



ARMENIA

Highlights

- **Economic growth has regained momentum.** GDP growth accelerated to an estimated 5.9 per cent year-on-year in the first half of 2017, supported by strong export performance and a recovery in money transfers which followed three years of contraction.
- **Fiscal consolidation is under way.** The higher-than-planned budget deficit in 2016 led to budget consolidation required by the fiscal rule, and the deficit is planned to fall to under 3 per cent of GDP in 2017. At the same time, tax revenue over-performance in the first half of 2017 has created space for additional capital spending.
- **Banking sector capital buffers have improved.** Higher minimum capital requirements for the banking sector became effective in January 2017. This led to the injection of additional capital into the banking system and to a reduction in the number of banks.

Key priorities for 2018

- **Policies should be aimed at creating more fiscal space for tackling social and infrastructural challenges.** Further reforms in tax and customs administration should focus on mobilisation of revenues in a fair and equitable manner, and the fiscal rule needs to be updated to allow counter-cyclical response to exogenous economic shocks.
- **A new framework for public-private partnerships (PPPs) needs to be developed and adopted.** A framework of universal PPP legislation would help in attracting a greater number of PPP projects and managing contingent liabilities that might arise from such projects. A robust PPP framework would require, among other things, sound planning and project selection, strong budgeting, accounting and reporting practices and adequate fiscal risk analysis on a project level.
- **The operational environment in the banking sector requires further improvement.** In the wake of the recent successful recapitalisation, the banking system's ability to raise overall profitability and generate higher returns on equity has been limited. Supervision should remain vigilant to avoid a deterioration in underwriting standards.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	3.3	3.6	3.2	0.2	3.5
Inflation (average)	5.8	3.0	3.7	-1.4	1.9
Government balance/GDP	-1.6	-1.9	-4.8	-5.6	-3.3
Current account balance/GDP	-7.3	-7.6	-2.6	-2.3	-3.6
Net FDI/GDP [neg. sign = inflows]	-2.9	-3.3	-1.5	-2.6	-3.6
External debt/GDP	78.5	73.6	84.5	94.1	n.a.
Gross reserves/GDP	20.2	12.8	16.8	20.8	n.a.
Credit to private sector/GDP	39.5	45.3	42.0	48.0	n.a.

Macroeconomic performance

Growth came almost to a standstill in 2016 but rebounded strongly in the first half of 2017.

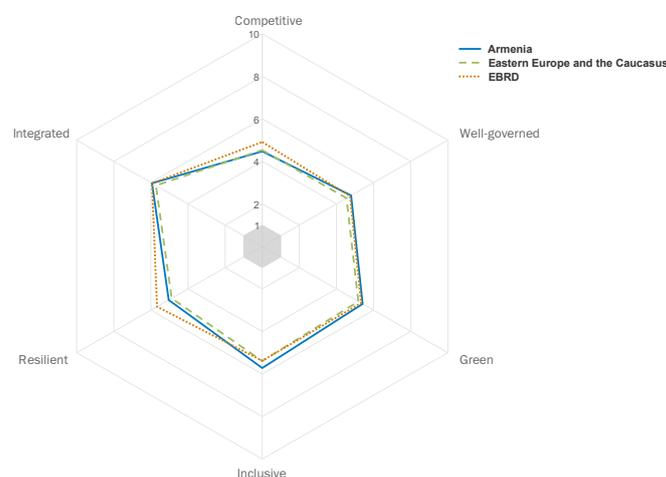
GDP growth slowed from 3.2 per cent in 2015 to 0.2 per cent in 2016, the lowest rate since 2009. This was driven by a decline in two major sectors of the economy: construction and agriculture. Construction output shrank by 10.8 per cent in real terms and agriculture contracted by 5.8 per cent in real terms. The decline in household consumption and capital investment was offset by a 19.1 per cent increase in the volume of exports. GDP expanded by 6.5 per cent year-on-year in the first quarter of 2017 and by a further 5.5 per cent year-on-year in the second quarter. In 2016, negative inflation of 1.4 per cent reflected weak domestic demand and low import prices. In reaction to slowing growth, deflation and a stabilising exchange rate, the Central Bank of Armenia (CBA) gradually lowered the refinancing rate from 10.5 per cent in August 2015 to 6.0 per cent in February 2017. An upturn in remittances in the first half of 2017 provided a stimulus to household consumption. As a result, consumer price inflation slowly increased to 0.6 per cent year-on-year in the first nine months of 2017.

External adjustment helped to maintain a stable exchange rate. The current account deficit shrank from 7.6 per cent of GDP in 2014 to 2.3 per cent in 2016 on the back of import compression and strong exports receipts driven by the recovery in copper prices and the diversification of Armenia's exports to new markets. Favourable net foreign exchange inflows have contributed to the stability of the dram-US dollar exchange rate from the beginning of 2015. Money transfers to Armenia increased by 17.5 per cent year-on-year in the first eight months of 2017 following a contraction of close to 30 per cent in 2015-16. Gross international reserves recovered from US\$ 1.26 billion in February 2015 to US\$ 2.1 billion in September 2017, providing five months of import coverage.

Fiscal consolidation aims to rein in public debt. In 2016, the budget deficit widened to 5.6 per cent of GDP, beyond the initially planned 3.5 per cent. The public debt-to-GDP ratio increased to approximately 57.0 per cent at the end of 2016, triggering the deficit adjustment required by the fiscal rule. To satisfy this requirement, the authorities plan to reduce the budget deficit to around 3.0 per cent of GDP in 2017, mainly through lower capital spending, although more recently tax revenue over-performance has created room for additional spending on infrastructure. Budget revenues increased by 6.3 per cent year-on-year in the first nine months of 2017.

The growth outlook is supported by the ongoing regional recovery. Economic recovery in the main trading partners is expected to have positive spillovers into Armenia's economy, which is projected to grow by 3.5 per cent in 2017 and 3.5 per cent in 2018, but the economy remains exposed to several risks, including volatility in the commodity markets.

Assessment of transition qualities (1-10)



Major structural reform developments

Armenia has successfully completed the IMF programme. The completion of the final review in June 2017 enabled the release of a US\$ 22 million tranche, bringing the total disbursement under the programme to approximately US\$ 112 million. The IMF assessed the programme performance as satisfactory. During the programme, the authorities enacted a financial recovery plan for the energy sector, adopted a new tax code in October 2016 and initiated improvements to the fiscal framework. Some efforts were made to develop legislative changes aimed at promoting domestic competition, improving bankruptcy procedures, and developing capital markets.

The fiscal framework is undergoing improvements. The authorities took steps to optimise planning of investment projects funded by international donor organisations. Prioritisation of these projects was carried out to ensure that loan absorption dynamics are consistent with the deficit and public debt reduction targets. The authorities initiated a revision of the fiscal rule to take into account implementation characteristics of donor-financed projects, mitigate the pro-cyclical bias and allow for more flexibility in periods of external shocks. The revised rule is expected to be submitted to the parliament by the end of 2017.

Recapitalisation of the banks was completed in an orderly fashion. The banking sector's capital buffers improved following the increase in minimum capital requirements (up from approximately US\$ 10 million to US\$ 60 million) which came into force in January 2017. New capital requirements led to consolidation in the banking sector, with the number of banks dropping from 21 to 17 in 2016. Progress has been made in developing a legal framework for capital markets. In October 2016, the parliament adopted laws on implementation of International Swaps and Derivatives Association (ISDA) Master Agreements, which will support the development of derivatives and hedging markets.

Measures to improve the business environment and attract investors continued. Efforts have been under way to streamline tax and customs administration, including via organisational changes. The time required for exporters to receive tax refunds has been shortened. In January 2017, the Center for Strategic Initiatives (CSI) was established to help attract foreign investments, promote PPPs, communicate key reforms and serve as a platform for cooperation between the private sector and the government. The board of trustees of the CSI involves high-level representatives of private and public sectors. Armenia ranks 47th out of 190 economies in the World Bank's *Doing Business 2018* report. Lower scores in dealing with construction permits, getting electricity, paying taxes and resolving insolvency contrast to higher scores in other areas.

The authorities have introduced a Government Reform Programme for 2017-22. Adopted in June 2017, the programme contains a list of reforms in the areas of public governance and legal system, foreign policy and defence, economic progress and social issues. Planned reforms are accompanied by implementation timelines.

Negotiations on the Comprehensive and Enhanced Partnership Agreement (CEPA) with the European Union (EU) have advanced. The negotiations were finalised on 26 February 2017, and the text of the agreement was signed off in March 2017. The CEPA will create a framework for closer political and economic cooperation between Armenia and the European Union.



AZERBAIJAN

Highlights

- **The economy is in recession but the pace of decline has slowed.** GDP declined by 3.1 per cent in 2016 but by just 0.6 per cent year-on-year in the first nine months of 2017. The modest recovery in oil prices and adjustment of macroeconomic policies are helping to stabilise the economy.
- **The International Bank of Azerbaijan (IBA) completed a voluntary debt restructuring.** This is part of the bank's broader restructuring plan that aims to clean up the balance sheet and prepare the bank for eventual privatisation.
- **The Commission on Transparency in Extractive Industries has been established and is operational.** Following Azerbaijan's withdrawal from the Extractive Industries Transparency Initiative (EITI), the authorities have pledged to continue to uphold the principles of revenue transparency and accountability.

Key priorities for 2018

- **Macroeconomic stability needs to be reinforced to improve business confidence.** Policies should be geared towards bringing down inflation while maintaining flexibility of the exchange rate and preserving the fiscal consolidation gains achieved in 2016.
- **IBA privatisation is a crucial priority.** The declared plan to privatise the IBA needs to be implemented on completion of the bank's restructuring process. This will help both to ensure the sustainability of the IBA's operations and to eschew contingent fiscal costs in the future.
- **Reform roadmaps should be implemented vigorously.** Key priorities in the short term include tax administration reforms to enhance predictability, fairness and taxpayer compliance, and decisive steps to tackle informality in the economy.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	5.8	2.8	1.1	-3.1	-0.5
Inflation (average)	2.4	1.4	4.0	12.4	12.0
Government balance ¹ /GDP	1.7	2.7	-4.8	-1.1	-0.3
Current account balance/GDP	16.6	13.9	-0.4	-3.6	1.9
Net FDI/GDP [neg. sign = inflows]	-1.5	-2.9	-1.5	-5.1	-5.7
External debt ² /GDP	11.7	14.5	18.5	20.4	n.a.
Gross reserves ³ /GDP	19.1	18.3	9.5	10.5	n.a.
Credit to private sector/GDP	26.5	31.4	40.0	27.2	n.a.

¹ Includes central government and main extrabudgetary funds, including operations of the oil fund and the social protection fund. Figure for 2016 is a projection.

² Public and publicly guaranteed external debt outstanding.

³ Excluding assets of the State Oil Fund (SOFAZ).

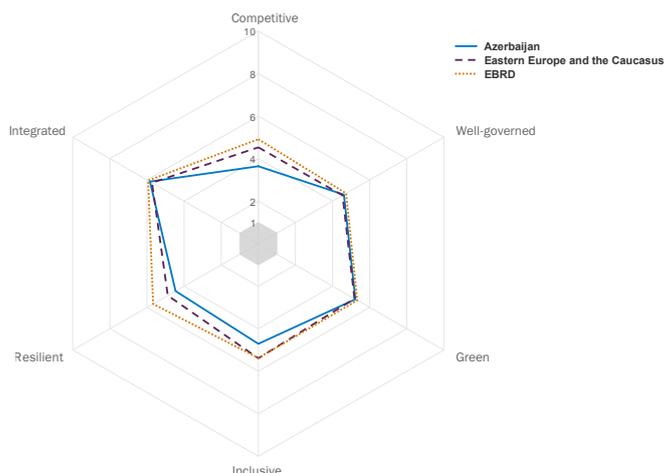
Macroeconomic performance

The economic recession is looking less severe. GDP declined by 3.1 per cent in 2016, but the pace of contraction decelerated to 0.6 per cent year-on-year in the first nine months of 2017. Non-oil GDP grew by 2.5 per cent in the first nine months of 2017 following a 4.5 per cent contraction in 2016. Last year's recession was accompanied by a major 21.7 per cent drop in capital investment, but the decline in investment has since levelled off during 2017. Macroeconomic policies have remained relatively tight to curb inflation, defuse foreign exchange pressures and safeguard liquidity buffers. However, inflation has picked up to 13.9 per cent year-on-year in the first nine months of 2017, reflecting the delayed pass-through effect of the manat devaluation in 2015-16.

Macroeconomic balances have improved. The manat devaluation in 2015-16 paved the way for increasing the competitiveness of non-oil exports and for the containment of imports, but external adjustment has been slow. In the first half of 2017, Azerbaijan's current account receipts from the oil and gas sector grew by approximately 8.0 per cent year-on-year in US dollar terms, enabled by the recovery in the oil price. As a result, Azerbaijan's overall current account moved from a deficit of 3.6 per cent of GDP in 2016 to a small surplus in the first half of 2017, but the non-oil current account balance remained negative. After a brief period of volatility at the beginning of 2017, the manat-US dollar exchange rate has stabilised amid stringent monetary conditions and a recovery in the oil price. Meanwhile, the consolidated fiscal deficit declined closer to 1 per cent of GDP in 2016 after reaching approximately 5 per cent of GDP in 2015, with the improvement driven by conservative budget planning and downsizing of public investment spending. Azerbaijan has maintained sizeable liquidity buffers despite pressures arising from the low oil price environment. As of mid-2017, the combined assets of the State Oil Fund of Azerbaijan (SOFAZ) and of the foreign exchange reserves of the central bank were US\$ 41 billion, which is approximately equivalent to the country's GDP.

GDP growth should rebound in 2018. A slight GDP downturn of 0.5 per cent is likely in 2017 as a whole as tight monetary and fiscal policies, necessary to safeguard macroeconomic stability and preserve liquidity buffers, weigh on the near-term growth outlook. However, the completion of landmark gas infrastructure projects (Shah Deniz stage 2, Southern Gas Corridor) is expected to provide impetus to growth from 2018 onwards, with GDP projected to rise by 2.0 per cent next year. Downside risks remain significant, associated mainly with the dependence on the resources sector and banking sector challenges.

Assessment of transition qualities (1-10)



Major structural reform developments

A series of reform roadmaps have been adopted. In December 2016, the President of Azerbaijan endorsed a set of strategic roadmaps for reforms in the key sectors of the economy, such as the oil and gas industry, agriculture, small and medium-sized enterprises, tourism, logistics and financial services among others. These roadmaps detail a short-, medium- and long-term horizon for each sector and provide action plans for 2016-20. A Center for Economic Reforms Analysis and Communication was established to promote the realisation of economic reforms and work on public outreach. However, the capacity to implement the reform roadmaps without delays remains uncertain.

Administrative requirements for doing business have been simplified. Following the streamlining of procedures for issuing licences and permits in 2016, ASAN (Azerbaijan Service and Assessment Network) introduced an e-visa portal in January 2017 which simplifies and substantially shortens the time period for issuing visas to foreigners, including business travellers. A moratorium on some of the inspections, which has been extended until January 2021, reduces the regulatory burden on businesses. A Board of Appeals introduced within ministries and under the presidential administration during the course of 2016 aims to create a dispute resolution mechanism for addressing private sector complaints, but its effectiveness remains largely untested. Improvements in customs administration as well as in other areas of government regulation have paved the way for more transparent and accurate financial reporting by companies operating in Azerbaijan. Azerbaijan ranks 57th out of 190 countries in the World Bank's *Doing Business 2018* report. Recent improvements relate to getting credit, protecting minority investors, enforcing contracts and resolving insolvency although the scores remain low in dealing with construction permits, getting electricity, getting credit and trading across borders.

The banking sector clean-up and consolidation is under way. The manat devaluation in 2015-16 negatively affected dollarised balance sheets in the banking sector, exposing capital shortfalls. Between its establishment in February 2016 and June 2017, the Financial Markets Supervisory Authority (FiMSA) closed 11 banks which failed to comply with regulatory capital requirements. Non-performing loans remain elevated, mainly reflecting foreign exchange-induced credit risks and the economic recession. Credit activity has shrunk in 2016 and in the first eight months of 2017 due to the turbulence in the banking system and the lack of credit demand from the real sector.

The authorities have initiated restructuring of the IBA. Following significant capital injections into the majority state-owned IBA in 2016-17 and transfer of some of its bad assets to a separate entity, the authorities launched a liability management operation to further de-risk and downsize the IBA's balance sheet. The IBA is the largest bank in Azerbaijan and accounted for approximately one-third of total banking assets before the debt operation. In May 2017, the IBA announced a voluntary restructuring of foreign exchange liabilities amounting to US\$ 3.3 billion, offering creditors to swap the IBA's debt for new sovereign bonds and limited new IBA debt. The debt restructuring was concluded in September 2017. As part of the broader bank restructuring effort, the IBA aims to dispose of non-core foreign assets and take further steps to clean-up the balance sheet ahead of the declared plan to privatise the bank in 2018.

Establishment of the Commission on Transparency in Extractive Industries followed Azerbaijan's withdrawal from the EITI. Azerbaijan joined the EITI in 2004 at the outset of the initiative and was the first country to be validated as fully compliant with EITI standards in 2009. In March 2017, the EITI suspended Azerbaijan's membership over concerns about the enabling environment for civil society. In response, Azerbaijan decided to withdraw from the EITI. The authorities stressed that Azerbaijan would remain committed to the principles of good governance, revenue transparency and accountability in the extractive sectors. In April 2017, the President of Azerbaijan signed a decree establishing a Commission on Transparency in Extractive Industries. The Commission has become operational under the chairmanship of the executive director of SOFAZ.



BELARUS

Highlights

- **GDP is growing again in 2017.** The economy shrank by 2.6 per cent in 2016 but in the first nine months of 2017 GDP grew by 1.7 per cent year-on-year, driven mainly by a recovery in external demand and the resulting growth in export-oriented manufacturing.
- **Macroeconomic stabilisation policies are bearing fruit.** So far in 2017, the exchange rate is stable and inflation is at its lowest level, reflecting a prudent fiscal and monetary policy stance as well as weak domestic demand. Transition to fully fledged inflation targeting has advanced.
- **The authorities prepared a comprehensive package of business liberalisation measures.** Changes are designed to lower barriers for engaging in private entrepreneurship and to minimise the administrative burden on businesses including through the enhanced provision of electronic public services.

Key priorities for 2018

- **Deeper structural adjustments are required to unlock growth potential.** Reforms should aim to overhaul the state enterprise sector and to phase out directed lending that misallocates financial resources away from the organically growing private sector.
- **Further reforms are needed in the energy sector and utility services.** The ongoing adjustment of utility tariffs should continue until full cost recovery has been attained. Efforts are required to increase the cost efficiency of winter heating for residential buildings to pave the way for full cost recovery in this area. Unbundling of the electricity sector is needed to attract private investment.
- **Remaining banking sector challenges should be addressed.** The banking sector should be fully discharged from performing quasi-fiscal functions. Preparation of some banks slated for privatisation, through corporatisation measures, institutional building and balance sheet sanitisation, should proceed without delay.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	1.0	1.7	-3.8	-2.6	1.5
Inflation (average)	18.3	18.1	13.5	11.8	8.0
Government balance ¹ /GDP	-1.0	0.1	-2.2	-3.4	-5.6
Current account balance/GDP	-10.0	-6.6	-3.2	-3.5	-5.3
Net FDI/GDP [neg. sign = inflows]	-2.6	-2.3	-2.7	-2.4	-3.4
External debt/GDP	52.4	50.7	67.5	79.1	n.a.
Gross reserves/GDP	8.8	6.4	7.4	10.4	n.a.
Credit to private sector/GDP	20.3	21.1	23.1	21.3	n.a.

¹ Includes central government, local government and social security funds.

Macroeconomic performance

The economy is showing signs of recovery but structural bottlenecks to growth remain.

GDP shrank by 2.6 per cent in 2016, the second year of recession in a row, with a broad-based output decline across major sectors of the economy. However, in the first nine months of 2017, the economy returned to low positive growth. GDP expanded by an estimated 1.7 per cent year-on-year in this period, driven by external demand and household consumption. Output in manufacturing, the economy's largest sector representing approximately 22.2 per cent of GDP, grew by 6.6 per cent year-on-year in the first nine months of 2017, mainly on the account of export-oriented industries, which are benefiting from the economic recovery in major trading partners. Agricultural output also demonstrated growth of 2.8 per cent year-on-year while construction contracted by 6.5 per cent year-on-year in the same period.

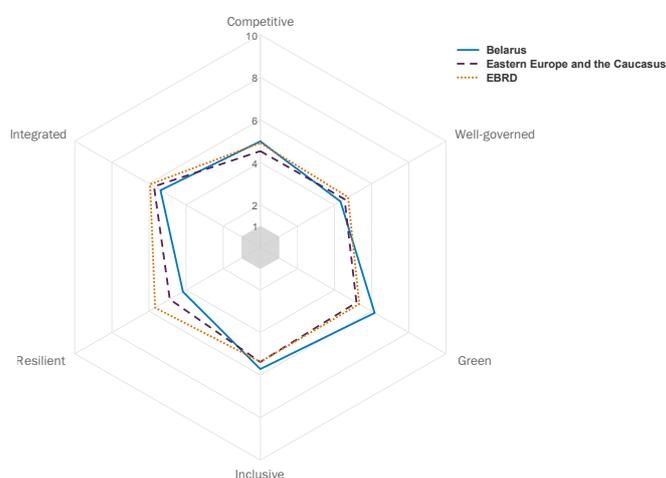
Inflation has fallen to its lowest level. Stabilisation of the exchange rate, weak domestic demand, moderation in wage growth as well as generally tight monetary and fiscal policies have helped to bring the inflation rate down to 4.9 per cent year-on-year in September 2017. This is significantly below the 9.0 per cent ceiling targeted by the National Bank of the Republic of Belarus (NBRB) in 2017, allowing for a gradual loosening of monetary policy. The refinancing rate decreased eight consecutive times in 2017 from 18.0 per cent in January to 11.0 per cent in October. Market interest rates have also declined.

The authorities made progress in unwinding macroeconomic imbalances although weaknesses remain.

The exchange rate has been relatively stable since mid-2016. The current account deficit declined from 6.6 per cent of GDP in 2014 to 3.5 per cent in 2016 supported by devaluation in 2014-15 and a more flexible exchange rate regime. Proceeds from the issuance of sovereign Eurobonds in July 2017 and disbursements by the Eurasian Fund for Stability and Development (EFSD) helped to replenish foreign currency reserves. They increased to US\$ 3.4 billion as of the beginning of October 2017 providing close to 1.5 months of imports coverage, which is still low relative to external liabilities. Despite the headline surpluses of the consolidated budget, the fiscal position is weakened by contingent liabilities arising from the high degree of state involvement in the economy and from directed and subsidised lending programmes.

Growth prospects depend on structural adjustments and the regional outlook. The near-term economic outlook has improved recently thanks to: (i) resolution of the gas price dispute with Russia and agreement to restore crude oil supplies to Belarus to ordinary annual volumes; (ii) resumption of disbursements by the EFSD and bilateral lending from Russia; and (iii) successful issuance by Belarus of dual-tranche sovereign Eurobonds for the aggregate principal amount of US\$ 1.4 billion in June 2017. These developments have helped to mitigate short-term funding pressures. However, downside risks remain and the longer-term prospects continue to depend on the extent of structural reforms and on scaling back state interference in the economy.

Assessment of transition qualities (1-10)



Major structural reform developments

Business deregulation initiatives aim to foster entrepreneurship. A comprehensive set of measures to cut “red tape” and ease administrative barriers for doing business was prepared and submitted to the President at the end of September 2017. The goal of the legislative package is to minimise the state’s intervention in business activities. The package envisages, among other things, reform of the state’s control functions; simplification of procedures for starting a business and conducting entrepreneurial activities in major areas of commerce; and a reduction in the number of licences and permits, as well as issuance of all licences in electronic form.

The state-dominated banking sector faces a backlog of problem assets. State-owned banks continued to dominate the market, accounting for around 65.0 per cent of sector assets at the end of the first quarter of 2017. The reported ratio of non-performing loans (NPLs) to total gross loans in the banking sector stood at 13.0 per cent as of 1 September 2017, up from 6.8 per cent at the beginning of 2016, but monitoring of the true level of problem loans is difficult due to directed and subsidised lending programmes which accounted for an estimated 40.0 per cent of all loans. The authorities have continued to reduce new directed lending, with its volume expected to decline from close to 5.0 per cent of GDP in 2013 to approximately 1.8 per cent of GDP in 2017 and an estimated 1.0 per cent of GDP in 2018. However, the stock of directed loans is expected to remain large in the medium term considering that it includes loans with long tenures and directed loans to corporates are often restructured due to their weak performance. The Development Bank of Republic of Belarus became the main administrator of directed lending programmes.

Monetary policy and regulatory frameworks are being gradually strengthened. Under the presidential decree issued in April 2017, the NBRB has switched from targeting exchange rate stability to price stability as the main monetary policy anchor. The authorities plan to move to a fully fledged inflation targeting regime by 2020. In May 2017, the NBRB adopted a resolution establishing a procedure for recognising banks as systemically important and introduced additional requirements for such banks to bolster capital buffers. The same resolution established Basel III liquidity ratios (liquidity coverage ratio and net stable funding ratio) as a functioning requirement for all banks and entitled the NBRB to apply countercyclical buffers if needed to mitigate excessive lending growth. This regulation is set to become effective from January 2018. To improve disclosure standards and transparency, from January 2017 the requirement to publish IFRS-compliant reporting has been extended to all companies whose securities are traded in a public market, banks, non-banking financial organisations and insurance companies.

Measures to prepare two state-owned banks for privatisation have advanced. Belinvestbank (BIB) made progress with commercialisation. The bank completed the inception phase of the institutional building programme in March 2017. New management was appointed and business processes were improved with the supervisory board assuming a more hands-on role. The clean-up of the balance sheet has advanced. By the end of 2016, a significant portion of the portfolio related to state programmes was transferred from the BIB’s balance sheet, mostly to the Belarus Development Bank, and more of such assets are expected to be removed in 2017. Five non-core subsidiaries were divested. Meanwhile, Moscow-Minsk bank has focused on improving its commercial operations and broadening the client base as a first step towards attracting strategic investors.

Utility tariffs are adjusting gradually. As of the end of 2016, cost recovery for provision of all utilities reached an estimated 60.7 per cent. Gas, electricity, hot water and heating tariffs were further increased by an estimated 8.0 per cent as of 1 September 2017. Tariff increases have been supported by efforts to optimise costs related to generation of utility services. The pace of adjustment has been higher for utility services that allow consumption control by individual users, such as water and electricity. Raising district heating tariffs has been more challenging considering that the utilisation is centrally managed and that heating’s existing cost recovery level is significantly lower compared with other utility services. The authorities introduced non-cash housing subsidies effective from October 2016 to mitigate the impact of tariff increases on vulnerable groups, that is, those whose spending on communal services is 20 per cent or more of their income in the city and 15 per cent or more of their income in rural areas.

Disbursements by the EFSD advanced but programme negotiations with the IMF were put on hold. Following a brief hiatus, EFSD acknowledged that Belarus met most of the programme conditions and disbursed three tranches totalling US\$ 800 million in the first 10 months of 2017. This brought total disbursements to US\$ 1.4 billion out of US\$ 2 billion allocated under the programme. Discussions between the IMF and Belarusian authorities about a possible programme have been under way since the beginning of 2015. More recently, the programme negotiations have stalled amid disparities related to the pace of utility tariff increases and the reform of the state enterprise sector.





GEORGIA

Highlights

- **Economic growth is accelerating.** In the first half of 2017, strong export performance and burgeoning tourism helped to lift GDP growth to an estimated 4.9 per cent year-on-year, up from 2.7 per cent in 2016.
- **The banking sector demonstrated resilience in the face of exchange rate volatility.** Despite volatility in the lari-US dollar exchange rate and high dollarisation of the economy, non-performing loans remained under control and efforts to incentivise usage of the local currency for economic transactions continued.
- **The government has adopted a new reform agenda.** A Four Point Reform Plan is in place, and measures to accelerate economic growth and implement well-coordinated macroeconomic policies are important priorities under the programme, which is also supported by a new IMF arrangement.

Key priorities for 2018

- **Public investment needs to be stepped up without compromising fiscal sustainability.** Scaling up implementation of competitiveness-enhancing public infrastructure projects will help to realise Georgia's potential as a regional hub economy and to reap greater benefits from its business-friendly environment and extensive network of free trade arrangements.
- **Public-private partnerships (PPPs) should be structured in line with the new PPP framework.** A new PPP law has been developed in conformity with modern PPP best practices and internationally accepted standards. Adoption of this law by the parliament will promote fiscally responsible implementation of the PPP structures for infrastructure projects.
- **Commercial dispute resolution capacity should be enhanced.** The ability of the judiciary system to mediate commercial disputes in a competent and impartial manner needs to be strengthened. Steps should be taken to rebuild investor confidence in the judiciary and improve the qualifications of judges dealing with business disputes.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	3.4	4.6	2.9	2.7	4.5
Inflation (average)	-0.5	3.1	4.0	2.1	6.0
Government balance ¹ /GDP	-2.6	-3.2	-3.7	-4.2	-4.1
Current account balance/GDP	-5.8	-10.7	-12.0	-12.8	-11.9
Net FDI/GDP [neg. sign = inflows]	-5.1	-8.2	-9.1	-9.3	-9.4
External debt/GDP	81.7	83.8	107.8	108.1	n.a.
Gross reserves/GDP	17.5	16.4	18.0	19.2	n.a.
Credit to private sector/GDP	39.0	44.5	50.4	55.7	n.a.

¹ According to the definition by the Ministry of Finance (GFS 1986).

Macroeconomic performance

Output growth has accelerated in 2017 on the back of an improving external environment.

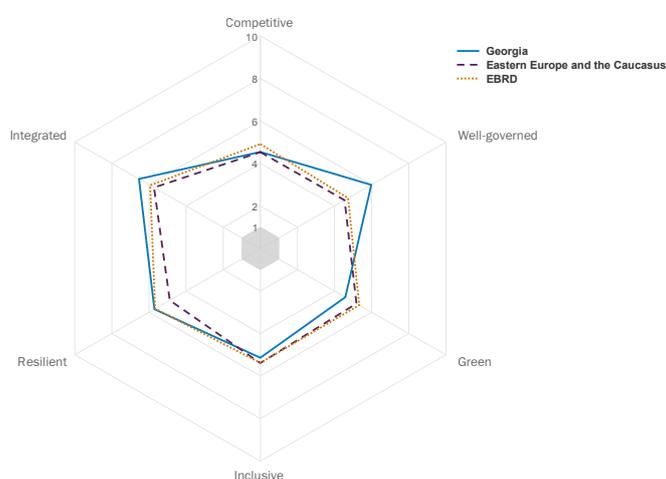
GDP growth averaged close to 6.0 per cent in 2010-14, but then fell below 3.0 per cent in 2015 and 2016 mainly due to a difficult external environment and a slow-down in key trading partners. In 2016, robust growth in the hospitality industry, construction and financial intermediation bolstered the economy. Growth picked up to an estimated 4.9 per cent year-on-year in the first half of 2017, supported by a 30.1 per cent year-on-year increase in exports and a 15.1 per cent increase in tourist arrivals in the same period.

The exchange rate volatility persists. Following in the footsteps of other regional currencies, the lari depreciated by approximately 34.4 per cent against the US dollar between 2014 and 2016. This exchange rate trajectory was reversed in the first nine months of 2017, with the lari appreciating by approximately 6.9 per cent against the US dollar. This was supported by foreign exchange inflows from increased merchandise exports, tourism receipts, tightening of monetary policy, and a recovery in remittances which increased by approximately 19.7 per cent in the first nine months of 2017. The exchange rate pressures have since reemerged. Between the beginning of October and 15 November the lari lost approximately 7.7 per cent of its value against the US dollar. Inflation accelerated to 6.2 per cent year-on-year in September 2017 from an average of 2.1 per cent in 2016 reflecting earlier depreciation of the lari, a spike in excise taxes and higher commodity import prices. The National Bank of Georgia (NBG) increased the refinancing rate two consecutive times from 6.5 per cent in September 2016 to 7.0 per cent in May 2017.

External and fiscal deficits are sizeable but sustainably financed. The high current account deficit, at 12.8 per cent of GDP in 2016, remained mostly financed by an inflow of net foreign direct investment which stood at approximately 9.3 per cent of GDP in 2016. Official international reserves remained steady in the first nine months of 2017, providing approximately three and a half months of import coverage (US\$ 3.0 billion at the end of September 2017). The fiscal deficit widened to 4.2 per cent of GDP in 2016 and is planned at 4.1 per cent of GDP in 2017, reflecting high infrastructure spending supported mainly by borrowing from international financial institutions on favourable terms.

Growth is set to remain vigorous. A recovery in consumption, investment in infrastructure and strong performance of the hospitality sector are expected to fuel short-term growth. The free trade agreement signed with China in May 2017, which abolishes approximately 95 per cent of import taxes on Georgian goods, and realisation of DCFTA benefits in the medium term are expected to stimulate exports. GDP growth is forecast at 4.5 per cent of GDP in 2017 and 2018. Weaker-than-expected regional recovery and geopolitical tensions could, however, affect growth on the downside.

Assessment of transition qualities (1-10)



Major structural reform developments

Georgia has introduced a new Reform Plan. The Four Point Reform Plan, introduced in February 2017, aims to improve the investment climate and generate higher and more inclusive economic growth. The plan's structural reform agenda focuses on, among other things, upgrading the education system, streamlining implementation of infrastructure projects to leverage Georgia's position as a transit and tourism hub, increasing efficiency and improving governance in the public administration, and further improving the business environment.

A new IMF programme is supporting fiscal and monetary discipline. A three-year US\$ 285 million Extended Fund Facility was approved by the IMF Board in April 2017, providing additional shock absorption capacity against exogenous economic risks. The main policy areas under the new programme include fiscal consolidation and improvements in public financial management, pension reform, development of a new PPP law with an emphasis on minimisation of contingent fiscal risks, measures to enhance the NBG's liquidity management framework, and financial sector reforms to strengthen banking regulation and supervision, improve the bank resolution framework and enhance overall resilience of the financial sector. Staff-level agreement between the IMF and Georgian authorities for completion of the first programme review was reached in October 2017.

Fiscal reforms are creating more space for growth-enhancing public infrastructure projects. Efforts were made in the past year to increase revenues and to shift fiscal resources from current expenditures to public investment spending. The tax model introduced in 2016 applies corporate income tax only to distributed profits, and to offset the resulting shortfall, the authorities raised excise taxes on tobacco, gambling, cars and fuels effective from January 2017. Current expenditure optimisation measures include reduction of the wage bill through rightsizing the headcount in public administration and reforms to the remuneration system. Universal healthcare insurance, launched in 2013, was modified to apply only to more vulnerable groups whose income is below the specified threshold. Legislative amendments were made to allow better state control over local government spending in order to ensure compliance with general government deficit limits. Work has also been initiated on designing a new pension system.

Incentives to use local currency are in place but with limited impact so far. A 10-point "larisation" plan was developed jointly by the NBG and the government of Georgia and rolled out in January 2017. As part of the plan, the authorities offered one-time subsidised conversion of dollar-denominated mortgage loans (issued before January 2015 and up to approximately US\$ 40,000 per loan) into local currency at the beginning of 2016. Only a quarter of eligible loans participated in the conversion opportunity. Small new loans (up to approximately US\$ 40,000) have been required to be issued in local currency only since January 2017. Other measures under the larisation plan include regulatory incentives to issue local currency corporate bonds, preferential treatment of local currency under the NBG's prudential regulations and the requirement to quote all prices in lari, including for real estate. As of August 2017, these measures have had limited cumulative impact. Dollarisation decreased somewhat but remained high with 57.6 per cent of loans and 66.0 per cent of deposits denominated in foreign currency as of 1 October 2017.

Safeguards have been added to the banking sector. Despite lari depreciation, non-performing loans remained low at approximately 3.1 per cent of total loans in the third quarter of 2017. In May 2017, the NBG increased the minimum capital requirement for Georgian banks more than four times, to approximately US\$ 20.4 million. Banks are expected to increase their capital in three stages until 2018. In May 2017, the parliament adopted a Law on Deposit Insurance System which provides for setting-up mandatory insurance for deposits up to 5,000 lari (US\$ 2,000), starting from January 2018. The scheme is to be fully funded by banks providing insurance contributions to the Deposit Insurance Fund, which will be governed by high-ranking officials from the ministries, NBG and independent members.



MOLDOVA

Highlights

- **The economy is growing again after the recession in 2015.** GDP increased by 4.3 per cent in 2016, supported by a bumper harvest, a recovery in household consumption and exports of goods and services, and further growth has occurred so far in 2017.
- **A new IMF programme is in place.** The three-year programme was approved in November 2016, on completion by the Moldovan authorities of prior actions mainly focused on the banking sector.
- **Banking sector vulnerabilities are being tackled.** The regulatory and supervision framework has been overhauled to provide the National Bank of Moldova (NBM) with tools for the identification of banks' ultimate beneficial owners and related party lending.

Key priorities for 2018

- **Key commitments under the IMF programme should be met.** The IMF programme is a crucial anchor for reforms and is essential to catalysing further international support and implementation of structural reforms.
- **Banking sector cleansing should be completed.** The new regulatory and supervision framework needs to be thoroughly implemented, and non-transparent shareholders still present in the ownership structure of some of the largest banks should be replaced with fit and proper investors.
- **Further business environment and governance reforms are needed.** Key priorities should include judiciary reform, simplification of the regulatory framework, an overhaul of the tax and customs administration, and improvement of governance in public institutions.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	9.4	4.8	-0.4	4.3	3.0
Inflation (average)	4.6	5.1	9.7	6.4	6.5
Government balance/GDP	-1.9	-1.9	-2.3	-2.1	-3.7
Current account balance/GDP	-6.2	-7.1	-7.2	-4.2	-4.0
Net FDI/GDP [neg. sign = inflows]	-2.7	-3.8	-3.2	-1.1	-2.2
External debt/GDP	86.4	81.4	93.7	92.1	n.a.
Gross reserves/GDP	35.5	27.0	27.0	32.6	n.a.
Credit to private sector/GDP	42.1	36.4	31.2	25.8	n.a.

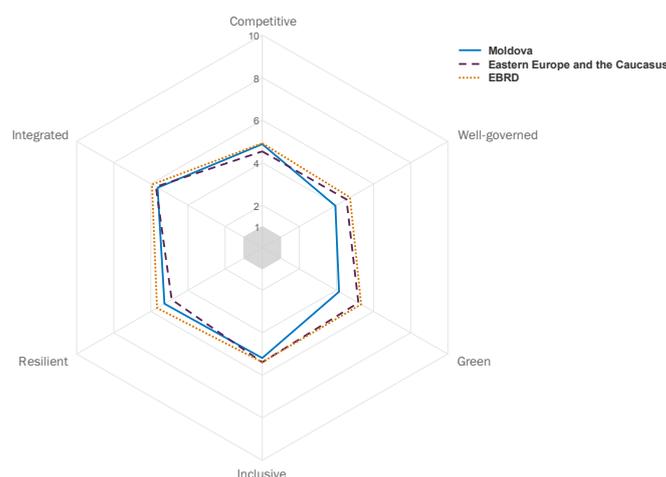
Macroeconomic performance

Economic growth has resumed. Following a 0.4 per cent economic contraction in 2015, real GDP grew by 4.3 per cent in 2016 on the back of a good agricultural season. Agricultural output increased in real terms by 18.0 per cent in 2016 after declining by 13.0 per cent in 2015. In 2016, household consumption rose by 3.6 per cent and the real volume of export of goods and services increased by 9.3 per cent, driven by higher export flows to the European Union (EU) countries. On the other hand, gross fixed capital formation contributed negatively to GDP growth, falling by 2.8 per cent in real terms in the same period. GDP continued to grow by 2.8 per cent year-on-year in the first half of 2017.

External and inflationary pressures have eased. The Moldovan leu stabilised in 2016 after depreciating by 33.6 per cent against the US dollar in 2014-15. Supported by strong export performance and recovering remittances, the leu appreciated by 13.5 per cent in relation to the US dollar in the first nine months of 2017. In the same period, inbound money transfers returned to growth of 9.5 per cent year-on-year after a decline in the previous two years. The current account deficit fell from 7.1 per cent of GDP in 2014 to 4.2 per cent of GDP in 2016. Official reserve assets increased from US\$ 1.8 billion at the end of 2015 to US\$ 2.6 billion in September 2017, lifting import coverage to approximately six months. Amid monetary tightening and a stable leu, inflation decelerated from 13.6 per cent year-on-year in December 2015 to 6.3 per cent year-on-year in the first nine months of 2017. General government gross debt increased from approximately 25.0 per cent of GDP in 2014 to close to 40.0 per cent of GDP in 2016, mainly due to the recognition of public debt arising from the emergency assistance provided by the NBM to the three failed banks.

The short-term growth outlook is positive but significant vulnerabilities remain. The new IMF programme has eased funding pressures and helped to stabilise Moldova's economy. Current projections for growth are 3.0 per cent in 2017 and 3.5 per cent in 2018, driven by macroeconomic stabilisation and an improved external environment. However, the forecast is subject to uncertainty due to a narrow economic base concentrated in agriculture. Vulnerabilities in the financial sector remain despite recent steps to improve banking supervision and the regulatory framework.

Assessment of transition qualities (1-10)



Major structural reform developments

Moldova's entry into an IMF programme has catalysed reforms. A three-year IMF arrangement for Moldova of US\$ 179 million was approved in November 2016. The programme has a strong focus on the banking sector and on addressing debt accumulated by the energy companies, setting utility tariffs at cost recovery levels and developing a sound medium-term budget framework for 2017-19. To satisfy prior actions and secure the agreement, the authorities undertook reforms in the financial and energy sectors, amended the 2016 budget law and converted state guarantees to the NBM into marketable government securities. In April 2017, the IMF completed the first programme review and released a US\$ 21.5 million tranche. Approval of the programme unlocked international budget assistance from the European Union, the World Bank and Romania.

The authorities made progress in tackling long-standing vulnerabilities in the banking sector. Legislative amendments adopted in 2016 equipped the NBM with stronger legal powers and the enforcement capacity to identify banks' ultimate beneficial owners (UBOs) and related-party lending. Under the new rules, the NBM has acquired statutory powers to deem any person to be a bank's related party on the basis of objective criteria, unless the bank is able to prove otherwise. Changes to the Banking Law approved in the course of 2016 imposed more severe sanctions on managers, administrators and shareholders of banks for misconducts. The new Bank Recovery and Resolution Law was enacted in October 2016 to provide adequate crisis management capacity to NBM by introducing new resolution and intervention tools. A Central Securities Depository was created in April 2017 to reinforce financial infrastructure and increase protection against raider attacks.

As of the end of August 2017, two of the three largest banks remained under special supervision, and the third under special administration, of the NBM. These banks together account for approximately 65 per cent of Moldova's banking sector assets. Full external diagnostic reviews were launched in these three banks focusing on exposure to related parties. Full-scope onsite inspections were conducted in the two banks under special supervision. The NBM blocked the shares of non-transparent shareholders in two banks and re-offered them for sale with a view to attracting fit and proper strategic investors. The Board of Directors of Victoriabank, one of the three largest banks, became operational again in October 2016.

Some reforms were undertaken in the energy sector. Energy tariffs have been increased closer to operating cost recovery levels, but they remain insufficient to address the accumulated debts of energy companies and to facilitate the requisite investments into energy infrastructure. To further the laws on electricity and natural gas promulgated in 2016, the parliament of Moldova adopted a new law on energy in July 2017 as an important step towards approximation with the EU's Third Energy Package. The new law supports the strengthening of the institutional set-up and independence of the energy regulator (ANRE) via, among other things, improved procedures for the appointment of its directors and establishing clear performance indicators. A new renewable energy law, approved in February 2017 and entering into force in 2018, transposes the EU directive and is expected to create an enabling framework for renewable energy projects.

A plan to restructure the government apparatus has been approved. In July 2017, Moldovan parliament supported a government restructuring plan that targets enhanced efficiency of public administration. Under the plan, the number of ministries was reduced from 16 to 9. Downsizing of public administration staff aims to generate savings on administrative expenses. According to the plan, deputy ministers are to be replaced with permanent state secretaries to foster a separation between political and administrative functions and to ensure continuity and stability in the work of ministries. The reorganisation is expected to take several months.

Pension system sustainability was improved. The new pension law entered into force from the beginning of 2017. It is set to gradually increase the retirement age to 63 by 2019 for men and by 2028 for women. The new pension system introduces basic pension coverage and requires that all public sector employees are subject to the same contribution and benefit rules. The link between contributions and benefits was strengthened to make the system more equitable and to stimulate compliance.

Steps were taken to ease the regulatory environment for businesses but significant obstacles remain. In 2016, the total number of authorisations, permits and licences required for starting a business decreased by approximately a quarter. The authorities approved an action plan to implement one-stop-shop solutions and procedures for orderly liquidation of businesses were simplified. The reporting burden on businesses is to be lowered, effective from January 2018, by unifying five reports on payroll and payroll taxes and on mandatory social and insurance contributions into one report deliverable to a single public institution.

A moratorium on inspections was introduced and work initiated on a new mechanism for performing state controls and on reforming and reducing the number of institutions with control functions. Measures were also taken to simplify procedures for obtaining construction permits, but implementation of reforms to address the remaining regulatory hurdles, improve customs administration and overhaul the judiciary is lagging behind. Moldova ranks 44th out of 190 countries in the World Bank's *Doing Business 2018* report with lower scores in dealing with construction permits, getting electricity, enforcing contracts and resolving insolvency compared with better rankings in other doing business indicators.



UKRAINE

Highlights

- **A modest economic recovery is under way.** After two years of deep recession GDP grew by 2.3 per cent in 2016 and remained nearly at the same low level in the first half of 2017. The volume of exports declined in 2016 and foreign direct investment (FDI) remains low.
- **Structural reforms have moved forward, but with delays and setbacks.** Key reforms include the application by the National Bank of Ukraine (NBU) of increasingly rigorous regulatory standards, and the adoption of laws on the electricity market and on the energy regulator. The recent passage of education, pension and healthcare reforms is a welcome sign of reform momentum. However, flagship reforms in the gas sector are being delayed and meaningful progress is lacking on the reform of governance in state-owned enterprises (SOEs), privatisation and the administration of justice.
- **The nationalisation of PrivatBank has helped to avert a financial meltdown.** Concerns about the low quality of assets, extensive related party lending and a shortage of capital led to the nationalisation of this systemically important bank, without major disruptions to the broader economy.

Key priorities for 2018

- **The economic recovery needs a stronger momentum.** A major push is required to get the privatisation process off the ground and foster inflows of FDI. Adoption of the new privatisation law and reform of the State Property Fund would bring more transparency to the process. The judicial system requires an overhaul.
- **Reform of the state-owned banks has become increasingly urgent.** The aim should be to scale back the state's large involvement in the banking sector following the nationalisation of PrivatBank. Low operating efficiency and balance sheet concerns at the state-owned banks need to be remedied as a stepping stone to eventual privatisation. Decisive steps must be taken to recover the assets of PrivatBank.
- **Quick and measurable progress is required in energy sector reform.** Implementation of Naftogaz's Corporate Governance Action Plan should be reinvigorated to compensate for significant delays and to eliminate policy uncertainty. Work on its unbundling needs to advance in line with authorities' commitment to the process.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	0.0	-6.6	-9.8	2.3	2.0
Inflation (average)	-0.3	12.1	48.7	13.9	12.8
Government balance/GDP	-4.8	-4.5	-1.2	-2.3	-3.0
Current account balance/GDP	-9.0	-3.4	-0.2	-3.7	-3.3
Net FDI/GDP [neg. sign = inflows]	-2.2	-0.2	-3.3	-3.5	-1.1
External debt/GDP	77.5	94.6	130.4	121.7	n.a.
Gross reserves/GDP	11.1	5.6	14.6	16.7	n.a.
Credit to private sector/GDP	61.8	64.0	49.2	41.8	n.a.

Macroeconomic performance

Ukraine's economy is growing moderately but output remains well below the pre-crisis level.

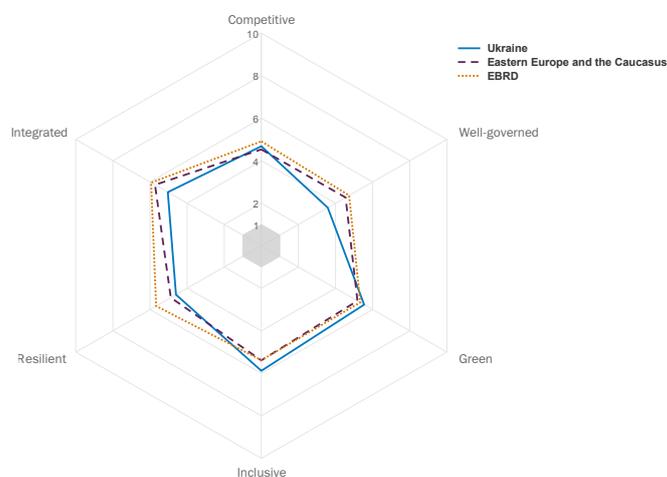
After a 16.0 per cent cumulative real GDP contraction in 2014-15, Ukraine's economy grew by 2.3 per cent in 2016. The economy sustained this modest pace of recovery in the first half of 2017, growing by 2.5 per cent year-on-year in the first quarter and by an estimated 2.3 per cent year-on-year in the second quarter. Gross fixed capital formation rebounded after a protracted downturn, growing by 20.1 per cent year-on-year in 2016 and by approximately 21.9 per cent year-on-year in the first half of 2017. Household consumption has picked up further this year on the back of increasing real wages and improving confidence, but the real volume of exports of goods and services declined by 1.6 per cent in 2016 and by 1.3 per cent year-on-year in the first half of 2017, dragging down headline GDP growth. In 2016 industrial production increased by 2.8 per cent, thus breaking a four-year cycle of decline. But in the first nine months of 2017, it slipped into 0.3 per cent year-on-year contraction on account of the economic blockade of the area that is beyond the control of the government of Ukraine (the blockade). FDI into the real sector remained low at just around 2.0 per cent of GDP in 2016. Consumer price inflation has slowed from the peak levels of 2015 but remains elevated at 16.4 per cent year-on-year as of September 2017. On 27 October 2017 the NBU raised its key policy rate for the first time since March 2015 from 12.5 per cent to 13.5 per cent.

International reserves are on the rise despite a higher current account deficit. The current account deficit widened from near-balance in 2015 to approximately 3.7 per cent of GDP in 2016 due to a domestic demand recovery and weak exports. It remained on the rise in the first half of 2017. However, the balance of foreign exchange inflows to the economy was favourable on account of international assistance inflows, including under the IMF programme, and with the help of foreign exchange cash returning to the banking system after a significant exodus in previous years. In September 2017 successful issuance of sovereign 15-year Eurobonds for the principal amount of US\$ 3 billion marked Ukraine's return to the international capital markets. It was accompanied by a liability management operation to buy back up to US\$ 1.7 billion of Eurobonds maturing in 2019 and 2020. Ukraine's official reserve assets increased to approximately US\$ 18.6 billion (close to four months of imports) as of September 2017. The hryvnia appreciated by approximately 2.5 per cent against the US dollar from the beginning of 2017 until the end of September.

The state of public finances has continued to improve. The combined general government and Naftogaz deficit decreased from 10.1 per cent of GDP in 2014 to approximately 2.3 per cent of GDP in 2016, below the initially planned 3.7 per cent of GDP. The increase of gas tariffs to import parity level in 2016 enabled the authorities to phase out the quasi-fiscal deficit of Naftogaz for the first time in recent years. The overall fiscal deficit is planned at approximately 3.0 per cent of GDP in 2017, which is in line with the IMF programme. The public debt-to-GDP ratio remained steadily high at approximately 81.0 per cent of GDP following the nationalisation of PrivatBank in December 2016, which led to the issuance of domestic government bonds to fill in the capital shortfall at the bank. Pension reform adopted in October 2017 aims to improve fiscal sustainability of the pension system.

Growth is forecast to increase in 2018 but medium-term prospects are contingent on reform implementation. GDP growth is expected to gain pace from 2 per cent in 2017 to a still-modest 3 per cent in 2018. The blockade is expected to have a moderate impact on Ukraine's growth and balance of payments in the near term. At the same time, reform momentum is weak, jeopardising medium-term growth prospects. Ukraine's ability to advance growth-friendly reforms under the umbrella of the IMF programme is uncertain.

Assessment of transition qualities (1-10)



Major structural reform developments

Continuation of the IMF programme is uncertain. The nationalisation of PrivatBank (see below), the adoption of the 2017 budget compliant with the programme framework, and the successful launch of the online asset declaration system for public officials paved the way for completion of the third programme review in April 2017. This was followed by the release of a US\$ 1 billion tranche, bringing total disbursements to US\$ 8.4 billion out of US\$ 17.5 billion envisaged under the programme. In May 2017 the IMF mission initiated discussions on the fourth programme review but noted that further work was needed to meet the reform objectives in relation to pension reform, the privatisation process and anti-corruption. An adjustment of domestic gas prices to maintain them at import parity level is also one of the conditions for completing the fourth review.

The banking system has been stabilising but credit activity is yet to recover. The NBU has been applying increasingly firm and transparent supervision in key areas such as corporate governance, ownership transparency, related party exposures and capital requirements, supported by an enhanced legislative and implementation framework. Related party diagnostic reviews were finalised for all banks in 2016, identifying 44 banks in which the ratio of credit exposure to related parties exceeded the required level. By the end of 2016, the 60 largest banks in the country, accounting for approximately 98 per cent of the banking sector assets, completed stress tests to determine capital needs and to develop recapitalisation schedules. Plans for recapitalisation and the unwinding of related-party exposures over the three-year horizon have been adopted, covering a large majority of the banking sector. An out-of-court voluntary debt restructuring mechanism became functional in April 2017 but the level of non-performing loans (NPLs) is still exceptionally high at approximately 58 per cent of total loans as of 1 July 2017 with significant concentration of the NPLs in the state-owned banks. Lending activity remained weak on the back of prevailing risk-aversion, deleveraging, lack of progress in creditor rights' protection and high (albeit-decreasing) interest rates.

PrivatBank was declared insolvent and nationalised to safeguard financial stability. It was the largest commercial bank in Ukraine by the end of 2016, accounting for approximately 20 per cent of total banking sector assets. PrivatBank was nationalised in December 2016 amid concerns about large related party exposures, poor asset quality and a significant capitalisation gap. In the days immediately following the nationalisation, the parliament extended a full state guarantee on all PrivatBank deposits and the NBU provided emergency liquidity assistance to bolster confidence and stem withdrawals from the bank. New supervisory and management boards were swiftly put in place. An international auditing firm was appointed to investigate insider loans issued to the bank's related parties, with the completion of the forensic audit expected before the end of 2017. As of the end of June 2017 the government had issued treasury bonds amounting to approximately 6 per cent of 2016 GDP in order to recapitalise the bank. The fallout from the nationalisation was mostly contained. Exchange rate pressures in the aftermath of the nationalisation were limited and no major disruptions were reported in ordinary bank transactions. The nationalisation of PrivatBank led to increased state involvement in the banking sector with around half of the banking assets presently owned by the state.

Major reforms in the energy sector have been delayed despite some recent progress. In April 2017 the parliament of Ukraine adopted a new electricity market law which stipulates the unbundling of the transmission and distribution of electricity. The law paves the way for enhanced competition in the electricity market. It aims to align the Ukrainian power sector closer to the requirements of the EU's Third Energy Package. The two-year transition period envisaged under the law will provide time to develop secondary legislation and gradually roll out an electricity market structure consistent with EU principles. Despite some recent progress, major gas sector reforms pertaining to the unbundling of Naftogaz, implementation of its corporate governance action plan and liberalisation of the gas market are well behind schedule.

Ukraine's business environment rankings improved but public governance challenges remain. Ukraine ranks 76th out of 190 economies in the World Bank *Doing Business 2018* report, moving up in the rankings compared with the previous year. However, weaknesses in Ukraine's business environment are reflected in the low scores with respect to getting electricity, protecting minority investors, trading across borders, enforcing contracts and resolving insolvency. Progress with the SOE reform is slow and privatisation continues to be mostly stalled. In August 2017 the state's minority stakes in three regional energy companies were sold to the existing majority shareholders. In July 2017 the Cabinet of Ministers of Ukraine endorsed a draft law on privatisation and contemplated a triage of SOEs to determine which need to remain in state ownership, which could be privatised and which could be liquidated. However, tangible results are still lacking. The launch of the online asset declaration system in September 2016 was an important step towards better transparency and accountability in public administration but the extension of declaration requirements to non-governmental organisations and SOEs needs to be rectified. The National Anti-Corruption Bureau of Ukraine (NABU) has opened a number of investigations including high-profile cases but the inefficient court system continues to obstruct the administration of justice.