Albania

Highlights

- **Economic growth is slowing down.** Strong domestic demand and an expanding hospitality sector led the 8.5 per cent expansion in 2021, but the pace of growth slowed in the first half of 2022 as output grew 4.2 per cent year on year.
- **Most public services have been digitalised.** Continuous progress in this area since 2013 means that nearly all public services in Albania where an in-person meeting is not essential are now offered solely online, despite pervasive cyber security problems.
- **The national energy and climate plan (NECP) has been adopted.** Albania was the first Western Balkans country to adopt the framework, which includes accelerating the development of non-hydro renewables and energy efficiency measures to reduce greenhouse gas emissions.

Key priorities for 2023

- **Fiscal reform would create more policy space and improve longer-term sustainability.** The medium-term fiscal strategy should mobilise revenue and create space for targeted social protection measures by broadening the tax base, boosting tax compliance and reducing the cash economy. In terms of sustainability, it should account for fiscal risks stemming from public-private partnerships and guarantees for public companies.
- **Diversification of renewable energy should lead to greater energy security.** In light of energy security concerns, developing the sizeable pipeline of solar and wind projects should be accelerated.
- **The business environment should be further improved.** Key measures that should be given priority include simplifying the tax system and streamlining procedures, enhancing support for micro, small and medium-sized enterprises and incentives to formalise activities, ensuring the security of e-government services and increasing the effectiveness of the public-private dialogue.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	4.0	2.1	-3.5	8.5	3.0
Inflation (average)	2.0	1.4	1.6	2.0	6.2
Government balance/GDP	-1.3	-1.9	-6.7	-4.5	-4.1
Current account balance/GDP	-6.7	-7.9	-8.7	-7.7	-8.6
Net FDI/GDP [neg. sign = inflows]	-8.0	-7.5	-6.7	-6.4	-6.5
External debt/GDP	65.1	60.0	64.4	63.1	n.a.
Gross reserves/GDP	26.5	24.4	29.7	32.1	n.a.
Credit to private sector/GDP	33.0	34.1	38.0	36.0	n.a.

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Macroeconomic developments and policy response

Economic expansion is slowing. The economy recovered by a strong 8.5 per cent in 2021 on the back of a major rebound of the sizeable tourism sector and heightened domestic demand. The expansion continued into the first quarter of 2022 as output grew by 6.5 per cent but slowed in the second quarter to 2.2 per cent as export and private investment growth were muted, though household consumption remained robust. Strong credit growth to residents, at 14 per cent year on year in August 2022, and steady inflows of remittances supported a 9 per cent annual increase of household consumption in the first half of the year. In spite of continually high credit growth to private companies, investment contracted by 7 per cent year on year in the second quarter given last year's strong expansion, with construction activity falling accordingly. As manufacturing output slowed and industrial activity contracted year on year in the second quarter, exports of goods continued to grow annually in real terms at a more moderate pace of 15 per cent compared with 44 per cent in the first quarter. In the first eight months of 2022 foreign tourist arrivals were up by 29 per cent annually and by 16 per cent compared with pre-pandemic levels while domestic trade posted double-digit growth in the first half of the year.

Inflation is rising but the exchange rate remains stable. Driven by globally higher prices of imported food and oil, annual inflation reached 8.1 per cent in September 2022. Though subdued by regional standards, this level of inflation is the highest in the last 20 years and weighs heavily on households for whom essentials such as food and utilities account for as much as 42 per cent and 10 per cent of consumption expenditure, respectively. Surging electricity prices in international markets did not affect Albanian consumers until October 2022, despite the country's frequent reliance on imports to supplement fluctuating domestic production from hydro sources, as the public sector absorbed the rising costs. The current account deficit narrowed in the first half of 2022, as robust goods and services export growth offset the rise in imports, supporting the relative stability of the exchange rate.

Policy measures are shielding the economy from rising prices. Following nearly two years of record low policy rates, the national bank tightened monetary policy four times in the first 10 months of 2022, raising the policy rate from 0.5 per cent in March to 2.25 per cent in October. In light of the start of the war on Ukraine and mounting energy security concerns, the government adopted the Social Resistance Package in March 2022. This includes measures such as pension indexation, subsidies for vulnerable groups, temporary tax relief on income (for all) and oil (for farmers), a slight increase in the minimum wage and a heightened energy price shield for firms. As another €100 million was pledged for inflation relief measures, further amendments in pension indexation, an increase in the electricity price for large consumers, and an increase in the minimum wage were approved in September 2022, alongside public sector wage indexation and the scaling up of social transfers. The fiscal deficit in 2022 was revised downwards in September, given better than expected fiscal performance in the first eight months of the year, and is projected at 4.1 per cent of gross domestic product (GDP), with public debt expected to decline in 2022.

Growth is expected to moderate further as downside risks increase. Economic growth is projected at 3.0 per cent in both 2022 and 2023. Key risks to the near-term outlook include rising inflation and tightened financing conditions, which dampen household consumption and investment. On the positive side, initial figures point to a strong tourism season which should boost external and fiscal accounts ahead of the challenging heating season and lead growth in the third quarter of the year.

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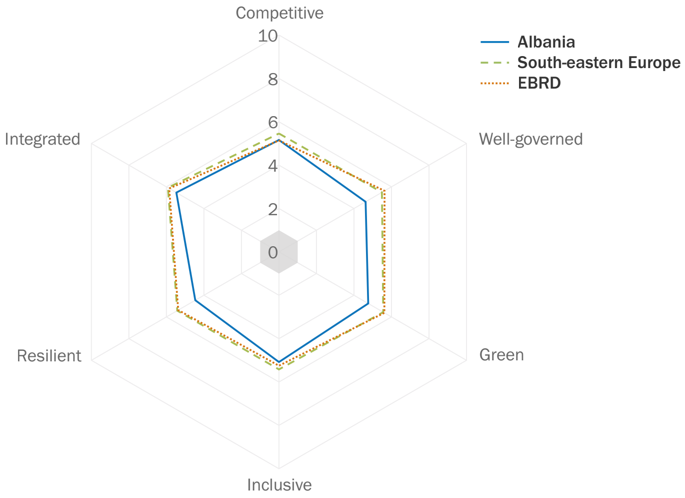
CHART Assessment of transition qualities (1-10)



Structural reform developments

European Union (EU) accession negotiations have begun. The long-awaited formal opening of the EU accession negotiations, the first intergovernmental conference, took place on 19 July 2022. It was followed by the inaugural launch by the European Commission of the screening process.

Nearly all public services are now available online. According to the authorities, 95 per cent of services delivered by the public administration are to be provided solely online from May 2022, with in-person service windows set to be shut down, in a bid to reduce corruption and improve service quality and transparency. The now all-encompassing e-Albania portal has been active since 2013, with public services continually added to the platform in parallel to simplifying processes through deregulation reform. However, digitalisation has not been smooth sailing for the country, as security breaches in December 2021 and April 2022 exposed the personal and income data of over a fifth of Albanians. The government was additionally forced to briefly shut down the online provision of services in July 2022 due to a cyber attack. Some 91 per cent of Albanian households have access to the internet, the highest rate in the Western Balkans.

Albania has adopted the National Energy and Climate Plan (NECP). Adopted in December 2021, the plan represents the framework governing Albania's energy transition efforts until 2030 and will be continually updated. The Albanian energy sector is unique in the Western Balkans due to its near complete dependence on hydropower for electricity generation, giving the country the opportunity to focus its decarbonisation efforts on other emission-intensive sectors such as industry. While domestic energy production is largely green, consumption is frequently supplemented by imported fossil fuels. The plan's targets for the period considered include reducing greenhouse gas emissions by nearly a fifth, cutting energy consumption, and increasing the share of renewables in final energy demand to over a half.

The constitution was amended to allow the vetting of the judiciary to continue. The vetting process has been a cornerstone of judicial reform in Albania, initiated in 2016 and extended for another two years via a constitutional amendment in February 2022. Judicial reform was one of the key conditions set by the EU for the beginning of accession talks. Though judged by the European Commission as effective in fighting deep-rooted corruption in the judiciary, the vetting process has taken longer than expected and resulted in a backlog of cases for courts due to a high number of the judiciary leaving their posts. Out of over half of the vetting files processed so far, some 60 per cent have resulted in dismissals or terminations due to resignations or retirement age being reached.

The second and final tranche of the EU's macro-financial assistance (MFA) was disbursed. The tranche, equal in size to the first one and amounting to €90 million, was disbursed in November 2021 as Albania had fulfilled the policy conditions agreed with the EU, including measures to strengthen public finance and financial sector resilience, improve governance and enhance social protection.

Armenia

Highlights

- **A strong post-Covid-19 recovery has continued in 2022.** Broad-based growth of 13.9 per cent year on year in the period from January to August 2022 was driven by a large rise in money transfers and growing demand for services associated with the arrival of many Russians finding temporary refuge in Armenia.
- **Reforms in the energy sector have advanced.** The authorities have announced plans for renewable energy production up to 2030 and for a more competitive domestic electricity market, with free and open electricity trading.
- **The digitalisation of government services has accelerated.** The single window e-system reduces interaction with public authorities and simplifies the process of issuing permits and customs clearance. The new system should be fully implemented by the end of 2022.

Key priorities for 2023

- **Governance standards need to be improved.** Key challenges in the short term include strengthening the quality of public institutions and enabling the independence and competence of the judiciary, along with a renewed focus on improving corporate governance standards and making further progress in implementing the competition framework.
- **Momentum towards an open and competitive electricity market should be stepped up.** As the domestic electricity market becomes more liberalised in 2022, the authorities should take advantage of the ongoing initiative to enhance the competitiveness of the electricity industry and attract further investment in renewable energy.
- **Anti-corruption institutions need to be strengthened.** The establishment of the Anti-Corruption Committee (ACC) in 2021 was welcome, but implementing anti-corruption measures has been limited so far.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	5.2	7.6	-7.4	5.7	8.0
Inflation (average)	2.5	1.4	1.2	7.2	8.5
Government balance/GDP	-1.8	-1.0	-5.4	-4.6	-2.3
Current account balance/GDP	-7.4	-7.3	-3.8	-3.7	-5.5
Net FDI/GDP [neg. sign = inflows]	-2.1	-1.7	-0.7	-2.5	-1.5
External debt/GDP	87.7	90.9	102.1	99.9	n.a.
Gross reserves/GDP	18.1	20.9	20.7	23.3	n.a.
Credit to private sector/GDP	57.1	62.6	73.3	61.5	n.a.

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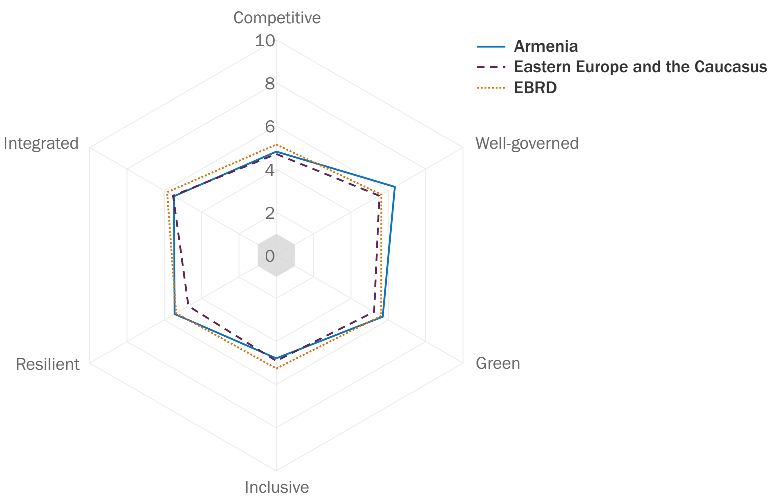
Macroeconomic developments and policy response

A strong economic recovery has continued into 2022. The rapid upturn in the economy experienced in the last quarter of 2021 further accelerated to gross domestic product (GDP) growth of 13.9 per cent year on year in the period from January to August 2022. Manufacturing recorded growth of 9.2 per cent, construction and trade growth was in double digits, and services increased by 27.1 per cent. Armenia has high exposure through trade, remittances and foreign direct investment to the recession-hit Russian, Ukrainian and Belarusian economies, but negative spillovers have been outweighed by the inflow of a significant number of people and businesses from Russia, which has boosted demand in the real estate and services sectors. The net inflow of money transfers between March and July 2022 increased by 109.0 per cent year on year due to a five-fold increase from Russia. This helped to finance the widening trade deficit, as imports rose by 58.2 per cent (and exports by 52.9 per cent) year on year from January to August 2022. As a consequence, foreign reserves increased by almost US$ 600 million since the start of the war on Ukraine, reaching US$ 3.6 billion at the end of August and covering five months of imports.

Inflationary pressures have prompted rises in the central bank's policy rate. The war on Ukraine and the associated disruption to food and energy markets have led to annual inflation rising from 6.5 per cent year on year in February 2022 to 9.1 per cent in August. Initially, inflation pressure came from rising prices of imported food, but the large foreign inflows supported an appreciation of the domestic currency by 18 per cent versus the US dollar between the start of 2022 and the end of August, thus alleviating the pressure from imported prices. More recently inflation has been driven by demand pressures, alongside supply disruptions caused by sanctions on Russia. These developments prompted the Central Bank of Armenia (CBA) to raise the policy rate by 225 basis points at the beginning of the year, to 10.0 per cent as of the middle of September. Meanwhile, the government has announced an increase in the minimum wage of 10.0 per cent from January 2023 and an increment to the minimum pension from 28,600 dram (US$ 71) to 30,500 dram (US$ 76) from September 2022.

Strong growth will continue in the short term, but significant risks remain. We expect GDP growth in 2022 to reach 8.0 per cent, followed by a moderation to 4.0 per cent in 2023. The current level of economic activity is driven by temporary factors that could easily be reversed. Also, the isolation of the Russian economy from western markets, if it persists, could have negative long-term consequences for the Armenian economy.

CHART Assessment of transition qualities (1-10)



NOTE: Belarus is not included in the EBRD region and respective regional averages.

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Structural reform developments

Armenia has started to liberalise the domestic electricity market. In February 2022 an electronic electricity trading platform was introduced to facilitate free and open trading under the auspices of Armenia's Public Services Regulatory Commission. Previously, the domestic electricity market had a single supplier, the Electric Network of Armenia. This shift to a more competitive and open power market enables open access to other suppliers and cooperation among all energy market participants. Full liberalisation, including direct contracts on the wholesale market, is planned for February 2023.

Transition to a green economy has accelerated. In March 2022 the government adopted the Programme on Energy Saving and Renewable Energy for 2022-30. It is based on commitments undertaken by the authorities under various international agreements and treaties on sustainable development, renewable energy, energy saving and climate change, and it defines the country's main goals and targets. It will be implemented in three stages: 2022-24; 2025-27; and 2028-30. The programme sets out the main actions and measures needed to achieve the targets. In April 2022 for example, the authorities granted an exemption on customs duty for 7,000 imported electric vehicles. This reflects a gradual movement towards one of the set targets, which is to increase the share of electric vehicles to 10 per cent of all light vehicles in Armenia by 2030. The programme aligns with the goals of the Energy Strategy of Armenia, adopted in January 2021, which aims for solar photovoltaic capacity reaching 100 MW by 2024 and 1,000 MW by 2030.

The digitalisation of government services has advanced. In October 2021 the State Revenue Committee launched a new electronic government service of a single window, one-stop shop. A total of 17 public administration organisations have been gradually joining this platform, which simplifies the process of issuing permits and customs clearance. Full implementation of the new system should be completed by the end of 2022. The CBA is also cooperating with the public administration and private sector to establish a national electronic identity system to enable safer digital payments.

The social protection scheme has been expanded to support the most vulnerable. Since January 2022 the minimum pension and other social benefits have increased. The minimum pension was raised from 26,500 dram (US$ 65) to 28,600 dram (US$ 70), while disability pensions for the military will rise by 3,000 dram (US$ 7). For those bereaved due to military engagement, the bereavement support payment has also increased from 27,000 dram (US$ 66) to 30,000 dram (US$ 73). Furthermore, the child disability pension and childcare benefits have increased, by 10,500 dram (US$ 26) and 1,100 dram (US$ 2.7), respectively.

An implementation plan for public-sector governance reform has been confirmed. To improve the efficiency of public services the authorities adopted a new public administration reform strategy in May 2022. The authorities aim to tackle the longstanding issue of inefficient governance across all levels of government through comprehensive reforms between 2022 and 2030. Reforms will focus on three areas: allocating human resources, improving the public-service database, and strengthening digital public service delivery.

The institutional capacity to tackle corruption in government has improved. The ACC, established in 2021, was overloaded with administration and investigative proceedings, and implementation was limited. In May 2022 the authorities proposed a legal amendment that enables staff at the ACC to focus fully on corruption crime cases. The adoption of a new code of conduct in July 2022 provided a strong impetus for anti-corruption reform. The code of conduct followed extensive consultation among social actors, including civil society, and requires all public servants to reduce corruption and bribery across the government.

Azerbaijan

Highlights

- **Rising gas demand and increasing output in the non-energy sector are supporting post-pandemic economic growth.** Domestic consumption has risen sharply and exports have recorded strong real growth due to high demand for alternative gas supplies to the European market.
- **The authorities are using fiscal and monetary measures to combat the effect of rising prices.** Inflation reached 14.2 per cent year on year in August 2022. The central bank has raised the policy rate, and the government has introduced a series of fiscal policy measures, including rises in the minimum wage, pensions and social assistance, to limit the impact of higher prices on vulnerable groups.
- **Access to financial services was enhanced.** The national postal service, with its wide network of offices around the country, was enabled to act as an agent offering services on behalf of domestic banks. Remote banking services were also introduced, contributing to the digitalisation of the economy.

Key priorities for 2023

- **The strong post-pandemic momentum of the non-oil sector should be steered towards sustainable diversification of the economy, making it more resilient to shocks.** This includes strengthening the competition regulation framework and reducing the state's footprint in many sectors of the economy. Opening up the financial sector to foreign investment would improve access to finance and support investment activity of small and medium-sized enterprises.
- **Anti-corruption efforts should be stepped up.** The recently adopted National Anti-Corruption Strategy should be implemented with clear goals towards transparent and accountable governance. Introducing digital tools to empower citizens to participate in political decisions would be a good step in the right direction.
- **De-carbonising the economy should be a priority.** As part of the "Azerbaijan 2030" long-term development plan, the gradual detachment from dependence on hydrocarbon exports can contribute to diversifying the economy. High revenues stemming from rising energy prices should be used to support investments in green energy and climate mitigation measures.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	1.5	2.5	-4.2	5.6	4.5
Inflation (average)	2.3	2.6	2.8	6.7	12.2
Government balance[1]/GDP	5.5	8.9	-6.7	4.1	17.1
Current account balance/GDP	12.8	9.1	-0.5	15.2	31.7
Net FDI/GDP [neg. sign = inflows]	1.7	2.9	1.8	3.8	3.5
External debt/GDP	47.1	47.2	55.7	43.7	n.a.
Gross reserves[2]/GDP	11.9	13.0	14.9	13.0	n.a.
Credit to private sector/GDP	16.3	18.7	20.0	18.4	n.a.

NOTE:
1 Includes central government and main extra budgetary funds, including operations of the oil fund and the social protection fund.
2 Excluding assets of the State Oil Fund (SOFAZ).

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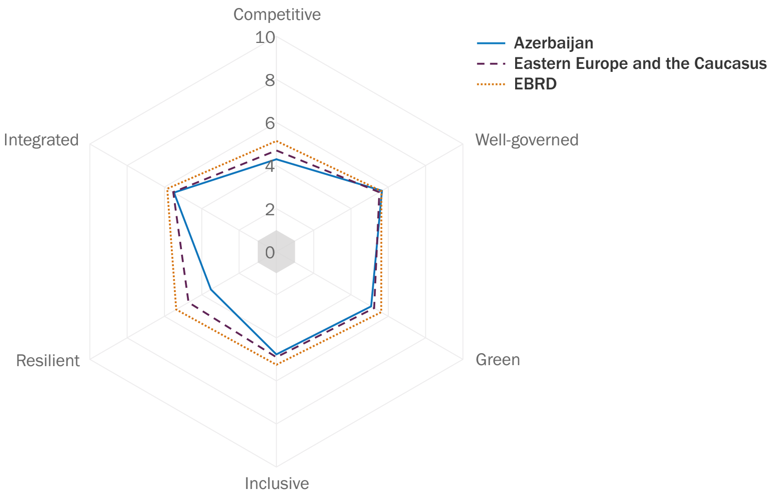
Macroeconomic developments and policy response

Economic growth has been higher than expected on the back of strong performance from the non-energy sectors. After a solid post-Covid-19 recovery of 5.6 per cent growth in gross domestic product (GDP) in 2021, the economy increased by 5.8 per cent year on year in the period January to August 2022, driven by strong growth of the non-oil and gas sector of 10.3 per cent. The oil and gas sectors decreased by 2.0 per cent in the same period, primarily because of oil production declining by 5.2 per cent, although gas production increased by 11.3 per cent. However, exports remain dominated by hydrocarbons, which doubled in nominal terms in the period January to August 2022, generating a large current account surplus driven by high demand for alternative gas supplies on the European market and facilitated by the Trans Adriatic Pipeline, which was completed in 2020.

The authorities have put measures in place to limit the impact of high inflation. Rising global food and energy prices and supply disruptions led to an acceleration of inflation in Azerbaijan from 12.0 per cent at the end of 2021 to 14.2 per cent in August 2022. Food prices saw the largest increases but prices of services also recorded almost double-digit growth. Strong economic activity and an increase of nominal income by almost 20 per cent in the period January to August 2022 added to inflationary pressures. The Central Bank of Azerbaijan has responded by tightening the refinancing rate five times since the beginning of 2021, to 7.75 per cent in September 2022. In parallel, the government supported vulnerable groups through a package of budgetary measures, including increases in the minimum wage, pension and social allowances, subsidies to flour producers, and value added tax (VAT) exemptions for wheat, wheat flour and bread. Despite these measures, tax revenues have been rising much faster than expenditures since the beginning of the year, generating a significant budget surplus.

Rising energy prices will likely support economic growth in the short term. The growth of the non-oil and gas economy will likely moderate due to slowly decreasing demand, as consumers are faced with high prices, but energy prices and demand for Azerbaijani gas are expected to remain high in the short term, which will support overall economic performance in the second half of 2022. Therefore we expect overall strong GDP growth of 4.5 per cent in 2022, but some moderation to 2.5 per cent in 2023. The main risks relate to persistent inflation, a potential drop in energy prices, and structural weaknesses in the economy. In the coming years, however, Azerbaijan may benefit from additional investments in the gas industry as the European Union tries to diversify away from Russian gas.

CHART Assessment of transition qualities (1-10)



NOTE: Belarus is not included in the EBRD region and respective regional averages.

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Structural reform developments

Efforts to fight corruption have increased. In April 2022 the president approved the National Anti-Corruption Strategy for 2022 to 2026. It consolidates and coordinates the anti-corruption efforts of various agencies with different areas of activity. The aim is to increase transparency of government agencies, prevent corruption from flourishing, and strengthen the public accountability of state bodies. Furthermore, the strategy outlines how to improve and digitalise public services, as well as ensure sustainability of anti-corruption measures. In parallel, the authorities launched new portals to encourage citizens' e-participation in decision-making processes and give them a platform to voice their concerns.

Financial inclusion has been strengthened with the launch of the first agent banking model in the country. In March 2022 the Central Bank of Azerbaijan enabled banking products and services to be sold by third parties to offer better access to financial services for the population in areas with little coverage by bank branches. Initially, the services of Access Bank will be delivered through the national postal service, Azerpost, with more banks expected to follow. The offer currently includes micro and agri-loans, as well as consumer loans and debit cards to customers.

The Central Bank of Azerbaijan is promoting digital banking and payments. In November 2021 the central bank developed methodological guidelines for the use of QR code payments. The guidelines will ensure that QR payments provided by banks and non-bank payment organisations are standardised and that contactless payments are accepted more widely, thus providing more affordable payment solutions. In April 2022 the central bank revised and approved the regulation which expands access to remote banking and provides for bank accounts to be opened remotely through digital identification.

The authorities are using tax changes to encourage capital market development. In June 2022 amendments to the tax code to form a favourable tax regime in the capital markets came into force. Dividends and interest income from publicly traded shares and bonds will be exempt from income tax for five years, starting in February 2023. This measure aims to stimulate the issuance of securities on the stock exchange and increase interest in securities traded on a regulated market.

The authorities have boosted the use of renewable energy. Following COP26 in November 2021 the authorities set a target of reducing greenhouse gas emissions by 40 per cent and increasing the share of renewable energy by up to 30 per cent of national energy generation by 2030. The start of construction at the beginning of 2022 on a 240 MW wind power plant and a 230 MW solar power plant was an important step in that direction.

A controversial new media law was introduced. The new law became effective in February 2022. According to the government, the law intends to bring this area into line with international standards, modernise the country's media legislation and improve the professionalism of journalists. However, according to the Council of Europe's Venice Commission, the new law constrains the range of media coverage and activities, thereby limiting freedom of expression. Parts of the law contradict the principles of free, independent, uncensored media and pluralism as the law provides for increased state control and regulation of the media through tighter licensing/registration procedures.

Belarus*

Highlights

- **Sanctions against Belarus have been expanded in response to the country's support of Russia's military invasion of Ukraine.** The European Union (EU) and many other developed economies have imposed new economic and individual sanctions targeting Belarus, including further trade restrictions, and bans on access to financial services and markets and the use of logistical services.
- **Political and geopolitical developments have damaged the economy.** Gross domestic product (GDP) fell by 4.9 per cent year on year in the period January to August 2022, while double-digit inflation has depleted real incomes.
- **Belarus's credit rating has been downgraded.** Both Fitch and Moody's adjusted Belarus's credit rating to "restricted default" in July 2022, as the authorities unilaterally decided to pay a US$ 23 million Eurobond debt in domestic currency.

Key priorities for 2023

- **Any economic recovery will likely require the improvement of Belarus's international standing and lifting of sanctions.** Access to the international financial system and to the EU market is an important prerequisite for sustainable economic growth. However, it is clear that it depends on the domestic political situation and on Belarus's ability to distance itself from Russia's invasion of Ukraine.
- **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. Both liberalising economic governance and introducing appropriate market regulations are critical for restarting the stalled economy.
- **Improving corporate governance and commercialising the state-owned sector are of the utmost priority.** Inefficiencies and a lack of corporate governance in state-owned enterprises (SOEs) are seriously undermining the growth potential of the economy. Further delays to corporate governance reforms will have long-term negative consequences for SOE valuations and growth prospects.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	3.1	1.4	-0.7	2.3	-5.5
Inflation (average)	4.9	5.6	5.5	9.5	16.5
Government balance[1]/GDP	1.8	0.9	-2.9	-1.7	-4.3
Current account balance/GDP	0.0	-1.9	-0.4	2.7	-1.5
Net FDI/GDP [neg. sign = inflows]	-2.3	-2.0	-2.2	-1.9	-0.7
External debt/GDP	65.5	63.1	70.0	61.5	n.a.
Gross reserves/GDP	11.9	14.6	12.4	12.4	n.a.
Credit to private sector/GDP	21.3	21.9	23.7	23.0	n.a.

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

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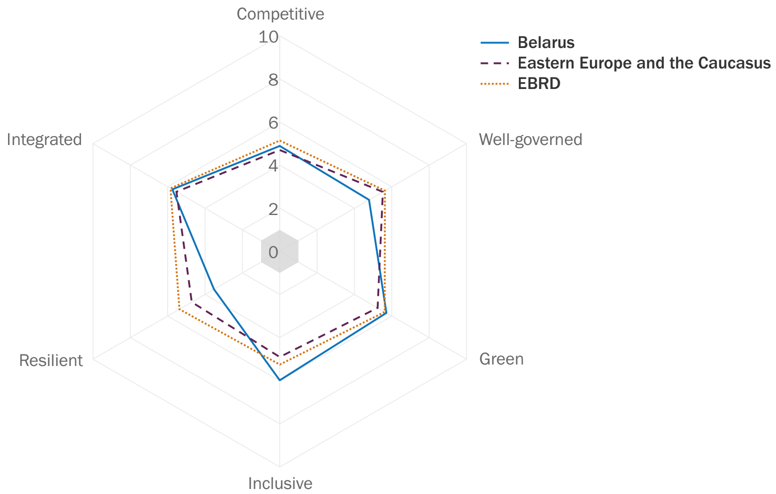
Macroeconomic developments and policy response

Geopolitical developments heavily affected the economy in the first half of 2022. The Belarusian economy contracted by 4.9 per cent year on year between January and August 2022 due to toughened sanctions on its economy and recession in Russia, the main trading partner. The new sanctions on industrial goods such as minerals, fertilisers, oil-based refinery commodities and machinery have hurt the economy. The output decline was broad based, with the transport sector down by 16.6 per cent, construction by 12.6 per cent, trade by 9.7 per cent and manufacturing by 7.9 per cent (all year on year). Information and communication technology and agriculture were among the rare sectors that increased output, by 3.8 per cent and 1.8 per cent, respectively. In addition, the country's interrupted access to the Baltic port in Lithuania has constrained exports to countries that have not joined the sanctions. Exports fell by 3.2 per cent year on year from January to August 2022, but a big drop in imports (by 9.3 per cent) resulted in a trade surplus. At the same time there was a geographical shift of trade in the past year, with exports to the Commonwealth of Independent States increasing by 8.8 per cent, while exports to the rest of the world declined by 20 per cent.

Inflation accelerated and the foreign exchange market came under pressure. The inflation rate reached 17.9 per cent in August 2022 on the back of logistical disruptions, exchange rate depreciation and rising food prices. The Belarusian ruble depreciated by 23 per cent to the US dollar in the first few weeks following Russia's invasion of Ukraine and gave an additional boost to inflation dynamics. The central bank of Belarus reacted swiftly at the end of February 2022 by lifting the policy rate from 9.25 per cent to 12.0 per cent, and the government introduced an export ban on wheat flour and buckwheat to mitigate the impact of currency depreciation on food prices. The recession-induced trade surplus and the authorities' decision to repay maturing foreign debt in domestic currency have prevented capital outflows and helped the ruble to recover to its pre-war level. After an initial sharp fall, foreign reserves have stabilised at US$ 7.6 billion in August 2022, which is still a significant reduction compared with US$ 8.4 billion at the beginning of 2022.

The uncertain geopolitical outlook and possible additional rounds of sanctions are creating high uncertainty. The expansion of sanctions by the EU and other developed economies since February 2022 prompted the authorities to look for alternative ports and trade routes as well as to implement import substitution programmes. A new insolvency management regulation prevents many domestic enterprises from becoming bankrupt and introduces mechanisms for rehabilitation. At the same time the authorities have increased the volume of trade with China. However, all these policies are having little effect so far in stemming the economic decline. As a result, GDP is forecast to decline by 5.5 per cent in 2022 and by a further 1.0 per cent in 2023.

CHART Assessment of transition qualities (1-10)



NOTE: Belarus is not included in the EBRD region and respective regional averages.

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Structural reform developments

The EU and other developed economies have strengthened sanctions against Belarus. In response to Belarus's role in Russia's military invasion of Ukraine, the EU and other international actors have imposed new economic and individual sanctions targeting Belarus, including trade restrictions, a SWIFT ban for five Belarusian banks, a prohibition on transactions with the central bank of Belarus, limits on financial inflows from Belarus, and a prohibition on the provision of banknotes to Belarus. They have also expanded sanctions already imposed after the contested presidential elections in August 2020, which were introduced because of continued internal repression and human rights abuses in Belarus. While the Belarusian economy was coping relatively well with the previous waves of sanctions, the new rounds introduced since March 2022 have severely hit the economy.

The situation with human rights and fundamental freedoms has continued to deteriorate. The authorities have continued to use systematic repression and intimidation, including against independent media and civil society organisations. Amendments to the Criminal Code have widened the scope for the use of capital punishment. The EU and relevant international organisations have been calling on the Belarusian authorities to immediately and unconditionally release all political prisoners and cease repression as well as to engage in a genuine and inclusive dialogue with all elements of society, leading to free and fair elections under international observation.

Economic sanctions and restricted access to the international financial system have damaged Belarus's ability to service external debt. The central bank announced in June 2022 that it would cover payment of a Eurobond in Belarusian rubles rather than US dollars due to economic sanctions. Consequently, both Fitch and Moody's adjusted the country's credit rating to "restricted default" in July 2022 after the authorities unilaterally decided to pay the US$ 23 million Eurobond debt in domestic currency.

The authorities implemented export support measures. In April 2022 the authorities adopted emergency support measures to boost exports through additional financing and lower customs fees for export-oriented enterprises. The authorities have also accelerated import substitution programmes by easing trade regulations with Russia to compensate for the loss of intra-regional trading partners. The export support measures include reductions in customs duties of imported commodities and a rearrangement of the logistics networks for exports. Also, the authorities have subsidised enterprises providing social benefits for their employees, in parallel with national initiatives to boost incomes through the social protection fund.

* The EBRD announced on 4 April 2022 that, following the invasion of Ukraine, its Board of Governors had formally suspended Belarus's access to EBRD funding for projects or technical cooperation.

Bosnia and Herzegovina

Highlights

- **The country is enjoying a better-than-expected post-pandemic recovery.** Following robust GDP growth of 7.5 per cent in 2021, the country continued to post strong growth rates in demand-driven service sectors and manufacturing in the first half of 2022.
- **The long-awaited public enterprise (PE) reform is slowly advancing.** The authorities have taken steps towards establishing PE oversight units in the two General Secretariats. Once active, the units will oversee the companies' financial performance.
- **The legislative framework to stimulate investment in renewables is gradually advancing, although the decarbonisation vision remains undeveloped.** The new legislation will replace state-determined feed-in tariffs with competitive bidding procedures for investments in clean energy.

Key priorities for 2023

- **The authorities should speed up initiatives to support the private sector and protect vulnerable groups.** Key short-term priorities in the current difficult global environment include targeted social support measures for vulnerable households, adopting a country-wide framework for e-signatures, and accelerating the digitalisation of public services.
- **A plan for green transition needs to be formed.** Setting up a vision for a decarbonisation pathway is crucial for Bosnia and Herzegovina, particularly given the large projected impact of the European Union (EU)'s forthcoming carbon border adjustment mechanism on the country's exports. The legislative package governing renewables should be finalised as soon as possible to leverage investor interest.
- **Reform of state-owned enterprises (SOEs) should progress.** Key steps required include operationalisation of SOE oversight units, implementation of systemic monitoring of fiscal risk stemming from state guarantees, and the creation of a country-wide SOE registry. The rationale for state ownership should be outlined in a State Ownership Policy document.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	3.7	2.8	-3.1	7.5	3.0
Inflation (average)	1.4	0.6	-1.1	2.0	10.5
Government balance/GDP	1.7	1.4	-4.7	0.7	0.5
Current account balance/GDP	-3.3	-2.6	-3.3	-2.4	-4.3
Net FDI/GDP [neg. sign = inflows]	-2.9	-2.1	-1.8	-2.3	-1.6
External debt/GDP	64.4	64.3	69.5	58.9	n.a.
Gross reserves/GDP	34.8	35.7	40.5	42.3	n.a.
Credit to private sector/GDP	57.5	58.0	58.5	54.0	n.a.

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Macroeconomic developments and policy response

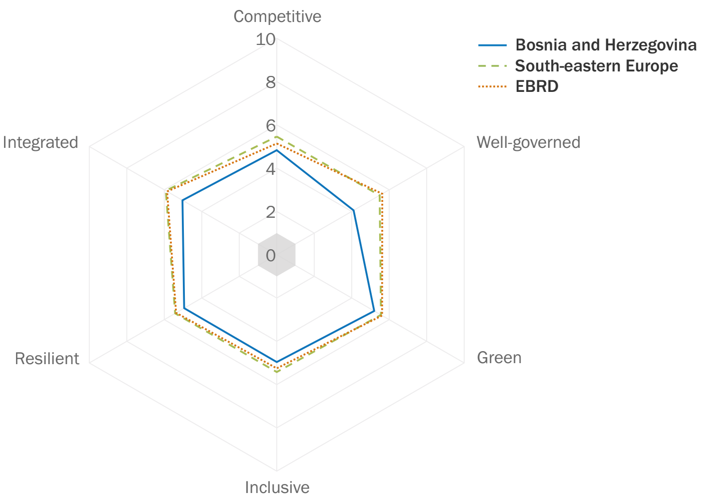
Robust economic growth continued into the first quarter of 2022. The economy expanded by 7.5 per cent in 2021, driven by very strong external demand and recovering domestic consumption, although investment remained weak. The first half of 2022 was marked by a continued expansion of GDP by 5.9 per cent year on year. Growth was led by investment, which rose by 24 per cent year on year, albeit partly driven by the base effect and a likely increase in inventories, and private consumption which grew by 3.5 per cent in real terms. Services led the expansion on the production side, as the fastest-growing sectors were trade, transport and hospitality, as well as information and communication services, followed closely by manufacturing. Exports continued to post strong growth rates in annual terms (30 per cent in the first half of the year), although their contribution was outstripped by imports rising to meet both producer and consumer demand. In line with the increased trade deficit in goods and elevated energy prices, the current account deficit doubled on an annual basis.

Inflation surged to unprecedented levels. The annual inflation rate has been rising since mid-2021 and reached a record-breaking 16.8 per cent in August 2022. While nearly all divisions of the consumer basket have registered price increases, the highest were food and transport, in line with globally rising food commodity and oil prices and the high proportion of household consumption going towards food. Unlike most countries in Europe, electricity has not been as significant a cause of inflationary pressures in Bosnia and Herzegovina as it continues to come from domestic coal-based production at below-market prices.

The authorities have implemented fiscal policy measures in an effort to shield the economy from rising prices. One-off increases in state aid for different categories were implemented and higher-than-planned pension hikes approved in the second quarter of 2022. While the Republika Srpska (RS) entity hiked electricity prices for firms at the beginning of 2022 but kept them well below market levels, the Federation of Bosnia and Herzegovina (FBiH) adopted in December 2021 an amendment to the Law on Electricity to enable a 20 per cent limit on electricity price increases for firms. Both entities have kept prices for households capped. A country-wide 90-day ban on log, firewood and pellet exports used for heating was adopted in June 2022 to curb price increases.

Growth is expected to moderate. GDP growth is forecast at 3.0 per cent in 2022 and 2.3 per cent in 2023 as risks tilt towards the downside. The economic impact of the war on Ukraine is expected to be reflected in a further rise in prices, thus eroding disposable income, a slowdown in the eurozone, Bosnia and Herzegovina's main export market, and increased geopolitical uncertainty. While political challenges associated with the elections in October 2022 complicate the short-term outlook, the economy's resilience demonstrated in recent years and a robust growth performance in the first half of the year bode well for short-term prospects.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

The European Commission has issued a conditional recommendation for EU candidate status. In 2019 the European Commission issued the Opinion on Bosnia and Herzegovina's application for EU membership, identifying 14 key priorities for the country to implement to become an EU candidate country. These priorities – a roadmap for a comprehensive EU reform agenda – lie in the areas of democracy and functionality of institutions, rule of law, fundamental rights and public administration reform. Although progress in implementation has been slow thus far, in June 2022 the European Council expressed its readiness to grant the status of candidate country pending the European Commission's assessment of the progress in implementation of the 14 key priorities. In October 2022 the European Commission recommended that Bosnia and Herzegovina be granted candidate status by the European Council, on the understanding that steps were taken in eight concrete areas of reform.

Incremental progress has been made on PE reform. The PE sector is large and poorly documented in Bosnia and Herzegovina, with around 550 PEs that account for upwards of 10 per cent of all employment, many of which are low productivity loss-makers. While PE reform is a long-standing issue, the authorities in both entities have recently affirmed a commitment to reform. Both entities took steps towards establishing central oversight units for PEs in 2022, although full regulatory frameworks have not yet been adopted. A reform plan for SOEs has been in place in the RS since mid-2021, while the FBiH is continually updating a registry of SOEs, albeit with incomplete financial reporting.

Supervisory and regulatory banking sector standards have received equivalence status to the EU. The prudence of Bosnia and Herzegovina's supervisory and regulatory requirements was affirmed by a European Banking Authority assessment of equivalence to those of the EU, published in November 2021. Nonetheless, the financial safety net is incomplete due to the weak bank resolution framework in the absence of an effective country-wide financial stability fund which could provide liquidity on an exceptional basis when required to ensure stability. The need for an effective lender of last resort was illustrated when, in February 2022 following Russia's invasion of Ukraine, the EU imposed sanctions on Russian-owned Sberbank, which resulted in significant deposit withdrawals. A prompt sale of the bank in both entities helped to ensure stability of the sector.

The lifetime of two highly polluting coal-powered thermal power plants was extended. The country's three oldest power generation units (Tuzla 3, Tuzla 4 and Kakanj 5) "opted out" of the EU's Large Combustion Plant Directive (LCPD) in 2016, meaning that they are allowed to operate for a total of 20,000 hours between 2018 and 2023, after which they need to either close or comply with limits under the new Industrial Emissions Directive. Against the backdrop of a global energy price increase, in March 2022 the parliament of FBiH cancelled the opt-out regime for Tuzla 4 and Kakanj 5, and decided to extend their operations to 2028. The Energy Community Secretariat, which opened a case against the country in February 2022 for failing to meet the emissions ceiling set in its National Emission Reduction Plan (NERP), has stated that this was a clear breach of the country's obligations. Financing for a new Tuzla 7 power plant came into question in July, when the State Aid Council ruled that the guarantee from FBiH constitutes as illegal state aid, aligning its decision with European state aid enforcement standards.

The legislative groundwork for renewable energy development is slowly advancing. The new Law on Renewable Energy Sources entered into force in the RS in March 2022, setting out competitive bidding procedures as determinants of incentives for larger renewable capacities. The law introduces two new concepts: prosumer – a customer that builds and connects to a renewable-source power plant for self-consumption; and Renewable Energy Community – a legal entity entitled to produce, consume, store and trade electricity from renewable sources between members of the Community and access all energy markets. A similar piece of legislation, the draft Law on the Use of Renewable Energy Sources and Efficient Cogeneration, was adopted by the government of FBiH and is set to go through the entity's parliament. The draft law similarly adopts the two concepts, but establishes that both feed-in tariffs for small plants and feed-in premiums for large plants are to be determined through auctions.

The Law on Public Procurement was amended. The adoption of the amendment in August 2022, following years of parliamentary procedure, aligns public procurement legislation further with the EU's and is an important step in fighting corruption and organised crime.

Bulgaria

Highlights

- **Economic growth is decelerating and inflation has risen sharply amid spillovers from the war on Ukraine.** Although growth was robust in the first half of 2022, inflation reached almost 19 per cent in September because of high food and energy prices, and a slowdown in gross domestic product (GDP) growth took hold in the third quarter.
- **The implementation of the Recovery and Resilience Plan (RRP) has commenced.** Following approval in April 2022, the government formally requested the first disbursement in early September 2022, contingent on the completion of 22 targets and milestones in digital transformation, innovation and education, green transition and justice.
- **The government has focused on social support in its policy response to the current crisis.** The key measure in response to elevated inflation has been an increase in wages and pensions, as pensioners are among the most vulnerable to price increases. State subsidies for company electricity and gas bills is the primary support measure to mitigate the effects of the energy crisis.

Key priorities for 2023

- **RRP implementation should be prioritised.** The country's political crisis meant that European Commission approval of a revised RRP worth €5.7 billion in grants occurred only in April 2022, and Bulgaria missed the pre-financing step. The ongoing crisis risks further delays, but political forces should commit to its implementation, as demonstrated so far.
- **Meeting the euro adoption criteria is important for investor confidence.** Bulgaria failed to meet the convergence criteria on the inflation measure in the summer 2022 assessment, and the earliest date for euro adoption is now 2024. Progress in this area would help counteract perceptions of political instability and would boost confidence in the economy.
- **Anti-corruption and judicial reforms should be stepped up.** In its latest *Rule of Law Report*, the European Commission flags, among other issues, Bulgaria's slow progress on tackling high-level cases of corruption, while the National Strategy for Prevention and Countering Corruption continues to be implemented.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	2.7	4.0	-4.0	7.6	3.0
Inflation (average)	2.6	2.5	1.2	2.8	12.4
Government balance/GDP	1.7	2.1	-3.8	-3.9	-3.3
Current account balance/GDP	0.9	1.9	0.0	-0.5	-0.9
Net FDI/GDP [neg. sign = inflows]	-1.3	-2.0	-4.5	-1.4	-1.0
External debt/GDP	66.1	61.3	63.8	58.4	n.a.
Gross reserves/GDP	44.6	40.4	50.1	48.7	n.a.
Credit to private sector/GDP	49.8	48.9	51.0	47.9	n.a.

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Macroeconomic developments and policy response

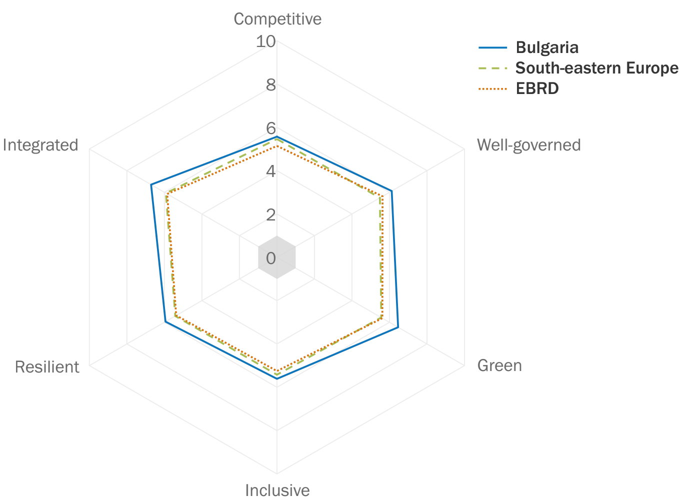
The robust growth seen in the first half of 2022 is slowing. GDP expanded 7.6 per cent in 2021, driven by strong private consumption. This, in turn, was underpinned by fiscal support and wage growth, though investment declined by 8.3 per cent. In the first half of 2022 GDP grew by 4.1 per cent year on year on the back of slowing private consumption, but increased public spending and accumulating inventories. However, preliminary figures show a further decline in investment of 9.6 per cent year on year in the first half of 2022. Although Bulgaria has stronger supply-chain links with Ukraine and Russia than most regional peers, the industrial sector has remained quite resilient so far, growing 18.6 per cent on the year in the first half of 2022. Despite decelerating amid high inflation, household spending is being supported by public spending and growing retail credit, which has accelerated in recent months amid deep negative real rates.

Russia's invasion of Ukraine has exacerbated already strong inflationary pressures. Consumer prices rose 18.7 per cent in September 2022, with food prices up 24.9 per cent on the year. Core harmonised inflation, as measured by Eurostat, reached 9.4 per cent the same month, implying relatively strong demand pressures. Higher utilities and food prices, as well as strong demand, are also feeding into services, as prices in restaurants and hotels increased 20.7 per cent year on year in the latest reading. Nominal private-sector wage growth reached 14 per cent in the first half of the year, outstripping the six-month average inflation rate of 13.1 per cent. This raises the risk of prolonged high inflation to some extent, although, in the public sector, average wages increased only 4.9 per cent in the first half of 2022.

Fiscal policy is being used to alleviate the impact of inflation. In June, the forecast fiscal deficit for 2022 was revised to 4.1 per cent of GDP, the same as in 2021. By July, however, the budget had recorded a cumulative surplus of about 1 per cent of GDP. The budget revision includes a package of measures to compensate for inflation, among them a 10 per cent hike in pensions, tax relief for families with children, full compensation of corporate electricity bills at prices above €125/MWh and value added tax (VAT) cuts to 0 per cent for bread and flour and 9 per cent for gas and heating. The government also raised the VAT registration threshold for firms from BGN 50,000 (€26,000) to BGN 100,000 (€51,200). Policy support did not include households, as the retail electricity market in Bulgaria is still regulated.

Inflation pressures, energy security risks and political uncertainty are all weighing on the short-term growth outlook. Although the economy has performed relatively well so far in 2022, the downside risks to growth are rising. A new political crisis could increase uncertainty and delay reforms, while inflation has the potential to rise even further given likely upward adjustments in electricity, heating and gas retail tariffs. Our 2022 GDP growth forecast is 3.0 per cent, while in 2023, we see a growth rate of 1.5 per cent as the overall slowdown in the eurozone affects Bulgarian exports and energy security risks weigh on confidence and economic activity.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

Energy security remains uncertain amid the halting of gas imports from Russia. In April 2022 Gazprom announced that it was shutting down exports to Bulgaria and Poland due to the countries' refusal to pay in Russian roubles. The announcement initially did not affect Bulgaria in a significant way, as gas accounts for the lowest share of gross energy consumption in the region, even though it imported almost entirely from Russia before the war. Moreover, immediately after the announcement, Bulgaria started to import Azerbaijani gas on a long-term contract, as well as liquefied natural gas (LNG), through Greece. Both the short- and long-term tenders for LNG and gas deliveries were launched in September 2022, as the caretaker government was considering all options, including relaunching Russian gas deliveries. The long-term LNG contract covers a 10-year period from 2024, booked through the Alexandroupolis terminal, while the important gas interconnector with Greece started operations from October 2022.

RRP implementation has started after significant delays. Despite the delay in the final approval of the RRP, which was given in April 2022, the authorities are trying to make up for lost time by fast-tracking the next steps. The government has swiftly set up a management and control system for the plan and has been actively meeting targets for the first disbursement request, initially planned for the second quarter of 2022, despite first needing to sign all of the technical agreements with the European Commission. In early August 2022 the Ministry of Finance signed the operational agreements with the Commission. To improve the management of RRP investments, the government reached an agreement on technical support with the European Bank for Reconstruction and Development (EBRD), while it signed agreements with the European Investment Bank and the World Bank for technical support in absorbing 2021-27 programming period funds totalling €11 billion. Parliament needs to adopt important milestones, including those related to judicial reform, by the end of 2022. However, the political uncertainty poses significant implementation risks.

E-governance reforms have progressed, alongside a new ministry focused on digital transformation. Some of the main measures adopted or in the works are: i) the development of an electronic identification tool and regulatory amendments to use the system; ii) the facilitation of online access to documents; iii) the digitalisation of cadastre, procurement and public information; iv) the strengthening of public institutions' cybersecurity; and v) support for ministries on various aspects of digitalisation, including justice, road administration, healthcare, tourism and education.

As part of the RRP, the government launched state-aid schemes for the modernisation of firms. The tender for the €130 million support scheme for technological modernisation was launched in July 2022 and received more than 2,500 proposals for about BGN 634 million (€323 million). The scheme targets small and medium-sized enterprise (SME) investment in new information and communication technologies, with the aim of increasing the overall productivity of Bulgarian SMEs, and has a target of 1,492 completed projects by the end of 2024. A second fund will be focused on equity investments in venture capital, technology transfer and social impact funds. The instrument will be managed by the European Investment Fund. These funds will be complemented by two similar programmes worth €3.57 billion financed by European Union structural funds, which will start in 2023.

The government has adopted a 2030 strategic plan to develop transport infrastructure. The plan includes measures to stimulate sustainable transport and intermodal infrastructure. These include intermodal links in Sofia and Northern Bulgaria and a feasibility study for a terminal in Vidin, as well as railway modernisation to link with ports. In July 2022 the transport ministry signed the decision that, for cost-cutting reasons, the state-owned Bulgarian Railways Holding would merge back into a single entity with its passenger and freight subsidiaries. This goes against the decision in late 2019 to fully separate the passenger and freight companies, but the announced plans include a potential listing of the company in 2024.

The Employment Promotion Act was amended. Parliament adopted the Employment Promotion Act in May 2022, aimed at strengthening the labour-market inclusion of inactive persons, young people not in training or education (NEETs) and those with informal training, who will get their skills validated in vocational training centres. This was a reform milestone for the second disbursement of the Recovery and Resilience Facility, planned for the end of 2022. The Employment Agency will now be tasked with actively interacting with and collecting information on inactive persons. An amendment to the bill ensures that Ukrainian refugees are included in the renewed effort.

Croatia

Highlights

- **Economic growth remained strong in the first half of 2022, but is showing signs of a slowdown.** Gross domestic product (GDP) maintained its momentum from 2021 and expanded by 7.4 per cent year on year in the first two quarters of 2022, while a successful tourist season alleviated the growth slowdown in the third quarter.
- **Implementation of the country's Recovery and Resilience Plan (RRP) is well under way.** Croatia was among the first countries in the European Union (EU) to receive a disbursement – a grant of €700 million in July 2022 – as the authorities met all 34 milestones and targets by the end of 2021.
- **Croatia will adopt the euro from 2023.** In July 2022 the country received the final positive assessment it needed to join the eurozone in January 2023. The government and the Croatian National Bank are implementing the requisite operational changes to ensure a smooth transition. Croatia is also preparing to join the Schengen area, pending final approval by the European Council.

Key priorities for 2023

- **Political commitment and effective implementation of more complex reforms included in the RRP will be needed to address structural issues.** RRP implementation has been adequate so far, but the next disbursements will be conditional on more challenging reforms, such as changes to recruitment and pay in the public sector, state-owned enterprise (SOE) governance and privatisations.
- **Support for households in the current inflation and energy crisis should shift towards more market-based measures.** Some announced measures, such as price caps, including for basic foods and fuels, provide short-term relief, but they can restrict markets, disincentivise consumption cuts and carry additional fiscal costs. Moreover, the cap on energy prices will put a financial strain on state-owned utility HEP and its ability to invest in new capacity.
- **The government needs to prioritise the green transition.** The focus should be on more medium-term solutions, such as investment in renewables, boosting energy efficiency and limiting subsidies only to those in need. While investor interest in Croatia's renewable potential is high, further administrative improvements and investments in the grid are needed to speed up the integration of new capacity.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	2.9	3.5	-8.1	10.2	6.5
Inflation (average)	1.5	0.8	0.1	2.6	9.8
Government balance/GDP	-0.1	0.2	-7.3	-2.6	-1.5
Current account balance/GDP	1.8	2.8	-0.5	3.2	2.2
Net FDI/GDP [neg. sign = inflows]	-1.6	-6.2	-1.4	-4.9	-2.0
External debt/GDP	80.8	72.5	79.8	77.4	n.a.
Gross reserves/GDP	33.1	33.4	37.7	43.7	n.a.
Credit to private sector/GDP	53.0	52.2	58.8	52.8	n.a.

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Macroeconomic developments and policy response

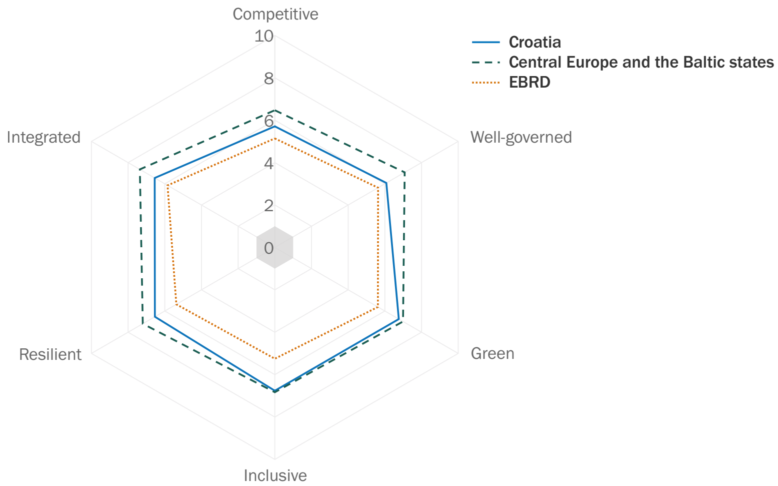
Robust domestic demand and strong exports have supported high growth rates since early 2021. The Croatian economy expanded by 10.2 per cent in 2021 in a broad-based recovery, bringing GDP above pre-pandemic levels. The strong growth continued in the first half of 2022, as GDP grew 7.4 per cent year on year. Despite rising inflation, private consumption and investment both increased in the second quarter of 2022 in yearly terms, while stock building slowed. A highlight since early 2021 has been the performance of goods exports, which in the first half of 2022 grew 28 per cent year on year in real terms, or 55 per cent relative to 2019. On top of this, service exports expanded 66 per cent on the year in the second quarter of 2022 and exceeded the levels recorded in the corresponding period of 2019. Despite strong import growth, net exports contributed positively to growth in the second quarter of 2022, highlighting Croatia's deeper integration into the EU economy.

Inflation has reached double-digit levels. Consumer prices grew 12.8 per cent annually in September 2022, with food prices up 14.9 per cent and catering and accommodation prices up 17.3 per cent. Labour-market conditions remained tight in the first half of the year, with unemployment below pre-pandemic levels, while real wages dropped by an average 1.9 per cent in the period, contributing to a slowdown in consumption and demand-side inflation.

Fiscal consolidation is continuing, despite crisis support measures. The government has set a target deficit for 2022 of 1.5 from 2.8 per cent of GDP after a budget revision in October 2022, as budget execution data for the first half of 2022 show a deficit of just 1.3 per cent of GDP, lower than the 2.6 per cent recorded in 2021. The main measures that the government adopted in April 2022 to compensate for rising inflation were: i) increases in household electricity prices were capped at 9.6 per cent and at 20 per cent for gas; ii) the value added tax (VAT) rate on heating was reduced for a year from 25 per cent to 5 per cent, then permanently to 13 per cent (including for heating, wood and pellets), while VAT on food products was cut to 5 per cent; iii) vouchers were given to vulnerable persons and pensioners; iv) de minimis support was provided to firms for gas consumption; and v) temporary fuel price caps were announced in some months.

Growth will moderate towards the end of 2022 and in 2023. We expect GDP growth to reach 6.5 per cent in 2022, supported by robust domestic demand and a strong tourist season, as overnight stays were 96 per cent of 2019 levels as of the middle of August. In the last quarter of 2022, a slowdown is likely amid the intensification of the energy crisis in Europe more broadly. Downside risks include a further acceleration in inflation, uncertain global growth prospects and persistent supply-chain issues. In 2023 high base effects related to tourism, in particular, weakening consumer confidence and slow or negative eurozone growth are likely to limit Croatian growth to 2 per cent. In terms of a potential gas shutdown, Croatia is among the most resilient countries in the region thanks to the Krk liquefied natural gas (LNG) terminal and robust domestic energy production.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

Croatia will adopt the euro in January 2023. Prior to eurozone entry, the authorities are focused on ensuring a smooth technical transition. In August 2022 the government announced that it had sent to parliament 65 amendments to relevant bills, while another 20 changes will be adopted by the end of the year. The government has prioritised a smooth transition to the euro to avoid potential price increases, although opinion polls among the population suggest a risk that businesses will convert prices at an unfair rate. Planned euro adoption has also led to credit-rating upgrades of two notches by Moody's and S&P and one notch by Fitch Ratings.

Earthquake reconstruction efforts have started after delays. The EU Solidarity Fund allocated slightly over €1 billion to tackle the consequences of the 2020 earthquakes, and the deadline for accessing it was prolonged by one year to June 2023 as the government got off to a slow start in implementing the mechanism. To quicken reconstruction, the authorities have implemented faster procurement, undertaken a reorganisation of the Reconstruction Fund, centralised reconstruction oversight and introduced more flexible price-setting. Moreover, procurement is to be adapted for small and medium-sized enterprises in order to activate the entire construction industry. The authorities also put in place a one-stop shop for reconstruction efforts, a milestone in the RRP. By the end of August 2022 the authorities reported that all houses covered by the programme of non-structural reconstruction in the earthquake-affected areas of Petrinja and Glina will be renovated before the heating season, while the construction of new homes is under way. However, only a small share of the funds have been disbursed so far.

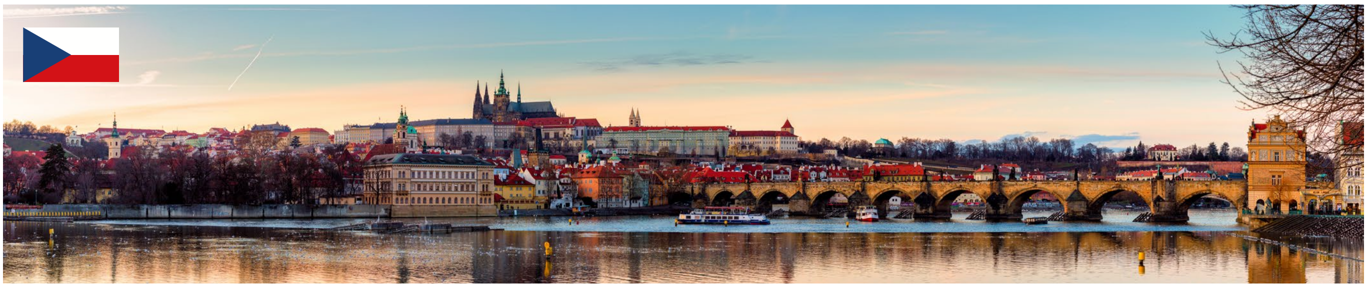
Croatia is becoming a regional energy hub, thanks to the expansion of the Krk LNG terminal's capacity. The LNG terminal's annual capacity of natural gas will be raised to 6.1 billion cubic metres from the current 2.6 billion thanks to a €25 million investment. Another €180 million has been allocated to the expansion of the pipeline network. The significant expansion of the terminal should make Croatia a hub for the supply of gas to countries in central and south-eastern Europe.

Energy-efficiency programmes have been launched, but interest in renewable auctions is low. In December 2021 the government adopted the Energy Efficiency Programme for decarbonising the energy sector. Similarly, it launched the energy renovation programmes for multi-apartment and public buildings, with planned investments of €133 million, mostly in the latter category. Two additional programmes were also adopted at the end of 2021, namely, for the energy renovation of buildings with cultural value and a programme to reduce energy poverty by 2025. Renewable auctions were unlocked in 2021, but investor interest has been far lower than auctioned capacity. This is down to higher electricity wholesale prices and investors agreeing to power purchase contracts with prices set above the offered market premiums.

A reform of the waste management sector has commenced. Water and wastewater infrastructure was earmarked at €863 million in the initial plan, the largest amount out of all RRP components. In line with this priority, at the end of 2021 the government adopted several acts and strategic documents to frame future activity. These include the amendment of the Waste Management Act, a revision of the Waste Management Plan of the Republic of Croatia for the period 2017-22, and the adoption of the Multiannual Water and Wastewater Construction Programme. In the coming years, the government will need to modernise a number of waste and wastewater facilities across the country, funded from the RPP.

Improvements in public governance are being targeted. Measures introduced so far have focused on budgeting, anti-corruption and EU funds management. Given the significant amount of EU funds allocated to Croatia up to 2027, a priority is improving the governance framework to allow efficient implementation. This started with the strengthening of capacity for EU project management, including an assessment of administrative capacity, an audit and control system for the RRP, and the adoption of an act on the institutional framework for EU funds. On top of this, the government adopted a new anti-corruption strategy for 2021-30 and an act amending the Law on Prevention of Conflict of Interest. Fiscal planning was strengthened by improvements to the functionality of the Fiscal Policy Commission and by amending the Budget Act.

The authorities are addressing inclusion issues. As part of the RRP milestones, at the end of December 2021 the government adopted the National Plan for the Equalisation of Opportunities for Persons with Disabilities 2021-27 and the National Plan for the Fight against Poverty and Social Exclusion 2021-27, together with their respective action plans to 2024. In a similar vein, the authorities also adopted the National Plan for the Development of Social Services 2021-27.



Czech Republic

Highlights

- **The economy was slow to recover to pre-pandemic levels.** After 3.5 per cent growth in 2021, gross domestic product (GDP) expanded 4.2 per cent year on year in the first half of 2022, but the short-term outlook is gloomy in light of global developments.
- **The government has introduced energy price caps to the end of 2023.** The authorities announced at the end of September 2022 their decision to cap energy prices for households and small businesses, to be offset by windfall taxes and dividends.
- **A series of green investments have started as part of the country's Recovery and Resilience Plan (RRP).** The strong green focus of the RRP has led to a series of tenders to finance private-sector energy and resource efficiency, as well as renewable energy production.

Key priorities for 2023

- **Energy security risks need to be mitigated, in particular, by accelerating efforts towards a green transition.** The Czech Republic is one of the countries in the region most dependent on Russian energy imports, and a shutdown of supply would inflict significant damage. While the country has ensured one-third of annual gas consumption through liquefied natural gas (LNG) deliveries, a structural shift towards renewables and energy efficiency needs to be accelerated.
- **Solutions to protect the most vulnerable are needed in light of a significant deterioration in real incomes.** The Czech Republic is projected to see one of the deepest real wage declines in 2022, which will affect real GDP growth and household wealth in 2023. The government needs to ensure that the most vulnerable segments are protected through targeted measures.
- **Support for Ukrainian refugees should continue and shift towards long-term integration.** As of the middle of September 2022, more than 430,000 refugees from Ukraine had entered the Czech Republic, one of the highest numbers in the region. The authorities need to step up solutions to ensure labour and social integration, including addressing skills mismatches and offering access to social services.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	3.2	3.0	-5.5	3.5	2.5
Inflation (average)	2.0	2.6	3.3	3.3	16.3
Government balance/GDP	0.9	0.3	-5.8	-5.1	-4.0
Current account balance/GDP	0.5	0.3	2.0	-1.8	-4.3
Net FDI/GDP [neg. sign = inflows]	-0.9	-2.4	-2.6	-0.2	-1.0
External debt/GDP	81.6	75.7	75.7	73.2	n.a.
Gross reserves/GDP	59.2	58.5	62.2	62.4	n.a.
Credit to private sector/GDP	20.3	19.6	19.9	19.6	n.a.

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Macroeconomic developments and policy response

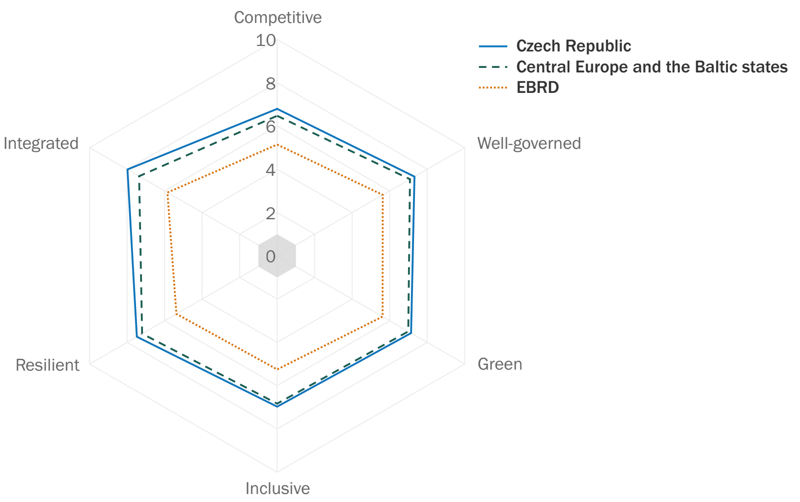
GDP growth showed signs of weakness in the first half of 2022, despite robust growth. In the first quarter of 2022, GDP expanded 4.9 per cent year on year (0.6 per cent quarter on quarter), supported by a rebound in investment and foreign trade. However, in quarterly terms, final consumption declined for the second quarter in a row, reflecting the negative effects of rising inflation. Net exports' negative contribution to growth in the second half of 2021 was partly reversed in the first quarter of 2022, as exports performed well. In the second quarter of 2022, GDP expanded 3.6 per cent year on year (0.5 per cent quarter on quarter), as the economy proved more resilient than expected, although retail turnover and industrial output declined on a yearly basis, heralding weaknesses ahead. This is confirmed by the preliminary 0.4 per cent quarter-on-quarter GDP decline.

Inflation remains broad based. In September 2022, inflation accelerated to 18.0 per cent, with core inflation at 14.7 per cent – among the highest in the European Union (EU) – implying strong broad-based inflationary pressures. The Czech National Bank has hiked the policy rate by a cumulative 200 basis points so far this year, to 7.0 per cent as of September 2022. The energy price cap will alleviate some of the inflationary pressures that were expected through further tariff adjustments. Real wages are likely to fall by about 6-7 per cent this year, moderating fears of a wage-price spiral, despite a very tight labour market.

Inflation-boosted budget revenues will only partly offset announced government support. Fiscal policy was expansionary in 2021 and, according to the government's October 2022 forecast, the fiscal deficit will reach 4.4 per cent of GDP in 2022. Measures to address the effects of high inflation and the energy crisis include additional pension indexation in July and October 2022, a one-off CZK 5,000 (about €200) transfer to low-income households and an array of energy subsidies. On top of this, the government has capped electricity and gas prices for households and small firms from October 2022 to December 2023, at an estimated cost of CZK 130 billion (€5.27 billion). This will be offset by a windfall tax on energy, banks and fuel producers, which will neutralise the fiscal impact of the support measures, according to the government. State expenditure on refugees was CZK 13.9 billion (€570 million) as of the end of September 2022.

Strong headwinds and downside risks complicate the growth outlook. We forecast economic growth of 2.5 per cent in 2022 and 0.5 per cent in 2023, with the risk of a recession in the second half of 2022 driven by negative real wage growth, weak business confidence and high-interest rates. Moreover, the external demand outlook remains uncertain. Weak momentum going into 2023 and the high risk of energy supply disruptions significantly affect next year's outlook, but funding under the EU's Recovery and Resilience Facility may provide an upside.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

The Czech RRP has been approved and implementation has commenced. The European Commission approved the Czech RRP in July 2021, disbursed the pre-financing tranche of €915 million in September 2021, and signed the operational agreements that detail all the targets and reform milestones in July 2022. In addition to meeting the EU's policy goals of green transition, digital transformation and enhancing economic and social resilience, the €7 billion plan includes provisions to ensure effective implementation and monitoring. The first request for disbursement is scheduled for September 2022, but delays are possible, as two targets, one on flood protection and another on RRP implementation control, have been delayed.

The government has issued a number of public calls for private investment in green projects. As part of the RRP, the government has launched several programmes to support private entities in the green transition. These include reducing the energy intensity of apartment buildings, photovoltaic panel installation, investments in the circular economy, subsidies for electric vehicles and water-saving investments. The private sector showed high interest in the photovoltaic scheme, as the total estimated investment for submitted projects was more than €600 million as of the end of August 2022, resulting in a subsidy of about €225 million (above the €203 million budget). On top of this, in December 2021 the government adopted the Circular Czechia Strategy 2040, covering waste management, water reuse and recycling, product design, bio economy and the prevention of food waste.

Investment in the railway network is being frontloaded. In the first quarter of 2022 the government launched a public call for the electrification of, safety improvements in and digitalisation of the country's railway system. The plan also includes the construction of seven tunnels and bridges for railway use and the modernisation of 35 railway stations and about 120 km of track, the latter to be completed by the end of 2022. The allocation to the sustainable transport component of the RRP amounts to CZK 24 billion (€970 million).

The Czech-Moravian Guarantee and Development Bank (ČMZRB) has been reorganised into the National Development Bank and will channel RRP funds. The ČMZRB has acted as the country's main promotional bank, offering largely preferential loans and guarantees. As of September 2021 the institution became a national development bank and its goals have been expanded in line with the "do no significant harm" principle of the EU. The institution will also now manage two new funds: the National Development Fund, channelling private funds into public infrastructure, and the National Development Investments, a vehicle for quasi-equity investments, as part of the RRP.

Judicial reform has advanced with a new Courts and Judges Act. The RRP includes anti-corruption reforms, including strengthening the legislative framework of the judiciary. As a reform milestone, the government adopted the Courts and Judges Act at the end of 2021, which changed procedures for the selection of judges and court officials, introduced mandatory training for candidates, limited the role of the Ministry of Justice in selecting judges and limited court chair mandates. It also requires the judgements of the lower courts to be published on an electronic platform. The act was based on the recommendations of the Group of States against Corruption (GRECO).

Digital transformation is a priority in the RRP, and initiatives cover both the public and private sectors. The RRP includes multiple measures to enhance digitalisation. Among the milestones already implemented are the creation of a platform for the digitalisation of the economy, gathering relevant stakeholders to promote relevant reforms, and a public tender for support for the digital transformation of small and medium-sized enterprises worth €85 million started in June 2022. Cybersecurity is a recurring topic in the RRP. Notably, related to digitalisation, in 2021 there was a change in notary regulation to allow the online creation of companies.

There is strong state buy-in to enhance skills and digitalise the educational system. In the first quarter of 2022 the government established the Reskilling and Upskilling Committee to upgrade qualifications. The Ministry for Education has initiated changes in university programmes to increase the focus on digital skills and careers and to create new study programmes, including cybersecurity, artificial intelligence and e-governance. In schools, information technology-related teaching hours will be increased alongside courses in data modelling and programming, among other things. Moreover, the ministry will provide schools with funds to digitalise study materials and purchase new digital devices. The government is also expected to launch regional training centres to promote Industry 4.0 standards.

Egypt

Highlights

- **Egypt's post-pandemic economic recovery was strong, but slowed in the wake of the war on Ukraine.** The subdued performance of the tourism and non-oil sectors weighed on growth in the second half of the 2021-22 fiscal year. Inflation surged and previous fiscal gains were reversed by increased social spending, although unemployment decreased slightly.
- **The country has become an attractive destination for renewable energy investments, which could help alleviate the precarious external-sector situation.** Prospects for a green transition by decommissioning domestic gas facilities in favour of renewables have gained traction, and COP27 offers an opportunity to translate high-level ambitions into concrete plans on the back of outside economic pressures.
- **The authorities have published a new draft state-ownership policy.** The policy highlights which sectors will be opened up for private investment, as well those where the public and private sectors will co-exist. A third group will be dominated by the public sector.

Key priorities for 2023

- **Macro-fiscal imbalances need to be addressed.** A staff-level agreement on a new International Monetary Fund (IMF) programme has been announced. Its implementation could help to alleviate external pressures and ensure debt sustainability.
- **Advancing the structural reform agenda is a top priority.** Key reforms that should be given immediate attention include strengthening competition and opening up state-owned enterprises (SOEs) for private investment, both of which would help support growth and attract foreign direct investment (FDI).
- **A strong green agenda could boost economic growth, complement efforts to strengthen food and energy security, and address the impact of climate change.** Key measures that the authorities should promote include further developing renewables, improving water and energy resource efficiency, and promoting sustainable agriculture.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	5.0	5.5	3.5	3.3	6.6
Inflation (average)	20.9	13.9	5.7	4.5	8.5
Government balance/GDP	-9.0	-7.6	-7.5	-7.0	-6.2
Current account balance/GDP	-2.3	-3.4	-2.9	-4.4	-3.6
Net FDI/GDP [neg. sign = inflows]	-2.8	-2.5	-1.9	-1.1	-1.7
External debt/GDP	35.2	34.2	32.3	31.3	32.2
Gross reserves/GDP	16.5	13.8	9.7	9.3	7.0
Credit to private sector/GDP	23.2	21.7	23.6	26.3	28.1

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Macroeconomic developments and policy response

Growth doubled in the 2021-22 fiscal year, but has levelled off in recent months. In the first three-quarters of 2021-22, gross domestic product (GDP) growth reached 6.6 per cent compared with 1.9 per cent in the same period the previous fiscal year. This was driven by strong manufacturing growth, a rebound in Suez Canal revenues and an expansion in construction activity. However, growth decelerated markedly in the fourth quarter to 3.2 per cent, held back by a muted private-sector recovery, although gas exports provided some counterweight to costlier oil imports. Annual inflation surged to 13.6 per cent in July 2022, fuelled by rising food and energy prices and by an exchange-rate devaluation of more than 20 per cent since March. Meanwhile, unemployment decreased slightly to 7.2 per cent in the second quarter of 2022, although it remains higher among women (17.8 per cent) and in urban areas (10.5 per cent).

In response to inflation, the authorities implemented a range of measures. In March 2022 the government announced a fiscal package of US$ 7 billion to mitigate the impact of global inflation, including expedited salaries and an inflation adjustment to pensions. In July 2022 the government raised diesel prices by EGP 0.5 (US$ 0.03) per litre to alleviate pressure on the general budget, although diesel subsidies for 2022-23 are still expected to reach EGP 55 billion (around US$ 2.8 billion). At the same time, the government announced a bonus of EGP 100 (US$ 5.30) on food subsidy cards for six months to help beneficiaries cope with rising food prices. The government also postponed reforms to its bread subsidy system, which has been supporting large segments of the population since the 1970s. In addition, the scheduled annual rise in electricity tariffs, which normally takes place in July, was postponed this year.

Fiscal and current account deficits have narrowed. The fiscal deficit shrank to 6.1 per cent of GDP in 2021-22 as revenues grew 9.8 per cent in the period from July 2021 to March 2022. However, government spending grew 10.2 per cent during the same period, reflecting continued fiscal stimulus. In parallel, government estimates show public debt decreasing to 85.3 per cent of GDP as of June 2022. Meanwhile, the current account deficit declined to an estimated 5.0 per cent of GDP by the third quarter of 2021-22, thanks to strong remittances and a recovery in tourism income. However, it probably widened in April to June 2022 as import prices rose. In parallel, FDI contracted and portfolio outflows increased significantly. As a result, foreign-exchange reserves decreased from US$ 41 billion in December 2021 to US$ 33.1 billion in July 2022, covering less than four months of imports.

A short-term slowdown in growth is expected. Continued global volatilities and the slow progress of essential structural reforms to create more space for the private sector are weighing on the economic outlook. We expect growth in 2022-23 to fall to 4.7 per cent and be held back by adverse global conditions and structural domestic factors that suppress the recovery of the non-oil private sector. As momentum for public mega projects will be constrained by limited fiscal space, a return to higher growth rates will require additional drivers beyond domestic demand, tourism and gas exports.

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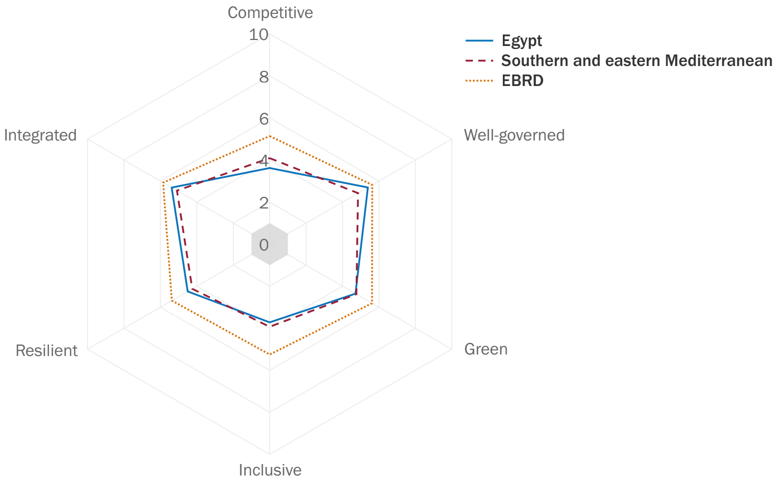
CHART Assessment of transition qualities (1-10)



Structural reform developments

Egypt has achieved a staff-level agreement with the IMF on a new programme. Key pillars include objectives on foreign-exchange policies, fiscal and debt management, and structural reforms, notably in the SOE sector and with a view to supporting the private sector as an engine of growth. Following its staff visit in July 2022, the IMF highlighted the need for decisive progress on fiscal and structural reforms.

The government published a draft of its first state ownership policy. The new policy, published in May 2022, classifies sectors into three groups: (i) the government mostly withdraws; (ii) the government remains partly involved; and (iii) the government remains fully involved and/or expands its presence in the coming years. Key sectors where private investment and privatisation will be encouraged include textiles, mining, chemicals and food processing. In contrast, the authorities are aiming for an increased presence in transport and in financial and insurance activities. The plan aims to attract US$ 40 billion in private investment over the next four years, but specific implementation arrangements have not yet been published. Consultations with the public and private sectors have been ongoing over summer 2022.

An Emergency Food Security and Resilience Project was launched. This programme, introduced in June 2022, will help mitigate the impact of the war on Ukraine on food security in Egypt. Supported by a US$ 500 million loan from the World Bank, the project will finance the public purchase of imported wheat, equivalent to one month's supply for the bread subsidy programme, which supports approximately 17 million low-income households, including about 31 million people living below the national poverty line. The plan will also support national efforts to reduce waste and losses in the wheat supply chain through the upgrade and expansion of climate-resilient wheat silos, thereby sustainably improving domestic grain production and strengthening Egypt's preparedness for and resilience to future shocks.

Egypt has developed a National Climate Change Strategy in the run-up to hosting COP27. Announced in May 2022, the strategy aspires to include adaptation and mitigation programmes in all sectors until 2050, with a focus on energy, transport, agriculture and water resources. The strategy also aims to improve access to green finance and infrastructure, strengthen research into green technologies and raise public awareness of climate change. Egypt is hosting COP27 in November 2022, which is widely seen as an opportunity to focus more on the impact of climate change on the world's least-developed countries, notably in Africa. Egypt will also aim to raise its profile as a leader in emerging green technologies, such as green hydrogen production (and associated renewable energy production) and industrial-scale desalination.

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A Women's Economic and Social Empowerment Programme is in place. Female labour force participation has been historically among the lowest in the region (on a par with Morocco and below Tunisia). The five-year programme, introduced in June 2022, aims to provide 200,000 women in seven Egyptian governorates with increased employment opportunities, strengthen financial inclusion and reduce violence against women and girls. The programme is looking to develop, scale up and advocate innovative solutions to realise the economic and social benefits of gender-responsive empowerment policies and practices.

The Ministry of Finance has started to automate the tax management system to improve the efficiency of tax administration. It is part of the government's strategy to digitalise the country's tax processes and procedures, as well as to integrate the informal economy into the formal economy, enhance governance over tax returns and expand the tax base. Tax revenues accounted for nearly 20 per cent of GDP in 2021-22 and for more than 75 per cent of general state revenues. However, facilitating tax payments to encourage the informal sector to contribute to the tax base could help maintain fiscal space without raising tax rates. The system was successfully piloted in 10 tax offices in Greater Cairo and will continue to expand across Egypt in 2022.

The government has announced a reform of ration cards. Egypt remains committed to improving the allocative efficiency of its social safety expenditure, which was set up during the previous IMF programme of 2016-20, including through reduced subsidies. Under the new scheme announced in June 2022, the Ministry of Supply and Internal Trade plans to stop issuing subsidy ration cards for Egyptians travelling outside the country, including those who have been abroad for more than three consecutive months (an estimated half a million citizens). New eligibility conditions for subsidies have been established. Citizens earning more than US$ 500 per month, households spending more than US$ 1,000 per month on their children's education and farmers owning more than 10 acres of land will no longer be eligible.

Estonia

Highlights

- **Growth has lost momentum while inflation has jumped sharply.** By mid-2022 the annual inflation rate exceeded 20 per cent, reaching the highest level since 1995, mostly driven by rising household expenditure on utilities.
- **The government introduced a number of measures in response to rising energy prices and inflation.** Assistance so far has included energy subsidies and partial compensation to eligible households for energy price increases, and a supplementary budget of €878 million has been set to cover unforeseen security-related expenses, support for Ukrainian refugees and further support to households to cope with surging energy prices.
- **The regulation of Virtual Asset Providers (VASPs) is being reinforced.** Important changes under a new draft law include tighter licensing rules, increased capital requirements and stricter information requirements in transaction originations.

Key priorities for 2023

- **Labour market reforms should be stepped up to help cope with immigration and demographic changes.** The large inflows of refugees fleeing the war on Ukraine and ongoing demographic challenges have highlighted the need to address labour shortages and skills mismatches by supporting active labour market policies, and bringing more refugees into the labour market.
- **Building on the timely implementation of the Recovery and Resilience Plan, Estonia will need to further progress its green transition.** The authorities should prioritise support for renewable energy production to achieve the target of 100 per cent of electricity consumption coming from renewables by 2030.
- **Further support to cope with the energy crisis should be targeted carefully.** While government spending should remain flexible to cope with extraordinary crisis expenses, support should be more targeted, focusing on the most vulnerable segments of society in order to avoid further inflationary pressures.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	3.8	3.7	-0.6	8.0	1.5
Inflation (average)	3.4	2.3	-0.6	4.5	21.0
Government balance/GDP	-0.6	0.1	-5.5	-2.4	-2.9
Current account balance/GDP	0.9	2.4	-1.0	-1.8	-0.2
Net FDI/GDP [neg. sign = inflows]	-4.8	-3.9	-10.4	-1.9	-2.9
External debt/GDP	77.9	76.1	88.8	84.7	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	62.3	60.2	63.8	59.8	n.a.

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Macroeconomic developments and policy response

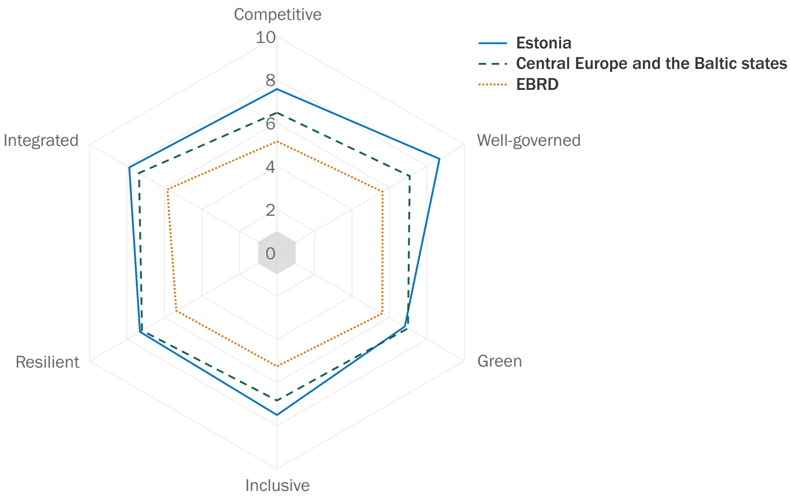
The economy has lost momentum in 2022. Following growth of 8.0 per cent in 2021, gross domestic product (GDP) growth slowed to 2.4 per cent year on year in the first half of 2022. Household consumption supported this growth, especially via higher spending on services that had suffered the most during the pandemic lockdowns. High levels of accumulated savings, money taken from the funded pension scheme as well as the government's energy price compensation measures were able to partially offset the negative impact on GDP of the historically high inflation (see below). Pre-sanctions trade with Russia was already low, so the slowdown in exports can be largely attributed to weaker demand from the European Union (EU). Despite the drop in growth, average employment grew to 81.9 per cent of the total labour force in the second quarter of 2022, while unemployment fell to 5.7 per cent in September 2022.

Inflation has jumped sharply. In September 2022 the annual inflation rate reached 24.1 per cent, down from 25.2 per cent in August 2022, and driven mostly by high household expenditure on energy, heating, gas and solid fuels, and food price growth. The average annual inflation is expected to exceed 20 per cent throughout 2022, and will likely not reach single digits until the second half of 2023.

The government has introduced measures to combat rising energy prices and inflation. In December 2021 energy subsidies worth €79 million, covered by revenues from the sale of CO_2 emission credits, were launched for households with incomes below €1,126 per month, and included full cover for gas network fees as well as compensation for 80 per cent of the increase in electricity costs, gas and district heating. In January 2022 the government discussed additional measures worth €90 million to target non-eligible recipients, and agreed to reduce network fees for businesses and introduce a cap on gas prices (€65 per MWh) and electricity prices (€0.12 per kWh). In May 2022 parliament approved a supplementary state budget of €878 million. It also passed amendments cutting excise duties on special purpose diesel, and lowered value added tax (VAT) rates applicable to press publications in an attempt to support free and independent quality media in Estonia. As a result of these measures, plus additional expenditure on defence and refugees, the general government deficit is expected to widen from 2.4 per cent of GDP in 2021 to almost 3.0 per cent in 2022.

GDP growth will slow further. The rapid rise in prices, especially energy prices, will weigh on household consumption and business performance in the short term. Weakening external demand in the EU will constrain Estonian exports, while expensive energy imports will weaken the terms of trade. Subdued corporate investments in 2022 are likely to rebound in 2023, when inflation eases and fresh EU funds will be more vigorously used by companies as the outlook improves. We therefore forecast GDP growth to remain subdued this year and the next, at 1.5 per cent and 1.0 per cent, respectively.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

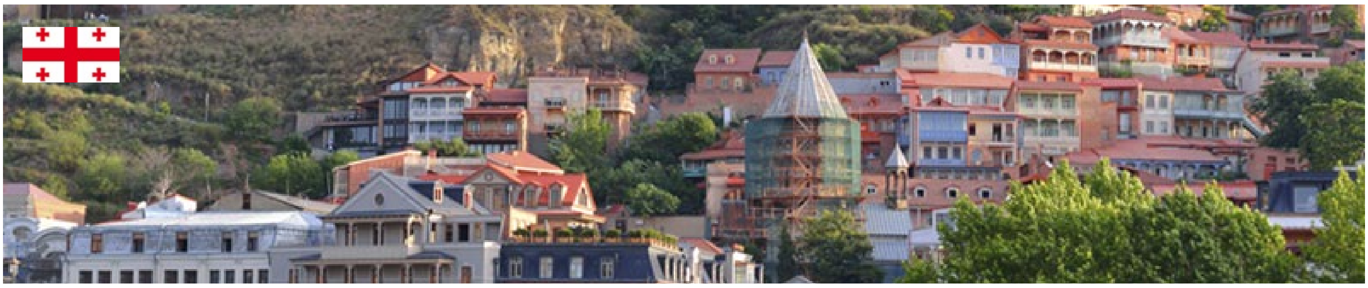
Efforts to strengthen energy security have been stepped up. In response to Russia's invasion of Ukraine, in May 2022 the supplementary budget included an additional €257 million for energy security-related measures. To become fully independent from Russian gas, the government is helping to develop the Paldiski Terminal so that it can receive liquefied natural gas (LNG), to be completed by the end of November 2022, and is supporting the leasing of a floating LNG terminal in partnership with Finland. A total of €242 million from the supplementary state budget was set aside to help Ukrainian refugees.

The government is supporting Ukrainian refugees' inclusion in the labour market. In the second quarter of 2022 there were about 3,300 Ukrainian refugees employed in Estonia, mostly in manufacturing, administrative and support services, trade, and accommodation and food services. At the same time, nearly 4,000 Ukrainian refugees were seeking employment through the Unemployment Insurance Fund. Additional funding will be provided to cover expenses for temporary protection of refugees, including healthcare, social benefits and employment support, as well as one-off grants for rental housing costs. Aid will also be given to the education system to accommodate Ukrainian children.

The government has adopted a new work plan for 2022-23. Approved in August 2022, it highlights eight areas of intervention, of which the three key priorities are: (i) enhancing the country's security, including cybersecurity of government digital services; (ii) in education, moving towards teaching purely in the Estonian language; and (iii) further supporting the population in coping with higher energy prices and inflation.

The government is reinforcing the regulation of VASPs. Estonia is a frontrunner among EU countries in cryptocurrency legislation. In December 2021 it introduced a draft law that will lead to tighter licensing rules – VASPs will need to meet additional requirements in order to obtain a licence, licensing fees will rise and capital requirements increased. In addition, the draft legislation introduced stricter transparency rules, ultimately aligning information requirements with those of banks and more traditional payment service providers. The purpose of the law is to regulate a significant portion of the fintech sector, thus reducing the risk of financial crime occurring and improving protection mechanisms. In June 2022 the Ministry of Finance announced the development of its first fintech strategy, aimed at supporting Estonian companies to exploit the full potential of fintech.

Implementation of the Recovery and Resilience Facility (RRF) is under way. Following the approval of Estonia's RRF in October 2021, the European Commission disbursed the first tranche of €126 million in pre-financing in December 2021. The funds are key in kick-starting the investments and reforms needed to meet a total of 71 milestones and 53 targets, mostly in green and digital transition, by 2026. Initial support for green transition included funding for energy efficiency projects for 2,600 housing units and the launch of a plan to strengthen the electricity grid and improve production capacity of renewable energy. Future green investments will mostly target businesses, supporting the development and use of new resource-efficient technologies and sustainable mobility, with sizeable investments in rail and tram infrastructure. Support for digital transition has already started with initial funding directed to digitalisation and automation of business processes, which will be followed by further enhancement of digital public services.



Georgia

Highlights

- **Rising tourism and money transfers are contributing to broad-based double-digit economic growth.** The economy has experienced a revival of the hospitality sector due to increasing inflows of Russian citizens and tourists from other regions, with tourist revenues from January to August 2022 reaching 95 per cent of the corresponding period in 2019.
- **The European Union (EU) Council recognised the European perspective of Georgia.** The EU is ready to grant candidate status once the progress on 12 priorities set by the European Commission has been addressed. The authorities are encouraged to prioritise judicial reform, strengthen the anti-corruption framework, lower the level of political polarisation, and enable more inclusive decision-making processes at all levels.
- **Labour market reform has been initiated, accompanied by a complementary social welfare policy.** The authorities took steps to increase labour market participation through inclusive policies. At the same time they increased social assistance to vulnerable groups to help them at a time of high inflation.

Key priorities for 2023

- **The authorities should continue educational reform and efforts to reduce skills mismatches.** Improving the quality of education and putting more focus on vocational training could better match the demand for and supply of labour skills and enable the economy to move towards sectors that are more productive.
- **Energy resilience should be strengthened by investing in additional renewable energy production capacity.** The seasonality of the country's hydro-dominated production and the increase in consumption, driven by economic growth, have made the country a net importer of energy. However, significant potential in additional hydro-energy and the largely untapped solar and wind energy, could be an opportunity to benefit from the increased demand for green energy.
- **Continuous strengthening of governance standards needs to remain a priority.** An impartial and independent judiciary, and transparent, efficient and accountable public institutions, would be strong enablers of a stable business environment.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	4.8	5.0	-6.8	10.4	8.0
Inflation (average)	2.6	4.9	5.2	9.6	11.6
Government balance/GDP	-0.7	-2.7	-9.3	-6.3	-3.0
Current account balance/GDP	-6.8	-5.9	-12.5	-10.4	-7.2
Net FDI/GDP [neg. sign = inflows]	-5.7	-6.1	-3.6	-4.9	-4.4
External debt/GDP	101.5	107.8	131.4	117.7	n.a.
Gross reserves/GDP	18.7	20.1	24.7	22.8	n.a.
Credit to private sector/GDP	56.8	61.7	74.6	69.0	n.a.

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Macroeconomic developments and policy response

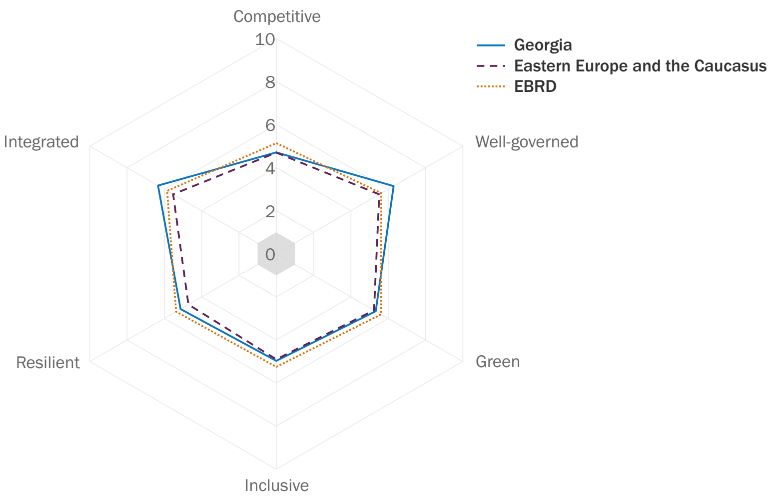
The economy is growing robustly. The economic recovery achieved in 2021 further accelerated in January to August 2022, when gross domestic product (GDP) grew by 10.3 per cent year on year. Growth was broad based but especially buoyant in the tourism, energy supply, transport and information technology (IT) sectors. Tourism benefited from the threefold increase in income generated by foreign travellers in the first eight months of 2022 compared with the same period in 2021, and revenues from tourism almost reached pre-pandemic levels. In the same period, the net inflow of money transfers increased by 70 per cent year on year, boosted by the arrival of Russian citizens and entrepreneurs who found temporary refuge in Georgia. Huge foreign inflows helped to cover the widening trade deficit, as exports and imports both rose by more than 30 per cent year on year between January and July 2022. By the end of September, the Georgian lari had appreciated by 20.0 per cent since the low point in March 2022, and by 9.0 per cent since the beginning of the year.

The authorities are using fiscal and monetary policies to combat high inflation. Inflationary pressures have risen as a result of rising fuel and energy prices, due to the war on Ukraine and associated spillovers, with the annual inflation rate reaching 10.9 per cent year on year in August 2022. Higher prices for food and non-alcoholic beverages and transport are the two biggest causes of high inflation. After several policy rate increases during 2021, the National Bank of Georgia further raised the rate to 11.0 per cent in March 2022, but has refrained from further increases as currency appreciation is helping to keep import prices under control. In parallel, the government implemented several measures to further alleviate the pressure on households and ensure the availability of food. These measures include low-interest-rate loans for the agribusiness sector to support crop production, wheat and barley export bans effective from July 2022, and subsidies to the socially vulnerable throughout 2022 to offset increasing food and energy prices.

A new International Monetary Fund (IMF) programme is in place. In June 2022 the authorities concluded a US$ 280 million precautionary stand-by arrangement with the IMF. This arrangement will reduce uncertainty and help to create a more predictable business environment, especially after international sanctions imposed on Russian-owned banks already caused significant deposit withdrawals from VTB Georgia, the fourth-largest bank in the country. The authorities managed the issue effectively by facilitating transfers of assets and liabilities to other banks, thereby preventing more severe damage to the financial system.

Strong growth will continue, but risks of spillovers from the war on Ukraine remain high. Therefore GDP growth is likely to be 8.0 per cent in 2022 and then moderate slightly to 5.0 per cent in 2023. The forecast for next year is highly sensitive to geopolitical uncertainty and risks are mostly on the negative side. However, progress on the EU membership agenda could be a strong anchor for growth-conducive reforms.

CHART Assessment of transition qualities (1-10)



NOTE: Belarus is not included in the EBRD region and respective regional averages.

CONTINUES

Structural reform developments

IT infrastructure development has expanded in rural areas. The authorities constructed additional fibre optics, with the help of €34 million in financing from the European Investment Bank in December 2021. By improving the digital connectivity of the rural population, around 500,000 Georgians residing in rural areas can now access fast-internet services. In June 2022 the authorities bolstered the diffusion of internet access by authorising the launch of SpaceX's satellite internet service to reach a larger share of the rural population. With SpaceX entering the Georgian telecommunications market, the authorities are planning to develop a more competitive and open market to foster innovation and enhance social inclusion.

The authorities have taken steps to advance state-owned enterprise (SOE) reform. As part of the SOE reform strategy 2021-24, a series of pilot projects to enhance the transparency of corporate governance have been implemented by introducing independent supervisory board members. The ultimate goal of these pilots is to reduce fiscal risks by adjusting the management rules of Georgian SOEs to be in line with international corporate practice. In April 2022 the Ministry of Finance, with technical assistance from the Asian Development Bank, began to reform the railway sector to reduce the debt of the Georgian railway company.

Investment in technical vocational education and training (VET) is being stepped up. The Ministry of Education and Science has led the reform of VET through public and private partnerships. Consequently, the Skills Agency, which is a newly established skills development agency, has been actively involved in providing training modules aligned with the needs of employers in the labour market from 2022. Through close consultation with the private sector, the Skills Agency aims to ensure that the VET system can supply and foster human capital most in demand from businesses.

The government has initiated the active labour market policy (ALMP) to increase labour market participation. Since March 2022 the ALMP has been implemented in a bid to encourage into work almost 200,000 socially vulnerable citizens aged over 18 who receive social welfare but are deemed to be employable. According to the programme they can choose between public works and vacancies offered on the labour market and receive additional income on top of their social assistance. The beneficiaries are assigned to jobs matching their skills, educational qualification and work experience.

The authorities took concrete steps to protect green areas and contribute to climate change mitigation. In June 2022 parliament unanimously approved a law that imposes stricter sanctions on illegal logging of timber to prevent deforestation in Tbilisi. In July 2022 the Ministry of Environmental Protection and Agriculture announced the establishment of a new national park in the west of Georgia. It will serve as a reservoir to safeguard biodiversity and ecosystems of local forests, create employment opportunities for local residents, and contribute to the development of tourism. In November 2021 a National Plastic Prevention Programme for 2022-26 was adopted, aiming to reduce single-use plastic. The programme is based on the principles of a circular economy. Furthermore, in December 2021 technical regulations setting ambient-air monitoring criteria were adopted, providing the framework for the installation of new air-quality monitoring stations by the end of 2022.

The EU has granted Georgia a European perspective, but not yet official candidate status. In March 2022 Georgia formally applied for EU membership. In June 2022 the European Council granted Georgia a European perspective, but official candidate status is subject to prior fulfilment of conditions such as commitment to democratic consolidation, judicial reforms, reducing the influence of vested interests, and action to reduce political polarisation and strengthen the rule of law.

Public administration reform and consumer protection have been advanced. In April 2022 a public services development strategy for 2022-25 was adopted. Its goal is to make the provision of public services easier and more accessible for citizens. It sets guidelines for standards on design, delivery and quality control for public services. In the private sphere, a new law on the protection of consumer rights, approved by parliament in March 2022, will enhance alignment with EU legislation in line with the Association Agreement. The law entered into force on 1 June 2022, but enforcement and processing of applications or complaints on alleged infringements will start from November 2022. The law establishes rules for consumer protection and prohibits unfair commercial practices that jeopardise the values of trust and good faith.

Greece

Highlights

- **The strong post-Covid rebound of 2021 has continued into 2022.** Following 8.3 per cent growth in 2021, gross domestic product (GDP) in 2022 remains driven by rising consumption and exports, a significant pick-up in investment and a tourism season on a par with the record year of 2019.
- **Greece has exited the European Union (EU)'s enhanced surveillance procedure.** The four-year procedure ended in August 2022, during which Greece delivered on most of its reform commitments to the Eurogroup and benefited from further debt relief measures.
- **Implementation of the EU's Recovery and Resilience Facility (RRF) is well under way.** Greece was one of the earliest countries in the EU to prepare a coherent plan, with a strong focus on digitalisation and green projects. It is funded by both grants and loans.

Key priorities for 2023

- **Fiscal discipline should be continued alongside targeted support for vulnerable groups.** The government's commitment to returning to a primary fiscal surplus in 2023 should be maintained, but further assistance for vulnerable groups will be needed to help them cope with double-digit inflation and rising energy costs.
- **Governance reforms should be accelerated.** Governance remains a weak point for Greece compared with its EU peers, and further progress is needed in areas such as public administration and judicial reform. The digital transition plans of the government are likely to accelerate the implementation of these reforms.
- **Backtracking on the ambitious green agenda should be strictly time-bound to meet urgent energy needs.** The recent decision to step up electricity production from lignite mines as a fall-out from the energy crisis due to Russia's invasion of Ukraine is a necessary step. However, it also highlights the need to vigorously pursue reforms in the energy sector, including the acceleration of renewables licencing and the attraction of new investment in this area.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	1.9	1.8	-9.0	8.3	5.2
Inflation (average)	0.8	0.5	-1.3	-0.6	9.2
Government balance/GDP	0.9	4.2	-7.2	-5.0	-1.7
Current account balance/GDP	-3.6	-2.2	-7.3	-6.5	-6.7
Net FDI/GDP [neg. sign = inflows]	-1.6	-1.7	-1.5	-2.2	-2.9
External debt/GDP	222.4	219.3	303.9	310.1	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	91.7	80.9	82.1	n.a.	n.a.

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Macroeconomic developments and policy response

Strong post-Covid economic growth has continued into 2022. After a major post-pandemic rebound in 2021, the economy continued to surge ahead strongly in the first half of 2022. GDP grew by 8.0 per cent year on year in the first quarter and by 7.7 per cent on the year in the second quarter (seasonally adjusted). The low base effect of lockdowns in the first half of 2021 helps to explain some of this high year-on-year growth, but the expansion was also driven by buoyant private consumption and rising government spending. Exports have continued to perform strongly, including high-technology exports. The tourism sector is once again contributing in a major way to growth in 2022, with the season as a whole so far close to matching (in revenue terms) the record-breaking pre-pandemic year of 2019. Unemployment has continued to decline, reaching 11.8 per cent in September 2022. However, confidence is showing signs of fragility in the second half of the year. The purchasing managers index fell to 48.1 in October 2022 on the back of weaker demand and lower orders, as global energy markets face increasing uncertainty and turbulence and as the eurozone faces the risk of a recession in the near future.

Inflation is at double-digit levels. As elsewhere in the eurozone, prices in Greece have been rising sharply in 2022, especially for food and energy, putting pressure on household budgets and damping economic sentiment levels, which had risen to 20-year highs earlier in the year. Annual inflation (as measured by the consumer price index) in September 2022 was 12.0 per cent, driven by the rising cost of services, non-energy industrial goods and processed food. Energy prices are up sharply as well, as Greece remains quite dependent on the import of fossil fuels (nearly half of all available energy), much of it traditionally from Russia.

The government has responded to the energy crisis with mitigating measures. Temporary energy measures, with a budgetary impact estimated at 2.2 per cent of GDP, include subsidies to households and enterprises to help them cope with the increasing cost of electricity, a voucher to further address rising costs for vulnerable households, a three-month fuel subsidy for low-income families and a reduced value added tax (VAT) rate on public transport (already in place during the Covid-19 crisis but extended to December 2022). In April 2022 the government increased the minimum wage by 7.5 per cent (following a 2 per cent increase at the start of the year) as another measure of support for low-income households, taking the minimum monthly salary to €713. Although these steps have a fiscal cost, the government remains on track for a primary government deficit of just 1.7 per cent of GDP this year and a return to a primary surplus of 0.7 per cent of GDP in 2023, according to the draft budget for 2023 published in October 2022. The public debt ratio remains the highest in Europe, at 193 per cent of GDP as of end 2021, but is on track to decline sharply in 2022.

Growth will slow in the short term, but the overall outlook remains positive. In light of the worsening global picture, a downturn in Greece's economic growth rate in the latter part of 2022 and into 2023 seems inevitable. We, therefore, forecast GDP growth of 5.2 per cent for 2022 as a whole, dropping to 2.2 per cent in 2023 as inflation weighs increasingly on disposable income and consumption. The implementation of projects, funded by both loans and grants under the EU's RRF, will help to keep growth in positive territory and will contribute to the long-term sustainability of the economy, but significant downside risks remain, mostly associated with any potential intensification of the war on Ukraine and correspondingly high international energy prices.

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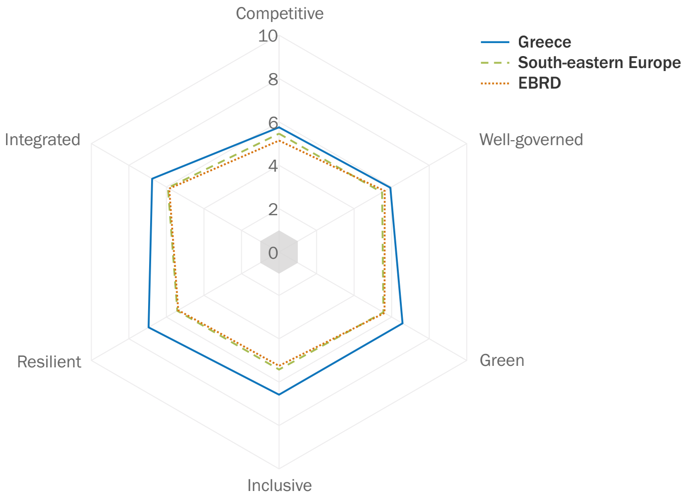
CHART Assessment of transition qualities (1-10)



Structural reform developments

Greece has exited the EU's enhanced surveillance procedure. The procedure was put in place in August 2018 following Greece's completion of the third economic adjustment programme and involved regular monitoring of reform progress and quarterly reports by the European Commission. In the Commission's view, Greece delivered on most of the policy commitments it made in 2018 and effectively implemented key reforms to strengthen the economy. From now on, Greece's economic, fiscal and financial situation will continue to be monitored in the context of post-programme surveillance and the European Semester. Greece also completed the early repayment of its outstanding International Monetary Fund (IMF) loans on 4 April 2022.

Good progress has been made so far on Greece's Recovery and Resilience Plan. The plan, known as Greece 2.0, is funded by the EU's RRF, and comprises €17.8 billion in grants and €12.7 billion in loans. The programme has a strong emphasis on the green transition, with more than one-third of funds allocated to projects in this area, and on digitalisation, to which nearly one-quarter of RRF funds will be targeted. The government is cooperating closely with the four systemic banks (and two smaller local banks) and with the European Investment Bank and European Bank for Reconstruction and Development, under agreements signed in early 2022, for the co-financing and the mobilisation of other private investment sources.

Ambitious climate-mitigation plans are progressing, but the global energy crisis is causing some delay. Greece's National Energy and Climate Plan (NEPC), adopted in 2019, is being implemented and the country unveiled a new Climate Law in November 2021. Among other measures, the new Law includes a commitment to phase out lignite plants by 2028, zero emissions for all new vehicles by 2030 and an increase in the share of renewables in gross final energy consumption to 50 per cent, also by 2030. However, in July 2022 the government agreed to temporarily increase the amount of electricity produced by coal mines in response to the growing energy crisis resulting from Russia's invasion of Ukraine. More encouragingly, the crisis has also led to a big increase in applications for renewable licences, and the government is making efforts to speed up the licensing process and to think strategically about which areas of the country should get the bulk of new projects.

Greece's non-performing loan (NPL) reduction remains on track. Data from the Bank of Greece show a steep fall over the past year in the ratio of non-performing exposures (NPEs) to total exposures, from 32.9 per cent in March 2021 to 10.0 per cent in June 2022, although it is significantly higher (18.4 per cent) in the consumer loans segment. The asset-backed Hercules resolution scheme, introduced in early 2020, will expire in October 2022 and has been largely successful in helping to reduce NPEs through securitisations. Direct sales of NPLs have also increased significantly in the past year.

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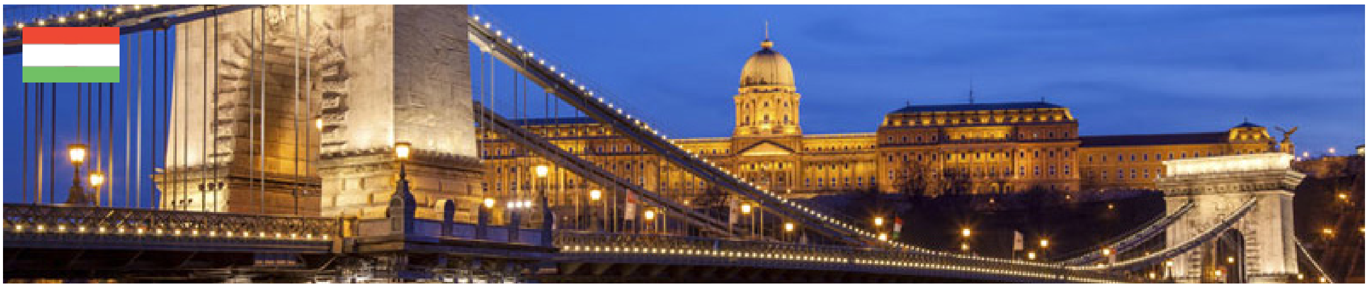
Privatisation continues to advance. The state budget for 2022 envisaged privatisation revenues in excess of €2.2 billion, far outstripping the amount recorded in 2021 (€638 million), but significant uncertainty remains around a number of key transactions. In particular, there have been delays in finalising some of the construction of the Egnatia motorway, putting in doubt the agreed end-2022 date for handover to the selected concessionaire. However, the Public Gas Corporation (DEPA) Infrastructure has been privatised for €733 million to an Italian company, Italgas, with the deal concluded in September 2022. Several privatisations in the ports sector are also progressing well, with the closure of several deals expected by the end of 2022.

New labour regulations are helping to reduce the informal economy. The new labour law approved in 2021 included a number of reforms on working time, family-friendly measures and the use of digital technology to facilitate work arrangements. The use of a digital work card to record overtime is helping to reduce undeclared hours and the informal economy.



Hungary

Highlights

- **Economic growth has been strong but it is starting to slow.** Gross domestic product (GDP) continued to rise rapidly during the first half of 2022, but high commodity and energy bills, weakening external demand and higher interest rates are dragging growth down in the second half of 2022.
- **The government has launched a seven-point plan to address the energy crisis.** The plan comprises placing an export ban on energy sources, increasing domestic gas and coal production, re-starting the coal-fuelled Matra power plant, extending the working hours of the Paks nuclear power plant, purchasing additional gas for storage, and increasing regulated utility prices to better reflect market conditions.
- **The state is planning to boost its stake in "strategically important sectors".** According to an announcement in August 2022, the government is planning to participate in the buyout of telecoms company Vodafone Hungary by the end of 2022.

Key priorities for 2023

- **The European Union (EU)'s rule of law concerns need to be addressed to unlock EU funds.** Even though the conditionality mechanism procedure, a tool that suspends EU funds to EU member states that breach the rule of law, is separate from the approval of the country's Recovery and Resilience Facility (RRF) plan, a solution to rule of law concerns will be important for unfreezing EU recovery funds.
- **Greater investments in the green economy are needed.** Concrete progress in areas such as energy efficiency in buildings and developing capacity in renewable energy production would enhance energy security and the economy's resilience.
- **More investment in sustainable water management and waste management is needed.** The intensifying droughts have already prompted substantial losses in the agriculture sector, which in 2022 had an almost 40 per cent lower yield than in the previous year.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	5.4	4.9	-4.5	7.1	5.0
Inflation (average)	2.9	3.4	3.4	5.2	14.0
Government balance/GDP	-2.1	-2.0	-7.5	-7.1	-4.9
Current account balance/GDP	0.2	-0.8	-1.1	-4.2	-6.7
Net FDI/GDP [neg. sign = inflows]	-1.9	-0.8	-1.7	-1.8	-1.1
External debt/GDP	79.8	74.2	84.1	87.1	n.a.
Gross reserves/GDP	19.6	19.4	26.3	23.9	n.a.
Credit to private sector/GDP	31.2	31.9	34.9	34.7	n.a.

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Macroeconomic developments and policy response

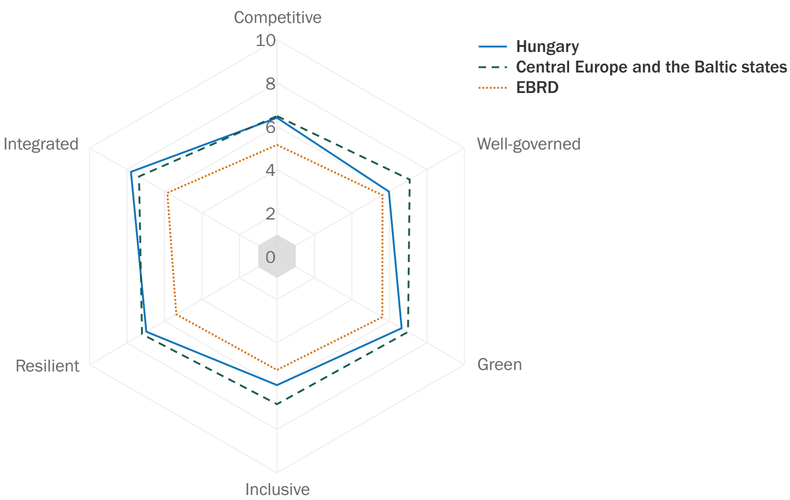
Economic growth has been strong post-pandemic but it is slowing. Following GDP growth of 7.1 per cent in 2021, the Hungarian economy continued to grow rapidly during the first half of 2022, at 7.3 per cent year on year. The weakening forint supported exports, while the tourism sector rebounded somewhat from the low base registered during the Covid-19 pandemic. Overall, domestic demand continued to be strong, fuelled by high corporate investment, especially in the automotive sector. The agriculture sector performed much worse, however, adversely affected by a severe drought which resulted in wheat output falling by 25 per cent relative to the average of the previous five years. The unemployment rate fell to 3.1 per cent in June 2022, one of the lowest levels in the EU, but employment growth in both the private and public sectors has slowed during 2022, and the government has planned redundancies in the public sector, with estimated savings of HUF 30 billion (€73.5 million) in 2023.

Inflation has risen sharply, prompting a monetary and fiscal response. Forint depreciation, elevated commodity and energy prices, increasing wages and strong domestic demand have all fuelled high inflation rates during 2022, with the rate reaching 20.1 per cent in September 2022. In response, the National Bank of Hungary (NBH) has been gradually raising its policy rate since June 2021, to 13.0 per cent in September 2022. Meanwhile, the government has extended to the end of 2023 the price caps on fuel (at HUF 480/€1.2 per litre) and food, which were initially introduced in November 2021 and February 2022, respectively. Small fuel stations are receiving financial support as they experience difficulties in operating under regulated fuel prices. At the same time the cap on mortgage interest rates, introduced in January 2021, was extended until the end of June 2023. In July 2022 however, the European Commission launched an infringement procedure against Hungary for the fuel price cap which only applies to domestic vehicles.

Substantial fiscal consolidation is expected to be carried out mainly by expenditure cuts. The government intends to consolidate the public finances by 3.0 per cent of GDP in 2022 in order to reduce the general government deficit from 6.8 per cent in 2021 to 6.1 per cent of GDP in 2022, as stated in the latest Excessive Deficit Procedure report. Larger savings are expected on the expenditures side, amounting to 1.7 per cent of GDP, mostly through cuts in ministries' budgets and postponed investments. The revenue-side measures, worth 1.3 per cent of GDP, include new windfall taxes, such as for the oil and gas group MOL, as well as increases in company car and public health taxes. Public debt is expected to gradually fall from about 76.8 per cent of GDP in 2021 to 73.8 per cent of GDP in 2023, according to the government's 2023 draft budget.

Slower growth is expected in the short term. We anticipate GDP growth in 2022 to remain high, at 5.0 per cent, before it drops to 1.5 per cent in 2023. High commodity and energy bills, weakening external demand and high interest rates are all contributing to a notable slowdown in economic growth during the latter part of 2022 and this is expected to continue into 2023. Private-sector investments, especially those by automotive manufacturers, will add to GDP growth and employment in the coming years, but the deteriorating global outlook, including potential new energy supply disruptions, will weigh on confidence and economic activities.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

The first road shipment of liquefied natural gas (LNG) has reached Hungary. In August 2022 the first LNG rail tanker delivered LNG to Hungary, directly from a vessel at the LNG terminal in Krk, Croatia, which started operations in January 2021. This new way of transporting natural gas complements the traditional method of pipes, and will be used for industrial purposes. At the same time, Gazprom increased its gas deliveries to Hungary via the Balkan Stream pipeline, as the government requested to buy an additional 700 million cubic metres of gas to cover the anticipated shortages during the upcoming winter. A long break in gas supply could result in output losses in more than 40 per cent of companies, and a complete shutdown in a third of them, according to a survey by the German-Hungarian Chamber of Industry and Commerce.

The government has launched a seven-point plan to address the energy emergency. The plan, which came into force in August 2022, envisages an export ban on energy sources and firewood, with the exception of gas stored in Hungary by foreign entities. The plan also envisages upping domestic gas production from 1.5 to 2 billion cubic metres a year, including through more expensive technologies, as well as substantially increasing coal mining, re-starting the coal-fuelled Matra power plant, extending the working hours of the Paks nuclear power plant, purchasing additional gas for storage and increasing regulated utility prices to better reflect market conditions. Eligible amounts of gas with reduced prices should be available only up to the level of the average household consumption, with an expected 75 per cent of households remaining under regulated prices. In addition, nearly 100,000 small and medium-sized enterprises remain under the scheme.

The government is supporting the agriculture sector in the face of drought. The agriculture sector is expected to experience a 25 per cent loss in wheat crops and see damage to corn crops in 2022 because of severe drought. In response, the government in September 2022 placed a moratorium on loan repayments for working capital and investment loans for agricultural companies, which will last until the end of 2023. Farmers will also be awarded subsidies to purchase animal feed and offset higher energy costs for irrigation. The support package also covers extraordinary water usage approvals and requires insurers to assess drought damage and pay any compensation promptly. In July 2022 the government extended indefinitely restrictions on grain exports that impose some notification requirements for exporters, and it has a pre-emptive right to buy grain intended for export.

Expansion of the nuclear power plant has started. Construction licences for two new nuclear reactors at the Paks nuclear power plant were issued by the Hungarian Atomic Energy Authority in August 2022. The plant's expansion will increase its installed capacity from 2,000 to 4,400 megawatts by 2030. The Paks nuclear power plant is based on Russian fuel and its expansion is excluded from the EU sanctions on Russia.

The biggest investment in Hungary is taking place in 2022. The Chinese company CATL, the world's largest electric battery producer, is expected to invest €7.34 billion in a new battery plant in Debrecen in eastern Hungary, close to the new German BMW plant. This will be the fifth electric battery plant in Hungary following the three facilities owned by Korean SK Innovation and Samsung SDI's plant. About 9,000 jobs are expected to be created. In addition, German car producers Mercedes and Audi are planning major new investments in electric car production.

The state is to boost its stakes in selected "strategically important sectors". The government announced in August 2022 that it was planning to take part in the buyout of telecoms company Vodafone Hungary by the end of 2022. The transaction is set at HUF 715 billion (€1.74 billion) and should be divided between the government-owned 4iG and state foundation Corvinus, with 51 and 49 per cent stakes, respectively. This transaction is in line with the government's strategy to increase the state's presence in strategically important sectors, which started in 2010. Also, energy companies, important for national energy security, will be placed under government supervision in case of emergency, according to a government decree issued under the current state of emergency due to the war on Ukraine.

Jordan

Highlights

- **The country's economic recovery continued steadily in 2021 and the first half of 2022.** This was supported by an upturn in services and tourism, but unemployment remains high and inflation is accelerating because of rising energy and food prices.
- **Important reforms in the energy sector have progressed.** The government completed a comprehensive review of power purchase agreements (PPAs) and adopted a three-year electricity tariff reform plan.
- **Jordan launched its Economic Modernisation Vision 2030.** The new strategy targets higher growth and the creation of 1 million additional jobs, with a focus on promoting high-value industries, addressing food and energy security and ensuring sustainable development.

Key priorities for 2023

- **High unemployment and low female participation in the workforce must be tackled.** Reforms to promote private investment, especially in labour-intensive sectors, will be key for employment creation. Bold labour-sector reforms and measures to address skills mismatches are needed to mitigate market rigidities, and should be complemented by measures promoting entrepreneurship and innovation.
- **Improved food and energy security should be prioritised.** A combination of better long-term planning and strategies to promote investment in agriculture is essential to mitigate sensitivity to food security risks and reduce import dependence. Sectoral reforms are also needed to diversify energy sources and improve energy efficiency.
- **Further efforts are needed to rein in public debt and free up resources to meet development needs.** Successful fiscal reforms in recent years under the International Monetary Fund (IMF)-supported programme have strengthened the country's resilience, and the authorities should now leverage public-private partnerships in key infrastructure projects.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	1.9	2.0	-1.6	2.2	2.0
Inflation (average)	4.5	0.7	0.4	1.3	3.8
Government balance/GDP	-4.7	-6.0	-8.6	-8.0	-5.9
Current account balance/GDP	-6.9	-1.7	-5.7	-8.8	-6.7
Net FDI/GDP [neg. sign = inflows]	-2.2	-1.5	-1.7	-1.3	-1.7
External debt/GDP	67.9	68.0	79.3	80.6	n.a.
Gross reserves/GDP	33.9	34.6	38.8	42.0	n.a.
Credit to private sector/GDP	80.9	81.4	87.5	88.9	n.a.

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Macroeconomic developments and policy response

A robust economic recovery has been under way since 2021. After 2.2 per cent growth in 2021, gross domestic product (GDP) expanded by 2.5 per cent year on year in the first quarter of 2022. Growth was led by a broad-based expansion of the services and industrial sectors, as well as a strong rebound in the tourism sector. Tourism revenues rose by 215 per cent year on year in the first quarter of 2022, reaching US$ 893 million, but were just half the level of the first quarter of 2019. However, the economy remains unable to absorb many workers; unemployment decreased slightly in the first quarter of 2022, but was still high, at 22.8 per cent. Disparities in unemployment between men (22.4 per cent) and women (30.7 per cent) are significant, with even higher rates among the youth (36.4 per cent) and graduates (32.6 per cent). Female labour force participation has been historically among the lowest in the region, at around 15 per cent, lagging even behind Egypt and Morocco at above 20 per cent. Meanwhile, inflation reached 5.3 per cent year on year in July 2022, mainly due to a 30.6 per cent increase in the cost of fuel and electricity as a result of the war on Ukraine and the new electricity tariffs introduced in April 2022.

Targeted subsidies have been increased in response to rising fuel and food prices. In the first quarter of 2022 the government partly alleviated the burden of rising energy prices by reducing fuel taxes to stabilise prices. However, fiscal space is limited: the government deficit in 2021 was 5.4 per cent of GDP and public debt at the end of the year was 113.8 per cent of GDP. The government is, therefore, gradually phasing out indirect blanket subsidies and moving instead to increasing targeted support for the poorest households. In August 2022 the authorities announced a payment mechanism of JOD 30 million (US$ 42 million) of fuel subsidies for the beneficiaries of the National Aid Fund (NAF), underprivileged university students and the public transport sector. The removal of general subsidies in favour of targeted support for the vulnerable, combined with higher-than-expected revenues, is keeping the primary deficit target of 3.4 per cent of GDP in 2022 within reach.

External imbalances have narrowed in 2022. In 2021 the current account deficit widened to 8.8 per cent of GDP (from 5.7 per cent in 2020), reflecting rebounding domestic demand. It narrowed in the first half of 2022, however, despite a rising import bill, in part thanks to recoveries in tourism and exports (mostly crude materials, such as phosphates). Meanwhile, foreign-exchange reserves reached US$ 16.6 billion in July 2022, covering around nine months of imports.

Growth is expected to continue, but uncertainty remains. GDP growth is projected to reach 2.0 per cent in 2022, led by the robust performance of the services sector, continued recovery in tourism and rising value of exports of raw materials. Faster growth in the non-service sector and a stronger recovery in global tourism and trade flows could push growth in 2023 to 2.7 per cent. However, global volatility could hold back growth (notably through inflation and risks to tourism revenues), while high unemployment and limited job creation will weigh on the recovery for many households, including the poorest parts of the population and refugees.

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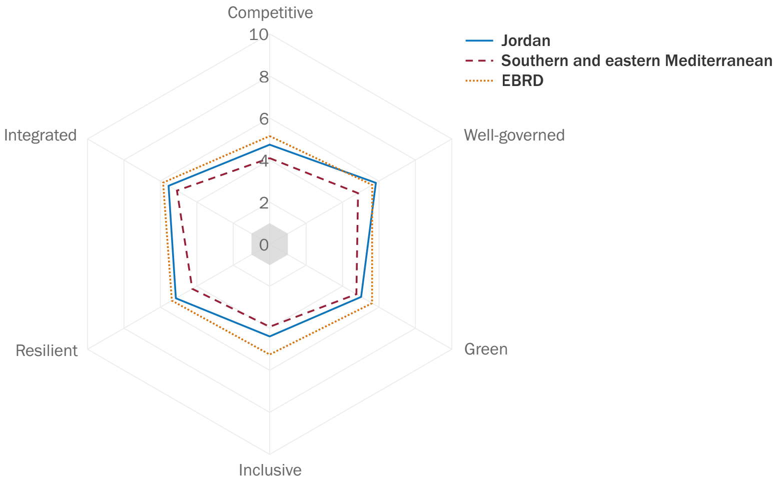
CHART Assessment of transition qualities (1-10)



Structural reform developments

The government is continuing with reforms under the IMF-supported programme. The IMF's four-year Extended Funds Facility remains on track, with the Fund approving in July 2022 an additional US$ 100 million of funding to deal with rising pressures from higher prices for hydrocarbons and raw materials. Current conditions are likely to flatten the downward path envisaged for public debt under the programme. The country has met most of the programme's fiscal and monetary targets, including those related to closing tax loopholes, widening the tax base (with better-than-expected revenue collection reported in 2021) and maintaining healthy foreign-currency reserves. As prior actions under the programme, the government completed a comprehensive review of PPAs and adopted a three-year electricity tariff reform plan.

The authorities have unveiled their Economic Modernisation Vision. The new 10-year plan, announced in June 2022, targets inclusive and sustainable growth. It aims to attract US$ 41 billion in foreign direct investment over the next 10 years and raise the country's GDP growth rate to 5.6 per cent by 2033, while increasing per capita income by an average 3 per cent per year. The reforms are designed to tackle persistent unemployment by creating over a million jobs in the next 10 years. To achieve this, the plan envisages US$ 5 billion of investment a year in high-value industries (pharmaceuticals, chemicals, engineering and textiles), with a focus on building integrated value chains and boosting productivity and innovation. Furthermore, the plan aims to enhance the sustainability of Jordan's natural resources in the areas of energy and water, as well as improving food security. In parallel, the government remains committed to ongoing reforms to the oversized public administration.

Public-sector reforms are advancing. In August 2022 the government approved a new public-sector modernisation plan in tandem with the launch of its Executive Programme 2022-25. The plan aims to transform public-sector operations, procedures, structure and policymaking; it is looking to fully automate operations, streamline procedures, digitalise services to citizens, including digital payments, and restructure ministries and government bodies towards a more agile government.

Jordan is prioritising food security planning in line with the National Food Security Strategy launched in September 2021. The country is highly dependent on food imports, as it buys in more than 95 per cent of its grain. The new strategy lays out key interventions to address availability, access, use and stability of food security. An initial investment of US$ 480 million will reduce short-term vulnerability to supply shocks. This investment will meet urgent domestic needs for wheat and barley, using the maximum physical storage capacity currently in the country. A second investment of US$ 20 million is expected to ensure food security to mitigate commodity risks, with US$ 15 million dedicated to expanding storage capacity. The creation of a High Council for Food Security is also planned to better manage food supply crises.

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The Support for Industry Development Fund Project was launched. Introduced in May 2022, it aims to promote investments and exports in the manufacturing sector through a new Industry Development Fund. Financed by a US$ 85 million World Bank fund, it will focus on upgrading and modernising industries, developing and promoting exports, and incentivising companies to perform well in key areas, such as manufacturing. The project aims to support more than 500 export-oriented companies directly through the fund's programmes and to leverage at least US$ 17 million in additional private capital. It will also support new and effective delivery mechanisms, strong governance and operational capacity, enabling the fund to support longer-term industry transformation.

Jordan-United Arab Emirates (UAE)-Israel signed a breakthrough water-for-energy deal. This agreement, signed in November 2021, will ease the impact of climate change on Jordan and address severe water shortages in the country. Under the deal, the UAE will build a solar power plant in Jordan, allowing the country to export 600 megawatts annually to Israel at a price of US$ 180 million, the proceeds to be shared between the UAE and Jordan. In exchange, Israel will send 200 million cubic metres annually of desalinated water to Jordan – an estimated 12 per cent of its annual needs.

Kazakhstan

Highlights

- **Economic growth continues amid rising inflation.** Real gross domestic product (GDP) grew 3.6 per cent year on year in the first half of 2022, driven by strong export growth amid elevated commodity prices. However, rising inflation and logistical challenges suggest a need to expand the capacity of existing trade routes and diversify into new ones.
- **Significant improvements in governance are under way.** Key developments in 2022 include the strengthening of parliament's role, efforts to renationalise embezzled assets and reduce the dominance of vested interests, and the appointment of new leaders to top government and state-owned enterprise management positions.
- **The reform agenda is advancing at a brisk pace.** The government has recently unveiled a comprehensive economic reform package to address gaps in the rule of law and protection of property rights, the competitive environment, industrial policies and social support mechanisms, human capital and public administration.

Key priorities for 2023

- **The government should intensify efforts to diversify trade and investment flows.** In light of the international sanctions imposed on Russia, Kazakhstan needs to re-route trade flows, build new supply-chain relationships and reach international agreements on key investments in alternative trade and transport corridors to take its export products to Europe and other markets, such as the Gulf region and south and south-east Asia.
- **Efforts to restore macroeconomic stability are urgently needed.** Ineffective fiscal stimulus measures, including support policies for small and medium-sized enterprises (SMEs), should be wound down and the central bank's involvement in subsidising the economy reduced as part of a broader effort to curb inflationary pressures, reduce the fiscal deficit and slow debt accumulation.
- **Social policies should be redesigned.** Targeted income support for the vulnerable should replace price controls and tariff subsidies for all. Utility tariffs should be brought closer to cost recovery over time to incentivise resource-saving behaviour, as well as private investment in renewables and energy-efficient technologies.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	4.1	4.5	-2.6	4.1	3.0
Inflation (average)	6.0	5.2	6.8	8.0	14.0
Government balance/GDP	2.6	-0.6	-7.0	-5.0	-2.0
Current account balance/GDP	-0.1	-4.0	-3.8	-2.9	3.0
Net FDI/GDP [neg. sign = inflows]	-0.2	-2.1	-4.2	-0.9	-1.1
External debt/GDP	89.4	87.8	96.2	83.7	n.a.
Gross reserves/GDP	15.7	15.9	20.8	17.4	n.a.
Credit to private sector/GDP	25.9	24.3	25.6	n.a.	n.a.

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Macroeconomic developments and policy response

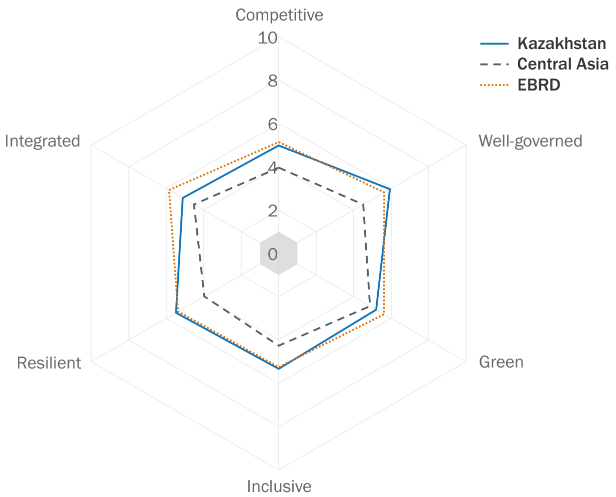
Economic growth has continued. Real GDP grew 3.6 per cent year on year in the first half of 2022. Despite disruptions at the Caspian Pipeline Consortium's terminal in Novorossiysk, exports demonstrated remarkable resilience (up 50.6 per cent year on year in January-August 2022) amid high oil prices. Growth was broad based, driven by the very strong performance of construction, transport and warehousing, and the economy is resilient to external shocks, despite taking on additional debt. Preliminary estimates suggest that the current account achieved a record surplus of US$ 6.6 billion in the first half of 2022, compared with a deficit of US$ 2.8 billion a year ago, driven by external demand for energy products. Official foreign-exchange reserves and assets held by the National Bank of Kazakhstan (NBK) and the National Oil Fund amount to US$ 83.8 billion (approximately 44 per cent of GDP) well above the country's total external public debt (18.4 per cent of GDP).

Inflation has been gaining momentum since late 2021. The war on Ukraine and sanctions on Russia led to a sharp depreciation in the Kazakh tenge (KZT) in late February-March 2022. To prevent excessive exchange-rate volatility, the NBK intervened in the foreign-exchange market and introduced a deposit protection programme, offering a premium interest rate on local currency-denominated deposits held in banks for at least one year. The NBK has also increased the policy rate in steps, from 9.75 per cent in December 2021 to 16.0 per cent in October 2022. However, strong growth of nominal wages (25.6 per cent year on year in September), coupled with a surge in transport, food and commodity prices, added to inflationary pressures, with CPI increasing by 18.8 per cent year on year in October compared with 8.4 per cent in December 2021.

The policy response to global and regional shocks has been varied. In addition to tightening monetary policy, the NBK has scaled back its involvement in financing post-Covid-19 stimulus programmes by exiting five out of seven state support programmes. Meanwhile, the government has introduced a new plan to ensure food security for 2022-24. As a temporary measure, the authorities have banned or restricted exports of certain key products, such as sugar and wheat. The country remains vulnerable to transport and logistics disruptions, as highlighted by "technical" incidents at the Caspian Pipeline Consortium's terminal in Novorossiysk, which accounts for about two-thirds of Kazakhstan's oil exports. While increasing oil shipments through available alternatives, Kazakhstan has joined regional efforts to add capacity on other trade routes, such as the Trans-Caspian Corridor.

Economic growth is likely to slow in the short term. Overall, we expect the economy to expand by 3.0 per cent in 2022 and 3.5 per cent in 2023. Significant downside risks remain, including any potential interruption to oil transit through Novorossiysk and continued challenges related to trade logistics worsening due to a further escalation of the geopolitical conflict over Ukraine.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

Political and economic governance is improving. Following the events of January 2022, the authorities emphasised the need to eliminate all artificial monopolies and underscored the urgency of transitioning from a "super-presidential" form of government to a presidential republic with a strong parliament. A nationwide referendum in June 2022 approved constitutional amendments designed to enhance political competition, reduce the president's powers, strengthen the lower house of parliament and improve human rights. Meanwhile, the government unveiled a comprehensive economic reform package prepared by the Agency for Reforms and Strategic Planning. The package addresses gaps in the rule of law and protection of property rights, the competitive environment, industrial policies and social support mechanisms, human capital and public administration.

A new programme to promote investment is in place. The New Investment Policy Concept of the Republic of Kazakhstan to 2026, approved by the government in June 2022, aims to boost fixed capital investment from 16.3 per cent of GDP in 2021 to 25.1 per cent of GDP by 2026 and to increase the inflow of foreign direct investment (FDI) to US$ 25.5 billion over the same period. The concept emphasises the need to enhance labour productivity, increase export volumes and complexity, develop higher-value-added activities and facilitate technological transfers and the gradual localisation of advanced production processes. In addition, it focuses on investment in transport infrastructure to help integrate regional and global value chains and to develop the skills needed to deliver strategically important investment projects.

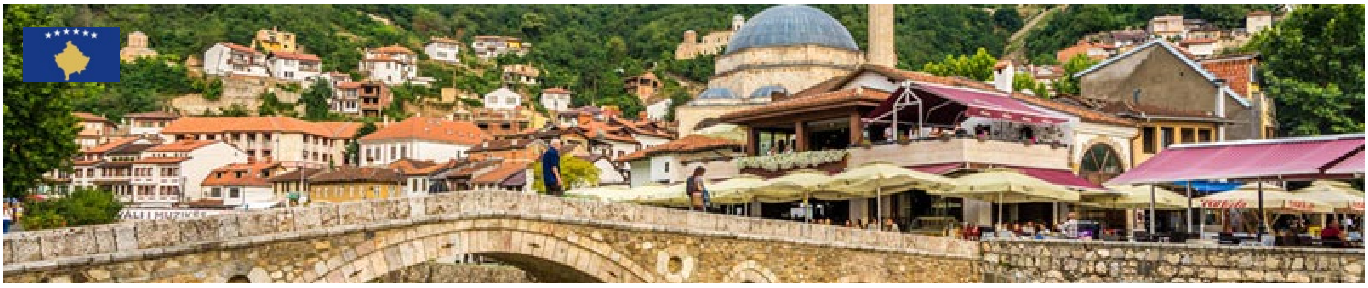
SME development is being promoted. In April 2022, the government adopted the Concept for the Development of Small and Medium-sized Enterprises of the Republic of Kazakhstan to 2030. Under this concept, the contribution of SMEs should increase from 33.5 per cent of GDP to 40 per cent by the end of the decade, with medium-sized companies contributing 20 per cent of GDP. To this end, the government has committed to reducing red tape and regulatory barriers for SMEs, enhancing the effectiveness of budgetary spending and existing SME support mechanisms, and developing high-quality infrastructure and automated reporting processes.

New counter-cyclical budgetary rules are being introduced. The new rules, to be implemented in the 2023-25 budgets, are designed to strengthen the country's fiscal stance. Two additional rules concern: (i) a cap on government spending growth; and (ii) setting transfers from the National Fund in relation to a cut-off price for oil.

Kazakhstan is advancing the digitalisation agenda. In June 2022, the NBK launched the Instant Payment System (IPS) platform. The IPS enables 24/7 interbank transfers using a mobile phone number or QR code. The authorities are exploring the opportunity to introduce digital currency (digital tenge), which would enhance financial inclusion by increasing the availability and affordability of financial services. On 1 July 2022 the National Bank and Centre for Development of Payment and Financial Technologies of the National Bank of Kazakhstan published a study discussing a decision-making model for the introduction of digital tenge. The project is currently being piloted. A final decision on the introduction of the digital currency is expected to be made by the end of 2022.

A long-term decarbonisation strategy is being developed. In 2020, Kazakhstan announced its commitment to reaching carbon neutrality by 2060. As part of its decarbonisation strategy, utility tariffs will be gradually brought closer to cost recovery, while the state will provide vulnerable families with targeted assistance. This will help the country remain on track to meet its objectives on the climate front by incentivising private investment in renewables and energy-efficient technologies.

The banking system is adjusting to geopolitical developments. To ensure compliance with international sanctions on Russia, local banks are working to strengthen their "know your client" practices when dealing with international customers. The Kazakh subsidiaries of sanctioned Russian banks Alfa Bank and Sberbank were recently purchased by BCC and Baiterek, respectively, while VTB is still negotiating with potential investors.



Kosovo

Highlights

- **Economic activity is slowing.** Strong demand-side pressures, underpinned by renewed mobility and the large diaspora, resulted in vigorous expansion in 2021. As the scope for recovery narrowed and demand became more muted, growth slowed to 3.2 per cent year on year in the first half of 2022.
- **Regulatory initiatives to improve the business environment have advanced.** Laws on inspection, the protection of competition and the establishment of a commercial court have been approved by the national assembly.
- **Reform is under way to improve the management of state assets.** The government has approved a concept paper on establishing a sovereign fund that will take over the management of strategic state assets from the Privatisation Agency of Kosovo.

Key priorities for 2023

- **Greening the energy sector is a critical component in ensuring energy security.** The National Energy Strategy should be finalised, featuring plans to decommission lignite-powered plants, an auctions system for renewables that would capitalise on the interest of private investors and plans to undertake necessary infrastructure investment.
- **Public-sector reforms need to continue without delay.** State-owned enterprises (SOEs) suffer from corporate governance and efficiency weaknesses, requiring greater oversight and management. Given the significant infrastructure gaps, scaling up public investment would help strengthen regional and domestic labour-market integration, lifting the country's growth prospects.
- **Enhancement of the business climate should continue.** Recent legislative changes should be followed up by developing stronger institutional capacity among implementing entities, enabling sound operational frameworks and ensuring transparency and effectiveness. Other needed reforms include improving public-private dialogue and taking more resolute measures to reduce widespread informality and tax evasion.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	3.4	4.8	-5.3	10.7	4.0
Inflation (average)	1.1	2.7	0.2	3.3	12.0
Government balance/GDP	-2.9	-2.9	-7.9	-1.4	-1.0
Current account balance/GDP	-7.6	-5.7	-7.0	-8.7	-10.9
Net FDI/GDP [neg. sign = inflows]	-3.4	-2.7	-4.2	-4.0	-4.4
External debt/GDP	30.5	31.2	37.2	37.4	n.a.
Gross reserves/GDP	11.5	12.2	13.3	13.8	n.a.
Credit to private sector/GDP	44.5	46.7	51.6	52.8	n.a.

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Macroeconomic developments and policy response

The rapid post-pandemic recovery is slowing. Output expanded by a stronger-than-expected 10.7 per cent in 2021 on the back of renewed mobility and support from the diaspora, reflected in a doubling of service exports compared with pre-pandemic levels and a high inflow of remittances. As the scope for recovery narrowed, growth moderated to 4.5 per cent and 2.1 per cent year on year in the first two quarters of 2022 respectively. In spite of continually strong annual credit growth, household consumption, which was previously driving the output expansion, became more muted in real terms in the second quarter and investment contracted by 17.0 per cent. In contrast to the domestic demand slowdown, external demand remained strong and net exports' contribution to growth turned positive in the second quarter of the year, helped by lower energy imports as the heating season ended. The broad-based output expansion, spanning nearly all economic segments in the first quarter, continued into the second quarter of the year but was partially offset by an 18 per cent annual contraction of the construction sector, in line with lower investment.

Inflation is rising and the current account deficit is widening. Higher food and oil prices pushed annual inflation to a high of 14.2 per cent in July 2022 before coming down to 12.7 per cent in September. Food accounts for as much as 34 per cent of the consumer price index in Kosovo, compared with 15 per cent in the European Union (EU). Electricity prices did not significantly contribute to inflationary pressures despite a state of emergency in the energy sector during the winter of 2021-22, as the public sector largely absorbed the impact of heightened electricity imports amid surging global prices. Higher energy prices (and volumes in the case of electricity during the winter) have, however, been reflected on the current account deficit which widened by a third on an annual basis in the first seven months of 2022.

Policy measures were implemented in response to the energy crisis and rising inflation. A 60-day energy emergency was first announced at the end of 2021 and reinstated in August 2022, as domestic power generation failed to meet demand and the price of imported power multiplied. The national energy distribution company, KEDS, introduced systemic temporary electricity outages both times. Kosovo's energy regulator approved a temporary discriminatory pricing model, increasing electricity tariffs from February 2022 for households consuming more than 800 kilowatts of electricity a month. In response to elevated inflation and food security concerns caused by the war on Ukraine, an export ban on agricultural products such as wheat, flour, corn and sunflower oil was introduced in April 2022. In the following months, the government scaled up agricultural subsidies, including for oil, introduced public-sector wage bonuses, approved temporary increases in social transfers and pensions and capped fuel prices. As inflationary pressures continued, another €150 million support package was introduced in September, continuing the trend of one-off aid for vulnerable citizens and public-sector wage bonuses, alongside subsidies of private-sector wage increases and electricity bills for those reducing consumption.

Growth is expected to continue at a slower pace. We forecast gross domestic product (GDP) growth of 4.0 per cent in 2022 and 3.7 per cent in 2023. The instability of the energy sector is likely to further impact the fiscal and external accounts and may adversely affect economic activity. Other key risks to the near-term outlook include elevated inflation, which is set to further dampen domestic demand, rising geopolitical uncertainty and an anticipated slowdown in external markets, affecting exports.

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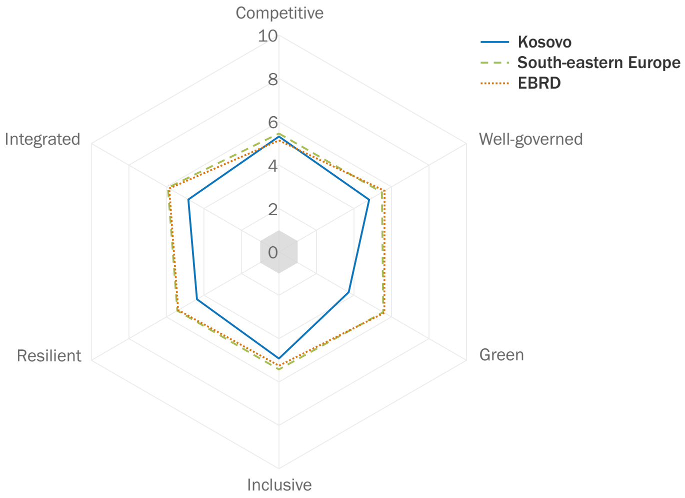
CHART Assessment of transition qualities (1-10)



Structural reform developments

There has been little progress on the EU approximation process. Kosovo signed its Stabilisation and Association Agreement (SAA) with the EU in October 2015. While the European Commission and the European Council have repeatedly stressed that the country shares the European perspective of the Western Balkans, the question of its practical integration into the EU remains contentious due to the fact that five member states do not recognise Kosovo bilaterally. Although the European Commission confirmed that Kosovo had met all visa liberalisation benchmarks, the decision on visa liberalisation is still pending in the European Parliament and European Council, and citizens of Kosovo remain unable to travel without a visa to the Schengen area.

Renewables development progressed. The Bajgora wind farm, which supplies up to 10 per cent of the country's electricity, started supplying electricity to the power grid in September 2021 and was fully operational as of March 2022. Kosovo's first biomass-fuelled heating plant opened in Gjakova in November 2021, aiming to reduce air pollution and costs incurred by the heavy oil-powered district heating system. In March 2022 the government approved the large-scale Solar Kosova project, which should span some 69,000 square kilometres and contribute to the heating system of the capital, Pristina. The National Energy Strategy, currently being finalised following public consultation in June 2022, is expected to set the pace of energy transition in the coming years.

The Commercial Court was established. In January 2022 the national assembly approved the Law on the Commercial Court, which establishes a special court for handling business disputes. Work is under way to develop an action plan to get the court up and running, including regulations on internal organisation, case transfer and the recruitment of key personnel. The Commercial Court, expected to open by the end of 2022, will take over the responsibilities of the Economic Department of the Pristina Basic Court and the Court of Appeals in handling commercial cases and those of the Administrative Department of the Pristina Basic Court in handling commerce-related administrative cases.

Inspections reform advanced. The Law on Inspections, approved by the national assembly in December 2021, is part of ongoing reforms to revise all laws and bylaws governing inspections. It is a novelty in Kosovan legislation as, to date, there has been no unified legislation governing inspections of businesses. Its approval met one of the conditions of the latest round of Development Policy Financing (DPF) from the World Bank, signed in March 2022. Amounting to €50.6 million, the DPF will support Kosovo's reform efforts to improve fiscal transparency, enhance private-sector development and strengthen environmental sustainability.

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The national assembly approved the new Law on the Protection of Competition in May 2022. The regulation represents a milestone in the alignment of the country's legislative framework with the EU *acquis communautaire*. The approval of this legislation aims to fulfil key commitments by Kosovo under three treaties: the EU-Kosovo SAA, the Energy Community Treaty, and the Central and Eastern European Free Trade Agreement (CEFTA). However, an assessment by the US State Department notes that Kosovo's Competition Authority, responsible for implementing the law, generally lacks the human resources for thorough investigations.

A sovereign fund to manage state assets is in development. In May 2021 the government dismissed the previous board of the Privatization Agency of Kosovo (PAK) as a first step in the process of closing the agency and establishing a sovereign fund to manage strategic state assets. The new PAK board identified the assets that it plans to transfer to the sovereign fund and, in June 2022, the government approved the concept paper on establishing the fund.

Kyrgyz Republic

Highlights

- **The economy is growing strongly in 2022.** Real gross domestic product (GDP) expanded 7.2 per cent year on year from January to September 2022 amid strong growth in industrial production, hospitality, trucking, retail and wholesale trade. However, a 6.5 per cent year-on-year drop in net remittances in January-August 2022 and strong inflationary pressures are clouding the outlook.
- **New tax and customs regulations have been introduced.** The new tax code mandates the use of cash registers, resulting in significantly higher tax revenues. By reducing illicit trade, these reforms may also help level the playing field for companies operating in the formal economy.
- **The investment environment is improving.** Strengthening the powers of the business ombudsman gives Kyrgyz companies an effective channel for addressing grievances. By resolving a long-running dispute with Canada's Centerra Gold Inc over the Kumtor gold mine, the government has cleared a major roadblock to gold exports and further foreign direct investment (FDI) in mining activities.

Key priorities for 2023

- **The need to ensure food and energy security is both urgent and challenging.** With food expenditure accounting for more than 50 per cent of total household spending, rising food and energy prices are putting additional pressure on vulnerable population groups. Because it has limited fiscal space, the government should opt for well-targeted and effective mechanisms to support those in need.
- **The authorities should step up efforts to ensure macroeconomic stability.** The recent increase in government revenues should be used to strengthen fiscal buffers rather than finance additional current expenditures, which may potentially add to inflationary pressures resulting from the country's reliance on imported commodities.
- **Efforts to improve the investment climate must continue.** The government should adopt measures to enhance access to electricity and other essential infrastructure, liberalise the labour market (ease restrictions on the hiring of foreigners) and streamline the licensing, permits and inspection systems. Investment in agriculture could be facilitated by establishing "free agricultural zones" to overcome legal restrictions on the foreign ownership of land.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	3.5	4.6	-8.6	3.7	7.0
Inflation (average)	1.5	1.1	6.3	11.9	13.5
Government balance/GDP	-0.6	-0.1	-3.3	-0.4	-3.3
Current account balance/GDP	-12.1	-11.9	4.8	-8.7	-12.5
Net FDI/GDP [neg. sign = inflows]	-1.7	-4.6	5.2	-6.8	-3.6
External debt/GDP	101.7	104.4	117.4	106.1	n.a.
Gross reserves/GDP	26.1	27.4	36.1	34.9	n.a.
Credit to private sector/GDP	23.4	24.6	28.3	26.0	n.a.

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Macroeconomic developments and policy response

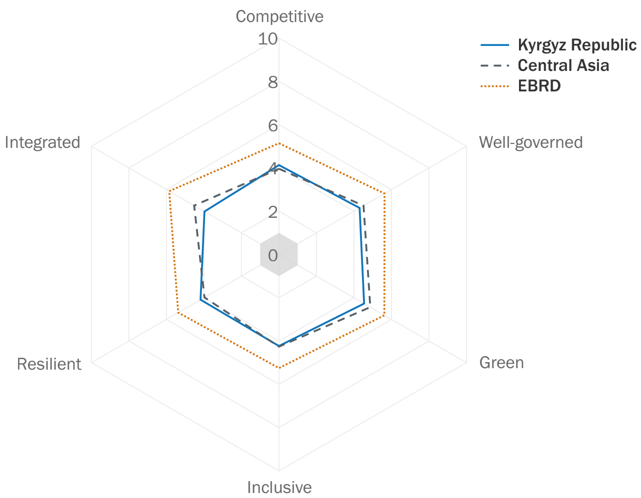
The economy has bounced back robustly in 2022. The economy expanded 7.2 per cent year on year in the first nine months of 2022 despite a major drop in exports. Wage increases for public-sector employees and strong demand for qualified labour, coupled with the government's efforts to reduce informality led to more than a 25 per cent increase in nominal wages – well above inflation (which was 15.5 per cent in September). Strong domestic demand resulted in gains in industrial production (up 16.6 per cent year on year), hospitality (up 19.4 per cent year on year), retail and wholesale trade (up 7.2 per cent year on year) and trucking (up 35.5 per cent year on year). Imports saw a gain of 77.2 per cent year on year in January-August 2022 on the back of higher global prices for food and energy products, as well as lower corruption in customs administration at the country's borders. In the first seven months of 2022, the Kyrgyz Republic imported 4.8 times more knitted fibre and 2.3 times more synthetic fibre than a year ago, suggesting a potential boost in re-exporting activity and textile production. However, stagnant fixed capital investment (up just 0.5 per cent year on year in January-September 2022) may hold back further growth.

Inflationary pressures persist, prompting some short-term measures. Fuelled by rising global prices and supply-chain disruptions, annual inflation reached 15.5 per cent in September 2022, far exceeding the National Bank's target range of 5-7 per cent and putting pressure on vulnerable households. The Kyrgyz som suffered the largest depreciation of the Central Asian currencies following the Russian rouble's collapse in early March 2022, but has since recovered to its pre-war value, in line with its regional peers. To soften the impact, in April 2022 the authorities prolonged until the end of 2022 the zero per cent value added tax (VAT) rate on imported grain for those involved in flour processing. What is more, to prevent a sugar deficit, in March 2022 the government reached agreement with the Eurasian Economic Commission on the delivery of 105,000 tonnes of duty-free sugar and raw materials. Concurrently, the authorities introduced a six-month ban on sugar exports, effective June 2022.

The fiscal stance is improving. In January-August 2022 growth in government spending (up 45.7 per cent year on year) was offset by a substantial (1.5-fold) increase in tax revenues (mostly VAT), resulting in a budget surplus of 1.2 per cent of GDP. However, since the beginning of 2022 gross international reserves have shrunk 18.8 per cent from US$ 2,978 million in December 2021 to US$ 2,416 million in August 2022. On the positive side, the government recently created the Holding of Nomads wealth fund to facilitate the accumulation of revenues from the Kumtor gold mine.

The economy should continue to grow strongly in the short term. We forecast an expansion in GDP of 7.0 per cent in both 2022 and 2023. The economy stands to gain from increased re-export opportunities, the relocation of Russian companies and individuals, including information technology (IT) developers and entrepreneurs. Nevertheless, downside risks remain, mostly related to rising inflation, high reliance on remittances from Russia and other regional and global shocks.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

A new national development programme for 2021-26 was approved in October 2021. The programme seeks to achieve a sustainable 5 per cent annual GDP growth rate, GDP per capita of at least US$ 1,500, a decrease in the unemployment rate to 5 per cent and a reduction in the poverty rate to 20 per cent. A corresponding roadmap was developed in January 2022 to boost economic activity, support entrepreneurship, implement fiscal reforms and promote initiatives in the areas of energy, mining, manufacturing, transport and the green economy.

A new public debt management strategy for 2022-24 has been introduced. The strategy, approved in July 2022, is designed to improve the country's debt sustainability. Under the strategy, new loans should have at least a 35 per cent concessional element, debt servicing should be timely and no more than 45 per cent of total debt should be attributed to a single creditor.

The authorities have introduced a new tax code. The new code, effective from 2022, mandates the use of cash registers at all points of sale. This reform is likely to help the authorities clamp down on illicit trade and shadow economic activities, thus contributing to public revenues, levelling the playing field for companies operating in the formal economy and creating incentives for investment in manufacturing.

The Kyrgyz authorities have resolved a long-running dispute with a major foreign investor. In April 2022 the authorities reached agreement with Canada's Centerra Gold Inc over Kumtor, the country's largest gold mine. The dispute arose when the government introduced external management to the mine, claiming violation of the country's environmental and mining standards. According to the agreement, Kumtor will be fully transferred to the Kyrgyz Republic. In another positive development, on 3 May 2022, the London Bullion Market Association restored Kyrgyzaltyn, the country's exclusive exporter of gold, to its Good Delivery list of accredited refiners, clearing a major roadblock to future gold exports and FDI.

A major railway construction project is about to be launched. A trilateral agreement signed at the Shanghai Cooperation Organization in Samarkand in September 2022 paves the way for the construction of the US$ 4-5 billion China-Kyrgyz Republic-Uzbekistan railway project. On ice for more than 20 years, this project will enhance regional connectivity by creating strong competition on the east-west railway routes across Eurasia.

A new programme has been launched to develop public-private partnerships (PPPs) from 2022 to 2026. Approved in June 2022, the programme aims to streamline the regulatory and legal framework and introduce financial tools to increase the attractiveness of PPP projects. It mandates the creation of a rigorous PPP methodology and a strengthening of the government's institutional capacity in related areas.

Further measures to diversify the economy are advancing. In an effort to diversify the economy, the Concept for the Development of Creative Economy for 2022-26 was approved in April 2022. In August 2022, the president signed a law on the Park of Creative Industries, seeking to stimulate innovation, increase the investment attractiveness of creative activities and reduce the national economy's dependence on the mining sector and migrant remittances.

In August 2022 the Kyrgyz Republic piloted its Digital Nomad initiative, seeking to create favourable conditions for developers and IT specialists from abroad. The project envisages granting "digital nomad" status to qualified foreigners, which will significantly reduce red tape and ease the relocation process by allowing for visa- and work permit-free entry to and employment in the country.

Latvia

Highlights

- **Gross domestic product (GDP) growth is falling and inflation is surging.** Despite better-than-expected growth in the first quarter of 2022, increased vulnerabilities driven by the repercussions of Russia's war on Ukraine are weighing on Latvia's economic activity and employment, and will keep inflation high for some time.
- **The government deployed comprehensive support measures to compensate households and businesses for increased energy prices.** With Covid-related aid being phased out, new measures included housing benefits, partial cover for heating bills and targeted support for companies.
- **Latvia has issued its first sustainability bond.** The first among Nordic and Baltic countries, Latvia established a sustainability bond framework and raised €600 million in support of its long-term agenda to promote climate mitigation measures as well as environmental and social policies.

Key priorities for 2023

- **Support measures to ease the effect of higher energy prices should remain well targeted and flexible.** This would ensure that the most vulnerable groups are receiving the most support, and households and businesses have the right incentives to support the transition to low-carbon energy sources.
- **The authorities should focus on designing and putting in place comprehensive inclusion measures.** The country's National Recovery and Resilience Plan (NRRP) contains measures designed to reduce labour shortages, skills mismatches and income inequality, and bridge the digital divide.
- **More capacity is needed to ensure that Recovery and Resilience Facility (RRF) targets are met.** The intention is to unlock almost one-third of the RRF grants in 2023. These funds will be key in accelerating the green transition, including through large investments in energy efficiency, sustainable mobility and climate change adaptation.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	4.0	2.6	-2.2	4.1	2.5
Inflation (average)	2.6	2.7	0.1	2.4	17.0
Government balance/GDP	-0.8	-0.6	-4.3	-7.0	-6.0
Current account balance/GDP	-0.3	-0.6	2.6	-4.2	-3.3
Net FDI/GDP [neg. sign = inflows]	-2.2	-2.8	-2.1	-2.5	-1.7
External debt/GDP	123.7	116.8	124.8	112.1	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	38.0	36.6	34.7	32.0	n.a.

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Macroeconomic developments and policy response

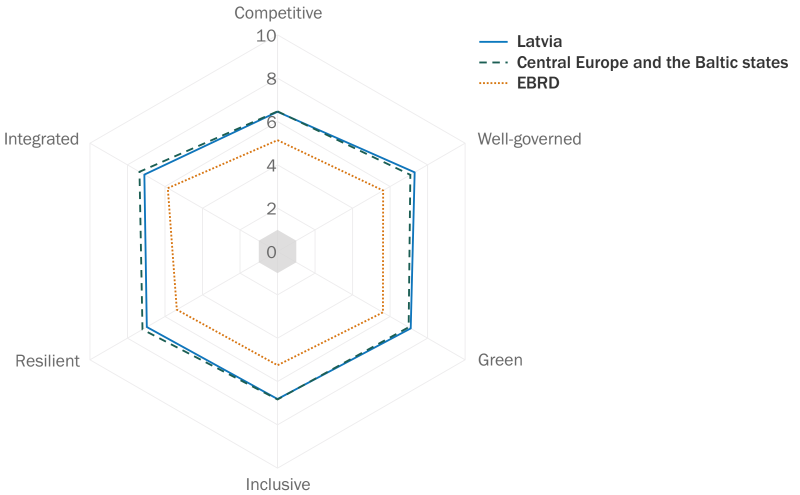
Growth has slowed in 2022. The economy performed relatively well in the first quarter of 2022, sustained by the easing of Covid-19 restrictions, private consumption and exports, but GDP growth slowed to 4.7 per cent year on year in the first half of 2022. Russia's war on Ukraine and trade disruptions, coupled with the energy crisis and surging inflation, adversely affected economic activity and households' disposable income. However, the unemployment rate stood at 6.6 per cent in September 2022, up from 6.4 per cent in June but below pre-pandemic levels. Increased employment and persistent labour shortages contributed to further wage growth, but these are expected to ease towards the end of 2022.

Prices are rising sharply. The harmonised index of consumer prices (HIPC) inflation rate hit 22.0 per cent year on year in September 2022, the highest rate since the 1990s. Housing and utility-sector prices saw the strongest growth (51.6 per cent year on year), followed by the food sector, with a significant increase of 27.5 per cent year on year. In response, the government introduced several support mechanisms to help mitigate the effects on households and businesses. In January 2022 parliament approved a €250 million support package to compensate firms and households for energy price increases. Children and young adults up to the age of 24 and pensioners received monthly allowances of €50 and €20, respectively, until April 2022. Longer-term measures to the end of the year include €7 million in compensation to help households withstand hikes in heating and gas prices. In addition, parliament allocated €64 million and €21 million, respectively, to indemnify 100 per cent of the power distribution fee and the mandatory procurement component of electricity bills. In August 2022 parliament approved amendments to the law on support measures for reducing the effects of increased energy prices, setting aside an additional €422.25 million to partially cover increases in heating bills and to expand the range of housing benefit recipients.

The general government budget tightened. The fiscal deficit, which stood at 7.0 per cent of GDP in 2021, is expected to decrease to 6.0 per cent in 2022, with a smaller gap in the first six months of the year compared with the same period 12 months prior. Government support for the Covid-19 crisis has been phased out slowly, but aid for Ukrainian refugees and compensation for the rise in energy prices has been substantial; the latter required a sizeable budgetary spending increase, with total planned support worth 6.0 per cent of GDP. Furthermore, spending on defence is set to rise from 2.2 per cent of GDP to 2.5 per cent over the next three years.

The economic outlook is complicated by the consequences of Russia's war on Ukraine. Subdued economic activity in the European Union, accompanied by supply-chain disruptions and rampant inflation, are likely to negatively affect Latvia's exports and consumption, but this will be partially offset by sustained demand for some of Latvia's main export products, including wood and food products. Our latest forecasts see GDP growth decrease to 2.5 per cent and 0.8 per cent in 2022 and 2023, respectively. Additional funds under the RRF will become available in 2023 (see below) and should support economic growth medium term.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

The government is supporting businesses through financial aid and structural assistance. The government approved an additional €100 million financial aid package in May 2022 to help companies and entrepreneurs navigate the repercussions of the war on Ukraine. Subject to parliamentary approval, unused funds from the Covid-19 crisis will be used to provide working capital and liquidity to those businesses affected by the war, related sanctions on Russia and countersanctions. Part of the package will also be spent on facilitating access to finance, as well as providing more structural assistance to companies, including support in adapting their business models, improving their export capacity and expanding to new markets. Further anti-inflationary measures, agreed by the government in August 2022, will include targeted assistance for energy-intensive businesses (companies with spending on energy resources higher than 10 per cent of total expenses) in the form of grants.

Efforts to strengthen energy resilience are being stepped up. The government's decision to ban Russian gas imports by 2023 has prompted the reorientation of gas supply. Latvia will be able to consume gas supplied by the Klaipeda terminal in Lithuania, as well as the Paldiski terminal in Estonia, which is currently under construction and should become operational in November 2022. To limit gas consumption, the government will introduce a plan for the public administration, setting common targets for energy saving in the upcoming winter season.

The authorities are targeting digital, inclusion and rule-of-law reforms in the early implementation stages of the RRF. In June 2022, following the completion of nine reform targets, Latvia requested that the European Commission disburse the first tranche of the country's €1.8 billion RRF allocation. The Commission provided a positive preliminary assessment of the milestones, which were achieved in the key areas of digital transition, inclusion and rule of law. Inclusion measures comprise the development of a minimum income support strategic framework, as well as amendments to existing rental legislation to improve affordable housing in the country. In the area of digital transformation, the country adopted two important frameworks on the organisation of remote learning in educational institutions and the development of last-mile broadband connection infrastructure, helping to narrow the digital divide. Improvements in public procurement were achieved, with the establishment of a regulatory framework to reduce corruption risks and improve the competition environment. Lastly, an amendment to the existing law on money-laundering prevention helped to shore up anti-money laundering/countering the financing of terrorism legislation.

Green transition is being targeted in the next round of the RRF. Latvia will need to achieve an additional 49 targets by the second quarter of 2023 to unlock the next payment under the RFF, which amounts to €503 million. Work has already started in the field of green transition, including financing for energy-efficiency projects in public and private buildings and the greening of the Riga Metropolitan Transport System.

Latvia has issued its first sustainability bond. The bond, issued in December 2021 with an eight-year maturity, raised €600 million. The first among the Baltic and Nordic countries to issue a sovereign sustainability bond, Latvia established a sustainability bond framework in order to attract investments to support the country's green agenda, in line with its financial development plan 2022-23. The issuance attracted strong interest from more than 120 investors, with an order book exceeding €2.5 billion.

Lebanon

Highlights

- **Lebanon is sinking further into financial and economic crisis.** The currency's depreciation has continued, with multiple exchange rates still in place, while inflation is soaring, pushing more vulnerable population groups into poverty.
- **The pressure on the government's finances continues to rise.** The government is still unable to access international financial markets. Improved remittances and tourism revenues are offering some relief, but rising food and energy prices have added more pressure on depleted foreign-currency reserves.
- **Lebanon was unable to pass the reforms outlined in the April 2022 staff-level agreement with the International Monetary Fund (IMF).** This has delayed a final agreement with the Fund that would unlock access to much-needed financing, including from other sources.

Key priorities for 2023

- **Meeting the requirements of an IMF-supported stabilisation and structural reform programme is the most immediate priority.** An agreement with the IMF would help rebuild credibility on reform commitment and provide access to necessary external financing.
- **A comprehensive social safety net is needed so that households can better access energy and food.** Wider coverage and a more transparent ration-card system are essential to the success of targeted subsidies to combat deepening poverty levels, but significant donor support will be vital.
- **Progress on energy reforms is necessary to unlock the financing needed to develop the sector's capacity.** A stronger commitment to greener energy production and improved efficiency would greatly help to address severe shortages and limit import dependence.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	-1.9	-6.9	-25.9	-10.0	-2.0
Inflation (average)	6.1	2.9	84.9	150.0	186.0
Government balance/GDP	-11.3	-10.4	-3.5	0.7	0.5
Current account balance/GDP	-28.6	-28.2	-15.8	-12.5	-14.2
Net FDI/GDP [neg. sign = inflows]	-3.7	-3.4	-5.3	-2.1	-2.3
External debt/GDP	193.6	200.6	349.1	n.a.	n.a.
Gross reserves/GDP	57.3	48.2	72.1	n.a.	n.a.
Credit to private sector/GDP	100.4	88.3	54.3	n.a.	n.a.

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Macroeconomic developments and policy response

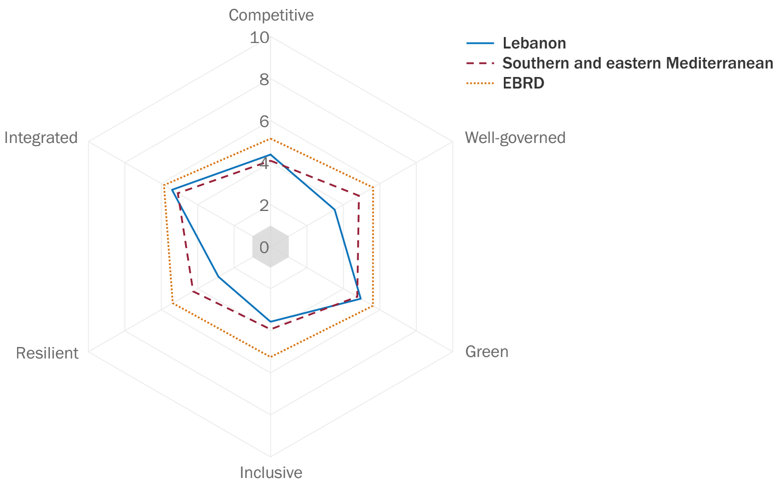
Lebanon has sunk into an even deeper economic crisis. The economy contracted by an estimated 10.5 per cent in 2021, on top of a decline of 25 per cent in 2020. Political inaction throughout the year undermined the country's ability to attract necessary external financing to shore up dwindling reserves. As a result, the Lebanese pound depreciated by an additional 70 per cent in 2021 on the black market (95 per cent since March 2020), fuelling even higher triple-digit inflation, which reached 168 per cent in July 2022. Political inaction has prolonged the economic crisis and exacerbated unemployment and poverty during 2022. As a result, the economy is expected to have contracted further in the first half of the year. According to the International Labour Organization (ILO), the unemployment rate was 29.6 per cent as of January 2022, and more than 80 per cent of the population was estimated to be living in poverty as of the end of 2021 (official data are not available, but a 2019 analysis of multidimensional poverty suggested that 53 per cent of residents suffered from multidimensional poverty).

Spiralling depreciation and parallel exchange rates persist. The official pegged exchange rate of 1,507.5 Lebanese pounds per US dollar for pricing customs, dubbed the "customs dollar", was recently increased to 15,000. The Banque du Liban's (BDL's) Sayrafa platform rate stood at 29,800 pounds to the US dollar at the end of September 2022, while the black market rate surpassed 38,000 pounds per dollar.

Access to wheat and energy imports remains uncertain. In the past year, Lebanese households have faced repeated price hikes and shortages of medicines, bread, fuel and electricity. However, the government is committed to maintaining the price of basic subsidised bread until spring 2023, thanks to a US$ 150 million World Bank loan approved in July 2022. Fuel prices have continued to change based on availability, exchange-rate fluctuations and global prices, while access to electricity in most areas is limited to two hours per day, increasing households' dependence on private generators. A gas import agreement was signed by Egypt, Syria and Lebanon in July 2022 (but is yet to be implemented) and the fuel supply deal with Iraq was extended for another year, but more progress is needed to improve energy access. An agreement signed with Jordan in January 2022 to import electricity is also awaiting implementation. Meanwhile, fiscal space remains extremely limited and public debt had soared to an estimated 360 per cent of GDP (end 2021) as the Lebanese pound has depreciated.

The short-term outlook remains bleak. We expect a further GDP contraction of at least 2.0 per cent in 2022 as the ongoing crisis is exacerbated by a costlier and intermittent supply of energy and food, as well as delays in implementing critical reforms and the drying up of financial resources. There could be some improvement in 2023, when we forecast growth of 4.0 per cent, but this is conditional on an IMF-supported programme being successfully implemented by a reform-minded government, which would allow negotiations on further aid to resume with international partners.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

Progress on an IMF programme has stalled. Staff-level agreement on a 46-month US$ 3 billion Extended Fund Arrangement was reached in April 2022, but further progress has been delayed by the failure so far to form a new government following general elections in May 2022. The 2022 budget law received parliamentary approval, but controversy continues on the appropriate exchange rate for operational revenues and expenses. A watered-down version of amendments to the bank secrecy law received the parliamentary stamp of approval in July 2022, but was rejected by the president after comments from the IMF. The law was returned to parliament for further amendments, while the draft capital controls law also remains stuck in parliament.

Lebanon's stakeholders have yet to reach consensus on the proposed economic recovery plan. The current plan, passed by the caretaker cabinet in May 2022, rests on sweeping banking-sector restructuring, including BDL. The plan estimates banking-sector losses at roughly US$ 72 billion, much of which might have to be borne by depositors. The Association of Banks in Lebanon (ABL) has repeatedly expressed strong opposition to the plan, citing severe risks to public confidence in the banking system and calling on the government to shoulder more of the losses. The ABL is also critical of plans to write off a large proportion of BDL foreign-currency obligations to commercial banks.

The central bank's forensic audit has been stalled. The audit was agreed with management consultants Alvarez & Marsal in September 2020, but faces several obstacles, mainly BDL management's refusal to share necessary documentation, citing bank secrecy laws. Parliament voted to lift bank secrecy for public officials in December 2020, but the audit has still faced multiple delays due to lack of cooperation and transparency from BDL management.

Public procurement reform is advancing steadily, but faces severe capacity constraints. Approved in 2021, the public procurement law came into effect in July 2022. An implementation action plan was also approved in June, but progress depends heavily on sweeping governance reforms and building capacity at ministries and public enterprises.

The cabinet passed a plan to reform the electricity sector, but it faces strong pushback in parliament. Restructuring the country's electricity sector is the main condition of the World Bank providing financing for regional deals to increase Lebanon's power supply. The plan, approved by the cabinet in March 2022, involves creating an electricity regulatory authority, expected to be in place by the end of the year provided parliamentary opposition can be overcome. It also includes a revision of an earlier plan to increase electricity tariffs, which forecasts a US$ 3.5 billion investment in the sector to secure 24-hour power across the country by 2026.

The rollout of the ration cards programme has faced multiple delays. Approved in June 2021, the programme aims to support 500,000 households at an estimated cost of US$ 556 million a year. This would provide the most vulnerable households (those facing extreme poverty) with some relief, but the application process has raised criticism with regard to accessibility. In addition, targeting is likely to be complicated, amid weak transparency and political concerns, and is further undermined by the fact that 80 per cent of Lebanese households (versus 40 per cent in 2019) are estimated to face multidimensional poverty.

Lithuania

Highlights

- **Gross domestic product (GDP) growth has slowed sharply.** The slowdown is largely the result of weakening domestic demand, especially household consumption, which has been hit by falling real disposable incomes amid soaring inflation.
- **Lithuania is set to turn from an electricity importer into an electricity exporter by 2030.** In June 2022 the government announced a massive €1 billion investment plan for green energy development and energy efficiency by 2030, with €604 million to be invested over the next 18 months.
- **Gas transmission security has been strengthened.** The improved capacity of interconnectors allows for gas transmission between the liquefied natural gas (LNG) terminal in Klaipeda, Lithuania and Poland and Latvia, including to the Latvian underground gas storage facility.

Key priorities for 2023

- **The shift away from fossil fuels should accelerate.** Plans are now in place for an ambitious green energy and energy efficiency programme over the coming years, but implementation will be key, not least private-sector investment.
- **The digital skills of citizens need further development.** Lithuania has dedicated nearly a third of its Recovery and Resilience Facility (RRF) funds to the digital transition. Its key short-term priority is to develop and improve new and existing digital services for businesses and citizens, as well as to centralise public information technology (IT) resources.
- **Steps are needed to mitigate the risks of poverty and social exclusion for vulnerable groups.** The share of people at risk of poverty or social exclusion has fallen since 2016, but remains well above the European Union (EU) average. The situation is being exacerbated by currently elevated food and energy prices. Short term, the government should focus on the provision of means-tested support measures for the most vulnerable groups.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	4.0	4.6	0.0	6.0	2.0
Inflation (average)	2.5	2.2	1.1	3.0	19.0
Government balance/GDP	0.5	0.5	-7.0	-1.0	-2.0
Current account balance/GDP	0.3	3.5	7.3	1.1	-1.6
Net FDI/GDP [neg. sign = inflows]	-0.5	-2.3	-1.1	-2.2	-2.3
External debt/GDP	78.3	70.1	75.3	77.0	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	40.5	39.6	37.6	37.5	n.a.

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Macroeconomic developments and policy response

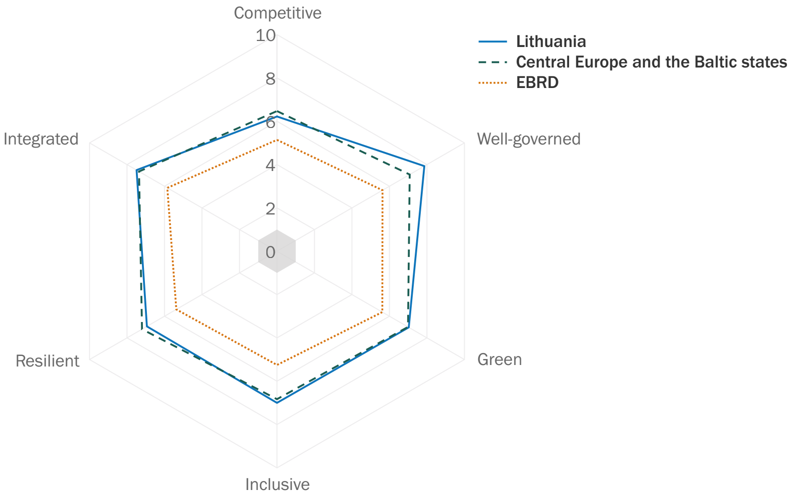
GDP growth has slowed sharply, but unemployment remains low. Following a strong rebound in economic activity in 2021, with GDP growth of 6.0 per cent, growth decelerated to 3.2 per cent in the first half of 2022. The slowdown was largely the result of weakening domestic demand, especially household consumption, which was hit by falling real disposable incomes amid soaring inflation. However, unemployment dropped to just 5.2 per cent in the second quarter of 2022, below pre-pandemic levels in the same quarter of 2019. To help Ukrainian refugees to start a business in Lithuania and to create new jobs, the government launched a cheaper loans programme for start-ups or working capital. These loans are available to Ukrainian-owned small and medium-sized enterprises established after 24 February 2022, when Russia invaded Ukraine.

Inflation is high and rising, prompting a government support package. In September 2022 the annual inflation rate jumped to 22.5 per cent year on year. The acceleration was largely triggered by rises in housing, food, energy and transport prices. To mitigate the effects of the price hikes on households, especially heating, in April 2022 the government approved a €2.26 billion package, which includes increases in non-taxable incomes, pensions and social benefits. Electricity and gas prices should not increase by more than 40 per cent in 2022 and the difference between end-user and market prices should be covered by the package.

The general government deficit has widened. After registering a general government deficit of just 1 per cent of GDP in 2021, the fiscal gap is expected to increase this year to 2 per cent, driven by government's measures to support households and businesses amid high inflation, assistance for Ukrainian refugees and greater spending on defence. However, general government gross debt remains moderate, falling from 43 per cent of GDP in 2021 to below 40 per cent of GDP in 2022, according to the finance ministry.

Reduced trade with Lithuania's non-EU neighbours will weigh on economic activity. Amid reduced exports to Belarus, Russia and Ukraine and weakening demand in the EU, GDP growth in Lithuania is expected to slow to 2.0 per cent in 2022 and 1.5 per cent in 2023. The inflation-driven reduction in households' real disposable income will continue to hamper consumption. Trade tensions with China could also negatively affect Lithuania's economic activity, but the bilateral trade volumes are rather small. Last year, Lithuania's exports to China constituted around one per cent of Lithuania's total exports. On the positive side, investments under the RRF will positively stimulate GDP growth.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

Further investments have been made to promote the green transition. In June 2022 the government announced a massive €1 billion investment plan for green energy development and energy efficiency by 2030, with €604 million to be invested over the next 18 months. The objective of the plan is to turn Lithuania from an electricity importer into an electricity exporter by 2030. Currently, imports account for 65 per cent of the country's electricity, while the rest is produced from wind and solar. By 2025 about 50 per cent of electricity consumed should be produced domestically. The government plans to allocate €118 million to households to partially compensate for the purchase of heat pumps, car charging stations and solar energy storage units. The estimated cost of Lithuania's green economic transition over the next decade is €14 billion, with €4 billion to be invested by the private sector. Furthermore, in August 2022 Orlen Lietuva, an oil refining and import company, embarked on €641 million of modernisation investments, which envisages the construction of a residue conversion unit. This project is expected to last until 2024 and to improve refining efficiency by 20 per cent.

Gas transmission security is being strengthened. Since November 2022 gas transmission capacity from Lithuania to the Latvian gas system has increased by one-third to 90 GWh per day, under the Enhancement of Lithuania-Latvia Interconnection (ELLI) project launched in 2017. The interconnectors also allow for gas transmission between Latvia and the LNG terminal in Klaipeda, Lithuania and from Poland to Latvia, including to the Latvian underground gas storage facility. Completion of the project, expected by the end of 2023, will lead to a doubling of the transmission of natural gas capacity between Lithuania and Latvia.

Electricity market liberalisation for the smallest consumers has been postponed. The first and second stages of liberalising retail electricity supply for households consuming more than 5,000 kWh and 1,000-5,000 kWh of electricity per year were completed at the end of 2020 and in July 2022, respectively. The government has postponed the final stage, for households consuming less than 1,000 kWh of electricity per year, until the end of 2025. Its intention is to reduce electricity costs for consumers through market liberalisation, but the current electricity price spike on the global markets, linked to Russia's invasion of Ukraine, has prompted the government to postpone this objective.

Energy resilience and efficiency are advancing. The project to synchronise the Baltic power grid with the continental European network received €170 million in EU funding in June 2022, to be used for network upgrades, frequency management and information system equipment worth a total of €227 million, adding to the already allocated more than €1 billion of EU funding in the previous years. The project was planned to be completed by 2025 but the synchronisation with the continental European network could be launched earlier if the Baltic States are disconnected from the electricity grid with Belarus and Russia (BRELL). Other sources of electricity include a power interconnection with Sweden (NordBalt) and a power interconnection between Finland and Estonia (Estlink) through Latvia to Lithuania. Meanwhile the government has earmarked more than €1 billion for investments in the renovation of buildings, the development of charging stations, the installation of solar panels, the replacement of fossil-fuel boilers with more advanced technology and the promotion of green energy solutions, including hydrogen and biofuel technologies.

Funds under the RRF are targeting the green and digital agendas. Two-thirds of investments envisaged under the RRF are expected to start this year. The first payment of RRF funds, €565 million out of the total €2.25 billion, is expected to be transferred to Lithuania in autumn 2022, following the €289 million of pre-financing paid out in September 2021. Key projects being funded under the RRF support climate objectives and the digital transition.

Trade with China has been disrupted, prompting the European Commission to support Lithuania. In April 2022 the European Commission approved a €130 million state aid scheme for companies affected by China's trade restrictions on Lithuania, which were imposed in reaction to the opening of a Taipei China representative office in Vilnius in late 2021. The scheme envisages loans of up to €5 million for affected companies, excluding the finance, agriculture and forestry, and fisheries and aquaculture sectors. Lithuania is preparing for an opening of a trade representative office in Taipei China, with a trade representative being nominated in September 2022. According to the European Commission, Lithuania is a victim of Chinese trade coercion, and has taken a trade discrimination case to the World Trade Organisation.

Moldova

Highlights

- **Rising gas prices and the war on Ukraine have disrupted the economy and fuelled inflation.** After a strong recovery in 2021, gross domestic product (GDP) stalled in the first half of 2022, while inflation reached 34.3 per cent in August 2022.
- **Financing from official creditors was pivotal in covering the twin deficits.** After significant losses of foreign reserves at the beginning of 2022, the augmentation of the International Monetary Fund (IMF) programme helped to mobilise additional financial support from the European Union (EU) and the World Bank, thereby stabilising external finances.
- **The European Council granted Moldova the status of EU candidate country.** The European Commission acknowledged that the authorities had demonstrated a commitment to anti-corruption and judicial and public administration reform, and set out the further steps that need to be taken.

Key priorities for 2023

- **The authorities should continue to strengthen institutional capacity and improve governance.** Key priorities in the short term include enabling an independent and professional judiciary, strengthening public institutions and continuing the fight against corruption.
- **Efforts to enhance energy resilience need to continue through the development of renewables and energy efficiency.** Moldova should build on the initial steps taken in 2022 to diversify energy sources. In addition, long-awaited renewables auctions need to be implemented, and energy efficiency investments are all the more necessary at a time of high energy prices.
- **The authorities should continue the digitalisation of public services.** Digitalisation could play an important role in steering the economy towards higher value-added sectors, and the digitalisation of public services could be a catalyst to a thorough transformation of public institutions and governance.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	4.1	3.6	-8.3	13.9	-1.0
Inflation (average)	3.1	4.8	3.8	5.1	28.5
Government balance/GDP	-0.9	-1.5	-5.3	-2.6	-6.2
Current account balance/GDP	-10.8	-9.4	-7.7	-12.4	-12.8
Net FDI/GDP [neg. sign = inflows]	-2.3	-4.0	-1.3	-2.8	-0.4
External debt/GDP	63.9	61.6	70.5	64.1	n.a.
Gross reserves/GDP	26.6	26.1	32.8	28.5	n.a.
Credit to private sector/GDP	18.8	19.6	22.9	23.3	n.a.

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Macroeconomic developments and policy response

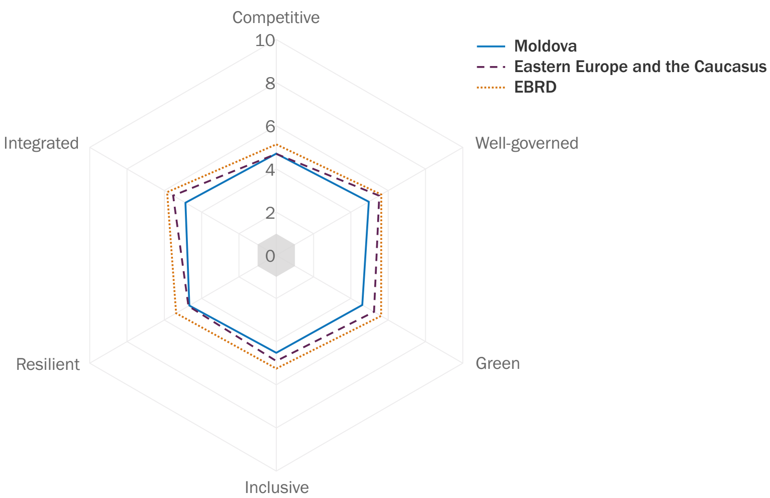
Rising gas prices and the war on Ukraine have brought growth to a virtual halt. After exceptionally strong GDP growth of 13.9 per cent in 2021, GDP stalled at zero per cent growth (year on year) in the first quarter of 2022. Government consumption and net exports showed solid growth, but were insufficient to compensate for the stagnation of private consumption and a decline in investment. The war on Ukraine has affected Moldova mainly through a major inflow of refugees and a sharp rise in inflation. Around 600,000 refugees entered the country, with an estimated 90,000 remaining in Moldova and the others transiting further. This influx of refugees has severely stretched the fragile economy and the country's institutional capacity.

Inflation had exceeded 30 per cent by the middle of 2022, prompting significant fiscal measures to help households and businesses. Expenses on utilities were one-quarter of household incomes on average, even before the threefold increase in gas prices over a period of several months. Real earnings have already dropped by 11.3 per cent in the second quarter (year on year) of 2022, not being able to keep pace with rising inflation. The government stepped in with gas subsidies for households and businesses, estimated at around 1.9 per cent of GDP in 2022. In addition, export bans on staple crops such as wheat and maize entered into force in February 2022 to prevent further food price increases. The authorities also expanded social spending by increasing subsidies for farmers in April 2022 to cover household income losses due to energy price rises, and by providing energy price compensation between January and March 2022. On top of that, adding expenses for dealing with refugees would result in a budget deficit projected by the IMF at 7.2 per cent of GDP in 2022. Public debt, which already increased by 5 percentage points during the Covid-19 pandemic, is forecast to increase by an additional 6 percentage points in 2022 to 38.4 per cent of GDP, but still remains at moderate levels.

International creditors are helping to fund external gaps. After an initial depletion of foreign reserves in early 2022, international financial support has stemmed the outflows and partially reversed the trend since April 2022. In December 2021 the IMF approved a new 40-month US$ 558 million Extended Credit Facility/Extended Fund Facility programme, which will focus on strengthening Moldova's governance and institutional frameworks. In light of the adverse shock to the Moldovan economy from the war on Ukraine, in May 2022 the IMF Board approved the augmentation of this programme by increasing the total to US$ 796 million. In addition, Moldova will benefit from €150 million in macrofinancial assistance from the EU between 2022 and 2024 and US$ 160 million budget support from the World Bank.

Short-term economic stagnation is likely and major uncertainties remain. Our current GDP forecast for 2022 is a decline of 1.0 per cent, followed by a stagnation of 0 per cent in 2023. Amid the high uncertainty, the risks to growth remain broadly balanced between further geopolitical deterioration and a positive boost from the country's recently granted EU candidate status.

CHART Assessment of transition qualities (1-10)



NOTE: Belarus is not included in the EBRD region and respective regional averages.

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Structural reform developments

Moldova gained EU candidate status amid escalated geopolitical tensions. In June 2022 the European Council agreed to grant candidate status to Moldova (and Ukraine). The country's commitment to, and important steps taken on, judicial reform and combating corruption helped to pave the path to EU candidacy. The European Commission indicated priority areas for further policy reform related to the rule of law, protection of property rights, governance and administrative capacity in the public sector, creation of a level playing field in the economy and creating a more inclusive society.

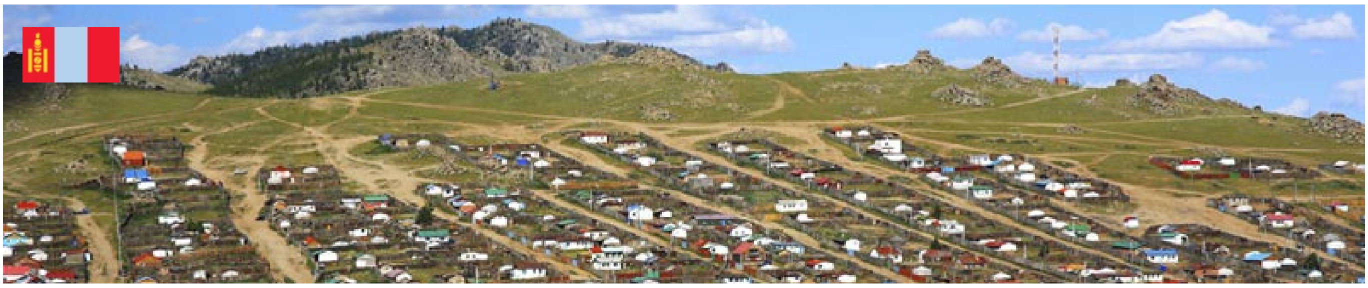
Digitalisation of the economy and the development of e-commerce have progressed. The Economic Council of Moldova has boosted the digitalisation of government services by implementing its Digitalisation Roadmap in 2021. The government has supported the digitalisation of the economy and the Legislative Package for Digitization 1.0 – a new initiative developed by the Ministry of Economy and the Economic Council – was approved in parliament in November 2021. All government institutions are obliged to use digital tools for business operations and offer e-government services. The new Legislative Package also aims to expedite e-commerce practices and simplify customs procedures through electronic means. Further legislative amendments and initiatives (Legislative Packages for Digitalisation 2.0 and 3.0) are under development, both of which are expected to boost e-commerce, thereby generating a more favourable investment climate. As part of the e-commerce boom, parliament approved in April 2022 the delivery of training programmes to promote the growth of small and medium-sized enterprises, local information technology industries and tech start-ups.

The authorities initiated a concrete step to enhance energy security. For decades Moldova has benefited from an affordable price of Russian gas, which is mainly used for generating electricity and thermal energy. However, the large increase in the imported gas price and rising geopolitical tensions have prompted the Moldovan government to diversify energy import sources. As a first concrete step, in May 2022 the Moldovan authorities signed a contract with the Ukrainian state hydropower supplier, Ukrhydroenergo, to secure 30 per cent of its electricity demand. Meanwhile, in April 2022 parliament passed a bill to oblige the country's gas supplier, Moldovagaz, to store gas reserves in adjacent countries sufficient for two months of winter consumption. Also, the country secured a €300 million loan from the European Bank for Reconstruction and Development (EBRD) to Moldova's state-owned energy supplier, JSC Energocom, to procure gas from EU hubs.

Institutional arrangements to tackle corruption have improved. The anti-corruption reform agenda focuses on enhancing the independence and accountability of anti-corruption and judicial bodies as well as curtailing political influence on legal processes. These priorities were included in a new strategy regarding judicial independence and integrity, which was adopted by parliament in December 2021. Further legislation was adopted in April 2022 around the selection of legal officials for specialised prosecution bodies, including the Anti-Corruption Prosecutor (ACP). This new selection process includes a special pre-selection committee comprising international legal experts to prevent undue political influence. Accordingly, the ACP was elected in June 2022 through a newly strengthened selection process for spearheading operations of the Anti-Corruption Prosecution Office.

Fiscal risk monitoring and public corporate management have improved. In accordance with an IMF structural benchmark, the authorities obliged state-owned enterprises (SOEs) across all layers of government to submit their quarterly financial statements beginning from March 2022. This SOE reform aims to improve the management of state assets and should contribute to lower fiscal costs. The authorities are drafting a new SOE management strategy, in close consultation with the IMF, to diagnose persistent SOE governance issues and assess ongoing reform progress.

Parliament has paved the way for enhancing gender equality and children's rights. In October 2021 parliament ratified the Istanbul Convention, seen as one of the most effective international treaties to tackle violence against women and domestic violence. The Convention entered into force in March 2022 with a newly launched implementation roadmap. The Ministry of Labour and Social Protection launched a new five-year national programme in June 2022 to strengthen the social protection system of children. New guidelines followed in July to outline the authorities responsible for the implementation and independent monitoring of progress to enhance children's rights.



Mongolia

Highlights

- **Growth is being affected by external shocks.** Real gross domestic product (GDP) grew by 1.9 per cent year on year in the first six months of 2022, despite intermittent border closures due to China's zero-Covid policy. Growth was supported by high commodity prices (total exports gained 29.8 per cent in the first half of the year) and the robust expansion of agriculture and service sectors.
- **The longstanding dispute with Rio Tinto over development costs for the Oyu Tolgoi copper mine has been resolved.** This helps allay concerns about Mongolia's investment climate while at the same time increasing the country's share of any benefits from future foreign direct investment (FDI) in the mining sector.
- **Mongolia is promoting its digitalisation agenda.** The newly established Ministry of Digital Development and Communications signed a memorandum of understanding with Estonia's e-Governance Academy to digitalise a wide range of government services, in a significant step towards Mongolia's digital transformation.

Key priorities for 2023

- **Better targeting of support measures and fiscal consolidation are required to ensure macroeconomic stability and debt sustainability.** Large stimulus spending in 2020-21 led to persistent imbalances, constraining the government's fiscal space and pushing public debt close to 100 per cent of GDP. Monetary policy remains accommodative (the policy rate is below the inflation rate), encouraging growth at the expense of price stability, adding to the inflationary pressures stemming from more complicated import logistics and higher commodity prices.
- **The authorities should step up efforts to improve the management of critical border crossing points and invest in connectivity.** Greater efficiency of and additional physical capacity in freight transport will allow the country to benefit fully from elevated commodity prices and reduce bottlenecks on existing trade routes.
- **Plans to improve regional inclusion should be stepped up.** Current efforts to bring essential services and modern infrastructure to Ulaanbaatar's ger districts and build new modern districts outside the capital should be accelerated. Improved municipal services would boost living conditions for the poor and enhance their access to the labour market.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	7.7	5.6	-4.6	1.6	3.5
Inflation (average)	6.8	7.3	3.7	7.1	14.8
Government balance/GDP	2.9	1.0	-9.2	-3.1	-0.4
Current account balance/GDP	-16.7	-15.2	-5.1	-12.8	-20.3
Net FDI/GDP [neg. sign = inflows]	-14.8	-17.2	-12.9	-13.3	-14.5
External debt/GDP	249.4	250.5	275.8	219.8	n.a.
Gross reserves/GDP	27.0	30.7	34.2	28.9	n.a.
Credit to private sector/GDP	55.4	48.9	45.8	46.3	n.a.

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Macroeconomic developments and policy response

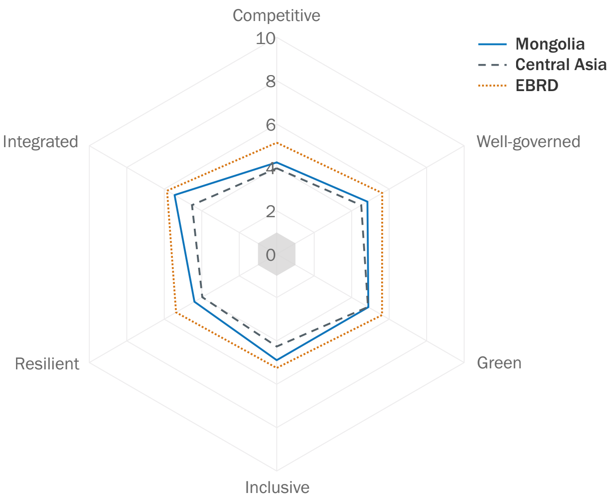
Growth has been modest so far in 2022. The economy shrank by 3.8 per cent year on year in the first quarter of 2022, but rebounded in the second quarter on the back of agriculture (up 11.3 per cent year on year) and services (up 4.9 per cent year on year), giving an overall growth rate of 1.9 per cent year on year in the first half. The country's lack of diversification means that economic performance remains closely linked to China's demand for its key export products (coal, copper and iron ore), though gold provides a significant hedge (increasing from 7.3 to 20 per cent of total exports in 2020). The recent Covid-19 outbreaks in China and Russia's war on Ukraine put further pressure on the Mongolian economy, with volatile demand from China resulting in a contraction in the Mongolian mining and quarrying sector (down 28.8 per cent year on year in the first half).

Inflation has become a key concern, necessitating a policy response. Inflation peaked at 16.9 per cent year on year in June 2022, driven by supply-chain disruptions, higher transport costs and the rising prices of imported goods. Excessive stimulus spending and the accommodative monetary policy stance of the Bank of Mongolia (BoM) have also been important drivers. Having kept its benchmark interest rate unchanged at 6 per cent from November 2020 till March 2022, the BoM raised it stepwise to 12 per cent by September 2022. Consequently, inflation slowed down to 13.8 per cent year on year in September. To counter the impact of rising food prices, the Ministry of Food, Agriculture and Light Industry (MoFALI) has signed agreements with 17 businesses with regard to customs tax exemptions on wholesale imports of rice, sugar and vegetable oil in exchange for ensuring price stability.

External resilience remains a challenge. The currency has come under pressure and lost about 14.6 per cent of its value (as of 23 September 2022) against the US dollar since late February 2022. The BoM's current international reserves (about US$ 3.1 billion) cover six months of imports and 53 per cent of upcoming debt payments. In May 2022 Fitch affirmed Mongolia's B rating with a stable outlook. However, a more recent rating by IHS Markit led to the outlook being downgraded from stable to negative, reflecting negative export dynamics due to frequent border closures with China.

Short-term growth is likely to rise, but downside risks remain significant. We expect real GDP to grow 3.5 per cent in 2022 and 7.0 per cent in 2023. Major downside risks relate mostly to the geopolitical situation and the possibility of negative spill-over effects on Mongolia's main industries. Significant upside potential to 2023 growth lies in the tourism sector, provided it can finally rebound to its pre-pandemic level.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

Major reforms are under way in the banking sector. Amended in January 2021, the Banking Law requires systemically important banks (SIBs) to conduct initial public offerings (IPOs) on the Mongolian Stock Exchange by June 2022 and to reduce maximum ownership by a single shareholder to no more than 20 per cent by 31 December 2023. Complying with the new limit is likely to require SIBs to sell their shares through multiple initial and secondary public offerings (IPOs and SPOs). On the International Monetary Fund's (IMF) recommendation, the deadline for IPOs has been postponed to allow all SIBs to undergo an asset quality review, which was completed by October 2022.

The government launched a new economic reform programme. Introduced in December 2021, the New Recovery Policy envisages a doubling of Mongolia's GDP by 2030 through investment and structural reforms focusing on: (i) border capacity and connectivity; (ii) industrial technology; (iii) regional integration; (iv) energy transmission and distribution networks; (v) climate change mitigation measures; and (vi) governmental and state-owned enterprise (SOE) efficiency. The programme's investment costs are estimated at around MNT 120-150 trillion (US$ 36-45 billion), requiring active cooperation with private-sector companies, foreign investors and international financial institutions.

A major dispute over FDI in the mining sector has been resolved. An important breakthrough occurred in December 2021, when Mongolia's largest foreign investor, Rio Tinto, agreed to write off US$ 2.3 billion of Mongolia's debt related to the Oyu Tolgoi mine. Putting this longstanding dispute to rest will help allay concerns over Mongolia's investment climate, while increasing the country's share of any benefits from future FDI in the mining sector. Meanwhile, in February 2022 the government decided to re-establish the country's Foreign Investment Agency. The agency will be responsible for resolving potential obstacles to FDI, including regulatory barriers and planning issues, as well as for landing high-value investment opportunities in Mongolia. It will also protect investors' interests and provide investor planning support and services.

Mongolia is advancing its digitalisation agenda. In January 2022 the authorities established the Ministry of Digital Development and Communications. In April 2022 the ministry and the Estonian e-Governance academy signed a memorandum of understanding to facilitate Mongolia's digital transformation. The scope of work includes introducing digital identity and electronic signatures, advising civil servants on digital skills and developing digital strategies.

The country is encouraging sustainable finance and mobilising private-sector companies and citizens to reverse deforestation and desertification trends. A national roadmap for sustainable finance, adopted in March 2022, envisages increasing green loans as a share of the total loan portfolios of banks and non-banking financial institutions to 10 and 5 per cent, respectively. Meanwhile, the One Billion Trees national movement, launched in late 2021, envisages the planting of 1 billion trees by 2030, with more than 600 million of those to be planted by large corporations.

Montenegro

Highlights

- **Economic recovery continues.** A strong performance by the tourism sector was the driving force behind 13.0 per cent gross domestic product (GDP) growth in 2021. Robust household consumption growth continued into 2022, supported by a minimum wage hike, but rising imports are stifling the growth rate.
- **The government introduced tax measures to improve living standards and decrease informality.** In addition to an 80 per cent minimum wage hike, the authorities introduced progressive taxation and reduced the sizeable labour tax wedge.
- **Reforms in the energy sector have continued.** The Montenegrin power exchange company is making progress on establishing a day-ahead electricity market with two regional power exchanges, while the state-owned power utility has joined the day-ahead power market of the Serbian power exchange.

Key priorities for 2023

- **There needs to be continuity of economic policy and implementation despite political change.** Public institutions should be strengthened to mitigate the potentially harmful effects of frequent political changes on policymaking and reform progress.
- **The pathway to decarbonisation should be developed.** The National Energy and Climate Plan (NECP) should be finalised, setting out plans for ending coal-powered generation, while a modern regulatory framework that creates incentives for private investment in renewable generation should be developed.
- **Public-sector reform should be stepped up.** Key measures that should be prioritised include adopting the draft Public Administration Reform Strategy, formulating a state ownership policy and centralising oversight of state-owned enterprises (SOEs), and improving fiscal impact analyses of proposed social measures and public investment plans.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	5.1	4.1	-15.3	13.0	3.7
Inflation (average)	2.6	0.4	-0.3	2.4	12.8
Government balance/GDP	-6.2	-1.8	-10.9	-1.7	-5.0
Current account balance/GDP	-17.0	-14.3	-26.0	-9.2	-13.8
Net FDI/GDP [neg. sign = inflows]	-6.9	-6.2	-11.2	-11.7	-11.1
External debt/GDP	163.7	167.4	221.6	191.5	n.a.
Gross reserves/GDP	22.3	27.6	41.5	35.3	n.a.
Credit to private sector/GDP	49.6	49.0	60.0	52.3	n.a.

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Macroeconomic developments and policy response

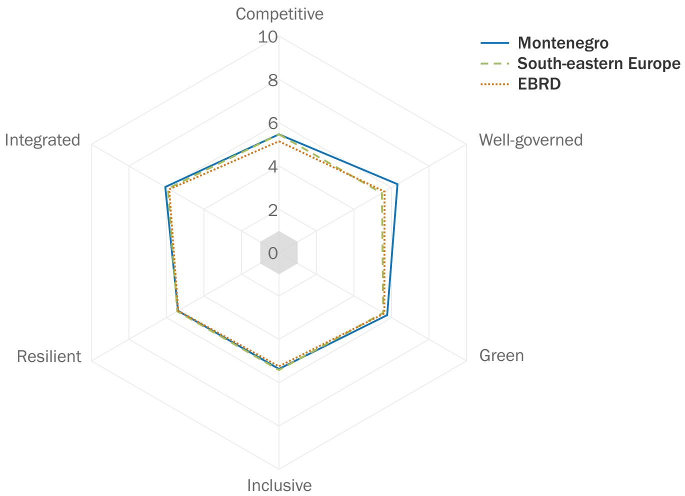
Economic recovery continues. Output grew by a strong 13.0 per cent in 2021 on the back of a successful summer tourism season, following a deep pandemic-induced recession in 2020. The expansion continued in 2022 with the economy growing by 7.1 per cent and 12.7 per cent year on year in the first two quarters of the year, respectively, as household consumption remained elevated but imports surged, leading to negative net exports. Household demand was supported by an 80 per cent minimum wage hike in January 2022 and the abolition of mandatory health contributions, driving a 33 per cent nominal increase in the average net wage in the first eight months of the year, albeit more muted in real terms due to high inflation. Retail trade led growth on the production side as foreign tourist arrivals were up by 59 per cent year on year by the end of August, although still below record 2019 levels. Investment remained weak amid a strong contraction in construction activity, as work on the Bar-Boljare highway, the country's largest infrastructure project, nears first-phase completion and political turmoil acts as a drag on new projects.

Inflation has risen sharply and the current account deficit has widened. The rate of inflation accelerated to 16 per cent year on year in September 2022, driven by rising prices for food and energy imports and exacerbated by wage growth. In the first half of the year, the current account deficit widened by 31 per cent annually, mainly because of higher prices for fossil-fuel imports, primarily petroleum. The country managed to satisfy power demand from local production in the 2021-22 winter, as the state-owned aluminium smelter, a significant electricity consumer, was closed temporarily. Meanwhile, foreign direct investment (FDI) increased by 80 per cent on the year in the first half of 2022 as investment in real estate more than doubled, with the largest portion of FDI coming from Russia.

Policy responses to rising prices were introduced with a delay due to political changes. In May 2022 the new government temporarily abolished value added tax (VAT) on cooking oil and flour and halved excise duty on fuel. In June 2022 retail profit margins on basic foodstuffs (cooking oil, flour, sugar and salt) were capped, VAT on bread was abolished and excise duties on single-use plastic were removed, to the benefit of domestic food producers. The government capped the rising price of wood pellets in July, and in September took steps to limit their export.

The short-term growth outlook is uncertain. We forecast GDP growth of 3.7 per cent in 2022 and 4.0 per cent in 2023. The economic impact of the war on Ukraine is reflected in continually elevated inflation, which is set to dampen demand. At the same time, stronger than expected private consumption and robust performance of the hospitality sector tilt the short-term outlook towards the upside. Political instability – with two governments being voted out in no-confidence ballots in parliament in the space of a few months – is creating uncertainty about the implementation of reforms needed to improve medium-term growth prospects.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

The authorities are focused on closing European Union (EU) accession negotiating chapters. Having opened all negotiating chapters of the EU accession negotiating framework, the *acquis communautaire*, the focus has now shifted to closing chapters. Only three chapters have been provisionally closed since the opening of accession negotiations in June 2012 and there has been no progress in this regard over the past year. According to the European Council and European Commission, further progress in negotiations will depend on Montenegro meeting the interim benchmarks set in the rule-of-law chapters (23 and 24) of the *acquis*.

Important tax and wage changes have been adopted. In December 2021 key components of a previous government's Europe Now programme were included alongside the state budget for 2022 in a bid to reduce the sizeable labour tax wedge and reduce informality. Changes from the start of 2022 included an 80 per cent hike in the minimum wage to €450, the introduction of progressive personal and corporate taxation, the introduction of a non-taxable salary base and the abolition of obligatory healthcare contributions. These reforms were designed to attract new investment and lead to the formalisation of employment, but are likely to lead to lower net tax revenues, partially as all proposed revenue-reducing measures were adopted, including additional last-minute ones, while also not including all proposed revenue-enhancing measures. A budget rebalance was adopted in September 2022.

The first section of the country's biggest infrastructure project has been completed. The planned 170-kilometre Bar-Boljare highway is set to eventually connect the Montenegrin coast with the Serbian border. Highway construction started in 2015, led by the China Road and Bridge Corporation and supported by financing from China ExIm Bank. The first section, opened in July 2022, is 41 kilometres long and, due to the difficult terrain, the most expensive section.

The government has adopted an economic recovery platform for 2022-26. The platform, adopted by the then government in March 2022, aims to provide a detailed picture of the Montenegrin economy and presents a vision for medium-term development that should serve as a basis for further strategic documents. The six key objectives of implementation are: macroeconomic stability, stabilisation of demographic challenges, economic diversification, better implementation of infrastructure projects, innovation, digitalisation and the green economy, and good governance. The effectiveness of the platform remains to be seen in light of political changes since adoption.

Regulatory requirements for banks have been strengthened. The new Law on Credit Institutions, the Law on Resolution of Credit Institutions and an accompanying set of by-laws came into effect at the start of 2022, aligning regulation and supervision with Basel III standards (with a transition period) and the EU's regulatory framework. The Law on Credit Institutions strengthens the capital requirements of banks, introduces mandatory board supervision, tightens norms for the identification and classification of non-performing loans and sets criteria for determining the systemic importance of banks, while the latter introduces the resolution fund, minimum requirements for eligible liabilities (MREL) and a bail-in tool.

The Strategy for the Development of Women's Entrepreneurship was adopted in October 2021. The Strategy and accompanying action plan run from 2021 to 2024 and set out four strategic priorities: enhancing the business environment for women in business, access to finance, access to knowledge and skills, and promotion and networking.

A day-ahead power market is in the works as the energy regulator strengthens supervision. The Montenegrin power exchange company, BELEN, signed a service agreement in October 2021 with the European Power Exchange (EPEX SPOT) and the Slovenian SouthPool Energy Exchange (BSP) to establish a day-ahead electricity market in Montenegro. According to the Energy Community Secretariat, the agreement is a key step in improving competition and liquidity in the power market. In June 2022, the state-owned power utility, EPCG, joined the day-ahead power market of the Serbian power exchange, SEEPEX, primarily selling output from the Piva hydropower plant. In January 2022 legislation on the supervision of wholesale electricity and gas markets entered into force, empowering the national energy regulator to monitor markets and investigate abuse, thus helping to ensure fair energy prices.

Montenegro Works, the SOE management company, was liquidated in July 2022, less than a year after its founding. The company was established in August 2021, tasked with overseeing and analysing the financial performance of SOEs.

Morocco

Highlights

- **The economic rebound of 2021 was short lived, as growth slowed in the first half of 2022.** A drought-induced decline in the agriculture sector has offset strong non-agriculture growth in 2022 and inflation has been well above target levels due to increasing global food prices.
- **The government has responded to rising global prices with a range of measures.** These include direct support for farmers, transport-sector subsidies and the doubling of budgetary spending on subsidies for gas, flour and sugar. The central bank increased its benchmark rate by 50 basis points in September 2022.
- **A new government programme, setting the country's path to 2026, has been announced.** The programme targets an annual growth rate of 4 per cent over the next few years and the creation of at least 1 million jobs by 2026. New employment and entrepreneurial programmes and labour-market reforms will underpin job growth.

Key priorities for 2023

- **A comprehensive approach to employment and investment promotion is essential.** The announced programmes and reforms are positive steps, but would benefit greatly from close coordination and links to complementary sectoral policies and action plans that create an attractive business climate.
- **Targeted support for vulnerable population groups is needed in the form of a stronger social safety net.** The government's decision to harmonise current assistance programmes into a single allowance scheme, starting in 2023, is a welcome step as part of broader subsidy reform.
- **The country should accelerate the development of renewables while leveraging the private sector's role.** This would enhance overall competitiveness (especially given rising fossil-fuel prices) and boost the achievement of Morocco's ambitious climate change objectives.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	3.1	2.9	-7.2	7.9	1.1
Inflation (average)	1.6	0.2	0.6	1.4	6.2
Government balance/GDP	-3.4	-3.6	-7.1	-5.9	-5.3
Current account balance/GDP	-4.9	-3.4	-1.2	-2.3	-4.3
Net FDI/GDP [neg. sign = inflows]	-2.2	-0.6	-0.8	-1.2	-1.5
External debt/GDP	35.0	36.7	44.5	37.1	n.a.
Gross reserves/GDP	19.2	20.5	29.7	25.0	n.a.
Credit to private sector/GDP	56.4	57.4	64.3	60.1	n.a.

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Macroeconomic developments and policy response

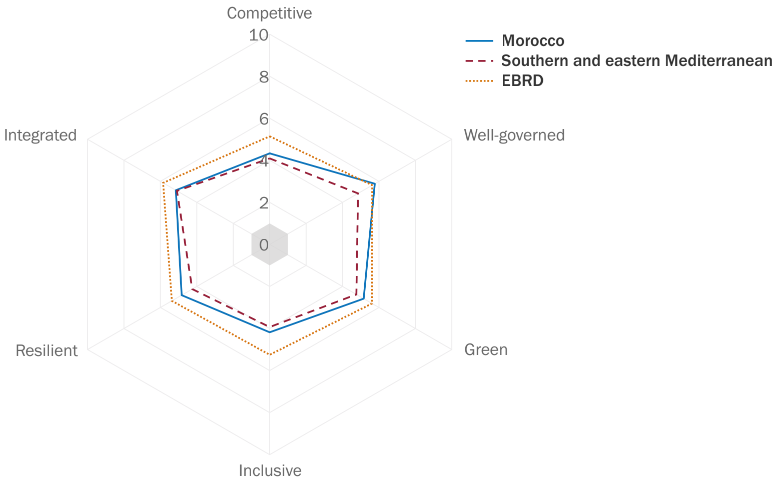
Following a strong rebound in 2021, the economy slowed in the first half of 2022. In 2021 the economy grew by 7.9 per cent, driven by strong growth in agriculture, manufacturing and trade. In the first half of 2022 the economy slowed, with growth of just 1.1 per cent year on year. The agriculture sector faced severe drought, but non-agricultural growth reached 3.2 per cent year on year. Inflation was 5.1 per cent in the first six months of 2022, well above the central bank's target of 2 per cent. This was mainly driven by a 7.8 per cent increase in food prices. Meanwhile, unemployment decreased slightly to 12.1 per cent in the first quarter of 2022 and was higher among women (17.3 per cent), the youth (33.4 per cent) and in urban areas (16.3 per cent).

The authorities implemented a range of measures to counteract the effects of the war on Ukraine. In March 2022 the government announced almost US$ 1 billion of support for farmers, initially in response to the country's drought, but also to help with soaring commodity prices, as feed and fertiliser prices had doubled since the beginning of the year. Between March and July 2022, Moroccan road freight companies received US$ 203 million in subsidies to help curb the impact of rising global fuel prices on domestic inflation. The government also doubled the budget for subsidies for butane gas, flour and sugar to US$ 3 billion (two-thirds of which was for butane). The space for further fiscal measures is limited, as the fiscal deficit was 6 per cent of GDP in 2021, and general government debt was 76.4 per cent of GDP as of the end of 2021.

External imbalances have risen. In 2021 the current account deficit widened to 2.3 per cent of GDP (from 1.2 per cent in 2020), as imports rose significantly, outweighing the increase in exports. The same trend continued in the first half of 2022, fuelled by higher energy and food prices. Even though tourist arrivals quadrupled in the first half of 2022, they are still just 63 per cent of pre-pandemic levels. The added demand for hard currency reduced the country's foreign-exchange reserves to US$ 32.9 billion in June 2022, but they still cover a healthy nine months of imports.

Growth is expected to pick up in 2023, but significant uncertainties remain. In 2022 we expect growth to slow to 1.1 per cent, due mainly to adverse weather conditions affecting agricultural production, the fallout from the war on Ukraine and a decline in tourism due to travel disruptions and higher costs. Agriculture is expected to recover in 2023 and we forecast the pace of growth to return to its pre-pandemic level of 3.3 per cent. However, Morocco remains vulnerable to increases in hydrocarbon prices, as it imports most of its energy, and global supply-chain disruptions may continue to provide further headwinds to growth.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

The government has set out a new programme for the country's path to 2026. The three strategic axes of the programme announced in October 2021 are to: strengthen the social foundations of the state; stimulate the economy for the benefit of employment; and improve public-sector governance and management. The programme targets an annual growth rate of 4 per cent over the next few years and the creation of at least 1 million jobs. The government has also addressed women's unemployment, aiming to increase the activity rate from the current 20 per cent to more than 30 per cent. The aim is to reduce the poverty rate among the most vulnerable by 2026 by introducing a minimum pension of MAD 1,000 (US$ 97) for each person over 60, as well as a family allowance of MAD 300 (US$ 29) per month for every child.

The Awrach (building sites) employment programme was launched in January 2022. The programme aims to create 250,000 public-service jobs in 2022 and 2023, including in infrastructure construction, the renovation of urban spaces and government-led cultural and sports activities. It seeks to improve the employability of discouraged workers, enabling them to enter the labour market more easily. The initiative is geared towards Moroccans who lost their jobs in the Covid-19 pandemic and those who have never worked or who have been registered with the National Agency for the Promotion of Employment and Skills (ANAPEC) for more than two years. The programme has two components: the first concerns temporary public worksites, where 80 per cent of the new jobs will be allocated, and the second involves support for sustainable integration, which includes personal assistance services, education or sports activities. Associations, cooperatives or companies that commit to hiring the remaining 20 per cent of the programme's beneficiaries will receive a subsidy of approximately MAD 1,500 (US$ 145) per month, for a period of 18 months for each integrated employee. The workers will be paid a minimum wage and will benefit from social security coverage.

The government has adopted a new Investment Charter. The Charter, in development since 2016 and finally adopted in July 2022, provides a strategy for increasing the share of private investment to two-thirds of total investment by 2035. It includes improving conditions for creating permanent jobs and reducing disparities between provinces and prefectures in terms of investment attractiveness. In addition, it aims to steer investments towards high value-added productive sectors to ensure sustainable development, as well as to increase Morocco's attractiveness for foreign direct investment.

The government has continued to promote digitalisation by introducing a national digital identity platform. New national electronic identity cards were introduced in 2020 and allow citizens to identify themselves digitally for numerous public and private (online) services. Functionalities have been expanded since then; for example, citizens can now choose directly which data to share, through a web platform and an app, with additional layers of security introduced in parallel.

North Macedonia

Highlights

- **Economic growth has moderated during 2022.** North Macedonia recovered well from the Covid-19 pandemic, as pent-up demand pressures led to an increase in domestic trade and stronger manufacturing in 2021. In 2022, however, inflation is growing and uncertainty has increased, holding back consumption and economic activity.
- **The commitment to a green transition has been strengthened.** In adopting its final National Energy and Climate Plan (NECP), the country set a date of 2027 for the closure of its two coal power plants. The ambitious plan features carbon taxation, energy efficiency measures and gas as a transition fuel.
- **Fiscal decentralisation reform has been adopted.** Municipalities are set to manage a higher portion of tax revenue and service their own debt, in line with defined responsibility and transparency guidelines.

Key priorities for 2023

- **Fiscal sustainability should be carefully maintained.** While policy responses to protect the living standards of citizens in an environment of surging inflation are warranted, care should be taken to avoid untargeted measures or ones that are difficult to reverse. A credible medium-term fiscal strategy in line with the Organic Budget Law would help govern decision-making.
- **Scaling up clean energy is key.** Diversifying energy sources with clean energy would boost the competitiveness of exports in the context of high energy import prices, strong trade links with the European Union (EU) and the EU's upcoming carbon border adjustment mechanism.
- **Enhancement of the business environment would help unleash private-sector potential.** Key steps that should be given priority include the systematisation and streamlining of state subsidies, in addition to linking them to outcomes, addressing informality and, in the long term, comprehensively revamping the education system to address skills mismatches.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	2.9	3.9	-4.7	3.9	2.7
Inflation (average)	1.5	0.8	1.2	3.2	10.6
Government balance/GDP	-1.8	-2.0	-8.2	-5.4	-5.3
Current account balance/GDP	0.2	-3.0	-2.9	-3.1	-6.7
Net FDI/GDP [neg. sign = inflows]	-5.6	-3.2	-1.4	-3.3	-3.2
External debt/GDP	73.0	72.4	78.7	81.9	n.a.
Gross reserves/GDP	26.7	29.0	31.0	31.2	n.a.
Credit to private sector/GDP	50.2	51.3	56.9	56.0	n.a.

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Macroeconomic developments and policy response

The economic recovery has slowed. Following a relatively strong demand-driven rebound of 3.9 per cent in 2021, economic activity moderated to 2.6 per cent year-on-year growth in the first half of 2022. Supporting economic expansion were strong annual gross investment growth (upwards of 40 per cent), driven by base effects in the first quarter and inventory changes in the second quarter, and persistent household consumption. On the flip side, imports surged 25 per cent year on year, outpacing export growth and damping the growth rate in the first half of 2022. On the production side, strong annual growth in domestic trade, reflecting continued pent-up demand pressures, led the expansion, while the second biggest economic sector, industry, recorded a more muted 2.3 per cent annual growth rate.

Inflationary pressures have accelerated, while energy imports have widened the current account deficit. Annual inflation reached 18.7 per cent in September 2022 as consumers in North Macedonia felt the rising prices of food and energy on world markets through imports. Despite an 18 per cent increase in the minimum wage, effective April 2022, real wage growth turned negative in May. A seven-month state of emergency was declared in the country's energy sector in October 2021 and reinstated in August 2022 due to vulnerabilities in domestic electricity production; household electricity bills increased twice in 2022, while heating prices rose 14 per cent on gas import prices alone. Higher energy prices have also prompted a sharp rise in the current account deficit. Macroeconomic stability is being supported by the managed floating exchange-rate regime, backed by sizeable foreign-exchange reserves of €3.8 billion as of September 2022. The National Bank of North Macedonia raised the key interest rate six times from 1.25 per cent in April to 3.5 per cent as of October 2022.

The government undertook extensive fiscal measures. A 26-measure €400 million package was introduced in March 2022, aiming to protect the living standards of citizens primarily through various tax relief measures, such as a value added tax (VAT) decrease on basic foodstuffs and energy, a delay in applying the upcoming environmental energy tax, the capping of retail trade margins and subsidies, and supporting companies' liquidity through favourable loan terms. Also in March, temporary export bans were introduced for key agricultural products. Fiscal space has tightened since the adoption of the package, prompting the government to undertake a budget rebalancing, featuring a higher 2022 deficit of 5.3 per cent of gross domestic product (GDP) and space for pension increases. The latest €360 million package, adopted in October 2022, is largely an extension of measures introduced in March, with more of the targeted and fewer of the broad-based support measures continued. To help safeguard the economy, the authorities requested a two-year Precautionary and Liquidity Line with the International Monetary Fund (IMF) and reached a staff-level agreement in October.

The economy will continue to grow, albeit at a slower pace. We forecast economic growth of 2.7 per cent in 2022 and 2.3 per cent in 2023 amid an unfavourable global outlook. Although North Macedonia has only limited direct economic links to Russia or Ukraine, the economic impact of the war on Ukraine has already partly materialised in the form of a further rise in prices, which is set to dampen household consumption further. The anticipated slowdown in eurozone export markets, relevant for the automotive sector, in particular, alongside increased uncertainty and tighter financing conditions, which may weigh on investor confidence, may further impact the economy. Fiscal vulnerabilities primarily relate to the upcoming 2022-23 heating season, which is likely to be challenging due to high energy prices worldwide, insufficient domestic production and illiquid state-owned utility companies.

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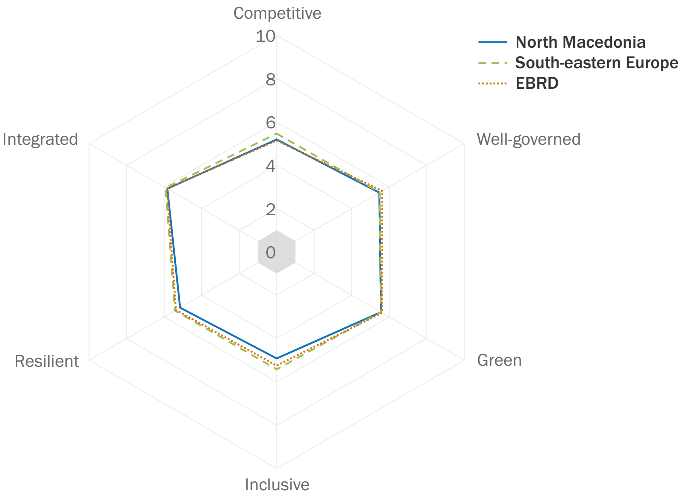
CHART Assessment of transition qualities (1-10)



Structural reform developments

EU accession negotiations have been opened. The long-awaited formal opening of North Macedonia's EU accession negotiations, the first intergovernmental conference, took place on 19 July 2022. It was followed by the European Commission's launch of the screening process. However, while screening will go ahead, to start accession negotiations in earnest (which requires an additional intergovernmental conference), North Macedonia will have to first adopt constitutional amendments related to the status of Bulgarian minorities in the country.

The government has adopted an ambitious Growth Acceleration Plan for 2022-26. The plan, adopted by the government in October 2021, aims to support the post-pandemic recovery and GDP growth. It foresees a 5 per cent annual GDP growth rate, partly through a €4 billion allocation to public investment, which is expected to mobilise double that amount in private investment, enhancing competitiveness. Fiscal consolidation, too, is part of the medium-term vision, as public debt is set to be below 60 per cent of GDP by the plan's end. Since the plan's adoption, fiscal consolidation has been delayed, however, because of the worsening external environment.

The minimum wage was increased. The new minimum wage law, adopted by parliament in February 2022 and effective from April, brings the minimum wage to 62 per cent of the average wage – a relatively high proportion compared with most EU countries. Nearly a fifth of workers in North Macedonia are set to benefit from the 18 per cent increase. The law also prescribes an annual adjustment of the minimum wage in line with the average net wage and inflation, as well as a benchmark that prohibits the minimum wage going below 57 per cent of the average wage. The policy sparked protest in the public sector, as non-minimum wages were not raised accordingly, most notably among workers employed in education, resulting in a 12 per cent increase in teachers' wages.

Fiscal decentralisation reform is beginning. The reform encompasses three pillars: (i) the improved fiscal capacity of municipalities, (ii) greater fiscal discipline and (iii) the transparency and accountability of municipal operations. Under the legal amendments adopted in July 2022, municipalities are to be allocated a progressively larger share of personal income tax and VAT revenues, with these revenues set to double from some €45 million in 2022 to more than €80 million in 2024. Two new funds will be established from which municipalities will be able to draw funds, based on their performance in terms of revenue collection. As far as fiscal discipline is concerned, municipalities are set to plan their own revenues and expenditures and will be expected to regularly service debt, while those that declare financial instability will be eligible for a credit line from the ministry of finance.

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The country committed to its energy transition pathway. The government adopted the final National Energy and Climate Plan (NECP) for 2021-30 in May 2022. The plan outlines the country's decarbonisation pathway, making North Macedonia the second Western Balkans country to firmly commit to the obligations of an Energy Community contracting party. The plan's ambitions include the closure by 2027 of coal power plants, which currently produce half the country's electricity supply, the introduction of a carbon tax, and a 20 per cent cut in consumption through energy-efficiency measures. Since its adoption, the energy regulator has approved a new pricing model for electricity, valid from July 2022, pegging price to consumption. Diversification efforts through the increased usage of natural gas are also included in the NECP; currently, gas is mostly used for heating in the country's capital, Skopje, and, to a limited degree, by industrial producers. It is sourced entirely from Russia on market terms. Having partially secured financing for a gas interconnector with Greece at the end of 2021, in February 2022, North Macedonia reserved liquefied natural gas (LNG) capacities at the floating terminal in Alexandroupolis, currently under construction, and, in March, joined the EU-led platform for joint LNG purchasing.

The Organic Budget Law was adopted. Adopted in September 2022, it introduces a new set of fiscal rules to guide fiscal consolidation and improve the budget process. Key reforms include medium-term projection, spanning both medium-term budgeting and a five-year fiscal strategy, as well as establishing a Fiscal Council, an independent body assessing fiscal policy.

Poland

Highlights

- **The post-pandemic recovery has decelerated in 2022.** The slowdown is due in part to increased commodity and energy prices and uncertainty associated with the country's proximity to the war in Ukraine, accompanied by market pressure and more difficult financing conditions.
- **Crisis support measures include loan holidays for mortgage borrowers and heating subsidies.** Between 85 per cent and 95 per cent of those eligible are expected to apply for eight months' worth of credit holidays on zloty mortgages in 2022 and 2023, while one-off heating subsidies will cover up to 40 per cent of energy price hikes between October 2022 and April 2023.
- **Consolidation of the fuel and energy sectors has gained momentum.** In July 2022 the government approved the final merger of state-controlled fuel giants PKN Orlen and Lotos, as part of the consolidation of the fuel and energy sector with state-owned gas giant Polskie Górnictwo Naftowe i Gazownictwo (PGNiG).

Key priorities for 2023

- **Unlocking Recovery and Resilience Facility (RRF) fund disbursements would speed up critical investment, while keeping fiscal stresses in check.** An added benefit would be a stronger currency, which would help to fight inflation. Efforts must, therefore, be intensified to resolve current disagreements between the government and the European Commission on judicial reform.
- **The replacement of the benchmark WIBOR rate needs to be done in a consistent and careful way and communication with market participants needs to be ensured.** A working group, consisting of key stakeholders, started to work in July 2022. According to the roadmap prepared by the working group, the plan is to replace the main benchmark WIBOR rate with a new O/N risk-free rate – WIRON from January 2025. The roadmap indicates that the market should be ready for a cessation of the WIBOR reference rates at the beginning of 2025.
- **Energy crisis-shielding measures and grid and capacity investment should be consistent not only with short-term price stability, but also with long-term energy security and climate mitigation.** Means-tested support measures for the most vulnerable groups, especially households at risk of energy poverty, will require greater administrative capacity. They could prevent excessive energy use and encourage green investments.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	5.4	4.7	-2.2	5.9	4.0
Inflation (average)	1.2	2.1	3.6	5.2	14.0
Government balance/GDP	-0.2	-0.7	-6.9	-1.8	-4.1
Current account balance/GDP	-1.9	-0.2	2.4	1.4	-4.0
Net FDI/GDP [neg. sign = inflows]	-2.8	-2.0	-2.4	-4.1	-4.7
External debt/GDP	64.3	58.8	60.7	56.6	n.a.
Gross reserves/GDP	19.9	21.5	25.6	24.5	n.a.
Credit to private sector/GDP	50.9	50.2	47.7	45.4	n.a.

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Macroeconomic developments and policy response

The post-pandemic recovery is decelerating in the second half of 2022. Following strong gross domestic product (GDP) growth of 6.8 per cent in 2021, the Polish economy grew 6.9 per cent year on year in the first half of 2022, mostly boosted by a large increase in inventories and still very strong household consumption. While direct exposure to trade with Russia and Ukraine is modest, the war is affecting the Polish economy, mainly through higher commodity and energy prices and by uncertainty associated with the country's proximity to the war, with the accompanying market pressure and more difficult financing conditions. The pessimistic outlook is confirmed in the central bank's corporate survey of July 2022, which points to a sharp slowdown in the next 12 months. At the same time, Ukrainian refugees are filling some of the vacancies in the labour market. As of mid-2022 about 210,000 refugees had taken up work in Poland – more than a third of all working-age (18-65) refugees who applied for Polish identity cards since 24 February 2022. Overall, there are an estimated 2.5-2.8 million Ukrainians in Poland, including those who migrated to Poland before the war, according to estimates by the central bank. Refugees find employment mostly in retail trade and home-care facilities, whereas pre-war, the immigrants were mostly men working in heavy industry or construction.

External developments and domestic factors are fuelling high inflation. In September 2022 the consumer inflation rate reached 17.2 per cent, its highest level for 25 years. Rising commodity and energy prices and disrupted supply chains were already significant drivers of inflation prior to Russia's invasion of Ukraine, but the war has magnified these effects. In response, the central bank has been gradually increasing interest rates, to 6.75 per cent as of September 2022, which, together with tighter liquidity conditions and banking sector regulatory measures, led to a drop in lending in most market segments. In parallel, the government approved two anti-inflation shield bills in November 2021 and January 2022, including indirect tax cuts on fuel, food, heating energy, gas and electricity. A further extension into 2023 is likely. As of the end of June 2022, the two shields had cost the state some PLN 30 billion (€6.4 billion).

The stabilising expenditure rule has been modified again. In June 2022 the government adopted a bill that ties the future expenditure ceiling to the substantially higher actual inflation rate, rather than to the previous benchmark tied to the central bank's target of 2.5 per cent. The bill also introduced an investment clause that allows for the special treatment of public investment in green measures, digital transformation and energy security, effectively allowing for higher investments in those areas. Poland committed to increasing its military spending to 3 per cent of GDP in 2023, above the North Atlantic Treaty Organization (NATO) requirement of 2 per cent. The general government deficit is expected to widen from 1.9 per cent of GDP in 2021 to 4.7 per cent in 2022, according to the draft 2023 budget law, driven by higher public spending related to the anti-inflation shields and the extension of Polish Deal tax cuts (see below), as well as increased defence spending and cost of hosting refugees from Ukraine, estimated to cost 0.5 per cent of GDP in 2022. So far, public debt remains moderate, at an estimated 52 per cent of GDP in 2022.

The short-term outlook is highly uncertain. Although the economy grew strongly in the first half of 2022, it has lost momentum in the second half of the year, as historically high inflation has negatively affected households' disposable income, weighing on consumption and confidence. We, therefore, forecast economic growth to reach 4.0 per cent in 2022, dropping to 1.5 per cent in 2023, on the assumption of continued war in Ukraine, further monetary tightening and a deteriorating external environment. On the positive side, the inflow of Ukrainian refugees and loose fiscal policy will continue to stimulate private consumption.

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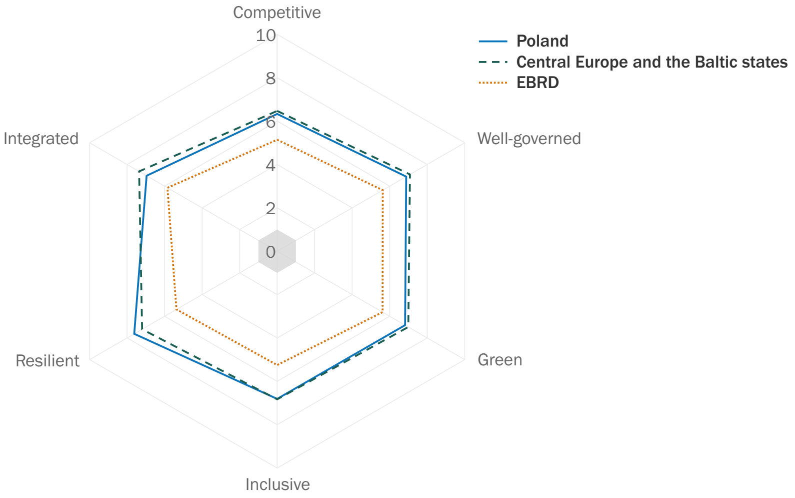
CHART Assessment of transition qualities (1-10)



Structural reform developments

Mortgage borrowers can seek loan holidays amid increased interest rates. In response to the sharp rise in inflation, in July 2022 the Polish president signed into law a borrower support package that allows for eight months' worth of credit holidays (four months in 2022 and four in 2023) for all zloty mortgage borrowers using a property for their own purposes. The Polish Bank Association (ZBP) expects between 85 and 95 per cent of those eligible, out of 2.1 million outstanding loans, to apply for the package, which is designed to have no impact on the evaluation of a borrower's creditworthiness. According to the central bank, the aggregate cost to banks will be some PLN 20 billion (€4.2 billion) in 2022-23, assuming a 100 per cent participation rate. Up to October 2022 the actual participation rate was 65 per cent.

Households can seek one-off heating subsidies, including for coal, and the tariff liberalisation of natural gas has been postponed. The president signed into law two heating subsidy bills in August 2022 amid energy price hikes. The first subsidy package is a one-off payment of PLN 3,000 (€635) for those who use coal for heating, while the other package ranges between PLN 500 (€105) and PLN 3,000 (€635) for sources of heating other than coal. It is hoped that the subsidies will cover about 40 per cent of expected energy price hikes. The PLN 11.5 billion (€2.4 billion) coal subsidy will be financed off budget from the Covid-19 countermeasure fund, which will be supplemented by some PLN 9.6 billion (€2 billion) of NBP profit in 2021. The non-coal subsidy is expected to cost PLN 9.5 billion (€2 billion) from October 2022 to April 2023. Also, the government currently envisages introducing special electricity price measures for households as well as small and medium-sized enterprises, which will freeze energy prices for a given consumption level and put a cap on them once this level is surpassed. Since Russia cut off the natural gas supply to Poland in April 2022, the country has been diversifying its energy sources. In August 2022 all gas storage facilities were filled to almost 100 per cent (about 3.2 billion cubic meter (bcm)). Poland consumes 20-21 bcm of natural gas annually, with domestic production at some 4 bcm, while 16 bcm can be imported through the newly opened Baltic Pipe (from Norway) and the liquefied natural gas (LNG) terminal in Swinoujscie. Natural gas tariff liberalisation has been postponed from 2024 to no earlier than 2027.

Consolidation of the fuel and energy sectors has gained momentum. In July 2022 the government approved the final merger of state-controlled fuel giants PKN Orlen and Lotos, as part of the consolidation of the fuel and energy sector with state-owned gas giant PGNiG. According to the government, the mergers are expected to improve energy security and improve operational efficiency in areas such as drilling and refining. Furthermore, according to the authorities, such a national champion would be in a better position to compete on the market, as the new concern would become one of the biggest integrated petrochemical producers in Europe by 2030.

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The ongoing disagreements between the government and the European Commission over judicial reform in Poland have caused the withholding of fund disbursements under the RRF. In September 2022 the government signed a financing agreement for the RRF funds with the European Commission. However, the unlocking of funds is conditional on Poland's prior and satisfactory fulfilment of the established milestones and targets, notably, those related to judicial reform. In the Commission's view, the legislative actions implementing the established milestones and targets into the Polish legal order by Poland have not gone far enough to enable the disbursement of funds. The national plan is based on €23.9 billion in grants and €11.5 billion in loans and, in addition to the green and digital transition, foresees strengthening health-sector capacity and supporting businesses in their post-Covid-19 pandemic recovery.

The Polish Deal tax reform was further revised. In June 2022 the president signed into law a modified and extended version of the Polish Deal tax bill. The altered law sees the personal income tax rate being cut from 17 per cent to 12 per cent, effective July 2022, and makes further modifications to tax thresholds, so that no group loses out (as was the case with the bill's first iteration, which entered into force in January 2022). Other solutions have also been introduced, including a division of the tax-reducing amount between up to three payers. Some 13 million taxpayers are expected to benefit from the programme, which is estimated to cost PLN 15 billion (€3.2 billion) over two years.

Romania

Highlights

- **The Romanian economy was resilient in the first half of 2022.** After finishing 2021 on a high note, gross domestic product (GDP) growth reached 5.7 per cent year on year in the first half of 2022, driven by strong domestic demand, despite rising headwinds. The currency remained stable in the face of rising inflationary pressures.
- **The government extended its intervention in the energy market in September 2022.** As the previous iteration of the energy price cap brought fiscal uncertainty, the state will regulate the energy market until October 2023 by levying windfall taxes on all market participants.
- **Justice system reform has commenced amid Recovery and Resilience Plan (RRP) milestones.** The government adopted revised justice laws in August 2022, in addition to accompanying operational strategies, but parliamentary approval is pending.

Key priorities for 2023

- **Energy crisis support for households should be targeted at the vulnerable.** The energy price cap introduced in April 2022 has come at a high cost to the government, complicating much-needed fiscal consolidation efforts. This is why support needs to be targeted and tied to incentives to decrease energy consumption.
- **RRP implementation should be prioritised as the main reform instrument.** The authorities included a comprehensive set of reforms and investments in the RRP, presenting an opportunity for structural reforms that should be grasped firmly, with a particular focus on implementation and disbursement.
- **The government should accelerate improvements in the rule of law.** Delays in the revision of the justice laws since 2019 have prompted the European Union (EU) to keep the Cooperation and Verification Mechanism in place. Moreover, further reforms are needed to strengthen anti-corruption measures and media independence.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	6.0	3.9	-3.7	5.1	5.4
Inflation (average)	4.1	3.9	2.3	4.1	13.3
Government balance/GDP	-2.8	-4.3	-9.2	-7.1	-6.4
Current account balance/GDP	-4.6	-4.9	-4.9	-7.3	-8.4
Net FDI/GDP [neg. sign = inflows]	-2.4	-2.3	-1.3	-3.7	-2.5
External debt/GDP	48.5	49.0	57.6	57.3	n.a.
Gross reserves/GDP	17.9	16.7	19.3	19.1	n.a.
Credit to private sector/GDP	25.4	24.3	25.5	26.3	n.a.

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Macroeconomic developments and policy response

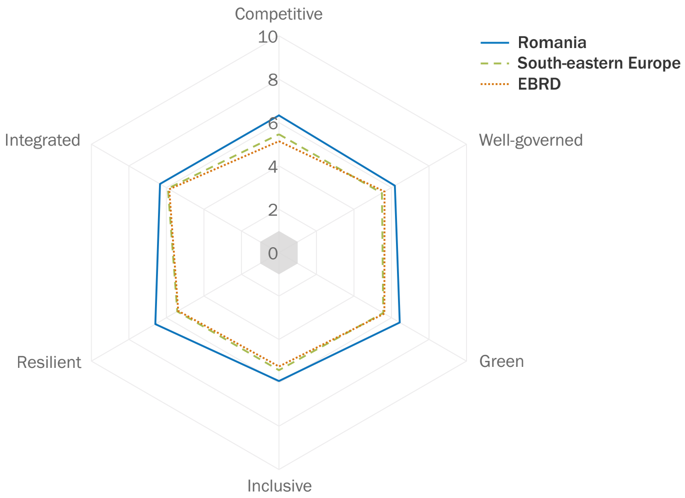
The economy has performed well so far in 2022, but is coming under increasing pressure. After a rebound of 5.1 per cent in 2021, mainly driven by strong private consumption, GDP expanded 6.4 per cent year on year in the first quarter and 5.1 per cent year on year in the second quarter of 2022. The buoyant private consumption of services, in particular, as well as fiscal stimulus and an inventory build-up contributed to growth. In the second half of the year, high inflation, deteriorating financing conditions and an uncertain global outlook are weighing more on consumers and, hence, overall economic growth.

Inflation plateaued at 15 per cent in summer 2022, triggering monetary tightening. The sharp rise in inflation in 2022 has been driven mainly by food and energy prices since the start of the war on Ukraine, but has shown signs of stabilisation since June, although it again accelerated in September 2022 to 15.9 per cent. Inflation depressed real wage growth to an average 0.2 per cent in the first half of 2022, as nominal wages rose at a double-digit rate. The National Bank of Romania raised the policy rate to 6.25 per cent in October 2022. It has also intervened in the secondary market for sovereign debt and has held a tight grip on the RON/EUR rate. The lack of RON liquidity on the market has led to increased financing costs, significantly above the policy rate.

Unforeseen expenses and weaker economic growth are threatening fiscal consolidation. The August 2022 budget revision maintained the government's fiscal deficit target for the year at 5.8 per cent of GDP, although the Fiscal Council expects the cash-based deficit to reach 7 per cent of GDP. Budget execution for the first half of the year was favourable, with the deficit reaching just 1.7 per cent of GDP. Considerable uncertainty surrounded the cost of capping electricity and gas prices for one year, which has not been fully budgeted; some estimates placed the costs at 3 per cent of GDP. The government modified its main energy measure in September 2022 and extended the price cap to October 2023, along with windfall taxes on all energy market participants, subject to adoption by parliament. A controversial provision includes limits on energy exports, which goes against EU regulations. Other support measures announced by the government include social support – one-off payments to pensioners and payments every two months to vulnerable families – as well as options to defer loan payments, along with extended state aid and credit guarantee schemes for small and medium-sized enterprises and companies in agriculture, production and construction.

The economy remains resilient, but the short-term outlook is highly uncertain. Taking into account the strong economic performance of the first half of 2022, we forecast GDP growth for the year as a whole at 5.4 per cent, but with significant downside risks depending on developments in the second half of the year. Deteriorating savings and income, lower credit demand and the weak performance of Romanian industrial production and exports all suggest a drop in GDP growth to 1.9 per cent in 2023. From an energy security standpoint, Romania largely relies on domestic production, which could help shield it from a shutdown of gas imports, but the spillover effects of any eurozone recession would still be considerable.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

Legislation has been introduced to improve governance and policymaking. In March 2022 the government adopted two acts introducing new methodologies for implementing government strategies and institutional strategic plans, including guidelines for the *ex ante* and *ex post* impact evaluation of policies. In April 2022 the government adopted another executive order devising methodology for the better elaboration and monitoring of budgetary programmes, all of which are included in the RRP milestones. The challenge now lies in the application of these guidelines to ensure quality policymaking.

The government has accelerated work on improving the rule of law, albeit with shortcomings. In addition to approving changes to the three central laws that form the justice laws in August 2022, the government, as part of the RRP, also adopted an anti-corruption strategy 2021-25 in December 2021 and a strategy for the development of the justice system 2022-25. A more difficult milestone has been the transposition of EU Directive 2019/1937 on whistle-blower protection. Civil society groups have argued that these amendments have weakened the position of whistle-blowers by removing both the presumption of good faith and the possibility of anonymous reporting of suspected fraud. The President has sent the law back to parliament for re-examination.

Pension reform is under way. As part of the RRP, the authorities agreed to conduct a comprehensive reform of the pension system, mainly to ensure fiscal sustainability. A first step was taken in early 2022, when the government approved the decision to increase the contribution of employees to the second pension pillar from 3.75 per cent to 4.75 per cent, starting in 2024. The Authority for Fiscal Stability approved complementary acts to digitalise the second pillar and diversify investments, but stakeholders have criticised the decision to exclude investments in private equity funds. The authorities have committed to proposing a comprehensive reform of the pension system by the end of 2022.

The governmental cloud project has started, but the schedule has been delayed. The implementation of the governmental cloud is the central element of the digitalisation component of the RRP. However, the first step, to form a working group tasked with defining the scope of the reform, was delayed until the middle of 2022. In June 2022 the government adopted an emergency ordinance on the governance of the public-sector cloud and a law on interoperability. In conjunction, it adopted a cybersecurity strategy for 2021-26.

School dropout rates are being tackled. Romania recorded the highest share of early school leavers in the EU in 2021 (at 15.3 per cent) and this remains a key problem in the educational system. In response, a government decision on implementing a national programme to reduce school dropout rates was adopted at the end of 2021. The project has two main dimensions: first, RRP funding will allocate resources to schools in vulnerable areas, where the share of early leavers is high, and, second, grants will be offered to pupils at risk of not going to high school. School selection will be conducted through a mechanism that considers five key indicators related to educational outcomes.

EU financial institutions will support Romania in channelling RRP funds to the economy. In May 2022 the European Investment Bank (EIB) said that, together with the Romanian Ministry for EU Investment and Projects, it had created a €300 million fund of funds for on-lending under the RRP. The EIB will manage the fund and provide direct and intermediated on-lending to Romanian schemes in line with outlined priorities. This complements the agreement signed with the European Investment Fund (EIF) in December 2021 for the implementation of equity instruments worth €400 million, in addition to the implementation of guarantee instruments worth €500 million under the InvestEU programme. The instruments should be launched in the second half of 2022 and will be injected into the banking sector, which will channel most of the funds to the economy, in early 2023.

The government has launched support schemes to improve the energy efficiency of buildings. A key green measure devised in the RRP is a support scheme for renovation and integrated energy and efficiency renovation, including the seismic strengthening of multi-family residential buildings and public buildings. The government also held a call for tenders on a €595 million scheme of wind and solar investments, which closed in May 2022.

Russia*

Highlights

- **The economy has been hit hard by sanctions but has also shown resilience.** The impact of the sanctions imposed by many countries after Russia's invasion of Ukraine has been mitigated by the significant buffers built up since 2014 and by the high global prices of oil and gas.
- **Policy response has helped to keep inflation in check.** The sanctions initially caused the rouble to depreciate heavily but the authorities' response – notably capital controls and sharp rate hikes by the central bank – resulted in a strong recovery of the rouble to above pre-invasion levels.
- **Structural reforms have largely stalled.** The increased isolation of Russia is already having a negative impact on productivity and growth, and the authorities' focus on the ongoing war has meant that much-needed reforms have been delayed or halted.

Key priorities for 2023

- **The priority for Russia is to end hostilities and seek to re-establish itself as part of the global economy.** Such a step seems unlikely in the short term, as the country has become increasingly isolated since the annexation of Crimea in 2014, and all the more so since the invasion of Ukraine in February 2022.
- **Beyond the conflict, reducing the role of the state would help boost growth, entrepreneurship and the competitiveness of the private sector.** From a structural perspective, the Russian economy suffers from a lack of diversification, being heavily dependent on commodity exports, with a dominant public sector and a challenging business environment.
- **Efforts are needed to promote innovation, digitalisation and technology development.** Such a programme would improve the productivity of the private sector and foster the growth of the manufacturing and services sectors. However, the loss of vital technology imports as a result of sanctions has seriously impacted the manufacturing sector, and the domestic development of alternatives will take time and are likely to be inferior.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	2.8	2.2	-2.7	4.7	-5.0
Inflation (average)	2.9	4.5	3.4	6.7	14.0
Government balance/GDP	2.9	1.9	-4.0	0.7	-2.3
Current account balance/GDP	7.0	3.9	2.4	6.9	12.2
Net FDI/GDP [neg. sign = inflows]	-0.5	-1.9	-0.6	-2.3	n.a.
External debt/GDP	28.5	28.7	32.2	27.1	n.a.
Gross reserves/GDP	28.4	32.8	40.4	38.4	n.a.
Credit to private sector/GDP	51.2	52.6	59.8	55.0	n.a.

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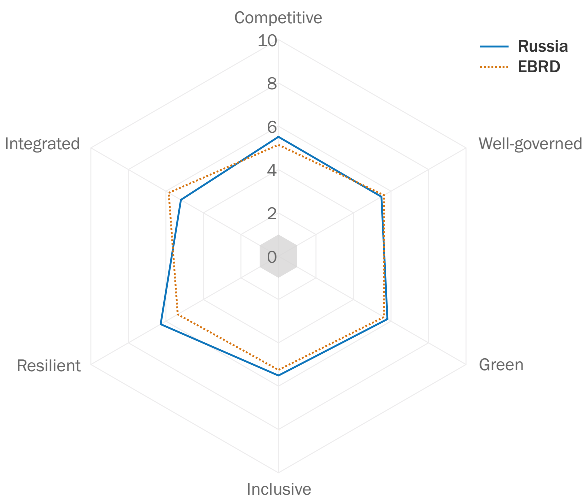
Macroeconomic developments and policy response

Russia's decision to invade Ukraine on 24 February 2022 resulted in the gradual imposition of widespread sanctions. The sanctions went much further than many had anticipated. Russia soon found itself cut off from much of the international financial system, with more than half of the central bank's international reserves being frozen. Other measures included: an embargo on exports to Russia of critical technological components, including semiconductors, and the direct sanctioning of more than 1,200 individuals. Beyond this, Russia has seen the withdrawal of more than 1,000 multinational companies in a form of self-sanctioning. Sanctions have also been imposed on the energy sector but these have been more limited initially, because some sanctions will not take effect before 2023 and Russia has been able to redirect exports to non-sanctioning countries. The economic impact has been significant, with gross domestic product (GDP) contracting 4 per cent year on year in the second quarter of 2022, the rouble depreciating by almost 50 per cent to more than 130 roubles per US dollar and inflation doubling to almost 18 per cent. However, after the initial shock of sanctions, the rouble rallied, and its October 2022 level of around RUB60/US$ is stronger than in the months before the invasion. This rally reflects the dissipation of the initial shock, the introduction of capital controls and the rise in the current account surplus as imports have collapsed and energy exports have continued to flow at high global prices.

Inflation has been brought under control. The central bank (CBR) was quick to respond to the inflationary impact of sanctions, hiking the policy rate from 8.5 per cent to 20.0 per cent over the course of a month. The subsequent strengthening of the rouble has had a disinflationary impact, helping to bring inflation back down to 13.7 per cent in September 2022, and weak consumer demand is likely to damp inflation further in the coming months.

The growth outlook is bleak. The impact of sanctions on activity has been severe, albeit not as bad as expected because of the CBR's policy response, the country's strong fiscal buffers and the resilience of the energy sector. But as far as the non-oil economy is concerned, in particular those sectors dependent on foreign imports, things look less positive. The economy is expected to contract by 5.0 per cent in 2022 and by 3.0 per cent in 2023. The growth outlook is likely to remain bleak in the absence of a peace agreement that results in a loosening of sanctions, and the economy's shift towards autarky and the loss of qualified workers to emigration mean that long-term growth potential will remain significantly eroded.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

Structural reform has been extremely limited in 2022. Russia's war on Ukraine has left the country isolated and barred from accessing much western technology. This is hindering the country's ability to diversify away from oil.

Implementation of the National Projects scheme has slowed significantly. The ongoing conflict has resulted in a diversion of government expenditures, hampering progress in implementing the National Projects, a series of 13 large-scale infrastructure and social development projects set out by the president in 2019.

The authorities continue with their comprehensive review of business regulations, known as the "regulatory guillotine". This involves a review of more than 20,000 business regulations and requirements. Many regulations, some of which date back to the Soviet era, are being cancelled or replaced based on cost-benefit analysis. The scheme is expected to improve the business environment by cutting red tape and aligning regulations more closely with the needs of businesses.

* The EBRD announced on 4 April 2022 that, following the invasion of Ukraine, its Board of Governors had formally suspended Russia's access to EBRD funding for projects or technical cooperation.

Serbia

Highlights

- **The economic recovery is slowing.** Domestic and external pent-up demand pressures resulted in strong, broad-based expansion in 2021, but Serbia's growth performance has been more moderate in the first half of 2022.
- **Key infrastructure improvements are advancing.** These include the high-speed railway, broadband in rural areas, the gas interconnector with Bulgaria, the modernisation of one of Europe's biggest landfills and the airport in Belgrade.
- **The energy sector is at a crossroads.** An energy crisis is affecting the country as structural vulnerabilities in domestic electricity production have come to light amid surging global energy prices. The authorities rolled out a set of short-term coping measures, while strategic plans are being developed.

Key priorities for 2023

- **The energy sector should be reformed with both immediate and long-term goals in mind.** As power production from coal proves undependable and expensive in light of domestic production weaknesses and the European Union (EU)'s forthcoming carbon border adjustment mechanism, the development of renewables should be accelerated by the adoption and implementation of the new regulatory framework. This should take place in tandem with the reform of state-owned enterprises (SOEs) in the sector and the finalisation of key strategic documents outlining the decarbonisation vision.
- **SOE reform needs to progress.** In line with the adopted action plan on state ownership policy, SOE reform should be stepped up to improve productivity and contain fiscal risk. Among the key measures needed are the centralisation of ownership, a unified legal framework and strengthened governance requirements.
- **The business environment needs improvement.** The playing field should be levelled for small and medium-sized enterprises (SMEs) and large foreign investors by streamlining business procedures and consistently applying legislation. The rule of law and the fight against corruption should be strengthened.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	4.5	4.3	-0.9	7.5	3.3
Inflation (average)	2.0	1.7	1.6	4.1	11.5
Government balance/GDP	0.8	0.0	-7.2	-3.3	-2.8
Current account balance/GDP	-4.8	-6.9	-4.1	-4.3	-8.4
Net FDI/GDP [neg. sign = inflows]	-7.4	-7.7	-6.3	-6.9	-4.8
External debt/GDP	62.2	61.4	65.8	68.4	n.a.
Gross reserves/GDP	26.3	29.1	28.8	30.9	n.a.
Credit to private sector/GDP	41.4	42.0	45.5	43.5	n.a.

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Macroeconomic developments and policy response

Growth has moderated in 2022. The 7.5 per cent gross domestic product (GDP) growth of 2021 was broad based, reflecting pent-up domestic demand pressures and a rebounding external sector. Growth continued at a more moderate pace of 4.3 per cent and 3.9 per cent year on year in the first two quarters of 2022, respectively. As inflation accelerated and real wage growth muted, the expansion of household consumption slowed from 7 per cent in the first quarter to 4 per cent in the second quarter of the year. Investment growth remained moderate throughout the period as construction output contracted. Imports surged in the first quarter due to high volumes of electricity imports, slowing to a more moderate expansion in the warmer second quarter of the year when export growth (20 per cent year on year) overshot import growth. The expansion of services, leading growth on the production side, moderated in the second quarter in line with lower household demand and retail trade output. This effect was partially offset by an increase in industrial activity which posted 5 per cent growth on the year in the second quarter, compared with 2 per cent in the first quarter.

Inflation has surged and the current account deficit has widened on energy imports. With food and, to a lesser extent, oil prices rising sharply, inflation had already been at the upper end of the central bank's target band from May 2021, overshooting it in September 2021. Since then, consumer price inflation has continued to rise, reaching 14 per cent year on year in September 2022. The increase in food prices is caused by rising import prices, coupled with poor weather conditions, which had a negative effect on this year's harvest. Energy prices did not go up in Serbia during the winter of 2021-22 as SOEs and the state absorbed the impact of surging global prices, while there was a higher-than-usual volume of electricity imports, caused by a breakdown at a vital power plant and lower supply of domestic coal. These higher import volumes at elevated prices were reflected in the current account deficit, which increased threefold year on year in the first seven months of 2022.

The authorities employed policy measures to shield the economy. Price caps on basic foodstuffs were set at the end of 2021 and on oil in February 2022, followed by a reduction in excise duty. From March 2022, multiple temporary export bans were put in place; those on wheat, flour and sunflower oil have since been abolished, but those on certain types of fuel and capped-price wood pellets remained in place as of October 2022. Subsidies for flour producers were introduced in June 2022. In July the government decided to cover the price difference in gas imports (compared with November 2021) for wholesale suppliers over the winter from the state budget, banning gas exports for a month in October. Moderate electricity and gas price increases (6.5 per cent and 9.0 per cent respectively) were adopted ahead of the 2022-23 winter. The National Bank tightened monetary policy seven times during the first 10 months of 2022, increasing the historically low policy rate from 1 per cent in March to 4 per cent in early October.

The economy is expected to continue growing at a slower pace. Growth is projected at 3.3 per cent in both 2022 and 2023. Serbia is not immune to the indirect effects of the war on Ukraine. These include an expected slowdown in eurozone export markets, which would impact Serbia's large manufacturing sector, and rising food and energy prices on global markets, which will weigh on the budgets of households, utility SOEs and the state. The continuation of sizeable public investment bodes well for Serbia's economic outlook, but the protracted energy crisis will be a drain on fiscal resources.

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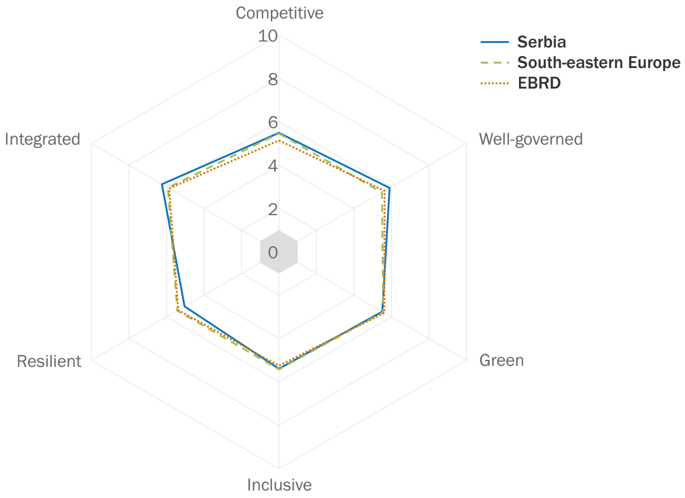
CHART Assessment of transition qualities (1-10)



Structural reform developments

EU accession negotiations are advancing, albeit slowly. After two years of stagnation, the end of 2021 saw the opening of Cluster 4 (green agenda and sustainable connectivity) of the EU *acquis communautaire*, comprising four negotiating chapters, bringing the total number of opened chapters to 22 out of 35. However, no new chapters have been opened in 2022. According to the European Commission, the future speed of negotiations will depend, among other things, on the pace of reforms with regard to the rule of law, as well as on progress on the normalisation of relations with Kosovo. The European Commission expects Serbia to align its foreign policy with the common foreign and security policy of the EU, including restrictive measures against Russia.

The energy sector is in crisis-management mode. Energy security concerns have increased as high global energy prices and geopolitical uncertainty caused by the war on Ukraine have intersected with vulnerabilities in domestic electricity production. High import volumes at high prices in the winter of 2021-22 raised costs for the utility SOEs and the state budget. The regulator approved a 9.0 per cent hike in the price of gas and a 6.5 per cent increase in the electricity price from August and September 2022, respectively. To ensure adequate coal reserves, the electricity SOE, EPS, signed import contracts in May and June 2022 with coal mines from Montenegro, Bulgaria and Bosnia and Herzegovina. While Serbia secured a new bilateral three-year contract to source the bulk of its gas supply from Russia at an oil-indexed price in May 2022, a significant share of gas continues to be bought on the market, weighing on the energy balance. Construction on a gas interconnector with Bulgaria began in February 2022 in an effort to diversify gas sources. To better manage gas demand in the peak winter months, the government reached an agreement with its Hungarian counterpart in March 2022, ensuring up to 500 million cubic metres of additional gas storage space in Hungary for the coming winter. Strategic energy documents, such as the National Energy and Climate Plan (NECP) and the National Energy Strategy, are expected to whet appetites for the development of renewables and to carve out the energy transition pathway.

Infrastructure improvements continue. A 75 km high-speed railway line, allowing trains to travel at up to 200 km per hour and connecting two of Serbia's biggest cities, Belgrade and Novi Sad, opened for passengers in March 2022. The stretch is the start of an ongoing project to connect Belgrade with Budapest as part of the Chinese government's Belt and Road Initiative. Other significant ongoing projects include the roll-out of ultra-fast broadband in rural areas, large public-private partnership projects to modernise Belgrade's airport, and for Vinca, previously one of Europe's biggest unmanaged landfills, to include a waste-to-energy facility. The construction of a gas interconnector between Serbia and Bulgaria started in February 2022.

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Capital markets development has been advanced. The Law on Capital Markets was adopted in December 2021, aligning the domestic legal and institutional framework further with the EU *acquis* in terms of increasing transparency and offering greater investor security guarantees, while also developing the offering of financial instruments on the market. Serbia had previously joined the Clearstream network in October 2021, enabling foreign investors to directly settle dinar-denominated government bonds. In January 2022 Serbia signed an agreement with Euroclear on the creation of a Euroclearable link once appropriate market conditions have been established.

A new model of fiscalisation has been introduced. Following the adoption of the amended Law on Fiscalisation in September 2021, the end of April 2022 was set as the deadline for implementing the new model, which introduces the use of electronic fiscal devices connected to the internet, making data immediately available to the Tax Administration. The new model aims to reduce the administrative burden, support revenue collection and help the authorities to reduce the size of the informal economy.

Amid incremental progress on SOE reform, broader public-sector adjustment has been delayed. A consolidated list of SOEs owned by the central government was developed and made public in December 2021, in a first step towards implementing the country's SOE reform plan. A new wage system that introduced pay grades to the public sector was set to come into force 2022, but was postponed to 2025 in December 2021, with the pandemic cited as the reason. The implementation of pay grades has been delayed several times since the original deadline of 2019.

Support for SMEs has been scaled up. A set of decrees adopted at the beginning of 2022 set aside RSD 2.5 billion (some €21 million) in financial support for SMEs, start-ups, and women and young entrepreneurs.

Slovak Republic

Highlights

- **The war on Ukraine has held back the economic recovery from Covid-19.** While its direct exposure to trade with Russia and Ukraine is modest, the Slovak Republic is heavily exposed to disruptions in Russian energy imports and mounting import costs, which have already hit the supply side of the economy.
- **Energy supplies have been enhanced by various policy measures.** A government memorandum has sheltered households from heavy electricity price increases until the end of 2024. Industry will be excluded from the mandatory European Union (EU)-wide gas consumption cuts and is exempt from the Russian oil embargo until a fully-fledged alternative can be found.
- **The first EU Recovery and Resilience Facility (RRF) payments have been disbursed.** The payments span 14 partial milestones, including reforms of the judiciary, higher education, energy and transport sectors, digitalisation of the public sector and the fight against corruption.

Key priorities for 2023

- **Administrative capacity needs to improve, especially at local level, to increase EU funds absorption.** The planned investments from the RRF amount to 6.5 per cent of gross domestic product (GDP), but the low absorption rate of the 2014-20 European Structural and Investment Funds highlights the current lack of capacity.
- **Energy security should be enhanced.** The immediate priorities are to bring about greater energy savings in the industry and residential heating sectors and to reduce the country's reliance on fossil-fuel imports.
- **Availability of affordable and quality childcare should be increased.** The gender employment gap is close to the EU average, but is significantly higher for women of childbearing age, in part because of the limited use and availability of formal childcare for children under the age of three.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	4.0	2.5	-3.4	3.0	2.0
Inflation (average)	2.5	2.8	2.0	2.8	12.0
Government balance/GDP	-1.0	-1.2	-5.4	-5.5	-4.0
Current account balance/GDP	-2.2	-3.3	0.4	-1.9	-3.7
Net FDI/GDP [neg. sign = inflows]	-1.3	-2.3	2.0	0.3	0.0
External debt/GDP	114.8	112.2	120.5	137.0	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	62.4	63.2	67.1	68.2	n.a.

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Macroeconomic developments and policy response

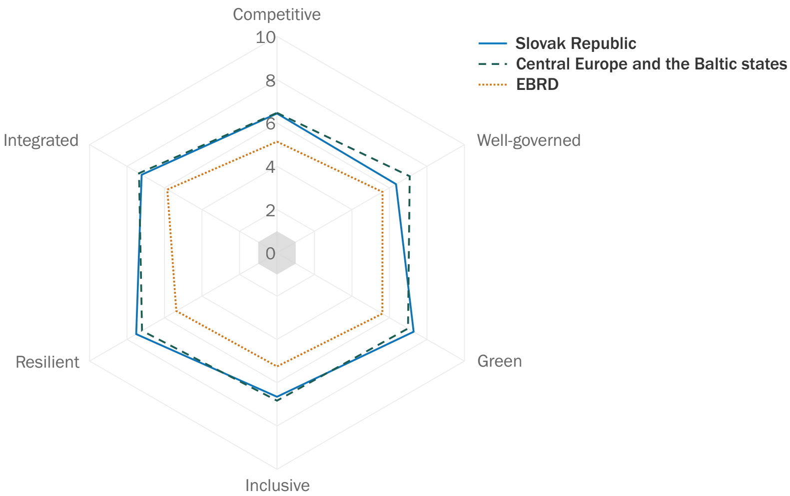
The war on Ukraine has damaged the economy, preventing a full recovery from the Covid-19 pandemic. GDP grew 3.0 per cent in 2021, mostly driven by strong household consumption and government spending. While its direct exposure to trade with Russia and Ukraine is modest, the Slovak Republic is heavily exposed to disruptions in Russian energy imports and the mounting import costs that have adversely affected the supply side of the economy. As a result, GDP growth slowed to 2.1 per cent year on year in the first half of 2022, propped up largely by high household consumption. Despite the slowdown, however, the labour market remains tight, with several sectors facing labour shortages. The unemployment rate dropped to 5.9 per cent in September 2022. But the jobless rate among the low-skilled, at 41.7 per cent in the second quarter of 2022, is the highest in the EU, while the share of long-term unemployed also remains high, at 64.4 per cent in the second quarter of 2022 of all unemployed persons.

High energy and food prices are fuelling inflationary pressures. In the middle of 2022 the harmonised index of consumer prices (HIPC) inflation rate exceeded 12 per cent year on year, not just because of rising food and energy prices, but exacerbated by supply-chain disruptions. Nominal wages are failing to keep up with prices and the resulting decline in households' real incomes is depressing consumption. In June 2022 parliament passed a €1.2 billion anti-inflation package of support, including child benefits and one-off payments to selected vulnerable groups. However, part of this decision overrode a veto by the president who, in July 2022, sent the bill to the Constitutional Court to examine its constitutionality.

Pandemic and war-related spending have led to pressure on public finances. The general government deficit widened from just 1.3 per cent of GDP in 2019 to 6.2 per cent in 2021. At the same time, general government gross debt jumped to 63.1 per cent of GDP. Fiscal buffers are expected to be rebuilt once the economy is on a solid growth path. The anticipated impact of fiscal consolidation on investment is likely to be offset by a higher EU funds inflow, including from the RRF, to be disbursed by the end of 2026.

Disruptions to Russian energy imports, mounting import costs and persistent supply-chain problems will weigh on GDP growth in the short term. On the upside, accelerated investments that engage RRF funding, as well as new capacity investments in the automotive sector, are likely to outweigh the negative factors associated with the war. On balance, therefore, we forecast GDP growth to slow to 2.0 per cent in 2022 and just 1.0 per cent in 2023.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

Households are sheltered from large electricity price increases until the end of 2024. The government signed a memorandum with the dominant power utility, Slovenske Elektrarne, in February 2022 to maintain the electricity price for households at €61.21 per megawatt hour, excluding distributional fees, the level when the memorandum was signed. According to the network industries regulator, without such a memorandum, the regulated electricity price for households could increase, on average, by more than 200 per cent in 2023. At the same time, two nuclear reactors in Mochovce are expected to start operating in 2022 and 2024 (on top of two plants already in place). Currently, the share of electricity produced by nuclear power plants is 55 per cent.

Oil supplies from Russia will continue to flow until a fully-fledged alternative is found. While the Slovak Republic supports the EU's June 2022 embargo on imports of crude oil and refined oil products from Russia, it is allowed to use Russian oil until it can be replaced. However, all countries benefiting from this exemption – Hungary, the Czech Republic and the Slovak Republic – will not be able to resell crude oil and petroleum products to other EU Member States or third countries. The Slovak Republic is fully dependent on Russian oil suppliers, and a change to the processing of lighter oil could take three years, according to the government.

Industry will be excluded from mandatory EU-wide gas consumption cuts when activated. The government negotiated several exemptions from the mandatory 15 per cent gas consumption cut regulation passed by the EU Energy Council in July 2022. The mechanism will be triggered when at least five EU countries have declared a state of emergency driven by disruptions to gas supplies from Russia. Industry will be excluded from the reduction in natural gas demand and the country has been granted a more favourable reference period for savings, namely, just the last year rather than the average of the last five years. The EU will also take into account the level of storage facilities, which exceeds the requisite 80 per cent total capacity threshold. In August 2022, 65 per cent of the total natural gas demand of the state-owned gas utility, SPP, was covered by non-Russian sources.

The first RRF payments have been disbursed. The European Commission had disbursed about €460 million to the Slovak Republic as of July 2022, including the pre-financing tranche of October 2021. The payment covers 14 partial milestones, including reforms of the judiciary, higher education, energy and transport sectors, digitalisation of the public sector and the fight against corruption. The overall plan includes 18 thematic milestones and is worth €6.3 billion in grants. In contrast, the absorption of the 2014-20 EU funds is slow, at almost 60 per cent as of the end of June 2022, holding back short-term growth potential.

The poor availability of affordable rental housing is being addressed. In July 2022 the government established a state agency to support rental housing. Four financial groups are considering allocating €6 billion into the construction of about 40,000 rental flats. Rents are expected to be 30 to 40 per cent lower than commercial rents, depending on the region. According to the European Commission, the low availability of affordable rental housing remains a challenge in addressing social exclusion. EU Statistics on Income and Living Conditions data show that the share of households living in rental flats owned by the public sector in the Slovak Republic, at 1.6 per cent, is substantially lower than the EU average of about 11 per cent. However, the overall lack of housing supply still persists and is connected to structural issues, especially institutional drawbacks and red tape.

A new factory is set to be built for the production of electric cars. Swedish car maker Volvo Cars will build a new €1.2 billion plant for the production of electric cars near Kosice. The construction of the plant is scheduled to kick off in 2023, with car production to be launched in 2026. The facility is expected to be in line with the highest global standards of energy and environmental efficiency. It will produce up to 250,000 cars annually and create more than 3,000 jobs in the region. This will be the fifth carmaker in the country, joining Volkswagen Slovakia in Bratislava, Stellantis in Trnava, Kia Motors near Zilina and Jaguar Land Rover in Nitra. The latter plans to expand its production of a new car this year, which is expected to create 700 new jobs. In 2021 there were 184 personal vehicles produced per 1,000 inhabitants in the Slovak Republic, the highest number per capita globally.

Slovenia

Highlights

- **The economy maintained its growth momentum in the first half of 2022, despite rising headwinds.** After an 8.2 per cent recovery in 2021, gross domestic product (GDP) expanded 8.8 per cent year on year in the first half of 2022 as domestic demand remained buoyant.
- **A cap on electricity prices is in place.** The cap was introduced in September 2022 and will last for one year. It comes alongside a reduction in value added tax (VAT) on energy products for the 2022-23 heating season.
- **The government adopted a package of measures to advance digital transformation.** Following the prioritisation of digital use at government level, a set of 65 measures was devised in collaboration with relevant stakeholders in 2021 and 2022.

Key priorities for 2023

- **Long-term care act implementation has been delayed, but needs prioritisation.** Some stakeholders considered the act, approved last year, to be flawed and the new government has decided to amend it and delay its implementation by one year to January 2024. However, the reform is included in the Recovery and Resilience Plan (RRP) and should be pursued without further delay.
- **Green transition should accelerate amid the energy crisis.** The government has taken its first steps on green reforms included in the RRP. However, these reforms remain behind schedule, especially the act on promoting renewables, which prompted the European Commission to send a reasoned opinion on infringement in July 2022.
- **Capital market development needs an impetus.** The European Commission has supported a diagnostic study on capital market development bottlenecks, as banks remain the dominant source of firm financing. This should result in solutions to develop capital markets. The Alternative Investment Funds Forms Act, adopted in July 2022, and a capital market development strategy, are part of the RRP.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	4.5	3.5	-4.3	8.2	6.0
Inflation (average)	1.9	1.7	-0.3	2.0	8.9
Government balance/GDP	0.7	0.6	-7.7	-4.7	-3.7
Current account balance/GDP	6.0	5.9	7.6	3.8	-0.1
Net FDI/GDP [neg. sign = inflows]	-2.0	-1.6	0.3	-1.0	-1.5
External debt/GDP	91.8	90.2	101.6	97.3	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	43.0	42.2	43.4	41.4	n.a.

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Macroeconomic developments and policy response

Growth momentum has extended into the first half of 2022, despite rising headwinds. The strong carry-over effect from 2021 contributed to GDP expansion of 0.7 per cent quarter on quarter in the first quarter of 2022, which translated into 9.6 per cent year-on-year growth. GDP further surprised to the upside in the second quarter of 2022, expanding 0.8 per cent quarter on quarter and 8.2 per cent year on year, showing that the war on Ukraine had only limited immediate effect on the Slovenian economy. Domestic demand drove growth, although household consumption growth eased from 19.3 per cent year on year in the first quarter to 12.2 per cent in the second quarter of 2022. Goods exports showed signs of weakness, meanwhile, but services exports compensated, particularly in the second quarter as tourism stepped up. Import growth moderated significantly in the second quarter, most likely due to a normalisation of inventory build-up, leading to a positive contribution by net exports.

Inflation has accelerated notably since April 2022, prompting government measures to alleviate the impact. In August 2022 consumer prices increased 11 per cent year on year, driven by rising food and fuel prices, but eased in September 2022 to 10 per cent. Nevertheless, price pressures seem to be quite broad-based, although services have seen a more moderate increase. After a package of measures, adopted in February 2022, focused on subsidies to vulnerable households and tax cuts on energy products, a one-year cap on electricity prices was introduced in September 2022. This will mitigate potential inflationary pressures from energy prices this winter, but risks leading to higher inflation when it expires in September 2023. Other anti-inflationary measures include a cut in VAT on energy products for the 2022-23 heating season, from 22.0 per cent to 9.5 per cent. Three support mechanisms based on state-aid rules for firms, worth €40 million, were also confirmed and will remain in force until March 2023. Wage growth will have a disinflationary effect, as nominal wages declined 0.9 per cent in the first five months of 2022, driven by the removal of pandemic support for the public sector.

Phase out of pandemic support and strong economic activity improved the fiscal stance, but medium-term gaps remain. In addition to Covid-19 support measures of €4.9 billion (around 10 per cent of GPD) in 2020 and 2021, the government also adopted permanent fiscal loosening measures, including personal income tax cuts and public and minimum wage increases. Nevertheless, the cash-based deficit improved significantly from €1.9 billion in the first half of 2021 to just €128 million in the first half of 2022 as spending on pandemic support was significantly wound down, though investment spending increased 29 per cent year on year. The government aims to increase income tax relief only once, by €500, in 2023, rather than annually, as previously planned.

Growth will moderate as headwinds and downside risks intensify. Given its strong performance in the first half of 2022, GDP growth should reach a robust 6 per cent in 2022, albeit with significant downside risks. This assumes a slowdown in the second half of the year, as higher inflation, the normalisation of fiscal policy and negative real wage growth affect consumer confidence. Other downside risks are possible further energy and commodity price increases, while a potential halt to Russian gas imports would inflict additional damage. Nevertheless, Slovenia is in a better position than some of its peers thanks to its access to liquefied natural gas (LNG) through Croatia and its energy connection to Italy. GDP growth is likely to moderate to 1.8 per cent in 2023 due to this weaker momentum, deterioration in consumer confidence and shallow (or possibly negative) eurozone growth.

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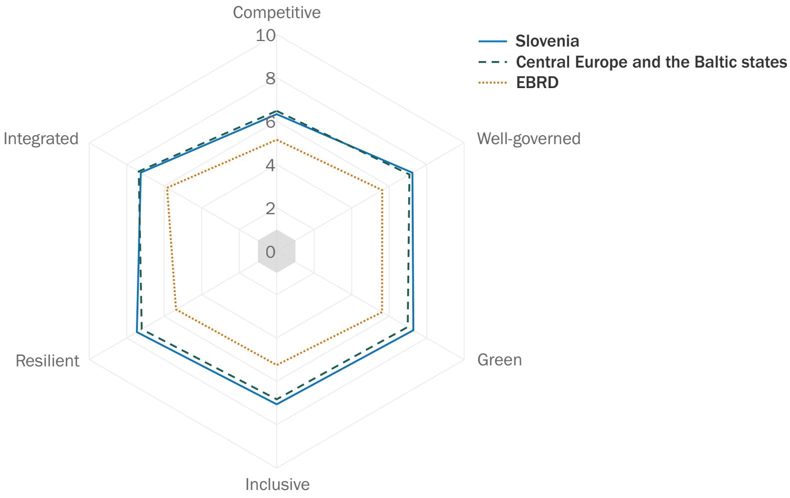
CHART Assessment of transition qualities (1-10)



Structural reform developments

Digital transformation efforts have intensified. Following the prioritisation of digitalisation at government level, a series of measures have been adopted in the past year as part of the RRP. The Strategic Council for Digitalisation recommended the adoption of 40 measures in 2021 (the first package of measures) and another 25 measures (the second package of measures) in March 2022 for the digital transformation of Slovenia. Among the measures already implemented are mandatory e-signature in state administration, an eHealth mobile app and a public tender for e-care for the elderly. The Digital Transformation Strategy for Enterprises was also adopted, a reform milestone in the RRP. In February 2022 the government also adopted a comprehensive bill to improve digital literacy, while a training programme to increase civil servants' digital skills should also commence as part of the RRP.

Reform of the national research, development and innovation (RDI) ecosystem has begun. The RRP foresees the establishment of a programme board in 2022 as part of a new governance model for the RDI system, merging the strategic and implementation levels into one unit. Related to this, the government adopted the Act on Scientific Research and Innovation Activity in November 2021. The main goals of the reform are to raise public spending for scientific research to 1 per cent of GDP, increase the quality of research and scientific output, attract international talent and offer more autonomy to research institutions.

The easing of the administrative burden has continued. Following the initiatives of the previous government in making Slovenia a more business-friendly environment in early 2021, the Act on Debureaucratisation was adopted in December 2021 as part of the RRP. The act repealed around 200 laws that were deemed obsolete. In addition, through the Stop Bureaucracy project, which enables the public to report perceived administrative obstacles, 312 out of 408 reported measures had been implemented by March 2022.

Investment promotion procedures were modified to better cover green and capital-intensive investments. Two amendments to the Investment Promotion Act were adopted in December 2021 and April 2022. The modifications expanded the categories of investment that can be covered by state aid, shifting the emphasis from job creation to capital-intensive and green investments. Related to this, the government adopted an amendment to the Public Procurement Act in 2021, which entered into force in January 2022, aimed at clarifying bidder selection and eliminating abnormally low offers that restrict competition. Another bill strengthens innovative public procurement.

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Lifelong learning and adult education will be strengthened. At the end of 2021 the government adopted a resolution on the National Adult Education Programme for 2022–30, which aims to raise the share of adults in lifelong learning, improve the level of basic and general skills of adults, and strengthen research and development in the field of adult education.

The Environmental Protection Act introduces new and comprehensive regulation in the area of waste management. The new act, adopted in March 2022, sets out basic rules for waste management, as well as the conditions and criteria for the end-of-waste status and the regulation of the extended producer responsibility system. Moreover, the act introduces provisions for reducing the impact of resource use and for improving overall resource efficiency, in line with the transition to a circular economy. Significant waste and wastewater investments are planned as part of the RRP.

Tajikistan

Highlights

- **The economy's post-Covid recovery is continuing apace.** Gross domestic product (GDP) grew 7.4 per cent year on year in the first half of 2022, with strong gains in all sectors. The impact of the war on Ukraine on the economy has been limited, as Russian demand for migrant workers and remittances peaked in the second quarter of 2022, and the country has also improved its external resilience by building up significant international reserves. With inflation at 5.7 per cent in September 2022, Tajikistan is the only regional economy to keep inflation within the central bank's target corridor.
- **Significant amendments to the tax code were put in place in late 2021.** To ease the burden on businesses, reduce informality and support the country's fiscal stance, the number of taxes was decreased from ten to seven and tax rates were reduced across the board. Further improvements and the digitalisation of tax services are envisaged to increase voluntary compliance and minimise corruption.
- **The inclusion agenda is advancing.** The authorities have introduced a new law on equality and the elimination of all forms of discrimination, appointed a Commissioner for Human Rights (ombudsman) and launched a new financial inclusion strategy.

Key priorities for 2023

- **Efforts to bolster food and energy security are required.** In light of export restrictions by neighbouring countries, the authorities should seek ways to diversify import routes. It is vital to ensure price stability by managing food reserves in line with best international practices, balancing market principles and the needs of vulnerable households.
- **The authorities should accelerate infrastructure investment.** The Tajik section of the CASA 1000 transmission line is expected to be completed by the end of 2022. The G7's Partnership for Global Infrastructure and Investment opens up new opportunities for Tajikistan to attract funding for the completion of the Roghun hydropower plant and other infrastructure projects.
- **Tajikistan should continue to improve its tax administration and broaden the tax base to create space for development projects without crowding out social spending or putting debt sustainability at risk.** Measures should include the adoption of a modern risk assessment methodology to guide audits, further simplification of tax reporting requirements, the harmonisation of tax and financial account reporting, the automation of selected taxpayer services, including the value added tax (VAT) refund system, and the gradual deployment of digital technologies, such as digital signatures.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	7.6	7.4	4.39	9.2	7.0
Inflation (average)	3.8	7.8	8.6	9.0	8.3
Government balance/GDP	-2.7	-2.1	-4.3	-0.7	-2.5
Current account balance/GDP	-4.9	-2.2	4.1	8.4	3.8
Net FDI/GDP [neg. sign = inflows]	-2.8	-2.6	-1.3	-0.4	-0.1
External debt/GDP	67.7	69.0	71.1	67.2	n.a.
Gross reserves/GDP	16.5	17.7	27.5	28.6	n.a.
Credit to private sector/GDP	11.9	11.6	13.0	9.7	n.a.

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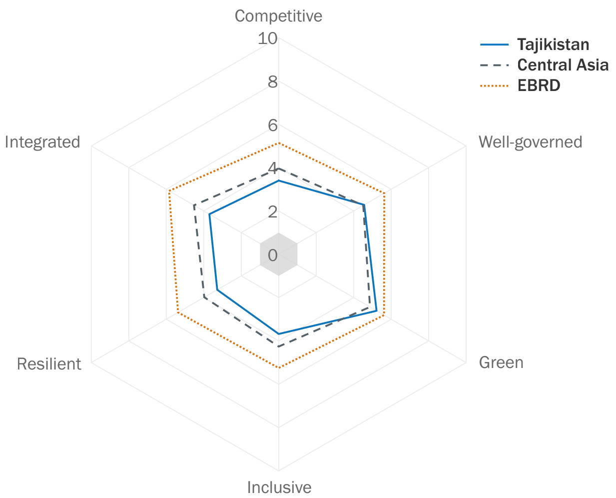
Macroeconomic developments and policy response

Economic growth remains robust. After expanding 9.2 per cent in 2021, the pace of GDP growth slowed marginally in the first half of 2022. An almost complete freeze on the export of precious metals and stones in January to April led to a significant drop in overall exports (down 38 per cent year on year). However, for the first half of 2022, industrial production, including export-oriented mining activities, grew considerably (up 17.3 per cent year on year), while the agriculture sector expanded 7.2 per cent. The rouble's strength and Russia's record demand for migrant workers supported consumer demand, resulting in higher imports (up 25 per cent year on year) and retail trade turnover (up 9.3 per cent year on year). Also, in the first seven months of 2022, Tajikistan saw an 85 per cent increase in imports from China, suggesting that the country is serving as a conduit for parallel imports to Russia. The Tajik somoni recovered almost fully to its pre-war value against the US dollar and appreciated significantly against the euro. Fixed capital investment increased 2.5 per cent on the year in the first half of 2022. Overall, in the first half of 2022 the economy grew 7.4 per cent year on year.

Inflation is easing following timely mitigation measures by the authorities. The National Bank of Tajikistan (NBT) has kept its policy rate well above inflation in 2021-22. Planned tariff increases for utilities (electricity, heat and water) have been postponed until October 2022 to counter the impact of rising food and commodity prices. In August 2022, as inflation slightly exceeded the NBT target range in June and July, the policy rate was increased by 25 basis points (to 13.5 per cent). With inflation easing further to 5.7 per cent in September 2022, the policy rate was restored to 13.0 per cent in November. Tajikistan is currently the only regional economy to keep inflation within the central bank's target corridor (of 4-8 per cent).

Fiscal and external balances have strengthened. In January-May 2022, budget revenues rose 13.6 per cent year on year, driven by a 13 per cent increase in tax receipts. To boost external resilience, Tajikistan has managed to build up significant international reserves. As of 1 July 2022 international reserves provided 8.1 months of import cover. In July total external debt decreased to US$ 3.1 billion from US$ 3.7 billion a month earlier. The country's public debt amounted to US$ 3.1 billion, or 46.3 per cent of GDP and, under the government's debt management strategy 2021-23, will remain below 60 per cent of GDP. Strong growth will continue in the short term. We forecast GDP to grow 7.0 per cent in 2022 and 8.0 per cent in 2023. Downside risks relate to potential violence in Afghanistan spilling over to Tajikistan's territory and/or derailing regional efforts to connect Central Asia to Pakistan and, further south, to India and Iran. Given the importance of the domestic agriculture sector, climate risks present a further vulnerability. An uptick in international financial institution (IFI) investment, supporting Roghun and other infrastructure projects, presents significant upside risk.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

The government has drawn up a new economic plan. Introduced in March 2022, the "action plan for the mitigation/prevention of the potential impacts and risks to the national economy" seeks to maintain macroeconomic stability (control inflation, shift contracts to national currencies, establish correspondent accounts in foreign banks and ensure banking sector stability), protect vulnerable population groups (prevent unreasonable price hikes and ensure adequate stocks of staple goods), improve the investment climate (showcase investment opportunities, allocate concessional credit to domestic producers and facilitate international trade) and ensure the effective and sustainable performance of state-owned enterprises (SOEs) (reduce non-priority expenses, improve financial disclosure and ensure the timely fulfilment of SOEs' obligations to the state budget).

The tax system has been significantly reformed. Significant amendments to the tax code were put in place in late 2021 with a view to weakening the incentives for tax evasion, reducing informality and broadening the tax base. The number of taxes was decreased from ten to seven and tax rates were reduced across the board. Income tax for legal entities was reduced from 23 per cent to 20 per cent and for individuals from 13 per cent to 12 per cent. The VAT rate was reduced from 18 per cent to 15 per cent and further decreases are planned: to 14 per cent in 2023 and 13 per cent in 2027. The social-security tax for employers was reduced from 25 per cent to 20 per cent.

Measures to promote inclusion have advanced. In June 2022 Tajikistan adopted a new law on equality and the elimination of all forms of discrimination – a significant step towards a more inclusive society. The bill introduces legal definitions for segregation, direct and indirect discrimination. In addition, a Commissioner for Human Rights (ombudsman) was appointed to help prevent all forms of discrimination and ensure equality. In a further development in July 2022, the government approved a new strategy for financial inclusion for 2022-26, focusing on digital services, increasing the variety of financial products, protecting customer rights and enhancing financial literacy.

The banking sector is being cleaned up. In 2021 the NBT liquidated three troubled banks – Agroinvestbank, Tojiksodirotbank and Kafolatbank – which had a high concentration of non-performing loans (NPLs). As a result, the NPL ratio declined to 13.4 per cent (as of 30 June 2022) from 22.7 per cent in March 2021.

Reforms to the tariff system in the energy sector are lagging. Overall tax arrears have increased substantially (by 25 per cent year on year in January-May 2022), with more than 40 per cent of them due to Tajiktelekom and two state-owned hydropower plants, Sangtuda and Roghun. Non-cost-reflective electricity tariffs are a major obstacle to the further development of the country's electricity system. Barqi Tojik's (Tajikistan's national power utility company) debt to interdependent power producers and the Ministry of Finance is currently assessed at US$ 3.1 billion.

Tunisia

Highlights

- **Tunisia's economic recovery has been muted, but the new staff-level agreement on an International Monetary Fund (IMF) programme has improved the outlook.** Growth slowed in the first half of 2022, contributing to a rising fiscal deficit and persistently high unemployment. Amid current uncertainty, the sovereign rating has deteriorated as fiscal pressures have risen.
- **The country launched its "Green hydrogen for sustainable growth and a low-carbon economy in Tunisia" (H2Vert.TUN) project.** Supported by development partners, this is Tunisia's first concrete commitment to green hydrogen production. The project seeks to improve the framework to develop a value chain based on renewable energy for green hydrogen and its derived products in Tunisia.
- **The National Programme of Reforms was launched in 2022.** The programme sets out a host of essential reforms to improve the business environment, strengthen competitiveness and loosen restrictions on foreign exchange, as well as reduce the role of the state and improve public-sector management.

Key priorities for 2023

- **Measures are urgently needed to bring public spending under control.** These include reducing subsidy expenditure and the public-sector wage bill and reforming state-owned enterprises (SOEs), all of which will also be important in the context of the new IMF programme.
- **Reforms to promote a business-enabling environment must advance in parallel.** These would support private-sector growth and attract foreign investment – both necessary for creating jobs, promoting exports and shoring up foreign reserves. Scaling back the role of SOEs and lowering barriers to domestic competition will be essential here, as will easing business regulations (licensing, general red tape) for enterprises.
- **Addressing disparities and strengthening social safety nets should be prioritised.** Effectively mitigating the impact of successive crises on the livelihood of vulnerable groups requires stronger support networks combined with targeted investment, innovative policies to support small businesses and the introduction of upskilling and employment programmes.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	2.5	1.4	-8.7	3.3	1.7
Inflation (average)	7.3	6.7	5.6	5.7	8.1
Government balance/GDP	-4.3	-3.6	-9.1	-7.6	-6.6
Current account balance/GDP	-10.4	-7.8	-5.9	-6.1	-9.1
Net FDI/GDP [neg. sign = inflows]	-2.3	-1.9	-1.4	-1.1	-1.2
External debt/GDP	80.9	91.2	98.7	87.4	n.a.
Gross reserves/GDP	12.2	17.8	21.4	18.5	n.a.
Credit to private sector/GDP	74.2	70.1	75.7	n.a.	n.a.

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Macroeconomic developments and policy response

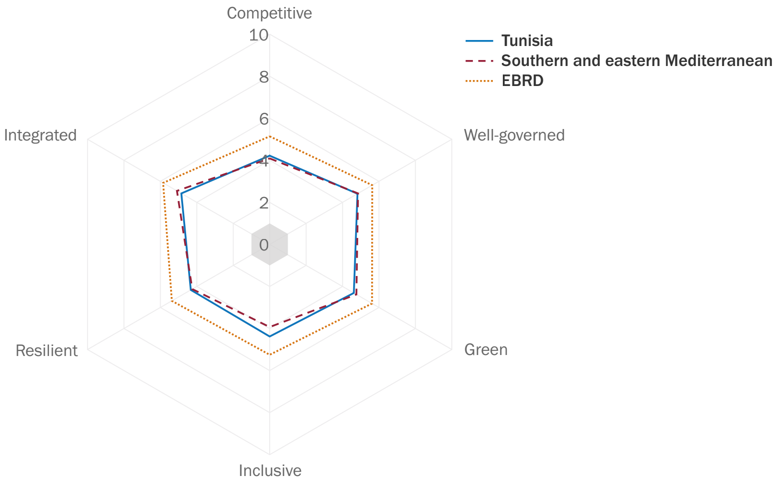
Tunisia is experiencing weaker growth in 2022 after a modest recovery in 2021. Gross domestic product (GDP) grew 3.1 per cent in 2021, after a sharp contraction (9.2 per cent) in 2020. The relative dependence of the economy on tourism, weak demand for exports, limited fiscal space and the difficult business environment all continued to weigh on growth. In the first half of 2022 economic growth was 2.6 per cent year on year, driven by growth in the agricultural and agribusiness sectors. Meanwhile, inflation reached a 30-year high of 8.2 per cent in July 2022, driven by large increases in food and energy prices. Unemployment decreased slightly to 15.3 per cent in the second quarter of 2022, although rates remain higher for women (20.9 per cent), the youth (38.5 per cent) and graduates (30.1 per cent).

Measures to alleviate pressures from the war on Ukraine are hindered by a lack of fiscal space. The country normally imports about 54 per cent of its wheat from Russia and Ukraine. The World Bank has provided a US$ 130 million loan to Tunisia to enable the government to purchase wheat for one and a half months' consumption, ensuring affordable bread for the poor in the immediate short term. As for energy, the government has sought to offset the impact of rising prices on vulnerable households by expanding subsidies to about 15.4 per cent of budgeted expenditures. The additional spending is likely to push the 2022 budget deficit above the target of 6.7 per cent of GDP. Public-sector wages are 17 per cent of GDP, one of the highest ratios in the world. Public debt was 85.5 per cent of GDP as of the end of 2021, of which 64.5 per cent was denominated in foreign currency.

Reserves are still falling and the country's sovereign rating has been downgraded. In 2021 the current account deficit slightly narrowed to 6.3 per cent of GDP, driven by the strong performance of remittances, which peaked at US$ 2.7 billion. In the first quarter of 2022 remittances and tourism revenues continued to increase. However, foreign reserves decreased to US$ 7.6 billion in August 2022, covering just under four months of imports. In the past year both Moody's and Fitch have downgraded the sovereign rating to Caa1 and CCC, respectively.

The economic outlook remains highly uncertain. A weak recovery is likely in 2022 (1.7 per cent GDP growth) as the country struggles to attract external financing. Structural challenges and uncertainty surrounding the war on Ukraine will continue to weigh on growth. The prospects for 2023 are more positive (we forecast 2.9 per cent growth) if a new IMF programme is approved and implemented, and global headwinds ease.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

Negotiations on an IMF-supported programme have advanced. In July 2022 the government submitted a reform plan to the IMF, which includes a freeze on the public wage bill, a reduction in subsidies and a restructuring of public enterprises. Following progress in the domestic dialogue on these reforms with key stakeholders, a staff-level agreement for a new programme was announced in October 2022, which should help to address financing needs as well as boost reforms.

Public-sector reform is still facing strong opposition. The public-sector wage bill in 2021 amounted to 17.5 per cent of 2020 GDP and almost 50 per cent of public expenditure, making it the highest wage-bill (relative to GDP) of all emerging markets. Strong labour unions have blocked reforms in this area and the commitments of previous governments to reduce the wage bill through limits on recruitment, wage constraint and voluntary departures remain unmet.

The government has developed an ambitious reform agenda. This includes the Vision 2035 initiative, along with accompanying development plans to address key challenges. The Vision 2035 agenda is focused on four pillars: promoting human capital; developing a more knowledge-based, digital economy; strengthening social justice (especially in the interior regions); and boosting private-sector development, especially the green economy.

The National Programme of Reforms 2023-25 was launched in June 2022. This programme aims to achieve economic stability in the short term and lay the foundations for inclusive and sustainable growth, in line with the Vision 2035 agenda. Planned measures include removing investment permits, incentives for investors in strategic sectors and improving legislative and institutional frameworks for start-ups. The authorities plan to reform the foreign-exchange code and to conclude sectoral competitiveness pacts in the textile, pharmaceutical and automotive component sectors.

Progress on crucial reforms to state-owned enterprises (SOEs) is slow, but momentum is picking up in the grain sector. In July 2022 the Office des Céréales (ODC) secured a US$ 150.3 million European Bank for Reconstruction and Development (EBRD) loan to finance grain imports and help secure them against potential disruptions in the global supply of cereals and consequent soaring prices. A grant of US$ 2 million will go towards technical assistance and support for a sectoral and corporate reform roadmap, in line with the Tunisian SOE reform agenda. The roadmap's main aim is to set out how to address the current structural weaknesses of the cereals sector, leading to the progressive liberalisation of cereal imports.

Tunisia is to launch the "Support for an accelerated energy transition" project. The project aims to enhance energy efficiency and renewable energy potential. It rests on four pillars: improving energy transition conditions; optimising the energy sector; enhancing private-sector capacity; and promoting innovation. The agreement between the Ministry of Industry, the Société Tunisienne de l'Electricité et du Gaz (STEG) and Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) was signed in July 2022 and implementation is planned over the next three years. This project aims to produce 35 per cent of electricity from renewable sources by 2030, while reducing greenhouse gas emissions by 45 per cent from 2010 levels.

Türkiye

Highlights

- **The economy bounced back strongly following the pandemic, but the currency has come under severe pressure.** Growth momentum in the past year has been supported by the introduction of the New Economic Model in September 2021, but the unorthodox approach of significant policy rate cuts amid high inflation has led to real interest rates turning deeply negative and further pressure on the lira, necessitating heavy intervention by the central bank.
- **External imbalances have widened.** Significant increases in energy and food prices, particularly following Russia's invasion of Ukraine, saw the current account deficit rise, increasing the fragility of external balances and bringing Türkiye's risk premium to its highest level in 18 years.
- **Reforms have advanced hesitantly.** The severity of dealing with macroeconomic challenges has meant that progress in implementing the Economic Reform Package, a high-level plan introduced in the middle of 2021 that focuses on improvements in public finances, the financial sector, governance and employment, has been slow.

Key priorities for 2023

- **A return to a more orthodox policy approach is needed to prevent current high inflation rates becoming entrenched.** Overly-loose monetary policy and a lack of policy credibility have contributed to inflation reaching a two-decade high in excess of 80 per cent. Higher policy rates are needed, rather than relying on regulatory measures to limit credit growth and running down reserves at the central bank.
- **Priority should be given to helping the employment and entrepreneurship opportunities of vulnerable groups.** Inclusion challenges were exacerbated by the pandemic, and deep-seated structural challenges remain. Women, the youth and refugees are in particular need of assistance in the post-pandemic period.
- **Türkiye needs to strengthen its institutional and regulatory environment.** Elements of this agenda are included in the Economic Reform Package, including improving the efficiency of public spending via public procurement transparency and investment management, and these reforms should proceed without delay.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	3.0	0.8	1.9	11.4	4.5
Inflation (average)	16.3	15.2	12.3	19.6	72.0
Government balance/GDP	-1.9	-2.9	-3.5	-2.8	-3.4
Current account balance/GDP	-2.8	0.7	-4.9	-1.7	-6.0
Net FDI/GDP [neg. sign = inflows]	-1.6	-1.3	-1.1	-1.6	-1.0
External debt/GDP	53.5	54.8	60.4	54.8	n.a.
Gross reserves/GDP	11.7	13.9	13.0	13.4	n.a.
Credit to private sector/GDP	67.5	65.5	75.2	60.1	n.a.

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Macroeconomic developments and policy response

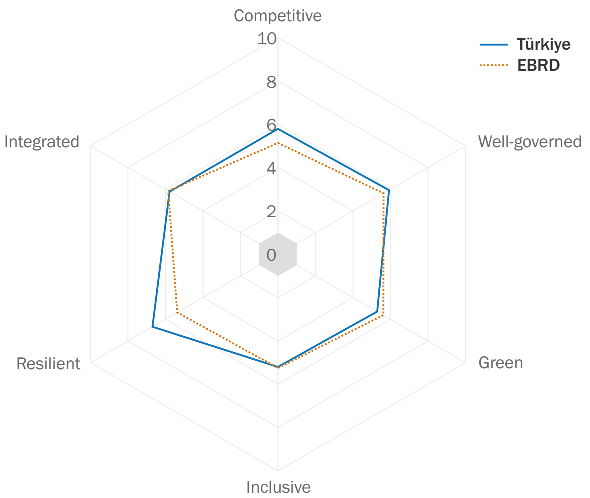
Strong growth in the past year has been accompanied by unstable price and currency developments. In September 2021 the government introduced the New Economic Model, which aimed to increase export competitiveness and private investment, and which foresaw price stability being achieved via a rebalancing of the current account. The economy grew by 11.4 per cent in 2021 and this momentum carried over into 2022, with gross domestic product (GDP) growing by 7.5 per cent year on year in the first half of the year. However, leading indicators point to a slowdown in the second half of the year, not least given the weakening global outlook. Policy rates were cut by 500 basis points (bps) to 14 per cent, and held at this level for seven months until further cuts of 100 bps were introduced in both August and September 2022. This was despite inflation increasing rapidly over this period to reach a two-decade high of 83 per cent in September 2022. Deeply negative real interest rates resulted in a steep depreciation of the lira, by around 30 per cent in 2022 to date, which in turn spurred significant dollarisation.

The policy response to high inflation has been unorthodox. Instead of tightening monetary policy the authorities have spent the past months attempting to introduce new policy instruments and regulatory measures to support the lira. The central bank (CBRT) has intervened heavily using its extremely limited reserves, and has introduced several schemes to encourage "liraisation" by compensating lira deposit holders for foreign exchange losses. At the same time, the authorities have sought to dampen the overly rapid commercial credit expansion associated with low policy rates, which had contributed to the widening current account deficit, through various regulatory measures.

Fiscal and external pressures have increased. Public finances remain one of the anchors of the economy, with the debt-to-GDP ratio standing at a relatively modest 38 per cent. However, some of the policy measures introduced (notably the new FX-linked deposit schemes) have shifted the burden of adjustment to fiscal policy, creating a potentially sizeable contingent liability. Meanwhile, the hoped-for rebalancing of the current account has failed to materialise, as higher commodity prices linked to the war on Ukraine have increased Türkiye's commodity import bill. Türkiye's large short-term external debt stock also remains a concern, particularly as the cost of servicing it has increased dramatically following the lira depreciation.

The short-term outlook is highly uncertain. We expect GDP to grow by 4.5 per cent in 2022 and 3.5 per cent in 2023, but there are significant risks to the outlook as current policy settings have rendered the macroeconomic situation extremely fragile. Furthermore, there are risks of spillovers to the Turkish economy from aggressive policy tightening in developed economies.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

Türkiye ratified the Paris Agreement in October 2021. The authorities also announced a net zero target year of 2053, although they have not yet submitted an updated nationally determined contribution (NDC) reflecting the more ambitious emissions reduction target that is in line with this commitment. Over the past year the authorities have taken steps to strengthen institutional arrangements for climate change issues by updating important policy documents, such as the National Climate Change Action Plan. And, to reflect the importance of climate change, the Ministry of Environment and Urbanisation has been rebranded the Ministry of Environment, Urbanisation and Climate Change (MoEUCC).

New instruments for green projects are being facilitated. In February 2022 the Capital Markets Board of Türkiye produced guidelines on Green and Sustainable Debt Instruments and Lease Certificates. These guidelines aim to ensure that such instruments and certificates are issued in compliance with best international practice and to increase transparency, integrity and comparability in the context of financing green projects.

Legislation to strengthen asset management companies (AMCs) has been adopted. To boost the capacity of AMCs, in October 2021 new regulations were brought in to allow all banks and non-bank financial institutions to sell problem (stage 1 and 2) loans in addition to non-performing loans (NPLs) to AMCs. Furthermore, the Capital Markets Board enabled the establishment of AMC funds to issue asset-backed securities, allowing for the securitisation of loan portfolios, including NPL portfolios.

To shield low-income families from rising energy prices the authorities introduced graduated tariffs based on consumption. From the start of 2022 the Energy Market Regulatory Authority moved away from a fixed electricity tariff system and began implementing a new system based on the level of consumption. The Authority also set up a tariff for vulnerable consumers in advance of some subsidies being lifted, which will adversely affect lower-income households.

Vocational training is being promoted. In the last year, the government has continued to implement its "Vision 2023" for the education system, improving the provision of technical and vocational education and training (TVET) by setting up formal cooperation agreements with local chambers of commerce. This cooperation is expected to strengthen the link between employers and training institutions, with positive effects on young people's school-to-work transition. The attractiveness of TVET in the country has been strengthened thanks to recently established diploma equivalency between vocational training centres (VTCs) and high schools and a new law introducing financial incentives for VTC students (Law No. 7346 from December 2021), resulting in a 57 per cent increase in VTC enrolment.

Turkmenistan

Highlights

- **High gas prices are helping to drive growth.** Real gross domestic product (GDP) grew by 6.2 per cent year on year from January to September 2022, as the country's exports added 50 per cent in the first half of 2022 thanks to higher gas prices.
- **Turkmenistan's external position has strengthened significantly.** Following gas pipeline debt repayment to China in 2021 and domestic debt repayment in January 2022, elevated gas prices are likely to further boost government revenues, contributing to the country's borrowing capacity.
- **Turkmenistan is developing trade and transport relations with its neighbours.** The country has agreed to develop bilateral trade, simplify the visa regime and ensure better transport connectivity with its neighbours, and the recently signed agreement on the construction of the China-Kyrgyz Republic-Uzbekistan railway corridor opens up further opportunities for Turkmenistan as a transit hub to Europe via Türkiye and to India via Iran.

Key priorities for 2023

- **The authorities should further liberalise the foreign exchange market.** The spread between the official and parallel market exchange rates has narrowed in 2022 but remains distortive, with access to foreign exchange at the official rate still used by the authorities as an import substitution subsidy, thus resulting in unfair competition and favouritism.
- **The opportunity to address transport and logistics bottlenecks across the Caspian Sea and the north-south trade corridor should be grasped.** Given its location at an important crossroads, Turkmenistan has an excellent opportunity to attract investment in additional transport and logistics corridors running through its territory, including pipelines, railways, roads, sea transport, and logistics infrastructure.
- **National statistics and economic data reporting standards should be improved.** Reliable and accessible economic data would be of benefit to Turkmen policymakers and businesses alike, enabling them to make informed policy and investment decisions.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	6.2	6.3	5.9	6.2	7.0
Inflation (average)	13.3	5.1	7.6	15.0	17.5
Government balance/GDP	-0.2	-0.3	-0.1	0.3	0.6
Current account balance/GDP	4.9	2.8	-3.3	0.6	2.5
Net FDI/GDP [neg. sign = inflows]	-3.3	-3.5	-2.7	-2.0	-1.2
External debt/GDP	15.7	12.1	9.9	8.4	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	n.a.	n.a.	n.a.	n.a.	n.a.

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Macroeconomic developments and policy response

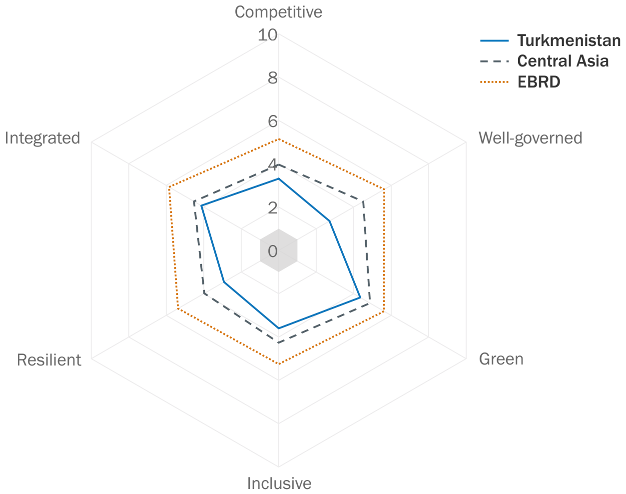
Turkmenistan continues to report remarkably stable growth rates. According to the authorities, the economy expanded by 6.2 per cent year on year from January to September 2022. The construction industry is booming, as reflected in manufacturing and services exceeding the government's plan by 52.5 per cent in January-July. The customs administration reported a particularly strong increase in exports of tomatoes and footwear. Overall, foreign trade turnover increased by 40.7 per cent year on year, and retail trade turnover by 10.5 per cent year on year in the first nine months of 2022.

The gap between the official and market exchange rates has narrowed. The official exchange rate peg continues to be maintained at 3.5 Turkmen manat (TMM) per US dollar. Having appreciated in 2021, the parallel market exchange rate stabilised in March 2022 at around 19 TMM per US$, reflecting greater availability of foreign currency at the heavily subsidised official rate to small and medium-sized enterprises operating in priority sectors (such as food and beverages), in exchange for significant price cuts and/or as a means of encouraging import substitution.

Elevated gas prices have strengthened the country's fiscal stance. In the first half of 2022 the government budget recorded a surplus of 0.1 per cent of GDP; from January to July 2022 government revenues had been officially reported at 103.6 per cent of the target. In August 2022 Fitch affirmed Turkmenistan's "B+" rating with a "Stable" outlook, citing the strong fiscal position but also persistent structural challenges. According to the International Monetary Fund, public debt was just 11.1 per cent of GDP in 2021 and is expected to decline further to 8.4 per cent of GDP in 2022.

Robust growth will continue in the short term. Turkmenistan is likely to continue to benefit from elevated gas prices and the country's "neutral" stance in 2022 and 2023. Overall, the economy is forecast to expand by 7.0 per cent in 2022 and 6.0 per cent in 2023. Downside risk is related to the volatility of gas prices.

CHART Assessment of transition qualities (1-10)



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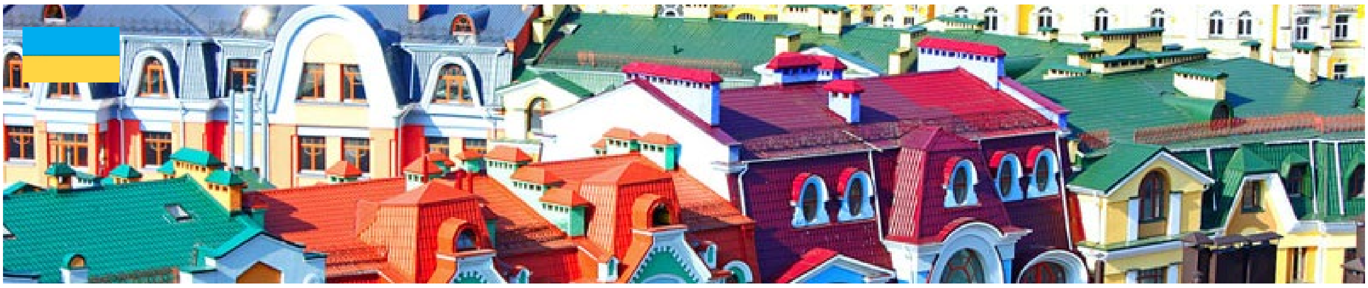
Structural reform developments

Turkmenistan is gradually ending its self-imposed isolation. Turkmenistan hosted the Ministerial Transport Conference of Landlocked Developing Countries in August 2022, resulting in agreements to jointly develop the international north-south corridor running through Turkmenistan, improve bilateral trade and transport connectivity, and simplify the visa regime. In June 2022 Turkmenistan and Iran signed a cooperation agreement and reached an understanding regarding Iran's outstanding gas debt. The clearing of Iran's US$ 1.8 billion debt will strengthen the government's fiscal accounts and enable the revival of gas exports to Iran, a significant step towards diversification of Turkmen exports. Under an agreement signed in June 2022, a trilateral gas swap deal involving Turkmenistan, Azerbaijan and Iran will allow Turkmenistan to double its gas exports via Azerbaijan.

Work on strengthening the statistical agency is ongoing. The United Nations Development Programme and the State Statistics Committee of Turkmenistan are working to improve the country's statistical capacity. The goal is to streamline existing methodologies in accordance with internationally recognised statistical standards.

Turkmenistan has applied for World Trade Organization (WTO) membership. The application was made in November 2021, and subsequently, Turkmenistan and the WTO reached an agreement to start negotiations. The country's customs authorities are seeking to establish a "single window" for export and import operations and introduced this principle into the Customs Code.

Newly introduced laws significantly harm women's rights. Gender equality has been set back through government-directed social campaigns against certain beauty services and types of clothing, and measures to prevent women from occupying the front seat in private vehicles or using male-driver taxi services.



Ukraine

Highlights

- **The war has put Ukraine's economy under enormous stress.** Gross domestic product (GDP) declined by 15.1 per cent year on year in the first quarter of 2022, and by 37.2 per cent in the second quarter when the most severe and widespread fighting took place. Inflation rose to 23.8 per cent year on year in August 2022 because of production and logistical disruptions.
- **Extraordinary financial support from official creditors/donors did not fully close the budget and external financing gaps.** Foreign reserves fell by almost 20 per cent between January and August 2022 and the Ukrainian hryvnia (UAH) devalued by 20 per cent. The main creditors agreed that foreign debt repayments would be postponed for two years, but financing gaps remain substantial and further support from bilateral creditors is needed.
- **The European Council granted Ukraine the status of European Union (EU) candidate country.** After Ukraine submitted an official request for EU membership in February 2022, the European Council granted it candidate status in June 2022. This is the beginning of an important journey that requires more intense reform efforts in several areas, including completing the institutional restructuring of the judicial system, finalising the anti-corruption system set-up and putting in place effective mechanisms to tackle the influence of vested interests.

Key priorities for 2023

- **Emergency support for the economy is vital, but governance standards should be maintained and enhanced.** Access to fundamental services that will facilitate people's return to economic activity should be restored. Repairs to infrastructure damaged by the war and reconstruction after the war will require accelerated procurement processes, but this should not be at the cost of transparency, inclusion and sustainability assessments.
- **The authorities should strengthen energy resilience.** Technical synchronisation of the electricity transmission network with continental Europe, completed in the middle of March 2022, should be followed by synchronisation with the EU electricity market. Ukrenergo and Naftogaz should be supported to maintain energy supplies and prepare for the winter.
- **Efforts are needed to preserve financial sector stability.** Achieving equivalence of supervision status and professional secrecy compatible with EU law would enable more investments by EU-owned banks and allow the National Bank of Ukraine (NBU) to take part in joint supervisory and resolution colleges with authorities in the home countries of banks active in Ukraine. It would also be beneficial to prepare a detailed plan for post-war reconstruction that would include recapitalising local banks and taking the necessary preceding steps (diagnostics, asset quality reviews and stress tests).

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	3.4	3.2	-3.8	3.4	-30.0
Inflation (average)	10.9	7.9	2.7	9.4	20.6
Government balance/GDP	-2.0	-2.2	-5.8	-3.6	n.a.
Current account balance/GDP	-4.9	-2.7	3.4	-1.6	n.a.
Net FDI/GDP [neg. sign = inflows]	-3.7	-3.4	0.0	-3.4	n.a.
External debt/GDP	87.6	79.1	80.2	64.8	n.a.
Gross reserves/GDP	15.9	16.4	18.6	15.5	n.a.
Credit to private sector/GDP	30.1	24.3	22.2	18.6	n.a.

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Macroeconomic developments and policy response

The war has brought economic recovery to an abrupt halt. Russia's invasion of Ukraine has put the economy under enormous stress, with heavy devastation of infrastructure and production capacities and the unprecedented loss of human capital. After GDP growth of 3.4 per cent in 2021, the economy shrank by 15.1 per cent year on year in the first quarter of 2022 and by 37.2 per cent in the second quarter when the most severe and widespread fighting took place. Initially, combat operations were widespread in regions that generated 60 per cent of GDP in 2021, but in more recent months the fighting has become more concentrated, in areas generating around 20 per cent of GDP. Approximately 15 per cent of the pre-war population were registered as refugees abroad as of the middle of August 2022 and an additional 15 per cent were displaced within the country. All this is severely weakening companies' finances and exposing the banking sector to a drastic deterioration in asset quality, once the moratoria on changing the risk classification of banks' credit exposures is withdrawn.

Inflation has risen sharply, reserves have declined, and tax revenues have plummeted. On the day of the invasion (24 February 2022) the NBU fixed the exchange rate, limited cash withdrawals and introduced capital controls by preventing most cross-border transactions. Nevertheless, huge production and logistical disruptions had caused inflation to rise to 23.8 per cent year on year by August 2022, and it is likely that inflationary pressures will persist throughout the rest of the year and into 2023. The government has implemented a range of measures to curb the impact of high inflation, including export bans and regulated prices for a range of essential food items, reduced fuel taxes and utility price freezes. Plummeting tax revenues combined with soaring defence and social spending opened a fiscal gap of at least US$ 4 billion a month (3.3 per cent of estimated 2022 GDP). The fiscal gap is accompanied by a substantial external financing gap. Monetary financing of the fiscal deficit, allowed under martial law, could plug only a small portion of the gap without endangering macroeconomic stability. However, official sector external financing and the current account surplus due to official grants were largely exceeded by spending and cash withdrawals by Ukrainians abroad. As a result, international reserves have declined from US$ 30.9 billion at the end of 2021 to US$ 25.4 billion in August 2022. To ensure exchange rate stability and curb inflation, NBU more than doubled the policy rate from 10 per cent to 25 per cent at the beginning of June 2022. Yet in July NBU had to devalue the hryvnia by 20 per cent and fix it at the new lower level.

External financing remains crucial for preserving macroeconomic stability. The financing burden was partially alleviated by private-sector creditors who accepted the government's request to postpone repayments of, and interest payments on, Eurobonds for two years. This exercise is expected to provide liquidity of around US$ 6 billion until the end of 2023. It is also meant to be net present value (NPV) neutral because of interest capitalisation. At the same time, the Paris Club creditors said they would let Ukraine suspend debt service at least until the end of 2023, while holders of GDP warrants accepted the next payment arising from 2021 GDP growth exceeding the 3 per cent threshold to be postponed from 2023 to 2024. So far Ukraine has been paying its debt as scheduled, despite the war. While the requested postponement of repayments would reduce the external financing gap, it is still substantial, leaving the country dependent on bilateral creditors.

With such unprecedented levels of uncertainty, economic activity will depend on the war dynamics. In 2022 GDP is expected to decline by 30.0 per cent to be followed by an increase of 8.0 per cent in 2023 on the assumption that Ukraine will have acclimatised to a prolonged but static war. The forecast is sensitive not only to the duration and the war dynamics, but also to the level of external financing and availability of ports' export capacities.

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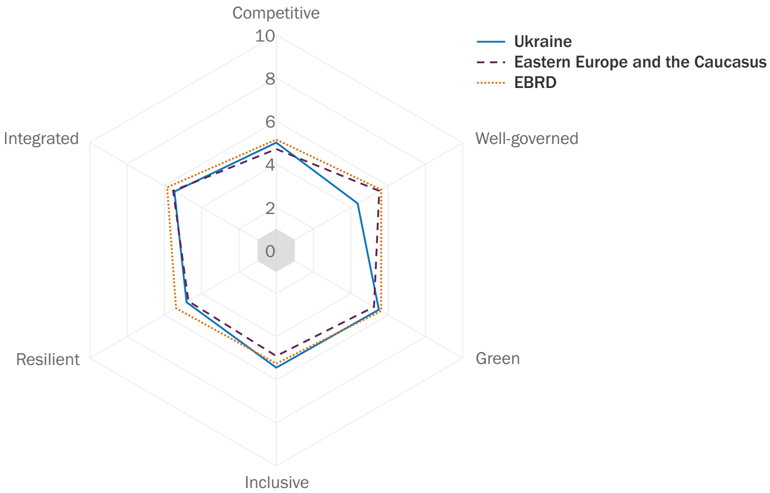
CHART Assessment of transition qualities (1-10)



NOTE: Belarus is not included in the EBRD region and respective regional averages.

Structural reform developments

The European Council granted Ukraine the status of EU candidate country. Soon after the Russian invasion in February 2022 Ukraine officially applied for EU membership as a first step in a long and complex process. In June 2022 the European Council granted it candidate status for EU membership and made further steps conditional on reform progress in seven areas outlined in the European Commission's opinion. By the end of the year, the Commission will assess Ukraine's progress on implementing judicial and anti-corruption reforms, preparation of a plan to reform the entire law-enforcement sector, limiting the excessive influence of oligarchs in the economy and politics and tackling vested interests, as well as reform of the legal framework for national minorities.

Efforts to tackle corruption have continued. In December 2021 the authorities selected the final candidate for head of its Specialised Anti-Corruption Prosecutors Office (SAPO), which had been vacant since August 2020. After a long delay, the appointment of the SAPO chief in July 2022 gave fresh impetus to the investigation of several high-profile corruption cases. Reinvigorating the work of anti-corruption bodies is a key element of the EU approximation process, while the selection of a new director of the National Anti-Corruption Bureau of Ukraine remains a key test outlined as priorities by the European Commission. Nonetheless, the country's EU candidate status and international support prompted parliament to adopt a new anti-corruption strategy to 2025, developed by the National Agency on Corruption Prevention (NACP). The new strategy pursues the EU criterion of accountable government and outlines the implementation of programmes to curtail corruption across the courts and law-enforcement agencies, taxation, construction and the defence sector, among others.

Judicial reform in Ukraine continues to progress. In November 2021 the authorities formed the Ethics Council as a key body for implementing judicial reform. Its main function is to review the integrity of the High Council of Justice, the highest judicial governance body in Ukraine. After a convoluted process, the Ethics Council selected and parliament appointed two reputable members to the High Council of Justice, a decision praised by international supporters of judicial reform. This sets high standards for the additional 15 appointments to follow. Civil society organisations noted that better communication between the Ethics Council and the public would increase the credibility of ongoing judicial reform.

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Digitalisation is enabling government services to function. In August 2022 NABU and SAPO resumed their service through the eCase Management System, which automates pre-trial investigation among detectives, prosecutors and judges. Since the war on Ukraine began, law enforcement agencies have faced difficulties preserving materials of criminal proceedings and investigative cases. The eCase Management System can store these materials electronically using online back-up, enabling critical legal materials to be preserved and transferred safely. Russia's full-scale invasion actually contributed to the expansion of the Diia platform as a one-stop shop for public services. Frequently used as a digital wallet to carry government-issued e-documents, the Diia platform has also been used by the authorities in recent months to detect military engagement, online fundraising and online registration of internally displaced persons.

Gradual progress in energy reforms has supported efforts to diversify energy sources. The war has destroyed many energy plants and led to a loss of energy production capacity. However, the authorities increased energy efficiency by integrating into the EU's single electricity network, the European Network of Transmission System Operators for Electricity (ENTSO-E). Accelerated integration into the EU electricity grid has enhanced energy security, providing Ukraine with greater energy independence from Russia and Belarus. It also has a positive impact on the Ukrainian electricity suppliers who can profit from the direct export of electricity to the European market.

The authorities ratified the Istanbul Convention to increase gender parity and tackle violence against women. In July 2022 Ukraine became the 36th state to ratify the Istanbul Convention. Once the Convention enters into force in November 2022 in Ukraine, the authorities will be more empowered to prevent gender-based violence and to carry out prosecutions related to gender-based abuse. This progress towards gender equality is expected to offer better protection to women and girls, who are disproportionately affected by the ongoing war on Ukraine.

The deposit guarantee system has been strengthened. In April 2022 the authorities passed a new bill to guarantee 100 per cent compensation for losses of bank deposits for the period of martial law and three months after it ends. Afterwards, the maximum compensation of deposits increases to UAH 600,000 (US$ 16,500) from the current UAH 200,000 (US$ 5,500). In addition, the state-owned Oschadbank, which was the only bank with a 100 per cent state deposit guarantee scheme before the war, eventually became a member of the Deposit Guarantee Fund, with the same deposit protection level as other banks in the system.

Uzbekistan

Highlights

- **Strong economic growth is continuing.** The economy expanded by 5.8 per cent year on year in January-September 2022 on the back of a doubling of remittances and gold exports, and macroeconomic stability has been restored following the initially tumultuous reaction to Russia's war on Ukraine.
- **Risks to the investment climate have abated.** Political risks to investment associated with the sudden eruption of social unrest in the Karakalpakstan region have been mitigated through a swift adjustment to the proposed constitutional amendments.
- **Uzbekistan is advancing on the digitalisation agenda.** The authorities have prepared more than 280 projects to facilitate the country's digital transformation, seeking to double the share of digital services in gross domestic product (GDP) in the next two years. Uzbekistan IT Park's "IT visa" mechanism will allow the country to benefit from the inflow of digital nomads, enabling the exchange of knowledge, skills and ideas.

Key priorities for 2023

- **To reduce dependence on Russia's labour market, the authorities should put in place a robust development strategy for small and medium-sized enterprises.** Such a strategy should eliminate artificial incentives for business fragmentation, enabling organic growth, innovation and exports, while addressing the country's regional inclusion challenges.
- **Efforts to accelerate the commercialisation and privatisation of state-owned assets should continue.** The aim should be to achieve greater operational efficiency of strategic state-owned enterprises (SOEs), attract private investment and boost lending to the economy. Privatisations and initial public offerings (IPOs) should be executed in line with best international practice, in a transparent and competitive manner.
- **Further efforts are needed to strengthen food and energy security.** This can be done through improved planning and investment in critical irrigation and food storage infrastructure, and greater energy generation and transmission capacity.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	5.3	5.7	1.9	7.4	5.5
Inflation (average)	17.5	14.5	12.9	10.8	11.2
Government balance/GDP	2.0	-0.3	-3.3	-4.7	-4.0
Current account balance/GDP	-6.8	-5.6	-5.0	-7.0	-3.3
Net FDI/GDP [neg. sign = inflows]	-1.2	-3.9	-2.9	-3.0	-1.3
External debt/GDP	32.5	40.5	56.0	57.7	n.a.
Gross reserves/GDP	51.5	48.7	58.3	50.8	n.a.
Credit to private sector/GDP	22.8	29.0	35.7	35.8	n.a.

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Macroeconomic developments and policy response

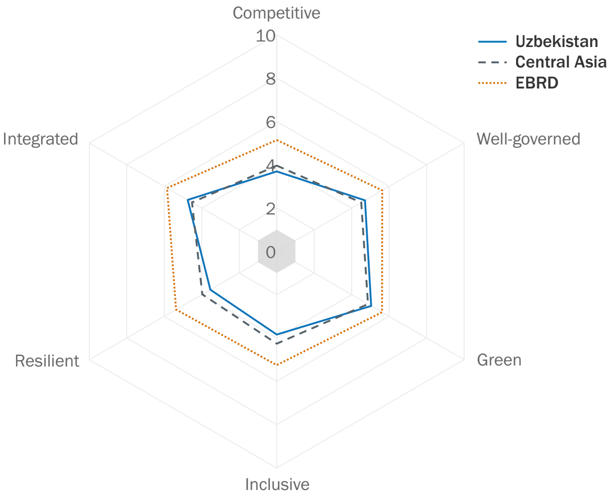
Strong economic growth is continuing in 2022. The economy grew by 5.8 per cent year on year in the first three quarters of 2022, supported by a boost in fixed capital investment (up 5.0 per cent year on year). From January to September 2022 growth was broad-based, with particularly strong gains in construction (up 6.3 per cent year on year), retail trade turnover (up 10.8 per cent year on year) and services (up 15.4 per cent year on year). On 10 March 2022 the Cotton Campaign ended its call for a global boycott of Uzbek cotton, thus creating an opportunity to expand cotton and textile investment and exports. In the first nine months of 2022 exports of goods and services grew by 35.7 per cent year on year, driven by a more than doubling of gold exports (reaching 21.1 per cent of total exports). Imports rose by 22.3 per cent year on year in the same period.

Inflation has reached double-digits, prompting policy rate adjustments. The inflation rate was 12.23 per cent year on year in September 2022. The war on Ukraine initially led to a depreciation of Uzbekistan's national currency, the Uzbek som, in late February and early March 2022. To stabilise the foreign exchange market and limit the pass-through effect on prices, the Central Bank of Uzbekistan raised the policy rate by 300 basis points to 17 per cent in March 2022. Timely actions of the regulator helped the Uzbekistan som to regain its pre-war value. Subsequently, the central bank decreased its policy rate to 16 per cent in June, and further to 15 per cent in July. Foreign currency-denominated loans account for 47.5 per cent of total loans. Non-performing loans have continued to decline, reaching 4.7 per cent of total loans by September 2022 compared with 5.8 per cent a year previously.

The fiscal position is strengthening. The state debt-to-GDP ratio has been declining since the first quarter of 2021. As of 1 April 2022 external public debt amounted to US$ 23.4 billion, and accounted for 32.9 per cent of GDP (down from 38.6 per cent in 2021). Concurrently, high international reserves (US$ 33.4 billion as of 1 October 2022) ensure adequate fiscal buffers. Remittances have increased dramatically during 2022, rising by 96 per cent year on year in the first half of the year.

Robust growth will continue in the short term. The economy is forecast to grow at 5.5 per cent in 2022, and 6.5 per cent in 2023. Uzbekistan's growth continues to rely on its large and industrious labour force, domestic market size, strong and diversified manufacturing capacity, and market-oriented reforms. However, a further deterioration of the Russian economy in 2023 presents a significant downside risk to the outlook.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

Plans for privatisation are advancing but in an uncertain environment. In March 2022 the president signed a Decree "On additional measures to further reduce state participation in the economy and accelerate privatisation", which sets out a privatisation timeline for some SOEs, including Uzbekistan Airways and the national oil and gas company, and initial IPOs for the state-owned banks. However, international sanctions on Russia may hinder this ambitious privatisation agenda, as prospective Russian investors may face sanctions.

Capital market development is ongoing. In January 2022 a 10-year government bond was issued at the Uzbek Republican Currency Exchange auction. In line with the government's agenda of attracting new market participants, individuals and non-residents were allowed to purchase government bonds in February 2022. Furthermore, the first inflation-linked government bond was issued in July 2022, a further step towards diversifying the capital market.

A new development strategy is in place. This Development Strategy for the New Uzbekistan 2022-26 reflects the authorities' stated commitment to strengthening the reform agenda. Centred around seven pillars, the strategy includes establishing a free civil society, strengthening the rule of law, economic development and rapid growth, fair public policies and human capital development, safeguarding national interests, and strengthening security and defence alongside an active foreign policy. In addition, the government set national sustainable development goals up to 2030. The ambitious roadmap envisages: a halving of the poverty rate; sustainable agricultural development to strengthen food security; streamlining existing support mechanisms; a one-third reduction in maternal mortality; rooting out violence against women and children; integrating gender equality principles; increasing water efficiency; achieving full access to reliable and affordable energy; and a 160 per cent increase in per-capita GDP.

The investment environment is improving. The Investment Programme for 2022-26 introduces a central project management office to coordinate strategic investment projects. The Direct Investment Fund will now be able to own up to 49 per cent of the authorised capital of holding companies. In June 2022 the authorities introduced additional measures to improve the management of special economic zones and reduce the time required for decision-making by eliminating the requirement that business plans and feasibility studies for investment projects be pre-assessed by the Centre for the Comprehensive Expertise of Projects and Import Contracts.

Significant progress has been made on the digitalisation agenda. The "Digital Uzbekistan-2030" strategy (introduced in 2020) envisages connecting every settlement to the internet and upgrading digital skills, among other goals. More than 280 projects will facilitate the digital transformation of regions and sectors, aiming to double the share of digital services in GDP in the next two years. As part of the strategy, three new data centres will be launched in Tashkent, Bukhara and Kokand. About US$ 2.5 billion will be invested in digital infrastructure in 2021-22. The strategy also strives for a gradual digitalisation of the banking sector, allowing for wider access to remote banking services by the population at large. Within the framework of the Million Programmers project, more than 100 information technology (IT) schools were organised, and more than 500,000 young people have taken programming courses. To benefit from the inflow of digital nomads, Uzbekistan's IT Park has recently introduced a new mechanism (IT-Visa) to assist in the relocation of IT businesses and programmers. In addition to assistance with registration, IT businesses are offered a tax-and-customs-free regime, and licence-free employment of foreign persons.

The country is progressing on its green agenda. Uzbekistan ratified the Paris Agreement and submitted its first Nationally Determined Contribution (NDC) in 2018. A more ambitious NDC, submitted in 2021, seeks to achieve a 35 per cent reduction in specific greenhouse gas emissions per unit of GDP by 2030 (compared with the 2010 level). Uzbekistan has already committed to a net-zero target for its power sector by 2050 and is in the process of developing an economy-wide long-term strategy. Currently, Uzbekistan has set an ambitious renewable energy target, including 7 GW of solar photovoltaic and 5 GW of wind power by 2030. Moreover, the country joined the Global Methane Pledge in May 2022, intending to reduce global methane emissions by at least 30 per cent by 2030 compared with the 2020 levels. In 2019 the president of Uzbekistan approved the Strategy on the Transition to a Green Economy for 2019-30 aiming to improve energy efficiency, rationalise consumption and conservation of natural resources, reduce greenhouse gas emissions, provide access to green energy, create jobs and ensure resilience to climate change. With its approval pending in 2022, Uzbekistan's Green Growth Strategic Framework provides the operational plan for green transformation across the entire economy.