ARMENIA

Highlights

- **The twin shocks of the Covid-19 pandemic and the conflict in Nagorno-Karabakh caused a strong fall in economic activity in 2020.** Gross domestic product (GDP) declined by 7.4 per cent in 2020 before recovering by 4.4 per cent from January to September 2021.
- **Access to external financing helped fund the Covid-19 policy response.** The Economic Response Programme, aimed at supporting economic recovery, is benefiting from funds received under the International Monetary Fund (IMF) programme and the issue of a US$ 750 million Eurobond in early 2021.
- **Anti-corruption reforms are continuing.** Parliament approved the formation of an Anti-Corruption Committee and an Anti-Corruption Court in 2021.

Key priorities for 2022

- **Structural reforms to support economic recovery and strengthen Armenia's resilience are needed.** They should focus on: strengthening governance and institutions; enabling the independence and competence of the judiciary; improving the insolvency resolution framework; improving corporate governance standards; and making continued progress on improving the competition framework.
- **Further efforts should be made to use the natural potential for renewables to tilt the economic recovery to green.** Favourable natural conditions for renewables, paired with a conducive regulatory environment, could attract foreign direct investment (FDI) in this area. This is even more important, bearing in mind the country's high import dependence on fossil fuels and its need to maintain competitiveness.
- **The right balance is needed between the increased public debt level and large infrastructure investment needs.** The authorities should prioritise and implement efficiency-enhancing infrastructure investment, while ensuring fiscal discipline and keeping public debt within manageable levels.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	7.5	5.2	7.6	-7.4	5.0
Inflation (average)	1.0	2.5	1.4	1.2	6.9
Government balance/GDP	-4.8	-1.8	-1.0	-5.4	-4.0
Current account balance/GDP	-1.5	-7.0	-7.4	-3.8	-2.9
Net FDI/GDP [neg. sign = inflows]	-1.9	-2.1	-1.7	-0.6	-1.6
External debt/GDP	91.3	87.7	90.9	102.1	n.a.
Gross reserves/GDP	20.1	18.1	20.9	20.7	n.a.
Credit to private sector/GDP	53.0	57.1	62.6	73.3	n.a.

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Covid-19: macroeconomic implications

The Armenian economy was hit by twin shocks in 2020. Economic activity contracted by 7.4 per cent in 2020 as the flare-up of the conflict in Nagorno-Karabakh in the second half of the year hit an economy already affected by the Covid-19 pandemic. The decline was broad-based as household consumption, investments and exports plummeted. Nevertheless, macroeconomic stability was preserved throughout 2020, as a strong import contraction outweighed the decline in export revenues, which helped to contain currency pressures and supported exchange rate stability throughout most of the year. Depreciation reappeared from November 2020 on the back of rising uncertainties but the exchange rate stabilised at the beginning of 2021. Inflation rose from 1.2 per cent in 2020 to 8.9 per cent year-on-year in September 2021 as a result of higher international food prices and a pass-through of Armenian dram depreciation. This prompted the Central Bank of Armenia to raise the re-financing rate five consecutive times, by 3 percentage points in total, to 7.25 per cent in September 2021.

The external sector remained stable. The authorities concluded the third review under the IMF programme in December 2020 and tapped external markets by issuing a US$ 750 million Eurobond in early 2021 to help finance the projected fiscal deficit. Armenia's public debt increased from 50.1 per cent of GDP in 2019 to 63.5 per cent in 2020 on the back of spending pressures to support the economy. The current account deficit narrowed from 7.4 per cent of GDP in 2019 to 3.8 per cent in 2020 mainly on the back of import contraction. Money transfers increased by 32.5 per cent year-on-year in the first half of 2021, versus a 17.4 per cent contraction in 2020, largely driven by a strong growth of transfers from the United States of America. This trend mostly reflects the increased share of remittances sent through formal channels, as long-distance travel remains constrained. International reserves remain at prudent levels, close to US$ 3.2 billion in September 2021 and cover approximately eight months of imports.

The economic recovery is accelerating. After a decrease of 3.3 per cent (year-on-year) in the first quarter of 2021, the economy achieved a growth of 5.0 per cent overall in the first six months as nearly all sectors of the economy posted strong growth in the second quarter. We expect GDP growth of 5.0 per cent in 2021, rising to 5.3 per cent in 2022. However, the economic recovery is faced with downside risks from the slow speed of vaccinations, especially in light of new and potentially more infectious virus strains. Risks also stem from geopolitical instability.

Policy response to Covid-19

The aim of immediate relief measures in 2020 was to support those most affected by the Covid-19 pandemic. The authorities, together with banks' support, allocated US$ 367 million (2.9 per cent of GDP) to support the economy in 2020. Measures included subsidised loans to the most affected sectors and businesses, in particular tourism and agriculture, grants to the private sector, direct wage subsidies to micro, small and medium-sized enterprises (MSMEs), and a strengthened social assistance programme with additional lump sum transfers. The main aim was to preserve jobs and thus protect the most vulnerable. Banks were advised to undertake voluntary loan restructuring and offer limited payment holidays to ease the liquidity pressures facing borrowers.

The government approved the Economic Response Programme and relevant action plan in February 2021 to support the economic recovery in 2021. Through 12 targeted actions and 14 assistance programmes, the government aims to restore economic activity, maintain viable and reliable business and consumer environments, and develop a medium-term economic policy agenda.

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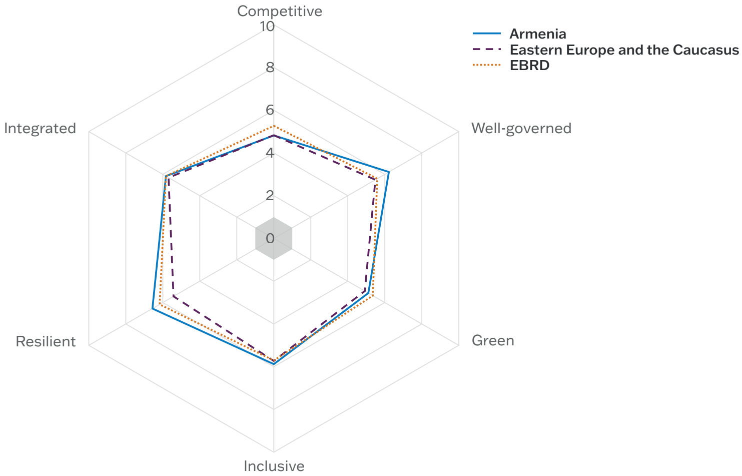
Assessment of transition qualities (1-10)



Structural reform developments

A centralised register of bank accounts of individuals was introduced in the regulatory framework. In June 2021 parliament approved an initiative of the Central Bank of Armenia to create a centralised register of bank accounts of individuals. By doing this, the legislature is aligned to global standards for combating money laundering and the financing of terrorism, and meets one of the obligations within the European Union (EU)-Armenia Partnership Agreement (CEPA). In future, this will be the foundation for innovative ideas related to the automation of bank accounts of citizens and it forms the appropriate infrastructure for advancing the online services sector. At the moment, the main purpose is to reduce operating costs when authorised bodies from law enforcement agencies apply for data.

Armenia is advancing its digitalisation efforts. A new digitalisation strategy, approved in February 2021, aims to advance the digital transformation of state institutions, individual economic sectors and society, through innovative technologies, cyber security and a data processing policy within the public administration. The goal of the strategy is to ensure system interoperability, introduce common standards, and implement educational programmes and various digital tools. This is expected to improve the quality of public services, increase public governance efficiency, promote institutional digitisation and infrastructure development, encourage data-driven decision-making and help develop a highly skilled workforce.

Anti-corruption reforms continued. In March 2021 parliament voted in favour of replacing the Special Investigative Service with an Anti-Corruption Committee with enhanced detection and investigative powers to examine corruption cases. A law on the creation of the Anti-Corruption Court, which will specialise in corruption crimes and anti-corruption civil cases and will have the right to examine the lawsuits for confiscation of property of illegal origin, was adopted in April 2021. Both laws are part of the government's anti-corruption strategy adopted in 2019, aiming to curb corruption and strengthen the rule of law in Armenia.

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Armenia is increasing its efforts to tackle climate change. In April 2021 the government approved Armenia's updated nationally determined contributions (NDCs) under the Paris Agreement for 2021 to 2030. The new NDCs are more ambitious and now include the goal to reduce greenhouse gas emissions by 40 per cent by 2030 from 1990 levels. Furthermore, Armenia has the ambition to double the share of renewable energy in its energy production by 2030, as well as to increase the forest cover by 12.9 per cent of the territory of Armenia in the same period.

Amended legislation on the rights of people with disabilities will help to reduce discrimination. In May 2021 the government amended the law on the rights of people with disabilities. The aim of the new law is to end discriminatory practices and to improve the disability assessment so that it is based on the extent of limited functionality and personal needs rather than on the degree of disability only. Thus, the new law creates opportunities for a more inclusive society.

AZERBAIJAN

Highlights

- **Economic recovery is under way.** The main driver of the recovery is the non-hydrocarbon sector but the oil and gas sectors are starting to contribute strongly too, with the rising demand for, and price of, oil, supported by an expected gradual increase in oil quotas.
- **A new reform vision has been developed.** The "Azerbaijan 2030" strategy outlines the main directions and priorities of sustainable socio-economic development. A draft strategy of socio-economic development in 2021-25 accompanies the vision.
- **A new regulatory framework to support renewable energy is in place.** It outlines the framework for foreign investment and specifies incentives for private investors.

Key priorities for 2022

- **Diversifying the economy would enhance its resilience to shocks.** This includes continuously improving the business environment to support private-sector development, as well as pursuing commercialisation and governance reforms in the state sector to increase efficiency. Considering the current regional disparities in the country, a balanced territorial approach is essential.
- **Implementing the "Azerbaijan 2030" vision and the accompanying strategies needs to go hand in hand with enhancing public administration capacity.** Public agencies and ministries need to be properly staffed, their expertise enhanced and the operational framework strengthened to effectively transform the long-term vision into socio-economic development of the country.
- **The authorities should continue to develop a sustainable and competitive energy market with a sound regulatory framework and institutions.** The new regulatory framework for renewables, which sets the groundwork for increased participation of the private sector, should be used as a stepping stone for greening the energy sector.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	0.2	1.4	2.5	-4.3	4.0
Inflation (average)	12.9	2.3	2.6	2.8	4.4
Government balance[1]/GDP	-1.3	5.5	9.1	-6.5	-1.8
Current account balance/GDP	4.1	12.8	9.1	-0.5	7.8
Net FDI/GDP [neg. sign = inflows]	-0.7	1.7	2.9	1.8	-0.8
External debt[2]/GDP	22.8	19.0	18.9	20.7	n.a.
Gross reserves[3]/GDP	13.1	11.9	13.0	14.9	n.a.
Credit to private sector/GDP	16.7	16.3	18.7	20.1	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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Covid-19: macroeconomic implications

The economic recovery in 2021 is being driven by the non-oil and gas sectors. After being hit by a triple shock – the Covid-19 pandemic, a slump in oil prices and the flare-up of the conflict over Nagorno-Karabakh – Azerbaijan's gross domestic product (GDP) declined by 4.3 per cent in 2020. A strong contraction in the oil and gas sector of 7.2 per cent was balanced by a softer decline in the rest of the economy, which was helped by the government's extensive support package. Non-hydrocarbon sectors started to recover in 2021, posting 6.2 per cent year-on-year growth from January to September 2021. However, overall GDP growth, estimated at 4.8 per cent year-on-year in the same period, continues to be weighed down by lower oil and gas production on the back of the Organization of the Petroleum Exporting Countries (OPEC) oil production cut. Exports, which are dominated by hydrocarbons, remained at the 2020 level in real terms from January to August 2021 (year-on-year). Monetary policy was loosened in 2020 as demand remained tightly constrained and inflation low. However, in spite of currency stability, increasing global price pressures are pushing inflation from an average of 2.8 per cent in 2020 up to 8.5 per cent in September 2021.

Large assets of the State Oil Fund of Azerbaijan (SOFAZ) helped to weather the crisis. Lower oil revenues on the back of the price slump and the production decline turned external and fiscal surpluses to deficits in 2020. The current account balance turned from a surplus of 9.1 per cent of GDP in 2019 to a small deficit of 0.5 per cent in 2020, while the fiscal balance went from a surplus of 9.1 per cent in 2019 to a deficit of 6.5 per cent in 2020. However, Azerbaijan's public debt remained low at 23.4 per cent of GDP in 2020 despite the ensuing gaps, as funding needs were met domestically by drawing on the large assets of SOFAZ. International reserves remained relatively stable, at US$ 7.0 billion in September 2021, covering almost eight months of imports.

Recovery is expected to continue but risks remain significant. Rising demand for, and higher prices of, oil, supported by an expected gradual increase of oil quotas in the coming months, will strengthen the overall economic performance in the second half of 2021. The non-oil and gas economy is expected to stay on the recovery path. On this basis, the economy is forecast to grow by 4.0 per cent in 2021 and 3.2 per cent in 2022. Numerous risks remain, related to structural weaknesses of the economy, geopolitical developments, the speed of vaccinations and possible volatility in commodity prices.

Policy response to Covid-19

The authorities implemented a crisis response package of economic and social support in 2020. The package was worth in excess of 4.6 per cent of GDP. It included wage subsidies, support for micro entrepreneurs, extended payment deadlines for various taxes, loans to businesses on preferential terms, state guarantees and subsidised interest rates on the existing loan portfolios of small and medium-sized enterprises (SMEs). The Central Bank of Azerbaijan relaxed capital requirements and risk weights on mortgage loans, introduced a moratorium on late fees and interest rate penalties and suspended inspections of credit institutions. The full deposit insurance scheme was once again extended in December 2020, until April 2021. The upper limit of the insured amount was increased and, to support SMEs, deposits of individual entrepreneurs to a certain threshold have been included in the scheme. Comprehensive social assistance measures bolstered the overall economic support programme.

Efforts to support the economy continue in 2021. The 2021 budget allocated another AZN 261 million (0.3 per cent of GDP) to fight the Covid-19 pandemic. Benefits to businesses have been expanded and additional social assistance has been provided. At the beginning of the year, the Central Bank of Azerbaijan lifted some measures introduced in 2020, including resuming inspections of credit institutions and reinstating additional capital requirements for consumer loans.

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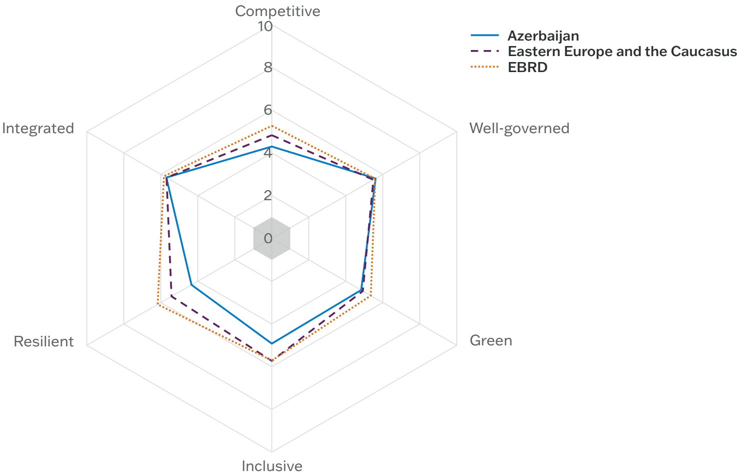
Assessment of transition qualities (1-10)



Structural reform developments

The government has outlined its main directions and priorities of sustainable socio-economic development until 2030. In February 2021 the president signed a decree on "Azerbaijan 2030: National Priorities for Socio-Economic Development", outlining a long-term framework of policies and reforms. The framework includes strengthening the connections between society, businesses and the state. It outlines the following key factors for economic recovery: effective and efficient management of the state's role in the economy via market-oriented reforms, bolstering private institutions, government-friendly business management and further liberalisation of trade practices. The Cabinet of Ministers is expected to prepare a draft strategy of socio-economic development in 2021-25 within nine months of the approval of "Azerbaijan 2030".

The authorities are stepping up efforts to promote renewable energy. A new law on the use of renewable energy sources in the production of electricity, approved in May 2021, was signed by the president in July, together with a presidential decree on implementing the renewable energy law. The law outlines the regulatory framework for foreign investment and specifies incentives for investors in renewable energy source projects in Azerbaijan, including guaranteed off-take and connection, priority in transmission and distribution, and long-term land leases. Additional efforts in the past year to green the economy include publishing an in-depth review of the energy efficiency policy, which will be followed by a national action plan to enhance energy efficiency.

There is more awareness of the need to enhance digitalisation of government services. In February 2021 a mobile application of the government portal "myGov" was launched to make public services more accessible. The Central Bank of Azerbaijan also continued its efforts to expand digital payments in the country. Strategic cooperation agreements and a memorandum of understanding were signed with Visa and MasterCard. These include initiatives to support key drivers accelerating the development of the payment market, introducing innovative payment solutions, increasing mobile payments, as well as expanding financial literacy and inclusion.

BELARUS

Highlights

- **The impact of Covid-19 on economic growth in 2020 was limited.** The authorities did not impose a full lockdown but they increased support to the real sector and halted the gradual phasing-out of directed bank lending to the state sector. The contraction of the services sector and domestic consumption was moderate, while manufacturing remained flat.
- **Economic recovery in the short term is facing significant uncertainty due to sanctions.** Export industries could have serious challenges in reaching developed Western economies while many domestic industries could face supply disruptions.
- **The general environment in the country and the business climate have been worsening.** Developments after the presidential elections and sanctions imposed by many developed economies made investors more reluctant than before to engage in the country.

Key priorities for 2022

- **The authorities should resume the gradual phase-out of directed lending.** During the Covid-19 pandemic, the support of state-owned banks to state-owned enterprises (SOEs) helped weather the negative impact of the Covid-19 crisis. However, this also significantly increases vulnerabilities in the medium term.
- **A regulatory level playing field is needed to unleash the full potential of private companies.** Private companies still face regulatory discrimination in many sectors of the economy. Liberalising economic governance and introducing appropriate market regulation are critical for restarting the stalled economy.
- **Improving corporate governance and commercialising the state-owned sector are utmost priorities.** Inefficiencies and a lack of corporate governance in SOEs are seriously undermining the growth potential of the economy. Further delays to corporate governance reforms will have long-term negative consequences on SOE valuations and growth prospects.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	2.5	3.1	1.4	-0.9	2.0
Inflation (average)	6.0	4.9	5.6	5.5	9.2
Government balance[1]/GDP	-0.3	1.8	0.9	-2.9	-3.9
Current account balance/GDP	-1.7	0.0	-1.9	-0.4	0.4
Net FDI/GDP [neg. sign = inflows]	-2.2	-2.3	-2.0	-2.2	-1.8
External debt/GDP	72.8	65.5	63.1	70.0	n.a.
Gross reserves/GDP	13.4	11.9	14.6	12.4	n.a.
Credit to private sector/GDP	20.9	21.3	21.9	23.7	n.a.

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

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Covid-19: macroeconomic implications

In the absence of a full lockdown, the impact of Covid-19 on the economy in 2020 was limited. Gross domestic product (GDP) contracted by 0.9 per cent in 2020 due to a decline in final consumption and investment by 1.4 and 8.3 per cent respectively, while net exports increased by 2.7 per cent. The services sectors fell by only 2.1 per cent. However, subsidised lending to SOEs and sustained real wage growth alleviated the impact of reduced global demand and supported domestic demand. Manufacturing remained flat, while ICT services and agriculture even enjoyed 7.0 and 5.3 per cent growth, respectively. Following the disruptions after the presidential election in August 2020, household deposits in banks and the currency came under pressure. In total, the Belarusian ruble depreciated by 18.2 per cent against the US dollar in 2020. In 2021 the currency stabilised to a large extent, as did the level of deposits withdrawal. However, the lagged pass-through from currency depreciation and rise of global food and energy prices pushed inflation to 10.2 per cent year-on-year in September 2021, well above the target rate of 5 per cent. This caused the National Bank of the Republic of Belarus to raise the refinancing rate twice, once in April and again in July 2021, from 7.75 per cent initially to 9.25 per cent in July. Consumption and investment remained weak, while net exports and manufacturing have been the main drivers of growth, which stood at 2.7 per cent year-on-year from January to September 2021.

Fiscal and financing constraints gave little room for manoeuvre. The fiscal position turned from a surplus of 0.9 per cent of GDP in 2019 to a deficit of 2.9 per cent in 2020. At the same time, foreign reserves declined from a historical high of US$ 9.4 billion at the end of 2019 to US$ 7.4 billion in July 2021, covering only 2.4 months of imports. This combination of a lack of available foreign financing, a low level of foreign reserves and substantial debt obligations have left the authorities little room to tackle the impact of economic sanctions. Access to external financing remains difficult and dependent on support from Russia. US$ 500 million was provided through the Eurasian Fund for Stabilization and Development (EFSD) in October 2020. In December 2020 Russia approved a US$ 1 billion loan to Belarus, paid in two tranches in 2020 and 2021. A new International Monetary Fund Special Drawing Rights allocation brought a windfall of almost US$ 1 billion in August 2021, lifting foreign reserves to US$ 8.5 billion and temporarily easing external financing pressures.

Short-term prospects for recovery are uncertain amid economic sanctions and the ongoing political crisis. Amid a deteriorating environment, the economy is predicted to grow by 2.0 per cent in 2021 and 0.2 per cent in 2022. Economic sanctions and targeting of the export-focused potash and petroleum industries are expected to hit the economy, although with some time lag due to the exemption of contracts concluded before the sanction date. In addition, sanctions-related supply shortages of products originating from developed economies could cause disruption of the production process in many companies. While direct lending of state-owned banks to SOEs helped to sustain the economy through the Covid-19 pandemic, vulnerabilities will likely increase in the medium term.

Policy response to Covid-19

The country's crisis-response measures in 2020 were limited amid the resumption of directed lending. Measures included capping price increases on socially important goods, delinking wages from productivity growth in the state sector, production subsidies for public-sector organisations and a significant increase in new directed loans to SOEs. The National Bank of the Republic of Belarus eased prudential requirements, issued guidance to banks recommending loan holidays for targeted customers, released some of its capital buffers and extended the maturity of its refinancing loans.

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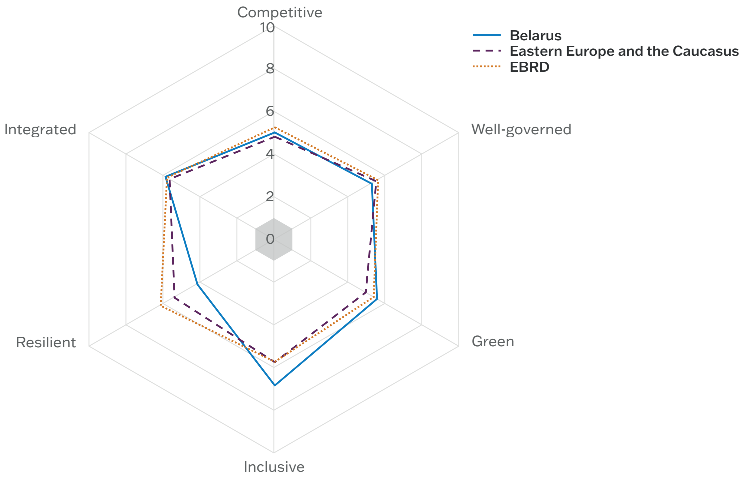
The government extended its 2020 package of fiscal measures to the end of 2021. Measures include additional resources for the healthcare sector (such as salary allowances for essential personnel) and tax relief and deferrals to support affected businesses. Employers at risk of having to reduce employment or close down were able to apply for wage subsidies for their employees up to the legal minimum for the period 1 May through to 31 July. Monthly allowances for eligible citizens were extended until August. Most measures were implemented at the local government level. The national vaccination plan for 2021-22 was approved in February 2021. Belarus started producing the Sputnik vaccine and mass vaccination is currently ongoing.

Assessment of transition qualities (1-10)



Structural reform developments

The general business climate worsened after the presidential elections in August 2020. Among other developments, in May and June 2021 the president signed new laws that significantly limit news media activities and increase the penalties for attending unauthorised demonstrations. The new laws allow the Ministry of Information to shut down media outlets without a court hearing. The penalty for attending protests has been increased from fines or a short jail sentence of up to two weeks, to potentially up to three years. The deterioration of the human rights situation after the presidential elections and resulting sanctions imposed by many developed economies have made potential investors more reluctant than before to engage in the country. International financial institutions have reduced their engagement with Belarus. The reform agenda was, to a large extent, crowded out from the authorities' priorities in the last 12 months.

Previously started activities for integration into the global financial system and digital advances were completed. In early 2021 the Ministry of Finance joined the International Organization of Securities Commissions (IOSCO) as an associate member. This would have supported the integration of the securities market into the global financial system if financial sanctions had not been introduced. Furthermore, the expansion of remote customer service systems in the non-banking segment of the financial market is ongoing, thus advancing the digital preparedness of the country. In December 2020 amendments to the tax code created the preconditions for the practical functioning of investment funds, aiming to stimulate the creation of new funds through a preferential taxation regime. The first special depository of investment funds was created in 2020.

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Currency control regulations were further liberalised. In April 2021 legislation was passed that formalises existing government decrees abolishing restrictions on foreign exchange operations. Individuals and legal entities can open bank accounts at foreign banks without restrictions. The National Bank of Belarus and the government can jointly introduce temporary currency restrictions for a period not exceeding one year in cases of threats to the economic security and stability of the financial system.

GEORGIA

Highlights

- **Economic recovery is gaining momentum in the first half of 2021.** Renewed growth is benefiting from a supportive external environment but risks to the recovery remain, in particular the slow vaccination rate and potentially extended travel restrictions.
- **A new insolvency framework aims to address a long-standing business environment vulnerability.** It could also help resolve Covid-19 pandemic-related bankruptcies in a more efficient way.
- **The government has presented a 10-year country socio-economic development vision.** The vision is supported by ministry-specific strategies, which will set out development goals, financial needs and planned instruments.

Key priorities for 2022

- **Strengthening governance standards needs to remain a top priority.** An impartial, independent, transparent, efficient and accountable formal and informal public institutional framework is key to maintain the trust of businesses and the general public.
- **The authorities should ensure that economic recovery is tilted to green, including by creating an enabling environment for non-hydro renewables.** Exploiting Georgia's great renewable energy potential would help ensure sustainable growth and increase the country's energy self-sufficiency and competitiveness.
- **Georgia should continue pursuing critical structural reforms such as education and state-owned enterprise (SOE) reform.** Pledges to reform the education sector and to bring corporate governance closer to best practices should be pushed forward to ensure the availability of skills and to increase competitiveness of the economy.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	4.8	4.8	5.0	-6.2	7.5
Inflation (average)	6.0	2.6	4.9	5.2	9.3
Government balance/GDP	-0.5	-0.8	-1.8	-9.2	-6.5
Current account balance/GDP	-8.0	-6.8	-5.5	-12.4	-10.0
Net FDI/GDP [neg. sign = inflows]	-10.5	-5.6	-6.0	-3.5	-3.9
External debt/GDP	106.6	101.3	106.7	129.7	n.a.
Gross reserves/GDP	18.7	18.7	20.1	24.6	n.a.
Credit to private sector/GDP	52.2	56.8	61.7	74.4	n.a.

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Covid-19: macroeconomic implications

The economy strongly contracted in 2020 as tourism and global demand plummeted. Following an average growth of 4.9 per cent in 2017-19, gross domestic product (GDP) declined by 6.2 per cent in 2020 as the economy was hit by the Covid-19 pandemic shock. The hospitality sector and exports of goods suffered an immediate blow. In 2020 exports of services contracted by 65.6 per cent and exports of goods by 12.1 per cent, investment activity shrank by 4.8 per cent while repeated lockdowns weighed on consumption and many small service providers. Nonetheless, household consumption posted 5.4 per cent growth. Inbound money transfers grew by 8.8 per cent in the same period as strong growth in the second half of the year outpaced the initial fall in the second quarter. Many indicators point to a strong recovery from January to September 2021: money transfers grew by 27.8 per cent and nominal goods exports by 24.0 per cent, both year-on-year, the latter driven largely by increased trade with China and neighbouring economies. As a result, high-frequency economic data point towards a strong growth of 11.3 per cent year-on-year from January to September 2021. As Georgia lifted restrictions on international air travel in February 2021, tourism started to recover slowly but it remains far below the levels seen before the Covid-19 pandemic. In the first nine months of 2021, the number of international travellers was just 18.0 per cent of the figures for the same period in 2019.

The downturn in 2020 led to higher public debt and inflation. Increased spending on the Covid-19 crisis response, shrinking budget revenues and reduced economic activity deepened the budget deficit from an average of 1.0 per cent of GDP in 2017-19 to 9.2 per cent in 2020. On the back of the new borrowing needed to cover the fiscal gap, currency depreciation and economic contraction, this resulted in a steeply rising public debt, from 40.4 per cent of GDP in 2019 to 60.0 per cent in 2020. Upon repaying the 10-year Eurobond in April 2021, the authorities issued a five-year US$ 500 million Eurobond at a historically low coupon of 2.75 per cent, with demand exceeding supply by a factor of four. Together with official lending, this helped to maintain international reserves at high levels, amounting to US$ 4.1 billion in September 2021 and covering approximately 5.4 months of imports, despite the National Bank of Georgia's (NBG) occasional interventions on the foreign exchange market to smooth out currency volatility. Earlier depreciation and rising commodity prices raised inflation pressures in the first half of the year. Consumer price index growth stood at 12.3 per cent year-on-year in September 2021, compared with 2.4 per cent year-on-year in December 2020. To combat inflation, the NBG raised the refinancing rate three consecutive times, from 8 per cent in March 2021 to 10 per cent in August 2021.

Recovery prospects are cautiously optimistic. GDP growth is forecast to recover to 7.5 per cent in 2021 and accelerate to 5.5 per cent in 2022. The main driver for the overall economic recovery remains the return of tourism, which is a lifeline for many businesses in Georgia. Major risks stem from the slow vaccination rate and potentially extended travel restrictions because of more infectious variants of the Covid-19 virus spreading. Maintaining macro-economic policy discipline, in particular in relation to adherence to the fiscal rule, will be a challenging task.

Policy response to Covid-19

The government implemented a comprehensive package of measures to support the economy in 2020. The total fiscal support package amounted to 3.8 per cent of GDP (Lari 1.86 billion). Economic support measures included the postponement of tax payments, subsidised interest payments on loans and scaling up of the credit guarantee scheme. The central bank lowered capital and liquidity requirements and relaxed regulatory requirements to support loan restructuring.

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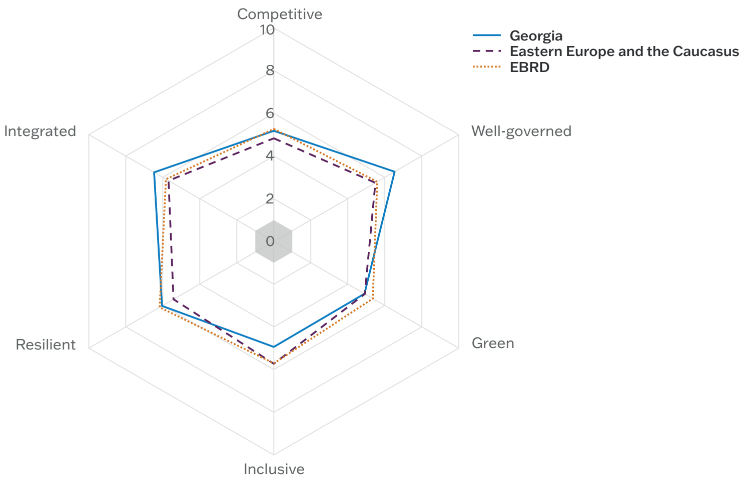
The fiscal support package for 2021 is expected to reach 2.3 per cent of GDP (Lari 1.2 billion). Previous measures were reintroduced during the second lockdown, including the coverage of utility fees for smaller household users and the exemption from income tax for those in low-paid jobs. In addition, employees in the hard-hit tourism sector are fully exempt from property tax in 2021. The Covid-19 policy response in 2021 is supported by external financing, including the International Monetary Fund programme finalised in April 2021 and Eurobond issue in early 2021.

Assessment of transition qualities (1-10)



Structural reform developments

Despite significant political volatility, the government presented a new 10-year development plan for Georgia. Repeated disruptions to the economy and a difficult environment on the domestic political scene, on top of Covid-19 pandemic-related uncertainties, have reduced the space for reforms. Despite this, in July 2021 the government produced an overarching medium-term development vision to advance the socio-economic development of Georgia. The development plan is supported by ministry-specific strategies setting out development goals, financial needs and planned instruments for the next 10 years.

A new insolvency framework is in place. After adopting the Law on Rehabilitation and Collective Satisfaction of Creditors in parliament in September 2020, the new framework entered into force in April 2021. Before the reforms, the legislation was focused on swift liquidation of debtors in financial difficulties, thus essentially neglecting other restructuring possibilities and the interests of some stakeholders. The new law introduces a new profession of licensed insolvency practitioners and creates incentives to use other restructuring possibilities at an early stage, even before getting to the point of bankruptcy liquidation. It also introduces the possibility of reaching a regulated agreement outside of court. Thereby it is intended to offer adequate protection of creditor rights, ensure timely and efficient insolvency processes and provide an effective rehabilitation framework in line with best international standards. The new regulation is expected to strengthen Georgia's economic and financial system and help resolve Covid-19 pandemic-related bankruptcies more efficiently.

CONTINUES

Labour reform law aims to unify interests of workers and employees and bring their rights into line with international standards. A comprehensive labour law reform package was adopted in autumn 2020. It includes extending the scope of the labour supervisory body to the full range of labour rights, prohibiting discrimination and regulating internships and overtime. Labour inspectors will be able to achieve compliance through proactive steps and by giving them the necessary enforcement tools. The new laws bring Georgia's labour legislation into line with relevant international labour standards of the International Labour Organization and European Union Directives and aim to strike a better balance between the rights and interests of workers and employers.

Significant improvements have been made in tax administration and reducing outstanding value added tax (VAT) refunds. In October 2020 the government introduced fully automatic VAT refunds. This should help provide liquidity to the private sector and reduce the outstanding stock of VAT credits. The Georgia Revenue Service has been enhancing its risk-based approach to better identify non-compliant cases and inform individuals and legal entities at an early stage about inconsistencies. It is training its auditors to implement an audit case management system, which should improve productivity and timeliness of audits.

The authorities have completed secondary legislation to support the banking resolution framework. The new regulations, designed to enhance financial resilience, include legislation on resolution plans, a temporary administrator and special manager, recapitalisation tools, and temporary public support and emergency liquidity assistance backed by government guarantees.

The digital agenda has advanced. New electronic services (such as online applications for identity cards and passports, birth certificates, changes of name, new business and land title registrations) were integrated into the Unified Service Portal (www.my.gov.ge) throughout 2020 and 2021 to enable citizens to receive critical services without leaving their homes.

MOLDOVA

Highlights

- **The economy is on the path to recovery in 2021.** On the back of growing global demand and private consumption, gross domestic product (GDP) grew by 11.7 per cent year-on-year in the first half of 2021.
- **Inflation accelerated sharply in the third quarter of 2021.** The acceleration took place after a lengthy period of relatively subdued inflation during most of 2020 and the first half of 2021, prompting an appropriate monetary policy response.
- **The financial sector continued to harmonise regulation with international standards.** The National Bank of Moldova (NBM) approved a new regulation that gradually introduces leverage indicators for banks, while the process of adopting the Solvency II Directive is advancing in parallel with an overhaul of the insurance sector.

Key priorities for 2022

- **The authorities should advance the structural reform agenda, and improve governance and the business climate.** Key priorities in the short term include enabling an independent and professional judiciary, strengthening public institutions and continuing the fight against corruption.
- **Harmonisation of financial sector regulation with international standards needs to continue.** The NBM's independence should be strengthened by ensuring the legal irrevocability of its monetary and supervisory decisions.
- **Policies to support a resilient recovery from the Covid-19 pandemic should be prioritised.** Climate-awareness policies are needed to maintain competitiveness on an increasingly climate-aware European Union (EU) market. Policies regarding equality of opportunities and improving living standards are crucial to reduce emigration flows and foster growth prospects for the economy.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	4.7	4.3	3.7	-7.0	7.0
Inflation (average)	6.6	3.1	4.8	3.8	3.0
Government balance/GDP	-0.6	-0.8	-1.4	-5.1	-4.3
Current account balance/GDP	-5.7	-10.6	-9.3	-7.5	-8.5
Net FDI/GDP [neg. sign = inflows]	-1.4	-2.3	-3.9	-1.3	-1.9
External debt/GDP	70.6	64.1	62.2	70.8	n.a.
Gross reserves/GDP	29.0	26.1	25.6	31.8	n.a.
Credit to private sector/GDP	18.7	18.4	19.2	22.1	n.a.

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Covid-19: macroeconomic implications

The economy is recovering in 2021 on the back of gradually increasing investments and reviving household consumption. The Covid-19 pandemic caused a deep GDP contraction of 7.0 per cent in 2020, with domestic consumption, investments and exports all registering substantial declines. In 2021 a recovery is under way, supported by growing global demand and private consumption. The automotive value chain led an export growth of 13.8 per cent year-on-year in nominal US dollar terms in the first half of 2021. In addition, money transfers have been exceptionally high in the first six months of 2021, increasing by more than 23.0 per cent year-on-year. This supported the recovery of economic activity, with 11.7 per cent growth year-on-year in the first half of 2021. Following higher food and oil prices and depreciation of the exchange rate, inflation accelerated from almost zero in January to 6.7 per cent in September 2021. The recent acceleration of inflation above the target rate of 5.0 per cent prompted the NBM to raise the base rate three times since July 2021, by a total of 2.85 percentage points, to 5.5 per cent in October 2021.

The stable macroeconomic position allowed for important fiscal support during the Covid-19 crisis. The current account deficit narrowed from 9.3 per cent of GDP in 2019 to 7.5 per cent in 2020, mainly financed by debt instruments, thus keeping international reserves at comfortable levels. International reserve assets amounted to US$ 4.0 billion in September 2021, covering more than seven months of imports. The relatively stable macroeconomic position before the Covid-19 crisis and access to US$ 235 million of the International Monetary Fund (IMF)'s rapid financing facility obtained at the onset of the Covid-19 pandemic helped the economy to cope with the pandemic shock. On the back of the economic contraction and fiscal costs of the policy support package aimed to reduce the impact of the pandemic, public debt increased from 28.3 per cent of GDP in 2019 to 34.8 per cent in 2020. The relatively low debt and availability of external financing allowed Moldova the fiscal space for a comprehensive support package.

The economy is expected to rebound in the short term, despite uncertainties. We expect GDP to grow by 7.0 per cent in 2021, helped by a recovery of global demand, followed by 4.0 per cent in 2022. The recovery of the economy depends on the roll-out of vaccines and a rebound of consumer and investor confidence. Since Moldova is integrated into the global supply chain of the automotive industry, the path of recovery is likely to be similar to the overall global recovery.

Policy response to Covid-19

The initial emergency policy response amounted to 2 per cent of GDP in 2020. It was focused on tax deferrals, a temporary increase in social benefits, monetary policy easing and liquidity provision. Further measures included a reduced value added tax (VAT) rate for the hospitality sector, faster tax reimbursements, subsidised lending to small and medium-sized firms and payroll compensation for firms that ceased operation during the state of emergency. Social assistance for vulnerable groups included expanded unemployment benefits and targeted social help. The NBM allowed banks to defer loan payments and reduced the local currency reserve requirements to support liquidity in the banking sector. The NBM further recommended banks to refrain from paying dividends, thus strengthening their capital positions.

Moldova's budget policy for 2021 prioritises support for the health sector and farmers. Medical staff, most of whom are financed by the National Medical Insurance Fund, will receive a 30 per cent salary increase. Furthermore, salary-related tax subsidies will continue and people who lost their jobs during the Covid-19 pandemic will be able to access grants.

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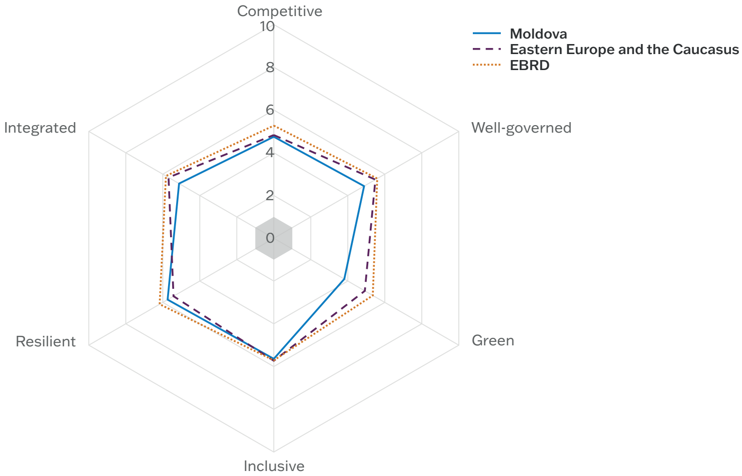
Assessment of transition qualities (1-10)



Structural reform developments

The retirement age has been lowered, threatening the sustainability of public finances. In December 2020 the previous parliament adopted a number of laws which have been criticised by the international community, among which was a lowering of the retirement age. While most of the laws have been ruled as unconstitutional by the Constitutional Court or sent back to parliament by the president, the law on pension age will enter into force in 2022, with women retiring at age 57 and men at 62. It is not yet clear how the new parliamentary majority will deal with the law but international institutions, including the IMF, have flagged the potentially serious macroeconomic and fiscal implications. Meanwhile, the retirement age for women increased by six months to 59.5 years in July 2021, in line with the provisions of the previous law.

The NBM continued to strengthen the prudence and soundness of the banking system. In December 2020 the Executive Board approved a new regulation that introduces leverage indicators for banks. Banks will now report quarterly information on these leverage indicators to the NBM and, after analysing data over three years, the NBM will set a minimum level to limit the risk of over-indebtedness of the banking sector.

The government adopted a comprehensive reform agenda for the insurance sector. In October 2020 the government adopted the law elaborated by the National Commission for Financial Markets focusing on the partial transposing of the Solvency II Directive, which covers provisions on supervision, prudential measures, corporate governance and risk management. It also imposes minimum capital requirements and increased transparency for licensing insurance companies. The law comes at a time when a number of insurers have declared insolvency, while the state has recently regained majority control of one of the key players in the sector.

CONTINUES

Digitalisation has been prioritised and advanced on a number of fronts. The new government has a Vice Prime Minister for digitalisation, responsible mainly for the digitisation of public administration. The public procurement platform, MTender, has been updated in terms of access to information, in line with open government data principles, but more progress is expected to develop all functionalities in line with the previously adopted law. Also, the NBM has implemented an automated information technology tool to assist in anti-money laundering and terrorist financing, a first in the region. In general, the use of e-government platforms, including the online signature, has significantly increased since the outbreak of the Covid-19 pandemic.

A limit on cash transactions has been imposed to curb informality. Since the beginning of 2021 there is a ceiling of MDL 100,000 (€4,700) per month in cash transactions, or €470 per transaction between firms regardless of their ownership and legal form. The measure intends to stimulate transactions through banks and cards, thus limiting the potential for informal payments and employment. Exceptions include settlements with citizens and economic actors purchasing agricultural products, and individuals who are not engaged in entrepreneurial activities.

UKRAINE

Highlights

- **The economy started to recover in the second quarter of 2021.** The prolonged lockdown caused economic growth to decline by 2.2 per cent year-on-year in the first quarter of 2021 but the gradual lifting of containment measures and high commodity prices supported a growth of 5.7 per cent year-on-year in the second quarter.
- **The authorities renewed Covid-19 crisis response measures throughout the first half of 2021.** In December 2020 parliament adopted a new set of fiscal measures to support the economy during the prolonged Covid-19 pandemic. The central bank has extended some prudential measures in 2021 and kept crisis liquidity instruments until the middle of the year.
- **After a long delay, parliament approved a series of key reform bills.** These include reinstating criminal liability for inaccurate asset declarations of public officials, strengthening the independence and regulatory power of the central bank and taking steps to reform the judiciary.

Key priorities for 2022

- **It is important to preserve reform achievements in the area of macro-financial stability and intensify reform efforts in the judiciary, anti-corruption and corporate governance.** An independent and professional central bank proved to be a great asset during the Covid-19 economic shock. Building an independent and professional judicial system, efficient anti-corruption bodies and good corporate governance in state-owned enterprises (SOEs) will lift the growth potential of the economy.
- **Post-Covid-19 recovery policies should focus on climate change and digitalisation.** A green-tilted recovery is necessary to reduce dependence on fossil fuels and to maintain the country's competitiveness on external markets, which increasingly take climate change into account. A systemic upgrade of digital infrastructure and skills, targeting all groups of society, could also boost competitiveness.
- **Preparations should be made to benefit from the expected reshuffle of global value chains.** As one of the largest economies in the European Union (EU) neighbourhood, Ukraine could play a significant role in the expected nearshoring efforts of companies in the EU.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	2.5	3.4	3.2	-4.0	3.5
Inflation (average)	14.4	10.9	7.9	2.7	9.5
Government balance/GDP	-2.2	-2.1	-2.2	-5.8	-4.5
Current account balance/GDP	-3.1	-4.9	-2.7	3.4	-0.7
Net FDI/GDP [neg. sign = inflows]	-3.3	-3.4	-3.4	0.1	-1.7
External debt/GDP	102.9	87.6	79.1	80.8	n.a.
Gross reserves/GDP	16.8	15.9	16.4	18.7	n.a.
Credit to private sector/GDP	34.1	30.1	24.4	22.6	n.a.

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Covid-19: macroeconomic implications

After a contraction in 2020 and the first quarter of 2021, the economy has returned to growth in the second quarter of 2021. In 2020 gross domestic product (GDP) declined by 4.0 per cent as a result of reduced foreign demand and Covid-19 pandemic containment measures. Private consumption remained slightly in positive growth territory, driven by a strong demand for goods, but investments in fixed assets fell by almost a quarter despite strong government stimulus in the roads sector. Exports and imports declined by 5.6 and 9.5 per cent respectively. A prolonged lockdown in early 2021 caused the economy to shrink by 2.2 per cent year-on-year in the first quarter of 2021, before returning to a growth of 5.7 per cent year-on-year in the second quarter of 2021, supported by higher commodity prices.

The Covid-19 pandemic caused a reversal of previous trends in public finances and the external sector. After several years of prudent fiscal policies, the government deficit deepened to 5.8 per cent of GDP in 2020 due to increased spending to finance the Covid-19 response. On top of that, the fall of output and currency depreciation led to an increase in public debt from 50.3 per cent in 2019 to 60.8 per cent in 2020. The current account deficit turned into a strong surplus of 3.4 per cent of GDP in 2020, supported by low prices of imported hydrocarbons, reduced spending on travel abroad and an increase in the primary income surplus. As a result, foreign reserves rose from US$ 25.3 billion in December 2019 to US$ 29.1 billion in December 2020, equal to 4.8 months of future import coverage. Reserves were boosted further in September 2021 by the new International Monetary Fund Special Drawing Rights allocation of US$ 2.7 billion, which fully compensated for the undisbursed remaining part of the Stand-By Arrangement (SBA) programme.

Inflation is rising, prompting the central bank to raise the policy rate. Driven by rising prices of utilities, food and transport, inflation accelerated in the first half of 2021 and reached 11.0 per cent in September 2021, prompting the National Bank of Ukraine (NBU) to raise the key policy rate four consecutive times since the beginning of the year to 8.5 per cent in September 2021.

A moderate recovery in 2021 is likely amid rising global commodity prices and erratic reform progress. The growth recovery which took hold in the second quarter of 2021 is expected to gain further traction in the second half of the year. We expect an economic growth of 3.5 per cent both in 2021 and 2022. Major downside risks remain, however, including the slow speed of vaccinations, the possibility of new variants emerging, and the slow progress of reforms.

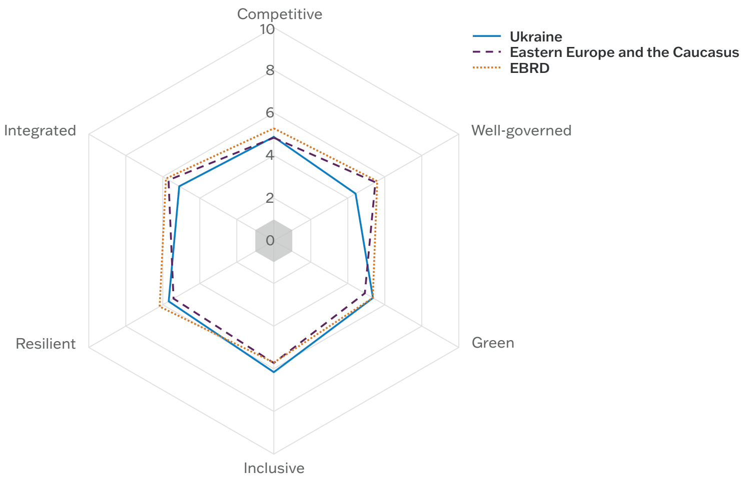
Policy response to Covid-19

In December 2020 parliament adopted a new set of fiscal measures to support the economy during the prolonged Covid-19 pandemic. To help businesses during the strict lockdown in January 2021, a one-off payment of UAH 8,000 (US$ 280) was made to more than 400,000 employees and sole entrepreneurs who lost their income. Those entrepreneurs most affected by the Covid-19 pandemic were exempted from paying income tax and social security distribution tax in the period December 2020 to May 2021, and tax debts not exceeding UAH 3,060 (US$ 110) were written off. The subsidised loans programme, which was expanded at the beginning of the Covid-19 crisis, continued in 2021. In addition, parliament approved state guarantees amounting to US$ 180 million for business loans granted by banks.

The central bank has extended some prudential measures in 2021 and kept crisis liquidity instruments until the middle of the year. Banks were recommended to restructure loans of borrowers facing financial difficulties from the Covid-19 pandemic and refrain from credit risk revision until the end of April 2021. As the economy returned to a steady growth and financial markets stabilised, the NBU decided in June 2021 to gradually phase out anti-crisis monetary measures such as long-term refinancing and interest rate swaps.

CONTINUES

Assessment of transition qualities (1-10)



Structural reform developments

Insufficient progress on reforms led to a pause in further disbursements of the IMF programme. To help sustain the external finances during the Covid-19 crisis, the authorities entered an 18-month IMF SBA of US$ 5.0 billion in June 2020. The lack of meaningful progress in the fight against corruption, in particular related to several rulings of the Constitutional Court undoing previous reform efforts, impeded the completion of several programme reviews. Additional concerns arose from the decision of the Cabinet of Ministers to temporarily reintroduce a regulated price for natural gas for households in January 2021 until the end of the heating season, which went against Ukraine's commitment to the IMF to apply a market-based pricing scheme.

Concerns regarding corporate governance standards and their application resurfaced. In April 2021 the Cabinet of Ministers dismissed the supervisory board of Naftogaz, the country's largest national oil and gas company, and subsequently dismissed the management board and appointed a new one. Immediately afterwards, the government reappointed the same supervisory board for another six months. This bypassing of the supervisory board to appoint a new Chief Executive Officer undermines the corporate governance principles of SOEs.

After initial setbacks, reform momentum gathered pace at the end of June 2021. A new bill, signed into law in July 2021, fully introduced criminal liability for civil servants for errors in asset declarations, significantly increasing the punishment for false or omitted reporting. The independence of the central bank and its regulatory powers regarding corporate governance and licensing in commercial banks were enhanced. Parliament approved in first reading the law to restructure the debt of the Deposit Guarantee Fund and for Oschadbank to join the Fund. The law also improves procedures for liquidating failed banks.

Parliament approved key judiciary reform bills. In July 2021 parliament approved a bill that relaunches an independent panel, the High Qualification Commission of Judges, to appoint judges and ensure they qualify for the job. The bill also includes a provision that gives international experts a decisive voice in selecting the nominees. Appointments of members of the High Council of Justice (HCJ), the key judicial governance body responsible for ensuring judicial independence and accountability of judges, are regulated by another regulation put in place in July 2021. The commission to select members of the HCJ, the Ethics Council, will include six members, of which Ukraine's Western partners will appoint three. The Ethics Council will also perform an integrity check of existing members of the HCJ.

CONTINUES

Efforts to improve the investment climate are ongoing. In March 2021 the president signed a law establishing the Bureau of Economic Security, which will take over the functions of investigating economic crimes from the Security Service of Ukraine, State Fiscal Service and State Bureau of Investigations. Efforts to make Ukraine more attractive for large investors have been increased in the past year. Investors can get state support of up to 30 per cent of their investment if it exceeds €20 million. State support can come in the form of tax benefits and special conditions for the rent of land or infrastructure construction around the project.

The authorities made significant pledges to contribute to the global efforts to fight climate change. Ukraine submitted its updated nationally determined contributions in July 2021. By 2030 greenhouse gas (GHG) emissions should not exceed 35 per cent of 1990 levels, which is a significant improvement on the 60 per cent target envisaged in 2016. In March 2021 the government approved the National Economic Strategy until 2030, through which climate neutrality is to be achieved no later than 2060. Ukraine also plans to set up a national GHG emissions trading system and to introduce carbon taxes in 2025. As a first step, in January 2021 the law implementing a system to monitor, report and verify GHG emissions came into force.

Digital services are expanding. The number of government services available via the “Diia” app is expanding. In March 2021 Ukraine gave e-passports the same legal status for domestic use as traditional paper documents.