WORLD BANK GROUP

Unleashing the Power of the Private Sector

Europe and Central Asia Economic Update

Office of the Chief Economist

Spring 2024

WORLD BANK **ECA ECONOMIC UPDATE** SPRING 2024

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1 2 3 4   27 26 25 24

ISBN (electronic): 978-1-4648-2108-0

DOI: 10.1596/978-1-4648-2108-0

Cover design: Lauren Kaley Johnson

Contents

Boxes

Figures

Tables

Acknowledgments

The bi-annual Europe and Central Asia (ECA) Economic Update is a product of ECA's Office of the Chief Economist led by Ivailo Izvorski. It is produced in collaboration with the Macroeconomics, Trade and Investment; Finance, Competitiveness and Innovation; and the Poverty and Equity Global Practices, and the Development Economics Vice Presidency. Antonella Bassani and the ECA regional leadership team have provided guidance and inputs during the preparation of the report.

Parts 1 and 2 were prepared by Miriam Bruhn, Ivailo Izvorski, Sergiy Kasyanenko, and Dorothe Singer, with contributions from Hrisyana Doytchinova. Valuable inputs were provided by Rafaela Martinho Henriques and Collette Mari Wheeler for Box 1.1. Siddharth Hari and Indhira Vanessa Santos contributed to Box 1.2. Useful comments were provided by Asad Alam, Cindy Audiguier, Florian Michael Blum, Reena Badiani-Magnusson, Francisco Campos, Jasmin Chakeri, Marcel Chistruga, Claire Honore Hollweg, Leonardo Iacovone, Mariana Iootty De Paiva Dias, David Knight, Armineh Manookian Salmasi, Martin Melecky, Antonio Nucifora, Catalin Pauna, Richard Record, Natasha Rovo, Miguel Eduardo Sanchez Martin, Lazar Sestovic, Natasha Sharma, Maryna Sidarenka, Ilias Skamnelos, Stefka Slavova, Melanie Simone Trost, Eskender Trushin, Yutaka Yoshino, and Bakhrom Ziyaev. Parts 1 and 2 were closely coordinated with contributions from Part 3 authors.

Part 3 was prepared by teams from the Macroeconomics, Trade and Investment Global Practice (led by Asad Alam, Andrew Burns, Jasmin Chakeri, and Antonio Nucifora) and the Poverty and Equity Global Practice (led by Ambar Narayan). These teams included the following staff: Azamat Agaidarov, Aibek Ashirov, Cindy Audiguier, Henry Eshemokhai Aviomoh, Reena Badiani-Magnusson, Florian Michael Blum, Paola Alejandra Alvarado Castillo, Marie-Anne Chambonnier, Vicky Chemutai, Marcel Chistruga, Alexandru Cojocaru, Maria Rechelyn De La Pena Pore, Mariam Dolidze, Andrei Silviu Dospinescu, Bakyt Dubashov, Olga Emelyanova, Anna Fruttero, Josip Funda, Gohar Gyulumyan, Alexander Haider, Lea Hakim, Sandra Hlivnjak, Claire Honore Hollweg, Saida Ismailakhunova, David Stephen Knight, Christos Kostopoulos, Milan Lakicevic, Joana Madjoska, Sanja Madzarevic-Sujster, Armineh Manookian Salmasi, Monika Anna Matyja, Kristina Cathrine Tan Mercado, Besart Myderrizi, Metin Nebiler, Nga Thi Viet Nguyen, Desislava Enikova Nikolova, Kristina Noelle Vaughan, Natsuko Kiso Nozaki, Mustafa Utku Ozmen, Catalin Pauna, Elizaveta Perova, Nathalie Picarelli, Alisher Rajabov, Nadir Ramazanov, Richard James Lowden Record, Monica Robayo, Isolina Rossi, Natasha Rovo, Zurab Sajaia, Miguel Eduardo Sanchez Martin, Ilyas Sarsenov, Lazar Sestovic, Natasha Sharma, Hilda Shijaku, Maryna Sidarenka, Karlis Smits, Sun Hwa Song, Tihomir Stucka, Melanie Simone Trost, Eskender Trushin, Ikuko Uochi, Pinar Yasar, and Bakhrom Ziyaev.

Sandra Gain provided the editorial support and Michael Alwan typeset the report. Indira Chand, Nicole Frost, Aaron Wesley Korenewsky, Marcelo Gonzales Montoya, and Amy Stilwell provided communications and outreach support. Ekaterina Ushakova oversaw the layout and production of the report.

Abbreviations

AE	advanced economies in Europe
bbl	barrel
BHAS	Bosnia and Herzegovina Agency for Statistics
BiH	Bosnia and Herzegovina
BOSs	businesses of the state
BTI	Bertelsmann Transformation Index
CAD	current account deficit
CAIT	Climate Watch—country greenhouse gas emissions dataset
CBAM	Carbon Border Adjustment Mechanism
CBAR	Central Bank of Azerbaijan
CBU	Central Bank of Uzbekistan
CDS	credit default swap
CEM	Country Economic Memorandum
EAP	East Asia and Pacific
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
ECAPOV	ECAPOV (ECA Poverty) database of standardized household surveys
ECB	European Central Bank
EMDEs	emerging markets and developing economies
EU	European Union
FDI	foreign direct investment
FX	foreign exchange
GDP	gross domestic product
GFC	global financial crisis
GFCF	gross fixed capital formation
GHG	greenhouse gas
GNI	gross national income
GSCPI	Global Supply Chain Pressure Index
GUS	Central Statistical Office of Poland
GVC	global value chain
H1, H2	first and second halves of the year
HBS	household budget surveys
HHI	Herfindahl-Hirschman Index
HHS	household surveys
ICT	information and communications technology
ILCS	Integrated Living Conditions Survey
IMF	International Monetary Fund
INSTAT	Institute of Statistics (Albania)
KIHS	Kyrgyz Integrated Household Survey
LAC	Latin America and the Caribbean
LCU	local currency unit
LFS	Labor Force Survey
MENA	Middle East and North Africa
MICs	middle-income countries

MPO	Macro Poverty Outlook (World Bank)
$mtCO_2e$	metric tons of carbon dioxide equivalent
NBG	National Bank of Georgia
NPL	non-performing loan
NRRP	National Recovery and Resilience Plan
OECD	Organisation for Economic Co-operation and Development
pc	per capita
PISA	Program for International Student Assessment
PPP	purchasing power parity
Q	quarter
R&D	research and development
SAR	South Asia
SILC	Statistics of Income and Living Conditions
SMEs	small and medium-sized enterprises
SOE	state-owned enterprise
SOFAZ	State Oil Fund of the Republic of Azerbaijan
SSA	Sub-Saharan Africa
UMIC	upper-middle-income country
UNESCO	United Nations Educational, Scientific and Cultural Organization
VET	vocational education and training
WB	World Bank
WDI	World Development Indicators
yoy	year-over-year

Regional Classification Used in this Report

This report covers the emerging markets and developing economies (EMDEs) in Europe and Central Asia (ECA). These are divided into the following groups: Central Asia, Central Europe, Eastern Europe, the Russian Federation, the South Caucasus, Türkiye, and the Western Balkans.

Central Asia: Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan

Central Europe: Bulgaria, Croatia, Poland, Romania

Eastern Europe: Belarus, Moldova, Ukraine

Russian Federation

South Caucasus: Armenia, Azerbaijan, Georgia

Türkiye

Western Balkans: Albania, Bosnia and Herzegovina, Kosovo, Montenegro, Republic of North Macedonia, Serbia

Executive Summary

Growth in the emerging markets and developing countries of Europe and Central Asia (ECA) increased to 3.3 percent last year from 1.5 percent in 2022, reflecting a shift from contraction to expansion in the Russian Federation and Ukraine and a more robust recovery in Central Asia. This compares with average growth of 3.1 percent a year during 2010–19 and 5.1 percent a year during 2000–09.

Excluding Russia and Ukraine, growth in the region weakened to 3.1 percent in 2023 from 4.8 percent in 2022 because of the sharp slowdown in major trading partners, substantial tightening of financial conditions, and lingering effects of the cost-of-living crisis. Headwinds from the lackluster recovery in China and moderating global commodity prices also weighed on growth in some ECA commodity exporters. In about two-thirds of the countries in ECA, economic growth was slower last year than in 2022, and in almost a third the growth estimates for 2023 were downgraded relative to the January 2024 projections.

Inflation—the main shock to living standards and consumption in 2022—has fallen sharply and much faster than earlier expected, owing to lower global food and energy prices and tighter monetary policies. The median annual consumer price inflation dropped to 4.2 percent by February 2024 from a peak of almost 16 percent in September 2022. Although inflation has declined, price levels are 40 percent higher than in 2018–19, and food prices are 50 percent higher. The 2022 cost-of-living crisis continues to affect households despite the significant increases in real incomes last year.

Economic activity in the region is likely to remain resilient but is projected to slow this year as a weaker global economy, slowdown in China, and lower commodity prices weigh on the region's growth outlook. Regional growth is expected to slow to 2.8 percent on average in 2024–25. The slowdown primarily reflects weaker expansions in Russia and Ukraine and moderation of growth in Türkiye as policies there remain tight. Growth in Central Asia and the South Caucasus is likely to decline as well amid the easing of remittances. However, growth is expected to pick up strongly in Central Europe and the Western Balkans because of strong recoveries in labor markets, wages, and investment boosted by EU funds.

The outlook faces multiple headwinds. A slower-than-expected recovery in key trading partners, especially in the euro area, restrictive monetary policies, and an exacerbation of geopolitical developments could further dampen growth across the region. Further delays of fiscal consolidations would limit fiscal space and may keep borrowing cost elevated. A sharp escalation of regional and geopolitical tensions could dampen growth by eroding consumer and investor confidence.

With heightened geopolitical risks and substantial policy uncertainty, investment growth in ECA, already much slower than before the global financial crisis, could weaken further, especially if progress in advancing structural reforms remains sluggish. Weak investment will depress long-term growth in ECA and further delay income convergence.

Against the background of slowing growth and convergence, this *ECA Economic Update* focuses on the role of business dynamism and innovation in boosting prosperity and productivity in the region.

Economic development in ECA has been the story of the transition from plan to market, the advance of broad and deep structural reforms, and the emergence of private initiative as the main driver of growth. In less than three decades, a dozen ECA countries joined the European Union. The successful transition of these countries to EU-integrated market economies with robust institutions and production structures illustrates just how far reforms have taken some countries in the region, including to high-income status. But the ambitious structural reform agenda of the 1990s has slowed in many middle-income countries in ECA, and their transition to market is still ongoing.

Weaker productivity growth in ECA over the past decade has slowed income convergence with advanced economies. While there was a broad-based slowdown in productivity across emerging markets and developing economies after the global financial crisis, and in most advanced economies since the 1970s, the decline was steepest in ECA. Fundamental drivers of productivity growth, including progress in advancing institutional and market reforms, and technology adoption and innovation, which are all key for enabling private sector led growth, have weakened in ECA. Many countries in the region have made limited progress in establishing more effective corporate and market institutions in recent years.

The region has plenty of room for improving business dynamism and innovation. Firms in ECA are less productive and less innovative than those in the advanced economies in Europe. Firm entry and exit rates are lower and firms do not grow much over time, pointing to a less competitive and dynamic business environment where firms tend to innovate less, absorb less knowledge, and often become less productive over time.

Boosting business dynamism in ECA will require addressing several challenges, including upgrading the competition environment, reducing state involvement in the economy, dramatically boosting the quality of education, and strengthening the availability of finance. Although meeting these challenges will look different in different countries, addressing them is an essential condition for stronger economic growth and overcoming the middle-income trap. Further, deepening integration into global markets will be crucial to help to accelerate both the adoption of new technologies and firms overcoming the limits to potential firm growth due to the small size of many economies in the region. Adverse demographics are also a challenge in the countries in the western part of the region, where tightening labor supply due to declining populations is exacerbated by high emigration rates of young and skilled workers.

PART

Recent Developments, Policies, and Outlook

Recent Economic Developments

Growth picked up in a few countries in the region but weakened in most

Growth in developing Europe and Central Asia (ECA) strengthened to 3.3 percent in 2023 from 1.5 percent in 2022, reflecting a shift from contraction to expansion in both the Russian Federation and Ukraine and a more robust recovery in Central Asia. This compares with average growth of 3.1 percent a year during 2010–19 and 5.1 percent a year during 2000–09.

Excluding Russia and Ukraine, growth in the region weakened to 3.1 percent in 2023 from 4.8 percent in 2022 because of the sharp slowdown in major trading partners, substantial tightening of financial conditions, and lingering effects of the cost-of-living crisis (table 1.1; figure 1.1, panel a).[1] Headwinds from the lackluster recovery in China and moderating global commodity prices also weighed on growth in some ECA commodity exporters (box 1.1). In about two-thirds of the 23 ECA countries, economic growth was slower last year than in 2022, while in almost a third the growth estimates for 2023 were downgraded relative to the January 2024 projections (table 1.2; figure 1.1, panel b).

In Russia, ECA's largest economy, gross domestic product (GDP) grew by an estimated 3.6 percent in 2023 as a surge in government spending supported larger social outlays, wages, and investment, especially in industries related to defense, boosting activity in manufacturing and construction. Russia's crude oil

1. The calculation of aggregate growth for both ECA and ECA excluding Russia and Ukraine uses country growth rates weighted by the size of the economy. As a result, large economies have a larger impact on regional gross domestic product (GDP) estimates and projections. Russia's economy accounts for almost 40 percent of ECA's GDP, Türkiye's for more than 24 percent, and Poland's for 14 percent.

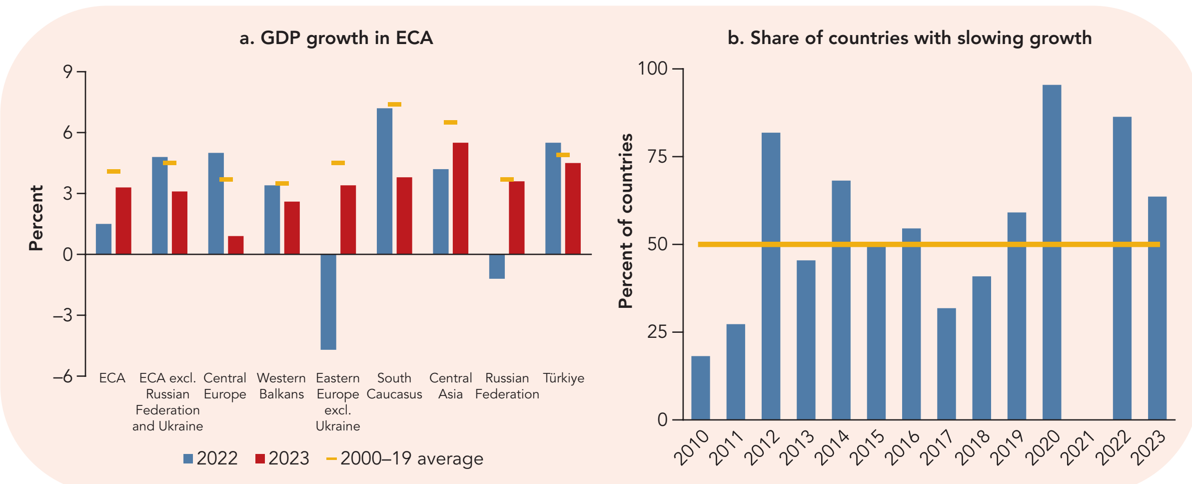
TABLE 1.1. **Europe and Central Asia economic growth summary, 2020–25**

(Real GDP growth at market prices in percent, unless indicated otherwise[a])

	2020	2021	2022	2023[e]	2024[f]	2025[f]	Percentage point differences from January 2024 projections 2023[e]	2024[f]	2025[f]
ECA	**−1.7**	**7.3**	**1.5**	**3.3**	**2.8**	**2.7**	**0.5**	**0.4**	**0.0**
ECA excl. the Russian Federation and Ukraine	−1.0	8.5	4.8	3.1	3.1	3.6	0.2	0.0	−0.1
ECA excl. the Russian Federation, Türkiye, and Ukraine	−2.7	6.6	4.4	2.2	3.2	3.7	0.1	0.1	0.1
Central Europe[b]	−3.0	7.1	5.0	0.9	3.0	3.5	−0.1	0.2	0.0
Western Balkans[c]	−3.0	7.9	3.4	2.6	3.2	3.5	0.1	0.2	0.0
Eastern Europe excl. Ukraine[d]	−1.8	4.0	−4.7	3.4	1.3	1.2	0.6	0.0	−0.1
South Caucasus[e]	−5.2	6.7	7.2	3.8	3.5	3.4	0.3	0.2	0.1
Central Asia[f]	−1.3	5.3	4.2	5.5	4.1	4.9	0.6	−0.6	0.1
Russian Federation	−2.7	5.9	−1.2	3.6	2.2	1.1	1.0	0.9	0.2
Türkiye	1.9	11.4	5.5	4.5	3.0	3.6	0.3	−0.1	−0.3
Poland	−2.0	6.9	5.3	0.2	3.0	3.4	−0.3	0.4	0.0

Source: World Bank.
Note: e = estimate; ECA = Europe and Central Asia; f = forecast; GDP = gross domestic product.
a. GDP is measured in average 2010–19 prices and market exchange rates.
b. Includes Bulgaria, Croatia, Poland, and Romania.
c. Includes Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia.
d. Includes Belarus and Moldova.
e. Includes Armenia, Azerbaijan, and Georgia.
f. Includes Kazakhstan, the Kyrgyz Republic, Tajikistan, and Uzbekistan.

FIGURE 1.1. **Recent developments**



Sources: World Bank.
Note: GDP is measured in average 2010–19 prices and market exchange rates. ECA = Europe and Central Asia; GDP = gross domestic product.

TABLE 1.2 Europe and Central Asia country economic growth, 2020–25

(Real GDP growth at market prices in percent, unless indicated otherwise[a])

Country	2020	2021	2022	2023e	2024f	2025f	Percentage point differences from January 2024 projections: 2023e	2024f	2025f
Albania	−3.3	8.9	4.9	3.3	3.3	3.4	−0.3	0.1	0.2
Armenia	−7.2	5.8	12.6	8.7	5.5	4.9	1.6	0.8	0.4
Azerbaijan	−4.3	5.6	4.6	1.1	2.3	2.4	−0.4	−0.1	−0.1
Belarus	−0.7	2.4	−4.7	3.9	1.2	0.7	0.9	0.4	−0.1
Bosnia and Herzegovina[b]	−2.9	7.3	3.8	1.9	2.6	3.3	−0.3	−0.2	−0.1
Bulgaria	−4.0	7.7	3.9	1.8	2.1	3.1	0.1	−0.3	−0.2
Croatia	−8.6	13.8	6.3	2.8	3.0	2.8	0.3	0.3	−0.2
Georgia	−6.3	10.6	11.0	7.5	5.2	5.0	1.0	−0.4	0.5
Kazakhstan	−2.5	4.3	3.2	5.1	3.4	4.7	0.6	−0.9	0.2
Kosovo	−5.3	10.7	4.3	3.1	3.7	3.9	−0.1	−0.2	−0.1
Kyrgyz Republic	−7.1	5.5	9.0	6.2	4.5	4.2	2.7	0.5	0.2
Moldova	−8.3	13.9	−4.6	0.7	2.2	3.9	−1.1	−2.0	−0.2
Montenegro	−15.3	13.0	6.4	6.0	3.4	2.8	1.2	0.2	−0.3
North Macedonia	−4.7	4.5	2.2	1.0	2.5	2.9	−0.8	0.0	0.0
Poland	−2.0	6.9	5.3	0.2	3.0	3.4	−0.3	0.4	0.0
Romania	−3.7	5.7	4.1	2.1	3.3	3.8	0.3	0.0	0.0
Russian Federation	−2.7	5.9	−1.2	3.6	2.2	1.1	1.0	0.9	0.2
Serbia	−0.9	7.7	2.5	2.5	3.5	3.8	0.5	0.5	0.0
Tajikistan	4.4	9.4	8.0	8.3	6.5	4.5	0.8	1.0	0.0
Türkiye	1.9	11.4	5.5	4.5	3.0	3.6	0.3	−0.1	−0.3
Ukraine	−3.8	3.4	−28.8	4.8	3.2	6.5	0.0	0.0	0.0
Uzbekistan	2.0	7.4	5.7	6.0	5.3	5.5	0.5	−0.2	0.0

Source: World Bank.
Note: e = estimate; f = forecast; GDP = gross domestic product.
a. GDP is measured in average 2010–19 prices and market exchange rates.
b. GDP growth rate at constant prices is based on the production approach.

exports remained stable, with energy shipments shifting from the European Union to China and India. In Türkiye, the region's second largest economy, growth slowed to 4.5 percent in 2023 from 5.5 percent in 2022, as a shift toward more restrictive monetary and fiscal policies led to slower growth of private consumption. A surge in investment, thanks to increasing private sector credit and government spending on reconstruction efforts after the February 2023 earthquakes, helped to support the economy.

In Central Asia, the pace of economic expansion quickened to an estimated 5.5 percent last year from 4.2 percent in 2022. In Kazakhstan, the pickup in growth reflected an increase in oil production by 6 percent in 2023. In the rest of Central Asia, growth was supported by steep declines in inflation, increased government spending, remittances, robust credit growth, and increased trade.

BOX 1.1 Global Outlook

The world economy is likely to slow for the third consecutive year in 2024. Global growth is projected to weaken to 2.4 percent in 2024, reflecting the negative effects of tight monetary policies, restrictive credit conditions, and sluggish global trade and investment. Near-term prospects are diverging across the world's regions. Growth is projected to slow in the advanced economies and China, falling below the 2010–19 average pace. By contrast, in emerging markets and developing economies with strong credit ratings, growth is set to firm to pre-pandemic levels (figure B1.1.1, panel a).

Growth in the advanced economies was resilient last year even as financial conditions tightened. The United States was the leader, with growth of 2.5 percent due to strong consumer spending and expansionary fiscal policies. Growth in the advanced economies is projected to slow to 1.2 percent in 2024.

In the euro area, growth weakened sharply in 2023 to 0.4 percent. High energy prices weighed on household spending and firm activity, particularly in manufacturing. Exports softened further, reflecting tepid external demand. Growth is projected to improve modestly to 0.7 percent in 2024, supported by easing price pressures and a recovery in real wages. Still, restrictive credit conditions are expected to restrain domestic demand, particularly investment.

The post-pandemic recovery in China is losing steam. Growth in China is expected to decline from 5.2 percent in 2023 to 4.5 percent this year and 4.3 percent in 2025, the slowest expansion in over three decades outside the pandemic-affected years. Weak consumer sentiment and a continued property sector downturn have weighed on activity. Trade growth is also set to remain weak in 2024, with subdued global demand moderating exports and slower domestic demand growth holding back imports.

Global headline and core inflation have continued to decline from their 2022 peaks. Nonetheless, global inflation is projected to remain higher than its 2015–19 average beyond 2024 (figure B1.1.1, panel b). Declining goods inflation amid easing global supply chain pressures and moderating import prices were partly offset by persistent services inflation, which was in part related to tighter labor markets and higher wage growth. As a result, core inflation has declined by less than headline inflation since its 2022 peak.

Global trade growth in 2023 was the slowest outside global recessions in the past 50 years. Global trade barely grew, with goods trade contracting by 2 percent and services trade rising by 2.3 percent (figure B1.1.1, panel c). Global trade growth is projected to pick up to 2.3 percent in 2024, partly reflecting a recovery in the demand for goods (figure B1.1.1, panel d).

Most commodity prices fell last year, but they remain above pre-pandemic levels (figure B1.1.1, panel e). Despite recent volatility triggered by the conflict in the Middle East, and if hostilities do not escalate, average oil prices are projected to edge down in 2024 as global growth weakens and oil production increases. Metal prices are set to decline again as slower growth in China further weighs down demand. Food prices are expected to soften further this year amid ample supplies of major crops but remain elevated compared to pre-pandemic values.

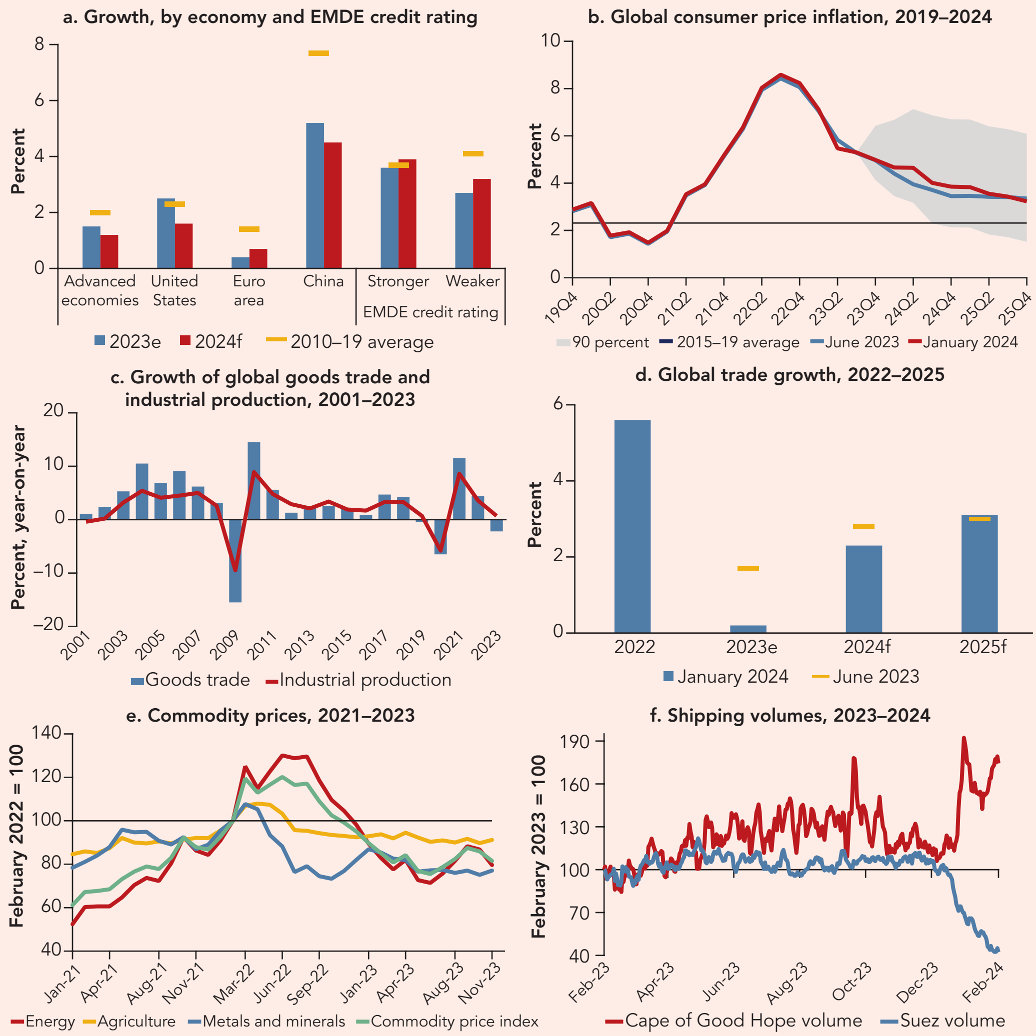
Downside risks to the economic outlook persist. The escalation of violence in the Middle East and Ukraine has significantly heightened geopolitical risks, which could adversely impact global confidence, investment, and trade. Attacks on commercial vessels in the Red Sea have already disrupted key shipping routes, in turn negatively affecting supply networks and increasing the likelihood of renewed inflationary pressures (figure B1.1.1, panel f). A further escalation and broadening of the conflict in the Middle East could severely disrupt energy supplies.

Other risks remain relevant. These include financial stress related to elevated real interest rates, persistent inflation, weaker-than-expected growth in China, further trade fragmentation, and climate change–related disasters. Central banks need to ensure that inflation expectations remain well-anchored and that financial systems are resilient. Elevated public debt and borrowing costs limit fiscal space and pose significant challenges to many economies seeking to improve fiscal sustainability while meeting investment needs.

(continued next page)

BOX 1.1 (continued)

FIGURE B1.1.1. Global outlook



Sources: Haver Analytics; Moody's Analytics; PortWatch; UN Global Platform; World Bank.

Note: e = estimate; EMDE = emerging market and developing economy; f = forecast; GDP = gross domestic product.

a. Advanced economy GDP aggregates calculated using real US dollar GDP weights at average 2010–19 prices and market exchange rates; EMDE aggregates show the median. Credit ratings are Moody's sovereign foreign currency ratings. "Stronger" is defined as credit ratings of B and above. "Weaker" is defined as ratings of Caa and below.

b. Model-based GDP-weighted projections of country-level inflation using the Oxford Economics Global Economic Model and global oil price forecasts from the January 2024 edition of the Global Economic Prospects report. Uncertainty bands are the distribution of forecast errors for the total Consumer Price Index from Consensus Economics for an unbalanced panel of 18 economies.

c. The panel shows goods trade volumes and industrial production, based on the first 10 months of data in each year for comparability purposes. The last observation is October 2023.

d. Trade measured as the average of export and import volumes. January 2023 forecasts are from the January 2023 edition of the Global Economic Prospects report.

e. Data are measured in US dollars. The last observation is November 2023.

f. The lines show the index of the 7-day moving average of transit trade volume in the Suez Canal and Cape of Good Hope.

In Ukraine, GDP grew by an estimated 4.8 percent last year after the economy contracted by 28.8 percent in 2022. The economic expansion was supported by a record high harvest, rerouting of exports to bypass the Black Sea, a sharp drop in inflation, and a more stable electricity supply. The economic recovery in Moldova from contraction in 2022 was modest amid still weak consumer and investor sentiment.

Weaker external and domestic demand dampened growth in Central Europe and the Western Balkans. In Central Europe, growth slowed sharply to an estimated 0.9 percent in 2023 from 5 percent the year before as the higher cost of living tempered household consumption and a sharp slowdown in the euro area hurt exports. Growth in the Western Balkans dropped to an estimated 2.6 percent last year from 3.4 percent in 2022 because of weaker growth in consumption and exports and despite a robust rebound in tourism and a pickup in construction in some countries.

In the South Caucasus, Armenia and Georgia remained among the fastest growing ECA economies even though the pace of economic expansion slowed. In Azerbaijan, growth weakened sharply to 1.1 percent last year from 4.6 percent in 2022 as oil production stagnated because of lower output in the existing oil fields.

The high cost of living continued to weigh down consumption

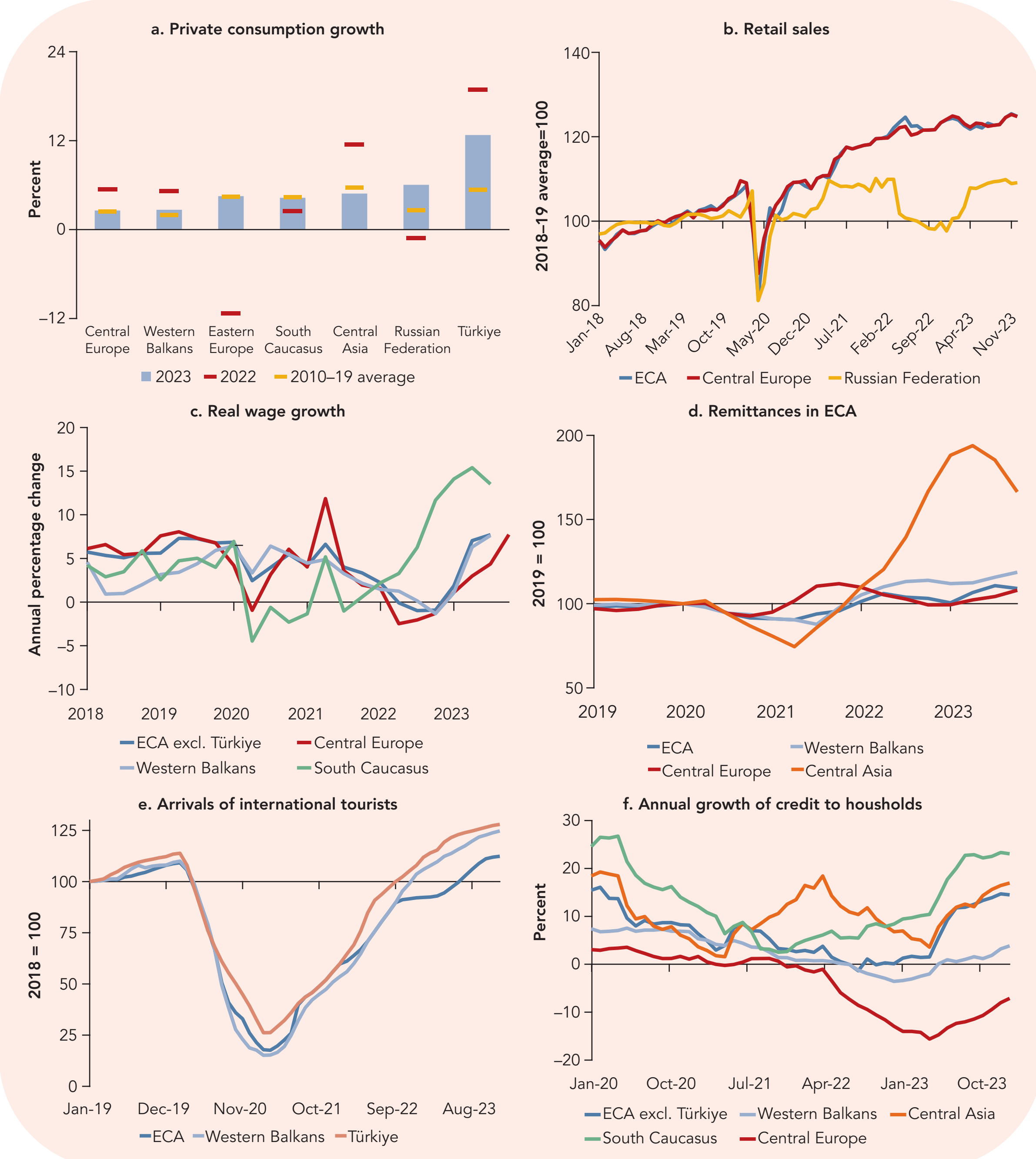
Private consumption growth softened last year, albeit with substantial differences across the countries in the region. Growth of private consumption more than halved in Central Europe and the Western Balkans as households coped with higher energy and food costs (figure 1.2, panel a). Moderating inflows of remittances cooled consumption growth in Central Asia. In Türkiye, private consumption grew more slowly than in 2022, but growth was still well-above its pre-pandemic trend as large wage hikes helped to mitigate the impact of surging inflation and tighter policies. By contrast, consumption recovered modestly in Eastern Europe, following a sharp contraction in 2022. Consumption growth rebounded strongly in Russia, sustained by strong wage growth and increased government spending.

Last year's aggregate numbers hide the firming of private consumption in the latter half of 2023, a trend that continued in early 2024. Falling inflation and rising real wages are supporting a gradual recovery of demand, with retail sales improving in most ECA countries (figure 1.2, panel b).

Labor markets in ECA remain tight. Unemployment rates have already returned to pre-pandemic levels or fallen in most countries (box 1.2). In Central Europe, median unemployment stood at about 5 percent in January 2024—down from 6.6 percent in mid-2020. In Russia, the unemployment rate declined to below 3 percent, twice as low as in 2020. In Türkiye, the jobless rate fell below 9 percent from 14 percent in mid-2020.

Real wages have rebounded. The median nominal wage growth strengthened to 16 percent year on year in the third quarter of 2023, supported by 15 percent increases in median minimum wages in ECA excluding Türkiye. In the latter, nominal minimum wages doubled last year and have been raised by another 49 percent in 2024. In ECA excluding Türkiye, with lower inflation, real wage growth turned positive, growing by 8 percent year on year in the third quarter of 2023, above the 6 percent annual average growth in 2018–19 (figure 1.2, panel c).

FIGURE 1.2. Recent developments: Consumption



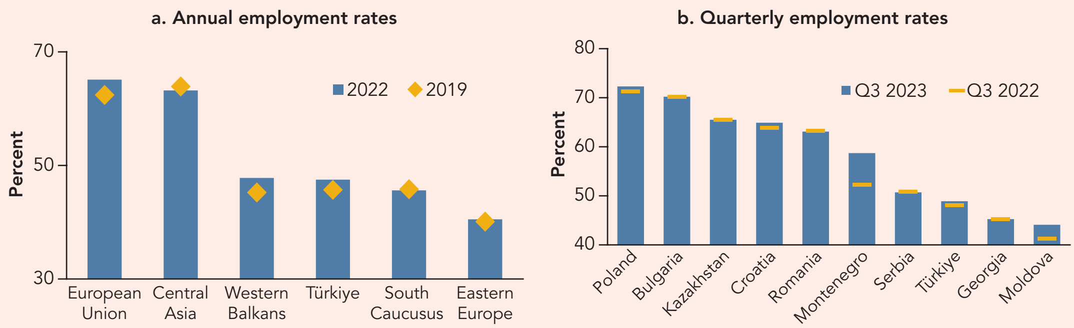
Sources: Eurostat; Haver Analytics; national statistical offices; World Bank.
Note: ECA = Europe and Central Asia.
a. Unweighted averages.
b. Real retail sales, seasonally adjusted. Group aggregates are medians.
c. Nominal wage growth adjusted for consumer price inflation, medians.
d. Cumulative four-quarter inflows of remittances, medians for each group. Remittances are measured in US dollars.
e. Cumulative 12-month arrivals of international tourists, medians.
f. Annual percentage change in credit to households, adjusted for consumer price inflation.

BOX 1.2 Labor Market Developments in ECA

Labor markets in ECA strengthened in 2023, with employment rates surpassing pre-pandemic levels in most countries. Employment rates increased by an average of 1.2 percentage points in the region in 2023. The robust employment growth in the Western Balkans benefited from the expansion in services, especially tourism (figure B1.2.1, panels a and b).

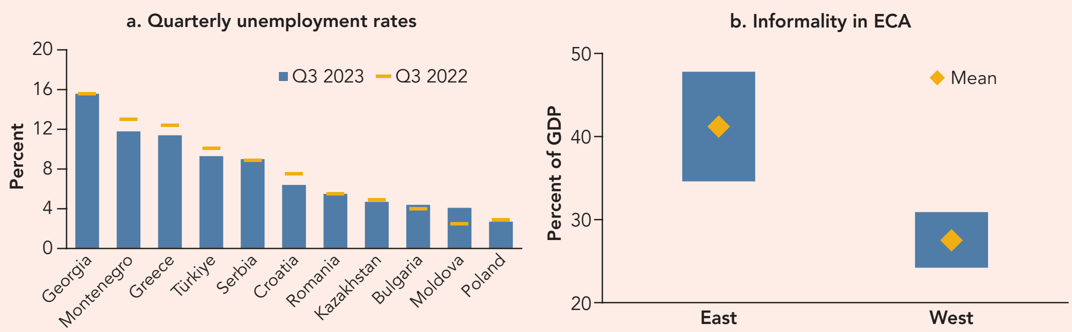
Labor force participation rates remained little changed, and unemployment declined in most countries. The average participation rate in ECA rose to 62.3 percent by the third quarter of 2023, slightly higher than the 61.3 percent a year earlier, with some variation across countries. Unemployment rates decreased in most countries, with the regional average declining from 8.9 percent in the third quarter of 2022 to 8.5 percent in the third quarter of 2023, more than 1 percentage point below its pre-COVID-19 level (figure B1.2.2, panel a). Robust growth in the service sectors helped to reduce the unemployment rates across the Western Balkans, Croatia, and Türkiye. However, unemploy-

FIGURE B1.2.1. Employment rates in ECA



Sources: Eurostat; national statistical offices; World Bank.
Note: The countries included in each grouping are as follows: European Union: Bulgaria, Croatia, Greece, Italy, Poland, and Romania; Central Asia: Kazakhstan, the Kyrgyz Republic, and Uzbekistan; Western Balkans: Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia; the South Caucasus: Georgia and Armenia; Eastern Europe: Moldova. The ECA average refers to the simple average of the relevant variable across countries for which data are available.

FIGURE B1.2.2. Unemployment in ECA



Sources: Eurostat; International Labour Organization; national statistical offices; World Bank.
Note: ECA = Europe and Central Asia; GDP = gross domestic product.
b. Output informality is based on dynamic general equilibrium model estimates, in percent of official GDP. "East" includes Eastern Europe (Belarus, Moldova, and Ukraine), the South Caucasus (Armenia, Azerbaijan, and Georgia), Central Asia (Kazakhstan, the Kyrgyz Republic, Tajikistan, and Uzbekistan), and the Russian Federation. "West" includes Central Europe (Bulgaria, Croatia, Hungary, Poland, and Romania), the Western Balkans (Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Montenegro, and Serbia), and Türkiye. Diamonds indicate subsample averages and blue bars indicate the one–standard deviation range. Data are for the latest year available, in most cases, for 2018. See F. Ohnsorge and S. Yu, eds., *The Long Shadow of Informality: Challenges and Policies* (Washington, DC: World Bank, 2022).

(continued next page)

BOX 1.2 (continued)

ment rose in some countries during this period, including in Moldova, which experienced a deep recession in 2022 and a weak recovery last year, and Bulgaria, where economic growth slowed.

Labor markets in ECA face multiple structural challenges. These include low female labor force participation, high informality, and continued emigration. The average female labor force participation rate amounts to 54 percent compared to 70 percent for men. Gender gaps are particularly pronounced in Türkiye (35 percentage points difference in participation rates), and some countries in the South Caucasus and the Western Balkans. Estimates suggest that informality is substantial, especially in Central Asia, Eastern Europe, and the South Caucasus (figure B1.2.2, panel b). In 2022, there were 14 million refugees in the region, and supporting their integration into local labor markets remains a challenge. High rates of economic emigration combined with a declining birth rate in many of the ECA countries also reduce the working-age population, exacerbating labor shortages, notably in the Western Balkans and Eastern Europe.

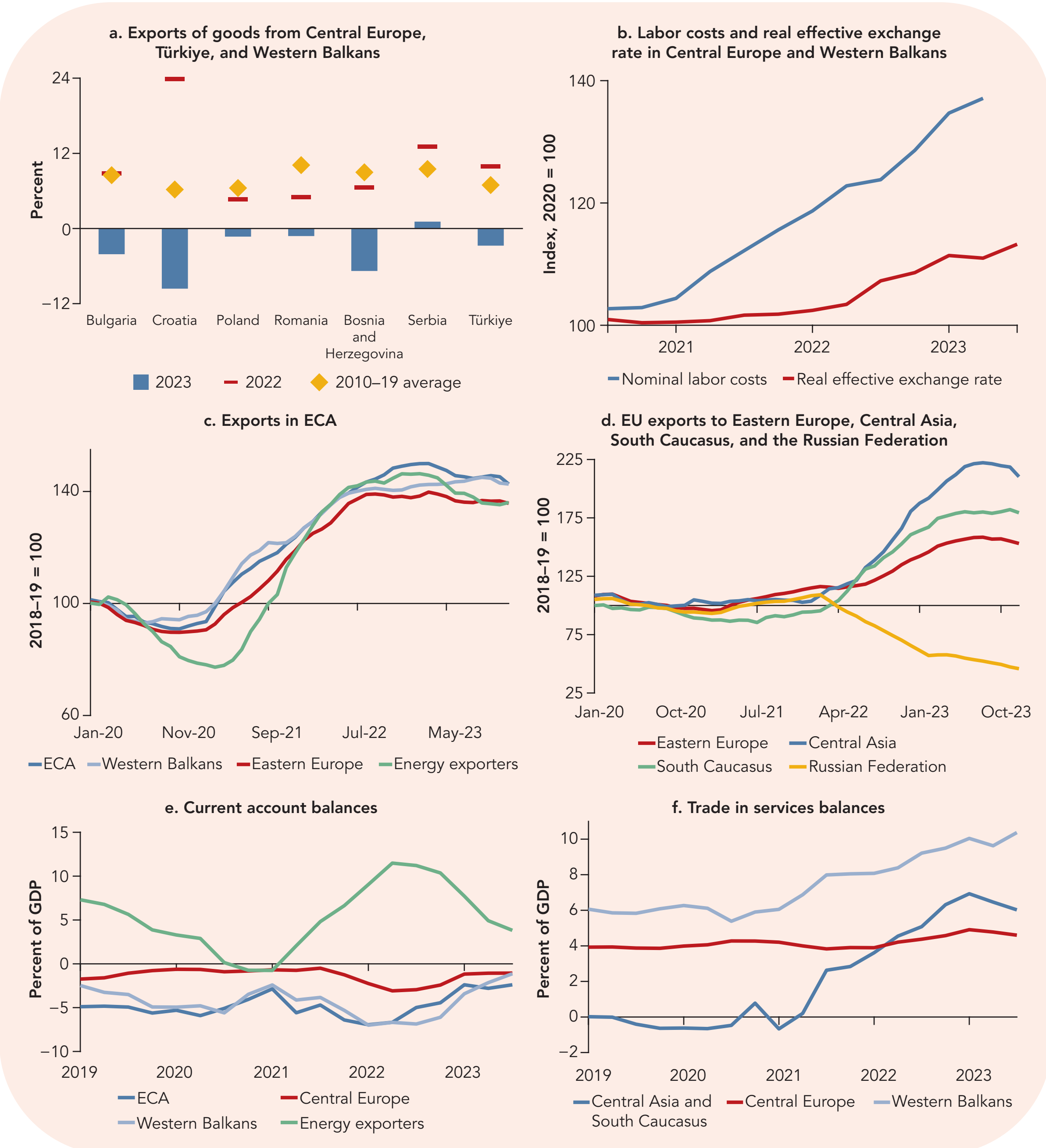
Remittance inflows eased but remained above pre-pandemic levels. Remittances to Central Asia fell from record highs in 2022 because of the weaker Russian rubble and elevated geopolitical uncertainty, which deterred labor migration (figure 1.2, panel d). For example, remittances to the Kyrgyz Republic, which are equivalent to nearly 30 percent of GDP, fell by more than 12 percent in 2023. A post-pandemic rebound in tourism has been a boon for domestic demand in many ECA economies, especially in the Western Balkans, Croatia, and Türkiye (figure 1.2, panel e).

Household borrowing remained strong. The nominal annual growth of credit to households in the median ECA economy, excluding Türkiye, increased to over 17 percent in the last quarter of 2023, well above its 2018–19 average of about 12 percent (figure 1.2, panel f). Credit growth adjusted for consumer price inflation firmed across ECA in the second half of last year, reflecting an uptick in demand for mortgages in some countries, partly owing to subsidized mortgage rates for first-time homebuyers. In some countries, increased inflows of migrants from Russia are contributing to higher housing prices and surging demand for housing as well, especially in Central Asia and the South Caucasus. Meanwhile, consumer credit continued to moderate in Türkiye, reflecting substantial policy tightening as average interest rates on mortgages and consumer loans have more than doubled since the start of 2023.

Demand in the region's main trading partners weakened

Slower growth in the euro area has tempered exports. Last year the growth of the volume of exports of goods from Central Europe, the Western Balkans, and Türkiye was one of the weakest since 2010 (figure 1.3, panel a). The values of the euro area's imports from the Western Balkans and Türkiye declined by 7 percent and 4.3 percent, respectively, while imports from Central Europe increased by only 1.3 percent. Rising unit labor costs hurt the competitiveness of exports in some countries as well (figure 1.3, panel b).

FIGURE 1.3. Exports



Sources: Bank for International Settlements; Eurostat; Haver Analytics; International Monetary Fund; World Bank.
Note: ECA = Europe and Central Asia; EU = European Union; GDP = gross domestic product.
a. Volume of exports of goods. For Türkiye, the data show exports of goods and services.
b. Median for Central Europe and the Western Balkans.
c. The sample includes 18 ECA economies. Energy exporters include Azerbaijan, Kazakhstan, and Russian Federation. Eastern Europe excludes Ukraine. Cumulative 12-month sum of exports valued in US dollars. Group aggregates are medians. The last observation is December 2023.
d. The sample includes 10 ECA economies. Cumulative 12-month sum of exports from the European Union. Group aggregates are medians. The last observation is December 2023.
e and f. Percent of GDP ratios are calculated as the sum of the four quarters of the current account balance (services trade balance) divided by the sum of the four quarters of GDP; group aggregates are medians.
e. ECA excludes energy exporters (Azerbaijan, Kazakhstan, and Russian Federation). The sample includes 14 ECA countries. The last observation is the third quarter of 2023.
f. The sample includes 12 ECA countries. The last observation is the third quarter of 2023.

Commodity exporters, especially energy producers, struggled with moderating global commodity prices and a sluggish rebound in China. For example, the value of exports of ECA's energy exporters dropped by over 20 percent on average in 2023 (figure 1.3, panel c). A substantial part of the decline in the value of commodity exports reflects their lower prices: the prices of energy and base metals fell by 42 and 32 percent, respectively, last year. This dampened the exports of ECA commodity producers, especially energy exporters. However, the exports of some countries in Eastern Europe, Central Asia, and the South Caucasus remained well above pre-pandemic levels, sustained by the continued trade rerouting from the European Union (figure 1.3, panel d).

Current account balances improved from record high deficits in 2022 because of lower import bills for energy, weaker demand for imports, and booming services exports. The median current account deficit in ECA, excluding the energy exporters, narrowed to about 2.4 percent of GDP in the third quarter of 2023 from 3.6 percent in 2022 (figure 1.3, panel e). Services exports were particularly strong in the Western Balkans owing to a robust rebound in tourism (figure 1.3, panel f). Meanwhile, the current account surpluses of oil producers decreased substantially because of sharply lower international crude oil prices and a strong rebound of imports, especially services imports related to travel. For example, Russia's current account surplus was five times smaller than in 2022 and amounted to an estimated 2.4 percent of GDP last year. In Kazakhstan, the current account balance flipped from the surplus of 3.5 percent of GDP in 2022 to the deficit of an estimated 3.8 percent of GDP in 2023.

Inflation has fallen faster than earlier expected

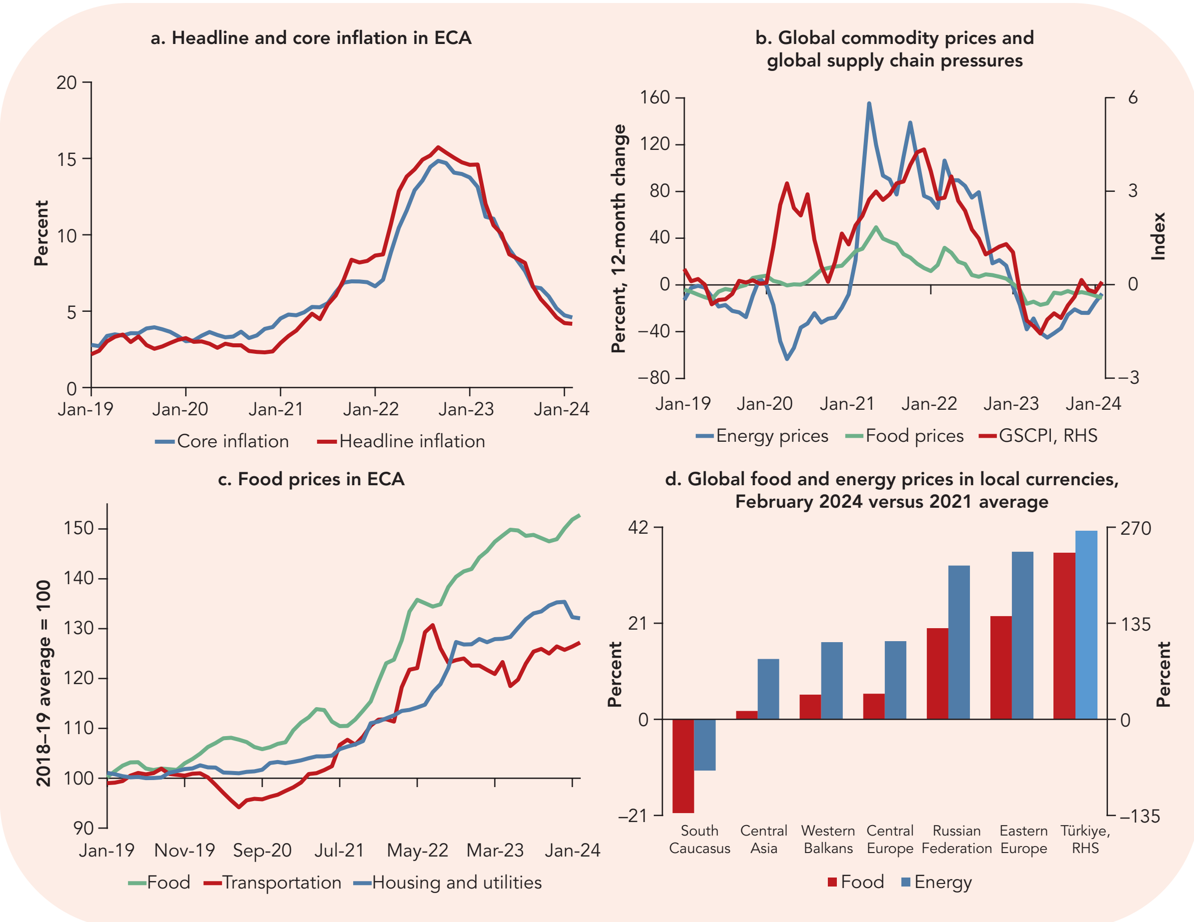
The median annual consumer price inflation in ECA fell to 4.2 percent in February 2024 from 14.6 percent at the start of 2023 and a peak of almost 16 percent in September 2022 (figure 1.4, panel a). The February inflation reading was below the 4.6 percent consensus expectations for median inflation in 2024, according to the latest Consensus Economics survey.

Lower inflation in ECA reflects tighter monetary policies, lower food and energy prices, and easing global supply chain pressures (figure 1.4, panel b). Stronger currencies in some countries also contributed. The median core inflation, which excludes the more volatile food and energy prices, fell to 4.6 percent in February 2024 from nearly 13 percent at the start of last year.

Food price inflation moderated sharply while services price inflation eased less. With foods accounting for the largest share of consumer spending in most ECA economies (box 1.3), much of the decline in headline inflation has occurred on account of a steep slowdown in global food prices. Nonetheless, despite lower food inflation, food prices across the region are 50 percent higher than they were in 2018–19 on average. Transportation and housing costs and utility tariffs are at near record high levels as well (figure 1.4, panel c).

Stronger local currencies helped to contain the passthrough of higher global commodity prices. For example, in the South Caucasus, food and energy prices, measured in national currencies, were 21 and 11 percent lower, respectively, in February 2024 than in 2021 on average (figure 1.4, panel d). Services price

FIGURE 1.4. Recent inflation developments

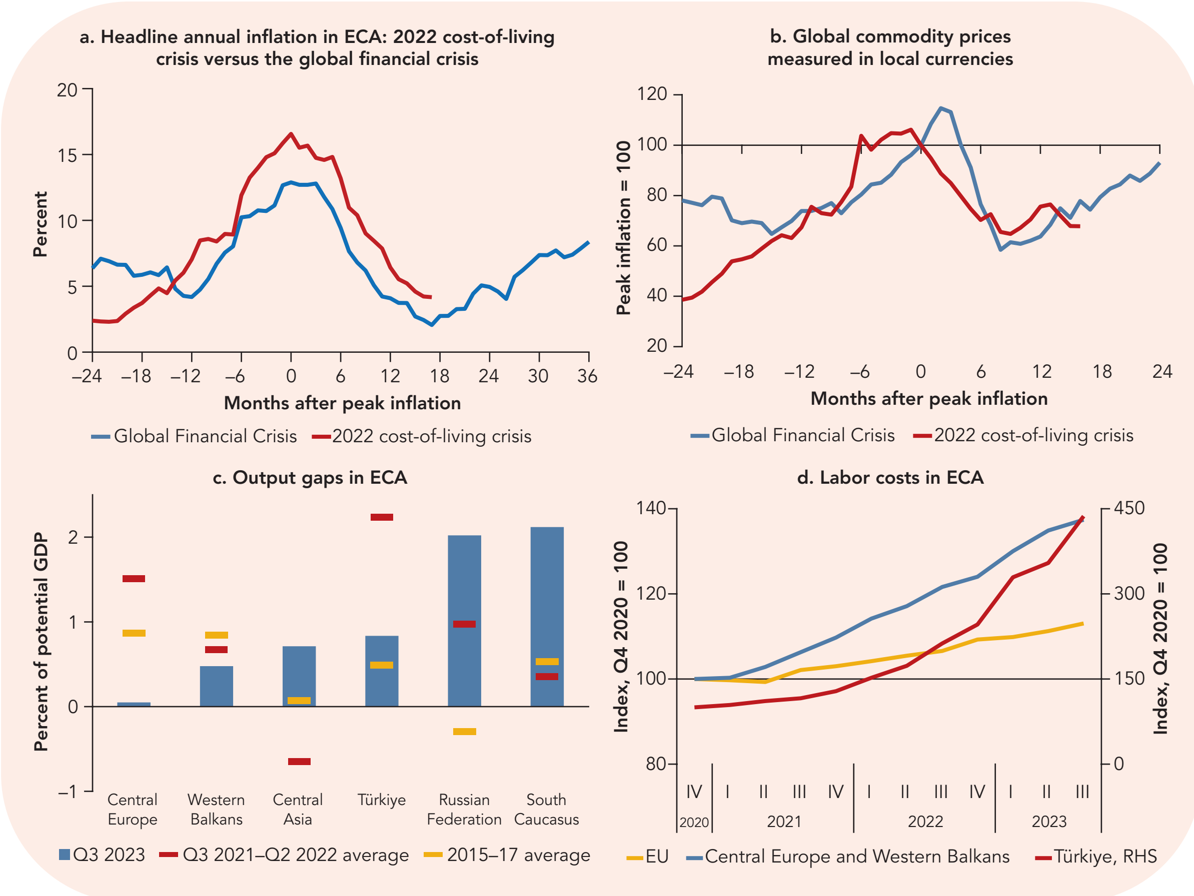


Sources: Haver Analytics; World Bank.
Note: ECA = Europe and Central Asia.
a. Median annual inflation rates. The sample includes 21 countries for headline inflation and 14 countries for core inflation. The last observation is February 2024.
b. GSCPI = Global Supply Chain Pressure Index, which measures the importance of supply constraints in global supply chains; a lower value indicates diminishing supply pressures. The last observation is February 2024.
c. Median, 2018–19 average = 100. The sample includes 21 countries. The last observation is February 2024.
d. Median across ECA subregions. The local currency value of global commodity prices is calculated using nominal US dollar global price indexes of food and energy multiplied by US dollar exchange rates.

inflation, which is more sensitive to local demand conditions, is slowing at a more moderate pace. In February 2024, the median annual inflation of prices of hotels and accommodations amounted to 8.7 percent, more than three times higher than food price inflation.

Previous episodes of disinflation after surging prices in ECA, for example during 2008–09, indicate that inflation could pick up again quickly if external inflationary pressures do not abate (figure 1.5, panels a and b). Further escalation of violence in the Middle East, for example, or an intensification of Russia's invasion of Ukraine could trigger more severe supply disruptions and heightened volatility of energy and food prices.

FIGURE 1.5. Inflation in ECA: Risks



Sources: Eurostat; Haver Analytics; Organisation for Economic Co-operation and Development; World Bank.
Note: ECA = Europe and Central Asia; EU = European Union; GDP = gross domestic product.
a and b. Months = 0 denotes September 2022 for the 2022 cost-of-living crisis and April 2008 for the global financial crisis.
a. Median annual inflation for the sample of 18 countries.
b. Median for the sample of 18 countries. The local currency value of global commodity prices is calculated using the nominal US dollar global commodity price index multiplied by US dollar exchange rates.
c. Subregional aggregates are medians. The output gap was calculated using the Hodrick-Prescott filter and seasonally adjusted quarterly real GDP. Central Asia includes Kazakhstan, the Kyrgyz Republic, and Uzbekistan. The South Caucasus includes Azerbaijan and Georgia.
d. Values for Central Europe and the Western Balkans are medians for Bulgaria, Croatia, Poland, Romania, and Serbia.

Rising wages and demand-side pressures could keep inflation elevated in some countries. Tight monetary policies managed to cool demand, with output gaps shrinking in ECA, although they remain positive in many countries amid weak supply responses (figure 1.5, panel c). In Türkiye, for example, the output gap more than halved in the third quarter of 2023. In Russia, the output gap widened to over 2 percent of its potential GDP, indicating a buildup of strong demand-side drivers of inflation. Moreover, with some economies operating above their potential, rapidly rising labor costs significantly elevate the risk of a prolonged period of high inflation (figure 1.5, panel d).

BOX 1.3 Regional Dimension of Inflation

Inflation has fallen the most in the South Caucasus. Median annual consumer price inflation dropped to 0.3 in February 2024, compared to the average annual inflation of over 10 percent in the last quarter of 2022. Declining food prices made a significant contribution to the inflation reduction in the South Caucasus, as food accounts for about 41 percent of the consumer price basket versus the ECA median of 35 percent.

Inflation in Central Europe declined to a multiyear low of 3.7 percent, albeit it remains above the 2–2.5 percent central bank inflation targets. Core inflation in Central Europe remains elevated and has been above the headline inflation rate since April 2023, reflecting the passthrough of higher input costs and wages into consumer prices.

Lower food prices helped to push inflation below central bank targets in most economies in the Western Balkans. Inflation dropped to 2.8 percent by February 2024 from almost 15 percent a year earlier. The decline in inflation also reflects receding cost-push pressures, falling inflation expectations, and slowing growth of credit.

Annual headline inflation in Moldova cooled to 4.3 percent in February because of weak recovery in demand, currency appreciation, and lower food and energy prices. Inflation in Ukraine dropped sharply as well, owing to restrictive monetary policy and the increased supply of food amid a good harvest and constrained exports. Food inflation fell to 2.6 percent in February 2024 from as high as 35 percent in late 2022. Food prices in Ukraine are still 75 percent higher than in 2018–19, however. In Belarus, annual food price inflation increased to 6.2 percent in February 2024 from below 4 percent in the second half of last year.

Price pressures persist in the Russian Federation and Türkiye, fed by strong demand and growing labor costs. In Russia, annual consumer price inflation rose to 7.7 percent in February, up from the post-pandemic low of 2.7 percent in the second quarter of 2023. Inflation in Türkiye hit almost 70 percent, reflecting the passthrough of the large currency depreciation, higher labor costs, strong domestic demand, and higher taxes. At 6.5 percent in February median annual inflation remained high in Central Asia as well, though it more than halved after peaking in early 2023.

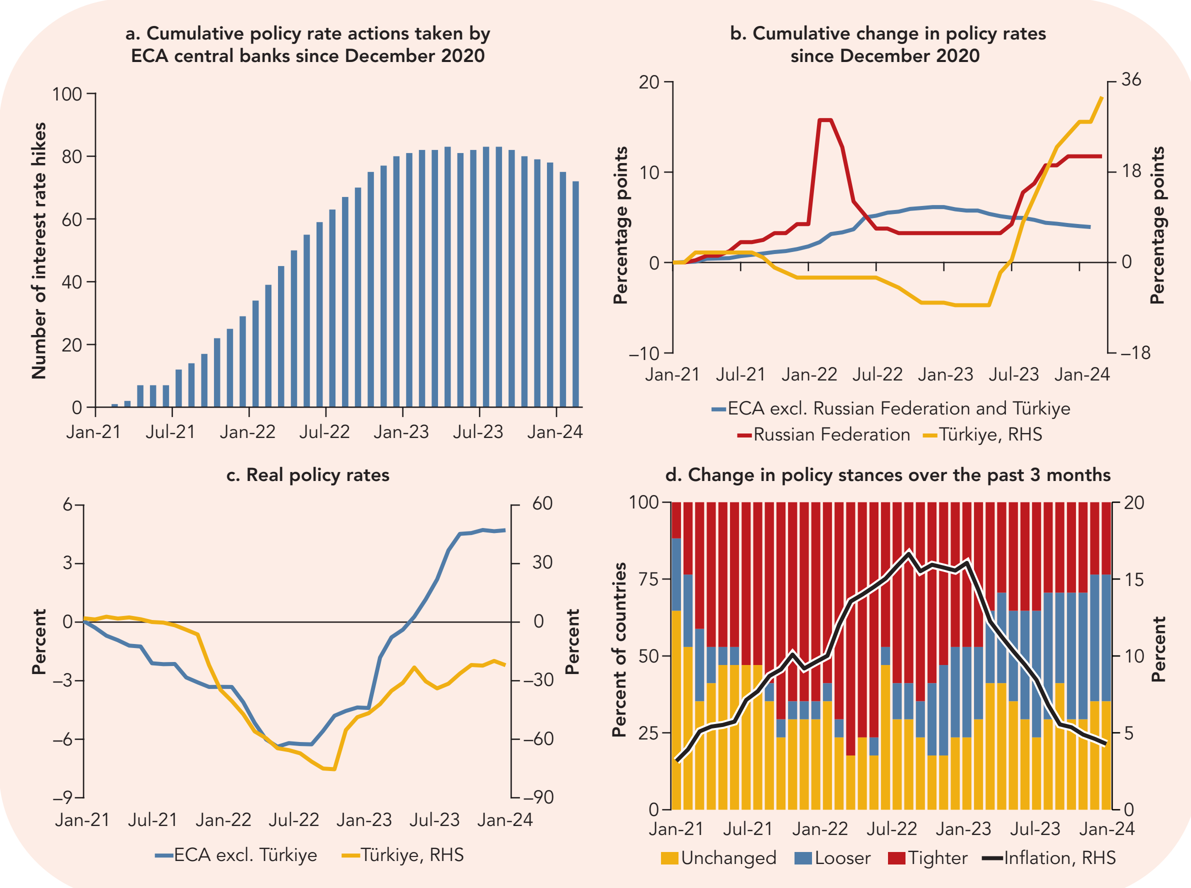
Economic Policies

Monetary policy remains restrictive despite policy rate cuts

Two-thirds of the central banks in the region have started to cut policy rates. ECA's central banks, excluding those in Türkiye and Russia, started to lower policy interest rates last year, bringing the two-year policy tightening cycle to an end (figure 1.6, panel a). Policy rates were cut by a median of 100 basis points. As a result, the nominal policy rate dropped from its peak of almost 11 percent in the first quarter of 2023 to 7.8 percent in February of this year. Türkiye and Russia, confronting resurgent inflation and renewed devaluation pressures, have lifted policy rates by 35 and 8.5 percentage points, respectively, since June 2023 (figure 1.6, panel b).

With inflation falling faster than the rate at which policy rates were cut, higher real interest rates are keeping monetary policy more restrictive. Real policy rates jumped to 4.7 percent in February 2024 compared to 2.9 percent in 2018–19 (figure 1.6, panel c). Although in over half of the ECA economies inflation is now below the central bank target or its upper bound, monetary policy in 80 percent

FIGURE 1.6. **Monetary policy in ECA**



Sources: Haver Analytics; national central banks; World Bank.
Note: The sample includes 17 ECA economies. ECA = Europe and Central Asia.
a. Cumulative interest rate decisions (hikes minus cuts) taken by ECA central banks since December 2020. The sample excludes the Russian Federation and Türkiye.
b. ECA excluding the Russian Federation and Türkiye denotes the average for 15 economies.
c. Medians.
d. The solid line indicates median inflation.

of countries is more restrictive than before the 2022 cost-of-living crisis. Nevertheless, policy space for further monetary easing appears to be limited amid persistent services inflation and moderating disinflation of goods prices. Over a third of the central banks in the region have kept their policy stances unchanged thus far in 2024 (figure 1.6, panel d).

Nominal exchange rates remained mostly stable across ECA last year. Some notable exceptions were sharp currency depreciations in Russia and Türkiye, where local currencies lost over 30 percent and almost 60 percent, respectively, of their value against the US dollar in 2023, adding to inflationary pressures. Meanwhile, the Polish zloty strengthened by over 8 percent in 2023, reflecting improving sentiments toward the policies of the new government.

Fiscal adjustment was delayed

Fiscal deficits in ECA, excluding Ukraine, averaged 2 percent of GDP in 2023, which was little changed from a year earlier but better than initially projected. Fiscal gaps narrowed in half of ECA's economies, reflecting some moderation of spending pressures due to lower energy subsidies and a revenue boost amid a pickup in nominal growth and, in some countries, booming international trade (figure 1.7, panels a and b). Tax policy reforms to enhance revenue mobilization and improve compliance, such as those in the Western Balkans and Central Asia, supported stronger government revenues as well. In Russia, the fiscal deficit amounted to 2.3 percent of GDP in 2023, as a strong increase in non-oil revenues helped to offset a sharp drop in energy-related revenues and a surge in defense spending.

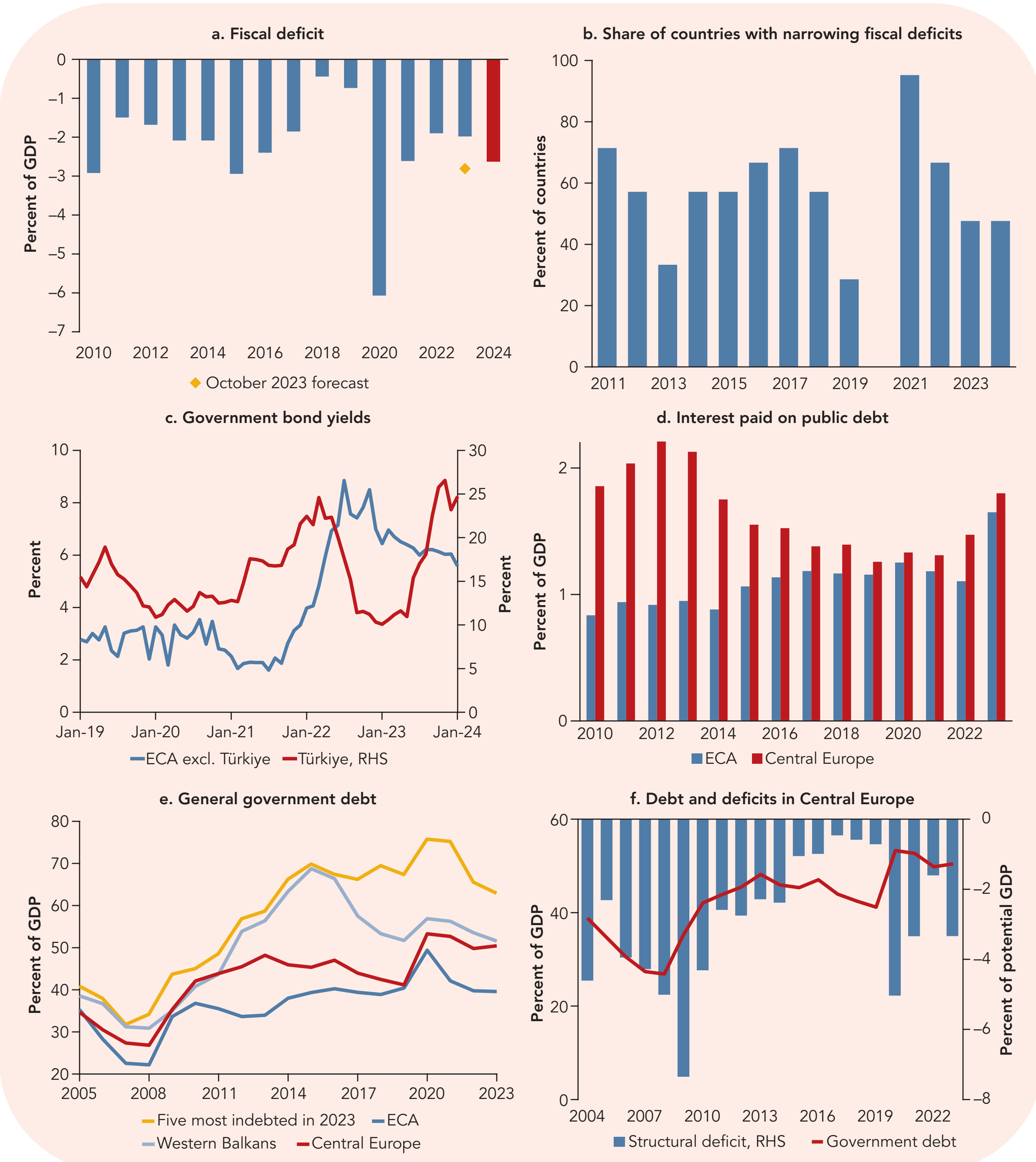
Fiscal deficits were higher in the rest of the ECA countries because of increased wages, social benefits, energy subsidies, and, in some countries, policy lending by state-owned banks. In Türkiye, the fiscal deficit surpassed 5 percent of GDP last year, which was significantly higher than its pre-pandemic average and its highest since 2009. Non-interest government spending more than doubled because of outlays in response to the earthquakes (about 3.7 percent of GDP), higher social transfers, and large wage hikes in the public sector.

This year fiscal deficits are projected to decline in about half of the ECA economies as governments gradually phase out energy subsidies and relief measures that were introduced over the previous two years. Despite earlier intentions, fiscal consolidations could be delayed as some governments grapple with slower growth, higher social spending, and increased interest payments. The average fiscal deficit in ECA is expected to widen to 2.6 percent of GDP, with slower nominal GDP growth tempering revenue increases.

Spending pressures are elevated partly because of election-related pledges. A third of the ECA countries held presidential or parliamentary elections in 2023, and more than a third will hold them this year. Continued cost-of-living adjustments to public sector wages and pensions as well as higher infrastructure spending could limit deficit reduction efforts. For example, the general government deficit in Poland was revised upward to 5 percent of GDP in 2024 due to public sector wage hikes. In Bulgaria, increases in public investment, wages, and pensions will keep the budget deficit at about 3 percent of GDP. Pension reform in Romania, which was enacted last year and includes a 13.8 percent indexation for all public pensions from January 2024, will raise the budget deficit as well. Meanwhile, a higher wage bill and social benefits are expected to widen the fiscal deficit in Croatia to over 2 percent of GDP from 0.3 percent last year.

Higher interest payments and elevated debt levels may worsen the debt dynamics in some countries. Although some governments regained access to international capital markets, government bond yields in ECA are still about 4 percentage points higher than at the start of 2021 (figure 1.7, panel c). As a result, budget spending to pay interest on public debt is approaching 2 percent of GDP in the median economy—or almost twice as high as a decade ago. This adds to the fiscal pressures in countries where debt levels are elevated, especially in Central Europe and the Western Balkans, or those at high risk of external debt distress (Tajikistan) (figure 1.7, panels d and e).

FIGURE 1.7. Fiscal policy in ECA



Sources: Haver Analytics; International Monetary Fund; national statistical offices; World Bank.
Note: ECA = Europe and Central Asia; GDP = gross domestic product.
a. Average fiscal deficits. Forecasts indicate the expected deficit as in the October 2023 edition of the Macro Poverty Outlook. The sample excludes Ukraine.
c. Median for 5 ECA economies. The last observation is January 2024.
d. Median for the sample of 12 ECA economies. The sample excludes Ukraine. 2023 estimates are from the International Monetary Fund's Article IV Consultation Reports.
e. Medians for each group. The sample excludes Ukraine. The five ECA countries with the highest levels of government debt in 2023 were North Macedonia, Croatia, Montenegro, Albania, and Serbia.
f. Medians for Bulgaria, Croatia, Poland, and Romania.

Growth-friendly fiscal consolidations will be needed to stabilize debt-to-GDP ratios (figure 1.7, panel e). Delayed fiscal adjustments elevate the risk to investor confidence and could further deepen the deterioration of public finances and keep borrowing costs elevated. On the upside, a credible commitment to growth-friendly structural and fiscal reforms could help to rebuild fiscal buffers and create space for much-needed public investments, including those related to the green transition.

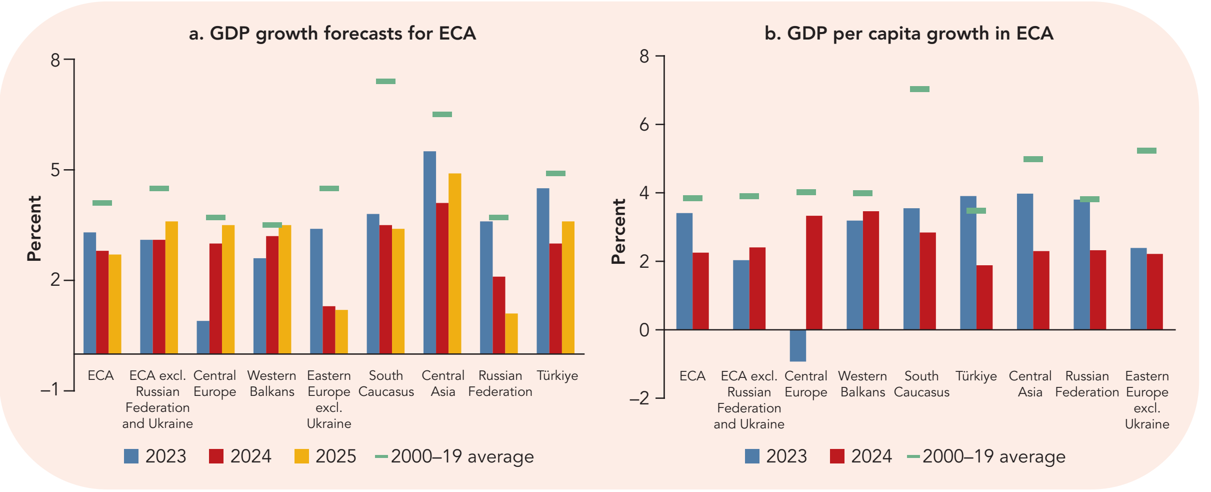
Outlook

Modest growth and continued disinflation

Growth in ECA is expected to slow to 2.8 percent this year from 3.3 percent in 2023 and 3.9 percent on average over the previous two decades. Economic growth in 2020–24 amounts to 2.6 percent a year on average, the weakest expansion in any five-year period since 2000. Russia is expected to grow by 2.2 percent in 2024, down from 3.6 percent in 2023. Tighter labor markets, capacity constraints, and restrictive monetary policy are expected to weigh on growth in Russia. Excluding Russia and Ukraine, growth in ECA is projected to remain little changed at 3.1 percent in 2024, as strong rebounds in Central Europe and the Western Balkans help to offset slower growth in the rest of the region (figure 1.8, panel a). Growth in Türkiye is expected to weaken to 3 percent this year—its lowest reading since 2009, outside the pandemic-affected years—as tighter policies continue to restrain domestic demand.

Growth in Central Europe and the Western Balkans is expected to strengthen this year primarily owing to more robust domestic consumption and a gradual recovery of exports. Growth in Central Europe is likely to pick up to 3 percent this year from an estimated 0.9 percent in 2023, led by a strong recovery in Poland. Poland is expected to start benefiting from the release of funds from the

FIGURE 1.8. Outlook



Sources: World Bank.
Note: GDP is measured in average 2010–19 prices and market exchange rates. Eastern Europe excludes Ukraine. Values for 2023 are estimates and those for 2024–25 are forecasts from the spring 2024 Macro Poverty Outlooks. ECA = Europe and Central Asia; GDP = gross domestic product.

European Union's Recovery and Resilience Facility as the government makes progress on reforms. Minimum wage increases, tight labor markets, and declining inflation are expected to sustain real wage growth boosting private consumption. Growth in the Western Balkans is projected to increase to 3.2 percent in 2024 from an estimated 2.6 percent last year, reflecting a recovery in domestic demand and a boost from investment.

Lower commodity prices, weak recovery in China, and the fading effects of remittances are expected to cool growth in Central Asia and the South Caucasus. In Central Asia, growth is expected to fall to 4.1 percent this year from an estimated 5.5 percent in 2023, with all countries experiencing a slowdown. Lower oil prices and stagnant oil output are likely to slow growth in Kazakhstan to 3.4 percent in 2024 from 5.1 percent last year. Policies are anticipated to remain restrictive as inflation expectations remain elevated. The countries in the South Caucasus are projected to grow by 3.5 percent this year, down from 3.8 percent in 2023. Growth is set to ease in Armenia and Georgia reflecting heightened geopolitical risks, moderating exports, and the fading boost to growth from the large inflows of migrants and capital from Russia. Growth in Azerbaijan is likely to be stronger as the downturn in the oil industry eases, oil revenues continue to support investment, and amid progress on structural reforms to diversify the economy and reduce the state's involvement in business.

Eastern Europe is anticipated to be the slowest growing part of ECA in 2024. In Ukraine, the pace of recovery is projected to slow to 3.2 percent this year from an estimated 4.8 percent in 2023, reflecting a smaller harvest and persistent tightness of the labor market. Ukraine's economic outlook remains conditional on the timing and quantity of external assistance receipts and the assumed duration of Russia's invasion.

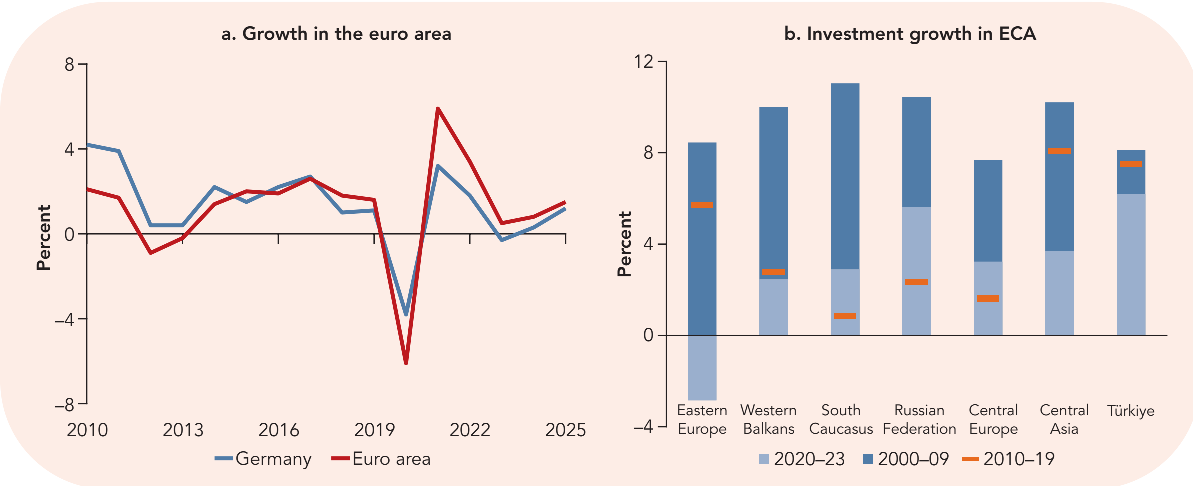
Risks

Slower growth of the region's main trading partners, especially in the euro area, could dampen growth across the region. Last year, the euro area grew at its slowest pace since the European debt crisis and the pandemic, and its recovery in 2024 is expected to be weak (figure 1.9, panel a). Export growth in ECA, especially in Central Europe and the Western Balkans, could be slower as a result. This risk could intensify substantially if global and regional trade fragmentation deepens. Meanwhile, a slower-than-projected growth in Russia could temper recoveries in Central Asia and the South Caucasus.

Monetary policies may stay tighter for longer if disinflation continues to slow. Sluggish reduction of inflation is likely to reflect sustained services inflation and tight labor markets. Import prices could also rise sharply in response to an escalation of violence in the Middle East. Higher interest rates for a longer period and continued rapid credit growth could lead to elevated risks to financial stability.

Delayed fiscal consolidation risks leaving fiscal buffers limited to counter new shocks and scale up the public investment needed to tackle climate change and incentivize private investment. A prolonged period of elevated global borrowing costs could significantly limit access to the financial resources required to strengthen those buffers and accelerate the green transition.

FIGURE 1.9. Risks to the outlook



Sources: Eurostat; European Commission; World Bank.
Note: ECA = Europe and Central Asia.
b. Investment denotes gross fixed capital formation.

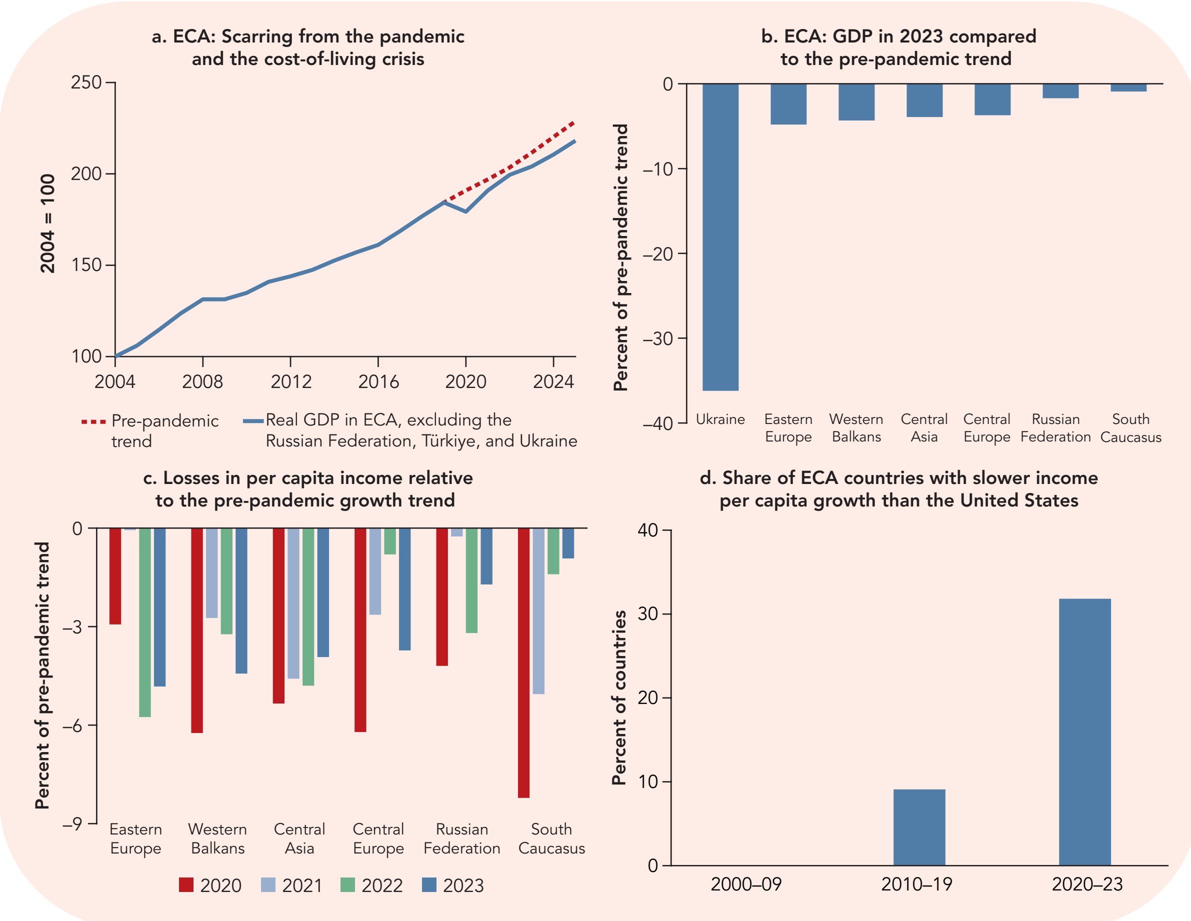
Rising geopolitical uncertainties could tip the balance of risks. Escalation of the already elevated incidence of geopolitical tensions, both within the region and globally, could dampen growth in ECA by eroding business and consumer confidence, slowing reform momentum, and constraining global supplies of key commodities. Further escalation of the Red Sea crisis could contribute to inflation risk in ECA by lengthening shipping times and raising shipping costs. Meanwhile, lack of sufficient external support could trigger a substantial deterioration of the security and humanitarian situation in Ukraine, with large negative spillovers for the region.

Investment growth could weaken further if the geopolitical situation deteriorates and progress on structural reforms remains sluggish. The average rate of investment growth in ECA was just 2 percent in 2020–23—four times slower than before the global financial crisis (figure 1.9, panel b). There is a substantial risk that investment growth could weaken further if geopolitical and policy uncertainties as well as stalled progress on structural reforms continue to undermine investor confidence. Lower investment growth would deepen the long-term trend of falling productivity growth and declining potential growth, and could seriously delay income convergence within the region.

Weak reform momentum weighs on growth and income convergence

Slow growth further delays ECA's recovery from the effects of past shocks and renewal of economic dynamism. The recovery from the pandemic-induced scarring was interrupted by the 2022 cost-of-living crisis and Russia's invasion of Ukraine. Although the losses from these shocks vary across ECA, the negative economic impacts remain substantial in all countries in the region except

FIGURE 1.10. Persistent scarring from the past shocks



Sources: World Bank.
Note: ECA = Europe and Central Asia; GDP = gross domestic product. GDP is measured in average 2010–19 prices and market exchange rates.
a and b. The pre-pandemic GDP trend is calculated using GDP growth forecasts from the January 2020 Global Economic Prospects reports. Values for 2023 are estimates and those for 2024–25 are forecasts from the spring 2024 Macro Poverty Outlooks.
b and c. Eastern Europe excludes Ukraine.

Türkiye. Ukraine's GDP was more than a third below its pre-pandemic trend last year (figure 1.10, panels a and b). In 2023, the aggregate GDP in ECA, excluding Russia, Türkiye, and Ukraine, was almost 4 percentage points below its pre-pandemic trend.

The 2022 cost-of-living crisis has dented much of the post-pandemic recovery in per capita incomes in ECA and slowed income convergence. Last year, Central Europe and the Western Balkans saw much of the earlier recovery in per capita incomes to the pre-pandemic trend disappear as growth slowed sharply (figure 1.10, panel c). The pace of income convergence in ECA, which was already much slower than it was prior to the global financial crisis, cooled further.[2] The

2. In only three ECA economies—Croatia, Kosovo, and Türkiye—income convergence was faster during 2020–23 than before the global financial crisis.

difference in income per capita growth between the median ECA economy and the United States amounted to just 1.2 percentage points on average in 2020–23. Average income per capita growth during 2020–23 fell short of income per capita growth in the United States in over a quarter of the countries in ECA (figure 1.10, panel d).

Unresolved structural challenges hinder the private sector's potential to boost growth and prosperity in ECA. The region's progress on improving competitiveness, strengthening governance, enhancing the rule of law, and reducing corruption has slowed noticeably in many countries. Substantial barriers to private sector development are still present across ECA (see part 2 of this update). These barriers deter investment, diffusion of knowledge and innovation, and they could further worsen competitiveness and productivity.

The private sector is the backbone of faster growth and convergence in ECA. There are many reasons to be optimistic about ECA's outlook. From 1995 to 2022, per capita incomes increased by over three times in Poland and more than doubled in Croatia and Romania—three ECA countries that have attained high-income status. Much of this can be attributed to the rapid pace of structural reforms that empowered the private sector to be more innovative and productive. Part 2 of this update argues that in many ECA countries there is still more to be done to unleash the full potential of private sector dynamism. To make ECA more resilient and prosperous, policy makers must double down on reforms fostering competition and free markets, education, and governance.

Annex 1A. Data and Forecast Conventions

The macroeconomic forecasts presented in this update are the result of an iterative process involving staff from the World Bank Prospects Group in the Equitable Growth, Finance, and Institutions Vice-Presidency; country teams; regional and country offices; and the Europe and Central Asia Chief Economist's Office. This process incorporates data, macroeconometric models, and judgment.

Data

The data used to prepare the country forecasts come from a variety of sources. National income accounts, balance of payments, and fiscal data are from Haver Analytics; the World Bank's World Development Indicators; and the International Monetary Fund's (IMF's) World Economic Outlook, Balance of Payments Statistics, and International Financial Statistics. Population data and forecasts are from the United Nations' World Population Prospects. Country and lending group classifications are from the World Bank. In-house databases include commodity prices, data on previous forecast vintages, and country classifications. Other internal databases include high-frequency indicators—such as industrial production, Consumer Price Indexes, housing prices, exchange rates, exports, imports, and stock market indexes—based on data from Bloomberg, Haver Analytics, the Organisation for Economic Co-operation and Development's analytical housing price indicators, the IMF's Balance of Payments Statistics, and the

IMF's International Financial Statistics. Aggregate growth for the world and all subgroups of countries (such as regions and income groups) is calculated as the gross domestic product–weighted average (in average 2010–19 prices) of country-specific growth rates. Income groups are defined as in the World Bank's classification of country groups.

Forecast process

The process starts with initial assumptions about advanced economy growth and commodity price forecasts. These assumptions are used as conditions for the first set of growth forecasts for emerging markets and developing economies, which are produced using macroeconometric models, accounting frameworks to ensure national accounts identities and global consistency, estimates of spillovers from major economies, and high-frequency indicators. These forecasts are then evaluated to ensure consistency of treatment across similar economies. This process is followed by extensive discussions with World Bank country teams, which conduct continuous macroeconomic monitoring and dialogue with country authorities. Throughout the forecasting process, staff use macroeconometric models that allow the combination of judgment and consistency with model-based insights.

PART II

Unleashing the Power of the Private Sector

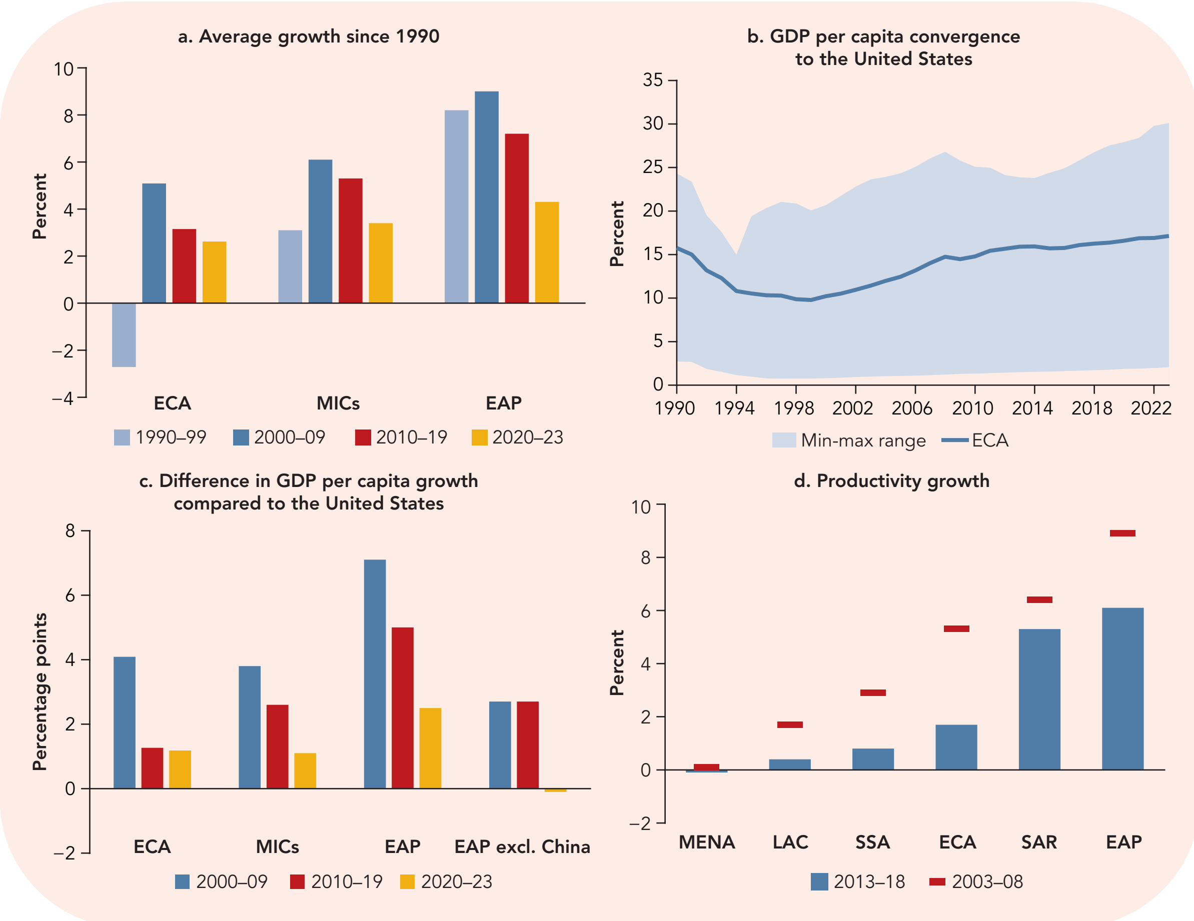
Introduction

Economic development in Europe and Central Asia (ECA) has been the story of the transition from plan to market, the advance of broad and deep structural reforms, and the emergence of private initiative as the main driver of growth. In less than three decades, a dozen ECA countries joined the European Union (EU). The successful transition of these countries to EU-integrated market economies with robust institutions and production structures illustrates just how far profound reforms have taken some countries in the region, including to high-income status. For another 20 countries in ECA, the transition to market is still ongoing.

The pace of economic expansion in ECA peaked during the first decade of this century but has slowed substantially since the 2007–08 global financial crisis (GFC). Economic growth weakened from 5.1 percent a year on average during 2000–09, to 3.1 percent during 2010–19, and further to 2.6 percent during 2020–23 as the region was battered by the aftermath of the GFC, the European debt crisis, the commodity price collapse of 2015, COVID-19, and the impact of the Russian Federation's invasion of Ukraine. While the pace of economic expansion also slowed in other developing regions and the advanced economies, economic growth in ECA, which had lower growth rates to start, lagged East Asia and Pacific (EAP), which expanded by 4.3 percent a year, and the middle-income countries on average, which grew by 3.4 percent per year in 2020–23 (figure 2.1, panel a).

Weaker growth in ECA resulted in a slowdown of income convergence with advanced economies. Real gross domestic product (GDP) per capita (at average 2010–19 prices and market exchange rates) in ECA increased from 10 percent of the US level in 1999 to 15 percent in 2009 (figure 2.1, panel b). Following the rapid convergence in 2000–09, the speed of convergence dropped by half in 2010–23. As

FIGURE 2.1. Slowing growth and income convergence



Sources: Vorisek et al. 2021; World Bank.
Note: EAP = East Asia and Pacific; ECA = Europe and Central Asia; GDP = gross domestic product; LAC = Latin America and the Caribbean; MICs = middle-income countries; MENA = Middle East and North Africa; SAR = South Asia; SSA = Sub-Saharan Africa.
a. Aggregate growth rates are calculated using GDP weights at average 2010–19 prices and market exchange rates.
b. The figure shows min-max ranges and averages for ECA. Real GDP at average 2010–19 prices and market exchange rates. Data for 2023 are estimates.
c. Relative per capita income growth is computed as difference in per capita GDP growth between respective country groups and the United States, expressed in percentage points. Headline aggregate growth rates are calculated using GDP weights at average 2010–19 prices and market exchange rates.
d. Productivity is defined as real GDP per worker (in 2010 market prices and exchange rates). Country group aggregates for a given year are calculated using constant 2010 US dollar GDP weights. The data for multiyear spans show simple averages of the annual data.

a result, almost two decades after the GFC, real GDP per capita in ECA reached only 17 percent of the US level in 2023 (estimate). Although this slowdown mirrors global trends, it has been steeper in ECA compared to its peers (figure 2.1, panel c). Indeed, from 2010 to 2023, real GDP per capita in ECA grew by only about 1 percentage point faster than the average growth rate of real GDP per capita in the United States.

Progress in advancing structural reforms during ECA's transition from centrally planned to market-based economies in the 1990s and 2000s drove much of the region's growth and convergence. Countries opened up to international trade and capital flows, liberalized prices and exchange rates, and established the foundations of corporate governance and competition policies. Privatization of state-owned enterprises (SOEs) began, which, along with the entry of new private enterprises, created the foundations for robust, private sector–driven economic growth (figure 2.2, panels a and b).

Tighter integration with the EU helped to accelerate institutional reforms and support economic growth in Central Europe and other countries in the western part of ECA. In the early 2000s, 12 countries that are or formerly were part of ECA joined the EU.[1] The rapid integration with Western Europe led to increased inflows of foreign capital, rapid financial deepening, and closer integration into European and global supply chains, accelerating the adoption of new technologies and processes. And thanks to the EU convergence machine, all but one of these EU member states have become high-income economies.[2]

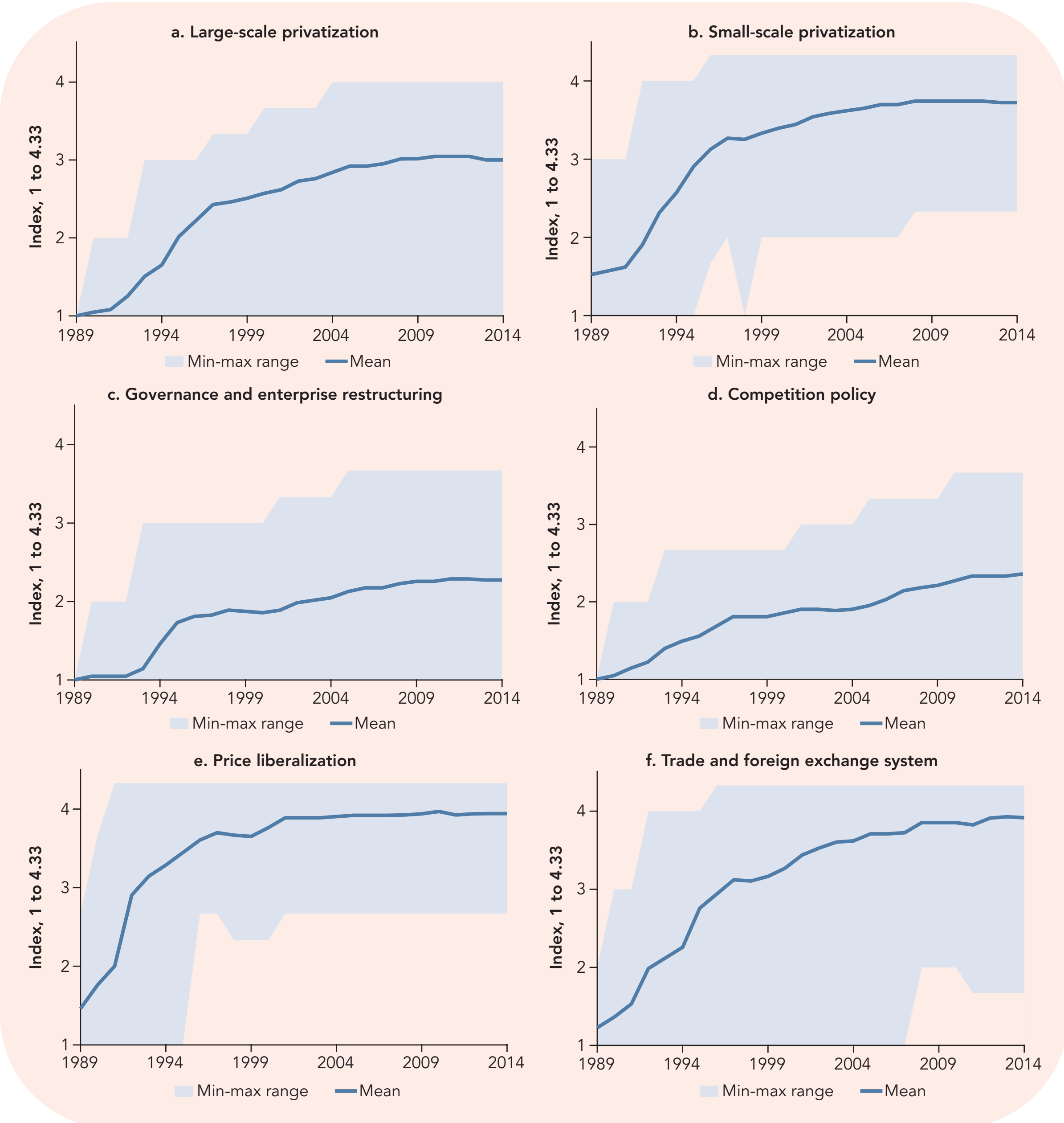
In the ECA countries that are outside the EU, the strong initial progress in advancing structural reforms has moderated over time. This has partly reflected the relatively rapid implementation of the so-called first-generation reforms in most countries in the region, including the market-enabling reforms related to privatization, especially the privatization of small firms, and liberalization of prices, interest rates, and international trade (figure 2.2, panels b, e, and f). In Central Europe, the South Caucasus, and the Western Balkans, these first-generation reforms were typically completed by the early 2000s. Other reforms, which often started at the same time, have progressed at a slower pace. The pace of large-scale privatization was slower across all countries, as was the pace of reforms related to establishing effective corporate governance and competition policy (Georgiev, Nagy-Mohacsi, and Plekhanov 2017) (figures 2.2, panels a, c, and d). Eleven countries that are or formerly were in ECA have become high-income economies since 1990, including by successfully advancing structural and institutional reforms and integrating into the EU. For the remaining 20 countries of ECA, the transition to market is still ongoing (figure 2.3).

Weaker economic growth and convergence are tightly correlated with slowing productivity growth in ECA over the past two decades. Although a worldwide slowdown in labor productivity growth since the GFC has been common—following a slowdown in advanced economies that began as early as the 1970s—ECA suffered the fastest decline compared to all other developing regions (figure 2.1, panel d). Within ECA, the productivity growth slowdown affected nearly all economies, but it was particularly steep in Russia, the South Caucasus, and the Western Balkans.

The COVID-19 pandemic and Russia's invasion of Ukraine have further exacerbated the productivity slowdown by disrupting private investments, education, as well as regional trade and financial integration. In some countries, sharply lower birth rates are contributing to the slowdown, amplified by large outward

1. In 2004, nine ECA countries joined the EU: Cyprus, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic, and Slovenia. Bulgaria and Romania joined in 2007, and Croatia followed in 2013.
2. Bulgaria joined the EU but is not a high-income economy.

FIGURE 2.2. **Progress on transition indicators moderated over time, 1989–2014**



Source: EBRD transition indicators, 1989–2014 (latest year available).

Note: The figures show min-max ranges and means for 23 ECA countries. Values range from 1 (worst) to 4.33 (best, indicating standards and performances that are typical of advanced industrial economies). The first available year is 2008 for Türkiye and 2013 for Kosovo. EBRD = European Bank for Reconstruction and Development; ECA = Europe and Central Asia.

a. Large-scale privatization (best): more than 75 percent of enterprise assets are in private ownership with effective corporate governance.

b. Small-scale privatization (best): no state ownership of small enterprises; effective tradability of land.

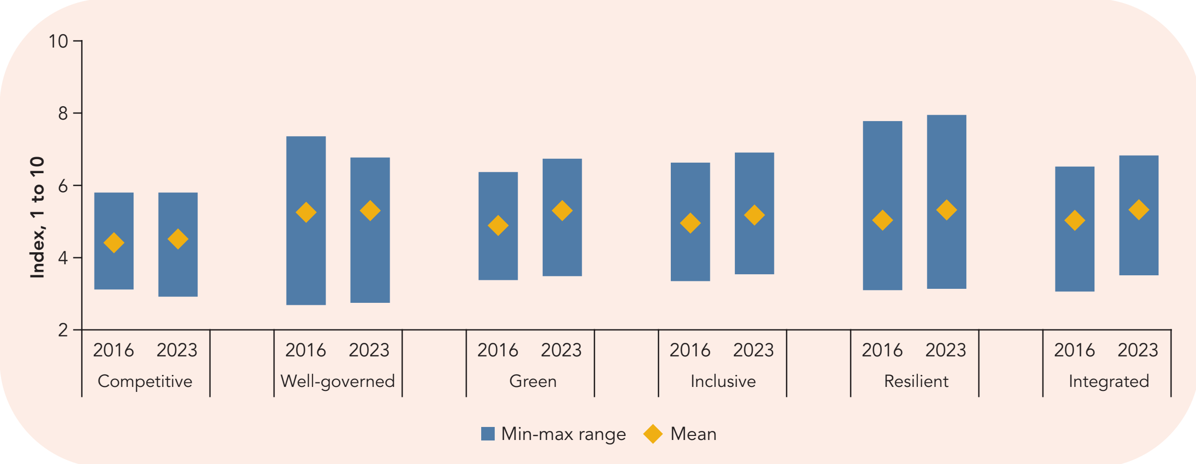
c. Governance and enterprise restructuring (best): effective corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring.

d. Competition policy (best): effective enforcement of competition policy; unrestricted entry to most markets.

e. Price liberalization (best): complete price liberalization with no price controls outside housing, transport, and natural monopolies.

f. Trade and foreign exchange system (best): removal of most tariff barriers; membership in the World Trade Organization.

FIGURE 2.3. Limited progress on assessment of transition qualities, 2016–23



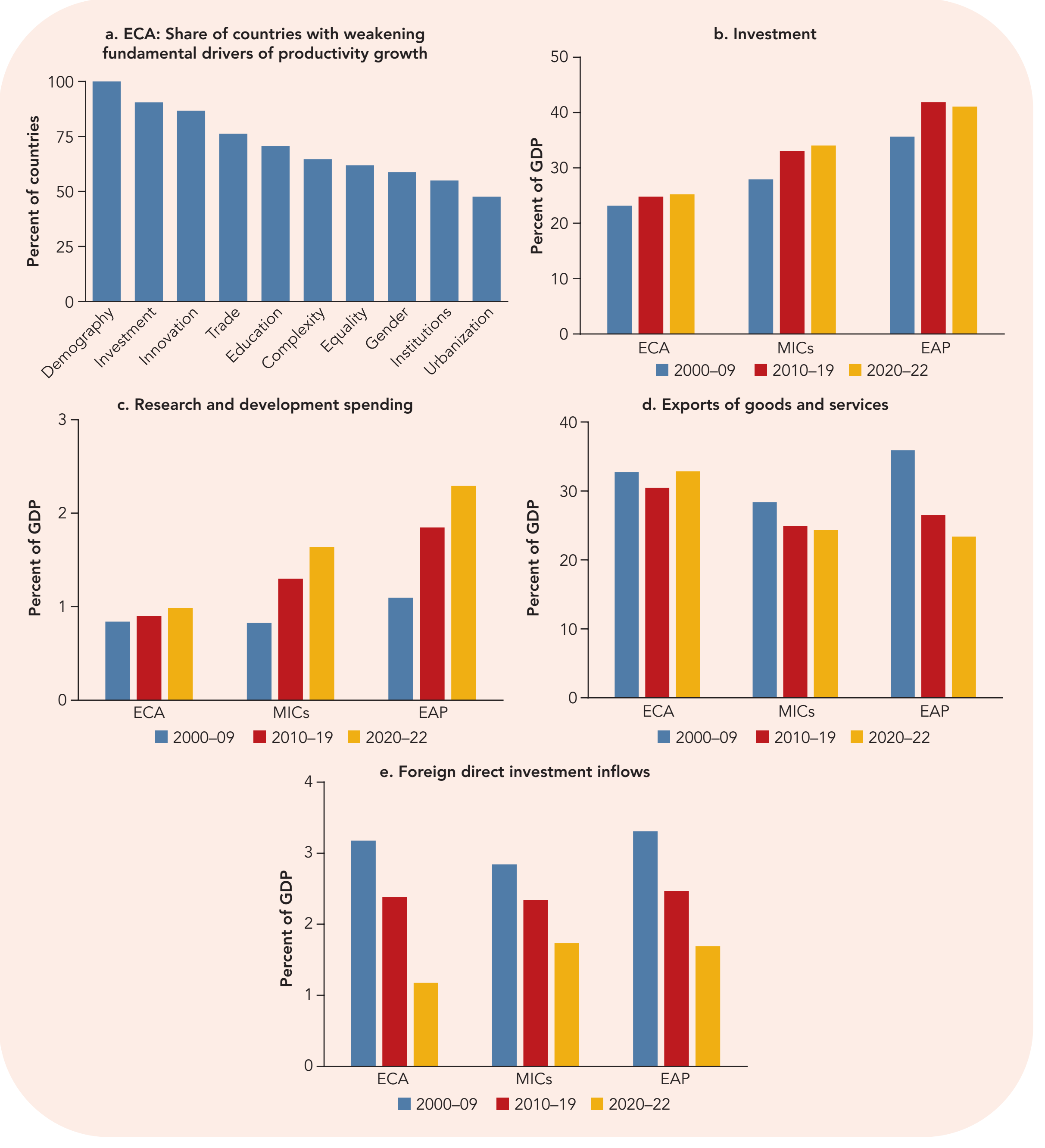
Source: EBRD, 2016 (first year available) to 2023.
Note: Data for 23 ECA countries. Values range from 1 (worst) to 10 (best, representing a synthetic frontier corresponding to the standards of a sustainable market economy). EBRD Assessments of Transition Qualities are composite indexes combining information from many indicators and assessments in a consistent manner. EBRD = European Bank for Reconstruction and Development; ECA = Europe and Central Asia.

migration (figure 2.4, panel a). Elevated levels of violence and conflict in some parts of ECA and policy uncertainty continue to deter private investments, both foreign and domestic. These regional challenges are seriously amplified by global risk factors such as tight financial conditions, geoeconomic fragmentation, and increasing vulnerabilities to the effects of climate change.

Fixed investment, research and development (R&D) spending, and exports in the region have remained little changed relative to GDP in this century, and inflows of foreign direct investment (FDI) have weakened. By contrast, fixed investment and R&D spending have expanded markedly in EAP and middle-income countries on average over the same period (figure 2.4, panels b and c). Exports of goods and services also remained little changed in ECA but declined in EAP and middle-income countries in 2010–22 compared to 2000–09 (figure 2.4, panel d). The latter mostly reflected the large decline in the exports-to-GDP ratio in China since 2006. Meanwhile, FDI inflows declined across middle-income countries between 2000–09 and 2010–22, but the decline was especially steep in ECA (figure 2.4, panel e).

Stronger economic growth depends crucially on a more vibrant and innovative private sector—and this part of the *ECA Economic Update* takes a closer look at business dynamism and innovation in the region. The next section examines the trends of business dynamism and innovation in ECA and compares them with those of the advanced economies in Europe and peer countries in EAP, where income and productivity growth have been broadly stronger in the past decade. Although productivity growth is driven by innovation in the advanced economies in Europe, ECA continues to rely on reallocation of resources to more productive uses, 30 years after the start of the transition. The following section

FIGURE 2.4. Weakening drivers of productivity growth



Source: World Bank.
Note: ECA = Europe and Central Asia; EAP = East Asia and Pacific; GDP = gross domestic product; MICs = middle-income countries.
a. The bars represent the percentage of 21 economies in ECA where improvements in each driver of productivity were lower during 2008–17 than in 1998–2007 or changes in 2008–17 were less than zero. Education = years of education; Urbanization = share of the population living in urban areas; Investment = investment as a share of GDP; Institutions = government effectiveness; Complexity = Hidalgo and Hausmann's (2009) economic complexity index; Equality = income equality defined as (-1)*Gini; Gender equality = share of years of schooling for females to males; Demography = share of the population younger than age 14; Innovation = log patents per capita; Trade = (exports+imports)/GDP.
b. Gross capital formation as a percentage of GDP.
c. Research and development spending as a percentage of GDP.
d. Exports of goods and services as a percentage of GDP.
e. Net inflows of foreign direct investment as a percentage of GDP.

discusses how the countries in the region can boost business dynamism and thus productivity growth, focusing on the competitive environment and reducing distortions due to the large presence of the state. The section also addresses the challenges of the skills gap and adequate access to finance. The final section concludes this part on unleashing the power of the private sector.

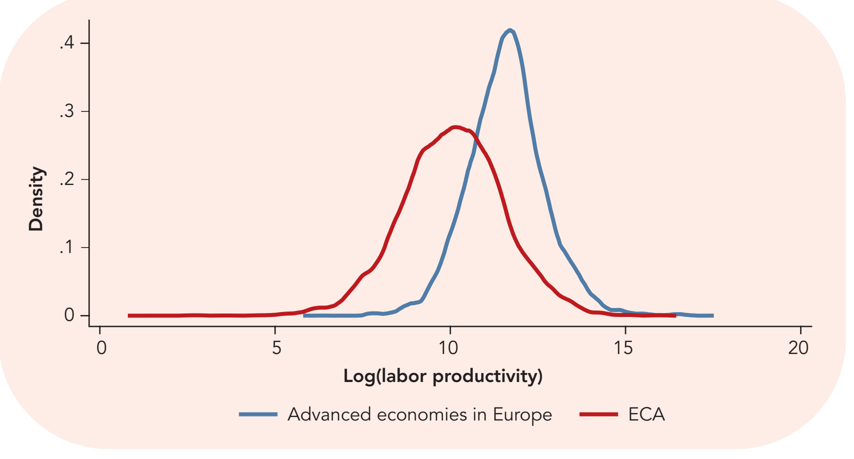
Firm Dynamism and Innovation in ECA

Productivity growth, enabled by business dynamism and innovation, is key to economic growth. Productivity captures how efficiently a firm converts inputs into outputs. Productivity growth can come through three channels: (a) entry and growth of new firms and exit of less productive ones (*market contestability/creative destruction* or the *selection* component of productivity growth); (b) reallocation of resources from less productive to more productive firms (*between-firm* component); and (c) increasing productivity within existing firms through adoption of new technology, innovation, or better management (*within-firm* component).[3]

Firm productivity

Firms in ECA are less productive than those in the advanced economies in Europe. Further, the productivity dispersion of firms in ECA is much larger than in the advanced economies in Europe: there are long tails of both lower productivity and higher productivity firms (figure 2.5). Another difference in firm characteristics is that fewer firms in ECA than in advanced economies in Europe focus mainly on the international market instead of local or national markets. In ECA,

FIGURE 2.5. Firm productivity in ECA lags advanced economies in Europe



Source: Calculations based on data from the latest World Bank Enterprise Surveys (for most countries, 2019).
Note: The figure plots the distribution of log(labor productivity) across firms, using scaled survey weights, so that each country has equal weight. For the list of countries, see table 2A.1, in annex 2A. ECA = Europe and Central Asia.

3. See Cusolito and Maloney (2018).

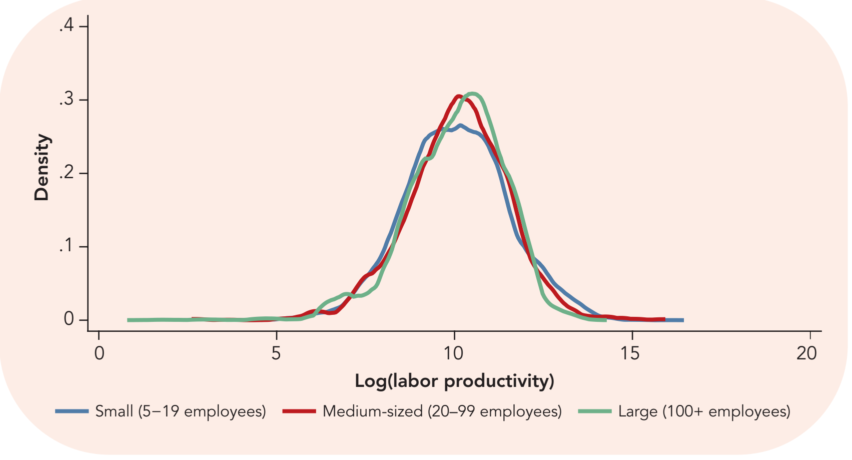
the share is 8 percent versus 13 percent in advanced economies in Europe. Other characteristics, including size and sector, are similar across ECA and advanced economies in Europe (table 2A.2, in annex 2A).

Within ECA, labor productivity does not vary across firm size.[4] The presence of highly productive large firms in an economy indicates a more dynamic business environment where competitive forces mean that large firms keep innovating (World Bank 2023b). ECA's pattern of productivity aligns with a business environment that does not reward more productive firms (figure 2.6). Instead, it is consistent with a business environment in which large firms may rely on market power, limited competition, and access to finance and procurement contracts rather than innovation and productivity growth.

Business dynamism

Business dynamism in ECA lags that in the advanced economies in Europe. Business dynamism is the process of new firms entering the market, growing, innovating, and, if unsuccessful, exiting, allowing for the reallocation of resources to more efficient and productive uses. New entrants keep pressure on incumbent firms to become more productive. The new business density rate in ECA averages 2.9 newly registered firms per 1,000 working-age adults, which is half the rate in the advanced economies in Europe (figure 2.7).[5]

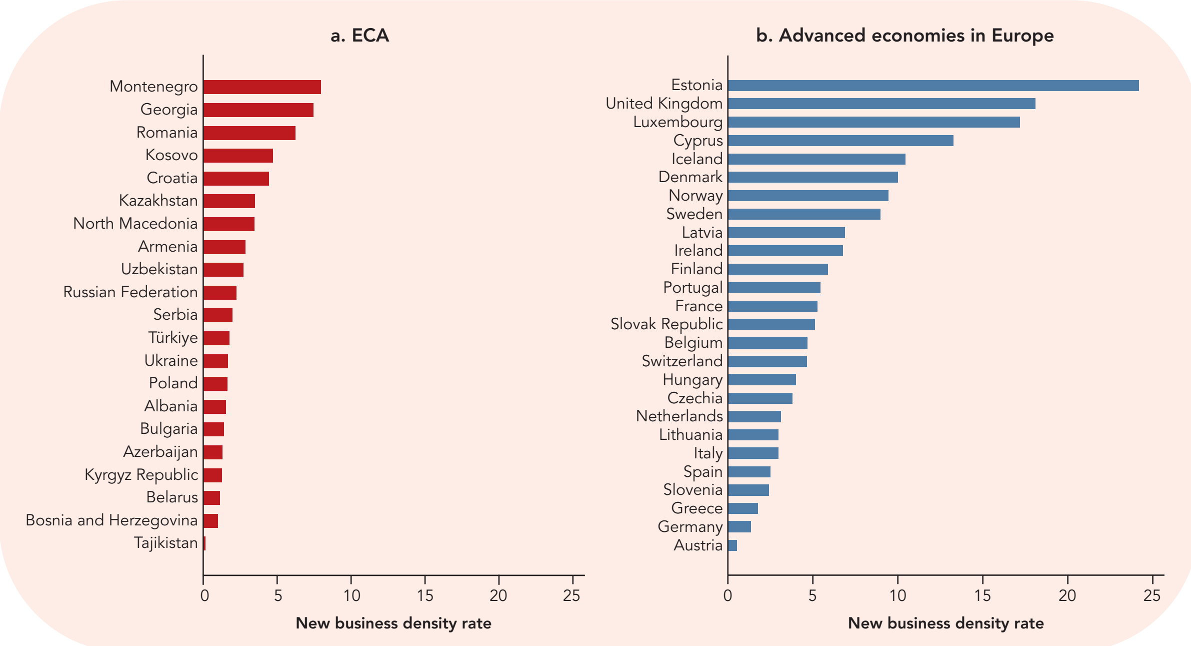
FIGURE 2.6. Firm productivity in ECA does not vary by firm size



Source: Calculations based on data from the latest World Bank Enterprise Surveys (for most countries, 2019).
Note: The figure plots the distribution of log(labor productivity) across firms, using scaled survey weights, so that each country has equal weight. For the list of countries, see table 2A.1, in annex 2A. ECA = Europe and Central Asia.

4. This analysis does not control for confounding factors, such as differences in the sectoral distribution of firms within countries.
5. The data only consider newly registered firms with limited liability, which is only one source of business registration. Moreover, in countries where informality is high, new firms may start and grow without registering.

FIGURE 2.7. New business density rates in ECA are about half those in advanced economies in Europe, 2020



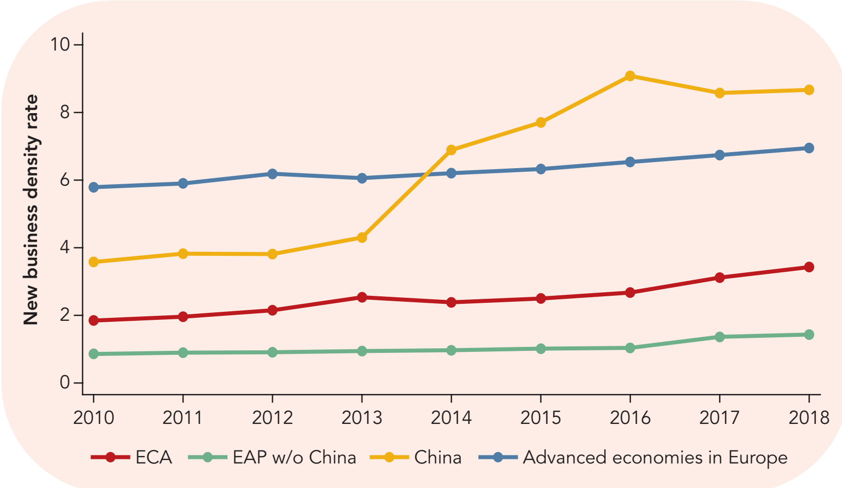
Source: World Bank Entrepreneurship Database.
Note: The new business density rate is the number of newly registered firms with limited liability per 1,000 working-age people (ages 15-64) per calendar year. The figures show the latest year available, typically 2020, except for Kyrgyz Republic (2016), Tajikistan (2018), Ukraine (2017), Denmark (2018), Italy (2018), Luxembourg (2018), and Switzerland (2019). ECA = Europe and Central Asia.

While business creation rates in ECA were little changed between 2010 and 2018, they were, on average, higher than those in EAP peers other than China. The average new business entry rate for Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam—countries with 44 (Viet Nam) to 110 (Malaysia) percent of ECA's GDP per capita in purchasing parity prices in 2022—was about half that for ECA (figure 2.8). China's new business density rate, by contrast, was twice as large as the ECA average in 2010 and started to surpass the average for the advanced economies in Europe in 2014.[6]

Business exit rates in ECA tend to be lower than those in advanced economies in Europe and China. Data on business closures are less reliable than those on business creation since the rules on reporting closures vary across countries, and closure rates are available for fewer countries. The average business closure density rate in ECA amounted to 1.5 closed firms per 1,000 working-age adults, less than half that in the advanced economies in Europe and in China in 2020. This suggests that there may be less creative destruction in ECA, if less productive firms are less likely to exit, leaving resources stranded rather than shifted to more productive enterprises.

6. The data for China are only based on regional data for Beijing and Shanghai and may overstate the country's rate compared to nationwide data for all other countries.

FIGURE 2.8. The new business density rate was little changed in ECA, 2010–18



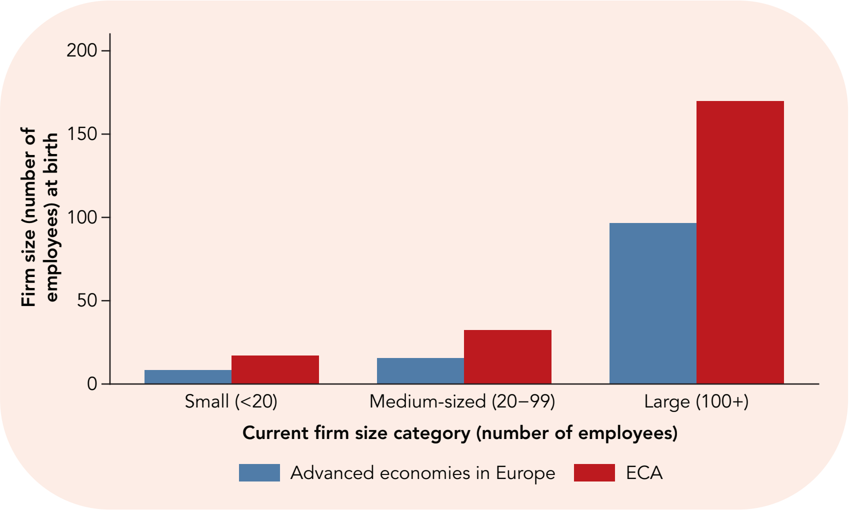
Source: World Bank Entrepreneurship Database.
Note: The new business density rate is the number of newly registered firms with limited liability per 1,000 working-age people (ages 15-64) per calendar year. EAP consists of Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam. Data for China are only based on regional data for Beijing and Shanghai. The samples are not necessarily balanced, and the following country-year observations are not available: Bosnia and Herzegovina (2010–15), Greece (2010), Indonesia (2017–18), Kyrgyz Republic (2017–18), the Netherlands (2010–18), Türkiye (2010–13), Ukraine (2018), and Viet Nam (2010). EAP = East Asia and Pacific; ECA = Europe and Central Asia.

Firms in ECA also tend to grow less than firms in the advanced economies in Europe over their life cycle. Firms that start small but grow in employment size as they age are a driver of economic development (Hsieh and Klenow 2014). Firms in ECA on average start out larger than firms in advanced economies in Europe, at about twice the size across all three size categories (figure 2.9). But the average firm in ECA today falls into the same size category as when it first started operating. For example, today's medium-sized firms in ECA (with between 20 and 99 employees) started with 32 employees on average, which means they were already medium-sized at birth. By contrast, firms in the advanced economies in Europe are more dynamic and have grown in employment size across size categories: today's medium-sized firms on average were small when they first started operating and today's large firms were medium-sized. The lower growth of firms in ECA may be driven in part by less innovation, which is the topic of the next subsection.

Innovation

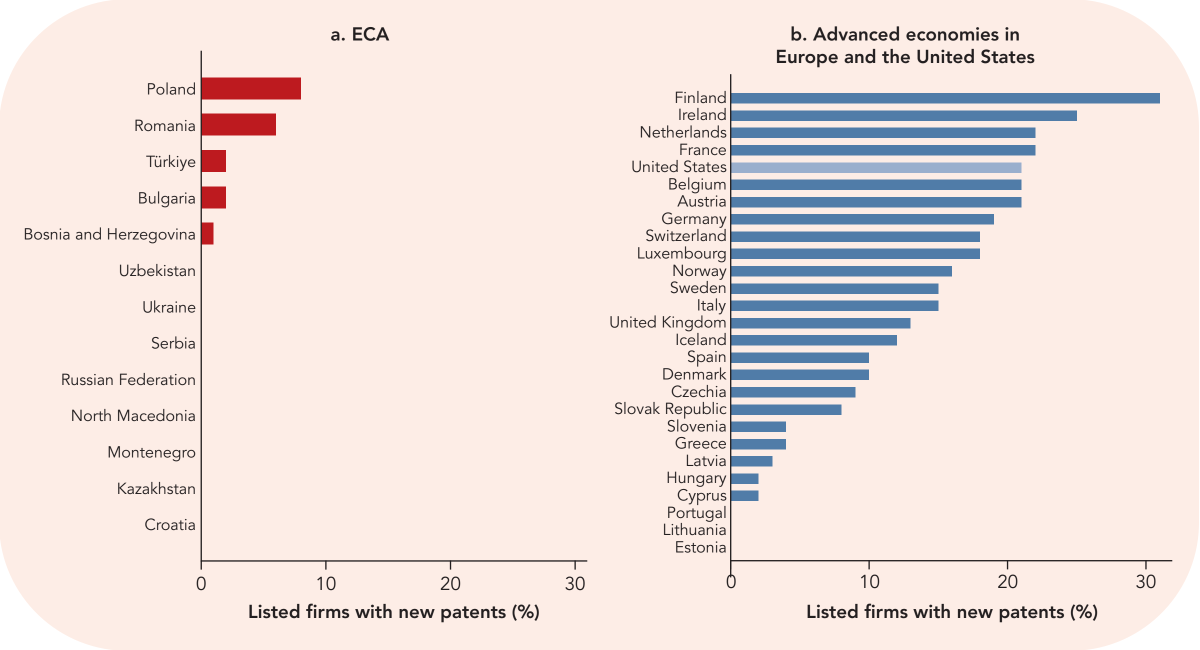
Most countries in ECA lag the advanced economies in Europe in terms of innovation. Firms in ECA are far less likely to generate new patents than those in advanced economies in Europe or the United States (figure 2.10). Two bright spots in ECA are Poland and Romania, which are home to the largest shares of firms producing new patents in the region, at 8 and 6 percent, respectively, although

FIGURE 2.9. **Firm size at birth, by current firm size category, in ECA and advanced economies in Europe, 2019**



Source: Calculations based on data from the latest World Bank Enterprise Surveys (for most countries, 2019).
Note: Firm-level responses were aggregated to the country level using weights. The averages for ECA and advanced economies in Europe are simple country averages. For the list of countries, see table 2A.1, in annex 2A. ECA = Europe and Central Asia.

FIGURE 2.10. **Most countries in ECA lag advanced economies in Europe in the share of firms with new patents**



Sources: Ayyagari, Demirgüç-Kunt, and Maksimovic 2022; Cheng 2019.
Note: The figure shows the percent of listed firms with new patents based on the average for 2014–18 for firms included in the Worldscope database, which covers firms listed on the stock market (3,117 firms in ECA, 8,085 firms in the advanced economies in Europe, and 8,724 firms in the United States). It excludes countries with fewer than 10 observations per year. Numbers are rounded to the closest integer. New patents are those granted by the United States Patent and Trademark Office. ECA = Europe and Central Asia.

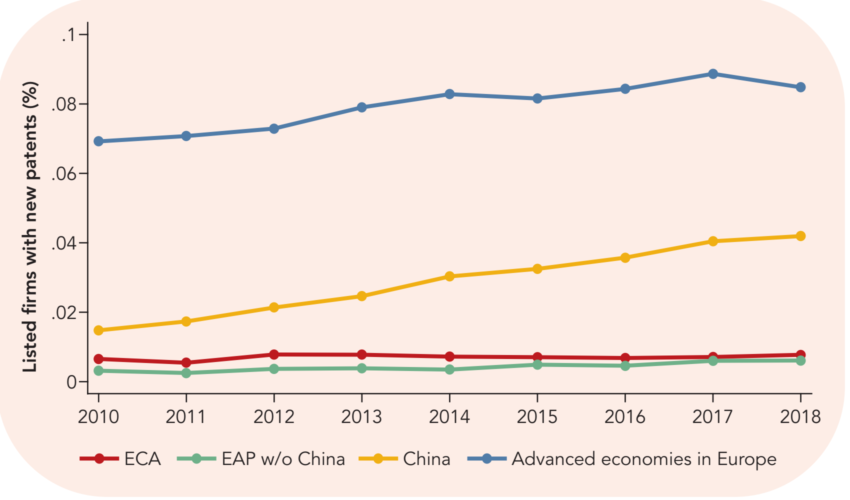
this is still lower than the percentages in the advanced economies in Europe, where on average the share of listed firms generating new patents is twice as large.

The percentage of firms with new patents has increased slightly over time in the advanced economies in Europe but remained constant in ECA, suggesting that the innovation gap might be widening. For comparison, the average percentage of firms with new patents in EAP countries excluding China was similarly low as among ECA countries over the same period. China is the only country that displayed a notable increase in the share of firms with new patents, from less than 2 percent in 2010 to more than 4 percent in 2018 (figure 2.11). The countries in ECA have a higher GDP per capita than the countries in EAP excluding China, however, suggesting that firms in ECA should be transitioning to a phase that is more dominated by innovation than just absorption of knowledge.

A lower percentage of firms in ECA spends on R&D than in the advanced economies in Europe. The data on new patents only cover innovation in listed firms, but data on R&D spending, which are available for the broader private sector and a crucial input for innovation, show a similar pattern. The share of firms that spend on R&D in ECA lags that in advanced economies in Europe, with on average 12 percent of firms in ECA spending on R&D compared to more than twice as many firms (28 percent) in advanced economies in Europe (figure 2.12).

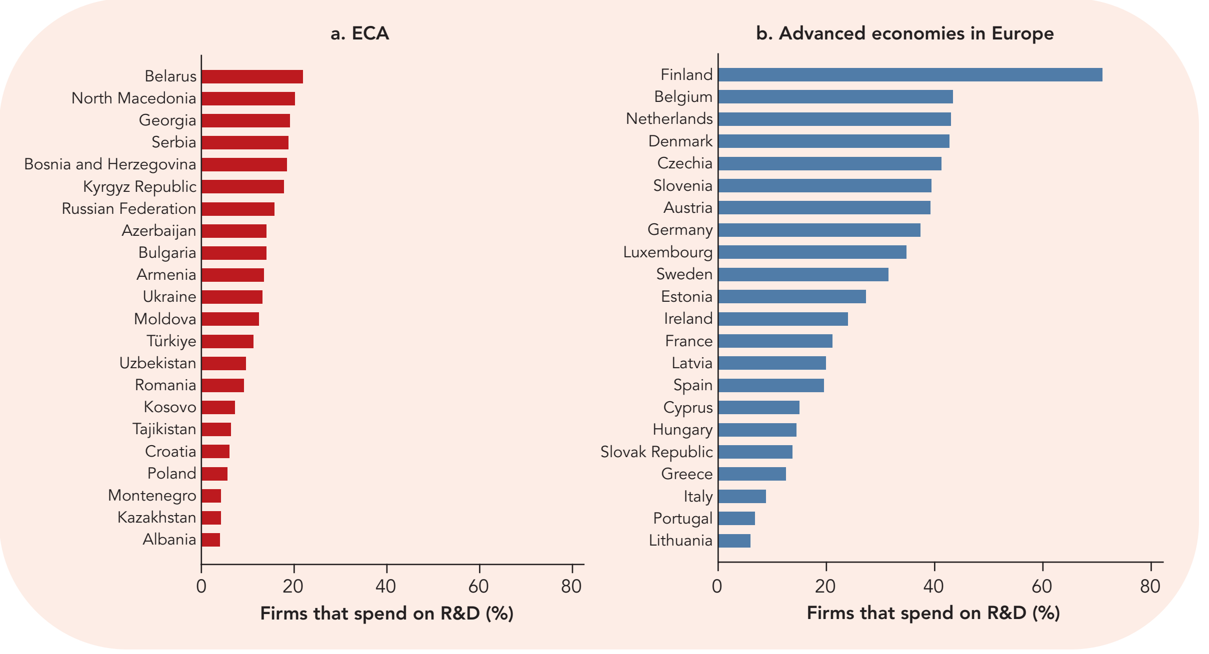
More broadly, innovation encompasses more than just patents and R&D spending. While at the productivity frontier patents and R&D spending are indicators of innovation, firms can also innovate by adopting technology,

FIGURE 2.11. A widening gap in the share of firms with new patents between ECA and advanced economies in Europe, 2010–18



Sources: Ayyagari, Demirgüç-Kunt, and Maksimovic 2022; Cheng 2019.
Note: The figure is based on firms included in the Worldscope database, which covers firms listed on the stock market (3,484 firms in ECA, 9,570 firms in advanced economies in Europe, 4,438 firms in EAP without China, and 5,546 firms in China). EAP consists of Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam. New patents are those granted by the United States Patent and Trademark Office. The data were first averaged across firms within a country and then averaged within groups. It excludes countries with fewer than 10 observations per year. EAP = East Asia and Pacific; ECA = Europe and Central Asia.

FIGURE 2.12. A lower share of firms spend on R&D in ECA compared to the advanced economies in Europe



Source: Calculations based on data from the latest World Bank Enterprise Surveys (for most countries, 2019).
Note: Firm-level responses were aggregated to the country level using weights. The averages for ECA and advanced economies in Europe are simple country averages. ECA = Europe and Central Asia; R&D = research and development.

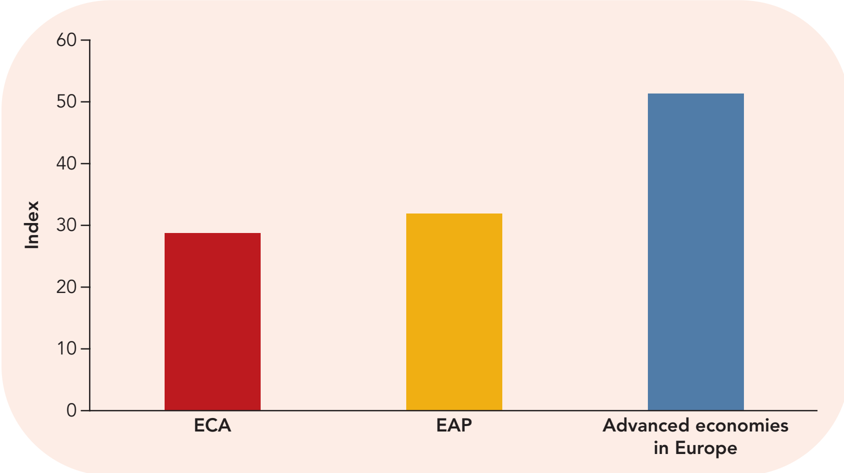
introducing new processes, and improving managerial quality (Cusolito and Maloney 2018). Innovation depends on an environment with many complementary factors, including human and physical capital (Cirera and Maloney 2017). A broad-based innovation index similarly shows ECA lagging advanced economies in Europe and EAP (figure 2.13).

Boosting Business Dynamism and Innovation in ECA

Boosting business dynamism and innovation in ECA will require addressing four challenges across countries in the region: strengthening the competitive environment, reducing distortions related to the still large presence of the state, investing in education and addressing the skills gap, and ensuring adequate access to finance. World Bank Country Economic Memorandums consistently mention these four challenges as major obstacles to private sector growth in the region (see table 2B.1, in annex 2B). ECA is a diverse region in terms of economic and institutional development, and addressing the challenges in these four areas might look different across countries.

ECA also encounters other challenges associated with limited integration into global markets and, for a large part of the countries in the region, adverse demographic developments. These challenges include the small size of many economies and thus the small markets, aging populations, and declining labor supply

FIGURE 2.13. **ECA lags advanced economies and EAP on the Global Innovation Index, 2023**



Source: Global Innovation Index, World Intellectual Property Organization (2023).
Note: Regional averages are simple country averages. EAP = East Asia and Pacific; ECA = Europe and Central Asia.

issues in ECA West,[7] and the need to take advantage of the potential demographic dividend in ECA East.[8] All this is against the backdrop of geoeconomic fragmentation, risks of de-globalization, an acceleration of the digital transformation, and the substantial impacts of climate change.

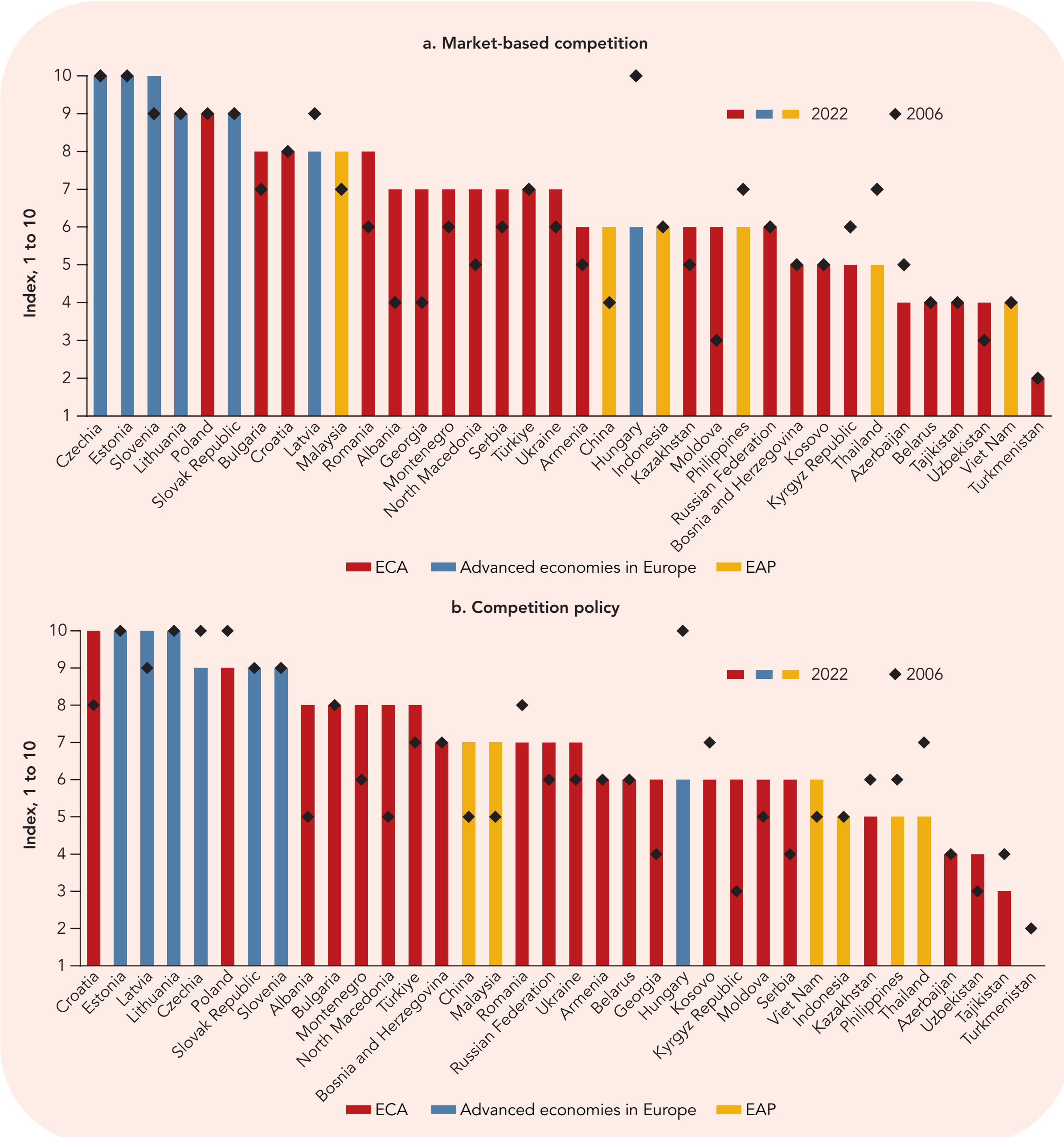
Competition

The competitive environment is a major obstacle to private sector growth in ECA. Long-standing structural issues related to a legacy of incomplete market transition characterize the environment in which many firms in the region operate. Limited product market competition, in part due to the large presence of SOEs, distorts the operating environment and creates an uneven playing field for private sector firms. These distortions impede resource allocation toward firms with higher productivity and growth potential (Izvorski et al. 2020). More competition can put pressure on firms to innovate, increasing productivity (Aghion et al. 2001; Bloom, Draca, and Van Reenen 2016). A level playing field for both small and large enterprises, private and state-owned ones, and those based in larger cities versus those in rural areas is a key precondition for more dynamic private sector growth.

The ECA countries with the most competition-friendly environments are in the western part of the region, and there is significant room for strengthening market-based institutions in the eastern part. The Bertelsmann Transformation Index (BTI) measures perceptions of the fundamentals of market-based competition (figure 2.14, panel a) and the implementation of competition policy (figure 2.14, panel b). BTI scores tend to be high for countries in Central Europe and the

7. ECA West comprises countries in Central Europe and the Western Balkans.
8. ECA East comprises countries in Central Asia, Eastern Europe, and the South Caucasus.

FIGURE 2.14. Most countries in ECA saw little change in the competitive environment between 2006 and 2022



Source: Bertelsmann Stiftung Transformation Index (2022).

Notes: The initial year for Kosovo is 2010, and for Montenegro it is 2008. BTI = Bertelsmann Transformation Index; ECA = Europe and Central Asia.

a. The BTI market-based competition measure captures the extent to which the fundamentals of market-based competition have been developed, with a maximum score (10) indicating that "market competition is consistently defined and implemented both macroeconomically and microeconomically. There are state-guaranteed rules for market competition with equal opportunities for all market participants. The informal sector is very small." The minimum score (1) indicates that "market competition is present only in small segments of the economy and its institutional framework is rudimentary. Rules for market participants are unreliable and frequently set arbitrarily. The informal sector is large."

b. The BTI competition policy measure captures the extent to which safeguards exist to protect competition and are enforced, with the maximum score (10) indicating that "comprehensive competition laws to prevent monopolistic structures and conduct exist and are strictly enforced." A score of 1 indicates that "no legal or political measures are taken to prevent monopolistic structures and conduct."

western part of the region, where institutions have been aligned with the EU. Many countries in the eastern part of the region score lower, with countries in Central Asia having the most room for improvement.

Limited progress has been made in improving the competitive environment in ECA in recent years. Indeed, between 2006 and 2022 there was no change in market-based competition for nine countries, and no change in competition policy for five countries (figure 2.14). Although some countries improved their BTI scores, most are still below the highest possible value of 10.

ECA's competitive environment is on par with the region's peers in EAP but lags advanced economies in Europe. Countries in both ECA and EAP have average scores of 6 for both BTI competition measures. Although the BTI typically does not collect data in advanced economies, it covers seven advanced countries in Europe: Czechia, Estonia, Hungary, Latvia, Lithuania, the Slovak Republic, and Slovenia. The average score for the six countries excluding Hungary (which scores 6 for both measures) is near or at the maximum for the competition measures: 9 for market-based competition and 10 for competition policy.

The Organisation for Economic Co-operation and Development's (OECD's) product market regulation indicators shed light on the areas of the competitive environment where ECA has the most room for improvement. These indicators codify distortions induced by state involvement and barriers to domestic and foreign entry along six dimensions. In all six dimensions, ECA countries (represented by red bars in figure 2.15), tend to score worse than advanced economies in Europe (blue bars). However, in all areas, except administrative burden on startup, countries in ECA perform better than countries in EAP (yellow bars).

Not surprisingly, the dimension of the competitive environment where ECA performs worst is public ownership. Such barriers are large in ECA, with Kazakhstan, Russia, and Serbia having the lowest scores among ECA countries. For example, in Serbia, SOEs are more prevalent than in similar countries and are less productive than other firms in the same sectors (World Bank 2020). This presence of SOEs can constrain private sector growth since it distorts prices and markets, leading to less private investment. Given that state ownership is the leading issue for competition in ECA, the next subsection discusses public ownership in more detail.

Most ECA countries also have scope for improving barriers in the service and network sectors. These barriers refer to entry and conduct regulations in the relevant sectors. For example, in Montenegro, lawyers are subject to entry and conduct restrictions. Notaries face quantitative and territorial restrictions. These barriers can raise costs and undermine service quality (World Bank 2023d). The network sectors are energy, transportation, and e-communications. Some barriers in the network and service sectors arise from continued state ownership, especially in Central Asia, where the large presence of the state, in combination with statutory monopolies, means that SOEs dominate key sectors. In Uzbekistan, for example, the weak performance of energy SOEs is a constraint on economic activity and private sector growth, and electricity and gas tariffs at below cost-recovery rates are a potential source of competition distortion (Izvorski et al. 2021). Two other examples of barriers in these sectors come from Moldova (World Bank 2023c). Here, retail tariffs on maritime passenger and freight transport are

FIGURE 2.15. Product market regulation in ECA needs most improvement in the areas of public ownership and barriers in the services and network sectors

Source: Calculations based on OECD Economy-wide Product Market Regulation Indicators (2018).
Note: Each index runs from 0 to 6, with higher values indicating greater distortions or barriers. Each bar represents a country in the respective region, including 12 ECA countries: Albania, Bulgaria, Croatia, Kazakhstan, Kosovo, Moldova, Montenegro, Poland, Romania, the Russian Federation, Serbia, and Türkiye; 26 advanced economies in Europe: Austria, Belgium, Cyprus, Czechia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, the Netherlands, Norway, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, and the United Kingdom; and four EAP countries: China, Indonesia, Malaysia, and Viet Nam. EAP = East Asia and Pacific; ECA = Europe and Central Asia; OECD = Organisation for Economic Co-operation and Development; SOEs = state-owned enterprises.
a. Public ownership covers the scope of SOEs, government involvement in network sectors, direct control over enterprises, and governance of SOEs.
b. Involvement in business operations codifies retail and price controls and regulations, command and control regulations, and public procurement.
c. Simplification and evaluation of regulations encompasses assessment of impact on competition, interactions with interest groups, and complexity of regulatory procedures.
d. Administrative burden on start-ups includes administrative requirements for limited liability companies and personally owned enterprises, as well as licenses and permits.
e. Barriers in the services and network sectors measures the extent of the qualitative and quantitative barriers to competition arising from existing regulation in key service sectors and from existing incentive-based regulation in network sectors.
f. Barriers to trade and investment assesses barriers to foreign direct investment, tariff barriers, differential treatment of foreign suppliers, and barriers to trade facilitation.

regulated by the government, discouraging entry. In road freight transport, foreign-registered trucks are not allowed to service domestic roads. As a result of such barriers, the quality of transport infrastructure in Moldova is poor, limiting trade and FDI.

The administrative burden on start-ups is low in some ECA countries but high in others. The three countries with the highest administrative burdens on start-ups in the region are Türkiye, Bulgaria, and Montenegro. For example, in Bulgaria, registering a limited liability company involves 10 public authorities, including a notary, and costs are higher than in other countries (Nikolova et al. 2023). This burdensome entry regulation may have contributed to inefficient resource allocation, with more productive firms in Bulgaria having lost market share, and may have stifled innovation.

In the area of simplification and evaluation of regulation, Poland is the only country in ECA that is a top performer, but most ECA countries perform well in the areas of trade and investment. Some countries in ECA have significant room for simplifying regulation. For example, in the Kyrgyz Republic, firms need to comply with more than 800 administrative procedures (including permits), generating a major obstacle for businesses in terms of time and cost (Izvorski et al. 2020).

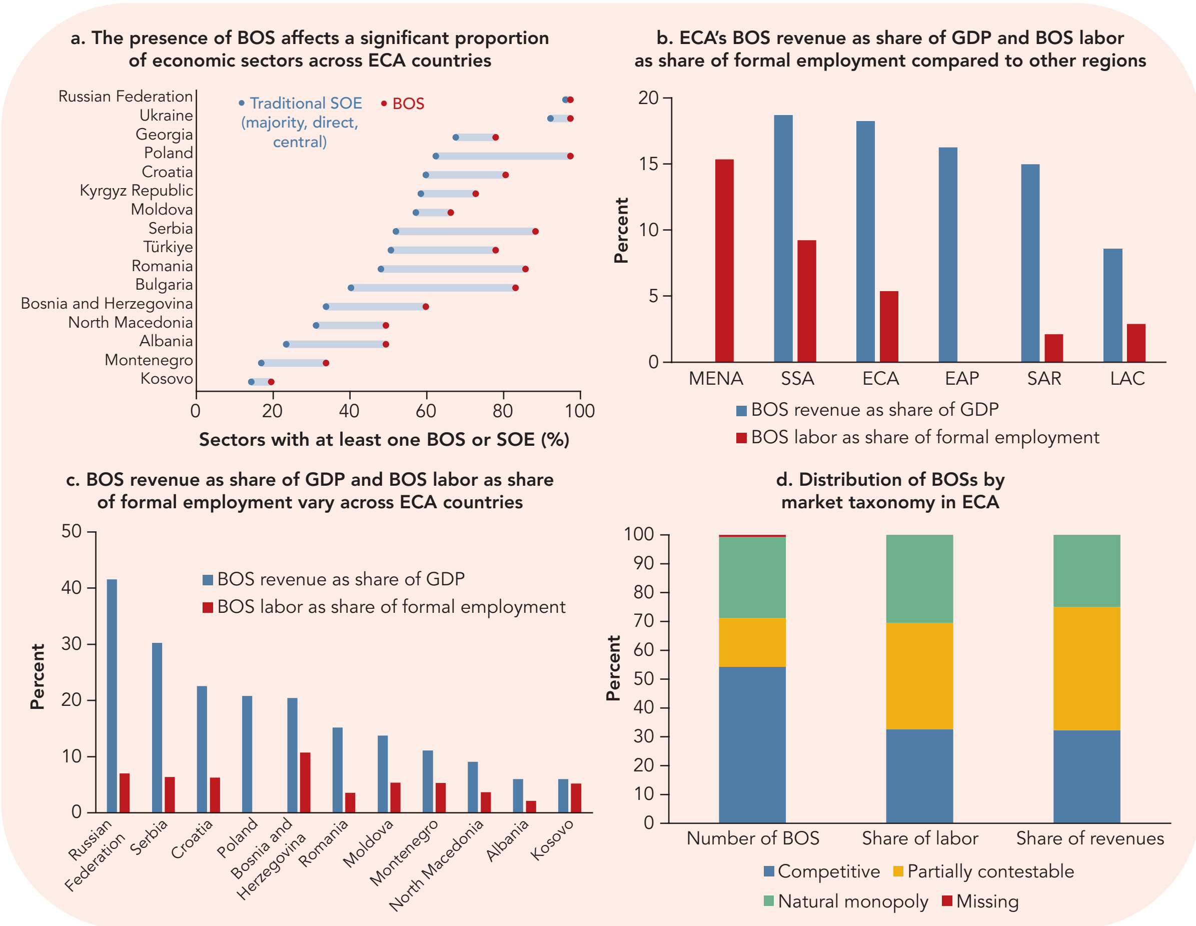
SOEs and the footprint of the state

The extensive presence of the state in enterprise ownership and management can negatively affect private sector growth. Government involvement in sectors where SOEs operate may create an uneven competitive landscape. SOEs may receive preferential treatment in terms of both access to resources and regulation, compared to privately owned firms, which can grant SOEs an unfair edge (World Bank 2023a). For example, price regulation or margin capping for products such as fuel, cement, or pharmaceutical products can lead to tacit collusion. Governments may also use SOEs to achieve non-profit objectives, such as the strategic control of natural resources or development of specific sectors.

Greater government ownership is associated with lower productivity and less market dynamism. In addition to SOEs, there are also firms that are indirectly owned or minority owned by the state and businesses run by local governments. Together, all such firms are referred to as businesses of the state (BOSs). BOSs are less productive than private firms with similar characteristics (see box 2.1). State presence can also affect market dynamism: an increase in BOSs is associated with lower rates of firm entry, crowding out of private investment, and increased market concentration.

SOEs still account for a large share of economic activity in many countries in ECA. The ECA region is home to more than 53,000 BOSs spread across 21 countries, with Russia accounting for more than half of such firms. BOSs in Russia are present in nearly all sectors of the economy (figure 2.16, panel a). Although ECA has the largest number of firms with some degree of state involvement compared to other regions, the presence of such firms in ECA in terms of their revenue as a share of GDP and their employment as a share of formal employment is comparable to that in other regions (figure 2.16, panel b). On average, BOS revenues represent 18 percent of GDP and BOSs employ 5 percent of formal workers in ECA.

FIGURE 2.16. Footprint of the businesses of the state in ECA



Source: World Bank.

Note: The BOS data are for 2019. BOSs = businesses of the state; EAP = East Asia and Pacific; ECA = Europe and Central Asia; GDP = gross domestic product; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa; SAR = South Asia; SOE = state-owned enterprise; SSA = Sub-Saharan Africa.

a. The traditional definition of SOE implies majority, directly owned firms by the central government. When the ownership information was missing, the BOS was assumed to be a centrally owned SOE.

b and c. Only countries within regions with revenue or labor data coverage exceeding 75 percent are included. Only regional averages based on country coverage exceeding 75 percent are included.

c. For Poland, data coverage does not exceed 75 percent for labor.

d. The figure uses the taxonomy of markets as developed by Dall'Olio et al. (2022). The sample includes Albania, Bosnia and Herzegovina, Croatia, Estonia, Kosovo, Latvia, Lithuania, Moldova, Montenegro, North Macedonia, Romania, the Russian Federation, Serbia, and Slovenia.

The presence of state ownership varies significantly within ECA. The BOS revenue share ranges from just over 40 percent in Russia to just over 5 percent in Albania and Kosovo. The BOS employment share ranges from 11 percent in Bosnia and Herzegovina to 2 percent in Albania (figure 2.16, panel c). Notably, on average just over half (55 percent) of BOSs in ECA operate in sectors classified as competitive according to the taxonomy of markets developed by Dall'Olio et al. (2022) (figure 2.16, panel d). These are sectors where state intervention may be less justified since fewer market failures exist.

BOX 2.1 Performance of Businesses of the State versus Private Sector Firms and Effects on Market Dynamism

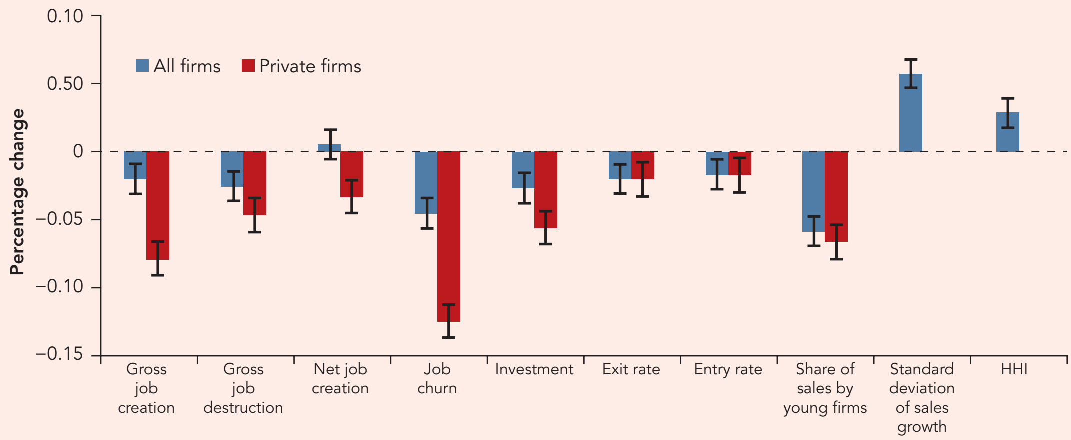
The extensive presence of state ownership in Europe and Central Asia (ECA) has important effects on private sector firm dynamism, productivity, and financial performance. New empirical analyses conducted for the World Bank's (2023a) *The Business of the State* report, using a cross-country panel data set for 14 Eastern and Central European countries and five country studies—including Romania and Türkiye in ECA—using census data show that businesses of the state (BOSs) are generally larger and more capital intensive than their private sector counterparts. Importantly, the relative performance of BOSs varies with the extent and nature of state ownership. BOSs with substantial private ownership are more efficient than those with majority or sole state ownership. BOSs that are indirectly owned by the state are often more efficient than those that are directly owned.

BOSs have lower levels of productivity than private firms with similar characteristics, and the growth rate of their employment is lower as well. A greater state presence in commercial activities is also associated with lower aggregate productivity and reduced firm entry, as reflected in fewer young firms or a lower share of economic activity accounted for by young firms.

Evidence from a panel dataset of 14 ECA countries suggests that state ownership might be linked to lower sector dynamism. Almost all the measures of dynamism are lower when the presence of the state is greater, although individual country results can vary (figure B2.1.1). The impacts are especially large in competitive sectors, which is worrying because a larger state presence is associated with less reallocation of capital and workers and less entry and exit, and because it affects private firms in the competitive sectors where private firms are likely to be the most viable.

The presence of distortions and significant state intervention can limit the efficient allocation of resources across firms, with implications for long-term economic growth. Cusolito et al. (2022) apply a model of misallocation that looks at frictions in the financial sector and include the role of state-owned enterprises in 24 countries in Europe. They find that an expanded state footprint is associated with lower costs of finance for BOSs, with a resulting increase in their assets and capital intensity. Removing frictions in financial markets and closing state-owned enterprises that are less productive can deliver potential productivity gains and thus long-term economic growth.

FIGURE B2.1.1. Impact of BOS presence on market dynamics in 14 European countries



Sources: World Bank Global Businesses of the State database; Orbis.
Note: Coefficients on the market share of BOS in a 2-digit sector for each of the outcomes run separately, controlling for sector size over time, sector, taxonomy, country, and year fixed effects. The error bars provide the 95 percent confidence intervals around the estimated effects. If the error bars cross the x-axis, the result is not statistically significant at the 5 percent level. BOSs = business of the state; HHI = Herfindahl-Hirschman Index.

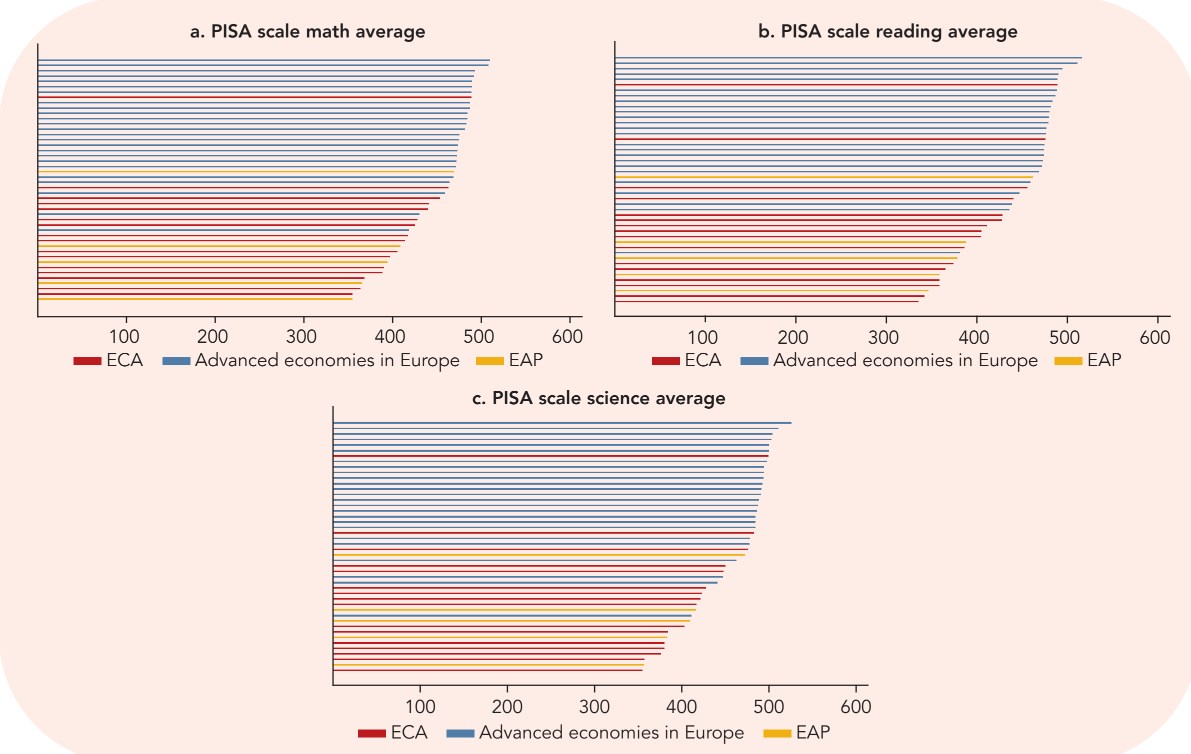
Source: World Bank 2023a.

Education and the skills gap

Large skills gaps and worsening education quality contribute to low innovation and growth in ECA. A better educated workforce is associated with higher productivity (Égert, de la Maisonneuve, and Turner 2022) and can lead to more innovation (Van Reenen 2022). Many firms in ECA report that the inadequately educated workforce is a major constraint to growth (table 2A.3, in annex 2A). Technological change and the accelerating digital transformation are resulting in increased demand for skilled labor, but firms cannot meet these demands amid significant skills gaps across ECA. Large and increasing emigration does not help in the short term.

The quality of basic education tends to be lower in ECA than in the advanced economies in Europe and has declined over time. Students in ECA scored lower than students in most advanced economies in Europe on all three knowledge areas measured by the OECD's Program for International Student Assessment

FIGURE 2.17. The quality of basic education tends to be low in ECA

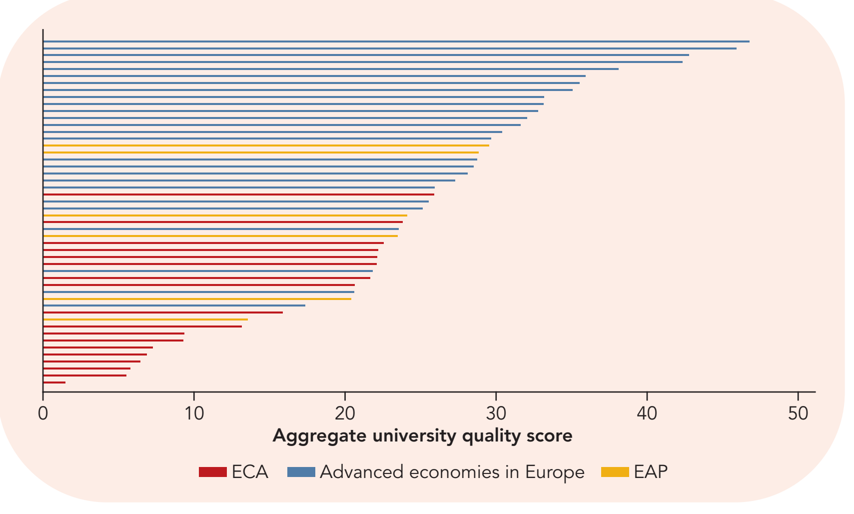


Source: Calculations based on the Organisation for Economic Co-operation and Development's Program for International Student Assessment (2022).
Note: PISA scores are based on tests administered to 15-year-olds in school. Each bar represents a country in the respective region, including 16 ECA countries: Albania, Azerbaijan, Bulgaria, Croatia, Georgia, Kazakhstan, Kosovo, Moldova, Montenegro, North Macedonia, Poland, Romania, Serbia, Türkiye, Ukraine, and Uzbekistan; 25 advanced economies in Europe: Austria, Belgium, Cyprus, Czechia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, the Netherlands, Norway, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, and the United Kingdom; and five EAP countries: Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam. The data for Azerbaijan only cover Baku. The data for Ukraine only refer to 18 of 27 regions. EAP = East Asia and Pacific; ECA = Europe and Central Asia; PISA = Program for International Student Assessment.

(PISA) in 2022 (figure 2.17). The exception is Poland, where students scored near the top. Poland's performance can be linked to its education reform of 1999, which expanded general academic schooling and delayed tracking into a vocational curriculum (Jakubowski et al. 2016). Most of ECA's peer countries in EAP also have lower scores—but their firms are largely integrating into global markets based on low-cost labor, which is in line with their relative endowments and GDP per capita. PISA data going back to 2000 suggest that the quality of basic education in most ECA countries has declined over time. Similarly, results from the Progress in International Reading Literacy Study show that countries in ECA face large learning losses, likely a result of COVID-19-induced school closures, with the reading achievement of students in the fourth grade declining in five of the six ECA countries where data were collected in both 2016 and 2021 (Iqbal, Shmis, and Almeida 2023).

Most of the ECA countries also lag on measures of the quality of higher education, especially relative to the advanced economies in Europe. However, there are exceptions: the quality of higher education in Russia, the Central European countries, and Türkiye, for example, is comparable to some of the lower scores for the advanced economies in Europe. These countries also rank similarly in the quality of higher education compared to some EAP countries, although China and Malaysia rank notably higher (figure 2.18).

FIGURE 2.18. Most of the ECA countries also lag on measures of the quality of higher education

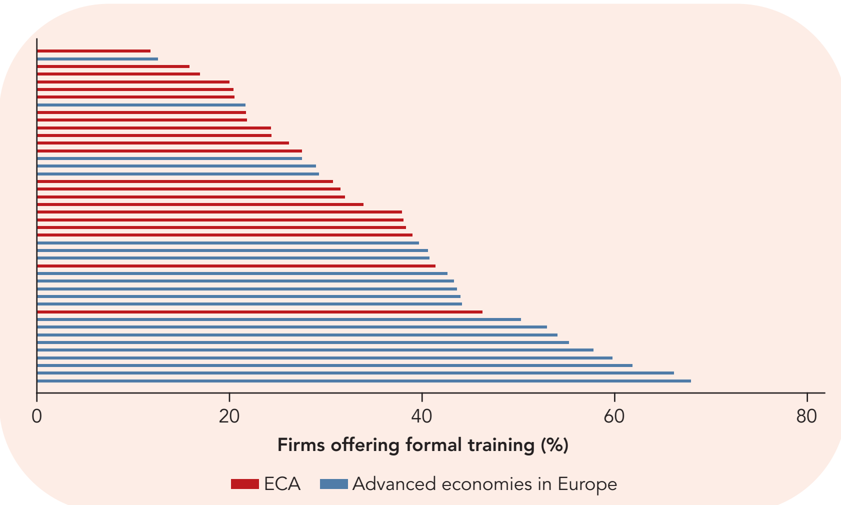


Source: Demirgüç-Kunt and Torre 2022.
Note: Each bar represents a country in the respective region, including 18 ECA countries: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Georgia, Kazakhstan, Moldova, Montenegro, North Macedonia, Poland, Romania, Russian Federation, Serbia, Türkiye, and Ukraine; 26 advanced economies in Europe: Austria, Belgium, Cyprus, Czechia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, the Netherlands, Norway, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, and the United Kingdom; and six EAP countries: China, Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam. The aggregate university quality score is as calculated by Demirgüç-Kunt and Torre (2022). EAP = East Asia and Pacific; ECA = Europe and Central Asia.

Furthermore, ECA faces challenges with vocational education and training (VET). VET is a mechanism through which workers can obtain skills that are relevant for firms. However, in practice, many VET programs struggle to deliver on the promise of skills development (World Bank, UNESCO, and ILO 2023). Data from EU countries, including countries in Central Europe, suggest that vocational students perform worse in math, reading, and science than students in general education (Dalvit et al. 2023). There is currently no comprehensive database that allows for comparing the quality of VET across countries in ECA,[9] but the following examples highlight issues with VET in ECA. In Azerbaijan, VET tends to be of low quality (World Bank 2022a). In both Albania and Azerbaijan, VET has insufficient linkages with the private sector. Firms often have limited involvement in shaping curricula (Ungerer et al. 2022). Consistent with this point, in Türkiye, graduates of VET institutions are employed mostly outside their field of education, suggesting skill mismatches with employment opportunities (Özer and Suna 2020).

Another way for workers to obtain the skills they need on the job is through training provided by employers, but firms in ECA are less likely to offer such programs than firms in the advanced economies in Europe. In most ECA countries, 20 to 40 percent of firms offer training, while 40 to 65 percent of firms in most advanced economies in Europe do so (figure 2.19). The two ECA countries where firms are most likely to offer training are the Kyrgyz Republic and Albania.

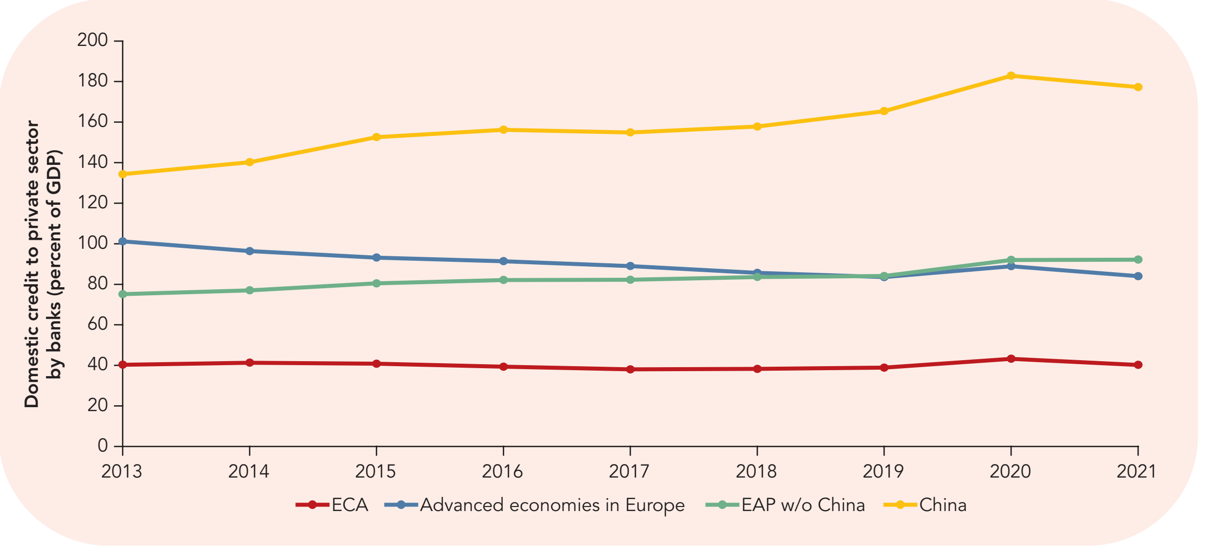
FIGURE 2.19. Fewer firms with worker training in ECA



Source: World Bank Enterprise Surveys (for most countries, 2019).
Note: Firm-level responses were aggregated to the country level using weights. Each bar represents a country in the respective region, including 22 ECA countries and 22 advanced economies in Europe (see table 2A.1, in annex 2A). ECA = Europe and Central Asia.

9. The OECD has launched the PISA-VET initiative to collect internally standardized assessments of VET programs in the future (https://www.oecd.org/pisa/vet.htm).

FIGURE 2.20. Domestic credit to the private sector is relatively low in ECA



Sources: Calculations based on data from the World Development Indicators. The original sources are the International Monetary Fund, International Financial Statistics and data files, and World Bank and Organisation for Economic Co-operation and Development GDP estimates.
Note: Domestic credit to the private sector by banks refers to financial resources provided to the private sector by other depository corporations (deposit-taking corporations except central banks), such as through loans, purchases of nonequity securities, and trade credits and other accounts receivable, which establish a claim for repayment. For some countries, these claims include credit to public enterprises. The data cover 22 countries in ECA, 25 advanced economies in Europe, and five countries in EAP excluding China. EAP = East Asia and Pacific; ECA = Europe and Central Asia; GDP = gross domestic product.

Access to finance

Insufficient access to finance may be preventing firms in ECA from investing in profitable and innovative opportunities and enhancing productivity. This subsection discusses how ECA fares in three dimensions of access to finance: domestic credit to the private sector, credit constrained firms, and proportion of long-term debt. The focus here is on bank lending since it is a major source of investment in ECA, given the relatively low prevalence of private equity and venture capital. For example, in 2022, only 816 venture capital deals, with a total value of €4 billion, took place in Central and Eastern Europe, compared to 9,476 deals in Western and Southern Europe, with a value of €79 billion (PitchBook 2022).[10]

Domestics credit to the private sector is relatively low in ECA and has not increased over the past decade. Domestic credit to the private sector in ECA was broadly unchanged at about 40 percent of GDP between 2013 and 2021, half the value in advanced economies in Europe (figure 2.20). Domestic credit to the private sector is also higher in EAP (excluding China), where it has increased from

10. The regional definition in the PitchBook report does not line up with the World Bank's definition. PitchBook's Central and Eastern Europe includes the following ECA countries: Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, North Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, and Ukraine. The PitckBook definition of Central and Eastern Europe also covers some advanced economies in Europe (Czechia, Estonia, Hungary, Latvia, Lithuania, the Slovak Republic, and Slovenia), likely making the number and value of venture capital deals in ECA even lower.

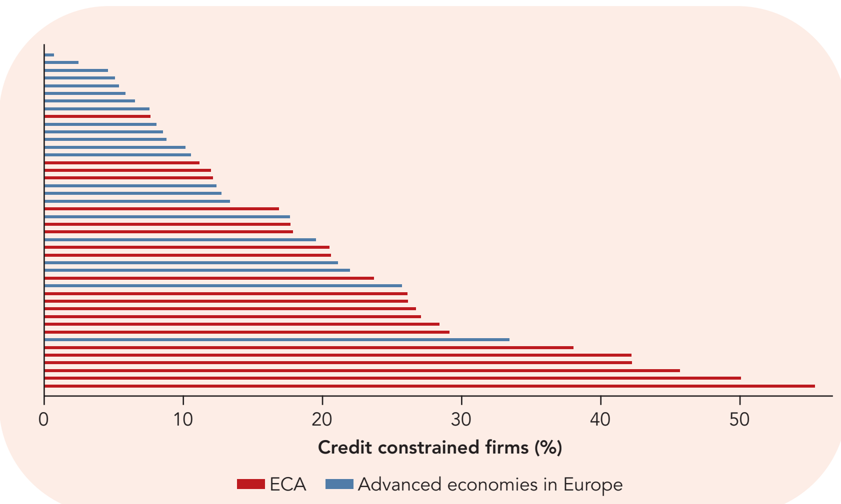
around 75 to 90 percent. China stands out since its domestic credit to the private sector was 180 percent of GDP in 2021, a sizable increase from 130 percent in 2013. Overall, the patterns show that ECA lags both advanced economies in Europe and EAP countries—most of which have lower GDP per capita—in the amount of funding provided to the private sector.

Accordingly, firms in ECA are more likely to report that they are credit constrained compared to firms in the advanced economies in Europe. In half of the ECA countries, at least one-fourth of the firms are credit constrained, ranging from more than half of the firms in Ukraine, the lowest performer in ECA, to less than one-tenth of the firms in Croatia (figure 2.21). By contrast, in most advanced economies in Europe, less than one-fourth of the firms are credit constrained.

Short credit maturities in many ECA countries may restrict investment and contribute to low productivity growth. Investments in innovation often take time to yield returns. For this reason, firms need access to long-term finance. In ECA, about 50 percent of debt was long-term in 2019, an increase from 40 percent in 2010 (figure 2.22). These percentages are higher than in EAP and China, but they fall short of advanced economies in Europe, where close to 70 percent of debt is long-term. The percentage of long-term debt in ECA increased until 2016, getting closer to that in advanced economies in Europe, but then started to decline.

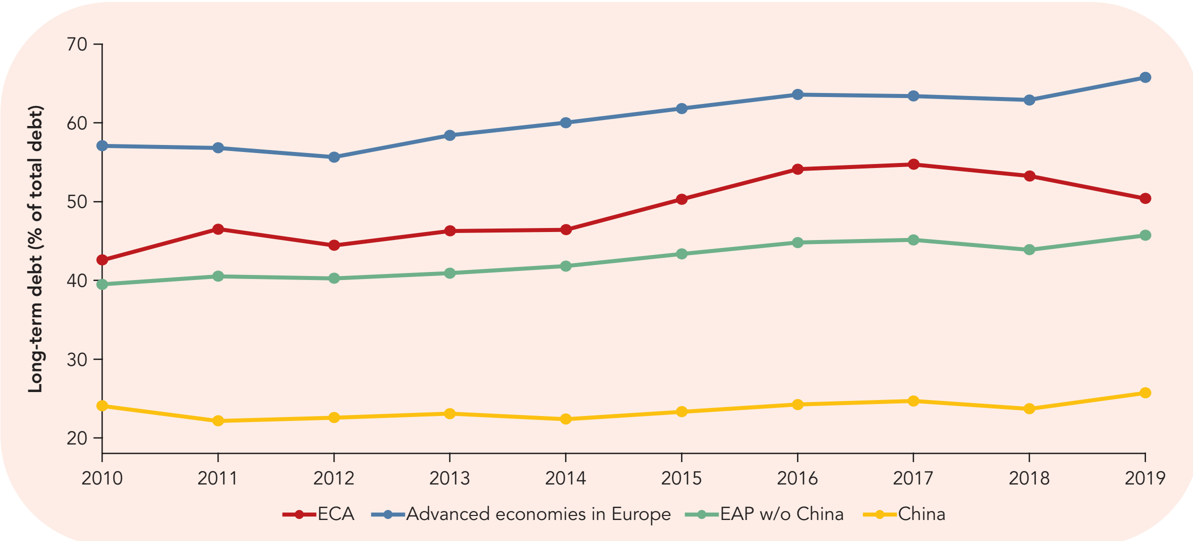
Within ECA, access to finance is more limited for small and medium-sized enterprises than for large firms. At 55 percent, the share of firms in ECA that have a loan or a line of credit from a financial institution is only slightly below the same percentage in advanced economies in Europe (59 percent). However, the gap between ECA and advanced economies in Europe in the use of loans is greater for medium-sized firms and even greater for small firms (figure 2.23).

FIGURE 2.21. Firms in ECA are more likely to be credit constrained



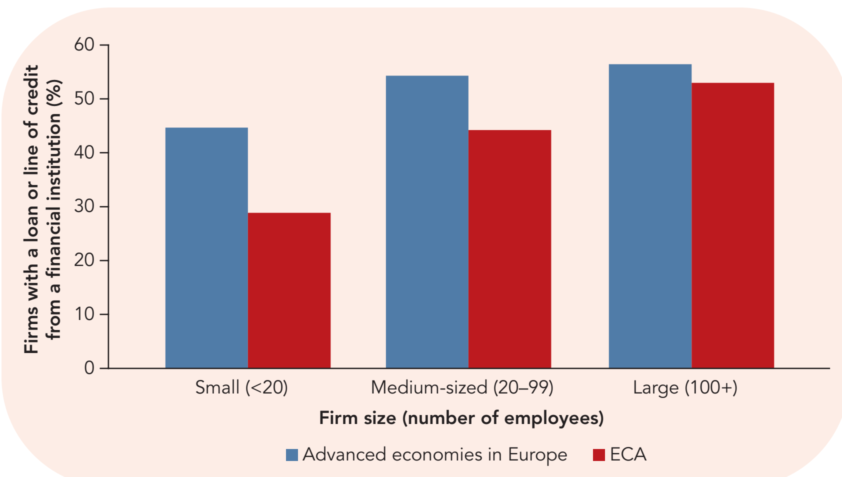
Sources: Islam and Meza 2023, based on World Bank Enterprise Surveys (most countries, 2019).
Note: A firm is classified as credit constrained if (a) it applied for a loan and was not approved in full, or (b) it did not apply even though it did not have enough capital. Each bar represents a country in the respective region, including 22 countries in ECA and 22 advanced economies in Europe. For the list of countries, see table 2A.1, in annex 2A. ECA = Europe and Central Asia.

FIGURE 2.22. Long-term debt in ECA first increased but then started to decline again, 2010 to 2019



Source: Calculations based on data from the Worldscope database.
Note: Long-term debt has an original maturity of more than one year. The Worldscope database covers firms listed on the stock market (with non-missing information on long-term debt: 2,586 firms in ECA, 6,714 firms in advanced economies in Europe, 3,440 firms in EAP without China, and 4,453 firms in China). The data were first averaged across firms within a country and then averaged within groups. It includes 13 countries in ECA: Bosnia and Herzegovina, Bulgaria, Croatia, Kazakhstan, North Macedonia, Montenegro, Poland, Romania, the Russian Federation, Serbia, Türkiye, Ukraine, and Uzbekistan; 26 advanced economies in Europe: Austria, Belgium, Cyprus, Czechia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, the Netherlands, Norway, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, and the United Kingdom; and five EAP countries: Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam. The figure excludes countries with fewer than 10 observations per year. EAP = East Asia and Pacific; ECA = Europe and Central Asia.

FIGURE 2.23. Smaller firms in ECA have more difficult access to finance



Source: World Bank Enterprise Surveys (for most countries, 2019).
Note: Firm-level responses were aggregated to the country level using weights, and then averaged across regions. The data include 22 countries in ECA and 22 advanced economies in Europe. Firm size is defined based on the number of employees. For the list of countries, see table 2A.1, in annex 2A. ECA = Europe and Central Asia.

Small firms tend to be less transparent and riskier borrowers, making them less attractive clients for financial institutions. For example, in Uzbekistan, banks provide a limited range of credit products to small and medium-sized enterprises, most of them with high collateral requirements (Izvorski et al. 2021).

Other challenges

The small size of many of the economies in the region limits potential firm growth, making integration into regional and global markets crucial. Sixteen of the ECA countries have populations of not more than 10 million people, including nine countries with fewer than 5 million people. Small population sizes make for small markets, which can limit firm growth due to limited demand for products or services and limited supply of inputs. Small markets may also limit a firm's opportunity to exploit economies of scale.

Trade integration can accelerate the adoption of new technologies, bring larger inflows of foreign investment, and spur market competition. Intensified integration through trade and FDI can help firms to accelerate technology adoption, including technology related to the green transition, and become more productive. Exporters have an incentive to increase their productivity to be competitive in foreign markets. FDI in firms can boost productivity through importing management and production technologies. Productivity gains are often especially pronounced when firms are part of a global value chain (GVC). In Türkiye, for example, GVC exporters are twice as productive as the average domestic firm. Moreover, as GVCs extend locally, they create more jobs and raise the productivity of local firms (World Bank 2022b).

Intensifying integration into global markets requires investments in trade-related infrastructure. This includes both upgrading the transport infrastructure and increasing the efficiency of the border crossing process. The OECD's product market regulation indicator for trade and investment shows that most ECA countries are doing well in terms of border crossing processes (figure 2.15, panel f). However, an issue that is not captured by the product market regulation indicator is the quality and certification infrastructure for verifying compliance with the standards that exporters must meet to access markets in advanced economies such as the EU. This infrastructure is often lacking. For example, in Albania, the insufficient quality infrastructure cannot credibly verify compliance with EU standards, which means that key animal products cannot be exported to the EU (Ungerer et al. 2022).

Demographic pressures in ECA West present a challenge to productivity growth. Declining population growth and aging populations leave countries in the ECA West subregion with smaller labor forces, presenting a drag on growth. This tightening of labor supply is exacerbated by high emigration rates of young and skilled workers. By contrast, countries in ECA East have younger populations and may be able to benefit from a demographic dividend, which is the economic growth potential due to having a larger working-age population share than non-working-age share. However, ECA East similarly faces high emigration rates of young and skilled workers.

Conclusion

A dozen countries—currently or formerly part of ECA—have become EU members in less than three decades, advancing extensive structural and institutional reforms; integrating into the EU and global trade, investment, and value chains; and, except for one country, reaching high-income status. Their progress has been remarkable. The transition to market economy is proceeding apace in the 20 middle-income countries currently in ECA.

Over the past decade, weaker productivity growth in ECA has resulted in a sharp slowdown in income convergence with advanced economies. Although there was a broad-based slowdown in productivity across emerging markets and developing economies after the GFC, and in most advanced economies since the 1970s, the decline was the steepest in ECA. Fundamental drivers of productivity growth, including progress in advancing institutional and market reforms, technology adoption, and innovation, are key for enabling private sector–led growth, but they have weakened in ECA. Many countries in the region have made only modest progress in establishing more effective corporate and market institutions in recent years.

ECA has plenty of room for improvement in business dynamism and innovation. Firms in ECA are less productive and less innovative than those in the advanced economies in Europe and some EAP peer countries. Firm entry and exit rates in ECA are lower and firms do not grow much, pointing to a less competitive and dynamic business environment in which firms tend to innovate much less, absorb less knowledge, and often become less productive over time.

Boosting business dynamism in ECA will require addressing several challenges in the region, including upgrading the competitive environment, reducing state involvement in the economy, dramatically boosting the quality of education, and strengthening the availability of finance. While ECA is a diverse region in terms of economic and institutional development, and addressing these challenges will look different across countries, addressing them is an essential condition for stronger economic growth and for overcoming the middle-income trap. Further, deepening trade integration will be crucial to help accelerate both the adoption of new technologies and firms' ability to overcome the limits to potential firm growth due to the small size of many economies in the region. Adverse demographics are also a challenge in the countries in ECA West, where tightening labor supply due to declining population growth and aging populations is exacerbated by high emigration rates of young and skilled workers.

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Annex 2A: World Bank Enterprise Surveys Data and Methodology

World Bank Enterprise Surveys provide nationally representative insights into the private sector landscape in Europe and Central Asia. Data for formal (registered) firms with five or more employees from the latest round of surveys were collected primarily in 2019 in the region (table 2A.1). More information on the Enterprise Surveys is available at https://www.enterprisesurveys.org/en/methodology.

TABLE 2A.1. Data overview of the World Bank Enterprise Surveys for Europe and Central Asia and advanced economies in Europe

Country	Year	ECA or AE	Subregion	Observations
Albania	2019	ECA	Western Balkans	377
Armenia	2020	ECA	South Caucasus	546
Austria	2021	AE	Western Europe	600
Azerbaijan	2019	ECA	South Caucasus	225
Belarus	2018	ECA	Eastern Europe	600
Belgium	2020	AE	Western Europe	614
Bosnia and Herzegovina	2019	ECA	Western Balkans	362
Bulgaria	2019	ECA	Central Europe and Baltic Countries	772
Croatia	2019	ECA	Central Europe and Baltic Countries	404
Cyprus	2019	AE	Southern Europe	240
Czechia	2019	AE	Central Europe and Baltic Countries	502
Denmark	2020	AE	Northern Europe	995
Estonia	2019	AE	Central Europe and Baltic Countries	360
Finland	2020	AE	Northern Europe	759
France	2021	AE	Western Europe	1,566
Georgia	2019	ECA	South Caucasus	581
Germany	2021	AE	Western Europe	1,694
Greece	2018	AE	Southern Europe	600
Hungary	2019	AE	Central Europe and Baltic Countries	805
Ireland	2020	AE	Western Europe	606
Italy	2019	AE	Southern Europe	760
Kazakhstan	2019	ECA	Central Asia	1,446
Kosovo	2019	ECA	Western Balkans	271
Kyrgyz Republic	2019	ECA	Central Asia	360
Latvia	2019	AE	Central Europe and Baltic Countries	359
Lithuania	2019	AE	Central Europe and Baltic Countries	358

TABLE 2A.1. (continued)

Country	Year	ECA or AE	Subregion	Observations
Luxembourg	2020	AE	Western Europe	170
Moldova	2019	ECA	Eastern Europe	360
Montenegro	2019	ECA	Western Balkans	150
Netherlands	2020	AE	Western Europe	808
North Macedonia	2019	ECA	Western Balkans	360
Poland	2019	ECA	Central Europe and Baltic Countries	1,369
Portugal	2019	AE	Southern Europe	1,062
Romania	2019	ECA	Central Europe and Baltic Countries	814
Russian Federation	2019	ECA	Russian Federation	1,323
Serbia	2019	ECA	Western Balkans	361
Slovak Republic	2019	AE	Central Europe and Baltic Countries	429
Slovenia	2019	AE	Central Europe and Baltic Countries	409
Spain	2021	AE	Southern Europe	1,051
Sweden	2020	AE	Northern Europe	591
Tajikistan	2019	ECA	Central Asia	352
Türkiye	2019	ECA	Türkiye	1,663
Ukraine	2019	ECA	Eastern Europe	1,337
Uzbekistan	2019	ECA	Central Asia	1,239

Source: World Bank Enterprise Surveys as of August 30, 2023.
Note: Most recent survey year available except Montenegro for which the 2019 round of data was used instead of the most recent available (2023) for consistency with other countries in the region. The advanced economies in Europe are based on the World Bank Global Economic Prospects June 2023 classification. AE = advanced economies in Europe; ECA = Europe and Central Asia.

TABLE 2A.2. **Characteristics of firms in Europe and Central Asia (percent of total)**

Region or country	Firm size (number of employees)			Sector			Firm age (years)			Main market		
	Small (5–19)	Medium (20–99)	Large (100+)	Manufacturing	Retail	Other services	Less than 10	10–20	More than 20	Local	National	International
Advanced economies in Europe	70	24	5	25	17	58	18	26	56	42	45	13
ECA	66	27	7	28	20	52	28	39	33	50	42	8
Central Asia	66	28	6	33	18	50	43	39	18	56	40	4
Kazakhstan	76	20	4	17	20	62	52	38	10	67	32	2
Kyrgyz Republic	56	35	9	37	22	41	22	43	36	34	57	9
Tajikistan	63	31	6	41	14	45	48	39	13	64	33	2
Uzbekistan	70	26	4	35	13	51	50	35	15	59	38	3
Central Europe	73	23	4	25	26	49	22	33	46	46	44	10
Bulgaria	68	28	4	27	22	51	26	45	29	46	37	17
Croatia	66	27	7	25	41	35	21	16	63	49	42	9
Poland	87	11	2	22	18	60	23	35	42	49	45	5
Romania	71	24	5	27	23	51	17	35	48	40	54	7
Eastern Europe	63	28	9	30	17	53	21	43	36	41	50	9
Belarus	62	28	10	28	18	54	31	38	31	42	48	9
Moldova	69	24	7	27	22	51	17	44	39	38	50	12
Ukraine	58	33	8	35	10	55	13	48	38	42	52	6
Russian Federation	74	22	5	16	12	72	42	48	10	69	31	0
South Caucasus	57	30	12	19	25	56	37	40	23	47	44	8
Armenia	60	26	13	21	28	51	34	36	30	42	48	10
Azerbaijan	55	31	15	16	25	59	23	52	25	42	50	8
Georgia	57	34	8	21	22	57	54	32	13	58	36	6
Türkiye	72	25	4	31	16	53	24	40	35	49	46	5
Western Balkans	66	28	6	31	19	50	22	38	40	51	38	11
Albania	68	26	6	26	17	58	40	37	23	53	36	11
Bosnia and Herzegovina	54	36	11	36	17	47	14	33	53	47	34	19
Kosovo	73	23	4	40	9	51	28	47	25	62	35	3
Montenegro	69	26	5	23	33	45	18	41	41	65	33	3
North Macedonia	70	25	5	30	28	42	14	37	48	45	39	16
Serbia	62	31	6	33	11	56	17	36	47	32	52	16

Source: Calculations based on data from the latest World Bank Enterprise Surveys (for most countries, 2019).
Note: Firm-level responses were aggregated to the country level using weights. ECA and subregional averages are simple country averages. ECA = Europe and Central Asia.

TABLE 2A.3. Top business environment obstacles reported by firms

Region or country	Biggest obstacle (% of firms)									
	Access to finance	Business licensing and permits	Corruption	Electricity	Inadequately educated workforce	Political instability	Practices of competitors in the informal sector	Tax administration	Tax rates	Transport
Advanced economies in Europe	7	3	1	3	27	6	9	4	19	5
ECA	11	3	6	4	13	12	14	5	18	5
Central Asia	8	2	8	7	10	10	17	6	19	5
Kazakhstan	7	2	7	7	16	8	16	1	18	5
Kyrgyz Republic	8	1	18	2	9	22	24	2	6	3
Tajikistan	5	1	2	8	6	10	14	19	29	2
Uzbekistan	10	3	5	12	8	0	15	3	23	9
Central Europe	5	3	3	2	22	5	11	6	26	5
Bulgaria	3	10	5	1	22	4	23	2	15	5
Croatia	2	2	3	0	16	5	3	10	48	3
Poland	4	2	3	4	11	7	6	10	36	4
Romania	8	4	8	2	22	9	4	6	20	5
Eastern Europe	14	3	10	2	12	17	10	1	16	3
Belarus	17	7	4	2	12	8	8	0	22	4
Moldova	10	1	8	3	20	18	13	1	14	0
Ukraine	14	1	17	2	4	25	9	3	13	4

(continued next page)

TABLE 2A.3. (continued)

Region or country	Biggest obstacle (% of firms)									
	Access to finance	Business licensing and permits	Corruption	Electricity	Inadequately educated workforce	Political instability	Practices of competitors in the informal sector	Tax administration	Tax rates	Transport
Russian Federation	15	6	6	1	8	6	10	8	23	11
South Caucasus	27	1	4	2	14	15	15	2	6	3
Armenia	30	1	4	1	11	12	13	4	10	2
Azerbaijan	24	1	8	3	15	3	28	2	2	1
Georgia	26	1	1	3	15	30	2	1	6	5
Türkiye	29	1	1	3	7	21	8	2	24	1
Western Balkans	7	3	7	6	10	14	19	4	14	7
Albania	3	5	8	8	9	8	11	4	21	8
Bosnia and Herzegovina	3	4	7	5	8	21	9	7	18	5
Kosovo	6	2	8	15	3	9	25	8	10	6
Montenegro	11	2	7	2	10	0	36	2	17	12
North Macedonia	10	3	4	3	13	29	14	2	7	7
Serbia	8	3	6	2	18	17	20	0	13	1

Source: Calculations based on data from the latest World Bank Enterprise Surveys available (most countries, 2019).
Note: ECA = Europe and Central Asia.

Annex 2B: World Bank Country Economic Memorandums

World Bank Country Economic Memorandums (CEMs) aim to provide a comprehensive analysis of a country's economic developments, prospects, and policy agenda. They also identify policy reforms for key economic sectors. CEMs serve as a basis for dialogue with governments on critical policy issues and provide background information and analysis to members of aid groups and other donors. CEMs are typically prepared every couple of years for a given country, and the CEMs published in 2019 or later are considered in the analysis.

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World Bank. 2023c. *Montenegro—Country Economic Memorandum: Towards a Sustainable Growth Strategy.* Washington, DC: World Bank Group.

TABLE 2B.1. Top business environment obstacles identified in the World Bank Country Economic Memorandums

Country	Access to finance	Access to land	Corruption	Rule of law	Trade regulation/ integration	Electricity	Inadequately educated workforce	Political/ policy instability	Tax administration	Tax rates	Transport	Competition, SOEs, and regulations
Central Asia												
Kazakhstan												
Kyrgyz Republic	Major obstacle	Obstacle										
Tajikistan												
Uzbekistan												
Central Europe												
Bulgaria												
Croatia												
Poland												
Romania												
Eastern Europe												
Moldova												
Ukraine												
South Caucasus												
Azerbaijan												
Georgia												
Türkiye												
Türkiye												
Western Balkans												
Albania												
Kosovo												
Montenegro												
Serbia												

Source: Coding based on the latest World Bank Country Economic Memorandum published in 2019–23.
Note: Only World Bank Country Economic Memorandums published in 2019 or later are included. Obstacles are coded based on obstacles identified and addressed in the policy recommendation section as they relate specifically to private sector development. The categories largely follow the top business environment obstacles identified by the World Bank Enterprise Surveys and reported in table 2A.3, but also capture trade integration (combined with trade regulations) and the competitive environment and unlevel playing field due to the presence of SOEs (combined with business licensing and permits). The categories "crime, theft, and disorder," "competition from the informal sector," and "labor regulations" are not reported because they were not identified as obstacles in any of the countries. SOEs = state-owned enterprises.

PART III

ECA Macro Poverty Outlooks

ALBANIA

Table 1	2023
Population, million	2.8
GDP, current US$ billion	22.7
GDP per capita, current US$	8219.5
International poverty rate ($2.15)[a]	3.9
Lower middle-income poverty rate ($3.65)[a]	11.3
Upper middle-income poverty rate ($6.85)[a]	34.2
Gini index[a]	36.0
School enrollment, primary (% gross)[b]	95.6
Life expectancy at birth, years[b]	76.5
Total GHG emissions (mtCO2e)	7.6

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2018), 2017 PPPs.
b/ WDI for School enrollment (2022); Life expectancy (2021).

Growth in 2023 is estimated at 3.3 percent, led by private consumption, tourism and construction. Price pressures continued to ease. Growth is projected at the same levels in 2024, led by services. Poverty is expected to continue declining as labor income increases. Medium-term prospects hinge on the recovery of the global economy and on the pace of domestic reforms. The EU accession aspirations provide an anchor to speed up convergence.

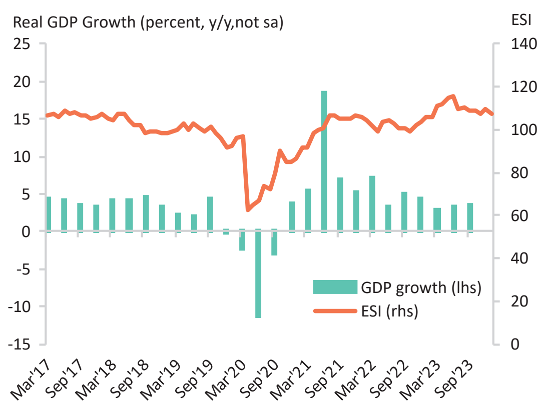
Key conditions and challenges

The Albanian economy has shown considerable resilience in the face of consecutive shocks during 2019-2022, which included the 2019 earthquake, the pandemic and the ensuing economic turmoil, and Russia's invasion of Ukraine. Prudent macroeconomic policies supported a strong economic rebound, with real GDP growth averaging 6.9 percent in 2021 and 2022, and GDP exceeding its pre-pandemic level in 2022. A key factor in Albania's resilience has been the proximity to the EU, which is a source of investment and remittances, and a main market for exports. Tourism has emerged as a key growth driver, helping to improve external imbalances and partially contributing to a steady appreciation of the lek in recent years. The availability of hydropower, which meets 85 percent of domestic energy demand in a year with average precipitation, has provided some insulation from the energy crisis and contributed to containing the country's greenhouse gas emissions. Albania's key development challenges are its declining population, partially due to outmigration; the poor quality of the labor force and the low quality of jobs created; the moderate pace of structural reforms, especially in the areas of private sector environment and governance; and rising fiscal pressures, due to government responses to multiple crises, climate risks, contingent liabilities, and debt refinancing at a time of high interest rates. To address the gap in human capital investment and the need for climate-resilient infrastructure, while maintaining support for the most vulnerable, Albania will need to implement a Medium-Term Revenue Strategy to strengthen domestic revenues. Unlocking further growth is conditional on the swift implementation of the government's program, anchored in the EU accession aspiration, and built on reforms tackling productivity, including improving the business environment, and expanding Albania's integration into foreign markets.

Recent developments

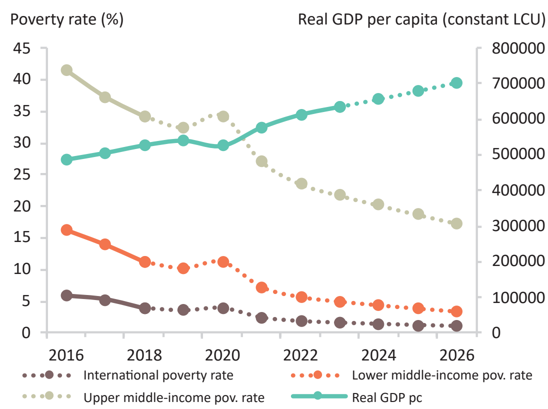
In 2023, GDP growth is estimated at 3.3 percent. Based on the performance of the first three quarters of 2023, trade, tourism and real estate led growth on the supply side, followed by construction and energy production. Private domestic demand and net exports drove growth on the demand side. Leading economic indicators suggest growth accelerated during Q4 with tourist arrivals hitting a record high, and construction activity accelerating. Increased income from employment, economic sentiment indicators and strong tax revenues, suggest a steady growth in Q4. Employment grew by 1.2 percent yoy in Q3 2023 notably in services, while declining in agriculture and manufacturing. Increasing wages and employment incentivized labor force participation (ages 15+), which peaked at 76.1 percent. Average private sector wages grew by 14.5 percent

FIGURE 1 Albania / Economic sentiment index (ESI) and GDP growth



Sources: Instat and Bank of Albania.

FIGURE 2 Albania / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

in Q3 2023. Unemployment went down to 10.5 percent in Q3 2023 marking a further decline in annual terms. Given strong GDP per capita growth in 2023, poverty is projected to have declined by 1.8 percentage points to 21.7 percent.

The annual inflation rate dropped to 3.9 percent in December 2023 from a record high of 8.3 percent in October 2022, as a result of downward pressures from lower food and energy import prices, domestic currency appreciation and monetary policy normalization. The banking system remains resilient, despite increasing interest rates.

The government recorded an improved fiscal position in 2023, on account of both stronger revenue collection and lower spending. Revenues from profits, personal income taxes and social security contributions increased, reflecting higher statutory minimum wages and private sector wage growth. A five-year Eurobond of EUR 600 million was issued with a 5.9 percent coupon, higher than the 3.5 percent in 2021, to prefinance spending in 2024 and buy back an existing Eurobond maturing in 2025.

Outlook

Growth is expected to remain robust at 3.3 percent in 2024, in the context of tight global financial conditions and limited economic growth in Europe. Nevertheless, increased tourism and construction are expected to drive exports, consumption, and investment growth at rates similar to the pre-pandemic period. The inflation rate is projected to start converging toward the 3 percent target by early 2025. Economic sentiment remains positive (Figure 1), though showing signs of moderation.

Albania's primary balance is projected to reach 0.2 percent of GDP in 2024 and stay at similar levels in observance of the fiscal rule. Fiscal consolidation is expected both revenue and spending side. On revenues, Government plans to continue improvement of tax administration, envisioned in the Medium-Term Revenue Strategy. Public debt is expected to decline further to 58.2 percent of GDP in 2024, and also in the medium term, as a result of higher nominal growth and the achievement of a positive primary balance. Given Albania's growing reliance on external financing, risks related to the exchange rate, interest rate, and refinancing remain elevated.

Further increases in food and energy prices are a key risk to growth, as they could affect real disposable income, slow poverty reduction and potentially constrain the fiscal space. As a small, open economy, Albania is highly exposed to external shocks, such as a recession in the EU or further tightening of financing conditions in international capital markets beyond the current year.

Risks to growth emanate from natural disasters, and unfavorable global conditions. Fiscal risks emanate from public-private partnerships and SOEs, in addition to the country's hydropower-based energy sector, mainly due to variation in hydrology.

TABLE 2 **Albania** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	8.9	4.9	3.3	3.3	3.4	3.5
Private consumption	4.3	7.4	2.5	2.6	2.7	2.8
Government consumption	7.8	-4.8	2.8	3.8	6.6	3.2
Gross fixed capital investment	19.2	6.5	1.3	3.2	1.4	2.6
Exports, goods and services	52.0	7.5	6.5	5.1	5.8	5.7
Imports, goods and services	31.5	13.1	3.4	3.6	3.9	3.7
Real GDP growth, at constant factor prices	8.2	5.3	3.2	3.3	3.4	3.5
Agriculture	1.8	0.1	-0.2	1.6	1.6	1.6
Industry	13.6	7.7	1.2	1.0	1.1	1.1
Services	8.1	5.9	5.4	4.9	5.0	5.1
Inflation (consumer price index)	2.6	6.7	4.8	3.0	3.0	3.0
Current account balance (% of GDP)	-7.8	-6.0	-3.8	-4.5	-4.5	-4.4
Net foreign direct investment inflow (% of GDP)	6.5	6.7	6.8	6.7	6.7	6.7
Fiscal balance (% of GDP)	-4.6	-3.7	-1.4	-2.3	-2.7	-2.9
Revenues (% of GDP)	27.5	26.8	27.9	27.8	27.8	27.9
Debt (% of GDP)	75.4	65.3	59.8	58.2	57.3	56.7
Primary balance (% of GDP)	-2.7	-1.8	0.7	0.2	0.2	0.2
International poverty rate ($2.15 in 2017 PPP)[a,b]	2.4	1.8	1.6	1.4	1.2	1.0
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	7.3	5.7	4.9	4.3	3.8	3.3
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	27.1	23.5	21.7	20.2	18.7	17.4
GHG emissions growth (mtCO2e)	1.1	-4.0	-3.4	-2.9	-2.7	-2.3
Energy related GHG emissions (% of total)	45.5	44.5	44.2	43.8	43.5	43.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2014- and 2019-SILC-C. Actual data: 2018. Nowcast: 2019-2023. Forecasts are from 2024 to 2026.
b/ Projection using point-to-point elasticity (2013-2018) with pass-through = 1 based on GDP per capita in constant LCU.

ARMENIA

Table 1	2023
Population, million	2.8
GDP, current US$ billion	24.2
GDP per capita, current US$	8715.8
International poverty rate ($2.15)[a]	0.8
Lower middle-income poverty rate ($3.65)[a]	10.0
Upper middle-income poverty rate ($6.85)[a]	51.3
Gini index[a]	27.9
School enrollment, primary (% gross)[b]	92.9
Life expectancy at birth, years[b]	72.0
Total GHG emissions (mtCO2e)	13.1

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2022), 2017 PPPs.
b/ Most recent WDI value (2021).

Growth exceeded expectations by reaching 8.7 percent in 2023, fueled by consumption and investment. Average inflation dropped from 8.6 percent in 2022 to 2 percent in 2023. Poverty and unemployment continued to decline. The economic outlook is subject to significant uncertainty due to ongoing border tensions with Azerbaijan, geopolitical turmoil, integration of refugees, and a possible slowdown in trading partner economies.

Key conditions and challenges

Armenia has weathered multiple crises since 2020. Thanks to sound macroeconomic management (inflation targeting, adherence to a fiscal rule, and sound financial sector oversight) and government mitigation measures, Armenia was able to recover from the significant contraction in 2020 resulting from the Covid-19 pandemic and the military conflict with Azerbaijan, while maintaining macroeconomic stability. Meanwhile, large money transfers from Russia contributed to high average annual growth of 10.7 percent in 2022-2023.

In recent years, the authorities aimed at reducing corruption and improving the business environment, in particular through improvement in tax and customs administration; however, important structural challenges persist, resulting in an undiversified economic structure, a narrow export base, insufficient private investment, low productivity, challenges to attracting FDI, and limited human capital. Armenia also faces significant geopolitical tensions and is highly vulnerable to climate related hazards.

Recent developments

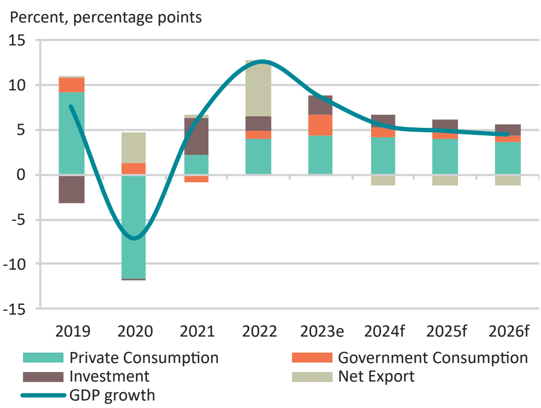
Growth reached 8.7 percent in 2023, exceeding expectations. On the demand side, private consumption grew by 6.3 percent (yoy), contributing to half of total growth. Public consumption and investment (up by 18 and 10 percent, respectively) had a similar combined contribution. Private consumption was fueled by a 12.5 percent increase in real average wages, improvements in employment, and cash transfers provided by the government to refugees in Q4 2023. On the supply side, growth was driven by an 11 percent (yoy) increase in services, primarily due to growth in trade and ICT services. Growth in industry slowed to 5.5 percent (yoy) due to a 6.6 percent contraction in the mining sector and a slowdown in manufacturing growth. Construction grew by 16 percent, (yoy), while agricultural growth remained flat.

The unemployment rate decreased from 13.7 percent in 2022 to an average of 12.5 percent in the first three quarters of 2023, benefitting from strong economic activity. The poverty rate, measured by Upper-Middle-Income poverty line (UMIC), decreased by 0.4 percentage points, to 51.3 percent in 2022.

Average inflation dropped from 8.6 percent in 2022 to 2 percent in 2023, largely driven by declines in food and transport prices. The Central Bank of Armenia has gradually cut the policy rate by 200 basis points since January 2023, to 8.75 percent by the end of January 2024.

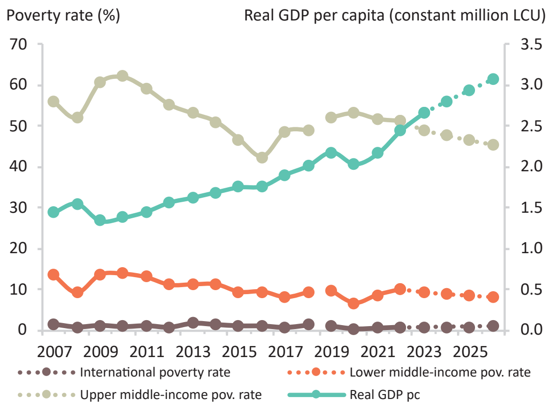
Credit to the economy in 2023 increased by 22 percent in nominal terms (yoy), driven mostly by an increase in dram-denominated loans. This lowered loan dollarization to 36 percent as of end-2023. Financial stability indicators remain sound, with the

FIGURE 1 Armenia / Real GDP growth and contributions to real GDP growth



Sources: Statistical Committee of Armenia and World Bank staff projections.

FIGURE 2 Armenia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

Capital Adequacy Ratio at 20 percent and the Non-Performing Loans ratio below 2.5 percent. However, the profitability of the banking system declined in 2023.

The budget registered a 4.1 percent of GDP deficit in 2023, all financed by domestic sources on a net basis. Total revenues overperformed by 3 percent compared to the original plan, supported by a 17 percent (yoy) nominal increase in tax collection, fueled by strong economic growth. Current expenditures (including social transfers to refugees) and capital expenditures increased by 22 and 27 percent (yoy) in nominal terms, respectively. The government debt increased from 46.7 percent at end-2022 to 48.1 percent end-2023.

In the first nine months of 2023, the export and import of goods remained robust, increasing by 34 and 43 percent (yoy in nominal USD), respectively, largely driven by re-exports. However, in this period the trade deficit increased to 8.8 percent of annual GDP, from 6.3 percent in the same period of 2022. Remittances dropped to 4.6 percent of annual GDP, from 7.7 percent in the same period of 2022 (affected by a 44 percent rise in the net outflow of non-commercial money transfers). Tourism-related service inflows increased by 47 percent (yoy) in the nine months of 2023 and partly mitigated the deterioration of the current account deficit, estimated at 2.8 percent of GDP in this period. The Armenian dram started to gradually depreciate in late 2023 and by end-2023 was 2.9 percent weaker against the USD (yoy). Gross international reserves decreased by USD 510 million in 2023 and reached USD 3.6 billion, covering 3 months of import.

Outlook

Growth is expected to ease to 5.5 percent in 2024 as the surge in investment moderates and net exports remain negative. Growth in the medium-term is projected to gradually converge towards the 4.5 percent potential growth rate. Average inflation is forecasted to gradually rise toward the inflation target of 4 percent in the medium term.

The budget deficit is projected to deteriorate to 4.7 percent in 2024 (owing to support to refugees amounting about 2 percent of GDP), followed by fiscal consolidation in the medium term. Capital expenditures are expected to increase over the medium term as a percent of GDP to address the infrastructure gap. The current account deficit is projected to deteriorate to 3.2 percent of GDP in 2024 but to remain manageable at around 3.5 percent in the medium term.

Due to robust economic performance and low inflation, the UMIC poverty rate is projected to decline gradually to 47.7 percent in 2024.

Downside risks are related to ongoing tensions with Azerbaijan, geopolitical turmoil, integration of refugees, and a possible slowdown in trading partner economies.

TABLE 2 **Armenia** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	5.8	12.6	8.7	5.5	4.9	4.5
Private consumption	2.8	5.5	6.3	6.0	5.8	5.1
Government consumption	-6.2	6.3	17.9	9.2	5.8	5.5
Gross fixed capital investment	23.6	9.0	14.4	6.2	6.0	5.9
Exports, goods and services	18.6	59.3	28.7	5.2	5.6	6.6
Imports, goods and services	12.9	34.5	28.3	6.7	7.0	7.8
Real GDP growth, at constant factor prices	5.6	13.2	8.4	5.5	4.9	4.5
Agriculture	-0.8	-0.7	0.2	0.9	1.2	1.4
Industry	2.6	9.2	5.5	5.3	4.7	5.0
Services	8.7	18.2	11.1	6.3	5.5	4.7
Inflation (consumer price index)	7.2	8.6	2.0	3.0	3.5	4.0
Current account balance (% of GDP)	-3.5	0.8	-2.3	-3.2	-3.4	-3.5
Net foreign direct investment inflow (% of GDP)	2.5	4.9	2.0	2.0	2.1	2.2
Fiscal balance (% of GDP)	-4.5	-2.2	-4.1	-4.7	-3.5	-3.1
Revenues (% of GDP)	24.9	25.1	25.8	26.0	26.2	26.6
Debt (% of GDP)[a]	60.2	46.7	48.1	49.0	48.6	48.2
Primary balance (% of GDP)	-2.0	0.1	-1.2	-1.4	-0.3	-0.2
International poverty rate ($2.15 in 2017 PPP)[b,c]	0.5	0.8	0.8	0.9	0.9	0.9
Lower middle-income poverty rate ($3.65 in 2017 PPP)[b,c]	8.7	10.0	9.3	8.9	8.6	8.3
Upper middle-income poverty rate ($6.85 in 2017 PPP)[b,c]	51.7	51.3	49.1	47.7	46.6	45.6
GHG emissions growth (mtCO2e)	2.4	6.4	14.7	14.5	12.8	11.2
Energy related GHG emissions (% of total)	63.2	65.7	70.0	73.5	76.1	78.1

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Excludes CBA debt.
b/ Calculations based on ECAPOV harmonization, using 2010-ILCS, 2018-ILCS, and 2022-ILCS. Actual data: 2022. Nowcast: 2023. Forecasts are from 2024 to 2026.
c/ Projection using annualized elasticity (2010-2018) with pass-through = 0.8 based on GDP per capita in constant LCU.

AZERBAIJAN

Table 1	2023
Population, million	10.2
GDP, current US$ billion	72.7
GDP per capita, current US$	7111.1
School enrollment, primary (% gross)[a]	99.8
Life expectancy at birth, years[a]	69.4
Total GHG emissions (mtCO2e)	53.8

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent WDI value (2021).

Economic growth slowed to 1.1 percent in 2023, as a result of declining crude oil production and lackluster growth in the non-energy sector. Annual inflation fell sharply to 2.1 percent as both external and domestic pressures eased. Buoyant energy prices sustained sizable external and fiscal surpluses. In the medium-term, growth is projected to converge to about 2.5 percent as the fall in crude oil production eases and non-energy sector growth picks up.

Key conditions and challenges

Azerbaijan's continued reliance on hydrocarbons as a major source of export and fiscal revenues remains its main vulnerability. This challenges long-term growth prospects because of declining oil production, oil price volatility, and the global transition away from fossil fuels.

Constraints to private sector development include a large state footprint in the economy, lack of a level playing field for companies, shallow financial markets, and a weak human capital base.

Mitigation efforts around the world can substantially reduce Azerbaijan's resource rents through declining global fossil fuel demand and prices. Carbon border adjustment measures could further adversely impact the economy. Azerbaijan's hosting of COP29 in November 2024 may be an opportunity to boost climate mitigation and adaptation efforts. Elimination of distorting fossil fuel subsidies could substantially reduce emissions and boost the green transition.

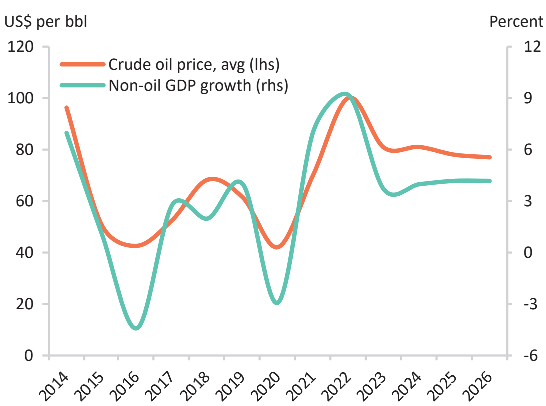
Recent developments

Economic growth decelerated to 1.1 percent in 2023, down from 4.6 percent in 2022. This slowdown was attributed to a contraction in crude oil production, while growth in the non-energy sector remained subdued (3.7 percent, yoy). The decline in transport sector output, which had exhibited robust growth in 2022 due to booming air cargo transportation, weighed down non-energy sector expansion. However, the construction sector experienced notable growth, fueled by increased public investment in reconstruction. On the demand side, strong public investment helped compensate for anemic growth in private investment, while consumption growth eased compared to 2022. The unemployment rate edged down to 5.5 percent in 2023.

Inflation fell sharply in the second half of 2023, driven by a decline in global food prices and subdued domestic demand. End of period inflation for 2023 reached 2.1 percent, approaching the lower limit of the CBAR's inflation target interval of 4 +/-2 percent. Since October 2023, the CBAR cut the policy rate three times by a total of 125 basis points, bringing it to 7.75 percent as of end January 2024.

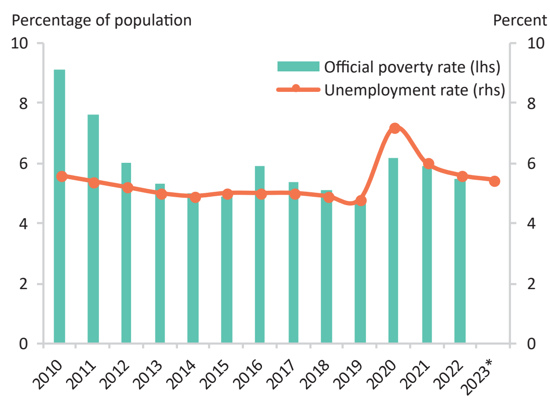
Buoyant oil and gas prices contributed to maintaining a robust external position. Hydrocarbon exports declined by 13 percent while non-hydrocarbon exports grew by 10 percent in 2023 compared to 2022. Over nine months, the current account balance (CAB) surplus reached 12.5 percent of GDP, as a substantial trade surplus offset the widening deficit in the primary income balance (driven by profit repatriation from energy companies). Remittance flows, primarily from Russia, declined in nine months of 2023 by 64 percent from the record-high levels seen in 2022, while remaining larger than in 2021. Financial outflows decreased significantly

FIGURE 1 Azerbaijan / Non-oil GDP growth and oil price



Sources: State Statistical Committee, World Bank data, and World Bank staff estimates.

FIGURE 2 Azerbaijan / Official poverty rate and unemployment rate



Source: State Statistical Committee.
Notes: The World Bank has not yet reviewed the official national poverty rates for 2013–2022.*Preliminary.

as capital repatriation from natural gas production companies eased.

The strong external position allowed the CBAR to accumulate reserves, which increased by 29 percent in 2023, to USD 11 billion, covering six months of imports.

The fiscal surplus expanded to 8 percent of GDP in 2023, buoyed by favorable oil and gas prices and despite a notable increase in spending, which grew by 5.5 percent in real terms. This spending surge was primarily driven by a 13 percent real increase in capital spending, with the majority directed towards reconstruction needs. The non-energy primary balance is estimated at 21 percent of non-energy GDP, in line with the targets set for the fiscal rule. Due to the substantial fiscal surplus, SOFAZ assets grew by 14 percent in 2023, reaching USD 56 billion, equivalent to 77 percent of GDP.

Credit to the economy experienced a marked increase of 9 percent (yoy) in real terms in 2023, with the NPL ratio easing to 1.8 percent. The deposit portfolio fell by 6.5 percent in real terms.

Outlook

Economic growth is anticipated to reach 2.3 percent in 2024, driven by a less pronounced decline in crude oil output attributed to the commissioning of new oil platforms. Non-energy sector growth is expected to improve to 4 percent in 2024, primarily due to robust expansion in the construction sector fueled by public sector investments in reconstruction. Other sectors are expected to sustain their growth rates. On the demand side, consumption growth is expected to stabilize while investment growth is projected to remain moderate, supported by public investment but held back by anemic private investment growth. In the medium term, growth is forecast to hover around 2.4 percent but could accelerate if backed by a faster pace of implementation of structural reforms.

Inflation is projected to remain low, averaging 2.2 percent in the medium term, owing to moderate domestic demand growth and stabilization in global food prices. The external balance is expected to stay in surplus in the medium term, with CAB averaging 7.5 percent of GDP, supported by favorable energy prices, while growth in imports is expected to stabilize. Money transfers are anticipated to cool further in 2024.

The fiscal position is expected to maintain a surplus in 2024-2026, averaging 3.2 percent of GDP, bolstered by a steady revenue flow from the energy sector. However, the fiscal surplus is estimated to ease in the medium term as the government has delayed reaching the fiscal target (set at non-energy primary balance as a percent of non-energy GDP at 17.5 percent) to 2027, allowing for increased spending.

The main downside risks relate to a fall in energy prices, which would impact economic activity. Upside risks include the potential increase in natural gas production due to a new field becoming operational.

TABLE 2 Azerbaijan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	5.6	4.6	1.1	2.3	2.4	2.4
Private consumption	7.0	4.9	4.0	3.8	3.7	3.6
Government consumption	3.8	6.3	8.1	5.1	6.9	6.8
Gross fixed capital investment	-6.0	5.7	9.6	5.4	3.9	3.5
Exports, goods and services	5.6	3.3	-2.9	0.4	0.5	0.6
Imports, goods and services	2.5	3.2	1.9	2.7	2.7	2.7
Real GDP growth, at constant factor prices	5.6	4.6	1.1	2.3	2.4	2.4
Agriculture	3.3	3.4	3.2	3.0	3.0	3.0
Industry	4.1	2.4	-0.9	0.2	0.2	0.2
Services	8.6	8.5	3.8	5.3	5.3	5.2
Inflation (consumer price index)	6.7	13.8	2.1	2.2	2.3	2.3
Current account balance (% of GDP)	15.2	29.7	9.5	7.9	6.5	5.4
Net foreign direct investment inflow (% of GDP)	-4.1	-1.4	-1.1	-1.0	-1.0	-0.9
Fiscal balance (% of GDP)	4.2	5.8	8.1	5.2	2.0	0.6
Revenues (% of GDP)	36.5	31.6	40.7	38.1	34.5	32.0
Debt (% of GDP)	16.2	11.0	8.5	7.7	10.5	12.4
Primary balance (% of GDP)	4.8	6.1	8.4	5.4	2.2	0.8
GHG emissions growth (mtCO2e)	4.4	-3.0	-0.6	0.5	1.1	1.3
Energy related GHG emissions (% of total)	64.1	62.9	62.7	63.0	63.3	63.5

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.

BELARUS

Table 1	2023
Population, million	9.2
GDP, current US$ billion	74.8
GDP per capita, current US$	8156.6
International poverty rate ($2.15)[a]	0.0
Lower middle-income poverty rate ($3.65)[a]	0.1
Upper middle-income poverty rate ($6.85)[a]	1.3
Gini index[a]	24.4
School enrollment, primary (% gross)[b]	94.7
Life expectancy at birth, years[b]	72.4
Total GHG emissions (mtCO2e)	88.9

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ WDI for School enrollment (2022); Life expectancy (2021).

On the back of a strong recovery in 2023, the economy has now reached its capacity limits and is navigating the challenges stemming from economic sanctions targeting key currency-earning sectors, impeding exports and altering trade routes. The growth trajectory faces further hurdles due to constraints and efficacy concerns surrounding price controls, monetary policies, and external demand from Eastern markets. With monetary and fiscal policies nearing their limits, there is a growing risk stemming from the country's decreasing potential growth.

Key conditions and challenges

Strong economic growth in 2023 exceeded expectations, but it stretched the country's production capacities and the limits of economic policies. Extensive administrative measures, combined with expansionary monetary and fiscal policies, were crucial to bolster domestic demand. However, potential GDP declined following the prolonged effects of sanctions and subpar investment activity.

To adapt to sanctions, the economy established new trade routes and redirected exports, particularly of potash fertilizers and refined oil products, through Russia, albeit at higher logistical costs. In the medium term, the authorities' focus is on addressing supply issues and enhancing local production by substituting imports. However, heightened reliance on the Russian market, amidst escalating competition facing Belarusian products, poses a notable risk and exposes Belarus to vulnerability stemming from weakened external demand, particularly in the event of a deteriorating economic outlook in Russia. Addressing labor market rigidities will become increasingly imperative, alongside necessary investments aimed at stimulating potential growth.

Heightened security concerns and geopolitical tensions add further strain to the economic outlook, especially with the potential introduction of additional sanctions, such as the closure of the western border for passenger and cargo transportation. Prolonged adherence to accommodative policies presents challenges, necessitating a delicate balance between preserving social benefits, wages, economic support, and overall stability. This, coupled with a deteriorating current account, exchange rate and price controls, and labor force constraints, heightens the risk of significant inflationary pressures.

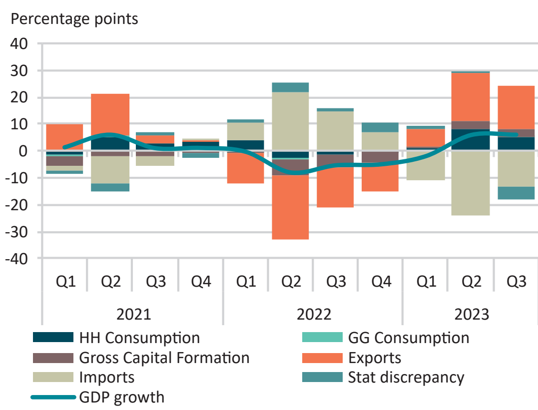
Finally, Belarus's economy grapples with its Soviet-era structure and a focus on quantitative growth, with diminishing prospects for economic diversification.

Recent developments

In 2023, Belarus's economy expanded by 3.9 percent. Key drivers were the manufacturing industry, particularly machinery and equipment, (9.2 percent), trade (12.7 percent) and the construction sector (11 percent). Conversely, the IT and transport sectors decreased by 14.2 percent and 2.8 percent, due to sanctions and labor migration, while the agricultural sector marginally declined. On the demand side, private consumption, boosted by subdued inflation and increased demand from consumer lending and wages (11 percent real increase), was the main contributor. A modest investment recovery, primarily from budgetary and quasi-budgetary sources, also contributed to growth.

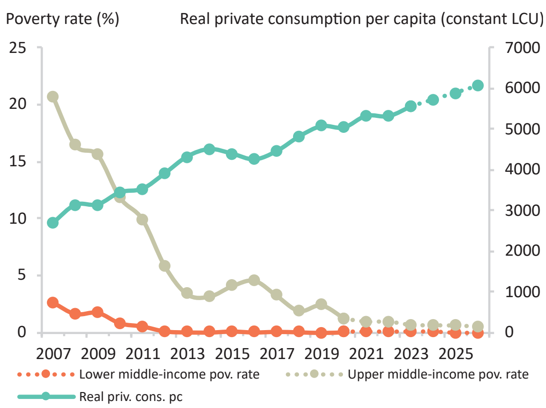
Inflation slowed to 5.8 percent due to base effects and price controls, prompting a base interest rate reduction from 12 percent in January to 9.5 percent in June 2023.

FIGURE 1 Belarus / Quarterly real GDP growth and contributions to real quarterly GDP growth



Source: World Bank calculations based on Belstat data.

FIGURE 2 Belarus / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see Table 2.

The exchange rate fluctuations are largely in tandem with the fluctuating value of the Russian ruble against major currencies. Belarusian ruble depreciated against major hard currencies while conversely modestly appreciating against the Russian ruble, as Russia being Belarus' largest export destination country.

The financial sector exhibited resilience, marked by a notable 30 percent surge in banking sector profits, predominantly driven by state-owned banks. The primary source of this growth stemmed from investments in state bonds. Concurrently, the proportion of non-performing assets remained stable.

Growing domestic demand and sanctions weakened the external position, leading to a current account deficit of 2 percent of GDP in Q1-Q3 2023. The trade surplus declined by 90 percent, driven by imports (17.7 percent), surpassing export growth (4.8 percent). Furthermore, a double-digit decline in remittances exacerbated the current account, leading to a shift from a USD2.2 billion surplus the previous year to a USD1 billion deficit, primarily funded by foreign direct investments. Despite this, there was no significant impact on external debt (-8 percent) or on foreign reserves (USD8.2 billion as of March 2024).

In 2023, households' real disposable income rose by 6.3 percent, from a 3.6 percent decline in 2022. Although employment fell by 1.5 percent, this was balanced by increases in real wages and pensions. Poverty, measured by the national poverty line, decreased from 3.9 percent in 2022 to 3.6 percent in 2023.

Outlook

With production capacities maxed out and inventories rising due to slower export growth, economic prospects look grim. Mounting inflationary pressures and trade flow concentration pose significant risks. In 2024, growth is expected to hinge on expansionary policies, support for state-owned enterprises, targeted lending, domestic borrowing, and sustained growth in disposable income. GDP growth is forecasted at 1.2 percent as the economy fully recovers from recession. Consumption will remain the primary driver of demand, albeit at a reduced intensity, with more modest public wage increases and social spending indexation compared to 2023. Similarly, investments, still below pre-2022 levels, are anticipated to contribute positively. Despite strong domestic demand and restricted foreign trade, imports are expected to surpass export growth, resulting in a negative net export contribution.

In the medium term, as economic stimuli effectiveness wanes, growth is expected to lag potential. While macroeconomic stability is upheld administratively, inflation and exchange rate volatility pose challenges. Inflationary pressures and market distortions resulting from price controls is likely to dampen consumer confidence. Investments, except in sectors aligned with Russian exports such as oil, fertilizers, and defense, are projected to slow down as the economy remains isolated. Consequently, the economy may face a trajectory of close to zero growth. Inflation is forecast to rise to 7.4 percent in 2024 and remain above historical averages in the medium term if administrative measures persist.

Lower external demand and commodity prices are expected to weigh on the current account balance, leading to currency pressures. The fiscal outlook is anticipated to deteriorate, with fiscal deficits expected as the government pursues economic stimulus and job preservation measures. Despite higher inflationary pressures, poverty levels are forecast to remain relatively unchanged in 2024 and 2025.

TABLE 2 Belarus / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	2.4	-4.7	3.9	1.2	0.7	0.5
Private consumption	4.9	-1.2	4.1	2.5	2.0	1.9
Government consumption	-0.8	-0.1	1.4	0.2	0.0	0.0
Gross fixed capital investment	-5.5	-13.3	12.1	1.8	1.4	1.3
Exports, goods and services	10.1	-12.3	23.1	3.2	2.6	2.5
Imports, goods and services	5.7	-11.4	29.1	4.7	4.1	4.0
Real GDP growth, at constant factor prices	2.4	-4.7	3.7	1.4	0.7	0.5
Agriculture	-4.1	4.4	-0.4	2.0	2.3	2.3
Industry	3.1	-6.2	8.0	1.9	1.2	1.2
Services	3.0	-5.1	1.1	0.8	0.0	-0.4
Inflation (consumer price index)	9.5	15.2	5.1	7.4	6.1	5.8
Current account balance (% of GDP)	3.1	-0.6	-3.4	-4.8	-5.2	-6.0
Net foreign direct investment inflow (% of GDP)	1.9	1.8	2.7	1.9	1.9	1.8
Fiscal balance (% of GDP)	0.0	-2.1	1.7	0.4	-0.6	1.1
Revenues (% of GDP)	37.5	33.9	35.8	36.7	36.2	36.0
Debt (% of GDP)	35.8	38.7	37.7	37.1	38.2	33.6
Primary balance (% of GDP)	1.7	-0.5	2.8	1.3	0.3	1.9
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	0.1	0.1	0.1	0.1	0.0	0.0
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	1.0	1.0	0.7	0.7	0.6	0.5
GHG emissions growth (mtCO2e)	7.0	-4.3	0.6	-0.3	-0.2	-0.3
Energy related GHG emissions (% of total)	63.9	62.9	63.0	62.7	62.5	62.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2020-HHS. Actual data: 2020. Nowcast: 2021-2023. Forecasts are from 2024 to 2026.
b/ Projection using neutral distribution (2020) with pass-through = 0.87 (Med (0.87)) based on private consumption per capita in constant LCU.

BOSNIA AND HERZEGOVINA

Table 1	2023
Population, million	3.2
GDP, current US$ billion	24.2
GDP per capita, current US$	7563.4
School enrollment, primary (% gross)[a]	87.8
Life expectancy at birth, years[a]	75.3
Total GHG emissions (mtCO2e)	24.5

Source: WDI, Macro Poverty Outlook, and official data.
a/ WDI for School enrollment (2022); Life expectancy (2021).

Driven by the drop in exports, real output growth halved to 1.9 percent in 2023 compared to the previous year. Slower private consumption helped rein in inflation, which stood at 6.1 percent in 2023 as food prices remained high. Upcoming municipal elections may double the fiscal deficit in 2024, yet public debt remains moderate. EU leaders have announced the commencement of accession negotiations upon the fulfillment of membership criteria.

Key conditions and challenges

To initiate EU accession negotiations, BiH needs to address four key reforms within the identified 14 priorities. Specifically, legislation concerning the prevention of money laundering, conflict of interest, and the law on courts requires immediate attention. In parallel, meeting the economic criteria for EU accession necessitates addressing internal market fragmentation. This involves strengthening country-wide regulatory and supervisory institutions, enhancing transparency and efficiency of the oversized public sector, and reducing the footprint of state-owned enterprises.

BiH has shown macroeconomic stability and resilience over the past decades, including during the COVID-19 pandemic. This resilience is attributed to three economic anchors: the currency board (which ties the BiH mark to the euro), the state-wide collection of indirect taxes through ITA, and the prospects of EU membership which guide the reform agenda.

Despite these achievements, real income growth has averaged around 2 percent from 2009 to 2023, resulting in stagnant living standards, with real per capita consumption around 40 percent of the EU27 average. Faster convergence with the EU27 had proved challenging due to low investment rates, and a growth model heavily reliant on private consumption.

The necessity for structural reforms has become even more apparent considering the challenges posed by a declining population and deceleration in total factor productivity in the longer run. Adding to these challenges is the gradual introduction of the EU CBAM (2026) which is expected to adversely impact BiH's export competitiveness from 2030 onwards.

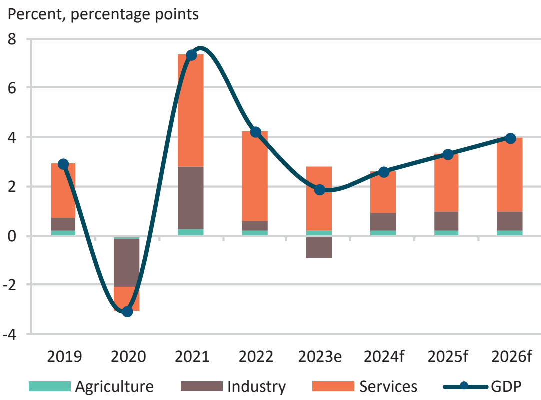
To ensure sustained longer-term trend growth between 3 and 4 percent, the implementation of economic and energy structural reforms is paramount. However, the pace of reform implementation remains sluggish due to political frictions, the disruptive influence of frequent elections, and fragmented responsibilities between entities and cantons. Addressing these impediments is essential for BiH to chart a trajectory towards a more prosperous and resilient economic future.

Recent developments

In 2023, real GDP growth slowed in line with the timid growth in the EU. Real output growth halved to 1.9 percent compared to 2022, driven by a 6 percent decline in exports and nearly stagnant investments, which rose a mere 1.6 percent after growing 18 percent in 2022. The lower exports and stagnant investment were offset in part by stronger government consumption.

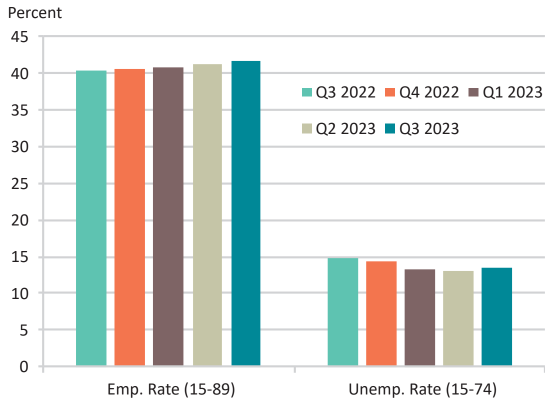
Inflation slowed to 6.1 percent in 2023, from 14 percent the year before. This deceleration resulted from a drop in transport prices and a deceleration in prices of housing, water, electricity, and gas, offsetting high food prices which

FIGURE 1 Bosnia and Herzegovina / Real GDP growth and contributions to real GDP growth



Sources: BiH Agency for Statistics (BHAS) and World Bank staff calculations.

FIGURE 2 Bosnia and Herzegovina / Labor market indicators



Sources: LFS 2022 – 2023 report and World Bank staff calculations.

grew at 10.7 percent in 2023 compared to 22.3 percent in 2022.

Despite the considerable growth slowdown, labor market indicators showed an improvement. The overall employment rate increased to 41.8 percent in Q3 2023 compared to 40.3 percent in Q3 2022, while the unemployment rate shrunk to 13.6 percent, a 1.2 percentage points decline from Q3 2022. This reduction in unemployment, observed for individuals with both low and high levels of education, occurred alongside a higher economic activity rate, which rose 1.5 percentage points to 48.3 percent.

Higher government spending contributed to a fiscal deficit of 0.9 percent of GDP in 2023, almost twice as large as the year before. The deficit was driven by an estimated 16 percent increase in subsidies, social benefits and transfers in the FBiH, and an 11 percent increase in the same spending items in RS. Nevertheless, public debt in BiH remains relatively low at around 35 percent of GDP.

Meanwhile, the current account deficit widened to 4.7 percent in 2023, or 3.9 percent of GDP after adjusting for net capital account inflows. The external deficit was 80 percent financed by FDI inflows, mainly into the foreign-owned banking sector.

Outlook

Against the backdrop of an expected improvement in the EU economic landscape, real GDP growth in BiH is set to increase to 2.6 percent in 2024, and 3.3 percent in 2025. This growth is underpinned by higher exports facilitated by strengthened foreign demand and an uptick in private consumption supported by stronger real incomes as inflation further decelerates to low single digits. By 2026, real output growth is projected to accelerate to 4 percent fueled by exports and private consumption stemming from improved economic conditions in the EU, and tightening labor markets in BiH. Despite the upswing in exports of goods and services from 2024 to 2026, the CAB is expected to deteriorate to over 5 percent of GDP due to higher imports of consumer goods in line with robust growth in private consumption.

The attention of policy makers is currently on the municipal elections in 2024 and meeting the legislative requirements for initiating EU accession negotiations. Hence, there appears little space for economic structural reforms in 2024.

The upcoming elections will likely further widen the fiscal deficit to 1.7 percent of GDP in 2024. Nonetheless, the fiscal stance should be firmly on track toward an overall balanced outcome, and primary surpluses, by 2025-26 leaving the consolidated general government debt hovering around 36 percent of GDP.

The outlook is clouded by downside risks. These risks entail a possible escalation of market disruptions and uncertainty stemming from the war in Ukraine as well as the volatility in the Middle East and Red Sea, an important trade route. These factors could reignite inflationary pressures and adversely impact the fragile recovery in the EU, affecting the demand for BiH exports. Finally, geopolitical conditions pose a risk of exacerbating domestic political frictions, undermining the much needed push for economic structural reforms.

TABLE 2 Bosnia and Herzegovina / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	7.3	3.8	1.9	2.6	3.3	4.0
Private consumption	4.0	3.0	2.0	2.3	2.8	3.2
Government consumption	6.1	2.7	4.1	4.6	1.5	3.7
Gross fixed capital investment	33.9	18.1	1.6	7.6	5.8	1.7
Exports, goods and services	5.0	9.9	-6.0	4.0	5.0	6.0
Imports, goods and services	8.0	12.0	-3.0	6.0	4.0	3.0
Real GDP growth, at constant factor prices	7.4	4.2	1.9	2.6	3.3	4.0
Agriculture	3.4	3.5	3.1	3.0	3.2	3.2
Industry	10.0	1.4	-3.4	2.8	3.2	3.2
Services	6.8	5.5	3.8	2.5	3.3	4.4
Inflation (consumer price index)	2.0	14.0	6.1	2.7	1.0	0.5
Current account balance (% of GDP)	-2.4	-4.5	-4.7	-4.8	-5.4	-5.2
Net foreign direct investment inflow (% of GDP)	3.3	3.0	3.2	3.4	3.9	3.9
Fiscal balance (% of GDP)	-0.3	0.4	-0.9	-1.7	-0.2	-0.4
Revenues (% of GDP)	43.2	39.9	39.4	39.3	39.7	38.6
Debt (% of GDP)	37.8	35.8	36.2	36.2	35.9	35.3
Primary balance (% of GDP)	1.0	1.2	-0.1	-0.9	0.5	0.4
GHG emissions growth (mtCO2e)	4.3	-2.3	-1.7	0.4	1.9	2.6
Energy related GHG emissions (% of total)	87.0	86.7	86.4	86.2	86.0	85.9

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.

BULGARIA

Table 1	2023
Population, million	6.4
GDP, current US$ billion	102.2
GDP per capita, current US$	15997.1
International poverty rate ($2.15)[a]	0.7
Lower middle-income poverty rate ($3.65)[a]	2.0
Upper middle-income poverty rate ($6.85)[a]	5.8
Gini index[a]	39.0
School enrollment, primary (% gross)[b]	87.3
Life expectancy at birth, years[b]	71.5
Total GHG emissions (mtCO2e)	50.5

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2021), 2017 PPPs.
b/ Most recent WDI value (2021).

Bulgaria's economy slowed down in 2023 in tune with trends in key trading partners. Inflation kept decelerating, but the pace is slow and puts at risk the country's eurozone accession bid for 2025. Real wage increases outpaced productivity growth in 2023, fueling concerns about competitiveness. A reescalation of political uncertainty threatens the government's reform agenda.

Key conditions and challenges

Even if Bulgaria has gradually converged to average EU incomes since the turn of the century, its development path has remained uneven. By 2022, its GDP per capita reached 62.1 percent of the EU average GDP per capita in purchasing power parity but Bulgaria remained the poorest member state. Moreover, institutional and governance weaknesses continue to hinder the country's faster productivity growth and development.

Bulgaria succeeded to weather the recent crises relatively well, not least due to timely fiscal support for households and businesses. Economic growth declined only moderately in 2020, followed by a robust recovery in 2021-2022. The fiscal position remained strong despite increased discretionary spending in response to the shocks. The bottom-line deficit did not surpass the 3 percent limit in any of the crisis years and public debt – at projected 23.8 percent of GDP in 2023 – remains among the lowest in the EU.

In 2015-2020, Bulgaria's economic growth improved living standards for the average and poorest 40 percent of households. These improvements led to a notable 9.6 percentage points reduction in poverty (using the US$6.85 poverty line) over the period. However, in 2021, this positive trend was reversed due to inflationary pressures and reduced employment rates among the unskilled.

In comparative terms, poverty levels remain relatively high by EU standards. Similarly, Bulgaria's inequality has been the highest in the EU for years in a row, with the Gini coefficient at 40.8 in 2021.

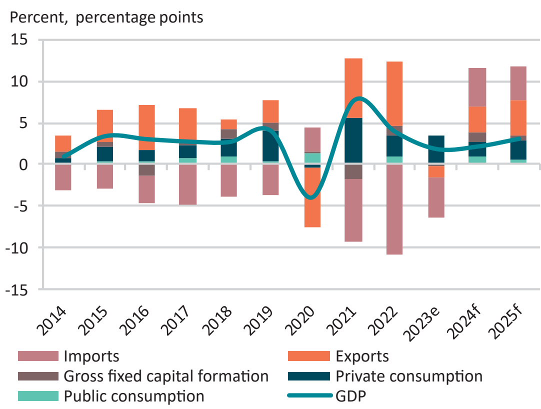
Since early 2021, the country has been marred by political instability and lost momentum for the reform agenda. This was briefly interrupted by two short-lived regular governments that tried to step up efforts and deliver on major policy goals, including milestones under the National Recovery and Resilience Plan. Yet, renewed political turmoil threatens to send the country back into an early elections spiral, with reduced appetite for reform.

Recent developments

Despite the stagnation of some of its key export markets, Bulgaria's economy managed to stay afloat thanks to robust private consumption. Nevertheless, the economy's expansion slowed down to 1.8 percent in 2023, as strong household consumption (+5.4 percent) and reduced contribution from negative net exports were offset by stagnating government consumption and a slump of gross capital formation. The latter fell by 18.1 percent due to a drawdown on inventories built up in 2021-2022, and likely cautiousness by businesses to reinvest in inventories during a slowdown.

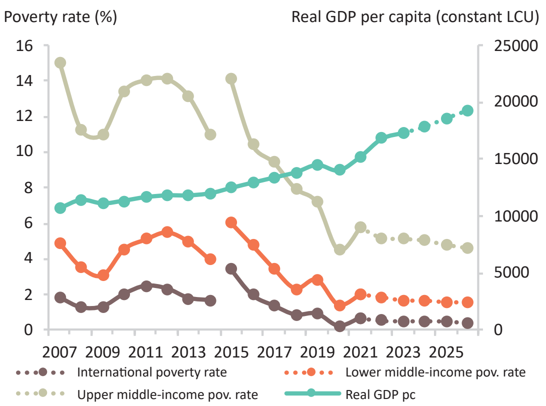
The deceleration of economic activity resulted in a moderate decline of employment in the second half of the year. Yet, nominal wages kept rising at double-digit rates y/y throughout 2023. Real average

FIGURE 1 Bulgaria / Real GDP growth and contributions to real GDP growth



Sources: World Bank and Bulgarian National Statistical Institute.

FIGURE 2 Bulgaria / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

wage growth thus came close to 5 percent for 2023, exceeding labor productivity growth and fueling concerns about the country's competitiveness.

Consumer price growth kept decelerating throughout 2023 to reach 3.8 percent y/y by January 2024. Yet, disinflation has been slow and annual average inflation reached a 15-year high of 9.5 percent in 2023.

Following the rapid deterioration of the fiscal position in early 2023, the balance improved later in the year as measures for strengthening revenue collection bore fruit. WB estimates suggest that on accrual basis the fiscal deficit reached 2.4 percent of GDP in 2023, or below the 3 percent Maastricht ceiling. The EC's Convergence Report on Bulgaria's readiness for eurozone accession is expected in June 2024. For the moment, inflation remains the only challenging Maastricht criterion for accession, but the gap between actual inflation rates and the line benchmark is shrinking rapidly.

Poverty reduction (using the 6.85$ poverty line) is expected to have slowed down in 2023 and reached 5.12 percent, mostly due to decelerated economic growth and still-high food and energy prices that affected adversely those whose nominal wages have not kept apace with inflation. The energy cost burden varies across households due to different consumption patterns and energy needs, with single-elderly households particularly affected.

Outlook

The economy's growth is expected to pick up in 2024-2025 with the expected recovery in the eurozone. Bulgaria's target to join the eurozone in 2025 may be difficult but not impossible to reach, should there be a stable government and the disinflation trend continues in the coming months, as expected.

Even if the banking sector remains stable and highly profitable (with net profit up 64 percent in 2023), the ongoing credit expansion – mirrored by a construction boom – fuels concerns about the build-up of a construction-credit bubble. The latter may lead to a painful correction and increase of non-performing loans – at 3.63 percent at end-2023 - going forward. Credit growth remained almost unabated at 12.4 percent y/y at end-2023 (against 12.7 percent at end-2022), with credit to households even accelerating to 15.9 percent, against 14.6 percent at end-2022. Similarly, construction permits for residential buildings kept growing at double-digit rates in Q4/2023.

Political risks have re-escalated after a failed PM rotation between the two ruling coalition partners that toppled the most recent regular government in March 2024. The country is now heading towards a new round of early elections – the 6th in about three years – which threaten to slow reform momentum and jeopardize the achievement of key policy goals such as near-term eurozone membership.

The government's budget sets a (cash-basis) 3 percent fiscal deficit target for 2024 on the back of an ambitious capital spending program. Thus, consolidation seems to have been put off beyond 2024. The current account is projected to keep its slight surplus in 2024-2026 due to the expected downward adjustment of import prices of key raw materials and the increase of net services export.

TABLE 2 Bulgaria / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	7.7	3.9	1.8	2.1	3.1	2.7
Private consumption	8.5	3.9	5.4	2.6	3.4	3.6
Government consumption	0.4	5.5	-0.4	5.9	3.4	3.0
Gross fixed capital investment	-8.3	6.5	3.3	4.0	1.3	2.6
Exports, goods and services	11.2	11.6	-1.9	4.8	5.8	6.0
Imports, goods and services	10.7	15.0	-6.3	6.3	5.5	6.6
Real GDP growth, at constant factor prices	8.0	5.3	1.8	2.1	3.1	2.7
Agriculture	28.8	-4.4	-3.9	4.3	1.2	1.0
Industry	1.7	12.1	0.9	4.7	5.2	5.3
Services	8.8	3.9	2.6	1.1	2.5	1.9
Inflation (consumer price index)	3.3	15.3	9.5	5.9	4.2	2.0
Current account balance (% of GDP)	-1.7	-1.4	1.6	1.6	2.0	2.2
Net foreign direct investment inflow (% of GDP)	1.8	2.4	3.1	2.5	2.7	2.6
Fiscal balance (% of GDP)	-2.7	-0.8	-3.1	-2.9	-2.7	-2.6
Revenues (% of GDP)	37.7	38.6	36.5	38.1	38.7	38.9
Debt (% of GDP)	23.9	22.6	23.7	23.2	23.2	22.8
Primary balance (% of GDP)	-2.3	-0.4	-2.6	-2.5	-2.3	-2.3
International poverty rate ($2.15 in 2017 PPP)[a,b]	0.7	0.5	0.5	0.5	0.5	0.4
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	2.0	1.8	1.7	1.7	1.6	1.6
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	5.8	5.2	5.1	5.0	4.8	4.6
GHG emissions growth (mtCO2e)	7.1	6.3	-0.4	0.6	0.6	0.1
Energy related GHG emissions (% of total)	78.7	75.9	75.0	73.8	72.6	71.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2022-EU-SILC. Actual data: 2021. Nowcast: 2022-2023. Forecasts are from 2024 to 2026.
b/ Projection using neutral distribution (2021) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

CROATIA

Table 1	**2023**
Population, million	3.8
GDP, current US$ billion	82.0
GDP per capita, current US$	21401.9
International poverty rate ($2.15)[a]	0.3
Lower middle-income poverty rate ($3.65)[a]	0.4
Upper middle-income poverty rate ($6.85)[a]	1.8
Gini index[a]	28.9
School enrollment, primary (% gross)[b]	95.9
Life expectancy at birth, years[b]	76.4
Total GHG emissions (mtCO2e)	17.5

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2021), 2017 PPPs.
b/ Most recent WDI value (2021).

Croatia's economic growth at 2.8 percent remained well above EU average in 2023, supporting income convergence. Poverty has likely stayed stagnant at 1.4 percent in 2023. The medium-term outlook is relatively favorable due to robust domestic demand, underpinned by a tight labor market, a strong inflow of EU funds, and slowly improving external demand. Fiscal policy is set to be expansionary with significant increase in spending in 2024, but public debt will remain on a declining path.

Key conditions and challenges

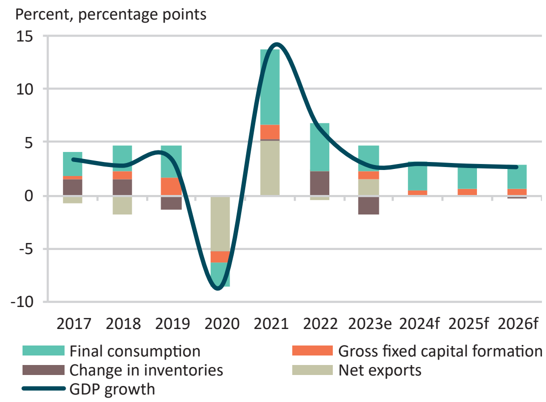
Croatia's economic activity continues to show resilience, which is reflected in an accelerated convergence with average EU incomes over the last three years. The country's GDP per capita is set to exceed 75 percent of the EU average in 2023, up by 9 p.p. compared to 2019. The recent GDP growth acceleration is largely due to the booming tourism sector and the strong inflow of EU funds. Economic activity was also underpinned by supportive fiscal policy, strong labor market, and large inflows of workers' remittances, which fostered robust personal consumption growth. Over the last year, Croatia was, however, not spared from the adverse effects of inflationary pressures and tighter monetary policy that weighed on business investments and external demand. The medium-term outlook remains relatively favorable on the back of robust domestic demand, an improved external environment, and substantial EU funding.

Notwithstanding the significant economic progress, there remains ample room to improve the quality of the institutional framework and to address shortcomings in the business environment, two of Croatia's long-standing issues. Lifting potential growth through structural reforms that augment productivity over the next couple of years will be especially important in the context of possible reduction in EU funds available to Croatia in the post-2030 period and still relatively low labor market participation and adverse demographic trends. The uncertain external outlook and geopolitical tensions still pose downside risks to growth but are partially mitigated by Croatia's improved economic resilience. Risks to fiscal sustainability are moderate: despite the short-term deterioration of the fiscal balance in 2024, the downward trajectory of the debt-to-GDP ratio is expected to continue over the medium term. Moreover, the banking sector remains resilient, with private sector debt and NPLs staying relatively low, while external vulnerabilities appear manageable, given the high positive current and capital account balance.

Recent developments

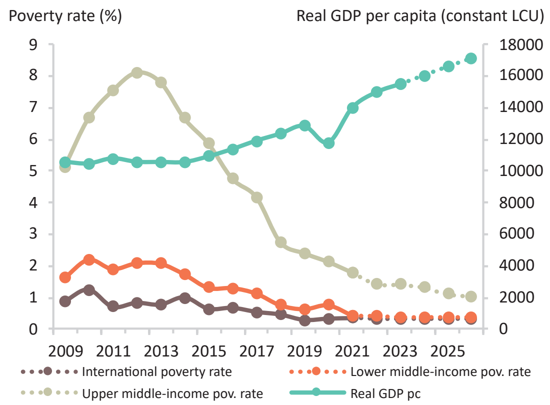
Croatia ended 2023 on a strong note. After a modest expansion in the third quarter (in q-o-q terms), real GDP growth accelerated in the last quarter with an annual growth rate surpassing 4 percent, primarily reflecting strong domestic demand. Overall, real GDP growth in 2023 stood at 2.8 percent and was one of the highest in the EU. The largest contribution came from private consumption, which was supported by favorable labor market developments and falling inflation, leading to an improvement in real disposable incomes. Investment activity, primarily supported by public sector investments financed by EU funds, also contributed positively. On the other hand, business investments remain stubbornly low compared to EU peers.

FIGURE 1 Croatia / Real GDP growth and contributions to real GDP growth



Sources: CROSTAT and World Bank.

FIGURE 2 Croatia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

Services exports continued to provide strong support to growth, whereas goods exports declined. The trade balance improved following the decline in imports which in part seems to have been linked to a relatively strong fall in inventories. On the supply side, growth was primarily supported by the services sector and construction, while manufacturing activity was suppressed, consistent with sluggish growth in Croatia's main trading partners. Net inflow of FDI remained significant but a large share of investments in real estate makes it less relevant for raising the country's growth potential. The labor market remained strong throughout 2023, with the strongest employment growth observed in sectors linked to tourism and construction. At the same time, nominal wage growth picked up, which, amid falling inflation, resulted in a strong rise in real wages. Despite robust growth and high inflation having a favorable impact on revenue performance, the significant rise in the government wage bill led to deterioration of the general government budget balance. Inflation steadily declined throughout 2023, and in January 2024 reached 4.8 percent. The slowdown has been consistent across major components, except for services price inflation, which remains elevated. Despite falling inflation, the World Bank 2023 Rapid Assessment Survey reports that most Croatians (78 percent) expected the increase in their total household income would not catch up with inflation. Poverty is expected to remain at 1.4 percent in 2023.

Outlook

Over the medium term, the country's growth rate, at around 2.8 percent, is expected to exceed the average for the EU. In 2024, growth is projected to accelerate to 3.0 percent reflecting positive carry-over effects from 2023, strengthening external demand, as well as expansionary fiscal policy. In addition, a strong labor market, which is reflected in a relatively high share of companies reporting shortages of labor and a strong rise in public sector wages, will further support increase in real incomes. Against this backdrop, personal consumption growth is expected to accelerate in 2024 and be the main driver of growth. The dynamics of goods exports could also strengthen in response to the improved external environment, while growth in services exports is expected to slow down given the strong performance in recent years and the reduced price-competitiveness of the Croatian tourism sector. Investment growth is expected to decelerate but remain relatively strong, supported by EU funds and improved private sector investments. While personal consumption growth is expected to decelerate following less expansionary fiscal policy in 2025, improvements in the external environment, less restrictive monetary policy, as well as an ample amount of EU funds will continue to support economic activity. Inflation is set to continue its declining trend and gradually narrow towards the ECB target of close to 2 percent by the beginning of 2025, but risks remain given upward wage pressures. At the same time, fiscal balance is expected to worsen significantly in 2024, largely reflecting rise in wage bill and social benefits, but it is set to remain relatively contained over the forecast horizon. Together with continued nominal economic growth, this will allow for a further decline in the public debt-to-GDP ratio that is forecast to reach 56 percent at the end of 2026. Poverty is expected to gradually fall to 1.0 percent by 2026.

TABLE 2 Croatia / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	13.8	6.3	2.8	3.0	2.8	2.7
Private consumption	10.6	6.7	3.0	3.7	2.8	2.7
Government consumption	3.0	2.7	2.8	2.9	2.9	2.8
Gross fixed capital investment	6.6	0.1	4.2	2.1	3.3	3.4
Exports, goods and services	32.7	27.0	-2.9	2.8	3.2	3.3
Imports, goods and services	17.3	26.5	-5.3	3.1	3.3	3.5
Real GDP growth, at constant factor prices	12.2	7.9	2.3	3.0	2.8	2.7
Agriculture	9.6	-4.3	0.4	0.9	1.0	1.0
Industry	12.4	2.7	-0.5	1.7	2.2	2.2
Services	12.3	10.5	3.4	3.6	3.1	2.9
Inflation (consumer price index)	2.7	10.7	8.4	3.9	2.3	2.2
Current account balance (% of GDP)	1.0	-2.8	1.0	1.6	1.6	2.4
Net foreign direct investment inflow (% of GDP)	5.2	5.4	3.5	3.4	3.4	3.2
Fiscal balance (% of GDP)	-2.5	0.1	-0.3	-2.3	-1.8	-1.6
Revenues (% of GDP)	46.1	45.0	46.6	45.4	45.5	45.8
Debt (% of GDP)	78.1	68.2	60.7	58.2	56.9	56.0
Primary balance (% of GDP)	-1.0	1.5	0.9	-1.2	-0.6	-0.5
International poverty rate ($2.15 in 2017 PPP)[a,b]	0.3	0.3	0.3	0.3	0.3	0.3
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	0.4	0.4	0.4	0.4	0.4	0.4
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	1.8	1.4	1.4	1.3	1.1	1.0
GHG emissions growth (mtCO2e)	4.2	-1.1	-0.1	0.7	0.4	0.3
Energy related GHG emissions (% of total)	87.5	86.8	86.6	86.2	85.8	85.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2022-EU-SILC. Actual data: 2021. Nowcast: 2022-2023. Forecasts are from 2024 to 2026.
b/ Projection using neutral distribution (2021) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

GEORGIA

Table 1	2023
Population, million	3.7
GDP, current US$ billion	30.5
GDP per capita, current US$	8212.4
International poverty rate ($2.15)[a]	5.5
Lower middle-income poverty rate ($3.65)[a]	19.1
Upper middle-income poverty rate ($6.85)[a]	55.4
Gini index[a]	34.2
School enrollment, primary (% gross)[b]	104.5
Life expectancy at birth, years[b]	71.7
Total GHG emissions (mtCO2e)	18.3

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2021), 2017 PPPs.
b/ WDI for School enrollment (2022); Life expectancy (2021).

After two years of double-digit growth, the economy expanded by 7.5 percent in 2023, driven by strong investment. Poverty and unemployment continued to decline. Growth is expected to decelerate in 2024, given tight monetary policy, a slowdown in trading partners, and heightened geopolitical risks.

Key conditions and challenges

Georgia has made notable gains in income growth and poverty reduction over the past decade. As a result of sound macroeconomic management, GNI per capita (constant 2017 USD) increased from USD 9,580 in 2010 to USD 15,880 in 2022. Poverty (measured by the USD 6.85 poverty line in 2017 PPP) declined from 70.6 percent in 2010 to an estimated 47.7 percent in 2022.

Nevertheless, structural challenges persist, notably weak productivity and limited high-quality job creation. About a third of workers remain engaged in low-productivity agriculture, and Georgia also has a large share of self-employed in other sectors. Access to finance remains a major obstacle for SMEs, while skills mismatches are reported to be an impediment for most firms. Due to its high degree of trade openness and dependence on tourism, Georgia is vulnerable to external shocks.

In December 2023, Georgia was granted candidate status by the European Union (EU). The EU accession process offers unique opportunities to boost reforms to achieve prosperity and converge with other member states.

Recent developments

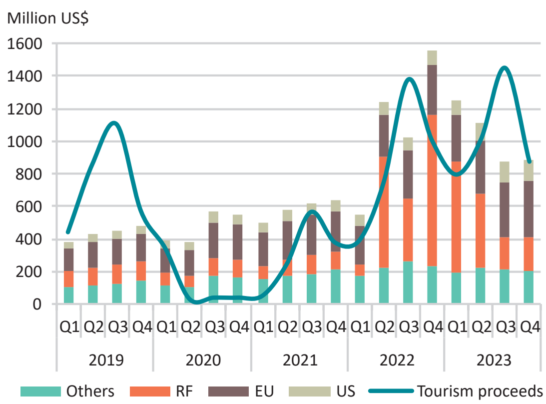
Growth in 2023 is estimated at 7.5 percent, driven by robust investment performance, notably fueled by a surge in construction activities (+17 percent in real terms). Strong growth in tourism revenues (+17 percent in USD terms) also supported growth.

Annual inflation slowed sharply to 0 percent at end-2023 from 9.8 percent in December 2022, reflecting falling global food and energy prices, and lari appreciation. Rental prices grew by 4 percent in 2023 (compared to 37.4 percent in 2022), while the introduction of reference prices for medicines exerted downward pressure on inflation. Core inflation stood at 2.0 percent in December (yoy). In response, the National Bank of Georgia cut the monetary policy rate 6 times, from 11 to 8.25 percent between May 2023 and March 2024.

Credit nominally grew by 18 percent (yoy) as of end-December, while deposits increased by 14 percent (yoy) (both adjusted for foreign exchange effects, in nominal terms), driven by strong growth in domestic currency deposits (28 percent, yoy). As a result, deposit dollarization fell by 5.4 percentage points (ppt) over the last year, to 50.8 percent as of end-2023.

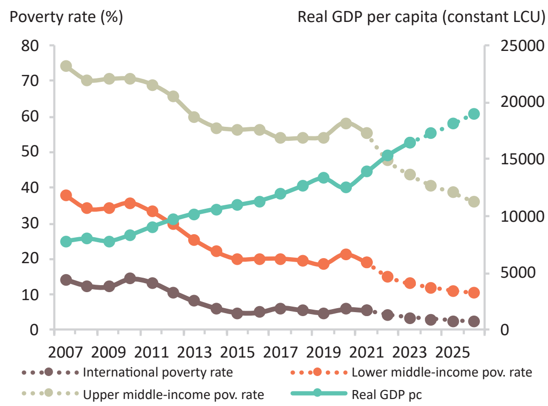
According to preliminary estimates, the current account deficit narrowed slightly in 2023, to 4.3 percent of GDP. The trade deficit of goods widened by 19 percent in nominal terms (USD). Exports grew by 8 percent (yoy) in nominal terms (USD), driven by the re-exports of used cars, while import growth reached 12 percent. Service exports remained supported by the continued post-COVID-19 recovery in tourism. International reserves increased

FIGURE 1 Georgia / Gross money transfers from abroad and tourism proceeds



Sources: Geostat, NBG, and World Bank staff estimates.

FIGURE 2 Georgia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

to USD 5.0 billion, equivalent to around 4.2 months of imports of goods in the same year. The Georgian lari appreciated by around 10 percent vis-à-vis the US dollar in 2023.

The fiscal deficit narrowed in 2023, reaching 3.0 percent of GDP (including privatization proceeds). General government revenues increased by 14.2 percent, while tax collection rose by 13.5 percent in 2023 in nominal terms. Current spending grew by 14.6 percent, reflecting increases across the board. Capital spending rose by 4.6 percent in nominal terms. At end-2023, public debt was estimated at 38.1 percent of GDP, slightly down from end-2022, driven by lower financing needs and rapid economic growth.

Poverty has been declining, supported by an increase in real wages (by around 17 percent in 2023), social protection measures, and declining food prices. The job market experienced a strong recovery, with unemployment falling from 20.6 percent in 2021 to a record low of 16.4 percent in 2023.

Outlook

Growth is expected to ease to 5.2 percent in 2024 as a result of tight monetary policy, a slowdown among trading partners, and heightened geopolitical risks. Growth is projected to stabilize at around 5 percent of GDP for 2025-26 as Georgia benefits from the gradual recovery among its trading partners. The poverty rate is expected to keep declining gradually.

Inflation is expected to converge to its 3 percent target by end-2024. Monetary policy is expected to continue easing gradually in 2024.

Despite dwindling money transfers, the current account deficit should remain well below pre-COVID-19 levels in the medium term.

The 2024 state budget law reflects the government's commitment to pursuing gradual consolidation by reducing the fiscal deficit to 2.5 percent (including privatization revenues) and maintaining public debt below 38 percent of GDP. Revenue and tax collection are projected to continue their solid performance in 2024, with additional profit tax revenues in the financial sector (0.5 ppt of GDP) and higher taxation of gambling (rendering 0.5 ppt of GDP increase). Current expenses are set to increase by 0.8 percentage points, to 23.0 percent of GDP, to be offset by a slight decline in public investment (to 8 percent of GDP).

There are substantial risks to the outlook, reflecting uncertainties. A more rapid reversal in money inflows, weaker tourism revenues, and an increase in global commodity prices could hinder growth and increase debt levels and financing needs. Other risks include tighter global financial conditions and climate change-related risks. An adequate monetary and fiscal policy stance with adequate buffers is expected to help cushion potential shocks while exchange rate flexibility should help shield reserve levels by supporting an adjustment in imports.

TABLE 2 Georgia / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	10.6	11.0	7.5	5.2	5.0	5.0
Private consumption	12.3	-2.8	3.2	3.1	3.3	3.7
Government consumption	7.1	-0.8	6.2	8.2	2.6	2.4
Gross fixed capital investment	-4.8	9.9	32.2	6.9	5.9	9.8
Exports, goods and services	23.5	37.4	8.2	8.2	8.6	8.3
Imports, goods and services	8.8	16.9	8.6	6.3	5.7	7.6
Real GDP growth, at constant factor prices	12.2	9.8	7.9	5.2	5.0	5.0
Agriculture	2.3	-1.8	-2.8	2.5	2.5	3.0
Industry	1.0	15.1	5.1	5.0	5.0	5.0
Services	17.4	9.6	10.0	5.5	5.2	5.1
Inflation (consumer price index)	9.6	11.9	2.5	2.3	3.0	3.0
Current account balance (% of GDP)	-10.3	-4.5	-4.3	-5.9	-5.4	-5.2
Net foreign direct investment inflow (% of GDP)	4.9	7.1	4.3	4.6	4.8	4.6
Fiscal balance (% of GDP)	-7.0	-3.5	-3.0	-2.9	-2.6	-2.5
Revenues (% of GDP)	24.9	26.6	27.6	28.0	27.7	27.2
Debt (% of GDP)	49.0	39.1	38.1	37.0	36.1	35.5
Primary balance (% of GDP)	-5.7	-2.4	-1.5	-1.1	-0.8	-0.6
International poverty rate ($2.15 in 2017 PPP)[a,b]	5.5	4.3	3.5	3.1	2.6	2.2
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	19.1	15.0	13.0	12.0	11.0	10.4
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	55.4	47.7	43.7	40.8	38.7	36.2
GHG emissions growth (mtCO2e)	3.6	0.9	-0.8	0.2	0.2	0.6
Energy related GHG emissions (% of total)	56.4	57.6	57.5	57.5	57.4	57.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2021-HIS. Actual data: 2021. Nowcast: 2022-2023. Forecasts are from 2024 to 2026.
b/ Projection using neutral distribution (2021) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

KAZAKHSTAN

Table 1	2023
Population, million	19.8
GDP, current US$ billion	259.7
GDP per capita, current US$	13088.5
International poverty rate ($2.15)[a]	0.0
Lower middle-income poverty rate ($3.65)[a]	0.3
Upper middle-income poverty rate ($6.85)[a]	10.6
Gini index[a]	29.2
School enrollment, primary (% gross)[b]	100.9
Life expectancy at birth, years[b]	70.2
Total GHG emissions (mtCO2e)	294.3

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2021), 2017 PPPs.
b/ WDI for School enrollment (2022); Life expectancy (2021).

Economic growth is projected to slow to 3.4 percent in 2024 before regaining momentum in subsequent years, driven by new oil production coming online. Inflation is expected to decrease but remain above the central bank target. Downside risks include weakening global demand and prices for oil, and potential disruptions to exports. Global decarbonization efforts pose a long-term challenge, necessitating a transition towards a new, sustainable growth model.

Key conditions and challenges

Kazakhstan's growth has slowed from 10 percent over 2000-2007 to below 4 percent over the last 10 years, highlighting the vulnerabilities of an economy still dependent on hydrocarbons and with stagnant productivity growth. Looking ahead, adjusting to the global green transition presents significant challenges for Kazakhstan.

Revitalizing economic growth and productivity will require bolder steps to enable the private sector to thrive and drive economic diversification by reducing the state's footprint and boosting competition across the economy, complemented with strengthening human capital and policies to support decarbonization.

Recent developments

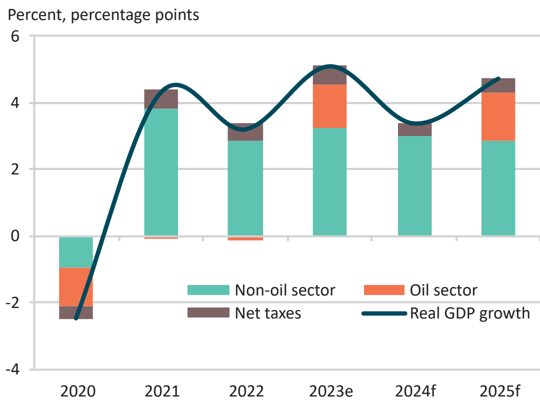
Real GDP grew by 5.1 percent in 2023 thanks to increased oil production, fiscal stimulus, and robust consumption. Oil production jumped by 6 percent yoy, accounting for one-third of growth. Despite stagnant real incomes and tight monetary policy, strong consumer and business sentiment was evident in retail trade growth (7 percent, real terms), car sales (8 percent), and new business registrations (10 percent). Capital investment picked up 14 percent yoy in 2023 (9 percent in 2022), with almost 80 percent from non-resource sectors.

While unemployment decreased slightly from 4.9 percent in 2022 to 4.7 percent in 2023, real incomes contracted 0.3 percent yoy due to high inflation. To ease the burden on living standards, the authorities once again raised the minimum wage, by 21.4 percent in nominal terms in 2023. This effectively doubled its level from 2021 (70 percent, real terms), exceeding inflation over the same period, and it helped to reduce the poverty rate to 8.8 percent (at USD 6.85/day) in 2023.

Slowing food prices and tight monetary policy helped ease price pressure. In February 2024, inflation decelerated to 9.3 percent yoy from a peak of 21.3 percent a year ago, but inflation expectations remain elevated. In line with the recent reversal in price dynamics, in February 2024, the central bank cut the policy rate by 0.5 percent to 14.75 percent.

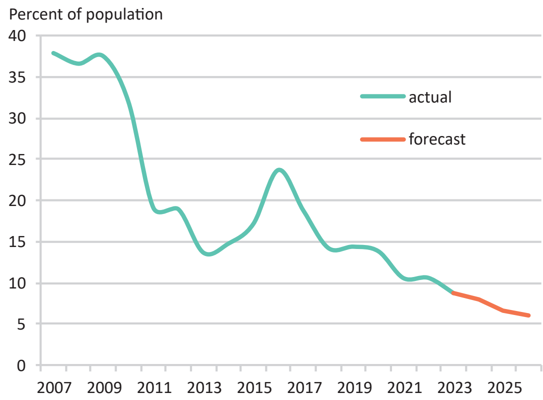
The current account has swung from a surplus of 3.5 percent in 2022 to a deficit of 3.8 percent of GDP in 2023. This deterioration was driven by a 6.6 percent fall in exports due to lower oil prices and import growth of 20.1 percent. FDI inflows continued, reaching an estimated 1.9 percent of GDP, and this helped to finance the deficit. However, momentum has weakened as major investment projects in the oil sector, financed through FDI, near completion. Gross international reserves remained stable in 2023, providing approximately seven months of import cover. The tenge has been relatively stable against the US dollar. The consolidated budget moved into a deficit of 1.6 percent in 2023, down from a

FIGURE 1 Kazakhstan / Real GDP growth and contributions to real GDP growth



Sources: Statistical Office of Kazakhstan and World Bank staff estimates.

FIGURE 2 Kazakhstan / Poverty rate, percent of population living on less than $6.85 (PPP) per day



Source: World Bank staff estimates.

surplus of 1.2 percent of GDP in 2022. This deterioration was due to increased spending on social welfare programs, housing, and utility infrastructure, along with rising interest payments, which collectively drove expenditures up by 1.6 percent of GDP. Revenues declined by 1.2 percent of GDP due to lower oil-related tax income.

The banking sector remains resilient, supported by robust capital and liquidity positions that exceed regulatory requirements. Profitability was boosted in 2023 by high interest rates. Non-performing loans amounted to only 3 percent of the loan portfolio in 2023, but this warrants close monitoring given rising household indebtedness and elevated interest rates.

Outlook

Economic growth is projected to moderate to 3.4 percent in 2024 before increased oil production temporarily raises it to 4.7 percent in 2025. Lower growth expectations for 2024 reflect reduced oil production expectations due to maintenance at major fields and Kazakhstan's adherence to OPEC+ production cuts.

Inflation is expected to gradually decline but remain above the 5 percent target in 2024. The planned utility tariff increases and the potential for a sustained budget deficit could hinder the projected downward trend.

The current account deficit is expected to decrease in 2024 and beyond, driven by an increase in oil exports.

The fiscal deficit is projected to increase to 2.7 percent of GDP in 2024, primarily due to lower oil-related revenues, before gradually decreasing to 1.2 percent by 2026. Sustained growth in non-oil sectors and improved tax collection efforts will contribute to growth in non-oil revenues. Following a series of fiscal stimulus measures, the government aims to comply with the fiscal rule by bringing budget spending down to pre-crisis levels.

Poverty is expected to fall to 7.9 percent (at USD 6.85/day) in 2024 as growth continues and inflation subsides, though elevated food prices remain a key challenge for the poorest households.

The outlook faces downside risks. Lower growth in major trading partners like China and the EU, could substantially worsen Kazakhstan's outlook, as would a weakening of oil prices. Stubborn inflation and the increased likelihood of climate-related shocks risk setting back poverty reduction progress. Disruptions to oil exports, such as unexpected maintenance in existing fields or delays in oil production coming online from the new Tengiz oilfield, could hinder oil output and economic growth. Lastly, there are risks to growth arising from the geopolitical situation and trade flows with Russia.

TABLE 2 Kazakhstan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	4.3	3.2	5.1	3.4	4.7	3.6
Private consumption	6.3	2.0	4.3	5.0	5.2	5.2
Government consumption	-2.4	9.1	3.1	1.5	0.9	0.5
Gross fixed capital investment	2.6	3.6	5.2	4.0	4.5	3.7
Exports, goods and services	2.3	10.2	5.5	0.0	6.4	1.6
Imports, goods and services	-0.3	11.6	4.1	3.8	5.0	4.1
Real GDP growth, at constant factor prices	4.1	2.9	5.0	3.3	4.7	3.4
Agriculture	-2.2	9.1	-7.7	3.0	3.0	2.0
Industry	4.5	2.7	5.7	3.4	6.0	3.8
Services	4.4	2.5	5.8	3.3	3.9	3.3
Inflation (consumer price index)	8.5	20.3	9.8	8.0	6.7	5.6
Current account balance (% of GDP)	-1.3	3.5	-3.8	-3.1	-2.3	-1.2
Net foreign direct investment inflow (% of GDP)	1.0	3.5	1.9	2.1	2.1	2.1
Fiscal balance (% of GDP)	-4.3	1.2	-1.6	-2.7	-2.1	-1.2
Revenues (% of GDP)	17.6	22.8	21.8	19.5	19.5	19.5
Debt (% of GDP)	23.7	22.5	22.3	23.9	26.3	27.5
Primary balance (% of GDP)	-3.1	2.6	0.0	-0.9	-0.3	0.6
International poverty rate ($2.15 in 2017 PPP)[a,b]	0.0	0.0	0.0	0.0	0.0	0.0
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	0.3	0.3	0.2	0.2	0.1	0.1
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	10.6	10.7	8.8	7.9	6.7	6.0
GHG emissions growth (mtCO2e)	3.2	-4.4	2.2	0.8	2.3	1.2
Energy related GHG emissions (% of total)	71.9	71.3	72.8	73.8	75.2	76.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2021-HBS. Actual data: 2021. Nowcast: 2022-2023. Forecasts are from 2024 to 2026.
b/ Projection using neutral distribution (2021) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

KOSOVO

Table 1	2023
Population, million	1.8
GDP, current US$ billion	10.5
GDP per capita, current US$	5926.7
Upper middle-income poverty rate ($6.85)[a]	34.2
Gini index[a]	29.0
Life expectancy at birth, years[b]	76.8

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2017), 2017 PPPs.
b/ Most recent WDI value (2021).

Amid a challenging external environment, GDP growth rose by an estimated 3.1 percent in 2023, on the back of lower international commodity prices, robust diaspora flows and strong credit growth. Over the medium term, growth is projected to stabilize at around 4 percent, supported by increasing real incomes and higher investment. However, higher commodity prices or tighter labor markets could lead to renewed inflation and lower private demand.

Key conditions and challenges

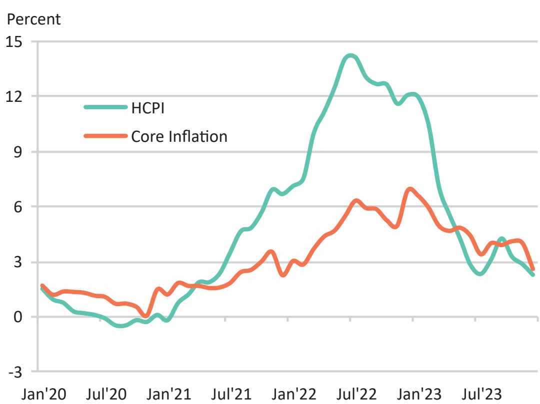
Kosovo is a unilaterally Euroized economy and a net importer of food and energy, reliant on outdated lignite power generation, which is insufficient to cover winter heating demand. Against this backdrop, stabilization in international food and energy prices positively impacted inflationary trends, the current account, and fiscal risks. Weaker growth in the EU and trading partners dampened demand for Kosovo's goods exports. In 2023, real GDP growth moderated to an estimated 3.1 percent, mainly on account of a lower contribution of exports. Despite recent gains in employment, only 39 percent of the working-age population was active in the labor market (22 percent for women) during 2022. Although the growth model has traditionally relied on consumption financed by remittances and diaspora spending, there has been a recent shift towards a more export-driven growth model. ICT services and manufactured goods exports have seen encouraging growth, in turn supporting job creation. More than half of foreign direct investments in 2023 remained focused on construction, but implementation of the new energy strategy could diversify investment.

Kosovo's human capital outcomes fall behind peers. In addition, the working-age population shrank in 2022, likely due to outward migration. In the medium term, growth is expected to reach around 4 percent, but risks remain elevated. Heightened geopolitical tensions may reignite inflation and scar investment confidence. A further increase in outward migration could negatively impact the supply and cost of labor. To accelerate poverty reduction, Kosovo needs to strengthen the drivers of job creation and enhance private sector productivity. To facilitate this transition and spur growth, it is critical to enhance the regulatory environment, reduce infrastructure gaps, and strengthen human capital.

Recent developments

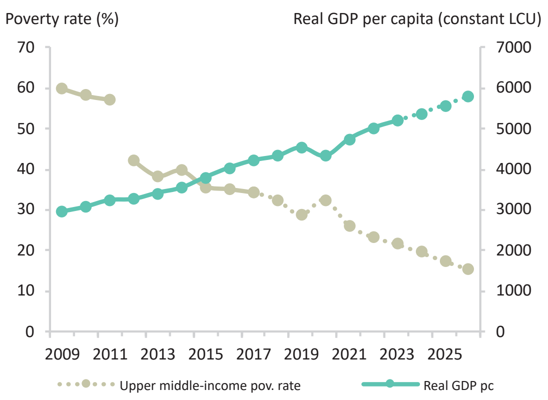
GDP growth reached 3 percent for the first three quarters of 2023. Compared to the same period of the previous year, growth was driven by resilient consumption (2.7 percent y/y), service exports (8.5 percent y/y), and investment activity (3.5 percent y/y); merchandise exports contracted by 6.7 percent y/y. On the supply-side, services continue to be a key contributor to growth. Agriculture recorded a positive performance (3.3 percent y/y), favored by decreasing input prices. In 2023, consumer inflation continued its downward path, averaging 5 percent. Food and beverage prices grew faster (8.6 percent y/y). In contrast, transport costs decreased (-1.9 percent y/y). Labor market formalization continued, as reflected in a 2.9 percent y/y increase in formal employment by November 2023. In 2023, the

FIGURE 1 Kosovo / Consumer price inflation



Source: Kosovo Statistics Agency.

FIGURE 2 Kosovo / Actual and projected poverty rate and real GDP per capita



Source: World Bank. Notes: see Table 2.

current account deficit narrowed, reaching 7.7 percent of GDP, from 10.3 percent in 2022, largely due to a reduction of import costs and strong service export performance. Remittance inflows remained strong in 2023, growing 10 percent y/y. Net FDI inflows increased by 12 percent y/y, on account of quadrupling reinvested earnings; equity and debt investments dropped by 8 percent y/y. By year-end, the fiscal deficit reached 0.2 percent of GDP, driven by continued positive revenue growth. Nominal tax revenues grew by 13 percent, reflecting compliance and formalization gains. Meanwhile, budget expenditures increased by 13.2 percent, driven by increases in capital expenditures (32.4 percent). In 2023, public and publicly guaranteed debt (PPG) fell to 17.2 percent of GDP, down from 20 percent in 2022, driven by an improvement in the budget balance. The financial sector remains robust. By December 2023, credit increased by 13 percent y/y, while capital buffers and asset quality remained adequate, with non-performing loans remaining stable at 2 percent. Poverty is estimated to have decreased in 2023 to 21.7 percent, driven by growth and higher employment.

Outlook

GDP growth is expected to accelerate to 3.7 percent in 2024, supported by continued stabilization of international prices. Tailwinds from the post-pandemic recovery are fading while the drag from external market uncertainty remains high. GDP growth is expected to pick up towards Kosovo's potential of around 4 percent, driven by resilient diaspora inflows and a gradual pickup in investment. Continued stabilization of international prices helped by the unwinding of the energy shock, is expected to boost consumer and investor confidence. Together with resilient labor markets, these factors are expected to support private consumption. Higher public and private investments in energy generation associated with the implementation of the energy strategy, as well as energy reforms, are expected to boost investment. Exports are expected to remain resilient on the back of strong diaspora-driven service exports, and a pickup in goods exports, driven by a recovery in foreign demand, continued diversification into non-commodity goods and regulatory reforms. Growth acceleration and further labor market outcome improvements (on top of a 5-percentage point increase in employment from 2020 to 2022) are expected to contribute to further poverty reduction. Nevertheless, an increase in commodity prices could lead to renewed inflation. The CAD is expected to narrow, driven by strong service exports and a continued decline in commodity prices, although at a slower than expected pace due to the drag in goods exports. Driven by increases in capital spending, the fiscal deficit is expected to widen to around 1 percent, remaining within the fiscal rule limit. Persisting uncertainties associated to both geopolitical tensions and domestic politics, and a further slowdown in the EU entail significant risks. Accelerating the economic convergence with the EU requires prioritizing reforms in the fiscal, governance, education, and energy sectors.

TABLE 2 **Kosovo** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	10.7	4.3	3.1	3.7	3.9	3.9
Private consumption	7.3	3.4	2.9	3.1	3.8	4.0
Government consumption	9.0	0.2	6.7	1.4	3.8	3.2
Gross fixed capital investment	13.0	-3.2	3.6	7.5	4.4	4.1
Exports, goods and services	76.8	18.9	6.9	3.0	4.0	5.0
Imports, goods and services	31.4	5.4	5.7	3.8	3.9	4.4
Real GDP growth, at constant factor prices	7.8	5.2	3.1	3.7	3.9	3.9
Agriculture	-2.5	4.5	3.4	2.3	2.5	1.8
Industry	7.8	4.0	3.7	3.5	4.0	4.2
Services	9.7	6.1	2.6	4.0	4.1	4.1
Inflation (consumer price index)	3.4	11.6	5.0	2.9	2.5	2.2
Current account balance (% of GDP)	-8.7	-10.3	-7.7	-7.5	-6.6	-5.8
Net foreign direct investment inflow (% of GDP)	4.0	6.3	6.4	5.2	5.3	5.7
Fiscal balance (% of GDP)	-1.3	-0.5	-0.2	-1.1	-1.1	-1.1
Revenues (% of GDP)	27.4	27.9	29.3	28.5	28.4	28.6
Debt (% of GDP)	21.1	19.7	17.2	17.9	18.1	19.1
Primary balance (% of GDP)	-0.9	-0.1	0.2	-0.6	-0.7	-0.7
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	26.2	23.4	21.7	19.7	17.6	15.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2017-HBS. Actual data: 2017. Nowcast: 2018-2023. Forecasts are from 2024 to 2026.
b/ Projection using neutral distribution (2017) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

KYRGYZ REPUBLIC

Table 1	2023
Population, million	6.9
GDP, current US$ billion	14.0
GDP per capita, current US$	2023.9
International poverty rate ($2.15)[a]	0.7
Lower middle-income poverty rate ($3.65)[a]	12.5
Upper middle-income poverty rate ($6.85)[a]	62.2
Gini index[a]	28.8
School enrollment, primary (% gross)[b]	94.2
Life expectancy at birth, years[b]	71.9
Total GHG emissions (mtCO2e)	13.4

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2021), 2017 PPPs.
b/ WDI for School enrollment (2022); Life expectancy (2021).

Economic growth was 6.2 percent and inflation was 10.8 percent in 2023. The fiscal balance was positive (1.2 percent of GDP) owing to strong revenue performance. GDP growth is projected to decline to 4.5 percent in 2024, reflecting a slowdown in the services sector, and inflation is expected to moderate to 5 percent. The fiscal deficit as a share of GDP is projected to widen due to lower tax revenues and higher capital spending.

Key conditions and challenges

The Kyrgyz Republic remains one of the poorest countries in the region with poverty stubbornly high at above 11 percent and an estimated additional 31 percent of the population vulnerable to poverty if the economy suffers any shocks.

The Kyrgyz Republic is subject to significant economic risks. Domestic prices are sensitive to rising global food and fuel prices and international earnings depend on gold exports and remittances. There is also a risk that remittances may decline with economic and financial implications. The economy has limited gross international reserves (GIR) to absorb shocks, while non-discretionary fiscal expenditure is high and the country is at a moderate risk of debt distress.

Economic opportunities and job creation are limited due to a stagnant private sector, constrained by a weak competitive environment, undue advantage enjoyed by poorly performing SOEs, high levels of informality, and a restrictive business environment. Private sector-led growth will require ambitious reforms to reduce the cost of regulatory compliance, ensure a level playing field, remove barriers for cross-border trade, and maximize spillovers from FDI.

Recent developments

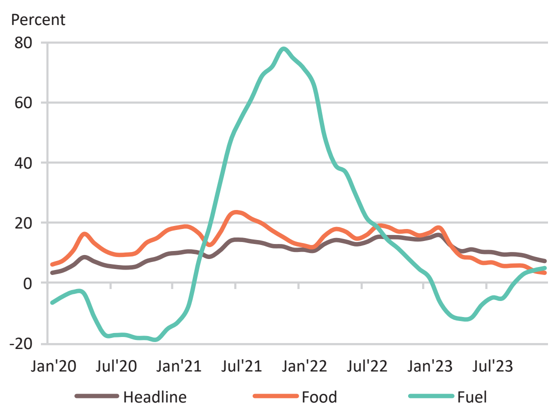
After growing at 9.0 percent in 2022, real GDP is estimated to have expanded by 6.2 percent in 2023. The services sector has driven growth, particularly services associated with transit trade since Russia's invasion of Ukraine. On the demand side, growth has been supported by higher consumption and exports.

Consumer price inflation decreased from 13.8 percent in 2022 to 10.8 percent in 2023, as global food and fuel price pressure abated and domestic monetary policy remained tight.

According to official statistics, the current account deficit amounted to 66.2 percent of GDP (US$3.4 billion) in H1 2023, the largest deficit to date, with 'errors and omissions' of 57 percent of GDP which is likely driven by under-reporting of exports. Imports increased by 38 percent in H1 2023, while exports soared by 52 percent (both in US$ terms) due to the resumption of gold exports, growth in tourism, and services related to transit trade. Income inflows declined due to a drop in inward remittances from 30.8 percent of GDP in H1 2022 to 25.6 percent a year later.

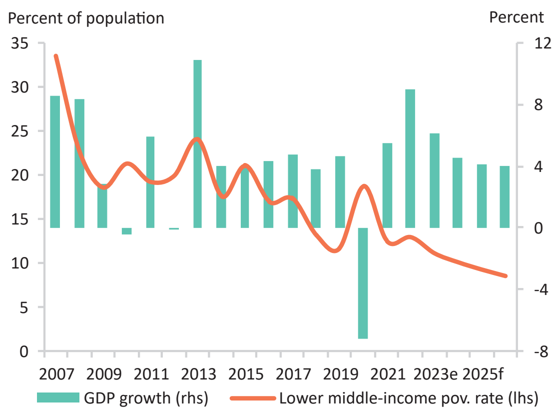
The deterioration in the external balance put pressure on the exchange rate, weakening the Kyrgyz Som against the US dollar by 4.4 percent in 2023. The central bank sold US$650 million of GIR to limit excess fluctuations in the exchange rate. GIR recovered slightly to 3.1 months of import

FIGURE 1 Kyrgyz Republic / Headline, food and fuel inflation



Source: Kyrgyz authorities.

FIGURE 2 Kyrgyz Republic / Real GDP growth and poverty rate



Sources: Kyrgyz authorities and World Bank staff.

cover by the end of 2023, but this remains below comfortable levels.

The government's fiscal position remained strong in 2023. The budget is estimated to have run a surplus of 1.2 percent of GDP in 2023, supported by increases in tax and non-tax revenues. Alongside strong revenues, expenditures increased, specifically wages and salaries, social benefits, and pensions. The fiscal surplus and economic growth have led to a lower public debt level of 45.5 percent of GDP as of end-December 2023, down from 46.9 percent a year earlier.

After a remarkable decline by 6.2 percentage points to 12.5 percent in 2021, the poverty rate (measured at US$ 3.65/day) increased slightly to 13 percent in 2022 on the back of high consumer price inflation. However, it is estimated to have declined to 11.2 percent in 2023 as inflation softened amid economic growth. Progress in poverty reduction is also supported by social assistance improvements such as pension increases, expansion of cash grants under "Social Contract" program, and the increase in transfers under the "Ui-Bulogo Komok" program.

Outlook

GDP growth is expected to decline to 4.5 percent in 2024 as growth in the services sector slows. On the demand side, consumption growth would moderate despite a slight increase in remittance inflows, while investment and net exports are expected to support growth. Annual GDP growth is expected to slow down to 4 percent over the medium term in the absence of structural reforms to raise potential growth.

Assuming the central bank maintains a prudent monetary stance and global food and fuel prices remain stable, inflation is projected to decline to within the target range of 5 to 7 percent by the end of 2024 and remain stable in the medium term.

The current account deficit is projected at 10.5 percent of GDP in 2024 and narrowing to 7.7 percent by 2026 as external demand for non-gold goods improves, exports of services continue to grow, and remittance inflows gradually increase. The deficit is expected to be financed by inward FDI and external borrowing.

The fiscal surplus is projected to turn into a deficit of 1.6 percent of GDP in 2024 owing to lower tax revenues. The deficit is expected to widen further to 2.4 percent of GDP by 2026, mainly due to higher capital spending.

High consumer prices and job insecurity will continue to be the most significant concerns for the welfare of the population. In 2024, the poverty level is expected to decrease slightly, with the continued effect of stabilizing inflation, social protection initiatives, and growth.

Risks to this outlook remain significant. There are external risks to growth, mainly arising from the geo-political situation and trade flows with Russia. Marked deterioration of the Russian economy may flow on through lower remittances and export demand. Possible upward spikes in global food and fuel prices might reverse the downward trend and push inflation into double digits.

Increasing the potential growth will require bold reforms to improve governance and reduce corruption, remove administrative barriers to private sector development, improve the electricity sector by adjusting tariffs to achieve cost recovery, and reduce the footprint of SOEs in the economy.

TABLE 2 Kyrgyz Republic / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	5.5	9.0	6.2	4.5	4.2	4.0
Private consumption	18.8	17.0	5.8	4.9	4.0	4.0
Government consumption	0.5	4.4	2.3	0.6	0.5	0.3
Gross fixed capital investment	8.0	6.9	9.4	15.0	15.5	16.0
Exports, goods and services	16.4	-1.6	49.7	21.5	20.4	17.5
Imports, goods and services	38.8	66.7	29.5	13.5	13.1	13.0
Real GDP growth, at constant factor prices	5.5	9.4	6.2	4.5	4.2	4.0
Agriculture	-4.5	7.3	0.6	2.5	2.2	2.3
Industry	6.5	11.9	2.7	5.3	6.0	6.0
Services	14.5	10.1	11.9	5.6	4.7	4.4
Inflation (consumer price index)	11.9	13.9	10.8	8.4	7.0	5.5
Current account balance (% of GDP)	-8.0	-42.7	-25.2	-10.5	-8.3	-7.7
Net foreign direct investment inflow (% of GDP)	6.1	4.2	3.7	3.9	3.9	3.5
Fiscal balance (% of GDP)	-0.3	-1.3	1.2	-1.6	-1.9	-2.4
Revenues (% of GDP)	31.8	34.6	37.2	31.9	29.6	27.9
Debt (% of GDP)	55.8	46.9	45.5	44.8	44.5	44.1
Primary balance (% of GDP)	1.2	0.0	2.3	-0.5	-1.0	-1.6
International poverty rate ($2.15 in 2017 PPP)[a,b]	0.7	0.7	0.6	0.5	0.4	0.4
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	12.5	13.0	11.2	10.2	9.3	8.6
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	62.2	61.3	58.4	56.6	55.1	53.6
GHG emissions growth (mtCO2e)	4.6	-1.0	0.6	0.4	0.7	0.8
Energy related GHG emissions (% of total)	65.9	64.6	64.3	63.7	63.0	62.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2016-KIHS, 2019-KIHS, and 2022-. Actual data: 2022. Nowcast: 2023. Forecasts are from 2024 to 2026.
b/ Projection using point-to-point elasticity (2016-2019) with pass-through = 0.7 based on GDP per capita in constant LCU.

MOLDOVA

Table 1	2023
Population, million	2.5
GDP, current US$ billion	16.5
GDP per capita, current US$	6583.5
Lower middle-income poverty rate ($3.65)[a]	0.3
Upper middle-income poverty rate ($6.85)[a]	14.4
Gini index[a]	25.7
School enrollment, primary (% gross)[b]	106.5
Life expectancy at birth, years[b]	68.8
Total GHG emissions (mtCO2e)	18.4

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2021), 2017 PPPs.
b/ Most recent WDI value (2021).

Despite avoiding another energy crisis, Moldova has grappled with the fallout from Russia's invasion of Ukraine, facing reduced incomes and a strained economy, resulting in sluggish growth in 2023. Structural reforms and EU integration are crucial amid persistent poverty and economic challenges, including low productivity and climate vulnerabilities. Despite the expected 2024 recovery, significant risks remain, including the ongoing war, potential energy shocks, and headwinds from the upcoming elections.

Key conditions and challenges

Moldova is facing unprecedented challenges due to the spillover effects of Russia's invasion of Ukraine, which resulted in an energy and refugee crisis, straining households, the economy, and public finances. Despite significant efforts to mitigate these crises through fiscal measures and monetary policies, dwindling household incomes and persistent high risks continue to stifle private consumption and investment confidence, resulting in sluggish growth in 2023 after the recession in 2022. While a moderate economic recovery and improved household incomes are expected for 2024, there are significant macroeconomic risks, including the potential intensification of the war in Ukraine, additional energy disruptions, and headwinds from the upcoming elections in 2024 and 2025.

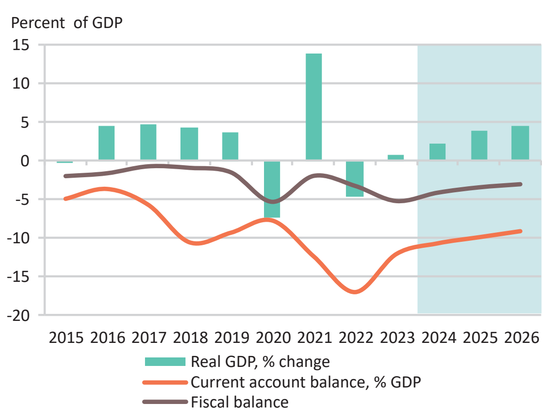
Moldova's medium-term prospects hinge on structural reforms and progress toward EU accession. Despite sustained economic growth over two decades, poverty remains pervasive, particularly in rural regions, with limited access to services and viable economic opportunities. Traditional means of poverty alleviation, such as remittances and social assistance, are slowing, while low labor force participation and employment rates impede a shift to employment-focused poverty reduction, underscoring the urgency for structural reforms.

Moldova faces structural challenges including low productivity growth, governance deficiencies, a large state footprint, limited competition, an imbalanced business environment, and tax distortions. The country remains vulnerable to adverse weather events and energy shocks due to its heavy dependence on energy imports and limited diversification in energy sources. Climate change worsens these vulnerabilities, increasing the frequency and severity of droughts and other natural hazards, thereby posing substantial risks to Moldova's agricultural sector and livelihoods. With EU candidate status, strong reform momentum and growth-enhancing, climate-resilient investments are needed to foster long-term, sustainable development and convergence toward EU income levels.

Recent developments

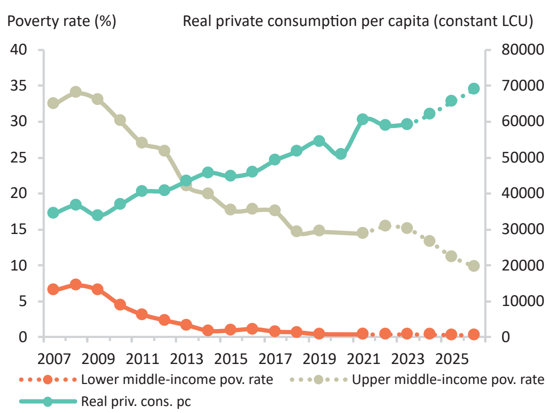
Spillovers from the war continue to weigh on the economy. The economy has grown by 0.7 percent in 2023, driven by a strong rebound in the agriculture sector, which grew by 31.9 percent after the 2022 drought. The industry and services sectors contracted, despite notable growth in IT, health, and accommodation and food services sectors, amid high input costs, lower demand from trading partners, and heightened risk. On the demand side, net exports contributed positively to growth, supported by services exports and reduced imports amid weak domestic demand. Private consumption and investments contracted due

FIGURE 1 Moldova / Actual and projected macroeconomic indicators



Source: World Bank, based on national statistics.

FIGURE 2 Moldova / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see Table 2.

to reduced disposable income, elevated interest rates, and uncertainties stemming from the war in Ukraine.

Albeit a 5.8 percent decline in remittances, the current account deficit improved to 11.9 percent of GDP in 2023, driven by lower trade balance alongside improvements in primary and secondary accounts. Following a decline in direct investments, the CAD was primarily funded through cash, deposits, and trade loans. External debt decreased by 2.8 percentage points compared to end-2022, reaching 63.3 percent of GDP.

Inflation decelerated rapidly in 2023 due to timely monetary responses in 2022 and declining food and fuel prices, reaching 4.6 percent in January 2024. With the easing of inflation, the Central Bank reduced the base interest rate from 17 percent in early 2023 to 4.25 by November 2024.

Total revenues increased by 11.8 percent, driven by income taxes, social contributions, and excise duties on imported goods. Elevated expenditures on social programs, wages, and interest payments offset the revenue increase, reflecting inflationary pressures and higher financing needs. As a result, the fiscal deficit widened to 5.2 percent of GDP. Public and publicly guaranteed debt is forecasted to reach 36 percent of GDP by 2023, fueled by new loan disbursements.

High food and fuel prices reduced purchasing power, with government energy subsidies providing some relief. Poverty rates, as measured by the US$6.85 2017 PPP poverty line, are expected to have stayed broadly constant, marginally dropping from 15.4 percent in 2022 to 15.0 percent in 2023.

Outlook

The economy is expected to grow by 2.2 percent in 2024, underpinned by rising real wages, a positive fiscal impulse, and subdued inflation. Private consumption and investments are expected to underpin growth, backed by an accommodative monetary stance. Net exports are expected to hinder growth, reflecting increased demand-driven imports. On the production side, the service sector, particularly IT, transport and public services, is expected to underpin growth. The contribution of the industrial sector will trailing pre-war levels, largely due to weak external demand. Agriculture sees modest gains amid higher input costs and good yields in 2023.

Reforms for economic diversification and competitiveness, aligned with the EU accession agenda, along with positive fiscal measures and favorable interest rates, will drive medium-term growth.

Average inflation is projected to decline further in 2024 as commodity prices ease and to remain within the target corridor in the medium term. However, inflation remains highly susceptible to geopolitical tensions due to the war in Ukraine.

While the CAD is expected to narrow in 2024, supported by service exports and a gradual recovery in remittances, it is expected to remain above pre-pandemic levels because of elevated import prices and transport costs.

The fiscal deficit is anticipated to remain high at 4.1 percent of GDP in 2024 due to spending pressures, including support for households, jobs, refugees, and infrastructure. The deficit is projected to decrease in the medium term, reaching 3 percent of GDP in 2026 as fiscal support is phase out.

As inflationary pressures ease, the poverty rate, as measured by the US$6.85 2017 PPP poverty line, is expected to decrease to 13.3 percent in 2024. With the anticipated economic recovery and normalization of inflation, poverty is projected to decline further to 11.2 percent in 2025.

TABLE 2 Moldova / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	13.9	-4.6	0.7	2.2	3.9	4.5
Private consumption	17.3	-4.8	-0.5	1.8	3.3	3.8
Government consumption	4.4	4.8	-2.2	0.8	0.7	0.2
Gross fixed capital investment	1.9	-10.5	-1.3	3.3	4.1	5.6
Exports, goods and services	17.5	29.7	5.1	3.5	5.7	5.9
Imports, goods and services	21.2	18.2	-5.1	2.9	3.9	4.3
Real GDP growth, at constant factor prices	13.4	-4.2	1.5	2.2	3.9	4.5
Agriculture	50.3	-23.5	31.9	2.3	3.8	3.8
Industry	0.5	-10.3	-10.0	4.6	4.8	5.2
Services	12.4	3.0	-0.1	1.5	3.6	4.4
Inflation (consumer price index)	5.1	28.7	13.4	4.9	5.2	5.0
Current account balance (% of GDP)	-12.4	-17.1	-11.9	-10.7	-9.9	-9.1
Net foreign direct investment inflow (% of GDP)	1.6	0.8	2.5	2.6	2.5	2.3
Fiscal balance (% of GDP)	-1.9	-3.2	-5.2	-4.1	-3.4	-3.0
Revenues (% of GDP)	32.0	33.3	34.1	33.0	32.6	32.4
Debt (% of GDP)	33.8	35.9	36.0	39.5	39.3	38.9
Primary balance (% of GDP)	-1.1	-2.0	-3.6	-2.8	-2.1	-1.7
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	0.3	0.4	0.4	0.3	0.3	0.2
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	14.4	15.4	15.0	13.3	11.2	9.8
GHG emissions growth (mtCO2e)	10.8	-3.0	29.9	2.1	2.5	3.2
Energy related GHG emissions (% of total)	66.9	67.4	72.5	71.9	72.1	73.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2021-HBS. Actual data: 2021. Nowcast: 2022-2023. Forecasts are from 2024 to 2026.
b/ Projection using neutral distribution (2021) with pass-through = 0.7 (Low (0.7)) based on private consumption per capita in constant LCU.

MONTENEGRO

Table 1	2023
Population, million	0.6
GDP, current US$ billion	7.4
GDP per capita, current US$	11996.9
International poverty rate ($2.15)[a]	2.1
Lower middle-income poverty rate ($3.65)[a]	3.8
Upper middle-income poverty rate ($6.85)[a]	12.3
Gini index[a]	34.4
School enrollment, primary (% gross)[b]	100.7
Life expectancy at birth, years[b]	73.8
Total GHG emissions (mtCO2e)	3.5

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2021), 2017 PPPs.
b/ WDI for School enrollment (2022); Life expectancy (2021).

Montenegro's economy performed strongly in 2023, with an estimated GDP growth of 6 percent. However, economic growth is expected to moderate in 2024, and the fiscal deficit is projected to widen during 2024-27 owing to higher social and capital spending. The country is also facing high financing needs due to significant debt repayments in an environment of high financing costs. Prudent fiscal and debt management policies are required, alongside structural reforms aimed at safeguarding and enhancing development prospects.

Key conditions and challenges

Montenegro's small, open, and service-based economy is vulnerable to external shocks, while the country's strategies and policies have not always been conducive to enhancing resilience. After a 15.3 percent contraction in 2020, the economy rebounded swiftly in 2021-22, averaging 9.7 percent growth per annum. Growth remained robust in 2023 at an estimated 6 percent, driven by booming tourism and private consumption, also supported by an influx of foreigners, primarily Russian and Ukrainian citizens.

Montenegro successfully reduced its public debt from 103.5 percent of GDP in 2020 to 60.7 percent in 2023, aided greatly by high nominal GDP growth. However, growth is expected to moderate in the medium term, while financing needs are high due to large debt repayments in an environment of uncertain global conditions. While one-off revenues resulted in a fiscal surplus in 2023, a return to fiscal deficits is expected in the medium term. The Parliament adopted the 2024 budget with a fiscal deficit of 3.2 percent of GDP; it includes an increase in the minimum monthly pensions from €300 to €450. In March, Montenegro issued a 7-year $750 million Eurobond at a coupon rate of 7.25 percent. Yet, financing needs in the medium term remain high and leave little or no fiscal room for other policy changes either on the revenue or expenditure side of the budget without adversely affecting the debt trajectory.

A new government, appointed in October 2023, placed EU accession at the top of its agenda. In the first three months of the new government, the country made key judiciary and prosecution appointments, unblocking the reform processes in the area of the rule of law, a cornerstone of Montenegro's EU accession process. Delivering on committed reforms is important for advancing Montenegro's long-term development prospects.

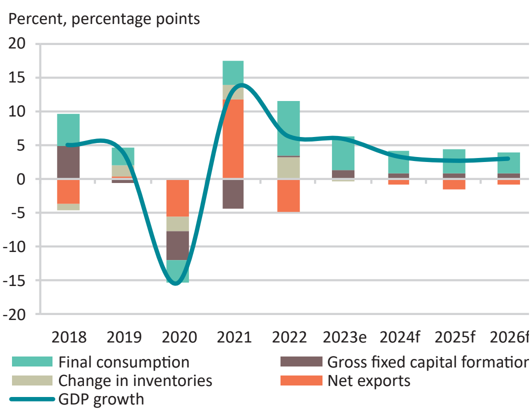
Recent developments

In 2023, real GDP growth reached 6 percent, driven by a strong tourism season and solid private consumption, underpinned by higher public sector wages, employment gains, and household borrowing, though it slowed down in the second half of the year. In 2023, real retail trade grew by 7.7 percent, while tourist overnight stays grew by 32.1 percent. Industrial production increased by 6.4 percent, but the value of construction works contracted by 7.9 percent.

In 2023 employment reached a historic high, with gains across all sectors. In Q3, the LFS data showed record employment and activity rates of 58.7 percent and 66.5 percent, respectively, while the unemployment rate dropped to 11.8 percent, the lowest on record. Administrative data show similar trends continued into Q4.

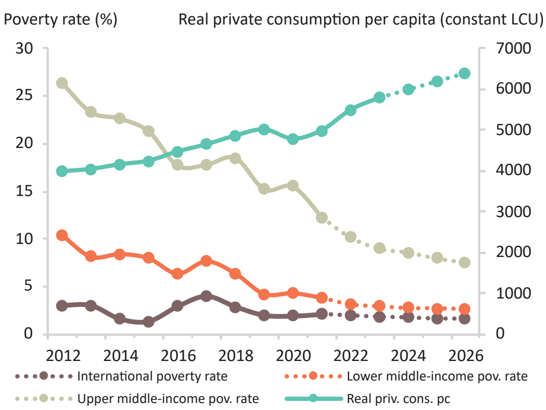
In 2023, inflation moderated to 8.6 percent, while real net average wages increased by

FIGURE 1 Montenegro / Real GDP growth and contributions to real GDP growth



Sources: MONSTAT and World Bank.

FIGURE 2 Montenegro / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see Table 2.

2.3 percent. Hence, poverty (income below $6.85/day in 2017 PPP) is projected to have declined to 9 percent in 2023.

Montenegro's financial soundness indicators improved in 2023. In September, the average capital adequacy ratio was at 20.7 percent, while non-performing loans declined to 5.9 percent from 6.7 percent of total loans a year earlier. By January 2024, banking sector lending and deposits increased by 12.1 and 3.6 percent y/y respectively.

The current account deficit (CAD) narrowed to 11.4 percent of GDP in 2023, owing to strong exports, despite a decline in net income accounts because of higher dividend and interest payments. Net FDI fell by 45 percent, financing just half of the CAD, the remainder being financed from reserves.

One-off revenues and strong economic activity resulted in a 0.5 percent of GDP fiscal surplus in 2023. Revenues increased by 28 percent, supported primarily by one-off revenues worth 2.3 percent of GDP. Expenditure growth was more moderate, at 12.8 percent, despite an 18.7 percent increase in public wages and higher social transfers. Public debt declined to an estimated 60.7 percent of GDP.

Outlook

The growth outlook is positive albeit challenged by an unfavorable global environment. Coming from a very high base, growth is expected to moderate to 3.4 percent in 2024, still led by private consumption and service exports, with investment in the tourism and energy sectors making a slight positive impact. Public investment is also expected to provide positive contribution to growth. The possibility of some announced, but not budgeted, large public investments and airport concessions could further boost growth, but the fiscal space is limited. Considering a closure of the thermal power plant in 2025 for reconstruction, which will necessitate greater energy imports, growth is expected to slow down to around 2.8 percent, and then bounce back in 2026 to 3 percent. While the CAD is expected to narrow to 11.0 percent of GDP in 2024, energy imports in 2025 would increase it again to an estimated 11.6 percent of GDP but are expected to remain largely financed by net FDI. Inflation is expected to soften to 3.9 percent in 2024 and further to 2.5 percent in 2025.

Poverty is projected to decline by 1.5 percentage points from 2023 to 7.5 percent in 2026.

The 2024 budget increased the minimum pensions and capital spending, which are expected to contribute to a fiscal deficit of 3.6 percent of GDP in 2024. The deficit is expected to decline gradually to 3.5 percent of GDP in 2025 and 3.4 percent of GDP in 2026. Additional fiscal consolidation measures would, however, result in a better fiscal performance. Public debt is expected to stabilize at around 62.5 percent of GDP through 2024–26. Maintaining debt sustainability requires strong fiscal discipline, particularly given challenging global financial conditions and Montenegro's sizable financing needs over 2024-26. The announced policies of reducing labor taxes and/or contributions without compensatory measures represent a risk to public finances.

The outlook is clouded by potential downside risks. Elevated geopolitical uncertainties could dampen growth prospects for Montenegro's trading partners, while the high cost of external financing poses a risk given the country's substantial financing needs.

TABLE 2 **Montenegro** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	13.0	6.4	6.0	3.4	2.8	3.0
Private consumption	4.0	9.7	5.4	3.4	3.4	3.3
Government consumption	0.5	1.5	3.1	2.8	2.7	1.8
Gross fixed capital investment	-12.3	0.1	4.8	3.4	3.5	3.3
Exports, goods and services	81.9	22.7	8.6	4.4	3.9	3.8
Imports, goods and services	13.7	21.3	5.2	3.9	4.5	3.5
Real GDP growth, at constant factor prices	13.2	6.3	5.4	3.0	2.8	3.1
Agriculture	-0.5	-2.9	-1.0	-0.5	0.0	0.0
Industry	1.4	-5.2	3.4	2.2	-5.0	6.0
Services	19.1	10.6	6.6	3.6	4.9	2.7
Inflation (consumer price index)	2.4	13.0	8.6	3.9	2.5	2.0
Current account balance (% of GDP)	-9.2	-12.9	-11.4	-11.0	-11.6	-11.3
Net foreign direct investment inflow (% of GDP)	11.7	13.2	6.3	7.1	7.0	7.0
Fiscal balance (% of GDP)	-2.1	-4.9	0.5	-3.6	-3.5	-3.4
Revenues (% of GDP)	44.0	38.6	42.8	41.5	41.7	41.8
Debt (% of GDP)	84.0	69.2	60.7	63.5	62.6	61.3
Primary balance (% of GDP)	0.2	-3.3	2.3	-1.6	-1.2	-0.9
International poverty rate ($2.15 in 2017 PPP)[a,b]	2.1	2.0	1.8	1.8	1.7	1.7
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	3.8	3.1	2.9	2.7	2.7	2.6
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	12.3	10.2	9.0	8.6	8.0	7.5
GHG emissions growth (mtCO2e)	3.9	2.6	2.6	0.8	-2.2	-0.4
Energy related GHG emissions (% of total)	67.8	69.2	70.3	70.6	71.0	71.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2022-SILC-C. Actual data: 2021. Nowcast: 2022-2023. Forecasts are from 2024 to 2026.
b/ Projection using neutral distribution (2021) with pass-through = 0.87 (Med (0.87)) based on private consumption per capita in constant LCU.

NORTH MACEDONIA

Table 1	2023
Population, million	1.8
GDP, current US$ billion	14.3
GDP per capita, current US$	7831.4
Upper middle-income poverty rate ($6.85)[a]	19.1
Gini index[a]	33.6
School enrollment, primary (% gross)[b]	92.1
Life expectancy at birth, years[b]	74.5
Total GHG emissions (mtCO2e)	9.5

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent WDI value (2021).
b/ Most recent value (2019), 2017 PPPs.

Real growth decelerated for the third consecutive year since the post-pandemic rebound amidst lingering inflationary pressures, stretched public finances, and higher borrowing costs. Poverty reduction continued as a result of crisis-support measures still in place and rising wages. Fiscal consolidation remains a priority in a context of higher mandatory spending commitments and a build-up of fiscal risks. The outlook over the forecast horizon remains positive, but downside risks prevail.

Key conditions and challenges

Real growth continued to slow down for the third year in a row after the brisk post-pandemic recovery in 2021. Inflation eased from double-digit growth in 2022 to a rate of 9.4 percent in 2023. However, rising wages risk keeping inflation higher for longer and a slower return to the long-term average. Poverty reduction is estimated to have continued in 2023, albeit at a slower pace vis-à-vis pre-pandemic trends, with the poverty rate projected to fall marginally by 0.3 percentage points in 2023, given the rise in real incomes as employment stagnates.

Fiscal consolidation continues to be challenging as the deficit remains sticky at above 5 percent and recent spending commitments related to the construction of a major highway to Albania and public sector wage increases have put additional spending pressure on medium-term fiscal plans. New strategic investments in the energy sector that have come with new tax expenditures also add to rising fiscal risks, including through guaranteed purchase liabilities for the energy sector SOE. Public debt increased back to 62 percent of GDP at end-2023, breaching the newly introduced fiscal rule (effective from 2025), while expenditure arrears remain continuously high at around 3 percent of GDP.

Monetary tightening has helped contain still-high inflation expectations amid lowered imported price pressures from food and energy. The main policy rate has been stabilized at 6.3 percent since September 2023, but increased interest rates have slowed the pace of private sector corporate borrowing to 3.3 percent y/y in December 2023.

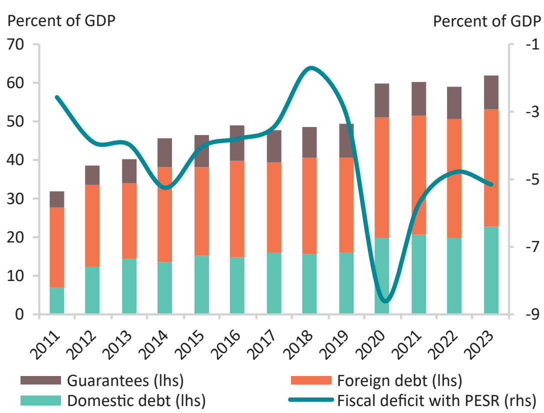
Navigating overlapping crises has left lasting scars in North Macedonia, slowing the pace of growth and income convergence with the EU. The growth recovery post-pandemic has been slower than in regional peers. Bolstering sustainability, boosting productivity, and bridging structural reform gaps will be critical to enable long-term growth in the context of heightened uncertainty and vulnerability.

Recent developments

Output growth subsided to 1 percent y/y in 2023 as consumption slowed while imports and inventories declined after a surge in the previous year. Growth was driven by services, in particular retail trade, finance, real estate, and ICT, while agriculture, manufacturing, and construction fell into negative territory.

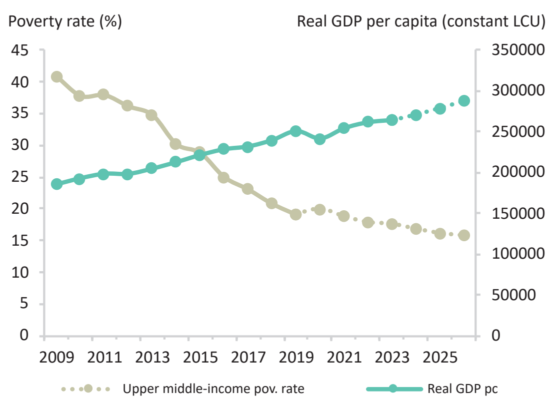
Compared to the previous quarter, labor market indicators in Q4 2023 showed rising unemployment to 13 percent, while the youth unemployment rate stood 2 pp higher at 32.5 percent. The labor force participation rate (ages 15+) lingers at a low 52.2 percent, while the employment rate fell marginally to 45.4 percent. Nominal wage growth continued to be brisk and reached 16.4 percent in December 2023, outpacing inflation by close to 13 pp.

FIGURE 1 North Macedonia / Fiscal performance



Sources: North Macedonia State Statistics Office, Ministry of Finance, and World Bank staff calculations.
Note: Fiscal deficit with PESR included.

FIGURE 2 North Macedonia / Actual and projected poverty rate and real GDP per capita



Source: World Bank. Notes: see Table 2.

Headline inflation fell to 3.6 percent in December 2023, but core inflation is still hovering above 5 percent. Inflationary pressures resulting from rising wages are set to continue as the minimum wage increases in April 2024.

The fiscal deficit (with the state roads finances included) is estimated at 5.2 percent of GDP for 2023 after two technical budget reallocations to accommodate additional spending for wages and transfers. The deficit grew despite a revenue boost from PIT, CIT, and social contributions as VAT collections disappointed and excises turned out lower, while transfers ended higher than initially planned.

Banking sector stability has been maintained in line with an increase in the capital adequacy ratio to 18.4 percent in Q3 2023, and a gradual return of the liquidity rate above 20 percent. At the same time, the NPL ratio remained constant at 2.8 percent.

The stability of the pegged exchange rate was maintained throughout 2023, and FX reserves stood above 4 months of imports by year-end. The current account ended 2023 in surplus, as the trade deficit narrowed to 18.9 percent of GDP and remittances and incomes from abroad remained strong. Net FDI inflows remained robust at 3.8 percent of GDP.

Outlook

The medium-term outlook remains positive, but risks are tilted to the downside. While real GDP growth ended 2023 at 1 percent, reflecting delays in the take-off of highway construction works, weaker external demand, and lingering price pressures, it is expected to step up in the medium term. GDP growth is forecasted to be 2.5 percent in 2024, rising towards 3.0 percent over the medium term. This projection assumes strong growth in public investments and a gradual recovery of consumption and exports.

Inflation is projected to remain above the long-term average at 3 percent in 2024, but to slow thereafter to 2 percent. The baseline scenario is built on the assumption that the impact of geopolitical tensions subsides over the forecast horizon and that the focus on the EU accession agenda remains in place after the general elections in May 2024. Poverty rates are projected to maintain a slow decline, falling by a further 1.8 percentage points over the forecast period.

Against several downside risks over the medium term, further progress with EU accession negotiations can provide an impetus for growth and accelerate income convergence with EU peers. Following up on pending structural reforms and ensuring fiscal sustainability is critical for boosting potential growth, which has declined to below 2 percent in the post-pandemic period. Importantly, scaling up decarbonization efforts accompanied by putting a price on carbon can strengthen domestic public revenues and maintain international competitiveness ahead of the implementation of the EU Carbon Border Adjustment Mechanism.

TABLE 2 North Macedonia / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	4.5	2.2	1.0	2.5	2.9	3.0
Private consumption	8.7	3.8	2.4	1.4	2.5	2.5
Government consumption	0.9	-5.0	-0.6	15.0	3.3	2.7
Gross fixed capital investment	-5.5	3.4	-16.7	2.7	3.1	2.8
Exports, goods and services	14.3	11.4	-0.1	5.1	5.6	5.6
Imports, goods and services	14.8	12.4	-5.8	5.1	4.5	4.3
Real GDP growth, at constant factor prices	4.0	2.4	1.0	2.5	2.9	3.0
Agriculture	-8.7	-5.0	-3.8	1.2	1.1	1.1
Industry	-5.1	-1.9	7.6	1.6	1.4	1.4
Services	8.9	4.6	-0.6	2.9	3.6	3.7
Inflation (consumer price index)	3.2	14.2	9.4	3.0	2.0	2.0
Current account balance (% of GDP)	-2.8	-6.1	0.7	-1.8	-2.1	-2.1
Net foreign direct investment inflow (% of GDP)	3.3	5.0	3.8	4.6	4.4	4.3
Fiscal balance (% of GDP)	-5.3	-4.5	-4.9	-4.5	-4.0	-3.8
Fiscal balance with the state roads (% of GDP)	-5.7	-4.8	-5.2	-4.8	-4.2	-4.1
Revenues (% of GDP)	32.1	32.1	34.9	35.4	35.9	36.5
Debt (% of GDP)	60.3	59.0	62.0	62.5	62.7	62.2
Primary balance (% of GDP)	-4.1	-3.4	-3.4	-2.7	-1.9	-1.5
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	18.8	17.8	17.6	16.8	16.1	15.7
GHG emissions growth (mtCO2e)	1.2	-0.8	-2.7	-2.9	-3.0	-2.9
Energy related GHG emissions (% of total)	71.5	71.1	70.0	68.8	67.6	66.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2020-SILC-C. Actual data: 2019. Nowcast: 2020-2023. Forecasts are from 2024 to 2026.
b/ Projection using neutral distribution (2019) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

POLAND

Table 1	2023
Population, million	39.1
GDP, current US$ billion	808.6
GDP per capita, current US$	20681.2
Upper middle-income poverty rate ($6.85)[a]	1.0
Gini index[a]	28.6
School enrollment, primary (% gross)[b]	95.8
Life expectancy at birth, years[b]	75.6
Total GHG emissions (mtCO2e)	318.9

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2021), 2017 PPPs.
b/ Most recent WDI value (2021).

Poland's GDP growth decelerated sharply in 2023 as high inflation, tighter financing conditions, and an unwinding inventory cycle weighed on growth. The outlook is positive with a newly elected pro-EU government that has unlocked EU funds, should boost investors' confidence, and address structural challenges, notably Poland's needed green transition.

Key conditions and challenges

The Polish economy has weathered global and regional external shocks thanks to a well-diversified economic structure, integration into regional value chains, a commitment to macroeconomic stability, a sound financial sector, and domestic labor markets that have supported significant wage growth and private consumption, feeding into long-term poverty reduction and median income growth. The crises have yet weakened the fiscal stance, and the energy crisis resulting from the invasion of Ukraine has led to a sharp increase in inflation which reduced purchasing power of households and has started to weigh down on growth.

A pro-EU administration took office in December 2023 marking the first political transition in 8 years. It faces steep challenges, notably that of improving the quality of institutions, particularly the rule of law. The Polish economic model is also at a crossroads: it requires boosting productivity through stimulating innovation, decarbonizing the energy sector, tackling rising inequality, and reskilling and upgrading of the labor force in a context of a rapidly aging population. Greater efficiency in public spending and tax expenditures is needed to rebuild fiscal buffers and accommodate spending on health, defense, and renewable energy.

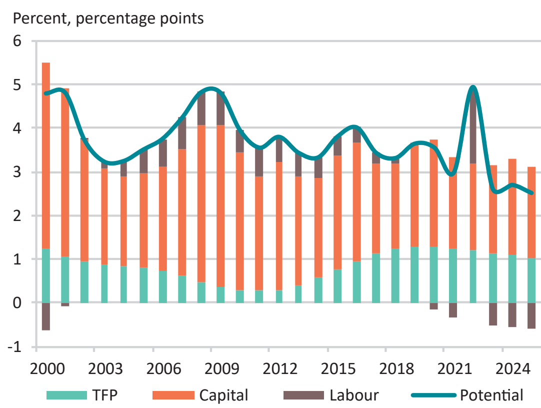
Medium-term economic prospects hinge on achieving the technological and green transitions, advancing inclusion, and addressing labor shortages despite nearly 1 million refugees from Ukraine easing some pressure. The technological transformation and ambitious EU decarbonization objectives, where Poland is lagging other EU Member States (MS), require investment and planning, including ensuring a just transition that contains growing regional disparities, with political uncertainty potentially affecting investments until the end of the electoral cycle in May 2025.

Recent developments

After a robust 5.3 percent real GDP growth in 2022, economic expansion decelerated markedly in 2023, to 0.2 percent. Private consumption was the main drag contracting due to high inflation, tighter financing conditions, and the unwinding of household support measures. This is despite a robust labor market and double-digit increases in average and minimum wages. External demand contracted as major trade partners' economic situations worsened. Exports significantly slowed in H2 2023. To the upside, firms' strong financial performance and the electoral cycle bolstered private and public investments.

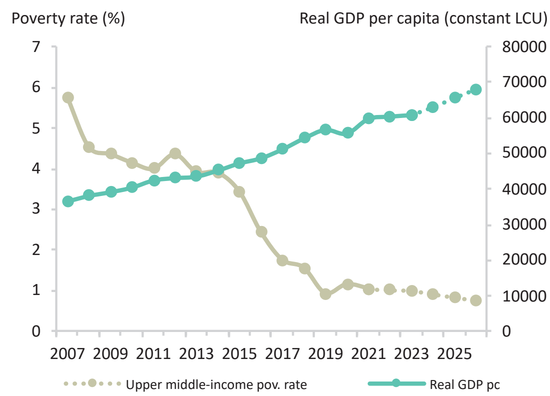
Inflation peaked at 18.4 percent year-on-year (y/y) in February 2023, then slowed down, reaching 3.9 percent y/y in January 2024, due to falling global commodity prices, a stronger zloty, and fewer supply disruptions. Measures like the extension of the zero VAT on essentials and

FIGURE 1 Poland / Potential output growth, and contributions to potential output growth



Sources: GUS and World Bank staff calculations.

FIGURE 2 Poland / Actual and projected poverty rate and real GDP per capita



Source: World Bank. Notes: see Table 2.

fuel price caps until H1 2024 kept prices lower. The National Bank of Poland started its monetary easing cycle with a 75 basis points (bps) cut in September 2023, ending an early monetary tightening cycle started in October 2021 (665 bps). The zloty 10 percent's real appreciation in 2023 mirrored positive government-related risk perceptions.

The banking sector remains well capitalized and higher interest rates allowed for further improvement in capital adequacy. Continuous strengthening will be granted to finance growing investment needs, in the context of an accelerated green transition. The terms of trade shock that led to a current account deficit in 2022 reversed, returning the CAB to surplus in 2023. Untargeted measures to protect households and firms from the energy and food price shocks contributed to the widening of the fiscal deficit to 5.6 percent of GDP, as did higher debt service costs and the time-lagged impact of the PIT reform.

Mid-2023 saw a resumption of real wage growth due to slowing inflation and increases in nominal and real wages, ending a prolonged period of real wage declines. Extreme poverty rates (national concept) remained slightly above those in 2017, due to lingering impacts of pandemic labor disruptions among vulnerable workers, reductions in the coverage of targeted minimum-income programs and in the real value of the Family 500 program, and declining purchasing power amid inflation. The Gini coefficient of inequality continued the upward trajectory visible since 2017.

Outlook

Economic growth is set to accelerate to 3 percent in 2024 and 3.4 percent in 2025, fueled by increased private consumption, as declining inflation and ongoing wage growth persist due to a tight labor market and a staged increase of the minimum wage in 2024. Boosts in the universal family transfers from 500 to 800 PLN per month, the expansion of the 14th month pension, along with investment driven by structural reforms and unlocked EU funds, will support growth, especially in 2025. Net exports' contribution to growth should turn negative in 2024 as domestic demand fuels imports while EU exports remain weak.

Inflationary pressures are expected during H2 2024 primarily due to the reinstatement of VAT on basic foodstuffs and the phasing out of energy price caps. On an annual average, it should stabilize at around 5 percent and move closer to the NBP target of 2.5 percent (+/- 1 percent band) in the medium term.

Revenue shortfalls (from the tax reforms and exemptions), increased defense and election-related spending, are expected to keep the general government deficit at 5 percent of GDP in 2024. Expenditure pressures will remain high, suggesting a slow pace of fiscal consolidation. Public debt is sustainable and should remain below 60 percent of GDP in the forecast period, but the off-budget debt contracted in recent years increases fiscal risks. Poland issued its largest Eurobond to date in January 2024 at favorable terms (115 bps above mid-swaps for the 10-year and at 160 bps for the 20-year).

In 2024, poverty reduction is expected to resume due to expanded untargeted social programs, a strong labor market, and higher minimum wages, feeding into higher living standards for families, retirees, and working poor households. However, socially vulnerable households remain at risk due to long-term reductions in the coverage and adequacy of minimum income programs.

TABLE 2 Poland / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	6.9	5.3	0.2	3.0	3.4	3.2
Private consumption	6.1	5.3	-1.0	3.6	3.5	3.2
Government consumption	5.0	0.3	2.9	2.6	3.0	2.1
Gross fixed capital investment	1.2	4.9	8.4	1.4	6.3	5.5
Exports, goods and services	12.3	6.7	-1.9	0.5	4.0	3.5
Imports, goods and services	16.1	6.8	-8.3	1.7	5.1	4.0
Real GDP growth, at constant factor prices	6.6	5.5	1.1	3.0	3.4	3.2
Agriculture	-11.5	1.1	2.2	0.2	0.1	0.1
Industry	1.9	7.0	-1.0	3.0	3.1	3.1
Services	9.7	5.0	2.1	3.1	3.7	3.3
Inflation (consumer price index)	5.1	14.4	11.4	5.4	4.3	3.6
Current account balance (% of GDP)	-1.2	-2.4	1.6	0.1	-0.4	-0.8
Net foreign direct investment inflow (% of GDP)	3.8	3.7	2.3	2.5	2.5	2.5
Fiscal balance (% of GDP)	-1.8	-3.8	-5.6	-5.0	-4.4	-3.8
Revenues (% of GDP)	42.3	39.9	40.1	40.2	40.3	40.5
Debt (% of GDP)	53.6	49.3	51.4	53.0	53.9	55.6
Primary balance (% of GDP)	-0.7	-2.2	-3.3	-2.6	-2.6	-2.2
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	1.0	1.0	1.0	0.9	0.8	0.8
GHG emissions growth (mtCO2e)	3.6	-3.9	-0.2	0.8	1.2	1.2
Energy related GHG emissions (% of total)	86.8	85.9	86.0	86.1	86.3	86.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2019-EU-SILC and 2022-EU-SILC. Actual data: 2021. Nowcast: 2022-2023. Forecasts are from 2024 to 2026.
b/ Projection using point-to-point elasticity (2018-2021) with pass-through = 0.7 based on GDP per capita in constant LCU.

ROMANIA

Table 1	2023
Population, million	18.6
GDP, current US$ billion	343.8
GDP per capita, current US$	18460.5
International poverty rate ($2.15)[a]	2.1
Lower middle-income poverty rate ($3.65)[a]	3.3
Upper middle-income poverty rate ($6.85)[a]	7.4
Gini index[a]	34.1
School enrollment, primary (% gross)[b]	90.8
Life expectancy at birth, years[b]	73.0
Total GHG emissions (mtCO2e)	65.7

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2021), 2017 PPPs.
b/ Most recent WDI value (2021).

The Romanian economy grew by 2.1 percent in 2023, supported by EU-financed investment and resilient consumption. Successful issuance of the first public green bond in February 2024 will support the green transition. Growth will accelerate in 2024, converging towards potential in the medium term. Fiscal and current account deficits will marginally decline. Poverty reduction is estimated to have decelerated in 2022 and 2023 due to slower growth and inflationary pressures.

Key conditions and challenges

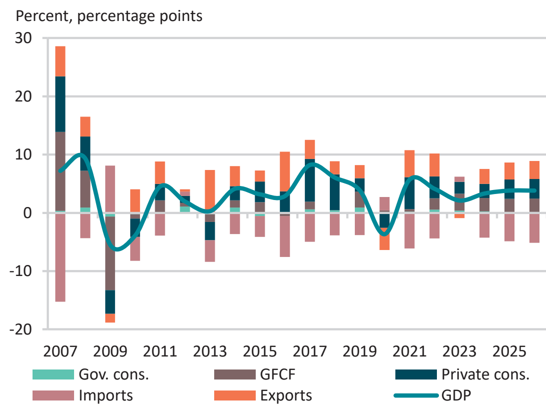
Romania has made considerable progress in economic performance and convergence with the European Union but faces challenges in fostering growth that is more inclusive and sustainable, both economically and environmentally. Challenges include regional disparities, weak institutions, skilled labor shortages, poor connectivity, and vulnerabilities to natural hazards and climate change. Procyclical fiscal policies have stimulated consumption, resulting in persistently high twin deficits.

Romania has made notable achievements in diminishing poverty and inequality despite facing unprecedented challenges, including the COVID-19 pandemic and Russia's invasion of Ukraine. Nevertheless, Romania's poverty and inequality remain among the highest in the EU, and there are still significant disparities among the country's regions. The key challenges in the short term are to curb inflation and address fiscal pressures, which are particularly significant in the 2024 election year, while simultaneously tackling the persistently high poverty rate. To achieve a sustainable recovery and support fiscal consolidation efforts, it is vital to implement the reforms under the National Recovery and Resilience Plan (NRRP) and thereby maximize and efficiently absorb sizeable EU funds.

Recent developments

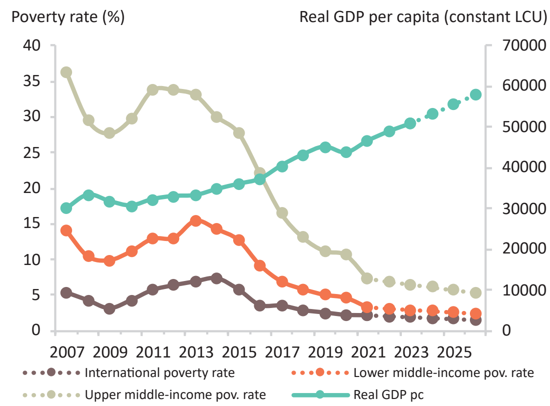
Growth decelerated to 2.1 percent y-o-y in 2023, impacted by higher inflation and weaker external demand. Investment (up 12 percent y-o-y), boosted by EU funds was the main driver. The contribution of private consumption remained significant (up 2.9 percent y-o-y), supported by low unemployment (close to pre-pandemic levels) and minimum wage and pension increases, which partially offset the impact of high energy and food prices on disposable incomes. Trade and current account deficits narrowed due to higher services surplus and reduced goods deficit amid import compression driven by slower consumption growth. Construction remained the main growth driver (up 11 percent y-o-y) but faced reduced momentum due to a deceleration in residential construction. Industry shrank for the second consecutive year due to elevated production costs, especially in energy-intensive sectors. Nominal net wages grew by 15.5 percent y-o-y in December 2023, above headline inflation, driven by wage increases in the private sector as the minimum wage increase fueled companies' labor costs. Headline inflation eased to 10.4 percent in 2023, supported by reduced energy and food market pressures and improved inflation expectations. The National Bank of Romania has maintained a tight monetary policy stance, keeping the policy rate at 7 percent since January 2023. Private sector credit growth decelerated to 6.4 percent y-o-y in December

FIGURE 1 Romania / Real GDP growth and contributions to real GDP growth



Source: World Bank.

FIGURE 2 Romania / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

2023 from 12.1 percent y-o-y in December 2022, reflecting the slowdown in loans to households (up 1.4 percent y-o-y).

The fiscal deficit declined to an estimated 5.7 percent of GDP in 2023 from a pandemic-related high of 9.3 percent in 2020, thanks to an expenditure-based consolidation. Additional tax measures implemented in January 2024 are expected to bring around one percent of GDP in extra revenue this year, supporting fiscal consolidation. However, more is required to accommodate higher recurrent spending in the short to medium term, stemming from the schedule of the recently adopted pension reform. The Ministry of Finance launched in mid-February 2024 two euro-denominated bond tranches with 7-year and 12-year maturities. The 12-year tranche, Romania's inaugural green bond issue, valued at EUR2 billion, was oversubscribed more than 4 times, underscoring the potential for sovereign green bonds to facilitate the shift towards a greener economy.

Poverty reduction ($6.85/day PPP) is projected to decelerate, with a modest decline of 0.5 percentage points (from 7.4 percent in 2021 to 6.9 percent in 2022) due to slower growth and inflation. In 2021, around 25 percent of the population faced energy poverty, spending about 8.7 percent of their budget on energy, with 17.8 percent struggling to pay utility bills, one of the highest rates in the EU. By 2022, 15.2 percent of households struggled to heat their homes, one of the highest rates in the EU, exacerbated by rising energy costs. Despite price caps, the burden on household budgets remains significant, especially at the lower end of the welfare distribution, indicating that the most economically disadvantaged segments of the population bear the brunt of these price increases. In 2023, poverty ($6.85/day PPP) is projected to have declined slowly, reaching 6.6 percent.

Outlook

Economic growth is expected to accelerate in 2024 to an estimated 3.3 percent, supported by private consumption (benefiting from rising disposable incomes) and EU-financed investment. Romania's short-term growth prospects are dampened by external shocks mainly stemming from the ramifications of Russia's invasion of Ukraine, persistent structural fiscal challenges, and political and social pressures in the context of the 2024 multi-level national and EU elections.

As fiscal consolidation is expected to accelerate with the resumption of the Excessive Deficit Procedures and the new economic governance framework, efficient EU fund absorption is key for a sustainable, green, and inclusive recovery. The Government has already received EUR6.3 billion (out of 28.5 billion by 2026) through the performance-based NRRP, reflecting the achievement of reform milestones in areas of decarbonization, database interoperability to reduce red tape, and fiscal and pension reforms. The NRRP funds and associated structural reforms are essential for a sustainable reduction of the fiscal deficit over the medium term, alongside strengthened lifelong skills formation and private capital mobilization, boosting potential growth.

With the growth acceleration, a slightly faster poverty reduction is expected in 2024. Maintaining or strengthening social safety nets during fiscal consolidation can help protect vulnerable populations from falling deeper into poverty, as some of the fiscal measures (i.e., higher VAT) can disproportionately affect low-income households. Adequate support for those facing economic hardships can be a crucial aspect of poverty reduction.

TABLE 2 Romania / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	5.7	4.1	2.1	3.3	3.8	3.8
Private consumption	7.2	5.8	2.9	3.5	4.7	4.8
Government consumption	1.8	-3.3	2.9	2.1	1.4	1.2
Gross fixed capital investment	2.9	5.9	12.0	8.4	7.9	7.8
Exports, goods and services	12.6	9.7	-2.1	5.4	6.0	6.2
Imports, goods and services	14.8	9.5	-1.8	7.5	8.2	8.3
Real GDP growth, at constant factor prices	5.3	3.6	2.1	3.3	3.8	3.8
Agriculture	13.7	-23.4	10.2	1.8	2.1	2.1
Industry	0.9	-4.6	-2.3	0.7	1.6	1.9
Services	6.8	9.4	3.4	4.4	4.7	4.6
Inflation (consumer price index)	5.1	13.8	10.4	6.3	3.9	3.2
Current account balance (% of GDP)	-7.2	-9.1	-7.0	-6.3	-6.1	-5.9
Net foreign direct investment inflow (% of GDP)	3.7	3.5	2.1	2.9	3.1	3.2
Fiscal balance (% of GDP)	-7.1	-6.3	-5.7	-5.5	-4.8	-4.3
Revenues (% of GDP)	32.9	33.7	34.0	34.7	36.4	36.7
Debt (% of GDP)	48.6	47.2	48.9	50.4	51.7	52.6
Primary balance (% of GDP)	-5.6	-4.7	-4.3	-4.1	-3.4	-3.0
International poverty rate ($2.15 in 2017 PPP)[a,b]	2.1	2.0	1.9	1.8	1.7	1.6
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	3.3	3.1	2.9	2.8	2.6	2.4
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	7.4	6.9	6.6	6.2	5.7	5.4
GHG emissions growth (mtCO2e)	2.2	-7.9	-4.2	-0.9	-0.3	-0.6
Energy related GHG emissions (% of total)	92.0	91.9	91.9	92.0	92.2	92.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2014-EU-SILC and 2022-EU-SILC. Actual data: 2021. Nowcast: 2022-2023. Forecasts are from 2024 to 2026.
b/ Projection using point-to-point elasticity (2013-2021) with pass-through = 0.7 based on GDP per capita in constant LCU.

RUSSIAN FEDERATION

Table 1	2023
Population, million[a]	143.8
GDP, current US$ billion	2020.3
GNI per capita, Atlas method, current US$[a]	11610.0
Upper middle-income poverty rate ($6.85)[b]	4.1
Gini index[c]	36.0
School enrollment, primary (% gross)[d]	104.1
Life expectancy at birth, years[d]	69.4
Total GHG emissions (mtCO2e)	1565.8

Sources: WDI, MPO, Rosstat.
a/ Most recent value (2021).
b/ Most recent value (2020), 2017 PPPs.
c/ Most recent value (2020).
d/ Most recent WDI value (2019).

Economic growth is expected to decrease to 2.2 in 2024, and 1.1 percent in 2025. Stronger momentum from 2023 and continuation of loose fiscal policy underpin the growth projections. Export volumes are expected to increase in 2024 after two years of contraction. Poverty is projected to experience a modest decline between 2024 and 2026.

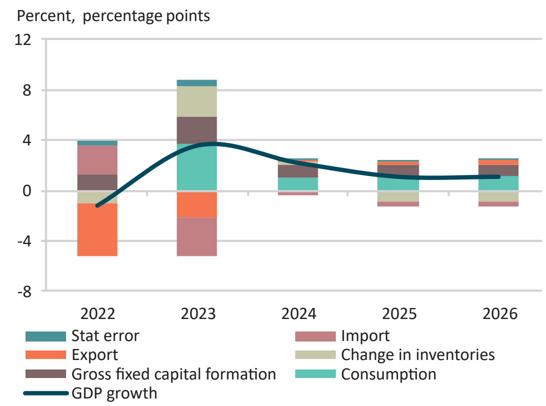
Key conditions and challenges

After the initial recessionary impact of sanctions in 2022, the economy has returned to growth in 2023, supported by fiscal stimulus including military spending and credit expansion, and by successfully mitigating the impact of the sanctions. Restrictions on trade and financing from the G7 countries and EU resulted in trade diversion to China, India, Türkiye, Central Asia and the South Caucasus, and investment in new infrastructure and logistics. Matching this process, the share of Russia's external trade transactions in currency of countries which introduced sanctions dropped from about 80 percent in 2021 to below 30 percent in 2023. The medium to long-term economic prospects remains dull, however. Russian businesses and households continue to be affected by great uncertainty, restrictions on export of a wide range of goods, persisting gaps in supply of some technological equipment, and higher trade costs. Restrictions on Russia's exports have put pressure on the external balance, exchange rate, and fiscal receipts. The fiscal position has deteriorated, with energy receipts compressed by the sanctions, and a sharp increase in general government spending on defense and national security, and social transfers. Moreover, there is a scarcity of labor for activities not related to the military, and the labor market has further significantly tightened due to accelerated outmigration, which has contributed to inflationary pressure. Overall, loss of skilled workers, restrictions on imports of technological goods, and loss of productive FDI is expected to depress medium- to long-term growth prospects.

Recent developments

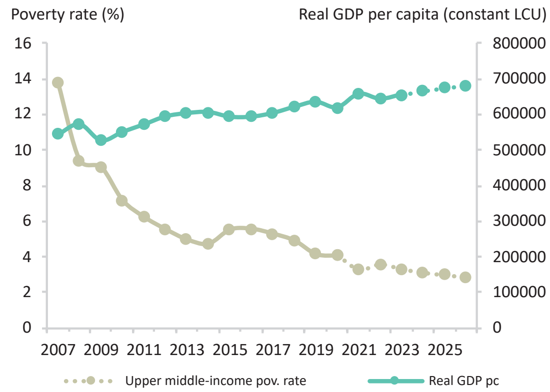
Russia's economy rebounded in 2023 with GDP growth of 3.6 percent. Growth was driven by manufacturing (+ 7 percent), reflecting a large increase in military related activity and import substitution, as well as a rebound in trade related services (+7.3 percent), the financial sector (+8.6 percent) and construction (+7 percent). Despite the sanctions on oil-related exports, extractives output declined by only 2 percent. Household consumption grew by 6.1 percent, and investment rose by 10.5 percent, supported by subsidized mortgages and military spending.
The economic rebound was partly fueled by expansionary fiscal policy, with general government expenditures rising by 1.3 percent of GDP, and investment from the sovereign wealth fund reaching 0.6 percent of GDP. Total revenues increased by 0.4 percent of GDP, as the drop in oil and gas revenues was compensated by an increase in non-oil/gas revenues. As a result, the general government deficit widened from 1.4 percent in 2022 to 2.3 percent of GDP in 2023.
The current account remained in surplus in 2023, but shrank five-fold compared to 2022, as export receipts slumped, and

FIGURE 1 Russian Federation / Real GDP growth and contributions to real GDP growth



Sources: Rosstat and World Bank.

FIGURE 2 Russian Federation / Actual and projected poverty rate and real GDP per capita



Source: World Bank. Notes: see Table 2.

imports rebounded. Capital outflows persisted, adding to the pressure on the exchange rate. The ruble depreciated by 20 percent via-a-vis the US dollar in 2023 but stabilized later in 2024, aided by the central bank foreign exchange sales.

Economic output exceeding its potential and ruble depreciation have fueled inflationary pressures. CPI inflation increased to 7.6 percent by December 2023, with average of 6 percent for the year. The central bank raised interest rates by 8.5 percentage points to 16 percent by December 2023, and tightened macro prudential regulations. The authorities tightened new FX surrender requirements for some exporters.

Unemployment reached the historically low rate of 3 percent in 2023, largely associated with the military effort and the emigration abroad of large numbers of young Russian men. In 2023, there was also a reallocation of labor toward sectors engaged in military production and import substitution.

The banking sector recorded a profit of RUB 3, 3 trillion (US$36 billion) in 2023, compared to RUB 0.2 trillion in 2022. Credit to the private sector grew by 17.4 percent in real terms in 2023 (yoy), in part thanks to government support measures, including a RUB 100 billion recapitalization of VTB.

Outlook

It is presently difficult to produce growth forecasts for Russia due to the significant changes to the economy associated with Russia's invasion of Ukraine, and the decision by Russia to limit publication of economic data, notably related to external trade, financial and monetary sectors. Available data limits our ability to assess the economic performance.

This outlook assumes that Russia's invasion of Ukraine and existing sanctions will continue. Growth of 2.2 percent is expected in 2024 before decreasing to 1.1 percent in 2025 and 2026. Fiscal stimulus is expected to maintain the economy above its potential level, with fiscal policy, monetary and quasi-fiscal policy not fully coordinated in this respect. Expansionary fiscal policy aimed at adjustment to sanctions through trade diversion and import substitution, as well as rapid military production will support domestic demand as the main growth driver. Investment growth is expected to moderate, as macro prudential regulations are tightened and subsidized mortgage programs, narrowed. Elevated expenditures are expected to keep the general government balance in deficit of 2.1 percent of GDP this year, and only gradually to decline thereafter. Average annual CPI inflation is expected to increase to 6.9 percent in 2024 and then gradually approach the target of 4 percent by 2026. The current account surplus is expected to decrease to 2.1 percent of GDP in 2024 from 2.5 percent a year before mostly due to import growth. Poverty is expected decline marginally between 2024 and 2026.

Possible further rounds of mobilization and sanctions are negative risk to the baseline growth projections. Stricter compliance to sanctions, particularly that affect inflows of oil and gas revenues, or disrupt nascent trade patterns for commodities, may have a significant impact.

TABLE 2 Russian Federation / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	5.9	-1.2	3.6	2.2	1.1	1.1
Private consumption	11.9	-1.1	6.0	1.4	1.2	1.2
Government consumption	2.9	3.0	3.7	2.8	2.3	2.1
Gross fixed capital investment	9.3	6.7	10.5	4.5	3.2	3.2
Exports, goods and services	3.3	-13.9	-8.2	1.0	1.5	1.5
Imports, goods and services	19.1	-11.0	16.9	3.2	2.0	2.0
Real GDP growth, at constant factor prices	6.5	-0.3	3.4	2.2	1.1	1.1
Agriculture	1.3	7.0	0.5	1.2	1.2	1.2
Industry	4.3	0.4	1.5	2.0	1.4	1.4
Services	8.0	-1.1	4.5	2.3	1.0	0.9
Inflation (consumer price index)	6.7	13.7	6.0	6.9	4.4	4.2
Current account balance (% of GDP)	6.6	10.3	2.4	2.0	1.1	1.0
Net foreign direct investment inflow (% of GDP)	-1.4	-1.2	-1.3	-1.0	-0.9	-0.8
Fiscal balance (% of GDP)[a]	0.8	-1.4	-2.3	-2.1	-1.7	-1.3
Revenues (% of GDP)	35.4	34.2	34.5	36.1	35.3	34.9
Debt (% of GDP)	17.2	16.7	17.1	17.8	18.6	18.7
Primary balance (% of GDP)[a]	1.6	-0.5	-1.2	-0.7	-0.2	0.3
Upper middle-income poverty rate ($6.85 in 2017 PPP)[b,c]	3.3	3.6	3.3	3.1	3.0	2.9
GHG emissions growth (mtCO2e)	4.4	-2.8	2.9	2.0	1.0	1.0
Energy related GHG emissions (% of total)	91.0	90.6	90.5	90.3	90.1	90.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Fiscal and Primary Balance refer to general government balances.
b/ Calculations based on ECAPOV harmonization, using 2020-HBS. Actual data: 2020. Nowcast: 2021-2023. Forecasts are from 2024 to 2026.
c/ Projection using neutral distribution (2020) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

SERBIA

Table 1	2023
Population, million	6.6
GDP, current US$ billion	75.6
GDP per capita, current US$	11397.7
International poverty rate ($2.15)[a]	1.6
Lower middle-income poverty rate ($3.65)[a]	2.9
Upper middle-income poverty rate ($6.85)[a]	7.9
Gini index[a]	33.4
School enrollment, primary (% gross)[b]	96.6
Life expectancy at birth, years[b]	72.7
Total GHG emissions (mtCO2e)	65.1

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2021), 2017 PPPs.
b/ WDI for School enrollment (2022); Life expectancy (2021).

The growth of the Serbian economy accelerated in the second half of 2023 bringing GDP growth for the year as whole to 2.5 percent. The incidence of poverty declined to an estimated 7.5 percent. Growth is expected to accelerate further in 2024, but risks to the outlook are tilted to the downside. Poverty reduction is projected to continue, although at a slower pace, as unemployment will remain significant in some regions and for some age groups.

Key conditions and challenges

Growth in 2023 is estimated at 2.5 percent, y/y, higher than previously projected thanks to a better-than-expected performance of the agriculture and construction sectors, and a strong recovery of the energy sector, after the 2022 crisis. On the expenditure side, net exports and, to a lesser extent, consumption, were the main drivers of growth in 2023 while investment had a negative contribution. Consumption started to recover only in the second half of the year because of persistent inflation, and overall investment decreased primarily due to lower inventories. As wages have started to post growth in real terms and inflation decelerates, it is expected that consumption will start to recover more rapidly. In order to resolve the problem of chronically low investment, Serbia primarily needs to remove bottlenecks for private sector investment including those related to governance, competition and the business environment.

Over the medium term, under the baseline scenario, the Serbian economy is expected to grow at around 3-4 percent. With limited space for future stimulus packages, structural reforms are needed to accelerate growth which in turn will help to accelerate convergence to EU incomes.

Recent developments

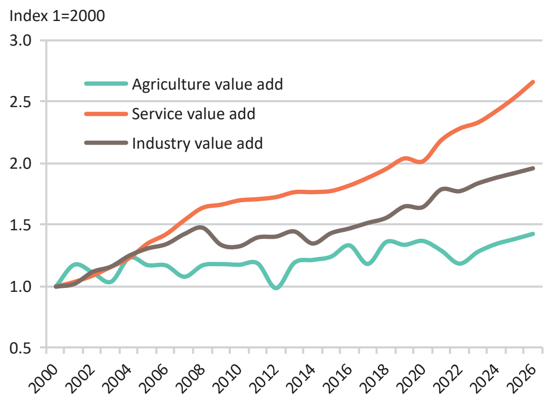
Weak GDP growth in Q1 and Q2 2023 (0.9 and 1.6 percent, y/y) was caused by a decline in investment and consumption. However, in the second half of the year consumption started to increase (compared to the same period of 2022), thus leading to an overall positive contribution to GDP growth in 2023. On the other hand, net exports made a positive contribution to growth in the first half of the year thanks to lower energy imports, which turned into a negative contribution in the second half of the year as external demand weakened.

Labor market indicators remained broadly unchanged in 2023. The unemployment rate reached 9.1 percent in Q4 2023 (a slight increase compared to Q3) thus leading an annual average unemployment rate of 9.5 percent in 2023. Wages increased by 14.8 percent in nominal terms in 2023 compared to 2022.

Poverty (based on the upper-middle income line of $6.85/day in 2017 PPP) is estimated to have slightly declined from 7.9 percent in 2021 to 7.5 percent in 2022. In 2023, poverty reduction continued due to strong economic growth and improving labor market conditions, though it was partly countered by an output decline in agriculture, rising inflation at the end of the year, and the phasing out of government support programs, which had fueled the strong post-COVID-19 recovery of 2021.

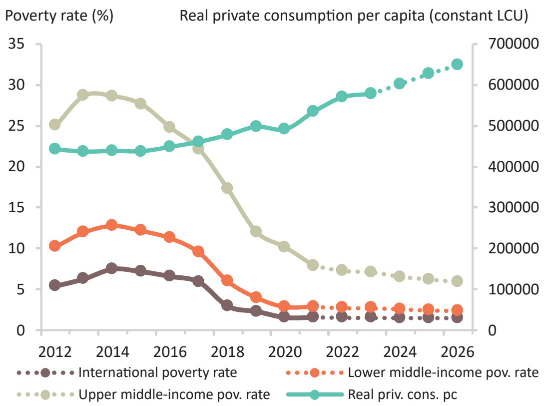
Inflation remained elevated throughout 2023, mainly due to a large increase in food and energy prices. The inflation rate

FIGURE 1 Serbia / Indexes of the level of sectoral GDP



Source: World Bank staff calculations.

FIGURE 2 Serbia / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see Table 2.

reached a peak in March 2023 (16.2 percent) and moderated to 7.6 percent by year-end. The NBS responded to high inflation by continuously increasing the key policy rate between April 2022 and July 2023. It is kept unchanged at 6.5 percent since July 2023.

Budgetary revenues have overperformed significantly in 2023, primarily thanks to a higher-than-planned collection of contributions for social insurance, VAT, and corporate income tax. In 2023 total revenues were higher by 11.9 percent in nominal terms compared to 2022. Over the same period, expenditures increased by 9.8 percent in nominal terms. As a result, the consolidated fiscal deficit declined by nearly 20 percent in 2023 in nominal terms, reaching an estimated 2.2 percent of GDP. As a result, public debt continued to decline and stood at around 52.9 percent of GDP at the end of December.

The current account deficit narrowed significantly in 2023 to reach 2.6 percent of GDP (down by 56 percent compared to 2022 in euro terms). This improvement, by and large, was driven by a major decrease in the trade deficit (which stood at EUR 6.6 billion in 2023 compared to EUR 9.4 billion in 2022) as imports slowed. The services balance similarly improved, due mainly to a continued increase in the export of IT services. Net FDI performed strongly reaching EUR 4.2 billion (or 6.1 percent of GDP). Foreign currency reserves increased to a record high level of EUR 24.9 billion by year-end. Overall credit decreased by 0.1 percent (y/y) through December. However, loans to private businesses and households were up by 2.4 percent and 1.2 percent respectively. Gross nonperforming loans declined to 3.1 percent in November 2023.

Outlook

The Serbian economy is expected to grow at around 3.5 percent in 2024, driven primarily by consumption. Over the medium term, the economy is projected to grow steadily at around 3-4 percent annually, supported by increases in consumption and investment, and a continued strong performance of exports. Foreign direct investment is expected to continue to play a key financing role. Inflation is expected to decline gradually and to return to the NBS target band by mid-2024. Fiscal deficit will continue to decrease and stabilize at around 1.5 percent of GDP. The banking sector is expected to remain resilient, with NPLs stable at around 3 percent.

The poverty reduction pace is expected to gradually decline in 2023 and beyond. Poverty in 2023 is estimated at 7.1 percent. While Serbia's economy is expected to continue to grow, contributing to income growth for households, rising inflation will limit purchasing power. Particularly, rising energy prices would dis¬prop¬ortionately affect the poor. The pace of labor market recovery remains critical for resumed poverty reduction. As the share of the poor shrinks, lifting out of poverty those that remain becomes more difficult – these are more likely to be families that are excluded from markets (due to disability, education, or other factors) and cannot benefit from positive economic trends. Thus, targeted social assistance or other direct channels will become essential in order to continue poverty reduction.

The outlook also crucially depends on the domestic reform agenda and its implementation. In particular, structural reforms in education, SOEs, along with further improvements in governance would pay off since those should incentivize private investors to invest more and to raise the quality of foreign investments in Serbia.

TABLE 2 **Serbia** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	7.7	2.5	2.5	3.5	3.8	4.0
Private consumption	7.9	4.0	0.8	3.7	3.6	2.9
Government consumption	4.3	0.4	0.1	2.8	1.6	4.0
Gross fixed capital investment	15.7	1.9	3.9	2.9	7.0	7.0
Exports, goods and services	20.5	16.6	2.4	4.0	6.5	6.1
Imports, goods and services	18.3	16.1	-1.1	4.7	6.3	6.0
Real GDP growth, at constant factor prices	7.7	2.2	2.6	3.5	3.8	4.0
Agriculture	-5.5	-8.3	4.8	3.4	3.4	3.4
Industry	8.9	0.1	-0.8	4.5	4.5	4.5
Services	8.8	4.5	4.1	3.0	3.5	3.8
Inflation (consumer price index)	4.0	11.9	12.1	5.0	3.5	3.2
Current account balance (% of GDP)	-4.3	-6.9	-2.6	-3.6	-3.9	-4.1
Net foreign direct investment inflow (% of GDP)	6.9	7.2	5.5	5.3	5.5	5.1
Fiscal balance (% of GDP)	-4.1	-3.0	-2.2	-2.0	-1.5	-1.5
Revenues (% of GDP)	43.2	43.4	42.9	42.8	42.7	42.4
Debt (% of GDP)	57.1	55.6	52.6	51.7	49.3	46.0
Primary balance (% of GDP)	-2.4	-1.5	0.1	0.2	0.2	0.1
International poverty rate ($2.15 in 2017 PPP)[a,b]	1.6	1.6	1.6	1.5	1.5	1.5
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	2.9	2.8	2.7	2.6	2.5	2.4
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	7.9	7.2	7.1	6.5	6.2	5.9
GHG emissions growth (mtCO2e)	1.9	1.5	0.2	1.6	1.7	1.9
Energy related GHG emissions (% of total)	74.1	74.8	74.8	75.1	75.4	75.8

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2022-EU-SILC. Actual data: 2021. Nowcast: 2022-2023. Forecasts are from 2024 to 2026.
b/ Projection using neutral distribution (2021) with pass-through = 0.87 (Med (0.87)) based on private consumption per capita in constant LCU.

TAJIKISTAN

Table 1	2023
Population, million	10.1
GDP, current US$ billion	12.1
GDP per capita, current US$	1189.0
International poverty rate ($2.15)[a]	6.1
Lower middle-income poverty rate ($3.65)[a]	25.7
Upper middle-income poverty rate ($6.85)[a]	66.4
Gini index[a]	34.0
School enrollment, primary (% gross)[b]	95.9
Life expectancy at birth, years[b]	71.6
Total GHG emissions (mtCO2e)	19.4

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2015), 2017 PPPs.
b/ WDI for School enrollment (2017); Life expectancy (2021).

Tajikistan's economy grew at a blistering pace of 8.3 percent in 2023, fueled by private consumption and exports of precious metals. The outlook remains robust for 2024, supported by private consumption and public investment, while precious metal exports are expected to subside. To maintain rapid growth and convergence to higher income levels, Tajikistan will need to press ahead with ambitious structural reforms that support private sector-led job creation and enhance the efficiency of public service delivery.

Key conditions and challenges

Although Tajikistan has grown at more than 7 percent a year for the last decade, it remains the poorest country in the ECA region, with a GNI per capita of $1,210 (Atlas method) in 2022 and 12.4 percent of households living below the LMIC poverty line.

Tajikistan's potential remains fettered by barriers to market competition, weak institutions, and limited human capital. Productivity is low, and few jobs are created by the private sector. Tajikistan depends on labor migration, primarily to Russia, and on exporting natural resources, particularly metals and minerals, which account for two-thirds of its total exports.

The government's short and medium-term priorities involve removing barriers to the development of a dynamic private sector, improving transparency and accountability of the public sector for better service delivery, including in state-owned enterprises (SOEs), and taking measures to make growth more inclusive and increase resilience to climate shocks.

Recent developments

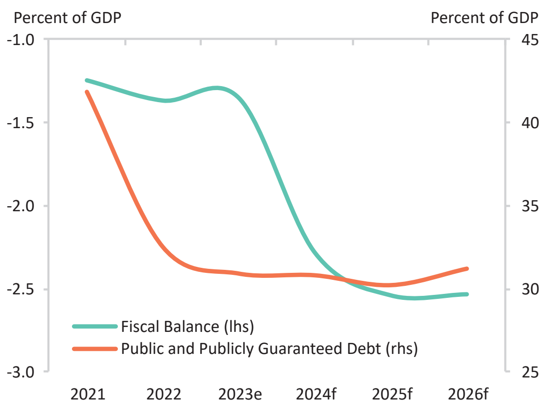
Tajikistan's economy grew by 8.3 percent in 2023, supported by remittance-induced domestic demand and exports of precious metals. The economy experienced a broad-based expansion led by the agriculture sector, followed by industry, construction, and services. Poverty under the LMIC poverty line is estimated to have declined from 12.4 percent in 2022 to 10.7 percent in 2023. According to the Listening to Tajikistan survey, about 42 percent of households had a migrant member and the share of households receiving remittances rose marginally from 17 percent in 2022 to 18 percent in 2023. The reduction in poverty was also supported by growth in domestic real wages of more than 7 percent in 2023.

Tajikistan's current account surplus remained robust at 5.7 percent of GDP. While inward remittances fell after the peak in 2022, this was offset by rising gold exports of 9.5 percent of GDP (from 4.9 percent in 2022). FDI inflows remained muted at below 1 percent of GDP. Gross international reserves stood at US$3.6 billion (7.7 months of import cover) at end-2023, slightly below their level of US$3.8 billion at end-2022.

Consumer price inflation remained contained in 2023, at 3.7 percent on average. Low inflation was supported by limited depreciation of the local currency, administrative price controls, solid agricultural output, and a drop in fuel prices. The central bank gradually loosened monetary policy reducing the policy rate from 13 percent to 10 percent in 2023, and to 9.5 percent in February 2024.

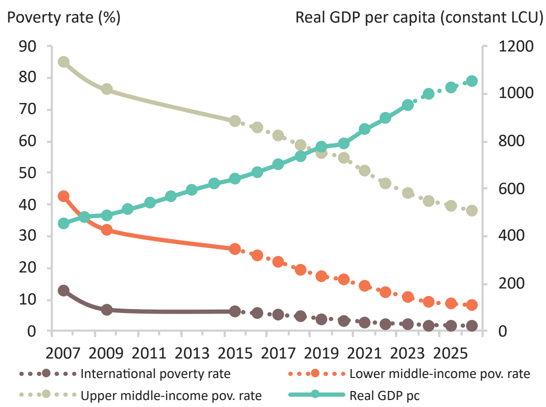
The 2023 budget deficit is estimated at 1.4 percent of GDP, which is similar to 2022. Due to robust economic activity and better tax administration, tax receipts increased from 18.5 percent in 2022 to 19.2 percent

FIGURE 1 Tajikistan / Fiscal balance and public debt



Sources: TajStat, Ministry of Finance, and World Bank staff estimates and projections.

FIGURE 2 Tajikistan / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

of GDP in 2023. Budget expenditures increased from 28.5 percent of GDP to 30.8 percent, led by spending on energy, education, and communication. From July 2023, the authorities improved targeted social assistance to better identify vulnerable households and increased the amount of payments for households with more children. The budget deficit was financed primarily through external financing. Tajikistan is at high risk of debt distress (largely due to Eurobonds and IMF Rapid Credit Facility principal repayments in 2025-2027) but it is on a sustainable debt path in the medium term.

Although the banking sector has high capitalization levels, asset quality is relatively poor. At the end of 2023, the ratio of capital to risk-weighted assets was 21.3 percent, much above the minimum requirement of 12 percent. The share of nonperforming loans (NPLs) in total loans remains high at 12.7 percent at end 2023, and increased slightly from 12.2 percent at end 2022.

Outlook

Tajikistan's economy is expected to grow at 6.5 percent in 2024, supported by private consumption as Russia's demand for labor migrants remains strong, as well as by continued growth in domestic real wages and higher public spending on infrastructure. The surge in gold exports observed in 2023 is expected to decline due to a high base effect. Poverty, at the $3.65 line (in 2017 PPP), is projected to decline from 10.7 percent in 2023 to 9.2 percent in 2024.

GDP growth potential is estimated at 4.5 to 5 percent in the medium term unless ambitious structural reforms are implemented. Inflation is expected to remain within the target range of 4 to 8 percent.

The fiscal deficit is expected to be capped at 2.5 percent of GDP over the medium term. The updated medium-term revenue program is expected to improve tax collection performance, including by phasing out inefficient tax exemptions. Spending on Rogun Hydro Power Project and other large infrastructure projects is expected to be financed by improving revenues, financing from development partners, and offsetting cuts to non-priority spending. The government plans to continue to raise the share of budget spending on social sectors, including enhancing targeted social assistance to better safeguard vulnerable population groups. The moderate projected fiscal deficit is consistent with debt sustainability considerations.

Several factors pose risks to Tajikistan's economic outlook. These include geopolitical uncertainty, slower-than-expected global growth and tighter financial conditions, the high contingent liabilities of the SOE sector, and the slow pace of structural reforms. Additionally, Tajikistan is highly vulnerable to climate change and natural disasters.

TABLE 2 **Tajikistan** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	9.4	8.0	8.3	6.5	4.5	4.5
Private consumption	4.3	15.7	4.7	3.2	2.9	2.8
Government consumption	4.6	12.6	13.0	7.9	3.8	3.8
Gross fixed capital investment	12.0	11.9	22.5	10.0	3.8	3.8
Exports, goods and services	55.4	-24.0	49.4	-20.4	5.7	4.2
Imports, goods and services	20.0	4.0	26.8	-3.0	5.5	2.5
Real GDP growth, at constant factor prices	10.4	9.0	8.3	6.5	4.5	4.5
Agriculture	-0.3	-4.5	9.0	5.0	3.0	3.0
Industry	13.2	9.1	11.3	8.0	5.0	5.0
Services	14.1	16.7	4.5	5.4	4.6	4.6
Inflation (consumer price index)	9.0	6.6	3.7	4.7	6.0	6.0
Current account balance (% of GDP)	8.2	15.3	5.7	3.5	3.0	2.4
Net foreign direct investment inflow (% of GDP)	0.4	1.5	0.8	1.5	1.5	1.5
Fiscal balance (% of GDP)	-1.2	-1.4	-1.4	-2.3	-2.5	-2.5
Revenues (% of GDP)	26.7	27.2	29.5	28.7	28.0	28.0
Debt (% of GDP)	41.9	32.5	30.9	30.8	30.2	31.2
Primary balance (% of GDP)	-0.4	-0.6	-0.7	-1.5	-1.7	-1.8
International poverty rate ($2.15 in 2017 PPP)[a,b]	2.8	2.3	2.1	1.8	1.7	1.5
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	14.2	12.4	10.7	9.2	8.6	8.2
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	50.6	46.8	43.8	41.3	39.7	38.0
GHG emissions growth (mtCO2e)	2.7	3.1	4.1	4.4	4.9	5.3
Energy related GHG emissions (% of total)	42.6	43.2	44.0	44.8	46.0	47.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2015-HSITAFIEN. Actual data: 2015. Nowcast: 2016-2023. Forecasts are from 2024 to 2026.
b/ Projection using neutral distribution (2015) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

TÜRKIYE

Table 1	2023
Population, million	85.8
GDP, current US$ billion	1024.5
GDP per capita, current US$	11938.8
International poverty rate ($2.15)[a]	0.4
Lower middle-income poverty rate ($3.65)[a]	1.4
Upper middle-income poverty rate ($6.85)[a]	7.6
Gini index[a]	44.4
School enrollment, primary (% gross)[b]	102.6
Life expectancy at birth, years[b]	76.0
Total GHG emissions (mtCO2e)	511.1

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2021), 2017 PPPs.
b/ Most recent WDI value (2021).

Over the past nine months Türkiye has been moving rapidly to normalize macroeconomic policies. Economic growth was strong at 4.5 percent in 2023 but is projected to moderate to 3.0 percent in 2024 before accelerating on a more solid footing in outer years. Poverty continued to decline in 2020 and 2021, though the combination of high inflation and macroeconomic policy adjustment related measures may slow progress in the short term.

Key conditions and challenges

The new economic team that took over after the May 2023 elections has been implementing an ambitious package of measures aimed at correcting previous macroeconomic imbalances. The central bank (CBRT) increased the policy rate by 4,150 bps since May 2023 to 50 percent in March 2024 while also adjusting reserve requirements, rolling back the FX-protected deposit scheme, lessening FX interventions, and providing targeted credit to exporters. Based on the new policy stance, in early March Fitch moved Türkiye's sovereign credit rating from B to B+ with a positive outlook. S&P and Moody's have not changed the credit rating but the outlook is positive.

Despite high GDP growth in recent years, there are longstanding structural challenges that undermine potential growth, including: low productivity growth; low labor force participation and employment levels; and weakening foreign direct investment. In addition, boosting domestic revenues and maximizing the efficiency of public spending will be important to counter the recent deterioration in fiscal balances. Ambitious structural reforms would help accelerate sustainable economic growth.

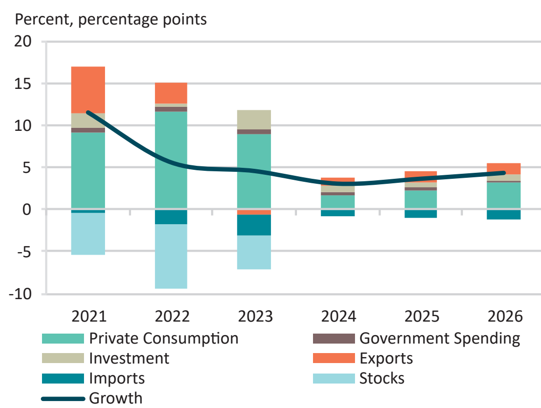
Recent developments

Türkiye's GDP expanded 4.5 percent in 2023, mainly driven by sustained growth in private consumption (12.8 percent in real terms) alongside a strong pickup in investment (8.9 percent) and government consumption (5.2 percent). Exports contracted 2.7 percent in 2023 while imports grew firmly at 11.7 percent, dragging on growth. On a sectoral basis, services growth remained resilient at 4.8 percent and construction expanded 7.8 percent with earthquake recovery. The Turkish labor market continues to be strong; the seasonally adjusted unemployment rate was 9.1 percent in January.

The current account deficit fell to US$45.4 bn in 2023 (4.2 percent of GDP) from US$49.1 bn in 2022 with a sharp improvement in the second half of the year. Fewer FX interventions, steady lira depreciation, returning portfolio inflows, and the significant decline in credit default swap (CDS; a measure of risk premium) on Turkish assets (from above 700 prior to the May 2023 elections to 320 in end-March) have allowed CBRT net reserves to continue recovering, from a negative US$5.7 billion in early June 2023 to a positive US$19.6bn as of March 15.

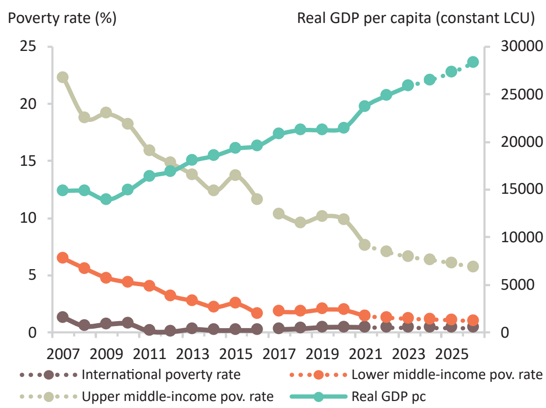
Inflation decreased from 57.7 percent in January 2023 to 38.2 percent in June 2023, but has since increased to 67.1 percent in February 2024 on the back of lira depreciation, sharp minimum wage increases (34 percent in July 2023 and 49.3 percent in January 2024), government tax adjustments, and strong demand. Interest rates are realigning and, along with high inflation and lower capital levels, are containing banks' loan growth despite the relaxation in credit market interventions: as of February 2024, nominal lira loan

FIGURE 1 Türkiye / Real GDP growth and contributions to real GDP growth



Sources: Turkstat and World Bank staff calculations.

FIGURE 2 Türkiye / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

growth (13-week, FX-adjusted annualized trend) for state and private banks was 13.2 percent and 38.7 percent, respectively. Despite ongoing maturity mismatches, the banking sector's net FX position has improved with capitalization remaining strong. Notably, non-performing loans (NPLs) have declined since 2022 and the NPL ratio shows significant improvement (1.6 percent in January 2024 versus 4.4 percent in 2020). While tight monetary policy may impact some economic segments, particularly SMEs, the overall trend indicates a resilient banking sector.

The overall fiscal balance deteriorated to below -5 percent of GDP in 2023 (from -0.8 in 2022) due to rising expenditures and earthquake-related investment needs, and the primary balance was close to -3 percent of GDP (from +1.4 in 2022). However, the fiscal deficit is relatively low excluding earthquake-related expenditures. Public debt remains moderate at around 30 percent of GDP in 2023.

Poverty continued to decline but inequality widened between 2020 and 2021; the Gini coefficient increased to 46.0 in 2021 as the bottom and top income deciles reaped the largest benefits of growth. The bottom decile experienced the highest real increase in labor income (26 percent), likely driven by the minimum wage increase that in 2021 exceeded CPI inflation; while the top decile reaped the highest benefits from real increases in business incomes (96 percent), likely due to the surge in asset prices. Poverty reduction was largely due to increased labor earnings.

Outlook

Economic growth is projected to moderate to 3.0 percent in 2024 on the back of policy tightening and slow global growth before accelerating to 3.6 percent in 2025 and 4.3 percent in 2026 with a more sustainable growth composition. Inflation is expected to decline gradually after peaking in May 2024 given tight monetary policy, while the current account balance is projected to improve starting from 2024 with a higher contribution of net exports. Given the economic slowdown and earthquake recovery needs, the general government deficit is expected to remain high in 2024 despite fiscal consolidation efforts.

The period ahead provides opportunities for tackling structural issues. It will be important to accelerate pro-growth structural reforms to unleash private sector productivity and investment in the medium-term.

Poverty is expected to continue declining in the short run as increases in average nominal wages exceeded CPI changes in 2022 and 2023. However, if the distribution of growth remains the same as between 2020 and 2021, inequality is also likely to increase, impeding potential for long-term poverty reduction.

The outlook is contingent on continuation of the current policy stance. Risks to the outlook are balanced. Downside risks include: low net reserves and high external financing requirements, which imply low buffers against external shocks; heightened geopolitical tensions; vulnerability of the fiscal position to high borrowing costs; and slower growth resulting in political pressures to reverse policy normalization. On the upside, the increasing credibility of the new economic team may result in more investment inflows, which would help stabilize the currency and accelerate the economic adjustment.

TABLE 2 Türkiye / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	11.4	5.5	4.5	3.0	3.6	4.3
Private consumption	15.4	18.9	12.8	2.3	3.1	4.2
Government consumption	3.0	4.2	5.2	2.5	2.1	1.7
Gross fixed capital investment	7.2	1.3	8.9	2.9	2.9	3.1
Exports, goods and services	25.1	9.9	-2.7	4.5	5.2	5.9
Imports, goods and services	1.7	8.6	11.7	3.7	4.2	5.6
Real GDP growth, at constant factor prices	12.7	6.2	4.5	3.0	3.6	4.3
Agriculture	-3.0	1.3	-0.2	1.4	1.5	1.5
Industry	13.0	-0.6	3.7	4.6	4.8	5.0
Services	13.2	10.1	4.7	2.5	3.3	4.2
Inflation (consumer price index)	19.6	72.3	53.9	57.8	28.9	16.4
Current account balance (% of GDP)	-0.9	-5.4	-4.2	-2.8	-2.4	-2.5
Net foreign direct investment inflow (% of GDP)	0.8	1.0	0.7	0.9	1.1	1.4
Fiscal balance (% of GDP)	-2.6	-0.8	-5.4	-5.4	-3.7	-2.4
Revenues (% of GDP)	30.9	27.8	26.4	26.2	26.2	26.5
Debt (% of GDP)	41.5	30.3	29.7	29.9	30.5	31.2
Primary balance (% of GDP)	0.0	1.4	-2.5	-0.8	0.6	0.7
International poverty rate ($2.15 in 2017 PPP)[a,b]	0.4	0.4	0.4	0.4	0.4	0.4
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	1.4	1.3	1.2	1.2	1.1	1.0
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	7.6	7.0	6.6	6.4	6.1	5.7
GHG emissions growth (mtCO2e)	11.1	-5.2	1.8	2.3	3.0	3.5
Energy related GHG emissions (% of total)	78.6	76.5	75.8	75.2	74.6	74.1

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2021-SILC-C and 2022-SILC-C. Actual data: 2021. Nowcast: 2022-2023. Forecasts are from 2024 to 2026.
b/ Projection using point-to-point elasticity (2020-2021) with pass-through = 0.7 based on GDP per capita in constant LCU.

UKRAINE

Table 1	2023
GDP, current LCU trillion[a]	6.4
GDP, current US$ billion[a]	177.3
GDP growth, annual %[a]	4.8
School enrollment, primary (% gross)[b]	92.8
Life expectancy at birth, years[b]	69.6
Total GHG emissions (mtCO2e)	154.3

Source: WDI, Macro Poverty Outlook, and official data.
a/ GDP numbers are expected (2023).
b/ Most recent WDI value (2021).

Ukraine's economy has resumed modest growth, estimated at 4.8 percent in 2023. Concurrently, macroeconomic risks emanating from the on-going active hostilities and uncertainty about the timing and amount of external assistance continue to rise and could require a policy adjustment if downside risks materialize. Household incomes increased in line with this economic growth, but household sentiments remain gloomy, with most people reporting financially worse conditions compared to their pre-war situation.

Key conditions and challenges

Even though Ukraine's economy has resumed modest growth in 2023 it continues to operate as a war economy that spent almost 50 percent of its 2023 budget on defense. Private demand remains subdued by a restrictive monetary policy, designed to rein in inflationary pressure resulting from continued supply disruptions and high demand from the public sector, whereas the public sector absorbs most scarce domestic resources and external aid to finance its large deficit.

As the war enters its third year, Ukraine's economic management has reached an inflection point. On the one hand, the country has been able to maintain macroeconomic stability since February 2022, controlling inflation, maintaining a stable currency, financing critical expenditure, and accumulating significant foreign exchange reserves. It has also been able to achieve EU candidacy status and has continued structural reform efforts despite the challenging conditions. On the other hand, the receipt of external aid - US$42.5 billion in 2023 – was instrumental to this achievement, and concerns about the timing and amount of future aid disbursements are increasing. Ukraine's 2024 budget plans for the receipt of US$37.3 billion in external financing, the timely receipt of which will be critical to enable the authorities to maintain macroeconomic stability and to finance critical expenditure, including for social assistance.

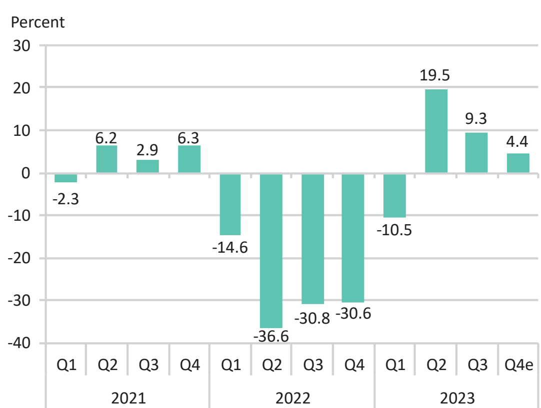
Looking ahead, Ukraine has, with support from its international partners, designed a medium-term structural reform agenda to enhance macro-fiscal sustainability and support growth. Effectively executing this agenda through timely reform approval and implementation, as well as prioritization, will be critical to reduce aid dependence and ensure that Ukraine benefits from the promise of EU membership. Restoring livelihoods through integration of displaced populations and ex-combatants into labor markets, ensuring continued social service delivery, and supporting households to recover from property damages are key priorities.

Recent developments

More reliable electricity, an exceptional harvest and the steadier receipt of external assistance have allowed for the first GDP expansion since February 2022, with year-on-year growth of 19.5 and 9.3 percent in Q2 and Q3 of 2023, respectively. Yearly growth for 2023 is estimated at 4.8 percent, with potential to the upside.

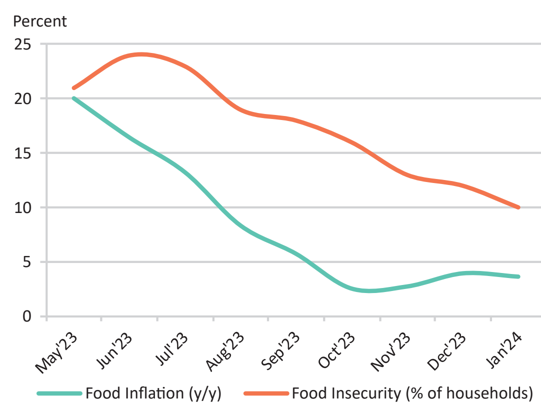
Inflation has declined from 26.6 percent at end-2022 to only 4.7 percent in January 2024. A restrictive monetary policy stance and conducive food supply contributed to this reduction. In October 2023, the NBU transitioned from a pegged to a slightly more flexible exchange rate regime, which has resulted in modest currency depreciation. Banks

FIGURE 1 Ukraine / Quarterly GDP growth, year-over-year



Source: Ukraine Statistics Office.

FIGURE 2 Ukraine / Trends on food inflation and food insecurity trends



Source: World Bank staff estimates.

have remained profitable and stable, but risks are prevalent.

After recording a surplus in 2022, Ukraine's current account turned into USD 9.6 billion deficit in 2023. This was driven by a widening trade deficit and the replacement of grant receipts by loans. Reserves were aided by external assistance and stood at USD 37.1 billion on March 1.

Higher needs for defense expenditure necessitated a significant revision of the 2023 budget and an expansion of the fiscal deficit, which reached an estimated 27 percent of GDP when excluding grants. Ukraine met its financing needs through domestic bank borrowing and external assistance but has not resorted to monetization in 2023.

There are signs of household incomes recovering. Estimates from earnings data suggest that nominal wages in the last quarter of 2023 had more than doubled year-on-year, outstripping inflation. Social transfers also increased in real terms. Nevertheless, 70 percent of households perceive being financially worse off compared to two years ago, reflecting a combination of high uncertainty, high prices after a period of inflation, lack of savings and loss of property, with more than 20 percent of households having experienced damages since the war started.

Outlook

Ukraine's economic outlook is conditional on the timing and quantity of external assistance receipts and the assumed duration of Russia's invasion. Under an indicative scenario which assumes that active hostilities will continue throughout 2024, GDP is expected to expand modestly by 3.2 percent in 2024. Starting from 2025, Ukraine's economic growth would accelerate to 6.5 percent under the baseline assumption as export growth resumes, and reconstruction investment supports the demand side. Private consumption growth is projected to remain modest due to contractionary monetary policy needed to reign in post-war inflation. Inflation is expected to pick up in 2024 as one-off factors subside but is projected to decrease from 2025.

The current account is expected to widen to 7.8 percent of GDP deficit in 2024 and remain elevated under the baseline assumption, as a reduction in grants outweighs a gradually decreasing trade deficit from 2025 onwards. The fiscal deficit (excluding grants) is projected at 20.4 percent of GDP in 2024 before gradually declining to 6.6 percent by 2026, and is projected to be financed by external assistance, with an increasing contribution from domestic sources over time. Public and publicly guaranteed debt is projected to stabilize around 98 percent of GDP in the medium term.

This scenario is subject to significant downside risks due to the vulnerability of Ukraine's economic trajectory to external financing shortfalls and the possible prolongation of the active hostilities beyond 2024. Should downside risks materialize, a more stringent macroeconomic adjustment could become necessary. That adjustment could affect social spending and transfers to households that most of the poor have come to depend on, which could push many of them deeper into poverty.

TABLE 2 Ukraine / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	3.4	-28.8	4.8	3.2	6.5	5.1
Private consumption	6.9	-27.9	9.9	2.3	10.0	4.9
Government consumption	0.8	31.4	18.9	19.1	12.2	8.5
Gross fixed capital investment	9.1	-33.9	4.0	3.8	12.4	17.5
Exports, goods and services	-8.6	-42.0	-0.2	26.1	35.7	22.8
Imports, goods and services	14.2	-17.4	18.4	18.3	25.6	15.9
Real GDP growth, at constant factor prices	3.5	-28.8	4.8	3.2	6.5	5.1
Agriculture	14.4	-25.2	6.0	-1.0	10.0	6.0
Industry	7.2	-42.8	3.0	2.6	4.5	4.5
Services	0.5	-24.7	5.0	4.1	6.3	5.0
Inflation (consumer price index)	10.0	26.6	5.1	9.5	7.9	7.3
Current account balance (% of GDP)	-1.9	5.1	-5.4	-7.8	-8.6	-7.9
Net foreign direct investment inflow (% of GDP)	3.8	0.1	2.4	0.8	2.4	3.9
Fiscal balance (% of GDP)[a]	-4.0	-24.8	-27.0	-20.4	-11.5	-6.6
Revenues (% of GDP)	36.5	40.6	36.9	37.4	38.4	39.5
Debt (% of GDP)	49.0	77.8	86.8	96.3	98.3	97.7
Primary balance (% of GDP)[a]	-1.2	-21.6	-23.0	-14.9	-6.9	-2.4
GHG emissions growth (mtCO2e)	0.7	-28.2	-4.8	-7.3	-4.8	-3.1
Energy related GHG emissions (% of total)	72.4	67.0	68.3	67.8	67.1	66.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Fiscal Balance and Primary Balance are excluding grants in 2022-2026.

UZBEKISTAN

Table 1	2023
Population, million	36.2
GDP, current US$ billion	90.9
GDP per capita, current US$	2510.1
International poverty rate ($2.15)[a]	2.3
Lower middle-income poverty rate ($3.65)[a]	5.0
Upper middle-income poverty rate ($6.85)[a]	17.3
Gini index[a]	31.2
School enrollment, primary (% gross)[b]	94.2
Life expectancy at birth, years[b]	70.9
Total GHG emissions (mtCO2e)	198.1

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2022), 2017 PPPs.
b/ Most recent WDI value (2021).

The economy grew by 6 percent in 2023 amid broad based expansion and fiscal stimulus. The government is expected to consolidate fiscal spending in 2024 following an increase in the fiscal deficit in 2023. Robust real wage growth has contributed to poverty reduction in 2023. The medium-term outlook is positive as ambitious and ongoing structural reform is expected to improve the business environment in key sectors and stimulate private sector-led investment and growth. Steady economic growth is expected to result in a reduction in poverty.

Key conditions and challenges

Uzbekistan has implemented sweeping reforms in recent years that have liberalized parts of the economy and improved prospects for private sector development. In 2023, the authorities established an independent energy regulator, began energy tariff reform, restructured the state-owned enterprise (SOE) rail operator, privatized a large chemical plant and a bank, and unbundled the leading chemical SOE to promote competition. They also established the National Agency for Social Protection, approved strong new legislation to combat gender-based violence, and expanded access to free legal aid. Uzbekistan also took a green transition path by introducing more ambitious environmental targets, a new pollution control system, and a national green taxonomy.

With high population growth and a large amount of youth entering the workforce each year, economic growth will need to support strong job creation. To do so, Uzbekistan needs to continue its reforms program to open up markets and boost competition, notably by reducing dominance of SOEs in the economy, strengthening land rights, liberalizing the telecommunications sector and raw materials trade, and reducing high trade costs. Faster job creation and productivity growth will also require increasing labor force skills.

Recent developments

Real GDP grew by 6 percent in 2023, led by investment, private consump¬tion, and exports. Faster invest¬ment growth was facilitated by credit growth to SOEs and private sector. Real credit (loans to SOEs and private sector) grew by 11.6 percent between 2022 and 2023, up from 5.1 percent between 2021 and 2022.

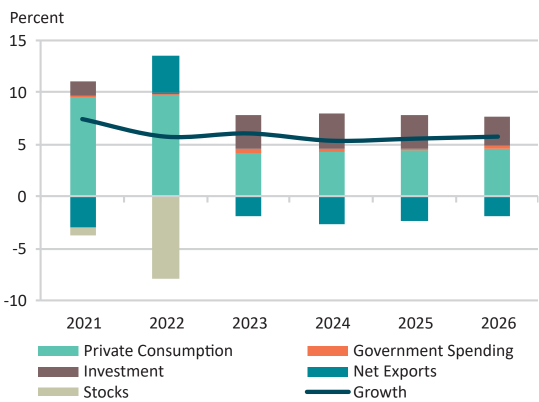
Consumer price inflation fell to its lowest level in seven years, dropping to 8.8 percent yoy in December 2023, compared to 12.3 percent in 2022. This was driven by sustained, tight monetary policy, as well as a VAT tax rate cut and lower international food and energy prices.

In 2023, the Uzbek som depreciated by 9 percent against the US dollar (USD), in part due to a flow on effect of the depreciation of the Russian ruble (a close trading currency) against the USD.

The current account deficit deteriorated as import growth accelerated and remittances declined in 2023 (the latter was related to the ruble's depreciation). Uzbekistan's gas exports dropped by half, and amid rising domestic gas needs, Uzbekistan began importing gas from Russia in 2023 for the first time.

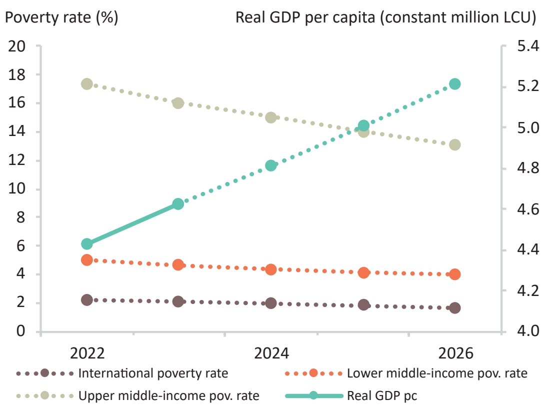
The fiscal deficit expanded from 4.1 percent in 2022 to 5.8 percent of GDP in 2023 due to emergency spending on energy infrastructure and fuel during the cold winter, higher spending on salaries and social benefits, energy subsidies, and subsidized lending to SOEs via state-owned banks. Foreign reserves remained ample

FIGURE 1 Uzbekistan / Real GDP growth and contributions to real GDP growth



Source: World Bank staff calculations based on official data.

FIGURE 2 Uzbekistan / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

at $34.6 billion by December 2023, more than 8 months of prospective imports.

Robust real wage growth contributed to reducing poverty from 5.0 percent in 2022 to 4.5 percent in 2023, measured at the lower-middle income poverty line (USD 3.65/day, 2017 PPP). The unemployment rate has dropped to 8.1 percent in 2023, down from 8.9 percent in 2022. Average real wages in 2023 increased by 7.8 percent not only due to growing demand but also because of skills shortages in the labor market. As a result, wage growth was higher among the more skilled (and wealthier) workers than among the poor, resulting in higher income inequality.

Outlook

GDP growth is projected at 5.3 percent in 2024 given the expected fiscal consolidation and slower export growth prospects to Russia and China, Uzbekistan's key trading partners. Growth will be supported mainly by the continued implementation of structural reforms, notably SOEs' restructuring and privatization, and high energy sector investment.

Inflation is expected to increase in 2024 due to relatively sharp increases in domestic energy prices because of the energy tariff reforms (accompanied by social protection measures). This will be partially offset by a continued tight monetary stance while the central bank completes its transition to full inflation targeting. Inflation is expected to decelerate to 8 percent in the medium term, higher than the CBU target of 5 percent. Import growth is expected to moderate in 2024 but remains buoyant as imports support both economic modernization and growing consumption.

Remittances in 2024 are projected to decline mainly due to an expected reduction in the number of labor migrants to Russia. With decreasing remittances and strong imports, the current account deficit will widen slightly but remain sustainable as Uzbekistan's transformation process brings in foreign savings to finance the deficit. This economic outlook is expected to reduce poverty moderately to 4.3 percent in 2024.

The fiscal deficit is expected to fall to 4.2 percent of GDP in 2024 and towards 3 percent of GDP by 2026 as large, untargeted energy subsidies and ineffective incentives to SOEs are withdrawn, and thanks to growing budget revenues amid privatization proceeds. The government is expected to adhere to its debt limits (60 percent of GDP for total Public and Publicly Guaranteed debt), with public debt slightly increasing to 36.5 percent of GDP in 2024 and then gradually declining to 34.4 percent of GDP by 2026.

Risks to outlook are tilted to the downside. External risks include possible deterioration of growth in key trading partners, notably China and Russia, and further tightening of external financial conditions. Domestic risks stem from the growing contingent liabilities from SOEs, PPPs, and state-owned banks. Upside risks include higher global gold and copper prices and stronger productivity growth due to ongoing structural reforms.

TABLE 2 Uzbekistan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	7.4	5.7	6.0	5.3	5.5	5.7
Private consumption	11.6	11.3	4.6	4.9	5.0	5.2
Government consumption	3.1	3.6	6.2	3.9	1.7	4.2
Gross fixed capital investment	2.9	0.2	7.6	7.8	7.3	6.2
Exports, goods and services	13.3	27.9	23.4	10.1	11.2	12.3
Imports, goods and services	19.9	9.1	24.9	15.1	14.1	13.6
Real GDP growth, at constant factor prices	7.4	5.7	6.0	5.3	5.5	5.7
Agriculture	4.0	3.6	4.1	3.7	3.9	3.8
Industry	7.9	5.5	6.3	5.6	6.5	7.1
Services	9.1	6.9	6.8	6.0	5.7	5.8
Inflation (consumer price index)	10.8	11.4	10.0	11.0	9.9	8.2
Current account balance (% of GDP)	-7.0	-0.8	-4.7	-5.0	-4.5	-4.3
Net foreign direct investment inflow (% of GDP)	3.3	3.1	6.0	3.6	3.8	4.0
Fiscal balance (% of GDP)	-6.0	-4.1	-5.8	-4.2	-3.6	-3.0
Revenues (% of GDP)	25.9	30.5	28.8	28.9	29.2	29.4
Debt (% of GDP)	36.6	34.0	36.1	36.5	35.3	34.4
Primary balance (% of GDP)	-5.7	-3.7	-5.3	-3.6	-3.0	-2.4
International poverty rate ($2.15 in 2017 PPP)[a,b]	..	2.3	2.1	2.0	1.8	1.7
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	..	5.0	4.6	4.4	4.2	4.0
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	..	17.3	16.0	15.0	14.0	13.1
GHG emissions growth (mtCO2e)	3.9	1.6	2.0	1.6	1.9	2.0
Energy related GHG emissions (% of total)	60.8	60.7	60.7	60.4	60.1	59.8

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2022-HBS. Actual data: 2022. Nowcast: 2023. Forecasts are from 2024 to 2026.
b/ Projection using neutral distribution (2022) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

WORLD BANK **ECA ECONOMIC UPDATE** Spring 2024

Unleashing the Power of the Private Sector

Economic activity in the Europe and Central Asia (ECA) region is expected to remain resilient but slow this year as a weaker global economy, slowdown in China, and lower commodity prices weigh on the region's growth outlook. Regional growth is likely to drop to 2.8 percent in 2024, following substantial strengthening to 3.3 percent last year because of a shift from contraction to expansion in the Russian Federation and war-hit Ukraine, and a more robust recovery in Central Asia. Regional output growth is projected to moderate further to 2.7 percent in 2025. The outlook faces multiple headwinds. A slower-than-expected recovery in key trading partners, restrictive monetary policies, and exacerbation of geopolitical developments could further dampen growth across the region.

Weak productivity growth in ECA in the recent decade has resulted in a sharp slowdown in income convergence with advanced economies. Fundamental drivers of productivity growth, including progress in advancing institutional and market reforms, technology adoption, and innovation, are key for enabling private sector–led growth. Boosting business dynamism in ECA will require addressing several challenges, including upgrading the competitive environment, reducing state involvement in the economy, dramatically boosting the quality of education, and strengthening the availability of finance. While meeting these challenges will look different across countries, addressing them is an essential condition to achieve stronger economic growth and overcome the middle-income trap.

ISBN (electronic): 978-1-4648-2108-0

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