



CROATIAN NATIONAL BANK

Macroeconomic Developments and Structural Issues in CEE Countries

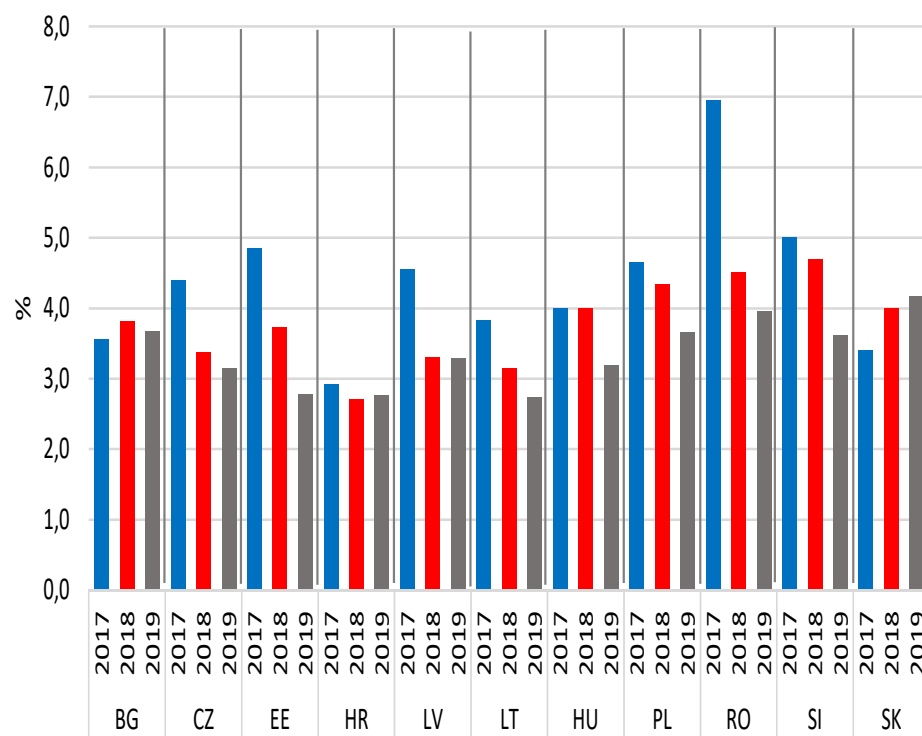
Roundtable on Macroeconomic Developments in CEE Countries

Budapest - November 2018

Boris Vujčić, Governor

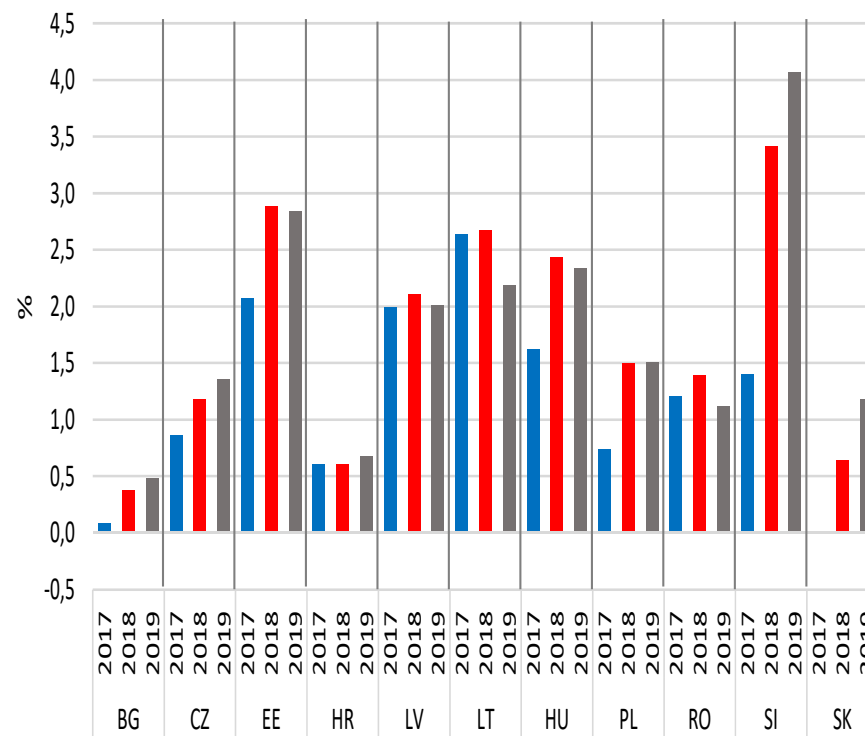
Growth continues but expansion might moderate

Real GDP growth



Sources: AMECO; CNB for Croatia

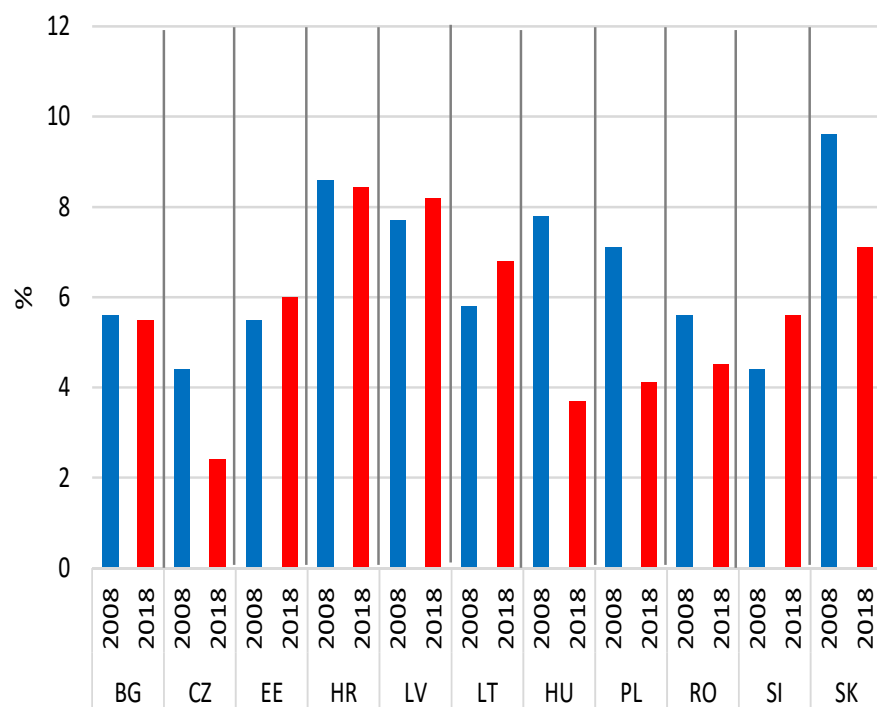
Output gap



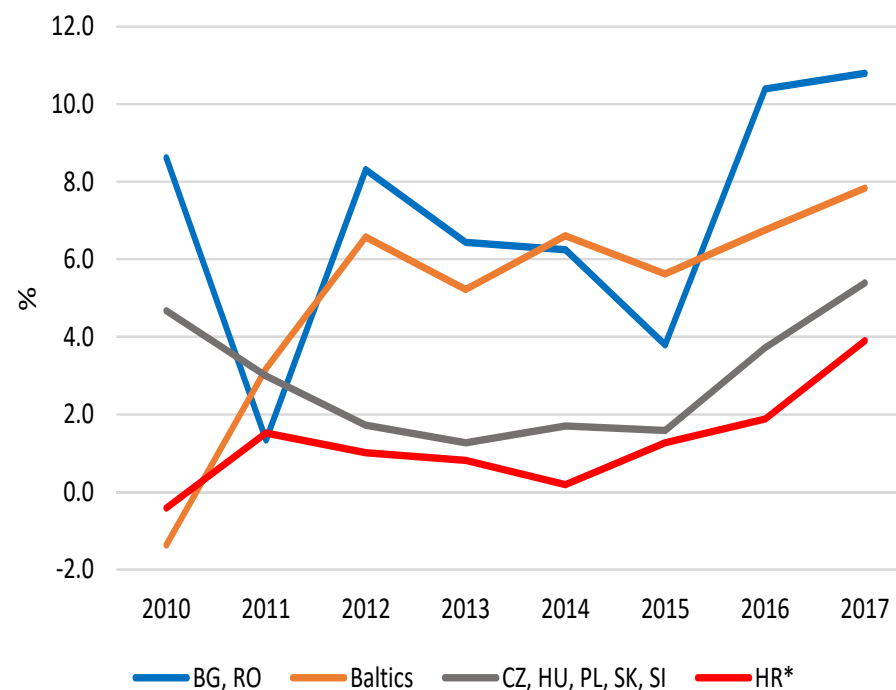
Sources: AMECO; CNB for Croatia

Unemployment rates are close or below pre-crisis levels, pushing wage growth

Unemployment rates



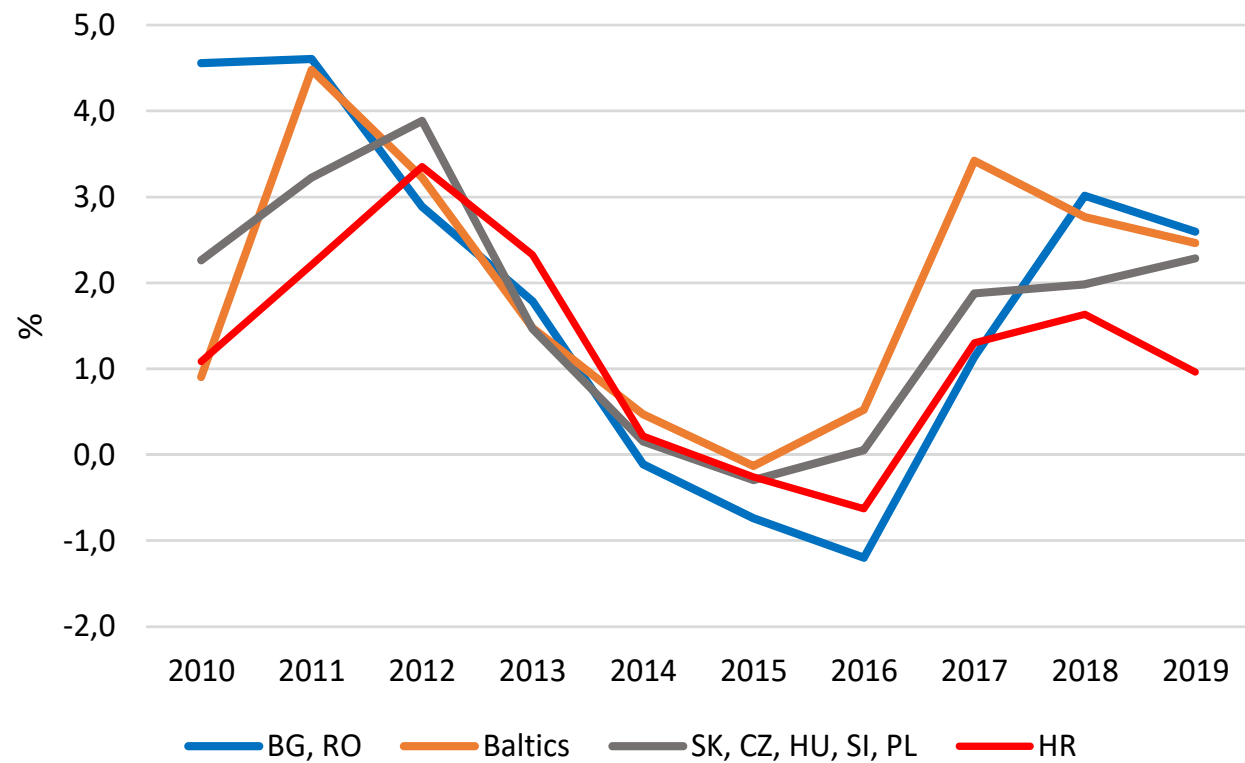
Compensation per employee



Sources: AMECO; CNB for Croatia

*Administrative data for Croatia
Sources: Eurostat, Croatian Bureau of Statistics (CBS)

However, inflation remains relatively low



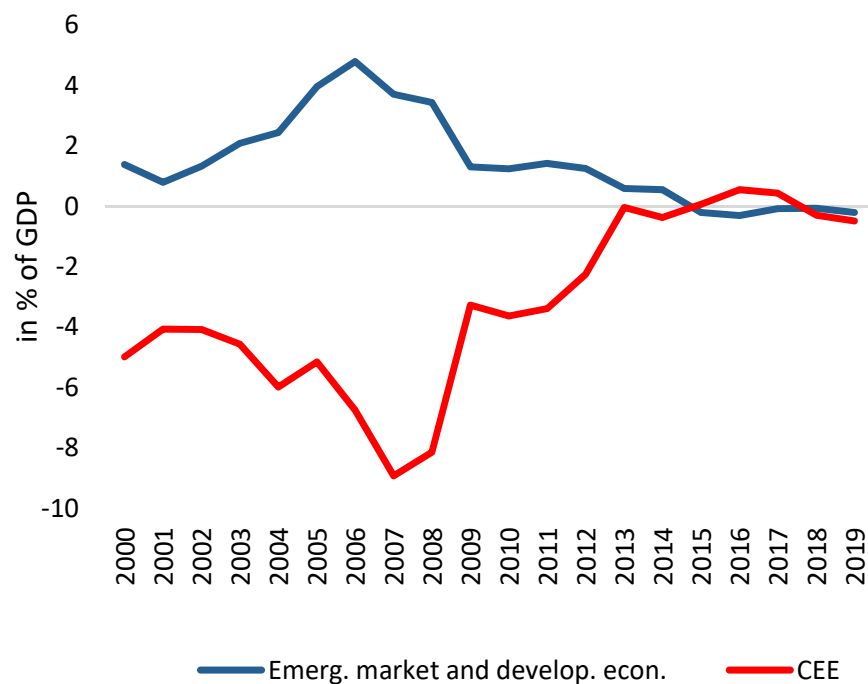
Sources: Ameco; CNB for Croatia

Mounting risks to the outlook

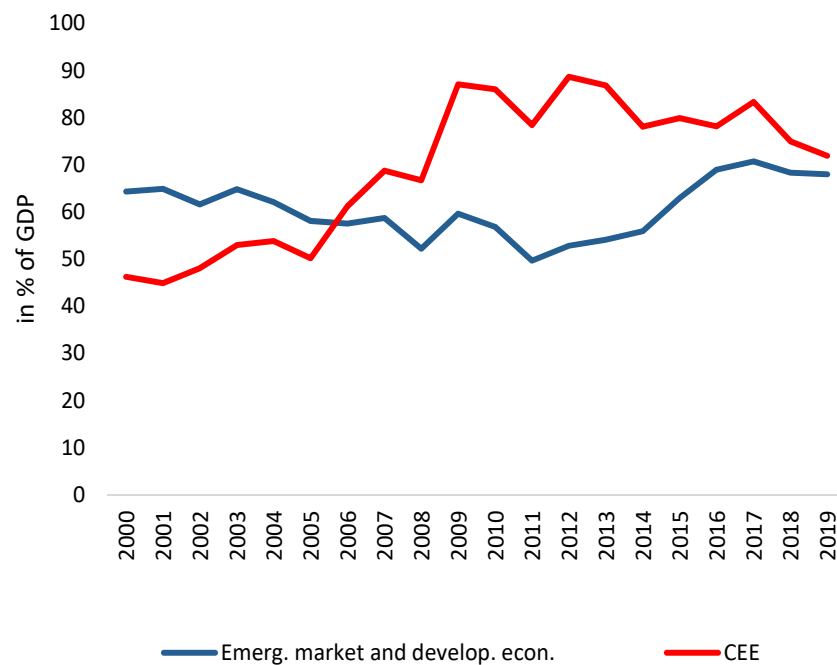
- Escalation of trade protectionism
- Monetary normalization
- Other negative spill-overs (Italy)

Yet, CEE seem to be in a good shape to withstand impact of negative shocks

Current account balance



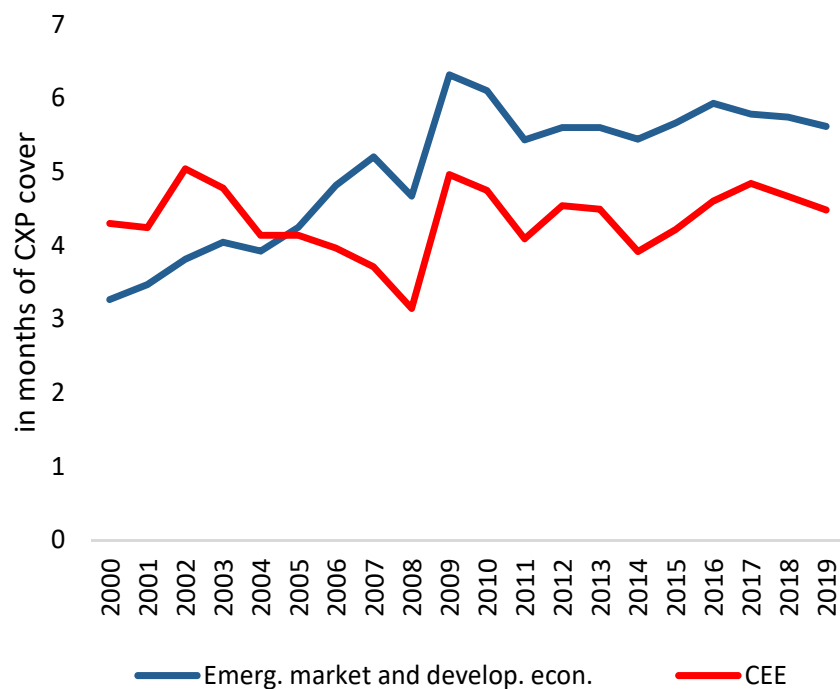
External debt



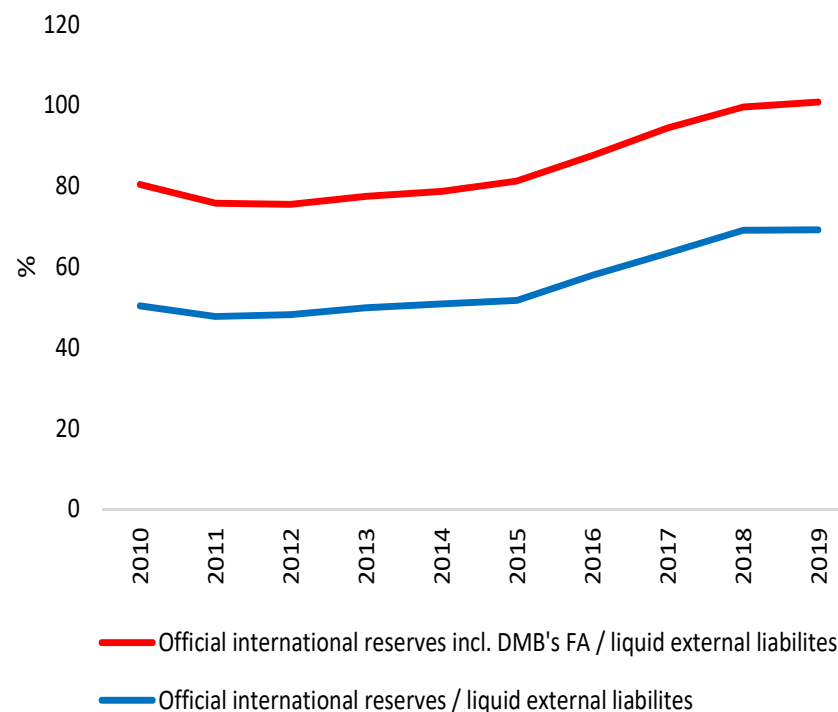
Source: IMF WEO

Solid international liquidity position

Official international reserves



CEE external liquidity position

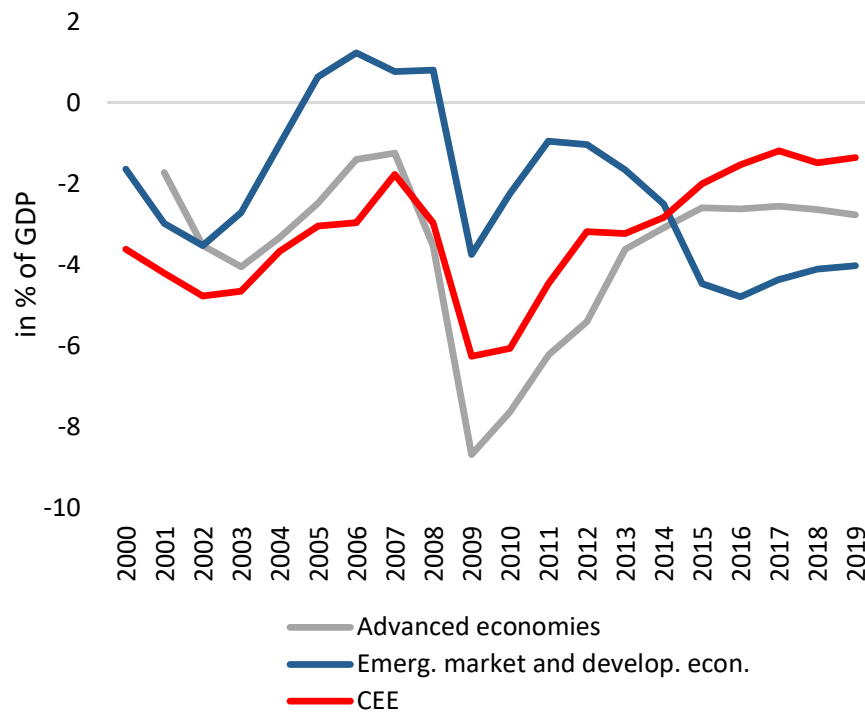


Source: IMF

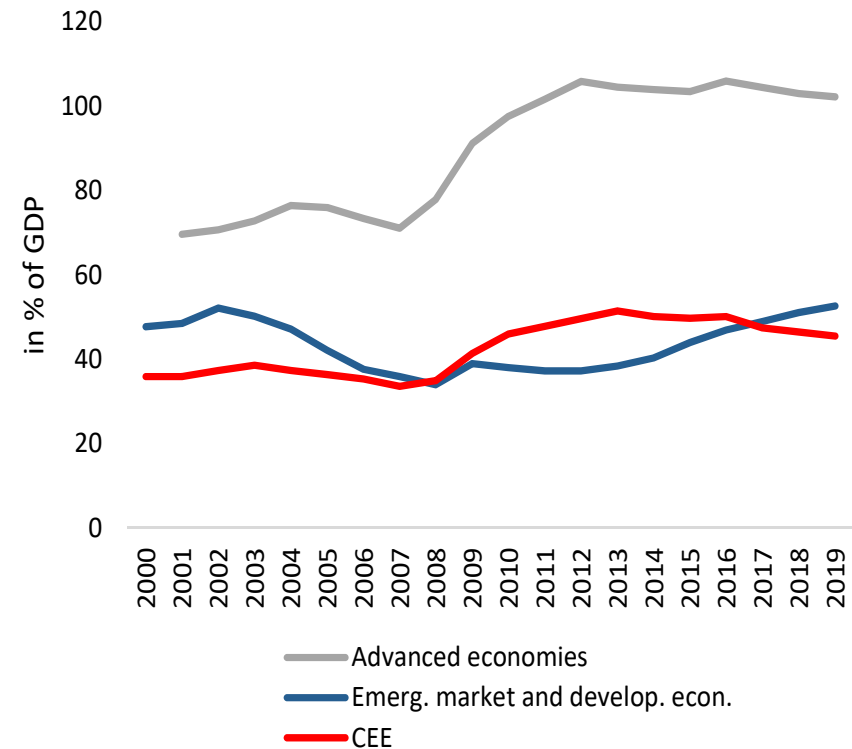
Note: DMB's FA – deposit money banks' financial assets

Fiscal position relatively comfortable

Fiscal balance



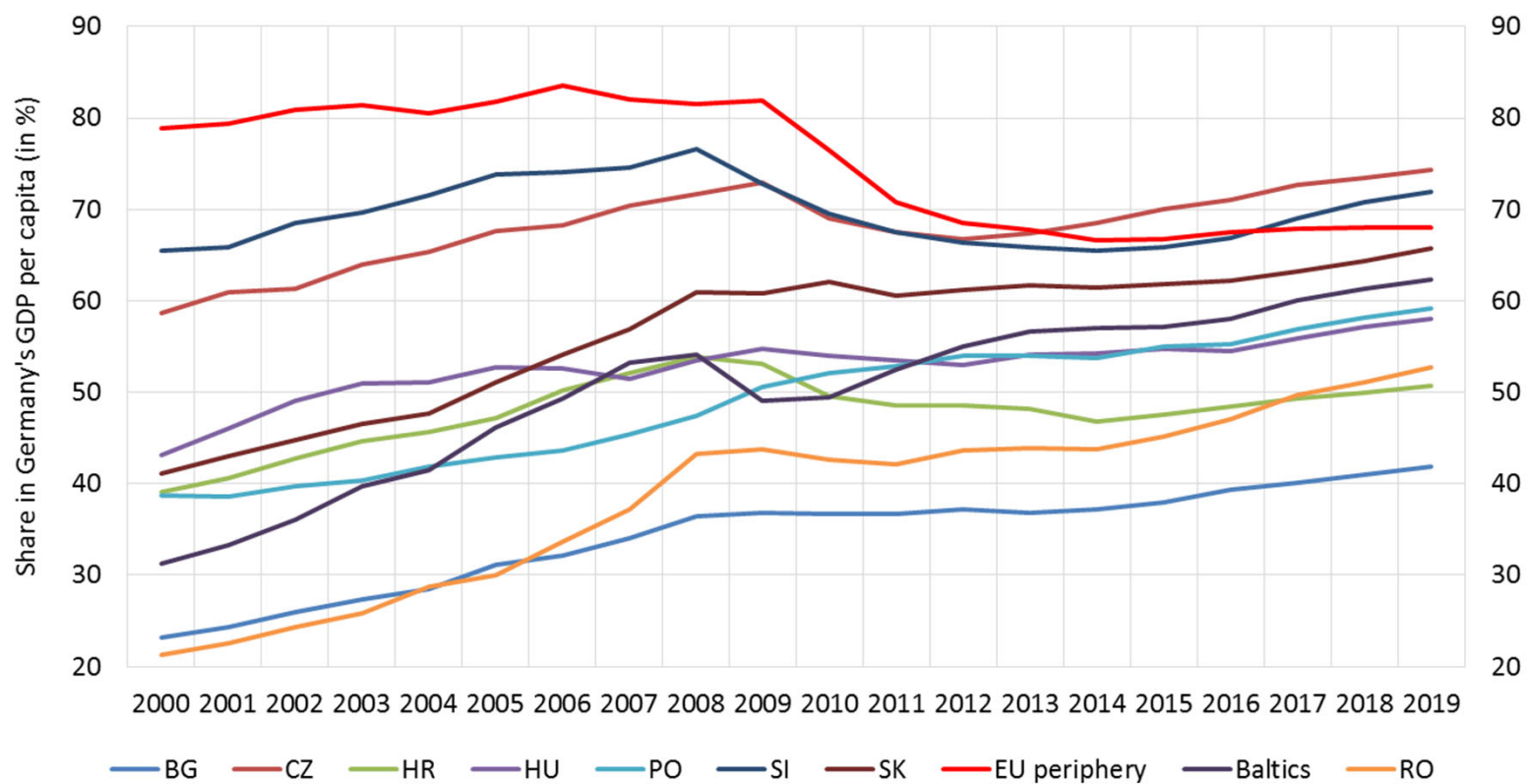
Public debt



Source: IMF WEO, April 2018

However, medium-term growth not sufficient to ensure pre-crisis pace of convergence

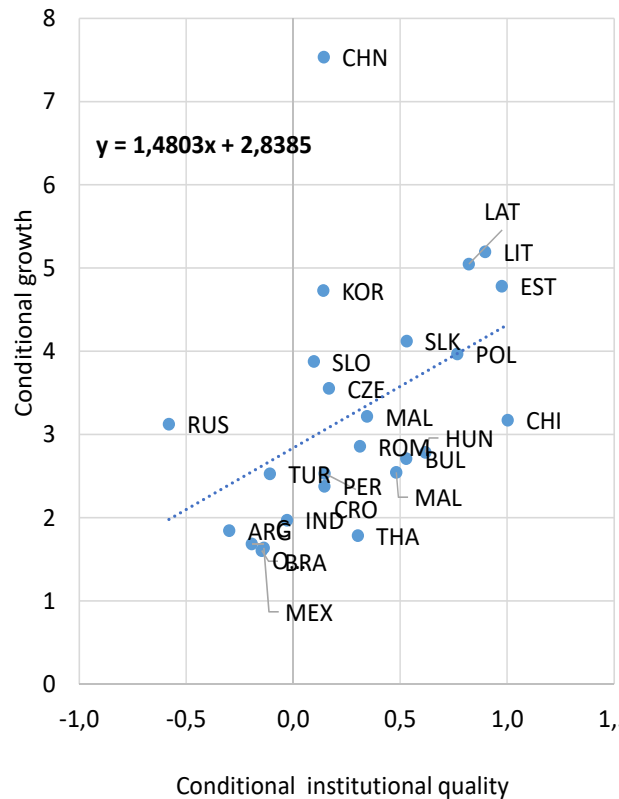
Real convergence, PPS, Germany=100



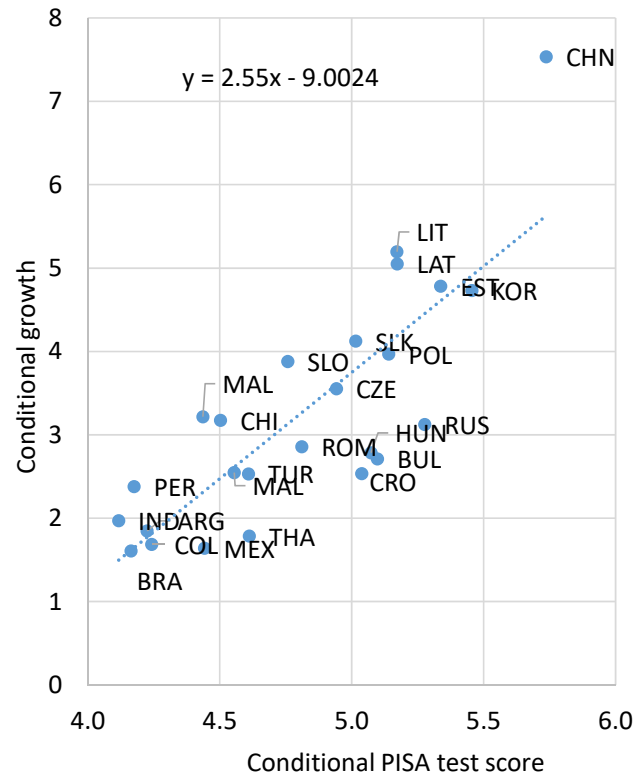
EU periphery – Italy, Spain, Portugal, Greece
Source: AMECO

Total factor productivity – the truth is out there

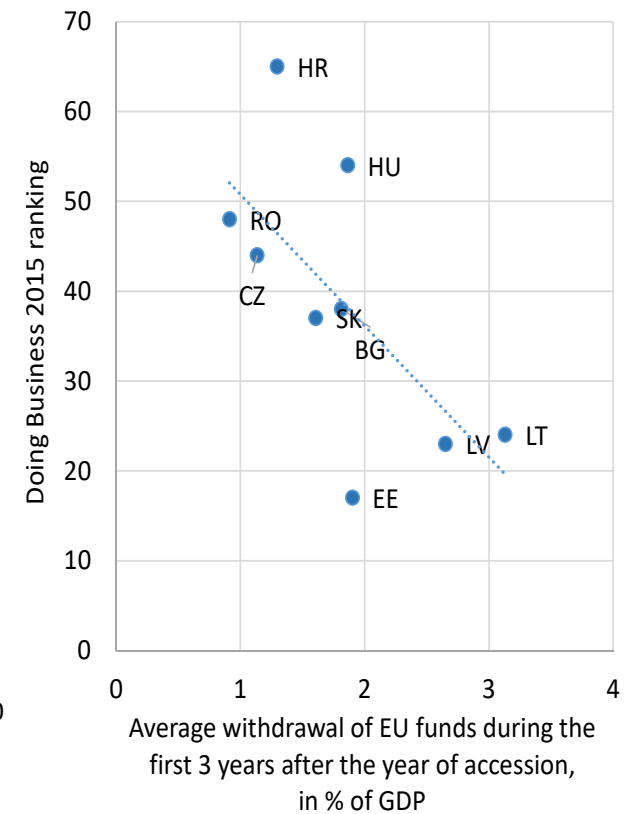
Institutions quality vs growth



Human capital vs growth



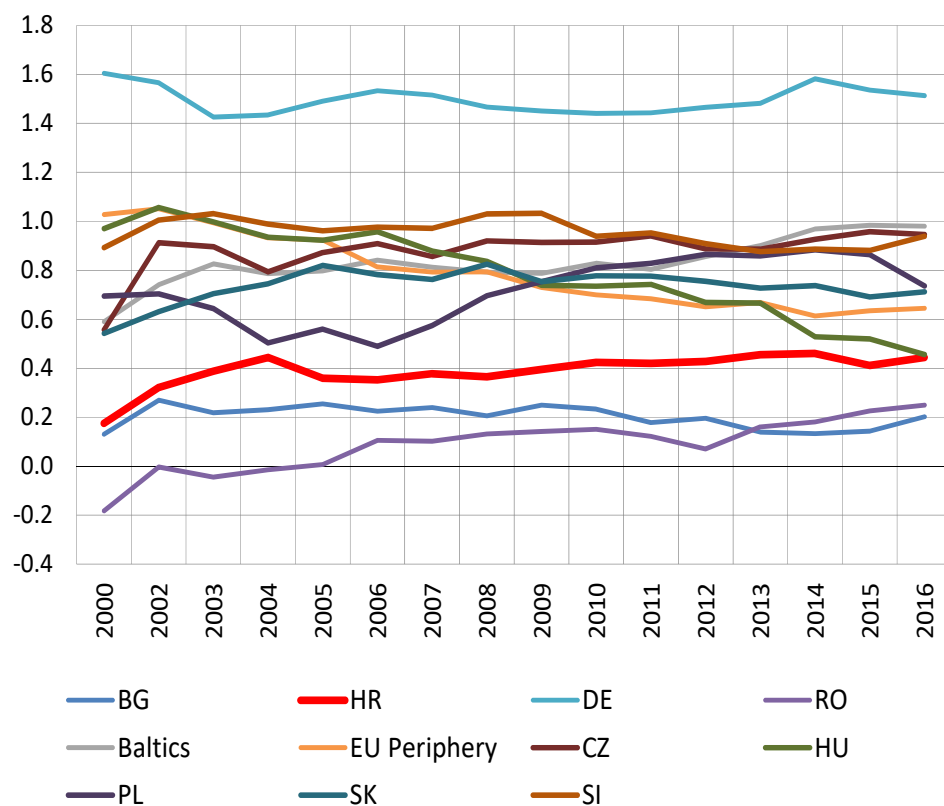
Institutions quality and EU funds withdrawal



Sources: World Bank; OECD; EC, CNB calculations

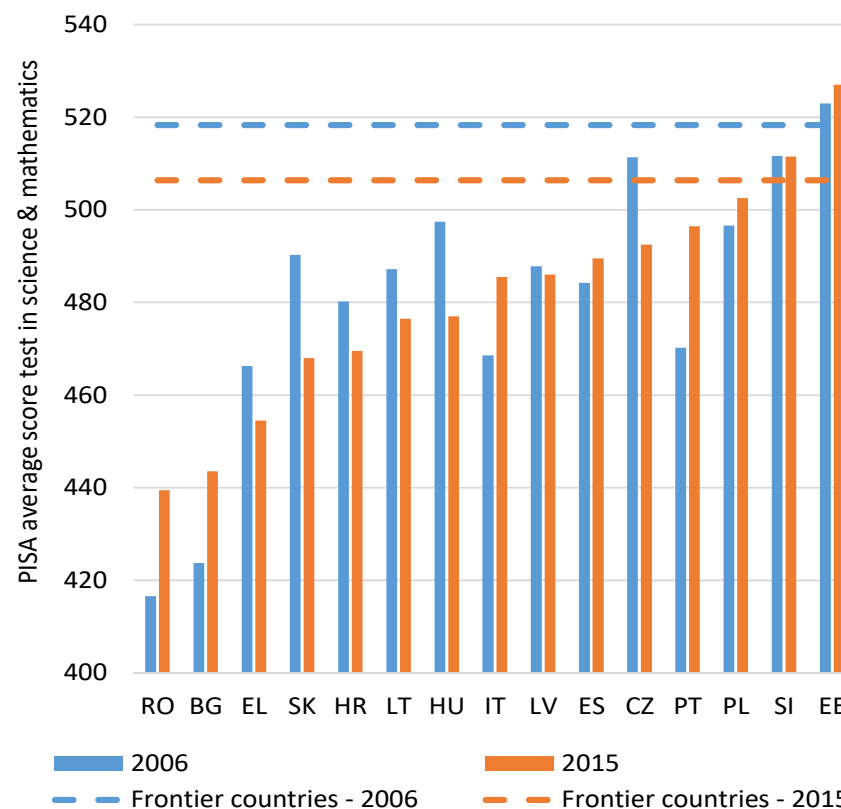
Large room for improvement but progress has been slow

Quality of institutions – no convergence



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

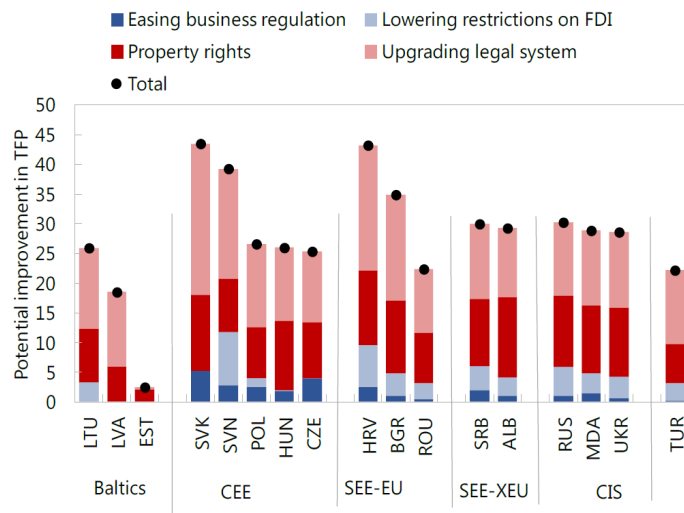
Human capital – still below frontier countries



Source: OECD

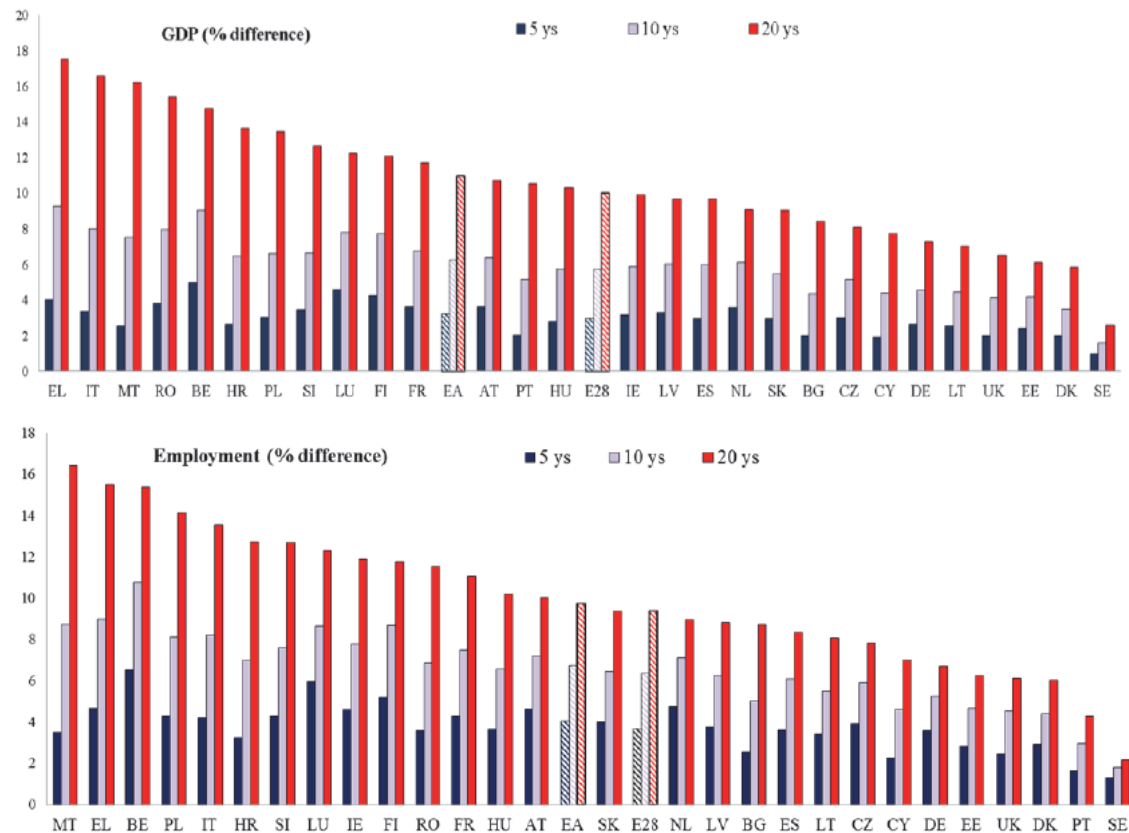
Potential gains from structural reforms are significant but...

Potential efficiency gains from structural reforms (Percent)



Source: IMF, CEESEE Economic Issues, May 2016

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



Source: EC (2014) The potential growth impact of structural reforms in the EU

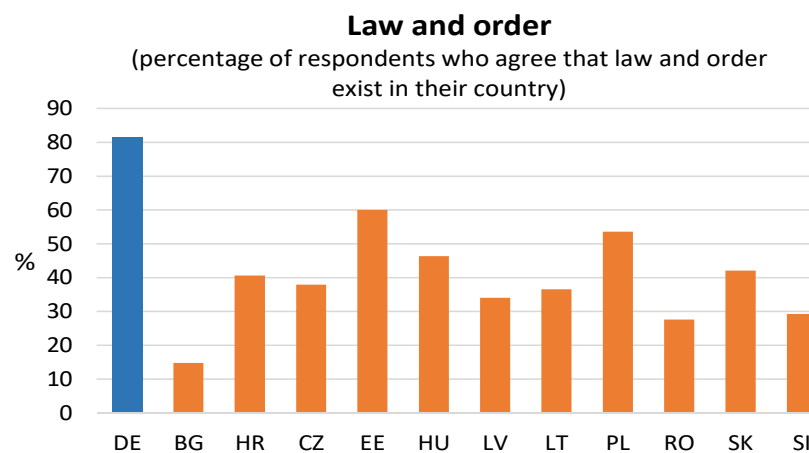
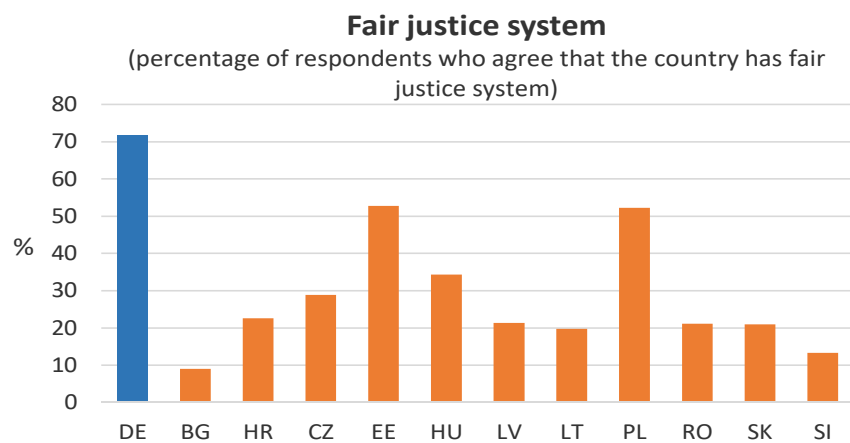
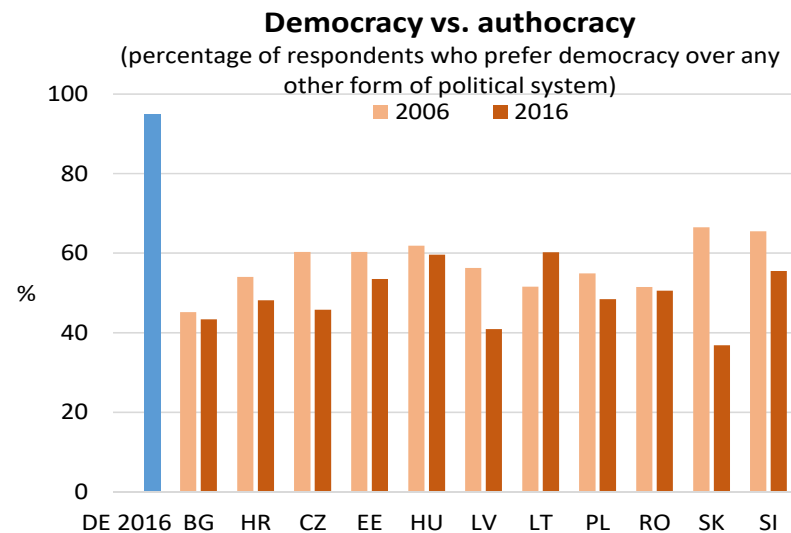
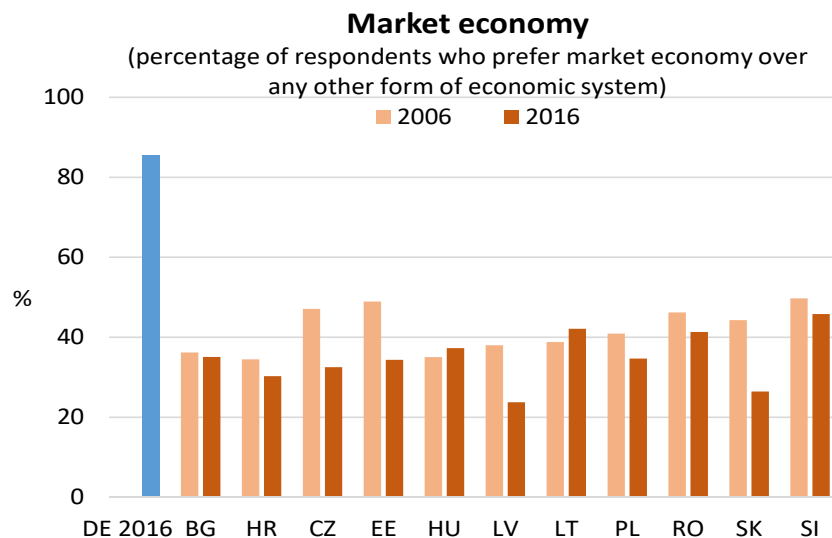
... how to get them right?

- 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 economist 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



Source: EBRD Life in transition Report (2016)

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!