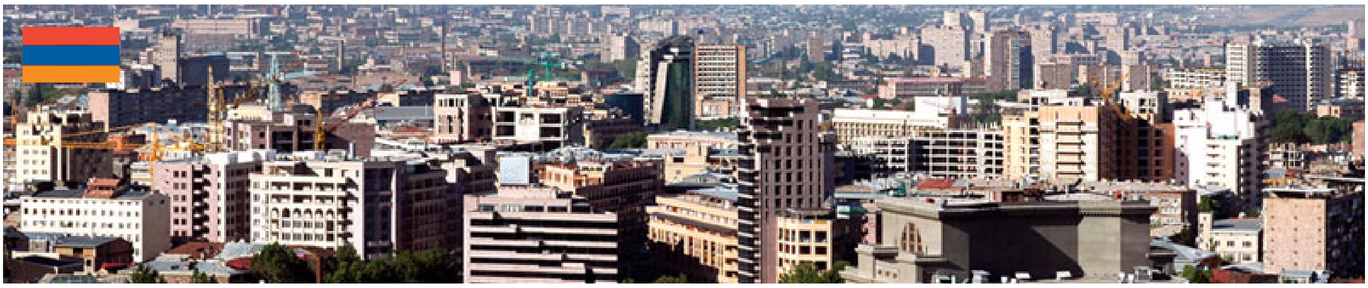

Armenia

Highlights

- **Economic growth has moderated in 2024.** Industry, construction and external trade are all performing well, as is the tourism sector, which has boosted service exports, but the net inflow of remittances has subsided.
- **Environmental sustainability is progressing.** A new 2023 green policy agenda, developed with the support of international partners, outlines key goals for enhancing renewable capacity, strengthening waste management and sustaining biodiversity.
- **Support for refugees was timely and effective.** The authorities reacted promptly to the humanitarian crisis and put in place a comprehensive support package without jeopardising the overall fiscal stance.

Key priorities for 2025

- **Humanitarian support for and the integration of refugees need to continue.** Support programmes should be expanded with the aim of fully including refugees in society. These programmes should focus on upskilling all refugees and introducing appropriate gender-sensitive policies to help smooth their integration into local labour markets.
- **The green policy agenda should be accelerated to improve energy resilience.** Given the country's high reliance on natural gas imported from Russia, the authorities should continue to make and promote investments in solar energy, upgrade the transmission network and build more interconnections with neighbouring countries.
- **Further progress on implementing tax reforms remains essential for robust public finances.** A new law to amend corporate tax collection has been adopted and it needs to be implemented in a timely manner. This will require efficient coordination between different government bodies.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-7.2	5.8	12.6	8.3	6.2
Inflation (average)	1.2	7.2	8.6	2.0	3.1
Government balance/GDP	-5.4	-4.6	-2.1	-2.0	-4.6
Current account balance/GDP	-4.0	-3.5	0.8	-1.9	-2.8
Net FDI/GDP [neg. sign = inflows]	-0.7	-2.5	-4.9	-2.4	-1.2
External debt/GDP	102.1	99.8	78.2	64.2	na
Gross reserves/GDP	20.7	22.8	20.5	15.0	na
Credit to private sector/GDP	72.2	61.7	52.6	55.4	na

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Macroeconomic developments and policy response

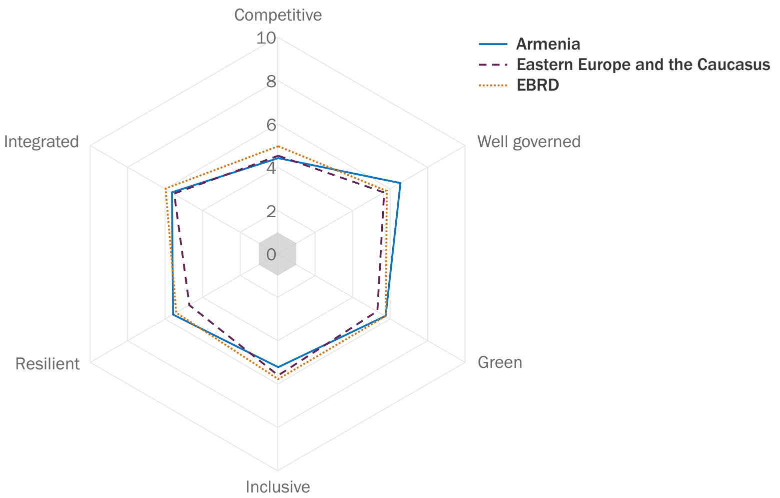
Economic growth has been moderating in 2024. After two years of robust growth, real gross domestic product (GDP) increased 6.5 per cent year on year in the first half of 2024, mainly driven by a double-digit percentage rise in construction, trade and the financial sector, along with robust growth in the manufacturing sector. Meanwhile, the growth of other services subsided after double-digit growth over the past couple of years, as the impact of highly skilled Russian migration moderated. The external sector remained driven by the same temporary factors that have dominated in recent years. Exports and imports of goods doubled year on year in the first half of 2024 thanks to an eightfold increase in exports and ninefold rise in imports of precious stones. Excluding these, exports and imports declined 15 per cent and 10 per cent, respectively. The current account deficit in the first half of 2024 was at a similar level to that of the first half of 2023, with an improvement in the balance of goods and secondary income offset by a deterioration in the balance of services and primary income. Net official transfers rose, related to refugee support, but the net inflow of remittances fell by 28 per cent year on year in the first half of 2024. Moderating capital inflows did not affect the Armenian dram, which remained broadly stable. Foreign reserves declined slightly to US$ 3.6 billion (€3.3 billion) at the end of August 2024, covering 2.5 months of goods imports.

Prudent monetary policy kept inflation low. The inflation rate had dropped to zero in 2023, mainly due to falling food prices, a relatively high central bank policy rate and the appreciation of the Armenian dram. Successful disinflation has allowed the Central Bank of Armenia (CBA) to cut the policy rate by 200 basis points since the beginning of 2024, to 7.25 per cent in October 2024. Annual inflation rebounded slightly to 0.6 per cent in October 2024, but remains well below the target level of 4.0 per cent. Despite low inflation, the CBA remains cautious about easing monetary policy due to strong consumer demand and a GDP growth rate that is still well above its long-run potential.

Further fiscal expansion is expected to temporarily widen the budget deficit in 2024. The authorities announced an increase in government expenditure to accommodate the integration of over 115,000 refugees of Armenian origin and to strengthen national defences. As the fiscal deficit was lower than expected in 2023 due to under-executed public investment projects, there is more room for fiscal loosening in 2024. Nevertheless, the new medium-term expenditure framework aims to keep the fiscal deficit at 2 per cent of GDP between 2025 and 2027, a level it has achieved over the past two years. Fiscal policy is, therefore, designed to further enhance public debt resilience against potential exchange-rate risks.

GDP growth is likely to moderate in the short run. We forecast real GDP growth to ease to 6.2 per cent in 2024 and 4.8 per cent in 2025. Although temporary capital inflows related to the war on Ukraine have dissipated, increased government spending to meet the needs of refugees and to strengthen national defences will compensate to some extent. The operation of the new gold mine, once completed, should have a positive impact on mining-sector output and exports in the medium term. However, geopolitical uncertainty poses sizeable risks to the economic outlook.

Assessment of transition qualities (1-10)



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Structural reform developments

The policy response to accommodating refugees has been timely and effective. In September 2023, an estimated 100,632 people, including some 30,000 children, arrived in Armenia. The Ministry of Labour and Social Affairs promptly launched social assistance programmes with a one-time direct transfer of AMD 100,000 (€230) per refugee. As more than half of the refugees are women, the programmes, which help them find employment and access to financial services, show great awareness of gender-specific risks, such as gender-based violence and sexual exploitation and abuse. Those refugees who have the right to a pension are eligible to reclaim their benefits in Armenia through an online platform.

Relations with the European Union (EU) are gaining momentum. Armenia started a new partnership agenda with the EU, underpinned by a €270 million Resilience and Growth Plan for 2024-27. At the same time, the EU launched a visa liberalisation dialogue with Armenia. These steps should have a positive impact on structural reforms, particularly those related to anti-corruption, rule of law and labour-market reform, and they will support investments in energy diversification and transport infrastructure.

Measures to improve environmental sustainability are under way. The green policy agenda, launched at the end of 2023 in collaboration with the Stockholm Environment Institute and the Swedish International Development Cooperation Agency, aims to develop a roadmap that will be finalised by the end of 2026. The policy agenda should harmonise national policies with European standards, ramping up renewable energy capacity, improving waste management, preserving biodiversity and preventing deforestation.

The reform of the public finance management (PFM) system continues. A new five-year PFM strategy and action plan has been in development since early 2024 following the conclusion of the first action plan for 2019-23. Proposed reforms included in the PFM aim to strengthen financial discipline and compliance while integrating digital tools to collect feedback from civil society. The plan should lead to enhanced transparency and improved methods of budgetary formulation and the evaluation of government service delivery.

A new loan agreement between Germany and Armenia is targeting greater energy resilience. Through this agreement, signed in March 2024, Armenia will receive a loan of €12 million for the development of renewable energy, with a focus on enhancing the capacity of solar power plants. The German-Armenian Fund, managed by the CBA, has been appointed to channel the loan directly to the private sector, with the aim of increasing solar energy capacity for households by as much as 150 MW.

Tax reform continues to improve government revenues. In June 2024, the National Assembly of Armenia adopted a draft law that aims to abandon the country's turnover tax and allows a switch to a unified tax system for fairer taxation. The authorities confirmed that the transition to the unified tax rate will be implemented gradually to avoid confusing business entities with changing tax codes. Initially, the turnover tax rate for small and medium-sized enterprises will be doubled and is set at 12 per cent for the catering sector, 10 per cent for trading companies and 7 per cent for manufacturing companies. Meanwhile, the threshold of eligibility for the turnover tax remains unchanged, at AMD 115 million (€265,000), above which business entities are subject to value-added tax and tax on profits.

Azerbaijan

Highlights

- **Economic growth has accelerated and inflation has slowed in 2024.** Public investment and real incomes have supported robust growth in non-oil gross domestic product (GDP), while the oil and gas sector has returned to growth on the back of strong gas demand. Inflation remains within the central bank's target range.
- **The digitalisation agenda has continued with investments in infrastructure and the adoption of the country's first cybersecurity strategy.** The authorities have increased investment in the physical cyber network, boosting network speeds, and enhanced cybersecurity by setting out the requirements for more resilient digital systems.
- **Some progress has been made on greening the economy.** The authorities set a target for renewable energy and undertook the first renewable energy auction for a utility-scale solar plant. They also laid out new energy-efficiency standards for construction.

Key priorities for 2025

- **More decisive efforts are needed to improve economic governance.** The government's stated commitment to strengthening the governance of state-owned enterprises cannot be achieved without implementing the Organisation for Economic Co-operation and Development's (OECD) principles of corporate governance. This should be accompanied by further steps to liberalise the economy and increase competition.
- **A sustained focus on the non-oil sector remains crucial for the diversification of the economy.** Levelling the playing field for private companies and reducing the state's footprint in many sectors of the economy could bring about the private-sector dynamism needed for economic diversification.
- **Enabling conditions for renewable energy are needed.** Grid capacity should be upgraded significantly to allow bigger investments in renewables, while more transparent regulatory and policy frameworks would encourage private investment in this sector.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-4.2	5.6	4.7	1.1	3.8
Inflation (average)	2.8	6.7	13.9	8.8	3.5
Government balance/GDP	-6.4	4.2	6.0	1.7	-1.1
Current account balance/GDP	-0.5	15.1	29.8	9.9	8.5
Net FDI/GDP [neg. sign = inflows]	1.8	4.1	6.5	4.3	2.8
External debt/GDP	21.6	15.1	9.7	9.8	na
Gross reserves/GDP	17.7	13.8	13.5	18.0	na
Credit to private sector/GDP	26.0	22.9	18.3	23.2	na

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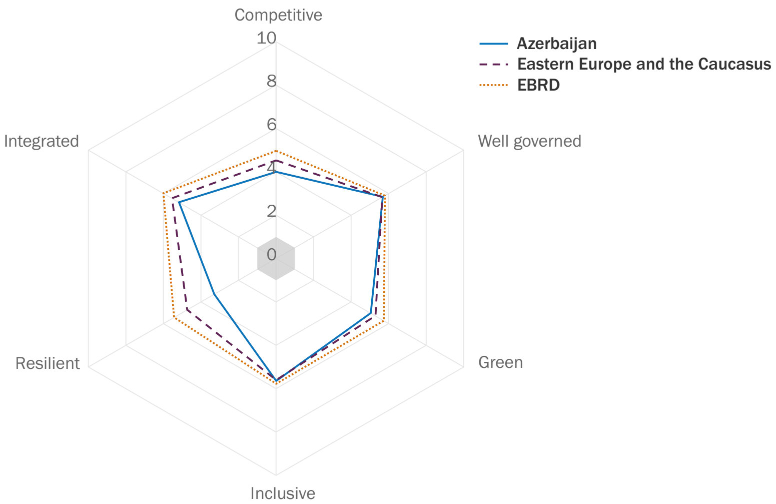
Macroeconomic developments and policy response

Economic growth has accelerated in 2024. Real GDP grew by 4.3 per cent year on year in the first half of 2024 on the back of solid real income growth and strong public infrastructure investment. Non-oil real GDP returned to robust growth of 6.8 per cent year on year after a slowdown in 2023, while the oil and gas sector posted positive growth (0.6 per cent year on year) for the first time in two years as a result of a continued increase in gas production. Gas production in the country is increasingly replacing oil due to strong demand for gas from Europe and the gradual depletion of existing oil fields. However, gas prices on the European market have been volatile in recent years, and the drop in prices in 2024 has negatively affected export revenues, halving the current account surplus in the first six months of the year.

Tight monetary policy and falling food prices have curtailed inflation. The annual rate of inflation dropped to 0 per cent in April 2024, before rising to 3.5 per cent in September. The central bank reacted to the disinflation in late 2023 with a series of gradual policy rate cuts, from 9.0 per cent in October 2023 to 7.25 per cent in May 2024. Annual credit growth has strengthened further to more than 20 per cent since the beginning of 2024, though from a very low base. Nominal income growth slowed to 5 per cent year on year in the first half of 2024, which still amounts to solid real income growth given the low level of inflation.

Energy exports and public investment will continue to drive short-term growth. The increase in demand for Azerbaijan's energy products is expected to support export revenues, though oil and gas price volatility poses a risk. A solid level of foreign reserves and an ample sovereign fund provide a liquidity buffer against this risk. The government is, therefore, likely to enable a continuation of current levels of public investment and expenditure. We forecast real GDP growth of 3.8 per cent in 2024, moderating to 2.7 per cent in 2025. The forecast is highly sensitive to fluctuations in oil and gas prices and geopolitical fragility in the region.

Assessment of transition qualities (1-10)



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Structural reform developments

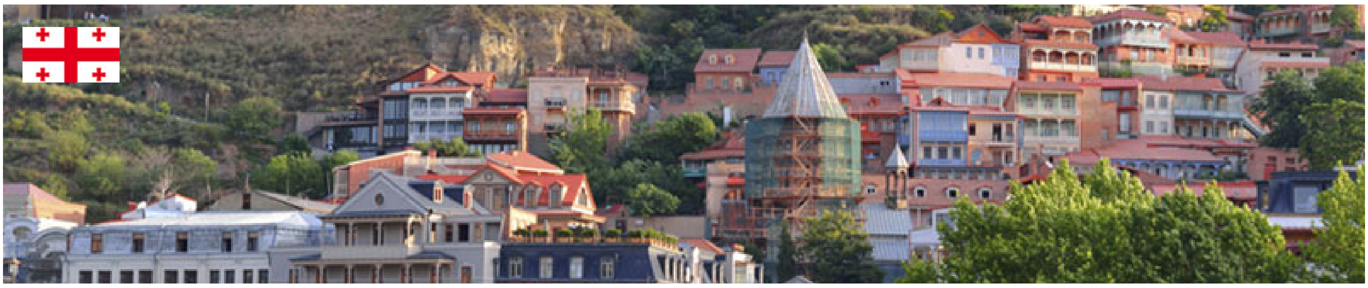
Digitalisation is continuing, with the removal of infrastructural constraints and improved cybersecurity. Investments in the physical network have increased the speed of the internet by one-third over the past year. In August 2023, the government unveiled its first five-year "Strategy of Azerbaijan Republic on Information Security and Cybersecurity for 2023–2027", which sets cybersecurity standards for the national digital space and requires enhanced personal data protection. Similarly, in 2024, the central bank enhanced requirements to improve information security in the financial sector, aimed primarily at strengthening data protection and minimising cybersecurity threats.

Azerbaijan updated its Nationally Determined Contribution (NDC) in October 2023. The authorities renewed the NDC, committing to reduce greenhouse gas emissions by 40 per cent compared with 1990 levels by 2050, providing they receive appropriate international support through financing, technology transfer and capacity building. The departure from the 2015 pledge of a 35 per cent reduction by 2030 is explained by the country's new strategic socioeconomic development programmes, specific national circumstances and growing recognition of the need to diversify the economy.

Work on capital markets development resulted in the country's first initial public offering. In May 2024, Azerbaijan's largest bank by assets, International Bank of Azerbaijan, announced the country's first initial public offering, which is expected to be finalised by the end of the year. The bank is offering a substantial portion of its shares to both domestic and international investors, aiming to diversify its shareholder base. Meanwhile, the authorities have adopted specific regulations to allow banks in Azerbaijan to provide investment services, thus expanding direct access channels. Work to improve financial derivatives and securitisation has been completed, and a corresponding draft law has been presented. In a move towards sustainable finance and the promotion of environmentally friendly investment opportunities, the basic criteria have been established to form the legislative framework for green bonds.

Some progress is being made on the green agenda. In April 2024, the first renewable energy auction was announced, while secondary regulation setting out norms for energy efficiency has been gradually adopted. The authorities, hosts of the COP29 climate conference in November 2024, have committed to increasing the renewable share of the country's installed generation capacity to at least 30 per cent by 2030 and to unlocking its green energy potential through private investment in utility-scale renewables. In 2024, the government announced the first renewable energy auction for a 100 MW solar power plant project in Garadagh. New energy-efficiency bylaws have been adopted that regulate eco design requirements and energy performance metrics for new buildings.

Expansion of the Southern Gas Corridor is under way. Responding to the rise in demand for gas, in 2024, the authorities signed several new gas supply agreements with European countries, as well as an agreement to increase the capacity of the Southern Gas Corridor connection to Greece and Italy. After the expansion, gas exports to Europe are expected to rise from the current 12 billion cubic metres to 20 billion cubic metres by 2027.



Georgia

Highlights

- **The economy continues to grow rapidly.** Strong domestic demand, a buoyant tourism sector and a geographically diversified export structure are supporting robust gross domestic product (GDP) growth amid low inflation, a sound fiscal position and a stable exchange rate.
- **The "de-oligarchisation" process has been kick-started.** The authorities accepted suggestions by the Venice Commission and European Commission and revised their action plan accordingly.
- **Progress on European Union (EU) membership has stalled.** The European Council granted Georgia candidate status for EU membership, but parliament's adoption of the Law on Transparency of Foreign Influence has halted the accession process.

Key priorities for 2025

- **The government should take the necessary steps to open the EU accession process.** The authorities should take the relevant steps set out in the European Commission recommendations from November 2023 and address concerns over the Law on Transparency of Foreign Influence.
- **Concerted efforts to "de-oligarchise" should be expedited.** The authorities need to make more effort to implement the action plan for removing the influence of oligarchs, in compliance with the recommendations of the Venice Commission.
- **Further reform of state-owned enterprises (SOEs) is needed.** Implementation of the best international corporate governance standards in SOEs would set appropriate standards for the business sector, leading to an improved business environment and higher economic growth potential.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-6.3	10.6	11.0	7.5	6.5
Inflation (average)	5.2	9.6	11.9	2.5	2.6
Government balance/GDP	-9.2	-6.0	-2.6	-2.3	-2.5
Current account balance/GDP	-12.4	-10.3	-4.5	-4.3	-5.8
Net FDI/GDP [neg. sign = inflows]	-3.5	-4.9	-7.1	-4.3	-5.0
External debt/GDP	131.2	116.9	95.1	80.2	na
Gross reserves/GDP	23.1	20.0	17.6	14.9	na
Credit to private sector/GDP	79.0	72.9	63.1	66.6	na

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Macroeconomic developments and policy response

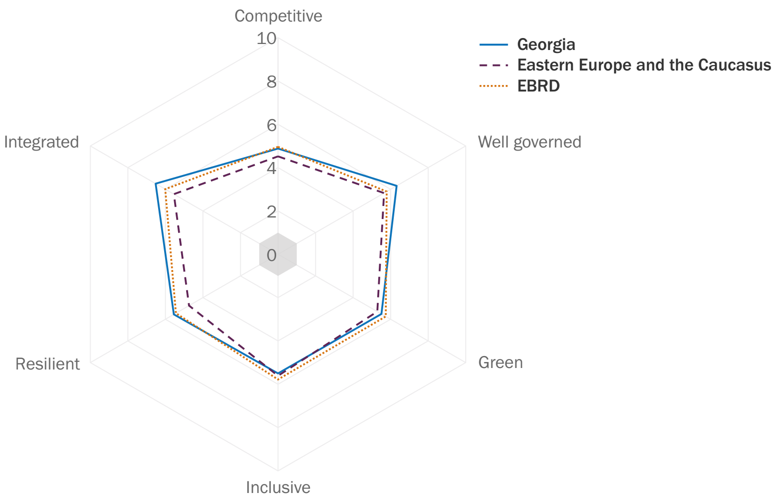
Economic growth has remained robust. Real GDP growth stood at 9.1 per cent year on year in the first half of 2024, supported mainly by the financial, information and communications technology (ICT), construction and transport sectors. However, growth in all of these sectors slowed as war-related financial inflows moderated amid a decline in migration from Russia. Consequently, the contribution of net exports of services to growth dropped, leaving domestic consumption the principal growth driver. During the same period, net money transfers to Georgia declined 33 per cent year on year because of the decrease in money transfers from Russia. Tourism revenues remained robust, but growth moderated as the number of tourists from Russia fell by 21 per cent on the year. However, the total number of tourists rose marginally in the first half of 2024 due to an increase in arrivals from EU countries and Türkiye. Exports of goods decreased by 6.8 per cent year on year in the first half of 2024, while imports increased by 3.6 per cent. The exchange rate of the Georgian lari to the US dollar remained broadly stable and occasional market pressures induced by political tensions were successfully managed by the National Bank of Georgia (NBG) with timely foreign-exchange interventions. However, foreign reserves fell by 11 per cent from their peak in August 2023 to US$ 4.8 billion (€4.4 billion) in August 2024, covering 4.1 months of imports.

Inflation has stabilised below the NBG's target level. In October 2024, annual inflation stood at 0.3 per cent, mainly due to the downward trajectory of food and energy prices, and is below the central bank's target rate of 3 per cent. The NBG has cut the policy rate by 150 basis points in 2024, bringing it to 8 per cent in May, and has kept it unchanged since then. With a falling policy rate and easing credit conditions, both households and corporate lending have risen, by 18 per cent and 23 per cent year on year, respectively, as at August 2024. Mortgage lending and corporate loans have picked up sharply, highlighting the need for the NBG's cautious approach to further rate cuts.

The fiscal position remains sound due to strong revenues and a moderate debt level. In the first half of 2024, government revenues rose by 18 per cent year on year, supported by robust growth in profit and income taxes, while government expenditure increased 16 per cent. The two largest spending items, social spending (39 per cent of the total) and public-sector wages (15 per cent), increased most, by 16 and 18 per cent, respectively, due to an increase in pensions and public-sector salaries. The budget, however, showed a surplus of 0.6 per cent of GDP, in line with the pattern of the last two years, when it was broadly balanced in the first half of the year and then rose to 2.5 per cent at the end of the year. The authorities announced their plan to maintain the fiscal deficit at 2.5 per cent of GDP in 2024 as well. The level of public debt stood at 39 per cent of GDP in 2023 and is likely to remain at a similar level in 2024.

Rapid growth is likely to continue in the short term. Although the favourable external factors related to Russian migration have dissipated, domestic consumption remains elevated and private-sector credit growth has soared. Therefore, we forecast real GDP growth of 6.5 per cent in 2024, moderating to 4.6 per cent in 2025. The main risks arise from domestic political polarisation and geopolitical developments in the broader region.

Assessment of transition qualities (1-10)



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Structural reform developments

Progress on EU accession has stalled. Georgia was granted candidate status for EU membership in December 2023. The European Council, recognising the reform progress in the economy, public administration and public procurement, asked for fulfilment of the remaining conditions specified in the European Commission's report. It expected the Georgian authorities to implement necessary measures for the proper functioning of democratic institutions and reforms related to justice and the rule of law in order to advance to the next step towards EU accession. In June 2024, the European Council expressed concern about the adoption by parliament in May 2024 of the Law on Transparency of Foreign Influence, which has led to a de facto halt to the accession process. This bill requires that media and non-profit organisations receiving more than 20 per cent of their funding from abroad officially register as organisations pursuing the interests of a foreign power. Those organisations that do not comply with the law are subject to fines of up to GEL 25,000 (€8,250). The bill authorises the Ministry of Justice to monitor the activities of civil rights organisations, media and non-governmental organisations (NGOs), including think tanks, and to share sensitive information. The Venice Commission announced that the law would suppress the freedom of assembly and expression and the right to engage in public affairs, urging the Georgian authorities to revoke the adopted bill.

The action plan on "de-oligarchisation" has undergone revision after its submission to the Venice Commission. The authorities endorsed the suggested revision by the Venice Commission and, in October 2023, updated the action plan, integrating recommendations made by the European Commission to accelerate the process. Later, they added more precise timelines for key milestones in the action plan. As a result, in early 2024, the Anti-Corruption Bureau announced a list of 300 highly ranked government officials whose asset declarations will be reviewed, with the support of an independent commission consisting of representatives of NGOs and academia.

Innovative financial tools are being implemented to improve the quality of infrastructure. In July 2024, Georgia Global Utilities (GGU), the country's largest privately owned water supply and wastewater utility company, issued a US$ 300 million (€270 million) green bond to modernise Georgia's outdated water supply infrastructure and expand the water supply network to areas surrounding the capital, Tbilisi. GGU is planning to use the proceeds of its green bond issuance to finance capital expenditure programmes, including a reduction in water losses and improved energy efficiency. International financial institutions, including the International Finance Corporation, Asian Development Bank and European Bank for Reconstruction and Development, invested a total of US$ 120 million (€109 million) in the bond.

The authorities are strengthening legislation to protect intellectual property rights. The new intellectual property protection programme, co-financed by the European Commission and the European Union Intellectual Property Office to the tune of €4 million, was launched in March 2024 to support the development of a consistent legal framework to enforce intellectual property rights. The programme aligns with EU accession requirements to build a more favourable business environment, thus attracting foreign investment and encouraging innovation. •

Moldova

Highlights

- **The country's economic recovery has continued in 2024, with inflation now within the central bank's target range.** Recent growth in real gross domestic product (GDP) has been broad based, while inflationary pressures have eased, mostly owing to declining energy prices.
- **Weak energy resilience and skills shortages are holding back the economy.** Continued outward migration flows are reducing the domestic labour supply, and the country's high dependence on imported energy from a single source has negatively affected economic growth over the last two years. The authorities have established new electricity and gas interconnectors with the European Union (EU), but their capacity is limited.
- **The EU has officially opened accession negotiations with Moldova.** After two years of implementing reforms and following EU recommendations in a challenging environment, the government is ready to embark on this far-reaching transformational process, with judicial reform, anti-corruption measures and the reform of state-owned enterprises (SOEs) high on its agenda.

Key priorities for 2025

- **The authorities need to improve administrative and institutional capabilities and expedite governance reforms.** The EU accession process requires a skilled and professional public administration and effective mobilisation of all domestic human resources. Enhancing institutional capabilities, strengthening the judiciary and establishing an effective anti-corruption framework will help the country to progress towards accession.
- **Reform of SOEs should be accelerated.** With most of the preparatory work completed, the next steps in the reform of SOEs involve restructuring and enhancing the efficiency of companies that will remain in state ownership, liquidating those that are not viable and commercialising those that are due to be privatised. This could help to unlock valuable resources and generate revenue.
- **Energy resilience needs to be strengthened through investment in energy infrastructure and renewables.** Building additional energy interconnectors with Romania will facilitate full integration into the EU's energy market and mitigate risks to economic growth, while renewables have the potential to be an important source of domestic electricity production.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-8.3	13.9	-4.6	0.7	3.2
Inflation (average)	3.8	5.1	28.7	13.4	5.0
Government balance/GDP	-5.3	-2.6	-3.2	-5.0	-4.7
Current account balance/GDP	-7.7	-12.4	-15.8	-12.8	-11.5
Net FDI/GDP [neg. sign = inflows]	-1.3	-2.7	-3.7	-2.2	-2.3
External debt/GDP	70.1	63.8	66.0	63.3	na
Gross reserves/GDP	32.7	28.4	30.9	33.1	na
Credit to private sector/GDP	28.7	28.5	27.5	25.8	na

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Macroeconomic developments and policy response

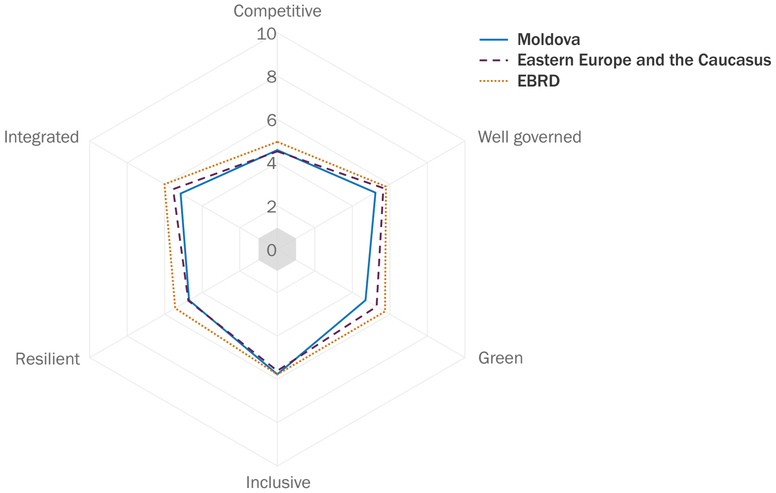
The country's modest economic recovery has continued in 2024. Real GDP increased by 2.2 per cent year on year in the first half of 2024 on the back of a broad-based recovery across multiple sectors. Agriculture grew by 6.0 per cent year on year, manufacturing rebounded solidly following the decline seen in the last two years, and information and communication technology services continued to grow, producing a robust performance. Declining inflation and real wage growth of close to 11 per cent year on year boosted private consumption. Investment in fixed assets also recovered, but net export growth turned negative. The current account deficit increased by 30 per cent year on year as a result of the higher trade deficit and reduced net inflows to the primary and secondary accounts. Foreign financing closed the balance of payments gap, while foreign reserves increased slightly in the first eight months of the year, standing at US$ 5.6 billion in August 2024, covering more than six months of imports.

Inflation is now low and the exchange rate is stable. The inflation rate has come down to within the central bank's target range of 5 per cent +/- 1.5 percentage points, and the exchange rate has been broadly stable since the beginning of 2024. Declining prices for imported electricity and gas have contributed to the falling inflation rate, allowing the National Bank of Moldova to cut its policy rate by a further 115 basis points in the first five months of the year, with that rate standing at 3.6 per cent since May 2024. The foreign-exchange market has remained broadly balanced thanks to stable foreign financing by the official sector, although grants are down compared with the last two years.

The country's fiscal performance is gradually strengthening. The fiscal deficit for 2024 is forecast to be below the 2023 figure of 5.2 per cent of GDP, indicating gradual consolidation amid improving budget revenues. The authorities are aiming to strengthen tax compliance by implementing tax administration reforms and harmonising the country's tax code and procedures with EU rules. Excise duties on tobacco and alcohol will be increased gradually to align them with EU directives by 2025. Meanwhile, public debt stood at a moderate 36.6 per cent of GDP at the end of 2023 and is forecast to increase slightly in 2024.

The economic recovery is likely to continue in the short term. We forecast real GDP growth of 3.2 per cent in 2024 and 3.5 per cent in 2025. However, the pace of the country's recovery is dependent on it having a stable energy supply and sufficient labour supply. In the last two years, economic growth has been badly hit by the war on Ukraine and the subsequent energy crisis. Newly built gas and electricity interconnectors with Romania have improved Moldova's energy security by reducing its reliance on a single source of supply, but their capacity is still limited. At the same time, migration flows to the EU have reduced the domestic labour supply, negatively affecting productivity and growth potential. There are signs that this problem is being addressed, with inclusion policies being introduced to raise the labour participation rate for women.

Assessment of transition qualities (1-10)



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Structural reform developments

EU accession negotiations have begun. Two years after granting Moldova EU candidate status, the EU officially opened accession negotiations in June 2024. Moldova will now embark on a complex process involving full implementation of the EU's acquis communautaire, which will require comprehensive reforms as regards the rule of law, the strengthening of democratic institutions and the public administration, and preparations to join the single market. In particular, the EU's negotiating framework has highlighted the need for further judicial reforms, improved anti-corruption measures and non-discriminatory treatment of minority groups. The European Commission has shown strong support for the structural reform agenda through the Growth Plan for the Republic of Moldova, adopted in October 2024. The plan is worth €1.8 billion in the period 2025-27, of which €285 million will be in the form of grants, and will be accompanied by a detailed reform agenda prepared by the authorities. In addition, Moldova has agreed a security and defence partnership with the EU to reduce military threats and enhance cybersecurity.

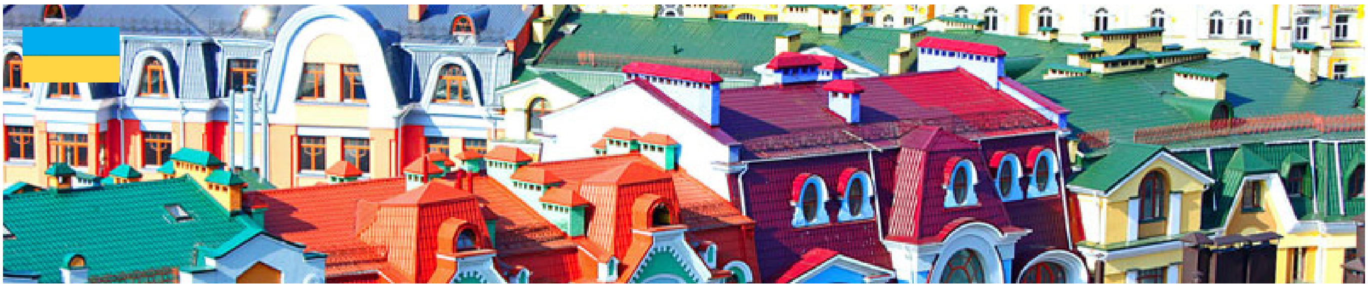
Judicial reform is under way. Moldova's Superior Council of Magistracy has established institutional reform guidelines in consultation with the Council of Europe, justice-sector institutions and civil society representatives. Launched in February 2024, these guidelines focus on strengthening judicial independence and the transparency of the courts.

Moldova has stepped up its anti-corruption efforts in order to accelerate the accession process. The National Integrity and Anti-Corruption Programme 2024-28, which was adopted in December 2023, aims to reduce corruption and enhance integrity in the public and private sectors. In effect since February 2024, it is overseen by the National Anti-Corruption Centre, which also monitors its implementation. Key areas include ensuring transparency in public decision-making, strengthening the judicial sector, and enhancing the democratic electoral process by tackling misinformation and illegal political financing.

Welfare spending remains a priority. Investment in education and training for people with disabilities was doubled at the beginning of 2024, while teachers' salaries rose by 15 per cent. The childbirth allowance was increased to MDL 20,000 (€1,000) to enhance child protection, the budget for veterans of the wars in Transnistria and Afghanistan rose to MDL 82 million (€4 million), and MDL 197 million (€10 million) was earmarked to support the development of small and medium-sized enterprises.

EU financing is being used to facilitate labour-market reform. In May 2024 Moldova and the EU signed an agreement giving the country access to the European Social Fund Plus in order to boost employment and re- or upskill Moldova's workforce. This agreement, which applies retroactively from January 2024, will fund policies supporting employment, social inclusion and the reduction of poverty. The specific projects that are financed will be determined in consultation with public authorities, civil society and other social development partners.

Preparatory work aimed at reforming SOEs has continued. The country's new Corporate Governance Code, which was adopted in October 2023, has established rules governing the responsibilities of SOE management and supervisory boards, reporting standards and criteria for the disclosure of information of public interest. At the same time, as a follow-up to the country's state ownership strategy, the Public Property Agency has screened 238 SOEs and determined whether they should be: (i) kept in public ownership; (ii) privatised; (iii) restructured and then privatised; or (iv) liquidated.



Ukraine

Highlights

- **The economy is being damaged by a new wave of destruction, with the Russian military targeting Ukraine's electricity infrastructure.** The new Black Sea shipping corridor along the coastline has opened up export possibilities for Ukraine's grain, mining and base-metal sectors. However, electricity shortages caused by Russia's renewed heavy bombing of electricity generation and transmission infrastructure have resulted in serious challenges for Ukraine's economic recovery.
- **The external financing required to maintain macroeconomic stability and the functioning of public services has now been received after some delays.** The financing gap for 2024 has eventually been closed, but delays in official foreign financing and associated uncertainty have placed pressure on the foreign-exchange market.
- **The opening of European Union (EU) accession negotiations marks the beginning of a complex process of harmonisation with EU legislation.** The government's Ukraine Plan shows that it is committed to a comprehensive economic recovery and transformation, with an early focus on judicial reform, the fight against corruption, and strengthening institutions and the public administration.

Key priorities for 2025

- **The authorities should use the momentum from the opening of accession negotiations and mobilise all domestic resources to advance reforms.** The Ukraine Plan is a viable roadmap, and strict adherence to it will bring irreversible progress in critical areas such as the rule of law, governance and the fight against corruption.
- **Stronger efforts should be made to bring veterans and women into the labour force.** Businesses face growing skills shortages, with many men engaged in the defence of the country and millions of people – mostly women and children – having been forced to leave Ukraine. Filling labour gaps with retrained veterans and currently inactive women will not only support the war effort through a stronger economy, but also foster inclusion and increase the economy's medium-term growth potential.
- **The authorities should improve energy resilience by enhancing Ukraine's energy generation capabilities (including renewables).** Large legacy thermoelectric plants have suffered heavy war damage, so diversifying supply using numerous low-capacity plants based on a mixture of gas and renewable sources will reduce energy-sector vulnerability and contribute to the green transition.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-4.0	3.4	-28.8	5.3	3.0
Inflation (average)	2.7	9.4	20.2	12.9	6.4
Government balance/GDP	-5.9	-4.0	-15.6	-19.6	-18.7
Current account balance/GDP	3.3	-1.9	5.0	-5.4	-8.1
Net FDI/GDP [neg. sign = inflows]	0.0	-3.8	-0.1	-2.4	-2.2
External debt/GDP	80.2	64.9	80.8	90.4	na
Gross reserves/GDP	17.7	14.6	15.7	21.1	na
Credit to private sector/GDP	28.2	23.6	23.3	na	na

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Macroeconomic developments and policy response

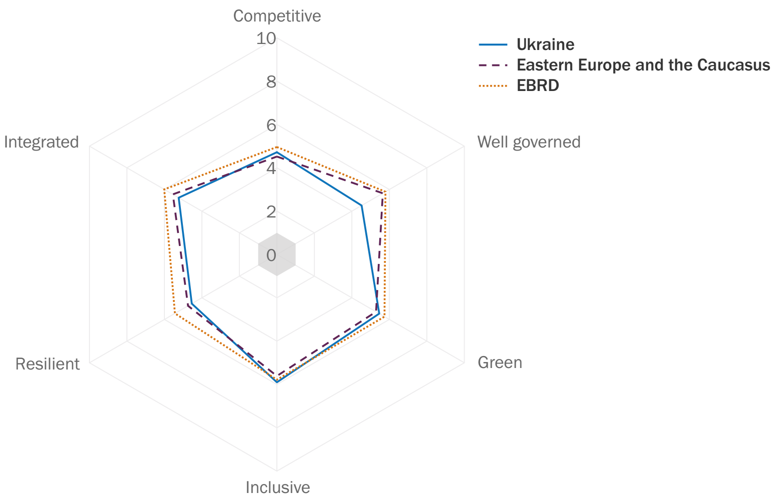
Russia's war of aggression continues to affect the economy. Real gross domestic product (GDP) increased by 6.5 per cent year on year in the first quarter of 2024, driven by a recovery in exports and the expansion of domestic military production. The opening of the new Black Sea export corridor along the coastline has enabled increased exports of grain and a resumption of maritime exports of other bulk goods, such as metals and ores (and even a resumption of container transport). This has boosted the metal and mining industries, which have been among the hardest hit over the last two years. However, Russia's heavy destruction of electricity infrastructure since late March 2024 has wiped out half of Ukraine's pre-war generation capability, causing power shortages and increased dependence on imported electricity at much higher prices. As a result, real GDP growth moderated to 3.7 per cent year on year in the second quarter of 2024.

Monetary policy easing has been paused amid resurfaced inflation. Annual inflation dropped to 3.2 per cent in March and April 2024. The National Bank of Ukraine consequently continued its monetary policy easing, cutting its policy rate by a further 200 basis points in the first half of the year to 13.0 per cent in June 2024. Inflation then rose again to 8.6 per cent in September, leading the central bank to pause further rate cuts. In October 2023 the central bank shifted its exchange-rate policy from a pegged exchange rate to a managed flexible exchange rate, allowing the hryvnia to gradually depreciate by 10 per cent. The resulting pass-through to inflation and the higher production costs caused by electricity shortages have boosted inflationary pressures in the second half of 2024, prompting an increasingly cautious approach to monetary policy.

External financing has supported economic stabilisation and growth. The authorities have performed well under the International Monetary Fund programme, successfully completing the third, fourth and fifth reviews in March, June and September 2024, respectively, and unlocking US$ 4.2 billion (€3.8 billion) in budget financing. Financing from the EU and the United States of America (which had accounted for around 70 per cent of the US$ 73.5 billion [€67 billion] received in the previous two years) was hit by delays at the beginning of 2024. Eventually, the EU's new €50 billion package for 2024-27 was approved in February 2024 (with around €16 billion set to be released in 2024) and the US contribution of around US$ 8 billion (€7.3 billion) was approved in April 2024. It is expected that this external financing, together with inflows from other bilateral and multilateral creditors, will fully cover Ukraine's budget deficit for 2024, which is forecast to stand at US$ 38.6 billion (€35 billion, or 20 per cent of GDP). Heavy reliance on foreign debt financing has increased the country's public debt by more than 60 per cent since the start of the war, to US$ 155 billion (€141 billion, or around 90 per cent of GDP) in August 2024. Bilateral creditors from the G7+ group of countries have extended the grace period for debt repayments to March 2027. Meanwhile, Ukraine has reached a deal on debt restructuring terms with a committee of bondholders for bonds totalling US$ 20.4 billion (€18.5 billion, or 13 per cent of total public debt). It will thus gain significant short-term cash-flow relief totalling US$ 11.4 billion (€10.4 billion) in the next three years.

Short-term growth prospects are highly uncertain. Amid the continuing war of attrition and unrelenting support by Ukraine's partners, GDP growth is expected to remain positive at 3.0 per cent in 2024 and 4.7 per cent in 2025. However, the risks remain exceptionally high and depend on the dynamics of the war.

Assessment of transition qualities (1-10)



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Structural reform developments

The EU has opened accession negotiations with Ukraine. Following the December 2023 decision to open negotiations, the European Council approved the negotiating framework in June 2024, two years after the original decision to grant Ukraine candidate status. Ukraine will now embark on the comprehensive process of incorporating the EU's acquis communautaire into its legal system. Accession negotiations are expected to help drive the reform process, with a focus on judicial reform, the fight against corruption, and strengthening institutions and the public administration.

The Ukraine Plan is the roadmap for the country's recovery and integration into the EU. The plan, which was published in March 2024 in close coordination with the European Commission, is a strategic guidance document detailing the reforms needed to: (i) foster recovery, reconstruction and modernisation; and (ii) support EU accession. It sets out the sequence of comprehensive reforms needed to access the EU's €50 billion Ukraine facility (of which €38.3 billion is budgetary support, €7.0 billion is investment funds in the Ukraine Investment Framework, and €4.7 billion is technical and administrative support, including interest-rate coverage for budgetary support). The plan is expected to drive the reform agenda and set investment priorities in the short to medium term.

Progress is being made on corporate governance reforms for state-owned enterprises (SOEs). In February 2024, the Ukrainian parliament adopted the SOE Corporate Governance Law, establishing the foundations for governance reform in that broad sector. Aside from a few temporary exclusions owing to the war, the law reflects the Organisation for Economic Cooperation and Development's guidelines on corporate governance, seeking to strengthen supervisory board powers, increase transparency, and introduce checks and balances. Members of supervisory boards will be selected using competitive and transparent processes, and boards will have full power to appoint and dismiss SOE executives, as well as to approve strategic plans and budgets. The Ministry of Finance will retain the power to approve key indicators assessing the financial plans of strategic SOEs in order to limit fiscal risks to public finances. Following the adoption of the law, the authorities have started to draft the comprehensive bylaws needed to implement it and establish a policy on state ownership.

New measures have been put in place to fight financial crime. In June 2024 the Ukrainian parliament adopted legislation aimed at reforming the Economic Security Bureau (ESB). Under the auspices of the government, the ESB will get enhanced analytical capacity and will focus on identifying and fighting major financial crimes. Its new management team is to be selected in a robust, competitive and transparent procedure by a committee of experts, half of whom are independent, international specialists with the right to cast the deciding vote. Existing staff will be recertified by the same committee, with international experts again having the deciding vote. The rebooted ESB comes in response to the concerns of Ukrainian businesses.

Ukraine is now fully connected to the European energy system. Now that Ukrenergo has fully complied with the necessary technical requirements, the European Network of Transmission System Operators for Electricity (ENTSO-E) has permanently connected Ukraine to the European energy system. This process was first initiated back in 2017, before being given renewed impetus in February 2022. The capacity limit for electricity trade between continental Europe and Ukraine and Moldova has been raised from 1,200 MW to 1,700 MW. This is vital at a time when Ukraine's electricity generation capabilities are under attack and being destroyed by Russia on a near-daily basis.

The authorities are taking steps to address labour shortages. Nearly three years of full-scale warfare have taken an enormous toll on Ukraine's human capital, with a highly negative impact on the labour market, the economy and social cohesion. With the support of the EBRD and other international partners, the Ukrainian authorities are working to enhance the workforce's capacity to adapt to challenges stemming from the ongoing war, with a focus on reintegrating veterans into work.