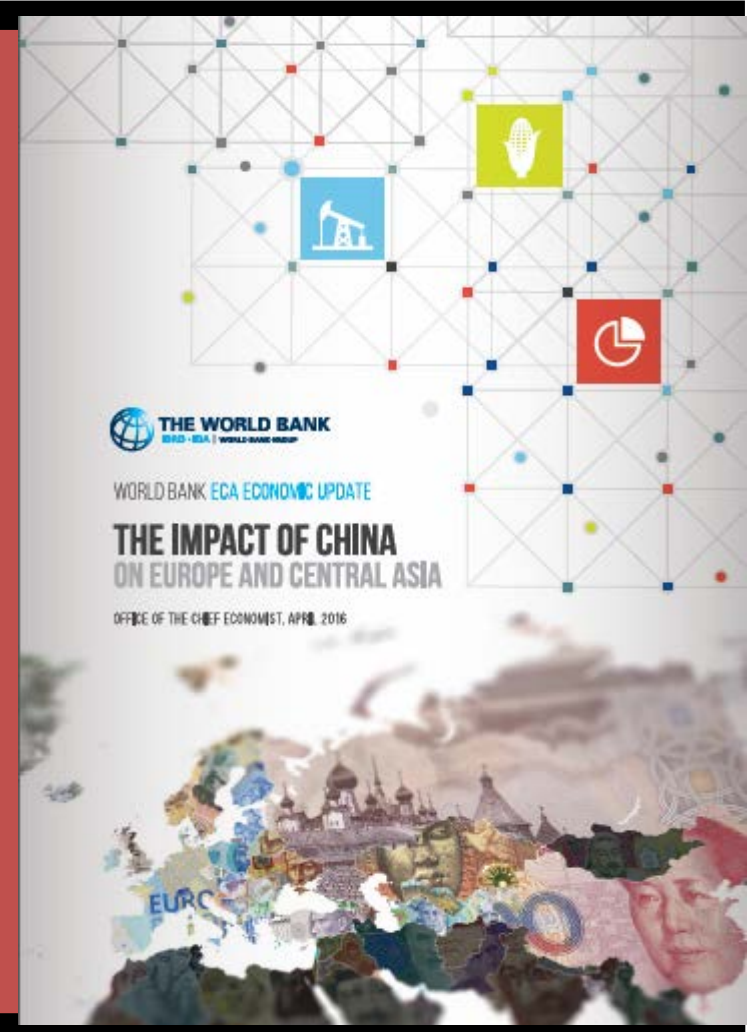


WILL CHINA'S SLOWDOWN BRING HEADWINDS OR OPPORTUNITIES FOR EUROPE AND CENTRAL ASIA?

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Bruegel, Brussels,
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Report site: www.worldbank.org/en/region/eca/publication/europe-and-central-asia-economic-update-april-2016



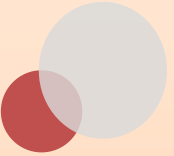
- Low growth is expected in Europe and Central Asia (ECA), as global headwinds remain strong.
- The headwinds are of structural, rather than cyclical nature. They are part of a new normal.
- This is also true for the slowdown in China, which has a pervasive impact on ECA. The impact creates challenges but also opportunities.
- Policies have to adjust to new circumstances.

Part I

Growth prospects and policy challenges differ across the Europe and Central Asia region

Country Groups

Europe and Central Asia	European Union and Western Balkans	Western Europe	Southern Europe	Central Europe	Northern Europe	Western Balkans
		Austria	Greece	Bulgaria	Denmark	Albania
		Belgium	Italy	Croatia	Finland	Bosnia and Herzegovina
		France	Portugal	Czech Republic	Sweden	Kosovo
		Germany	Spain	Hungary	Estonia	FYR Macedonia
		Ireland	Cyprus	Poland	Latvia	Montenegro
		Luxemburg	Malta	Romania	Lithuania	Serbia
		The Netherlands		Slovak Republic		
	United Kingdom		Slovenia			
	Eastern Europe and Central Asia	South Caucasus	Central Asia	Russia	Turkey	Other Eastern Europe
Armenia		Kazakhstan			Belarus	
Azerbaijan		Kyrgyz Republic			Moldova	
Georgia		Tajikistan			Ukraine	
		Turkmenistan				
		Uzbekistan				



Subdued growth in new forecast

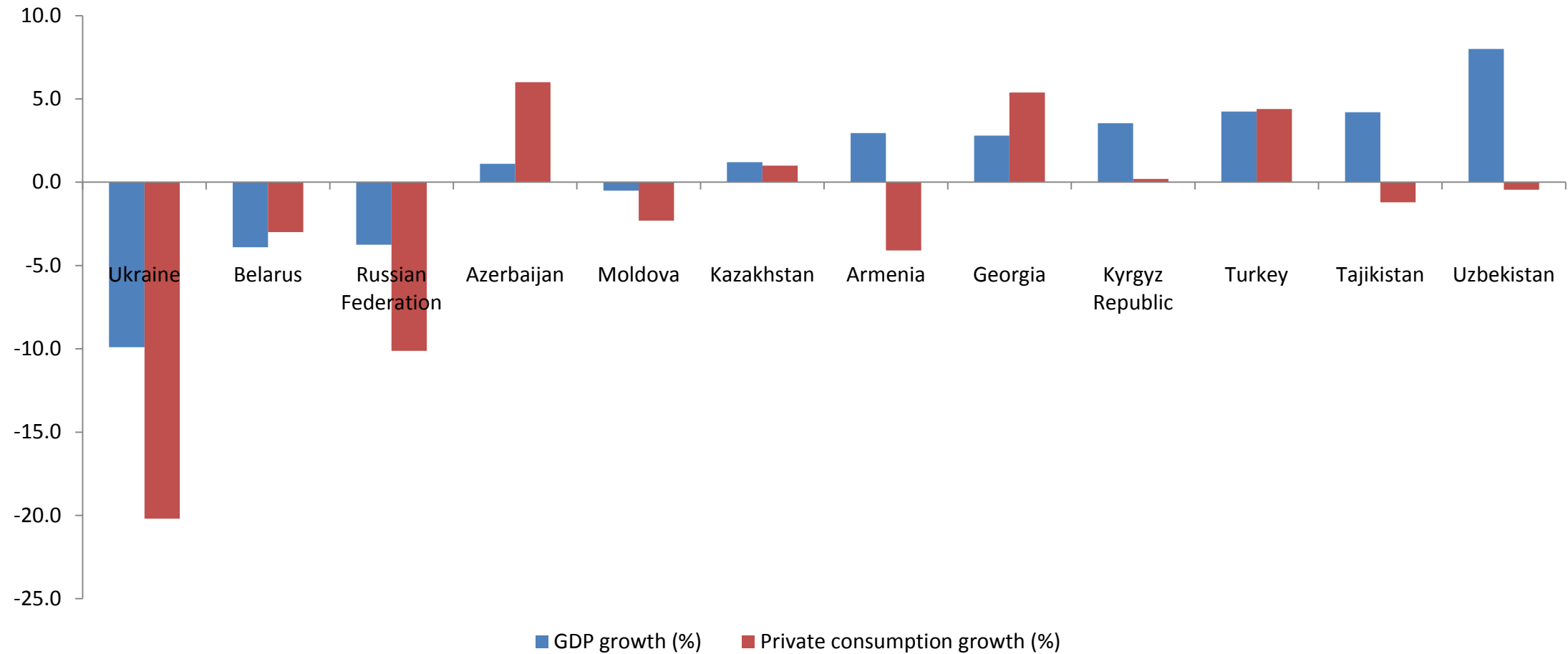
	GDP growth, % annual				Change in forecast since October 2015	
	2014	2015e	2016f	2017f	2015e	2016f
Europe and Central Asia	1.2	1.4	1.6	1.9	0.0	-0.3
European Union and Western Balkans	1.3	1.9	1.8	1.8	0.0	-0.1
Western EU	1.5	1.7	1.7	1.7	-0.1	-0.2
Northern EU	1.5	2.2	2.3	2.2	0.2	0.0
Central EU	2.8	3.5	3.2	3.1	0.2	0.0
Southern EU	0.3	1.6	1.6	1.6	0.2	0.1
Western Balkans	0.5	2.2	2.7	3.2	0.5	0.4
Eastern Europe and Central Asia	0.2	-1.1	0.1	2.0	0.4	-1.0
South Caucasus	3.2	1.6	-0.6	1.7	-0.4	-3.3
Central Asia	5.0	2.7	1.9	3.2	0.0	-1.6
Russian Federation	-1.4	-3.7	-1.9	1.1	0.1	-1.3
Turkey	2.9	4.2	3.5	3.5	1.0	0.1
Other Eastern Europe	-4.0	-7.8	-0.2	1.2	1.3	-0.7

Big shifts in relative prices are affecting consumption and exports

- Collapse in oil revenues amounts to large terms-of-trade losses and sharp depreciations.
- Reductions in remittances (deflated by import prices) imply large declines in household incomes.
- Diverging monetary policies and reversals of capital flows lead to changes in competitiveness.

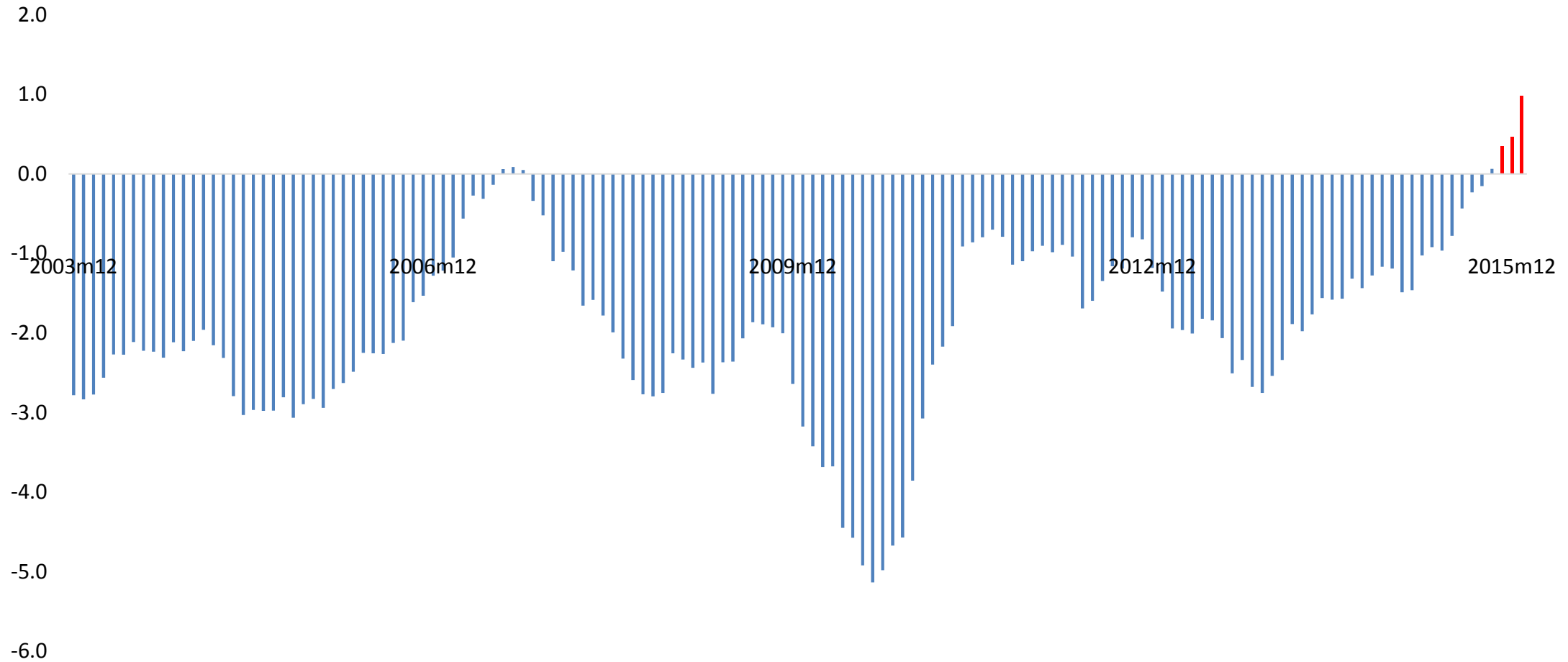
Consumption has sharply declined in Eastern Europe and Central Asia

Annual growth rates, 2015

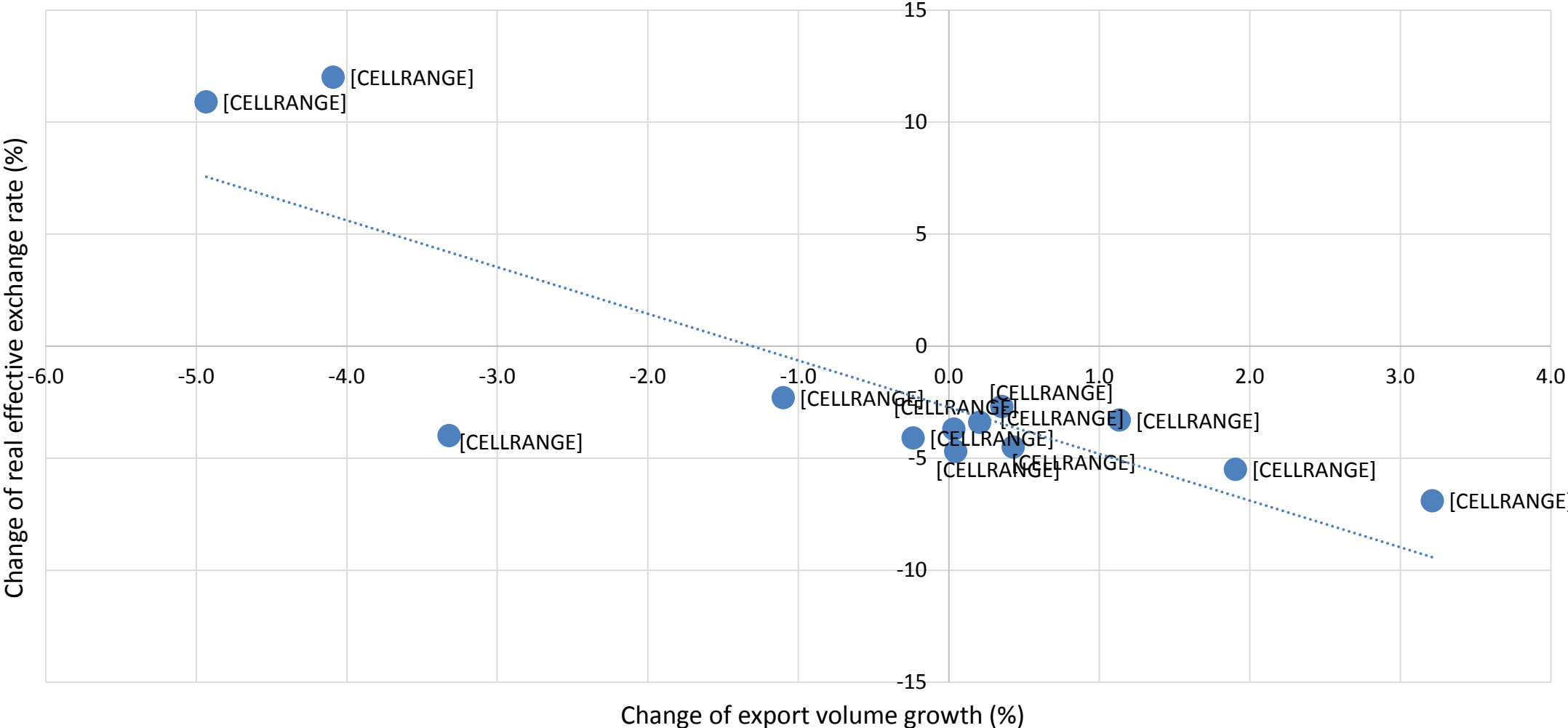


Euro Area export growth now outpaces global average

Percentage points difference between growth export volume euro area and global export growth, 12m/12m

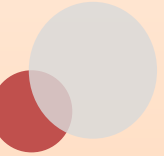


European export growth accelerates as U.S. and Chinese exports slow down



Labor markets affected by cyclical and structural factors

- Unemployment in European Union is declining as the EU enters fourth year of recovery.
- Crisis in many countries in eastern part of region starts showing in rising unemployment.
- Digital technologies, sharing economy, migration, and globalization are fundamentally changing labor markets, and requires new social contract.



Growth moderation and rebalancing in China: headwinds or opportunities?

Growth moderation and rebalancing in China

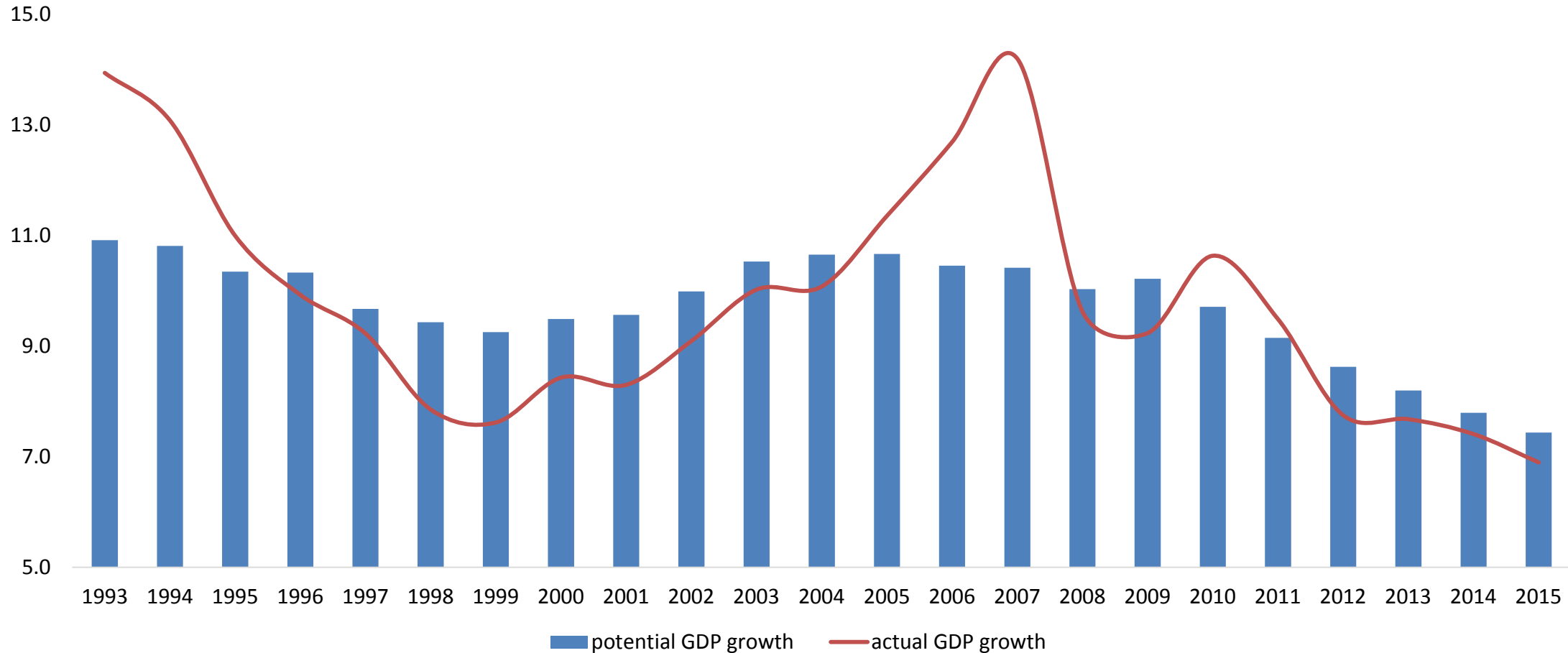
- Slowdown is result of slower expansion of production capacity
- Rebalancing entails
 - Shift from investments to consumption
 - Shift from low-skilled to high-skilled production
 - Shift from inward FDI to outward FDI

Chinese Growth moderation and demand for the rest of the world

- The nature of the slowdown is important because its consequences on the rest of the world are quite different
- Cyclical slowdown (a reduction of domestic demand) implies an increase in trade surplus (i.e. a reduction of Chinese demand on global production);
- Structural slowdown (a reduction of production) implies a reduction of both imports and exports
 - Need of a structural (supply side) analytical approach

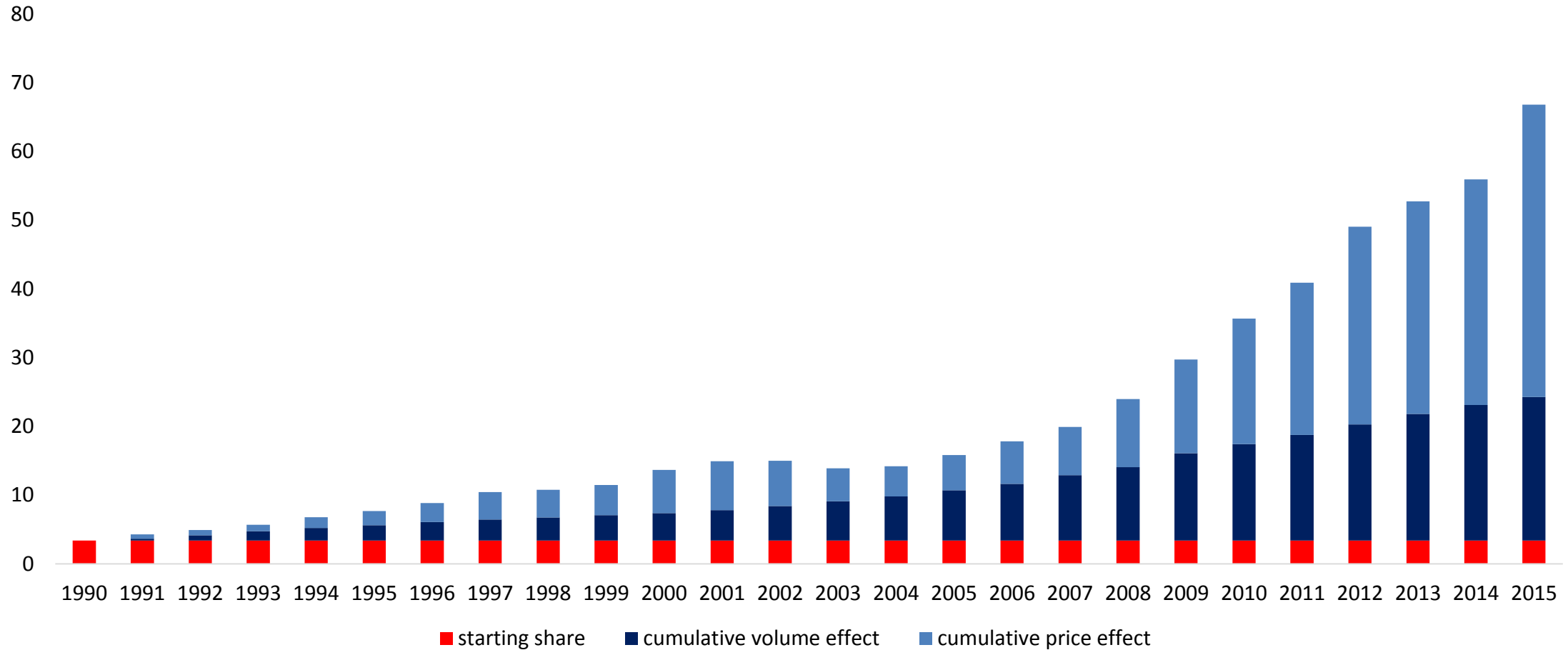
Slowdown in China coincides with decelerating potential growth

Annual percentage change



China is catching up to the European Union

China's nominal GDP as percentage of EU's nominal GDP

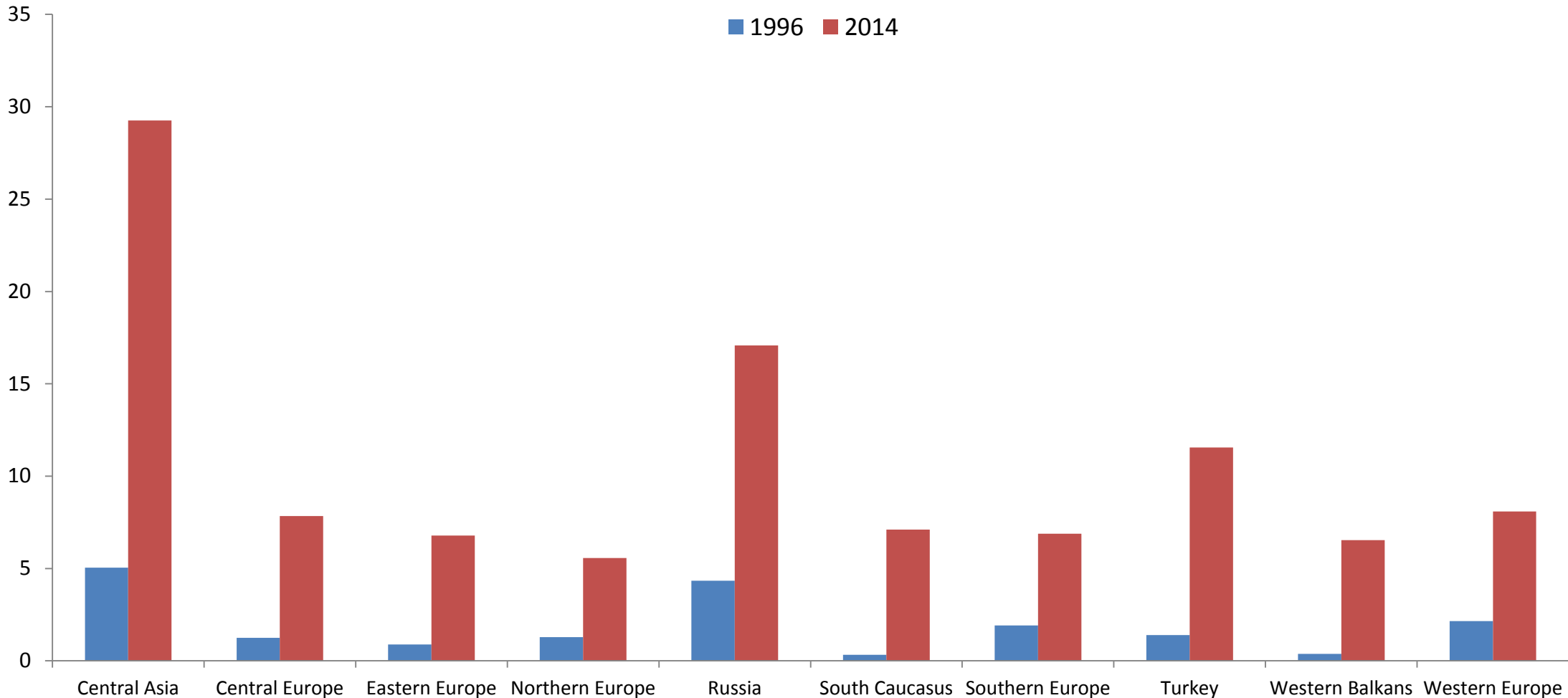


China and ECA trade links

The evolution of ECA's links with China: is the region exporting to China at its potential?

China's share of imports by ECA has expanded rapidly

Share of imports from China in total imports, percent

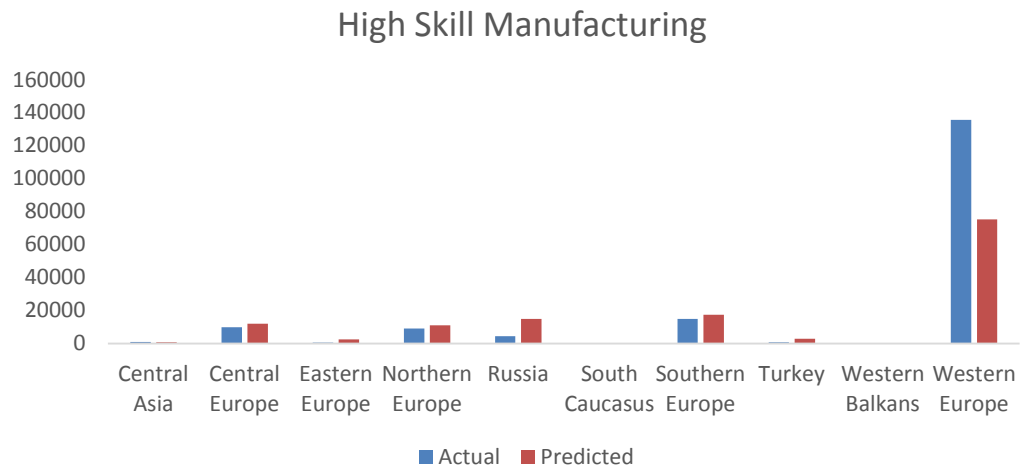
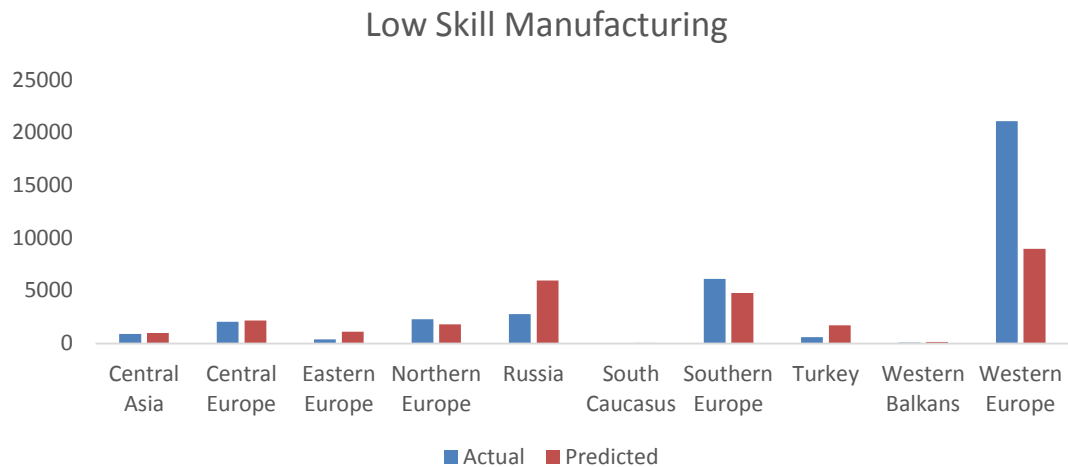
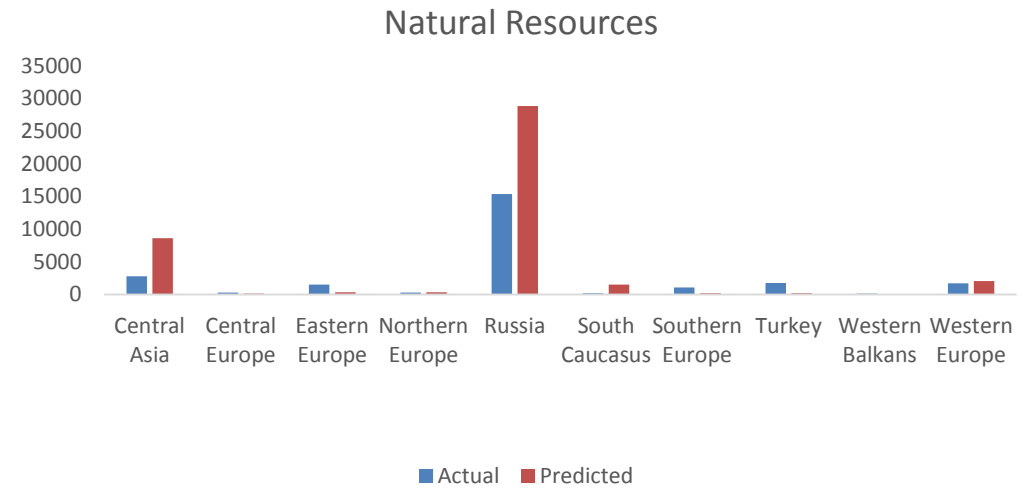
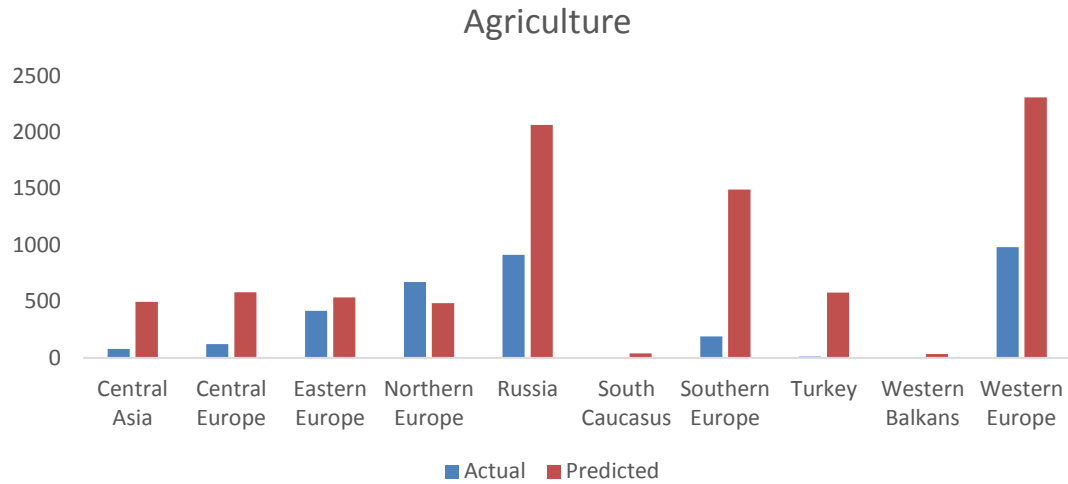


But region can export even more to China

- Exports are not as big as gravity model predicts. There seem to be special factors impeding exports to China.
- Sharp real depreciations vis-à-vis China have made producers much more competitive.

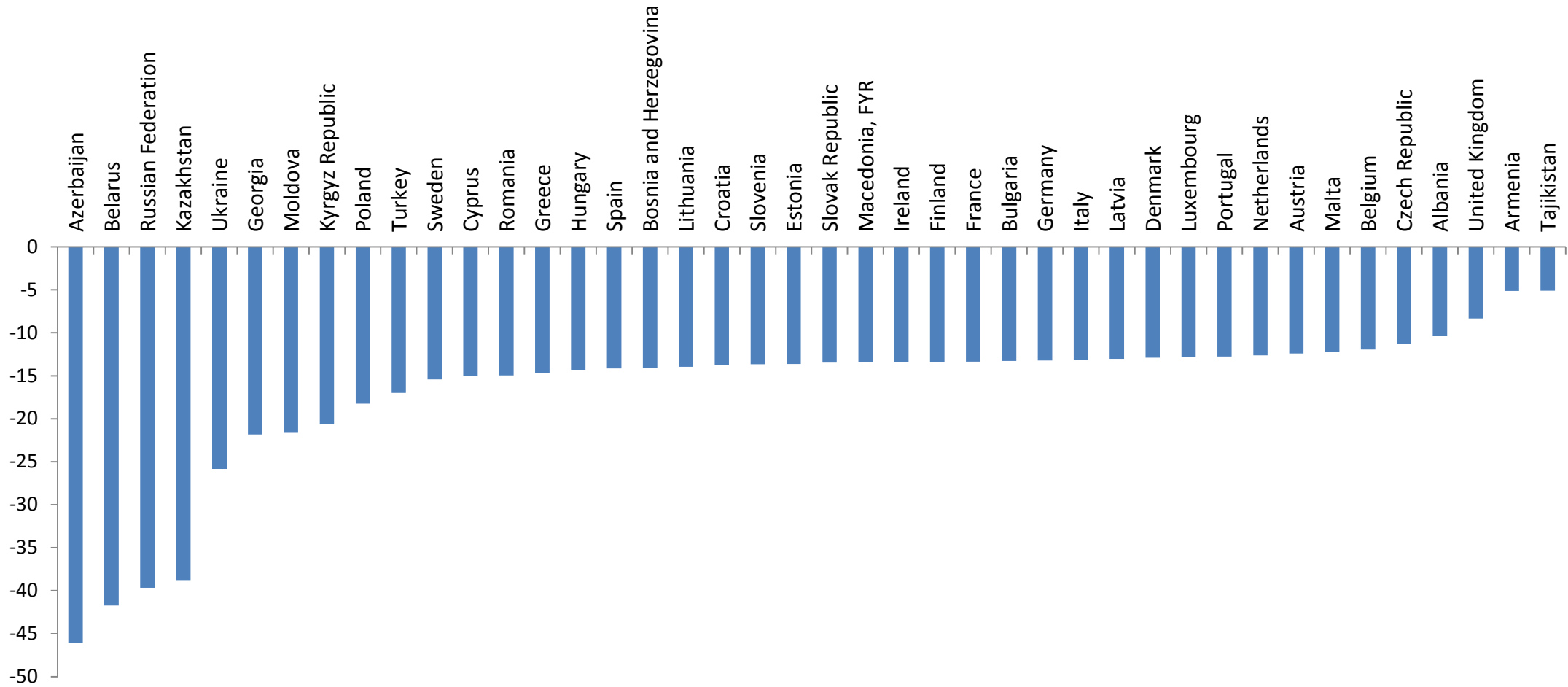
Eastern ECA may have greater potential than western ECA to increase exports to China

Exports to China by sector from ECA sub-regions, US\$ million



ECA currencies depreciated sharply over past year

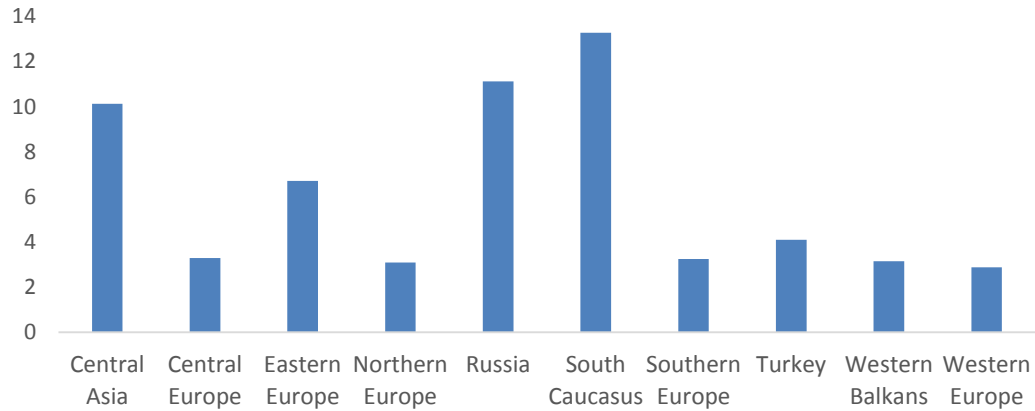
Percent change in real exchange rate with China, Jan-Feb 2015 to Jan-Feb 2016



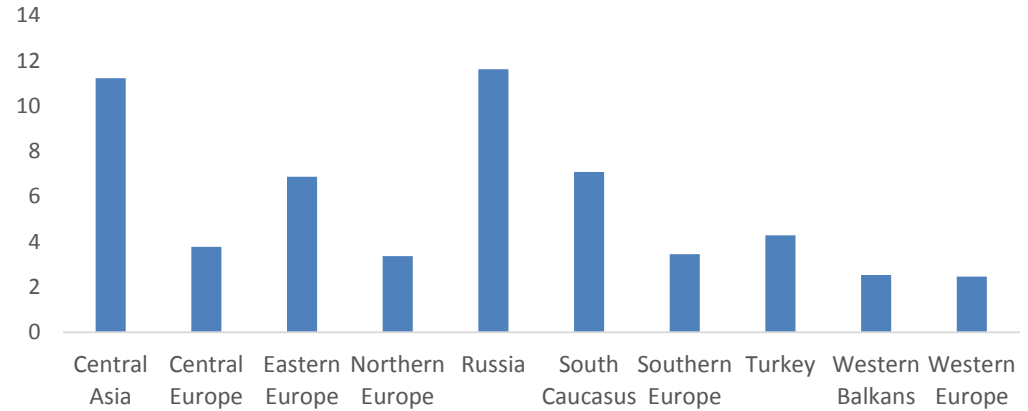
Exchange rate depreciation could boost ECA's exports to China

Percent change in volume of total exports as a result of real exchange rate depreciation in ECA

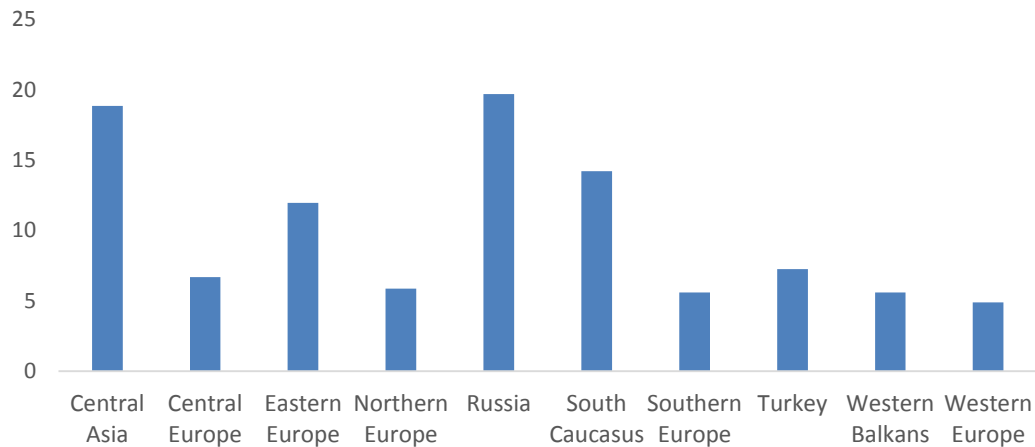
Agriculture



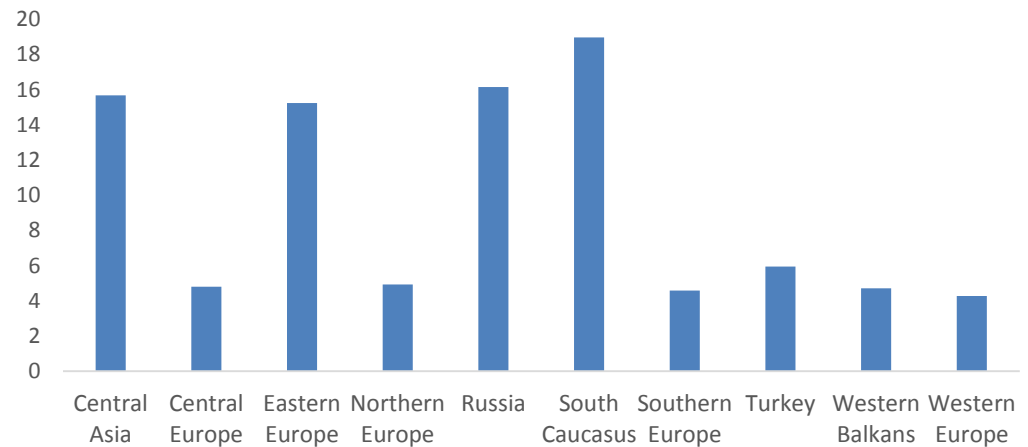
Natural Resources



Low Skill Manufacturing

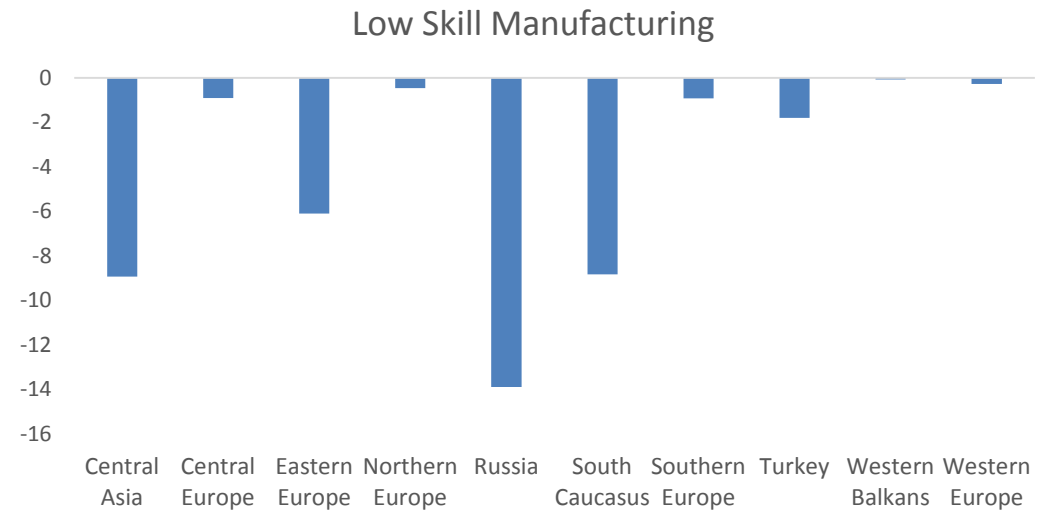
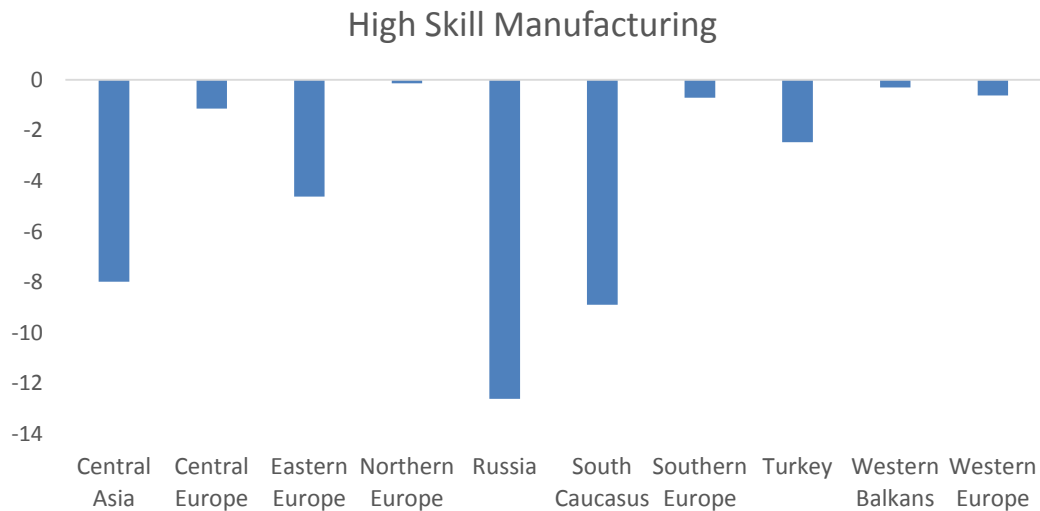
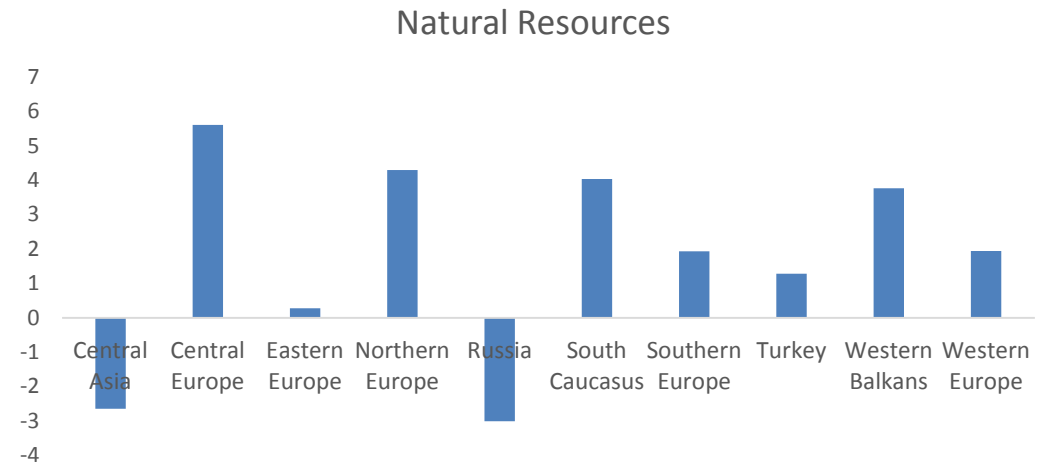
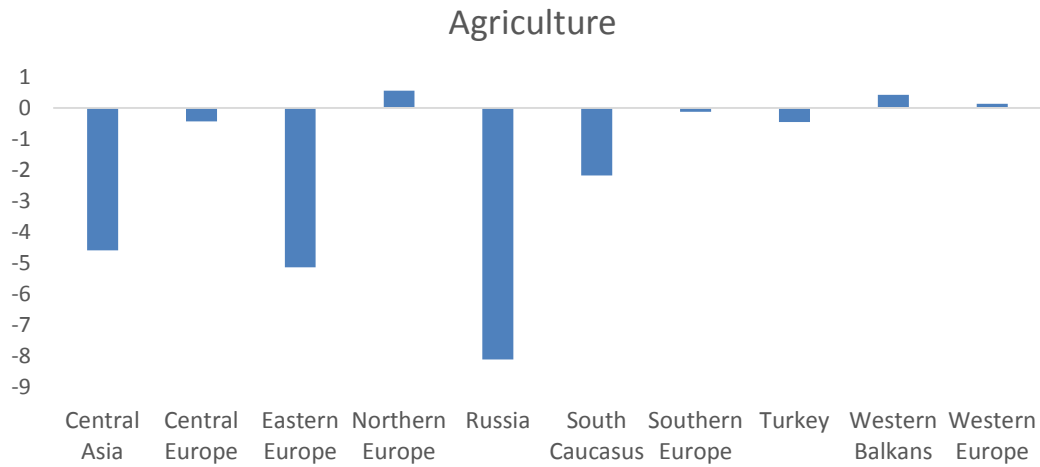


High Skill Manufacturing



Exchange rate depreciation has created opportunities to compete with imports

Percent change in potential imports as a result of real exchange rate depreciation in ECA

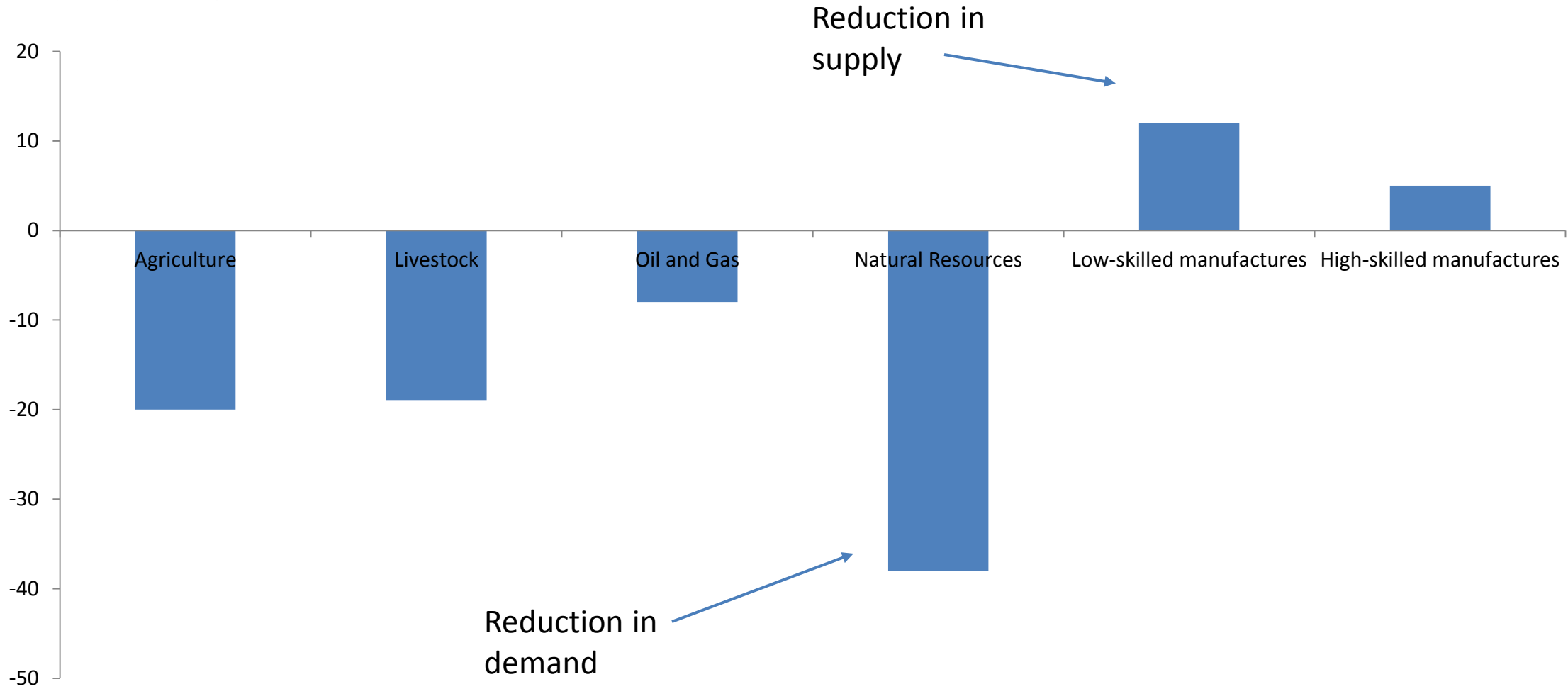


China growth slowdown and rebalancing

- **The impact of a *slowdown* in China would hurt resource exporters in the East, while reducing competition for exporters in the West;**
- **A *rebalancing* (towards consumption, high skill production, and outward FDI) will benefit more the East;**
- **Factorial distribution of income will change favoring labor versus capital and low skill vs high skill.**

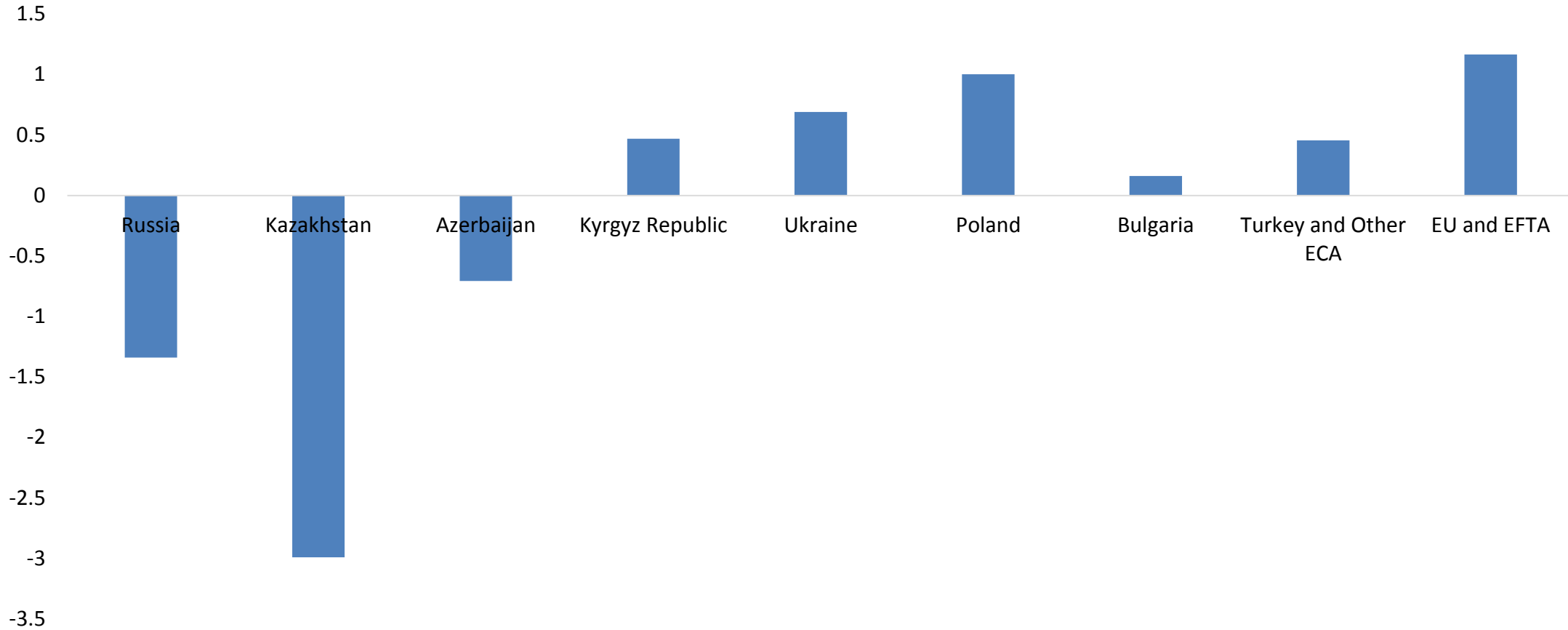
China imports primary goods and exports manufactures

Net surplus as a percent of world trade, 2016 forecast



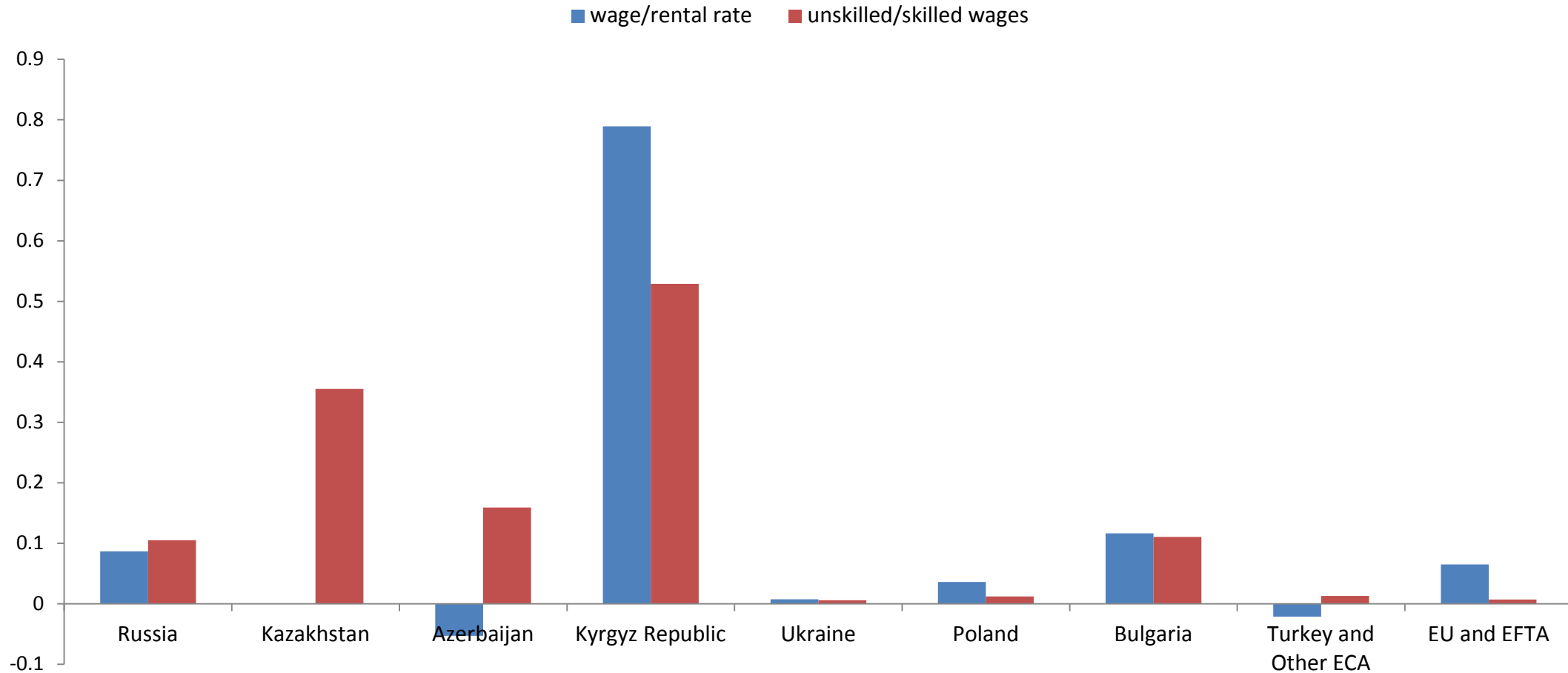
China's slowdown has a mixed impact on ECA's exports

Percentage difference in export volumes in slowdown compared to business as usual scenario



China's slowdown improves wages, particularly of unskilled workers

Percent change in China slowdown versus business as usual scenarios

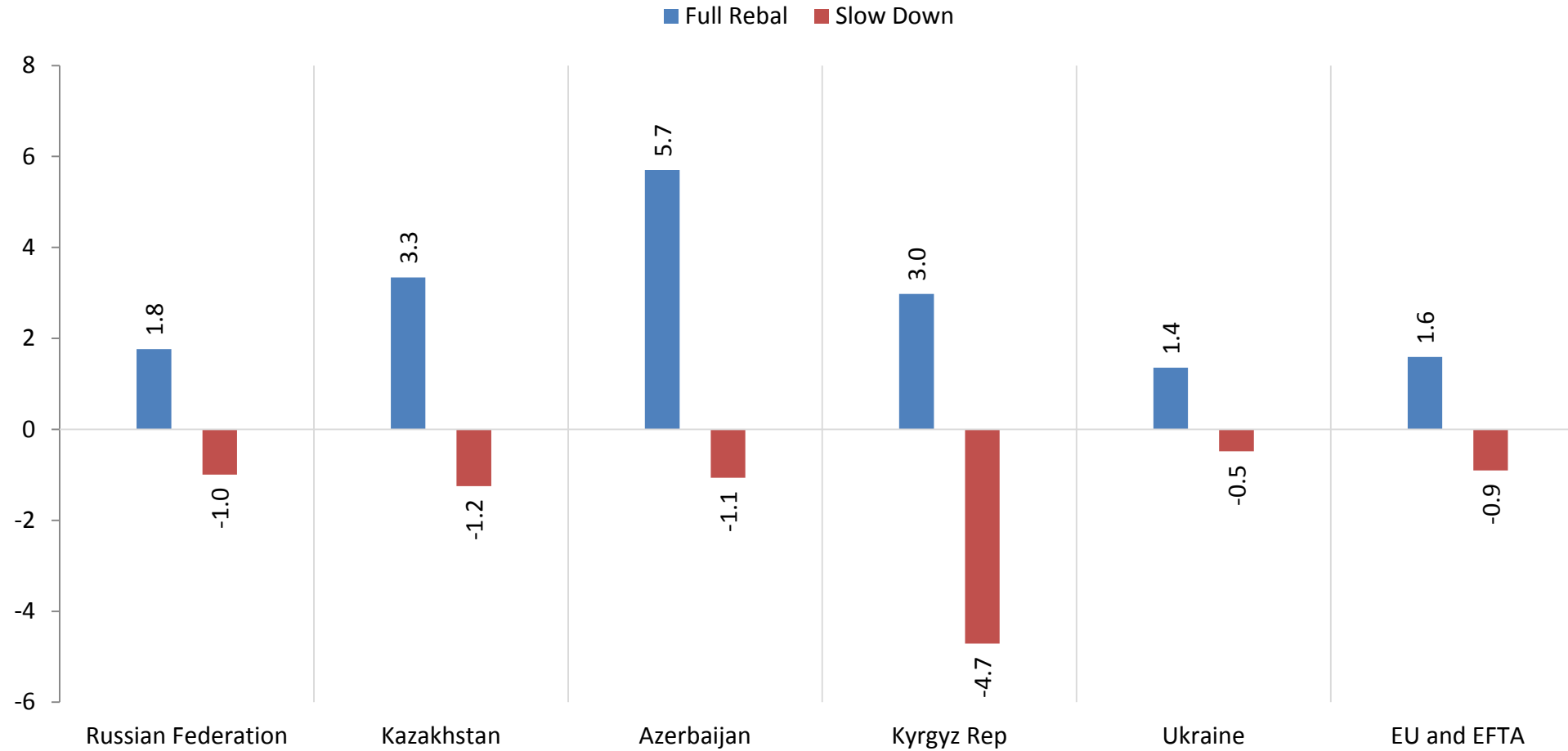


China rebalancing

- **Investment at 42% of GDP is simulated to go down by 15 ppt; with corresponding rise in consumption;**
- **The share of skilled workers in China will almost double over the next 10 years, implying an increase of 100 million skilled workers;**
- **A rise of China's FDI outflows equal to 5 percentage points of GDP over the next 10 years.**

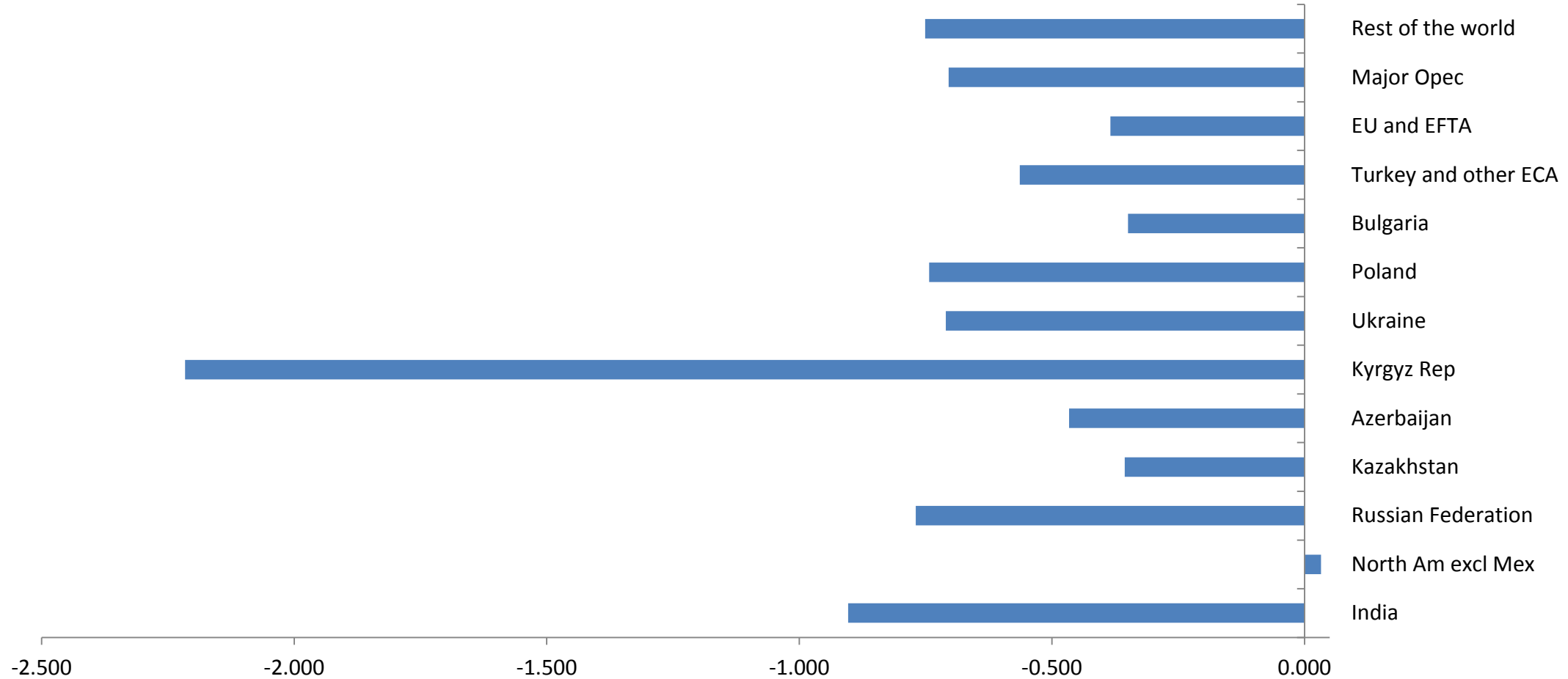
Change in private consumption relative to business as usual scenario

Percent



China rebalancing reduces the skill premium globally

Percentage difference in skill premium between rebalancing and business as usual scenarios



Conclusions

- Expected slow GDP growth tells only part of the story. Big changes in relative prices have far-reaching consequences.
- Slowdown and rebalancing in China are key elements of structural changes in global environment.
- There are some silver linings in the outlook. Unemployment is declining in EU and export opportunities are improving.
- Policies challenges most complicated for Eastern Europe and Central Asia.

Thank you!

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