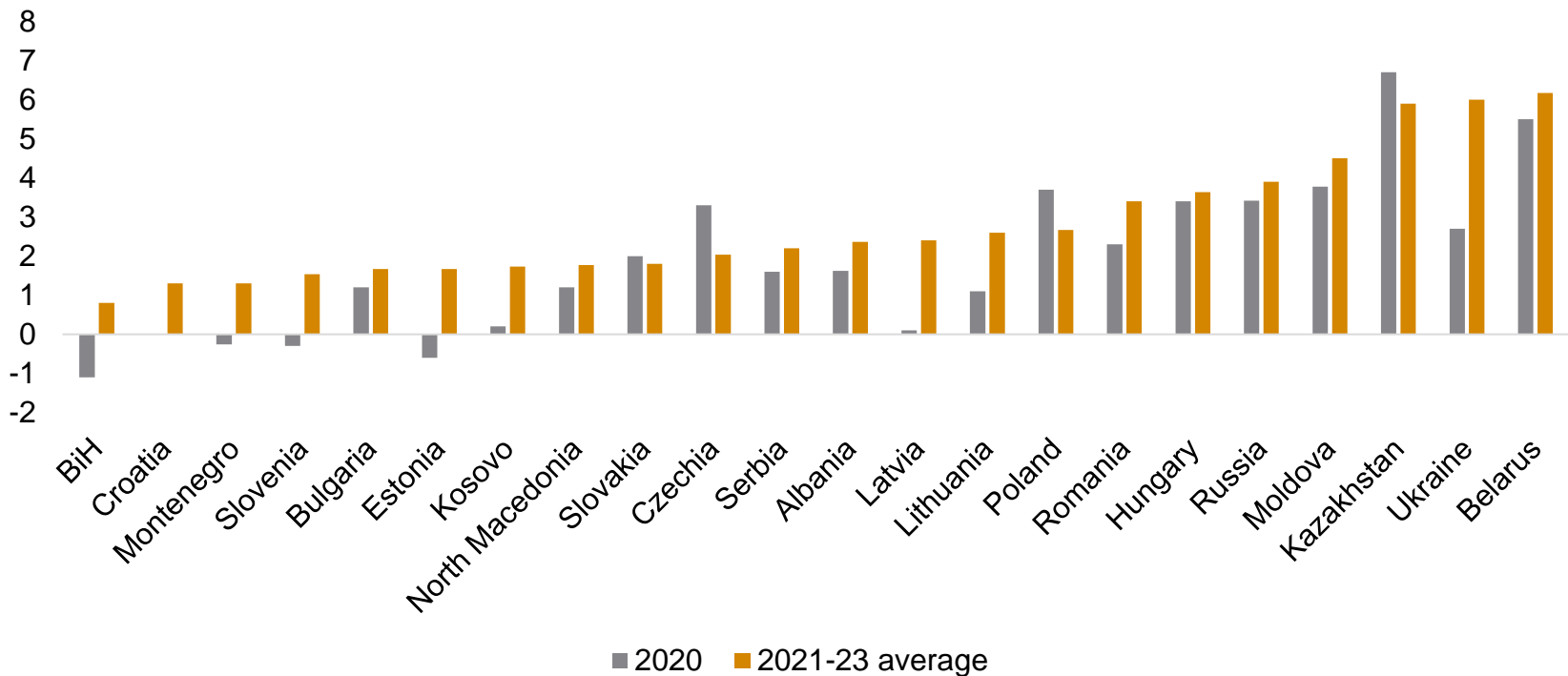
Rising US rates, but this is not 2013 for most countries,
and key rate is anyway the euro for most

Current account, % of GDP



Should we be worried about inflation? Cost pressures rising, but large output gaps will limit pass-through

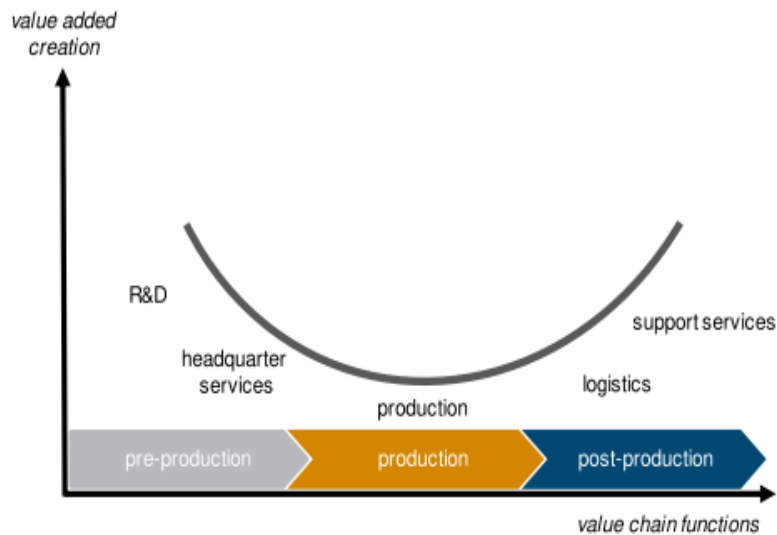
Consumer price index, % change on previous year



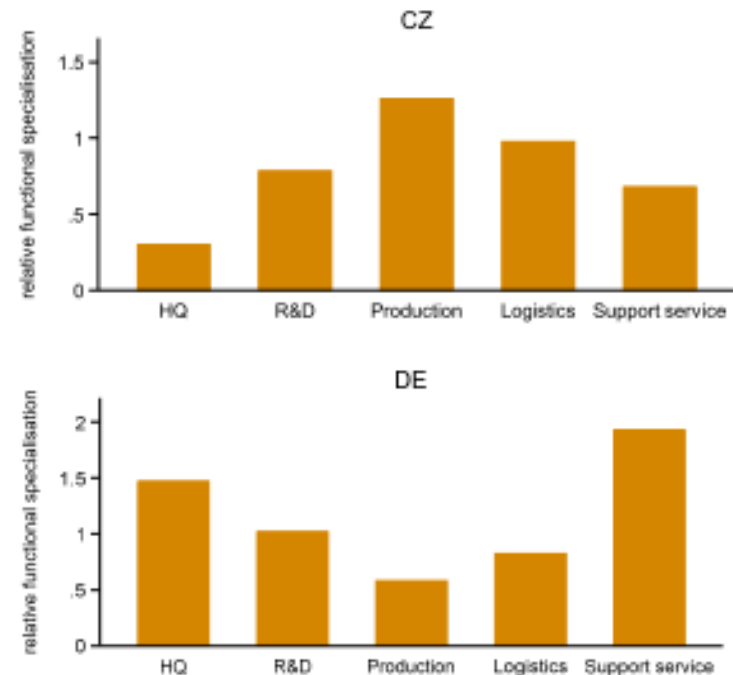
6. Medium-term outlook: Changing growth model, mega-trends and geo-politics

Making the transition from imitation to innovation remains the central economic challenge for CESEE

The ‚smile curve‘



Relative functional specialisation, 2003-15 average

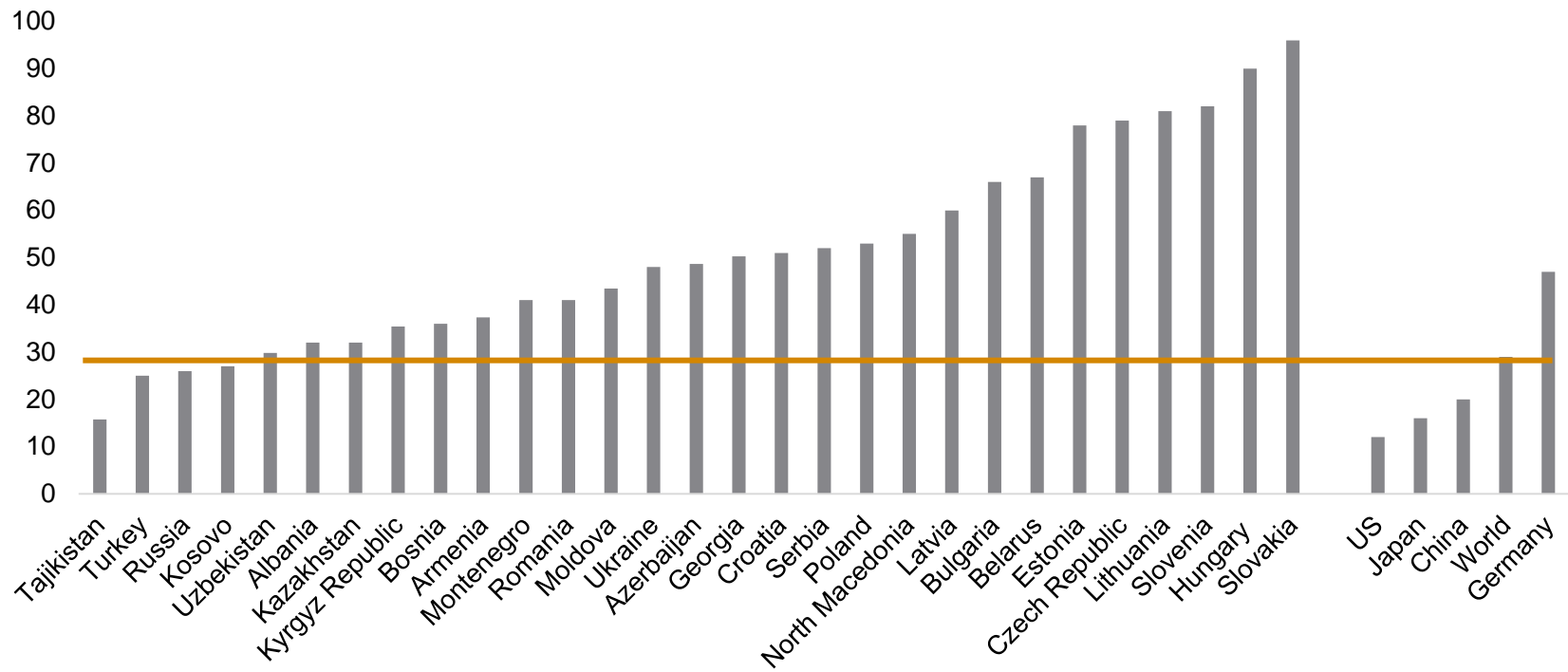


Sources: wiiw, OECD. Note: Relative functional specialisation derived from FDI projects in the manufacturing sector.

Full study: <https://wiiw.ac.at/testing-the-smile-curve-functional-specialisation-in-gvcs-and-value-creation-p-4807.html>

In a world of rising protectionism and potential trade conflicts, risks for export-dependent economies

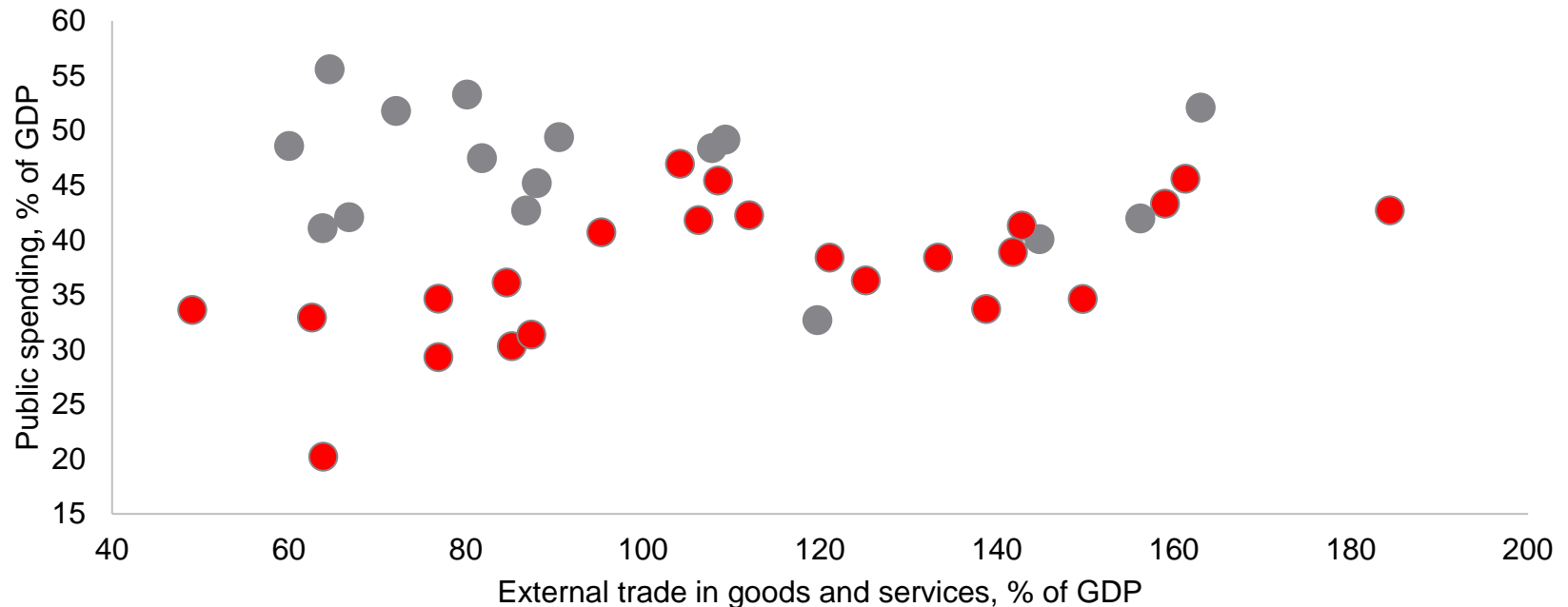
Exports of goods and services, % of GDP



Source: World Bank. Note: orange line = global average.

‘Integrative’ growth model under pressure: mixing economic openness with small state*

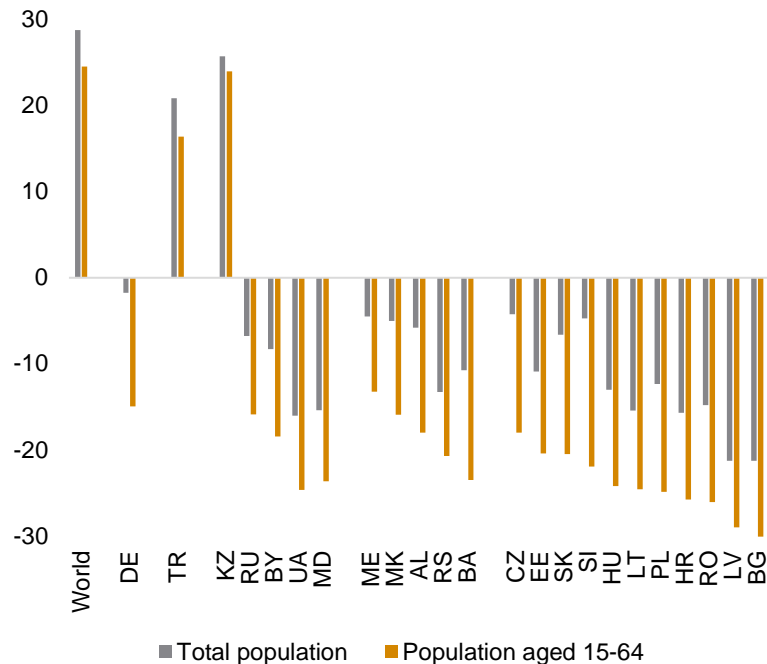
Economic openness and public spending, % of GDP, EU + CEE countries



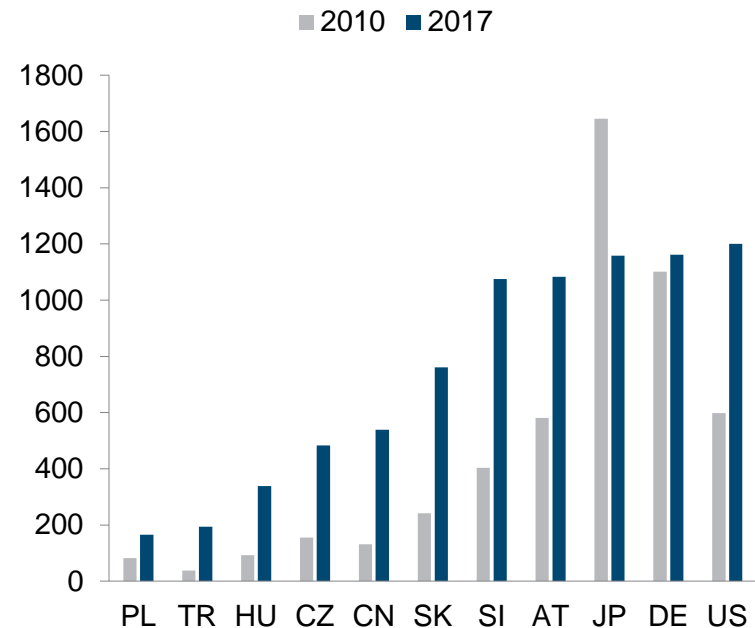
Sources: Eurostat, national sources, wiiw. Note: grey = Western Europe; red = Eastern Europe. *Rodrik (1996) showed that higher economic openness required a bigger state to manage volatility and fairly redistribute gains of globalization.

Unprecedented demographic decline outside of war or famine; automation to the ‘rescue’?

UN population projections, % change between 2015 and 2045



Estimated number of multipurpose industrial robots per 10,000 persons employed in automotive industry

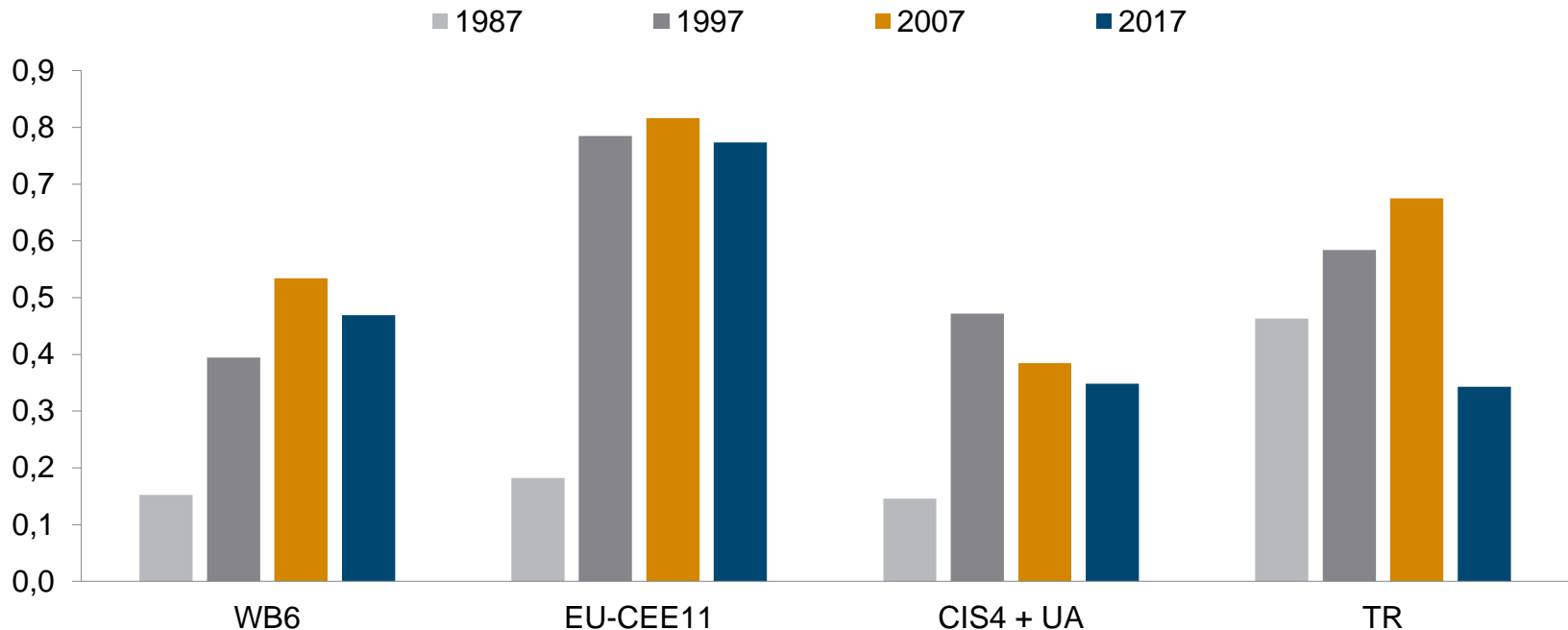


Sources: UN, IFR, OECD, national sources.

See also: <https://wiiw.ac.at/looking-back-looking-forward-central-and-eastern-europe-30-years-after-the-fall-of-the-berlin-wall-p-5059.html>,
<https://wiiw.ac.at/eu-faces-a-tough-demographic-reckoning-n-384.html>.

Rise of authoritarianism/state capture, with implications for institutional quality and potentially development

V-Dem Electoral Democracy Index, overall score over time



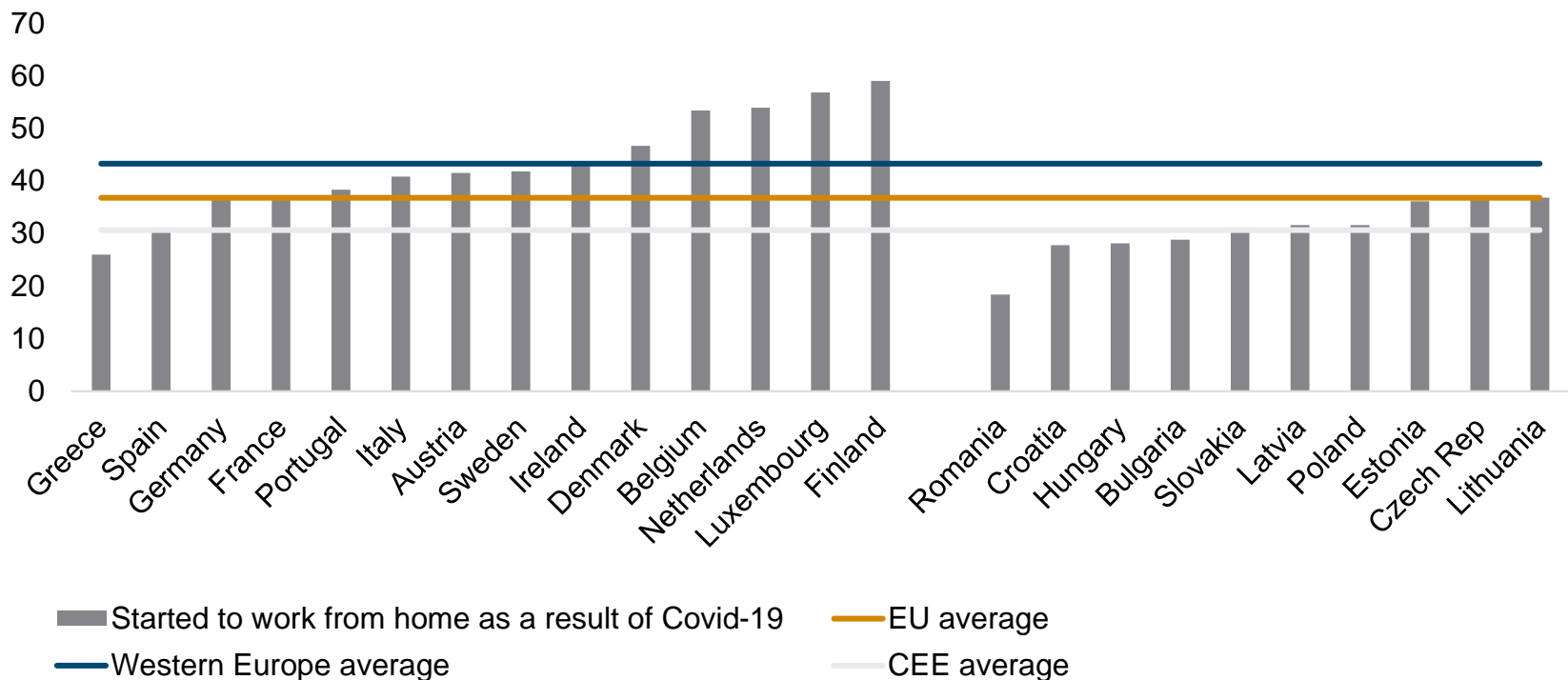
Note: Five high-level principles of democracy: electoral, liberal, participatory, deliberative, and egalitarian are measured.

Source: Varieties of Democracy.

See also: <https://wiiw.ac.at/looking-back-looking-forward-central-and-eastern-europe-30-years-after-the-fall-of-the-berlin-wall-p-5059.html>

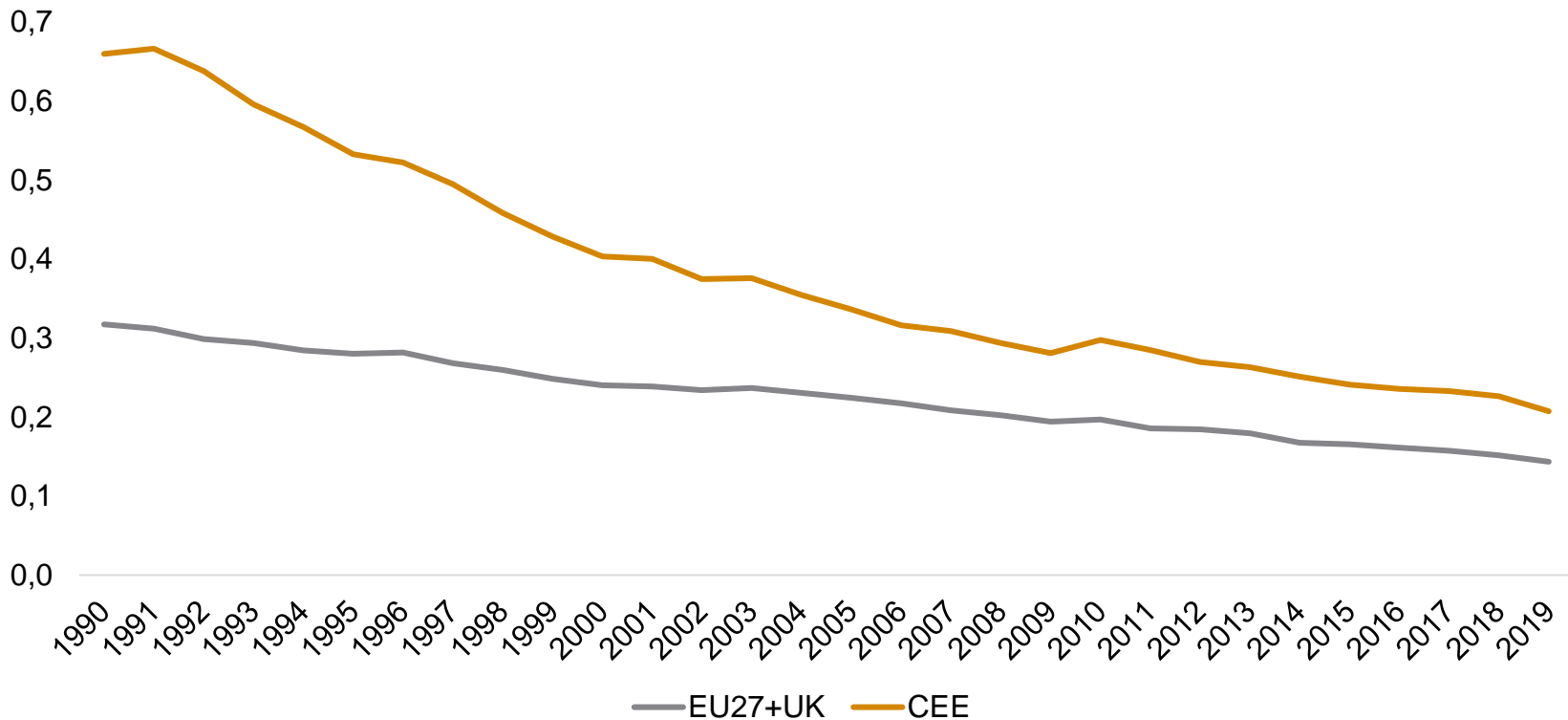
Digital shock reveals strengths and weaknesses; could change economic geography and create opportunities

Respondents who started to work at home due to the Covid-19 crisis, %



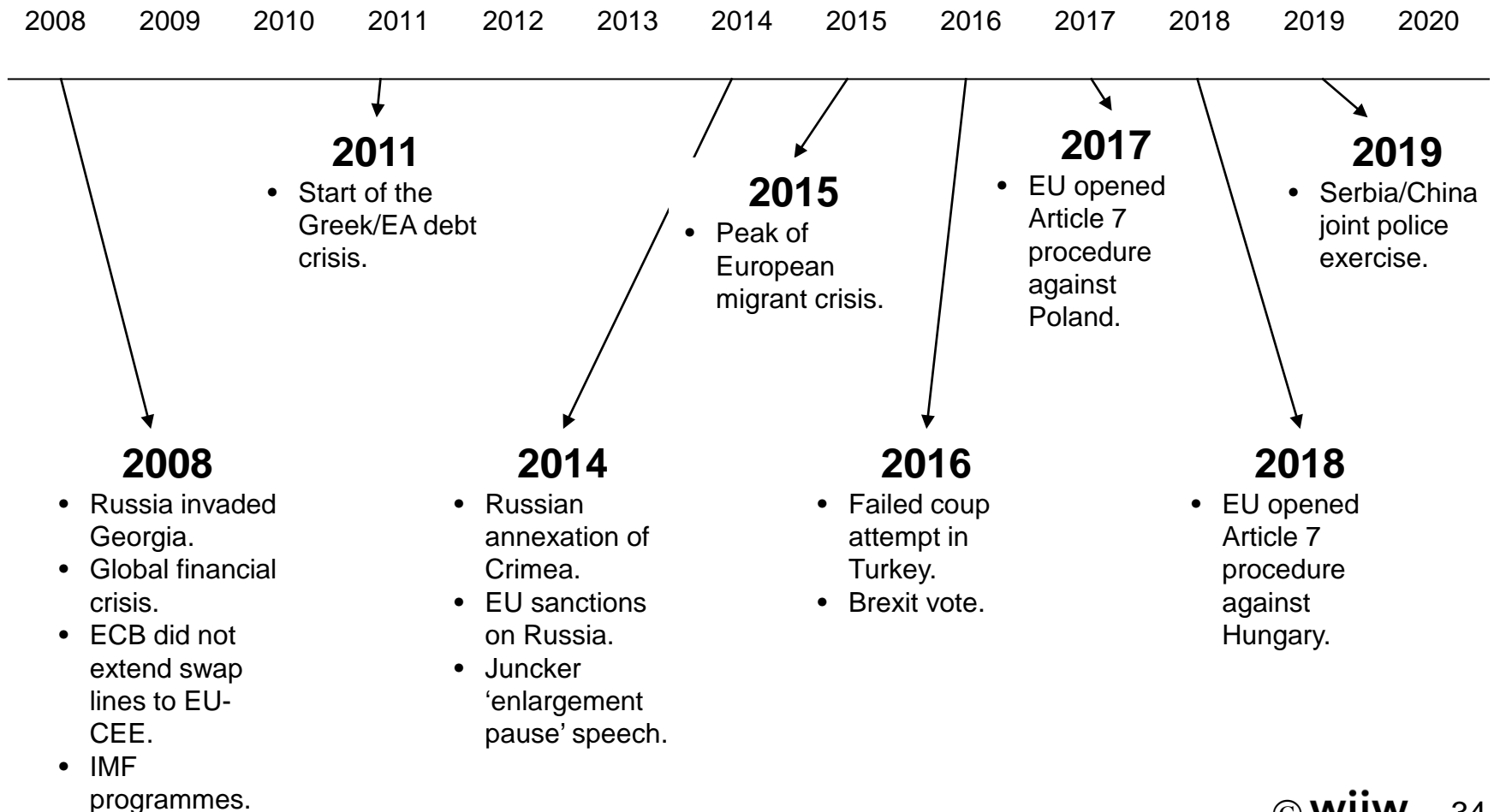
Green revolution: A major opportunity for CESEE

CO2 emissions per unit of GDP*



Source: European Commission, EDGAR - Emissions Database for Global Atmospheric Research v5.0, FT2019. * Tons of CO2 emitted per thousand of USD of output

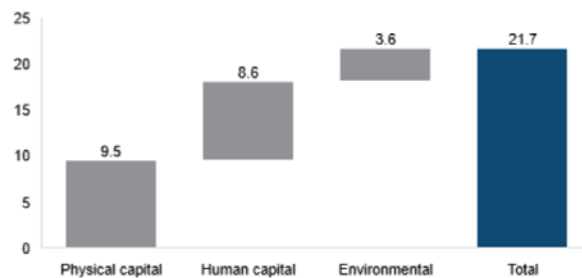
In geo-politics and geo-economics, a lot has changed in Europe since 2008



In large parts of CIS, Ukraine and Western Balkans, conflict is a barrier to economic development

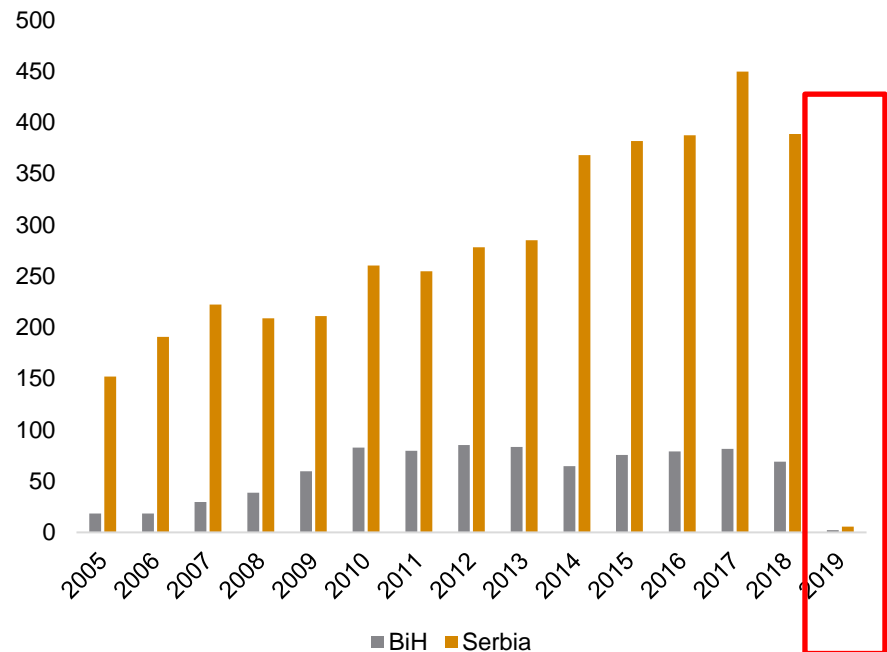
Estimated Donbass reconstruction costs

Figure 19 / Reconstruction costs of Donbas, USD billion



Source: wiiw estimations.

Kosovan imports from selected sources, EURm



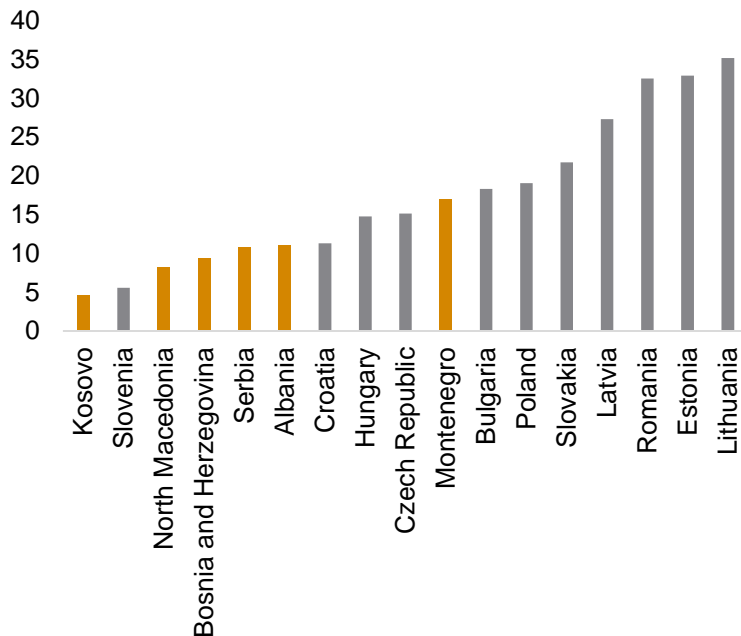
Source: wiiw. Taken from following studies:

<https://wiiw.ac.at/economic-challenges-and-costs-of-reintegrating-the-donbas-region-in-ukraine-p-5351.html>

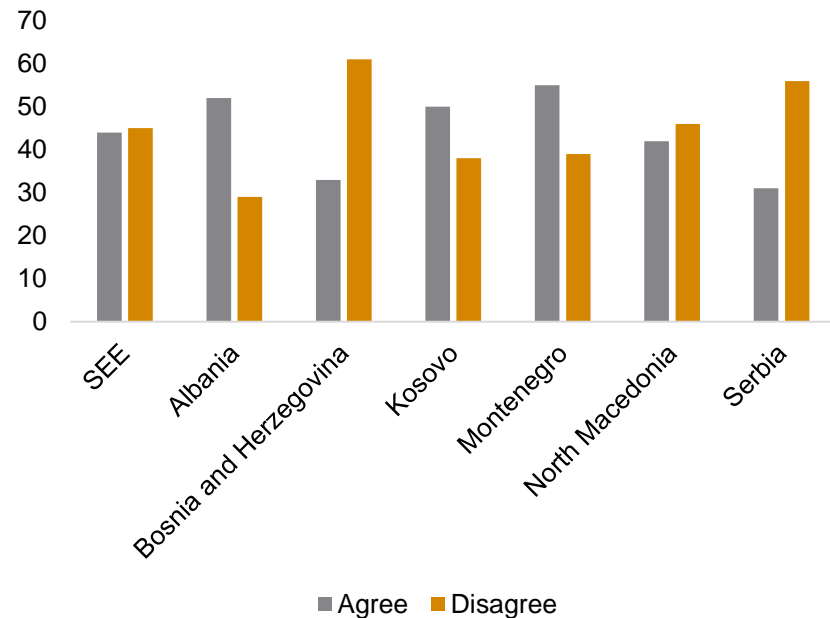
<https://www.bertelsmann-stiftung.de/en/publications/publication/did/pushing-on-a-string-en>

Western Balkans: Stuck in the waiting room, both economically and politically

Change in per capita GDP relative to Germany between 2000 and 2018; percentage points



Do you agree that regional relations in SEE are better than 12 months ago? % of total answers

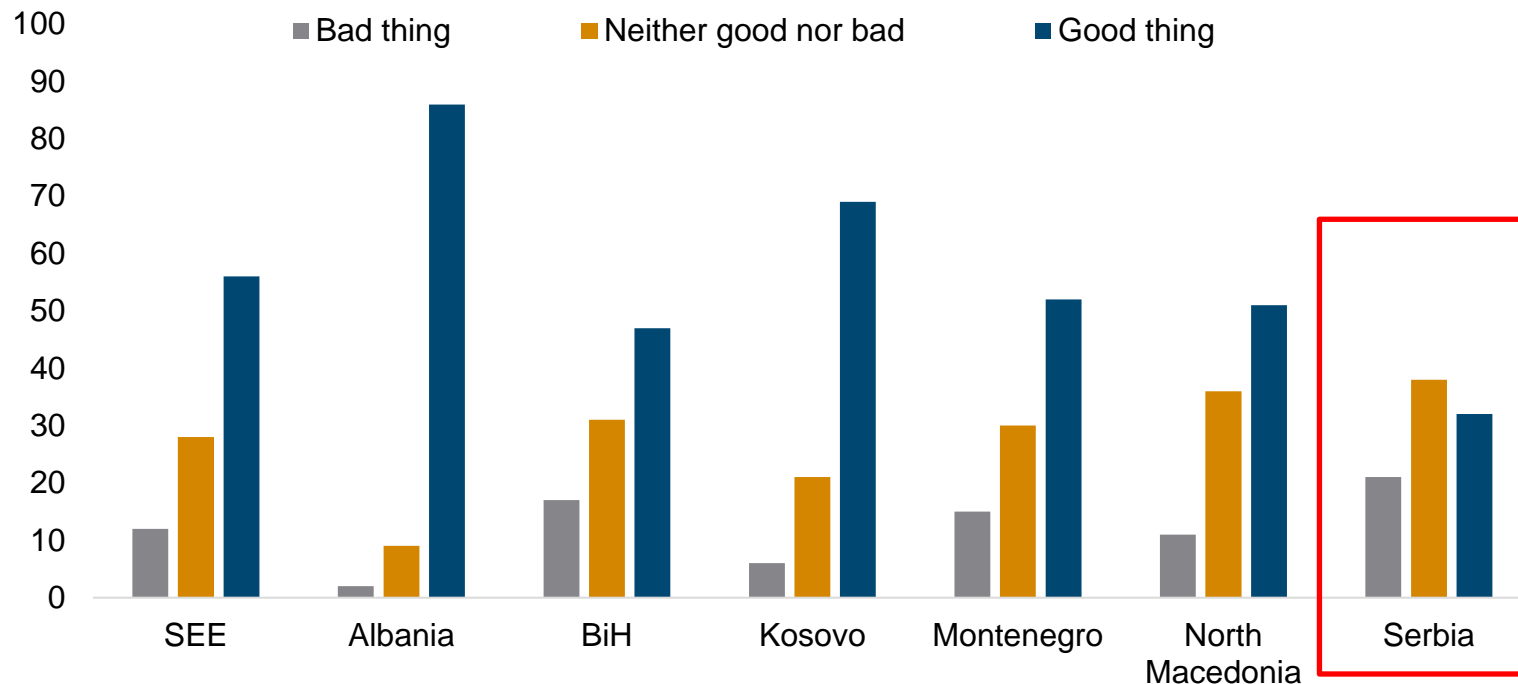


Sources: National sources, Balkan Barometer, wiiw.

See also: <https://www.bertelsmann-stiftung.de/en/publications/publication/did/pushing-on-a-string-en>

To break the Western Balkans deadlock, EU needs to change Serbia's calculations

Would EU membership be a good or bad thing for your economy? %



Source: Balkan Barometer.

See also: <https://www.bertelsmann-stiftung.de/en/publications/publication/did/pushing-on-a-string-en>

Conclusions: CESEE outlook

- Recovery is here, will be delayed but not stopped by current waves of pandemic: region has already partly adapted.
- Key growth drivers: delayed consumption, policy, global recovery.
- Risks: Asset markets, rising US rates, commodity price inflation, labour markets.
- Since 2008 have seen that convergence process in CESEE (economic, institutional, geopolitical) can go backwards as well as forwards.
- Geo-economic backdrop has changed dramatically since 2008, and much of CESEE is now a 'contested space'.
- Growth model based on external openness and fiscal restraint is reaching its limit.
- Pandemic matters, but climate change, digitalisation, automation and demographics are mega-trends that will define CESEE in the 21st century. Opportunities in this for CESEE

Thank you for your attention!

Follow us at:

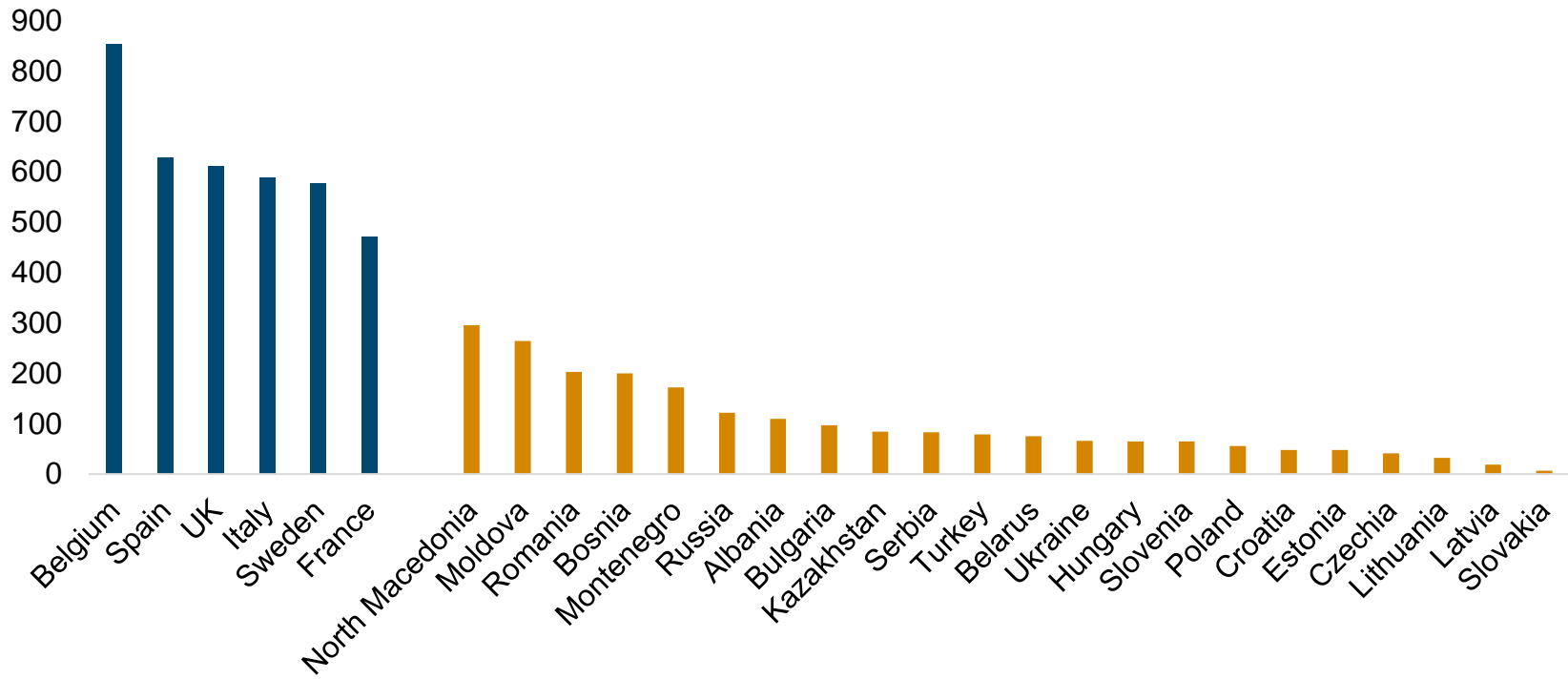
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Extra slides

Why has CESEE done better economically? In the first wave, simply managed the pandemic better.

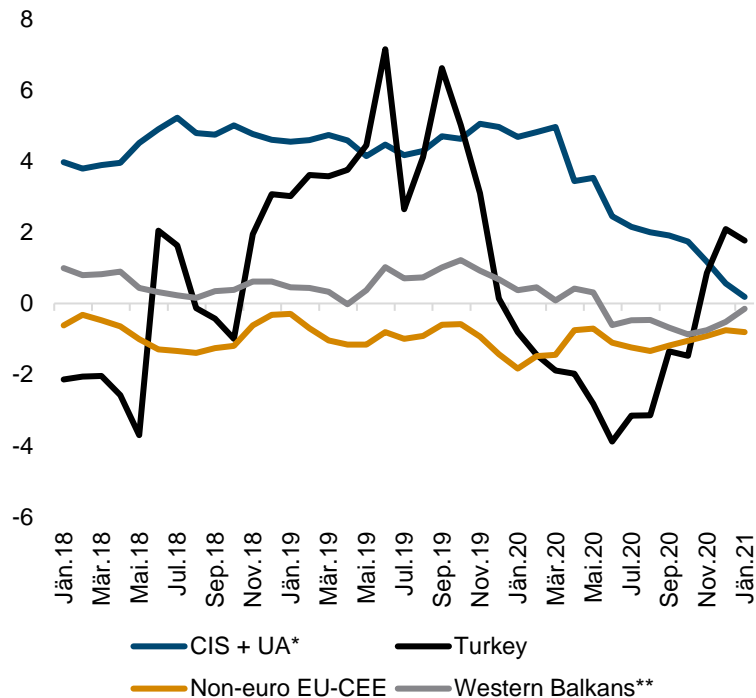
Deaths per million from COVID-19 as of September 2020



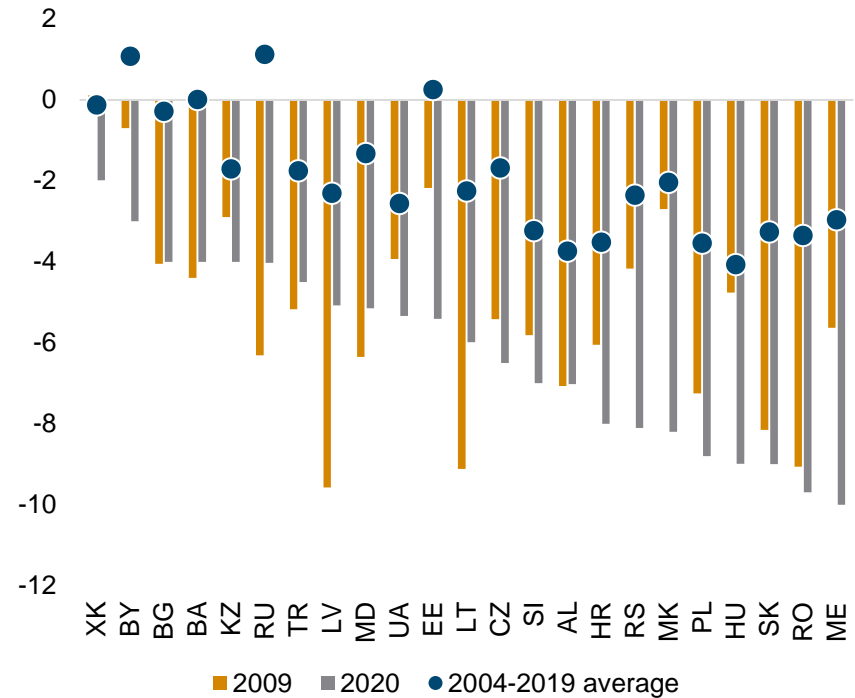
Source: Worldometer. See also Jovanovic (2021): Is higher COVID-19 mortality hurting economic growth? <https://wiiw.ac.at/monthly-report-no-3-2021-p-5689.html>.

Policy (mostly fiscal) response has also been much bigger than in the past

Real interest rates, CPI-adjusted, %



Fiscal balance, % of GDP



Sources: National sources, wiiw. *CIS + UA = average of Belarus, Kazakhstan, Russia, Ukraine. **Western Balkans = average of Albania, North Macedonia, Serbia.

Structural differences also mattered: CESEE less reliant on services.

Share of services value-added in GDP in 2019, %

