

Europe and Central Asia Economic Update, Fall 2020 **COVID-19 and Human Capital**

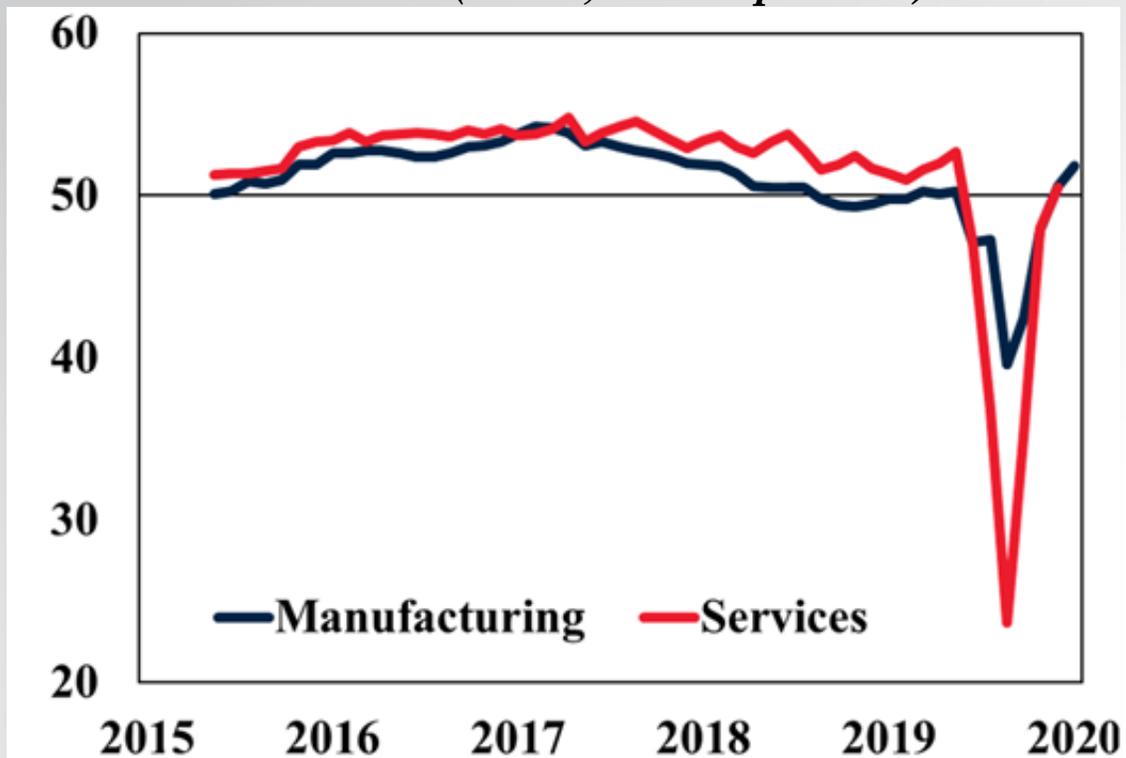
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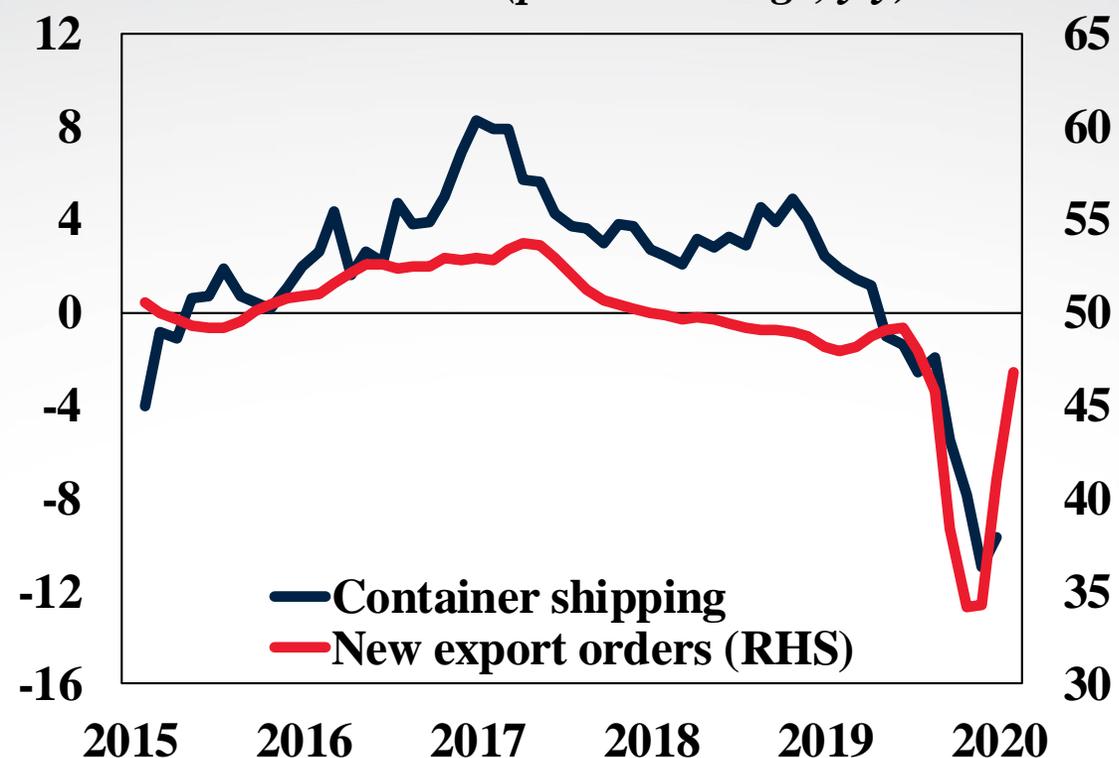
Economic Outlook

Recovery in Activity Despite Protracted Pandemic

Global PMI (Index, 50+=expansion)



Global trade (percent change, y/y)



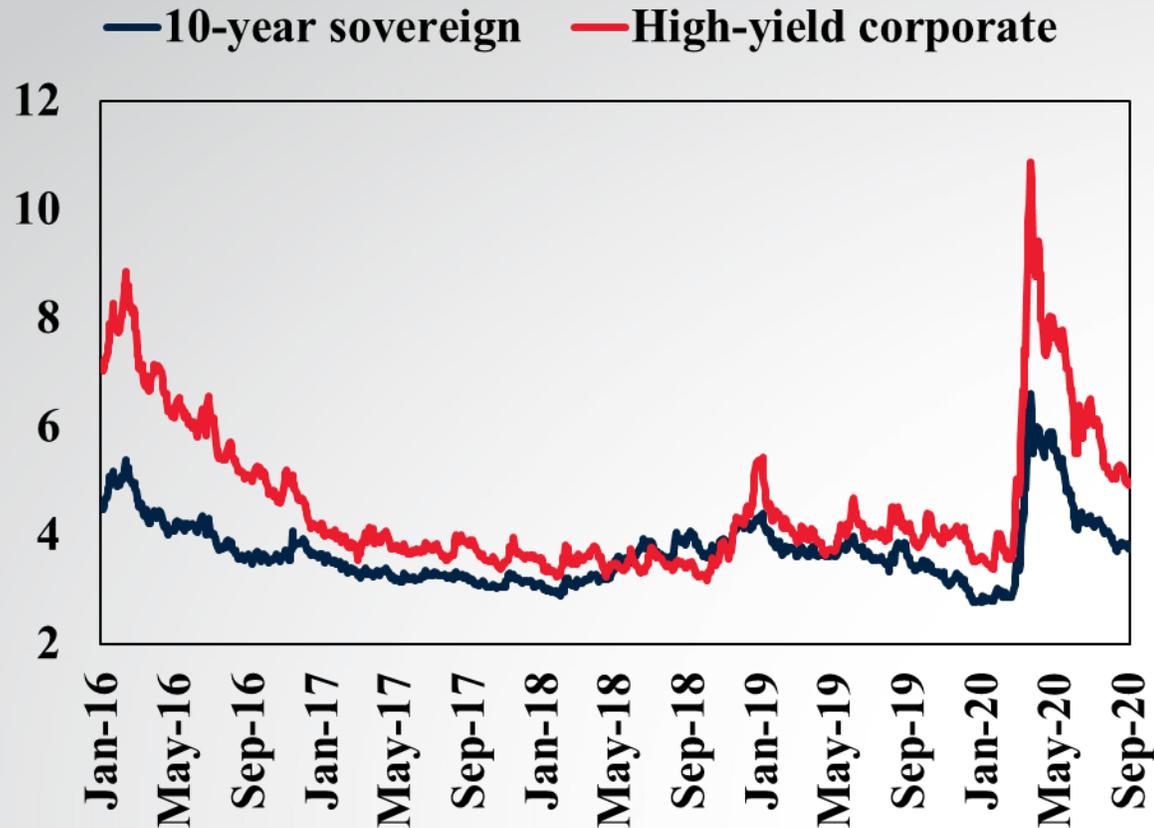
Sources: Bloomberg, Haver Analytics, Institute of Shipping Economics and Logistics, World Bank.

Left panel. Manufacturing and services are measured by Purchasing Managers' Index (PMI). PMI readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction. Last observation is August 2020 for manufacturing and July 2020 for services. Right Panel. Figure shows 3-month moving averages. New export orders measured by Purchasing Managers' Index (PMI). Last observation is August 2020 for new export orders and July 2020 for container shipping.

Economic Outlook

Bond Yields Stabilized—yet EMDEs are vulnerable

EMDE bond yields (Percent)

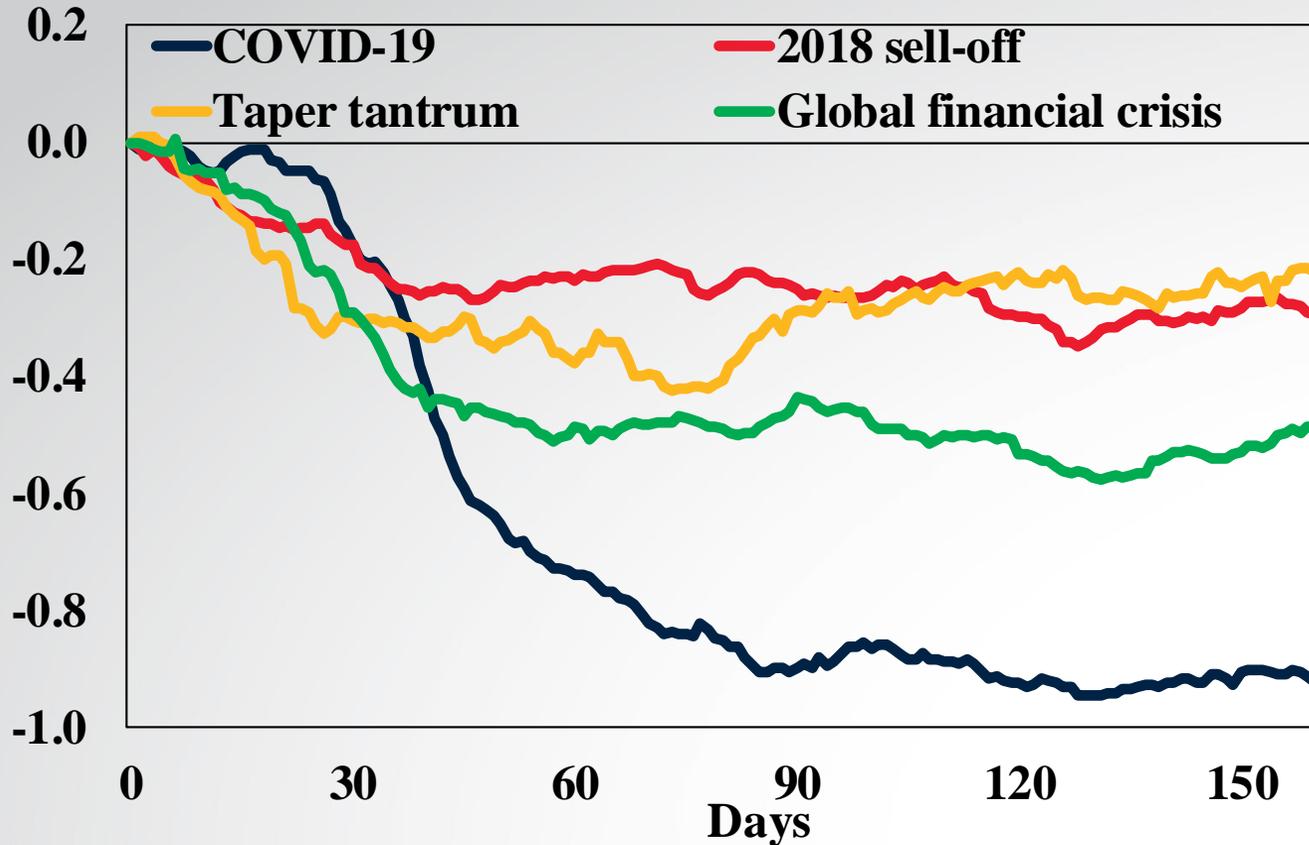


- Borrowing conditions sharply rose in response to the COVID-19 pandemic, but substantial monetary easing by major central banks has helped stabilize conditions and inject liquidity into the market.
- EMDE borrowing costs have trended down after reaching their highest level since the global financial crisis in March; however, the EMBI spread remains higher than at the start of the year which will put pressure on EMDEs with large, persistent current account deficits. Rising debt levels have increased vulnerability

Economic Outlook

Financial Conditions Remain Fragile

EMDE Portfolio flows plunged

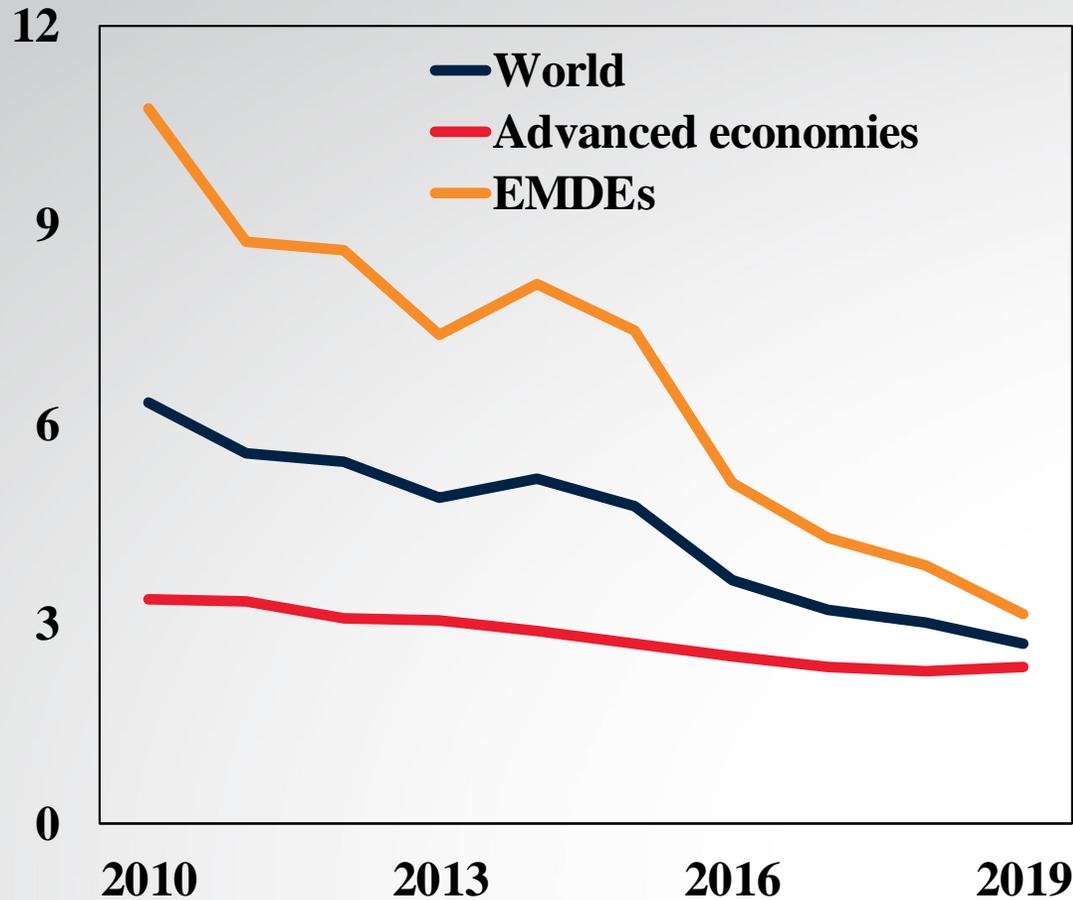


- EMDEs suffered record high capital outflows with rise in sovereign borrowing spreads
- Significant pressure on currencies/correlated with their current account deficits
- FDI is expected to fall considerably
- Remittances have contracted/expected to fall further
- Banking system profitability being eroded in many countries due to increase in non-performing loans

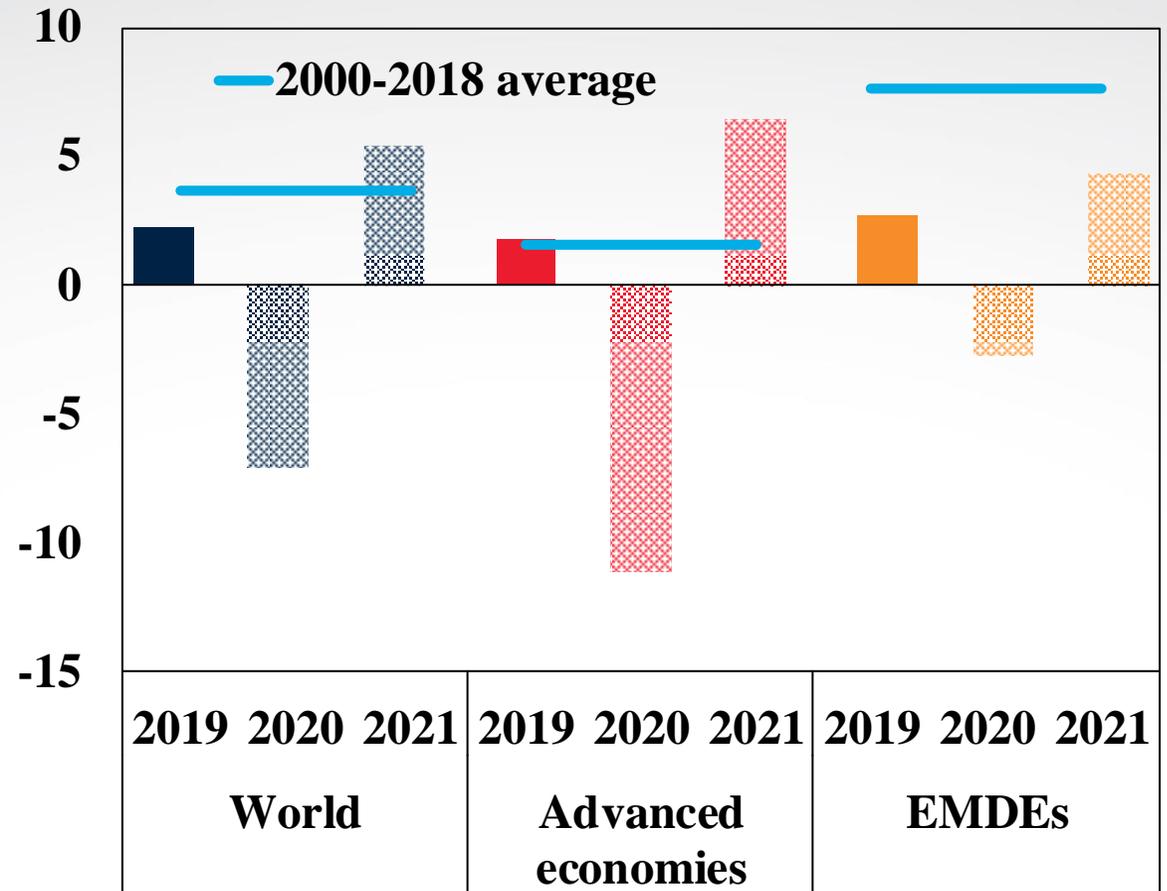
Economic Outlook

Investment Growth Weakness had Long Persisted Prior to COVID-19

Long-term investment growth forecasts (Percent)



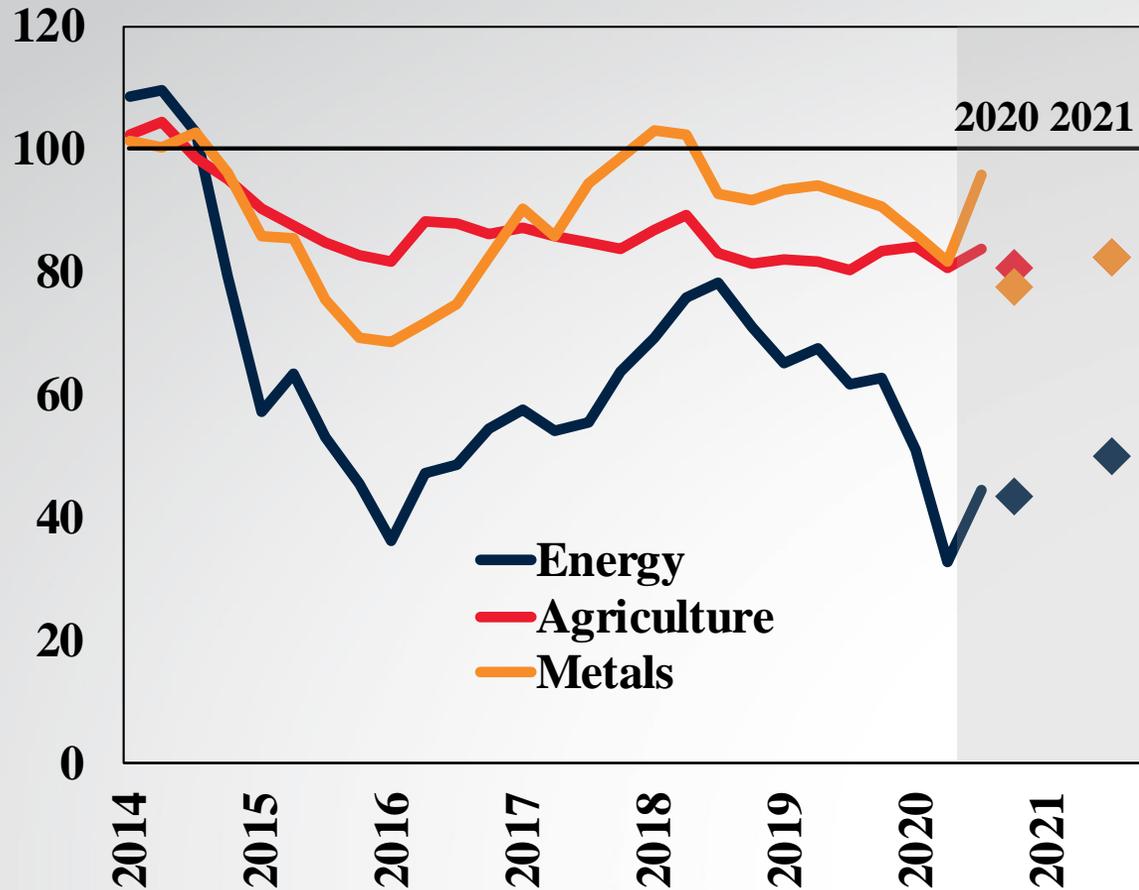
Investment growth forecasts (Percent)



Economic Outlook

Commodity Markets – Oil Prices Firm After Suffering Sharp Fall

Nominal commodity prices (Index, 100=2014)



- Most commodity prices have firmed in recent months, led by crude oil. The price of Brent crude oil fell from about \$60/bbl at the beginning of the year to below \$20/bbl in April, before rising to \$45/bbl more recently.
- The prices of base metals have also increased, boosted by optimism about the speed of the recovery in China and, for copper, by COVID-19-related supply disruptions in Chile, the world's largest producer of copper.

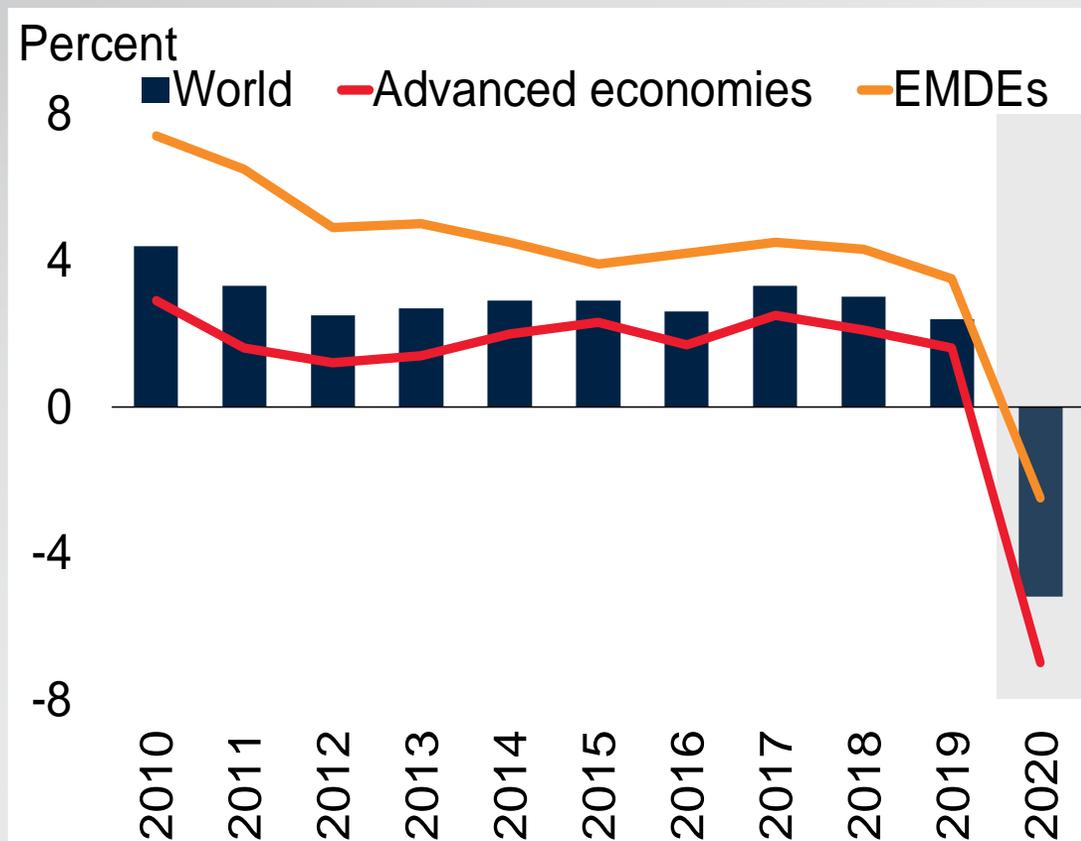
Sources: Bloomberg, World Bank.

Dots in shared area refer to price forecasts in 2020 and 2021. Last observation is 2020Q2, which includes data through April 2020.

Economic Outlook

COVID-19 has Triggered a Global Output Contraction

Annual GDP growth (Percent)



Risks are tilted to the downside, with the future recovery fragile due to:

- Uncertainty surrounding COVID-19; longer lasting epidemic, second or third waves
- Much greater output contractions in major economies
- Potential re-escalation of trade tensions; disruptions of GVCs
- Further collapse in industrial commodity prices
- High debt; wide-spread defaults; financial crises
- **Downside scenario-global growth shrinks by 8% in 2020 and barely recovers to over 1% in 2021**
- Particularly vulnerable EMDEs are those with weak health systems; heavy reliance on global trade, tourism, remittances; prone to financial market disruptions; and dependent on oil and other commodity exports

Economic Outlook – ECA Forecasts

- Aggregate growth is projected to fall into a steep contraction in 2020 as the region suffers from widespread COVID-19 outbreaks and the subsequent collapse in industrial commodity prices.
- Regional growth expected to gradually pick up in 2021 as trade and investment gradually recover. Substantial downside risks cloud the outlook, however, including those emanating from geopolitical tensions.

	2017	2018	2019e	2020f	2021f	2021d
EMDE ECA, GDP	4.1	3.3	2.2	-4.4	3.3	1.1
EMDE ECA, GDP excl. Turkey	3.0	3.5	2.6	-4.7	3.1	1.2
Commodity exporters	2.1	2.8	1.9	-4.6	2.8	1.1
Commodity importers	6.1	3.9	2.5	-4.3	3.8	1.2
Central Europe and Baltics	5.0	4.8	4.0	-4.9	4.2	2.1
Western Balkans	2.7	4.0	3.5	-4.8	3.5	2.3
Eastern Europe	2.6	3.3	2.6	-4.7	-0.6	-1.3
South Caucasus	2.0	2.7	3.6	-4.9	2.7	1.8
Central Asia	4.3	4.5	4.9	-1.7	3.2	1.5
Russian Federation	1.8	2.5	1.3	-5.0	2.8	1.0
Turkey	7.5	3.0	0.9	-3.8	4.0	1.0
Poland	4.9	5.3	4.1	-3.9	3.5	0.2

Near-Term Risks to ECA Outlook

- A more protracted COVID-19—as economies gradually reopen, there is the risk of new infections, which could trigger lockdown measures, and greater contraction.
- Sharper than expected contraction to ECA's largest trading partner—the Euro Area—as well as sharper than expected growth slowdown in China as the world grapples with the COVID-19 pandemic; trade and GVC disruptions.
- COVID crisis turning into financial crisis—increase in debt/servicing costs; sudden stop to financial flows; drop in remittances, wide-spread shifts in investor sentiment particularly for countries with high debt and reliance on foreign flows; financial sector weakening.
- Escalation of geopolitical tensions and potential threat of additional international sanctions, as well as social unrest; hard Brexit.

Why Focus on Human Capital ?

COVID-19 has hit human capital directly in the region

- The pandemic led to significant loss of human life and its long-term health effects are likely to impact productivity
- Disrupted the education of children

Governments need to make investment in human capital a centerpiece of their recovery plans

Governments need to take decisive action because..

Human capital is fundamental for economic development.

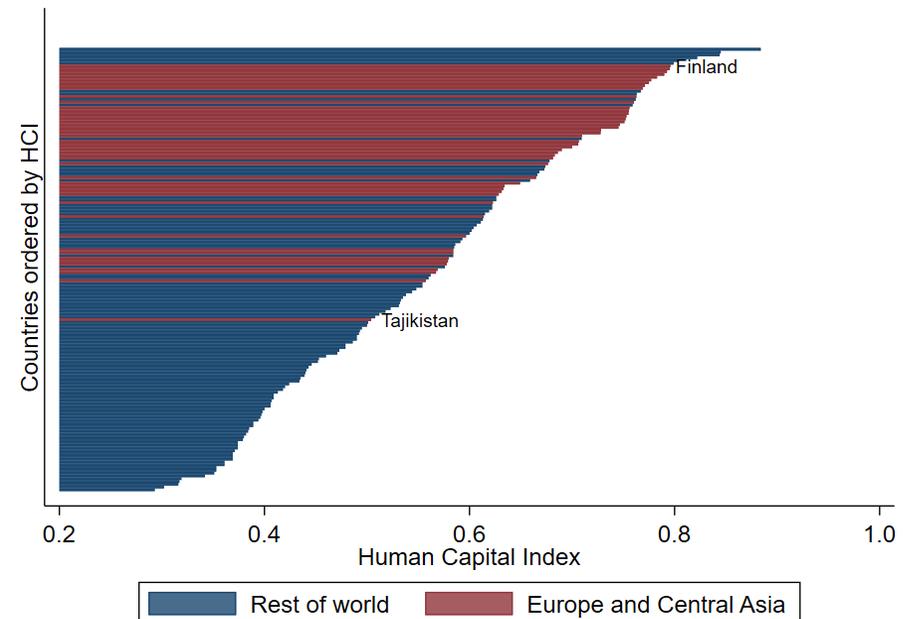
- Healthy and educated citizens are more productive and make their countries flourish.
- Yet, individuals/families may underinvest in human capital because
 - They may underestimate the returns to investing since they are only evident in the long run
 - Some of the benefits may accrue to others in the society (externalities)
 - They may not have the resources or access the financial system
- This is why it is important for governments to actively promote investments in human capital and offset the impact of the pandemic

This ECA Economic Update

- Summarizes the pre-pandemic education and health outcomes in ECA focusing on those where the region faces special challenges:
 - Higher education – attainment and quality
 - Adult health risk factors – for noncommunicable diseases and some infectious diseases
- Illustrates the pandemic's impact on education and health in the region;
- Discusses policy options to improve human capital outcomes that have proven to be effective.

Human Capital in ECA

- In 2018 the Bank launched the Human Capital Index (HCI) which is designed to highlight how improvements in current health and education outcomes shape the productivity of the next generation of workers.
- The HCI measures the amount of human capital that a child born today can expect to have by age 18, in view of the risks of poor education and poor health that prevail in the country where she/he was born.
- But, the index is global and cannot use the better data available for the countries in the region and does not present a granular enough picture.



Beyond the HCI: Education

- Basic education is not enough if higher education institutions do not prepare students for future challenges. Higher education is also very important in stemming out-migration and attracting skilled migrants.
- It is useful to also look at quality-adjusted years of tertiary education, a combined measure of attainment and quality.

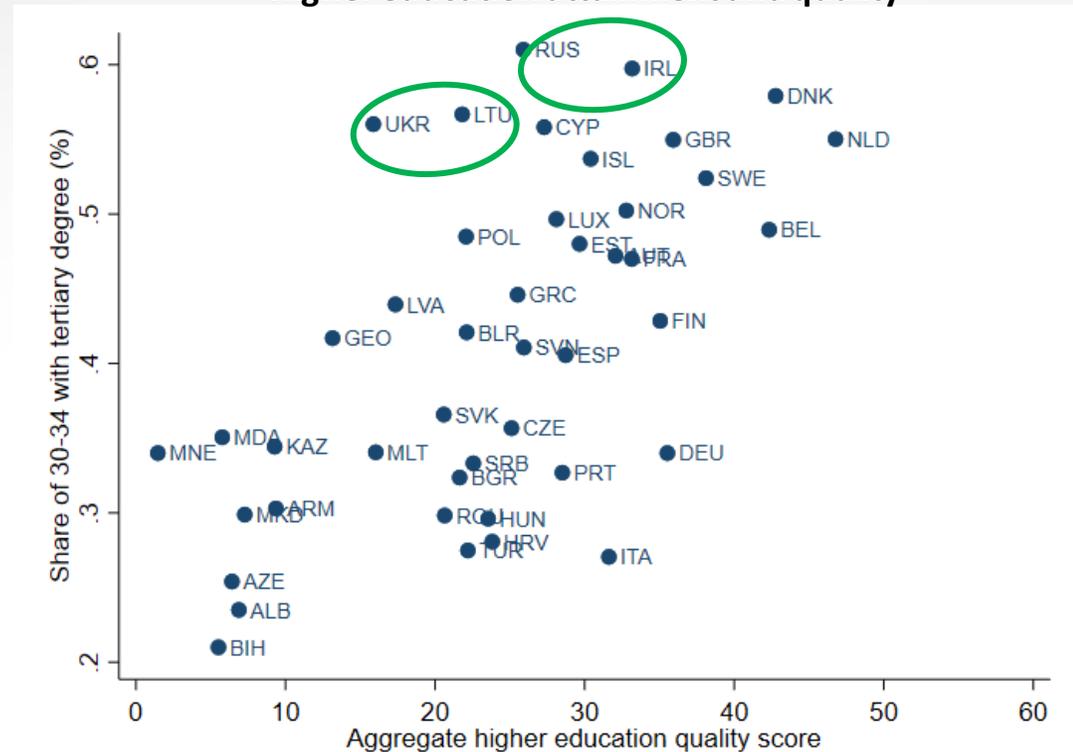
Beyond the HCI: Health

- Just surviving is not enough, citizens will need to remain healthy and active throughout their life, and in aging countries of the region, active productive aging requires addressing and minimizing health risks.
- Noncommunicable diseases (NCDs) explain most of the disease burden of ECA – cardiovascular diseases being the most important ones.
- Several risk factors are behind them: **obesity, smoking and heavy drinking**. They also increase the morbidity and mortality risks of infectious diseases like COVID-19.

Higher Education

- Better higher education for a rapidly changing labor market.
- Quantity (% of individuals with a higher education degree equivalent to 3.5 years, at ages 30-34) and Quality (based on information from six university rankings worldwide)
- Higher quality is generally correlated with higher attainment but there are exceptions.
 - **High attainment, lower quality – Lithuania and Ukraine**
 - **High attainment – Russia, Ireland**

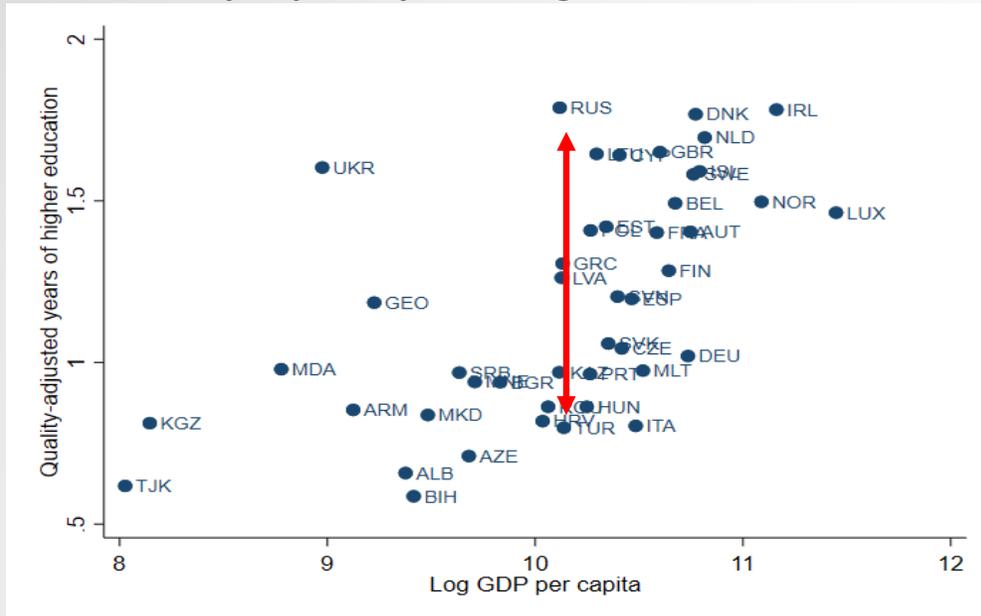
Higher education attainment and quality



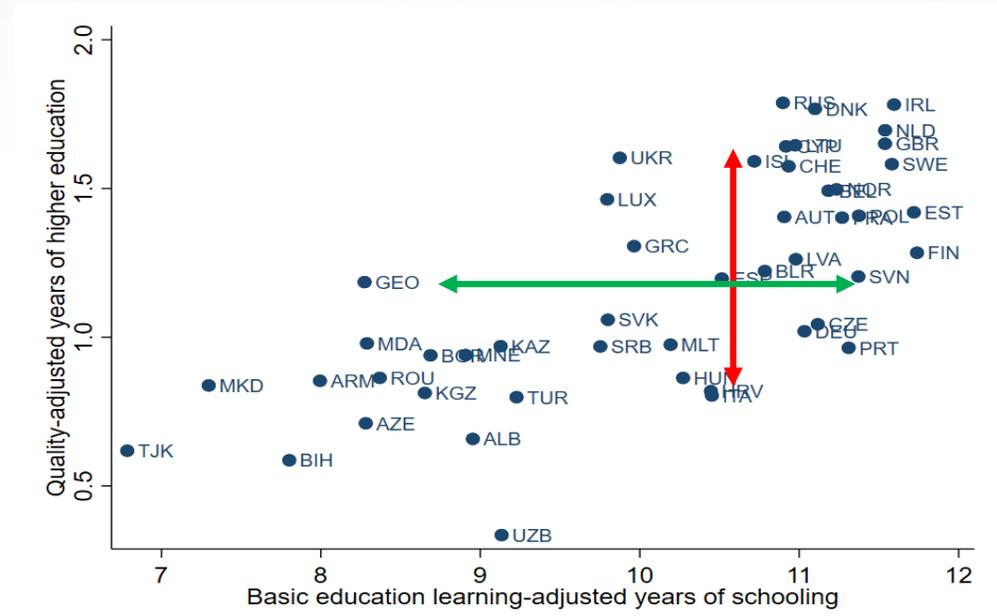
Quality-adjusted Years of Higher Education

- QAYH generally increases with income, but there are outliers – for example Ukraine, Russia vs. Turkey
- QAYH correlates with basic education, yet Croatia and Cyprus have similar basic education but different QAYH. And Georgia and Slovenia have similar QAYH but quite different basic education

Quality-adjusted years of higher education and income

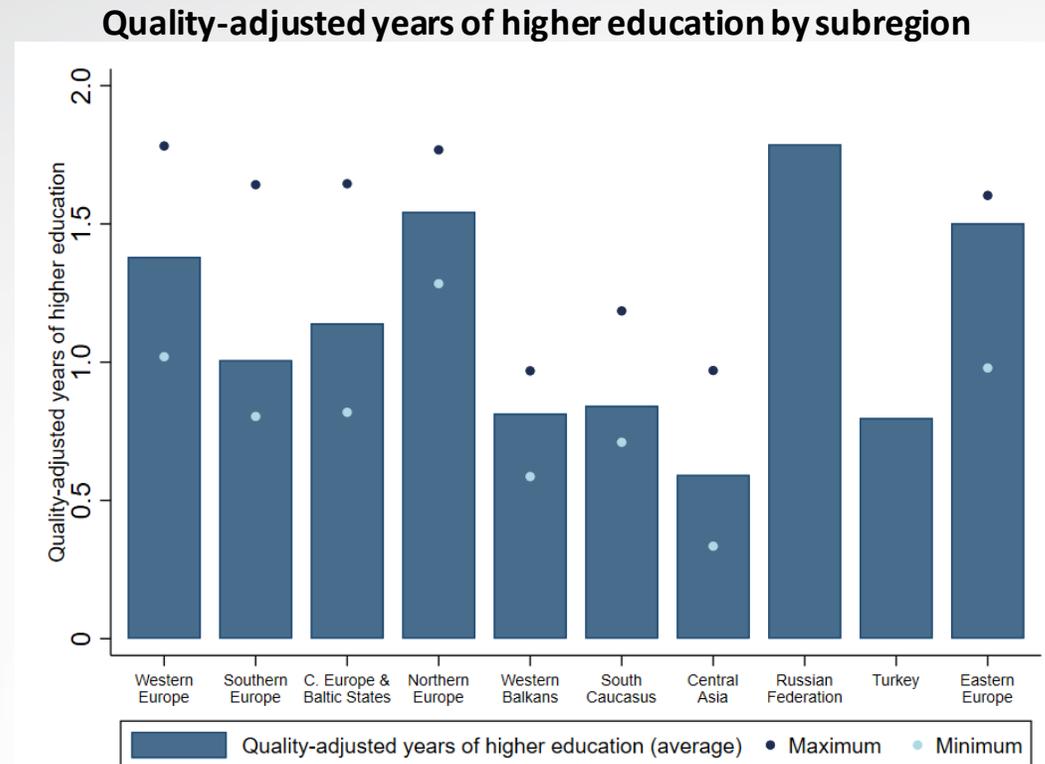


Quality-adjusted years higher and basic education



Quality-adjusted Years of Higher Education

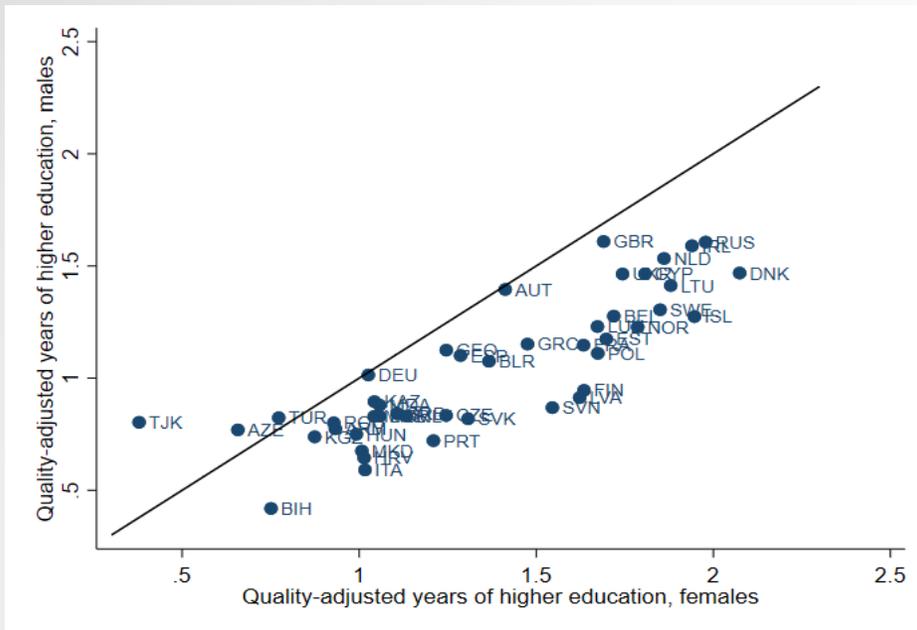
- Central Asia, Turkey, the South Caucasus and the Western Balkans have space to improve the quality and quantity of higher education.



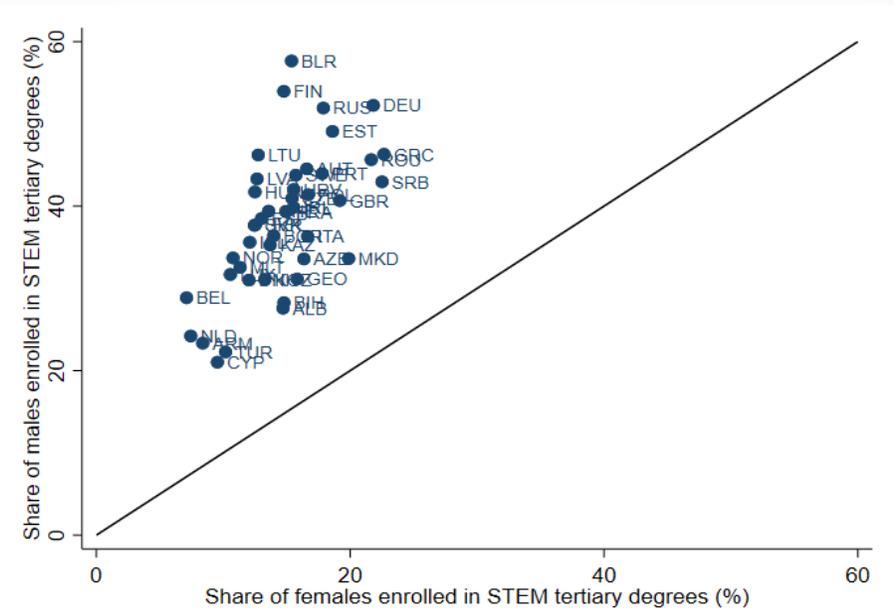
Quality-adjusted Years of Higher Education by Gender

- Just as in basic education, QAYH for females are higher than males in all ECA countries except Tajikistan and to a lesser extent in Azerbaijan and Turkey. Men are in disadvantage across all levels.
- But fewer women earn degrees in STEM fields across the board.

Quality-adjusted years of Higher Education by Gender



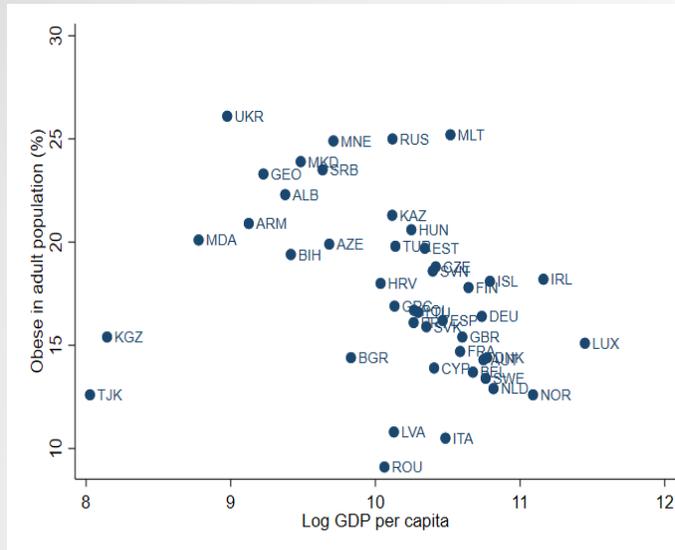
Male vs. Females Enrolled in STEM Tertiary Degrees



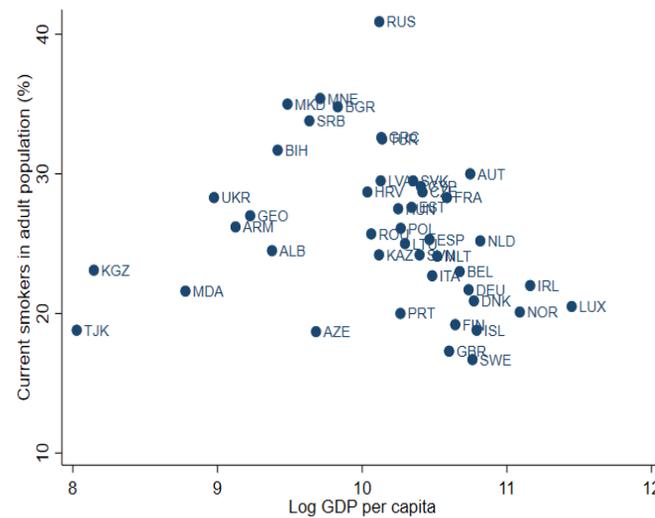
Health Risk Factors

- Obesity, smoking and heavy drinking are risk factors for NCDs and increase the morbidity and mortality by COVID-19.
- Because of their impact on health, these risk factors have an impact on productivity, which ranges between 10% and 20%.

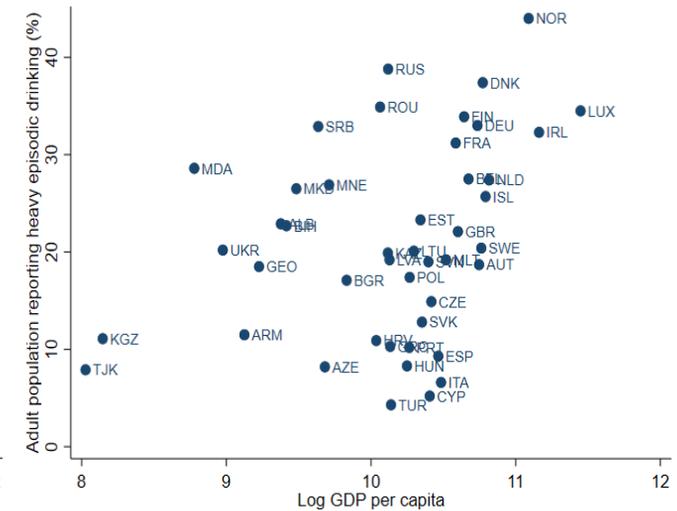
Obesity and Income



Smoking and Income



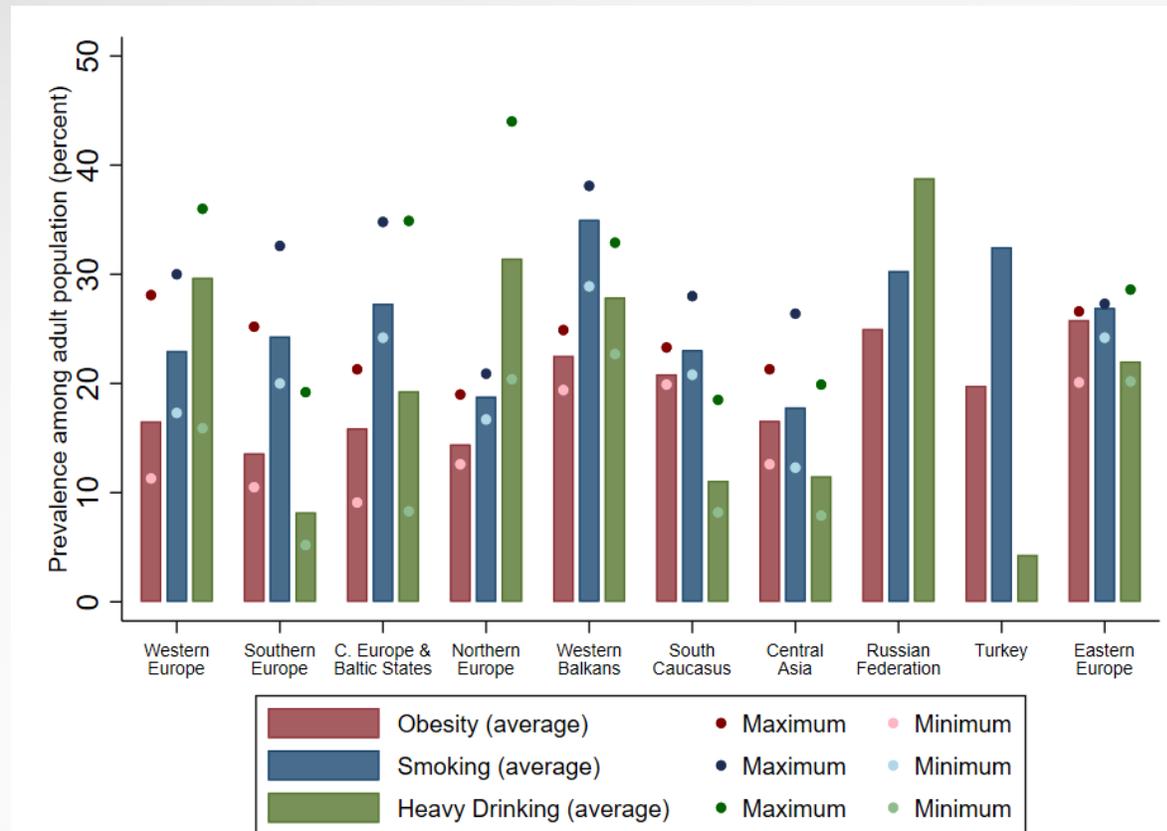
Heavy Drinking and Income



Health Risk Factors

- The prevalence of health risk factors is high in Eastern Europe, the Russian Federation, and the Western Balkans .

Health Risk Factors by Subregion



How is COVID-19 likely to affect human capital in ECA?

Education:

- School closures; students learn less and there is also a learning loss when schools are closed
- Mitigate the overall learning loss by offering remote learning...but effectiveness is not clear; also widens inequalities.
- Projections suggest that the worst case scenario – where only 5-15% of the learning loss is mitigated – may lead to a learning loss equivalent to 1.2 learning adjusted years of schooling. (more optimistic scenarios suggest half as much loss.)
- Since remote learning modalities are less available/effective for lower income students, the reading achievement gap between richest and poorest quintile of students is expected to increase by (percentage points) in Central Asia (8-30), S. Caucasus (11-18), Western Balkans (11), Central Europe (9).
- Impact on tertiary education is less clear. Higher grades tend to do better with remote learning, though enrollments may drop. Yet recession may reduce the opportunity cost of attending university.

How is COVID-19 likely to affect human capital in ECA?

Health:

- Significant loss of human life, potential long-term health impacts that may reduce productivity of working age population
- Disruption of healthcare services; particularly concerning for maternal and child health.
 - Projections suggest this can impact probability of survival to age 5; declines range from 0 to 0.8 percentage points.
 - Can be significant for countries such as Kyrgyz Rep., Moldova, Tajikistan and Uzbekistan
- Pandemic can also have significant impact on adult health due to disruptions in healthcare provision; mental health, vulnerability to gender-based violence..
- If food insecurity grows increases in child stunting may also occur.

These impacts are subject to significant uncertainty.

Prioritizing Education and Health Interventions

Education:

- **Modernizing the foundations**...still needed in Central Asia, South Caucasus, Western Balkans, Bulgaria, Romania and Moldova.
- **Improving post-secondary education** both quality and attainment... some former Soviet Union countries, attainment is high but quality is average, in Western Balkans and South Caucasus both attainment and quality are low. Important all across the region, particularly for countries that suffer from out-migration
- **Closing inequality gaps**...income gaps are important to close across the board, particularly for disadvantaged minorities – like Roma in most of Eastern Europe. These will likely widen with Covid. Gender differences favor women, except in STEM fields where women continue to be underrepresented. Reverse gender gaps are also concerning for men across all levels.

Policies need to be mindful of challenges to mitigate effects of Covid-19 on learning, as well the central role of remote learning in this process even in the post-pandemic world.

Prioritizing Education and Health Interventions

Health:

- **Reducing health risk factors**...in many countries, but particularly the Russian Federation and the former Soviet Union
- **Aging** is an additional challenge across the region, all the more important to keep the aging population active and productive into old age
- **Closing inequality gaps**...Few ECA countries – Tajikistan, Turkmenistan and the Kyrgyz Republic have significant child stunting levels that need to be addressed. Child and maternal health gaps exist for the most disadvantaged. The prevalence of male smoking and heavy drinking is a concern in parts of the region.

In a world where infectious disease outbreaks may become more common, pandemic preparedness will be an important priority – health risk factors and older demographic makes the population even more susceptible.

Implications for Operational Work in ECA

Supports major themes of our operations in education and health

Education

- Especially the emphasis on tertiary education: Central Asia (Uzbekistan, Kazakhstan, Tajikistan), South Caucasus (Georgia, Armenia), Western Balkans (Kosovo, N. Macedonia), Eastern Europe (Belarus, Moldova, Ukraine), Romania
- Reduce reverse gender gaps in education and women's gap in STEM fields?

Health

- Especially the emphasis on health risk factors (Kazakhstan, Tajikistan; Armenia; Turkey; Romania; Ukraine; Moldova) and improving care for an aging population (Albania, Belarus, Bosnia, Georgia, Kazakhstan, Kosovo, Kyrgyz Rep., Romania, Serbia, Tajikistan, Turkey, Ukraine, Uzbekistan)
- There is also work on closing equity gaps...but what about gaps in male health outcomes?



Thank you!

Europe and Central Asia Chief Economist web page:

<http://www.worldbank.org/en/region/eca/brief/office-of-the-chief-economist-europe-and-central-asia>

ECA Economic Update:

<http://www.worldbank.org/en/region/eca/publication/europe-and-central-asia-economic-update>