Rebalancing in Non-Euro Area EU CEE Countries

Ettore Dorrucci
European Central Bank

(inputs from P. Iossifov, A. Melemenidis, M. Schmitz and O. Tkacevs are gratefully acknowledged)

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1 Current account drivers

→ An exchange rate regime perspective

2 Debt drivers

→ A de(leveraging) perspective

3 Where do we stand now?

→ Temporary vs. permanent rebalancing

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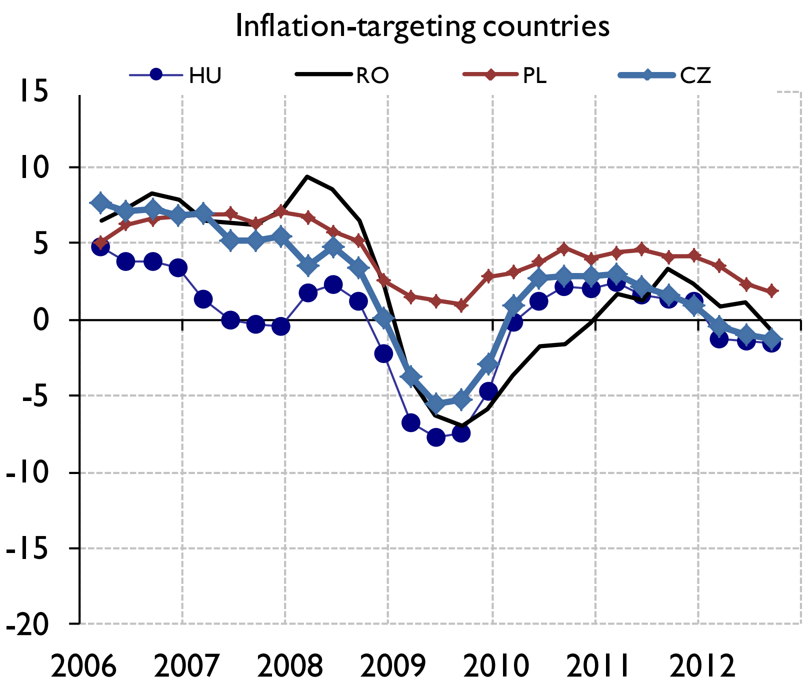
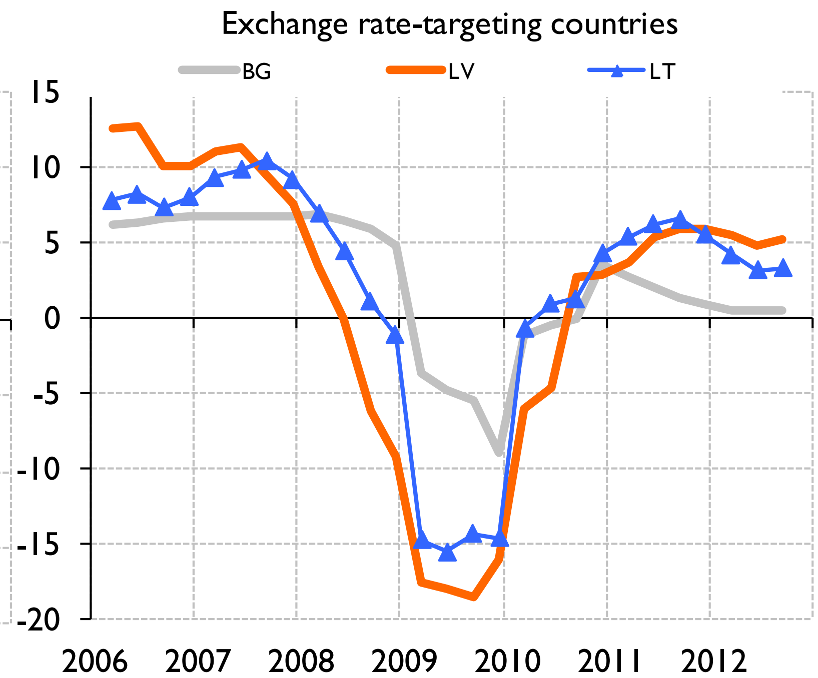
Business cycle more pronounced in exchange rate targeting (ET) countries than in inflation targeting (IT) countries. *Why?*

Real GDP growth

(year-on-year growth rates in %; quarterly frequency)

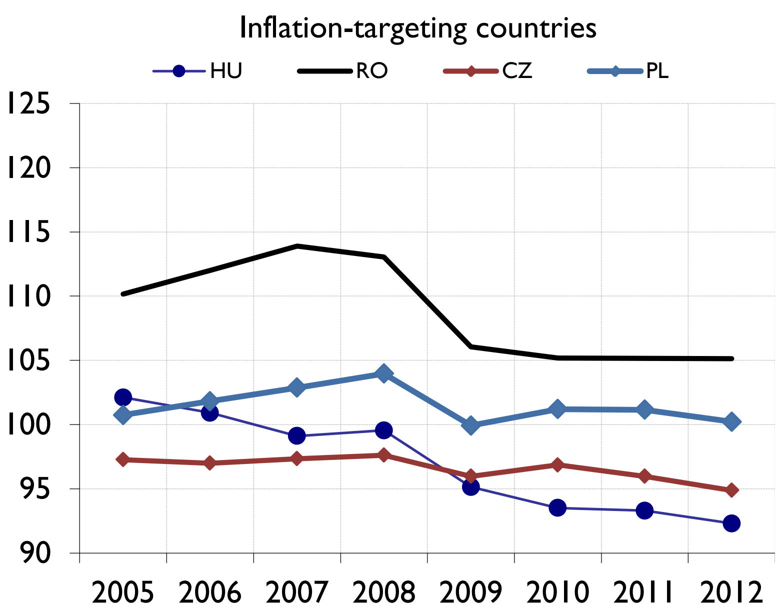


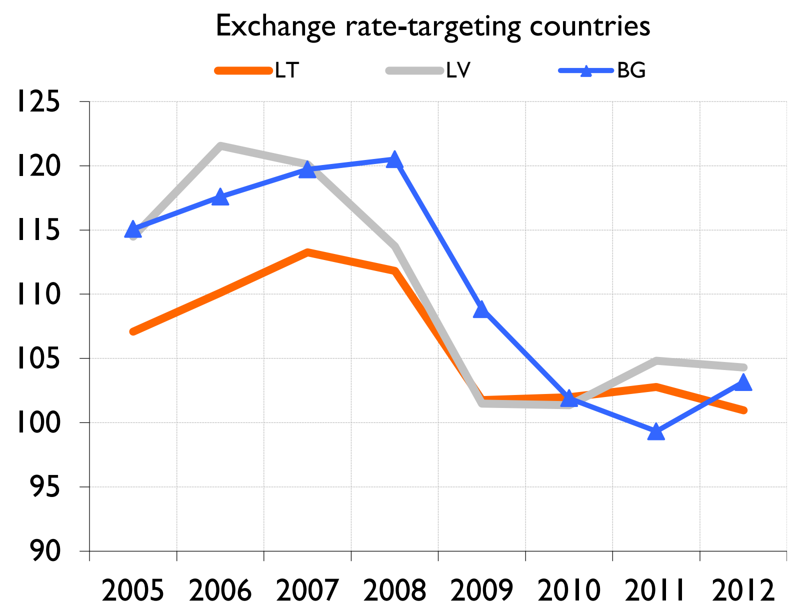


Source: Eurostat.

Domestic demand as a ratio to GDP

(% ; annual frequency)



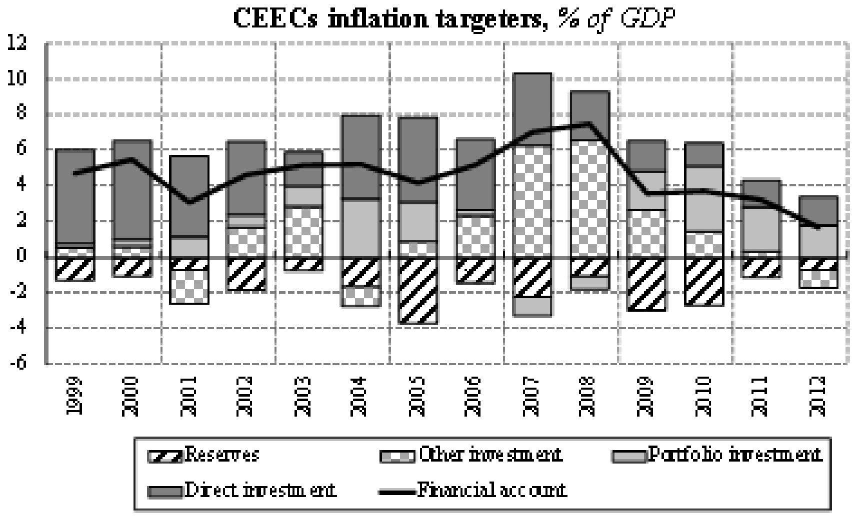


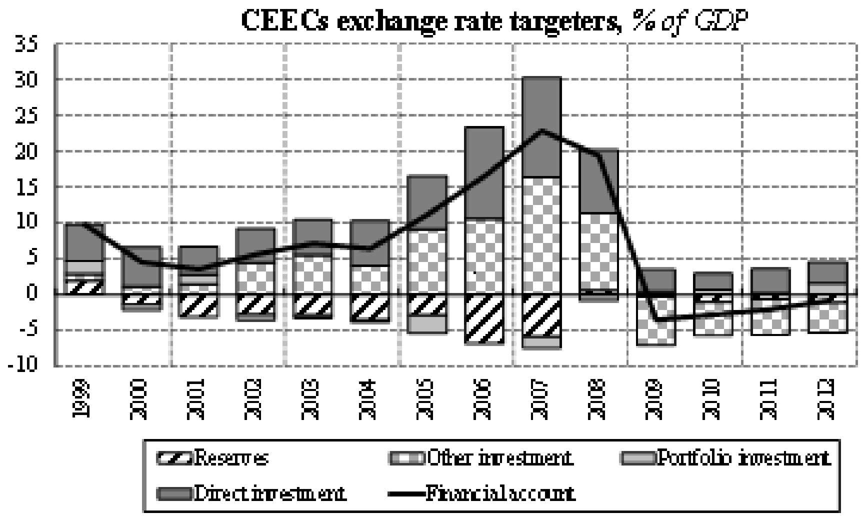
Source: Eurostat and ECB staff estimates.

Note: Ratios derived from annual, non-seasonally adjusted data. 2012 annual data are proxied by summing up the quarterly non-seasonally adjusted values of the respective series over the four quarters ending in September 2012.

Financial account broken down by instrument, as a ratio to GDP

(% ; annual frequency)



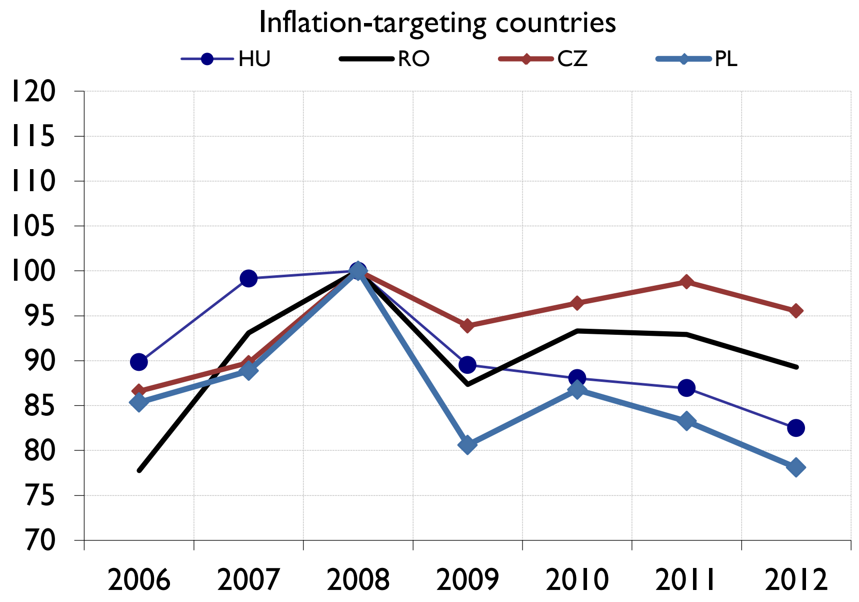


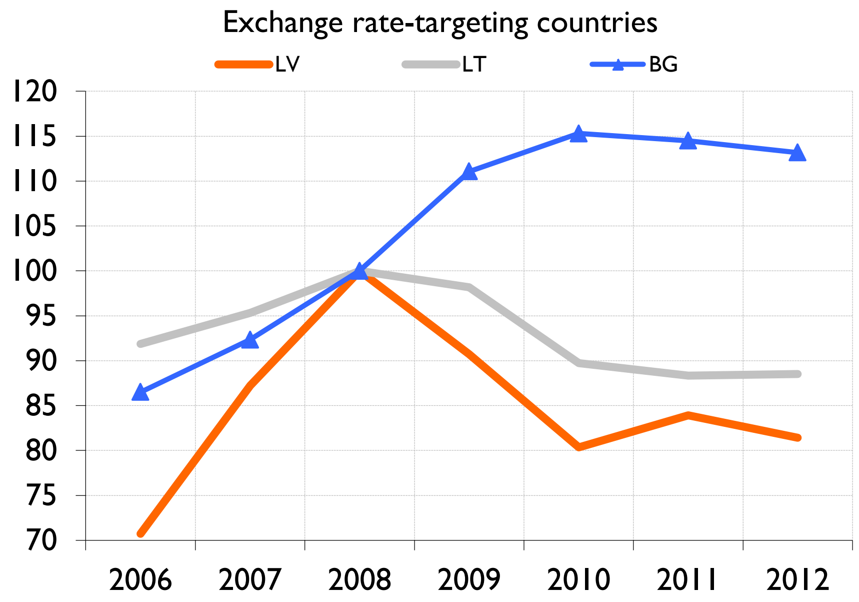
Source: IMF WEO.

Chapter 2 - Catching-up led to REER appreciation until 2008. Price competitiveness was eroded, and later restored via post-crisis REER depreciations …

Real Effective Exchange Rates, ULC-deflated

(Index 2008 = 100, annual frequency)





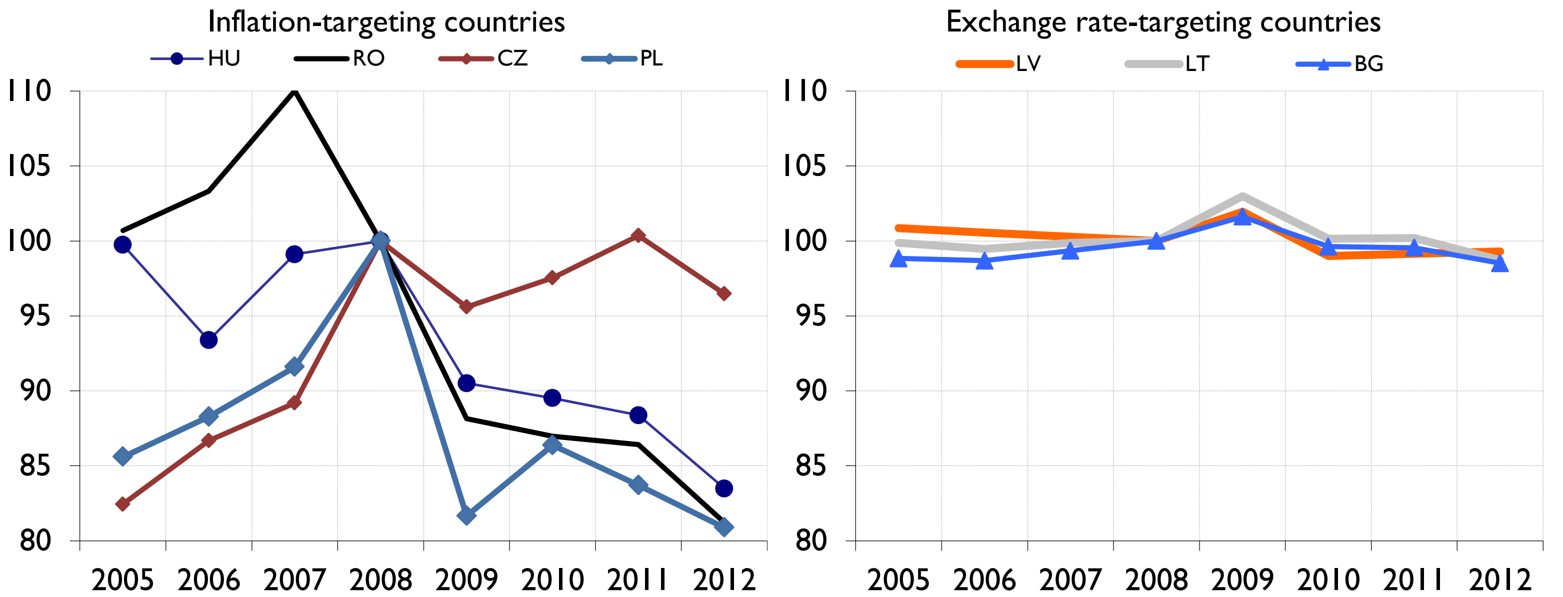
Source: ECB.

Note: 2012 annual ULC-deflated REER data are proxied by averaging the four quarters ending in 2012Q3.

→ In IT countries REER adjustment was coupled with nominal exchange rate adjustment, which dampened the boom-bust cycle …

Nominal effective exchange rate

(Index 2008 = 100, annual frequency)

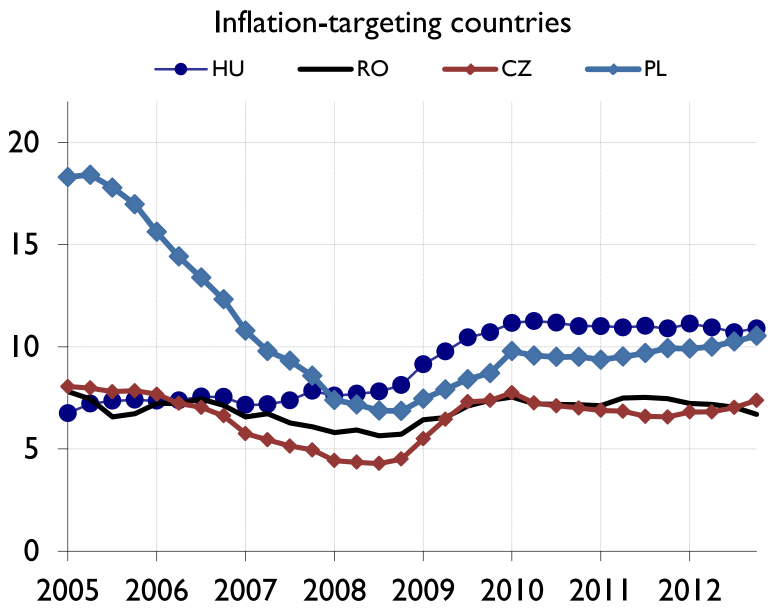


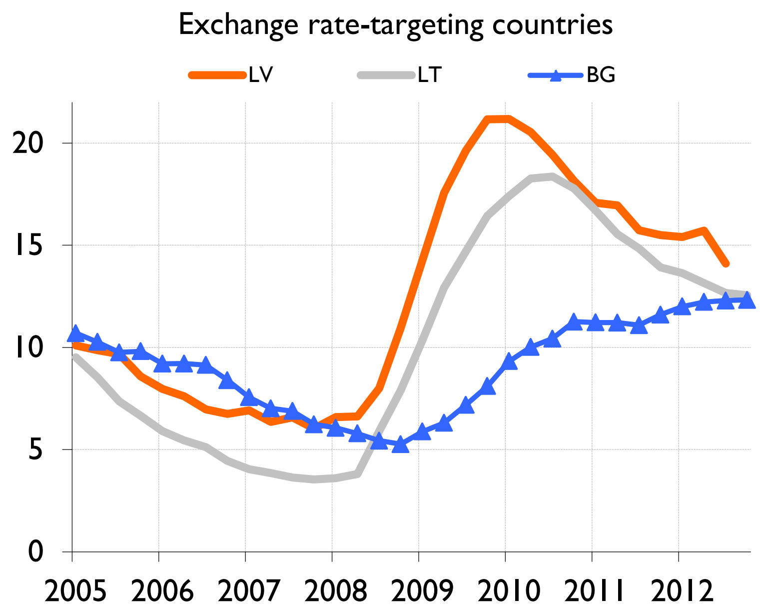
Source: ECB.

Chapter 3 - In ET countries the adjustment burden instead fell on labour inputs…

Unemployment rate

(% of labour force, quarterly frequency)

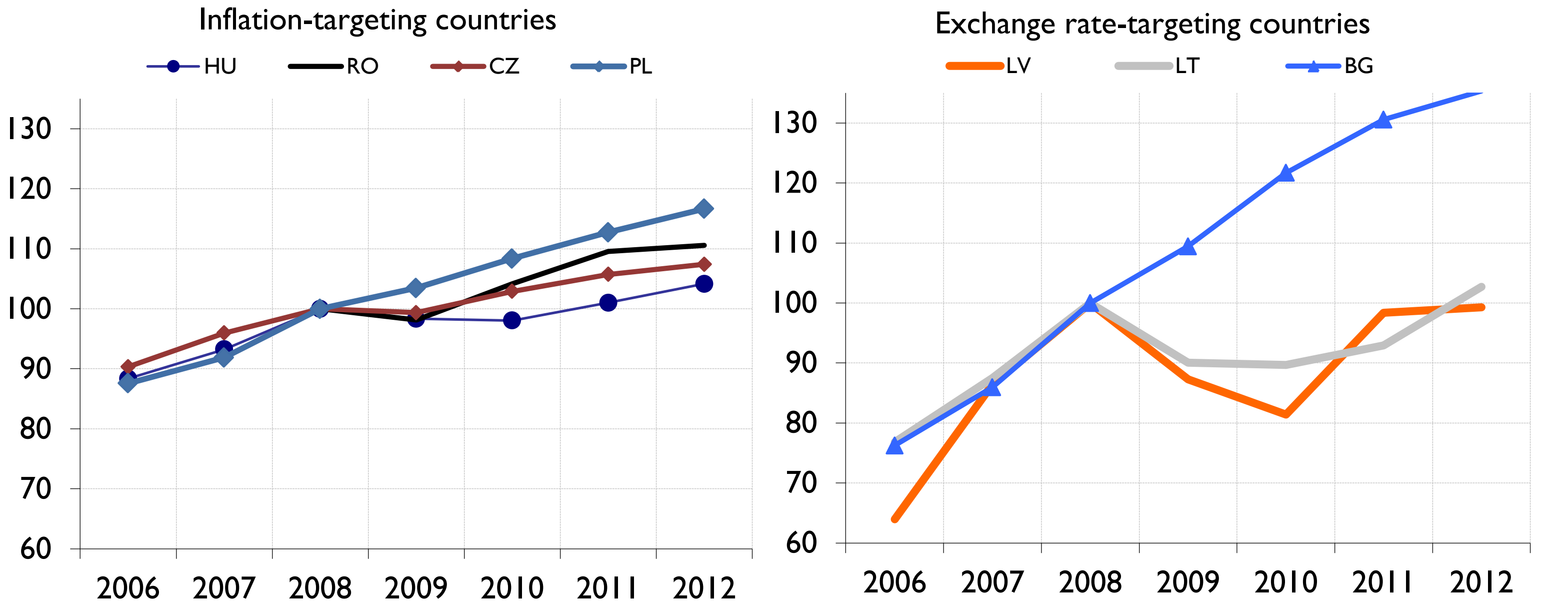




Source: Eurostat.

Compensation per employee (nominal)

(Index 2008 = 100, annual frequency)



Source: Eurostat.

Note: 2012 annual compensation per employee data are proxied by averaging the four quarters ending in 2012Q3.

… where the nominal wage level is the lowest in the EU …

	2008	2009	2010	2011
EU-27	21.6	22.1	22.5	23.1
EA-17	25.8	26.5	26.9	27.6
Belgium	35.6	37	38.2	39.3
Bulgaria	2.5	2.9	3.1	3.5
Czech Republic	9.3	9.3	9.9	10.5
Denmark	35.4	36.5	37.6	38.6
Germany	28.4	29	29.1	30.1
Estonia	8	7.9	7.7	8.1
Ireland	27.2	28	27.9	27.4
Greece	16.5	17.6	17.5	:
Spain	18.9	20.0*	20.2*	20.6
France	31.8	32.1	33.1	34.2
Italy	24.5	25.6	26.1	26.8
Cyprus	15.3	15.9	16.2	16.5
Latvia	5.9	5.9	5.7	5.9
Lithuania	6	5.6	5.3	5.5
Luxembourg	30.8	32	32.7	33.7
Hungary	7.9	7.3	7.3	7.6
Malta	11.2	11.3	11.5	11.9
Netherlands	29.2	29.8	30.5	31.1
Austria	26.5	27.7	28	29.2
Poland	7.5	6.4	7	7.1
Portugal	11.5	11.9	12	12.1
Romania	4.1	4.0*	4.2*	:
Slovenia	13.4	13.8	14.1	14.4
Slovakia	7.6	7.9	8	8.4
Finland	27.6	28.7	28.9	29.7
Sweden	33.8	31.7	36	39.1
United Kingdom	21.1	18.9	20	20.1
Norway	37.8	36.9	41.4	44.2

Labour cost per hour (nominal)

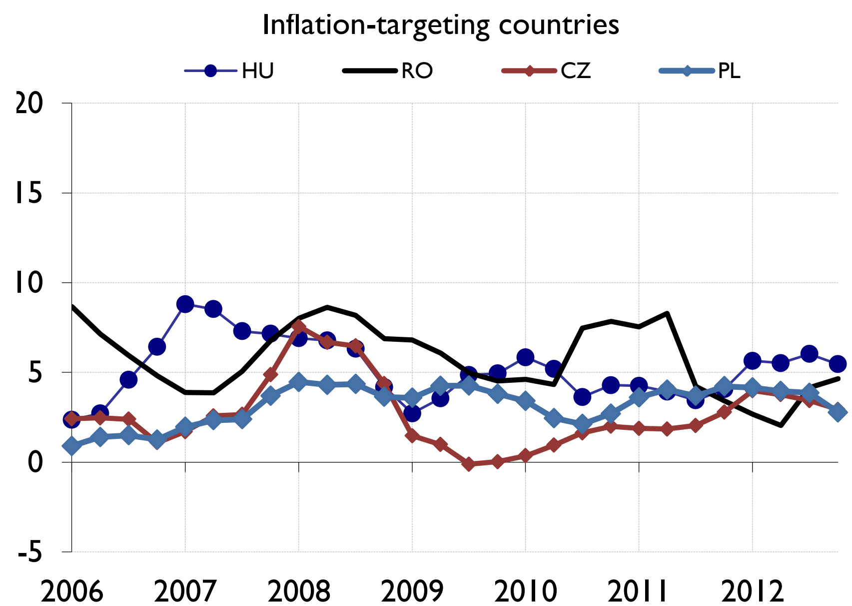
(in euros)

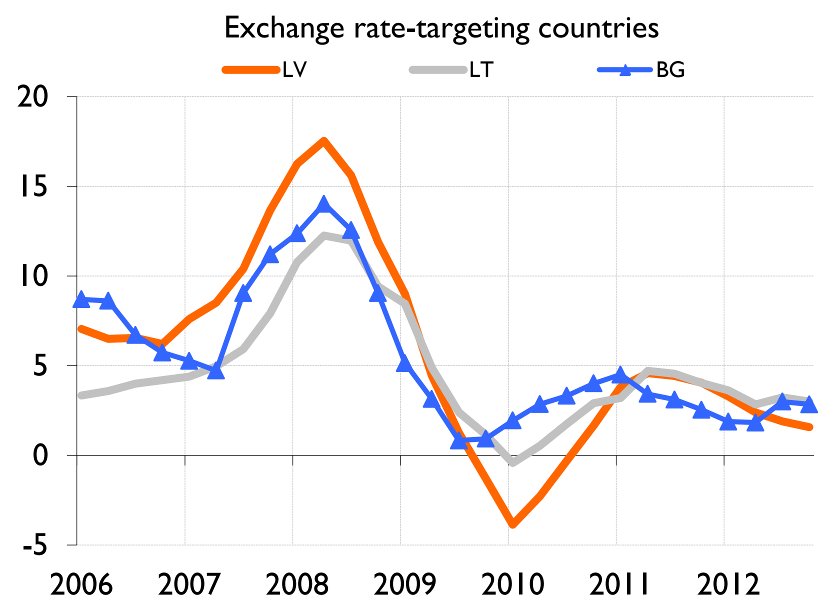
Source: Eurostat.

Note: Data for enterprises with 10 or more employees.

Inflation

(year-on-year growth rates of HICP index in %; quarterly frequency)

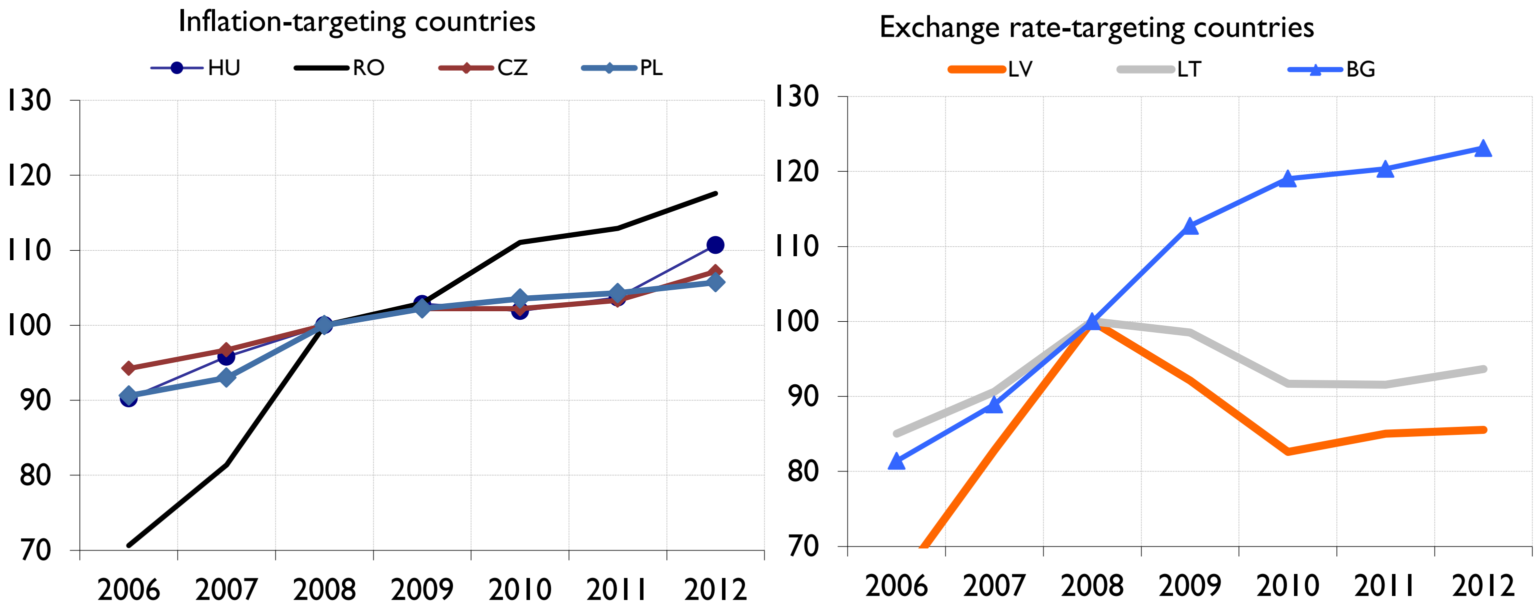




Source: Eurostat.

Unit labour costs (nominal)

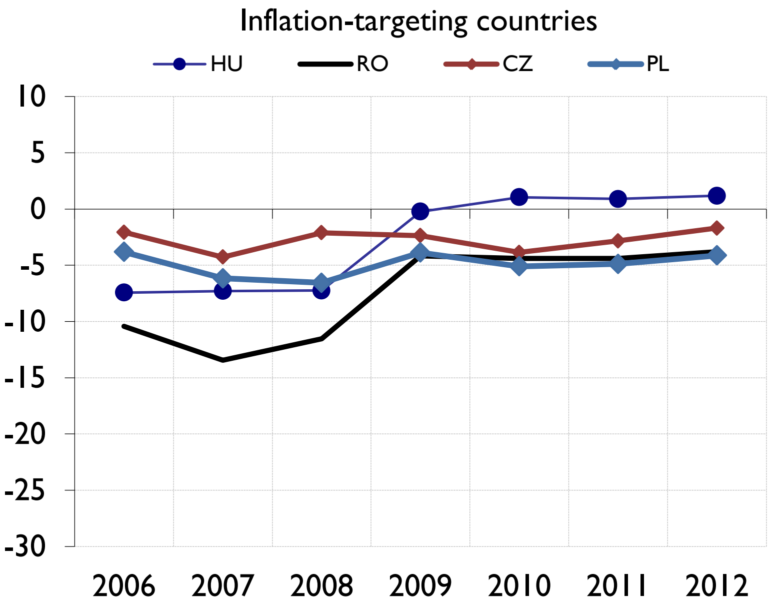
(Index 2008 = 100, annual frequency)

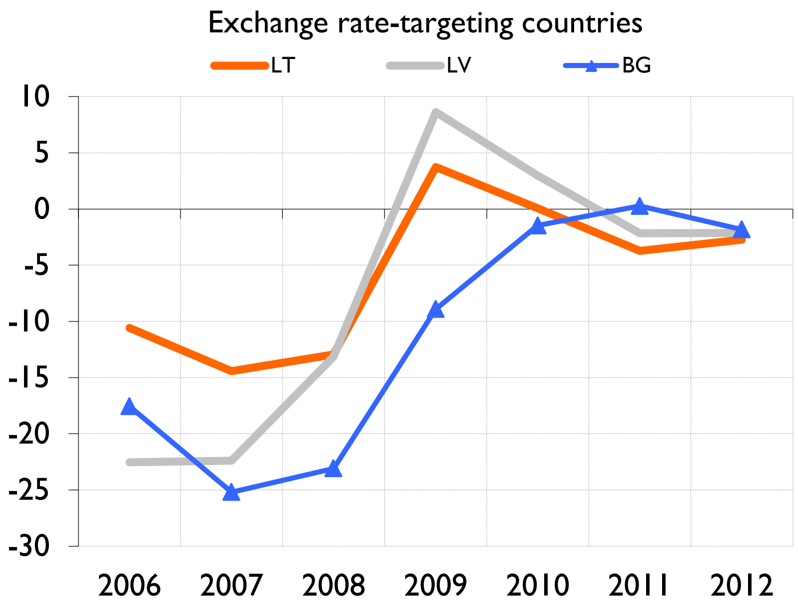


Source: European Commission Autumn 2012 forecast.

Current account balance

(as % of GDP; annual frequency)





Source: Eurostat and ECB staff estimates.

Note: Ratios derived from annual, non-seasonally adjusted data. 2012 annual data are proxied by summing up the quarterly non-seasonally adjusted values of the respective series over the four quarters ending in September 2012.

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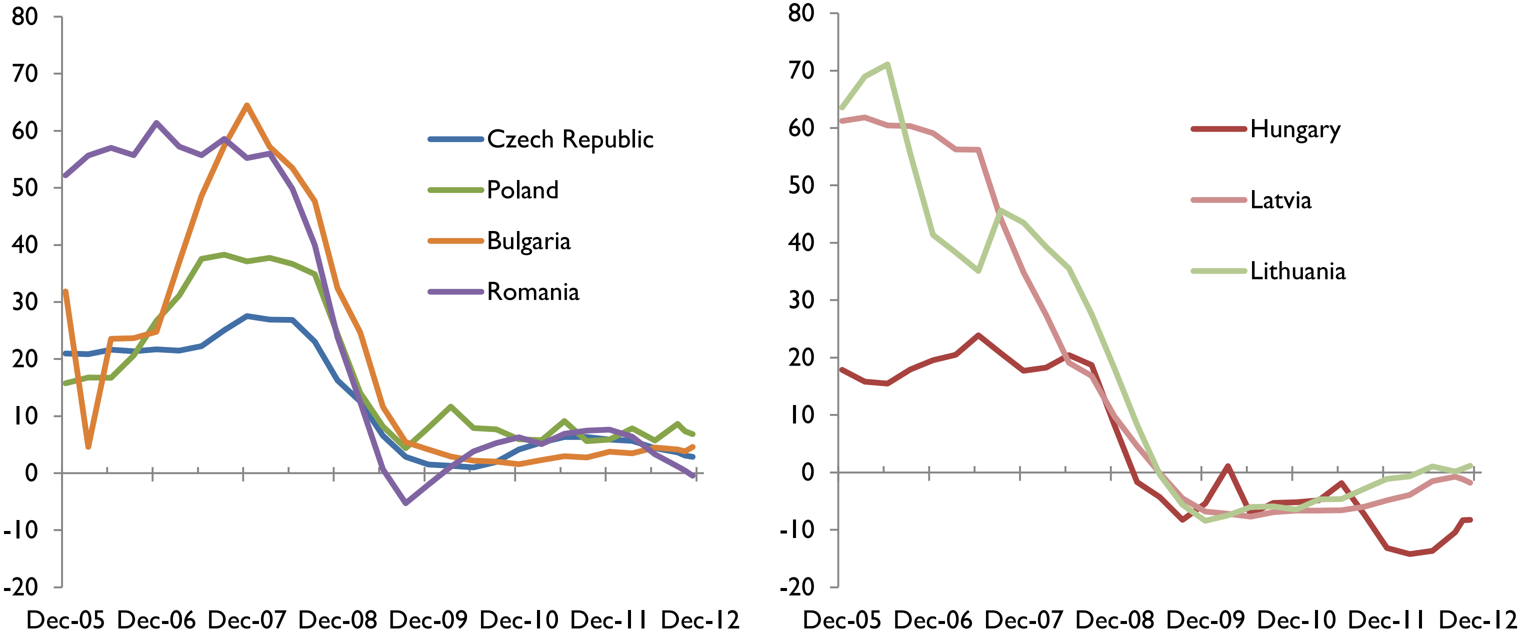
The demand boom was financed by rapid credit growth that later turned into a crunch (which is still there in Hungary) …

Bank credit to the private sector

(year-on-year growth rates in %; quarterly frequency)



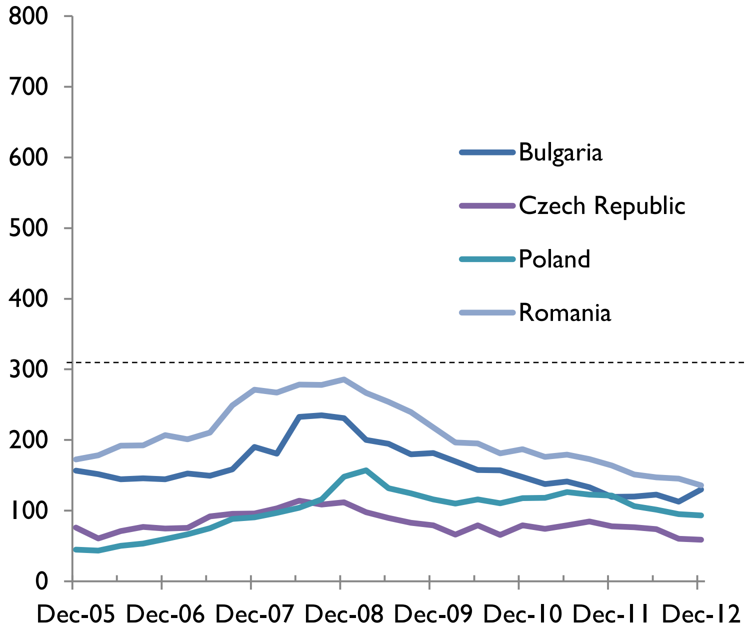
Source: ECB.

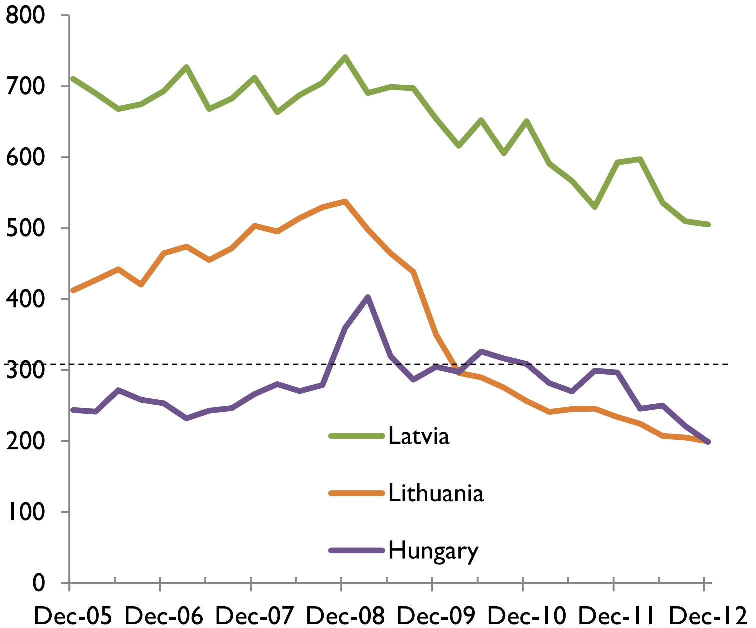
Note: Growth rates calculated from indices of outstanding amounts adjusted for reclassifications, other revaluations, exchange rate variations and other changes not arising from transactions.

The credit boom was mainly financed by external borrowing …

Bank foreign liabilities to own capital and reserves ratio

(in %; quarterly frequency)



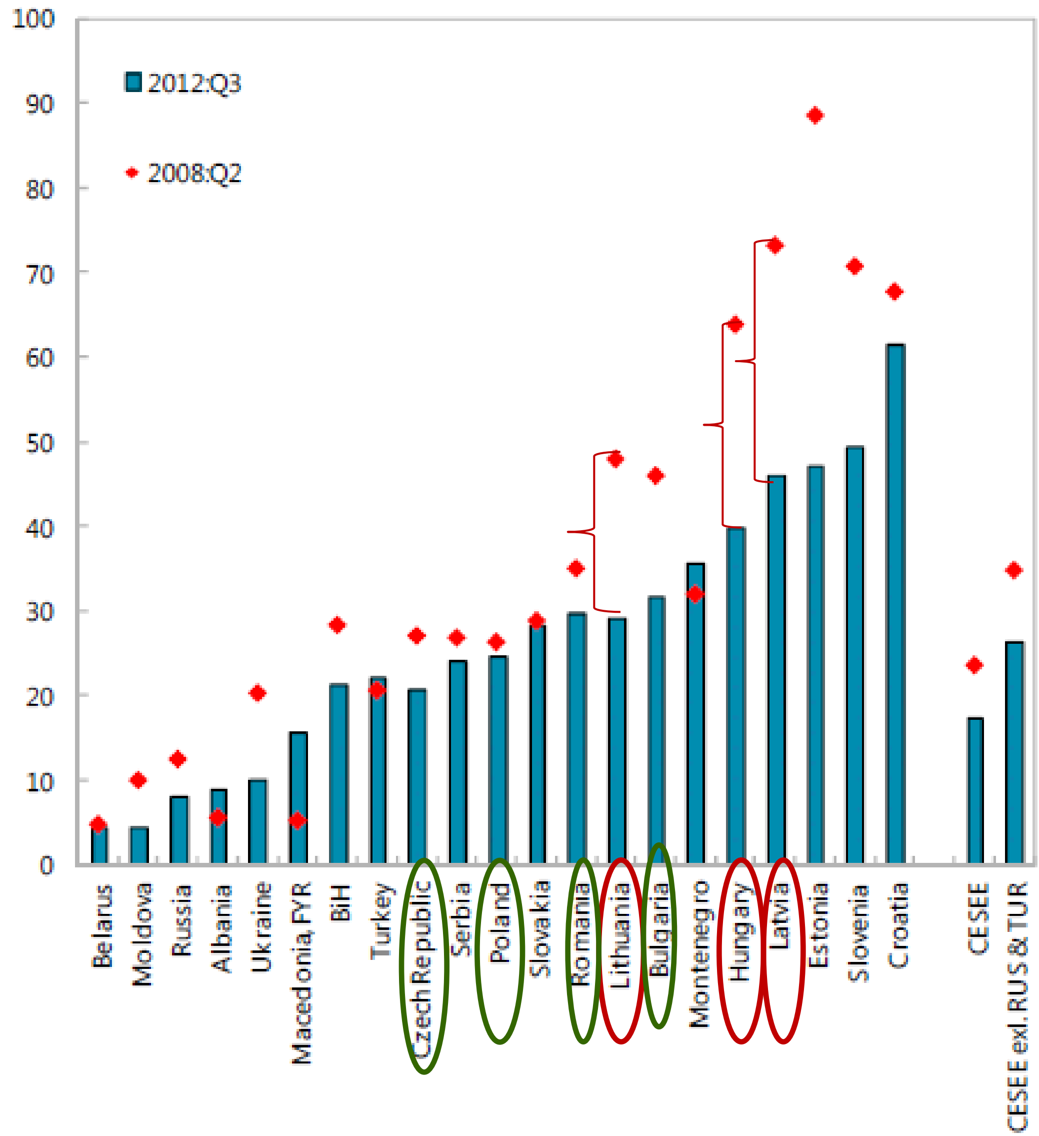


Source: ECB.

… provided primarily by foreign parent banks, which have been deleveraging since the onset of the crisis

External positions of BIS reporting banks vis-à-vis all sectors

(stocks in % of GDP)

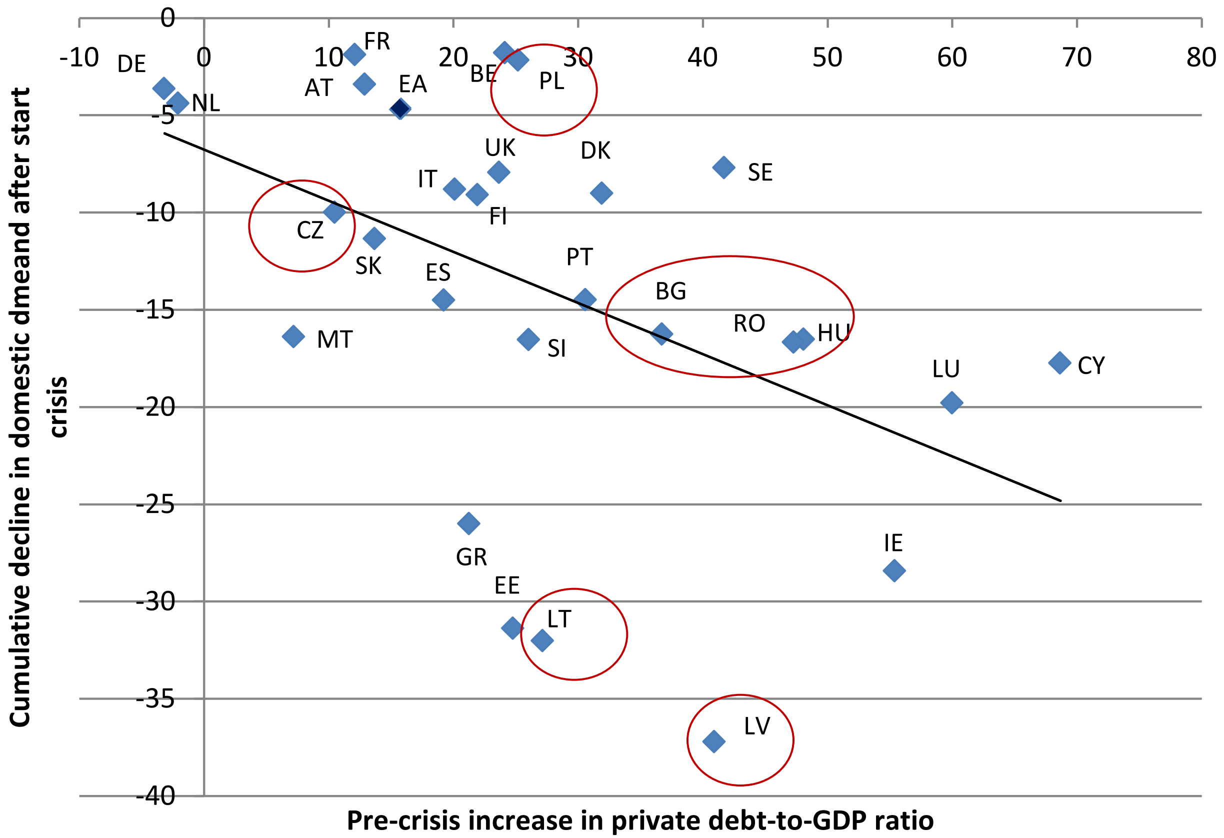


Sources: Vienna Initiative, CESEE Deleveraging Monitor, January 2013. Based on data from BIS Locational Banking Statistics; IMF, International Financial Statistics; and IMF staff calculations.

Pre-crisis increases in private sector gross debt have weighed on economic performance

Change in pre-crisis private sector debt-to-GDP ratio and subsequent decline in domestic demand

(in percentage points and in %, respectively)

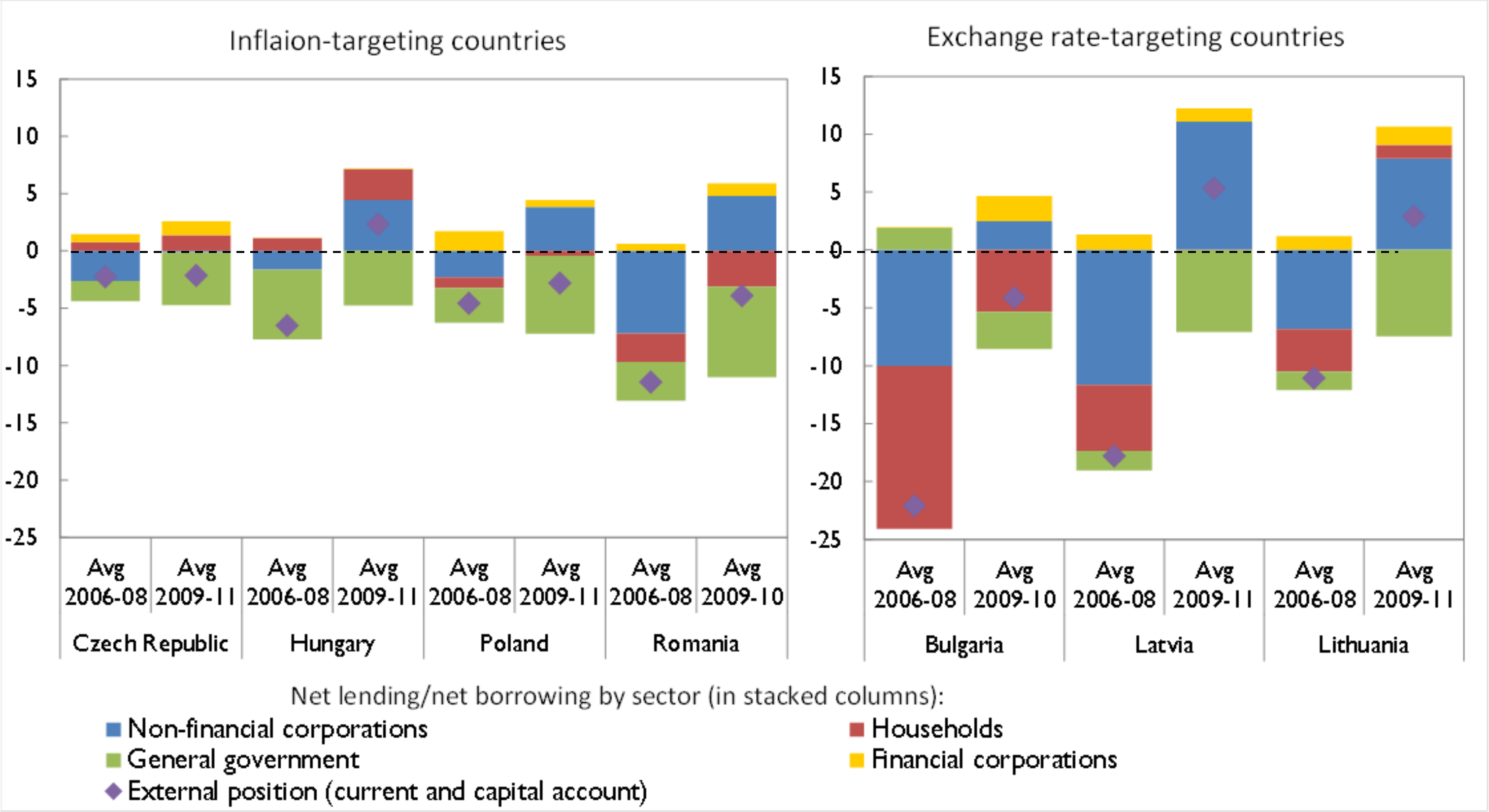


Sources: Eurostat and ECB.

The correction of imbalances was driven by higher net savings in the private sector

Net lending/net borrowing by sector of the economy

(as % of GDP; period-averages)



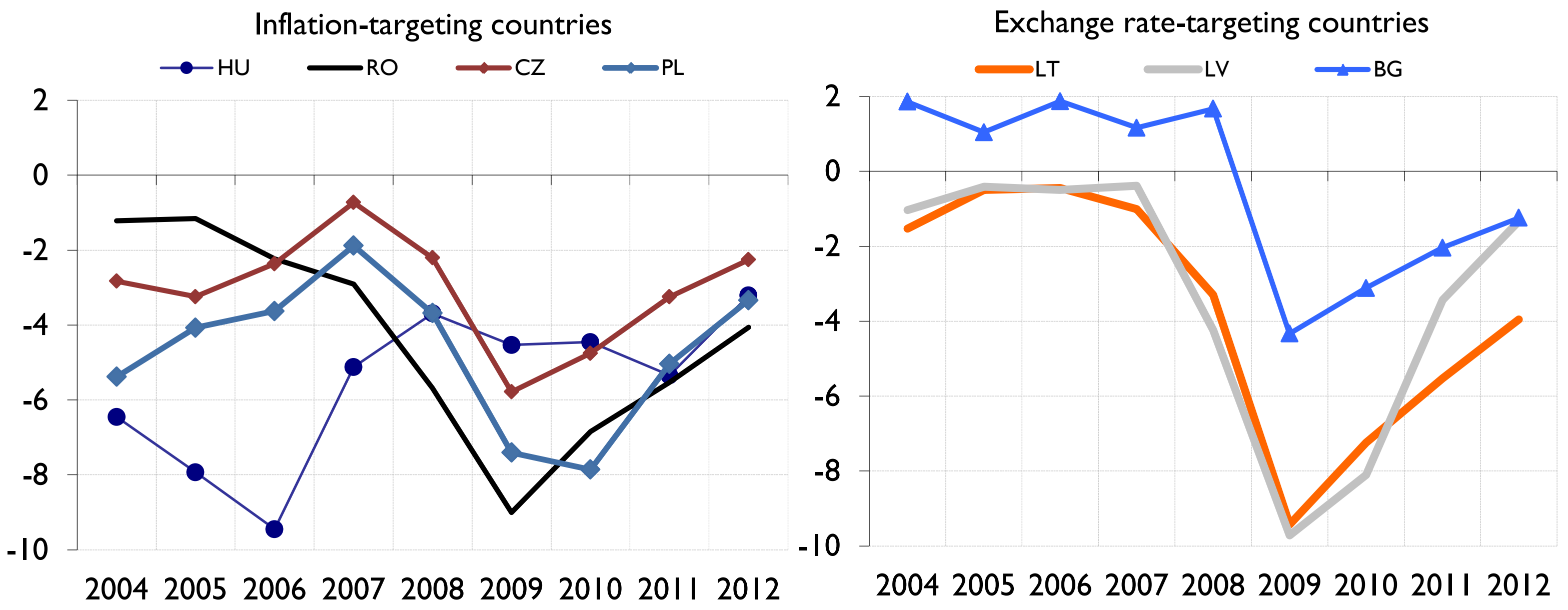
Source: ECB, Eurostat, and ECB staff estimates.

Notes: For the economy as a whole, domestic sectors net lending/borrowing is equal to the sum of the current and capital account balances. / In the case of Hungary, the government dissolved the obligatory private pension schemes and transferred their assets to the state pension fund, generating one-off revenues of 9.6% of GDP in 2011. The capital transfers between households and the government arising from this operation are netted out from the plotted data. / 2011 data is not available in the cases of Bulgaria and Romania.

ET countries had followed more prudent fiscal policies prior to the crisis. General government balances became counter-cyclical during the crisis, and adjusted thereafter

General government balance

(as % of GDP; annual frequency)



Source: Eurostat and ECB staff estimates.

Note: Ratios derived from annual, non-seasonally adjusted data. 2012 annual government balance and GDP data are proxied by summing up the quarterly non-seasonally adjusted values of the respective series over the four quarters ending in September 2012.
2011 data for Hungary adjusted to exclude the transfer of assets from the obligatory private pension schemes to the state pension fund in the amount of 9.6% of GDP.

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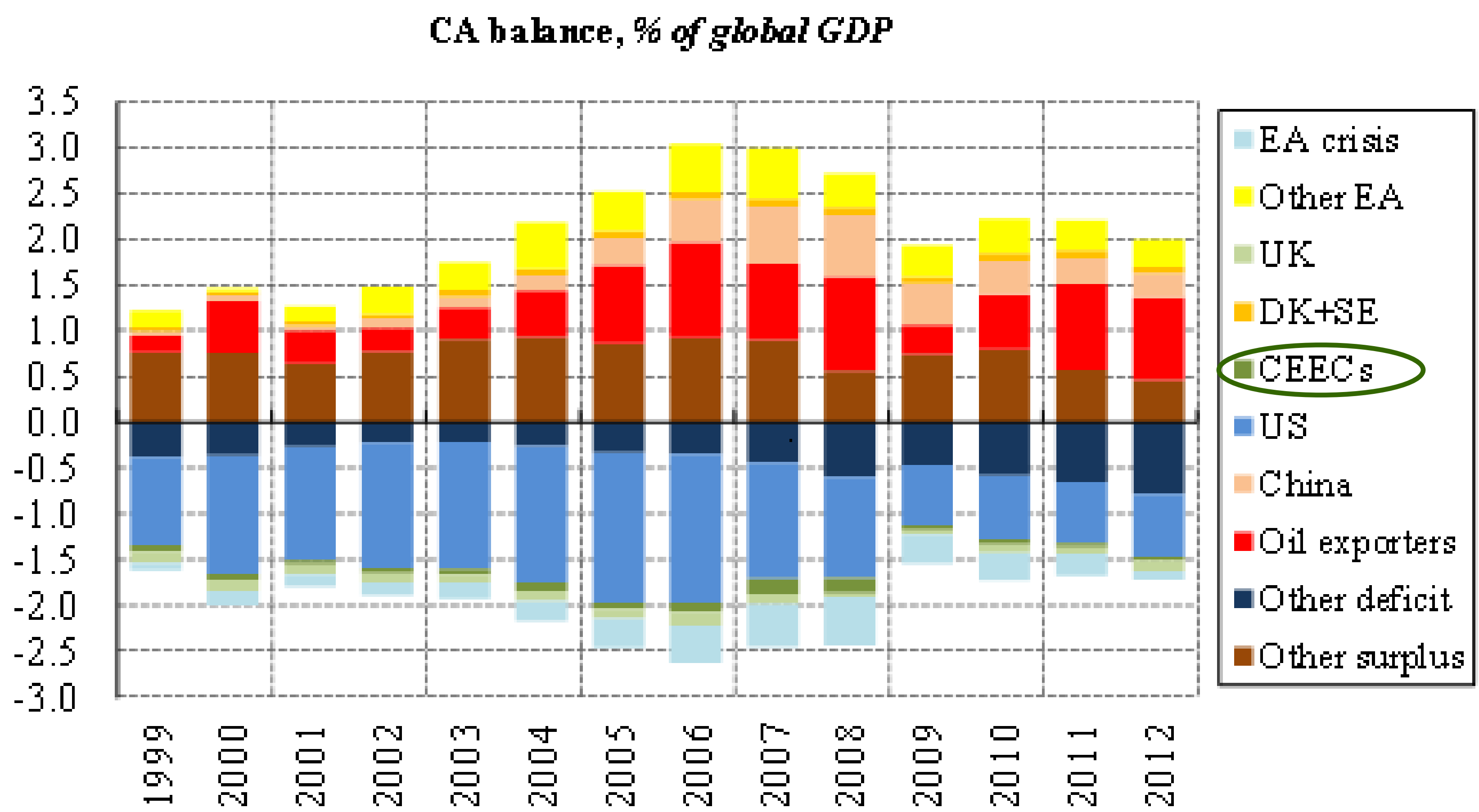
The CEE region has given its own contribution to global rebalancing …

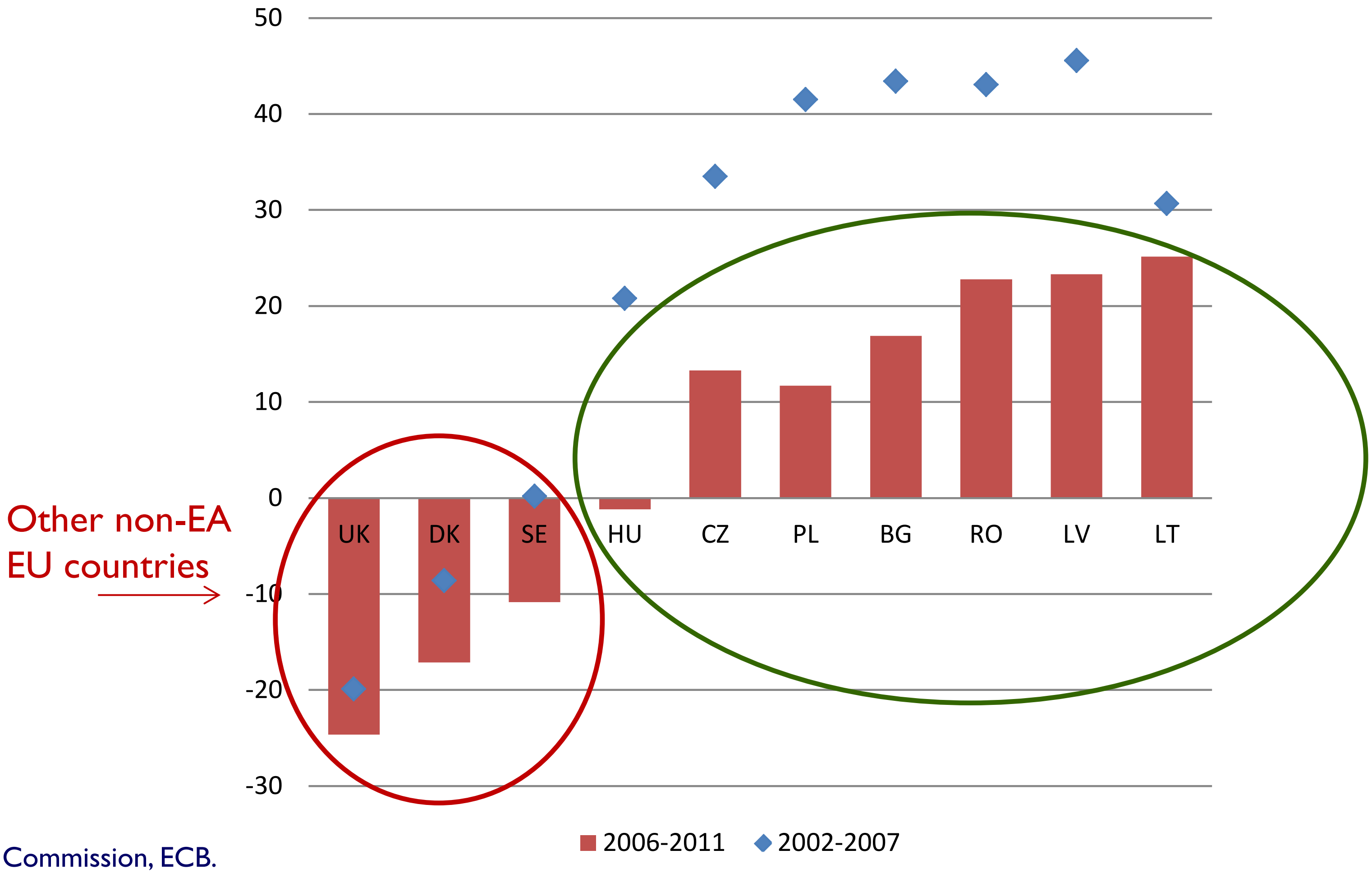


Sources: IMF WEO.

… partly driven by further gains in export market shares (except for Hungary)

Export market shares

(changes in % during the most recent five years and the pre-crisis period)

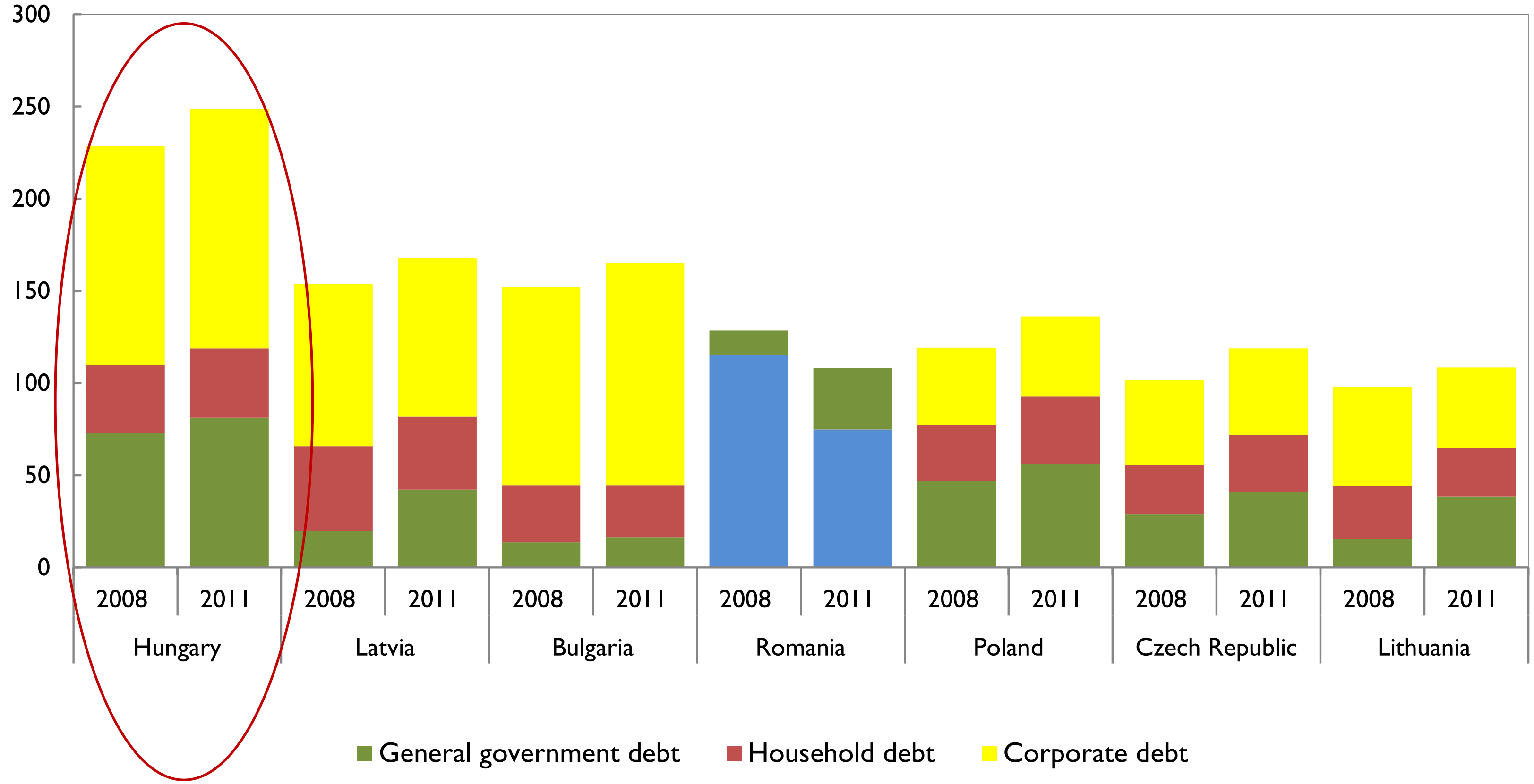


Sources:
European Commission, ECB.

Debt burden remains high, especially in the private sector …

Public and Private Sector Indebtedness

(as % of GDP)



Source: ECB, Eurostat, and ECB staff estimates.

Note: In the case of Romania, household and corporate debt are combined, due to lack of data.

… and vis-à-vis non-residents. Hence, balance-sheet repair will continue to weigh on the outlook in most CEE countries

Current account balance and net IIP (NIIP)

(percentages of GDP; grey area = exceeding MIP threshold)

	2007		latest	
	CA	NIIP	CA	NIIP
N.B. All countries with net liabilities in excess of 35%				
HU	-7.4	-104.1	1.7	-104.4
BG	-18.1	-81.1	-0.1	-84.6
LV	-10.7	-75.1	-0.4	-70.1
LT	-19.2	-55.8	0.1	-54.5
PL	-4.2	-52.6	-4.2	-64.9
RO	-10.8	-43.5	-4.2	-61.4
CZ	-2.5	-40.3	-3.1	-50.0

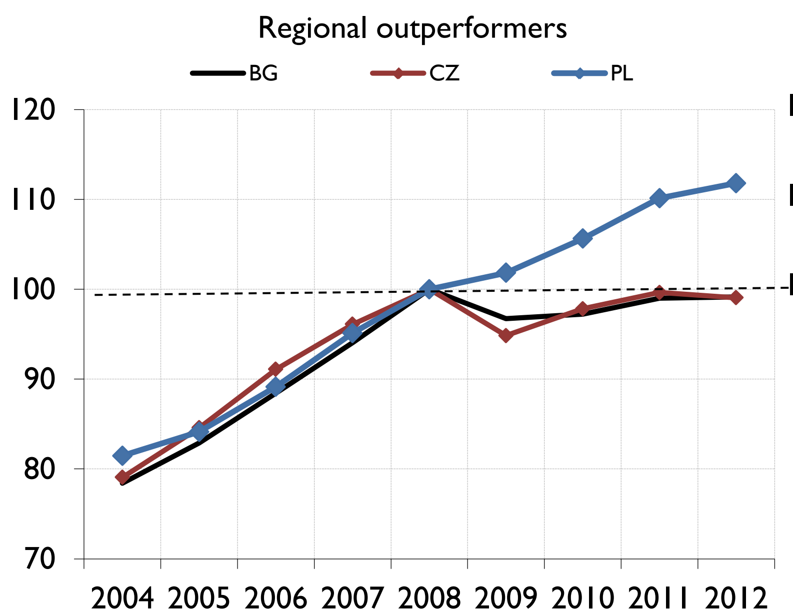
Sources: ECB, Eurostat and IMF.

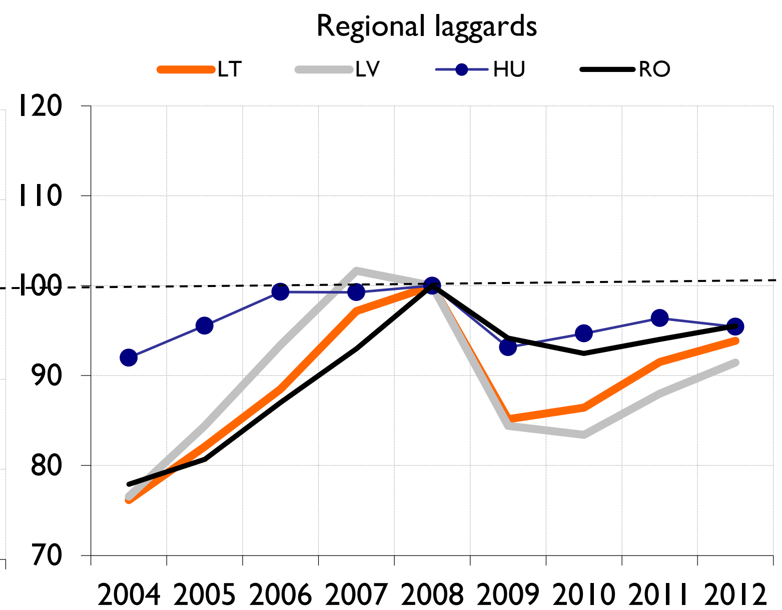
Note: Grey area = breach of Macroeconomic Imbalances Procedure (MIP) threshold. The thresholds are **-4/+6%** for the current account (3-year average) and **-35%** for the NIIP, as in the MIP. "Latest" refers to the 3-year average up to 2012 for the current account (IMF WEO) and 2012Q2 for the NIIP.

Gross value added remains below its 2008 peak in four non-EA EU CEE countries …

Real value added at basic prices

(Index 2008 = 100; annual frequency)



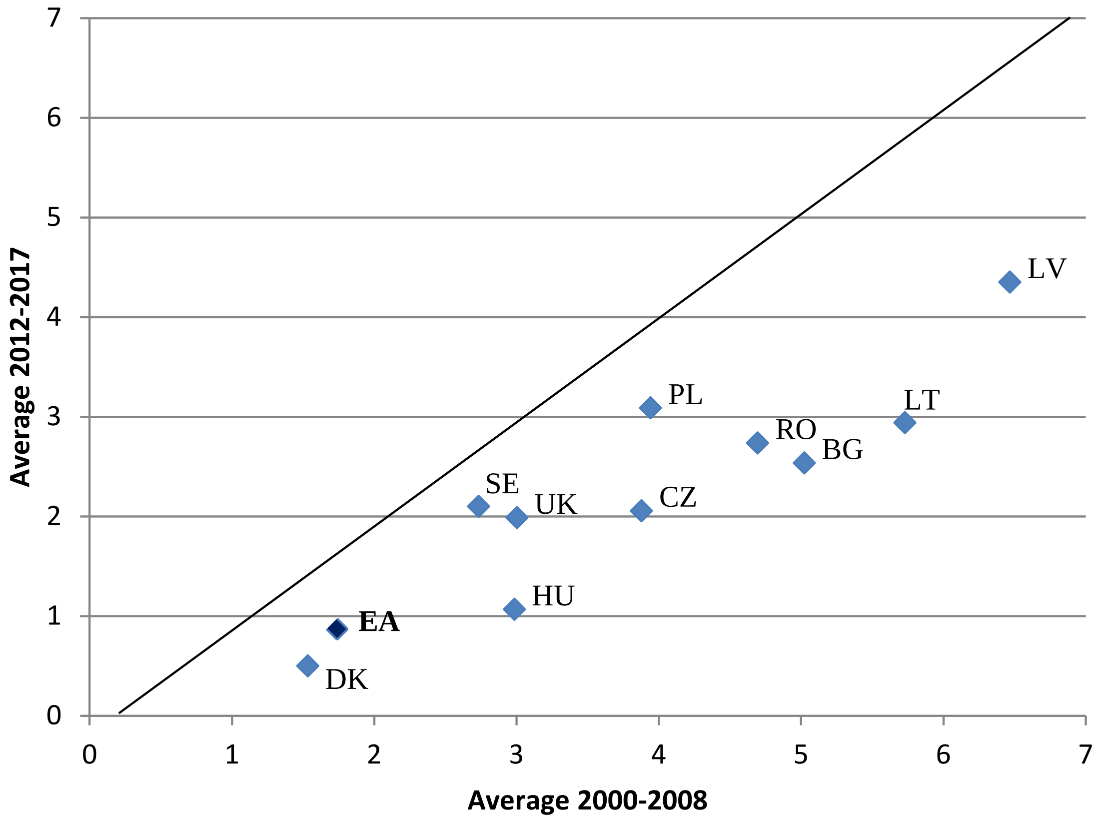


Source: Eurostat and ECB staff estimates.
Note: Indices derived from annual, non-seasonally adjusted data. 2012 annual VA data are proxied by summing up the quarterly non-seasonally adjusted values of real VA over the four quarters ending in September 2012 (June 2012 in the case of Romania).

… and potential growth is likely to be lower than before the crisis

Potential output growth before and after the crisis

(in %)



Source: ESCB.
DK and SE: average for 2012-2014 (EC).

All in all, several vulnerabilities have subsided. But debt overhang and high unemployment remain key weaknesses

Select indicators from EU Macroeconomic Imbalances Procedure (MIP) scoreboard

(2012 Q4/Q3 data)

	Net International Investment Position (% of GDP)	Private sector debt (% of GDP)	General government debt (% of GDP)	Unemploy-ment rate (3 years average)	Current account balance (% of GDP, 3 years average)
Threshold	*-35%*	*+160%*	*+60%*	*+10%*	*+6/-4%*
Bulgaria	-81.6	151.1	18.7	11.3	-1.1
Czech Republic	-52.9	79.7	44.9	7.0	-2.8
Latvia	-67.3	117.8	40.4	17.6	0.6
Lithuania	-53.9	68.4	40.6	15.4	-0.7
Hungary	-102.5	148.0	78.6	11.0	1.1
Poland	-64.7	78.5	55.9	9.8	-4.7
Romania	-62.4	76.4	34.6	7.2	-4.4

= MIP breach

= In line with MIP, but deterioration from 2008

= In line with MIP, improvement from 2008

Sources: Eurostat and ECB staff estimates.

Temporary vs. permanent factors affecting the rebalancing process: A policy assessment

PERMANENT

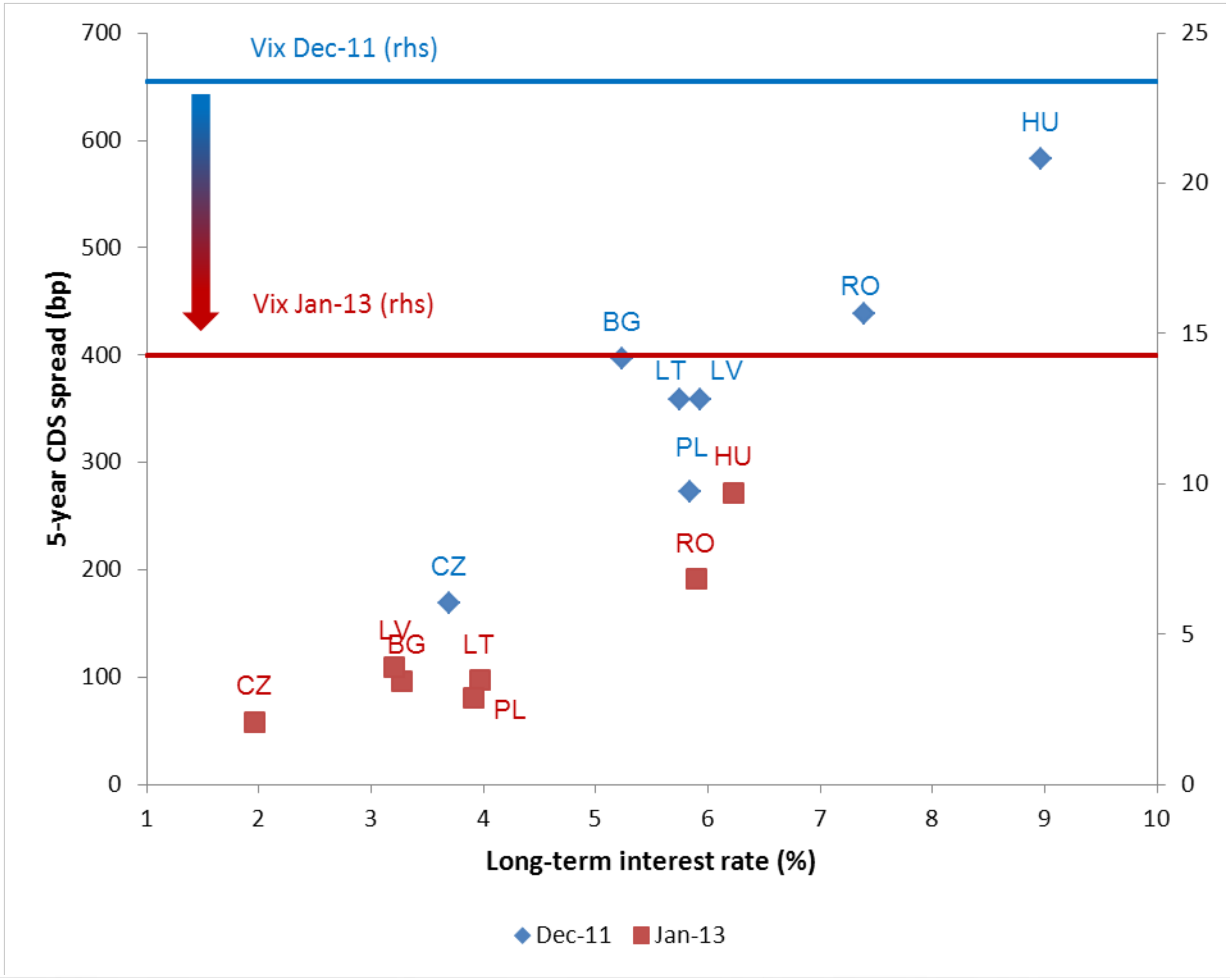
- Structural reforms enhancing competitiveness
- Sound macroeconomic and prudential policies
- Enhanced EU architecture (e.g. fiscal compact)
- Enhanced EU surveillance (e.g. MIP/EIP, EDP)
- Deleveraging process
- Reduced profitability or losses incurred by foreign-owned companies
- Post-crisis contraction in economic activity
- Post-Lehman/Athens increase in risk aversion

TEMPORARY

Some temporary factors have already faded!

Long-term interest rates, CDS spreads and VIX

(DEC 2011 vs. JAN 2013)



Conclusions

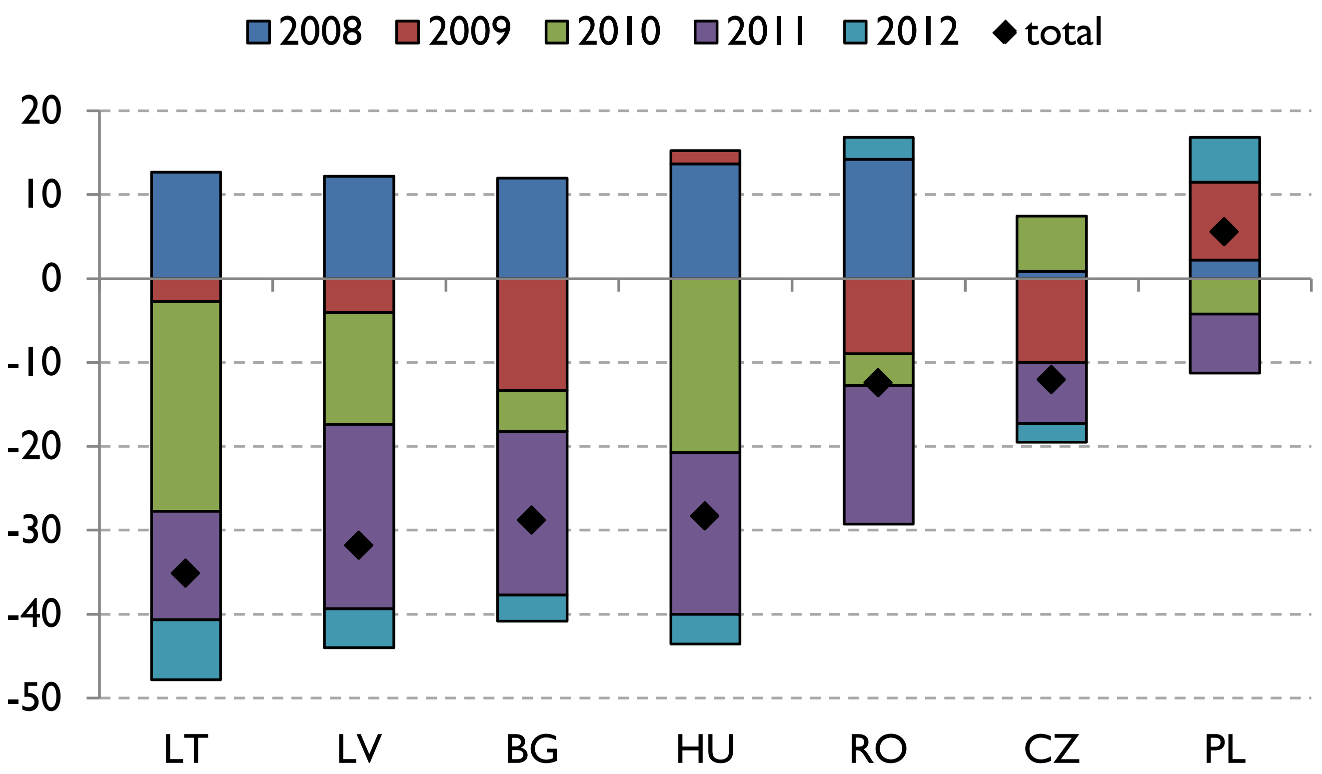
- Jury still out about permanent vs. temporary nature of adjustment
- Permanent nature of adjustment will depend on:
  - Critical mass of structural reforms supporting competitiveness
  - Long-term oriented, sound macroeconomic and prudential policies
- Success ultimately rooted in:
  - Strong national ownership of reforms
  - Effective EU/EA rules and surveillance

BACKGROUND SLIDES

Parent bank deleveraging since the onset of the crisis

External positions of BIS reporting banks vis-à-vis all sectors

(change in ratio to GDP (in %) relative to 2008Q3



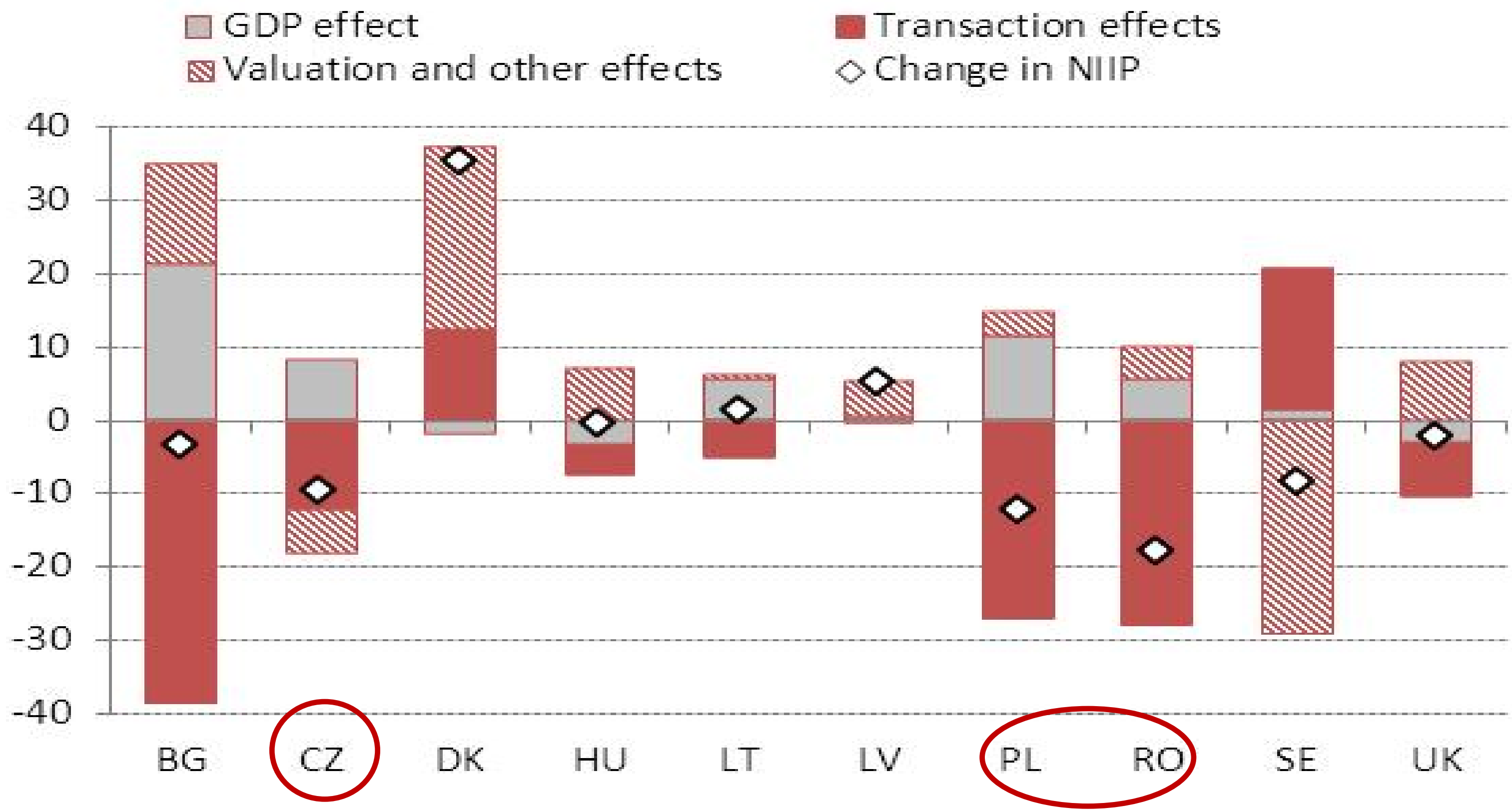
Source: BIS Locational Banking Statistics, Eurostat and ECB calculations.

Note: Data for 2008 refers to the change between 2008Q3 to 2008Q4; 2012 refers to the change in 2012 through June.

Developments in net international investment positions

Non-EA EU countries: Contributions to the change in the net international investment position (NIIP) between 2007Q4 and 2012Q2

(percentages of GDP)

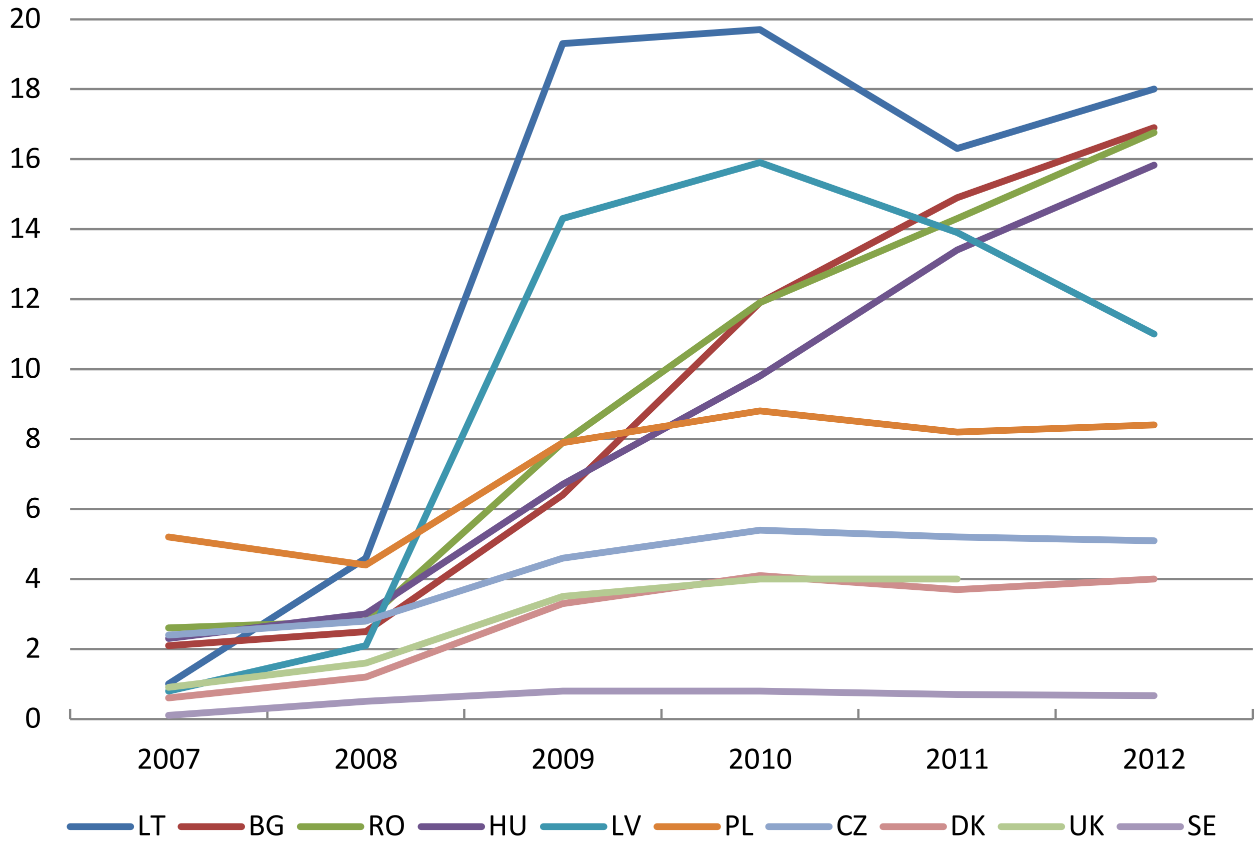


Sources: IMF and ECB staff calculations.
Note: The GDP effect measures the mechanical change in the NIIP-to-GDP ratio due to changes in GDP. Transaction effects reflect accumulated financial account balances (= current account + capital account). Valuation and other effects account for the remaining NIIP changes. Last observation is 2012Q2..

Upward trend in NPLs continues in some countries, but stabilisation in others

NPL ratios in CEE Member States

(% of total loans outstanding)



Source: IMF Financial Soundness Indicators.
Definitions not strictly comparable across countries.