

European Department

Central, Eastern and Southeastern Europe (CESEE)

# Recovery at risk? - CEE external vulnerability and Poland Article IV preliminary conclusions



CASE, Warsaw - May 27, 2014

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IMF Regional Office for Central and Eastern Europe

# Outline



Outlook for the region

External funding patterns and risks

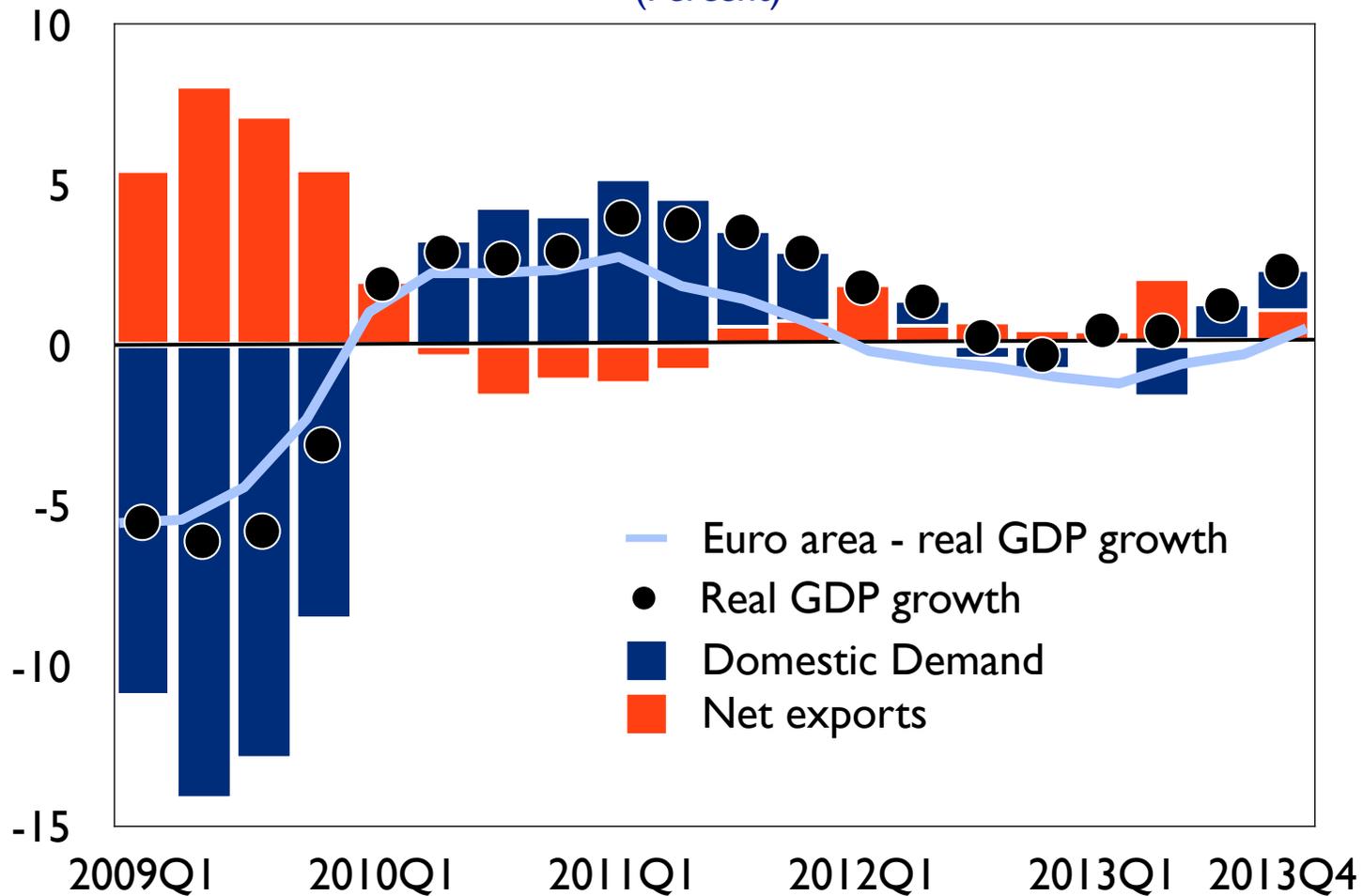
Policy priorities

Poland Article IV

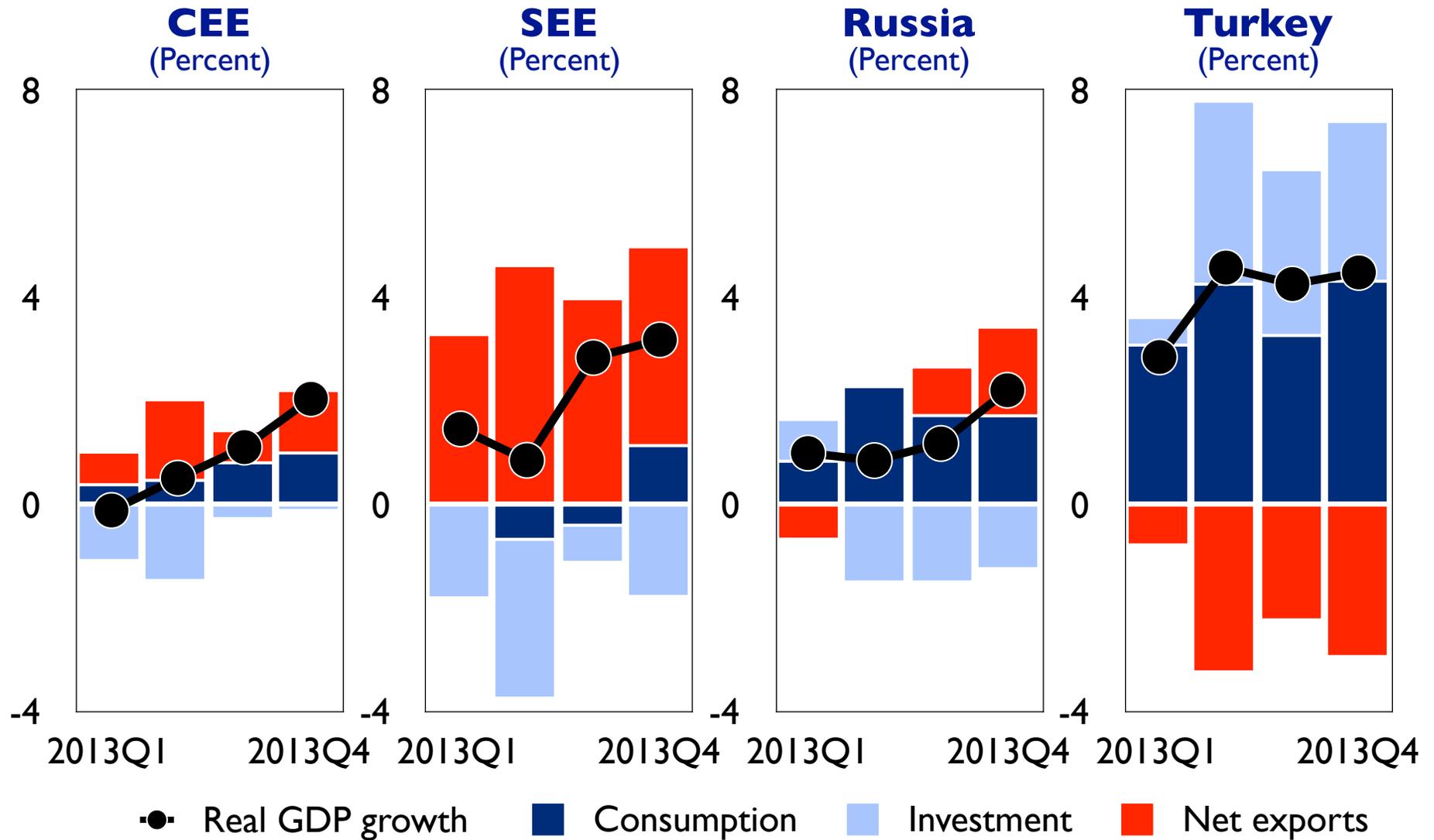
# Growth picked up in 2013H2...



## CESEE excl. RUS & TUR: Contributions to Real GDP Growth (Percent)



# Drivers of growth different across region...

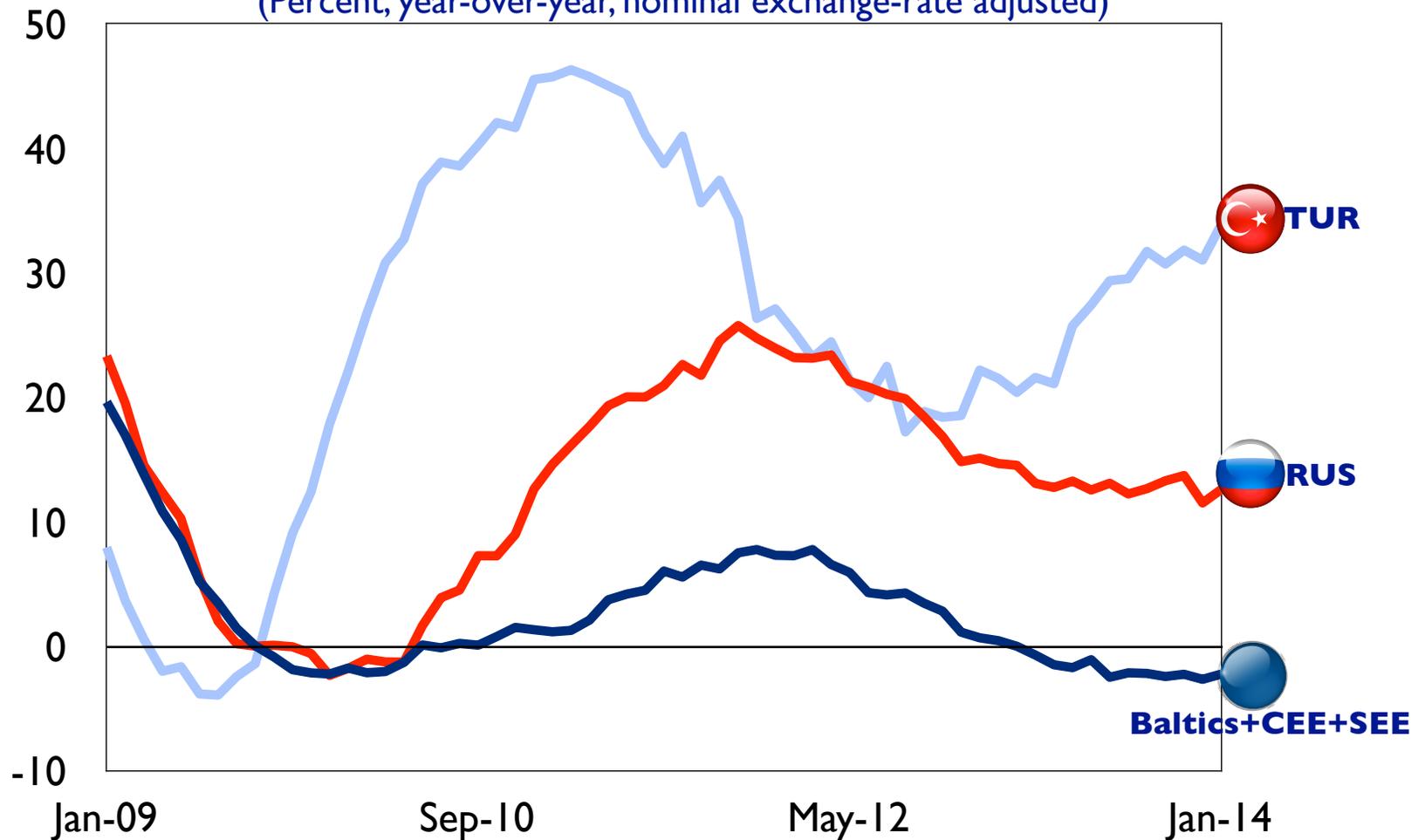


... but recovery is mostly “creditless” ...



## Credit to Nonfinancial Corporations

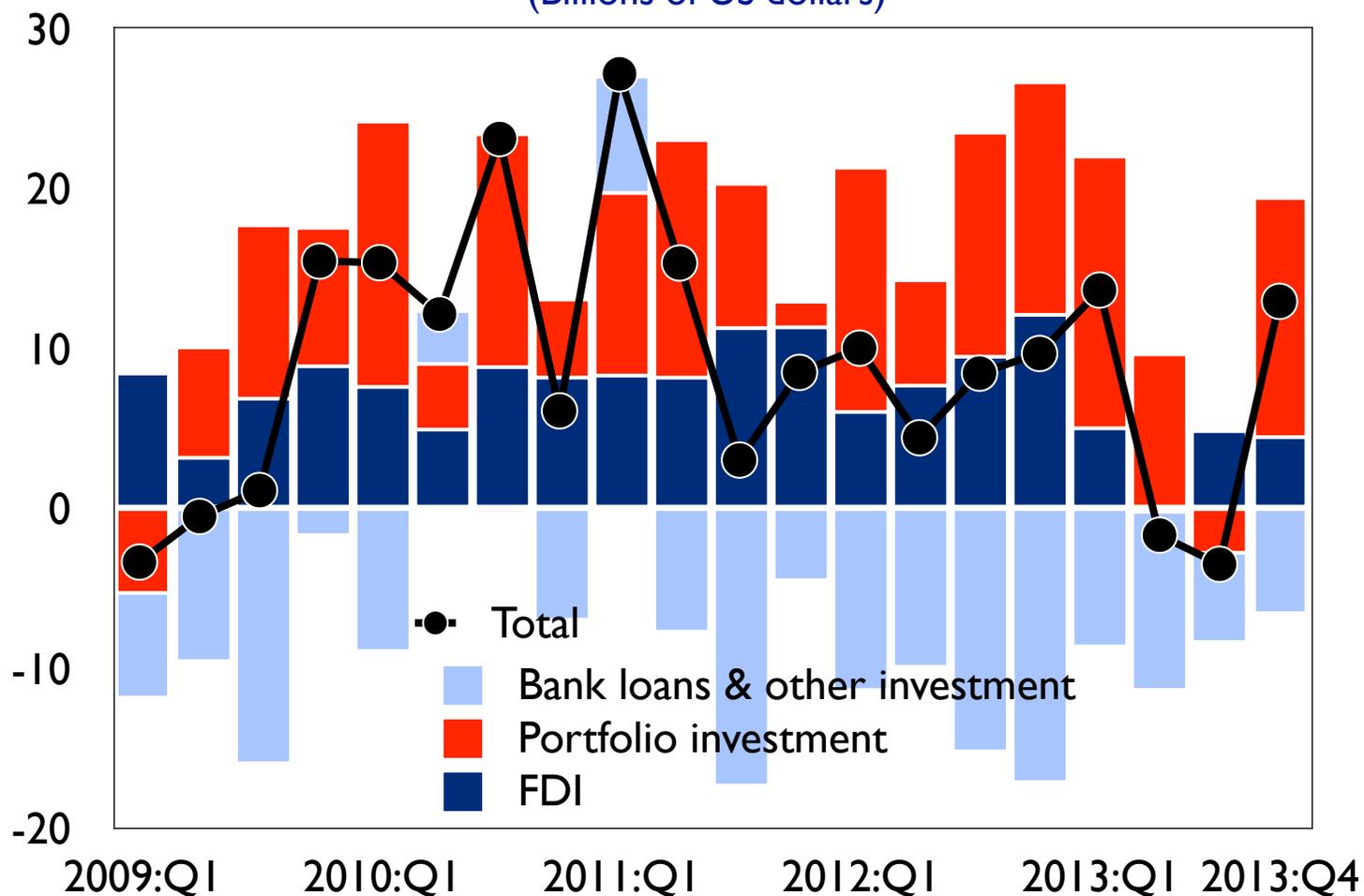
(Percent, year-over-year, nominal exchange-rate adjusted)



... while external funding flows became more volatile post-taper talk



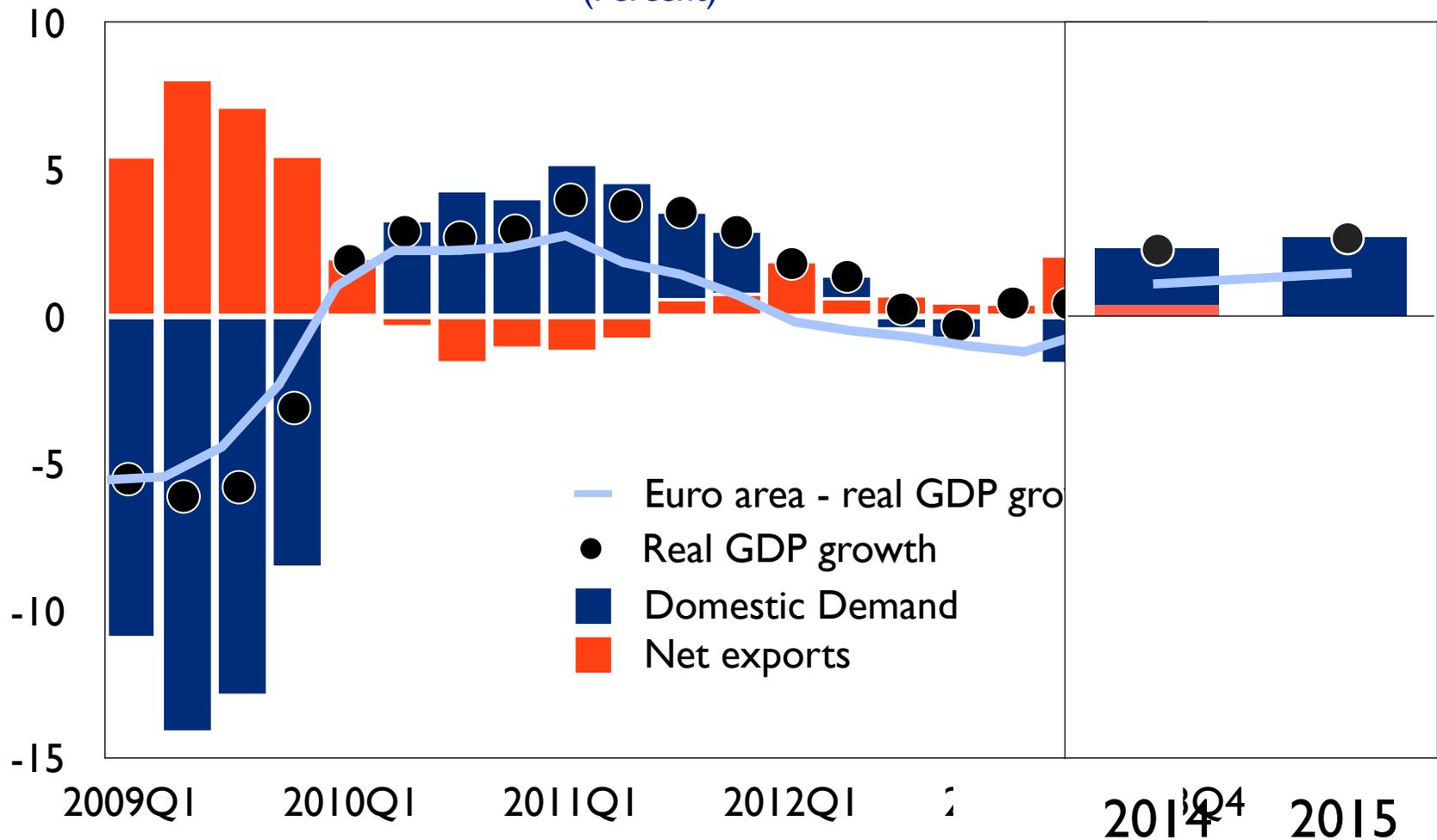
### CESEE excl. RUS & TUR: Capital Flows (Billions of US dollars)



# Growth is expected to accelerate...



## CESEE excl. RUS & TUR: Contributions to Real GDP Growth (Percent)



...but projections have been revised downwards.



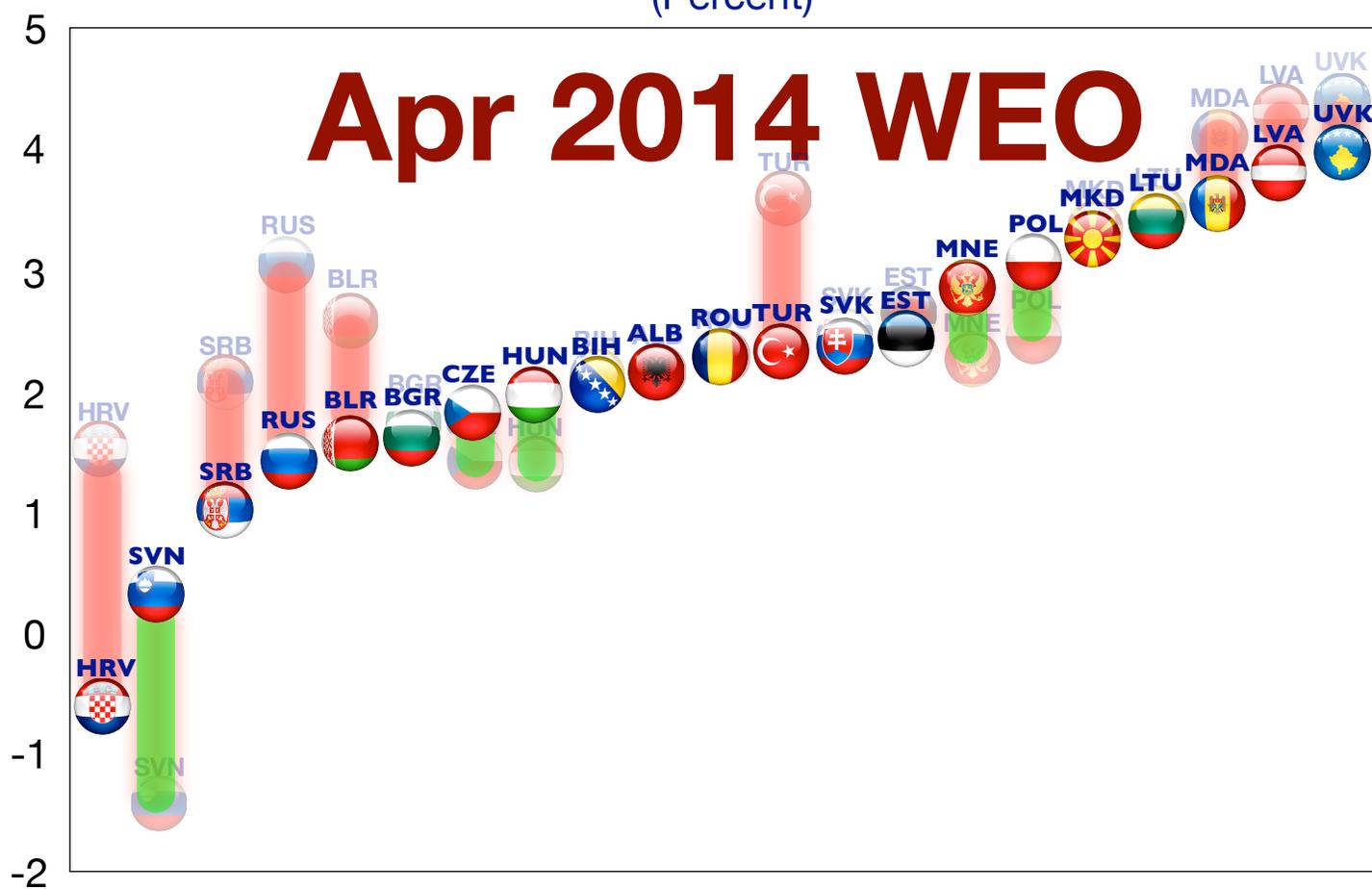
Real GDP Growth, 2014  
(Percent)



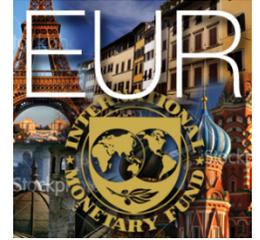
...but projections have been revised downwards.



Real GDP Growth, 2014  
(Percent)



# Key Risks



Protracted weak growth in euro area

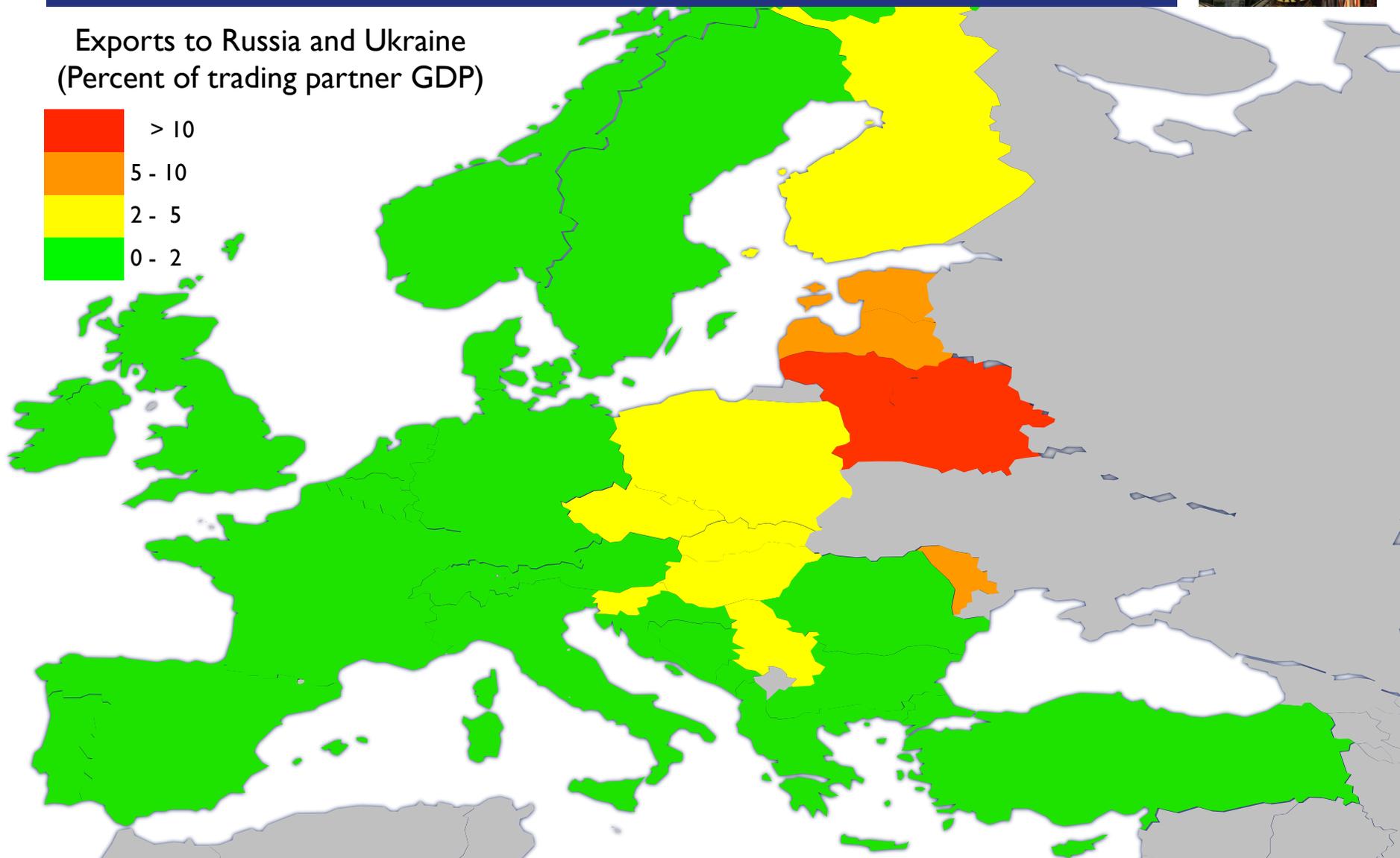
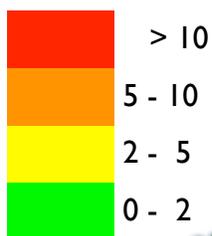
Increasing geopolitical tensions

Global financial market volatility

# Risks from geopolitical tensions: trade linkages with Russia and Ukraine



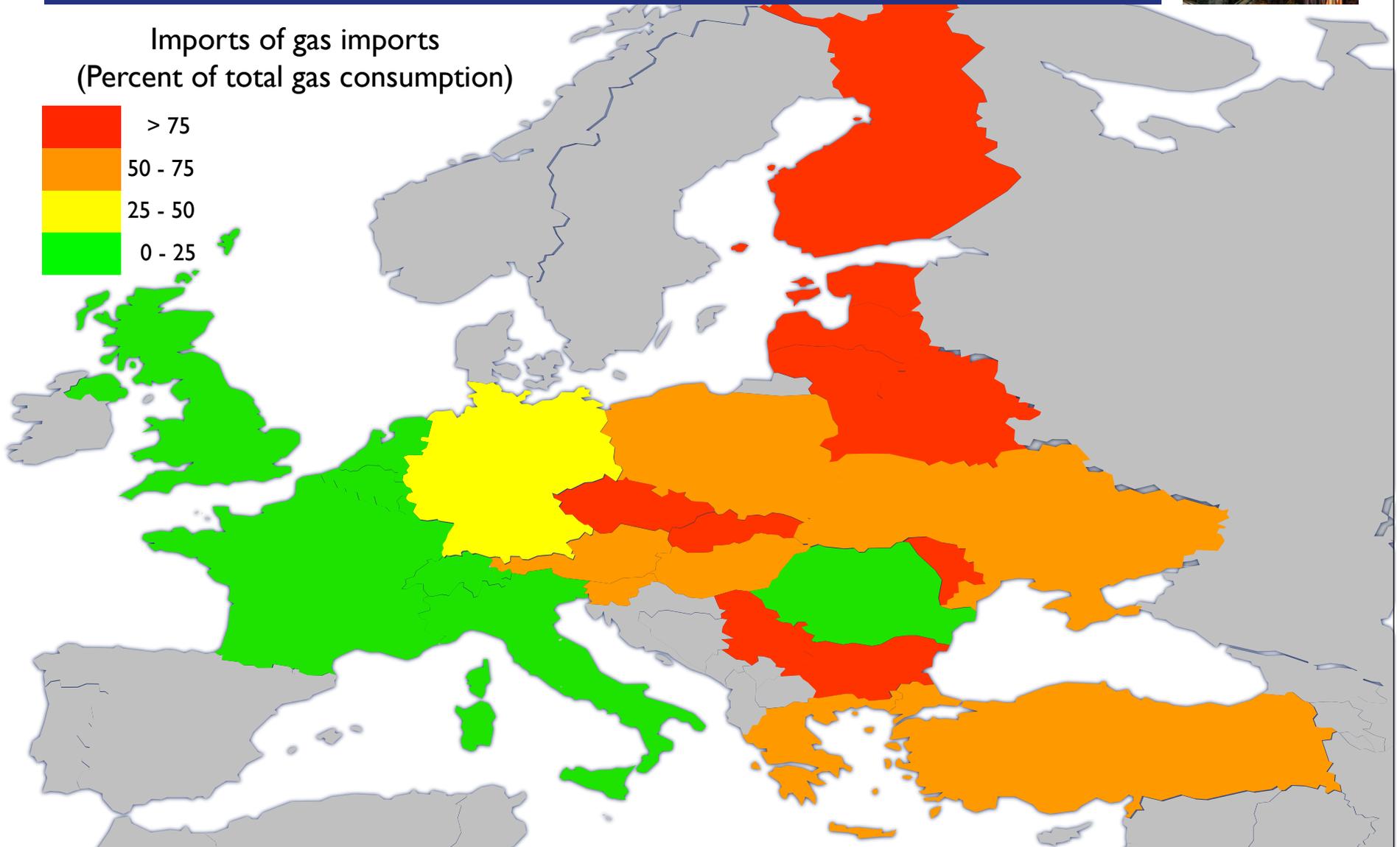
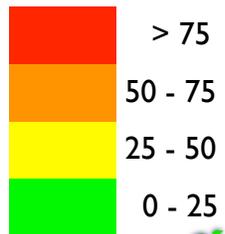
Exports to Russia and Ukraine  
(Percent of trading partner GDP)



# Risks from geopolitical tensions: Dependence on Russian gas



Imports of gas imports  
(Percent of total gas consumption)



# CESEE External Funding Patterns and Risks



1 External Funding Structures

2 External Funding Conditions

# CESEE External Funding Patterns and Risks



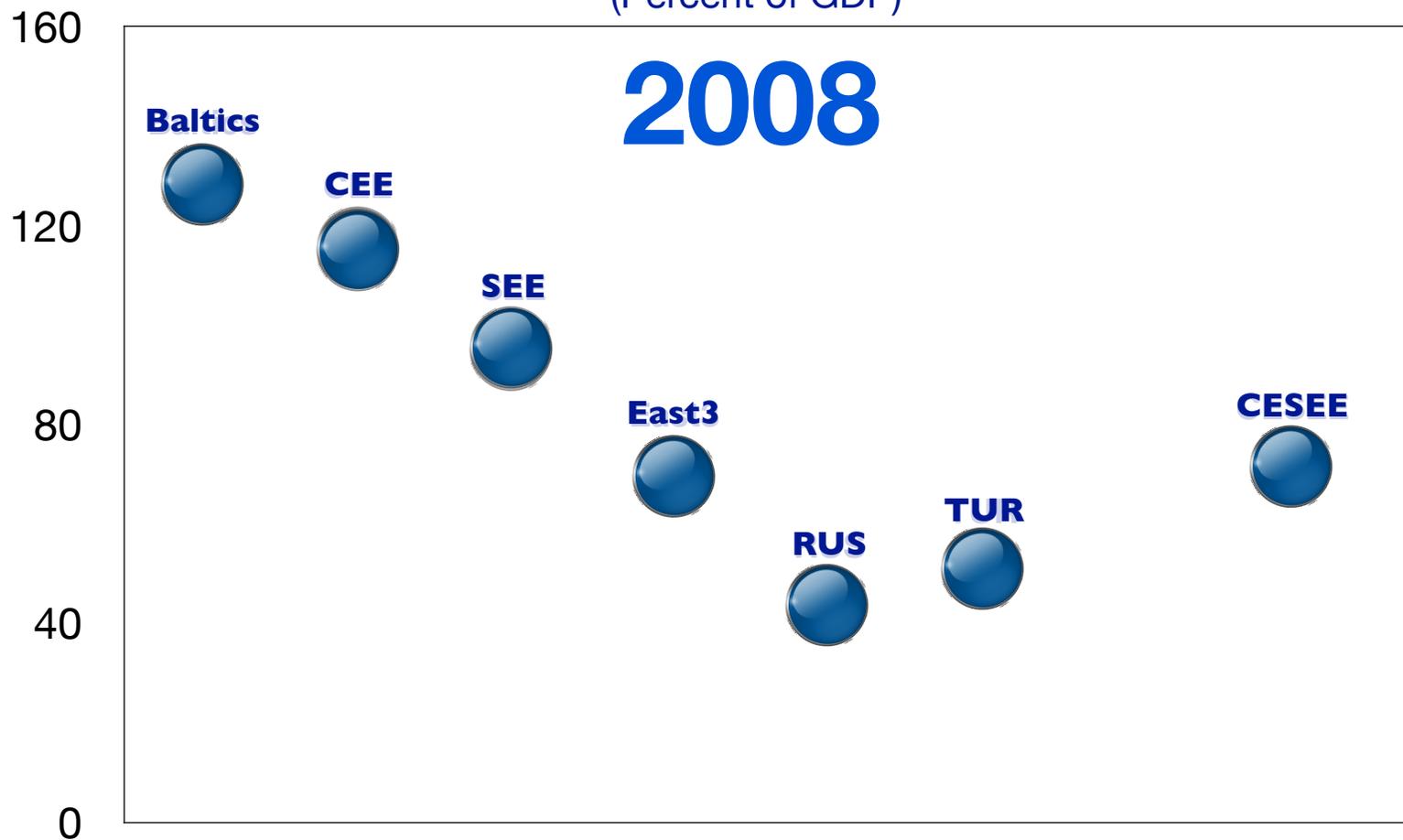
1 External Funding Structures

2 External Funding Conditions

# High dependence on external funding



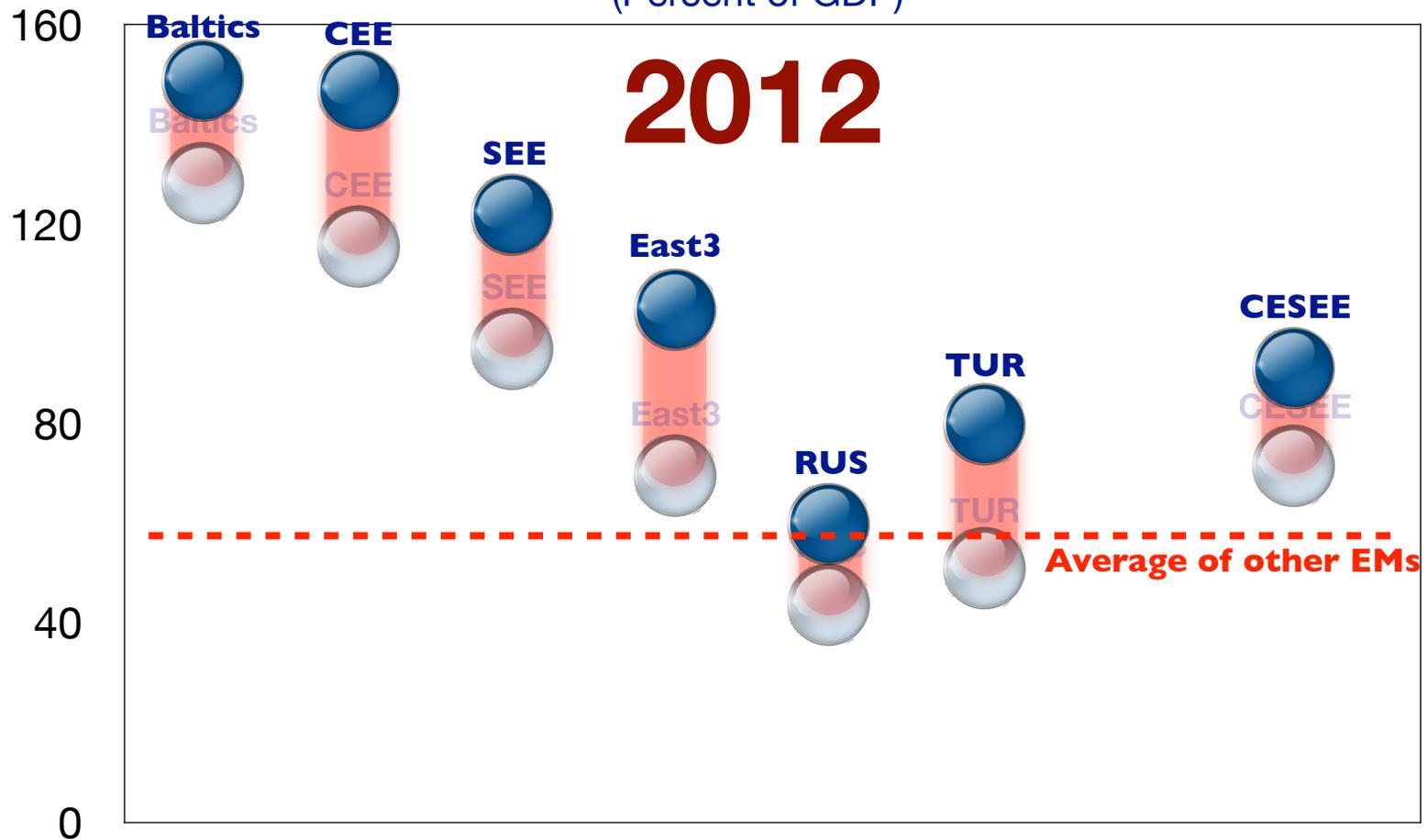
## Gross External Liabilities (Percent of GDP)



# High dependence on external funding



## Gross External Liabilities (Percent of GDP)



# Significant share is FDIs



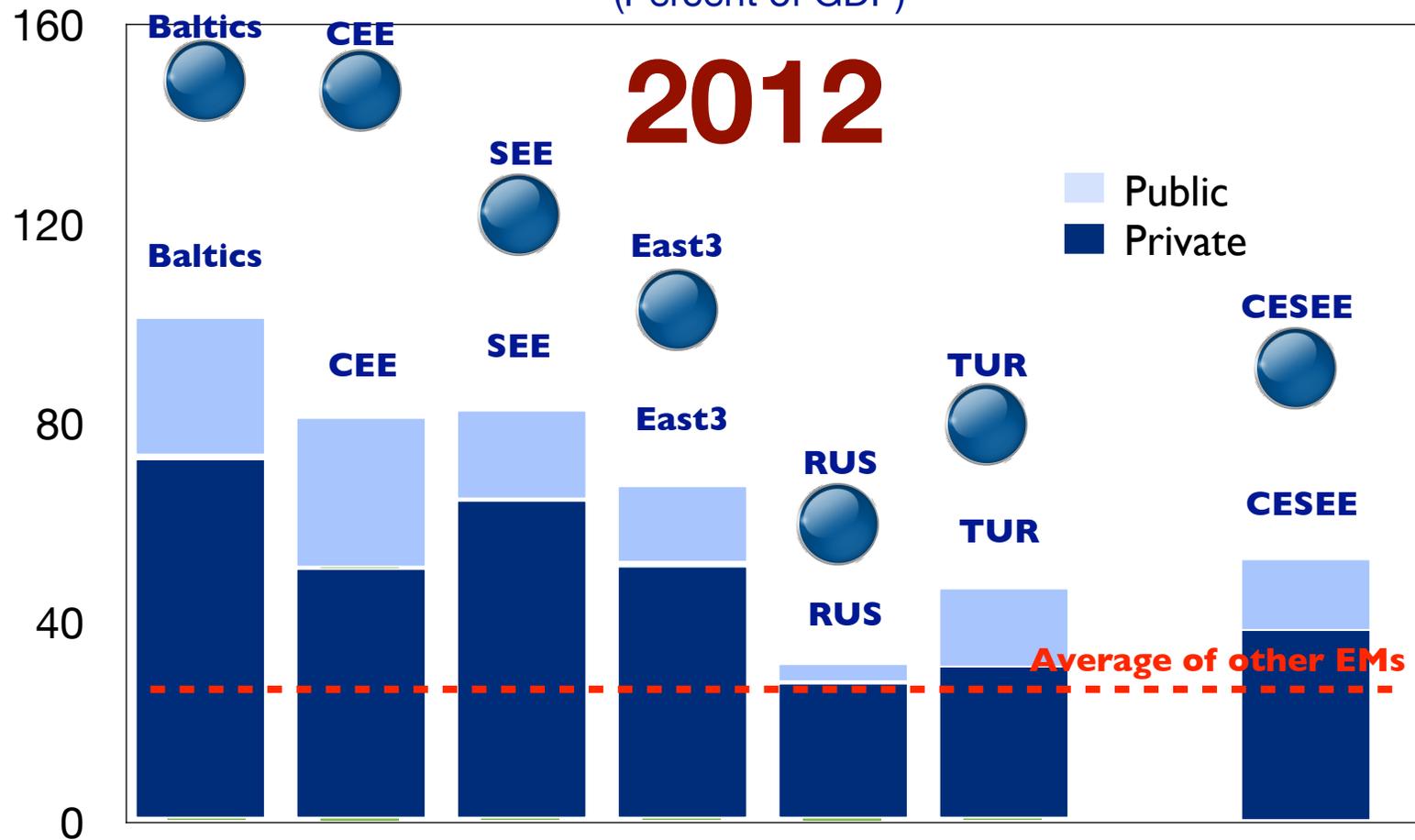
## Gross External Liabilities (Percent of GDP)



# Private sector accounts for most of the external debt



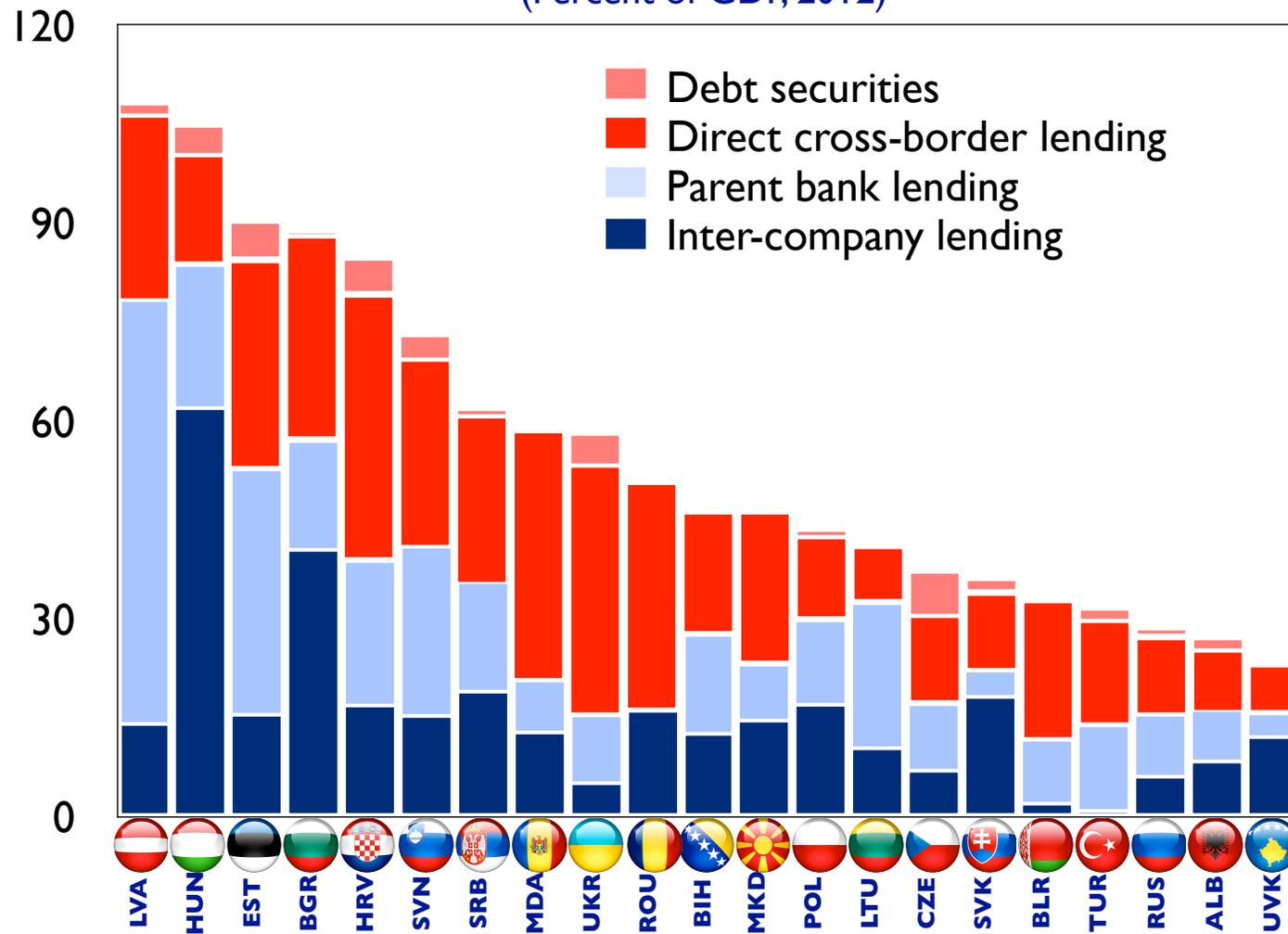
**External Debt**  
(Percent of GDP)



# Funding structure matters



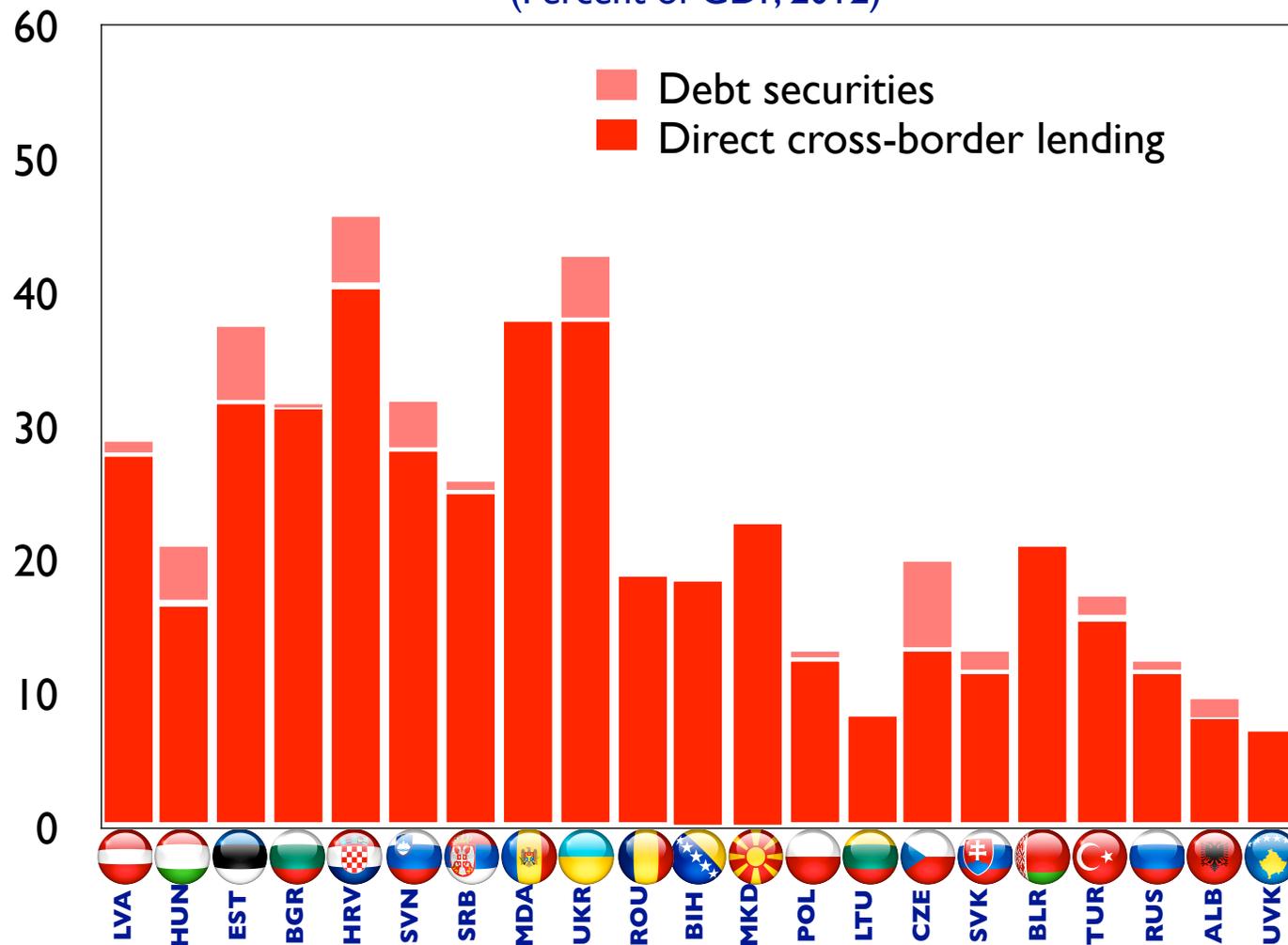
## Private External Debt Structures (Percent of GDP, 2012)



# Taking out funding from affiliated entities gives a different picture



## Private External Funding from Non-Affiliated Sources (Percent of GDP, 2012)

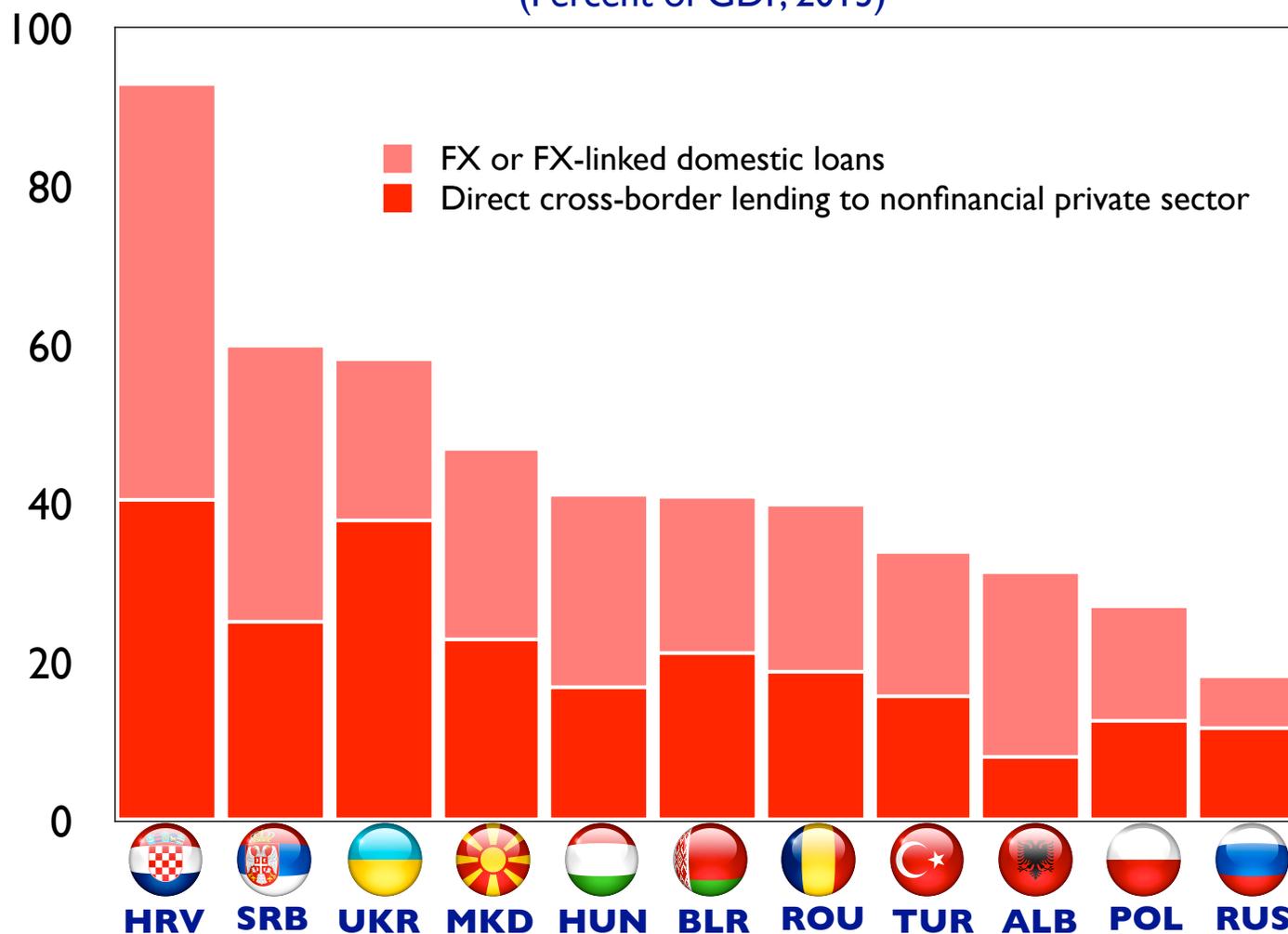


FX risks arise from external borrowing, but also from FX or FX-linked domestic loans



## FX or FX-Linked Loans to Nonfinancial Private Sector

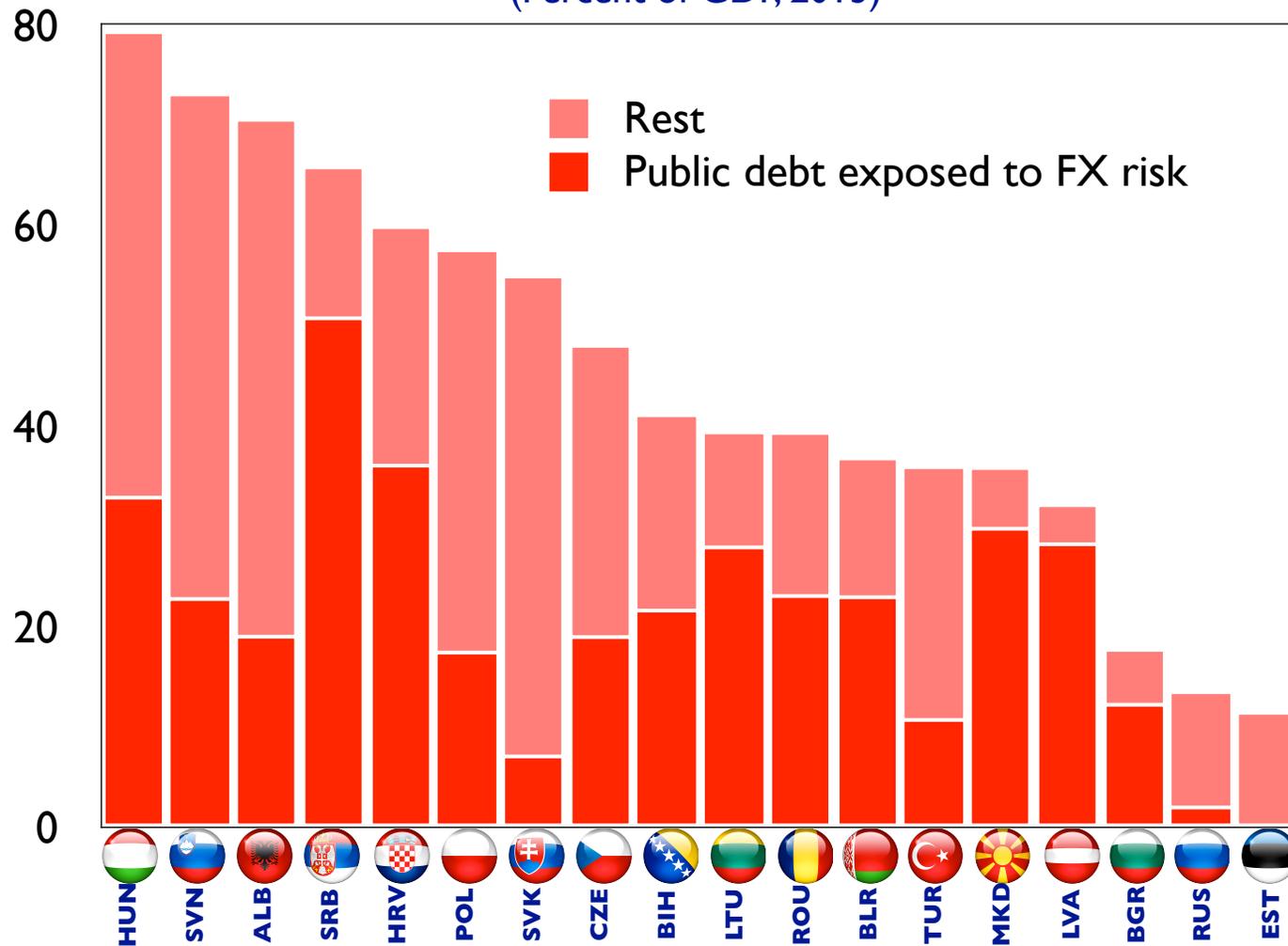
(Percent of GDP, 2013)



# Public sector is exposed to foreign funding and exchange rate risks as well...



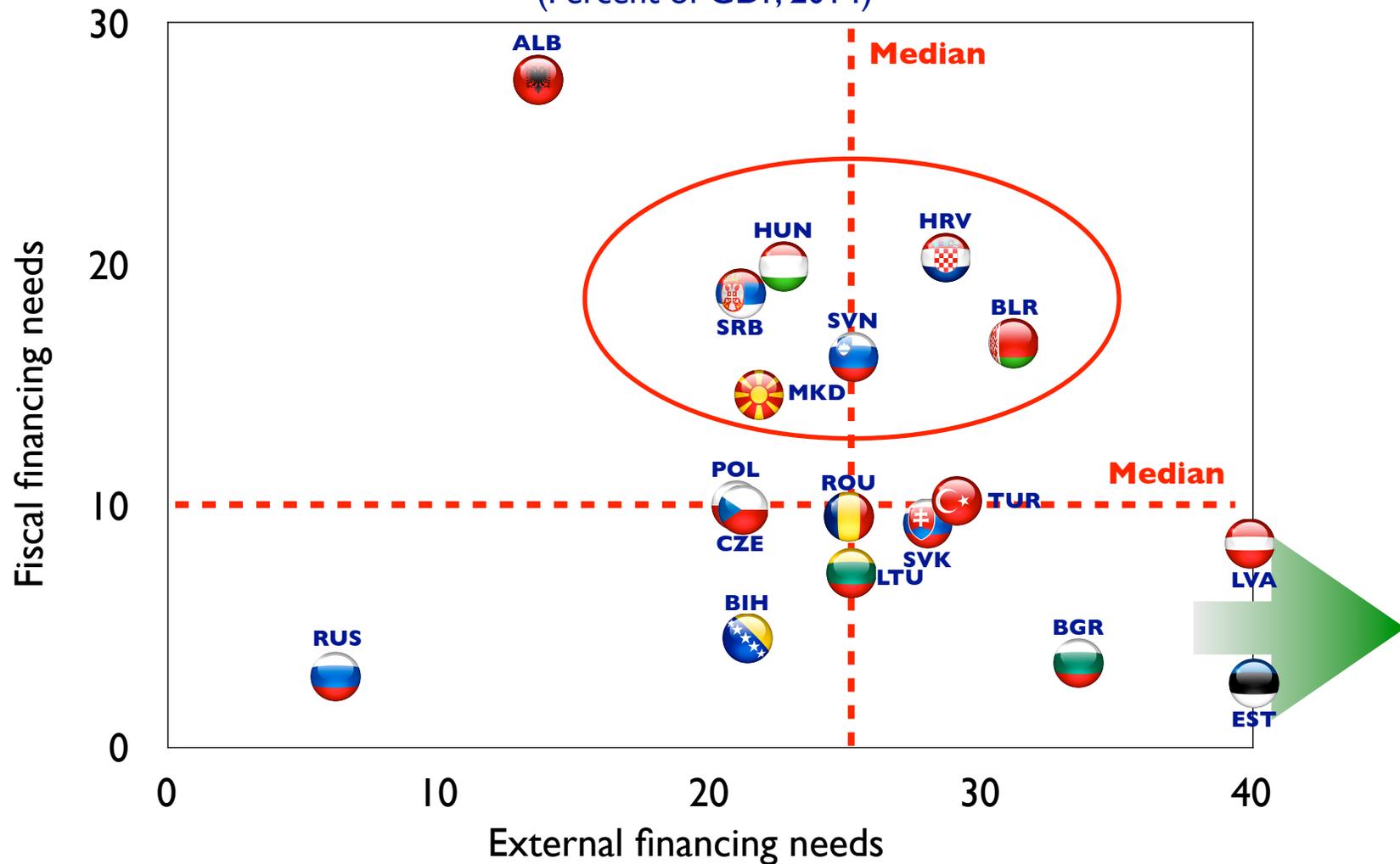
## Public Debt and Foreign Exchange Risks (Percent of GDP, 2013)



# Some countries have both high external and fiscal financing needs



**Financing Needs**  
(Percent of GDP, 2014)

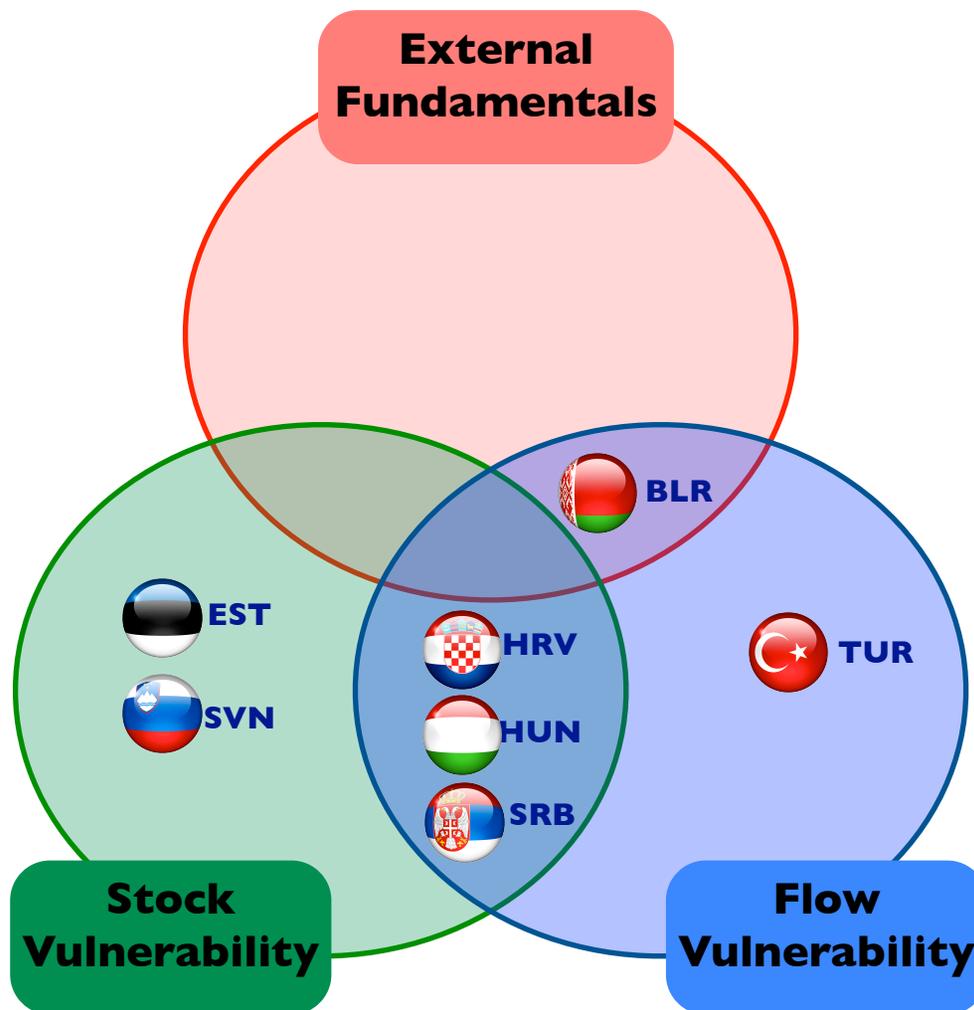


# To sum up: sources of external funding risks



<b>Stock vulnerabilities</b>	<b>Flow vulnerabilities</b>	<b>External fundamentals</b>
Stock of debt	External financing needs	Exchange rate misalignment
External funding from non-affiliated sources	Fiscal financing needs	Reserve buffers
Debt denominated or linked to FX	Funding costs	

# Countries susceptible to external funding risks



# CESEE External Funding Patterns and Risks



1 External Funding Structures

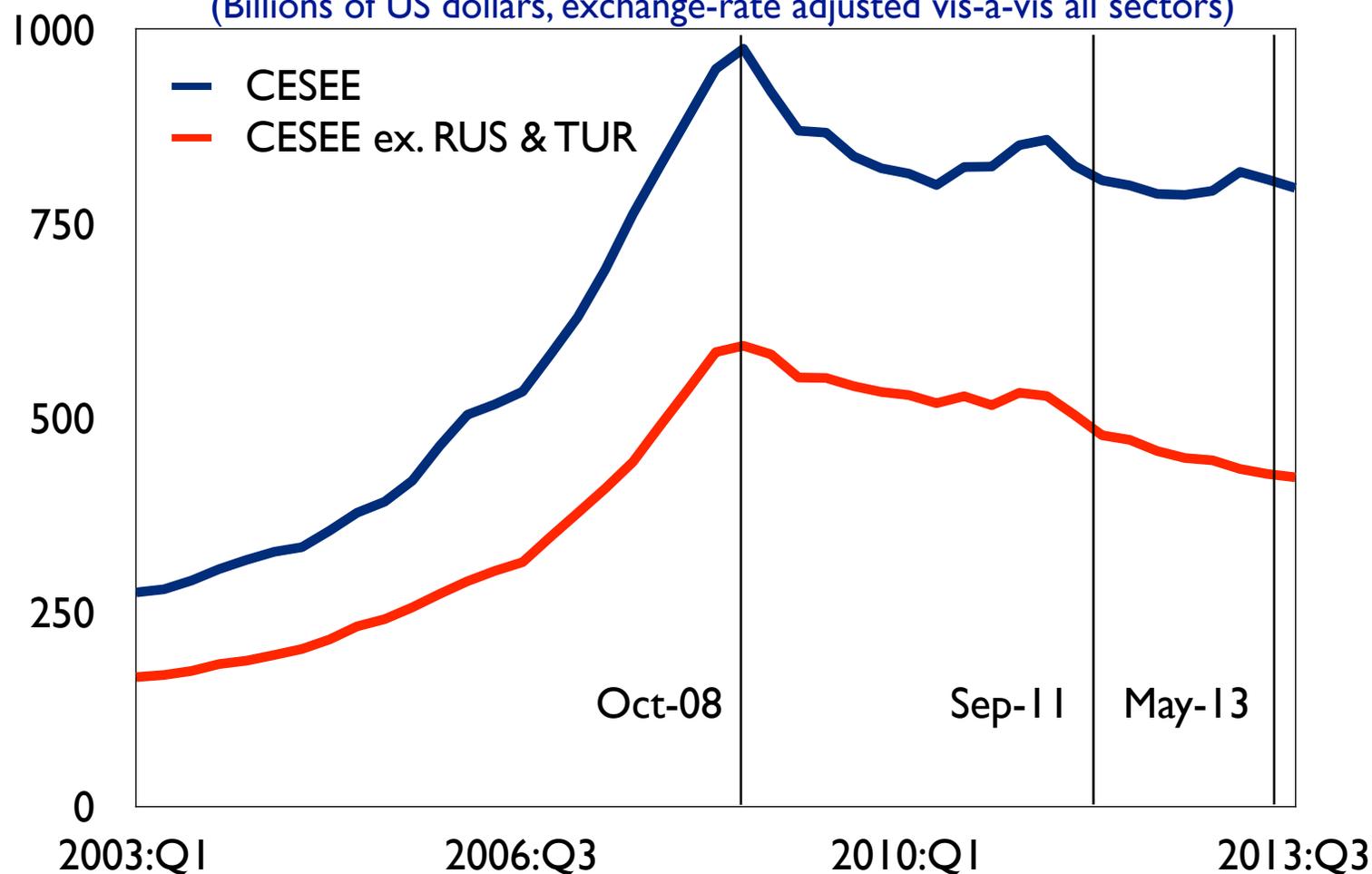
2 External Funding Conditions

CESEE region has undergone large scale foreign bank funding reduction since the crisis ...



## External Position of BIS-Reporting Banks, 2003:Q1-2013:Q3

(Billions of US dollars, exchange-rate adjusted vis-à-vis all sectors)

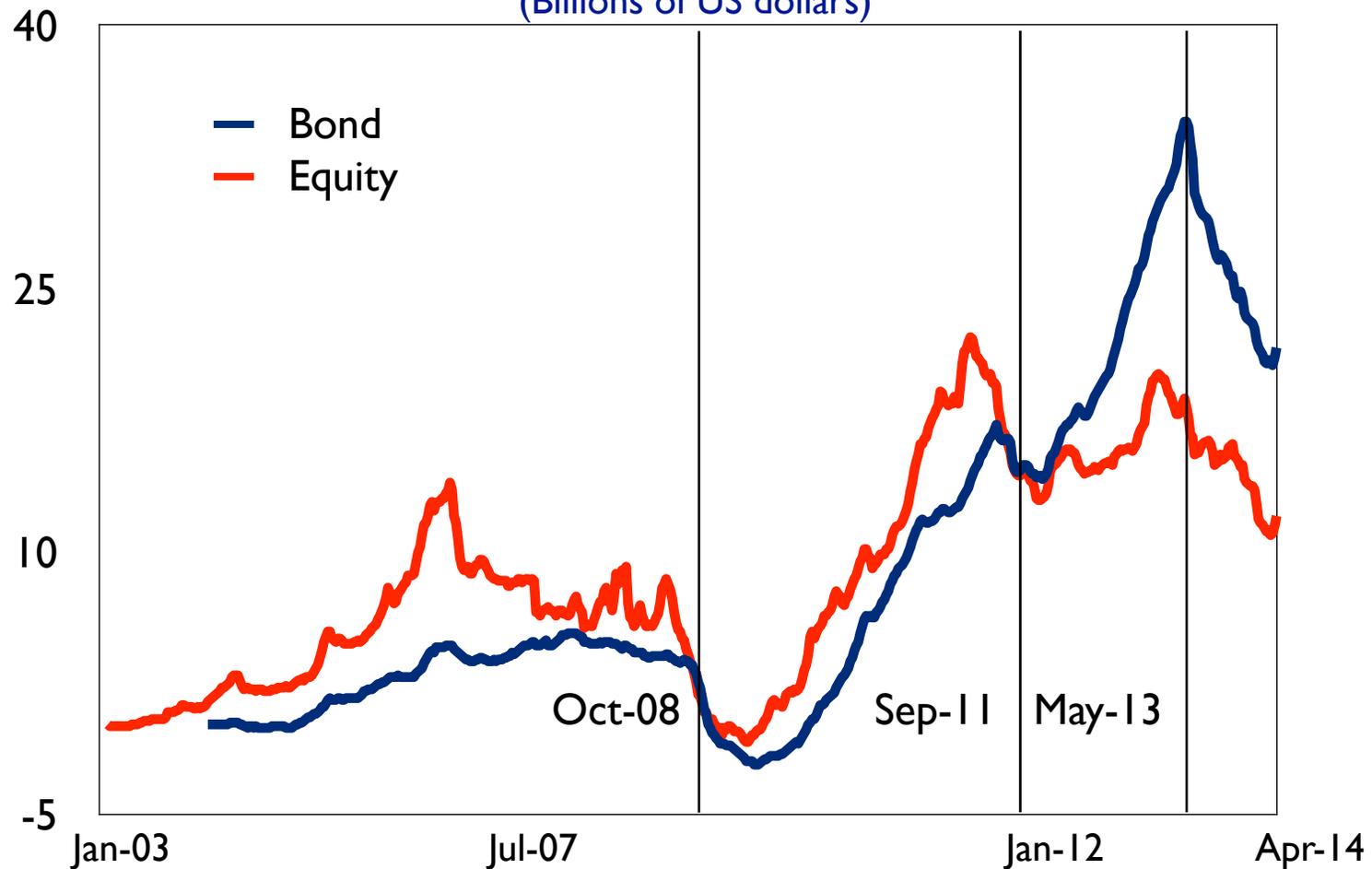


# Reversal of portfolio inflows since taper talk



## Cumulative EPFR Flows into CESEE ETFs and Mutual Funds

(Billions of US dollars)

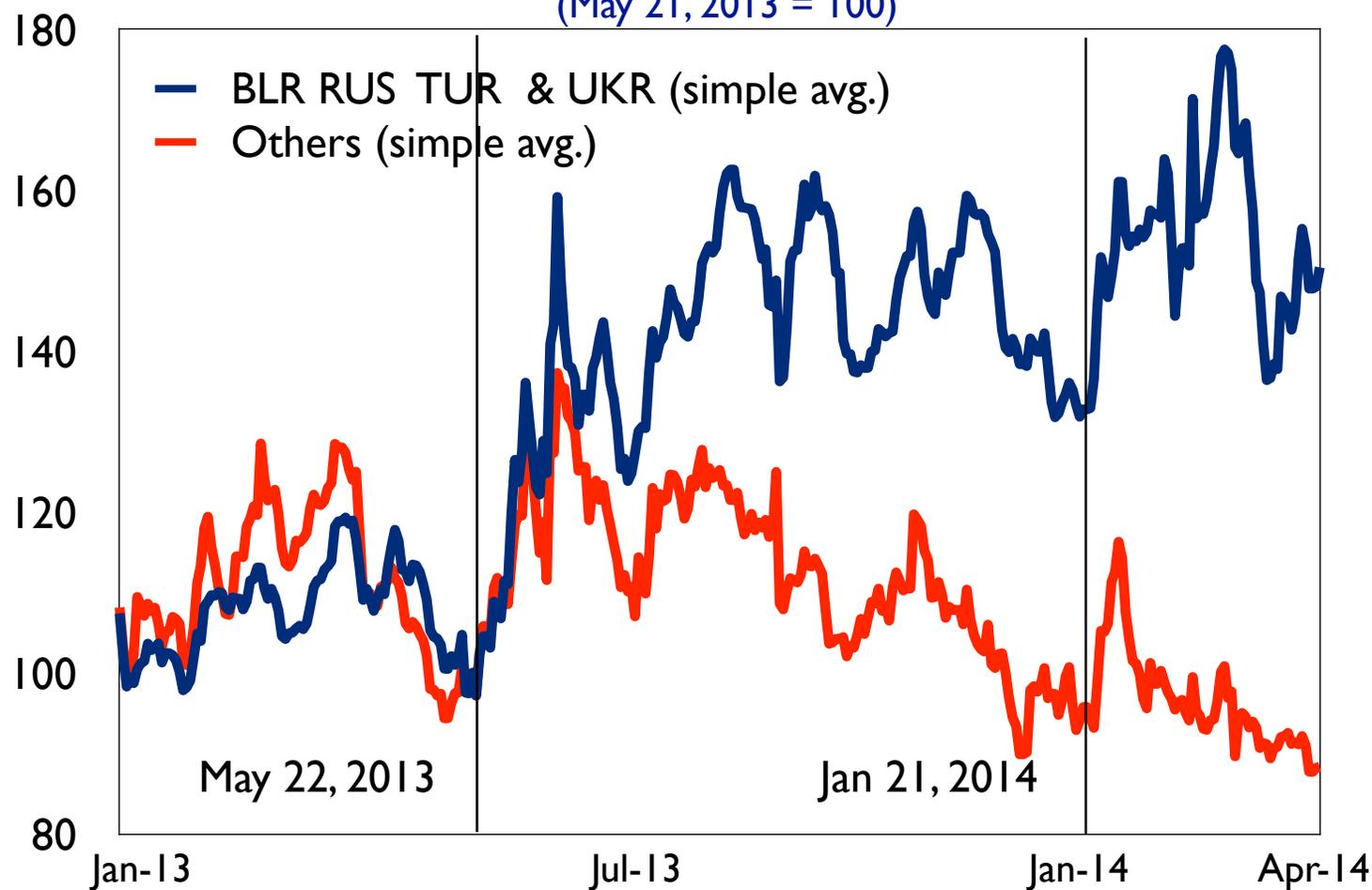


... accompanied by a divergence in bond market spreads



## EMBIG Spreads Indices, Jan 2013 - Apr 2014

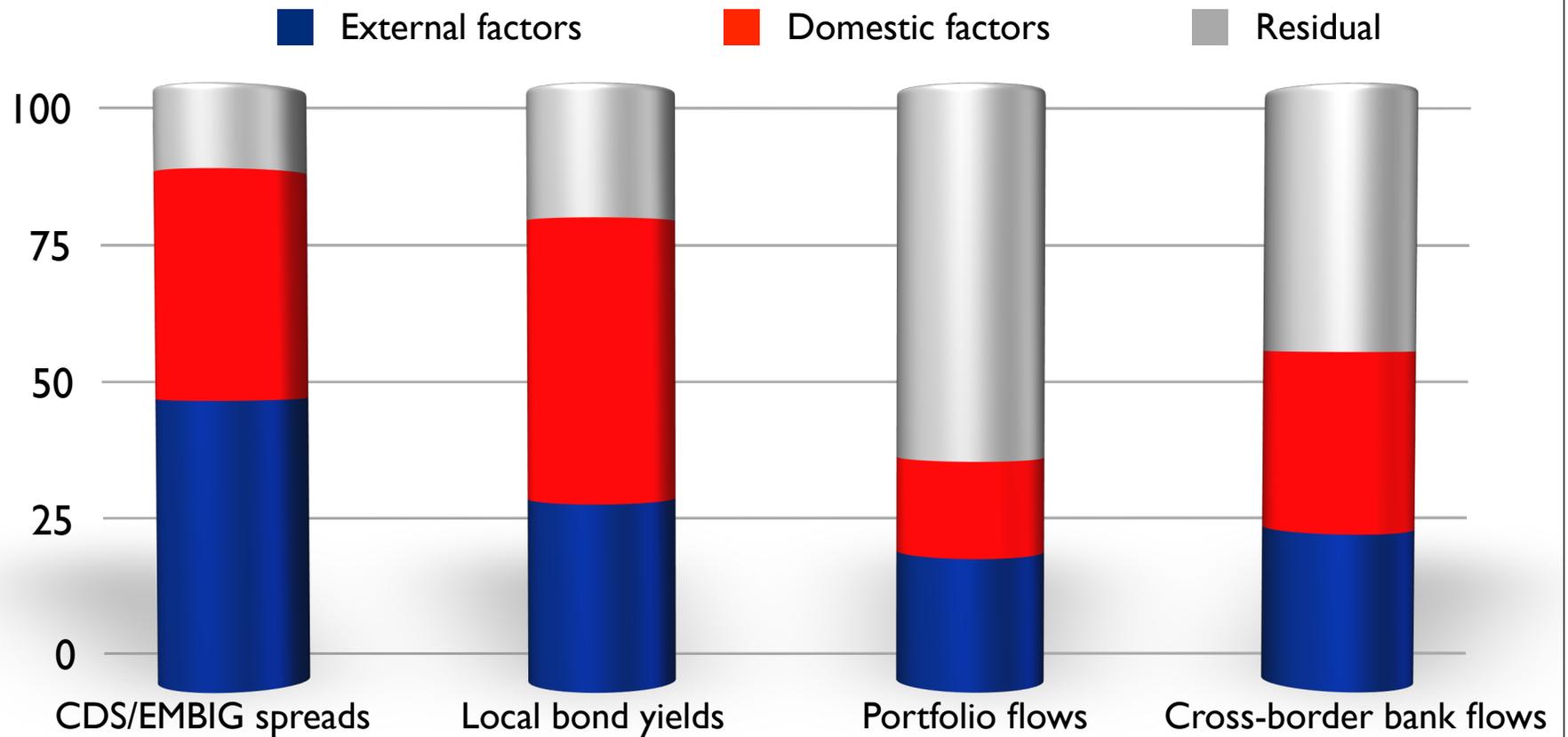
(May 21, 2013 = 100)



While external factors are important, domestic fundamentals also matter



**External and Domestic Drivers**  
(Percent of variance)



# Near term policy priorities



Monetary & Exchange Rate Flexibility

Targeted Liquidity Provision

Active Debt Management

International Cooperation

# Medium term policy priorities



Rebuild Fiscal Buffers

Address Crisis Legacies

Address Structural Weaknesses

Diversify Funding Sources

# Outline



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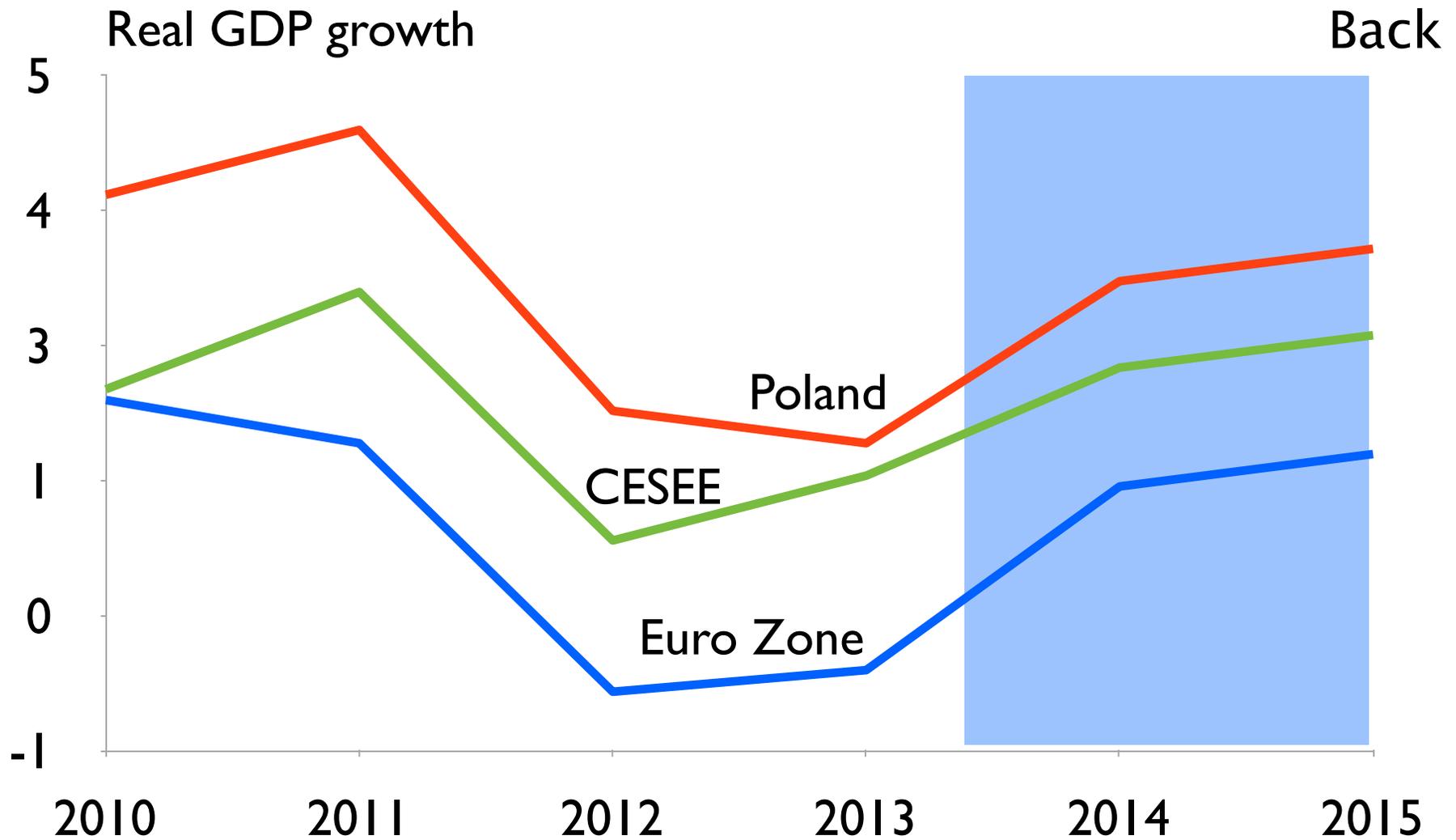
**Poland Article IV**

# Main messages from annual consultation



- Steady recovery from 2012-13 slowdown
- External risks remain, FCL helps
- Inflation low, challenge for monetary policy
- Fiscal consolidation at appropriate pace
- Pension system changes don't address legacy issues
- Financial sector resilient, but supervisory framework needs further work
- Labor market and business climate reforms needed

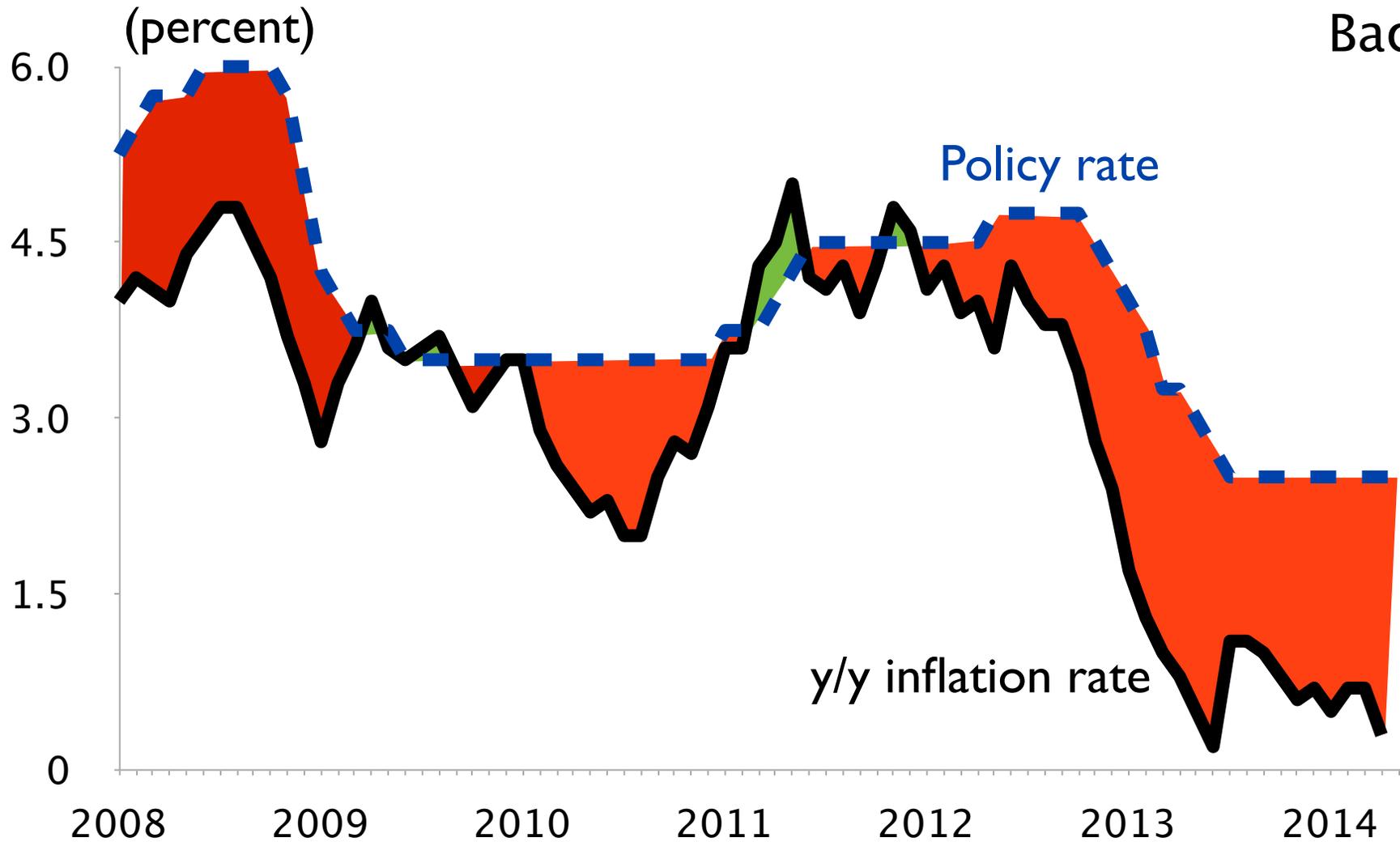
# Recovery picking up momentum



# Real rates rising as inflation falls



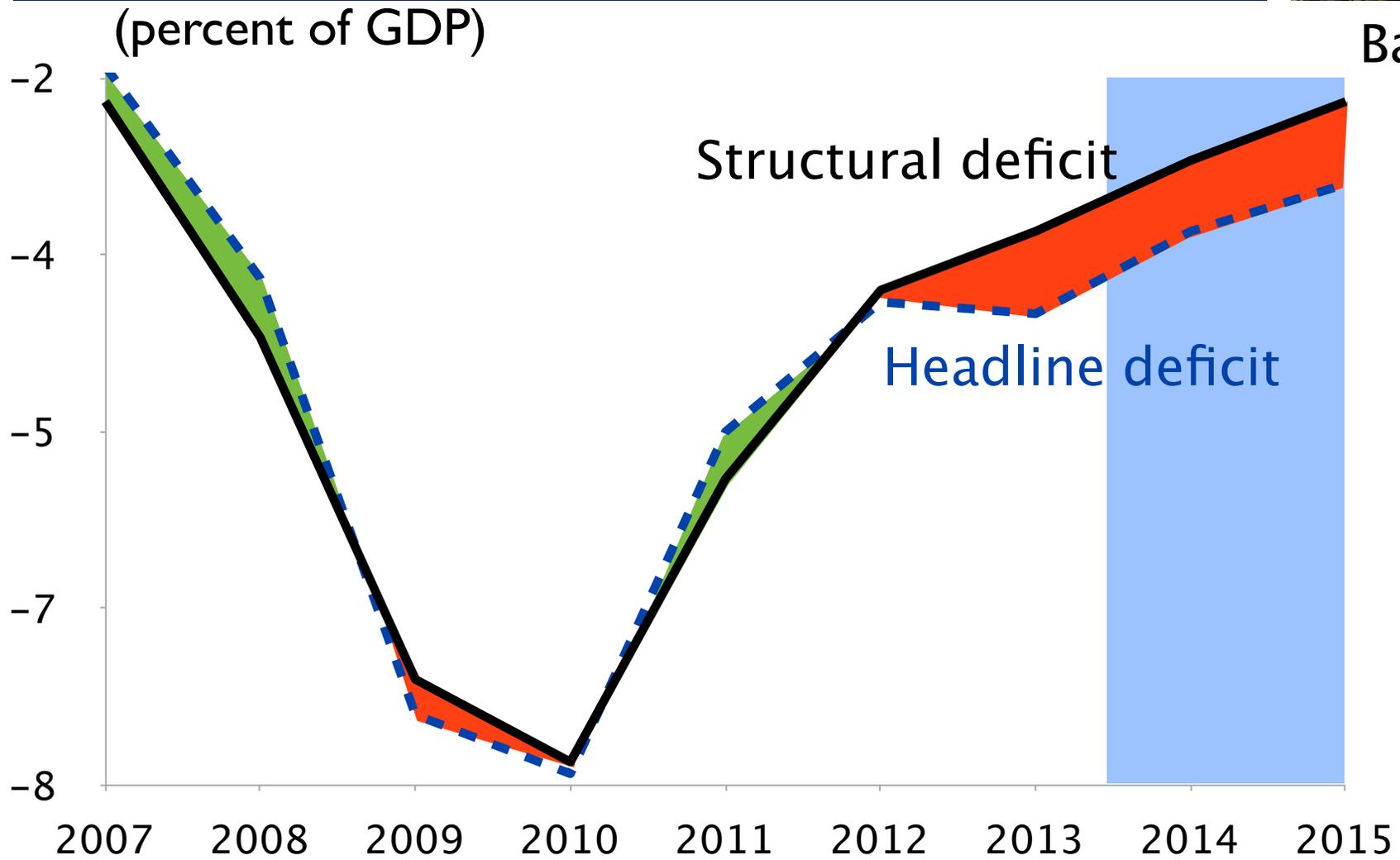
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# Calibrated fiscal policy



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# Pension changes



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- Improve fiscal aggregates by about 30 percent of GDP in present value terms
- But implicit liabilities rise in turn
- Liquidity in bond and equity markets could fall
- Legacy flaws pose long-term risks
  - fix zero floor in indexation mechanism
  - align disability pension formula with regular benefits
  - address imbalances in special occupational schemes
  - low replacement rates threaten old-age poverty and fiscal pressures

# Main messages from annual consultation



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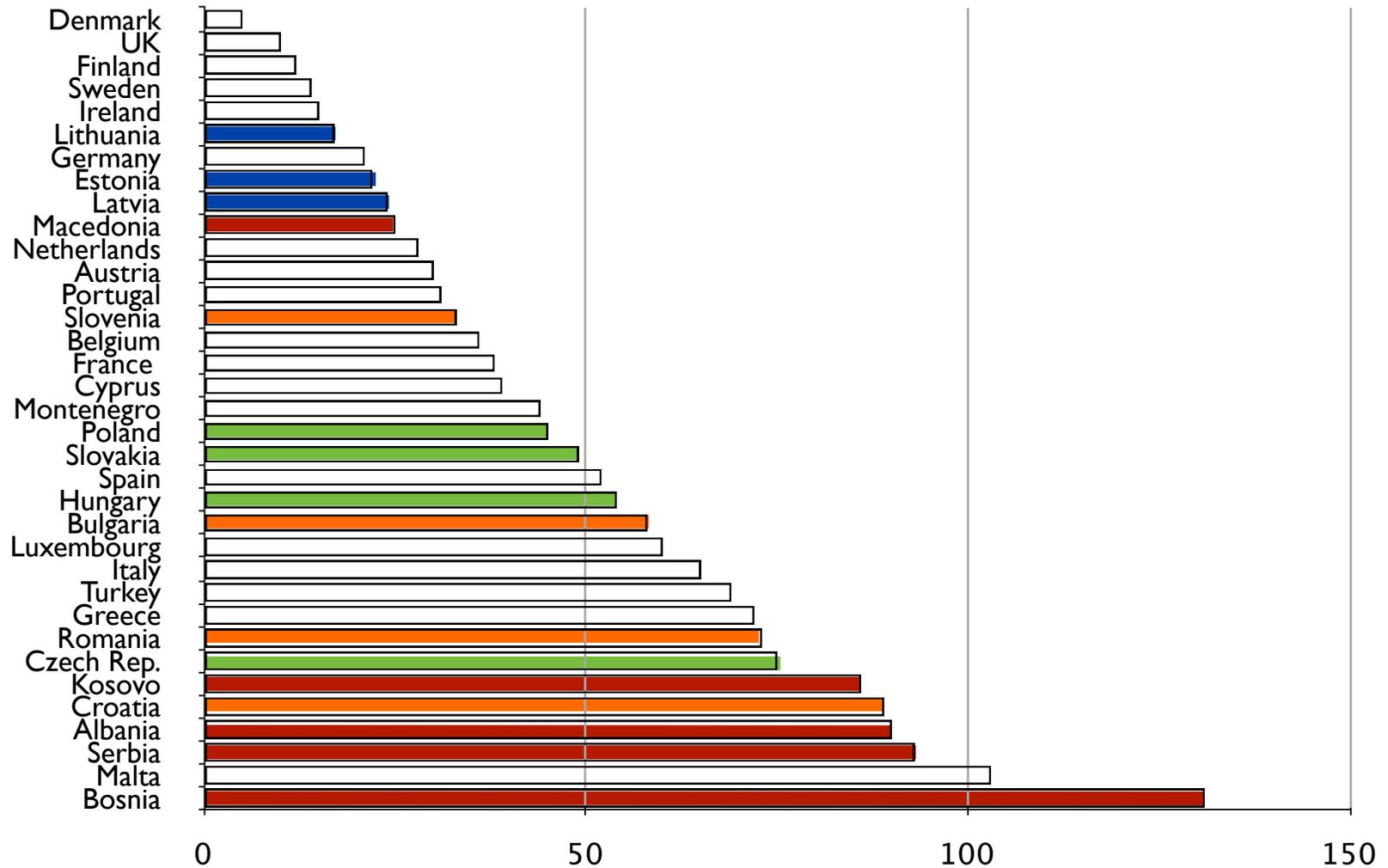
- Steady recovery from 2012-13 slowdown
- External risks remain, FCL helps
- Inflation low, challenge for monetary policy
- Fiscal consolidation at appropriate pace
- Pension system changes don't address legacy issues
- Financial sector resilient, but supervisory framework needs further work
  - fix legal and tax obstacles to NPL resolution
  - restructure credit unions
  - finalize Systemic Risk Board legislation

# Business climate



## Doing Business 2014 rank

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European Department



Thank you!