Regional Economic Prospects

November 2019

Stalling engines of growth
Growth in the EBRD regions slowed to 2.1 per cent in the first half of 2019 relative to 2018.

This deceleration reflects continued weakness in Turkey, a slowdown in Russia and weaker export growth across the region, mirroring the global trade slowdown.

Average real GDP growth rates
(12-month rolling average, per cent)

Sources: CEIC, EBRD model forecasts and authors’ calculations.
Global growth slowed further, 2019 growth forecast to be slowest since 2009, according to IMF

Real GDP growth forecasts for 2019
(Per cent)

Sources: IMF and authors' calculations.
Notes: Dates refer to the releases of IMF forecasts for 2019.
Sharp slowdown in industrial production

Weaker industrial production in the EU, and Germany in particular, is weighing on central and south-eastern Europe.

Industrial production is also slowing in China, albeit more moderately, translating into lower global demand for commodities.
Drivers of the slowdown:
AUTOMOTIVE SECTOR
Contraction in the global automotive sector in 2018-19

Motor vehicle production
(1997=100)

- Production in selected economies in the EBRD regions
- Global production

Sources: CEIC, Eurostat, International Organization of Motor Vehicle Manufactures and authors' calculations.
Note: Projections for 2019 are based on partial data for January-September.
Falling production in China weighed on global car production…

…alongside new emission standards in the Eurozone and falling demand for diesel-powered vehicles.

Longer-term trends (less frequent replacement of higher-quality cars, shift away from ownership of manufactured goods, restrictions on emissions in Europe) also contributed.

Sources: IMF and authors' calculations. Notes: EBRD economies included in 'rest of the world' account for 5 per cent of global car production, with a growth contribution of around 0.1ppt in 2018.
Emerging Europe vulnerable to weakness in the automotive sector and further slowdown in Germany

Relative to its population, the Slovak Republic is the world’s largest car producer.

Other economies in central and south-eastern Europe, such as Hungary, Poland, Romania and Slovenia, are also highly dependent on the automotive industry.

Sources: CEIC, Eurostat, International Organization of Motor Vehicle Manufactures and authors’ calculations.
Employment in the automotive sector in Emerging Europe is high and has been growing rapidly.

Direct employment in car production (excluding suppliers) accounts for 3 to 5 per cent of employment in the Slovak Republic, Hungary, Slovenia and Romania – exceeding the share observed in Germany.

While overall manufacturing employment in the region has declined since 2010 or remained broadly flat, employment in the automotive sector has been growing rapidly.

Direct employment in the automotive industry, 2018
(Per cent of total employment)

Employment growth by sector, 2010-2018
(Per cent)

Sources: Eurostat and authors’ calculations.
Industry employment is high in the EBRD regions relative to other emerging markets.

Most countries in the EBRD regions have a higher share of manufacturing employment than other countries at similar levels of development.

Sources: World Bank and authors' calculations.
Industry employment in EBRD regions has, however, been declining—as in advanced economies.

This slowdown is in strong contrast with still-increasing industry employment in most emerging markets.

Most of the decline occurred in the 1990s and 2000s. More recently, employment by foreign-owned enterprises, and rapid employment growth in the automotive sector in particular, have leaned against the secular decline.

Sources: World Bank and authors’ calculations.
Foreign affiliates account for a quarter of production in manufacturing in the EBRD regions.

Foreign-owned multinationals dominate car manufacturing and to a lesser extent electronics.

Gross output share of foreign owned multinational enterprises, 2016
(Per cent of industry output)

Sources: OECD and authors’ calculations.
Note: Based on data for 15 EBRD countries (EU-12, Morocco, Russian Federation, Turkey).
Exports of Central European countries highly correlated with Germany

A further slowdown in the German car industry and potential near-term disruptions from imposition of tariffs on import of EU cars into the US thus constitute key risks to the outlook for central European economies.

GVC integration and export correlation with Germany, 2009-2019

Sources: ITC, OECD TiVa and authors’ calculations.
Drivers of the slowdown:

CHINA
Growth has also been slowing in China, is projected to slow further in a trade-conflict scenario.

Growth slowed from an average of 10.6 per cent in 2001-10 to 6.6 per cent in 2018.

Forecasts incorporating the latest global data in a principal-component-based framework also point to a weaker outlook in a trade-conflict scenario.

Sources: EBRD, IMF and authors’ calculations. Note: IMF forecasts from the October 2019 WEO, EBRD model-based forecasts.
This weighs on commodities and the outlook for commodity-exporting countries.

China is the main export destination for some Central Asian countries, primarily through commodity links.

Sources: ITC and authors’ calculations.
Russia and some Central Asian countries are vulnerable to a slowdown in China

For some countries (Kazakhstan, Russia, commodity exporters) export correlations (primarily through the exports of coal, copper, gas and oil) are as high as those between countries in central Europe and Germany.

Manufacturing value chain linkages account for high export correlations between China and Asian economies.

Export share and export correlation with China, 2009-2019

Sources: ITC and authors’ calculations.
Drivers of the slowdown:
LIMITS TO FURTHER TRADE INTEGRATION
Technological change has been weighing on FDI inflows, even before trade conflicts.

As automation reduced value of offshoring while wage differentials between economies narrowed, FDI and trade in intermediate goods have been falling as % of GDP since 2007-08.

Trends predated trade conflicts, but now in the spotlight, exacerbated by trade tensions.

Sources: IMF, UNCTAD and authors' calculations
Trade in intermediate goods also started declining as a share of GDP in emerging markets

In the EBRD regions it has also plateaued.

While a slight pickup has been observed recently on account of large exchange rate depreciations in Egypt and Turkey, in two thirds of the economies trade in intermediate goods is now below 2011 levels as a share of GDP.

Sources: IMF, WITS and authors’ calculations.
Notes: EBRD regions exclude Bulgaria due to data issues.
OTHER DEVELOPMENTS
The composition of growth shifted from investment (including FDI) towards consumption…

…relative to the boom years of the 2000s.

While in the 2000s the difference between high investment and moderate savings drove large current account deficits, external imbalances have recently been smaller.

**Savings, investment and FDI flows**  
(Per cent of GDP)

**New EU Member States**
- FDI, net
- Other capital flows, net
- Savings
- Investment

**Emerging Asia**

Sources: IMF World Economic Outlook and authors' calculations.
Consumption has been boosted by high wage growth in a context of tight labour markets.

Wage growth far exceeding labour productivity growth has not yet translated into significant inflationary pressures – possibly explained by a combination of well-anchored inflation expectations and high demand for real estate assets (house prices in the capitals have been rising particularly fast).

Growth in central Europe and the Baltic States thus exceeded expectations in the first half of 2019.

Sources: Eurostat, OECD and authors’ calculations.
Notes: Central Europe comprises Hungary, Poland, Slovak Republic and Slovenia.
Growth in 2019 as a whole is projected to moderate

Turkey entered a recession in the second half of 2018; output contracted by almost 2 per cent in H12019.

High-frequency indicators point to a slowdown in central Europe in the second half of 2019; car exports have started falling in Hungary and the Slovak Republic.

Sources: IMF World Economic Outlook, EBRD forecasts and authors’ calculations.
However, risks remain: escalation of trade tensions, rising uncertainty, slowdowns in eurozone and China.

Effects of Brexit on the EBRD regions as discussed in previous REPs (e.g. November 2018, Box 1).

The cost of Brexit (comparing the UK’s performance to comparator economies before and after the referendum) is estimated at around 1ppt a year.

**Per capita GDP growth in the United Kingdom and comparator economies**

(Per cent)

Sources: IMF World Economic Outlook and authors' calculations.
Country developments
Growth in 2019 as a whole is projected to moderate

Average real GDP growth rates (per cent)

EBRD Total  Central Europe  SE Europe  Turkey  Eastern Europe  Russia  Central Asia  SE Med

Sources: IMF World Economic Outlook, EBRD forecasts and authors' calculations.
Western Balkans
Growth to slow with Eurozone deceleration

Growth of the region is to decelerate to 3.0 - 3.5 per cent in 2019-2020, from 4.0 per cent in 2018.

FDI remains strong compared to new EU member states.

Real GDP growth of the Western Balkans
(per cent)

Net FDI
(per cent of GDP)

Sources: National authorities, Eurostat, EBRD forecasts and authors' calculations.
Structural reforms needed to boost the growth potential

Region’s growth stabilises at 3.0 per cent.

Though, with variations across the region.

Sources: National statistical authorities, IMF WEO and authors’ calculations.
Russia

Pickup to be driven by more neutral fiscal stance


Sources: Central Bank of the Russian Federation, Federal Statistics Service and authors’ calculations.
Central Asia: Uzbekistan's reforms lay the foundations for rapid expansion of fixed investment and future growth

Fixed investment, % GDP

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<td>% GDP</td>
<td>23.9</td>
<td>24.6</td>
<td>25</td>
<td>24.6</td>
<td>24.7</td>
<td>27.4</td>
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Balance of payments, US$ million

- Other investment (incl. net foreign loans)
- Net FDI
- Current account

Source: National authorities.
Turkey
Macroeconomic stabilization but fragilities remain

A significant improvement in the current account, policy rate hikes and a supportive global environment saw the lira stabilize and inflation fall. However, the economy’s dependence on foreign capital, coupled with low reserves, means this stability is fragile.

Sources: Turkstat, BRSA and authors’ calculations.
The rising tourism tide do not lift all boats

Sources: National statistical authorities, IMF WEO and authors’ calculations
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