IMF presents its fall report on CESEE Regional Economic Issues (REI): "Reconciling Fiscal Consolidation and Growth"

Summarized by
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On November 13, 2015, the IMF's Regional Economic Issues (REI) report for Central, Eastern and Southeastern Europe (CESEE)[2] was presented at the Oesterreichische Nationalbank (OeNB). This event also marked the official launch of the IMF's fall 2015 REI, as the report was published on the IMF's website at the same time and was then presented in a series of seminars in several European cities.

Jörg Decressin, Deputy Director of the IMF's European Department, analyzed the risks and policy priorities for CESEE countries, while *Johannes Wiegand*, Deputy Chief of the Emerging Economies Division in the IMF's European Department, focused on reconciling fiscal consolidation and growth in CESEE. *Anna Ilyina*, Chief of the Emerging Economies Division in the IMF's European Department, then provided further insights into the economic performance of CESEE countries.

The presentations were followed by a discussion during which journalists, OeNB economists and experts from various economic institutions and commercial banks raised additional topics and exchanged their views.

Opening remarks

The event was opened by *Ewald Nowotny*, Governor of the OeNB, and chaired by *Franz Nauschnigg*, Head of the OeNB's European Affairs and International Financial Organizations Division.

In his opening remarks, Governor Nowotny underlined the importance of CESEE as a region of strategic interest for the OeNB and stressed the importance of Vienna as a hub for CESEE know-how, as regards economic, administrative, commercial and legal linkages to the CESEE region. He furthermore mentioned that CESEE cannot be considered as a homogenous region, as, for instance, the Southeastern European (SEE) countries are facing a bigger fiscal consolidation challenge than the Central and Eastern European (CEE) countries.

Positive growth in 2016

At the beginning of his presentation, Jörg Decressin explained that the 2015 GDP growth forecast for the CESEE region as a whole remained broadly unchanged compared to the REI publication of May 2015, but that there were notable shifts in the contribution of countries: Growth was revised up for CEE and SEE, kept unchanged for Russia and Turkey, and revised down in the Baltic states and other CIS countries. In other words, most CESEE countries are growing at a healthy pace, whereas Russia and other CIS economies are facing significant economic challenges and are in recession.

However, stabilization is expected for 2016, as the Russian economy adjusts to low oil prices and sanctions: The CESEE region as a whole is set to contract by

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[2] *The IMF's semiannual CESEE REI report assesses the macroeconomic outlook for CESEE in light of the latest global economic and financial developments and covers more than twenty countries, including Central and Eastern Europe (CEE), Southeastern Europe (SEE), the Baltic region, the Commonwealth of Independent States (CIS), and Turkey.*

0.6% in 2015, but to expand by 1.3% in 2016. The growth divergence among CESEE countries is mainly driven by different levels of domestic demand, and partly spurred by payouts from EU structural and cohesion funds. Also the rates of inflation differ among the countries, with very low inflation prevailing in many economies.

New risks to the outlook

The balance of risks has shifted to the downside, as China's slowdown and the ongoing refugee crisis represent new risks. Jörg Decressin highlighted that it now depends on European politics whether the refugee crisis will translate into a downside or rather an upside risk, as in the medium term the associated spending increases might boost growth.

According to Decressin, policy priorities depend on how far along the economies are in their postcrisis adjustment and on their exposure to external risks: Where the recovery is well advanced, the focus should be on implementing structural reforms and rebuilding fiscal buffers, while in case of economies in recession, fiscal policy should aim at supporting domestic demand, and monetary policy should address inflation where it is high. In addition, countries vulnerable to external shocks (as for instance Turkey) need to be prepared to deal with market pressures by using exchange rate flexibility as a shock absorber alongside macroprudential policies designed to contain the buildup of financial sector risks.

Growth-friendly consolidation and budget reform necessary

Johannes Wiegand then elaborated on fiscal consolidation in CESEE and its long-term impact on growth: As large fiscal challenges remain in CESEE, lifting potential growth is a key medium-term goal for CESEE countries.

Wiegand highlighted that the growth friendliness of government budgets remains a key policy challenge: Most CESEE economies had entered the global financial crisis with growth-unfriendly budgetary structures: on the spending side, budgets were characterized by high public consumption and large unproductive transfers, whereas on the revenue side, they showed a disproportionate reliance on labor taxes, notably social security contributions.

Hence, in the aftermath of the global financial crisis, economies in CESEE came under pressure to correct external and internal imbalances as the global financial crisis forced sharp, procyclical fiscal adjustments in many CESEE countries.

As regards budget structures, Wiegand stated that intra-CESEE differences are modest and that these structures resemble those of advanced Europe more closely than those evident in other emerging economies. However, since the global financial crisis, the budget structure has changed markedly and budget balances have generally improved: governments came under pressure to consolidate public finances, which tended to have a positive impact on the quality of budgets. Growth-friendly consolidation and budget reform is critical to strengthen long-term growth prospects. However, fiscal consolidation has not yet run its course, with sizeable adjustment needs remaining, especially in SEE, where the budgetary situation has deteriorated. In contrast, the expenditure structure of the Baltic and CEE countries has improved, as they have cut current spending.

According to Wiegand, key policy priorities should include reducing unproductive transfers while protecting productive spending on health, education and public infrastructure, reforming public employment, leveraging access to EU funds and shifting taxation from income to consumption: Growth friendly consolidation and budget reform is critical to strengthen long-term growth prospects in CESEE.

The IMF's CESEE REI report can be downloaded at:
http://www.imf.org/external/pubs/ft/reo/2015/eur/eng/pdf/rei1115.pdf