Regional Economic Prospects in

EBRD Countries of Operations: May 2014[1]

EBRD Office of the Chief Economist

Overview

The Ukraine/Russia crisis weighs on transition region's growth

Since our forecast in January 2014, events in Ukraine/Russia have significantly increased geopolitical and economic uncertainty, with direct negative effects on the economies of Ukraine and Russia and potentially wider implications for the region as a whole. Turkey's outlook has also worsened due to domestic political risks and persistent macroeconomic imbalances. A more positive outlook for the Eurozone, which is benefiting central and south-eastern European countries in particular, will be more than outweighed by increased geopolitical uncertainty for the whole region.

The outlook for growth in the transition region has thus materially deteriorated compared with the January 2014 forecast, dashing hopes that the continuous decline in the region's growth rate since 2011 would be reversed in 2014. Our central scenario foresees growth in the transition region to slow further to 1.4 per cent in 2014 from 2.3 per cent in 2013, and compared with 2.7 per cent in our January forecast. The negative spillovers are expected to be largely contained to the neighbourhood of Russia and Ukraine under our central scenario, though several central and south-eastern European economies will also see some impact. A modest pickup to 1.9 per cent is possible in 2015 provided that the Ukraine/Russia crisis does not escalate.

However, unusually high uncertainty surrounds this forecast with major risks on the downside. Under a less benign scenario including the imposition of financial sanctions in particular, Russia would slip into recession and average growth in the region would grind to a halt in 2014-15.

Regional overview

Since our January forecast, three major developments have reshaped the economic outlook for the transition region. First, events in Ukraine have markedly increased geopolitical uncertainty and economic risks for the region, though these risks have thus far been contained to a few neighbouring countries. Russia’s already weak growth outlook has suffered a blow as a result of the tensions. Second, pressures from the tapering of the quantitative easing (QE) in the United States on market interest rates and capital flows into the emerging markets have eased at least for now. Third, recovery in the Eurozone has gained some momentum and even crisis-hit periphery countries have managed to issue new debt in international markets. On

[1] This document is provided as a companion to the EBRD’s growth forecasts for its countries of operations, which are released four times a year. For more comprehensive coverage of economic policies and structural changes, the reader is referred to the EBRD’s Transition Report 2013 as well as country strategies and updates and statistical series on economic and structural reform variables, which are all available on the EBRD’s website (www.ebrd.com).

balance, however, for the region as a whole the positive impact of the latter two developments will likely be overshadowed by the unfolding crisis in Ukraine.

- **Events in Ukraine have raised uncertainty in the region and increased market volatility**. As the situation in Crimea escalated in late February/early March, **Russian** equity markets plunged by 10 per cent in a single day and downward pressure on the rouble intensified, despite a 150 basis point interest rate hike by the Central Bank of Russia (CBR) on 3 March 2014. In the first quarter of 2014 growth in Russia is estimated to have decelerated to below one per cent year-on-year and net private capital outflows reached the amount of total outflows of the whole year of 2013. The Ministry of Finance has had to cancel three government bond auctions in a row due to lack of demand and the CBR hiked rates again in late April. Syndicated loans were 70 percent lower for Russia (year-on-year, adjusting for Rosneft's acquisition loan in the first quarter of last year) and major global banks started deleveraging. In **Ukraine**, the currency plunged by 28 per cent between January and early May and CDS spreads have widened by around 400 basis points. The announcement of a staff-level agreement on an IMF programme lifted market sentiment in late March but subsequent news from eastern Ukraine has unsettled markets again, with CDS spreads over 1,200 basis points. Global market volatility also spiked around the time of the referendum in Crimea (Chart 1).

- **Pressures on emerging markets stemming from QE tapering in the US have reduced recently, following significant volatility in May-December 2013**. Interest rates and emerging market currencies have stabilized in the first four months of 2014, despite the fact that QE monthly purchases have been reduced. Moderating pressures reflect expectations of a slower tightening of monetary policy in advanced markets and better policy communication. In addition, emerging markets also stand to benefit from faster export market growth associated with higher growth in advanced economies that had prompted the QE tapering in the first place. Larger buffers and stronger policy frameworks have also helped cushion emerging markets from market volatility. There is now also an expectation that long-term interest rates will stay lower longer due to generally suppressed post-crisis demand conditions ("secular stagnation").

- **The recovery in the Eurozone is taking hold** (Chart 2). The single currency area grew at the rate of 0.3 per cent in the last quarter of 2013 (1.2 per cent in annualised terms) and Greece and Portugal were able to access international debt markets at reasonably favourable rates. Purchasing managers indices and indicators of consumer and business confidence suggest further strengthening of economic performance in the first half of 2014. Recovery gained momentum in advanced countries more broadly, including in the United States, the United Kingdom and Japan. By contrast, China's growth decelerated somewhat in the first quarter of 2014 to 7.4 per cent, and is widely expected to remain around this level for the remainder of the year.

Recovery in the Eurozone is particularly benefitting countries which have the closest links to it – central Europe and the Baltics (CEB) and south-eastern Europe (SEE). Growth in the last quarter of 2013 in these regions was stronger than initially estimated, particularly in Poland, and even Slovenia returned to positive

growth in that quarter. However, serious energy security concerns have arisen in many countries in view of the dependence on energy sources (primarily gas but also oil) from Russia (Chart 3) and other signs of contagion such as reduced access to finance for firms with financial linkages to Russian entities.

Growth in the Eastern Europe and the Caucasus (EEC) region accelerated towards the end-2013, but the outlook has worsened considerably in early 2014 amidst tensions in Ukraine. A growth pick-up in the last quarter of 2013 was in part driven by a good harvest season. At the same time, this strong growth in agriculture was not sufficient to compensate for the general slowdown in many other sectors during the year as well as weak investment activity. The region is at risk of direct material impact from the Ukraine/Russia crisis. Intensifying trade linkages with the EU in the context of the Association Agreements, including Deep and Comprehensive Free Trade Agreements (AA/DCFTA) expected to be signed by Moldova and Georgia by June 2014 should help redirect exports over the medium term.

Growth has so far remained strong in Central Asia. Large new mining and hydrocarbon extraction projects contributed to growth in Kazakhstan, Mongolia and Turkmenistan. Remittances from Russia to the Kyrgyz Republic, Tajikistan and Uzbekistan continued to grow, notwithstanding Russia's slowdown, providing an important source of external financing and consumer demand. However, a further lowering of Russian growth would affect several of these countries negatively.

Despite political uncertainty and global shifts in sentiment last summer, Turkey's economy expanded by 4 per cent in 2013, somewhat more than expected. Growth was primarily driven by private consumption and inventories, whereas net exports have been a drag, pushing the current account deficit to 7.9 percent of GDP, one of the highest on recent record. Meanwhile, average annual inflation reached 7.7 per cent in March 2014, remaining above the central bank's target of 5 per cent for the third consecutive year.

Recovery in the South-eastern Mediterranean (SEMED) has been slow due to a combination of domestic and external shocks. Protracted political transition and volatile security conditions have weighed on economic activity in Egypt and, until recently, Tunisia. However, Tunisia has seen significant progress in political transition in recent months, with expected positive spillovers onto the economy going forward. Regional turmoil continues to adversely affect Jordan's economy and strain the country's public services. At the same time, growth in Morocco accelerated markedly in 2013 reflecting a strong harvest, and increased FDI thanks to a relatively more favourable policy environment. Improvements in the Eurozone should provide support for export, tourism and remittance flows to Morocco and Tunisia, which are closely linked to the economies in the southern part of the monetary zone.

Capital flows and currency movements

Private capital flows to the transition region as a whole have remained relatively low. While the aggregate flows recovered somewhat in the fourth quarter of the year compared with the low of the third quarter, they remain modest, as FDI inflows into SEE and CEB have been partly offset by the impact of cross-border deleveraging and capital outflows from Russia. The latter accelerated further in the first quarter of 2014 (Chart 4).

Several currencies and stock markets in the region have experienced downward pressures (Chart 5). The Ukrainian Hryvnia depreciated by around 28 per cent against the US dollar in the first four months of the year, and the Russian rouble depreciated by 9 per cent against the policy basket of US dollar and euro over the same period. Depreciation in Russia led to increasing expectations of downward exchange rate movements in some of the neighbouring countries, where residents increased purchases of foreign currency. In response to these pressures, in early February the National Bank of Kazakhstan made a one-off downward adjustment to the tenge's tightly managed exchange rate against the US dollar resulting in a devaluation of around 16 per cent. The Kyrgyz som subsequently also weakened against the US dollar. Mongolia's currency continued depreciating as the economy faced an adverse terms of trade shock and uncertainty regarding major mining projects.

The pressure on a number of regional currencies thus has mainly reflected country-specific factors and increased geopolitical uncertainty in the region. In contrast, emerging market currencies in Asia, Latin America and the Middle East regions have tended to appreciate slightly over the same period, (with the notable exception of Argentina), as tapering-related pressures on emerging markets eased. This contrasts with the trends of the second half of 2013 when emerging markets in Europe and Central Asia generally performed better than emerging market peers elsewhere, as discussed in the November 2013 *Regional Economic Prospects* (see also Chart 5).

Credit conditions

Cross-border deleveraging in the region continued. Sustained deleveraging is delaying the resumption of credit growth, particularly in CEB and SEE. While credit surveys indicate a growing demand for loans, local and international funding conditions continued to tighten. However, the pace of tightening slowed, compared with the third quarter of 2013, as concerns about the impact of QE tapering on domestic markets subsided and a number of policy rate cuts in the region took effect. Credit standards were tightened further across all loan categories, except for business loans.

In addition, an overhang of non-performing loans (NPLs) continues to hold back the recovery. NPL ratios continued rising in Hungary, Slovenia, and most SEE countries. All these countries and Ukraine now have NPL ratios close to or above 20 per cent. In Kazakhstan, the NPL ratio persistently exceeds 30 per cent, notwithstanding a slight decline recently. Completion of asset quality reviews in several CEB countries may lead to further revisions of NPL estimates and NPLs in Ukraine may rise significantly in the aftermath of the crisis.

Inflation

In line with global trends, inflation rates continued to decline in most countries. Lower inflation reflects weaker demand pressures against the background of slower growth in emerging markets, high unemployment in advanced economies and lower prices of agricultural and energy commodities, as the commodity supercycle appears to be over (though energy price volatility is possible around the Ukraine/Russia events). Administrative reductions in utility tariffs in a number of countries also

contributed to lower inflation. In Egypt and Mongolia, however, inflation rates remained high and rising, and inflation in Russia and Turkey remains above the central bank's target range. Ukraine will see a temporary spike in inflation due primarily to pass-through of currency devaluations.

Outlook

Forecasting uncertainty for the EBRD region is unusually high at the current juncture due to the Ukraine/Russia crisis.

In our baseline scenario, growth in the transition region slows down to 1.4 per cent in 2014 from 2.3 per cent in 2013, instead of rising to 2.7 per cent as foreseen in our January forecast, mainly on account of expected slowdown in Russia and Ukraine with spillovers primarily to neighbouring countries as well as a deceleration in Turkey (see Chart 6 and Table). Growth is then expected to edge up to only 1.9 per cent in 2015.

Ukraine's economy is expected to undergo a major, though gradual, adjustment with significant short-term output costs. External and fiscal imbalances would be gradually reduced with the support of an IMF programme, complemented by assistance from multilateral and bilateral donors and IFIs. Under this baseline scenario, necessary structural reforms would be implemented on schedule and a systemic banking crisis would be averted, though fiscal costs of bank recapitalisation may turn out to be significant. However, ongoing disruptions related to developments in eastern Ukraine will weigh on growth even without any further escalation. Under these assumptions, GDP would contract by about 7 per cent in 2014 and growth would stagnate in 2015.

In Russia, the already weak growth outlook has materially worsened since February/early March. Investor confidence, which had been already feeble, has been hit by the events in Ukraine/Russia. It may suffer further, resulting in continued, and possibly stronger, capital flight, lower investment and hence lower growth, despite some limited use of the resources from the National Welfare Fund and quasi-fiscal operations of state-owned entities to support investment. Stubbornly high inflation and pressure on the rouble may limit the scope for monetary easing while fiscal policy response is constrained by the current level of oil prices as well as apparent supply-side bottle-necks. Growth is expected to come to a halt in 2014 and remain below 1 per cent in 2015.

Increased uncertainty will have a clear negative impact on the region, though with significant country differences:

- The growth outlook for the **CEB** region was expected to improve significantly on account of a stronger recovery in the Eurozone as well as improving domestic demand, but the Ukraine/Russia events are dampening growth rates to a certain extent. Private investment has recovered in several countries, lifting growth which has suffered following the financial crisis. Slovenia has by now emerged from its recession, yet as corporate deleveraging and bank restructuring continue to unfold, economic growth is unlikely to resume with much momentum for the time being. As elsewhere in the Eurozone periphery, risk spreads on bond issuance have been compressed thus far, allowing the

government to meet much of this year's funding needs. Croatia in contrast will continue to remain in recession (growth of -0.5 per cent in 2014) on the basis of depressed investment and credit. Croatia is the only country in the transition region, other than crisis-hit Ukraine, that continues to remain in recession. At the same time, the three Baltic states' trade and investment linkages to Russia and Ukraine are significant, and financial contagion in the form of reduced access of funding to firms with contacts to Russian businesses – possibly out of fear of Iran-type financial sanctions – may deepen. Several central European countries are also dependent on Russia's gas and oil (Chart 3). Greater risk aversion in bank and bond market funding is more likely to present a downside risk to growth this year.

- Recovery in **SEE** will continue but growth rates will remain modest. Growth in Serbia has been revised down on the likelihood of significant spending cuts by the government to be formed after the March 16 elections. Serbia also has important trade and investment links with Russia, which raises further uncertainties in the present climate, while tourist numbers in Bulgaria and Montenegro may also be adversely affected by a downturn in the Russian economy.
- Growth in **EEC** (excluding Ukraine) is likely to be lower than previously projected on account of lower remittance from Russia, lower demand for exports in the subregion and increased uncertainty.
- A number of large natural resource projects will continue underpinning relatively strong growth in **Central Asia**. At the same time, slower expected growth of remittances from Russia and Russia's weaker export demand will constrain growth, in particular in lower-income countries.
- Since the beginning of the year the risk premium facing **Turkey** has increased, in part reflecting high political uncertainty, and the higher cost of finance is expected to weigh on domestic demand and growth. In addition, export demand and tourism income may be somewhat constrained by the events in Ukraine. As a result, growth in 2014 is now expected at 2.5 per cent, down from a January forecast of 3.3 per cent.
- The **SEMED** region is less directly dependent on the situation in Ukraine and Russia and is likely to grow somewhat faster in 2014. Growth is expected to accelerate to a still modest 3.0 per cent in 2014 but is subject to a high degree of uncertainty as all countries in the region remain vulnerable to external shocks. A direct channel of potential transmission from Ukraine is lower grain and wheat exports to the region, especially to Egypt, which could face a higher import bill.

The global external environment is expected to continue to improve slowly but will remain challenging. The projections assume weak growth in the Eurozone. The stronger outlook for the United States and Japan will be partly offset by increased economic volatility in the emerging markets generally and a slower growth in China. In addition, if the Eurozone-wide stress tests reveal significant recapitalisation needs of major banking groups operating in the CEB and SEE countries, cross-border bank deleveraging pressures in the region may again intensify. QE tapering in the US will continue to impact countries with large external current account and fiscal vulnerabilities.

Risks to the outlook

The risks to the economic outlook are concentrated on the downside:

- Escalation of the crisis and/or a disorderly adjustment of Ukraine's economy could have significant negative impact on investor confidence, growth, trade and possibly energy and food security in the region. In particular, many countries in CEB, SEE and EEC rely heavily on imports of Russian gas (Chart 3).

- Heightened tensions and economic difficulties in Ukraine are likely to be associated with intensified capital flight from Russia, leading to a sharp drop in investment. Lower demand from Russia will impact negatively countries that have close trade and financial links with it.

- A lower growth of remittances will particularly affect Tajikistan, the Kyrgyz Republic, Moldova and Armenia.

- Heightened geopolitical uncertainty may lead to temporary oil price spikes. Currencies in a number of countries in EEC and Central Asia may come under stronger pressure in case of a significant depreciation in Russia coupled with the devaluation in Kazakhstan in February.

Under a more negative scenario, Russian economy would enter recession and output contraction in Ukraine would deepen. Coupled with increased risk aversion in global markets, this would bring growth in the EBRD region to a standstill (Chart 6). At this point, the Russia/Ukraine crisis would start impacting the global economy.

Real GDP Growth

(In per cent; EBRD forecasts as of 7 May 2014)

	Official estimate	Current forecast		EBRD Forecast in January 2014	
	2013	2014	2015	2014	Change January-May
Central Europe and the Baltic states					
Croatia	-1.0	-0.5	0.5	1.0	-1.5
Estonia	0.8	2.0	3.1	2.8	-0.8
Hungary	1.1	1.6	1.2	1.7	-0.1
Latvia	4.1	3.8	3.9	4.1	-0.3
Lithuania	3.3	3.0	3.4	3.3	-0.3
Poland	1.6	2.8	2.8	2.7	0.1
Slovak Republic	0.9	2.0	2.3	2.0	0.0
Slovenia	-1.1	0.0	1.0	-2.0	2.0
Average [1, 2]	**1.3**	**2.2**	**2.3**	**2.2**	**0.0**
South-eastern Europe					
Albania	0.4	1.7	2.0	1.7	0.0
Bosnia and Herzegovina	2.1	1.8	2.0	1.8	0.0
Bulgaria	0.9	1.9	2.0	1.8	0.1
FYR Macedonia	3.1	3.0	2.5	3.0	0.0
Kosovo	2.5	3.5	3.5	3.5	0.0
Montenegro	3.5	3.0	2.5	2.0	1.0
Romania	3.5	2.6	2.8	2.4	0.2
Serbia	2.5	1.0	1.0	1.3	-0.3
Average [1]	**2.7**	**2.2**	**2.4**	**2.1**	**0.1**
Eastern Europe and the Caucasus					
Armenia	3.5	3.0	3.5	3.5	-0.5
Azerbaijan	5.8	3.5	3.0	3.5	0.0
Belarus	0.9	0.0	0.5	1.0	-1.0
Georgia	3.2	4.0	4.0	4.5	-0.5
Moldova	8.9	2.0	4.0	3.5	-1.5
Ukraine	0.0	-7.0	0.0	1.5	-8.5
Average [1]	**1.8**	**-2.6**	**1.0**	**2.0**	**-4.6**
Turkey	4.0	2.5	3.2	3.3	-0.8
Russia	1.3	0.0	0.6	2.5	-2.5
Central Asia					
Kazakhstan	6.0	5.0	5.1	5.5	-0.5
Kyrgyz Republic	10.5	4.5	4.8	5.0	-0.5
Mongolia	11.7	12.5	8.7	14.0	-1.5
Tajikistan	7.4	4.4	4.4	5.0	-0.6
Turkmenistan	10.2	10.0	10.0	10.2	-0.2
Uzbekistan	8.0	7.5	7.6	7.0	0.5
Average [1]	**7.1**	**6.2**	**6.1**	**6.5**	**-0.3**
Average EBRD region (excl. SEMED) [1]	**2.3**	**1.3**	**1.9**	**2.8**	**-1.5**
Southern and Eastern Mediterranean					
Egypt	2.2	2.5	3.0	2.5	0.0
Jordan	2.8	3.4	4.1	3.4	0.0
Morocco	4.3	4.2	5.0	4.0	0.2
Tunisia	2.7	3.4	4.7	3.8	-0.4
Average [1, 3]	**2.8**	**3.0**	**3.7**	**3.0**	**0.0**
Average EBRD region (incl. SEMED) [1]	**2.3**	**1.4**	**1.9**	**2.7**	**-1.3**

[1] Weighted averages. The weights used for the growth rates are WEO estimates of nominal dollar-GDP for 2012.

[2] Weighted averages do not include the Czech Republic, for which EBRD no longer produces a forecast.

[3] As of January 2014, EBRD figures and forecasts for Egypt's real GDP reflect the fiscal year, which runs from July to June.

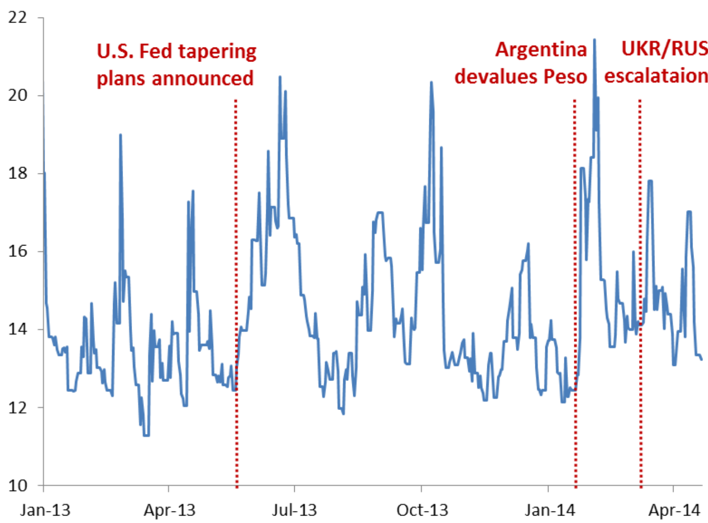


Chart 1. Market Volatility Index (VIX)

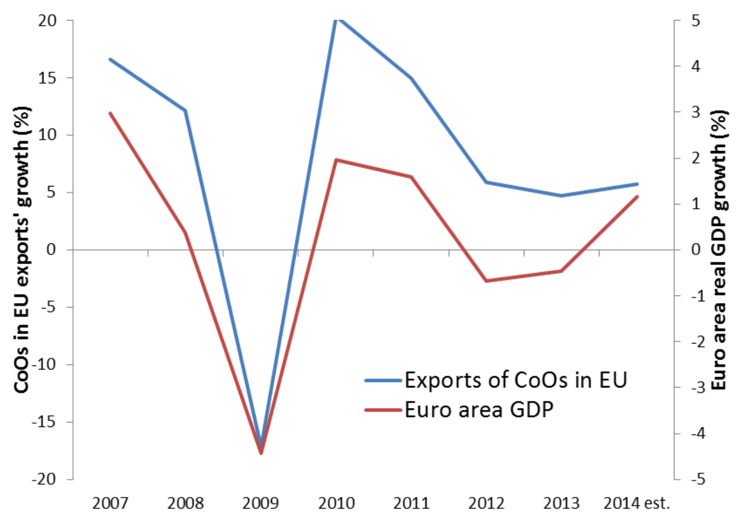


Chart 2: Euro area growth and exports of EU CoOs (%)

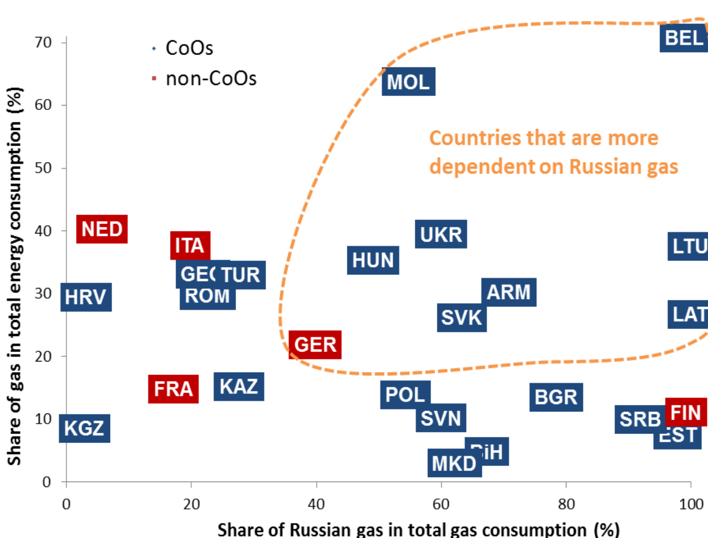


Chart 3. Role of Russian gas in selected countries

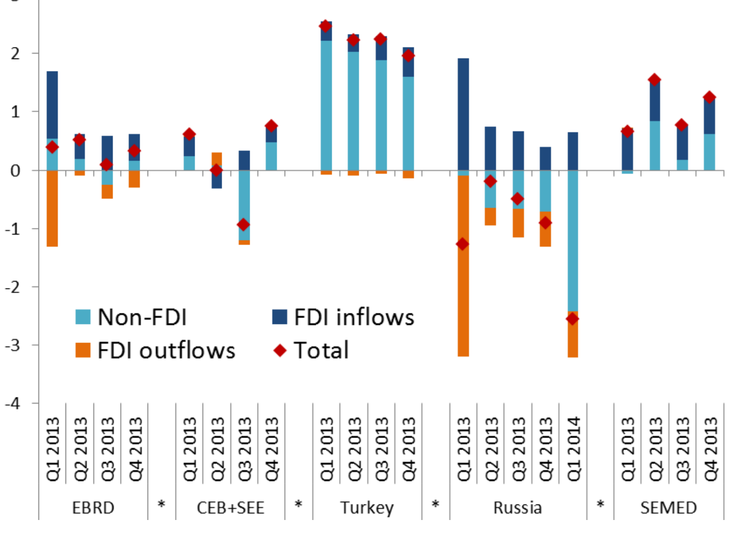


Chart 4. Private capital flows (% of 2013 GDP)

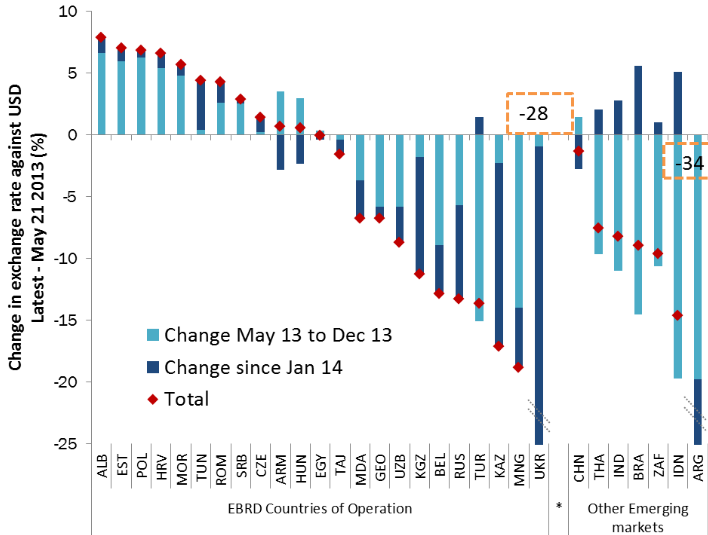


Chart 5. Currencies in the EBRD region and other EM

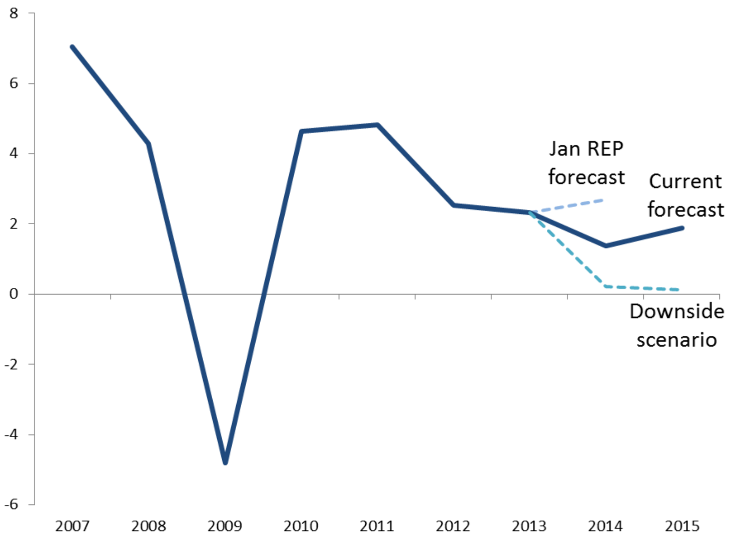


Chart 6. EBRD region GDP growth (%)

Central Europe and the Baltic States (CEB)

Growth rates in the CEB region have continued to gain momentum since the second half of 2013, primarily on the back of rebounding demand from the Eurozone. Due to falling unemployment, historically low inflation rates and increasing real wages in most countries, private consumption is expected to pick-up gradually. A key positive development is the incipient recovery in private investment, which reinforces public investment trends as countries transition into the new period for the disbursement of EU structural funds. We now expect a recovery in average growth for the eight countries of the central Europe region to 2.3 per cent, close but still below the growth rate observed in 2010. Nevertheless, growth in *potential* output, the level of real GDP that does not trigger overheating, will continue to lag, given the diminished growth in the real capital stock, and continued adverse financing conditions for companies. International financing conditions for the public sector have been remarkably supportive, so that countries are on the whole well prepared for a change in US monetary policy and the expected change in capital market conditions. With the notable exception of the three Baltic countries direct exposures through trade and investment to Russia and Ukraine are modest. Still, regional security concerns are beginning to impact financing conditions of companies, in particular at long maturities, and may dampen confidence of local and foreign investors.

- **Poland's** recovery continues to accelerate, following last year's expansion by 1.6 per cent. Labour market developments in the first quarter point to very strong growth in real wages, and a further expansion in employment. This should continue to support a more balanced expansion that benefits to a considerable degree from private consumption. Improving external demand has also led to a pick-up in industrial production that is set to underpin private investment, as credit conditions improve further. In a similar vein, currently low public investment is set to recover as the government has started disbursing the roughly €106 billion of EU structural funds that are foreseen to fund infrastructure and R&D projects during the 2014-20 EU financial funding framework. Our projections are upgraded to 2.8 per cent this year and next. While the direct exposure through trade to either Russia or Ukraine remains relatively small, downside risks could materialise in terms of more adverse financing conditions for enterprises.

- Having suffered a second recession in 2012, **Hungary**'s economy rebounded last year with growth of 1.1 per cent. A surprisingly brisk expansion of 2.7 per cent in annual terms in the fourth quarter was mainly driven by domestic demand. Still, one-off factors such as the administratively decreed reduction in utility tariffs or the final disbursement of EU grant funds explain much of this. Total credit continued a contraction that began in 2009. Credit in local currency turned positive in September last year on the back of the central bank's *Funding for Growth* scheme. The second phase of this programme has begun only slowly, and is unlikely to overcome the underlying lack of investment demand. Even though medium-term growth potential remains much diminished, the recovery in domestic demand can give some impetus in the short term. On balance, we downgrade our projections to 1.6 per cent this year and 1.2 per cent in 2015.

- After a significant slowdown in 2013, GDP growth in the **Slovak Republic** is expected to pick up markedly as domestic demand recovers. Last year, gross investment continued to contract, falling by 4.3 per cent. Private consumption has remained subdued due to persistent high unemployment (13.9 per cent in February), even though consumer confidence has steadily improved since the second half of 2013, along with retail trade data. Industrial production (excluding construction) has been relatively strong since the end of the last year, boosted by robust results for manufacturing, primarily stimulated by recovery in demand from Germany and the pick-up in domestic demand. We have upgraded our forecasts for growth to 2 per cent this year and 2.3 per cent next year.
- Last year, growth in the **Lithuania and Latvia** again stood out in the European context, at 3.3 and 4.1 per cent respectively, while growth in **Estonia** slowed down on account of weaker export performance. Private consumption was one of the main growth drivers in all three economies, though only in Lithuania gross investments positively contributed to growth. Going forward, private investments should continue to support growth, given increasing demand from the Eurozone and recovering business sentiment, in particular in Latvia where the recent euro adoption has reduced investors' risk perceptions. Private consumption is expected to continue to revive, amid moderate inflation rates and higher real wages in these economies. In contrast to the other CEB countries, the immediate developments in economic performance of all three Baltic States are more directly exposed to trade with Russia to which Lithuania, for instance, sells about 20 per cent of its exports (13 per cent of GDP).
- The year 2013 saw a continuation of the recession in **Croatia**, with real GDP dropping by 1 per cent. The economy continues to face long-standing problems of competitiveness, a large public sector and difficulties in the business environment. Credit growth has been minimal and the level of NPLs has risen above 15 per cent of total loans. In January 2014, Croatia entered the EU's excessive deficit procedure because of persistent government deficits above 3 per cent of GDP and a rising level of public debt that is now close to 60 per cent of GDP. In the absence of any obvious growth drivers, GDP growth may once again be negative this year at around -0.5 per cent, but the recovery is expected to begin in 2015 on the back of an improved external environment and the absorption of some EU structural and cohesion funds.
- In **Slovenia** the year-on-year growth rate turned positive in the last quarter of 2013, after two years of recession, although the economy contracted by 1.1 per cent overall in 2013. The major culprit behind the negative growth was the depressed domestic demand, which stem from the rising unemployment, decline in real wages, high cost of finance, and firms' limited access to capital and credit. If sustained, the recapitalization and restructuring of banking and corporate sectors, which commenced following the asset quality review and stress tests in December, will prove a turning point for Slovenian reforms and growth. Although it may weigh down on employment and domestic demand, suppressing growth in the second half of 2014 and in 2015, it will also provide much better grounds for sustainable growth in the medium to long run. So far, the credible progress in reforms has boosted the confidence of the market and led to a fall in the country risk premium and the costs of sovereign financing.

It is critical to persevere with the necessary reforms that have been underway during the past year. Alongside rising export demand from the euro zone this will partly compensate the above-mentioned temporary negative effect of restructuring, keeping the economic activity still in 2014 and pushing the growth up to 1.0 per cent in 2015.

South-Eastern Europe (SEE)

The year 2013 saw a pickup in growth in SEE to 2.7 per cent, relative to 0.2 per cent in 2012. Growth was driven by several factors, notably by a sizable increase in exports in most countries and a good harvest. However, domestic demand remains subdued and foreign direct investment flows continue to lag well behind levels seen in the pre-crisis years. Several countries in the region face big fiscal challenges, as the combination of weak growth and the failure to rein in public expenditure to accompany fiscal tightening on the revenue side, has led to rising fiscal deficits and public debt levels. In the financial sector, deleveraging pressures persist and the level of non-performing loans is close to, or has exceeded, 20 per cent of total loans in several cases. Inflation is low in all countries, helped by the drop in regional and food prices, although an uptick in global agricultural prices is apparent in recent months and could cause a renewal of inflationary pressures in the immediate future. Progress in deeper structural reforms has been limited in the past year, and there have been regressive steps in some crucial areas such as energy sector reform.

- **Albania's** economic growth was minimal in 2013, reflecting a combination of weak domestic demand and corporate balance sheets, as well as difficulties in neighbouring EU countries (Italy and Greece) which have contributed to a sharp drop in remittances in the past year. Public debt has risen to 70 per cent of GDP and financial sector vulnerabilities are evident with NPLs of around 23 per cent of total loans. The government has signed a new agreement with the IMF and, with the support from the World Bank, has started to clear public arrears to companies, which had surged to more than 5 per cent of GDP. This should help to alleviate the problems of high NPLs and weak credit growth, thus contributing to a modest upturn in growth in 2014 and 2015.

- **Bosnia and Herzegovina's** economy emerged from recession with mild GDP growth of 2.1 per cent in 2013, mainly due to some improvements in exports. However, gross fixed capital formation in the last two years has been almost non-existent, and remittances are far behind their pre-crisis level. Moreover, an unfavourable political stalemate has held back necessary structural reforms. The authorities remain committed to reforms agreed under the IMF Stand-By Arrangement, approved in September 2012 and recently extended into 2015. Growth is expected to remain around 2 per cent this year and next mainly on the back of some big infrastructure investments and a further improvement in exports, but downside risks, both internal and external, remain considerable.

- The economy in **Bulgaria** grew modestly at just under one per cent in 2013. Export performance improved but weak internal demand and minimal credit growth are holding back domestic consumption and investment. The combination of subdued domestic demand and a series of electricity tariff cuts has led to a negative inflation rate in recent months. Bulgaria's fiscal position remains strong. Growth is expected to slightly pick up this year to around 2.0

per cent, driven by continual improvement of exports and some recovery in domestic private consumption.

- Economic performance has considerably improved in **FYR Macedonia** in 2013. Output grew by 3.1 per cent driven primarily by a strong rise in investment. The country continues to make strong effort to attract much-needed FDI, and these efforts should maintain positive growth prospects in the coming years and enable FYR Macedonia to reap the benefits of sustained macroeconomic stability and business environment reforms that have been pursued in recent years.
- Economic growth in **Kosovo** in 2013 continued to be high, at an estimated 2.5 per cent, but the country also remains the poorest in SEE, with unemployment and poverty at elevated levels. The macroeconomic environment is stable, with low inflation and fiscal deficit and modest levels of public debt. The economy is expected to grow at 3.5 per cent in the coming years supported by strong remittance inflows and a pick-up in external demand.
- In **Montenegro**, economic activity picked up in 2013 on the back of strong growth in electricity production and a good tourism season. However, the current account deficit at 15 per cent of GDP remains the highest in the region. In addition, the fiscal position has been weakened by the activation of state loan guarantees related to aluminium company, KAP, which raised the budget deficit. Consequently, the public debt has further risen, and now it stands just below 60 per cent, a 10 percentage point increase relative to 2011. Growth in 2014 is forecast at 3.0 per cent, on account of the improvements in external demand, as well as the progress in several major infrastructure projects, but downside risks remain large.
- Economic activity in **Romania** has improved in 2013 above market expectations. GDP rose by 3.5 per cent mainly on account of a strong export performance and an exceptional harvest. Inflation returned to the central bank's target range of 2-4 per cent and has recently dropped below the lower band. Fiscal performance has also been good and the country exited the European Union's excessive deficit procedure in 2013. Growth is expected to be around 2.6 per cent in 2014, slightly rising in 2015, driven by exports and a pick-up in domestic demand. However, the high level of NPLs (over 20 per cent of total loans), ongoing cross-border deleveraging and increased uncertainties in the neighbouring Ukraine, may weigh down on growth prospects in the near term.
- **Serbia's** economy grew by 2.5 per cent in 2013 on the back of a strong harvest and a major jump in exports, much of them related to the car industry. Inflation has fallen significantly in recent months and the March 2014 rate was below the central bank's target zone of 2.5 - 5.5 per cent. However, the country has major fiscal problems, with a large government deficit (above 7 per cent of GDP on a broad definition of the general government deficit) and public debt above 60 per cent of GDP. NPLs are around 20 per cent of total loans and also constitute a significant vulnerability for the banking sector and the economy as a whole. Fiscal tightening is now essential and will constrain growth in the next two years, but exports will continue to be the main growth driver in 2014. Growth is expected to drop to 1 per cent in 2014 and 2015, and

it can slow further down under the downside scenario of negative external developments.

Turkey

Economic activity in **Turkey** picked up in 2013, following a sharp slowdown in 2012. Despite political uncertainty and global shifts in sentiment during the summer, the economy expanded by 4 per cent in 2013, somewhat more than expected. The growth was primarily driven by private consumption and the build-up of inventories, whereas net exports have been a drag, pushing the current account deficit to 7.9 percent of GDP.

The country risk premium and thus the cost of finance shot up in the first quarter of 2014 due to elevated political uncertainty, Federal Reserve's tapering, and necessary monetary tightening. As a result, lira depreciated around 10 per cent in the three months by mid-March. Since then, however, following the local elections and Federal Reserve's dovish messages, most of the rise in the country risk premium has been erased, lira appreciated by around 4 per cent, and the exchange rate stabilised. Meanwhile, average annual inflation reached 9.4 per cent in April 2014, remaining above the central bank's target of 5 per cent for the third consecutive year, and is expected to remain elevated above the target in 2014 at an average of 8.5 per cent, driven by tax hikes and currency depreciation passing through to inflation, and less favourable base effects of food and energy prices. The usually persistent core inflation reached a multi-year high of 9.3 per cent in March, posing a risk to de-anchor inflationary expectations.

The inflationary pressures will likely keep interest rates, and thus the cost of finance, high throughout 2014. The higher cost of finance, alongside the introduction of legislation curtailing credit card spending, is expected to constrain private consumption and investment activity, and weigh on growth in 2014. Although net exports may benefit from the recent depreciation and constrained consumption, the growth in 2014 is expected to moderate to 2.5 per cent. We expect growth to recover somewhat in 2015 to 3.2 per cent on the back of favourable base effect, opening up the space for monetary easing, and somewhat elevated business and consumer confidence resulting in higher contribution of consumption and investment.

The major downside risk is that Fed's tapering weighs on the flow of foreign funds to the emerging markets more than expected, where Turkey might take the brunt of the drain in short term capital flows, with its still large external imbalances mainly financed through this channel. But on a positive side, the economy proved resilient to unfavourable circumstances in 2013, with still positive net portfolio inflows, and continuing access to international markets for both public and private sectors, albeit with higher interest rates. Besides, banking sector remains well-capitalized and non-performing loans are low.

While we don't expect large impact of the Russia/Ukraine crisis on growth outlook in Turkey, a further deepening of the crisis, especially if it pushes up the price of oil, would pose a downside risk.

Eastern Europe and the Caucasus (EEC)

Growth in the region accelerated towards the end-2013, but underlying weakness remained. Growth pick-up in the last quarter of 2013 was in part driven by the good harvest season. This late-2013 acceleration, however, was not enough to compensate for general slowdown in most economies outside agriculture during the year, reflected in weaker annual growth rates. Investment activity and FDI inflows remained subdued across the region, while consumer spending growth moderated. In 2014, crisis in Ukraine, substantial slowdown in Russia and rapidly increasing geopolitical risks in the region and enhanced probability of negative cross-border economic and financial spill-overs will constrain economic activity further. Devaluation of Russian ruble, Kazakh tenge, Ukrainian hryvnia and Turkish lira in the beginning of the year may affect competitiveness in the EEC region and impact trade volumes.

- Growth in **Armenia** rebounded in the fourth quarter of 2013, led by agriculture, industry and financial services. Construction sector showed early signs of stabilization after steep contraction in the first nine months of the year. Still, the annual pace of growth slowed down to 3.5 per cent in 2013, the lowest since 2010. Remittances growth was also weaker than in 2012, and this weakness persisted into early 2014 mainly due to the fall in the investment spending in Russia. Cabinet reshuffle and the decision of the Constitutional Court on the pension reform may increase near-term political uncertainty in the country and weigh on the private investor confidence. Negative impact on Armenia's economy by the expected slowdown in Russia and by the deteriorating regional security situation may be mitigated by some fiscal easing (envisaged in the recently announced IMF programme). The 2014 GDP growth forecast is slightly downgraded to 3 per cent and growth is expected to accelerate in 2015.

- After growing 5.8 per cent in 2013, **Azerbaijan's** economy slowed down considerably in early 2014. Preliminary estimates show that GDP grew by 2.5 per cent year-on-year in the first quarter of 2014 on the back of the fall in oil output. Non-oil sector continued to grow at fast pace. Credit growth remained buoyant at the beginning of 2014 and showed little signs of moderating. Assuming that the fall in oil production is short-lived and non-oil sector continues expansion, output is expected to grow at the rate of 3.5 per cent in 2014, in line with the January forecast.

- Unsustainable policies of the past led to large external imbalances and economic stagnation in **Belarus**. After meagre growth in 2013, preliminary estimates point to a growth of 0.5 per cent year-on-year in January-March 2014. Exports continued to decline in the first two months of 2014 while real wages growth decelerated from 15.8 per cent in 2013 to 4.4 per cent year-on-year in January-February 2014. Inflation stayed elevated in the first quarter, at 15.5 per cent on average year-on-year, propelled by relaxation of some administrative price controls and high nominal wage and credit growth. Investments plunged by almost 20 per cent year-on-year in January-February 2014 as the government tightened policies to avoid sharp adjustment. Still, as gross international reserves fell to the critically low level of 1.5 months of imports as of end-March, Belarus's economy is in urgent need of external financing to avoid a sharp adjustment and financial crisis. Timing, source and

volume of external support and risks associated with potential expansionary economic policies in the run-up to the presidential elections in November 2015 generate uncertainty which may lead to a wide range of potential outcomes for the economy in 2014-2015. The 2014 GDP growth forecast has thus been revised down to zero, with large downside risks.

- In **Georgia**, growth slowed down to 3.2 per cent in 2013 after a rapid growth period of 2010 to 2012. The slowdown was reverted in the last quarter of the year, after the government increased expenditures considerably. The net export performance had a positive impact on the growth throughout the year on the back of strengthened demand from the EU and the increased access to the Russian market for Georgian foodstuffs. October's presidential elections have lowered political tensions and paved the way to improved consumer and business confidence. The Association Agreement with the EU, due to be signed on 13 June 2014, is expected to boost exports further thanks to the reduction or removal of trade barriers on agricultural products. However, the Russia/Ukraine crisis will weigh on growth through lower regional export demand, more cautious investors, and possibly less favourable tourism revenues. The growth outlook for Georgia is thus moderately reduced to 4.0 per cent in 2014 and 2015, providing that the Russia/Ukraine crisis does not significantly deepen.
- **Moldova** registered a record-high growth in 2013 at 8.9 per cent driven by agricultural recovery and related growth of manufacturing and trade. Investment activity, including FDI inflow, remained subdued, aggravated by the weak business environment and poor corporate governance in banks. Remittances were growing steadily throughout 2013, fuelling private consumption growth, but some signs of a slowdown emerged by year-end. With unfolding crisis in Ukraine and deceleration of investment activity in Russia in 2014, private remittances and export demand for goods from Moldova may weaken further. Adoption of visa-free regime with the EU could facilitate labour mobility and support inbound remittances. Parliamentary elections in 2014 and problems in the financial sector introduce element of uncertainty. Economic growth is expected to moderate to 2 per cent this year and accelerate to 4 per cent in 2015.
- **Ukraine's** economy is going through a painful macroeconomic adjustment with high short-term costs for growth. As the crisis unfolded, the National Bank of Ukraine abandoned the currency peg in early February, allowing the hryvnia to depreciate significantly. Simultaneously, the government embarked on fiscal austerity and hiked energy tariffs for households and industry. Significant vulnerabilities in the financial sector constrain credit growth. As a result, domestic demand is expected to contract this year. Trade liberalisation with the EU and the hryvnia depreciation may benefit exports, although further disruption of economic and financial links with Russia will affect investor and lender confidence and trade flows. GDP is expected to contract by 7.0 per cent in 2014. Following the developments in the Crimea, any further intervention in Ukraine would increase the downside risks to the outlook. Structural reforms are of the essence for the medium-term economic recovery.

Russia

The growth outlook for 2014 has been strongly affected by geopolitical tensions. These have added to the drag of underlying structural factors. Household consumption growth, one of the main drivers of growth since 2010, went down from almost 8 per cent in 2012 to below 5 per cent in 2013 also driven by the cooling down of consumer lending. After fast investment growth driven by the preparations for the Sochi Olympics, investments declined by more than 6 per cent in 2013 and further in January-February 2014. Exports were an important growth driver at 4.2 per cent while imports decelerated in line with lower consumption and investment growth.

The deceleration has been mainly driven by weakening investor and consumer confidence as well as growing household indebtedness and difficult external environment. While oil prices remained high, they were slightly lower in year-on-year terms, not providing enough support for Russian growth. Public and private sector forecasts for this year have been revised down to the range between 0 and 1 per cent. Both the central bank and the Ministry of Economic Development consider that recent growth has been below potential, but high inflation and close-to-full capacity utilisation limits policy choices to raise growth in a sustainable manner.

Net capital outflows increased driven by lower external borrowing. In the first quarter of 2014, private sector capital outflows reached US$ 64 billion, exceeding the annual amount for 2013 or 2012. Unlike the previous years, capital outflows were driven primarily by lower borrowing rather than more extensive investment abroad. The corporate sector borrowed only US$ 9 billion in the first quarter 2014 compared to US$ 36 billion in the first quarter of 2013, due to such factors as weaker investment activity and more constrained access to external financing. Due to higher capital outflows and lower current account surplus, the rouble has weakened by more than 10 per cent during 2014 keeping inflation above the central bank's target level. This, together with the loss of reserves of almost US$ 50 billion, forced the central bank to hike interest rates by 150 basis points in March and another 50 basis points in April, to 7.5 per cent. Inflationary pressures and increased country risk premium may keep monetary policy tight for a prolonged period.

Fiscal room is limited. Even though the central budget is expected to receive an additional 1 per cent of GDP due to the substantially weaker rouble and slightly higher than projected oil prices, there is little capacity to increase spending. Russia's fiscal stance is different from the crisis year 2008, as sovereign wealth funds are half of their pre-crisis levels (as a percentage of GDP), government debt exceeds savings, and regional debt is rapidly growing. Government bond yields are some 200 basis points above their 2013 levels, and foreign holdings of sovereign rouble debt went down from 24 to 22 per cent, as associated demand dwindled. As a result, the Ministry of Finance was forced to cancel some of its auctions.

GDP is expected to stagnate in 2014 and pick up only to 0.6 per cent in 2015, unless supported by a significant increase in fiscal and quasi-fiscal spending. This scenario assumes that geopolitical tensions do not escalate but will only ease very slowly, nevertheless trade sanctions are not applied. Prolonged geopolitical uncertainties would lead to significantly weaker investor sentiment, contributing to accelerating capital inflows, further drop in investments and deceleration in consumption. Higher oil price in this scenario would only provide a temporary respite as demand for

Russian oil and gas may also decline due to the search for alternative suppliers. Fast de-escalation of tensions in Ukraine and intensified reforms improving the business climate would be needed to reinvigorate Russia's medium- to long-term growth potential.

Central Asia

Most of the countries in Central Asia showed strong economic growth in 2013; however, the slowdown in Russia, as a result of the Russia/Ukraine crisis, is expected to be a drag on the growth in Central Asia in 2014. Any further escalation of the Russia/Ukraine crisis poses significant downside risk to growth and would put downward pressure on currencies in the region. The weakening of remittances flows, as well as, to a lesser degree, exports, are expected to be a drag on growth, adding to internal vulnerabilities associated with weak banking sectors and uncertainties surrounding such large natural resources projects as Kumtor in the Kyrgyz Republic, Kashagan in Kazakhstan and Oyu Tolgoi in Mongolia. Notably, the Eurasian Customs Union is likely to have a more positive role in Central Asia going forward, if reduction in non-tariff barriers and costs of trading across border materialise, increasing economic benefits from the membership to Kazakhstan and, once accession is complete, to Kyrgyz Republic.

- In **Kazakhstan,** GDP growth increased from 5 per cent in 2012 to 6 per cent in 2013 on the back of strong investment growth and robust consumer spending. However, the growth is expected to slow down to 5.0 per cent in 2014, largely as a result of slowdown in Russia and reduced consumer spending. The banking sector, which is suffering from overhang of NPLs (in excess of 30 per cent of total loans), also continues to be a drag on growth. Inflation increased from 4.8 per cent in December 2013 to 6.2 per cent in March 2014 following the 20 per cent devaluation of Tenge in February 2014, and it is expected to increase further, as the effects of devaluation feed through to price increases.

- In the **Kyrgyz Republic,** growth rebounded strongly after a disruption at the Kumtor gold mine in early 2012, reaching 10.5 per cent in 2013. Reflecting the impact of current slowdown in Russia on remittances and, to a lesser degree, exports, as well as the base effect, the growth is expected to moderate to 4.5 per cent in 2014. Inflation averaged 6.6 per cent in 2013, and it declined to 4.7 per cent in March 2014, however, significant depreciation of Som over the first quarter of 2014 and recent increases in wheat and corn prices are expected to translate into higher inflation.

- In **Tajikistan**, GDP growth remained strong at 7.4 per cent in 2013. However, it is expected to moderate to 4.4 per cent in 2014 on account of slowing remittances and, to a lesser degree exports, as a result of the slowdown in Russia. Moreover, the weaknesses in banking sector, including increasing levels of NPLs, are expected to be a further drag on the growth. Inflation declined from 7 per cent in the beginning of 2013 to 4.8 per cent in March 2014, and it is expected to average around 5 per cent in 2014.

- **Turkmenistan** continues to experience a strong economic expansion with GDP growth of 10.2 per cent in 2013, driven by large construction projects and

strong gas exports to China. GDP growth is expected to reach 10 per cent in 2014, as a new gas field comes on stream, with only minimal impact from the slowdown in Russia.

- **Uzbekistan's** GDP growth remained strong at 8.0 per cent in 2013, driven by a combination of such factors as diversification of gas export routes and accommodating monetary conditions. Growth is expected to slow down to around 7.5 per cent in 2014, which is, however, an upward revision of growth projection for 2014, which can be explained by an upward revision of the actual growth in 2013.
- **Mongolia** continued to benefit from a mining boom, and production of copper concentrate at Oyu Tolgoi, which started operating in July 2013 and is expected to become one of the world's largest copper mines, made an important contribution to growth. The output expanded by 11.7 per cent in 2013, notwithstanding weaker external demand, decreases in prices of key commodities and delays at key mining projects. Growth is projected to reach 12.5 per cent in 2014, as the first phase of Oyu Tolgoi comes fully on stream.

Southern and Eastern Mediterranean (SEMED)

The SEMED economies muddled through in 2013, faced with a combination of domestic/regional turmoil and a weak external environment. The increased government spending on social benefits and subsidies in response to rising social pressures since 2011 has exacerbated fiscal deficits, which remain high across the board. However, SEMED countries have taken some positive steps towards reforming expensive subsidy schemes, in particular by raising some energy prices. In the meantime, pressures on the balance of payments continue to persist. IMF programmes in place in Jordan, Morocco, and Tunisia continue to provide buffers against any further deterioration of external conditions while in Egypt the GCC financial support has eased immediate financing concerns. Meanwhile, implementing comprehensive reform programmes to restore macroeconomic stability remains challenging in the SEMED countries, as this requires a broad buy-in from key stakeholders, which has proved difficult to secure during complex political transitions. Growth for the region as a whole has been muted in 2013, and expected to pick up modestly in 2014. In Egypt, economic performance will hinge on the unravelling domestic and political situation. In Tunisia, achieving key milestones in the country's political transition will have positive spill-overs on the economy. In Jordan and Morocco, an improvement in the external environment, particularly from a Eurozone recovery, will be a key factor in economic recovery.

- Stalled reforms and continued volatile security conditions in **Egypt** are weighing on the economy, despite financial assistance from the Gulf. The US$15 billion pledged so far is expected to cover Egypt's external financing needs in the short term and has allowed the government to announce two stimulus packages of US$4.3 billion each (1.6 per cent of GDP each), mostly for infrastructure projects. However, the effects of the stimulus packages have yet to be felt. Meanwhile, underlying macroeconomic conditions continue to worsen. Output grew by a mere 1.3 per cent in the second quarter of the FY2013-14 fiscal year, and is forecasted to reach 2.5 per cent in the full fiscal year. The fiscal deficit remains large and continues to rise, which along with

high and persistent inflation, are key macroeconomic challenges. Spill overs from the Ukraine/Russia crisis are expected to have minimal economic impact on Egypt. As the largest importer of wheat in the world, Egypt has already begun diversifying its sources of wheat imports. This could, however, push up the import bill and could pose additional fiscal burdens on the country.

- Economic activity in **Jordan** remains sluggish, adversely impacted by on-going regional turmoil. The conflict in Syria has disrupted trade and tourism and resulted in an influx of over half a million refugees, putting a strain public services and finances and labour market conditions. Fiscal pressures have persisted, although a large influx of grants has helped to ease budget strains arising from the massive inflow of refugees. The current account deficit still remains large, despite a slight improvement on the back of external financial assistance. The IMF's US$ 2 billion Stand-by Arrangement has helped reduce the country's financing gap. Jordan has also secured additional financial support from the US (through loan guarantees) and the World Bank to alleviate budget pressures in addition to non-budget grants from the GCC. GDP is expected to gradually recover in the near-term, with output growth projected at 3.4 per cent in 2014 and 4.1 per cent in 2015.
- In **Morocco**, economic activity rebounded in 2013 on the back of a strong harvest. Real GDP expanded by a 4.3 percent in 2013 compared to 2.6 per cent in 2012, driven by the continued rebound in the agricultural sector (which accounts for around 13 per cent of GDP and 40 per cent of employment), while growth of non-agricultural output slowed. In the meantime, Morocco successfully completed the third and last review of the IMF US$6.2 billion precautionary credit line. The authorities have treated the arrangement, which will expire in August 2014, as precautionary. External balance dynamics improved in 2013, driven mostly by a lower import bill and some revival of tourism. The fiscal deficit also narrowed in 2013, reflecting a reduction in the subsidy bill and lower international oil prices. Growth in 2014 is expected to moderate slightly to 4.2 per cent predominantly due to bumper crop harvest in the previous year, but will pick up to 5 per cent in 2015 as the non-agricultural sector picks up in tandem with an expected recovery in the Eurozone.
- **Tunisia's** economy was hard hit by political and security unrest in 2013, with real GDP growth reaching a mere 2.7 per cent. Large-scale protests and strikes, coupled with deteriorating security conditions, negatively impacted the economy, and the protracted political crisis weighed on economic conditions. Progress on structural reforms has been slower than planned, especially on those requiring wide popular buy-in and legislative approval, and performance under the IMF programme has so far been mixed, with the fiscal and current accounts remaining under considerable pressure. Nevertheless, major milestones in Tunisia's political transition have been completed in 2014 and are expected to have positive spill-overs on the economy. Growth is expected to pick up to 3.4 per cent in 2014 and 4.7 per cent in 2015 on the back of stabilising domestic conditions and a gradual pickup in external demand from the Eurozone.

Table 1. Transition Region: Vulnerability Indicators 1/

	Public and External Debt /2				Total reserves (excl. gold) /2				Bank dep.	Loans/ dep.	Country risk			Domestic FX loan stocks (latest)				Nonperforming loans /3	Unem- ployment
	(% of GDP)								latest					(% GDP)					
	Government (end 2013)	External			billions US$ (latest)	in percent of					07-May-14	Latest		Total pvt sector	of which		% FX credit in total loan stock		
		Total (end 2013)	Private (end 2013)	Short term (remaining maturity)		GDP	Short term debt	month of prosp. Imports	% of GDP	Private sector, in %	(CDS spread, bps)	S&P sovereign country ratings	Fitch sovereign country ratings		Corp.	HH		latest	% (latest avail.)
Central Europe and Baltics																			
Croatia	59.8	103.4	80.0	30.4	16.6	27.0	88.9	8.4	68.4	134.6	300.0	BB	BB+	54.5	25.2	29.3	74.7	15.6	17.6
Estonia*	10.0	85.1	78.6	51.5	…	…	…	…	48.9	142.4	…	AA-	A+	…	…	…	1.3	1.8	8.7
Hungary	79.2	115.9	66.6	27.8	49.6	36.0	129.8	5.2	40.1	117.2	200.7	BB	BB+	25.8	12.4	13.4	51.9	17.3	8.3
Latvia*	38.1	134.8	104.5	60.8	…	…	…	…	33.5		130.0	BBB+	BBB+	…	…	…	86.5	8.3	11.6
Lithuania	39.4	64.4	32.7	30.5	7.4	17.1	56.1	3.0	35.8	118.2	…	A-	BBB+	33.2	17.4	15.8	72.2	11.0	11.5
Poland	57.0	71.1	41.8	19.6	98.6	19.1	97.6	5.2	45.3	107.5	71.0	A-	A-	15.1	3.8	11.3	29.8	8.5	9.7
Slovak Republic*	55.4	…	…	…	…	…	…	…	48.9	96.7	59.5	A	A+	…	…	…	0.4	5.5	13.9
Slovenia*	71.7	108.9	52.0	17.2	…	…	…	…	53.3	119.2	…	A-	BBB+	…	…	…	4.1	18.0	9.8
South-Eastern Europe																			
Albania	70.5	39.7	10.7	2.4	2.7	21.0	874.7	6.4	69.1	56.5	…	B	…	24.6	18.8	5.8	61.6	23.2	13.9
Bosnia and Herzegovina	42.7	52.1	22.8	13.0	4.7	25.8	198.7	6.0	44.6	130.9	…	B	…	39.5	21.3	18.2	66.1	15.1	27.5
Bulgaria	17.6	95.9	87.5	37.1	17.6	32.8	88.5	5.7	67.0	99.8	125.0	BBB	BBB-	41.7	32.5	9.2	60.9	16.9	13.1
FYR Macedonia	35.8	64.9	41.5	27.2	2.4	22.6	83.1	3.9	51.1	93.2	…	BB-	BB+	24.1	15.3	8.8	48.2	11.2	28.6
Kosovo*	…	…	…	…	1.2	17.4	…	4.0	…	…	…	…	…	…	…	…	…	7.5	30.9
Montenegro*	56.8	120.4	…	…	0.6	13.2	…	2.5	55.8	102.4	…	BB-	…	…	…	…	…	17.7	19.5
Romania	39.3	69.7	45.1	31.9	43.1	23.5	73.6	6.4	30.8	107.6	152.0	BB+	BBB-	22.6	10.9	11.7	61.2	22.5	7.2
Serbia	65.8	87.4	40.6	16.0	14.1	32.3	201.5	7.1	40.6	118.4	…	BB-	B+	37.9	25.5	12.4	72.5	21.1	20.1
Eastern Europe and the Caucasus																			
Armenia	41.9	79.3	41.0	9.8	2.0	19.4	198.0	4.7	22.7	159.9	…	…	BB-	24.7	19.3	5.4	62.8	6.0	15.4
Azerbaijan	13.8	13.4	…	…	16.3	25.1	…	11.2	15.9	149.7	…	BBB-	BBB-	7.2	4.0	3.2	28.6	5.3	5.2
Belarus	36.7	50.1	28.6	30.3	3.8	6.4	21.1	1.0	23.5	164.3	…	B-	…	23.4	23.2	0.0	49.6	4.6	0.5
Georgia	31.8	60.0	34.2	18.9	2.3	14.5	116.0	3.6	35.3	109.4	…	BB-	BB-	22.9	12.1	10.8	62.9	7.3	15.0
Moldova	24.4	80.4	57.7	32.0	2.7	39.0	122.0	5.1	43.0		…	…	…	17.6	17.2	0.4	40.4	13.2	4.1
Ukraine	41.0	76.6	60.1	38.0	13.3	8.1	21.5	1.6	42.7	138.2	1251.0	CCC	CCC	20.4	15.4	4.9	35.6	16.9	7.6
Turkey	35.8	45.8	32.3	18.7	109.0	13.3	84.4	5.2	41.5	110.7	181.5	BB+	BBB-	19.4	19.4	0.0	27.7	2.7	10.1
Russia	13.4	34.3	7.7	30.7	442.8	23.4	278.3	11.2	40.7	121.8	261.5	BBB	BBB	8.9	8.5	0.4	17.0	4.3	5.2
Central Asia																			
Kazakhstan	13.5	67.0	64.5	8.8	20.3	10.8	122.3	4.0	29.6	109.4	175.0	BBB+	BBB+	10.9	9.3	1.7	29.5	33.6	5.1
Kyrgyz Republic	47.7	74.2	29.3	12.1	2.0	31.7	261.0	3.4	…	…	…	…	…	8.3	6.5	1.8	52.8	5.5	7.6
Mongolia	…	119.9	76.6	…	2.1	24.4	…	3.3	…	…	…	BB-	B+	15.2	14.1	1.2	31.8	5.2	7.8
Tajikistan	29.2	43.2	19.1	1.5	0.4	5.7	379.1	0.8	…	…	…	…	…	…	…	…	…	9.8	2.4
Turkmenistan	20.6	20.6	0.0	0.3	…	…	…	…	…	…	…	…	…	…	…	…	…	...	…
Uzbekistan	8.6	13.0	4.9	0.9	…	…	…	…	…	…	…	…	…	…	…	…	…	...	…
Southern and Eastern Mediterranean														…	…	…			
Egypt	89.2	14.5	0.7	2.2	17.4	7.4	337.0	3.7	62.0	46.3	678.0	B-	B-	8.4	8.3	0.2	…	9.5	13.4
Jordan	87.7	24.5	0.0	2.4	13.6	39.9	…	5.4	106.5	70.9	…	BB-	…	11.5	…	…	…	...	11.8
Morocco	61.9	30.9	4.1	1.9	17.5	17.6	924.6	4.2	63.5	103.6	…	BBB-	BBB-	…	…	…	…	6.1	9.5
Tunisia	44.4	52.0	16.0	16.8	7.1	15.4	91.5	3.1	54.2	…	…	NR	BB-	…	…	…	…	...	14.3

1/ National sources based on CEIC and IFS, unless stated otherwise.
2/ WEO April 2014 estimates. CEB figures from Eurostat.
3/ Slovenia NPLs: EBRD estimate
* Euro area members, Kosovo and Monetnegro use the Euro as legal tender.

Table 2. Transition Region: Annual indicators and projections 1/

	GDP Growth (year over year percent change)			GDP Growth (end year) (Q4 over Q4 percent change)			Inflation (average) (year over year percent change)		Fiscal Balance /4 (Gen. gov; % of GDP)	Primary fiscal balance to GDP /4	GG Debt/revenues (%)	Current Account (% of GDP)	Net FDI (% of GDP)
			Forecast 2/					Forecast 2/	3/	3/	3/	3/	3/
	2012	2013	2014	2011	2012	2013	2013	2014	2013	2013	2013	2013	2013
Central Europe and Baltics													
Croatia	-1.9	-1.0	-0.5	-0.4	-2.2	-1.2	2.2	0.5	-5.5	-2.4	157.6	1.2	2.1
Estonia	3.9	0.8	2.0	5.2	4.9	0.3	3.2	2.5	-0.2	0.7	26.2	-1.0	2.4
Hungary	-1.7	1.1	1.6	1.3	-2.7	2.7	1.7	1.0	-2.2	2.1	166.4	3.0	0.6
Latvia	5.2	4.1	3.8	5.1	4.6	4.6	0.0	1.6	-1.0	0.7	108.5	-0.9	1.5
Lithuania	3.7	3.3	3.0	5.7	4.0	3.6	1.2	1.3	-2.2	-0.5	122.0	1.5	0.9
Poland	1.9	1.6	2.8	4.9	0.8	2.3	0.8	1.3	-4.3	-1.7	152.0	-1.3	-2.1
Slovak Republic	1.8	0.9	2.0	3.5	0.4	1.5	1.5	0.8	-2.8	-0.8	154.0	2.1	1.1
Slovenia	-2.5	-1.1	0.0	-2.0	-3.3	2.1	1.9	1.1	-14.7	-12.1	160.4	6.3	-1.6
South-Eastern Europe													
Albania	1.2	0.4	1.7	2.2	1.0	1.1	1.9	2.5	-6.2	-2.9	293.8	-9.1	7.7
Bosnia and Herzegovina	-1.2	2.1	1.8	0.0	-1.1	2.0	0.1	1.0	-2.2	-1.5	95.2	-5.6	2.6
Bulgaria	0.6	0.9	1.9	0.6	0.4	1.6	0.4	-0.5	-0.8	0.1	53.1	2.1	2.8
FYR Macedonia	-0.4	3.1	3.0	1.0	0.0	3.2	2.8	1.5	-4.0	-3.2	120.0	-1.8	3.2
Kosovo	2.5	2.5	3.5	…	…	…	2.0	2.0	-2.5	-2.4	61.1	-6.8	4.3
Montenegro	-2.6	3.5	3.0	2.3	-2.8	4.7	2.2	0.4	-2.4	-0.2	135.8	-15.0	9.8
Romania	0.6	3.5	2.6	1.9	0.8	5.4	3.2	2.6	-2.5	-0.8	123.8	-1.1	1.8
Serbia	-1.5	2.5	1.0	0.6	-1.7	2.7	7.7	3.5	-5.7	-3.1	162.1	-5.0	2.4
Eastern Europe and the Caucasus													
Armenia	7.1	3.5	3.0	5.2	6.2	5.2	5.8	3.4	-2.5	-1.3	187.7	-8.4	5.2
Azerbaijan	2.3	5.8	3.5	-3.8	4.3	6.7	2.5	2.5	0.8	1.1	34.8	19.7	-0.9
Belarus	1.7	0.9	0.0	0.3	-0.5	-0.3	18.3	16.4	-0.9	0.1	87.5	-9.8	3.0
Georgia	6.2	3.2	4.0	8.5	3.0	7.1	-0.5	4.0	-2.7	-0.3	116.1	-6.1	6.0
Moldova	-0.7	8.9	2.0	5.8	-2.5	11.2	4.4	5.7	-1.8	-1.2	66.0	-4.8	2.9
Ukraine	0.3	0.0	-7.0	5.0	-2.3	3.3	-0.3	14.4	-4.5	-1.1	93.8	-9.2	1.8
Turkey	2.1	4.0	2.5	5.3	1.3	4.4	7.5	8.5	-1.5	1.6	99.4	-7.9	1.2
Russia	3.4	1.3	0.0	5.1	2.1	2.0	6.8	5.8	-1.3	-0.6	37.4	1.6	-0.3
Central Asia													
Kazakhstan	5.0	6.0	5.0	8.7	4.5	6.7	5.9	7.9	5.0	5.5	51.6	0.1	3.7
Kyrgyz Republic	-0.9	10.5	4.5	4.6	8.1	13.1	6.6	6.5	-3.8	-2.9	140.6	-12.6	7.6
Mongolia	12.4	11.7	12.5	20.2	14.0	12.3	12.5	12.4	-7.7	-6.8	159.2	-27.9	19.9
Tajikistan	7.5	7.4	4.4	7.2	7.5	7.4	5.0	5.1	-0.8	0.1	108.4	-1.9	1.8
Turkmenistan	11.1	10.2	10.0	…	…	…	6.6	5.3	0.2	...	124.9	-3.3	7.5
Uzbekistan	8.2	8.0	7.5	8.5	8.2	7.8	11.2	11.4	1.3	1.4	24.6	1.7	1.2
Southern and Eastern Mediterranean													
Egypt	2.2	2.2	2.5	3.3	1.5	1.3	6.9	10.6	-14.1	-6.4	356.0	-2.1	1.0
Jordan	2.7	2.8	3.4	3.1	2.2	2.9	5.5	4.1	-5.3	-1.8	251.0	-11.1	5.2
Morocco	2.7	4.3	4.2	4.6	2.3	4.5	2.0	2.5	-7.5	-2.9	221.4	-7.4	2.9
Tunisia	3.7	2.7	3.4	-1.6	4.0	2.7	6.1	5.9	-5.9	-4.1	147.3	-8.4	2.2

1/ EBRD data and projections unless otherwise stated.

2/ As of May 7, 2014. Figures for Egypt reflect the fiscal year, which runs from July to June.

3/ WEO April 2014. Figures for the CEB countries (excl. Croatia) are sourced from Eurostat.

4/ Ukraine: Augmented general government balance: overall government balance includes Naftogaz and other debt-creating flows.

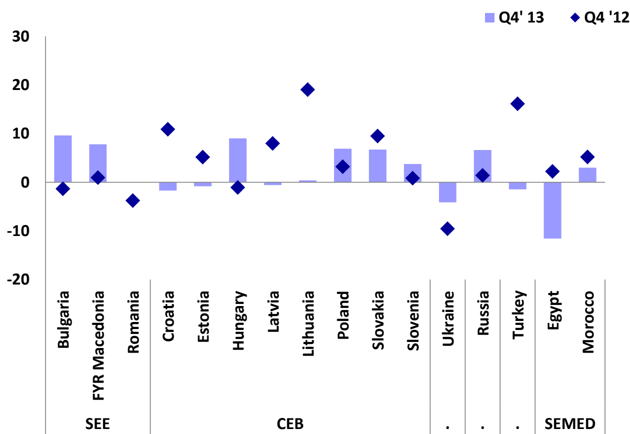
Table 3. Transition Region: Quarterly GDP actuals and projections, Q1 2012- Q4 2013 1/

	Quarterly GDP Growth (seasonally adjusted, quarter-on-quarter percent change)								Quarterly GDP Growth (year-on-year percent change)								GDP Growth (year over year percent change)			
	2012				2013				2012				2013						Forecast 1/	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2012	2013	2014	2015
Central Europe and Baltics																				
Croatia	-0.6	-0.8	-0.3	-0.3	-0.2	-0.1	-0.2	-0.4	-0.9	-2.5	-1.8	-2.2	-1.5	-0.7	-0.6	-1.2	-1.9	-1.0	-0.5	0.5
Estonia	2.3	-0.1	1.2	0.6	-0.2	-0.3	0.5	0.2	5.0	2.5	3.4	4.9	1.3	1.0	0.7	0.3	3.9	0.8	2.0	3.1
Hungary	-1.4	-0.4	-0.3	-0.5	1.1	0.3	0.8	0.5	-0.6	-1.6	-1.7	-2.7	-0.8	0.8	1.8	2.7	-1.7	1.1	1.6	1.2
Latvia	0.7	2.2	1.6	1.2	1.7	0.1	1.2	0.8	7.1	4.9	4.6	4.6	3.8	4.6	4.6	4.6	5.2	4.1	3.8	3.9
Lithuania	0.3	0.7	2.0	0.2	1.0	0.8	0.4	1.2	3.8	1.8	5.0	4.0	3.5	3.8	2.2	3.6	3.7	3.3	3.0	3.4
Poland	0.4	0.0	0.2	0.2	0.4	0.6	0.7	0.6	3.6	2.0	1.6	0.8	0.5	1.2	2.0	2.3	1.9	1.6	2.8	2.8
Slovak Republic	0.3	0.3	0.2	0.0	0.3	0.3	0.3	0.4	2.7	2.3	1.9	0.4	0.5	0.8	0.9	1.5	1.8	0.9	2.0	2.3
Slovenia	-0.2	-1.3	-0.4	-1.5	0.1	0.2	0.4	1.2	-0.2	-3.5	-3.0	-3.3	-4.6	-1.4	-0.5	2.1	-2.5	-1.1	0.0	1.0
South-Eastern Europe																				
Albania	0.0	0.4	2.3	-1.0	-0.3	1.1	-2.1	2.3	-0.6	1.9	2.2	1.0	1.7	1.7	-2.5	1.1	1.2	0.4	1.7	2.0
Bosnia and Herzegovina	-0.5	-0.4	-0.3	0.5	0.9	0.4	0.1	-1.3	-1.5	-0.7	-1.5	-1.1	3.2	2.0	1.5	2.0	-1.2	2.1	1.8	2.0
Bulgaria	0.2	0.2	-0.1	0.1	0.3	0.2	0.5	0.3	0.9	0.6	0.6	0.4	0.9	-0.1	1.1	1.6	0.6	0.9	1.9	2.0
FYR Macedonia	-1.4	-0.4	1.7	0.1	1.2	0.5	1.2	0.4	-1.1	-1.5	0.8	0.0	2.6	3.5	3.0	3.2	-0.4	3.1	3.0	2.5
Kosovo	…	…	…	…	…	…	…	…	…	…	…	…	…	…	…	…	2.5	2.5	3.5	3.5
Montenegro	-1.7	0.6	-0.2	0.7	-0.2	2.8	0.3	-0.5	-3.4	-1.9	-2.3	-2.8	1.1	3.4	4.0	4.7	-2.6	3.5	3.0	2.5
Romania	-0.5	1.5	-0.9	0.6	1.0	0.8	1.8	1.6	0.1	2.0	-0.6	0.8	2.1	1.4	4.2	5.4	0.6	3.5	2.6	2.8
Serbia	-1.7	2.2	-1.3	-0.1	2.6	-0.3	1.3	-1.0	-2.6	0.0	-1.8	-1.7	3.0	0.5	3.8	2.7	-1.5	2.5	1.0	1.0
Eastern Europe and the Caucasus																				
Armenia	1.4	4.0	1.8	-1.2	2.0	-1.4	2.0	0.5	5.4	7.1	9.1	6.2	7.5	0.6	1.6	5.2	7.1	3.5	3.0	3.5
Azerbaijan	0.0	0.7	1.9	1.1	0.3	3.0	1.5	1.5	1.9	0.0	1.7	4.3	1.7	6.5	7.0	6.7	2.3	5.8	3.5	3.0
Belarus	2.3	0.2	-2.0	0.0	5.2	-4.1	-0.1	-0.4	3.3	2.7	1.6	-0.5	4.1	-0.5	0.6	-0.3	1.7	0.9	0.0	0.5
Georgia	0.8	2.6	1.0	-1.4	0.3	1.4	0.9	1.8	6.6	8.2	7.5	3.0	2.4	1.5	1.4	7.1	6.2	3.2	4.0	4.0
Moldova	-3.2	0.8	-1.7	1.6	2.8	3.7	3.9	0.7	1.0	0.6	-1.7	-2.5	3.5	6.1	12.9	11.2	-0.7	8.9	2.0	4.0
Ukraine	-0.7	0.4	-0.8	-1.4	0.7	0.1	-0.4	2.8	2.5	3.1	-1.3	-2.3	-1.2	-1.3	-1.2	3.3	0.3	0.0	-7.0	0.0
Turkey	-0.5	1.4	0.3	0.3	1.4	2.0	0.8	0.5	3.1	2.7	1.5	1.3	2.9	4.5	4.3	4.4	2.1	4.0	2.5	3.2
Russia	0.9	0.5	0.4	0.1	-0.1	0.6	0.6	0.8	4.8	4.3	3.0	2.1	0.8	1.0	1.3	2.0	3.4	1.3	0.0	0.6
Central Asia																				
Kazakhstan	-0.3	2.1	0.9	1.5	0.5	2.4	2.1	1.5	5.6	5.6	4.6	4.5	4.7	5.4	6.6	6.7	5.0	6.0	5.0	5.1
Kyrgyz Republic	-3.2	2.7	1.9	4.7	-0.6	2.7	3.9	5.5	-7.1	-4.8	-3.9	8.1	7.6	8.2	10.5	13.1	-0.9	10.5	4.5	4.8
Mongolia	7.8	-0.4	4.0	2.7	0.6	6.4	1.5	3.4	15.9	11.3	9.6	14.0	7.1	14.3	11.9	12.3	12.4	11.7	12.5	8.7
Tajikistan	1.9	2.2	2.0	1.2	1.8	2.4	1.6	1.4	7.2	7.5	7.6	7.5	7.3	7.6	7.3	7.4	7.5	7.4	4.4	4.4
Turkmenistan	…	…	…	…	…	…	…	…	…	…	…	…	…	…	…	…	11.1	10.2	10.0	10.0
Uzbekistan	1.3	3.0	1.9	1.7	0.9	3.6	1.7	1.4	7.5	8.5	8.3	8.2	7.5	8.4	8.2	7.8	8.2	8.0	7.5	7.6
Southern and Eastern Mediterranean																				
Egypt	0.8	0.1	-0.3	0.7	-0.3	0.7	0.5	0.8	2.6	2.2	2.2	1.5	2.2	1.5	1.0	1.3	2.2	2.2	2.5	3.0
Jordan	0.3	0.6	0.8	0.5	0.8	0.8	0.5	0.7	3.0	2.9	2.6	2.2	2.6	3.1	2.8	2.9	2.7	2.8	3.4	4.1
Morocco	-0.3	0.3	1.6	0.6	1.3	1.3	0.6	1.2	2.8	2.7	2.9	2.3	4.5	4.8	4.0	4.5	2.7	4.3	4.2	5.0
Tunisia	1.3	0.3	0.6	0.1	0.3	1.1	0.4	1.3	4.9	2.2	3.7	4.0	2.7	3.2	2.6	2.7	3.7	2.7	3.4	4.7

1/ As of May 7, 2014.

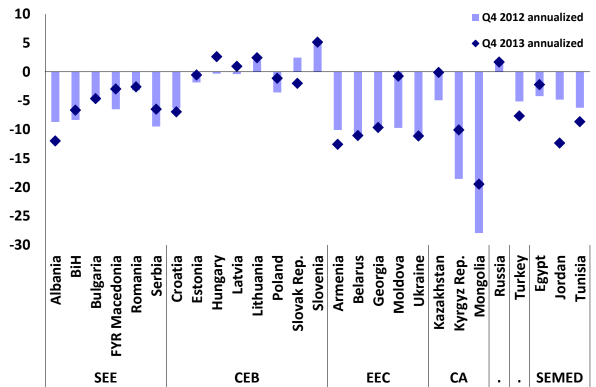
Figure 1. External environment

Export volumes, y-o-y, %



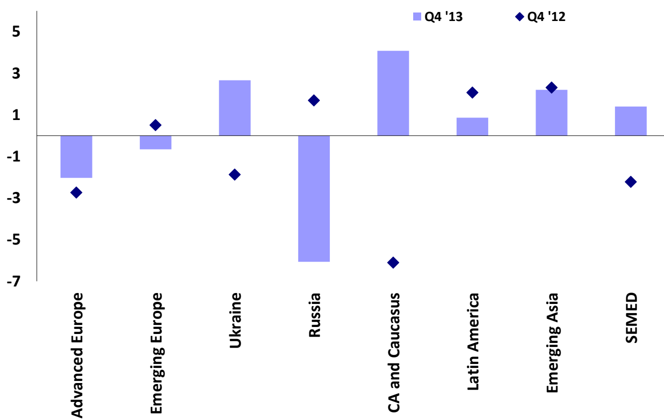
Source: National authorities via CEIC data service.

Current account, % of GDP



Source: National authorities via CEIC data service.

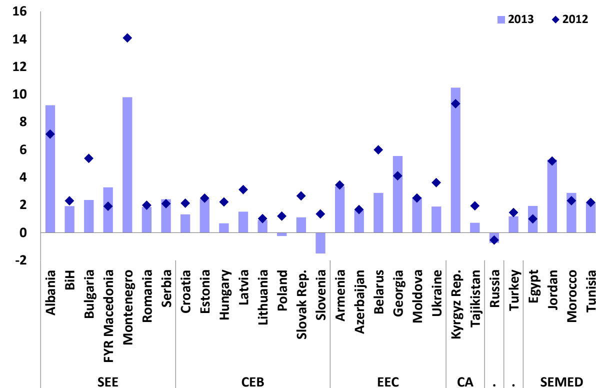
Net lending from BIS-reporting banks, exch. rate adjusted, q-o-q



1/ Emerging Europe excludes Russia and Ukraine.
2/ Emerging Asia excludes China, Central Asia and Caucasus.

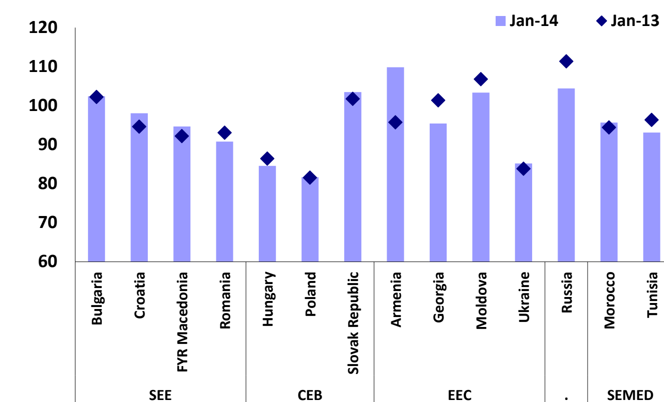
Source: BIS via CEIC data service.

FDI net inflows, % of GDP



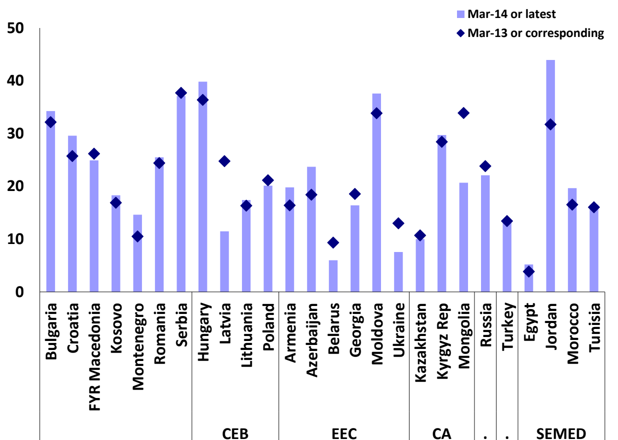
Source: National authorities via CEIC data service.

Real effective exchange rate, July 2008=100



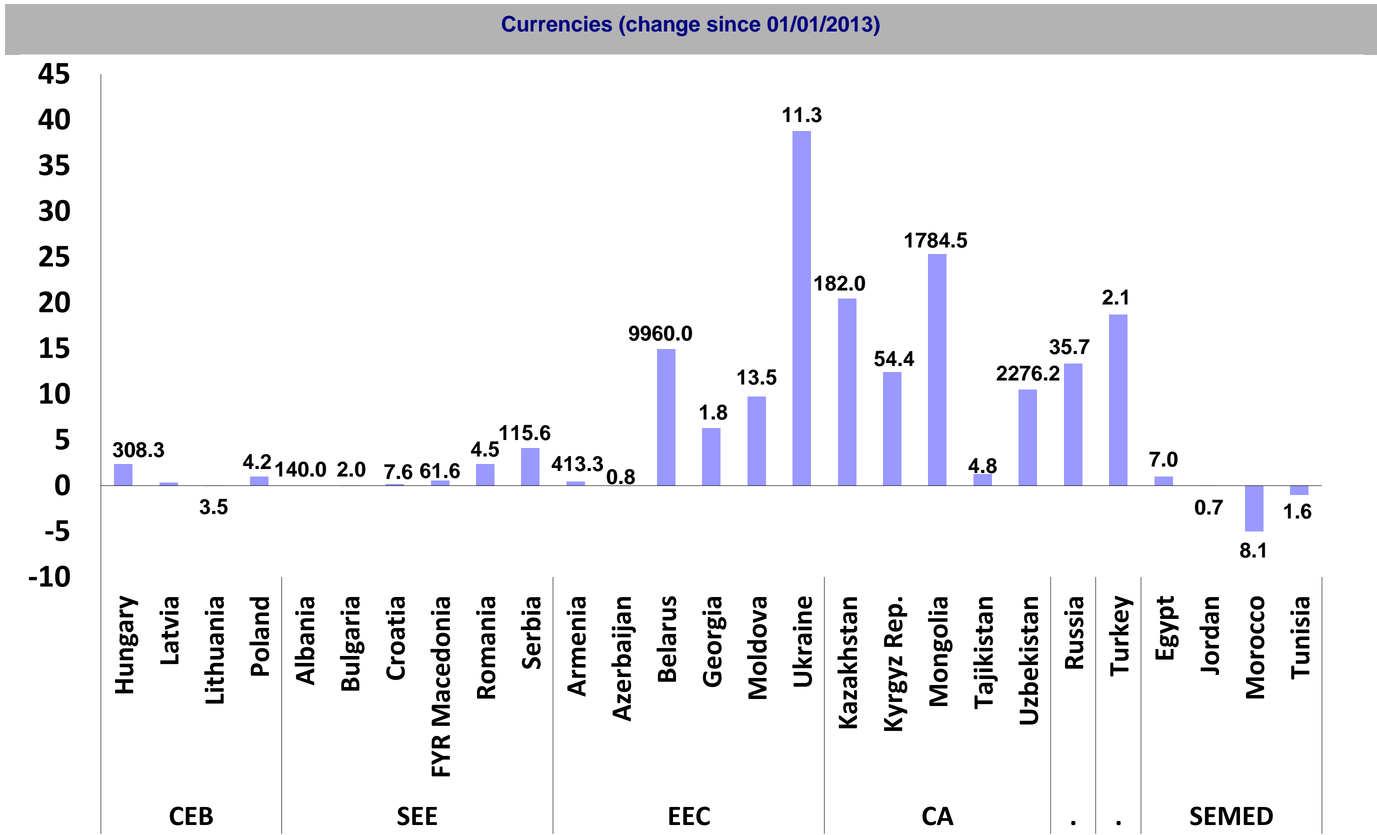
Source: IMF International Financial Statistics.

Reserves, end of period, % of previous year GDP



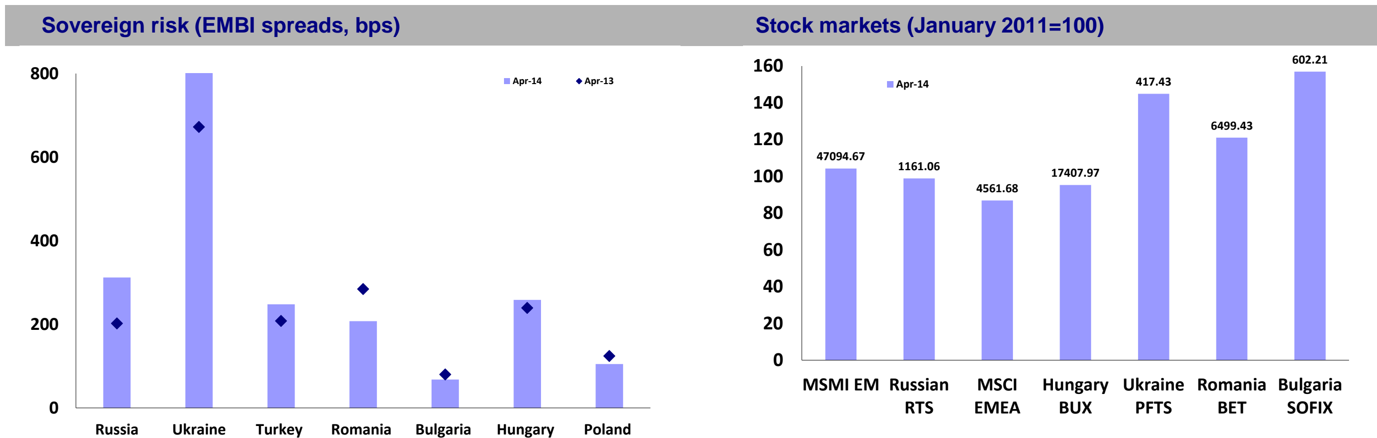
Source: IMF International Financial Statistics.

Figure 2. Currencies and financial market indicators (daily frequency)

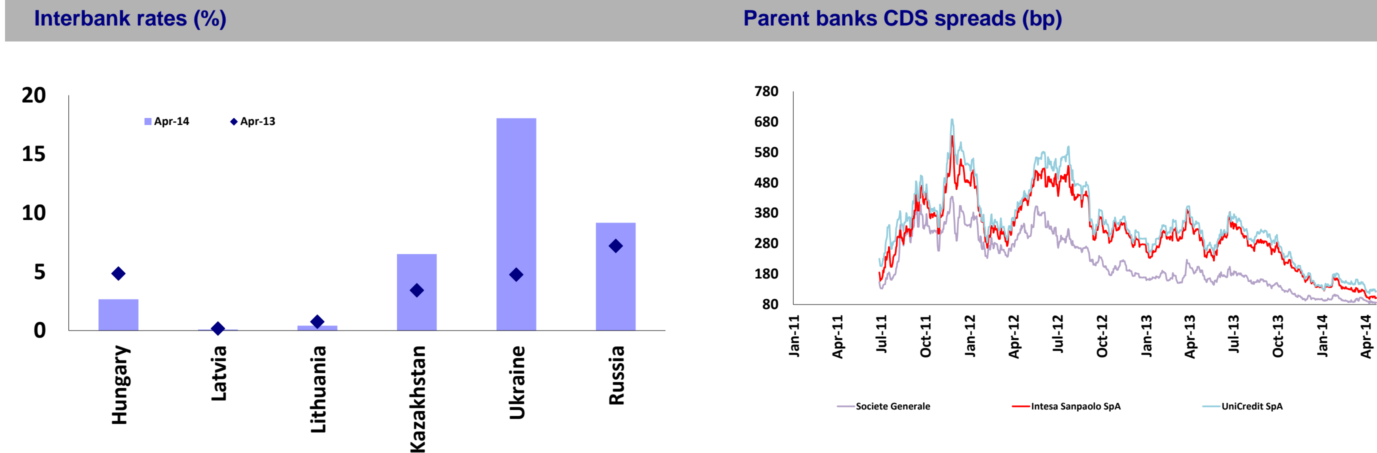


Source: Bloomberg.
For EEC, CA, SEMED, Turkey and Russia the reference currency is U.S. dollar; For CEB and SEE the reference currency is Euro. A decrease represents an appreciation. Numbers on bars represent actual exchange rate values

•



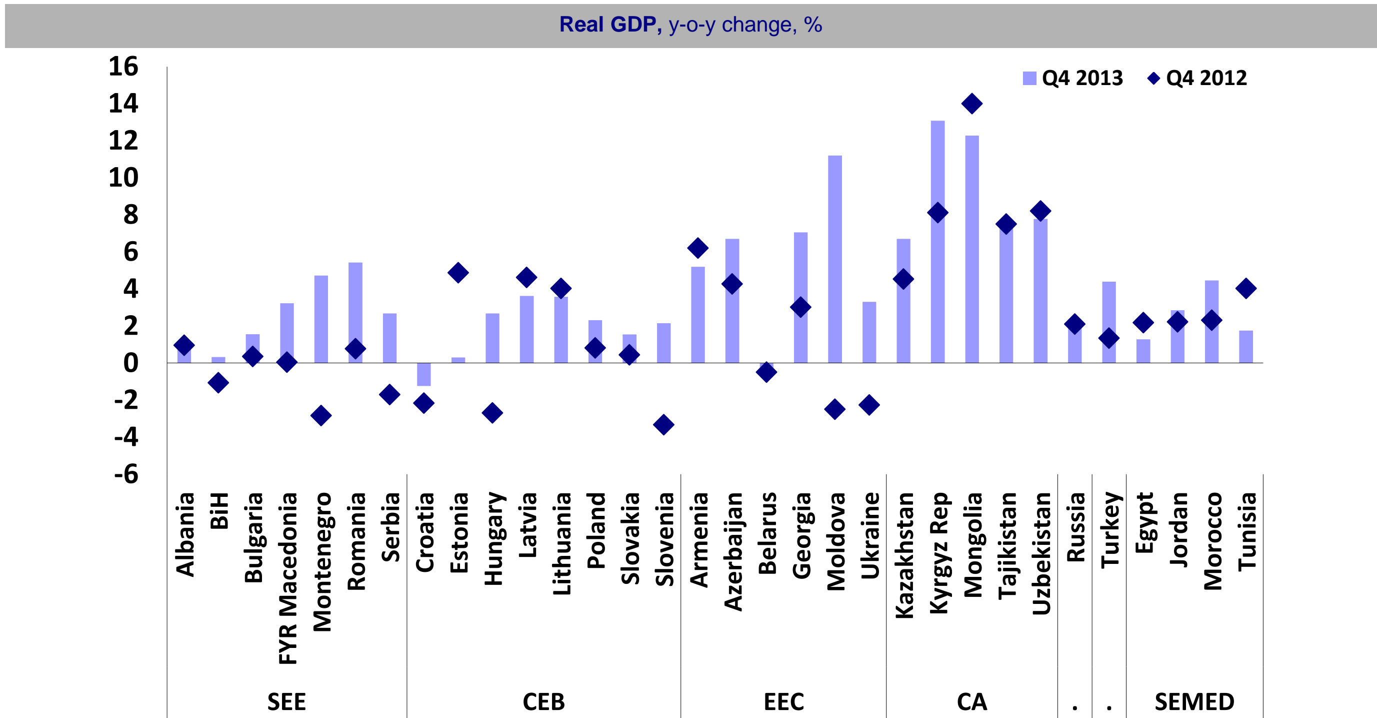
Source: Bloomberg. Numbers on bars represent actual values of stock indices.



Source: Bloomberg.

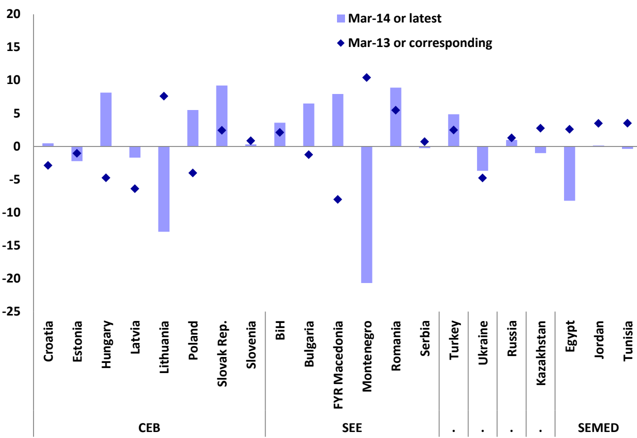
Figure 3. Indicators of real activity

Real GDP, y-o-y change, %

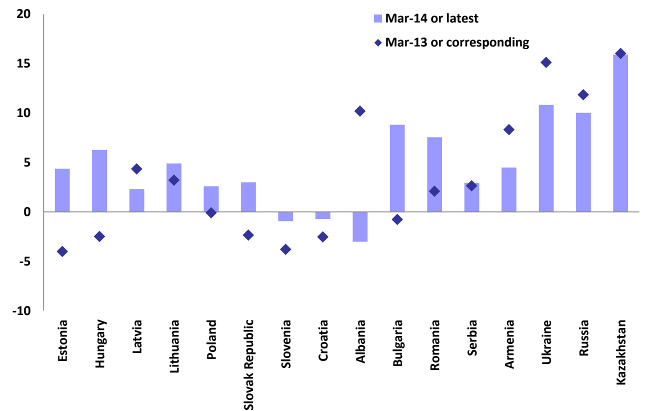


Source: National authorities via CEIC data service.

Industrial production, monthly y-o-y change, %

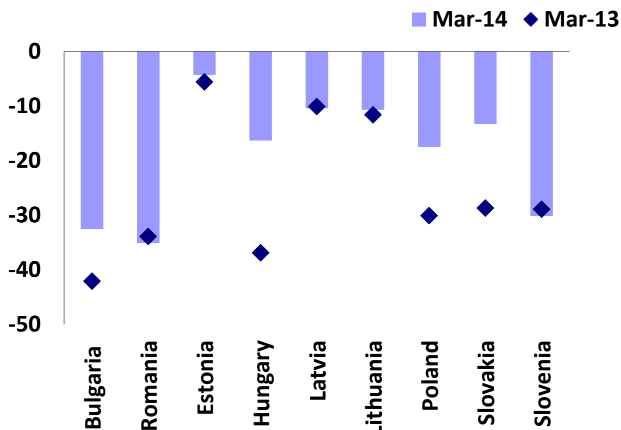


Retail sales, monthly y-o-y change, %



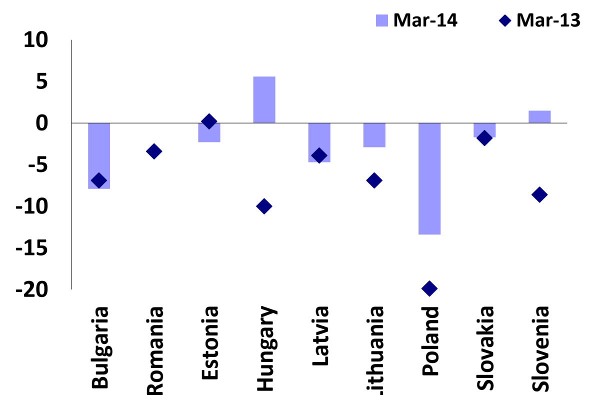
Source: National authorities via CEIC data service.

Consumer confidence



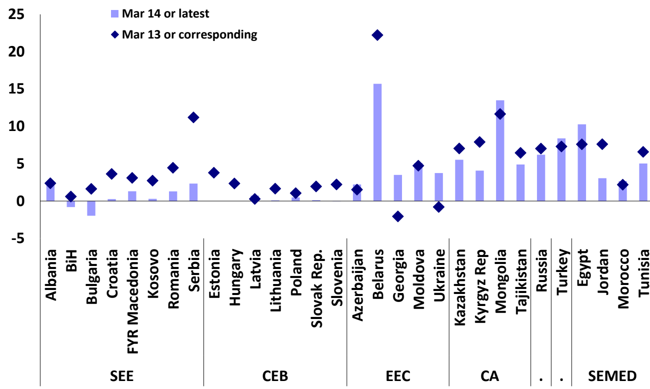
defined as the difference (in percentage points of total answers) between positive and negative answers
Source: Eurostat

Industrial confidence

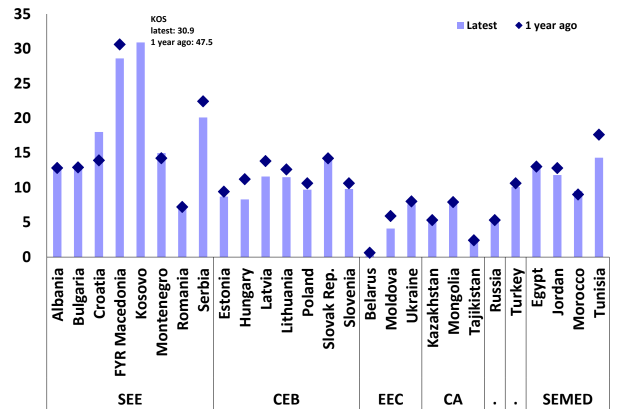


defined as the difference (in percentage points of total answers) between positive and negative answers

CPI, y-o-y change, %



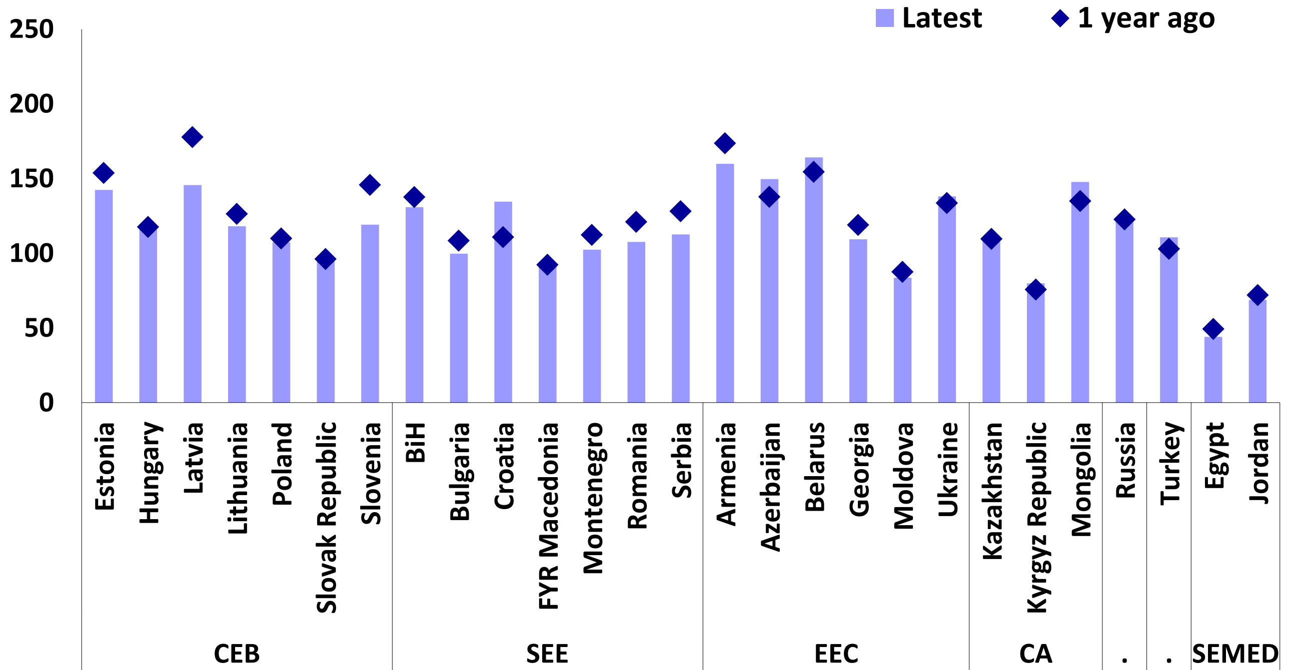
Unemployment rate, %



Source: National authorities via CEIC data service, Eurostat

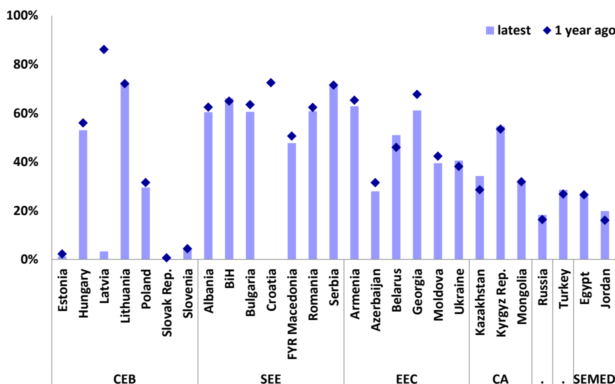
Figure 4: Financial sector indicators: loans and deposits

Loan to deposit ratio, (%)

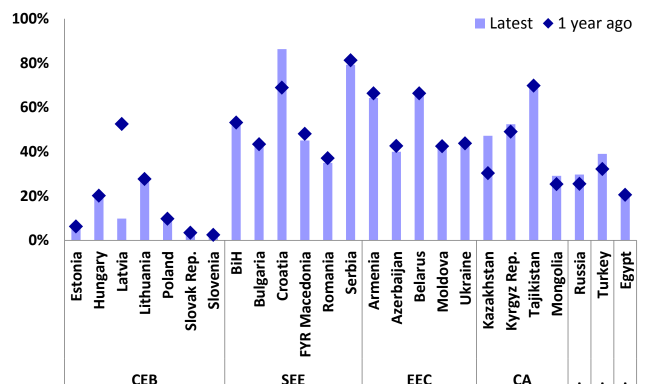


Source: National authorities via CEIC data service.

Foreign currency loans to total loans ratio, (%)

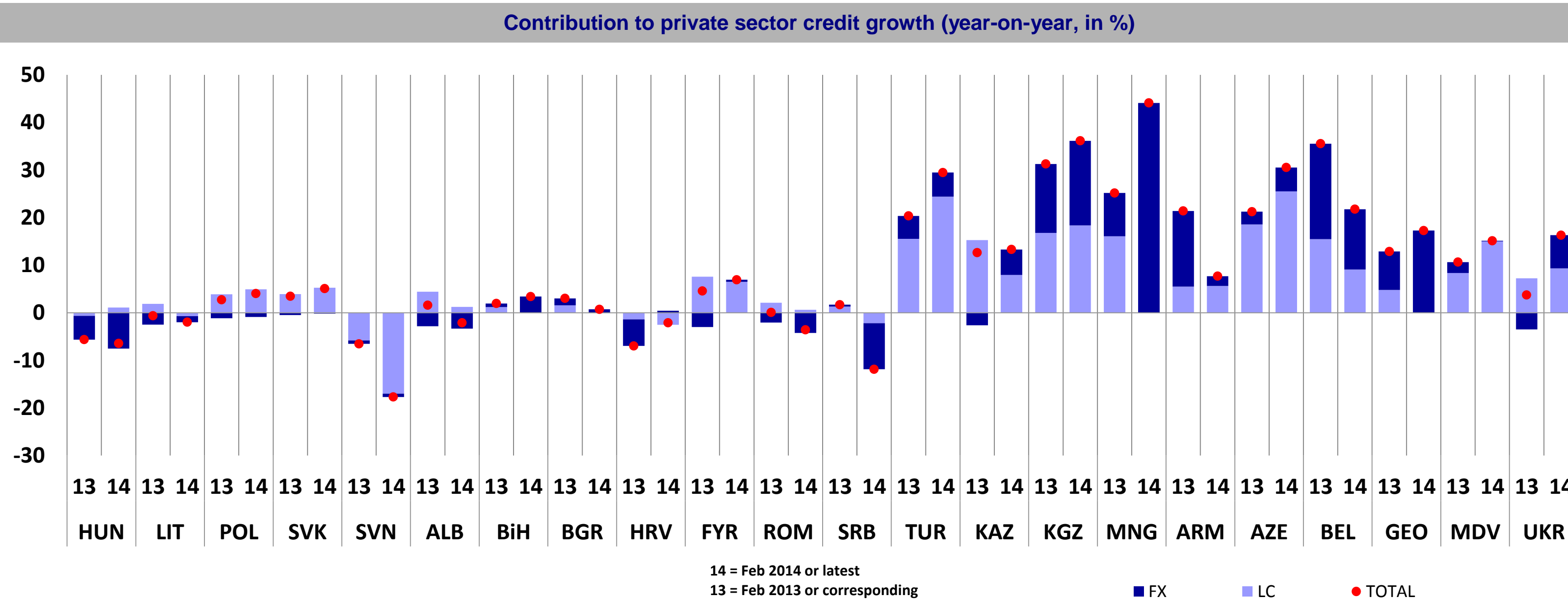


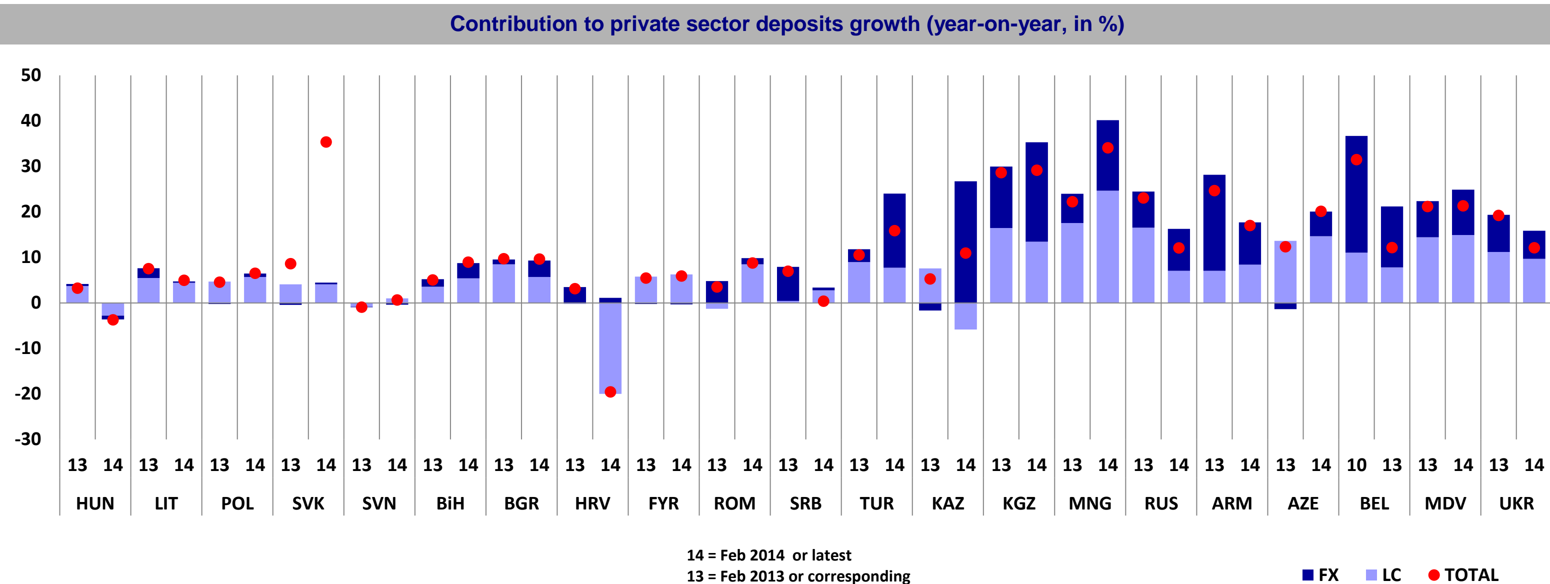
Foreign currency deposits to total deposits ratio, (%)



Source: National authorities via CEIC data service

Figure 5. Financial sector indicators: foreign and local currency lending and deposits





Source: National authorities via CEIC data service