REGIONAL ECONOMIC PROSPECTS

COVID-19: FROM SHOCK TO RECOVERY

MAY 2020 UPDATE
Covid-19: From shock to recovery

Growth in the EBRD regions averaged 2.6 per cent in 2019, down from 3.4 per cent in 2018 and 3.8 per cent in 2017, mirroring the ongoing slowdown in global growth and global trade growth. The Covid-19 pandemic hit on top of this deceleration and is expected to result in a substantial output contraction, at least in the near term.

Assuming domestic containment measures are gradually relaxed, with return to normality during the second half of the year, output in the EBRD regions is projected to contract on average by 3.5 per cent in 2020 followed by a recovery in 2021, with an average growth rate of 4.8 per cent in 2021. While this scenario assumes a modest impact of the crisis on the long-term trajectory of output, the pandemic may have significant longer-term economic, political and social impacts.

These estimates are subject to unprecedented uncertainty. If social distancing remains in place for much longer than anticipated, the recession may be much deeper, with the 2019 levels of output per capita not attained again for years to come.
Table 1. Real GDP growth, in per cent per annum

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Memo: Egypt (fiscal year ending June) 5.3 5.6 2.5 3.0 -3.4

Note: 'e' indicates unofficial estimates. Averages are weighted by economies' nominal GDP in US dollars at PPP.
Regional outlook

Growth projections for the EBRD regions assume various intensities and lengths of lockdowns across countries, introduced with the view to contain the spread of Covid-19 (see Chart 1). On average, trips to recreation facilities including restaurants and retail shops other than groceries were 54 per cent below the usual levels in the second half of March and the first weeks of April, based on Google mobility data (see Chart 2) while trips to mass transit stations were 53 per cent down.

Intensity of lockdowns varies

As discussed in the April issue of the Regional Economic Prospects, social distancing is associated with sharp declines in economic activity as people avoid public gatherings (weighing on domestic demand) and workers stay at home (reducing domestic supply). The impact of social distance is compounded by external shocks, including a sharp drop in commodity prices, weighing on commodity exporters, disruption to global value chains, a collapse in tourism and a drop in remittances.

Fiscal and monetary policy packages are thus being deployed across the region’s economies to limit layoffs and insolvencies while shoring up individuals’ incomes.

During the period of social distancing, GDP is assumed to contract, on average, by 10 per cent year-on-year (and up to 25 per cent year-on-year in some cases, depending on country circumstances). These assumptions are based on early data from China for the first quarter (where growth in Hubei province was close to -40 per cent year-on-year), flash estimates of GDP in the European Union in the first quarter of the year, and data on various major disruptions to economic activity experienced in the past.

Output is expected to contract in 2020

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Projections assume a gradual relaxation of containment measures and return to normality during the second half of the year, with some sustained negative impact on aggregate demand, in particular in service sectors such as tourism and hospitality.

Under this central scenario, output in the EBRD regions is projected to contract by 3.5 per cent in 2020, a drop of 6.5 percentage points relative to the economic performance that could be expected in the absence of the pandemic (see Table 1 and Charts 3 and 4).

Growth is projected to resume towards the end of the third quarter, in line with early indications from China. Growth in 2021 is projected at 4.8 per cent as economies recover.

**Depth of expected contraction varies across economies**

*Chart 4. Average growth (per cent)*

![Average growth chart](image)

*Source: CEIC, national authorities and EBRD forecasts.*

**Risks to the outlook**

The projections are subject to unprecedented uncertainty. In a scenario, in which social distancing remains in place for much longer than anticipated, job losses may be widespread and recovery sluggish, with the 2019 levels of output per capita not being attained for years to come (see Chart 5).

**Downside risks are high**

*Chart 5. GDP per capita in the EBRD regions under prolonged social distancing, index, 2010=100*

![GDP per capita chart](image)

*Sources: National authorities, CEIC, International Monetary Fund and authors’ calculations.*

*Note: Weighted by GDP at purchasing power parity. The scenario assumes lockdowns lasting, on-and-off for up to 18 months followed by period of subdued demand in sectors relying on discretionary spending and mass gatherings (economies operating at 85-90 per cent of pre-crisis capacity).*

In the longer term, response to the Covid-19 crisis may also offer economic opportunities. As discussed in the April issue of *Regional Economic Prospects* (Box 4), the crisis may lead to greater scrutiny of supply chains, with an emphasis on resilience and diversification. In many sectors, a single economy, often China, is currently a dominant supplier globally. In some of these sectors the economies of the EBRD regions already enjoy a comparative advantage and high export volumes, with a potential to scale up their exports further.

In addition, governments could put climate action at the core of economic stimulus packages accompanying recovery, as discussed in Box 2 of the April issue of *Regional Economic Prospects*, ensuring that public spending addresses the current economic crisis and the longer-term climate emergency.
Regional updates

Central Asia

The outbreak of the coronavirus and the subsequent collapse of commodity prices have put Central Asian economies under immense pressure. Suffering from limited economic diversification and high dependence on remittances, the region will be very strongly affected via slowing global demand for oil, gas, metals and other commodities as well as trade and travel restrictions put in place to contain the spread of Covid-19. On the demand side, exports, private consumption and investment will take a major hit as a result of internal containment measures and worsening external conditions – including lower demand for seasonal workers. On the supply side, many businesses, particularly small and medium-sized enterprises (SMEs) in the services and hospitality sectors, will not be able to maintain full-scale operations due to internal lockdown measures, border closures and disruption of trade and international supply linkages. At the macro level, all countries in the region are experiencing pressures on their balance of payments, fiscal accounts and currencies. These pressures are stronger in smaller economies, such as the Kyrgyz Republic, Mongolia and Tajikistan, characterised by tight fiscal space, limited foreign exchange reserves and large stocks of foreign currency-denominated debt. Oil and gas exporters, such as Kazakhstan, Turkmenistan and Uzbekistan, though able to rely on significant fiscal buffers and international reserves to cushion the negative impact of virus containment measures on the economy, will also be stressed as a result of a dramatic decline in the demand for energy resources.

Kazakhstan

Real GDP growth in Kazakhstan accelerated from 4.1 to 4.5 per cent in 2019 on the back of rising private consumption and fixed investment. With the state of emergency declared only on March 16, the economy continued expanding in the first three months of 2020, adding 2.7 per cent year-on-year. Retail trade, transport and hospitality industries were the first sectors to be affected by the lockdown, seeing negative growth already in the first quarter. Social distancing measures, partially eased since late-April, will remain in place at least until mid-May 2020, wreaking havoc on the service industry and the SME sector in particular. In parallel, the economy is strongly affected by lower commodity prices, and the planned cuts in oil production, in line with Kazakhstan’s OPEC+ commitments. As a result, the tenge came under strong pressure and lost 11 per cent of its value in the first four months of the year. On the positive side, Kazakhstan has sufficient fiscal space and international reserves to support businesses and domestic demand. The banking sector is liquid, and lending to the economy is mainly constrained by a perception of elevated risks. The government reacted to the crisis with a US$ 13 billion (9 per cent of GDP) stimulus package providing support to the affected businesses and households. To address short-term liquidity needs in the SME sector, the government and the central bank are offering loans at concessional terms as well as tax, utility and loan repayment deferrals. The change in relative prices could also create the conditions for diversifying the economy away from excessive dependence on the gas and oil sector. Overall, we expect the domestic demand to reach its pre-crisis level only by mid-2021, leaving the economy on a lower growth trajectory. According to our forecast, the economy will contract by 3.0 per cent in 2020, followed by a 5.5 per cent rebound in 2021, supported by a partial recovery of oil prices.

Kyrgyz Republic

GDP growth in the Kyrgyz Republic accelerated to 4.5 per cent in 2019 from 3.8
per cent in 2018, supported by a strong recovery in gold production. Remittances decreased by 14 per cent year-on-year in US dollar terms in 2019, but their share in GDP remains high at 28 per cent. With travel restrictions in place and bleaker economic prospects in Russia, the Kyrgyz Republic faces a significant reduction in remittances. Strict lockdown measures, introduced in late-March, are expected to last until mid-May 2020, further weighing on domestic demand. In addition, the border with China was closed since early February and only partially re-opened, resulting in declining imports from China, which will hit domestic production relying on China-made inputs and weigh on re-exports. Facing balance of payment pressures, the Kyrgyz Republic has seen its currency depreciating by 13 per cent between February and April 2020, after 3 years of relatively stable exchange rates. Given low international reserves (2.5 months of current account payments), limited fiscal space and a significant debt overhang, the Kyrgyz Republic was the first country to receive emergency assistance from the International Monetary Fund (IMF; US$ 120.9 million). In the first quarter of 2020, economic growth was still positive, at 1.5 per cent year-on-year, thanks to robust performance in the mining industry. However, a contraction of 4.0 per cent is expected in 2020, due to subdued domestic demand and losses in the SME sector, which accounts for 41.5 per cent of GDP. In 2021, the economy is forecast to achieve a 5.5 per cent GDP growth as remittances partially recover, re-exports pick up and gold exports increase due to additional production from the Jerooy gold mine.

Mongolia

Economic growth in Mongolia moderated to 5.1 per cent in 2019 from 7.2 per cent in 2018 on account of a weaker contribution from mining. Growth continued to be driven by private consumption and investment (primarily foreign direct investment into mining). The pandemic exposed Mongolia’s key vulnerabilities: extreme dependence on China as its main export market (accounting for 93 per cent of total exports in 2019), and a narrow specialization in exports of copper, coal and gold. Within the first three months of 2020, exports declined by around 42 per cent year-on-year (with coal exports contracting by 62 per cent) as a result of weaker demand and partial border closure for freight cargo. Partial lockdown measures involved the closures of most public places from mid-February till end-April, significantly constraining household demand. The negative impact of the coronavirus will also be felt via declining tourism receipts (in 2019, tourism accounted for about 11 per cent of GDP). The Mongolian government’s ability to provide significant stimulus to the economy is hampered by high debt levels (public and external debt reached 73 per cent and 220 per cent of GDP, respectively, in 2019). Overall, Mongolia’s GDP is expected to contract by 1.0 per cent in 2020. The economy is forecast to return to growth (6.0 per cent) in 2021 on the back of a strong recovery in China’s demand as well as domestic private consumption and investment.

Tajikistan

Tajikistan’s real GDP expanded by 7.5 per cent in 2019, up from 7.3 per cent in 2018. On the demand side, growth was driven by household consumption, which continues to be financed by remittances (32 per cent of 2019 GDP, mainly from Russia). Private consumption was also boosted by a pickup in credit expansion, growing 12 per cent year-on-year in December 2019 (versus 2 per cent a year ago), partly thanks to a successful credit bureau reform. Demand conditions are expected to significantly worsen in 2020, with the pandemic triggering border closures and limiting Tajikistan’s access to the Russian labour market and hence weighing on remittances. The already strained public finances will deteriorate further in light of
reduced tax receipts while the country is facing a significant debt overhang and high cost of ambitious infrastructure projects, including the Rogun hydropower plant. Given limited foreign exchange reserves (worth 1.9 months of current account payments) and large fiscal and balance of payments deficits, the government submitted an official request for emergency assistance from the IMF. With the first coronavirus cases declared only in late April 2020, no strict containment measures have been imposed at the time of writing. The economy is expected to contract by 1.0 per cent in 2020. In 2021, real GDP is forecast to grow by 5 per cent, supported by recovery in Russia and China.

**Turkmenistan**

In Turkmenistan, GDP growth reached 6.3 per cent in 2019 and the first quarter of 2020 (year-on-year). According to the IMF, fiscal and external accounts improved in 2018-2019 in line with fiscal consolidation and import substitution measures undertaken by the authorities. Turkmenistan still depends on China for most of its gas exports (more than 90 per cent in 2018). The spread of the coronavirus has caused Chinese gas imports to decline by 17 per cent year-on-year in the first two months of 2020, and in March they were suspended altogether. Turkmenistan’s economy as a whole will be hit by a reduction in the value of its gas exports. Reduced foreign exchange inflows have already translated into tighter foreign exchange regulations, interfering with private-sector activities. The government introduced restrictions on the internal and external movement of citizens but refrained from imposing a strict lockdown that would have disrupted business activities. Overall, the economy is expected to grow by 1.0 per cent in 2020, and 6.0 per cent in 2021 supported by a recovery in China’s demand for gas.

**Uzbekistan**

In 2019, Uzbekistan’s GDP grew by 5.6 per cent, slightly accelerating from 5.4 per cent in 2018. In the first quarter of 2020, the economy expanded by 4.1 per cent but is likely to contract in the second quarter as the impact of virus containment measures (lasting for at least two months) kicks in. Exports declined by 11 per cent year-on-year in the first three months of 2020, despite being much more diversified in terms of products and markets compared to other countries in Central Asia. Commodity exports constituted about 50 per cent of Uzbekistan’s total exports in 2019, with gold, which accounts for more than a half of those, providing a natural hedge in turbulent times. China was Uzbekistan’s largest export market in 2019, but its share in total exports was only 14 per cent (mostly gas). Rapid expansion in credit to the private sector (up 26 per cent year-on-year in December 2019) is a source of vulnerability given higher probability of businesses defaulting at a time of a major slowdown in the economy, with negative implications for the stability of the banking system. Remittances from Russia (accounting for 8 per cent of GDP) are expected to shrink affecting the most vulnerable parts of the population. In addition, the tourism and hospitality sector (about 6 per cent of GDP), will be among the hardest hit by coronavirus-related disruptions. GDP is still expected to grow in 2020, albeit at a modest rate of 1.5 per cent. Much stronger growth performance, of 6.5 per cent, is expected in 2021, reflecting a recovery in both exports and domestic demand.
Central Europe and the Baltic States (CEB)

The CEB region had entered a cyclical slowdown already in 2019, and the early phase of the global coronavirus crisis in late-January 2020 hit selected industries, such as electronics, which heavily rely on inputs from China. At the beginning of March most countries introduced strict containment measures, including a massive shutdown of businesses and schools. Disrupted value chains are preventing production, including in automotive industry, which accounts for almost a half of industrial production in the Slovak Republic. Weaker external demand will likely further delay the recovery. Output in the region is set to fall in 2020, but bounce back strongly in 2021. Governments are meanwhile providing significant relief measures to preserve employment and to support companies in a state of hibernation. Some governments started to introduce gradual lockdown exit strategies at the end of April, the progress of which will further depend on epidemiological developments in those countries. Public finances are expected to deteriorate sharply in all CEB economies, driven by discretionary spending measures related to crisis response and revenue losses. As the General Escape Clause from the Stability and Growth Pact was invoked, market access and long-term fiscal sustainability are the only constraints on the size of public spending programmes. At the same time, non-euro zone central banks, following the example of the European Central Bank (ECB), launched their own quantitative easing programmes in order to lower financing costs of the governments’ crisis response packages.

Croatia

The economy of Croatia recorded a growth rate of 2.9 per cent in 2019, as domestic consumption and investment increased, fuelled by higher earnings and employment rate, an increasing pace of lending, growing disbursement of EU funds and rising economic sentiment. However, for 2020, a sharp recession of up to 7.0 per cent is expected because of the coronavirus pandemic. In mid-March, the government introduced a number of lockdown measures, with tough restrictions on travel and economic activity. A key channel for disruption is tourism, which is a mainstay of the Croatian economy (tourist spending accounts for about 20 per cent of GDP). There was a drop of 75-80 per cent in tourist arrivals in March year-on-year, with a similar drop expected in the second quarter and a decrease of about 30 per cent in third quarter, mitigated by the fact that Croatia is easily reachable by land from the tourists’ main countries of residence such as Germany, Austria, Slovenia, Hungary and the Czech Republic. As revenues from tourism drop, spillover effects of the crisis are likely to be multiplied, including through a labour market shock (25 per cent of employed in Croatia are on temporary contracts, and most of them are related to the tourism sector). The domestic lockdown, introduced in mid-March, is heavily reducing demand for both services and durable goods (the categories together account for about 40 per cent of consumption spending). Still, decreases in sales of investment goods may be less severe, as some spending on repairs would need to take place following the March earthquake in Zagreb. Goods exports will also decrease, particularly given the high exposure to the severely hit Italian economy (15 per cent of the total). Despite the country’s high public debt (71 per cent of GDP) and limited fiscal space, the government responded with strong stimulus measures, of around 7 per cent of GDP so far. These are expected to limit the immediate negative consequences to the economy but are also bound to worsen fiscal indicators. On the monetary side, Croatia is proceeding with the Action Plan on Euro adoption, aiming to enter the ERM2 as early as in the second half...
of 2020. As gradual lifting of restrictions started from end of April, and more broadly from early May, we expect to see some normalisation of economic activity in 2020, although to levels still below the economy’s potential. For 2021, we expect a rapid recovery, with a growth rate of 6.0 per cent.

Estonia

GDP growth in Estonia decelerated to 4.3 per cent in 2019, but was still the second highest in the CEB region. A double-digit recovery in investment, strong exports and private and public consumption all contributed to robust growth last year. While the economy was expected to register a gradual slowdown this year and next, the outbreak of the coronavirus pandemic has shifted the expectations towards a substantial contraction in economic output, at least in 2020. As a small and open economy, with the value of exports and imports representing more than 170 per cent of GDP, Estonia is particularly vulnerable to external shocks. In addition, a high exposure to the tourism sector, which makes up 15 per cent of GDP, has already translated into closures of tourism-oriented businesses, such as restaurants, hotels and transport companies. The domestic lockdown has aggravated businesses’ liquidity problems and weighed on employment. The government has started implementing a broad package of support measures targeting the labour market, liquidity support, tax relief as well as increased capacity of Kredex, a state-owned financial institution. Local governments can receive financial support towards purchases of personal protective equipment, investment and road maintenance. A lockdown exit strategy was approved by the government at the end of April, but it does not describe steps in detail. GDP is forecast to fall by 6.0 per cent in 2020 before rebounding strongly in 2021, by 7.0 per cent.

Hungary

Hungary registered the strongest GDP growth in the CEB region, at 4.9 per cent, in 2019. An impressive double-digit investment growth rate persisted, at 15.3 per cent in 2019, while household and government consumption strengthened. Despite the recently rising importance of domestic consumption, a massive exposure of the economy to global trade (with exports and imports adding up to more than 190 per cent of GDP) aggravates the economy’s vulnerability to disruptions to global supply chains from the coronavirus crisis. The automotive industry (28 per cent of manufacturing output) is at the core of the country’s high global value chain integration. The temporary closures of all four car plants will significantly weigh on short-term GDP growth and employment. A one-month closure of the car plants is estimated to cost 0.4 per cent of annual GDP. Some of the car plants restarted production in end-April. In order to alleviate the economic fallout from the coronavirus containment measures, domestic banks were ordered to soften loan repayment conditions for all borrowers, individual and businesses. Among other measures, interest and amortisation payments on loans have been suspended until end-2020, short-term loans extended and interest rates on consumer loans capped at 5 percentage points above the base rate. More vulnerable sectors, such as tourism, hospitality, entertainment and passenger transport have been exempted from the obligation to pay social security and health insurance contributions until mid-2020. Tax relief has been provided to vulnerable businesses, especially small ones. A gradual easing of the economic restrictions, involving smaller shops and restaurants, started in early May. Despite these measures, GDP is
forecast to fall by 3.5 per cent in 2020, with a recovery of 4.0 per cent in 2021.

**Latvia**

GDP growth dropped sharply from 4.3 per cent in 2018 to 2.2 per cent in 2019. Poor investment, amid continuously contracting credit to the non-financial sector (which dropped from more than 100 per cent of GDP at end-2010 to 35 per cent at end-2019), and weaker private and public spending and external demand all weighed on economic performance. Latvia is a small, open economy and is therefore vulnerable to external developments. The coronavirus outbreak is expected to lead to heavy losses in the tourism, hospitality, passenger transportation and airline sectors. The national carrier Air Baltic has already reduced its staff by 700 (out of approximately 1,600 people) due to the coronavirus crisis. The government has introduced support measures worth €1 billion, including tax holidays and sick pay leave via the state-owned development bank ALTUM. A loan of €500 million from Nordic Investment Bank will be used to finance part of the stimulus package including measures to protect employment and secure personal protective equipment. The government is expected to start revising containment measures in early May. In 2020, GDP will likely fall by 7.0 per cent, with a recovery in 2021 (5.0 per cent growth).

**Lithuania**

Lithuania’s GDP expanded by 3.9 per cent in 2019, thanks mainly to strong exports and investment. However, the economy is now on course for a severe downturn because of the coronavirus crisis. Services such as retail trade, transport, accommodation and catering account for a relatively large share of economic output (32 per cent of GDP). At the same time, these services are the most affected by the crisis. Disruptions in global value chains will likely affect manufacturing, as about 25 per cent of Lithuania’s production inputs need to be sourced abroad. In order to protect employment, the parliament has approved provision of wage to companies hit by the coronavirus crisis. The state could cover 60 per cent of wages, with a subsidy not exceeding the minimum wage of €607 per month. The use of state guarantees on loans has been increased, such as through Invega, a national financial institution promoting funding for business. At the end of April, the Parliament approved a law to regulate prices of essential goods and services, applicable only in a state of emergency. The drop in GDP in 2020 could be limited to 7.0 per cent, with a rebound (of 5.0 per cent) in 2021.

**Poland**

GDP growth in Poland decelerated to 4.1 per cent in 2019. Household consumption remained strong, although it started to moderate in the second half of the year, as did investment and exports. While Poland has proved to be resilient during the global financial crisis of 2008-2009, the coronavirus crisis is expected to have a more severe impact on domestic businesses and employment. Despite its substantial domestic market, Poland is highly integrated into global value chains and has a large exposure to trade, especially within the EU. Therefore, the overall slump in demand for Polish goods from Western Europe, especially Germany (about 30 per cent of total exports), has already severely affected Polish exporters. The significance of small and medium-sized enterprises in employment also constitutes a risk. Micro companies represent 38 per cent of total employment, higher than the EU average of 30 per cent. These are largely self-employed individuals with no permanent contracts, mostly active in services that had to be temporarily closed. The Polish government announced several ‘anti-crisis shield’ packages, worth almost 15 per cent of GDP. They focus on protecting employment (wage subsidies), companies
(liquidity injections), healthcare (infrastructure improvements, including tele-medicine), strengthening the financial system (central bank measures) and higher public investment. The central bank has assisted the government through several purchase operations of government-backed securities from domestic financial institutions, especially the state development bank (BGK) and the state-run Polish Investment Fund (PFR). These two institutions have been key players in managing the crisis policy response. Taking all these measures into account, the drop in GDP in 2020 could be limited to 3.5 per cent, with a recovery of 4.0 per cent in 2021.

**Slovak Republic**

The economy registered a slowdown from 3.9 per cent in 2018 to 2.4 per cent in 2019, largely driven by shrinking exports. With regard to the coronavirus outbreak, the country’s deep integration into global value chains, especially in the automotive industry, will weigh heavily on output, at least in the short term. In April 2020, the country's four carmakers – Volkswagen, PSA Groupe, Jaguar Land Rover and Kia Motors – temporarily stopped production due to disrupted supplies of inputs, lower demand and concern about the health of workers. Car manufacturing, including smaller domestic suppliers, accounts for almost half of industrial production and 47 per cent of total exports from the Slovak Republic. The low diversification of the Slovak manufacturing is a particular risk factor, given the disrupted supply chains and a possible drop in demand for cars, particularly in the light of a massive damage to the transport sector. The government has adopted 31 measures to support the economy, and redirected €1.25 billion of EU funds to crisis response. We expect output to fall by 6.0 per cent in 2020 before recovering strongly in 2021, by 7.0 per cent.

**Slovenia**

Economic growth in Slovenia slowed down in 2019 to 2.4 per cent, from the high rates of the previous two years, amid slower growth of exports to the main trading partners, primarily the eurozone, mirroring the slowdown in global trade. In 2020, we project a drop in GDP of 5.5 per cent, with a significant contribution from the lower exports of goods, which account for more than 80 per cent of GDP. Slovenia is among the EBRD countries most highly integrated into global value chains, which were already heavily disrupted in the first quarter of 2020, with the disruption expected to continue. Also, around 10 per cent of GDP worth of exports go to the severely hit Italian economy. Furthermore, the domestic containment measures imposed in mid-March to fight the epidemiological crisis are expected to significantly affect private consumption, particularly spending on recreation and durables (which together account for 44 per cent of consumption spending, or almost 30 per cent of GDP). Moreover, some investment projects may be postponed amid a bearish market sentiment (economic sentiment in March was down 10 points month-on-month). Another key channel for disruption is tourism, which accounts for about 7 per cent of GDP. A fiscal package of about 10 per cent of GDP was introduced to support the economy. In addition, as a eurozone member, Slovenia stands to benefit from the ECB measures aimed at providing additional liquidity and ensuring financial stability. Slovenia started easing restrictions from late April, allowing a number of stores to reopen, with further loosening from early May. For instance, the automotive industry, is now also resuming its activity. In 2021, output is expected to grow
by 5.0 per cent, from the low base of 2020, as the economy returns to normality.

**Eastern Europe and the Caucasus**

EEC countries are likely to be severely affected by the coronavirus crisis. The initial hit came from tightening global financial markets, strong pressure on domestic foreign exchange markets and reduced foreign demand for exports. Domestic demand has been reduced due to public health measures put in place to contain the spread of the virus. Lower commodity prices are putting additional strain on the exporters of hydrocarbons and metals – Azerbaijan, Ukraine and Armenia – while an expected drop in remittances will likely further suppress household disposable income in most countries in this region, especially in Moldova, Armenia, Ukraine and Georgia. Loss of tourism receipts will be a significant blow to the Georgian economy.

**Armenia**

Economic growth in Armenia accelerated to 7.6 per cent in 2019, driven by the significant increase in the consumption of households and supported by stronger export growth. The increase in consumption was led by household credit, up by 30 per cent in 2019, and by a 10 per cent increase in money transfers from abroad. On the production side, growth was led by the manufacturing and financial sectors, closely followed by domestic trade. The resumption of operations at one of the mines helped support expansion of exports. Despite strong household demand, inflation turned negative in the first quarter of 2020. With a relatively stable exchange rate combined with deflationary pressures, and in an effort to support domestic demand, the Central Bank of Armenia lowered the refinancing rate two consecutive times to 5.0 per cent in April 2020, the lowest rate since 2010. The global uncertainty and decreasing demand resulting from the coronavirus crisis, combined with volatility in commodity prices, will affect the economy directly via a decrease in exports, which are dominated by copper and other mining products, and indirectly through economic links with Russia, including a likely downturn in remittances. Prolonged measures of social containment and low mobility would hurt Armenia’s tourism sector, which is largely dependent on visits from Armenians abroad. We project the Armenian economy to shrink by 3.5 per cent in 2020, with a rebound of 5.5 per cent in 2021.

**Azerbaijan**

Azerbaijan’s output expanded modestly in 2019, by 2.2 per cent, driven by the non-oil and gas sector which grew at the rate of 3.6 per cent. Agriculture and services also showed positive growth. Low inflation (below 3 per cent) has allowed the central bank to continue cutting the refinancing rate, to 7.25 per cent at end-January 2020. With the hydrocarbon sector generating more than a third of GDP, roughly two thirds of government revenue and 90 per cent of export receipts, the recent oil price decline will hit Azerbaijan’s economy in 2020. The State Oil fund of Azerbaijan (SOFAZ) sold nearly US$ 2 billion of foreign exchange to local banks in March amid soaring demand. The pressure on the currency weakened in April. In an effort to boost confidence in the banking sector, the authorities extended a blanket guarantee for all deposits until early December 2020. The exchange rate has remained stable to date. Large SOFAZ assets (approximately 90 per cent of GDP) will continue cushioning the economy against the external shock. However, a prolonged period of low oil prices and weak global demand could cause serious imbalances in the economy. On the back of these developments, we expect the economy to
contract by 3.0 per cent in 2020, recovering by 3.0 per cent in 2021.

Belarus

GDP growth in Belarus slowed to 1.2 per cent in 2019 due to a supply shock in the petrochemical sector caused by the contamination of oil imported through the Druzhba pipeline. The current account deficit widened from near-zero in 2018 to 1.8 per cent in 2019 on the back of declining oil derivatives exports (and a drop in the secondary income surplus), resulting in exchange rate pressures and falling international reserves. However, the government’s fiscal position remained strong in 2019 due to higher tax revenues and very conservative public spending. According to preliminary estimates, economic growth turned slightly negative in the first quarter of 2020 as manufacturing contracted by 2.3 per cent year-on-year due to the delay in reaching a new agreement for oil and gas trade with Russia, which resulted in a disruption of oil supplies to the oil refineries in Belarus at the beginning of the year. Domestic trade is falling on the back of rising uncertainties. Extensive economic ties with Russia (accounting for 41 per cent of exports, 56 per cent of imports of goods and 31 per cent of the total stock of inward foreign direct investment) make Belarus vulnerable to oil price declines and the expected recession in Russia. Meanwhile, the coronavirus pandemic will likely deepen the recession by reducing foreign and domestic demand. The output is expected to decline by 5.0 per cent in 2020 and to rebound by 3.5 per cent in 2021.

Georgia

Georgia recorded another year of robust growth in 2019. GDP expanded by 5.1 per cent, supported by another record year for the number of international visitors (7.7 million, of which 5 million were tourists staying overnight). Amid rising inflation the policy rate was increased from 6.5 per cent in July 2019 to 9 per cent by December 2019. While inflation remained elevated in the first four months of 2020, the authorities cut the policy rate by 0.5 per cent in April as the ongoing reduction in demand is expected to create downward pressure on prices. Depreciation pressures reappeared in March 2020 on the back of increased volatility in the global financial markets and an expected drop in tourism receipts. To help stabilise expectations and ensure financing of the widening external and fiscal deficits, the authorities secured additional financing from multilateral creditors. Looking ahead, the hospitality sector will be severely hit as countries contain the spread of the coronavirus and ban travel abroad. With tourism receipts normally amounting to nearly one-fifth of GDP, the negative impact will be widespread across many sectors. We expect the economy to shrink by 5.5 per cent in 2020 before recovering by 5.5 per cent in 2021.

Moldova

Economic growth in Moldova decelerated to 3.6 per cent in 2019 due to a near-standstill in the last quarter of the year. Strong investments benefiting from heightened construction activity, private consumption and robust export growth all contributed to economic expansion. However, the one-off factors behind the growth in construction levelled off toward the end of the year. Inflation was boosted by strong demand and a rise in food and regulated prices during 2019, reaching 7.5 per cent in December but falling to 5.9 per cent in March 2020. The coronavirus crisis will likely have a significant negative impact on the already decelerating economy. Weaker demand from trade partners will lower Moldovan exports, especially from the free trade zone which is well integrated into the global supply chains. This will be exacerbated by a likely drop in remittances, which will weigh on disposable incomes. Increased uncertainty,
compounded by the volatility in the financial markets, will likely lead to postponed private-sector investment projects. We expect GDP to decline by 4.0 per cent in 2020 followed by a recovery of 5.0 per cent in 2021.

Ukraine

Economic growth in Ukraine decelerated slightly to 3.2 per cent in 2019, following a disappointing fourth quarter. Consumption and construction-led investments continued to drive the economy. Exports performed well through most of the year due to exceptional performance in agriculture but slowed down markedly in the last quarter. Inflation declined to 4.1 per cent year-on-year in December 2019 and to 2.3 per cent year-on-year in March 2020, prompting the National Bank of Ukraine (NBU) to further cut its key policy rate to 8.0 per cent in April 2020, the lowest since April 2014. Buoyant activity of institutional investors helped to replenish foreign reserves to a 7-year high of more than US$ 27 billion in February 2020 and led to a 17.0 per cent appreciation of the local currency to the US dollar in 2019. However, high-frequency data for the first months of 2020 indicate that the economy was already slowing down when it was hit by the global coronavirus-induced economic shock. The rising global uncertainty caused a confidence crisis, resulting in currency depreciation and soaring cost of refinancing debt in international financial markets. A combination of reduced foreign demand and drop in domestic demand due to public health measures put in place to contain the spread of the virus took its toll on the manufacturing and services sectors. We forecast a GDP contraction of 4.5 per cent in 2020, followed by a rebound (5.0 per cent) in 2021.

Russia

The Russian economy grew by 1.3 per cent in 2019, down from 2.3 per cent in 2018. This slowdown was driven in part by the ongoing stagnation of real incomes, weighing on domestic demand. At the same time, weaker external demand negatively affected net exports, while tight fiscal policy in the face of international sanctions constrained public and private investment.

A government reshuffle in January 2020 provided a clear signal of intentions to adopt a more pro-growth stance and relax the tight policies of recent years. Key actions were the announcement of a 2.1 trillion roubles social spending package to support real incomes, and the pledge to access 1 trillion roubles from the National Wealth Fund to push the 12 National Projects, a US$ 400 billion investment aimed at modernising and revitalizing Russian society, implementation of which had been behind schedule. These activities will take place within the constraints of the budget rule, which mandates the sterilization and transfer of oil revenues in excess of a US$ 42 per barrel threshold to the National Wealth Fund.

The question is what will happen to policy in the face of twin shocks: the coronavirus pandemic which has hit global demand, and the collapse of the OPEC+ agreement to limit oil production, which together caused oil prices to fall substantially and resulted in a sharp slowdown in activity. A subsequent renegotiation between the partners of the OPEC+ agreement has failed to cut production sufficiently to support oil prices. The fall in the oil price caused a significant depreciation in the rouble, but the CBR has continued its rate cutting cycle, assessing the inflationary impact of the depreciation to be outweighed by the deflationary impact of the coronavirus-related slowdown in activity.

Despite the diversification seen in recent years, the Russian economy remains dependent on oil for budget revenues and exports, so the fall in oil prices is significant, particularly in light of the fiscal stimulus needed to offset the impact of the pandemic. Although the National Welfare Fund has
enough funds to finance several years of budget deficits, and international reserves stand at US$ 570 billion, enough to fully cover public and external debt, this financial security has been hard won and will be closely guarded.

Taking all factors into account, the economy is expected to shrink by 4.5 per cent in 2020, followed by a rebound of 4.0 per cent in 2021. This forecast is subject to significant upside and downside risks, depending primarily on the path of oil prices and the extent and duration of social distancing measures.

**South Eastern European Union**

*This region is likely to be severely affected by the coronavirus crisis. A key channel for disruption is tourism, which is a mainstay of the Cypriot and Greek economies but is also important for Bulgaria. Supply chains in the region are also being affected by the virus containment measures and border closures. Fiscal packages may help to alleviate some of the impact of the crisis, although governments of all countries, apart from Bulgaria, face limited fiscal space; but recessions in 2020 seem inevitable, with some recovery expected in 2021.*

**Bulgaria**

In 2019, Bulgaria recorded a solid growth of 3.4 per cent, driven mainly by private consumption, fuelled by increased earnings and a higher employment rate amid the tightening labour market, with an unemployment rate of around 4 per cent. In 2020, however, economic output is expected to decline by 5.0 per cent, mainly due to a sharp decrease in economic activity in March and during the second quarter due to the domestic containment measures pursued by the authorities to fight the coronavirus pandemic. Bulgaria declared a state of emergency on 13 March, imposing tough restrictions on travel and economic activity including closing schools, restaurants, bars and non-essential shops. A significant drop in consumption of services and durable goods is expected, affecting SMEs in particular. Demand-side effects are likely to be large, given that retail trade and other directly affected services account for almost 25 per cent of GDP. Other key transmission channels include a slowdown in exports of goods, given the lower demand globally, and postponed investments amid increased uncertainty and bearish market sentiment. In addition, the country's tourism sector will be strongly hit (tourist spending accounts for about 10 per cent of GDP). The mitigating factor will come from the increased government spending in the form of a fiscal crisis response package of about 3 per cent of GDP announced so far. The budget, re-drafted in light of the new circumstances, envisions a deficit of 2.9 per cent of GDP, compared to a previously planned balanced budget. After four consecutive years of budget surpluses, and with public debt at 21 per cent of GDP, Bulgaria is among the least indebted countries in the EU. Also, the Bulgarian National Bank has reacted promptly providing liquidity to the banking sector. The country’s entry to the ERM2 is now scheduled for July 2020, although a further delay could not be ruled out. Under the baseline scenario, a recovery is expected in 2021, with GDP growth of 4.0 per cent.

**Cyprus**

In 2019, GDP growth in Cyprus decelerated moderately but remained robust at 3.2 per cent. Investment, particularly in the construction sector, was one of the main drivers of growth. Private consumption also remained resilient throughout the year given the strong economic sentiment and improving market conditions. Unemployment stood at 6 per cent in January 2020, seven percentage points below the 2014 peak. Despite the robust recovery observed over several years, Cyprus is going to be heavily hit by the consequences of the coronavirus
pandemic. The closure of the borders and the measures to reduce contagion have brought construction and tourist arrivals to a halt. Given the country’s exposure to travel and tourism (around 14 per cent of GDP) and the traditional role of investment and financial services in supporting growth, the impact of the coronavirus crisis is expected to last for some time. The extent of the recession in 2020 will thus be highly dependent on the duration of restrictions on movement of people in the UK and Russia, which together account for about half of annual tourist arrivals. It will also be dependent on the capacity of the government to implement financial support measures. In March 2020, the government announced a financial support package €700 million. In the baseline scenario, we expect GDP to fall by 6.0 per cent in 2020, with a rebound of 5.0 per cent in 2021.

Greece

Economic indicators in Greece continued to improve in 2019, with the growth rate of 1.9 per cent, the same as in 2018. The main drivers of growth remain exports of goods, private consumption and another successful tourism season. Economic sentiment reached a 12-year high in 2019. Capital controls, introduced in 2015, were fully lifted in September 2019, and the country has been boosted by ratings upgrades from the main ratings agencies and several successful bond issuances. The coronavirus pandemic has abruptly interrupted the steady recovery of the Greek economy. The halt of virtually all travel across Europe and beyond will heavily hit the travel and tourism sector, which represents more than a fifth of GDP. The implementation of confinement measures will also reduce the level of consumption and weigh particularly heavily on small and medium size companies. The extent of the recession in 2020 will thus depend on the duration of the pandemic and associated travel restrictions across the world, as well as on the fiscal measures taken to support businesses and consumption both at the Greek and EU levels. The Greek government has so far approved a discretionary fiscal stimulus programme of €15 billion (8.9 per cent of GDP) to support businesses and employees, alongside targeted tax holidays and deferment of loan payments via the banks. We expect GDP to contract by 6.0 per cent in 2020, with a rebound of 6.0 per cent in 2021, but downside risks to this scenario are significant.

Romania

The Romanian economy continued growing at a robust rate in 2019, at 4.1 per cent, driven by a strong expansion of private consumption on the back of pro-cyclical fiscal policy, including public salary and pension hikes. As a result, the fiscal deficit increased, reaching 4.6 per cent of GDP in 2019, but general government debt remained moderate, at 35 per cent of GDP as of end-2019. In 2020, we forecast a contraction of 4.0 per cent, assuming the epidemic significantly slowing down from the second quarter, with all containment measures removed. The domestic lockdown (a state of emergency was introduced in mid-March) is reducing private consumption of services involving face-to-face contact and durable goods, which together account for around 30 per cent of total spending (for instance, new passenger car registrations fell by 32 per cent year-on-year in March). This impact may be somewhat compensated by an increase in food spending, which accounts for 25 per cent of total spending, the largest share in the EU. Investment has been falling amid uncertainty and bearish market sentiment, while liquidity pressure and disruption of supply chains may interrupt ongoing investment projects. Although Romania is less dependent on international trade compared with its regional EU peers, goods exports (which account for about 33 per cent of GDP) have been hit, not least because of the significant exposure to the strongly affected Italian economy (goods exports to
Italy account for about 10 per cent of total goods exports). Moreover, Italy is also an important source of remittances for Romania, accounting for about one third of the country’s remittance inflows. The fiscal stimulus package deployed, of about 3 per cent of GDP aims to inject additional liquidity and preserve jobs. Further support may, however, be limited in the context of the fiscal position, with a target deficit of 6.7 per cent of GDP in 2020 in the revised budget. Romania’s sovereign rating outlook has been downgraded to negative by the main rating agencies. As part of crisis response, the National Bank of Romania (NBR) eased monetary policy and started buying public debt. In 2021, the private sector is expected to bounce back and drive the recovery, with a growth rate of 4.0 per cent.

Southern and Eastern Mediterranean

The coronavirus crisis is expected to impact economic activity in the SEMED region through several channels, including tourism (a major driver of growth in all countries in 2019), a decline in domestic demand due to containment measures, and consequently a drop in domestic investment, a decline in demand from the main trading partners and a slowdown in foreign direct investment inflows. Growth is expected to fall to -0.8 per cent in 2020 before rebounding to 4.8 per cent in 2021, supported by a recovery in global economic activity and domestic demand, lower imports in light of the slowdown in global trade, the implementation of business environment reforms and lower political uncertainty.

Egypt

Growth in Egypt has continued to accelerate in the first half of fiscal year (FY) 2019-20, matching the rate achieved in FY2018-19, of 5.6 per cent, driven by retail, industry and agriculture, in addition to oil refining, communications, construction and tourism. Measures to contain the spread of the coronavirus will lead to a slowing of growth in the last quarter of the fiscal year ending June 2020 and the first half of the next fiscal year. We project GDP growth of 2.5 per cent in FY2019-20 and 3.0 per cent in FY2020-21, due mainly to the weak outlook in the tourism sector, disruptions in global value chains, weaker demand from trading partners, and the slowdown in foreign direct investment. However, large public construction projects and the boom in the telecommunications sector have so far sustained growth. On the calendar year basis, growth will drop to 0.5 per cent in 2020, before rebounding to 5.2 per cent in 2021. The main risks to the outlook arise from the need for a tougher lockdown should the spread of Covid-19 accelerate and from the negative outlook in Egypt’s main trading partners.

Jordan

The rate of growth in Jordan remained subdued in 2019 at 2.0 per cent, even as tourist arrivals increased for the third consecutive year. The economic fallout from the coronavirus containment measures is expected to push GDP growth in 2020 into the negative territory (–2.5 per cent), due mainly to the contraction in tourism and cross-border trade. Growth is expected to pick up again in 2021, to 3.0 per cent, sustained by the lower cost of imported energy, increased finance provided to SMEs under various schemes from the Central Bank of Jordan, and reforms anchored in the new IMF-supported programme. The projections take into account the recent announcement of gradual lifting of social distancing measures. Risks to the outlook include an erosion of real competitiveness stemming from the strengthening of the dinar (in light of the peg to the US dollar), with stronger pressure on the overvalued exchange rate should capital inflows fall short of expectations. Regional instability, and a possibility of slower-than-expected recovery
of partner economies also pose risks to the outlook.

Lebanon

Lebanon’s economy is estimated to have fallen into recession in 2018 and 2019 (contracting by 1.9 per cent and 6.0 per cent, respectively). The GDP contraction reflected regional and domestic political uncertainties culminating in domestic social unrest, the slow implementation of reforms and the resulting wait-and-see approach of international partners after the CEDRE conference in April 2018. The slowdown in private investment and consumption as a result of lower capital inflows and the contraction in trade and construction contributed to the weakness in economic activity. Taking into account the default on debt repayments in March 2020 and the ongoing economic crisis, exacerbated by the coronavirus pandemic and the associated containment measures, a further contraction of 11.0 per cent is expected in 2020. The deceleration will be driven by a sharp decline in tourism, measures to contain the spread of Covid-19, as well as a likely poor harvest, recession in Europe because of the coronavirus crisis, and lower commodity prices. On the other hand, expansion in mining could support growth, as the decline in China’s production of phosphate may benefit Morocco, the world’s second largest producer of phosphate. Downside risks include rising social discontent, slower-than-expected recovery in the main trading partners in Europe, and the continued vulnerability of agricultural production to adverse weather and fluctuations in agricultural commodity prices.

Morocco

The economy in Morocco slowed down in 2019, with the rate of growth declining to 2.2 per cent, held back by the 4.1 per cent contraction in the agricultural sector due to poor rainfall. In contrast, strong growth was recorded in non-agricultural activities, mainly services, manufacturing, water and electricity, and trade. GDP is expected to contract by 2.0 per cent in 2020, before rebounding to 4.0 per cent growth in 2021. The deceleration will be driven by a sharp decline in tourism, measures to contain the spread of Covid-19, as well as a likely poor harvest, recession in Europe because of the coronavirus crisis, and lower commodity prices. On the other hand, expansion in mining could support growth, as the decline in China’s production of phosphate may benefit Morocco, the world’s second largest producer of phosphate. Downside risks include rising social discontent, slower-than-expected recovery in the main trading partners in Europe, and the continued vulnerability of agricultural production to adverse weather and fluctuations in agricultural commodity prices.

Tunisia

Economic growth in Tunisia decelerated to 1.0 per cent in 2019, the weakest since the recession in 2011, driven by a fall in olive oil output, the contraction in manufacturing industries as a result of weak local and external demand, a sharp fall in oil and gas output, and the contraction in the transport sector, partly because of a reduction in trade volumes. At the same time, the economy benefitted from the large cereal harvest, the modest rise in phosphate production, and expansions in tourism, financial services and telecommunications. Growth is projected to be negative, at –2.5 per cent, in 2020 before picking up to 2.5 per cent in 2021. The economy will be held back this year by the implications of the coronavirus containment measures, both domestic and those applied in Tunisia’s main trading partners in Europe. Supply chains for the textile and clothing and car-parts industries may be affected. The weak outlook in the tourism and transportation sectors, is compounded by an expected contraction in agriculture (after poor rainfall in January and February), and a decline in global foreign direct investment flows. On the other hand,
lower global oil prices and reforms anchored within a new IMF-supported programme are expected to support the economy.

Turkey

The Turkish economy grew by 0.9 per cent in 2019, as significant policy loosening and credit growth drove a consumption-led recovery from the recession of 2018. Relative macroeconomic stability was achieved over the course of 2019. Inflation has come down to the lower double digits, allowing policy rates to be slashed from 24 per cent to 8.75 per cent in the past nine months. At the same time, the current account moved into surplus in late-2019 before returning to deficit more recently due to stimulus-driven domestic demand growth.

While leading indicators suggest the recovery was sustained in the first months of 2020, domestic and external demand will be hard hit by the pandemic. The significant decline in tourism revenues and weaker export demand will put more pressure on the external balance, although if sustained, the lower oil price will provide limited support given Turkey’s dependence on imported energy. Likewise, the lower oil price, alongside the sharp slowdown in domestic activity, will help offset the inflationary impact of the weakening lira.

Until recently, Turkish financial markets had been remarkably stable, particularly given the low and now-negative real policy rates, and ongoing concerns about the sufficiency and quality of foreign exchange reserves held by the Central Bank relative to the economy’s external liabilities. This period of calm reflected the supportive global policy stance, but can also be attributed to extensive interventions by the authorities. However, coronavirus concerns have resulted in financing costs and risk premia rising in Turkey, as in other emerging markets, and have caused a recent sell-off of Turkish assets.

With the non-performing loan ratio standing at a 10-year high of 5.3 per cent, the weakness of the lira and contractions in tourism, retail and export sectors are likely to put further stress on the already strained asset quality of banks, particularly in light of the large foreign-exchange-denominated debt overhang in the corporate sector. Meanwhile, government efforts to spur bank lending may lead to further asset quality deterioration down the road.

Growth is likely to be heavily impacted by the coronavirus pandemic in 2020. We expect GDP to contract by 3.5 per cent in 2020, followed by a robust recovery to 6.0 per cent growth in 2021. There are significant risks surrounding this forecast, which is heavily dependent on the duration and extent of the social distancing measures.

Western Balkans

Western Balkans countries will be affected by the coronavirus crisis through different channels. Service sectors, especially SMEs, will feel the effect of lock-down measures through lost revenues in all countries, albeit to a varied extent. Bosnia and Herzegovina, North Macedonia and Serbia, all of which have strong manufacturing bases, may be mostly hit through the disruption of global supply chains. Albania and Montenegro, with their strong reliance on tourism, will be negatively affected by limitations of movement of people, while in Kosovo, (and to some extent in other Western Balkans countries), lower remittances will reduce domestic demand.

Albania

The economy of Albania expanded by 2.2 per cent in 2019, down from 4.1 per cent in 2018. The slowdown came mainly as a consequence of weaker power generation,
combined with the high base effect from the previous year, but also as a consequence of a decline in construction output, visible especially in the last quarter. On the other hand, services, especially tourism, remained an important contributor to growth. On the expenditure side, investment recorded a mild decline year-on-year in the first three quarters, which deepened to 12 per cent year-on-year in the fourth quarter due to the November 2019 earthquake. Amid continued low inflation, in March 2020 the central bank cut the key policy rate to a record low of 0.5 per cent (from 1.0 per cent) to help alleviate the impact of the coronavirus crisis. Nevertheless, the economy is likely to be strongly affected by the epidemic due to its high reliance on tourism and exports of low-value-added intermediate goods to Italy’s fashion industry. A likely reduction in remittances will also act as a drag on growth. The economy is expected to contract by 9.0 per cent in 2020 but rebound by 12.0 per cent in 2021 on the assumption that virus containments measures are short-lived, with recovery from the earthquake providing a further boost to the economy.

**Bosnia and Herzegovina**

Growth in Bosnia and Herzegovina decelerated to 2.6 per cent in 2019, from 3.7 per cent in 2018, primarily due to a (mild) decline in industrial and agricultural output. On the expenditure side, the economy saw a fall in exports, especially those of base metals and mineral products. At the same time, private consumption growth picked up to 2.4 per cent year-on-year, around one percentage point above the rate seen in the previous two years. GDP is expected to decline by 4.5 per cent in 2020 and rebound by 6.0 per cent in 2021. A likely drop in remittances (which usually amount to 11 per cent of GDP) will negatively affect consumption, while the closure of borders and factories will constrain exports to and imports of production inputs from the main trading partners, notably in the eurozone. Sectors that might be most strongly hit by the virus outbreak include manufacturing (especially, textiles, footwear and furniture industries, as most of them rely on contracts with Italian companies), transport, accommodation and food services, and construction.

**Kosovo**

Relatively strong economic growth in Kosovo continued in 2019, with GDP expanding by 4.2 per cent, up from 3.8 per cent in 2018. Growth was driven by domestic demand, with investment and private consumption contributing equally. However, Kosovo has the highest unemployment rate in the region, with one in four working-age persons and one in two young persons unemployed. The effects of the measures aimed at containing the pandemic, and a likely decline in remittances in particular, are expected to result in a decline in GDP of 5.0 per cent in 2020, with a rebound of 7.5 per cent in 2021.

**Montenegro**

GDP growth slowed to 3.5 per cent in 2019, from 5.1 per cent in 2018. The deceleration was primarily due to large investment projects approaching completion (the Bar-Boljare highway) or being completed (power link to Italy). Last year was also marked by a fall in industrial production, on the back of declines in electricity production and manufacturing sector output. On the other hand, the tourism sector has continued to perform well and the 2019 season was the strongest on record. Looking ahead, however, the economy is likely to suffer severely from the coronavirus outbreak, because of the expected impact on the tourist season, as tourists from the main origin countries may not be able to travel (around 80 per cent of tourist stays are normally between June and September). In early May 2020, S&P revised the outlook on the sovereign rating from stable to negative, keeping the rating
unchanged. Under the assumption that half of the 2020 tourism season is affected, we expect GDP to fall by 8.0 per cent in 2020, recovering strongly, by 10.5 per cent, in 2021.

**North Macedonia**

Growth in North Macedonia accelerated to 3.6 per cent in 2019, from 2.7 per cent in 2018, driven by domestic demand, primarily the recovery of investment. The resolution of the name issue with Greece helped to strengthen investor confidence, as reflected in the June 2019 upgrade of the country's sovereign rating to BB+ by Fitch, a rating agency. Amid low inflation (averaging 0.8 per cent in 2019), the central bank lowered the policy rate by 0.25 percentage points in January 2020, to 2.0 per cent, and followed up with another 25 basis point cut in March 2020, with the view to mitigate the adverse effect of the coronavirus containment measures on the domestic economy. Vulnerabilities to the epidemic in North Macedonia are moderate and, under the assumption of social distancing receding, GDP is projected to fall by 3.5 per cent in 2020, rebounding by 5.5 per cent in 2021.

**Serbia**

GDP grew by 4.2 per cent in 2019, a minor slowdown compared with 2018 (4.4 per cent), despite poor industrial performance in the first half of the year. Economic activity picked up in the second half of 2019, boosted by industrial output returning to growth and strong construction activity, supported by the building of the TurkStream gas pipeline. Strong fiscal performance continued: the 2019 budget recorded a small deficit (0.2 per cent of GDP), while public debt stood at 53 per cent of GDP at the end of 2019, significantly below the level of just a few years ago. Inflationary pressures remain subdued and, after three cuts of 25 basis points each in 2019, the central bank lowered the key policy rate by another 75 basis points in total in March and April 2020, to 1.5 per cent. The latest cuts sought to mitigate the economic effects of the pandemic. The Covid-19 crisis also prompted S&P to revise the outlook on Serbia's long-term credit rating from positive to stable in early May 2020, but without changing the rating. In recent years, Serbia has increased its integration into global supply chains, mainly with the eurozone countries. The epidemic has disrupted international trade and forced several large manufacturers in Serbia to close temporarily. In light of the Covid-19 crisis, GDP is expected to fall by 3.5 per cent in 2020, recovering in 2021 by 6.0 per cent.
About this report

The Regional Economic Prospects are published twice a year. The report is prepared by the Office of the Chief Economist and the Department of Economics, Policy and Governance and contains a summary of regional economic developments and outlook, alongside the EBRD’s growth forecasts for the economies where it invests.

For more comprehensive coverage of economic policies and structural changes, see the EBRD’s country strategies and updates, as well as the Transition Report 2019-20, which are all available on the Bank’s website at www.ebrd.com.

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