ALBANIA

Highlights

- **Growth accelerated in 2018, but has slowed in 2019.** After 4.1 per cent growth in 2018, the economy grew by just 2.4 per cent year-on-year in the first half of 2019, the slowdown being primarily due to weaker power generation.
- **Despite primary surpluses in recent years, public debt remains high.** Over the past year, the debt excluding arrears has been hovering around 68.0 per cent of GDP, even without taking into account the potentially significant costs of unsolicited public-private partnerships (PPPs).
- **The banking sector has undergone further consolidation.** At the same time, there is an ongoing shift in ownership away from eurozone banks towards domestic and foreign non-EU (European Union) owners. Non-performing loans (NPLs) have halved since 2014 but still remain at double-digit levels.

Key priorities for 2020

- **Legitimate businesses need further government efforts to tackle informality and level the playing field.** Informality remains one of the most important obstacles for doing business, and further measures are needed to tackle the problem. Measures include a simplified tax system and procedures, and strengthened capacities for inspections and the fight against corruption and bribery in public administration.
- **The government should focus on improving standards of fiscal and public governance.** Issues that need urgent attention include improving the conduct of PPPs and strengthening institutions and the rule of law. In addition, energy sources should be diversified by reducing the country's dependency on hydro generation and continuing reforms to improve governance and transparency in the power sector.
- **Financial sector resilience and intermediation should be enhanced.** The banking sector is stable but faces important challenges, including the relatively low quality and quantity of lending, high exposure to sovereign debt and high euroisation.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	2.2	3.3	3.8	4.1	2.8
Inflation (average)	1.9	1.3	2.0	2.0	1.7
Government balance/GDP	-4.1	-1.8	-2.0	-1.6	-2.5
Current account balance/GDP	-8.6	-7.6	-7.5	-6.7	-6.5
Net FDI/GDP [neg. sign = inflows]	-8.0	-8.7	-8.6	-8.0	-7.5
External debt/GDP	74.4	73.5	68.7	65.2	n.a.
Gross reserves/GDP	28.1	27.5	25.9	26.4	n.a.
Credit to private sector/GDP	37.2	36.6	35.1	33.0	n.a.

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Macroeconomic performance

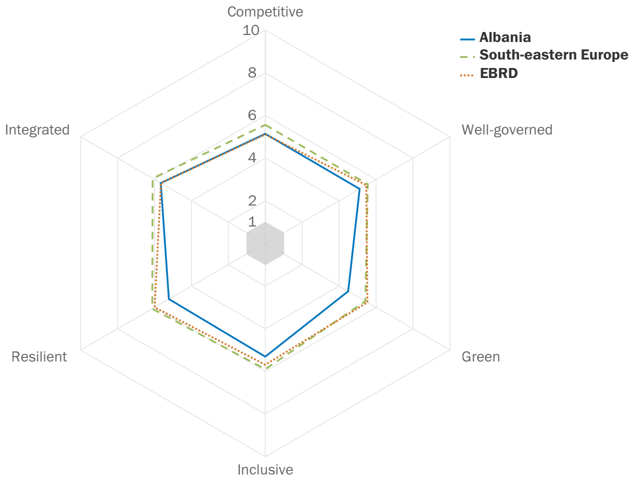
After accelerating in 2018, growth has slowed in 2019. GDP growth increased to 4.1 per cent in 2018, primarily as a result of good hydrological conditions and, consequently, high electricity production. Tourism remained an important contributor to growth too. However, the first half of 2019 saw a significant slowdown in economic growth, to 2.4 per cent year-on-year. It came mainly as a consequence of weaker power generation, combined with the high base effect from last year. Unemployment continued to decline but remains at double-digit levels (12 per cent).

Fiscal deficits are low but public debt is still high. Fiscal policy was slightly tighter in 2018, with the primary surplus increasing to 0.6 per cent of GDP (from 0.1 per cent in 2017). Overall, the budget recorded a deficit of 1.6 per cent of GDP. In the first five months of 2019, the budget (both overall and the primary one) was in surplus, but public debt remains high, at 68 per cent of GDP at the end of March 2019. Government arrears are estimated by the International Monetary Fund at 1.8 per cent of GDP, and contingent liabilities arising from recent PPP contracts, some of which have been inadequately assessed, pose risks for a further increase in public debt.

Monetary policy remains accommodative. At 2.0 per cent in 2018, inflation stayed below the central bank target of 3.0 per cent for the seventh consecutive year. In the first nine months of 2019 it decreased to 1.5 per cent on average, while core inflation, indicative of medium-term inflationary pressures, was even lower, at 0.7 per cent. As a result, the central bank's key policy rate has remained at a record low of 1.0 per cent since June 2018.

Economic catch-up is likely to slow in the short term. The economy is projected to expand at 2.8 per cent in 2019, driven mainly by private consumption, and to accelerate to 3.5 per cent in 2020, helped by the previous year's low base in power generation and under the assumption of further growth of tourism and investment in transport infrastructure. The risks to the forecast are tilted to the downside and relate to the economic slowdown of Italy and the rest of the eurozone, another delay in starting the EU membership talks, and internal risks (associated with both contingent liabilities stemming from unsolicited PPPs and the ongoing political instability).

Assessment of transition qualities (1-10)



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Major structural reform developments

The opening of EU accession negotiations has been delayed. Based on the assessment of the progress in the implementation of the comprehensive EU reform agenda, the Council of the European Union in its Conclusions on the Enlargement adopted in June 2018 set out the path towards opening the accession negotiations with Albania in June 2019. In May 2019, the European Commission issued a strong unconditional recommendation to the Council to launch EU accession negotiations with the country. However, at the European Council meetings in June and October 2019 no consensus was reached on this issue. Consequently, on 18 October 2019 the European Council decided to postpone the decision and to revert to this issue again before the EU-Western Balkans Summit in May 2020.

The business environment remains difficult. Albania was ranked 82nd overall (out of 190 countries) in the World Bank *Doing Business 2020* report, dropping 19 places from the previous year. Albania moved forward in getting electricity by increasing somewhat the reliability of power supply, but made no notable progress in other areas. Getting electricity is still one of the most problematic areas for doing business (107th), together with dealing with construction permits (166th), paying taxes (123rd) and enforcing contracts (120th). In the World Economic Forum 2019 Global Competiveness Index, the country also fell back relative to a year ago, losing five places and ranking 81st out of 141 countries. The country scores poorly in the areas of innovation capability (110th), financial sector development (105th) and infrastructure (98th).

Informality remains one of the most significant obstacles for doing business. The estimates of the size of the informal economy in Albania vary between 25 and 50 per cent of GDP. The causes are numerous and range from poverty to a heavy administrative burden, from complex procedures and frequently changing tax rules (making it altogether difficult and costly to comply), to weak rule of law and lack of trust in public institutions. Formal employment increased significantly since the launch of a campaign against informality in 2015 (with the employment rate rising from 51 per cent in 2014 to 60 per cent in 2018). However, despite contributing to creating a level playing field, a lower VAT registration threshold since April 2018 significantly increases the burden on small businesses, potentially resulting in the under-reporting of revenues.

Further controversial PPPs have been initiated. Large unsolicited PPPs continue to be awarded, particularly in the road sector (for example the Milot-Balldren and Orikum-Llogara sections), without a sufficient level of cost-benefit analysis and competition in the tender process. This increases the potential social cost and exposes the government to implementation risks, also given the general lack of track record and financial standing of the chosen bidders relative to the scale of the projects tendered.

Albania has made the first step towards establishing its first power exchange. Electricity market reforms (that is, liberalisation of the market, unbundling of distribution and supply, establishment of the Albanian Power Exchange and regional integration of the electricity market) are advancing slowly. Following the adoption of the Power Sector Law in 2015, a number of important reforms were made to liberalise the power market, but progress has been limited in the past year. The establishment of the Albanian Power Exchange (APEX), which would support price transparency, was delayed several times from the original deadline (March 2017) mentioned in the Law. Lastly, in May 2019 the government adopted the decision to set up a power exchange, with day-ahead and intraday markets. In order to establish the exchange and make it operational, the relevant implementing legislation remains to be enacted. The country continues to be largely dependent on hydropower generation and exposed to climate change risks. This can be remedied through the diversification of the energy mix, which could be supported by, among other measures, the tendering of solar capacities.

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Consolidation and change of ownership in the banking system is ongoing. Following a strategy to withdraw from the central, eastern and south-eastern European countries and the Western Balkans, several EU-owned banks have left Albania recently. The latest cases were in March 2019, with the acquisition of the Albanian subsidiary of Societe Generale Group by the Hungarian OTP Bank and the sale of Tirana Bank, the Albanian unit of Greece's Piraeus Bank. In July 2019, the acquisition of International Commercial Bank by the local Union Bank was announced. As a result, the number of banks operating in the country went down to 12 in August 2019, from 16 in September 2018.

The banking sector is stable but faces several challenges. Although the banking sector on the whole is well-capitalised, liquid and profitable, high euroisation (around 50 per cent), an NPL ratio of 11 per cent (at the end of August 2019) and high exposure to the sovereign debt (with around one-quarter of assets invested in government securities) remain among the main challenges to the sector's level of resilience. Private sector credit, at 33 per cent of GDP in 2018, is one of the lowest in Europe and acts as a drag on investment. The low level of lending is a consequence of multiple factors, both supply and demand-related: limited investment opportunities, high NPLs, weak demand by the private sector, low financial literacy of small and medium-sized enterprises, and high levels of informality in the economy, including improper accounting practices.

ARMENIA

Highlights

- **Strong GDP growth has continued despite a slowdown in exports.** The economy grew by 5.2 per cent in 2018 and by an estimated 6.8 per cent year-on-year in the first half of 2019. The export-oriented mining sector, however, underperformed in 2018.
- **The new government is targeting higher and inclusive growth.** A new precautionary programme from the International Monetary Fund (IMF) is supporting the authorities' reform efforts.
- **The authorities have adopted a package of tax reforms.** Measures include flattening the personal income tax system, cutting corporate taxes and simplifying taxation for small businesses. Social security contributions, excise taxes and licence fees have been increased to offset the fall in budget revenues.

Key priorities for 2020

- **Efforts to tackle corruption, strengthen competition, foster transparency and ensure a level playing field need to continue.** Reforms need to be institutionalised in a way that does not negatively affect regular operations of the private sector.
- **Initial success in enhancing tax compliance opens space for further reforms.** Strengthening the tax administration and further increasing the fairness and transparency of the tax framework would facilitate the private sector's ability to drive future growth.
- **Addressing infrastructure bottlenecks needs to remain among the top priorities.** Building public administration capacity and advancing the regulatory and operational framework for public-private partnerships would improve the execution of existing and new growth-enhancing infrastructure projects.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	3.2	0.2	7.5	5.2	6.0
Inflation (average)	3.7	-1.4	1.0	2.5	1.7
Government balance/GDP	-4.8	-5.6	-4.8	-1.8	-1.4
Current account balance/GDP	-2.7	-2.1	-3.0	-9.4	-7.4
Net FDI/GDP [neg. sign = inflows]	-1.5	-2.5	-1.9	-2.0	-2.2
External debt/GDP	84.5	94.4	91.3	87.8	n.a.
Gross reserves/GDP	16.8	20.9	20.0	18.1	n.a.
Credit to private sector/GDP	45.6	52.2	53.0	57.2	n.a.

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Macroeconomic performance

The economy maintained robust growth despite a slowdown in exports. In the first half of 2018, the economy expanded by a strong 8.7 per cent year-on-year. However, a contraction in the agriculture sector, traditionally the largest sector of the economy, and the mining and quarrying sectors, the strongest contributors to export growth, led to a growth slowdown in the second half of the year. With GDP growth at 3.0 per cent year-on-year in the second half of the year, Armenia's economy grew to 5.2 per cent overall in 2018. Gross fixed capital formation, household consumption and exports grew in real terms, albeit at lower rates than a year earlier. From a production perspective, the arts, entertainment and recreation sectors were the main contributor to growth, expanding by 31.5 per cent in real terms. This sector has been growing rapidly in recent years; its output doubled since 2015 in current prices and has increased nearly six fold since 2012. GDP growth increased to an estimated 6.8 per cent year-on-year in the first half of 2019, supported by strengthened household consumption that is benefiting from credit growth and a stronger inflow of money transfers.

In light of slower export growth, healthy domestic demand led to the widening of the current account deficit. Weighed down by underperformance in the mining sector, the growth of export receipts decelerated to 9.0 per cent in 2018 from 23.2 per cent a year earlier. At the same time, imports increased by 16.1 per cent in nominal US dollar terms. This led to a widening of the trade deficit by more than three times compared with the previous year and moved the current account deficit to a nearly double-digit level (as a per cent of GDP). The current account deficit levelled off in the first half of 2019. Nevertheless, the Armenian dram remains stable, financed largely by the inflow of foreign currency and deposits to the banking sector in the same period. Inflation declined from 2.5 per cent in 2018 to 1.6 per cent in the first nine months of 2019 (0.5 per cent in September) affected by the contractionary fiscal policy and stable exchange rate. This prompted the Central Bank of Armenia (CBA) to lower its refinancing rate two consecutive times from 6.0 per cent in January 2019 to 5.5 per cent in September 2019, bringing the policy rate to its lowest level since the beginning of 2010. International reserves are at adequate levels, covering approximately four months of imports.

Fiscal balances have improved. After reaching nearly 60.0 per cent of GDP, the public debt to GDP ratio decreased by approximately three percentage points in 2018 compared with a year before and stood at 55.7 per cent at the end of 2018. This reflected favourable macroeconomic developments, including strong GDP growth and fiscal consolidation. The lower-than-planned fiscal deficit in 2018 at 1.6 per cent of GDP was underpinned by strong tax administration efforts and government underspending on the back of delays in both current and foreign-financed capital expenditure. In the first six months of 2019, the fiscal balance was in surplus, at 1.9 per cent of forecasted GDP.

Economic growth is expected to stay robust. Real GDP is forecast to grow by 6.0 per cent in 2019 and by 5.0 per cent in 2020. However, the economy remains vulnerable to external shocks in the form of a global and regional slowdown in growth, volatility in the commodity markets and the conflict over Nagorno-Karabakh. Unleashing the economy's growth potential requires consistent implementation of comprehensive economic reforms and the attraction of efficiency-enhancing foreign investments.

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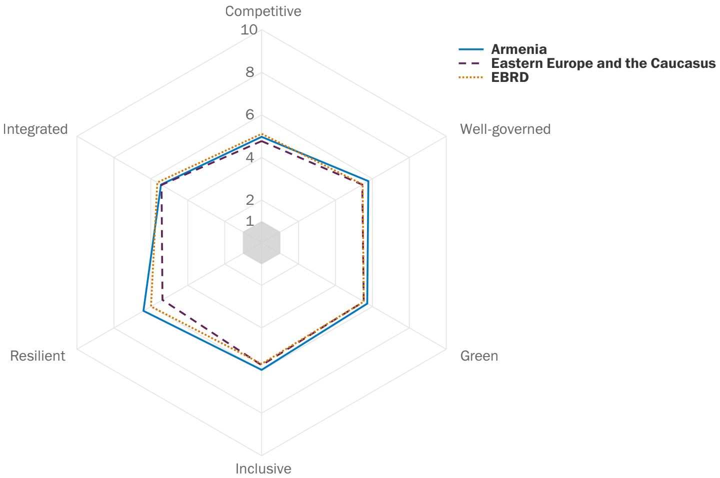
Assessment of transition qualities (1-10)



Major structural reform developments

The authorities have introduced a new five-year programme for 2019-23. The programme was adopted by the new government in February 2019, one month after it took office. The overall aim is to promote competitive and inclusive economic growth. It focuses on combating corruption and enhancing public governance, creating conditions for positive economic activity, developing human capital, ensuring social protection and expanding access to infrastructure.

A new precautionary Stand-By Arrangement (SBA) with the IMF has been signed. The three-year SBA was approved in May 2019 for the total amount of US$ 248.2 million. In the absence of external shocks, the authorities intend to treat the programme as precautionary. The arrangement aims to support the government's reform efforts towards strengthening economic fundamentals and policy frameworks as well as implementing the structural reforms needed to generate broad-based economic growth.

A new tax reform has been introduced. The reform, adopted in June 2019, aims to boost medium-term economic activity and to increase tax compliance. Among other measures, the corporate income tax was reduced by two percentage points to 18.0 per cent and the tax on dividends for non-resident organisations halved to 5.0 per cent. Two alternative tax systems for small businesses – on self-employed and on family-entrepreneurship – were replaced by a single micro entrepreneurship system. Micro entrepreneurs, defined as entities with an annual sales turnover lower than AMD 24 million (US$ 50,500), will be subject to an income tax of only AMD 5,000 (US$ 10) per employee per month. The fall in revenues from these measures will be offset partly by higher excise taxes, the removal of selected tax exemptions, and by increased gambling and financial-sector licence fees. The authorities are also developing measures that will address any potential distributional effects from the tax amendments that might affect those from a lower-income background.

The Ministry of High-Tech Industry has granted tax privileges to tech start-ups. Amendments to the law on State Support for the Information Technologies Sector, voted in April 2019 and effective since May 2019, include a zero per cent profit tax and 10 per cent income tax to tech start-ups. Companies eligible for the preferential tax treatment need to have fewer than 30 employees and should not have been established as a result of the reorganisation of another company. The authorities are hoping these measures will help draw the Armenian diaspora back to the country. While still small in size, Armenia's information and communications technology sector has been developing rapidly in recent years. From 2012-18, the number of companies and employees in the sector approximately doubled, while their turnover and exports nearly tripled.

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The central bank has set additional capital buffers in the banking sector. In force since April 2019, the regulator set three buffers exceeding the current capital adequacy requirement compliant with the Basel III regulation: a capital conservation buffer, a counter-cyclical capital buffer and a systemic risk buffer. Full implementation of the buffers over the course of the next few years will strengthen the financial sector's resistance to economic shocks and help increase the efficiency of macroprudential policies.

Government restructuring was completed in 2019. In an effort to enhance efficiency, several ministries were merged. The overall number of ministries was reduced from 17 to 12.

AZERBAIJAN

Highlights

- **Azerbaijan's economic recovery is strengthening.** The recent expansion of gas production and export capacities combined with positive price developments on the commodity markets bode well for the economy.
- **The authorities undertook important fiscal reforms.** Amendments to the tax code aim to simplify the rules, decrease the tax burden, increase taxpayer compliance and support the development of micro, small and medium private sector business, while implementation of the fiscal rule and public debt strategy should support the sustainability of public finances.
- **Steps were taken to decrease the stock of non-performing loans (NPLs) in the banking sector.** The state has funded generous measures that incentivise resolution of overdue individuals' loans, particularly those affected by the steep devaluation of the manat in 2015. participation.

Key priorities for 2020

- **Implementation of recent fiscal reforms is commendable and should be followed with additional steps.** The functioning of the tax and customs administration should be further improved, the efficiency of public spending should be enhanced, and there needs to be a better oversight of the risks arising from large contingent liabilities.
- **Banking sector reform remains incomplete and should be reinvigorated.** Privatisation of the International Bank of Azerbaijan (IBAR) needs to advance as initially planned. Remaining weaknesses in the banking sector also need to be addressed by strengthening both the regulatory framework and the independence and capacity of the regulator.
- **Policies that support private sector development and economic diversification should remain high on the priority list.** To ensure their effectiveness, horizontal policies improving the overall investment climate and sector-specific reform programmes should be combined with enhancing the institutional capacity of the implementing state agencies.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	1.1	-3.1	0.1	1.4	2.8
Inflation (average)	4.0	12.4	12.9	2.3	2.8
Government balance[1]/GDP	-4.8	-1.1	-1.4	5.6	5.3
Current account balance/GDP	-0.4	-3.6	4.1	12.9	9.7
Net FDI/GDP [neg. sign = inflows]	-1.5	-5.1	-0.7	1.7	-5.0
External debt[2]/GDP	19.8	20.4	22.8	19.0	n.a.
Gross reserves[3]/GDP	9.5	10.5	13.1	12.0	n.a.
Credit to private sector/GDP	40.0	27.2	16.7	16.3	n.a.

[1] Includes central government and main extrabudgetary funds, including operations of the oil fund and the social protection fund.
[2] Public and publicly guaranteed external debt outstanding.
[3] Excluding assets of the State Oil Fund (SOFAZ).

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Macroeconomic performance

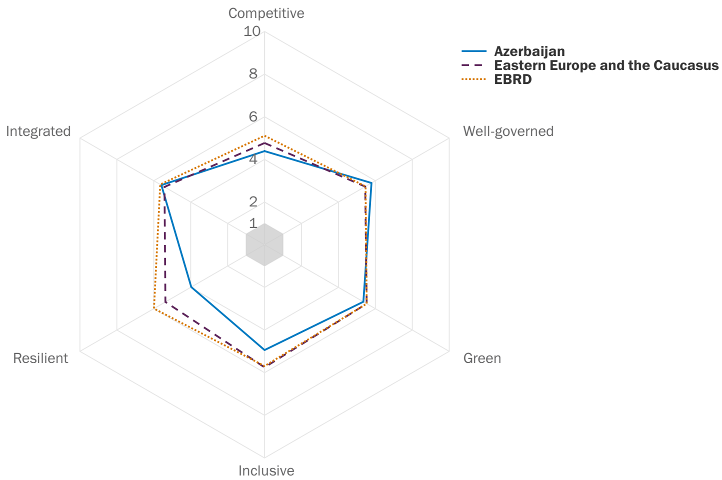
Output growth is gradually strengthening. Following a near-stagnation in 2017, GDP grew by 1.4 per cent in 2018. On the production side, transport, manufacturing, agriculture and retail trade were the main contributors to growth in 2018. Growth was supported by the ongoing expansion of hydrocarbon production and export capacity; real output in the oil and gas sector recovered from a 5.3 per cent contraction in 2017 to a 0.5 per cent expansion in 2018. In contrast, the construction sector was the main drag on overall economic performance, contracting by an estimated 9.0 per cent. Growth of output outside of the hydrocarbon sector strengthened from 1.9 per cent in 2018 to 3.5 per cent year-on-year in the first nine months of 2019. This strengthening of growth in non-oil sectors supported an overall acceleration of GDP growth to 2.5 per cent year-on-year in the same period.

The external surplus widened while the fiscal balance turned into a surplus on the back of higher hydrocarbon revenues. The current account surplus rose from 4.1 per cent of GDP in 2017 to 12.9 per cent in 2018 on the back of increased hydrocarbon exports and favourable commodity prices. In the first half of 2019, this trend halted on the back of weak exports of services combined with a near stagnation in the oil and gas sector balance in comparison to the same period last year. The consolidated budget moved from a deficit of 1.4 per cent of GDP in 2017 to a 5.6 per cent surplus in 2018.

Credit activity started recovering but weaknesses in the financial sector remain. The loan portfolio stopped contracting in 2018 and started to gradually increase in nominal terms at the end of the year amid overall macroeconomic stabilisation and the resumption of economic growth. However, the ratio of private credit to GDP, at 16.3 per cent in 2018, is low by regional standards. Loan and deposit dollarisation has been declining, but remains high at 34.3 per cent and 63.0 per cent respectively as of August 2019. The share of overdue loans as defined by the Central Bank of the Republic of Azerbaijan (CBA) has dropped in the past two years but, at 10.8 per cent, is still significant.

A modest economic recovery is expected to continue. We forecast the economy to grow by 2.8 per cent in 2019 and 2.4 per cent in 2020. Volatility in commodity prices represents the main risk to the near-term growth prospects. The economy's resilience to external shocks is supported by significant liquidity buffers, as the combined official foreign exchange reserves of the CBA and assets of the State Oil Fund of Azerbaijan (SOFAZ) are approximately equal to the forecasted 2019 GDP. Steeper longer-term growth requires deeper reforms that would enable the private sector outside of the oil and gas industry to play a more significant role in growth creation.

Assessment of transition qualities (1-10)



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Major structural reform developments

Tax reforms have been introduced. The reforms were adopted in December 2018 and entered into force in January 2019. They aim to increase transparency and accountability, encourage businesses to formalise and promote economic diversification. The reforms include measures to foster development of the private sector outside of the hydrocarbon sector. The tax rate for micro, small and medium sized enterprises (MSMEs) was reduced from 4 per cent to 2 per cent, while sole entrepreneurs are taxed at a minuscule fixed rate. Furthermore, MSMEs are exempted from profit and land tax as well as from VAT on imported manufacturing and processing machinery for seven years since the date of their establishment. At the same time, sanctions for non-compliance with the new tax rules were increased.

New fiscal rules are in place. Adopted in the second half of 2018 and implemented with the 2019 budget, the new fiscal rule fosters fiscal prudence and reduces the pro-cyclicality of the budget at times of high oil prices. The rule sets an upper limit on the overall amount and annual nominal increase of the consolidated budget expenditures, obliges the government to gradually decrease the non-oil budget deficit in the coming years and determines escape clauses in the events of significant budget underperformance. In addition a new strategy for managing the state debt in 2018-25, adopted in August 2018, sets ceilings on the government debt to GDP ratio, the overall government debt service and the level of debt denominated in foreign currency. It also defines specific projects eligible for foreign financing and government guarantees in the strategy period.

Problem loans are being addressed. Various measures to tackle the high share of overdue loans were authorised by the presidential decree signed in February 2019. The first set refers to foreign currency-denominated loans taken out by individual borrowers prior to the step-devaluation of the manat that started in February 2015. The authorities are obliged to pay back a certain share of such loans. To be eligible for the scheme, the loan must not be higher than US$ 10,000 and the maximum amount of compensation is limited to half of that amount. The second set of measures aims to incentivise banks to restructure non-performing loans, which the authorities offer to fund at very low preferential terms and with a grace period of one year. This applies to loans in any currency in the maximum amount of AZN 17,000 or US$ 10,000 that are overdue by more than 360 days and were taken out by individuals not earlier than 2012.

Presidential decrees aim to speed up reforms in the judicial system and energy sector. Published in April 2019, a decree on enhancing reforms in the judicial-legal system recommends setting up a specialised court that would handle cases related to entrepreneurs and clarifying timeframes for judicial examination of disputes in various areas. It also aims to increase awareness of the mediation process; a law on mediation which provides the legal basis for this alternative dispute resolution mechanism was approved at the same time. An Order of the President, issued in May 2019, intends to accelerate institutional reforms in the energy sector with the aim of developing private sector activity in the sector, including attracting foreign investments, and creating a competitive environment.

The authorities have continued to introduce focused business environment reforms. A green corridor gating system, launched in February 2019, is expected to facilitate foreign trade of best-performing companies in non-oil sectors with external markets. Companies granted the right to use the green corridor will face faster customs procedures and increased flexibility and transparency in customs control. Building on the success of ASAN, the state agency for public services, authorities has established a one-stop-shop agency for social services. Opened in May 2019, the Centre for Sustainable and Operational Social Security (DOST) provides 126 different services including those related to labour market, social benefits and pensions, medical services, and social protection. A single e-procurement website, integrating all state agencies in one platform and automating the public procurement process, was launched in January 2019. Efforts to advance digitalisation in public services and cut the red tape, among others, were recognised in the World Bank's *Doing Business 2020* report; Azerbaijan improved its rank from 57th place in 2018 to 34th in 2020.

BELARUS

Highlights

- **Economic growth has sharply decelerated.** After reaching a peak of 5.3 per cent in the first quarter of 2018, growth has since decelerated to 0.9 per cent year-on-year in the first half of 2019.
- **Short-term risks to the outlook have increased.** The authorities are working on a response to the adverse supply shock coming from the new energy taxation system that is being introduced by Russia.
- **The business environment is improving.** The authorities have made progress in creating a better business environment for private enterprises, but the commercialisation and privatisation of state-owned enterprises (SOEs) are lagging behind.

Key priorities for 2020

- **Commercialisation of the state sector needs to be scaled up.** Achievements of particular SOEs need to be replicated more widely, and the application of corporate governance principles, as created by the Organisation for Economic Co-operation and Development, will be necessary to improve the quality of management in the state sector.
- **Further progress should be made in the modernisation of the financial sector.** The ongoing institutional building and pre-privatisation work in some of the state banks should be followed by good-quality equity participation of private investors. The phasing out of state lending programmes also needs to continue.
- **The authorities need to undertake benchmark-setting privatisation in the real sector.** A successful entry of a credible international investor in one of the several non-strategic SOEs whose preparation for privatisation has been jointly supported by international financial institutions (IFIs) would set a precedent that could be replicated by other SOEs.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	-3.8	-2.5	2.5	3.0	1.3
Inflation (average)	13.5	11.8	6.0	4.9	5.4
Government balance[1]/GDP	-3.0	-1.7	0.3	2.4	-1.3
Current account balance/GDP	-3.3	-3.4	-1.7	-0.1	-0.9
Net FDI/GDP [neg. sign = inflows]	-2.7	-2.4	-2.2	-2.3	-2.5
External debt/GDP	67.8	78.6	72.8	65.9	n.a.
Gross reserves/GDP	7.4	10.3	13.4	12.0	n.a.
Credit to private sector/GDP	22.8	20.4	20.9	21.5	n.a.

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

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Macroeconomic performance

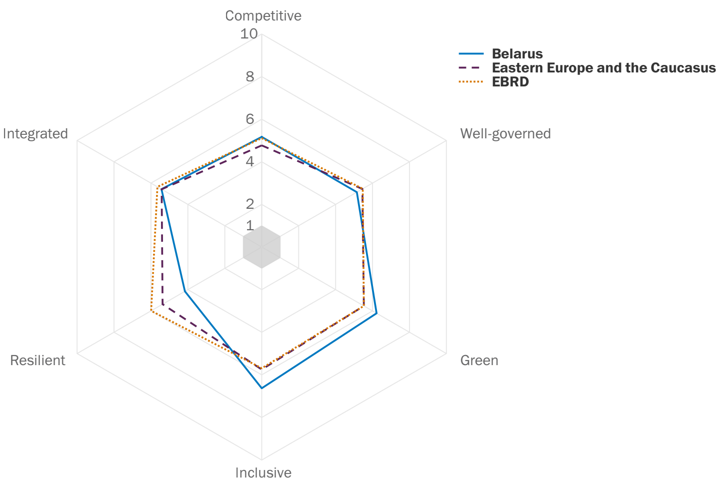
Economic growth accelerated to 3.0 per cent in 2018, driven by domestic demand, but net exports continued to have a negative impact. Household consumption recorded robust growth of 8.3 per cent, benefiting from a strong increase in disposable incomes, while investments in fixed assets increased by 4.9 per cent as a result of growing external and internal demand. Value added increased in all large sectors except agriculture, where it declined by 4.0 per cent. The growth rate reached a peak in the first quarter of 2018 and then started decelerating. This trend continued in 2019 when real gross domestic product (GDP) increased by 0.9 per cent year-on-year in the first half of 2019 on the back of stagnation in the manufacturing sector. Inflation fell below 5.0 per cent in 2018 for the first time since the country became independent, but has since risen to 5.9 per cent in January to August 2019 year-on-year on the back of increases in regulated prices and tariffs. The latest data for September show inflation slowing down to 5.3 per cent year-on-year due to decelerating core inflation and a reduced contribution from regulated prices and tariffs.

The current account is close to balance and foreign reserves have increased. The current account deficit dropped to just 0.1 per cent of GDP in 2018 as a result of an increase in the export of services and the surplus of secondary incomes due to a transfer of duties on energy resources from Russia. The size of the deficit remained more or less unchanged in the first half of 2019. International reserves have increased by US$ 1.7 billion year-on-year to US$ 8.9 billion in September 2019, but coverage is still relatively low, at just two and a half months of imports.

New energy tax arrangements in Russia may affect Belarus's fiscal position and competitiveness. Belarus has long benefited by importing oil from Russia without export duty within the Customs Union of the Eurasian Economic Union, processing it in its own refineries and exporting refined products to Europe, while collecting the oil export duty as income in its own budget. A new energy taxation system is being introduced by Russia, the so-called "tax manoeuvre", which will gradually replace the oil export duty with an extraction tax from 2019 to 2024. According to the Belarus Ministry of Finance, the lost budget revenues will rise from 0.4 per cent of GDP in 2019 to 4.0 per cent in 2025, when the new system is fully in place. In addition, the new system may negatively affect the competitiveness of the oil refineries, which account for almost 20.0 per cent of total exports. The authorities are currently negotiating a new energy agreement with Russia, with the aim of compensating for the losses that are expected to be incurred by the tax manoeuvre.

Positive growth is expected to continue but short-term risks to the outlook are rising. GDP growth is forecast at 1.3 per cent in 2019 and 1.2 per cent in 2020. However, risks are on the downside: the economy is particularly vulnerable to the external shock coming from the aforementioned tax manoeuvre. The current model of economic growth is stalling, and recharging will require an increased appetite for, and the implementation of, reforms.

Assessment of transition qualities (1-10)



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Major structural reform developments

A new government programme of activities in 2018-20 was adopted. The programme, which was approved at the end of October 2018, targets improvements in the oversight, corporate governance and financial discipline of SOEs. It also aims to improve the investment climate by streamlining the regulatory framework, facilitating structural transformation towards a service-led economy, in particular in the information technology sector, and promoting trade diversification.

The authorities have taken steps to improve the business environment. A joint working group, consisting of members of the government and the business community, prepared a new edition of the Tax Code of the Republic of Belarus, which entered into force on 1 January 2019. The amendments aim to reduce the tax burden on businesses and create favourable conditions for investments. According to the authorities, the updated edition includes simplification of the tax administration, measures to facilitate interaction between taxpayers and tax authorities and provisions to soften penalties for tax wrongdoings. In addition, legislative changes adopted in December 2018 and signed by the President in January 2019 decriminalised some aspects of business operations, alleviated penalties for selected economic crimes, in particular those for first-time offenders, cancelled the general confiscation of property and increased the amount of damage that falls under the definition of “large” and “especially large” damage.

Access to finance for small and medium-sized enterprises (SMEs) is being enhanced. The government launched a credit guarantee fund for SMEs in April 2019. The scheme targets the smaller segment of enterprises, namely those with fewer than 100 employees. It operates through three partner banks, and the fund guarantees cover for up to 60 per cent of bank loans and leasing contracts to a maximum amount of BYN 134,950 (US$ 64,000). This is an encouraging sign of improving access to finance for SMEs and indicates a move towards more commercially based financing mechanisms.

Measures were taken to reduce the banks’ excessive risk exposure. Since 1 March 2019, the National Bank of the Republic of Belarus (NBRB) introduced macro prudential measures aimed at limiting the systemic risk generated by business models of banks with increased risk appetite. Banks setting significantly higher interest rates, compared with a standard risk estimated value, will be obliged to comply with higher capital adequacy requirements, generate special provisions for possible losses and create a compulsory reserve fund. In addition, as part of the gradual phasing out of direct lending, the amount of direct lending to the real sector in 2019 was reduced by 35.0 per cent year-on-year to 0.6 per cent of GDP.

Foreign exchange liberalisation gradually continued. Effective from March 2019, current currency transactions between residents and non-residents are not subject to any restrictions. Capital transactions remain subject to a registration requirement but no longer require approval from the NBRB. Currently, all transactions between residents and non-residents are classified as either current or capital transactions. The former include those related to trade, intellectual property, provision of services, operational or financial lease of immovable property, transfer of income investments and similar activities. All other business deals are classified as capital transactions.

Disbursements by the Eurasian Fund for Stabilisation and Development (EFSD) continued unevenly. The EFSD initiated a financial loan in 2016 for the overall amount of US$ 2 billion to be disbursed in seven tranches until 2018. Disbursements so far have been subject to occasional delays. The sixth tranche, of US$ 200 million, was disbursed in October 2018, bringing total disbursements to US$ 1.8 billion. In January 2019, the EFSD extended the date of credit availability.

BOSNIA AND HERZEGOVINA

Highlights

- **Growth continued in 2018 amid political uncertainty but has slowed in 2019.** In 2018, GDP increased by 3.6 per cent. However, it eased to 2.7 per cent year-on-year in the first half of 2019.
- **The delay in forming governments has blocked much-needed reforms.** The Federation entity- and state-level government are still not in place after the October 2018 elections, and the IMF programme continues to be stalled.
- **In May 2019, the European Commission adopted the Opinion on Bosnia and Herzegovina's EU membership application.** The Opinion identified 14 key priorities, in the areas of democracy/functionality, rule of law, fundamental rights and public administration reform, which the country needs to fulfil in order to progress with EU approximation.

Key priorities for 2020

- **The business climate needs to improve substantially.** The business environment remains one of the most convoluted in Europe, with different regulations in the two entities and the Brčko district. The private sector would benefit greatly from harmonised regulations and a reduction in "red tape" and para-fiscal charges.
- **Inefficient state-owned enterprises (SOEs) should be tackled.** SOEs impose a significant fiscal burden and have negative effects on other businesses. They should be depoliticised and restructured, followed in some cases by a renewed and credible push for privatisation.
- **Public administration reform should be pursued.** Bosnia and Herzegovina is known for an oversized and inefficient public sector, putting a significant burden on taxpayers and adversely affecting the business environment. The Republika Srpska should also adopt as soon as possible the strategic framework of public administration reform for 2018-22, and the country should embark on developing a professional, de-politicised and merit-based civil service.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	3.1	3.1	3.2	3.6	3.0
Inflation (average)	-1.0	-1.1	1.2	1.4	1.0
Government balance/GDP	0.7	1.2	2.6	2.3	1.0
Current account balance/GDP	-5.1	-4.7	-4.3	-3.7	-5.0
Net FDI/GDP [neg. sign = inflows]	-1.8	-1.8	-2.1	-2.6	-3.0
External debt/GDP	62.9	63.8	61.1	61.0	n.a.
Gross reserves/GDP	30.1	31.9	33.5	35.3	n.a.
Credit to private sector/GDP	55.0	54.3	55.6	55.2	n.a.

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Macroeconomic performance

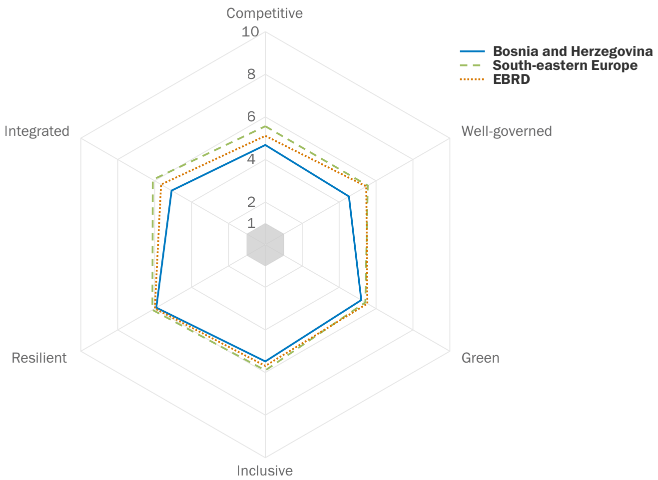
The economy has once again proved to be resilient to a slowdown of reforms and continued political uncertainty. GDP growth in 2018 surprised on the upside, reaching 3.6 per cent, 0.5 percentage points higher than the 2015-17 average. The value-added increased most in the agriculture sector and in electricity production. Unemployment dropped by two percentage points, but at above 18 per cent remains high, especially for young people (close to 40 per cent). In the first half of 2019 growth slowed to 2.7 per cent year-on-year, primarily due to a slowdown in exports and increase in the growth of imports.

Inflation has trended down. After increasing from 0.3 to 1.8 per cent year-on-year in the first half of 2018, on the back of rising fuel prices and excise duties on cigarettes, inflation stabilised around that level for the rest of the year. In 2019, it started to decline, falling back to 0.3 per cent year-on-year in September. The decline was primarily led by the slowdown of transport prices growth.

The consolidated budget stayed in surplus for the fourth year in a row, also due to the under-execution of capital expenditures. In 2018, government revenues were higher than expenditures by 2.2 per cent of GDP. Public debt also fell, reaching 33.6 per cent of GDP as of the end of June 2019. However, the quality of fiscal governance has remained low. The country lacks medium-term fiscal planning and focuses strongly on maintaining current spending patterns, often at the cost of delaying much-needed public investment. Also, accumulated public sector arrears pose significant fiscal challenges. In the Republika Srpska these mostly stem from the health sector, while the majority of arrears in the Federation of Bosnia and Herzegovina (FBIH) have been accumulated by SOEs. Documentation and monitoring of arrears are weak in both entities, too.

Further moderate growth is likely in the short term. GDP is expected to expand by 3.0 per cent annually in both 2019 and 2020. Risks to the projection are tilted to the downside and mainly relate to uncertainty about the reforms (that is, improvements in the business climate and standards of governance, as well as advancement of the country's EU approximation agenda) and slowdown in the main export market, the eurozone.

Assessment of transition qualities (1-10)



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Major structural reform developments

The European Commission has adopted the Opinion on Bosnia and Herzegovina's EU membership application. The country submitted an EU membership application in February 2016. In May 2019 the European Commission issued the Opinion on the application. The Opinion identifies 14 key priorities for the country to fulfil in order to be recommended for the status of EU candidate country. These priorities lie in the areas of democracy and functionality of institutions, rule of law, fundamental rights and public administration reform. The Commission encouraged the authorities to agree and implement socio-economic reform measures, in line with the Economic Reform Programme policy guidance, and to continue engaging in regional cooperation and strengthening bilateral relations with neighbouring countries.

Business environment has remained unchanged over the past year. Bosnia and Herzegovina keeps lagging behind its Western Balkans peers on global competitiveness lists. In 2019, the country was ranked 92nd among 141 economies in World Economic Forum's Global Competitiveness Index, one place lower than in 2018, with several areas with a rank above 100th (institutions, product and labour market, business dynamism and innovation capability). Similarly, Bosnia and Herzegovina ranked 90th among 190 countries in the *World Bank's Doing Business 2020* report, dropping one place from the year before as no major reforms took place. While it ranked relatively well on trading across borders and resolving insolvency (27th and 37th, respectively), the areas in need of major push are starting a business (184th), dealing with construction permits (173rd) and paying taxes (141st).

Public administration reform is stalled. A countrywide strategic framework on public administration reform for 2018-22, developed by inter-institutional working groups appointed by the Council of Ministers of Bosnia and Herzegovina and the entity and Brčko District governments in March 2018, is lacking as Republika Srpska has still not adopted it. The need for reform is urgent as the public administration in Bosnia and Herzegovina is complex and often has overlapping competences, duplications of functions and an unclear division of responsibilities across various levels of governments. The poor quality of the institutional set-up is reflected in the country's lowest ranking (111th) in Europe on institutions in the World Economic Forum's Global Competitiveness Index 2018.

There has been little progress in the past year with privatisation or restructuring of SOEs. The Republika Srpska authorities managed to sell (minority) stakes in three companies out of 14 in the 2018 privatisation plan. The plan also included three strategic enterprises, but one of these went into bankruptcy in February 2019 (a producer of special diesel engines and spare parts for engines Fabrika motora specijalne namjene), while the other two have not been privatised. The entity's railway company started a financial, workforce and organisational restructuring in 2018, planned for completion in 2021. The process is supported by a World Bank loan (€51.3 million) and technical assistance. The FBIH entity sold none of the four enterprises in the 2018 privatisation plan, although they have been planned for sale for a long time. The state footprint in Bosnia and Herzegovina is large, with around 550 SOEs employing 80,000 people, or about 10 per cent of the total workforce. These companies are usually characterised by weak transparency, accountability and performance, and suffer from political influence. Many of them are burdened by excess employment and debts, and are loss makers. As such, they pose risks to macroeconomic performance, fiscal sustainability and competitiveness. One of the recent examples is the indebted aluminium smelter Aluminij, which required government intervention in September 2018. In mid-July 2019, the company was disconnected from the power grid, after strategic partnership talks between the Federation entity's government and a consortium failed. The entity's government gave the company a deadline of the end of 2019 to restructure. Failure to do so could potentially lead to bankruptcy and loss of employment of 900 workers in Aluminij and about 10,000 workers in the supply chain.

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The road network is being improved slowly. The improvements focus mostly on the Corridor Vc motorway, connecting the Port of Ploče in Croatia with Budapest in Hungary. The motorway will represent an important trade route to European markets. In the past year, contracts for few motorway sections in FBIH have been signed, while works on the first section of the corridor in Republika Srpska started in June 2019. In general, the project is lagging behind (it was initially expected to be finished in 2012) and by September 2019 around one-third of the highway (or around 100 kilometres) had been completed. The EBRD supported the project in 2019 with a loan of up to €210 million for a new motorway section that will include a bypass for the town of Doboj. The project is expected to be completed by 2030 and will cost around €4 billion. In addition, the Republika Srpska and China's SDHS-CSI BH signed in December 2018 a 33-year concession agreement on the construction of the 42 kilometre Banja Luka-Prijedor highway.

The banking sector is well-capitalised, but non-performing loans (NPLs) remain elevated. The capital adequacy ratio of the banking sector stood at 17.9 per cent at the end of June 2019, well above the regulatory minimum of 12.0 per cent. Still, some (primarily local) banks have insufficient capital endowments and unfavourable credit portfolios. The NPL ratio of the banking sector stood at 8.0 per cent at the end of June 2019 (down from 9.3 per cent a year ago). The NPLs are concentrated in domestically owned banks and are largely a legacy issue. The new banking laws adopted in 2017 should support the soundness of the banking sector, but banking sector supervision is hampered by fragmented competences. In addition, the country has not yet adopted a law on deposit insurance that would complete the bank resolution framework in line with EU directives.

A controversial coal-fired power station may breach EU commitments and conserve polluting generation capacities. In March 2019, the Energy Community opened an infringement procedure against Bosnia and Herzegovina over state aid to the Tuzla 7 coal power plant. The 450 MW extension of Tuzla thermal power plant is planned to be financed through a loan of €614 million from the Chinese Exim Bank, which received a guarantee by the Federation entity in spring 2019. The new facility (with other planned units) would further increase Bosnia and Herzegovina's reliance on highly polluting lignite-based power generation and would result in expensive stranded assets at a later date.

The entity governments have endorsed a joint package of socio-economic reforms (2019-22). Under this package, which was endorsed in October 2019, the governments will be aiming at improving the business environment and stimulating growth and competitiveness, as well as at depoliticising SOEs, reforming the healthcare system and providing better opportunities for young people, women and other vulnerable groups.

BULGARIA

Highlights

- **Growth has remained solid during 2019.** The economy grew by an estimated 3.1 per cent in 2018, following an average growth rate of 3.8 per cent in 2015-17. The economy grew robustly at 4.2 per cent year-on-year in the first half of 2019.
- **Reforms in the energy sector have continued.** Bulgaria is also developing a number of gas infrastructure projects, with the aim of becoming a major gas hub and transit route in the region.
- **Steps have been taken to advance Bulgaria's integration into the financial architecture of the European Union (EU).** Bulgaria is aiming to join the eurozone and has officially announced its intention to join the European Exchange Rate Mechanism (ERM II) and the EU's banking union simultaneously.

Key priorities for 2020

- **Reforms needed to prepare the country for joining ERM II and the EU's banking union should be stepped up.** While Bulgaria consistently meets the macroeconomic requirements to become part of ERM II, the authorities should remain committed to key structural reforms needed to achieve this goal.
- **Bulgaria should continue working on implementation of the commitments within the framework of the EU's Cooperation and Verification Mechanism (CVM).** According to the latest CVM report, the European Commission considers that the progress made by Bulgaria under the mechanism is sufficient to meet the country's commitments made at the time of its accession to the EU.
- **Reforms on improving the business environment need to be implemented.** Bureaucratic processes remain an impediment to doing business, while access to skilled labour is a growing challenge. Attention should be turned to reforming the business environment, retaining qualified workers and improving the skills of the existing labour force.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	4.0	3.8	3.5	3.1	3.7
Inflation (average)	-1.1	-1.3	1.2	2.6	2.0
Government balance/GDP	-1.7	0.1	1.1	1.8	0.8
Current account balance/GDP	0.0	2.3	4.4	2.4	1.6
Net FDI/GDP [neg. sign = inflows]	-5.0	-1.3	-3.9	-2.6	-2.4
External debt/GDP	72.6	67.8	68.7	58.2	n.a.
Gross reserves/GDP	44.0	47.3	48.0	43.8	n.a.
Credit to private sector/GDP	54.9	52.1	51.3	51.9	n.a.

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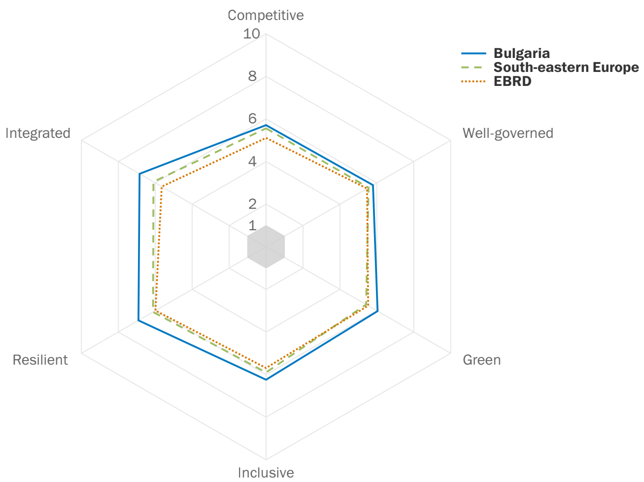
Macroeconomic performance

Economic growth remains solid. The economy grew by an estimated 3.1 per cent in 2018, following an average growth rate of 3.7 per cent in 2015-17. Private consumption has been the main driver of growth, fuelled by increased earnings and a higher employment rate amid the tightening labour market. Unemployment was down to almost 4.0 per cent as of June 2019, while nominal wages kept growing at high single-digit rates. The government raised the monthly minimum wage by 10.0 per cent in January 2019, to €286. Investment has also been strong, with growth of about 6.0 per cent in 2018, helped by the growing disbursement of EU funds. Meanwhile, net exports have weighed on growth in 2018 as strong private consumption has pushed up imports, while exports experienced a small decline, not least because of the downturn in the economy in Turkey, an important trading partner. Real gross domestic product (GDP) expanded by 4.2 per cent year-on-year in the first half of 2019. Household consumption has continued to be the main source of growth. Inflation reached a high of 3.7 per cent in August 2018, averaging 2.6 per cent in 2018, but has since come down to 2.5 per cent as of August 2019.

Fiscal policy has remained tight. A period of fiscal tightening resulted in three consecutive years of budget surpluses in 2016-18, reaching 1.8 per cent of GDP in 2018, which places Bulgaria among the top performers in the EU. Government spending rose in 2019, mainly due to a large one-off army-related expense, and the budget may be in deficit after three consecutive years of budget surpluses. Nevertheless, public debt continues to decline and stands at around 21.0 per cent of GDP, one of the lowest percentages in the EU.

Growth is expected to remain solid. The economy is expected to grow by 3.7 per cent in 2019 and 3.0 per cent in 2020, the latter being broadly in line with the country's current growth potential. Growth is likely to be underpinned by private consumption, which traditionally fuels economic activity. Investment should also contribute positively to growth, as the absorption of EU funds is accelerated towards the end of the 2014-20 funding period. Fiscal policy is expected to remain tight, limiting the contribution of government spending to growth. Key risks to the outlook are: prolonged weakness of major trading partners, particularly that of the eurozone and exacerbation of current labour shortages (due to the declining population, emigration of skilled workers and a skills gap in the workforce). While convergence prospects remain high, with GDP per capita (in purchasing power standards) standing at just half of the EU average, sustaining high growth rates in the long term will require the reinvigoration of structural reforms.

Assessment of transition qualities (1-10)



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Major structural reform developments

Plans for euro adoption are advancing. In November 2018, the parliament adopted legislative changes to strengthen the autonomy of the central bank, as recommended by the European Central Bank (ECB). This was a necessary step for the country's entry into the EU's banking union. Bulgaria is eager to join the eurozone and has stated its firm intention to apply to the ERM II, having met all the nominal criteria for membership, namely, a stable currency (fixed peg to the euro), low inflation and healthy public finances. The ECB has undertaken a comprehensive analysis of six Bulgarian banks as part of the procedure for the country's parallel entry into the banking union. The analysis, published in July 2019, identified a capital shortfall in two domestically owned banks. Additional commitments relate to other financial-sector issues and institutional quality and governance.

There was further progress in implementing the Cooperation and Verification Mechanism (CVM). According to the latest CVM report, published in October 2019 by the European Commission, Bulgaria's progress has been assessed as sufficient to meet the country's commitments at the time of its EU accession.

The business environment remains problematic in some areas. According to the latest World Bank *Doing Business 2020* report, published in October 2019, Bulgaria ranked 61st out of 190 countries in ease of doing business, dropping two places compared with the previous year. This is among the lowest rankings in the EU. Procedures for starting a business, paying taxes and getting electricity remain burdensome, although, similar to most EU members, Bulgaria performs well in trading across borders.

Energy infrastructure improvements have continued. Construction of the Turkish gas stream, aimed at bringing Russian gas to central Europe through Bulgaria, Serbia and Turkey, is progressing. In June 2019 the Competition Protection Commission restored a Saudi Arabian-Italian consortium (Arkad) as the tender winner for the construction of the Turkish stream extension in Bulgaria. Subsequently, in September 2019 the Bulgarian natural gas transmission system operator Bulgartransgaz and Arkad signed a contract for the delivery of materials, investment project design and the development and commissioning of the gas pipeline. Also, construction of the long-delayed €220 million Bulgaria-Greece gas interconnector was launched in May 2019, a week after Greece's J&P AVAX was selected to execute the project. The interconnector will help diversify natural gas sources for Bulgaria, which, at present, mainly depends on Russian gas. Meanwhile, in December 2018, the European Commission's anti-trust body fined the state-owned energy firm Bulgarian Energy Holding and its gas infrastructure subsidiary Bulgartransgaz €77 million for blocking access to natural gas infrastructure in Bulgaria during 2010-15, thus not allowing potential competitors to enter wholesale gas supply markets in Bulgaria. Also, the Czech energy company ČEZ Group has decided to withdraw from Bulgaria over longstanding disputes with the Bulgarian authorities. In June 2019, Bulgarian financial and insurance group Eurohold signed a deal with ČEZ to buy its local assets for €335 million, including an electricity distribution business with two million customers and two renewable plants. However, in October 2019, Bulgaria's competition regulator blocked the acquisition, saying that the deal could hinder competition.

Transport infrastructure is being developed. In April 2019, the government launched the construction of a 56-kilometre section of the Hemus motorway heading eastwards from the junction with the Veliko Tarnovo-Ruse road to the city of Targovishte. The Hemus motorway links Sofia to the Black Sea port of Varna through the northern part of the country. In December 2018, the government decided to allocate €690 million for the construction of a 134-kilometre stretch of the Hemus motorway, to be built by the state-owned civil engineering company Avtomagistrali, which was given the contract without a public procurement procedure. Meanwhile, the EU has allocated €293 million to fund the modernisation of the railway between two of Bulgaria's biggest cities, Plovdiv and Burgas, which would reduce travel time significantly. In July 2019, the government picked SofConnect – a consortium between French-registered Meridiam Eastern European Investments, the Austrian construction company Strabag and the Munich Airport operator – as the 35-year concessionaire for Sofia Airport. The decision, however, was appealed in front of Bulgaria's Commission for the Protection of Competition by the other four bidders.

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Consolidation and change of ownership in the banking system are ongoing. In June 2019, the Eurobank-owned Post Bank acquired the Bulgarian subsidiary of Piraeus Bank. Following the acquisition, Post Bank will become one of the largest banks in Bulgaria, with a market share of around 10 per cent. The operational integration should be completed by the end of the year. In January 2019, DSK Bank, owned by OTP Bank, closed the acquisition of Société Générale's Bulgarian unit, Expressbank, which has a market share of 6 per cent. This will further strengthen OTP Bank's market position in Bulgaria and boost its market share to almost 20 per cent after the acquisition. Profits in the banking sector, as a whole, increased by 43 per cent in 2018 to €860 million.

CROATIA

Highlights

- **Economic recovery has continued.** The growth rate decelerated from a post-recession high of 3.5 per cent in 2016 to 2.6 per cent in 2018, but rose again in the first half of 2019.
- **Croatia is back to investment grade.** The country is rated BBB-/Positive by Fitch (June 2019) and BBB-/Stable by Standard & Poor's (March 2019), following significant macroeconomic improvements in recent years.
- **Plans for joining the eurozone have advanced.** The authorities have sent a letter of intent, representing the first formal step towards joining the Exchange Rate Mechanism II (ERM II) in 2020, which would be one stage ahead of joining the eurozone.

Key priorities for 2020

- **Reforms aiming to prepare the country for joining ERM II and the banking union should be stepped up.** While Croatia has improved its macroeconomic conditions to become part of ERM II, the authorities should speed up key structural reforms, focusing in particular on improving public-sector governance.
- **Acute shortages in skilled labour need to be addressed sustainably**. Several sectors (tourism, in particular) have long been experiencing a lack of qualified staff. Increased quotas for foreign workers are helping to provide a short-term fix, but a longer-term solution is needed, including a further reduction in labour market rigidities.
- **Business environment reforms should continue to be prioritised.** Despite improvements, bureaucratic processes remain an obstacle to doing business. In addition, state-owned enterprises remain dominant in some sectors, and privatisation of these enterprises, including through initial public offerings, would attract investors and increase the competitiveness of the economy.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	2.4	3.5	3.1	2.6	3.0
Inflation (average)	-0.3	-0.6	1.3	1.6	1.0
Government balance/GDP	-3.3	-1.1	0.8	0.3	0.1
Current account balance/GDP	4.5	2.6	3.9	2.7	2.3
Net FDI/GDP [neg. sign = inflows]	-0.5	-4.3	-2.6	-1.4	-1.4
External debt/GDP	100.1	85.1	87.4	73.2	n.a.
Gross reserves/GDP	30.2	27.6	34.1	32.9	n.a.
Credit to private sector/GDP	62.3	57.7	55.4	54.4	n.a.

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Macroeconomic performance

Growth has somewhat moderated in the past year, but remains solid. The economy experienced growth of 2.6 per cent in 2018, its fourth consecutive year of recovery following a six-year recession from 2009-14. Private consumption remained the main driver of growth, fuelled by increased earnings, a higher employment rate and an increasing pace of household lending. The unemployment rate as of June 2019 was about 7.0 per cent, down from 18.3 per cent in 2014 (the final year of recession). Investment continued along its recovery path from 2015, helped by the growing disbursement of funds from the European Union (EU), rising economic sentiment and low interest rates, rising 4.0 to 5.0 per cent per year on average ever since, and thus contributing around one percentage point to growth per year. Gross domestic product (GDP) grew by 3.1 per cent year-on-year in the first half of 2019, driven again by broad-based domestic demand. Inflation turned positive in 2017 but remained low in 2018, averaging 1.6 per cent. The current account was in surplus in 2018 (2.9 per cent of GDP), despite stronger imports.

Fiscal adjustment has continued in 2018, albeit at a slower pace. The 2018 budget surplus is estimated at 0.3 per cent of GDP, following a budget surplus of 0.8 per cent in 2017, and is underpinned by expenditure restraint, lower interest costs and higher revenues from favourable macroeconomic developments. A balanced budget is expected in 2019, despite an increase of 5.0 per cent in the public wage bill. Also expected are revenue losses from reductions in excises, value added tax (VAT) rates on some products and social security contributions. Public debt ratios have come down from a peak of 85.0 per cent of GDP in 2014 to an estimated 75.0 per cent by the end of 2018. The government's commitment to joining the ERM II, as part of the euro adoption strategy, should serve as an anchor for prudent fiscal policy in the coming years.

Croatia's credit rating was raised to investment grade. In June 2019, Fitch raised the country's credit rating from "BB+" to "BBB-", with a positive outlook. This follows Standard & Poor's upgrade in March 2019, which also raised Croatia to investment grade "BBB-". In June 2019, the government successfully issued a 10-year Eurobond, raising €1.5 billion with an annual coupon interest rate of 1.125 per cent. In August 2019, the government issued a one-year Eurobond with a negative interest rate of 0.05 per cent. For shorter maturities, average yields in local currency have remained close to zero.

Economic performance is expected to stay at solid levels in the short term. We expect GDP growth of 3.0 per cent in 2019, in line with that of the first half, and light moderation to 2.5 per cent in 2020, broadly in line with the country's current growth potential, as supply side constraints for the tourism sector become apparent. Growth is expected to be driven by private consumption and supported by positive labour market developments, low inflation and steadily increasing remittances. Risks to the projection come from possibly weaker demand from Croatia's main economic partners, such as the eurozone. While convergence prospects remain high, with GDP per capita (in power purchasing standards) standing at just 63.0 per cent of the EU average, a further tightening of labour market conditions and an increasingly difficult demographic profile are making it challenging for employers to fill highly qualified positions amid emigration and an ageing population, which could weigh on long-term growth prospects.

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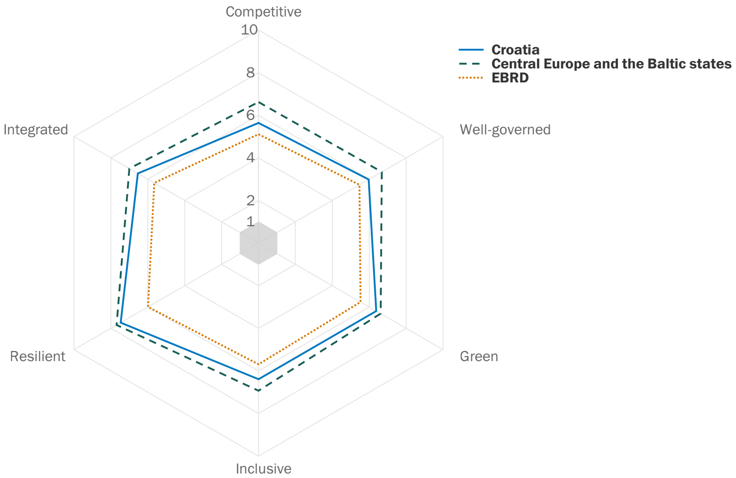
Assessment of transition qualities (1-10)



Major structural reform developments

Croatia's business environment has improved over the past year. Croatia has made a number of reforms over the past year making it easier to do business. The country made starting a business easier by abolishing certain requirements for company registration, and by reducing the paid-in minimum capital requirement. Also, it made dealing with construction permits less costly by reducing the water contribution for building a warehouse. Transferring property has been facilitated by a decrease in the real estate transfer tax and a reduction in the time to register property title transfers. However, Croatia made accessing credit information more difficult by ending the distribution of individual credit data. The overall sum of reforms and reversals helped Croatia to rise by seven places, ranking 51st (out of 190 economies) in the World Bank's *Doing Business 2020* report.

The restructuring of Agrokor continues. The company was, at one point, Croatia's biggest employer but almost collapsed in 2017 due to a debt crisis. Following the agreement between Agrokor and its creditors in July 2018 on a debt-for-equity settlement deal, implementation started in April 2019, when the management of the company was transferred from emergency administration to a new company called Fortenova Group. The biggest shareholder in the new company is Russia's Sberbank, with a 39.0 per cent stake.

Croatia has sent a letter of intent to join the ERM II. The letter was sent by the authorities to the European Commission in July 2019. It represents the first formal step towards joining ERM II, intended for 2020, which would be one stage ahead of joining the eurozone. Croatia has committed to implementing reforms in six areas in the following ways: (i) further strengthening the supervision of the banking system by establishing close cooperation between the Croatian National Bank and the European Central Bank; (ii) strengthening the framework for implementing macroprudential policies; (iii) strengthening the framework for the prevention of money laundering; (iv) improving the system for collecting, processing and publishing statistical data; (v) improving public-sector governance; and (vi) reducing the administrative and financial burden on the economy.

CONTINUES

New pension reforms, designed to make the pension system more sustainable, have been partly reversed. In December 2018, the parliament approved changes to the pension system which were meant to make the system more sustainable. Among other measures, it was envisaged that the statutory retirement age of 67 years for both men and women would be introduced as of 2033, from the current 65 for men and 62 for women. But following a widespread campaign against the changes, in September 2019 the government agreed to reinstate the retirement age to 65 and change the law accordingly. However, all pensioners will now be allowed to hold part-time jobs (of up to four hours a day) without losing their pensions. In addition, measures were introduced to boost population growth by allowing additional months of service for parents when they fulfil the retirement conditions.

Tax reforms have advanced. A new package introduced in January 2019 includes: lowering the VAT rate on a number of food products and cultural professions (for example, writers, composers and artists) to 13.0 per cent from the standard rate of 25.0 per cent, and on both non-prescription and over-the-counter drugs to 5.0 per cent; raising the salary range to which the lower income tax rate of 24.0 per cent is applied, from the current monthly HRK 17,500 (€2,350) up to HRK 30,000 (€4,000), with the higher rate of 36.0 per cent remaining for higher salaries; and raising the tax-free amount of annual bonuses for employees to HRK 7,500 (€1,000) from HRK 2,500 (€340).

Oil and gas sector production capacity is being enhanced. According to the Croatian Hydrocarbon Agency, in July 2019 four companies placed bids for six (of the seven) offered sites in the Pannonian Basin, in northern Croatia. As a result of the first onshore tender, two new drilling wells have been opened in Croatia's eastern region of Slavonia by Canada-based Vermilion. In addition, in February 2019 the government launched a tender for gas and oil exploration in the southern part of the country, with a deadline for September 2019. Croatia is also in the process of building a liquefied natural gas terminal on its island of Krk, and is participating in the Ionian-Adriatic Gas Pipeline, which is a continuation of the Trans Adriatic Pipeline that brings natural gas from Azerbaijan's gas field of Shah Deniz to Bosnia and Herzegovina, Croatia and Montenegro. Both of these plans should have an important role in diversifying the natural gas supply as well as ensuring security of a natural gas supply not only for Croatia, but also for the wider region. In addition, the Croatian natural gas transmission operator Plinacro announced that two-way gas flow between Croatia and Slovenia has been enabled, thus fulfilling its obligation under EU regulations regarding gas supply security measures.

Rail transport infrastructure is being enhanced. Croatia has received 10 bids for the construction of its €297 million 43-kilometre rail project on the Krizevci-Koprivnica-Hungarian border. This is the largest railway infrastructure project in Croatia's recent history and will help modernise the rail line shipping cargo from the Adriatic port of Rijeka to central Europe through the capital, Zagreb. The EU is financing 85 per cent of the total cost of the project. The implementation of this project will raise the capacity of railroads, increase the speed of traffic with a modern two-lane line and enhance the level of safety in the corridor.

CYPRUS

Highlights

- **The strong post-crisis economic recovery continues.** Gross domestic product (GDP) growth remained solid in 2018 at 3.9 per cent, driven by rising investment and private consumption, and unemployment rates continue to fall.
- **Non-performing exposures (NPEs) have dropped significantly.** Current levels (as of the middle of 2019) of NPEs are still elevated by European standards at 20 per cent of all loans, but this constitutes a major reduction relative to the 43 per cent recorded at the end of 2017. Legislative changes and sales of bad loans have both contributed to this major reduction in NPEs.
- **Energy sector liberalisation has been delayed.** Progress is being made towards full opening up of the energy market but plans are behind schedule and are meeting some resistance.

Key priorities for 2020

- **Further efforts are needed to reduce non-performing exposures.** The major reduction in NPEs in the past year is welcome, but the share of NPEs in total remains high and should be cut to single digits. This means the government should avoid any steps that would unnecessarily impede the resolution of NPEs.
- **Business environment reforms should be accelerated**. The authorities should focus on areas such as public administration and the judiciary, as well as anti-money laundering, where Cyprus continues to lag behind best practice in other EU countries.
- **Energy sector reform should advance.** Increasing the efficiency and competitiveness of the state-owned power company is crucial for the strength and development of the economy.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	2.0	4.8	4.2	3.9	3.2
Inflation (average)	-1.5	-1.2	0.7	0.8	0.5
Government balance/GDP	-0.3	0.3	1.8	-4.8	3.3
Current account balance/GDP	-1.5	-5.1	-8.4	-7.0	-7.3
Net FDI/GDP [neg. sign = inflows]	47.4	-9.8	-23.1	-22.6	-8.9
External debt/GDP	572.6	576.5	552.3	494.6	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	246	222.8	198.2	142.3	n.a.

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Macroeconomic performance

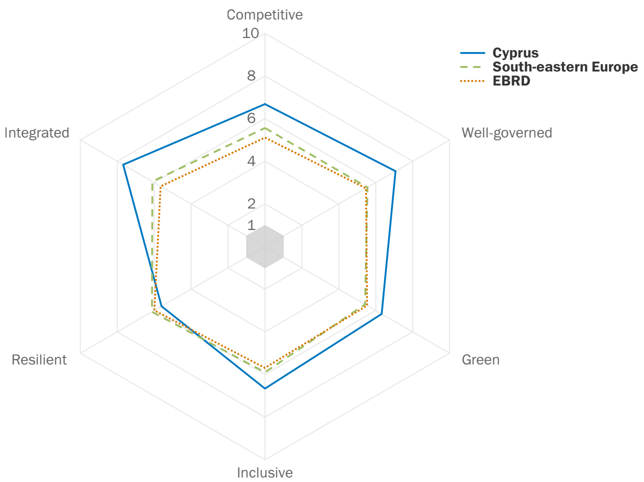
Robust growth is continuing. Economic activity continued at a strong rate in 2018 with GDP growth of 3.9 per cent. Investment was one of the main drivers, as the construction sector continued to grow strongly. The increase in private consumption was another significant factor and is expected to remain resilient, thanks to improving labour market conditions, wage increases and buoyant economic sentiment. Unemployment has continued on a downward trend, reaching 6.6 per cent (seasonally adjusted) in September 2019, its lowest level in eight years and more than eight percentage points below the peak in 2014. In the first quarter of 2019, GDP growth moderated slightly to 3.4 per cent year-on-year, followed by 3.2 per cent year-on-year in the second quarter. On the demand side, private consumption has remained robust, while gross fixed capital formation grew strongly, especially in residential investment. Cyprus enjoyed a particularly good tourism season in 2018, but the sector has levelled off so far in 2019, with tourist arrivals down by 1.1 per cent over the first five months of 2019 compared with the same period in 2018.

Fiscal performance remains strong. Due to the sale and winding down of the Cyprus Cooperative Bank (CCB), the second-largest bank in the country, the public debt burden remains large at around 102.5 per cent of GDP and the primary fiscal balance was negative at -2.3 per cent of GDP in 2018. However, strong GDP growth and primary surpluses (expected to be at 5.7 per cent of GDP in 2019) should allow the debt-to-GDP ratio to resume its downward path from this year onwards. Moreover, the resolution of CCB has reduced systemic risks in the banking sector significantly.

Cyprus is rated investment grade by some credit rating agencies. Both Standard & Poor's (S&P) and Fitch rate Cyprus at investment grade BBB-, with S&P raising the sovereign rating to that level in September 2018 and Fitch in October 2018. In October 2019, Fitch also revised the outlook on its BBB- rating for Cyprus from stable to positive. The other major rating agency, Moody's, still has Cyprus below investment grade at Ba2, but in September 2019, it raised the outlook from stable to positive. Yield spreads over German sovereign bonds have dropped to historically low levels, helping the government to issue a €1 billion 15-year Eurobond and a €750 million 30-year Eurobond in 2019, the longest maturity Eurobonds to date, at an average yield of 2.75 and 2.88 per cent, respectively. Moreover, given the current low market rates of Republic of Cyprus bonds, the government announced in October 2019 that it intends to repay early the remaining amount of the debt to the International Monetary Fund, which stands at 570 million Special Drawing Rights (approximately €700 million).

Robust growth is likely to continue in the short term. Taking into account all the relevant factors, we expect growth to slow down moderately in 2019 and 2020 to 3.2 per cent and 2.8 per cent, respectively. Key downside risks include the slowing European economy and internal risks associated with high levels of personal and corporate debt, as well as an economy that remains dependent on a few key sectors.

Assessment of transition qualities (1-10)



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Major structural reform developments

The banking sector continues to strengthen. In 2018, the sector reported the first net profit in eight years. NPEs had been exceptionally high, accounting at one point for more than half of all loans, but the rate has come down dramatically in the past two years, from 43.0 per cent as of the end of 2017 to 30.5 per cent at the end of 2018. The process was helped by two one-off transactions in 2018: the transfer of the non-performing Cyprus Cooperative Bank (CCB) assets to the state-owned management company KEDIPES, and the sale of a large NPE portfolio by the Bank of Cyprus. These two operations strengthened the balance sheets of these two banks, which are the largest in the country. Legal changes in recent years to encourage the sale of NPEs are also having an important effect.

Anti-money laundering (AML) legislation and supervision of insurance and pension funds are being improved. According to the fifth AML Law, the transposition of the fifth EU AML Directive into Cyprus law should take place in 2019. Full functionality of the Ultimate Beneficial Owner registries is expected to be in place from March 2020. Meanwhile, in order to integrate and strengthen the supervision of insurance companies and occupational pension funds, a draft bill on the creation of a single independent supervisory authority for the supervision of insurance companies and occupational pension funds has been prepared, based on an independent report commissioned with the support of the European Insurance and Occupational Pensions Authority. It aims at a more efficient and effective supervision of the two sectors, thus better managing risks and guarding the interests of stakeholders. The future organisational structure of the new supervisory entity is currently under consultation, following which the final draft Bill will undergo legal vetting, with the aim of adopting the bill by December 2019.

Energy-sector liberalisation has been delayed. The authorities originally committed to liberalising electricity and gas markets by 2019, but progress to date has been slow. The Cyprus Energy Regulatory Authority (CERA) is now working towards the full opening up of the energy market and granting consumers the right to choose their own supplier – with expectations of full liberalisation in 2020-21. CERA's proposition is a "net pool" model, where the operations of the state power company, EAC, are unbundled and the production and supply operations separated. EAC production would then enter into bilateral agreements with suppliers for the sale of energy at regulated prices. However, these plans have experienced some resistance from unions, as they are seen as moves that could increase pressure to privatise EAC.

The business environment still has serious deficiencies in several areas. Cyprus continues to receive a poor overall ranking (54th out of 190 countries) in the World Bank's *Doing Business 2020* report, although it has risen by three places relative to the previous year. The reform of the judicial system and, in particular, the ongoing reforms to increase the efficiency of the courts and accelerate enforcement of commercial claims remain key challenges for achieving a better business environment. Other issues to be tackled include the reform of public administration and the establishment of an e-justice system.

EGYPT

Highlights

- **The economic situation continued to strengthen.** Real gross domestic product (GDP) grew by 5.6 per cent in the fiscal year 2018-19, the highest rate in 11 years; inflation declined markedly to one-digit levels; the fiscal and current account deficits narrowed; and unemployment has declined to its lowest level in eight years.
- **Reforms under the Egypt Tourism Reform Programme were reflected in an increase in competitiveness and attractiveness.** Egypt had the fourth-highest performance improvement in the World Economic Forum's Travel and Tourism Competitiveness Index 2019, the World Travel and Tourism Council awarded Egypt the annual "2019 Global Champion Award" for promoting tourism resilience, the United Kingdom lifted flight restrictions to Sharm El Sheikh, and tourism revenues increased to US$ 12.5 billion in the fiscal year 2018-19; a record high.
- **Structural reforms have progressed strongly.** The government has taken effective steps towards reforming energy subsidies, widening social protection coverage, strengthening tax collection, and deepening the efficiency of financial markets, in addition to amending the investment law.

Key priorities for 2020

- **Measures to improve private investment should be prioritised.** The laws encouraging private participation in certain public-dominated sectors should be implemented, and interest rates – led by Central Bank of Egypt (CBE) policy rates – should continue to be lowered, in line with the decline in inflation.
- **Sustained and advanced implementation of structural and fiscal reforms is essential to consolidating the gains in macroeconomic stabilisation.** Expected reforms in the coming year include conducting a medium-term revenue strategy, promoting a comprehensive privatisation of state-owned enterprises, improving the availability of and access to industrial land, reforming competition policies, and implementing e-public procurement.
- **Implementation of the National Water Resources Plan is needed to develop solutions for water scarcity.** Egypt is already below the United Nations' water poverty threshold and is approaching a state of "absolute water crisis". There is an urgent need to develop non-renewable subterranean water extraction methods, desalinate water, manage wastewater and ration water usage.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019
GDP growth	4.4	4.3	4.2	5.3	5.6
Inflation (average)	11.0	10.2	23.5	20.9	13.9
Government balance/GDP	-11.4	-12.5	-10.9	-9.7	-8.2
Current account balance/GDP	-3.7	-6.0	-6.1	-2.4	-3.1
Net FDI/GDP [neg. sign = inflows]	-1.9	-2.0	-3.3	-3.0	-2.2
External debt/GDP	14.5	16.8	33.4	37.1	34.1
Gross reserves/GDP	5.9	5.1	13.0	17.4	14.5
Credit to private sector/GDP	25.5	26.3	28.3	24.4	22.9

* Data for Egypt corresponds to fiscal year, July to June, except for reserves and credit to the private sector.

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Macroeconomic performance

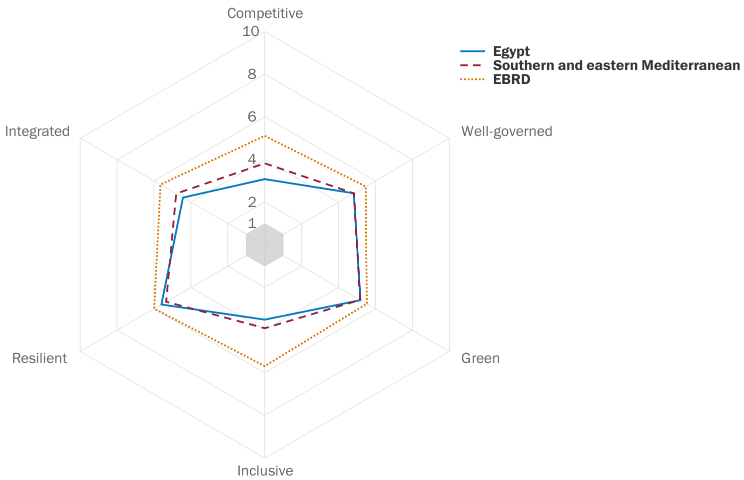
Real GDP growth continued to increase, reaching its highest level in 11 years. It reached 5.6 per cent in the fiscal year 2018-19, mainly driven by rising net exports and investments. The gas, tourism, trade and construction sectors were the main contributors to the strong growth. Meanwhile, unemployment dipped to 7.5 per cent in the second quarter of 2019, the lowest level since 2011, compared with its peak of 13.2 per cent in the fourth quarter of 2013. The continued contraction in the unemployment rate is mainly due to the sound implementation of economic and structural reforms – which resulted in a number of investment opportunities – and the implementation of major national development projects.

Inflation has decreased to its lowest rate in more than six years. Year-on-year inflation declined from its record high level of 33.0 per cent in July 2017 to 4.8 per cent in September 2019. The decline is mainly due to currency appreciation and a slowdown in food inflation. Following the moderation of underlying inflationary pressures, the CBE continued loosening its monetary stance by cutting its discount rate by 150 basis points in August and a further 100 basis points in September 2019, to 13.75 per cent.

The fiscal position continued to improve. In fiscal year 2018-19, the fiscal deficit narrowed to 8.2 per cent of GDP, from 9.7 per cent in the previous fiscal year, thanks to lower subsidies and lower interest payments (relative to GDP). The current account deficit widened slightly to 3.1 per cent of GDP in the fiscal year 2018-19, from 2.4 per cent in the fiscal year 2017-18. Lower remittances and non-oil exports – mainly gold – were only partially offset by a narrower oil trade deficit (due to Egypt's achievement of self-sufficiency in oil as of October 2018) and stronger tourism revenues. Inflows of foreign direct investment to Egypt are stable at US$ 10.2 billion in the fiscal year 2018-19, and are mainly in the oil sector. International reserves have increased to US$ 45.1 billion in September 2019, covering over eight months of imports.

Robust economic growth is expected to continue in the short term. In the fiscal years 2019-20 and 2020-21, we expect GDP to rise by 5.9 per cent. Growth will be supported by the continued strengthening of the tourism sector and of exports, large public construction projects including the building of the new administrative capital, natural gas production from the Zohr field and other new discoveries, the reengagement of private investors – both domestic and foreign – following the recent trend of interest rate cuts and the continued implementation of business environment reforms and prudent macroeconomic policies. The main risks to the outlook arise from a persistent wait-and-see approach taken by foreign investors, the erosion of competitiveness because of the recent appreciation of the pound, and the negative outlook for the economy of the European Union, Egypt's main trading partner. The risks are partially mitigated by the authorities' demonstrated commitment to the implementation of structural reforms.

Assessment of transition qualities (1-10)



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Major structural reform developments

The government continued to implement fuel and electricity subsidy reforms, and has increased metro ticket prices. In June 2019, the government hiked the ticket price on the third Cairo metro line after adding three new stations. Ticket prices had tripled in May 2018, which also saw the pricing scheme change to a tier system based on distance travelled. In July 2019, electricity tariffs for residential consumers increased by 14.9 per cent on average, and tariffs for commercial consumers rose by between 7.0 and 22.0 per cent. Electricity subsidies will be phased out fully by the middle of 2022. In July 2019, the government also raised fuel prices between 16.0 and 30.0 per cent in order to achieve cost-reflective prices, improve energy consumption efficiency and free up fiscal resources for development spending. The government will start applying the new fuel pricing indexation mechanism to all petroleum products in the fourth quarter of 2019.

The Central Bank of Egypt introduced the benchmark Cairo Overnight Index Average. The introduction of the risk-free interest rate benchmark in August 2019 will lay the foundation for the enhancement and improved efficiency of the market. The new benchmark was developed by the Egyptian Money Market Contact Group, which brings together the central bank, selected commercial banks and the EBRD.

Plans are advancing for a sharp increase in the minimum capital base requirements. Under a draft bill on banking and financial institutions, presented to the parliament in May 2019, the capital base of local banks will be raised tenfold to EGP 5 billion (around US$ 300 million), while the subsidiaries of foreign banks will face a threefold increase to US$ 150 million. The banks will have a three-year deadline to comply with the new regulations. The proposed bill aims to boost the banks' financial strength and ability to withstand competition from other banks in the region.

Social protection measures have been widened. The government has increased spending allocations to commodity goods – including bread – and pension funds, as well as the *Takaful* and *Karama* (solidarity and dignity) programmes, in addition to increasing salaries and pensions in the fiscal year 2019-20. Furthermore, the government has started the *Forsa* (chance) programme, which helps create job opportunities, the *Mastoura* (covered or guaranteed) programme, which helps with microcredit for women, and the *Sakan Karim* (decent accommodation) programme, which promotes access to clean drinking water and sanitation. Meanwhile, in July 2019 the Ministry of Health launched a new comprehensive healthcare insurance system for all segments of society.

The Ministry of Petroleum and Mineral Resources has proposed new terms and rules on mining gold and mineral resources. In July 2019, the parliament approved amendments to the law, which aim to attract reliable investments, especially in gold mining, by granting licences to investors and offering more flexible terms for exploring and bidding.

The Investment Law is being amended. The objective of the amendments, approved by the parliament in July 2019, is to attract more investments in the most economically disadvantaged provinces, improve the standard of living of citizens and diversify the sources of growth nationwide. The amendments also aim to grant incentives for the expansion of existing investment projects, set new conditions for establishing new production lines and create new business opportunities. In addition, the General Authority for Investment will monitor foreign inflows of direct investment in order to reach accurate figures on the volume of investment.

Credit ratings for SMEs are being enabled. In September 2019, the Egyptian Financial Regulatory Authority approved the offering of licences to credit rating companies specialising in SMEs. These licences will enable SMEs credit rating companies to practice their activities in the Egyptian market and provide SMEs with the required funds for their projects. This will be achieved through acquiring loans and issuing various kinds of bonds, including medium-term bonds for capital asset financing and short-term bonds for working capital financing.

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Tax laws are being consolidated. In June 2019, the cabinet approved a draft unified tax law, and committed to implementing a new tax system by June 2020. The unified tax law regulates the procedures for linking and collecting income tax, value added tax, the development of revenues, stamp duty, and other taxes of a similar nature. The law aims to consolidate the provisions governing these procedures and facilitate their application, depending on modern technical means. The Ministry of Finance is planning to issue a small and medium tax treatment law to create incentives for firms in the informal economy to register their businesses.

Significant progress has occurred in the tourism sector. In November 2018, the Ministry of Tourism launched the Egypt Tourism Reform Programme (E-TRP). The vision was to achieve a sustainable tourism sector through implementing structural reforms that strengthen the sector's competitiveness, in line with international best practices. Historically, tourism accounted for over 15 per cent of GDP, and was mainly driven by the private sector, which accounts for 98 per cent of the sector. Travel and tourism revenues contributed 51.5 per cent of total services exports in the fiscal year 2018-19. E-TRP was designed as a comprehensive, coherent and consistent policy framework, with structural reforms established on five reform pillars; institutional reforms, legislative reforms, promotion and marketing, infrastructure and tourism development, and global tourism trends. These efforts were reflected in Egypt being granted the fourth-highest performance improvement in the World Economic Forum's Travel and Tourism Competitiveness Index 2019. The World Travel and Tourism Council awarding Egypt the annual "2019 Global Champion Award" for promoting tourism resilience. Moreover, this has also been reflected strongly in tourism revenues increasing to US$ 12.5 billion in the fiscal year 2018-19; an all-time high.

ESTONIA

Highlights

- **Gross domestic product (GDP) growth has decelerated somewhat.** Higher investments, mainly by non-financial companies, and increased government spending underpinned GDP growth in the first half of 2019. At the same time, household consumption has moderated despite rising wages.
- **Anti-money laundering supervision has been strengthened.** The Nordic and Baltic states' financial supervisors have agreed on measures to enhance the cooperation among the countries' authorities, with the aim of fighting money laundering and the financing of terrorism.
- **The banking sector has expanded and become more concentrated.** The acquisition of Luminor Bank by Blackstone was one of the largest mergers and acquisitions (M&A) transactions in the history of the Baltic states.

Key priorities for 2020

- **The development of new and innovative technologies in the country's financial markets should advance.** Regulatory sandboxes, which are a live testing environment for technology and FinTech companies against regulation, may help in designing an environment that supports innovative start-ups.
- **Reforming the second pillar pension system should take into account the system's sustainability.** The established funded pension working group will need to work out appropriate solutions to the problem of pension sustainability in the context of a rapidly ageing population and adverse demographics.
- **Strengthening anti-money laundering (AML) supervision should remain a priority.** While AML risks in the banking sector have declined markedly and the risk-based supervision of financial institutions has been implemented, efforts at further deepening regional cooperation should be continued.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	1.8	2.6	5.7	4.8	3.2
Inflation (average)	0.1	0.8	3.7	3.4	2.5
Government balance/GDP	0.1	-0.5	-0.8	-0.6	-0.2
Current account balance/GDP	1.8	1.7	2.7	2.0	1.5
Net FDI/GDP [neg. sign = inflows]	0.6	-2.4	-3.9	-4.7	-4.0
External debt/GDP	92.2	88.5	83.1	76.4	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	68.6	70.2	64.5	62.1	n.a.

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Macroeconomic performance

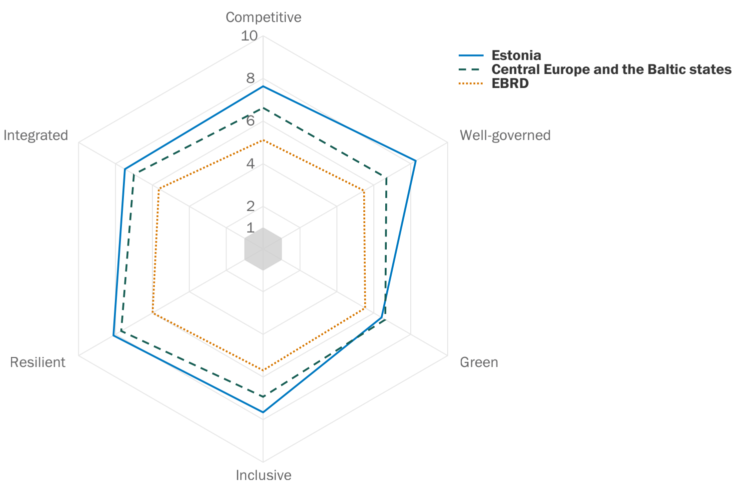
Domestic demand continues to fuel economic growth. GDP growth decelerated to 4.9 per cent in 2018, largely driven by strong consumption-driven imports, which significantly outperformed exports. In the first half of 2019, economic expansion decelerated to 4.2 per cent, mainly due to moderating household consumption. Nominal wage growth reached almost 8.0 per cent on average in the first half of 2019, causing unit labour costs to grow faster than labour productivity. This reflects a shrinking labour market and raises concerns about Estonia's prospective competitiveness.

Investment has recovered. Following a slowdown to 1.7 per cent in 2018, gross fixed capital formation rose by 21.4 per cent in the first six months of 2019. Non-financial enterprises registered higher investment expenditures into transportation equipment and machinery. Household expenditures into dwellings increased markedly as well. Credit to non-financial companies turned positive in the third quarter of 2018, especially long-term credit (over five years), which has grown by more than 10.0 per cent since then.

Fiscal expenditures will continue to grow. In 2018, the general government balance fell to a deficit of 0.6 per cent of GDP, mainly due to higher-than-expected social spending and investment. According to the ruling coalition's action programme for 2019-23, fiscal expenditures are expected to grow, especially on family policies, pension hikes, healthcare and defence. Public debt continues to fall, reaching 8.4 per cent of GDP in 2018. According to European Commission estimates, it will likely remain low, at around 8.5 per cent of GDP in the coming years.

Short-term GDP growth will remain buoyant. The tightening labour market will result in further wage increases, keeping household consumption elevated. At the same time, mounting labour shortages and competitive pressures will likely force companies to invest in efficiencies unless the outlook worsens severely. Negative risks to the outlook come from intensification of trade tensions and weaker export demand in advanced economies, especially in the Nordic region. As a result, GDP growth is anticipated to slow to 3.2 per cent and 2.6 per cent in 2019 and 2020, respectively.

Assessment of transition qualities (1-10)



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Major structural reform developments

Cross-border cooperation on AML supervision has strengthened. In May 2019, the heads of the Nordic and Baltic states' financial supervisors agreed on measures to enhance their cooperation with the aim of fighting money laundering and combating the financing of terrorism (CFT). In July 2019, the Estonian government decided to amend the penal code and relating laws to adopt the European Union (EU) directives on protection of EU financial interests, which increases the maximum length of imprisonment for money laundering. Further work on strengthening the AML/CFT framework will continue. Recently, the total share of non-resident deposits from high-risk clients without any links to the Estonian economy dropped substantially. It went down from 18.6 per cent at the end of 2014 to 7.2 per cent at the end of 2018, while the share of offshore deposits declined from 3.9 per cent to just 0.5 per cent over the same period.

The banking sector has expanded and became more concentrated. In September 2018, the Nordic banks Nordea and DNB announced that they would sell a 60 per cent stake in Luminor Bank, which operates in the three Baltic states, to Blackstone, the United States of America-based private equity giant. This acquisition, with a value of €1 billion, is one of the largest M&A transactions in the history of the Baltic states. As a result, the size of the banking sector in Estonia will increase from 102 per cent to 145 per cent of GDP and the sector will become more concentrated, as the three largest banks hold a market share of 85 per cent. In January 2019, the European Commission cleared the deal and stated that it raises no competition concerns, given its limited impact on the market structure. The deal is still awaiting the approval of the European Central Bank before it materialises in late 2019.

A covered bond law has entered into force. Estonia is the first of the Baltic states to adopt covered bond legislation, which came into force in March 2019. Estonia, Latvia and Lithuania started work on developing covered bond and securitisation frameworks in late 2017, with the aim of creating a pan-Baltic covered bond market. The new law enables banks to diversify funding sources and limit their reliance on parent funding. Estonia's Luminor Bank is expected to make the first covered bond issuance, preceded by various structural and ownership changes in 2019 that will help to raise new secured funding in the pan-Baltic market.

The pension system is becoming more flexible. In December 2018, the parliament adopted a bill that ties the retirement age to average life expectancy, starting from 2027. In addition, the pension payment will depend on both the final salary and the person's length of service. The flexible pension will allow employment on a part-time basis. In addition, the government plans to reform the second pillar pension fund. As a result, FinanceEstonia, a public-private financial sector cluster organisation, established a funded pension working group in June 2019 to formulate solutions for the Estonian social security system.

Additional measures for preventing corruption were introduced. In January 2019, the parliament adopted an amendment to the law to reduce the risk of corruption and conflicts of interest at the local government level. Compared with the previous year, Estonia advanced three places to joint 18th (out of 180 countries) in Transparency International's 2018 Corruption Perception Index.

Estonia is advancing in climate change adaptation. In December 2018, Estonia joined a political declaration that focuses on comprehensive and sustainable management of forests, accepted at the UN Climate Change Conference in Katowice, Poland. The declaration emphasises the importance of forests as carbon sinks and stresses that their ability to adapt to climate change needs to be improved. Estonia is rich in woodland, and the share of strictly protected forests is at the forefront of EU efforts to combat the negative effects of climate change.

GEORGIA

Highlights

- **Economic growth remains strong.** The economy expanded by 4.7 per cent year-on-year in the first half of 2019, but the inflow of foreign investments (relative to gross domestic product) slowed substantially, although this number remains among the highest in the EBRD regions.
- **The fiscal framework was improved.** The fiscal rule was revised to ensure counter-cyclicality, provide more clarity and allow for a broader coverage of fiscal risks, and efforts to strengthen the value added tax (VAT) system continued.
- **Important structural reforms have advanced.** Notable reforms in the past year include the central bank's implementation of new regulations on responsible lending to individuals, the approval of a corporate governance code for banks and the launch of a credit guarantee scheme.

Key priorities for 2020

- **Governance standards need to be improved.** This includes ensuring the impartiality of the justice system, continuing to advance the quality and transparency of public services and safeguarding the independence of economic institutions from undue political influences.
- **To make full use of Georgia's strategic geographic location, efforts to implement multimodal infrastructure development projects need to be deepened.** There is a need to advance with core public infrastructure projects, in particular the East-West highway and the North-South corridor.
- **Comprehensive reform of the education sector is needed to address labour market shortcomings.** The authorities' initial efforts to tackle inefficiencies in the sector need to be followed by an encompassing reform plan and decisive implementation.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	2.9	2.8	4.8	4.7	4.5
Inflation (average)	4.0	2.1	6.0	2.6	4.3
Government balance[1]/GDP	-1.1	-1.3	-0.9	-0.8	-2.2
Current account balance/GDP	-12.6	-13.1	-8.8	-7.4	-5.9
Net FDI/GDP [neg. sign = inflows]	-10.2	-8.6	-11.2	-5.7	-5.6
External debt/GDP	109.4	110.7	114.7	109.8	n.a.
Gross reserves/GDP	18.0	19.2	20.1	20.3	n.a.
Credit to private sector/GDP	47.6	52.5	56.2	61.7	n.a.

[1] According to the definition by the Ministry of Finance (GFS-2001).

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Macroeconomic performance

Georgia's economic performance remains strong. Economic output increased by 4.7 per cent in 2018. The growth was broad-based; all sectors expanded, apart from construction. Trade was up by nearly 6.0 per cent, followed by real estate, transport, financial intermediation and other sectors, such as social and personal service activities. The negative growth rate in the construction sector is largely explained by delays in public infrastructure spending and completion of the landmark gas pipeline project. Tourism continued to boom. Gross domestic product (GDP) grew by an estimated 4.7 per cent year-on-year in the first half of 2019. Exports of goods in nominal US dollar terms increased by 11.5 per cent year-on-year in the first half of 2019, down from 22.7 per cent growth in 2018. Inflows of money transfers are growing for the fourth consecutive year and credit growth remains robust despite the slowdown, supporting private consumption.

The inflow of foreign direct investments decelerated after reaching a peak in 2017. The current account deficit shrank further in 2018 on the back of thriving tourism and a strong increase in the exports of goods, benefiting from ongoing geographical diversification as the network of free trade agreements grows. At the same time, following an all-time high in 2017, foreign direct investment (FDI) into Georgia decreased by 35.3 per cent in 2018, hitting a five-year low. The drop is mainly explained by the completion of the South Caucasus Pipeline Expansion (the gas pipeline connecting Azerbaijan and Turkey), the transfer of several enterprises to domestic ownership and debt repayments between connected companies. Despite the decline, FDI remained the main source of currency inflows, nearly offsetting the current account deficit. Similar trends have continued in the first half of 2019.

The Georgian lari came under renewed pressure. Helped by the high degree of trade diversification, the currency has demonstrated resilience to adverse developments in large trading partners in the recent past. However, the currency came under renewed pressure on the back of domestic political uncertainties and negative expectations, based on anticipated movements in the balance of payments, stemming from the deterioration in Georgian-Russian relations in mid-2019. A Russian ban on direct flights to and from Georgia has been in force since July 2019, and the import of wine from the eight largest Georgian wineries has been prohibited since the end of June 2019. In 2018, Russian tourists accounted for approximately one-fifth of all international visitors and a significant portion of foreign exchange inflows from tourism. Coupled with domestic political uncertainties, this has influenced expectations, leading to currency depreciation of more than 9.0 per cent in the first nine months of 2019. Inflation has risen from 2.6 per cent in 2018 to 6.4 per cent in September 2019 due to pass-through from nominal exchange rate depreciation and the increase in excise taxes earlier in the year. This prompted the National Bank of Georgia (NBG) to intervene on the foreign exchange market and raise the monetary policy rate by 200 basis points to 8.5 per cent in October. Official international reserves increased by 9.5 per cent since the beginning of 2019 and stood at US$ 3.6 billion in August 2019, providing around four months of import coverage.

Economic growth is expected to stay at similarly strong levels. We currently forecast real GDP to grow by 4.5 per cent in both 2019 and 2020. Downside risks to the outlook stem from potential external shocks that would hit the Georgian economy through trade, investment, tourism or remittances channels and geopolitical vulnerabilities, recently intensified by the deterioration in Georgian-Russian relations.

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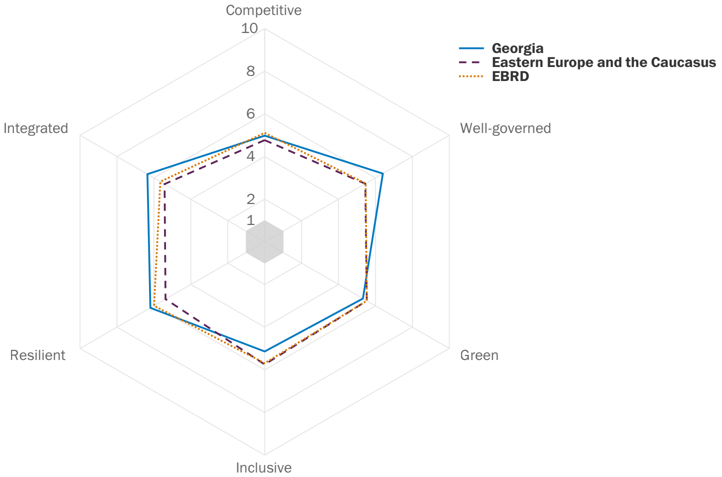
Assessment of transition qualities (1-10)



Major structural reform developments

Implementation of reforms under the International Monetary Fund (IMF) programme advanced. In June 2019, Georgia completed the fourth review under the three-year Extended Fund Facility arrangement signed in April 2017. The completion of the review enabled the release of US$ 41.4 million, bringing total disbursements under the arrangement to US$ 207.2 million. Measures implemented under the IMF programme so far include the enhancement of financial supervision and regulation, improvements to the fiscal framework and administration, advances in setting up the public-private partnership (PPP) framework and pension reform. The authorities have been able to maintain fiscal prudence and create space for increasing social and capital spending.

A new credit guarantee scheme aims to facilitate access to finance for entrepreneurs. Eligibility for the scheme, which was launched in April 2019, is limited to entrepreneurs whose average total turnover is below GEL 20,000 (US$ 7,000) in the three years preceding the application and whose loan liabilities do not exceed GEL 8,000,000 (US$ 2,800,000). The guarantee can be issued on loans in Georgian lari worth between GEL 50,000 (US$ 17,000) and GEL 2,000,000 (US$ 700,000), with the maximum term of the guarantee at 10 years. The scheme will receive direct budget allocation of GEL 20 million in each of the next five years, which will cover up to 15 per cent of the loan portfolio under the scheme in each participating bank. Loan selection is carried out by the banks and the scheme will be subject to internal and external audits as well as a report on requirements regarding activities and financial outcomes.

The fiscal rule was revised. The Economic Liberty Act, in force since 2014, stipulates that public debt must not exceed 60 per cent, public expenditures must be contained to 30 per cent and the fiscal deficit needs to be lower than 3 per cent, all as a share of GDP. The revised rule removes the restriction on expenditures, clarifies the scope of the public debt and deficit definitions and defines escape clauses. Liabilities stemming from PPPs are included under the debt ceiling, helping to better track and contain fiscal risks.

The NBG continues to strengthen its financial stability and monetary policy frameworks. At the end of September 2018, a corporate governance code for banks was approved. The code sets out principles for introducing supervisory boards in the commercial banks and supporting committees, such as risk management, internal audit and remuneration. According to the code, at least one-third of supervisory board members need to be independent and a minimum of 20 per cent or one member needs to be female. To facilitate sound banking and retail lending, a new regulation on responsible lending to individuals was adopted in December 2018. The regulation sets out threshold levels for loan-to-value ratios and debt service payments-to-income levels,

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differentiated by the currency of the loan and by income brackets. In force since the beginning of 2019, the new regulation helped curb mortgage lending: the growth of loans secured by real estate decreased from 31.7 per cent in 2018 to 11.2 per cent in the first seven months of 2019. In addition, to help address risks related to foreign currency, the NBG further increased reserve requirements on deposits in foreign currency by 5 percentage points to 30.0 per cent, while keeping the reserve requirements on local currency deposits unchanged at 5.0 per cent. The threshold under which loans can be issued only in local currency was doubled to GEL 200,000 (US$ 70,000) and expanded to include legal entities as well. Lastly, the NBG's arsenal of regulatory and supervisory tools was expanded in early 2019 to include foreign exchange options, with the primary goal of using the instrument to boost international reserves.

Further business-friendly reforms have been introduced. From January 2019, assessments of all new VAT declarations are automated and the authorities are planning further improvements, including risk-based auditing. Energy market deregulation is also being gradually implemented. Since May 2019, household and industrial consumers are separated and industrial consumers are buying electricity at market prices.

GREECE

Highlights

- **Economic indicators continue to improve.** The economic recovery, which began in 2017, continued into 2018 and the first half of 2019, but at a relatively modest rate. Economic sentiment has risen sharply since May 2019, reaching a 12-year high, and unemployment has dropped below 17 per cent.
- **Important reforms have advanced.** The previous government made sufficient progress on achieving specific reform commitments by the end of 2018 to enable creditors to grant €970 million debt relief measures, while the new government has already brought forward important fiscal, labour market and governance reforms.
- **Capital controls have been fully lifted.** Effective since September 2019, this measure brings to an end more than four years of restrictions on the free flow of capital.

Key priorities for 2020

- **Further progress is needed in reducing non-performing exposures (NPEs).** New levers are now in place or in preparation, including an asset protection scheme, and should be used vigorously to help banks bring down the level of NPEs from current excessive levels.
- **Flagship privatisations should be carried out in a timely way.** The key short-term project is Hellenikon (the former Athens airport), which has the potential to be transformative for the economy, but other important assets should also be commercialised and prepared for sale in a timely way.
- **Reforms to governance are urgently needed.** Greece's ranking on global governance measures is poor, reflecting many years of weak public administration, problems in the judiciary and inadequate corporate governance standards. The new government should follow up promptly on its plans for reforms in these areas.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	-0.4	-0.2	1.5	1.9	2.0
Inflation (average)	-1.1	0.0	1.1	0.8	1.1
Government balance/GDP	-5.7	0.6	1.0	0.4	-0.2
Current account balance/GDP	-0.2	-1.7	-2.4	-3.4	-2.7
Net FDI/GDP [neg. sign = inflows]	0.2	-2.4	-1.5	-1.6	-1.8
External debt/GDP	245.5	236.1	224.0	217.7	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	112.2	107.3	99.0	89.1	n.a.

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Macroeconomic performance

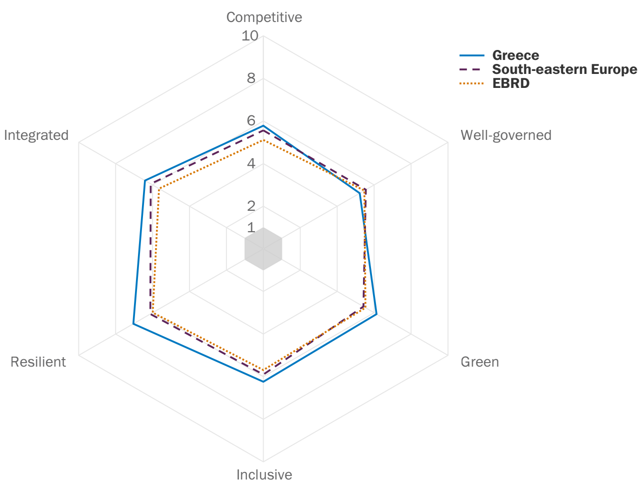
Modest economic growth has continued. GDP grew by 1.9 per cent in 2018. Private consumption continued to have a positive impact on growth and labour market developments have been encouraging, with unemployment falling to 16.9 per cent (seasonally adjusted) in July 2019 – still very high relative to peers but the lowest rate since 2011. The economic recovery is broad-based, with services being the main driver. In the first half of 2019, GDP increased by 1.5 per cent year-on-year, as exports of goods and services (including tourism) and public consumption all moved in a positive direction. Investment remains a weak spot, with gross fixed capital formation falling at double-digit levels in 2018, and net investment (gross investment minus depreciation) still strongly negative. However, all main components of investment apart from transport equipment and weapons investments are increasing and are expected to pick up further in the short term. Foreign direct investment (FDI) has been on an upward trend since 2015, reaching €3.7 billion in 2018, versus less than €1.2 billion in 2015, with further strong inflows (€2.5 billion) in the first seven months of 2019.

Fiscal and external balances remain encouraging. The primary fiscal surplus reached 4.3 per cent of GDP in 2018, outperforming significantly the target of 3.5 per cent of GDP. An expansionary fiscal package was adopted by the previous government in May 2019 but the recovering economy and boosted revenue collection should help ensure that the target is again achieved in 2019. Meanwhile the current account deficit rose from -0.8 per cent of GDP in 2017 to -3.4 per cent of GDP in 2018, despite the continued upward trend in exports of goods and services, but is countered by the positive developments in FDI noted above.

Capital market access has improved amid boosts to the country's sovereign credit rating. The government has issued several bonds in 2019, including a seven-year €2.5 billion bond in July 2019, with a yield of just 1.9 per cent (below US Treasuries' yields). The low yield reflects not only global financing conditions but also Greece's improved standing among creditors in recent years. In March 2019, Moody's raised Greece's sovereign rating by two levels to B1 and in October 2019, Standard & Poor's upgraded Greece's sovereign credit rating from B+ to BB-, given the reduced fiscal risks and lifting of capital controls. However, all major credit ratings agencies still have Greece several notches below investment grade.

Short-term GDP growth is likely to rise somewhat. Our current projection is that the economy will grow by 2.0 per cent in 2019 and 2.4 per cent in 2020. The main drivers of growth are likely to be exports and a stronger impact of private consumption as a result of the sharp increase in economic sentiment and falling unemployment rates. However, risks associated with a possible deterioration in the global economy remain significant. Internally, the new government has committed to an ambitious reform agenda, and investors will be looking to see if they can deliver on their promises and make major improvements to the business environment. If that happens, prospects for higher growth rates in the medium term will be significantly enhanced.

Assessment of transition qualities (1-10)



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Major structural reform developments

Important reforms have advanced. Following the completion of the Third Economic Adjustment Programme in August 2018, Greece is now in a post-programme enhanced surveillance framework. As of September 2019, there have been three enhanced surveillance reports, prepared by the European Commission in partnership with other institutions. The third report, published in June 2019, presented a mixed picture. It noted progress in areas such as public sector reform, corporate governance in state-owned enterprises (SOEs) and land reform, but it revealed that the pace of reform had slowed in 2019, with reversals in certain areas. Meanwhile, the new government, which took office in July 2019, has placed economic reform and governance improvements at the heart of its programme. An omnibus bill with a number of growth-enhancing reforms was submitted to parliament in September 2019.

Privatisation is advancing, albeit with some delays. The privatisation strategy and the governance reform of SOEs is being implemented by the Privatisation and Investment Fund (the Hellenic Corporation of Assets and Participations). Important deals in the past year include the sale of 66 per cent of the gas transmission systems operator, DESFA, which was closed at the end of 2018; and a 20-year extension of the concession agreement for Athens International Airport, completed in February 2019. Other major projects in preparation and at an advanced stage include the development of Hellenikon (site of the former Athens airport) and Egnatia motorway. With regard to the former project, final submissions under a tender for a casino licence were submitted on 4 October 2019, and construction should begin on site in early 2020. However, other privatisations have encountered delays, and the proposed sale of a majority stake in Hellenic Petroleum failed to attract any bids.

Capital controls have been fully removed. As of 1 September 2019, all remaining restrictions on the transfer of capital abroad were removed. Capital controls were introduced at the height of the crisis in June 2015 but had been relaxed gradually in stages since then.

The financial sector is still recovering and NPEs are being reduced. The banking sector as a whole is profitable, but banks continue to be burdened by exceptionally high levels of NPEs, which stood at €75.4 billion, or 43.6 per cent of total loans as of June 2019. The four systemic banks are addressing the problem using a variety of tools and according to targets agreed with the Bank of Greece. The new government has developed an asset protection scheme, which was approved by the European Commission (DG Comp) in October 2019. It is expected to be operational in the coming months. Under this scheme, special purpose vehicles would be set up to issue government-guaranteed bonds, allowing banks to take some of their NPEs off their balance sheets.

Further improvements have been made to the business environment. Important steps over the past year include efforts to streamline licensing and customs procedures, the introduction of one-stop shops, and progress on land and cadastral reform. Further business-friendly measures are in the pipeline of the new government's programme. At the same time, Greece's ranking on the World Bank's ease of doing business assessment remains low by EU and OECD standards, reaching 79th position (out of 190 countries) in the 2020 report (down seven places from the previous year), with persistent problems in getting credit, registering property, enforcing contracts and resolving insolvency.

Governance reforms are being introduced. A key pillar of the post-programme enhanced surveillance framework is public administration reform and building a modern state. Important steps have been taken in the past year to improve the management of human resources in public institutions and the development of a more modern staff appraisal system. The new government has also signalled that governance reform will be at the heart of its programme, and has already taken steps to unify all entities that audit and oversee the activities of the government.

HUNGARY

Highlights

- **Investment has been the key driver of recent gross domestic product (GDP) growth.** Strong credit growth, substantial foreign direct investment (FDI) and funds inflows from the European Union (EU) are supporting investment, while household consumption also remains strong, boosted by sharp wage growth and increased government spending.
- **An economic protection programme has been introduced.** According to the authorities, this programme aims to increase the GDP growth rate by an additional two percentage points above the EU average in the coming years.
- **The cost of funding for eligible corporates has decreased.** The National Bank of Hungary (NBH) has launched a new scheme for corporate bond purchases. While the scheme provided liquidity to the market, it remains to be seen whether it will be able to trigger new private investment flows to the market.

Key priorities for 2020

- **Market-based non-bank financial instruments and a wider investor base should be further developed.** The capital market remains shallow and reliant on stimulus measures by the NBH. A greater availability of modern alternative sources of finance from the private sector would enhance investment and productivity.
- **Transparency and governance of EU funds' absorption need to improve.** In its annual report, the European Anti-Fraud Office concluded 52 probes into misuse of EU funds and recommended to the European Commission (EC) to recover 3.8 per cent of payments. This is the highest proportion within the EU.
- **More domestic enterprises should be integrated into global value chains.** Despite the great openness of the economy, domestic small and medium-sized enterprises (SMEs) are largely excluded from international value chains and do not benefit from technology and international skills diffusion.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	3.8	2.2	4.3	5.1	4.6
Inflation (average)	0.1	0.4	2.4	2.9	3.4
Government balance/GDP	-2.0	-1.8	-2.4	-2.3	-1.9
Current account balance/GDP	2.4	4.5	2.3	-0.5	-0.8
Net FDI/GDP [neg. sign = inflows]	-1.3	-2.2	-1.6	-2.1	-2.5
External debt/GDP	107.4	96.1	84.3	80.8	n.a.
Gross reserves/GDP	26.6	20.3	19.7	19.9	n.a.
Credit to private sector/GDP	68.6	70.2	64.5	62.1	n.a.

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Macroeconomic performance

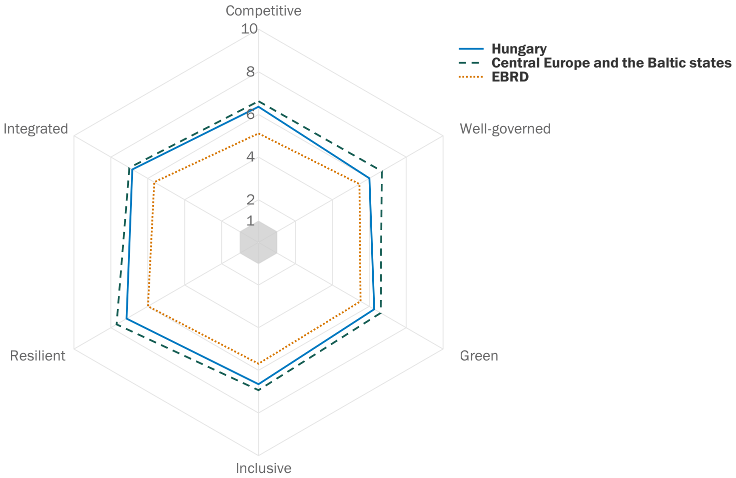
Investment and consumption are boosting GDP growth. Following the 5.1 per cent GDP growth in 2018, the economy continued to grow at the same pace in the first half of 2019. A substantial hike in investment and continuously strong household consumption were the key drivers of the strong GDP performance. Consumption was fuelled by strong gross nominal wage growth (above 10.0 per cent in annual terms) in both the private and public sectors. Salaries of employees in the central public administration were raised on average by 30.0 per cent from January 2019.

Investment growth has been impressive. Since 2017, investment has registered an average annual growth rate of more than 17.1 per cent and accelerated further to 20.6 per cent in the first half of 2019, the highest among the economies in central Europe and the Baltic states. In June 2019, the corporate loan stock increased by almost 15.0 per cent, supported by new subsidised lending by the NBH. Moreover, amid greater EU fund inflows, FDI inflows reached 6.3 per cent of GDP in 2018 but slowed down somewhat in the first half of 2019. Relatively strong FDI inflows are expected to continue as foreign companies, mainly in the automotive and aviation industries, and have already announced further greenfield and capacity expansion investments in the coming years.

Pro-cyclical government policies are preventing a greater budget deficit reduction. In 2018, the general government deficit narrowed slightly to 2.3 per cent of GDP, in a favourable macroeconomic environment. The government is planning both a 2.5 percentage point cut in employers' social contribution rates and higher expenditures related to various development programmes, such as family support or village development schemes. Despite this, the headline deficit is expected to fall to 1.9 per cent of GDP in 2019. According to EC estimates, the public debt is projected to fall below 70.0 per cent of GDP by the end of 2019, with a targeted reduction to 60.0 per cent of GDP by 2022.

Economic expansion is expected to decelerate, mainly due to weakening external demand. The stronger-than-expected performance of the economy in the first half of 2019 will help ensure continued strong growth of 4.6 per cent in 2019, but in 2020, we anticipate GDP growth to moderate to 3.1 per cent. This slowdown will be partially offset by domestic demand, powered by a double-digit recovery in corporate credit and still-strong wage hikes. The latter is largely a result of the tightening labour market, caused by the falling working-age population and mounting skill-mismatches. EU funds absorption will likely further underpin investment in 2019, but reduced EU fund inflows will constitute a drag on public investment from 2020 onwards. Trade disputes and the economic performance of Hungary's main trading partners, such as Germany, constitute negative risks to that scenario.

Assessment of transition qualities (1-10)



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Major structural reform developments

State withdrawal from the banking sector remains slow. The planned sale of Budapest Bank, acquired by the state in 2015, is on hold, as government plans and the timeline remain unclear. In January 2019 a minister without portfolio in charge of state assets was mandated to hold talks with potential investors regarding a potential sale of the bank.

The corporate bond market lacks a wider investor base. Currently, the corporate bond market represents around 1.6 per cent of GDP, below that of 6.0 to 7.0 per cent in peer countries such as Poland or the Czech Republic. In July 2019, the NBH launched a new HUF 300 billion (€930 million) scheme for corporate bond purchases (up to 70.0 per cent of a series). While the scheme provided liquidity to the market, it remains unclear whether this will introduce new private investors to the market.

An economic protection programme has been announced. The programme, initially announced by the Finance Ministry in May 2019, contains 16 economic support measures to counteract the negative impact of the economic slowdown in the eurozone. The measures include a reduction of social contributions by two percentage points, various tax changes and simplifications, more loan guarantees and research and development funding, assistance to companies for providing worker accommodation facilities and support for irrigation in agriculture. The authorities claim that this programme will boost the GDP growth rate by an additional two percentage points above the EU average in the coming years.

The government is taking measures to improve competitiveness. In June 2019, the NBH, at the government's request, unveiled 330 proposals in 12 areas for reforms to make the economy more competitive. The goal is to achieve higher productivity growth, driven by improvements in efficiency and export capacity of SMEs, reduced state bureaucracy and a renewal of the financial model (for example, through a prudent increase in lending, by strengthening alternative forms of financing or by promoting digital solutions). The NBH report also proposed reforms in healthcare. The report echoes largely the recommendations of the Competitiveness Council, a consultative body at the Finance Ministry, from November 2018.

The government has introduced measures to alleviate labour market shortages. In December 2018 the President signed an amendment to the labour code, raising the annual ceiling on working overtime from 250 to 400 hours. The amendment triggered a number of street protests and strike threats by trade unions. However, the Constitutional Court found the new law to be valid, noting that proposed overtime hours are still below some other EU countries.

A generous family support scheme aims to address demographic challenges. In order to enhance greater birth rates, the parliament approved new demographic and family support measures in April 2019, taking effect in July 2019. Measures in the adopted legislation include interest-free loans for married couples, grants for family purchases of seven-seated vehicles, write-offs of mortgage loans depending on the number of children in a family, and permanent income tax reliefs to women with at least four children. The anticipated cost of this family support is expected to add 0.1 per cent and 0.5 per cent of GDP to the budget deficit in 2019 and 2020, respectively. According to the EC 2018 Ageing report, the share of the working-age population in Hungary will fall by more than 11 percentage points in the next 50 years.

The EC has referred Hungary to the European Court of Justice for non-compliance with EU law for its asylum-and-return legislation with the EU. In September 2018 the European Parliament adopted a resolution proposing that the Council determine whether there is a risk of a serious breach of the values on which the Union is founded.

JORDAN

Highlights

- **The economic situation continues to be challenging.** Growth in 2018 – at 1.9 per cent – recorded its lowest level in 23 years, and remained around the same level in the first half of 2019, while unemployment is high and increasing.
- **The pace of fiscal consolidation progressed slightly.** Additional revenue and expenditure measures were adopted to reduce the fiscal deficit and contain high public debt levels.
- **Structural reforms continued to target inclusive growth and private sector participation.** Jordan was among the top 20 improvers in the World Bank's *Doing Business 2020* report. Recent reforms include: enforcing the new income tax and insolvency laws, implementing a financial inclusion strategy, promoting energy efficiency projects, enacting the long-delayed amendment to the secured lending law, and using movable assets as collateral for small and medium-sized enterprises (SMEs).

Key priorities for 2020

- **Trade needs further diversification in terms of destination, routes and products.** Jordan needs to increase the economic complexity of export products and to improve its integration into global value chains.
- **Addressing water scarcity is crucial for further economic growth**. Given that Jordan is one of the most water-scarce countries in the world, policies are needed to secure a sustainable use of water. This would contribute to attracting private investors in the agriculture and food-processing sectors.
- **Reducing unemployment and alleviating poverty should be achieved in collaboration with the private sector.** Efforts are required to continue simplifying business regulations, improving education and vocational training, addressing skills mismatches, and promoting women's participation in the labour force.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	2.4	2.0	2.1	1.9	2.1
Inflation (average)	-0.9	-0.8	3.3	4.5	2.0
Government balance/GDP	-8.5	-3.7	-3.7	-4.8	-3.4
Current account balance/GDP	-9.0	-9.4	-10.6	-7.0	-7.0
Net FDI/GDP [neg. sign = inflows]	-4.2	-4.0	-5.0	-2.3	-3.6
External debt/GDP	65.1	66.3	69.6	69.1	72.3
Gross reserves/GDP	43.6	39.6	38.2	34.5	37.2
Credit to private sector/GDP	72.1	76.5	80.6	82.3	n.a.

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Macroeconomic performance

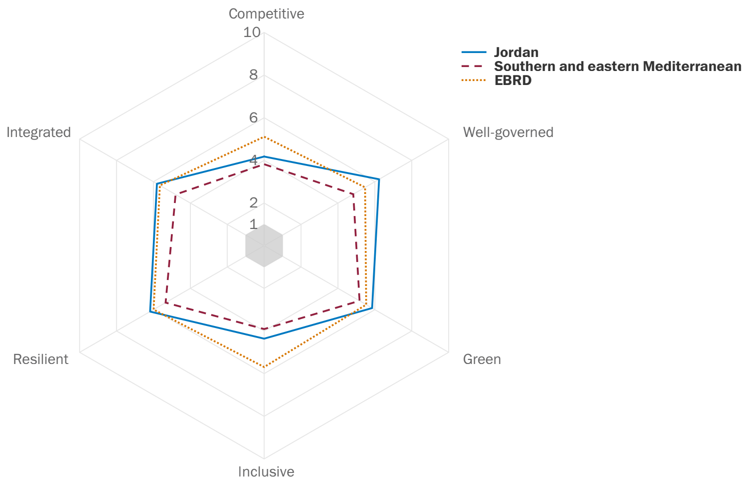
The pace of economic growth was restrained in 2018 and at the beginning of 2019. In the first half of 2019, growth remained sluggish at 1.9 per cent year-on-year. Financial services – including insurance, real estate and the business services sector – were the major drivers of growth, followed by the transport, storage and communications sectors, and manufacturing. Tourism arrivals continued to increase for the third consecutive year, but are still just 75 per cent of the record levels achieved in 2010. Inflation declined from its peak of 5.7 per cent in July 2018 to -0.3 per cent in September 2019. The unemployment rate increased to 19.2 per cent in the second quarter of 2019, and is particularly high for women (27.2 per cent) and young people (43.1 per cent).

The fiscal and external balances continued to improve. The overall fiscal deficit (excluding foreign grants) was reduced to 4.6 per cent of GDP in the first half of 2019, from 5.3 per cent in the same period of 2018, reflecting the increase in revenues and lower capital expenditures. Meanwhile, public debt remains elevated at 94.6 per cent of GDP. The current account deficit narrowed to 4.8 per cent of GDP in the first quarter of 2019, down from 9.3 per cent a year earlier. The reduction was driven by a decline in the trade deficit due to the decrease in imports of goods, and to the pick-up in exports. Gross official reserves have been decreasing since December 2017 and reached US$ 13.9 billion in July 2019, but are still covering more than seven months of imports.

The Central Bank of Jordan (CBJ) has lowered interest rates. There were three reductions in the key policy rate in 2019, in August, September and October; the first cuts in almost a decade. These were in line with interest rate changes in the United States of America and in regional markets, given the Jordanian dinar peg to the US dollar.

The outlook remains broadly unchanged. GDP growth is expected to remain subdued in 2019 (2.1 per cent) and 2020 (2.3 per cent), supported by various factors. These include rising domestic and foreign investment, the lower cost of imported energy, increased finance provided to SMEs under various schemes from the CBJ, greater certainty and confidence stemming from the commitments of the London Conference in February 2019, and the increase in exports resulting from the re-opening of the border with Iraq. Risks to the outlook include the erosion of real competitiveness stemming from the strengthening of the dinar, slow progress in implementing reforms, and the regional instability. On the upside, significant fiscal and structural reform progress would raise the growth forecast, improving private sector-led growth. Given that parliamentary elections are scheduled to be held in late 2020, current spending is expected to be higher in 2019-20.

Assessment of transition qualities (1-10)



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Major structural reform developments

Jordan is working to diversify its export and import portfolio of products and destinations. A bilateral trade agreement with Iraq was signed in February 2019, providing customs duty exemptions on Jordanian exports to Iraq. Meanwhile, the agreement in November 2018 to relax rules-of-origin of the 2016 trade agreement with the EU should lead to an increase in exports to the EU for 52 Jordanian products, including textiles and garments, engineering and electrical products, chemicals and furniture. However, the impact is yet to be seen. Regarding energy imports, the government has made efforts to secure energy supplies from neighbouring countries. In February 2019, Jordan and Iraq agreed that the former would obtain oil at concessionary prices in exchange for lowering tariffs on Iraqi goods imported through Jordan's Aqaba port. The Jordanian authorities have also reached agreements with regional countries (for example, Egypt) relating to imports of natural gas.

A new Income Tax Law has become effective. The new law entered into force in January 2019. It includes changes to corporate income taxes, withholding taxes, personal income taxes, penalties, and taxation in the development zones and free zones. It also imposes a new national contribution tax, which will be levied on the income of corporations and certain high-earning individuals in conjunction with income taxes.

The government has launched a Social Protection and Poverty Alleviation Strategy for 2019–25. The strategy "Opportunities, Dignity and Empowerment", launched in May 2019, will be implemented across many sectors, supporting needy households with access to education and free health insurance. In addition, it will introduce job opportunities to the labour market, supply families with solar power system units, and guarantee good food supplies to schoolchildren. Moreover, the strategy seeks to increase female participation in the labour market, and to decrease the poverty rate to around 12.0 per cent from its current level of 15.7 per cent.

The government is making efforts to incentivise development. A two-year development plan was introduced in November 2018 with the aim of improving education and public services and creating more jobs. The new plan is based on maintaining the rule of law, boosting productivity and strengthening solidarity, in line with priorities identified by the King in a speech to parliament in October 2018. The newly established Jordan Entrepreneurship Fund is expected to support over 800 new projects, which will create additional jobs. Furthermore, the government launched the "One Million Jordanian Coders" project in June 2019, to offer free digital skills courses and information on jobs available to qualified graduates; an approach that could provide young Jordanians with job opportunities both locally and globally.

A draft law on the fees of work permits for non-Jordanian workers has been approved. The new law, adopted in September 2019, which aims at better controlling and regulating the labour market, stipulates a new fees system for work permits for non-Jordanian workers. It also organises the issuance of two new types of work permits: the daily work permit (free permit), and the permit of workers with specialised skills.

Jordan was among the top 20 improvers in the World Bank's *Doing Business 2020* report. The country improved in the areas of getting credit, paying taxes and resolving insolvency. Access to credit was expanded after the credit bureau began offering credit scores to banks and other financial institutions. Access to credit was strengthened by introducing a new secured transactions law that regulates functional equivalents to loans secured with movable property. Jordan made paying taxes easier by integrating labour taxes and other mandatory contributions into its electronic payment system. All of these improvements helped raise Jordan to 75th place (out of 190 countries) in the global rankings, up from 104th the previous year.

KAZAKHSTAN

Highlights

- **Real GDP growth remains above 4 per cent.** The economy grew by 4.3 per cent year-on-year in the first three quarters of 2019, enabled by expansion in construction, trade and transportation. Annual inflation remains within the central bank's target band.
- **The blue-chip phase of the government's privatisation programme commenced with Kazatomprom's initial public offering (IPO).** In November 2018, Kazatomprom, the world's largest uranium producer, sold 15 per cent of its shares. The IPO was conducted on the London Stock Exchange and on the new Astana International Exchange.
- **An asset quality review (AQR) of the banking sector has been initiated.** The AQR will assess loan quality and bank capital needs of the 14 largest banks. The results are expected in December 2019.

Key priorities for 2020

- **The authorities need to further accelerate the implementation of structural reforms.** Key short-term priorities include measures to facilitate public-private partnerships, implement tariff reform in regulated sectors and improve the fiscal framework, all of which are critical for increasing the competitiveness of the economy.
- **Commercialisation and privatisation of large SOEs should advance.** The state- and quasi-state-owned enterprises should make further progress in improving operational efficiency and corporate governance practices to maximise value for the government.
- **The banking sector needs to be strengthened.** Despite a significant clean-up of the banking sector, asset quality remains a key risk in the system caused by weaknesses in governance and lending to related parties.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	1.2	1.1	4.1	4.1	3.9
Inflation (average)	6.7	14.6	7.4	6.0	5.2
Government balance/GDP	-6.3	-4.5	-4.4	2.7	0.5
Current account balance/GDP	-3.3	-5.9	-3.1	0.0	-1.5
Net FDI/GDP [neg. sign = inflows]	-3.6	-12.6	-2.9	-0.1	-2.5
External debt/GDP	83.0	118.9	100.3	88.5	89.0
Gross reserves/GDP	15.1	21.6	19.3	18.1	n.a.
Credit to private sector/GDP	37.7	33.0	29.9	27.3	n.a.

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Macroeconomic performance

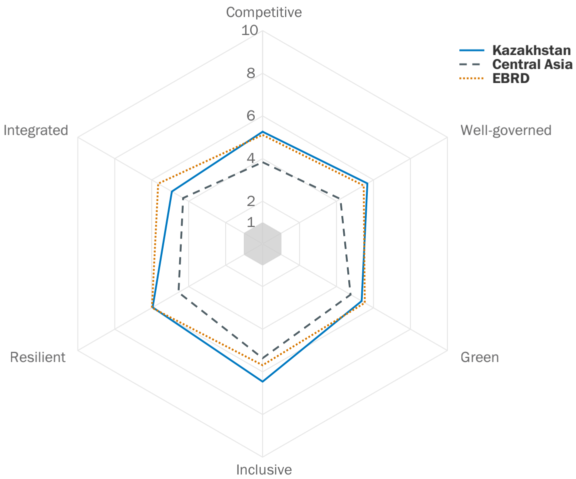
The economy is growing steadily. Real GDP growth continued at 4.3 per cent year-on-year in the first three quarters of 2019. It was supported by expansions in construction, trade and transportation. Oil production slowed down in the first nine months of 2019 due to planned repair works in the three main oilfields. As a result, exports declined by 4.5 per cent year-on-year in US dollar terms in the first eight months of 2019. At the same time, imports rose by 13.2 per cent. The growth in real wages, fuelled by increases in minimum wages and public sector salaries, continues to support private consumption. Fixed investment increased by 9.7 per cent in the first nine months of 2019, partly related to the construction of the Saryarka gas pipeline.

The exchange rate has been broadly stable. Capital outflows and rouble depreciation weakened the tenge against the US dollar by 14 per cent over the course of 2018, but depreciation of the exchange rate in the first half of 2019 has been limited despite market pressures. Annual inflation reached 5.5 per cent in October 2019. Rising inflationary pressures prompted the central bank to increase the base rate by 25 basis points to 9.25 per cent in September 2019. Credit growth has slightly accelerated (6 per cent year-on-year in September 2019), with loans growing only in the retail sector. The non-performing loan (NPL) ratio stood at 9.3 per cent in September 2019.

Fiscal and external accounts improved in 2018. The fiscal balance turned to a surplus of 2.6 per cent of GDP in 2018 from a deficit of 4.4 per cent in 2017, on account of higher tax revenues and a moderation of government spending. The non-oil fiscal deficit narrowed to 5.0 per cent of GDP in 2018 from 10.5 per cent in 2017. Growth on the revenue side was driven by increased corporate income tax and value added tax receipts as well as improved tax administration. Lower spending in 2018 was due mainly to a reduction in banking sector support outlays. However, in 2019 the guaranteed transfer from the National Oil Fund has been increased to KZT 2.70 trillion (US$ 7 billion) to finance various social support programmes. The current account came almost to balance in 2018, supported by rising net exports, after a deficit of 3.1 per cent of GDP in 2017, but the deficit widened again in the first half of 2019.

Moderate growth is expected to continue. The economy is expected to expand more slowly, by 3.9 per cent in 2019 and 3.6 per cent in 2020, as the contribution of mining is expected to moderate. With minimum wages increasing in January 2019, growth in real incomes, along with higher consumer lending, will continue to drive private consumption. Downside risks include a possible deterioration in the external environment and an escalation of internal banking sector weaknesses.

Assessment of transition qualities (1-10)



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Major structural reform developments

The government is enhancing its efforts to attract investment. The Coordination Council for Attracting Foreign Investment, chaired by the prime minister, was created in April 2019. Combined with concrete benefits for investors, including special legal and tax regimes and simplified procedures for obtaining work permits for expatriates, the new approach represents a concerted effort to promote investment opportunities in Kazakhstan to foreign investors.

Renewable energy is gaining traction, while legislative reforms on the green economy are under way. The share of renewable energy in the energy mix increased to 1.2 per cent in total production volume in 2018, up from 1.0 per cent in 2017, with the government aiming to achieve a target of 3.0 per cent by 2020. The ecological code is currently being updated to bring the current legislation in line with Organisation for Economic Co-operation and Development standards and introduce best available technologies. Adoption of the code is expected in 2020. At the same time, in other areas progress on the green economy transition has been limited. Despite the re-launching of the emissions trading system in January 2018, trading of quotas has not commenced. Energy efficiency measures in buildings and industry are lagging behind the declared targets due to weak regulation and lack of economic incentives.

The government has frozen utilities tariff reform. The current system of tariff regulation does not motivate utility companies to improve their performance and minimise operating costs. Most of these firms are therefore loss-making. The first steps have been taken to change long-term tariff regulation to stimulate the economic involvement of utility firms in reducing their operating costs. A new performance-based tariff methodology was developed for water, wastewater, district heating and electricity distribution sectors, and approved by the tariff regulator. The new methodology was referenced in a new law “On Natural Monopolies” that came into force in December 2018. However, the work on methodology has experienced a temporary set-back, with its detailed promulgation delayed due to the government’s decision to reduce or freeze tariffs for all utilities across the country in 2019 in order to reduce the social burden.

Privatisation is proceeding but at a slow pace. As of the end of July 2019, 734 out of 922 state-owned enterprises earmarked for privatisation had been sold for Tenge 453 billion (US$ 1.2 billion). In November 2018, Kazatomprom, the world’s largest uranium producer, sold only 15 per cent of its shares for US$ 451 million out of the 25 per cent planned to be privatised. The IPO was conducted on the London Stock Exchange and on the new Astana International Exchange. Partial privatisations of two other blue-chip assets – Air Astana, the national carrier, and Kazakhtelecom, the national telecommunications operator – have been postponed to late 2019. The government is falling behind its target of cutting the share of the state in the economy to 15 per cent by 2020, with the latest data showing that the share remains at 48 per cent. Preparation for privatisation of sizeable blue chip companies is taking longer than expected due to complexities in restructuring and commercialising large operations and a lack of momentum in regulatory reform in key sectors.

Banking sector restructuring has continued and the supervisory framework of the central bank has improved. In April 2019 Moody’s credit ratings agency upgraded its forecast for the banking sector from “stable” to “positive”, enabled by improved capitalisation and asset quality and an overall better liquidity situation. Following the merger of two large banks in July 2018 and revocation of the licences of three smaller banks, sector consolidation has continued in 2019. The fourth largest bank, Tsesnabank, had its distressed assets acquired by the state-owned Problem Loan Fund and was bought out by First Heartland Bank in February 2019. The National Bank of Kazakhstan has strengthened its supervisory functions by shifting to risk-oriented supervision in January 2019. The new approach is forward-looking and focuses on pre-empting risks by identifying problems early on. Another key development is the launch of the independent AQR of 14 (out of 28) banks in August 2019, which will be key to understanding the real situation with problem loans and identifying additional provisioning needs.

KOSOVO

Highlights

- **Relatively strong growth continues.** Gross domestic product (GDP) grew by 3.8 per cent in 2018 and 4.2 per cent year-on-year in the first half of 2019, driven by robust domestic demand.
- **Inflation has accelerated.** Average inflation has increased from below 1.0 per cent in the period of January to October 2018 to above 3.0 per cent thereafter, driven primarily by rising food prices.
- **The country has stepped up the fight against informality.** In May 2019, Kosovo adopted a revised strategy and action plan for fighting informality for the period 2019 to 2023.

Key priorities for 2020

- **Business climate reforms are needed to accelerate the growth of the private sector.** The Kosovo authorities should step up the fight against informality and tax evasion, as well as facilitate access to finance for small and medium-sized enterprises (SMEs) by addressing the underlying legal and institutional constraints that discourage formal activities. The competitiveness of SMEs should be supported as well since businesses often lack skills and expertise.
- **Problems in state-owned enterprises (SOEs) should be addressed.** Financial oversight, corporate governance, accountability and efficiency of SOEs are areas that need improvement. In addition, the privatisation of non-strategic SOEs should be stepped up.
- **Diversification away from coal is warranted.** The country should urgently take measures to decrease its (almost exclusive) reliance on lignite as a source of electricity and increase the share of renewables in power generation. Also, a broader green agenda is needed, including steps to improve energy efficiency at the residential, private sector and municipal level, and the construction of new wastewater treatment plants.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	4.1	4.1	4.2	3.8	4.0
Inflation (average)	-0.5	0.3	1.5	1.1	3.0
Government balance/GDP	-1.9	-1.5	-1.4	-2.9	-3.5
Current account balance/GDP	-8.6	-7.9	-6.0	-8.0	-7.5
Net FDI/GDP [neg. sign = inflows]	-4.7	-2.9	-3.3	-2.5	-3.0
External debt/GDP	33.3	33.2	33.2	30.3	n.a.
Gross reserves/GDP	12.2	10.0	10.7	11.4	n.a.
Credit to private sector/GDP	34.5	36.5	38.6	40.8	n.a.

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Macroeconomic performance

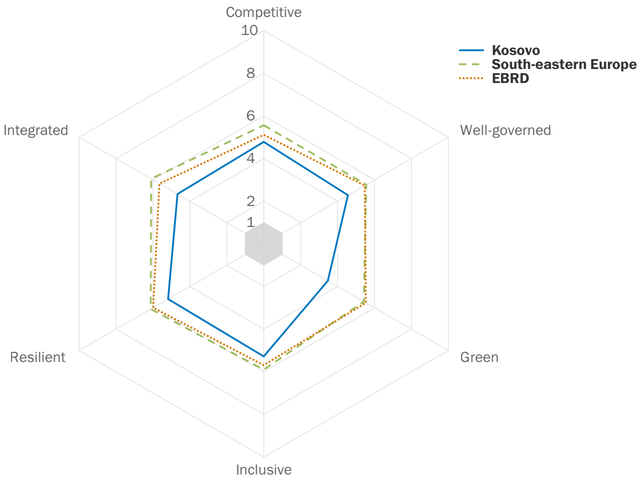
Relatively strong economic growth has continued for the fifth year in a row. After 4.2 per cent growth in 2017, GDP grew by 3.8 per cent in 2018, driven by investment and consumption. However, greater domestic demand contributed to an increase in imports and a widening of the current account deficit to over 8.0 per cent of GDP. Higher growth has not yet translated into more jobs, as the employment rate fell in 2018 by one percentage point, to 28.8 per cent. Similarly, the unemployment rate fell only slightly, staying close to 30.0 per cent, and at 55.4 per cent for young people. Despite high unemployment, businesses often struggle to find a skilled labour force. A salient feature of Kosovo's labour market is the very limited presence of women, with the female employment rate at only 12.3 per cent in 2018. Strong, domestic demand-driven growth continued in the first half of 2019, at 4.2 per cent year-on-year. Nevertheless, growth has been hindered by political instability and is still low for a meaningful catch-up.

Inflation has picked up. Inflation in 2018 remained subdued for the year as a whole, at around 1.0 per cent, but it has risen since the second half of the year, averaging 3.0 per cent year-on-year in the first nine months of 2019. The surge in inflation has been mainly driven by food prices (increasing on average 6.9 per cent year-on-year in the first nine months of 2019) and possibly also related to the imposition in November 2018 of 100.0 per cent taxes on goods imported from Serbia and Bosnia and Herzegovina.

Public debt remains low, but the government expenditure structure is unfavourable. While the budget deficit as defined by the fiscal rule (that is, the deficit excluding investments financed by international financial institutions, donors and privatisation proceeds) stayed well within the fiscal rule ceiling of 2.0 per cent, the overall deficit increased to 2.9 per cent of GDP in 2018 (from 1.4 per cent in 2017). Still, the public debt remains exceptionally low by regional standards. At the end of June 2019, it reached 16.5 per cent of GDP. However, transfers and subsidies have risen rapidly in recent years, accounting for a significant share of government current expenditures (around 40.0 per cent). The reform of the war veteran pension schemes, which would reduce pension costs, has still not been implemented. High social spending is not only adversely affecting the fiscal balance but is also having a negative impact on labour market participation. A government plan to build a new lignite-based power station and renovate an old one would not only conserve a highly polluting power generation structure with excessive carbon emissions, but also create additional fiscal risks, potentially leading to a breach of the fiscal rule.

Further catch-up is likely in the short term. GDP growth in 2019 and 2020 is expected to be 4.0 per cent annually, with domestic demand continuing to be the main growth driver. The risks to the projection are balanced. While upside risks relate to the possible start of the construction of a major new power plant and faster reform progress, weaknesses in public investment management, the economic slowdown in the European Union (EU), domestic political uncertainty and deteriorating relations with neighbours represent the main downside risks.

Assessment of transition qualities (1-10)



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Major structural reform developments

There has been little progress in EU approximation over the past year. Kosovo signed the Stabilisation and Association Agreement (SAA) with the EU in October 2015. It formally entered into force on 1 April 2016. While the European Commission has repeatedly stressed that Kosovo shares the European perspective of the Western Balkans, the question of its integration into the EU remains contentious due to the fact that five Member States do not recognise Kosovo bilaterally. The decision by the Kosovo government, on 20 November 2018, to impose 100 per cent tariffs on goods from Serbia has further complicated relations with the EU as it has been perceived by Brussels as a violation of the SAA and Central European Free Trade Agreement (CEFTA).

The business environment remains problematic. Widespread informality and corruption, an inefficient judiciary and weak rule of law and institutions are the key obstacles to doing business. Although business registration is simple and fast, with "one-stop shops" in place, businesses are burdened with a large number of licences and permits, cumbersome administrative procedures and frequent, uncoordinated and costly inspections. A general inspections reform is ongoing, with a plan to decrease the number of (overlapping and parallel) inspections from 36 to 15. However, the new Law on Inspections has not been adopted yet. According to the World Bank, Kosovo ranked 57th out of 190 in the *Doing Business 2020* report, dropping 13 places from the year before. Despite some improvements over the past year, the most problematic areas remain the same – dealing with construction permits (160th), protecting minority investors (128th) and getting electricity (90th).

A strategy against informality has been adopted. The informal economy, estimated by international institutions at close to one-third of GDP, is one of the main barriers for doing business in Kosovo. In May 2019, Kosovo adopted a revised strategy and action plan for fighting informality for the period 2019 to 2023. The measures include improving information exchange between relevant government institutions, reducing the cost of transactions for electronic payments in order to reduce cash payments and provision of bank loans based on financial statements submitted to the Tax Administration. The strategy also includes qualitative and quantitative indicators to enhance the monitoring process.

Public administration reform has advanced somewhat. A process of rationalisation of agencies has started, based on an action plan adopted in June 2018. In February 2019, the Law on Public Officials, defining different categories of public officials, and the Law on Salaries were adopted. The latter sets up a coherent and transparent salary system, although it risks having an adverse medium-term impact on the budget. A large increase in wages as part of the public administration reform, combined with an increase in employment, might entail a large fiscal cost and put the fiscal rule at risk. Also, political influence on senior appointments is still present and a comprehensive monitoring system of the public administration reform has not yet been established. The reform monitoring reports are neither actively discussed nor followed up at the political level. In addition, the reform relies predominantly on external donors, whose support often has not been secured, while annual budgetary expenditures are usually lower than planned. This raises concerns about the financial sustainability of the reform.

Resolution of state-owned enterprises (SOEs) is progressing slowly. According to the IMF, there are 16 non-financial central level and 44 local level publicly owned companies in the sectors of energy, telecommunications, railway and bus transport, water supply, sewerage and waste. The financial oversight, accountability and efficiency of SOEs are often inadequate. The privatisation process has lagged behind after the authorities' decision in November 2017 to freeze privatisation of socially owned land. In the second half of 2018, there were just six asset sales by the Privatization Agency from a total of 400 in the tender process. In January 2019, the government decided to re-launch the procedure for the privatisation of Kosovo Telecom (the third attempt since 2011), with the assistance of the EBRD. The company is overstaffed and has been a loss-maker since 2015. In March 2019, the socially owned Trepça mining complex, which holds Europe's largest lead-zinc and silver ore mine, was officially transformed into a joint stock company. The government has kept control of 80 per cent of the shares, while the remaining 20 per cent is owned by the employees. However, the ownership of the company has been disputed by Serbia.

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Modernisation of the country's transport infrastructure has progressed. Infrastructure development is key to the country's continued integration with the region. In May 2019, a second motorway was completed – the 60-kilometre highway linking the capital Pristina to the border with North Macedonia – but the project was criticised for its lack of transparency. In July 2019, the country started to upgrade its only operational international rail link, the 148-kilometre line connecting the Serbian border and Pristina with the capital of North Macedonia, Skopje. The project should improve the connection between Kosovo's railway network and the wider European network through European transport Corridor VIII and Corridor X.

Progress has been made to unlock investments in renewables. Kosovo is characterised by high energy intensity and over-reliance on coal, with less than 5 per cent of electricity produced from renewable sources in 2017. Following extensive policy dialogue, improvements to the power offtake structure were adopted in June 2019 and the EBRD financed the country's first major investment in wind power later that month. In line with the country's obligations as a member of the Energy Community, the next step is to establish an open and transparent auction system for further renewable energy projects. Limited progress has also been made to improve energy efficiency in the residential, public and private sectors, and adjustment of energy tariffs and incentives are required.

KYRGYZ REPUBLIC

Highlights

- **Economic growth has improved.** Real gross domestic product (GDP) growth accelerated to 6.1 per cent year-on-year in the first three quarters of 2019 from 3.5 per cent in 2018, reflecting strong gains in the mining and manufacturing sectors and the low base effect.
- **The fiscal deficit has narrowed.** The general government deficit declined to 1.3 per cent of GDP in 2018, from 4.6 per cent in 2017, due to fiscal consolidation measures. This has contributed to a reduction of public debt to 56.0 per cent of GDP.
- **A Business Ombudsman has been established.** This is a major step towards more transparency and predictability and an overall improvement of the business climate. The weak rule of law and inadequate protection of property rights are widely regarded as key obstacles to doing business.

Key priorities for 2020

- **Regulatory reform needs to be accelerated.** The sustainability of municipal infrastructure and the energy sector should be improved through tariff reform, and greater private-sector participation should be promoted in the energy sector by implementing measures to increase competition across the value chain.
- **Governance should be strengthened.** Corruption and public governance issues remain major hindrances to private-sector development. Strengthening private property protection and the enforcement of contracts would significantly ease the difficulty of doing business.
- **Fiscal consolidation should continue.** In order to maintain debt sustainability, the government should adhere to the fiscal rule, currently under parliamentary consideration, which requires the deficit to not exceed 3 per cent of GDP and caps the public debt at 70 per cent of GDP.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	3.9	4.3	4.7	3.5	4.3
Inflation (average)	6.5	0.4	3.2	1.5	1.2
Government balance/GDP	-2.7	-6.4	-4.6	-1.3	-3.0
Current account balance/GDP	-15.9	-11.6	-6.2	-8.7	-10.0
Net FDI/GDP [neg. sign = inflows]	-17.1	-9.0	1.4	-0.6	-2.0
External debt/GDP	99.9	100.2	91.0	84.0	n.a.
Gross reserves/GDP	26.6	28.9	28.3	26.6	n.a.
Credit to private sector/GDP	22.8	20.6	21.4	23.9	n.a.

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Macroeconomic performance

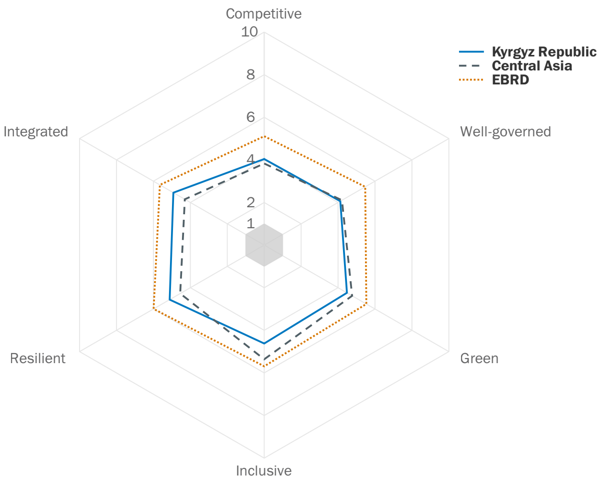
The economy is growing steadily. Following a moderation of real GDP growth to 3.5 per cent in 2018 from 4.7 per cent in 2017, economic growth picked up to 6.1 per cent year-on-year in the first three quarters of 2019, reflecting strong gains in the mining and manufacturing sectors and the low base effect. Gold production has rebounded thanks to an increased ore grade and a higher recovery rate. Excluding the Kumtor gold mine, GDP growth in the first three quarters of 2019 reached 3.2 per cent year-on-year. Net remittances, however, declined by 12.0 per cent year-on-year in US dollar terms in the first eight months of 2019.

Inflation remains subdued. Average annual inflation decelerated to 1.5 per cent in 2018 from 3.2 per cent in 2017 on the back of falling food prices. Inflation remained low in September 2019 at 2.3 per cent and is expected to stay well below the central bank target of 5.0 to 7.0 per cent. The low inflationary environment prompted the central bank to cut the policy rate twice in 2019 by 25 basis points each time – in February and May – to 4.50 per cent and 4.25 per cent, respectively. The strong loan growth observed in 2018 continued in the first half of 2019, with total credit expanding by 15.0 per cent year-on-year in September 2019.

The fiscal deficit has narrowed but external deficits have widened. The general government deficit declined to 1.3 per cent of GDP in 2018 from 4.6 per cent in 2017 as a result of lower current expenses. This has contributed to a reduction of public debt to 56.0 per cent of GDP in 2018 from 58.8 per cent in 2017. According to estimates from the International Monetary Fund, the current account deficit widened to around 8.7 per cent of GDP in 2018 from 6.2 per cent in 2017, reflecting reduced gold exports and a marked slowdown in growth of remittances from Russia due to the weaker rouble. In the first half of 2019, the deficit started narrowing, however, to US$ 370 million versus US$ 804 million a year earlier, as gold exports recovered. The exchange rate remained stable in nominal terms in 2018 and 2019 but continued to appreciate in real effective terms.

Robust GDP growth is expected to continue in the short term. GDP growth is expected to reach 4.3 per cent in 2019, driven by increased gold production. Exports from the Kumtor gold mine, more evenly distributed over the year than in 2018, and private consumption, supported by further increases in real wages and remittances, are expected to be major contributors to economic growth in the short term. The scope for fiscal expansion is, by contrast, very limited. Downside risks include the weakening of growth in Russia, with negative implications for remittances and increasing fiscal pressures related to the parliamentary elections in 2020.

Assessment of transition qualities (1-10)



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Major structural reform developments

The business environment is improving. The Kyrgyz Republic was among the top 20 most improved countries in the World Bank's *Doing Business 2020* report. The country has made significant progress in three areas: getting electricity, getting credit and paying taxes. The reliability of the country's electricity supply has been enhanced by modernising the infrastructure and better monitoring outages. The country has also improved access to credit information by providing credit scores to banks, financial institutions and borrowers. Lastly, paying taxes has been made easier by consolidating the tax on interest income into the corporate income tax and by introducing an online platform for filing and paying taxes. The country ranks 80th out of 190 countries in this year's report.

Progress has been made towards a strategic agreement between the government and Centerra Gold on the Kumtor gold mine. The two parties – Centerra Gold and the Kyrgyz government – had entered into a strategic agreement in September 2017, which settled an environmental dispute and allowed the subsidiary company of Centerra Gold to transfer cash to its parent company in Canada. However, the deadline for implementing the agreement has been postponed by the Kyrgyz authorities several times since then. In August 2019, Centerra Gold announced that all conditions to complete the agreement were satisfied or waived, and the parties are now moving to terminate the remaining legal proceedings. Establishing a stable and permanent framework for operations in and ownership of the Kumtor gold mine demonstrates the government's commitment to legal stability and will help attract more foreign direct investment.

A decree establishing a Business Ombudsman has been signed. The signing took place in December 2018. The Business Ombudsman institution aims to protect the rights of businesses by investigating their complaints about instances of abuse of power by the state, municipalities and entities controlled by them. The Business Ombudsman and its deputies are selected unanimously by three votes – the government, international partners and business associations – which preserves balance and ensures commitment from these three key stakeholders. The Ombudsman's activity is financed by international development partners. This is a major step towards more transparency and predictability and an overall improvement of the business climate. However, the key to success of the institution will be in its implementation.

The central bank has strengthened its supervisory framework but compromised its credibility by acquiring a troubled bank. The National Bank of the Kyrgyz Republic (NBKR) continued transitioning to risk-oriented supervision by introducing amendments in June 2018 to the requirements of risk management policies and procedures of banks. It also approved new provisions related to inspections of banks, in line with the new approach. However, other issues pertaining to governance and oversight arrangements in the NBKR, such as independence of its board, remain unaddressed. In addition, in October 2018 the NBKR acquired a troubled bank – Rosinbank – after taking possession of the shares that it had accepted as collateral for emergency liquidity assistance. This measure is unwelcome as it carries the risk of a conflict of interest between ownership and the NBKR's supervisory role.

The Kyrgyz Republic has endorsed the open skies policy. Amendments to the Air Code of Kyrgyzstan, signed in January 2019, unilaterally declare an open skies policy and the fifth freedom for countries that want to operate international flights through the airspace of the Kyrgyz Republic. The fifth freedom allows foreign airlines to carry passengers, baggage, freight and mail on flights from the Kyrgyz Republic to third countries (outside their origin) and back. This is expected to bring more international traffic to Manas International Airport and stimulate the country's air travel market.

The legal framework for anti-money laundering and combating the financing of terrorism has been improved. The updated law "On Combating Terrorist Financing and Money Laundering" came into force in September 2018. It adopts international standards on combating money laundering, the financing of terrorism and financing the proliferation of weapons of mass destruction, as provided in the Financial Action Task Force recommendations. The law provides requirements to ensure transparency of beneficial owners of legal entities and a database of beneficial owners of legal entities established and registered in the Kyrgyz Republic. The NBKR now needs to update the relevant regulations in line with the new law.

LATVIA

Highlights

- **Economic growth is moderating.** In 2018, the improved absorption of European Union (EU) funds and positive economic sentiment resulted in strong investment and gross domestic product (GDP) growth, but both investment and household consumption have been subdued in the first half of 2019.
- **Supervision of the banking sector has improved.** Following the accusations of money laundering in 2018 at ABLV Bank, the government has introduced several measures to reduce exposure to risky banking operations.
- **The government is encouraging small and medium-sized enterprise (SME) presence on the stock exchange.** The goal is to increase the international competitiveness of SMEs and to develop local capital markets.

Key priorities for 2020

- **Further efforts to strengthen banking supervision are needed.** In order to restore the reputation of Latvia's financial sector, extra reforms are required in order to prove the effectiveness of the regimes of anti-money laundering (AML) and combating the financing of terrorism (CFT).
- **Poor health outcomes should be addressed.** Life expectancy remains among the lowest in the European Union (EU), while amenable mortality is high. The long-awaited healthcare reform should be continued and more public funds should be devoted to improving patient access to treatment.
- **Productivity and GDP growth require greater investment in innovation.** Amid a shrinking population, a greater focus needs to be placed on knowledge-intensive activities. The recent efforts by the largest state-owned enterprises to boost innovation were welcome, but more private-sector involvement is needed early on.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	3.3	1.8	3.8	4.6	2.6
Inflation (average)	0.2	0.1	2.9	2.6	2.8
Government balance/GDP	-1.4	0.1	-0.5	-0.7	-0.8
Current account balance/GDP	-0.8	1.4	0.7	-0.7	-1.5
Net FDI/GDP [neg. sign = inflows]	-2.3	0.0	-2.0	-2.3	-2.5
External debt/GDP	143.7	148.6	140.3	120.9	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	49.7	49.2	43.8	38.0	n.a.

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Macroeconomic performance

Economic growth is moderating. After reaching 4.8 per cent in 2018, GDP growth slowed to 2.4 per cent in the first half of 2019. Domestic demand continued to be strong in 2018, fuelled by strong household and government consumption and a double-digit hike in investment. Net exports weighed on GDP performance in 2018 (by negative 2.2 percentage points), as investment-driven imports robustly outperformed weak exports. In the first half of 2019, almost all GDP components (except exports) saw some deceleration.

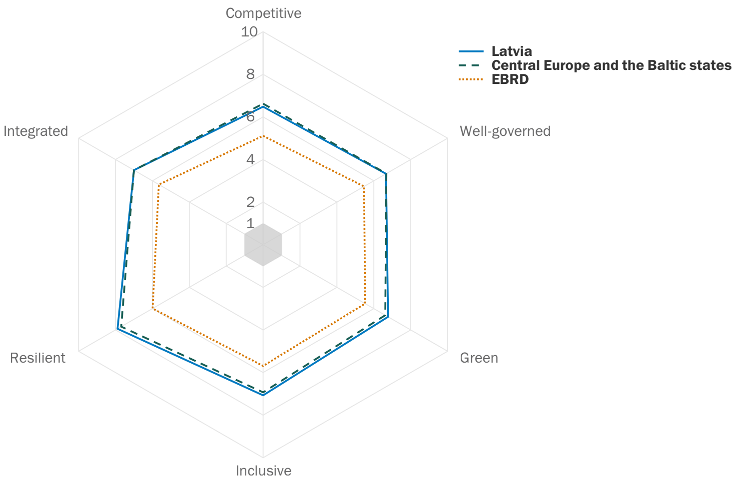
Investment remains strong despite a credit decline. Investment growth of 16.4 per cent in 2018 was mainly caused by improved EU funds absorption. As of mid-2019, 77.0 per cent of EU funding available in 2014-20 (€5.63 billion) was already invested in various projects. On the other hand, restructuring of the banking sector has continued to reduce banks' balance sheets. In the first half of 2019, the decline in lending activity to the private sector decelerated somewhat from -5.8 per cent in 2018 to -3.3 per cent year-on-year. Overall, the stock of credit to the private sector shrank to about 36.8 per cent of GDP by mid-2019, compared with almost 50.0 per cent at the beginning of 2016.

Growth of labour costs have been among the highest in the EU. Since 2010, unit labour costs increased by more than 35.0 per cent, the third-highest rate in the EU. Over the same period, real labour productivity improved by almost 28.0 per cent. Wage growth was 8.4 per cent in 2018, driven by labour shortages and an increase in the minimum wage. Wages are expected to increase further in the short term, albeit at a slower rate.

General government budget deficit widens. Following a small surplus in 2016, the general government balance turned negative in 2017 and dropped to a deficit of 0.7 per cent of GDP in 2018 as a result of increased public investment and higher public-sector wages. The government deficit is expected at 0.8 per cent of GDP in 2019. Government debt will likely decrease further, from 36.4 per cent of GDP in 2018 to below 35.0 per cent of GDP in 2020.

Labour shortages and restrained financing will weigh on growth. GDP growth is projected to decelerate to 2.6 per cent in 2019 and further to 2.2 per cent in 2020. The slowdown is due to a combination of factors, including decelerating economic growth in advanced European countries, adverse demographics and the reduced availability of sources of finance, such as EU funds and bank credit. However, additional rises in wages will drive further consumption growth.

Assessment of transition qualities (1-10)



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Major structural reform developments

Supervision of the banking sector continues to tighten. Following the completion of the financial system assessment by the Council of Europe's Moneyval committee (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism), the prime minister signed three decrees on a further reform of the financial sector's supervisory system in February 2019. These measures are designed to address concerns raised in the Council of Europe's report about Latvia's AML/CFT regime. The new measures strengthen the Financial and Capital Market Commission, enable the government to expel banks involved in money laundering and enable more focus of the courts and prosecutors on more serious financial crimes.

The government is attracting more local companies to the stock exchange. In May 2019, the Finance Ministry proposed regulations to encourage more SMEs to be listed on the Riga Stock Exchange. The goal is to increase the international competitiveness of the companies and to develop local capital markets. A support scheme is expected to promote and support financing availability for SMEs. Stock capitalisation in Latvia remains relatively small (4.6 per cent of GDP), compared with neighbouring Baltic states, and way below the EU average of 78.0 per cent. So far, reasons given by SMEs for not listing their shares include: high costs, low market liquidity, and insufficient awareness of the potential benefits.

Regional development has been enhanced. In April 2019, the parliament adopted a draft resolution on launching an administrative-territorial reform. According to the reform, the number of local governments would be reduced from 119 to 35. The economically weaker regions would be merged with stronger ones, with the goal of enhancing regional development and ensuring equal services to all residents The reform constitutes a continuation of the territorial reform started in 1998 and is expected to be completed by 2021.

The business environment is improving. In May 2019, the government endorsed a finance ministry plan to enhance the business environment in 2019-20. The key principles of the 40 measures in the plan include a consumer-friendly public administration, the expansion of e-governance, a competitive tax system, and promotion of the rule of law and innovation. Moreover, a specialised court for handling economic cases is expected to be established by 2021. According to the American Chamber of Commerce, the slow and unpredictable proceedings of complicated economic crime cases have contributed to corruption and make Latvia appear less attractive for investors. In the World Bank *Doing Business 2020* report, Latvia remained at 19th position (out of 190 countries).

The government has set targets to shrink the shadow economy. According to the action plan prepared by the government in April 2019, the shadow economy should be reduced from 21.3 per cent of GDP in 2017 to 17.1 per cent in 2022. The priority measures aim to improve tax payments and introduce fair competition in those economic sectors with the highest risks of informality, such as the construction and retail sectors.

LEBANON

Highlights

- **The macroeconomic environment deteriorated in 2019.** As a result, credit ratings have been cut and credit default swaps spreads have reached record levels.
- **Energy reforms are advancing.** A new electricity sector reform plan has been approved by the parliament and reforms of the electricity, oil and gas sectors are under way, strengthened by public-private partnerships (PPPs).
- **Political instability and social uprisings undermined the timely implementation of crucial reforms.** The formation of a national unity government at the beginning of 2019 initially had provided an enabling governance framework to effectively attract investments and boost economic and structural reforms, which was diluted following the resignation of the government in October.

Key priorities for 2020

- **The authorities should boost the diversification of the financial sector.** Further efforts should be made to expand the non-bank financial sector, including microfinance, equity finance, leasing and insurance activities.
- **More labour market opportunities are needed for excluded groups.** Creating employment opportunities could be supported by the improvement of technical and vocational education and training (TVET), and the provision of equitable access to economic opportunities for women and young people.
- **A scaled-up National Poverty Targeting Programme should accompany fiscal tightening and reforms.** The government should widen the current social safety net and broaden coverage of healthcare programmes to the poor and most vulnerable segments of society, in order to protect them from the short-term impacts of austerity measures.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	0.4	1.6	0.6	0.2	0.2
Inflation (average)	-3.7	-0.8	4.5	6.1	3.1
Government balance/GDP	-7.5	-8.9	-8.6	-11.0	-9.8
Current account balance/GDP	-19.3	-23.1	-25.9	-25.6	-26.4
Net FDI/GDP [neg. sign = inflows]	-3.0	-3.1	-2.3	-2.4	-3.0
External debt/GDP	166.6	182.0	189.4	191.1	195.7
Gross reserves/GDP	73.5	78.5	76.1	64.7	54.1
Credit to private sector/GDP	100.5	103.8	106.9	97.8	n.a.

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Macroeconomic performance

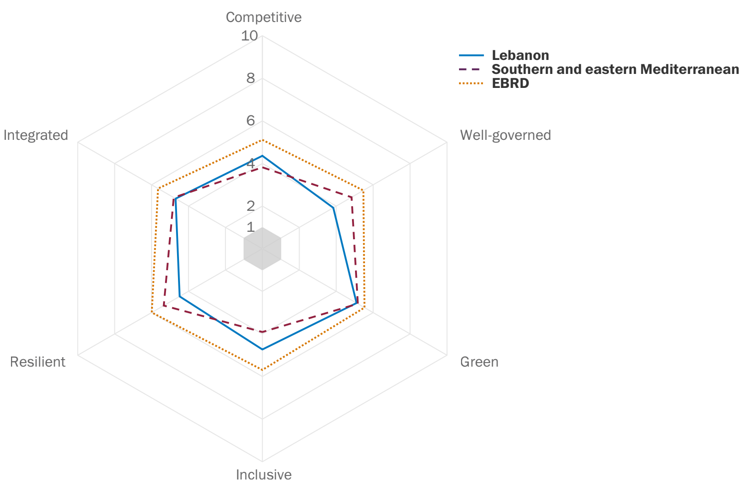
Economic growth remained sluggish in 2018. Gross domestic product (GDP) grew by a mere 0.2 per cent, mainly driven by private consumption, tourism and exports. The removal of the travel ban to Lebanon in a number of Gulf countries led to an improved performance in the tourism sector, which subsequently benefited private consumption. Furthermore, exports also rose, driven by the opening of land routes with Syria. Inflation moderated to 1.2 per cent year-on-year in August 2019, down from a peak of 7.6 per cent in June 2018, due to an easing in food-price inflation.

The fiscal situation is increasingly challenging. The fiscal deficit widened in 2018 to 11.0 per cent of GDP, as efforts to rein in spending were hindered by political opposition and post-election deadlock from the middle of 2018. Transfers to Electricité du Liban amounted to US$ 1.75 billion, or 3.1 per cent of GDP, mainly because of higher international oil prices. Interest payments also increased, amounting to one-third of total spending, leaving little room for other current or capital spending. The first half of 2019 witnessed an improvement in fiscal conditions, with the budget deficit narrowing by about 20.0 per cent. However, the target of a deficit of 7.0 to 8.0 per cent of GDP in 2019 will be difficult to achieve. Meanwhile, public debt is still the third-highest in the world, at more than 150.0 per cent of GDP as of the end of June 2019.

External imbalances have widened. The current account deficit remained exceptionally high in 2018, at an estimated 25.6 per cent of GDP, the third-highest in the world. This was due to the continued appreciation of the real effective exchange rate (4.4 per cent year-on-year in June 2019) and a large import bill (59.0 per cent of GDP), which was only partially compensated by exports of services (27.9 per cent of GDP) – mainly tourism and financial services. Tourist numbers increased by 7.6 per cent in the first eight months of 2019, mainly due to an increase in tourist arrivals from Gulf Cooperation Council countries, signalling the best tourism season since 2010. Non-resident deposits grew by 0.7 per cent in July, and the net foreign assets of the banking sector (excluding Banque du Liban and gold) declined by 8.7 per cent. Foreign exchange reserves stood at US$ 31.1 billion at the end of July 2019, a US$ 2.6 billion decline since the beginning of the year.

Growth is expected to remain subdued. Growth is expected to remain stagnant in 2019, before falling into negative territory in 2020. However, the outlook remains uncertain, with significant downward risks, given the political instability and social uprisings in the fourth quarter of 2019, which are undermining the timely implementation of crucial fiscal, energy and structural reforms.

Assessment of transition qualities (1-10)



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Major structural reform developments

The government has approved a new electricity-sector reform plan. Demands on the electricity network have risen markedly since 2012 because of the arrival of more than one million Syrian refugees, which put huge pressure on the electricity national grid. The 10-year plan, approved in April 2019, targets improved electricity generation, transmission and distribution, as well as the elimination of the deficit of Electricité du Liban by 2020. The intention is to reduce the current daily and prolonged blackouts by bridging the supply shortfall. The plan sets out a target of building six new gas-fired power plants over the next six years to cover demand and reduce dependence on temporary capacity, in addition to diversifying the sources of renewable energy. Meanwhile, a set of regulatory and electricity tariff reforms will be considered to attract private investments in energy infrastructure, which will help in addressing infrastructure gaps. Furthermore, the parliament approved a law in April 2019 allowing the government to grant licences for electricity production to private companies.

Plans for increasing renewable energy are advancing, alongside further oil and gas exploration. The government has a target of achieving 12.0 per cent of the energy mix from renewable energy by 2020 and 15.0 per cent by 2030. The government is working on increasing the share of wind and solar energy, alongside hydropower, through PPPs and technology transfers. The government has also launched several solar photovoltaic and wind farm projects under power purchasing agreements, in addition to improving electricity generation from renewable sources to secure a stable and adequate supply for the national grid. Meanwhile, the second licensing round for offshore oil and gas exploration and production was launched in April 2019, and a law for the creation of a sovereign fund for the oil and gas sector is currently awaiting approval.

The Capital Markets Authority has launched an Electronic Trading Platform (ETP). The platform, launched in June 2019, will start its operations within a year. It aims to provide the necessary equity and liquidity for small and medium-sized enterprises and facilitate access to the Lebanese financial markets. In that context, the ETP will contribute to boosting investments in the Lebanese knowledge economy. In addition, it will cooperate with other exchanges around the world, and will attempt to attract investments from the Lebanese diaspora, enabling them to trade and invest in Lebanon electronically.

The Code of Commerce has been amended. The new amendments were approved in March 2019 and entered into force in July 2019. They are intended to modernise the legal framework for companies and improve the business environment. The law also aims to ease the conditions for establishing a limited liability company in Lebanon by no longer requiring firms to have three partners in order to register.

A national statistic framework for TVET for 2018-22 has been launched. The framework articulates the key pillars for reforming the TVET system, with the aims of reducing the inclusion gap through improved employability of young people and helping businesses grow by ensuring the availability of a skilled workforce. Meanwhile, the role of the private sector in developing the TVET system is particularly important, given the market's inability to create enough jobs – and the right jobs – to accommodate highly skilled graduates, and given the scarcity of skilled labour due to migration.

The parliament has endorsed an e-transaction law. The law, enacted in January 2019, governs digital documents and contracts for individuals and businesses. It brings the country's e-transactions regulations in line with international best practices, and governs the legal rights and penal provisions for the misuse of data, privacy and modification. The new law also sets forth legal aspects for e-commerce, monetary guarantees and e-banking, with e-checks and digital checks being introduced under the supervision of the Bank of Lebanon.

A new Anti-Corruption Law has been adopted. The law was adopted in June 2019 and is part of the anti-corruption national strategy initiated in 2018, as part of the government's reform agenda prepared and presented at the CEDRE conference. It aims to address the widespread corruption in the public sector, and paves the way for establishing a National Anti-Corruption Commission.

LITHUANIA

Highlights

- **Gross domestic product (GDP) growth remains solid.** Rising disposable incomes, boosted by higher wages and, to a limited extent, the cut in the labour tax wedge, continue to stimulate consumption, while the accelerated absorption of funds from the European Union (EU) is fuelling investment.
- **Linkages between business and science are strengthening.** The Economy and Innovation Ministry and the European Organisation for Nuclear Research (CERN) have signed an agreement to set up two business incubator centres in Lithuania's two largest cities, Kaunas and Vilnius.
- **Power grid synchronisation is accelerating.** The Lithuanian parliament adopted a law on the synchronisation of the power grid with the continental European system, as well as 14 associated projects to facilitate the process, which should be finalised by 2025.

Key priorities for 2020

- **Enhanced interaction between business and academia should improve innovation.** Business research and development expenditures remain among the lowest, so particular efforts should be made to capitalise on the recent establishment of the two CERN technology centres to promote innovation among businesses in Lithuania.
- **Fintech and technology-focused innovative solutions should be fostered.** At the same time, the associated risks need to be addressed by enhanced supervisory capacity and strengthened anti-money laundering safety measures.
- **Skill mismatches and adverse demographic changes need to be tackled.** Upskilling the labour force, increasing employment among people with disabilities and introducing smart migration policies are all necessary to counteract unfavourable labour supply trends.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	2.0	2.6	4.2	3.6	3.6
Inflation (average)	-0.7	0.7	3.7	2.5	2.3
Government balance/GDP	-0.3	0.2	0.5	0.6	0.7
Current account balance/GDP	-2.4	-1.1	0.5	0.3	1.2
Net FDI/GDP [neg. sign = inflows]	-1.7	-0.9	-2.0	-0.8	-1.0
External debt/GDP	76.8	86.2	82.6	81.5	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	41.4	42.7	41.0	40.7	n.a.

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Macroeconomic performance

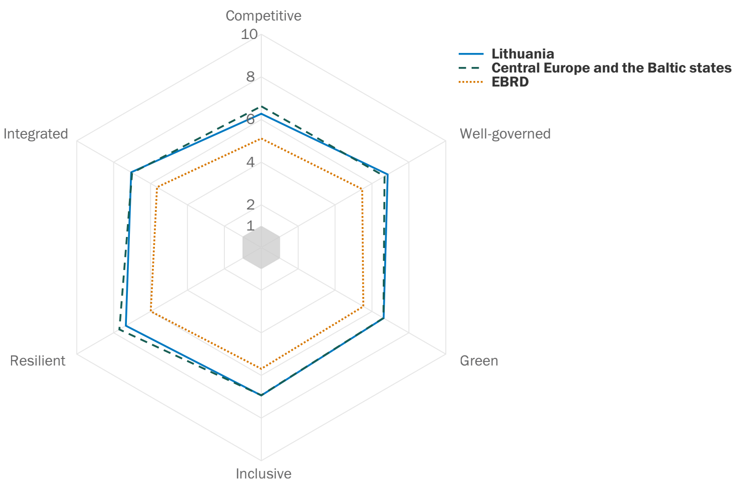
The economic expansion remains robust. GDP growth, at 3.5 per cent in 2018 and 4.1 per cent year-on-year in the first half of 2019, continues to be supported by vibrant household consumption, investment and exports. Recent labour tax reforms have effectively reduced the tax wedge in 2019 and, amid rising wages and low unemployment rates, have provided an additional boost to household spending. Investment growth is strong as a result of better utilisation of EU funds. Net exports have also positively contributed to growth, especially in the first half of 2019, despite the weaker external environment and a strong base effect.

Investment continues to be the critical engine of GDP growth. In 2018, investment grew by 6.5 per cent, and then accelerated to 8.2 per cent year-on-year in the first half of 2019. The improved utilisation of EU funds (66.0 per cent of the funds already allocated at the end of 2018), greater investments in automation by corporates and a positive business sentiment were the key factors in explaining strong investment performance. By contrast, increases in bank lending to non-financial corporates started to decline in the middle of 2018, before coming to a halt in June 2019. This temporary slowdown is largely due to financial imbalances in the Nordic countries, where the headquarters of some parent banks of major Lithuanian banks are located, along with the money laundering scandals that have occurred in all three Baltic states recently.

Public finances saw surpluses for three years in a row. In 2018, the general government balance remained in surplus, at 0.6 per cent of GDP. The structural fiscal position stayed broadly neutral and the achieved surpluses resulted from the better-than-expected economic environment. The government balance is estimated to reach a surplus of 0.7 per cent of GDP in 2019, before it balances in 2020. The pre-financing of 2020 bond redemptions are expected to hit government debt in 2019, which is expected to reach 37.0 per cent of GDP by the end of the year, 2.8 percentage points higher than in the previous year.

Structural factors and demographics are the main risks over the medium term. In the short term, GDP growth is expected to reach 3.6 per cent in 2019 and 2.3 per cent in 2020. Domestic demand will likely remain the key growth engine, driven by strong household consumption and investment, as companies continue to invest in automation amid mounting labour shortages. Greater investment in productivity could partially offset negative demographic trends associated with ageing and emigration.

Assessment of transition qualities (1-10)



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Major structural reform developments

Power grid synchronisation is accelerating. In July 2019, the parliament adopted a law on the synchronisation of the power grid with the continental European system, which, among other effects, will facilitate conditions for land acquisition. In August 2019, the government approved a list of 14 projects, such as the expansion of LitPol power interconnection and the reconstruction of the electricity transmission line between the Lithuanian power plant and Vilnius, which all were granted the status of national importance. In January 2019, the European Commission approved €323 million of financing for the first stage of the grids' synchronisation. The disconnection from the Russian BRELL network (the energy ring linking Belarus, Russia, Estonia, Latvia and Lithuania) and full synchronisation with the continental European system is expected to be completed by 2025.

Lithuania has applied to join the International Energy Agency (IEA). Following acceptance from the IEA's governing board of Lithuania's membership application in June 2019, the accession process will likely start at the end of 2019. As a member, Lithuania will be able to benefit from the experience of advanced economies and actively shape energy, environment and climate-related policies with the other 30 members of the organisation. The process of becoming an IEA member typically takes from two to five years.

Immigration rules are being relaxed to boost labour supply. In April 2019, the government proposed a law introducing quotas for third-country nationals coming to work in Lithuania. These quotas should enter into force in 2021 and be set annually by the Employment Service in response to labour market needs. Highly skilled workers will be exempted from those quotas. Also, citizens of the most economically strong countries who do not require a visa to travel to Lithuania will be easily granted temporary residence permits for up to three years, and will be allowed to bring their families with them. Amid shrinking demographics and mounting labour market shortages, these measures are designed to mitigate the impact of labour supply constraints on Lithuania's competitiveness and growth potential.

The size of the shadow economy is being addressed. In June 2019, the government adopted a set of measures to reduce the shadow economy in the construction, meat and car sectors. The size of the grey economy in these three sectors is estimated by the government at €800 million, with the greatest contribution coming from the construction sector. For the latter, the plan envisages the introduction of mandatory identity cards for builders and a related information system. According to the Shadow Economy Index for the Baltic countries, produced annually by the Stockholm School of Economics, the extent of the shadow economy in Lithuania is 18.7 per cent of GDP in 2018, above Estonia (16.7 per cent) and below Latvia (24.2 per cent).

Linkages between business and science are strengthening. In July 2019, CERN signed an agreement to set up two business incubator centres in Lithuania's two largest cities, Kaunas and Vilnius. The two centres will support the development and application of innovative ideas in technical areas relevant to CERN activities. The Lithuanian businesses will be able to participate in CERN's multi-million euro public procurement projects, while researchers will be able to contribute to major inventions, mainly to research particle physics. Lithuania became an associate member state of CERN in 2018.

The government is creating disincentives for the purchase of cars run on diesel. In August 2019, the government announced that it aims to reduce the country's reliance on old diesel-fuelled cars. The government envisages cash subsidies of €1,000 for citizens who choose to exchange their old diesel cars for newer ones running on petrol, gas or hybrid, which pollute the air less. Currently, about 75 per cent of all cars in Lithuania run on diesel.

Plans for a rail connection between the Baltic Sea and the Black Sea are advancing. In May 2019, the railway representatives of Belarus, Ukraine and Lithuania signed an agreement to launch a container train service between Klaipeda and Odessa. The cargo train connection aims to replace road transportation, is more environmentally friendly and may reduce transportation costs by an estimated 25 per cent.

MOLDOVA

Highlights

- **Recent economic growth has been robust.** Gross domestic product (GDP) grew by 4.0 per cent in 2018, supported by strong domestic demand and growing exports. A similar trend continued in the first half of 2019 when the growth rate accelerated to 5.2 per cent.
- **Reforms have largely come to a halt.** The political stalemate following the inconclusive parliamentary elections in February 2019 led to a caretaker government with limited powers and little appetite for reform.
- **Governance reforms continued in the banking sector.** Foreign investors entered the second-largest bank in the country. In parallel, the National Bank of Moldova (NBM) has lifted the intensive supervision regimes for Victoriabank and Moldova-Agroindbank, which had been in place since June 2015.

Key priorities for 2020

- **The new government should address deficiencies in the system of governance.** Particular emphasis should be given to fighting corruption and vested interests, irrespective of political affiliations, ensuring the independence of the judiciary and de-politicising state institutions.
- **Relations with the international financial institutions (IFIs) need to be maintained.** In particular, the implementation of structural reforms and macroeconomic policies agreed under the International Monetary Fund (IMF) programme is crucial for maintaining investor confidence and for receiving financial support from international development partners.
- **Independence of the NBM needs to be respected and its capacities strengthened.** The NBM needs to finalise the restructuring and cleaning of the banking sector without compromising fit and proper criteria for the banks' shareholders. Fully transcribing international standards for the supervision of banking and non-banking sectors needs to remain high on the agenda.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	-0.3	4.4	4.7	4.0	3.8
Inflation (average)	9.7	6.4	6.6	3.0	4.9
Government balance/GDP	-1.9	-1.8	-0.8	-1.1	-3.0
Current account balance/GDP	-6.0	-3.5	-5.7	-10.6	-9.1
Net FDI/GDP [neg. sign = inflows]	-2.8	-0.9	-1.5	-2.4	-4.2
External debt/GDP	78.4	76.8	72.1	65.2	n.a.
Gross reserves/GDP	22.7	27.3	29.0	26.2	n.a.
Credit to private sector/GDP	25.9	21.4	18.6	18.3	n.a.

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Macroeconomic performance

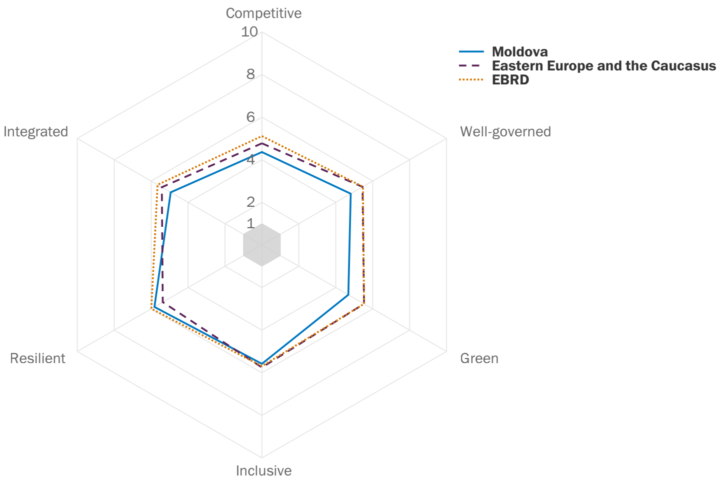
Economic output continued to expand at a solid pace. GDP grew by 4.0 per cent in 2018 and accelerated to 5.2 per cent year-on-year in the first half of 2019. Output expansion in 2018 was driven by a strong increase of investments in fixed assets on the back of construction-sector growth and by household consumption, which was supported by strong growth in real wages and a steady inflow of remittances. Capital investments increased by 14.0 per cent while household consumption grew by 3.8 per cent in 2018. Net exports contributed negatively to economic growth as the expansion of imports outpaced that of exports. While exports strengthened from 4.8 per cent growth to 6.9 per cent year-on-year in the first half of 2019, capital investments remained the main contributor to economic development, growing at 20.3 per cent. Growth of household consumption continued in the same period, albeit at a slower pace.

Macroeconomic stability was maintained, despite challenges. Following an exchange rate appreciation of 16.8 per cent in 2017, the current account deficit widened in the subsequent year to 10.6 per cent of GDP on the back of a strong increase in imports, mitigated somewhat by a solid inflow of remittances and exports receipts. This trend of a widening deficit continued in the first quarter of 2019, albeit at a slower pace. After broad stability in 2018, exchange rate pressures reappeared in the first half of 2019 but stabilised by mid-year. International reserves, at US$ 2.9 billion at the end of September 2019, provide more than five months of imports coverage. A persistent strengthening of demand has put upward pressure on prices. Consumer price inflation increased from 0.9 per cent in December 2018 to 6.3 per cent in September 2019. To keep inflationary pressures under control, the NBM increased the main policy rate twice in mid-2019, from 6.5 per cent in June 2019 to 7.5 per cent in July.

Financial-sector health continues to improve. The four-year cumulative contraction of 20.6 per cent in the banking sector loan portfolio has bottomed out and the clean-up of the sector, after the massive fraud in 2014, has moved to an advanced stage. The stock of loans provided to the private sector increased by 5.9 per cent in 2018 and by 16.3 per cent year-on-year in August 2019. The recovery was led by the growth of household loans, which expanded by a strong 31.0 per cent in 2018 and by 41.2 per cent year-on-year in August 2019. Growth of corporate credits was still in negative territory in 2018 but has turned to a modest 6.8 per cent growth year-on-year in August 2019.

Swift implementation of governance-oriented reforms would boost the economic outlook. The new coalition-based government is well placed to address governance and other constraints, thus giving an impetus to economic growth. At the same time, Moldova continues to face longstanding structural and demographic challenges, including a lack of economic diversification and the ongoing emigration of a large proportion of the population. We forecast Moldova's real GDP to grow by 3.8 per cent in 2019 and by 4.0 per cent in 2020.

Assessment of transition qualities (1-10)



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Major structural reform developments

Months of political uncertainty have halted most reforms. After the stalemate, which was brought by general elections held on 24 February 2019, the government was eventually formed at the beginning of June. Taking into account the period of pre-election campaigning, Moldova has functioned for almost half a year with a caretaker government with limited powers and little appetite for reform.

Relations with the IFIs and the EU (European Union) are being restored. After a stand-off between the IMF and the previous government on the fourth and fifth reviews of the Extended Credit Facility and Extended Fund Facility, scheduled for September 2018 and March 2019, respectively, the new government reached staff-level agreement with the IMF team in July 2019. The IMF executive board completed the fourth and fifth reviews in September 2019, enabling the disbursement of a US$ 46.1 million tranche. It was concluded that the programme remained broadly on track. In addition, there were signals that the EU will resume the Macro Financial Assistance (MFA) for Moldova. MFA was put on hold in 2018 after parliament had approved an ill-conceived capital amnesty and legislative revisions to reduce criminal liability for certain economic crimes, and following the invalidation by the judiciary of the results of the Chisinau mayoral election, which was won by the opposition candidate.

Governance reforms continued in the banking sector. Shares in Moldindconbank, Moldova's second-largest bank, were sold to a strategic foreign investor in February 2019. Moldindconbank is the third and last systemic bank in the country to be acquired by a foreign investor. Nevertheless, in April 2019, the NBM decided to extend its temporary administrator mandate at Moldindconbank for a further six months. At the same time, the NBM has lifted the intensive supervision regimes for Victoriabank and Moldova-Agroindbank, which were in place since June 2015.

The NBM continued to strengthen banking regulation. Basel III is being implemented gradually by transposing international standards and best practices into the field of banking-sector supervision. The introduction of the Internal Capital Adequacy Assessment Process and the Supervisory Review and Evaluation Process methodology in 2019 represents a fundamental step in implementing a future-oriented risk-based supervision process using professional reasoning. This should improve the whole supervisory framework and provide the possibility for the early detection of bank risks and deficiencies, thus strengthening the stability of the banking sector.

The authorities have launched an e-procurement system. The new system, in place since late 2018, provides transparency, openness and accountability. It constitutes an important effort to transform the way in which public funds are spent and to step up the fight against corruption. The benefits of e-procurement also include improvements in market access and competition, promotion of integrity, information cost reduction and easier access to information. The new electronic system, MTender, has been introduced in all key central government ministries and 100 subordinated entities.

MONGOLIA

Highlights

- **Strong growth rates are being sustained.** The economy expanded by 7.3 per cent year-on-year in the first half of 2019, accelerating from 6.9 per cent in 2018, mainly due to increases in gross capital formation related to the underground expansion of the Oyu Tolgoi copper mine.
- **The authorities are taking steps to strengthen the banking sector albeit with some delays in resolving bank undercapitalisation.** Following an Asset Quality Review, some banks were supposed to take action to boost capital by the end of 2018 but, as of September 2019, not all of them have met capital requirements in full.
- **Key tax laws have been revised by the parliament.** Amendments to the General Law on Taxation, the Corporate Income Tax Law, the Value Added Tax Law and the Personal Income Tax Law were passed in March 2019. One of the key changes includes a reduction in the licence transfer tax for land rights.

Key priorities for 2020

- **Financial-sector reforms should advance.** The central bank should strengthen the supervision of the sector and implement the non-performing loan (NPL) resolution strategy.
- **It is critical to maintain fiscal discipline to achieve a commitment to reducing debt.** The authorities need to avoid fiscal loosening in the run-up to parliamentary elections in 2020 and should adhere to the budget targets agreed under the International Monetary Fund (IMF) programme.
- **Governance issues need to be addressed.** Maintaining judicial independence and improving judiciary capabilities to effectively deal with commercial cases are essential for attracting investment, including in non-extractive sectors. The authorities should also take concrete measures to reduce corruption.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	2.4	1.2	5.3	6.9	6.8
Inflation (average)	5.9	0.5	4.6	7.6	8.1
Government balance/GDP	-8.5	-17	-1.9	-3.4	0.5
Current account balance/GDP	-4.0	-6.3	-10.1	-17.0	-15.0
Net FDI/GDP [neg. sign = inflows]	-0.8	37.2	-13.1	-15.0	-18.0
External debt/GDP	171.3	183.9	245.4	235.3	n.a.
Gross reserves/GDP	25.6	11.6	26.3	26.5	n.a
Credit to private sector/GDP	53.9	56.9	53.0	56.2	n.a

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Macroeconomic performance

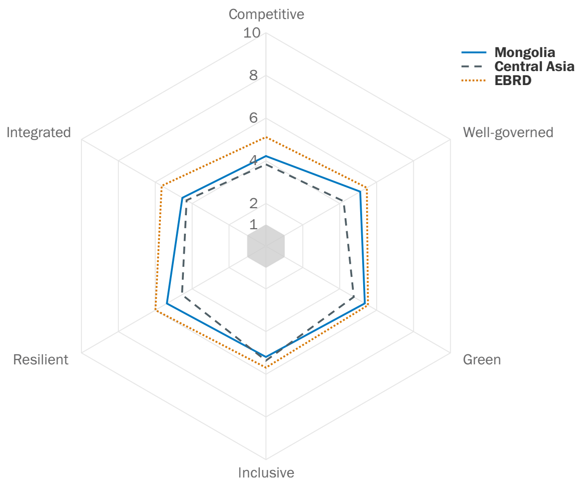
Real GDP growth remains strong. Economic growth accelerated to 6.9 per cent in 2018 and to 7.3 per cent year-on-year in the first half of 2019. Growth was primarily driven by fixed investment in the mining sector, related to the underground expansion of the Oyu Tolgoi copper mine. Gross capital formation increased by around 25.0 per cent year-on-year in the first half of 2019. Inflation accelerated from an average of 4.3 per cent in 2017 to 6.8 per cent in 2018. Credit growth expanded to 27.0 per cent in 2018 from 10.0 per cent in 2017. In response to these developments, the central bank tightened monetary policy by raising the policy rate from 10.0 per cent to 11.0 per cent in November 2018 and by restricting the growth of consumer lending through a ceiling on the household debt-to-income ratio. Inflation reached 9.0 per cent year-on-year in June 2019, exceeding the central bank's 8.0 per cent target.

External pressures intensified in 2018. Exports rose by 13.0 per cent year-on-year in US dollar terms in 2018 and imports surged by 35.0 per cent in the same period. High import growth was driven by major inflows of foreign direct investment, which financed purchases of machinery and equipment. This led to a further widening of the current account deficit to 15.0 per cent of GDP in 2018 from 10.0 per cent in 2017. In the second half of 2018, the tugrik came under pressure, depreciating overall by 8.0 per cent in 2018. However, in the first six months of 2019 the current account deficit narrowed slightly, as the growth of exports outpaced that of imports. Exchange rate pressures eased in the first half of 2019. This, coupled with central bank interventions, has stabilised the exchange rate. Gross international reserves continued rising and reached US$ 3.2 billion in June 2019, covering six and a half months of imports.

The fiscal position continued improving. The overall fiscal balance was in surplus in 2018 (versus a 3.8 per cent of GDP deficit in 2017). This is the first time this has happened since 2010. This was achieved by improved economic performance and fiscal adjustment policies. Revenues increased due to rising tax receipts from value added tax and social insurance. A moderation in capital expenditures also contributed to better fiscal performance. Public debt decreased to 73.3 per cent of GDP in 2018 from 84.6 per cent in 2017, according to the IMF.

High growth will continue, although at a slightly slower pace. The economy is projected to grow by 6.8 per cent in 2019, slowing down somewhat to 5.4 per cent in 2020, aided by further investment in the underground expansion of Oyu Tolgoi. Private consumption is also projected to support GDP growth as real incomes rise, thanks in part to an increase in public workers' salaries. Downside risks include a possible slowdown in growth in China and the stalling of reforms due to political uncertainty in the run-up to parliamentary elections, which are scheduled for 2020.

Assessment of transition qualities (1-10)



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Major structural reform developments

The authorities are taking steps to strengthen the banking sector, but delays are occurring. An Asset Quality Review in 2017 identified a capital shortfall in the sector of around 2.0 per cent of GDP. Banks were supposed to take action by the end of 2018 but, as of September 2019, not all of them have met capital requirements in full. The regulator – Bank of Mongolia (BoM) – is committed to ensuring all banks raise capital as required. In April 2019, the BoM dissolved Capital Bank, as the bank failed to fulfil requirements for reserve and capital adequacy and could no longer carry out normal operations. Weak asset quality remains a concern for the sector, with NPLs rising at the end of 2018 and reaching 10.5 per cent of total loans as of June 2019.

The sixth review of the IMF's three-year Extended Fund Facility has been suspended. Disbursements have been impeded since December 2018, partly due to the delays in financial-sector reform regarding banks' capitalisation. In addition, as requested by the IMF, the BoM launched a forensic review in July 2019 to ensure that the additional capital, contributed by shareholders of five banks in 2018, is from legitimate sources. For 2019, the programme goals are to continue reducing public debt, resume international reserve accumulation, ensure the banking system is well-capitalised and strengthen the investment climate to attract foreign capital.

Key tax laws, including the licence transfer tax, have been amended. Amendments to the General Law on Taxation, the Corporate Income Tax Law, the Value Added Tax Law and the Personal Income Tax Law were passed by the parliament in March 2019. The changes will be effective from January 2020. One of the key amendments includes a reduction in the licence transfer tax for land rights. In 2017 the authorities introduced a payment of a 30.0 per cent tax rate on gross assessed value of transfer of licence for land use, including exploration and extraction licences for mining, which further increases the costs of doing business for investors. The revised law lowers the rate to 10.0 per cent of the assessed net value of the transfer rights. Furthermore, there are reductions in the withholding tax on income provided to non-residents and tax on dividends for foreign investors. Other changes concern the simplification of reporting procedures and the provision of tax relief for companies that are struggling financially.

Judicial reform has experienced a major setback. In March 2019 the parliament adopted a new regulation regarding the dismissal of judges, prosecutors and the head of the Anti-Corruption Agency. Legal amendments were quickly passed by the parliament and were not subject to hearings and public consultations. They allow the National Security Council (consisting of the president, the chairman of the parliament and the prime minister) to remove judges and prosecutors, thus undermining judicial independence and investor confidence in the country. The president then dismissed 17 judges, as well as the head and deputy head of the Mongolian anti-corruption agency, supposedly on the grounds of corruption. Transparency International has issued several statements condemning these developments, while UN Special Rapporteurs from the United Nations have urged the government not to politically interfere in the judicial system.

Data transparency is improving, with Mongolia subscribing to the IMF's Special Data Dissemination Standard. Previously, Mongolia implemented the enhanced General Data Dissemination System, which includes maintaining a National Summary Data Page, where key macroeconomic and financial indicators are published online. In April 2019, Mongolia made the next step in enhancing data dissemination in line with the best international practices by committing to ensure timely availability of statistics in accordance with an advance release calendar. This measure is key to enhancing decision-making by the authorities and enabling access to important data for external stakeholders.

MONTENEGRO

Highlights

- **Growth surprised on the upside in 2018, but has slowed in 2019.** GDP growth rose to 5.1 per cent in 2018 on the back of strong domestic demand. However, it slowed to 3.1 per cent year-on-year in the first half of 2019 as a consequence of the slowdown in investments.
- **Public debt has increased further from already elevated levels.** At the end of 2018, public debt, including guarantees, reached almost 75.0 per cent of GDP. This is mainly due to the large highway project, which is financed by a Chinese loan.
- **Two non-systemic banks went bankrupt over the past year.** The banking sector, however, remained stable, while the non-performing loan (NPL) ratio has dropped to 5.3 per cent.

Key priorities for 2020

- **Public debt sustainability should be further reinforced.** Achieving this will require, among other things, the maintenance of a primary surplus over the medium term, sustained efforts to strengthen budgeting procedures and public investment management and improved public and tax administration. Once the first phase of the highway project is completed, any further construction should be preceded by a careful cost-benefit analysis.
- **The private sector would benefit from less informality.** More comprehensive measures, focusing on underlying causes such as the regulatory burden, weak enforcement capacity and corruption, should be put in place in order to reduce unfair competition from the informal sector, which weighs primarily on local micro, small and medium-sized enterprises.
- **The financial system needs strengthening.** A bank asset quality review and stronger banking supervision would be welcome. In addition, the central bank should closely monitor the rapid growth of cash loans with long maturities in order to limit potentially negative systemic effects.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	3.4	2.9	4.7	5.1	2.8
Inflation (average)	1.5	-0.3	2.4	2.6	0.5
Government balance/GDP	-8.0	-3.4	-5.5	-3.5	-3.3
Current account balance/GDP	-11.0	-16.2	-16.1	-17.2	-17.0
Net FDI/GDP [neg. sign = inflows]	-16.9	-9.4	-11.3	-7.0	-9.0
External debt/GDP	166.2	160.9	159.2	167.5	n.a.
Gross reserves/GDP*	16.8	18.1	20.8	22.1	n.a.
Credit to private sector/GDP	49.7	48.7	48.6	49.5	n.a.

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Macroeconomic performance

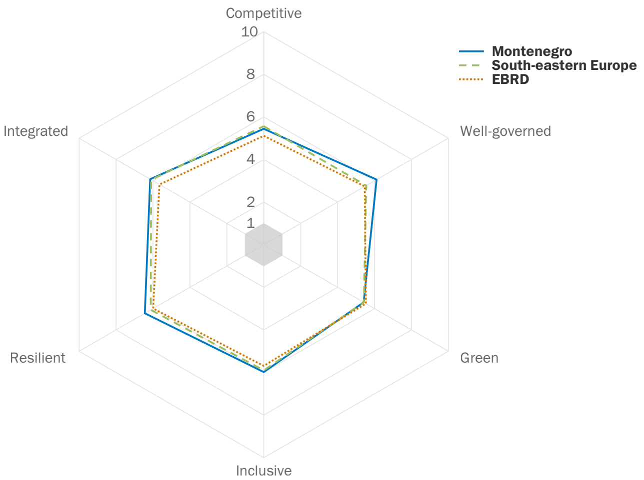
Growth stepped up to 5.1 per cent in 2018. The economy expanded strongly on the back of the highway construction, some coastal flagship real estate projects, an exceptionally strong tourism season and a further rise in private consumption. However, strong domestic demand and consequently higher imports caused the current account deficit to widen further, to over 17.0 per cent of GDP. In the first half of 2019 GDP growth slowed to 3.1 per cent year-on-year, primarily due to large investment projects (the Bar-Boljare highway and the power link to Italy) approaching completion. The first half of 2019 was also marked by poor industrial performance, due to declines in electricity production and manufacturing sector output. On the other hand, the tourism sector has continued to perform well.

Inflation has trended down. Price growth has slowed since the second half of 2018, primarily on the back of falling tobacco, clothing and footwear prices, but also due to decreasing transport prices, which is related to oil prices. As a consequence, the average inflation rate decreased from 2.6 per cent in 2018 to 0.3 per cent in the first nine months of 2019. The period from June to September 2019 has been marked by deflation (-0.2 per cent monthly on average).

Gradual fiscal consolidation has started to yield results. The budget deficit narrowed to 3.5 per cent of GDP in 2018 (from 5.5 per cent in 2017), but was above the target of 1.6 per cent in the original budget (2.2 per cent in the revised budget), and the public debt, including guarantees, reached close to 75.0 per cent of GDP by the end of 2018. The debt, which is expected to start declining in 2020, is also helped by phasing out highway-related spending. However, contingent liabilities and spending overruns may threaten the results. Further necessary fiscal reforms are planned, such as optimising public administration, introducing medium-term budgeting, improving tax administration and conducting the pension reform.

Growth is likely to slow down in the short term. With the completion of large investment projects, growth is projected to moderate significantly, to 2.8 per cent in 2019 and 2.6 per cent in 2020. Still, private investment in tourism and energy is expected to stay high. The risks to the projections mainly relate to weaker growth in the European Union. Besides improving public finance management, growth risks could be mitigated by reforming the labour market and public administration, as well as by strengthening economic institutions.

Assessment of transition qualities (1-10)



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Major structural reform developments

Montenegro continues to advance in EU approximation. Over the past year, the country has opened one new chapter, bringing the number of opened chapters to 32 in total (out of 33 chapters) since the opening of accession negotiations in June 2012. Three chapters have been provisionally closed. According to the 2019 European Commission's country report, further progress in negotiations will primarily depend on meeting the interim benchmarks set in the rule-of-law chapters (23 and 24).

Business conditions have improved somewhat. An action plan for the implementation of the 2018-22 strategy for the development of micro, small and medium-sized enterprises, envisaging over 200 activities, was adopted in December 2018. Furthermore, in 2019 three important laws were approved: the law on administrative fees, eliminating or reducing 18 per cent of existing taxes; the law on fiscalisation, allowing a real-time transfer of data from the taxpayers' POS terminals to the Tax Administration and supporting the fight against the informal economy; and the law on domestic trade, making Sunday a mandatory non-working day for the majority of businesses. An e-cadastre is being developed, with notaries and public bailiffs being the first to get access in July 2019. However, there is still room for improvement, especially in the area of getting electricity (as suggested by World Bank's *Doing Business 2020* report, where the country ranks 134th among 190 countries) and with regard to infrastructure (as suggested by the World Economic Forum's 2019 Global Competitiveness Index, where Montenegro ranks 83rd out of 141 countries).

Public administration reform is advancing slowly and with some setbacks. The public service in Montenegro is relatively large and often politicised. In November 2018, a new Law on State Administration was adopted, rationalising its organisation and addressing the main issues related to accountability lines between institutions. However, it was followed by a very rapid reorganisation of many bodies, without sufficient transition or enough time for stakeholders to adequately prepare for changes. Also, before the optimisation plan 2018-20 was adopted in July 2018, additional staff were hired, which partly undermined the reform results.

Important infrastructure concessions have been granted, while further legal changes are envisaged. In November 2018, a 30-year concession for the bankrupt shipyard, Bijela Adriatic, was approved. Also, in July 2019, following a delay, the government adopted a plan to award 30-year concessions for the country's two main airports (in Podgorica and Tivat). Besides these, work is ongoing for concessions on a ski resort, public forests and agricultural land. However, in order to align the legislation with EU rules and comply with principles of transparency, competition, equal treatment and non-discrimination, amendments to the law on public procurement and a new public-private partnership law are under consideration. Their adoption was envisaged by mid-2019 but faces delays. On the privatisation side, there has been some progress in 2019. Negotiations to sell the health institute in Igalo have started, and the asset restructuring (prior to the sale) of the hotel group Budvanska Rivijera has been completed. In addition, calls for privatisation have been published for another two companies from the 2019 privatisation plan. Conversely, the government proceeded with the buy-back of shares of the power utility (EPCG) from the minority Italian shareholder (A2A), raising its stake to close to 77 per cent in July 2019. The national flag carrier (Montenegro Airlines) and the national railway operator (ZPCG) continue to face financial issues due to accumulated debt.

Works on the transport and energy infrastructure continue, albeit sometimes with delays. The two big investments in recent years have been the construction of the Bar-Boljare highway, and the power link to Italy. The third large investment planned (the construction of the second unit of the Pljevlja thermal power plant) was cancelled in September 2019 due to environmental concerns. While the power link (a largely undersea cable that measures 455 kilometres) is in a testing phase and expected to be fully operational by the end of 2019, the construction of the 170-kilometre long highway, financed by a Chinese loan, has suffered delays and cost overruns. The first section of the highway, which was supposed to have been completed by the end of May 2019, is now planned for completion in September 2020 and will cost 10 per cent more than initially planned. The latter is also due to the unfavourable US dollar-euro exchange rate developments, as the loan is US dollar-

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MOROCCO

Highlights

- **Growth and fiscal consolidation are slowing down.** Gross domestic product (GDP) growth slowed to 2.6 per cent year-on-year in the first half of 2019, mainly due to a drop in agricultural production. Meanwhile, fiscal consolidation continued at a slower pace and unemployment remains high among young people and women, particularly in urban areas.
- **A multi-year privatisation programme is under way.** The privatisation programme aims to improve the performance of state-owned enterprises (SOEs) and governance in the public sector, thus leading to further incentives for public-private partnerships.
- **Structural reforms are advancing.** The authorities recently accelerated the implementation of business reforms, enhanced competition, lowered hiring costs, and boosted financial and gender inclusion.

Key priorities for 2020

- **Economic diversification is needed to boost economic growth and to promote employment.** It is essential to divert the triggers of growth away from dependence on agriculture and to decrease the impact of rainfall on economic growth.
- **Measures to enhance the efficiency of the labour market are needed.** The authorities should ease restrictive regulations, support labour mobility across highly productive sectors and tackle informality, as well as enhance the quality of the educational system and vocational training and address skills mismatches.
- **Commitment to structural reforms should continue.** Top priorities in the short term include developing regional transportation, modernising the irrigation system and introducing social programmes that efficiently target the most vulnerable households.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	4.5	1.1	4.2	3.0	2.7
Inflation (average)	1.5	1.6	0.8	1.9	0.6
Government balance/GDP	-4.2	-4.5	-3.5	-3.7	-3.7
Current account balance/GDP	-2.1	-4.0	-3.4	-5.4	-4.5
Net FDI/GDP [neg. sign = inflows]	-2.6	-1.5	-1.5	-2.5	-1.7
External debt/GDP	33.4	33.7	34.5	31.1	32.5
Gross reserves/GDP	22.5	24.3	23.9	20.6	21.0
Credit to private sector/GDP	62.4	62.5	61.6	60.5	n.a.

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Macroeconomic performance

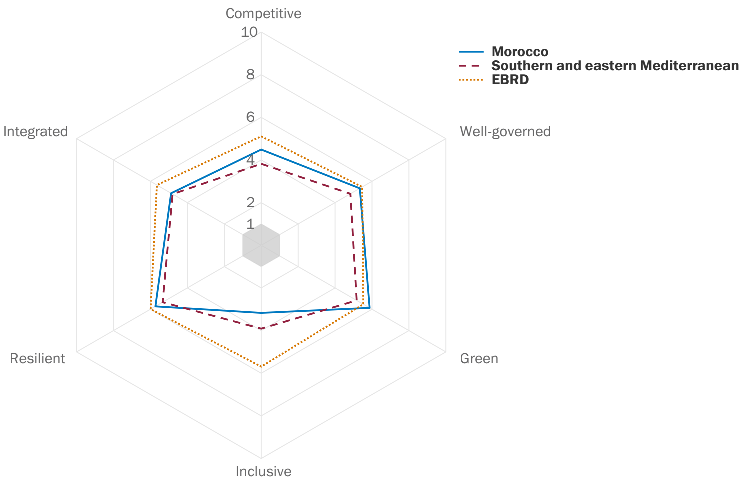
Economic growth slowed in 2018 and the first half of 2019. In 2018, the rate of GDP growth was 3.0 per cent, compared with 4.2 per cent in 2017, the slowdown being mainly due to falling agricultural output. This pattern continued in the first half of 2019, as growth decelerated to 2.6 per cent year-on-year, compared with 3.5 per cent over the same period in 2018, as a result of poor rainfall. Inflation remained low at 0.3 per cent in September 2019, due to lower prices of food, oil and lubricants, with average inflation in the first nine months of the year standing at only 0.2 per cent. Despite the poor harvest and substantial agricultural job losses, unemployment declined from 9.8 per cent in 2018 to 8.5 per cent in the second quarter of 2019, but a very high unemployment rate persists among young people in urban areas, at 40.3 per cent in mid-2019.

Fiscal consolidation continued, but at a slower pace. The fiscal deficit (including privatisation proceeds) narrowed slightly to 3.6 per cent of GDP in the first half of 2019 (compared with 3.7 per cent of GDP in 2018). The deficit was wider than the government's target of 3.0 per cent of GDP, mostly because of a sharp rise in oil prices and the subsequent increase in the cost of energy subsidies for liquefied petroleum gas, as well as lower-than-expected grants from the Gulf Cooperation Council. Meanwhile, public debt remained broadly stable at 64.9 per cent of GDP in 2018.

The current account deficit widened to 5.4 per cent of GDP in 2018. This was due to higher imports, mainly energy and capital goods, only partly balanced by increased exports of phosphate, aeronautics and cars. Tourism picked up in the first half of 2019 by 6.6 per cent compared with the same period in 2018. The flow of foreign direct investments declined by 19.6 per cent in the first half of 2019, compared with the same period in the previous year. International reserves increased to US$ 24.4 billion in July 2019, covering 5.3 months of imports.

Growth is expected to remain moderate in 2019-20. GDP is expected to grow at 2.7 per cent in 2019, improving gradually to 3.3 per cent in 2020. The increase in 2020 is expected to be driven by stronger non-agricultural growth, – particularly in mining and the automotive and aeronautics industries – a rebound in agriculture, continued recovery of tourist arrivals, improved fiscal management and an increase in foreign direct investment. Downside risks include falling growth in Europe, lower commodity prices, rising social discontent and the vulnerability of agricultural production to weather and price developments.

Assessment of transition qualities (1-10)



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Major structural reform developments

The government has initiated an overhaul of SOEs. The reform will result in the government withdrawing from sectors that could be covered by the private sector. A draft bill to expand the list of companies eligible for privatisation was adopted by the Government Council in November 2018. The intention is to raise up to MAD 6 billion (US$ 620 million) in privatisation proceeds. The government started implementing the privatisation programme in June 2019, with the sale of 8.0 per cent of its shares in Maroc Telecom.

The King has launched a new economic development model. The new model, launched in July 2019, is planned to be the driving force of inclusive growth, social equity and sustainable development. In this regard, it seeks to address the shortcomings of the former development plan and reduce social disparities through improving living conditions in rural areas, fostering private-sector investment in communal agricultural land and promoting vocational training.

Morocco continues to make significant progress in easing business conditions. The country rose to 53rd place in the World Bank's *Doing Business 2020* report, compared with 115th in 2011. Significant improvements have been made in dealing with construction permits, getting electricity, protecting minority investors, paying taxes, trading across borders, enforcing contracts and registering property. However, several obstacles continue to hinder Morocco's business environment. These include shortages of highly skilled labour, inefficient bureaucracy, regional disparities and non-inclusive economic growth.

Fiscal decentralisation has progressed. A draft law to reform the Regional Investment Centres was submitted to the parliament in October 2018. The law aims to strengthen the role of these centres in encouraging and promoting investments, as well as exploiting further investment opportunities. In addition, the decentralisation charter was implemented in late 2018 and transparent criteria for the transfer of public resources to regions were adopted.

New laws on access to information and digital platforms were introduced in 2019. They aim to reinforce public accountability and transparency, in addition to making the public sector more transparent and accountable, simplifying administrative procedures, promoting e-government and countering corruption.

Education reforms are advancing. The Ministry of National Education, Vocational Training, Higher Education and Scientific Research launched the national platform Maroc Université Numérique in July 2019. This platform, the first of its kind in Morocco, and indeed in Africa, aims to develop private online courses for small groups. It is intended to solve issues related to overcrowding in universities and to improve the quality of training. Parliament also approved a new framework law for education, which aims to promote access to equal education for all Moroccan citizens and allows technical subjects to be studied in foreign languages. The government has increased social spending for the education and health sectors in the 2019 budget to help move towards universal access to pre-school by 2027 and to finance the expansion of the Tayssir facilitation programme. This programme aims to increase student participation in primary schools and reduce the dropout rate, through providing conditional cash transfers to families with children aged six to 15.

A national strategy for financial inclusion is under way. The strategy, approved in March 2019, supports access to finance for small and medium-sized enterprises, as well as women and young people. In addition, it aims to increase financial literacy, expand electronic payment infrastructures and ease constraints on microcredit activities. Furthermore, in July 2019 the parliament approved a law governing Sharia-compliant insurance (*takaful*) to boost Islamic finance.

Universal subsidies are being replaced by targeted mechanisms. The government plans to replace across-the-board subsidies on all remaining products with a targeted compensation mechanism. The introduction of a unified social registry will be finalised in 2019 to address the vulnerability of middle and low-income households to the impact of reduced subsidies, higher property costs and expensive alternatives to poor-quality public services.

NORTH MACEDONIA

Highlights

- **An historic agreement with Greece on the country's new name has been reached.** Although this can help facilitate North Macedonia's European Union (EU) approximation and NATO membership, the opening of EU accession negotiations has been delayed.
- **The economy has been recovering after the resolution of the political crisis.** GDP expanded by 2.7 per cent in 2018 and a further 3.6 per cent year-on-year in the first half of 2019.
- **The NPL ratio is on the rise.** Liquidity is ample and capital adequacy is relatively high, but the share of non-performing loans (NPLs) increased somewhat in the first half of 2019.

Key priorities for 2020

- **Further measures are needed to improve the business climate.** The focus should be on implementing measures to reduce the informal economy, in accordance with the government's 2018-22 strategy and 2018-20 action plan, but also on balancing formal enforcement with measures targeting underlying incentives for informality, such as simplifying the rules for the establishment and operation of businesses (especially in the case of entrepreneurs and micro enterprises).
- **The labour market needs to become more competitive.** Addressing skills shortages and aligning better vocational training with business needs are necessary in order to enhance the country's competitiveness.
- **To ensure the sustainability of public finances, more ambitious fiscal consolidation measures are needed.** The public debt is relatively high and the structure of government spending worsened further in the past year, shifting from capital to current expenditures. The government should further improve revenue collection, reduce tax exemptions, rationalise subsidies and ensure long-term pension sustainability. The introduction of fiscal rules is also needed; North Macedonia is the only Western Balkans country lacking such rules.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	3.9	2.8	0.2	2.7	3.2
Inflation (average)	-0.3	-0.2	1.4	1.5	1.2
Government balance/GDP	-3.5	-2.6	-2.7	-1.8	-2.5
Current account balance/GDP	-2.0	-2.9	-1.1	-0.1	-1.0
Net FDI/GDP [neg. sign = inflows]	-2.2	-3.3	-1.8	-5.6	-2.5
External debt/GDP	69.3	74.7	73.6	73.1	n.a.
Gross reserves/GDP	24.9	27.1	23.4	26.7	n.a.
Credit to private sector/GDP	50.9	47.9	48.6	48.8	n.a.

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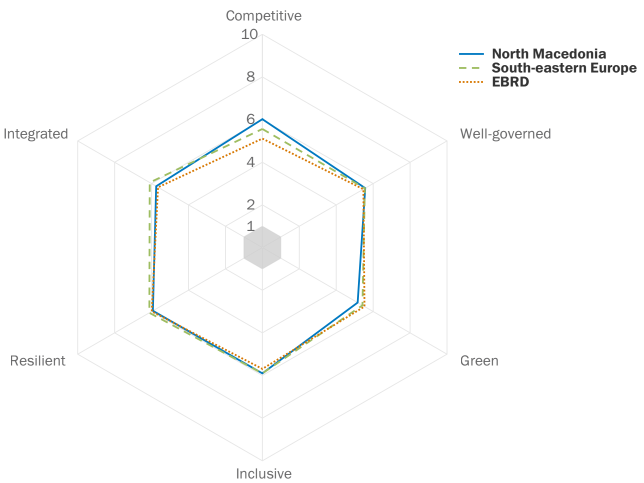
Macroeconomic performance

The economy has been recovering after the resolution of the political crisis. Growth recovered to 2.7 per cent in 2018 after just 0.2 per cent in 2017, driven mainly by strong exports but also private consumption. Robust export performance came as a result of stronger activity of both foreign direct investment-related and traditional industries (machinery and transport equipment, chemicals, iron and steel, furniture), helping to reduce the current account deficit to 0.4 per cent of GDP. However, total investments declined due to the postponement of large infrastructure projects and stagnating construction. The growth rate accelerated in the first half of 2019, to 3.6 per cent year-on-year, driven primarily by investment recovery. Despite declining, unemployment stayed high over the past year, at close to 20.0 per cent, and especially for young people for whom the unemployment rate is about 40.0 per cent. Inflation remained subdued at 1.5 per cent in 2018 and 1.0 per cent in the first nine months of 2019.

Public debt increased slightly in 2018. The general government deficit decreased to 1.8 per cent of GDP in 2018, after 2.7 per cent in 2017. Lower spending on public investment, instead of restraint on current expenditures, and higher tax revenues have been major drivers of the adjustment. Government arrears, including in VAT refunds, have continued to decline and measures were taken to prevent their build-up in the future. Public debt increased in 2018 by 0.7 percentage points, to 48.5 per cent of GDP. Financing of public enterprises and large infrastructure projects is often non-transparent, adding to medium-term fiscal risks.

Growth is projected to pick up to 3.2 per cent in 2019 and 2020. It will be supported primarily by a rebound in investment. The resolution of the name issue with Greece was expected to speed up EU accession progress, thus strengthening investor confidence and growth, as confirmed by Fitch's upgrade in June 2019 of the country's sovereign rating to BB+. However, current risks to the projection are more on the downside. These are mainly related to the delayed start of EU accession talks, which may weaken the reform momentum within the country, and the economic slowdown of the European Union.

Assessment of transition qualities (1-10)



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Major structural reform developments

The opening of EU accession negotiations has been delayed. Based on assessment of the progress in the implementation of the comprehensive EU reform agenda, the Council of the European Union in its Conclusions on the Enlargement adopted in June 2018 set out the path towards opening the accession negotiations with North Macedonia in June 2019. In May 2019, the European Commission issued a strong unconditional recommendation to the Council to launch EU accession negotiations with North Macedonia. The latter was based both on its assessment of the progress in reforms and on the country's achievements in normalisation of relations with regional neighbours, including the historic agreement on the resolution of the name issue and establishment of a strategic partnership with Greece. However, at the European Council meetings in June and October 2019 no consensus had been reached on this issue. Consequently, on 18 October 2019 the European Council decided to postpone the decision and to revert to this issue again before the EU-Western Balkans Summit in May 2020. The decisions of the Council triggered early general elections in North Macedonia, expected in April 2020.

Despite a high Doing Business ranking, the business environment needs to improve further. For many years, North Macedonia has ranked near the top of the annual World Bank *Doing Business* rankings, above many of the world's richest and most advanced economies. In the 2020 report the country dropped six places from the year before and ranked 17th out of 190 economies. The areas with the most room for improvement were starting a business (78th) and getting electricity (68th). In the World Economic Forum's 2019 Global Competitiveness Index (GCI), however, the country is relatively low-ranking, at 82nd out of 141 countries. While North Macedonia has advanced a lot in its business legislation and processes, in other institutional elements the country still has a lot of gaps to fill, including in improving the quality of the transport infrastructure and education, levelling the playing field for businesses, removing distortive taxes and subsidies and strengthening innovation. Political connections are also perceived to be important for success in life, according to the EBRD/World Bank Life in Transition Survey III.

The government is working on measures to reduce the informal economy. A government strategy and action plan to reduce informal employment, adopted in 2018, focuses on the formalisation of jobs and on mitigating incentives to do business informally. Competition from the informal sector and access to finance (more than in other Western Balkans economies) are significant obstacles to doing business and weigh on competitiveness of the formal private sector, according to the latest round of the EBRD-European Investment Bank-World Bank Group Enterprise Survey. The size of the informal economy is estimated to range between 20 and 40 per cent of total output, depending on the method applied.

Work is ongoing on improving energy security and efficiency. The government plans to adopt an energy sector strategy up to 2040, based on the principles of the EU Energy Union. A new draft law on energy efficiency has also been prepared. The energy law, adopted in May 2018, allows small and medium-sized enterprise and households to install photovoltaic electricity generation facilities for their own consumption, transferring the surplus to the network. ELEM, the state-owned electricity company is also investing in its first 10 MW photovoltaic power plant. Construction of a national gas distribution system and connection to regional gas pipeline systems are among the government's priorities. The first ever auction for a feed-in premium for 35 MW photovoltaic plants on state-owned land was successfully published in June 2019, with the EBRD's support.

The banking sector is liquid and well-capitalised but the share of NPLs is increasing. Liquid assets make up more than 30 per cent of total assets, while capital adequacy was at 17.4 per cent at the end of June 2019, exceeding the regulatory minimum. Lending growth picked up on the back of corporate lending to 8.4 per cent year-on-year in the first half of 2019 (from 6.7 per cent in 2018). NPLs had declined from 6.1 per cent at the end of 2017 to 4.9 per cent in September 2018, mainly due to the collection of corporate claims, but have increased thereafter. In June 2019, the NPL ratio stood at 5.4 per cent. Foreign currency (euro) lending declined substantially since 2012 (from around 60 per cent of total loans), but at close to 40 per cent in mid-2019 remains high.

POLAND

Highlights

- **Domestic demand continues to drive strong economic growth.** Robust household consumption, underpinned by rising disposable incomes, has been the key driver of growth since 2016, while investment growth accelerated in 2018 and in the first half of 2019.
- **A massive fiscal package has been announced.** The cost of the proposed five measures, including pre-election tax cuts and social spending increases, is estimated at 1.8 per cent of GDP annually.
- **The Occupational Pension Scheme (PPK), a new voluntary retirement savings scheme, began in June 2019.** As part of the pension system changes, the government has published a bill that liquidates the second pillar pension funds (OFEs) from 2020.

Key priorities for 2020

- **Controversies related to judicial reform remain to be resolved.** A satisfactory resolution would have a positive effect on business sentiment and could help increase private-sector investment. In related business environment news, Poland fell seven spots to 40th position (out of 190 economies) in the World Bank *Doing Business 2020* report, which makes a total loss of 16 places relative to the 24th position in 2016.
- **The increasing role of renewables should be further reinforced.** In the draft National Energy and Climate Plan (NECP) the country proposed a 21 per cent target for the renewables share in final energy consumption by 2030.
- **National capital markets should be further strengthened.** The draft capital market strategy, adopted by the government in October 2019, sets out two primary goals for the Polish capital market: (i) break down the barriers preventing accessible finance; and (ii) further develop infrastructure that will allow for more agile market development and innovation.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	3.8	3.1	4.9	5.1	3.9
Inflation (average)	-0.7	-0.2	1.6	1.2	2.3
Government balance/GDP	-2.6	-2.4	-1.5	-0.2	-1.7
Current account balance/GDP	-0.6	-0.5	0.1	-1.0	-0.9
Net FDI/GDP [neg. sign = inflows]	-2.1	-0.9	-1.4	-2.5	-2.2
External debt/GDP	71.8	76.4	67.0	63.9	n.a.
Gross reserves/GDP	19.9	24.3	21.4	20.0	n.a.
Credit to private sector/GDP	51.1	52.4	52.1	51.0	n.a.

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Macroeconomic performance

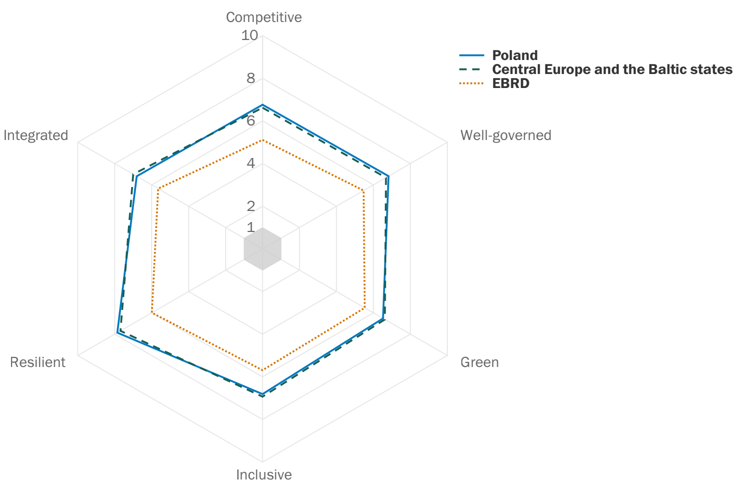
Government spending is providing a substantial boost to GDP growth. Poland's economy grew by 5.1 per cent in 2018, the highest growth rate in central Europe and the Baltic states, then slowed to 4.6 per cent in the first half of 2019. Domestic demand was the principal engine of growth, driven by recovered investment, continuously robust household consumption and especially by strong government consumption, at 4.5 per cent growth in the first half of 2019. A significant wage increase in the economy, averaging 7.1 per cent in the first half of 2019, substantial government transfers and favourable labour market trends have all contributed to increases in household disposable incomes and consumer confidence.

Investment growth improves. Overall, investment rose by 8.7 per cent in 2018. In the first half of 2019, it accelerated further to 10.5 per cent year-on-year, with non-financial corporate investment registering an increase of 19.0 per cent. In particular, companies have been investing strongly in buildings and structures, transport equipment, followed by machines and technical devices. A more intense inflow of European Union (EU) funds has provided a boost to corporate investment, amid mounting needs for greater automation as a result of labour shortages and higher labour costs. The stock of credit to the private sector remains stable, slightly above 50.0 per cent of GDP in the middle of 2019, whereas foreign direct investment inflows slowed from almost 4.0 per cent of GDP in 2016 to 2.8 per cent in 2018.

Fiscal deficits are improving on the back of strong nominal growth, one-off measures and extra taxes. The general government deficit narrowed to 0.2 per cent of GDP in 2018. A sharp increase in fiscal expenditures, such as the child benefit programme or the reduction in the pension age, was largely offset by improvements in tax compliance, including higher revenues derived from the economy's buoyant cyclical position and the introduction of a tax on assets of financial institutions. New social security contributions and one-off revenues, mostly gained from the conversion of the second pension pillar assets and CO2 emission rights, will counterbalance some of the new fiscal measures, with the budget draft forecasting a 0.3 per cent general government deficit (and a 1.3 per cent deficit without one-offs) in 2020. The general government debt to GDP ratio continues to fall and is estimated to drop below 48 per cent by the end of 2020.

Robust growth will continue but the weakening external environment constitutes a negative risk. The Polish economy will likely continue to grow robustly in 2019 and 2020, at 3.9 and 3.5 per cent, respectively. Rising household disposable incomes will drive further strong consumption, which will be only marginally trimmed by rising inflation. For the time being, investment will remain supported by substantial inflows of funds from the EU and government-led investments, including those financed by savings in the Occupational Pension Scheme. Nevertheless, the approaching slowdown in Poland's key trading partners in the EU represents an important risk to that scenario.

Assessment of transition qualities (1-10)



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Major structural reform developments

The government has adopted a new capital market strategy. The new strategy, drafted with support from the EBRD and the EU and adopted in October 2019, aims to help Poland's economy to compete successfully in rapidly changing and challenging international markets. The strategy is one of the tools for developing Polish capital markets and is in line with the Strategy for Responsible Development adopted by the Polish government in February 2017. The document sets out 90 steps including measures to improve the regulatory environment by creating a frictionless marketplace, and to develop market infrastructure and introduce new products and services.

A massive fiscal package has been announced. In February 2019, the government announced a package of pre-election tax cuts and social spending increases. They amount to about 1.8 per cent of GDP annually. Among other measures, an expanded (non-means tested) child subsidy increase of about €4 billion a year almost doubles the child subsidy programme introduced in 2016, which ultimately amounts to 1.7 per cent of GDP annually. A "13th" old-age pension disbursement adds an additional 0.4 per cent of GDP in both 2019 and 2020. A uniform reduction of the labour tax wedge for regular contracts adds another 0.2 per cent of GDP. The elimination of personal income tax for those under 26 years old (leaving the social security contribution unchanged) constitutes another 0.04 per cent of GDP and 0.06 per cent of GDP in 2019 and 2020, respectively. Subsidies to public transport for underserved regions are expected to cost 0.03 per cent of GDP. Also, from 1 January 2018, all entrepreneurs conducting research and development (R&D) activities (regardless of their size) can benefit from an additional deduction of 100 per cent of eligible costs, and research and development centres up to 150 per cent. Along with the increase of deductions for R&D tax relief, the catalogue of eligible costs was extended. Furthermore in 2019, preferential taxation of income generated on the basis of intellectual property rights (IP Box) entered into force with a 5 per cent rate. IP Box relates to income obtained from the commercialisation of entrepreneurs' intellectual property rights.

Pension system reform continues. The Occupational Pension Scheme (PPK), a new voluntary retirement savings scheme, began in June 2019. The main goal of the scheme is to increase the domestic savings rate, as participants will put aside between 0.5 and 4.0 per cent of their income, topped up by an additional 1.5 per cent to 4.0 per cent by the employer and some additional money by the state. The extra money saved by participants is aimed to partially offset the low pension replacement rates. In addition, in May 2019, the government published a bill that liquidates the second pillar pension funds (OFEs) from 2020. The OFEs' assets will be transferred either to the first pillar pension funds or to the Personal Retirement Accounts (IKEs). As the IKE option privatises the pension fund assets, a 15.0 per cent conversion fee will be charged. While the government predicts that 80.0 per cent of future pensioners will choose the IKE option, both options are expected to raise one-off income for public finances. In fact, the remaining 20.0 per cent will be credited to the Social Insurance Fund (FUS), from which pensions are paid out.

"Pro-family" measures have been extended. In March 2019, special pension rights, at the level of the minimum old-age pension, to women giving birth to at least four children. Moreover, the Family 500+ programme was extended to include all children in July 2019. As many beneficiaries of the latter change are mid to high-income, the short-term consumption, income equality or natality effect is likely to be limited. The expected costs of the programmes are 0.03 per cent and 1.7 per cent of GDP, respectively.

Disagreement raised by judicial reform has continued. The European Commission (EC) and the Polish government have continued to engage in the rule-of-law dialogue in the framework of the Article 7(1) procedure triggered by the EC in December 2017. On 3 April 2019, the EC launched an infringement procedure against Poland on the grounds that the new disciplinary regime for Polish judges undermines their judicial independence and does not guarantee to protect judges from political control. The new procedure follows two previous infringement procedures concerning the law on ordinary courts (launched in July 2017) and regarding the law on the Supreme Court (launched in July 2018), both on the grounds of their retirement provisions and their impact on the independence of the judiciary and of the Supreme Court. The Court of Justice of the EU delivered its

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final judgment on the Polish law on the Supreme Court (case C 619/18) in June 2019, having found that lowering the retirement age of judges of the Supreme Court in Poland was contrary to EU law and breached the principle of judicial independence. Prior to the final judgment of the Court of Justice of the EU, Poland adopted a law on 21 November 2018 reinstating the Supreme Court judges previously forced into retirement, thus correcting the effects of the law on the Supreme Court.

Electricity prices have been frozen. Following a sharp increase in electricity prices in 2018 (a 43.0 per cent increase of the average day-ahead electricity price on the Polish power exchange), largely driven by rising coal prices and carbon emission costs, the government adopted a law in January 2019 to keep electricity prices in 2019 at the level registered in the first half of 2018. Following EU objections to this measure, the authorities have been working with the EC to adjust the underlying regulations so that they are consistent with EU regulations, while still temporarily reducing the burden of high electricity prices for end-consumers. These developments have somewhat hindered the liquidity of the electricity market, but, more importantly, have sent a negative signal for the regulatory predictability in the sector. However, with the interim nature of the price freeze, these negative implications are expected to be temporary.

A clear path for change in the energy mix has been set. The first large-scale renewables auctions were successfully conducted in November 2018, attracting a wide range of investors and demonstrating the increasing competitiveness of renewables. The winning projects are expected to add over 1.5 GW of renewable energy capacity to the Polish energy system. Poland has also reconfirmed its long-term ambitions to diversify the energy mix. In the draft NECP the country has proposed a 21.0 per cent target for the renewables share in the final energy consumption by 2030. This translated to a target of approximately 27.0 per cent renewables in net electricity production, which would require a near tripling of renewable electricity generation in the next decade. The final NECP, to be submitted by the end of 2019, may also include an even more ambitious target, following discussions between the EC and the Polish government.

ROMANIA

Highlights

- **Growth remains strong.** The economy grew by 4 per cent in 2018 but fiscal and current account deficits have increased as a result of the government's pro-cyclical stimulus measures.
- **Progress under the Cooperation and Verification Mechanism (CVM) continues to be uneven.** The latest CVM report noted reversals on Romania's progress in the areas of the rule of law and the fight against corruption.
- **Investor sentiment was hurt by a package of measures taken in late December 2018 (Emergency Ordinance 114/2018).** The proposals would have had a potentially significant negative impact on specific sectors, including banking, pension funds, energy, and telecommunications, but following pressure from various stakeholders, the government has softened the measures.

Key priorities for 2020

- **Further reforms to strengthen good governance should be undertaken.** Progress in this area would help to alleviate concerns surrounding the independence of the judiciary and the government's anti-corruption commitment.
- **Privatisation of state-owned enterprises (SOEs) needs to be prioritised.** SOEs remain dominant in some sectors such as energy and transport. Initial public offerings (IPOs) and secondary public offerings (SPOs) of SOEs already listed would attract investors and increase market capitalisation.
- **Business environment reforms should be prioritised.** Efforts to address the difficulties in accessing skilled labour, inadequate transport infrastructure and inefficient government bureaucracy constitute the highest reform priorities.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	3.9	4.8	7.1	4.0	4.0
Inflation (average)	-0.4	-1.1	1.1	4.1	3.6
Government balance/GDP	-0.6	-2.6	-2.6	-3.0	-3.5
Current account balance/GDP	-1.2	-2.1	-3.4	-3.5	-3.4
Net FDI/GDP [neg. sign = inflows]	-1.8	-2.6	-2.6	-2.5	-2.5
External debt/GDP	56.3	52.0	52.3	46.4	n.a.
Gross reserves/GDP	21.7	21.2	20.8	17.5	n.a.
Credit to private sector/GDP	29.9	28.0	26.3	25.9	n.a.

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Macroeconomic performance

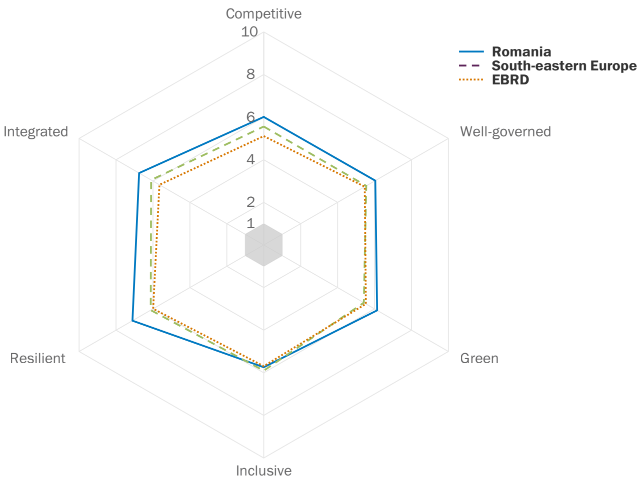
Growth has moderated but remains strong. Following a growth peak of 7.1 per cent in 2017, the economy slowed to an estimated 4.0 per cent growth in 2018. Private consumption has been the main driver of the economy over the past two years (although at a slower pace in 2018), supported by a pro-cyclical fiscal policy, including public-sector salary hikes. Fuelled by increased absorption of EU funds, the contribution of investment to growth was also positive. Despite growing exports, the trade deficit has been widening since 2015, as rising domestic demand has driven up imports even more, thus negatively contributing to growth. The unemployment rate, at about 4.0 per cent as of the end of 2018, is the lowest in a decade, making recruitment difficult and driving wage growth. The average net monthly wage in December 2018 was €635, an increase of about 10.0 per cent year-on-year in real terms. The economy grew by 4.6 per cent year-on-year in the first half of 2019, which was better than expected by most analysts.

Inflation has accelerated. Driven by the tightening labour market and rising household consumption, inflation peaked at a five-year high of 5.4 per cent in June 2018, well above the central bank's upper target of 2.5 per cent +/-1pp. Consequently, the central bank tightened its monetary policy, raising its main policy rate three times in 2018 from 1.75 to 2.50 per cent. Although inflation gradually receded to 3.3 per cent in December 2018, it has risen to an average of 3.9 per cent in the first half of 2019, again above the central bank's upper target.

Twin deficits have increased in the wake of government pro-cyclical stimulus measures. The current account deficit is estimated to have widened to 3.5 per cent of gross domestic product (GDP) in 2018 (from about 1.0 per cent in 2015), driven by rising imports and dividends outflows from the accumulated foreign direct investment stock. Meanwhile, the budget deficit is estimated to have reached 3.0 per cent of GDP in 2018 (second highest in the European Union (EU)) on the back of continued loose fiscal policies as well as weak revenues. The International Monetary Fund and the European Commission (EC) have expressed concerns about plans for pension and public-sector wage increases. In June 2019, the lower house of the parliament passed the new pension law, which provides for an accelerated increase in public pensions over the next two years until they reach a level 70.0 per cent higher than the current one by September 2021. On the positive side, general government debt is low by regional standards, at around 35.0 per cent of GDP, and has been stable for some time thanks to high nominal growth.

GDP growth is likely to moderate further in the short term. Growth is expected at 4.0 per cent in 2019, moderating to 3.2 per cent in 2020, reflecting weakness in major trading partners, not least the euro area, and higher perceived investment risks. In the longer term, the diversified economy, large market size and scope for convergence within the EU (GDP per capita in power purchasing standards is 64.0 per cent of the EU average) should allow growth rates of around 4.0 per cent to be sustained, provided structural reforms remain on track.

Assessment of transition qualities (1-10)



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Major structural reform developments

Controversial economic policy measures have been softened. A set of measures announced in December 2018 (Emergency Ordinance 114/2018) and affecting the banking, pension, telecommunications (telecoms) and energy sectors caused significant concern among investors because of their potentially damaging impact on investment and business confidence. Steps have been taken since to soften some of the measures. The bank asset tax was eventually set at 0.4 per cent (which may be further adjusted downwards depending on the credit growth and the loan-deposit (net) interest margin), with the taxable amount excluding government loans and securities. Capital requirements for private pension funds have been raised (although lowered relative to the original ordinance), while a cap was introduced on administration fees charged by private fund managers. In the telecoms sector, the 3 per cent turnover tax levied on all telecoms operators as of January 2019 remains in place, as originally proposed. Similarly, the gas price caps, at RON 68 (around €14) per MWh for the next three years, will be maintained for household consumers and producers supplying household heating centres, but will be removed for industrial consumers. The latter measures are still at odds with EU legal requirements, and the EC has already launched an infringement procedure against Romania, claiming that the provision breaches the EU Gas Directive. Nevertheless, the measures left significant doubts about the predictability of the business environment and the quality of the legislative process.

Some business environment reforms have advanced. Over the past year, Romania made starting a business easier by allowing voluntary value added tax registration and making paying taxes less costly by eliminating a number of employer-paid taxes and contributions. However, the country's ranking fell three places to 55th (out of 190 economies) in the World Bank's *Doing Business 2020* report. In a positive development, in September 2019 FTSE Russell announced that Romania will be assigned Secondary Emerging market status, effective in September 2020.

Progress under the European Commission's Cooperation and Verification Mechanism (CVM) continues to be uneven. The latest CVM report, published in October 2019, noted reversals on Romania's progress in the areas of the rule of law and the fight against corruption. However, the authorities have recently confirmed their commitment to close the relevant benchmarks.
The government has endorsed a plan for euro adoption. A memorandum with this aim was published in February 2019, including the plan for the adoption of the euro by 2024. Romania meets only one of the nominal criteria for joining the eurozone, namely, the criterion that the government deficit should be below 3 per cent of GDP (although with a negative trend). The country does not fulfil the criteria on price stability and on the convergence of long-term interest rates.

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The government has revived plans for establishing an investment and development sovereign fund. According to a revised draft bill from March 2019, the fund's portfolio would include controlling or minority stakes in 28 companies in the transport, pharmaceutical and energy sectors and cash of €2 billion to be disbursed in stages, which is supposed to come from privatisation revenues held in a reserve account of the government. Also, according to the legislation, the fund will be able to privatise the companies it holds at discretion and without complying with a high degree of transparency. The most valuable companies that will be part of the fund, besides the state-owned minority stakes in OMV Petrom, Telekom Romania, and Engie, Eon subsidiaries, are Hidroelectrica, Romgaz, Nuclearelectrica, Constanta Port, Conpet, Romanian Lottery, Cuprumin, Unifarm and Antibiotice Iasi.

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Offshore gas development in the Black Sea is progressing slowly. The Black Sea Oil & Gas company has launched its investment in developing the offshore gas reserves in the Black Sea, following government approval in April 2019. This is the first new offshore gas development project in Romania's Black Sea to be built after 1989. At the same time, in late 2018 OMV Petrom deferred a decision to go ahead with investments in its offshore gas fields, due to changes in both the offshore law (including the mandatory sale of 50 per cent of the output on the local market at regulated price) and the introduction of a supplementary 2 per cent turnover tax on energy companies, enacted by the government suddenly in late 2018. OMV Petrom runs the project in a 50-50 joint-venture with American group ExxonMobil. Meanwhile, in December 2018 Romania's gas transport grid operator Transgaz launched the tender for a major pipeline, aimed at bringing the natural gas produced by OMV Petrom and ExxonMobil at the Black Sea to the Bulgaria-Romania-Hungary-Austria gas pipeline. The new connection is the latest of a long series of pipelines Transgaz is currently developing or planning to build quickly. Under another project, Transgaz will make its gas route from Moldova reversible in order to allow exports to Moldova (and Ukraine, in principle) as well.

Romanian banks continue to clean up their balance sheets amid increasing profits. The non-performing loan (NPL) ratio in the country's banking system, calculated under European Banking Association methodology, dropped to less than 5 per cent as of the end of 2018, from a peak of more than 20 per cent in 2014. Romania's banks reported aggregated net profits of €1.5 billion in 2018, the highest annual profit for the past decade (2009-18). However, the introduction of the tax on bank assets may put pressure on the banks' profitability. Meanwhile, in June 2019 Romania's state-owned Eximbank, which specialises in corporate banking, reached an agreement to take over Banca Romaneasca, the local subsidiary of the Greek bank NBG. Also, in March 2019 Romania's Constitutional Court invalidated three controversial banking laws (which had been passed in December 2018) following objections raised by the opposition parties. The first law capped interest rates on retail loans (mortgage and consumer); a second law regulated the regime for NPLs, allowing the buyers of such loans to recover from debtors at almost twice the price they paid to buy them from the original creditors; and the third law reduced the power of creditors, obliging them to ask for court orders to enforce their claims.

RUSSIA

Highlights

- **The economy has slowed in 2019.** After growing by 2.3 per cent in 2018, the economy expanded by just 0.7 per cent year-on-year in the first half of 2019, with the slowdown explained by declining energy exports and the impact of rising inflation on household consumption.
- **The macroeconomic situation remains stable.** Helped by the ongoing conservative fiscal policies, fiscal and current account surpluses remain healthy. Pre-emptive increases in policy rates by the Central Bank of Russia (CBR) towards the end of 2018 helped contain the inflationary impact of an increase in value-added tax (VAT). A more neutral policy stance is now being adopted in order to support growth.
- **There was some progress in the past year in the area of structural reforms, mainly in the form of an ambitious investment plan.** The government unveiled plans to spend 25.7 trillion roubles (US$ 390 billion) on physical and social infrastructure over the next five years.

Key priorities for 2020

- **Reforms to improve the business environment need to be undertaken.** Priorities include reducing the state's role in the economy, addressing physical infrastructure gaps and implementing business-friendly measures to enhance private-sector competitiveness.
- **Asset quality and concentration risks in the banking sector need to be addressed**. Efforts to consolidate the sector need to be sustained, while steps should be taken to address the high concentration of assets in large state banks and the persistently high level of non-performing loans (NPLs).
- **Planned public investments need to be well targeted to contribute to growth in the long term.** Areas that need improvement include coordination among public institutions and inclusion of stakeholders in the planning and implementation phases of public investments.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	-2.8	-0.2	1.5	2.3	1.1
Inflation (average)	15.5	7.1	3.7	2.8	4.7
Government balance/GDP	-3.4	-3.6	-1.5	2.9	1.5
Current account balance/GDP	4.9	1.9	2.2	6.8	5.9
Net FDI/GDP [neg. sign = inflows]	1.1	-0.8	0.5	1.4	-0.5
External debt/GDP	37.8	39.5	32.8	28.9	n.a.
Gross reserves/GDP	26.8	29.1	27.4	28.3	n.a.
Credit to private sector/GDP	57.3	52.9	77.9	76.0	n.a.

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Macroeconomic performance

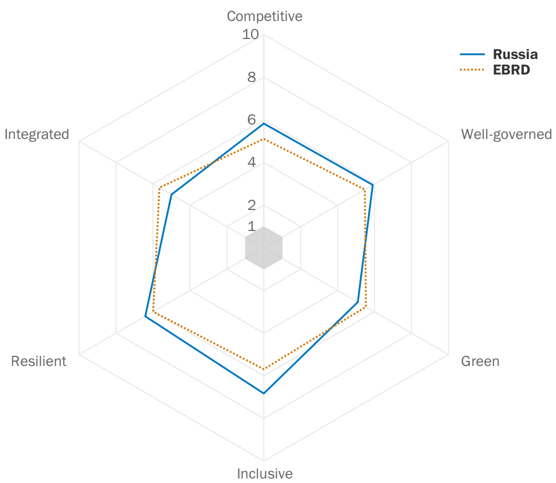
The economy is slowing down after moderate expansion in 2018. The economy grew by 0.7 per cent year-on-year during the first half of 2019, following growth of 2.3 per cent in 2018. Weaker external demand, lower oil prices and a stronger rouble since the start of the year have negatively affected net exports. Ongoing international sanctions and continuing tight fiscal policy constrained public and private investment, while household consumption growth was sluggish due to declining real wage growth and a two percentage point increase in VAT, which was introduced in January 2019.

Fiscal and current account surpluses have been maintained despite declining oil prices, thanks to conservative macroeconomic policies. Driven by the decline in oil prices, a stronger rouble and weaker external demand, the current account surplus has started to decline after peaking in March 2019. Meanwhile, the government has continued to abide by the fiscal rule that was adopted in 2017, which mandates transferring oil revenues in excess of the threshold, corresponding to US$ 40 per barrel to the National Wealth Fund. Budget performance has improved following advancements in tax collection and changes in tax regulations that came into force in January 2019, which include a VAT increase of two percentage points.

The CBR has loosened monetary policy in response to softening inflation and growth. The inflationary impact of the VAT increase has been more modest than expected, having been contained by policy rate increases towards the end of 2018. Having peaked in March 2019 at 5.3 per cent, inflation has been declining as a result of weak real household incomes and a stronger rouble. Declining inflation and weaker expected output led the CBR to cut its policy rate by a total of 125 basis points since June 2019.

Growth will remain moderate in the absence of comprehensive structural reforms or a change in the sanctions regime. The growth outlook is expected to improve slightly, starting with the second half of 2019, thanks to more supportive monetary policy and a stronger fiscal impulse. However, private investment is likely to remain weak, given the continuing negative impact of sanctions imposed by the European Union and the United States of America, and exports are likely to be held back by the weaker global trade environment. A growth rate of 1.1 per cent is expected for 2019, followed by 1.7 per cent in 2020. The key risk to the outlook is the possibility of more severe sanctions being imposed.

Assessment of transition qualities (1-10)



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Major structural reform developments

The government is increasingly developing domestic industries in order to hedge against the impact of international sanctions. This has manifested itself in the increased pursuit of import substitution policies, albeit with mixed success. With the aim of reducing transactional dependence on the US dollar, the government signed a deal with China in June 2019 to settle trade transactions in national currencies. It also made agreements with foreign banks to use the national payment service in order to bypass US sanctions affecting the Society for Worldwide Interbank Financial Telecommunication system. A bill requiring internet service providers to route internet traffic through servers in the country was introduced, enabling the government to prevent access to foreign servers.

The government announced a major investment programme aimed at implementing 13 "National Projects". The National Projects were a key element of the decree signed by the President in May 2018 and comprise strategy documents laying out key development targets for the period 2019-24 in the social, economic and environmental sectors. The projects have an estimated cost of 25.7 trillion roubles (US$ 390 billion) over the period 2019-24. Around half of the projects' costs are planned to be borne by the central government, with the rest shared by regional governments and the private sector.

The authorities continued their efforts to consolidate the banking sector. In the past year, the government has continued to close down badly managed and under-capitalised banks, and more than 500 banks have been closed down since 2013. Meanwhile, the government continues to provide funding and capitalise the large private banks it has taken over, two of which (Otkritie and BN Bank) were successfully merged in January 2019. However, the consolidation process has led to an increasing concentration of the banking sector in state hands, with around 60.0 per cent of bank assets being owned by state-owned or state-controlled banks. While the system-wide capital adequacy ratio is stable at around 12.0 per cent, asset quality remains a problem, with the NPL ratio standing at 10.4 per cent in March 2019, while fast-growing unsecured household credit is raising concerns.

Pension reforms introducing a higher retirement age were launched in January 2019 but have been controversial. The reforms increased the retirement ages for men and women to 65 and 63, respectively. The changes were introduced to address fiscal pressure arising from demographic issues, but met widespread protest. This resulted in some softening of the measures, including a reduction in the proposed retirement age for women to 60.

The authorities made efforts to improve the business environment. In collaboration with the business community, the authorities have prepared a Transformation of Business Climate Plan that aims to ease tax administration, utilities registration, business establishment and resolution and customs processes. In addition, in June 2019, the government adopted a "regulatory guillotine" reform aiming to significantly reduce the number of business regulations. Progress in the business environment is reflected in an improvement in the country's ranking in the World Bank *Doing Business 2020* report, moving from 31st to 28th place out of 190 countries.

SERBIA

Highlights

- **After a robust performance in 2018, economic growth is moderating in 2019.** Lower growth primarily reflects stagnation in the agricultural sector and a fall in industrial production.
- **Foreign direct investment (FDI) inflows have been strong in the past few years, especially in 2018, more than covering the growing current account deficit.** Nevertheless, the structure of FDI has changed to more labour-intensive projects, requiring low-skilled labour and supported by high subsidies.
- **Non-performing loans (NPLs) in the banking sector have continued to decline, but the financial sector remains highly euroised.** The NPL ratio fell to 4.9 per cent in August 2019, mainly due to mandatory write-offs. Euroisation of loans and deposits remains at close to 70.0 per cent.

Key priorities for 2020

- **Serbia has to systematically address the institutional causes of chronically weak growth.** Average growth between 2010 and 2018 was just 1.7 per cent, significantly below that of regional peers. The focus should be on strengthening the rule of law, fighting corruption and increasing domestic private and public investment.
- **The governance of state-owned enterprises (SOEs) and public projects needs to be improved.** The government should focus on improving the efficiency of large SOEs, also through necessary legal changes and/or stronger implementation of existing legislation. A single pipeline for all public projects should be developed, enabling proper cost-benefit assessment and monitoring while project implementation should be strengthened further.
- **Public administration reform should be high on the agenda.** Planned reform measures, including the introduction of a new public-sector pay grade system, as well as professionalisation and de-politicisation of public administration, have been postponed several times and should be implemented without further delay.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	1.8	3.3	2.0	4.4	3.2
Inflation (average)	1.9	1.2	3.0	2.0	2.0
Government balance/GDP	-3.5	-1.2	1.1	0.6	-0.5
Current account balance/GDP	-3.5	-2.9	-5.2	-5.2	-5.5
Net FDI/GDP [neg. sign = inflows]	-5.1	-5.2	-6.2	-7.5	-6.1
External debt/GDP	73.5	72.1	65.3	62.7	n.a.
Gross reserves/GDP	29.1	27.8	25.4	26.3	n.a.
Credit to private sector/GDP	40.7	41.0	40.3	41.5	n.a.

CONTINUES

Macroeconomic performance

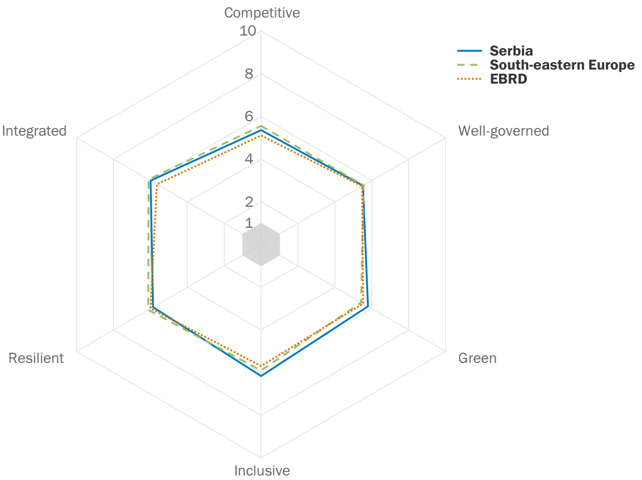
Growth was strong in 2018, but has subsided during 2019. GDP expanded by 4.4 per cent in 2018, driven by private consumption and investments and supported by a strong agricultural season. On the other hand, a negative contribution by net exports acted as a drag on growth for the second year running. In addition, mining and utilities output started to fall again in the second half of 2018, indicating governance problems at the state-owned electricity company EPS. Unfavourable trends in industrial production continued in the first half of 2019, with industrial output declining by 2.0 per cent year-on-year on the back of falling mining and manufacturing, while utilities output stagnated. In addition, agricultural output stagnated. As a consequence, the overall growth rate slowed to 2.8 per cent year-on-year in the first half of 2019.

The general government budget remained in surplus for the second year in a row. The 2018 budget recorded a surplus of 0.6 per cent of GDP, versus an initially planned deficit of 0.7 per cent. Although prudent fiscal policy is desirable, persistent significant over-performance of the planned budget targets indicates a need for better budget planning. In addition, the composition of expenditures is heavily weighted towards consumption, while public investments, despite the increase in 2018 and 2019, remain low. Public debt continued to decline, reaching 54.5 per cent of GDP at the end of 2018, but remained broadly at the same level in the first half of 2019. In September 2019, the Fitch agency upgraded Serbia's credit rating from "BB" to "BB+" (with a stable outlook), citing among other factors the maintained fiscal discipline and decreasing public debt. In October, the 2019 budget was revised to account for additional capital spending, a one-off payment to pensioners and public-sector wage increases. That moved the budget from a small surplus in the first eight months of the year to a deficit of 0.5 per cent of GDP expected for the year as a whole.

Inflationary pressures have been low, also thanks to the strong exchange rate. Inflation fell to 2.0 per cent in 2018, coming closer to the lower bound of the central bank's target band (3 ± 1.5 per cent). In 2019, it initially picked up, reaching 3.0 per cent year-on-year in April, but then fell back to 1.1 per cent in September. After keeping the policy rate unchanged at 3.0 per cent for more than a year, the central bank cut the rate again in the third quarter of 2019. In October 2019, the rate stood at 2.5 per cent. The central bank also continues to actively intervene in the foreign exchange market, on both the purchase and sale sides, but has remained a net buyer of foreign exchange.

Growth is expected to moderate in the short term. GDP is expected to expand by 3.2 per cent in 2019 and 3.5 per cent in 2020. Domestic demand should remain the main growth driver, while net exports will most likely keep contributing negatively. On the other hand, the economic slowdown of the main trading partner, the European Union (EU), and the slow pace of reforms within the country might act as a drag on growth in the near term and make it more volatile. While the introduction of a 100.0 per cent tariff on Serbian products by Kosovo may have a negative effect on exports of up to €400 million a year, reliable assessments of the effects are not yet available.

Assessment of transition qualities (1-10)



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Major structural reform developments

EU accession negotiations are advancing, albeit slowly. Over the past year, three new chapters have been opened, making 17 in total (out of 35) since the opening of negotiations in January 2014. Two chapters were provisionally closed earlier. According to the 2019 European Commission's country report, the future speed of negotiations will primarily depend on the pace of reforms to the rule of law as well as on progress in the normalisation of relations with Kosovo. In October 2019, the country signed a free trade agreement with the Eurasian Economic Union, from which it has pledged to withdraw on the day of EU accession.

The business environment remained broadly unchanged. In the World Bank's *Doing Business 2020* report Serbia ranked 44th out of 190 economies. While the country made starting a business more complicated by requiring that entrepreneurs obtain an electronic certificate and register the ultimate beneficial owners separately after incorporation, the business environment improved in several other areas, resulting in an increase of four positions from last year's report. Enforcing contracts, getting credit and resolving insolvency are the areas where Serbia lags behind the frontier most. In the World Economic Forum's 2019 Global Competitiveness Report, Serbia's weakest areas are its financial system, adoption of information and communications technology (ICT) and its institutions. The country has worsened its overall standing in the report, ranking 72nd out of 141 countries (down seven places from the previous report). Over the past year there was no progress in establishing the legal framework for microfinance institutions.

The state's footprint in the economy remains large. Serbia has the third-largest share of SOE employment among the 21 central, eastern and south-eastern European countries, according to recent estimates by the International Monetary Fund (IMF). The financial performance of SOEs is also weak compared with the private sector. Recurring problems in mining and electricity generation at the electricity company EPS in the past couple of years, due to weak management, have decreased economic growth visibly. Improved resource allocation at SOEs could result in sizeable growth benefits, raising GDP by 2 per cent permanently, according to IMF estimates. Under the IMF programme, the government has committed to new reform targets related to SOEs, namely, publishing the full list of SOEs by the end of October 2019 and adopting the state ownership policy by the end of February 2020. However, recent examples of growing state ownership in certain sectors (for example, cable television) have raised concerns about increasing political influence. The resolution of SOEs that are not bankrupt or in the process of being privatised has been advancing cautiously.

Public administration reform is progressing slowly. Implementation of legislation related to much-needed public administration reform has been partial or delayed. Amendments to the Law on Civil Servants from December 2018 and new secondary legislation from January 2019 introduced criteria for the organisation of recruitment selection tests and a new performance assessment system. However, heads of institutions still have much discretion, for example, in setting up selection committees. In addition, the amendments to the law did not address the frequent misuse of provision on "acting" positions. Namely, the majority of senior staff are in such positions, making them more susceptible to political influence and limiting proper professional conduct. The introduction of the pay grade system, introducing "equal pay for equal work" for all public-sector employees, based on a law from 2016, has been postponed again to mid-2020. Tax administration reform is also progressing slowly.

Efforts are under way to fight informality. Amendments to the Law on Inspection Supervision, adopted in December 2018, give more remit to supervise unregistered activities. The coordination of inspections and risk-based approaches has advanced as well, including through the introduction of a unified inspection information platform. However, the law may need to be amended further in order to comply with the International Labour Organization's Labour Inspection Convention. Namely, contrary to the convention, which states that inspectors enter a company without previous notice, the current law requires written notice at least three days in advance, which opens the space for misconduct.

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NPL resolution has progressed further, but euroisation remains high. Over the past year, NPLs declined by 2.6 percentage points, to 4.9 per cent in August 2019, mostly due to mandatory write-offs. To address remaining issues, a new NPL resolution programme (2018-20) was adopted in December 2018. Despite regulatory efforts to discourage foreign currency lending and depositing, euroisation has remained high at close to 70.0 per cent, potentially posing financial stability risks if the dinar were to depreciate significantly. Foreign currency lending for households has declined, but mainly due to the increase in (often) long-term dinar-denominated cash loans that could pose risks to financial stability during a downturn. In response, in December 2018 the National Bank of Serbia limited the tenor of these loans to eight years from 2019, reducing it to six years from 2021. The privatisation of the third largest bank, Komercijalna banka is finally advancing and a tender was announced in May 2019. Four non-binding offers have been submitted and the submission of binding bids is expected by early December 2019.

A law on the conversion of Swiss franc mortgage loans was adopted. The new law, adopted in April 2019, envisages the conversion of mortgage loans denominated in Swiss francs to euros by July 2019, with a 38 per cent haircut and capped interest rates, and with the state covering 15 per cent of banks' related losses. The selected solution, relieving borrowers and banks of some of the financial consequences of their decisions, has budgetary costs of up to 0.2 per cent of GDP and may create moral hazard risks. Around 90 per cent of Swiss franc loans have been converted to euros.

SLOVAK REPUBLIC

Highlights

- **Gross domestic product (GDP) growth has lost momentum.** Following solid growth stemming from strong household consumption and investment in 2018, the economy has slowed in the first half of 2019, although exports continue to perform well.
- **Measures to simplify foreigners' recruitment have been introduced.** New legislation is intended to shorten the time required for assessing requests from those who live outside the European Union (EU) for residence and employment in the Slovak Republic, particularly in professions with identified labour shortages.
- **Improvements in the fight against corruption have entered into force.** A new independent state administration body provides protection and remuneration to whistleblowers, and monitors the compliance of authorities with the new anti-corruption law.

Key priorities for 2020

- **Educational reform should focus on matching labour demand and supply.** Key short-term measures should include fostering skills, in particular through training and requalification programmes, with a greater engagement of the business sector.
- **Sustainability of the healthcare system needs to improve.** Measures proposed in the Value for Money project in November 2018 would make current healthcare spending more efficient and effective and could free up around €140 million for additional spending in the sector.
- **Decommitment of funds from the EU that have already been allocated should be avoided.** Efforts should be intensified to improve strategic planning, strengthen capacity and overcome administrative problems so that allocated EU funds can be used effectively.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	4.8	2.1	3.0	4.0	2.5
Inflation (average)	-0.3	-0.5	1.4	2.5	2.6
Government balance/GDP	-2.7	-2.5	-1.0	-1.1	-0.9
Current account balance/GDP	-2.1	-2.7	-1.9	-2.6	-2.0
Net FDI/GDP [neg. sign = inflows]	-0.1	-0.8	-2.8	-0.9	-0.1
External debt/GDP	85.2	92.2	107.8	113.0	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	53.3	57.3	60.4	62.5	n.a.

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Macroeconomic performance

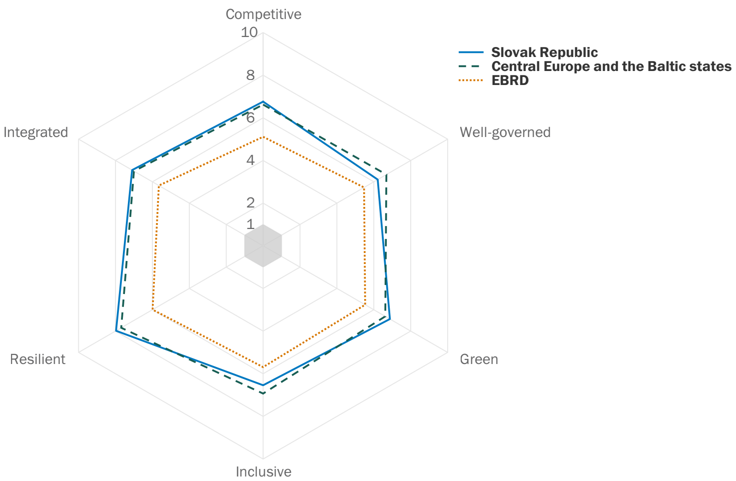
Economic growth has slowed. Domestic demand, particularly household consumption and investment, continued to underpin GDP growth of 4.1 per cent in 2018. However, a slowdown is evident in the first half of 2019, with the economy growing by just 3.0 per cent year-on-year. Despite weakening external demand in western Europe, exports grew by 3.9 per cent in the first half of the year. Inflation accelerated to 2.5 per cent in 2018, and further to 3.0 per cent in July 2019. Service price inflation saw the greatest hikes, in line with expectations of rapidly rising wages and positive consumer confidence.

Investment has moderated. As many large investment projects were completed in 2018, such as the construction of the Jaguar plant and some other upgrades of existing automotive capacities, investment growth decelerated from 3.7 per cent in 2018 to 1.3 per cent in the first half of 2019. While further foreign direct investment is expected this year, such as the Swiss Mubea Automotive project to construct a manufacturing plant in Presov, one of the least-developed regions in the Slovak Republic, overall investment is expected to slow, largely due to cyclical reasons. Lending to private-sector companies, especially with a maturity over five years, remains robust, but also started to lose steam in the first half of 2019.

The fiscal deficit remains historically low. The strong GDP upswing in 2018 resulted in higher tax revenues, which enabled an increase in current transfers and subsidies and higher public-sector wages. The general government deficit saw a slight deterioration to 1.1 per cent of GDP in 2018. In 2019, it is expected to improve to 0.9 per cent of GDP, before it increases somewhat in 2020, partially driven by the upcoming elections. Public debt dropped below 49.0 per cent of GDP in 2018, and will likely decrease further in the short term.

External uncertainties are the main risks to further economic growth. GDP growth will likely continue to be driven by domestic demand, although its strength will moderate. We expect growth to slow to 2.5 per cent in both 2019 and 2020. Key negative risks include the possibility of a hard Brexit and the eurozone's economic slowdown. By contrast, improved absorption of EU funds provides upside potential to that scenario.

Assessment of transition qualities (1-10)



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Major structural reform developments

A new retirement age cap is a setback to pension sustainability. In March 2019, the parliament amended the constitution by introducing a retirement age ceiling of 64 years, effective from July 2019. Previously, the formula for pension calculations tied the retirement age to average life expectancy, which is revised annually. The amended law allows women to retire earlier if they raise children and up to a year and a half early in the case of three children or more. Amid a rapidly ageing population and a rising life expectancy, embedding the retirement age cap in the constitution will adversely affect public finances and threaten the sustainability of the future pension system. According to the fiscal responsibility council, the measure will reduce future pensions by 10 per cent and will lead to a level of GDP 9 per cent lower than in a status quo scenario by 2067.

Improvements in the fight against corruption have entered into force. In February 2019, the President signed a law on the protection of whistleblowers that sees the formation of an independent state administration body with nationwide power. Effective from March 2019, the law provides protection and remuneration to whistleblowers, monitors adherence to the new anti-corruption law and educates the public about the fight against corruption. The amended law makes the protection of whistleblowers more flexible and faster than before. Until now, only whistleblowers who brought information that significantly contributed to clarifying a deed were eligible for protection. In 2018, the Slovak Republic was ranked 57th in the perception of corruption index by Transparency International, three spots lower than in the previous year.

Legislation to enhance the business environment has been proposed. In February 2019, the government approved a package of 36 measures to reduce the administrative burden on businesses and to promote digitalisation. The majority of measures are expected to be implemented by the end of 2019 and the rest in 2020. This package follows two other anti-bureaucratic packages, approved in June 2017 and May 2018, respectively. All three are expected to provide businesses savings of more than €100 million annually. In the World Bank's *Doing Business 2020* report, the Slovak Republic dropped three places to 45th out of 190 countries. The most significant deterioration was registered under the resolving insolvency sub-category. In contrast, the score for starting a business improved significantly, largely due to the abolition of the requirement to obtain and submit information on tax arrears.

Measures to simplify the recruitment process for foreigners aim to mitigate the impact of labour shortages. An amendment to the Act on Employment Services came into force in January 2019. It is intended to shorten the time for assessing non-EU nationals' requests for residence and employment in the Slovak Republic, particularly in professions with identified labour shortages. For instance, the process linked to employing foreigners has decreased in length from around 150 to 90 days. According to the country's employers' union, the Slovak economy currently needs approximately 100,000 extra workers. The Slovak Ministry of Labour estimates that the economy will need more than 500,000 new workers by 2023, mainly in industry, commerce, education, healthcare, transport and construction. As of the end of June 2019, there were more than 73,000 foreign workers in the Slovak Republic.

EU funds absorption has remained problematic. According to the prime minister's office, the Slovak Republic placed 23rd in the EU and last among the Visegrad-4 countries in terms of the share of payments received at the end of 2018 from the country's 2014-20 EU funds allocation. The government expected that the absorption of EU funds would exceed €5 billion by the end of 2019, which would represent 33 per cent of the total allocation of €15.3 billion. According to the European Commission, the lack of capacity, the absence of strategic planning as well as administrative problems are the key obstacles preventing the smooth absorption of EU funds. Consequently, the Slovak Republic has already lost €120 million in funding, partially driven by the scandals at the education ministry in 2017.

A law on the impact of Brexit is expected to lessen the potential negative impact. In March 2019, the government passed legislation amending several acts in preparation for a potential hard Brexit by the United Kingdom (UK). These measures would be effective only if the UK leaves the EU without a deal. A potential no-deal Brexit outcome is expected to have an impact not only on direct trade between the Slovak Republic and the UK, but also on indirect exports through value chain integration within the EU. According to EBRD estimates, indirect exports account for 30 per cent of overall domestic value added exports to the UK.

SLOVENIA

Highlights

- **Robust economic growth is continuing.** Gross domestic product (GDP) grew by 4.1 per cent in 2018, following 4.8 per cent in 2017. Growth was broad-based, and among the highest in the European Union (EU).
- **Fiscal performance remains strong.** Following the balanced budget in 2017, the government reached an overall fiscal surplus in 2018, the first time since the country gained independence.
- **The restructuring of the banking sector has been completed.** The privatisation processes of NLB and Abanka have been completed, in accordance with the country's commitments to the European Commission (EC) following the government's bailout of, and state aid to, the banking sector in 2013.

Key priorities for 2020

- **Further fiscal adjustments are needed to reduce public debt sustainably.** In light of still-high public debt levels, the authorities should keep expenditure growth under strict control to achieve their medium-term fiscal targets, while an ageing population highlights the need to reform the pension, health and long-term care systems.
- **Privatisation of state-owned enterprises (SOEs) needs to be prioritised as it would enhance competitiveness and productivity.** SOEs remain dominant in a few sectors, therefore privatisation should be accelerated so that performance can be improved.
- **Despite significant improvements in recent years, corporate over-indebtedness highlights the need for more capital market financing (primarily equity) and governance improvements.** Notwithstanding the substantial deleveraging in recent years, the country still has one of the highest ratios of long-term debt of over-indebted companies to GDP among the peer central and eastern European countries.[1]

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	2.2	3.1	4.8	4.1	3.0
Inflation (average)	-0.8	-0.2	1.6	1.9	1.8
Government balance/GDP	-2.8	-1.9	0.0	0.8	0.7
Current account balance/GDP	4.5	5.5	7.2	6.4	5.8
Net FDI/GDP [neg. sign = inflows]	-3.3	-2.1	-1.2	-2.0	-1.0
External debt/GDP	116.4	104.5	105.3	88.7	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	48.7	45.7	44.0	42.2	n.a.

CONTINUES

[1] The long-term debt is concentrated in a small number of companies, including in the Slovenian highways company, reflecting major investments in this sector over the last 20 years.

Macroeconomic performance

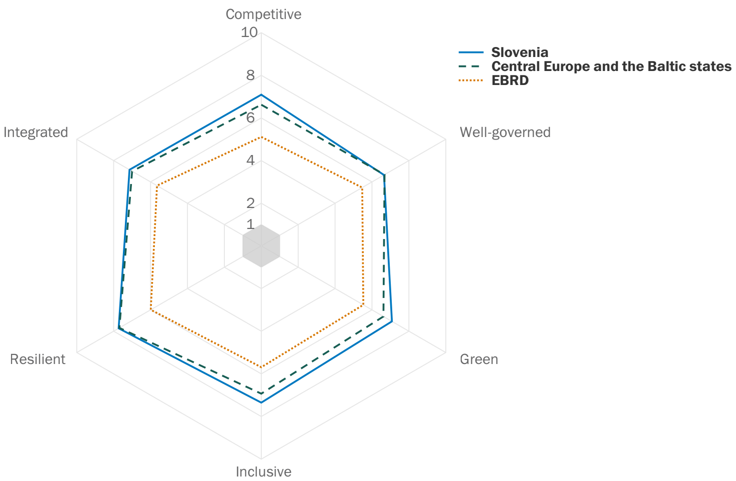
The economy continued to grow strongly in 2018. Real GDP growth was 4.1 per cent, among the fastest growth rates in the EU, following 4.8 per cent in 2017. Growth was broad-based, with investment being the largest contributor in both years, rising by more than 10.0 per cent each year. The strong labour market (unemployment being just 4.4 per cent as of the end of 2018), combined with a 3.0 to 4.0 per cent earnings growth in both 2017 and 2018, contributed to rising private consumption, of which growth remained robust at around 3.0 per cent. Exports continued their strong performance and grew by more than 6.0 per cent in 2018, helping net exports to contribute positively to growth despite a domestic demand expansion, which also pushed imports up. GDP increased 2.9 per cent year-on-year in the first half of 2019. Inflation has picked up but remained relatively low, averaging 1.9 per cent in 2018 (measured by the change in the Harmonised Index of Consumer Prices).

The fiscal position has improved significantly. The general government budget was balanced in 2017 for the first time since independence in 1991 and in surplus by 0.8 per cent of GDP in 2018. The improvement in the fiscal position came as a result of expenditure restraint (due to existing austerity measures in the field of social and family benefits and labour costs in the public sector), the strong cyclical growth in revenues, and the reduction in the interest payment burden on outstanding debt. The budget surplus and strong nominal GDP growth led to a significant decline in the ratio of public debt to GDP, from a peak of 83.0 per cent in 2015 to 70.0 per cent in 2018. The declining trend is expected to continue.

The sovereign credit rating has improved further. In June 2019 Standard & Poor's rating agency upgraded Slovenia's sovereign credit rating from A+ to AA-, with a stable outlook. In July 2019 Fitch upgraded Slovenia's rating from A- to A, also with a stable outlook. The upgrades reflect Slovenia's strong growth developments, fiscal surpluses and public debt improvements. This follows the country's exit from the EU's Macroeconomic Imbalances Procedure (MIP) in 2018 (having entered the procedure in 2013), following the EC's assessment that the country had made significant progress in fiscal consolidation, bank resolution and corporate deleveraging.

Growth is likely to moderate in the medium term. The economy is projected to grow at 3.0 and 2.8 per cent in 2019 and 2020, respectively, as the temporary effects of the new investment cycle wear off and the economy reaches its potential. Private consumption, supported by rising employment and wages, and favourable bank lending conditions, are expected to play a major role in maintaining solid growth rates over the forecasting period. The risks to the downside come from possibly weaker demand from main trading partners, as the country's economy, which is highly integrated into eurozone supply chains, significantly relies on exports. On the other hand, a stronger-than-envisaged government investment cycle and growth in private consumption could push up short-run growth rates above projections.

Assessment of transition qualities (1-10)



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Major structural reform developments

The business environment is improving. Slovenia ranks 37th (out of 190 economies) in the World Bank's *Doing Business 2020* report, three positions higher than the year before. The country ranks 35th among 141 countries (the same position as in the previous year) in the World Economic Forum's Global Competitiveness Index 2019. Slovenia scores particularly well on macroeconomic stability (that is, inflation and debt dynamics), but significant obstacles are the small market size (82nd), and the depth and stability of the financial system (61st).

Slovenia's foreign direct investment has risen sharply in recent years due to takeovers. These include instances of privatisations in the banking sector, including that of the country's largest bank, NLB, through an initial public offering (IPO), but also includes China's Hisense takeover of the Slovenian household appliances maker Gorenje in 2018 and Generali Group's acquisition of insurer Adriatic Slovenica and fund manager KD Funds in 2019.

The privatisation processes of NLB and Abanka have been completed. With the sale of the remaining 10.0 per cent stake on the London Stock Exchange in June 2019, the Republic of Slovenia completed the privatisation process of NLB, the largest bank in the country. The first phase of the privatisation process was implemented in November 2018, when the Slovenian Sovereign Holding (SSH), in the government's name, carried out the IPO of a 65.0 per cent stake, listing the shares of NLB on the Ljubljana and London Stock Exchanges. A further 10.0 per cent was sold in June 2019; the Republic of Slovenia will remain the largest shareholder of NLB, with a 25.0 per cent stake plus one share. In June 2019 the SSH signed the sale and purchase agreement for Abanka, which is 100.0 per cent state-owned and the country's third-largest bank, with a market share of about 10.0 per cent, with the NKBM bank, the country's second-largest, which is owned by US investment fund Apollo and the EBRD. The closure of the transaction is subject to receiving all necessary approvals from the relevant authorities. Following the acquisition, the combined market share of the two banks will reach 22.0 per cent, almost equal to that of NLB. Also, in May 2019 Hungary's OTP Bank signed a deal to buy SKB Banka, the subsidiary of Société Générale, as part of a regional buy-out. SKB Banka has a market share of 9.0 per cent and is the fourth-largest bank in Slovenia.

The parliament has approved the Act on judicial and out-of court relief granted to holders of qualified bank credit (the so-called "bailout law"). The objective of the Act is to prescribe a process for judicial protection of former holders of qualified bank credit, compliant with the Constitutional Court decision on the topic. Any potential compensation will be paid by the Bank of Slovenia, subject to the rules on liability for damages in force at the time of the imposition of the extraordinary measures arising from the 2013 banking system overhaul. At the time, the sector was burdened with a large number of bad loans, and six banks – NLB, NKBM, Abanka, Banka Celje, Probanka and Factor banka – received capital from the government. In the meantime, Probanka and Factor banka were liquidated, while Banka Celje was merged with Abanka, which (as noted above) was recently bought by NKBM. At the same time, a total of around €600 million of subordinated bonds were scrapped. Many former subordinated bondholders and shareholders are now suing the banks and the central bank to get their money back.

Slovenia has adopted energy law amendments. In June 2018 the parliament adopted amendments to the Energy Law, which bring in a number of changes, including transposing EU directives' provisions on energy efficiency, following a warning on non-compliance from the EC. In addition, if it does not meet the targets for electricity generation from renewable energy sources, the amendments will allow the country to meet these obligations by making renewable energy payments to other EU countries. Energy consumption from renewable sources in Slovenia, at 22.0 per cent in 2018, is still below the 2020 target of 25.0 per cent.

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The government has passed pension and tax system reforms, aimed at better social protection and longer labour activity. In October 2019 the government adopted various measures, including increases in vesting percentage, disability benefits and minimum pensions, and more generous benefits for pensioners with more than 40 years in employment and for those on maternity or paternity leave. The changes also include raising the replacements rates and providing further incentives to remain in the insurance scheme and prolong active participation in the labour market. The government will also continue the dialogue with social partners to address other issues of the pension system, such as the retirement age. The ageing population of the country is one of the main challenges for Slovenia, making healthcare and long-term care among the high-level priorities of the Slovenian government. This issue is expected to put an increasing burden on public finances in the long run. At the same time, the government adopted measures to lower labour taxation to boost growth. After reduction in the taxation of the holiday allowance, implemented in spring 2019, the additional tax changes include reducing the tax rate for personal income within certain brackets, and increasing general tax allowances. The revenue implications of these measures will be offset by the restriction on the use of corporate tax reliefs up to a certain percentage of the tax base, by some changes in capital taxation for individuals and rental income, and by putting an extra effort into improving the efficiency of collecting fiscal duties.

TAJIKISTAN

Highlights

- **Officially reported economic growth remains strong.** Real GDP grew by 7.5 per cent year-on-year in the first half of 2019 as growth in services and industry picked up.
- **The first two turbines of the Rogun hydropower plant (HPP) were put into operation.** The first turbine, launched in November 2018, produced 211.3 million kWh of electricity in the first half of 2019, while the second turbine came online in September 2019.
- **Barqi Tojik, the state-owned energy company, has been unbundled into power generation, transmission and distribution.** Two entities were created which will be responsible for electricity transmission and distribution and will be subordinated to Barqi Tojik, which retains electricity generation.

Key priorities for 2020

- **Banking sector stabilisation is an immediate priority.** While the sector has been recapitalised, the protracted resolution and restructuring of the two troubled banks continues to hinder sector development. Legacy problems of weak governance and directed and related party lending should be tackled vigorously.
- **Efforts to address investment, regulatory and institutional gaps in the energy sector should be stepped up.** The required measures include restructuring Barqi Tojik's debt, implementing the recently adopted tariff methodology and establishing an independent sector regulator. There is a need for greater transparency, higher efficiency, independent oversight, and careful management of public investments.
- **Business environment constraints should be addressed**. Simplifying tax policies and improving tax administration are of paramount importance to incentivise firms operating in the real economy to become more transparent.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	6.0	6.9	7.1	7.3	7.0
Inflation (average)	5.8	5.9	7.3	3.8	7.9
Government balance/GDP	-2.0	-9.0	-6.0	-2.8	-4.5
Current account balance/GDP	-6.1	-4.2	2.2	-5.0	-6.0
Net FDI/GDP [neg. sign = inflows]	-5.8	-3.5	-2.6	-2.9	-2.5
External debt/GDP	51.3	61.2	71.2	69.8	n.a.
Gross reserves/GDP	6.3	9.4	14.4	14.6	n.a
Credit to private sector/GDP	22.7	19.2	13.7	12.3	n.a

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Macroeconomic performance

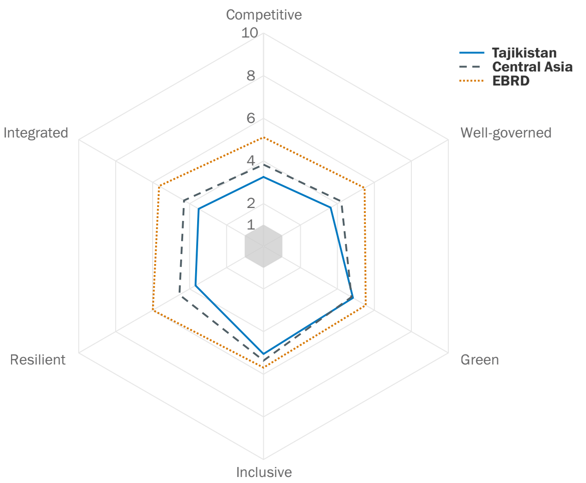
The economy continues to grow by more than 7.0 per cent. In the first half of 2019 officially reported real GDP growth was 7.5 per cent year-on-year, following 7.3 per cent growth in 2018. Growth was driven by gains in services and industry. Exports increased by 8.1 per cent year-on-year in US dollar terms in the first six months of 2019, while imports grew by 2.3 per cent. However, fixed investment contracted by 8.6 per cent in the same period, mainly due to lower public investment in the energy sector, which also contributed to a slowdown in import growth. The economy continues to face structural challenges stemming from the solvency and liquidity issues in the banking sector, as well as a significant debt overhang.

Inflation has accelerated. After decelerating to an average of 3.8 per cent in 2018 from an average of 7.3 per cent in 2017, inflation started rising again in early 2019, mainly due to higher food prices. Inflation reached 8.1 per cent year-on-year in September 2019, nearing the upper bound of the central bank's targeted inflation corridor of 5.0 to 9.0 per cent. Nevertheless, the central bank reduced its refinancing rate to 13.25 per cent in May 2019 from 14.75 per cent set in February 2019, with the expectation that inflationary pressures would subside in the second half of 2019. The somoni has been broadly stable since August 2018, supported by the administrative measures introduced by the authorities in 2015. In August 2019, the central bank devalued the currency by 2.7 per cent to bring the official exchange rate closer to the unofficial rate.

Fiscal accounts have improved but external deficits are rising. The fiscal deficit narrowed in 2017 and 2018, with the authorities undertaking fiscal consolidation aimed at reducing the large amount of public debt. Capital expenditures were reduced, except for infrastructure outlays for the construction of the Rogun dam. Public debt fell to 47.9 per cent of GDP in 2018 from 50.4 per cent in 2017. The current account turned into a deficit of 5.3 per cent of GDP in 2018 from a surplus of 2.1 per cent in 2017 as imports surged rapidly. The significant growth in imports largely reflects the purchase of equipment for the construction of the Rogun HPP. In the first half of 2019, the growth of exports exceeded that of imports and the current account deficit slightly narrowed to 3.1 per cent of GDP.

A moderation in the growth rate is likely in the short term. Real GDP growth is projected at 7.0 per cent in 2019 and 6.3 per cent in 2020. Fiscal challenges, combined with a difficult business environment, are likely to continue to weigh on economic activity. Remittances, electricity exports from the Rogun HPP, and improving bilateral ties with Uzbekistan are expected to be the main growth drivers. An agreement on an International Monetary Fund (IMF) programme, which is currently under negotiation, would support economic stability by enabling banking sector resolution, building fiscal and external buffers and improving the investment climate.

Assessment of transition qualities (1-10)



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Major structural reform developments

The business environment is improving. Tajikistan was among the top 10 improvers in the World Bank's *Doing Business 2020* report, rising from 126th to 106th place (out of 190 countries). Areas of improvement included starting a business, getting credit and trading across borders. Access to credit is helped by the introduction of a collateral registry and establishment of a secured-transactions system. The new registry will allow business owners to use movable assets such as motor vehicles and livestock to secure business loans. This is an important step towards enabling secured lending and expanding access to credit by accepting collateral beyond land and real estate – Tajikistan now ranks 11th on this indicator. Trading across borders was made easier by prioritising customs clearance of perishable goods exports. However, the country continues to experience major bottlenecks in getting electricity, paying taxes and resolving insolvency.

The Rogun dam – the largest HPP in Central Asia – has begun operating. The first unit of the Rogun HPP started operating in November 2018 and produced 211.3 million kWh of electricity in the first half of 2019. The second unit was launched in September 2019. Once all six turbines are operational, the Rogun HPP is expected to generate 13.1 billion kWh of electricity per year. This will be sufficient to close the domestic energy deficit, which is particularly acute in the winter, and export electricity to Afghanistan and Pakistan. In the past, Tajikistan has resorted to regular power rationing during the winter and, while formal limits on power delivery have been lifted as of now, the country still experiences occasional power outages. The Rogun HPP is not only expected to strengthen the energy security of the country but also to become the main driver of economic growth and living standards. However, there are challenges with the full implementation of the project, primarily related to financing. While Tajikistan used proceeds from the sale of Eurobonds to finance the initial stages of the project, further funding options remain unclear given the constrained fiscal space and weak investment climate.

Institutional and regulatory reforms in the energy sector have proceeded. In June 2019, the government established two new joint stock companies (transmission and distribution) subordinated to Barqi Tojik, a state-owned energy company, which retains electricity generation. These companies are later expected to be separated from Barqi Tojik. A draft action plan on improving the financial viability of Barqi Tojik for 2019-25 has been prepared, the implementation of which would require US$ 1.2 billion. Part of the funds will be used to repay debt owed to two HPPs, Sangtuda-1 and Sangtuda-2. In addition, a new electricity tariff methodology was approved in June 2019, which envisages gradual increases in electricity tariffs. A new tariff-setting unit is expected to be established by the end of 2019 with the primary function of setting tariffs for the regulated sectors.

Banking sector restructuring after the crisis in 2016 is still under way, with the resolution of problematic systemic state-owned banks pending. Resolution of the two troubled banks, Agroinvestbank and Tojiksodirotbank, is high on the agenda of financial sector reforms to be targeted by a potential IMF programme, which has been under discussion for the last three years. Further consolidation in the sector is expected, including through a potential increase in capital requirements for banks. Banking sector indicators are moving in the right direction. For example, overdue and non-performing loans, mostly concentrated in the two banks, declined from around 35.8 per cent of total loans at the end of 2017 to 24.8 per cent in June 2019. However, data quality remains an issue. Loan and deposit dollarisation fell to 52 per cent and 48 per cent, respectively, as of the end of June 2018. Apart from contraction in the demand for foreign currency loans, this was in part due to measures to reduce the foreign exchange exposure of banks by prohibiting foreign currency-denominated mortgage loans to unhedged borrowers and increasing the risk weight for foreign currency loans from 100 per cent to 150 per cent.

Businesses continue to face restrictions on currency convertibility. This is flagged as a top concern in the World Economic Forum's Executive Opinion Survey. Banks are unable to meet the foreign currency demands of clients, which necessitates prioritising specific sectors and transactions, as recommended by the central bank (for example, export-oriented transactions, or imports of food and fuel). The shortage of foreign currency liquidity in part reflects the contraction in remittances from Russia, limited inflows of foreign exchange from exports, and low foreign direct investment. Compliance requirements related to remittance operations have been tightened by the regulator, which had the effect of shifting remittances to informal channels to some extent.

TUNISIA

Highlights

- **Economic growth rebounded at a slower pace and unemployment remains high.** The GDP growth rate reached just 1.2 per cent year-on-year in the first half of the year. Unemployment, one of the major challenges in Tunisia, has stabilised at an elevated level.
- **Some structural reforms have progressed.** The government has taken steps in the past year to improve the business climate, reform the financial system by opening a money exchange office, and implement energy subsidies reforms, supported by improved social protection programmes.
- **A new investment law may help attract foreign interest.** The new law is encouraging investors in various ways, including through the elimination of bottlenecks, enhanced access to finance for small and medium-sized enterprises (SMEs), and the enablement of public-private partnerships (PPPs) and concessions.

Key priorities for 2020

- **Structural reforms need to be reinforced.** Key short-term priorities include energy-sector reform, adopting the law on excessive lending rates and implementing the strategy to support green tourism and to provide incentives to encourage domestic and foreign tourism.
- **The authorities should accelerate the pace of fiscal consolidation and maintain monetary tightening.** Measures are needed in order to keep a lid on current expenditures, and a tight monetary stance, supported by continued exchange rate flexibility, would help contain inflationary pressures.
- **Obstacles to private-sector participation in the economy should be removed.** Priority areas to be tackled are clarifying the ownership of land properties, ensuring the good governance of state-owned enterprises and countering corruption.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	1.2	1.3	1.9	2.5	1.5
Inflation (average)	4.4	3.6	5.3	7.3	6.6
Government balance/GDP	-5.3	-6.2	-5.9	-4.6	-3.7
Current account balance/GDP	-9.7	-9.3	-10.2	-11.1	-10.4
Net FDI/GDP [neg. sign = inflows]	-2.2	-1.7	-2.0	-2.5	-2.2
External debt/GDP	63.2	66.9	82.0	86.0	92.8
Gross reserves/GDP	17.2	14.2	14.0	13.0	14.8
Credit to private sector/GDP	73.2	76.0	80.1	79.3	n.a.

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Macroeconomic performance

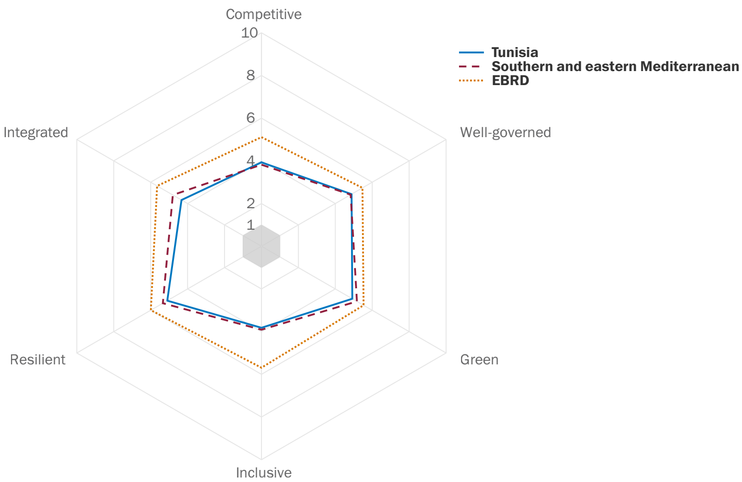
The economy grew at a slower pace in the first half of 2019. The 1.2 per cent growth year-on-year in this period, down from 2.7 per cent in 2018, was mainly driven by the fall in manufacturing industries and the decline in extraction industries, although there was an expansion in commercial services – mainly in tourism, communication and financial services – and agriculture. Unemployment remained high at 15.3 per cent in the second quarter of 2019, and especially so among young people (34.4 per cent), women (22.6 per cent) and graduates (28.2 per cent).

Inflation slowed down, but remains high. In September 2019, the inflation rate remained high at 6.7 per cent year-on-year, compared with a peak of 7.7 per cent in June 2018. Food and tobacco prices remain the main drivers of inflation, while the appreciation of the Tunisian dinar and monetary tightening by the Central Bank of Tunisia – the key interest rate was increased by 100 basis points to 7.75 per cent in February 2019 – helped keep inflationary pressures in check.

Fiscal and external deficits have fallen. The fiscal deficit declined to 4.6 per cent of GDP in 2018, from 6.0 per cent in 2017, on the back of improved tax collection. This, in turn, allowed for an increase in spending on job-creating public investment and social spending. Meanwhile, public debt (external and domestic) increased to 77.1 per cent of GDP in 2018, driven mainly by the depreciation of the Tunisian dinar, as two-thirds of the debt is denominated in foreign currency. The current account deficit narrowed to 5.7 per cent of GDP in the first seven months of 2019, compared with 6.1 per cent of GDP in the same period of 2018. This reduction was mainly due to the increase in tourism receipts and labour income, in addition to a rebound in phosphate exports and the sound performance of exports of the manufacturing industries sector, combined with a slowdown of imports. Tourism increased by 16.7 per cent year-on-year in the first six months of 2019. Meanwhile, reserves increased but remained low, covering just over three months of imports in September 2019.

The outlook remains mixed in 2019-20. In 2019, growth is expected to slow to 1.5 per cent, impeded by the delay in the implementation of structural reforms, notably due to uncertainty in the run-up to the presidential and parliamentary elections in September and October 2019, respectively. In 2020, we expect a recovery in foreign investors' confidence and in the reform momentum in Tunisia once the elections are over. This will result in significant improvements in both domestic and foreign investment, pushing growth to 2.6 per cent. Risks stem from the possibility that socioeconomic protests will disrupt production and slow progress on reforms, given the new political structure and falling growth in Europe. Upsides include improvements in tourism and investment and the restoration of confidence following the successful democratic transition, which should be reflected in an increase in productivity and growth.

Assessment of transition qualities (1-10)



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Major structural reform developments

Pension reform has advanced. A new reform law for the public pension fund was approved by the parliament in April 2019. The law raises the retirement age for civil servants from 60 to 62 as of 2020. It also imposes a 1.0 per cent social security tax on employees and a 2.0 per cent tax on employers.

Energy subsidies have been reduced after some delay. Fuel prices were raised in September 2018, but planned increases in fuel and utility tariffs for October and November 2018 were not implemented due to social tensions. Instead, the government increased the prices of fuel and other oil products by around 6.0 per cent in March 2019 and raised the prices of low-pressure natural gas and low-voltage electricity in May 2019.

Energy-sector digitisation is advancing gradually. The government started implementing a "smart grid project" in June 2019, which is part of Tunisia's energy plans in the form of a PPP. The project aims to obtain 30.0 per cent of electricity from renewable energy sources by 2025. The development of the smart grid will allow the Tunisian Electricity and Gas Company to monitor consumption patterns of the grid's power supply, leading to reduced energy losses, fewer unpaid bills, enhanced energy efficiency, an improved ecosystem and increased competitiveness of the electricity sector. The project comprises two phases: the first phase includes the installation of 430,000 smart meters over three years in the Sfax governorate in southern Tunisia; and the second phase will extend the programme to the rest of the country. Tunisia's national grid is connected to those of Algeria and Libya, and is therefore essential to improve electricity transmission and distribution networks across northern Africa.

A new Investment Climate Improvement Law is in place. The new law, approved in April 2019, aims to unblock investments and eliminate bottlenecks, and has four objectives. First, it tackles administrative bureaucracy, further simplifies procedures and significantly reduces paperwork. Second, it increases access to finance, notably to SMEs, by reducing the costs of financing through subsidies. Third, the new law includes provisions allowing SMEs to access concessions and private operators to intervene in the more advanced stages of projects. The fourth objective is to improve corporate governance in the private sector, in order to protect savers and minority shareholders.

The government has widened social protection to cover vulnerable segments of society. In March 2019, the government improved access to public health care and established the AMEN social database. Social spending increased in 2018 through the expansion of the main social programme for vulnerable families (Programme National d'Aide aux Familles Necessiteuses). In addition, a database on vulnerable households was established in March 2019 in order to better target low-income households. Furthermore, new medical and payment cards have been issued. The parliament adopted the CNRPS reform law, which became effective in May 2019, limiting the short-term need for government support. A decree based on similar reform parameters for the private pension fund is about to be passed.

TURKEY

Highlights

- **The economy entered recession in 2018 but a stimulus has led to a return of growth in 2019.** The recession was primarily driven by a currency depreciation in summer 2018, caused by significant macroeconomic imbalances, along with the policy tightening implemented to address these imbalances. Various forms of stimulus lifted private consumption and helped the economy exit recession at the beginning of 2019. Similar stimulus measures continue to be applied in the face of weak domestic sentiment and the deteriorating external environment.
- **The economy has seen a rebalancing of the external account.** Within the space of a year the current account has moved from a large deficit to a balance. However, this has been a cyclical phenomenon, the result of import compression associated with the economic slowdown and a pickup in exports due to the depreciation of the currency.
- **The past year has seen limited progress in structural reforms.** A prolonged election period and a challenging macroeconomic environment have absorbed much of the authorities' attention. However, the approval of the 11th Development Plan in mid-2019 was a positive step.

Key priorities for 2020

- **Efforts to return the economy to growth need to be balanced with containing fiscal and external risks.** Improving confidence and macroeconomic stability need to be prioritised without allowing slippage from fiscal targets. The credibility of the central bank needs to be preserved to increase the effectiveness of monetary policy.
- **Rules for the recognition of non-performing loans (NPLs) should be tightened.** Lending by private banks is being inhibited by asset quality problems, most notably in the energy, real estate and construction sectors.
- **Structural reforms need to be enacted to ensure a genuine rebalancing of the economy.** The low real exchange rate and an election-free period of four years create an opportunity to enact reforms to improve workforce skills, firm-level innovation and global value chain integration.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	6.1	3.2	7.4	2.8	-0.2
Inflation (average)	7.7	7.8	11.1	16.3	15.7
Government balance/GDP	-1.0	-1.3	-1.5	-1.9	-3.0
Current account balance/GDP	-3.7	-3.8	-5.6	-3.5	-1.0
Net FDI/GDP [neg. sign = inflows]	-1.6	-1.3	-1.0	-1.2	-1.2
External debt/GDP	46.4	47.4	53.4	57.1	n.a.
Gross reserves/GDP	13.1	12.3	12.6	11.8	n.a.
Credit to private sector/GDP	66.8	69.9	70.9	68.5	n.a.

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Macroeconomic performance

The economy experienced a sharp slowdown. Tight monetary policy, currency depreciation and a credit crunch took their toll on growth in 2018, with the economy growing by 2.8 per cent in the year as whole but declining in the second half of the year by 0.3 per cent year-on-year. Fiscal stimulus measures and state bank-driven credit growth helped the economy exit recession in the first quarter of 2019 but ongoing private sector deleveraging indicates that recovery will be slow.

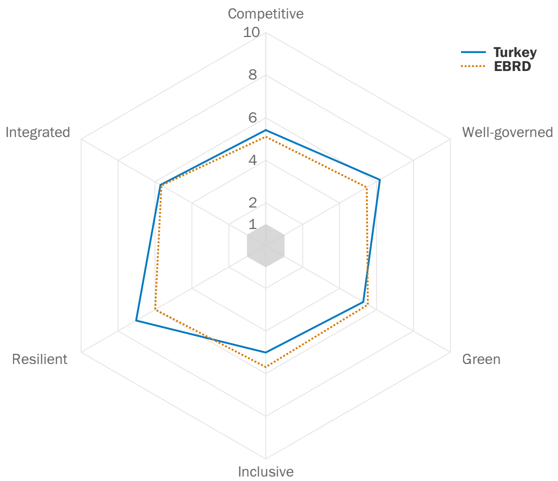
The slowdown resulted in a rebalancing of the external account. The 12-month current account balance has turned from a deficit of US$ 58 billion in May 2018 to a surplus of US$ 5 billion in August 2019, driven by a sharp contraction of imports and a pickup in exports as a result of currency depreciation and declining domestic demand. However, this has been a cyclical adjustment driven by the downturn, and, in the absence of structural reforms, the deficit will likely reappear when growth picks up again.

Inflation is declining but there are concerns about the independence of the central bank. After peaking at 25.2 per cent in October 2018, inflation has been declining due to high policy rates, the negative output gap and base effects. However, the sacking of the governor of the central bank in July 2019 and subsequent policy rate cuts amounting to 1,000 basis points fuelled concerns about the independence of the central bank. Although there is scope to reduce nominal rates as inflation falls, Turkey needs to ensure real rates remain high relative to its peers in order to anchor inflation expectations and avoid capital outflows in the uncertain global environment, particularly given the authorities' reliance on unorthodox economic policies.

Fiscal policy has been loosened, leading the government to seek alternative sources of funding to meet budget targets. As a result of pre-election government spending and temporary tax cuts on durable consumer goods and real estate transactions, after six months the budget deficit had almost exceeded the original annual target, resulting in a substantial revision of the year-end deficit target. The government is tapping into the reserve fund of the central bank (and is planning to revise the borrowing limits) in order to close the funding gap.

Economic activity is expected to remain subdued in the second half of 2019, and recovery is likely to be slow. Despite some tailwind provided by the reversal of monetary tightening in the developed economies, a return to the high growth rates of recent years is unlikely in the short term due to constraints on bank lending and weakening external demand. A contraction of 0.2 per cent is expected for 2019, followed by 2.5 per cent growth in 2020. The main risk to the outlook is another round of currency depreciation related either to geopolitical risks or to policy measures that are perceived by investors to support growth at the expense of macroeconomic stability.

Assessment of transition qualities (1-10)



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Major structural reform developments

The 11th Development Plan was approved in July 2019 and is a blueprint for reform. The main goal of the plan is to help Turkey transition from a consumption- and debt-driven economy to a production- and export-driven one, financed by domestic savings. In order to achieve this, the plan aims at boosting competitiveness through innovation, upgrading workforce skills and promoting inclusion, redesigning the tax and social security system, promoting renewable energy use and increasing transparency and predictability in policymaking.

The authorities continue to take steps to improve the business environment. Reforms have been undertaken to streamline processes, time frames and costs for small and medium-sized enterprise operations. An amendment to the value added tax code was introduced in order to exempt certain capital investments, and the authorities took steps to facilitate property registration. These steps have helped Turkey improve its ranking in the World Bank *Doing Business 2020* report by 10 places to 33rd out of 190 countries.

There has been backsliding in the past year as regards governance and policymaking. The authorities have increasingly resorted to unorthodox policies, including frequent interventions in the market mechanism, which have resulted in concern among investors and Turkish citizens. This has resulted in increased dollarisation and volatility of capital flows with more than 50 per cent of domestic savings with banks now held in foreign currency. An increasingly centralised approach to policymaking saw the removal (as noted above) of the governor of the central bank from his post by the President on the grounds of disagreements over monetary policy.

Positive steps were taken to improve the financial sector's resilience, but rising corporate NPLs in certain sectors remained unaddressed. In January 2019, the government established a Financial Stability and Development Committee consisting of the representatives from government agencies and financial institutions. Amendments to the banking law facilitated the use of a framework for out-of-court restructuring of loans to troubled firms deemed capable of repayment. However, plans to address NPLs in the energy, real estate and construction sectors have yet to be finalised.

There has been an increase in restrictions to trading across borders. Import tariffs on a wide variety of products, including textiles industry inputs, were raised in January 2019, while the duty exemption for small quantity goods imported via e-commerce was removed in May 2019. In the same month, the United States of America removed Turkey from the Generalized System of Preferences, which had allowed for limited tariff-free access to the US market.

Reforms were made in the fields of waste reduction and renewable energy generation. Net metering was introduced in May 2019 to unlicensed solar energy producers, allowing for surplus electricity from residential and commercial rooftop solar energy systems to be sold back to the grid. In July 2019 the government passed a waste reduction regulation, mandating public and large private buildings to obtain "zero waste" certificates. Meanwhile, a charge for the retail use of plastic shopping bags was introduced at the beginning of 2019.

TURKMENISTAN

Highlights

- **Officially reported GDP shows strong growth figures.** Growth of GDP remains above 6 per cent, driven by an acceleration of growth in industry. The official exchange rate remains overvalued at 3.5 manats per US dollar but pressures on the parallel market exchange rate have been easing since the beginning of 2019.
- **Turkmenistan has signed a long-awaited five-year contract with Russia for gas delivery.** Regular gas supplies to Russia had been stopped since 2016. The new contract reduces Turkmenistan's dependence on China as its sole gas export market.
- **Free access to electricity, gas and water ended in 2019.** This is indicative of the government's stated intention to move to a market-based economy and improve public finances.

Key priorities for 2020

- **Currency convertibility issues need to be addressed and the exchange rate should be adjusted to reflect macroeconomic fundamentals.** Removing exchange rate distortions would improve the competitiveness of the country's exports and correct external imbalances while stimulating growth of the private sector.
- **The authorities need to reduce the role of the state in the distribution of resources.** Key necessary steps include the commercialisation of state-owned enterprises, transparent privatisation, and a reduction in state-directed lending.
- **It is critical to deal with governance gaps.** Greater transparency and data availability, stronger protection of property rights, and an improved regulatory environment are essential for enabling foreign direct investment (FDI) inflows and strengthening the role of the private sector.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	6.5	6.2	6.5	6.2	6.3
Inflation (average)	7.4	3.6	8.0	13.2	13.5
Government balance/GDP	-0.7	-2.4	-2.8	-0.2	-0.1
Current account balance/GDP	-15.6	-20.2	-10.3	5.7	-1.0
Net FDI/GDP [neg. sign = inflows]	-8.5	-6.2	-5.5	-4.9	-5.0
External debt/GDP	21.8	23.1	25.1	25.4	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	n.a.	n.a.	n.a.	n.a.	n.a.

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Macroeconomic performance

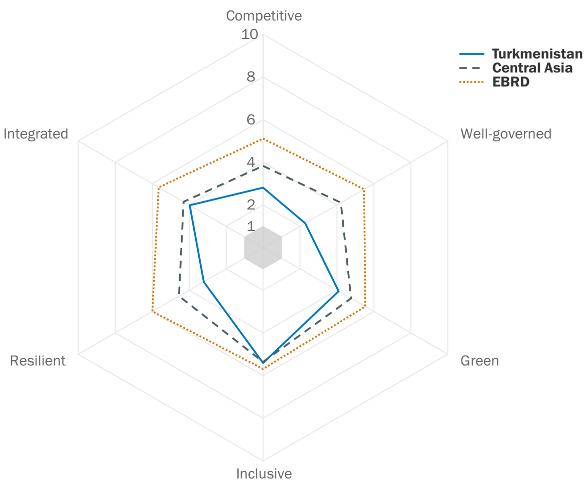
The economy continues to grow strongly according to official figures. Reliable economic data are hard to find in Turkmenistan but, according to official figures, economic growth remains above 6 per cent. The growth rate accelerated marginally to 6.3 per cent year-on-year in the first three quarters of 2019 from 6.2 per cent in 2018. This was enabled by acceleration of growth in industry (6.9 per cent versus 4.6 per cent a year earlier). Exports were reported to have risen by 7.5 per cent year-on-year in the first three quarters of 2019, helped by a resumption of gas exports to Russia. Imports contracted by 5 per cent in the same period. Retail trade turnover increased by 19 per cent in the period January to July 2019. Credit growth reached around 10 per cent in the first half of 2019. However, fixed investment continued to contract as public spending decreased.

The exchange rate remains overvalued and exchange rate controls continue to be imposed. The central bank is still implementing foreign exchange rationing, which severely disrupts foreign trade and profit repatriation. While exports recovered to US$ 11.2 billion (26 per cent of GDP) in 2018 after a deep slump in the previous two years, it remains uncertain how much of the exports actually translate to export proceeds. The gap between the official and unofficial exchange rates has widened significantly, suggesting that the manat is overvalued. The parallel market exchange rate stayed around 17 to 19 manats per US dollar in the first three quarters of 2019 (well above the official rate of 3.5 manats), but pressures have been easing since the beginning of the year. Average inflation accelerated to 13.6 per cent in 2018 from 8.0 per cent in 2017, also due to increases in public sector wages and pensions and higher gasoline prices.

Fiscal adjustment is proceeding and the external position has improved. The general government fiscal balance turned to a surplus of 0.6 per cent of GDP in 2018 from a deficit of 2.8 per cent in the previous year. This was enabled by reductions in state subsidies and cuts in capital expenditure. The current account registered a surplus of 3.1 per cent of GDP in 2018 (versus a deficit of 10.3 per cent in 2017). Higher gas demand from China enabled strong export growth in 2018 (by 49.6 per cent year-on-year in US dollar terms). In contrast, registered imports declined by 47.8 per cent in 2018.

GDP growth is forecast to moderate slightly in the short term. We expect GDP to grow by 6.3 per cent in 2018 and 6.0 per cent in 2019, provided the external demand for gas remains favourable, although we note the difficulty of providing forecasts in the absence of reliable data. The resumption of gas exports to Russia following a three-year interruption is expected to improve growth prospects. Growth will continue to be weighed down by fiscal restraint, restricted access to foreign exchange except for priority projects, a difficult business environment and limited FDI inflows.

Assessment of transition qualities (1-10)



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Major structural reform developments

The government has ended social transfers for electricity, gas and water. The relevant decree was signed in September 2018 and took effect from January 2019. Turkmen citizens had enjoyed such benefits since late 1992. This termination of transfers is an indication of the government's stated intention to move to a market-based economy but is also suggestive of the difficult economic conditions faced by the country, notwithstanding the reported high growth rates. In addition, the government intends to increase domestic gasoline prices, which are currently among the lowest in the region, to achieve cost-recovery levels. The most recent price hike (by about 50 per cent) was implemented in February 2018.

Turkmenistan has signed a long-awaited five-year contract with Gazprom. Under the terms of the contract, signed in July 2019, 5.5 billion cubic metres (bcm) of gas will be exported to Russia annually. This follows the short contract signed in mid-April 2019 for delivery of 1.2 bcm of Turkmen gas from April to June 2019 (Russia had stopped buying Turkmen gas at the beginning of 2016). There are no details on pricing. The new contract is likely to somewhat ease the pressure on the external accounts and reduce the country's dependence on China as its sole gas export market.

Turkmenistan has ratified the convention on the legal status of the Caspian Sea. Ratification took place in December 2018 and follows signing of the convention by Azerbaijan, Iran, Kazakhstan, Russia and Turkmenistan in August 2018. This is an important milestone for the region after more than 20 years of discussions, and it ends the dispute over ownership of water resources. The Caspian Sea has been granted a special legal status, whereby each of the five countries has 15 miles from the coast of territorial waters and a further 10 miles of sovereign fishing waters. The convention makes it possible to build pipelines along the seabed, provided they adhere to environmental requirements. It therefore lays the foundation for construction of the Trans-Caspian pipeline between Turkmenistan and Azerbaijan, which would deliver gas from Turkmenistan to Turkey and then to Europe. Further uncertainties remain regarding the delimitation of the seabed and subsoil resources, but nevertheless the agreement represents an important step for major energy projects.

A land fund established in October 2018 will allocate land to private farmers under a lease of up to 99 years. The land transferred to tenants for long-term use should be used only for agricultural purposes. Farmers are required to use 70 per cent of the land to grow crops (cotton and wheat) to fulfil government demand. In addition, state purchasing prices for those crops have been increased since January 2019. The government also subsidises farming costs by providing concessional loans, at 1 per cent interest for 10 years, to finance acquisition of agricultural equipment. These measures are designed to promote the growth of agriculture and to increase productivity of the sector.

Foreign investors have filed several cases against the government of Turkmenistan. In April 2019 MTS, a Russian telecommunications company, filed a case against Turkmenistan with the International Centre for Settlement of Investment Disputes (ICSID), an international arbitration institution. MTS states that it had to terminate its operations in Turkmenistan because of the government's actions, with losses amounting to US$ 1.5 billion. In October 2018 SECE Group, a Turkish construction company, and Unionmatex, a German engineering company, also filed cases with ICSID, citing the non-payments of contractually owed monies by the Turkmen government. These add to a few other arbitration cases pending since 2009. Weak property rights and a complex regulatory environment characterised by arbitrary enforcement continue to constrain the inflow of FDI and are major obstacles to doing business in the country.

UKRAINE

Highlights

- **Economic growth remained resilient despite pressures from the twin election cycle.** After a slight moderation in gross domestic product (GDP) growth from 3.3 per cent in 2018 to 2.5 per cent in the first quarter of 2019, the economy accelerated to 4.6 per cent growth in the second quarter of 2019.
- **Foreign portfolio inflows have increased significantly.** Investors have been attracted by restored macroeconomic stability and sound central bank policies, along with favourable conditions on international financial markets.
- **Reform progress has been mixed.** Financial-sector and public finance reforms have continued as planned, but anti-corruption efforts suffered a setback, while the launch of an ill-prepared electricity market reform has asymmetrically hit industrial electricity consumers and disrupted the payments of feed-in tariffs to renewables.

Key priorities for 2020

- **Ukraine needs to preserve macroeconomic and financial-sector stability.** The National Bank of Ukraine (NBU) has played a crucial role in restoring macroeconomic stability and overhauling the banking sector. Its independence has to be respected and its decisions in the banking sector accepted as irreversible.
- **The authorities should speed up implementation of reforms.** Cooperation with the International Monetary Fund (IMF) on a new reform-focused programme is vital. Key reforms should include: unbundling of the gas transmission system operator from Naftogaz together with the establishment of the gas exchange; land market reform; commercialisation and privatisation of state-owned enterprises (SOEs) and state-owned banks (SOBs); fighting against corruption; judicial reform; and digitalisation of public-sector services.
- **Legal obstacles to reforms should be tackled urgently.** Following opinions from the Constitutional Court of Ukraine on the illegal enrichment provisions in the criminal code and the establishment of the electricity market regulator, the parliament should amend the Constitution of Ukraine to enable provisions compliant with the country's international commitments.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	-9.8	2.4	2.5	3.3	3.3
Inflation (average)	48.7	13.9	14.4	10.9	8.7
Government balance/GDP	-0.9	-2.1	-1.2	-2.1	-1.5
Current account balance/GDP	1.8	-1.4	-2.2	-3.3	-2.8
Net FDI/GDP [neg. sign = inflows]	-3.3	-3.5	-2.3	-1.8	-1.9
External debt/GDP	129.3	120.5	102.9	87.7	n.a.
Gross reserves/GDP	14.6	16.6	16.8	15.9	n.a.
Credit to private sector/GDP	49.4	41.9	34.1	30.2	n.a.

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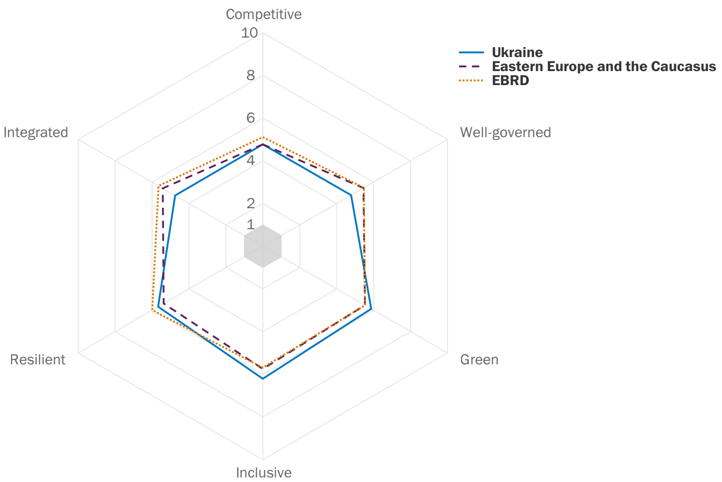
Macroeconomic performance

GDP growth has accelerated. The growth rate of the economy rose from an average of 2.5 per cent in 2016-17 to 3.3 per cent in 2018. Improvement in 2018 was driven by robust growth in household consumption and domestic investment in fixed assets. The strong real wage recovery, as well as an increase in the average pension and a rise in the inflow of remittances all supported household consumption, which grew by 8.9 per cent. Exports of goods and services declined by 1.6 per cent, while imports increased by 3.2 per cent in real terms. GDP growth remained at 3.3 per cent year-on-year in the first half of 2019 notwithstanding the challenging environment. Among the expenditure components, the growth of household consumption accelerated to 11.3 per cent driven by continued strong growth of real income and growth of fixed investments increased by 12.0 per cent, benefiting from strong construction activity. Government consumption declined by 7.3 per cent. Exports and imports both recorded solid real growth of 5.6 and 7.8 per cent, respectively.

Macroeconomic stability has strengthened in 2019. Inflation has slowed to 7.5 per cent in September 2019 but remains higher than the 5.0 per cent target of the NBU. Positive developments allowed the NBU to start the loosening cycle by reducing the key policy rate from 18.0 per cent in April to 15.5 per cent in October. The NBU's credible monetary policy, coupled with high real interest rates, favourable conditions on international financial markets and an enabling settlement of domestic securities on Clearstream, have all helped attract significant foreign private capital inflows on the domestic government securities market. In addition, in mid-June 2019, the Ministry of Finance issued a €1 billion seven-year Eurobond at 6.75 per cent, followed in July by US$ 1.5 billion at slightly higher rates by Naftogaz and Ukrainian Railway. The abundance of foreign portfolio capital inflows led to a 15.0 per cent appreciation of the local currency to the US dollar from January to September 2019. Such inflows also helped to increase foreign reserves to US$ 21.4 billion at the end of September 2019, despite large debt repayments in the same period.

Economic growth is likely to stabilise in the short term. GDP growth is expected to be 3.3 per cent in 2019 and 3.5 per cent in 2020. Bearing in mind that Ukraine has significant foreign exchange public debt liabilities (including SOEs and domestic foreign exchange treasuries) in the next 24 months, IMF support is of crucial importance for anchoring investors' expectations.

Assessment of transition qualities (1-10)



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Major structural reform developments

Foreign exchange market liberalisation has continued. Satisfactory macroeconomic conditions have enabled the NBU to continue liberalising the foreign exchange market in accordance with the Law on Currency and Currency Operations, which entered into force in July 2018. Over 30 foreign exchange market restrictions were cancelled in the first six months of 2019. These restrictions include: abolishing the mandatory foreign exchange conversion requirement for exporters (exchange of foreign currency receipts to local currency); cancelling all limits on repatriation of dividends and proceeds from selling securities and equity rights; lifting the limit on funding foreign representative offices of Ukrainian businesses; replacing individual NBU licences with a general cap for certain cross-border payments; abolishing cross-border loan registration and the cap on the cost of funding; and removing restrictions on foreign currency purchases with loan funds.

Financial-sector supervision was strengthened. New legislation, the so-called "split law" adopted in September 2019, divided financial-sector regulation and supervision between the NBU and the National Commission for Securities and Financial Market (NCSFM). In addition to regulating the banking sector, the NBU also became a regulator of the insurance sector, as well as leasing, financial companies, credit unions and pawn shops. The NCSFM will regulate private pension funds and building societies.

The process of harmonisation and integration with the international financial infrastructure has advanced. In May 2019, the Ukrainian market connected to Clearstream, the international central securities depository, a step that enabled settlement of all government bonds denominated in local currency through the international system. This move has improved efficiency, reduced costs for investors and increased demand for Ukrainian government bonds issued on the domestic market. As of 5 August 2019, banks have started to open new customer accounts in line with the International Bank Account Number (IBAN) system, which will harmonise the Ukrainian payment landscape with that of the European and contribute to the further planned upgrade of the NBU's system of electronic payments. In general, the use of the IBAN standard with fewer payment details is intended to simplify the drafting of payment documents. All transfers will use IBAN from 1 November 2019.

Fiscal administration and accountability are being improved. In March 2019, the State Fiscal Service of Ukraine was split into two separate executive bodies: the State Tax Service and the State Customs Service. The main goals of the reorganisation were to create a function-based revenue administration, to increase the transparency and accountability of both institutions and to improve the quality of services. The Ministry of Finance strengthened its supervisory and control functions by implementing a system of reporting requirements and key performance indicators.

Corporate governance reform in SOBs has entered a new phase. A law on improving the functioning of the financial sector, signed by the President in October 2018, enabled the implementation of governance changes in SOBs. Following a competitive selection process, supervisory boards of three state-owned banks (PrivatBank, Ukreximbank and Oschadbank) were appointed in May 2019 and confirmed by the Cabinet of Ministers. However, in line with its legal right and based on the assessments of compliance with the qualification criteria, the NBU rejected a number of candidates for the supervisory boards in Oschadbank and Ukreximbank in August 2019. Vacant positions remain to be filled in the coming months.

Electricity market liberalisation has commenced but is facing obstacles. Liberalisation began on 1 July 2019. Unfortunately, shortly before that date, on 13 June 2019, the Constitutional Court of Ukraine ruled that a number of provisions of the Law "On Sector Regulator (NEURC)" contradict the constitution of Ukraine, and will need to be brought into compliance with the constitution by 1 January 2020. The parliament has launched the process of amending the constitution, but such amendments cannot be approved and enter into force before February 2021, leading to the ambiguity of the status of the NEURC for a period of a few months.

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New legislation has introduced an auction system for "green energy" power plants. The introduction of competitive conditions for building power plants that produce electricity from renewable sources is in line with the international trend of making the process more competitive, controllable and cost-effective. From 2020, auctions will be compulsory for newly developed solar power plants with a capacity of more than 1 MW and wind farms with a capacity of more than 5 MW.

Anti-corruption reforms have experienced a setback. In February 2019, the Constitutional Court of Ukraine declared the Criminal Code article that criminalises illicit enrichment of public officials to be unconstitutional. This is a setback from the previous reform. The effect of the decision was retroactive, effectively dismissing all cases investigated by the National Anti-Corruption Bureau or those that were examined in courts. The norm on liability for illegal enrichment, adopted in 2015, was among the preconditions both for receiving a visa-free regime from the European Union and for the previous programme with the IMF. The President submitted to the parliament a draft law aimed at reinstating the criminal nature of illicit enrichment, in accordance with Ukraine's constitution and the country's international commitments.

UZBEKISTAN

Highlights

- **The economy is growing strongly.** Real gross domestic product (GDP) growth reached 5.1 per cent in 2018 and 5.7 per cent year-on-year in the first three quarters of 2019, and the country has moved towards greater exchange rate flexibility.
- **The government has initiated a large-scale restructuring and privatisation programme.** A total of 29 state-owned enterprises (SOEs) in the energy, chemical, financial and consumer sectors have been selected for privatisation, and major SOEs in the energy and transportation sectors are undergoing reorganisation.
- **Uzbekistan has issued its first Eurobond.** Issued in February 2019, it consists of two tranches of US$ 500 million five-year and US$ 500 million 10-year sovereign bonds. Standard & Poor's (S&P) and Fitch assigned first-time sovereign ratings for Uzbekistan at "BB- Stable" in December 2018, and Moody's assigned it "B1 Stable" in February 2019.

Key priorities for 2020

- **Efforts to restructure and privatise SOEs need to step up.** The newly established State Assets Management Agency should facilitate the improvement of corporate governance practices, transparency and accountability of SOEs and take forward privatisation of identified SOEs in a transparent manner.
- **Price liberalisation should continue.** Following the liberalisation of bread prices and increases in utility tariffs combined with social safety net increases in 2018, it is important to continue price adjustments and to bring energy and water prices closer to cost recovery levels.
- **Banking-sector reform is critical.** State-directed lending still remains prevalent with negative implications for credit intermediation in the economy and effective banking supervision. The state's presence in the sector should be reduced and privatisation of the state-owned banks should be taken forward.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	7.4	6.1	4.5	5.1	5.5
Inflation (average)	8.5	8.8	13.9	17.5	14.6
Government balance/GDP	1.1	1.6	1.8	2.2	0.5
Current account balance/GDP	0.6	0.4	2.5	-7.1	-6.0
Net FDI/GDP [neg. sign = inflows]	-0.1	-2.0	-3.0	-1.2	-3.5
External debt/GDP	16.1	18.6	34.1	34.5	n.a.
Gross reserves/GDP	36.6	39.4	57.5	65.7	n.a.
Credit to private sector/GDP	n.a.	n.a.	n.a.	n.a.	n.a.

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Macroeconomic performance

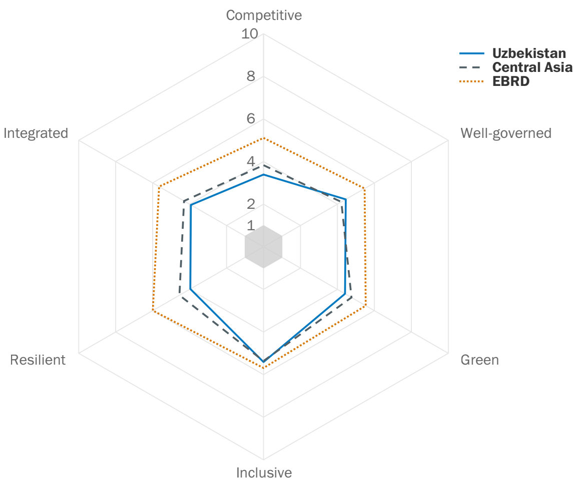
Economic growth remains robust. The economy continued growing steadily in the first three quarters of 2019 at 5.7 per cent year-on-year on the back of strong performance in the industry, construction and services sectors. Exports increased by 45.0 per cent year-on-year in US dollar terms in the first eight months of 2019, and imports by 33.0 per cent, reflecting trade liberalisation policies. Credit expansion remains high at 60.4 per cent year-on-year in August 2019, which has supported the growth of infrastructure investment and surging imports. Average inflation decelerated to 14.1 per cent in the first three quarters of 2019 from 18.9 per cent during the same period in 2018. This mostly stems from the slower growth of food prices, which has compensated for an increase in services inflation. The central bank has kept the policy rate unchanged at 16.0 per cent since September 2018.

The central bank has moved towards greater exchange rate flexibility. As of August 2019, the monetary authorities have removed the 5.0 per cent limit on daily exchange rate fluctuations. In addition, the sale of foreign currency by commercial banks is now allowed for purposes other than business or tourism travel, including in cash form, which was not possible earlier. This is part of a wider set of measures to further liberalise the foreign exchange market. The exchange rate was broadly stable in 2018 and in the first half of 2019, but market pressures intensified in August 2019.

The external position has weakened, but the fiscal deficit is contained. Uzbekistan's current account posted a deficit in 2018 – for the first time since 1999 – of 7.1 per cent GDP in 2018. This was caused by surging capital imports reflecting higher investment in housing and infrastructure to modernise the economy. The overall fiscal deficit, according to the International Monetary Fund's definition which includes policy lending, increased to 2.1 per cent of GDP in 2018 from 1.9 per cent in 2017. Public debt is low at around 20.0 per cent of GDP in 2018.

Real GDP growth is projected to remain stable in the short term. The economy is predicted to grow by 5.5 per cent in 2019 and 5.8 per cent in 2020, driven by further expansion of fixed investment, helped by rapid credit expansion and foreign direct investment (FDI) facilitated by the government's policies. Downside risks include a slowdown in the economies of trading partners and a continued credit surge, which may ignite inflationary pressures.

Assessment of transition qualities (1-10)



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Major structural reform developments

A Reform Roadmap for 2019-21 was adopted in early 2019. The roadmap outlines economic reform goals in five “strategic directions”. These include maintaining macroeconomic stability, strengthening social protection and accelerating market transition, including through the creation of an Economic Council, a consulting platform bringing together the government and local and international experts. FDI and greater private-sector participation via privatisations and public-private partnerships (PPPs) are seen as the main priorities of economic development. In this regard, the new PPP Law, adopted in May 2019 and based on the recommendations of international financial institutions, will be an important step towards increasing the overall attractiveness of investment.

A large-scale privatisation programme has been launched and SOE restructuring is moving forward. Since January 2019 the newly established State Assets Management Agency has been responsible for SOE restructuring, corporatisation and optimisation of state ownership of assets. A presidential decree signed in April 2019 sets out steps for the privatisation of 29 state-owned enterprises (SOEs) in the energy, chemical, financial and consumer sectors. In most cases, the SOEs billed for sale were mid-size, and only partial privatisations were proposed. Controlling (51 per cent or above) stakes were offered in the remaining companies, except for minority shares in three banks, an insurance company and a cement plant. In addition, a presidential decree adopted in January 2019 sets out the framework for preparing the Uzbek Metallurgy Plant, Almalyk and Navoi mining and metallurgy plants, which are potentially very valuable assets, for initial and secondary public offerings in 2022-23. SOEs in energy and transportation are undergoing restructuring, along with the separation of managerial, supervisory and regulatory responsibilities.

Institutional and legal reforms in the energy sector are advancing. In February 2019, a new Ministry of Energy was established as a policy-setting and regulatory body in the oil and gas and power sectors. The overall sector reform will be guided by a new strategy, signed in March 2019, for further development and reform of the energy sector. Among other measures, the strategy envisages the splitting of Uzbekenergo, the vertically integrated state-owned electricity utility, into three separate entities (generation, transmission and distribution). In addition, in July 2019 the government announced measures to unbundle Uzbekneftegas, a state-owned oil and gas company, into gas and oil, pipelines and gas distribution companies. A key advance in the sector includes the adoption of a new electricity tariff methodology in April 2019, which outlines measures to bring tariffs to full cost recovery levels and aims to achieve financial sustainability of electricity companies. The government introduced higher utility tariffs in August 2019.

The pace of banking-sector reform has been slow. Distortions in the banking sector, due to state-directed lending at preferential terms, remain unaddressed. A new concept for financial-sector development, currently under progress, envisages lowering state ownership in banks, reforming the government’s approach to directed lending and developing capital markets. Three banks have been earmarked for privatisation with a proposed sale of a 25 per cent equity stake in each. Amendments to the banking law and central bank law were approved by the parliament in September 2019. The amendments provide greater independence to the central bank operations and improve its supervisory powers, ensure its transparency and accountability and include provisions to ensure better corporate governance in banks.

Tax reforms have advanced. Measures adopted so far in 2019 include the simplification of tax reporting, reductions in several types of taxation, including corporate income tax, and wider applicability of value added tax. A key change was the introduction of a turnover-based taxation for small businesses to operate under the simplified tax regime, replacing headcount-based taxation. This removes the incentive for small firms to limit firm growth beyond a certain size. At the same time, some elements of the original plan have undergone significant changes since June 2018, when the plan was first published, and uncertainty remains as to how exactly the tax reform will be implemented. A revised tax code will come into force in January 2020, instead of December 2018 as originally planned.

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Steps have been taken to further improve fiscal transparency. A presidential resolution signed in August 2018 envisages measures for bringing budget accounting in line with international standards and inclusion of the budget in the Open Budget Index rankings after 2020. The authorities have published medium-term fiscal projections and an assessment of key fiscal risks in the 2019 budget. Another major advance is the publication of a citizen's guide to the budget, which encourages greater public engagement. By the end of 2019, the government plans to bring off-budget expenditure (primarily, the Uzbekistan Fund for Reconstruction and Development) on budget.

Uzbekistan tapped the international bond market with a debut Eurobond placement. Two tranches of a US$ 500 million five-year sovereign bond, yielding 4.75 per cent and a US$ 500 million 10-year sovereign bond yielding 5.375 per cent were successfully placed in February 2019. Uzbekistan received its first sovereign credit ratings "BB- Stable" from S&P and Fitch in December 2018 and a "B1 Stable" from Moody's in February 2019. According to a presidential decree, US$ 889.2 million will be deposited in banks, US$ 20 million will be loaned to Agrobank and US$ 89.9 million will be loaned to the state-owned enterprise Navoi mining and metallurgical complex, a large gold and uranium producer.