

wiiw Spring Seminar

4 April 2019

Moving into the slow lane

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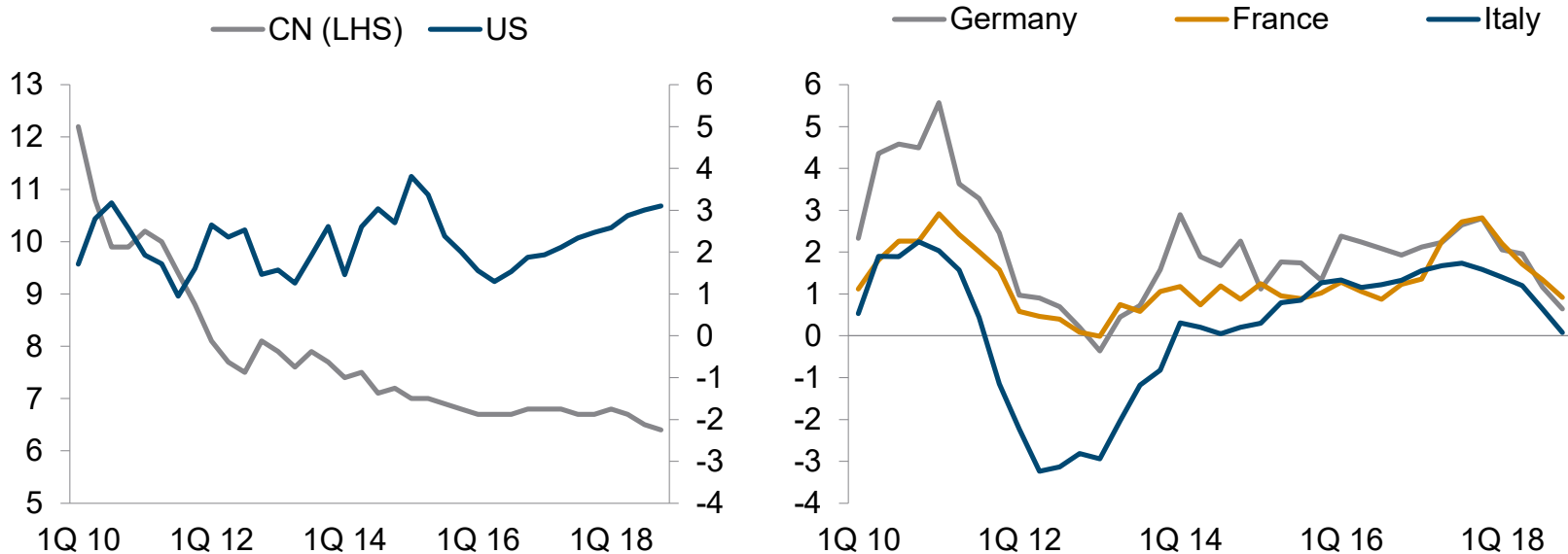
Overview

1. Global economy: End of the cycle
2. Outlook for CESEE in 2019-21: Adjusting to life in the slow lane
3. Risks: Eurozone downturn/crisis, trade war, next EU budget
4. Long-term challenges: How well prepared is CESEE for the future?

1. Global economy: End of the cycle

Global growth trends: Major slowdown in most places

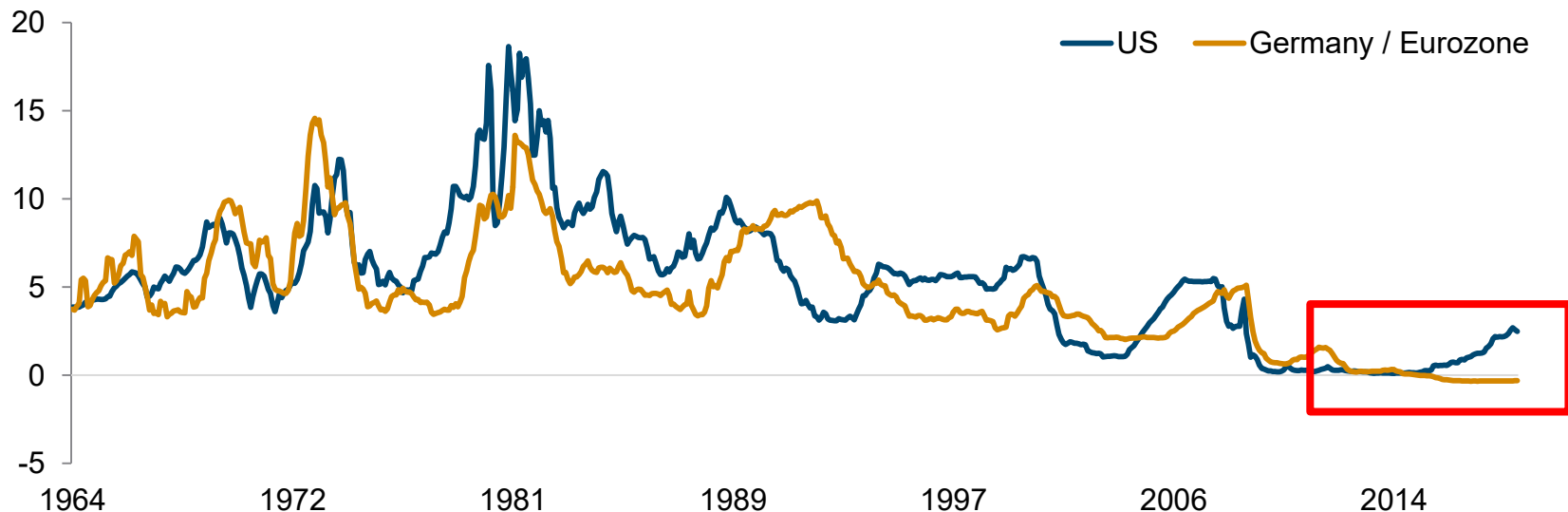
Real GDP, % change year-on-year, seasonally adjusted



Source: OECD.

Global monetary policy remains extraordinarily loose.

Short-term interest rates, % per annum



Note: Germany / Eurozone = Germany until 1999, Eurozone thereafter.

Source: OECD.

2. Outlook for CESEE in 2019-21: Adjusting to life in the slow lane

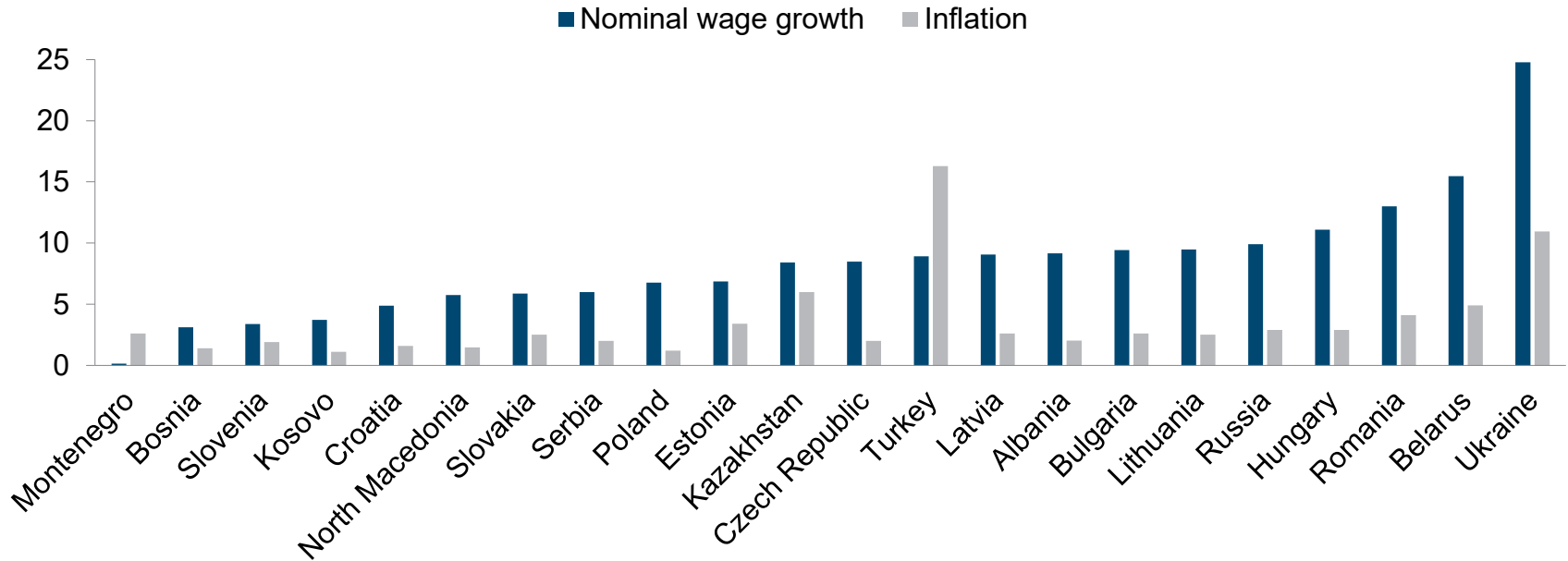
Slowdown imminent for most countries

| | | Forecast, % | | | | Revisions, pp | | |
|----------|----|-------------|------|------|------|---------------|--------|--------|
| | | 2018 | 2019 | 2020 | 2021 | 2018 | 2019 | 2020 |
| EU-CEE11 | BG | 3.0 | 2.8 | 2.5 | 2.5 | ↓ -0.3 | ↓ -0.4 | ↓ -0.5 |
| | CZ | 3.0 | 2.6 | 2.7 | 2.8 | ↓ -0.3 | ↓ -0.6 | ↓ -0.4 |
| | EE | 3.9 | 2.9 | 2.5 | 2.2 | ↑ 0.4 | ↓ -0.2 | ↓ -0.2 |
| | HR | 2.7 | 2.6 | 2.5 | 2.5 | ↑ 0.2 | → 0.0 | ↓ -0.2 |
| | HU | 4.9 | 3.3 | 2.3 | 1.9 | ↑ 0.6 | ↑ 0.3 | → 0.0 |
| | LT | 3.5 | 3.0 | 2.6 | 2.3 | → 0.0 | → 0.0 | → 0.0 |
| | LV | 4.8 | 3.5 | 3.0 | 2.5 | ↑ 0.7 | ↑ 0.2 | → 0.0 |
| | PL | 5.1 | 3.7 | 3.3 | 3.3 | ↑ 0.1 | ↑ 0.2 | → 0.0 |
| | RO | 4.2 | 2.8 | 3.0 | 3.2 | ↑ 0.4 | ↓ -0.8 | ↓ -0.7 |
| | SI | 4.5 | 3.2 | 3.0 | 2.9 | → 0.0 | ↓ -0.4 | ↓ -0.5 |
| | SK | 4.1 | 3.6 | 3.0 | 2.5 | ↑ 0.3 | ↓ -0.5 | ↓ -0.3 |
| WB6 | AL | 4.1 | 3.8 | 3.8 | 3.4 | → 0.0 | ↓ -0.2 | ↓ -0.2 |
| | BA | 2.9 | 2.5 | 2.6 | 2.7 | ↓ -0.1 | ↓ -0.9 | ↓ -0.8 |
| | ME | 4.0 | 2.5 | 2.2 | 2.0 | ↓ -0.2 | ↓ -0.6 | ↓ -0.9 |
| | MK | 1.9 | 3.0 | 3.0 | 3.0 | ↓ -1.0 | ↑ 0.2 | ↓ -0.1 |
| | RS | 4.4 | 3.4 | 2.9 | 2.9 | ↑ 0.1 | → 0.0 | ↑ 0.1 |
| | XK | 3.9 | 4.1 | 4.0 | 3.9 | ↓ -0.3 | ↑ 0.1 | ↓ -0.2 |
| Turkey | TR | 2.9 | -0.7 | 3.2 | 3.7 | ↑ 0.4 | ↓ -1.7 | ↓ -0.8 |
| CIS4+UA | BY | 3.0 | 2.4 | 2.2 | 2.0 | ↓ -0.7 | ↓ -0.6 | ↓ -0.6 |
| | KZ | 4.1 | 3.0 | 3.0 | 3.0 | ↑ 0.1 | ↓ -0.1 | → 0.0 |
| | MD | 4.0 | 3.8 | 3.6 | 3.5 | | | |
| | RU | 2.3 | 1.8 | 1.7 | 1.9 | ↑ 0.6 | ↑ 0.2 | ↓ -0.1 |
| | UA | 3.3 | 2.5 | 2.0 | 2.9 | → 0.0 | ↓ -0.2 | → 0.0 |

Source: wiiw Spring 2019 forecasts.

Real wages a major growth driver, underpinned by tighter labour markets.

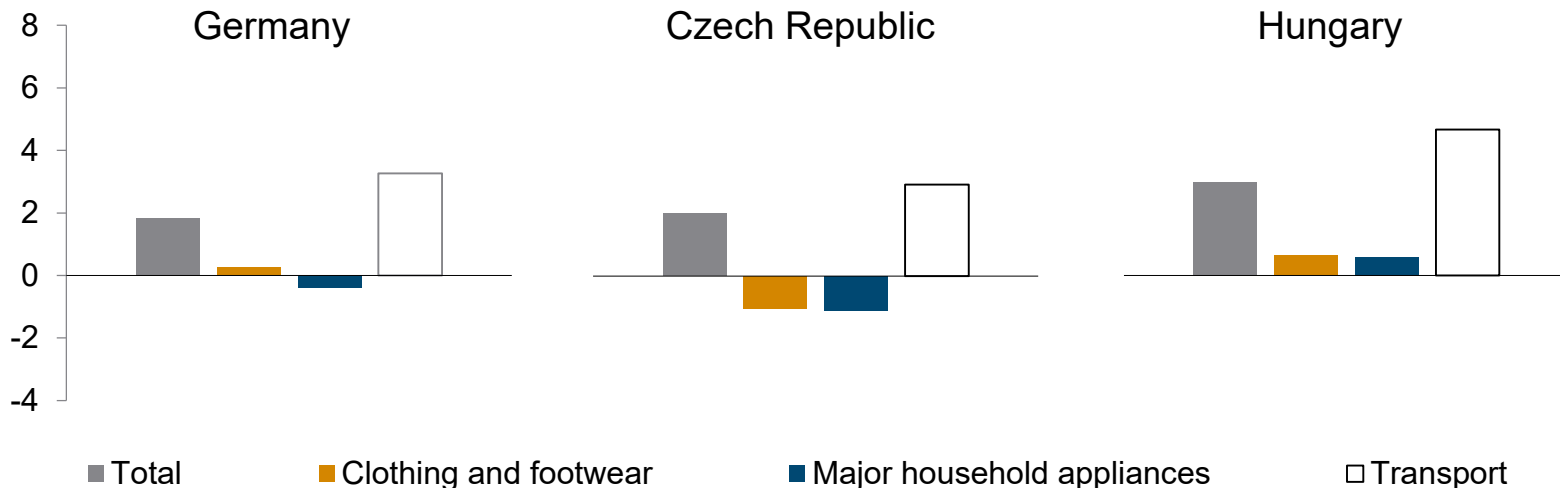
Wages and inflation, % change, 2018



Source: wiiw Annual Database incorporating national statistics and Eurostat.

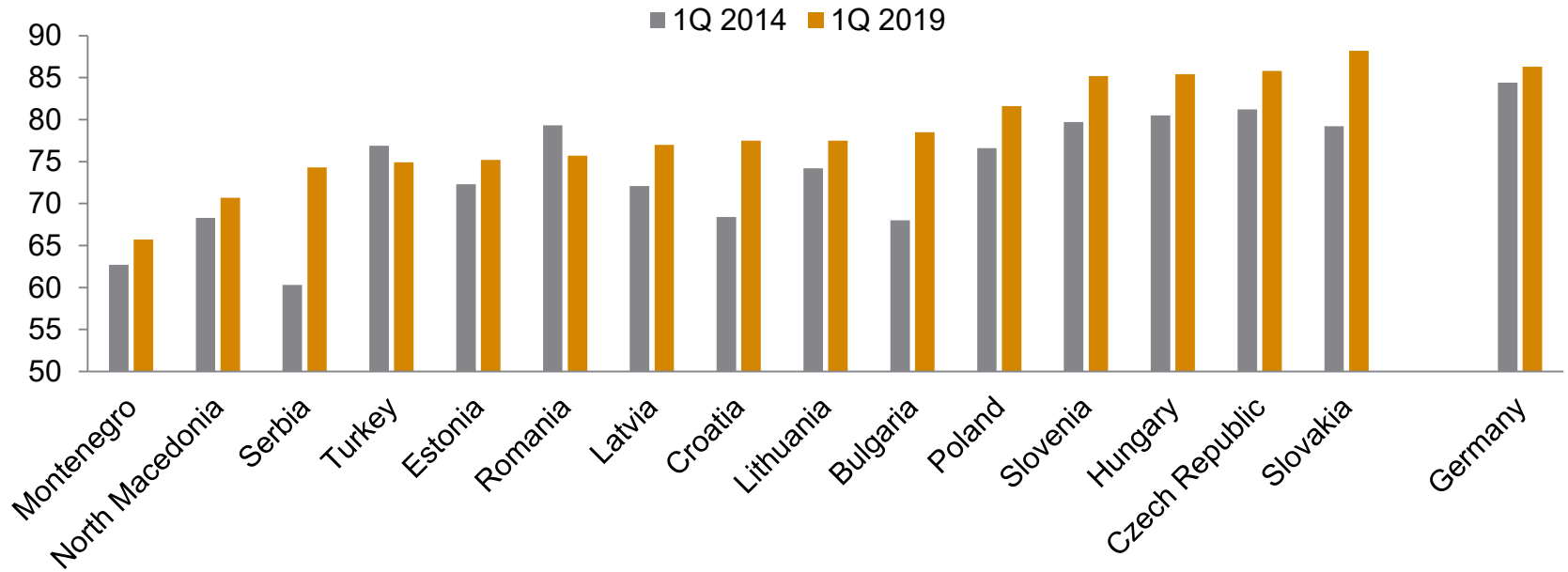
Inflation set to remain low: Eurozone trends, expectations de-anchoring, productivity, competition.

EU-harmonised inflation, % change in 2018, selected components



Investment outlook is still fairly positive in the short run ...

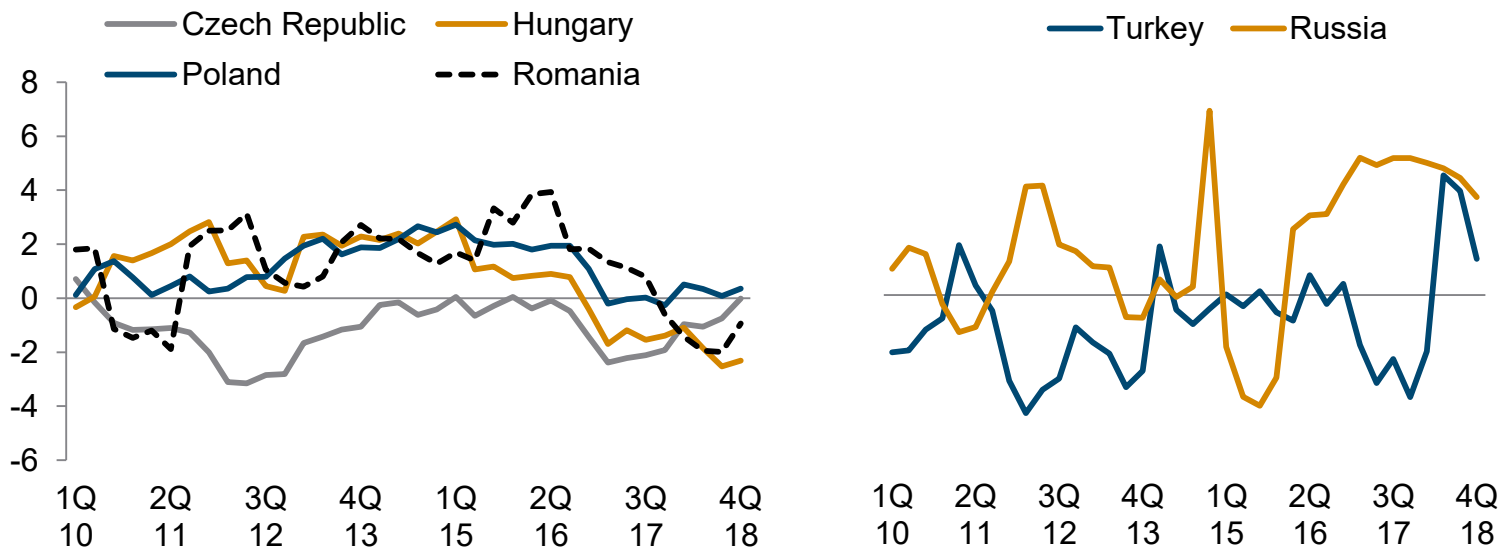
Capacity utilisation in manufacturing industry, %



Source: Eurostat.

Real interest rates to remain at historically low levels outside CIS, Ukraine and Turkey

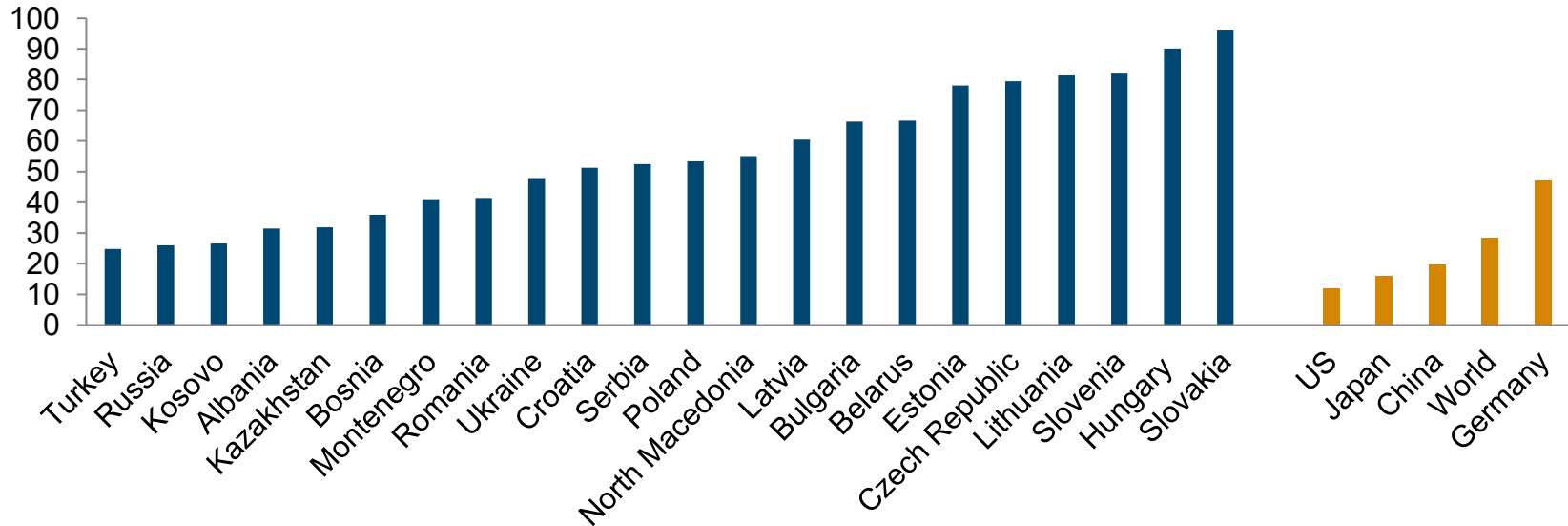
Real interest rates, CPI-adjusted, %



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

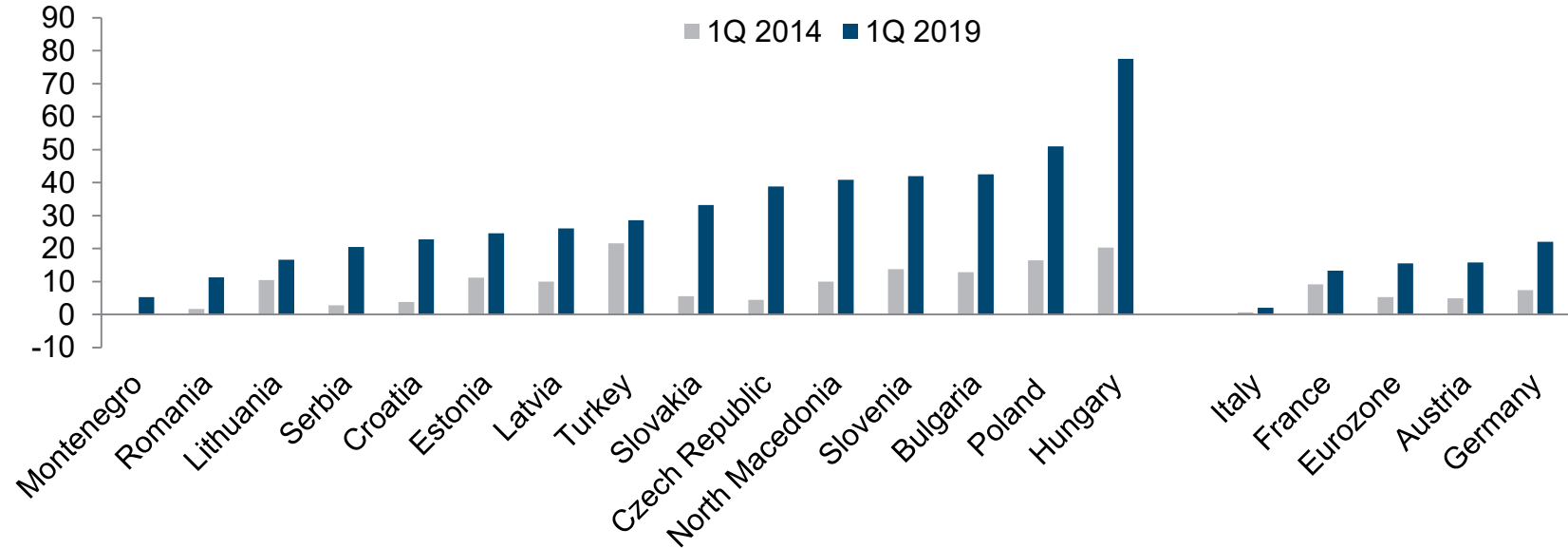
Who's afraid of a global slowdown? External resilience will be severely tested

Exports of goods and services, % of GDP, 2017



Labour shortages an increasing impediment to growth

Firms in industry reporting labour as constraint on production, balance of positive and negative responses



Source: Eurostat.

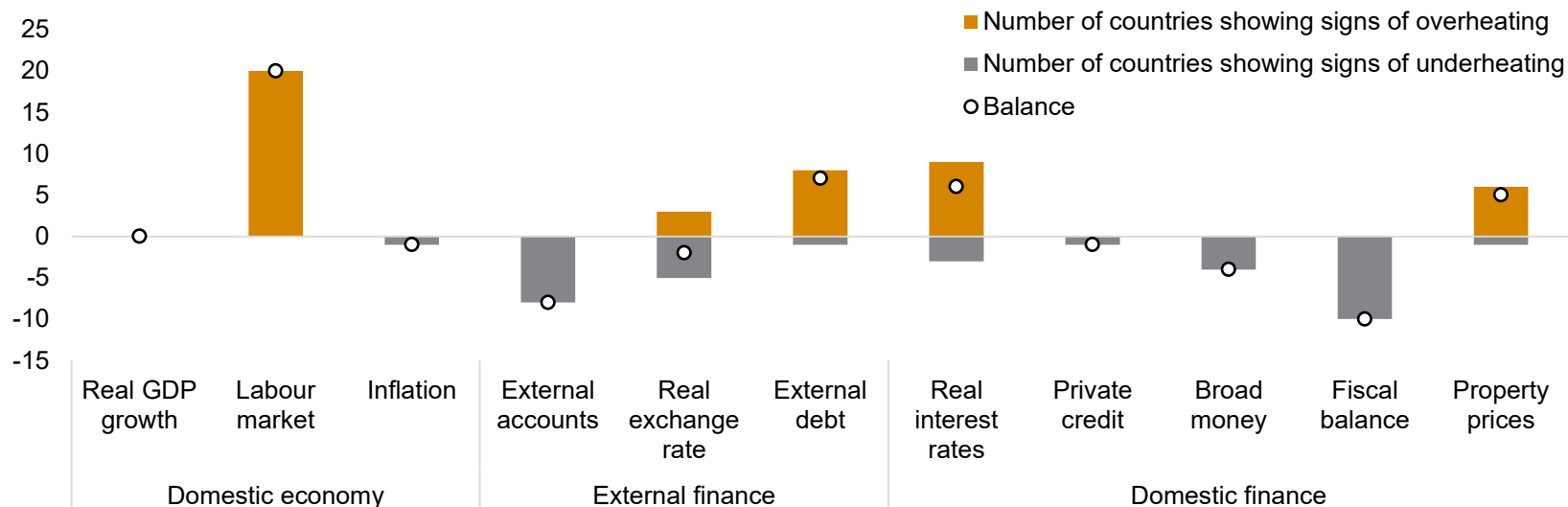
3. Major risks to the forecast

Major risks to the forecast

- Taking into account likelihood and impact on CESEE, three still stand out:
 - i. Deeper **Eurozone** downturn/crisis
 - ii. Global **trade war**, including higher US tariffs on EU cars
 - iii. Smaller **EU budget**

Signs of overheating?

wiiw Business Cycle Monitor, December 2018



Source: wiiw Business Cycle Monitor.

Note: Potential over-/under-heating = > 1 standard deviation from historical average.

Risks building in the financial sector?

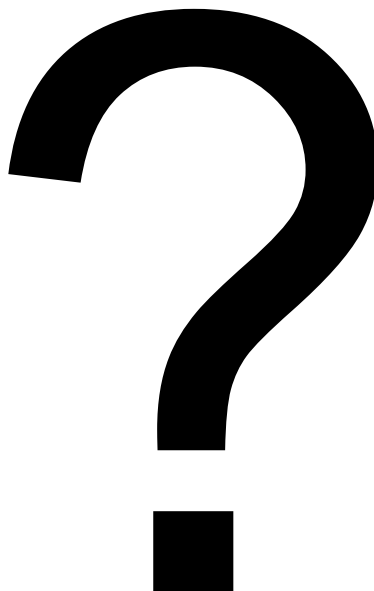
wiiw Credit Monitor as of December 2018

| | AL | BA | BG | BY | CZ | EE | HR | HU | KZ | LT | LV | ME | MK | PL | RO | RS | RU | SI | SK | TR | UA | XK |
|---------------------------------------|------|------|------|------|-----|------|------|------|------|------|------|------|------|-----|------|------|------|------|------|------|------|------|
| Loans to non-fin.corporations, % yoy | -7.2 | 3.7 | 5.2 | 7.7 | 5.7 | 3.6 | -1.1 | 14.8 | -4.6 | 3.9 | -5.0 | 5.9 | 4.5 | 7.6 | 6.3 | 7.8 | 10.5 | -0.4 | 7.0 | 12.0 | 3.6 | 10.6 |
| Loans to households, % yoy | 3.8 | 7.3 | 11.2 | 28.4 | 7.6 | 6.3 | 4.6 | 5.8 | 16.8 | 8.0 | -5.4 | 12.0 | 10.3 | 7.0 | 9.2 | 12.5 | 22.4 | 6.5 | 11.4 | 3.4 | 15.5 | 11.2 |
| Real interest rate, CPI deflated, % | -0.8 | -1.6 | -2.3 | 4.1 | 0.1 | -3.2 | 2.0 | -1.8 | 3.6 | -1.7 | -2.5 | 4.1 | 1.6 | 0.6 | -0.5 | 1.0 | 3.2 | -1.4 | -1.8 | 3.1 | 7.5 | 3.0 |
| Non-performing loans (NPL), in %, eop | 11.1 | 9.4 | 7.6 | 4.1 | 3.2 | 0.5 | 10.3 | 3.5 | 7.4 | 2.5 | 4.2 | 6.5 | 5.1 | 6.8 | 5.0 | 6.4 | 4.7 | 2.5 | 3.3 | 3.9 | 54.0 | 2.7 |

Source: wiiw Credit Monitor.

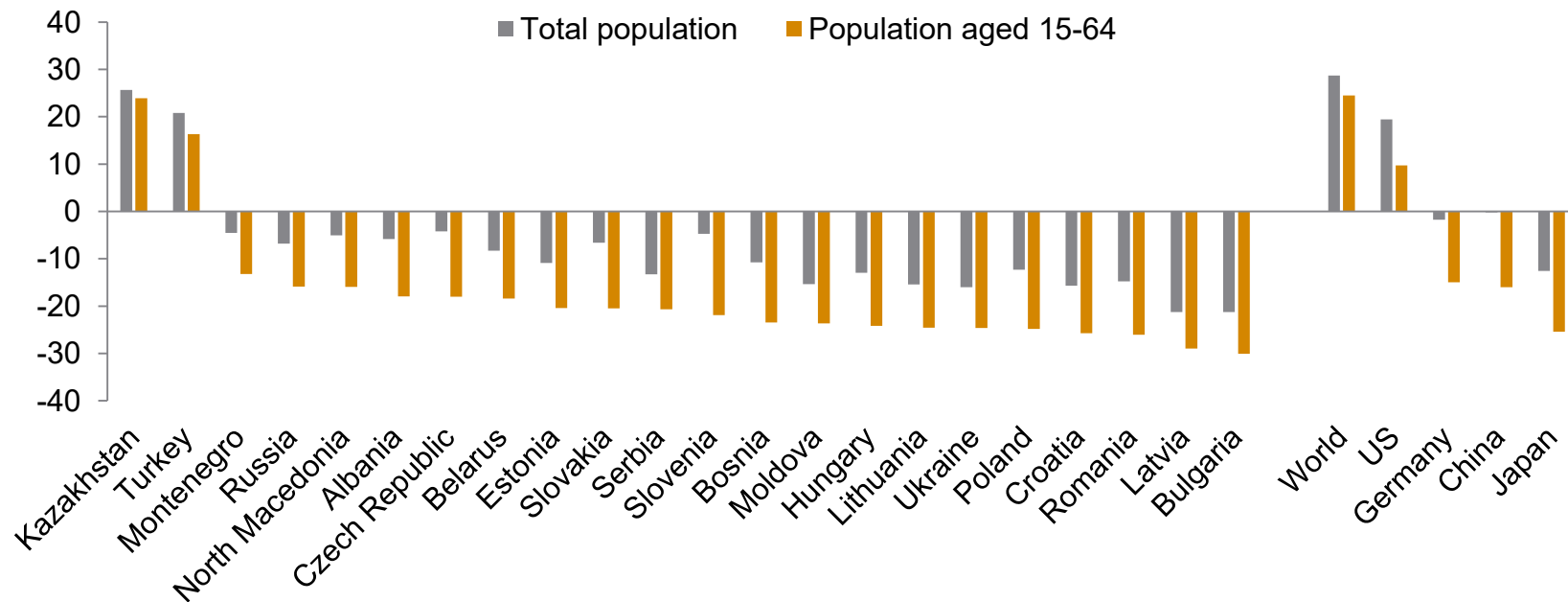
Orange = potential overheating, grey = potential under-heating.

Brexit:



A. Unprecedented demographic decline in peacetime

UN population projections, % change between 2015 and 2045

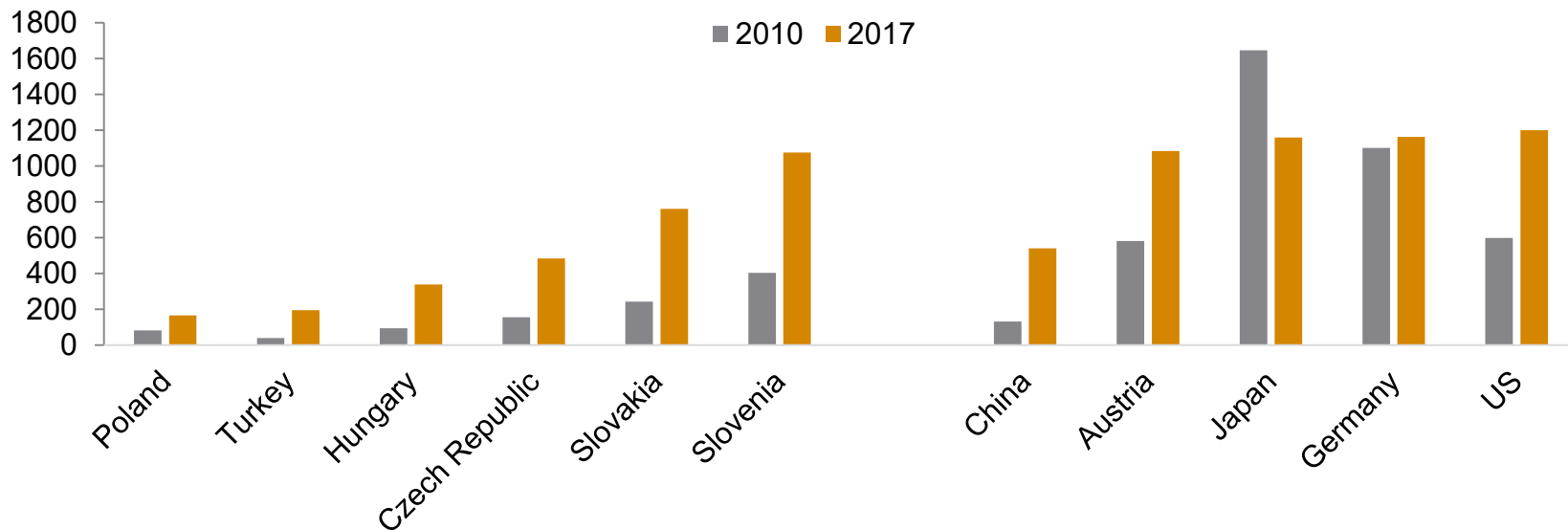


Source: UN, Medium fertility variant.

4. An increasingly challenging long-term outlook

B. Relatively low level of automation compared with frontrunners

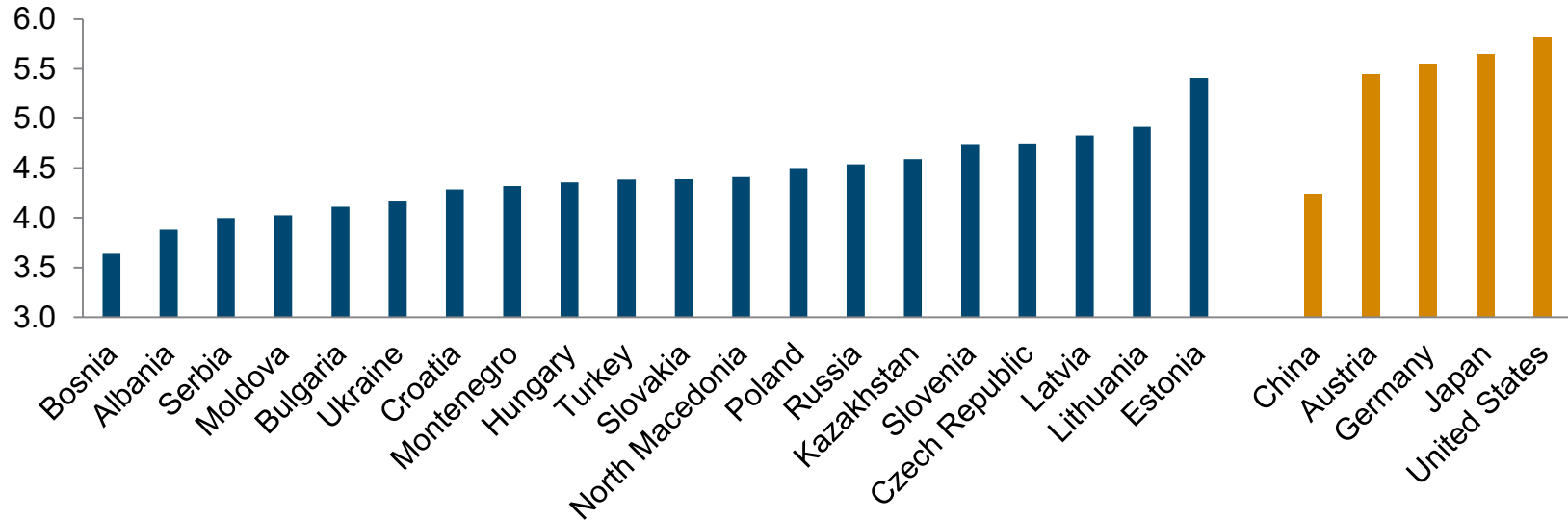
Estimated number of multipurpose industrial robots per 10,000 persons employed in automotive industry



Sources: International Federation of Robotics (2018), World Robotics 2018, Tables 2.6 and 2.7.

C. Lack of preparedness for new digital economy?

World Economic Forum Networked Readiness Index

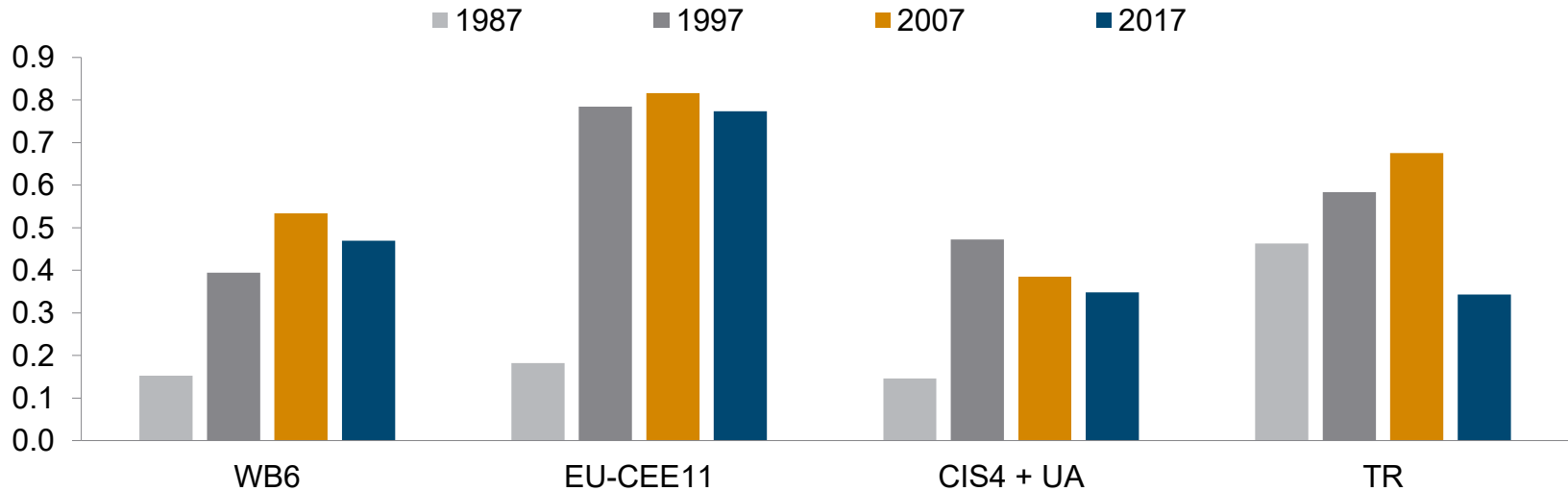


Note: The index assesses countries' indicators including the legal framework around ICT, ICT use by government and firms, availability of latest technologies and venture capital, tax rate on profits, ease of starting a business, education level, coverage of electricity, mobile and broadband, innovation capacity, and knowledge-intensive jobs as share of workforce.

Source: World Economic Forum.

D. Rise of authoritarianism/state capture, with implications for institutions

V-Dem Electoral Democracy Index



Source: Varieties of Democracy (V-Dem). 0 = best, 1 = worst.

Conclusions

- Past the peak: **growth will be lower** from here, due to weaker activity in China + Germany plus labour shortages.
- But still a **story of two CESEEs**: 'goldilocks' in EU-CEE and much of WB6, tougher conditions in CIS, Ukraine + Turkey.
- Medium-term, **Russia will remain regional laggard**. Volatile future for **Turkey**. Particularly big slowdown vs current levels for **Hungary** by 2020-2021.
- Still most worried about **EZ, trade war and next EU budget**. High level of uncertainty around Brexit, but direct links to CESEE are limited.
- Real challenges for CESEE are in medium and long term. **Demographics, automation, digitalisation, institutions** represent daunting list of potential issues for policy-makers and firms in the region.

Thank you for your attention!

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Country codes

| | | | | | |
|----|------------------------|----|-----------------|----|----------|
| AL | Albania | KZ | Kazakhstan | RS | Serbia |
| BY | Belarus | LT | Lithuania | RU | Russia |
| BA | Bosnia and Herzegovina | LV | Latvia | SI | Slovenia |
| BG | Bulgaria | MD | Moldova | SK | Slovakia |
| CZ | Czech Republic | ME | Montenegro | TR | Turkey |
| EE | Estonia | MK | North Macedonia | UA | Ukraine |
| HR | Croatia | PL | Poland | XK | Kosovo |
| HU | Hungary | RO | Romania | | |

CESEE23 Central, East and Southeast Europe

CIS4+UA Commonwealth of Independent States-4 and Ukraine

EA19 Euro area

EU-CEE11 European Union – Central and Eastern Europe

WB6 Western Balkans