



**EUROPEAN
DEPARTMENT**

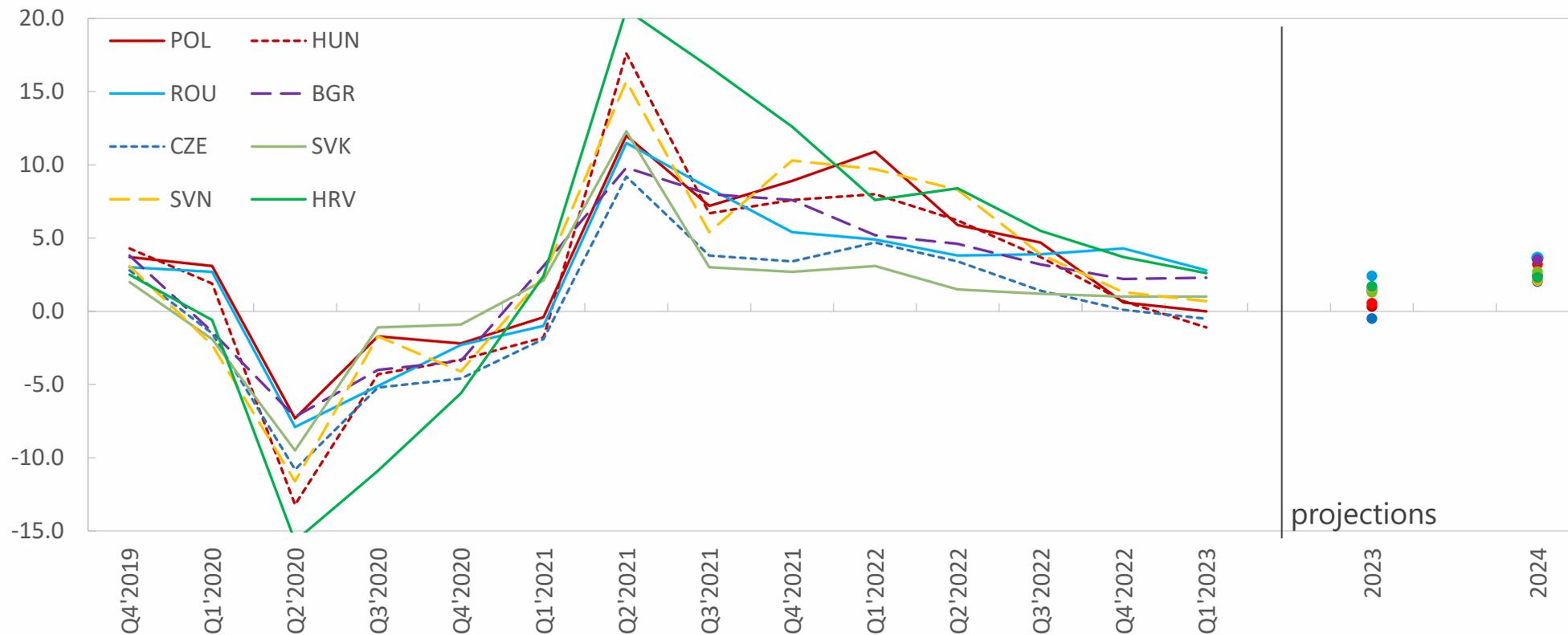
Europe in a Fragmented World

FRANKFURT, JULY 17, 2023

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European Department

Soft landing expected, followed by a mild recovery

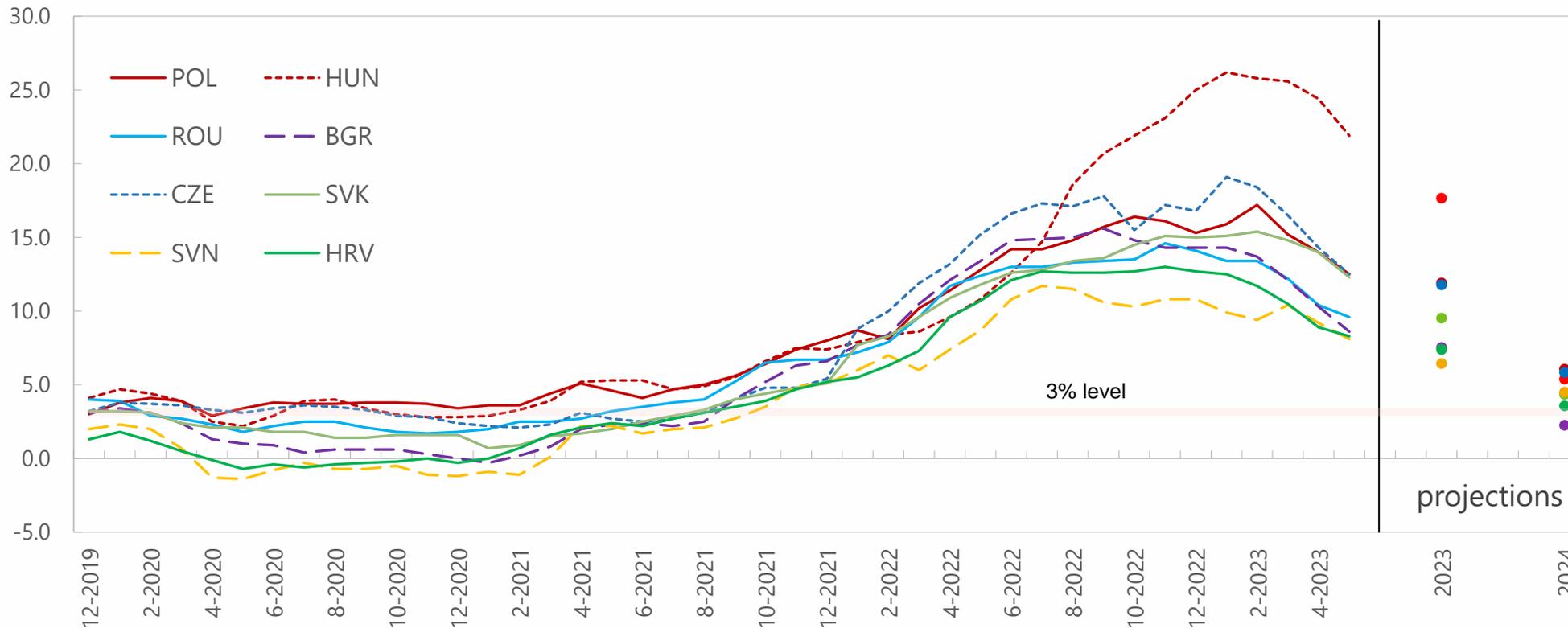
Select CESEE Countries: Real GDP growth 2019-2024 (Percent y/y)



Source: Haver Analytics; Eurostat; and IMF WEO projections.
Select CESEE countries include, Bulgaria, the Czech Republic, Croatia, Hungary, Poland, Romania, Slovakia, and Slovenia.

Inflation pushed to worrying levels...

Select CESEE Countries: HICP Inflation 2019-2024
(Percent y/y)

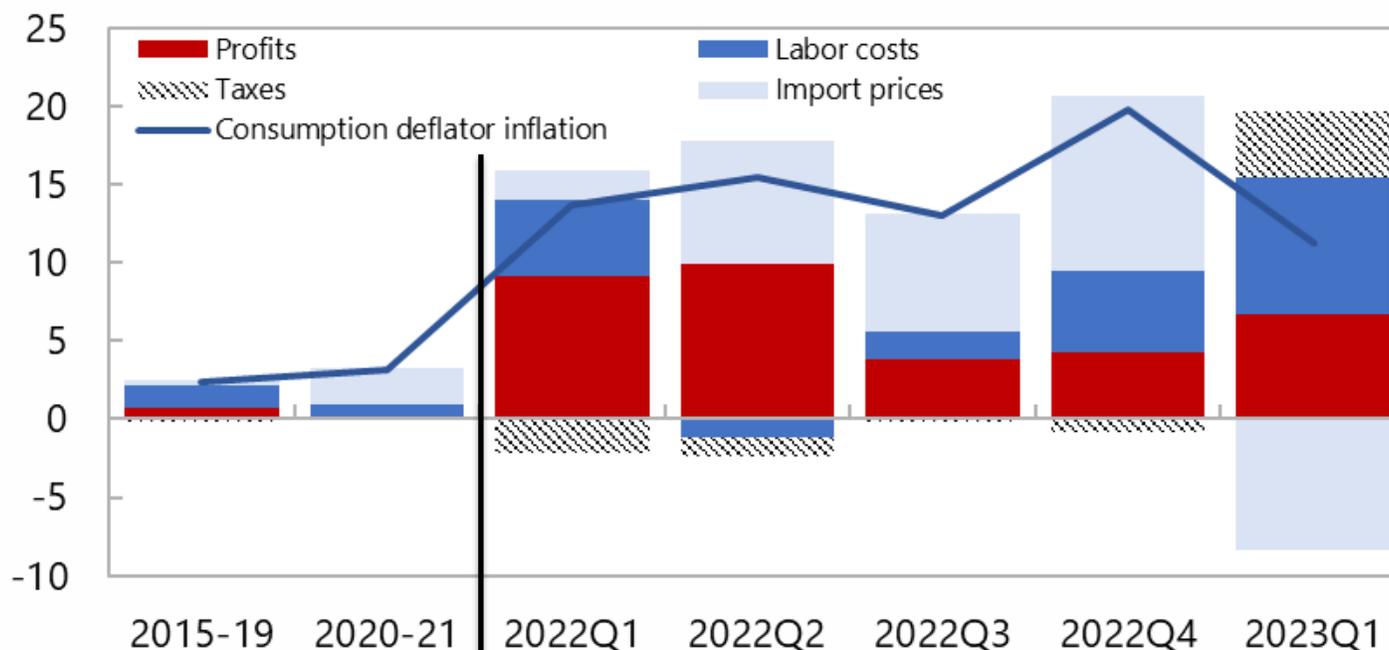


Source: Haver Analytics; Eurostat; and IMF WEO projections.

Select CESEE countries include, Bulgaria, the Czech Republic, Croatia, Hungary, Poland, Romania, Slovakia, and Slovenia.

...driven by global factors, profits, and rising labor costs

Select CESEE Countries: Consumption Inflation Decomposition (Percentage Points, qoq saar)

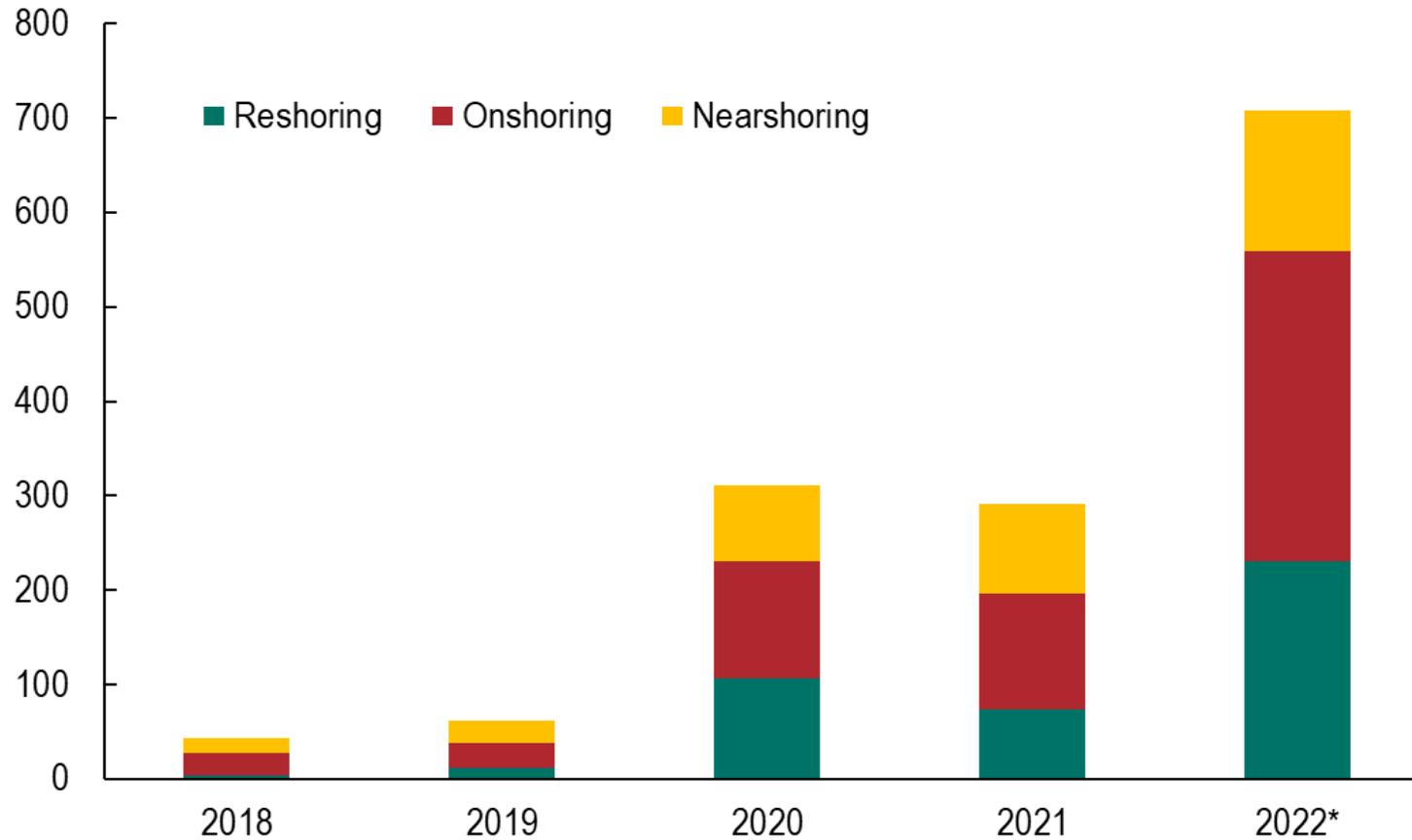


Sources: Eurostat, OECD, IMF staff calculations.

Note: Country samples include BGR, CZE, EST, HRV, HUN, LTU, LVA, POL, ROU, SVK and SVN from 2015 to 2022. BGR and ROU are excluded from the aggregation in 2023Q1 due to missing decomposition components.

Fragmentation will continue to disrupt...

Frequency of Mentions of Key terms in Corporate Presentations
(Absolute numbers)

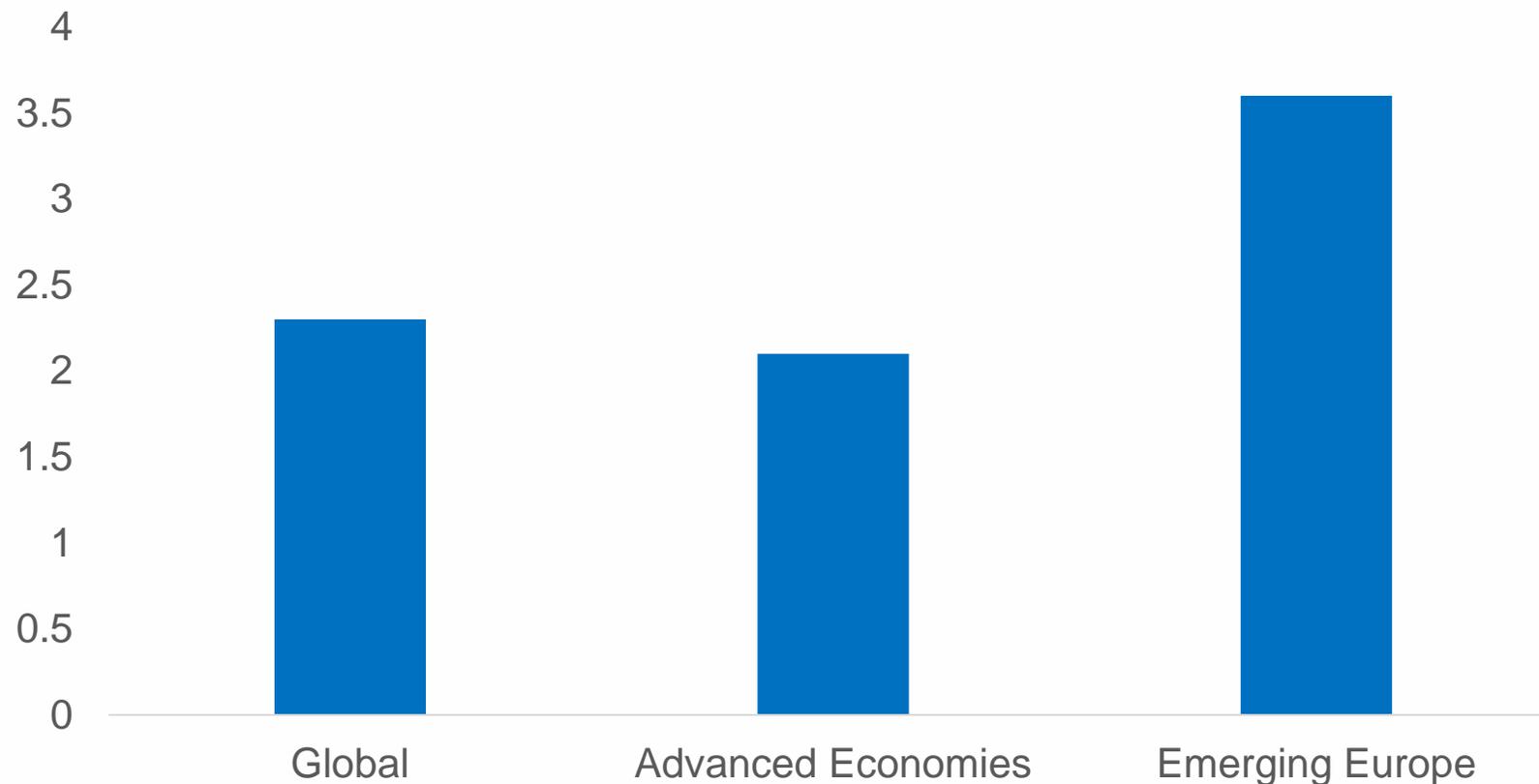


Sources: IMF 2022

...and can lower productivity, raise inflation, and erode competitiveness

Permanent Growth Cost from Geoeconomic Fragmentation

(In percentage points; cumulative)

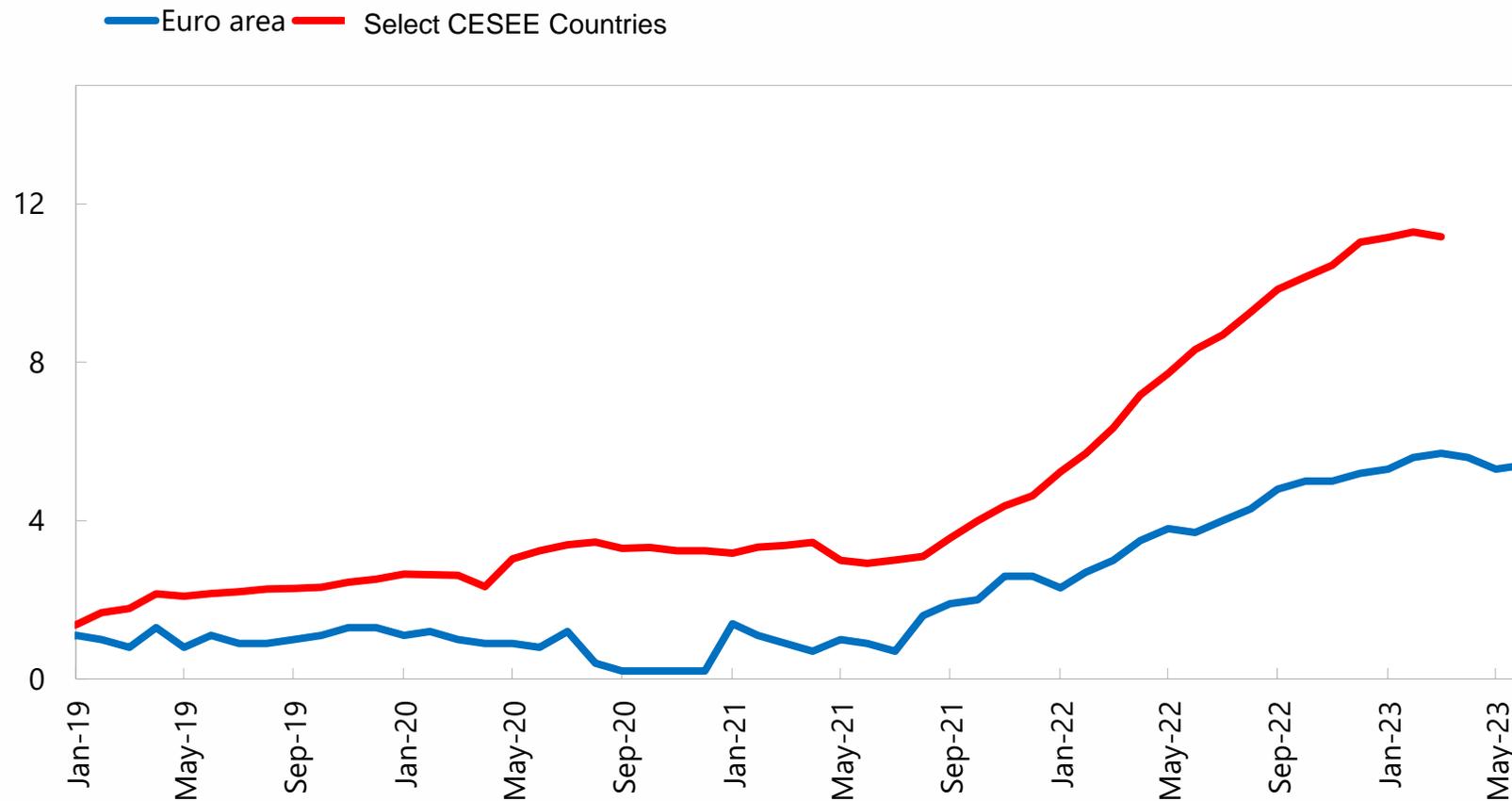


Source: Bolhuis, Chen, and Kett (2023) Fragmentation in Global Trade: Accounting for Commodities, IMF WP

Estimates based on scenario analysis assuming barriers on commodity trade between the US-EU and China; RoW countries trade either exclusively with the US and EU or with China.

All these developments make disinflation a priority

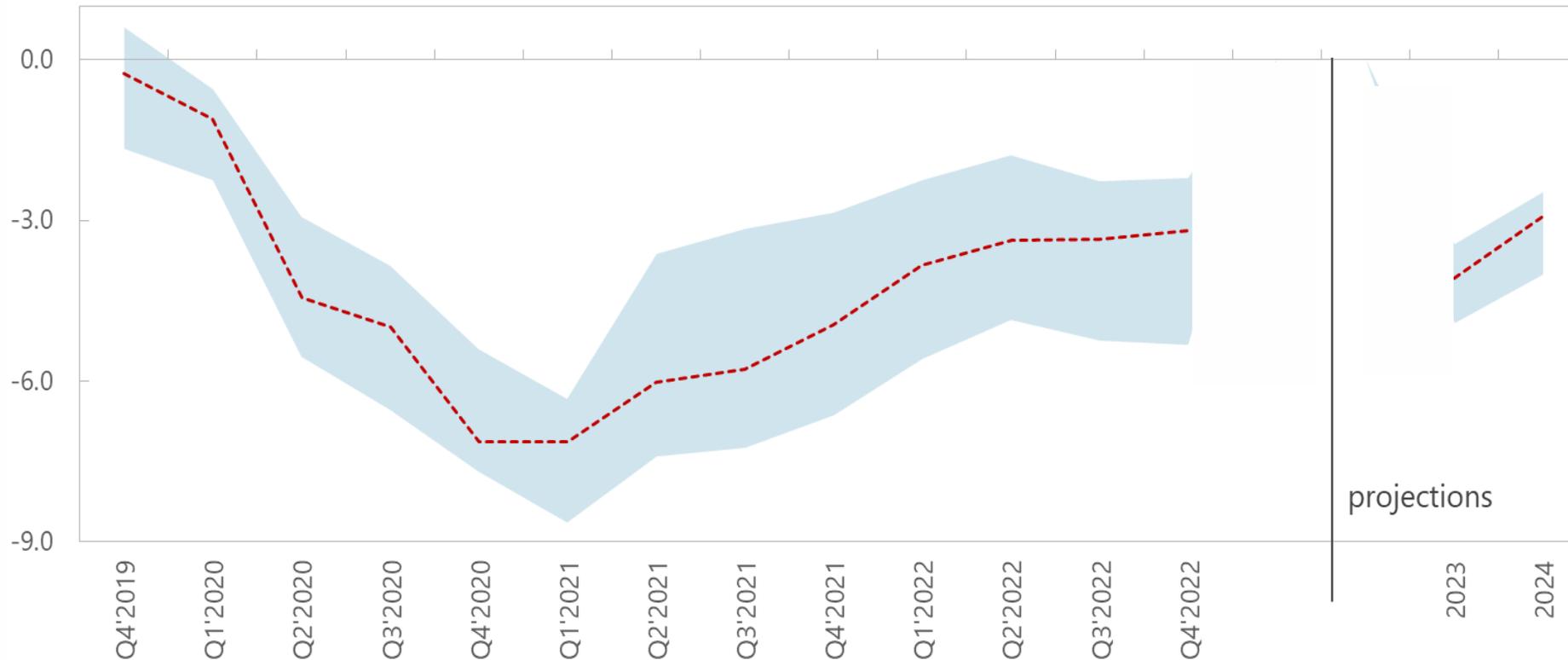
Select CESEE Countries and Euro area: Core Inflation 2019-2024 (Monthly, in percent y/y)



Source: Haver Analytics; ECB,
Select CESEE countries include Albania, Bosnia and Herzegovina, Bulgaria, the Czech Republic, Croatia, Estonia, Hungary, Kosovo, Latvia, Lithuania, Moldova, Montenegro, North Macedonia, Poland, Romania, Serbia, Slovakia, and Slovenia.

Fiscal policy should help more with disinflation...

Select CESEE Countries: General Government Balance
(Median and 25-75th range in percent of GDP, 4q-rolling average)



Source: Haver Analytics; Eurostat; and IMF WEO projections. Sample includes CZE, BLG POL HRV, ROM, SLV, SVK
Median and range measures bottom 25th and top 75th percentile.

...and with right policy mix, changing GVCs are an opportunity

Select CESEE Countries: Value Added in Exports (In percent)



Source: IMF staff estimates based on Eurostat.

Select CESEE countries include Albania, Bosnia and Herzegovina, Bulgaria, the Czech Republic, Croatia, Estonia, Hungary, Kosovo, Latvia, Lithuania, Moldova, Montenegro, North Macedonia, Poland, Romania, Serbia, Slovakia, and Slovenia

Main messages

Soft landing expected, followed by a mild recovery.

Sustained high inflation reinforced by fragmentation can erode productivity and competitiveness.

The right policy mix needed to secure low inflation and higher long-term growth,

- Do not ease monetary policy too early. Fiscal policy should help with disinflation
- Complementary policies can retain competitiveness and long-term growth
 - > Durably attract FDI: sound governance and transparency critical
 - > Retain a strong banking sector: avoid adding distortions
 - > Strengthen and grow labor force: upskilling and employment matching

Thank you