Macroeconomic Developments and Structural Issues in CEE Countries
Roundtable on Macroeconomic Developments in CEE Countries

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Boris Vujčić, Governor
Growth continues but expansion might moderate

Real GDP growth

Output gap

Sources: AMECO; CNB for Croatia
Unemployment rates are close or below pre-crisis levels, pushing wage growth

Sources: AMECO; CNB for Croatia

Compensation per employee

Sources: Eurostat, Croatian Bureau of Statistics (CBS)

*Administrative data for Croatia
However, inflation remains relatively low
Mounting risks to the outlook

- Escalation of trade protectionism
- Monetary normalization
- Other negative spill-overs (Italy)
Yet, CEE seem to be in a good shape to withstand impact of negative shocks

Current account balance

External debt

Source: IMF WEO
Solid international liquidity position

Official international reserves

CEE external liquidity position

Source: IMF

Note: DMB's FA – deposit money banks' financial assets
Fiscal position relatively comfortable

Fiscal balance

Public debt

Source: IMF WEO, April 2018
However, medium-term growth not sufficient to ensure pre-crisis pace of convergence

Real convergence, PPS, Germany=100

Source: AMECO
Total factor productivity – the truth is out there

Sources: World Bank; OECD; EC, CNB calculations
Large room for improvement but progress has been slow

Quality of institutions – no convergence

Human capital – still below frontier countries

Note: Estimate of governance performance ranges from -2.5 (weak) to 2.5 (strong).
Source: World Bank

Source: OECD
Potential gains from structural reforms are significant but...

Potential efficiency gains from structural reforms
(Percent)

Macroeconomic impact of structural reforms
(Stand-alone reforms, difference from baseline)

Source: IMF, CEESEE Economic Issues, May 2016

Source: EC (2014) The potential growth impact of structural reforms in the EU
... how to get them right?

- Two dimensions of structural reforms:
  - Moving closer to the efficiency frontier – reallocation of resources, more efficient usage of inputs.
  - Potential growth rate – expanding the efficiency frontier.

- But many policies:
  - product market reforms, competition policy, labour market reforms, public finance and taxation (including social security system), human capital development, innovation policy, ...

- Do economists really understand all the mechanisms at play:
  - synergies and complementarities of reforms;
  - diminishing marginal effects of reforms?
No guarantees, but reforms remain the safest bet

- No guarantees that convergence will gain momentum again
- Closest thing to a recipe for reducing probability of being caught in middle income trap:
  - High quality of human capital - education reform
  - Facilitate private sector investment in physical capital and know-how
  - Adequate access to finance for SMEs
  - Friendly business environment
- Keep in mind that political economy also matters
Limited „political inclusiveness” might hinder support for the reforms

Conclusion

- CEE achieved considerable improvement in macro and financial position due to a combination of sounder domestic policies but also due to more favourable external conditions as the euro area economy recovered.
- However, given mounting risk to the outlook no space for complacency.
- Aim is to improve the potential growth.
- Not everything we do will always get full support from the broad public, and especially in the case of structural reforms with long-term gains and short-term costs.
Thank you!