

Current economic challenges facing Central and Eastern Europe

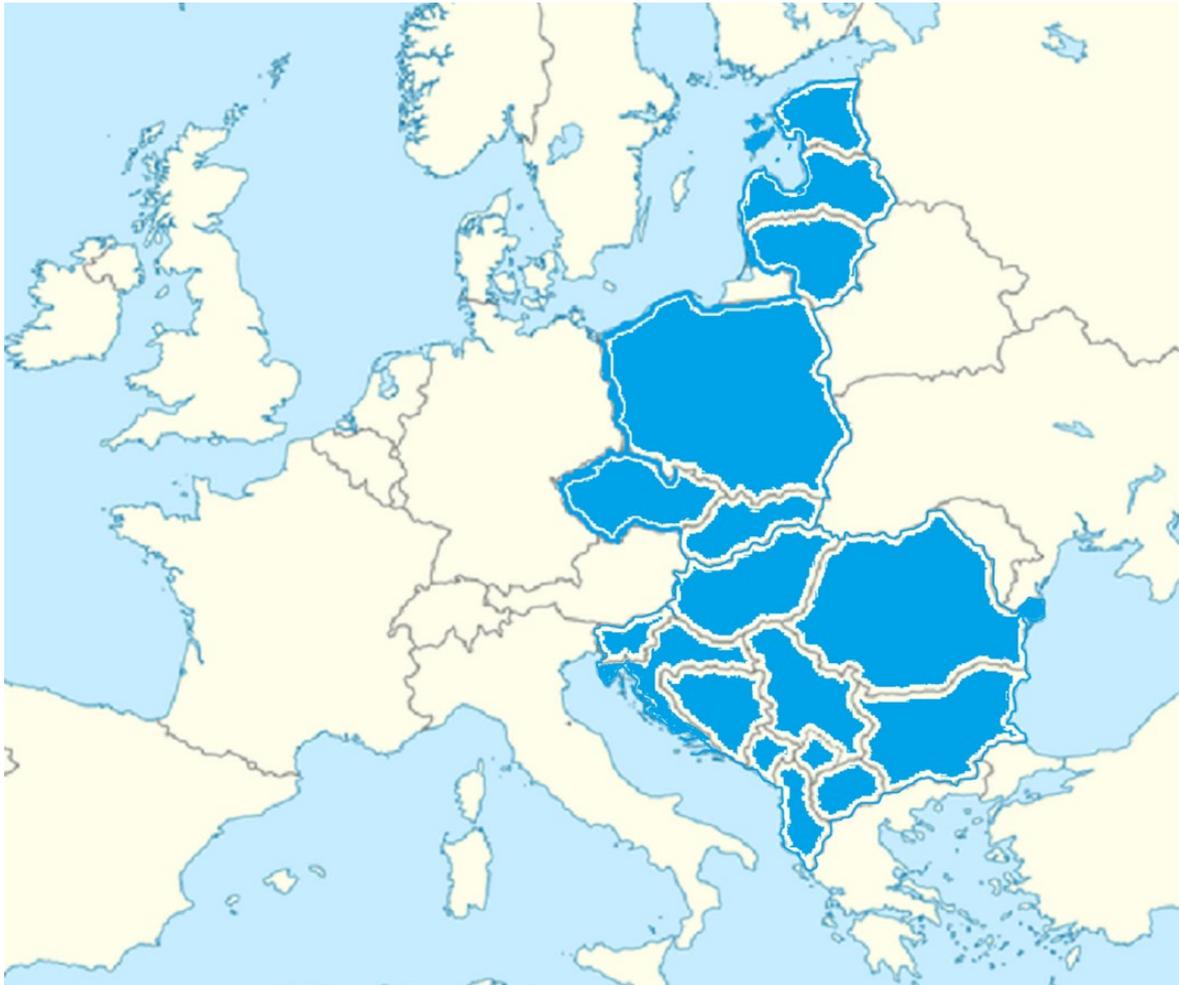
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- Common features of the countries in the Central and Eastern European region
- Some differences among the countries under review
- Main challenges for the region



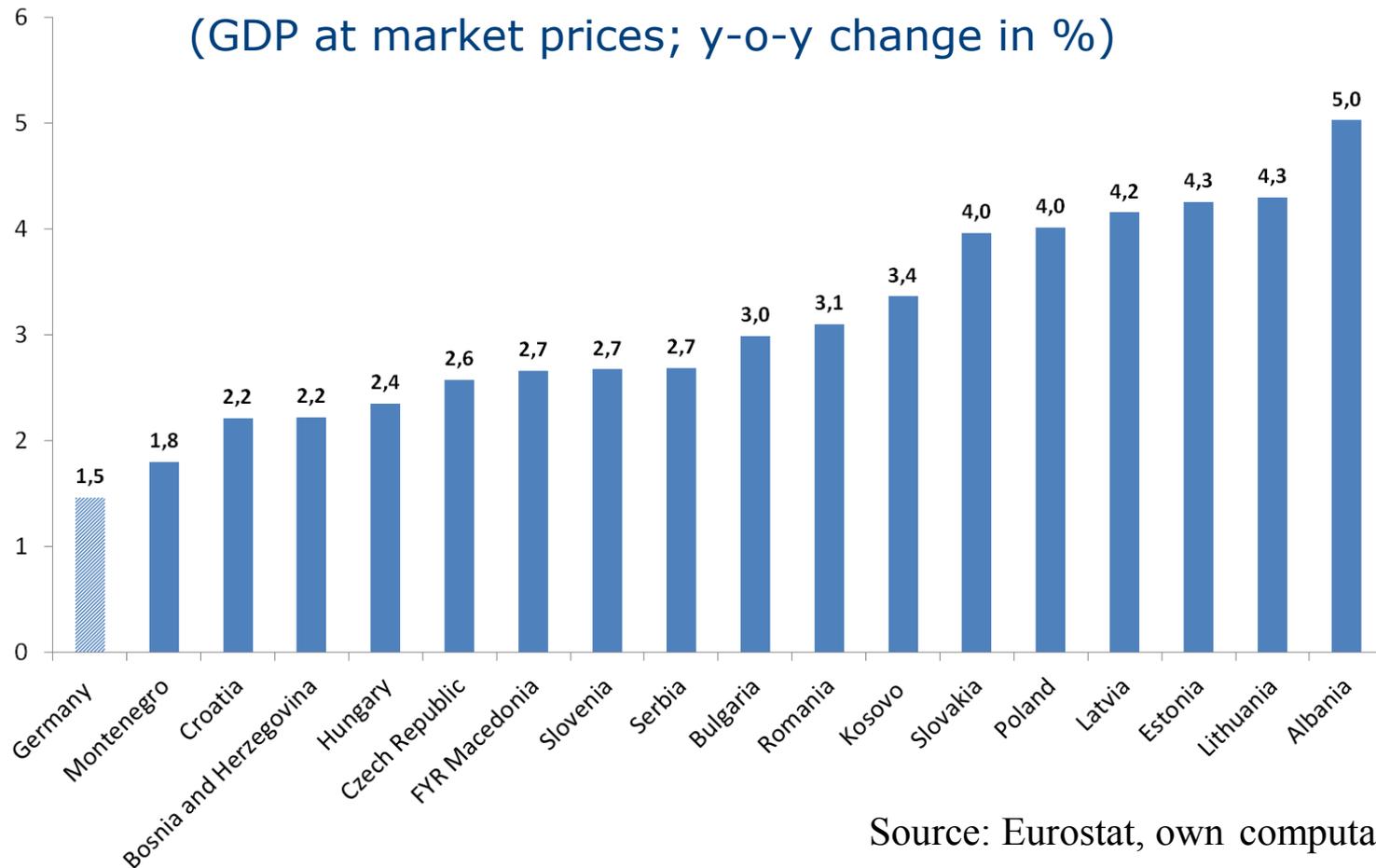
Region: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Rep., Estonia, Hungary, Kosovo, Latvia, Lithuania, FYR Macedonia, Montenegro, Poland, Romania, Serbia, Slovakia, Slovenia

Total population: 120,6 mil. (Poland: 40 mil., Romania: 19.6 mil., ... Montenegro: 0.6 mil.)

- All these countries had to shed the burden of a communist dictatorship and a system of (more or less strict) central planning based on predominant state ownership
- After the fall of communism, all these countries embarked on a journey towards Western-style democracy and market economy
- The main goal of all these countries was EU (or euro area) and NATO membership
- The economic transition took about two decades; often a strenuous and very complex process with varying results (different “national” factors)

Despite the difficulties of the transition period, all countries in the region have recorded convergence towards the economic core of the euro area

Average growth rates 1995–2017



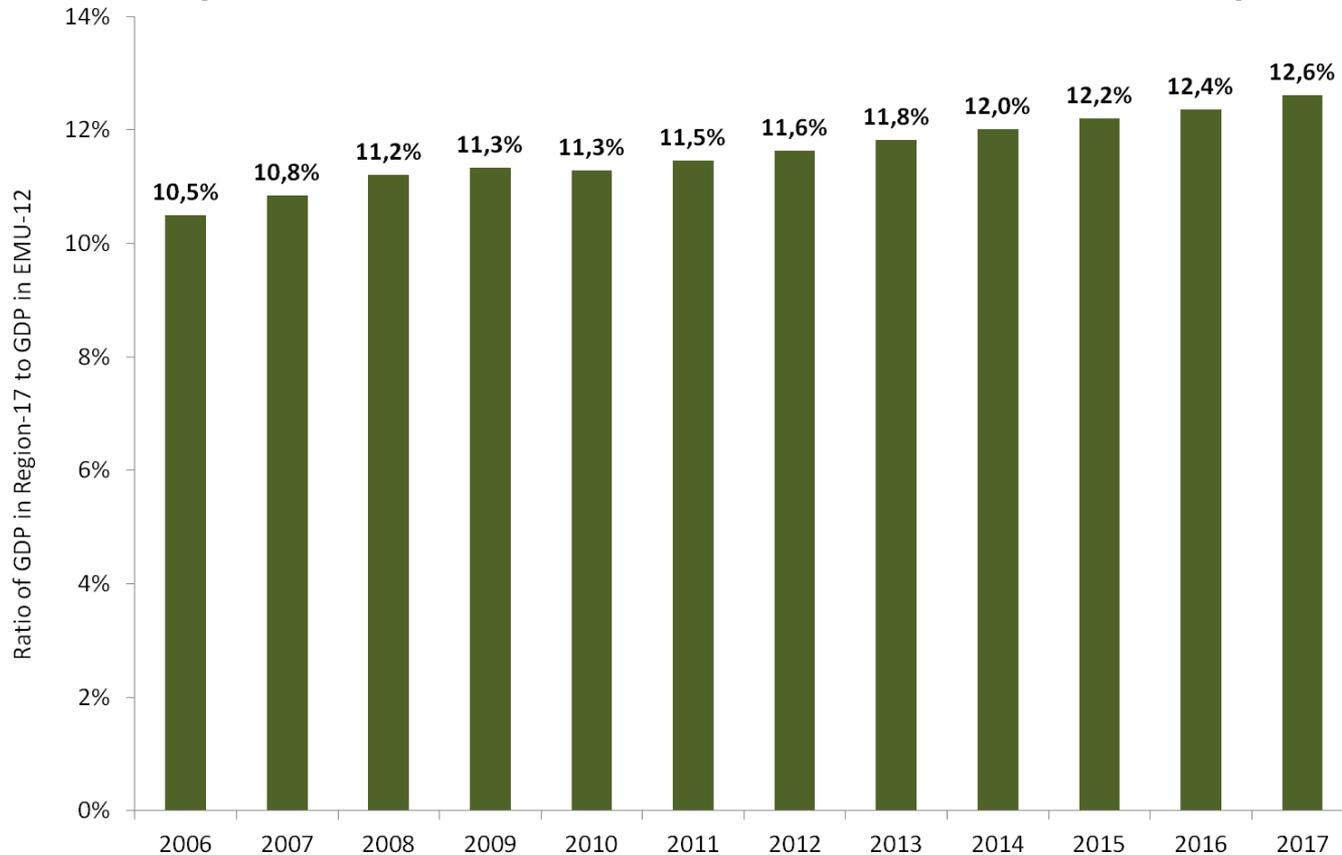
Source: Eurostat, own computation

Note: Montenegro 2007–2016; FYR Macedonia 2000–2017; Albania 1997–2017; Bosnia and Herzegovina 2005–2016; Kosovo 2008–2016

All these countries have grown faster than Germany over the long run and some even substantially faster

Ratio of GDP in region to GDP in EMU-12, 2006–2017

(in %; EUR millions, chained linked volumes (2010))



Source: Eurostat, own computation

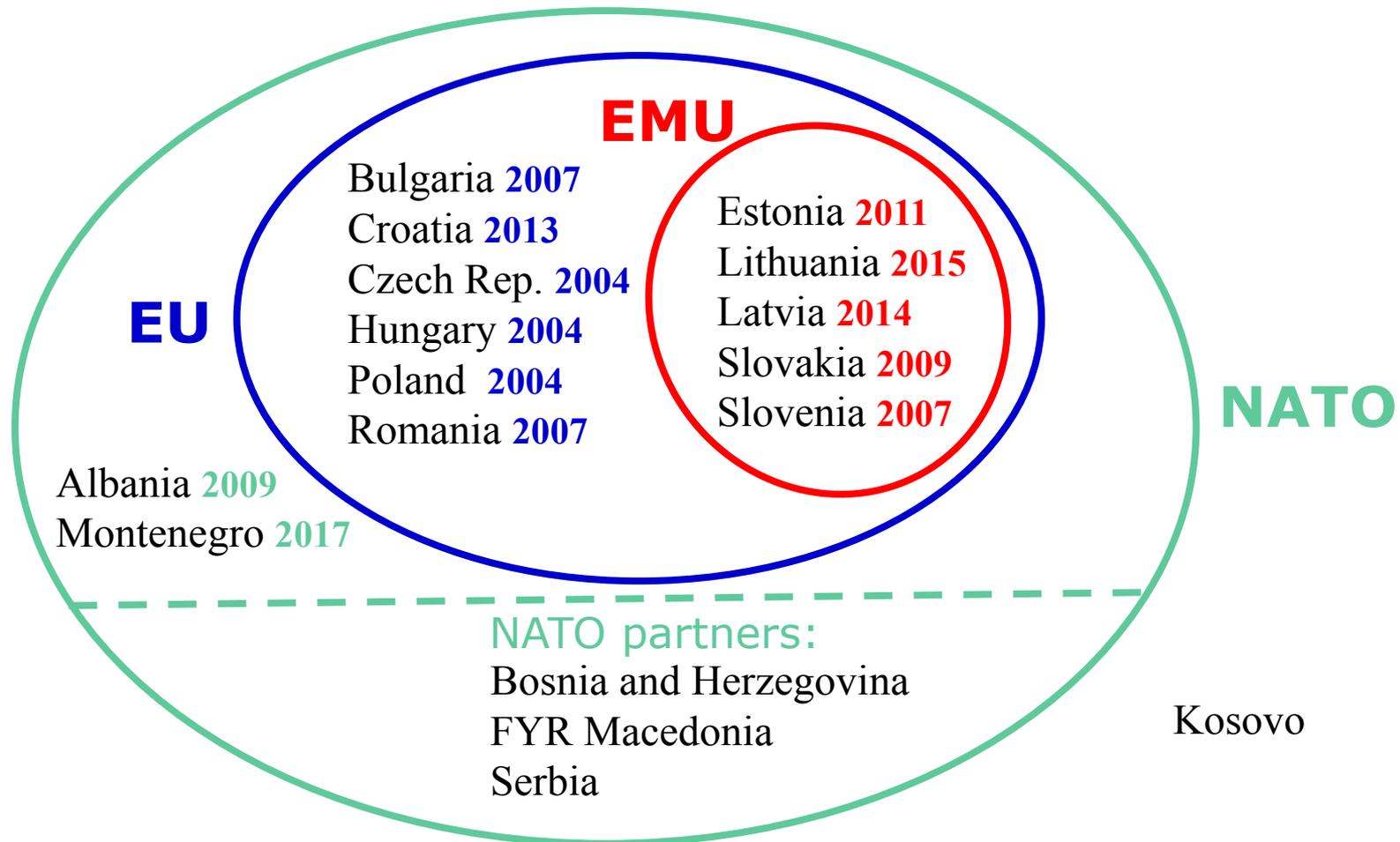
Note: Montenegro 2007–2016; Bosnia and Herzegovina 2005–2016; Kosovo 2008–2016

The ratio of the region's GDP to that of EMU-12 has risen by 2 pp over the last decade

- Introduction of market economy, re-birth of private property and emergence of competition
- Trade openness
- Foreign direct investment lured by:
 - cheap (but relatively educated and qualified) labour
 - improving economic conditions (especially after joining EU)
 - geopolitical stability (entry to NATO)
- Intra-industry links (participation in global value chains)
- Inflow of EU structural funds
- Advancement of democratic institutions and rule of law
- Exchange rate fixation (EMU members) ⇒ replacement of exchange rate risks ⇒ trade gains

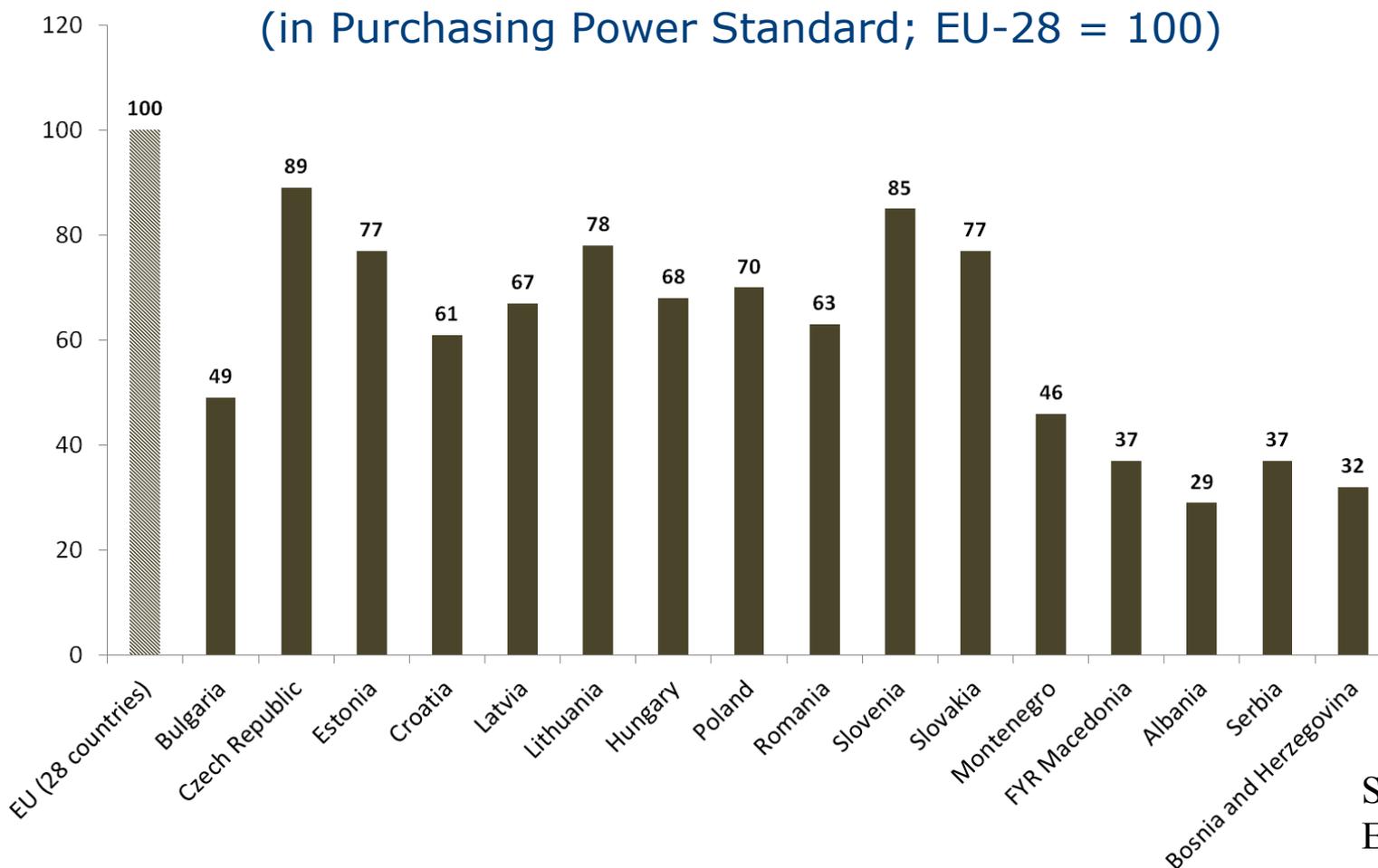
EU (and EMU) entry helped to boost economic growth and convergence vis-à-vis advanced economies

Some differences among the countries under review



Different patterns of institutional integration with Europe: while EMU members are most integrated, Kosovo is least

GDP per capita in 2017



GDP per capita varies significantly across the region: it ranges between 29 in Albania and 89 in the Czech Republic

	Overall ranking
Estonia	29
Czech Republic	31
Poland	39
Lithuania	41
Slovenia	48
Bulgaria	49
Latvia	54
Slovakia	59
Hungary	60
Romania	68
Croatia	74
Albania	75
Montenegro	77
Serbia	78
Bosnia and Hercegovina	103

Total number of countries: 137

12 pillars of competitiveness:

- Institutions
- Infrastructure
- Macroeconomic environment
- Health and primary education
- Higher education and training
- Goods market efficiency
- Labour market efficiency
- Financial market development
- Technological readiness
- Market size
- Business sophistication
- Innovation

Source: Global Competitiveness Report 2017–2018; World Economic Forum

Baltic and Central European countries are typically ranked higher than countries of former Yugoslavia and Albania

	Score	Rank	Some benchmarks	Score	Rank
Estonia	71	21	Switzerland	85	3
Slovenia	61	34	Germany	81	12
Poland	60	36	Austria	75	16
Lithuania	59	38	Italy	50	54
Latvia	58	40	Greece	48	59
Czech Republic	57	42	Turkey	40	81
Slovakia	50	54	Ukraine	30	130
Croatia	49	57			
Romania	48	59			
Montenegro	46	64			
Hungary	45	66			
Bulgaria	43	71			
Serbia	41	77			
Kosovo	39	85			
Albania	38	91			
Bosnia and Hercegovina	38	91			
FYR Macedonia	35	107			

Source: Transparency International

While some new EU members are doing better than some old EU members, several former Yugoslav countries are ranked between Turkey and Ukraine

Students' performance in science, reading and mathematics – PISA results 2015

	Performance in:		
	Science	Reading	Mathematics
OECD average	493	493	490
Estonia	534	519	520
Slovenia	513	505	510
Poland	501	506	504
Czech Republic	493	487	492
Latvia	490	488	482
Hungary	477	470	477
Lithuania	475	472	478
Croatia	475	487	464
Slovakia	461	453	475
Bulgaria	446	432	441
Romania	435	434	444
Albania	427	405	413
Montenegro	411	427	418
FYR Macedonia	384	352	371
Kosovo	378	347	362

- 540,000 students
- ... representing about 29 mil. 15-year-olds
- 72 participating countries

performance **above** OECD average

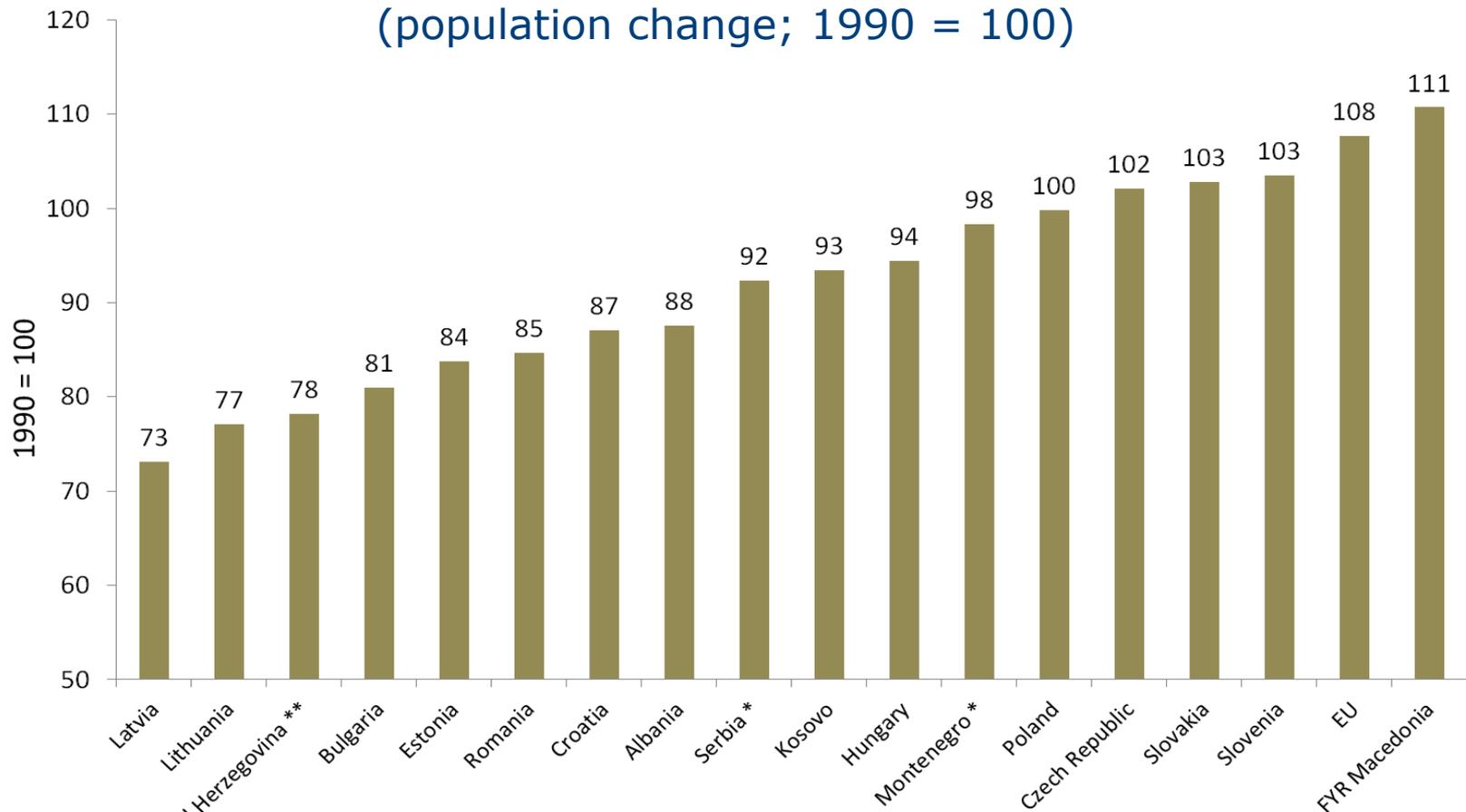
performance not significantly different from OECD average

performance **below** OECD average

Source: OECD

While Estonia is the best performer, Kosovo is a laggard

Population in 1990 and 2017



Note: Serbia and Montenegro 1995–2016
Bosnia and Herzegovina 1990–2016

Source: Eurostat

A worrisome long-run decline in population in the Baltic countries and in some countries of South-Eastern Europe

Main challenges for the region

The above-mentioned differences between countries imply the following main challenges:

- To improve education and enhance competitiveness especially South-Eastern Europe
- To lessen the scope of corruption especially former Yugoslavia (except Slovenia), Albania, Bulgaria, Hungary, Romania
- To avoid shrinking of population and reverse brain drain especially Baltic countries, Bosnia and Herzegovina, Bulgaria, Romania

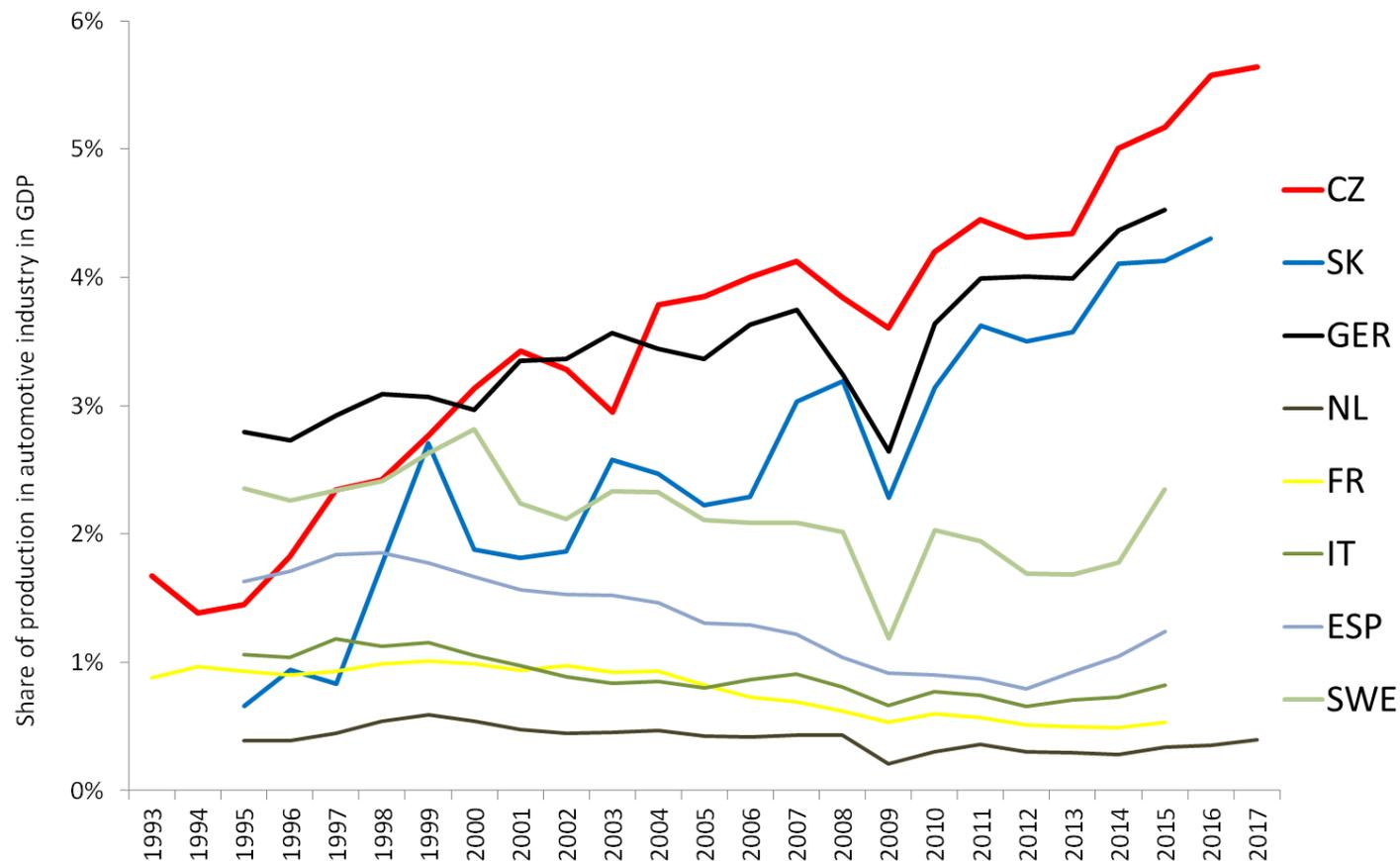
Nevertheless, there are also other challenges:

- To mitigate excessive dependence on the automotive industry especially Czech Republic and Slovakia
- To escape the „middle-income trap“ whole region

The less advanced countries of the region are challenged to follow their more advanced neighbours, who in turn are challenged to catch up with the EU's best performers

Share of car production in GDP

(share of NACE 29 in gross value added)



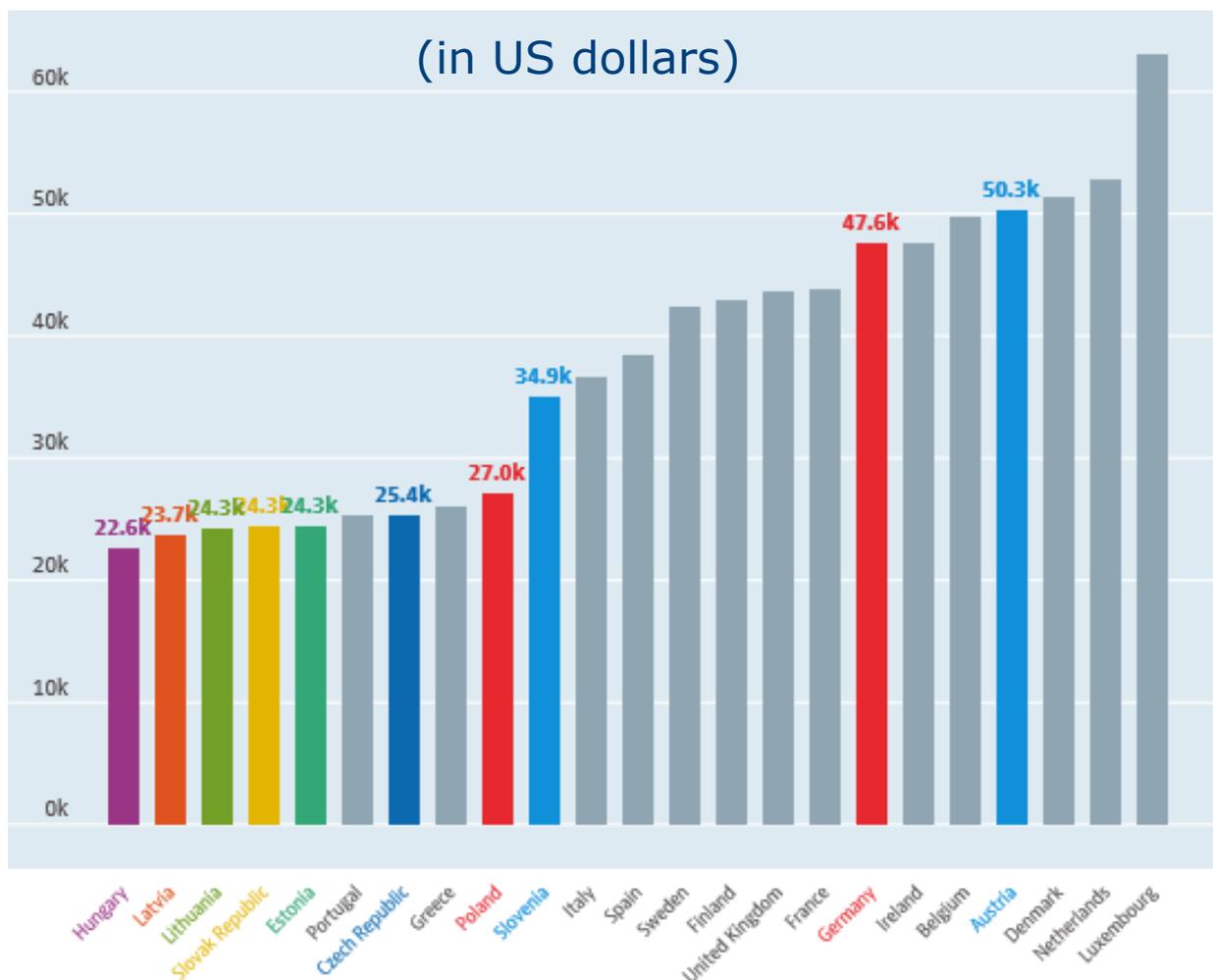
Source:
Eurostat

The share of car production in CZ (and SK) is very high compared to many other EU countries (except Germany) ⇒ the economy is vulnerable in case of an asymmetric shock

- The concept of „middle-income trap“ is ambiguous
- It claims that middle-income countries can be squeezed between higher-tech and lower-wage rivals on either side
- Rich countries need advanced technologies and skills to offset high wages and poor countries need low wages to offset low levels of technology and skill
- There are at least four possible sources of GDP growth:
 - Moving workers from overmanned fields to more productive factories (e.g. structural transformation in Polish agriculture)
 - Adding more capital per worker (capital deepening)
 - Augmenting capital or labour by making it more productive
 - Technological innovation (new products or services)

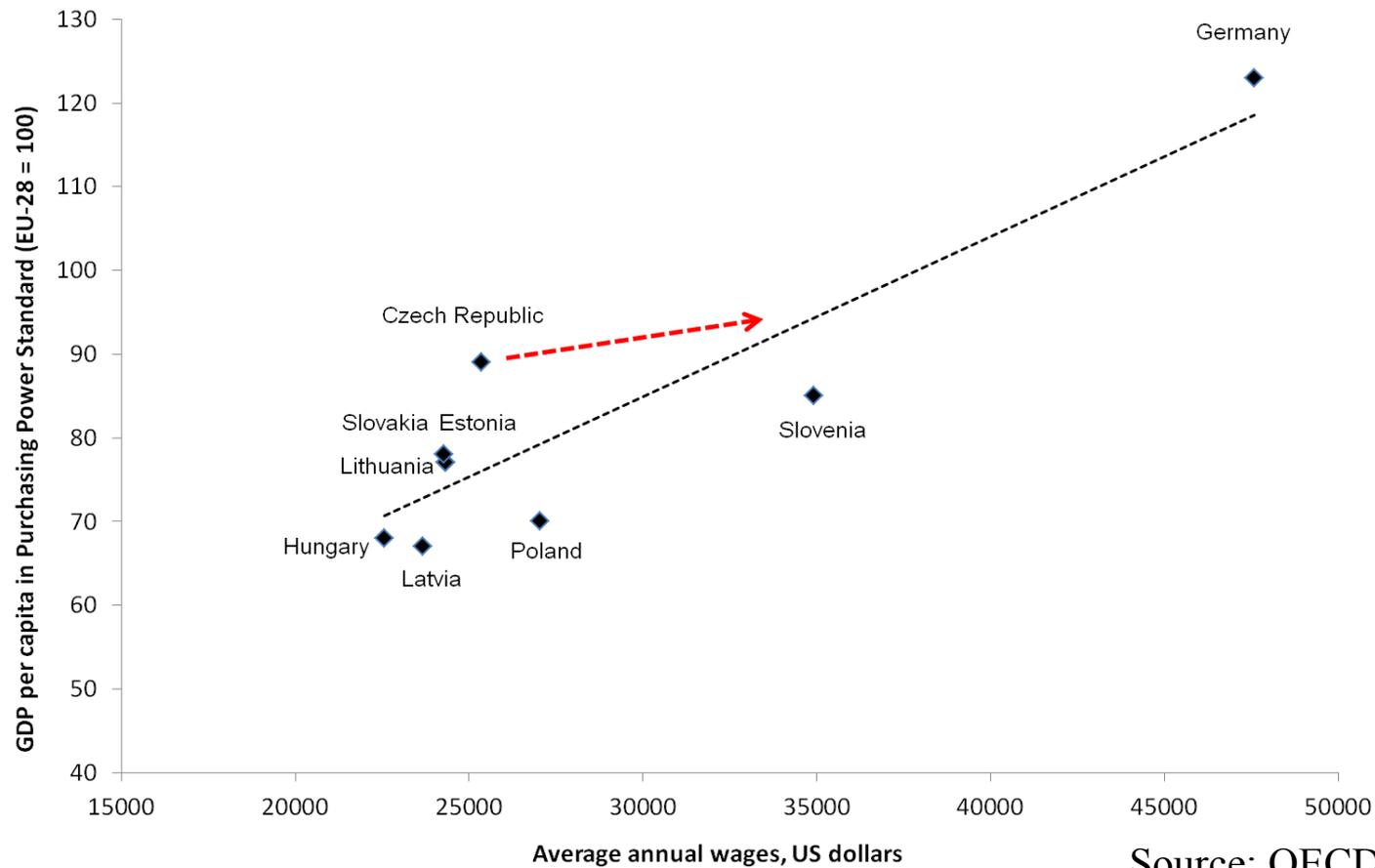
Challenge: to switch from middle-wage, middle-skill economies to higher-tech and knowledge-driven ones; in other words to upgrade in global value chains towards high-value-added stages (design, marketing, sale services rather than just production)

Average annual wages in 2017



Source:
OECD

The average annual wage in Austria is about double that in most countries of the region except Slovenia; low wages \Rightarrow reallocation of production from Germany



Source: OECD, Eurostat

The Czech Republic is a bit of an outlier: while its GDP per capita is higher than that of Slovenia and Poland, its wages are lower; this justifies the rather robust wage growth which we are currently observing

- Despite common history, the region is rather heterogeneous:
 - While the more advanced countries are already well integrated to the EU, the less advanced countries are still pre-occupied with better geopolitical and economic anchoring in Europe and to „Western values“ (democracy, transparency, rule of law)
 - There are also sizeable differences in terms of GDP per capita
- Main challenges (especially for the less advanced countries):
 - Improving education
 - Enhancing competitiveness
 - Reducing corruption
 - Preventing brain drain
 - Avoiding shrinkage of population
 - Upgrading in global value chains, mitigating over-specialisation

With the benefit of hindsight: the transformation of some countries proved to be a success story (especially the Baltic countries)



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