HAS GROWTH PEAKED?

2018 growth forecasts revised upwards as broad-based recovery continues
Stronger growth momentum: Growth in Q3 2017 was the strongest since Q3 2011 in the EBRD regions

Following several years of weaker economic performance, growth in the EBRD regions accelerated to 3.8% in 2017, at par with average global growth.

Momentum broadly shared, in 1/3+ of region’s economies growth in 2017 was the strongest since 2011.

Source: National authorities via CEIC, IMF and authors’ calculations. Dotted line represents nowcast based on 152 global indicators.
EBRD growth to decelerate from 3.8% in 2017 to 3.3% in 2018, although upward revision from 3%

- Unlike global growth, which is projected to pick up slightly in 2018-19 from the same rate in 2017
- ~ unchanged views about the long-term growth rate in the region even though economies managed to converge to this rate faster, helped by the cyclical recovery in the advanced economies.

Source: IMF, EBRD and authors’ calculations. Growth averages derived using PPP-based weights.
Deceleration as growth returns to medium-term potential, shortages of skilled labour a constraint in Central Europe

- And fiscal stimulus is expected to wear off in Turkey
- In SEMED, projected growth corresponds to an annual increase in output per capita of ~ 2.5%

Source: IMF, EBRD and authors' calculations. Growth averages are population-weighted.
Pick-up in investment supported economic growth in 2017

Investment growth is backed by greater disbursement of EU structural funds to central and south-eastern Europe

Gross inward FDI in a typical economy amounted to 2.3% of GDP, in line with the 2012-16 average

Gross Fixed Capital Formation, % of GDP

Source: National authorities via CEIC, World Bank and author’s calculations.
Global growth ↑ by 0.6 pp in 2017 to 3.8%, trade growth picked up to 4.7% reflecting stronger investment

Global trade has also been aided by weaker US dollar (exports/imports are commonly priced in US$)

Source: World Trade Organisation (WTO) and authors’ calculations. GDP growth is weighted using purchasing power parity-based values.
In EBRD regions, export performance strengthened virtually across the board in 2017

Exports (goods and services), % change in Euro terms

- Exports growth, 2017, € terms
- Exports growth, 2016, € terms

Source: National authorities via CEIC, authors’ calculations.
Oil prices up 25% yoy in 2018 so far, after +24% in 2017: boost to growth in Russia/Central Asia

Brent surpassed US$ 70 / barrel in January 2018 and again in April 2018, on stronger demand, cuts by OPEC and Russia and concerns about supply disruptions.

Source: Reuters and authors’ calculations. The 2018 estimate is based on January-April.
Despite increased volatility, Emerging Europe equities up 14% in € terms compared with 2 years ago

Higher volatility / February correction reflected higher inflation expectations + unwinding of speculative bets made on sustained low volatility itself

Source: Thomson Reuters.
In many countries, price-to-earnings ratios have been high in historical perspective.

Source: Thomson Reuters and CEIC.
The search for yield resulted in many weaker-rated borrowers in emerging markets globally enjoying access to funding on unprecedentedly favourable terms.

**Yields, %**

- **Emerging markets high risk yield**
- **10-year US treasuries**

Source: Bloomberg.
Weaker US dollar has contributed to easing financing conditions for emerging markets

Region’s currencies have remained broadly stable, depreciating slightly against the euro, up against US dollar

**Exchange rate movements against the US dollar, %**

Source: National authorities via CEIC, Thomson Reuters and authors’ calculations.
Risks related to indebtedness: Real credit growth has remained broadly in line with GDP growth since ‘15

Lending conditions in Emerging Europe eased in the first quarter of 2018 according to Institute of International Finance survey

Total credit growth in real, currency- and inflation-adjusted terms, % change year-on-year

Source: National authorities via CEIC and authors’ calculations. Average is weighted by total size of credit stock in US dollars at market exchange rates.
But regions’ overall corporate debt ↑ to 61% of GDP in 2018 from 42% in 2007, largely external and/or forex

A source of risk if case global financial conditions start tightening

Source: National authorities via CEIC; IMF, WB, BIS, OECD via Joint External Debt Hub. Domestic debt numbers are based on bank balance sheet data from national sources. External Debt data consists of external loans from BIS reporting banks, as well international debt securities.
Now at par with Germany/US and emerging market average (excluding China)

Non-financial sector corporate debt, % of GDP, BIS estimates

Source: Bank for International Settlements (BIS) and authors’ calculation. BIS estimates may differ from estimates based on national sources.
Reductions in NPLs on the back of policy actions, virtuous cycle of lower NPLs and economic upswing

A typical (median) country saw the ratios of NPLs to total loans decline by 5.3 percentage points from the post-2008-09-crisis peaks.

At the same time, NPL ratios remain in double digits in 1/3+ of the countries.

Winding up of the third largest lender in Latvia highlights challenges in regulation and supervision.

Source: CEIC, national authorities, World Bank and Fitch.
Capital inflows into EBRD regions remained strong, could moderate if financial conditions start tightening.

Net mutual fund flows to the EBRD regions, 6-months moving average, % of assets under management.

Selected EM countries

EBRD regions

Source: EPFR Global. Selected emerging markets comprise Argentina, Brazil, Chile, China, Indonesia, Korea, Malaysia, Mexico, Philippines.
Most countries in the region have significant buffers in case of a major reversal in capital flows to EMs

But pockets of risk: Reserve coverage of one-year gross external financing needs is relatively low in a number of countries, including Belarus, Georgia, Mongolia, Tajikistan, Tunisia, Turkey and Ukraine.

External financing requirements and reserves, % of GDP

Source: World Bank WDI and author’s calculation. External financing requirements calculated as the sum of current account deficits and short-term external debt. External financing requirements calculated as the sum of current account deficits and short-term external debt. Euro area economies not shown.
Remittances fully recovered in local currency real terms although still 40% below peak in US dollar terms

Remittances grew by 28% in US dollar terms in 2017

Source: Central Bank of Russia and authors’ calculations
Stronger wage growth supported growth, reflecting tighter labour markets

The highest wage growth has been recorded in Ukraine, Turkey, Belarus and Romania

Wage growth and inflation, year-on-year, latest

Source: National authorities via CEIC, Thomson Reuters and authors’ calculations. Ukraine had 26% year-on-year wage increase, not included due to formatting.
However, inflation pressures have been limited so far

- Even as median unemployment rate declined by 3.1 percentage points since 2013 peak, to 8.7%
- Substantial slack following modest growth since the 2008-09 crisis
- Technological change may have weakened the so-called Phillips curve relationship
  - Easier for workers to be matched with job openings reducing the structural rate of unemployment
  - Risk of automation workers’ ability or willingness to seek pay rises when labour markets are tight

Changes in unemployment rate and consumer price inflation, %

Source: National authorities via CEIC, Thomson Reuters and authors’ calculations.
Concluding remarks: Growth accelerated and may have peaked; challenges remain

Stronger growth in the EBRD regions in 2017 on improved global outlook, stronger investment activity, higher commodity prices

Growth may have peaked: Region to grow at around 3.3% in 2018; 3.2% in 2019, in line with medium-term potential as effects of one-off measures, fiscal stimulus fade away

Recent correction in global stock markets put an end to a long period of low volatility but has had little effect on financing conditions or the real economy

Capital flows robust so far, most countries have buffers against capital flow reversals but some countries look vulnerable based on indicators of gross external financing needs coverage

Corporate debt increased 1.5 times since the 2008-09 crisis, on average, as a share of GDP and much of it is external / foreign-currency denominated, adding to the risks as global financial conditions start tightening; other risks relate to higher equity valuations globally; rising populism; escalation of protectionist rhetoric
Country developments
So where did growth peak and why?

GDP growth and population growth by sub-regions, %

Source: IMF, EBRD and authors’ calculations.
Turkey: Overheated economy will slow down

Government stimulus resulted in rapid credit and GDP growth…

…leading to surging inflation and a widening current account deficit

Source: National authorities.
EU-10: Tightening labour markets and less fiscal stimulus will weigh on growth

Scarce labour supply limits production…

In Hungary, 9 out of 10 companies cite labour shortages as the key factor limiting the industrial production.

… with the growth of unit labour costs reaching the one of productivity.

Source: Business and consumer surveys, DG ECFIN.

Source: Eurostat. Productivity and unit labour costs per hour worked.
Russia: Recovery on the back of higher oil prices and domestic demand but anaemic growth potential

The economy emerged from a two-year recession growing by 1.5% in 2017

Higher oil price has supported stronger rouble and disinflation

Source: National authorities via CEIC and US Energy Information Administration
Central Asia: Growth accelerated in 2017 on the back of favorable commodity prices and investment

Rising energy and metal prices have been main drivers of growth in Central Asia in 2017 and early 2018

Fixed investment growth accelerated in 2017, except in Turkmenistan

Energy and metal prices in US$, 2010=100

Fixed investment growth, % year-on-year


Source: National statistics agencies, CEIC.
Western Balkans: Modest slowdown in 2017 but further pick-up expected in 2018 and in 2019

Credit growth acceleration has been broad-based across the region, supporting domestic demand

Progress has been achieved in reducing NPLs

Average credit growth, year-on-year, %

Non-performing loans, % of total loans

Source: National Central Banks, IMF.
EEC: Continued recovery in disposable incomes is contributing to regional growth

Real wages and remittances are on the rise…

Per cent change in 2017, remittances in current US$ terms

… supporting household consumption and growth

Per cent change in 2017, in real terms

Source: National statistical authorities and central banks, EBRD calculations. Real wage growth in Georgia is an estimate.
SEMED: Despite continued regional turmoil, growth is picking up on stronger confidence, reforms in Egypt

Growth has been picking up...

... supported by recovery in tourism

Source: National authorities.