

# Global Economic Prospects



THE WORLD BANK

## Europe & Central Asia

**June 2014**

Andrew Burns





# Main Messages

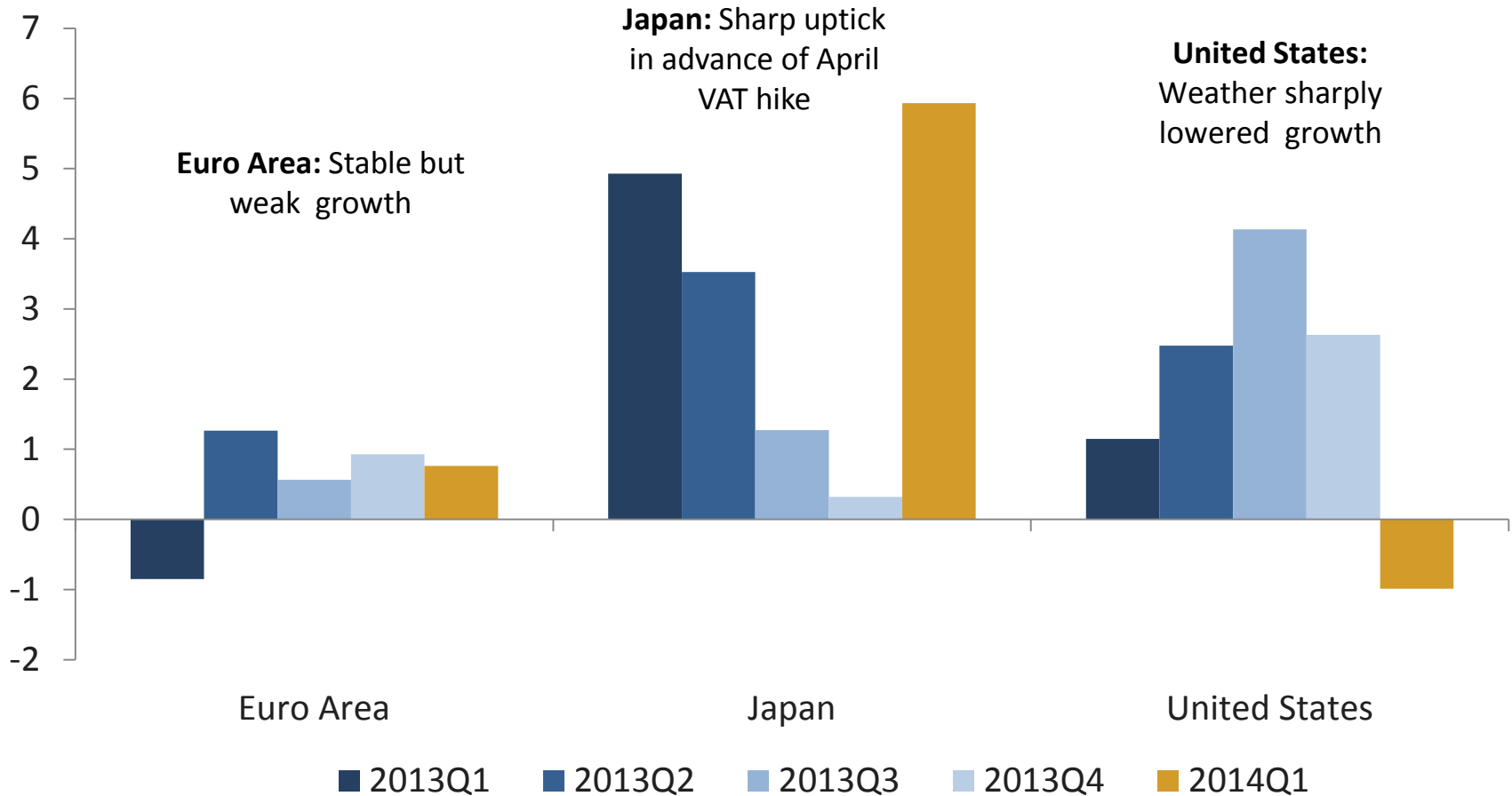


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- 2014 Global forecast has been downgraded, mainly reflecting one-off factors
- Growth in Europe and Central Asia, including Turkey, has been strong this year despite headwinds from Ukraine
- Financing conditions have eased temporarily, but are expected to tighten once again— carrying with them risks
- Medium-term outlook is for growth to remain flat in 2014 and to rise moderately in 2014 and 2015.
- Despite some adjustment, macroeconomic vulnerabilities remain
- Stronger growth will require structural reforms

# First quarter GDP data in high-income countries was mixed

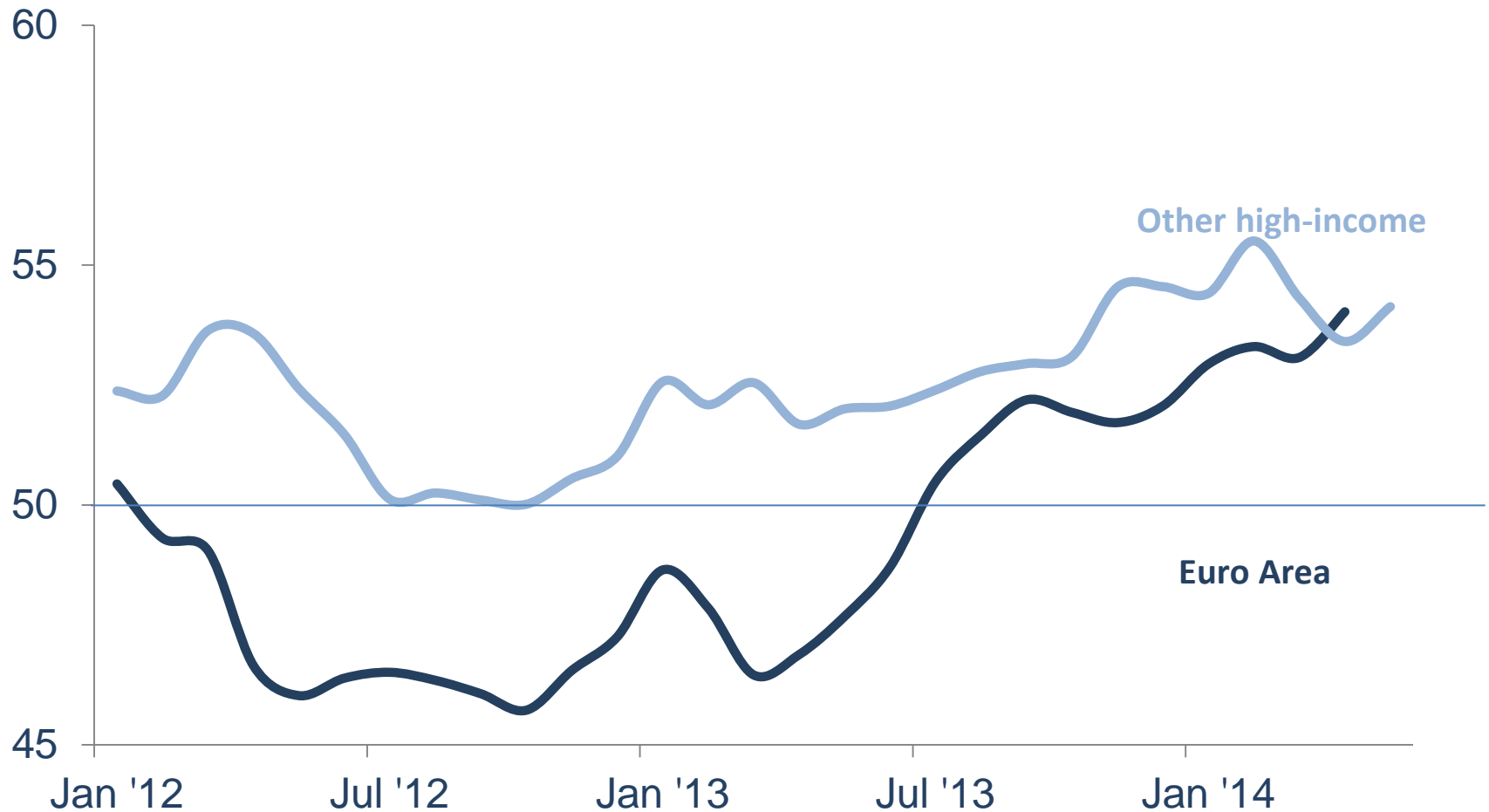
Percent quarterly GDP growth, annualized pace



Source: World Bank, Haver Analytics.

# Despite first quarter, business confidence in high-income countries remains strong

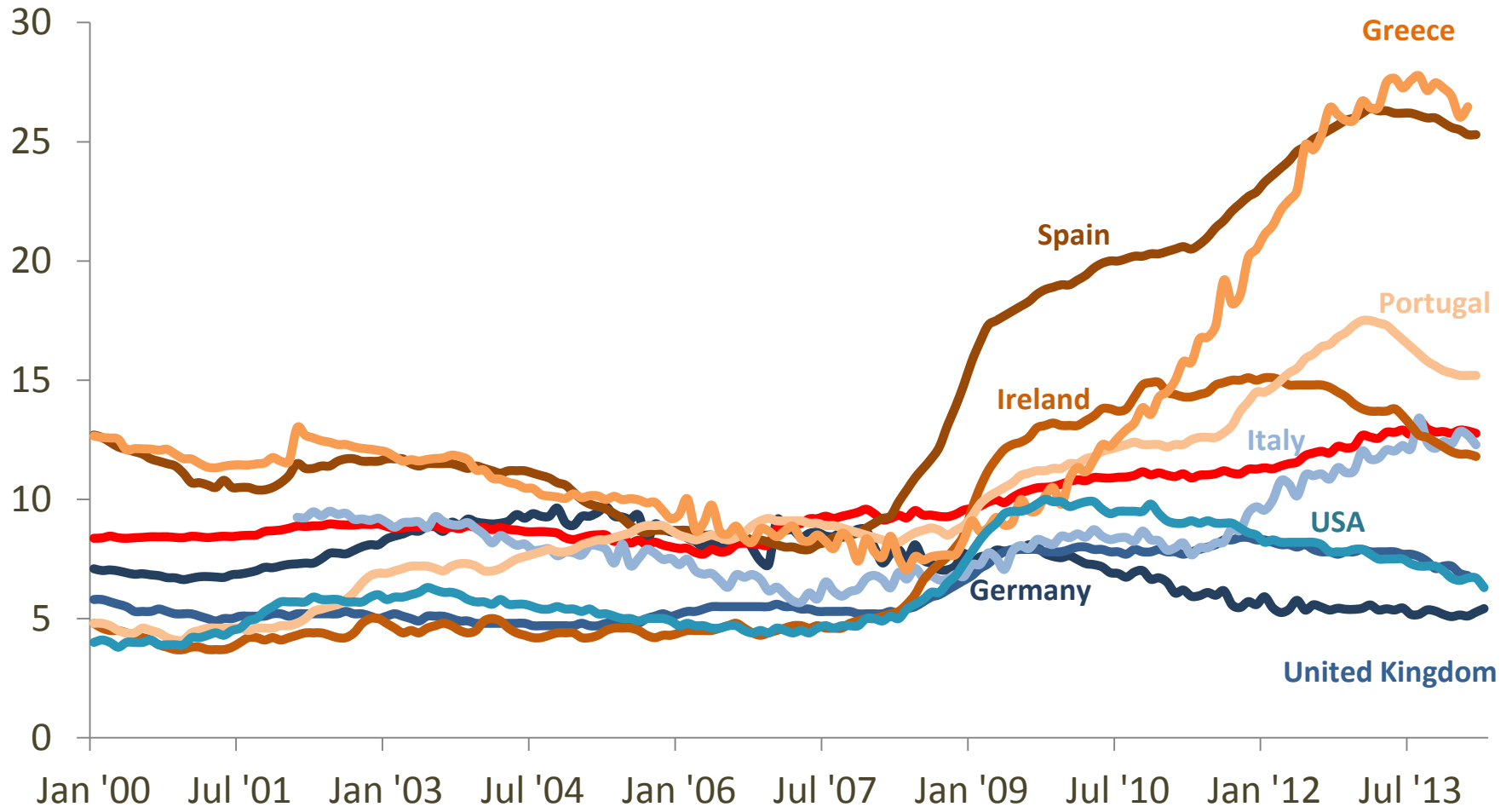
Purchasing Managers, indexes (50 or more indicates expansion)



Source: World Bank, Markit, Haver Analytics.

# Unemployment in high-income countries appears to be turning the corner

Unemployment, % of labor force



Source: World Bank; Haver Analytics.

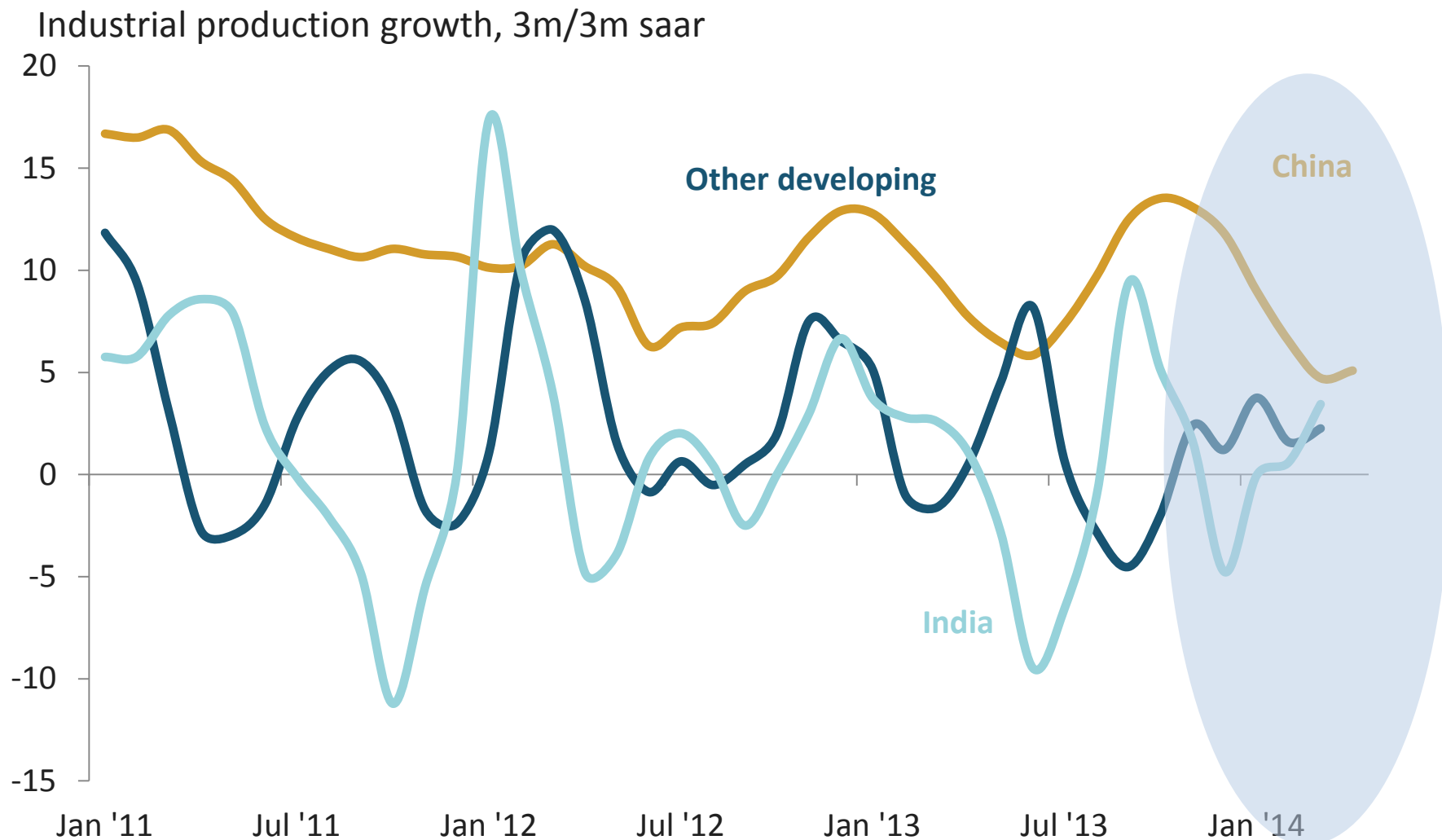


# Developing countries

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- Real data still positive for most countries, but confidence measures have weakened— perhaps because of Ukraine
- Financial turmoil has eased, borrowing costs are up, but remain low
- Forecast is for modest pickup in growth
- Growth has been disappointing in some regions

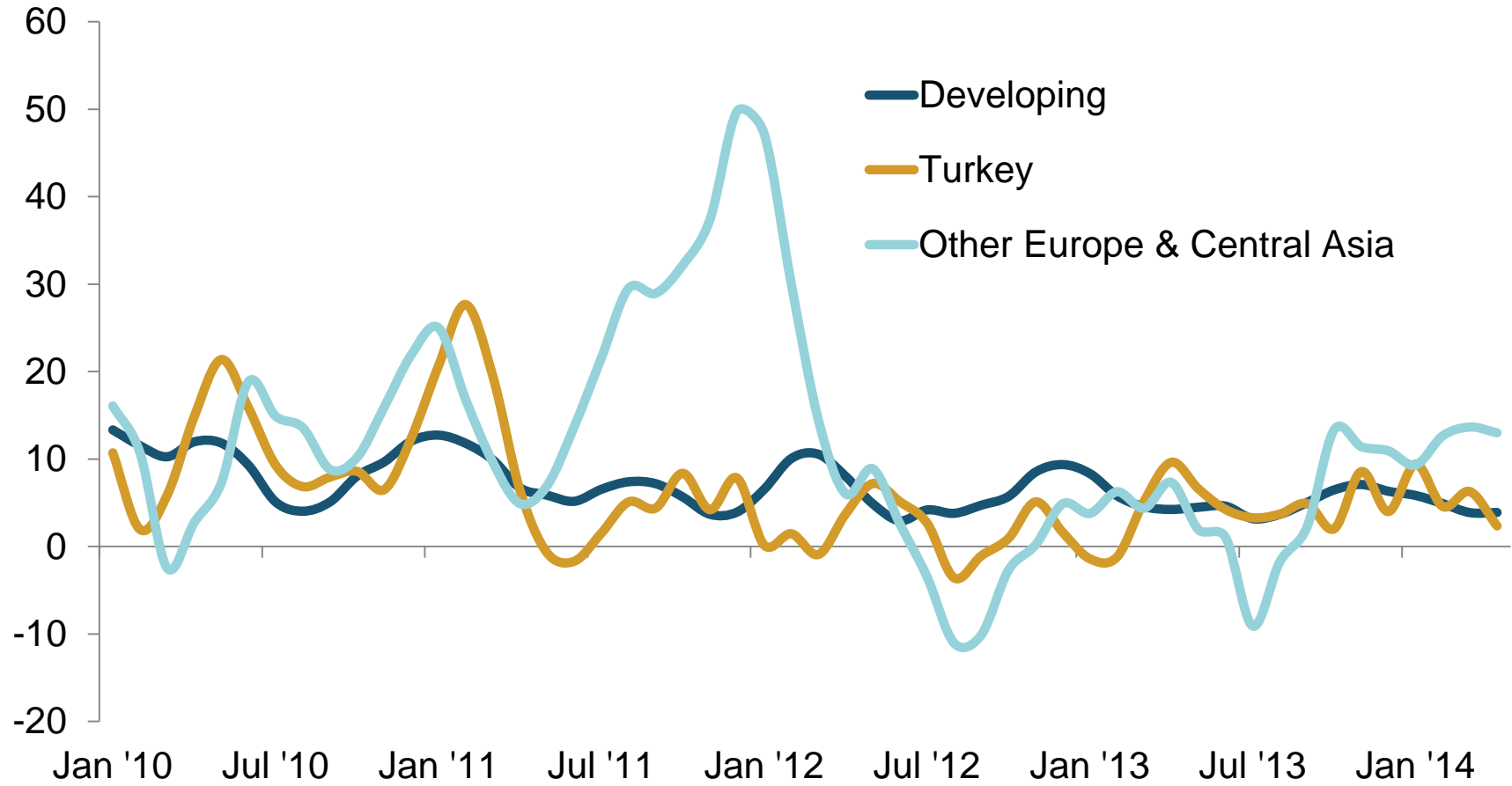
# First quarter growth in most developing countries about the same as 2013Q4



Source: World Bank, Haver Analytics.

# Regional economic activity remains very strong into second quarter

Industrial production growth, 3m/3m saar



Source: World Bank.



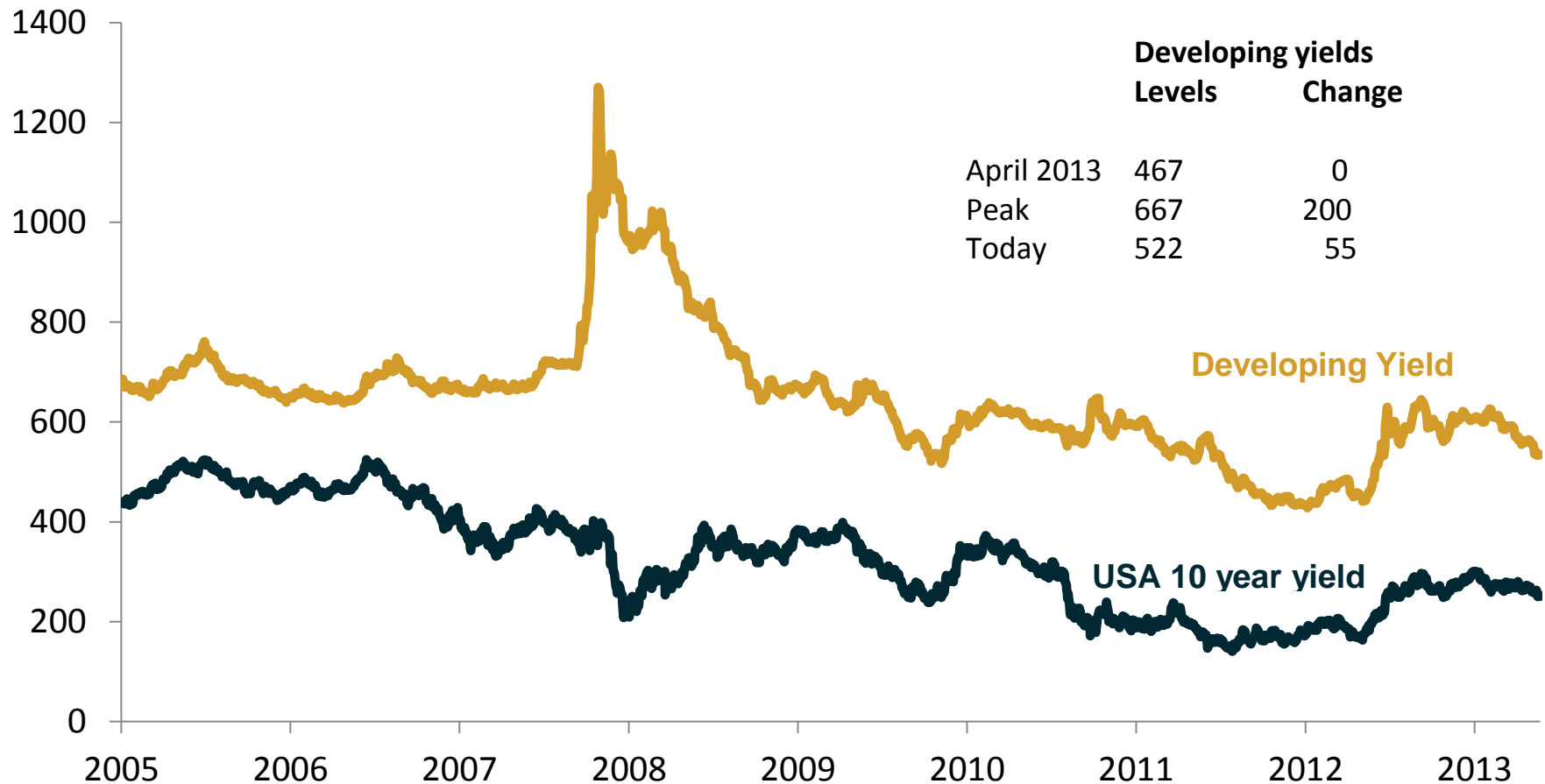
# Financial conditions have loosened since January in contrast to earlier expectations

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- Most developing countries not affected by turmoil
- Capital flows have recovered
- Developing country yields have returned to fall levels, and are actually 55 basis points lower than before the crisis
- Market remains volatile, in part because rising rates will change portfolio decisions
- Vulnerabilities have declined but remain

# Rather than rising further, developing country borrowing have declined

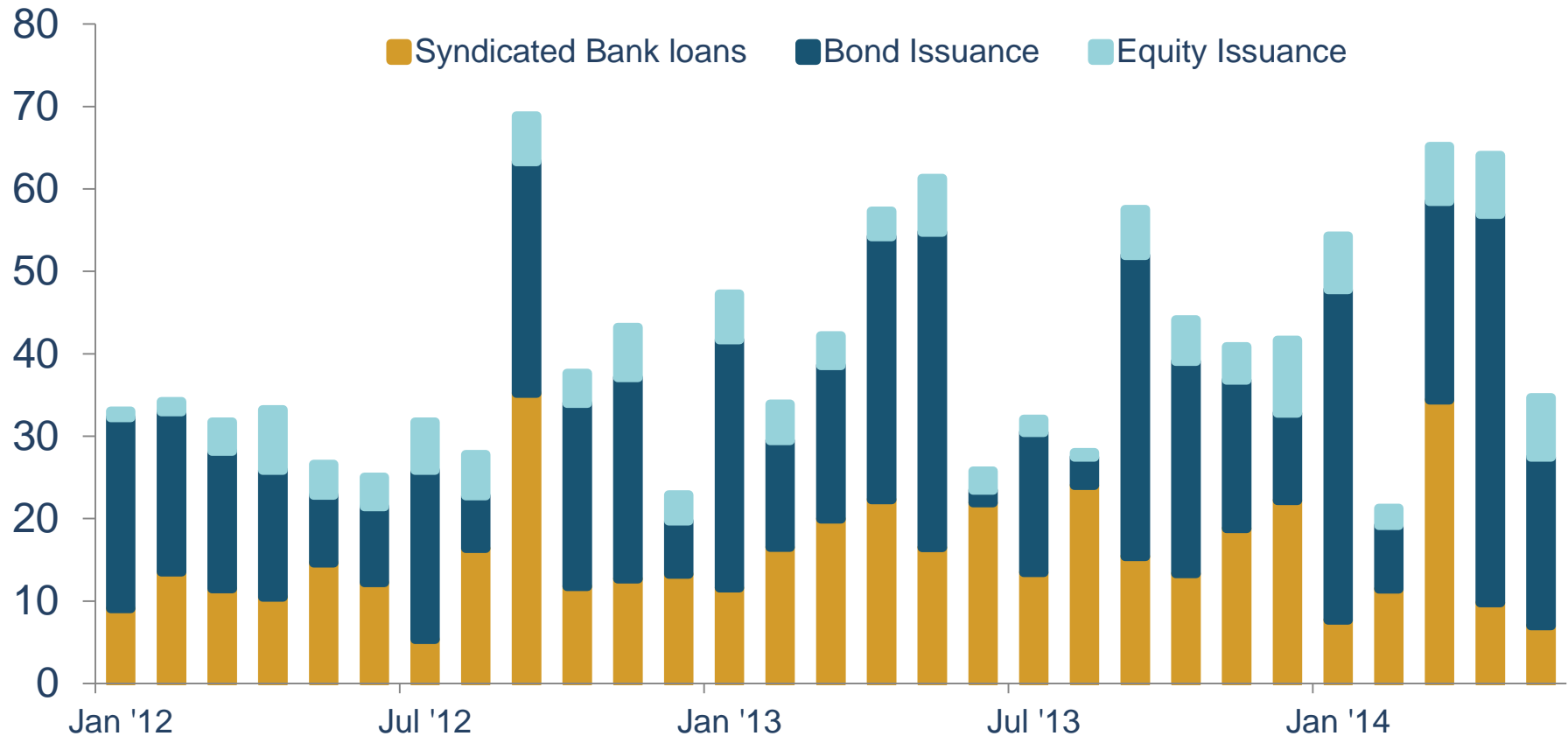
Yields on sovereign debt, basis points



Source: World Bank, JPMorgan, Haver Analytics.

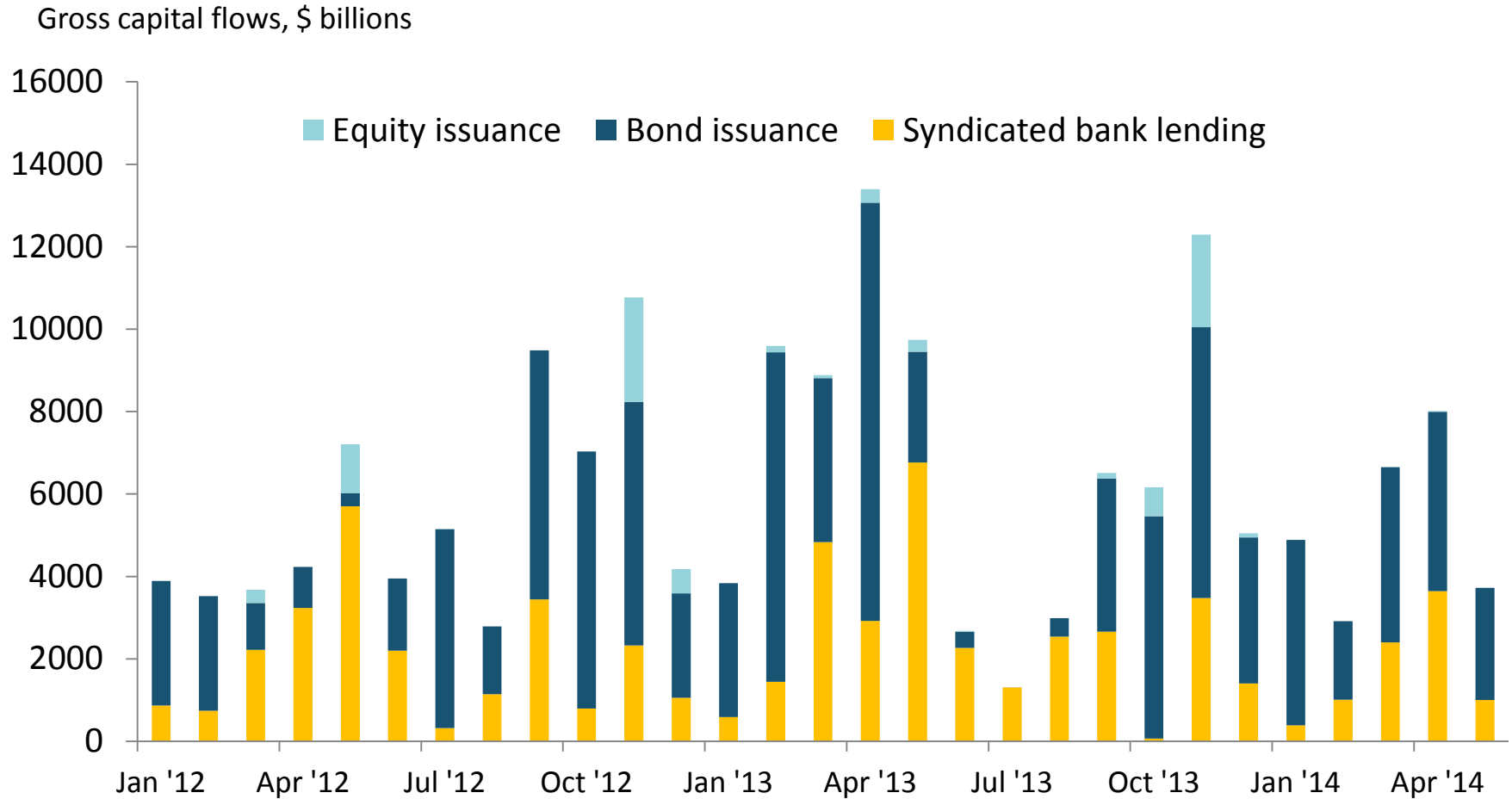
# Capital inflows declined abruptly in February, but recovered in March & April

Gross capital flows, billions USD



Source: World Bank, Dealogic.

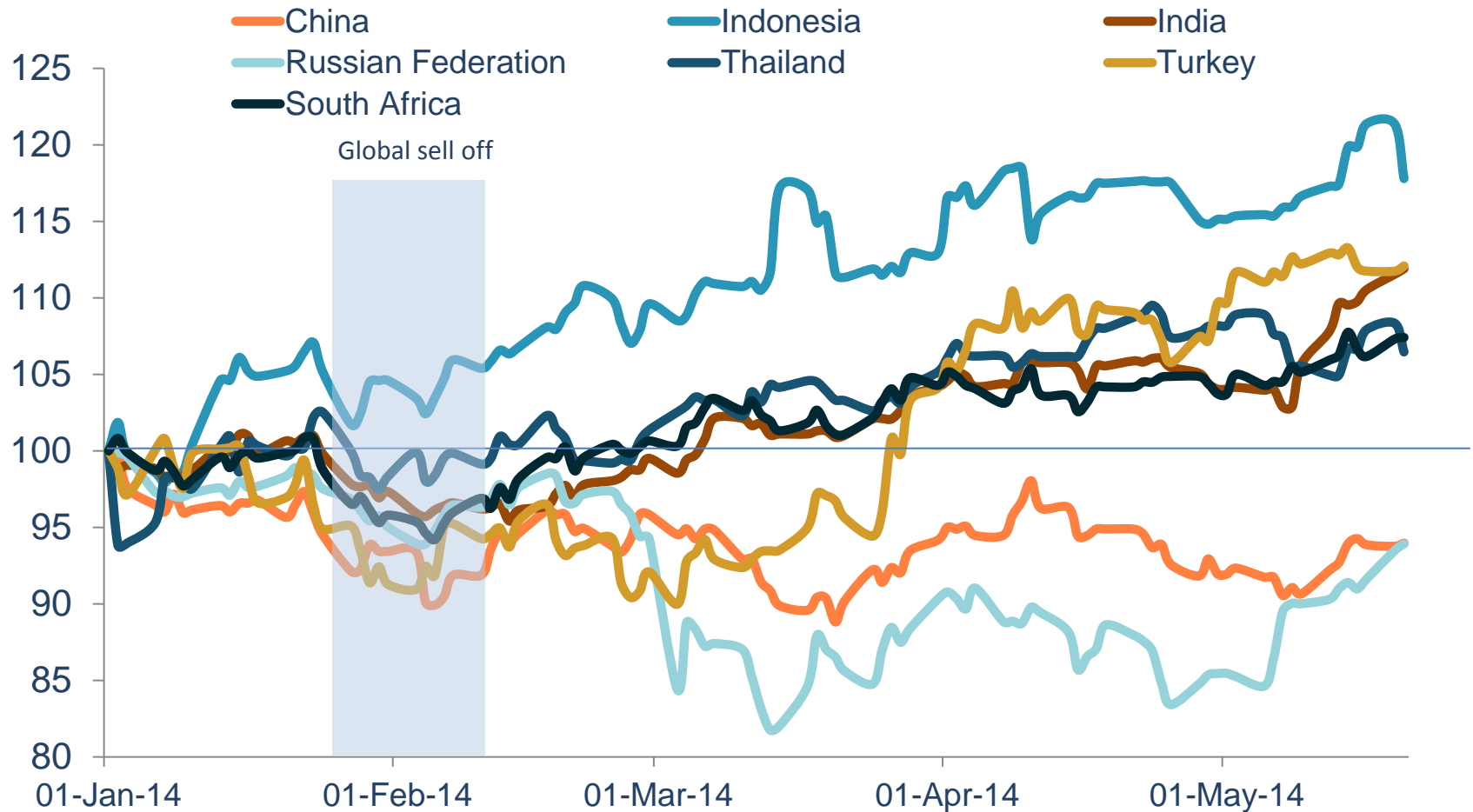
# Gross capital flows to Europe & Central Asia have also recovered



Source: World Bank and Dealogic

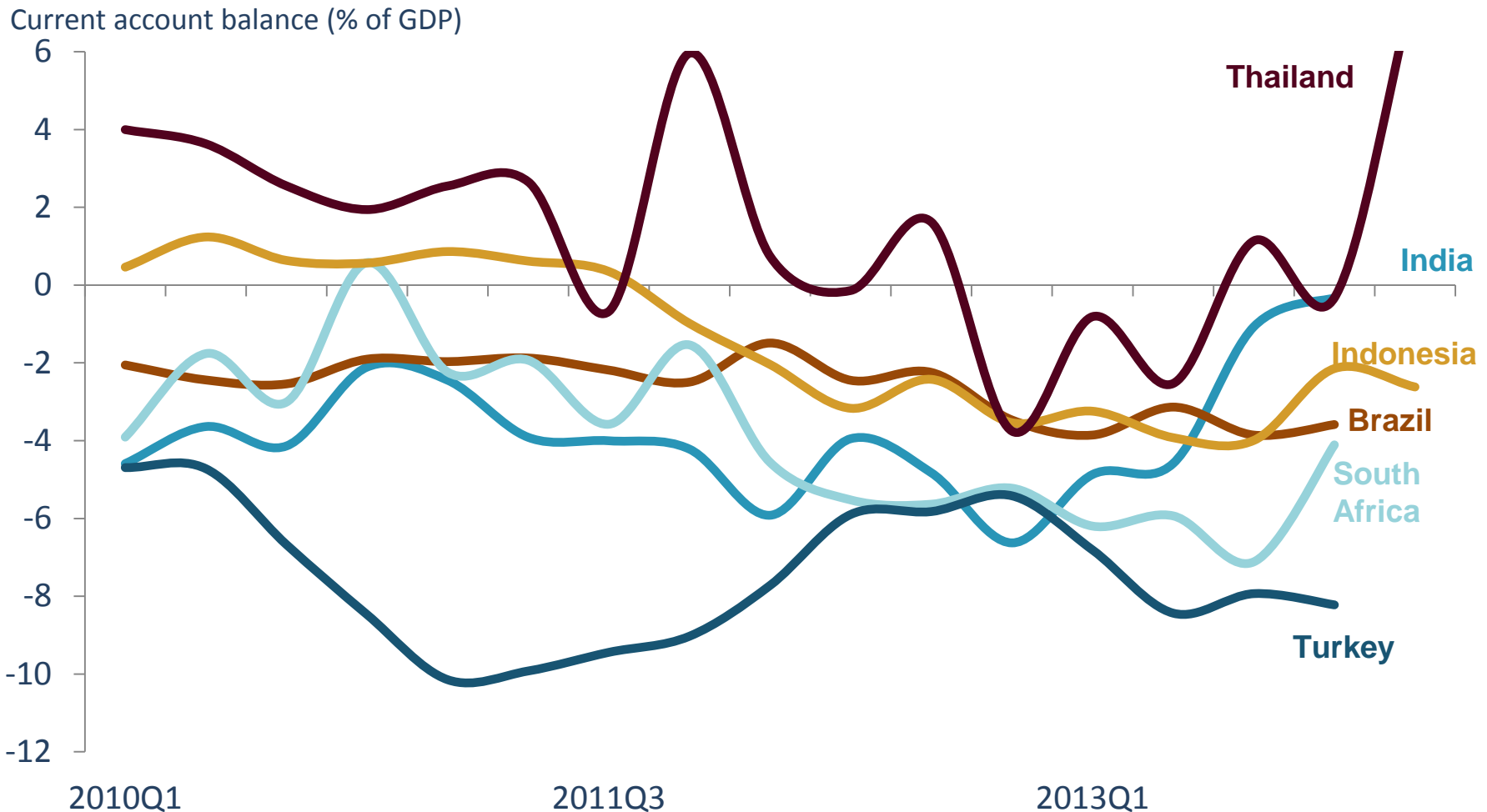
# Except China and Russia stock markets have recovered

Index, January 1 2014=100



Source: World Bank, Datastream.

# Current accounts deficits have narrowed in many of the countries hardest hit during the summer turmoil





# Outlook

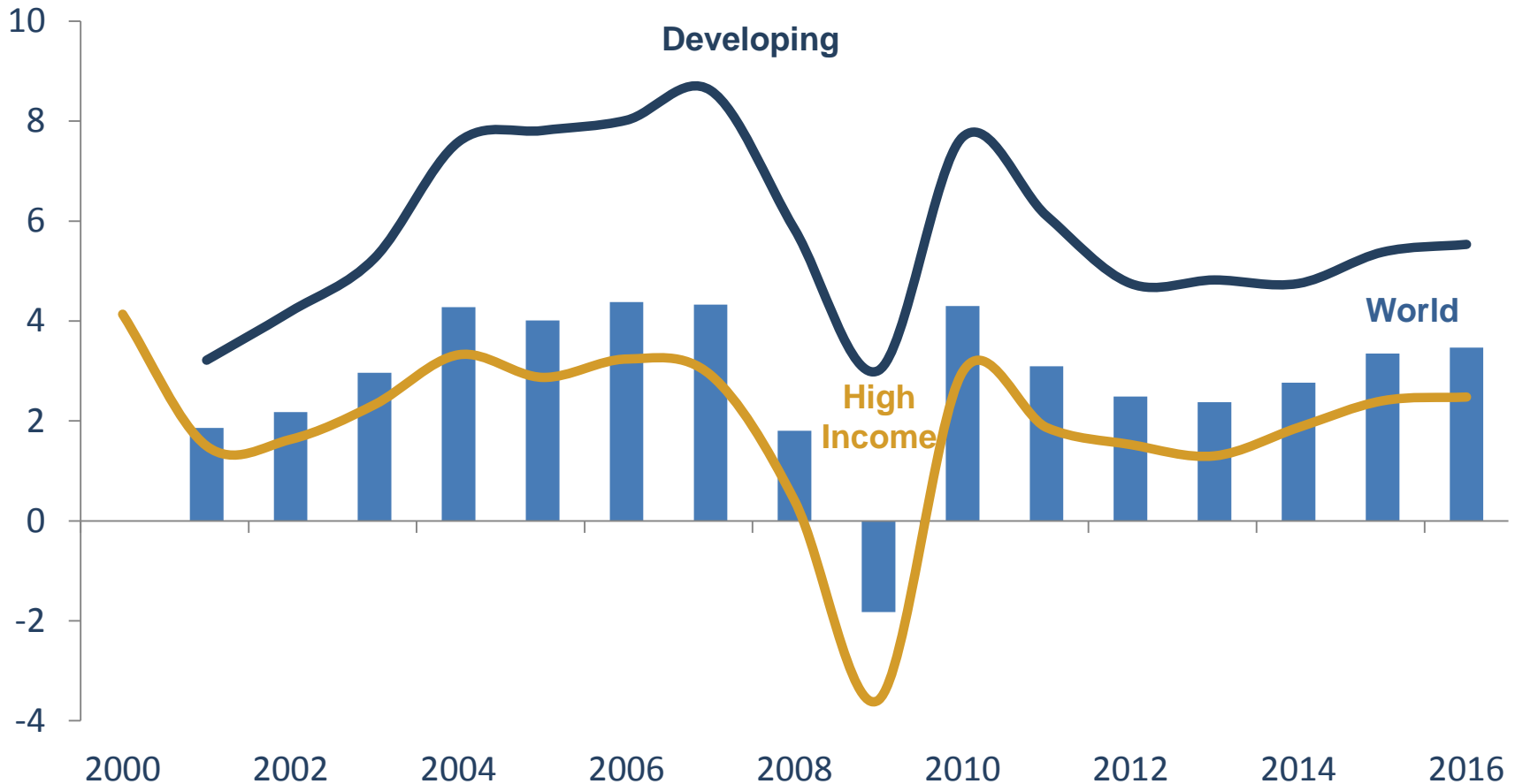


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- Projected pick up in growth to be led by high-income countries
- Developing-country growth in line with underlying potential
- Regional growth shows strengthening or stability going forward
- Slower growth in middle-income countries may reflect weaker than thought potential

# A gradual pick up in growth, led by high-income countries

Percent annual GDP growth



Source: World Bank.



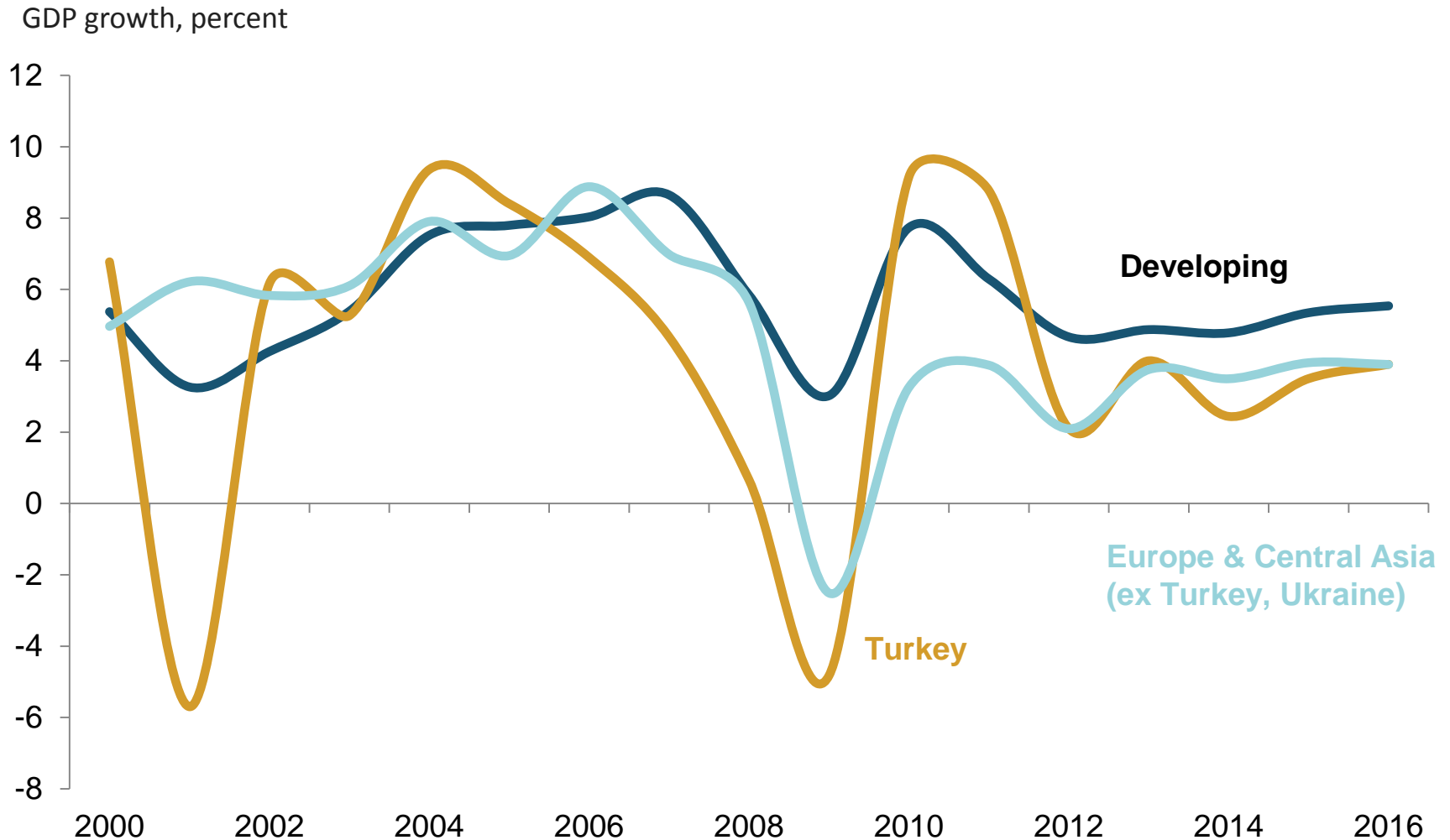
# Regional Outlook



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- Medium-term outlook for the region is for growth to remain flat in 2014 and pick up moderately in 2015 and 2015.
- Output in developing Europe & Central Asia, including in Turkey has strengthened along with Euro Area recovery
- Growth impact of eventual tightening of financial conditions has been postponed
- Weak investment in recent years has cut into potential output growth in Turkey

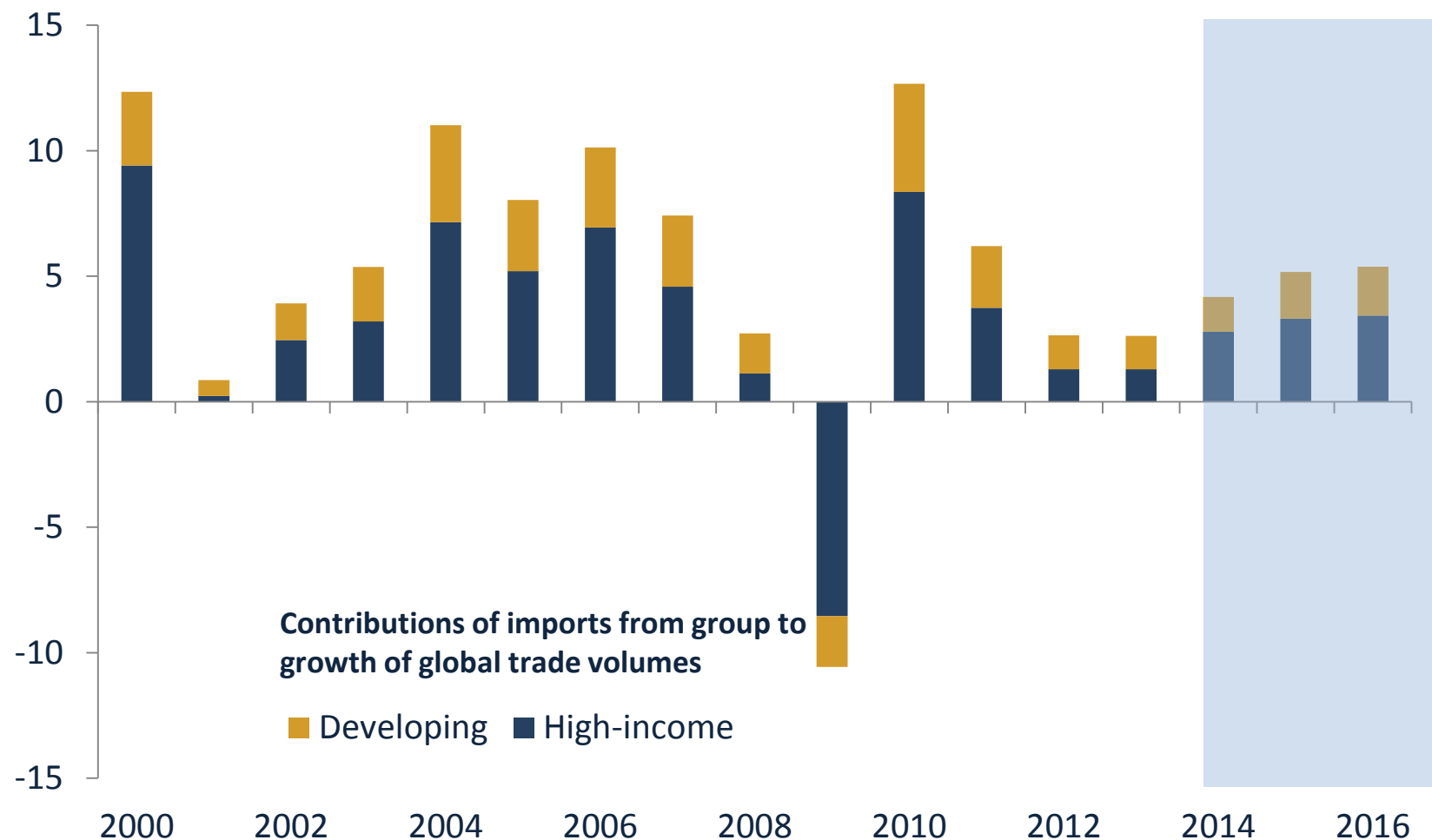
# Growth in Turkey to pick up, benefiting from high-income Europe recovery



Source: World Bank.

# Contribution of high-income countries to global trade growth will more than double

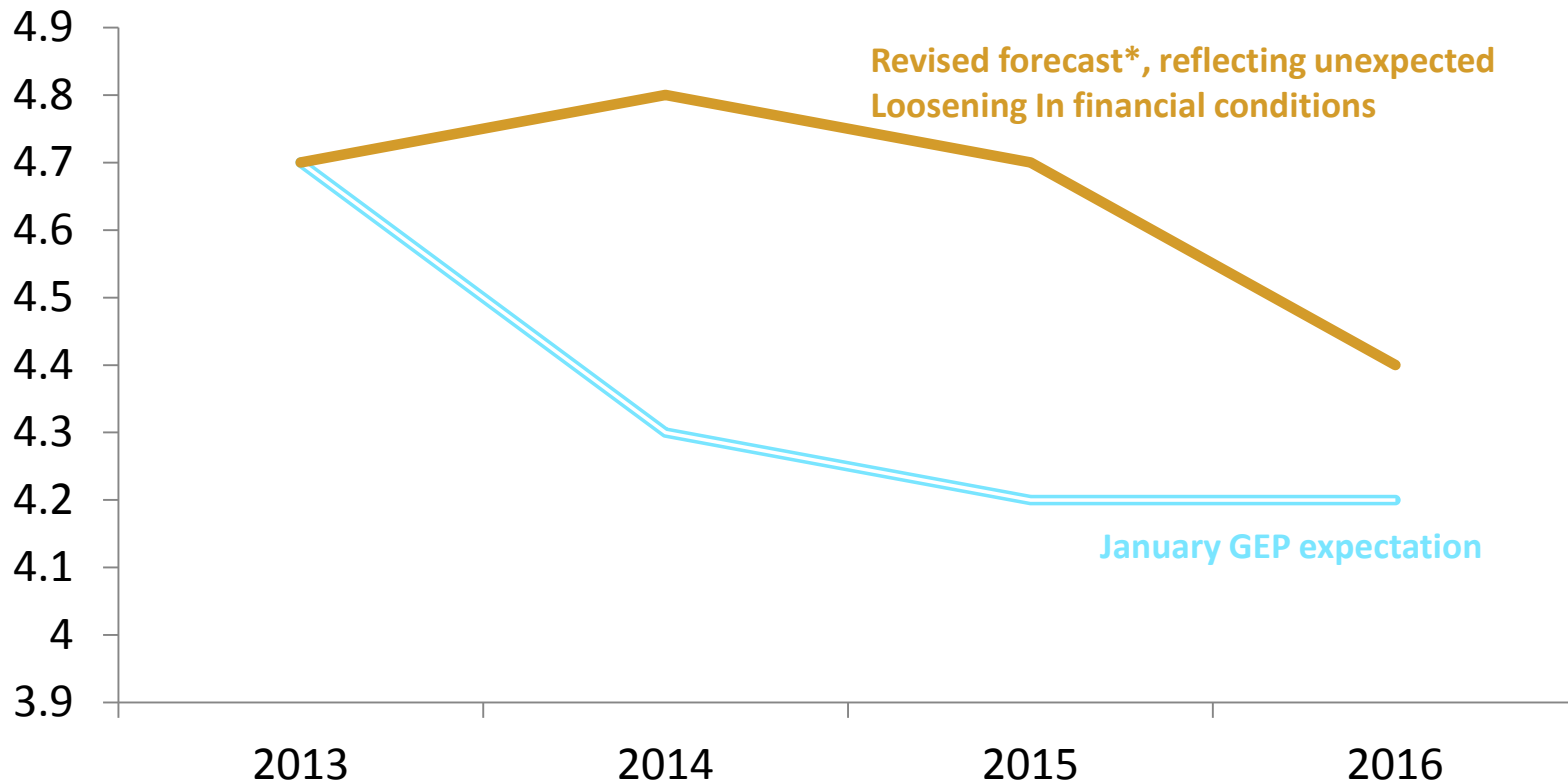
Contribution to annual growth of global trade



Source: World Bank.

# Unexpectedly loose conditions will delay compression in capital flows in smooth scenario

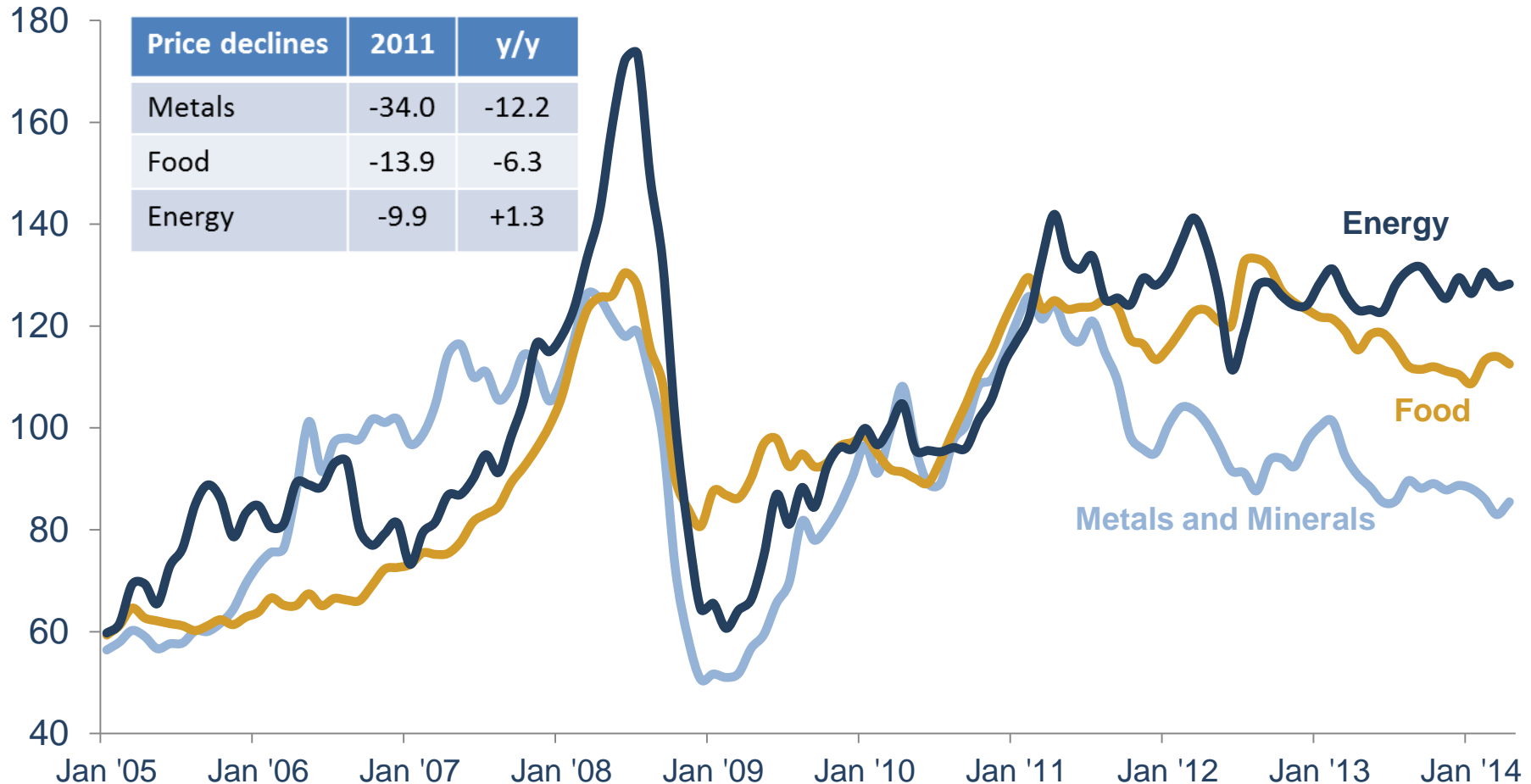
Capital inflows to developing countries, % of GDP



\* Both the January 2014 and revised capital flows projections are presented here on a basis consistent with the January 2014 methodology, versus the revised BMP6 methodology used in the June GEP. Flows on this measure are about 0.5 percent of GDP higher.

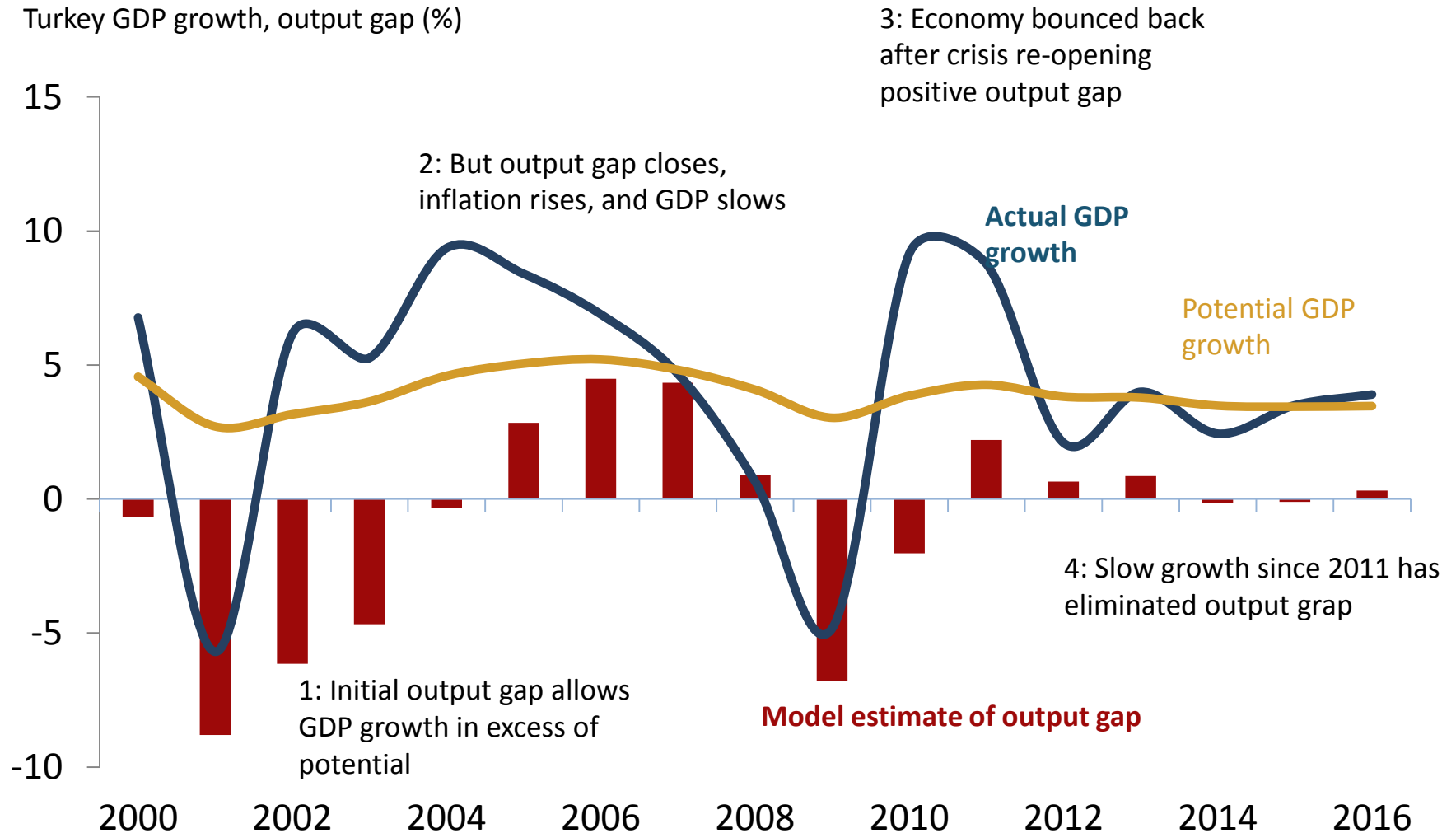
# Commodity prices are critical to region and expected to remain stable or decline

USD price of internationally traded commodities, index 2010=100



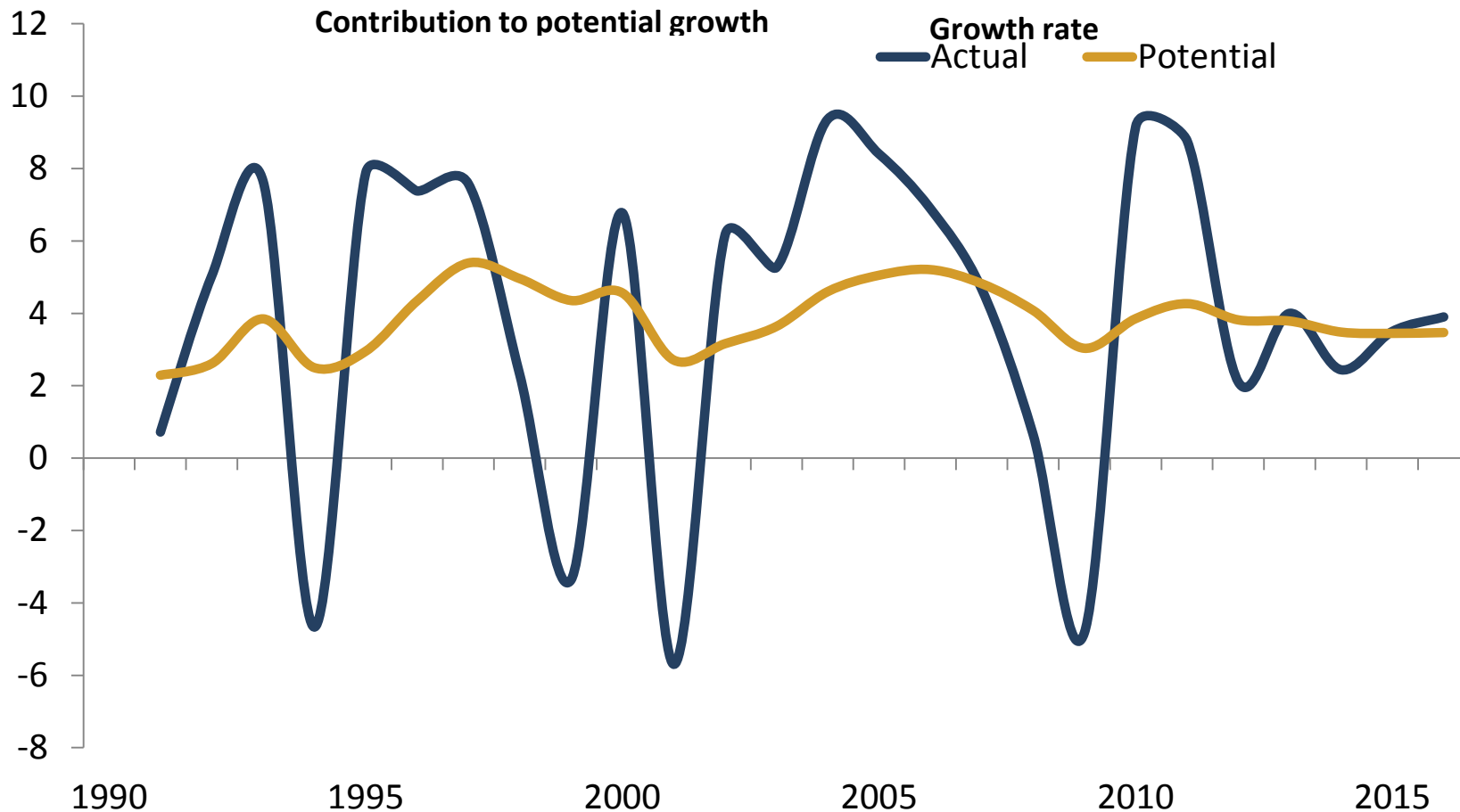
Source: World Bank.

# Structural policies will be key for sustaining stronger growth



# Decomposing potential output

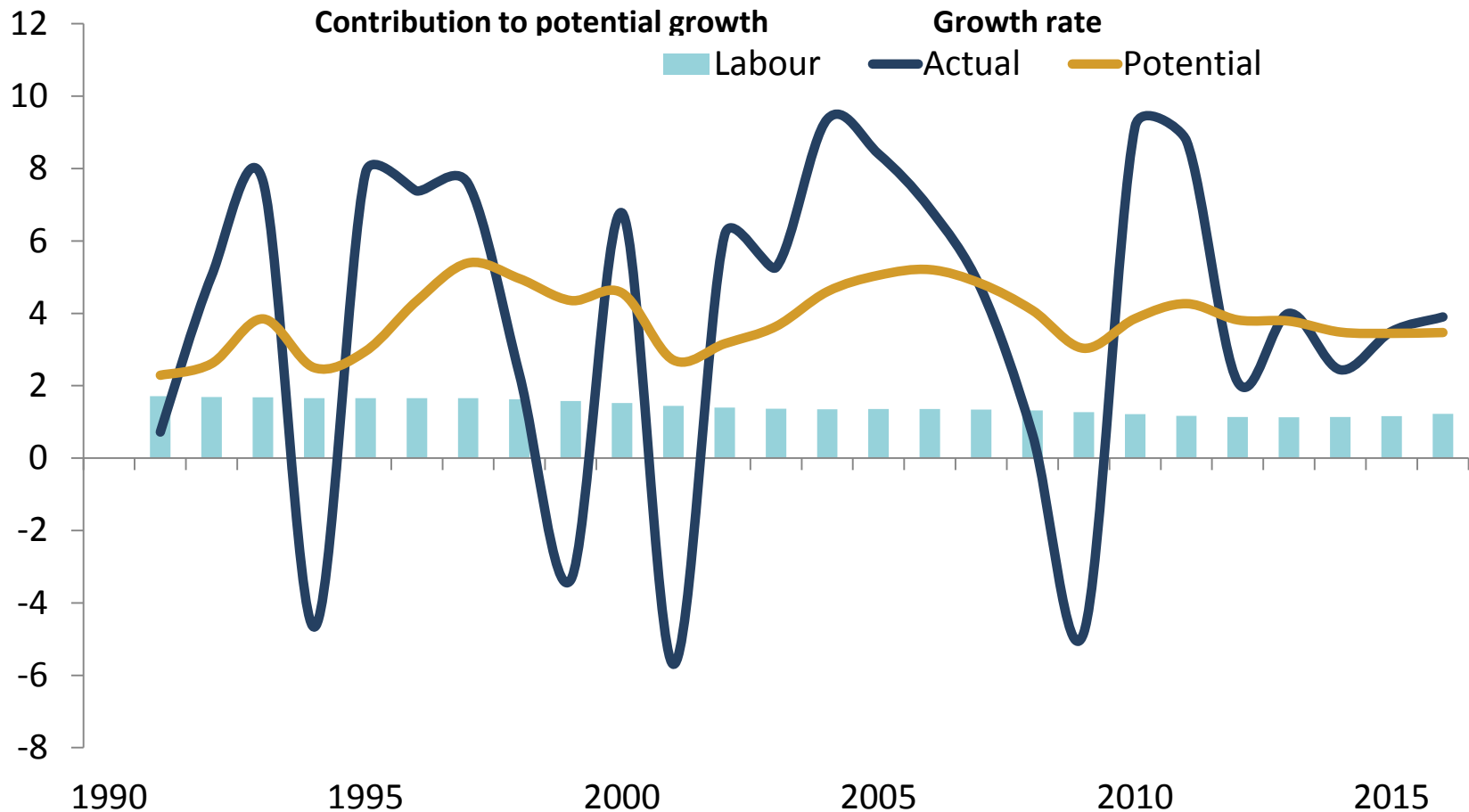
GDP and potential Growth, and contributions to potential, percent



Source: World Bank.

# Slower labor force growth has diminished its contribution to potential growth

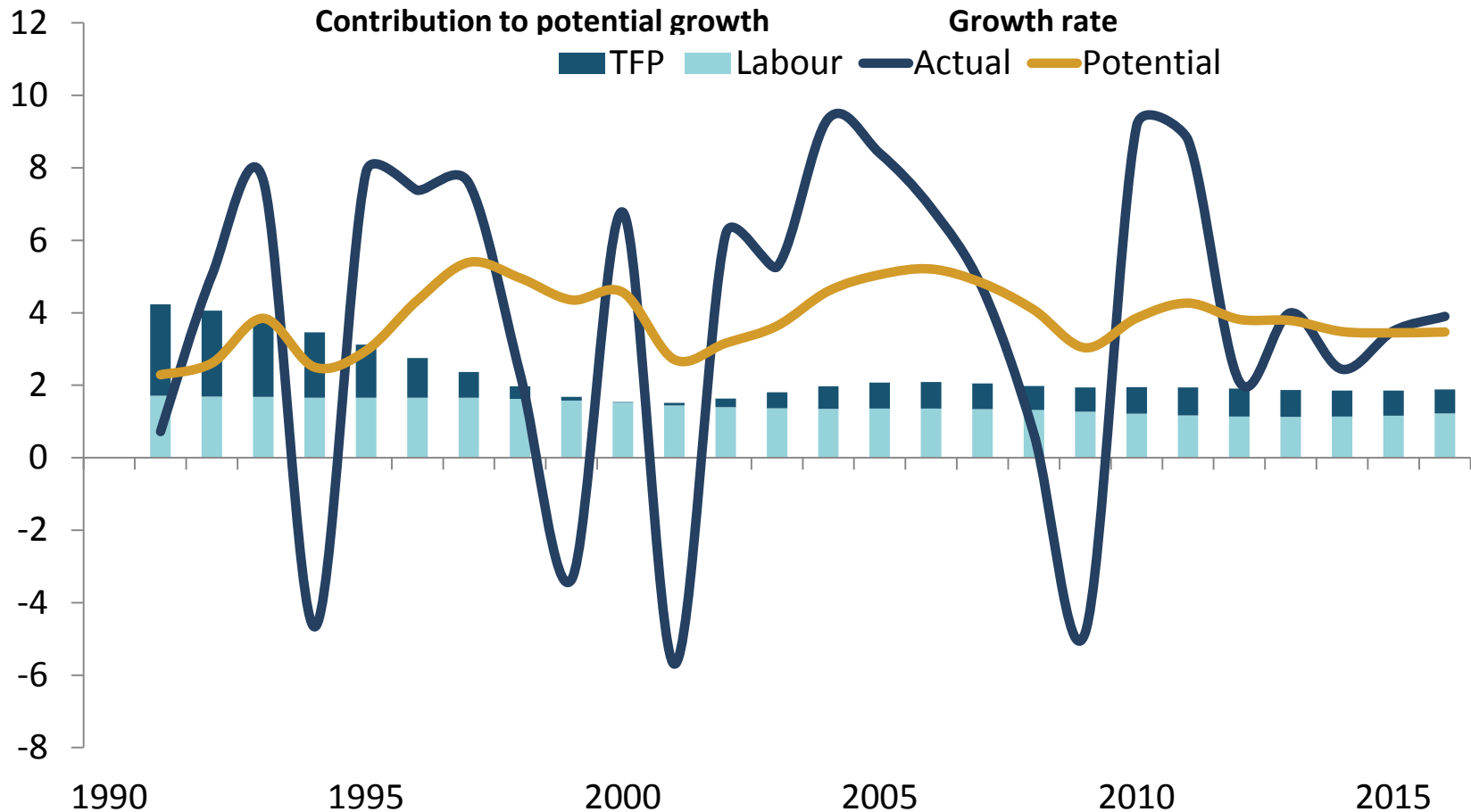
GDP and potential Growth, and contributions to potential, percent



Source: World Bank.

# Contribution of productivity growth broadly stable

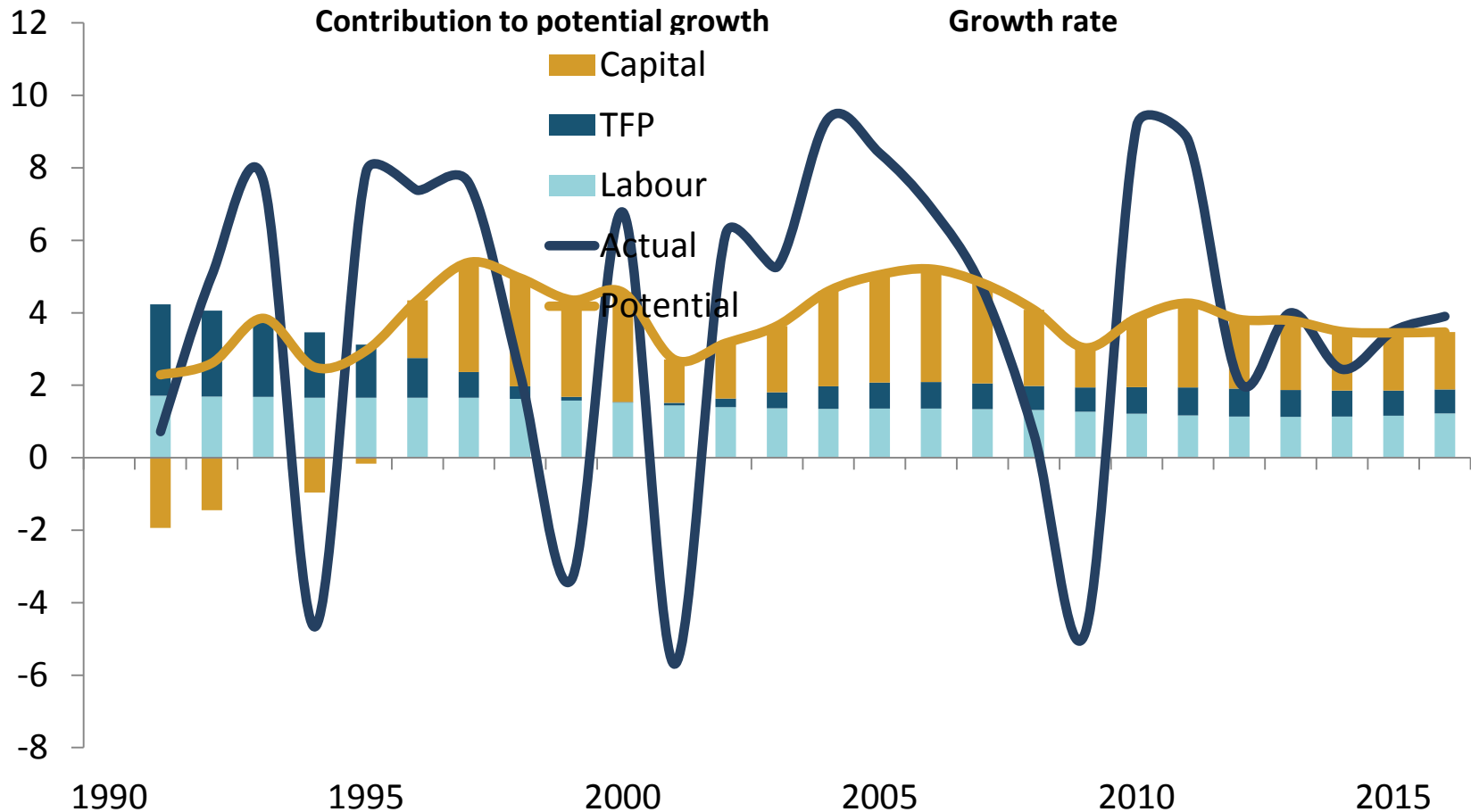
GDP and potential Growth, and contributions to potential, percent



Source: World Bank.

# Most of deceleration reflects weaker investment growth

GDP and potential Growth, and contributions to potential, percent

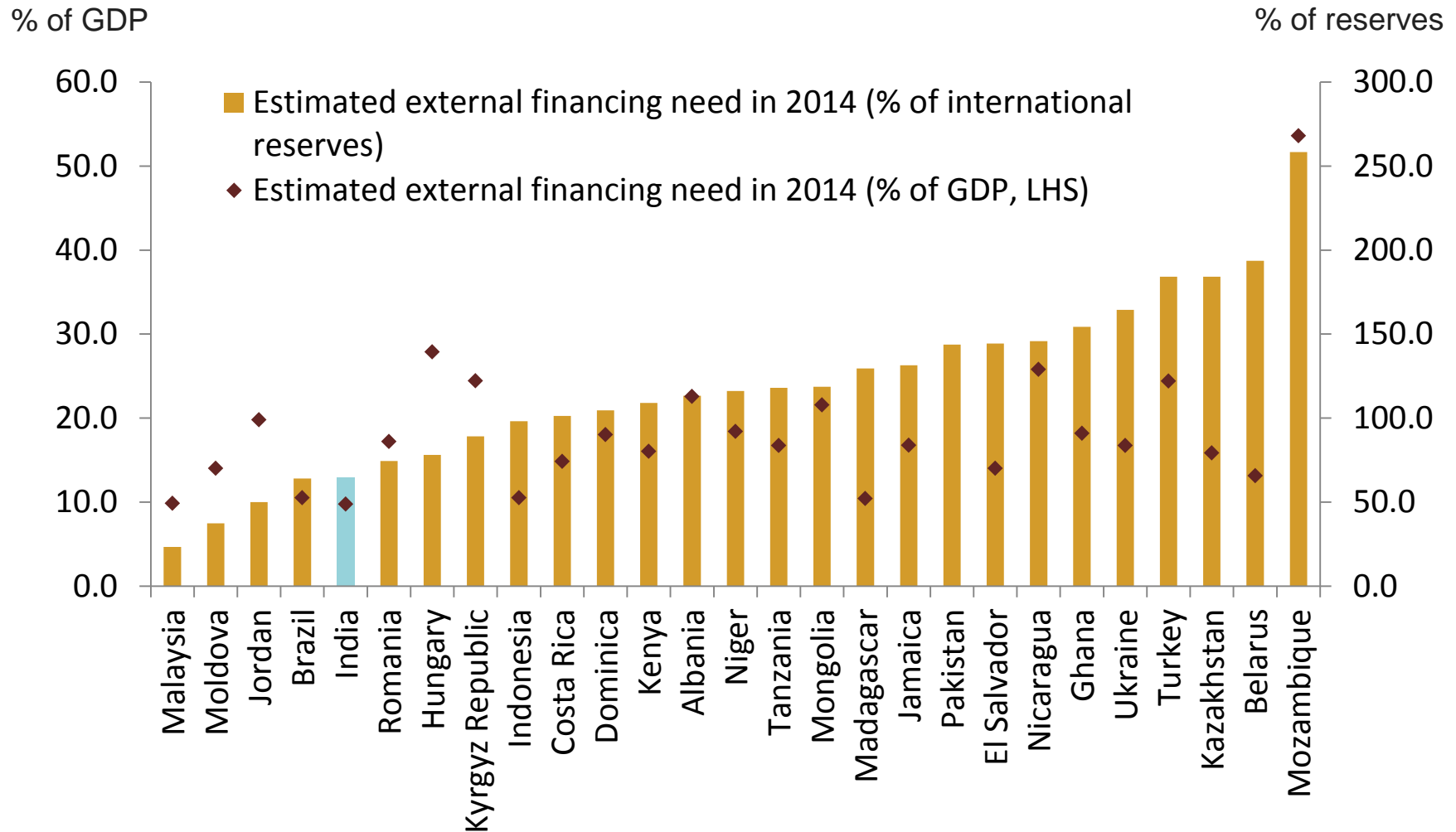


Source: World Bank.

# Risks

- **Looser financial conditions could regenerate vulnerabilities:** while the events of last summer and early 2014 have served to tighten developing country financial conditions and reduce vulnerabilities, capital flows have re-ignited and risk prices declined further creating the conditions under which vulnerabilities could build up once again.
- **Longer-term financial conditions will be tighter,** implying weaker financial flows, higher capital costs. Smooth adjustment should be manageable but an abrupt reaction to policy normalization could be destabilizing.
- **Developing countries remain vulnerable:** little progress has been made to strengthen developing-country buffers depleted in post-crisis period or push forward with structural reform
- **Situation in Ukraine** small impact in baseline, but potentially large consequences if global confidence is shaken

# Financial vulnerabilities have declined but remain

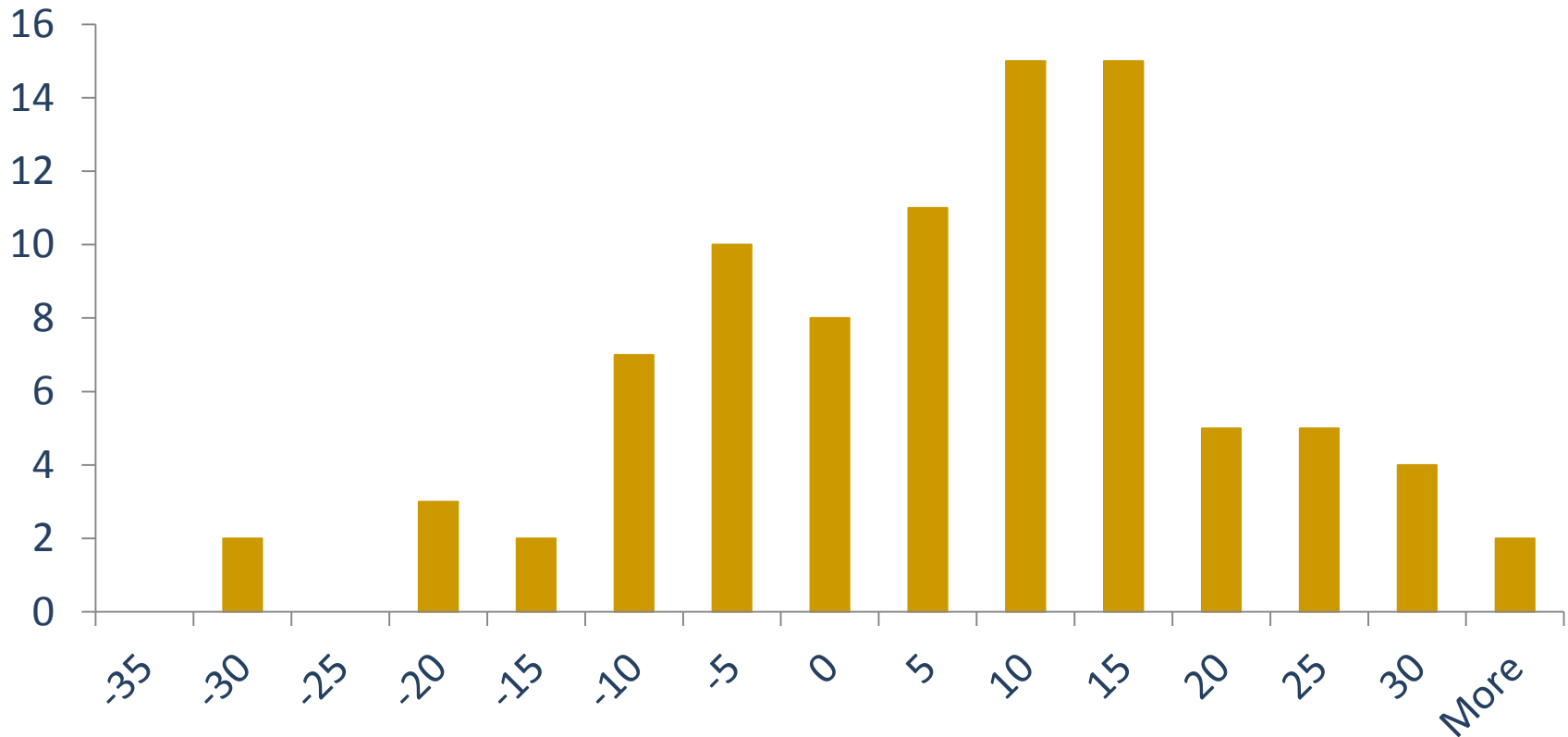


Source: World Bank

# Partly as a result, developing country debt to GDP ratios have been rising

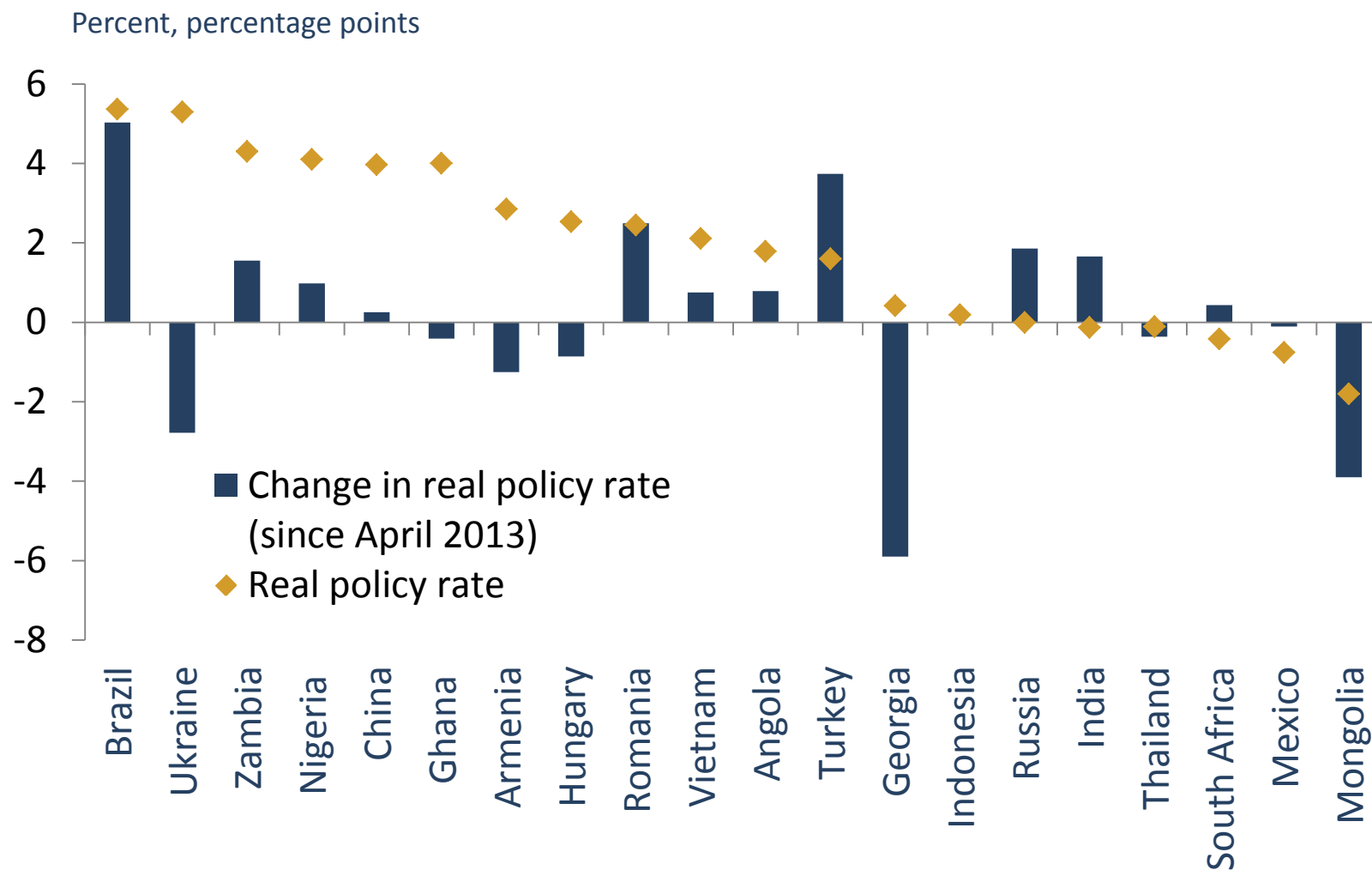
# of countries

Rising debt to GDP ratio



Source: World Bank.

# Despite recent rate hikes, real interest rates are low in many developing countries





# Concluding remarks

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- Downgrade in 2014 growth mainly explained by weak first quarter and situation in Ukraine
- Looser than expected financial conditions now could mean faster tightening in the future
- Developing country growth has disappointed for 3 years running – reinforcing the need to focus on structural policies to speed growth
- Vulnerabilities have declined but remain, macro cushions should be gradually rebuilt

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