

IMF Regional Economic Issues Update

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Geopolitical Tensions Taking a Toll

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Significant Downside Risks Are Threatening Growth

The IMF's October 2014 Regional Economic Issues (REI)¹ Update for Central, Eastern and Southeastern Europe (CESEE)² has revised CESEE growth for 2014 down by ½ percentage point compared to the April 2014 REI, largely reflecting the effects of the tensions between Russia and Ukraine, sanctions, counter-sanctions and protracted weak growth in the euro area, CESEE's main trading partner. Growth is slowing across most of the CESEE region, with the exception of Central and Eastern Europe (CEE) and the Baltics. The IMF projects CESEE growth at 1.2% for 2014, before picking up again to 1.7% in 2015.

Diverging Macroeconomic Trends across CESEE

Private consumption has become the key growth driver in CEE (with the exception of Hungary) and in much of the Baltics and Southeastern Europe, thus contributing to the strengthening of domestic demand. As to inflation, declining world food and energy prices and disinflationary spillovers from the euro area have further enhanced the downtrend of inflation in most countries, whereas Turkey, Russia and the CIS countries have experienced high inflation. With the exception of Russia and Ukraine, external financing conditions have remained supportive for most CESEE countries. Funding by foreign banks to the CESEE region has continued to decline since late 2008, which in part reflects the unwinding of the precrisis credit boom. Foreign banks now seem to be following a more differentiated approach across countries; only countries with healthier fundamentals are seeing a resumption of foreign bank funding.

Policy Priorities: Securing a Robust Recovery and Improving Potential Growth

According to the IMF, the establishment of robust and balanced growth requires a recovery in corporate credit and investment. Given significant downside risks, CESEE countries need to reduce vulnerabilities and increase buffers. In addition, as CESEE countries are highly dependent on energy imports, they should make a concerted effort to improve their resilience to energy shocks, such as contributing to a more integrated regional energy market.

¹ The REI is published twice a year by the IMF and covers analytical issues of interest to policymakers, academics and the broader public in the relevant region.

² The CESEE region includes Turkey and the following four subregions: Central and Eastern Europe (CEE) consists of the Czech Republic, Hungary, Poland, Slovakia and Slovenia (21% of regional GDP); Southeastern Europe (SEE) consists of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, the former Yugoslav Republic of Macedonia, Montenegro, Romania and Serbia (8% of regional GDP); the Baltic region consists of Estonia, Latvia and Lithuania (2% of regional GDP); the CIS group consists of Belarus, Moldova, Russia and Ukraine (51% of regional GDP).