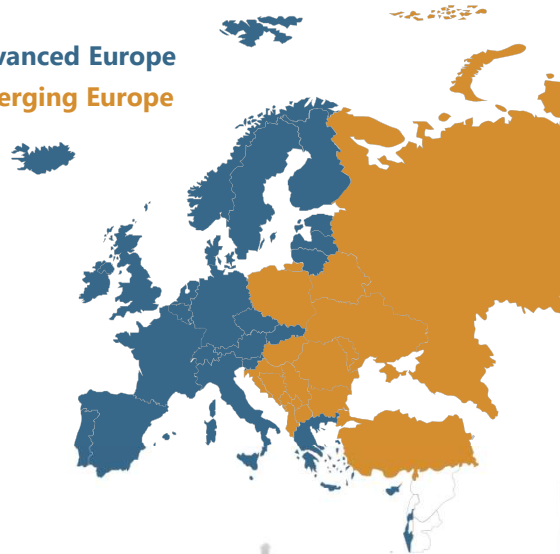




Regional Economic Outlook

Spring 2018

Advanced Europe
Emerging Europe



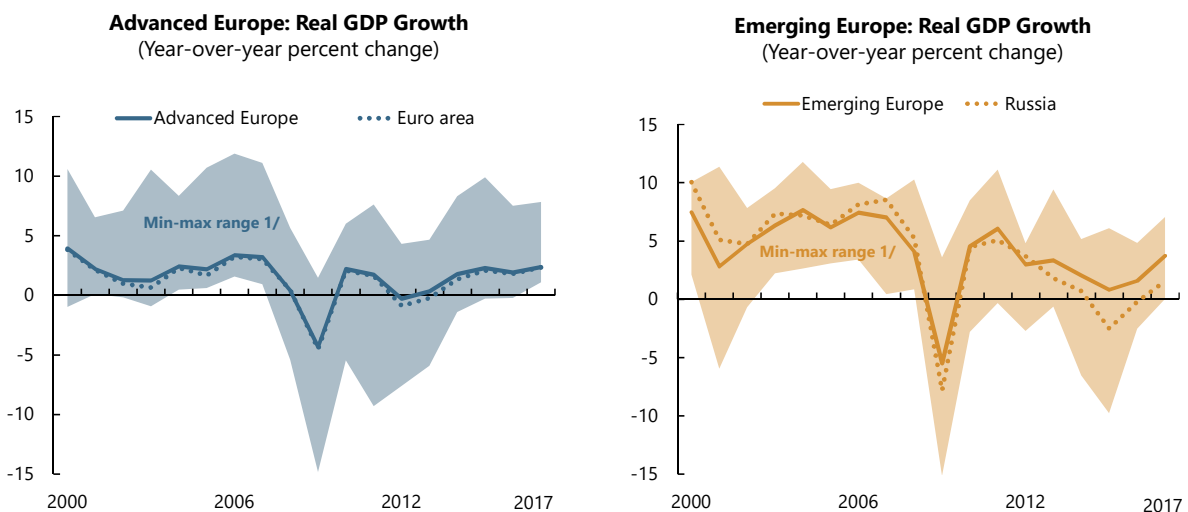
Key Messages

- ✓ Strong economic growth but lead indicators point to a peak
- ✓ Much lower wage growth in most of advanced Europe than in new EU member states because of slack, a flatter Phillips curve, and entrenched low inflation expectations
- ✓ Monetary policy normalization to proceed more slowly in most of advanced Europe: implications for capital flows to new EU member states and exchange rates
- ✓ Fiscal adjustment insufficiently ambitious, given the strength of the cycle. Some countries have even relaxed
- ✓ Policymakers need to seize the good times to advance further with fiscal consolidation and structural reforms



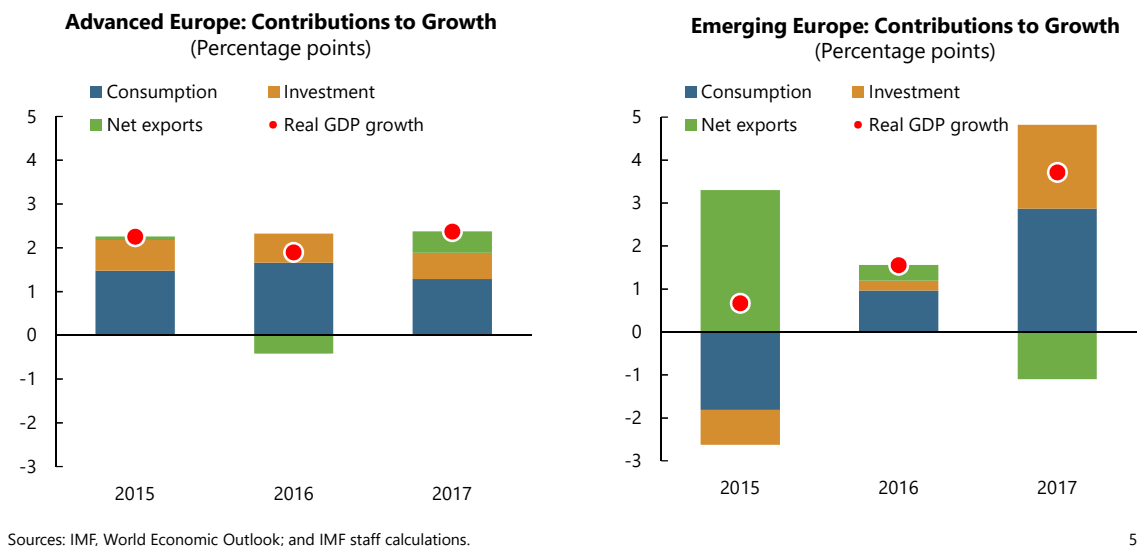
Developments and Outlook

Europe continues to enjoy strong growth



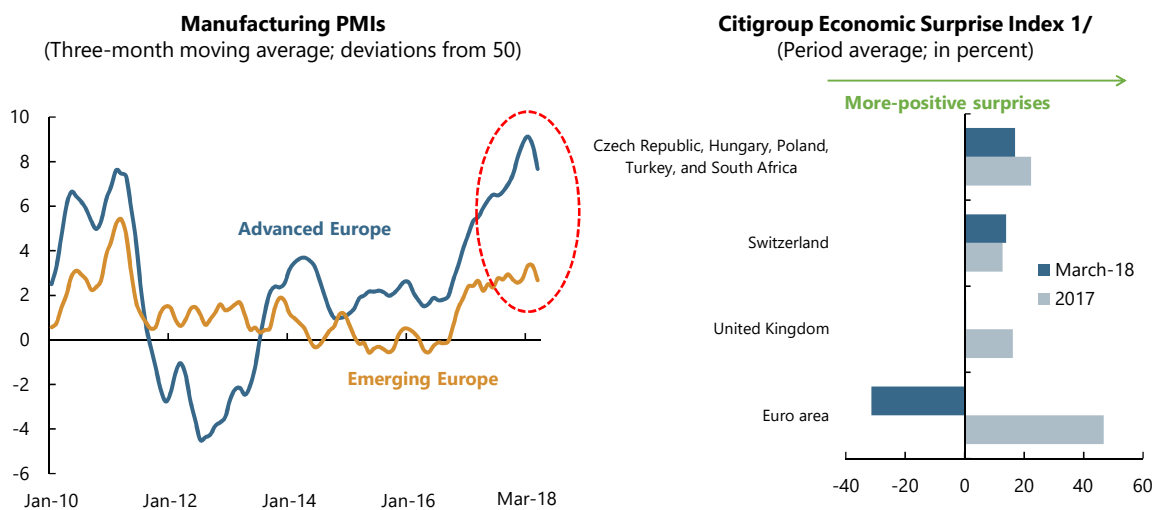
Sources: IMF, World Economic Outlook; and IMF staff calculations.
1/ The upper and lower bounds of the shaded areas depict the minimum - maximum growth range.

Growth is driven by domestic demand



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High-frequency data suggest that momentum is peaking



Sources: European Commission; Haver Analytics; IMF World Economic Outlook; and IMF staff calculations.

1/ Measures macroeconomic data surprises relative to market expectations. A positive/negative reading means that the data releases have been stronger/worse than expected.

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Risks

Near-term risks balanced. Medium-term risks to the downside

Near-term risks balanced:

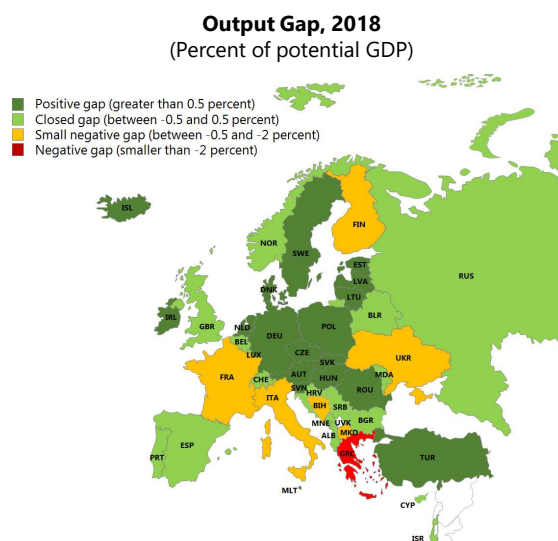
- Robust confidence and still strong conjunctural indicators
- But greater trade tensions and market volatility

Medium-term downside risks have become more acute:

- Inward looking policies and rising protectionism
- Protracted policy and economic uncertainty
- Richly valued asset prices could correct abruptly

Cyclical Position and Inflation

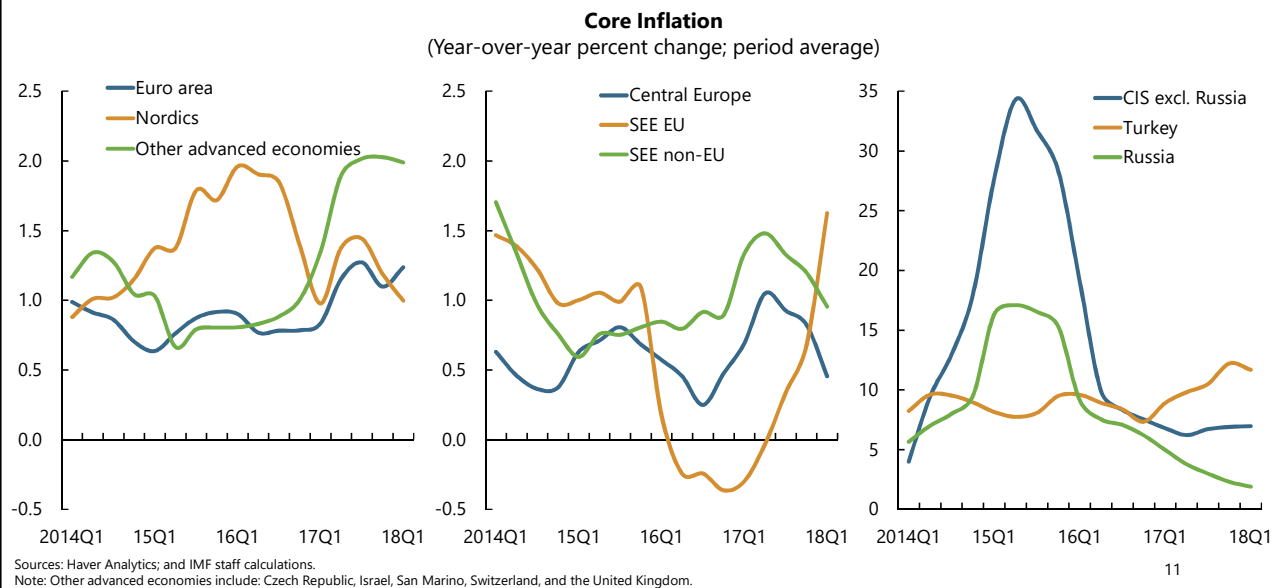
Output gaps appear largely closed



Sources: IMF World Economic Outlook; and IMF staff estimates.

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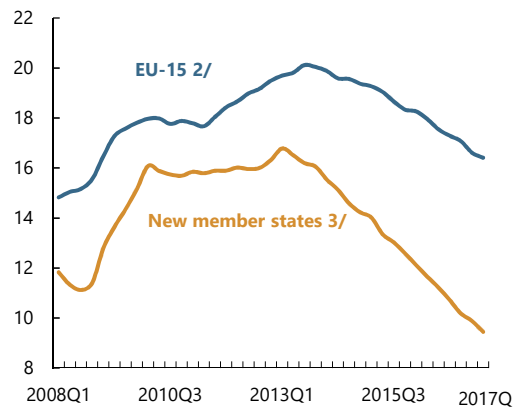
Inflation pressures are diverging across economies



Labor Markets and Wages

Labor market slack has declined, but remains high in EU-15, unlike in NMS

EU: Unemployment and Additional Labor Market Slack 1/
(Percent)



Sources: Eurostat; and IMF staff calculations.

1/ Additional slack includes persons marginally attached to the labor force and underemployed part-time workers.

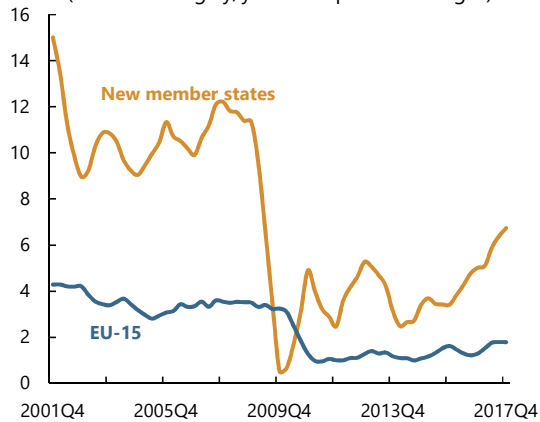
2/ EU-15: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

3/ New member states: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia.

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Wage growth is sluggish in EU-15 and strong in NMS

Nominal Wage Growth
(Percent change y/y in four-quarter averages)

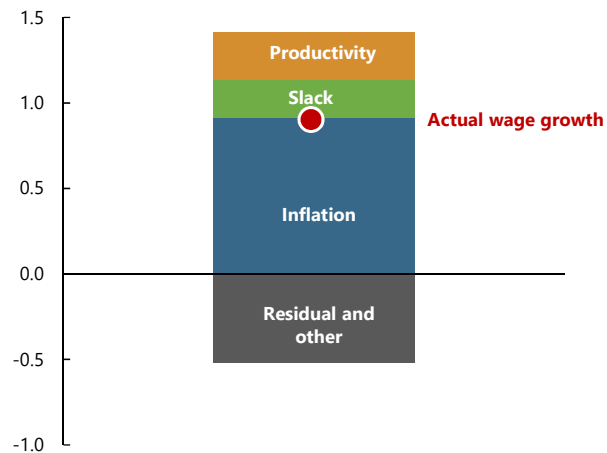


Source: Eurostat.

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In selected EU-15, low inflation, labor slack, and sluggish productivity are weighing on wages

Contributions to Wage Growth: Selected EU-15, 2017
(Percentage point)



Source: IMF staff calculations.

15

In NMS, tight labor markets and spillovers from EU integration will push wages up

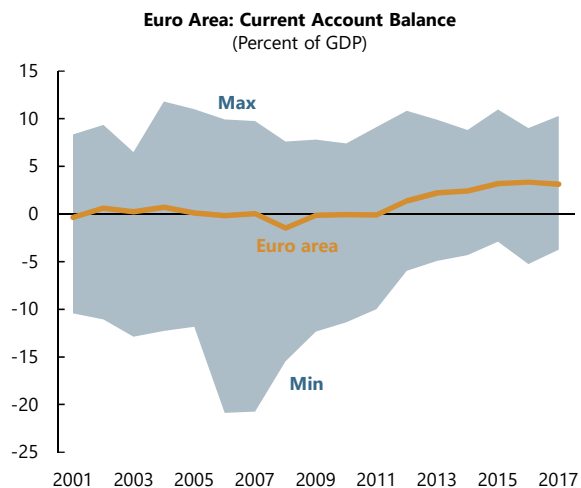
New Member States: Contributions to Wage Growth, 2017
(Percentage point)



Source: IMF staff calculations.

16

Overall, euro area current account still broadly in equilibrium;
deficits shrinking, surpluses flat

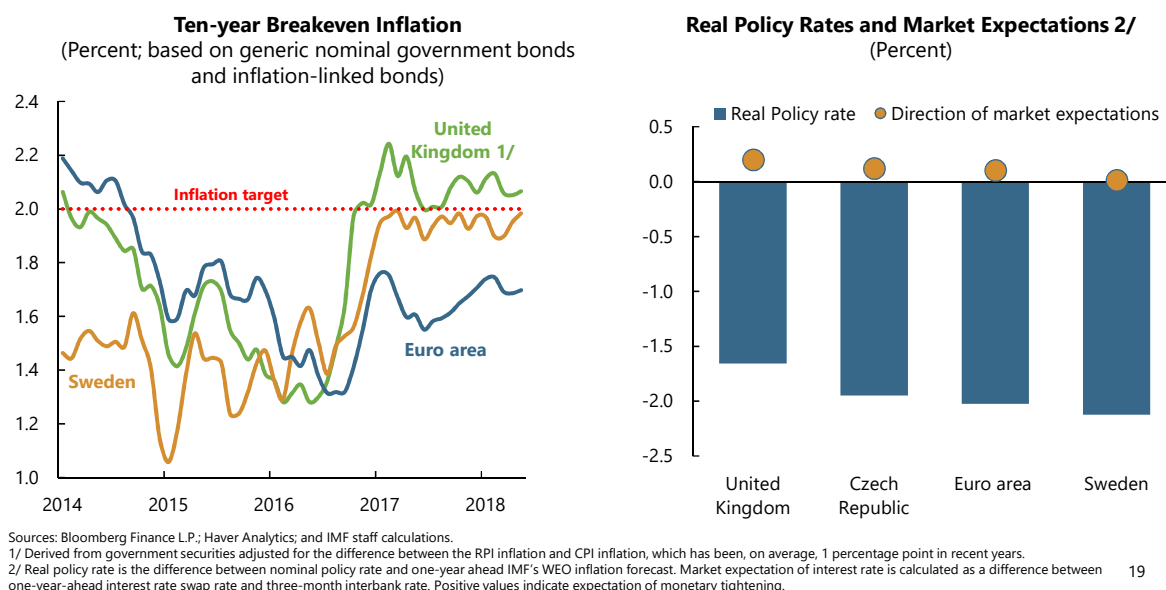


Sources: IMF, World Economic Outlook (WEO); and IMF staff calculations.

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Policies

In most of advanced Europe, maintain accommodative monetary policy



Monetary Policy Challenges in NMS

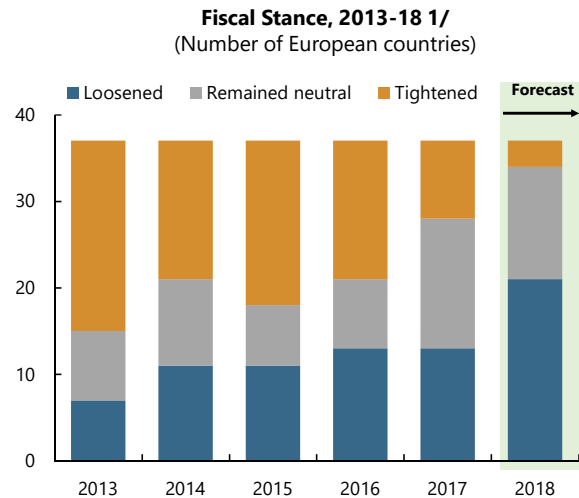
NMS are more advanced in the cycle

- ✓ Output gaps appear largely closed, wage growth is strong

Thus, they have to tighten sooner, but mind spillovers

- ✓ Policy rates low for longer in advanced Europe
- ✓ Pressure for capital inflows and exchange rate appreciation

A picture of procyclical fiscal policies



Sources: IMF World Economic Outlook; and IMF staff calculations.

1/ The fiscal stance is considered to have tightened if the ratio of the structural primary balance to potential GDP improves by at least 0.25 percent per year, to have loosened if that ratio deteriorates by at least 0.25 percent per year, and to have remained neutral otherwise. General government non-oil primary structural balance is used for Russia, and structural non-oil balance in percent of mainland trend GDP is used for Norway. No data for ALB, BLR, UVK, MKD, MDA, MNE, and SMR.

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Strengthen the EU Architecture

Complete the Banking Union

Advance the Capital Market Union

Fiscal Institutional Reforms

Role of the European Stability Mechanism (ESM)



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Thank You