Kastryčnicki Ekanamičny Forum

Ураджай ідэяў дзеля ўстойлівага развіцця

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Даследчы цэнтр ІПМ

KEF-2017: Foundations of the future

Sustaining growth. Focus on the transition region

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Sustaining growth
Focus on the transition region

Artur Radziwill

Director, Country Economics and Policy

KEF-2017: Foundations of the future
Minsk, November 2–3, 2017

European Bank
for Reconstruction and Development

Current economic outlook

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Global economic outlook has strengthened in recent months

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Global growth ↑ by 0.4 pp in 2017, to 3.6%, and further to 3.7% in 2018

The recovery momentum has been broadly shared across countries, signs of investment revival

Global trade growth has picked up somewhat, expected at 4%+ in volume terms in 2017 (in line with output growth)

Global growth, %

Source: IMF and authors' calculations.

Financing conditions cycle has run ahead of economic cycle: improved financing conditions for EMs

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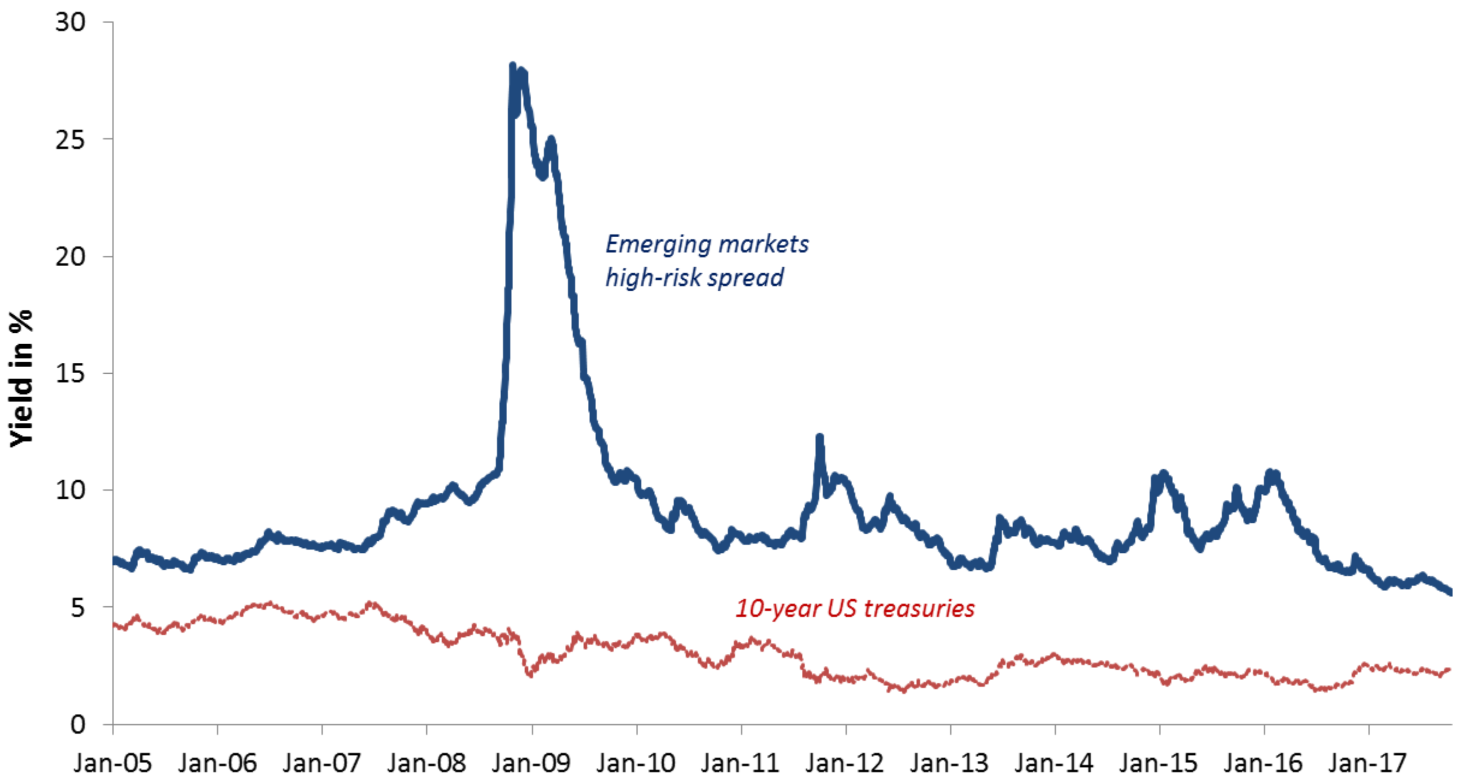
Argentina's 100-year old bond placement in Jun'17 and Ukraine's US$ 3 billion bond in Jun'17 oversubscribed several times

Tajikistan (S&P B-) issued a 10-year bond in Sep'17 with a yield of 7.1% (US$ 500m = 7% of GDP, oversubscribed 6+ times)

Belarus placed 10-year bonds yielding 7.6 per cent in Jun'17, others countries took advantage of favourable conditions, too

Yields, %



Source: Bloomberg.

Stock market volatility low for the longest time since 2013

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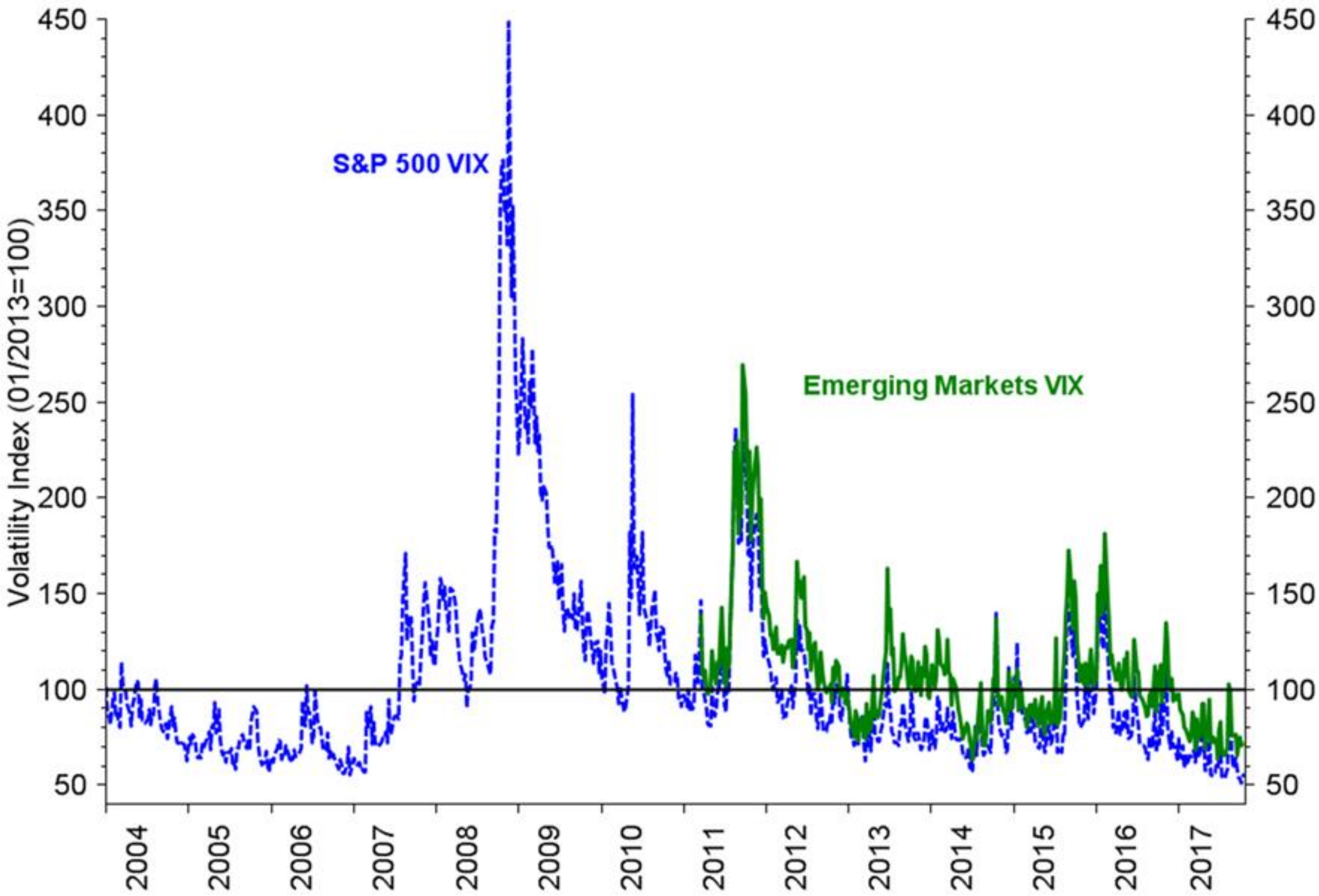
Market volatility, Index 100 = 01/2013



Source: Thomson Reuters.

Oil prices in January-October 2017 up 19% yoy, the highest increase since 2011

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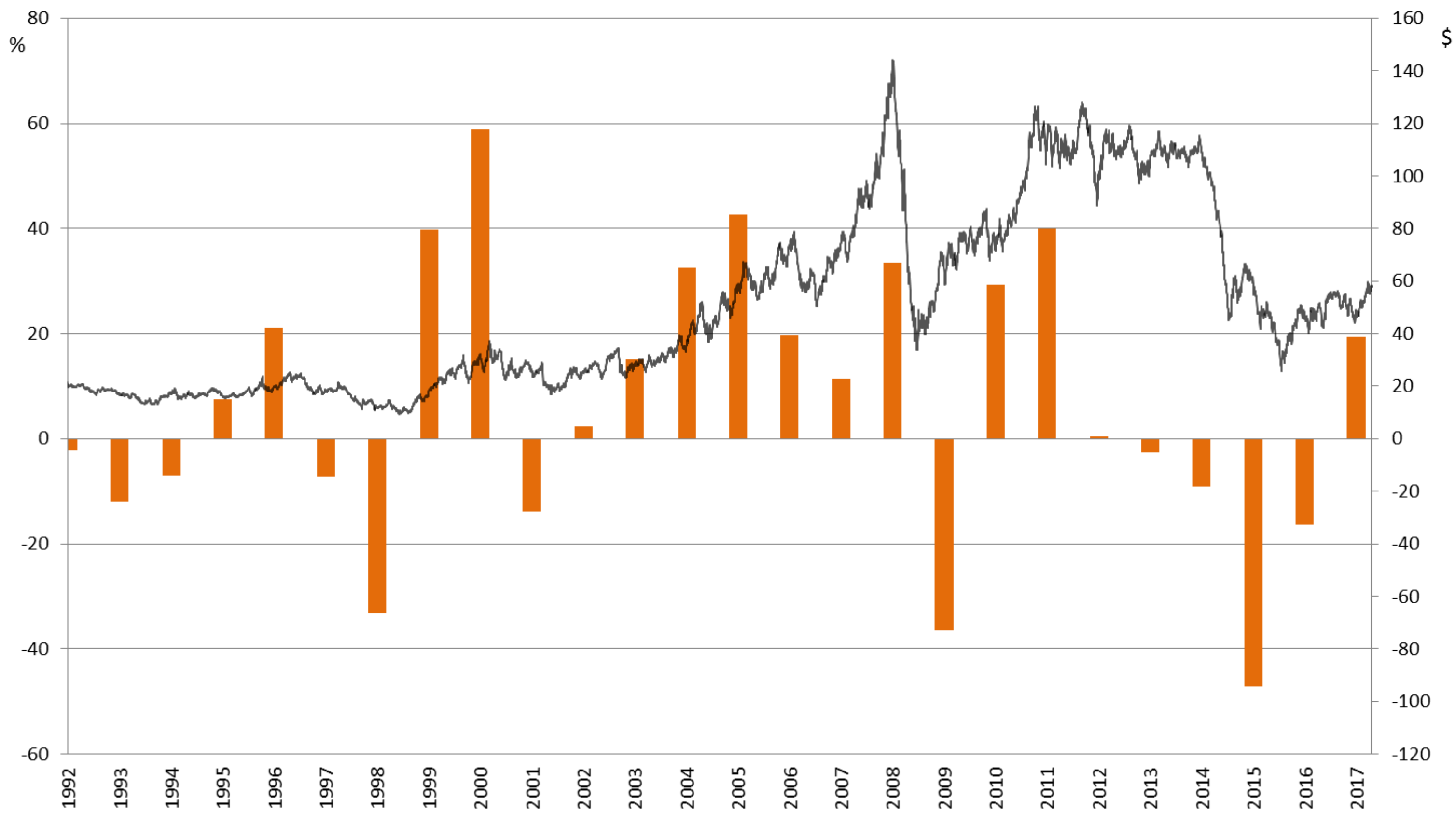
This differential provided a substantial boost to year-on-year growth in Russia and Central Asia
Oil price expected in the US$ 50-60 range as increased demand can be met by shale

Change in annual average oil price (Brent), %



Source: Reuters and authors' calculations. The 2017 estimate is based on January-October.

EBRD region: 3.3% in H1 2017, up from 1.9% in 2016
Same trend into November, based on EBRD Nowcast

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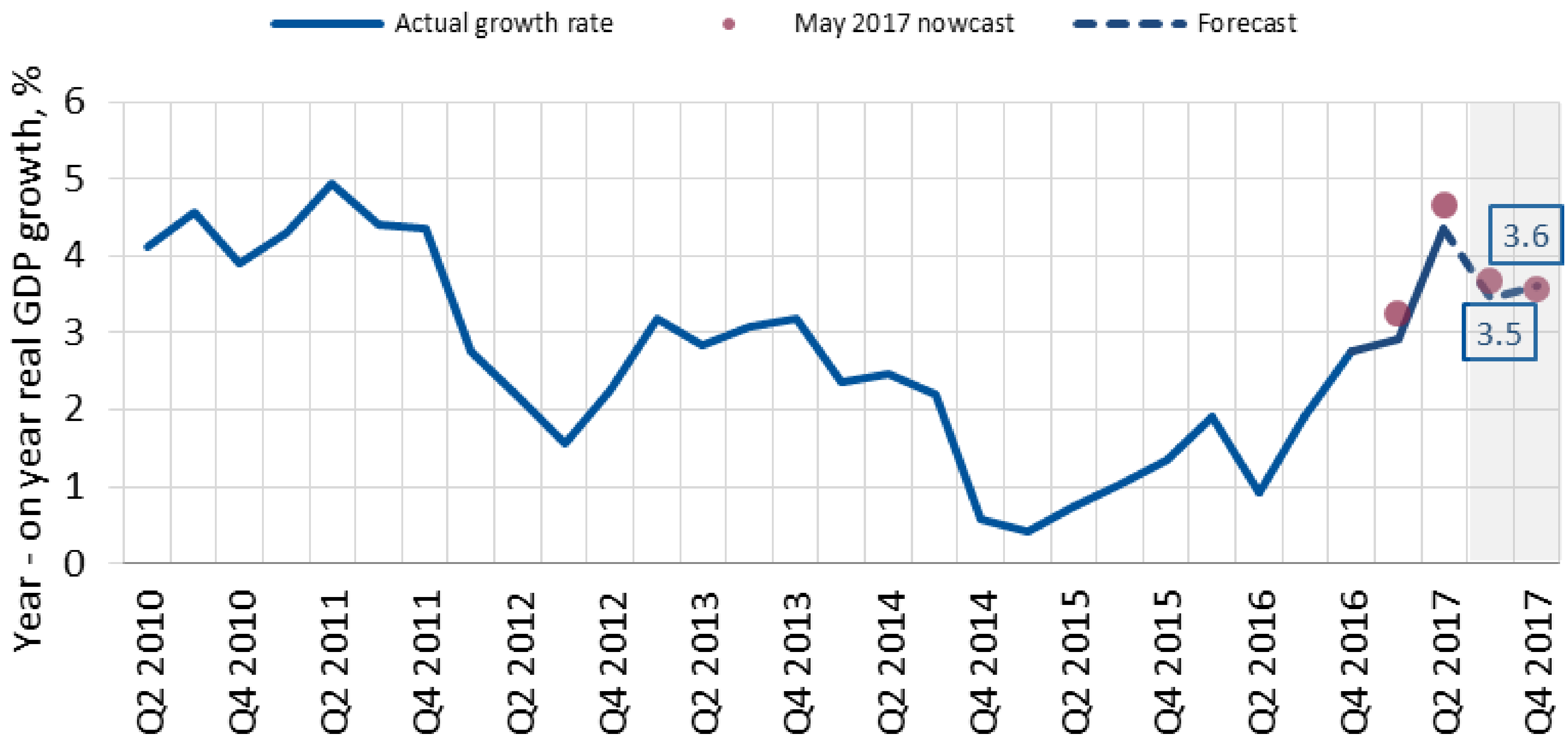
EBRD Nowcast estimates growth in the region based on 152 economic and financial variables monitored in real time

Growth, year-on-year, %



Source: EBRD calculations based on CEIC, national authorities, IMF, Bloomberg.

The recovery momentum is perhaps more notable for its breadth than its strength

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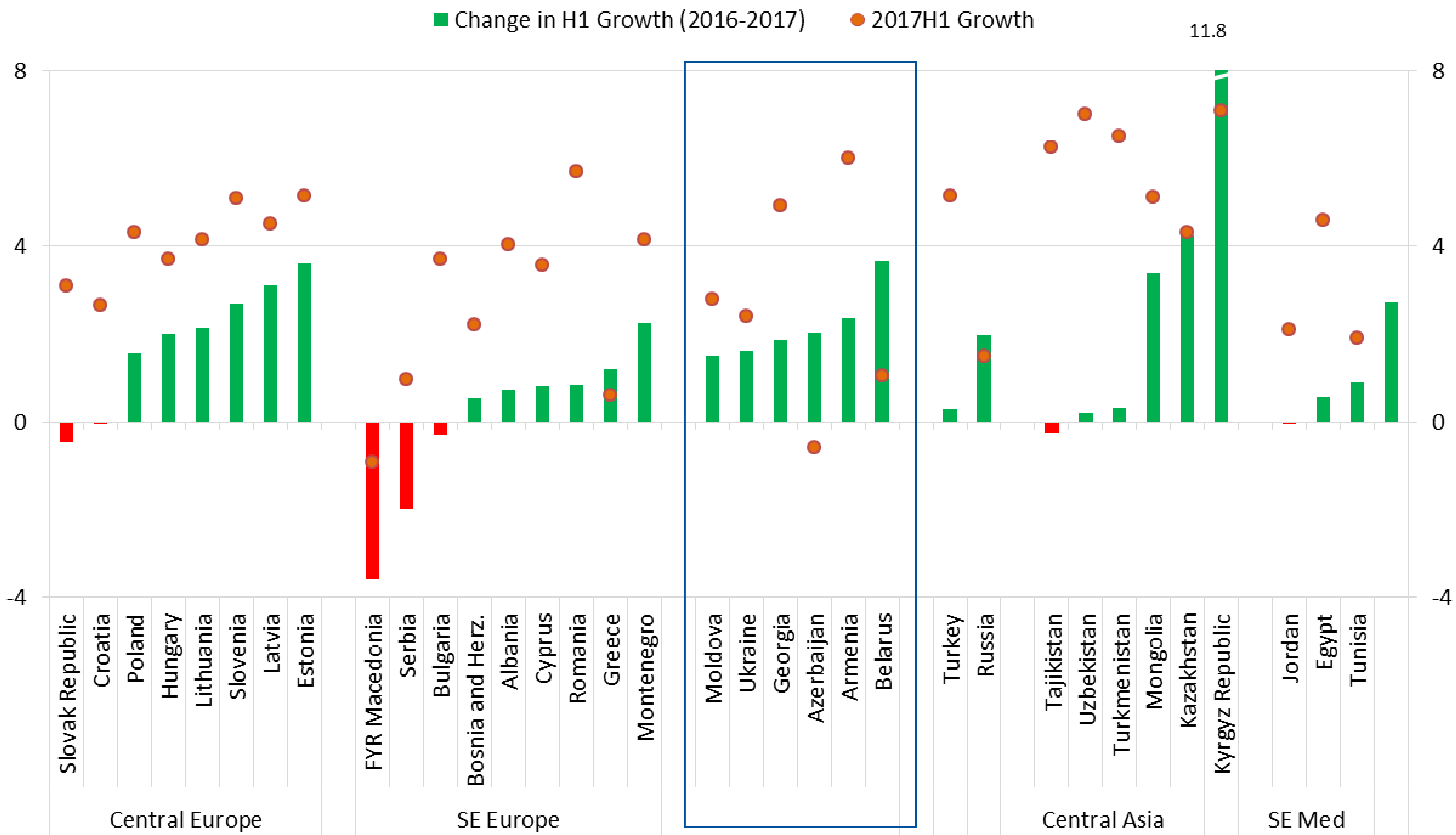
Growth in H1 2017, year-on-year, %



Source: National authorities, CEIC and authors' calculations.

Year-on-year growth picked up in 29 countries out of 36 in H1 2017 vs. H1 2016

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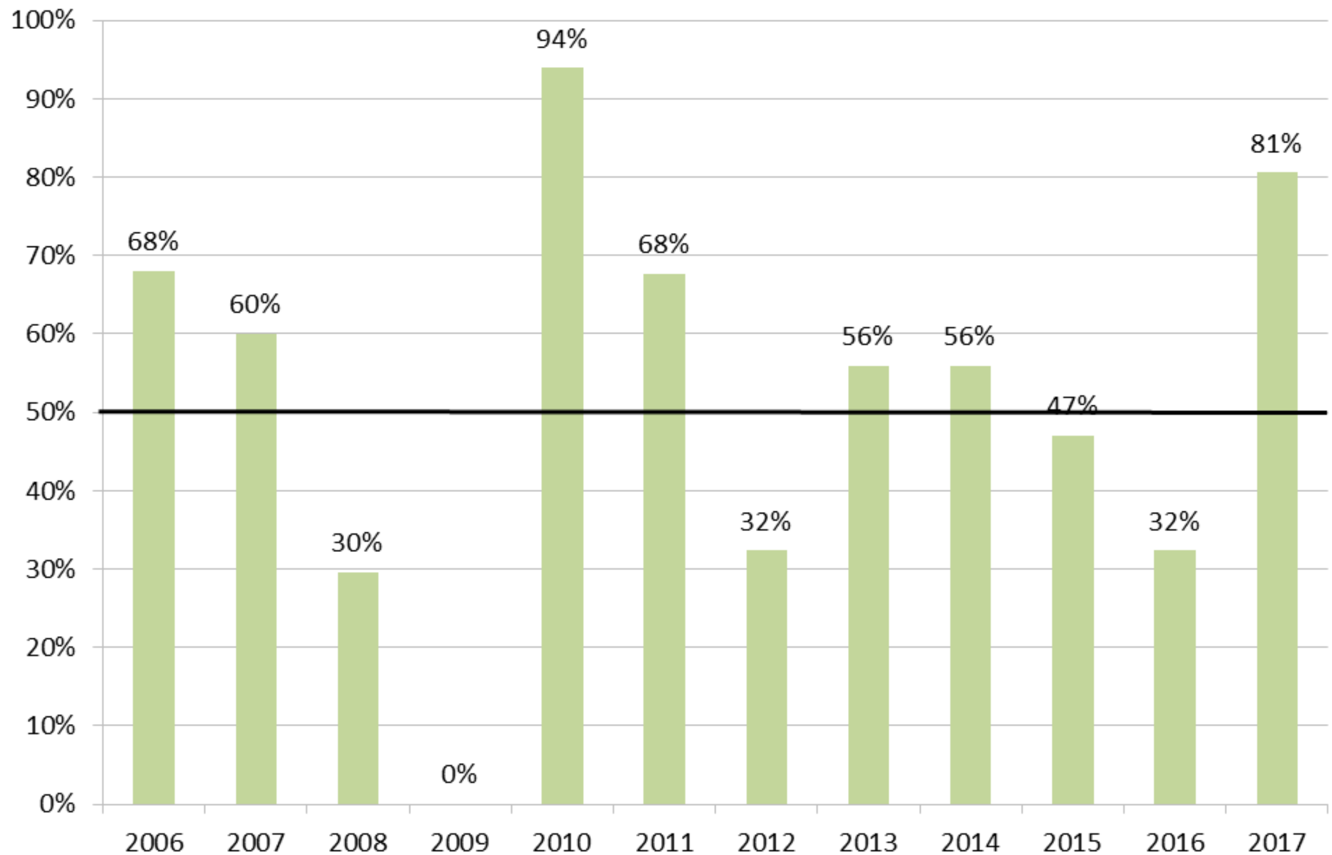
The first such occurrence since 2010

% of countries in the EBRD region with accelerated year-on-year growth in H1



Source: National authorities, CEIC and authors' calculations.

But growth remains below that of comparator emerging markets with similar per capita incomes

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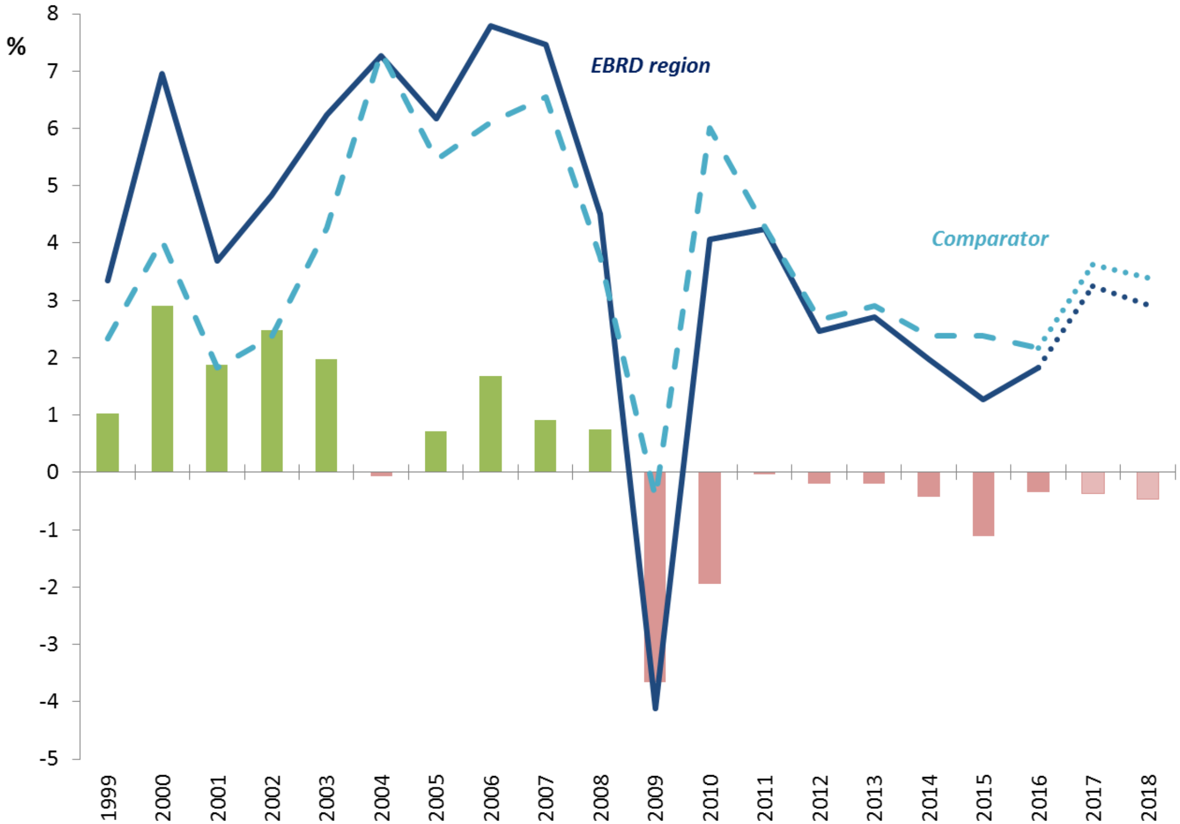
EBRD region outperformance yielded 15% higher output; underperformance cost 9% of output

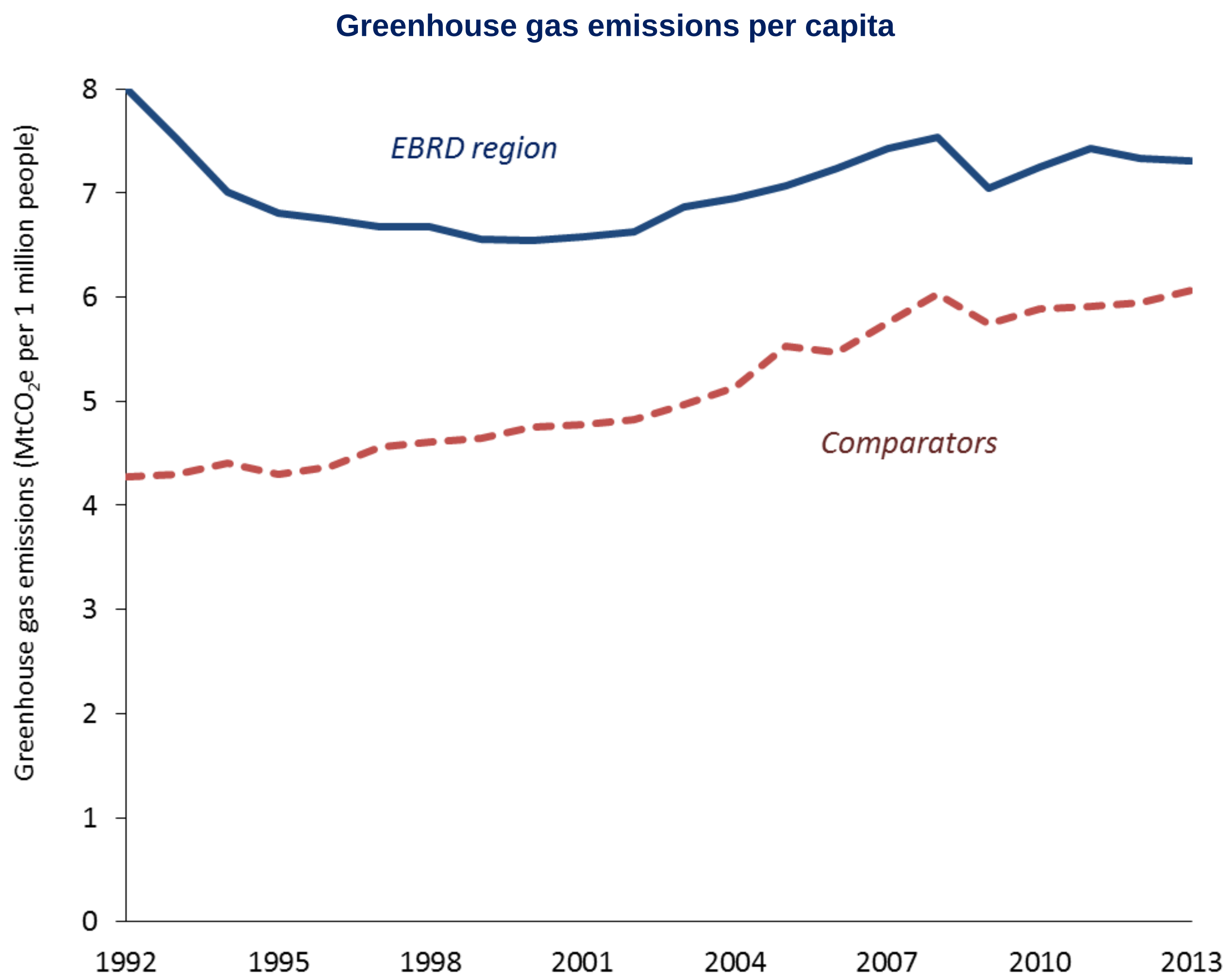
For each country, construct synthetic comparator (15+ countries with max weight 15%) in each year (income per capita, population)

EBRD region's growth, %



Source: IMF WEO and authors' calculations. For instance, Tunisia's comparators include Ecuador, Indonesia, Sri Lanka, ++.

… while its environmental footprint remains higher



Source: World Resources Institute (2017) and authors' calculations.

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Growth in 1998-2008 was driven by total factor productivity

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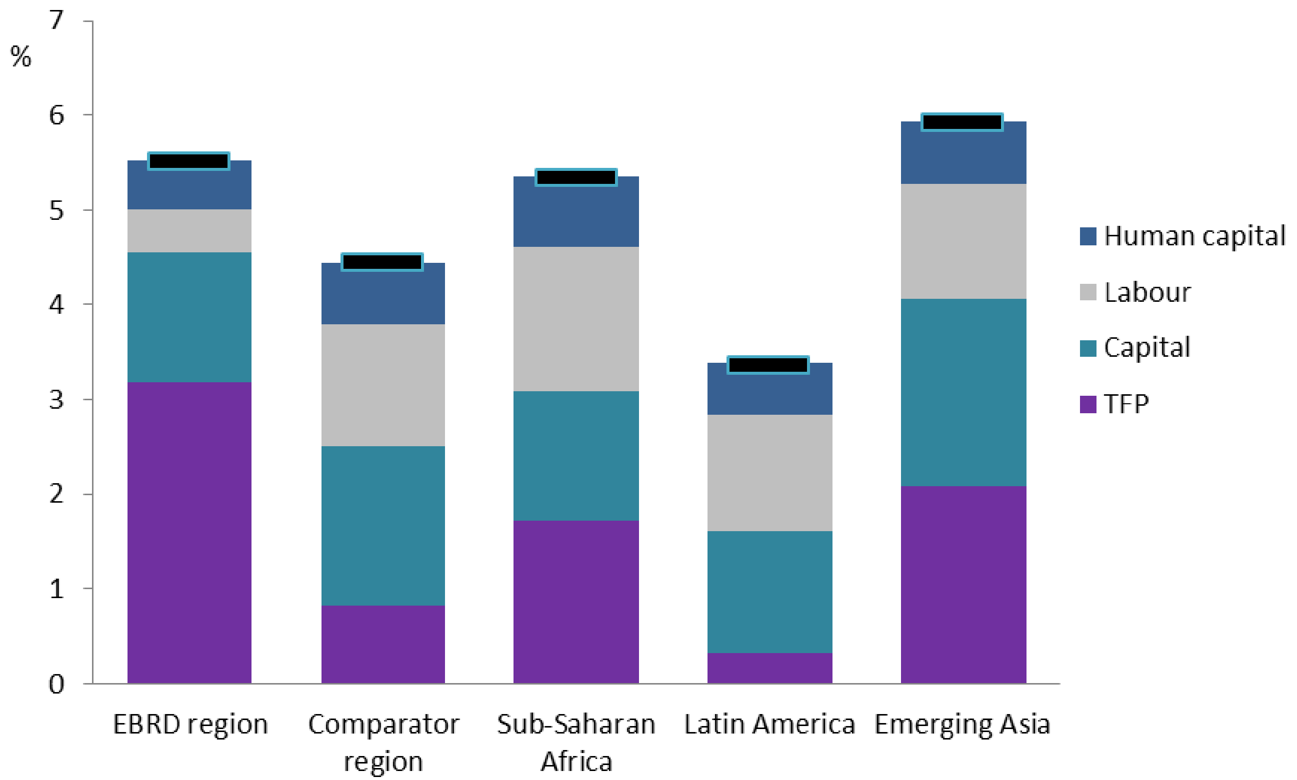
High levels of education, urbanisation and industrial development but factors of production had been combined inefficiently under central planning

Market reforms helped to improve efficiency of factor use, boost productivity and close TFP gap

Decomposition of sources of growth, 1998-2008, % per annum



Source: Penn World Tables, IMF, World Bank and authors' calculations.

With inefficiencies eliminated, countries seem to face typical middle-income challenges

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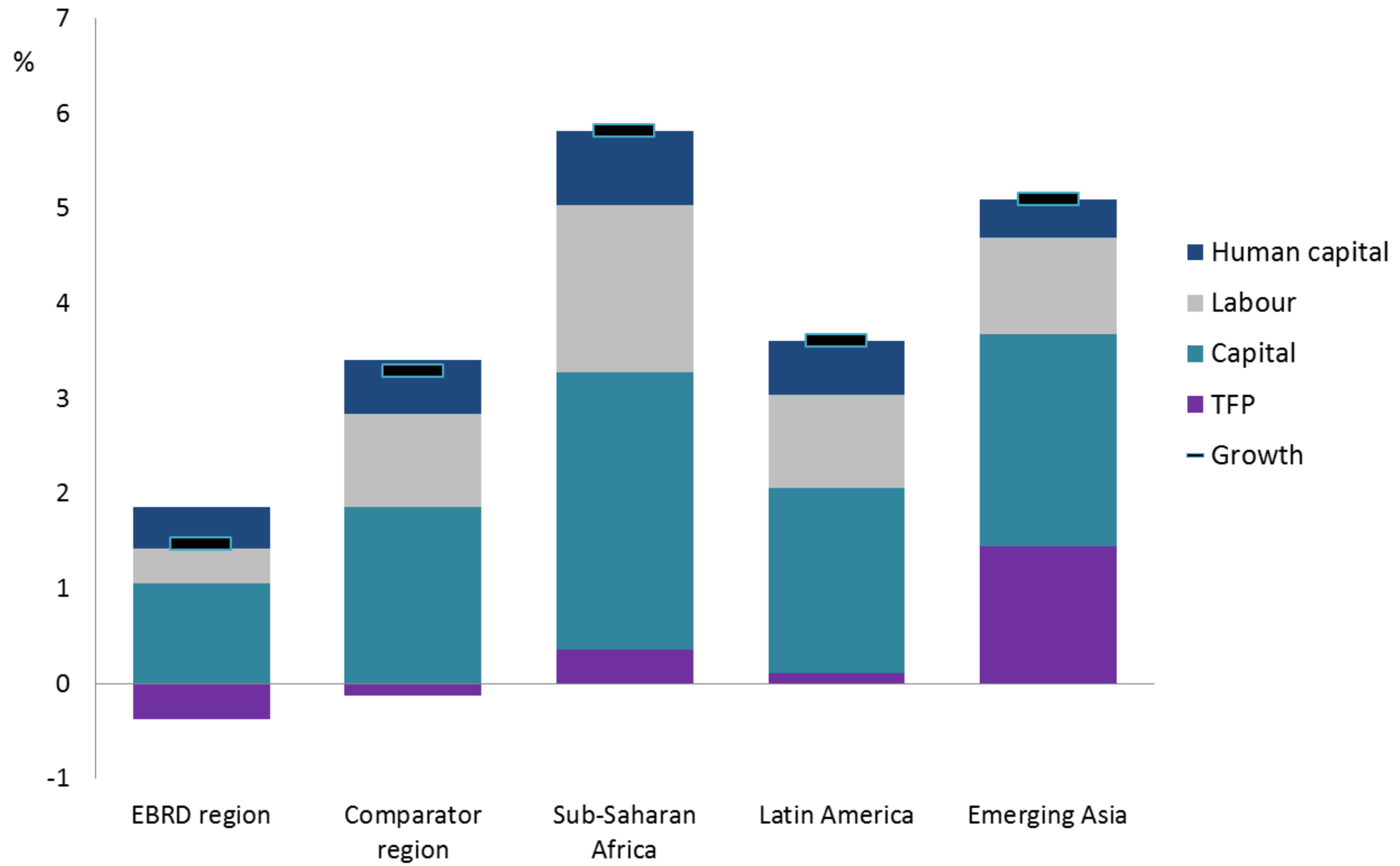
TFP slowdown also in (small) part reflects lower capacity utilisation (limited data)

Growth now driven by capital accumulation (as in most EMs)

Decomposition of sources of growth, 2008-14, % per annum



Source: Penn World Tables, IMF, World Bank and authors' calculations.

Middle-income trap?

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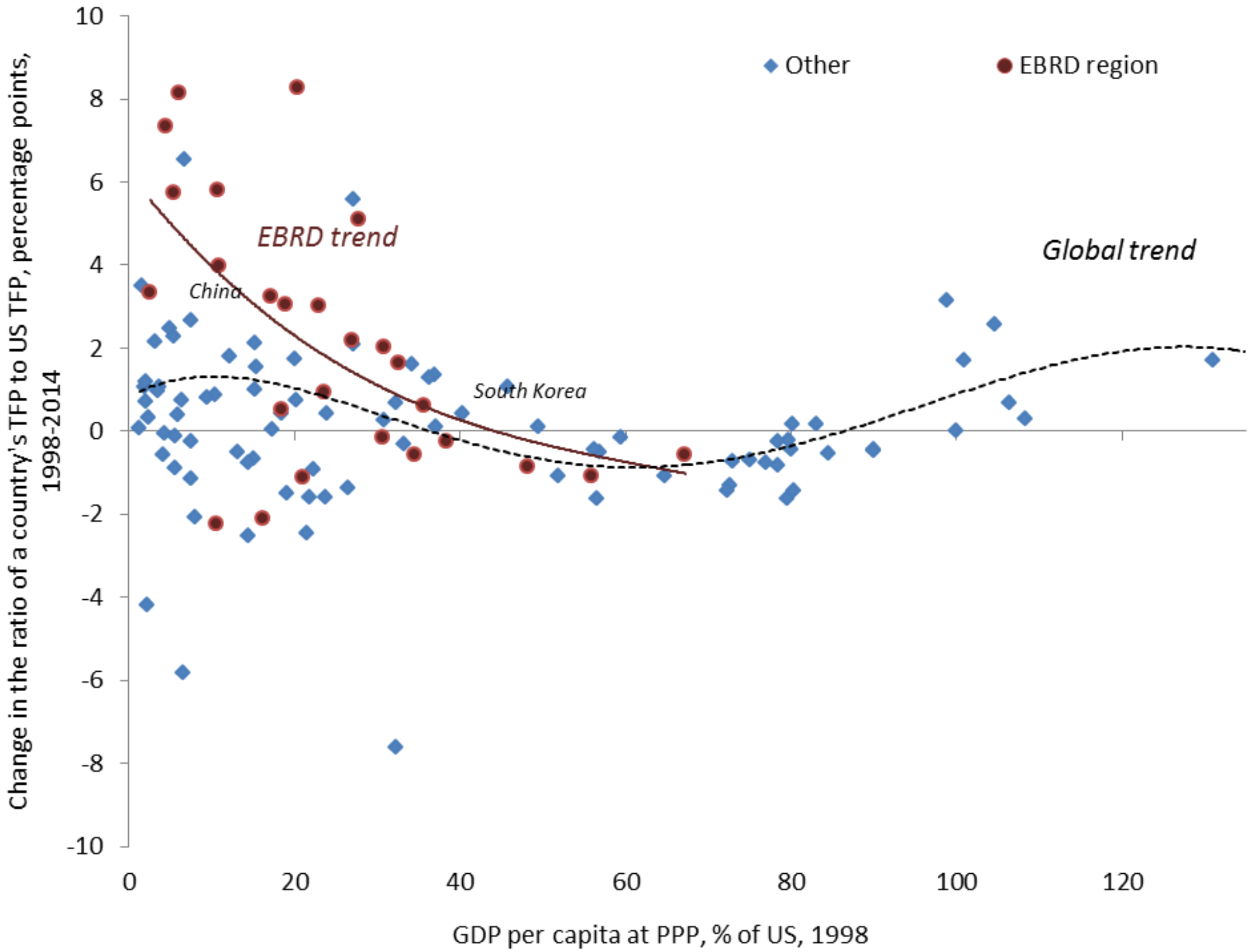
Initial per capita income and total factor productivity growth, 1998-2014



Source: IMF, World Bank, Penn World Tables and authors' calculations. The trend line is based on a polynomial fit.

Another aspect of middle-income trap: least green production ("the environmental Kuznets curve")

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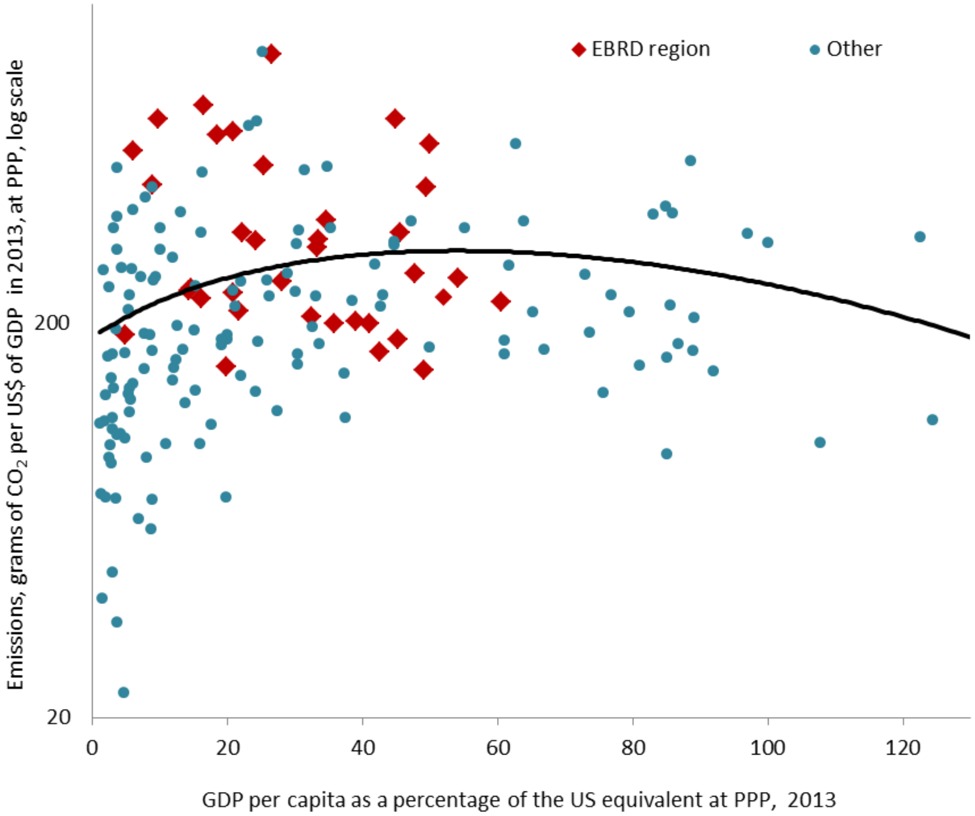
Middle-income countries have higher level of pollution per unit of GDP than poorer peers (that have not yet built polluting industries) and advanced economies (that moved on to develop post-industrial, greener sectors)

GDP per capita and emissions per unit of GDP in 2013



Source: World Resources Institute, IMF and authors' calculation. The trend line is based on a polynomial fit.

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Some countries succeeded in middle-income transitions, for example, Korea first boosted TFP, then capital

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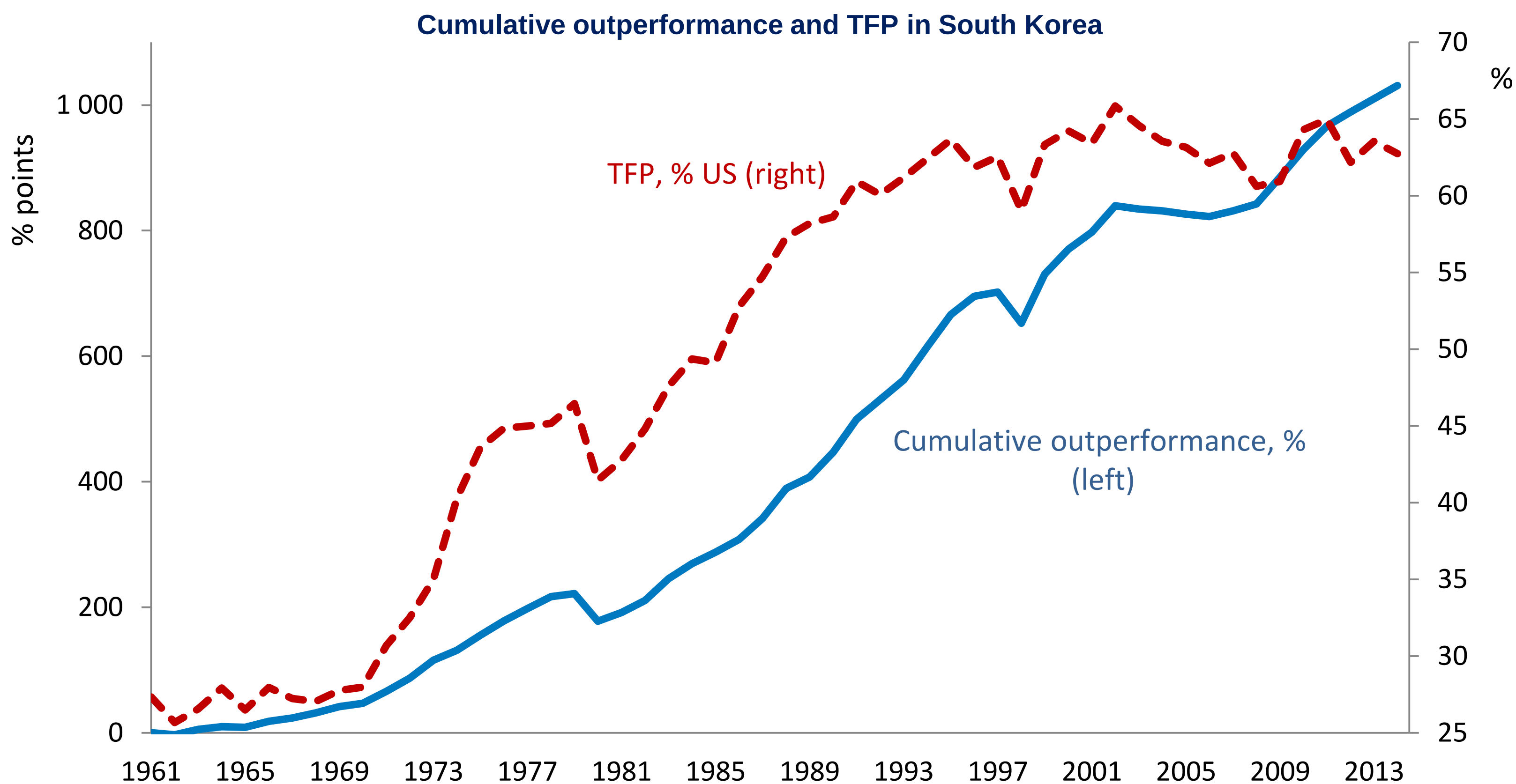
Balanced contributions from all factors: large human capital gains; high investment financed domestically

Focus on lower end of high-tech exports: gradual shift imitation → innovation, facilitated by human capital ↑

Hard hit by multiple crises of 1980 and 1998 but recovered swiftly; GDP per capita now 48% of US (66% at PPP)



Source: IMF, World Bank, Penn World Tables and authors’ calculations.

But investment in all but 5 EBRD economies has been well below comparators' levels

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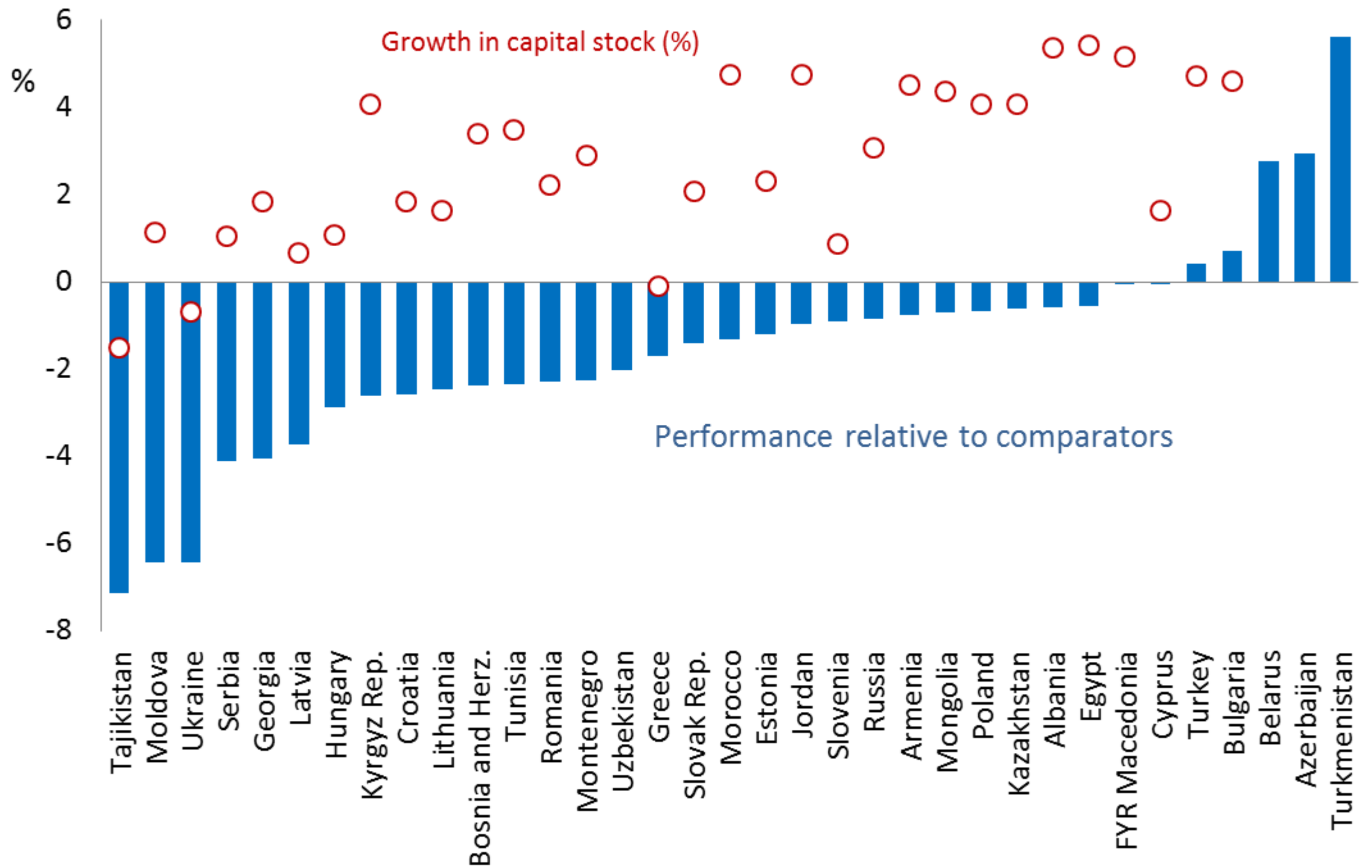
Total capital stock gap € 2.2 trillion (~18% of capital stock), of which ~ €500 bn due to 2008-14

~ 40% is due to infrastructure deficit; 60% due to equipment, buildings, intellectual property

Average annual growth in capital stock, 2008-14



Source: Penn World Tables, IMF and authors' calculations.

… and innovation in the EBRD region lag behind per capita income: "innovation-light" growth

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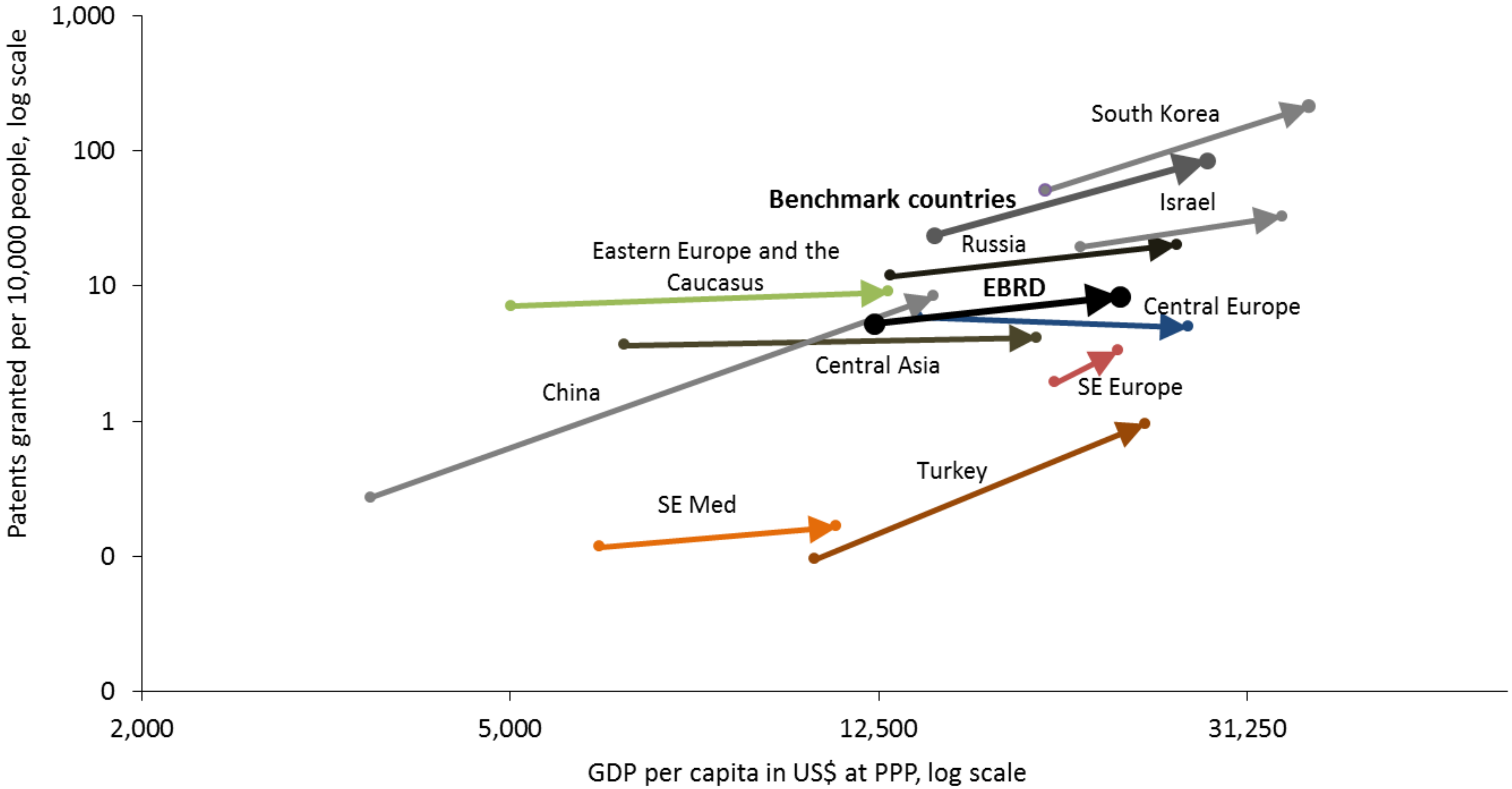
<1% of firms introduce a product that is new to the world

Change in patents granted and per capita income, 2002-15



Source: World Bank, World Intellectual Property Organization (WIPO) and authors' calculations

Growth outperformance: high investment financed by domestic savings, quality institutions, equity markets

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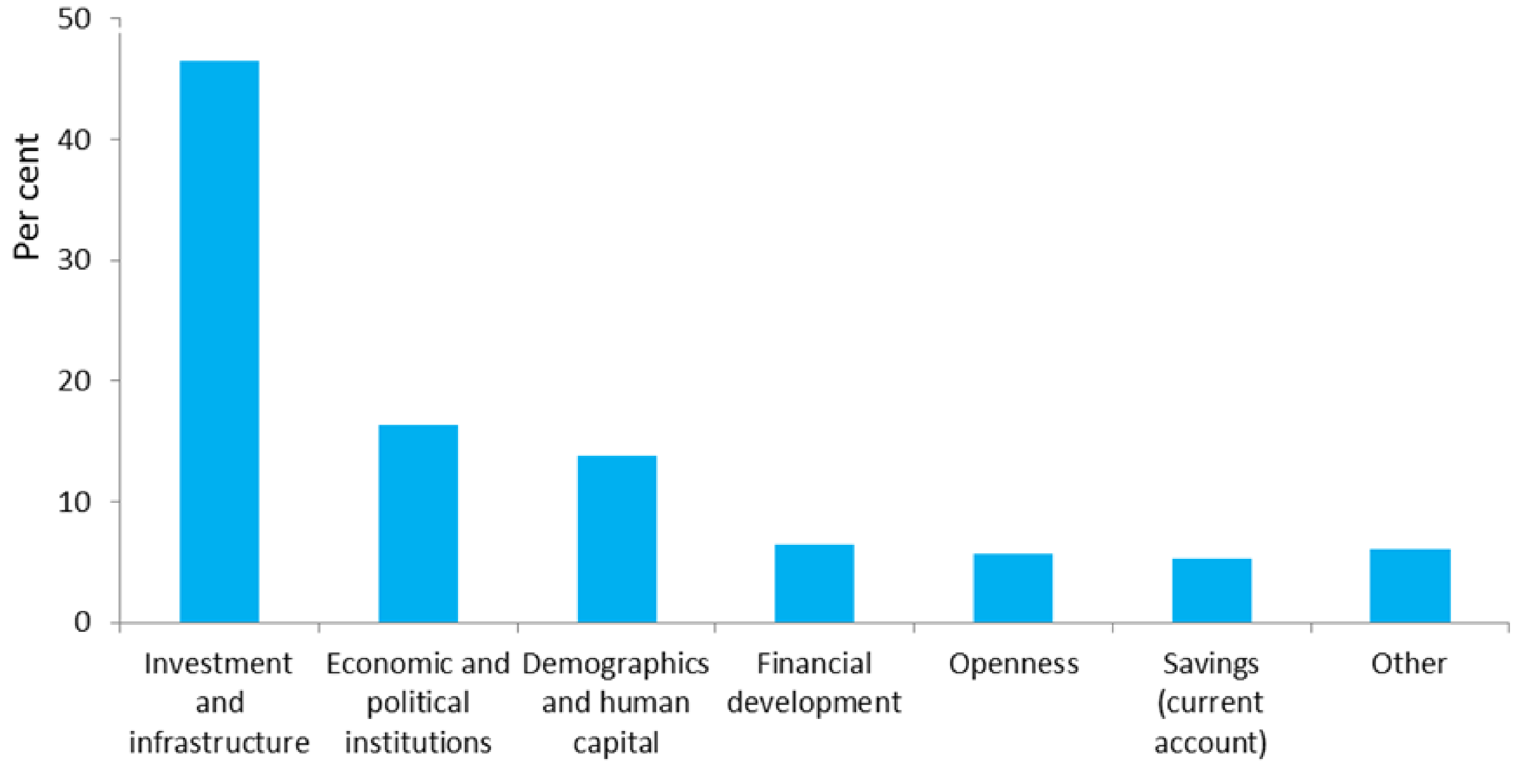
Finance matters, in particular equity and longer-term debt

Trade and financial openness reduce chances of underperformance episodes

Determinants of growth outperformances and underperformances since 1995: Shapley decomposition



Source: IMF, World Bank, Penn World Tables and authors’ calculations.

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Growth accelerating, challenges remain

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- Stronger growth expected in EBRD region on improved global outlook, higher commodity prices
- The recovery momentum is notable for its breadth
- But higher growth rates in 2017 and 2018 still lower than comparator emerging markets with similar per capita incomes
- Many countries seem to have reached middle-income status and have to review the growth model
- Environment footprint remains high

In search of new growth drivers

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- strengthen institutions
- support firm dynamics and innovation
- integrate in global economy
- invest in sustainable infrastructure,

for more see: Transition Report 2017-18, *Sustaining growth*
to be launched on 22 November