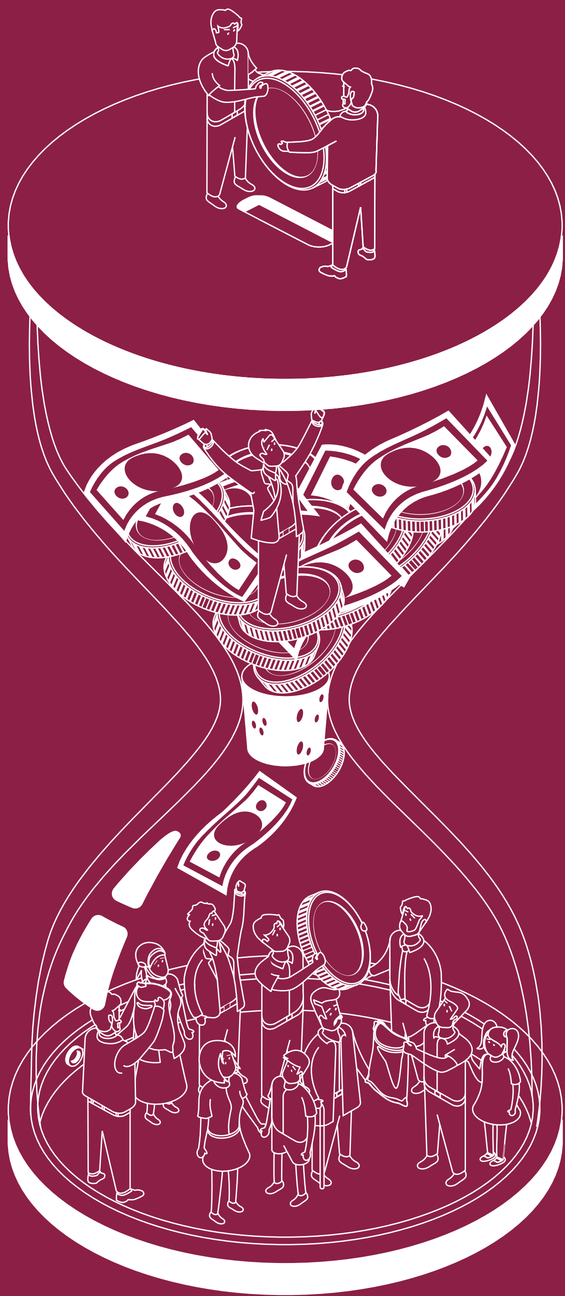
# MACROECONOMIC OVERVIEW



5
CONSECUTIVE YEARS OF ECONOMIC SLOWDOWN IN THE EBRD REGION

0.5%
AVERAGE ANNUAL GROWTH RATE IN THE EBRD REGION IN 2015, DOWN FROM 1.9% IN 2014

AROUND
0.1%
OF GDP: VALUE OF NET CAPITAL INFLOWS IN THE CEB AND SEE REGIONS IN 2015

AROUND
30%
DECLINE IN REMITTANCES FROM RUSSIA TO CENTRAL ASIA, THE CAUCASUS AND MOLDOVA IN LOCAL CURRENCY TERMS IN 2015

Following four consecutive years of deceleration, the average annual growth rate in the region where the EBRD invests fell further to stand at 0.5 per cent in 2015. It is expected to pick up modestly in 2016 and 2017. Low commodity prices and the continued recession in Russia are weighing on the economic performance of both Central Asia and eastern Europe and the Caucasus. At the same time, decreases in the cost of energy imports are benefiting the economies of central and south-eastern Europe as well as Turkey, where growth momentum has been sustained. Those economies have also benefited from accommodative policies in the eurozone, although expectations of monetary tightening in the United States of America have led to a decline in capital flows to the EBRD region.

# Introduction

The average annual growth rate in the region where the EBRD invests declined sharply in 2015, falling to just 0.5 per cent, down from 1.9 per cent in 2014. This deceleration is broadly in line with the projections made last year and reflects divergent growth trends within the EBRD region.

In Russia, Central Asia, and eastern Europe and the Caucasus (EEC), the economic outlook has remained weak. Commodity exporters have been negatively affected by the low oil prices, while other economies in the region have been suffering because of the recession in Russia, which is a major source of remittances and an important trading partner. In terms of the combined economic significance of trade, investment and remittances, Russia remains the main economic partner for most economies in the EEC region and Central Asia, followed by the eurozone. That said, China is rapidly gaining in importance as an economic partner (see the discussion in the May 2016 *Regional Economic Prospects in EBRD Countries of Operations*).[1]

In contrast, countries in central Europe, south-eastern Europe (SEE) and the southern and eastern Mediterranean (SEMED) have continued to benefit from low commodity prices and an accommodative monetary policy in the eurozone, as has Turkey. These economies have generally been less affected by the reversal of capital flows to emerging markets, as they benefited less from the previous upturn in flows than economies in Asia and Latin America. Turkey, which is a notable exception in this regard, has benefited from decreases in the cost of fuel imports, which have partially offset the impact that reduced capital flows have had on its external position.

## Global economic environment

The last year has been characterised by moderate growth in advanced economies and a slight deceleration in China and other emerging markets, in combination with declines in commodity prices and subdued growth in international trade. In addition, global financial markets have experienced bouts of volatility, partly reflecting developments in China and the United Kingdom (UK).

The price of Brent crude oil fell from around US$ 50 per barrel in September 2015 to US$ 28 per barrel in January 2016, before recovering to stand at around US$ 45-55 per barrel in August 2016. The lows observed in January reflected the further weakening of global growth and strong production in countries such as Saudi Arabia and other members of the Organization of the Petroleum Exporting Countries (OPEC), as well as expectations of increased oil production in Iran (which had previously been subject to sanctions). Since then, expectations of a further decline in oil production in the United States of America (USA) and greater confidence in China's economic prospects have led to gradual increases in oil prices.

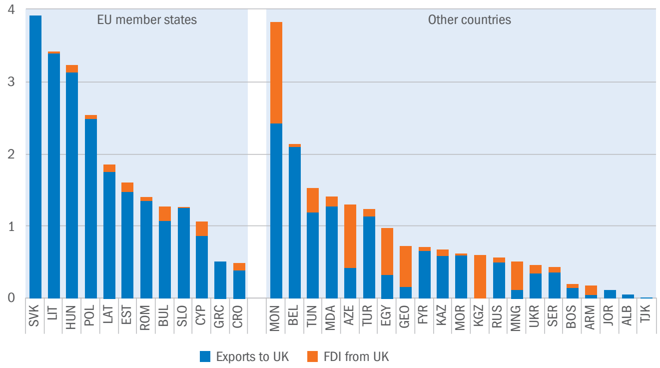
Volatility in global financial markets increased substantially in the first few months of 2016, with the global VIX index – a measure of volatility based on option prices – spiking almost threefold to stand at levels last seen during the eurozone debt crisis in 2011. A fresh downward correction in China's equity markets at the start of the year sparked a reassessment of global prospects among investors. Bank shares came under strong pressure, particularly in Europe, with investors taking account of the impact of new regulations on the bailing-in of creditors in bank resolutions, as well as high (and, in some countries, rising) non-performing loan (NPL) ratios. Global equity markets have largely recovered the losses recorded at the start of the year.

Volatility in European and global financial markets also increased in response to the UK's referendum on 23 June 2016 on whether or not to stay in the European Union, in which 52 per cent of voters favoured leaving. The terms and timing of the UK's departure from the EU are uncertain and will be the subject of complex negotiations. The direct impact on the region where the EBRD invests is expected to be limited, as the UK accounts for a relatively small percentage of trade and investment flows to/from those countries (see Chart M.1). The high levels of UK foreign direct investment (FDI) seen in Mongolia and Azerbaijan are concentrated in the natural resources sector.

Emigrants from EU countries who reside in the UK represent significant percentages of the populations of their countries of origin (more than 5 per cent in the case of Latvia and Lithuania; see Chart M.2). Depending on the nature and timing of the UK's

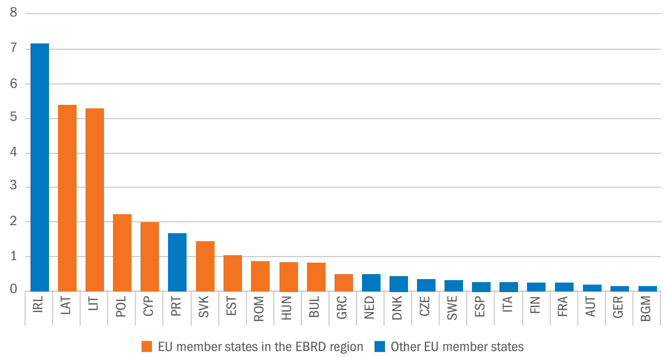
[1] See also Levitin et al. (2016).

**CHART M.1. Export and investment links with the UK as a percentage of GDP**




**Source:** Bank for International Settlements (BIS), International Monetary Fund (IMF), United Nations Conference on Trade and Development (UNCTAD), national authorities and authors' calculations.

**CHART M.2. Emigrants from EU countries who now reside in the UK as a percentage of the population of their country of origin**




**Source:** UK Office of National Statistics, IMF and authors' calculations.
**Note:** Data relate to 2014.

exit from the EU, some of these migrants may relocate elsewhere in the EU or return to their home countries. This has the potential to boost the pool of skilled labour and entrepreneurial capital in the recipient economies, while also causing short-term pressures on domestic labour markets.

The UK's exit from the EU could end up having a greater impact through adverse effects on other EU economies (see Box M.1), which will depend, in turn, on the impact that the UK referendum has on political developments in individual member states. In the longer term, a reduction in the EU budget following the UK's departure may result in declines in the EU structural funds available to EU member states in the SEE region and central Europe and the Baltic states (CEB).

The US Federal Reserve raised its funding rate by 0.25 percentage point in December 2015, the first rate increase since the financial crisis of 2008-09. Markets expect the Federal Reserve to raise that rate further in 2016-17, but only gradually, given the relative weakness of the global economy and concerns about the UK's eventual departure from the EU.

Capital flows to emerging markets are expected to decline, with monetary policy in the USA expected to gradually tighten. The Institute of International Finance (IIF) estimates that net portfolio capital flows to emerging markets totalled around US$ 20 billion in 2015, which represents a decline of approximately 80 per cent relative to the average figure for
2013-14 and the lowest reading since 2008. Portfolio flows appear to have picked up slightly in the first half of 2016. China has experienced significant capital outflows in both 2015 and 2016, partly reflecting the refinancing of external debt using domestic sources.

In contrast, the European Central Bank (ECB) expanded its quantitative easing programme in March 2016. Monthly asset purchases have increased to €80 billion and now cover selected corporate bonds. The deposit rate has moved further into negative territory, and banks are now able to receive long-term funding at negative interest rates in the ECB's targeted longer-term refinancing operations (TLTRO II). At the same time, banks' capital constraints and the fact that companies already have large cash holdings (relative to the levels seen in the USA) are reducing the effectiveness of those measures.

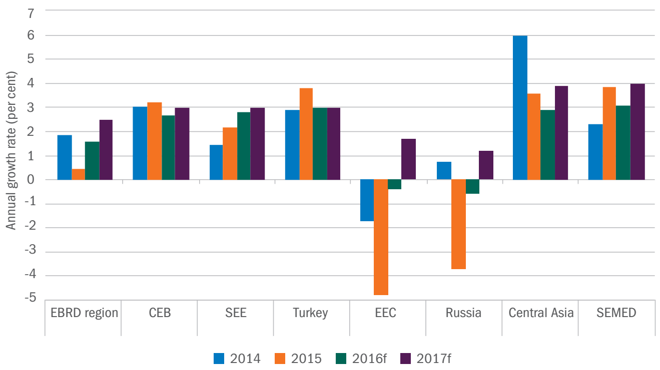
Growth in global trade has remained subdued in 2015 and 2016. This reflects a weakening of demand in advanced economies and major commodity exporters, the fact that services are gradually making a larger contribution to China's economy while the contribution of manufacturing is declining, and reductions in investment activity (reflected in reduced shipments of capital goods). In volume terms, global trade grew at an annual rate of just 2.8 per cent in 2015, compared with an annual average of 5 per cent over the last two decades.

Geopolitical tensions remain a major source of risk for the global economy. Countries across the region where the EBRD operates continue to be affected by the refugee crisis, with Jordan and Turkey affected the most. In addition, geopolitical tensions and terrorism have had a significant negative impact on income from tourism in Egypt and Tunisia – and, to a lesser extent, Greece and Turkey. On the other hand, countries such as Croatia and Montenegro may have benefited from tourists seeking alternative destinations during the summer season.

## Economic growth in the region

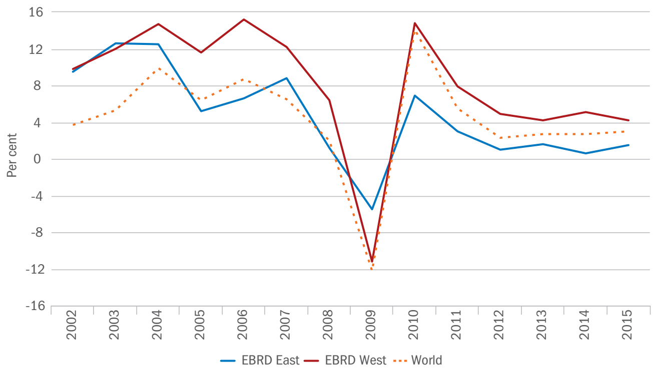
The annual growth rate in the CEB region averaged around 3 per cent in 2015, virtually unchanged from 2014 (see Chart M.3). In most cases, this was supported by a combination of strong private consumption, a recovery in investment activity (helped by the accelerated utilisation of EU structural funds) and reductions in the cost of fuel imports. Croatia's economy grew for the first time in seven years on the back of a good tourist season, a strengthening of external demand and reductions in oil prices. The annual growth rate in the SEE region averaged in excess of 2 per cent, up from 1.5 per cent in 2014, despite a slow-down in Greece. The economic situation in Greece remains very tough, with GDP falling by 1.4 per cent year on year in the first quarter of 2016. Nevertheless, Greece has made progress with a number of important reforms, enabling the disbursement of further financial support from the European Stability Mechanism

**CHART M.3. Economic growth**




**Source:** National authorities, IMF and EBRD projections.
**Note:** In the key, f = forecast.

**CHART M.4. Annual growth in export volumes**




**Source:** IMF, World Trade Organization (WTO) and authors' calculations.
**Note:** "EBRD East" comprises the EEC region, Central Asia and Russia. "EBRD West" comprises Turkey and the CEB, SEE and SEMED regions. "World" represents an estimate based on WTO data.

in June 2016 under its current adjustment programme.

In Russia, output contracted by 3.7 per cent in 2015, with consumption and investment remaining weak and government spending declining in real (inflation-adjusted) terms. The economy remained in recession in the first half of 2016. A sharp decline in imports owing to the weakness of the rouble, on the other hand, made a positive contribution to overall growth. Ukraine's economy contracted by almost 10 per cent in 2015, but the recession bottomed out in the second half of the year. In fact, annual growth slowed in all EEC economies in 2015, also turning negative in Belarus and Moldova. The average annual growth rate in Central Asia likewise declined markedly, falling from 6 per cent in 2014 to less than 4 per cent in 2015, reflecting the region's strong dependence on Russia and commodity exports.

Turkey's economy grew by 4 per cent in 2015, with consumers increasing their purchases of durable goods against the backdrop of the weakening of the lira. A large influx of refugees and a supportive fiscal stance also played an important role in propping up consumption. That strong growth momentum was sustained at the start of 2016, although economic uncertainty has since risen following the attempted coup d'état in July.

Resilient consumption and a rebound in investment in Egypt, along with higher agricultural output in Morocco, supported economic activity in the SEMED region, where growth accelerated to almost 4 per cent in 2015 from 2.3 per cent in 2014. At the same time, growth slowed in Jordan and Tunisia, reflecting deteriorating security conditions both domestically and across the region as a whole.

## Trade

Growth in the volume of exports emanating from the region where the EBRD invests has slowed in recent years, in line with global trends. Export growth has been slower in the east of the EBRD region (namely, in the EEC region, Central Asia and Russia; see Chart M.4). In fact, exports from Russia, the EEC region and Central Asia grew more slowly than their respective economies between the mid-2000s and 2014. In contrast, while global growth in export volumes has lagged behind economic growth since 2011, reversing a long-term trend, exports from Turkey and the CEB, SEE and SEMED regions have continued to grow faster than output. This reflects, in part, the lower levels of economic growth seen in the region in recent years.

## Capital flows

Net capital flows to the region declined in 2015, mirroring broader trends in emerging markets. In the CEB and SEE regions, balance of payments data indicate net capital inflows totalling around 0.1 per cent of GDP in 2015, compared with 1.1 per cent of GDP in 2014 (see Chart M.5). Net private capital outflows from Russia moderated further in 2015, with a significant percentage of the external debt owed by banks and companies having been repaid in previous quarters.

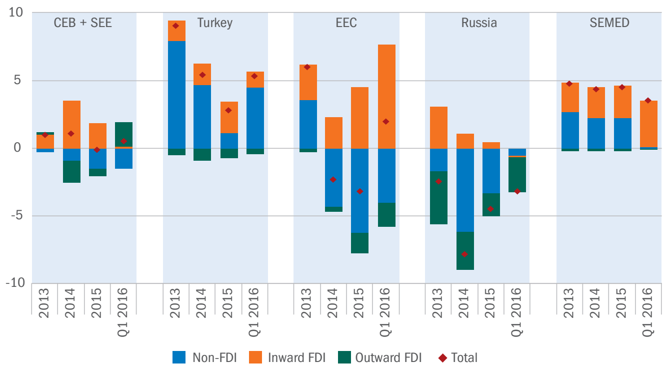
The up-and-down pattern of capital flows, which reflects changing expectations regarding the Federal Reserve's monetary policy stance, has been less pronounced in the EBRD region than it has been in emerging Asia and Latin America. During the period of loose monetary policy in advanced economies and quantitative easing in the USA, capital flows to emerging Asia and Latin America averaged around 5 per cent of GDP (see Chart M.5), approximately 1.5 percentage points of GDP more than before the 2008-09 financial crisis. Capital flows then declined markedly in 2015.

In contrast, emerging Europe has, on average, experienced a steady reduction in capital inflows in recent years. When measured relative to recipient countries' GDP, those net inflows have been similar in size to those observed in other emerging markets. At the same time, in the case of emerging Europe, current levels represent around half of those experienced during the pre-crisis boom of the 2000s (when inflows were, to a significant extent, driven by cross-border bank lending).

Unlike non-FDI flows,[2] FDI flows to emerging markets increased by 1.5 per cent in 2015, according to preliminary estimates by the United Nations Conference on Trade and Development (UNCTAD). At the same time, FDI flows to

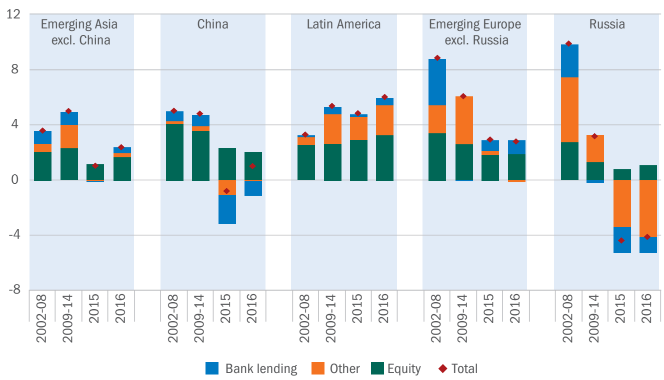
[2] Non-FDI flows include portfolio investment and debt flows except shareholder loans.

CHART M.5. Capital flows to/from the EBRD region as a percentage of GDP




**Source:** National authorities via CEIC Data and authors' calculations.

CHART M.6. Average net non-resident private capital flows as a percentage of GDP




**Source:** IIF and authors' calculations.
**Note:** Values for 2016 are IIF forecasts based on trends observed in the first half of the year.

CHART M.7. Year-on-year percentage changes in remittances from Russia


**Source:** Central Bank of Russia, Bloomberg and authors' calculations.
**Note:** Based on data on remittances to Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

commodity-dependent economies declined significantly, both globally and in the region where the EBRD invests, as major projects were put on hold and investors reassessed the medium-term prospects of those economies. In contrast, FDI flows to Turkey increased, partly offsetting the reduction in non-FDI flows, while in Mongolia the economy was supported by the prospect of the second phase of the Oyu Tolgoi project – a major copper and gold mining initiative – being implemented.

Capital flows to emerging markets recovered somewhat in the first half of 2016, and they are expected to pick up further on the back of a search for yield, against the backdrop of low rates in advanced markets and reduced concerns about the slow-down in China. What is more, increases in commodity prices support capital flows to commodity-exporting countries. At the same time, the pick-up in capital inflows in emerging Europe is expected to be weaker than those observed in other regions, partly owing to higher levels of perceived geopolitical risk.

## Remittances

Remittances from Russia to Central Asia and the EEC region fell by around 40 per cent in 2015 in US dollar terms and continued declining in the first quarter of 2016. However, when expressed in rouble terms, remittances decreased by less than 10 per cent, which suggests that the fall was largely attributable to exchange rate movements (see Chart M.7).

When expressed in the currencies of the individual recipient countries, remittances declined by an average of around 30 per cent in 2015, as most national currencies weakened against the US dollar but strengthened against the Russian rouble. This suggests that decreases in remittances may exert further pressure on the external balances of these economies.[3]

## Currency movements

The region's currencies have weakened further against the US dollar, mirroring broader trends in emerging markets and reflecting reduced inflows of capital and subdued demand for emerging markets' exports (often commodities). The currencies of Russia, the EEC region and Central Asia have tended to weaken the most. The currencies of the region's major oil exporters (namely Azerbaijan, Kazakhstan and Russia) have adjusted in a way that has broadly maintained, or restored, the price of a barrel of oil in local currency terms (see Chart M.8), thus supporting budget revenues (in nominal terms) and helping to maintain the value of international reserves. In oil-importing countries, energy has become significantly cheaper in local currency terms.

## Credit conditions

Recent surveys of lenders indicate that credit conditions in the region have eased slightly, albeit less so than in other emerging markets. At the same time, credit growth remains subdued in most countries in the CEB and SEE regions. In Turkey, Russia, the EEC region and Central Asia, credit growth has slowed markedly. Indeed, in many instances it has turned sharply negative in

[3] Based on data from the Central Bank of Russia. Discrepancies between data reported by the Central Bank of Russia and figures provided by authorities in recipient countries have increased, possibly reflecting greater use of informal channels for sending money between countries.

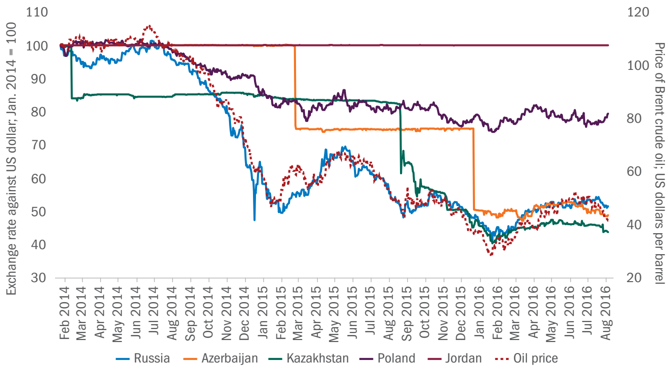
inflation-adjusted terms, after years of rapid credit expansion.

As was highlighted in the *Transition Report 2015-16*, levels of NPLs in the region remain high by the standards of emerging markets globally and are continuing to limit banks' ability and willingness to provide fresh credit. Kazakhstan, Romania and a number of other countries made significant progress with the removal of NPLs from banks' balance sheets over the last year, although in some cases these assets may remain on the books of special vehicles that are fully owned by the originating banks.

A forthcoming EBRD paper finds that growth rates in countries with persistently high NPL ratios tend to be significantly lower (when controlling for various factors), as those high ratios place a considerable burden on banks and companies alike.[4] Causality between NPLs and growth runs both ways: reducing NPL ratios boosts growth, while stronger growth helps to lower those ratios. Indeed, in some cases, ratios have eventually fallen on account of a favourable external environment and strong credit growth. As one would expect, growth levels in such instances tend to be significantly higher than they are in the presence of persistently high NPL ratios. However, countries can achieve similar growth dividends by actively seeking to reduce their stock of NPLs – thereby lowering their NPL ratios – from high to moderate levels. This results in gains of around 2 percentage points in terms of additional annual growth (see Chart M.9).[5]

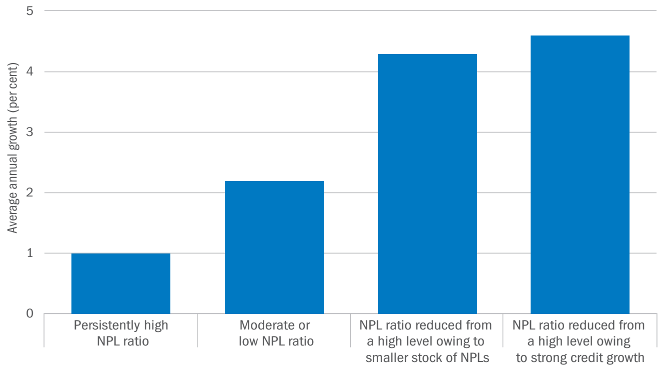
These findings highlight the value of policies aimed at proactively reducing the stock of NPLs – for instance, policies that remove tax and regulatory disincentives to write off non-performing loans, tighten provisioning rules and/or establish specialist asset management companies to purchase and handle NPLs.

CHART M.8. Oil price and exchange rate developments




**Source:** Bloomberg.
**Note:** Upward movements denote appreciation against the US dollar.

CHART M.9. Average growth depending on the evolution of NPL ratios




**Source:** Balgova and Plekhanov (2016).
**Note:** Based on a broad sample of 100 developed and developing countries during the period 1998-2014. Definitions of NPLs may vary across countries. High NPL ratios are defined as those in excess of 8 per cent.

## Inflation

The current period of low oil prices has contributed to disinflation in most commodity-importing countries. In several CEB and SEE countries, consumer prices have been declining, on average, since 2012. In contrast, countries whose currencies have weakened substantially have seen rising inflation, largely owing to increases in the prices of imported goods.

By mid-2016, 23 countries in the EBRD region had adopted some form of inflation target (with seven doing so by virtue of joining the eurozone). Of the remaining countries, around half currently peg their currencies to the euro or the US dollar.

In all but four of the countries with some form of inflation target, consumer price inflation rates were below target levels at the end of June 2016, with demand pressures remaining weak and economies having adjusted to lower commodity prices. Most of those countries' central banks have lowered their policy rates in the last 12 months (see Chart M.10). Meanwhile, where countries' inflation rates are above target levels, central banks have tended to tighten monetary policy, albeit with some notable exceptions. In Russia, for example, the central bank has begun loosening its policy stance, as annual inflation has been falling towards its indicative target of 4 per cent in 2017. Annual inflation in Russia stood at 7 per cent in July 2016, down from 15 per cent 12 months earlier, reflecting weak domestic demand (and the end of base effects resulting from the sharp depreciation of the rouble and the ban on selected food imports). In Turkey, the impact of a weaker currency has outweighed the effect of declining commodity prices, with inflation remaining well above the central bank's target and the policy rate remaining unchanged.

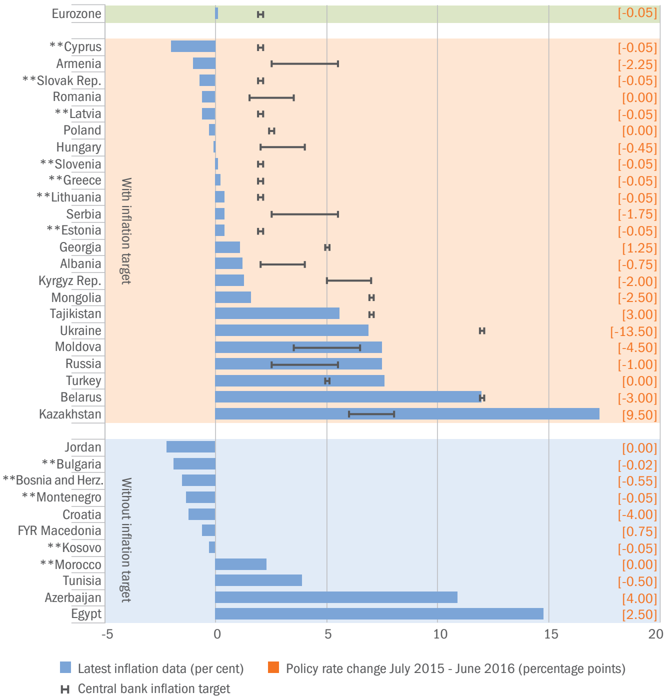
## Outlook and risks

The average annual growth rate in the region where the EBRD invests is expected to rise from 0.5 per cent in 2015 to around 1.5 per cent in 2016. That modest recovery is then expected to continue in 2017, with an average annual growth rate of 2.5 per cent, as growth in Russia and a number of EEC economies returns to positive territory and economic growth in the SEMED region and Central Asia strengthens.

The economic outlook for the CEB region remains relatively strong, on the back of accommodative policies in the eurozone and sustained low commodity prices. Income convergence is set to continue, with average annual growth rates in the region close to 3 per cent in 2016 and 2017. Similarly, the average annual

[4] See Damijan (2016) for evidence of how excessive debt affects the performance of companies in the EBRD region, with a negative impact on both supplier and customer firms.
[5] See Balgova and Plekhanov (2016).

**CHART M.10. Inflation rates and central bank targets**




**Source:** National authorities via CEIC Data.
**Note:** The rates shown are year-on-year figures based on consumer price indices. ** denotes a country that uses the euro as legal tender or as an anchor for its exchange rate peg. Inflation targets include indicative targets for future time periods; 2016 targets are shown where available.

growth rate in the SEE region is expected to increase in 2016, before rising further to stand at around 3 per cent in 2017.

Russia's recession is expected to continue in 2016, reflecting low oil prices and reduced availability of investment funding, with modest levels of positive growth expected in 2017. The low commodity prices and the recession in Russia will continue to weigh on growth in the EEC region and Central Asia. Following a deep contraction in 2015, Ukraine's economy is on course to return to positive growth in 2016, supported by the implementation of its structural reform programme, although confidence among investors remains weak.

Following a strong economic performance in 2015, growth in Turkey is projected to moderate in 2016 and 2017, as the outlook for private investment appears to be weaker and figures for tourist arrivals are expected to recover only gradually. The short-term outlook for the SEMED region has also weakened, reflecting an expected decline in tourist numbers and a subdued demand for exports, but growth is expected to pick up again in 2017.

These projections are subject to risks, notably those related to geopolitical tensions in and around the region. The conflict in Syria and the threat posed by Islamic State risk exacerbating the refugee crisis. The economies of the SEMED region and Turkey have the potential to be particularly strongly affected by the instability in the Middle East. The situation in eastern Ukraine also remains volatile. Moreover, a sharp deceleration in China's growth could further exacerbate investors' loss of confidence and amplify volatility in global markets, which could be compounded by concerns about the health and profitability of global banks in the current low interest-rate environment. Although growth in China has already slowed noticeably, China's contribution to global demand remains broadly unchanged compared with the mid-2000s, as the Chinese economy has become significantly larger in nominal US dollar terms. However, a "hard landing" in China could result in a marked decline in global demand. Prolonged weakness in commodity prices and any fresh declines in the price of oil could also exacerbate pressures on the economies of Russia and other commodity exporters, as well as countries in Central Asia and the EEC region with close economic ties to Russia.

# References

**M. Balgova and A. Plekhanov (2016)**
"Non-performing loans, investment and growth", EBRD working paper, forthcoming.

**J. Damijan (2016)**
"Corporate NPL portfolios in CESEE countries: Impact of corporate leverage and debt spillovers on firm performance", EBRD working paper, forthcoming.

**S. Dées, F. di Mauro, M.H. Pesaran and L.V. Smith (2007)**
"Exploring the international linkages of the euro area: a global VAR analysis", *Journal of Applied Econometrics*, Vol. 22, pp. 1-38.

**IMF (2016)**
"Uncertainty in the aftermath of the UK referendum", *World Economic Outlook Update*, July.

**O. Levitin, J. Milatović and P. Sanfey (2016)**
"China and South-Eastern Europe: Infrastructure, trade and investment links", EBRD background paper.

**NIESR (2016)**
"Prospects for the UK Economy", *National Institute Economic Review*, Issue 237, August.

## Box M.1. Potential spillovers from weaker growth in the UK, the eurozone, China and Russia

Following the UK referendum on EU membership, the UK's National Institute of Economic and Social Research (NIESR) cut its UK growth forecast for 2017 by 1.7 percentage points, pointing to the risk of a sharp slow-down in adverse scenarios (see also the July 2016 update to the IMF's World Economic Outlook).[6] How will weaker growth in the UK affect the region where the EBRD invests? And how does this potential impact compare with the effects of other external shocks that the region has been exposed to in recent years, such as the weakening of growth in China, the subdued economic activity in the eurozone, or the recession in Russia (which has been aggravated by Western sanctions and declining oil prices)?

In answer, this box estimates the impact of growth shocks in the UK, the eurozone, China and Russia using a global vector autoregressive (GVAR) model. That model encompasses countries accounting for more than 90 per cent of global GDP and captures various channels for economic stress, modelling its transmission through the real economy (via international trade, for instance), financial markets (via interest rates and equity prices) and global commodity prices. It also captures the complex interlinkages that allow shocks to propagate through third parties (spreading, for example, from the UK to the eurozone and then from the eurozone to central Europe). For each country, the external variables in the estimation represent weighted averages of estimates of domestic variables for other countries.[7]

The weights are based on a combination of export revenues, remittances and investment, thus reflecting the fact that the various economic partners are important in a number of different respects (see Chart M.1.1). The eurozone is the main economic partner for most countries in the EBRD region. Direct economic links with the UK are relatively modest in scope, primarily reflecting trade and FDI flows. Most economies in the EEC region and Central Asia have close ties with Russia (as do the Baltic states) on account of trade and remittances. The strongest economic links with China can be found in Central Asia, primarily reflecting investment flows and exports.

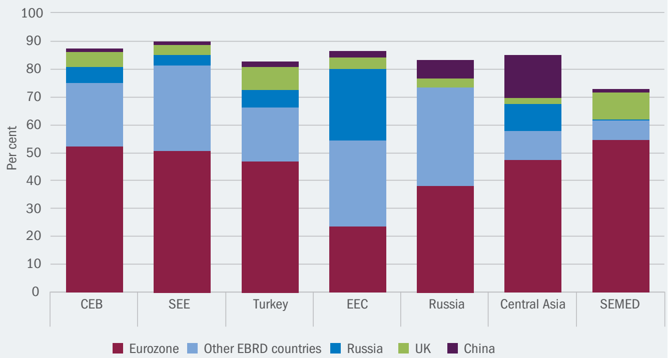
A negative growth shock in the eurozone has the largest impact (see Table M.1.1). A 1 percentage point decrease in growth in the eurozone translates, on aggregate, into a 0.8 percentage point reduction in average growth in the EBRD region. The impact is strongest in Turkey, the CEB region (excluding Poland), the SEE region (excluding Greece), Russia and Ukraine. In contrast, Poland appears to be highly resilient to external shocks.

A 1 percentage point decline in UK growth is estimated to translate into a 0.4 percentage point reduction in average growth in the EBRD region. That impact stems largely from indirect channels, such as weaker growth in the eurozone and the tightening of financial conditions in the USA, the eurozone and globally. In contrast, the direct impact of a UK slow-down is limited to a 0.1 percentage point decline in the EBRD region's growth, with no strong impact on any of the individual regions.

In contrast, the impact of a recession in Russia stems mostly from direct channels. The overall impact is relatively modest, but concentrated in Ukraine, the Kyrgyz Republic and selected economies in the EEC region. A 1 percentage point decline in China's growth is estimated to have approximately half of the impact of a slow-down in the eurozone, with the largest impact being observed in the SEE region (excluding Greece), Russia and Ukraine, as well as certain economies in Central Asia.

Overall, these results suggest that while the projected recovery in the Russian economy is likely to have a positive effect on growth in the region, those benefits could be more than offset if risks to growth in the eurozone and China were to materialise. The UK's exit from the European Union could have a significant impact on the region to the extent that it could affect the economic outlook for the eurozone.

**CHART M.1.1. Relative importance of economic partners for various regions/countries**




**Source:** BIS, IMF IFS, UNCTAD, World Bank, Comtrade and authors' calculations.
**Note:** Data are based on exports, remittances and FDI inflows. The residual percentages denote the rest of the world.

**TABLE M.1.1. Estimated impact of a 1 percentage point decline in growth in the UK, the eurozone, China and Russia (average impact over one year; percentage points)**

| | UK | | Eurozone | | China | Russia |
|---|---|---|---|---|---|---|
| | Total | Direct | Total | Direct | | |
| EBRD region | -0.4 | -0.1 | -0.8 | -0.5 | -0.4 | -0.2 |
| CEB excl. Poland | -0.2 | 0.0 | -1.0 | -1.0 | -0.3 | -0.2 |
| Poland | 0.1 | 0.0 | 0.1 | 0.1 | 0.0 | -0.1 |
| SEE excl. Greece | -0.4 | 0.1 | -1.0 | -0.6 | -0.5 | -0.3 |
| Greece | -0.4 | 0.0 | -0.4 | 0.6 | -0.3 | -0.1 |
| EEC excl. Ukraine | -0.4 | -0.1 | -0.6 | -0.7 | -0.4 | -0.2 |
| Ukraine | -0.7 | -0.2 | -1.0 | -0.8 | -0.7 | -0.9 |
| Turkey | -0.2 | -0.1 | -1.2 | -1.3 | -0.4 | -0.2 |
| Russia | -0.6 | -0.2 | -1.0 | -0.4 | -0.6 | |
| Central Asia | -0.4 | 0.0 | -0.5 | 0.2 | -0.3 | -0.2 |
| SEMED | -0.2 | 0.0 | -0.5 | -0.5 | -0.3 | 0.1 |

**Source:** Authors' calculations.
**Note:** The table shows point estimates derived from a GVAR model encompassing 35 different countries/regions and is based on quarterly data for 2001-15. Point estimates are average impulse responses over the first four quarters following a shock. The weights used to calculate regional aggregates are based on GDP at purchasing power parity.

[6] See NIESR (2016) and IMF (2016).
[7] The model follows Dées et al. (2007) in terms of the choice of domestic variables, incorporating GDP, inflation, exchange rates, equity market indices and both short and long-term interest rates, as well as including global variables such as the price of oil, metals and agricultural commodities. Data cover the period from 2001 to 2015.