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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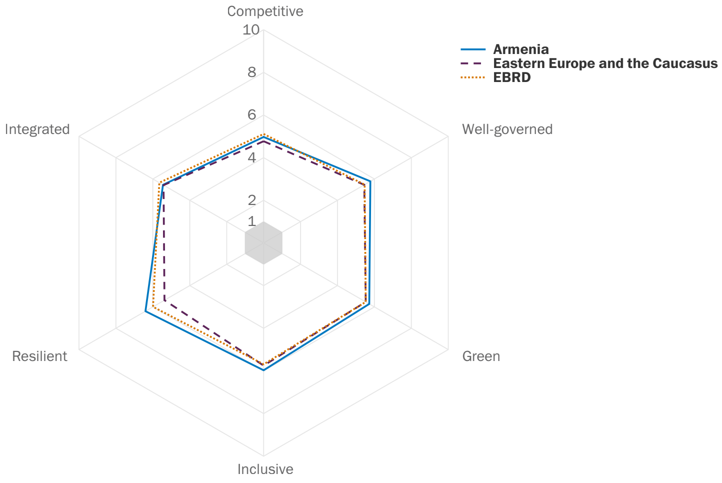
Assessment of transition qualities (1-10)



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

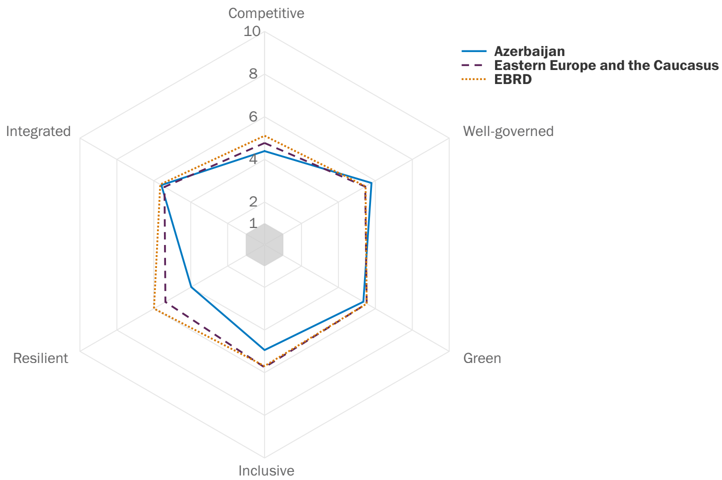
Output growth is gradually strengthening. Following a near-stagnation in 2017, GDP grew by 1.4 per cent in 2018. On the production side, transport, manufacturing, agriculture and retail trade were the main contributors to growth in 2018. Growth was supported by the ongoing expansion of hydrocarbon production 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

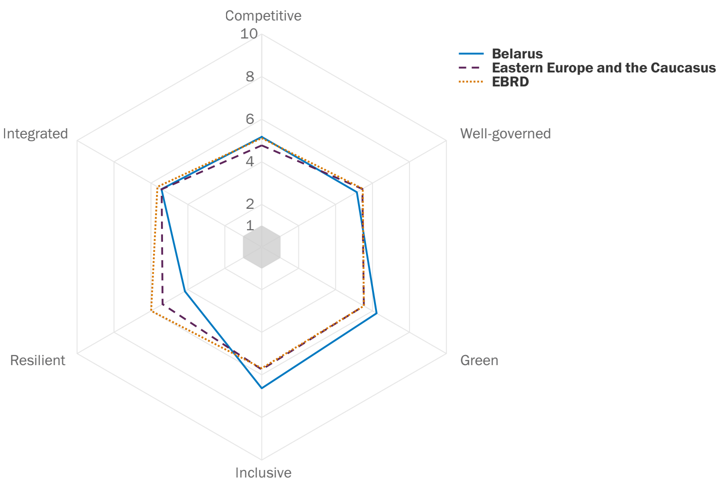
Economic growth accelerated to 3.0 per cent in 2018, driven by domestic demand, but net exports continued to have a negative impact. Household consumption recorded robust growth of 8.3 per cent, benefiting from a strong increase in disposable incomes, while investments in fixed assets increased by 4.9 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.

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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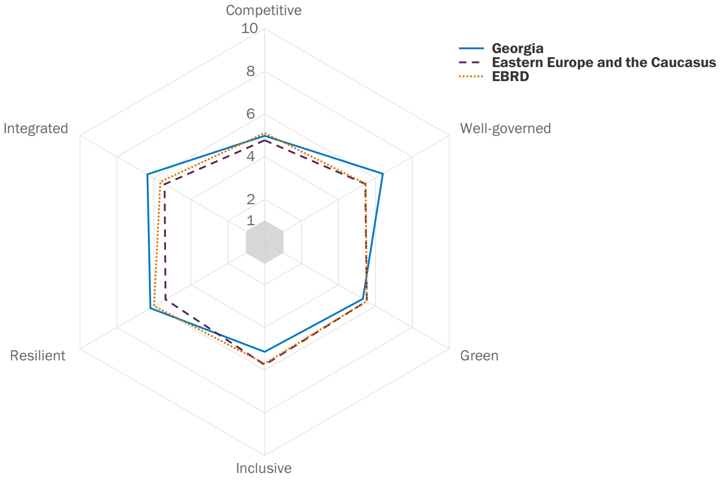
Assessment of transition qualities (1-10)



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.

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

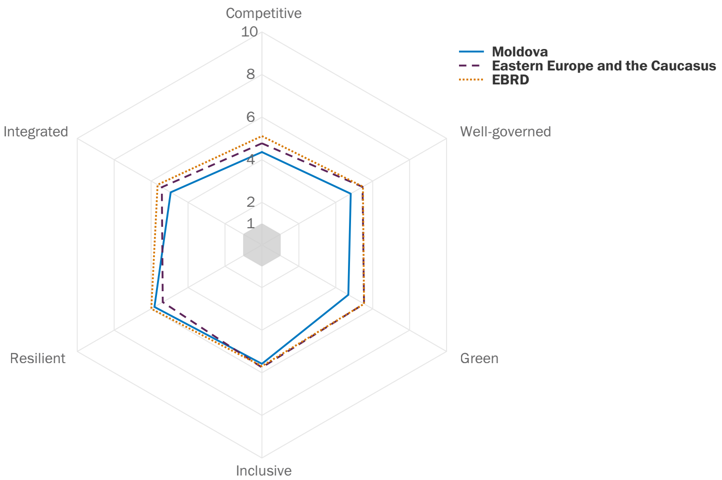
Economic output continued to expand at a solid pace. GDP grew by 4.0 per cent in 2018 and accelerated to 5.2 per cent year-on-year in the first half of 2019. Output expansion in 2018 was driven by a strong increase of investments in fixed assets on the back of construction-sector growth and by household 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 had 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.

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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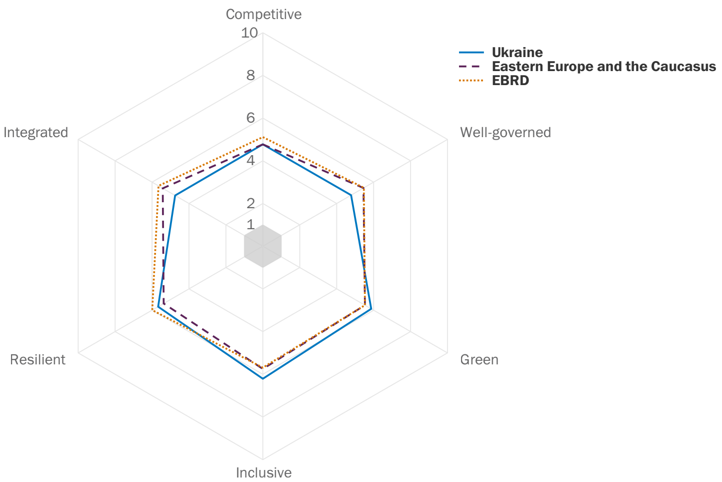
Macroeconomic performance

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.