



World Economic Outlook

Central Europe and Baltic Countries

Presentation by

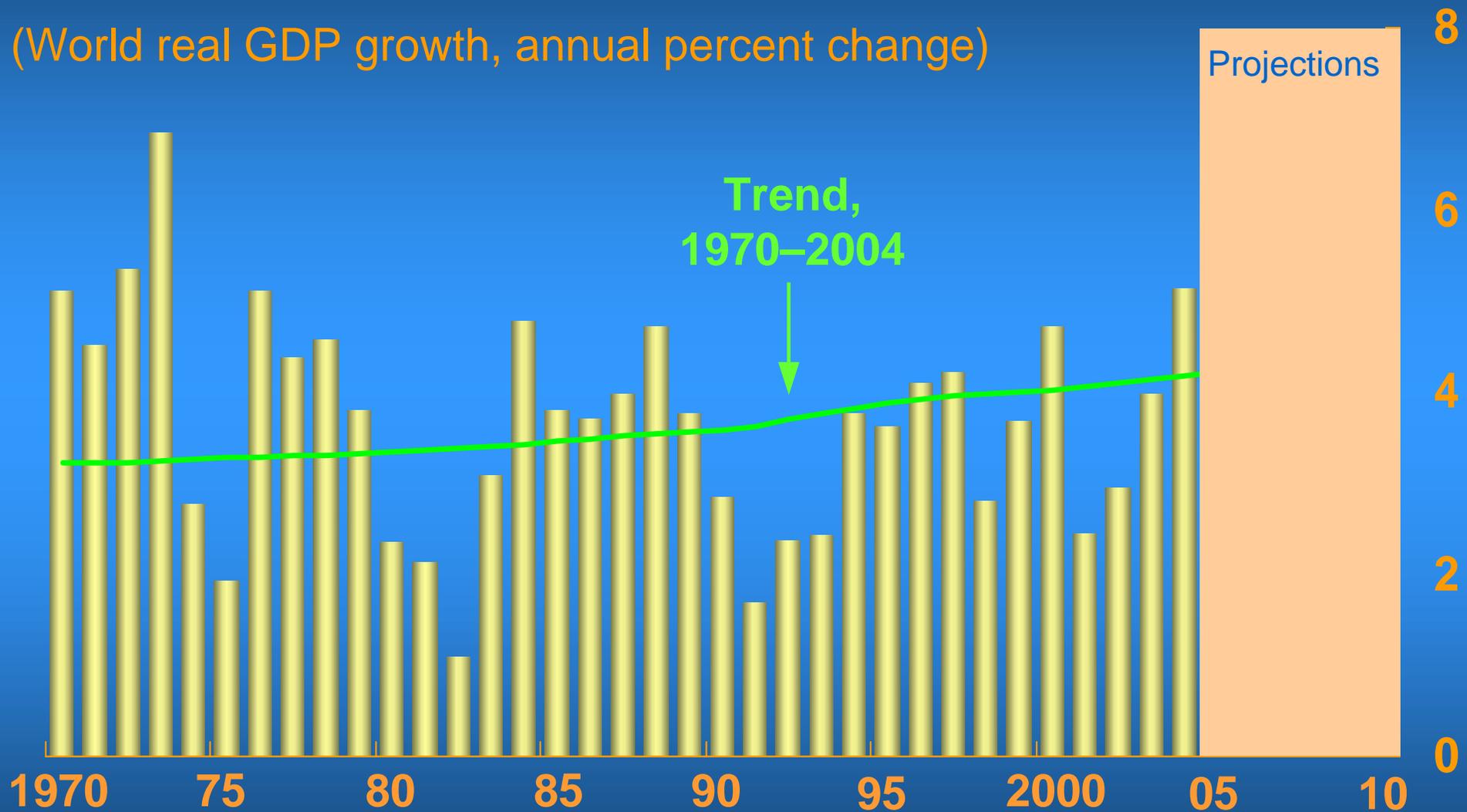
Susan Schadler
and

Christoph Rosenberg

September 2005

World growth returns to trend.

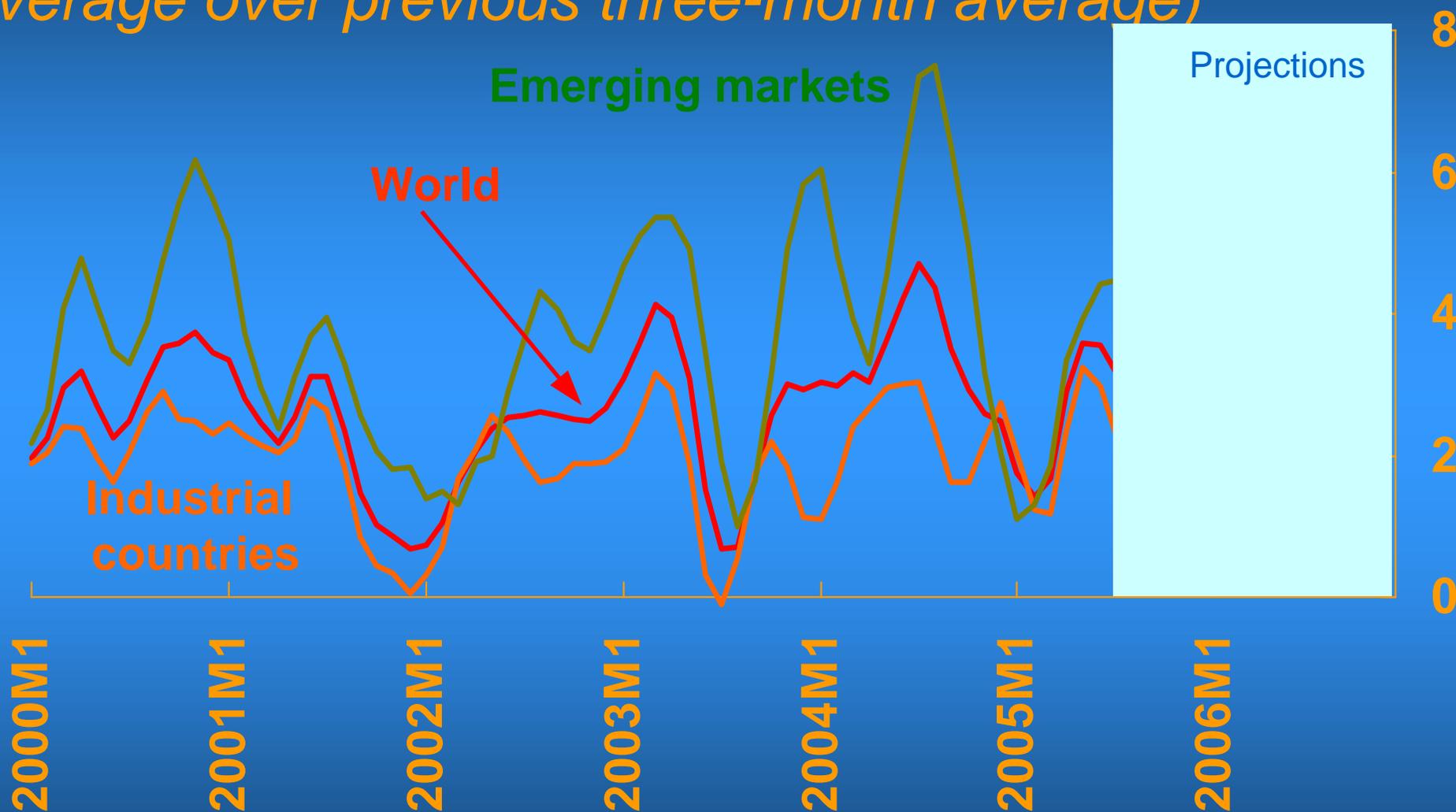
(World real GDP growth, annual percent change)



Source: IMF staff estimates.

Headline Inflation remains contained

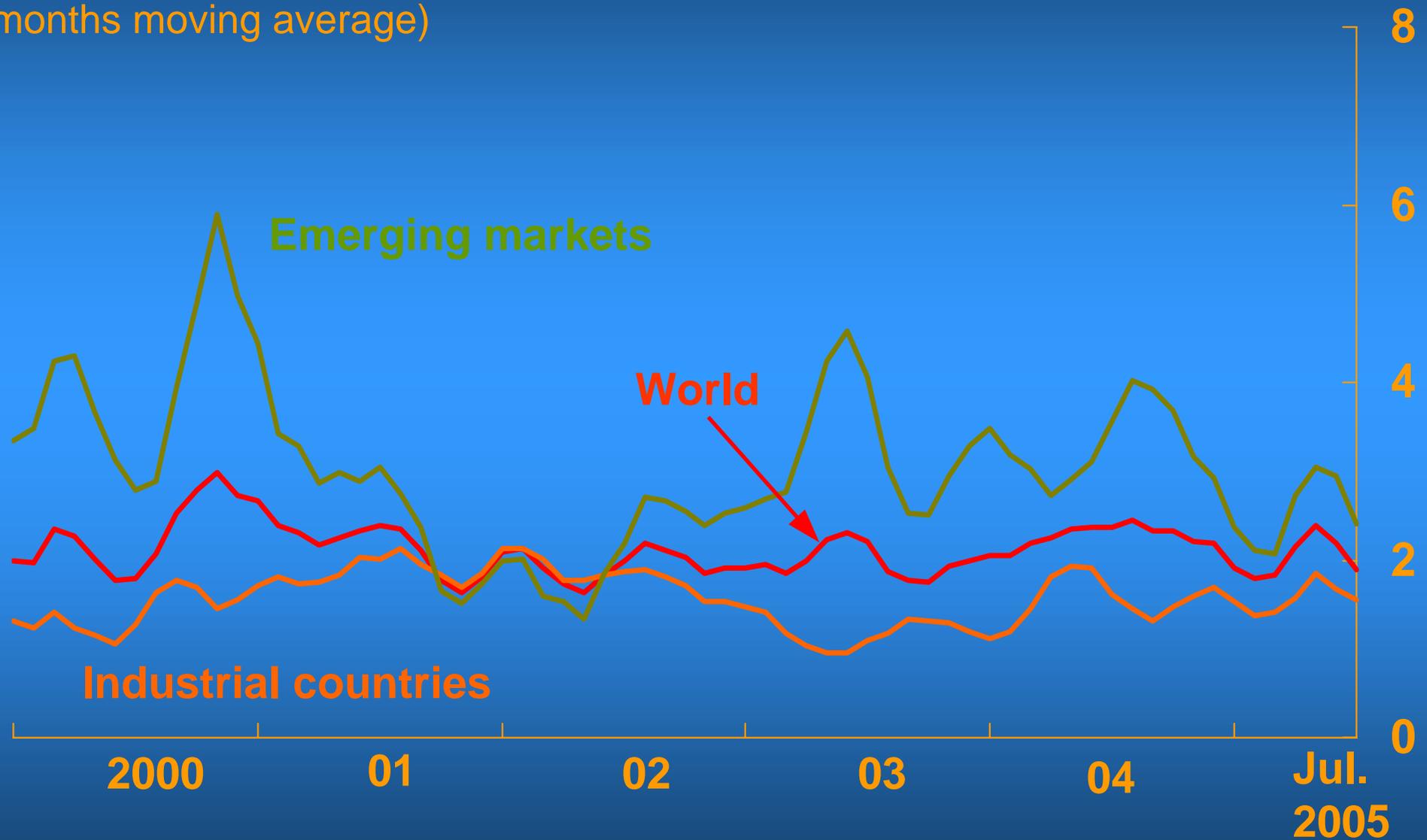
(Annualized percent change of three-month moving average over previous three-month average)



Source: Haver Analytics.

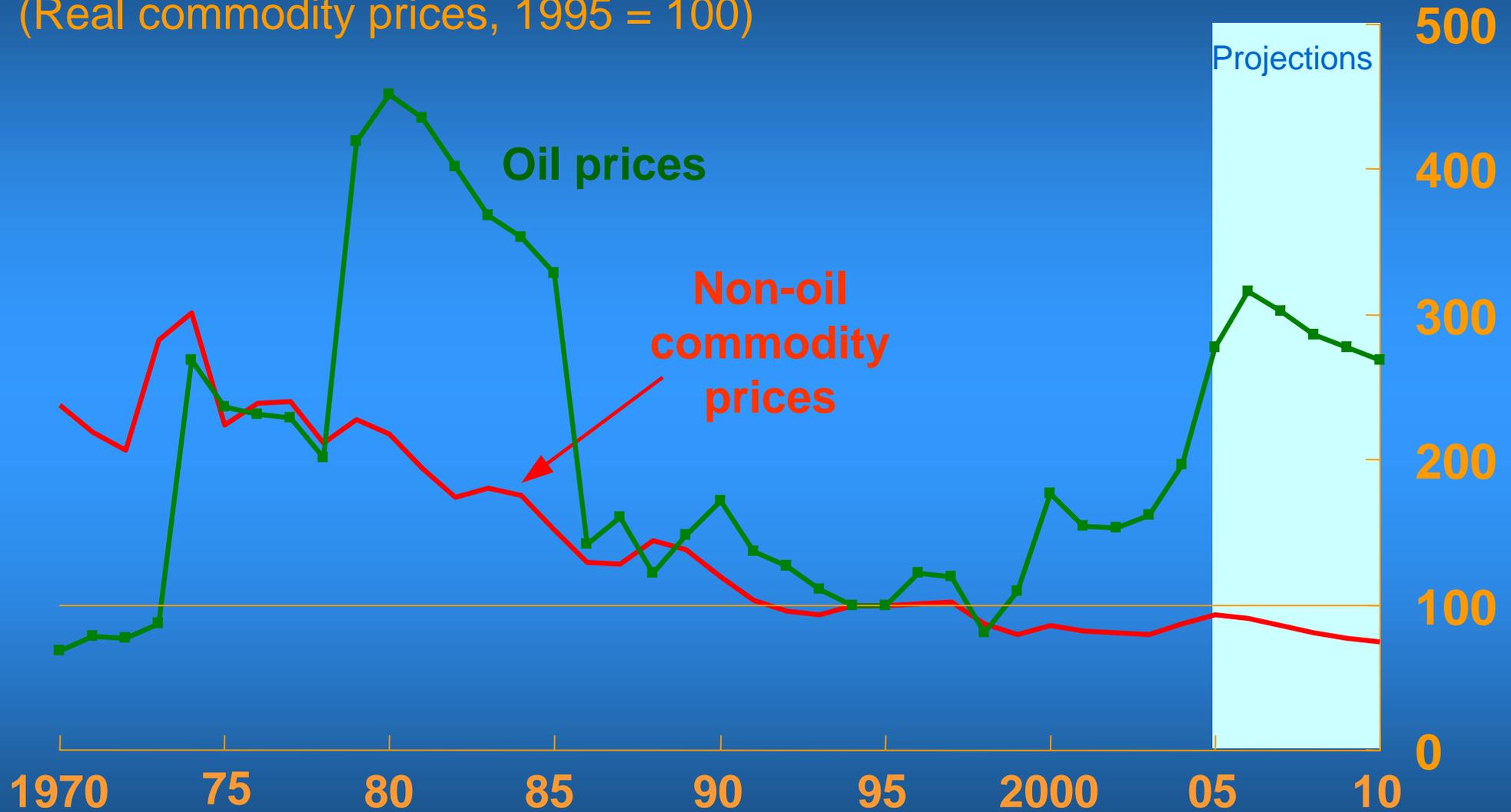
... reflecting low core inflation,

(Annualized percent change of 3-months moving average over previous 3-months moving average)



... stable non-oil commodity prices, yet high oil prices.

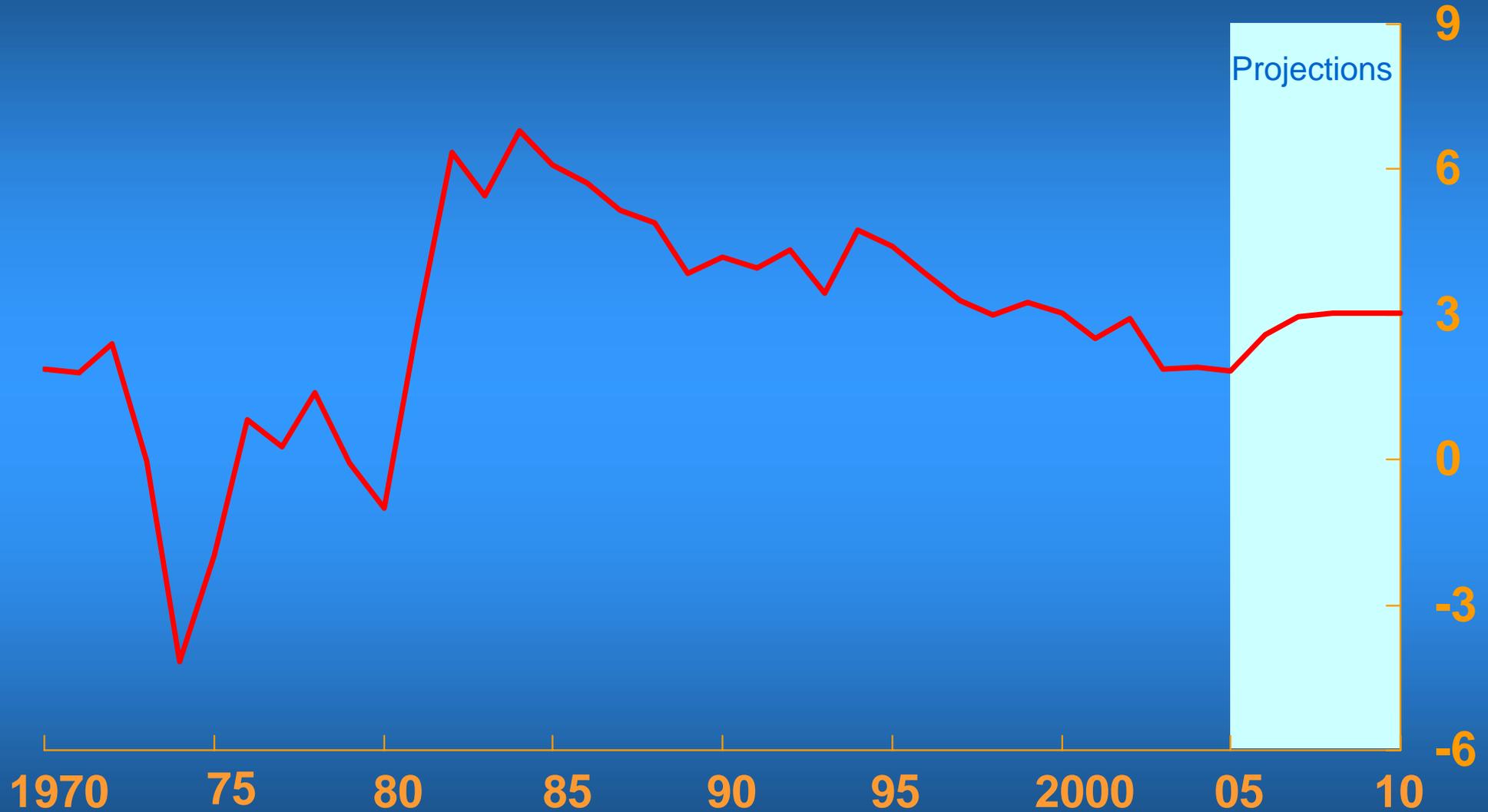
(Real commodity prices, 1995 = 100)



Source: IMF staff estimates.

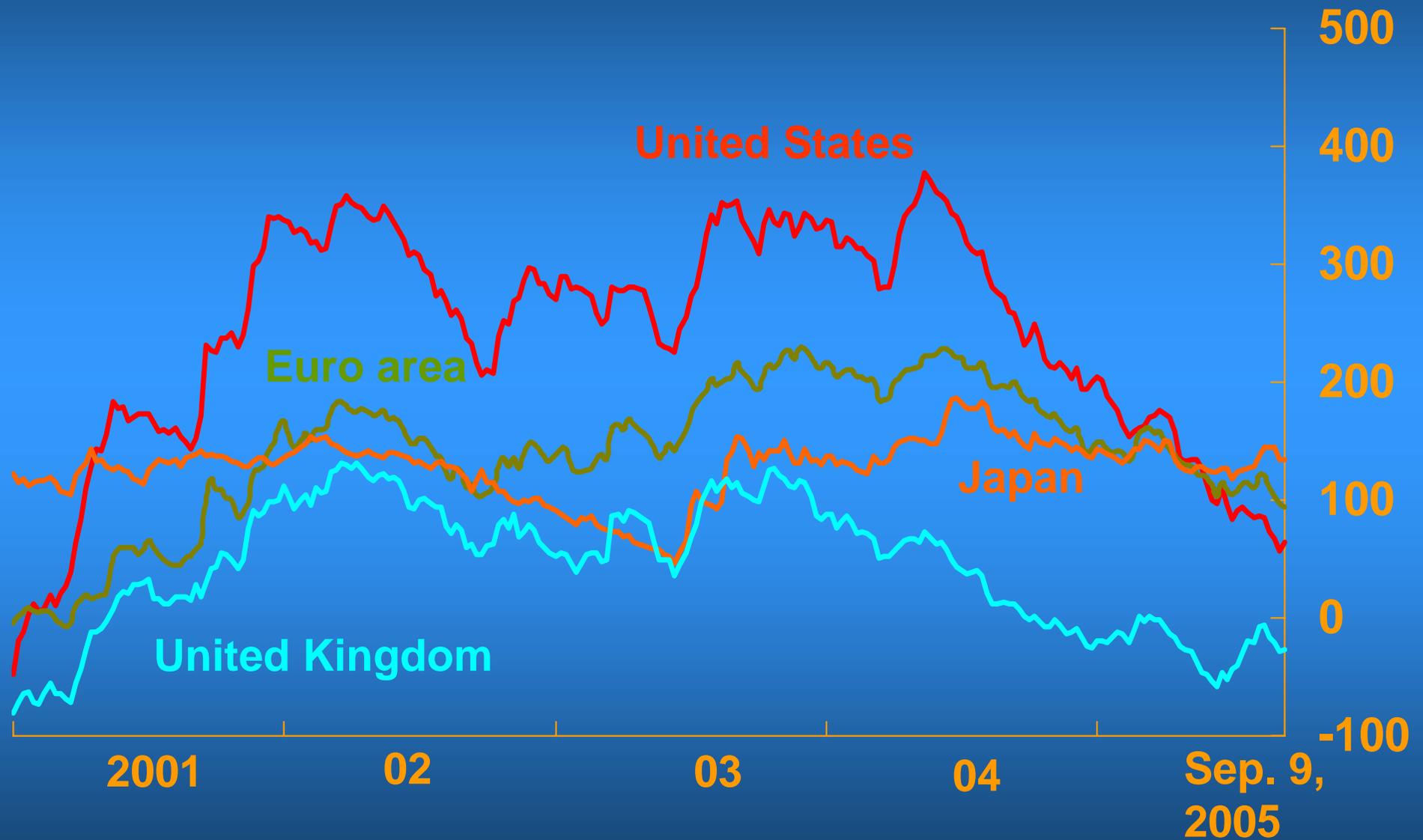
Financial market conditions remain benign.

(World real long-term interest rate, percent)



Source: IMF staff estimates.

Yield curves are flattening 1/ *(Basis points)*



Source: Bloomberg Financial Markets, LP.
1/ 10-year government bond less 3-month treasury bond yields.

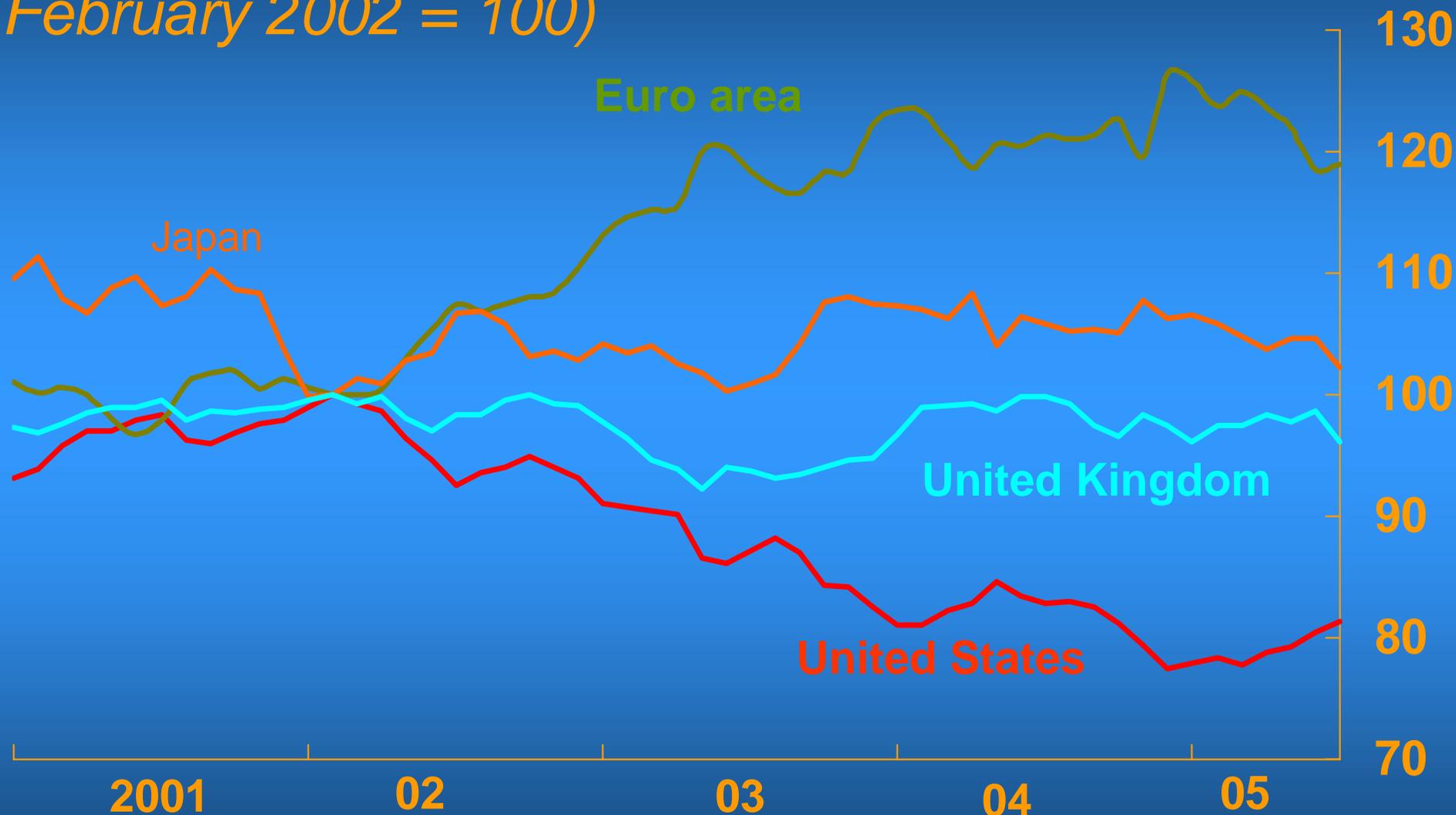
Mature equity markets are resilient

(March 2000 = 100; national currency)



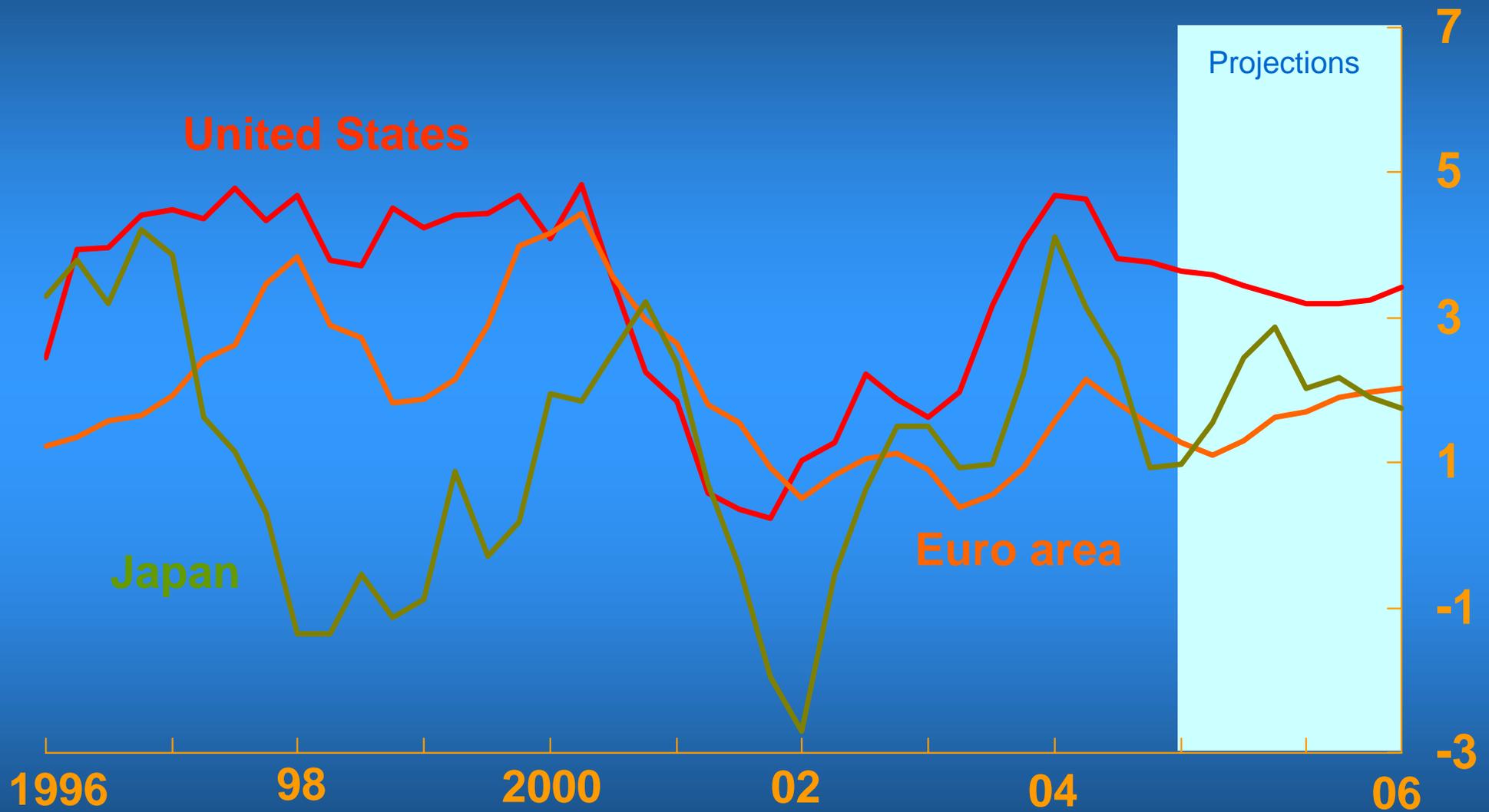
Nominal effective exchange rates have varied within stable ranges

(February 2002 = 100)



Euro area: recovery continues to struggle

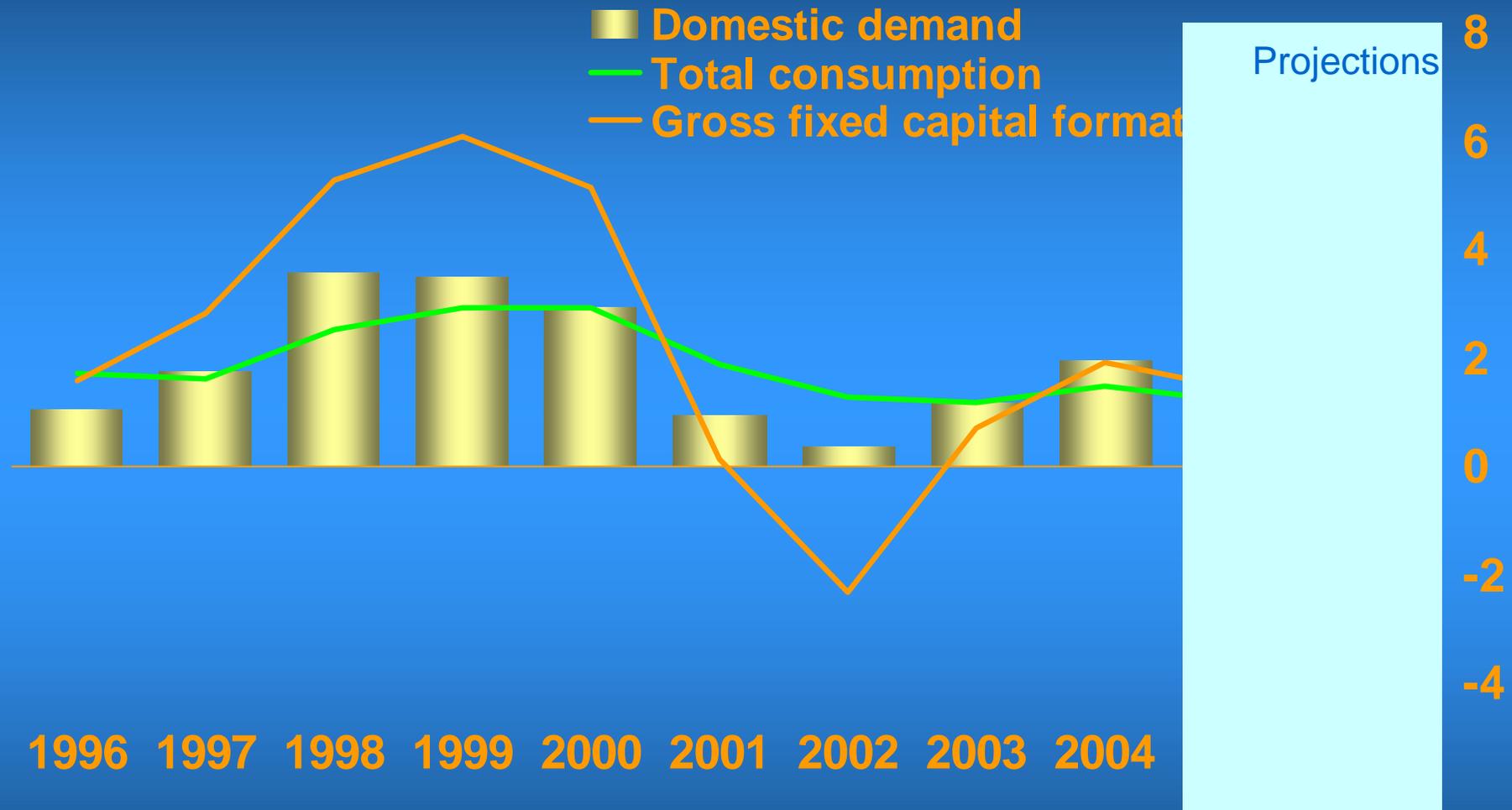
(Real GDP; percent change from four quarters earlier)



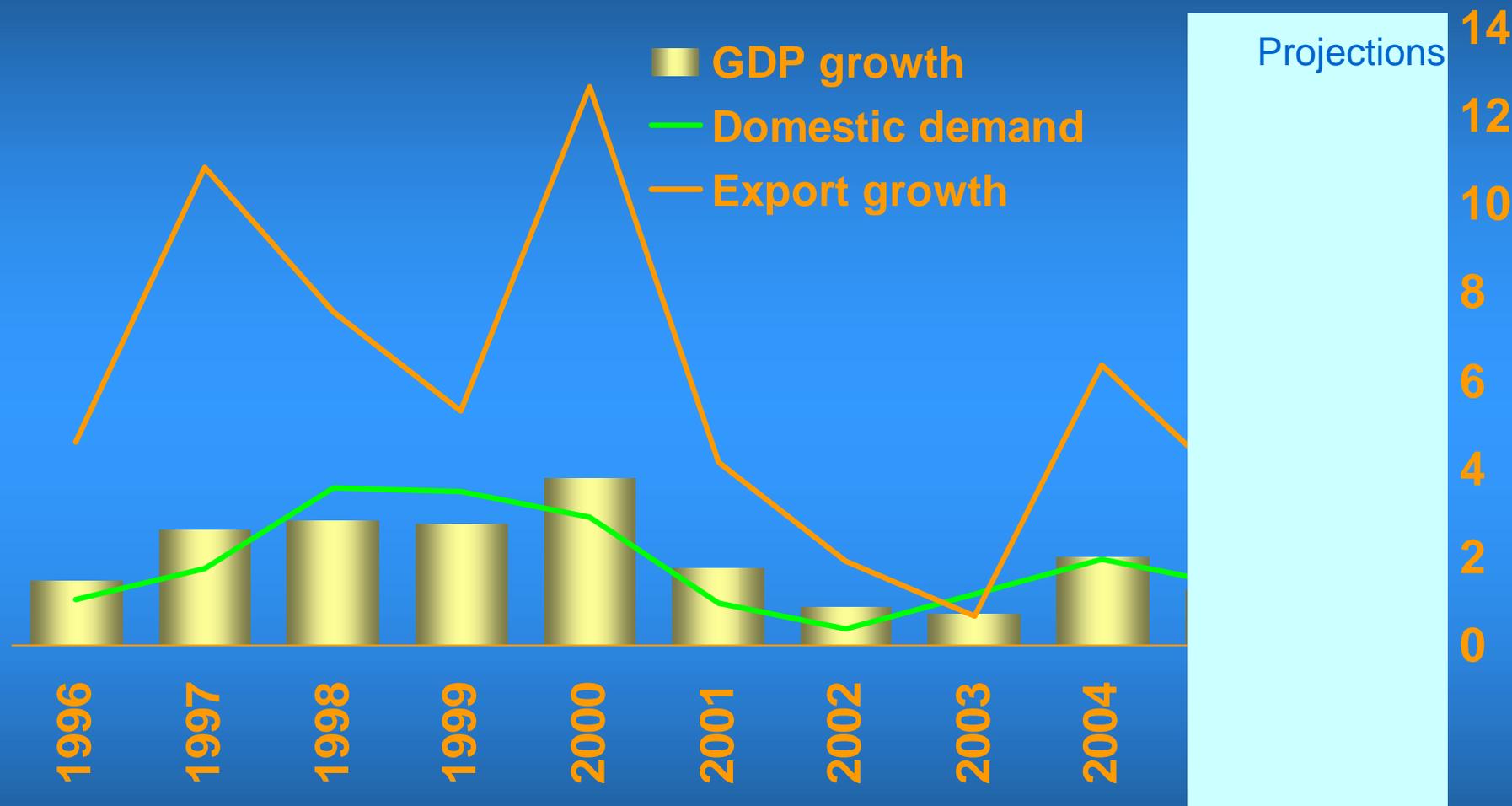
Sources: Haver Analytics; and IMF staff estimates.

Euro area: investment contribution has recovered

(Annual percent change)



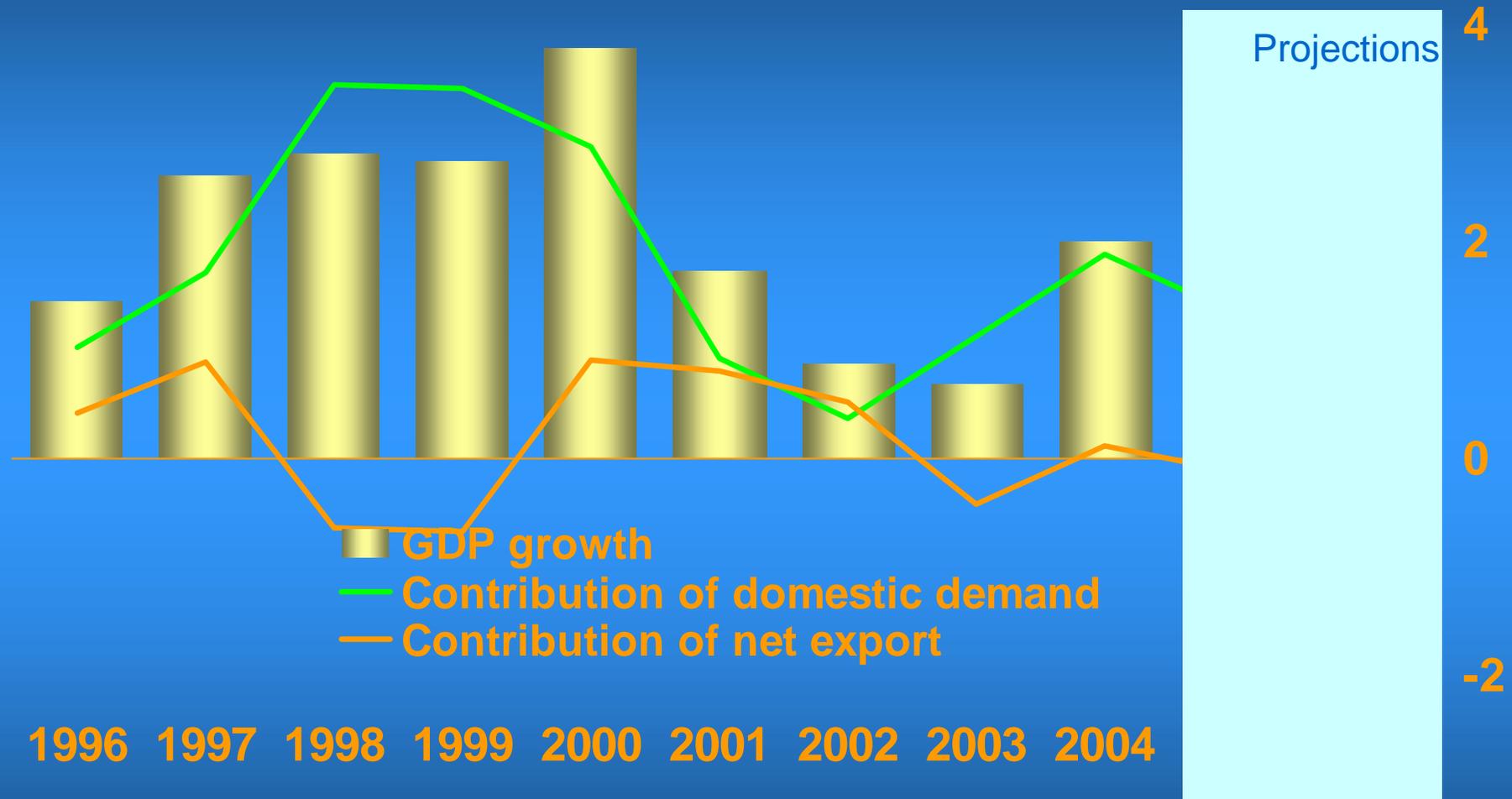
Euro area: Exports continue to lead, (In percent)



Source: IMF staff estimates.

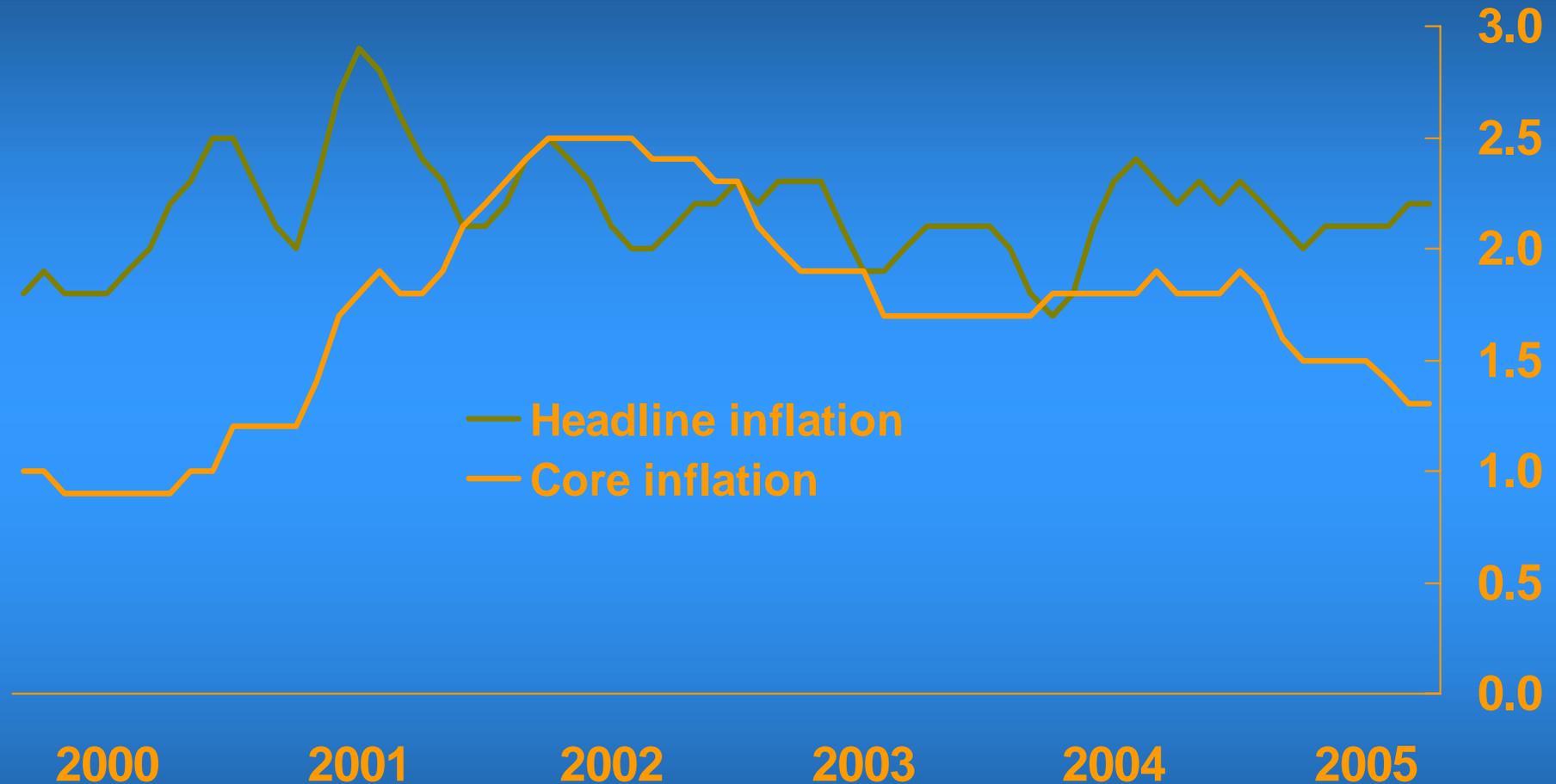
Euro area: but net exports have been flat

(In percent)



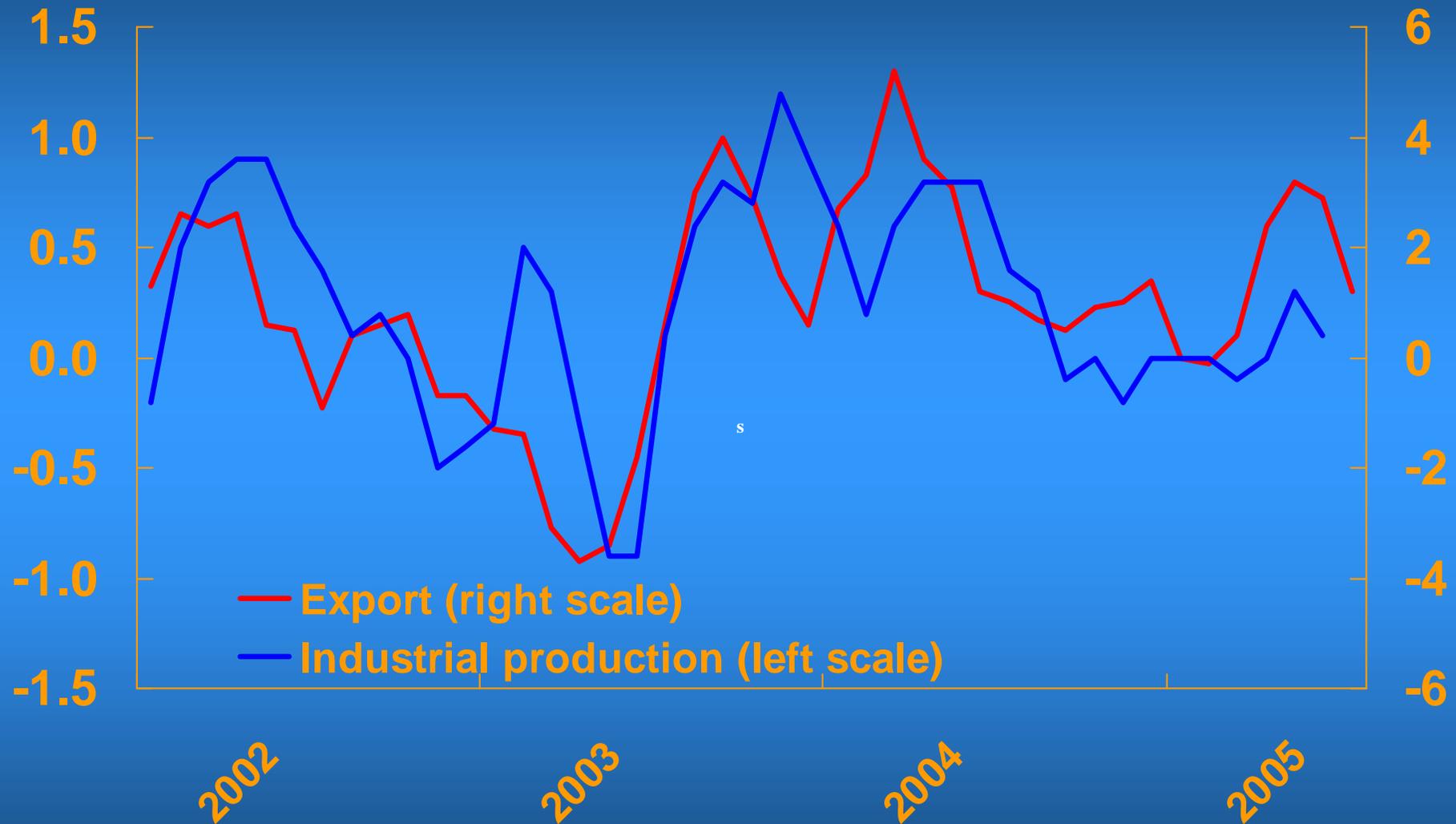
Euro area: headline, core inflation subdued

(Annualized percent change of 3-month moving average over previous 3-month average)



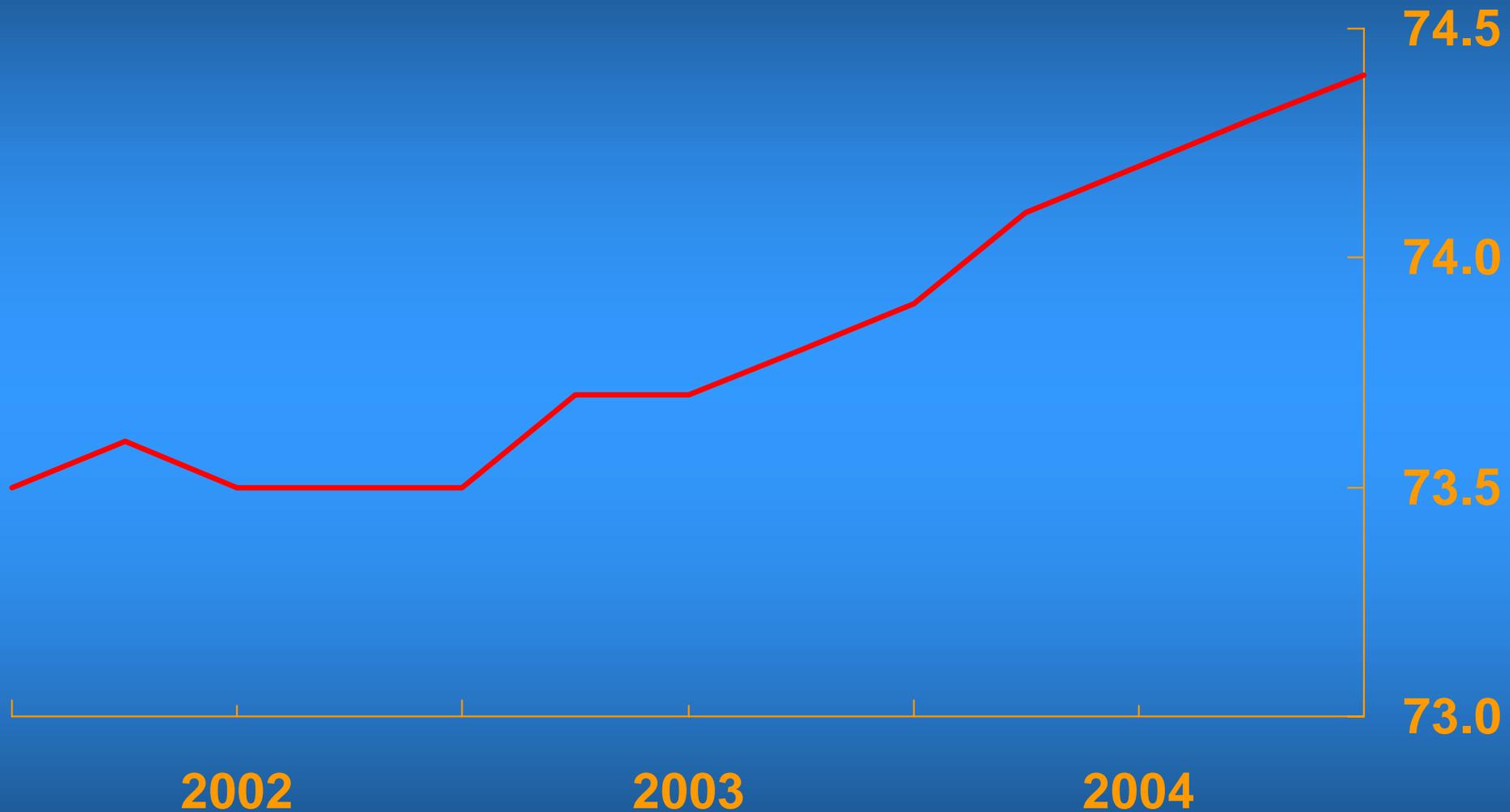
Euro area: Recent data have been positive,

(Percent change of 3-month moving average)



employment is growing,

(Employment in percent of working age population)



Source: European Commission.

and long-term interest rates are falling.

(Basis points)



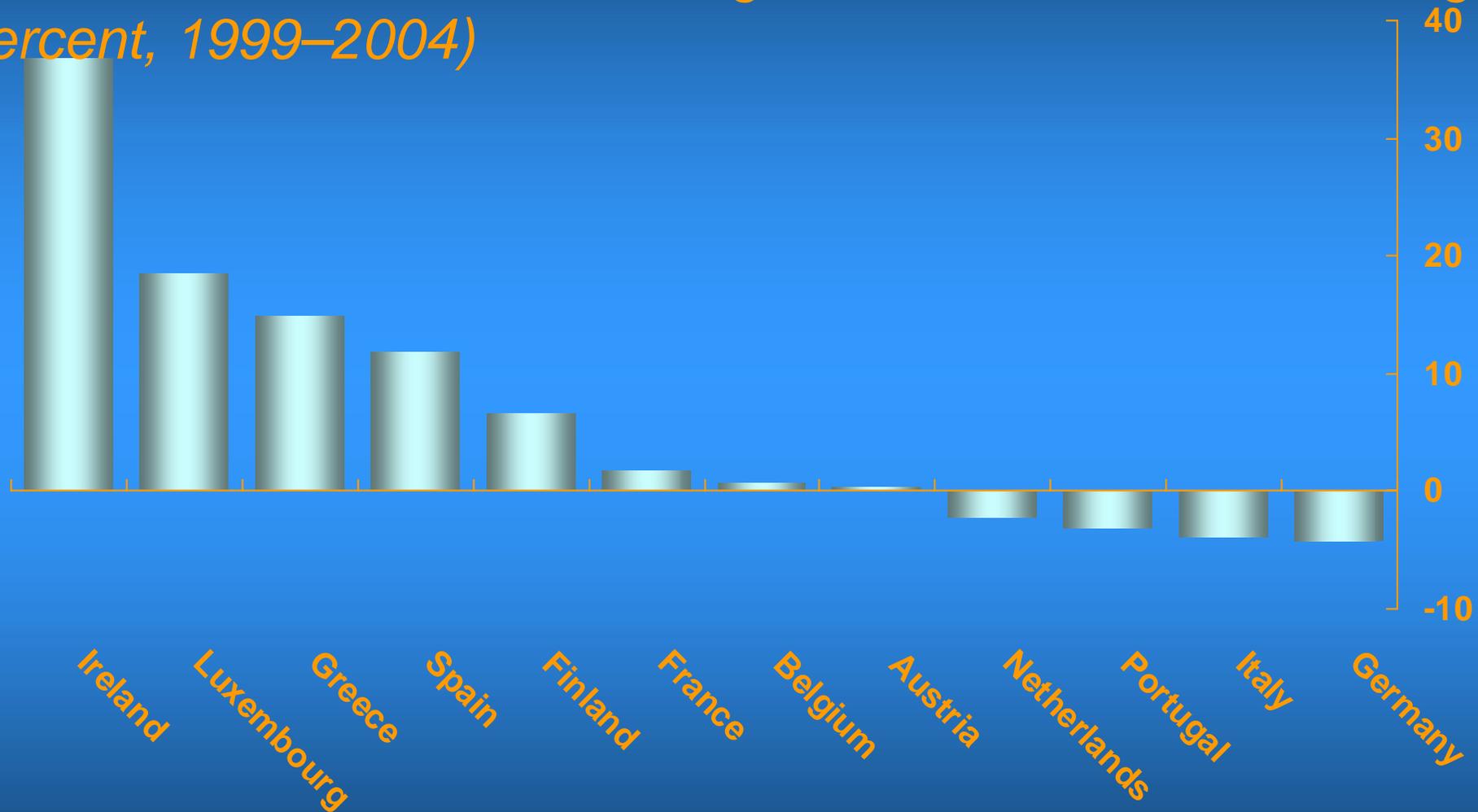
Source: Bloomberg Financial Markets, LP.

But confidence indicators remain subdued...



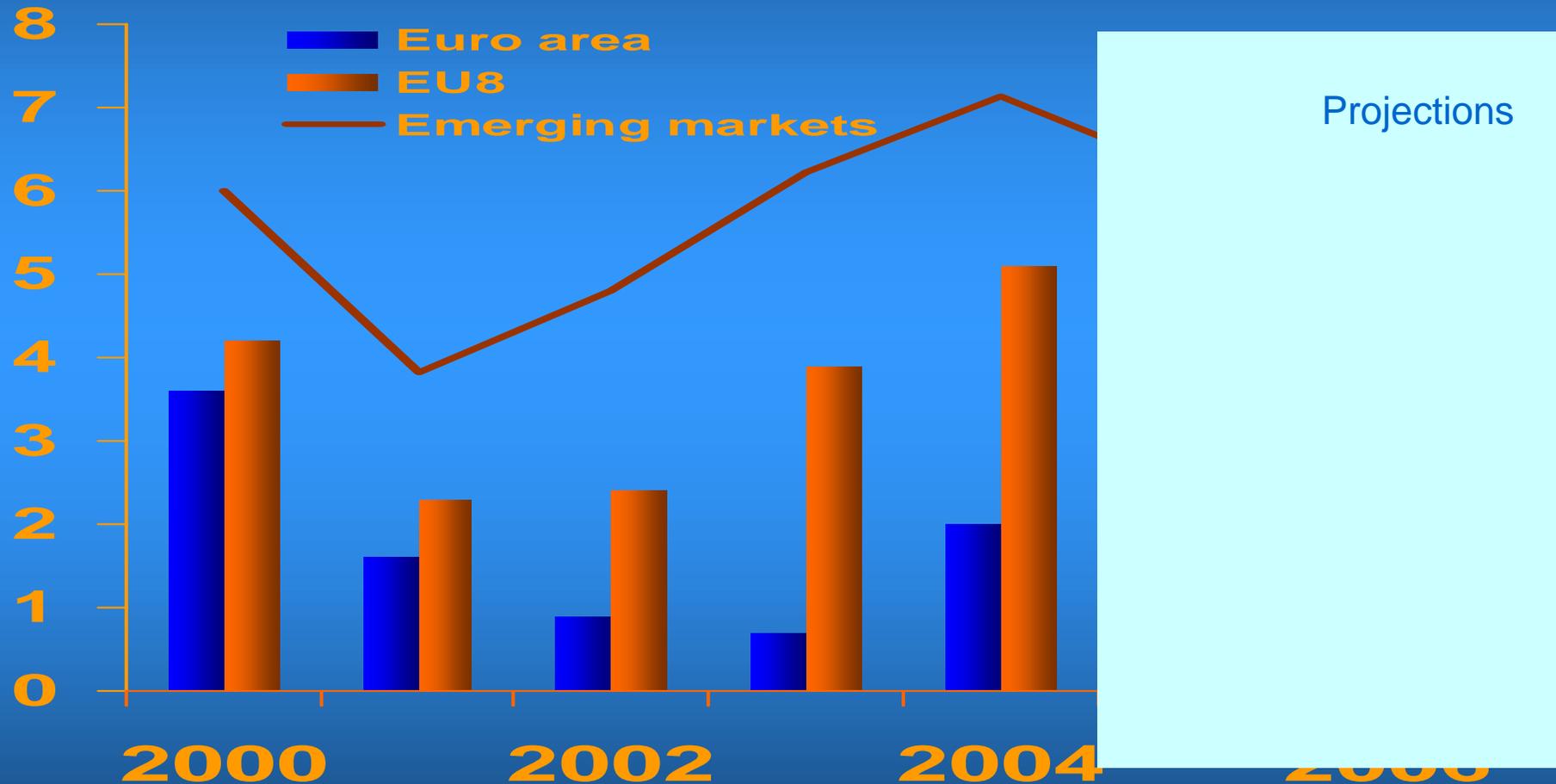
...and differences in GDP growth across countries reflect local weaknesses

(Cumulative difference in GDP growth from euro area average in percent, 1999–2004)



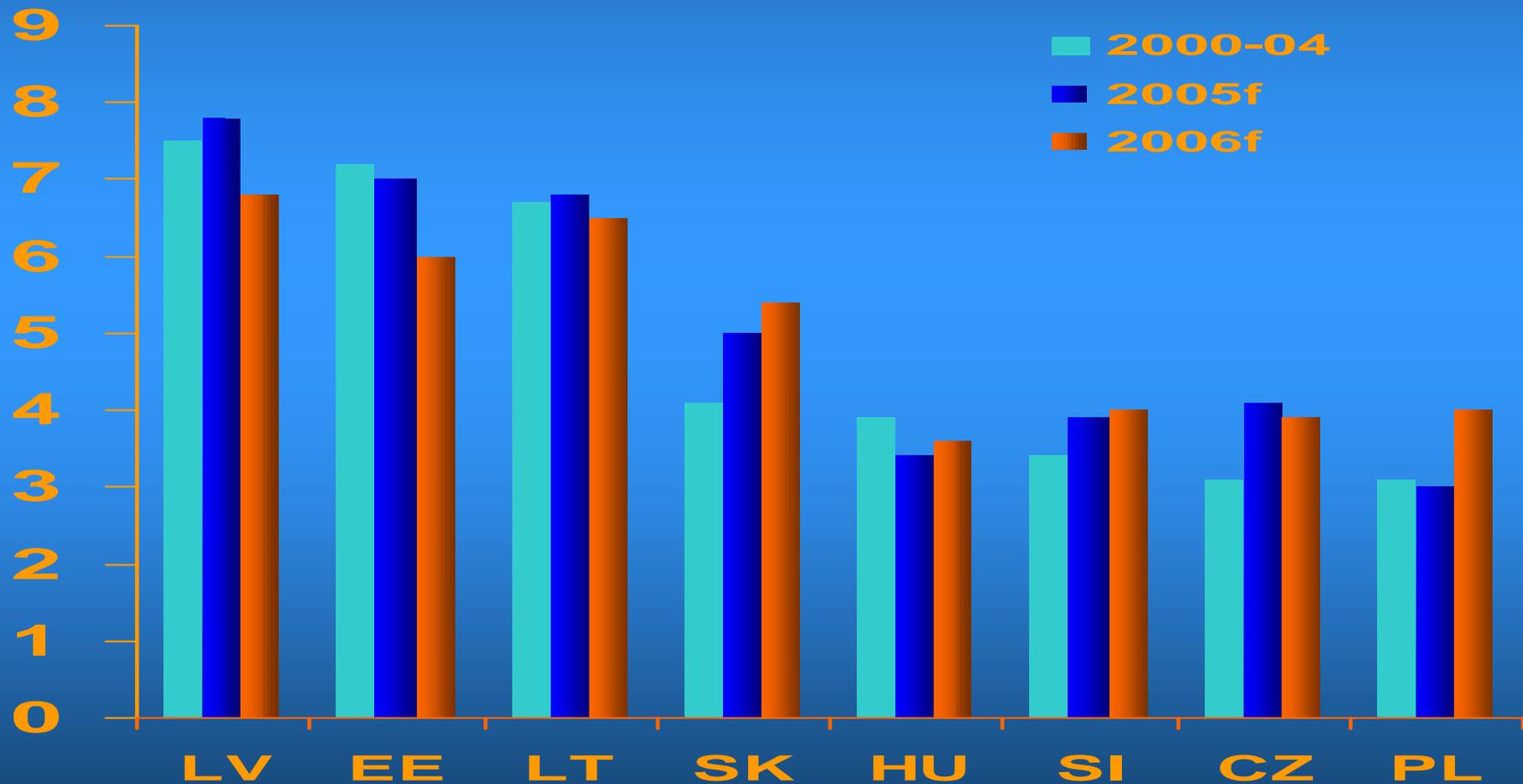
EU8: Growth will continue to outpace the euro area

Real GDP change(weighted average, in percent)



Baltics and Slovakia will continue to grow faster than central Europe

(Real GDP growth, in percent)

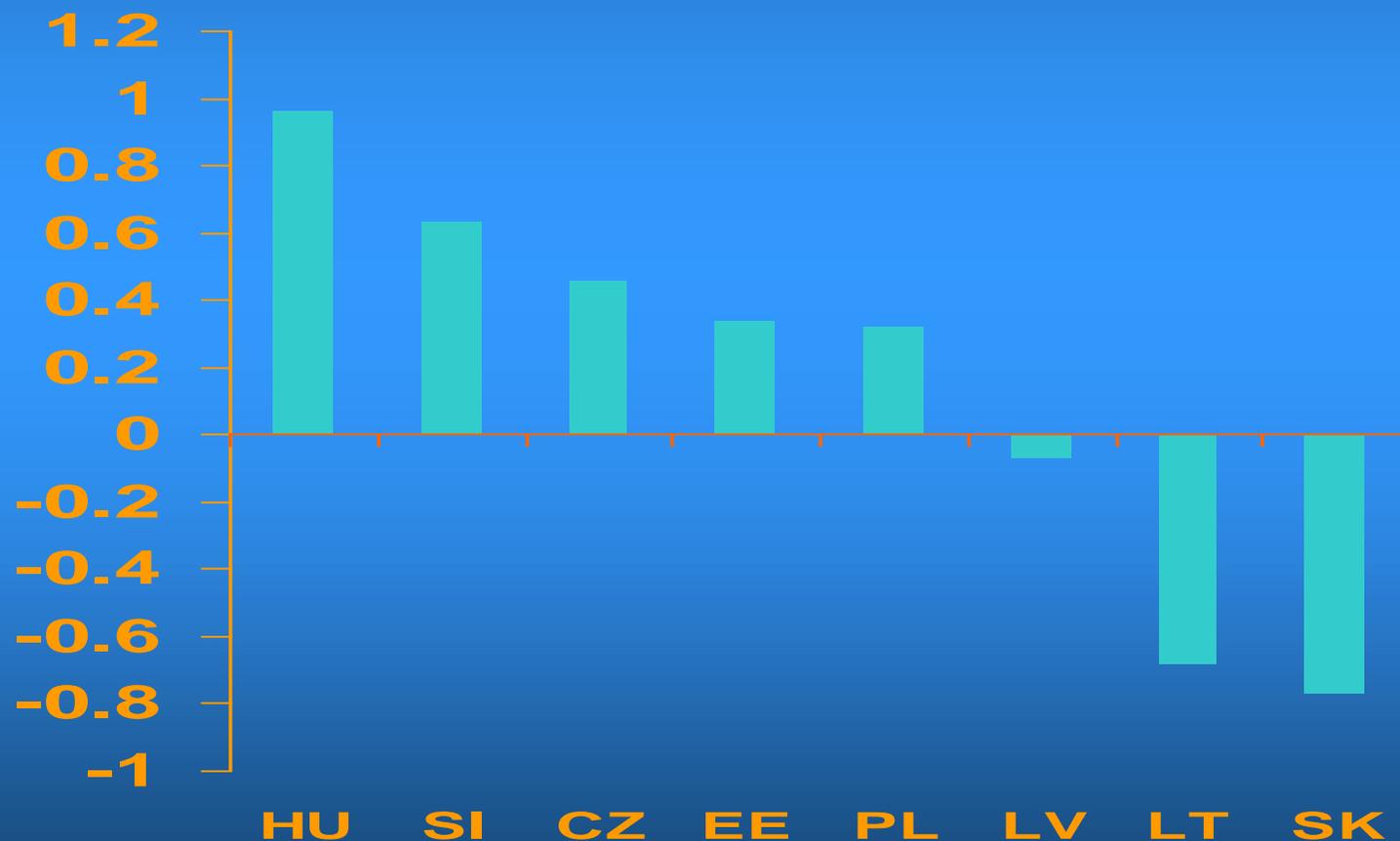


Source: National authorities; IMF; and WEO.

EU8: Euro area activity matters but effect varies

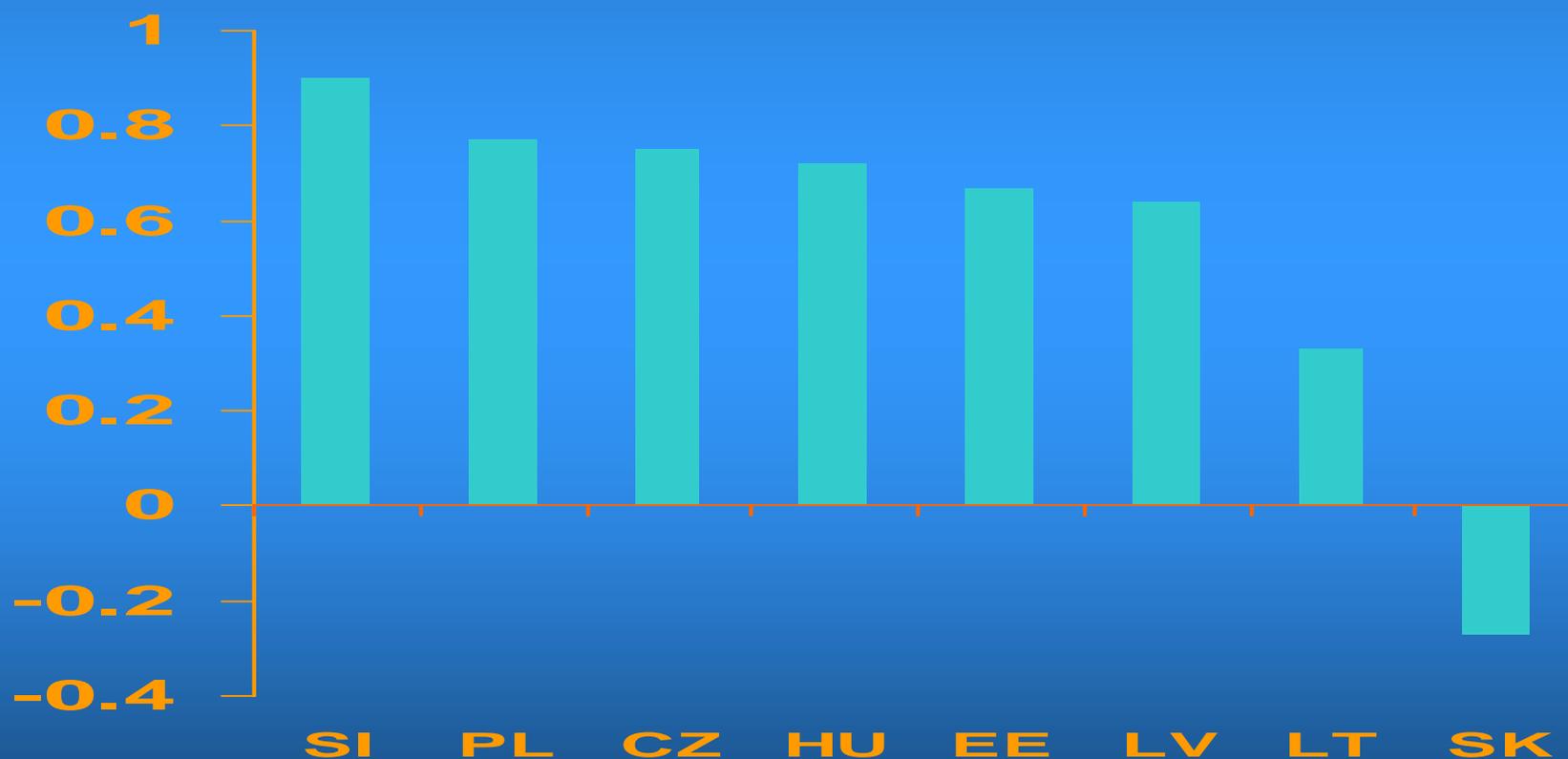
Business cycle synchronization 2000-04

(correlation coefficients between GDP growth in EU8 and EU12)



And euro-area exports matter even more for EU8 exports

Correlation coefficients between EU8 Exports and the Euro zone Exports 2001-04



Sources: National authorities; IMF; and WEO.

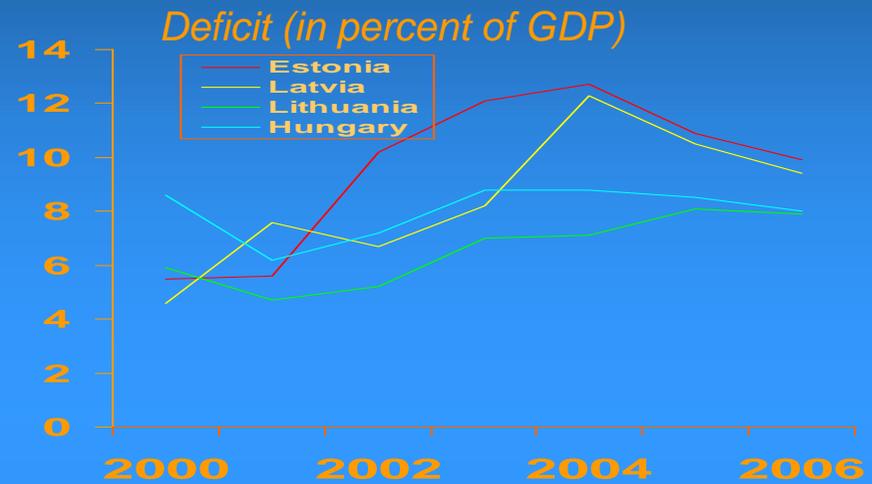
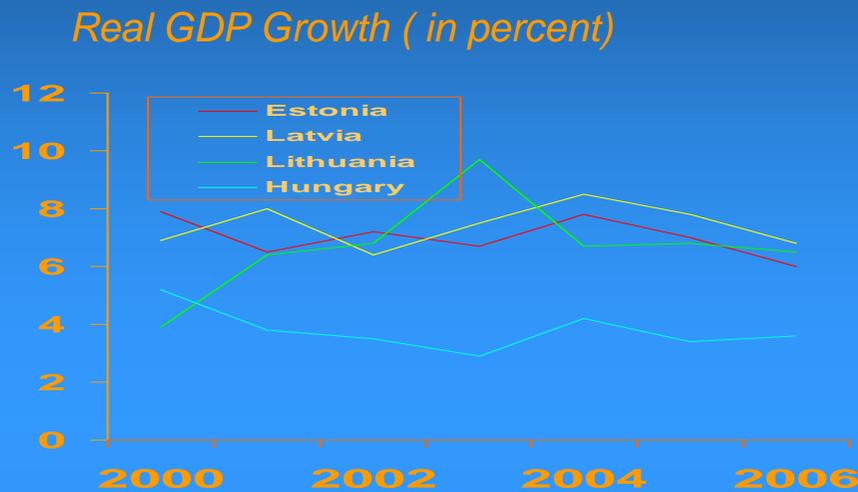
EU8 and Emerging Market Growth: Raising labor utilization key to growth in the region

(Contribution to GDP growth, in percent)

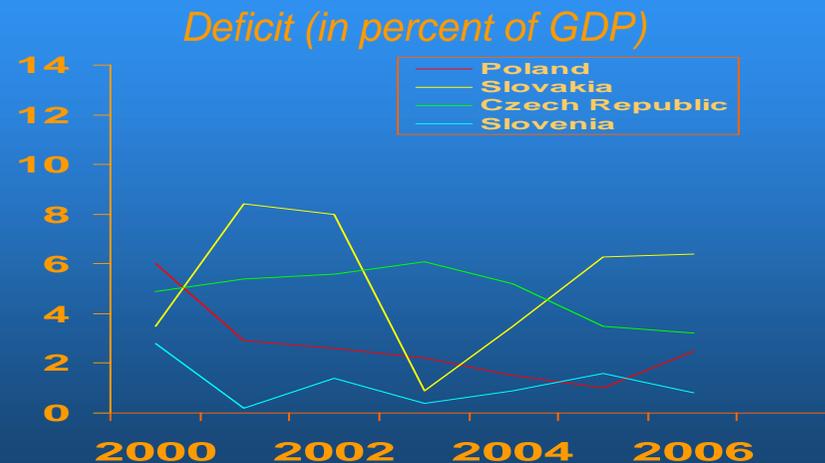
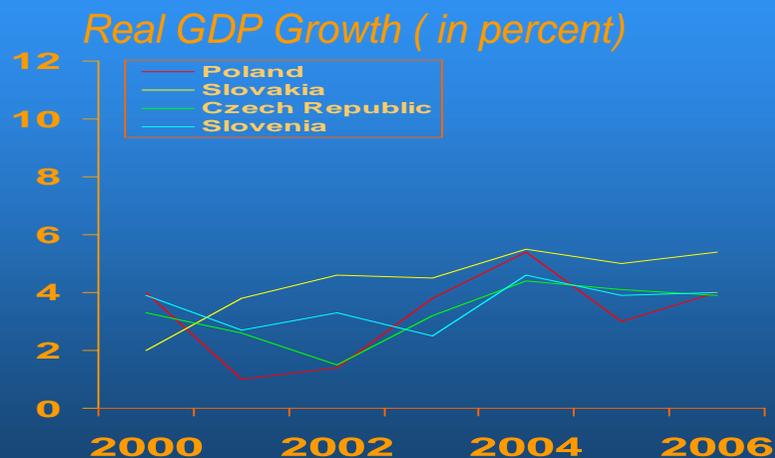


EU8: Large Current Account deficits come with high growth

EU8: Higher Current Account Deficit Countries

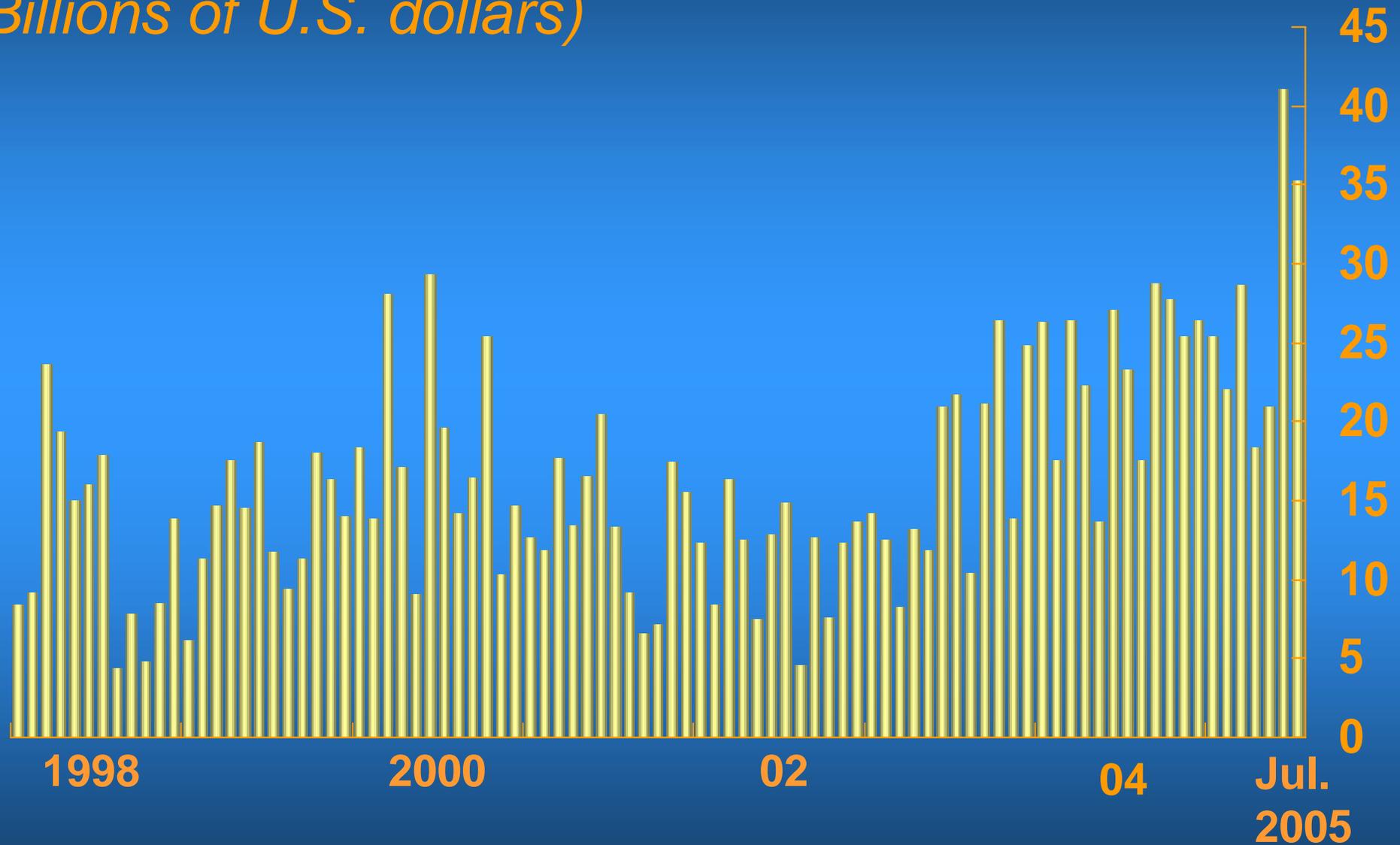


EU8: Lower Current Account Deficit Countries



Fortunately, emerging market financing is plentiful...

(Billions of U.S. dollars)

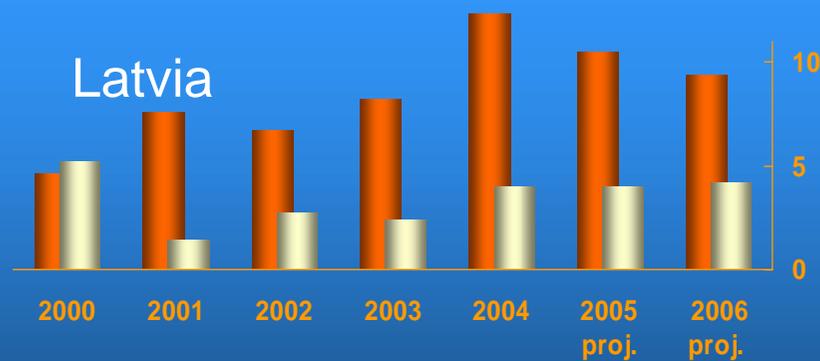
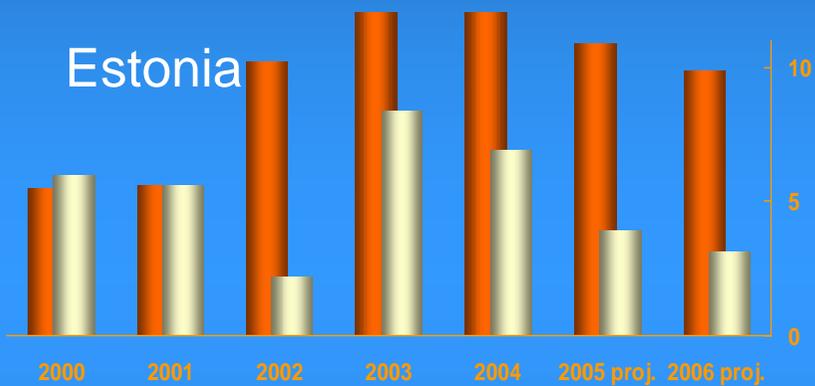


Source: Capital Data.

And large deficits have sizable FDI backing

(In percent of GDP)

Higher deficit countries



■ Current account deficit ■ FDI

Source: IMF staff calculations.

while smaller deficits are almost fully FDI-financed

(In percent of GDP)

Lower deficit countries



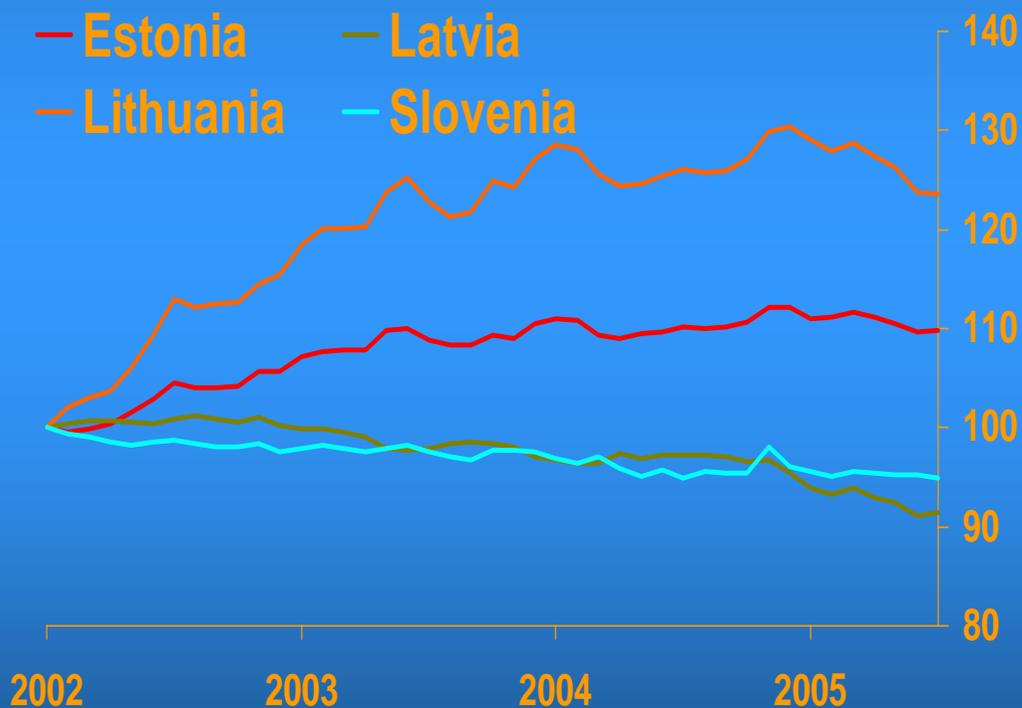
■ Current account deficit ■ FDI

Source: IMF staff calculations.

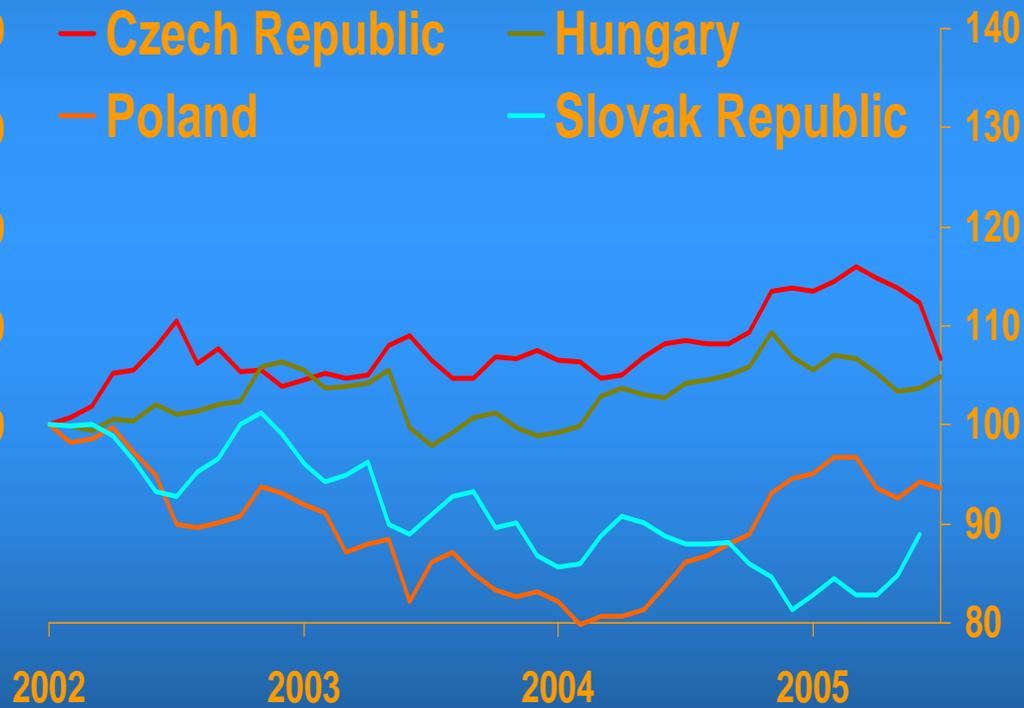
EU8: exchange rates have edged up

(Nominal effective exchange rates, Jan. 2002 = 100)

ERM2 countries



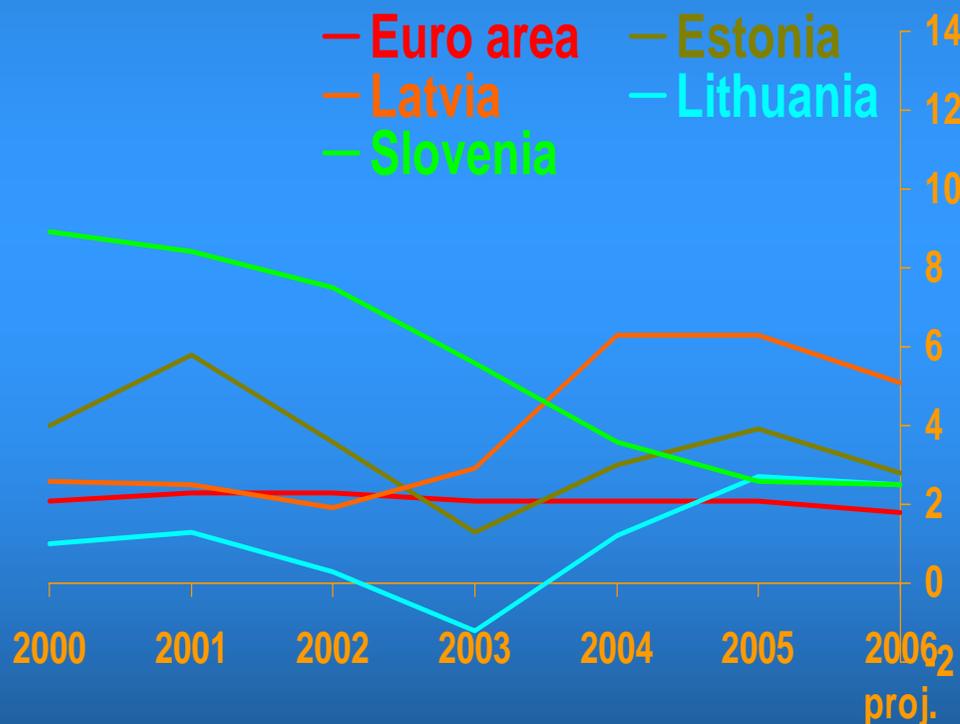
IT countries



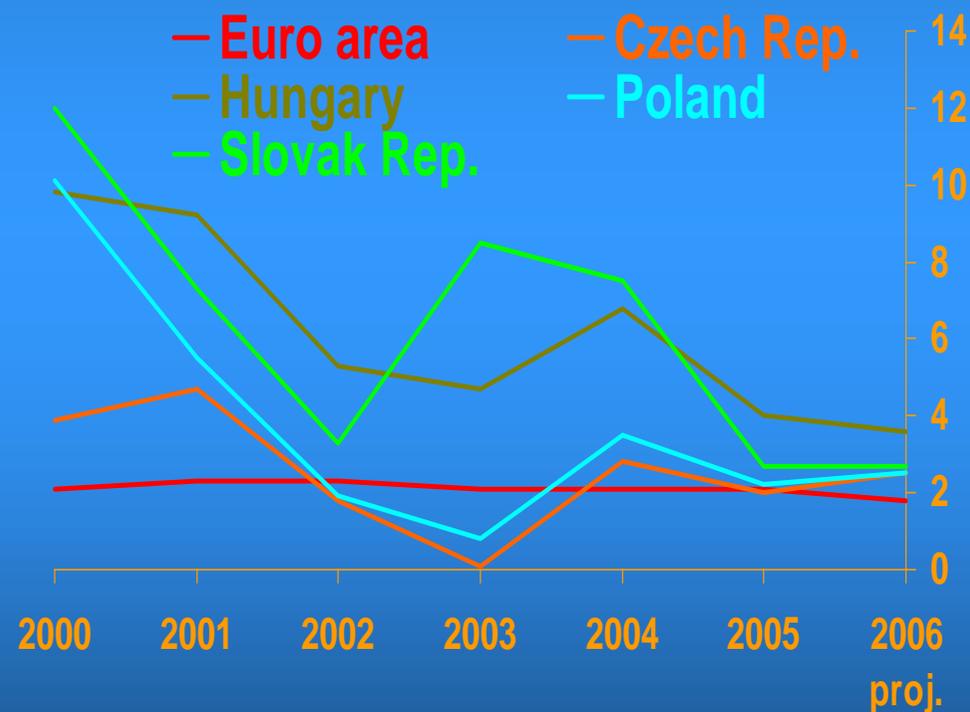
Source: IMF staff calculations.

EU8: inflation subdued in most countries but oil prices a risk (Annual percent change)

ERM2 countries



IT countries



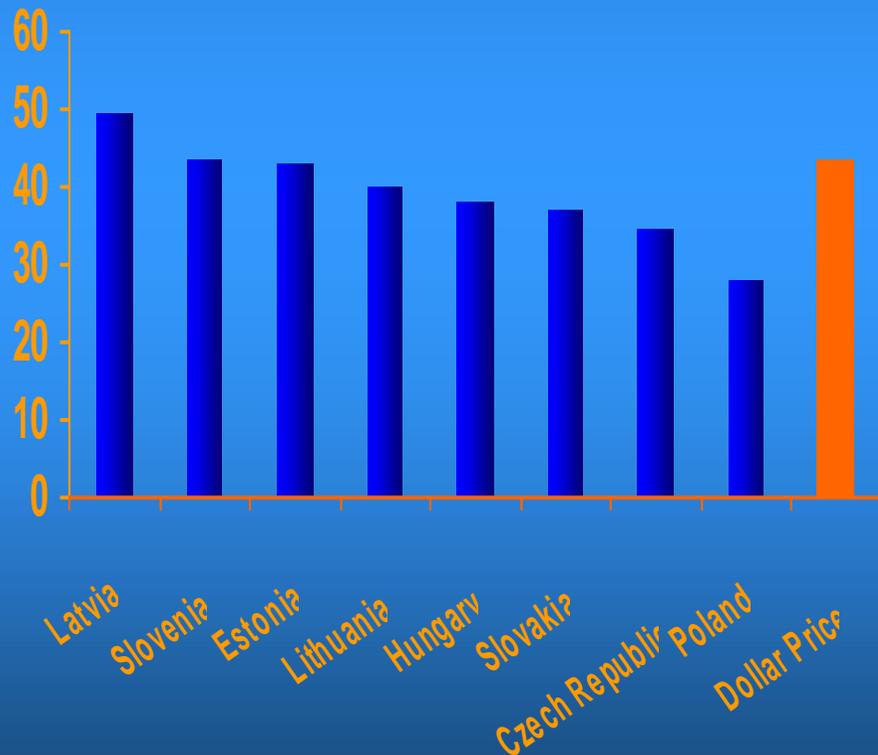
Source: IMF staff calculations.

Major risks to the projections:

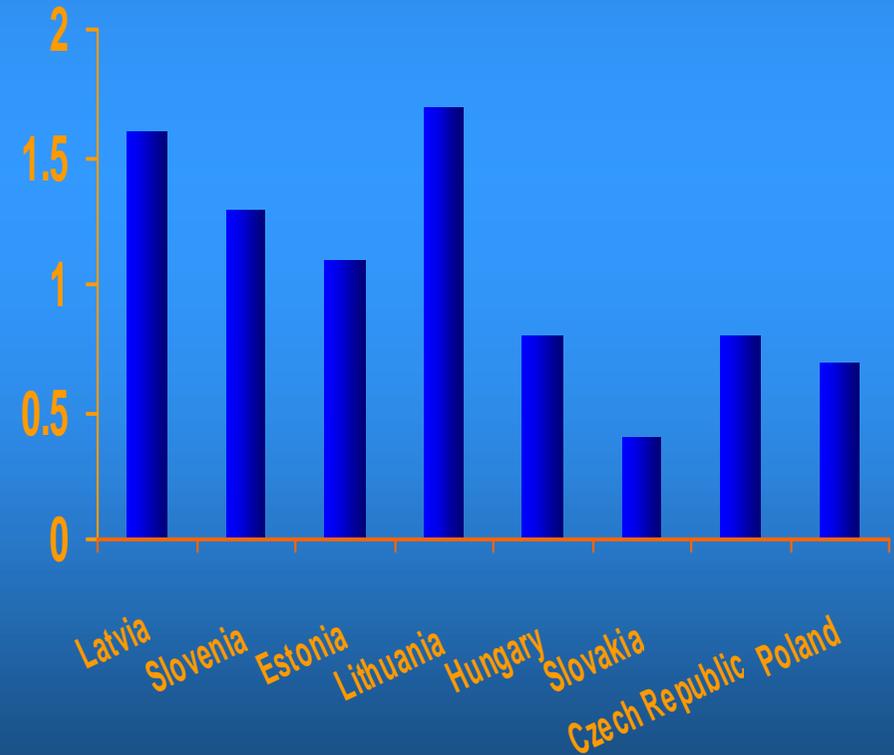
- Oil price increases
- Unwinding global imbalances

EU8: Oil Price increases will hurt Inflation & Growth but not by much

Oil price increase in local currency
(2005, per barrel)



Net tax equivalent^{1/} (in percent of GDP)



Source: IMF staff calculations using UN Comtrade data.

1/ Notional increase in local currency equivalent of oil payments (net of re-exports) in 2005 on 2004 volumes.

Growing global imbalances are a risk

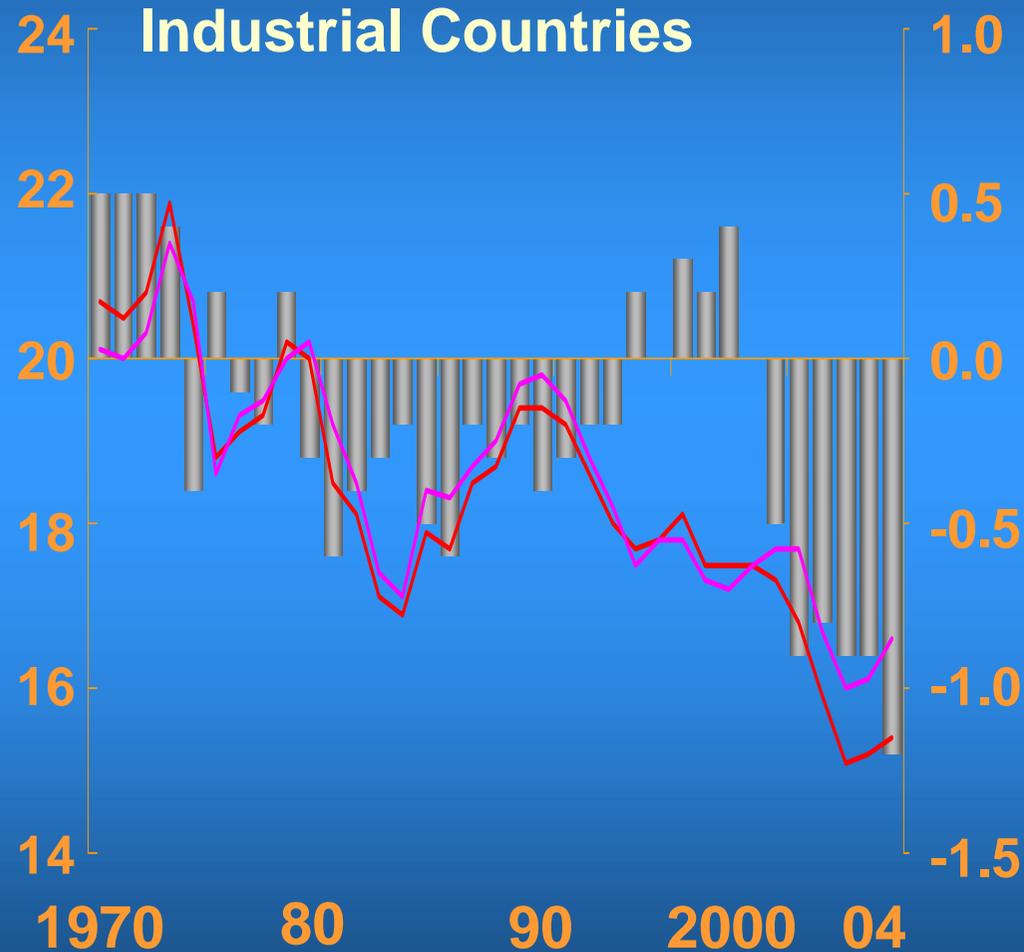
(In percent of world GDP)

— Saving

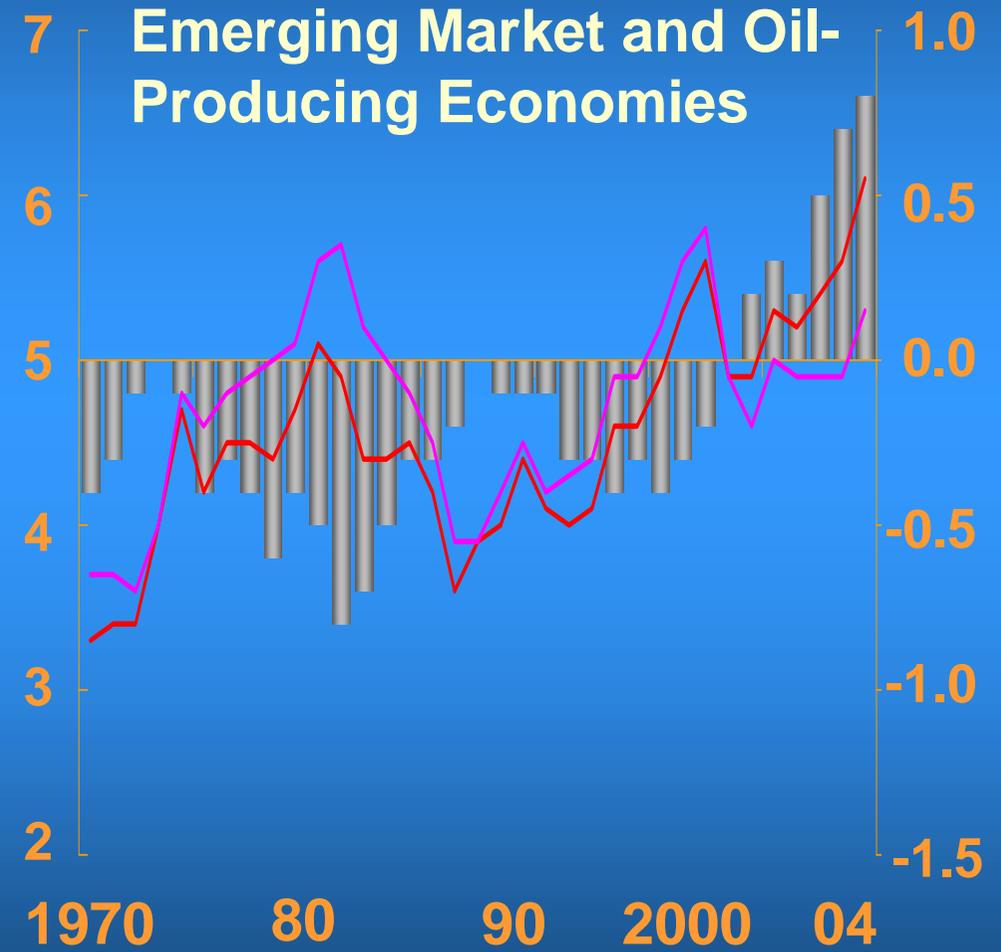
— Investment

■ Current account (right scale)

Industrial Countries



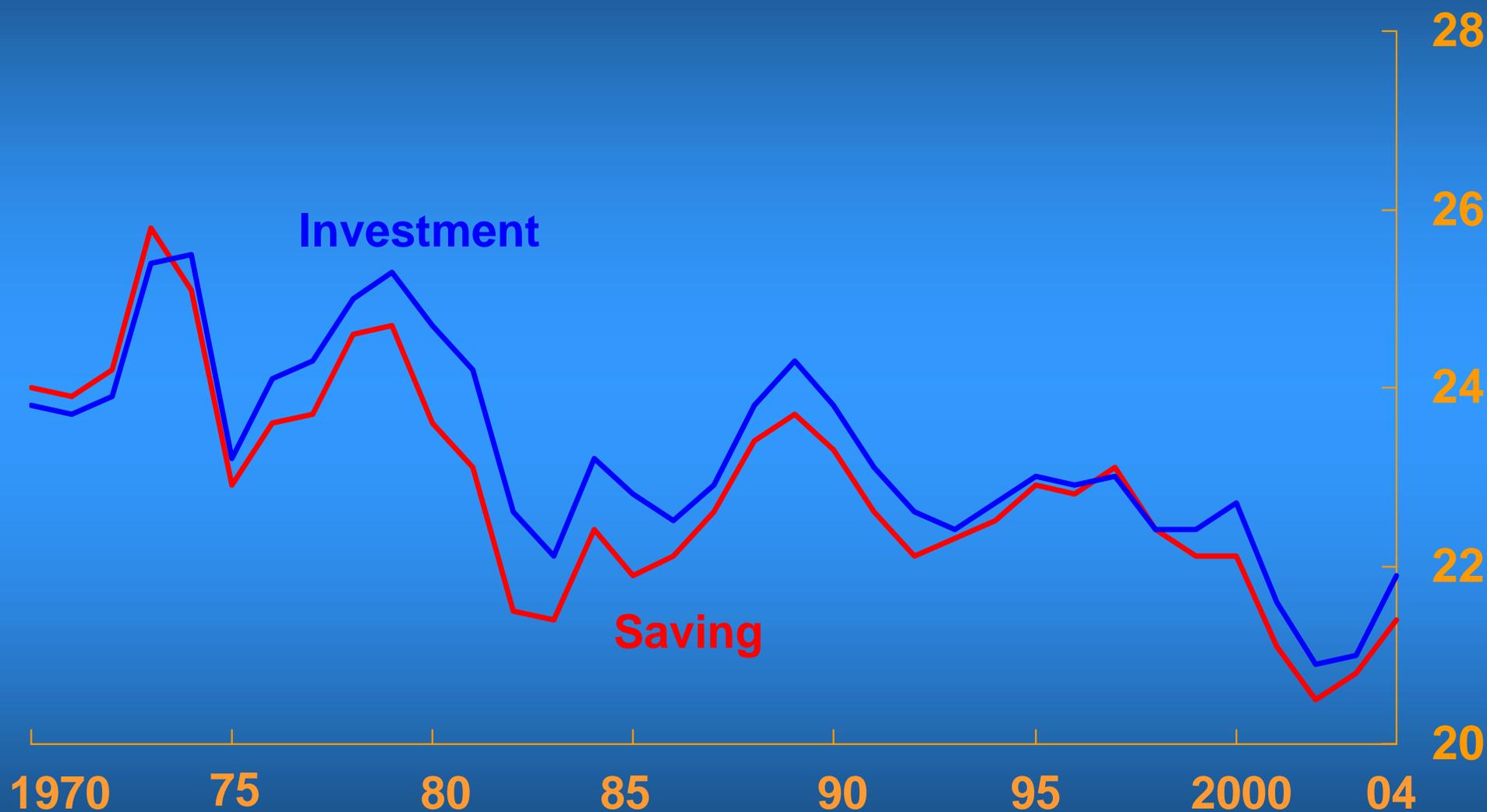
Emerging Market and Oil-Producing Economies



Sources: OECD Analytic Database; World Bank, *World Development Indicators*; IMF staff estimates.

World saving and investment at historic lows

(Percent of GDP)



Sources: OECD Analytical Database; World Bank, *World Development Indicators*; IMF staff estimates.

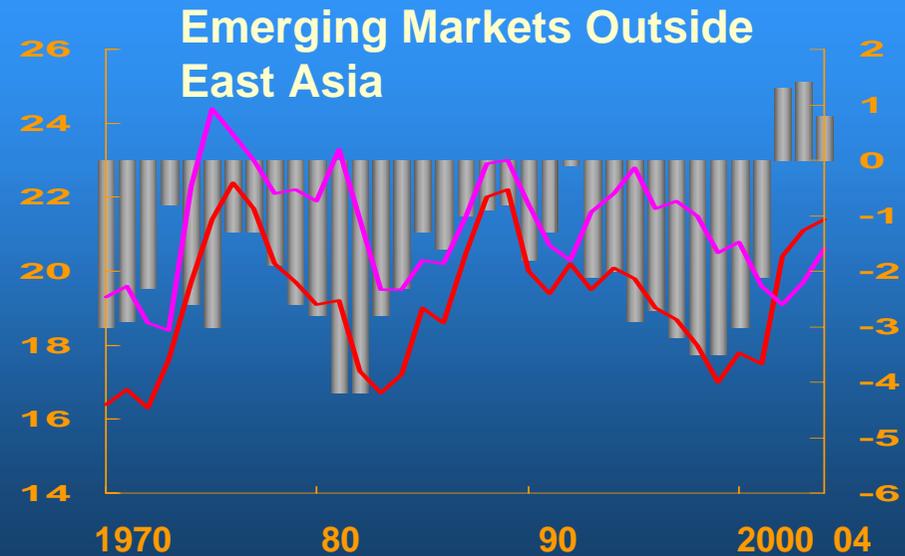
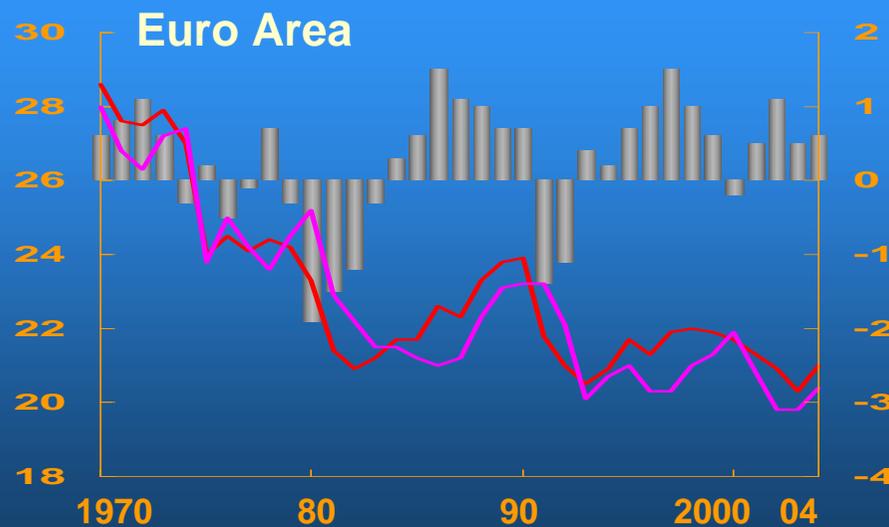
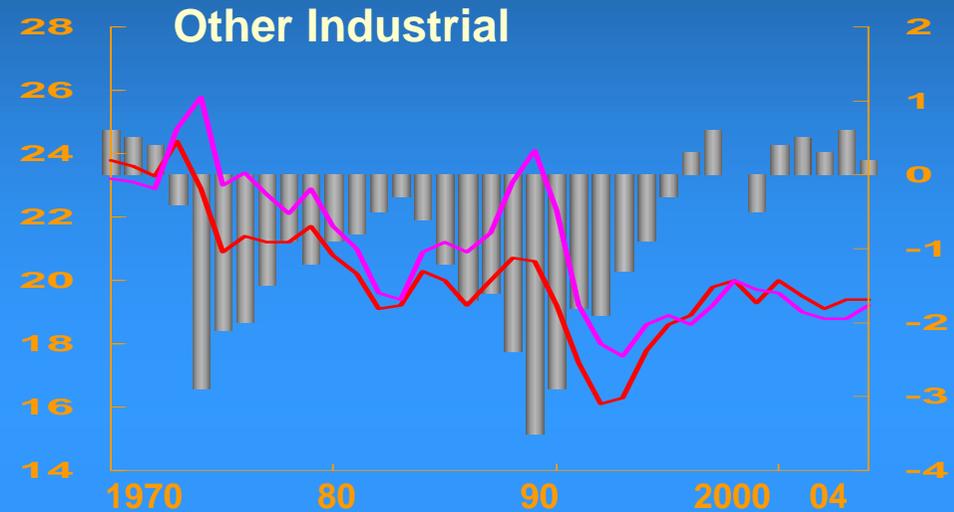
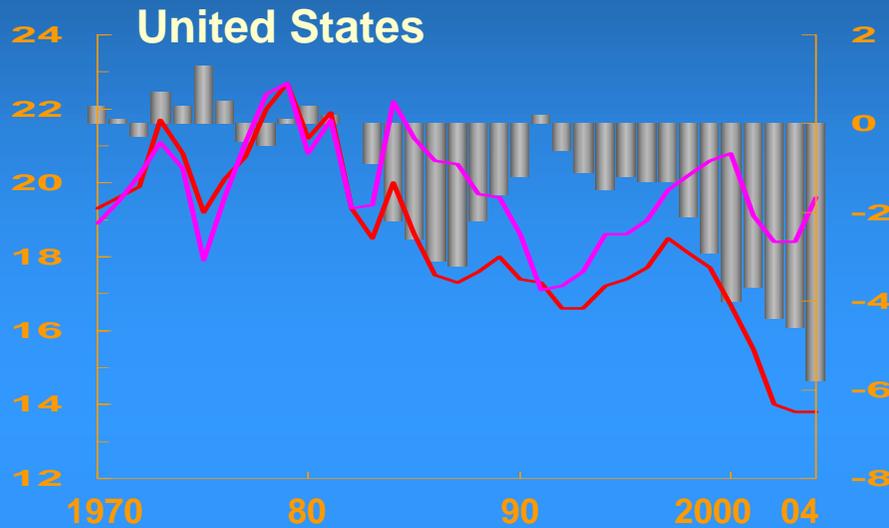
Low savers generally are low investors

— Saving

— Investment

■ Current account (right scale)

(Percent of each sub-region's GDP)



Sources: OECD Analytical Database; World Bank, *World Development Indicators*; and IMF staff calculations.

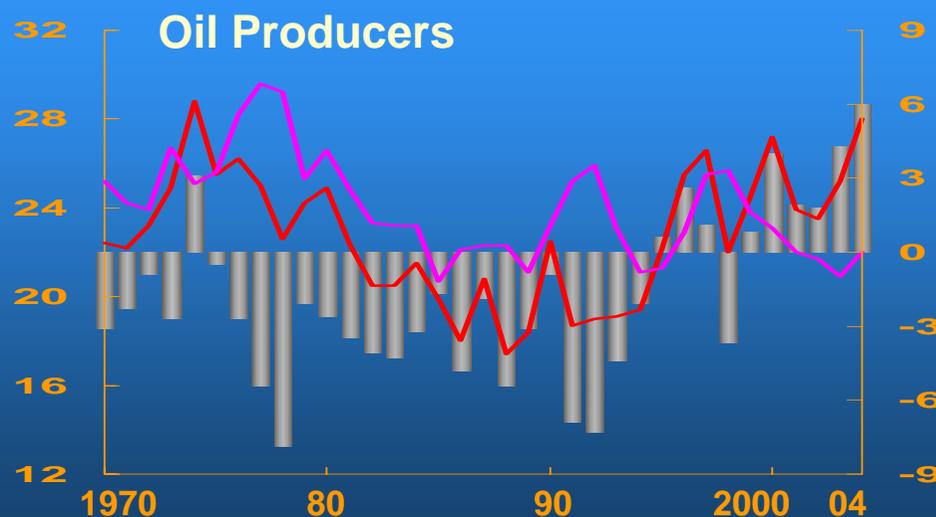
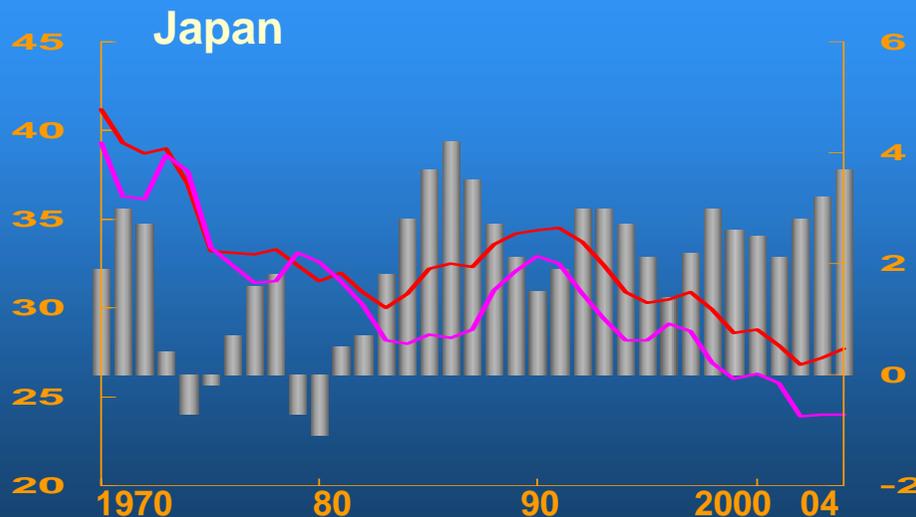
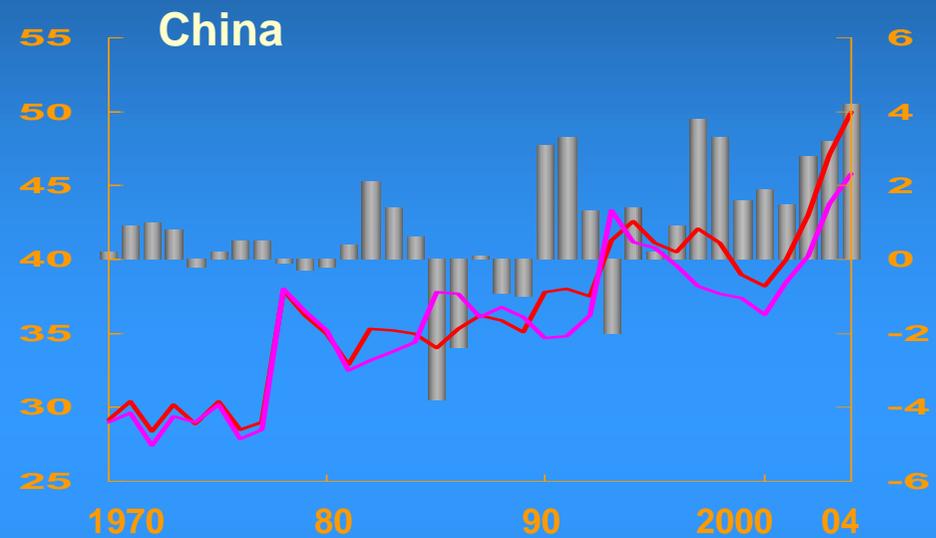
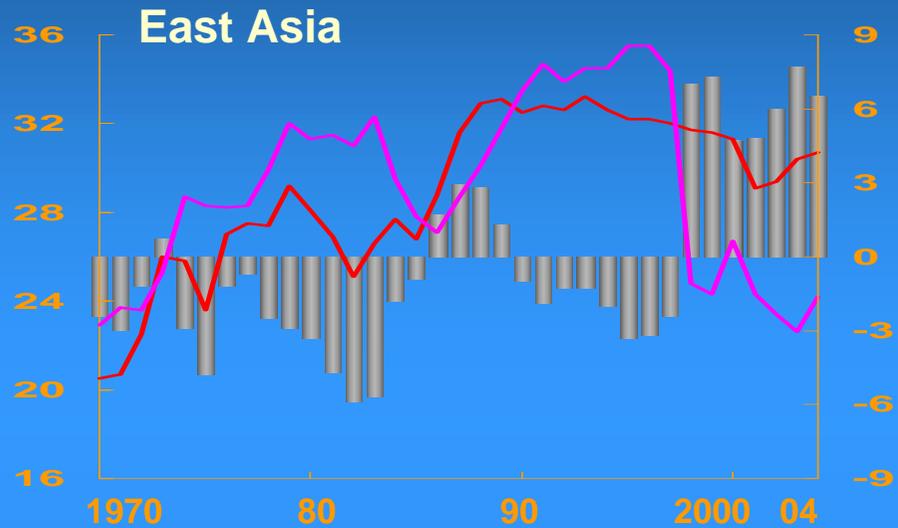
High savers are not all high investors

— Saving

— Investment

■ Current account (right scale)

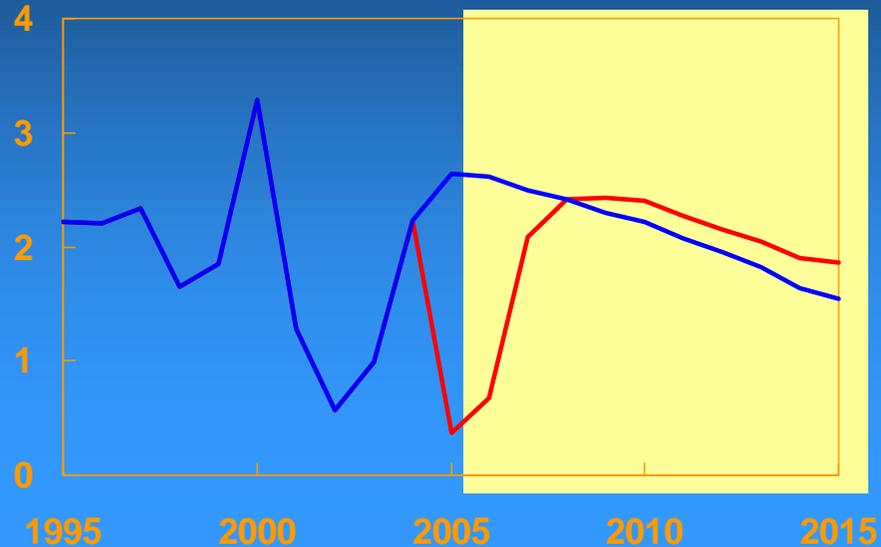
(Percent of each sub-region's GDP)



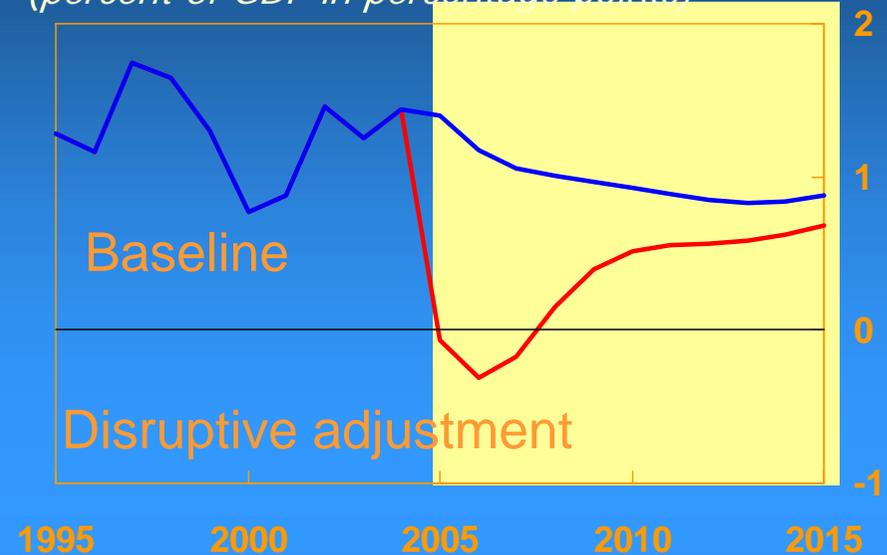
Sources: OECD Analytical Database; World Bank, *World Development Indicators*; and IMF staff calculations.

Euro Area and Japan: Effects of benign, disruptive adjustments

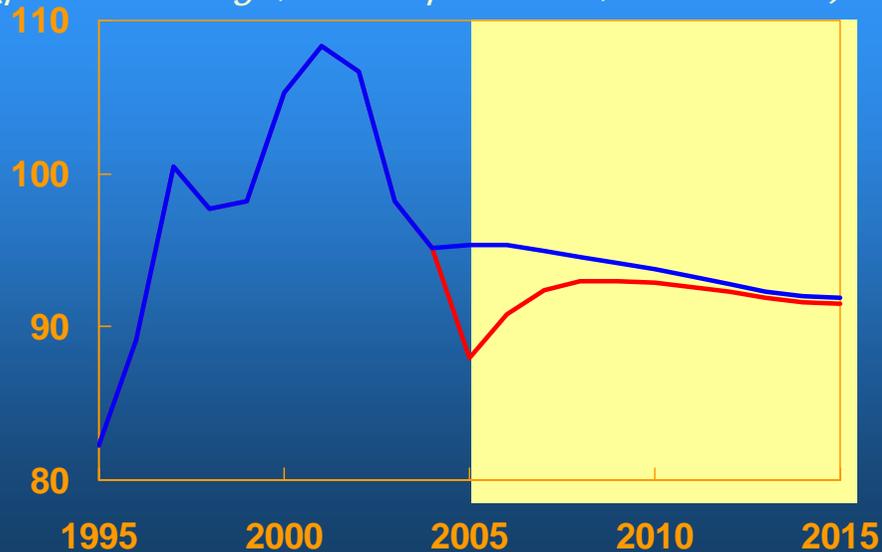
Output Growth (percent)



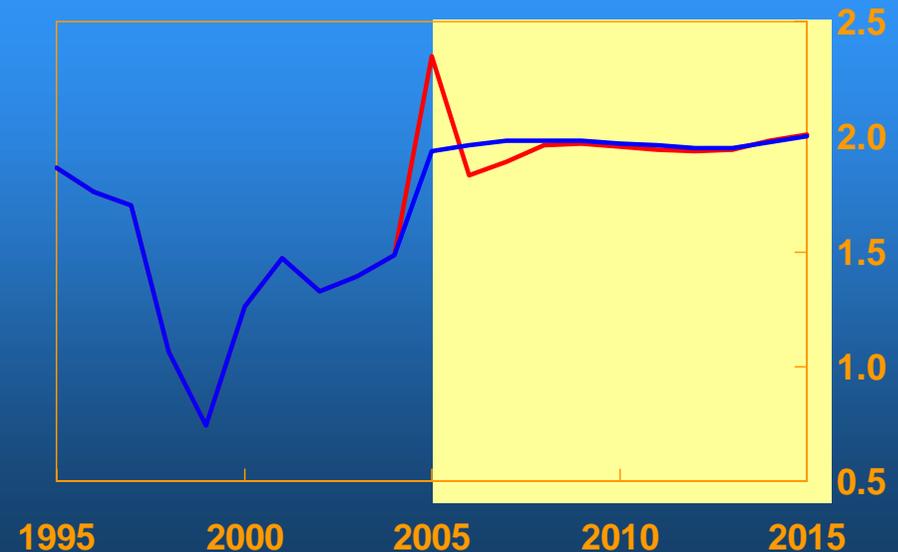
Current Account Balance (percent of GDP in percentage points)



Real Effective Exchange Rate (percent change, + = depreciation, 1990 = 100)

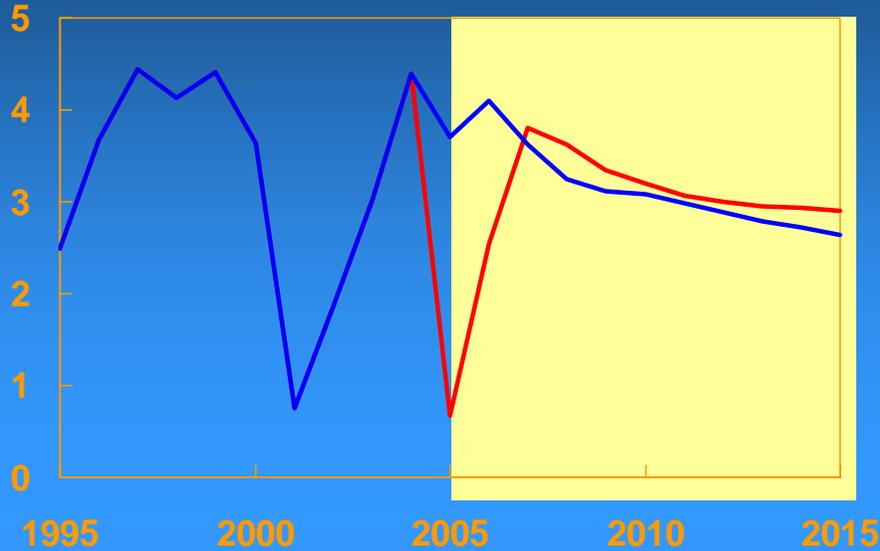


Inflation (percent)

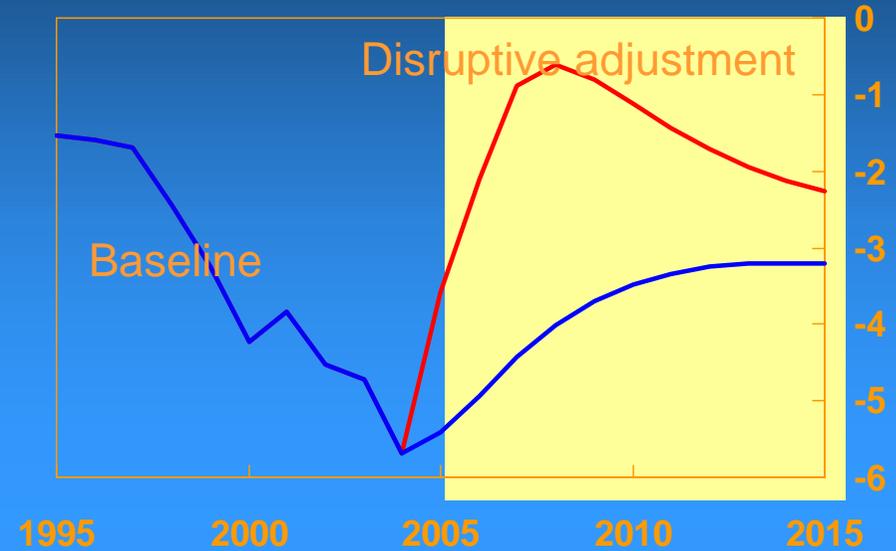


U. S.: Effects of benign, disruptive adjustment

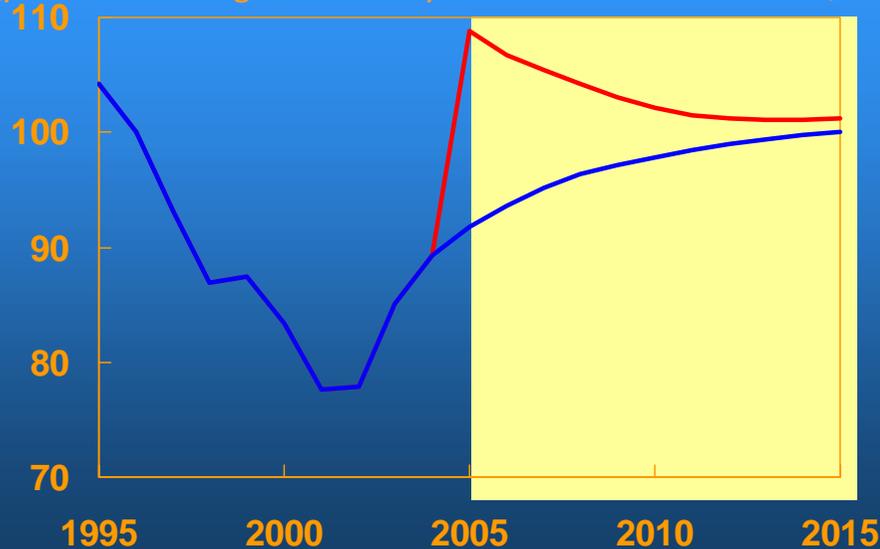
Output Growth (percent)



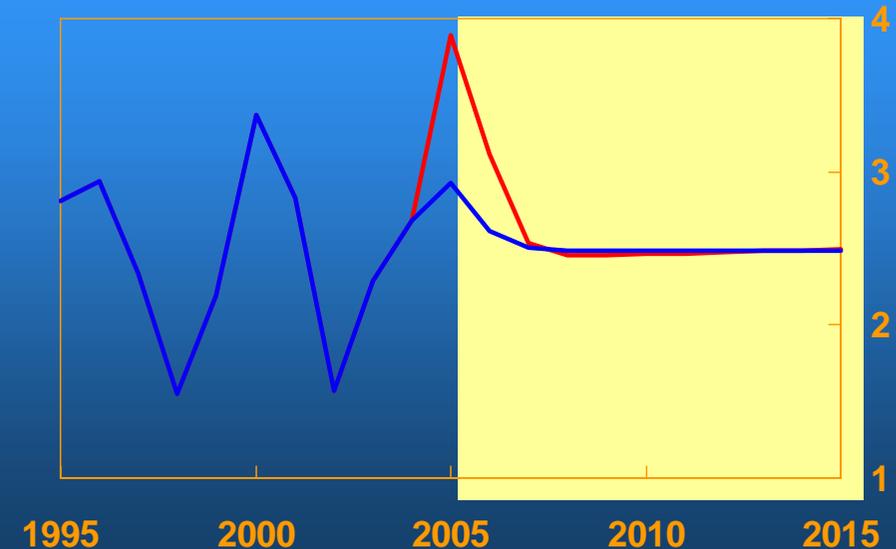
Current Account Balance (percent of GDP in percentage points)



Real Effective Exchange Rate (percent change, + = depreciation, 1990 = 100)



Inflation (percent)

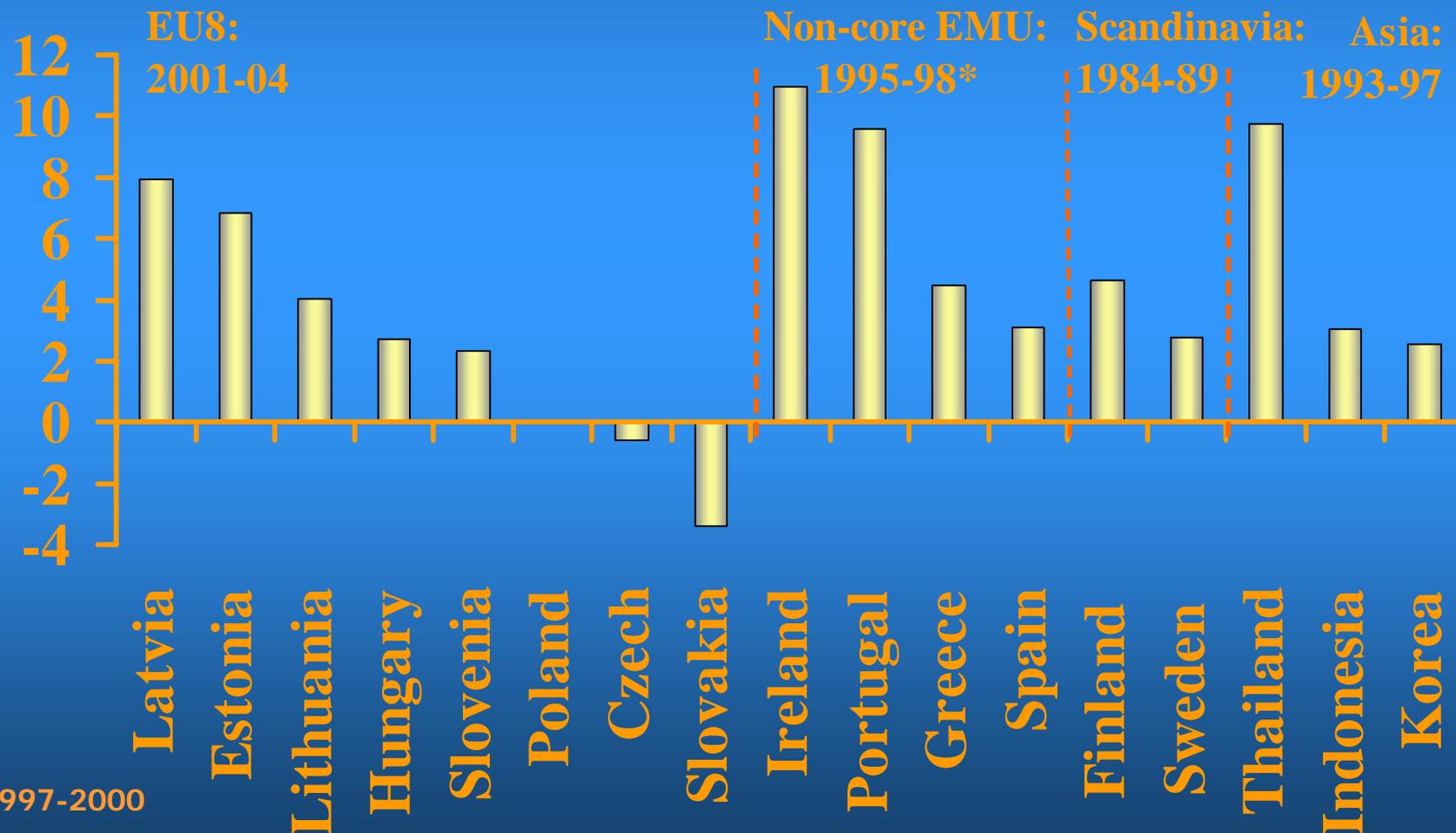


Positioning EU8 to reduce vulnerabilities to global risks— Special Issues

- Understanding fast credit growth
- Keeping debt at prudent levels

Banks' lending to the private sector is growing fast in some countries.

Average growth of credit to the private sector (in percentage points of GDP)



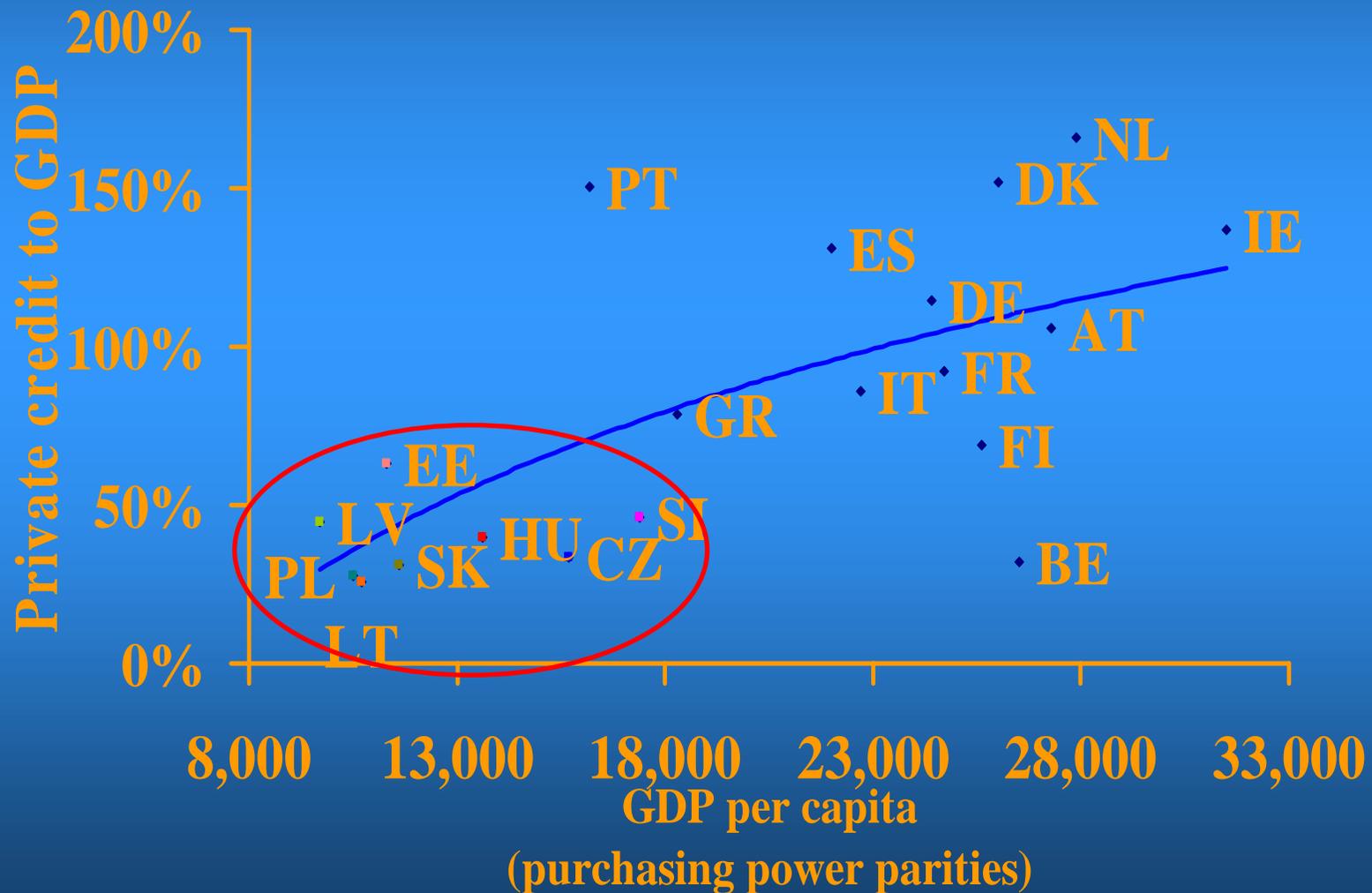
*Greece 1997-2000

**Czech Republic 2002-2004

Source: IFS, national authorities, IMF staff calculations

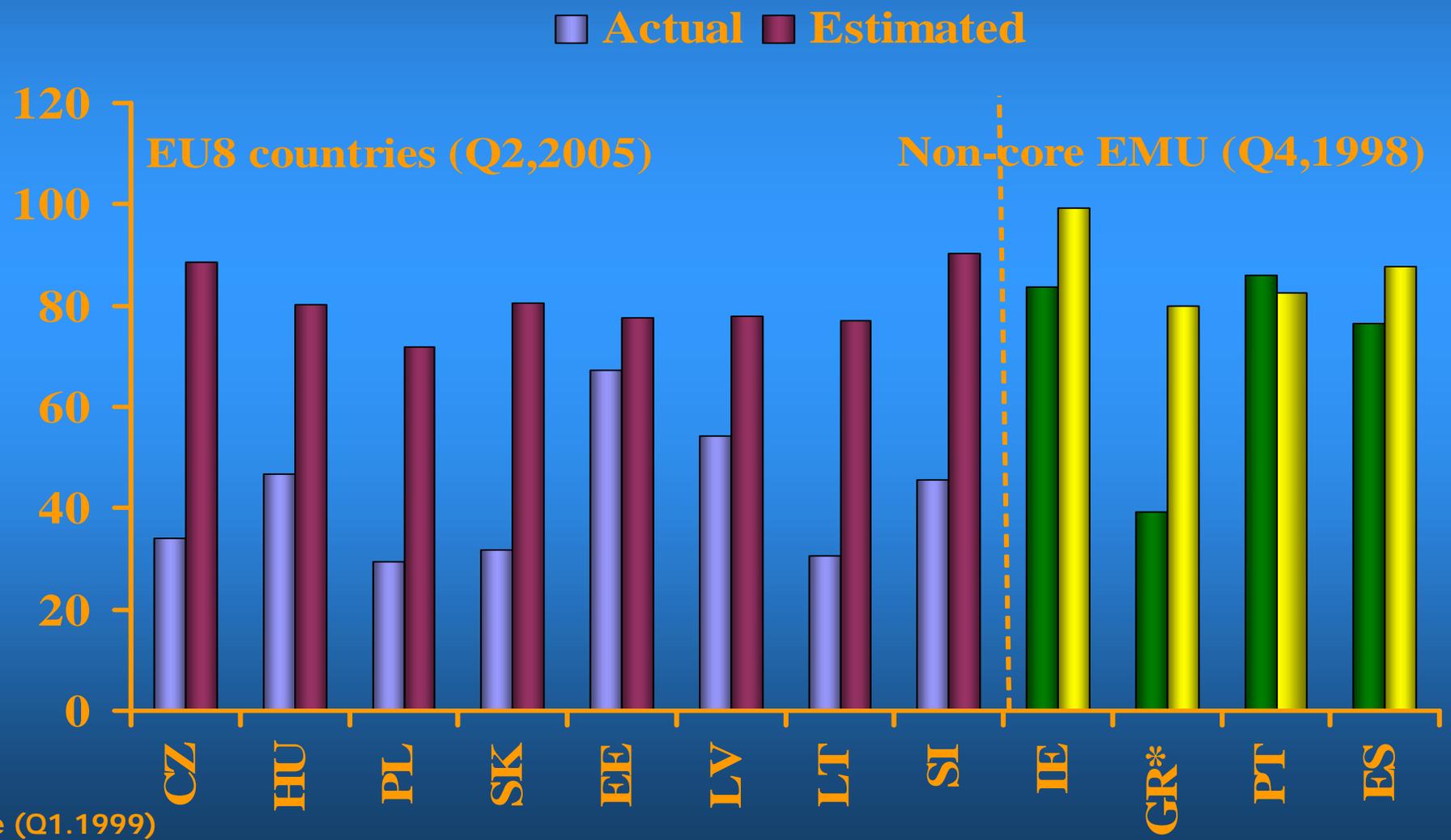
Indebtedness corresponds to income levels.

Private credit to GDP and income per capita, EU countries, 2004



Private sector debt has still some way to grow.

Bank credit to the private sector: Actual and estimated equilibrium levels (percent of GDP)

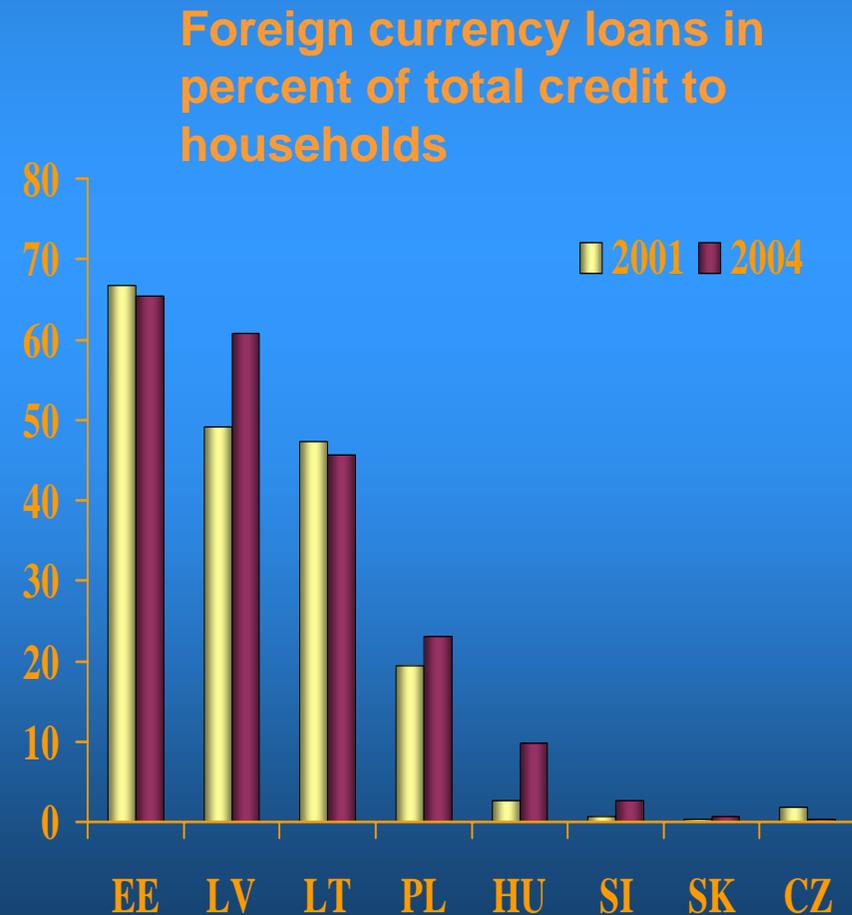
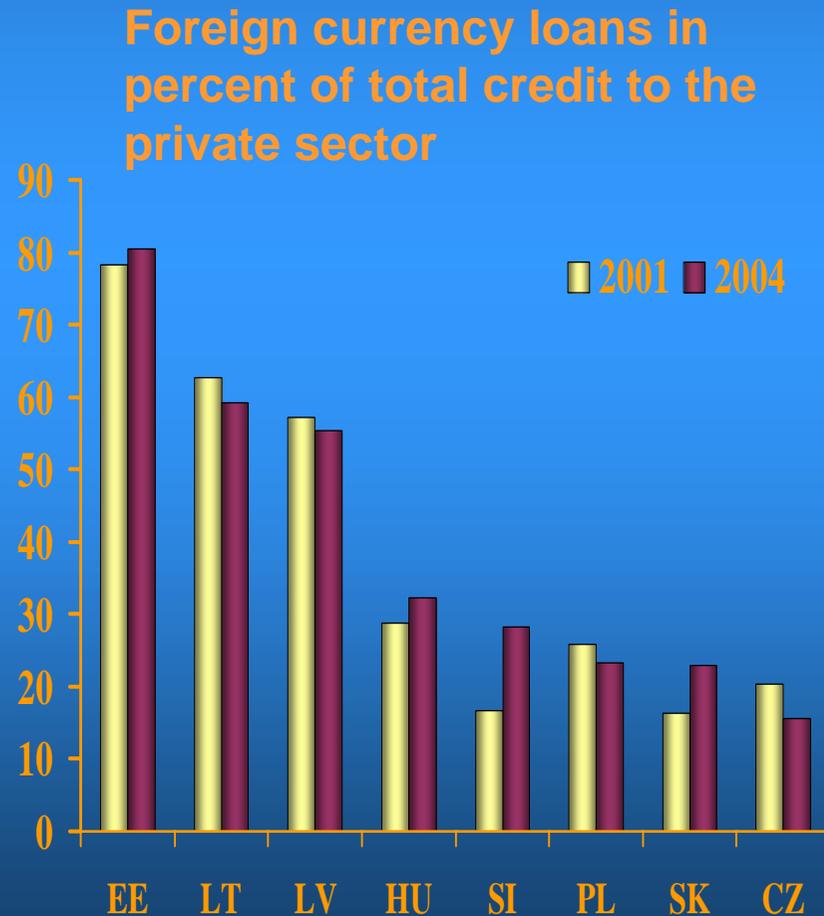


*Greece (Q1.1999)

Source: National authorities, calculations based on Schadler et al. (2005)

Households increasingly borrow in foreign currency.

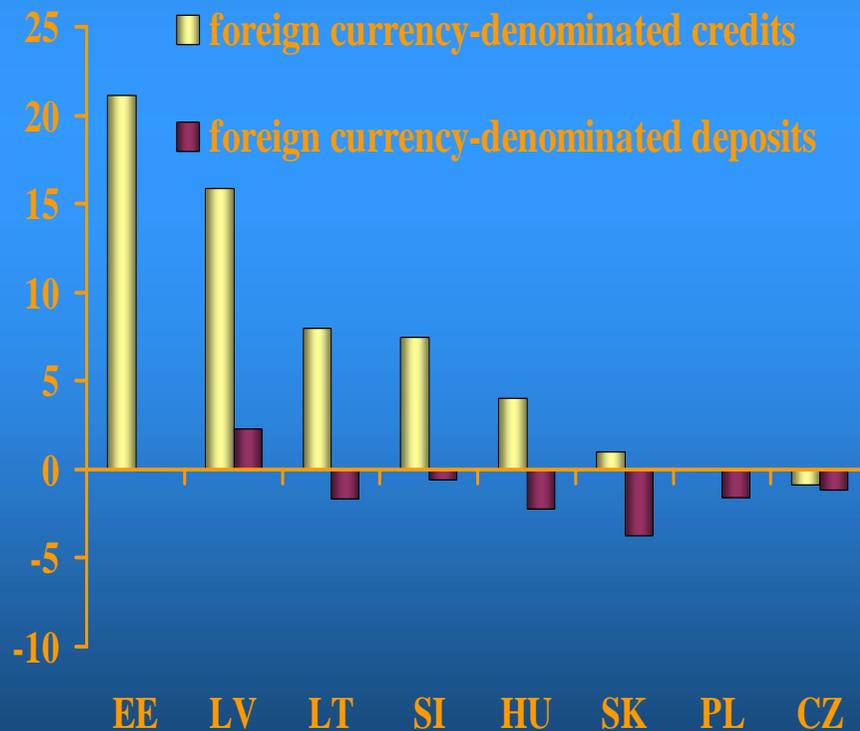
EU8: Credit denominated in foreign currency 2001-2004
(calculated at constant 2000 exchange rates)



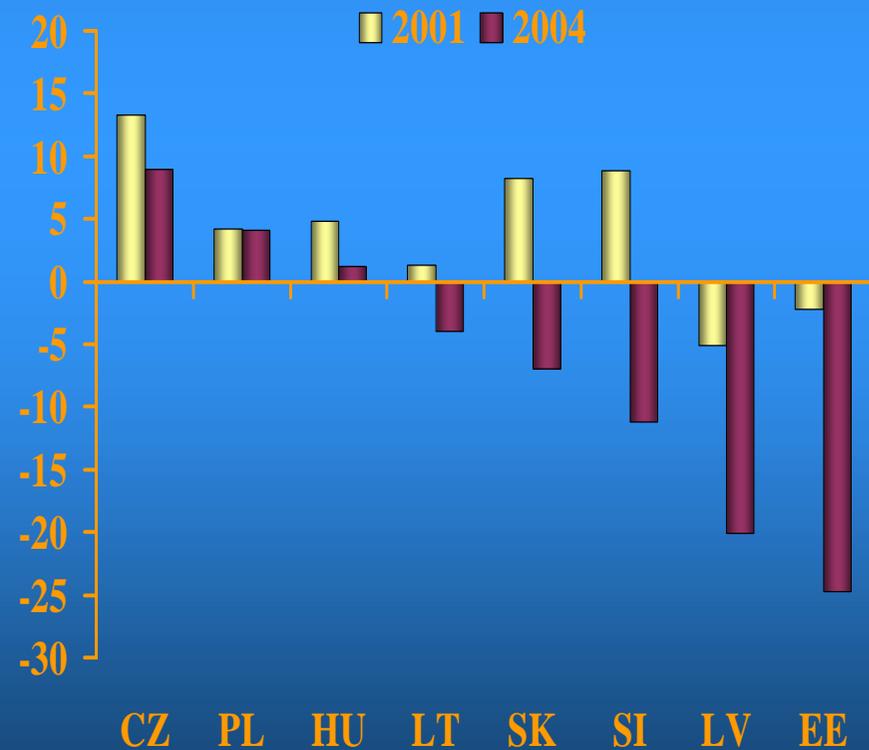
Banks that lend in foreign currency rely increasingly on foreign funding.

EU8. Foreign currency credits and deposit

Change of foreign currency credits and deposits* during 2001-04 (in percentage points of GDP)



Net foreign assets of the banking sector (in percent of GDP)



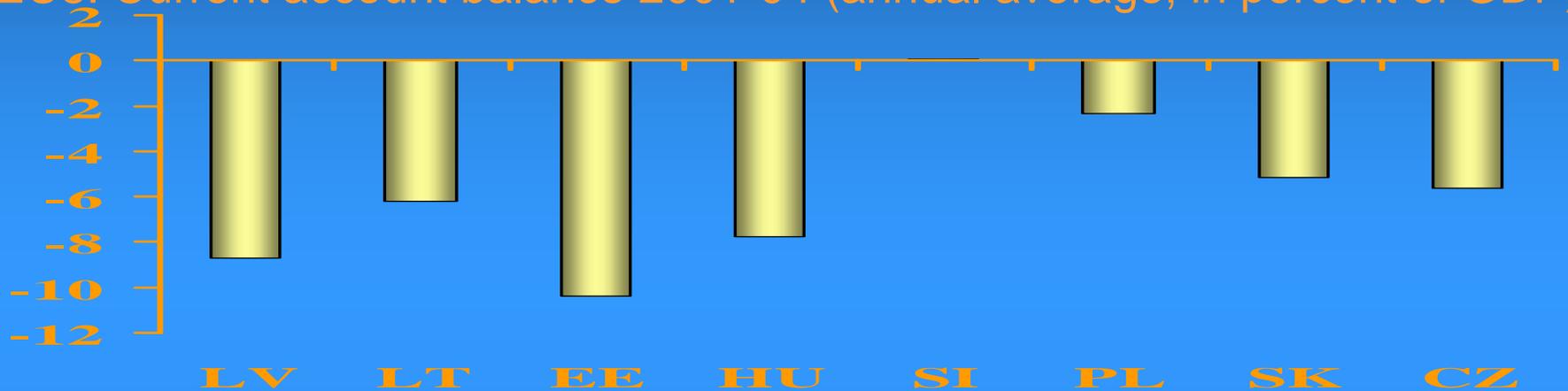
Source: National authorities, IMF staff estimates

*Residents only, except for CZ and EE.

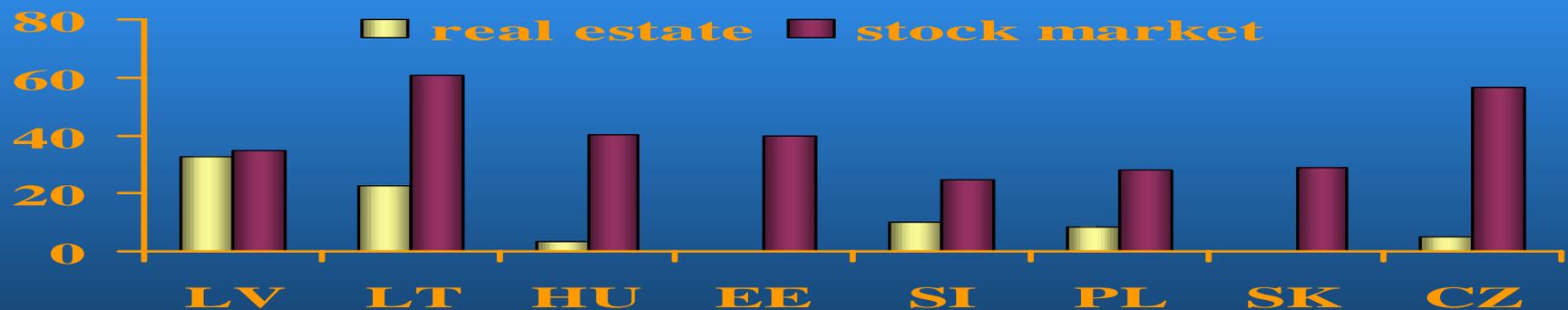
Credit growth raises concern about overheating in some countries .

EU8: Current account balance 2001-2004 and asset prices 2003-2004

EU8: Current account balance 2001-04 (annual average, in percent of GDP)



EU8: Real estate* and stock market prices 2003-2004 (average annual change in percent)

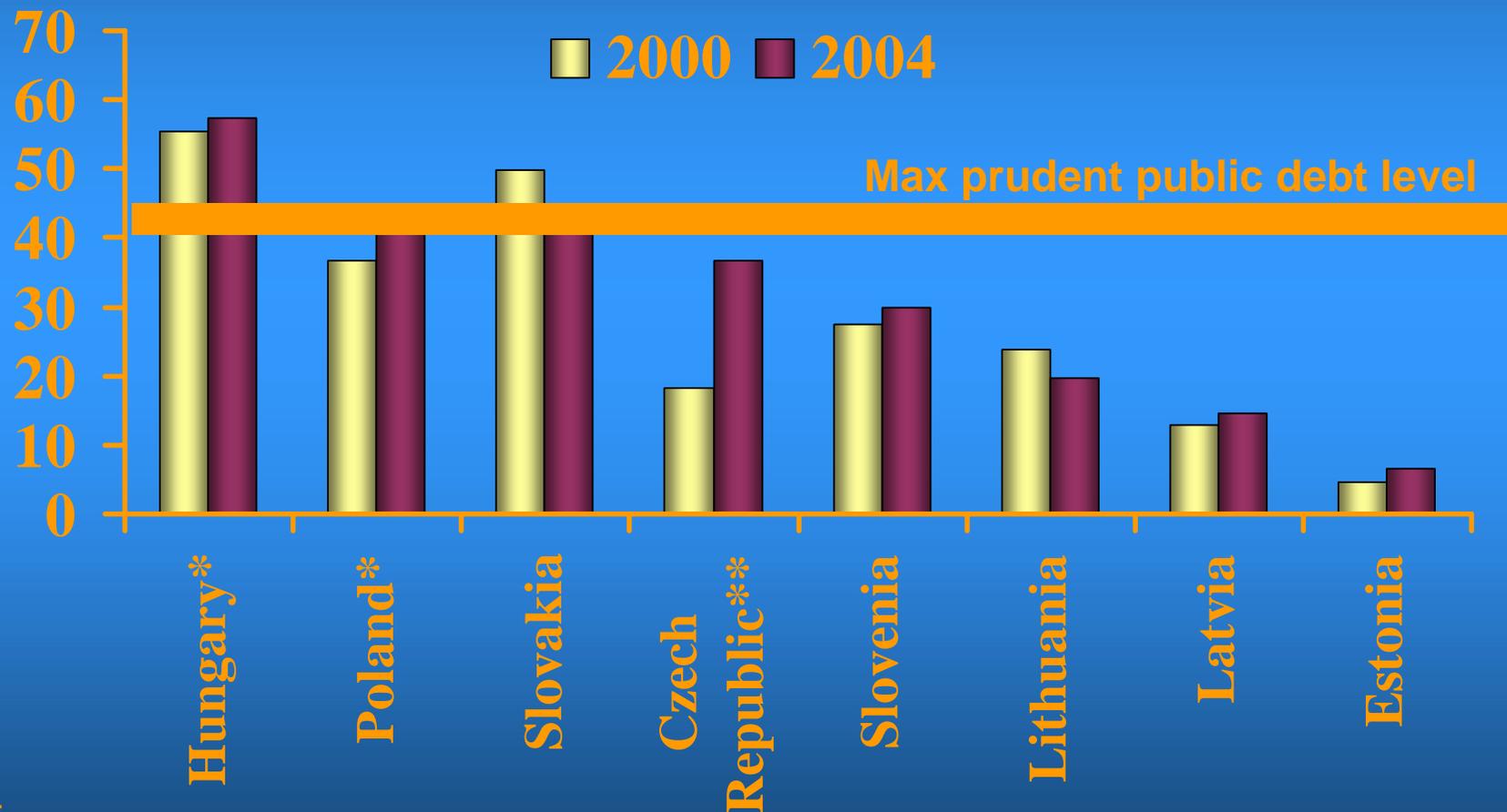


Source: Eurostat, European Council of Real Estate Professions - Annual Report 2004, National authorities, IMF staff estimates

* Percentage change in average sales prices for houses and apartments in 2003-04; EE and SK –not available

Debt ratios are high in some countries in Central Europe.

EU8: Debt to GDP ratio, 2000 and 2004 (ESA 95, percent)



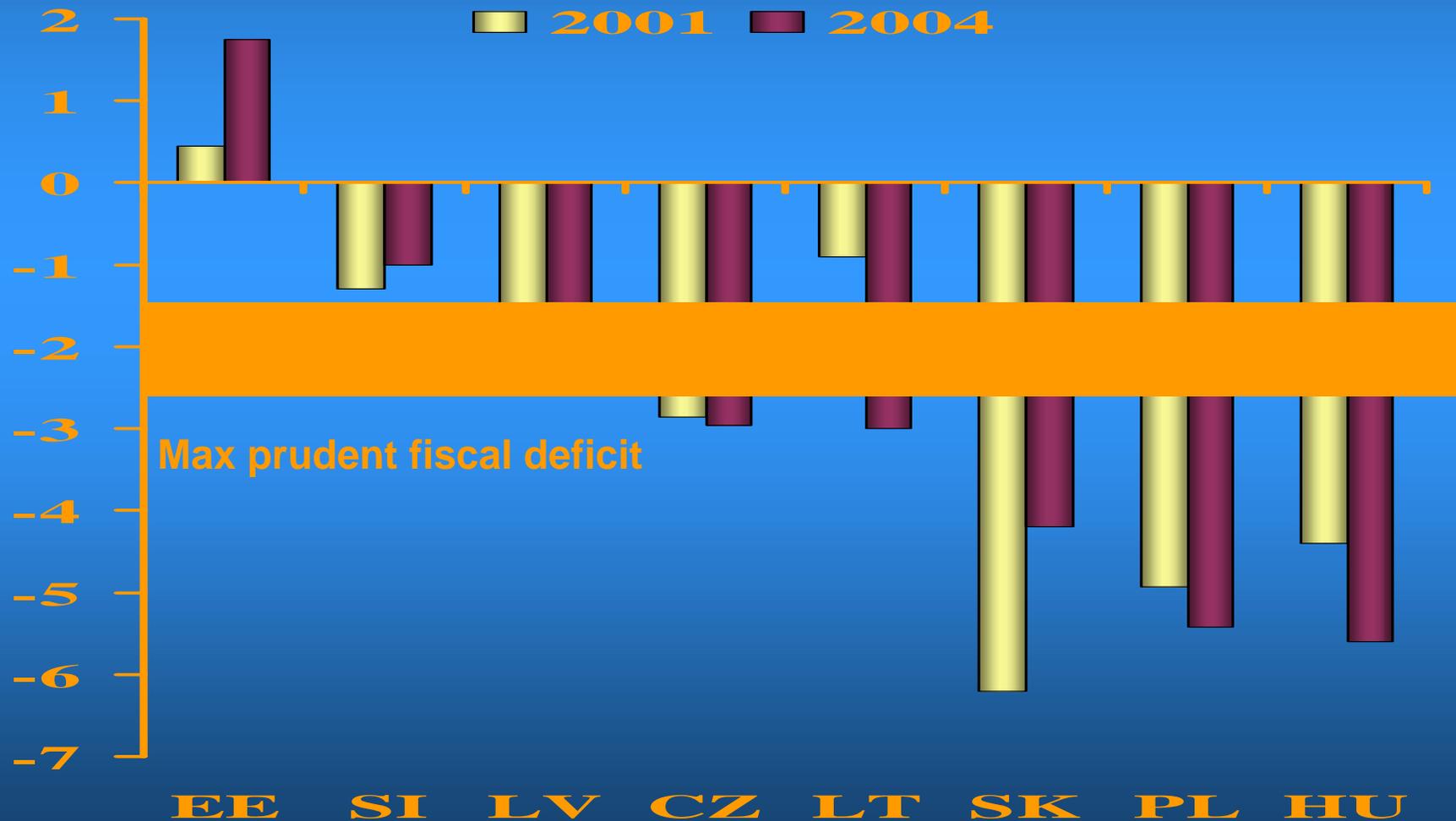
Source: Eurostat

*Funded pension schemes with government guarantees included in the general government.

** Including state guarantee provided to IPB bank, recording of this guarantee is a subject to ongoing discussions between Eurostat and the authorities.

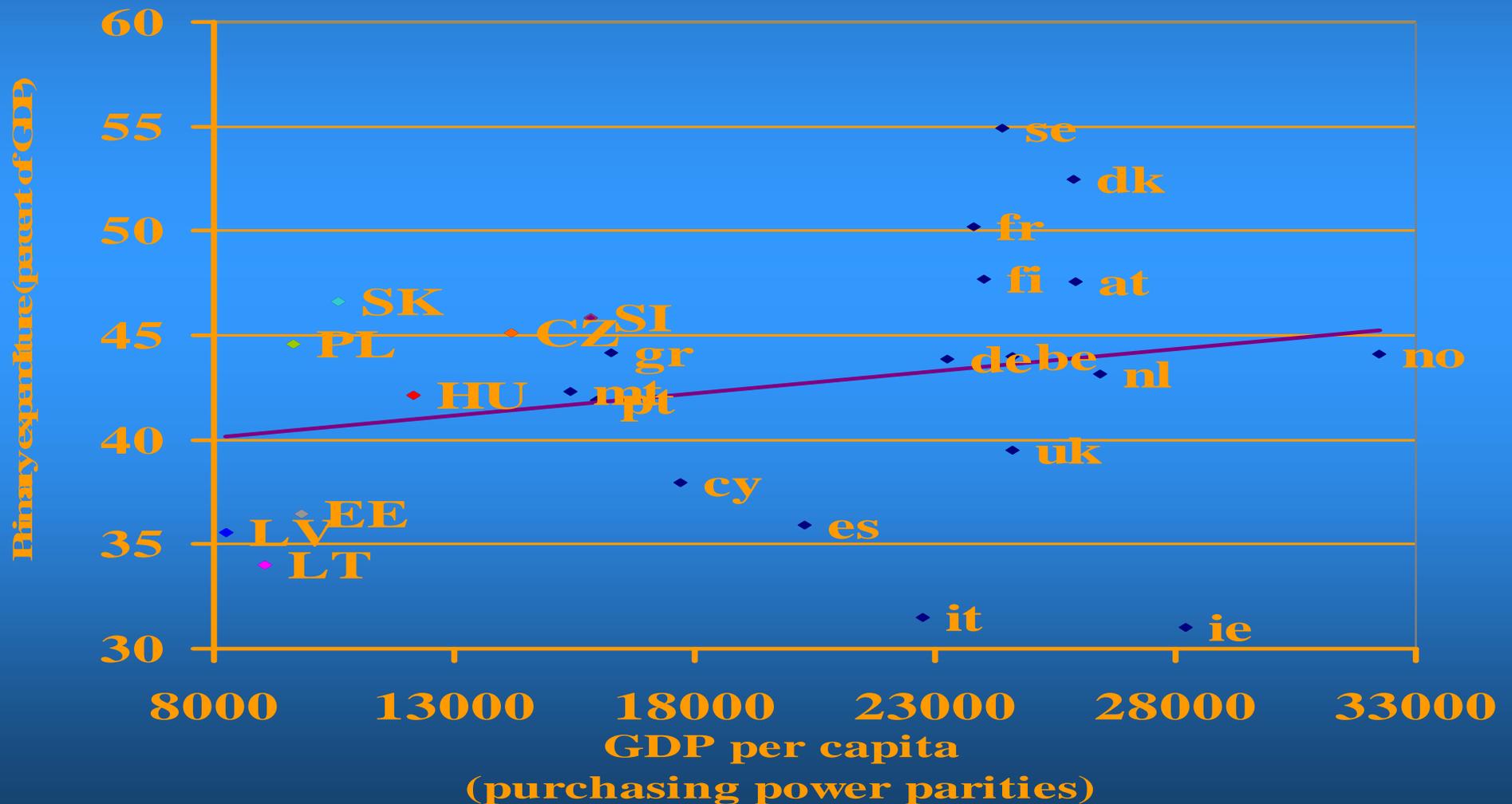
Few countries have used the benign global environment to undertake fiscal adjustments.

EU8: Structural Fiscal Balances (in percent of GDP)



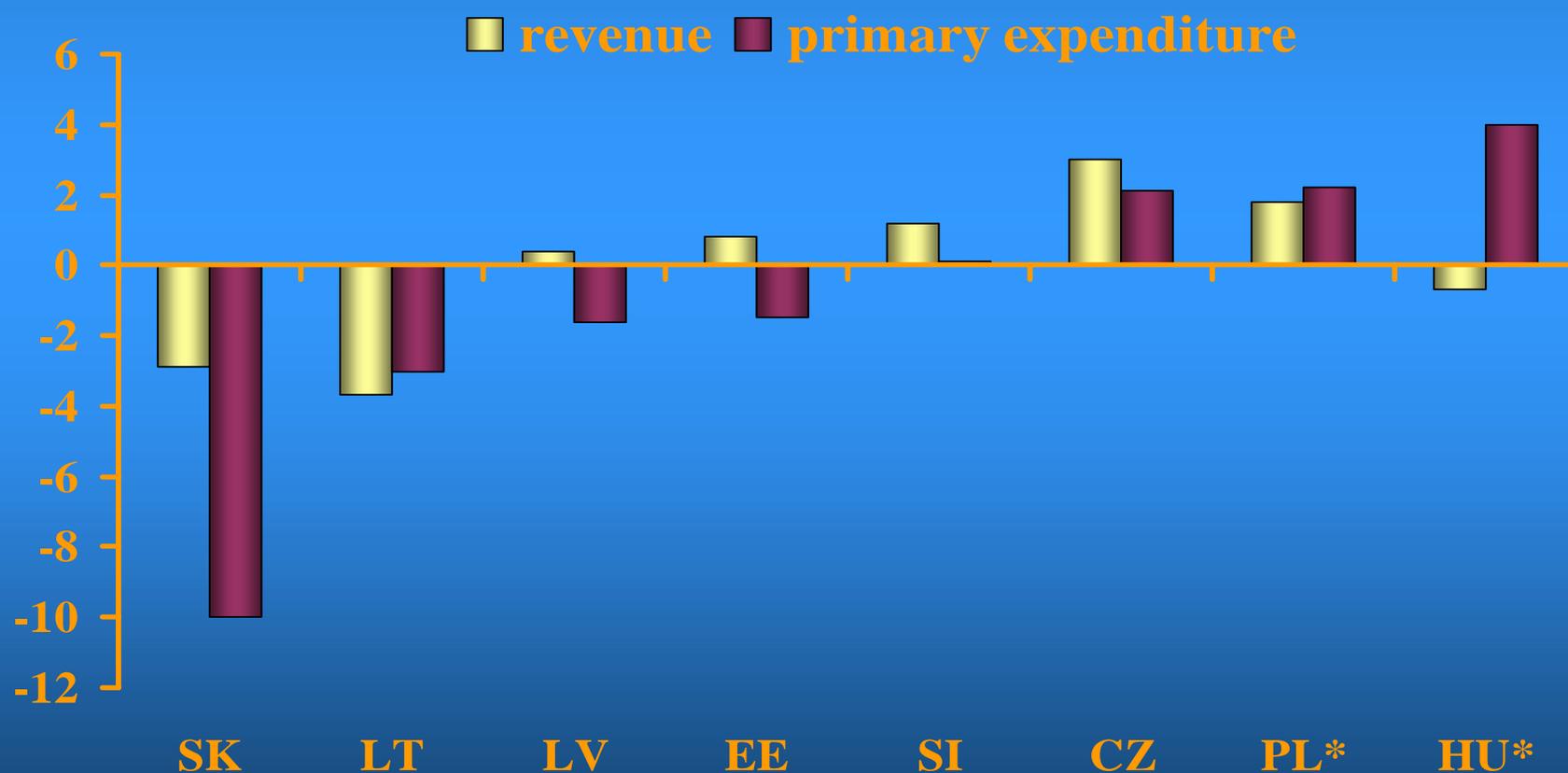
Primary spending in Central Europe is high, suggesting that fiscal adjustments should start at expenditure side.

EU8: Primary expenditure, 2000-04 average



The Baltics and Slovakia have reduced spending.

EU8. Change in general government revenue and primary expenditure 2000-2004
(in percentage points of GDP)



*Hungary and Poland data for 2003

Flat taxes are popular in the region.

Flat tax rates, implemented and under discussion				
	Year	PIT rate	PIT rates before the reform	CIT rate
Estonia	1994	24 ^{1/}	16,24,33	24 ^{2/}
Lithuania	1994	33	Rates 18-33	15
Latvia	1995	25	Five rates 15-35	15
Slovakia	2004	19	Five rates 10-38 ^{3/}	19
Russia	2001	13	12-30	37
Ukraine	2004	13	10-40	25
Georgia	2005	12	12-20	20
Romania	2005	16	18-40	16
Poland	2008 ^{4/}	18	19,30,40	18
Slovenia	2007 ^{5/}	20	Five rates 17-50	25
Czech Rep.	after 2006 ^{6/}	15	Four rates 15-32	15

1/ The rate was introduced at 26 percent, with a phased reduction to 20 percent by 2007.

2/ Estonia subsequently reduced the CIT on retained profits to zero, with dividends taxed at the PIT

3/ On average production earnings, the average PIT rate was about 20 percent.

4/ Proposed by the outgoing government.

5/ Proposed by Council of advisors to the government.

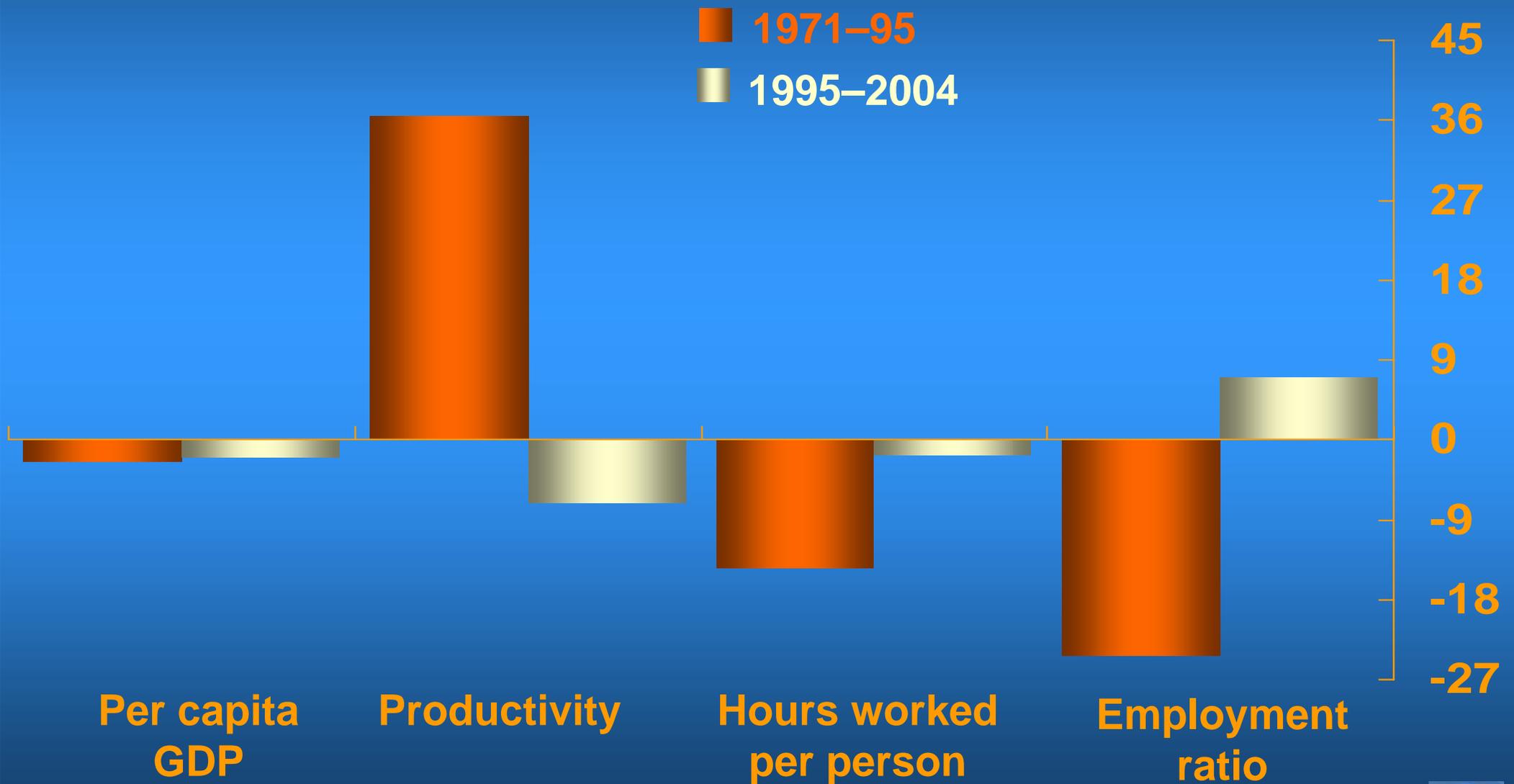
6/ Proposed by opposition party ODS



Thank You

September 2005

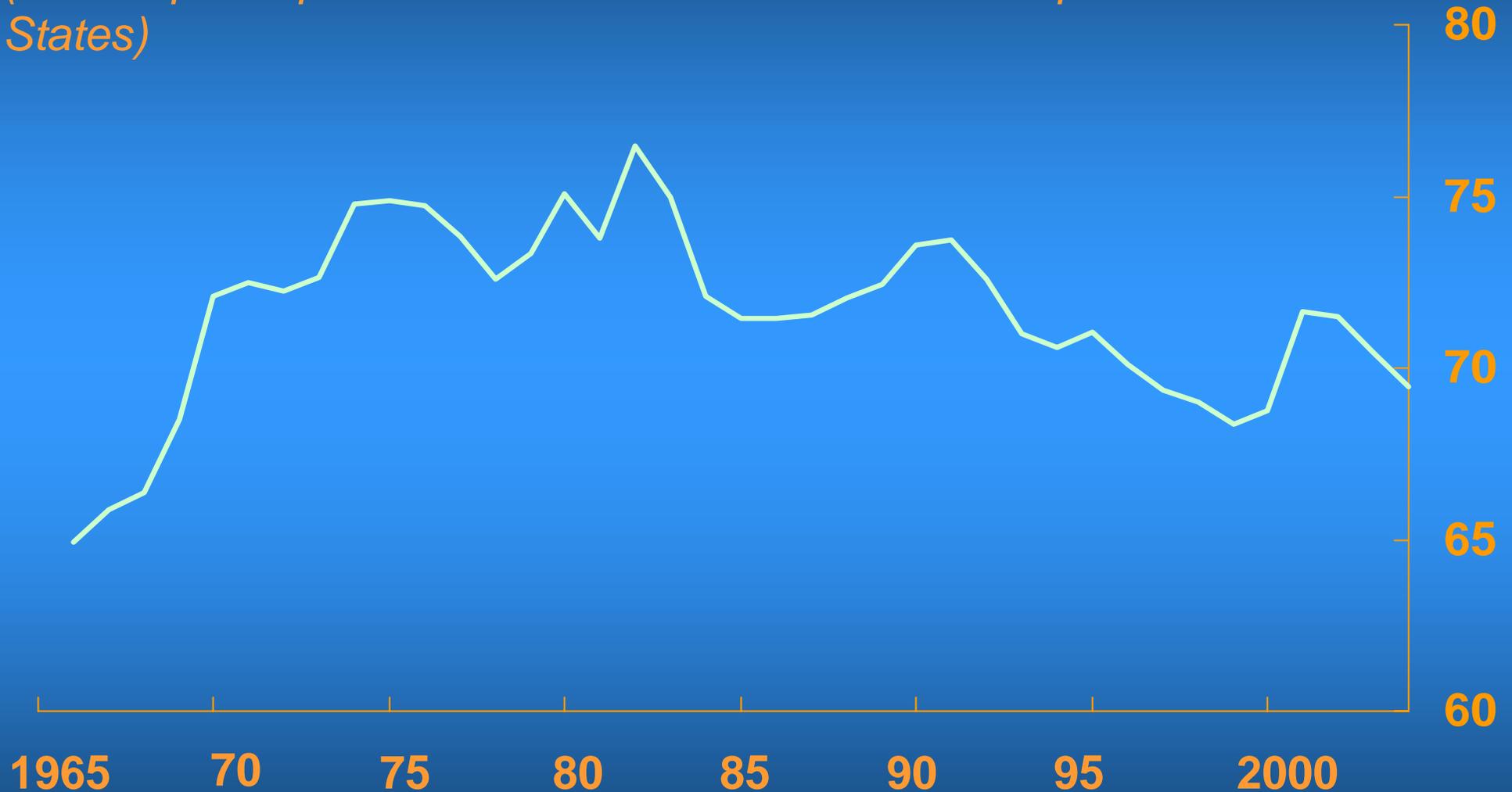
18. Strong Productivity Growth Offset by Weak Labor Utilization



Sources: OECD, *Economic Outlook*; Eurostat; and IMF staff calculations.

17. EU15 Per Capita GDP Stuck at about 70 Percent of US

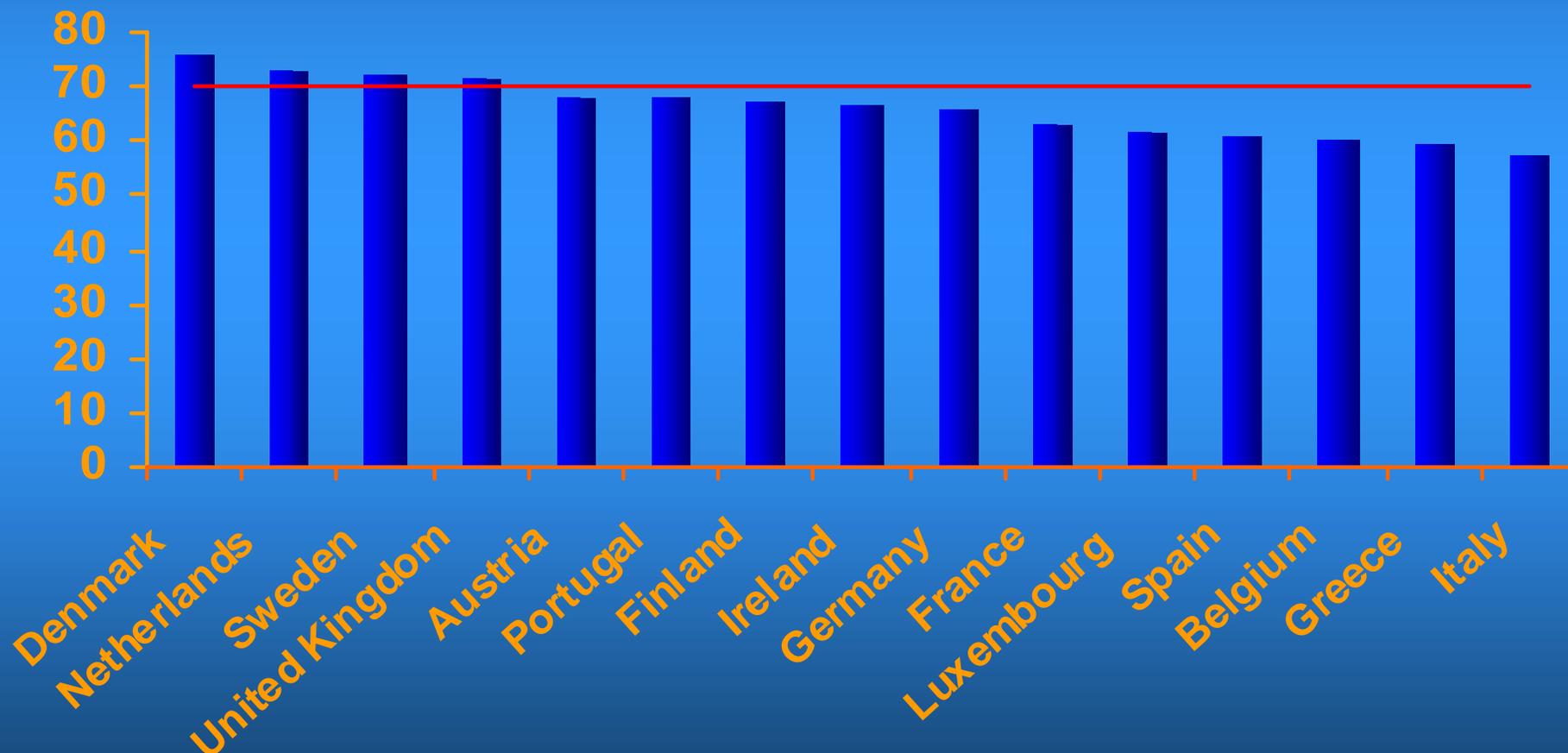
(ratio of per capita GDP in 2000 PPP dollars in Europe to that in the United States)



Source: IMF staff estimates.

19. Employment Rates Still Far from Lisbon Targets

Percent 2004



Source: OECD, Economic Outlook; Eurostat; and IMF staff calculations.