Implications of changing geopolitical landscape for Western Balkan economies

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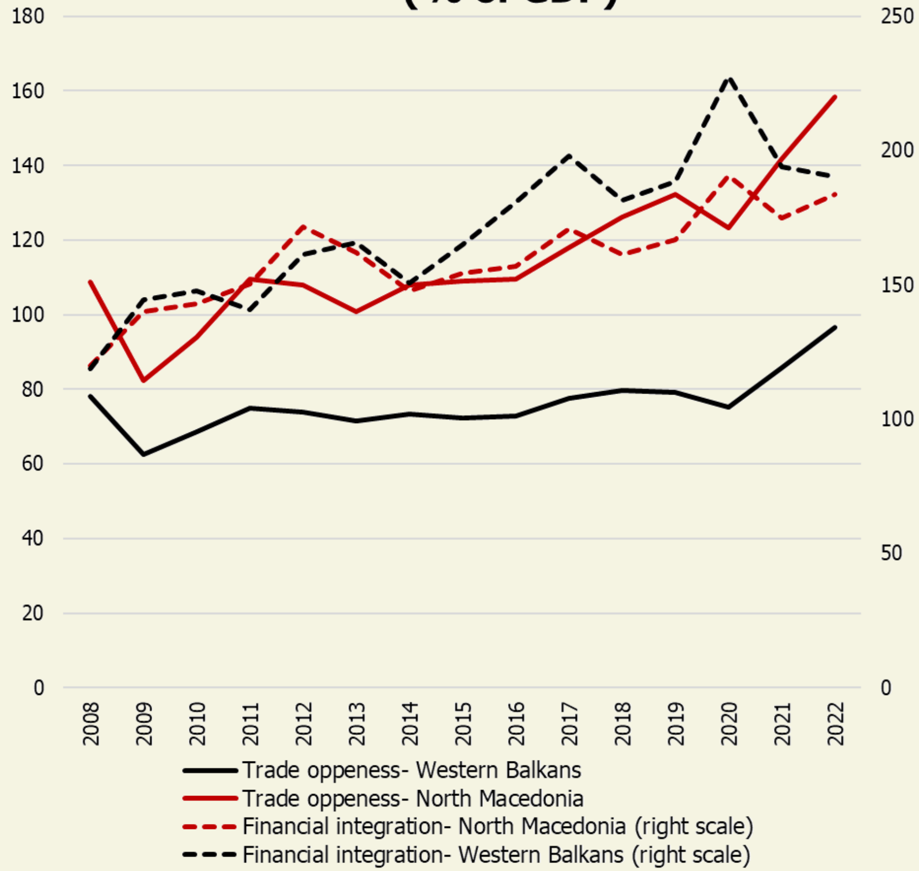
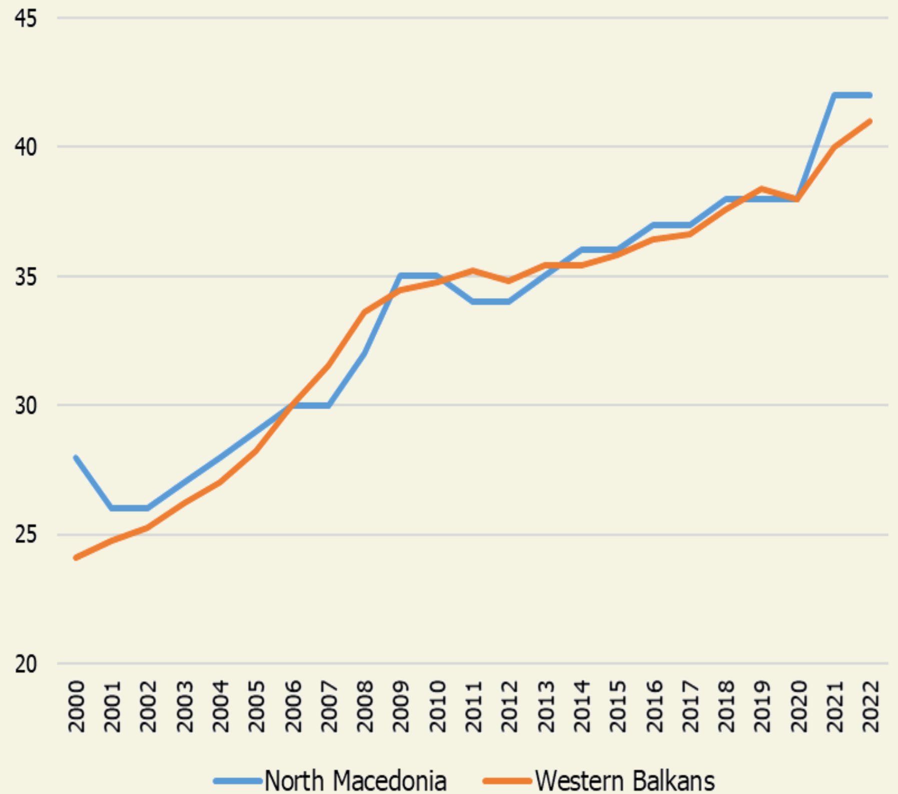
Trade and financial integration acted as catalyst for growth and income convergence

Measures of integration (% of GDP)



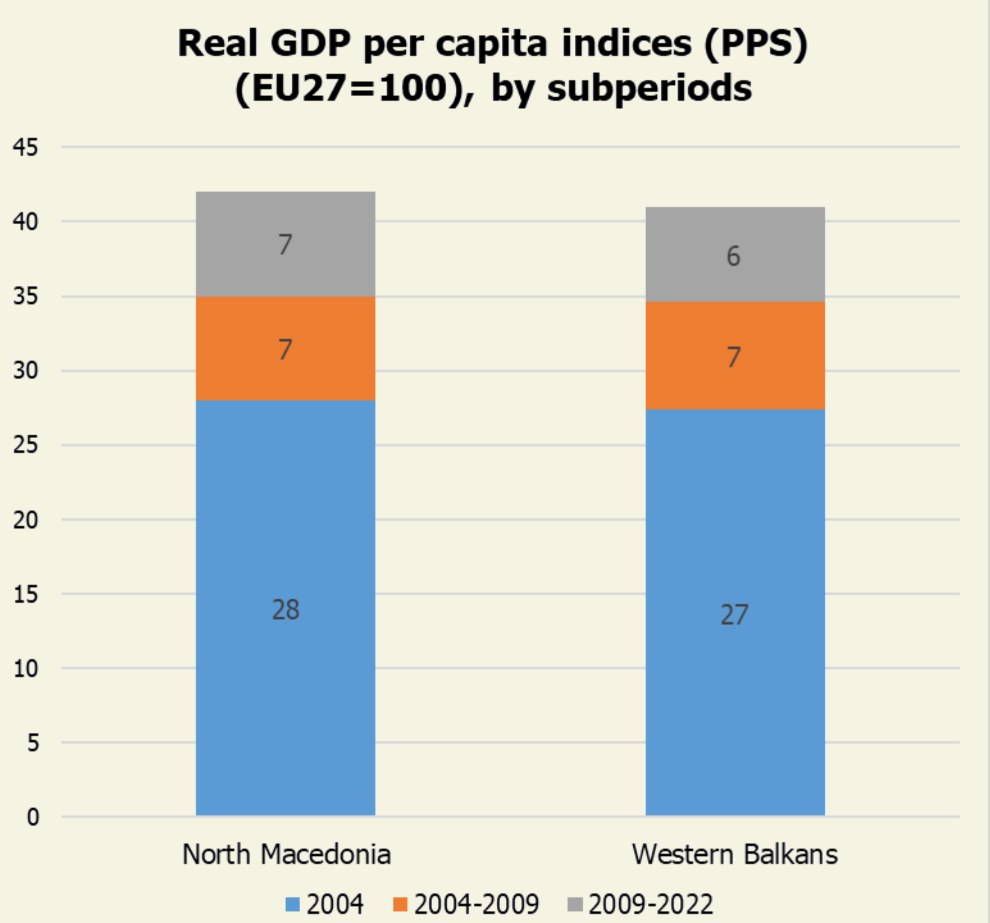
Source: Eurostat, IMF, central banks' databases and own calculations.

Real GDP per capita indices (PPS) (EU27=100)



Source: Eurostat.

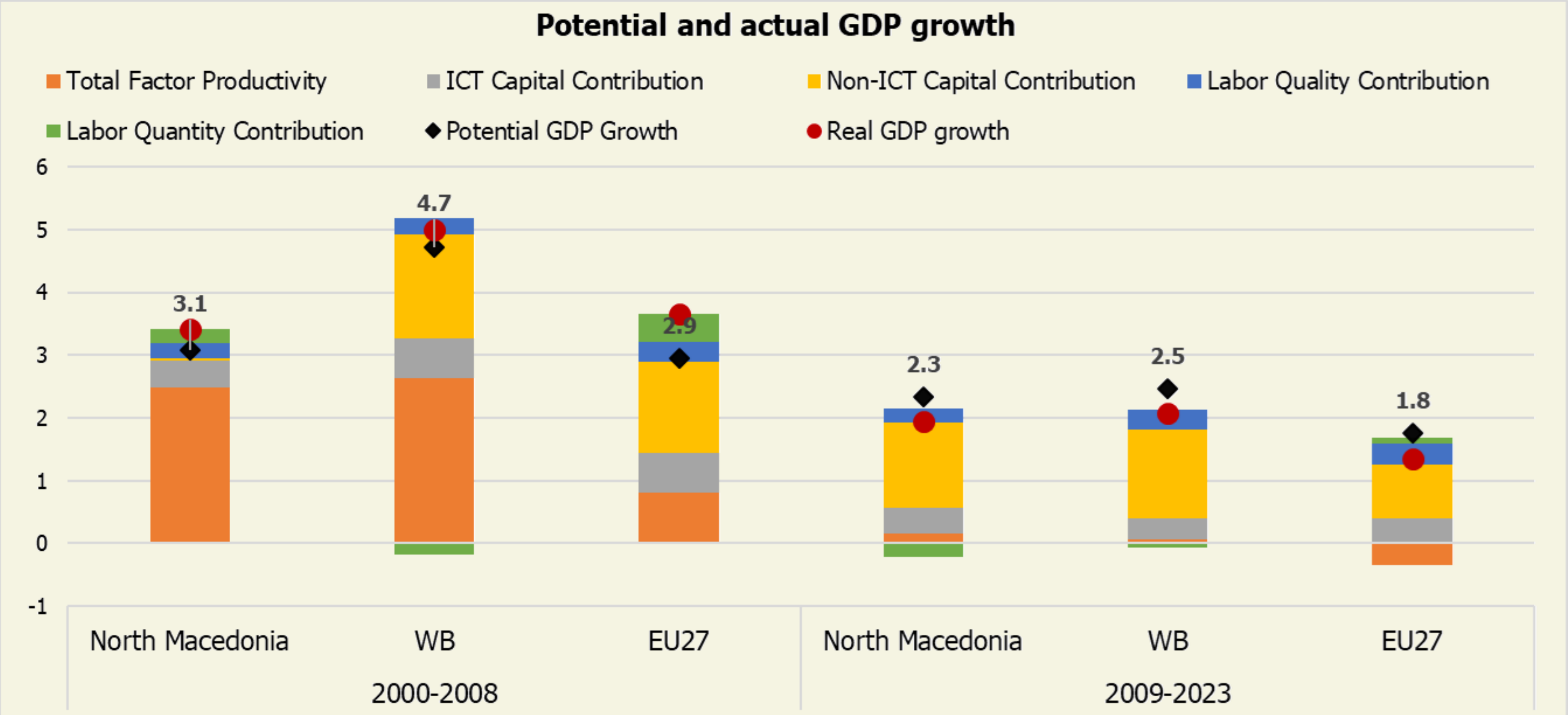
However, the pace of convergence significantly decelerated after the GFC



Source: Eurostat and own calculations.

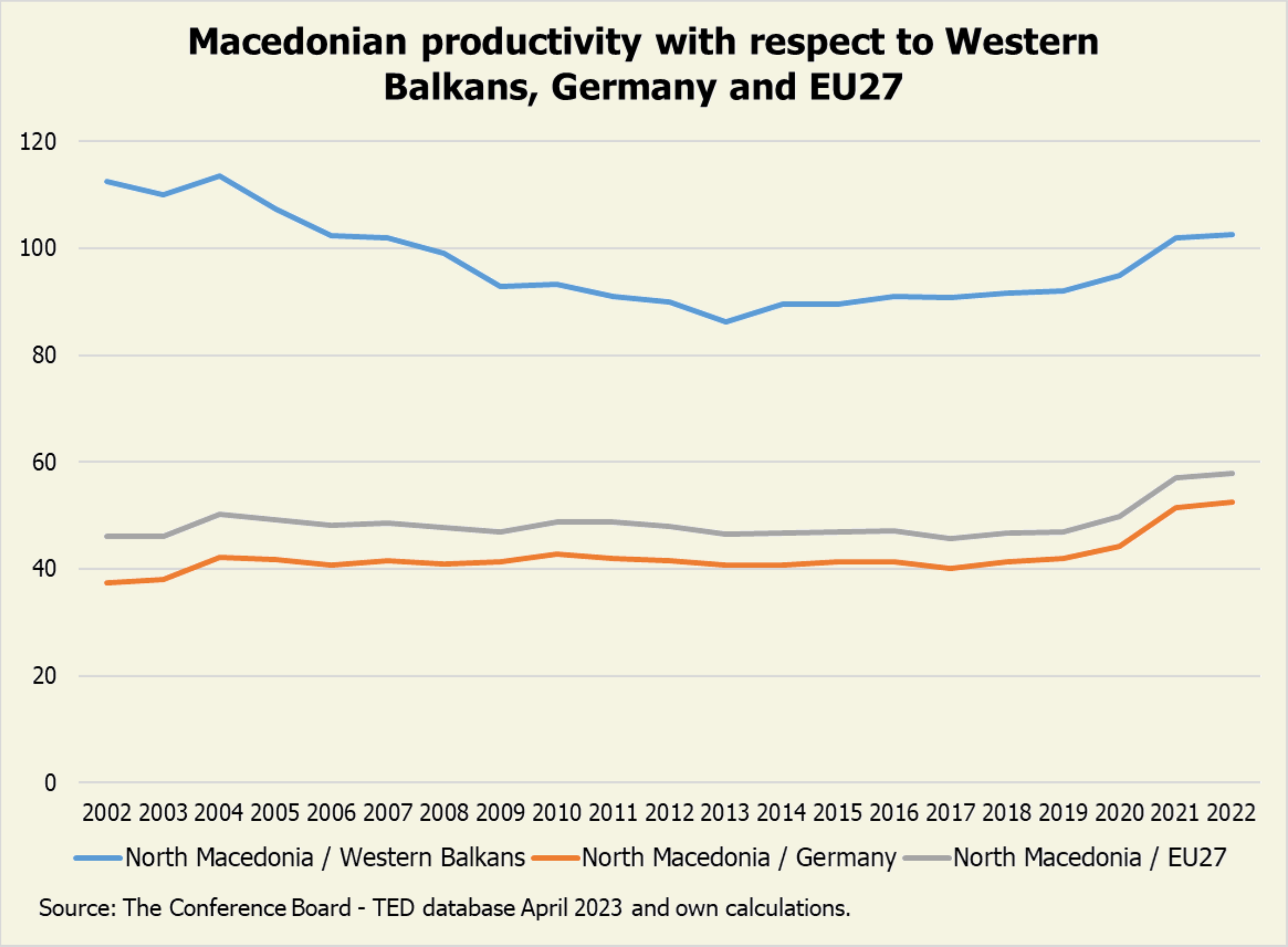
Deceleration can be attributed to structural issues as potential growth has halved – a stronger reduction than in the EU

- **Why?** Structural hurdles along all three long-term growth factors



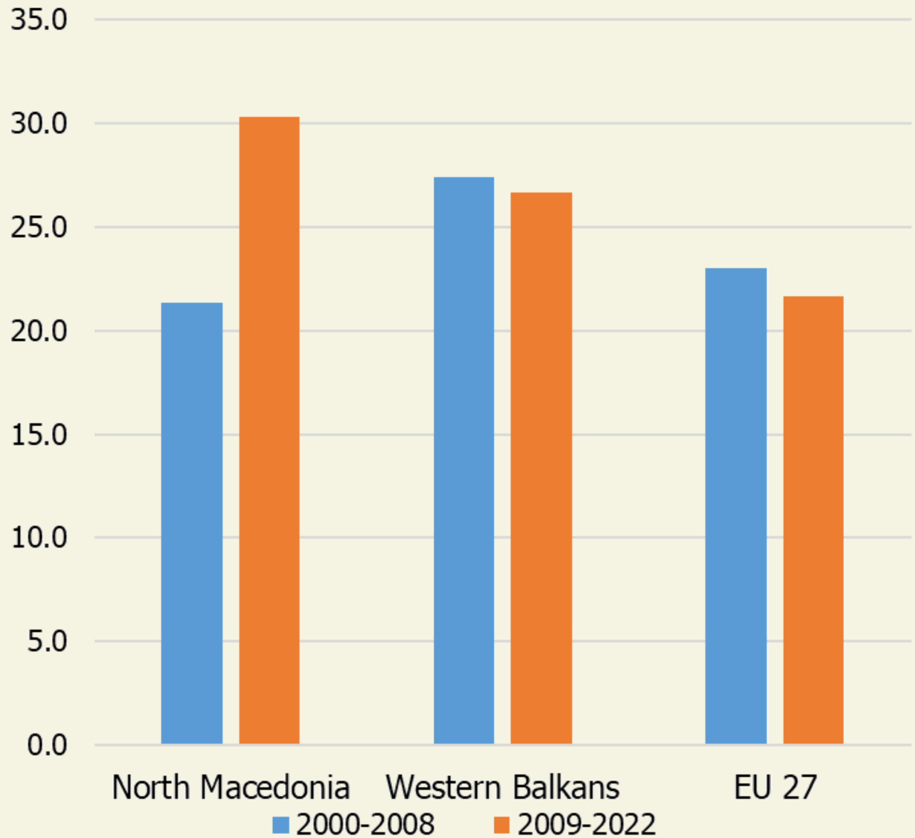
Source: The Conference Board - TED database April 2023 and own calculations.

Productivity: catching up process is sluggish and productivity gap remains wide (about half of EU)



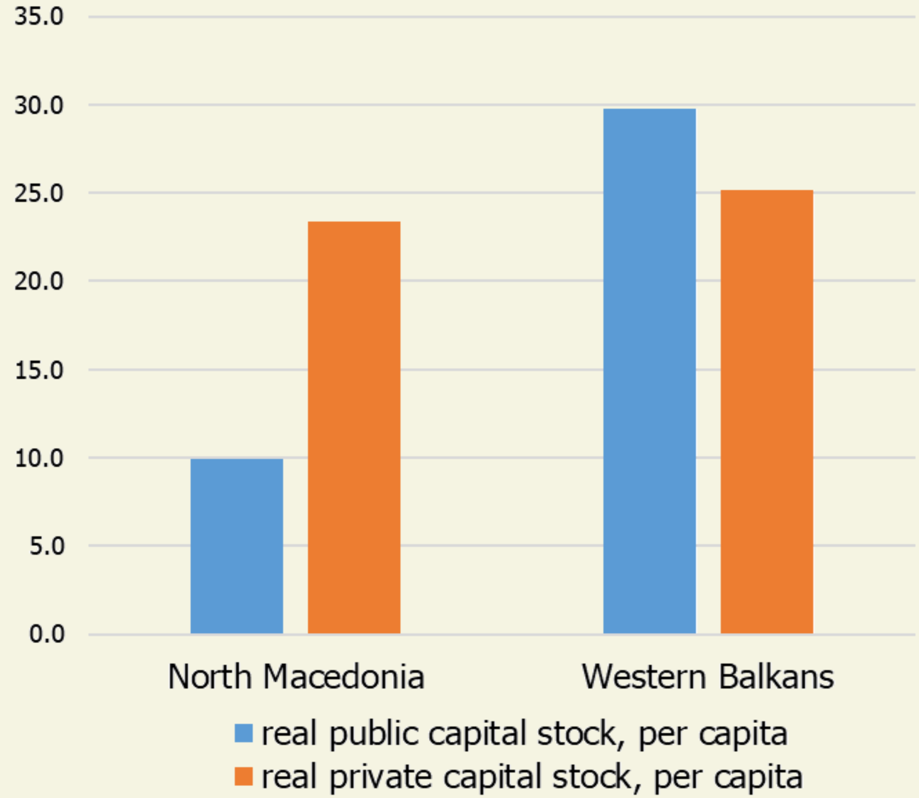
Physical Capital: investments decelerated and not adequate to narrow the capital stock gap that remains wide, both private and public

Share of investment in GDP, in %



Source: Eurostat and own calculations.

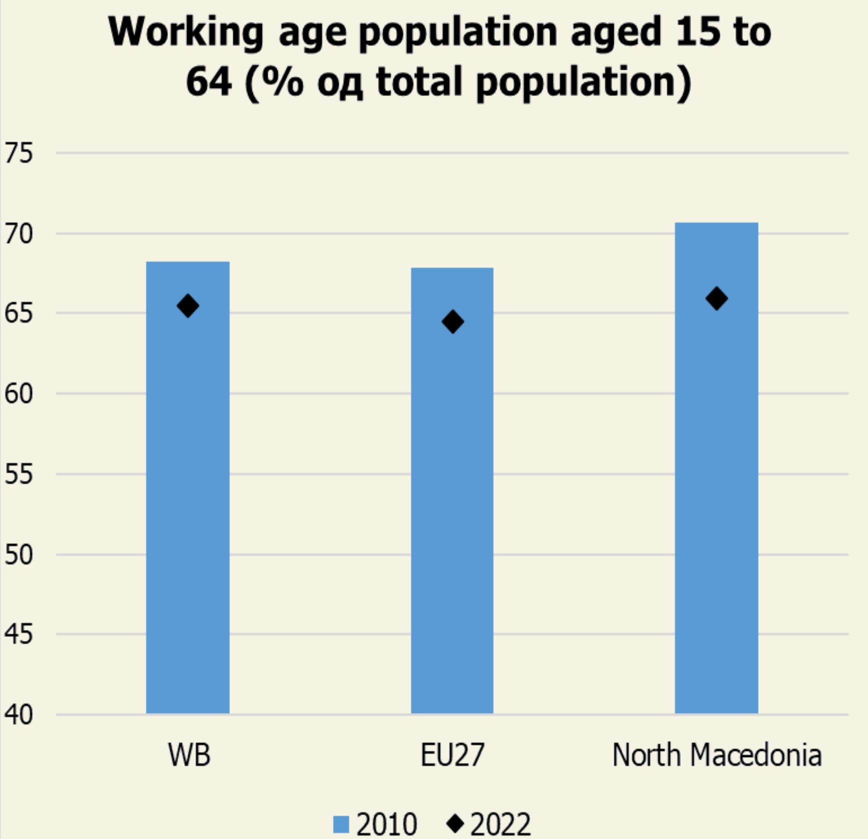
Capital stock in 2018
EU27 = 100



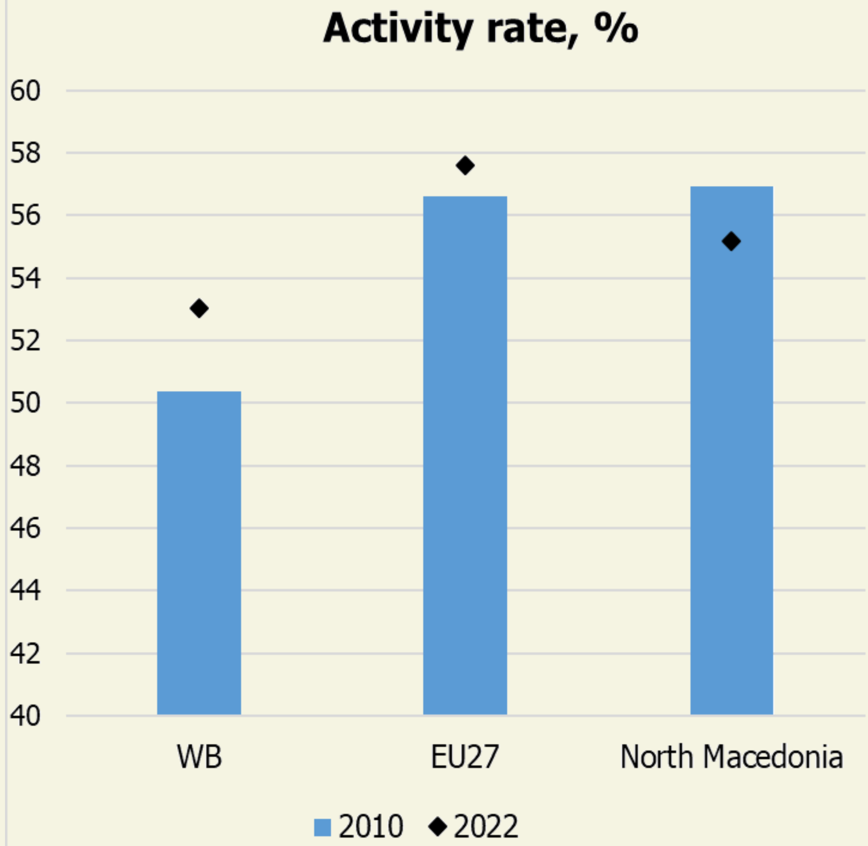
Source: IMF database and own calculations.

Human capital: working age population has declined and is set to further decline amidst adverse demographic and migration trends

- As 1/3 of emigration is highly skilled it impacts quality as well



Source: Eurostat.

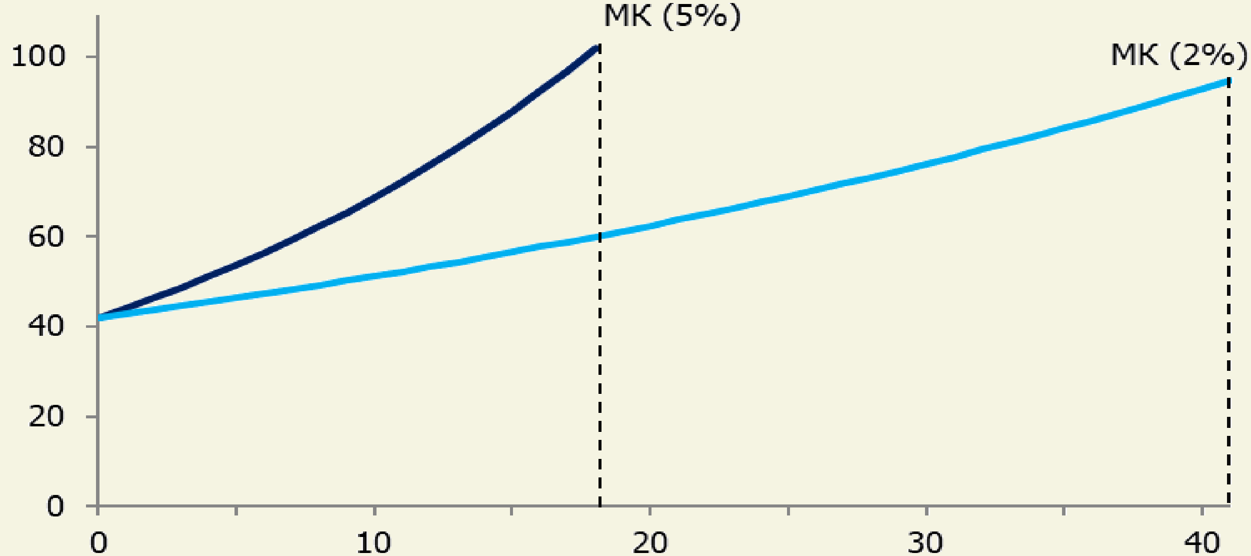


Source: Eurostat, WIIW and national statistics offices.

Thus, a serious catching up is ahead of us, even without embedding geo-economics fragmentation risks

- At the historical relative growth speed, it will take us about 40 years to converge to the average EU income level

GDP/capita in PPS and years to achieve convergence



Source: Eurostat and own calculations.
Note: Growth rates are relative to the EU. Average growth rates are for 2001-2021.

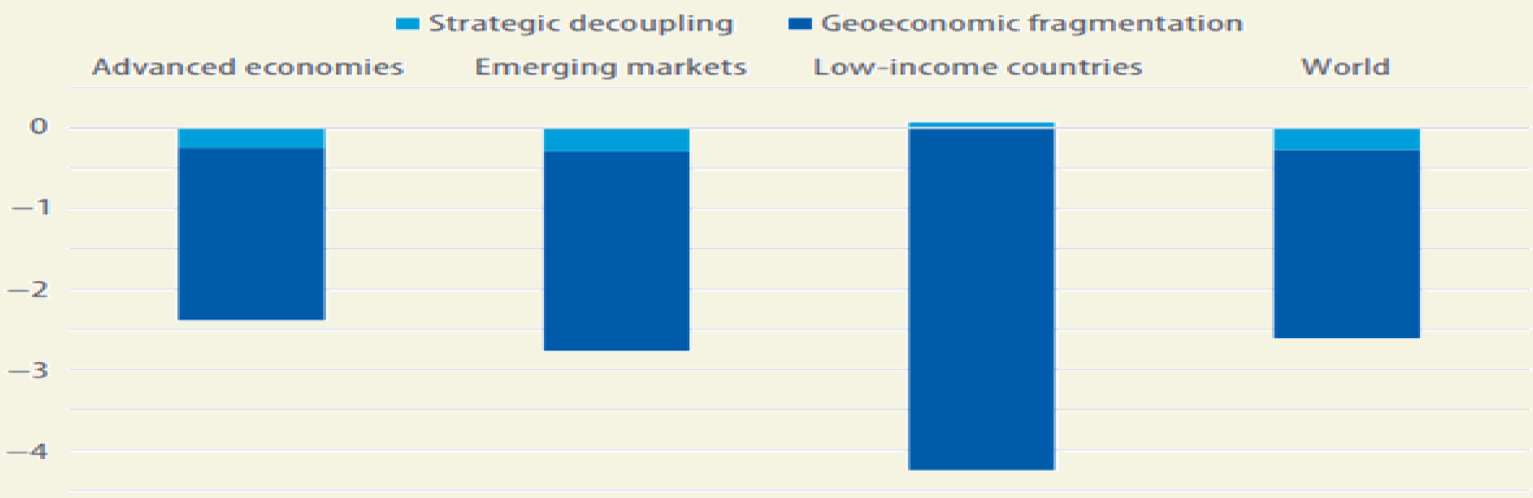
Geo-economic fragmentation creates additional challenges as costs of a de-globalized world can be severe and work through a number of channels

- In particular for small and open economies that are more dependent on external trade and finance

The costs of fragmentation

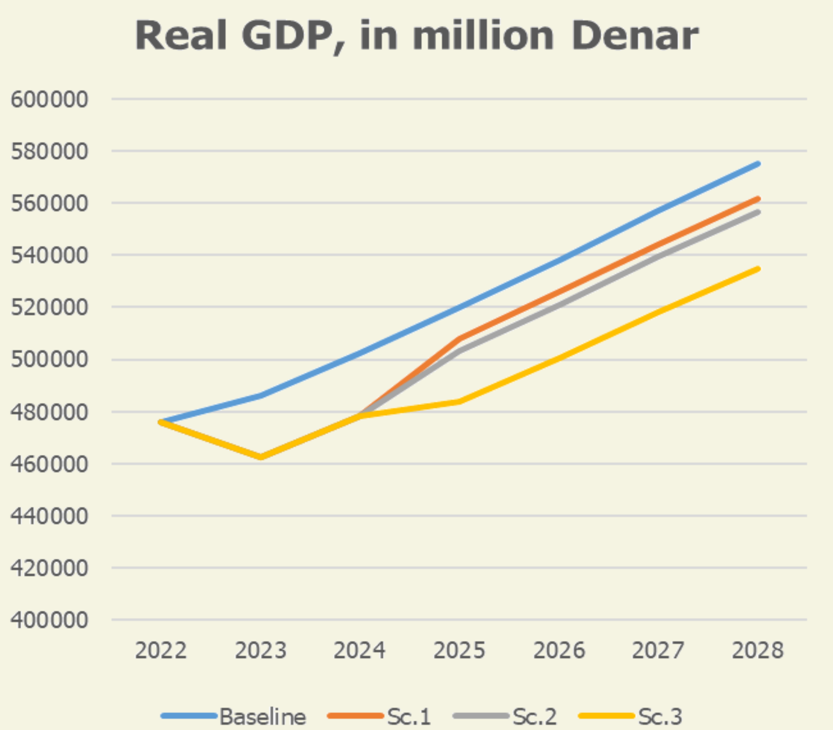
A world split into two exclusive trading blocs would result in permanent losses to global GDP, most severely in low-income countries.

(permanent real GDP losses, percent)

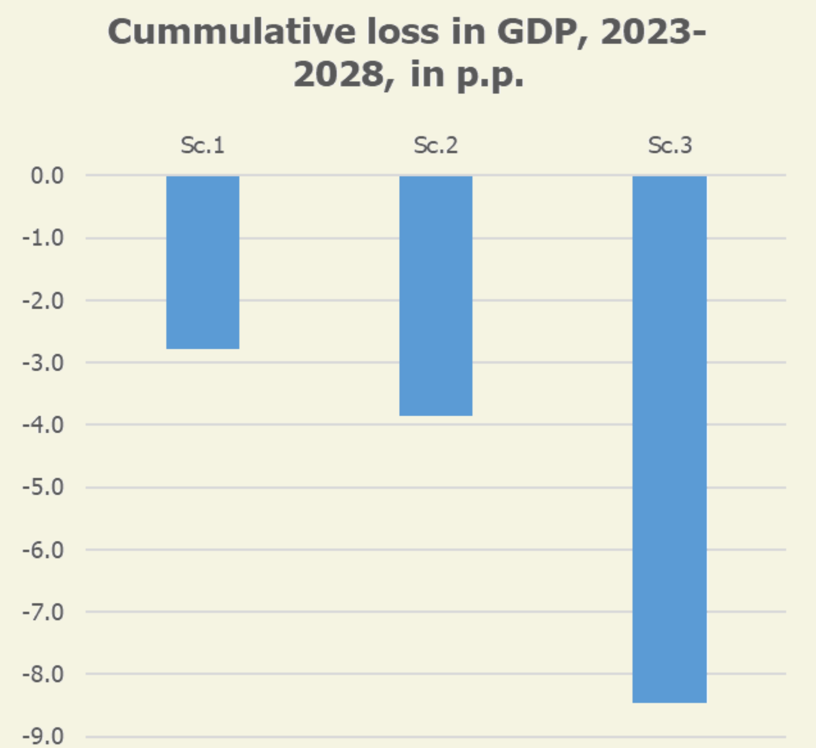


Source: Bolhuis, Marijn A., Jiaqian Chen, and Benjamin R. Kett. 2023. "Fragmentation in Global Trade: Accounting for Commodities." IMF Working Paper 2023/073, International Monetary Fund, Washington, DC.

The estimated impact on the Macedonian economy seems non-negligible



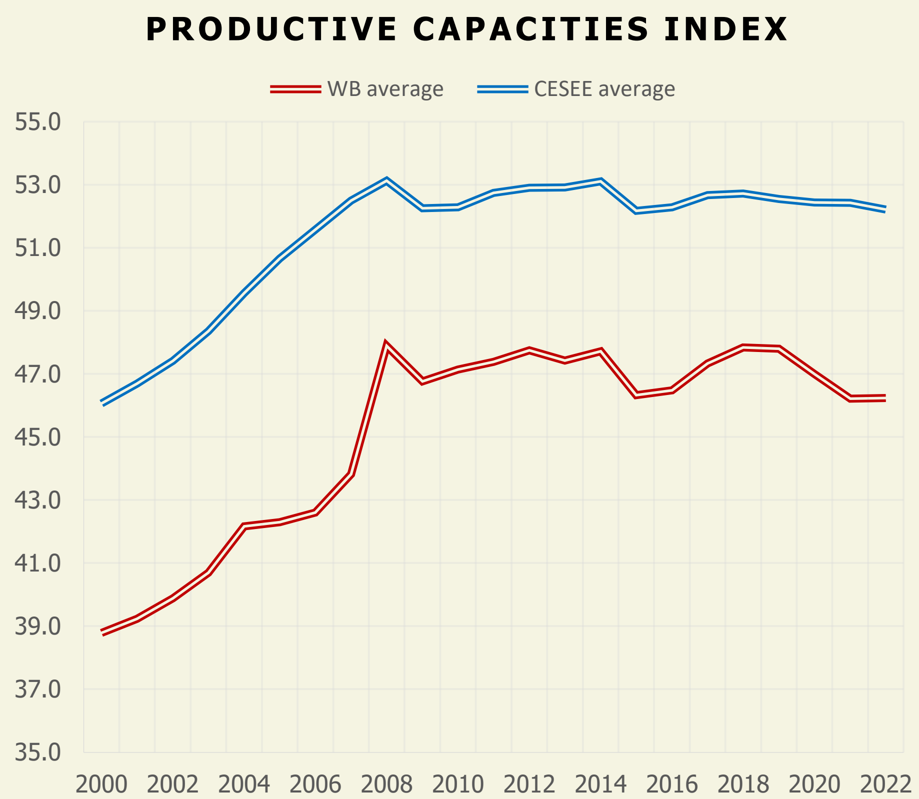
Source: Own calculations.

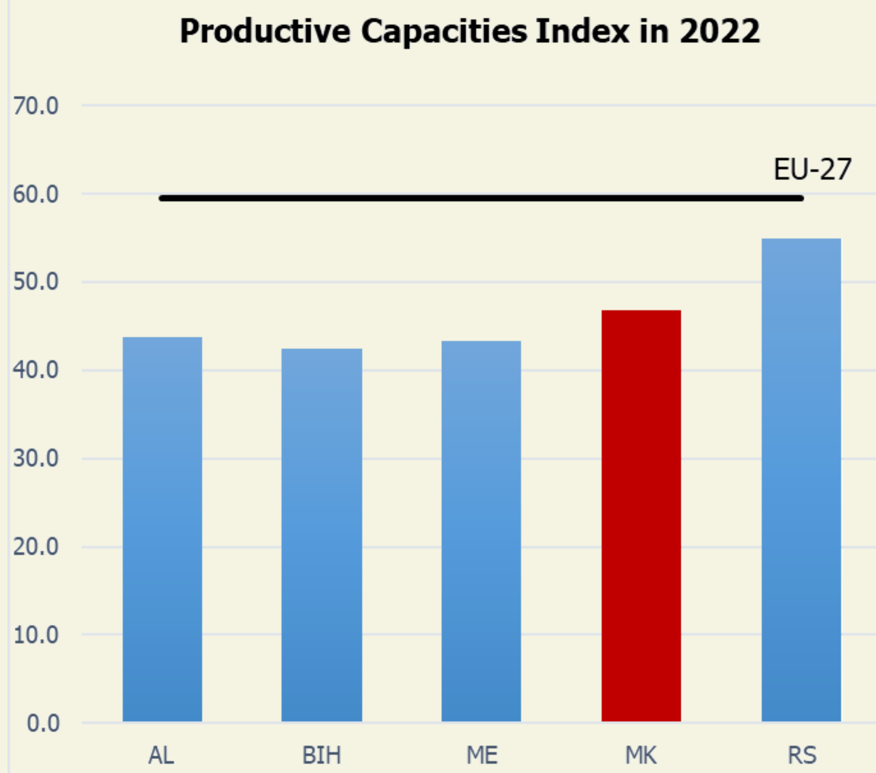


Source: Own calculations.

- **The impact will depend on policy efforts to cope with the risks**, but also use opportunities such as nearshoring

WB countries should harness their still untapped potential in response to the changing geopolitical environment





Source: UNCTAD.

To conclude

- **Income convergence in the WB region has been off the fast track even before the recent crisis**, which emphasized further the old structural hurdles that still remain unaddressed, and brought to the fore new ones, such as fragmentation, climate risks…

- **To avoid the risk of further slow convergence or even divergence**, dealing with structural issues is priority. Past experience shows that faster EU accession process can play a catalytic role in this regard.

- Structural transformation of economies requires **stable and sustainable sources of finance…**

- **…which is a challenge** given elevated debt levels, no access to different EU tools (NGF), and domestic savings that are below investment needs…

- … **thus pointing to a need for alternative external finance,** amidst tightening of financial conditions as central banks must remain focused on price as well as financial stability (as a precondition to sustainable growth).

- **Support of IFIs and European institutions** in lifting the growth potential and putting the convergence again on fast track is key.

THANK YOU FOR YOUR ATTENTION