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# CESEE Research Update

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## Content



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Oesterreichische Nationalbank,
Foreign Research Division
Postal address: P.O. Box 61, A 1011 Vienna, Austria
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The CESEE Research Update is released quarterly by the Foreign Research Division of the Oesterreichische Nationalbank (OeNB). The aim of this newsletter is to inform readers about OeNB analysis and research output on Central, Eastern and Southeastern Europe (CESEE) as well as past and forthcoming CESEE-related events.

**Foreign Research Division**
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## Highlight of this Issue

### Summary: World Bank's January 2022 Global Economic Prospects report expects global recovery to decelerate markedly - OeNB webinar

with Franziska Ohnsorge (Manager) and Amat Adarov (Senior Economist) of the World Bank Prospects Group in the Equitable Growth, Finance and Institutions Practice Group

moderated by Julia Wörz (Head of the OeNB's Central, Eastern and Southeastern European Analysis Unit)

The world economy is in the midst of a pronounced global growth slowdown, which is hitting emerging market and developing economies before the recovery from the recession in the wake of the pandemic is complete, the World Bank says in its January 2022 Global Economic Prospects report, which Franziska Ohnsorge and Amat Adarov presented at a Webinar hosted by the OeNB on January 17, 2022.

Julia Wörz

The world economy experienced the steepest global recession in 2020 and an extremely powerful recovery in 2021 growing at an estimated 5.5 percent per annum. For 2022, the World Bank projects growth to decelerate to 4.1 percent. This slowdown is the strongest cooling down after a recovery from recession since the Second World War. The expected slowdown reflects the withdrawal of the extraordinary monetary and fiscal policy stimulus during the pandemic, but it also reflects renewed COVID-19 outbreaks, including the Omicron wave. For advanced economies the World Bank expects growth to slow down from 5.0 percent in 2022 to 3.8 percent in 2021, for emerging market and developing economies estimated growth in 2021 is 6.3 percent, expected growth for 2022 is 4.6 percent. Most of the slowdown in emerging market and developing economies is driven by China with growth expected to come in at 8 percent in 2021 and 5.1 percent in 2022.

Franziska Ohnsorge

Ohnsorge stressed that in contrast to advanced economies the withdrawal of fiscal and monetary policy support is well under way in emerging market and developing economies. Europe and Central Asia surprised on the downside (expected growth is 5.8 percent in 2021 and 3.0 percent in 2022), partly due to swifter tightening in policy support but also due to political uncertainties. Ohnsorge stressed that the slowdown for emerging markets and developing economies implies that they will not complete their recoveries any time soon with investment remaining 4 percent below pre-pandemic trends in 2023, excluding China the figure would be as high as 8 percent[1]. The World Bank stresses that risks to this outlook are tilted to the downside and more acute than six months ago. Risks include new COVID-19 outbreaks, inflationary pressures, financial stress, climate related risks and supply bottlenecks.

Amat Adarov

Adarov zoomed in on income inequality starting from the observation that even if none of the downside risks to growth materialize the pandemic will leave a long-term impact on inequality. Between-country income inequality had declined prior to the pandemic – progress which is likely to be partially reversed. Per capita income convergence is expected to flip into per capita income divergence for many emerging market and developing economies. In contrast to the global financial crisis, where between-country inequality declined, the Gini coefficient computed using GDP per capita has increased by about 0.8 points from 2019 to 2021. Adarov added that within-country income inequality has likely also increased in emerging market and developing economies. Based on household phone surveys, the World Bank finds that 63 percent of households in surveyed emerging market and developing economies reported income losses since the start of the pandemic, the figure is as high as 74 percent for low-income countries. Less than a quarter of households reported that they had been able to access government support, whereas women, informal workers and households with lower education have been disproportionately affected. Simulation exercises suggest that within-country income inequality has likely increased, but the magnitude of this increase is quite small with the average within-country Gini having increased by an estimated 0.3 points in 2020 compared with the no-COVID-19 counterfactual scenario.

Adarov went on to discuss the development in commodity prices since the beginning of the pandemic. He stressed that energy and metal prices co-moved with the global economic activity – declining sharply in 2020 and strongly increasing in 2021. He highlighted that moving away from fossil fuels will cause profound changes in the pattern of demand and supply of commodities, for example, increasing demand for metals and minerals as inputs for renewable energy generation. As commodity upcycles are much stronger than downcycles the World Bank identifies a development opportunity for commodity exporters – provided policy frameworks are

Photos: Christoph Gstrein, World Bank.

[1] *Figures are the percent deviation between the January 2022 and January 2020 projections.*

strengthened and reliance on commodity-related revenues is diversified.

Ohnsorge concluded the webinar by emphasizing that there is very little room for traditional macroeconomic policy measures. Monetary and fiscal policy tightening is already well underway. For example, because of rising inflation, in 40 percent of inflation-targeting emerging market and developing economies central banks have already increased policy rates. With both fiscal and monetary policy being constrained and focused on maintaining credibility and sustainability, policy makers, according to Ohnsorge, should focus on structural reforms which enhance growth in the future and improve investor confidence today.

Markus Eller

The webinar was concluded by a lively Q&A session. Markus Eller (principal economist, OeNB) kicked off the discussion by zooming in government debt and the question of how to restructure debt after the pandemic (see analysis below). He pointed out that government debt increased by about ten percentage points in Central, Eastern and Southeastern European countries due to the pandemic and is unlikely to return to 2019 levels before 2027, further foreign currency denominated debt, debt maturities and spikes in debt redemption as well as the share of variable interest rate debt may pose challenges to policy makers. The further discussion raised the questions how the necessary structural reforms can be financed against the background of already elevated debt levels. In addition, the discussion addressed the issue of how structural reforms can be implemented against the background of political instabilities and polarization in societies.

For more information see Presentation of the World Bank Global Economic Prospects report - Oesterreichische Nationalbank (OeNB)

## Changes in the level and structure of government debt in CESEE in the wake of the COVID-19 pandemic

by Markus Eller[2]

The COVID-19 pandemic has brought about a more active role for fiscal policies in stabilizing the economy. The size of fiscal policy support has been extraordinarily large by historical standards, especially in advanced economies but also in the Central, Eastern and Southeastern Europe (CESEE) region. This significant fiscal support has certainly preserved a critical share of economic activity and thereby forestalled a much larger and destructive accumulation of bad debts. But government debt-to-GDP ratios rose considerably in the region[3] in 2020, by 10 percentage points on average, so that several countries reached once again the peaks observed after the global financial crisis (GFC) – see chart 1. Above-average debt ratios of around 80% can currently be observed in Slovenia, Croatia, Hungary and Albania. Projected debt ratios decline only slightly in most countries in 2021-2022 compared to 2020; further increases are imminent in some countries (notably Czechia, Romania, North Macedonia). The next years will also require extra public spending for coping with the legacies of the crisis, such as increased economic inequality, and for managing the green transition to climate neutrality. As a result, pre-pandemic figures are likely not reached soon again, e.g. not before 2027

[2] *At the time of writing with the Oesterreichische Nationalbank (OeNB), Foreign Research Division; now Senior Economist at the Joint Vienna Institute (JVI), meller@jvi.org. Opinions expressed by the authors of studies do not necessarily reflect the official viewpoint of the OeNB, the Eurosystem or the JVI. The author would like to thank Zoltan Walko (OeNB) for excellent research assistance.*

[3] *Regional figures in this note refer to unweighted cross-country averages for 8 EU Member States from CESEE (Slovakia, Slovenia, Bulgaria, Croatia, Czechia, Hungary, Poland, and Romania), 4 EU candidate countries (Albania, North Macedonia, Serbia, and Turkey) as well as Russia and Ukraine.*

according to most recent IMF forecasts (October 2021). Elevated government debt ratios over the medium term imply risks for debt sustainability, even though several scholars have recently argued that debt could be sustainable at levels higher than it has been in the past because neutral interest rates are still low.[4]

To provide some more qualifications for this debate and to enrich the respective risk assessment, let us have in a second step a closer look at the structure of government debt along several dimensions (see table 1)[5]:

- First, the share of government debt owed to domestic creditors in overall debt is comparatively low in the CESEE countries, not least because of still relatively weakly developed local capital markets.[6] However, compared to regional highs in the 2010s of almost 60% of total debt, the share of debt owed to foreign creditors has been reduced somewhat, with a further decrease during the pandemic to an average of now 45%. This contrasts with the development in the wake of the GFC, when the proportion of foreign creditors has increased significantly.
- Second, the share of government debt denominated in foreign currency had fallen from regional highs of over 50% in the 2010s to nearly 40% by 2019 and has remained roughly constant during the pandemic. However, some countries clearly record above-average shares. Several of them have a large proportion of euro-denominated debt and at the same time a fixed exchange rate vis-à-vis the euro, thus being less vulnerable to exchange rate fluctuations. But others that have a large share of foreign currency debt, an already high level of government debt and volatile exchange rates appear relatively more vulnerable, as a combination of these factors would imply significant increases in outstanding debt stocks in case of an exchange rate depreciation. For instance, Albania, Serbia, Ukraine and to some extent also Romania would fall into this group.
- Third, on a positive note, refinancing risks are now less severe than in the years after the GFC as the maturities of debt portfolios have become longer-term and the share of short-term debt has steadily declined since the GFC – a trend that also continued during the pandemic. At the end of 2021, the proportion of debt to be serviced in the short term had fallen to 11% of total debt on average. That said, some countries are still characterized by significant proportions of the more vulnerable combination of short-term and foreign currency-denominated debt (e.g. Bulgaria, Croatia, Romania, Turkey, and Ukraine). Moreover, many countries in the region are characterized by a volatile debt redemption profile in the next few years, with some quarters being subject to sizable repayment spikes (not shown) – a source of refinancing risk in the event of a contemporaneous macrofinancial shock.
- Fourth, variable rate debt is important in a few countries, even though its share has on average slightly declined during the pandemic. Currently the largest shares of variable rate (bond) debt can be observed in Ukraine (40%), Albania (30%), Russia and Poland (26%). Given strong inflationary dynamics in the region in recent quarters, several central banks have already tightened their monetary policies. The related hikes in interest rates obviously constitute vulnerabilities in countries characterized by considerable shares of variable rate debt. Moreover, pending – or already initiated – tightening of monetary policies in advanced economies could exacerbate interest rate risk in those CESEE countries that are subject to substantial shares of foreign currency-denominated debt.

[4] *For instance: Blanchard, O. 2021. Why low interest rates force us to revisit the scope and role of fiscal policy: 45 takeaways. Peterson Institute for International Economics (PIIE). Realtime Economic Issues Watch. December 21, 2021. https://www.piie.com/blogs/realtime-economic-issues-watch/why-low-interest-rates-force-us-revisit-scope-and-role-fiscal.*

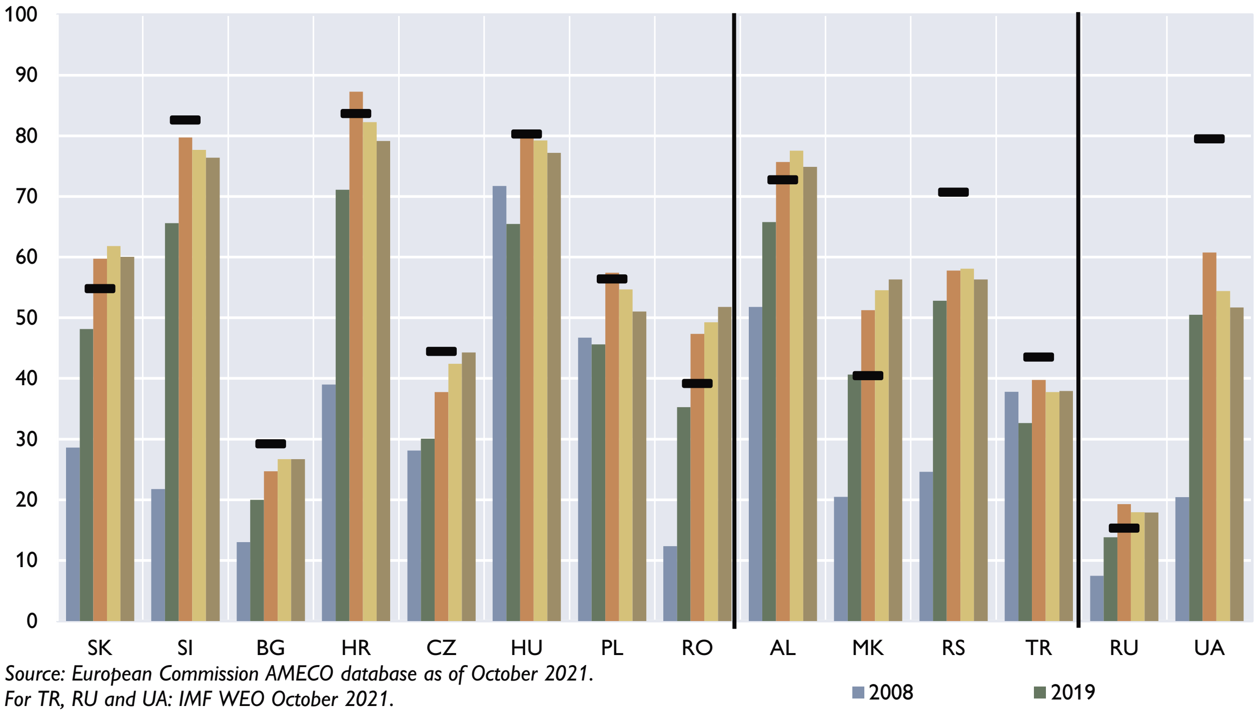
[5] *Building on: Eller, M. and J. Holler. 2018. Digging into the composition of government debt in CESEE: a risk evaluation. In: OeNB. Focus on European Economic Integration. Q2/18. 56–80.*

[6] *See: Reininger, T. and Z. Walko. 2020. A sleeping beauty or a dead duck? The state of capital market development in CESEE EU Member States. In: OeNB. Focus on European Economic Integration. Q3/20. 7–35.*

Chart 1

## General government gross debt

*% of GDP*




*Source: European Commission AMECO database as of October 2021.*
*For TR, RU and UA: IMF WEO October 2021.*

## Government debt profile indicators for selected CESEE economies

Table 1

| | SK | SI | BG | HR | CZ | HU | PL | RO | AL | MK | RS | TR | RU | UA | CESEE-14 (unweighted average) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Debt owed to nonresidents, % of total debt | | | | | | | | | | | | | | | |
| Maximum value 2009-2018 | 70,5 | 76,5 | 55,1 | 45,5 | 45,9 | 64,4 | 58,7 | 55,8 | 43,1 | 69,7 | 70,4 | 47,7 | 29,4 | 52,5 | 56,1 |
| 2019 | 63,0 | 67,3 | 49,3 | 32,6 | 39,6 | 38,1 | 41,7 | 50,4 | 41,1 | 61,6 | 63,8 | 36,8 | 36,3 | 50,4 | 48,0 |
| 2020 or 2021H1 (for EU countries) | 56,9 | 60,3 | 53,1 | 34,3 | 30,9 | 31,0 | 30,5 | 54,1 | 41,5 | 59,5 | 61,7 | 28,8 | 29,8 | 51,0 | 44,5 |
| Foreign currency debt, % of total debt | | | | | | | | | | | | | | | |
| Maximum value 2009-2018 | 9,1 | 25,4 | 80,8 | 76,5 | 23,4 | 46,3 | 40,1 | 67,0 | 53,7 | 68,0 | 80,7 | 46,6 | 38,3 | 76,3 | 52,3 |
| 2019 | 4,9 | 4,5 | 79,1 | 69,3 | 12,5 | 24,4 | 31,9 | 51,0 | 46,4 | 58,2 | 63,1 | 46,3 | 21,0 | 60,5 | 40,9 |
| 2021 | 3,7 | 3,9 | 71,9 | 69,6 | 4,3 | 24,1 | 24,3 | 54,4 | 52,9 | 67,7 | 63,8 | 59,4 | 17,9 | 62,5 | 41,5 |
| Euro-denominated debt, % of total foreign currency debt | | | | | | | | | | | | | | | |
| 2019 | .. | .. | 99,8 | 80,5 | 96,9 | 44,9 | 83,5 | 81,8 | 67,7 | 93,5 | 66,0 | 30,8 | 8,1 | 18,7 | 64,3 |
| 2021 | .. | .. | 99,9 | 90,3 | 94,5 | 58,8 | 85,2 | 83,1 | 68,2 | 88,6 | 81,1 | 25,3 | 15,2 | 23,6 | 67,8 |
| Short-term debt, % of total debt | | | | | | | | | | | | | | | |
| Maximum value 2009-2018 | 21,9 | 16,3 | 32,9 | 37,1 | 23,1 | 44,7 | 25,4 | 57,1 | 61,2 | 55,3 | 36,8 | 36,8 | 18,1 | 16,3 | 34,5 |
| 2019 | 7,3 | 6,4 | 5,0 | 18,4 | 12,1 | 24,2 | 6,8 | 11,3 | 29,4 | 18,9 | 12,8 | 14,2 | 20,3 | 11,8 | 14,2 |
| 2021 | 2,8 | 4,9 | 9,6 | 15,8 | 14,1 | 9,0 | 10,2 | 11,7 | 23,3 | 7,3 | 8,9 | 12,0 | 7,4 | 14,5 | 10,8 |
| Short-term foreign currency debt, % of total debt | | | | | | | | | | | | | | | |
| 2019 | 0,0 | 0,0 | 1,7 | 10,3 | 2,0 | 3,7 | 2,7 | 2,8 | 2,9 | 5,3 | 7,9 | 3,1 | 2,9 | 8,0 | 3,8 |
| 2021 | 2,8 | 0,6 | 8,6 | 10,6 | 2,9 | 0,0 | 1,9 | 4,0 | 1,1 | 0,4 | 2,9 | 4,8 | 1,6 | 5,4 | 3,4 |
| Government bonds with variable rates, % of total government bonds | | | | | | | | | | | | | | | |
| 2019 | 6,8 | 13,6 | 12,5 | 19,5 | 14,8 | 23,5 | 29,6 | 8,1 | 32,3 | 11,5 | 26,1 | 16,4 | 28,0 | 36,7 | 20,0 |
| 2021 | 5,2 | 4,2 | 8,8 | 16,6 | 12,0 | 14,9 | 26,3 | 5,8 | 29,2 | 21,6 | 21,7 | 19,6 | 26,2 | 39,3 | 18,0 |

*Source: Bloomberg, OeNB calculations.*
*Note: Calculated numbers are based on Bloomberg debt redemption data for the general government (in several cases also including state-owned enterprises), i.e. residual maturities of government bond principals and term loans outstanding, as of the end of the indicated year. Short-term debt is defined as outstanding debt maturing within one year.*

# Summary: Conference on European Economic Integration (CEEI) 2021
# Recalibrating tomorrow's global value chains – prospects for CESEE

The CEEI was held in November 2021 by the Oesterreichische Nationalbank (OeNB) in cooperation with the European Investment Bank (EIB). Around 300 participants from more than 25 countries took in and discussed past trends, recent challenges and future prospects for global value chains (GVCs), with a special focus on the Central, Eastern and Southeastern European (CESEE) region.

In his introductory remarks, *Robert Holzmann, Governor of the OeNB*, pointed out that the CESEE economies, in particular, have benefited from deep GVC integration, which has strongly supported their successful transition and catching-up process. However, recent events have laid bare the vulnerability and risks associated with GVC integration, such as supply shortages and supply-demand mismatches during the recovery. Some individual sectors such as the car industry – a sector the CESEE region is heavily reliant on – have been hit particularly hard. He then alluded to the most pressing policy priorities and challenges: climate change and striking the right balance between relocating production to ensure strategic autonomy and diversifying trade flows to create a more robust world trading system. *Ricardo Mourinho Félix, Vice-President of the EIB*, shed further light on the challenges associated with the current recovery process. He noted that if the supply bottlenecks and disruptions were structural, they might change the structure of GVCs. Against this background it will be important to reduce the dependency on imports of strategically relevant inputs. While policymakers focused all efforts on stimulating demand after the global financial crisis, it is now key to also keep a close eye on the supply side and build more resilient supply chains. He also stressed the EIB's active role in the recovery from the COVID-19 pandemic.

## Keynote by Ricardo Hausmann: Do GVCs make development easier?

In his keynote lecture, *Ricardo Hausmann, Professor at Harvard University*, compared GVCs to the modular principle of the word game Scrabble: He views production as assembling "letters," which stand for capabilities, to make "words," which represent products. Since technology has developed more capabilities (letters) and has made products more intricated (longer words), one would assume that the world has become a complex place where only those who have all the letters can get into business. Yet, this is not the case thanks to GVCs which allow for trade in syllables, not words. GVCs have thus made progress easier for less developed countries. However, for GVCs to open these new doors, technology has to spread. While transferring know-how into brains is a slow and tedious process, moving brains, i.e. workers

Photos: OeNB, Harvard University.

with know-how is much easier, cheaper and faster. Therefore, Professor Hausmann concluded that the most important prerequisites to reap the full developmental gains from GVC integration are migration policies and transport infrastructure.

## Stability versus vulnerability in GVCs: tracing the benefits and risks of increasing interconnectedness

*Gábor Márk Pellényi, Economist at the European Commission*, argued in favor of more specialization in services as they capture a higher share of value added in GVCs and are less volatile than production as that the provision of services needs fewer intermediate inputs and is less sensitive to supply disruptions. Of course, this was different during the COVID-19 pandemic, as many services are contact-intensive. So far, the CESEE region has mostly attracted assembly-like production. To shift the region's focus toward services would require investments in skills and strong digital infrastructure. *Andreja Jaklič, Professor at the University of Ljubljana*, focused on domestic versus global value chains, explaining that CESEE countries started out with a comparatively lower share of domestic value chains. Furthermore, CESEE has seen this share decline in importance over time. Taking Slovenia as an example, she pointed out that complex value chains feature lower productivity growth. This could mean that the CESEE countries are not yet ready for complex value chains. According to Jaklič, this might in turn explain missed convergence opportunities in the region. With reference to the COVID-19 pandemic, her research shows that only firms that had invested in human resources and digitalization managed to improve their position within GVCs. She agreed that CESEE countries should focus on digitalization.

*Fritzi Köhler-Geib, Chief Economist at the KfW Group*, showed that German SMEs have been hit hard by the COVID-19 pandemic as internationally active companies have been hit harder than locally operating companies. Many companies have learned their lessons and intend to reexamine existing GVCs. This could be a window of opportunity for CESEE countries, as many German companies want to diversify their GVCs by putting a stronger focus on European markets. Köhler-Geib concluded that firms have so far proved to be very flexible during the pandemic, which is why she was confident that firms would also be able to move toward a green digital economy.

The last panelist, *Boris Vujčić*, Governor of the Croatian National Bank, argued that GVCs have been less affected by the COVID-19 crisis than predicted. Overall, GVCs have been recovering rather quickly, and while some reshoring has already taken place, no major reversal is underway. He expects GVCs to remain resilient. Vujčić agreed that digitalization is a key factor for reaping the benefits of GVC integration. He added that structural changes driven by technology improvements are expected to be cost-efficient or even cost-neutral, leaving no impact on the inflation rate in the medium to long run. Touching on environmental issues, he pointed out that reducing carbon emissions could negatively affect GVCs in developing countries, as production tends to be more emission-intensive. However, exports of emission-efficient technologies from Europe to developing countries could also have an impact on the structure of GVCs.

## Central bankers' views on monetary policy implications of GVC integration

*OeNB Governor Robert Holzmann* chaired the panel discussion and opened it with the observation that while the role of globalization for domestic prices has received increased attention, this has been less the case for the impact of multistage international production processes on the design of monetary policy.

*Jiří Rusnok, Governor of the Czech National Bank*, started out by stressing Czechia's deep integration into GVCs. He emphasized that GVC integration increases cost and price competitiveness due to comparative advantages, while at the same time making economies more vulnerable to disruptions originating in GVCs. Such disruptions act as a supply-side shock, increasing inflationary pressure and slowing economic growth. Having moved higher up the value chain over the last three decades, the exchange rate pass-through has lost importance for Czechia, converging to levels typically observed in more advanced economies. *Mārtiņš Kazāks, Governor of the Bank of Latvia*, perceived his country's integration into GVCs as a key instrument to strengthen domestic productivity, exports and eventually income. In his view, many aspects of vulnerabilities can be best addressed by using instruments that lie outside the monetary policy realm like targeted labor market policies. Moreover, he argued that domestic disinflation is not an adequate solution, as long as the current price pressure stems from global supply-side frictions and remains transitory (i.e., as long as second-round domestic effects remain negligible). *Peter Kažimír, Governor of the National Bank of Slovakia*, stressed the importance of the automotive industry for Slovakia. Taking a longer-term perspective, he argued that increased GVC participation has been associated with lower core inflation and a flattening of the Phillips curve. At the same time, he expressed skepticism about GVC participation returning to pre-pandemic levels any time soon, as initiatives to nearshore and diversify supply chains have already been launched – not least for geopolitical reasons.

In a second round of discussion, the governors addressed the impact of price hikes that may directly or indirectly result from the climate crisis. They agreed that monetary policy is not in the driving seat in this context. However, they also acknowledged that there is an impact on price stability, financial stability and banking supervision, and thus on central banks' ability to achieve their mandates. Governor Kažimír expressed his concern that a rapid green transition could increase production costs, putting an upward pressure on prices. While decarbonization-related investments could indeed have inflationary effects in the short run, Governor Kazāks expects a positive impact on economies' growth potential in the longer run. Overall, he pleaded for more research on the inflationary effects of the climate crisis and put up for discussion whether the impact of carbon pricing should be taken out from the euro area's inflation target.

The final round of discussion focused on the implications for euro adoption. The declining role of the exchange rate pass-through to inflation in Czechia gave rise to the question of whether this could be an argument pro euro adoption. Governor Rusnok replied that although Czechia's economic integration with the euro area has deepened, there is currently no political majority in the country to progress accordingly. Governor Kazāks stressed that during the global financial crisis, when Latvia had not yet adopted the euro, external borrowing constraints were a major challenge, while, during the COVID-19 pandemic, being part of the euro area has acted as a shelter. Governor Kažimír emphasized that during the global financial crisis, Slovakia benefited from having joined the exchange rate mechanism ERM II in 2005 and from having adopted the euro in 2009. Being part of the euro area has also been helpful for Slovakia's participation in GVCs.

## Structural changes in the automotive industry: can CESEE escape the functional specialization trap?

In their lead statements, *Matteo Ferrazzi, Senior Economist at the EIB*, and *Tomáš Slačík, Senior Economist at the OeNB*, presented their joint research on the future of the automotive industry in CESEE focusing on the current electric car revolution. In their assessment, CESEE is well integrated into this transition and is expected to largely benefit from it, not least due to its links with Germany, the electrification hub. However, CESEE is strongly dependent on decisions taken by companies' headquarters. The authors underscored the role of policies in promoting patent applications, digitalization of production and regional and technological diversification.

In the following panel debate *Sigrid de Vries, Secretary General of the European Association of Automotive Suppliers (CLEPA)*, emphasized the sector's commitment to supporting the climate transition in a manageable way. At the same time, she stressed that all renewable energy solutions and clean drivetrain technologies are needed to decarbonize the road transport sector and achieve the EU's climate neutrality objective. She went on to alert the audience to the social and employment dimensions of the climate policy-induced. According to a recent study, a pace of vehicle electrification in line with the European Commission's "Fit for 55" proposal implies that about half a million jobs would be at stake in the European automotive industry until 2040. Yet, the study also suggests that new jobs created particularly in European battery production would reduce the net job losses to 275.000.

According to *Petr Pavlínek, Professor at the University of Nebraska Omaha and Charles University*, Europe will stay a significant player in the automotive industry, as it is an important market and car production needs to be located close to final sales. Moreover, CESEE continues to be attractive for the automotive industry thanks to its continued lower labor costs and proximity to markets. However, the high degree of foreign ownership and weak innovation activities indicates that combustion engine production may stay longer in the region and the introduction of mass production of electric vehicles will be slower than in Western Europe.

Referring to the previous speaker, *Martin Jahn, Board Member of ŠKODA AUTO a.s.*, was more positive not only about the sector's innovative power in CESEE but also about its future. He admitted that the transition would take some time, though. Even when assuming that new combustion engine cars will no longer be sold after 2035, they will still remain in operation until about 2045. This will give the industry enough time to adjust. Moreover, Jahn highlighted that not only electrification but also other trends like automated driving provide many new opportunities for suppliers. Yet having said that, Škoda's Board Member stressed that policy support is needed for upskilling and R&D investment. Jahn concluded that it is still unclear how quickly electric vehicles will be accepted by the market. The ensuing discussion with the audience centered on how future mobility trends may affect demand for cars. The panelists agreed that cars will continue to be produced in Europe and that European car demand will stay roughly constant, while the global car market will grow.

## Keynote by Richard Baldwin: Risks in global supply chains: do we need policy?

(photo: Graduate Institute Geneva)

*Richard Baldwin, Professor at the Graduate Institute Geneva*, focused on GVC risks: given the great heterogeneity within GVCs with respect to size, complexity, products, country and regional coverage as well as the variety of interaction modes, risks also differ depending on the type and configuration of each supply chain. Moreover, GVCs can be subject to supply, demand or transport shocks. Hence, appropriate policy responses have to address these. Focusing on systemic shocks to supply chains – such as pandemic, climate and geopolitical shocks, or the recent US-China trade conflict – he referred to the well-known risk versus return trade-off whereby private companies are likely to under- estimate risks. This opens up a role for economic policy in three ways: First, policies need to match the respective shock. Second, policies should provide public information on suppliers and apply public stress tests to critical supply chains. Finally, the public sector should work as a macro circuit breaker. This was demonstrated well in the pandemic when macroeconomic stabilization dampened snowball effects and thus kept demand afloat. Baldwin argued that public intervention should focus on certain industries of public interest, such as medical supplies, essential foodstuff and strategically important inputs.

## Keynote by Hylke Vandenbussche: Digitalizing and greening GVCs: what does the future hold?

*Hylke Vandenbussche, Professor and Vice Dean of Research at the University of Leuven*, emphasized. that Europe is facing serious supply problems for critical production inputs, in particular microchips. The European Chips Act, announced in September 2021, aims at doubling chip production in Europe by 2030, reduce vulnerabilities and reach more technological sovereignty. She pointed out that this represents a new form of non-protectionist strategic trade policy, which is not aimed at substituting for imports from competing suppliers but rather at complementing domestic production. Whether this is a viable strategy remains to be seen, as it implies a major efficiency-availability trade-off with potential implications for product quality as well. But in view of increasing systemic risks, the balance may well shift toward availability considerations. However, there are still many open issues related to reestablishing the microchip industry in Europe.

More specifically, Europe still has to determine in which parts of the value chain it wants to invest in, decide on the regional dispersion of production within Europe and consider the availability of necessary raw materials as well as the ecological footprint. And broader questions also arise: Will the reestablishment of the microchip industry foster a new regionalism, thus putting the multilateral approach under pressure? Will government interventions work for the technology sector given its reliance on innovation? And how can strategic mistakes from the past be avoided, which caused critical technology players like Philips, Nokia and Ericson to exit the European market?

## The future of GVCs from the firms' perspective: relocation, regionalization and just-in-time manufacturing in CESEE?

*Professor Giorgio Barba Navaretti from the University of Milan and Sciences Po, Paris*, pointed to the costs of nearshoring. As GVCs tend to embody relationship-specific sunk costs, it tends to be quite costly to give up relationships. Breaking up GVCs might be more attractive if trade and transportation costs with distant partners swelled substantially. As to Europe, there is plenty of evidence that CESEE is highly integrated into GVCs; yet, the contribution of domestic value added tends to be quite shallow. If CESEE aimed at a more sophisticated integration, the region would need to upgrade its social and service technologies. While GVC structures in Europe are likely to be resilient, a deepening of these chains and a clear technological overhaul in CESEE currently appear unlikely, in his view.

*James Zhan, Director of the United Nations Conference on Trade and Development (UNCTAD)*, pointed to GVCs' two decades of growth, followed, from about 2010, by tendencies of stagnation. Currently, we are witnessing regionalization pressures partly in response to growing geopolitical tensions. Against the backdrop of the continuing US-China trade war, national security needs have also been driving GVC diversification. In Zhan's opinion, the overall directional trend in international production points toward shorter value chains and greater concentration of value added.

*Xiaolan Fu, Professor at the University of Oxford*, emphasized the importance of digitalized value chains for sustainable post-pandemic GVCs. Lessons learned from COVID-19 and the trade war will push business to build more resilient production systems. Geopolitically determined regionalization is the major underlying trend. Digital technologies should also be harnessed to facilitate global knowledge flow, especially in a situation where human mobility is still hindered by pandemic-related measures. The green transition may imply a comparative advantage for on- or nearshoring. In the post-COVID-19 world, there may be a "green window of opportunity."

## Building a smart and green Europe: GVCs and the role of skills

*Michael Landesmann, Professor at Johannes Kepler University Linz*, provided a review of how CESEE economies' integration into GVCs has contributed to convergence, relying, however, on strong specialization in the production phase. He argued that economies may be restricted in moving beyond this specialization, especially in the intra-European context where the potential for further outsourcing is limited. He argued that structural adjustments toward green and smart economies will require active labor market policies and sufficient funds to address CESEE-specific challenges.

*Olga Strietska-Ilina, Senior Skills and Employability Specialist at the International Labour Organization (ILO)*, highlighted that the pandemic augmented inequality in the labor market with respect to job security, gender and skills. At the same time, awareness of climate-related vulnerabilities intensified, raising demand for green skills and jobs. She argued that new skills, such as resilience, change management, problem-solving, innovation and creativity as well as occupational health and safety, have become extremely important during the pandemic.

*Alexandra Bocşe, State Adviser* and *Head of the Department of Climate and Sustainability at the Romanian Presidential Administration*, provided insights into Romania's experience. The country is involved in the construction of components for wind turbines and has successfully developed regional champions, such as the Renewable Energy School of Skills and a new biofuel plant. At the same time, there are a number of regions in the country which are reliant on coal and pollutant industries. Workers in these regions will be strongly affected by the green transition and will require programs to develop new or transferable skill sets.

## The future of GVCs from the political economy perspective: strategic autonomy, social responsibility and environmental sustainability

The chair of the final session, *Gabriel Felbermayr, Director at the Austrian Institute of Economic Research (WIFO)*, emphasized the timeliness of the discussion and highlighted three factors that are likely to shape future trade policy: (i) the vanishing trust in the global economic system, (ii) the increasing use of trade policy to achieve social, environmental and human rights objectives; and (iii) the national attempts to safeguard domestic businesses after the introduction of measures such as CO2 pricing.

*Maria Demertzis, Deputy Director of Bruegel*, pointed out that the discussion is too narrowly focused on the dimensions of dependency versus strategic autonomy, neglecting related trade-offs: If you are autonomous, you are very predictable but forgo potential efficiency gains. A map of the "geography of dependence" shows that the US and the EU are highly interdependent, with both hinging heavily on China. While the EU's dependency on China is concentrated on a small number of items, these have shown to be crucial (including health products or raw materials). She warned that a reversal of globalization would disproportionally hurt less advanced countries Global public goods such as the environment require global collaboration. We thus need a narrative of global, fair solutions instead of strategic autonomy discussions.

*David Haugh, Senior Economist at the OECD*, focused on his institution's contribution to implement certain social responsibility standards in companies´ operations, supply chains and business relationships. The OECD's Multinational Enterprise Guidelines and Due Diligence Guidelines give recommendations for responsible business conduct. From a political economy perspective, this approach has proved to be effective in spite of its voluntary nature.

*Robert Koopman, Chief Economist at the WTO*, began by observing that 12% of greenhouse gas emissions are caused by transportation of traded goods. However, producing everything locally would not solve the problem, as less efficient local production may offset the gains from shorter distances. By the same token, domestic production would not fully isolate from the adverse effects of climate change. Over time, Koopman expects supply chains to become more modular and standardized, providing parts and components that fit into many different products. With climate challenges being too pressing to wait for a global consensus, groups of countries may push ahead with climate clubs in certain areas.

For more information see [Conference on European Economic Integration 2021 - Oesterreichische Nationalbank (OeNB)]

# OeNB Euro Survey

The OeNB Euro Survey has been conducted since 2007 in ten Central, Eastern and Southeastern European (CESEE) countries. Its central focus is on exploring different dimensions and drivers of currency holdings and households' saving and borrowing behavior. The main results of the OeNB Euro Survey are published on the OeNB's website at https://www.oenb.at/en/Monetary-Policy/Surveys/OeNB-Euro-Survey/Main-Results.html. The charts are available for download in different file formats and the underlying data can be exported as CSV files.

The data collected in fall 2021 are currently undergoing internal quality checks and the main results on the website are expected to be updated in the course of the second quarter 2022. Data from the Euro Survey are regularly used for analyses by researchers and policy makers. For example, the EBRD's recent Transition Report 2021/22 features a box (pp.104-5) on the relationship between digitalization and the use of contractual savings and capital market investments, an analysis that draws on Euro Survey data from 2015-2020 and links the survey data with data on mobile coverage.

# Save the date

## 89th East Jour Fixe

**CESEE countries in (e-)motion: trends in the automotive industry and individual mobility Recalibrating tomorrow's global value chains – prospects for CESEE**

organized by the Oesterreichische Nationalbank (OeNB) in cooperation with the European Investment Bank (EIB) and The Vienna Institute for International Economic Studies (wiiw)

March 28, 2022

Oesterreichische Nationalbank
Otto-Wagner-Platz 3, 1090 Vienna, Austria

Hybrid live and online conference

If you want to attend, please contact event-management@oenb.at

## Focus on European Economic Integration Q4/21 – latest issue (full version)


### Call for applications

Klaus Liebscher Economic Research Scholarship

### Recent economic developments and outlook

Developments in selected CESEE countries
Easing of the pandemic fuels growth and inflation

Box 1: Ukraine: economy struggles to recover amid tighter monetary policy conditions following rising inflation

Box 2: Western Balkans: removal of COVID-19-related restrictions fueled V-shaped recovery

CESEE-6: broad-based recovery subject to still high uncertainty – Russia: from rebound back to moderate growth amid persistently high risks

### Studies

Green transition: what have CESEE EU member states achieved so far?
*Andreas Breitenfellner, Mathias Lahnsteiner, Thomas Reininger and Jakob Schriefl*

Which borrower in CESEE gets which loan? Evidence from the OeNB Euro Survey
*Marc Bittner*

## Event wrap-up

88th East Jour Fixe - Household financial vulnerabilities in CESEE: what impact has COVID-19 had and how to best measure the changes?
Compiled by Elisabeth Beckmann, Pirmin Fessler, Julia Wörz

26th Global Economy Lecture - Partha Dasgupta on "Viewing the future from the population-consumption-environment nexus"
Compiled by Andreas Breitenfellner and Maria Silgoner

# Upcoming Events

The following events are organized by the OeNB and i. a. cover CESEE relevant topics.
**Please note that attendance is by invitation only.** If you are interested in participating in one or more of the events, please send an e-mail to event-management@oenb.at.

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|---|---|
| March 28, 2022 | 89th East Jour Fixe: CESEE countries in (e-)motion: trends in the automotive industry and individual mobility Recalibrating tomorrow's global value chains – prospects for CESEE |
| November 21–22, 2022 | Conference on European Economic Integration (CEEI) |

# OeNB Courses at the Joint Vienna Institute (JVI) 2022

In light of the ongoing COVID-19 global health emergency, the Joint Vienna Institute (JVI) has suspended its face-to-face training operations until the beginning of May 2022. Courses are being delivered as virtual training events. In addition, the JVI is offering a series of webinars.

For the most up-to-date information on JVI training courses, please click the following link: https://www.jvi.org/courses/course-schedule-2022.html

# Upcoming OeNB courses

| Title | Organization | Date |
|---|---|---|
| HR Issues and Compliance | Oesterreichische Nationalbank, in cooperation with the Deutsche Bundesbank | February 21–25, 2022 |
| Financial Education | Oesterreichische Nationalbank | April 25–29, 2022 |
| Euro Area Integration and Accession: Institutional Challenges and Governance Issues for Central Bankers | Oesterreichische Nationalbank | May 9–13, 2022 |
| Climate Change and Green Finance | Oesterreichische Nationalbank, in cooperation with the Austrian Federal Ministry of Finance | June 20–24, 2022 |
| Macrofinancial Stability in Central, Eastern and Southeastern Europe | Oesterreichische Nationalbank, in cooperation with the JVI | October 10–19, 2022 |

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|---|---|---|
| Financial Translation and Editing: Trends and Tools for Future Challenges | Oesterreichische Nationalbank | October 19 – 21, 2022 |
| Cash Circulation and Payment Systems in Austria | Oesterreichische Nationalbank | November 21 – 23, 2022 |
| Monetary and Financial Statistics Collected and Compiled by the ESCB | Oesterreichische Nationalbank | November 21 – 25, 2022 |

For more information please follow this link: https://www.jvi.org/home.html